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The Michigan Municipal League has consistently expressed our concerns over the diversion of existing General Fund resources to fix Michigan's infrastructure.

So the question is: If the legislation that is currently in the House were to become law, how is it likely to impact the ability to maintain current levels of state services and funding for state departments, local governments, and education?

To better understand these issues, the League requested much respected non-partisan former House Fiscal Agency Director Mitch Bean to look at the implications of SB 414 (S-1). His report is attached.

Key findings in Bean's report:

1. The state's general fund has declined 1.8 percent since FY 2001, and adjusted for inflation has declined 23 percent. No state in the nation has cut its budget more than Michigan over that period.
2. The state already faces revenue pressure from several tax changes scheduled to take effect in FY 2017-18, when SB 414 (S-1) would take full effect.
3. Additional general fund spending pressures are also expected, given federal policy changes that will require more state support for basic human services.
4. If SB 414 (S-1), as passed by the Senate becomes law, the likely impact on the FY 2017-18 General Fund (GF/GP) budget would be $450 million to $550 million in GF/GP budget cuts.
5. The state would have to cut between 11 percent and 13 percent from each department line item if they were able to reduce health and human services, and corrections spending, the two largest items in the GF budget, by a combined $100 million. (See the attached chart)

The Michigan Municipal League believes this report helps identify what potential general fund cuts policymakers may consider should SB 414 (S-1) take effect and what the potential impact would be on public goods and services provided by the state.

The League firmly believes we must find a sustainable long-term solution to the problem that includes new revenue that is dedicated to the entire transportation system, while ensuring sustainability and investment in all areas that are critical to the health, public safety, attraction and retention of talent and other areas that benefit Michigan job providers and residents.
We recognize that finding an answer to this problem is a process and we stand willing and able to work with you and your colleagues on a reasonable solution.

If you have questions, please John LaMacchia at 517-908-0303 or jlamacchia@mml.org

**Summary and Analysis of the GF/GP Revenue and Budget Impact of Senate Bill 414 (S-1)**

Prepared by Great Lakes Economic Consulting for Michigan Municipal League; July 9, 2015

Senate Bill 414 (S-1) dedicates $350 million of income tax revenue to transportation in FY 2016-17 and $700 million each year thereafter. In addition, beginning January 1, 2018, the individual income tax (IIT) rate is reduced when prior-year GF/GP growth exceeds the rate of inflation.

That means it could turn out to be a TABOR-like system (as passed in Colorado several years ago) that would be particularly devastating when coming out of a recession, because revenues could actually decline during the recession but would then be capped at inflation during the recovery.

**CONTEXT**

Legislative intent for GF/GP is clear. Senate Bill 414 (S-1) states: "It is the intent of the legislature to offset the fiscal impact on the state general fund resulting from the [proposed] earmark to the Michigan transportation fund…by reducing or cutting general fund expenditures in fiscal year 2016-2017 and each fiscal year thereafter."

So the question is; if the legislation that is currently in the House were to become law, how is it likely to impact the ability to maintain current levels of state services and funding for state departments, local governments, and education?

Figuring the magnitude of the needed cuts is complicated by the fact that we only have a consensus revenue estimate and a FY 2015-16 budget in place.

For FY 2016-17, the budget projection is a revenue trend estimate based on current law; there are no budget proposals for either FY 2016-17 or FY 2017-18, which is when the revenue and budget impact will hit GF/GP budgets.

The bill also raises important questions about funding the individual income tax earmark for the School Aid Fund (SAF) which is currently $2,561 million, the Earned Income Tax Credit (EITC) currently about $117 million, and the Homestead Property Tax Credit (HPTC) about $560 million.

The budget begins to get a lot tighter when you get to FY 2017-18. We don't have a consensus revenue estimate for FY 2017-18 yet, but the Michigan Transportation Fund transfer increases from $350 million to $700 million, we may have an individual income tax rate cut, the Health Insurance Claims Assessment (HICA), sunsets, and GF/GP revenue will be reduced as the Personal Property Tax (PPT) begins to be phased out and use tax revenue that currently goes to GF/GP and is used to partially replace some of the lost local government revenue.

It's worth noting that General Fund/General Purpose spending has actually declined 1.8 percent since FY 2001, and adjusted for inflation has declined 23 percent. No state has cut spending more than Michigan over that period.

**Other spending increases looming**

We also know the state's matching cost of key federal health and food programs will be increasing:

- The federal Medicaid match (FMAP) will increase from about $2.65 GF/GP billion currently to about $2.8 billion GF/GP in FY 2018.
- Maintenance of effort (MOE) for the Temporary Assistance for Needy Families (TANF) will increase from about $570 million to about $585 million GF/GP in FY 2018.

**OUR ANALYSIS:**

If SB 414 (S-1) as passed by the Senate becomes law, the likely impact on the FY 2017-18 General Fund (GF/GP) budget would be $450 million to $550 million in GF/GP budget cuts. If $100 million in HHS and Corrections cuts can be achieved, an additional 11 percent to 13 percent of all other budgets would be required to cover other than the required $700 million distribution to Transportation.

We arrived at the range of $450 to $550 by assuming that at least one-half of the potential $895 GF shortfalls are solved by FY 2018.

Sources of potential $450 million to $550 million FY 2017-18 shortfalls include:

| | |
|---|---|
| Increased Dedication to Transportation | $350 |
| Increased FMAP | $150 |
| HICA and HMO Use Tax Sunset, and other Medicaid Cost increase | $350 |
| Use Tax Shift to Locals | $30 |
| Increased TANF MOE | $15 |
| | $895 |

So where are the GF/GP cuts likely to occur? We do not yet have a revenue estimate or budget proposal for FY 2017-18, but as intended by the Senate, SB 414 would restrict revenue increases to the rate of inflation or less. And the first $700 million of GF/GP is off-limits because it is dedicated to the Transportation budget.

Moderate revenue growth of about 2 percent would likely be needed to maintain a current services budget. So we could get a reasonable estimate by asking; what budget cuts would likely occur if the FY 2015-16 GF/GP budget were cut by $450 million to $550 million?

The largest GF/GP budgets in the General Government Omnibus Bill in FY 2015-16 are:

- Health Services (DCH) at $3.2 billion
- Human Services (DHS) at $924.2 million.
- Corrections at $1.9 billion

Together they account for over $6 billion GF/GP and about 71 percent of the $8,464 billion FY 2015-16 GF/GP General Government omnibus budget bill.

However, when looking for potential budget cuts to solve the anticipated FY 2018 GF/GP shortfall, much of the $6 billion should largely be considered off-limits.

**Health services:**

Finding savings in Health and Human Services will be difficult due to federal match requirements. In Health Services (DCH) in FY 2018, the state will need to spend about $2.8 billion GF/GP, compared to about $2.65 billion in 2016, in order to satisfy Medicaid match rates (FMAP).

The other potential areas to find some savings are optional Medicaid services and provider rates.

The GF/GP cost of optional Medicaid services the state provides amount to about $450 million to $500 million. The largest lines are MIChoice, Adult Home Help, Pharmaceutical Services, and Dental. These could be eliminated. However, all of the optional services are in the current state policies because they prevent even higher medical costs, either from nursing homes or inpatient hospital stays. For example, MIChoice and Adult Home help keep persons out of expensive nursing homes.

One could also argue that while non Medicaid mental health is technically optional at this time, the federal government will be mandating Medicaid mental health services for those enrolled in Medicaid managed care (around 70% of the Medicaid population) fairly soon – and probably will do so by 2018.

The other area where some savings could potentially be realized is provider rates. However, provider rate cuts are controversial and the potential savings are small. Reducing provider rates by one percent only yields about $17 million in savings – and there would be significant push-back from providers who can't cover costs at current rates.

**Human services:**

The state is still under court oversight arising from the 2006 Children's Rights settlement that mandates the state provide certain services in the $942.2 million GF/GP Human Services budget. As a result budget cuts would be scrutinized by the courts. It would be very difficult to find GF/GP savings in Human Services programs related to Child Welfare or Foster Care that would pass muster with the Court. That would mean further cuts would have to be made to the Family Independence Program (FIP) and the State Disability Assistance program which are currently at about $36.2 million GF/GP combined.

**Corrections:**

Unless the Legislature is willing to start releasing inmates early or willing to do major changes in sentencing reform, the Corrections budget can't take much of a cut either. These types of changes have been discussed for years, and specific reform recommendations have been made, but not approved by the Legislature. In addition realizing savings from reforms if they were to occur would not be immediate – it takes time.

**Other possible sources of cuts:**

If we were to get about $100 million from Corrections and Human Services combined, we may still need to cut an additional $350 to $450 million out of GF/GP budgets. Those would need to be accomplished in the remaining $2.1 billion (GF/GP) in the General Government Omnibus Bill (after the $700 million mandatory transfer to Transportation is taken off the table)

The Omnibus Education Budget bill includes about $1.4 billion GF/GP.

- $1.23 billion GF/GP for Higher Education
- $131 million for community colleges
- $45.9 million for School Aid

Some of these could be targets for budget cuts by lawmakers. Each has its own consequences.

**<u>POTENTIAL BUDGET WITH CUTS</u>**

What might a GF/GP cut of about $450 million to $550 million look like? The chart that follows shows the relative magnitude of proportional cuts to other departments if we could achieve $66 million of cuts in Health and Human Services ($33 million each from DCH and DHS) and $34 million in Corrections.

As shown, $100 million in HHS and Corrections plus 11 percent in all other budgets saves about $477 million and $100 million in HHS and Corrections plus 13 percent in all other budgets saves about $546 million.

| Department | FY 2015-16 GF/GP | Cut HHS and Corrections $100 million combined and cut remaining budgets 11% | Cut HHS and Corrections $100 million combined and cut remaining budgets 13% |
|---|---|---|---|
| Agriculture & Rural Development | $43.1 | ($4.7) | ($5.6) |
| Community Colleges | $131.1 | ($14.4) | ($17.0) |
| Health Services (DCH) | $3,200.6 | ($33.3) | ($33.3) |
| Corrections | $1,903.9 | ($33.3) | ($33.3) |
| Education | $74.9 | ($8.2) | ($9.7) |
| Environmental Quality | $34.8 | ($3.8) | ($4.5) |
| General Government | | | |
| Attorney General | $37.0 | ($4.1) | ($4.8) |
| Civil Rights | $12.9 | ($1.4) | ($1.7) |
| Executive Office | $5.5 | ($0.6) | ($0.7) |
| Legislature | $131.9 | ($14.5) | ($17.1) |
| Legislative Auditor General | $15.5 | ($1.7) | ($2.0) |
| State | $17.2 | ($1.9) | ($2.2) |
| Technology, Management, Budget | $477.2 | ($52.5) | ($62.0) |
| Treasury | $280.4 | ($30.8) | ($36.4) |
| Talent and Economic Development MSF | $198.5 | ($21.8) | ($25.8) |
| Higher Education | $1,232.4 | ($135.6) | ($160.2) |
| Human Services DHS) | $942.2 | ($33.3) | ($33.4) |
| Insurance & Financial Services | $0.2 | ($0.0) | ($0.0) |
| Judiciary | $183.4 | ($20.2) | ($23.8) |
| Licensing & Regulatory Affairs | $38.5 | ($4.2) | ($5.0) |
| Military & Veterans Affairs | $51.2 | ($5.6) | ($6.7) |
| Natural Resources | $39.6 | ($4.4) | ($5.1) |
| School Aid | $45.9 | ($5.0) | ($6.0) |
| State Police | $376.3 | ($41.4) | ($48.9) |
| Transportation | $400.0 | $0.0 | $0.0 |
| | $9,874.1 | ($476.9) | ($545.6) |

Departments would not be able to maintain current services and could be forced to reduce staffing levels. It should be noted that state employment measured as FTE positions has declined about 17 percent and over 10,600 positions since 2000, and about 7.5 percent and over 5,200 positions since 2005.

If Departments aren't able to absorb cuts of 11 percent to 13 percent, Higher Education and local governments could be a target of significant cuts.

The Education budgets (Higher Education, Community Colleges, and School Aid) take an 11 percent to 13 percent hit amounting to about $155 million to $182 million, and statutory revenue sharing currently about $249 million would be impacted.

## BEYOND THE DOLLARS

What are the consequences of these across the board style cuts in layoffs and services to Michigan?

**Public Safety:**

- Cuts to the State Police budget of $41.4 million to $48.9 million would almost certainly mean fewer troopers on the road.
- The number of local public safety employees (Police & Fire) fell 16.3 percent from 30,600 to 25,297 from 2000 to 2013 – that decline would grow.

**Education:**

- The average tuition at 4-year universities in Michigan in 2014-2015 was $11,909, sixth highest in the nation.
- To maintain quality institutions capable of retaining our best and attracting the smartest from around the world, tuition, and student debt, would increase even further.

**Other:**

- The Earned Income Tax Credit could be eliminated, saving $117 million.
- Further reduction of the Homestead Property Tax Credit: Provides about $600 million annually in tax relief.