

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

### January/February 2004



#### **Balancing the State General Fund/General Purpose Budget: Four Consecutive Years of Fiscal Stress**

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The slowing of the United States and Michigan economies, which began in the spring of 2000, ended up having a very significant impact on state budgets. The economic slowdown, coupled with a massive drop in the valuation of equity stocks, resulted in actual state revenue collections' falling below the initial estimates on which state appropriations were based. This decline in state revenue collections forced most states to institute significant changes in their state budgets from the point that original spending plans were recommended by state Governors until the final revenue and expenditure totals were reached at the close of the states' fiscal years.

This article provides a summary of the steps that the Michigan Governors and the Legislature took to adjust the State's General Fund/General Purpose (GF/GP) budget from the original recommendation of the Governor to the final revenue and expenditure totals. The analysis covers fiscal years 2000-01, 2001-02, 2002-03, and 2003-04, the four recent fiscal years most affected by the deteriorating economic conditions.

The Michigan budget process begins in the winter before the start of the State's next fiscal year, when the Governor, pursuant to constitutional and statutory requirements, delivers a detailed budget recommendation to the Legislature. This budget recommendation includes any recommended tax policy changes along with a comprehensive set of recommended appropriations for each State department or agency. The Governor's budget recommendation sets off a budget process that concludes at the end of the fiscal year when the final accounting of actual State revenues and expenditures is completed.

In order to analyze the changes in the Michigan GF/GP budget from the original recommendation of the Governor to the final revenue and expenditure figures, various assumptions are used. A comparison of the Governor's original GF/GP appropriation recommendation to the final level of GF/GP ongoing revenues is undertaken. The difference between these two numbers is the amount of deficit that the Governor and the Legislature were forced to eliminate throughout the fiscal year in order to keep the GF/GP budget in balance. This analysis will explain in each of the three fiscal years how much of this deficit was eliminated as a result of reductions in appropriations from the Governor's original recommendation versus tax policy changes that increased revenues above the amount assumed in the Governor's original budget versus other policy changes that had the impact of providing increased GF/GP revenue to support appropriations.

#### **Fiscal Year 2000-01 GF/GP Budget**

On January 27, 2000, Governor John Engler presented to the Legislature his recommendation for the fiscal year (FY) 2000-01 GF/GP budget. The Governor recommended GF/GP appropriations of \$9.64 billion. When the final accounting of FY 2000-01 GF/GP revenues was completed, the amount of ongoing GF/GP revenues actually collected totaled \$8.99 billion, for an imbalance of \$647.9 million from the Governor's original appropriation recommendation.

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Table 1 provides a summary of the actions that the Governor and the Legislature took to eliminate this imbalance.

In terms of appropriations, the actual level of FY 2000-01 GF/GP expenditures exceeded the level originally recommended by the Governor by \$79.1 million. The imbalance was closed by a variety of actions that provided for non-ongoing increases in GF/GP revenue. These revenue increases included a \$270.1 million withdrawal from the Budget Stabilization Fund, the use of a \$211.8 million beginning balance carried forward from FY 1999-2000, a \$211.2 million funding shift in the construction of new State-financed buildings from a cash system of financing to debt issued by the State Building Authority, a \$20.0 million transfer of Tobacco Settlement Trust Fund revenue, and \$42.1 million of revenue from the liquidation of several prior work project accounts. These actions in total eliminated the imbalance and allowed FY 2000-01 to close with a \$28.1 million balance.

<b>Table 1</b>	
<b>FY 2000-01 General Fund/General Purpose Budget Summary</b>	
<b>Governor's Original Proposal to Final Bookclosing</b>	
<b>(millions of dollars)</b>	
Governor's Original Appropriation Recommendation . . . . .	\$9,637.4
Final Consensus Revenue Collections . . . . .	8,989.5
Difference . . . . .	\$ (647.9)
<u>Actions Taken to Balance Budget:</u>	
GF/GP Appropriation Increases . . . . .	(79.1)
<u>Non-Ongoing Revenue Sources:</u>	
Budget Stabilization Fund Withdrawal . . . . .	270.0
Use of Prior Year-End Balance . . . . .	211.8
Tobacco Settlement Trust Fund Transfer . . . . .	20.0
State Building Authority Funding Shift . . . . .	211.2
Work Project Reductions . . . . .	42.1
Subtotal Non-Ongoing Revenue Adjustments . . . . .	<u>\$755.1</u>
<b>Remaining Balance . . . . .</b>	<b>\$ 28.1</b>

**Fiscal Year 2001-02 GF/GP Budget**

On February 8, 2001, Governor Engler presented to the Legislature his recommendation for the FY 2001-02 GF/GP budget. The Governor recommended GF/GP appropriations of \$9.78 billion. When the final accounting of FY 2001-02 GF/GP revenue was completed, the amount of ongoing GF/GP revenue actually collected totaled \$8.28 billion, for an imbalance of \$1.51 billion from the Governor's original appropriation recommendation. Table 2 provides a summary of the actions that the Governor and the Legislature took to eliminate this imbalance.

In terms of appropriations, the actual level of FY 2001-02 GF/GP appropriations was \$662.5 million below the level originally recommended by the Governor. The remaining amount of the

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\$1.51 billion imbalance was closed by non-ongoing GF/GP revenue increases. These revenue increases included a \$452.8 million withdrawal from the Budget Stabilization Fund, the use of a \$28.1 million beginning balance carried forward from FY 2000-01, a \$131.5 million transfer from the Merit Award Trust Fund, a \$27.5 million transfer from the Tobacco Settlement Trust Fund, a \$60.5 million revenue increase from a reduction in the statutory level of revenue sharing payments, a \$79.5 million transfer from the Employment Contingency Fund, a \$63.0 million transfer from statutory restricted transportation funds, a \$56.0 million revenue increase from the shifting of the financing of homestead property tax credits to available Federal funds, a \$15.5 million revenue increase from a tax amnesty program, a \$28.7 million revenue increase from the liquidation of several prior year work project accounts, and \$17.3 million from other fund shifts and revenue adjustments. These actions in total eliminated the imbalance and allowed FY 2001-02 to close with a \$114.5 million balance.

<b>Table 2</b>	
<b>FY 2001-02 General Fund/General Purpose Budget Summary</b>	
<b>Governor's Recommendation to Final Bookclosing</b>	
<b>(millions of dollars)</b>	
Governor's Original Appropriation Recommendation . . . . .	\$9,784.6
Final Consensus Revenue Collections . . . . .	8,276.2
Difference . . . . .	\$(1,508.4)
<u>Actions Taken to Balance Budget:</u>	
GF/GP Appropriation Reductions	662.5
<u>Non-Ongoing Revenue Sources:</u>	
Budget Stabilization Fund Withdrawal . . . . .	452.8
Use of Prior Year-End Balance . . . . .	28.1
Merit Award Trust Fund Transfers . . . . .	131.5
Tobacco Settlement Trust Fund Transfers . . . . .	27.5
Revenue Sharing Reductions . . . . .	60.5
Employment Contingency Fund Transfer . . . . .	79.5
Transportation Funding Shifts . . . . .	63.0
Homestead Property Tax Credit to TANF . . . . .	56.0
Tax Amnesty Revenue . . . . .	15.5
Work Project Reductions . . . . .	28.7
Other Revenue/Fund Shift Adjustments . . . . .	17.3
Total Adjustments to Balance Budget . . . . .	\$1,622.9
<b>Actual Year-End Balance . . . . .</b>	<b>\$ 114.5</b>

**Fiscal Year 2002-03 GF/GP Budget**

On February 7, 2002, Governor Engler presented to the Legislature his recommendations for the FY 2002-03 GF/GP budget. The Governor recommended GF/GP appropriations of \$9.29 billion. The consensus estimate of FY 2002-03 ongoing GF/GP revenue was \$7.71 billion, for

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an imbalance of \$1.58 billion from the Governor's original appropriation recommendation. Table 3 provides a summary of the actions that Governor Engler, Governor Granholm, and the Legislature took to eliminate this imbalance.

<b>Table 3</b>	
<b>FY 2002-03 General Fund/General Purpose Budget Summary</b>	
<b>Governor's Original Proposal to Final Bookclosing</b>	
<b>(millions of dollars)</b>	
Governor's Original Appropriation Recommendation . . . . .	\$ 9,285.3
Final Revenue Collections . . . . .	7,709.8
Difference . . . . .	\$ (1,575.5)
<u>Actions Taken to Balance Budget:</u>	
GF/GP Appropriation Reductions . . . . .	520.6
<u>Revenue Increases:</u>	
Tobacco Tax Increase . . . . .	141.6
Pause in Single Business Tax Rollback . . . . .	76.3
Subtotal Revenue Increases . . . . .	\$ 217.9
<u>Other Non-Ongoing Revenue Sources:</u>	
Budget Stabilization Fund Withdrawal . . . . .	124.1
Use of Prior Year-End Balance . . . . .	114.5
Merit Award Trust Fund Transfer . . . . .	151.3
Tobacco Settlement Trust Fund Transfer . . . . .	14.6
Revenue Sharing Reductions . . . . .	146.2
Revenue Sharing Reserve Account . . . . .	181.0
Unrestricted Federal Aid . . . . .	169.0
SERS Pre-Funded Health Reserve . . . . .	58.2
Liquor Purchase Revolving Fund Transfer . . . . .	3.7
Waterways Fund Transfer . . . . .	7.8
Hospital Assessment Revenue . . . . .	8.9
Investor Lawsuit Settlement . . . . .	13.5
Vitamin Lawsuit Settlement . . . . .	10.6
Tobacco Company Lawsuit Settlement . . . . .	7.6
Subtotal Non-Ongoing Revenue Sources . . . . .	\$1,011.0
Total Actions Taken to Balance Budget . . . . .	\$1,749.5
<b>Remaining Balance . . . . .</b>	<b>\$174.0</b>

During the summer of 2002, the Legislature, as a result of a recommendation from Governor Engler, took two actions with tax policy implications to address the imbalance. The rate of the excise tax on cigarettes was increased from 75 cents per pack to \$1.25 per pack. A portion of this revenue increase, totaling \$141.6 million, was dedicated to the GF/GP budget. The other tax policy change implemented at this time was a suspension of the 0.1 percentage point reduction in the rate of the single business tax (SBT) scheduled to occur on January 1, 2003.



This suspension of the SBT rate reduction resulted in a \$76.3 million increase in FY 2002-03 GF/GP revenue.

In terms of appropriations, the year-to-date level of FY 2002-03 GF/GP appropriations was \$520.6 million below the level originally recommended by Governor Engler. The remaining amount of the \$1.58 billion imbalance was closed by non-ongoing GF/GP revenue increases. These revenue increases included a \$124.1 million transfer from the Budget Stabilization Fund, the use of a \$114.5 million beginning balance carried forward from FY 2001-02, a \$151.3 million transfer from the Merit Award Trust Fund, a \$14.6 million transfer from the Tobacco Settlement Trust Fund, \$146.2 million from a reduction in the level of statutory revenue sharing payments, \$181.0 million from a transfer of a revenue sharing reserve account, \$169.0 million from unrestricted Federal funds, \$58.2 million from a transfer from the State Employees Retirement System, \$31.6 million from the settlement of three lawsuits, and several other non-ongoing revenue items that increased revenues by \$20.4 million. These actions eliminated the imbalance and allowed the FY 2002-03 GF/GP budget to close with a \$174.0 million balance.

#### **FY 2003-04 GF/GP Budget**

On March 6, 2003, Governor Jennifer Granholm presented to the Legislature her recommendations for the FY 2003-04 GF/GP budget. The Governor recommended GF/GP appropriations of \$8.59 billion. The current consensus estimate of ongoing GF/GP revenues is \$7.78 billion, for an imbalance of \$810.7 million from the Governor's original appropriation recommendation. Table 4 provides a summary of the actions that Governor Granholm and the Legislature took to eliminate this imbalance.

During December 2003, the Legislature approved and the Governor signed into law legislation that paused a scheduled reduction in the rate of the State income tax. The income tax rate reduction from 4.0% to 3.9%, which was scheduled to occur on January 1, 2004, was delayed until July 1, 2004. This income tax rate reduction pause resulted in a \$77.0 million increase in FY 2003-04 GF/GP revenue.

In terms of appropriations, the year-to-date level of GF/GP appropriations is \$221.7 million above the amount originally recommended by the Governor. This increase is mostly related to the level of the GF/GP grant to the K-12 School Aid Fund. The Governor's original budget recommendation contained no GF/GP grant to the School Aid Fund, while the year-to-date GF/GP grant to the School Aid Fund is \$327.7 million.

The remainder of the \$810.7 million FY 2003-04 GF/GP budget imbalance was closed by non-ongoing GF/GP revenue increases. These revenue increases included the use of a \$174.0 million beginning balance carried forward from FY 2002-03, \$289.7 million from a reduction in the level of statutory revenue sharing payments, \$169.0 million from unrestricted Federal funds, \$76.6 million from the sale of surplus State property, \$65.0 million from fee increases related to driver responsibility legislation, \$25.9 million from increases in the cost of driver licenses, \$49.0 million from the enhanced enforcement of State tax laws, \$39.6 million from work projects accounts that were closed out, \$15.0 million from escheats law revisions, \$10.0 million from a transfer from the Employment Security Fund, and \$70.9 million from the transfer to the General

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Fund of a variety of other restricted revenue accounts. These action eliminated the imbalance and will allow the FY 2003-04 GF/GP budget to close with a \$29.3 million estimated year-end balance.

<b>Table 4</b>	
<b>FY 2003-04 General Fund/General Purpose Budget Summary</b>	
<b>Governor's Original Proposal to Current Enacted Budget</b>	
<b>(millions of dollars)</b>	
Governor's Original Appropriation Recommendation . . . . .	\$8,591.2
Current Estimated Consensus Revenue Collections . . . . .	7,780.5
Difference . . . . .	\$(810.7)
<u>Actions Taken to Balance Budget:</u>	
GF/GP Appropriation Increases . . . . .	(221.7)
<u>Revenue Increases:</u>	
Pause in Income Tax Rate Rollback . . . . .	77.0
<u>Other Non-Ongoing Revenue Sources:</u>	
Use of Prior Year-End Balance . . . . .	174.0
Revenue Sharing Reductions . . . . .	289.7
Unrestricted Federal Aid . . . . .	169.0
Sale of Surplus State Property . . . . .	76.6
Driver Responsibility Fee Increases . . . . .	65.0
Drivers License Fee Increases . . . . .	25.9
Enhanced Enforcement of Delinquent Taxes . . . . .	49.0
Work Project Lapses to General Fund . . . . .	39.6
Escheats Law Revision . . . . .	15.0
Transfer from Employment Security Fund . . . . .	10.0
Restricted Revenue Transfers to General Fund . . . . .	70.9
Subtotal Non-Ongoing Revenue Adjustments . . . . .	\$ 984.7
Total Actions Taken to Balance Budget . . . . .	840.0
<b>Projected Year-End Balance . . . . .</b>	<b>\$ 29.3</b>

**Summary**

During the past four fiscal years, the Michigan GF/GP budget has faced a total of \$4.54 billion in projected imbalances between the Governor's original appropriation recommendation and the final level of ongoing GF/GP revenue collections. [Table 5](#) provides a summary of the actions that were taken over this four-fiscal year-period to eliminate these budget imbalances. Appropriation reductions over the period totaled \$882.3 million or 18.0% of the total adjustments taken to eliminate the imbalances. Other major actions taken to eliminate the imbalances included transfers from the Budget Stabilization Fund, \$848.9 million or 17.3% of the total adjustments; the use of prior year-end balances of \$528.4 million or 10.8% of the total adjustments; tobacco settlement transfers of \$344.9 million or 7.1% of the total adjustments; statutory revenue sharing reductions of \$496.4 million or 10.2% of the total adjustments; unrestricted Federal aid of \$338.0 million or 6.9% of the total adjustments; revenue increases

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of \$294.9 million or 6.0% of the total adjustments; a revenue sharing reserve account transfer of \$181.0 million of 3.7% of the total adjustments; a State Building Authority fund shift of \$211.2 million or 4.3% of the total adjustments; the sale of surplus State property of \$76.6 million or 1.6% of the total adjustments; and \$687.8 million of other various adjustments that accounted for 14.1% of the total adjustments.

<b>Table 5</b>						
<b>Actions Taken to Balance GF/GP Budgets</b>						
<b>(millions of dollars)</b>						
	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	Total	% of Total
Potential Deficit	\$(647.9)	\$(1,508.4)	\$(1,575.5)	\$(810.7)	\$4,542.5	
Appropriation Reductions	(79.1)	662.5	520.6	(221.7)	882.3	18.0%
Budget Stabilization Fund Transfers	270.0	452.8	124.1	0.0	846.9	17.3%
Use of Prior Year-End Balance	211.8	28.1	114.5	174.0	528.4	10.8%
Tobacco Settlement Transfers	20.0	159.0	165.9	0.0	344.9	7.1%
Revenue Increases	0.0	0.0	217.9	77.0	294.9	6.0%
State Bldg Authority Fund Shift	211.2	0.0	0.0	0.0	211.2	4.3%
Rev. Sharing Statutory Reductions	0.0	60.5	146.2	289.7	496.4	10.2%
Rev. Sharing Reserve Transfer	0.0	0.0	181.0	0.0	181.0	3.7%
Unrestricted Federal Aid	0.0	0.0	169.0	169.0	338.0	6.9%
Sale of Surplus State Property	0.0	0.0	0.0	76.6	76.6	1.6%
All Other Fund Shifts/Transfers	42.1	260.0	110.3	275.4	687.8	14.1%
<b>Total Adjustments</b>	<b>\$676.0</b>	<b>\$1,622.9</b>	<b>\$1,749.5</b>	<b>\$840.0</b>	<b>\$4,888.4</b>	<b>100.0%</b>
<b>Year-End Balance</b>	<b>\$ 28.1</b>	<b>\$ 114.5</b>	<b>\$ 174.0</b>	<b>\$ 29.3</b>		

It is clear that Governor Engler, Governor Granholm, and the Legislature have used a wide array of fiscal changes in order to keep the GF/GP budget in balance over the past four fiscal years. The use of these fiscal adjustments is important to an understanding of how the budget has been balanced and also provides a source of budget-balancing ideas that could be used in future economic downturns.