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Public Sector Reports

PUBLIC POLICY ADVISOR

Overview and Analysis of Michigan Budget Appropriations, Fiscal Year 1989-90

Governor Blanchard continued his policy of recommending constrained state budgets. The general fund/general purpose (GF/GP) recommendation for FY 1989-90 is $6,988.3 million, a 2.5 percent increase. The governor's first budget in 1983-84 called for a 13.1 percent increase, largely to restore cuts made during the recession-racked early 1980s. Since that first budget the largest increase recommended by the governor was 2.8 percent in FY 1987-88. Expenditures always have exceeded the original recommendations, however, due to legislative revisions, supplementals, and overexpenditures. From FY 1979-80 to FY 1987-88 supplementals and overexpenditures totaled about $2.4 billion, of which $1.4 billion were in the Department of Social Services. The revenue estimates on which budget recommendations are based generally have been conservative, and additional revenues almost always have been spent.

This paper outlines the governor's major recommendations and the economic and revenue assumptions underlying the budget, compares recommended FY 1989-90 spending with current-year spending, and comments on the political and economic practicality of the budget. We believe that some of the recommendations for K-12 education and social services will meet with considerable opposition in the legislature and that, as usually has been the case in recent years, available revenues will exceed estimates.

Consistent with previous budget recommendations, the largest dollar increases for FY 1989-90 are allocated to the departments of Corrections, Mental Health, and Education. The allocations received by the various program categories are shown in Exhibit 1.

The largest recommended increases (in percentage terms) are: Department of Education, 23.7 percent; Civil Service, 19.4 percent; capital outlay, 10.7 percent; Corrections, 8.7 percent; school aid, 7.3 percent; and Mental Health, 7.1 percent. (The large increases for Military Affairs and Management and Budget are due to transfers of programs from other departments.)

Recommended for reductions are the departments of Social Services, Commerce, Labor, Public Health, Licensing and Regulation, Civil Rights, State, and Treasury and debt service. As shown in Exhibit 2, the reductions for several of these departments are the result of a financing shift to restricted revenues, reducing the GF/GP contribution. Many of these new revenue sources are contingent on legislative action.

Total state spending for FY 1989-90 is recommended at $16,450.4 million, a 2.9 percent increase above the estimated spending level for FY 1988-89. Federal aid is projected to increase only 0.8 percent, the smallest increase in recent memory, due mainly to a projected 1.5 percent decline in federal aid received by the Department of Social Services, which accounts for about 53 percent of total federal aid to the state. Exhibit 3 summarizes the GF/GP budgets for FY 1987-88, FY 1988-89, and FY 1989-90. The discussion in this paper focuses primarily on GF/GP expenditures.

ECONOMIC AND REVENUE ASSUMPTIONS

The Blanchard administration generally has used conservative economic and revenue projections in developing budgets. For example, in FY 1987-88 the administration underestimated the growth in gross national product (GNP) by about one percent and Michigan personal income by almost 3 percent. Most of the latter error was due to a one percent underestimate of wage and salary employment growth and a 1.2 percent underestimate of inflation. Motor vehicle sales exceeded the administration's estimate by about 700,000 units. The administration was not alone, however, in underestimating economic growth in 1988. The average increase in GNP projected by 42 economists and 8 econometric models surveyed by *Business Week* in late 1987 was 1.9 percent (fourth quarter 1987 to fourth quarter 1988). The actual increase was 2.8 percent. (The average increase for 1988 was 3.8 percent.) The economic assumptions on which the FY 1989-90 budget is based are summarized in Exhibit 4.

As a result of underestimating the strength of the economy, revenue sharply exceeded the FY 1987-88

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EXHIBIT 1

General Fund/General Purpose and School Aid Fund Budget Changes, FY 1989-90

Program Category	Dollar Change (millions)	Percent of Total Increase
Education[a]	$194.8	70.5%
Social Services	-34.0	-12.3
Health	55.0	19.9
Law Enforcement (Corrections, State Police, Judiciary, Attorney General)[a]	61.8	22.4
Regulatory (Commerce, Labor, Licensing and Regulation)[a]	-11.6	-4.2
Environmental Protection (Natural Resources and Agriculture)	1.0	0.4
General Government[a]	-6.1	-2.2
Capital Outlay and Debt Service	15.4	5.6
TOTAL	$276.3	100.0%

[a]Adjusted for transfer of the Research Excellence Fund from higher education to Department of Management and Budget (DMB) and transfer of two programs from DMB to the departments of Commerce and State Police.

estimates—although the administration's revenue forecast was more accurate than other available forecasts, all of which were even more pessimistic. Revenue from personal income tax withholding and quarterly and annual payment exceeded the estimate by $304 million or 6.7 percent. This was offset partially by a $100 million underestimate of income tax refunds. (Actual cash refunds were only $45 million above the estimate, but since three-fourths of the refunds received in 1989 are accrued to FY 1988, the number was increased to reflect an estimate of higher refunds in 1989.) Single business tax revenue (GF/GP) exceeded the estimate by $174 million or 12.6 percent, and lottery revenues exceeded the budget estimate by about $67 million. These underestimates were offset partially by an estimated shortfall of $113 million in insurance tax collections and about $80 million in other tax and nontax revenue sources.

The FY 1989-90 budget assumes a continuation of moderate national economic growth. Real GNP is projected to increase 2.5 percent in 1989 and 2.2 percent in 1990. U.S. passenger car sales are estimated at 10.1 million units in 1989 and 10.3 million units in 1990, down from 10.6 million units in 1988.

The budget also assumes slow and steady growth for the Michigan economy. Personal income is projected to increase 6.2 percent in 1989 and 4.3 percent in 1990. Wage and salary employment is projected to increase 1.5 percent in 1989 and 1.3 percent in 1990, compared to 0.9 percent in 1988. The increase in the growth rate for employment is the result of fewer job losses from General Motors plant closings in 1989 and 1990 than in 1988, when about 50,000 jobs were lost. Consumer prices are expected to increase 4 to 4.5 percent in Michigan and 4.5 to 5 percent nationally during the forecast period.

The major threat to the administration's forecast is that inflation will accelerate, causing the Federal Reserve Board to tighten monetary policy further and pushing interest rates higher. This could choke off the economic recovery and result in a mild recession. Another threat, cited in the budget, is that, if the Bush administration is unable to reduce the federal budget deficit and keep financial markets calm at home and overseas, interest rates could be driven higher and cause a recession.

The economic forecast translates into a GF/GP revenue estimate of $6,817.4 million in FY 1988-89, a 1.9 percent increase, and $6,992 million in FY 1989-90, a 2.6 percent increase. Adjusted for noneconomic factors such as tax policy changes and one-time revenues, the increases are 4.7 percent for FY 1988-89 and 3.3 percent for FY 1989-90. There are an unusual number of tax policy changes that affect revenue in both FY 1988-89 and FY 1989-90. These are presented in Exhibit 5.

REVENUE SOURCES AND EXPENDITURE ALLOCATIONS

Exhibits 6 and 7 illustrate the funding sources and allocations of the recommended 1988-89 budget. Exhibit 6 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 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

EXHIBIT 2

Fiscal Adjustments by Department or Program, FY 1989-90 Executive Budget (dollars in thousands)

Program or Department	Program/Grant Reduction and Efficiencies	Program Transfer	Financing Shifts	Economic Increases	Program Increases	Technical and Other Adjustments	Total Change
Agriculture	-$218	$379	-$1,274	$531	$1,709	$355	$724
Attorney General	-62	0	0	379	0	0	317
Civil Rights	-516	0	0	211	0	9	-296
Civil Service	-251	0	0	238	2,009	546	2,542
Commerce	-11,341	9,450	-1,672	316	5,232	-2,541	-556
Corrections	-25,617	0	-10,989	16,418	70,335	3,053	53,200
Education	-335	0	-961	511	10,768	88	10,071
Executive	0	0	0	0	0	0	0
Higher Education							
Community Colleges	0	0	0	5,839	290	0	6,129
Universities	0	-26,053	0	32,850	5,109	-43	11,863
Judiciary	-174	0	-1,645	1,315	5,795	44	5,335
Labor	-300	0	-3,473	628	2,478	185	-482
Legislature	0	0	0	0	0	62	62
Library of Michigan	0	0	0	0	292	0	292
Licensing and Regulation	0	0	-1,544	266	84	76	-1,118
Management and Budget	-5,934	7,297	-3,518	1,516	7,076	2,013	8,450
Mental Health	-40,555	-264	696	12,499	75,094	10,428	57,898
Military Affairs	-746	1,380	0	218	274	53	1,179
Natural Resources	-10,196	0	2,400	1,329	6,284	479	296
Public Health	-1,668	0	-8,767	1,689	5,912	22	-2,812
School Aid	0	0	0	0	36,577	0	36,577
Social Services	-111,132	-1,000	9,928	6,533	25,272	36,428	-33,971
State	-943	0	-750	343	106	527	-717
State Police	-3,064	7,424	-1,899	3,768	5,069	-957	10,341
Treasury	-2,662	0	-6,950	393	1,000	115	-8,104
Debt Service	-5,869	0	0	0	0	0	-5,869
Capital Outlay	0	0	0	0	21,343	0	21,343
TOTAL GF/GP	-$221,583	-$2,145	-$30,418	$87,790	$288,008	$50,942	$172,594

SOURCE: Calculated by Public Sector Consultants from data in *The State of Michigan Executive Budget, 1989-90 Fiscal Year*.

legislature. Exhibit 6 also shows that about 70 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—contributing an estimated $3.91 billion in FY 1989-90.)

Exhibit 7 shows the governor's recommended distribution of state own-source revenues among major state program areas for FY 1989-90. Education, social services, transportation, health, and local revenue sharing account for 80 cents of every budget dollar.

FY 1989-90 SPENDING POLICIES

The following section details the budget recommendations for most departments and programs. For comparison purposes exhibits 8 and 9 show the percentage growth in selected departments and programs from FY 1983-84 to FY 1989-90 for both GF/GP spending and spending from state revenue sources.

Social Services and Health

Recommended GF/GP allocations to the **Department of Social Services** (DSS) total $2,185.3 million, a $34 million or 1.5 percent decline from 1989 appropriations. A 1.3 percent, or $61.4 million, decline in spending from all sources also is included in the recommendations.

Reductions in GF/GP spending for the DSS are due in part to an estimated $58.2 million in savings resulting from Medicaid cost containment that include: (1) a $28-million reduction in the hospital services and therapy budget, with most of the savings ($14.1 million) resulting from elimination of the medical education subsidy; (2) a $17.5-million reduction in spending on long-term care, half of which will result from the

EXHIBIT 3

General Fund/General Purpose Budget Summary, Fiscal Years 1987-88, 1988-89, and 1989-90 (dollars in millions)

Program or Department	FY 1987-88 Expenditures	Projected FY 1988-89 Appropriations[a]	FY 1989-90 Recommendations	Dollar Change From FY 1988-89	Percentage Change From FY 1988-89	Percentage Change Adjusted for Interdepartmental Financing Transfers and Shifts[b]
Human Services						
Social Services	$2,148.6	$2,219.2	$2,185.3	-$33.9	-1.5%	-1.1%
Mental Health	804.8	810.3	868.1	57.8	7.1	7.3
Public Health	137.7	129.8	127.0	2.8	-2.2	5.0
Education						
State Universities						
—Operations	1,023.7	1,051.7	1,061.1	9.4	0.9	3.5
—Financial Aid	85.3	84.9	87.5	2.6	3.4	3.0
Community Colleges	198.1	201.4	207.5	6.1	3.0	3.0
School Aid	603.6	503.8	540.4	36.6	7.3	7.3
Education	40.6	42.7	52.8	10.1	23.7	23.7
Library of Michigan	22.8	25.5	25.8	0.3	1.2	1.1
Safety and Defense						
Corrections	558.1	614.7	667.9	53.2	8.7	10.6
State Police	158.2	167.4	177.7	10.3	6.2	2.8
Military Affairs	11.7	12.2	13.4	1.2	9.8	-1.5
Regulatory						
Commerce	111.0	103.4	102.9	-0.5	-0.5	-7.4
Labor	70.2	79.7	79.2	-0.5	-0.6	3.9
Licensing and Regulation	13.1	12.9	11.8	-1.1	-8.5	3.9
Natural Resources and Recreation						
Natural Resources	103.7	110.8	111.1	0.3	0.3	-1.9
Agriculture	26.9	28.2	28.9	0.7	2.5	8.5
General Government						
Management and Budget	158.0	90.0	98.4	8.4	9.3	5.0
Legislature	72.8	77.8	77.9	0.1	0.1	0.1
Judiciary	97.6	102.3	107.6	5.3	5.2	6.9
Treasury	55.4	51.1	43.0	-8.1	-15.9	-2.6
Attorney General	20.8	23.0	23.3	0.3	1.3	1.3
State	13.3	17.0	16.2	-0.8	-4.7	-0.3
Civil Service	10.3	13.3	15.8	2.5	18.8	18.8
Civil Rights	10.8	10.9	10.6	-0.3	-2.8	-2.8
Executive Office	3.8	4.0	4.0	0.0	0.0	0.0
Other						
Capital Outlay	71.0	199.0	220.3	21.3	10.7	10.7
Debt Service	47.5	28.5	22.6	-5.9	-20.7	-20.7
TOTAL	$6,679.5	$6,815.6	$6,988.3	$172.7	2.5%	3.0%

[a]Includes recommended supplementals for FY 1988-89 of: Social Services, $75 million; capital outlay, $26.4 million; Management and Budget, $4.1 million; Mental Health, $2.7 million; and Public Health, $0.7 million.

[b]See Exhibit 2 for a list of interdepartmental transfers and financing shifts.

transfer of mentally retarded and impaired residents to the mental health system; and (3) a $10.4-million savings in pharmaceutical services spending due primarily to the elimination of reimbursements for certain high-cost drugs.

In other areas, the Job Start program is expected to reduce General Assistance (GA) caseloads by 4,650 and save about $2 million—additional reductions related to the Job Start program total about $10.4 million. (Overall, the program is budget neutral as resources are reallocated.) Revisions to the Energy Assistance program are expected to save about $20.7 million, and limiting the 20 percent income offset for Aid to Families with Dependent Children (AFDC) and GA to earned income is expected to save approximately $16.2 million.[1]

[1]Grant levels are determined by comparing income after certain deductions to need. Currently, 20 percent of all household income may be excluded. Allowing the exclusion to apply only to earned income, which is smaller than household income, will reduce allowable deductions and thereby reduce grant levels.

EXHIBIT 4

Economic Assumptions, FY 1989-90 Budget

	CY 1988 (Actual)	CY 1989 (Estimate)	CY 1990 (Estimate)
United States			
GNP (% change)	3.8%	2.5%	2.2%
Passenger car sales (millions of units)	10.6	10.1	10.3
Import share	29.1%	28.7%	29.8%
Federal budget deficit (billions)	-$142.7	-$131.7	-$99.3
Michigan			
Motor vehicle production (millions of units)	3.21	3.15	3.09
Wages and salary employment (% change)	0.9%	1.5%	1.3%
Unemployment rate	7.6%	7.8%	8.3%
Real personal income in 1982-84 dollars (% change)	3.0%	1.6%	0.2%
Detroit CPI (1982-84 = 100) (% change)	3.9%	4.5%	4.1%

CY = calendar year.

EXHIBIT 5

Tax Policy Changes Affecting FY 1989-90 Budget (millions)

	FY 1988 Effect	FY 1989 Effect	FY 1990 Effect
Income Tax			
Higher personal exemption, partial exemption for working dependents, and other changes[a]	-$48.1	-$134.2	-$167.1
Senior citizens prescription drug credit	0	0	-20.0
Community foundation tax credit	0	-1.5	-1.5
Farmland tax credit adjustment	0	-4.0	-4.0
Michigan Education Trust	0	-12.1	-12.1
Single Business Tax			
Alternative profits tax for small business	0	-7.0	-8.0
Use Tax			
Tax on construction contracts	0	2.0	20.0
Intangibles Tax			
Preferential treatment for "Chapter S" corporations (P.A. 465 of 1988)	0	-3.0	-4.5
Liquor Purchase Revolving Fund			
Modernize liquor distribution system	0	20.0	0
TOTAL	-$48.1	-$139.8	-$197.2

SOURCE: Calculated by Public Sector Consultants from data in *The State of Michigan Executive Budget, 1989-90 Fiscal Year.*

[a]The personal income tax exemption is $1,800 for 1988, $2,000 for 1989, and $2,100 for 1990 and subsequent years.

EXHIBIT 6

FY 1989-90 Budget Funding: From State Sources

$16,595.5
(millions)

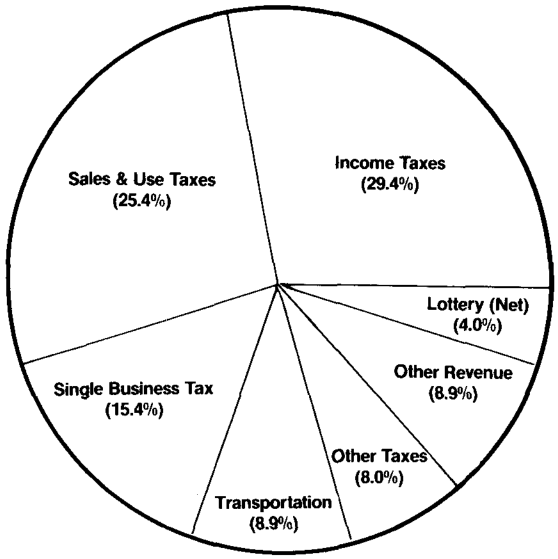
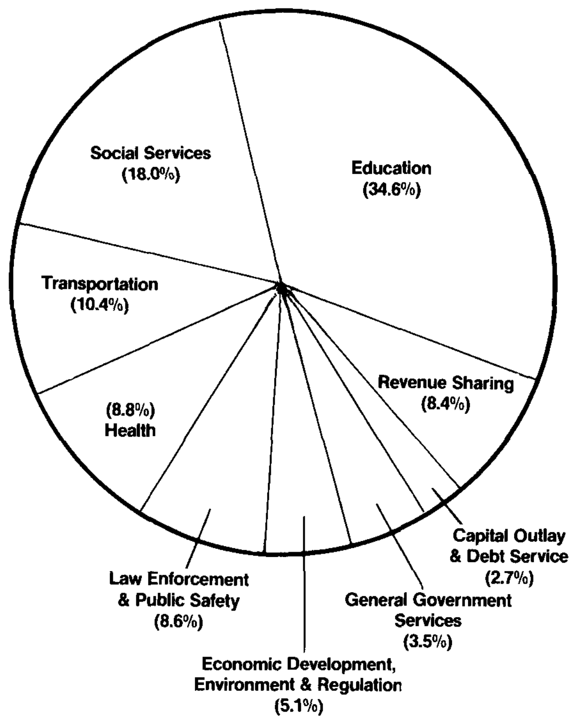


EXHIBIT 7

FY 1989-90 Budget Allocations: From State Revenue Sources

$16,450.4
(millions)



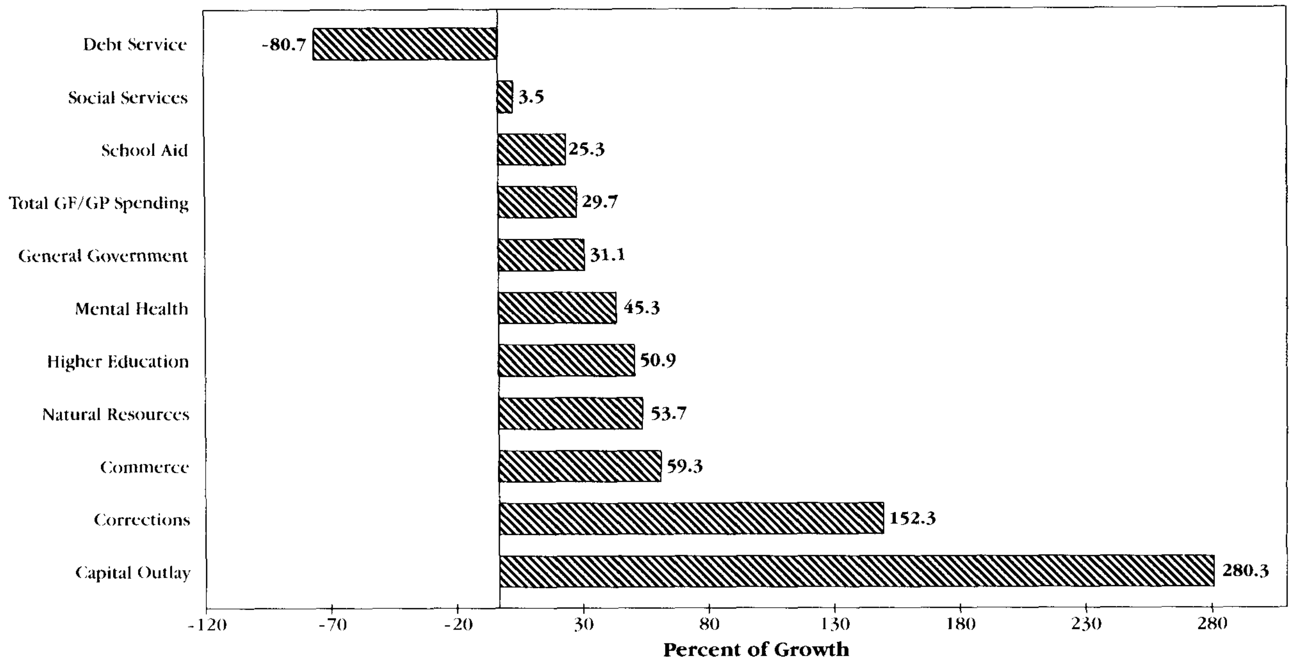
These cuts are offset partially by spending increases of $25.4 million in base adjustments to foster care and $21.8 million in base adjustments and cost/price increases for Medicaid and by an additional $6.7 million in Medicaid expenditures and $3.9 million in AFDC spending due to the projected cost and caseload increases associated with last November's passage of Proposal A, which prohibits state-funded abortions. A $6.5-million economic increase for higher costs is also included.

The recommended GF/GP appropriation to the **Department of Mental Health** is $868.1 million, a 7.1 percent increase from allocations made in FY 1988-89. The Mental Health budget has increased 45.6 percent since FY 1983-84 compared with a GF/GP spending increase of only 29.7 percent. Increases in the budget include $25.5 million in additional funds to comply with federal requirements in nursing home care and $15.2 million for the Community Residential Services Program for the developmentally disabled. An increase of $32.6 million for Community Mental Health programs is offset partially by reductions of $15.8 million. Savings of $6.8 million on mentally ill adult facilities are the result of staffing and other cost reductions.

The recommended GF/GP appropriation for the **Department of Public Health** is $127 million, a 2.2 percent decline from FY 1988-89 appropriations. Adjusted for financing shifts, however, spending is 5 percent above that for the current fiscal year. Increases in the budget include $4.8 million for the Governor's antidrug-abuse initiatives and $0.7 million for groundwater protection programs. An additional $1.7 million is recommended to cover economic increases.

Savings in GF/GP expenditures will be realized as the result of increases in federal funding to veterans' facilities, fee increases for laboratory services, and a $2.9 million increase in restricted revenue from state licensure and fine revenues and substance abuse treatment licensure fees. Savings within the department of more than $8.5 million for FY 1989-90 are due to revenue generation and financing shifts of this nature.

EXHIBIT 8
Growth in General Fund/General Purpose Expenditures, Selected Programs, FY 1983-84 to FY 1989-90



Education

Education remains a high priority with Governor Blanchard. The budget includes a number of new programs, most designed to improve the quality of K-12 education. About 38 percent of the total increase in the 1989-90 GF/GP budget is allocated to education.

The GF/GP recommendation for **school aid** is $540.4 million, $36.6 million above projected spending for FY 1988-89. Total school aid, including restricted revenue (sales tax and lottery revenue, for example) is recommended at $2,821.4 million, a 5.3 percent increase. Expenditures per pupil (excluding retirement funds) also will increase 5.3 percent. The basic membership formula recommends a gross allocation per pupil of $300 plus $83 per mill.[2] (The current-year formula is $350 plus $77.71 per mill.) The formula includes $44 per pupil in incentives for offering a minimum curriculum, graduation requirements, and class size reductions. The new formula favors high-millage districts. For example, a district levying 26 mills will receive a 3.7 percent increase in state aid, while a district levying 38 mills will receive a 4.6 percent increase in state aid. The average district (32 mills) will receive a 4.2 percent increase.

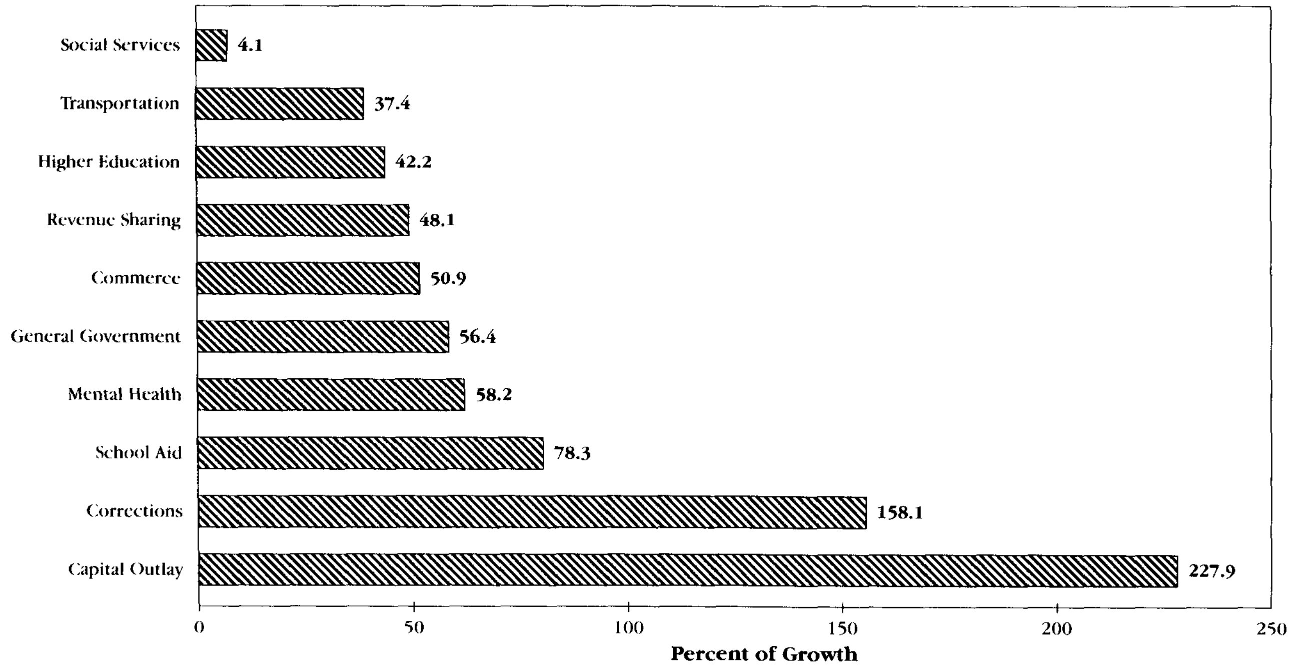
[2]A school district levying 32 mills would be out-of-formula (receive no membership aid) if the district's state equalized valuation (SEV) per pupil exceeded $92,375.

The budget recommends several important policy changes. First, state spending for Social Security and school employees retirement is frozen at the FY 1988-89 level. The state, however, will cover fully increased costs for Social Security and retirement for out-of-formula school districts with less than $3,000 in per pupil revenues. Second, the transportation categorical payment will be eliminated for school districts in which per pupil revenues exceed the state aid formula guarantee by more than 25 percent; this will save $14.5 million.[3] The effect of this reduction will be offset partially by a $7-million reduction in the recapture of state categorical funds (grant money withheld) from some out-of-formula school districts.

The only categorical increase is $14 million for preschool education. The budget, however, does recommend new money for a number of "quality" improvements. The major increases are $15 million for the Governor's Achievement Incentive Program, which will reward schools that have large numbers of "at risk" students who improve academically and that achieve 90 percent attendance rates for those students; $5 million for a Schools of Tomorrow fund, which will provide incentives for parental choice, school restructuring, professional development, and mentor teacher

[3]Unlike membership aid, which is allocated on a need-based formula, all districts receive categorical aid for specific purposes.

EXHIBIT 9
Growth in State Spending from State Sources, Selected Programs, FY 1983-84 to FY 1989-90



networks; and $2.4 million for incentives to encourage schools to adopt long-range improvement plans and a core curriculum.

One effect of these recommendations is to shift resources from out-of-formula school districts to in-formula districts. There will be an estimated loss of $33 million for the former and a gain of $64 million for the latter.

The budget recommends a 23.7 percent increase for the **Department of Education,** the largest for any department. This represents $10.1 million in new money, most of which is allocated for the governor's education quality programs. Recommended program changes include increases of $3.7 million for Early Childhood Development programs to continue expansion of the preschool program; $3 million to pay debt service on bonds that will be issued through the School Bond Loan Fund (Department of Treasury) to purchase $50 million worth of computers for K-12 classrooms; $1 million for math and science challenge grants to establish regional centers for advanced math and science education; $0.5 million to develop an accreditation process based on performance standards; and $0.4 million to establish a Michigan Institute for Adult Learning.

The FY 1989-90 budget recommendation for **four-year universities** operations is $1,061.1 million, only 0.9 percent higher than projected expenditures for the current fiscal year. This small increase is misleading, however, as the budget recommends the transfer of the Research Excellence Fund ($26.1 million) to the Department of Management and Budget (DMB). (The DMB budget includes an additional $2 million for the fund.) Adjusted for this transfer, the increase is 3.4 percent.

Each university will receive a 3 percent increase in operating funds, and $4.1 million is appropriated to fund utility and maintenance costs for new buildings opening for use. Also in the budget is $0.5 million for a Teaching Excellence Fund to reward outstanding performance by faculty members.

Adjusted for inflation, state expenditures per student have increased 32 percent since FY 1982-83. This contrasts with a 3.1 percent decline from FY 1976-77 to FY 1982-83. Tuition per student, adjusted for inflation, increased 17.5 percent from FY 1976-77 to FY 1982-83 and 27 percent from FY 1982-83 to FY 1988-89. The governor can be expected to continue to pressure the universities to keep tuition increases moderate.

The recommended appropriation for **financial aid** is $87.5 million, a 3.1 percent increase above the current-year level. State financial aid has increased 74 percent since FY 1982-83. The budget includes $0.5 million for a Michigan Education Trust (MET) Challenge Fund, which will match funds from private sources to provide MET contracts for children otherwise unable to afford the program.

The budget recommends an across-the-board 2.9 percent increase for **community college** operations to a level of $207.5 million. The governor has recommended that $0.29 million be appropriated for a student guarantee program to encourage community colleges to guarantee that students will be prepared adequately for employment.

Safety and Defense

The FY 1989-90 GF/GP recommendation for the **Department of Corrections** is $667.9 million, an 8.7 percent increase above the projected expenditure level for the current fiscal year. (The increase is 10.7 percent adjusted for proposed financing shifts.) The original recommendation for FY 1988-89 was $576.5 million, but expenditures currently are estimated at $614.7 million by the Department of Management and Budget. (The original recommendation was revised upward by the DMB.) Underfunding the Department of Corrections budget has been standard practice for several years (although the FY 1987-88 appropriation was adequate), and the Senate Fiscal Agency is projecting that a supplemental appropriation of $32.9 million will be needed for FY 1988-89. This will result in a 12.3 percent increase in spending in FY 1988-89. There is a good chance that a supplemental also will be required in FY 1989-90.

The Corrections budget includes $86.6 million in program and economic increases and $25.6 million in program reductions and efficiencies. Also included are about $11 million in new revenue that will reduce the general fund contribution. Most of this money will come from a proposed $30-per-month fee to be paid by persons on probation or parole to help offset a portion of the cost of supervision. The majority of the new money in the budget is needed to operate new facilities. In fiscal years 1988-89 to 1990-91, 23 new facilities with about 10,250 cells have opened or are expected to open. Prison capacity is projected to reach 31,518 by the end of FY 1990-91 compared to 12,780 as of October 1, 1984. The FY 1989-90 budget funds 14,115 full-time equated (FTE) positions, an increase of 728 employees, mostly prison guards. In FY 1984-85 the department employed only 6,352 persons.

The GF/GP appropriation for the **Department of State Police** is recommended at $177.7 million, a 6.2 percent increase. This increase is misleading, however, as the $7.4 million Secondary Road Patrol program is recommended for transfer from the Department of Management and Budget. Adjusting for this transfer reduces the increase to 1.7 percent. The budget includes $5.4 million in program and economic increases, with about $1.1 million going for new drug enforcement initiatives. The budget also includes about $5 million in program reductions and financing shifts. Almost half of these involve program reductions and increased fees for the Fire Marshal program.

Natural Resources and Recreation

The FY 1989-90 recommended GF/GP appropriation to the **Department of Natural Resources** is $111.1 million, a 0.3 percent increase from FY 1988-89. Improvements in the department's budget include a $3.5 million increase in allocations to restore employment levels that were reduced as the result of a hiring freeze and budgetary constraints in the FY 1989 budget. Proposed are an increase of $0.7 million for additional enforcement in cases of identified air pollution violations and another $0.7 million to develop and implement a strategy to attain air quality standards for ozone and carbon monoxide. The budget also includes a proposal to increase camping fees by one dollar to raise $0.8 million, allowing a shift of $0.4 million from the State Park Improvement Fund to the general fund.

Reductions include a $5-million decrease in the "superfund" base; it is felt that the remaining base and carry-overs from the current fiscal year will be sufficient to cover federal matching requirements for the fund. An additional $3.1 million will be saved by eliminating funding for one-time special projects initiated by the legislature, and about $2.1 million will be saved through elimination of grants and funds for one-time studies.

A transfer of $4.9 million from the Clean Michigan Fund and $4.8 million from the Environmental Response Fund will be made to the grants appropriation for environmental cleanup and to the debt service appropriation. These funds will be used to implement environmental cleanup projects and to make debt payments on the bonds issued as a result of passage of Proposal C last November.

The **Department of Agriculture** is recommended to receive a GF/GP appropriation of $28.9 million in FY 1989-90, a 2.6 percent increase from FY 1988-89. (Adjusted for financing shifts, the increase is 9.1 percent). Appropriation increases include $0.8 million for the implementation of a groundwater protection program and $0.7 million for the elimination of the negative appropriation for PCB silo contamination. Reductions include $0.3 million from the transfer of the Center for Agricultural Innovation and Development to the Department of Commerce. Some funds from savings within this latter program will be used to establish the Michigan Premium program, which will promote and provide market and economic development opportunities within the agricultural industry. Another $0.8 million in GF/GP funds will be saved due to the recommended increase from $5 to $50 in the food handler licensing fee.

Regulatory

The FY 1989-90 GF/GP appropriation for the **Department of Commerce** is recommended at $102.9 million, $0.5 million below projected spending for the current fiscal year. Adjusted for the transfer of the Senior Citizens' Cooperative Housing Tax Exemption program ($9.45 million) from the Department of Management and Budget, the appropriation is about $10 million below the FY 1988-89 level.

There have been major shifts in funds within the department in order to redirect economic development efforts in more promising directions. The budget includes general reductions of $4.3 million, with these funds redirected to other programs; a $4.2 million reduction to reflect changes in cash flow commitments for the Chrysler Jefferson/Oak Park project; and a $2.9 million reduction due to Michigan not being chosen as the site of the supercollider facility. New programs include $0.25 million to open a Toronto office to take advantage of the new trade agreement with Canada; $0.5 million for the "Celebrate the Great Lakes" tourism promotion; $2.0 million to provide grants to local governments and nonprofit organizations for programs to assist the homeless ($1.0 million GF/GP and $1.0 million federal aid); and $0.3 million to encourage domestic banks to expand operations in the state and international banks to locate in the state (restricted funding).

The recommended FY 1989-90 budget appropriation for the **Department of Labor** is $79.2 million, $0.5 million below the projected spending for the current fiscal year. The reduction is due to a $3.5 million financing shift from GF/GP support to restricted revenue. The budget includes an additional $1 million for rent and moving costs and $0.6 million for the Michigan Opportunity Card program.

General Government

This category includes six departments, plus the judiciary, the executive office, and the legislature. The recommended appropriation for FY 1989-90 is $396.8 million, 1.9 percent above projected spending for FY 1988-89.

The largest recommended increase is 9.3 percent for the **Department of Management and Budget** (DMB). Most of this increase, however, is due to program transfers, which increase the budget by a net of $7.3 million. Recommended is the transfer to the DMB of the Research Excellence Fund from higher education (+$26.1 million) and the Nutrition Services program from the Department of Social Services (+$1 million) and the transfer from the DMB of the Senior Citizens' Cooperative Housing Tax Exemption Program to the Department of Commerce (-$9.5 million), the Secondary Road Patrol program to the State Police (-$7.4 million), and military retirement to Military Affairs (-$1.5 million). The budget includes $2 million in new money for the Research Excellence Fund, $0.55 million for Victims' Rights grants, and $0.5 million to help expand the opportunity card program.

Savings result from replacing $2.1 million in GF/GP funds with increased revenue from state agency rental charges. Also recommended are $4.3 million in program and grant eliminations.

The recommended appropriation for the **Department of Treasury** is $43 million (excluding debt service), $8.1 million below the projected FY 1988-89 level. This decline is due mainly to a financing shift of about $7 million from the general fund to restricted revenues from delinquent tax collections.

The recommended appropriation for the **judiciary** is $107.6 million, 5.1 percent above the current-year level. The budget includes an additional $3 million for the trial court employees union wage settlement, which is retroactive to FY 1985-86, and $1.25 million for an increase in judges salaries. A portion of the increase is to be financed by $1.6 million in new revenue from local parking fines and restricted revenues from fees charged to local courts for Judicial Data Center services.

The **Department of Civil Service** received the second largest increase of any department, 18.8 percent, to $15.8 million. This large increase reflects the recommendation that the department receive a larger share of the one percent of the state classified payroll guaranteed by the constitutior

Other

The **Department of Transportation** is funded by restricted revenues, mainly gas and weight taxes and federal revenues. The budget recommends appropriations of $1,535.4 million, 6.7 percent above the projected spending level for FY 1988-89. The only major new program recommended in the 1990 budget is $2 million to promote jet service to Traverse City, Marquette, and a third northern Michigan city to be named.

The recommended **capital outlay** appropriation of $220.3 million is $21.3 million above the projected spending level for FY 1988-89. The budget includes $140.1 million for state building authority rent, a $43 million increase from the FY 1988-89 level. These additional monies are needed for increased insurance costs, new correctional facilities, and initial rent payments for other previously authorized projects.

As was the case for last year, there is little money in the budget for new construction starts, except for the Department of Corrections, which in addition to general fund support will receive $28 million from the Budget Stabilization Fund. The capital outlay recommendations include $80.2 million for construction, remodeling and additions, special maintenance, and lump-sum projects. A total of $40.2 million is recommended for special maintenance, remodeling and additions, fire protection, and open space conversion, of which $21.3 million is allocated to four-year universities and $3.7 million to community colleges. The four-year universities also receive $22.7 million and community colleges $1 million to complete construction of projects already under way.

The economic forecast underlying the budget indicates that in FY 1988-89 a $66.9 million pay-in to the **Budget Stabilization Fund** (BSF) could be made. This transfer is not required by law, however, and the budget does not assume such a transfer. If revenues exceed estimates there may be some pressure on the legislature to make the transfer. The budget does assume that $28 million will be available from the BSF for capital outlay. The BSF law allows funds to be withdrawn when the Michigan unemployment rate averages 8 percent or more for a quarter, but the rate is projected to remain below that level. As a result, the budget includes a recommendation for a supplemental appropriation. Another option would be a legislative override of the BSF formula. The balance in the BSF at the end of FY 1988-89 is estimated at $417.4 million.

General revenue sharing grants to local units are projected at $1,021.4 million for FY 1989-90, a 4.1 percent increase. The budget includes no other increases in support for local governments. 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 1989-90 budget returns an estimated 44 percent, about $341 million more than required. The local share has increased largely because state support for revenue sharing and school aid, which comprise 60 percent of all local spending have increased faster than most state programs, particularly social services, which comprises about 23 percent of total spending, but only 2.3 percent of local spending.

Article IX, section 26 of the state constitution restricts the amount of revenue the state may collect in any fiscal year. The limit for FY 1989-90 (10 percent of 1988 Michigan personal income) is estimated at $15.2 billion. Total state revenue (less federal aid and general obligation debt plus specified tax credits) is projected to fall about $2.5 billion below the limit.

COMMENT

On the surface the FY 1989-90 budget appears to be very constrained. In reality it is even more constrained than it appears. First, the proposed 2.5 percent increase in the GF/GP budget is actually a decline of 2 to 2.5 percent after adjusting for inflation. Second, many of the increases in the budget are the result of financing shifts and cuts in other programs. For example, the GF/GP budget for the Department of Corrections is reduced by about $11 million due to a proposal to finance probationary services by levying a $30-per-month fee on persons on parole or probation. Another example is the Department of Social Services budget, which proposes cuts in Medicaid of about $58 million in GF/GP funds. The increase in school aid support appears generous, but much of it is taken back by freezing retirement and Social Security payments at the FY 1988-89 level—leaving a net increase in school aid of about 2 percent, well below the expected rate of inflation. Third, the 3.5 percent pay raise for state employees, amounting to about $50 million, is not funded in the budget. This will require additional program efficiencies.

Another way to illustrate the tightness of the budget is to compare the FY 1989-90 recommendations with the continuation budget estimates prepared by the Senate Fiscal Agency (SFA). (The SFA numbers are adjusted for program transfers and financing shifts.) Exhibit 10 indicates that the FY 1989-90 budget is about $293 million short of maintaining the status quo, taking into account inflation, increased debt requirements, higher caseloads, and budget policies already in place. The largest shortfalls are $150 million in Social Services and $94 million in Corrections. There is also a large shortfall in the Department of Natural Resources budget. The estimate of overfunding in school aid is due largely to the governor's recommendation for $36 million to fund new "quality" programs.

Some of the proposed fee increases and budget reductions will face tough sledding in the legislature. The most controversial areas of the budget are school aid and the Department of Social Services. Conflict is likely to arise over the recommendation to freeze school retirement and Social Security payments; this is about a $100-million item. In Social Services, the Medicaid cuts (some recycled from proposals not approved last year) could be difficult to achieve. About half of last year's recommended cuts were approved, but the easy cuts have been made and the battle will be tougher this year. There is likely to be pressure to provide a cost-of-living increase for welfare recipients, particularly with inflation apparently on the rise. Also, the governor's proposal to eliminate General Assistance for 18- to 25-year-olds and to direct them into the new Job Start program will be hotly debated.

One saving grace is that the budget appears to be based on conservative economic assumptions. The Senate Fiscal Agency is projecting that GF/GP and school aid fund (SAF) revenues will be $116 million higher in FY 1988-89 and $153 million higher in FY 1989-90 than the budget estimates. Based on revenue collections for the first three months of FY 1988-89, the SFA estimate for the current fiscal year appears reasonable. The higher revenue base for the current year will translate into higher revenues in FY 1989-90, unless economic growth slows even more than

EXHIBIT 10

Comparison of FY 1989-90 GF/GP Budget Recommendations with Senate Fiscal Agency Continuation Budget, FY 1989-90

Program or Department	FY 1989-90 Recommendation	Senate Fiscal Agency Continuation Budget, FY 1989-90	SFA Continuation Budget Adjusted for Financing Shifts and Program Transfers	Excess or Shortfall
Human Services				
Social Services	$2,185.3	$2,325.1	$2,335.0	-$149.7
Mental Health	868.1	862.6	863.0	5.1
Public Health	127.0	139.2	130.4	-3.4
Education				
State Universities	1,148.6	1,186.8	1,160.7	-12.1
—Operations	1,061.1	—	—	—
—Financial Aid	87.5	—	—	—
School Aid	540.4	489.1	489.1	51.3
Community Colleges	207.5	210.2	210.2	-2.7
Education	52.8	46.3	45.3	7.5
Library of Michigan	25.8	26.7	26.7	-0.9
Safety and Defense				
Corrections	667.0	772.8	761.8	-93.9
State Police	177.7	175.6	181.1	-3.4
Military Affairs	13.4	13.3	14.7	-1.3
Regulatory				
Commerce	102.9	107.5	115.3	-12.4
Labor	79.2	81.9	78.4	0.8
Licensing and Regulation	11.8	13.5	12.0	-0.2
Natural Resources and Recreation				
Natural Resources	111.1	125.9	128.3	-17.2
Agriculture	28.9	30.2	28.5	0.4
General Government				
Management and Budget	98.4	91.2	95.6	2.8
Legislature	77.9	81.3	81.3	-3.4
Judiciary	107.6	110.3	108.7	-1.1
Treasury	43.0	57.6	50.6	-7.6
Attorney General	23.3	24.0	24.0	-0.7
State	16.2	17.7	17.0	-0.8
Civil Service	15.8	13.9	13.9	1.9
Civil Rights	10.6	11.5	11.5	-0.9
Executive Office	4.0	4.2	4.2	-0.2
Other				
Capital Outlay	220.3	249.8	249.8	-29.5
Debt Service	22.6	44.1	44.1	-21.5
TOTAL	$6,988.3	$7,312.0	$7,281.2	-$292.9

SOURCES: Calculated by Public Sector Consultants from data in *The State of Michigan Executive Budget, 1989-90 Fiscal Year* and Senate Fiscal Agency, *Baseline Budget Estimates, FY 1989-90 and FY 1990-91*, February 1, 1989.

forecast by the Blanchard administration. This is not likely unless inflation becomes a serious problem and the Federal Reserve Board squeezes the money supply too tightly and chokes off economic growth. The January reports of sharply higher wholesale and consumer prices are cause for concern and increase the risks, but the economy still appears strong enough to avoid a recession for at least another year.

The legislative response to the budget is likely to be to adopt the higher SFA revenue figure, to reduce the cuts in Medicaid, to reject the freeze on school retirement and Social Security benefits, to put some money into the budget to provide a small cost-of-living increase for welfare recipients, and to increase funding for Corrections and higher education. Much of the additional revenue in FY 1988-89 will be needed to fund higher spending for the departments of Social Services and Corrections and for capital outlay.

We had hoped to see a new proposal for school finance reform, but the governor decided to recycle his failed one-cent sales tax increase of last fall. Without more leadership from Blanchard, little is likely to happen on this critical issue. Even if the legislature puts a proposal on the ballot, it is unlikely to win voter approval, particularly if the governor is not strongly behind it. The last school finance reform ballot measure in 1981 had strong support from the governor, good support from the education community, and bipartisan support in the legislature and captured only 26 percent of the votes cast.

In his budget message, the governor made one additional proposal that does not affect the FY 1989-90 budget but will affect future budgets. This proposal, called the Home Ownership Savings Trust (HOST) and patterned after the Michigan Educational Trust (MET) program, will provide first-time home buyers with a guaranteed down payment on any new home in any location in Michigan. Families or persons wishing to enroll in the program will select the type of home they wish to buy and the date they wish to purchase the home. The state will calculate the investment required to guarantee the down payment on the specified date. The earnings on the investment will be exempt from state and federal taxes. Full details on the plan have yet to be released. It is also unclear whether this proposal requires legislative approval. The HOST program is similar to an individual retirement account but has a different purpose. The state provides a tax benefit and also manages the money for investors in the HOST program, further extending its role as a banker for Michigan residents. Providing affordable education and housing for low-income persons generally has been viewed as an appropriate government role, but Michigan is extending its reach to higher income persons. The question is how far the state's responsibility should extend. The next logical step might be a program to help finance the purchase of new automobiles (U.S. made models only, of course). At some point financial institutions will begin to view programs like these as unfair competition.

Another important question is whether the state is taking risks that may some day place a drain on the state budget. The MET program is expected to reduce state revenues by about $12 million in FY 1989-90 (because contributions are exempt from the state income tax). The HOST program has the potential to be even costlier. A related concern is whether the guaranteed funds always will be available. It is unlikely that housing prices will increase faster than the return earned on the investments, but this could occur if supply-demand imbalances cause inflation to be concentrated in the housing sector. If this occurred, presumably the state would be obligated to make up the shortfall. The proposed program is an interesting idea with an admirable goal, but whether the state should assume this role is a question that should be carefully debated.

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