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The Road Ahead: An Opinion

by Gerald A. Faverman, Ph.D.

There is an ancient curse: "May you live in interesting times." This year just aborning certainly has the potential to be a vintage one for interesting times, replete with danger, uncertainty, risk, and surprise. In these volatile days, what are economic experts to make of what may occur in the nation and in Michigan?

Forecasts and estimates are based on experience, analysis, and instinct. The more distant they are from the events projected, the less likely they are to be accurate. This discussion presents my sense of the course of events that could transpire over the coming two years, knowing that as we get closer in time, accuracy in forecasting should improve, and consensus increase. Compared to the immediate past, 1990 shapes up to be a less promising year economically. At present, the prevailing opinion of many economists is that the current fiscal recovery will continue over the next 24 months. To the contrary, I envision the possibility that a downturn will occur, likely to be categorized as a "mild recession" and lasting no longer than two years. This "correction" will be managed so that the economy will begin to exhibit improvement before the next presidential election, even if higher-than-expected inflation is a trade-off for more robust marketplace activity. It is imperative to understand that political events and their psychological aftermath will more radically affect the stock market and the domestic economy than will classical economic forces.

Whatever the economy brings nationally, the situation in Michigan will be more severe, with higher unemployment and significantly lower economic activity, than in more diversified states.

For the last 75 years, the Michigan economy has lived or died based on the strength of the automobile industry. Despite all the change that the industry has undergone in terms of structural modification and response to the internationalization of the automobile industry, it is no different in 1990 than before: Cars continue to be the bellwether of our state economy.

The last six years have been among the best in the entire history of the automotive industry. This year, however, I believe that considerably fewer cars will be sold, with a concomitant decline in the industry's profitability. Industry downsizing, reorganization, consolidation, and mergers are inevitabilities for the years ahead. In 1990, layoffs will occur, and marginal factories will be closed, as the major U.S. auto makers deal with the very painful reality that their total world market share is declining and will grow smaller still.

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This unpromising prospect for 1990 will have its ineluctable effect on the state budget, which is already on a collision course with political and economic reality. Many seasoned observers are concerned about the viability of the current—as well as the forthcoming—budget, without any consideration of the possibility of a recession. The stresses and strains facing the state budget, entirely independent of those facing the state's economy, include the following.

- The expenditure base continues to be—despite every effort to constrain it—about 104 percent of available revenues. There is already speculation about a 3 percent cut in the 1989-90 budget.
- Revenue growth in 1990 and 1991, on which this current budget and the forthcoming budget are based, may well be less than anticipated.
- Mandated increases in human services programming and judicial and statutory requirements continue to be at a level beyond the system's ability to fund. In the last decade, for example, foster care has grown by 479.6 percent, corrections by 392.9 percent. In this same period, the increase in all other budgets has been 70.9 percent.
- Pressure on the legislative and executive branches for program expansion is most extraordinarily severe in this election year. Increases in welfare caseloads, inadequate Medicaid funding, demand for mental health services, growing corrections populations and staffing, expanded programs in higher education, the continuing K-12 financial crisis, transportation and highway construction funding, and urban renewal requirements for our decaying core cities all create legitimate, competitive demands on a system without adequate new resources and unready to cope with reallocation or economic contraction.
- There lurks the very real danger of political gridlock between Democrats and Republicans in this election year as the Republican-controlled Senate squares off against the Democratic-controlled House and executive branch.
- It is virtually certain that no new taxes will be enacted in 1990 to cope with pressures to meet mandated programs and expansion priorities.
- Prospects are equally certain that there will be new taxes in Washington and Lansing in 1991. While there is never a good year for tax increases, they are more likely to occur in this state in 1991, 1995, and 1999—when the House, Senate, and governor simultaneously begin new terms.

With these competitive, contradictory, and unpromising prospects, what can we expect in terms of the 1990-91 budget? Some key factors can be anticipated:

- a 1990-91 budget longer on rhetoric and imagery and shorter on hard cash;
- a most conservative growth projection for mandated expenditure increases in health, welfare, and corrections;
- disagreements between legislative and executive agencies about the correctness of revenue projections;
- severe conflict among the legislative chambers, the gubernatorial candidates, the political parties, and the special interests;
- the state's continued imposition of tuition and fee restraints on universities, curtailing the ability of these ostensibly autonomous units to meet their budgetary ambitions from nonappropriated dollars at a time when state funding will be less than desired;

- the potential that all these conflicts may bear poisoned fruit. In a worst-case scenario, no budget would be enacted before the June recess, only some minor agency budgets would be approved after the August primaries, and the major appropriations bills would not be enacted until after the November election. This scenario would require enactment of a continuing budget resolution for the initial weeks of the 1990-91 budget year.

The budget, for all its monolithic appearance, is a three-stage process characterized by the opening gambit, the counteroffer, and the end game. The governor's State of the State Message and Executive Budget, for all the confidence and theatricality with which they are presented, are but the opening gambit. They attempt to set aspiration, expectation, and funding priorities and levels and seek to garner political credit.

In the counteroffer stage, the executive proposals are scrutinized by competitive political interests, special interest groups, regional and local interests, and state agencies and their constituencies, resulting in more recommendations for appropriations legitimized by legislative advocacy. The conclusion of the second stage frequently can result in requests for increases of as much as $300 million in the proposed spending level, rarely and infrequently accompanied by proposals to enhance revenue by enacting new taxes.

The end game occurs in a very tight time frame, usually between Memorial Day and July 4th. If a budget is to be enacted, the multiplicity of "nonnegotiable," "unalterable" positions of principle must be negotiated and compromised in an exercise driven by the determination to conclude this annual appropriations process. It is at this time that legislative leaders of both chambers meet with executive branch leadership to determine appropriation targets and budget levels. At this juncture, about six months from the opening gambit, rhetoric, posturing, and optimistic or pessimistic expectations have to bow to the reality of whatever is then the current best judgment.

This process—elaborate yet subtle, hard-knuckled yet delicate—will likely be overlaid to some large degree by the machinations of election-year politics in 1990. Thus, there will be a nearly inescapable temptation to manage public opinion by underestimating expenditure requirements, overestimating projected revenues, promising greater funding for ongoing programs and new initiatives, and utilizing a wide variety of accounting deviations that will project a more wholesome view of the gathering financial storm.

Public policy driven by public relations considerations, a process of smoke and mirrors, may well delay public recognition of the need for sterner actions entailing cuts and the enactment of new taxes in 1990-91. Thereafter, a national recession would help create a more accepting public climate for new taxes with minimum blame for locally elected incumbents.

In the year ahead, we think that the state's political life will be exceptionally volatile and painful. A wide variety of issues and requirements will be left unaddressed, avoided, and postponed—to be dealt with *seriatim* as events demand or politics permit.

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