

Michigan's Current Budget Situation 2003-2004

This brief paper provides an overview of Michigan's current budget, including the appropriations for fiscal year 2003-04. It also contains information about the December 2003 Executive Order to reduce the budget and a summary of the revenue projections for the 2004-05 budget.

The Total State Budget

In July 2003 the Michigan Legislature and Governor Granholm approved a \$38.5 billion budget for the 2004 fiscal year which began October 1. The budget decisions reflected reductions in expenditures, the use of a one-time allocation from the federal government, new revenues (driver's license and bad driver fees, etc.) and the expectation of a \$360 million surplus for the 2002-03 fiscal year.

The total state budget has three parts:

General Fund (\$8.9 billion) represents the portion of the total state budget where the legislature makes decisions about spending. Comprising 23 percent of the total budget, the general fund includes many of the programs and services of state government such as State Police, Department of Natural Resources, Secretary of State, the Governor's office, Department of Agriculture, higher education, Family Independence Agency etc.

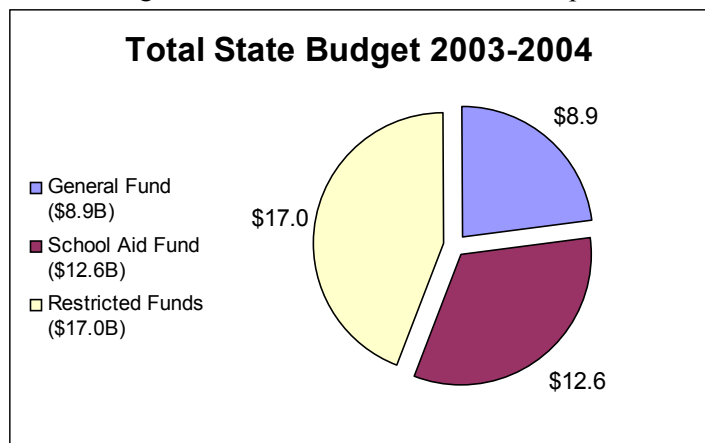
School Aid Fund (\$12.6 billion) represents the budget for public K-12 education in Michigan. State law and constitutional requirements specify the way that money is allocated. School aid comprises about 33 percent of the total budget. The State School Aid Fund, established in 1994, receives

revenue from a variety of sources, including the sales tax, an earmarked portion of the income tax, all lottery revenue, the real estate transfer tax, and specified amounts of the taxes on tobacco, cigarettes, and the liquor excise tax and monies from the state's general fund. These revenue sources have all been impacted by the general economic conditions facing the state.

Restricted Monies (\$17 billion) represent 44 percent of the total state funding. The use of these funds is restricted by law or by the constitution. Some of these monies are designated for specific uses such as transportation and constitutional revenue sharing. Federal grants also restrict the use of monies (Medicaid, etc.).

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General Fund Budget

In July 2003 the legislature approved a General Fund (GF) budget of \$8.9 billion for 2003-2004. The December Executive Order reduces that budget to \$8.6 billion, the lowest general fund expenditure in 10 years.

Note: These figures represent the budget as appropriated; they do not reflect the Executive Order decisions (12/18/03) for reducing the budget. See information in the next section of this paper.

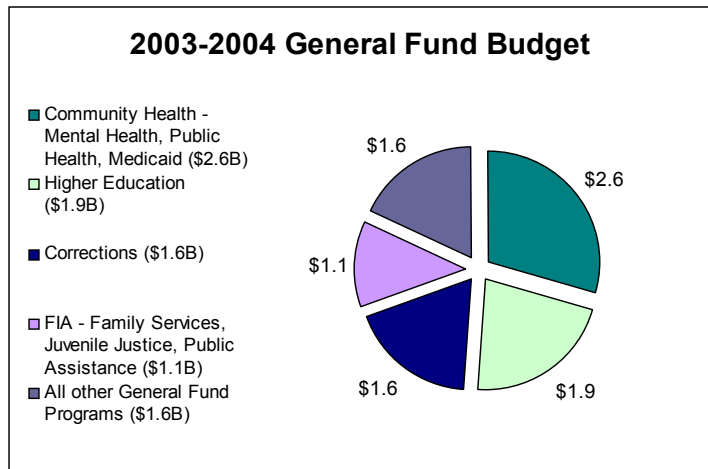
Department of Corrections (\$1.6 billion or 18 percent of GF)—This budget pays for housing prisoners and employing about 30 percent of the state government’s workforce. In order to make major changes in the amount spent on corrections, there would need to be reductions in length of sentences and/or the length of time in prison.

Higher Education (\$1.9 billion or 22 percent of GF)—This money funds the state’s 15 public universities, paying about half of the operating expenses. Higher education received a zero percent increase in 2002-2003 and 3.5 percent in rescissions. Most of higher education received a 6.7 percent decrease in 2003-04.

Community Health (\$2.6 billion or 29 percent of GF)—This budget includes monies for Medicaid, mental health, substance abuse prevention and treatment, local public health support, and programs for the aging. Federal dollars match with state dollars for the Medicaid program. There are also many federal requirements for how the money is spent.

Family Independence Agency (\$1.1 billion or 13 percent of GF)—This budget includes funding for family assistance, juvenile justice, foster care and adoption, domestic violence and assistance with child-care for low-income families

All other programs (\$1.5 billion or 18 percent of GF)--This includes funding for most of the 19 departments of state government, such as Agriculture, Natural Resources, Secretary of State etc.



It also includes revenue sharing to local governments. **State revenue sharing for local governments** is provided in two forms: constitutionally required payments and statutory payments. Revenue sharing is a significant revenue source for local governments, ranging from 8-20 percent of general fund revenues. Statutory payments were cut by 19 percent in 2002; there was an additional 3.5 percent rescission in December 2002 and a 3 percent reduction for 2003-04.

Dealing with the 2003-04 Budget Deficit

Two weeks after the beginning of the 2003-04 fiscal year, a Consensus Revenue Estimating Conference (House and Senate Fiscal Agencies and the State Treasurer) agreed that the state's general fund budget had a deficit of \$569 million and that the State School Aid Fund had a deficit of \$350 million. The 2003-04 budget had reflected the expectation of a \$360 million surplus for the previous fiscal year. However, tax revenues were considerably lower than projected and that surplus did not exist.

Michigan's constitution requires that the state budget must be balanced at the end of the fiscal year. If budget projections show that the revenue will not cover the expenditures, then the governor has the responsibility to adjust the budget so that it will be balanced. This can be done by cutting programs and services, by raising revenues, or by some combination of the two. The Michigan Constitution (Article V, Sec. 20) specifies that the governor will make the necessary reductions with the approval of the house and senate appropriations committee.

After several weeks of discussion, Governor Granholm and the legislature reached final agreement on Executive Order 2003-23 on December 18, 2003. Strong spending controls by state agencies and a slightly lower Medicaid caseload meant that the revised deficit estimate was \$484 million for the general fund. The Executive Order contained 24 percent in revenue enhancements, 63 percent in spending reductions and 13 percent in accounting changes.

The governor's executive order budget message specified that the plan to reduce the deficit would be protecting programs such as Medicaid, mental health services, programs for needy families, day care benefits, environmental protection, economic development, and "Cooperative Extension and the Agricultural Experiment Station." The major components of the plan to deal with the 2003-04 budget deficit are listed below.

For more detailed information, go to http://www.michigan.gov/documents/Budget_Deal_80925_7.pdf.

Income Tax "Pause"--The income tax reduction slated to begin Jan 1, 2003 will not take effect until July 2004. Legislation approved in 1999 called for reducing the state's personal income tax rate by one-tenth of a percentage point per year, from 4.4 percent in 1999 to 3.9 percent in 2004. The decision to delay the 2004 reduction will net the state \$76.7 million in revenue, with \$45.6 million of that amount transferred to the School Aid Fund.

Other Revenue Sources--Additional revenue will be gained by increasing the funding to enforce the collection of delinquent taxes, earmarking of revenue from cigarette manufacturers, and money from federal child support revenue.

Reductions for Higher Education—The funding for the state's 15 universities was reduced by five percent, for a savings of \$73.1 million. There is a provision specifying that any university that "exercises fiscal restraint for the remainder of academic year 2003-04 and for the next fiscal year, will have their appropriation restored to an amount equal to three percent of their original allocation." Funding for Michigan's 29 community colleges was reduced by 5 percent for a savings of \$12.4 million.

Revenue Sharing—Statutory general sharing for local units of government was reduced by five percent, for a savings to the state of \$72 million. This action means that 250 townships and 30 villages will not be eligible for funds under the statutory formula. The three cities presently operating under a state-appointed financial manager are exempt from this reduction.

Cuts to State Agencies—The Executive Order included \$92.5 million in reductions to state agencies. Most of that reduction was taken in the form of administrative savings (travel, training, holding vacancies, etc.). In some cases, general fund appropriations were substituted with monies from specific sources (fees, grants, etc.).

- The Department of Corrections received the largest dollar amount reduction (\$6 million), reducing their appropriation by .4 percent
- The Department of Environmental Quality sustained a 5 percent cut, but the revenue from waste reduction fees will replace some of that revenue.
- The Family Independence Agency, with a 2.8 percent cut, will be eliminating before and after school pilot projects and making a relatively small reduction in day care programs for welfare recipients.
- The Department of Agriculture, with a 3.6 percent cut, will reduce seasonal staff for fruit and vegetable inspections and pesticide inspection programs, as well as making other administrative reductions.
- The Department of Career Development's budget cuts call for reducing workforce development boards and eliminating the Council of Michigan Foundations.

School Aid Fund— In October, the projected deficit for the school aid fund was \$350 million, translating into a \$190 per pupil reduction. That amount has been lowered to an estimated \$86 per pupil. Part of the revenue from delaying the income tax reduction was transferred to the school aid fund. In addition, a set of revenue adjustments and a larger than anticipated balance from 2002-03 boosted the amount of money available.

Revenue Estimates for 2004-05

On January 14, the participants in the Consensus Revenue Estimating Conference agreed on the estimates for revenues for the 2004-05 budget. The projected deficit for the general fund budget is approximately \$800 million. Governor Granholm has announced that she will use a deficit figure of \$1 billion in establishing her budget proposal. There are various policy decisions that will need to be made by the governor and the legislature that will influence the actual size of the deficit. These include the way tobacco monies are handled, the cost of state employees' retirement, reduction of federal support for Medicaid and an increase in Medicaid caseloads. The conference also agreed that the budget for the current year appears to be in balance, following the December Executive Order.

Options For Changing Revenue Sources

Discussions are taking place concerning the need to examine Michigan's current revenue sources and explore options for change. The argument is made that the present tax structure was based on a manufacturing economy and that it is not as appropriate for a more service-based economy. As the state has dealt with a series of budget deficits in recent years, a variety of ideas for raising additional revenue have been suggested. Here are some of the possible options:

- Further delaying (beyond July 1, 2004) the final one-tenth of a percentage point reduction in the state income tax.
- Increasing taxes on beer and wine or other such products. The beer tax yields about \$6 million per dollar of tax.

- Eliminating various tax credits.
- Allowing video lottery terminals at horse race tracks. This proposal has been approved by the House and is under discussion in the Senate (House Bills 4609-11).
- Raising the state income tax. This could be done by a majority vote of each house in the legislature. (Each one percent of the income tax yields approximately \$1.5 billion after credits and refunds.)
- Raising the state sales tax. This needs statewide voter approval. The sales tax yields approximately \$1 billion per percentage point.
- Extending the sales tax to out-of-state sales (catalog and Internet purchases etc.) Efforts are underway for a national solution on this.
- Extending the sales and use tax to services.
- Separating Michigan's Estate Tax from the Federal Estate Tax, saving the state approximately \$100 million.

Another issue under discussion relates to the 1999 legislation that calls for the phasing out of the Single Business Tax by 2020. The SBT netted about \$1.8 billion in 2003. There is no plan in place at the present time to replace that revenue source. Governor Granholm has asked the state treasurer to lead an effort to explore possible options for replacement revenue. Republican legislators are also undertaking a study effort on business taxes.

For More Information:

Citizens Research Council of Michigan— <http://www.crcmich.org>

State Budget Notes—October 2003

Outline of the Michigan Tax System—November 2003

Senate Fiscal Agency-- <http://www.senate.michigan.gov/sfa/>

House Fiscal Agency— <http://www.house.mi.gov/hfa/home.asp>

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