ELIMINATING STATE GENERAL FUND BUDGET DEFICITS: THE MICHIGAN SOLUTION

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For the first time in the past 10 years, the Michigan Legislature during the 2001 legislative session was faced with the task of eliminating projected deficits in the State budget. Over the prior decade the Legislature was dealing with surplus revenues and eliminating budget deficits was not an issue. This shifting of budget-making decisions occurred quickly as a result of a slowdown in the Michigan economy which resulted in substantial downward revisions in the consensus revenue estimates. These downward revisions in the consensus revenue estimates resulted in projected deficits in the fiscal year (FY) 2000-01 and FY 2001-02 General Fund/General Purpose (GF/GP) State budgets. This article provides information concerning the action taken by the Legislature to eliminate the projected budget deficits and also discusses the budget problems that will face the Legislature as it develops an FY 2002-03 State budget.

FY 2000-01 State Budget Deficit

On May 15, 2001, the Consensus Revenue Estimating Conference convened and agreed to substantial downward revisions in the estimates of FY 2000-01 and FY 2001-02 GF/GP revenues. The change in the consensus revenue estimates resulted in a projected $340.4 million FY 2000-01 GF/GP budget deficit. Table 1 provides a summary of the adjustments enacted by the Legislature to eliminate this projected deficit. These actions consisted of a combination of reductions in appropriations, refinancing of capital construction projects, the elimination of previously authorized departmental work projects, and a withdrawal from the Budget Stabilization Fund. The remaining $1.5 million deficit will be eliminated by appropriation lapses at the close of the fiscal year.

Table 1: FY 2000-01 Enacted Adjustments to Balance General Fund/General Purpose Budget (millions of dollars)

Projected Revenues:	
Beginning Balance	$ 211.8
Consensus Revenue Estimate	9,189.1
Subtotal Available Revenues	9,400.9
Enacted Appropriations	$9,741.3
Projected Year-End Balance	**$(340.4)**
Legislative Action to Balance Budget:	
Positive Supplemental Appropriations (S.B. 283)	$(82.0)
Positive Supplemental Appropriations (S.B. 291)	(7.0)
Negative Supplemental Appropriations (S.B. 283)	83.7
Funding Shift on State Building Authority Projects	211.2
Work Project Funding Lapsed to the General Fund	56.0
Budget Stabilization Fund Withdrawal (S.B. 463)	77.0
Total Actions to Balance Budget	$338.9
Projected Year-End Balance	**$(1.5)**

The direct appropriation adjustments consisted of both positive and negative supplemental appropriations. The positive supplemental appropriations, which resulted in a larger projected budget deficit, were primarily for expenditure items beyond the control of the Legislature. The two largest positive supplemental appropriations enacted were a $35.5 million appropriation to the Family Independence Agency to offset the impact of Federal sanctions for the State's failure to comply with requirements involving a uniform child support collection system, and a $21.3 million supplemental appropriation for the Department of State Police to match Federal disaster relief funding. Offsetting these positive supplemental appropriations was a total of $83.7 million of negative supplemental appropriations. The vast majority of these appropriation reductions involved appropriations that otherwise would have lapsed at the close of the fiscal year. In general, these negative supplemental appropriations did not have an impact on the operation of State programs.

The largest action that was taken to eliminate the FY 2000-01 budget deficit was the refinancing of three previously authorized capital construction projects. These projects, which had been authorized to be financed with surplus GF/GP revenues, were switched to financing by the sale of State Building Authority bonds. This financing switch provided the budget with a one-time $211.2 million GF/GP revenue transfer. These three capital construction projects were the Hall of Justice, $87.8 million; the forensic center at the Ypsilanti State Hospital, $95.1 million; and the State Police communications system, $28.3 million.

The final actions involving the FY 2000-01 GF/GP budget were the elimination of $56.0 million of departmental work projects and a $77.0 million transfer from the Budget Stabilization Fund to the General Fund. Work projects are prior-year appropriations that are allowed to carry-forward in order to complete action on a multiyear project. The elimination of these work projects allows these funds to be transferred to the General Fund budget and be used to reduce the projected budget deficit. The transfer from the Budget Stabilization Fund to the General Fund was the final action taken to eliminate the projected FY 2000-01 GF/GP budget deficit.

FY 2001-02 Budget Deficit

On February 8, 2001, Governor John Engler submitted to the Legislature his FY 2001-02 budget recommendations. These recommendations were based on consensus revenue estimates agreed to during January 2001. When the FY 2001-02 consensus revenue estimates were revised on May 15, 2001, the FY 2001-02 GF/GP appropriation recommendations of the Governor exceeded the revised consensus revenue estimates by $514.3 million. The Legislature undertook a variety of budget adjustments to eliminate the budget deficit. Table 2 provides a summary of the actions taken to

Table 2: FY 2001-02 Enacted Adjustments to Balance General Fund/General Purpose Budget (millions of dollars)

FY 2001-02 GF/GP Consensus Revenue Estimate	$9,270.3
FY 2001-02 Governor's Original Appropriation Recommendation	$9,784.6
FY 2001-02 Projected Deficit	**$ (514.3)**
Legislative Action to Balance Budget:	
Reduction of Governor's Recommended Appropriations	$209.2
Merit Award Trust Fund Transfer	72.5
Tobacco Settlement Trust Fund Transfer	10.0
Reduction of Revenue Sharing Increase to 1.5%	50.0
Treasury Technology Upgrade-Delinquent Tax Revenue	2.5
Tax Amnesty Program	15.5
Budget Stabilization Fund Withdrawal	155.0
Total Actions to Balance Budget	$514.7
Projected Year-End Balance	**$0.4**

eliminate the projected budget deficit. The adjustments included reductions to the Governor's original appropriation recommendations, the transfer of restricted funds to the General Fund budget, the enactment of a tax amnesty plan, and a withdrawal from the Budget Stabilization Fund.

The appropriation reductions, from the Governor's original budget recommendations, totaled $209.2 million. These reductions applied to all of the State departments. The only budget area that did not receive a reduction in the GF/GP appropriation level recommended by the Governor was the GF/GP grant to the School Aid Fund. The overall budget for the School Aid Fund was reduced because of a reduction in estimated restricted School Aid Fund revenues. The level of the GF/GP appropriation reductions included in the final appropriation levels varied among the State departments. Tobacco settlement funds totaling $82.5 million were transferred to the General Fund. This transfer included $72.5 million of unallocated Merit Award Trust Fund revenues and $10.0 million of Tobacco Settlement Trust Fund revenues that resulted from a $10.0 million one-time reduction in the grant to the

Life Science Initiative implemented by the Michigan Economic Development Corporation. Restricted State sales tax revenues of $50.0 million were transferred to the General Fund as a result of a 1.5% overall cap on the level of appropriated State Revenue Sharing payments to cities, villages, townships, and counties. The final restricted revenue transfer to the General Fund was $2.5 million of delinquent tax revenue available from a delay in the implementation of Department of Treasury technology upgrades. The overall budget deficit solution also included $15.5 million of projected additional revenues from a tax amnesty plan that is expected to be implemented during the spring of 2002. The final method used to eliminate the projected budget deficit was a $155.0 million transfer from the Budget Stabilization Fund to the General Fund.

FY 2002-03 Budget Outlook

Most people might assume that the outlook for the FY 2002-03 State GF/GP budget will improve considerably if the economic performance of the State improves. Unfortunately, the FY 2002-03 State GF/GP budget is likely to be a very difficult budget to enact even if the performance of the Michigan economy improves significantly. This difficult budget scenario results from two previously enacted decisions that will significantly influence the FY 2002-03 GF/GP budget. These decisions are the continued phase-in of additional reductions in the rate of the State income and single business taxes and an enacted increase in the level of the GF/GP grant to the School Aid Fund.

The State income tax rate will drop from 4.2% to 4.1% on January 1, 2002, and to 4.0% on January 1, 2003. This rate reduction will result in an incremental FY 2002-03 GF/GP revenue loss of $226.3 million compared with the revenue loss from the income tax rate reductions already built into the FY 2001-02 State budget. The State single business tax rate will drop from 2.0% to 1.9% on January 1, 2002, and to 1.8% on January 1, 2003. This rate reduction will result in an incremental FY 2002-03 GF/GP revenue loss of $53.6 million from the single business tax rate reductions already built into the FY 2001-02 State budget. Therefore, the first $279.9 million of FY 2002-03 GF/GP revenue growth is already committed to fund these enacted tax rate reductions.

The level of the GF/GP grant to the School Aid Fund also will be increasing in FY 2002-03 compared to the level of the grant built into the FY 2001-02 State budget. During FY 2001-02 the GF/GP grant to the School Aid Fund was appropriated at $205.6 million. The Legislature already has enacted an FY 2002-03 School Aid Fund appropriation bill (Public Act 297 of 2000), which contains an FY 2002-03 GF/GP grant to the School Aid Fund of $420.7 million. This represents an increase of $215.1 million over the prior fiscal year.

In combination the incremental cost of the income and single business tax rate reductions and the increased level of the GF/GP grant to the School Aid fund will consume the first $495.0 million of any FY 2002-03 GF/GP revenue growth. The first consensus estimate of FY 2002-03 GF/GP revenues will not be developed until January 2002. However, if one assumes that FY 2002-03 GF/GP revenues increase by 5.0% over the current FY 2001-02 consensus revenue estimate, this will result in $463.5 million of increased FY 2002-03 GF/GP revenues. Therefore, the estimated revenue growth, assuming a moderate rate of economic improvement, already will be more than consumed by the tax rate reductions and the School Aid Fund grant increase.

Table 3 provides a summary of the overall problems that the State will be dealing with during the debate on the FY 2002-03 budget. As previously discussed, the projected GF/GP revenue growth of $463.5 million is more than offset by the $495.0 million cost of the tax cuts and the increased GF/GP grant to the School Aid Fund. In addition, the Senate Fiscal Agency has identified four additional budget items that will be very difficult to avoid. The first is a $100.0 million GF/GP budget increase in the Medicaid program resulting from a decline in the State's Federal Medicaid match rate. This rate is already established for FY 2002-03 and the GF/GP contribution to the Medicaid program will have to increase by $100.0 million in order to support the program that is being funded for the current year. This $100.0 million increase in the GF/GP contribution to the Medicaid program does not include any cost increases associated with expected inflationary pressures affecting the program. Second, the Department of Corrections budget is expected to increase by at least $60.0 million reflecting projected population and cost increases. This expenditure could be avoided only by significant policy changes that would reduce prison sentences. The third major cost increase that will have to be built into the FY 2002-03 State budget is a $40.0 million increase for debt service payments on State Building Authority construction projects. The final item is a

$100.0 million cost associated with providing economic cost increases to State agencies. This includes the salaries of State employees, fringe benefit costs, and other expenses such as utilities. These types of economic expenses will have to be covered in the budget or program reductions will occur to provide this funding.

As illustrated in Table 3, $795.0 million of FY 2002-03 GF/GP expenditure items have been identified, while only $463.5 million of additional revenue will be available if the State's economy grows at a moderate rate. This means that funding for increases in all other budgets such as Higher Education, Community Colleges, Community Health and Capital Outlay, will be in question. As a result of these circumstances, the FY 2002-03 GF/GP State budget will be another major challenge for the Legislature to face.

Table 3: FY 2002-03 General Fund/General Purpose Budget (millions of dollars)

FY 2001-02 Consensus Revenue Estimate	$9,270.3
FY 2002-03 Projected Revenue Estimate (5.0% Growth)	$9,733.8
Projected FY 2002-03 Increased Revenues for Expenditures	**$ 463.5**
FY 2002-03 GF/GP Enacted Budget Increases:	
Incremental Cost of Income Tax Rate Reduction	$ 226.3
Incremental Cost of Single Business Tax Rate Reduction	53.6
Increased GF/GP to School Aid Fund	215.1
Total Enacted Budget Increases	**$ 495.0**
Other Potential Budget Increases:	
Medicaid Match Rate	$ 100.0
Corrections Operating Increase	60.0
State Building Authority Debt Service	40.0
Economic Increases in Departments	100.0
Total Other Potential Budget Increases	$ 300.0
Total Enacted and Potential Budget Increases	**$ 795.0**
Budget Increases Compared with Available Revenues	**$(331.5)**

Senate Fiscal Agency, June 7, 2001