



Michigan COMMENTARY

The Michigan Budget: Difficult Choices Ahead

by Robert Kleine and Gerald Faverman

Michigan may be facing its worst budget crisis since the early 1980s. Revenues have softened and expenditures continue to outpace estimates. Michigan has a very cyclical economy because of our dependence on the automobile industry, and the state has been through three difficult budget and economic periods since 1970. The Michigan economy may be headed into a mild recession, as car sales are slow and economic growth is sluggish. As a result of this weakness and heavy spending pressures, we are facing a budget situation that could be destabilizing for many programs. The administration has acknowledged that a problem exists but believes it is not serious and can be managed with budget cutbacks, adjustments, and transfers. Others, however, including Public Sector Consultants, believe the problem may be more difficult to handle than the Blanchard administration currently is willing to admit.

On May 23 the Senate Fiscal Agency (SFA) released a report projecting a \$163.6 million deficit for FY 1989-90 and \$91.8 million for FY 1990-91. The estimates for FY 1989-90 assume passage of the supplemental bill as approved by the Senate, which increases expenditures by a net of \$55.1 million, and the withdrawal of \$68.8 million from the Budget Stabilization Fund (BSF) to cover increased school aid costs. The SFA also is projecting additional expenditure needs of \$56 million in the current fiscal year. The SFA reduced its March general-fund/general purpose and school aid fund revenue estimates for FY 1989-90 by \$73.6 million. The estimate is now \$50 million below the FY 1989-90 statutory estimate of \$9,451 million. This is significant in that the constitution requires that the governor issue executive orders to reduce spending when it appears revenues are below the statutory estimate. However, this determination can be made by the executive branch and at the time it chooses, and the administration does not agree with the SFA numbers. The Department of Management and Budget (DMB) is estimating that revenues are still \$36.4 million above the statutory estimate and that the year will end with a \$1.7 million surplus—which is about enough money to run state government for one hour. The DMB has estimated that expenditures will be \$95.5 million less than the SFA estimate as the result of an additional one percent across-the-board cut worth \$53 million, \$15 million in lapses, and \$29 million less in payments to the State Building Authority. None of these saving were assumed by the SFA. The DMB has not released revisions in its FY 1990-91 numbers.

The \$73.6 million reduction in the SFA revenue estimate for FY 1989-90 was due largely to a projected \$58 million shortfall in single business tax (SBT) revenue. Because a change in the current year also affects the budget year and the Michigan economy is expected to be slightly weaker in 1991 than estimated earlier, the FY 1990-91 revenue estimate was reduced by \$102.4 million. The SFA revenue estimates are about \$74 million below the DMB estimates for FY 1989-90 and \$99 million lower for FY 1990-91.

Our view is that SBT revenue will fall short of the SFA estimate and that the "real" FY 1989-90 deficit will exceed \$200 million. For FY 1990-91 we believe revenue will fall \$100 million below the SFA

estimate, and expenditures are likely to be well above current estimates. As has been the case in recent years, there are significant overexpenditures in Corrections and Social Services. Our best estimate at this time is that the FY 1990-91 budget is out of balance by at least \$300 million. This amount could double if the state loses appeals of court cases involving Medicaid payments to hospitals and nursing homes and section 30 (Headlee) payments to local governments. There are also several school finance reform measures under discussion, including the Paterson-Anderson ballot proposal, that if adopted, could add hundreds of millions of dollars to the K-12 budget.

What are the options for eliminating the projected deficit? The first is to reduce expenditures, and this is being done, but with only four months left in the year it will be difficult to cut the amount needed. A \$164 million reduction (as estimated by the SFA) is equal to about 7 percent of expenditures for the remainder of the year. If education is excluded, as it has been to date, the cut would have to exceed 10 percent. The second option is to raise taxes, but this is an election year and no one is likely even to consider this option. A third option is to take money out of the BSF. The fund will have a balance of \$400 million at year end. To take money out of the fund for the current year requires that real Michigan personal income decline in 1989. Current estimates indicate that did not happen. A withdrawal for FY 1990-91 requires that real personal income decline in 1990. Current estimates by the DMB and SFA indicate that this will not happen, but at this point we believe there is a good chance it could. In any event, the money is needed this year, and there are two other ways to withdraw it. First, the law allows the legislature to declare an emergency with a two-thirds vote and withdraw funds. Second, the legislature can change the BSF law and take out funds as was done for prison construction and, most recently, school aid. Use of this option, however, would only delay the inevitable and increase next year's shortfall to as much as \$500 million. But this is an attractive option and would allow the governor and the legislature to avoid the hard budget cutting and taxing decisions until after the election.

A final option is for the legislature to use \$400 million from the elimination of the SBT capital acquisition deduction, which has been declared unconstitutional by the Michigan Court of Claims. One can argue, however, that this is bad policy, as the deduction is an important part of the tax and its elimination without offsetting relief to business likely would have a negative effect on the business climate. The temptation, however, to pick up \$400 million without a vote may be irresistible, so don't be surprised if this occurs. The only long-term solution is to reduce expenditures permanently or raise revenues, and the process must begin by adopting honest, balanced budgets at the start of the budget process.

The situation we find ourselves in is one caused largely by spending beyond our means. Only once in the past decade has current revenue exceeded spending. A major contributing factor has been the consistent underestimate of expenditures. From FY 1979-80 to FY 1988-89 budget revisions increased spending by a total of \$2.8 billion. These increases were covered by higher-than-expected revenues, use of carryover surpluses, borrowing, tax increases, and accounting adjustments. The Blanchard administration has been just as adroit in the use of balancing techniques as was the Milliken administration in the early 1980s, but it has been less forthcoming about doing so. Those who remember the 1982 election rhetoric attacking Governor Milliken for his use of these techniques will understand the administration's reluctance to advertise its creativity.

As shown in Exhibit 1, state spending has increased much faster than inflation and the federal budget and about in line with personal income. Exhibit 2 shows that the largest spending increases have been for

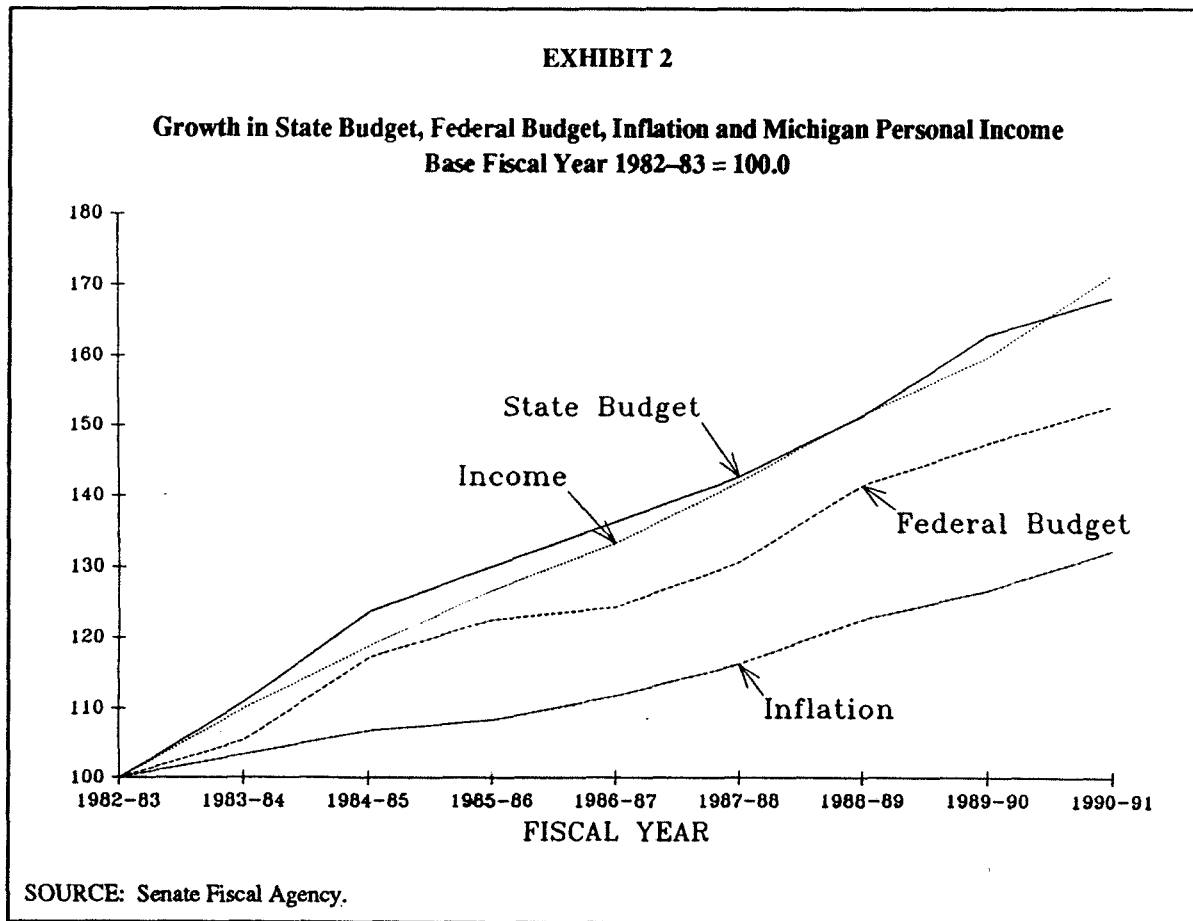
EXHIBIT 1

State Appropriation Growth, State Spending from State Resources (actual dollars)

	1982-83 Year-to-Date Appropriations	1990-91 Government Receivables	Dollar Change	Percentage Change
Social Services	\$1,874,239,700	\$2,371,579,500	\$497,339,800	26.5%
Mental Health	539,092,700	964,119,000	425,026,300	78.8
Public Health	102,391,000	178,314,100	75,923,100	74.2
Corrections	228,587,200	799,011,800	570,424,600	249.5
SUBTOTAL HUMAN SERVICES	2,744,310,600	4,313,024,400	1,568,713,800	57.2
Education	32,904,424	66,838,600	33,934,176	103.1
School Aid	1,196,501,000	2,679,887,000	1,483,386,000	124.0
Community Colleges	135,000,000	223,115,100	88,115,100	65.3
Higher Education	780,497,239	1,255,294,800	474,797,561	60.8
Retirement-Public School Employees	508,428,700	377,491,200	-125,937,500	-25.0
SUBTOTAL EDUCATION	2,648,331,363	4,602,626,700	1,954,295,337	73.8
Executive	2,601,357	4,071,900	1,470,543	56.5
Legislative	52,929,000	81,532,300	28,603,300	54.0
Library of Michigan	15,152,700	26,130,600	10,977,900	72.4
Judicial	67,665,000	128,225,800	60,560,800	89.5
Attorney General	17,318,600	29,540,100	12,221,500	70.6
State	38,312,900	65,136,400	26,823,500	70.0
Management and Budget (Operations)	155,007,536	246,907,100	91,899,564	59.3
Management and Budget (Revenue Sharing)	595,092,300	1,086,200,000	491,107,700	82.5
Treasury (Operations)	52,873,200	119,238,200	66,365,000	125.5
Treasury (Debt Service)	112,472,000	28,082,100	-84,389,900	-75.0
Civil Service	9,124,200	24,544,000	15,419,800	169.0
Civil Rights	7,821,800	11,434,200	3,612,400	46.2
SUBTOTAL GENERAL GOVERNMENT	1,126,370,593	1,851,042,700	724,672,107	64.3
Commerce	119,469,900	235,471,200	116,001,300	97.1
Labor	63,695,100	113,904,700	50,209,600	78.8
Licensing and Regulation	15,309,600	26,914,900	11,605,300	75.8
SUBTOTAL REGULATORY	198,474,600	376,290,800	177,816,200	89.6
State Police	122,800,700	222,780,200	99,979,500	81.4
Military Affairs	9,660,100	16,203,902	6,543,802	67.7
SUBTOTAL SAFETY AND DEFENSE	132,460,800	238,984,102	106,523,302	80.4
Agriculture	32,075,070	60,332,500	28,257,430	88.1
Natural Resources	124,193,700	236,730,100	112,536,400	90.6
SUBTOTAL AGRI. AND NAT. RESOURCES	156,268,770	297,062,600	140,793,830	90.1
Transportation	819,424,900	1,345,174,300	525,749,400	64.2
Capital Outlay	83,197,800	234,944,700	151,746,900	182.4
Unrestricted Federal Revenue	-23,000,000	-20,000,000	3,000,000	-13.0
TOTAL APPROPRIATIONS	\$7,885,839,426	\$13,239,150,302	\$5,353,310,876	67.9%

SOURCE: Senate Fiscal Agency.

NOTE: The table is not adjusted to reflect program shifts.



Corrections, capital outlay, school aid, revenue sharing, and Commerce. If spending on Corrections had been at the same rate as overall spending, the FY 1990-91 budget would be about \$400 million lower. The phase-out of the 1983 increase in the income tax and slow growth in other tax sources also has added to the problem. State taxes as a share of personal income have declined from 8.2 percent in FY 1983-84 to about 7 percent in FY 1988-89. The tax base also has been eroded by an estimated 52 percent increase in state tax expenditures (deductions, exclusions, and credits) from FY 1981-82 to FY 1987-88.

Until there is evidence of more leadership in the legislature and the governor's office we can expect these episodes of poor budget planning and brinkmanship to continue. The interesting question is how this will play out in the current year with the governor's office at stake. Governor Blanchard does not want to be forced to make executive order budget cuts, nor does he wish to look like a spender. He has to hope the economy cooperates so that the problem can be shoved under the carpet until after the election. Senator Engler has much to gain if the situation reaches crisis proportions, but only if he can avoid being viewed as an obstructionist. He certainly does not want to be associated with cuts in education spending; but human services spending such as Corrections and Social Services are fair game.

In any case, Michigan is in for troubling times that will extend well into the next fiscal year. These budget problems must be resolved before we can have institutional stability.