CHAPTER 3
About the State Budget

The state budget is the spending plan for state government; it reflects the program priorities of the governor and the legislature. The budget is a complete financial plan; it encompasses all revenue and expenditures (both operating and capital outlay) of the General Fund and special revenue funds for the 12-month period, the *fiscal year*, extending from October 1 of one calendar year through September 30 of the next.

PROCESS

In the case of state government, "budget" also refers to the document submitted by the governor to the legislature. This document—formally, the *Executive Budget,* and informally, the "governor's budget message"—sets forth the governor's spending recommendations for each department and function of state government. The requirement for budget preparation is set out in Article V, section 18, of the Michigan Constitution.

> The governor shall submit to the legislature at a time fixed by law, a budget for the ensuing fiscal period setting forth in detail for all operating funds, the proposed expenditures and estimated revenue of the state. Proposed expenditures from any fund shall not exceed the estimated revenue thereof. On the same date, the governor shall submit to the legislature general appropriation bills to embody the proposed expenditures and any necessary bill or bills to provide new or additional revenues to meet proposed expenditures. The amount of any surplus created or deficit incurred in any fund during the last preceding fiscal period shall be entered as an item in the budget and in one of the appropriation bills. The governor may submit amendments to appropriation bills to be offered in either house during consideration of the bill by that house and shall submit bills to meet deficiencies in current appropriations.

Exhibit 1 summarizes the budget process, which begins 13–14 months prior to a new fiscal year, when the various departments submit their spending requests to the Michigan Department of Management and Budget (MDMB). The requests include program descriptions, financial needs, program alternatives, and performance data. These requests are reviewed by MDMB analysts, hearings are held with the departments and the governor, and final recommendations are presented by the governor to the legislature, usually in February. By law, the governor must present the budget to the legislature within 30 days after it convenes in regular session on the second Wednesday in January. (In a governor's first year in office, the presentation deadline is extended to 60 days.) Half of the several appropriation bills are introduced ("originated") in the House and the other half in the Senate.

The governor's budget recommendations are considered first by the appropriations committees of the House and Senate. These each have subcommittees that specialize in various sections of the budget; for example, the Higher Education Subcommittee reviews the recommendations made for public colleges and universities. The governor's proposals may be accepted as presented, changed by a committee, or changed by either

GLOSSARY

Consensus Revenue Sharing Conference
A twice-yearly meeting of officials from the Senate and House fiscal agencies and the Michigan Department of Treasury at which they agree on the amount of revenue they expect the state to collect in the current and next fiscal year.

Executive order
In a budget context, a document the governor issues that will cut spending; must be approved by the appropriations committees in both legislative chambers.

Fiscal year (FY)
In Michigan, October 1 through September 30.

General Fund/General Purpose (GF/GP) Fund
Monies not "earmarked," or dedicated, to a specific purpose; available for appropriation for any purpose specified by the legislature.

Line-item veto
The governor's authority to veto individual items ("lines") in a budget bill.

Special revenue fund
Holds revenue "earmarked" for a special purpose; e.g., the School Aid Fund.

Supplemental appropriation
Legislation passed after the budget has been enacted that appropriates additional money to an agency or program.

EXHIBIT 1. State Budget Process, Step-by-Step Summary

I. Preparation and Presentation

Several months in advance of a new fiscal year, departments review current operations, program objectives, issues, and future plans relative to their budget. The departments submit management plans to the Office of the Budget in the Michigan Department of Management and Budget (MDMB) along with supporting material for their funding requests, analytical studies of major issues, alternatives for resolving issues, and comparisons of costs and effectiveness.

Briefings and hearings occur among department officials, budget analysts, and the governor, to prepare funding recommendations for the upcoming fiscal year.

In February the Consensus Revenue Estimating Conference (budget officials from the executive and legislative branches) meet and agree on a revenue forecast to be used for budget; the forecast is updated in May.

In February the governor presents the recommended budget to the legislature. Bills are submitted containing the governor's recommended appropriations.

II. Consideration

An appropriation bill is "read" (the title only, not the text) in the chamber in which it is being considered. Because there are several appropriation bills, half are introduced (originated) in the House and half in the Senate.

The bill is referred to the chambers' respective appropriations committees.

The bill is deliberated by a subcommittee.

The full appropriations committee holds a hearing on the subcommittee's recommendations.

The full appropriations committee adopts or amends the subcommittee recommendations and reports the bill with amendments or as a substitute to the floor.

Floor debate, amendment, and passage of the bill occur in the chamber of origin.

The bill is transmitted to the other chamber, where the process is repeated.

III. Enrollment and Enactment

If the bill passes both chambers in identical form, it is ordered enrolled by the originating chamber and printed. Upon enrollment, the bill is sent to the governor.

If the bill is passed in a different form by the second chamber, it must be returned to the originating chamber for concurrence. If that chamber accepts the amendments or the substitute bill of the other, the bill is enrolled and sent to the governor.

If the originating chamber rejects the amendments or substitute bill of the other, the bill is sent to a special conference committee composed of legislators from both bodies who attempt to make compromises between the two versions. The conference committee does not consider any matters other than the differences between the two versions. If the agreement reached affects other parts of the bill, the conferees may recommend amendments to conform with the agreement. They also may recommend correction of any errors in the bill or in the title. When the conference committee reaches a compromise, it submits a report to both chambers. If the report is approved by both, the bill is enrolled and sent to the governor. If the conference committee cannot reach a compromise, or if the legislature does not accept the conference report, a second conference committee may be appointed.

When the governor receives the bill, s/he may sign it into law, veto the entire bill, or veto only specific "line items." To override a veto, a two-thirds vote by the full membership of each chamber is required.

IV. Implementation and Adjustments

During the fiscal year each department may request allotment revisions, transfers, or supplemental appropriations. The MDMB submits revised allotments to the State Administrative Board for approval. Transfers of funds within a department are submitted by the MDMB to the House and Senate appropriations committees for approval before being sent on to the State Administrative Board. Action by the legislature and the governor on supplemental appropriation bills is similar to that taken on an appropriation bill.

The MDMB reviews appropriations, prepares allocations, and estimates revenue (in cooperation with the legislature and Consensus Revenue Estimating Conference). If there is insufficient revenue, the MDMB prepares an executive order by which the governor makes recommendations to reduce the budget.

The governor transmits the executive order to the legislature. It is not necessary that the full legislature act, but the approval of both appropriations committees is required within 10 days after the recommendation is made.

SOURCE: Public Sector Consultants, Inc.

legislative chamber. The budget bills must be approved by both chambers (differences between the two are resolved in conference committees comprising three members from each chamber) and signed by the governor before becoming law. The governor may veto any item in the budget (this is called a *line-item* veto). The legislature may override a veto by a two-thirds vote of the full membership in both chambers.

After the governor submits the budget recommendations in February, the appropriation bills usually are considered and passed in the spring by the chamber in which they were introduced and in early June by the other; conference reports or final action usually is completed around July 4. If legislative passage of a budget bill is not accomplished by October 1, the beginning of a new fiscal year, a *continuing resolution* is passed, keeping spending for that section of the budget at the level of the prior year.

The process is not complete with the budget's final enactment. At any time during the year *supplemental spending* bills may be enacted, or the governor may submit an *executive order* cutting spending; the latter must be approved by both appropriations committees but not by the full legislative bodies. In roughly the last 25 years there have been 16 executive orders to reduce expenditures; on five occasions they were not approved by the appropriations committees, but in each instance the governor issued a subsequent executive order that was.

SIZE AND COMPOSITION

State government (including public colleges and universities) is a major industry in Michigan, spending more than $36 billion in FY 2000–01 and employing 170,000 workers. If higher education and other nonagency employees (e.g., university and state hospital workers) are excluded from the number of state employees, the current figure is about 64,000.

A major share of the budget is allocated to local units of government; spending on local programs has been increasing faster than spending on state programs for several years. The largest local-program categories are school aid, revenue sharing, transportation, community mental health, and community colleges. As a result of the so-called Headlee amendment (1978), the constitution (Article IX, section 30) requires that no less than 41.6 percent of the state budget (not including federal aid) be allocated to local units of government. If this percentage is not met, make-up payments must be made in the following fiscal year; this has occurred twice. Because of school finance reform (1994), which shifted most K–12 funding to the state level and therefore increased state payments to local school districts, the share of state spending allocated to local units of government now is about 60 percent, effectively eliminating the relevance of this provision.

Exhibit 2 displays total FY 2000–01 state spending by major category. The largest are school aid and community health, accounting for 30 percent and 23 percent, respectively, of total state spending.

Exhibit 3 shows the FY 2000–01 figures for the three major fund categories into which the state budget is divided; these are the revenues that support state spending.

- General Fund/General Purpose (GF/GP), commonly, the "General Fund"
- General Fund/Special Purpose (GF/SP), commonly, "special purpose" funds
- Special revenue

The major share of transactions occurs in GF/GP funds. The budget process is concerned mainly with the *general purpose* portion, as only these monies are subject to the complete control of the governor and the legislature (special purpose funds may be expended only for designated programs).

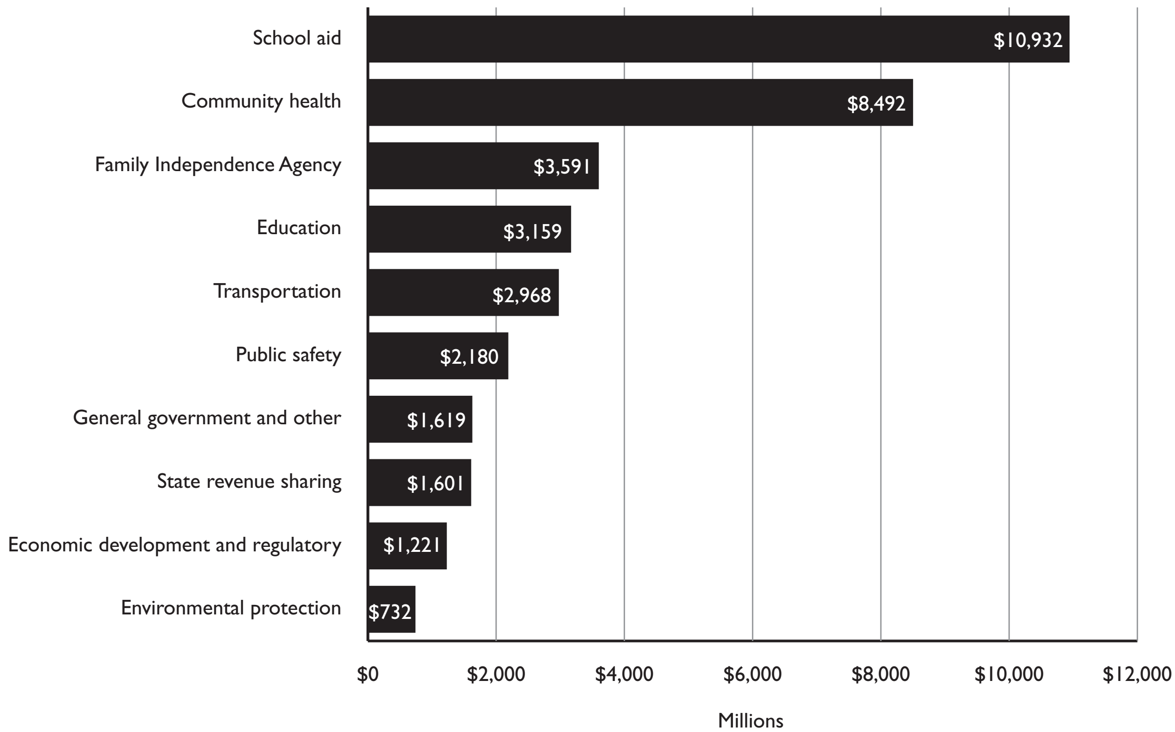
- In FY 1999–2000 the GF/GP budget totaled $9.40 billion.
- In FY 2000–01 the GF/GP budget totaled $9.74 billion.
- For FY 2001–02 the governor's recommended GF/GP spending (after executive order reductions) is $9.27 billion.
- For FY 2002–03 the governor's recommended spending is $9.24 billion.

As mentioned, the uses to which *special purpose* revenue may be put are restricted. By constitution, statute, contract, or agreement, such revenue is reserved ("earmarked") for specific purposes, and its expenditure is limited by how much revenue there is. The major categories—which account for about 86 percent of special purpose revenue and spending—are

- tax revenue that is allocated to local governments ($1.47 billion in FY 1999–2000), and
- federal aid ($8.5 billion in FY 1999–2000).

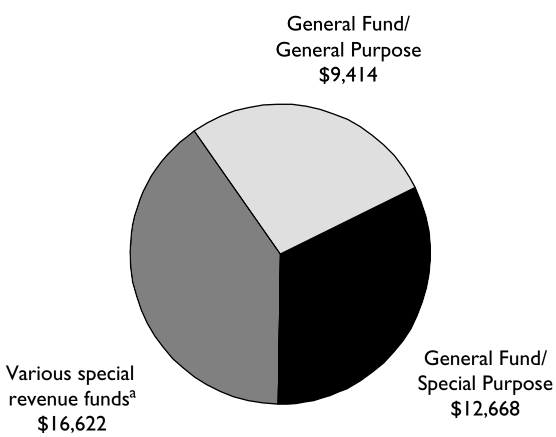
Special revenue funds are used to finance particular activities from the receipts of specific taxes or other revenue. Such funds are created by the constitution or statute to provide certain activities with definite and con-

EXHIBIT 2. Total State Spending by Major Category, FY 2000–01 ($ millions)



SOURCE: Senate Fiscal Agency, 2000 Statistical Report
NOTES: (1) Higher education = higher education and Department of Education. (2) Public safety = departments of Corrections, State Police, and Military Affairs. (3) Economic development and regulatory = departments of Career Development and Consumer and Industry Services and the Strategic Fund Agency. (4) Environmental protection = departments of Agriculture, Environmental Quality, and Natural Resources.

EXHIBIT 3. Major State Funds, FY 2000–01 ($ millions)



SOURCE: State of Michigan, Comprehensive Annual Financial Report, FY 2000–01.
[a]*Includes the School Aid, Lottery, and Transportation funds.*

tinuing revenue. The largest special revenue funds—which together account for more than 90 percent of total special fund revenue ($16.62 billion in FY 2001–01)—are the School Aid and Transportation funds; another is the Lottery Fund.

- The School Aid Fund is financed by restricted taxes, lottery revenue, and a grant from the General Fund.
- The Transportation Fund is financed mainly by motor fuel and weight taxes and federal aid.
- The Lottery Fund receives all revenue from lottery ticket sales; after deductions for prizes and administrative expenses, the remainder is transferred to the School Aid Fund.

The Budget and Economic Stabilization Fund (BSF, usually called the "budget stabilization" or "rainy day" fund) is among the most important budget tools available to state government. It was established in 1977 to smooth out the peaks and valleys in state spending. During years of economic health or malaise, monies are deposited or withdrawn according to a formula: Deposits are made when real (adjusted for inflation) Michigan personal income increases more than 2 percent, and withdrawals are made when that income declines from the previous year. The law also provides for withdrawals when the Michigan unemployment rate averages more than 8 percent for a quarter; these monies are to be used for economic stabilization purposes, such as job retraining or summer youth employment. Major withdrawals from the BSF, ranging from $170 million to $530 million, to cover budget shortfalls were made in FYs 1979–80, 1990–91, 1991–92, 2000–01, and 2001–02. Smaller withdrawals have been made several times to fund such programs as school aid, prison construction, road construction, and court judgments. Large payments were made from the General Fund to the BSF in FYs 1992–93, 1993–94, 1994–95, 1995–96, 1998–99, and 1999–2000. The balance in the BSF as of September 30, 2001, was about $995 million. The balance as of September 30, 2002 is expected to be about $740 million.

CHANGES IN STATE SPENDING

Spending priorities change over time because economic, social, and political conditions change. This certainly has been the case in Michigan during the last 25 years. Tracking these changes has been complicated by school finance reform and government reorganization.

As may be seen in Exhibit 4, school aid (and two smaller programs) increased from about 20 percent of the state budget in FY 1990–91 to nearly 33 percent 10 years later, in FY 2000–01. This resulted from the transfer of most K–12 funding from the local to the state level and the accompanying increase—from about $3.5 billion to more than $10.5 billion—in state payments to school districts. School finance reform vastly increased total state spending, which means that the share of the total attributed to other programs has diminished.

REVENUE SOURCES

Exhibit 5 compares state revenue sources over the past 10 years. The three largest sources are federal aid, the personal income tax, and sales and use taxes.

- Federal aid accounted for about 24 percent of total state revenue in FY 1999–2000. This is down from 25.5 percent in FY 1990–91.
- The personal income tax accounted for about 22 percent of total revenue in FY 1999–2000. This source also is down due to Proposal A's enactment in 1994 and the subsequent cuts in the income tax rate and addition of new and increased state revenue sources to replace school property taxes.
- Sales and use tax collections accounted for nearly 22 percent in FY 1999–2000. This is up due to Proposal A's increase in the rate of both taxes from 4 percent to 6 percent.

The decline over the last decade in business tax revenue is due largely to reductions in the rate and base of the single business tax, which is being phased out over 20 years.

The increase in other taxes, to almost 6 percent in FY 1999–2000, is due to Proposal A, which replaced most school property taxes with new and increased state revenue sources, the most important of which are the 6-mill state education property tax, real estate transfer tax, and 50-cent-per-pack cigarette-tax hike.

EXHIBIT 4. Selected Expenditure Categories as a Share of the Total State Budget, Selected Fiscal Years

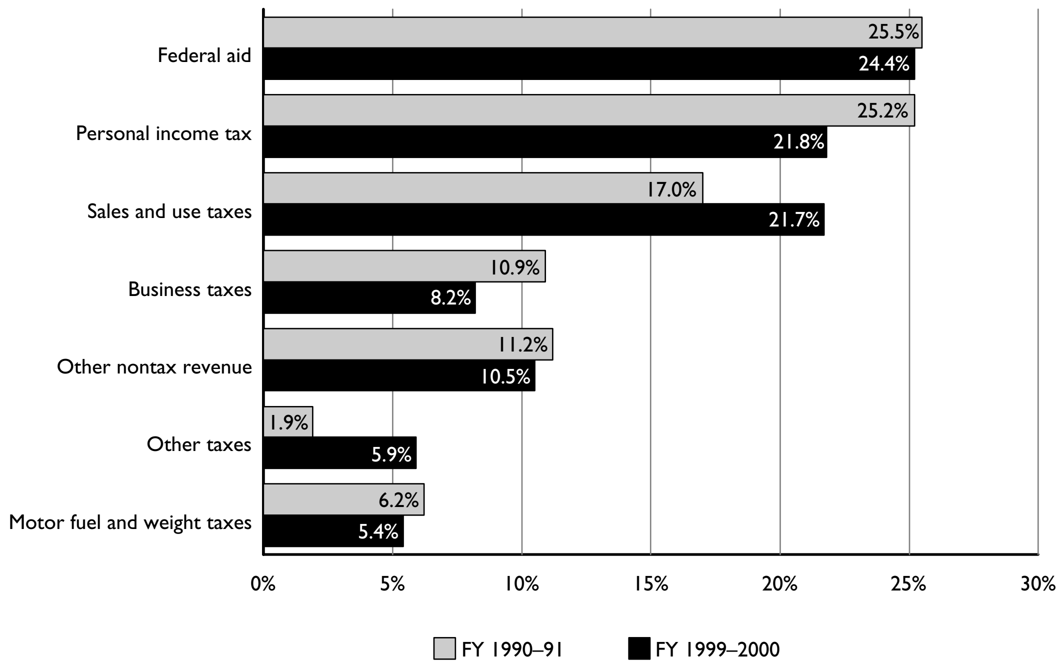
Category	*FY 1982–83*	*FY 1990–91*	*FY 2000–01*
School aid (K–12), Department of Education, and State Library	19.4%	20.1%	32.6%
Family Independence Agency[a]	33.5	30.5	9.8
Transportation	9.4	8.5	8.1
Higher education	8.1	8.4	6.1
Community Health[a]	7.9	9.1	23.3
Grants to locals (revenue sharing)[b]	6.1	5.6	4.4
Safety and corrections	3.9	5.7	6.0
General government and other	15.6	12.1	9.7

SOURCES: Senate Fiscal Agency, 2000 Statistical Report; State of Michigan Executive Budget, 2001–02 Fiscal Year. *Calculations by Public Sector Consultants, Inc.*

[a]*In FY 1990 the departments of Mental Health and Public Health were merged, creating the Department of Community Health, and the Medicaid program was transferred to the new department from the Department of Social Services. The latter was renamed the Family Independence Agency.*

[b]*In 1994 school finance reform shifted most K–12 funding to the state level and therefore increased state payments to local school districts.*

EXHIBIT 5. State Government Revenue Sources, FY 1990–91 and FY 1999–2000



SOURCE: Senate Fiscal Agency, 2000 Statistical Report. *Calculations by Public Sector Consultants, Inc.*

SPENDING TRENDS

State Government Spending Growth

As indicated in Exhibit 6, the rate of state government spending growth has slowed markedly in recent years. In the 1960s and 1970s state government spending increased faster than the national average. Since 1975 Michigan spending growth has been below the national average. Spending growth slowed even more in the last two years and, due to the economic slowdown and the phased reduction of the income and single business tax rates, declined sharply in FY 2001–02.

Limits on State Spending

Partly in response to large increases in spending and taxes, in 1978 the voters approved a constitutional limit on state spending—the so-called Headlee amendment, which requires that

- total state spending (excluding federal aid) not exceed 9.49 percent of Michigan personal income (the ratio in the fiscal year in which the amendment was approved) and
- any excess revenue be refunded to the taxpayers.

As a result of the 1994 school finance reform, which replaced local property taxes with state taxes (mainly on sales, use, and property), revenue approached the limit in FY 1994–95 and would have exceeded it except for enacted tax cuts—one of which was a 2 percent income tax credit enacted specifically to keep revenue below the Headlee limit. Revenue is expected to be about $3.84 bil-

EXHIBIT 6. Growth in Total State General Fund Spending, Michigan and All States, FY 1959–60 to FY 2001–02 (average annual rates)

Time Period	*Growth, Michigan*	*Growth, All States*
FYs 1960–70	11.1%	10.5%
FYs 1970–75	13.4	12.4
FYs 1975–80	10.6	10.7
FYs 1980–90	5.9	8.7
FYs 1990–00	3.1	5.4
FYs 2000–01	1.1	8.1
FYs 2001–02	–6.4	3.6

SOURCE: National Association of State Budget Officers, Washington, D.C.

lion below the limit in FY 2001–02 and $4.26 billion below in FY 2002–03.

COMPARISONS WITH OTHER STATES

Expenditures

State-local spending (direct general-government expenditures) in Michigan is $5,125 per capita—almost exactly the U.S. average (FY 1998–99 data, the latest available). As a share of personal income, state-local spending is 19.3 percent; the U.S. average is 18.9 percent.

Exhibit 7 shows state-local spending in various categories for all states. Michigan ranks high in education, sanitation, and corrections but low in public welfare, highways, interest payments, parks and recreation, and government administration and other. The low ranking in highway spending is somewhat misleading because that category is largely a function of population density: States with a small population and many miles of highways (e.g., Alaska, Wyoming) have high per capita spending, and states with a large population and few miles of highway (e.g., Massachusetts, Rhode Island) have low per capita expenditures. Michigan's low rank on interest payments reflects its "pay-as-you-go" philosophy for financing capital projects.

Revenue

One criterion for a good state-local tax system is the balanced use of the major revenue sources—income, sales, and property taxes. A rule of thumb is that each should contribute 20–30 percent of total state-local taxes. Prior to school finance reform in 1994, it could be said that for many years the Michigan tax system was unbalanced because it relied too much on property taxes and too little on the sales tax. The 1994 reforms corrected this imbalance by reducing property taxes by about one-third and increasing the sales tax rate by 50 percent.

Michigan's total tax burden is slightly above average. Total state-local own-source revenue is 16.3 percent of personal income (down from 17.3 percent in FY 1993–94), or $4,362 per capita; this compares with the U.S. average of 15.8 percent and $4,268 per capita. Michigan ranks 22d and 15th, respectively, in these categories (FY 1998–99 data).

EXHIBIT 7. Per Capita State-Local Direct General Spending, by Category, Michigan and the United States, 1998–99

Category	*Michigan*	*United States*	*Michigan as a Percentage of U.S. Average*
Education	$2,150.54	$1,772.19	1.21%
K–12	1,463.33	1,246.36	1.17
Higher education	631.78	450.02	1.40
Public welfare	654.10	789.13	0.83
Health and hospitals	429.30	437.72	0.98
Highways	308.50	341.11	0.90
Police and fire	232.84	273.67	0.85
Corrections	185.08	167.22	1.11
Parks and recreation	66.65	85.87	0.78
Sanitation and sewerage	189.32	157.86	1.20
Interest on general debt	226.04	246.78	0.92
Govt. admin. and other	683.09	857.09	0.80
TOTAL	$5,125.46	$5,128.64	1.00%

SOURCE: U.S. Department of Commerce, Bureau of the Census, Government Finances: 1998–99.