Gerald Faverman, Ph.D. • *Chairman of the Board*
Robert J. Kleine • *Editor*
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Public Sector Reports

PUBLIC POLICY ADVISOR

Overview of Michigan Budget Appropriations Fiscal Year 1988-89

Governor James Blanchard has recommended a very constrained budget for fiscal year 1988-89, which will begin on October 1, 1988. The general fund/general purpose (GF/GP) recommendation is $6,628.4 million, an increase over the current fiscal year of $16.9 million, or 0.3 percent. This paper outlines the governor's major recommendations and the economic and revenue assumptions on which he based his budget, compares recommended FY 1988-89 spending with current year expenditures, and comments on the overall political and economic practicality of the proposed budget. We believe certain aspects of the budget will face strong contention in the legislature, and the possibility exists of significant budget shortfalls.

The governor recommends reductions for twelve departments, the legislature, the judiciary, and debt service. The only departments recommended for substantial increases are Commerce, Civil Service, Mental Health, and Education, but like most departments, they also received reductions in a number of program areas. (The increase for Commerce is due to a transfer of funds from another department.) A large increase is also recommended for capital outlay; the appropriation is abnormally low in the current fiscal year.

The governor's recommended GF/GP appropriation for school aid is $568.8 million, a decline of 15.9 percent. (The FY 1987-88 appropriation was unusually large due to a shortfall in lottery revenue.) When funds dedicated to education are included, such as sales tax and lottery revenues, total school aid is $2,692 million, a decline of 0.5 percent. If retirement expenditures, which declined about $34 million due to a revaluation of pension funds, are excluded, however, the school aid increase is 0.9 percent.

There are several new initiatives in this budget, as will be discussed, but very few existing programs receive much new money, and many are reduced or eliminated. In dollar terms, the majority of the new money in the budget (GF/GP and the school aid fund) goes for capital outlay, health, and education. (See Exhibit 1.)

Total state spending for FY 1988-89 is recommended at $15,579.4 million, a one percent increase above the estimated spending level for FY 1987-88. Federal aid is projected to decline $163 million, or 4.3 percent, the first such decline in recent memory. The decrease is almost entirely in social services. Exhibit 2 summarizes the GF/GP budgets for FY 1986-87, FY 1987-88, and FY 1988-89. The discussion in this paper focuses primarily on GF/GP expenditures.[1]

ECONOMIC AND REVENUE ASSUMPTIONS

A budget is only as good as the economic assumptions on which it is based. In FY 1986-87, the administration's economic forecast was quite accurate. Personal income was somewhat underestimated; it increased slightly faster than forecast (3.6 percent compared to an estimate of 3.2 percent). As a result of small errors in the economic forecast and an $85 million overestimate of lottery revenue, GF/GP and school aid fund revenue fell about $28 million short of the budget estimate made in January 1987. The shortfall would have been much greater had the state not picked up about $90 million in additional income tax revenue as a result of federal income tax reform. A significant portion of this amount was a one-time gain because taxpayers took capital gains in late 1986 to avoid higher rates in future years.

The FY 1988-89 budget assumes, like most national forecasts, that the national economy will continue to grow at a moderate pace. It projects that real gross national product (GNP) will increase 2.7 percent, the same rate as was estimated for FY 1987-88. (GNP increased 2.5 percent in FY 1986-87.) The budget estimates that total U.S. passenger car sales will be 10.4 million units, up 3.2 percent from the FY 1987-88 estimate, but about 2 percent below the FY 1986-87 level.

[1]In the current fiscal year (1987-88), GF/GP appropriations exceed estimated revenues by $82 million. However, the budget is expected to be balanced at year end because of an expected $53 million in expenditure lapses; $26.5 million from the State Building Authority bonding payback of money advanced from the general fund; and a surplus of $12.5 million carried over from FY 1986-87. For FY 1988-89, estimated revenues exceed recommended expenditures by $23 million. When the carryover of $10 million from FY 1987-88 is added, the surplus is estimated at $33 million by the end of FY 1988-89.

Public Sector Consultants, Inc.
Knapp's Centre • 300 S. Washington Square
Suite 401 • Lansing, MI 48933 • (517) 484-4954

EXHIBIT 1

General Fund/General Purpose and School Aid Fund Budget Changes, FY 1988-89

Program Category	Dollar Change (millions)	Percent of Total Increase
Education[a]	$36.5	25.0%
Social Services	3.7	2.5
Health	32.0	21.9
Law Enforcement (Corrections, State Police, Judiciary, Attorney General)	17.2	11.8
Regulatory (Commerce, Labor, Licensing and Regulation)	24.0	16.4
Environmental Protection (Natural Resources and Agriculture)	-14.2	-9.7
General Government[b]	-11.7	-8.0
Capital Outlay and Debt Service[b]	58.7	40.2
TOTAL	$146.2	100.0%

[a]Excludes Public School Employees Retirement System.
[b]Adjusted for transfer of State Building Authority rent from Department of Management and Budget (DMB) to capital outlay. The FY 1987-88 DMB budget included $60.6 million for rent. This amount was transferred to the capital outlay budget, and an additional $31.8 million for rent was recommended.

The administration expects the Michigan economy to be slightly weaker than the national economy due to the slow growth in auto sales and the General Motors plant closings. Michigan motor vehicle production is projected to increase 3.3 percent in FY 1988-89 after declining an estimated 8.7 percent in the current fiscal year. Michigan wage and salary employment is projected to rise less than one percent in both the current fiscal year and FY 1988-89. Real Michigan personal income was projected to increase only 0.2 percent in FY 1987-88 and is estimated to increase 0.5 percent in FY 1988-89, down from a 1.3 percent increase in FY 1986-87. (See Exhibit 3 for a summary of the administration's economic forecasts.)

Three key assumptions underlie the Blanchard administration's economic forecast.

- The dollar will decline to about 12 percent below its current value, resulting in a significant improvement in the U.S. trade deficit.
- The Gramm-Rudman-Hollings federal budget spending reduction targets will not be met in either the current or the next fiscal year, and the federal deficit will exceed $160 billion in both years.
- There will be modest increases in inflation and interest rates in 1989.

The Blanchard administration is estimating GF/GP revenue at $6,651 million in FY 1988-89, an increase of 1.9 percent; adjusted for noneconomic factors, such as one-time revenue gains, the increase is 3.5 percent. The following four revenue adjustments were included in the 1987-88 budget; if realized, they also will affect the FY 1988-89 budget.

- $49 million is owed to the state by Wayne County.
- $29 million is being held in escrow for the insurance premiums tax pending a final court ruling on the legality of the tax.
- $53 million in revenue will result from federal tax reform (an additional $47 million was credited to FY 1986-87).
- $40 million in single business tax revenue will be generated from a new tax on insurance companies.

The FY 1988-89 one-time revenue adjustments include $20 million resulting from efficiencies in liquor warehouse operations (which would increase the transfer to the Liquor Purchase Revolving Fund) and $7 million resulting from federal tax reform. In future years, revenue gains from federal tax reform will be offset by the increase in the state income tax personal exemption from $1,500 to $1,600 for the 1987 tax year, $1,800 in 1988, $2,000 in 1989, and $2,100 in 1990.

REVENUE SOURCES AND EXPENDITURE ALLOCATIONS

Exhibits 4 and 5 illustrate the funding sources and allocations of the recommended 1988-89 budget. Exhibit 4 shows the origin of state own-source revenue (which excludes federal aid and local and private revenue sources). This is the most meaningful way to

EXHIBIT 2

General Fund-General Purpose Budget Summary, Fiscal Years 1986-87, 1987-88, and 1988-89 (millions of dollars)

Department or Program	FY 1986-87 Expenditures	Projected FY 1987-88 Spending	FY 1988-89 Executive Recommendation	Dollar Change from FY 1987-88	Percentage Change from FY 1987-88
Human Services					
Social Services	$2,058.7	$2,081.6	$2,085.3	$3.7	0.2%
Mental Health	754.9	759.9	800.8	40.9	5.4
Public Health	132.2	139.2	130.2	-9.0	-6.5
Education					
State Universities	1,041.7	1,106.6	1,117.5	10.9	1.0
—Operations	967.5	1,023.4	1,033.5	10.1	1.0
—Financial Aid	74.2	83.2	84.0	0.8	1.0
School Aid	576.3	676.5	568.8	-107.7	-15.9
Community Colleges	186.7	196.6	198.6	2.0	1.0
Education	40.2	37.9	39.8	1.9	5.0
Library of Michigan	20.7	22.9	22.9	0.0	0.0
Safety and Defense					
Corrections	472.8	557.1	576.5	19.4	3.5
State Police	159.7	160.4	157.5	-2.9	-1.8
Military Affairs	12.1	12.4	11.4	-1.0	-7.7
Regulatory					
Commerce	96.0	99.6	125.2	25.6	25.7
Labor	86.0	79.7	79.2	-0.5	-0.6
Licensing and Regulation	13.9	14.0	12.9	-1.1	-7.9
Natural Resources and Recreation					
Natural Resources	116.4	119.9	106.8	-13.1	-10.9
Agriculture	27.0	29.3	28.2	-1.1	-3.8
General Government					
Management and Budget	151.4	148.3	86.8	-61.5	-41.5
Legislature	66.4	75.7	75.3	-0.4	-0.5
Judiciary	92.7	99.9	100.8	0.9	0.9
Treasury	60.4	56.3	52.2	-4.1	-7.3
Attorney General	20.6	22.7	22.5	-0.2	-0.9
State	15.1	15.2	9.0	-6.2	-40.8
Civil Service	11.0	11.8	13.5	1.7	14.4
Civil Rights	10.3	11.2	10.4	-0.8	-7.1
Executive Office	3.6	4.0	4.0	0.0	0.0
Other					
Capital Outlay	156.1	40.4	163.5	123.1	304.7
Debt Service	43.0	32.3	28.5	-3.8	-11.8
TOTAL	$6,425.9	$6,611.5	$6,628.4	$16.9	0.3%

look at the state budget because it includes revenue earmarked for the school aid fund, transportation, and revenue sharing but excludes federal aid, which is largely outside the influence of the governor and the legislature.

Exhibit 4 also shows that about 71 percent of state revenue is generated by just four of the state's taxes—individual income, single business, sales, and use. (Federal aid is the state's largest revenue source—an estimated $3.66 billion in FY 1988-89.)

Exhibit 5 illustrates the governor's recommended distribution of state own-source revenues among major state program areas for FY 1988-89. Education, social services, transportation, health, and revenue sharing with local units together use 80 cents of every budget dollar.

EXHIBIT 3

Economic Assumptions, FY 1988-89 Budget

	FY 1986-87 (actual)	FY 1987-88 (estimate)	FY 1988-89 (estimate)
United States			
GNP (% change)	2.5%	2.7%	2.7%
Passenger car sales (millions of units)	10.6	10.0	10.4
Import share	30.5%	31.4%	30.1%
Federal Budget Deficit (billions)	-$158.6	-$167.1	-$160.9
Michigan			
Motor vehicle production (millions of units)	3.5	3.2	3.3
Wages and salary employment (% change)	1.3%	0.5%	0.9%
Unemployment rate	8.3%	8.8%	9.3%
Real personal income in 1967 dollars (% change)	1.3%	0.2%	0.5%
Detroit CPI (1967 = 100) (% change)	2.3%	3.3%	4.3%

EXHIBIT 4

FY 1988-89 Budget Funding: From State Sources

$15,605.6
(millions)

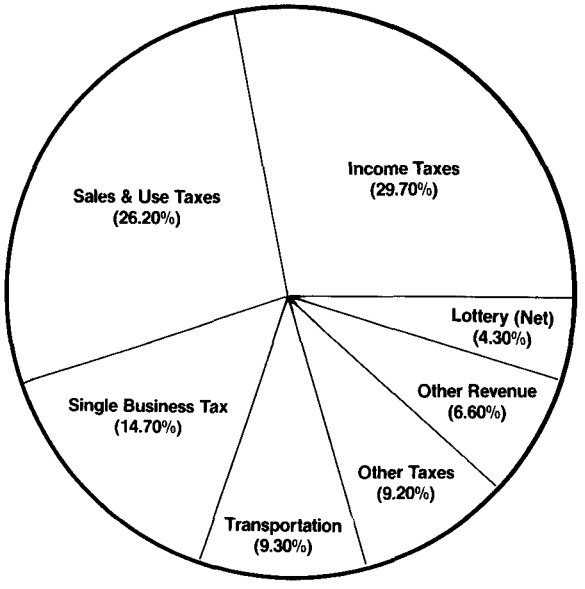
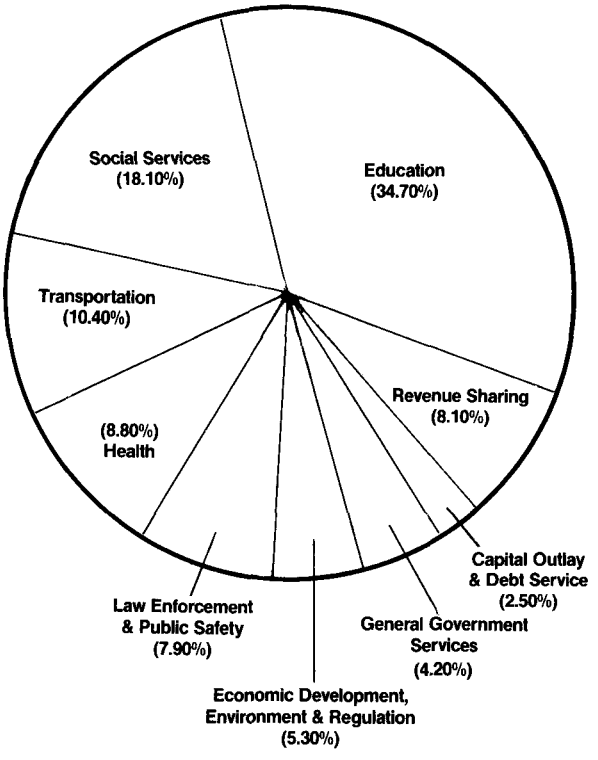


EXHIBIT 5

FY 1988-89 Budget Allocations: From State Revenue Sources

$15,579.4
(millions)



FY 1988-89 SPENDING POLICIES

Social Services and Health

As has been the case in recent years, the budget recommends a very small increase for the **Department of Social Services**. The GF/GP recommendation is $2,085.3 million, only 0.2 percent above the estimated spending level for FY 1987-88. (The percentage increase would have been higher if not for a supplemental appropriation of $90 million, which was added to the FY 1987-88 figure to cover cost overruns.) The new budget includes an unusually large number of cost-saving recommendations for some programs to finance unavoidable increases caused by reduced federal funds. In medical services, for example, the budget proposes $52.9 million in Medicaid cost-containment measures and transfers $7.1 million in nursing home funding to the Department of Mental Health. These various savings measures are necessary to offset several large increases: $58.7 million to cover higher than expected Medicaid spending in the current fiscal year and $27.2 million to offset reduced federal Medicaid matching funds in FY 1988-89. In the public assistance program, the budget assumes savings of

- $12.8 million from a general assistance (GA) caseload decline of 5,000;
- $17.9 million due to 7,100 fewer GA cases as a result of the neighborhood job corps; and
- $11.5 million in savings in the energy assistance program.

These and other smaller savings will be offset by several substantial increases: $21.4 million to cover reduced federal matching funds for aid to families with dependent children (AFDC); $14.4 million for a GA caseload increase of 2,750; and $13.6 million for inflation and increased participation in the energy program.

Other major decreases in the Department of Social Services budget are $12 million due to a reduction of 554 employees and a $7.1 million transfer of Project Self-Reliance funds to the Department of Commerce. Other major increases are $39.3 million for a change in funding sources for several programs and $13.2 million for growing caseloads in foster care, adult home help, adoption subsidy, and day care programs.

The recommended GF/GP appropriation for the **Department of Mental Health** is $800.8 million, 5.4 percent above projected spending for FY 1987-88. This is the largest increase for any department (after adjustment for transferring programs between departments). The recommended budget includes an additional $21.6 million for community residential services, $26 million for community mental health programs, $9.8 million for state facilities for mentally ill children, and $8.7 million for economic increases.[2] The budget for the department also contains $17.5 million in reductions, including the elimination of 176 positions at state facilities for the developmentally disabled that saves $3.9 million.

The recommended GF/GP appropriation for the **Department of Public Health** is $130.2 million, $9.1 million below the FY 1987-88 appropriation. Total spending recommended for the department is up $10.5 million, due mainly to more federal aid. The large GF/GP reduction results primarily from

- the replacement of $4.7 million in GF/GP funds with fee increases, federal funds, and a transfer from the Michigan Health Initiative Fund;
- employment reduction savings and efficiencies (program cost savings) totaling $2.5 million; and
- a $3 million reduction in state-local cost-sharing.

The department budget includes an increase of $4.5 million for AIDS prevention and control and $1.1 million for the health promotion program, both funded from the Michigan Health Initiative Fund. The budget also includes an additional $0.4 million in GF/GP money for prenatal care for low-income women and $11.7 million from one cent of a four-cent increase in the cigarette tax (restricted revenues) that will be allocated to 48 local health departments for health promotion programs.

Education

The GF/GP recommendation for **school aid** is $568.8 million, $107.7 million below projected spending for FY 1987-88. Total school aid, including restricted revenue (sales tax and lottery, for example), is recommended at $2.692 billion; expenditures per pupil (excluding retirement) will increase 1.4 percent. The basic membership formula recommends a gross allocation per pupil of $350 plus $77.40 per mill. (The current year formula is $350 plus $75.10 per mill.) A major change proposed in the formula is that adult education enrollments no longer be included; instead, the governor has recommended a $200 million adult education categorical appropriation. Adult education students generated an estimated $230-240 million in membership aid payments to school districts in FY 1987-88. This will have a major effect on school districts that use the money they receive for adult education to fund other programs.

The budget recommends increased funding for only three items: preschool education ($14 million), special education ($1.6 million), and social security ($11.2 million). The budget also includes $5 million as a contingency fund for school district millage increases.

[2]Economic increases include inflation increases for compensation and other costs.

The governor also has recommended a $250-million quality assurance fund to be financed by closing "tax loopholes." These monies would be used to expand the preschool program and provide teacher in-service training as well as reward schools that reduce dropout rates, improve the performance of "at-risk" students, and meet state standards for excellence. Until the necessary tax legislation is passed, however, the spending proposals will remain outside the budget.

After receiving generous increases in the previous five Blanchard budgets and most Milliken budgets, higher education is being asked to tighten its belt—though not as much as most departments. The FY 1988-89 GF/GP recommendation for **four-year universities'** operations is $1,033.5 million, only one percent higher than the current fiscal year appropriation. (The increase in operating funds for individual universities average 1.5 percent.) This is the smallest increase in recent memory. The governor recommends that the entire $10.2 million increase over the FY 1987-88 appropriation plus $5.6 million of reallocated one-time appropriations be used to establish a tuition assistance fund at each institution to increase the amount of financial aid available to needy students.

The budget restores $16 million for maintenance (included in the capital outlay budget) that was cut for FY 1987-88. It is also recommended that the administration of the $26 million Research Excellence Fund be transferred to the Department of Commerce.

State **financial aid**, which increased 73.5 percent from FY 1982-83 to FY 1987-88, will receive a one percent increase.

The budget recommends a one percent increase for **community college** operations, to a level of $198.6 million. Included is a recommendation for restoring $2.8 million for maintenance that was cut for FY 1987-88. The governor recommends that one percent of the state aid for each institution be contingent on each college adopting, by July 1, 1989, a plan that will guarantee to employers that graduates have necessary job skills.

Safety and Defense

The **Department of Corrections** is recommended for one of the larger increases, but still well below those of recent years. The proposed GF/GP appropriation is $576.5 million, 3.5 percent above the projected spending level for the current fiscal year. The budget includes $46.4 million in program and economic increases and $28.7 million in program reductions and efficiencies. The majority of the new money is needed to operate new facilities. In the last three years, eleven prisons have opened; a total of twenty with an additional 12,243 cells will have been built by the end of 1990. The FY 1988-89 budget includes funds for an additional 677 prison guards.

The **Department of State Police** GF/GP appropriation is recommended at $157.5 million, 1.8 percent below the projected figure for the current fiscal year. The only major GF/GP increase is $0.9 million for a new computer. Restricted funding of $6 million has been added for troopers to enforce the 65-mile-per-hour speed limit. The budget includes about $3.8 million in program reductions and efficiencies.

Natural Resources and Recreation

The recommended appropriation for the **Department of Natural Resources** is $106.8 million, about 11 percent below projected spending for FY 1987-88. This sharp decline is due to funding transfers rather than program reductions. First, spending will fall $5.3 million because of a reduction in federal "superfund" cleanup monies, reducing the GF/GP match needed. Second, the budget carries forward $4.9 million in unexpended funds for the cleanup program, which also reduces GF/GP requirements. Third, $2.8 million in GF/GP funds for the state parks program will be replaced by revenue from the State Park Improvement Fund and from a $10 increase in the annual motor vehicle permit fee. The budget recommendation includes about $5.7 million in new money, which is mainly for property taxes on land purchased by the department, Great Lakes cleanup grants, wetlands program enhancements, and economic increases.

The recommended GF/GP appropriation for the **Department of Agriculture** is $28.2 million, $1.1 million below projected spending for FY 1987-88. The decrease is due to discretionary reductions in operations and grants of $1.4 million and a cut of $.25 million in clean water incentive grants. The only new money in the budget is about $0.4 million for economic increases.

Regulatory

The FY 1988-89 GF/GP appropriation for the **Department of Labor** is recommended at $79.2 million, $0.5 million below projected spending for the current fiscal year. Included is an increase of $6.2 million, of which $5 million is allocated to the Michigan Youth Corps, reflecting restoration of funding to the amount recommended in FY 1987-88. The reductions total about $5 million, including $2.2 million from replacing state funding with restricted revenue, $1.2 million from a reduction in the weatherization program, and $0.5 million from eliminating the Workers' Compensation Appeals Board. The department also will lose $12 million in federal aid.

The recommended FY 1988-89 appropriation for the **Department of Commerce** is $125.3 million, $25.7 million above projected expenditures for FY 1987-88.

This large increase is due mainly to the transfer of $25.1 million from the Department of Social Services for support of the Neighborhood Corps program. About $11 million in new money will be allocated to the Michigan Neighborhood Corps or to other programs to revitalize city neighborhoods. The Neighborhood Corps will put economically disadvantaged young people to work rebuilding city neighborhoods. The budget includes $3 million to help local governments with economic development advertising and $2.9 million to help Michigan win the competition as the site for the superconducting supercollider. Also recommended are reductions of $19.3 million, including $6.6 million from the Michigan Equity Program, $5 million from the administration of the Research Excellence Fund, $3 million in deferral of funds for the Chrysler Jefferson/ Oak Tech project, and $2 million from community development grants.

General Government

This category includes seven departments, plus the judiciary, the executive office, and the legislature. The recommended appropriation is $374.5 million, 15.9 percent below projected spending for FY 1987-88. This large drop is due mainly to a 41.5 percent reduction in the recommendation for the **Department of Management and Budget** (DMB), resulting from the transfer of $60.4 million in State Building Authority rental payments to the capital outlay budget. Other reductions in the DMB budget are $5.2 million due to a technical adjustment in accounting for state agency rental charges, and $5.5 million in program and grant eliminations and other efficiencies. The budget includes $10.5 million in new money; the major increases are recommended for

- maintenance staff for the new state library/museum complex ($1.8 million);
- the Michigan Human Investment program ($1.5 million);
- community and nutrition services for the aged ($1.5 million);
- math and science challenge grants ($1.5 million); and
- reimbursement to counties for prosecuting crimes committed by inmates in state prisons ($0.9 million).

The FY 1988-89 budget includes an appropriation of about $9 million for the **Secretary of State**, $6.2 million below projected FY 1987-88 spending. This sharp decline results from replacing GF/GP money with $6.9 million from a $2 increase in commercial look-up fees (fees charged insurance companies and others for driver records). The budget includes $1.6 million for rent assessed to pay off the bonds on the new state museum complex.

The $52.2 million recommendation for the **Department of Treasury** is 7.3 percent below the estimated spending level in the current fiscal year. This decline is due largely to deferring $3.7 million in restoration payments to the Veterans' Trust Fund and a discretionary reduction of $1 million.

The recommended budget for the **Judiciary** is up by less than one percent from projected spending in the current year. However, the budget includes an additional $4 million for judicial salary increases and six new judges on the court of appeals. This is financed largely by a $3.9 million shift in funding for trial court operations.

Other

The **Department of Transportation** is funded by restricted revenues, mainly gas and weight taxes and federal revenue. The budget recommends spending of $1,508.6 million, 3.4 percent above the projected level for FY 1987-88. A major new initiative is a $53 million Economic Development Fund that sets aside monies for transportation projects to enhance Michigan's economic development. These monies will be shared by state, local, and county governments and will be used to upgrade roads, highways, and rail facilities to improve the ability of Michigan and local communities to expand the state's economic base.

The recommended **capital outlay** appropriation of $163.5 million is $123.1 million above the FY 1987-88 appropriation. This large increase is misleading, however, because $60.4 million in State Building Authority rental payments is to be transferred from the Department of Management and Budget. The budget contains an additional $32.2 million for Building Authority rent. The capital outlay budget also includes $25.4 million from the Budget Stabilization Fund for corrections projects. There is little money in the budget for new construction, other than for the Department of Corrections. The capital outlay budget includes $36 million for four-year schools; $20 million for special maintenance, remodeling, and planning; and $16 million to continue or complete construction on previously authorized projects. For community colleges there is $2.8 million for special maintenance and $3.8 million for ongoing construction projects.

For the third consecutive year, **debt service** requirements will be lower than in the previous year. The budget allocates $28.5 million for this purpose, $3.8 million less than in FY 1987-88. The major reduction is $3.7 million for water pollution control bond interest and redemption requirements.

No transfer of funds to the **Budget Stabilization Fund** (BSF) will be required in FY 1987-88 or FY 1988-89. Based on our economic forecast, it appears that from $80 million to $100 million could be transferred from the BSF to the general fund in FY 1987-88 or

FY 1988-89.[3] The language in the law is ambiguous as to the year in which the transfer may be made, but the Senate Fiscal Agency is estimating that $82.9 million could be transferred to the general fund in FY 1987-88. Given the confusing language in the law, the legislature probably could make the transfer in either fiscal year without fear of legal challenge. The BSF law also allows money to be transferred from the fund when the unemployment rate averages more than 8 percent for a quarter, which it is likely to do for the next few quarters. The balance in the BSF at the end of FY 1987-88 is expected to be $371 million.

As a result of the recent passage of the Wayne County financial package, the budget includes new monies for **local government**. The legislation increased the cigarette tax by four cents, extended sales and use taxes to computer software, and imposed a 30 percent excise tax on airport parking in Wayne County. The cigarette tax money will be allocated to county health departments and to a health and safety fund, where proceeds will be used in the current fiscal year to

- pay outstanding obligations of the county for services rendered before March 1, 1984, under the resident county hospitalization program, the community mental health share management and state institution programs, and the state ward charge-back program (most of this money will go to Wayne County in FY 1987-88 and will be paid back to the state for services previously provided under the resident county hospitalization program); and
- repay the principal on any loans made to the county under the Emergency Municipal Loan Act.

In FY 1988-89 and subsequent years these funds will be split 50-50 between Wayne County and the other counties, to be used for health and safety purposes or property tax relief. The airport tax money will go to Wayne County and to several cities in the county. The new sales tax money will go to the Michigan Health Initiative Fund, which will pay for state and local health promotion programs. The revenue from these new taxes is estimated at $41.4 million in FY 1987-88 and $61.5 million in FY 1988-89.

General revenue sharing grants to local units are projected to increase $31.7 million, or 3.3 percent, in FY 1988-89. Article IX, section 30 of the Michigan Constitution requires that 41.6 percent of state spending (excluding federal aid) be allocated to local governments. The FY 1988-89 budget returns an estimated 44 percent, about $280 million more than required.

Article IX, section 26 of the state constitution restricts the amount of revenue the state may collect in any fiscal year. The limit for 1988-89 (10 percent of 1987 Michigan personal income) is $13.948 billion. Total state revenue (less federal aid and general obligation debt plus specified tax credits) is projected to fall about $2 billion below the limit.

COMMENT

The FY 1988-89 budget is the most constrained one submitted by a governor since the early 1980s. Although there is a small increase in the budget, there are substantial program reductions and efficiencies and fee increases built in to free up monies for spending needs in social services, corrections, mental health, economic development, and other areas. As indicated in Exhibit 6, the budget includes $342.9 million in program and grant reductions and efficiencies, which are necessary to offset the $362.9 million in increased spending on other programs and $44 million in economic increases. (These figures are based largely on the changes highlighted in the governor's budget document and may not completely cover all increases or reductions.) Some reductions, such as the Medicaid cost-containment proposals, may be difficult to achieve, and the legislature may not approve all the fee increases. The most controversial aspect of the budget is likely to be the one percent increase proposed for education, the smallest in recent memory. This is likely to result in substantial increases in tuition at state institutions of higher education and to intensify pressure for reform of the K-12 financing system. There is a strong probability that the legislature will add funds to the education budgets, although it is unclear where the money would be found.

Complicating the 1988-89 budget debate is the expected imbalance in the FY 1987-88 budget. The Senate Fiscal Agency (SFA) is projecting a shortfall of about $167 million; its revenue estimate is $152 million below that of the DMB (the SFA does not include $49 million from Wayne County, but this is mostly offset by a $40 million overestimate of the FY 1986-87 year-end balance), and the SFA estimates overexpenditures of $114 million for social services and mental health. The administration has incorporated a $90-million supplemental estimate for social services in the FY 1987-88 budget.

Public Sector Consultants projects that the FY 1987-88 budget could be out of balance by as much as $150 million. The governor and the legislature will have to make cuts or other fiscal adjustments to bring it into balance. As discussed above, up to $100 million may be available for transfer from the BSF to the general

[3] A transfer from the BSF is allowed when inflation-adjusted state personal income declines. We are estimating that the decline will be about 1.5 percent. This number is multiplied by GF/GP revenue for the fiscal year ended in the current calendar year (FY 1987-88), producing an estimated $100 million.

EXHIBIT 6

Fiscal Adjustments by Department or Program, FY 1988-89 Executive Budget (millions)

Program or Department	Program/Grant Reductions and Efficiencies	Program Transfers	Financing Shifts	Economic Increases	Program Increases	Technical and Other Adjustments	Total Change
Agriculture	-$1,561	$0	$0	$438	$0	$0	-$1,123
Attorney General	-665	0	-324	555	232	0	-202
Civil Rights	-964	0	0	117	0	67	-780
Civil Service	0	0	0	246	1,542	-24	1,764
Commerce	-19,300	31,300	0	685	19,700	-6,761	25,624
Corrections	-28,694	0	0	13,216	33,205	1,564	19,381
Education	-4,316	0	0	363	5,437	458	1,942
Executive Office	-60	0	0	55	5	0	0
Community Colleges	0	0	0	0	1,966	0	1,966
Universities	-5,625	0	0	0	16,691	-136	10,930
Judiciary	-950	0	-2,907	0	4,824	-115	852
Labor	-2,834	0	-2,156	496	5,707	-1,685	-472
Legislature	0	0	76	0	1	-486	-409
Library of Michigan	0	0	0	0	0	0	0
Licensing and Regulation	-1,081	0	0	323	0	-331	-1,089
Management and Budget	-5,509	-60,614	-5,159	1,122	9,331	-645	-61,474
Mental Health	-18,579	0	0	8,705	65,049	-14,209	40,966
Military Affairs	-1,018	0	0	61	0	0	-957
Natural Resources	-805	0	-14,897	1,079	4,639	-3,085	-13,069
Public Health	-5,556	0	-4,712	1,944	668	-1,400	-9,056
School Aid	-107,707	0	0	0	0	0	-107,707
Social Services	-124,683	-16,740	81,542	14,346	128,110	-78,857	-3,718
State	-1,029	0	-6,949	281	1,645	-101	-6,153
State Police	-2,734	0	0	-1,110	1,246	-292	-2,880
Treasury	-5,219	0	0	1,088	0	0	-4,131
Debt Service	-4,029		0	0	207	0	-3,822
Capital Outlay	0	60,400	0	0	62,655	0	123,055
TOTAL GF/GP	-$342,918	$14,346	$44,514	$44,101	$362,870	-$105,948	$16,874

SOURCE: Calculated by Public Sector Consultants from data in the *State of Michigan Executive Budget*, 1988-89 fiscal year.

fund. Other fiscal adjustments may be available to close the remaining gap. If the BSF money is not used or if the economy weakens more than expected, budget cuts will have to be made by executive order, something the governor would very much like to avoid.

When the legislature turns its full attention to the FY 1988-89 budget there are likely to be questions about the validity of the economic assumptions used to put it together. The administration is forecasting very modest economic growth in FY 1988-89, whereas Public Sector Consultants believes there is a high probability of a recession within the next year. One of even moderate severity could cause a shortfall of up to $200 million in combined GF/GP and school aid fund revenues and increase social services expenditures. The budget assumes the general assistance caseload will decline by 16,500 in FY 1988-89. (A portion of this reduction, 7,100 cases, is attributed to the new Neighborhood Corps.) It also assumes a 3,800 drop in the AFDC caseload in FY 1988-89. (A 1,000 caseload increase in GA or AFDC increases GF/GP expenditures by about $2.5 million.) Given our outlook for weak economic growth in 1988 and 1989, we feel these caseload estimates are low.[4] The SFA is projecting that FY 1987-88 combined AFDC and GA caseloads will number about 22,000 more than budgeted (assuming that a 7,900 caseload reduction from department initiatives is not realized).

In summary, the proposed FY 1988-89 budget will be a tough sell for Governor Blanchard. The legislature can be expected to make major changes, and additional reductions and fiscal adjustments will be required before fiscal year 1988-89 is over.

[4]For FY 1987-88, the DMB is projecting that GA caseloads will be 6,500 higher and AFDC cases will be 8,300 higher than originally estimated. These shortfalls are reflected in the social services supplemental appropriations.

In his budget message, the governor made one additional proposal to the legislature that does not affect the FY 1988-89 budget, but would affect future budgets. The governor has asked the legislature to place an $800-million bonding proposal on the ballot for voter approval; a two-thirds vote of the legislature will be required. The bonds would be used for solid and hazardous waste disposal, recreation projects, infrastructure improvements, and economic development. On the surface this appears to be a responsible proposal, and there is little question of a critical need for expenditures in these areas. One important argument for bonding is that these projects benefit future as well as present generations, and the costs should not be fully borne by current taxpayers. However, the governor and the legislature must make sure that (1) the bonds are used for long-term projects, not for programs that could be funded on a pay-as-we-go basis, and (2) the principal and interest payments on the bonds do not place a strain on the state budget. One point in the proposal's favor is that Michigan currently does not have a heavy long-term debt burden. In FY 1985-86 (the latest year for which data are available), its per capita long-term debt was $1,885, ranking Michigan 43rd among the states (including the District of Columbia). Issuing $800 million in debt would add $88 per capita, moving Michigan up to 40th place. On this basis, the state seems capable of taking on the additional debt.

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Its principal consultants are

Gerald A. Faverman, Ph.D., *Chairman and Senior Consultant for Public Policy*

Craig Ruff, M.P.P., *President and Senior Consultant for Health Policy*

William R. Rustem, M.S., *Vice President and Senior Consultant for Environmental Policy and Economic Development*

Robert J. Kleine, M.B.A., *Senior Economist and Editor of PUBLIC SECTOR REPORTS*

Christine F. Fedewa, *Director of Operations and Senior Consultant for Public Policy*

Gerrit Van Coevering, *Senior Consultant for Taxation and Revenue Policy*

Michael French Smith, Ph.D., *Director of Research and Senior Consultant for Marketing and Economic Development*

Richard Hathaway, *Senior Consultant for Public Policy Research*

William R. Knox, *Senior Consultant for Communications and Market Development*

Sebastian Wade, *Senior Consultant for Corporate Relations*

Wilma L. Harrison, *Senior Editor and Research Associate*

Frances L. Faverman, *Editor of the* Health Policy Bulletin *and Consultant for Health Policy*

Linda Headley, *Editor of Public Sector Media Reports and Consultant for Education*

Diane Drago, *Conference Coordinator*