Gerald Faverman, Ph.D. • *Chairman of the Board*
Robert J. Kleine • *Editor*

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Analysis of Michigan Budget Appropriations, Fiscal Year 1990–91

by Robert Kleine and Frances Spring

INTRODUCTION

Michigan is facing its most difficult budget problems since the early 1980s. Although work on the FY 1990–91 budget is not finished (agreement has not been reached on capital outlay, the Corrections budget may be reworked, and the governor's vetoes must be considered), as it now stands this budget may be one of the most unbalanced ever adopted in this state. According to the House Fiscal Agency (HFA) in its February 12, 1990, *Economic and Fiscal Outlook*, "The fiscal year 1990 and 1991 budgets will be the most controversial and painful budgets since those of the 1978–83 economic and fiscal debacle in Michigan."

The HFA projected that the FY 1989–90 and 1990–91 budgets together were underfunded by $750 million; since then, spending requirements have increased, and revenues have weakened. Recently, in a memo to the senators, the Senate Fiscal Agency stated its belief "that potential FY 1990–91 budget shortfalls total $312.4 million." We believe that the FY 1989–90 budget is out of balance by $150 million to $200 million and the FY 1990–91 budget by at least $750 million.

This paper describes the FY 1990–91 budgets of the major departments and budget categories, compares them to FY 1989–90, discusses significant changes from the governor's recommendations, and reports the governor's vetoes. Comments follow on the economic forecast, the implications of the overspending, and the budget-balancing options available to policy makers.

OVERVIEW

The FY 1990–91 general fund/general purpose (GF/GP) budget is $7.657 billion, 4.5 percent above projected spending for FY 1989–90 (including supplementals of $211.5 million and reductions of $193.4 million). The legislature added $34.3 million to the governor's original recommendation of $7.623 billion, mainly in school aid ($14.3 million); the Department of Commerce ($7.5 million); the legislature ($6.1 million); and higher education ($6 million). The budgets for debt service and the Department of Labor are reduced by $8.2 million and $3.4 million, respectively.

As can be seen in Exhibit 1, the largest increases above projected FY 1989–90 spending are for the Department of Military Affairs (26.4 percent); capital outlay (15.4 percent); retirement (14.4 percent); and the Department of Agriculture (13.4 percent). The appropriation for the Department of Social Services is roughly the same, only 0.1 percent above projected spending for FY 1989–90. The only reductions are in debt service (–26.3 percent); the Department of Labor (–3.3 percent); and the Department of Public Health (–1.8 percent). The departmental reductions result from financing shifts or program transfers and the failure to recognize funding requirements.

The governor exercised his veto on higher education ($7.5 million, mostly for Michigan State University's research excellence fund); school aid ($2.8 million for foreign language studies); the

Public Sector Consultants, Inc.
Knapp's Centre • 300 S. Washington Square
Suite 401 • Lansing, MI 48933 • (517) 484-4954

EXHIBIT 1

General Fund/General Purpose Budget Summary
Fiscal Years 1988–89, 1989–90, and 1990–91
(dollars in millions)

Department or Program	FY 1988–89 Expenditures	FY 1989–90 Appropriations	Supplementals (net of reductions)	Projected FY 1989–90 Expenditures	FY 1990–91 Recommendations	FY 1990–91 Appropria-tions	Dollar Change from FY 1989–90	Percentage Change from FY 1989–90
Human Services								
Social Services	$2,302.5	$2,281.5	$70.9	$2,352.4	$2,355.5	$2,355.5	$3.1	0.1%
Mental Health	863.9	878.1	0.0	878.1	915.5	915.5	37.4	4.3
Public Health	135.7	139.1	6.9	146.0	143.3	143.3	–2.7	–1.8
Education								
State Universities	1142.8	1195.5	0.0	1195.5	1255.3	1261.2	65.7	5.5
Operations	1052.2	1106.5	0.0	1106.5	1161.8	1167.2	60.7	5.5
Financial Aid	90.6	89.0	0.0	89.0	93.5	94.0	5.0	5.6
School Aid	473.8	600.0	9.2	609.2	685.7	700.0	90.8	14.9
Community Colleges	205.4	212.5	0.0	212.5	223.1	225.5	13.0	6.1
Education	42.7	52.8	–1.4	51.4	54.4	54.4	3.0	5.8
Retirement	0.0	12.5	0.0	12.5	14.3	14.3	1.8	14.4
Library of Michigan	25.5	26.7	–0.7	26.0	26.1	27.0	1.0	3.8
Safety and Defense								
Corrections	655.3	684.7	46.1	730.8	770.3	770.3	39.5	5.4
State Police	166.9	183.4	3.5	186.9	197.6	197.6	10.7	5.7
Military Affairs	11.8	12.5	0.0	12.5	15.8	15.8	3.3	26.4
Regulatory								
Commerce	98.0	107.4	–3.0	104.4	106.4	113.9	9.5	9.1
Labor	79.1	81.1	–1.9	79.2	83.0	76.6	–2.6	–3.3
Licensing and Regulation	12.9	12.1	–0.4	11.7	11.9	11.9	0.2	1.7
Natural Resources and Recreation								
Natural Resources	138.7	115.1	–4.6	110.5	117.7	121.3	10.8	9.8
Agriculture	27.4	31.5	–1.0	30.5	33.2	34.6	4.1	13.4
General Government								
Management and Budget	97.2	73.3	–2.8	70.5	79.0	79.0	8.5	12.1
Legislature	76.0	82.2	–1.4	80.8	80.2	86.3	5.5	6.8
Judiciary	105.9	110.3	2.3	112.6	111.4	113.6	1.0	0.9
Treasury	65.1	42.7	–1.1	41.6	39.1	42.6	1.0	2.4
Attorney General	22.6	23.7	–0.2	23.5	24.4	24.9	1.4	6.0
State	16.9	17.5	–0.5	17.0	18.5	19.2	2.2	12.9
Civil Service	13.8	14.6	–0.5	14.1	15.3	14.4	0.3	2.1
Civil Rights	10.7	11.0	–0.1	10.9	11.0	11.5	0.6	5.5
Executive Office	3.8	4.2	–0.1	4.1	4.1	4.3	0.2	4.9
Other								
Capital Outlay	200.7	259.5	–83.6	175.9	203.0	203.0	27.1	15.4
Debt service	24.8	28.6	–1.6	27.0	28.1	19.9	–7.1	–26.3
TOTAL	$7,019.9	$7,294.1	$34.0	$7,328.1	$7,623.2	$7,657.4	$329.3	4.5%

Department of State ($1 million for the historical program); the Department of Commerce ($4 million for the information technology network); the Department of Natural Resources ($5.7 million, of which $3 million is GF/GP involving federal land and water conservation fund payments); the Department of Corrections ($30.5 million for education and other programs); the Department of Education ($2 million, $1 million of which is GF/GP); and the Department of Social Services ($2.4 billion, about $1 billion of which is GF/GP, mainly for Medicaid). The legislature will deal with the vetoes after its summer recess; most of the approximately $1 billion in the Department of Social Services budget will be restored, but the fate of the roughly $50 million in the seven other budgets is unclear.

As shown in Exhibit 2, total GF/GP expenditures have increased 43 percent over the last seven years (FY 1983–84 to FY 1990–91), considerably more than the total rate of inflation (34 percent). Although spending in most budget categories has grown faster than the total GF/GP budget, the overall growth rate has been held down by a relatively low 6.4 percent increase in Social Services spending (which accounts for about 31 percent of the budget) as well as a large decline in debt service requirements. The slow growth in general government spending has been due in part to program transfers and financing shifts. The fastest-growing budget categories have been capital outlay, Corrections, Natural Resources, and Agriculture.

Compared to other states, however, Michigan's budget growth rate—at least in recent years—is moderate. Exhibit 3 provides percentage changes (from the previous fiscal year) in budget expenditures for all the states for FY 1989–90 and FY 1990–91. Michigan's growth in spending was below average in both fiscal years examined. In FY 1989–90 spending among the states rose by an average of 8.5 percent over the previous year (compared to 4.5 percent in Michigan), while FY 1990–91 expenditure hikes averaged 5.1 percent (compared to 4.2 percent for Michigan). In FY 1989–90 changes in spending rates ranged from an increase of 33.1 percent (in Wyoming) to a decrease of 6 percent (in North Dakota). States seemed to have scaled back planned expenditures for the upcoming fiscal year: Changes range from an increase of 15 percent (in Kentucky) to a decrease of 16.4 percent (in Wyoming).

The figures for Michigan in Exhibit 3 do not reflect the FY 1989–90 supplemental appropriation, which totals $211.5 million. More than 90 percent went to the departments of Social Services

EXHIBIT 2

Growth in Selected Budget Categories, FY 1983–84 to FY 1990–91 (before vetoes)

GF/GP Category	Percentage Change in Appropriations
Capital outlay	715.3%
Corrections	193.6
Natural Resources and Agriculture	100.6
State universities—financial aid	85.7
State universities—operations	77.6
Executive, judiciary, and legislative	73.8
Department of Education/library	68.9
School aid/retirement	60.7
Community colleges	56.1
Mental Health	44.4
State Police and Military Affairs	50.4
Public Health	43.3
TOTAL GF/GP EXPENDITURES	43.0
Commerce, Labor, and L&R	34.0
Social Services	6.4
General government	2.2
Debt service	-77.6
Other Categories	
Total school aid	93.8 %
General revenue sharing	61.3
TOTAL STATE BUDGET	48.0
Transportation	40.7
State-local price deflator (U.S.)	34.0
School employees Retirement	-28.8

SOURCE: Calculated by Public Sector Consultants, Inc. from data in *State of Michigan Executive Budget*, selected issues.
NOTE: The increase in the general government category has been adjusted for the transfer of State Building Authority rental income from the DMB budget to the capital outlay budget.

EXHIBIT 3

Nominal Percentage Expenditure Change, FYs 1988–89 to 1989–90 and FYs 1989–90 to 1990–91

	FY 1989–90	FY 1990–91
States with Annual Budgets		
Alabama	–0.6%	9.3%
Alaska	8.0	–0.4
Arizona	8.0	10.6
California	11.6	6.3
Colorado	7.9	6.0
Connecticut	10.2	4.3
Delaware	9.1	4.8
Georgia	19.8	1.8
Idaho	21.1	7.2
Illinois	12.1	3.7
Iowa	7.3	10.1
Kansas	12.0	1.6
Louisiana	2.8	7.9
Maryland	12.3	3.3
Massachusetts	4.8	–1.6
MICHIGAN[1]	3.9	4.3
Mississippi	5.4	8.5
Missouri	9.7	7.6
New Jersey	2.4	–0.3
New Mexico	4.3	2.9
New York	4.9	2.6
Oklahoma	5.3	3.7
Pennsylvania	8.7	2.8
Rhode Island	5.2	3.3
South Carolina	8.7	5.3
South Dakota	8.8	8.0
Tennessee	8.8	1.9
Utah	9.5	–0.5
West Virginia	18.4	2.0
States with Biennial Budgets		
Arkansas	1.8%	2.6%
Florida	5.9	11.6
Hawaii	21.3	–1.0
Indiana	9.8	8.9
Kentucky	7.2	15.0
Maine	3.1	5.2
Minnesota	11.9	7.4
Montana	12.5	3.2
Nebraska	26.1	7.0
Nevada	1.6	7.6
New Hampshire	3.9	5.8
North Carolina	14.8	5.3
North Dakota	–6.0	0.0
Ohio	7.6	7.4
Oregon	13.0	8.3
Texas	9.2	8.4
Vermont	–1.5	8.4
Virginia	1.1	8.7
Washington	8.6	6.2
Wisconsin	6.6	4.8
Wyoming	33.1	–16.4
AVERAGE	8.5%	5.1%

SOURCE: Marcia A. Howard, *Fiscal Survey of the States* (Washington, D.C.: National Governors' Association and National Association of State Budget Officers, March 1990), p. 30.
NOTE: The figures used for this exhibit are preliminary.
[1]After changes in the budget, Michigan's rates of increase are 4.4 percent and 4.5 percent, respectively.

($128.7 million) and Corrections ($63.2 million). Other significant amounts went to the departments of Public Health ($9.7 million for the children's special health care services program) and State Police ($6.4 million). The legislature also approved $193.4 million in spending reductions: The largest cuts were in capital outlay ($83.6 million) and the departments of Social Services ($57.8 million), Corrections ($17.1 million), and Labor ($6.1 million, mainly in the Michigan Youth Corps program). The governor vetoed $5.8 million of these reductions; the legislature has filed a suit challenging the legality of this action.

FY 1990–91 SPENDING POLICY

Although attention generally focuses on the GF/GP portion of the budget because it is within the control of the governor and the legislature, the GF/GP budget comprises only about 41 percent of the total. The remainder is comprised of federal aid, such restricted revenues as fuel and weight taxes, which may be used only for designated purposes or programs, and private and local revenue. Changes in these revenue sources affect the GF/GP appropriation required to keep a program going at its current level. For example, a reduction in federal or restricted funding will require either an increase in GF/GP funding or a tax increase; the alternative is to reduce the program. An increase can be used to replace GF/GP funding, thereby reducing the budget. Therefore, a GF/GP appropriation can change without affecting program support. For a full discussion of the funding sources for each department (or program) see our budget analysis of October 25, 1989.

The discussion below focuses primarily on the GF/GP budget and is concerned mainly with changes from the governor's original recommendations and comparisons with FY 1989–90 spending. For a more complete discussion of the recommended programs, see our March 9, 1990, analysis of the governor's budget.

Education

The FY 1990–91 appropriation for **school aid** is $700 million, about $14 million above the governor's recommendation and $90.8 million (14.9 percent) above projected expenditures for FY 1989–90. Not reflected in these numbers is the governor's veto of $2.8 million for foreign language studies.

The gross school aid appropriation for the budget year is $3.19 billion, $205 million (8.7 percent) above the FY 1989–90 level. Included in this amount is $391.8 million for the Public Employees' Retirement System, of which $14.3 million is GF/GP money.

The membership formula is increased from the governor's recommendation of $310 plus $88.55 per mill per student to $310 plus $90 per mill per pupil. The legislature also provided an incentive of $25 per pupil for districts meeting such specified quality standards as implementation of a school improvement plan. Out-of-formula districts are not eligible for the incentive, which is questionable policy as efforts to improve quality standards should cover all school districts, regardless of district wealth.

Several other major changes from the governor's recommendations also were made.

- The deduction for categorical aid to out-of-formula districts is increased from a recommended $45 million to $72.1 million, and a complex new formula is adopted.
- A provision is added requiring the legislature to increase gradually the equalization of resources among districts by reducing the amount of unequalized revenue (above the state guarantee) as a share of total revenue from 9 percent in FY 1991–92 to 5 percent in FY 1994–95 and succeeding fiscal years.
- The low-income categorical for out-of-formula districts with local resources of less than $3,000 per pupil is reduced from a recommended $27 million to $20 million.
- The reimbursement to intermediate school districts that levy millage for special education is increased from a recommended $24.2 million to $29.2 million.

For **state universities** the FY 1990–91 appropriation for operations is $1.17 billion, $5.4 million more than recommended by the governor. Of this, the governor vetoed $7.4 million in research excellence funds for Michigan State University and $0.2 million for Ferris State University because they increased tuition more than the 6.5 percent agreed to by the other institutions. (The governor is expected to recommend restoration of most of these monies.) The appropriation for financial aid is $94 million, $0.5 million above the recommendation.

For **community colleges** the FY 1990–91 appropriation is $225.5 million, $2.4 million above the governor's recommendation and $13 million (6.1 percent) above projected spending for FY 1989–90. The increases in operating funds for the 29 community colleges range from 3.9 percent to 8 percent; Bay de

Noc Community College (8 percent) and Kellogg Community College (7.8 percent) received the largest increases. Among the bigger schools, Lansing Community College received the largest increase (7.4 percent).

The **Department of Education** FY 1990–91 GF/GP appropriation is $54.4 million, unchanged from the governor's recommendation and $3 million (5.8 percent) above projected expenditures for FY 1989–90, which were reduced by a $1.4 million negative appropriation in the supplemental bill to help balance the current budget. Not reflected in the FY 1990–91 figure is the governor's veto of $2 million ($1.1 million GF/GP) in grants for vocational rehabilitation, the Metropolitan Detroit Youth Foundation (a dropout prevention program), and a training program for interscholastic coaches.

Human Services

The FY 1990–91 **Department of Social Services** (DSS) budget, as passed by the legislature, consists of a GF/GP appropriation of $2.4 billion, $3.1 million (3.2 percent) more than spending in FY 1989–90. Although the *amount* of GF/GP funding for FY 1990–91 is equal to the governor's recommendations, the *apportionment* is not, and Governor Blanchard vetoed approximately $1.1 billion GF/GP, including the entire Medicaid budget.

In passing the DSS budget the legislature adopted some of the governor's recommended cost containment measures—including acceptance of voluntary rebates from pharmaceutical manufacturers on certain drugs (estimated to save $4.5 million GF/GP), creation of the pharmacy prescribing education services program ($1.1 million GF/GP), and requirement of prior authorization for psychiatric hospitalizations ($1 million GF/GP)—and rejected the governor's newly proposed Healthy Start program. In vetoing the budget the governor contended that actual expenditures would exceed appropriations by $250 million GF/GP because the legislature's budget underestimates caseloads, overestimates revenues, ignores federal mandates, and fails to account for actual costs. The legislature has two weeks after the beginning of the fall session to approve a new budget or contingency plan: The new fiscal year begins October 1.

The **Department of Mental Health** (DMH) budget for FY 1990–91 includes a GF/GP appropriation of $915.5 million, $37.7 million (4.3 percent) more than the FY 1989–90 appropriation and equivalent to the governor's target. A lower level of federal revenue is contained in the approved budget than was assumed by the governor; the amount will be made up with additional state restricted funds. Several other changes from the governor's recommendations also were made.

- The recommended funding within community mental health programs for implementing improvements mandated under the federal Omnibus Reconciliation Act is cut; the governor had recommended gross funding of $68 million, and the legislature appropriated $30 million.

- The appropriation for institutional services is increased from $131.4 million to $135.5 million, primarily for funding for a facility the governor had recommended be closed.

- The appropriation for special projects is raised from $11.4 million to $17.1 million. The governor had recommended that some projects be transferred to other accounts and other projects cut. The legislature restored several programs including the developmental disabilities dental program, the mental health community services project, and mentally ill/mentally retarded mental health services.

The FY 1990–91 GF/GP appropriation for the **Department of Public Health** (DPH) is $143.3 million. The GF/GP appropriation—which meets the governor's recommended target—is $2.7 million below last year's funding level. Again, several major changes from the governor's recommendations were made.

- An additional $6.5 million gross ($134,300 GF/GP) is appropriated for substance abuse grants and contracts.
- Community service grants to local agencies are increased by $3.9 million gross ($2.1 million GF/GP), including a $3.5 million hike in funding for Women, Infants, and Children (WIC) local agreements and food costs.
- Spending on communicable disease control is raised an additional $2.1 million gross ($208,200 GF/GP), of which a majority will go for immunization local agreements. (Most of the increase will be funded by added federal dollars.)
- Radiological health is cut by $1.4 million, of which $1.1 million are GF/GP funds.

Regulatory

The **Department of Commerce** appropriation of $113.9 million is $7.5 million above the governor's recommendation, and $9.5 million (9.1 percent) above projected spending for FY 1989–90. The increase is due to an $8.6 million increase in Michigan equity program grants to cities and the addition of a $1.2 million grant to the Detroit public library system; there were partially offsetting reductions in several other programs. (The legislature also approved a $3.1 million reduction in the department's FY 1989–90 budget as part of the overall budget reduction agreement.)

The legislature approved an appropriation of $76.6 million for the **Department of Labor**, $6.4 million less than recommended by the governor and $206 million (3.3 percent) below FY 1989–90 spending. The reduction was mainly in funding for the Michigan Youth Corps program, which was reduced by $6 million.

The budget for the **Department of Licensing and Regulation** is $11.9 million, as recommended by the governor, 1.7 percent above FY 1989–90 expenditures.

Natural Resources and Recreation

The **Department of Natural Resources** budget of $121.3 million exceeds the governor's recommendation by $3.6 million. The additional funds, which are mainly for increased grants for federal land and water conservation fund payments (the monies go to local communities for fishing piers, docks, and boat launches), were vetoed, however. It is likely that the veto will stand, meaning that the increase in the DNR budget will be 6.5 percent rather than 9.8 percent. (The FY 1989–90 appropriation was reduced by $4.6 million in the supplemental bill.)

The appropriation for the **Department of Agriculture** is $34.6 million, $1.4 million above the governor's recommendation, due mainly to a $1.3 million increase in grants. The FY 1990–91 budget is 13.4 percent above projected spending for FY 1989–90, the second largest rate of increase among the departments.

Safety and Defense

The FY 1990–91 GF/GP appropriation for the **Department of Corrections** is $770.3 million, unchanged from the amount of the governor's recommendation and $39.5 million (5.4 percent) above projected expenditures for FY 1989–90. The governor vetoed programs totaling $30.5 million but announced that his veto restoration plan will recommend appropriations to expand the number of boot camp beds by 600 and fully fund the expansion of the Office of Community Corrections, two earlier recommendations the legislature had not adopted. Additional major changes likely will be made in the FY 1990–91 appropriation, as most estimates indicate that this budget category is underfunded by $75 million to $100 million. (The FY 1989–90 supplemental bill includes additional funds of $63.2 million and reductions of $17.1 million.)

The **Department of State Police** has been appropriated $197.6 million for FY 1990–91, unchanged from the governor's recommendation and $10.7 million (5.7 percent) above projected spending for FY 1989–90, which includes a net supplemental increase of $3.5 million.

The **Department of Military Affairs** received an appropriation of $15.8 million for FY 1990–91, unchanged from the amount of the governor's recommendation and 26.4 percent above the spending level in the previous year. This large increase is due to the transfer of $1.4 million for the military retirement program from the Department of Management and Budget and the addition of $1.4 million to fund the demolition of drug houses by Michigan National Guard troops ($.35 million less than recommended by the governor).

General Government

The FY 1990–91 GF/GP appropriation for the **Department of Management and Budget** is $79 million, unchanged from the governor's recommendation and 12.1 percent above projected spending for FY 1989–90. The large increase is due mainly to the transfer of the $9.2 million senior citizens' cooperative housing tax exemption from the Department of Commerce. The gross appropriation for the department is $1.4 billion, including $1.1 billion for general revenue sharing grants to local governments.

The **judiciary** budget of $113.6 million is $2.2 million above the governor's recommendation, 0.9 percent above FY 1989–90 expenditures. (The FY 1989–90 budget included a $2.3 million supplemental to cover salary increases for trial court judges, and this was rolled into the FY 1990–91 budget.)

The budget for the **legislature** is $86.3 million, $5.5 million above the recommendation and 6.8 percent above projected spending for FY 1989–90.

The **Department of Treasury** received a GF/GP appropriation of $42.6 million, $3.5 million above the recommendation and 2.4 percent above FY 1989–90 spending. The increase was due to the transfer of $3.5 million in monies for classroom computers from debt service (education technology bonds) to the grants line (to support bonds issued by school districts).

The **Department of State** received the third-largest rate of increase of any department, 12.9 percent. The appropriation of $19.2 million is $0.7 million more than recommended by the governor, and $2.2 million above FY 1989–90 spending. The additional funds are mainly to restore recommended cuts of $0.4 million in historic site preservation grants. These numbers do not reflect the governor's veto of $1 million for the history program, monies reportedly used by several legislators for pet projects not otherwise approved for funding.

Other

The **capital outlay** bill has not yet been approved by the legislature, but the tentative FY 1990–91 appropriation is $203 million, unchanged from the governor's recommendation and $27.1 million (15.4

percent) above projected expenditures for FY 1989–90. The large increase is the result of an $83.6 million reduction in the appropriation for FY 1989–90 as part of the agreement on the supplemental bill: The State Building Authority share is increased by $34.3 million, reducing the GF/GP share, and state agency, community college, and higher education special maintenance projects are deferred.

The legislature approved an appropriation of $19.9 million for **debt service**, $8.2 million below the governor's recommendation and $7.1 million below projected spending for FY 1989–90. Funding for the Quality of Life (water and recreation) bonds is reduced by $3.2 million, and $3.95 million for the Education Technology (classroom computers) bonds is transferred to the grants line and reduced to $3.5 million.

The **Department of Transportation** received an appropriation of $1.63 billion, all from restricted taxes and federal aid. This is $8.7 million more than recommended by the governor, and $45 million (2.8 percent) less than the FY 1989–90 appropriation.

The formula for the **Budget Stabilization Fund** (BSF), which is tied to increases in Michigan personal income (adjusted for inflation), is not expected by policy makers to trigger a pay-in or payout to the general fund in FY 1989–90 or FY 1990–91. (We believe, however, that if the economy continues to slow there is a chance that real personal income will decline in 1990, triggering a payment in FY 1990–91 from the BSF to the general fund.) Assuming no payout, the BSF is expected to have a balance of $415 million at the end of FY 1990–91.

The budget also must take into account **constitutional restrictions on revenue and local spending.** Article IX, Section 26 restricts the amount of revenue the states may collect in any fiscal year. The limit for FY 1990–91 (9.49 percent of 1989 Michigan personal income) is estimated at $15.6 billion. Total state revenue (less federal aid and general obligation debt service) is projected to fall $2.5 billion below the limit.

Article IX, Section 30 of the constitution requires that a minimum of 41.6 percent of spending from state sources be allocated to local units of government. FY 1990–91 spending on local governments will exceed this requirement by an estimated $225 million. The court of appeals, however, ruled in *County of Oakland* v. *Michigan Department of Mental Health* that payments to county mental health boards cannot be counted as payments to local governments. The state is appealing the decision, but if it stands, this will reduce local spending by about $450 million a year and require offsetting spending increases in other local programs.

COMMENT

Beginning this fall, the governor and the legislature will be faced with some very tough budget decisions. The most immediate will involve balancing the FY 1989–90 budget, which we expect to end up about $200 million in the red. It is likely that most of this deficit can be handled through accounting adjustments, but the remainder may have to be carried into FY 1990–91. The administration, however, is unlikely to report a deficit even if that means taking actions inconsistent with general accounting practices. If a deficit *is* carried over, it will compound the problem in FY 1990–91. We are projecting a budget shortfall in that year of at least $750 million; this amount could increase substantially if the expected recession is deeper and lasts longer than anticipated. In June the House Fiscal Agency estimated that the FY 1990–91 budget would be out of balance by $594.4 million; this was based on the February revenue estimate in the executive budget, which is clearly too high. The Senate Fiscal Agency has projected a shortfall of $450 million based on a May revenue estimate, which is also clearly too high.

In addition to accounting adjustments, the governor and the legislature have three other means to bring the budget into balance: (1) cut spending, (2) use the Budget Stabilization Fund, and (3) raise taxes. We hope that any budget reduction plan will combine all three.

The first option is to cut spending, but it will be difficult to reduce the budget by the required 7–8 percent. The second is to use the roughly $400 million in the BSF, which was created to deal with just such problems. Although this is very attractive politically, a major disadvantage is that it maintains the spending base near its current level, which cannot be supported by the current revenue system; a February estimate by the Senate Fiscal Agency indicated that a continuation budget (taking into account current policy, inflation, caseload increases, and so on) would exceed available revenues by $512 million in FY 1990–91 and $706 million in FY 1991–92. The third option is to raise taxes. Always an unpopular course of action, this may be more palatable after the election. Governor Blanchard was able to survive raising taxes in his first year in office—although two state senators did not—and he may be willing to support a tax increase if reelected, particularly if he does not plan to run for a fourth term.

Michigan will not be alone if it opts for a tax increase: Steve Gold, director of the Center for the Study of the States, believes that 1991 could be the biggest year for state tax increases in a generation (see Exhibit 4, which lists revenue changes proposed in several states). We would be surprised if the Michigan income tax is increased, but policy makers have several alternatives. One is to increase cigarette and alcohol taxes.

EXHIBIT 4

Summary of Proposed 1991 Revenue Changes
(dollars in millions)

State	Personal Income	Sales	Corporate Income	Cigarettes/ Tobacco	Motor Fuels	Alcohol	Others	Total
Alabama							$55.0	$55.0
Alaska					$34.2			34.2
Arizona	$69.3		$39.3	$30.5			30.9	139.1
Delaware						$5.0	2.9	7.9
Florida				259.3				259.3
Georgia		–$125.0						–125.0
Hawaii	–64.0						–45.0	–109.0
Illinois				80.0			135.0	215.0
Kentucky	332.2	82.4	30.2	37.8				482.6
Louisiana							604.0	604.0
Maryland		29.5					4.7	34.2
Massachusetts							12.0	12.0
Missouri		5.0						5.0
New Hampshire				7.8	10.0	1.9	16.1	35.8
New Jersey		1,007.0		100.0		52.0	255.0	1,414.0
New Mexico		45.7		9.1				54.8
New York	400.0	77.0	175.0	66.0			426.0	1,144.0
Ohio					116.0			116.0
Oklahoma	101.4	97.0					5.0	203.4
Rhode Island							53.1	53.1
Vermont	17.2	5.0	3.3	5.0			14.0	44.5
Virginia	15.0		29.9			9.1		54.0
Washington					130.0			130.0
TOTAL	$871.1	$1,223.6	$277.7	$595.5	$290.2	$68.0	$1,568.7	$4,836.9

SOURCE: National Association of State Budget Officers and The Conference Board, "Regional Economies and Markets," Second Quarter 1990.

Increasing these taxes is easy politically, but they do not raise much money. A second alternative is to increase the single business tax (SBT). The legislature and the governor may be willing to support this because weakness in SBT collections has been the major factor in the revenue shortfall. A 0.1 percent hike would raise about $65 million. It also is possible that the yield from the SBT will be increased without policy makers having to take any action at all: If the courts rule that the capital acquisition deduction is unconstitutional (see "The Michigan Budget: Difficult Choices Ahead," *Michigan Commentary*, June 1, 1990), about $400 million in revenue would be generated annually. A third alternative is to extend the sales tax to services; this could generate significant revenues and would improve the fairness of the sales tax. Business services most likely to be taxed include consulting, accounting, and computers; personal services likely to be taxed are haircuts and dry cleaning; repairs; and such amusements as theaters, sports events, and bowling. The Federation of Tax Administrators has developed a list of about 170 services that could be taxed, and Exhibit 5 shows the number taxed in each state. As can be seen, Michigan taxes only 18, ranking 38th among the 50 states. A 1987 estimate by the Senate Fiscal Agency indicated that a comprehensive tax on services would yield about $600 million annually (*Notes on the Economy and the State Budget*, August 1987).

The next two budgets will be the tightest and most difficult since the early 1980s. State policy makers should use this as a opportunity to adopt realistic spending and revenue policies. Once the FY 1990–91 budget is balanced, spending priorities and policies must be adjusted to reflect the slower growth in revenues expected during the next few years.

EXHIBIT 5

Extent of State Taxation of Services, 1990

Rank	State	Number of Services Taxed	Rank	State	Number of Services Taxed	Rank	State	Number of Services Taxed
1	Delaware	158	18	Florida	53	34	Maine	23
2	Hawaii	154	19	Louisiana	48	36	North Dakota	19
2	New Mexico	154	20	Arkansas	47	36	Vermont	19
4	Washington	151	20	Utah	47	38	**MICHIGAN**	**18**
5	South Dakota	131	22	Nebraska	40	39	Indiana	17
6	West Virginia	111	23	Pennsylvania	37	40	South Carolina	16
7	Iowa	83	24	New Jersey	35	41	California	15
8	Connecticut	76	25	Ohio	34	41	Illinois	15
8	Texas	76	26	Idaho	33	41	Oregon	15
10	Mississippi	67	26	Oklahoma	33	41	Virginia	15
11	Tennessee	66	28	Alabama	31	45	Montana	14
11	Wisconsin	66	28	Georgia	31	46	Colorado	12
13	Kansas	64	30	North Carolina	26	46	Nevada	12
14	Minnesota	60	31	Maryland	25	48	New Hampshire	11
15	New York	58	32	Missouri	24	49	Massachusetts	4
16	Wyoming	56	32	Rhode Island	24	50	Alaska	2
17	Arizona	54	34	Kentucky	23			

SOURCE: *State Policy Reports* (Alexandria, Va: July 1990).

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Principal Consultants

Gerald A. Faverman, Ph.D., *Chairman and Senior Consultant for Public Policy*
Craig Ruff, M.P.P., *President and Senior Consultant for Public Policy*
William R. Rustem, M.S., *Vice President and Senior Consultant for Environmental Policy and Economic Development*
Robert J. Kleine, M.B.A., *Senior Economist and Editor of PUBLIC SECTOR REPORTS*
Christine F. Fedewa, *Director of Operations and Senior Consultant for Public Policy*
Michael French Smith, Ph.D., *Director of Research and Senior Consultant for Marketing and Economic Development*
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David Kimball, *Senior Consultant for Public Policy*
Peter Pratt, Ph.D., *Senior Consultant for Health Policy and Editor of BILL ANALYSIS SERVICE for HEALTH*
Gerrit Van Coevering, *Senior Consultant for Taxation and Revenue Policy*
Keith Wilson, *Senior Consultant for Waterways Development*
Wilma L. Harrison, *Senior Editor and Research Associate*
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Frances Spring, *Economist*
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Harriett Posner, *Editor and Graphic Designer*
Elizabeth Johnston, *Editor and Community Service Projects Coordinator*

Affiliated Consultants

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Sister Mary Janice Belen
Clark E. DeHaven, M.A.
Richard D. Estell, M.A.
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