



CITIZENS RESEARCH COUNCIL OF MICHIGAN

# Michigan Education Finances: Short- and Long-Term Challenges

BLM Leadership Summit  
Solving Michigan's Fiscal Crisis

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# State and Local Education Spending

## *The Big Picture*

- Largest single outlay – \$17.3 B (Census, 2007)
  - 28% of total state/local operating spending (2007)
  - Supported by mix of state taxes (70%) and local property (30%) tax (2007)
- Revenues determined by Lansing, spending decisions set at local level (result of Prop. A of '94)
  - Challenge for locally-elected officials and administrators
  - Very few options to raise add'l revenue locally
  - Spending “sticky” in short-run and concentrated in personnel (80%)
- Schools currently face two fiscal problems simultaneously
  - Short-term: economic in nature
  - Long-term: structural in nature



## Short-Term Problem

*Economic Pressures = Steep Revenue Declines*

	annual growth rates		
	FY2009	FY2010	FY2011
Sales	-10.2%	-3.2%	0.9%
Income	-10.5%	-6.2%	1.4%
Use	-19.8%	3.4%	1.5%
State Education	-1.9%	-8.1%	-4.0%
Real Estate Transfer	-26.2%	1.4%	6.3%
School Aid Fund	-5.1%	-4.2%	0.2%
General Fund	-12.4%	-5.1%	0.5%

*FY2010 School Aid Fund down \$1 **billion** from FY2008*



## **Short-Term Solutions**

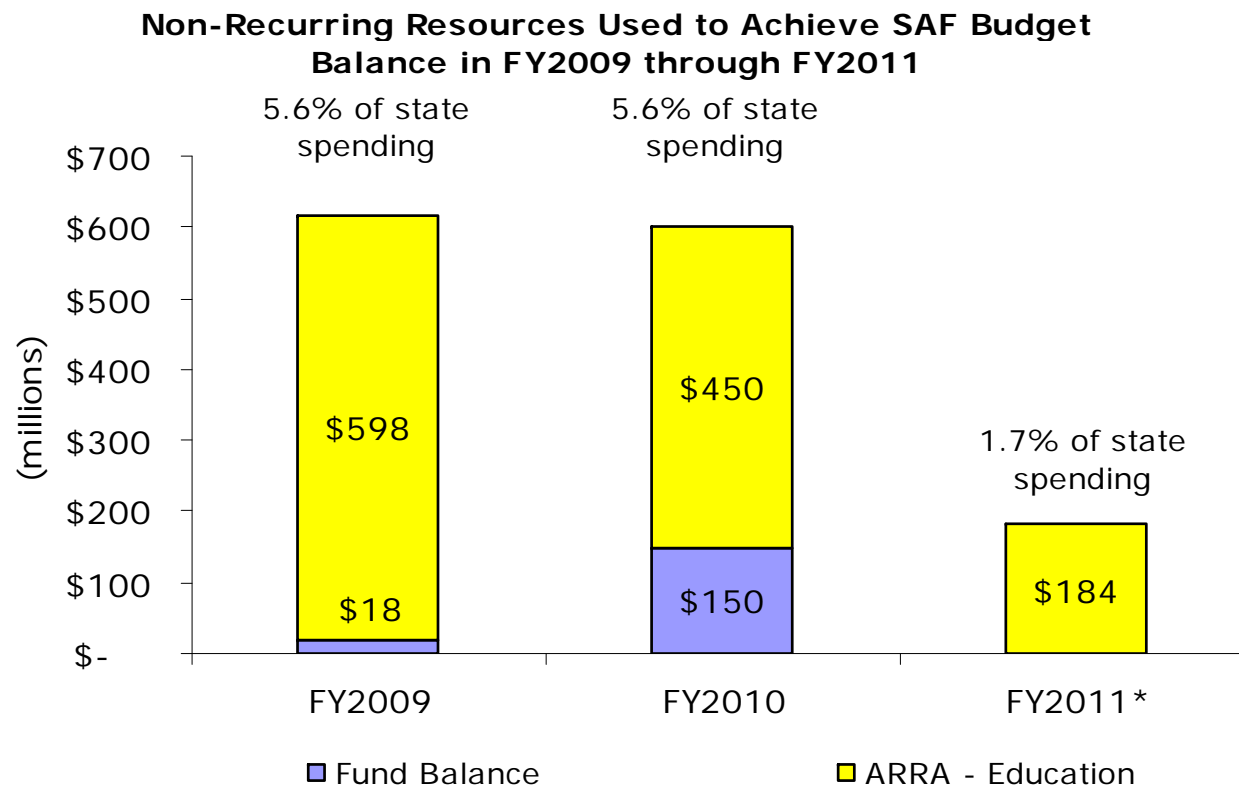
### *Some Cuts and Some One-Timers*

- Problem/solutions garnering most attention
  - Per-pupil and categorical funding cuts – state
  - Service reductions - local
- Full impact of the short-term problem not realized
  - Stimulus funding plays a significant role - state
  - Use of fund equity, but declining – local
  - Policies prudent if revenues rebound, but rebound unlikely
- How this problem was/is addressed has implications for long-term problem
  - Still working through current cuts, picture not clear what might occur in FY2011
  - Time-sensitive: over 750 local districts with varying financial conditions



# Stimulus Helps Mitigate Cuts

*Pushes Problems to Out-Years*



Fund Balance = \$247 million at 10/1/08. State spending excludes federal.

\* Based on Governor's executive budget.



## State Revenues Make the Turn, but Local Revenues Fall

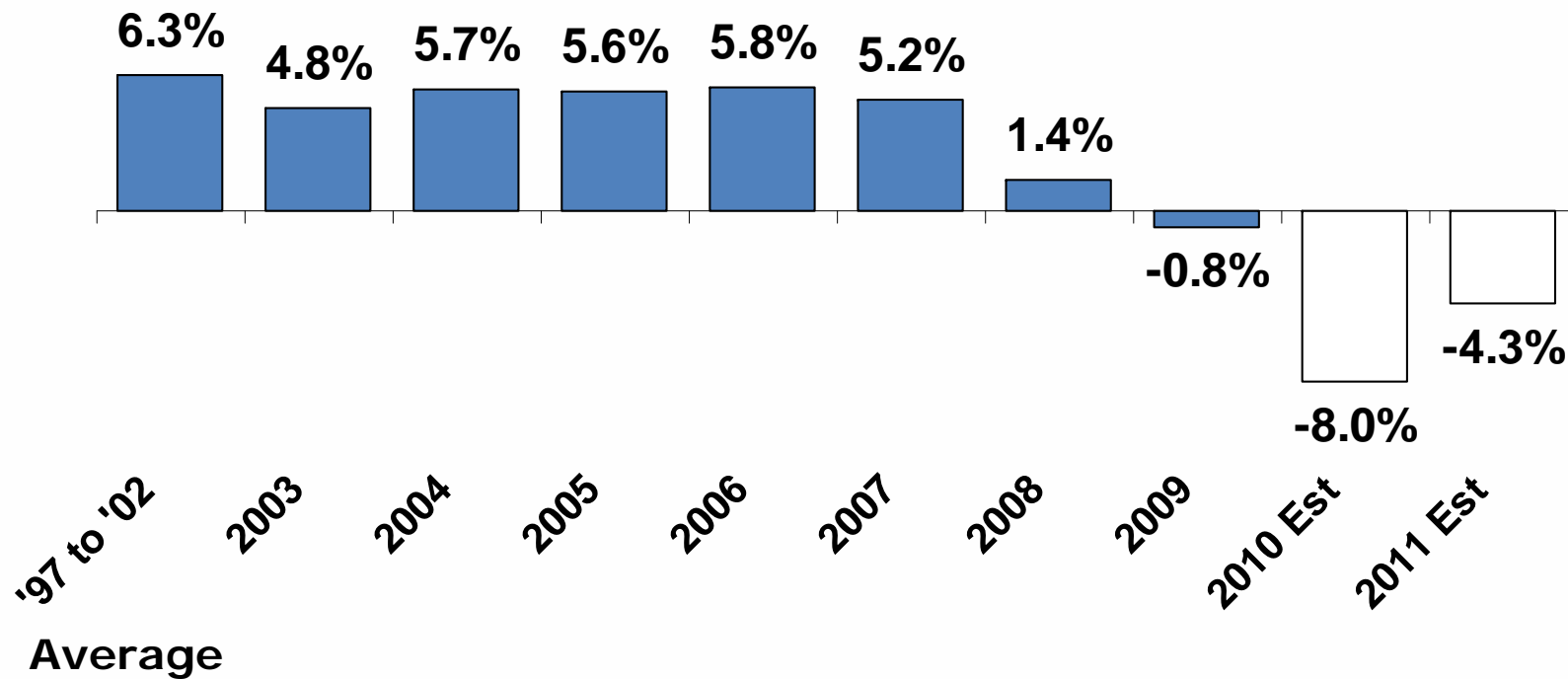
- To date, local property tax has provided stability to K-12 revenue picture – 5% growth/yr ('00 – '07)
  - In short-term and fairly short order, this picture changes dramatically
  - Non-homestead base decline 5.7% in FY2011
  - State revenues will not be positioned to help
- Coming out of the downturn, tax value growth capped (Prop. A) – restrains revenue growth
- Again, add'l revenue options for local districts limited (Prop. A)



# TV Growth Provided Stability

## *School Property Taxes Will Tumble*

% Change in Total Taxable Value





# Long-Term Problem Facing Schools

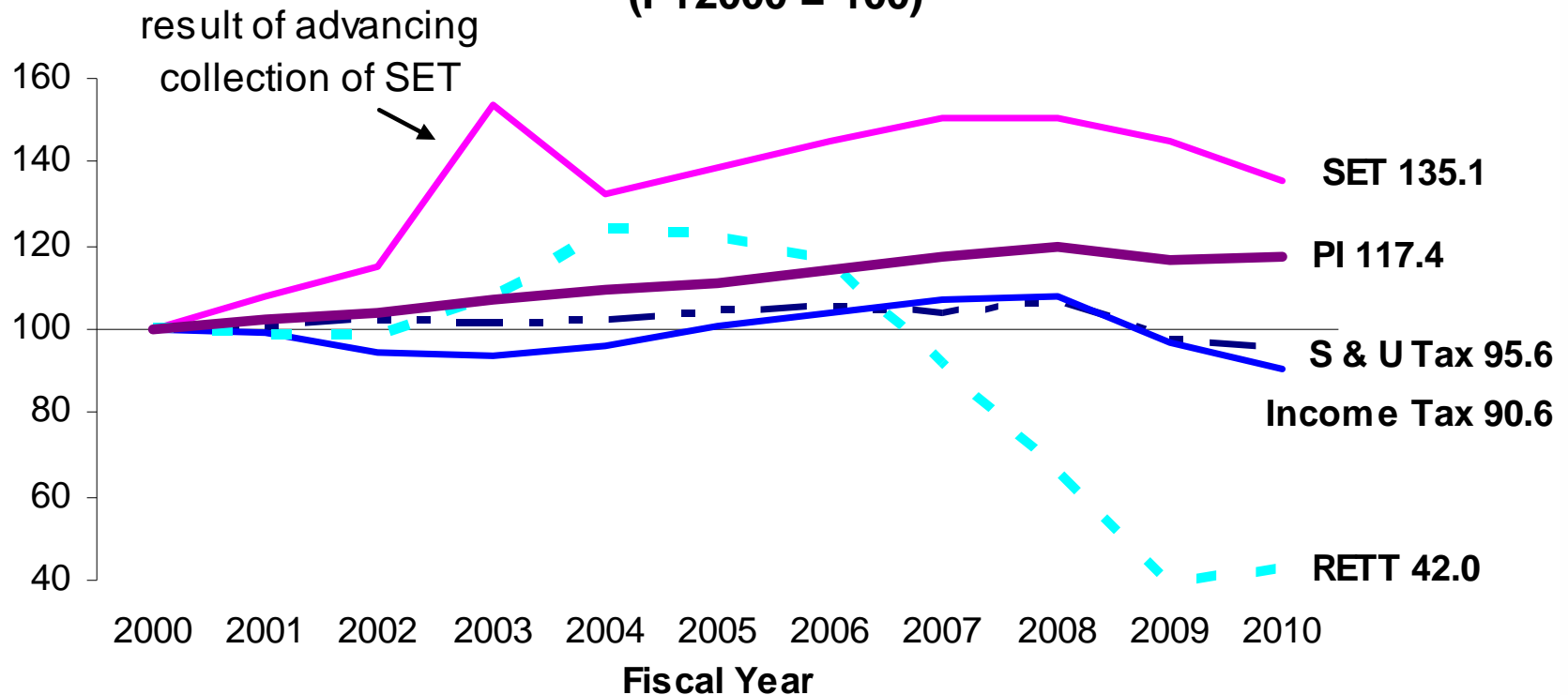
## *Combination of Spending and Revenue Pressures*

- Bottom line: even in improving economic climate, schools face an on-going, structural problem
  - Spending pressures grow faster than revenues
  - Revenues do not grow as fast as the economy
  - “Structural” deficit, different from short-term
- Problem present since early 2000s
  - Use of “stop gap” measures to balance budget
  - Recent economic decline has taken center stage
- No “silver bullet” – combination of approaches required
  - Spending: health care for current and retired employees
  - Revenues: align major sources with economy



# Revenues Do Not Keep Pace with Economy

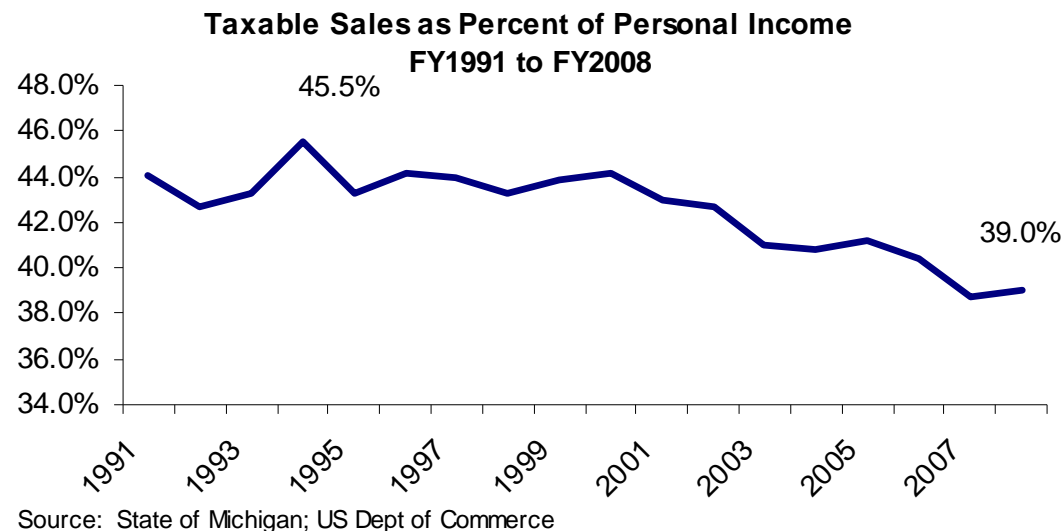
**Growth of Major SAF Revenues and Personal Income (PI)  
(FY2000 = 100)**





## What is the Long-Term Problem with Revenues?

- **Sales Tax** – Largest source of funding for schools
  - Primarily on goods and few services
  - Services growing section of economy (healthcare) thus sales tax share of economy shrinking





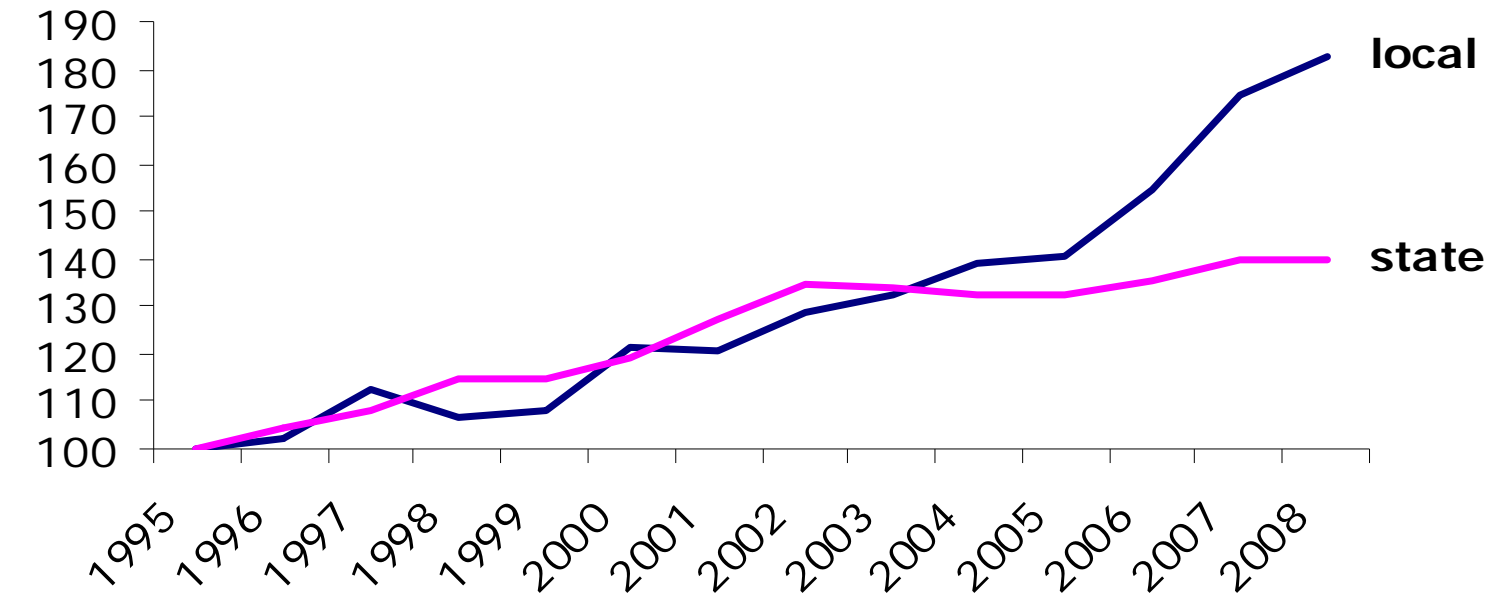
## What is the Long-Term Problem with Revenues?

- **Income Tax** – flat rate tax, generally less progressive than graduated rate structure
  - Very generous treatment of retirement income, as population retires this income is not taxed
- **Tobacco Tax** – revenues falling about 2% per yr with the overall consumption (4% of total, but falling)
- **SET** – Statewide property tax will decline with near-term erosion of taxable values
  - During rebound, taxable value growth will be capped at inflation even if housing prices escalate faster
  - Also affects local property taxes for schools (18 mills)



## Local Revenues Show Steady Growth *Property Taxes Exhibit Stability*

Per-Pupil Revenue Growth (1995 = 100)

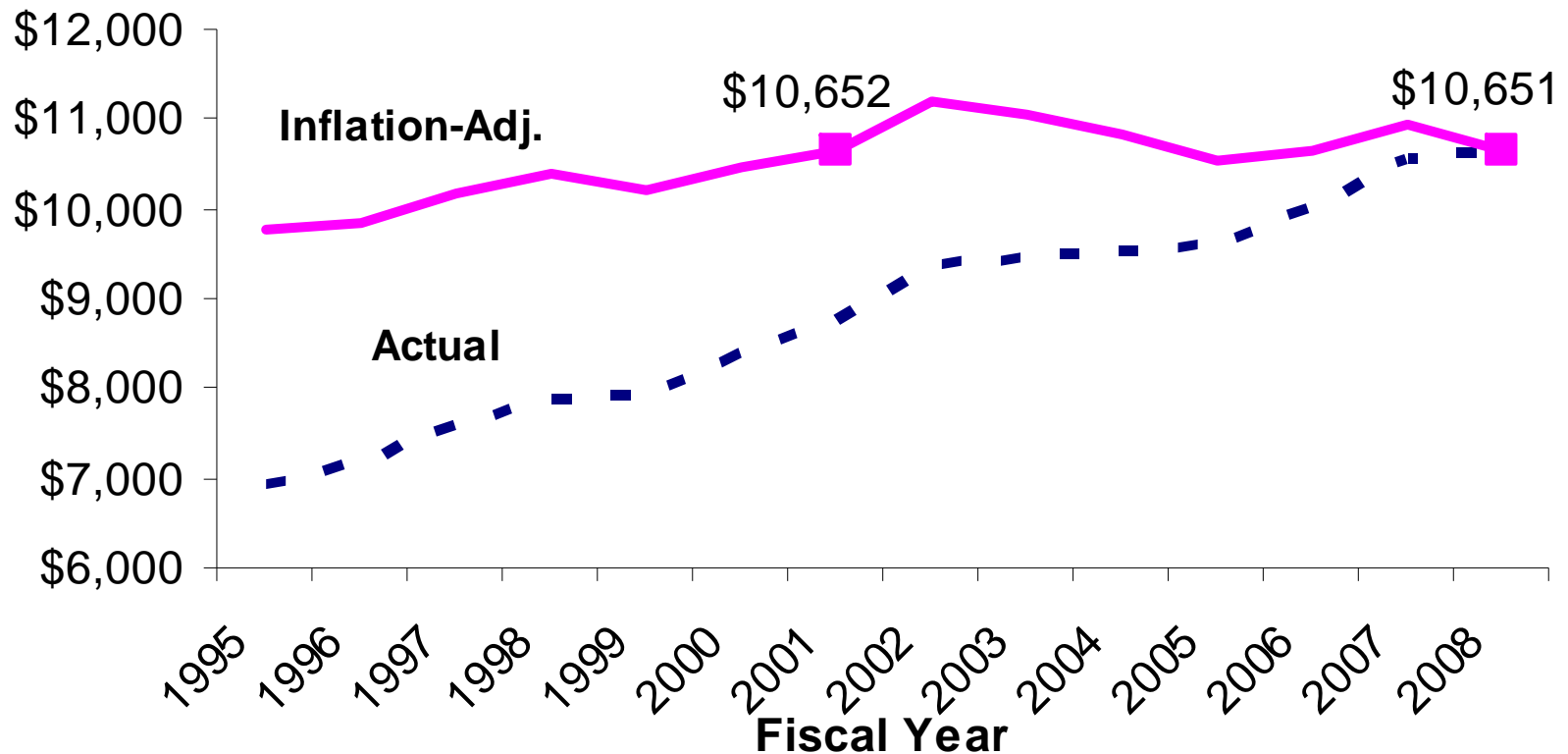


Source: National Public Education Financial Survey



## Per-Pupil Revenues at FY2001 Level

State and Local Operating Revenues: Actual and Real





## **Spending Pressures Outpace Revenue Growth**

*Costs are Largely Fixed in Short-Run*

- Retirement contributions—rapid growth
- Employee health insurance—rapid growth
- General pay raises -- inflationary
- Other—Fuel, Utilities, Supplies – inflationary
- Declining enrollments provide marginal relief



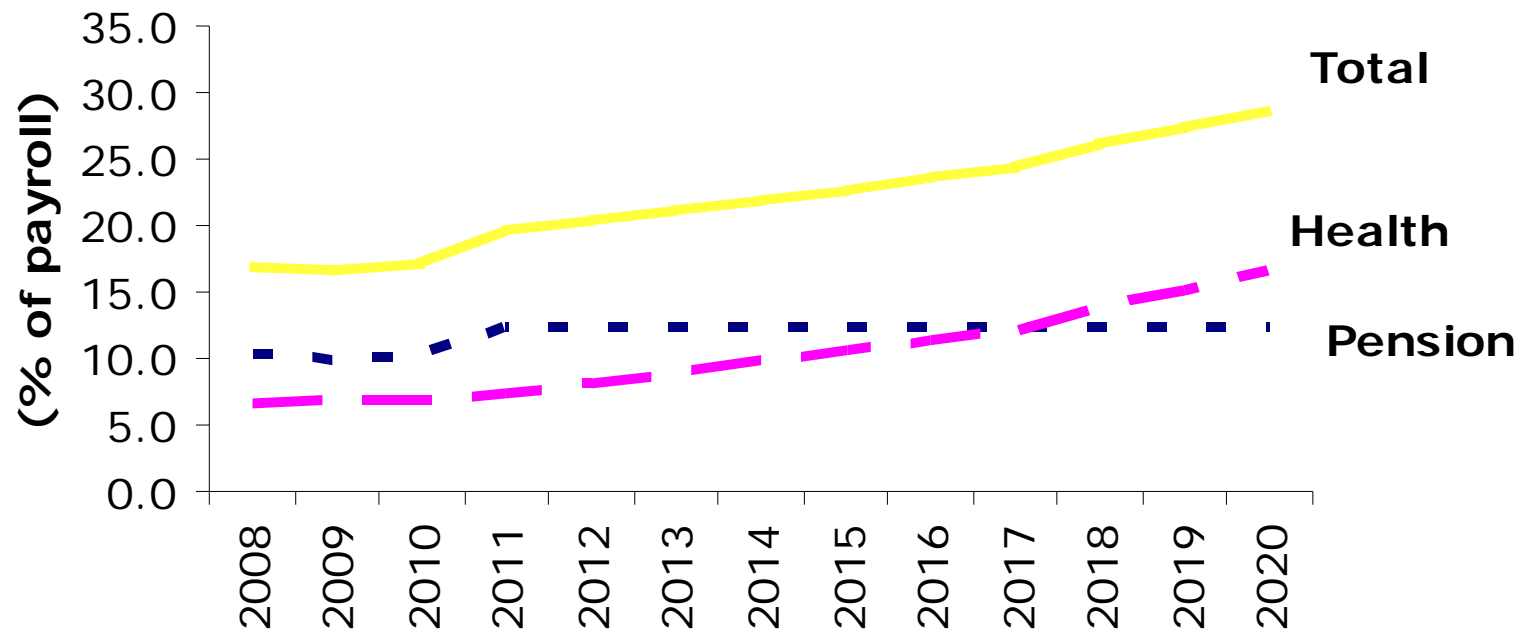
## Retirement Funding

- School districts make pension contributions – advance funded
- School districts also pay for retiree health care – cash funded
  - OPEB liability- \$26 billion, only 3% funded
  - Add'l \$1.8 billion needed to provide full-funding (FY2009)
- Rate for FY2010 is 16.94% of payrolls
  - Expected to go to 19.41% without reforms
- Contribution rate composed of two parts
  - Pension benefit (10.13% of payroll)
  - Health care benefits (6.81% of payroll or \$398 pp)
- Both parts will continue to increase in the future
  - Pension because of market in 2008
  - Health because of increase in retirees and cost of health care



# Without Reforms, Rates Will Continue to Rise

MPSERS Projected Rates





## Retirement Reforms Under Consideration

- **Governor** – Mix of long-term reform w/ retirement incentives and disincentives
  - Long-term: Employee 3% contribution and “hybrid” plan (new hires)
- **Senate** – Focus on long-term reforms including employee contribution and “hybrid” plan
- **House** – Combination of “early out” and long-term reform
  - Long-term: employee 3% contribution to begin pre-funding retiree health

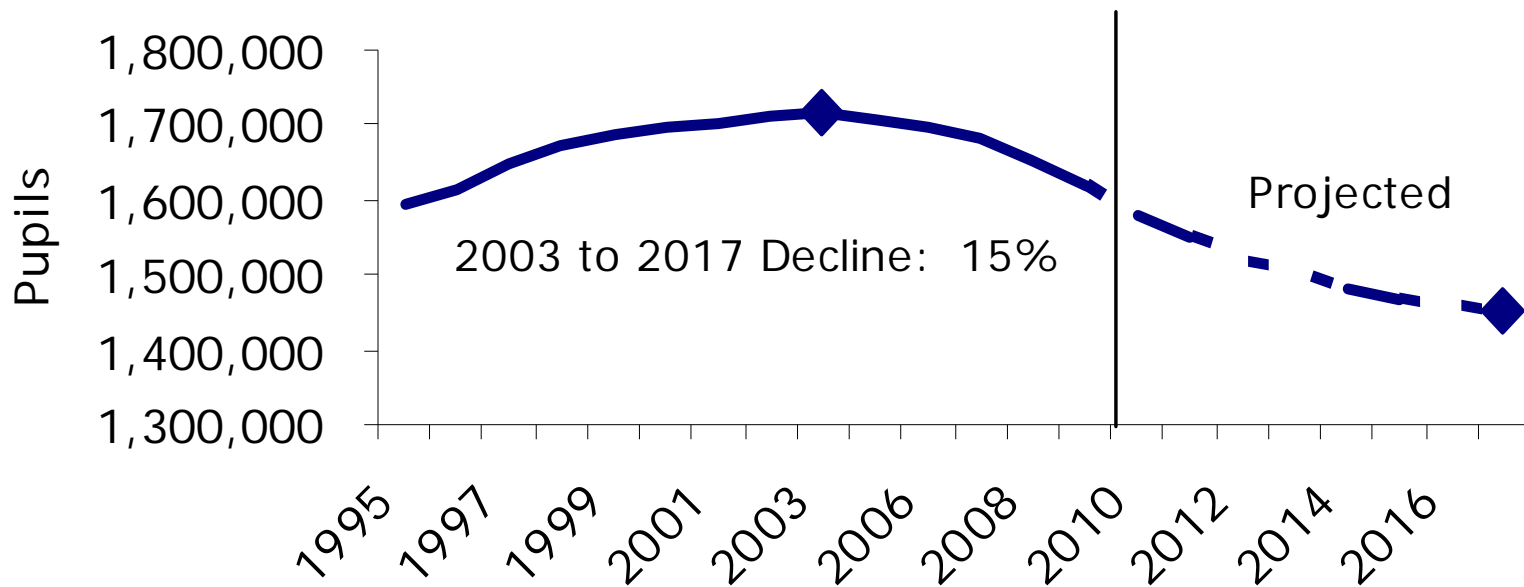
**Estimates (over 10 years) vary considerably:  
costing \$400 million to saving \$2.8 billion**



# Continued Enrollment Losses

*Less Revenue, but not Lower Costs*

Statewide Enrollments Decline 1.4% per Year



Source: Michigan Dept. of Education; CRC report *Michigan's Fiscal Future, 2008*



# Problem Does not Go Away on its Own

*Shortfalls Persist and Grow without Structural Reforms*

**Per Pupil Shortfall Projections**

