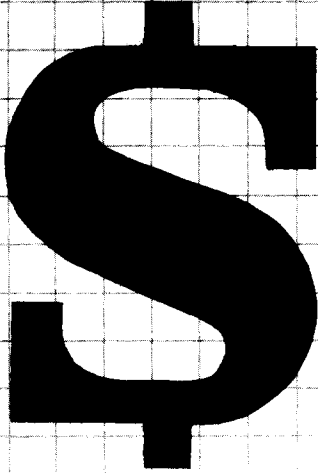


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*** Executive budget requests a 3.2% increase over 1984 GF-GP spending level ***
Mandated expenditures and rollback of income tax increase resurrects spectre of structural budget deficit ***

The 1985 Executive Budget Recommendation

Widely advertised as a zero-growth budget, the governor's proposed fiscal year 1985 general fund-general purpose (GF-GP) budget recommendation is nonetheless 3.2% higher than the anticipated postsupplemental 1984 budget level. The total budget of \$12.6 billion would be 3.7% above the total budget of \$12.2 billion of 1984 (Table 1).

The proposed general fund budget would slash funds for four departments: Labor (\$28.9 million), Management and Budget (\$11.8 million), Mental Health (\$10.7 million), and Social Services (\$94.5 million). Capital outlay expenditures would fall by \$4.8 million. The state's improved credit rating would shave interest payments on short-term borrowings by \$26 million. The budget would also accelerate repayment of the fiscal year 1983 shortfall in state spending to local units of government; while the 1983 deficiency of approximately \$60 million would not have to be repaid until fiscal year 1985, repayment tentatively has been scheduled for the 1984 fiscal year. This would help relieve some of the expenditure pressures on the 1985 budget.

The preceding savings would enable appropriation increases for other state departments and programs. The largest dollar increase would go for higher

education institutions and programs. Community colleges would gain \$14.6 million from state GF-GP sources. State colleges and universities would receive as much as 10% (\$73.4 million) more than in fiscal year 1984 if they froze tuition for Michigan students. Institutions that increased student tuition would lose a prorated share of state aid, but would be guaranteed a minimum 6% increase even if tuition was raised. As an additional effort to counter rising tuition costs, a Michigan Merit Scholarship Fund beginning in 1985 would provide \$2.5 million of college scholarships to 5,000 high school seniors.

The smallest dollar increases (\$200,000) would go to the governor's office and to the Library of Michigan. The governor's office would receive \$3.1 million while the Library of Michigan's appropriation would increase to \$18.0 million.

The largest percentage increase in general fund appropriations would go to the Department of Natural Resources (23.4%). The additional funding would primarily be used as a state match to federal EPA superfund monies to clean up toxic waste sites in the state and to dismantle, dispose of, and replace PCB-contaminated silos.

Table 1. Comparison of 1984 and Proposed 1985 General Fund and Total State Budgets
(in millions of dollars).

Area and/or Department	General Fund			Total Budget		
	Enacted 1984	Recommended 1985	% Change	Enacted 1984	Recommended 1985	% Change
EDUCATION						
Community Colleges	144.7	159.3	10.1	144.7	159.3	10.1
Education	27.0	30.6	13.3	427.0	427.2	0.0
School Aid	489.3	490.0	0.1	1,965.3	2,112.2	7.5
State Colleges and Universities	761.2	834.6	9.6	763.6	837.0	9.6
GENERAL GOVERNMENT						
Attorney General	16.2	18.7	15.4	26.8	29.4	9.7
Civil Rights	8.6	9.6	11.6	10.2	11.2	9.8
Civil Service	8.5	9.8	15.3	15.3	16.9	10.4
Executive Office	2.9	3.1	6.9	2.9	3.1	6.9
Judiciary	64.9	67.7	4.3	93.2	98.1	5.2
Legislature	54.0	57.3	6.1	56.0	59.4	6.1
Management and Budget	107.9	96.1	-10.9	903.3	963.4	6.6
State	9.9	10.4	5.0	84.3	89.8	6.5
Treasury	52.6	56.2	6.8	71.4	75.5	5.7
HUMAN SERVICES						
Mental Health	596.3	585.6	-1.8	745.3	817.6	9.7
Public Health	100.2	106.7	6.5	236.8	258.7	9.2
Social Services	2,110.5	2,016.0	-4.5	4,100.8	3,979.3	-3.0
REGULATORY						
Commerce	64.6	72.3	11.9	203.9	215.9	5.9
Labor	59.0	30.1	-49.0	372.6	240.4	-35.5
Licensing and Regulation	13.7	14.1	2.9	16.5	18.0	9.1
RESOURCES						
Agriculture	22.0	22.8	3.6	37.7	39.3	4.2
Natural Resources	68.4	84.4	23.4	206.0	218.5	6.1
SAFETY						
Corrections	264.7	290.6	9.8	265.6	296.2	11.5
Military Affairs	9.9	10.7	8.1	17.3	18.3	5.8
State Police	134.4	143.3	6.6	157.0	165.4	5.4
TRANSPORTATION						
Transportation	9.2	-0-	--	1,116.1	1,189.4	6.6
OTHER						
Budget Stabilization Fund	35.1	281.4	801.7	35.1	281.4	801.7
Capital Outlay	58.8	54.0	-8.2	116.9	95.7	-18.7
Debt Service	117.5	91.5	-22.1	174.6	155.6	10.9
Section 30 Repayment	58.5	-0-	--	58.5	-0-	--
Less: Interdepartmental Transfers				-258.5	-251.3	
TOTAL	5,488.3	5,664.9	3.2	12,189.6	12,644.6	3.7

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School aid funding, with a 0.1% gain in general fund appropriations, would receive the smallest percentage increase. Funding from state general fund sources would rise by approximately \$700,000. However, revenue from dedicated sources such as the state lottery and the sales tax would permit total school aid funding to rise by \$146.9 million (7.5%) to \$2,112.2 million.

Unlike the budgets of the past several years, the proposed 1985 budget would provide more dollars to local units of government than mandated by the state constitution. The proportion of state spending returned to local governmental units would be 41.9%, \$27.4 million above the required 41.6% share.

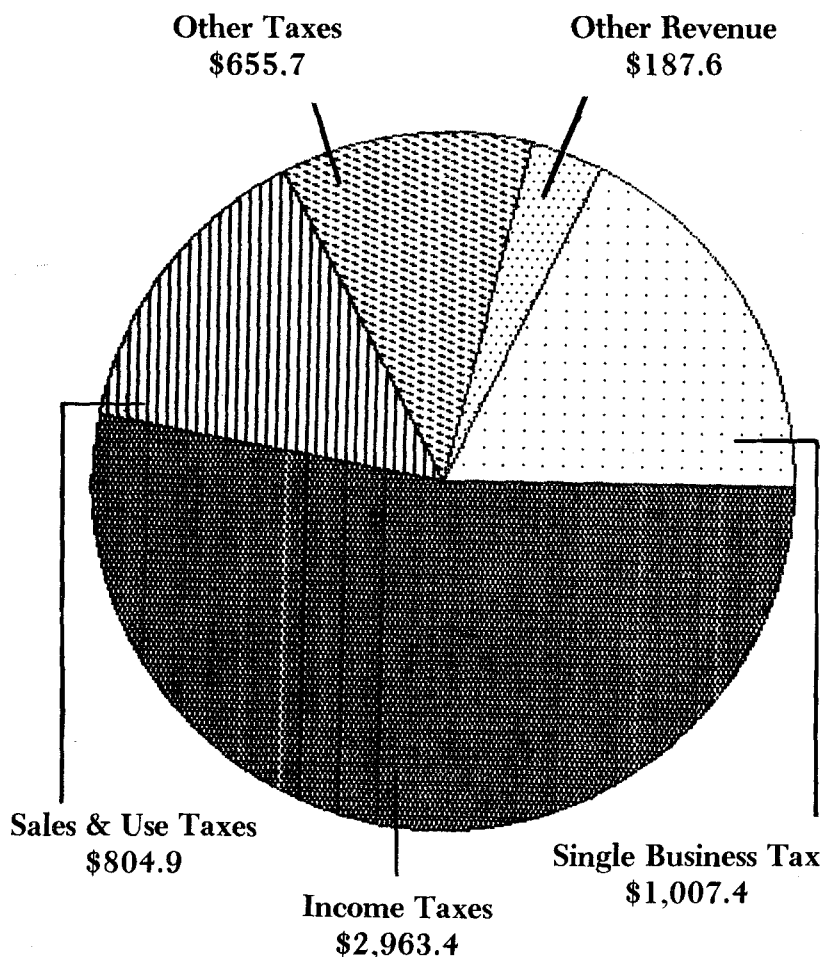
The two major forces restricting growth in the 1985 budget will be the statutory transfer from the general fund to the Budget Stabilization Fund and the rollback of the income tax increase. The proposed budget anticipates that the transfer to the Budget Stabilization Fund will cost the general fund approximately \$281.4 million. The mandated January reduction in the income tax rate will cut the revenue base by approximately \$420 million. The executive budget assumes an additional revenue loss of \$105 million due to a three-month acceleration of the income tax increase rollback. The combined impact of these two forces is an effective reduction in general fund resources of \$806.4 million, an amount equivalent to roughly 15% of the current year's general fund budget.

Distribution of Revenues and Expenditures, Fiscal Year 1985

Figures 1 through 4 illustrate the funding sources and allocation of Michigan's proposed 1985 GF-GP and total state budgets. Figure 1 shows that 85% of general fund revenues would be derived from the four largest taxes -- individual income, single business, sales, and use. Figure 2 shows that these same taxes would account for only 50% of total anticipated state revenues.

FIGURE 1

FY 1985 General Fund-General Purpose Budget
Revenue: \$5,619.0 (millions of dollars)



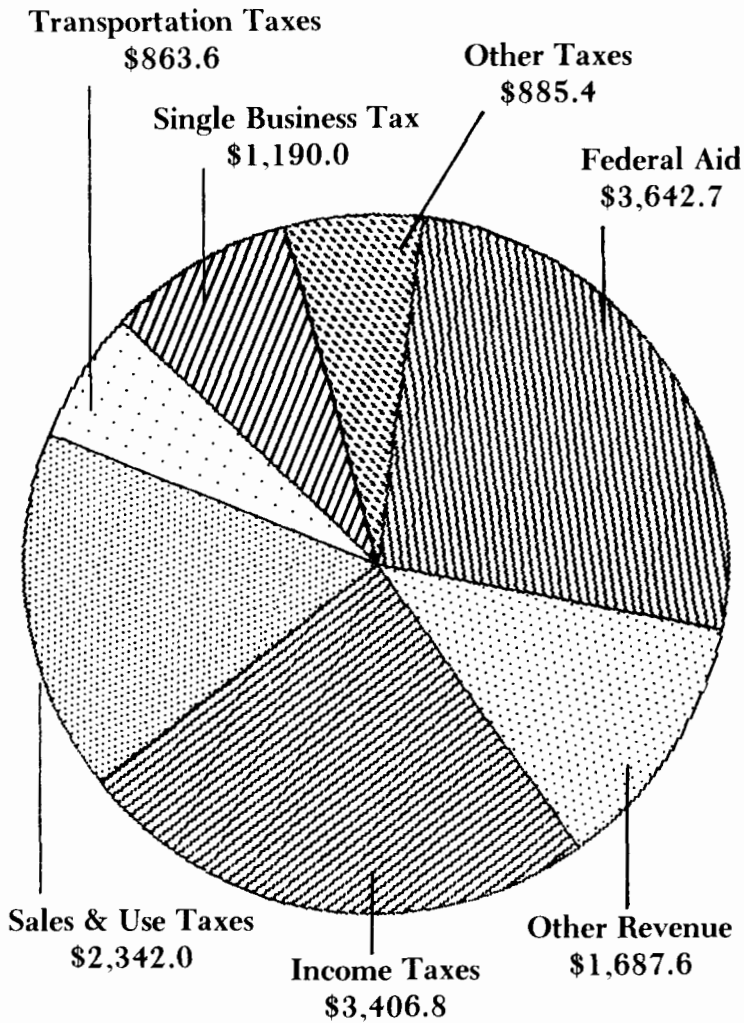
The General Fund-General Purpose Budget Dollar

Where It Comes From:

Income Taxes.....	53¢
Single Business Tax.....	18¢
Sales and Use Taxes	14¢
Other Taxes	12¢
Other Revenue.....	3¢

FIGURE 2

FY 1985 Total State Budget
Revenue: \$14,018.2 (millions of dollars)



The Total State Budget Dollar
Where It Comes From:

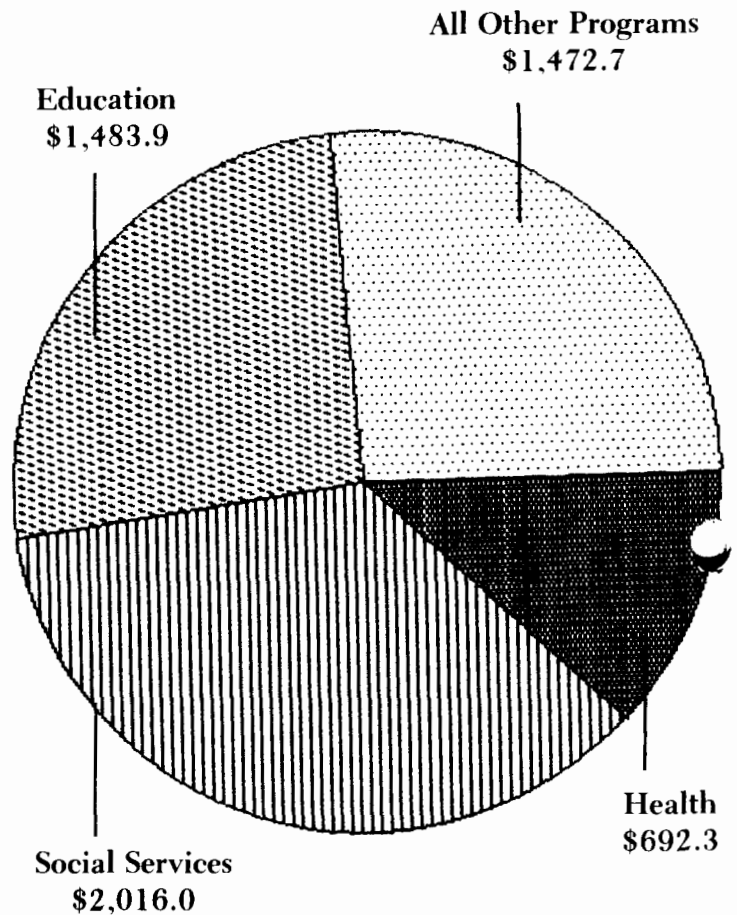
Income Taxes	24¢
Sales & Use Taxes	17¢
Single Business Tax	9¢
Transportation Taxes	6¢
Other Taxes	6¢
Federal Aid	26¢
Other Revenue	12¢

Figure 3 discloses the distribution of proposed state spending on discretionary items, i.e., items whose funding is not derived from dedicated

revenue sources. As shown here, social services, health, and education account for 84¢ of every general fund budget dollar.

FIGURE 3

FY 1985 General Fund-General Purpose Budget
Expenditures: \$5,644.9 (millions of dollars)



The General Fund-General Purpose Budget
Dollar

It Goes To:

Education	26¢
Health	12¢
Social Services	36¢
All Other Programs	26¢

Figure 4 shows how budget dollars, from both dedicated and undedicated revenue sources, would be distributed among the various state functions. Education would account for 25¢ of every Michigan budget dollar, while social services would absorb 32¢, transportation 9¢, and health care 8¢. All other programs would compete for the remaining 26¢ share.

FIGURE 4

FY 1985 Total State Budget
Expenditures: \$12,644.6 (millions of dollars)

**The Total State Budget Dollar
Where It Goes To:**

Education	25¢
Social Services	32¢
Transportation	9¢
Health	8¢
All Other Programs	26¢

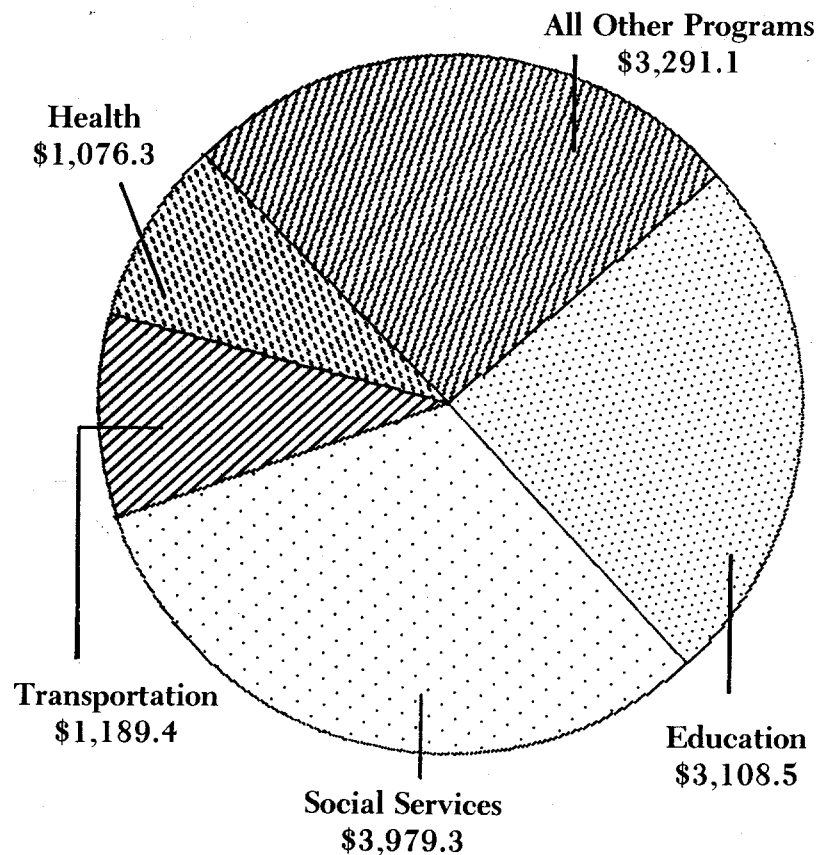
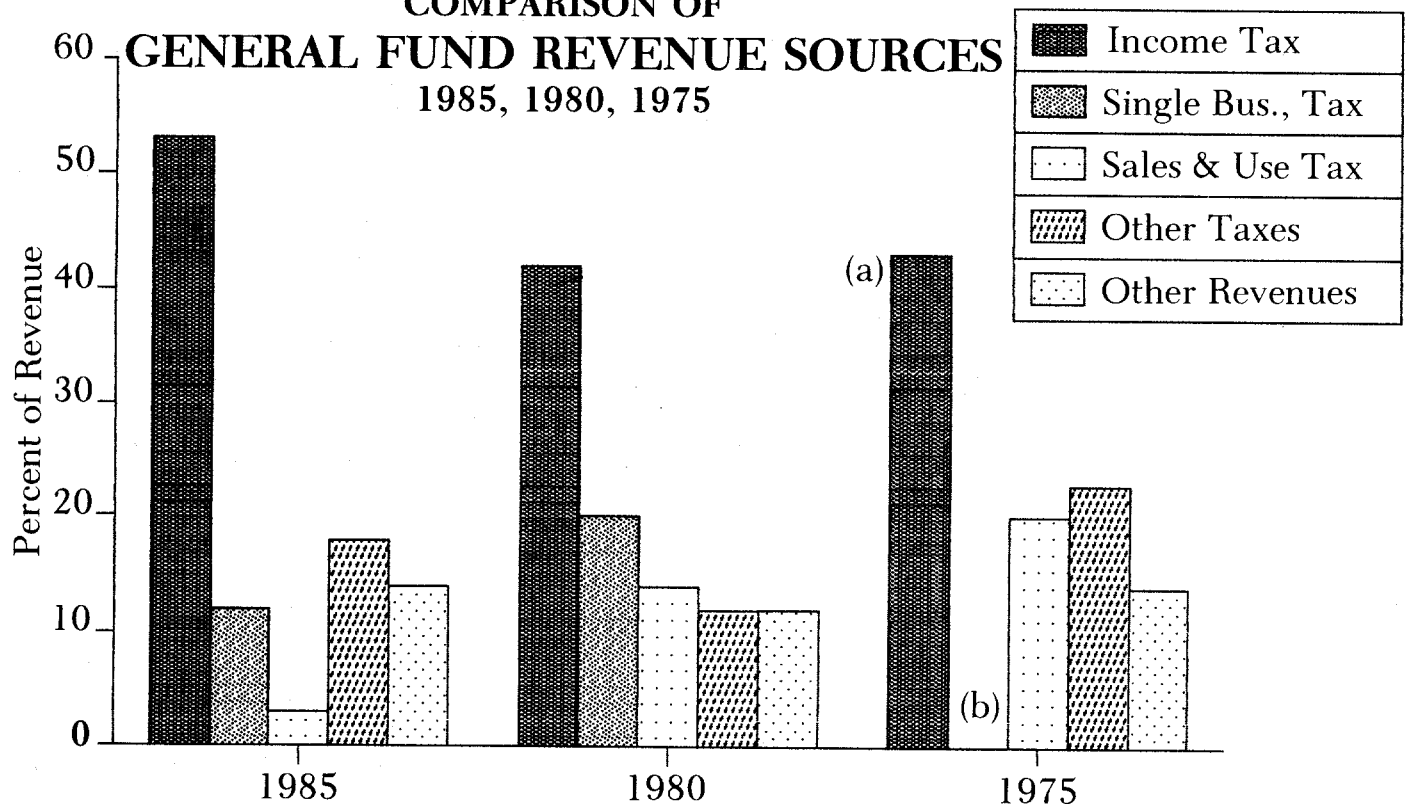


FIGURE 5

**COMPARISON OF
GENERAL FUND REVENUE SOURCES
1985, 1980, 1975**



(a) Net income tax receipts from all sources

(b) SBT did not exist; state levied corporate income tax

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Budget and Revenue Trends, Fiscal Years 1975-1985

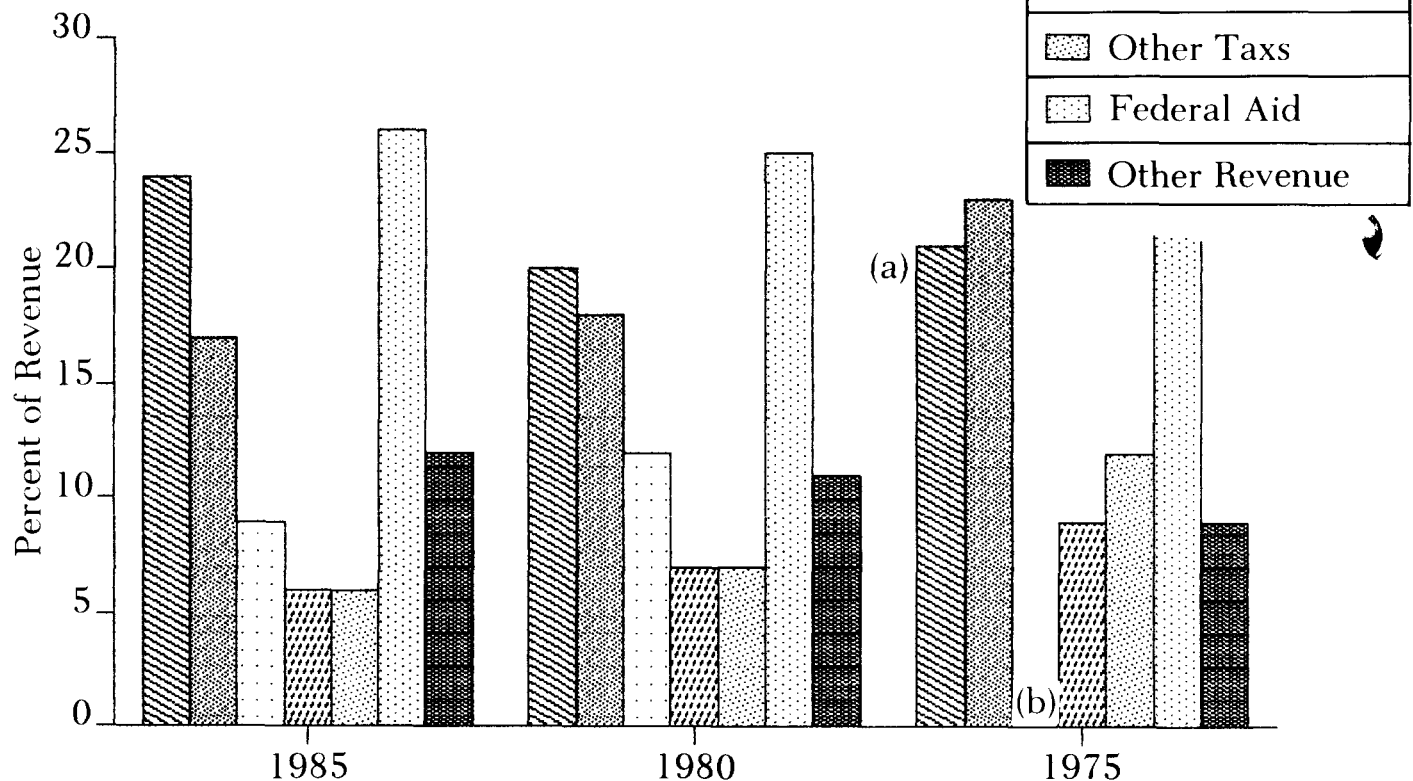
Figures 5 through 8 show how 1985 revenues and expenditures compare with those of 1980 and 1975. It is interesting to note that both 1980 and 1975 were recession years while 1985 is projected to be one of continued economic expansion.

Figure 5 displays an extraordinarily increasing dependence on the personal income tax. Ten years ago, the individual income tax provided only 34%

and the use tax during the ten-year period, while the revenue contribution from other taxes has been reduced almost one-half.

Figure 6 shows a similar trend, along with increased use of licenses and permits to generate revenue. (This is captured in the category "Other Revenue.") However, in stark contrast to recent rhetoric about the negative

FIGURE 6
COMPARISON OF
TOTAL STATE BUDGET REVENUES
1985, 1980, 1975



of Michigan's general fund revenue. By 1980, it provided 42%; by 1985, even after an early rollback, the individual income tax will provide 53% of the general fund revenue. During the same period of time, total business taxes increased only slightly, rising to 21.7% of GF-GP revenues from 20.6% in 1975. Tax credits and exemptions have reduced the relative importance of the sales tax

(a) Net income tax receipts from all sources
(b) SBT did not exist; state levied corporate income tax

impact of the "New Federalism" and the funding shifts from the federal to the state government, Figure 6 demonstrates that revenue from federal aid sources has remained virtually constant at 21% over the intervening ten years..

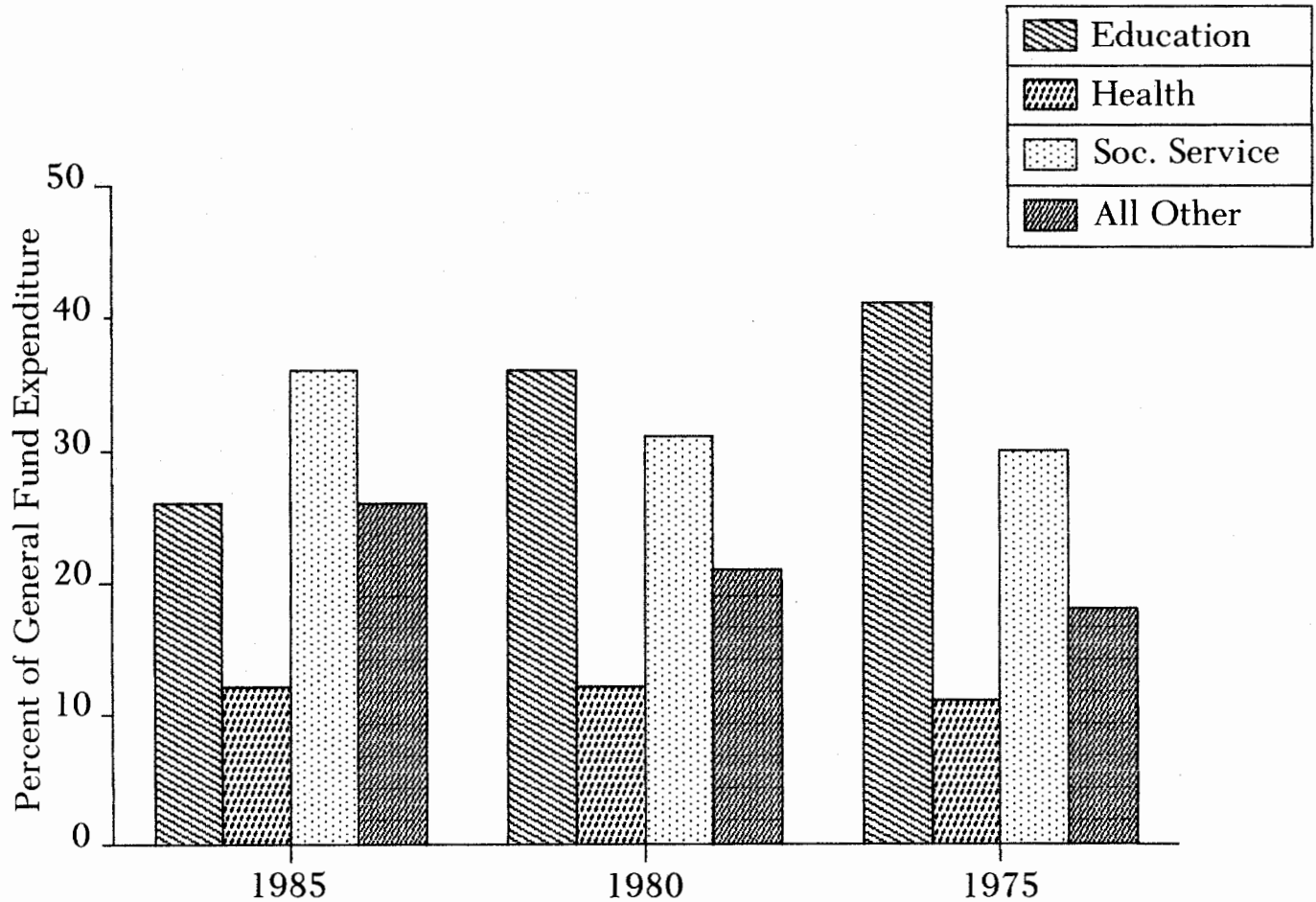
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FIGURE 7

COMPARISON OF GENERAL FUND EXPENDITURES

1985, 1980, 1975



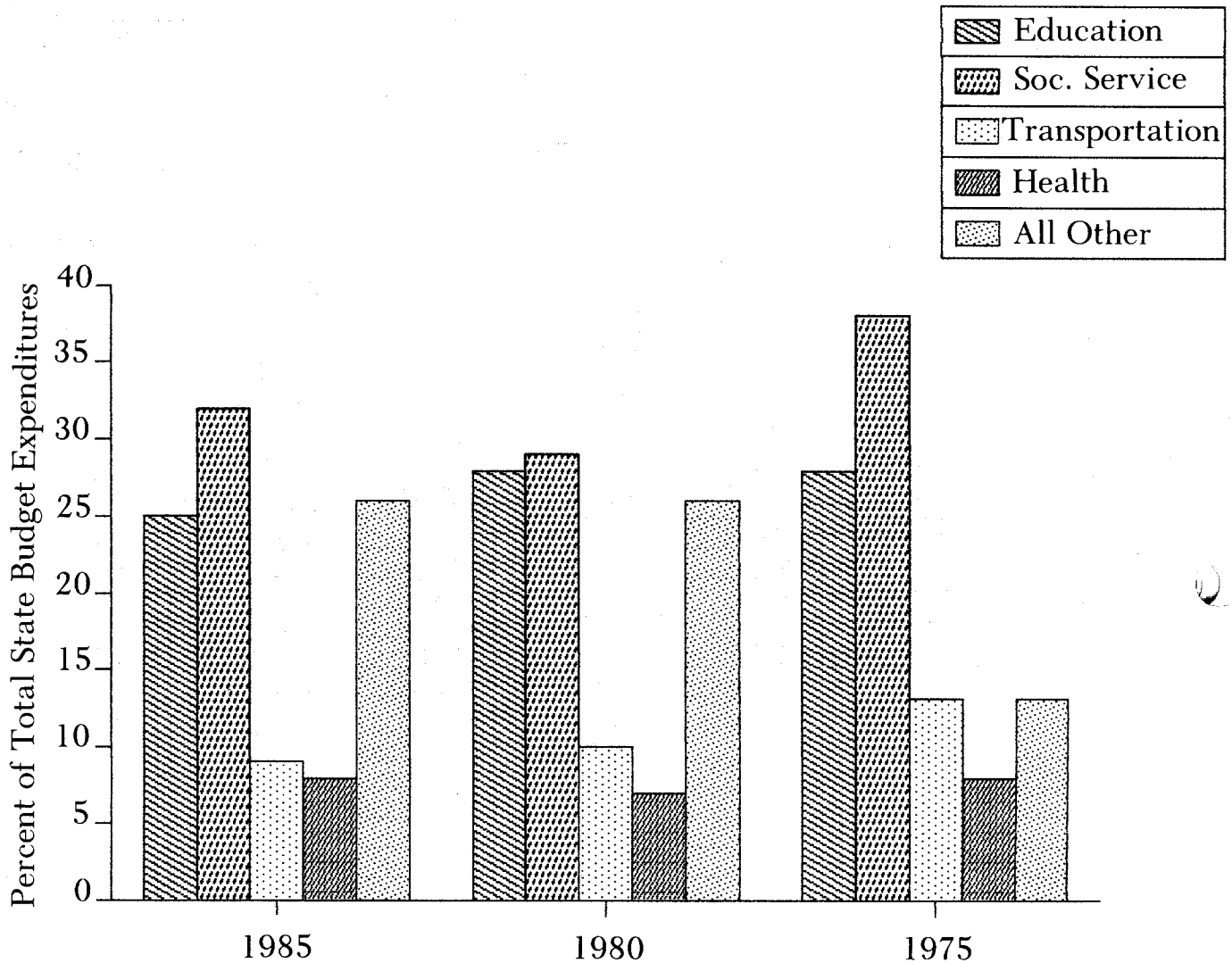
Figures 7 and 8 indicate the extent to which Michigan's funding priorities have shifted during the ten-year interval. Although state support for education has risen considerably over the past two years, Figure 7 shows that it remains proportionately far less a general fund budget priority than it did in 1975, a year of severe economic

recession in Michigan. GF-GP funding for health programs has remained a fairly constant proportion of the budget, even though galloping health care costs have seriously eroded the purchasing power of the health care dollar. GF-GP spending for human service entitlement programs rose modestly over the period.

FIGURE 8

COMPARISON OF TOTAL STATE BUDGET EXPENDITURES

1985, 1980, 1975



The largest shift occurred in funding for other programs such as debt service and environmental quality.

Figure 8 illustrates a similar set of trends, although total funding for

education programming did not decline as precipitously as did GF-GP funding. The total proportion of expenditures for nonspecified programming, however, doubled over the ten-year period.

Budget Assumptions

The economic underpinnings of the executive budget suggest that continued economic growth will increase yields of all taxes during 1985. Mandated and accelerated rollback of the temporary income tax increase will deprive Michigan government of much of the fiscal benefit of this growth. Consequently, total 1985 GF-GP revenues are projected to increase only \$55.5 million. Program improvements of \$172.7 million, along with the statutorily required transfer to the Budget Stabilization Fund will, even by executive calculations, create a 1985 general fund budget deficit of \$45.9 million.

The proposed fiscal year 1985 budget projects continued but slower economic growth. Total U.S. auto sales

would show an anemic improvement, rising to sales of 10.2 million units, up from an estimated volume of 10.0 million units in the current fiscal year. Employment would increase 3.7% to 3.39 million workers while unemployment would decline from a rate of 12.1% to 11.1%. Consumer prices would rise slightly, edging up 5.1% compared to an expected increase of 4.1% during fiscal year 1984. A growing economy would help prevent new layoffs in 1985 and would provide jobs for thousands of the unemployed. Easing demand for income maintenance programs would contribute to a 10% decline in average monthly welfare caseload levels. Increased employment and reduced welfare payments would cause personal income to rise by 9.2%. This would produce a 4.1% improvement in personal income after adjustment for inflation.



FAS Comment

As was the case with the 1984 budget recommendation, the economic assumptions on which the proposed executive budget are based are deliberately conservative. The economic overview presented in the 1984-85 fiscal year Budget Message of the Governor reflects a weaker economy and a lower rate of economic growth than we currently envision. (See our economic forecasts of October 1983 and February 1984.)

Contributions to the Budget Stabilization Fund coupled with the mandated and accelerated rollback of the income tax increase would deprive the general fund of \$806.4 million, leaving a 1985 general fund deficit of \$45.9 million based on the economic, revenue, and expenditure projections of the executive

budget. Despite our more favorable economic expectations for 1985, our January 31, 1984 newsletter placed 1984-85 GF-GP revenues at \$5,665 million. Our estimate does not anticipate early rollback of the income tax increase. This level of revenue would almost exactly balance the proposed expenditures of \$5,664.9 million. Moreover, we estimate the payment into the Budget Stabilization Fund will cost the state's general fund \$350 million, \$68.6 million more than projected by the executive budget. Consequently, without policy changes, the 1985 fiscal year budget will be \$68.7 million short of revenue to cover requested general fund expenditures.

As also noted in our January newsletter, welfare caseloads may decline more slowly than usual during the current period of economic recovery and

expansion. If caseloads fail to register the 10% decline outlined in the budget proposal, state spending on income maintenance programs would of necessity exceed the requested funding level. Alternatively, unusually low sales tax or lottery receipts would reduce school aid revenues, requiring the shortage to be made up from the state's general fund. Should either of these events occur, the state's ability to honor its commitment to increase funding for education, local spending, economic development, environmental protection, and health would be seriously undermined.

The administration has vowed not to disrupt funded programs with budget cuts or to use accounting subterfuges to acquire the requisite funds. In view of

these considerations and spending commitments, we believe that the framers of the 1985 budget will confront a series of politically difficult and fiscally challenging decisions. Protection of Michigan's credit rating, continued progress toward restoration of fiscal stability, economic development initiatives, and efforts to broaden employment opportunities will be challenged by forces that seek the alleviation of current tax burdens. However these conflicting demands are ultimately balanced could have far-reaching implications for the future, making the 1985 state budget Michigan's most important spending plan of the decade.



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