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FOCUS TURNS ON HOW TO TRIM BUDGET BY UP TO \$400M

With lower, and not surprising, revenue estimates in hand, the focus turned quickly Friday on how to balance the 2008-09 budget which is as much as \$393 million in the red based on administration spending recommendations and actions by the Senate and House.

Despite the gloomier outlook tied to the national economic troubles and housing slump, continued weak domestic auto sales and high fuel prices, the good news part of the Consensus Revenue Estimating Conference was that the state can finish the 2007-08 year without budget cuts or slicing school aid, and still provide some funds to carry into the new fiscal year.

Some topics immediately put on the table were the state's new generous film tax credits/rebates, the earned income tax credit, the depreciation allowances businesses get under the federal stimulus package that the state could ignore, and some new or higher spending increases now pending before the Legislature. Another way to soften the blow is to not put \$150 million in the rainy day fund as the governor had proposed.

The economy's impact on the current fiscal year is somewhat offset by higher income tax rates and the transition to the new Michigan Business Tax, but the revenue experts also said the unusually high number of changes in the tax law make the projections harder to pin down. Even in the new fiscal year, most of the lowered estimates were blamed not on the economy but the new film credit and the federal stimulus package as well as the reduction of casino revenues as permanent facilities open.

Less at risk, it appeared, is the 4 percent increase in statutory revenue sharing, the first such recommended increase in several years, particularly given the hit local governments are seeing due to falling property tax values.

"It's not a very good day, but the numbers are manageable," said Treasurer Robert Kleine, who along with Senate Fiscal Agency Director Gary Olson and House Fiscal Agency Director Mitch Bean arrived at the updated revenue estimates.

He pegged the budget imbalance for 2008-09 at some \$368 million for the general and school aid funds, with \$168 million of that in school aid, while Mr. Olson set it at \$393 million under the spending levels set by the Senate.

Senate Appropriations Chair [Sen. Ron Jelinek](#) (R-Three Oaks) said he was not surprised with the new numbers given the economy's weak performance. "Tough decisions will be made regarding each department as we continue to work toward our July 1 deadline for completion of the fiscal year '09 budget," he said.

A spokesperson for state Budget Director Robert Emerson said, "We have difficult decisions ahead." Leslee Fritz added, "While solving a budget deficit is never easy, we intend to find solutions to balance the budget that reflect the governor's priorities of education, health care, and public safety and that do not raise taxes for citizens."

The School Aid Fund is faring better than the general fund, with a growth of 2.9 percent over the current year to \$11.71 billion. But that is \$163.2 million lower than estimates in January and even with \$17 million in savings due to lower enrollment projections, the figures likely mean districts will not see the foundation grant increases that the governor recommended of \$108-\$216 per pupil or even the Senate-passed increases of \$71-\$142.

The new estimated general fund revenues for 2008-09 of \$8.88 billion represents a 3 percent drop or \$309.1 million less than the current fiscal year.

The updated numbers for the current fiscal year show general fund revenues at \$9.16 billion, or \$82.4 million below the January estimate, and school aid revenues of \$11.38 billion, a \$21.9 million increase.

Mr. Kleine, who said the general fund will have to be adjusted by some \$250 million-\$350 million, said several factors could affect how much will have to be cut when the governor and legislative leaders set spending targets.

That includes use of surpluses from the current year, perhaps more than anticipated unspent appropriations that would carry over, and savings from welfare caseloads and use of tobacco funds.

But the new numbers, Mr. Kleine acknowledged, make it unlikely the governor's recommended increases in school foundation allowances can be supported.

In a [memo](#) summarizing updated revenues and expenditures, Mr. Olson said the current year will end with a \$148.8 million general fund surplus, including \$61.9 million in unspent appropriations due in part to lower Medicaid and welfare caseloads. Using that money plus \$91.8 million in cuts the Senate Republicans have recommended from the governor's budget (including junking the revenue sharing increase and a new \$48.5 million nursing corps program) leaves \$102.2 million yet to be addressed. He said the school aid shortfall means the foundation grant would have to be trimmed to no more than \$63-\$126 per pupil.

Mr. Kleine said looking at capping the new film credit, which is estimated to cost the state \$99.2 million in incentives to filmmakers, will have to be looked at. He also said some legislators will want to take a look at the earned income tax credit (a program directed at low-income households that will cost the general fund \$133 million), but the administration opposes such a move.

House [Speaker Andy Dillon](#) (D-Redford Twp.) will be looking for "reasonable cuts and government reform" to get the budget in balance, said spokesperson Greg Bird. "Over the past few weeks, it had become apparent that the revenue was going to be a little bit lower than we had expected, but we certainly believe it's manageable," he said.

He said the speaker would work to protect education, safety and health care, while pursuing reforms in areas such as corrections and employee health care.

House Republicans said the governor needs to submit a new budget that does not rely on more revenue than was set at Friday's conference, arguing her current budget sets the state up for a future tax increase (see related story).

The possibility of breaking the state's tax treatment link to the federal government's new depreciation allowance was raised by Mr. Bean, who noted some 30 states went that route the last time a similar incentive was offered. The provision means that even with higher revenues from spending by individuals with their tax rebates, the state will see a net revenue loss of \$96.5 million.

Michigan did not and Mr. Kleine said the administration has not decided whether to recommend it do so this time, but argued it should not be viewed as a tax increase if it were to happen. "It's certainly an option that's on the table," he said.

Michigan Chamber of Commerce tax policy director Tricia Kinley called it a tax increase, and said the state would be better served by admitting a mistake in adopting the film credits sought by the administration.

"Enough already," she said in defending a benefit that businesses were expecting. "It's a matter of priorities. This administration thinks it's OK to send refund checks to Hollywood producers who have no incentive to keep a presence here and not to hard-working job providers who are trying to improve this economy."

Though school groups were disappointed in the \$163.2 million expected drop in School Aid Fund revenues, they saw a variety of ways the loss could be absorbed.

Brad Biladeau, legislative liaison for the Michigan Association of School Administrators, expected schools would see about half the increase Ms. Granholm had proposed for the coming fiscal year under the new estimates. So increases would range from \$52 to \$104 per student.

Ray Telman, executive director of the Middle Cities Education Association, said the foundation grant could be brought back to close to what the Senate had approved if the \$32 million for the infrastructure program (what had been Ms. Granholm's small high school initiative) was eliminated from the bill ([SB 1107](#)).

The Senate had approved \$11.778 billion in SAF spending in the bill, but reduced the foundation grant increase to between \$71 and \$142. Eliminating the \$32 million and adding back in the \$17 million expected to be saved through falling enrollment closes the gap between the Senate and the \$11.707 million estimated revenue, he said.

Mr. Biladeau agreed with the idea of focusing on the foundation grant. "We'd like to see the Legislature put as much in the foundation as possible," he said.

"School districts as has always been the case would like money that's not already been encumbered," Mr. Telman said. "That's the foundation."

But both said the timing and the size of the problem are going to make times difficult for schools.

"I think everybody feels a lot of pressure because the increase in the foundation is not really keeping up with the costs schools are facing," Mr. Telman said. "We just came up short again."

"It comes at a time when school districts have to have their budgets in place in less than a month," Mr. Biladeau said. "So you're going to see schools scrambling to make some changes."

Ed Sarpolus, lobbyist for the Michigan Education Association, argued the problem would not be as

large for schools if the state would return to its practice of putting general fund money into the School Aid Fund. "Every time they give the schools more money, they give schools more bills to pay," he said.

The Michigan Municipal League issued a warning to the state to not cut funds that local governments use for services such as police, fire fighting and sewer systems.

The Michigan Fiscal Responsibility Project renewed its call for reforms, saying the budget will continue to starve vital public services until that is done and the state stops handing out dollars to special interests such as the film industry and in other business tax breaks.

"This revenue estimating report should make it plain that Michigan continues to have a structural budget deficit caused not by out-of-control spending, but by policymakers' actions that have reduced revenues. These decisions are not putting our state onto the path of creating and attracting college graduates, the key to future prosperity in the international flat-world economy," said Michael A. Boulus, executive director, Presidents Council, State Universities of Michigan.

MML Executive Director Dan Gilmartin said the new revenue numbers put all general fund spending at risk, including revenue sharing. "It's time for state elected officials to solve the structural budget deficit, and it's time they stop balancing the budget with cuts that harm public safety, drinking water, waste collection and other local services that are undeniably essential to everyday life," he said.

Mr. Kleine took note of the property tax picture, which supports most local programs, in saying, "We would like to protect revenue sharing, but I can't guarantee that."

Department of Treasury experts noted Michigan's mortgage foreclosure rate, home values, and rate of home building have suffered deeply in the past three years, faring far worse than most other states.

Preliminary numbers set Monday by the State Tax Commission show a 1.3 percent decrease in the value of real property, the first decline since 1962, with residential property falling 2 percent. It was even worse in the Detroit metro area, where the three-county decline was 3.9 percent.

But because many homes had taxable values below their assessed values due to the limits set by Proposal A, those properties will experience higher taxable values, which helps the state's overall taxable value figures show an increase of 1.1 percent-1.3 percent.

Howard Heideman said county experts expect things to continue to decline next year, with taxable value "probably weaker than this year. This will put a strain on local governments even more than the state and school aid fund."

Part of the school aid fund (\$2.1 billion in 2007) comes from the state education tax, and the forecast for its revenues are \$105 million lower than in January.

A two-year averaging system used to assess market values of property means any increase in the housing industry will not immediately be reflected in higher property tax revenues.

"We're potentially facing a huge fiscal problem for local governments in future years," Mr. Olson said.

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