

Myth-Busting the State of Michigan Budget

*The Consequences of Michigan's
Fiscal Debacle 2000 to 2008*

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It's not news that since 2000, Michigan's state government has struggled. Year after year, governors and lawmakers have fought to balance budgets, cutting many areas deeply. The process has been dynamic and divisive, with lawmakers of both parties participating in tax cutting exercises even as state revenues have fallen behind inflation and dramatically behind the growth in state income.

This paper provides a brief overview of the consequences of state policymaker decisions to cut taxes and make spending decisions that have reduced the state's ability to return to prosperity. Indeed, there is a growing group of business leaders who believe the turmoil in Lansing is hurting the state more than economic circumstances itself, making the current economic situation, which is not good, look far worse than it really is.

It is vital that policymakers begin educating themselves and their constituents about the true nature of Michigan's fiscal situation and overcome the statements of those who seek to continue Michigan's plunge into chaos through a studied campaign of disinformation.

Frankly, a series of myths engulf the state budget. As the Governor and Legislature begin work on the Fiscal Year 2009 budget, all lawmakers and the public must better understand the facts and the root causes of Michigan's current fiscal debacle. The decisions that will be made in the next six to nine months will determine whether Michigan will continue to flounder in partisan bickering, or whether our state will invest wisely to create a state that can prosper in a world economy where the single most important asset is human talent.

Myth One: State personal income is falling, so government spending should be contracting too.

FACT: From 2001 to 2008, state personal income has increased by 19.3 percent. Inflation has increased by 17.4 percent.

Myth Two: State taxes and state spending are growing faster than personal income.

FACT: State personal income growth has almost doubled the rate of state spending from state resources, i.e., state taxes and fees. While state personal income has grown by nearly 20 percent, state spending from state resources – even after the tax increases of 2007 – has increased by 10 percent.

Myth Three: State government across the board is growing at a high rate.

FACT: Only two major areas of state government have seen growth faster than the rate of inflation: Medicaid spending to cover health care for the poor, and corrections. Every other area has increased slower than the rate of

inflation, and far slower than the growth of incomes in our state. State spending on higher education and on state revenue sharing for Michigan's communities has actually decreased since 2000, despite last year's tax increases. State spending on Medicaid has increased because Michigan's Medicaid caseload has skyrocketed from about 1 million in 1999 to more than 1.5 million now. A significant share of the Medicaid spending is from funds provided by the federal government.

Myth Four: The overall state budget, including federal funds, has increased faster than Michigan can afford.

FACT: Since 2000, the overall state budget has increased by less than the rate of state personal income – even after taking into account the 2007 tax increases. And the only way that the overall budget has been able to increase at a rate even near state personal income or inflation has been because of a massive infusion of federal funds, the majority earmarked to cover health care for the poor.

Myth Five: State government is taking a larger bite out of our paychecks than ever.

FACT: The bite out of each paycheck today is far lower than it was in 2000. In 2000, state government took 9.49 cents out of every dollar a Michigan family earned. This year, that tax bite is about 8 cents. If Michigan's tax bite was the same as in 2000, we would have \$5 billion more to help hire police officers and fire fighters, hold down college tuition and help nonprofit associations provide vital social services.

Myth Six: State spending has gone out of control since 2000 – before that, the state budget was under control.

FACT: From 1994 to 1999, state spending from state resources rose faster than the rate of inflation and faster than the growth in personal income during that period. According to the Senate Fiscal Agency, state spending from state resources grew 25.5 percent during that period, while state personal income increased by 24.8 percent. That is contrasted with the period since 2000, when state spending from state resources grew by 10 percent, compared to a 19.3 percent increase in state personal income. The reality is government spending has grown far slower since 2000 than during the late 1990s.

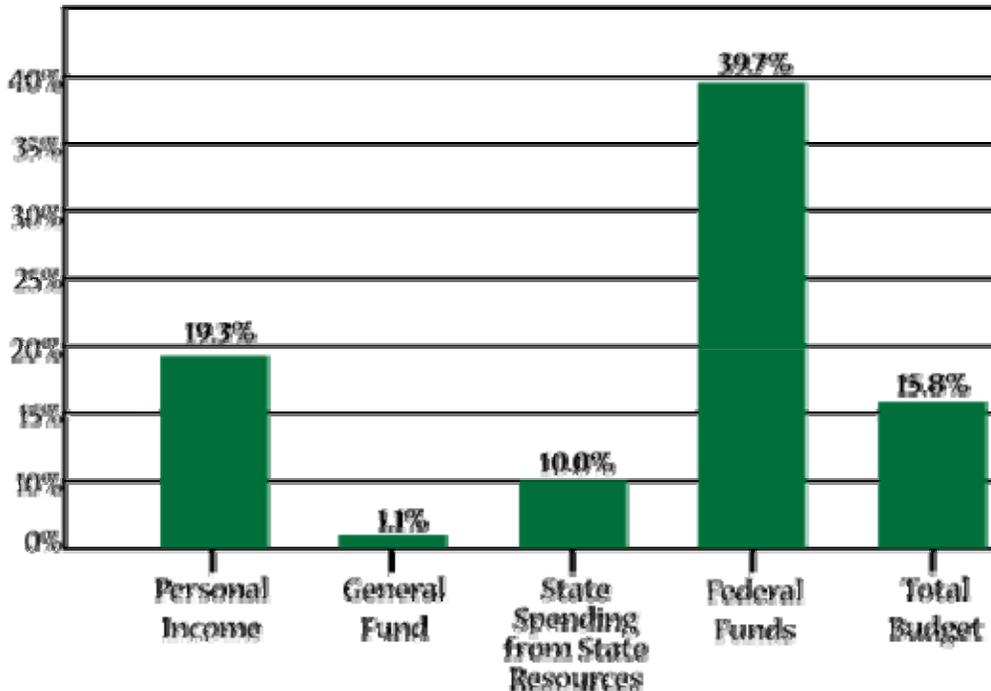
It is vital that policymakers begin challenging those who continue to purvey myths, and begin educating the public about the reality of Michigan's budget situation. The misinformation that forms the basis of too many decisions in Lansing is making it impossible for the state to invest in key areas critical for the state to compete in the knowledge economy.

Failing to focus attention properly – and choosing to continue the failed policies of the last eight years – will ensure continued fiscal chaos and failure for our state.

The big picture: State spending from state taxes and fees has increased 50 percent slower than state incomes

Since 2000, personal income in Michigan has grown by 19.3 percent. During that period, state general fund spending has increased by 1.1 percent, and overall state spending from all resources – all state taxes and fees, including the current year budget built on the 2007 tax increases – has increased by 10 percent.

Personal income growth far outpaces state tax spending



Source: Senate Fiscal Agency data

In other words, state spending from state revenues has increased about half as fast as the rate of growth of state incomes. Michigan has seen a major increase in federal funds coming to the state, primarily in the area of Medicaid. That has made possible a total budget growth in line with state personal income over the last nine years.

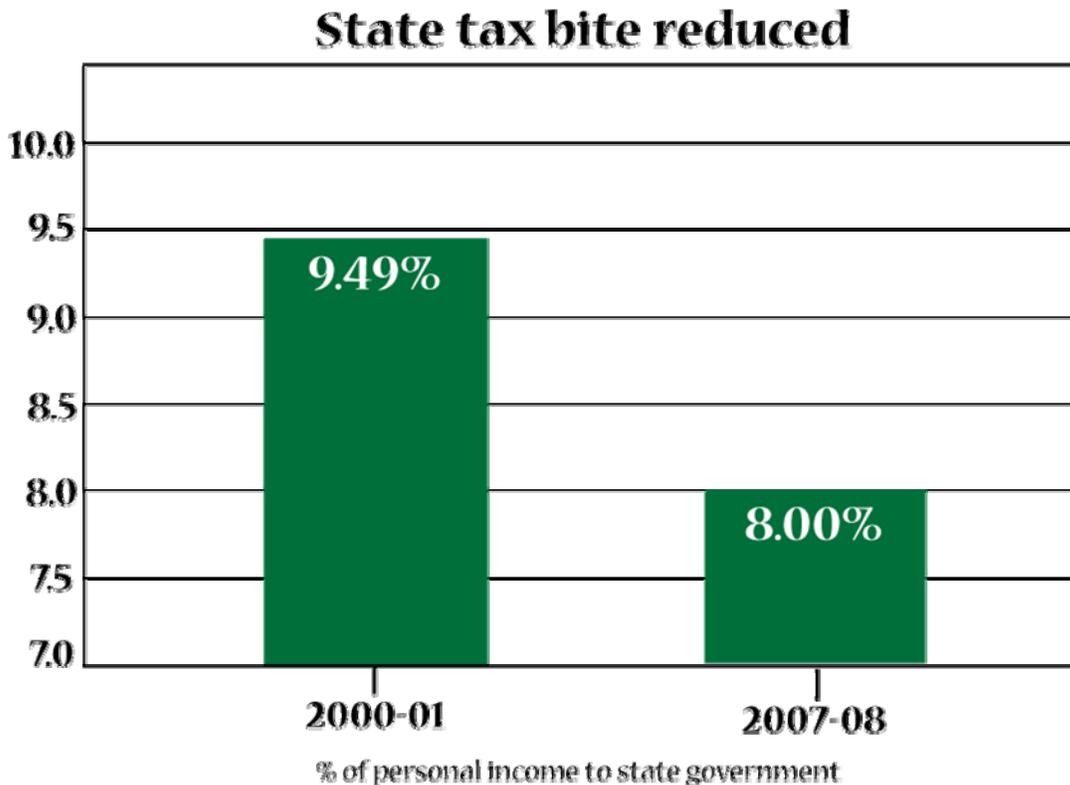
Those who continue to point to growth in the state's overall budget as evidence of a need for further budget cuts need to realize that the easiest way to cut the overall budget is for the state to return to the federal government funding now received to pay for Medicaid and for road construction. Of course, those who do so are also advocating for higher health care premiums for Michigan businesses, since cutting patients off Medicaid results in those patients continuing to receive health care through high-cost emergency rooms and hospitals passing those costs onto paying customers. Cutting Medicaid significantly will also harm tens of

thousands of children, elderly and disabled residents, whose health status will worsen.

Or Michigan can cut its overall budget by returning millions of dollars in highway funding to the federal government. Doing so, of course, means less money for much needed road improvements.

Michigan today taking a smaller bite out of state paychecks than 2000

As the chart below shows, Michigan today is taking fewer pennies out of each dollar earned by Michigan families than it did in the late 1990s and 2000 – even after the tax increases of 2007. This fact is generally ignored by those who wish to incite the public by stating that state government must “live within its means.”



This reduction of state taxes' share of state personal income is due to major tax cuts in the late 1990s and early 2000s, which are continuing. In 1999, for instance, the state income tax rate was 4.4 percent. That was reduced over several years to 3.9 percent, and increased last year to 4.35 percent.

The state's business tax rate under the old Single Business Tax was cut from 2.35 percent to 1.9 percent over the same period. The new Michigan Business Tax was designed to recover revenue at the 1.9 percent rate.

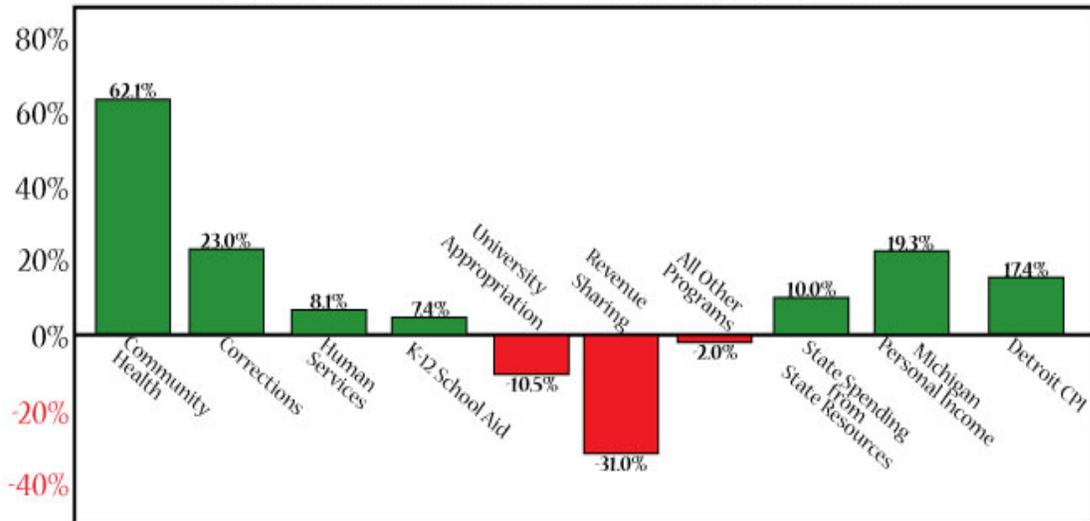
Additionally, the state has now introduced another phased-in tax cut, the earned income tax deduction. This will cost the state's general fund an additional \$393 million in 2009-10, potentially forcing even deeper budget cuts.

State government's tax bite today is far less than in 2000 – about 15 percent less, even after taking into account the income tax and business tax increases passed in 2007. If this reduction in state tax bite were apportioned equally, a family making \$50,000 would have seen its share of the state's total bill reduced from \$4,700 in 2001 to \$4,000 in 2008.

Eating our seed corn: Budget choices are limiting our future

Within the state budget, comparing the 2000-01 fiscal year to the budget just approved for the 2007-08 fiscal year, it is apparent that the state has shifted its spending priorities in major ways toward Community Health (Medicaid almost exclusively) and Corrections. Spending on human services and K-12 school aid is also up, although by far less than the rate of inflation, and by far less than the increase in state personal income.

State spending from state resources FY 01 to FY 08



Meanwhile, the state has dramatically underfunded revenue sharing, higher education, and all other areas of state government. One easily quantifiable result: The failure of state government to increase state funding for universities at the same rate as inflation, coupled with an increase in the number of students enrolled, means the average student pays \$2,500 more in tuition today than in 2000.

With the state's personal income over the period increasing 19.3 percent and with inflation running at 17 percent, funding for public universities has been cut by 10.5 percent, and revenue sharing – vital for improving our state's developed communities – has been cut an astounding 31 percent. One easily quantifiable result: The failure of state government to increase state funding for universities at the same rate as inflation, coupled with an increase in the number of students enrolled, means the average student pays \$2,500 more in tuition today than in 2000. And Michigan today has 1,700 fewer police officers than in 2001.

We continue cutting higher education and revenue sharing at our peril. Evidence is increasing that states and regions that are the most prosperous are those with the highest percentage of college graduates. That would suggest Michigan needs to do what it takes to prepare, attract and retain more college graduates. That means doing more to keep college affordable by providing additional resources that would allow universities to hold down tuition increases while maintaining high quality, and taking steps to make inner cities, where an increasing number of college graduates say they want to live, more attractive.

MFRP recommendations:

1. **“Pay as you go” approach to state tax cuts.** The major reason Michigan has suffered through its prolonged fiscal crisis is it has artificially created a structural deficit through major tax cuts passed by the Legislature and signed by governors. Cutting taxes is easy; cutting programs is much harder. Any recommendation of further tax cuts or tax expenditures should be accompanied by a proposal for what programs would be cut to pay for the tax cut.
2. **The Legislature should put a priority on finding reforms that will result in taxpayers getting high quality services at the lowest cost.** The failure of the Legislature to seriously consider a number of important reforms during the 2007-08 budget talks was disappointing. Lawmakers should begin unveiling serious reforms in time for them to start taking effect for the FY 2009 state budget. All areas of the budget should be examined for possible reforms that lower costs without sacrificing essential services.
3. **The state should complete a serious review of tax expenditures.** According to the Department of Treasury, tax expenditures – various credits and exemptions to state taxes – increased by \$1.2 billion last year, to \$31.865 billion. Many of these special tax subsidies were created decades ago, and may have outlived their usefulness. Others are simply the result of special interest lobbying that Michigan can no longer afford. All should be reviewed carefully, and reasons for continuing them should be specifically expressed by lawmakers – or they should be eliminated.

4. **This year's budget discussions should recognize what has already been cut since 2000.** Clearly further cuts in revenue sharing, higher education and human services are unwarranted given the significant cuts those areas have already absorbed since 2000.