STATE BUDGET NOTES

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Reconcilable Differences
Towards Completion of the FY2013 State Budget

As the single-party controlled Michigan Legislature marches toward wrapping up its work on the Fiscal Year 2013 (FY2013) state budget in advance of its self-imposed June 1 deadline and the traditional summer recess, notable differences exist between the spending plans proffered by the two legislative chambers. In some cases, appropriation decisions made by either the Senate or the House of Representatives deviate from the recommendations included in Governor Snyder's Executive Budget. To escape the prospect of gubernatorial vetoes of the final legislative product, state budget decisions will likely involve negotiations among all three principal players based upon their respective plans. Additionally, these negotiations will have to take into account the official revised state revenue picture agreed to at the May 16 revenue conference.

The Governor's Plan

Unlike his first Executive Budget (FY2012), Governor Snyder proposes few, if any, fundamental changes to the state's fiscal landscape in his latest iteration. Looking at last year, the FY2012 Executive Budget was predicated on the fact that the General Fund budget faced a $1.5 billion shortfall that had to be addressed. Such a bleak prospect did not confront the Governor for FY2013 as an improving economy and actions taken to address the FY2012 deficit meant that the state did not face a projected shortfall for FY2013. In addition to the FY2012 budget shortfall, the Governor's budget last year had to address the fiscal effects of his proposed tax restructuring. The Governor's newest proposal does not include the significant appropriation reductions, sweeping business and individual income tax changes, or shifts in budget policy that characterized his first budget recommendation. Instead, the FY2013 Executive Budget is largely a continuation of the fiscal policies and practices enacted as part of the FY2012 budget.

In the wake of some fairly sizeable and wide-reaching appropriation reductions enacted for FY2012 and buoyed by a steadily recovering state economy (and stabilized tax revenue), the FY2013 Executive Budget includes year-over-year increases, albeit small ones, in total outlays (1.4 percent) and General Fund appropriations (2.9 percent). The Governor's total School Aid Fund spending recommendation (used to finance K-12 education and partially fund higher education appropriations) is held basically flat compared to the FY2012 amount. However, these minor changes in year-over-year aggregate spending levels mask important appropriation recommendations within specific programs that merit further exploration, especially in light of the legislative response to specific areas of the Governor's FY2013 Executive Budget.

Bottom Line: Legislative Proposals Make Cuts to Governor's Budget

The Governor's Executive Budget recommends total FY2013 General Fund spending of $9.0 billion, or about 19 percent of the total $48.1 billion Executive Budget, while federally financed appropriations (e.g., Medicaid, transportation programs (highway and transit), public assistance programs) account for 42 percent and state restricted appropriations (including School Aid Fund) account for 39 percent. (Despite its relatively small share of the total, the General Fund budget perennially garners the most attention because of its discretionary nature and the host of varied interests competing for its limited resources.) Both legislative proposals make overall reductions to the Governor's General Fund budget; the Senate's plan comes in $232 million below and the House of Representative's comes in $120 million below the amount contained in the Executive Budget. Where these

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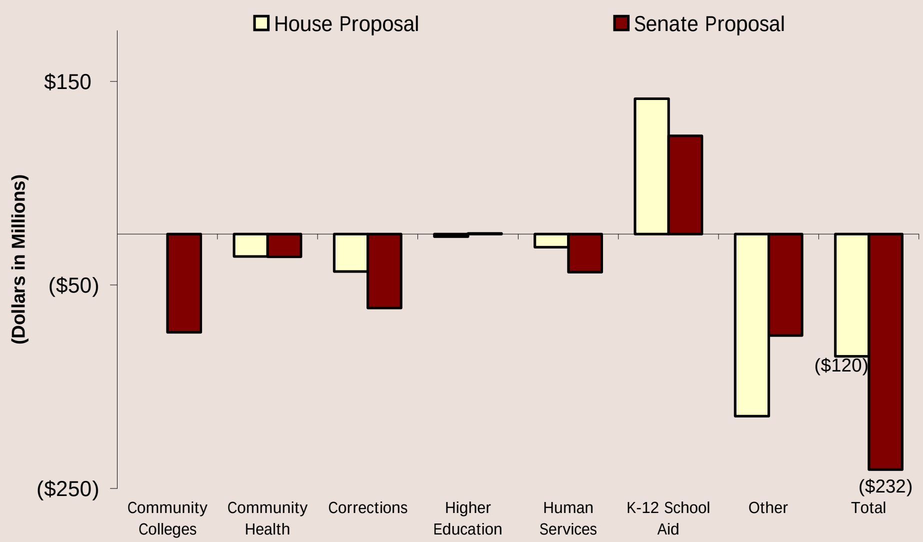
cuts appear in the budget and how they compare to the Governor's recommendations varies across the two proposals (See **Chart 1**). In terms of total School Aid Fund appropriations, the proposals are much closer to the Governor's recommendation for all education budgets ($11.2 billion); the Senate plan spends $26 million more and the House plan spends $3 million less.

Chart 1
General Fund Appropriation Differences Compared to Executive Budget



These aggregate reductions to the Executive Budget were premised on two reasons; legislative priorities that differ from those of the Governor and concern about revenue projections. Addressing the policy and budgetary differences and arriving at consensus will occur during the final budget negotiations between the legislative chambers and the executive branch. Budget differences arising from concerns about state revenue collections will be resolved following the May 16th revenue estimating conference, when updated economic and revenue forecasts for FY2012, FY2013, and FY2014 are produced. Current-year state revenue collections through March are exceeding expectations established in the official biannual forecasts, albeit by a fairly slim margin for both the General Fund and the School Aid Fund, according to both legislative fiscal agencies.

Education Appropriations

Budget recommendations from both legislative chambers continue the policy of treating the General Fund and School Aid Fund synonymously for purposes of financing education appropriations. Recall, the FY2012 budget broke with past precedent of using the School Aid Fund exclusively to support K-12 education appropriations. Last year, the Governor recommended using nearly $900 million in School Aid Fund resources for community college and higher education appropriations and called for reductions in K-12 state aid; however, the final budget reduced the total to roughly $400 million ($198 million for community colleges and $200 million for higher education) and the proposed K-12 cuts were reduced.

Table 1 highlights the appropriation differences between the House and Senate plans by education level and the amount of state support supplied to each, by major fund. The aggregate funding amounts are nearly the same under each plan, but the financing sources vary in key ways. Also, both legislative plans allocate more state funding and discretion-

Table 1
FY2013 Education Appropriations by Major Fund
(Dollars in Millions)

	House			Senate		
Recommendation	**General Fund**	**School Aid Fund**	**Total**	**General Fund**	**School Aid Fund**	**Total**
K-12 State Aid	$333	$10,782	$11,115	$297	$10,715	$11,012
Community Colleges	$97	$198	$294	$0	$294	$294
Higher Education	$1,100	$201	$1,301	$1,102	$201	$1,303
Total Education	$1,530	$11,180	$12,710	$1,399	$11,210	$12,609
Compared to Executive Budget						
K-12 State Aid	$133	$(3)	$130	$97	$(71)	$26
Community Colleges	$ -	$ -	$ -	$(97)	$97	$ -
Higher Education	$ (2)	$ -	$(2)	$ -	$ -	$ -
Total Education	$131	$(3)	$127	$ -	$26	$26

* Only General Fund (GF) and School Aid Fund (SAF) appropriations included, while federal appropriations are excluded here.

ary General Fund resources to K-12 state aid than the Executive Budget, which provides $10,986 million in total and $200 million from the General Fund.

The aggregate post-secondary education appropriation amounts do not vary across the two chambers; however, the financing of these appropriations differ in one material way. The Senate completely eliminates the General Fund support for community colleges, relying entirely on the School Aid Fund to finance the $294 million appropriation. The Senate recommendation expands on the budget policy initiated last year by adding $100 million to the School Aid Fund's financing burden for post-secondary education.

The Governor's Executive Budget holds per-pupil foundation grants constant at FY2012 amounts ($6,846 minimum grant), but provides districts with additional state aid through three categorical programs: best practices funding, pay for student performance, and retirement cost reimbursement. Although overall K-12 state aid amounts are similar, the legislative proposals deviate significantly from the Governor's plan in terms of the methods used to allocate additional funds next year.

The Senate concentrates its appropriation increases in changes to the foundation grants, as opposed to upping categorical dollars. All districts, traditional public schools and charter schools, would benefit from a foundation increase. The Senate plan redirects all of the retirement cost reimbursement ($177 million) and best practices funding ($126 million) to provide foundation grant increases ranging from $116 per pupil to $232 per pupil using the "2X formula" (i.e. range of annual adjustments in which the minimum foundation grant receives an increase that is twice as large as the maximum grant). This approach improves per-pupil funding equity across districts. Also of note, the recommendation retains $40 million (Governor called for $70 million) to provide new performance-based funding (equal per pupil amount) to districts that show student growth in grades 2 through 12 using a computer adaptive test at least twice a year.

The House of Representatives, like the Governor, does not make any changes to the foundation grants and instead provides additional per-pupil funds via categorical grants. However, the House scraps the Governor's proposal to fund school districts for academic achievement. Also, the House plan continues the best practices funding, but at a lower amount than the current year (reduced to $75 per pupil from $100 per pupil) and revises the criteria – the Senate eliminates this program entirely. The House increases per-pupil funding through the retirement cost reimbursement mechanism, providing a total of $249 million or $166 on a per-pupil basis (equivalent to a 2.8 percentage point reduction to the employer contribution rate for FY2013, which is set at 27.37 percent of payroll). Only districts participating in the school employee retirement system (mostly traditional public schools as opposed to charter schools) benefit from this funding and the per-pupil amount is directly related to the district's pay-

Table 2
Effective Per-Pupil Funding Changes Compared to FY2012

		FY2013		
	FY2012	**Governor**	**House**	**Senate**
Foundation (minimum)	$6,846	$6,846	$6,846	$7,078
Best Practices/ Performance Funding	$100	$175*	$75	$26
Retirement Reimbursement	$100	$115	$166	$0
Subtotal	$7,046	$7,136	$7,087	$7,104
Retirement Cost Increase**		$(170)	$(170)	$(170)
Net Change	*$7,046*	*$6,966*	*$6,917*	*$6,934*
% Change from FY2012		*-1.1%*	*-1.8%*	*-1.6%*

* Based on districts qualifying for full $100 per pupil in academic performance funding.

** Estimated per-pupil retirement cost increase (compared to FY2012) for those districts participating in MPSERS resulting from the rise in the employer retirement contribution rate from 24.26% to 27.37% of covered payroll as required by the School Aid Fund budget.

roll as a share of the statewide total payroll. The House and Senate also disagree on the Governor's proposal for savings resulting from the shift to paying one-half of a foundation grant to districts that deliver half-day kindergarten. The Governor and Senate recognize $50 million in savings from this change, but the House does not reflect any savings in its budget.

In terms of total discretionary per-pupil funding allocations, the proposals vary because of the different methods used to allocate state aid and the amounts appropriated in each case. **Table 2** estimates the effective per-pupil funding amounts under each proposal and compares them to FY2012. A key difference between the Governor's per-pupil recommendation and those coming from legislative chambers relates to the criteria used to distribute state aid. The legislative proposals, especially the Senate's, are much less restrictive in terms of the requirements that must be met to receive additional state aid in FY2013. The Governor recommends that districts could be eligible for up to $175 per pupil in combined best practices ($75 per pupil) and academic performance funding ($100 per pupil) if certain conditions are met. However, it is projected that a good number of districts would not qualify for the full amount and a number would not qualify for any of the dollars tied to performance. The legislative proposals allocate more funding to programs that all districts will qualify for without having to satisfy stated requirements, including the foundation grant (Senate) and the retirement cost reimbursement (House). The additional dollars in the Executive Budget are designed as incentives to get districts to engage in certain behavior aligned with Governor Snyder's policy direction. The legislature, on the other hand, provides new resources with much fewer strings attached.

The two legislative bodies concur with the Governor's plan to increase total state support for community colleges by 3.6 percent ($10.3 million) over the current-year amount; however, the methods to distribute the additional money among the individual colleges vary and will require reconciliation before the final budget is settled. The House's plan would distribute all the additional funding to help districts cover retirement cost increases arising from the jump in the employer retirement contribution rate. The plan would provide a 3.6 percent across-the-board increase based on each entity's state appropriation; a method related to, but not directly tied to, each school's retirement cost increase.

The Senate, on the other hand, provides schools with some additional money to help them with their rising retirement costs, but the majority of the money ($8.5 million representing a 3 percent increase over FY2012) would go to schools using the five-part formula recommended by the Performance Indicator Taskforce (the largest piece (50 percent) is based on each school's proportionate share of total FY2012 appropriation with smaller distributions based on degrees awarded, student contact hours, administrative costs, and local impact). Both legislative proposals reject the Governor's call to divide additional money using past student performance measures.

Similarly, all three proposals agree to the same aggregate 3 percent General Fund increase to support university operations, but differ as to the means for distributing the dollars to the 15 institutions. Again, these fundamental differences will have to be resolved in final budget negotiations. The Governor proposes using an equally divided four-part, performance-based equation to dole out the additional $36 million to schools. The House's plan also relies on a performance-based plan, but uses a single component with different weights for graduate/undergraduate degrees and programs. The range of annual increases is 0.5 percent (Wayne State University) to 7.4 percent (Grand Valley State University). The additional funding would not be available to a school that fails to meet four requirements, including tuition restraint and reporting on embryonic stem cell research.

The Senate higher education plan uses a three-piece adjustment method: 1) $9 million for tuition restraint language (similar to Governor); 2) $18.1 million distributed across-the-board based on current appropriation amounts; and 3) $9 million using schools' performance relative to eight metrics from their Carnegie classification. Annual increases under this plan range from 1.8 percent (University of Michigan and Michigan State) to 4.9 percent (Lake Superior State). The Senate plan also conditions its funding increases on meeting specific requirements; some similar to, and others different from, the House. These "boilerplate" conditions will have to be worked out at the same time with the appropriation decisions.

Other Major Differences

Although education appropriations tend to garner the most attention, there are notable differences between the legislative proposals in the other areas of the state budget with large concentrations of General Fund resources – Department of Corrections, Community Health, and Human Services. Combined with the education appropriations, allocations to these departments account for over $4 of every $5 in the FY2013 General Fund budget proposed by the Governor. Additionally, the legislative chambers differ in their proposals for sharing state revenue with units of local government.

Department of Corrections

One area of the state budget that has received continual scrutiny by both the executive and legislative branch in recent years is the Department of Corrections because of its shear size and tendency to crowd-out spending in other areas, especially during periods of state budget austerity. Despite a fairly significant reduction in the state prison population since its all-time high in March 2007 (roughly 51,000) to about 44,000 today, the total General Fund allocation has remained stable at about $2 billion, or $1 of every $5 in the budget. The corrections workforce also declined from more than 16,000 employees in 2007 to approximately 13,400 today. The reasons for these seemingly contradictory trends are complex and beyond the scope of the analysis here; however, they are at the forefront of the recommendations offered by the House and Senate and their efforts to control the growth of appropriations for FY2013.

Both chambers make cuts to the Governor's spending plan for corrections, which recommends a $50 million increase over the current-year amount. However, neither legislative plan proposes changes to corrections policy (sentencing, length of stay, etc.) that would reduce Michigan's prison population significantly, but instead these plans seek to reduce per-prisoner costs through various means. The Senate plan is the most ambitious at controlling costs; it comes in at nearly $73 million below the Governor and $23 million under the FY2012 budget. Savings are achieved primarily through the elimination of 580 positions (mostly non-custodial) cutting $59 million from the budget, which raises concerns in many corners about the ability of the department to adequately staff facilities, provide both prisoner and worker safety, and other considerations. Additional savings are sought through facility closures and privatization of health care and mental health services and food services.

The House plan approaches its savings, slated at almost $40 million below the Governor's plan (but $11 million above current year), by closing a prison in Ionia and transferring nearly 1,300 prisoners (mostly higher security) to other facilities. Given the significant savings involved and the disparate means for achieving them, the Department of Corrections budget proposals originating in each chamber will require reconciliation. In either case, corrections policy is likely to be affected more than on the margins as a result of the final budget figures agreed to.

Department of Human Services

Both legislative chambers recommend privatizing different aspects of human services operations, something the Governor did not include in his Executive Budget. For example, the House's plan includes the closure and privatization of the state's three juvenile justice centers.

The Senate asked for a work group to look into privatizing one of these facilities, the W.J. Maxey Boys Training School. The Senate's budget also includes language requiring a pilot project to privatize all child welfare services, except child protective services, in Kent County. Despite the different approaches contained in each proposal, it is likely that increased use of privatization will be included in the final human services budget; however, the details will have to be hashed out in negotiations with the Governor.

Revenue Sharing Payments

The total appropriation amounts for state revenue sharing do not vary significantly across the two legislative spending plans, but there are key differences beneath these totals in how funds are shared with local governments. The House allocates $1,087 million in sales tax revenue and the Senate slightly more, $1,073 million, to be shared among units of local government; however, in each case, $711 million of this total is constitutionally dedicated to cities, villages and townships on a per-capita basis and outside the control of the legislature. Thus, about one-third of the total ($376 million in House and $362 million in Senate) remains to be divided up under statutory provisions. The Senate plan would allocate the same amount ($210 million) to cities, villages, and townships under the Economic Vitality Incentive Program (EVIP) as the current year, but the House would increase this allocation to $220 million. EVIP payments are provided to units that meet certain state-determined financial and reporting requirements (equal payments in three separate categories: accountability/transparency, service consolidation, and employee compensation). Both chambers relax, to some degree, the requirements that locals have to meet to qualify for the state aid.

The greatest difference in the revenue sharing proposals relates to the plans to distribute monies to Michigan counties, which do not participate in the constitutional revenue sharing program and only receive statutory allocations. It is important to note that the Governor calls for completely eliminating current statutory revenue sharing payments (payments to those units that have exhausted their revenue sharing reserve funds – funds established to account for the accelerated collection of 2004-05 county property taxes in exchange for the temporary elimination of statutory state revenue sharing payments) and converting this to a $126 million incentive-based program similar to the EVIP available to other local units. County Incentive Program payments would be available to those counties that have exhausted their reserve funds and meet the same conditions that apply to the EVIP payments (three equal payments for each category). Under current statutory provisions, 61 counties will qualify for statutory revenue sharing in FY2013 totaling $168 million under a full-funding scenario, but the County Incentive Program provides $126 million or 75 percent of the total. (For FY2012, 50 counties qualify to share $115 million, $37 million less than the full-funding amount.)

Both chambers only partially adopt the Governor's county revenue sharing plan, with the House allocating slightly more ($39 million) to the new county EVIP plan than the Senate ($25 million). In each case, the remainder of the county funds is distributed through the traditional revenue sharing program, with the Senate allocation slightly greater ($102 million) than the House plan ($91 million). After combining the two county programs the total amounts are basically the same; the House would distribute $131 million and the Senate would share $127 million.

Both chambers include a $25 million set-aside (up from $15 million recommended by the Governor) for competitive grants to assist local units with costs of mergers, interlocal agreements, and cooperative efforts needed to combine government operations. The Senate plan restricts this funding to general units of government, but the House opens the funding to school districts (including intermediate districts).

Other Budget-Related Legislation

At the same time that the legislative chambers are considering their plans for the FY2013 budget, they are, individually, pursuing other legislation that, if enacted, would affect the budget. Proposed legislation that modifies the distribution of some state sales tax revenue currently credited to General Fund would be reflected in the Department of Transportation appropriations. Also, another round of legislative changes is contemplated for the Michigan Public School Employees' Retirement System (MPSERS), which would affect pension and retiree health care benefits and would address short- and long-term costs of the system.

Following the four-cent-per-gallon state gasoline tax increase in 1997 and throughout much of the 2000s, Michigan enjoyed a situation where it had sufficient annual state transportation revenues (gas and motor vehicle registration taxes) to match federal funds provided for the federal-aid highway program (mainly road and bridge maintenance). The state never risked "losing" federal funds for its failure to meet the required state match, but instead was at the front of the line to receive others states' federal funds when they were unable to come up with the requisite match. Recently, however, Michigan's situation has changed with the slowdown in state transportation revenue growth. A perennial question during budget-related discussions has been, "Will the state have sufficient matching resources?" In recent years, a host of solutions have been offered and implemented to stave off the loss of federal funds resulting from failing to meet the required match.

The FY2013 transportation budgets recommended by both legislative bodies contemplate the passage of legislation that would dedicate 18 percent of the 4 percent sales tax on motor fuels (gasoline and diesel) to the State Trunkline Fund, instead of the General Fund, for state and local highway and bridge programs. On a full-year basis, this change would amount to an additional $135 million in dedicated transportation revenue and a reduction of the same General Fund amount. Both legislative chambers earmark approximately $100 million of this money in the transportation budget to match the federal-aid provided to Michigan in FY2013. In contrast, the Governor's plan calls for a direct appropriation of $96 million General Fund to ensure the federal funds are received in the coming years. Both the legislative and executive proposals serve the same purpose, but by different methods. Also, they divert General Fund resources from other purposes in FY2013, so the effect on the overall state budget is basically the same.

In contrast to the Governor's plan, which represents a short-term solution to a fairly narrow question of how to match federal aid in FY2013, the legislature's response provides a longer-term solution by permanently increasing the amount of state transportation funding. However, it appears that the main focus of the new sales tax earmark (75 percent of total) is to match existing federal funds and skirts the larger issue of fully addressing Michigan's long-term transportation funding needs.

The proposed changes to MPSERS would have the effect of reducing the spending-side of most school districts' budgets by reducing the required employer contributions to the system. These changes include:

- narrowing the definition and amount of compensation used for pension calculations;
- requiring higher employee contributions for current pension benefits;
- changing from a 90/10 (employer/retiree) to a 80/20 insurance premium cost share;
- eliminating retiree health care premium coverage for new employees; and
- increasing the eligibility age for retiree health care to at least 60.

These changes would generate immediate savings ($380 million) for the retirement system (not the state budget directly) that could be translated into a lower employer retirement contributions from school districts. Currently, the required contribution rate is slated to rise to 27.37 percent of covered payroll in FY2013, up from 24.46 percent of payroll in the current year. The vast majority of the savings to the system (and school districts) occur over the longer term – the pension and retiree health liabilities of the system would be reduced by $1.6 billion and $6.0 billion, respectively. The MPSERS reforms are expected to move concurrently with the final School Aid Fund budget so schools should know, by the end of May, both the amount of state aid as well as the required retirement contribution rate for the coming year.

Conclusion

Passage of all the FY2013 appropriation bills by the Senate and House of Representatives represent one of the near-final steps in the state's budget process; not to mention an important one for meeting the legislature's plan to wrap things up by June 1. While much work is complete, much remains given some key differences between the two legislative proposals, both in terms of funding amounts and the provisions conditioning certain appropriations. Reconciling these differences will also have to consider the recommendations included in the Executive Budget. Although total budgeted amounts in some areas are similar across all three iterations, beneath these totals lie notable differences in the details – how dollars are allocated across programs, services, and sub-state entities. Final budget decisions will be the result of a three-way negotiation between the House, Senate, and Governor Snyder. Despite single-party control of the legislature and the executive branch, final negotiations may be more difficult than the nominal dollar differences suggest, as there are disparate points of view and policy objectives in each case.