State Budget: A Most Difficult and Demanding Year

The revenue picture and news on the economy have been rather grim this year, but the situation in our opinion remains one in which moderate optimism for next year is appropriate. We remain convinced that after the elections, bold leadership can create a climate to solve our problems in an orderly way.

The continued deterioration of the economy, increased welfare caseload, unemployment, and the collapse of car sales to a 24-year low created a state budget shortfall of more than $1 billion. The state has been able to cope with these massive challenges by a combination of executive orders, programs cuts, tax increases, deferrals, actuarial revisions in its retirement programs, and expenditure reductions.

Our opinion is that the hemorrhaging has ceased and a lengthy, slow-paced recovery will become observable in late fall and early winter. Revenues will improve some $400-500 million and a climate of increasing stability will result.

State officials are preparing a $150 million executive order, the fourth of this fiscal year. Areas targeted for reduction are K-12 education, $72.3 million; community and junior colleges, $7.0 million; colleges and universities, $32.0 million; and revenue sharing, $38.7 million. With only five weeks remaining in the fiscal year, it is obvious that $150 million of savings cannot be effected by these units in such a time frame. Any additional cuts would be devastating to these financially-strapped units. There is not a scintilla of evidence that the units have any residual savings available for sacrifice. Approximately half of the proposed amount, $70 million, was to free up funds so they could be reallocated to cover welfare funding shortages; the remaining $80 million in cuts has been attributed to weaker than anticipated revenue collections.

It is improbable that such an ill-conceived executive order which pits schools, colleges and universities, and cities against the poor should win the approval of the House and Senate appropriations committees. Moreover, this combination of spending cuts and supplemental appropriations would push state spending to local units below the 41.6% required under the Headlee amendment to the constitution. This would have to be made up in fiscal 1983, thereby further restricting the flexibility of the budget-making process for that year.

Nor does a cut of this magnitude appear necessary. There are obviously considerations other than fiscal ones at play here. A wide variety of choices and options are available besides striking at budget units whose fiscal year began July 1.

We continue to estimate that $75 million of shortfall remains to be dealt with in this fiscal year. An additional $90 million from the temporary income tax surcharge will not be collected until April 1983, but will be accrued to this fiscal year. Thus, the difficulty facing state budget managers is not a deficit, but a cash shortage.

We believe the $75 million can be managed within the usual capabilities of the Department of Management and Budget. In previous years the state has realized $40 million-plus from lapses, has made extensive use of interfund borrowing, delayed payment of bills and/or switched Medicaid accounting from an accrual to a cash basis. While some of these approaches have been looked upon with disfavor by New York bond rating companies, the state's economic condition cannot improve rapidly enough to raise its credit rating prior to the hoped for October bond sale. Consequently, use of these techniques would have minimal impact on fiscal 1982 or 1983 in terms of the state's credit rating, but it could assist in managing the cash deficit. We remain pessimistic that an upgrading of the state's bond rating will occur in the near future, and doubt that the state will be able to sell its bonds in the traditional manner. We anticipate the state will utilize other options such as the sale of commercial paper and the issuance of $200-$300 million of short-term notes.

Unemployment

Michigan's heavy dependence upon automobile manufacturing and the extremely cyclical nature of that industry hypersensitizes unemployment in Michigan to fluctuations in the general economy. Michigan's unemployment rate increases sooner and accelerates more quickly than the national unemployment rate when the economy slips into a recession. Conversely, as economic activity increases coming out of a recession, Michigan's unemployment rate has always declined earlier and more precipitously than the national unemployment rate. This phenomenon has magnified normal fluctuations in state revenues--tax revenues fall more precipitously and grow more quickly going into and coming out of a recession than the nation as a whole.

The post-war record high July national unemployment rate of 9.8% is unchanged from June. However, Michigan's unemployment rate of 14.4%, also unchanged from June, is significantly below the March 1982 record of 15.7%. We project Michigan's average unemployment rate will decline to 12.3% in fiscal 1982-83.

Autos

The decline of the U.S. automotive industry and its decreasing share of worldwide automobile production suggests that Michigan's unemployment experience coming out of this recession may be fundamentally different. Domestic auto sales currently stand at about half the 1978 rate, while the import portion of the market has been increasing. Over 500,000 jobs have been eliminated from auto and auto-related industries. Since approximately 1/3 of the U.S. auto employment is centered in Michigan, a significant proportion of these job eliminations has occurred in Michigan.

It will take years to retrain and absorb these workers back into the workforce, and a concentrated effort will be necessary to attract new industries and jobs to this state. We expect employment to rebound slowly in Michigan even as the national and state economies improve. The 1981 calendar year automobile sales were 8.2 million units. The 1982 calendar year sales may well be as low as 7.1 million. At this early date, we are projecting 1983 calendar year auto sales at 8.3 million units. Spring will be the test of the level and percentage of Michigan's economic recovery; 8.6 million units may well be attainable if consumer confidence and consumer spending recover.

1983 Budget Considerations

Current discussions on additional reductions in the state FY 1983 budget appear to be premature. We expect that recent declines in interest rates and the expiration of the temporary state income tax surcharge on October 1, 1982 may result in improvements in consumer confidence late this fall. If this encourages consumers to draw down their savings balances to finance purchases of consumer durables, Michigan should see signs of a modest economic recovery beginning late this fall and early this winter.

Since increased purchasing translates readily into higher tax revenues and increased employment, even a very weak upturn, perhaps as little as 1/3 of the normal improvement coming out of a recession, should generate a 4-5% revenue increase in FY 1983. Inflation in the expected 6-7% range would nudge the total increase in gross state product up to 10-12% over this year, thereby providing the basis for a state general revenue fund level of approximately $4.7 billion.