



## MICHIGAN'S BUDGET SITUATION—A LONG-TERM PROBLEM

In June, Citizens Research Council of Michigan Note 2001-02 outlined the difficulties confronting the State in dealing with the budget. Since that time, actions were taken by the Governor and the State Legislature to close the budget gaps for fiscal years 2000-01 and 2001-02.

This Note summarizes the Fiscal Year 2000-01 and 2001-02 actions and provides some findings relative to the fiscal year 2002-03 budget outlook. In many respects the 2002-03 situation may be more difficult to solve than the previous two years.

### Fiscal Year 2000-01 Review

Faced with revenues falling far short of original projections, the enacted Fiscal Year 2000-01 budget exceeded revised revenue projections for the General Fund-General Purpose and School Aid portions of the budget by nearly \$1 billion. The General Fund gap between revenues and original and supplemental appropriations is projected at \$641 million. Actions to close this revenue shortfall are largely of a one-time nature; permanent spending reductions or revenue enhancements were not significant components of the budget solution. **Table 1** summarizes the components of the solution.

for subsequent years. With projected revenues of \$9,189 million and appropriations of \$9,747 million, a gap between base revenues and enacted General Fund appropriations of \$558 million carries into Fiscal Year 2001-02.

The only item that might be available in years after Fiscal Year 2000-01 to reduce the spending base in whole or in part are the \$83.7 million of reduced appropriations and only if those reductions are reflected in appropriations

The solution to the School Aid revenue shortfall is much simpler. The surplus in the fund remaining after Fiscal Year 1999-00 totaled \$853 million and it was intended to be used in Fiscal Years 2001-02 and 2002-03 to help support appropriations already enacted before the revenue shortfalls unfolded. Rather than reducing spending in Fiscal Year 2000-01 to close the shortfall, a portion of that surplus, \$344 million, is covering the Fiscal Year 2000-01 shortfall in the School Aid Fund.

**Table 1**  
**Actions to Balance Fiscal Year 2000-01 General Fund Budget**  
(\$ in millions)

Use of Fiscal Year 1999-00 Surplus	\$211.8
Reduced Appropriations Authority	83.7
Shift Building Projects from Pay-as-you Go to Bonding	211.2
Elimination of Work Project Funding from Carrying Forward to Subsequent Years	56.0
Withdrawal From Rainy Day Fund	<u>77.0</u>
Total Actions	\$639.7

### Fiscal Year 2001-02 Review

Although a few issues remain to be resolved related to the Fiscal Year 2001-02 budget, the strategic approach to closing the shortfall between projected revenues and the Governor's recommended expenditures is in place. The

gap between the Governor's recommended General Fund spending and the revised revenue forecast is \$514 million. **Table 2** summarizes the adjustments to the original budget plan.

# CRC Memorandum

**Table 2**  
**Actions to Balance Fiscal Year 2001-02 General Fund Budget**  
(\$ in millions)

Reductions to Governor's Original Recommended Spending	\$209.2
Tobacco Settlement Funds Transfers to General Fund	82.5
Reduction in Revenue Sharing Payments to Local Government	50.0
Tax Amnesty Program and Treasury Delinquent Tax Revenue	18.0
Withdrawal From Rainy Day Fund	<u>155.0</u>
Total Actions	\$514.7

The reductions in the Governor's recommended appropriations affected every area in the General Fund Budget except School Aid. If all reductions are continued in subsequent budgets, the gap between base spending and revenues will close somewhat. Also, there is precedent for making reductions in local government revenue sharing permanent, but a statutory change would be required to modify the formula allocation from sales tax revenues. With projected revenues of \$9,270 million and appropriations of \$9,575 million, a gap between base revenues

and General Fund appropriations of \$305 million carries into Fiscal Year 2002-03.

The Fiscal Year 2001-02 School Aid budget was enacted in June 2000, 15 months before the fiscal year begins. That appropriation assumed the use of fund surplus to finance part of the overall spending plan. Use of some of the surplus to cover the Fiscal Year 2000-01 revenue shortfall leaves the School Aid Fund with insufficient resources to cover the appropriations for fiscal year 2001-02. As a result, reductions in

appropriations of \$172 million will be made, with the form of those reductions still being debated in the Legislature. At current spending and revenue projections, the School Aid Fund will end the year without any surplus to finance spending in the following year. With projected base revenues (including Federal, Budget Stabilization Fund, and General Fund) of \$10,837 million and appropriations of \$11,350 million, a gap between base revenues and School Aid Fund appropriations of \$513 million carries into fiscal 2002-03.

## Fiscal Year 2002-03 Outlook

The overall imbalance between base revenues and appropriations in the School Aid Fund and General Fund combined for Fiscal Year 2001-02 totals \$818 million. In order to bring base revenues and spending into balance, the first \$818 million of revenue growth in the two funds would have to be committed to that purpose.

While formal forecasts of Fiscal Year 2002-03 revenues have not been produced by the state, the Senate Fiscal Agency has produced some preliminary figures based on an *assumed* increase of five percent in General Fund revenues generated before the effects of scheduled tax rate re-

ductions in the Personal Income and Single Business Taxes are factored into the calculation. That calculation yields a starting point of \$9,734 million. However, tax rate reductions total \$269 million and the effects of Federal tax reform, which reduce state revenues by roughly \$100 million in Fiscal Year 2002-03, bring available General Fund revenues to only \$9,365 million despite the assumed five-percent baseline growth. Prior year appropriations are projected at \$9,575 million, so the budget development process starts \$210 million in the hole before considering pressures for increased spending. **Table 3** provides a list of spending pressures identified in the

Senate Fiscal Agency analysis.

Adding this list to the starting gap yields a problem of \$725 million. It should be noted that no additional funding is included for higher education and capital outlay. For example, a three percent increase to cover general inflation would add about \$64 million to the list for the higher education budgets.

It is clear that the task of developing the General Fund budget for fiscal year 2002-03 will be very challenging; even if the economy returns to a growth path sufficient to generate five percent annual revenue increases.

# CRC Memorandum

**Table 3**  
**General Fund Spending Pressures for Fiscal Year 2002-03**  
 (\$ in millions)

Already enacted increase in General Fund grant to School Aid Fund	\$215.1
Increase in state matching rate for Medicaid Program	100.0
Increase in Department of Corrections population and operating costs	60.0
Debt service costs for State Building Authority	40.0
Economic increases for state agencies	<u>100.0</u>
Total	\$515.1

Source: Senate Fiscal Agency

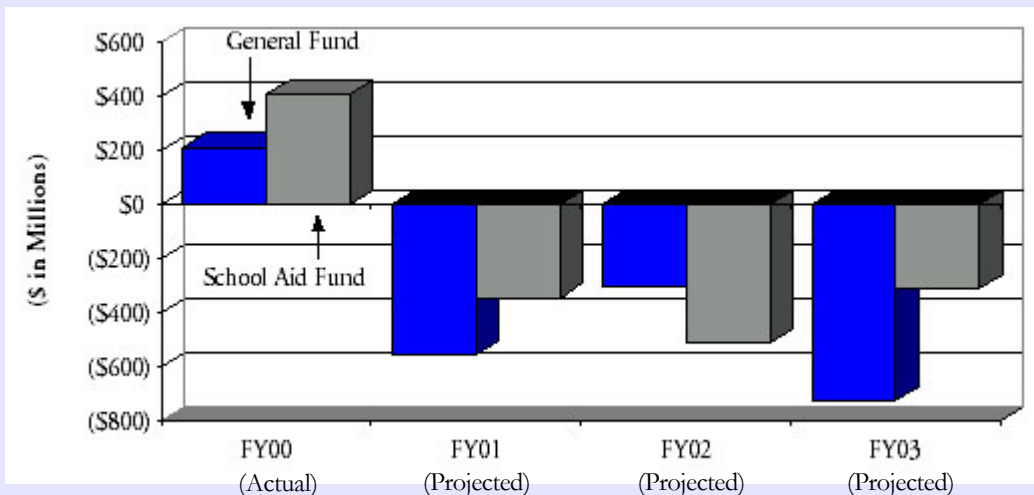
The School Aid budget for Fiscal Year 2002-03 has already been enacted at a level of \$11,885 million. That budget was predicated on a higher base revenue figure than is likely and the use of \$24 million of School Aid Surplus carrying forward from the previous year. Revised projections have eliminated the surplus. Applying the same general approach used in the Senate Fiscal Agency analysis a five percent *assumed* increase in School Aid Fund tax revenues and factoring in other revenue sources already enacted would produce total available revenues of \$11,575 million compared with enacted appropriations of

\$11,885 million, a gap of \$310 million. If School Aid is constrained to the available revenues calculated in this scenario, the increase in School Aid spending would be \$225 million or two percent from the likely fiscal year 2001-02 spending total of \$10,350 million after reductions.

While there will be pressure to use one-time revenue and spending actions to permit greater spending increases, this approach cannot continue indefinitely. At some point base spending and revenues will have to be brought together. **Chart 1** illustrates the gaps for the General and School Aid Funds re-

spectively. While one-time actions such as using the Rainy Day fund, delaying scheduled tax rate decreases, using special Medicaid reimbursement funds, and using Tobacco Settlement funds are possible, heavy reliance on actions postponing the inevitable need to balance base revenues with spending may create other problems. Large withdrawals from the Rainy Day fund would have an adverse effect on the State's cash position and could harm the State's credit rating. It is clear that the Fiscal Year 2002-03 budget may be, in some respects, the most difficult in this three-year period of budget doldrums.

**Chart 1**  
**Michigan General Fund and School Aid Fund Operating Surplus/Deficit**



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