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Public Sector Reports

PUBLIC POLICY ADVISOR

Overview and Analysis of the Governor's Recommended Budget for Michigan, Fiscal Years 1993–94 and 1994–95

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The governor has recommended another tight budget for FY 1993–94, providing little or no increases for most departments. Most of the new money in the budget is allocated for prisons, community mental health, and Medicaid. There are major new proposals for school aid, health care, and retirement. The increases in the budget are financed by shifting funding to federal aid, reducing general fund/general purpose (GF/GP) appropriations for retirement systems, and making several small revenue adjustments.

The GF/GP recommendation for FY 1993–94 is $8,224.7 million, 4.8 percent above projected spending for the current fiscal year. After proposed reductions of about $300 million in state and public employees' retirement appropriations, however, the GF/GP budget is $7,923.7 million, only one percent above projected spending for the current fiscal year. The total budget recommendation for FY 1993–94 is $22,614.3 million, a 5.3 percent increase; after deducting the proposed retirement saving, the increase is 4.2 percent. The large increase in the total budget is due mainly to $474 million in additional federal funds, of which $373 million are for the Department of Social Services (DSS), mainly for Medicaid.

As a first step toward a biennial budget, this proposal also presents recommendations for FY 1994–95, but in almost every case the numbers are the same as for FY 1993–94. The budget also assumes the same GF/GP revenue growth, 4.7 percent, for each of the two years. This analysis will not discuss the FY 1994–95 recommendations, except to note that by presenting the bare budget for FY 1994–95, the debate will clearly be focused on "automatic" spending increases when the legislature begins to make the needed adjustments in that budget.

As shown in Exhibit 1, the only major GF/GP budget increases are $140.5 million for the DSS, $148.5 million for law enforcement, including $140 million for the Department of Corrections, and $77.6 million for the Department of Mental Health (DMH). Unlike in previous years, there is no new GF/GP money for education, although the taxes restricted to the school aid fund (SAF) are estimated to

EXHIBIT 1

Executive Budget, GF/GP and School Aid Budget Changes (adjusted for program transfers), FY 1992–93 to FY 1993–94 (dollars in millions)

Program Category	Dollar Change	Percent Change	Percent of Total Increase
Law enforcement[a]	$148.5	11.2%	198.0%
Social services	140.5	6.8	187.3
Health[b]	83.7	7.9	111.6
Capital outlay and debt service	9.2	5.0	12.3
Environmental protection[c]	0.9	0.6	1.2
Regulatory[d]	–0.2	–0.2	–0.3
Education[e]	–4.4	–0.2	–5.9
General government	–2.2	–1.1	–2.9
Retirement	–301.0	nm	
Total	$75.0	1.0%	100.0%

SOURCE: Calculated by Public Sector Consultants, Inc., from data provided by the Michigan Department of Management and Budget.

nm: not meaningful
[a]Includes corrections, state police, judiciary, attorney general, and military affairs budgets.
[b]Excludes social services (Medicaid).
[c]Includes natural resources and agriculture budgets.
[d]Includes commerce, labor, and Michigan Jobs Commission budgets.
[e]Does not reflect balance sheet reductions for retirement and lottery transfer of $286.4 million.

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increase about $94 million in FY 1993–94. However, this recommendation is probably academic as there will be a major change in school funding if the voters approve the school finance/property tax relief ballot proposal on June 2. Even if the proposal fails, the governor is expected to make some changes in his recommendations.

As shown in Exhibit 2, the largest GF/GP increases (adjusted for transfers) are the Department of Corrections, 14.3 percent; debt service, 10.4 percent; the DMH, 8.5 percent; and the DSS, 6.8 percent. The

EXHIBIT 2

GF/GP Executive Budget Summary, FYs 1991–92, 1992–93, and 1993–94
(dollars in millions)

Department or Program	FY 1991–92 Expenditures	FY 1992–93 Approps.	FY 1993–94 Recommends.	Dollar Change from FY 1992–93 (Proj. Exp.), GF/GP	Percent Change from FY 1992–93, GF/GP	FY 1992–93 Gross Approp.	FY 1993–94 Gross Recommend.	Percent Change from FY 1992–93
Human Services								
Social Services	$2,140.8	$2,076.4	$2,216.9	$140.5	6.8%	$6,498.2	$7,117.9	9.5%
Mental Health	910.6	911.8	989.4	77.6	8.5	1,330.5	1,449.2	8.9
Public Health	135.4	144.7	150.8	6.1	4.2	499.0	505.5	1.3
Education								
State Universities	1,295.6	1,312.3	1,314.6	2.3	0.2	1,316.5	1,319.1	0.2
Operations	1,199.4	1,209.4	1,209.4	0.0	0.0	1,209.4	1,209.4	0.0
Financial aid	96.2	102.9	105.2	2.3	2.2	107.1	109.7	2.4
School aid	906.8	1,116.1	829.7	–286.4	–25.7	3,145.3	3,289.3	4.6
Community Colleges	241.1	240.0	232.7	–7.3	–3.0	240.0	232.7	–3.0
Education	40.7	39.8	40.5	0.7	1.8	770.2	809.5	5.1
Retirement	3.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Safety and Defense								
Corrections	866.6	978.9	1,118.4	139.5	14.3	1,034.6	1,162.5	12.4
State Police	191.7	200.8	203.9	3.1	1.5	290.6	293.3	0.9
Military Affairs	26.5	30.8	31.0	0.2	0.6	67.3	72.8	8.2
Regulatory								
Commerce	57.0	60.6	59.5	–1.1	–1.8	372.6	370.9	–0.5
Labor	30.0	32.1	33.0	0.9	2.8	419.8	400.0	–4.7
Michigan Jobs Commission	0.0	0.0	0.3	0.0	nm	0.0	0.3	nm
Natural Resources and Recreation								
Natural Resources	94.4	94.9	95.1	0.2	0.2	330.0	329.8	–0.1
Agriculture	26.3	26.6	27.3	0.7	2.6	55.8	56.5	1.3
General Government								
Management and Budget	49.7	47.9	47.9	0.0	0.0	252.2	244.0	–3.3
Legislature	88.9	91.4	91.4	0.0	0.0	94.9	94.9	0.0
Judiciary	114.2	119.3	123.6	4.3	3.6	181.8	187.1	2.9
Treasury	51.2	48.9	46.4	–2.5	–5.1	180.0	218.7	21.5
Attorney General	24.0	24.7	25.8	1.1	4.5	44.1	43.3	–1.8
State	19.2	12.6	12.7	0.1	0.8	134.3	139.0	3.5
Civil Service	11.8	11.0	11.0	0.0	0.0	27.8	27.9	0.4
Civil Rights	11.0	11.0	11.0	0.0	0.0	12.8	12.8	0.0
Executive Office	4.3	4.4	4.4	0.0	0.0	4.4	4.4	0.0
Library of Michigan	27.1	27.2	27.2	0.0	0.0	31.7	31.7	0.0
Other								
Capital outlay	185.8	146.9	152.2	5.3	3.6	264.0	309.3	17.2
Debt service	24.6	37.6	41.5	3.9	10.4	38.3	42.2	10.2
Revenue sharing	0.0	0.0	0.0	0.0	0.0	1,050.4	1,085.6	3.4
Transportation	0.0	0.0.	0.0	0.0	0.0	2,427.8	2,477.9	2.1
TOTAL	$7,579.0	$7,848.6	$7,923.7	$75.1	1.0%	$21,420.1	$22,041.4	2.9%

SOURCE: Calculations by Public Sector Consultants, Inc., from data provided by the Michigan Department of Management and Budget and the Senate Fiscal Agency.
NOTE: School aid and total expenditure numbers for FY 1993-94 reflect balance sheet adjustments of: PSERS defined contribution ($39.1 million); health reserve ($222.3 million); and lottery deferred transfer to school aid fund ($25 million).

largest reductions are school aid, -25.7 percent (due to temporary adjustments; base spending remains unchanged); the Department of Treasury, -5.1 percent; and community colleges, -3 percent (due to a one-time adjustment; each college will receive the same appropriations as in the current fiscal year).

Every year the budget includes a number of upward and downward adjustments as well as program transfers and financing shifts, but there are fewer in the FY 1993–94 budget than in previous years. As shown in Exhibit 3, the main change in the budget is about $293 million in current policy program increases, mainly

EXHIBIT 3

Fiscal Adjustments by Department or Program, GF/GP, FY 1993–94 Executive Budget (dollars in thousands)

Program/ Department	Program/ Grant Reductions and Efficiencies	Program Transfers	Financing Shifts	Economic Increases	Program Increases		Technical and Other Adjustments	Total Change
					New	Current Policy		
Agriculture	$0	$0	$0	$741	$0	$0	$0	$741
Attorney General	0	0	0	1,188	0	0	0	1,188
Civil Rights	0	0	0	0	0	0	0	0
Civil Service	0	0	0	0	0	0	0	0
Commerce	–2,896	0	–2,840	0	4,805	0	–130	–1,061
Corrections	–11,886	0	5,830	21,334	45,105	13,791	65,270	139,444
Education	0	0	–150	3	158	645	0	656
Executive	0	0	0	0	0	0	0	0
Higher Education	0	0	0	0	0	0	0	
Community Colleges	–7,324	0	0	0	0	0	0	–7,324
Colleges and Universities	0	0	0	0	0	0	0	0
Financial Aid	–58	0	0	0	0	2,335	0	2,277
Judiciary	0	0	0	1,734	0	2,204	453	4,391
Labor	0	0	0	0	1,520	0	–574	946
Legislature	0	0	0	0	0	0	0	0
Library of Michigan	0	0	0	0	0	0	0	0
Management and Budget	0	0	0	0	0	0	0	0
Office of Services to Aging	0	0	0	0	0	0	0	0
Mental Health	–4,646	0	–9,563	10,547	2,000	87,519	–8,286	77,571
Michigan Jobs Commission	0	0	0	0	300	0	0	300
Military Affairs	–400	0	0	841	0	0	–191	250
Natural Resources	0	0	0	0	297	500	–628	169
Public Health	–200	6,600	–50	1,793	0	4,522	82	12,747
School Aid	0	0	–286,400	0	0	0	0	–286,400
Social Services	–2,148	–6,600	–83,329	13,019	29,220	174,970	9,045	134,177
State	0	–2,089	0	0	0	110	0	–1,979
State Police	–6,654	0	0	6,910	2,293	2,371	–1,755	3,165
Treasury	0	0	0	0	0	0	–2,552	–2,552
Debt service	0	0	0	0	0	3,860	0	3,860
Capital outlay	0	0	0	0	6,319	0	–988	5,331
Retirement adjustment								–14,700
Total GF-GP	–$36,212	–$2,089	–$376,502	$58,110	$92,017	$292,827	$59,746	$73,197
Less: School aid	–$36,212	–$2,089	–$90,102	$58,110	$92,017	$292,827	$59,746	$359,597

SOURCE: Calculated by Public Sector Consultants, Inc., from data in *The State of Michigan Executive Budget, Fiscal Years 1994 and 1995*, and Senate Fiscal Agency, *1992 Statistical Report*.

in the DSS (Medicaid, in particular) and the DMH. There were very few program reductions, only $36.2 million, although this may be understated as shifts within programs are not counted. New programs totaled about $92 million, an increase over the last two or three years. This money was mainly to fund the Healthy Kids Initiative and open new prisons. The $83 million in financing shifts for the DSS are changes designed to increase federal funds.

ECONOMIC AND REVENUE ASSUMPTIONS

The FY 1993–94 budget is based on the assumption that the economic recovery that began late last year will continue at a moderate pace throughout 1993 and 1994. (See Exhibit 4.) Real gross domestic product (GDP) is projected to increase 2.8 percent in 1993, 2.7 percent in 1994, and 2.4 percent in 1995. This is about half the rate of growth for a normal economic recovery and below most economists' forecasts. Motor vehicle sales are estimated to increase 5.5 percent to 13.5 million units in 1993 and 5.2 percent to 14.2 million units in 1994.

EXHIBIT 4

Economic Assumptions, FY 1993–94 Budget

	CY 1992 (actual)	CY 1993 (estimate)	CY 1994 (estimate)
United States			
GDP (% change from previous year)	2.1%	2.8%	2.7%
Passenger car sales (millions of units)	8.4	8.8	9.4
Light truck sales (millions of units)	4.4	4.7	4.8
Import share	25.2	22.8	21.7
3-month Treasury bills (percent)	3.6	3.6	3.4
Michigan			
Wage and salary employment (% change from previous year)	0.7	0.7	1.0
Unemployment rate	8.8	8.6	8.6
Real personal income in 1982–84 dollars (% change from previous year)	2.1	2.1	1.3
Detroit CPI (1982–84 = 100%) (% change from previous year)	2.1	2.8	3.8

CY = calendar year

Economic growth is expected to be even slower in Michigan, with real personal income increasing only 2.1 percent in 1993 and 1.3 percent in 1994 (compared with an estimated 2.3 percent in 1992). One reason for the projected slowdown in real growth is that the inflation rate (as measured by the Detroit Consumer Price Index) is forecast to increase from 2.1 percent in 1992 to 2.8 percent in 1993 and 3.8 percent in 1994. Employment is expected to increase only one percent in 1993 and 0.5 percent in 1994 (compared with 0.7 percent in 1992). The unemployment rate is projected to decline from 8.8 percent in 1992 to 8.6 percent in 1993 and remain at that level in 1994.

The governor's budget estimates that baseline GF/GP and SAF revenues will increase 4.1 percent in FY 1992–93 and 4.6 percent in FY 1993–94. The budget also assumes new and one-time revenues of $348 million in FY 1992–93 and $216 million in FY 1993–94.

These are very conservative estimates and there is little risk that they will not be achieved. The major risk is that Congress will not enact a credible deficit reduction plan. If this happens, interest rates will rise and consumer confidence will fall, which could stall the economic recovery. Public Sector Consultants expects a stronger Michigan economy and revenue growth of 4.5 to 5 percent in FY 1992–93 and 5.5 percent in FY 1993–94.

The revenue estimates reflect several legislated and proposed policy changes. Those having the largest effect in FY 1993–94 are (1) a $49.6 million savings in revenue sharing by basing payments on the previous year's growth, (2) $37.5 million from the accrual of delinquent single business taxes (SBT) and income taxes, and (3) $24 million from extending the sales tax to motor vehicle leases. The budget also reflects $87 million savings in property tax credits, which assumes passage of the governor's original property tax cut plan; this has changed, however, with the agreement reached on the ballot proposal. If the proposal passes, the state will pick up $335 million in additional revenue in FY 1992–93 from 2.5 months of sales tax collections. About half this amount is expected to be allocated to the Budget Stabilization Fund and the remainder to be used for spending needs. If the proposal fails, an $87 million adjustment in the budget will be required, unless the legislature quickly enacts another property tax relief measure. Revenues will decline an estimated $27 million in FY 1993–94 because of enacted and proposed changes in the inheritance tax. Exhibit 5 provides a complete list of revenue changes.

EXHIBIT 5

Tax Policy and Other Changes Affecting FY 1993–94 GF/GP Budget (dollars in millions)

	FY 1993 Effect	FY 1994 Effect
Income Tax		
Change in treatment of tax credits, to grants	$220.0	$0.0
Reduction in property tax credits due to 1992 property tax freeze and proposed cut	54.0	87.0
Reduced revenue sharing to local governments	45.5	49.6
Single Business Tax		
SBT small business tax credit[a]	–15.0	–20.0
Sales Tax		
Motor vehicle leases	0.0	24.0
Inheritance Tax: One-time accrual/Reduction and phase out	50.0	–27.0
Horse Racing Revenues: Reduction in restricted expenditures	3.5	0
Other		
Increased federal money for low income heating credits	19.0	0.0
Accrued delinquent income/SBT taxes	0.0	37.5
TOTAL	$377.0	$151.1

SOURCE: Calculated by Public Sector Consultants, Inc., from data provided by the Michigan departments of Treasury and Management and Budget.

[a]Reflected in revenue estimate, not shown on balance sheet.

REVENUE SOURCES AND EXPENDITURE ALLOCATIONS

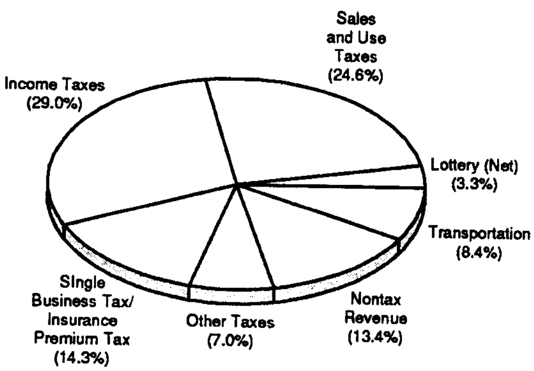
Exhibits 6 and 7 illustrate the funding sources and expenditure allocations of the recommended FY 1993–94 budget. Exhibit 6 shows the origin of state own-source revenue, which excludes federal aid and local and private revenue sources. This is the most meaningful way to look at the budget because it includes revenue earmarked for the SAF, restricted transportation revenues, and revenue sharing but excludes federal aid, which is largely outside the influence of the governor and the legislature. However, it should be noted that the current administration has taken creative actions to increase federal revenue, which has the effect of reducing GF/GP expenditures. About 68 percent of state revenue is generated by just four taxes—individual income, SBT (including insurance premiums tax), sales, and use. Federal aid, however, is the state's largest and fastest growing revenue source, contributing $6.5 billion, up 57.7 percent since FY 1989–90 compared with only a 9.3 percent increase for state taxes.

Exhibit 7 shows the governor's recommended distribution of own-source revenue among state program areas for FY 1993–94. Education, health, social services, transportation, and revenue sharing account for about 78 percent of state spending from state resources. The fastest growing program area is law enforcement and public safety (mainly corrections), which has increased from 8.8 percent of the budget in FY 1989–90 to 11.1 percent in FY 1993–94.

EXHIBIT 6

FY 1992–93 State Funding From State Sources

$14,510.0 (millions)

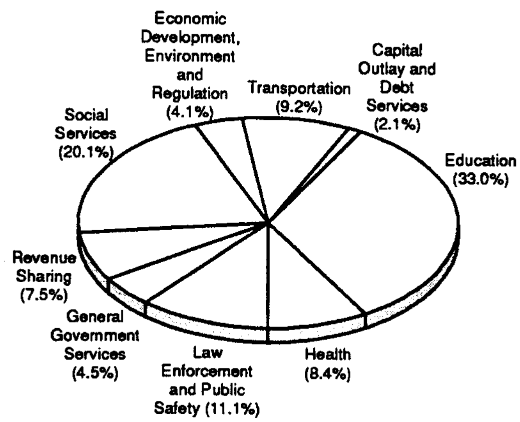


SOURCE: *State of Michigan Executive Budget, Fiscal Years 1994 and 1995.*

EXHIBIT 7

FY 1993–94 State Spending From State Revenue Sources

$14,480.6 (millions)



SOURCE: *State of Michigan Executive Budget, Fiscal Years 1994 and 1995.*

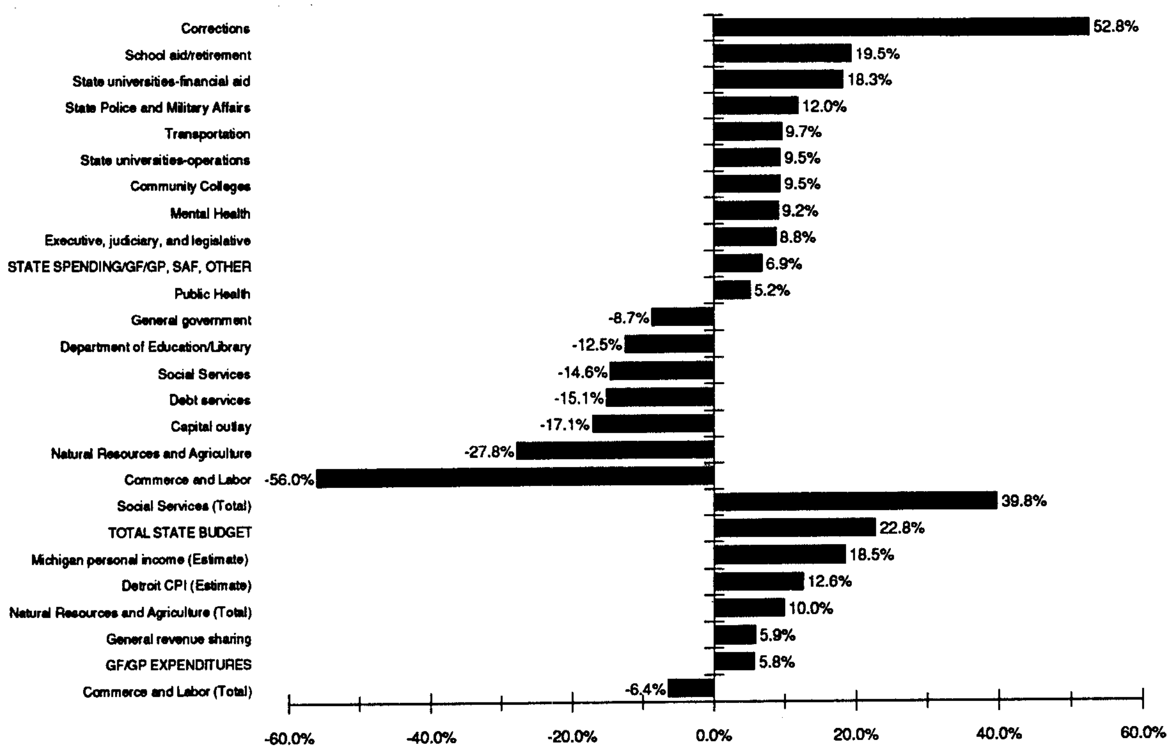
FY 1993–94 SPENDING POLICIES

The following section details the budget recommendations for most departments and programs. For comparison purposes, Exhibit 8 presents the percentage growth in selected areas from FY 1989–90 to FY 1993–94 for GF/GP, school aid, transportation, and revenue sharing spending and reflects the priorities of the Engler administration. Spending growth was greatest in the Department of Corrections (52.8 percent), school aid/retirement (19.5 percent), and financial aid (18.3 percent).

There were large declines in a number of budget categories, including the departments of Commerce and Labor (down 56 percent), Natural Resources and Agriculture (down 27.8 percent), and Social Services (down 14.6 percent). Total spending from GF/GP, SAF, and other state spending sources (refer to Exhibit 8) increased only 6.9 percent over the four-year period, well below the rate of inflation (12.6 percent) and the growth in Michigan personal income (18.5 percent). Total state spending from all sources rose at a much faster rate, 22.8 percent, due mainly to a large increase in federal funds. Federal aid increased 57.7 percent from FY 1989–90 to FY 1993–94, and now accounts for about 31 percent of total state revenue, up from about 24 percent in FY 1989–90. A large share of this increase was in the DSS budget—the result of state-initiated changes in Medicaid financing and an increase in the federal matching rate—as indicated by the 39.8 percent increase in total DSS spending compared with the 14.6 percent decline in GF/GP spending. Federal aid to the DSS increased from $2.2 billion in FY 1989–90 to an estimated $3.8 billion in FY 1993–94, accounting for two-thirds of the total increase in federal aid to the state.

EXHIBIT 8

Growth in Selected Budget Categories, FY 1989–90 to FY 1993–94



SOURCE: Calculated by Public Sector Consultants, Inc., from data in *The State of Michigan Executive Budget, Fiscal Years 1994 and 1995*, and Senate Fiscal Agency, *1992 Statistical Report.*

NOTE: State spending/GF/GP, SAF, and other category does not reflect balance sheet adjustments of PSERS defined contributions ($39.1 million); health reserve ($222.3 million); and lottery deferred transfer to school aid fund ($25 million).

Human Services

The governor has recommended that the **Department of Social Services** receive GF/GP funding totaling $2,216.9 million, a $140.5 million (6.8 percent) increase over last year's appropriation. Recommended gross spending totals $7,117.9 million, a 9.5 percent rise from the FY 1992–93 level, and is largely the result of obtaining additional federal funding, partly through an increase in federal matching rates; the latter will save the state an estimated $25.9 million GF/GP in FY 1993–94. The Medicaid budget accounts for $950 million, or 43 percent, of the department's total GF/GP budget, a 12.1 percent rise over FY 1992–93 funding.

DSS spending includes $24.4 million in GF/GP monies for the newly proposed Healthy Kids Initiative, aimed at providing Medicaid and health insurance coverage to children living in low-income households who previously had been ineligible for Medicaid. Included are children aged 2 to 15 living in families with incomes below 150 percent of the federal poverty level ($17,910 for a family of three). Funding for the program includes $2 million GF/GP to obtain additional federal matching dollars for the Child Caring program, a component of the Healthy Kids program aimed at providing ambulatory coverage (nonhospitalization services) to children aged 2 to 15 in families with incomes below 150–185 percent of the poverty level and to 16- to 18-year-olds in families with incomes 55 to 185 percent of the poverty level if not covered by Medicaid or other insurance; this program will still be funded in part with federal and private monies.

A second major change is the financing shift allowed the state by the federal government for Medicaid funding that previously had been financed through hospital voluntary contributions. The federal government prohibited states from using the contributions method for increasing state dollars toward the federal match. Michigan, however, has been granted permission to make a special share payment of $489 million ($213 million GF/GP and $276 million in federal matching funds) to the University of Michigan hospital. The hospital will return the funds to the state, thereby increasing state funds by the $276 million in federal dollars. This will cover expenses formerly paid for through the contributions program; funding from this source will rise by $31.4 million from the level in the FY 1993–94 budget. A similar financing shift (an intergovernmental transfer to county medical care facilities) will provide an additional $62.1 million in gross funding (primarily federal dollars) for county programs while reducing GF/GP funding by $35 million.

Other changes in the budget include:

- Medicaid base increases of $157 million
- Economic increases totaling $13.1 million GF/GP (for retirement, insurance, utilities, and food costs)
- $8.6 million for data processing needs as the department continues to implement its automation plans
- Reduced spending of $2.1 million to reflect lower costs associated with the transfer of public assistance clients to AFDC

The **Department of Mental Health** has been recommended to receive $989.4 million, a $77.6 million (8.5 percent) rise over FY 1992–93 appropriations. Total spending is recommended to increase 8.9 percent, from $1,330.5 million to $1,449.2 million, net of a $53.2 million transfer from the Department of Corrections (resulting from the proposed transfer of responsibility for prisoner mental health to the DMH).

Increases in current program spending total $77.6 million GF/GP and include (1) $33.4 million for community mental health (CMH) programs for expected current year tradeoff earnings (savings resulting from the transfer of DMH clients from state institutions to community-based settings) and an appropriation for past earnings not yet appropriated and (2) an additional $7.7 million for CMH programs to restore cuts (primarily for Omnibus Reconciliation Act implementation) made in Executive Order 1993-6.

The budget also includes recommendations for an additional $2 million for the community demand bed program and an additional $10.5 million for economic increases. A reduction of $8.3 million in spending for institutional services is recommended to adjust for lower caseloads and lower-than-expected costs.

Recommended GF/GP appropriations in the **Department of Public Health** total $150.8 million, a $6.1 million (4.2 percent) rise over last year. Total spending is recommended at $505.5 million, $6.5 million (1.3 percent) more than the FY 1992–93 appropriation level. (These figures take into account the $6.6 million transfer of the substance abuse disability assistance program from the DSS.)

The budget recommends increased spending for current programs totaling $4.5 million, including $2.9 million for crippled children's medical care and treatment and for increased caseloads and reduced federal funding. Economic increases total $1.8 million, primarily for higher retirement and insurance costs. There are no increases for new programs. Recommended reductions total $200,000, one-half for dental programs and the other for local public health infrastructure. The budget also reflects restructuring of the department into five offices.

Education

The GF/GP recommendation for **school aid** is $1,116.1 million. This is unchanged from estimated expenditures for FY 1992–93; however, the budget recommends changes to the retirement system and a transfer of lottery money that reduce GF/GP appropriations by $286.4 million to $829.7 million.

The proposed adjustments are to (1) fund 1994 health benefits for retired teachers by using $222.3 million from the Public School Employees Retirement System (PSERS) health reserve, (2) change the retirement system for teachers hired after January 1, 1994, to include employee contributions for retirement (for a FY 1993–94 savings of $39.1 million), and (3) transfer $25 million in lottery funds to the SAF that should have been credited in previous years. Total school aid, including restricted revenue (sales tax and lottery revenue, for example), is recommended at $3,575.8 million, excluding the adjustments described above. This results in an adjusted increase of 4.7 percent and includes a $94 million increase in restricted revenues and $361.4 million in additional retirement costs.

The school aid budget includes some major policy changes. One is to roll most categorical funding, along with one-third of the current payments for social security, into the Children's Education Guarantee. This will guarantee that school districts levying the state average millage rate (34.6 mills) receive a basic state/local grant of $4,211 per student. Districts levying more mills will receive $69 per mill per student, while those levying fewer mills will lose one percent for every one percent their millage rate is below the state average.[1] Also, in the next two years the remainder of the social security and retirement money would be rolled into the guarantee. In addition, the plan proposes to eliminate the $79 million recapture of categorical funds from out-of-formula school districts and the current tax base sharing program, which has been tied up in court. The $8 million in tax base sharing money in escrow will be added to the guarantee.

The budget continues to appropriate categorical monies for transportation, special education, intermediate school districts, preschool education, and several other small items. It includes several increases, including (1) $5 million to fund Michigan Education Assessment Program (MEAP) test improvement incentives, (2) $3.6 million for the Partnership for New Education, and (3) a $1.6 million increase for special education.

Another major policy change is the replacement of adult education funding with a new Work Force Development Competitive Grants program, recommended at $240.1 million. This will require school districts to compete with community colleges, nonprofit organizations, and private firms to provide training and education for adults. This controversial proposal will have a major effect on the budgets of many school districts.

At this writing a school finance/property tax relief plan is slated to be voted on in a special election on June 2. If this proposal is approved, the budget recommendations will become moot. It is likely, however, that the legislature will pass a school aid budget that will allow voters to know how much the schools will receive if the proposal is defeated. It likely will contain many of the components described above.

The FY 1993–94 **Department of Education** budget is recommended to increase 1.6 percent to $40.5 million. The budget includes (1) $0.5 million to match higher matching requirements to bring in federal dollars for vocational rehabilitation, (2) $80,000 to make MEAP tests available to all Michigan students, and (3) $158,000 to continue development of a high school proficiency test to be given to all students beginning in 1994–95 school year.

For the second consecutive year the budget recommends no increase for **four-year universities** operations. The FY 1993–94 recommendation of $1,209.4 million is only 9.5 percent above FY 1989–90 expenditures, or down 2.8 percent adjusted for inflation. Each university is recommended to receive the same appropriation as in FY 1992–93.

1 For example, a district levying 40 mills would receive a guarantee of $4,584 per pupil (and would receive $2,584 per pupil from the state if it raised $2,000 per pupil locally) and a district levying 30 mills would receive a guarantee of $3,650 per pupil.

The FY 1993–94 GF/GP budget for **financial aid** is recommended at $105.2 million, $2.3 million above FY 1992–93 appropriations. This includes an additional $2 million for caseload increases in the Tuition Incentive Program and $0.3 million for caseload increases in the Indian Tuition Waiver program.

The FY 1993–94 recommendation for **community colleges** is $232.7 million, down $7.3 million from FY 1992–93 appropriations. The decline is due the proposed elimination of the special $7.3 million tax subsidy for Wayne County Community College, made possible because the voters approved a millage increase for the college that will raise these funds locally. Each community college is recommended to receive the same appropriation as in FY 1992–93.

The recommended FY 1993–94 appropriation for the **Library of Michigan** is $27.2 million, unchanged from the current-year appropriation.

Natural Resources and Agriculture

Recommended spending for the **Department of Natural Resources** totals $95.1 million, a $0.2 million or 0.2 percent increase from last year's appropriation level. Increases are $0.3 million for the restoration of field staff, $0.5 million for payments in lieu of taxes. The budget also includes a $0.6 million net decrease in departmental grants.

The **Department of Agriculture** is recommended to receive $27.3 million in GF/GP funds in FY 1993–94, a $0.7 million or 2.8 percent increase over FY 1992–93. Recommended increases in departmental spending include $0.8 million for retirement and insurance, while various small reductions total $0.1 million. In addition, food bank funding ($0.5 million) was transferred from the executive line to the grants line.

Regulatory

The recommended FY 1993–94 GF/GP appropriation for the **Department of Commerce** is $59.5 million, 1.8 percent below the FY 1992–93 appropriation. The total recommendation is $370.9 million, down 0.5 percent. The GF/GP recommendation includes several new programs as well as reductions. The recommended increases are

- $2.3 million for increased travel promotion,
- $2 million for a new Michigan Jobs Investment Fund, which will ensure that employers know where to go to upgrade the skills of their employees, and
- $0.5 million for a new Michigan Community Education Initiative to make Michigan residents aware of job opportunities and other government services.

The budget will be reduced $2.5 million, as the final payment for the Grand Rapids Museum was made in FY 1992–93. In addition, the general fund will save $2.8 million because the Insurance Bureau budget will be financed entirely by assessments and fees collected from its regulated companies.

The recommended GF/GP appropriation for the **Department of Labor** is $33 million, 2.9 percent above current year appropriations. The only major increase is $1.5 million for the Supplemental Benefit fund to provide additional benefits for injured workers. The gross recommendation is $400 million, 4.7 percent below projected FY 1992–93 expenditures.

The governor has recommended $0.3 million for a new **Michigan Jobs Commission**, which will coordinate the job training and job creation resources of the various state and federal agencies. Initially, this will be an independent agency.

Safety and Defense

Growth in the **Department of Corrections** budget continues to outpace that of all other budgets. The FY 1993–94 GF/GP recommendation is for $1,118.4 million, a 14.2 percent increase. Since FY 1989–90, the Corrections budget has increased 52.8 percent, about three times faster than any other GF/GP budget. The budget includes funds ($13.6 million) to open new prisons in Baraga, Saginaw, and Detroit, which will complete the opening of all prisons currently constructed. A significant share of additional department funding will go to increase capacity at current facilities ($13.8 million) and to expand the capacity to treat mentally ill prisoners pursuant to a federal court consent decree. Also included are $5.9 million in additional funding for developing community alternatives to incarceration and $4 million for a vaccination program. The budget recommends $10.6 million in savings from downsizing boot camps.

The prison population has increased from 28,406 in 1990 to 34,933 in 1993 and is expected to increase by an additional 3,849 prisoners by the end of FY 1993–94, exceeding prison capacity despite double bunking in 6,876 cells. The budget recommends the funding of 15,959 full-time equated classified positions, an increase of 936 positions from FY 1992–93. Employment in the department has more than doubled since FY 1985–86, while employment in the remainder of state government has declined by about 2,500 jobs.

The FY 1993–94 budget for the **Department of State Police** is recommended at $203.9 million, a 2 percent increase. The major increases are (1) $1 million for a trooper recruit school to add 128 new troopers, (2) $1.3 million for installation of a new statewide radio system, (3) $1.7 million for step increases for trooper and civilian dispatchers, and (4) $6.9 million for economic increases. The budget also proposes several major reductions: (1) $2.7 million due to attrition by reorganizing duties, (2) $2.3 million due to completion of computer purchases, and (3) $1.5 million due to local units assuming the cost of 911 central dispatch through their newly authorized telephone surcharge revenue.

The recommended FY 1993–94 appropriation for the **Department of Military Affairs** is $31 million, an 0.8 percent increase. The budget recommends economic increases of $0.8 million and savings of $0.6 million from other adjustments.

General Government

This category includes six departments, plus the judiciary, Executive Office, and legislature. The recommended GF/GP appropriation for FY 1993–94 is $374.4 million, 0.8 percent above projected FY 1992–93 appropriations.

The recommendation for the **Department of Treasury** is $46.4 million, $2.6 million (5.2 percent) below current year funding. The only significant changes are a $3.2 million reduction in the amount appropriated to pay back a loan from the Veterans Trust Fund, which reflects a decision to repay interest only on the loan and delay principal payments.

The **judiciary** budget is recommended at $123.6 million, 3.7 percent above FY 1992–93 appropriations. The major additional funds are $2.2 million for salary increases for judges and $1.7 million in economic increases for social security, retirement, and insurance.

The FY 1993–94 GF/GP budget recommendation for the **Office of Attorney General** is $25.8 million, up 4.8 percent. The budget includes $1.2 million for economic increases. The proposed privatization of the Accident Fund reduces the need for 25 positions and will lessen gross expenditures by $2.5 million.

The **Department of State** budget for FY 1993–94 is recommended at $12.7 million, after the proposed transfer of the $2.1 million auto emission testing program to the Department of Transportation. Adjusted for this transfer the budget is 0.9 percent above last year's spending level.

The FY 1993–94 budget proposes no significant changes in GF/GP funding for the **legislature, Executive Office,** and **departments of Civil Rights, Civil Service, and Management and Budget (DMB)**. The gross budget for DMB, however, will be reduced by $9 million due to program transfers, shifts in financing, and other adjustments.

Other

The **Department of Transportation** is funded by restricted funds, mainly gas and weight (registration) taxes, and federal revenues. The recommended appropriation for FY 1993–94 is $2,477.9 million, an increase of only 2.1 percent. There are no major new programs funded in the budget, but the $2.5 million auto emission testing program has been transferred to Transportation from the Department of State.

The governor has recommended a GF/GP **capital outlay** budget of $152.2 million, 3.6 percent above the current fiscal year budget. The only increases are $4.3 million for community college and university projects and $2 million in additional planning funds. (This budget has already been approved by the legislature.)

The governor has also recommended a new bond program to fund 33 construction projects at universities and community colleges at a cost of $613 million and several other public protection projects, including dividing Jackson Prison into four smaller prisons, and natural resources and transportation projects at a cost of about $110 million. The education projects will be financed by the State Building Authority, which will require the bonding cap to be raised by $650 million.

The recommended GF/GP appropriation for **debt service** for FY 1993–94 is $41.5 million, a $3.9 million increase. The budget reflects a $3.7 million reduction in payments for water pollution control bonds and an additional $7.5 million for Quality of Life bonds.

The budget assumes no withdrawal from or payment to the **Budget Stabilization Fund** (BSF) in FY 1993–94. The Senate Fiscal Agency is estimating, however, that the formula will require a payment to the BSF of $46 million. This can be avoided by an act of the legislature. In FY 1991–92, $170 million was withdrawn to help balance the budget. Up to $6 million can be withdrawn from the BSF in FY 1992–93 if needed to balance the budget. Any surplus at the end of the year will be paid to the BSF as will the proceeds of the proposed sale of the state Accident Fund. The BSF will have an estimated balance of about $22 million at the end of FY 1992–93.

General revenue sharing grants to local governments (from sales, income, single business, and intangibles taxes) are recommended at $1,085.6 million, a $35.2 million increase from the FY 1992–93 level. The recommended payment for FY 1993–94 is based on the increase for the previous year rather than the current year, as normally required by the law. This change reduces the payment by about $50 million. The grant for the Michigan Equity Program (included with $4.1 million in arts money in a new line called arts and cultural grants) is recommended at $25.6 million, down $2.5 million due to the final payment being made to the Grand Rapids Museum in FY 1992–93.

Article IX, Section 30 of the Michigan Constitution requires that 41.6 percent of state spending (excluding federal aid) be allocated to local units of government. The FY 1993–94 budget as recommended exceeds this requirement by $158 million, based on DMB estimates. The budget as presented for FY 1994–95 is estimated to exceed the requirement by $426 million, although this number could change considerably as significant adjustments in the FY 1994–95 recommendations (or suggestions as they might more appropriately be called) are likely.

Article IX, Section 26 (**state tax limit**) of the state constitution restricts the amount of revenue the state may collect in any fiscal year to 9.49 percent of Michigan personal income. The limit for FY 1993–94 is estimated at $17.4 billion (9.49 percent of 1992 Michigan personal income). Total state revenue (less federal aid and general obligation debt plus specified tax credits) will fall about $3.8 billion below the limit.

COMMENT

Tight budgets have become a way of life in Michigan and FY 1993–94 and FY 1994–95 are no exceptions. Until there are major changes in our revenue structure, uncontrollable cost increases, such as for health care, are likely to outstrip normal revenue growth (see our *Public Policy Advisor*, "Reforming the Michigan Tax System," February 12, 1993). There are clear winners and losers in the FY 1993–94 budget—corrections is the big winner and education is the loser.

Spending for the Department of Corrections appears to be out of control, the result of policies enacted in the 1980s and early 1990s. While these policies may have been politically expedient when initiated, their popularity will be tested as we pay ever-increasing amounts to incarcerate criminals. The Michigan Council on Crime and Delinquency, for example, points out that Michigan's spending on prisons exceeds the national average by more than 40 percent. One contributing factor is that citizens are reporting crimes with greater frequency than before; the council reports that Michigan ranks second among the midwestern states in the number of violent crimes reported in 1991. In addition, Michigan has more than twice the rate of incarceration for nonviolent crimes as neighboring states. At the same time, criminals are serving longer sentences, the result of mandatory sentencing guidelines established by the legislature.

These factors—more reporting of crime, greater rates of incarceration of nonviolent criminals, and longer prison terms—have resulted in a prison population that has increased 165 percent between 1981 and 1991 and a correspondingly high rate of spending growth (52.8 percent between FY 1989–90 and FY 1993–94, the greatest rate of growth for any state department during that period. All this would indicate the need for the implementation of either (1) additional alternative incarceration measures for nonviolent offenders or (2) additional spending on preventative programs, such as those aimed at physical and substance abuse awareness, expanded educational opportunities, and job training.

The governor advocated the former in his budget address, which included additional funding for developing community alternatives to incarceration, the continuation of funding for electronic tethering, and expanded local responsibility for felon custody. It is interesting to note, however, that in the same message the governor said that community alternative programs have only reduced the number of locally institutionalized prisoners, not the state prison population. The budget also recommends reduced funding for boot camps, the result of restrictive legislative mandates regarding the program.

Ironically, funding for programs aimed at crime prevention will be increasingly scarce given Michigan's current economic and budget situation, which is likely to continue for some time. Absent tax rate increases or expansions of the base, normal growth of the existing tax base would be the only source of additional revenue and most of this will be eaten up by health, retirement, and the inflation cost increases. Greater expenditures for corrections, therefore, could only come at the expense of other programs, including programs focusing on prevention.

The big loser in this budget is education, both K-12 and higher education. For the second year in a row, higher education is recommended for no increase in funding, resulting in an after-inflation decline in appropriations. Like the state, higher education institutions will have to reduce spending, raise revenues, or use some combination of the two. Those that have not had time to and/or cannot cut costs because of contracts will be left with few alternatives other than increasing tuition rates. While not politically popular, the legislature and the administration may not be able to restrain such increases in light of appropriation levels. For the longer term, higher education must find more efficient methods to deliver services. Business, and now government, has been forced to reduce overhead and become more creative in the face of increasing global competition and slow economic growth. Many colleges and universities have tightened their belts, but they have been slow to recognize that the world has permanently changed and they must change or become second rate institutions with declining enrollments.

Because of the expected upward pressure on tuitions we would like to see an expansion of funds for financial aid and the development of partnerships with business to insure that talented low and middle income students are not priced out of the market. The state should also examine the feasibility of establishing new revolving loan funds to supplement current state and federal loans. This could be tied to statewide exams for high school seniors, awarding scholarships and/or reduced interest loans to those students who scored highest and who had the greatest financial need.

The recommendation that K-12 school districts pay social security and retirement costs out of their membership grant will place an increasing burden on them, especially those least able to raise local taxes. In the absence of school finance reform aimed at reducing inequities between rich and poor districts, many districts will soon be facing a financial crisis. The property tax/school finance measure to be decided on June 2 will require that increases in retirement costs be equally shared by the state and local districts. Yet to be resolved, however, are what costs schools would be required to pay out of the guaranteed $4,800 per pupil funding amount. Schools will not have to pay for special education, but there is no consensus yet on other areas of spending (including social security and adult education) currently funded through state categorical aid. These issues will be taken up in the normal process of passing the school aid bill. If Proposal A fails, the state will be hard pressed to adequately fund the schools in the future.

The human services budgets appear very reasonable, with estimated caseloads and spending levels in line with economic reality. Although aided by the increase in the federal matching rate, the administration has done a exceptional job of procuring additional federal funding and was especially inventive in the agreement it reached regarding the replacement of funds previously derived from the hospital contributions program.

The governor must also be given credit for recommending long-term strategies to deal with accelerating health and retirement costs. First, the state signed an agreement with the unions that provides an incentive to slow the growth in health care costs. In the first year of the agreement, employees receive all of the savings; in the second, employees receive 75 percent and the state 25 percent; and in the third year, the savings are shared equally. Second, the budget includes a recommendation for a new defined contribution retirement program for state employees and teachers hired after January 1, 1994. This will result in significant savings for the state and will provide employees with portability of pensions and more flexibility in investing funds. New employees may receive lower retirement benefits than current employees, but this will depend on how well their money is invested.

Finally, although the biennial component of this budget is only a small first step, it could serve as an impetus for enacting legislation that would put in place a true biennial budgeting system. While some questions of constitutionality have yet to be answered, the enactment of a true two-year budget—that would spread spending and revenues over two years as opposed to one—could prove especially beneficial to Michigan, given the volatile nature of our economy. The ability to spread expenditures over two years could reduce the need for budget cuts and allow for better planning by state government, local governments, and colleges and universities.

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