

A Matter of Priorities: A Guide to the State Budget

Over the last decade, Michigan lawmakers have struggled to balance the state budget, and communities and families have felt the impact in terms of reduced funding for basic public services. A number of trends have contributed to the state's budget woes, including, most significantly, the Legislature's reliance on budget cuts rather than a more balanced approach that includes a modernization of Michigan's revenue system.

In addition, federal and state economic changes, including high unemployment, created dramatic growth in the need for very critical public services, including healthcare. One of the clearest examples is growth in the state's Medicaid program, which is now the primary source of healthcare coverage for nearly 1.9 million people in the state.

Never has there been a stronger need for Michigan citizens to engage with their lawmakers to influence the budget decisions that will affect the quality of life for their families and children for years to come, yet it seems that the budget process is becoming less transparent, with too many decisions made behind closed doors. This guide—along with periodic budget briefs to follow—is intended to help open the doors to the state budget process, assist communities and families in getting more involved, and ultimately ensure that we have a state budget that reflects the needs of all Michiganders.

THE STATE BUDGET: THE CLEAREST EXPRESSION OF THE STATE'S PRIORITIES

Each year, the Michigan Legislature adopts a budget that spells out how the state will use its resources to fund the basic public services needed to protect its citizens, invest in the educational system that can build a highly qualified workforce, keep its roads and bridges in working order, protect its natural resources, and ensure that food and water are safe to consume. The annual state budget is the single, most powerful expression of the state's priorities, yet too few Michigan citizens

Every Resident has a Stake in the State Budget

While many Michigan residents cannot easily identify the public services they rely on, each day in homes across the state, they in fact wake to routines that depend upon the availability of publicly funded services.

- They may start their day with a shower and a cup of coffee, thanks to municipal water systems that provide a constant supply of clean water.
- They flush their toilets thanks to reliable sewage, septic and drainage systems.
- They drive to work or school on roads and streets that are built and maintained by state, county and municipal road systems, and protected by state and local law enforcement officials.
- They take their children to child care centers or providers who are licensed by the state of Michigan and required to engage in training.
- They attend local public schools as well as Michigan's many fine community colleges and universities.
- They eat in restaurants that are regularly inspected by local public health departments.
- They have elderly parents, family members and friends with mental illnesses and disabilities that are able to find needed services, including community mental health services, nursing homes that are licensed and inspected by the state, or assistance in living independently in their homes and communities.
- They take advantage of Michigan's beautiful natural resources, including state parks and recreational areas.

While these services are funded by a range of federal, state and local revenues, many of the decisions about how much funding will be available, and which services will be funded, are made in Lansing through the development of the annual state budget.

have their voices heard because of the many barriers they face in getting involved in the priority-setting process.

The barriers to citizen involvement in the budget process are many. First, without full-time representation in Lansing, it can be very difficult to have access to timely information about budget deliberations, a problem made worse by the fact that budget bills are often complex and dense documents that are difficult to interpret.

In addition, the budget decision-making process often moves quickly and in unpredictable ways, making it difficult for families and other residents—and particularly those with little time and few financial resources—to engage in meaningful ways. Meetings can be scheduled with relatively little notice, and increasingly, budget decisions and trade-offs are made behind closed doors by a limited number of political leaders. Finally, many citizens either find the budget process intimidating, or have become disillusioned about the likelihood that their involvement will make a difference.

Broad, informed and thoughtful citizen involvement in setting Michigan’s budget priorities is critical if we want an allocation of resources that reflects the values and priorities of all Michigan residents, and meets the most critical needs. This guide is intended to help demystify the budget process, and serve as a primer on how the state currently allocates its revenues.

BUILDING THE STATE BUDGET

One of the most important tasks for lawmakers is to debate and adopt a state budget each year. State budgeting is a complex process that involves political choices and priority-setting at many different levels of state government, with important roles for the governor, state department directors and the Legislature.

The State’s Fiscal Year

The state’s fiscal year begins on Oct. 1 of each year, and ends on Sept. 30 of the following calendar year. The budget that will be under consideration this year is the fiscal year 2014 (FY 2014) budget, which appropriates funds for the period beginning on Oct. 1, 2013, and ending on Sept. 30, 2014.

Constitutional and Statutory Requirements

Michigan’s Constitution and statute provide some mandates related to the state budget, including:

- The budget must be balanced each year; the state cannot spend more than it collects in revenue.
- The governor has the responsibility to develop and release the state budget for the upcoming fiscal year within 30 days after a new legislative session.

- Michigan’s governor has the power to execute a “line item” veto, meaning he/she can eliminate funding for specific line items in the budget that appropriate funds for programs and services approved by the Legislature, and that veto can only be overturned by a two-thirds vote of the Legislature.
- The governor is required to issue an Executive Order to cut the budget if spending is expected to exceed available revenues.
- Michigan is required to have a “rainy day” fund to help cover years when revenues are insufficient to fund basic services.
- The state is required to hold consensus revenue estimating conferences to develop an agreement on the expected revenues for the upcoming fiscal year.

Revenue Estimating Conferences

Because Michigan is required to have a balanced budget, it is critical to have as accurate a picture as possible of the revenue that is expected to be available in the upcoming fiscal year. Michigan law requires the Department of Treasury and the House and Senate Fiscal agencies to agree on revenue estimates through revenue estimating conferences held in January and May. The final Executive budget is based on the January estimates, while legislative revisions to the budget are based on the May forecast.

The Executive Budget

Work on the governor’s budget begins in the summer of the prior year when state departments and agencies prepare their individual planning documents and budget requests based on their evaluation of current spending and needs. These budget requests are submitted to the State Budget Office in the fall and are used in the development of the Executive Budget, which is typically released in February, after review of the most recent revenue estimates.

The Legislative Process

There is no completely predictable annual legislative budget process or timetable, because legislative leaders have substantial flexibility when building the annual budget. In some years, including FY 2012, the process moved very quickly, in part because one party controlled the House, Senate and Executive Office. In other years, when revenues were low and deep cuts were on the table, the budget was not completed until October, after the beginning of the new fiscal year.

In general, after the governor releases his proposed budget for the upcoming fiscal year, the recommendations are considered by subcommittees of the House and Senate Appropriations Committees. The Appropriations subcommittees general-

ly review specific state department budgets, such as the budgets for the Departments of Human Services, Community Health or Education.

Appropriations subcommittees typically hold hearings with state department staff and accept public testimony, so this is an ideal time for public comment and input. The subcommittees ultimately adopt their versions of the budget for the department(s) under their purview, and report their budget bills to the full Appropriations committees.

The House and Senate Appropriations Committees review the budget bills and are able to make amendments before sending the bills to the full House or Senate. Amendments can also be made on the floor of the House or Senate.

When both the House and the Senate have approved their budgets, the bills are sent to joint House/Senate conference committees that are charged with resolving the points of difference between the House and Senate versions. Their consensus conference reports are then sent to the floor of both the House and Senate where they can be either approved or rejected, but not amended.

The Governor's Veto Power

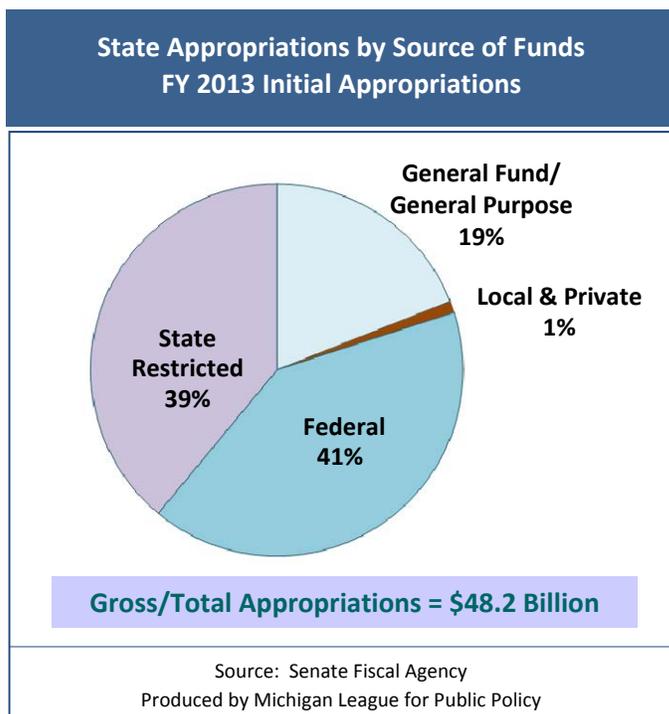
The final step in the process is approval or vetoes by the governor. After being presented with an enrolled budget bill, the governor has 14 days to approve or veto it. It is at this point that the governor can also exercise his "line item" veto, which can only be overridden by a two-thirds vote of the House and Senate—a rare occurrence.

WHERE DOES THE MONEY COME FROM?

There are two sides to every state budget—revenues and appropriations—with the former driving the latter. When revenues are not sufficient to meet the need for critical public services, the state has three basic options: (1) raise new revenues; (2) make additional budget cuts; or (3) pursue a balanced approach that includes strategic cuts along with revenue increases.

Over the last decade, Michigan lawmakers have largely balanced the state budget through budget cuts, along with temporary tax increases and tax shifts that have decreased the responsibility of businesses for funding public services, while increasing taxes for individual taxpayers, particularly low- and moderate-income families. The result has been greater economic hardship for many families and children, the weakening of public services needed to ensure a strong workforce and economic prosperity, and a more regressive tax system.

When building the state budget, legislators determine gross or total expenditures, as well as expenditures from the state's General Fund and state restricted funds.



- ▶ **Gross appropriations:** Includes the total level of state spending from all revenue sources, including federal, state and local/private funds. Michigan's total state budget in the current fiscal year (FY 2013) is \$48.2 billion. More than \$4 out of every \$10 spent is from federal sources. The other major sources of revenue are sales and use taxes and the state's personal income tax.¹
- ▶ **State spending from state resources:** Includes total spending from state resources, including both state General Fund/General Purpose dollars (General Fund) and state restricted funds. In FY 2013, total state spending from state resources stands at \$27.8 billion.²
 - **General Fund:** General Fund dollars are state funds that are not restricted by constitutional or statutory provisions and can be appropriated by the Legislature for a wide range of state services and purposes. Because the Legislature has more control over the use of these dollars, they are often at the center of the yearly budget debates. In FY 2013, initial General Fund appropriations were slightly under \$9 billion, and represented 19% of total state spending.³ The major sources of revenue for the General Fund are currently the personal income tax, and sales and use taxes.
 - **State Restricted Funds:** Because of provisions in the state Constitution or statute, state restricted funds can be used only for certain specified purposes. The two largest state restricted funds are the School Aid Fund (\$12.9 billion) and state transportation funds (\$3.3 billion).⁴ Other restricted funds include local revenue sharing funds and certain funds that protect the state's natu-

ral resources and environment. In FY 2013, state restricted funds accounted for 39% of total state spending.⁵ The major sources of revenue for the School Aid Fund, the largest state restricted fund, are the sales and use taxes, the personal income tax, and the State Education Tax.

WHERE DOES THE MONEY GO?

Nearly Three-Quarters of Total State Spending Goes to Three State Departments

In the current fiscal year, nearly \$3 of every \$4 appropriated (from federal and state sources) were used to support budgets for three state departments: the Michigan Department of Community Health (31.2% of total state spending), K-12 education and the Michigan Department of Education (27.5%), and the Department of Human Services (13.5%).⁶

Where the Money Goes: FY 2013 Total Appropriations from Federal and State Funding Sources

1. Community Health	31.2%
2. K-12 & Department of Education	27.5%
3. Human Services	13.5%
4. Transportation	7.2%
5. Corrections	4.1%
6. Higher Education & Community Colleges	3.5%
7. Local Revenue Sharing	2.3%
8. Other	10.6% ⁷

Source: Senate Fiscal Agency
Produced by Michigan League for Public Policy

Included in these three departments are many of the critical programs and services that create economic opportunities for low- and moderate-income families, educate children so they can compete in the knowledge economy, protect children from child abuse and neglect, and provide primary healthcare and public health services.

At \$15 billion, the budget for the Department of Community Health is the largest state budget, and total appropriations (state and federal) for the DCH grew by 49% between FY 2004 and FY 2013, with much of that growth coming from increased caseloads.⁸ Medicaid currently insures 1.88 million Michigan residents, including nearly 995,000 children, or 40% of all children in the state.⁹

TRENDS IN STATE SPENDING

Appropriations Trends from State Revenue Sources

Over the last decade, as Michigan's outdated tax structure has failed to produce the revenues needed to maintain basic services and invest in human and other capital, the state's reliance on federal funds has grown significantly. Between fiscal years 2003 and 2013, federal funds rose from 31% of the total state budget to 41%—an increase of 34%. Some state departments are highly dependent on federal funds, including the Department of Human Services (83%), and the Department of Community Health (65%).¹⁰

Federal Revenue as Percentage of Adjusted Gross Appropriations

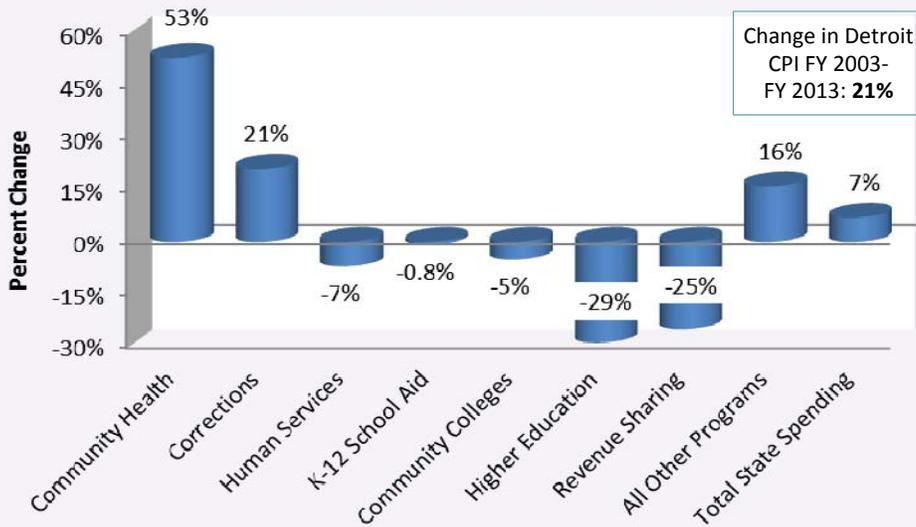
	FY 2003	FY2013
Human Services	69.2%	82.6%
Community Health	55.7%	64.5%
Education	9.3%	13.7%
Total Budget	30.9%	41.3%

Source: Senate Fiscal Agency
Produced by Michigan League for Public Policy

It is important to focus on the state's revenue sources—those the Michigan Legislature can control—to assess lawmakers' spending priorities, as well as their willingness to create a tax system that can fund them. Between 2003 and 2013, overall state spending from state resources (both state General Funds and restricted funds) increased by 7%, with a growing portion of those funds being directed to the Departments of Community Health and Corrections, up 53% and 21% respectively. Many other state departments received reduced state funding, with cuts of 29% in higher education, 25% in local revenue sharing, 7% in human services, and 5% in community colleges.¹¹

In addition, the cost of providing the same level of a government service rises over time, along with changes in the number of people who need and are eligible for important state services such as Medicaid. Between FY 2003 and FY 2013, while total state spending increased by nearly 7%, the Detroit Consumer Price Index, which measures the impact of inflation, increased by 21%.¹² As a result, even in areas where there were budget increases over the decade, the higher cost of providing that service, along with increased demand and caseloads, forced cuts in eligibility or benefits for many low-income families, and forced local public schools and governments to make deep reductions.

**Percent Change in State Spending
(General Fund and State Restricted)
FY 2003 to FY 2013**



Source: Senate Fiscal Agency
Produced by Michigan League for Public Policy

When state General Funds began to fall, lawmakers turned to a variety of temporary revenues and funding shifts to help balance the budget—in addition to program and staffing cuts—including transfers from the “Rainy Day” and restricted funds, and reliance on temporary federal funds, including a significant influx of federal dollars from the American Recovery and Reinvestment Act of 2009. The result was a structural budget deficit that left the state with a revenue system that couldn’t generate the funds needed for basic public services.

In more recent years, the governor has recommended that some appropriations be designated as “one-time,” as an indication that they may not be funded in the subsequent budget year in order to maintain a structurally-balanced budget.¹⁶ This

use of one-time funding adds to the lack of certainty about the sustainability of state-funded programs, as well as the state’s ability to draw down federal funds.

In the current fiscal year, the largest share of General Fund dollars in Michigan is used for the Department of Community Health (31%), particularly for the state’s growing Medicaid program. Other major uses of General Fund include Correc-

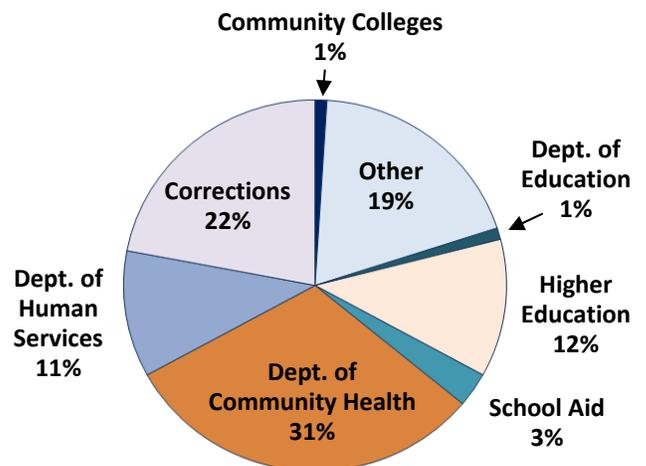
Appropriations Trends from Michigan’s General Fund

Michigan’s General Fund is the source of funding for basic state services and programs that cannot be funded with federal or restricted funds. Over the last decade, tax policy decisions by the Michigan Legislature, along with economic downturns, resulted in declines in state General Fund revenues, and increased competition for these more flexible state dollars.

Because state General Funds have traditionally come largely from three major tax sources—the personal income tax, businesses taxes and sales/use taxes—state policy decisions related to these three taxes have a strong effect on available state revenues, and determine who pays for needed public services. For example, in FY 2007, over 22% of the state General Fund came from businesses taxes. With the adoption of the new state Corporate Income Tax in 2011, business taxes are expected to generate only 3% of state General Funds in FY 2013.¹³

In the decade between FY 2003 and FY 2013, state General Funds rose by only 2 percent, from \$8.83 billion to approximately \$9 billion—again in the face of inflationary increases of 21%. However, during the early part of the decade, and during the national Great Recession, state General Funds dropped sharply. Between FY 2001 and FY 2005, state General Funds fell by 11%; during the Great Recession (FY 2008-2010), ongoing state General Funds dropped 22%.¹⁴ As part of those funding contractions, the number of state employees fell by 15% in the decade between FY 2003 and FY 2013.¹⁵

General Fund Appropriations — FY 2013



Source: Senate Fiscal Agency
Produced by Michigan League for Public Policy

tions (22%), Higher Education and Community Colleges (13%), and the Department of Human Services (11%). Very little is used for K-12 public education, which is primarily funded by the School Aid fund and other local and federal funds.¹⁷ Over the last decade, nearly all state departments experienced reductions in state General Funds, with the major exceptions being the Departments of Community Health and Corrections.¹⁸

Appropriations Trends in Michigan's School Aid Fund

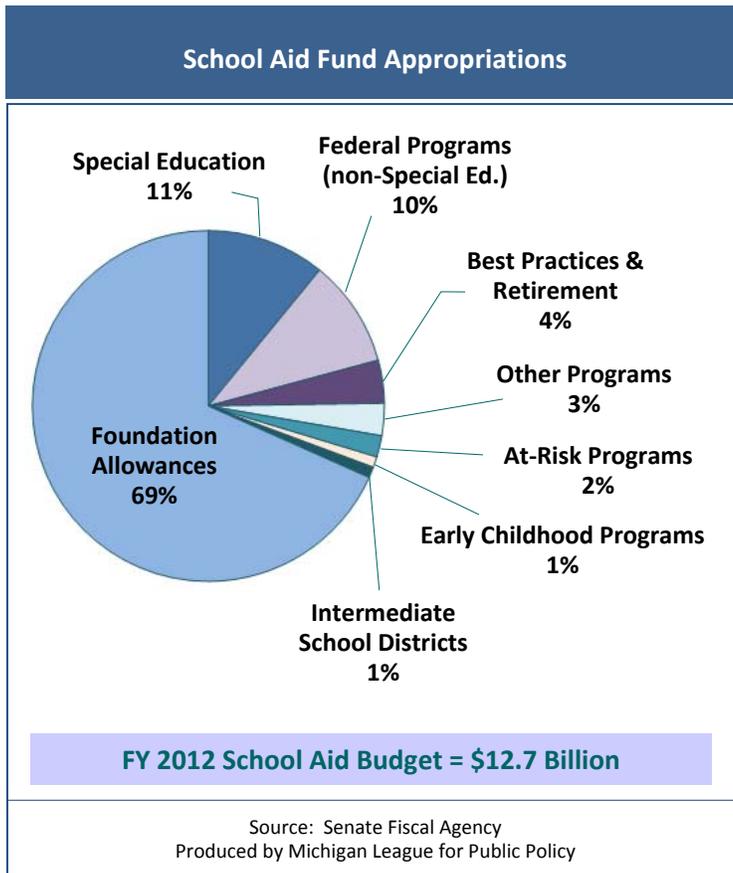
Michigan's School Aid Fund is a restricted fund that can only be used to fund local school districts, Intermediate School Districts and various other education agencies and entities. In the decade between FY 2003 and FY 2013, School Aid funds remained relatively flat (down 0.8%), despite increases in costs.¹⁹ The per-pupil foundation allowance accounts for more than \$2 of every \$3 dollars in K-12 School Aid, with the remainder of the funds used for such programs as special education (11%), services for at-risk students (2%), and Michigan's state-funded preschool program.²⁰

Between FY 2003 and FY 2013, the number of students in Michigan's public schools fell from 1.7 million to 1.5 million. During that same period, the minimum per-pupil foundation allowance increased by only 4%, in the face of a 21% increase in inflation.²¹

A SHARED RESPONSIBILITY FOR MAKING THE BUDGET REFLECT THE PRIORITIES OF ALL RESIDENTS

Decisions made by lawmakers over the last decade have reduced the funds available for public services, placed public schools at risk, resulted in deep cuts in the number of public employees able to meet the needs of citizens and ensure public safety, and made the dream of a college education seem very far off for many young people.

While the state budget process can seem complicated and daunting, it is important that we all work to make our voices heard. It is the only way we can ensure that the budget ultimately reflects the needs and priorities of all the state's citizens.



FACTS ABOUT FUNDING FOR K-12 PUBLIC SCHOOLS

- Funding has failed to keep pace with inflation over the last decade with state funding per pupil rising by 10% in the face of a 21% increase in the cost of living as measured by the Detroit CPI
- Total state funding for K-12 education fell by 0.8% during the decade, reflecting in part a reduction of 10% in the number of students.

ENDNOTES

1. Ellen Jeffries, *State Budget Overview*, Senate Fiscal Agency, November 29, 2012.
2. Ibid.
3. Ibid.
4. *State of Michigan Revenue Source and Distribution*, House Fiscal Agency, July 2012.
5. Ellen Jeffries, *State Budget Overview*, Senate Fiscal Agency, November 29, 2012.
6. Ibid.
7. Ellen Jeffries, *State Budget Overview*, Senate Fiscal Agency, November 29, 2012. Other state appropriations include: General Government Agriculture, Natural Resources & Environmental Quality; State Police, Military & Veteran Affairs; Licensing & Regulatory Affairs; and Judiciary. Percentages may not total due to rounding.
8. Margaret Alston, Susan Frey and Steve Stauff, *Community Health Background Briefing*, House Fiscal Agency, December 2012.
9. Ibid, and Kids Count in Michigan 2012 Data Book, Michigan League for Public Policy, January 2013.
10. *Federal Revenue as Percentage of Adjusted Gross Appropriations*, Senate Fiscal Agency, Updated August 31, 2012.
11. *State Spending from State Resources Appropriations Total Compared in Selected Budget Areas*, Senate Fiscal Agency, Updated October 4, 2012.
12. Ibid.
13. *State of Michigan Revenue Source and Distribution*, House Fiscal Agency, June 2006; and Ellen Jeffries, *State Budget Overview*, Senate Fiscal Agency, November 9, 2012.
14. General Fund/General Purpose Appropriation History, Senate Fiscal Agency, Updated October 10, 2012.
15. *Appropriated Full-Time Equated Positions (FTEs) in Michigan State Budget*, Senate Fiscal Agency, updated October 10, 2012.
16. Memorandum dated September 7, 2012, from Kyle I. Jen, Deputy Director, House Fiscal Agency to Interested Parties re: Changes in State Appropriations, GF/GP Appropriation History.
17. Ibid.
18. The largest growth was in the Michigan Department of Education (MDE) that had relatively little General Fund in its budget, with the growth attributed to the Creation of the Office of Great Start and the shift of funding for the Child Care Subsidy program from the Department of Human Services to the MDE.
19. Ellen Jeffries, *State Budget Overview*, Senate Fiscal Agency, November 29, 2012.
20. Bethany Wicksall and Mark Wolf, *School Aid Background Briefing*, House Fiscal Agency, January 2012.
21. *Pupil Membership History: FY 1004-95 to FY 2012-13*, and *K-12 Schools Minimum Foundation Allowance*, Senate Fiscal Agency, updated September 18, 2012.