



STATE BUDGET NOTES



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NOW THE REAL WORK CAN START ON THE FY2012 STATE BUDGET

Recently, and much earlier than years past, the framework for the upcoming state budget began to take shape when both chambers of the Michigan legislature passed their respective spending plans. The Senate was the first chamber to complete its work on the Fiscal Year 2012 (FY2012) state budget when, in late April, it approved all operating appropriation bills financed by the General and School Aid Funds, the state's two major funds. This action was closely followed by the House of Representative's approval of all appropriations bills in early May. Both chambers

incorporate many of the recommendations made by Governor Snyder in his proposal, but the plans also deviate in significant ways from the Executive Budget. The two plans for the General Fund share some key similarities; however, the Senate's plan spends \$179 million, or 2 percent, more than the House's budget and the two recommendations differ in other substantial and material ways. The legislature has cleared a major hurdle in the budget process, but much detailed work remains if the budget is to be completed by May 31 as requested by the governor.

Revenue Assumptions

Governor Snyder's FY2012 proposed spending plans for the General and School Aid Funds were balanced against the January consensus revenue estimate, adjusted for his tax restructuring proposal involving business and individual income taxes, which he presented with his budget. The net effect of the tax

changes on the budget would be revenue neutral when fully phased in, but they would result in a net tax cut in the first fiscal year. The Executive Budget used nearly all the projected FY2011 \$500 million School Aid Fund year-end surplus to finance appropriations in FY2012, but it reserved the projected year-end

Table 1
Proposed Tax Changes by Major Fund for FY2012*
 (Dollars in Millions)

	Original			House-Passed		
	General Fund	School Aid Fund	Total	General Fund	School Aid Fund	Total
Business Taxes						
MBT Repeal (eff. 1/2012)	(\$1,420)	(\$750)	(\$2,170)	(\$1,420)	(\$750)	(\$2,170)
MBT Revenue (net of credits)	607	-	607	607	-	607
New Corp. Income Tax	460	-	460	460	-	460
Financial Institutions Tax	28	-	28	28	-	28
Other Adjustments	-	-	-	50	-	50
Net Business Tax Changes	(325)	(750)	(1,075)	(275)	(750)	(1,025)
Individual Income Tax						
Rate Freeze @ 4.35% until 1/2013	-	-	-	170	-	170
Other Income Tax Changes	651	153	804	331	71	402
Net Income Tax Changes	651	153	804	501	71	572
Total Tax Changes	\$326	(\$597)	(\$271)	\$226	(\$680)	(\$454)

* Changes measured against current law revenue estimates.

Source: Executive Budget; House Fiscal Agency analysis of House Bills 4361 and 4362

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General Fund balance (\$300 million) as a hedge against a host of current-year budget risks.

In mid-April Governor Snyder and the legislative leadership of the majority party in each chamber agreed to modify the original tax plan, retaining the business tax components but changing the income tax pieces significantly. The re-worked plan, which the House passed in late April and the Senate is expected to pass in early May, provides a larger net tax cut because it raises \$183 million less

in income taxes than the governor's original proposal (see **Table 1**). Furthermore, the changes affect the General and School Aid Funds differently.

While neither chamber has released publicly its updated balance sheet for either major fund since completing budget action, each body is working from the January revenue estimate adjusted for the revenue effects of the compromise tax plan. Similar to the Executive Budget, both chambers achieve balance by

using nearly all the projected FY2011 School Aid Fund surplus to finance appropriations in FY2012. It appears that the Senate General Fund budget may rely on a portion of the FY2011 year-end balance to achieve budget balance given the slightly higher spending amount in FY2012 compared to the House budget. Against the Executive Budget, both chambers cut the overall appropriation amount to reflect the lower revenue figure from tax restructuring (see **Table 2**).

Table 2
Total General and School Aid Fund Appropriations for FY2012
(Dollars in Millions)

	<u>Governor</u>	<u>Senate</u>	<u>Difference from Governor</u>	<u>House</u>	<u>Difference from Governor</u>
General Fund	\$8,111	\$8,125	\$15	\$7,946	(\$165)
School Aid Fund – state	11,003	10,923	(81)	11,007	4
Total	\$19,114	\$19,048	(\$66)	\$18,961	(\$161)

Source: Executive Budget; Senate and House Fiscal Agencies

General Fund Appropriations Overview

Unlike prior years where each chamber worked on one-half of the budgets before passing its proposal to the other chamber for consideration, the House and Senate are working on the entire slate of appropriation bills simultaneously. **Chart 1** summarizes, at a high level, the key differences between the House and Senate

spending recommendations for the General Fund. General Fund appropriations under the Senate plan are greater for post-secondary education support, both community colleges (\$34 million) and universities (\$500 million). The House spends more than the Senate for K-12 school aid (\$243 million), human services (\$56 mil-

lion), community health (\$35 million), and corrections (\$20 million). Overall, the Senate spends \$179 million more in the General Fund than the House (\$8,125 million versus \$7,946 million).

The areas of the General Fund budget where there are the greatest differences between the leg-

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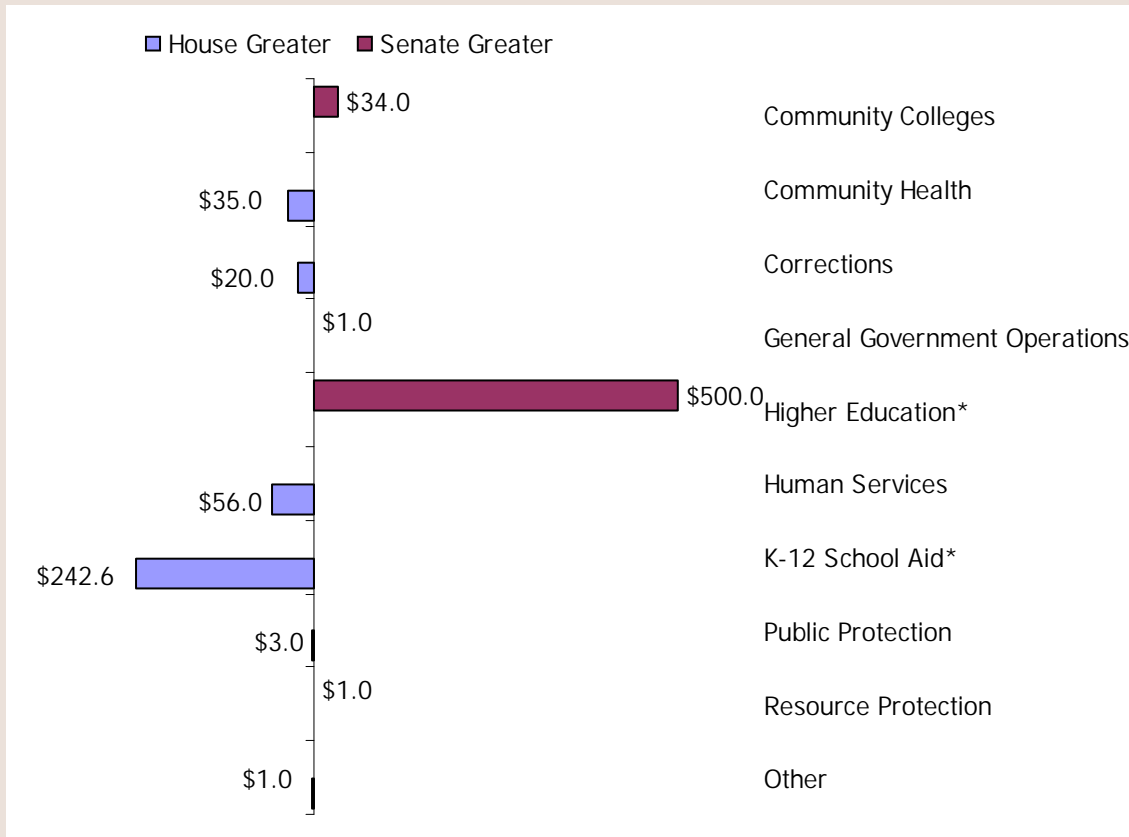
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Chart 1
General Fund Appropriation Differences
(Dollars in Millions)



* Differences relate, in part, to use of School Aid Fund to finance appropriations.
 "Other" includes Departments of Education and Energy, Labor and Economic Growth
 "Resource Protection" includes Departments of Agriculture, Environmental Quality, and Natural Resources
 "Public Protection" includes Departments of State Police and Military and Veterans Affairs.

islative proposals relate to education funding. Recall, the Executive Budget proposal called for the use of approximately \$900 million in School Aid Fund revenue to finance appropriations made to community colleges and universities, offsetting an equal

amount of General Fund resources in those budgets to help address a projected \$1.4 billion shortfall. To accommodate this funding shift and achieve School Aid Fund balance, Governor Snyder recommended an additional \$300 K-12 per-pupil cut in

state aid for FY2012 on top of the current \$170 per-pupil reduction. The legislative responses to this proposal account for the major differences in the General and School Aid Fund appropriations and the amount of the K-12 per-pupil cut.

Education Funding: Blurring the Lines Between Major Funds

Both chambers concur, in part, with Governor Snyder's plan to treat the General and School Aid Funds as effectively synonymous for the purposes of financing education appropriations. **Table 3** highlights the appropriation differences between the House and Senate plans by education level and by major fund. Similar to the Executive Budget, both chambers break with past precedent by financing higher education and community college appropriations from School Aid Fund resources, but to varying degrees. The key difference between the proposals is that the Senate proposal directs more School Aid Fund revenue to support K-12 education and less to

post-secondary education – allocating approximately the same amount (\$200 million) to finance higher education and community college appropriations. While both chambers recommend the same overall spending level for university funding (\$1,264 million) and incorporate Governor Snyder's recommended 15 percent operations cut, the House finances a greater portion of the total (55 percent) with School Aid Fund revenue compared to the Senate plan (16 percent).

The post-secondary education appropriation decisions directly influence the appropriation decisions for K-12 education in each chamber. Again, at a high level,

the House plan is much closer to Governor Snyder's proposal in that it includes a similar overall funding reduction from the current-year appropriation and recommends a per-pupil cut that approximates what the governor proposed. Where the Executive Budget included a \$300 per-pupil cut for all districts, the House requires each district to take a 3.5 percent reduction to their respective foundation grant. The percentage reduction results in a range of cuts (\$256 per pupil to \$297 per pupil) because foundation grants vary across districts. The Senate, like the governor, recommends that all districts take an equal, but much smaller, across-the-board per-pupil cut

Table 3
FY2012 Education Appropriations by Major Fund
(Dollars in Millions)

	<u>School Aid Fund</u>	<u>General Fund</u>	<u>Total</u>
K-12 School Aid			
House	\$10,111	\$461	\$10,572
Senate	10,527	219	10,745
Difference (House – Senate)	(416)	242	(173)
Community Colleges			
House	196	56	252
Senate	196	90	285
Difference (House – Senate)	0	(34)	(34)
Higher Education			
House	700	564	1,264
Senate	200	1,064	1,264
Difference (House – Senate)	500	(500)	0
Total Appropriations			
House	\$11,007	\$1,081	\$12,088
Senate	10,923	1,372	12,296
Difference (House – Senate)	84	(291)	(207)

Source: Senate and House Fiscal Agencies. Totals may not add because of rounding.

(\$170). In addition, the Senate plan reduces funding to districts that offer half-day kindergarten programs by halving the per-pupil grant for students enrolled in these programs (this equates to a \$110 per-pupil cut if applied uniformly statewide). In addition to the per-pupil reductions, both plans reduce or eliminate a variety of categorical programs (e.g., declining enrollment, small class size) to save \$85 million.

Both legislative recommendations agree with Governor Snyder's plan to use \$196 million School Aid Fund to finance community college appropriations in FY2012. However, whereas Governor Snyder maintained current-year spending levels, the Senate plan reduces overall General Fund support to the colleges by \$10 million and the House cuts \$44 million, creating a \$34 million difference in the legislative proposals.

Overall, the House spends approximately the same amount on education appropriations in total as the Executive Budget; however, this amount is \$207 million less than the Senate budget. The larger overall Senate figure results from the smaller K-12 per-pupil reduction and the smaller cut in community college appropriations.

Other Major General Fund Budget Differences

In addition to education appropriations, significant differences between the chambers exist with respect to spending decisions for the large General Fund-financed budgets - Departments of Corrections, Community Health, and Human Services. Both legislative chambers reduce General Fund appropriations to the Department of Corrections beyond those included in the executive budget, but for different reasons and by varying amounts. The House plan includes closing an additional prison facility in southeast Michigan along with the closures recommended by the governor. Also, the House budget anticipates additional savings from operational efficiencies in corrections expenditures. Compared to the House plan, the Senate budget relies on greater General Fund reductions to the corrections budget primarily through operating efficiencies (food service, transportation, and prisoner programming), greater privatization, sentencing policy changes, and central office and supervisory staffing reductions. Overall, the

more ambitious Senate plan, which contemplates fairly significant policy changes, is \$20 million less than the House corrections budget.

House and Senate budgets for the Department of Community Health, which includes the Medicaid program, mainly concur with and expand upon the General Fund reductions included in Governor Snyder's budget. The Executive Budget protected Medicaid optional services and provider rates from cuts; however, funding for Medicaid graduate medical education (GME) was reduced by 40 percent, a savings of \$23 million. Both legislative proposals spend less than the governor's recommendation, while the Senate budget would spend \$35 million less than the House plan. The primary difference between the chambers relates to the Senate's proposal to eliminate all funding for GME, an additional \$34 million reduction. Whereas the Executive Budget contained a modest \$1 million cut, both chambers make much larger Healthy Michigan Fund reductions

- the Senate completely eliminates funding (\$11 million) and the House eliminates all but one grant (\$10 million). Also of note, both proposals contemplate the adoption of a new one percent insurance claims tax to replace the use tax on Medicaid HMOs, as recommended by the governor.

The Senate's recommendation for the Department of Human Services is \$56 million below the House because it assumes an across-the-board 10 percent cut in administrative and staff costs, which may create unpredictable effects on state welfare and child support programs administered by the Department. Additionally, the Senate achieves savings through child care and disability program reductions.

A major component of the Executive Budget to achieve balance in FY2012 involved extracting \$180 million savings from the state workforce through unidentified employee concessions. While these savings have not yet been incorporated into the operating

budgets, they are being carried on each chamber's General Fund balance sheet. To date, the spe-

cifics of the concessions have not been articulated by the Snyder Administration and minimal

progress has been made towards achieving the savings.

Conclusion

While a major milestone in the budget process has been achieved, much work remains before the final FY2012 state budget can be enacted, especially if the legislature wants to meet Governor Snyder's self-imposed May 31 deadline. All of the differences in the two spending plans have to be reconciled, which will occur via budget conference committees over the coming weeks. This is more difficult than the total dollar differ-

ences in the General Fund (\$179 million) and School Aid Fund (\$85 million) might suggest, as there are significant differences in details between the two plans. Most notable is the precedent-setting plan to use the School Aid Fund to finance post-secondary education appropriations. Also, consensus and final approval will have to be achieved on the business and individual income tax restructuring proposals currently before the legislature. These proposals

will be key components to the revenue side of the FY2012 budget. Finally, it is expected that the May revenue estimating conference will agree to revise upward, perhaps substantially, the General and School Aid Fund revenue estimates for both the current year and FY2012. These revisions will likely play a role in the final appropriation decisions made by the legislature.