SENATE FISCAL AGENCY
MEMORANDUM

DATE: December 5, 2001

TO: Members of the Senate

FROM: Gary S. Olson, Director

RE: FY 2002-03 State Budget: Major Decisions Facing Legislature

In early November 2001, the Legislature and Governor John Engler completed action on a series of measures to ensure that the FY 2001-02 State budget is balanced between estimated revenues and enacted appropriations. This action was necessary as a result of the impact that the national economic recession has had on State revenue collections. The next major item of business that will face the Michigan Legislature involving the State budget is the initial work on the enactment of the FY 2002-03 State budget. While legislative action on the FY 2002-03 State budget will not begin until after Governor John Engler makes his FY 2002-03 State budget recommendations to the Legislature on February 7, 2002, we can currently identify some of the issues that will be facing the Legislature regarding the FY 2002-03 State budget.

The first issue that has to be dealt with involving a preliminary analysis of the FY 2002-03 State budget is the potential level of revenues that will be available to support appropriations. The State budget is based on a consensus revenue estimate established pursuant to State statute by the Consensus Revenue Estimating Conference. The consensus estimate of FY 2002-03 revenues will be agreed to in early January 2002. If we utilize the current consensus estimate of FY 2001-02 revenues as a starting point and assume a level of projected growth in FY 2002-03 we can approximate a future potential consensus estimate of FY 2002-03 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenues. For purposes of this analysis, we will assume that FY 2002-03 GF/GP and SAF revenues will grow by 5.0% over the current FY 2001-02 consensus revenue estimates. This 5.0% revenue growth assumption would be consistent with a year in which the State's economy is recovering from a recession, which most likely will be the case during FY 2002-03. To the extent that the revenue growth is below or above this 5.0% assumed level of growth, this analysis of the overall FY 2002-03 State budget would have to be adjusted accordingly.

This analysis of the FY 2002–03 State budget then will involve a comparison of this projected level of FY 2002-03 GF/GP and SAF revenues with the enacted level of FY 2001-02 GF/GP and SAF appropriations. This comparison will provide a summary of potential growth in the FY 2002-03 GF/GP and SAF appropriations above the current level of appropriations.

FY 2002-03 General Fund/General Purpose Budget

Table 1 provides a summary of a comparison of estimated FY 2002-03 GF/GP revenues versus FY 2001-02 year-to-date GF/GP appropriations. This analysis results in a projected $496.6 million deficit. While it may be possible to freeze most FY 2002-03 GF/GP appropriations at the FY 2001-02 levels, the SFA has identified two FY 2002-03 appropriations increases that have to be addressed in the budget. The first is a projected $100.0 million GF/GP funding increase in the State Medicaid program that is a result of a reduction in the Federal match rate for the program. This reduction in the Federal match rate, which has already been established by the federal government, will result in a $100.0 million GF/GP funding increase simply to continue the same Medicaid program in place during the current year. The second required appropriation increase that will have to be built into the FY 2002-03 GF/GP budget is a projected $45.0 million increase in the level of debt service payments required on bonds issued by the State Building Authority. These two required increases combined with the original assumptions leads to an adjusted $641.6 million deficit in the FY 2002-03 GF/GP budget assuming a freeze in all FY 2002-03 appropriations. This $641.6 million projected adjusted deficit equals 6.9% of FY 2001-02 appropriations.

Table 1
FY 2002-03
General Fund/General Purpose Budget Projection
(dollars in millions)

	SFA Estimate
FY 2001-02 Consensus Revenue Estimate	$8,779.8
FY 2002-03 Projected Revenue Estimate (5.0% Growth)	$9,218.8
Adjustments to Revenue Estimate:	
Incremental Cost of Income Tax Rate Reduction	(178.3)
Incremental Cost of Single Business Tax Rate Reduction	(116.2)
Federal Tax Reform Impact on State Revenues	(120.0)
Projected FY 2002-03 Revenue Available for Expenditures	$8,804.3
FY 2001-02 GF/GP Enacted Appropriations	$9,259.1
Pending FY 2001-02 Supplemental for DCH & FIA	41.8
Total FY 2001-02 GF/GP Appropriations	$9,300.9
Projected Deficit if FY 2002-03 Appropriations are at FY 2001-02 Levels	$(496.6)
Required Appropriation Increases:	
Medicaid Match Rate	$100.0
State Building Authority Debt Service	45.0
Subtotal Required Appropriation Increases	$145.0
Projected Adjusted Budget Deficit	$(641.6)

FY 2002-03 School Aid Fund Budget

Table 2 provides a summary of a comparison of estimated FY 2002-03 SAF revenues with enacted FY 2001-02 SAF appropriations. This analysis results in a projected $289.7 million deficit. This $289.7 million projected deficit equals 2.5% of FY 2001-02 appropriations.

Table 2
FY 2002-03 School Aid Fund Budget Projection
(millions of dollars)

	SFA Estimate
FY 2001-02 On-Going SAF Revenues:	
Consensus Revenue Estimate	$10,189.2
General Fund/General Purpose Grant	205.6
Budget Stabilization Fund (Durant)	32.0
Federal Aid	203.0
Subtotal On-Going SAF Revenues	$10,629.8
FY 2002-03 SAF Revenue Estimate (5.0% Growth)	$11,161.3
FY 2001-02 SAF Appropriations	$11,451.0
Projected Deficit if FY 2002-03 Appropriations are at FY 2001-02 Levels	$(289.7)

These projected deficits in the FY 2002-03 GF/GP and SAF budgets are directly a result of the decisions to utilize a variety of one-time revenue sources in the FY 2001-02 GF/GP and SAF budgets and enacted State tax policy. The FY 2001-02 GF/GP budget includes several one-time revenue sources. These one-time revenue sources include $155.0 million of funding from the Budget Stabilization Fund, $159.0 million of funding from the Merit Award and Tobacco Settlement Trust Funds, $63.0 million of restricted transportation funding, $65.1 million of revenue sharing payment reductions and $64.6 million of revenue generated from the sale of surplus State property. The FY 2001-02 SAF budget includes the utilization of $492.1 million of surplus revenue carried forward from FY 2000-01. This carry forward balance will not be available in the FY 2002-03 SAF budget. The FY 2001-02 SAF budget also includes $322.5 million of funding from the Budget Stabilization Fund. In terms of enacted State tax policy, the FY 2002-03 GF/GP budget will be impacted by the additional $178.3 million of revenue loss from the enacted income tax rate reductions, an additional $116.2 million of revenue loss from the enacted single business tax rate reductions and $120.0 million of revenue loss from the impact of Federal tax reform on State revenues.

Options to Balance the FY 2002-03 State Budget

The extent of the budget problems that the Legislature and the Governor will be facing in developing and enacting a FY 2002-03 are very significant. There are several options that will have to be considered to bring a balance between projected FY 2002-03 revenues and appropriations. The following information provides a summary of these options.

Appropriation Reductions: Any effort to reduce FY 2002-03 GF/GP appropriations below the FY 2001-02 year-to-date level will be difficult due to the fact that FY 2001-02 GF/GP appropriations are already 5.0% below the actual level of FY 2000-01 appropriations. In fact, FY 2001-02 GF/GP appropriations are 3.6% below the level of FY 1999-2000 appropriations and 1.7% below the level of FY 1998-99 appropriations. Significant reductions in the level of FY 2002-03 GF/GP appropriations will only be accomplished by program eliminations or reductions. Reductions in the level of FY 2002-03 SAF appropriations below the FY 2001-02 levels could be easier to accomplish than is the case with GF/GP appropriations because FY 2001-02 SAF appropriations are 5.1% above the FY 2000-01 levels.

Budget Stabilization Fund: Based on current appropriation policy, the Budget Stabilization Fund should have a balance of $543.3 million at the close of FY 2001-02. It is very likely that a significant portion of this remaining balance will be utilized to help balance the projected FY 2002-03 deficits in the GF/GP and SAF budgets.

Tobacco Settlement Revenues: Based on a continuation of the current appropriation policy of tobacco settlement revenues in FY 2002-03, the SFA estimates that the Merit Award Trust Fund and the Tobacco Settlement Trust Fund will have a combined $103.7 million of surplus revenue in FY 2002-03. It is very likely that as was the case in FY 2001-02, this surplus tobacco settlement revenue will be utilized to help balance the deficits in the FY 2002-03 GF/GP and SAF budgets.

Tax Policy Changes: The rate of the State income tax will drop from 4.1% to 4.0% on January 1, 2003. Temporarily suspending this scheduled income tax rate reduction would increase FY 2002-03 GF/GP revenues by $178.3 million. The rate of the single business tax will drop from 1.9% to 1.8% on January 1, 2003. Temporarily suspending this scheduled single business tax rate reduction would increase FY 2002-03 GF/GP revenues by $116.2 million.

In summary, the Governor and the Legislature face major challenges ahead as they begin to formulate the structure of the FY 2002-03 GF/GP and SAF budgets. The decisions made regarding how to balance the FY 2001-02 budget along with enacted State tax policy will create significant deficits in both the GF/GP and SAF budgets even if FY 2002-03 appropriations are frozen at the FY 2001-02 levels. These budget problems will force the Governor and the Legislature to consider all alternatives as they struggle to meet their constitutional mandate to approve a budget balanced between estimated revenues and appropriations.

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