Michigan League for Human Services

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Proposed Constitutional Spending Limit Poses Grave Threat to Michigan's Fiscal Health

Adoption of the Stop Overspending (SOS) Ballot Initiative would significantly worsen Michigan's ongoing fiscal crisis and narrow the options for its solution—forcing deep cuts in K-12 and higher education, public health and safety, and child and family support and protection programs.

Michigan voters are currently being asked to sign a petition in support of an initiative called Stop Overspending (SOS) which, unlike the existing Headlee constitutional spending limit, would prohibit government revenues from growing with the state's economy. The effect of SOS would be similar to the effect of the so-called "Taxpayer Bill of Rights" (TABOR) adopted by Colorado in 1992, because SOS includes the following three core features of Colorado's TABOR:

- It is a constitutional amendment.
- It limits growth to a population-plus-inflation formula.
- It requires voter approval to override the limit

Colorado's TABOR is the only state budget limit in the country with these three provisions, and since its adoption public services have greatly deteriorated.

- Under TABOR, Colorado declined from 35th to 49th in the nation in K-12 spending as a percentage of income.
- Under TABOR, inflation adjusted funding for in-state college students declined by 31 percent.
- Under TABOR, the share of low-income children lacking health insurance doubled in Colorado, even as it fell in the nation as a whole. Colorado now ranks last among the 50 states on this measure.

Due to the reductions in the quantity and quality of public services in Colorado, TABOR was shelved by disenchanted voters last November for five years.

Proponents may claim that SOS sidesteps TABOR's problems, but this is not true. While there are minor differences between SOS and TABOR, such as a Budget Stabilization Fund and a spending limit freeze during economic downturns, at best, these would only mitigate some of TABOR's negative effects in the aftermath of the next recession. Moreover, SOS also contains provisions that make it more severe than Colorado's TABOR, increasing the likelihood that it would do great damage to Michigan.

Regardless, by retaining TABOR's three main features, SOS can be expected to cause a decline in public services in Michigan similar to that caused by TABOR in Colorado.

TABOR's Impact on Colorado's Public Services

Last November over 1,100 organizations representing business, labor, elected officials of both parties, teachers, nurses, firefighters, farmers and many other groups came together to support a suspension of the TABOR constitutional spending limit adopted in 1992. In response to this coalition, and in recognition of the stunning impact dwindling resources have had on critical public services, Colorado's voters agreed to shelve the nation's most restrictive spending limit for five years.

The following details many of the state spending and related program reductions that have persuaded Colorado's leaders and voters to support the suspension of TABOR:

Public Education

- Under TABOR, Colorado declined from 35th to 49th in the nation in K-12 spending as a percentage of income.
- Per pupil funding fell from approximately $300 above the national average in 1991, just prior to TABOR's adoption, to approximately $700 below the national average by 2000.
- The impact of TABOR on public education funding was so significant that in 2000 voters approved Amendment 23, a measure that permits K-12 education funding to increase by inflation plus 1 percent beginning in 2001. While this change in the stringent limits of TABOR benefited the K-12 budget, it focused the impact of ongoing revenue shortfalls on the budgets of the other departments of state government.

Public Health

- Under TABOR, the share of low-income children lacking health insurance doubled in Colorado, even as it fell in the nation as a whole. Colorado now ranks last among the 50 states on this measure.
- Colorado plummeted from 24th to 50th in the nation in the share of children receiving their full vaccination regiment. Only by investing additional funds taken from federal Homeland Security allocations was Colorado able to improve its state ranking to 43rd by 2004.
- Under TABOR, Colorado declined from 23rd to 48th in the nation in the percentage of pregnant women receiving adequate access to prenatal care as defined by standards established by the Centers for Disease Control and Prevention.
- Colorado ranks 49th in per capita spending on substance abuse and treatment programs despite substance abuse rates significantly above the national average.

Higher Education

- Under TABOR, inflation adjusted funding for in-state college students declined by 31 percent.
- College and university funding as a share of personal income declined from 35th to 48th in the nation.
- In the four years from 2002 through 2005 inflation adjusted system-wide tuition increased by 21 percent to offset losses in public funding. A recent report indicated that tuition increases in Colorado were the highest in the nation in 2006 at 17 percent.

Other Areas of the Budget

- Since 2002 state funding for public libraries has been cut by 79 percent.
- Between 2002 and 2004 the Colorado Council on the Art's General Fund appropriation fell from $1.9 million to $100,000.
- Between 2001 and 2005, the percentage of state park operating costs covered by authorizations from the state's General Fund has declined by 37 percent.
- In 2003 the American Society of Civil Engineers gave Colorado a D+ for the condition of the state's roads and bridges and the Governor's Task Force indicated that a minimum investment of an additional $206 million per year would be required just to maintain the state's current transportation infrastructure.
- Over the last two years Colorado State University's Agricultural Extension Agency had its state authorizations reduced by $1.6 million while funding for the Office of Economic Development was reduced by 57 percent.

As noted above, it was in response to the deep and broad-based impacts of TABOR's downward revenue formula that a consensus, which included many former TABOR supporters, emerged to suspend Colorado's inflexible constitutional spending limit.
As the only state to have implemented a spending limit comparable to the SOS proposal, Colorado should serve as an object lesson for Michigan.

Why the SOS/TABOR Inflation-Plus-Population-Growth Formula Forces Cuts in Public Services

Permitting revenues and expenditures to increase at the rate of inflation plus population growth may sound eminently reasonable, but upon closer examination it becomes clear that such a limit would not permit state revenues to grow with the economy as the existing Headlee spending limit does, or to adequately cover the most rapidly growing components of public services costs.

Inflation

The Consumer Price Index, which would be used in determining inflation under the SOS formula, does not capture the growth in the kinds of services purchased or provided by the public sector. Health care costs, for example, are a significant and integral part of almost everything state and local governments do, from providing teachers for public schools and colleges, to providing fire and police protection for Michigan's citizens, and health care coverage for low income children and adults. The inflation rate for the health care component of these critical public services, which has approached double digits on an annual basis in recent years, can be expected to be far higher than the relatively modest 2 to 3 percent seen in recent years for the economy as a whole.

Population

Overall population growth, the second part of the SOS formula, is not a good proxy for the change in the populations served by public services. The segments of the population that states serve tend to grow more rapidly than the overall population used in the formula. An example is senior citizens. According to the U.S. Census Bureau, Michigan's total population is projected to increase by 8 percent from 2000 to 2030, while its population aged 65 and older is projected to grow by more than 70 percent over the same period.

Rapidly rising costs for health and support services for an aging population, including nursing home care, support the contention that limiting state spending increases to inflation plus population growth would not realistically reflect public service usage and cost trends. The institution of an SOS spending limit would, therefore, force annual reductions to programs and services already struggling due to dramatic reductions in state staffing over the last two decades and significant budget cuts in each of the last five years.

This formula would also prevent Michigan from providing new or expanded services that may be required. These include services needed in response to major economic events such as plant closings and recessions, to court mandates, and to natural disasters or public health emergencies.

Thus, while the SOS "inflation plus population" growth limit may sound reasonable and innocuous, it is clearly a fiscal wolf in sheep's clothing. It would both prevent the reversal of policies and trends that contributed significantly to the current crisis, and dig the fiscal hole even deeper, necessitating dramatic and permanent cuts to critical public services already significantly weakened by years of program and staffing reductions.

SOS Does Not Significantly Improve Upon Colorado's TABOR

SOS does contain some slight improvements over Colorado's TABOR; however, these improvements, which include freezing the spending limit during a downturn and a reserve fund to be used as a safeguard against revenue shortfalls, do not fully fix Colorado's most talked about problem: the "ratchet."

During a recession, states typically reduce the quantity of public services they provide. A ratchet prevents public services from ever recovering from these reductions because the recession-depressed service level becomes the new base to which the population-growth-plus-inflation formula is applied. For example, revenues in Colorado fell during the recession, and that reduced level became the base for calculating allowable revenue growth in all subsequent years. As revenue growth returned to normal, spending could not because the TABOR limit was stuck at the low recession level. This prevented Colorado from restoring cuts made in public services during the downturn.

If Colorado had not suspended TABOR for five years in November 2005, it would have had to continue making deep reductions in public services each year for a number of years to come. To avoid facing this problem again, Coloradoans also voted to change the way the formula is applied. At the end of TABOR's five-year suspension, the population-growth-plus inflation formula will be calculated from the TABOR limit in the previous year, rather than from actual revenues.

Spending Limit Freeze During Downturn

In the SOS proposal, the dollar amount of the spending limit would be frozen during an economic downturn. While the limit would not ratchet backward during a downturn, as it did in Colorado, it would remain fixed, and could not continue to rise by the change in population and inflation.

Thus, the SOS proposal would only mitigate and not eliminate the ratchet. If the limit were frozen in response to a downturn, public services would fall substantially behind even the standard of need recognized in the TABOR formula; the population would continue to grow and inflation would continue to push up the cost of services over those years, but the limit would not be adjusted to reflect this growth. So while expenditures wouldn't be ratcheted back to recession levels, they would stagnate. And as revenue growth fully recovered, expenditures could not because they would be based on this frozen level.

Budget Stabilization Fund

SOS advocates contend that a provision in their initiative permitting up to 50 percent of revenue surpluses to be deposited in the state's Budget Stabilization Fund (BSF) would help mitigate the acknowledged negative impacts of TABOR style spending limits on state programs. However, in Michigan, it is unlikely that the BSF would help do this.

In the best of circumstances, a well designed budget stabilization fund (BSF) could prevent the expenditure limit from ratcheting downward. To accomplish this, however, it must be sufficiently large to compensate for all revenue shortfalls during the downturn, it must not face obstacles to its use when it is needed, and transfers from the reserve fund to the general fund must count as expenditures for calculating the subsequent year's limit.

The Senate Fiscal Agency has indicated that no deposits would have been made to the now depleted BSF over the last four years under the provisions of the SOS proposal. Given the $400 million deficit acknowledged in the Executive Budget for FY2007, and out-year structural deficit forecasts by credible research organizations including the non-partisan Citizens Research Council, it appears doubtful that surplus revenues will be available to replenish the Budget Stabilization Fund and preserve critical public programs in the foreseeable future.

Moreover, it is not clear from the petition language whether transfers from the BSF would be counted as expenditures for calculating the upcoming year's limit.

Regardless, it was not the ratchet that caused the sharp decline in public services in Colorado, but rather the operation of the population-growth-plus-inflation formula for more than a decade. Public services in Colorado declined significantly before the 2001 recession began, and thus before the ratchet could have had any effect. For example, between 1992 (when TABOR took effect) and 2001, Colorado fell from 35th to 49th in the nation in K-12 education spending as a percentage of personal income and from 23rd to 45th in access to prenatal care, a sign of funding shortages in local health clinics.

SOS is More Restrictive than Colorado's TABOR Spending Limit

While the program and spending cuts instituted in Colorado in recent years have been significant, they were mitigated in part by state and local government's ability to increase a variety of fees. Sections 28 and 31 of Article 9 of the Stop Overspending (SOS) constitutional amendment proposal, however, would effectively prohibit Michigan's state and local governments from increasing or adjusting fees in a manner that would increase real net revenues. These sections would, for example, require increases in fees for services such as state park camping to be offset elsewhere in the budget, thus preventing Michigan governments from increasing net fees to supplement limited tax revenues as was done in Colorado.

Additionally, while SOS supporters suggest that their proposal promotes democracy by permitting Michigan's citizens to vote on specific tax policy issues, the actual impact of the SOS language must be considered carefully. Article 9, Section 27 as amended indicates that a suspension of state revenue and spending limits can only occur if "two-thirds of the members of each house" agree to an emergency declaration by the Governor or to refer the matter to the voters for their consideration. This super-majority requirement implies that one-third of either house of the legislature can prevent the governor and the voters from taking action to address a perceived emergency or avoid cuts to critical services. This super-majority of both houses requirement is arguably a "less rather than a more" democratic process, and would turn ultimate control of the state's fiscal policy over to a minority within a single house of the legislature.

Features of Colorado's TABOR revenue and spending limit, in contrast, could be amended or suspended – as it was last November, by a simple majority of the electorate.

The Potential Impact of SOS on State and Local Public Services

While the size of Michigan's budget deficits under SOS could be expected to vary significantly depending on the performance of the state's economy, the Michigan League for Human Services estimates that SOS revenue limitations would increase forecast structural deficits to at least $600 million annually over the next decade. Closing a deficit of this magnitude would require the equivalent of approximately a 30 percent reduction in current state spending for all of the existing K-12 Education and General Fund programs detailed below:

K-12 Education	$11.23 billion
Community Health	$2.95 billion
Higher Education	$1.86 billion
Department of Corrections	$1.78 billion
Human Services	$1.08 billion
All Other Departments, etc	$.54 billion
Total	**$19.44 billion**

More likely, however, are targeted program reductions or eliminations in Community Health, Human Services and the Department of Corrections and very large reductions to "optional" state programs that would not result in the loss of matching federal funds, such as Higher Education and revenue sharing payments to local units of government. Also a likelihood given the magnitude of projected deficits under SOS would be periodic freezes in the K-12 Education foundation allowance equivalent to a 2 to 3 percent cut to local schools depending on the prevailing inflation rate in a given year.

While the revenue and spending limits specified in the SOS initiative would have significant negative consequences for state funded programs, its impact on local funding and services could be equally significant and potentially more immediate. Of the $1.1 billion in revenue sharing payments that flow annually to local units of government, $422 million is considered "discretionary". Because these payments do not support state programs directly, and they are not typically linked to federal mandates or matching resources, they could be an early casualty of budget cuts necessitated by structural deficits expected to worsen under SOS.

To put the potential loss of $422 million in revenue sharing payments into perspective, the Michigan League for Human Services estimates that it would require statewide reductions equivalent to the annual cost of over 7,000 police officers and firefighters to close the resulting budget gap.

Another potential impact of the SOS initiative on local units of government is the constraint it would place on the state's ability to raise and spend revenues for highway construction and maintenance projects. In FY2005 over $1.5 billion in local highway projects were financed with state grant revenues. Under the SOS initiative, however, the state's ability to periodically adjust supporting fuel taxes and license fees in recognition of increasing construction and maintenance costs would be strictly limited, potentially leading to significant decreases in state and local spending on highway projects similar to those that occurred in Colorado under TABOR.

Just like TABOR, SOS Would Hurt Critical Public Services

SOS contains the three core provisions of Colorado's TABOR, a budget limit that caused a severe deterioration in that state's public services.

The negative impacts in Michigan resulting from these three core provisions would be in addition to the $3.5 billion in program and staffing reductions instituted by the state since FY2002, and recurring structural deficits projected to total approximately $4 billion over the next decade. Having exhausted virtually all fiscal reserves, Michigan already faces the prospect of dramatic additional cuts to K-12 and higher education, public health and safety, and family support and protection programs in the coming years. The adoption of SOS would significantly increase the magnitude of expected deficits, and by preventing revenues from growing with Michigan's economy, necessitate significant additional reductions in many if not most state and locally funded public services.

Adoption of SOS would likely assure that Michigan, like Colorado, would experience declines in the quantity and quality of public services upon which citizens and businesses rely.

Sources: *Details regarding the change in public service levels and outcomes in Colorado under TABOR were taken from research by the Bell Policy Institute of Denver, Colorado and the Center on Budget and Policy Priorities of Washington, D.C.*