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## Michigan's General Fund/General Purpose Budget

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### Executive Summary

- Michigan's 8.3 billion General Fund/General Purpose (GF/GP) budget—which funds basic state services and other programs for which federal and restricted funds are not available—represents 17.7 percent of the total state budget for fiscal year (FY) 2010-11.
- The largest sources of GF/GP revenue are the state Income Tax, Michigan Business Tax, and Sales and Use Taxes. Relative to the size of the state's economy, GF/GP revenue has declined by over 40 percent since FY 1998-99—from 3.47 percent of the state's personal income to an estimated 1.97 percent—largely as a result of growth in the number and amounts of tax credits, exemptions, and deductions available under the state tax code.
- Over the last decade, a variety of temporary revenue sources and funding shifts—including the Budget Stabilization Fund, restricted fund transfers, and temporary federal funds—have been used to balance the GF/GP budget, leaving a structural budget shortfall.
- Nearly all state budget areas have experienced significant GF/GP reductions since FY 2000-01. The major exceptions are Corrections and, adjusting for temporary federal support available in FY 2010-11, Community Health. In some cases, the availability of additional restricted or federal funds has offset a portion of GF/GP reductions. Total appropriations from state-level revenue sources have been flat over the decade.
- The number of state employees has declined by 18.4 percent since FY 2000-01. Meanwhile, compensation-related costs have increased, largely as a result of rising health insurance costs for both active and retired employees and increases in required pension contributions for employees hired prior to 1997, when new state employees were placed into a defined contribution system. State employee compensation-related costs represent roughly 30 percent of the GF/GP budget.
- For FY 2010-11, 93.4 percent of GF/GP appropriations are contained in a relatively small number of budget areas: Community Health, Corrections, Higher Education and Community Colleges, Human Services, Debt Service and State Building Authority rent payments, State Police, and constitutionally-required salaries. The remaining 6.6 percent of GF/GP appropriations, equal to \$548.9 million, fund the costs associated with 10 state departments, plus the legislative branch, judicial branch, and the Executive Office (excluding constitutional salary costs in those areas).
- The existing FY 2010-11 budget and tax policy changes currently in state statute contain \$1.5 billion in structural imbalances that will have direct implications for balancing the FY 2011-12 GF/GP budget. While additional factors and policy decisions will affect the overall shortfall in the FY 2011-12 GF/GP budget, it is clear that substantial budget balancing actions will be required.

## Introduction

As of January 2011, fiscal year (FY) 2010-11 adjusted gross appropriations for the State of Michigan total \$47.0 billion. This figure represents all spending authorized in the state budget, inclusive of all revenue sources but subtracting funds appropriated in multiple places in the budget through interdepartmental grants (IDGs) or intradepartmental transfers (IDTs). Over 80 percent of total appropriations are funded by revenue sources with specific restrictions or requirements attached to them (as shown in **Figure 1**):

**Federal Funds:** A total of \$20.5 billion in appropriations are funded from federal revenue sources. Of that total, \$1.9 billion is appropriated from temporary revenue sources related to the American Recovery and Reinvestment Act (ARRA). Major ongoing federal revenue streams include funding for Medicaid, Temporary Assistance to Needy Families (TANF), Food Assistance, education-related purposes, and transportation programs. Federal grants are almost always dedicated to specific purposes, with varying levels of flexibility, and generally cannot be used to supplant state funds on an ongoing basis. Some federal funding streams (Medicaid and TANF, most prominently) include state matching-fund and/or maintenance-of-effort (MOE) requirements that limit the state's ability to reduce appropriations from state funding without forfeiting associated federal funds.

**Private/Local Funds:** A relatively small amount of state appropriations, \$488.3 million, is funded through revenue received from private organizations or local governments. The majority of these appropriations are made in the Community Health budget and are tied to specific health-related programs.

**State Restricted Funds (Constitutional):** A total of \$13.6 billion in appropriations are made from state-level funds with legal restrictions established in the State Constitution. These funds are as follows:

- The School Aid Fund: \$10.9 billion.
- Transportation-related funds: \$1.9 billion.
- The constitutional portion of Revenue Sharing to local units of government: \$633.5 million.
- Natural resources- and environment-related funds: \$128.1 million.
- The Veterans Trust Fund: \$5.0 million.

While there is a certain level of flexibility in how some of these funds can be expended—in the case of the School Aid Fund, funds can be used for both K-12 and postsecondary educational costs—they are restricted to the broad purposes established in the constitution. Altering the basic use of the funds, therefore, would require approval of a constitutional amendment by the state's voters.

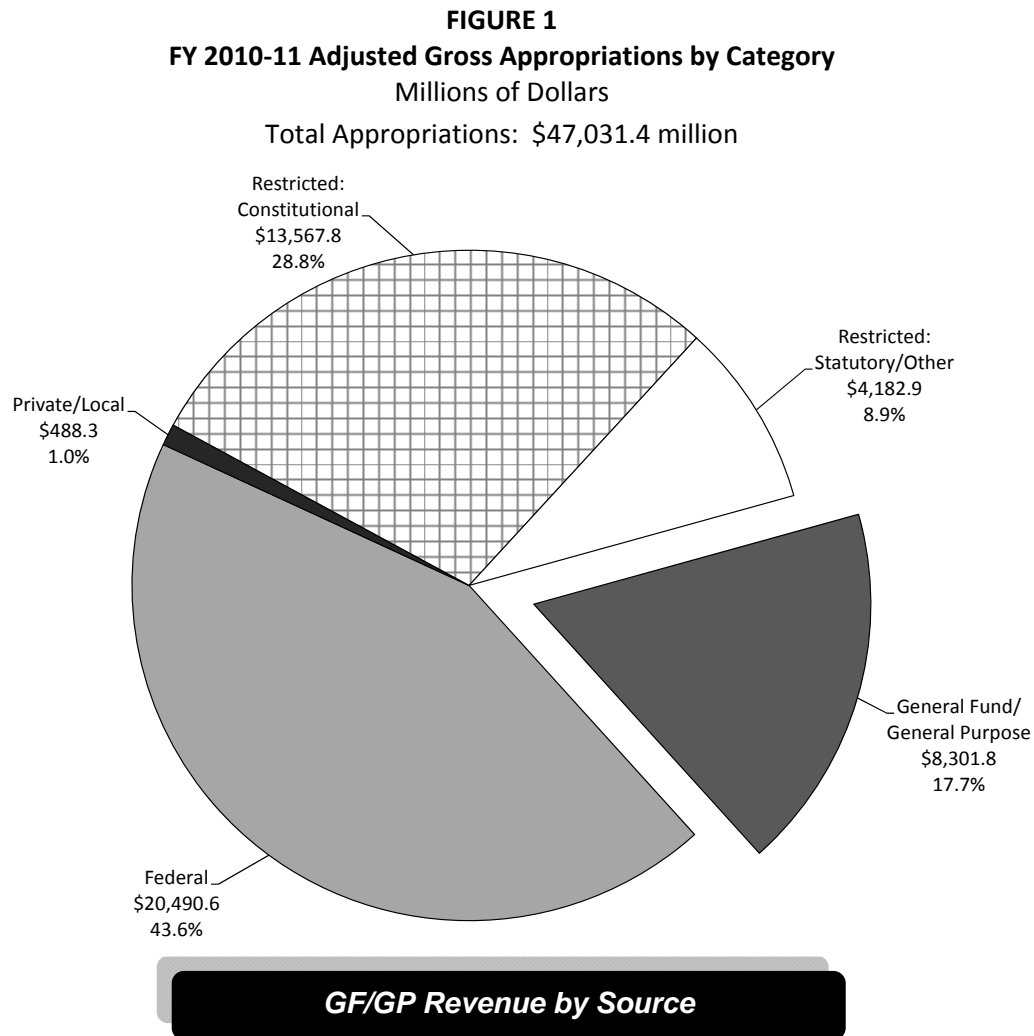
**State Restricted Funds (Statutory/Other):** Other state-level funds receive revenue that is restricted either by state statute or the specific nature of the revenue stream (fee-for-service programs). Appropriations from these types of sources total \$4.2 billion, appropriated from a large number of individual funds. Specific examples include the statutory portion of Revenue Sharing, Medicaid provider assessments, the Refined Petroleum Fund and other non-constitutional funds for natural resources and the environment, the use of tobacco settlement revenue for economic development purposes, Secretary of State fees, and occupational licensing fees. While some of these revenue streams could be redirected to other purposes, legislative amendment of state statute is required in most cases.

After accounting for appropriations from the federal, private, local, and state restricted fund sources described above, what remains is \$8.3 billion in General Fund/General Purpose (GF/GP) appropriations. These appropriations are funded from revenue received from state taxes and other sources that are not dedicated for a specific purpose under either the state's constitution or statutes and are, therefore, deposited in the state's General Fund.<sup>1</sup> In FY 2010-11, GF/GP appropriations represent 17.7 percent of the total state budget.

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<sup>1</sup> As an accounting matter, the state's General Fund also accounts for revenues received by restricted funds created outside the state constitution, referred to as "General Fund/Special Purpose" revenues. In this report, however, the term "General Fund" is used synonymously with "General Fund/General Purpose."

GF/GP revenue represents the funding available to the Legislature to fund basic state services and other programs for which federal or state restricted funds are not available. The GF/GP budget, along with the School Aid budget, tends to require the majority of the Legislature's attention during the annual budget process, as GF/GP appropriations across the various state departments and budget areas must be balanced with available revenue.



In FY 2010-11, the state is projected to collect \$7.3 billion in GF/GP revenue from ongoing revenue sources (as shown in **Figure 2**):<sup>2</sup>

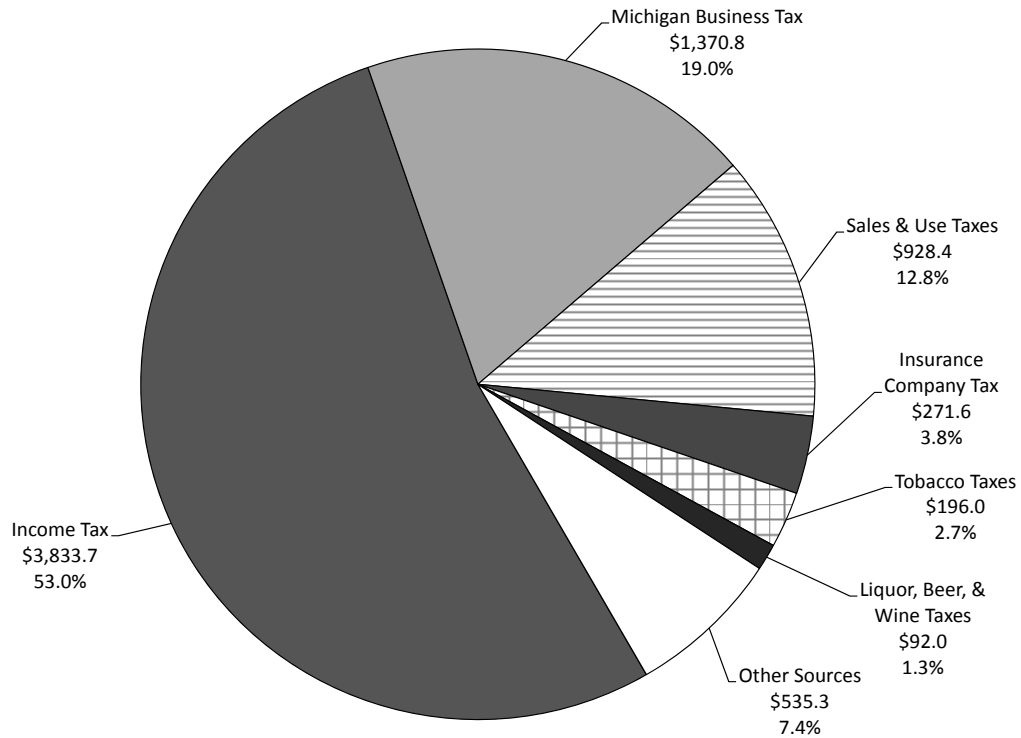
- \$3.8 billion from the state Income Tax.
- \$1.4 billion from the Michigan Business Tax (MBT).
- \$928.4 million from the Sales and Use Taxes.
- \$271.6 million from the Insurance Company Tax.
- \$196.0 million from Tobacco Taxes.
- \$92.0 million from Liquor, Beer, and Wine Taxes.
- \$535.3 million from other sources, including taxes on gas and oil severance, utility property, and horse race wagering.

Almost 85 percent of GF/GP revenue is received from the state's three major tax sources: the Income Tax, the MBT, and the Sales and Use Taxes. The state's General Fund is particularly reliant on the Income Tax and the MBT; approximately two-thirds of the revenue from both taxes becomes GF/GP revenue.

<sup>2</sup> Estimates are based on the results of the January 2011 Consensus Revenue Estimating Conference.

Most major state tax changes over the last 10-15 years, generally related to the state income and business taxes, have affected GF/GP revenue. The School Aid Fund also receives large portions of major state taxes (particularly the Sales Tax), but has been affected more by economic changes than by tax policy changes, as the School Aid Fund has generally been held harmless from Income Tax rate changes and receives an earmark from the MBT that is annually adjusted for inflation.

**FIGURE 2**  
**FY 2010-11 GF/GP Revenue by Source**  
 Millions of Dollars  
 Total GF/GP Revenue: \$7,227.8 million



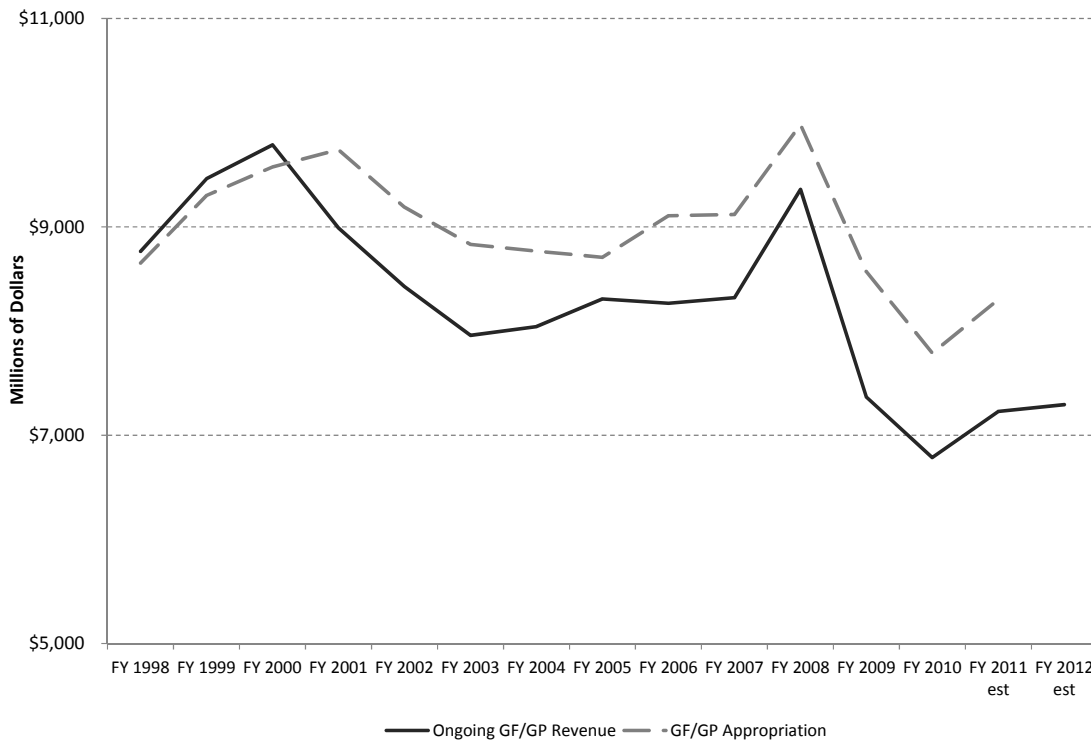
**Historical GF/GP Revenue and Appropriations**

Over the last decade, Michigan has faced persistent obstacles in balancing its GF/GP budget, as state revenue has declined in response to the state's economic difficulties and shrinking tax bases. **Figure 3** shows GF/GP revenue and appropriations from FY 1997-98 through FY 2011-12.

- Revenue peaked in FY 1999-2000 and then declined through FY 2002-03 as a result of an economic downturn and tax cuts that had been previously enacted into law (specifically, incremental reductions in the Income Tax and Single Business Tax rates).
- Revenue was relatively flat over the next four years before increasing significantly in FY 2007-08 following the income tax rate increase and MBT surcharge enacted by the Legislature in 2007.
- GF/GP revenue declined dramatically in FYs 2008-09 and 2009-10, primarily in response to the national- and state-level economic downturns but also due to the creation of the Earned Income and Film Tax Credits.
- Projected FY 2010-11 GF/GP revenue growth will recapture a small portion of the large revenue loss realized over the previous two years, with revenue then approximately flat for FY 2011-12 under current tax code provisions.

Cumulatively, GF/GP revenues will have declined by an estimated 25.5 percent (on a non-inflation-adjusted basis) between FY 1999-2000 and FY 2011-12, from \$9.8 billion to \$7.3 billion.

**FIGURE 3**  
**GF/GP Budget History**



GF/GP appropriations have followed a similar path: peaking in FY 2000-01, declining or holding flat over the next six years, rising briefly in FY 2007-08, declining dramatically in FYs 2008-09 and 2009-10, and growing again in FY 2010-11. Note that the GF/GP appropriation amounts for FYs 2008-09 through FY 2010-11 have been substantially affected by the availability of temporary federal ARRA revenues available to offset ongoing state appropriations. The impact of the phase-out of that revenue, which began in FY 2010-11 and will be complete in FY 2011-12, is discussed later in this report.

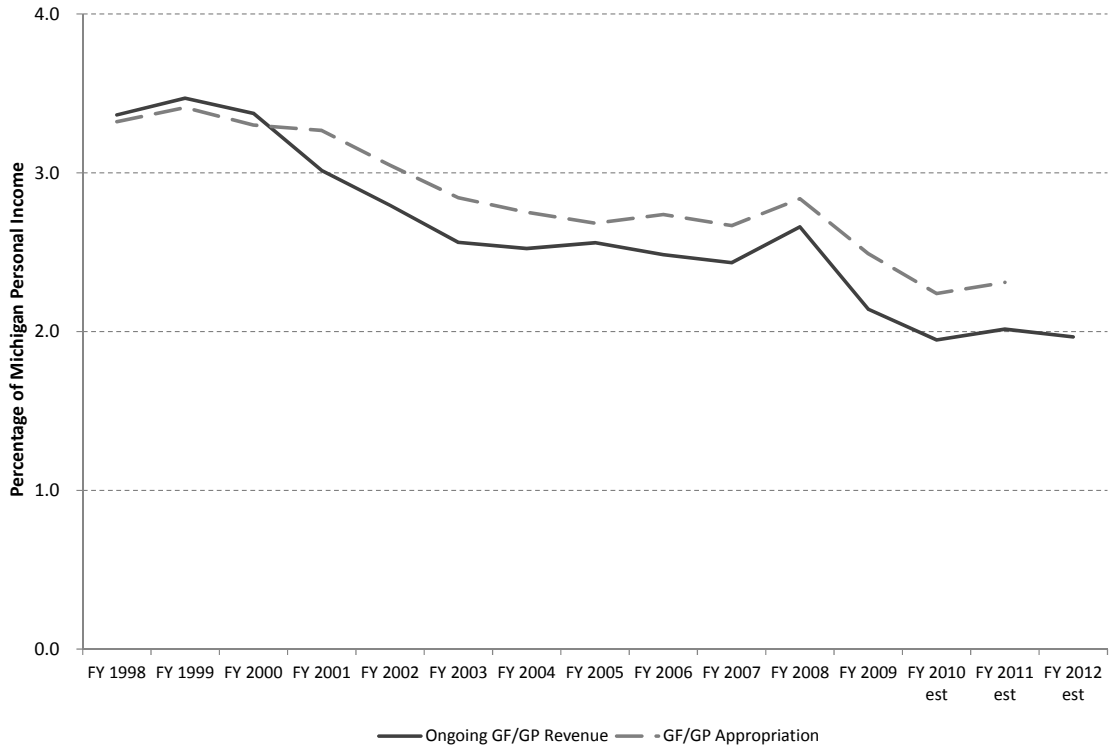
Over the last decade, GF/GP appropriations have been reduced by 14.7 percent (on a non-inflation-adjusted basis), from \$9.7 billion in FY 2000-01 to \$8.3 billion in FY 2010-11.

**Figure 4** places GF/GP revenues and appropriations in the context of the state's overall economy, as measured by Michigan's total personal income.

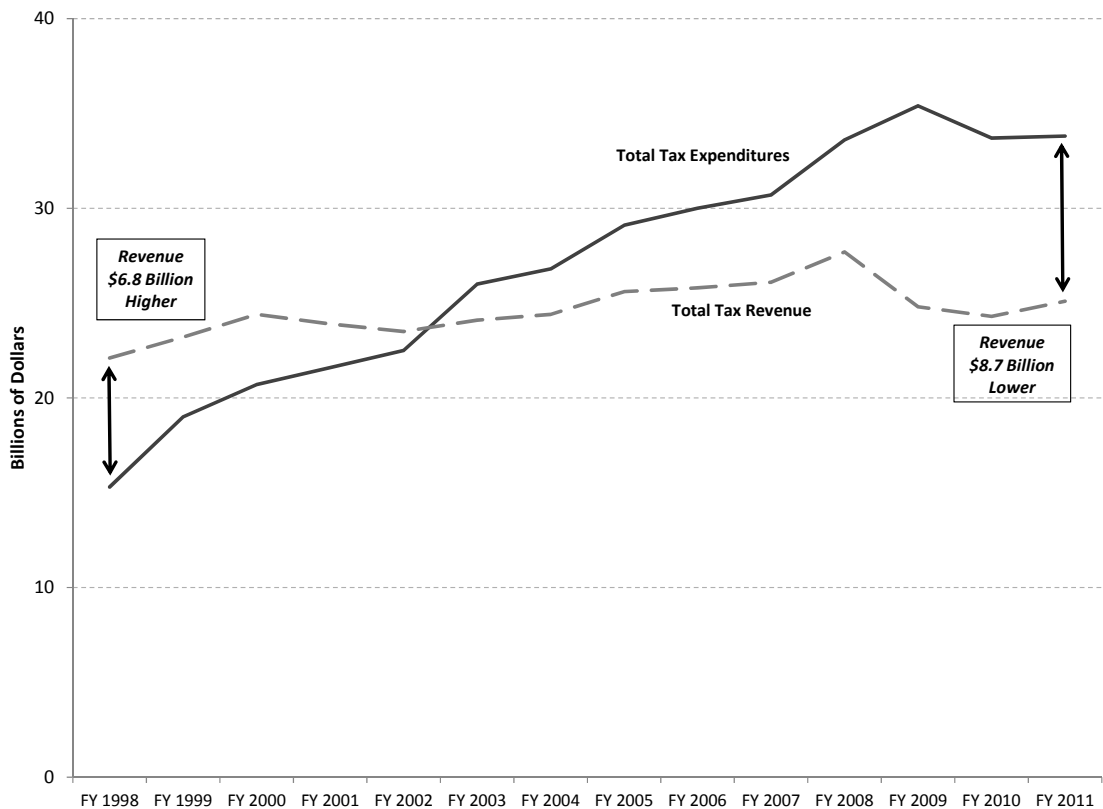
- As a percentage of personal income, GF/GP revenue has fallen from 3.47 percent in FY 1998-99 to an estimated 1.97 percent in FY 2011-12, despite relatively meager state personal income growth over that time period.
- Similarly, GF/GP appropriations have fallen from 3.41 percent of state personal income in FY 1998-99 to 2.31 percent in FY 2010-11.

The large decline in GF/GP revenue as a percentage of the state's economy is largely the result of growth in tax expenditures—foregone revenue resulting from the adoption of tax credits, deductions, and exemptions, or from growth in the amounts of existing credits, deductions, and exemptions taxpayers have been able to claim. As a result of tax expenditure growth, the tax bases for Michigan's major taxes have been reduced relative to the state's overall economy.

**FIGURE 4**  
**GF/GP Budget History: As a Percentage of Michigan Personal Income**



**FIGURE 5**  
**Total State Tax Revenue and Tax Expenditures**



**Figure 5** shows total state tax revenue and total value of all tax expenditures available under the state tax code since FY 1997-98. In FY 1997-98, the amount of revenue collected under the state's tax system exceeded total tax expenditures by \$6.8 billion. In FY 2010-11, the two figures had reversed positions, with revenue foregone from tax expenditures exceeding revenue collected by \$8.7 billion. A large portion of that shift has directly reduced the state's GF/GP revenue base.

Examples of new tax expenditures enacted into law in recent years are the Film Credit applied to the MBT and the Earned Income Tax Credit applied to the state Income Tax. Meanwhile, a number of existing tax expenditures have grown rapidly over the last decade. Major examples are the exemption of most services from the Sales and Use Taxes, Income Tax exclusions for senior citizens and certain other taxpayers, and the Homestead Property Tax Credit. Growth in existing tax expenditures has resulted from both economic and demographic trends in the state and tax code provisions that automatically increase credit, deduction, and exemption amounts based on inflation.<sup>3</sup>

### *Additional GF/GP Revenue Sources*

The gap in **Figure 3** between ongoing GF/GP revenue and GF/GP appropriations that has existed since FY 2000-01 is the result of additional revenue sources beyond regular ongoing GF/GP revenue that have been utilized by the Legislature to finance GF/GP appropriations. Those revenue sources include the following:

**GF/GP Beginning Balances:** In most years, a small beginning GF/GP balance is available due to appropriations lapses or other factors. The largest such balance was \$457.9 million at the beginning of FY 2008-09. In most years, the beginning GF/GP balance has been in the range of roughly \$100 to \$250 million.

**Budget Stabilization Fund:** From FY 2000-01 through FY 2002-03, a total of \$846.8 million was transferred from the state's Counter Cyclical Budget and Economic Stabilization Fund (or Budget Stabilization Fund) to the General Fund. A balance of \$1.3 billion had been established in the Budget Stabilization Fund (BSF) as of FY 1999-2000, as deposits were made during the preceding period of strong economic and revenue growth. That balance was entirely depleted through transfers to the General Fund, School Aid Fund, and other state funds by the end of FY 2002-03.<sup>4</sup>

**Revenue Sharing Reductions:** Under state statute, 21.3 percent of revenue collected from the first 4 percentage points of the Sales Tax rate is allocated to Revenue Sharing for local governments. This allocation is above and beyond the portion of Sales Tax revenue collections constitutionally dedicated to Revenue Sharing. When reductions in appropriations from the statutory allocation to Revenue Sharing are adopted, the revenue reverts to the state's General Fund. Since FY 2004-05, ongoing GF/GP resources have been increased by roughly \$500 to \$575 million per year due to reductions from statutorily-specified amounts for Revenue Sharing. These savings are gradually declining due to the costs of reinstating revenue sharing payments to counties as they exhaust the reserve funds that were established by shifting property tax collections forward after FY 2003-04.

**Restricted Fund Transfers:** The Legislature has chosen to transfer revenue from statutorily-restricted funds to the General Fund in various budget years. A major source for such transfers has been the state's share of national tobacco settlement revenues. Since FY 2000-01, transfers of tobacco settlement revenue to the General Fund have totaled over \$450 million. Smaller amounts of funding have been identified in other state restricted funds and transferred to the General Fund on a one-time basis in some budget years. Tobacco settlement and other restricted revenues have also been appropriated directly for state programs, primarily Medicaid base funding in the case of tobacco settlement funding, in order to reduce the need for GF/GP appropriations. As another example, \$90.0 million in Michigan Higher Education Student Loan Authority funds were transferred from the authority and utilized to offset GF/GP appropriation in FY 2006-07.

<sup>3</sup> Additionally, growth in internet and mail order sales from out-of-state that are technically subject to the use tax but for which payments are generally not submitted to the state has reduced the Sales and Use Tax base.

<sup>4</sup> \$81.3 million was transferred to the BSF from the FY 2003-04 ending GF/GP balance but was subsequently withdrawn to help fund the FY 2004-05 GF/GP budget.

**Various One-Time Revenue Sources and Funding Shifts:** Other major revenue sources that have been utilized to fund GF/GP appropriations were temporary unrestricted federal aid (\$169.0 million in each of FYs 2002-03 and 2003-04) and funds received from the securitization of tobacco settlement revenues (\$207.2 million in FY 2006-07). Additionally, GF/GP appropriations have been reduced at different times to realize one-time savings. For example, in FY 2000-01 \$211.0 million in partially-completed building projects that were initially paid for with up-front GF/GP appropriations were moved to a debt-financed basis to help balance the budget. At other times, state-owned property has been sold to realize additional GF/GP revenue.

**Use Tax on HMOs:** Revenue from the Use Tax imposed on Medicaid managed care plans, which replaced a Qualified Assurance Assessment Program (QAAP) for managed care plans beginning in FY 2009-10, is not included in the revenue estimates determined at the Consensus Revenue Conference. For FY 2010-11, \$377.4 million in such revenue is assumed in the GF/GP budget.

Most of the revenue sources identified above have been temporary in nature, contributing to an ongoing structural gap in the state's GF/GP budget. Additionally, GF/GP appropriations have been reduced at times through the use of temporarily-available restricted or federal funds, creating similar structural issues. Most recently, a total of \$2.8 billion in federal ARRA-related revenue has been utilized over a three-year period (FY 2008-09 to FY 2010-11) to fund appropriations that would have otherwise required GF/GP funding. (The gap between ongoing GF/GP revenue and GF/GP appropriations in **Figure 3** does not necessarily represent the full structural gap between ongoing GF/GP revenues and expenditures in a given year due to the use of restricted and federal funds to temporarily lower GF/GP appropriation amounts.)

In terms of the overall state budget, a very large amount of one-time resources and savings was utilized to balance the budget early in the decade. From June 2001 to December 2002, a total of \$3.3 billion in temporary budget-balancing actions were taken to balance the FY 2000-01, 2001-02, and 2002-03 General Fund and School Aid budgets.<sup>5</sup> As budget problems persisted over the decade, additional one-time measures have been implemented. While some permanent budget reductions and revenue increases have been implemented in recent years, a large structural shortfall in the state's General Fund budget persists. Specific structural issues for the GF/GP budget going into the FY 2011-12 budget process will be discussed later in this report.

### ***GF/GP Appropriation Changes by Budget Area***

This section provides information on changes in GF/GP appropriations by budget area since FY 2000-01. Making comparisons for individual departments and budget areas is complicated in several cases by departmental reorganizations and programs transfers between budget areas. The FY 2000-01 appropriation amounts in **Table 1** have been adjusted to match the current departmental organizational structure (prior to any changes made under Governor Snyder's administration) in order to make the amounts as comparable as possible. Those adjustments to FY 2000-01 amounts are as follows:

- The appropriation for the Library of Michigan budget area is added to the Department of Education's appropriation total, as library-related programs were moved to that department when the Department of History, Arts and Libraries (which the Library of Michigan had previously been merged into) was eliminated in 2009.
- The appropriation for the Departments of Civil Service is added to the appropriation for the Department of Technology, Management and Budget (DTMB), as the department was merged into DTMB (then DMB) in 2007.<sup>6</sup>

<sup>5</sup> The \$3.3 billion was composed of \$1.3 billion in funds withdrawn from the BSF, \$870 million in School Aid Fund surpluses, \$454 million in one-time revenue from changing State Education Tax collection dates, and \$689 million in other one-time revenue from various fund shifts and property sales.

<sup>6</sup> The Department of Information Technology (DIT) was also merged in DTMB, but DIT's appropriations were funded entirely through interdepartmental grants and, therefore, have no impact on adjusted gross or GF/GP appropriations.



**TABLE 1**  
**General Fund/General Purpose Appropriation Changes Since FY 2000-01**  
*(Dollars in Thousands)*

Budget Area (2001 Budget Areas)	FY 2000-01	FY 2010-11	FY 2010-11 vs. FY 2000-01		
	GF/GP <u>Approps</u>	GF/GP <u>Approps</u>	<u>\$ Change</u>	<u>% Change</u>	<u>% Adjusted for US CPI</u>
<b><u>Education</u></b>					
Community Colleges	315,012	295,881	(19,131)	(6.1)	(25.0)
Dept of Education (Library of Michigan)	70,353	21,914	(48,439)	(68.9)	(75.1)
Higher Education	1,785,851	1,543,379	(242,472)	(13.6)	(31.0)
School Aid	385,614	18,642	(366,971)	(95.2)	(96.1)
<b>SUBTOTAL</b>	<b>2,556,829</b>	<b>1,879,816</b>	<b>(677,013)</b>	<b>(26.5)</b>	<b>(41.3)</b>
<b><u>General Government</u></b>					
Attorney General	35,271	28,559	(6,712)	(19.0)	(35.3)
Civil Rights	14,267	10,976	(3,291)	(23.1)	(38.5)
Executive Office	5,651	4,631	(1,020)	(18.1)	(34.5)
Legislative Auditor General	13,184	11,155	(2,029)	(15.4)	(32.4)
Legislature	104,979	100,574	(4,405)	(4.2)	(23.5)
State	66,805	13,911	(52,894)	(79.2)	(83.4)
DTMB: Operations (Civil Service)	68,400	57,878	(10,522)	(15.4)	(32.4)
DTMB: SBA Rent / Capital Outlay	289,636	241,871	(47,765)	(16.5)	(33.3)
Treasury: Operations	69,088	56,038	(13,050)	(18.9)	(35.2)
Treasury: Mich Strategic Fund (MSF)	65,275	22,782	(42,493)	(65.1)	(72.1)
Treasury: Debt Service	90,871	42,118	(48,752)	(53.7)	(63.0)
Treasury: Revenue Sharing*	15	0	(15)	(100.0)	(100.0)
<b>SUBTOTAL</b>	<b>823,440</b>	<b>590,495</b>	<b>(232,948)</b>	<b>(28.3)</b>	<b>(42.7)</b>
<b><u>Health/Human Services/Corrections</u></b>					
Community Health	2,673,556	2,421,484	(252,073)	(9.4)	(27.6)
Corrections	1,619,601	1,917,880	298,279	18.4	(5.4)
Human Services (FIA)	1,216,438	924,018	(292,420)	(24.0)	(39.3)
<b>SUBTOTAL</b>	<b>5,509,595</b>	<b>5,263,381</b>	<b>(246,214)</b>	<b>(4.5)</b>	<b>(23.7)</b>
<b><u>Public Safety</u></b>					
Military and Veterans Affairs	41,648	36,425	(5,223)	(12.5)	(30.1)
State Police	321,356	260,383	(60,972)	(19.0)	(35.3)
<b>SUBTOTAL</b>	<b>363,003</b>	<b>296,808</b>	<b>(66,195)</b>	<b>(18.2)</b>	<b>(34.7)</b>
<b><u>Resource Management</u></b>					
Agriculture	51,795	30,297	(21,497)	(41.5)	(53.3)
Nat Resources & Environ (DNR/DEQ)	153,085	41,309	(111,776)	(73.0)	(78.4)
<b>SUBTOTAL</b>	<b>204,880</b>	<b>71,607</b>	<b>(133,273)</b>	<b>(65.0)</b>	<b>(72.1)</b>
<b><u>Other</u></b>					
Energy, Labor, Econ Growth (DCD/CIS)	113,675	47,608	(66,067)	(58.1)	(66.5)
Judiciary	170,317	152,073	(18,244)	(10.7)	(28.7)
Transportation	0	0	0	--	--
<b>SUBTOTAL</b>	<b>283,992</b>	<b>199,681</b>	<b>(84,311)</b>	<b>(29.7)</b>	<b>(43.8)</b>
<b>GRAND TOTAL</b>	<b>9,741,739</b>	<b>8,301,785</b>	<b>(1,439,954)</b>	<b>(14.8)</b>	<b>(31.9)</b>

\*A small GF/GP appropriation for a special Revenue Sharing payment was included in FY 2000-01 budget.

- Capital Outlay appropriations are included with the General Government budget areas, since the largest piece of the budget historically—State Building Authority (SBA) rent—is now included in the budget for DTMB. SBA rent is broken out from the DTMB total for FY 2010-11. Maintenance-related funding previously included in the Capital Outlay budget is now appropriated in the operating budgets for various departments, however, leaving that comparison somewhat misleading.
- The appropriation for the Michigan Strategic Fund (MSF), which was previously an independent budget bill, is included with the General Government budget areas, since the MSF budget is now part of the budget for the Department of Treasury.
- The appropriations for the Departments of Consumer and Industry Services (CIS) and Career Development (DCD) are totaled and compared with the appropriation for the Department of Energy, Labor, and Economic Growth, into which they were merged in 2003. (Energy-related functions were moved into the department in 2008.)
- The Family Independence Agency (FIA) was renamed as the Department of Human Services in 2004.
- The appropriations for the Departments of Natural Resources (DNR) and Environmental Quality (DEQ) are totaled and compared with the appropriation for the Department of Natural Resources and Environment, into which they were merged in 2010. (The department will be resplit into two separate departments in 2011.)

Programs transfers between existing departments over the last decade will result in somewhat misleading percentage changes in some cases—although the magnitudes of the transfers are generally relatively small compared to total appropriation changes in the various budget areas.

In addition to information on nominal budget changes, **Table 1** also includes inflation-adjusted changes based on the U.S. Consumer Price Index (CPI). The CPI provides a rough measure of inflationary cost growth over the last decade, although it does not account for changes in target populations for state programs (Medicaid caseloads, prison populations, educational enrollments, etc.) or cost increases for state government that may exceed those faced by consumers.

Nearly every budget area has experienced significant GF/GP reductions since FY 2000-01. Most operational departments have seen GF/GP reductions of at least 15 percent, or 30 percent on an inflation-adjusted basis.

- Several departments and agencies have seen much larger GF/GP reductions—the Departments of Education; Energy, Labor and Economic Growth; Natural Resources and Environment; and State, and the Michigan Strategic Fund. These larger reductions have generally occurred in conjunction with the creation, enhancement, or diversion of restricted fund sources (fees or other specific charges) to offset a portion of those reductions.
- Departments and agencies with limited or no restricted fund options, meanwhile, have generally seen smaller GF/GP reductions: the Executive Office, the Judiciary, the Legislature, the Department of Military Veterans Affairs, and the Department of Technology, Management and Budget.

The only budget area to see an increase in its GF/GP appropriation over the last decade is the Department of Corrections—at a rate slightly below inflation.

Adjusting for the GF/GP funds that would be needed to fund the current FY 2010-11 Community Health budget absent ARRA funds, that department's GF/GP budget would have also grown on a nominal—but not inflation-adjusted—basis. The use of special financing mechanisms has held GF/GP cost growth for the Medicaid program below the overall level of Medicaid cost growth, which has been high throughout the decade due to both economic factors and national health care trends.

In absolute terms—and excluding the ARRA-related reduction in the Community Health budget—the largest GF/GP reductions over the last decade have been as follows:

- The \$367.0 million reduction in the GF/GP subsidy for the **School Aid** budget—a 95.2 percent reduction. The remaining GF/GP appropriations in the School Aid budget are for items that cannot be funded with School Aid Fund revenue under the State Constitution.
- The \$292.4 million reduction in the **Human Services** budget—a 24.0 percent reduction. This budget has been maintained partially through the use of one-time TANF revenue.
- The \$242.5 million reduction in the **Higher Education** budget—a 13.6 percent reduction. Appropriations for both public university operational support and student financial aid have been significantly reduced.
- The \$111.8 million reduction in the **Natural Resources and Environment** budget—a 73.0 percent reduction. This reduction is partially the result of the use of restricted funds to offset GF/GP appropriations.

The increase of \$298.3 million GF/GP in the Corrections budget has partially offset those GF/GP reductions. Corrections populations and costs grew for the first half of the decade before declining somewhat in recent years.

Additionally, a reduction of \$545.3 million in restricted fund appropriations for Revenue Sharing since FY 2000-01—equal to 34.1 percent of FY 2000-01 Revenue Sharing appropriations—has resulted in substantial savings to the GF/GP budget.

### *Changes in State-Source and Adjusted Gross Appropriations*

To provide additional context regarding state budget changes over the last 10 years, **Table 2** provides information on percentage changes in major budget areas and categories for three measures of state appropriations:

- **GF/GP appropriations:** These amounts correspond to the information discussed in the previous section of the report, reflecting adjustments made over time to balance the state's GF/GP budget.
- **State-source appropriations:** GF/GP appropriations plus state restricted appropriations—measuring total spending from state-level revenue sources.
- **Adjusted gross appropriations:** Total appropriations from all sources, including federal revenue.

**Figure 6** displays this same information, consolidated into major budget areas and categories. In some cases, a portion of reductions in appropriation amounts since FY 2000-01 may be the result of one-time budget items included in the budget for that fiscal year; those one-time amounts are generally small relative to overall appropriation changes.

While appropriation changes vary significantly across budget areas and funding sources, changes in state-source appropriations have generally been negative or below the rate of inflation. Where adjusted gross appropriations have increased at or above the rate of inflation, the growth has been primarily the result of increases in available federal revenues:

- The enhanced Medicaid match rate and special financing mechanisms used in the Community Health budget.
- Increases in Food Assistance funding in the Human Services budget.
- Increased homeland security funding in the State Police budget following the 2001 terrorist attacks.

In some cases, increases in state restricted or federal appropriations have directly offset reductions in GF/GP appropriations (for the Medicaid program, for example), but often increases in those funding sources have been for specific purposes that do not allow for GF/GP savings (for example, the Food Assistance program, which is 100 percent federally-funded).

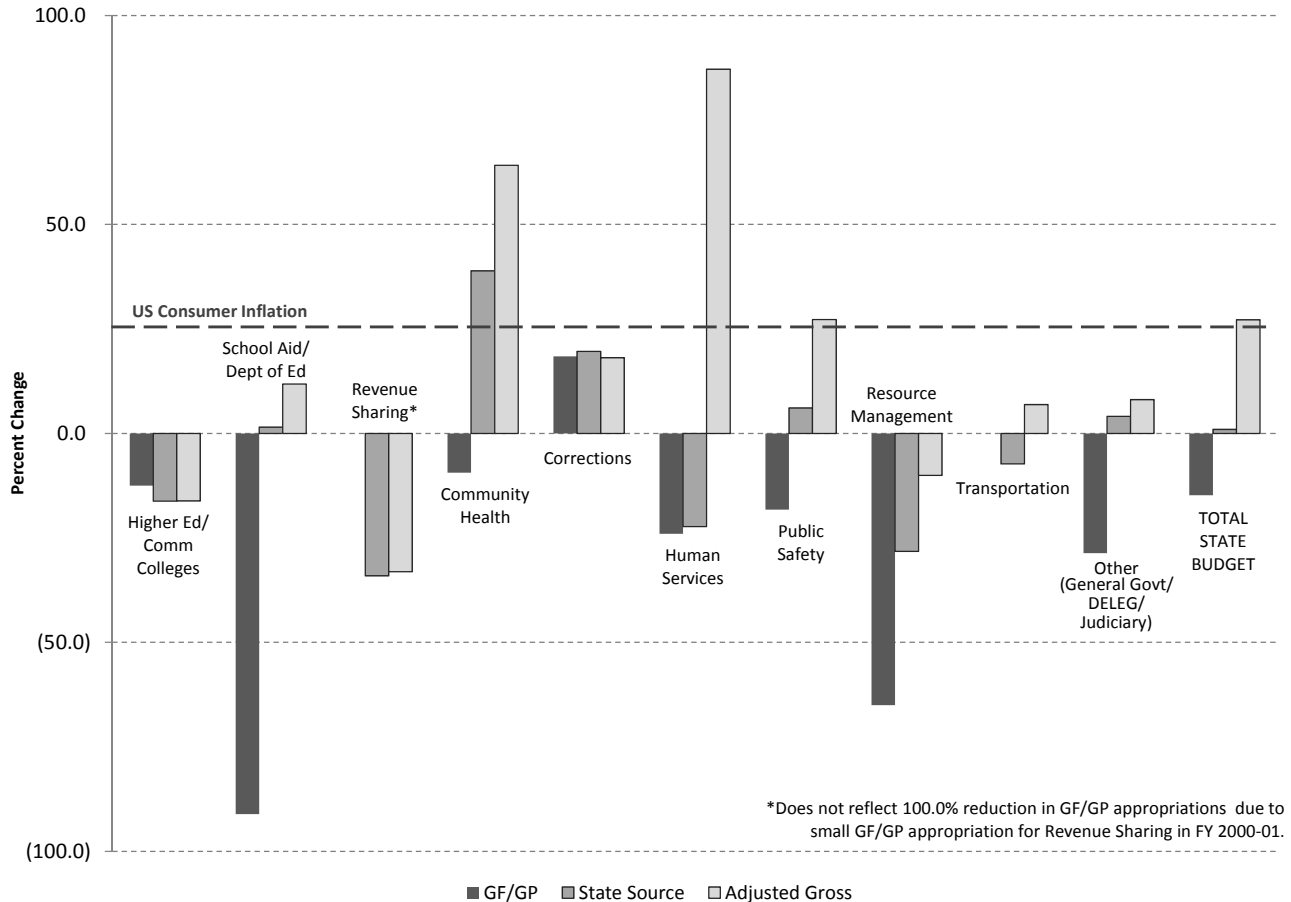
TABLE 2

## Percentage Change in Appropriations by Budget Area: FY 2000-01 to FY 2010-11

Budget Area (2001 Budget Areas)	GF/GP Appropriations	State-Source Appropriations	Adjusted Gross Appropriations
<b><u>Education</u></b>			
Community Colleges	(6.1)	(9.0)	(9.0)
Dept of Education (Library of Michigan)	(68.9)	(65.6)	(86.9)
Higher Education	(13.6)	(17.5)	(17.4)
School Aid	(95.2)	2.0	20.6
<b>SUBTOTAL</b>	<b>(26.5)</b>	<b>(1.5)</b>	<b>7.4</b>
<b><u>General Government</u></b>			
Attorney General	(19.0)	(0.2)	(0.6)
Civil Rights	(23.1)	(22.7)	(15.9)
Executive Office	(18.1)	(18.1)	(18.1)
Legislative Auditor General	(15.4)	(5.6)	(5.6)
Legislature	(4.2)	(4.1)	(4.1)
State	(79.2)	47.0	44.3
DTMB: Operations (Civil Service)	(15.4)	12.9	9.6
DTMB: SBA Rent / Capital Outlay	(16.5)	(37.2)	(52.9)
Treasury: Operations	(18.9)	37.9	83.1
Treasury: Mich Strategic Fund (MSF)	(65.1)	(14.7)	(7.6)
Treasury: Debt Service	(53.7)	(36.6)	(53.7)
Treasury: Revenue Sharing*	(100.0)	(34.1)	(33.1)
<b>SUBTOTAL</b>	<b>(28.3)</b>	<b>(18.7)</b>	<b>(15.9)</b>
<b><u>Health/Human Services/Corrections</u></b>			
Community Health	(9.4)	38.9	64.2
Corrections	18.4	19.6	18.1
Human Services (FIA)	(24.0)	(22.3)	86.8
<b>SUBTOTAL</b>	<b>(4.5)</b>	<b>20.6</b>	<b>64.6</b>
<b><u>Public Safety</u></b>			
Military and Veterans Affairs	(12.5)	0.0	44.0
State Police	(19.0)	7.1	23.0
<b>SUBTOTAL</b>	<b>(18.2)</b>	<b>6.1</b>	<b>27.2</b>
<b><u>Resource Management</u></b>			
Agriculture	(41.5)	(33.7)	(29.1)
Nat Resources & Environ (DNR/DEQ)	(73.0)	(27.4)	(7.4)
<b>SUBTOTAL</b>	<b>(65.0)</b>	<b>(28.2)</b>	<b>(10.1)</b>
<b><u>Other</u></b>			
Energy, Labor, Econ Growth (DCD/CIS)	(58.1)	19.8	17.5
Judiciary	(10.7)	7.9	10.1
Transportation	--	(7.3)	6.9
<b>SUBTOTAL</b>	<b>(29.7)</b>	<b>(2.6)</b>	<b>9.7</b>
<b>GRAND TOTAL</b>	<b>(14.8)</b>	<b>1.0</b>	<b>27.1</b>

\*A small GF/GP appropriation for a special Revenue Sharing payment was included in FY 2000-01 budget.

**FIGURE 6**  
**Percentage Change in Appropriations by Major Area/Category**  
 FY 2000-01 to FY 2010-11



Overall, total state-source appropriations in Michigan's budget have been flat since FY 2000-01 (increase of 1.0 per cent), while adjusted gross appropriations have grown at approximately the same rate as inflation (increase of 27.1 per cent). Due to the combination of declining GF/GP revenue and increases in available federal revenue, the percentage of the total state budget composed of GF/GP appropriations has declined from 26.3 per cent in FY 2000-01 to 17.7 per cent in FY 2010-11.

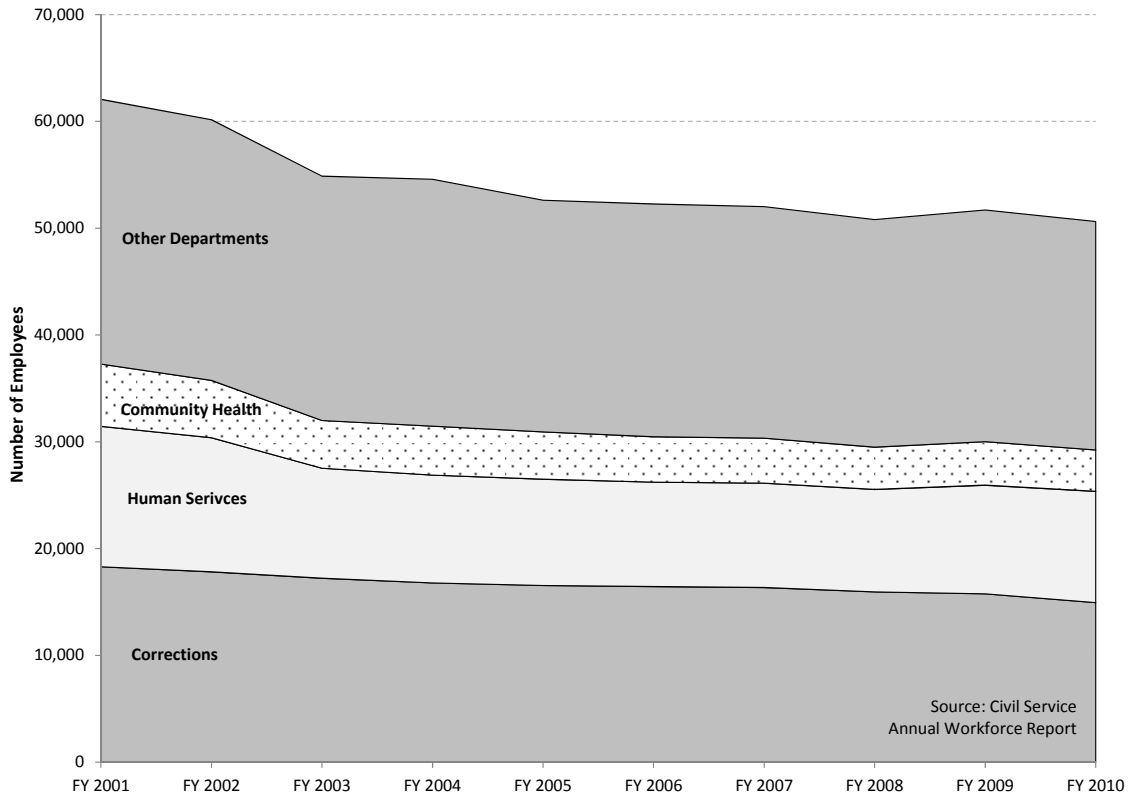
For more detailed information on appropriation changes in each budget area over the last decade, see the "Budget Area Synopses" document and the Budget Area Briefings available on the House Fiscal Agency website.<sup>7</sup>

**State Employee Compensation Costs**

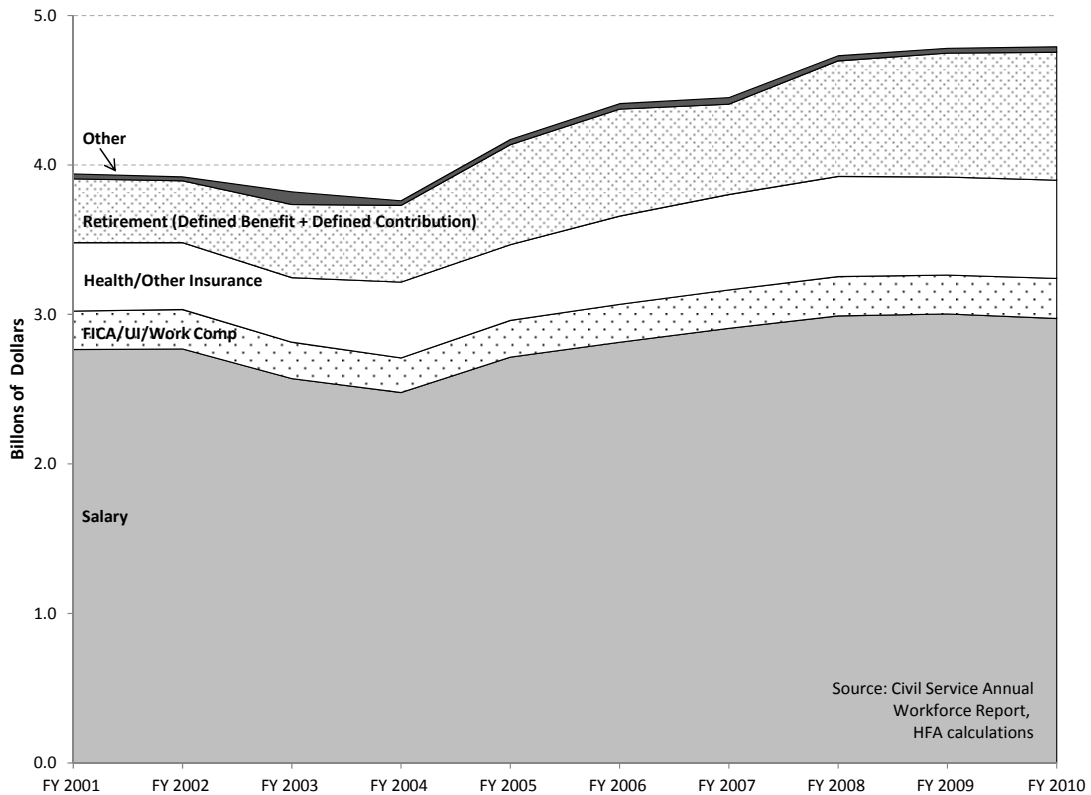
In conjunction with the 2002 early retirement plan and continuing efforts to balance the state budget over the last decade, the number of state government employees has declined significantly. As shown in **Figure 7**, the number of classified state employees was 18.4 per cent lower in FY 2009-10 than it was in FY 2000-01 – declining from 62,057 to 50,616. Significant reductions in employment levels occurred across all state departments over that time period, with the largest numerical reductions occurring for the three departments with the largest numbers of employees (Corrections, Human Services, and Community Health). State government employment is expected to fall further following the early retirement plan implemented in 2010.

<sup>7</sup> <http://www.house.mi.gov/hfa/briefings/briefings.asp>

**FIGURE 7**  
**Classified State Employee History**



**FIGURE 8**  
**Total Classified Employee Compensation-Related Costs**  
**All Funding Sources**



Meanwhile, total compensation-related costs for classified state employees have grown significantly over the same time period, increasing from \$3.9 billion in FY 2000-01 to \$4.8 billion in FY 2009-10 (an increase of 21.6 percent). As shown in **Figure 8**, the bulk of that growth has occurred for fringe benefit costs—specifically health insurance and retirement-related costs. Consistent with national trends, health and other insurance costs for active employees have increased over time—by approximately \$200 million since FY 2000-01. Those costs have leveled out since FY 2007-08 due to increased cost sharing by state employees.

In 1997, Michigan began placing all new employees other than uniformed State Police personnel into a defined contribution retirement plan (i.e., a 401k-style plan), substantially lowering the immediate costs of providing retirement benefits to new employees. As of June 2010, Michigan was one of only two states to adopt a defined contribution plan as the exclusive retirement plan for new state employees.<sup>8</sup>

As of September 30, 2010, 25,478 active state employees remained in the state's defined benefit plan (i.e., a pension plan), while over 27,000 active employees hired since 1997 were participants in the defined contribution plan.<sup>9</sup> The early retirement program implemented in 2010 has further reduced the number of active employees in the defined benefit plan by over 4,700. The number of total active state employees participating in the defined contribution plan now exceeds the number in the defined benefit plans and will continue to increase over the next several decades.

Still, total retirement-related costs, including both the defined benefit and defined contribution plans, increased by approximately \$430 million between FY 2000-01 and FY 2009-10. This increase is due in large part to pension system investment returns underperforming relative to actuarial assumptions, increasing required pension contributions by the state to the system. Increased pension costs have also resulted from the early retirement incentive offered to state employees in 2002.<sup>10</sup> Contributions to the State Employees Retirement System (SERS) by the state for pension-related costs increased from \$112.3 million in FY 2000-01 to \$370.0 million in FY 2009-10, reflecting the significant unfunded actuarial accrued liability that currently exists in the system.<sup>11</sup>

The costs of providing health insurance coverage to retired state employees, which are funded on a pay-as-you-go basis (as opposed to being pre-funded as pension benefits are), have also contributed to the increase in retirement-related costs over the decade. In FY 2000-01, the state contributed \$249.2 million for the cost of health, dental, and vision coverage for retirees under SERS and the defined contribution plan. In FY 2009-10, the state's contribution had increased to \$360.1 million.<sup>12</sup> Beginning in FY 2010-11, active state employees will make a contribution equal to 3.0 percent of their salaries to pay for current retiree health care costs, which will offset approximately \$80 million of those costs. These contributions are currently being held in escrow while the legality of the 3.0 percent contribution is adjudicated.

A remaining amount of approximately \$210 million in increased state employee compensation costs between FY 2000-01 and FY 2009-10 is the result of increased salary costs. From FY 2000-01 to FY 2009-10, the average state employee salary has increased by 26.4 percent—from \$42,816 to \$54,121. That equates to an annualized increase of 2.6 percent per year. For comparison, the U.S. CPI increased by 2.3 percent per year over the same time period.

A substantial portion of state employee compensation-related costs are funded through federal and restricted revenue sources, corresponding to employees who administer and operate programs funded through those sources. In FY 2009-10, approximately \$2.4 billion of the state's total compensation-related costs of \$4.8 billion were funded

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<sup>8</sup> The other state is Alaska. Some other states have optional defined contribution plans and/or hybrid retirement plans. (Michigan created a hybrid retirement plan for new school employees in 2010.) See the National Conference of State Legislatures report "State Defined Contribution and Hybrid Pension Plans" at <http://ncsl.org/?tabid=18511>.

<sup>9</sup> Sources: FY 2009-10 State Employee Retirement System Comprehensive Financial Report (CAFR), HFA estimate. Link to CAFR: [http://www.michigan.gov/documents/orsstatedb/SERS\\_2010\\_Published\\_1-10-11\\_342741\\_7.pdf](http://www.michigan.gov/documents/orsstatedb/SERS_2010_Published_1-10-11_342741_7.pdf).

<sup>10</sup> Similar costs will result from the early retirement incentive offered in 2010. The enhancement to the pension benefit multiplier was lower than it was in 2002, but the 2010 early retirement incentive costs will be amortized over five years, whereas the 2002 costs were amortized over 30 years.

<sup>11</sup> Source: FY 2009-10 SERS CAFR.

<sup>12</sup> Source: FY 2009-10 SERS CAFR.

from GF/GP revenue. The \$2.4 billion in GF/GP compensation-related costs were equal to roughly 30 percent of the total FY 2009-10 GF/GP budget of \$7.8 billion.

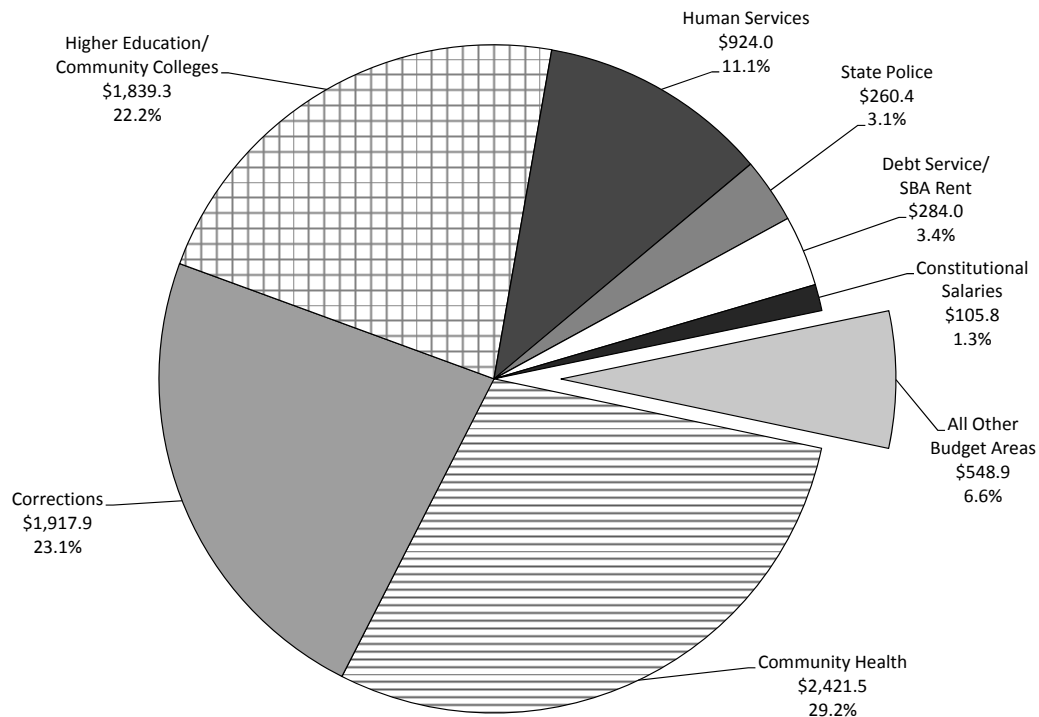
For further background information on state employee compensation, including data on comparisons with private sector compensation, see the 2008 House Fiscal Agency report "Civil Service Salary and Benefit Comparisons."<sup>13</sup>

**FY 2010-11 GF/GP Appropriations  
by Budget Area**

The large majority of current GF/GP appropriations are contained in a relatively small number of budget areas (as shown in **Figure 9**):

- Community Health: \$2.4 billion
- Corrections: \$1.9 billion
- Higher Education and Community Colleges: \$1.8 billion
- Human Services: \$924.0 million
- Debt Service and State Building Authority rent payments (which fund borrowing costs associated with state-financed capital projects): \$284.0 million
- State Police: \$260.4 million
- Constitutionally-required salaries and related costs for elected officials and judges: \$105.8 million

**FIGURE 9**  
**FY 2010-11 GF/GP Appropriations by Major Area**  
Millions of Dollars  
Total GF/GP Appropriations: \$8,301.8 million



<sup>13</sup> <http://www.house.mi.gov/hfa/PDFs/civil%20service%20comparisons%2008.pdf>



GF/GP appropriations for state functions not included in the list above total \$548.9 million, which is equal to just 6.6 percent of total GF/GP appropriations. Those appropriations fund the costs associated with 10 state departments, plus the legislative branch, the judicial branch, and the Executive Office (excluding constitutional salary costs in those budget areas). The percentage reductions in GF/GP appropriations for these smaller departments and budget areas have generally been larger than reductions in overall GF/GP appropriations over the last decade, so they represent an even smaller portion of the total GF/GP budget than they did ten years ago.

As noted in the previous section, state employee compensation costs represent about 30 percent of the total GF/GP budget—with the largest groups of employees in the Departments of Corrections, Human Services, and Community Health. A larger share of GF/GP appropriations is composed of funding distributed to outside entities: public universities and community colleges, local units of government, health care providers, etc.

### ***FY 2011-12 GF/GP Budget Outlook***

Going into the FY 2011-12 budget process, the Legislature faces a large structural gap in the state's GF/GP budget. Factors contributing to that structural gap include the following:

- The first in a series of five scheduled annual reductions in the state income tax rate—from 4.35 to 4.25. This rate reduction will be effective October 1, 2011, and is projected to reduce FY 2011-12 GF/GP revenue by an estimated \$161.8 million in FY 2011-12.
- An estimated \$40.0 million in foregone revenue due to the phase-in of the MBT tax credit for advanced battery technology created in 2009.
- An estimated \$520.0 million in enhanced federal Medicaid matching funds from ARRA-related sources available in FY 2010-11 that will no longer be available in FY 2011-12.
- A one-time payment of \$160.0 million into the Medicaid Benefits Trust Fund available to offset GF/GP appropriations in FY 2010-11 only.
- Approximately \$239.0 million in one-time federal TANF revenue used to offset GF/GP funding in the FY 2010-11 Human Services budget.
- The use of a tax amnesty program and changes to unclaimed property procedures to produce one-time revenue for the FY 2010-11 GF/GP budget. The GF/GP revenue collected under these initiatives is projected to decline by \$242.6 million for FY 2011-12.
- A short-term restructuring of debt obligations that reduced GF/GP debt service costs in FY 2010-11. Those costs are expected to increase by \$83.3 million in FY 2011-12.
- Increased costs of approximately \$22.0 million due to a projected reduction in savings related to state employee retirement costs under legislation enacted in 2010.
- A projected increase of roughly \$37.3 million in revenue sharing payments to counties that have exhausted their reserve funds for FY 2011-12.

In sum, the existing FY 2010-11 budget and tax policy changes currently contained in state statute include \$1.5 billion in structural imbalances that will have direct implications for balancing the FY 2011-12 GF/GP budget. The overall FY 2011-12 GF/GP budget shortfall will also depend on other factors, including the potential use of the ending FY 2010-11 GF/GP balance, Medicaid caseload growth, the annualization of part-year staffing increases provided in the FY 2010-11 Human Services budget, increased costs for state employee benefits, other potential state costs not built into the FY 2010-11 budget (unemployment insurance borrowing costs, possible disallowed federal Medicaid funding mechanisms), and any changes adopted by the Legislature to state tax policy.

While the state will no longer be limited by ARRA-related MOE requirements tied to Medicaid, School Aid, and Higher Education spending in FY 2011-12, other federal restrictions still exist for the Community Health and Human Services budgets. Provisions included in the recent federal health care reform act prevent the state from reducing Medicaid eligibility without jeopardizing federal funding for the expansion of Medicaid in 2014. Ongoing TANF MOE requirements will continue to apply to programs in the Human Services budget (and other budget areas), while compliance with a legal settlement mandates specific improvements and outcomes for child welfare-related programs contained in that budget, including reductions in caseload-to-staff ratios that could necessitate further staffing increases.

Under any scenario, substantial budget balancing actions will be required for the FY 2011-12 General Fund budget: budget reductions; new, increased, or redirected sources of revenue; or tax expenditure reductions. If GF/GP budget reductions are utilized to solve all or most of the FY 2011-12 budget shortfall, the magnitude of the shortfall will require that major reductions be made in some or all of the four largest areas of the GF/GP budget: Community Health, Corrections, Higher Education and Community Colleges, and Human Services. Those four areas account for over 85 percent of the FY 2010-11 GF/GP budget.

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*NOTE: This report was written by Kyle I. Jen, Associate Director, with input and suggestions provided by a number of other HFA staff members. Kathryn Bateson, Administrative Assistant, prepared the report for publication.*

*REVISIONS: This report has been revised from the original version. The original version of the report incorrectly stated that the costs of health insurance coverage for retired state employees were excluded from the data presented in Figure 8 and the accompanying text. The main changes from the original version are in the discussion of retirement-related costs on page 15 of the report, with smaller changes to the fifth bulletpoint on the first page and the second paragraph on page 17.*