



Michigan COMMENTARY

Finally, a Budget Agreement—of Sorts

by Robert Kleine, Vice President and Senior Economist

We are pleased that the governor and the legislature finally were able to get together and agree to actions that eliminate, at least on paper, most of the potential budget shortfall for the current fiscal year. However, there is less to the agreement than meets the eye. Most of the actions taken were one-time revenue adjustments and one-year budget reductions (see Exhibit 1); almost all of the reductions were recommended in the FY 1991-92 budget. Nothing was done to correct the structural imbalance in the budget. The state still will spend nearly \$1 billion more than it collects in revenue in the current fiscal year. The cash flow situation is still the worst in memory; the agreement will provide some relief to state government at others' expense. The general and school aid funds were about \$725 million in the red at the end of May, and the state has delayed payments to school districts and other local governments and, as part of the agreement, will be delaying payments to higher education. The red ink in the cash accounts will continue to increase over the next few months, likely requiring further delays in state payments.

EXHIBIT 1

Components of Budget Agreement (dollars in millions)

Proposed Executive Order (cuts)		Proposed Supplemental (add-ons)	
Capital Outlay	\$36.9	Social Services	\$168.1
Management and Budget	3.4	Medicaid underfunding	154.3
Arts grants	2.3	Partially restore AFDC reduction	12.1
Treasury	6.3	Foster care	10.4
Lottery—excess retained earnings	5.8	Excess GF-GP funding for Office of Children and Youth Services	-46.3
Commerce	45.1	Other	37.6
Liquor equity transfer	28.0	Treasury (debt service-environmental bonds)	4.9
Michigan Equity Program	4.0	Natural Resources (payments-in-lieu of taxes)	3.1
Neighborhood initiatives	3.5	Mental Health	3.0
Labor	22.9	Other	5.2
Michigan Youth Corps	14.5	TOTAL	\$184.3
Job training grants	7.5		
Natural Resources	4.7	Other Adjustments	
Public School Employees Retirement	53.8	Property tax credit accounting change	\$366.2
Education (driver education fees)	4.7	Budget Stabilization Fund	223.0
Other	1.0	School bond loan repayments	103.0
TOTAL	\$178.9	Delayed payments—colleges and universities	114.4
		Escheats fund transfer	56.0
		State compliance furloughs	15.0
		Reallocation of transportation funds	1.5
		TOTAL	\$879.1

THE FY 1991-92 BUDGET

Although the FY 1990-91 budget may be nearly in balance (see Exhibit 2), assuming the problem with the single business tax capital acquisition deduction is resolved, the FY 1991-92 budget is still far out of balance. General fund-general purpose and school aid fund revenues are expected to increase about \$500 million in FY 1991-92, but this increase will be needed to make up for the one-time revenues built into the current-year budget. Even if the governor drops his property tax reduction plan (net expenditures of \$278 million) the proposed FY 1991-92 budget is more than \$500 million out of balance, and the governor recommended a number of deep cuts that are not likely to win legislative approval. It will be difficult to reach a budget agreement for FY 1991-92, as the governor opposes a tax increase and the Democrats oppose the cuts needed to bring the budget into actual

EXHIBIT 2

FY 1990-91 Budget Crisis
(dollars in millions)

Components of Budget Problem		Proposed or Enacted Solutions	
Revenue Shortfall	- \$714.0	One-time revenues	\$755.0
Additional expenditures		Pre-June budget reductions	560.0
Pre-June supplementals and other spending requirements	-568.0	June executive order	179.0
June agreement	-184.0	Delayed payment—colleges and universities	114.0
SBT/CAD court case	-300.0	Medicaid voluntary contribution	100.0
FY 1989-90 deficit	-310.0	Lapses	20.0
TOTAL	- \$2,076.0	Employee furloughs and other	16.5
		TOTAL	\$1,744.5
		Remaining Deficit	- \$331.5

balance. This means that there will be a phoney budget agreement this summer, or no agreement until the fall. It is likely that education will no longer be exempt from budget reductions.

One of the casualties of the budget problems will be the governor's 20-percent property tax cut. However, the recent agreement by the Engler administration to settle the suit brought against the state by Oakland County will require the state to increase aid to local governments by up to \$450 million in FY 1992-93. The aid likely will be provided in the form of a reimbursement for a state-mandated reduction in local property taxes. This is just a shell game and provides no additional revenue for local governments, but Richard Headlee and his supporters are likely to accept it as the price that must be paid for property tax relief.

A PERMANENT SOLUTION

The state budget has had a structural imbalance for more than a decade, as has been pointed out by the House Fiscal Agency. Each year it is papered over by accounting gimmicks. Michigan is no longer a rich state and cannot continue to provide the level of services provided in the 1960s and 1970s. If the state is to remain solvent and retain our high credit rating, we must make the hard decisions required to balance current revenues and expenditures.

In addition to resolving the dispute over the SBT deduction and rescinding the state pay raise, two additional actions should be taken.

1. **Increase taxes temporarily.** The squeamish remember the 1983 recalls of two state senators over the income tax hike in 1983. But no legislator lost reelection in 1982 for casting a "Yes" vote for a Milliken-led, temporary income tax hike. The discussion must turn on what taxes to increase (ending deductions or credits, raising the income tax, extending the sales tax to services, increasing the single business tax, or a host of others) and on a sunset date.

There appears to be public support for a tax increase. In an April opinion poll Public Sector Consultants found that 54 percent of the respondents favored reducing services and balancing the reductions with a small tax increase, 9 percent favored increasing taxes to avoid reductions in services, and 30 percent were opposed to any tax increase.

2. **End an array of state services.** Reducing less essential services, allowing for everyone's interpretation of what is essential, is more responsible than cutting back every program by x percent. We could start by delaying all capital outlay projects except those essential for public safety and health.

For now, we can breathe a temporary sigh of relief, but congratulations are not yet in order. More cooperation and political courage than has been shown to date will be required to balance the FY 1991-92 budget. A starting point will be for the conference committees to cut out the more than \$200 million added to the governor's recommendations. If this cannot be done there will be little chance of reaching agreement on the budget this summer. Tight budgets have become a way of life in Michigan, and this is not likely to change for the next two or three years.

We can only hope our leaders in Lansing will learn how to bring more order and forward thinking to the process.