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Michigan Budget Reform: Why Reform is Needed, and Key Ideas for Reform

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January 12, 2010

Testimony to the State Board of Education

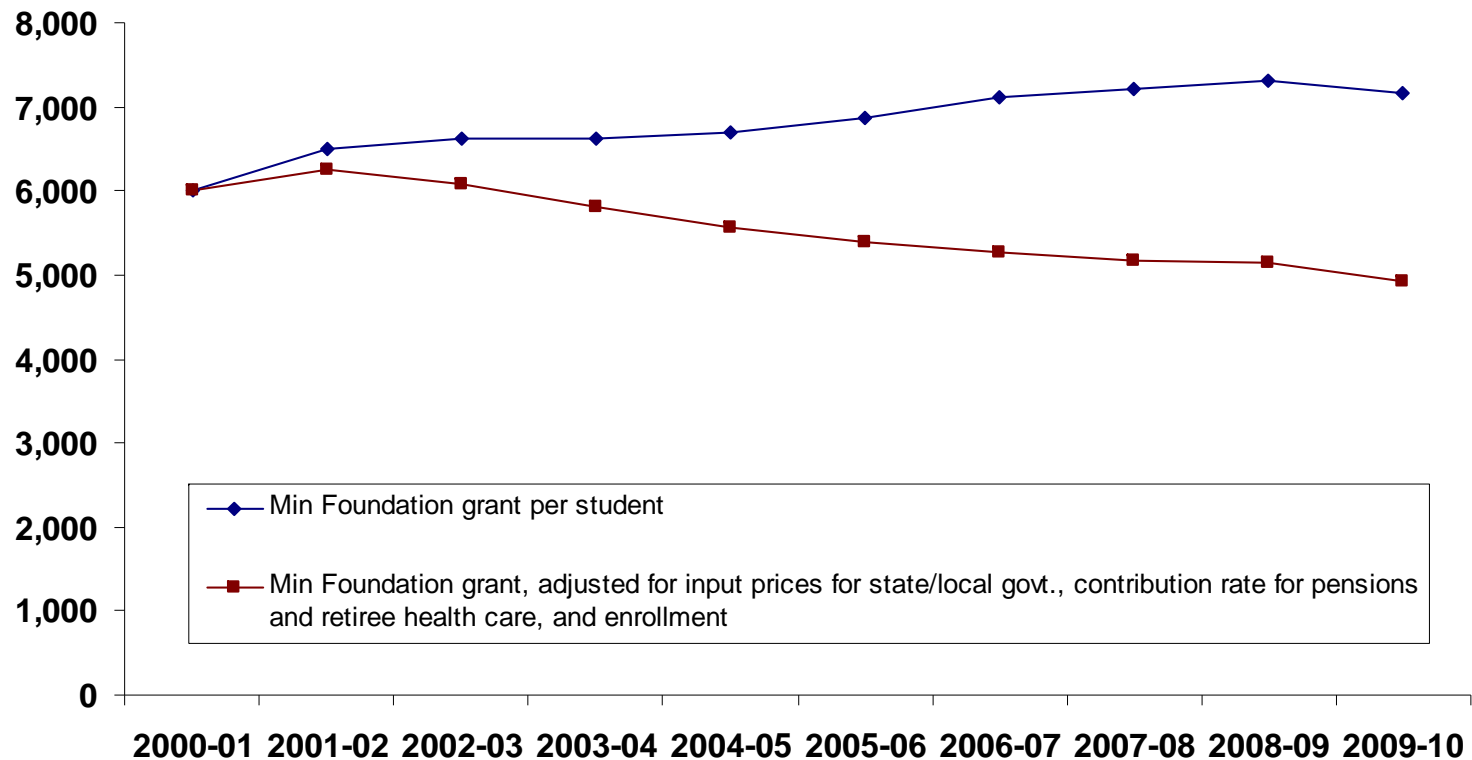
My presentation focuses on two topics:

- **Why we need to talk about budget reform**
- **Ideas for needed budget reforms**

Why we need to talk about budget reform:

- **Decline over last decade of real resources available in Michigan for education**
- **Long-term structural budget problem in maintaining current services**
- **Need for new investments, including K–12 and other education services, to revive Michigan’s economy**

Decline in real resources available for education: The case of the foundation grant



- After adjustments, foundation grant declined 18% over decade
- Offsetting this decline would require increase in foundation grant of \$1,483 per student

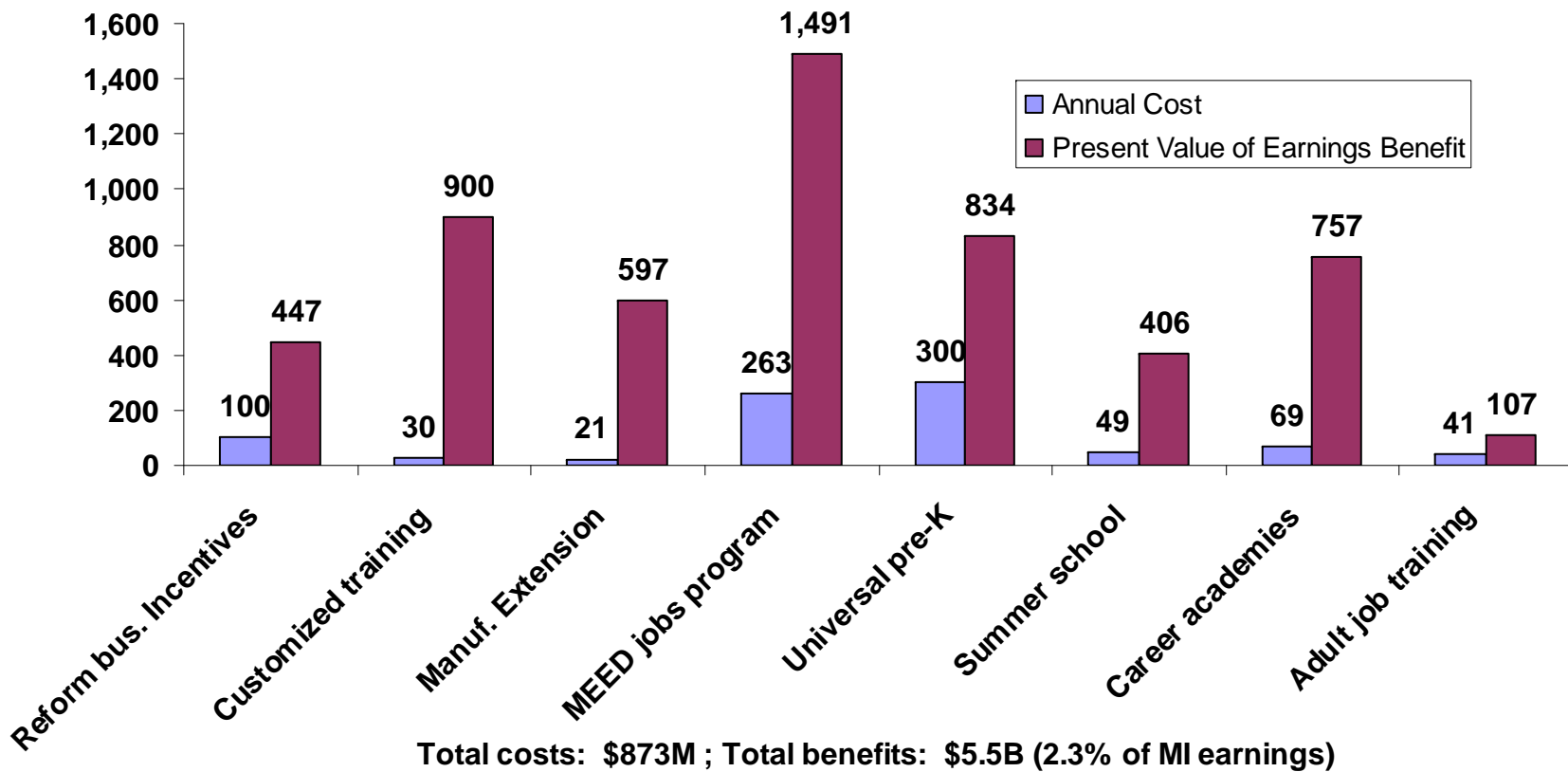
Dollar magnitude of education funding deficits:

- **Offsetting real foundation grant declines: would require \$2.4 billion extra annually**
- **Offsetting recent declines in university funding: would require \$0.4 billion**
- **Total education funding deficit: \$2.8 billion**

Long-term structural budget problem (CRC estimates, using Upjohn Institute long-run economic model):

- **School Aid Fund**: Over next 8 years, default spending pressures for K–12 grow about 1.7% per year faster than revenues. Cumulative problem by 2017: \$4 billion
- **General Fund**: Over next 8 years, default spending pressures grow 5.4% per year faster than revenues. Cumulative problem by 2017: \$6 billion
- Total long-run structural budget problem: \$10 billion

New research-based investments to revive Michigan's economy:



Source: Bartik, Timothy J. 2009. *What Should Michigan Be Doing To Promote Long-Run Economic Development?* Upjohn Institute Working Paper No. 09-160. Available at: <http://www.upjohninstitute.org/publications/wp/09-160.pdf>

Why we need to talk about budget reform:

- **Decline over last decade of real resources for education of \$2.8 billion**
- **Long-term structural budget problem of \$10 billion**
- **Need for new investments of at least \$0.9 billion**
- **Total budget challenge: \$13.7 billion**

Needed budget reforms:

- **Tax side**: Broader sales tax, graduated income tax, reduced exemptions for senior citizens, some scaling back of tax breaks
- **Spending side**: Scale back correction dollars, restrain health care spending
- **Local side**: Need to allow more local initiatives: more options for local school property taxes, local sales tax option

Budget reforms must be comprehensive:

- **Address both School Aid Fund and General Fund**
- **Address both state budget situation and local options.**

Why:

- Overlapping revenue sources
- Overlapping spending problems (e.g., health)
- Money is fungible

Budget problem is big enough that solution must address all key revenue sources and all key sources of spending pressures:

- **Solution must include both revenue reforms and spending reforms**
- **Difficult to see how problem can be solved:**
 - **without graduated income tax**
 - **if business tax is eliminated or drastically downsized**
 - **if health care costs not aggressively addressed**

Special importance of health care reform:

- **Even if all other dramatic budget reforms are enacted, difficult to solve budget problem without bending cost curve for health care**
- **Health care reform requires genuine reform in cost-effectiveness of system**
- **Must consider how affects attractiveness of education careers**
- **Requires statewide solution. Decentralized approaches have failed**

Notes to slides:

Foundation grant slide: The nominal foundation grant amounts are after prorations and any added funds. The adjusted numbers adjust for prices of inputs to state and local government services, the contribution rate imposed on school districts to pay for school employee pensions and retiree health care, and enrollment. The price adjustment uses the deflator for state and local general government services from the National Income and Product Accounts provided by the Bureau of Economic Analysis, U.S. Department of Commerce. The adjustment for the contribution rate takes the difference between the contribution rate for 2000-2001 and the contribution rate for the year in question, and translates it into a per student amount. This adjustment uses data from the Citizens Research Council that implies that the contribution rate is imposed on about 69% of total local school costs, based on statistics from 2003 that when contribution rate was 12.99%, school contributions for retirement and retiree health care were 9% of school costs (Citizens Research Council, 2004, "Financing Michigan Retired Teachers and Pension and Health Care Costs," Report 337). The adjustment for enrollment changes considers total Michigan enrollment from 2000-2001 to 2009-2010. I assume that over this time period, an enrollment change of $x\%$ changes costs by two-thirds of $x\%$.

Slide on education funding deficits: The calculated K–12 education deficits multiply the per student deficit, comparing 2000-2001 to 2090-2010, by figures from House Fiscal Agency for total Michigan school enrollment. The university funding deficit comes from figures from House Fiscal Agency that compare fiscal year 2002 with fiscal year 2010.

For more on education investments and Michigan's economy: See Bartik, Timothy. 2009. "Boosting Michigan's Economy Through Educational Improvements." Available at http://www.upjohninst.org/bartik_testimony_12-14-09.pdf