

# PUBLIC POLICY ADVISOR

## Overview of Michigan Budget Appropriations Fiscal Year 1987-88

Governor Blanchard has recommended a budget for fiscal year 1987-88 that provides for modest spending increases by historical standards, but is more generous than last year's budget recommendation. The general fund-general purpose (GF-GP) recommendation is \$6,456.9 million, an increase over the current fiscal year of \$174.5 million or 2.8%. (If the FY 1986-87 projected supplementals of \$115.1 million are excluded, the increase is 4.7%. Exhibit 1 lists the supplemental appropriations requested for the current fiscal year.) The budget is more generous than it appears; the small increase for the Department of Social Services and declines in spending for capital outlay and debt service allow healthy increases for many departments. Excluding these, GF-GP spending is 5% above the FY 1986-87 level. (See Exhibit 2.)

The GF-GP recommendation for school aid is \$577.4 million, an increase of only 1.1%. When other state funds, such as sales tax and lottery revenues are included, total school aid is \$2,738.7, a 3.8% increase. Total state spending is recommended at \$15,181.0 million, an increase of 3% above projected appropriations for FY 1986-87.

As he has since he took office, Governor Blanchard emphasizes corrections, education, health, and economic development in his budget recommendations. Excluding capital outlay and debt service, about 83% of the recommended increase in spending is allocated to corrections, education, and health. (See Exhibit 3 for a depiction of the change in budget priorities since FY 1982-83, five budget years ago.)

The budget discussion below focuses primarily on general fund-general purpose expenditures.

### ECONOMIC AND REVENUE ASSUMPTIONS

One of the most difficult tasks in putting together the state budget is forecasting the revenues that will be available to spend. Generally, revenue forecasters tend to be conservative to avoid unpleasant surprises. This has been the Blanchard administration's approach, which is understandable because the budget problems of the early 1980s are still fresh in their memories. GF-GP revenues were underestimated by about \$200

### EXHIBIT 1

#### FY 1986-87 Supplementals

The governor has requested \$88.7 million in supplemental appropriations for FY 1986-87, and an additional \$26.4 million for school aid will also be required. The largest supplementals requested are for the departments of Labor and Commerce: \$17 million for the Youth Corps; \$15.5 million for job training grants, principally for Mazda and Chrysler; and \$13.9 million in commerce grants for Chrysler's Jefferson Avenue/Oak Tech project. Other major supplemental requests are

- \$6.2 million for judicial and court employee salary increases;
- \$3.5 million for the costs to the DNR of the swamp tax increase enacted last year;
- \$2.8 million for the "YES Michigan" program;
- \$2.6 million for reimbursement to the state police for flood disaster assistance;
- \$2.2 million for additional Great Lakes shoreline erosion prevention grants; and
- \$2 million for Crippled Children's Program services.

million in FY 1985-86 and \$160 million in FY 1984-85. Politically, this has probably been wise, but such a strategy does undermine budget discipline because it encourages supplemental appropriations. Another result can be tax increases, perhaps even larger than needed. With the economic recovery at a very mature stage, the FY 1987-88 budget is unlikely to experience the large unanticipated revenues enjoyed this year and in 1984-85.

The FY 1987-88 budget assumes that the national economic recovery will continue at a moderate pace. Real gross national product (GNP) is projected to increase 2.9% compared with an estimated 2.7% increase in FY 1985-86 and in FY 1986-87. Total U.S. passenger car sales are estimated at 10.5 million units, a small improvement over the current fiscal year (an estimated 10.4 million units), but still down from 11.3 million units in FY 1985-86.

**EXHIBIT 2**  
**General Fund-General Purpose Budget Summary,**  
**Fiscal Years 1985-86, 1986-87, and 1987-88**  
**(millions of dollars)**

Department or Program	FY 1985-86 Expenditures	Projected FY 1986-87 Spending	FY 1987-88 Executive Recommendation	Dollar Change from FY 1986-87	Percentage <sup>a</sup> Change from 1986-87	Addendum: Projected FY 1986-87 Supplementals
<b>Human Services</b>						
Social Services	\$2,003.4	\$1,972.1	\$2,003.1	\$31.0	1.6	10.2
Mental Health	651.6	707.7	762.4	54.7	7.7	0.2
Public Health	122.8	130.1	139.8	9.7	7.5	2.0
<b>Education</b>						
State Colleges and Universities	972.8	1,040.3	1,100.0	59.7	5.7	0.5
— Operations	901.4	966.1	1,017.6	51.5	5.3	0.5
— Financial Aid	71.4	74.2	82.4	8.2	11.1	-0-
School Aid	524.9	571.4	577.4	6.0	1.1	26.4
Community Colleges	175.3	186.7	196.1	9.4	5.0	-0-
Education	35.3	37.3	37.4	0.1	0.2	-0-
Library of Michigan	19.8	20.7	21.4	0.7	3.4	-0-
<b>Safety and Defense</b>						
Corrections	392.8	484.3	537.0	52.7	10.9	7.8
State Police	147.8	158.6	161.6	3.0	1.9	2.7
Military Affairs	10.6	11.7	12.2	0.5	3.9	-0-
<b>Regulatory</b>						
Commerce	88.2	102.2	97.7	-4.5	-4.5	17.3
Labor	55.5	102.0	88.3	13.7	-13.5	32.6
Licensing and Regulation	14.5	15.3	16.1	0.8	4.9	-0-
<b>Natural Resources and Recreation</b>						
Natural Resources	93.3	114.8	123.1	8.3	7.2	7.0
Agriculture	26.0	26.4	27.1	0.7	2.7	1.1
<b>General Government</b>						
Management and Budget	135.9	141.7	148.0	6.3	4.5	0.9
Legislature	59.7	68.9	71.6	2.7	4.0	-0-
Judiciary	84.4	91.5	99.0	7.5	8.2	6.2
Treasury	65.6	60.4	56.6	-3.7	-6.1	-0-
Attorney General	19.3	21.3	23.0	1.8	8.3	-0-
State	15.7	15.1	15.4	0.3	1.7	-0-
Civil Service	9.9	10.9	11.8	0.9	8.6	-0-
Civil Rights	9.7	10.4	11.2	0.9	8.4	-0-
Executive Office	3.3	3.6	4.0	0.4	9.2	-0-
<b>Other</b>						
Capital Outlay	151.9	128.9	82.9	-46.0	-35.7	0.3
Debt Service	79.1	45.0	32.6	-12.4	-27.6	-0-
Transportation	0.5	-0-	-0-	-0-	-0-	-0-
Budget Stabilization Fund Transfer	30.6	-0-	4.9	-26.7	-0-	-0-
<b>TOTAL</b>	<b>\$6,000.4</b>	<b>\$6,279.4</b>	<b>\$6,456.9</b>	<b>\$177.5</b>	<b>2.8%</b>	<b>115.1</b>

<sup>a</sup>Based on unrounded numbers.

**EXHIBIT 3**  
**State Budget Allocation**  
**from State Resources,**  
**FY 1982-83 and FY 1987-88<sup>a</sup>**

Category	FY 1982-83	FY 1987-88
Education	33.2%	36.4%
Social Services	25.0	18.0
Transportation	9.7	9.5
Health	8.3	8.9
Revenue Sharing	7.7	8.4
Law Enforcement and Safety	5.8	8.0
Other	10.3	10.8
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>

<sup>a</sup>State spending from state sources (excludes federal aid).

The Michigan economy is expected to be slightly weaker than the national economy due to the softening in auto sales and the General Motors plant closings. Michigan motor vehicle production is projected to decline 6.2% in the current fiscal year and 9% in FY 1987-88, reducing Michigan's share of national production to about 26%, down from the one-third share that Michigan has maintained for nearly 20 years. Michigan wage and salary employment is forecast to increase 1.7% this fiscal year and only 1% in FY 1987-88, compared with a 2.5% increase in the last fiscal year, 1985-86. (See Exhibit 4.)

There are four key assumptions underlying the Blanchard administration's economic forecast.

1. The federal deficit will not meet Gramm-Rudman targets, but will decline modestly.
2. Oil prices will remain stable and the overall rate of inflation will rise moderately.
3. Interest rates will be stable.
4. Declines in Michigan manufacturing employment will be more than offset by growth in other sectors.

The revenue projections for FY 1987-88 assume a reduction in the state income tax rate from 4.6% to 4.4%, which is expected to exactly offset Michigan's revenue gain from federal tax reform. Overall, GF-GP revenue for FY 1987-88 is forecast to increase 5% above the current year level. (If adjusted for noneconomic factors such as one-time payments, the increase is 5.7%.)

**REVENUE SOURCES AND  
EXPENDITURE ALLOCATIONS**

Exhibits 5 and 6 illustrate the funding sources and allocations of the recommended 1987-88 budget. Exhibit 5 shows state expenditures from state revenue sources, which exclude federal aid and local and private revenue sources. This is the most meaningful way to look at state spending because it includes the school aid fund, transportation, and revenue sharing, but

**EXHIBIT 4**  
**Economic Assumptions, FY 1986-87 Budget**

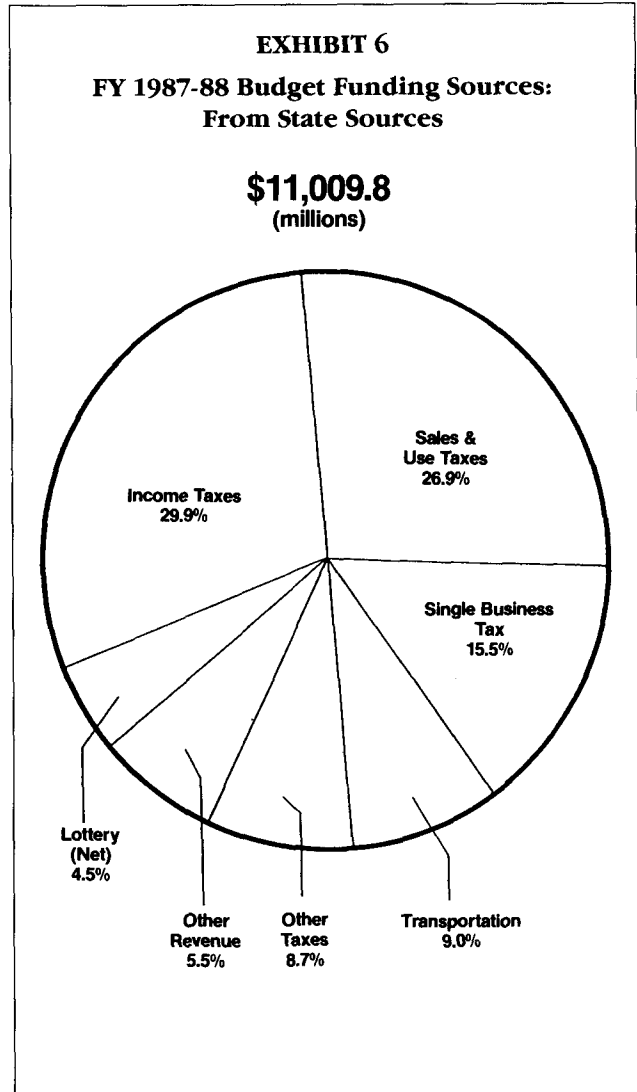
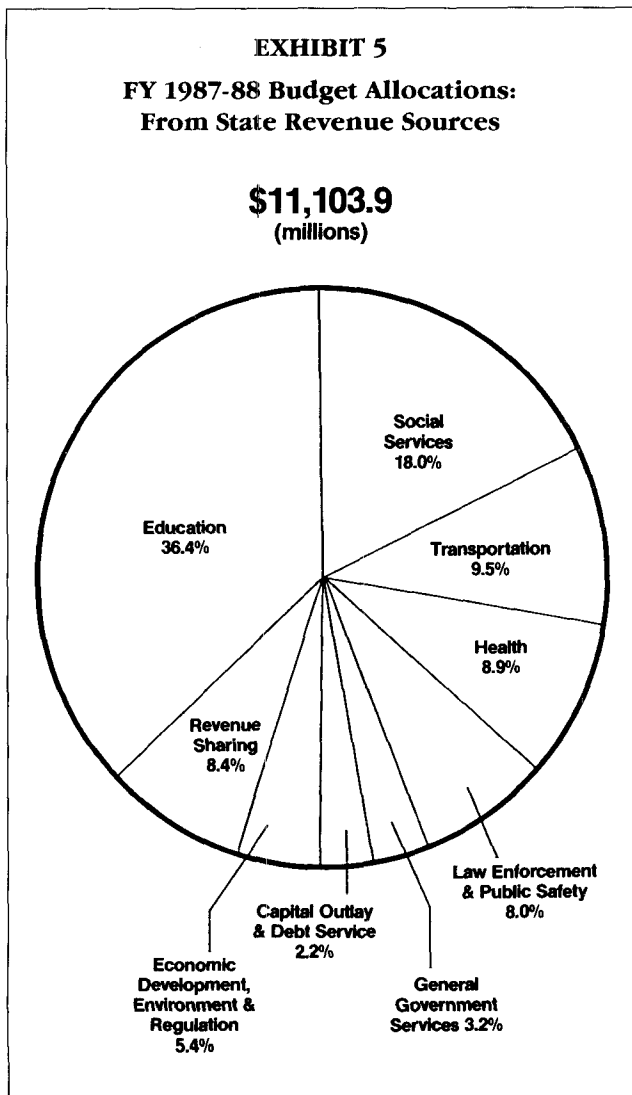
	FY 1985-86 (actual)	FY 1986-87 (estimate)	FY 1987-88 (estimate)
<b>United States</b>			
GNP (change)	2.7%	2.7%	2.9%
Passenger Car Sales (millions of units)	11.3	10.4	10.5
Import Share	27.8%	31.4%	32.4%
Federal Budget Deficit	\$220.7	\$191.4	\$183.6
<b>Michigan</b>			
Motor Vehicle Production (millions of units)	3.3	3.1	2.8
Wages and Salary Employment (change)	2.5%	1.7%	1.0%
Unemployment Rate	9.0%	8.7%	8.8%
Real Personal Income (% change in millions of 1967 dollars)	2.2%	0.9%	1.0%
Detroit CPI (1967 = 100) (change)	2.2%	2.3%	3.4%

excludes federal aid, which is largely outside the influence of the governor and the legislature.

Exhibit 5 illustrates the distribution of state own-source revenues among major state program areas. Education, social services, transportation, health, and revenue sharing together use 81 cents of every budget dollar from state revenue sources.

Exhibit 6 shows that about 72% 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 \$3.85 billion in FY 1987-88.)

Exhibit 7 shows the discretionary portion of the budget relative to total appropriations for selected program categories. (Discretionary funds are those subject to the direct control of the governor and legislature.) In FY 1987-88, only 41.9% of the budget will be discretionary. As recently as FY 1979-80, about 50% of the budget was discretionary.



**FY 1987-88 SPENDING POLICIES**

**Human Services**

In the late 1970s and early 1980s the social services budget claimed the largest share of increases in state spending; GF-GP social services spending increased 63.9% from FY 1978-79 to FY 1983-84, claiming about 74% of the total increase in GF-GP spending.<sup>1</sup> Sharp declines in welfare caseloads due to the improved economy reversed this trend in FY 1984-85. (See Exhibit 8.) The fiscal year 1987-88 recommended GF-GP appropriation for the **Department of Social Services (DSS)** is \$2,003.1 million, 9.5% below FY 1983-84 expenditures.

The recommended appropriation is 1.4% above the FY 1986-87 appropriation. The budget assumes a 3,000

<sup>1</sup>The FY 1983-84 figure has been adjusted for a change in the method of accounting for Medicaid expenditures.

**EXHIBIT 7**  
**Comparison of Discretionary and Restricted Funding,**  
**Budget Recommendations by Category, FY 1987-88 Budget**  
**(millions of dollars)**

Program Category	General Fund- General Purpose (Discretionary)	Total, All Funds	GF-GP Expenditures as Percentage of Total Funds
Education	\$1,932.3	\$4,561.8	42.4%
Social Services	2,003.1	4,313.7	46.4
Health	902.1	1,383.0	65.2
Law Enforcement (Corrections, State Police, Judiciary, and Attorney General)	820.7	905.4	28.5
Regulatory (Commerce, Labor, Licensing and Regulation)	202.0	707.8	43.9
Environmental Protection (Natural Resources and Agriculture)	150.2	341.9	43.9
Revenue Sharing	-0-	927.7	-0-
Transportation	-0-	1,361.1	-0-
General Government	331.0	693.4	47.7
Capital Outlay and Debt Services	115.5	218.1	53.0
<b>TOTAL</b>	<b>\$6,456.9</b>	<b>\$15,413.9<sup>a</sup></b>	<b>41.9%</b>

<sup>a</sup>Components do not add to total because of \$232.9 million in interdepartment appropriations.

**EXHIBIT 8**  
**Welfare Caseloads**  
**FY 1978-79 to FY 1987-88**

Fiscal Year	AFDC	% Change	GA	% Change
1978-79	200,097	—	48,340	—
1979-80	219,814	9.9%	77,111	59.5%
1980-81	241,157	9.7	107,673	39.6
1981-82	231,643	-3.9	107,450	-0.2
1982-83	239,848	3.5	132,411	23.2
1983-84	240,066	0.1	148,720	12.3
1984-85	224,991	-6.3	131,668	-11.5
1985-86	220,050	-2.2	117,166	-11.0
1986-87 (est.)	206,000	-6.4	105,000	-10.4
1987-88 (est.)	203,000	-1.5	93,000	-11.4

SOURCE: Senate Fiscal Agency, *1986 Statistical Report*, October 1986, p. 50 and Department of Management and Budget, *Executive Budget 1987-88 Fiscal Year*, January 1987, pp. V34 and V36.

caseload decline in the Aid for Families with Dependent Children (AFDC) program for a savings of \$6.8 million and a 12,000 caseload decline in the General Assistance (GA) program, for a savings of \$27.6 million. One-half of the projected GA caseload decline is due to improved economic conditions and one-half to department policy changes. The budget also builds in \$30.2 million in savings in the Medical Services program due to cost-containment and utilization reductions.

The major increases in the DSS budget are \$19.4 million to provide a \$2-per-month increase in the food

and clothing benefit and a \$5-per-month increase in the shelter benefit for AFDC and GA recipients; \$13.6 million for the Special Heating Allowance program, which was formerly funded by oil overcharges refunds; and \$9.9 million to offset reduced federal matching funds for Medicaid and AFDC. The budget also includes an additional \$2.9 million to improve prenatal care.

The Blanchard administration continues to place heavy emphasis on health programs; both the departments of Public Health and Mental Health are recommended to receive well-above-average increases.

The recommended appropriation for the **Department of Public Health** is \$9.7 million, or 7.5% above the FY 1986-87 appropriation. The major new initiative is \$5 million for mother and child health improvement as part of the state's infant mortality reduction effort. Substance abuse services are a high priority for the department, and several programs will be funded from a new \$4.6 million federal Anti-Drug Abuse Act block grant.

The recommended GF-GP appropriation for the **Department of Mental Health** is \$762.4 million, 7.7% above the FY 1986-87 appropriation. About 54% of the increase in the mental health budget will go to community mental health programs. State facilities for mentally ill adults will receive an increase of \$8.3 million.

## Education

As was the case this fiscal year, the largest dollar increases in the FY 1987-88 budget recommendations are for education programs. A \$51.6 million, or 5.3%, increase in operating funds is recommended for **four-year colleges and universities**. The budget provides for a 3.3% increase to meet inflationary costs; \$4.3 million for operation and maintenance of new facilities at five institutions, \$1.25 million for the Research Excellence Fund; and \$15 million for first-year implementation of a funding model. The Governor's Commission on Higher Education recommended in December 1984 that Michigan state colleges and universities should be funded at levels based on comparisons with their peers across the nation. The details of the funding model will be made available by the Blanchard administration at a later date.

One of the main purposes of funding increases for higher education in recent years has been to slow tuition increases, as tuitions at Michigan public colleges are among the highest in the nation. In the current fiscal year, the intention was that tuitions would increase no more than the rate of inflation, but it is estimated that tuitions increased about 2.7% (per full-year equated student) above the rate of inflation.<sup>2</sup> The FY 1987-88 budget states that "it is intended that higher education institutions again demonstrate fiscal responsibility and hold tuition increases to the absolute minimum."

The GF-GP appropriation for financial aid is 11.1% above the projected FY 1986-87 spending level. The appropriation is much less generous than it appears, however, as \$7 million in GF-GP monies are being used in the FY 1987-88 budget to fund the Work-study and Part-time Student Grant programs, which are being

funded in the current fiscal year by carry-forward funds from the previous fiscal year.

The budget recommends a 5.1% increase for community college operations. The increases for the 29 institutions range from about 4% to 6%. The Job Training and Retraining Investment Fund, a significant source of program grants for community colleges, is recommended at the current-year level of \$4 million. One of the more significant changes in the fund allocation reduces the minimum grant per institution from \$82,700 to \$50,000. This change will increase the allocations determined through competitive proposals to 64% of the total, which should more effectively target funds to community college projects promoting economic development and job training activities.

The GF-GP recommendation for **school aid** is \$577.4 million, an increase of only 1.1%. Total school aid, including restricted revenue (sales tax and lottery revenue, for example) is recommended at \$2.738 billion, a 3.8% increase; a 4.7% increase on a per-pupil basis. The basic membership formula recommends a gross per-pupil allocation of \$301 plus \$75.10 for each levied operating mill. In addition, \$30 per pupil is available for school districts that provide minimum high school curriculum offerings (or graduation requirements) and \$14 per pupil is available to school districts that institute class size reductions in kindergarten through third grade. Also, the budget provides an additional \$4.8 million for special education and \$7.5 million for a new statewide preschool program. Eligible districts would receive about \$1,000 per child to provide preschool readiness programs for "educationally disadvantaged" children.

## Safety and Defense

As has been the case in recent years, the **Department of Corrections** is a top priority with the Blanchard administration. The recommended appropriation for the department is \$537 million, 10.9% above the appropriations for the current fiscal year, the largest increase for any department. The majority of the \$52.7 million increase in the corrections budget is needed to operate new prisons that have opened or will open in 1987. By the end of FY 1986-87, six new prisons will be open, adding to the five prisons opened in the last two years. By the end of 1989, 17 permanent new prisons will have opened, adding 10,000 additional prison cells. The FY 1987-88 appropriation provides 643 new positions, largely for corrections officers; 2,377 new positions were funded in the current-year appropriation.

Also included in the FY 1987-88 appropriation for corrections are \$2.2 million for expanded security at all community corrections centers (in addition to a \$1.3 million supplemental request in the current year); \$1.7 million for increased supervision of those assigned to probation and parole; \$2.8 million for community-

<sup>2</sup>It should be noted that the actual rate of inflation will likely be significantly lower than the 4.3% rate projected in the FY 1986-87 budget. All 15 institutions kept increases to 4.3% or less.

based corrections alternatives, such as locally operated halfway houses; and \$9.2 million to provide more psychiatric and psychological treatment of mentally ill inmates.

The **Department of State Police** appropriation is recommended at \$161.6 million, only 1.9% above the FY 1986-87 appropriation. This small increase is due partly to the elimination of the one-time appropriation of \$2.6 million for flood disaster assistance. The budget includes \$643,000 to form three new cooperative drug teams for the northern Lower Peninsula and Upper Peninsula and \$500,000 for state participation in state/local cooperative 911 central dispatching operations.

### National Resources and Recreation

The **Department of Natural Resources** appropriation recommendation is for \$123.1 million, an increase of 7.2% above the current-year appropriation. The major increase in the budget is \$11.1 million for the Superfund program to clean up toxic waste sites. This would restore a one-time deferral of state matching funds due to delayed reauthorization of the federal Superfund program. The budget also includes several reductions: \$1.3 million for one-time environmental grants, \$2.2 million for one-time funding of Great Lakes shoreline erosion prevention, and \$2.2 million for tourism development.

One of the more interesting recommendations is contained in the DNR budget. The governor is proposing to use \$9.7 million in unredeemed bottle deposit money to fund a set of programs to clean up the environment, protect against future contamination, rebuild parks and campgrounds, and improve wildlife/recreation opportunities. About \$2.9 million of this amount would be used to improve Great Lakes water quality and \$1.1 million would be used to implement a five-year plan to expand and rebuild state park personnel and services. (See PSC Policy Paper #4, titled "Unreturned Beverage Containers and Unclaimed Deposits," August 1986.) Increases in camping and motor vehicle permit fees would also be used to fund this plan.

The recommended appropriation for the **Department of Agriculture** is \$27.1 million, \$1.7 million above the FY 1986-87 appropriation. The major increases are an additional \$500,000 for a clean water incentive program to support five to ten local implementation projects and \$500,000 for agricultural export development to assist foreign importers to identify Michigan products and producers and Michigan firms to export agricultural products overseas.

### Regulatory

The FY 1987-88 GF-GP appropriation for the **Department of Commerce** is recommended at \$97.6 million, \$4.6 million below the FY 1986-87 appropriation. The decline is due mainly to the elimination of

\$6.7 million for the Chrysler Jefferson/Oak Tech project and \$1 million for the one-time funding of the Employee-Owned Corporation Revolving Loan Fund initiative. Major additions to the commerce budget are \$1.5 million for the Michigan Industrial Technology Development Service to provide technical services to targeted small manufacturers; \$1 million for sudden and severe economic impact assistance to communities affected by plant closings; \$1 million for Michigan promotion programs to promote the state's agricultural products; and \$0.5 million to establish a cabinet council on labor relations to research Michigan's changing industrial economy and recommend new economic development strategies.

Other important changes having little or no effect on the general fund are a loss of \$6.8 million from the federal Community Development Block Grant program and a \$3.4 million reduction (\$0.4 million in GF-GP monies) in grants to cities under the Michigan Equity program, mainly for the Resource Recovery program, which provides no-interest loans to businesses and municipalities to fund resource recovery and energy conservation programs.

The FY 1987-88 GF-GP appropriation for the **Department of Labor** is recommended at \$88.3 million, \$13.8 million below the FY 1986-87 appropriation. The decline is due mainly to a \$7 million reduction in the request for the Michigan Youth Corps (made possible by the supplemental request in FY 1986-87 of \$17 million); a one-time job training grant of \$7 million in FY 1986-87 that will not be funded again in FY 1987-88; and a \$1.5 million savings due to elimination of the Workers' Compensation hearing program.

### General Government

The recommended appropriation for the seven departments in this category, the judiciary, executive office, and the legislature is \$453 million, 4% above the FY 1986-87 appropriation.

The largest recommended increase is \$7.5 million or an 8.2% gain for the **judiciary**, of which \$6.6 million is for funding of judicial pay raises and salary standardization.

The recommended increase for the **Department of Management and Budget** is \$6.4 million. The major program increases are \$1.5 million (including a transfer of \$0.5 million from DSS) for community and nutrition services to the aged; \$1.9 million for the Senior Citizens Housing Tax Exemption program; \$1.1 million for rental payments to the State Building Authority; \$875,000 for property management of the new state library/museum complex; \$850,000 for additional arts grants; and \$750,000 to develop model child care programs. The department will save \$0.6 million with the recommended transfer of the Toxic Substance Control Commission to the DNR.

Included in the **Department of State** budget is \$1.37 million to fund the opening of the new state museum and \$515,000 for additional automotive emissions testing in southeast Michigan. These increases are partly financed by an increase in commercial look-up fees, which free up \$1.65 million in GF-GP monies.

The FY 1987-88 recommendation for the **Department of Treasury** is \$56.7 million, \$3.7 million below the FY 1986-87 appropriation. This is the result of the financing of \$5.8 million for the Delinquent Tax Collection program from the revenues generated by this program; this reduces GF-GP spending by a like amount.

The department is also allocating \$11.2 million in restricted revenues to fund 83 full-time positions for expansion of the Enhanced Tax Law Enforcement program. This is expected to generate an additional \$38.2 million in state revenues.

## Other

The recommended **capital outlay** appropriations of \$82.9 million is about \$46 million below the FY 1986-87 appropriations, yet when combined with \$62 million in State Building Authority rental payments, the total is exceeded only by the current fiscal year and FY 1985-86. More than half, or about \$44 million, of the GF-GP appropriations recommended for capital outlay is allocated to higher education.

The budgets for fiscal years 1985-86 and 1986-87 provided funding for many priority public safety and education projects that the State was unable to fund during the recession years of the early 1980s. About 91% of the FY 1987-88 recommendation, or \$75.5 million in general funds, is allocated to maintenance and construction funding for projects begun during the last two years. Only \$7.5 million is allocated for new maintenance projects and other facilities. The only new facility construction projects are for the replacement of one classroom at a corrections camp and state matching funds for planning and construction of job training facilities at Delta and Washtenaw community colleges.

The FY 1987-88 budget institutes a significant change in capital outlay policy. The governor has recommended that \$194 million of financing for the construction of five prisons be shifted to bonding; this will allow substantial reimbursement of funds previously assumed by the Budget Stabilization Fund (BSF) and the general fund. (Amounts withdrawn for prison construction were \$39.2 million in FY 1984-85; \$110.8 million in FY 1985-86; and \$55.5 million scheduled in FY 1986-87.) In addition, the new \$42 million Northern Michigan Prison will be financed with bonding. (See the comment section for our view on this important policy change.)

Also included in the capital outlay budget is a proposal to divert \$4 million from the Liquor Purchase Revolving Fund to begin a \$10 million program to complete plans and begin construction of several regional liquor warehouse facilities as part of the modernization of the state liquor distribution system.

For the second consecutive year, **debt service** requirements will be lower than the previous year. The budget allocates \$32.6 million for this purpose, \$12.5 million less than the current year. The major reduction is \$16.1 million for Vietnam veterans' bond and interest redemption payments.

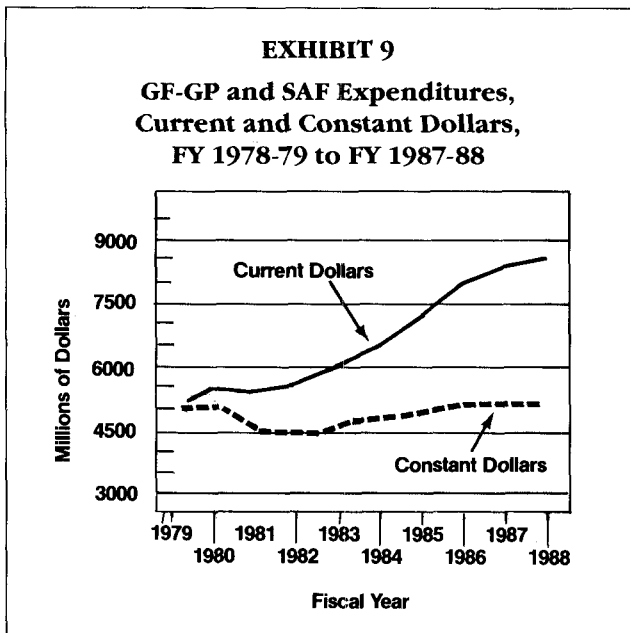
No transfer of funds to or from the Budget Stabilization Fund will be required in FY 1987-88. For the current fiscal year, the estimate in the general government appropriations bill projected a pay-in of \$34.9 million, with the first \$30 million to be earmarked for prison construction. However, current personal income data indicate that no pay-in is required for this year; a final determination will not be made until final personal income numbers are available in May. (BSF pay-ins and pay-outs are based on changes in Michigan personal income, adjusted for inflation.) The year-end balance in the BSF for FY 1985-86 was \$358.3 million. Because of interest earnings, the balance in the fund will increase about \$50-55 million by the end of FY 1987-88, assuming administration proposals to bond for most prison construction projects are approved and planned withdrawals for prison construction are not made.

As was the case with the FY 1986-87 budget, there will be little new money for local governments; less than \$10 million for new programs or program expansions. However, state revenue sharing with local units will increase by \$47.4 million, or 5.4%, over the current fiscal year. Section 30 of the Michigan Constitution requires that 41.6% of the state spending (excluding federal aid) be allocated to local governments. The FY 1987-88 budget returns an estimated 44.5 percent of state spending to local governments, about \$320 million more than required.

## COMMENT

The budget appears to be based on reasonable economic assumptions, although there are considerable risks on the downside, and follows prudent spending policies. (See Exhibit 9 for comparisons of expenditure trends in current and constant dollars.) However, we do not agree with the governor's recommendation to reduce the income tax rate from 4.6% to 4.4%. Given that any changes in the economy are likely to be on the downside rather than on the upside, we continue to believe that a tax reduction is not prudent at this time. Even if a tax reduction were in order, we do not agree with the approach proposed





by the governor. In our opinion, the best options in terms of tax equity and fiscal stability—in order of preference—are to

1. increase the personal income tax exemption by \$500,
2. eliminate the sales tax on utilities for residential users and increase the personal exemption with remaining monies, or
3. allocate the money to the Budget Stabilization Fund until the fund balance is equal to 10% of general fund-general purpose and school aid fund expenditures.

There are three particularly compelling reasons to increase the personal income tax exemption. First, the increase in the standard deduction and the personal exemption on the federal income tax will create a situation in which as many as 500,000 taxpayers will be exempt from the federal income tax but still subject to the Michigan income tax, causing administrative as well as political problems. Second, the Michigan personal exemption has not been increased since 1973; adjusted for inflation, the current \$1,500 exemption is worth \$624 in 1973 dollars. Third, an increase in the personal exemption would improve the progressivity of the income tax by reducing taxes proportionally more for low-income taxpayers than for high-income taxpayers. (See our Policy Paper #5, "Federal Tax Reform: Options for the State," October 3, 1986, for a more detailed discussion of this issue.)

We are pleased by the recommendation for increased bonding for prison construction; this will allow reimbursement of funding previously assumed by the Budget Stabilization Fund and general fund. As we stated in

our September 1985 budget analysis, "we disagree with the decision to raid the BSF to finance prison construction. We do not understand the aversion to bond financing. First, the proposed projects will benefit future as well as present generations, and these costs should not be fully borne by current taxpayers. Second, the cost of borrowing these funds will likely be less than the return that could be earned by investing the money. [This is even truer today.] Third, we believe the current period of relative economic prosperity and fiscal stability is the time to develop bonding programs for needed projects. . . ."<sup>3</sup>

There are areas of the budget with which we find fault. First, we are not convinced that formula funding is the best way to finance higher education. We believe it will be difficult for the administration to reach agreement on the details of a formula funding plan. A formula is used for community colleges, but political realities prevent full operation of the formula. This is even more likely to occur in the case of four-year institutions. We also believe that the formula approach is an abdication of the governor's and the legislature's responsibility to determine appropriate funding levels for Michigan's 15 colleges and universities. One must concede, however, that the formula approach, if fully implemented, would largely remove politics—for good or bad—from the appropriations process.

Second, if history is any guide, spending likely has been underestimated in several areas, particularly social services and corrections. Underestimates of corrections spending have resulted in supplementals of \$51 million in the last three budgets,<sup>4</sup> and a \$7.8 million supplemental has been requested for the current fiscal year. Supplementals for the Department of Social Services have totaled \$40.4 million in the last three budgets, and net overexpenditures have added a similar amount in spending over this period. A \$10.2 million supplemental has been requested for the current fiscal year. Additional revenues to fund such supplementals are not likely to materialize, as in the past three budgets.

Third, a major omission from the budget is any mention of school finance or major property tax reform. Rebuilding the state's financial base and revitalizing the economy have absorbed much of the energy of the Blanchard administration in the last four years; but, with this job largely complete, we think attention should be given to this issue. We would like to see a proposal that would gradually shift support for K-12 education from property taxes to other state and local revenue sources, reduce the number of assessing districts, provide for state assessment of large commercial and industrial properties (with possible redistribution of the revenues from these properties), and eliminate unfair or ineffective property tax exemptions.

<sup>3</sup>Public Sector Consultants, Inc., "Overview of Michigan Budget Appropriations, Fiscal Year 1985-86," vol. 4, no. 4, September 1985.

<sup>4</sup>A large share of these supplementals were due to faster than expected progress on prison expansion.

On balance, we believe the governor's 1987-88 executive budget is based on prudent policies and provides generous support for many programs; increases well in excess of inflation were recommended in many program areas. Over the longer term, we

believe that more funding for education, the environment, and economic development would be more beneficial than a reduction in the income tax. Given current economic and political realities, this budget should certainly receive a passing grade.

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