


FISCAL AWARENESS SERVICE

AN INDEPENDENT FISCAL ANALYSIS OF STATE SPENDING



August 1986
Volume 5 Number 3

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Analysis of Michigan Budget Appropriations Fiscal Year 1986-87

The fiscal year (FY) 1986-87 state budget appropriations recently approved by the legislature and the governor set general fund-general purpose (GF-GP) spending at \$6.12 billion, 1.3% above the projected spending level for FY 1985-86.¹ The legislature added \$73.5 million to the governor's revised budget request of \$6,046.5 billion.² The major areas of increase were \$28.6 million in school aid, \$13.6 million in higher education (including community colleges), \$11 million in general government, \$10 million in social services, \$9 million in public health, and \$3.5 million in mental health. FY 1986-87 appropriations for all funds are \$14.6 billion, about 3% above the estimated spending level for FY 1985-86.

The only program areas receiving significant increases are education, corrections, mental health, and labor. There will be reductions from the FY 1985-86 level in seven departments and increases below inflation in several others. State colleges and universities received a 7% increase (excluding financial aid) and community colleges a 6.4% increase. The school aid appropriation is 6.7% above projected expenditures for FY 1985-86; total school aid spending is up 7%

¹The governor vetoed the entire Medicaid budget because the legislature added a provision to disallow Medicaid payments for abortions. As a result, the appropriation for the Department of Social Services is not finalized. The Department of Management and Budget estimates the appropriation at \$1,913.7 million; the Senate Fiscal Agency estimate is \$1,922.3 million, the actual amount in the bill passed by the legislature. The DMB estimate is used here.

²The governor line-item vetoed GF-GP appropriations amounting to \$8.7 million and asked for restoration of \$5 million.

or 7.7% per pupil. The largest increases were 21.5% for the Department of Labor and 19.9% for the Department of Corrections.

In addition to GF-GP monies, several departments and capital outlay divided \$82.6 million of Exxon oil overcharge money received from the federal government (see Table 1).

As reported in our February analysis, increases in several areas of the budget are possible because of a \$90 million reduction in capital outlay spending, a \$35.5 million reduction in debt service, and a \$30 million reduction in welfare expenditures. The relatively constrained 1986-87 budget is made necessary by the rollback of the income tax rate from 5.1% to 4.6%, effective January 1, 1986, which reduces revenues by about \$300 million in the current fiscal year and \$425 million in FY 1986-87.

In our February budget analysis we estimated that revenues would be \$100-150 million higher in the current fiscal year and in FY 1986-87 than reported in the governor's budget. This still appears to be a good estimate, and this additional revenue (which is also expected by the Senate Fiscal Agency) has allowed the legislature to be somewhat more generous than the governor.

ECONOMIC ENVIRONMENT

The FY 1986-87 budget is based on a forecast of continued moderate growth in the economy. Real gross national product is projected to increase 3.4%

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TABLE 1
Distribution of Oil Overcharge Revenue

Department of Agriculture: Energy efficiency grants for farm/forestry equipment	\$13,500,000
Department of Commerce:	
Community foundations	3,000,000
Electricity options study (includes \$175,000 prior supplemental)	425,000
Resource recovery program	3,008,300
Hospital interest write-down program	750,000
Community Colleges: Energy conservation projects	2,400,000
Higher Education: Energy conservation projects	5,900,000
Department of Social Services: Energy conservation incentives program	38,628,000
Department of Transportation: Signal modernization projects	*
Department of Labor: Weatherization	12,988,700
Capital Outlay: Renovation and maintenance of senior centers	2,000,000
TOTAL EXPENDITURES	\$82,600,000

* Commitment for future funding from Stripper Well settlement.

compared with a projected 2.6% increase in FY 1985-86. Passenger car sales are forecast to increase about 1% in FY 1986-87.

The governor's economic forecast assumes that the Michigan economy will be slightly stronger than the national economy in FY 1986-87. Michigan personal income is projected to increase 5.9% compared with an estimated 4.8% increase in FY 1985-86. Wage and salary employment is projected to increase 1.4%, and the unemployment rate is expected to average 9.7%.

At this point, the governor's economic forecast for FY 1986-87 appears to be slightly conservative. The forecast assumes stable oil prices and a stable U.S. dollar. In recent months, both oil prices and the value of the dollar relative to major currencies have fallen sharply. This has resulted in lower inflation, lower interest rates, and a stronger market overseas for American goods. As a result, the economy has been stronger and revenues about \$150 million higher (includes an additional \$36 million transfer from the Working Capital Reserve Account) in the current fiscal year than assumed in the governor's estimate. However, the bill that rolled back the income tax rate from 5.1% to 4.6% on April 1 provided for an additional rollback if the surplus for FY 1985-86 exceeded \$50 million. Since the surplus is expected to exceed this amount by at least \$105 million, the rollback will be effective January 1, 1986, reducing revenue by about \$105 million. After this rollback, Public Sector Consultants estimates the year-end balance will be \$100-125 million for the current fiscal year and \$25-50 million for FY 1986-87.

There are several factors that could affect these estimates. First, the courts could require the State to refund about \$150 million in excess revenues pursuant to the constitutional revenue limit (Headlee amendment). Second, the passage of a federal tax reform bill would increase state tax revenues by about \$150-200 million.³ This revenue gain will result from the elimination of a number of federal deductions, which will increase adjusted gross income, the starting point for the calculation of the state income tax. However, the governor has already proposed returning these "wind-fall" revenues to state taxpayers by reducing the income tax rate from 4.6% to 4.4%. The Senate Republicans have raised the ante by introducing legislation to reduce the income tax rate to 4.2%. Third, each house has passed a bill to provide additional property tax relief, which would reduce available revenues by \$100-150 million.

1986-87 SPENDING POLICY

The general fund-general purpose budget is that portion of the total state budget that is not constitutionally or statutorily mandated for use on designated programs. Table 2 details anticipated FY 1985-86 GF-GP expenditures, FY 1986-87 executive budget recommendations, and FY 1986-87 legislative appropriations.

³This increase is not automatic, but would occur if Michigan changed its income tax law to reference the current federal tax code or if taxpayers changed their behavior, i.e., reduced IRA contributions.

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

Department or Program	Projected FY 1985-86 Expenditures	FY 1986-87 Revised Executive Recommendation	FY 1986-87 Legislative Appropriation ^a	Change from FY 1985-86	Percentage Change
Human Services					
Social Services	\$1,943.7	\$1,904.9	\$1,913.7	\$ - 30.0	- 1.5%
Mental Health	669.6	704.0	707.5	37.9	5.7
Public Health	123.1	119.1	128.1	5.0	4.1
Education					
State Colleges and Universities	978.3	1,026.7	1,038.9	60.6	6.2
— Operations	901.4	948.5	964.7	63.3	7.0
— Financial Aid	76.9	78.2	74.2	- 2.7	5.1
School Aid	510.6	516.4	545.0	34.4	6.7
Community Colleges	175.5	185.2	186.7	11.2	6.3
Education	39.7	36.6	37.3	- 2.4	- 6.0
Library of Michigan	19.8	20.1	20.7	0.9	4.5
Safety and Defense					
Corrections	397.2	477.5	476.4	79.2	19.9
State Police	152.7	156.0	156.2	3.5	1.6
Military Affairs	11.7	11.7	11.6	- 0.1	- 0.9
Regulatory					
Commerce	89.1	86.8	85.9	- 3.2	- 4.6
Labor	57.2	77.8	69.5	12.3	21.5
Licensing and Regulation	15.5	15.2	15.3	- 0.2	- 1.3
Natural Resources and Recreation					
Natural Resources	120.0	103.6	107.8	- 12.2	- 10.2
Agriculture	26.0	25.3	25.4	- 0.6	- 2.3
General Government					
Management and Budget	142.0	131.8	140.8	- 1.2	- 0.8
Legislature	63.5	60.9	68.9	5.4	8.5
Judiciary	79.9	85.2	85.3	5.4	6.8
Treasury	58.5	66.7	60.4	1.9	3.2
Attorney General	20.5	21.2	21.3	0.8	3.9
State	16.0	15.8	15.1	- 0.9	5.6
Civil Service	10.4	10.9	10.9	0.5	4.8
Civil Rights	9.9	10.1	10.4	0.5	5.1
Executive Office	3.5	3.6	3.6	0.1	2.9
Other					
Capital Outlay	218.9	127.4	128.6	- 90.3	- 41.3
Debt Service	80.5	46.0	45.0	- 35.5	- 44.1
Transportation	0.0	0.0	0.0	—	—
Budget Stabilization					
Fund Transfer	30.6	0.0	4.9	- 25.7	—
TOTAL	\$6,063.9	\$6,046.5	\$6,121.2	57.3	0.9 ^b

^a Reflects vetoes and restorations.

^b Increase is 1.3%, excluding BSF transfers.

Education

The largest adjustment to the governor's budget was the addition of \$28.6 million in *school aid*. The governor's recommended general membership formula was increased from \$339.35 per pupil plus \$68.50 per mill to \$345 plus \$72.25; a funding increase of \$15 million. The legislature also increased the appropriations for compensatory education (\$3.2 million), special education (\$6 million), vocational education (\$1 million), intermediate school districts (ISD) special education (\$1 million), and programs for the academically talented (\$1.1 million).

The governor's recommendation for *higher education* was increased \$12.1 million by the legislature. The three largest universities, Michigan State University, University of Michigan, and Wayne State University, received an additional \$9.2 million. The legislature also appropriated \$2.9 million to be distributed by formula to institutions that receive less than the state average appropriation per full-year equated student and reduced the inflationary adjustment for colleges and universities by \$3.4 million. In addition, the legislature appropriated \$2.6 million for a new Martin Luther King, Jr.-Rosa Parks scholarship program and added \$1.9 million for tuition grants. The legislature supported the governor's recommendation to continue funding the Research Excellence Fund at \$25 million.

The legislature added \$1.5 million to the governor's recommended appropriation for *community colleges*.

Institutions of higher education and community colleges also received \$5.9 million and \$2.4 million, respectively, from federal oil overcharge revenues.

Human Services

The legislature added \$21.3 million to the governor's recommendations for *human services* programs: \$9 million in public health, \$8.8 million in social services,⁴ and \$3.5 million in mental health. The major change in the *Department of Public Health* was replacement of proposed fee increases of almost \$8 million with general fund support. The legislature also appropriated additional funds for the Office of Substance Abuse Services and for the state/local cost sharing program.

The main additions in the *Department of Mental Health* were about \$3.5 million for special projects programs such as a family subsidy for households including adults age 60 and over, training and referral

⁴This was not an actual increase in program support, but a transfer of a program from the Department of Labor.

services for Alzheimer's disease, community services, a pilot program for prevention of mental illness in children, and special dual diagnosis services. Appropriations for community mental health and community residential services were increased \$16.5 million and \$13 million, respectively, due to increased federal funding and a \$7.3 million reduction in the appropriation for community residential services support for the developmentally disabled.

The *Department of Social Services* budget has not been finalized because of the governor's veto of the section prohibiting use of Medicaid funds for abortions. However, the appropriation levels in the final conference report are unlikely to change much. The legislature added funds to the aid for dependent children (AFDC) program and reduced funds for general assistance (GA) and medical services. These changes involved the transfer of cases from GA to AFDC, additional cost-containment measures in Medicaid, and an adjustment to the FY 1986-87 spending base for medical services. The legislature also retained in Social Services Project Self-Reliance, an \$8.8 million program; the governor had recommended transfer of the program to the Department of Labor.

There was no increase in the grant levels for AFDC and GA, although recipients received a substantial increase in energy cost assistance funds.

Both the *Department of Mental Health* and the *Department of Public Health* received above-average increases in appropriations for FY 1986-87; 5.7% and 4.1%, respectively. The appropriation for the Department of Social Services is 1.5% below the projected spending level for FY 1986-87, due mainly to an expected decline in caseloads; the FY 1986-87 appropriation is almost 5% below the peak reached in FY 1983-84.

Regulatory

This category includes the *departments of Commerce, Labor, and Licensing and Regulation*. The FY 1986-87 appropriation for these departments is 5.5% above the projected expenditure level for FY 1985-86. The legislature appropriated almost the exact amount recommended by the governor, but there were several significant offsetting changes. In the Department of Commerce, the governor recommended the elimination of the \$4 million grant to cities for resource recovery, but the legislature only reduced the grant by \$1 million. The department received about \$7 million in oil overcharge funds, \$3 million of which was used to fund the resource recovery program. The recommended appropriation for the Michigan promotion program (Say "Yes") was reduced by about \$2.3 million, and the monies were used to fund a number

of other programs, such as the Michigan equity package (aid to Detroit) and celebration of Michigan's sesquicentennial.

The legislature made one major change in the governor's GF-GP recommendations for the Department of Labor. The governor's recommendation that Project Self-Reliance be transferred from the Department of Social Services to Labor was not adopted by the legislature. Also, the governor's recommendation for a \$22 million appropriation to the department from oil overcharge revenue was reduced to \$13 million. (These are restricted funds and do not show up in the GF-GP appropriation.)

Natural Resources and Recreation

The FY 1986-87 GF-GP appropriation for the *departments of Natural Resources (DNR) and Agriculture* are lower than the projected spending level for FY 1985-86. The appropriation for the DNR is \$12.2 million below the projected spending level for FY 1985-86,⁵ due largely to elimination of one-time payments and departmentwide reductions (see Public Sector Consultants' February 1986 analysis of the governor's recommended budget for FY 1986-87).

The legislature added \$5.3 million to the governor's recommendation for the DNR. The major increases were \$2.2 million for tourism development grants, \$1 million for commercial fishers compensation payments, \$0.8 million to replace proposed park fee increases, and \$0.6 million for air and groundwater quality programs.

The appropriation for the Department of Agriculture is \$0.6 million below the projected spending level for FY 1985-86, unchanged from the amount recommended by the governor. The gross appropriation for the department was increased \$15.4 million above the governor's recommendation due mainly to a \$13.5 million appropriation of the oil overcharge funds to encourage the energy-efficient use of farm and forestry equipment; the department is to develop a plan for distribution.

Safety and Defense

The legislature made few changes in the governor's recommendations for the *departments of Corrections, State Police, and Military Affairs*.

The governor increased his original recommendation for the Department of Corrections by \$52 million, largely to cover the costs of about 3,200 additional beds. The FY 1986-87 appropriation for the depart-

ment is 19.9% above the projected expenditure level for FY 1985-86.

The State Police appropriation is slightly above, and the Military Affairs appropriation slightly below, the FY 1985-86 level.

General Government and Other

The remaining areas of the budget account for less than 10% of total GF-GP spending and generally comprise monies for accounting, tax collection, building maintenance, debt service, capital outlay, and the judicial and legislative branches of government.

The FY 1986-87 legislative appropriation for *general government* (excluding capital outlay and the debt service) was almost unchanged from the projected spending level for FY 1985-86. The legislature added about \$12 million to the governor's recommendation — most of this increase was in the Department of Management and Budget (DMB), where the legislature added \$10 million for building authority rent for the University of Michigan hospital. The legislature also increased its own appropriation by \$2.2 million, added \$455,000 to the DMB budget for arts grants, added \$600,000 for the Library of Michigan, and increased the Department of State budget by about \$400,000 for historical programs and historic site grants.⁶

The FY 1986-87 appropriation for capital outlay is \$128.9 million, \$90.3 million below FY 1985-86 and \$1.5 million more than the governor recommended.

The appropriation for *debt service* is \$35.5 million below the FY 1985-86 projected expenditure and \$1 million less than recommended by the governor.

There is little new money for *local government* in the budget, but tax revenue restricted for revenue sharing will increase an estimated 6%. Section 30 of the Michigan Constitution requires that 41.6% of state spending be allocated to local governments. This requirement will be exceeded by almost \$285 million in the FY 1986-87 budget.

The formula for the *budget stabilization fund* indicates a transfer to the fund of \$34.9 million in FY 1986-87; however, \$30 million will be used for prison construction; an estimated additional \$34.8 million will be withdrawn for prison construction under the economic stabilization provisions of the fund.

Under one interpretation, revenues collected by the State in FY 1984-85 exceeded the constitutional revenue limit by about \$150 million. In the current fiscal

⁵This reflects a \$1.1 million veto by the governor.

⁶The governor vetoed almost all the proposed appropriations for historical programs and sites.

year and in FY 1986-87, revenues will be well below the limit; as much as \$700 million below in FY 1986-87.

COMMENT

The most significant budget development during the Blanchard administration has been the commitment to the corrections system. The GF-GP budget for the Department of Corrections has increased almost 112% from FY 1982-83 to FY 1986-87. Spending on corrections has accounted for 20% of the increase in total GF-GP spending during this period. The corrections budget was a high priority in the last few years of the Milliken administration, but the recent commitment to adding and improving prison facilities is unprecedented. The public rejected a 1980 ballot proposal to increase the income tax by 0.1 percentage point to support prison construction, although crime is one of the public's major concerns. Construction of new prisons does little to control crime, but it will negate the need for early release of prisoners and holds out the hope for an improved success rate in rehabilitating prisoners.

The largest share of the increase in state spending since FY 1982-83 has gone to education (see Table 3). The governor and the legislature have recognized the importance of education to the state's future and have been relatively generous in allocating funds for this purpose. There are, however, several changes in policy we would like to see. First, a workable plan should be developed to reduce the reliance of K-12 education on the property tax. Public Sector Consultants, Inc.,

favors a plan that would increase the sales tax by two cents and use the proceeds to reduce residential property taxes; this would require a constitutional amendment. A two-cent increase would generate \$1.4 billion, which would finance about a 60% reduction in residential property taxes when combined with savings from the current homestead property tax credit program. Michigan currently ranks tenth among the states in its residential property tax burden (measured as a percentage of income) and sixth in its sales tax burden. This revenue shift would drop Michigan's rank on residential property tax burden to about twentieth — about equal to the U.S. average — and move its sales tax burden to about eleventh among the states. Several ballot proposals to shift part of the burden to another revenue source have failed in the past, and this plan would require a well-financed, well-organized campaign to be successful. In the event the voters again reject this program, an alternative would be for the legislature to enact a gradual reduction in school property tax millage rates without shifting support for education to a new revenue source.

Second, the community college funding formula should be adjusted to better reflect the needs of community colleges serving the larger urban areas of the state. These colleges can play an important role in revitalizing the Michigan economy, and this should be recognized in the formula.

Third, the governor should not interfere with the tuition-setting process for higher education. The constitution grants autonomy to state colleges and universities, and the governor and the legislature should not attempt to abrogate this autonomy without

TABLE 3
Change in General Fund-General Purpose
Expenditures by Major Category, FY 1983 to FY 1987

Category	Percentage Change FY 1983 to FY 1987	Percentage of Dollar Increase in GF-GP Budget	Percentage of Total GF-GP Budget, FY 1987
Education	41.4%	39.8%	29.5%
Corrections	111.5	20.0	7.8
Health	36.9	18.0	13.7
Capital Outlay	424.9	8.3	2.1
Debt Service	-52.0	-3.9	0.7
Social Services	-0.8	-1.2	31.3
Other	35.4	19.0	14.8
TOTAL GF-GP	25.9%	100.0%	100.0%

amending the constitution. If the colleges and universities act irresponsibly, the governor and the legislature can make adjustments in appropriation levels in subsequent budgets.

The governor and the legislature are rightly concerned with tuition levels and access to higher education. However, a more effective approach might be to provide more assistance to parents to cover higher education tuition costs. The governor has proposed the Baccalaureate Education System Trust (BEST) to help parents accumulate funds to cover future tuition costs. This program could be supplemented by using the ten-cent cigarette tax, which generates about \$110-115 million annually, to partially match contributions to the BEST program. The ten-cent cigarette tax was allocated to the Working Capital Reserve Account from May 1982 to November 1985 to retire accumulated state debts and is now a GF-GP revenue.

One area of the budget that is sometimes overlooked because it is financed with restricted funds is transportation. In the 1970s Michigan's roads, bridges, and highways were deteriorating because funding was tied to declining revenue sources: gas and weight taxes. In FY 1959-60, transportation spending accounted for 18.8% of the state budget; by FY 1982-83, transportation accounted for only 8.8% of state spending. In one of his final acts in office, Governor Milliken signed the transportation survival package, which completely restructured and increased the funding sources for transportation. As a result, transportation has been one of the fastest growing areas of the budget; the FY 1986-87 appropriation is 47.1% above FY 1982-83 expenditures. This is a welcome development given the importance of the transportation system to Michigan's efforts to improve its business climate and expand employment opportunities.

Tax relief is always a popular political issue and

this year is no exception, even though the personal income tax rate has already been rolled back to 4.6%. Republican gubernatorial candidates William Lucas and Daniel Murphy, Governor Blanchard, and a number of legislators have advanced property tax reduction proposals. Further rollbacks in the income tax rate have also been proposed by the governor, candidate Lucas, and a number of legislators. Most of these rollback proposals are contingent on the State gaining additional tax revenues from federal tax reform.

In our opinion, the best use of this money would be to increase the personal income tax exemption. The current \$1,500 exemption has not been increased since 1973; adjusted for inflation, the exemption is worth \$634 in 1973 dollars. The federal tax reform bill passed by both the House and Senate proposes to increase the federal personal exemption to \$2,000. (The House version reduces the exemption to \$1,500 for itemizers.)

A \$500 increase in the Michigan personal exemption would reduce state income tax revenues by about \$180 million. The tax savings for a family of four with a \$25,000 income would be \$92 compared with a tax savings of \$38 for an equivalent 0.2 percentage point reduction in the income tax rate. For a family of four, the savings from the rate reduction does not exceed the savings from the increase in the personal exemption until income exceeds \$52,000. For a single taxpayer, the breakeven income level is \$13,000. The rate reduction is more beneficial for small, high-income families and the increase in the personal exemption favors large, low- and moderate-income families.

Unless spending is tightly controlled there will be few opportunities for significant tax relief for the next several years. We hope equity and not politics will be the deciding factor in the type of tax relief program adopted.

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CORRECTION

The August 1986 FISCAL AWARENESS SERVICE newsletter on the state budget contained an error on page 6. Michigan ranks thirty-sixth among the states in sales tax burden not sixth as the newsletter states.

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