

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

July/August 2006



### **History of State Revenue Limit By Gary S. Olson, Director**

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On November 7, 1978, the voters of Michigan approved an initiative to amend the Michigan Constitution referred to as the Tax Limitation, or Headlee, Amendment. One of the key provisions of this constitutional amendment was a limit on the maximum amount of State revenue that could be collected by the State during any particular fiscal year. This constitutional revenue limit has now been in place for 28 years. On November 7, 2006, the voters of Michigan may have an opportunity to vote on changes to this longstanding constitutional revenue limit and to place a new limit on the growth in State spending. A citizen initiative to amend the State Constitution, referred to as the Stop Overspending (SOS) Michigan Constitutional Initiative, is currently pending before the Secretary of State for certification to appear on the November general election ballot. This article provides a historical overview of the existing constitutional revenue limit and analyzes the State's compliance with the revenue limit over the past 28 years.

### **State Constitutional Revenue Limit**

The State constitutional revenue limit (Article IX, Section 26 of the State Constitution) caps the maximum amount of State revenue that can be collected in any State fiscal year at a percentage of Michigan personal income reported during the calendar year that is prior to the calendar year in which the final year begins. The percentage was established using fiscal year (FY) 1978-79 State revenue as the base fiscal year and dividing that amount by the actual level of Michigan personal income reported in calendar year 1977. This ratio was calculated as 9.49%. State revenue is defined as all State-generated revenue including taxes, fees, permits, licensing revenue, and other miscellaneous revenue sources. The Federal revenue received by the State and appropriated in the budget is not counted in this definition of State revenue.

The State revenue limit essentially established the amount of revenue collected in FY 1978-79 as the maximum amount of State revenue that may be collected in each future fiscal year, adjusted for future growth in Michigan personal income. As long as the total amount of State revenue collected in any fiscal year is less than 9.49% of the Michigan personal income reported during the prior calendar year, the State is in compliance with this constitutional revenue limit.

The constitutional revenue limit also provides for the procedures that must be followed if actual State revenue collections in any fiscal year exceed the maximum amount allowed under the revenue limit. The Constitution provides that any revenue collected that exceeds the revenue limit by 1.0% or more, must be refunded to individual income and single business taxpayers. State law provides that if actual State revenue collections in any fiscal year exceed the maximum amount allowed by less than 1.0%, the excess revenue may be deposited into the Budget Stabilization Fund.

### **State's Compliance with Revenue Limit**

Table 1 provides a summary of the State's compliance with the constitutional revenue limit for the period FY 1979-80 through FY 2006-07. During this 28-year-period, actual State revenue collections have exceeded the constitutional revenue limit during three fiscal years: FY 1994-95, FY 1998-99, and FY 1999-2000. In each of these fiscal years the amount by which actual

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revenue collections exceeded the revenue limit was less than 1.0% and therefore there was no requirement to refund excess revenue to income and single business taxpayers.

**Table 1**

<b>State's Compliance with Constitutional Revenue Limit Sec. 26, Article IX, State Constitution of 1963 (Millions of Dollars)</b>			
<b>Fiscal Year</b>	<b>Constitutional Revenue Limit</b>	<b>Actual Revenue Collections</b>	<b>Amount Under/(Over) Limit</b>
1979-80	\$7,396.8	\$6,870.1	\$ 526.7
1980-81	8,215.7	7,043.0	1,172.7
1981-82	8,763.0	7,348.9	1,414.1
1982-83	9,424.9	8,103.5	1,321.4
1983-84	9,488.1	9,243.5	244.6
1984-85	9,867.7	9,861.6	6.1
1985-86	10,857.3	10,483.8	373.5
1986-87	11,736.6	10,891.9	844.7
1987-88	12,822.2	11,472.3	1,349.9
1988-89	13,439.5	12,087.9	1,351.6
1989-90	14,513.4	12,363.1	2,150.3
1990-91	15,351.4	12,311.9	3,039.5
1991-92	16,228.2	12,540.6	3,687.6
1992-93	16,583.8	13,435.3	3,148.5
1993-94	17,624.2	15,473.2	2,151.0
<b>1994-95</b>	<b>18,475.8</b>	<b>18,585.4</b>	<b>(109.6)</b>
1995-96	19,982.0	19,798.8	183.2
1996-97	21,672.2	20,694.3	977.9
1997-98	22,712.4	22,072.3	640.1
<b>1998-99</b>	<b>23,186.8</b>	<b>23,208.5</b>	<b>(21.7)</b>
<b>1999-00</b>	<b>24,203.2</b>	<b>24,362.9</b>	<b>(159.7)</b>
2000-01	26,315.4	23,909.2	2,406.2
2001-02	27,463.1	23,546.0	3,917.1
2002-03	28,243.1	24,061.6	4,181.5
2003-04	28,825.4	24,384.7	4,440.7
2004-05	29,842.3	25,626.8	4,215.5
2005-06	30,760.3	26,211.0	4,549.3
2006-07	31,807.1	27,121.1	4,686.0

**Sources:** FY 1979-80 through FY 2004-05 numbers are from Annual Reports from the Department of Management and Budget. FY 2005-06 and FY 2006-07 estimates are from the May 2006 Consensus Revenue Estimating Conference.

The data in Table 1 clearly show how the volatility of actual revenue collections affects the revenue limit. During periods of economic slowdown in Michigan, actual revenue collections tend to fall significantly under the constitutional revenue limit. This can be best observed during the FY 1980-81 through FY 1982-83 period, the FY 1989-90 through FY 1993-94 period, and the FY 2000-01 through FY 2006-07 period. Tax policy changes also have had an impact on the State's compliance with the revenue limit. The State approved a major increase in the rate of the State income tax in calendar year 1983 and this tax rate increase significantly affected the State's compliance with the revenue limit during FY 1984-85. On the other hand, the State approved significant reductions in the rates of the income and single business taxes beginning



in calendar year 2000 and these tax reductions, along with a very significant prolonged State economic slump in the calendar year 2000 through calendar year 2006 period, have put actual State revenue collections significantly under the revenue limit in recent years. Based on the current estimate of FY 2006-07 State revenue, revenue collections will be almost \$4.7 billion under the revenue limit. This estimated level of FY 2006-07 State revenue equals 8.09% of calendar year 2005 Michigan personal income.

The other major factor that has had an impact on the State's compliance with the revenue limit over the past 28 years is the voter approval of a constitutional amendment on March 15, 1994, which significantly changed the way the State funds local K-12 public schools. The passage of Proposal A on this date reduced local funding for K-12 public schools and offset this loss of local property tax revenue with increases in State revenue. While the overall impact of Proposal A was a net reduction in State and local taxes, Proposal A did result in significant increases in State taxes that are subject to the constitutional revenue limit. This means that State tax revenue that now is being used to fund K-12 public schools was not part of the original calculation of State revenue that led to the 9.49% of Michigan personal income revenue limit.

Table 2 provides a summary of the State's actual compliance with the constitutional revenue limit for the period FY 1993-94 through FY 2006-07 and the State's compliance with the revenue limit adjusted for the additional State revenue raised to offset reductions in local property taxes under Proposal A. These State tax increases under Proposal A are very significant and are estimated to total \$6.3 billion in FY 2006-07. During FY 2006-07, after adjusting for the Proposal A revenue increases, estimated State revenue is \$11.0 billion under the constitutional revenue limit. Using this adjusted amount, estimated FY 2006-07 State revenue equals 6.2% of calendar year 2005 Michigan personal income.

**Table 2**

<b>State's Compliance with Constitutional Revenue Limit Sec. 26, Article IX, State Constitution of 1963 Adjusted for Proposal A Revenue Increases (Millions of Dollars)</b>			
<b>Fiscal Year</b>	<b>Actual Amount Under/(Over) Limit</b>	<b>Proposal A Revenue Increases</b>	<b>Revenue Limit Compliance Adjusted</b>
1993-94	\$2,151.0	\$1,300.1	\$3,451.1
1994-95	(109.6)	3,867.1	3,757.5
1995-96	183.2	4,093.1	4,276.4
1996-97	977.9	4,240.2	5,218.1
1997-98	640.1	4,492.0	5,132.1
1998-99	(21.7)	4,725.0	4,703.3
1999-00	(159.7)	4,988.0	4,828.3
2000-01	2,406.2	5,194.7	7,600.9
2001-02	3,917.1	5,415.4	9,332.6
2002-03	4,181.5	5,530.0	9,711.5
2003-04	4,440.7	5,818.2	10,258.9
2004-05	4,215.5	5,984.2	10,199.7
2005-06	4,549.3	6,131.3	10,680.6
2006-07	4,686.0	6,326.1	11,012.1

**Source:** Senate Fiscal Agency calculations.



## **Summary and Conclusions**

When the voters of Michigan in 1978 approved a constitutional limit on the amount of State revenue that could be collected during any fiscal year in 1978, the intent was to limit the size of State government in the future. As this analysis has shown, the actual size of State government, as measured by State revenue, has been significantly reduced over the past 28 years. During FY 2006-07, estimated State revenue collections will be under the constitutional revenue limit by approximately \$4.7 billion or 12.3%. Adjusting for the State tax increases that were used to offset local tax reductions contained in Proposal A of 1994, estimated State revenue in FY 2006-07 will be under the constitutional revenue limit by \$11.0 billion or 35%.

As the State's voters consider the proposed Stop Overspending Michigan Constitutional Initiative on the November 7, 2006, ballot to reduce the size of State government, it is important to understand that over the past 28 years since the passage of the Tax Limitation Amendment, the size of State government has been significantly reduced.

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### **Methamphetamine-Related Legislation** **By Suzanne Lowe, Bill Analysis Coordinator**

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#### **Introduction**

Methamphetamine is a highly addictive and easily manufactured drug that has made its way from the western and southwestern United States to southwestern Michigan, as well as other regions of this State. Methamphetamine, or “meth”, can be produced with common household products, and its ingredients often include pseudoephedrine or ephedrine (found in many over-the-counter cold remedies) and anhydrous ammonia (a popular and inexpensive fertilizer). It is typically “cooked” in clandestine labs, which may be found in homes, barns, recreational vehicles, motels, and open spaces, creating myriad environmental and health hazards. Although meth labs have been present in the State since at least the late 1990s, the number of labs found in Michigan rose from 40 in 2000 to 261 in 2005.<sup>1</sup>

In 2003, the State enacted legislation to combat the increasing meth problem in various ways. Among other things, this legislation extended to pseudoephedrine existing criminal penalties for the possession of large quantities of ephedrine; added criminal penalties for the possession or transport of anhydrous ammonia except in an approved container; enhanced criminal penalties for the operation of illegal drug labs where meth is produced; and required premises where illegal drug labs are located to be inspected for contamination and vacated if contamination is found. As the number of meth labs continued to rise, legislation was enacted in 2005 to restrict over-the-counter sales of products containing pseudoephedrine or ephedrine.

A series of legislation enacted in 2006 continues the State’s fight against the manufacture and sale of methamphetamine, and addresses additional aspects of the problem, including the need for standardized reporting, improved interagency communication, and greater public awareness; use of the internet to sell ephedrine or pseudoephedrine or to publish instructions on manufacturing meth; and the impact on children who are exposed to meth production. Public Acts 255 through 265 of 2006, as well as the previously enacted measures, are described below.

#### **Background**

Methamphetamine is a synthetic drug classified as a Schedule 2 controlled substance under the Public Health Code. (The Code requires a substance to be placed in Schedule 2 if it has a high potential for abuse; its abuse may lead to severe psychiatric or physical dependence; and it has currently accepted medical use in treatment in the United States, or currently accepted medical use with severe restrictions.) According to the Office of National Drug Control Policy, meth has limited medical uses for the treatment of narcolepsy, attention deficit disorders, and obesity. Also known as “speed”, “crank”, or “ice”, meth can be injected, snorted, smoked, or ingested orally. It appeals to users because it creates a sense of enhanced alertness, euphoria, and increased energy. Over time, however, meth use can lead to nervousness and irritability, violent behavior, extreme paranoia, prolonged psychosis, hallucinations, insomnia, brain

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<sup>1</sup> According to the Michigan Department of State Police, the number of meth labs seized in this State was 19 in 1999, 40 in 2000, 91 in 2001, 189 in 2002, 186 in 2003, 209 in 2004, and 261 in 2005. In 2006, as of August 8, 69 meth labs had been seized.



damage, and increased risk of stroke and heart attack. In addition, a recent study at the University of Buffalo found that the use of meth can promote the spread of HIV in users.

The popularity of meth can be attributed both to its highly addictive nature and its ease of production. The clandestine labs where it is cooked can be set up with simple household items such as mason jars, coffee filters, hot plates, pressure cookers, plastic tubing, and gas cans. Although there are several production methods, the meth labs discovered in Michigan typically have used a process that involves extracting pseudoephedrine or ephedrine from cold tablets. As noted above, other ingredients used in the process often include the nitrogen-based fertilizer anhydrous ammonia.

Despite the simplicity of production, manufacturing meth can be very dangerous and some of the chemicals used can be hazardous. Solvents and fumes are flammable and gases formed in the process can be deadly. The labs also produce highly toxic waste, which can pollute soil, groundwater, drinking water supplies, vehicles, and dwellings (saturating the carpet, walls, ceilings, drapery, and furnishings). Waste products include corrosive liquids, acid vapors, and heavy metals. Reportedly, for every pound of methamphetamine, meth labs produce five to six pounds of toxic waste, which almost always is illegally dumped.

The methamphetamine problem originally was concentrated in the southwestern and western United States, and spread steadily eastward during the 1990s. It is reported that the number of addicts using meth in the country doubled from 63,000 in 2002 to 130,000 in 2004, and addicts using meth committed 6.0 million crimes in 2004—more than double the 2002 rate.<sup>2</sup> According to the Office of National Drug Control Policy, the number of admissions to treatment in which meth was the primary drug of abuse increased from 33,443 in 1994 to 129,079 in 2004. In Michigan, the number of admissions in which meth was the primary, secondary, or tertiary drug of abuse rose from 314 in fiscal year (FY) 1999-2000 to 1,341 in FY 2003-04.<sup>3</sup>

While the meth labs discovered in Michigan continue to be concentrated in the southwestern portion of the State, they also are found elsewhere, particularly in the central Lower Peninsula.

### **Previously Enacted Legislation**

In 2003, there were 186 meth labs found in Michigan. While the situation in this State had not reached the severity that states like Idaho, Iowa, Nebraska, and Washington were experiencing, many believed that a relatively early response to the problems surrounding meth use and production would help to blunt the spread of the drug in Michigan. Thus, Public Acts 307 to 313 of 2003 were enacted to establish criminal penalties and address environmental contamination.<sup>4</sup>

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<sup>2</sup> "Meth Crime Rises as Budget Axe Falls: Will Congress Cut Law Enforcement and Investments that Help Get Kids on the Right Track?", A Report from Fight Crime: Invest in Kids, 2006.

<sup>3</sup> "Michigan Methamphetamine Prevention Project Baseline Data Report", Prepared by the Pacific Institute for Research and Evaluation and Richard Calkins for the Michigan Department of Community Health, Office of Drug Control Policy and the Michigan Methamphetamine Task Force, March 2005.

<sup>4</sup> For a detailed analysis of these laws, please see the Senate Fiscal Agency Enrolled Analysis of Senate Bills 648-652, 698, and 777, dated 6-17-04, at <http://senate.michigan.gov/sfa/>.



Since 1994, the Public Health Code had prohibited the possession of more than 10 grams of ephedrine (which is used to manufacture another popular and addictive drug, methcathinone (“Cat”), as well as methamphetamine). Public Act 308 of 2003 amended the Code to include pseudoephedrine in that prohibition, and increase the prohibited amount to 12 grams or more. An offense is a felony punishable by up to two years’ imprisonment and/or a maximum fine of \$2,000.

Under amendments enacted in 2000, the Public Health Code also prohibits a person from owning, possessing, or using a vehicle, structure, or place, or owning, possessing, or providing to another person any chemical or lab equipment, that the violator knows or has reason to know is to be used to manufacture a controlled substance illegally. The standard penalty is up to 10 years’ imprisonment and/or a fine of up to \$100,000. Under Public Act 310 of 2003, for a violation that involves manufacturing a substance that contains any quantity of methamphetamine, the maximum term is 20 years and the maximum fine is \$25,000.

Public Act 312 amended the Michigan Penal Code to prohibit a person from transporting or possessing anhydrous ammonia except in a container approved by law, or tampering with such a container. A violation is punishable by up to four years and/or \$5,000.

Public Acts 309, 311, and 313 amended the sentencing guidelines in the Code of Criminal Procedure to include the offenses under Public Acts 308, 310, and 312, respectively.

On the environmental front, Public Act 307 amended the Housing Law of Michigan to require a State or local law enforcement agency to notify the Housing Law enforcing agency and the Department of Environmental Quality (DEQ) regarding the potential contamination of any property or dwelling that was or had been the site of illegal drug manufacturing. The DEQ was required to review the information received from the law enforcement agency, emergency first responders, or hazardous materials team called to the site, and make a determination about the likelihood of contamination and the health or safety hazard to occupants. (As discussed below, these responsibilities recently were transferred from the DEQ to the Department of Community Health.) If it is determined that contamination is likely, the enforcing agency must order the property to be vacated until the owner establishes that it is decontaminated or the risk of likely contamination no longer exists.

In order to restrict the availability of ephedrine and pseudoephedrine, Public Acts 86 and 87 of 2005 amended the Public Health Code to limit over-the-counter sales of products containing these ingredients, effective December 15, 2005. The Acts require a retail seller to 1) maintain the products behind a counter, within a locked case, or where an attendant can monitor them, or use an antitheft device along with constant video surveillance; 2) require photo identification for the purchase of an ephedrine or pseudoephedrine product; and 3) maintain a log of purchases, if the retailer does not keep the products behind a counter or in a locked case. The Acts also limit the quantity of products that may be sold in a single over-the-counter sale, prohibit sales to someone under 18, and prescribe a \$50 civil infraction penalty for violations.



## Recently Enacted Legislation

The measures enacted to date in 2006 follow up on some of the earlier legislation, as well as address additional issues. An overview of the legislation follows.<sup>5</sup>

### Environmental Contamination; Reporting Requirements

Although Public Act 307 of 2003 provides for notification to State and local officials when an illegal drug lab is discovered, requires a determination of contamination, and requires the property to remain vacant until decontaminated, there continued to be complaints about the problems that meth labs pose for landlords, realtors, and prospective tenants or home-buyers, who do not always know whether property has been contaminated or properly cleaned. It was reported that the presence of meth lab sites can be a disincentive to operate, or invest in, rental property in some areas. It also was pointed out that the DEQ does not deal with indoor contamination, while the Department of Community Health (DCH) is actively involved in the State's efforts to address meth activity.

Several of the recent amendments, including Public Acts 258 and 260 of 2006, responded to these concerns. Public Act 258 amended the Housing Law provisions enacted in 2003, to transfer the DEQ's responsibilities to the DCH, set a deadline of 48 hours after discovery of an illegal drug lab for a law enforcement agency to notify the DCH and a local agency, and require notice to the local health department if it is not the enforcing agency. The Act also allows a property owner to establish that the property is decontaminated by submitting to the enforcing agency written assessments of the property before and after decontamination, along with a certification that the property has been decontaminated and the risk of likely contamination no longer exists. Public Act 260 added parallel language to the Public Health Code.

Public Act 260 also requires the DCH, in consultation with the DEQ, to develop a cleanup of clandestine drug labs guidance document. The DCH must make the document available on its website and, upon request, give a copy of it to a local health department.

Several other measures address the need for reporting. Public Act 262 creates the Methamphetamine Reporting Act to require the Michigan Department of State Police (MSP) to collect and compile information regarding methamphetamine manufacture, use, possession, and distribution from various State departments and law enforcement agencies. The Act also requires the MSP to report annually to the Legislature regarding methamphetamine trends in Michigan, and make the report publicly available on the MSP website. Under Public Act 255, which creates a new statute, the MSP must transmit to the DCH information obtained under the Methamphetamine Reporting Act regarding the discovery of a meth lab. The DCH must post on its website the location of the lab as well as a statement as to whether the remediation of a site has been completed.

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<sup>5</sup> For detailed analyses of these laws, please see the Senate Fiscal Agency Enrolled Analysis of Senate Bills 1112, 1115, & 1119 and House Bills 5798, 5841, & 5845, the Enrolled Analysis of Senate Bill 1116 and House Bills 5843, 5844, & 5930, and the Enrolled Analysis of Senate Bill 1282 and House Bill 5822, each dated 8-16-06, at <http://senate.michigan.gov/sfa/>.



Another reporting provision was enacted by Public Act 265, which amended the Natural Resources and Environmental Protection Act to require the DEQ to report to the Legislature every two years on environmental contamination caused by releases associated with clandestine drug labs.

Public Acts 258, 260, and 265 took effect on July 6, 2006. Public Act 262 will take effect on October 1, 2006, and Public Act 255 will take effect on January 1, 2007.

#### Criminal Penalties; Civil Action

Several measures continue efforts to deter the production of methamphetamine, by enhancing the restrictions on access to ephedrine and pseudoephedrine, and allowing a civil action for posting manufacturing instructions on the internet.

Public Act 261 of 2006 amends the Public Health Code to prohibit a person from selling, distributing, delivering, or otherwise furnishing a product that contains any compound, mixture, or preparation containing any detectable quantity of ephedrine or pseudoephedrine, if the sale is transacted through the mail, internet, telephone, or other electronic means (subject to several exceptions). A violation is a felony punishable by up to four years' imprisonment and a maximum fine of \$5,000. Public Act 259 includes this offense in the sentencing guidelines.

Under Public Act 257, which amends the Revised Judicature Act, the Attorney General may bring an action against a person who develops or maintains a website for the purpose of publishing instructions on manufacturing meth or information on how to obtain substances that may be used in its manufacture. The court may order various forms of relief, including actual damages sustained by the State or its residents and punitive damages.

Public Acts 257, 259, and 261 will take effect on October 1, 2006.

#### Child Protection

An issue new to the 2006 legislation involves the protection of children who are exposed to meth production. Children living in homes where the drug is cooked often are subjected to a highly toxic environment, where their clothes, blankets, and toys may be contaminated. More than adults, children are susceptible to the harmful health effects of meth production and can develop respiratory ailments, brain or organ damage, or other serious health conditions. These children also are at risk of being abused or neglected, since parents using or cooking meth are unlikely to be in the proper frame of mind to care for their children. In addition, children living where meth is produced may be exposed to firearms and violence.

Public Acts 256, 263, 264, and 266 of 2006 amended the Child Protection Law (CPL) to address this situation. Under the CPL, certain professionals (such as physicians, nurses, social workers, teachers, and clergy) are required to report to the Department of Human Services (DHS) if they have reasonable cause to suspect child abuse or neglect. When a report is made, the DHS and law enforcement agencies are subject to various reporting and investigative requirements, including requirements that they report certain cases to each other and refer some cases to the prosecuting attorney.



The 2006 amendments, which took effect on July 6, 2006, do the following:

- Require reporting and investigation by the DHS and law enforcement agencies if a report or investigation of child abuse indicates a drug lab violation involving meth, or if there is evidence that a child has been exposed to meth production.
- Require the DHS to submit a petition for family court jurisdiction over a child who was allowed to be exposed to or have contact with meth production.
- Require the DHS to refer to the prosecuting attorney a central registry case (one in which there is evidence of abuse or neglect and other criteria are met) if the case involves a child's exposure to meth production; and require the prosecutor to review the investigation of the case.
- Require the DHS to have a medical evaluation made without a court order if a child is suspected of being exposed to meth production.

### **Conclusion**

According to the Department of State Police, the number of meth labs seized in Michigan dropped from 261 in 2005 to 69 in 2006, as of August 8. The reasons for this decline are unclear, although it may be attributable to the restrictions on over-the-counter sales of products containing ephedrine or pseudoephedrine, which took effect in December 2005. Whether the decline will persist also is unknown. The small number of meth lab seizures this year, however, does not necessarily imply a reduction in meth sales or use, since more of the finished product is coming into Michigan from out of State, according to the MSP.

As described above, the State has enacted comprehensive legislation to deter the production of methamphetamine, penalize offenders, identify meth lab sites, and protect children who are exposed to meth production. Additional measures have been proposed, as well. These include bills that would do the following: establish anhydrous ammonia safety and security practices (AASSPs) and provide tort immunity to sellers and end users who comply with them (House Bill 4108, which has passed the House and the Senate, and Senate Bill 877, which has passed the Senate); create an income tax credit for the cost of tank or valve locks or dye additive to prevent anhydrous ammonia theft (Senate Bill 492 and House Bill 5037); create a tax credit for farmers for the cost of complying with AASSPs (Senate Bill 878); and require anhydrous ammonia manufacturers and distributors to add a dye to the product (House Bill 4894).

While only one of these bills has passed both houses of the Legislature to date, it is not unforeseeable that additional measures--perhaps with a different focus--may be enacted. Although the environmental contamination and safety and health problems related to meth labs might be diminishing, the social welfare and criminal justice impacts of meth use and sales remain.

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### **Countywide Authorities and Revenue Sharing** **By David Zin, Economist**

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Certain authorities established under State law are allowed to levy property taxes. Current law also requires that these authorities receive a portion of the revenue sharing payment made to any local unit that collects property taxes for the authority. Since fiscal year (FY) 2004-05, however, countywide authorities have generally not received these payments. This article discusses the history of this issue, describes legislation that has been introduced to address the problem, and identifies some related issues regarding revenue sharing and authorities.

#### **Background**

Under both constitutional and statutory provisions, the State shares a portion of its sales tax revenue with local units of governments. These revenue sharing payments peaked at \$1,555.5 million in FY 2000-01 but have fallen to an estimated \$1,106.4 million in the recently adopted FY 2006-07 budget, a 28.9% decline. A portion of this revenue reflects revenue designated by the State Constitution to be distributed to cities, villages, and townships on a per-person basis. Estimated constitutional revenue sharing payments in FY 2006-07 will be 8.7% above those during FY 2000-01. As a result, the net decline in revenue sharing payments has reflected reduced payments under the statutory provisions. These reductions have been dominated by two principal changes: 1) reduced statutory payments to cities, villages, and townships, and 2) the temporary elimination of statutory revenue sharing payments to counties. These reductions have not affected all local units to the same degree and a number of different factors have combined to affect countywide authorities.

#### Shift in the Collection Date for County Property Taxes

As part of the FY 2004-05 budget, the Governor recommended that statutory changes be made to eliminate State revenue sharing payments to counties for a number of years into the future. The adopted changes included: 1) accelerating the collection of property taxes levied by counties for operating purposes over a three-year period, 2) placing these accelerated collections into a reserve fund, 3) regulating withdrawals from the reserve fund, and 4) eliminating State revenue sharing payments to a county until its reserve fund is exhausted. Each county's allowed withdrawal equals the revenue sharing payment the county received during FY 2003-04, adjusted for inflation. While the revenue sharing payment and the allowed withdrawals are for comparable amounts, differences in their source of revenue have created other difficulties.

#### Property Taxes and Authorities

Michigan statute allows the creation of certain governmental entities that have limited authority, both in terms of their areas of responsibilities and in their ability to levy taxes. These "authorities" may be confined to all or part of an individual local unit, or may span several counties. Countywide authorities are often associated with providing library or transit services. The largest countywide authority in the State is the Huron-Clinton Metropolitan Authority (HCMA), which covers Livingston, Macomb, Oakland, Washtenaw, and Wayne 90



Counties. The HCMA has developed and maintains 13 parks located along the Huron and Clinton Rivers in southeastern Michigan. Many of these authorities, including the HCMA, levy property taxes voted on by the residents of the area covered by an authority and collected by the local units within its jurisdiction. Taxes levied by countywide authorities are generally collected by each respective county and remitted to the authority.

#### Business Inventories and the Property Tax

Before the single business tax (SBT) was adopted, business inventories were included in the tax base for property taxes. When the SBT was adopted, the local property tax on business inventories was eliminated. To hold local units harmless, an additional component was added to revenue sharing payments: an inventory reimbursement payment, paid from SBT revenue. Local units that collected taxes for an authority were required to reimburse the authority for the lost property tax revenue from their revenue sharing payments.

#### The Current Problem

The current issue with regard to inventory reimbursement payments to countywide authorities relates to the accelerated collection of county property taxes and the reserve fund used to replace revenue sharing payments. The reserve fund and the withdrawals from it are authorized under the General Property Tax Act, not the Glenn Steil State Revenue Sharing Act. Reimbursements to authorities are required to be made from funds received under the Revenue Sharing Act. As a result, there is no statutory obligation for counties to provide an inventory reimbursement payment to authorities for which they collect property taxes. Counties are free to use their general fund revenue, which includes revenue that is withdrawn from the reserve fund, to make such payments. However, there is no statutory compulsion for counties to make the payments to these authorities and a number of counties have chosen not to do so.

Table 1 shows the counties that collect property taxes for a countywide authority and the inventory reimbursement payments required under the Revenue Sharing Act. Revenue to the HCMA comprises almost half of the inventory reimbursement payments by counties to authorities. However, the share of total authority revenue composed of inventory reimbursement payments has declined over time. For example, in FY 1999-2000 inventory reimbursement payments comprised 2.1% of the HCMA's revenue, compared with 1.6% in FY 2003-04. The inventory reimbursement amounts to be remitted to authorities are also a negligible portion of the total withdrawals authorized from the reserve fund, averaging approximately 1.1% of the withdrawal amounts; in the case of the counties covered by the HCMA, authority payments only average 0.7% of the withdrawals the affected counties are authorized to make.

While the law does not require counties to provide the inventory reimbursement payment to the authorities, statute does allow counties to withdraw from the reserve fund an amount calculated on a total inclusive of the payment. While some counties reportedly have not withdrawn amounts that would have included the inventory reimbursement payment, other counties have made the withdrawal and then used the funds for purposes unrelated to the authorities. Furthermore, because the inflationary adjustment for the withdrawal also



includes the reimbursement payment amounts, the withdrawals effectively allow the inventory reimbursement payment to grow with inflation, even though previously the amount had been fixed at the FY 1997-98 level.

**Table 1**

<b>County Inventory Reimbursement Payments to Authorities</b>					
County/ (Type of Authority)	Inventory Payment	Est. 2004 Revenue	Inventory Payment Percent of Revenue	FY 2005-06 Authorized Res. Fund Withdrawal	Inventory Payment Percent of Withdrawal
Bay (Transit)	\$44,048	\$2,033,047	2.2%	\$2,338,928	1.9%
Genesee	375,141	16,366,129	2.3%	8,947,994	4.2%
Library	163,502	7,133,025	2.3%		
Airport	116,787	5,095,018	2.3%		
Transit	94,852	4,138,086	2.3%		
Grand Traverse (Library)	24,063	4,077,266	0.6%	1,420,411	1.7%
Jackson (Library)	76,628	3,656,810	2.1%	3,048,328	2.5%
Livingston (Parks-HCMA)	4,454	1,604,449	0.3%	2,669,499	0.2%
Macomb	198,804	15,135,226	1.3%	14,533,809	1.4%
Parks-HCMA	80,297	6,113,144	1.3%		
Smart	118,507	9,022,082	1.3%		
Mason (Library)	4,153	592,964	0.7%	515,496	0.8%
Monroe (Library)	21,940	2,635,252	0.8%	2,649,286	0.8%
Oakland (Parks-HCMA)	106,700	12,625,279	0.8%	21,783,442	0.5%
Presque Isle (Library)	2,479	354,563	0.7%	259,161	1.0%
Washtenaw (Parks-HCMA)	27,958	2,894,741	1.0%	5,920,969	0.5%
Wayne (Parks-HCMA)	339,009	10,606,259	3.2%	45,175,379	0.8%
Wexford	7,459	723,866	1.0%	575,239	1.3%
Library	4,144	402,148	1.0%		
Transit	3,315	321,718	1.0%		
<b>Total</b>	<b>\$1,232,836</b>	<b>\$73,305,851</b>	<b>1.7%</b>	<b>\$109,837,941</b>	<b>1.1%</b>
Addendum: HCMA	\$558,418	\$33,843,872	1.6%	\$75,549,289	0.7%

**Source:** Michigan Department of Treasury, the Senate Fiscal Agency

### Legislative Remedies

Several bills have been introduced to address the issue of inventory reimbursement payments to authorities. House Bill (H.B.) 5274 would require counties to use a portion of their reserve fund withdrawal to make the payment. The bill would have no fiscal impact on the State, but would have a fiscal impact on counties. Counties that have continued to withdraw the payments and then used them for other purposes would need to divert the funds back to the authorities and either find alternative funding for those activities or reduce/eliminate them. Counties that have not withdrawn amounts inclusive of the inventory reimbursement payment would be required to withdraw the amounts, thus depleting their reserve funds at a more rapid rate and accelerating the date when the State will need to begin making regular revenue sharing payments. Counties withdrawing the amount and remitting it to the authority essentially would be unaffected by the change.



While H.B. 5274 would ensure that the authorities received funds for the inventory reimbursement payment, the withdrawal amounts (which include the payment) would grow by inflation, although the payment to the authority would remain fixed. As a result, although the authorities still would receive funding as they did before the reserve fund was created, counties still would be able to reap a small windfall from the inflation growth in the withdrawal. Furthermore, because the money for the payments previously came from State revenue and now would be drawn from the reserve fund (funded with revenue from locally voted and levied taxes), the bill could violate constitutional Headlee provisions regarding unfunded mandates. It should be noted that while the bill probably would present Headlee implications, the violations would stem from the requirement to make the payment. There would be no constitutional issue raised if a county simply chose to make the payment (as opposed to being mandated by the State).

Senate Bills 965 and 966 take a different approach to the issue than H.B. 5274. Senate Bill (S.B.) 965 would amend the formula for computing revenue sharing payments to the county by adding an additional amount equal to the inventory reimbursement payments made to authorities. Senate Bill 966 then would require that the county remit the additional revenue sharing payment to the authority. Senate Bill 1006 would fund the requirements of S.B. 965 and S.B. 966 by providing a supplemental appropriation to the FY 2005-06 budget of \$2.5 million. The supplemental appropriation would cover payment to the authorities for FY 2004-05 and FY 2005-06. This approach also would provide authorities with the money, although it would increase State obligations despite the fact that the State's support for the inventory reimbursement payment has been declining. In addition, the bills would extend the obligation, at least as far as countywide authorities are concerned, past the existing June 30, 2007, termination for these payments to all authorities. Furthermore, it would allow counties to continue to withdraw from the reserve fund amounts that include the inventory reimbursement payment to the authority, and would continue to increase those amounts by inflation, essentially providing a small (and growing) windfall to counties. If the statutory commitment created by S.B. 965 and S.B. 966 were funded in years after FY 2005-06, it would involve approximately \$1.2 million per year in appropriations. House Bill 5629 is the same as S.B. 966.

House Bill 5274 has been referred to the House Appropriations Committee, and House Bill 5629 has been referred to the House Local Government and Urban Policy Committee. Senate Bills 965, 966, and 1006 have been referred to the Senate Appropriations Committee. To date, all of the bills remain in committee.

Table 1 indicates, on average, that the inventory reimbursement payment comprises only 1.7% of authority revenue, but this figure neglects changes in rest of the revenue base for authorities. Table 2 illustrates the impact of not remedying the situation, either through counties' voluntarily making the payments or through some sort of legislative change. Between 2000 and 2006, countywide authorities have experienced average increases in taxable value of 5.9%. The HCMA also averaged increases in taxable value of 5.9% over the same period. Since the reserve funds were established, taxable value for the HCMA has risen by similar amounts, growing 5.6% from the prior year in both 2005 and 2006. Had the HCMA not received inventory reimbursement payments from any county during FY 2004-05 or FY



2005-06, HCMA revenue still would have grown 3.9% in FY 2004-05 and 5.6% in FY 2005-06. For some authorities, such as those in Grand Traverse County, revenue would have increased by 6.6% in FY 2004-05 and 8.9% in FY 2005-06 even if no inventory reimbursement payment were made by the county. At the other end of the spectrum, revenue to authorities in Bay County would have grown 1.8% in FY 2004-05 and 4.5% in FY 2005-06. Consequently, the lack of the inventory reimbursement payment does not result in a county authority receiving less revenue than was received in a previous year.

**Table 2**

<b>County Inventory Reimbursement Payments to Authorities</b>						
County/ Type of Authority	Average Growth in Taxable Value 2000-2006	Est. 2004 Revenue	Est. 2005 Revenue	Revenue Growth Excluding Inventory Reimburse. Payment	Est. 2006 Revenue	Revenue Growth Excluding Inventory Reimburse. Payment
Bay (Transit)	4.6%	\$2,033,047	\$2,070,265	1.8%	\$2,164,398	4.5%
Genesee	5.6%	16,366,129	16,961,929	3.6%	17,909,740	5.6%
Library		7,133,025	7,392,699	3.6%	7,805,794	5.6%
Airport		5,095,018	5,280,499	3.6%	5,575,567	5.6%
Transit		4,138,086	4,288,731	3.6%	4,528,379	5.6%
Grand Traverse (Library)	8.0%	4,077,266	4,347,121	6.6%	4,734,912	8.9%
Jackson (Library)	7.2%	3,656,810	3,766,894	3.0%	3,986,329	5.8%
Livingston (Parks-HCMA)	8.7%	1,604,449	1,734,585	8.1%	1,866,725	7.6%
Macomb	6.3%	15,135,226	15,834,469	4.6%	16,815,001	6.2%
Parks-HCMA		6,113,144	6,395,570	4.6%	6,791,608	6.2%
Smart		9,022,082	9,438,900	4.6%	10,023,393	6.2%
Mason (Library)	5.4%	592,964	619,768	4.5%	654,848	5.7%
Monroe (Library)	4.5%	2,635,252	2,736,825	3.9%	2,884,583	5.4%
Oakland (Parks-HCMA)	5.8%	12,625,279	13,161,737	4.2%	13,893,032	5.6%
Presque Isle (Library)	6.2%	354,563	374,744	5.7%	398,734	6.4%
Washtenaw (Parks-HCMA)	7.2%	2,894,741	3,061,836	5.8%	3,271,210	6.8%
Wayne (Parks-HCMA)	5.2%	10,606,259	10,801,915	1.8%	11,307,979	4.7%
Wexford	6.7%	723,866	767,675	6.1%	818,640	6.6%
Library		402,148	426,486	6.1%	454,800	6.6%
Transit		321,718	341,189	6.1%	363,840	6.6%
<b>Total</b>	<b>5.9%</b>	<b>\$73,305,851</b>	<b>\$76,239,763</b>	<b>4.0%</b>	<b>\$80,706,131</b>	<b>5.9%</b>
Addendum: HCMA	5.9%	\$33,843,872	\$35,155,642	3.9%	\$37,130,555	5.6%

**Source:** Michigan Department of Treasury, the Senate Fiscal Agency

### Related Issues

As revenue sharing payments have been reduced or frozen over the last few years, the issue of authority payment has not just affected counties. Approximately \$5.1 million is remitted by cities, villages, and townships across the State to various authorities. Because the inventory reimbursement received by the authorities is frozen, local units have been required to absorb reduced revenue sharing payments but not been able to reduce the reimbursement provided to the authorities. For some municipalities, maintaining inventory reimbursement payments to authorities has created additional difficulties for already tight budgets.



The inventory reimbursement requirement is part of the Revenue Sharing Act and requires the distributions to be made from “payments received under this act”. While the Revenue Sharing Act specifies the timing of payments received as a result of constitutional revenue sharing provisions, constitutional revenue sharing payments likely would not be considered to be payments received under the Revenue Sharing Act. (For instance, if the Act were repealed, the constitutional payments still would continue although there would be no guidance as to when the payment would be required to be made.) Due to the changes in revenue sharing distributions since FY 2001-02, many local units no longer receive statutory revenue sharing payments. In FY 2005-06, approximately 798 local units did not receive statutory revenue sharing payments. Under the FY 2006-07 budget, as enacted, an estimated 981 cities, villages, and townships will not receive a statutory revenue sharing payment. Like counties, these local units are not likely to be obligated to make an inventory reimbursement payment to the authorities for which they collect taxes (because, strictly speaking, they are no longer receiving payments under the Revenue Sharing Act) but may choose to continue to make those payments as part of their regular budget process. Whether any city, village, or township authorities have been affected by this issue is unknown. Furthermore, because once a local unit ceases to receive statutory revenue sharing payments its revenue sharing payment generally has grown from year-to-year because of the growth in constitutional revenue sharing payments, it may be that for these local units the burden of continuing authority payments is not substantial. However, to the extent that future revenue sharing distributions result in more local units ceasing to receive statutory revenue sharing payments, the likelihood that city, village, or township authorities will no longer receive inventory reimbursement payments will increase.

### **The State’s Obligation Regarding Inventory Reimbursement Payments**

The link between SBT revenue and the inventory reimbursement has declined over the last 10 years, with the State reducing the amounts by which it factors in reimbursements for a tax that was repealed more than 30 years ago. In 1996, sales tax revenue replaced SBT revenue in funding the inventory reimbursement payment, eliminating the link between SBT revenue and the reimbursement. Furthermore, in 1998, when the mechanism for distributing statutory revenue sharing payments was completely replaced, the inventory reimbursement payment began to be eliminated from revenue sharing—at least for some local units.

The new revenue sharing formula produced a different distribution mechanism for cities, villages, and townships than the one used for counties. Counties were to receive 25.06% of the statutory appropriation and that money would be distributed under two mechanisms. First, each county would receive the same amount as it received for the reimbursement payment during FY 1997-98. Second, any remaining money would be distributed on a per-person basis to all the counties. As a result, as revenue sharing payments would presumably grow, the share of the total composed of inventory reimbursement payments would steadily decline.

The calculation for distributing payments to cities, villages, and townships was more complicated, and involved phasing in a new formula over 10 years. The new formula did not include any consideration of the reimbursement payment received by cities, villages, and



townships. Payments under the old formula, which produced a smaller share of the total payment each year, was based on the amount of total revenue sharing that the local units received during FY 1997-98. As a result, the old formula still retained, at least implicitly, some element of the inventory reimbursement payment—although the phase-out meant that the contribution decreased each year. Since FY 2001-02, the 1998 formula essentially has been suspended, with local units receiving some percentage of the payment they received in the prior year. However, the implicit inventory reimbursement payment has continued to decline as a share of total revenue sharing payments, as constitutional payments have grown and statutory payments (of which the inventory reimbursement payment was a component) have declined or even ceased.

Furthermore, unlike many other provisions in the 1998 legislation that indicate certain distributions under the Revenue Sharing Act would continue “as provided by law” past FY 2006-07, the requirement for local units to reimburse authorities from their revenue sharing payments for the inventory reimbursement payment is set to terminate for all local units as of June 30, 2007. Whether the State will fund inventory reimbursement payments, either for countywide authorities or for all authorities, remains a policy decision for the Legislature to make.

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

July/August 2006



### **Revenue Changes and Retirement Costs in the Public School Employees' Retirement System**

**By Kirk Sanderson, Fiscal Analyst**

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#### **Introduction**

Retirement costs for Michigan's public school employees are becoming a growing concern across the State. Decreases or small increases in school district revenue in recent years are forcing an increasing percentage of district budgets to fund pension and health insurance benefits for retirees under the Michigan Public School Employees' Retirement System (MPERS), which is one of four State-administered retirement plans for public sector workers.

A defined benefit retirement system that covers retirees' health and pension costs, MPERS includes all of Michigan's public school districts, community colleges, and district libraries, and is available to public school academies. Seven of the State's 15 public universities also are covered under the system. These universities are: Central Michigan, Eastern Michigan, Ferris State, Lake Superior State, Michigan Tech, Northern Michigan, and Western Michigan.

Two factors have been causing retirement obligations to rise since fiscal year (FY) 1999-2000. First, active membership (i.e., current working employees) has declined slightly over the last two years in response to tightening budgets, while retired membership continues to grow. Since FY 1999-2000, active membership has increased by only 8,358 members, or 2.7%. During the same time, retired membership has increased by 25,591, or 20.3%.

In addition to changes in membership, exogenous factors such as poor stock market performance and rising health costs have negative impacts on MPERS. Taken together, these changes have been requiring Michigan's school districts to pay larger portions of their total operating revenue to fund their MPERS obligations every year since FY 1999-2000.

This article looks specifically at how contributions to MPERS have grown relative to operating revenue for Michigan's school districts from FY 1999-2000 through FY 2005-06, and looks ahead using projections for FY 2006-07. In addition, it breaks down numbers on a per-pupil basis to analyze what increases in the foundation allowance are needed to keep up with increases in MPERS contributions.

#### **MPERS Expenditure and School District Revenue**

Members of MPERS are enrolled in one of two plans, the Basic Plan or the Member Investment Plan (MIP). The Basic Plan covers employees who were hired before 1987 and did not choose the option of becoming part of MIP. Beginning in 1990, all new hires were required to join MIP. The two major differences between the plans include the way pension payments are determined and the requirement that MIP members make contributions toward their plan based on their salary.

Since MPERS is a defined benefit plan, employees receive a monthly pension benefit that is calculated according to a formula that includes years of service and final average compensation. Members become vested in the program based on criteria including age and



years of service, depending on whether they are members of MIP or the Basic Plan. Basic Plan members may retire starting at age 55, while MIP members may retire as young as 46 with a certain number of years of service.

To determine each school district's contribution to MPSERS, a contribution rate determined by the State is applied to wages paid. The total rate is composed of two different rates. The first part is the pension rate, which funds monthly pension payments to retirees. The second component of the total rate is the health insurance rate, which pays for health coverage for retirees. These rates are determined by the Office of Retirement Services, and in FY 2005-06 were 6.55% for health benefits and 9.97% for pensions for a total contribution of 16.34% of wages paid. The rates and contributions from FY 1999-2000 to FY 2005-06 are shown in Table 1. As the table indicates, the total contribution has increased every year since FY 1999-2000, from just under \$1.0 billion to about \$1.6 billion.<sup>1</sup>

**Table 1**

<b>MPSERS Contribution Rates and Total K-12 Contributions*</b>							
<b>(Dollars in Millions)</b>							
	FY 1999-2000	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
Health Rate	4.60%	5.55%	6.05%	6.05%	6.05%	6.55%	6.55%
Pension Rate	7.06%	6.61%	6.12%	6.94%	6.94%	8.32%	9.79%
Total Rate	11.66%	12.16%	12.17%	12.99%	12.99%	14.87%	16.34%
Wages	\$8,093.9	\$8,281.1	\$8,627.7	\$8,842.9	\$8,932.4	\$8,748.3	\$8,887.3 **
Total Contribution	\$943.8	\$1,007.0	\$1,050.0	\$1,148.7	\$1,160.3	\$1,300.8	\$1,452.2 **
* MPSERS contribution figures only include payments from school districts and public school academies.							
** Estimated.							

**Source:** Office of Retirement Services

As shown in Table 1, MPSERS contributions have increased by almost 60.0% since FY 1999-2000. Growing costs for health and pension benefits have resulted in rising contribution rates. The health rate has been relatively stable since FY 2000-01, only increasing one percentage point over that time, from 5.55% in FY 2000-01 to 6.55% in FY 2005-06. This account, created in 1997, used overfunding from previous years to offset increases in health costs in FY 2003-04 through FY 2005-06.

The pension contribution rate has risen in recent years after strong investment returns in the late 1990s allowed the rate to decrease to a low of 6.12% in FY 2001-02. Since then, poor stock market performance, increasing numbers of retirees, and rising costs have forced the rate to increase steadily. The pension rate is 9.79% in FY 2005-06, and will increase to 11.19% in FY 2006-07. That is an increase of nearly 83.0% over the FY 2001-02 level.

<sup>1</sup> For a more detailed description of how MPSERS works, see <http://www.senate.michigan.gov/sfa/Publications/Notes/2005Notes/notesmarapr05jc.pdf>.

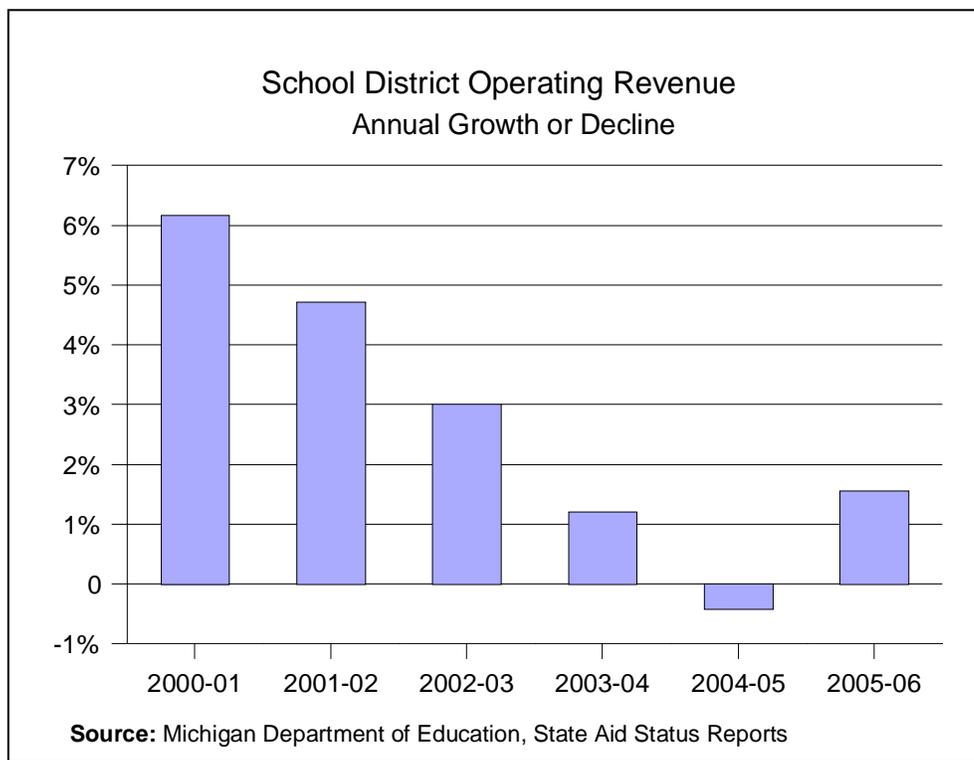


### Funding MPSERS Obligations

Michigan's public school districts fund MPSERS obligations with money from their operating revenue. Districts receive this revenue from two sources: State aid payments and local revenue through property taxes. First, under Section 22a of the State School Aid Act (which provides for districts' foundation allowance), a district receives an amount equal to its FY 1994-95 total State and per-pupil revenue as outlined in Proposal A (the constitutional amendment approved by the voters in March 1994). The remainder of a district's State revenue is granted as discretionary payments pursuant to Section 22b. The net result is that districts receive the same amount of State funding under the new system as they would have when there was a single payment.

In most cases, local contributions are generated through an 18-mill nonhomestead property tax that each district keeps for its own revenue. (This is not to be confused with the State education tax, which levies six mills on all property and contributes to the State School Aid Fund.) Figure 1 illustrates the changes in total operating revenue of Michigan school districts from FY 1999-2000 to FY 2005-06, defined here as the sum of State foundation allowance payments, (appropriated in Sections 22a and 22b of the State School Aid Act of 1979), plus local revenue. One can note the decline in the rate of growth of total funding from FY 2000-01 to FY 2004-05, with a slight decline in funding in FY 2004-05, and an estimated 1.5% growth in FY 2005-06.

**Figure 1**





### District Budgets and Rising MPSERS Contributions

Increasing MPSERS obligations come during a period when school district operating revenue either has been declining or is seeing only meager growth, as illustrated in [Figure 1](#). Revenue from the State education tax has steadily increased on the strength of the real estate market in recent years. State budget problems, however, have limited funding increases from the State. Budget shortfalls forced the State to prorate some school funds in FY 2002-03 and FY 2003-04, and total unrestricted operational funding actually decreased in FY 2004-05. The decrease in funding that year was the result of an unchanged foundation allowance and a decline in enrollment.

As a result of increasing MPSERS contributions combined with stagnating revenue, a greater portion of a school's budget is used for MPSERS. This can become problematic for a district as these funds are diverted from other areas of its budget. As [Table 2](#) shows, in FY 1999-2000 MPSERS contributions constituted 9.13% of Michigan school districts' operating revenue. By FY 2003-04, that percentage had increased to 9.69%. Large increases in contribution obligations in the last two years have pushed the percentage up to an estimated 11.99%.

**Table 2**

Percent of Operating Revenue Needed to Fund K-12 MPSERS Obligations* (Dollars in Millions)							
	FY 1999-2000	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
MPSERS Contributions	\$943.80	\$1,007.00	\$1,050.00	\$1,148.70	\$1,160.30	\$1,300.8	1,452.2**
Operating Revenue	\$10,312.8	\$10,973.6	\$11,490.0	\$11,476.4	\$11,586.1	\$11,495.3	\$11,636.3
% Required to Pay MPSERS	9.13%	9.18%	9.14%	9.71%	9.69%	10.90%	11.99%
* MPSERS contribution figures only include payments from school districts and public school academies.							
** Estimated.							

**Source:** Office of Retirement Services, Michigan Department of Education, and Senate Fiscal Agency estimates.

Another way to look at increases in MPSERS contributions is to determine how much of the yearly foundation allowance increase is needed to match the contribution increases. The foundation allowance is the annual per-pupil payment from the State. In all but two years during the period covered in this paper, the foundation allowance increased. In FY 2003-04 and FY 2004-05, there was no increase.

The percentage of the foundation allowance needed for MPSERS contributions fell in the early 2000s as contribution rates remained low and foundation allowance increases were high. As [Table 3](#) shows, the rate dropped to a low of 5.0% in FY 2001-02. This changed the next year when \$58 of the \$200 foundation increase, or 29.0%, was needed to cover MPSERS increases.

In FY 2003-04, MPSERS rates remained unchanged, with only a \$7 per-pupil increase in contributions due to rising district payroll. This mitigated the effect of having no foundation allowance increase in FY 2003-04 and having some funding prorated due to revenue shortfalls at the State level.



**Table 3**

<b>Per-Pupil Increases in K-12 MPSERS Contributions and Basic Foundation Allowance Payments*</b>							
	FY	FY	FY	FY	FY	FY	FY
	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Foundation Allowance Increase	\$530	\$300	\$500	\$200	\$0	\$0	\$175
MPSERS Contribution Increase	\$75	\$37	\$25	\$58	\$7	\$82	\$89
% Needed to Cover MPSERS Increase	14.2%	12.3%	5.0%	29.0%	N/A	N/A	51.0%

\* MPSERS contribution figures only include payments from school districts and public school academies.

**Source:** Office of Retirement Services, Michigan Department of Education, and Senate Fiscal Agency estimates.

There was no increase in the foundation allowance again in FY 2004-05, though funding prorated in FY 2003-04 was restored. Nevertheless, the contribution rates for health and pension benefits increased by 0.5 and 1.6 percentage points, respectively. These increases, combined with a slight decline in the total number of pupils, caused MPSERS contributions to increase by \$82 per pupil.

The foundation allowance increased by \$175 in FY 2005-06, but as in the previous year, declining enrollment and an increase in the total contribution rate caused MPSERS contributions to increase by \$89 per pupil. That represents 51.0% of the total foundation allowance increase. When the last three years are taken together, however, it looks much worse for districts. Over that time, MPSERS contributions have increased by \$178 per pupil, while foundation allowances increased by \$175.

### Looking Ahead to FY 2006-07

Several of the trends that have emerged in the last two years should continue in FY 2006-07. Despite modest rate increases, estimates indicate that MPSERS contributions will continue to require a larger portion of total operating revenue for districts, and that those costs will be spread over fewer students, resulting in increased requirements on a per-pupil basis.

These projections use MPSERS contribution rates released by the Office of Retirement Services, and are based on assumptions about payroll data, local revenue contributions, and the number of pupils. Projections for local revenue and payroll were based on previous years' growth rates. This averaging may lead to an overstatement of local contributions, as growth rates for local contributions have slowed in recent years.

The MPSERS contribution rate will increase to 17.74% in FY 2006-07, according to the Office of Retirement Services. The pension rate will increase 1.4 points to 11.19%. Changes in the Medicare system will provide some savings to MPSERS, allowing the health rate to remain at 6.55% for FY 2006-07. Combined with the payroll estimates, total MPSERS contributions are likely to increase by nearly 10.0% in the next fiscal year.

To help partially offset the rise in MPSERS obligations, total operating revenue for school districts should see the biggest increase in five years. The foundation allowance will be \$210



more than in FY 2005-06 and the discretionary payment has been increased by more than 10.0% from the current year. Despite these increases, MPSERS obligations will account for an estimated 12.95% of total revenue, up from 11.99% in FY 2005-06.

Declining enrollment and rising retirement costs push MPSERS obligations even higher in FY 2006-07 when measured on a per-pupil basis. An estimate of the FY 2006-07 pupil count shows a decrease of 0.42%, or roughly 7,060 students. Along with the increasing contributions described above, MPSERS funding will likely cost around \$1,040 per pupil. This is the highest level yet and an increase of 77% over the FY 1999-2000 level.

### **Conclusion**

Several of the factors mentioned in this paper will put growing strains on the ability to Michigan school districts to fund their MPSERS obligations in the coming years. Some of the primary challenges include:

- Growth in the number of retired members likely will outpace any growth in active membership as large numbers of teachers approach retirement age.
- Slow or negative growth in active membership will result in a smaller base over which to spread costs, forcing contribution rates to increase if districts are to meet MPSERS obligations, particularly for the pay-as-you-go health benefit system.
- These higher rates will continue to divert from instructional uses a larger portion of total operating revenue as well as foundation allowance increases.

The demographic trends and rising costs that have begun to cause concern for school districts in recent years show no indication of reversing in the near future. Pressure on Michigan school districts to fund obligations to their employees while increasing student instruction and achievement will become greater as MPSERS consumes an ever-larger portion of district revenue. Proposals such as the K-16 ballot initiative are attempting to address the issue, but any potential solution must carefully weigh both the long-term benefits and drawbacks of changes to the current structure.

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

July/August 2006



### **Gone Fishin': The Decline of the Game and Fish Protection Fund** **By Jessica Runnels, Fiscal Analyst**

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In tandem with the shrinking revenue to the State's General Fund, many State restricted or special revenue funds are experiencing a decline. One of these is the Game and Fish Protection Fund, which contributes 25.0% of the total budget in FY 2006-07 for the Department of Natural Resources (DNR). Revenue to this Fund has stagnated and slightly declined, creating budgetary strain in areas that have not been highly affected by the statewide General Fund reductions enacted in the past five fiscal years. The Game and Fish Protection Fund supports activities throughout the DNR, including the maintenance and development of wildlife habitat, operation of the State's six fish hatcheries, monitoring of animal, fish, bird, and plant species, research and educational programs, and enforcement of game laws.

The policies governing use of the Game and Fish Protection Fund often seem mysterious. Revenue to the Fund comes primarily from the sale of hunting and fishing licenses, but the equation to divide up the money is complicated. Within the Fund, there is a general purpose fund and multiple subfunds. In addition, a trust fund with the same name makes annual contributions to it. Further complicating its distribution, expenditures from the Fund are tied to Federal funding, but the strings attached to the money are rarely explained fully, although mentioned frequently as an obstacle to using the Fund to compensate for General Fund budget reductions.

#### **Revenue and Expenditures**

Revenue to the Game and Fish Protection Fund is decreasing while costs are increasing. The two principal reasons for the loss of revenue are a decrease in the sales of hunting and fishing licenses and the fact that license fees have been relatively constant for almost 10 years. In June 2005, the Natural Resources Commission was presented with a staff report detailing expenditure reductions of \$8.1 million spread over three fiscal years that were necessary to operate within the anticipated revenue. Table 1 demonstrates the reduction in hunting and fishing license sales over the six-year period of 2000 through 2005. While there are a few ups and downs, the intervening years generally show a steady decline in licenses sold.

**Table 1**

<b>Hunting and Fishing License Sales from 2000 to 2005</b>			
<b>License Type</b>	<b>2000</b>	<b>2005</b>	<b>Change</b>
Fish .....	1,405,265	1,289,212	(8.3)%
Small Game .....	358,725	294,965	(17.8)
Firearm Deer .....	349,768	288,985	(17.4)
Archery Deer .....	84,467	58,410	(30.8)
Combination Deer .....	740,871	721,651	(2.6)
Antlerless Deer <sup>1)</sup> .....	683,517	552,738	(19.1)
Spring Turkey <sup>1)</sup> .....	215,555	200,956	(6.8)
Fall Turkey <sup>1)</sup> .....	72,746	46,712	(35.8)
<b>Totals .....</b>	<b>3,910,914</b>	<b>\$3,453,629</b>	<b>(11.7)%</b>

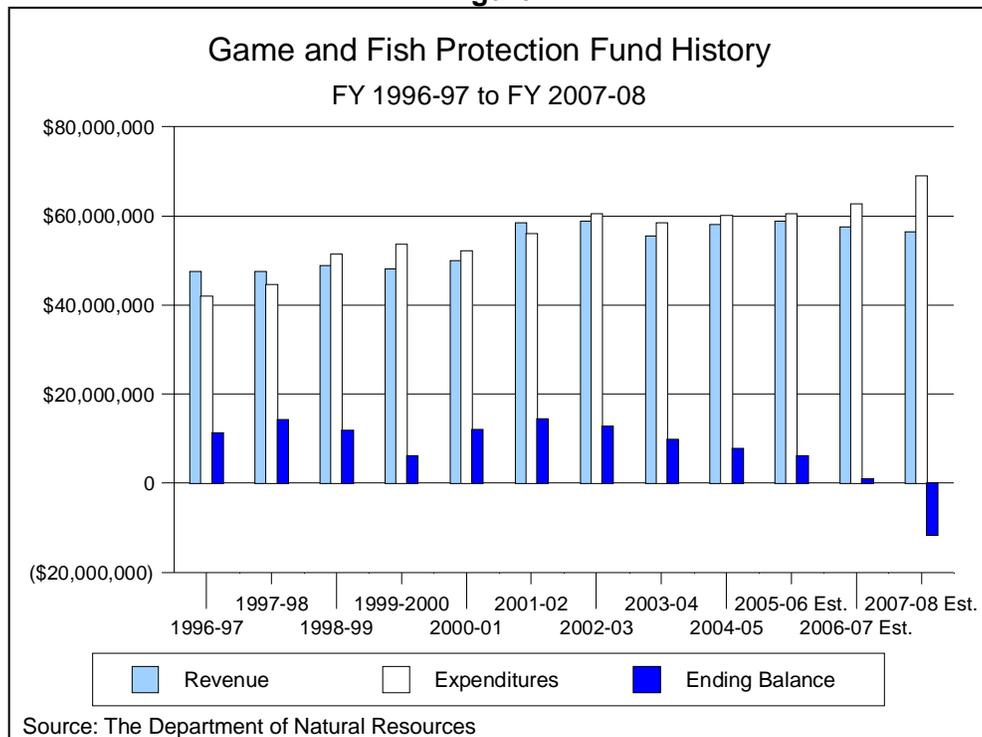
<sup>1)</sup> Includes applications

**Source:** Department of Natural Resources



The amounts charged for hunting and fishing licenses are established in the Natural Resources and Environmental Protection Act. Most of the current license fees were implemented in 1997. Six types of licenses (small game, firearm deer, archery deer, bear, fur harvester, and fish) were increased by \$1 in 2001 and 2005 pursuant to provisions included in the 1996 act setting the current license fees. In FY 1996-97 and FY 1997-98, annual revenue was greater than expenditures. Effective March 1, 2001, after three years of higher expenditures and declining Fund balances, the DNR Director used statutory authority to increase the fees for those six licenses by \$1. This worked for four more years and then the Director increased the fees by \$1 again on March 1, 2005, to bring revenue and expenditures closer together. The fluctuations in revenue and expenditures are shown in Figure 1. The program reductions implemented over a three-year period are an effort to match expenditures and revenue. The DNR Director cannot increase license fees again without new statutory authorization. A proposal to increase hunting and fishing license fees is anticipated within the next year to support the budget in FY 2007-08 and beyond.

**Figure 1**



The Game and Fish Protection Fund also receives an annual transfer of funds from the Game and Fish Protection Trust Fund. The Trust Fund receives royalties from minerals extracted from land purchased with Game and Fish Protection Fund money. The Trust Fund is not appropriated in a budget act, but interest and earnings on the Trust Fund and up to \$6.0 million from the balance is transferred annually to the primary Fund's general purpose account. In FY 2005-06, the total amount transferred from the Trust Fund to the Game and Fish Protection Fund's general purpose fund will be about \$12.0 million.



In addition to the Game and Fish Protection general purpose fund, there are six specialty subfunds that receive portions of the fees for specific licenses or dedicated revenue from a legal settlement. The subfunds are: deer range improvement, turkey, waterfowl, wildlife resources protection, youth hunting and fishing education and outreach, and fisheries settlements. Statute requires that the subfunds be used for habitat development for the species identified in the fund title. The subfunds comprise 10.0% of the total in the Game and Fish Protection Fund and the general purpose account is the remaining 90.0% of the Fund.

Of the annual appropriations from the Fund, approximately 98.0% are included in the DNR operating budget. The DNR divisions of Wildlife, Fisheries, and Law Enforcement receive 74.0% of the appropriations from the Fund in the DNR budget. The balance is spent for real estate and land management, research grants, administrative expenses, forest certification activities on land purchased using the Fund, and payments in lieu of taxes on land purchased with Fund money. Appropriations from the Fund in other State budgets include payments to the Departments of Attorney General, Civil Service, History, Arts, and Libraries, Management and Budget, and Treasury, and the Legislative Auditor General for services provided to the DNR. Table 2 compares the amounts appropriated from the Fund.

**Table 2**

<b>FY 2006-07 Appropriations from the Game and Fish Protection Fund, Including General Purpose and Subfunds</b>		
<b>Purpose</b>	<b>Amount</b>	<b>Percent of Total</b>
Program Units .....	\$55,292,200	75%
Administration .....	14,392,400	20%
Purchased Land PILT .....	2,040,000	3%
Other State Departments .....	1,444,500	2%
<b>Total .....</b>	<b>\$73,169,100</b>	<b>100%</b>

**Source:** Public Act 344 of 2006

Statute limits expenditures to certain activities within the DNR and prohibits use of the Fund for activities not specified in law. Allowable uses of the Fund are provided for in MCL 324.43553:

- a) Department operations related to the protection, propagation, distribution, and control of game, fish, birds, fur-bearing animals, and other wildlife forms, including the enforcement and administration of the game, fish, and fur laws of the State and equipment necessary to perform these duties.
- b) The propagation, liberation, and increase of game, fur-bearing animals, birds, or fish.
- c) The purchase, lease, and management of land for establishing and maintaining game refuges, wildlife sanctuaries, and public shooting and fishing grounds for the purpose of propagating and rearing game, fur-bearing animals, birds, and fish.
- d) Investigations and the publication of information relative to the propagation, protection, and conservation of wildlife.
- e) Appropriate educational activities relating to the conservation of the wildlife of this State.
- f) Grants to colleges and universities in this State to conduct fish and wildlife research.



One of the reasons that the use of the Fund seems mysterious is the fine line between allowable uses and those that are not. For example, the DNR is testing deer for the presence of Bovine Tuberculosis in a combined effort with the Michigan Department of Agriculture to eradicate the disease from the bovine population in the State and to prevent the disease from spreading to the wild deer population. While the testing is being done on game animals as part of the effort to prevent the wild deer herd from contracting Bovine TB, the disease is agricultural and the original issue was raised in an agricultural context. In this situation, the Game and Fish Protection Fund may not be used to pay for the testing of the deer.

### **Federal Funding**

The DNR will receive approximately \$43.0 million from the Federal government in FY 2006-07. Of this amount, about \$18.5 million is contingent upon the DNR's adhering to certain Federal restrictions on the expenditure of hunting and fishing license fees. The Federal revenue is generated from Federal taxes imposed on items such as sporting arms, ammunition, bows and arrows, certain fishing tackle, electronic trolling motors, yachts, and motorboat fuel.

**Sport Fish.** In order to receive Federal funds for fish programs, the State had to enact a statement that it would use revenue from license fees paid by anglers in compliance with rules and regulations promulgated by the U.S. Department of the Interior and only for fish and game activities under administration of the DNR (MCL 324.47701). Specifically, the State must comply with all provisions of the Federal Aid in Sport Fish Restoration Act (often called the Dingell-Johnson Act of 1950) to receive the Federal funds for this program, which are estimated to be \$8.3 million in FY 2006-07.

The amount of Federal support may be up to 75.0% of the cost of approved sport fish-related projects and the remaining 25.0% is provided by the State from a non-Federal source. Projects may include acquisition and improvement of fish habitat; research into fishery resources; surveys and inventories of fish populations; and the development of public access. Each state's share is based 60.0% on its licensed anglers and 40.0% on its land and water area. Theoretically, this means that a decline in the number of fishing licenses sold affects the amount of Federal funds received by the State. However, other states have experienced a similar decline in license sales, so the Michigan portion of the Federal funding has not been reduced.

**Wildlife.** The State had to enact a similar statute regarding license fees paid by hunters stating that it would comply with rules and regulations of the U.S. Department of Agriculture and only use the State and Federal funds only for fish and game activities under administration of the DNR (MCL 324.40501). The State must comply with the Federal Aid in Wildlife Restoration Act (often called the Pittman-Robertson Act of 1937) to receive \$10.2 million in Federal funds in FY 2006-07. This program is now administered by the Fish and Wildlife Service of the U.S. Department of the Interior.

Also similar to the Federal sport fish funding, the amount of Federal support for wildlife projects is based on the number of licensed hunters in the State and the total area of the State. The Federal funds can pay for up to 75.0% of the total project cost with the State match coming from a non-Federal source. Wildlife projects may include acquisition and improvement of wildlife habitat; introduction of wildlife; research, survey, and inventory of wildlife populations;



development of public access; and hunter education programs, including the construction and operation of public target ranges.

According to both of the Federal programs, receipt of the Federal funds is all-or-nothing, so a small deviation in the expenditure of license revenue from the uses specified in the Federal acts may result in a loss of all of the Dingell-Johnson or Pittman-Robertson Federal money. The Federal government periodically audits the State's expenditures from the Game and Fish Protection Fund. Usually, these audits are uneventful and the State is found to be in compliance with Federal regulations. However, the audit completed for the period of October 1, 1995, to September 30, 1997, found areas of noncompliance. In settlement of the findings, in FY 2002-03 the DNR was required to reimburse the Game and Fish Protection Fund a total of \$2,456,000. Of the total reimbursement, \$560,000 was from the Snowmobile Registration Fee Fund, \$1,340,000 was from the Off-Road Vehicle Trail Improvement Fund, and \$556,000 from the State's General Fund. Federal funds were not withheld since the DNR restored money to the Game and Fish Protection Fund and was not found to be diverting revenue intentionally.

### **Constitutional Proposal**

The Game and Fish Protection Fund, including its general purpose fund and all subfunds, and the Trust Fund are included in ballot proposal 2006-1, which will be before the voters in the general election this November. The proposal would create in the Michigan Constitution the Conservation and Recreation Legacy Fund with 17 existing DNR funds and two trust funds as accounts within the larger Legacy Fund. Since the use of the Game and Fish Protection Fund is tied to a large amount of Federal funding, the additional restrictions that would be imposed if the Fund were established in the Michigan Constitution would not be any more limiting than the Federal regulations. The ballot proposal is an effort to restrict the expenditure of user fees to activities consistent with the statute establishing the fees, preventing diversion of the fee revenue. The ballot proposal would not increase or decrease any user fees or affect the amount of revenue received or spent by the DNR.

### **Conclusion**

In order to support its game and fish programs, the DNR is looking for ways to decrease expenditures from the Game and Fish Protection Fund and increase revenue to it. As demands on the State General Fund increase in other areas of the overall State budget, departments with a significant portion of restricted funds, such as the DNR, are asked to pay for an even greater percentage of their operations with those restricted funds.

The Game and Fish Protection Fund contributes such a large percentage of the DNR budget that it is a potential target for this strategy, although the Federal and statutory restrictions limit its flexibility. With General Fund appropriations prioritized to other departments, inflationary increases and additional policy costs for the DNR are borne by State restricted funds. This makes it difficult to decrease expenditures in programs without jeopardizing the natural resources and recreational opportunities within the State. The remaining option is raising more revenue for the Game and Fish Protection Fund. One can hope that the future brings more "Gone Fishin'" signs hanging on front doors instead of on account books.