Michigan League FOR Human Services

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Budget Challenges Call for a Balanced Approach

The January Revenue Estimating Conference confirmed what was expected: Michigan faces a substantial budget gap for the fiscal year 2011 budget. Although the numbers vary some, the Senate Fiscal Agency, the House Fiscal Agency and the state Treasurer agree that the state is likely facing a $1.6 billion to $1.8 billion shortfall. Those numbers would be even higher without the $395 million of remaining American Recovery and Reinvestment Act dollars that can be used in the 2011 budget.

Projections from the Revenue Estimating Conference indicate that state revenues are likely to be flat at best for the upcoming budget. Early indications are that the School Aid Fund will experience a slight decline in revenues—about $425 million. Although revenues are not projected to plunge as much as they have over the previous years, a large budget gap remains. The current year 2010 budget relied on over $1.5 billion in Recovery Act dollars to fill budget holes. Unless there is further action by Congress, Michigan will have far less federal money for the 2011 budget and will need to find other ways to address the anticipated shortfall.

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Even with the federal money available to help fill holes in the 2010 budget, deep cuts were made in last year's budget. These cuts are impacting families across the state at a time when there has been a greater need for services during this recession. The Department of Human Services and the Department of Community Health, which are charged with providing services for the state's most vulnerable residents, experienced substantial cuts to their budgets. While the two departments were helped by federal funds from the Recovery Act, those dollars may not be available for the 2011 budget. In particular, increased federal funding for Medicaid is due to expire at the end of 2010. Temporary Assistance to Needy Families funding, which has helped with soaring caseloads in the Department of Human Services, is also due to expire.

Fiscal year 2010 marks the 10th consecutive year in which state revenues have not been adequate to fund state services and programs in Michigan. Since revenues first began to fall in 2001, the state has experienced overall shortfalls well in excess of $10 billion, has exhausted over $6 billion in fiscal reserves and has made spending cuts of over $4 billion.

As years of budget cuts add up, as federal fiscal relief is due to expire and as the state faces yet another budget gap, it is time to take a balanced approach to addressing the budget shortfall. A cuts-only approach will not only hurt vulnerable families during these difficult economic times, but it will also impact all sectors of the Michigan economy.

As economists point out, budget cuts are particularly harmful to state economies during a recession. When a state cuts its spending, the

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economic impact is widespread. When employees are laid off because of budget cuts or when benefits are cut to struggling families, they have less money to spend in their local communities, which hurts businesses. Reduced state spending often means that contracts with businesses and nonprofit organizations providing services are also cut. All of this runs counter to efforts to stimulate local economies and to encourage economic recovery.

A more balanced approach to filling budget gaps than a cuts-only approach, includes increasing state revenues. According to the Center on Budget and Policy Priorities, 30 states have addressed budget shortfalls during this recession in part by increasing taxes. For many states the imbalance between revenues and services has been so great that cuts have been combined with increasing revenues and using federal dollars to fill the gap.

Economists, such as Joseph Stiglitz and Peter Orszag, have pointed out that in addition to providing needed revenues for a state, tax increases take less money out of the economy than spending cuts. This is particularly true when tax increases target high-income households that tend to spend a smaller fraction of their income and save the rest.

Voters in Oregon recently voted to increase the income tax on the top 3 percent of filers and on businesses in order to avert deep budget cuts.

Modernizing Michigan's tax structure must be a part of a balanced approach to addressing the state's ongoing budget hole. There are a number of ways to do this, one of them being a graduated income tax structure. Michigan is one of only seven states that has a flat tax income tax, rather than a graduated income tax. Moving to a graduated tax would increase state revenue and would provide greater stability during changing economic times.

Another option, which could be done in tandem with adopting a graduated income tax, would be to extend the state's sales tax to services. Thirty-eight states tax more services than Michigan. Households now spend much less on the purchase of goods and much more on the purchase of services. Because Michigan does not tax most services, that potential revenue is being lost. And, like the graduated income tax system, extending sales tax to services also provides a more stable revenue source.

Faced with a looming budget gap of almost $2 billion as the fiscal year 2011 budget process begins, a balanced approach is needed.

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