

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

July/August 2007



### **Balancing the Fiscal Year 2006-07 State Budget and the Implications for the Fiscal Year 2007-08 State Budget**

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During August 2006, the Michigan Legislature and Governor Granholm completed action on the original fiscal year (FY) 2006-07 State budget. The enacted budget was based on the May 2006 consensus revenue estimate and estimates of expenditure needs agreed to at that time. Subsequent to the original enactment of the FY 2006-07 State budget, actual revenue collections fell below the May 2006 consensus revenue estimate and actual expenditures in several State departments exceeded the appropriations contained in the original budget. This combination of revenue shortfalls and expenditure increases led to sizeable deficits in the FY 2006-07 General Fund/General Purpose (GF/GP) and School Aid Fund budgets. This article outlines the size of the FY 2006-07 State budget deficit and describes the actions that were taken by the Legislature and the Governor to eliminate the projected budget deficit. Finally, the article examines the impact on the FY 2007-08 State budget of the decisions made to balance the FY 2006-07 State budget.

#### **Size of the FY 2006-07 GF/GP and School Aid Fund Budget Deficits**

One approach to outlining the size of the FY 2006-07 GF/GP and School Aid Fund budget deficits is to compare the current consensus revenue estimates with actual appropriations before the adoption of any adjustments to the budget to eliminate the projected budget deficit. Table 1 provides a comparison of the original enacted FY 2006-07 GF/GP budget with the current estimates before any adjustments to eliminate the deficit. This analysis reflects an \$856.4 million potential GF/GP budget deficit. This potential budget deficit was a result of a \$411.2 million decline in revenue below the May 2006 consensus revenue estimate upon which the original enacted budget was based and \$445.5 million of increased appropriations resulting from the positive GF/GP supplemental appropriations that were enacted since the original budget was put in place. The positive supplemental appropriations were primarily in the Departments of Community Health, Corrections, and Human Services budgets. These supplemental appropriations were needed to adjust these budgets to reflect higher caseload associated spending and to adjust for certain cost savings assumptions that were built into the original enacted budgets and failed to materialize. This potential deficit of \$856.4 million represented 8.9% of the year-to-date GF/GP appropriations.

Table 2 provides a comparison of the original enacted FY 2006-07 School Aid Fund budget with the current revenue estimates before the adoption of any adjustments to eliminate the deficit. This analysis reflects a \$515.2 million potential School Aid Fund budget deficit. This potential deficit was a result of a \$570.4 million decline in revenue below the May 2006 consensus revenue estimate upon which the original enacted budget was based, offset slightly by a \$55.2 million decrease in the estimated costs of fully funding the formulas in the School Aid Fund budget. This potential deficit of \$515.2 million represented 4.0% of the year-to-date School Aid Fund appropriations.



**Table 1**

<b>FY 2006-07 Budget General Fund/General Purpose Revenue, Expenditures, and Year-End Balance (millions of dollars)</b>			
	<b>Original Enacted</b>	<b>August 2007 SFA Estimate</b>	<b>Dollar Difference</b>
<b>Revenue:</b>			
Beginning Balance .....	\$ 109.6	\$ 2.5	\$(107.1)
Ongoing Revenue Estimate .....	8,435.4	8,187.5	(247.9)
Revenue Sharing Freeze .....	585.0	544.6	(40.4)
Other Revenue Adjustments .....	93.1	77.3	(15.8)
<b>Total Revenue .....</b>	<b>\$9,223.1</b>	<b>\$8,811.9</b>	<b>\$(411.2)</b>
<b>Expenditures:</b>			
Original Enacted Appropriations .....	\$9,222.8	\$9,222.8	\$ 0.0
<b>Supplemental Appropriations:</b>			
Supplemental Appropriations (PA 3 of 2007) ..	0.0	17.6	17.6
Supplemental Appropriations (PA 17 of 2007)	0.0	209.2	209.2
Supplemental Appropriations (PA 41 of 2007)	0.0	218.7	218.7
Subtotal Supplemental Appropriations .....	0.0	445.5	445.5
<b>Total Appropriations .....</b>	<b>\$9,222.8</b>	<b>\$9,668.3</b>	<b>\$445.5</b>
<b>Potential Year-End Deficit .....</b>	<b>\$0.3</b>	<b>\$(856.4)</b>	<b>\$(856.7)</b>

**Table 2**

<b>FY 2006-07 Budget School Aid Fund Revenue, Expenditures, and Year-End Balance (millions of dollars)</b>			
	<b>Original Enacted</b>	<b>July 9, 2007 SFA Estimate</b>	<b>Dollar Difference</b>
<b>Revenue:</b>			
Beginning Balance .....	\$ 95.2	\$ 0.0	\$ 95.2
Ongoing Revenue Estimate .....	11,552.4	11,077.2	(475.2)
GF/GP Grant .....	35.0	35.0	0.0
Federal Aid .....	1,411.2	1,411.2	0.0
<b>Total Revenue .....</b>	<b>\$13,093.8</b>	<b>\$12,523.4</b>	<b>\$(570.4)</b>
<b>Expenditures:</b>			
Original Enacted Appropriations .....	\$13,093.8	\$13,093.8	\$ 0.0
Midland Property Tax Case Funding Adjustment .....	0.0	24.8	24.8
Projected Appropriation Lapses .....	0.0	(80.0)	(80.0)
<b>Total Appropriations .....</b>	<b>\$13,093.8</b>	<b>\$13,038.6</b>	<b>\$(55.2)</b>
<b>Potential Year-End Deficit .....</b>	<b>\$0.0</b>	<b>\$(515.2)</b>	<b>\$(515.2)</b>
<b>Actions Taken to Eliminate Potential Year-End Deficit:</b>			
Categorical Grant Funding Reductions (PA 6 of 2007) ..	\$0.0	\$ 5.0	
Retirement Contribution Accounting Adjustments .....	0.0	262.0	
Refinancing of Outstanding Debt (PA 6 of 2007) .....	0.0	40.4	
Tobacco Securitization Borrowing .....	0.0	207.8	
<b>Subtotal Actions Taken to Eliminate Deficit .....</b>	<b>\$0.0</b>	<b>\$515.2</b>	
<b>Projected Year-End Balance .....</b>	<b>\$0.0</b>	<b>\$0.0</b>	



**Actions Taken to Eliminate FY 2006-07 Budget Deficits**

Throughout the spring and summer of 2007, the Legislature and the Governor agreed on a series of actions to eliminate the potential deficits in the FY 2006-07 GF/GP and School Aid Fund budgets. These actions include the approval of an Executive Order to reduce appropriations, the enactment of negative supplemental appropriations to reduce expenditures, and the approval of a series of one-time revenue sources that would be used to increase revenue. The combination of these actions has eliminated the potential GF/GP and School Aid Fund budget deficits.

Table 3 provides a summary of the actions that were taken to eliminate the potential \$856.4 million FY 2006-07 GF/GP budget deficit. The largest single portion of the GF/GP budget deficit solution involved \$207.2 million of one-time revenue resulting from the borrowing of a total of \$415.0 million to be paid back from future tobacco settlement revenue received by the State. The remainder of the \$415.0 million of revenue from the tobacco settlement borrowing was dedicated to the School Aid Fund budget. The next largest portion of the GF/GP budget solution was a one-time appropriation reduction resulting from a decision to delay the scheduled August 2007 payments to universities and community colleges until October 2007. This change reduced FY 2006-07 appropriations by \$164.6 million and resulted in an increased obligation of the same amount in the FY 2007-08 budget.

**Table 3**  
**FY 2006-07 Budget**  
**General Fund/General Purpose**  
**Actions Taken to Eliminate Projected Budget Deficit**  
**(millions of dollars)**

<b>Potential Year-End Budget Deficit.....</b>	<b>\$(856.4)</b>
<b>Actions Taken to Eliminate Potential Year-End Deficit:</b>	
Tobacco Securitization Borrowing .....	207.2
Community College and Higher Education Funding Delays.....	164.6
Retirement Contribution Accounting Adjustments .....	104.1
<u>Restricted Revenue Transfers to GF/GP:</u>	
Higher Education Authority Transfer to General Fund.....	70.0
Refined Petroleum Fund Transfer to General Fund .....	90.0
21st Century Jobs Fund Transfer to General Fund .....	50.0
Conservation Corps Transfer to General Fund.....	20.0
Subtotal Restricted Revenue Transfers to GF/GP.....	230.0
Fund Source Shifts.....	47.7
Refinancing State Debt .....	15.1
Reductions in State Programs .....	90.0
<b>Subtotal Actions Taken to Eliminate Deficit.....</b>	<b>\$858.7</b>
<b>Projected Year-End Balance .....</b>	<b>\$2.3</b>

The GF/GP budget deficit was reduced by \$104.1 million from changes in several assumptions that were used in making contributions into the State Employees Retirement System. These changes in retirement funding assumptions likely will result in increased



retirement contribution rates in the future. The GF/GP budget deficit was reduced by four one-time transfers of State Restricted revenue to the GF/GP budget which totaled \$230.0 million. These one-time revenue sources included: \$90.0 million from the Refined Petroleum Fund, \$70.0 million from the Higher Education Finance Authority, \$50.0 million from the 21<sup>st</sup> Century Jobs Fund, and \$20.0 million from the Conservation Corps Fund. Other one-time solutions included a total of \$47.7 million of fund source shifts where Federal or State Restricted funds were used to replace funding originally supported by GF/GP dollars. A total of \$15.1 million of savings resulted from a reduction in debt service payments on State outstanding bonds. The final component of the elimination of the FY 2006-07 GF/GP deficit was \$90.0 million of actual reductions in State programs. These reductions had an impact on a broad range of budget programs, with the largest reduction being a \$28.0 million decrease in the funding of universities.

Table 4 provides a summary of the actions that were taken to eliminate the potential \$515.2 million FY 2006-07 School Aid Fund budget deficit. The largest single portion of the School Aid Fund budget deficit solution involved \$262.0 million of savings from changes in several assumptions that were used in making contributions into the Public School Employees Retirement System. These changes in retirement funding assumptions likely will result in increased retirement contribution rates in the future. A total of \$207.8 million of the potential deficit was eliminated by the School Aid Fund portion of the \$415.0 million of tobacco settlement revenue borrowing. The refinancing of outstanding State debt paid with School Aid Fund revenue saved \$40.4 million. This change will result in increased debt service payments in the future. Finally, a total of \$5.0 million of the deficit was eliminated by actual reductions in programs.

**Table 4**  
**FY 2006-07 Budget**  
**School Aid Fund**  
**Actions Taken to Eliminate Projected Budget Deficit**  
**(millions of dollars)**

<b>Potential Year-End Budget Deficit</b> .....	<b>\$(515.2)</b>
<b>Actions Taken to Eliminate Potential Year-End Deficit:</b>	
Retirement Contribution Accounting Adjustments .....	262.0
Tobacco Securitization Borrowing .....	207.8
Refinancing of Outstanding Debt (PA 6 of 2007).....	40.4
Categorical Grant Funding Reductions (PA 6 of 2007) .....	5.0
<b>Subtotal Actions Taken to Eliminate Deficit</b> .....	<b>\$515.2</b>
<b>Projected Year-End Balance</b> .....	<b>\$0.0</b>

Table 5 provides a summary of the actions that were taken to eliminate the combined potential FY 2006-07 GF/GP and School Aid Fund budget deficits. The combined potential budget deficits totaled \$1.37 billion. The budget deficit solutions included 30.2% from tobacco settlement borrowing, 26.6% from changes in retirement contribution assumptions, 16.7% from restricted revenue transfers, 12.0% from funding delays to universities and community colleges, 6.9% from reductions in State programs, 4.0% from the refinancing of State debt, and 3.5% from fund source shifts.



**Impact of FY 2006-07 Budget Balancing Decisions on FY 2007-08 Budget**

The decisions made by the Governor and the Legislature to balance the FY 2006-07 GF/GP and School Aid Fund budgets will have a substantial impact on the FY 2007-08 State budget. As was summarized in Table 5, a large percentage of the decisions made to balance the FY 2006-07 budget involved one-time revenue sources, one-time revenue from borrowing, funding delays, and retirement accounting changes. While these decisions did bring the FY 2006-07 budget into balance, they create imbalances in the FY 2007-08 State budget. This occurs from the fact that these one-time solutions in FY 2006-07 supported ongoing appropriations. During FY 2007-08 these ongoing appropriations will continue to be part of the budget, but the one-time revenue sources will not be available to support them. This results in significant projected imbalances between ongoing FY 2007-08 GF/GP and School Aid Fund revenue and appropriations. This is the current issue that the Legislature and the Governor are attempting to resolve. The imbalance will be resolved by any combination of appropriation reductions, revenue increases, and/or the potential of additional one-time revenue sources.

**Table 5**  
**FY 2006-07 Budget Balancing Summary**  
**General Fund/General Purpose and School Aid Fund**  
**(millions of dollars)**

	July 9, 2007 SFA Estimates	Percent of Total Actions
<b>Projected Year-End Deficits:</b>		
General Fund/General Purpose .....	\$ (856.4)	
School Aid Fund .....	(515.2)	
<b>Combined Projected Year-End Deficit.....</b>	<b>\$(1,371.6)</b>	
<b>Actions Taken to Eliminate Deficits:</b>		
Tobacco Securitization Borrowing .....	\$415.0	30.2%
Retirement Accounting Changes.....	366.1	26.6
Restricted Revenue Transfers to GF/GP .....	230.0	16.7
Funding Delays to Universities and Community Colleges	164.6	12.0
Programmatic Appropriation Reductions.....	95.0	6.9
Refinancing State Debt.....	55.5	4.0
Fund Source Shifts .....	47.7	3.5
<b>Total Actions Taken to Eliminate Deficit.....</b>	<b>\$1,373.9</b>	<b>100.0%</b>