

Common Sense Conversations on Michigan's Future

ISSUE GUIDE

March 2011



PURPOSE

The Center for Michigan and Detroit Public Television welcome you to Common Sense Conversations about Michigan's future. Our aim:

- ❖ Expand citizen knowledge about the choices facing Michigan as our citizens and leaders work to transform our state.
- ❖ Gather citizen perspectives and preferences on the major tax, budget, and other policy issues proposed by the new governor and legislature.
- ❖ Build on, and update, the recent public engagement efforts of MiVote.org and the Michigan's Defining Moment (MDM) campaign.
- ❖ Amplify citizen voices in Lansing, bringing citizen views to bear on the work of the new administration and legislature.

The MiVote.org project was created to explore the ways technology could give citizens a larger voice in the issues that affect them. MiVote.org is dedicated to a free, open, and thoughtful discussion of the issues that citizens and communities are grappling with in Michigan. Since the site launched in 2008, Detroit Public Television and the Center for Michigan have worked collaboratively to support those discussions.

In 2010, the MiVote.org collaboration produced more than 200 interviews and debates featuring candidates all across Michigan. The collaboration also provided neutral ground for the one and only debate by the candidates for governor—an event carried by radio and television stations throughout the state. The meeting you are attending this evening reflects an ongoing commitment to listen to the citizens of Michigan and to provide information that helps voters make informed decisions about the important issues shaping Michigan's future.

This brief issue guide offers background information on the topics we'll discuss today. We hope this guide informs your perspectives!

BACKGROUND: TAXES AND SPENDING

Taxes: Governor Snyder's Proposal in Brief

Governor Rick Snyder offered his first budget plan in February. The governor and legislature must negotiate and sign into law a final budget by October 1. The budget must address an estimated \$1.4 billion deficit—the difference between what the state is on pace to spend and funds currently available.

In his budget plan, Governor Snyder proposed major changes in state taxes, most notably a reduction in business taxes and an increase in individual income taxes. Key points of his plan are:

- ❖ Elimination of the Michigan Business Tax, to be replaced by a 6 percent corporate income tax. This combination—along with other changes—reduces state revenues by \$1.8 billion per year.

- ❖ Increases in some individual income taxes and elimination of various tax breaks. The biggest changes would be to tax all public and private pension income and end the state earned income tax credit, designed to help the working poor. These and other income tax changes would boost tax revenues by \$1.7 billion per year.
- ❖ Under Governor Snyder’s proposal, individual income taxes rise from 28 percent to 32 percent of all taxes paid to the state. Businesses’ share of taxes declines from 11 percent to 7 percent. (For a summary of state tax revenue, please see the pie chart below.)

Taxes: The Arguments

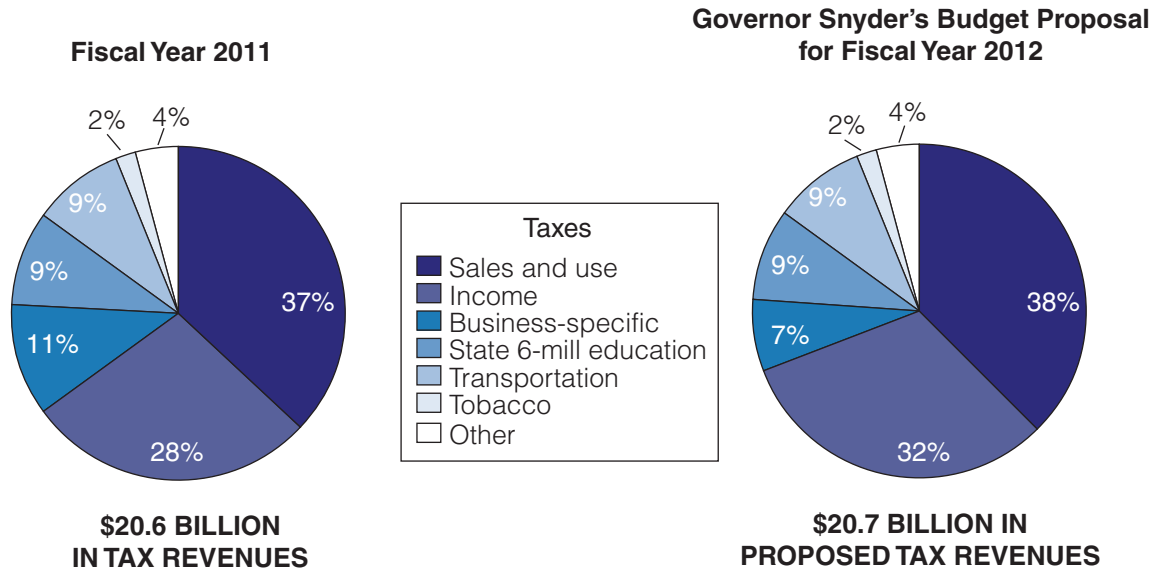
Here is what people are saying for and against the governor’s tax proposals:

PRO	CON
<p><i>People who favor reducing business taxes and increasing individual income taxes contend that...</i></p> <ul style="list-style-type: none"> • Michigan’s business climate is unfriendly to existing Michigan businesses and also discourages new businesses from starting up in Michigan, especially if the investors are from outside our state. We need fewer tax impediments to job creation, and lowering business taxes will lead directly to higher profits and job creation. • As the governor’s budget overview states, “[our] complicated tax structure hurts Michigan businesses and constrains job growth. He proposes a simple, fair, and efficient Corporate Income Tax that will even the playing field and enable all businesses and industries, large and small, to grow and create jobs.” Without a strong, job-creating economy, all other investments that Michigan needs are not possible. • Michigan is one of only three states to shelter all or most pension income from income tax. Pensions should be taxed like any other income. • It’s a question of fairness. If a younger working family, a retiree without a pension, and a retired couple with pensions all have the same income, shouldn’t they have the same tax burden? 	<p><i>People who oppose the governor’s proposal to reduce business taxes and increase individual income taxes argue that...</i></p> <ul style="list-style-type: none"> • While Michigan’s economy is not yet robust, business taxes do not explain its failure to grow. Businesses actually bear a relatively small burden of the state’s taxes—and with this proposal businesses’ share of state tax burden will decline even more. • We are still managing the transition from an economy dependent on one industry and we need to invest in schools, roads, cities, and talent development and retention; cutting business taxes prevents us from making these investments. • Michigan residents with pensions retired believing that their pensions would not be taxed—they made plans for the future on that assurance. To tax people with fixed incomes is unfair. • While reductions in business taxes will have a positive impact on economic activity in Michigan, the tax increase on certain individuals will have a negative impact on economic activity by reducing their disposable income.

Taxes: Which Taxes Does Michigan Collect and How Much Does Each Bring In?

The pie charts below illustrate the range of Michigan taxes and how much they bring in to state coffers. It is important to note that state taxes account for only half of the funding for the state budget. The other half comes largely from federal funds (42 percent) and non-tax revenues (8 percent), such as license and use fees.

State Tax Revenues



SOURCE: Public Sector Consultants calculations, based on estimates in State of Michigan Executive Budget (Governor Snyder's budget message).

NOTE: Percentages may not equal 100 due to rounding.

Taxes: Other Options

There are, of course, many other ways that taxes could be cut or raised. Here are some of the other ideas that have been floated and how much revenue they raise:

- ❖ Extend the sales tax to personal services. Lower the rate from 6 percent to 5.5 percent, but tax home and car repairs and maintenance, cable and satellite TV, legal services, entertainment and sports, and many others (\$1 billion)
- ❖ Tax all carbonated soft drinks at 6 percent (\$90 million)
- ❖ Raise beer tax from 2 cents to 6 cents per bottle and raise wine tax from 1 cent to 3 cents per liter (\$106 million)
- ❖ Extend Governor Snyder's proposed 6 percent corporate income tax to all businesses, not just corporations, and exempt the first \$250,000 of business income (\$475 million more than the governor's proposal)

State Revenues and Spending: A Brief History

To give you some sense of how the state budget and state government have changed in the last decade, we offer a few comparisons between 2000 and 2010 (except as where noted). All dollar amounts in this section are adjusted for inflation and indexed to the earlier year.

Total State Revenue (Taxes and Fees)

- ❖ FY 2001: \$23.9 billion
- ❖ FY 2011: \$21.0 billion
- ❖ Percentage change: **-12%**

SOURCE: Senate Fiscal Agency speech to University of Michigan Research Seminar in Quantitative Economics, November 2010.

Total State Budget

- ❖ FY 2000: \$24.6 billion
- ❖ FY 2010: \$20.7 billion
- ❖ Percentage change: **-16%**

SOURCE: Senate Fiscal Agency speech to University of Michigan Research Seminar in Quantitative Economics, November 2010.

NOTE: This captures state spending from state resources, so it excludes spending from federal sources.

Major State Budget Spending Areas, FY 2000 and FY 2010 (in millions)

	FY2000	FY2010	% Change
Community health	\$3,056	\$3,187	4%
Human services	\$1,291	\$812	-37%
Corrections	\$1,518	\$1,635	8%
K-12	\$10,133	\$8,752	-14%
Community colleges	\$306	\$246	-20%
Higher education	\$1,835	\$1,201	-35%
Revenue sharing	\$1,471	\$818	-44%
All others	\$5,010	\$4,076	-19%

SOURCE: Senate Fiscal Agency speech to University of Michigan Research Seminar in Quantitative Economics, November 2010.

NOTE: This captures state spending from state resources, and thus excludes federal funds.

Total Number of Michigan State Employees

- ❖ FY 2000: 61,493
- ❖ FY 2010: 50,615
- ❖ Percentage change: **-18%**

SOURCE: Michigan Department of Civil Service, *31st Annual Workforce Report*.

Total Number of Full-Time Equivalent Government Employees in Michigan

(K–12 schools, community colleges, public universities, state and local government)

- ❖ 2000: 492,461
- ❖ 2009: 482,579
- ❖ Percentage change: **-2%**

SOURCE: U.S. Census Bureau.

The Total Size of the Michigan Economy

(measured as total personal income)

- ❖ 2000: \$292.6 billion
- ❖ 2010: \$290.2 billion
- ❖ Percentage change: **-1%**

SOURCE: U.S. Bureau of Economic Analysis and State of Michigan Consensus Revenue Estimating Conference, 2011.

Spending: Governor Snyder's Proposal in Brief

The governor's budget recommendation features major funding cuts for public universities, aid to local governments through the revenue sharing program, aid to K–12 schools, state employee compensation, and other major state programs. The list below highlights major, but not all, proposed cuts:

- ❖ A 15 percent reduction (\$222.1 million) in operational appropriations to the state's 15 **public universities**. The governor proposes to restore \$83 million of funding to universities if their governing boards agree to restrain FY 2012 tuition increases to an average of 7.1 percent or less.

- ❖ Cuts in **revenue sharing payments** to cities, villages, townships, and counties. These payments help support the operations of local units of government, including police, fire, and other services to residents. Proposed cuts total \$344 million. But \$200 million could be earned back through incentive-based payments to local governments that meet best practices outlined by the governor.
- ❖ A \$483 million cut in state funding for **K-12 schools**. That’s a 4.6 percent cut. Governor Snyder is recommending that the base per pupil funding level be reduced by 6.4 percent. This cut comes as schools face ever-growing retiree pension and health care costs. Statewide, those legacy costs now equal 24.5 percent of payroll. This year’s increased legacy costs alone will be \$380 million statewide, or \$245 per student.
- ❖ \$180 million of unspecified General Fund cuts to **state employee wages and benefits**. These savings would be realized by negotiations between the state and labor unions representing state employees. Increasing the health care costs borne by state employees from the current level of 10 percent of total health care costs to 20 percent would save approximately \$39 million. This leaves an additional \$141 million of employee concessions coming from either wages or retirement contribution costs. If the additional \$141 million of employee concessions came from wage reductions, this would equate to an 8.2 percent reduction in state employee compensation.
- ❖ Various cuts in **health programs, human services, and corrections**. These cuts include cuts/efficiencies in adult home help programs (\$18 million), a lifetime limit of 48 months on public assistance (\$77 million), and closing one state prison and other prison system spending cuts (\$57 million).

Spending: Where Does the Money Go in State Government?

The state essentially has two budgets—the overall \$46.6 billion budget and the \$8.1 billion “General Fund,” which is only a small part of the overall budget. Much of the overall budget is paid for by the federal government and set-aside taxes such as sales tax and lottery revenues for K-12 schools. In Lansing, the General Fund is where the action is—it is the source of much political debate because it is completely within the discretion of the governor and the legislature. The exhibit below shows the major areas of state spending, along with their proportions of the overall budget and the General Fund budget.

Budget Area	FY 2011		Governor’s Proposal, FY 2012	
	% of General Fund	% of Total Budget	% of General Fund	% of Total Budget
Crime, justice & public safety	28%	6%	29%	6%
Education (early childhood, K-12, and higher education)	23	32	13	30
General government	8	4	9	5
Environment	0	2	0	2
Health care and human services (for example, Medicaid, public assistance)	40	45	47	45
Economic development	1	3	1	3
Revenue sharing to local governments	0	2	0	2
Transportation	0	7	0	7

Spending: Other Options

There are, of course, many other ways that spending could be cut or increased. These options are just a few possibilities:

- ❖ Across-the-board 10 percent reduction in general government expenses in selected state departments (\$53 million)
- ❖ Prison sentence reforms: Various approaches to further reduce prison population, including credits for good time and releasing 4,000 prisoners still incarcerated after their earliest release date (\$125 million)
- ❖ Cut Medicaid and other optional health services—dental, optical, mental health, and hospice—for the poor (\$97 million)
- ❖ Cut Medicaid payments to hospitals, physicians, and other providers by 10 percent (\$188 million)

Note that all dollar amounts in parentheses in the bullets above represent possible savings in the General Fund budget. With Medicaid, overall spending cuts would be 2–3 times as great, as federal matching dollars would be lost, too.

Spending: The Public Workforce

According to the U.S. Census Bureau, 482,579 employees in Michigan worked for state government, local public school districts, public universities and community colleges, and municipal governments and special authorities in 2009. This is 10 percent of the total Michigan workforce.

While complete information is not available for all public employees, we do have state employee salary, wages, and benefits expenditures:

- ❖ The governor's FY 2011–12 *overall* budget recommendation is \$46.6 billion. Not taking into account the governor's proposed \$180 million cut to state employee compensation, state employee salaries would total \$3.3 billion, or 7 percent of the total budget in FY12. State spending on health care for active state employees would total \$715 million, or 2 percent of the total budget. State spending on retired state employee pension and health care benefits would amount to \$1.5 billion, or 3 percent of the total budget. Taken together, state employee and retiree salaries and benefits would amount to 12 percent of the overall state budget in the next fiscal year.
- ❖ The governor's FY 2011–12 *General Fund* (GF) budget recommendation is \$8.1 billion. Not taking into account the governor's proposed \$180 million cut to state employee compensation, state employee salaries would total \$1.7 billion, or 21 percent of the GF budget in FY12. State spending on health care for active state employees would amount to \$361 million, or 5 percent of the GF budget. State spending on retired state employee pension and health care benefits would total \$747 million, or 9 percent of the total budget. Taken together, state employee and retiree salaries and benefits would be 35 percent of the state General Fund budget in the next fiscal year.
- ❖ In addition to these costs, the state is obligated to pay retired state employees and retired public school employees their future health care benefits. These health care benefits are currently funded on a pay-as-you-go basis. This means each year the State appropriates the funds to make these retirement health care

payments for the current year. Based on governmental accounting principles, the state reports each year the estimated amount of all future retiree health care costs. These future liabilities total \$12.6 billion in the State Employees Retirement System and \$27.6 billion in the Public School Employees Retirement System.

CITIZEN NEXT STEPS – HOW TO STAY INVOLVED

Thank you for participating and lending your voice to the debate over our state’s strategic priorities. Here’s what you can do next...

- 1. Follow the budget process.** Read the Center for Michigan’s weekly e-newsletter, which will feature regular updates as the budget works its way through the legislature. To sign up, simply request the newsletter in an e-mail to info@thecenterformichigan.net.
- 2. Make your voice heard.** Take what you have heard today and talk with or write to your legislators. They need and want to hear from their constituents on the game-changing proposals of our new governor. Or write a short (75–100 words) letter to the editor of your local newspaper. Your local legislators pay attention to articulate and thoughtful considerations of major issues.
- 3. Play the Center for Michigan’s budget game. If you haven’t already, balance the budget yourself.** Go to <http://www.thecenterformichigan.net/you-balance-the-state-budget/> and see how your priorities line up with financial reality. Once you have completed the exercise, you can see how your answers compare with the thousands of Michigan residents who have played before you.
- 4. Participate further in the Center for Michigan activities.** Through the Center for Michigan weekly e-newsletter and invitation e-mails, stay tuned for more forums and small group Lansing meetings—and televised forums with Detroit Public Television—that will allow you to join with leaders to discuss taxes, spending, investment, and our state’s priorities.