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The Executive Budget:

The 1982-83 general fund budget proposal recommends an expenditure level of $4.98 billion, an increase of $700 million over the estimated 1981-82 budget. The 16.4% increase is based on the following assumptions: (1) economic recovery will begin in April 1982; (2) the 10% phase 2 federal income tax cut will significantly stimulate Michigan business and industry; (3) lower interest rates will stimulate economic activity; (4) the state's economy will expand 12%; and (5) federal aid will increase 52% over anticipated 1982 levels.

Some significant recommendations by program area are:

(1) K-12 education: Provides a per pupil increase of 8.7% from combined state and local sources.
(2) Higher education: The 11.5% increase in this area is the largest in the budget and includes 5% for salary and 7% for other costs. Medicine, agriculture, and student financial aid are singled out for special consideration.
(3) Mental health: $352.5 million to improve staffing and services at state mental health facilities; $43.3 million for community mental health programs; and $32.7 million for community residential programs.
(4) Social services: $19.7 million to replace lost federal medicaid funds, and an easing of eligibility requirements.
(5) Corrections: $14 million for prison construction and $4.7 million for increased staffing.
(6) Public health: $7 million for increased cost sharing with local health departments; $2.1 million for maternal and child care projects; and $1 million for family planning.
(7) State police: $3.1 million for additional troopers and civilian staffing.
(8) State employees: A 5% general wage increase.

FAS Comment:

We do not concur with the revenue assumptions underlying the 1982-83 executive budget. The proposed budget projects revenue increases of $700 million; we project revenue increases of $400 million. Our 9.5% increase is predicated on the following assumptions: (1) An economic recovery that begins in July at a slower rate of increase than anticipated by the executive budget. (2) Consumer confidence and willingness to spend will increase slowly, notwithstanding the benefits of the federal tax cuts. (3) Interest rates will not moderate until late summer and will delay the turnaround. (4) Auto sales of 9.6 million units in fiscal 1982-83, 1.1 million lower than the proposed budget, combined with structural changes in the auto industry will increasingly net fewer tax dollars for Michigan's coffers. (5) Since federal funds to Michigan have declined in the previous two years, it is not likely that Michigan's share of the federal budget will be anywhere near as promising as projected.

Important considerations relevant to selected program area recommendations are:

(1) K-12 education: With rising SEV and the continued decline in pupil enrollment, we calculate the state share will be less than 2%.
(2) Mental health: This is the most vexing area of the 1982-83 budget. Federal fund cuts may sharply curtail current program activity below recommended levels in this area as well as public health and social services.
(3) Social Service: Increases in caseload, cost per case, and changes in case mix, as well as exhaustion of unemployment benefits are significantly stressing the welfare system. Estimated caseload decline for fiscal 1982-83 are more optimistic than warranted.

Perspective about Michigan's long term economic condition is easily lost in the midst of the discord and confusion surrounding immediate events. We believe it is important to state that, in our opinion, the end of this recession is near at hand: recovery will begin within 6 months; auto production will increase by 900,000 units in fiscal 1982-83; unemployment will decline significantly, as well as welfare case load. It is possible general fund revenues, which we project to increase in 1982-83 by $400 million, will further increase in 1983-84 by an additional $900 million.

Volume 1, number 1 of the Fiscal Awareness Service characterized this fiscal year as another year to forget. Unfortunately this has proven to be the case. The projected 8.5% revenue increase has not materialized and shows little sign of materializing in the next 6 months. To date, the budget has been reduced $647 million through executive orders, appropriation lapses, requested nonpayment of fourth quarter appropriations, and proposed revision of actuarial assumptions for state retirement. We project a revenue shortfall for fiscal 1981-82 of $633 million and welfare cost increases brought about by the recession of $221 million for a total budget shortfall of $854 million. We estimate an additional $200 million remains to be withheld or reduced from the budget. Withholding of summer K-12 school aid payments could be one mechanism to deal with this shortfall.

An unfortunate consequence of the requirement for income maintenance programs in this time of economic adversity is that the reduction of higher education funding has caused higher tuition and diminished student aid, forcing college students into a contracted labor market, thereby swelling the ranks of the unemployed. This has skewed state investment in human potential. As more dollars have gone into defensive social strategies, fewer dollars have been available to create a skilled labor force, which in turn prevents the development of the very resources needed to achieve economic renewal.

High interest rates more than any other single factor have caused the current recession. We expect interest rates to decline in late summer just prior to the fall elections. The impact will not become apparent in the upturn of state revenues until the end of the first quarter of fiscal 1982-83. With approximately $425 million of payment reinstatement required for colleges, universities, cities, et. al., the remaining $200 million problem from fiscal 1981-82, and the $300 million of recommended over-appropriations, new income and nuisance taxes will be required in the fall to maintain the current diminished level of state programs. The longer these taxes are delayed, the higher the rate of taxation will have to be. Cowardice in the face of this requirement will inevitably lead in fiscal 1982-83 to the closing of colleges, universities, parks, hospitals, mental health institutions and other facilities, and the curtailment of services for the elderly, sick, poor, and disadvantaged.

Social Service Income Maintenance Programs:

Welfare caseload has increased in the past 15 months. The increase is largely attributable to intact families receiving AFDC benefits. Single parent households increased only 2% in fiscal 1980-81 and have since declined. Two-parent families have increased 65.5% for the same period. While they currently comprise 22% of AFDC caseload compared with 10% in October 1981, they receive $91.30 more per month per case than an average single parent household.

Generally, these newly eligible families are usually headed by an unemployed primary wage earner whose unemployment benefits have been exhausted. While there is usually a 6-month lag between unemployment and eligibility for social service benefits, the lag is frequently longer for unemployed auto workers because they generally have assets they must dispose of in order to qualify. There is evidence to suggest the existence of an impending but unanticipated increase in welfare recipients in this category due to the layoffs of last summer and fall. Privately, some quarters are extremely apprehensive about this potentiality.

The Cash Deficit Issue:

The July 29, 1981 Citizens Research Council comment (number 924) discussed the deterioration of Michigan's cash position. They pointed out cash outlays exceeded cash receipts by $600 million.

There is a clear-cut interrelationship between general funds, restricted funds, special revenue funds, and trust and agency fund accounts. Appropriately, the state has transferred and borrowed funds to meet required obligations.

Recessions exacerbate cash flow problems for governmental units. Because of lags in collection of tax revenues, program funds are released at appropriated levels which may exceed actual revenues, incurring a deficit before corrective action can be taken.

Declining tax receipts and increased spending for human service programs during 1981-82 compounded existing cash flow problems. The state has been required to reduce spending and resort to revisions of accounting practices, payment delays, borrowing from other restricted funds, and sale of short-term notes to compensate for cash shortages due to the need for timely payments to local units.

At the end of fiscal year 1971 the cash deficit was $67 million; following the 1976 recession it was $215 million. By September 14, 1981 the cash deficit was estimated at $1.058 billion.

January 1982 started with a cash deficit of $507.9 million. It is expected the state will finish fiscal year 1982 with a cash deficit of about $1.2 billion.

Two consecutive state cash deficits of $1 billion plus have made the bond market skittish. The proposed delay in fourth quarter payments to local units and colleges and universities heightens this concern. We are concerned about the potential difficulty of marketing our $500 million loan renewal. New York bond traders and analysts have criticized the state for creative accounting. Wall Street may further downgrade Michigan's bond rating, effectively raising bond prices to compensate for the perceived greater risk. This would have negative ramifications for local units, school districts, drainage districts, and other entities whose credit is backed by the state.

Unemployment:

Michigan's unemployment rate has been higher than the national rate in each year since 1967. Michigan's unemployment rate averaged 4 percentage points higher than the national rate in 1975, 5.5 percentage points in 1980, and 4.9 percentage points in 1981.

Employment rates in Michigan have improved more slowly than the national average as our eonomy has recovered. Michigan's industrial base is heavily dependent on automobile manufacturing and related industries. Of manufacturing jobs lost in this recession, those related to the auto industry accounted for 44%.

Our non-diversified industrial base possesses few countercyclical industrial components. The gross state product is concentrated in the consumer durable sector, hence we are the first to suffer as retrenchment occurs and the last to benefit as recovery begins.

Auto Sales:

Prince Metternich observed in the nineteenth century that when Russia sneezed, Europe caught cold. Michigan's fortunes are so closely tied to the automobile industry that auto industry decline creates havoc in the orderly process of Michigan's financial affairs.

Domestic auto sales for 1981 were 6.2 million units, down 5.9% from 1980 sales. Domestic and foreign sales for 1981 were 8.5 million units, down 4.5% from 1980 levels.

In mid-November, auto makers still expected to achieve sales of 8.7 million units, and projected 1982 sales at 10.5 million units. General Motors currently anticipates industry-wide 1982 auto sales of 9.6 million units. Chrysler remains the least optimistic of all the manufacturers, and has revised its estimate of sales to 9.3 million units for calendar 1982. The executive budget projects calendar year sales of 10 million units, while we project sales of 9.1 to 9.2 million units.

Initial data on auto sales belie these estimates. January sales slipped 10.3% below depressed year-earlier sales, and production was slashed to its lowest level since 1961. February statistics have been equally dismal. U.S. auto makers had a 97-day backlog of unsold cars on hand February 1, the largest stockpile ever for a February. However, the annual sales rate for the first 10 days of February was 6.3 million units, up slightly from the 6.2 million rate in January, as new rounds of rebates were offered to tempt recession-shy buyers back into the showrooms.

Economic conditions and five-digit automobile prices continue to depress sales. Japanese producers continue to have a price and quality advantage. It is unlikely auto sales will approximate the 9% to 13% growth rate the industry projects for 1982. We believe a 7% growth rate (600,000 units) over 1981, yielding total sales of 9.1 to 9.2 million units is more realistic. On a fiscal year basis, this will provide auto sales of about 8.7 million units. About 6.5 million will be domestically produced. We project Michigan's share of this production at 2.0 million units. State officials anticipate 1983 sales of 10.8 million units, an 8% increase over their expected 1982 sales figures. We anticipate total automobile sales to reach 9.6 million in 1983, up from 9.1 in 1982.

As the automobile industry recovers from this decline, the relief afforded Michigan will be much less. Factors such as permanent reduction of the base for car sales, automation, changes in consumer tastes, importation of components formerly manufactured in our state, the export of jobs to more favorable locales, and increasing standardization of cars the world over have converged to force a major restructuring of the auto industry and its profitability.

Robert Dederick, Assistant Secretary for Economic Affairs in the U.S. Department of Commerce, has predicted a permanent loss nationwide of 200,000 direct auto industry jobs and 350,000 jobs in auto-related industries. A disproportionate number of these jobs are in Michigan. Economic renewal will require the replacement of these lost jobs by industrial and commercial diversification.