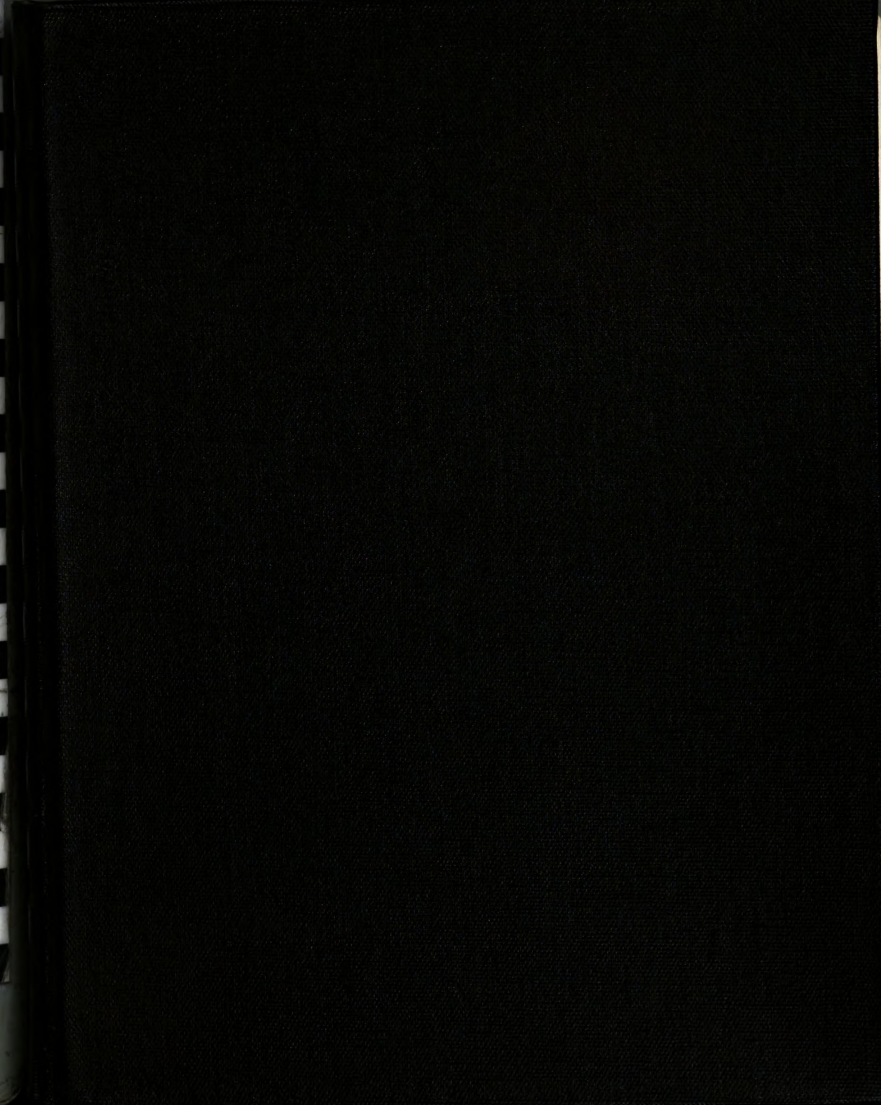




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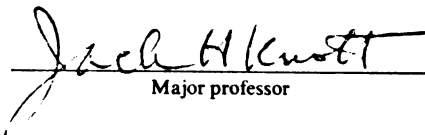
BUDGET CUTBACK:
AN EMPIRICAL TEST OF BUDGETING THEORY
IN CONDITIONS OF FISCAL STRESS

presented by

Susanne Rockne Morris

has been accepted towards fulfillment
of the requirements for

Ph.D. degree in Political Science


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**BUDGET CUTBACK: AN EMPIRICAL TEST OF BUDGETING THEORY
IN CONDITIONS OF FISCAL STRESS**

**By
Susanne Rockne Morris**

A DISSERTATION

**Submitted to
Michigan State University
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ABSTRACT

BUDGET CUTBACK: AN EMPIRICAL TEST OF BUDGETING THEORY IN CONDITIONS OF FISCAL STRESS

By

Susanne Rockne Morris

In the 1970s and early 1980s a combination of increasing expenditures and declining revenues created varying degrees of fiscal stress for many governments in the United States. Budgeting under such conditions was thought to depart from behavior predicted by established theory, incrementalism, which had been developed in periods of prior economic growth and stability.

This research provides an empirical test of the applicability of incrementalism, to the budget process when changes occur in financial and political stability and growth is lessened. It assesses the response of budgetary decision makers under conditions of cyclical and protracted fiscal stress.

Michigan state government budget data from 1963 to 1984 is used as an extreme test of the propositions. During this period, a volatile state economy and varying political constraints forced state policymakers to withdraw from spending commitments through executive order which, in effect, re-cast the budget thirteen times.

The analysis focuses on expenditure decisions made for twenty-five categories of the general fund general purpose budget. This section of the total state budget is

Susanne Rockne Morris

considered to be unreserved and therefore subject to annual negotiation.

The research design is cast in two stages. The first tests through time series four variations each of two established quantitative expenditure models. The second develops findings from source materials and in-depth interviews of political actors.

The linear model is found to hold for the greater part of the state budget but not for the most volatile budget categories. Contrary to expectations of critics of incrementalism, the fair shares dimension also holds and marginal change is the strongest predictive feature of all the quantitative model variations.

As predicted, there is some breakdown in the annual cycle: funds were reprogrammed but payment schedules, however partial, tended to hold firm for tested categories. Centralization of budgetary roles did occur, but the abandonment of power by some players was neither uniform nor consistent. "Politics of avoidance" was apparent. The role of the budget clearly changed from a tool for planning, management and control to a destabilizing force in itself. The state's increasing reliance on structural constraints to balance the budget is questioned. *Twenty-eight tables and figures plus a chronology of events are included.*

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Chapter One

I. Introduction

In the late 1970s and early 1980s a combination of increasing expenditures and declining revenues created varying degrees of fiscal stress for many governments in the United States. Increasing expenditures were, in part, attributable to changes in federal programs and an unusual degree of inflation but also to the economic recession which produced substantial unemployment and thereby increased social services costs. The recession also contributed to loss of tax revenue and, in part, to the citizen tax revolts which also diminished government revenues. The result for some governments was a degree of fiscal stress unmatched since the Depression of the 1930s.

The effects of this fiscal stress were thought to be reflected in three different types of governmental response (Nagel 1980:8): changed output in many kinds of services, increased interest in efficiency and productivity, and substantial budgetary cutback. While all of these responses are interrelated in varying ways, it is the latter which primarily interests us here.

II. The Research Question

Budgeting is a central topic in political science, public policy and public budgeting. Cutback in budgets as a test of budgetary theory, particularly incrementalism, is the focus of this study.

III. The Importance of the Question

Budgetary cutback is an interesting problem for several reasons. The first is the theoretical concern. Compared to some other subfields of public policy analysis, budget analysis has benefitted from relatively well developed theory and incrementalism is its dominant expression. Incrementalism assumes conditions of economic growth and stability. During the late 1970s and early 1980s, these conditions were not evident in various parts of the United States. This situation has led some scholars to question the utility of this theory. Bozeman and Straussman (1982) and Schick (1983), for example, have argued that budgeting behavior in a cutback era is substantially different from budgeting under economic growth conditions and, therefore, alternative conceptualizations are needed. This is an argument also made by Caiden (1984).

The second reason has to do with the nature of the budget itself. According to Wildavsky (1975:5), budgets are "attempts to allocate financial resources through political processes to serve differing human purposes." Viewed this way, budgeting is much akin to politics itself. When we review the dynamics of the budgetary process, we are asking some fundamental questions about the political system.

In this analysis of budgetary behavior in a cutback situation, we are essentially looking at organizational response to substantial environmental transformation and uncertainty in a particular functional area of government: budgeting. The lessons we learn from this analysis may

provide additional insights into how our political system responds to marked change generally, i.e., in a cutback situation do politics change. Cutback, as opposed to growth, affects public policy in what way? Are some policies affected more than others?

In a cutback situation, the availability of resources becomes much more tenuous and problematic than is the case in "normal" times. The level of commitment to existing policies would seem inevitably to alter as attention to the budgetary emergency becomes more necessary. Under such conditions the interrelationships between budget constraints, particularly in political units which must maintain parity between expenditures and revenues, and policy imperatives will change and such change calls for new analysis and interpretation. Furthermore, there is major concern about the way in which the policy making as well as the policy implementing agency sustains innovation under budgetary recession.

Another reason speaks more directly to public policy concerns. The decisions implicit in the budget and the role of the budget in governance directly shape the content and scope of public policy. Or, as Nagel (1980:8) observes, how governments do, can and should deal with scarce resources is a perennial problem in public policy.

The fourth reason concerns the lack of research in this area. As noted by Lowery (1983:118), aside from the largely prescriptive literature on cutback management, there has

been little research on the fiscal implications of and the political and managerial responses to fiscal limitation.

This study seeks to test existing budget theory under the altered conditions of economic recession and political/administrative uncertainty. As will be seen, an aspect of this analysis involves an assessment of the impact of rules and other structural constraints on budgeting and their interaction over time with changes in financial and political stability and economic growth.

The purpose of the research is to enlarge our understanding of budget theory and to provide enhanced explanations and perhaps predictions of political and managerial behavior under conditions of fiscal stress.

The study addresses this issue focusing on several research questions:

1. What is the response of budgetary decision makers under conditions of cyclical and protracted fiscal stress? For example, can patterns of behavior be identified which are associated with particular stages of fiscal stress and/or with roles of the decision makers?

2. How does the role of the budget change under such conditions? Analysts have typically argued that budgets serve three major roles: planning, management and control. These roles, thought to be equally important, are played out in various stages of the budget cycle. Do these roles change when uncertainty and resource availability become increasingly problematic? And, to a lesser extent,

3. To what extent do rules and other structural

constraints shape budgetary decision making as financial instability and economic decline worsen?

4. How do decision makers and political institutions integrate such change, if any, i.e., what sort of organizational learning takes place?

In addressing these questions the research may provide a fuller understanding of budgetary behavior and the role of the budget under other than growth conditions. Budgets typically are viewed as means for planning, management, and control. But budgets are also powerful communication tools in the policy-making process (Wooldridge 1984). They tell us a great deal about our policy preferences as well as our capacity to govern our affairs.

The study provides the field of budget research systematic exploration of the obverse condition under which theory has been developed to date. For policymakers and practitioners the findings provide theoretically grounded explanations and perspectives under which cutback activities can be undertaken and evaluated in the future.

With the issue identified, we now turn to the experts. What have they had to say regarding incrementalism, its legacy and limitations. That is discussed in Chapter Two.

Chapter Two

Review of the Literature

I. Incrementalism, The Received View

Until recently incrementalism has been the predominant theory of budgeting. It is best represented in the work of Wildavsky (1965) and Davis, Dempster and Wildavsky (1966). This theory has been interpreted in the context of decision theory, particularly those models emphasizing bureaucratic rules and organizational routines (e.g., Allison 1971:78), although other decision models have also been associated with the budgeting process (see, e.g., Hoole, Handley and Ostrom 1979 and Natchez and Bupp 1973 and Padgett 1980). Incrementalism is based on the work of Simon (1957) and Lindblom (1959) and has been used to test budgetary decision making in a variety of contexts at the U.S. federal (e.g., Davis 1971 and 1974), state (Sharkansky 1968), and local levels (Crecine 1969), as well as elsewhere.

As applied to budgetary theory, the concept of incrementalism has incorporated a variety of uses (Padgett 1980:355, LeLoup 1978). One use emphasizes the change in marginal adjustments to the previous year's budgetary base. The base is accepted. Changes in the increment are never very great and are made through a complex set of negotiations between the executive and legislative body. As Bozeman and Straussman (1982:510) note, this approach pays less attention to the specific impact of fiscal and tax policies, broad policies of the executive, structural constraints such as balanced budgets and mandated outlays, and other

environmental and economic factors.

Another use refers to the linearity of decision rules which is also the use addressed by the various quantitative goodness of fit models which have been developed to explain the budgetary process.

A third use has referred to the concept of fair shares which informs budgetary decisions. This notion reflects attitudes of some decision makers that agencies ought to receive some appropriate share of the total amount available to the system.

A fourth use has referred to the roles of the budget decision makers and to the assumption that these roles are defined, that the players do not change very much and that they take a fairly narrow view of their roles. Executive departments will try to expand their budgets, the budget office will try to guard against expansion, and legislative committees will act to endorse that expansion because it means more services for constituents while vowing to hold the line. Redundancy is available.

Undergirding all these uses is the assumption of a certain stability in the budgetary process. Budget making is a predictable process.

According to Wanat (1974), some of these usages of incrementalism, e.g., the marginality, fair shares, and budgetary roles applications are more useful for description than explanation. He argues that only the linearity usage has true explanatory power.

In 1975 Wildavsky introduced an expanded theoretical

framework of the budgetary process. It was based on research that he as well as others, e.g., Wildavsky and Caiden (1974) had undertaken here and abroad since the introduction of his earlier work.

Briefly, Wildavsky argued that budgets could be studied from several different standpoints. They could be analyzed in terms of their size or in view of the political institutions and structures which produced them. Alternatively, budgets could be analyzed from the perspective of the values and elite norms incorporated in the choices reflected in them. One could also study budgets in view of the relative resources which are available or, in terms of the predictability of the financial environment in which decision making regarding budgeting takes place.

In Wildavsky's view the last two are key. Wealth and predictability control all other variables. By wealth, Wildavsky means economic resources such as gross national product. Predictability is the certainty or uncertainty about likely demands for spending compared to available economic resources. These independent variables determine patterns of budgetary behavior. The following figure summarizes the patterns identified by Wildavsky and integrates as well findings of Meltsner (1971) and Crecine (1969) which can be said to amplify the Wildavsky framework as it pertains to municipal budgeting.

Figure 2.1
Budgetary Behavior as a Function of Environmental Conditions

Predictability:	Health	
	Rich	Poor
Certain	Incremental Budgeting	Revenue Budgeting
	Characteristics: - Defined budgetary roles - Acceptance of budgetary base - Change only in margin of previous base - Decisions negotiated between executive and legislative body - Concern for fair share - Redundancy is available	Characteristics: - Inelastic revenue base - Focus on short-term control of expenditures - Negotiation problematic - Little impact by interest groups on decisions - Rules are important Examples: - US federal government - Most US state governments - US cities
Uncertain	Alternating a) Incremental and b) Supplemental Budgeting	Alternating a) Incremental & Revenue Budgeting and b) Supplemental Budgeting
	Characteristics (of b): - Administrative incapacity to match available funds with identified needs - Each expenditure request treated like supplement to budget	Characteristics: - Budgets remade throughout year - Delayed payments - Reprogramming of funds Examples: - France in 3rd & 4th Republics - US Confederate States - Poor nations

Source: Wildavsky (1975:11-16).

As we can see, Wildavsky builds the older theory into the broadened framework. In this framework, incrementalism is now seen to be a pattern which is found in relatively wealthy political systems in which there is a fair ability for policy makers to calculate the likely flow of revenues and expenditures based on past experience. There are now several added dimensions of incrementalism which must be considered. In addition to the four previously mentioned, we now have

- 5) the notion of an annual budget with timely payments and programming of funds,
- 6) the use of the budget for longer-term planning, and
- 7) a relatively decentralized decision process.

For Wildavsky, this pattern is found in most of the great post-industrial nations and in the United States at the federal level and in most states.

In putting incrementalism into this broadened framework, Wildavsky partly rebuts the charges of critics that incrementalism ignores the impact of fiscal and tax policies, executive preferences, structural constraints and other environmental factors because these factors will determine availability of resources and, to some extent, the predictability of their availability.

Putting incrementalism into this broadened framework is also useful for another reason: it answers the attacks of critics (e.g., Wanat 1974, Padgett 1980, and Schick 1983:3) who have observed that incrementalism in some of its uses is not so much a theory as a description of budgetary behavior,

i.e., it lacks explanatory and predictive power. For these critics, incrementalism says little about which variables are likely to trigger such activity, only how it proceeds once set in motion.

This broadened framework provides the basis for testing linkages between resource availability and predictability on the one hand and the marginality of the increment. The framework may also suggest why budgets sometimes have annual cycles and why budgets may be used for long-term planning. It does not provide the necessary or sufficient conditions, however, for explaining the predisposition of budget makers to award fair shares and to play certain roles. Nor does it explain why budget making tends to be a decentralized process. Although these patterns have been associated with incrementalism, they derive from other factors in the political system.

II. Incrementalist Corollaries

An alternative perspective of budgeting which is sometimes advanced is found in the argument that the most important independent variables are the rules or constitutional and statutory requirements under which budget decisions must be made (see, e.g., Schick 1980:27-30, Likens 1978, and Shepsle 1983). Chief among these are: a) the requirement in some political units for a balanced budget, i.e., that expenditures not exceed revenues; b) spending limits such that expenditures not exceed a certain percentage of some previously established level, c) entitlements, d) transfer payments, and/or e) that the

budget be internally balanced so that certain programs continue to receive given percentages of monies appropriated. There are other requirements as well such as funding of employee pensions, repayment of general obligation debts, statutory division of tax receipts, and special use restriction of other tax collections. In this view, structural limitations more than any other variables determine budget outcomes.

Wildavsky (1979:90) suggests that such rules are responses to previous uncertainty and thus are tangible accumulations of previously resolved conflict. The rules continue to be observed so long as they reflect an underlying moral consensus.

Given this insight, we can argue that the rules perspective is really a corollary to incrementalism. The rules become the base which is accepted. Although in incrementalist theory the base is conventionally thought of as a sum expressed in monetary terms, it must be understood that implicit in the sum are agreements and procedures which determine the nature of the base and which need not be rejustified each year. Where this view does differ from conventional incrementalist theory is the requirement that the base must be recalculated, if not rejustified.

Thus, we have an additional dimension of incrementalism which must be taken into account. This is the dimension of the rules or structural constraints.

A further perspective on incrementalist budgeting is found in a rather interesting analysis of Michigan's fiscal

crisis. Brazer (1982) argues that much of the State of Michigan's recent fiscal stress derives from two key independent variables: financial unpredictability deriving from the national economic recession and elite norms which he sees expressed as a determined effort by political leaders to reduce the scope and size of government programs in Michigan. Although Brazer's theory is more concerned with interpreting the causes of the recent fiscal crisis, we can recall that these are variables which Wildavsky says can also be used to explain budget behavior and outcomes. But Wildavsky also suggests that elite preferences will be translated into availability of resources, i.e., these norms will determine, in part, how much revenue is available to the state. Therefore, Brazer's argument cannot be seen as an alternative theory of budgeting. What Brazer's argument raises, however, and what Wildavsky's framework does not resolve, is which factor is more important in limiting availability of resources: the downturn in the economy or elite preferences translated into tax policies. This is a matter of empirical inquiry that goes beyond the scope of the present study.

III. The Attack on Incrementalism: Its Inadequacies in Explaining Budgetary Behavior in a Cutback Period

Is incrementalism applicable to the cutback situation? Policy analysts who have studied the behavior of those involved in the budgetary cutback process say that

incrementalism is insufficient and inappropriate to explain what is going on. Their concerns relate to several of the conceptual usages previously identified:

a) Marginality. In periods of cutback the focus of budget policymakers turns from the increment to the base (Bozeman and Straussman 1982:514, Schick 1983:2). There is more interest in zero-based budgeting (Hammond and Knott 1980:63; O'Toole 1984:21) and attempts are made to re-negotiate the base.

b) Fair Shares. Budgeting becomes more redistributive rather than distributive or proportional as is the case in growth periods (Schick 1983:23). Fair share, therefore, becomes less important.

c) Budgetary Roles and Centralization. In periods of cutback the role of the executive fiscal agency becomes more important (Bozeman and Straussman 1982:511). Negotiations between the individual departments and the legislative body become less important (Knott 1981:77).

In some cases, interest on the part of policymakers in negotiating may disappear altogether. In a study of budgeting practices in the City of Oakland, Meltsner (1971) found that instead of negotiating, policymakers faced with scarce resources practiced "politics of avoidance."

Although the search for additional revenue was constant, efforts were made to obtain it from the least politically costly sources in order to avoid conflict. Furthermore, elected officials tended to rubber stamp the decisions of the bureaucracy which, therefore, maintained effective

control over the budget. And the bureaucracy kept the peace partly by deliberately underestimating revenue and overestimating expenses.

In an analysis of recent federal budget cuts, Behn (1985:159) found that negotiation stalled for a period not only because no one wanted to accept cuts. No one wanted to be associated with proposing specific cuts. It was "'...a minuet in which no one wants to really dance.'"

d) The Role of the Budget. Schick (1980:127) argues that budget-related planning diminishes in a period of fiscal uncertainty because of the sense that events are out of control. Similarly, Caiden and Chapman (1982:118) found in an analysis of California's response to the passage of Proposition 13 that there was no commitment to facing budget problems and no systematic response to the budget crisis. Walker and Chaiken (1982) found a lack of innovative response to fiscal contraction in use of the budget.

Schick (1980:127) also argues that use of the budget as a control instrument increases during a period of fiscal stress as does Alexander (1984:2) who sees the role of the budget shifting from an instrument of legislative control over the executive branch to one functioning as a stabilizing instrument to accommodate uncertainties arising from changing legislative priorities and a shifting economy.

There have been other reasons offered for the inadequacy of incrementalism as an explanation of budgetary behavior in a cutback period:

e) Different Processes Emerge. Repetitive budgeting

(Wildavsky 1975:12), a process somewhat different from incremental budgeting, comes into use. Executive orders which mandate budget cuts can be construed as repetitive budgets. (The role of mid-year appropriations changes is not well defined in budget theory, was explicitly ignored in the early models (e.g., Davis, Dempster and Wildavsky 1966:532), and has only recently come to be addressed (Hoskins 1984).)

Similarly, a variant called revenue budgeting (Wildavsky 1975:12) may be found. Incrementalism has also been found to be less useful in describing budgetary behavior in American cities where officials have to cope with inelastic sources of revenue (because that is what state policies have provided them) and, therefore, they have little room for maneuvering. These political units cannot raise revenue to keep up with inflation and service needs. Therefore, budgeting becomes almost entirely oriented to short-term control, a maintenance activity. Cities are able to predict fairly accurately what their revenues and expenditures are likely to be; they simply never have sufficient revenue. Crecine's (1969) comparative study of budgetary practices in Cleveland, Detroit and Pittsburgh found decision making to be dominated by the revenue constraint.

f) Prior Budgets Disappear. Incrementalism has been found to be an inadequate explanation of budgetary behavior in poor countries because there is no real budget from the previous year against which to calculate the current year's.

Budgets tend to disappear and they are fragmented (Caiden and Wildavsky 1980:66).

Thus, in summary, we find that incrementalism as a description and explanation of budgetary behavior in conditions of fiscal stress is inadequate because interest shifts from the increment to the base, budgetary outcomes are less proportional and more redistributive. The budget may be passed repetitiously or disappear altogether. Instead of negotiating budget levels, policymakers may avoid conflict and turn to the bureaucracy for decisions. Contrary to expectations, the budget may be used less for long-term planning and more for short-range control. The process becomes more centralized. The arguments against incrementalism, however, have not addressed the linearity argument.

IV. Why Incrementalism May Still Work

On the other hand, there are reasons to argue that incrementalism, up to a point, will still govern budgetary decision making in a cutback era. One reason is that cutbacks are likely to be viewed as temporary. May and Meltsner (1981), studying the response of organizations to California's tax cutting Proposition 13, found that managers looked on the perceived crisis as part of the usual business and made it part of the budgetary routine. There was also a tendency to rely on budgetary quick fixes.

Another reason incrementalism may still work is that if the cuts are not substantial, cutbacks are likely to be made in the fringes of discretionary spending areas. This avoids

conflict for program managers and policymakers. We see this approach in the program budgets in some political units where program managers are asked to describe program activity at a continuation level (i.e., at 100 percent of current budget), and at a slightly decreased level (e.g., 90 percent of current budget). This tendency to deal with the problem by tinkering at the margins is one response identified by Caiden and Chapman (1982) in their analysis of local government response to Proposition 13-generated revenue losses in California and echoes the May and Meltsner findings noted previously.

In other cases, decision makers will attempt to retain fair shares in some form by recommending across-the-board cuts. Maintenance of fair shares is one means federal lawmakers used to maintain the coalition needed to pass the recent cuts in social security programs (Behn 1985).

In addition, there is some evidence (e.g., Lipson and Lavin 1980) that the strength of the political base of the program is crucial in determining which programs are cut (or saved). This suggests that negotiation is not abandoned even in times of fiscal stress, a finding also observed by Crecine (1969).

Incrementalist budgeting has always been viewed as a decentralized process. Some researchers (e.g., Levine and Rubin 1980:15) argue that fiscal stress fragments authority even more.

Finally, some observers note the increasing importance and greater impact of structural constraints on the

budgetary process during times of fiscal stress. Crecine (1969), for example, found that an important characteristic of the budget process in the cities he studied was the importance of rules, e.g., the need for a balanced budget and the need for uniform wage policies.

To the extent that efforts are made to maintain the prior commitments and rules which constitute the base, incrementalism may continue to be applicable. This is so because, while the focus of budget policymakers turns from the increment to the base, it is not done with intent to re-negotiate, but to recalculate. The structural constraints assume more importance because they take precedence. They must be served before other discretionary choices can be made.

V. Summary

In this chapter we have reviewed the arguments concerning incrementalism: its genesis, place in budgetary theory and its alleged weaknesses in periods of fiscal stress. We identified the chief criticisms leveled against incrementalism under such conditions: that the focus of decisions changes from the increment to the base and that outcomes are more redistributive, that the budgetary process becomes more repetitive and centralized, and that the classic parallel functions of the budget (planning and control) become distorted as interest in control surges and planning subsides.

We also looked at the opposing view and found that incrementalism may still be useful in analyzing budgetary

behavior in a cutback period because decision makers may view their fiscal crisis as temporary and go about business as usual or rely on quick fixes, across the board cuts, and tinkering at the margins. It was suggested that this may be especially inviting if the cuts are not to be substantial, there is some evidence that negotiations between the executive and the legislative body will continue, that the role of the more entrenched bureaucracies will continue to be influential in reaching cutback decisions, and that stress will fragment authority. Finally, the rebuttal suggested that while interest may turn from the increment to the base, it may be because the base must be served first rather than re-divided.

The following chapter presents a strategy for evaluating these arguments. It is the research design.

Chapter Three

The Research Design

I. Introduction

The study involves a two-stage analysis of the argument that incrementalism is an inadequate model to explain budgetary behavior in a cutback era. In stage one, tests are made of the linear, marginality and fair shares dimensions of incrementalist theory through quantitative analyses of budget appropriations based on the work of Davis, Dempster and Wildavsky (1974), Natchez and Bupp (1973), and Hoole, Handley and Ostrom (1979) among others.

The second stage explores in depth the response of budgetary decision makers to changing conditions of resource availability and uncertainty. Hypotheses are drawn in part from Schick's work (1980) which is a conceptual framework similar to Wildavsky's (1976) but which explicitly addresses and formulates hypotheses concerning behavioral response in adapting budgets to resource scarcity. Attention is focused in this stage on the dimensions of incrementalism which emphasize the annual cycle, budgetary roles and the centralization issue in the budgetary process, and the role of the budget itself.

Data is drawn from the Michigan State Government experience for the period, 1963-64 through 1983-84. During this twenty-one year period, state government had to recede from previous spending commitments thirteen times. And in three of those fiscal years, i.e., the period covering FY 1980 through mid-1983, the State of Michigan reduced state

spending by more than \$2.6 billion. In constant dollars, spending in FY 1982 alone was the equivalent of a drop of 21.5 percent compared to FY 1979, in some respects the last "normal" year before the most recent fiscal crisis began.

Although Michigan has not been alone among the states in facing fiscal crisis and is like 49 of the 50 states in needing to maintain a balanced budget (Yondorf and Summers 1983:16), the state has been exceptional in having to manage such severe and continuing cuts. A 1981 survey of fiscal pressures in the fifty states found that Michigan had been the most seriously affected (Comparative State Politics Newsletter 1981:1,16).

The Michigan experience is selected, in part, because it represents an extreme case which is potentially a crucial test of the budget theory propositions. According to Lijphart (1971:692), this sort of theory-confirming or theory-infirmit case study is enhanced if the case is extreme on one of the variables.

Michigan data is also selected because the level of professionalization within the legislative and executive branches is relatively high compared to other states. Therefore, we may assume that the quality of information developed and secured during the time period reflects state of the art analysis within the states and that inability to forecast revenue falls was not a product of administrative or technical incompetence. In addition, Michigan data is also selected because, as the nation's tenth largest and as an industrialized, urbanized state, Michigan has developed

the full range of programs customarily found in these more complex socio-economic systems.

Finally, Michigan data is also chosen for accessibility to this researcher. Having been a legislative staff member in the mid-1970s and having maintained contact with many individuals in the Michigan legislative and executive branches through activities with professional associations increased the likelihood that information about budgetary decisions would be available to this researcher if such data were available at all to anyone outside the budgetary process.

II. About the Data

Data was drawn from the State of Michigan General Purpose-General Fund budget for the twenty-one year period beginning with fiscal year (FY) 1963-64 through FY 1983-84. This period begins and ends in growth but incorporates three cutback periods: 1970-71, 1974-75 and the most recent and most severe, 1980-83.

General Purpose-General Fund budget data was used because it is the part of the total state budget which is subject to the discretion of the executive and the legislature. This amounts to about one-half of the total state budget. The other half is earmarked by constitutional or statutory requirement for specified purposes or programs (Cutts 1982:48).

Although budgetary data for the State of Michigan is available from several sources, an attempt was made to compile data as much as possible from a single source, the

Executive Budget. However, for two years, 1969-70 and 1970-71, appropriations data was taken from a different source, Detail of Current Operations of the Executive Budget. This alternative source was used because Executive Budget data was not available for those years. At that time the State of Michigan was in the process of adopting a program budgeting system and the reporting format was changed. Also, for the period 1969-70 to 1983-84, prior year (actual) expenditures were not reported in the Executive Budget and were therefore taken from a separate publication of the Michigan Department of Management and Budget, "General Fund General Purpose Expenditures."

Two types of budgets are in the data set: 1) the general budget adopted for each of the twenty-one fiscal years in the time period under consideration, and 2) "cutback" budgets which are reconstructions of the fiscal year budget based on the executive orders of the Governor which implemented spending reductions. There are thirteen cutback budgets in the data set. They represent three-fourths of the executive orders which were actually issued during the twenty-one year period, as five were not approved by the legislature. Thus, the data set consists of thirty-four budgets.

The data set comprises three categories of information for twenty-five administrative and funding units for each of the twenty-one fiscal year budgets. These are recommendations of the governor, appropriations approved by the legislature, and reported expenditures. For the

cutback budgets, appropriations and expenditures are reported, but gubernatorial recommendations are not for reasons discussed in Chapter Five.

The twenty-five administrative and funding units include the following nineteen executive branch departments:

- Attorney General
- Civil Rights
- Civil Service
- Commerce
- Corrections
- Education
- Executive Office
- Labor
- Licensing and Regulation
- Management and Budget
- Mental Health
- Military Affairs
- Natural Resources
- Public Health
- Social Services
- State
- State Police
- Treasury

Also included are the two other branches of state government, the legislature and judiciary; the two major funding categories for education, higher education and school aid; and debt service and capital outlay.

The data set does not include values for items which appeared intermittently in various budgets throughout the period. For example, data is not included for the Department of Transportation because that unit is largely maintained with special purpose funds, although occasionally general purpose monies have been appropriated to the department for special projects. Similarly, no attempt was made to include values for the budget stabilization fund which has received line item attention in several budgets.

In building a data set with comparable categories across the twenty-one year time period, some adjustments had to be made to account for reorganizations in state government which occurred during that time. In 1963, the State of Michigan adopted a new constitution which created some new units and consolidated a number of others into nineteen departments. Much of this was implemented with the reorganization act of 1965. A further but smaller reorganization occurred in 1973 with the creation of the Department of Management and Budget. These organizational changes are summarized in the table below:

Departments Separated Out in Data Set

<u>From (line item)</u>	<u>To (department)</u>	<u>When Created (or absorbed)</u>
Conservation, Recreation & Agriculture	Agriculture Natural Resources	1965 1965
Administration (budget unit)	Executive Office	1965
Executive Office (budget unit) Administration	Management & Budget	1973
Safety & Defense	Military Affairs State Police	1965
Public Welfare Commission on Aging	Social Services	1965
Mental Hygiene	Mental Health	1965
Fair Employment Practices Commission	Civil Rights	1963

General Government:		
State Treasurer		
Revenue Department		
Tax Commission		
Tax Appeals Board	Treasury	1965
Municipal Finance		
Commission		
State Board of		
Equalization		
Auditor General		
Commission on Inter-		
governmental	Legislature	1963
Relations		
Corporations &		
Securities		
Commission		
Insurance Department		
Liquor Control		
Commission	Commerce	1965
Public Service		
Commission		
Banking Department		
Economic Development		
State Universities		
& Colleges		
Junior & Community	Higher Education	1966
Colleges		
Employment Bureau		
Labor Department		
Labor Mediation Board	Labor	1965
Workmen's Compensation		
Board		
various items for		
professional &		
vocational boards	Licensing &	1965
Athletic Board of	Regulation	
Control		

Data pertinent to any department or fund in existence in 1983-84 was separated out in the older budgets and grouped appropriately. For example, budget items grouped under the heading of Conservation, Recreation and Agriculture in the pre-1965 budgets were separated to reflect the current departmental alignments for Agriculture

and Natural Resources. Similarly, items in the General Government category for State Treasurer, the Department of Revenue, Tax Commission, Tax Appeals Board, Municipal Finance Commission and the State Board of Equalization were grouped under the Department of Treasury.

The higher education figures do not reflect changes in organization but rather in budgetary reporting. Until 1966-67, reporting for junior and community colleges on the one hand and state colleges and universities on the other, were reported in separate sections of the executive budget.

This extrapolation affected about half (14 out of 25) of the administrative and funding units in the data base, but was primarily concentrated in the first two budget years. The principal exception was the separation out of Budget Office items from the Executive Office into the Department of Management and Budget. This extrapolation affected seven budget years. Three cutback budgets affected by that extrapolation were similarly adjusted, but the adjustments were minor because only one of the executive orders implementing budget cuts during that period actually affected the budget unit.

While the extrapolation was done carefully and comparisons made with other budget documents, particularly the Detail of State Operations and Local Benefits Budget for the fiscal years ending June 30, 1964 until this publication ceased to be produced in 1971, it is possible that this has produced some error in the data. As explained above, however, the impact is relatively small.

Although we have incurred some risk in this process, the data set produced is comparable in time-span to the sets developed to test the early incremental models at the federal level. In addition, it incorporates all of the budgetary experience up to 1984 of the State of Michigan under its current constitution.

This period also has been selected because the time period under study encompasses several different administrations with somewhat differing policy commitments. Comparing budgetary behavior across several administrations may permit identification of key political variables which influence budgetary decision making. Clark and Ferguson (as reported in Hansen 1983:231) found many differences among Republican, Democratic and reform city governments in their responses to fiscal stress.

Summary. Thus, in a cutback period, we would expect the budgetary process to be relatively less linear than in growth periods, and more redistributive. We are likely to see a greater degree of centralization with less negotiation between executive and legislative authorities, more importance attached to the executive budget agency, and to structural constraints. The process is likely to be erratic and repetitive. The role of the budget shifts from long-term planning to short-term ad hoc control.

In other words, we would expect to see changes in the budgetary process affecting at least six dimensions of incrementalism: linearity, fair shares, marginality, budgetary roles and centralization, annual cycle, and the

role of the budget.

III. Stage One

Having reviewed the methods by which the data was gathered and organized, we now need to look at the specific hypotheses and how they are operationalized. That is the focus of this section.

H₁. Linearity. The linear model is an inadequate explanation of budgetary behavior in periods of fiscal stress, i.e., there is no relationship between expenditures totals and the total appropriation as a fixed percentage of the prior budget in a cutback period.

A direct empirical test of the model first developed by Davis, Dempster and Wildavsky (1966) as interpreted by Hoole, Handley and Ostrom (1979) is made:

$$E_t = b A_{t-1} + e_t \quad (1)$$

where E = expenditure total

b = a fixed percentage of the prior budget

A = the total appropriation

e = the error term

Inclusion of the error term in this equation was originally justified by Davis, Dempster and Wildavsky because the model is not a deterministic one but is stochastic, i.e., the model makes allowance for the effect of random or unspecified influences from the environment. It was argued then that even the most routine budget process is subject to some stochastic disturbance. In the case of fiscal stress the inclusion of the error term becomes even more important.

This model is tested with three groups of data:

1) The mean percentage change for each of the 25 department/fund categories over the twenty-one year period under study is calculated. The department/fund categories are grouped by deviation from the mean. The regression model is then tested using data from the extreme groups on the far side of the mean by comparing them with all groups taken as a whole.

The size of the error term for both sets are compared. It is anticipated that the group with the larger budget cuts would reflect a larger error term than the average group, lending credence to the hypothesis that the linear model is less useful in explaining budgetary cutback decisions than in periods of budgetary expansion.

2) The model is tested by comparing all values of all departments for the twenty-one regular budgets with all values of all departments for the thirteen cutback budgets.

H₂. Fair Shares. The fair shares model is an inadequate explanation of budgetary behavior in periods of fiscal stress, i.e., there is no relationship between an agency's expenditures and a fixed percentage of the total budget for the system in a cutback period.

This second measure is the model developed by Natchez and Bupp (1973) (as interpreted by Hoole, Handley and Ostrom, 1979):

$$E_t = b P_{t-1} + e_t \quad (2)$$

where E = expenditure total

b = a fixed percentage

P = the total budget for the system

e = the error term

This model is based upon the "fair share" or prosperity argument. In this model, budget decisions are seen to be reflections of attitudes that agencies ought to receive some appropriate share, i.e., a fixed percentage, of the total available to the system.

This model is thought to be especially useful in analyzing zero-sum conditions such as declining or constant budgets (Hayes 1975, Gist 1982). One reason, of course, is that in periods of cutback, budgeting is thought to become more redistributive rather than distributive (Schick 1983: 23) because:

- H_{2a}. Retrenchment is directed at the most vulnerable parts of the budget such as discretionary programs like libraries and museums, maintenance, and administrative overhead (Schick 1980: 127), and
- H_{2b}. Those programs with the strongest political bases are least likely to be cut (Lipson and Lavin 1980), i.e., redistributive in the sense that the powerful get richer and the weak get poorer.

It is also argued (Gist 1982: 871) that this approach provides a bridge to research which focuses on the broader policy consequences of budget allocations.

In this model, the shares or expenditures of each department in the regular budgets are compared with the shares received in the cutback budgets. Comparison is made of the goodness of fit for the combined budgets which are captured in the simple model with the regular and cutback budgets which are evaluated in the complex model. This tests the argument concerning redistribution.

The subsidiary hypotheses require differing analyses:

a) Line-item budgets of three departments representing highest, mean, and least cuts are inspected and compared across the thirteen cutback budgets. It is anticipated that the discretionary parts such as maintenance and capital funding will show proportionately deeper cuts as the departments in this distribution show increasing cuts.

b) We would expect that:

- ° constitutionally established units such as the legislative and judicial branches, would receive proportionately smaller cuts compared to the executive branch.
- ° executive departments headed by elected officials such as the attorney general and secretary of state would receive proportionately smaller cuts.
- ° executive branch departments such as mental health and social services which serve less organized and less affluent groups would receive proportionately more cuts.

In testing these models, the analysis needs to confront the issue of the repetitive adjustments, or in this particular policy issue, the numerous executive orders mandating budget cuts. For the purpose of testing these two hypotheses, each executive order will be treated as restructuring the annual budget which it, in effect, amends. Therefore, each order is interpreted as constituting in the revision a new budget, just as a substantive amendment to a statute creates a new law.

This position may be justified under the following assumptions because:

1) the executive orders are subjected to joint, albeit truncated, action of both the executive and legislature and are handled in much the same way the original appropriations are treated (Legislative Service Bureau 1987:8).

2) in reviewing the proposed budget cut, an implicit if shortened review of the entire budget takes place.

3) the orders are analyzed in the order in which they occurred, and

4) there is nothing in the assumptions of the statistical analysis which requires sampling at specified intervals, only that the data entered reflects comparable decision points.

In testing these models, the analysis also needs to confront the issue of the gubernatorial line item veto. This is a power provided governors in over eighty percent of the states, including Michigan, but which is not permitted the President of the United States. Since most of the budgetary models were developed with federal-level data, the issue of the line item veto does not arise.

Since, in Michigan, the legislature does have an opportunity to override the line-item veto (provided the bill is repassed by a 2/3 vote of the members elected and serving in each house) we argue that the appropriation as finally reported to the State Administrative Board, the body charged with allotting the monies appropriated to the various branches and agencies of government, and reported

in subsequent executive budgets is the appropriation as signified in the equations.

It is also arguable that the analysis needs to consider within-year departmental requests for allotment revisions and legislative or administrative transfers. That will await further research.

Each of these models are assessed by goodness of fit and comparisons are made within subsets of each model and, in a more limited fashion, across the two, i.e., across the linear and fair shares models. A sophisticated falsificationist approach after the work of Lakatos (1970; see also Tucker, 1982) is taken. The size of the correlation coefficient and of the error term for the cutback budgets are compared to values reported for the regular budgets. It is anticipated that the goodness of fit for the cutback budgets will not satisfy predicted levels.

H₃. Marginality. Marginal change to the previous year's budgetary base is an inadequate description of budgetary outcomes in a period of cutback, i.e., expenditures will not be closely associated with a fixed percentage of the agency's budget for the prior year.

Operationalizing this hypothesis requires two different tests:

a) Magnitude. The test for degree of change is the same as the test for Hypothesis 1, but attention is focused on the change in the size of the regression coefficient and its standard error. We would expect the marginal coefficients in the cutback budgets to be smaller and to have a greater error term compared to those of the regular

budgets if the incremental model has less predictive value for the cutback period.

b) Interest in base. Testing this part of the hypothesis requires analysis of three subsets of questions:

H3b₁. In periods of cutback the focus of budget policymakers turns from the increment to the base (Bozeman and Straussman 1982: 514, Schick 1983:2).

If this is the case, we would expect to see statistically significant base changes in the linear model. This would be especially persuasive if the significant base changes are accompanied by smaller marginal changes.

We would also expect to see increased demand for zero-based justification for programs (O'Toole 1984:21). Here, analysis focuses on the most recent and severe cutback period. Interviews are conducted with key executive and legislative figures to determine whether:

- ° Management plan documentation requirements changed during 1981-83, a period characterized by several cutback budgets, compared to the pre-recessional period to require additional program explanation.
- ° Briefing papers prepared for legislative appropriations subcommittee hearings during the same period contained additional program explanation compared to prior years.

We would also expect:

H3b₂. The response of budget policymakers to follow a discernible path, proceeding from an initial stage of disbelief in which there is an attempt to maintain business as usual (May and Meltsner 1981) or to resort to quick fixes, followed by later stages in which there is more serious concern with the base.

Here, analysis also focuses on the most recent and severe cutback period. Content of selected news reports from major Michigan newspapers and news services, together with interviews of key policy makers, are the primary documentation for data analysis.

Finally,

H_{3c}. As the attention of policymakers becomes more absorbed in the base, we would expect the role of structural constraints to take on increasing importance.

Operationalizing this aspect of the hypothesis is somewhat more problematical. As Caiden (1984:116) observes, interpretations of what constitutes the base vary considerably especially when actual figures for preceding year expenditures are unknown and there is disagreement about how much and whether to factor in a percentage for inflation.

Nevertheless, if we regard the base as a collection of rules or constitutional, statutory and procedural requirements which are or may be intervening variables affecting budget decisions, we may find the following measures useful:

- We would expect to see attempts to secure constitutional protection of program budgets and fund allocation.
- We would expect to see greater use of certain procedures such as unit voting rules to secure passage of budgets.

Behn (1985) notes that the adoption of

all-or-nothing voting procedures was one means by which Congressional leaders managed to keep the coalition needed to secure passage of federal budget cuts in 1981. The anthropologist Malinowski (cited in Marz 1978) also discusses the importance of rules and ritual in times of uncertainty.

- ° The need to serve the primary rule in state budgeting, the constitutionally mandated balanced budget requirement, would be increasingly evident through a larger number of executive orders to implement budget reductions.
- ° Where special funds and allocations are protected, we would expect to see greater incidence of judicial activity and advisory opinions concerning attempts to circumvent such protections.

IV. Stage Two.

In this stage we explore further dimensions of the response of budgetary decision makers to changing conditions of resource availability and uncertainty. In this stage of the analysis, focus is also on the more recent experience.

- H₄. Annual cycle. There is no timely relationship between authorization of expenditure and actual programming of funds. Payments and transfers to operating units become erratic.

This is operationalized in two ways:

- a) A time index of payment transfer to key funds such as the school aid fund is developed and comparison will be made between the periods 1977-79, a growth period, and

1980-83, a cutback time. It is anticipated that the 1980-83 period would show considerable volatility compared to the earlier period.

b) Wildavsky's framework predicts that in periods of cutback there is greater incidence of repetitive budgeting. In other words, the annual cycle is interrupted by the need to recast the budget. The incidence of executive orders mandating expenditure change in the cutback period is compared to the incidence of such orders in the growth years.

H5. Budgetary Roles and Centralization. There is no relationship between expenditures and the roles traditionally exercised by budget decision makers in a cutback period.

Evidence from the literature is divided on this question and presents something of an interesting crucial test. On one hand, Levine and Rubin (1980:15) argue that under stress, the strategies of budgetary politics weaken central control just when it is needed most. They say scarce resources fragment authority. On the other hand, Bozeman and Straussman (1982:511) say that in periods of cutback the budgetary process becomes more centralized.

Operationalization of this hypothesis requires several different measures:

a) If the budget process becomes more centralized we would expect to see the role of the executive fiscal agency become more important. In such a case we would expect to find:

- more directives on various aspects of the budget

process emanating from the executive budget office.

- ° complaints in the press and elsewhere of unilateral decisions being taken by the fiscal agency.
- ° negotiations between the individual departments, lobbyists and the appropriations committees assuming less importance: there are likely to be fewer hearings and, for those that do occur, briefer hearings.

Individuals serving legislative liaison positions in the various departments are likely to be told to channel their communications through the executive fiscal agency.

- ° Statements by legislative fiscal agency personnel that they routed their inquiries on proposed expenditures to executive fiscal agency personnel rather than to departmental program managers as they would do in normal periods.

b) Statements by program managers that they were reluctant to assume any greater involvement in the budget process.

c) Statements by lobbyists that legislators were less interested in listening to their positions.

H₆. Role of the Budget. In a cutback period there is no relationship between expenditures and traditional uses of the budget for planning, management and control.

Operationalization of this hypothesis also requires several different measures:

- a) Schick (1980:127) argues that budget-related

planning diminishes because of the sense that events are out of control. If this is the case we would expect to see decreased and/or delayed completion of management program documentation for forthcoming budgets, particularly during the period April 1-August 1 when such activity normally takes place.

b) Caiden and Chapman (1982:118) found no commitment to facing budget problems and no systematic response to budget crisis. If this is so, then we should find:

- ° incidence of "creative accounting" procedures reported in the press and elsewhere.
- ° incidence of quick fixes such as use of special purpose funds to balance the budget reported in the press and elsewhere.
- ° statements from national bond rating agencies that the state is not facing fiscal responsibilities.
- ° no changes in overall fiscal forecasting procedures, budget monitoring and program management documentation.
- ° no overall fiscal policy changes such as tax innovation or disengagement from identifiable expenditure programs.
- ° discussion in legislative appropriations committees centered on remediation rather than reform.

In order to test these hypotheses interviews are conducted with major executive, legislative, and interest group figures. Although these individuals are identified initially by the positions they occupied during the period

1977-1984, it is expected that some will have changed positions during that period and thus will be able to bring some comparative perspective to their observations. In addition, it is expected that some will have occupied these or related positions prior to 1977 and their longer view will also enrich the analysis.

The virtue of this research design is that it builds on established theory and incorporates quantitative as well as qualitative tests of the data. Its most conspicuous weakness is that it tests data drawn from a single state and thus lacks overall comparative quality. However, by using a longer time frame and drawing on the entire state general fund general purpose budget comprising more than a score of budget categories, many useful sub-comparisons can still be made.

The following chapter takes us from the archive and our research design to the field. Here we will look at the research setting, that complex reality where theory is formulated and tested.

Chapter Four

The Michigan Case

In the previous chapters we presented a problem for budgeting theory which is implied in cutback practices. Chapter One outlined the problem and presented an argument why this question might interest political scientists. A summary of pertinent budgeting literature, particularly the principal attack on incrementalism and some rejoinders as they pertain to the cutback problem, followed in Chapter Two. Chapter Three described a strategy for researching this question.

In this chapter we turn to the research setting, the environment which spawned interest in this particular research problem. That environment is state government in Michigan, the Great Lakes State, the union's eighth largest by population (Lane 1985:642) and home of the automobile capital of the world.

As we suggested in the previous chapter, in many ways Michigan is an extreme test of the propositions, a very good case study for cutback budgeting. While the federal government, among others, merely slowed the growth of programs in the early eighties, Michigan actually reduced spending. Expenditures were lower in 1982 than they were in 1979.

Wildavsky says that lack of resources and uncertainty of their availability fundamentally affects budgetary behavior. Michigan experienced both, but particularly the latter, in large doses.

Besides these, however, Michigan has a rather large number of restrictions on its distribution of public money. These present an interesting magnification of the influence of structure on budget cutbacks and may tell us something about their utility. At a time when pressure is mounting to adopt similar constraints at the federal level (but evidence from abroad suggests that loosened constraints may be a better alternative--Schick 1988), examining the Michigan response is especially appropriate and timely. Our analysis begins with the basic document, the budget.

I. The Budget

According to Michigan law, a state budget is "a financial program to deliver state government services" (MCLA 18.1304). As a preeminent scholar of state budgeting explains, a state government budget is "a financial plan reflecting the dollar costs of state program activities for a given fiscal period. The budget shows the monetary input required to provide specific services and to accomplish various goals and objectives as relates to public policy" (Howard 1973). In Michigan, the state budget is "a complete financial plan and encompasses all revenues and expenditures, both operating and capital outlay, of the General Fund, special revenue funds, and federal funds for the twelve-month period extending from October 1 of one year to September 30 of the next." (Legislative Service Bureau 1987:1)

Historically, Michigan has been legally obliged to budget the spending of its revenues since the passage of

the Budget Act of 1919. Adopted as part of the "Good Government" reform movement which energized public administration in the early part of this century (Press and VerBurg 1983:7-9), the Michigan response came after the famous Taft Commission Report of 1912 which identified the need for a national budget but before Congress finally passed the Budget and Accounting Act in 1921 (Hyde and Shafritz 1978:iii).

A. State Constitutional and Statutory Requirements (1)

Like all state government budgets, the Michigan budget is developed according to a mixture of constitutional and statutory mandates and court opinions interpreting them. These mandates tend to structure the budget in ways that, over the years, have become more and more tightly defined. Chief among the Michigan requirements are that:

- ° the governor submit an annual budget to the legislature (Michigan Constitution of 1963, Article V, Section 18),
- ° surpluses or deficits in any year must be part of the budget of the following year (Article V, Section 18),
- ° the general budget must be passed by each house of the legislature before any supplemental spending may be approved and part of it must contain an estimate of revenues (Article IV, Section 31),
- ° the budget must be balanced as proposed by the governor, as approved by the legislature, and must remain in balance during the fiscal year such that if anticipated revenue levels are not realized, corresponding mid-year spending reductions must be made (Article V, Sections 18 and 20 and

Article IV Section 31),

- ° total spending levels proposed in the budget may not exceed certain limits and must be internally balanced so that local units of government continue to share a fixed percentage of whatever revenues are available generally throughout the fiscal year (Article IX, Sections 26-28), (2) and
- ° any change in the formula establishing state spending limits must be approved by a vote of the people (Article IX, Sections 26-28).

In addition, there are other limitations: revenues from sales taxes (four percent) are largely reserved for local units of government, with only about 25 percent available to the state General Fund. The sales tax can only be raised by a vote of the people (Article IX, Sections 8, 10 and 11). The income tax is a flat rate. Any "graduation as to rate or base" is prohibited (Article IX, Section 7). Transportation-derived revenues such as gas and weight taxes are restricted for transportation purposes (Article IX, Section 9). Any long-term borrowing must be approved by a two-thirds vote of each house of the legislature and a vote of the people (Article IX, Section 15). Short-term borrowing, i.e., that which would be repaid by the end of the fiscal year, cannot exceed 15 percent of the previous year's unrestricted revenues (Article IX, Section 14) (3), (4).

Still further limitations exist including constitutional protection of the public employee pension and

retirement systems funds which precludes their use for financing other "unfunded accrued liabilities," (Article IX, Section 24). There is a provision which guarantees (but in practice is never fully tapped) the Civil Service Commission funding up to one percent of the previous year's state payroll. By statute, there is required funding of the Working Capital Reserve Account (Michigan Compiled Laws--MCL-- Section 21.451) and the Budget Stabilization Fund (MCL 21.401). More will be said about the stabilization fund later.

Finally, there are structural constraints which shape budgetary implementation, particularly cash-flow. One of the most significant is the disparity in timing between tax collection and state payments. School aid payments, for example, must be made on the first day of the fiscal year (October 1), but payments for some taxes are not due until October 15. Therefore, when reserves were short, Michigan has resorted to short-term borrowing to cover the cash gap.

B. Federal Requirements

Another important feature of the state budget are those federally supplied funds which become part of the total state budget. The distribution of those funds is also mentioned below in Section III of this chapter. The point to be made here is that most of the federal funds coming into Michigan are targeted for specific purposes and may not be used to other purposes (House Taxation Committee 1983:1).

C. Summary

This description summarizes the limitations which were

in place at the end of the study period, the fiscal year 1983-84. They include two major constraints which were implemented toward the end of the period under consideration: creation of the Budget Stabilization Fund in 1977 and passage of the Tax Limitation Amendment in 1978, both of which resulted from prior pressures on the budget in the recession of 1974-75 and its policy outwash.

It is apparent from the outset that structural constraints are built into the process. They shape the overall size of the budget and control the disposition of shares vertically between the state and its constituent local units and horizontally among some of the funds and departments. They dictate to some extent the timing and process of budget development. And, as we shall see, they are critical factors in shaping the response of policymakers to fiscal crisis.

II. The Budget Process: The Cycle

In the view of one legislative research unit, creation of the state government budget is "one of the most important activities performed by the legislative and executive branches of Michigan government each year" (Legislative Service Bureau 1987:1). It is also, as one veteran legislator has observed, "a year round activity" (Jacobetti 1986:97).

A useful way to conceptualize the budget process, one found throughout the budgeting literature, is to describe budget building as a cycle. That approach will also be used here.

A. Development of the Executive Budget

Although, as previously noted, the fiscal year in Michigan runs from October 1 through September 30 of the following year, development of the budget for that fiscal year actually begins about eighteen months prior to October 1 (House Fiscal Agency 1986, Legislative Service Bureau 1987). At that time the Department of Management and Budget (DMB) develops economic assumptions and fiscal forecasts for the governor who uses this information in discussions with the DMB Director and executive staff regarding prospects for the budget and corresponding policy implications. On the basis of this information, DMB issues guidelines and instructs the various agencies of state government to begin work on their section of the budget.

During this time, units of the legislature, particularly the House and Senate Fiscal Agencies, are preparing their own forecasts and comparing their analyses with that of DMB. And the various committees of the legislature are reviewing programs of the state agencies in a continuing, but varying pattern of oversight.

What the agencies begin to do is to prepare management plans. These are the building blocks of the overall budget. Management plans are based on a review of current operations, future plans and program objectives within each department. They include descriptions and justifications of programs, identification of resources needed to sustain those programs, and information about program performance over the past five years and projected levels of activity

for the pending budget period.

Most importantly the management plans rank programs according to priority. The ranking identifies each program by name and shows how many employees and dollars are needed to sustain it. There is a parallel list which shows the cumulative effect in terms of needed manpower and money to sustain each added program. The approach here, of course, is to provide decision makers information on what aspects of a department's program would be cut if a reduction were to be made (Office of the Budget, n.d.). Those familiar with the budgeting literature will recognize this as a modified form of zero-based budgeting. (See, for example, Hammond and Knott 1980).

Once the management plans are developed and submitted to the DMB, budget analysts review the plans and hearings are held to learn more about the proposals and their budgetary implications. Comparisons are made with revenue estimates. There are on going consultations among staff of the various departments, the legislature and DMB's Budget Office. This phase lasts about six months and by October an interim budget is prepared.

By this time the governor begins a series of meetings with department directors to discuss the implications of their budget proposals. More hearings are held to review the interim budget recommendations. Legislative fiscal agency personnel attend these meetings and report their observations to members of the appropriations committees of the House and Senate. The governor's decisions are conveyed

to the Director of DMB who then discusses these developments with the departments and prepares a final budget recommendation for each.

By early December the governor makes final decisions about budget limits for each department and work begins on drafting the governor's budget message which, according to law, must be submitted to the legislature within ten days after the regular legislative session begins on the second Wednesday of January. The budget message of the governor typically follows in a very short period the State of the State message which provides the policy backdrop for the budget particulars yet to come. The budget message, in turn, is buttressed by the Executive Budget, a document about as large as a telephone book of a mid-size city.

B. The Legislative Response

The executive budget proposals, like all proposed legislation, are translated into bill form and introduced into the legislature for discussion. They are usually introduced in both houses (5) and in each case by a member belonging to the political party of the governor. (6) By convention, about fourteen bills are introduced, one each for the largest departments and funds, one for the two public safety departments (State Police and Military Affairs), one for what are considered the three regulatory units (Labor, Commerce, and Licensing and Regulation) and one for the general government units including the Judiciary, the Executive Office, the Legislature, Treasury, State, Management and Budget, Attorney General, Civil Rights

and Civil Service.

During the months of late winter and early spring, the legislative appropriations subcommittees hold hearings on the budget proposals (7). The general form in which they are first presented is gradually modified with detail as legislative fiscal and legal staffs expand and check information in the proposals (Legislative Service Bureau 1984:6) (8). Representatives of all agencies including those from the DMB are called to testify, agency representatives to justify their program requests and DMB personnel to explain overall budget and revenue projections as well as the governor's policies. Once subcommittee recommendations have been made, they are transmitted to the full appropriations committee for review. Generally, the subcommittee recommendations are accepted by the full committee.

Once passed by the appropriations committees the bills are subjected to floor debate in both houses like any other bill. Both houses must pass the bills and the recommendations of the appropriations committees are usually not changed much in floor debate. During this time, however, DMB may revise the governor's recommendations to accommodate new information or resolve political pressures. These changes become part of the legislative debate and may result in changes in the bills at any point prior to their passage. Disagreements in the House and Senate versions are resolved in a conference committee and its report must be adopted by both houses.

The consequence of this particular bill process means that the budget proposals receive their most critical review in the appropriations subcommittees where the effects of member seniority and tenure combine to ensure that subcommittee members, particularly the chairpersons, become well-informed specialists, sometimes even advocates, in their policy subfield. This process also means that the conference committee becomes the forum where the final disputes are really resolved.

In Michigan the legislative rule of thumb is to try to pass the package of budget bills by July 4, but this is not always realized. However, once the bills have been passed by both houses they are forwarded to the governor who may approve, veto, or use the selective line-item veto mentioned previously. During the period 1974-1983, the governor vetoed, on average, line items in thirty percent of all appropriations bills passed by the legislature (Legislative Service Bureau 1987:5). Of course, vetoed items may be subjected to a legislative override but that occurs rarely in Michigan politics.

It is also important to note that the budget bills by constitutional mandate must be taken care of before the legislature may consider any appropriation bill for items not in the budget except for supplemental appropriations for the current year's budget. By legislative rule, any bill containing or implying an appropriation must be referred to the appropriate appropriations committee. In recent years, the appropriations committees have considered about ten

percent of all bills introduced (Morris 1979:19-21).

The effect of this process as described so far means that in normal times, the governor and the governor's deputies in the executive branch have most control over the budget in its formulation stages and the legislature in its adoption. This is no great surprise as this is the way the system was designed to function in budget building. It is important to keep in mind, however, as analysis later turns to the process of budget renovation.

In addition, those familiar with the comparative budgeting literature (see, e.g., Schick 1986, 1988) will recognize that this budget development process is not the conventional bottom-up approach seen in many places where program demands are first factored in by the constituent departments and total cost is only realized when all appropriations bills are summed. Instead, it is a rather sophisticated technique of infusing program driven bottom-up spending needs into a casing of top-down fiscal policy. This is not to say that this entire process was in place during the entire time-span of the study. Indeed, as discussed in later chapters and Appendix B shows, parts of it were developed at different stages, some in direct response to early fiscal crises. But most was in place when the great crisis occurred in the early 1980s.

Once the budget bills are signed into law, DMB reviews the appropriations and prepares allocations for each agency. Allocations may be distributed only after approval of the State Administrative Board, a statutory and largely

invisible component of the process composed of the Governor, Lieutenant Governor, the State Treasurer, Secretary of State, Attorney General and the Superintendent of Public Instruction (Michigan Compiled Laws Annotated--MCLA 18.1145).

At this point the budget shifts into an implementation stage. The fiscal year for which the budget was developed now begins.

C. Budget Modification

Even though the budget is now a public law and is being actively implemented, it can still be amended like any other law. There are rules for that process as well.

1. Supplemental Appropriations

Generally, if extra monies are available or if unforeseen needs arise and funds must be redistributed, supplemental budget bills may be passed but they are subject to all of the limitations and procedures just described. In all, the legislature may pass an average of six to seven supplemental appropriation bills a year (Senate Fiscal Agency 1985:39-42). During the period 1969-70 through 1983-84, supplemental appropriations ranged from nine to almost \$400 million and averaged about \$112 million or about three percent of the total General Fund-General Purpose Budget.

As we can see in Table 4.1 the supplemental appropriations fluctuate considerably over the period. Their peaks tend to coincide with the recession periods of 1970-71, 1974-75 and 1980-83 when budgetary adjustment were

Table 4.1

Supplemental Appropriations
as a Percentage of
Total Appropriations
in the General Fund-General Purpose Budget
(in millions of dollars)

Fiscal Year	Supplemental Appropriations	Total Appropriations	Percentage
1969-70	9.50	1,516.82	.63
1970-71	76.30	1,767.63	4.32
1971-72	24.90	2,068.74	1.20
1972-73	78.01	2,416.09	3.23
1973-74	14.70	2,822.22	.52
1974-75	42.60	2,965.72	1.44
1975-76	22.44	3,079.87	.73
1976-77	77.10	3,502.55	2.20
1977-78	99.00	3,983.70	2.49
1978-79	24.40	4,263.01	.57
1979-80	205.40	4,817.62	4.26
1980-81	75.00	4,545.13	1.65
1981-82	389.10	4,968.60	7.83
1982-83	392.70	4,940.99	7.95
1983-84	151.10	5,333.30	2.83
Average	112.15		2.79

Source: State of Michigan. Senate Fiscal Agency
Statistical Reports of 1982 and 1985 and
Department of Management and Budget
Expenditure Reports.

more likely to be needed. They are a kind of mirror of as well as integral to the cutback process. Thus they are another index of the way environmental uncertainty plays itself out in budgeting.

among the agencies and funds. If redistribution is needed within an agency, the agency must secure approval of both appropriations committees and the budget director (MCLA 18.1393). Once the transfer is approved, DMB forwards the requested allotment revision to the State Administrative Board for approval. In either case, additional rules and conditions govern the process.

2. The Executive Orders Mandating Spending Cuts

One of the conditions that may trigger the need for a supplemental appropriation bill is the executive order mandating a budget cutback. Executive orders are issued by the governor generally for one of several reasons. According to one conceptualization by the Legislative Service Bureau these are: 1) reorganization of the executive branch, 2) response to emergencies, creation of and/or appointments to 3) administrative and 4) advisory bodies, 5) quasi-judicial and other purposes, and 6) spending reductions. It is the last category, the executive orders which mandate spending reductions, which interests us here.

As the Constitution of 1963 states, "no appropriation shall be a mandate to spend". This section goes on to require that,

"The governor, with the approval of the appropriating committees of the house and senate, shall reduce expenditures authorized by appropriations whenever it appears that actual revenues for a fiscal period will fall below the revenue estimates on which appropriations for that period were based. Reductions in expenditures shall be made in accordance with procedures prescribed by law. The governor may not reduce expenditures of the legislative and judicial branches or from funds constitutionally dedicated for specific purposes."

According to comment by the convention which wrote it, this section was new in the history of Michigan's constitutional development. It was written to ensure joint control by both executive and legislature over state expenditures, but to give the legislature the last word on fiscal policy (MCLA, Art. 5, Section 20).

Because the balanced budget requirement must be honored during the implementation as well as during the proposal and adoption stages of the budget cycle, there are occasions when the governor must retreat from previously agreed upon spending levels. That process is also defined in statute (MCLA 18.1391) and the procedure resembles the way a transfer is approved for a spending change within a department, even though the recommendation may cut across many departments and funds. The constitution makers clearly thought that arriving at a spending cut should be easier than securing permission to spend more. Some would further argue they also recognized that spending cuts are the result of financial emergencies and some increased power on the part of the governor to respond promptly to such emergencies might be reasonable.

When it appears that revenues will fall short of

expected levels, the governor must ask the budget director to recommend budget cuts. According to the constitution, these may come from anywhere except "the legislative and judicial branches or from funds constitutionally dedicated for specific purposes" (Article V, Section 20).

The recommendations can be either "direct or open-ended" and are presented to a joint meeting of the appropriations committees. Once the recommendations have been made the committees must reach a decision within ten days. A majority vote of the members elected and serving on each committee is needed for approval. If the order is not approved, the governor has thirty more days to develop another recommendation.

Because the appropriations committees can only accept or reject the proposed spending cuts, i.e., they cannot amend them as they would a normal budget bill, the need to negotiate and make preliminary agreements is great except, perhaps, in those cases when the executive order is a deliberate trial balloon. More will be said about this aspect of the cutback process in Chapter Seven.

Since the Constitution of 1963 went into effect, the governor has issued eighteen executive orders implementing expenditure reductions, five of which were not initially approved by the appropriations committees but which were ultimately passed after revision and resubmission. These orders are summarized in Table 4.2.

Although the executive orders are analyzed in detail in Chapters Five through Seven, some introductory comments are

Table 4.2

Executive Orders Implementing Budget Reductions 1963-1983 **
(in millions of dollars)

Number	Date	Status	Total Cut	--Department and Fund Budget Categories--													
				AG	ATT	CR	CS	COM	COR	ED	EXE	HED	JUD	LAB	LEG	L&R	
1970-17	11-17-70	Approved	41.00							2.80	.10	2.80					
1971-03	02-18-71	Approved	38.30							1.32							
1971-06	06-02-71	Approved	10.00														
1974-10	12-04-74	Rejected	66.93	*	*	*	*	*	*	.70*	*	7.53	*	*	*	*	*
1974-11	12-16-74	Approved	78.20	*	*	*	*	*	*	.70*	*	7.53	.37	*	.50	*	*
1975-02	03-04-75	Approved	31.50														
1975-11	10-29-75	Rejected	149.50	.46	.23	.20	.15	.13	.15	1.02	.05	7.47		.12		.54	.54
1975-12	12-09-75	Approved	123.70	.58	.26	.23	.17	.20	.20	1.16	.06	7.51		.19		.08	.08
1980-03	05-28-80	Approved	97.50	.37	.24	.15	.10	.55	.73	.86	.05	8.90	.59	.62	.62	.15	.15
1981-07	09-16-81	Rejected	125.90	1.10	.48	.02	.16	.90	.94	1.23	.05	31.23	.71	.53	.80	.70	.70
1981-08	09-30-81	Approved	101.80	1.10	.48	.02	.16	.90	.94	1.23	.05	21.49	.71	.53	.80	.70	.70
1981-09	10-22-81	Approved	270.00	4.00	.50	.40		2.90	4.00	2.30	.20	26.29		10.00		1.50	1.50
1982-03	03-07-82	Rejected	451.00	1.12	.87	.45		1.04	6.99	1.42	.15	166.88		1.37		.85	.85
1982-04	04-07-82	Approved	308.00	1.60	1.00	.53	.40	2.60	7.70	1.60	.15	80.00		1.50		1.10	1.10
1982-06	05-20-82	Approved	50.00	1.20	.22	.05		2.40	.10	.25	.04	7.30		1.50	1.17	.35	.35
1982-11	09-01-82	Rejected	150.00									39.00					
1982-13	09-15-82	Approved	150.00									39.00					
1983-05	03-30-83	Approved	225.00	1.70	.30	.15	.69	4.60	5.20	2.30	.05	29.50		6.00		.50	.50

**The executive orders are not published as a separate document. They have been photocopied and collected in a loose-leaf binder by the Legislative Service Bureau Reference Library.

*Denotes across-the-board cuts. Amounts for particular executive orders are described in the notes following.

Table 4.2, continued
Executive Orders Implementing Budget Reductions 1963-1983**
(in millions of dollars)

Number	Department and Fund Categories													Notes
	DMB	DMH	MIL	DNR	DPH	SCH	DSS	ST	POL	IRS	DS	CO	REVSHR	
1970-17						12.30						13.90		1
1971-03	.08					24.96					2.40	5.97		2,3,4
1971-06						10.00								
1974-10	*	3.60*	*	1.32*	.72*	20.24	*	.15*	.27*	*	.10	32.30		5
1974-11	*	*	*	1.70*	.57*	16.74	*	.05*	.27*	*	.10	36.25		6
1975-02						11.00			1.50		4.00			7
1975-11	.79	8.19	.20	1.16	2.71	47.45	57.51	.11	3.86	.26		7.77	9.10	8,9
1975-12	.90	6.83	.23	1.33	2.89	40.48	37.98	.12	4.64	.65		5.36	12.10	
1980-03	.98	4.43	.13	.89	1.38	35.00	12.34	.18	.08	.34		3.90	23.00	10
1981-07	1.90	3.50	.05	1.46	4.40	17.60	21.40	1.00	3.00	1.50	4.23		27.00	
1981-08	1.90	.20	.05	1.46	4.40	6.60	21.40	1.00	3.00	1.50	4.23		27.00	11
1981-09	4.00	9.00	.50	5.50	5.00	15.30	152.00	4.00	4.50	.10			18.03	
1982-03	2.11	24.04	.33	2.03	4.29	34.90	36.89	.84	12.18	.98			58.10	12
1982-04	2.60	24.20	.35	2.40	6.30	.86	48.30	1.40	15.50	6.60				13
1982-06	1.10	3.00	.05	.50	2.50	8.40	10.00	.10	.10				9.68	
1982-11						72.30							38.70	
1982-13						72.30							38.70	
1983-05	4.10	17.90	.25	4.20	6.50	25.00	69.50	1.20	5.00	.50		25.00	15.00	14

Notes to Table 4.2

1. Total cuts reported are those identified at the beginning of each executive order and may not completely tally with values in the component calls as some were computed by formula and, in all cases, values were rounded. This executive order also mandated the Liquor Control Commission to defer payments to vendors by one month.
2. This executive order stated that a concurrent executive order would require an additional across-the-board one percent lapse of remaining allotments for the final three months of the fiscal year totaling \$1 million, but there is no record that the order was implemented. Therefore, this lapse was not taken into consideration in this study.
3. The Department of Social Services was also directed to reduce Medicaid payments to physicians by ten percent for the final four months of the fiscal year. The total amount was undetermined and thus was not considered in this analysis.
4. As explained in Chapter Three, debt service was combined for the purposes of this analysis with grants and transfers.
5. This order also asked agency heads to curb expenses under their control and to develop plans for a two percent across-the-board cost reduction.
6. The orders described in note 5, above, were also repeated in this executive order. Although a rough calculation at two percent would more than double that amount, those across-the-board cuts were stated to amount to \$13.4 million which brings the actual total to slightly above \$78 million. Where an asterisk appears beside a number, this means that specific program cuts in that amount were mandated in addition to the across-the-board cuts in administration and operations.
7. In this order, "heads of all principal departments" were asked to plan for further reductions totalling \$15 million, bringing the total to about \$31.5 million. As the order did not specify the distribution, details do not appear above.
8. In this executive order as in several others, cuts were targeted at specific programs as well as at general administration. For the purposes of this table, all cuts affecting a single department are totalled together.
9. This executive order also mandated a formula cut in the final state aid payment to community colleges. This worked out to about \$1.41 million.
10. This budget cut also called for reductions in spending for transportation and automatic data processing, budget categories not included in this analysis.
11. The reduction in DS is applied to grants and transfers only.
12. This order also proposed to cut \$93.34 million from the State Employees and Public School Employees Retirement Fund state contributions, a recommendation which also appeared, but in larger amounts, in the following order.
13. This executive order included 2.4 percent cuts in classified salaries, wages and retirement benefits for all employees of executive branch agencies including the Department of Transportation. In addition, \$5.6 million of the cut in Treasury funds were state funds for the gubernatorial campaign which reverted to the general fund five weeks before the November 1982 election. Also, attempts spelled out in this executive order to change assumptions on which the state funded the State Employees and Public School Employees Retirement systems in order to cut \$101.68 million were subsequently quashed.
14. This order also included cuts in the Department of Transportation, a budget category not in this analysis.

appropriate here. Of the thirteen orders which were approved by the legislature, the average total cut was about \$116 million, almost mirroring the average annual supplemental appropriation.

The average reductions per budget unit range in size from \$90,000 absorbed by the Governor's Executive Office to the more than \$50 million taken from the Department of Social Services. The average across all units is slightly more than \$6.5 million.

In scanning Table 4.2, we can see that the reduction orders either tended to focus on a few units or to cut across almost all. It is the latter which is most prevalent. Over sixty percent of the orders affected twenty or more units. The units which received the most consistent attention were higher education and school aid. While the modal frequency of cut per budget unit was eight, higher education was cut eleven out of thirteen times and school aid, twelve.

A more interesting comparison of the orders which were initially rejected with the finally approved versions is found in Chapter Seven. It appears as part of the analysis of budgetary roles and centralization in fiscal crisis.

D. Summary.

Budgeting is an established part of the policy process in the State of Michigan. Its nature is cyclical, spanning parts of three years in its development, adoption and implementation. As with much legislation, the governor proposes and the legislature disposes of budgets. It is a ritual, but the outcomes are not entirely predictable. Like

a suit of clothes, budgets once passed sometimes need to be altered, either let out to accommodate an expanding political economy or taken in to suit the reverse. The requirement to budget and the actors and procedures involved are all shaped by rules which, in turn, shape the budgetary outcomes. One of these outcomes is the distribution of the budget which is the subject of the next section.

III. How the Budget is Distributed

Section I of this chapter defined the concept of budget and discussed the legal requirements which structure the state budget in Michigan. Section II described how the budget is developed, adopted and changed. This section will look at the characteristics of the budget, particularly how it is distributed.

When most people discuss the budget process, they tend to focus on that section of the budget which is subject to annual deliberations of the legislative appropriations committees. In Michigan that section is known as the General Fund/General Purpose (GF/GP) budget. But that section is actually only part of the total state budget. The remainder consists of federal, local and private, and other restricted funds which, while formally appropriated, may be used only for specific purposes.

A. The Total State Budget

In 1983-84, the final fiscal year in this study, Michigan's total state budget was about \$12.25 billion dollars. As we can see in Table 4.3 somewhat less than half (44 percent) of that amount is attributable to the General

Table 4.3
Comparison of 1983-84 Appropriations

Category	-----Percentage-----	
	Total Budget	General Fund
Human Services	42.71	57.04
Education	27.26	25.34
General Government	10.52	8.16
Regulatory	5.02	2.71
Safety & Defense	1.38	2.67
Agri. & Nat. Res.	2.03	1.75
Other	11.08	1.09
Total %	100.00	98.76
Total (in billions)	\$12.25	\$5.39

Source: State of Michigan. 1985 Statistical Report.
Senate Fiscal Agency, Lansing, Michigan,
October 1985, p. 21.

Fund. And, while spending among the functional areas retains much the same relative rank in both the total budget and the general fund, the actual percentages differ. For example, while appropriations for human services (social services, public health, mental health and corrections) tops the list in both budgets, a larger percentage (57 percent) of the general fund goes to these programs than of the total budget. Spending for human services accounts for just under 43 percent of the total state budget. On the other hand, a larger percentage of total budget funds (27 percent) goes to education than general fund dollars (25 percent).

These differences are differentiated in Table 4.4 where sources of revenue for the appropriations dollars are broken down among four separate categories. As we can see, the amount of GF/GP funds which actually sustain the different budget units varies greatly from zero for revenue sharing to 100 percent for the governor's executive office. The Departments of Education and Labor receive most of their funding from federal sources (91 percent and 76 percent, respectively), while state restricted funds account for most of the monies spent on revenue sharing, school employees' retirement programs, transportation, school aid, and the Department of State. Overall, federal funds account for about 27 percent of the total budget, local and private funds another 1.13, other state restricted funds 28 percent, and GF/GP the remaining 44 percent.

Missing from the list in Table 4.4 is a category for GF/GP payments into the Budget Stabilization Fund. This

Table 4.4

1983-84 Appropriations

Budget Unit	-----Percentage of Gross-----					Total
	Gross (in millions of dollars)	Federal Funds	Local & Private Funds	Other State Restricted	General Funds	
Agriculture	38.22	2.71	.11	39.62	57.56	100.00
Attorney General	23.49	14.05	.00	17.13	68.81	99.99
Civil Rights	10.18	15.81	.00	.00	84.19	100.00
Civil Service	13.75	9.70	3.83	24.61	61.86	100.00
Commerce	203.81	30.27	.22	37.82	31.58	99.99
Corrections	268.09	.06	.04	1.14	98.76	100.00
Education	443.43	90.88	1.19	1.91	6.02	100.00
Executive Office	2.92	.00	.00	.00	100.00	100.00
Higher Education**	908.45	.27	.00	.00	99.73	100.00
Judiciary	92.96	8.65	9.20	12.35	69.81	100.01
Labor	394.48	75.93	.00*	1.59	17.18	94.70
Legislature	55.50	.22	.00	2.35	97.42	99.99
Licensing & Reg.	16.47	.00	.15	17.22	92.62	99.99
Mgmt. & Budget	163.42	24.10	.00	22.45	53.45	100.00
Mental Health	641.27	3.70	.54	2.77	92.99	100.00
Military Affairs	17.34	38.46	.00	4.40	57.14	100.00
Natural Resources	210.64	25.82	3.49	36.37	34.32	100.00
Public Health	225.38	47.45	1.02	6.46	45.06	99.99
Retirement:						
School Employees	550.33	3.14	.00	96.59	.27	100.00
School Aid	1,437.16	2.43	.00	67.55	30.00	99.98
Social Services	4,096.46	46.70	1.78	.00	51.52	100.00
State	42.57	3.36	.37	73.89	22.39	100.01
State Police	151.23	8.15	1.34	1.98	88.54	100.01
Treasury	59.50	.00	1.75	9.92	88.33	100.00
Debt Service	128.00	.00	8.22	.00	91.78	100.00
Capital Outlay	139.90	30.36	8.47	19.77	41.41	100.01
Transportation	1,158.67	19.59	.96	78.65	.79	99.99
Revenue Sharing	673.43	.00	.00	100.00	.00	100.00
Library of Michiga	23.50	23.94	.30	.17	75.59	100.00
Prior Year						
Local Requirement	58.50	.00	.00	.00	100.00	100.00
Total	12,249.15	26.84	1.13	28.04	43.99	100.00

*Actually .002%.

**Includes community colleges.

Source: State of Michigan. 1985 Statistical Report.
 Senate Fiscal Agency, Lansing, Michigan, October 1985,
 p. 21. (Does not include interdepartment transfers.)

fund (also known as the "rainy day" fund) was established in 1977 as a means to save money from good economic years as a reserve against which funds could be drawn in lean years. Payments into the fund are based upon a formula tied to actual economic growth (House Taxation Committee 1983). As the Michigan economy was still in the recovery stage in 1983-84, there was no pay-in that fiscal year (Senate Fiscal Agency 1985). The fund is discussed in more detail in the Section IV of this chapter.

Also subsumed in Table 4.4 are payments to local government through programs administered by state agencies. As mentioned in Section I, since adoption of the Headlee Amendment to the State Constitution in 1978, state government must share about 42 percent of total spending (excluding federal funds) with local governments as a whole (House Taxation Committee 1983). In 1983-84 this totalled \$3.58 billion in actual expenditures and included such items as the \$1.4 billion spent on school aid and \$160,000 spent by the Department of State for grants to local units of government for historical site preservation (Senate Fiscal Agency 1985:116-123). Headlee Amendment spending includes the \$673.43 million appropriation for revenue sharing found in Table 4.4.

B. General Fund-General Purpose Budget

As mentioned previously, the General Fund-General Purpose Budget is that section of the total budget which contains no reserved or dedicated funds. Theoretically, the entire GF/GP is negotiable each year. Although some

scholars (e.g., Cross 1982:338) have complained that the GF/GP is an "unreliable guide for analysis" because it contains some funds which look like user fees and thus are presumably not transferable from one program to another, excludes others which some regard as discretionary, and changes in some respects from year to year, it remains the centerpiece of analysis for research in Michigan state government budgetary decisionmaking because it is what the executive and legislative policymakers have agreed to haggle over each year. In other words, it retains its virtue for purposes of political rationality, although it may beg some aspects of economic rationality.

Table 4.3 shows the general distribution of GF/GP funds as appropriated for the 1983-84 fiscal year. Details for each department are found in Table 4.4.

As needs and public policy have changed over the years, so too has the distribution of the GF/GP Budget. Table 4.5 is a comparison of expenditures across the twenty-one-year period in this study.

As we can see in this table, there has been substantial growth in spending on human services, although its percentage share of the GF/GP budget actually declined slightly in the ten-year period, 1963-64 to 1973-74. The largest force here has been the increase in spending on social services which accounted for \$88 million in 1963-64 and \$2.2 billion in 1983-84, followed by corrections, mental health, and public health in that order.

There is also fluctuation in education, regulatory

Table 4.5
Comparison of GF/GP Expenditures

Category	-----Percentages-----		
	1963-64	1973-74	1983-84
Human Services	39.64	39.06	59.43
Education	34.66	45.03	25.85
General Government	11.16	8.01	7.31
Regulatory	2.26	1.30	2.83
Safety & Defense	3.04	2.30	2.66
Agriculture & Natural Resources	2.34	1.50	1.46
Other	6.91	2.81	.47
Total	100.00	100.00	100.00

Source: State of Michigan. Executive Budget for 1966-67, "General Fund General Purpose Expenditures" and personal communications with John Cheeseman, Budget Analyst, Budget Analyst, Department of Management and Budget, Lansing, MI.

affairs, and safety and defense with the latter two showing an upswing. Education, which enjoyed a ten-percent increase in the share of the GF/GP during the ten years from 1963-64 to 1973-74, thereafter showed a decline of 19 percent in the following decade for a net loss of almost nine percent of the pie over the twenty-year period. The share for safety and defense, which declined in the 1960s by almost one percent, rallied to almost 2.7 percent by 1983-84.

There is a clear decline in spending in general government, agriculture and natural resources, and capital outlay. In 1983-84, spending for general government captured over 11 percent of the GF/GP and by 1983-84 showed only 7.3 percent.

It should be noted here that the data used for this table does not quite include the same subcategories used in Table 4.3, so the two, although similar, are not quite comparable. The data used to construct Table 4.5 is discussed in detail in Chapter Four. The data used in Table 4.5 is not corrected for inflation. If it were, the data would show that there was about a five-percent decrease in GF/GP spending in the decade 1972-73 to 1982-83.

D. Summary.

The General Fund General Purpose section of the total budget is that part of the budget which generally captures the headlines. When newspapers report that the governor is confronting legislative leaders on budgetary matters, it is usually this section they are discussing. The GF/GP can be dissected many ways, but is usually described in functional categories such as amounts spent for human services,

education, general government, regulation, safety and defense, and agriculture and natural resources. Over the years, budgeting for these categories has changed and so, too, has the budget process itself. That is the subject of the next section of this chapter.

IV. The Events Which Shaped the Budget Process in the Cutback Periods: 1970-1971, 1974-1975 and 1980-1983

As we noted in Chapters One and Two, public budgeting takes place in political and economic environments which may vary considerably in stability and resources. It has been argued that the combination of those variables tends to produce distinct budgetary outcomes. We turn now to an examination of the environment which produced the exceptional budgetary outcomes which are the focus of this study.

A. The Michigan Political Economic Environment

1. Fundamental to Michigan's condition is its status as an industrial state with a highly cyclical economy. No one who studies the state can escape making that observation. For example, an analysis by Bryan and Howard (1979) of unemployment rates in the 50 states plus the District of Columbia for 1957-1977 showed that Michigan's unemployment ranged from a low of 3.5 to 13.8, making it number one in the nation.

a. At the center of Michigan industry is the automobile. Automobiles have dominated the Michigan economy for decades. A University of Michigan study in the early 1970s reported that 80 percent of the variance in the

Michigan economy could be attributed to changes in the auto industry.

Although the link began to weaken in the mid-1970s when a combination of increasing interest rates and fuel shortages brought about by the international oil crisis (9) caused consumers to rethink their automobile preferences, motor vehicles and related products still are a significant part of Michigan's economy. According to Rosen and Wang (1983) one in six Michigan workers owe their living to the auto or related industries.

b. National economic cycles are magnified in Michigan because of the dominance of high-wage durable goods industries. As of 1980, although only 22 percent of the nation's workers were employed in manufacturing, that percentage was seven percent higher in Michigan. According to a major study released in 1982 (Brazer and Laren), national industrial output which slumped three percent in 1969-70, nine percent in 1973-75, and an equal amount in 1979-80, was magnified in Michigan to 16, 18 and 31 percent respectively.

Slumps in the national economy come to Michigan later, are deeper and stay longer. For example, when leading economic indicators showed that the national economy was going into a period of stagflation in the fall of 1976, newspapers in the Michigan capital reported that the economy was good there (The State Journal, October 30, 1976). But when the national economy was showing a turn-around in 1982 and unemployment stood at 8.5 percent, joblessness in

Michigan was 14.9 percent and going higher.

c. Michigan's declining share of the national economic pie.

Because of the changing structure of the national economy in which manufacturing and heavy industry is shrinking and services are expanding, Michigan's personal income has been steadily eroding. Once among the highest in the nation, Michigan's share of U.S. per capita income has tumbled during the last thirty years to a point now just below the national average. These trends are summarized in Table 4.6.

Yet Michigan continues to receive relatively less federal largesse because of disadvantageous federal policies. Among the states, Michigan is a net donor to the federal treasury and shares unequally in federal monies. Because it is a high wage state, Michiganians send relatively large amounts of tax dollars to the federal government. For example, in 1980 Michigan ranked fifth among the states in contributing federal tax dollars and was last in receiving assistance. State policymakers say this inequity arises from several factors. Among them: matching formulas for federal spending programs are based on per capita wealth but do not take into account unemployment rates, cost differentials, tax effort or relative welfare burden. The national defense build-up which has poured billions into some states has largely bypassed Michigan, along with other midwestern and northeastern states (Hollister 1983a).

Table 4.6
Michigan Personal Income 1950-84

Year	Per Capita Income	Percent of U. S. Per Capita Income
1950	1,687	113.10
1955	2,172	116.00
1960	2,339	105.60
1965	3,053	110.10
1970	4,131	101.90
1975	6,190	101.90
1978	8,737	107.40
1979	9,574	106.00
1980	10,168	102.60
1981	10,867	99.30
1982	11,105	96.80
1983	11,830	97.80
1984	12,989	99.00

Source: Robert J. Kleine, Senior Economist,
Public Sector Consultants,
Lansing, MI.

Other federal policies have also cost Michigan directly. For example, adoption of the Individual Retirement Act (IRA) income tax deduction reduced tax receipts in Michigan for a period just when they were needed most because the state's income tax is based on the federal system. (10) Or, adoption of the federal Omnibus Reconciliation Act which took effect in October 1981, forced Michigan to reduce its state budget by \$50 million.

And, when federal assistance has been available, for example to shore up the state's unemployment compensation fund, it has had to be repaid.

2. Michigan's financial market credibility is only partially controlled by state policymakers. Financial rating services external to the state play a crucial role in the state's ability to borrow money on the national market.

3. The population base: its shrinking rate of growth and some consequences.

In the decade of 1960 to 1970, Michigan's population grew by 11.4 percent. In the decade that followed, growth slowed to 4.2 percent. And in the period 1980-82, population actually shrank by almost two percent. Out migration increased and, instead of consisting largely of retirees heading to Florida and other points south, record numbers of mid-career workers left looking for better opportunities elsewhere. Most of this loss was attributed to the state's stagnating economy (Gorwitz 1982 and 1983a and b).

The consequences of this population decline meant not only an absolute loss in income and business tax revenue,

but also contraction of federal aid which is based, in part, on population size. It also cost Michigan a seat in Congress (Gorwitz 1982).

At the time that Michigan's population was shrinking, its distribution was also changing. Outmigration from the cities into suburban and exurban areas continued, bringing with it a redistribution of political preferences wherein suburban and exurban interests, traditionally more fiscally conservative, became more dominant (Gorwitz 1982).

4. An aging liberal political establishment under siege and a disbelieving electorate.

In the post-World War II period, this industrialized, high-wage, relatively well educated population had begun to vote for fairly consistently liberal administrations in state government. As one veteran consultant says,

"From 1948 on, it's impossible for the Republicans to be elected as mainstream.... You either had to be (or act like) an independent or a Democrat. (Governor) Romney played the independent game and (Governor) Milliken made an accommodation with the Democrats and took the Republican Party to the left. There was an aspiration for programming beyond resource and unwillingness to raise the level of taxation to accommodate that resource.... So we have not had a balanced budget for more than a decade. Milliken made this political choice, hoping that things were going to improve.

It's sort of like embezzlement. If you were to interview an embezzler, he's never going to tell you that he's going to steal money. He says that he's going to borrow money, nobody will know, and that he's going to use this money to make money and then return it. So, in fact, I would say that the government policy from 1974 to 1982 was a policy of embezzlement."

Captured in this view are a configuration of forces:

- ° a constituency increasingly interested in expanding public services and unconvinced that funds are insufficient to cover everything,
 - ° a legislative body eager to respond to that preference, and
 - ° a much-elected governor, also committed through accommodation to those preferences, but lodged in a political party traditionally opposed to raising taxes.
- This antipathy toward raising taxes was powerfully reinforced through recurrent (almost annual) exposure to various voter initiatives designed to limit government spending, one of which did succeed in 1978 and markedly changed the nature of state budgeting in Michigan.

Hidden, however, in this view are undercurrents arising from the natural competition between the legislature and the executive. For example, in the spring of 1976, although it was not an election year for the Senate, lawmakers there twice declined to give the governor's budget year extension bill immediate effect which meant that the law would not have been implemented until the following April, leaving the state seriously in arrears in that fiscal year. Only the governor's threats to unleash further budget slashes in social services finally persuaded the Senate to give the Governor what he wanted. (The State Journal, May 15, 1976).

Also hidden are contradictory views about the leadership role of the governor, especially of the governor whose term in office extended for the greatest share of the time period under study. On one hand there are those

who argue that after years in office, the governor simply tired of being involved and left things to his underlings who lacked the power to carry through. There are those scholars (e.g., VerBurg and Press, 1982) who argue that the governor, enamored of professionalism, turned the budget process over to the technocrats who could make no political decisions. Then there is a management view that the governor, being a skilled executive, believed in delegation and let his budget officer take care of things. And there is a fifth view that the governor, a skilled politician, knew he was in an untenable position and let his underlings take the heat.

Add to this those demographic changes and the industrial and financial forces unleashed by a turbulent economy described above, and we have the setting for a budget under stress.

B. The Dilemma of the State Response.

As observed in Chapter Two, a fiscal crisis consists of the following components: 1) inadequate resources to meet 2) spending obligations in 3) an uncertain environment. There are various options available to a state to deal with these components. They are interrelated. Exercising one often means doing something with another.

1) The problem of inadequate resources can be met by raising revenue through tax increases or short-term borrowing, using reserves such as equity in various state funds or capital outlay reserves, substitution, or enlarging the time period on which the revenue collection is based.

Temporary "paper" adjustments can also be made in hopes that the crisis will go away.

2) Too many spending obligations can be handled by reducing expenditures. These can either be immediate cuts in spending commitments, mandated lapses wherein funds previously appropriated for a particular program are withdrawn and returned to the general account, wage reductions, and delayed payments. Here, paper adjustments can be made as well.

3) An uncertain environment can be stabilized through a) countercyclical economic measures such as various development or savings programs, b) political coalition building to i) sustain the state while the siege lasts and ii) make needed changes, and c) tactical holding decisions such as adoption of a kind of budgetary "going rate".

A fourth option theoretically exists. That is to do nothing, but in Michigan's case, that was not available. The constitution required a balanced budget and certain obligations had to be honored.

Michigan exercised all of these options, some more enthusiastically, timely, and thoroughly than others. Let us review them.

1. The Revenue Dilemma.

The tax issue. Although tax increases were least likely to be discussed openly as a remedy for the fiscal crisis, the State of Michigan did raise taxes several times during the period under study: In 1970-71 the state income tax rate was increased from 2.6 to 3.9 percent in order to counter

the revenue depleting effects of a record length autoworkers strike. Again, in November 1974, income taxes were increased from 3.9 to 4.6 percent to replace lost revenues when voters approved a sales tax ban on food and drugs. In August 1975 the Single Business Tax was adopted, partly to cover a looming deficit. And again in 1981-82, a six-month, one-percent income tax increase was adopted together with an increase in the cigarette tax. When these taxes lapsed in September 1982, a 1.5 percent increase (from 4.6 to 6.35 percent) in the income tax together with a .25 percent increase in the cigarette tax was adopted in 1982-83.

These taxes were raised at some cost. The third round of income tax increases was especially painful and cost the Democrats control of the Senate in 1984. Even so, some thought the leaders acted too late. A former House aide said,

"I do know that throughout the 1980-82 period (the Speaker) went repeatedly to (the governor) a number of times in my presence so I know it happened and said, 'Look, don't you think we've cut all we can cut in the budget here? Isn't it time to go for the tax increase?' (The governor) repeatedly said, 'No, I don't think we can.'

(The governor) took great pride in not raising taxes and the longer that period became (i.e., his tenure in office) the more committed he was to try to get out of office without doing it. If he truly had that as a goal, I think that was a major stumbling block to dealing with that situation earlier.

Over that time period (the Speaker) repeatedly offered to do whatever was necessary to bring the Democrats in the legislature along if (the governor) would consent to work with the Republicans in the legislature. It simply did not happen until 1982. Then, all (the governor) proposed, I believe, even then was a temporary tax and that's what we ended up with, a temporary tax increase. I know (the governor) proposed a half percent for the calendar

year and we ended up with a one percent for six months of the fiscal year."

Short-term Borrowing. Michigan continuously shored up its leaky budgets with short-term borrowing during this period. This was something the state constitution allowed, but the framers did not have in mind anything other than contingency purposes when they permitted it because they also wrote in a proviso that any borrowing had to be repaid within the fiscal year.

As resources became leaner with each passing year, short-term borrowing became critical to cover October 1 payments into the school aid fund, for example, when tax revenues were not receivable until October 15. Overuse of short-term borrowing together with the state's declining credit worthiness eventually caused Wall Street money lenders, the prime source of such funds, to cut the source of supply. As the state budget director said, "They have immense power over this state. If they drop my rating and I can't borrow, then we can't pay our bills in October, we have payless paydays, we have chaos." (The Detroit News, March 3, 1982)

Michigan reached its nadir in this respect in September of 1982 when only a letter of credit issued by a consortia of five Japanese banks permitted the state to borrow \$500 million. The banks charged a 12 percent fee.

Tapping the Funds. The State of Michigan used its equity in numerous funds to get additional revenue during

Vehicle Accident Claims Fund in 1970-71 and \$50 million from its Veterans' Trust Fund, \$34.6 million from the teachers' pension fund contingency reserve and other millions from the Uninsured Motorist Fund in FY 1975-76.

In 1978-79, the state took \$25 million from the Liquor Control Commission revolving fund. In 1979-80 the state borrowed \$26 million from the Recreational (Kammer) Trust Fund and \$46.2 million more in 1980-81, (Heckman 1981a). That same year the state also attempted to borrow \$20.1 million from the Railroad Delinquent Tax Fund but gave up when it was found that some of the fund had already been committed elsewhere. (Lansing State Journal, September 30, 1981).

The state also borrowed from the Budget Stabilization Fund, but as that fund was set up expressly for that purpose, it is discussed in a later section. (See Attempts to Reduce Environmental Uncertainty, below.)

Using Capital Outlay Reserves. In addition to making outright cuts in capital outlay commitments through executive orders, on at least two occasions (\$51 million in FY 1974-75 and \$46.2 million in FY 1980-81) Michigan raised additional revenue by what some call non-funding unencumbered capital outlay reserves (Heckman 1981b). The procedure was this: normally, at the end of a fiscal year, all unspent (unencumbered) capital outlay appropriations balances would be carried over into the following fiscal year and marked for expenditure. A fund reserve is also carried over to cover appropriations. By diverting funds normally used to fund that reserve, the revenue can be used

to cover deficits in other areas. The cost of that procedure was that it required consistent yearly capital outlay appropriations.

Substitution. Once a useful ploy for states in a federal system, substitution of federal for state funds has become much more difficult to do as federal lawmakers have tightened loopholes. Nevertheless, Michigan was able to generate \$88 million in FY 1981-82 by substituting federal funds in programs administered by the Departments of Social Services and Mental Health, and by a newer form of substitution, user fees (Citizens Research Council 1982).

Enlarging the Time Frame. Michigan extended its fiscal year by three months in 1975-76 and considered extending it twelve months in 1979-80 (Heckman 1981b). At the time the first extension was approved in 1976, the intention was to bring the state back to a July 1-June 30 fiscal year by mid-1979, having followed the original extension with a twelve-month fiscal year and then a 21-month fiscal year (The State Journal, May 15, 1976). However, subsequent events cancelled those plans.

The Paper Adjustments. According to generally accepted accounting procedures, organizations account for monies received and spent either by the cash method or by accrual. The cash method counts monies only when actually received and spent. Accrual counts when earned and obligated. For an example, an item ordered in September is considered obligated in September by the accrual method, but if actually paid for in October, is not accounted for until

October under the cash method. Accountants tend to recommend accrual accounting because it pictures financial activity closer to decision points and therefore gives less distorted data points to analyze for planning purposes. In some instances, some organizations use both methods for different accounts, but using both, i.e., accruing revenue and not liabilities, for the same account is bad practice. It can, however, be an attractive maneuver if budgets have to be in balance at the end of a fiscal year and bills for activities undertaken near the end of the year are unlikely to appear until several weeks into the new year.

During the period 1975-1982, Michigan steadily accrued revenues (but not liabilities) for assorted sources. Beginning with the marathon end-of-year adjustment on June 30, 1975, the state accrued revenues for sales, use and withholding taxes. As one tax committee aide later said, "Suddenly we started to get into what has been popularly known in this state as "Chinese bookkeeping."

The following fiscal year (1975-76), utility property taxes were added. In 1977-78, in an attempt at reform, the entire Medicaid account was shifted to accrual accounting, but the liabilities were shifted back to a cash basis in 1980-81. In 1979-80, revenues from the single business tax and insurance premiums were put on an accrual basis, as were oil and gas taxes and beer and wine taxes in 1981-82. That same year, two more shifts took place. Liabilities for utility bills of welfare recipients were returned to cash accounting, but the state also began to pay back the debt on

property tax credits by starting to accrue liabilities.

Playing around with the Medicaid account was by far the most costly. It was a prime bone of contention in the October 1981 negotiations with Wall Street lenders and was partly to blame for Michigan's subsequent credit rating drop to lowest in the nation the following December.

The other cost was, of course, the tax reckoning. In 1981-82, the state needed to pass a ten-cent increase in the cigarette tax, part of which was used to correct the bookkeeping manipulations.

Although fudging the books in an attempt to meet the constitutional requirements for a balanced budget received the most notoriety, at least one study (Citizens Research Council 1982) indicated that this option had less fiscal impact, at least during the crisis years 1980-82, than the other options of reducing expenditures or raising revenues. Although it was the leading variable in 1981, accounting for 37 percent of the adjustments made to eliminate GF/GP imbalances, over the three-year period it accounted for about 25 percent.

2. Attempts to Reduce Expenditures.

Spending Ceilings. In addition to the constitutional requirement for a balanced budget, state lawmakers made at least two other attempts to set spending limits. The first occurred in 1977 as part of the legislation establishing the Budget Stabilization Fund (BSF). In addition to its "saving for a rainy day" feature, the Budget Stabilization Fund served to limit the rate of growth in state spending.

Indeed, the governor pushed for adoption early in 1977 before the adoption of the budget for the ensuing fiscal year, because the BSF language established ceilings for the budget. At the time, budget officials saw it as similar to the federal process in which ceilings are set early in the process, before specific appropriations are approved. (The State Journal, January 25, 1977). Michigan was the first state to adopt such a fund.

The second occurred in 1980 when the Senate adopted new budgeting procedures which required targets to be set before appropriations could be approved. Some saw this as reinforcing the target setting required by the prior BSF legislation, others saw it as redundant.

Spending Reductions. Even though spending ceilings may have been readjusted downward, sometimes it is necessary to back away from appropriations commitments. The most conspicuous efforts in this category are the spending reductions mandated through executive orders described previously in this chapter. In addition to these, however, were other methods which were often taken before the heavy axe of the executive orders was swung. These methods included freezes in hiring, travel, and equipment purchases. Often regarded as first maneuvers, it was these options which the governor exercised in November 1978 when the second recession seemed possible. As he said, "I must act now to anticipate an economic downturn in order to meet the constitutional obligations of a balanced budget." (The Detroit News, November 23, 1978)

Mandated Lapses. Another means used to withdraw from appropriations commitments, mandated lapses are "agreements between the Executive Office and the Legislature to transfer appropriations from various line item appropriations into the Executive or Administrative component appropriation line item, such as a retirement line item" (Heckman, 1981b). Michigan policymakers resorted to mandated lapses on at least two occasions. In 1979-80, \$60.8 million was recaptured through this means and \$31.8 million in 1981-82 (Heckman 1981a).

Wage Reductions. Personnel costs in most public organizations account for about 80 percent of operating costs. Therefore it is not surprising that efforts to reduce spending would involve some sort of wage reductions. In Michigan, wage reductions took several forms. Some involved down-sizing of jobs in which full-time jobs were made into three-quarter or half-time positions. Others included voluntary wage reductions, voluntary wage deferrals, mandatory wage reductions including cuts in total pay and total hours that could be worked and mandatory payless days. For example, in 1980-81, Michigan attempted to cut a proposed nine percent pay increase for civil service workers to 4.5 percent, saving the GF/GP about \$43 million. Later the executive office required that executive branch employees work six days without pay, which saved another estimated \$12 million. Some legislative employees had one day's pay deducted from their bi-weekly paycheck, and had to take 16 days off, some of which were discretionary, saving

another \$700,000 (Heckman 1981b).

Another approach involved deferring pay increases. In a hotly contested decision in August 1982, the Michigan Civil Service Commission reversed its April 1982 decision to approve a five percent pay increase for 17,000 state workers and moved to delay the increase until the beginning of the new fiscal year in October. Three public employee unions filed court suits that the commission violated constitutionally set procedures for setting civil service wages. They won. The following year the courts ruled that the governor's need to reduce spending does not limit the civil service commission's power to set wages (Michigan Association of Governmental Employees v. Michigan Civil Service Commission (1983) 336 N.W.2d 463, 125 Mich. App. 180).

Of course the ultimate tactic in wage reduction was layoffs. As mentioned previously, during this period the number of state employees was reduced by about 16,000. The cost of this in terms of employee morale has never been fully documented, but is described in terms of one department in Mowbray, Tableman and Gould (1984).

One feature of the layoffs involved what came to be known as "bumping." A pink-slipped employee could save his or her job by identifying someone with less seniority and, in effect, commandeering that person's position. The state retained presumably more experienced and qualified employees that way, but the dislocations were enormous. People employed in one department such as Social Services might

wind up in Treasury doing quite unrelated work. Although some found the changes energizing, its indirect net cost in terms of lost efficiency has yet to be studied comprehensively. However, House (1981), among others, has identified bumping as questionable policy akin to penny wisdom and pound foolishness.

Delayed Payments. Another tactic used was deferred payments. This took several forms. The most controversial were the delays in installment payments to public institutions. Schools, colleges, universities and local governments were all affected as in, for example, the February 1982 decision to defer \$225 million in school aid, higher education and local revenue sharing payments and a similar decision in January 1983. The argument at the time was that the payments would be made up later, but as late as November 1986, some were still waiting for restitution.

The other form was delay in payments to contractors. In October 1980, faced with a cash crunch, this was one of the options chosen by the State of Michigan. That was the same month that banks cut off the state's short-term credit because lawmakers had been unable to formulate a budget.

Negative Appropriations. This was used to penalize agencies which had overspent funds. The overrun is built into the following year's appropriation which, if stable, means that the agency has, in effect, reduced resources for the following year (Heckman 1981b).

But spending reductions were never easy. One reason why expenditures were so hard to cut had to do with the

increasing demand for social services. One analysis (Heckman 1981a) showed that AFDC and General Assistance cases increased 50 percent between October 1979 and April 1981. During the 1980-82 period, there was over \$600 million in supplemental spending, 80 percent of which went to the Department of Social Services which experienced unprecedented increases in welfare caseloads. The Citizens Research Council (1982) estimated that \$100 million of that was actually never appropriated but simply runover in accounts, "indicative of a breakdown in legislative control of spending."

One of the reasons for the upsurge in welfare caseloads was the incapacity of unemployment insurance to meet demand. A few facts about the Unemployment Insurance Trust Fund will explain this. The Unemployment Insurance Trust Fund is a reserve against which insured unemployed workers may draw benefits up to a maximum of 39 weeks, almost 10 months, of which the first 26 weeks are funded by employers and the remaining 13 by state and federal government. These benefits are paid through the Michigan Employment Security Commission (MESC), a division of the state's Department of Labor. The devastation of the recessions in both 1974-75 and 1979-1982 were such that funds were rapidly exhausted. Workers who were without other benefits then sought welfare assistance. The other aspect of this incapacity, of course, derived from the fact that unemployment insurance was available to only about a third of the state's unemployed workers (Blaustein 1982). Again, those with no other

recourse looked to welfare benefits from the state.

Although the state GF/GP budget was not directly impacted by the fund exhaustion and consequent borrowing until March 1982 when a change in the law made states liable for interest on the debt (prior to that borrowing was interest free), the GF/SP was and the consequent increase in employer taxes needed to repay the fund tended to depress other efforts to attract private industry to Michigan and, in any case, made existing employers wary of other kinds of tax increases.

Another reason why costs were so hard to contain was that some were never put into the equation. The cost of the debt, for example, was never budgeted. In order to meet obligations during the 1980-82 crisis, Michigan engaged in a great deal of short-term borrowing to get working capital. Interest on these notes was estimated at \$176 million, but it was never budgeted (Citizens Research Council 1982).

3. Stabilizing an Uncertain Fiscal Environment.

Countercyclical Economic Measures. The most direct effort in this area involved establishment of the Budget Stabilization Fund (BSF), described previously. As the name suggests, the BSF was primarily an attempt to stabilize revenue flows. The Stabilization Fund works by formula tied to the level of Michigan Personal Income (MPI). If real (i.e., deflated less transfer payments) growth is greater than two percent, then the state must pay into the fund. Payouts in the form of limited quarterly withdrawals for public works projects are allowed under two conditions: a) if unemployment levels reach eight percent (larger

withdrawals are allowed if it exceeds 12 percent) (House Taxation Committee 1983) and b) if there is negative growth in the adjusted MPI (Bryan and Howard 1979).

The BSF was recommended by the Michigan Economic Action Council which was chaired by Michael Blumenthal, a prominent Michigan industrialist and later Secretary of the Treasury under President Carter. Adoption of the BSF was a joint effort of the Speaker of the House, Bobby Crim, and Governor Milliken. As one legislative aide said,

"My memory is that Crim took the idea to Milliken and said, 'Look, we've got to take a look at some fundamental things that need to be done here.' It was basically a recognition that we had a cyclical economy and that we needed to adopt something that would put us in a situation where in the good economic years we did two things: we controlled spending by adopting a formula that forced us to put some money aside and secondly, kept us from reducing the rate of taxation, i.e., kept a certain base level of taxation but controlled the growth of that base and allowed us to take it out on the low side."

But the BSF, good as it was, was limited. As the same aide went to say,

"The concept of the BFS clearly is not one that would allow you to handle something like the 80-82 (crisis). It could handle a 75-76 recession, which I guess you might characterize as more of a normal recession, but could not even begin to handle something like an 80-82 crisis, which for this state was a depression, not a recession."

As we finally went into the recession of the early 1980s, we might have had \$450 million or \$500 if we hadn't made that (previous cut in BSF funding). But 1980, '81, '82 and '83 collectively were such horrendous years that the existence of another \$200 million or so in the fund would not have made a material difference in the way we had to respond to that time--we blew through that money so fast."

In its August 1984 issue, the Michigan Municipal Review

graphed the impact of the BSF on diminishing the fiscal crisis. It sustains this respondent's thesis. That graph is reproduced in Figure 4.1.

Welcome as the BSF was, however, it was only designed to deal with future spending. It was not designed to take care of already incurred debts which had been, in effect, rolled over since 1975 (Citizens Research Council 1982).

Other countercyclical economic measures taken by the State of Michigan certainly include the numerous economic development programs endorsed annually but particularly in the governor's budget messages of 1977, the economic development package proposed by the governor in 1981 and the budget messages of 1982 and 1983.

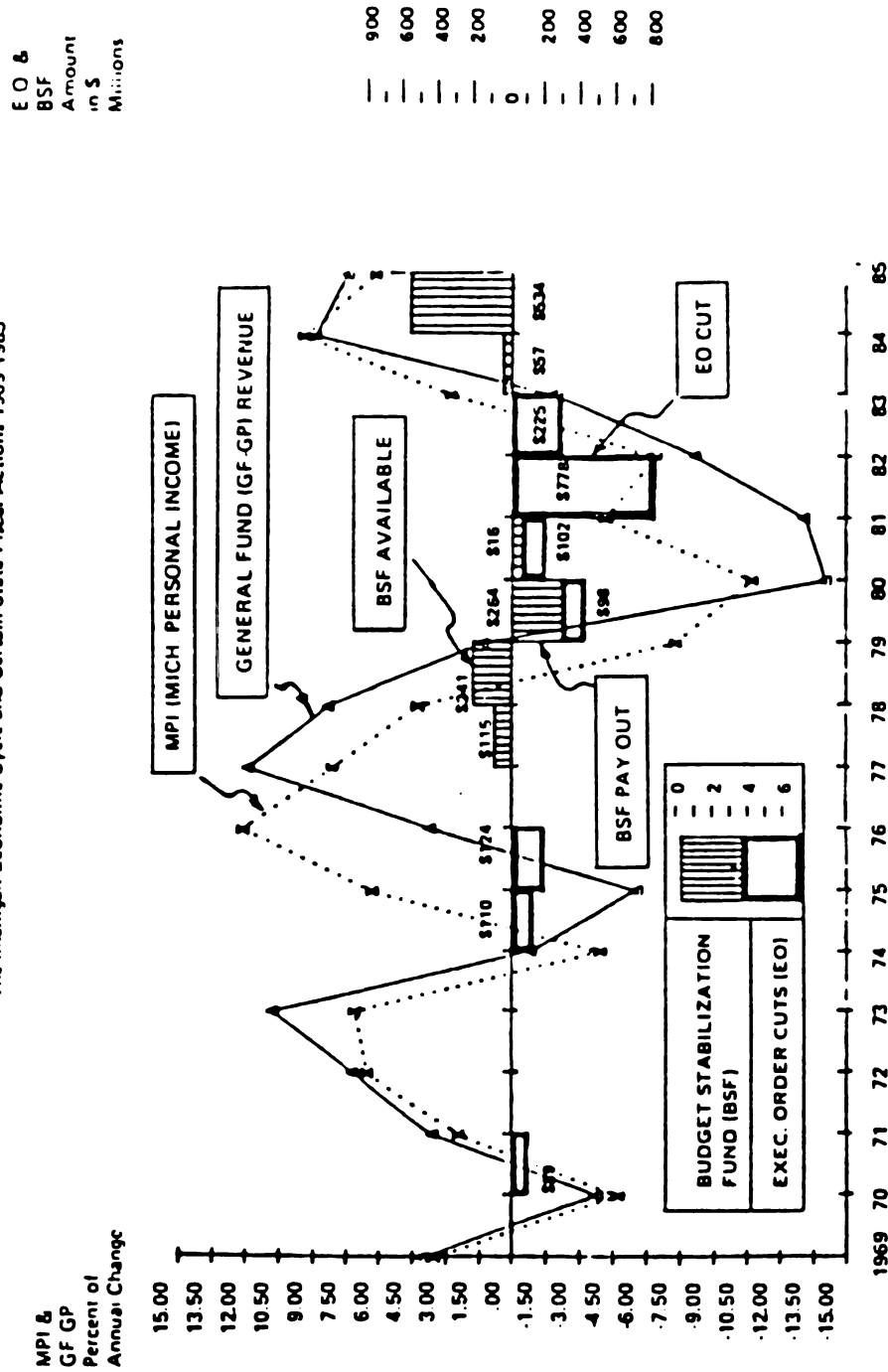
Political Coalition Building. Although discussed more fully in later chapters, this was clearly a stabilizing tactic needed to sustain the political leadership through the state's fiscal crisis. It was most clearly seen in the procedures used in dealing with the executive orders mandating budget cuts.

Rationalization of the Budget Process. Some would not characterize budget reform as an attempt to reduce environmental uncertainty. However, it should certainly be included because these reforms typically have the effect, in part, of controlling uncertainty internal to the system by requiring enhanced planning.

During the period under study, the State of Michigan saw a progression of attempts at budget reform, even though not all of were precipitated by fiscal crisis. Among them:

Figure 4.1

The Michigan Economic Cycle and Certain State Fiscal Actions 1969 1985



Source of line graph: Senate Fiscal Agency (SFA) BSF3, March 19, 1984
 Source of bar chart: SFA Economic and Revenue Forecasts, February 22, 1984
 and SFA 1983 Statistical Report

Michigan Municipal League
 August 1984

in 1971, the House Fiscal Agency attempted to implement a program budgeting system and, although this system was not ultimately used, a variation was introduced by the executive office in 1972-73. In 1975 there was attempted introduction of a legislatively sponsored program evaluation zero-base budget system. In 1976-77, the executive budget began to be developed according to target budget concepts in which each department submitted requests based on 95, 100, and 108 percent support of prior year appropriations. Programs were also ranked according to priority. The 1981-82 budget was developed on a minimum operating level approach and the Management and Budget Act of 1984 consolidated budget practice and tightened reporting requirements.

Tactical Holding Decisions. Sometimes the environment seems so unstable that the only known is the immediate past. When revenue and spending patterns seemed most inscrutable in mid-1980, Michigan lawmakers opted not to pass a full-year budget for 1980-81, but passed an interim measure for October-December instead that, in effect, adopted going rates based on those of the previous fiscal year. The interim budget was ultimately repealed and folded into the full budget when it was passed. (Heckman 1981b).

This decision was, however, not without cost. Michigan lost what little remained of its credit standing and banks refused to issue the state loans because there was no plan, i.e., budget, available on which repayment could be plotted.

The attempt to peer into the future. The key to controlling the environment is prediction. The State of

Michigan also attempted to do that. State officials signed a contract with the University of Michigan to fund development of the University of Michigan model for forecasting Michigan tax revenue and the Michigan economy. "The principal reason was that legislative leadership simply did not trust what the governor's office, this (DMB) department, and this office (Revenue and Tax Analysis) was telling them and had every reason to believe that (the budget director) was not so much lying as withholding information. In fact, I know that to be the case."

Despite the availability of the model and the assistance of world-class economists, revenues in the crisis period (1980, 1981 and 1982) were overestimated by \$1.3 billion, 92 percent of which was appropriated (Citizens Research Council 1982).

Thus, there were many options available to state government to confront a fiscal crisis and Michigan policymakers exercised them all. There were efforts to raise revenues, reduce spending and reduce environmental uncertainty. All were done amid enormous controversy and with considerable pain to policymakers and citizens alike. A selected chronology of those events and the state's response appears in Appendix B.

D. Summary

In this chapter we have attempted to describe the research setting for this study, giving some of the flavor of the complex events which gave rise to the budget crisis and the response of state government. In order to do this,

we have first defined budgeting and described the budget process as it has been carried out in the State of Michigan. We have also described the distribution of the budget, including the total state budget and the general fund general purpose section which is the focus of this study.

We have attempted to describe functionally the critical events which shaped the budget process in the cutback periods and the response of Michigan policymakers to those events. Finally, we have included a chronology (Appendix B) of selected activities during the period under study, 1963-1984, which provided the raw data for the functional description.

With this background we can now proceed to report specific findings of the hypotheses identified in Chapter Three. An evaluation of the first, the linearity argument, follows in Chapter Five.

Notes to Chapter Four

1. Much of the information in this section concerning the constitutional and statutory requirements imposed on the Michigan budget and some of their changes are drawn from an invaluable summary put together by the House Taxation Committee (1983).
2. The total spending limit works out to about ten percent of total personal income in Michigan for the previous calendar year although that figure has fluctuated from a low of 8.45 percent in 1974-75 to a high of 10.01 in 1978-79, the year the Tax Limitation (Headlee) Amendment was adopted. Even in the depths of the Michigan economic recession in 1981-82, the percentage was 8.61, somewhat above the 1974-75 low (Senate Fiscal Agency 1985:10). The internal local share is about 42 percent (of the 10 percent) and was also based on the amount local governments were receiving in FY 1979, the year the tax limitation took effect. (House Taxation Committee 1983:1).

It is interesting to note that expenditure reductions do not have to be proportionate as well. In a suit brought against the Department of Management and Budget by the Michigan Association of Counties, the courts held that the reductions do not have to be proportionate to a decline in estimated revenue. The counties were worried about maintaining their revenue sharing funds and lost. (1984) 345 N.W. 2nd 584, 418 Mich. 667.

3. In FY 1982-83 this amounted to about \$625 million (House Taxation Committee, 1983:1).
4. An important additional constitutionally based feature of the Michigan budget is the line item veto. The governor may delete specific items from appropriations bills passed by the legislature (Article V, Section 19). Although the gubernatorial line-item veto was not a critical factor in this study, it is an important characteristic of the budgetary process in Michigan as it is in 40 other states and so is mentioned in this context (Yondorf and Summers 1983:66).
5. Unlike Congress where appropriations bills can only be introduced in the House of Representatives, such bills can be introduced in either house in the Michigan Legislature which allows both houses to work simultaneously on different aspects of the budget and, in the long run, saves a considerable amount of time.

Generally, all bills are introduced in both houses, but only half are initially taken up in either house. The same categories of bills used to be considered by the same house each year (with the exception of the School

Aid bill which alternates annually), but more recent practice has the bills alternating the house of origin each year. The bills receive their greatest scrutiny in the house subcommittee which first hears them and more general attention by the subcommittee of the other house (Legislative Service Bureau 1987:7).

There is an exception to this division of work. Capital outlay proposals are considered by a joint subcommittee of twelve members, six from each of the respective appropriations committees (Legislative Service Bureau 1984:8).

6. On occasion, an entirely separate set of budget bills has been introduced by members of the other party. This occurred, for example, in the mid-1970s when both houses of the legislature were controlled by one party, the governor belonged to the other, and both branches were strongly at odds over policy objectives.
7. The subcommittees are numerous. In the 1985 Legislature there were seventeen subcommittees in the House and twenty in the Senate (Kennedy and Harris 1985:9).
8. It is interesting to note that the legislature moved to regularize the format of the appropriations bills in 1981 with the adoption of Public Act 18. This act "regulated appropriations, allocations, and expenditures; provides for expenditure reductions, accounting and auditing procedures; provides for general legislative oversight of the budgetary process; makes stipulations concerning the lapsing of funds; and requires certain reports. The purpose of compiling the standard boilerplate into one statute was to reduce bill printing costs and to prevent inconsistencies in the various bills." (Legislative Service Bureau 1987:6). It is interesting to note that this move to control the budget format came just at a time when external uncertainties shaping budget content, i.e., the fiscal crisis, were most severe.
9. Some writers observe that the oil shortage, in turn, was a direct response by Arab oil producers to a fundamental change in U. S. monetary policy, i.e., a decision to let the dollar float (see, e.g., William Greider. "Annals of Finance," The New Yorker, November 9, 1987).
10. Interview with Douglas Drake, Director of the Office of Revenue and Taxation, Department of Management and Budget, and former Democratic Staff Director to the House Taxation Committee, September 25, 1986.

Chapter Five

Findings: The Linearity Argument

I. Introduction

In this chapter we analyze the first of the hypotheses identified in the research design. That is whether the linear model, i.e., the functional relationship between expenditures and prior-year appropriations, fails to explain budgetary behavior in a cutback situation.

II. The Analysis

Linearity has been advanced as one of the most appealing aspects of incrementalism. By this we mean that budgetary decisions, whether requests, appropriations or expenditures bear a direct relationship to some prior budgetary decision concerning requests, appropriations or expenditures. The appeal of the linearity argument lies in its explanatory power. If a linear relationship exists between expenditures and appropriations, then we can predict that budgetary spending will occur in constant absolute amounts for given appropriations.

Linearity of budgetary decision rules is that dimension of incrementalism seen in the various quantitative goodness of fit models which have been developed to explain the budgetary process. Most of these models (e.g., Davis, Dempster and Wildavsky 1966, 1971; Hoole 1976, Gist 1982, Hendrick 1986) have focused on the relationship between the request and the appropriation, i.e., they have posited that the budgetary appropriation is a linear function of a prior request.

That interest should focus on the request-appropriations relationship comes as no surprise. It is this aspect of the request-appropriations-expenditure budget cycle which especially captures the political drama of the legislative process and the relationships between the executive who makes the request and the legislature which acts upon that request.

A. Focus on Expenditures as the Dependent Variable

An exception to this approach is found in the work of Hoole, Handley and Ostrom (1979). Here, attention is focused instead on the relationship between the expenditure and the appropriation. They compare four different models of expenditures in an attempt to explain budgetary behavior of several international governmental organizations.

This approach was adopted in the current study. Although interest is retained in the request and appropriations relationship, the expenditure-appropriation relationship is explored as a surrogate for the appropriation-request relationship to test the linearity argument.

The reason for this choice is a logistical one. In the Michigan budgetary cutback process, the appropriations committees by law must either accept or reject completely the governor's executive order, i.e., the cut back request. Once approved by the appropriations committees, the executive order becomes law. This process is explained in detail in Chapter IV.

As we observed in that chapter, in the twenty-one years

under study, eighteen executive orders mandating budget cuts were submitted by the governor and thirteen were approved. Of the five disapproved, all were subsequently approved in modified form in a later executive order. Therefore, in separating out gubernatorial requests from legislative appropriations in the cutback process, the nature of the executive order is ambiguous. Whether the executive order should be interpreted as the request, or the appropriation, or both is not clear.

In order to circumvent this problem, analysis of the linear model is focused on the expenditure-appropriation relationship and the executive order is interpreted as the appropriation. This shift is theoretically justified because the expenditure is conceptualized as a function of the appropriation in the prior budget. Thus, the gubernatorial request is subsumed in the equation. For example, expenditures by the Department of Social Services in 1979-80 are seen as a function of the appropriations for that department in 1978-79, the prior budget. Since every budget has as part of its cycle a request, an appropriation and an expenditure, the expenditures of 1979-80 encompass the requests of 1979-80 and, arguably, 1978-79.

The linear model was specified as described in Chapter Three, The Research Design:

$$E_t = b A_{t-1} + e_t \quad \text{where}$$

E = expenditure total

b = a fixed percentage of the prior budget

A = the total appropriation

e = the error term (factors not in the equation)

B. Statistical Considerations

Use of the usual regression technique, ordinary least squares, poses problems for the analyst testing budgetary models like that specified above. That is because the ordinary least squares equation calls for inclusion of a constant term (also called the intercept), which is the value of the dependent variable when the value of the independent variable is zero. This equation is conventionally seen as:

$$Y_t = a + bX_t + e_t$$

In terms of the current budgetary model, the constant would therefore be the value of expenditures when appropriations are zero. Since this is nonsense, the analyst must decide how to deal with the intercept.

One alternative recommended by Hoole (1976) calls for the use of constrained least squares, a procedure in which the intercept is forced through the origin, i.e., the total sum of squares is calculated from zero instead of from the mean as in ordinary least squares. When this is done, the value of the intercept becomes zero and the estimates reported conform to the linear model described above.

Using constrained least squares is not without its problems, however. Chief among these is the resulting distortion of the estimate of the slope. This estimate will make the slope appear much steeper than it is and leave the researcher with biased information about the key relationship that is being investigated. Therefore, this approach was not used in this study.

Another alternative is to use the basic ordinary least squares (OLS) estimation technique, report the constant and interpret it in some fashion which is consistent with budgetary practice. There is some precedent for this approach in the literature. Hoole, Handley and Ostrom (1979:929) proceed this way in order to preserve comparability across several expenditure models being tested. Some of these models call for an intercept and some do not. Where the intercept is reported it is viewed as "a constant amount for contingency factors."

There are other interpretations which may be applied to the constant as well. Although the law of most states mandates balanced budgets, i.e., that expenditures match appropriations, such perfect efficiency is difficult to achieve. Inevitably some funds are left over, returned to the general fund, or in some cases, continued over to the following budget. The constant could be viewed as that slack. Another interpretation is that the constant is implicitly a kind of "floor" on which the annual appropriation is built. Others (e.g., Gujarati 1978:52) would argue that the constant is the average effect on expenditures of all the variables not in the model, i.e., all other environmental effects. In order to preserve some comparability with the Hoole, Handley and Ostrom study which is unique in its focus on expenditures, this analysis also uses the OLS technique.

Two further observations regarding the statistical analysis need to be made. They concern tests for

heteroskedacity and serial correlation.

Heteroskedacity. One of the assumptions of the regression model is that the error is independently distributed with a constant variance, i.e., is homoskedastic. This is particularly important where the sample population includes observations drawn from heterogeneous groups, e.g., groups of varying sizes. In this analysis, however, data was analyzed separately for each budget unit (department and fund) in a model containing a single exogenous variable (plus a constant and an error term). Therefore, testing for heteroskedacity did not appear to be warranted in the initial analysis. Where comparisons across departments seemed warranted in subsequent analyses, the weighted least squares estimation technique was used. In each case the weighted value was the base, the lagged value of the appropriation.

Serial Correlation. An equally serious problem can be serial correlation, or autocorrelation, a condition in which the errors are interrelated across observations. As Ostrom (1978:24) notes, autocorrelation is often a problem in time series analysis because errors that enter into a relationship in one time period often carry over into the next. Estimates obtained under conditions of serial correlation are unbiased, i.e., they are an accurate reflection of the true population parameters, but they no longer are the most efficient, i.e., showing the smallest variance. If there is positive serial correlation, the estimates of the coefficient variances are likely to be

undervalued (and the R^2 and f values correspondingly inflated) leading the researcher to infer a relationship exists when the null hypothesis is more likely true (Hanushek and Jackson 1977: 156). Serial correlation is usually positive rather than negative in most social and economic data (Ostrom 1979).

The Durbin-Watson test was used to test for this condition. This test is especially recommended for small population sizes like that in this study and is the test used in the Hoole, Handley and Ostrom (1979) expenditure study.

The Durbin-Watson test is not without its limitations, however. As Ostrom (1978) points out, the test is not useful when lagged endogenous variables appear in the equation. But our variables are exogenous. (1)

Where the Durbin-Watson test suggested serial correlation existed, disturbances were assumed to be caused by a first order autoregressive process. Estimates were then recalculated by an alternative method, the Cochrane-Orcutt technique (Kmenta 1971:288).

III. The Initial Findings

Data was first analyzed for the entire state budget for the twenty-one regular budget years using the Time Series Processor Version 3.5 (Hall and Hall 1980). This was done to establish a basic picture of the overall Michigan budget and to see how the model fitted the data. Dummy variables for intercept and slope were used to assess the effects of the cutback budgets. These procedures can be summarized in

the following equations:

$$\text{Simple: } E_t = a_1 + b_1 A_{t-1} + e_{1t} \quad (1)$$

$$\text{Base Change: } E_t = a_2 + b_2 A_{t-1} + gD_2 + e_{2t} \quad (2)$$

$$\text{Marginal Change: } E_t = a_3 + b_3 A_{t-1} + gD_3(A_{t-1}) + e_{3t} \quad (3)$$

$$\text{Complex: } E_t = a_4 + b_4 A_{t-1} + gD_4 + gD_5(A_{t-1}) + e_{4t} \quad (4)$$

where E = expenditure total
 a = constant (intercept)
 b = a fixed percentage of the prior budget
 A = the total appropriation
 g = estimate of the dummy variable
 D = a dummy variable where
 1 = regular budgets
 0 = cutback budgets
 e = the error term (factors not in the equation)

The results of the regression runs are reported in Table 5.1.

In this set of equations we find predictably high coefficients of determination. The R^2 s are about .97. This means that in these models, about 97 percent of the variation in the dependent variable (the expenditures) is explained by the independent variable (the lagged appropriations) plus the pertinent dummies and the error term. Furthermore, this statistic is significant at the .05 (actually the .01) level, suggesting that the results are not due to chance. Although social scientists might rejoice at such "full" explanation, it is unremarkable in the

Table 5.1

LINEAR MODEL. COEFFICIENT ESTIMATES
State Expenditure Totals 1964-1984: 25 Categories

(N=34)										
Budget Model	Base	t	-----Margin-----		-----Additive Dummy-----		-----Multiplicative-Dummy-----		R2	f
			Slope	SE	t	Base	SE	t		
Cochrane-Orcutt Estimation										
Simple	246,475,000	2.16*	.98	.03	29.45*				.97	867.56*
Base										
Change	35,395,200	.25	1.00	.04	27.16*	264,174,000	68,846,300	3.84*	.96	372.07*
Marginal										
Change	209,246,000	1.74	.95	.03	27.61*			.07 .02	4.02*	404.28*
Complex	171,379,000	.90	.96	.05	19.34*	55,262,600	207,467,000	.27	.06 .06	1.06
									.97	258.13*

*Significant at the .05 level.

Source: State of Michigan. Executive Budgets, 1964-1984 and various Executive Orders.

budgetary literature. These types of models analyzed in time series frequently produce such results. What these statistics do reveal, however, is that the linear model holds the Michigan data very well. This model (and these variations) continues to be robust even in cutback circumstances, so far as the overall state budget is concerned. Now let us consider these models in more detail.

Simple. The simple model incorporates all budgets, both regular and cutback. It is a composite picture of budgetary decisions across thirty-four budgets in the twenty-one year period. In a period in which total expenditures for the twenty-five categories grew from \$524 million to \$5.3 billion with intervening episodes of reduced spending, the average base is about \$246 million. It is statistically significant. The slope is .98 which means that \$.98 (plus or minus \$.06, the value of the standard error times the appropriate t statistic for the 95 percent confidence level) of every dollar appropriated in the prior year was spent. As Michigan state law mandates a balanced budget, this should come as no surprise, but as a measure of administrative efficiency, this is a creditable track record indeed. This value is also statistically significant.

Base Change. With this model we are able to assess some of the impact of the cutback budgets. It helps us to compare the average (mean) bases of the twenty-one regular budgets with the average bases of the thirteen cutback budgets. The coefficients tell us that the average base expenditures for the twenty-one regular budgets are about

\$300 million (a value determined by combining the value of the base with the additive dummy base) and that the average base expenditures for the thirteen cutback budgets is about \$35.4 million. This is intuitively satisfactory because we would expect that base expenditures in the regular, or normal, budgets would be higher than those in the cutback budgets and that the combined base (found in the simple model) would be somewhere in between.

We can see that the estimate of the additive dummy remains statistically significant but that the estimate of the base of the cutback budgets is not. This leads us to conclude that the reason the model is so robust in the simple version is the overwhelming impact of the regular budgets. In other words, the changes occurring in the bases of the cutback budgets are not statistically significant and could have occurred by chance.

Marginal Change. This version of the model gives us added insight into the changes occurring in the slope (margin) when we compare the regular budgets with the cutback budgets. The estimates show that for every dollar appropriated in the prior year, \$1.02 (i.e., .95 plus .07) was spent, give or take \$.04 at the 95 percent confidence level. For the thirteen cutback budgets, the tendency to spend was lower, i.e., \$.95 for every dollar appropriated, but the error is larger, i.e., plus or minus \$.06.

Once again this pattern has intuitive appeal. The tendency to spend is higher during the normal years, lowest during the cutback periods and somewhere in between when

the budgets are combined. Furthermore, these changes are all statistically significant at the .05 (actually at the .01) level.

Complex. Finally, data was analyzed in a model which included both dummy variables. This was done to assess their combined effects. The base averages for the regular budgets drop to about \$226 million and to \$171 million for the cutback budgets but neither figure is statistically significant. The slope of the twenty-one regular budgets also drops slightly to \$1.02, but even this is not statistically significant. The only remaining statistically significant estimate is that of the thirteen cutback budgets, which is \$.96, but it has a larger standard error.

We can conclude from this exercise that the linear model remains quite useful as an explanation of budgetary decision making for the state budget as a whole and that it does provide some insights about the separate effects on the margin when regular and cutback budgets are compared. It is less useful, however, when attempting to analyze their interactive effects.

IV. More Extreme Tests

The model was seen to be quite useful when applied to the budget as a whole, i.e., to expenditures across twenty-five budget categories. The budget as a whole, however, is an average. What would happen if the model were tested with component parts which were extreme cases?

We had originally hypothesized that the model would be less useful in severe cutback cases. In order to test this,

some means had to be devised to identify those budget categories which had experienced more serious cutbacks. Accordingly, the mean percentage change each year in appropriations for each of the twenty-five department/fund categories over the twenty-one year period was calculated. Percentage change for the twenty-one, regular budgets was calculated in addition to the change for all thirty-four budgets. A rank-order index of change, or volatility, was then constructed to show which categories changed most. The index was constructed in three different ways: through simple addition, squared percentages, and as whole numbers. The whole number scale was selected because it more clearly reflected the range of change compared to the additive scale and was a simpler clone of the scale of squared percentages. The index is shown in Table 5.2 and Figure 5.1.

Before proceeding to apply the index, some observations about the index itself are in order. The first and most obvious is that a range of change is indeed apparent and that it is fairly broad, ranging from over 50 percent for capital outlay to barely over eleven percent for the Department of Mental Health for the twenty-one regular budgets. That range expands to over 500 percent for capital outlay and extends down to a bit over seven percent for Mental Health when the thirteen cutback budgets are included.

The second observation which must be made is the fairly consistent pattern between the two budget columns. This shows that budget categories that are relatively more

Table 5.2

Volatility Index
Percent Change (Whole Number)
in Appropriations by Department

Dept	21 Budgets	34 Budgets	Percentage Difference
AG	17.58	13.92	3.66
ATT	16.46	11.34	5.12
CR	22.22	14.33	7.89
CS	12.06	8.28	3.78
COM	23.39	14.91	8.48
COR	15.15	9.79	5.36
ED	21.53	14.57	6.96
EXE	24.16	17.76	6.40
HED	12.13	9.29	2.84
JUD	21.90	13.56	8.34
LAB	32.32	22.98	9.34
LEG	17.97	11.32	6.65
L&R	13.84	10.21	3.63
DMB	37.16	24.29	12.87
DMH	11.03	7.38	3.65
MIL	15.39	10.72	4.67
DNR	20.16	13.61	6.55
DPH	15.45	11.47	3.98
SCH	24.89	20.03	4.86
DSS	17.82	11.90	5.92
ST	32.76	22.35	10.41
POL	13.61	9.42	4.19
TRS	11.82	8.13	3.69
DS	34.29	20.84	13.45
CO	53.49	526.56	-473.07
AVE	13.14	10.04	3.10

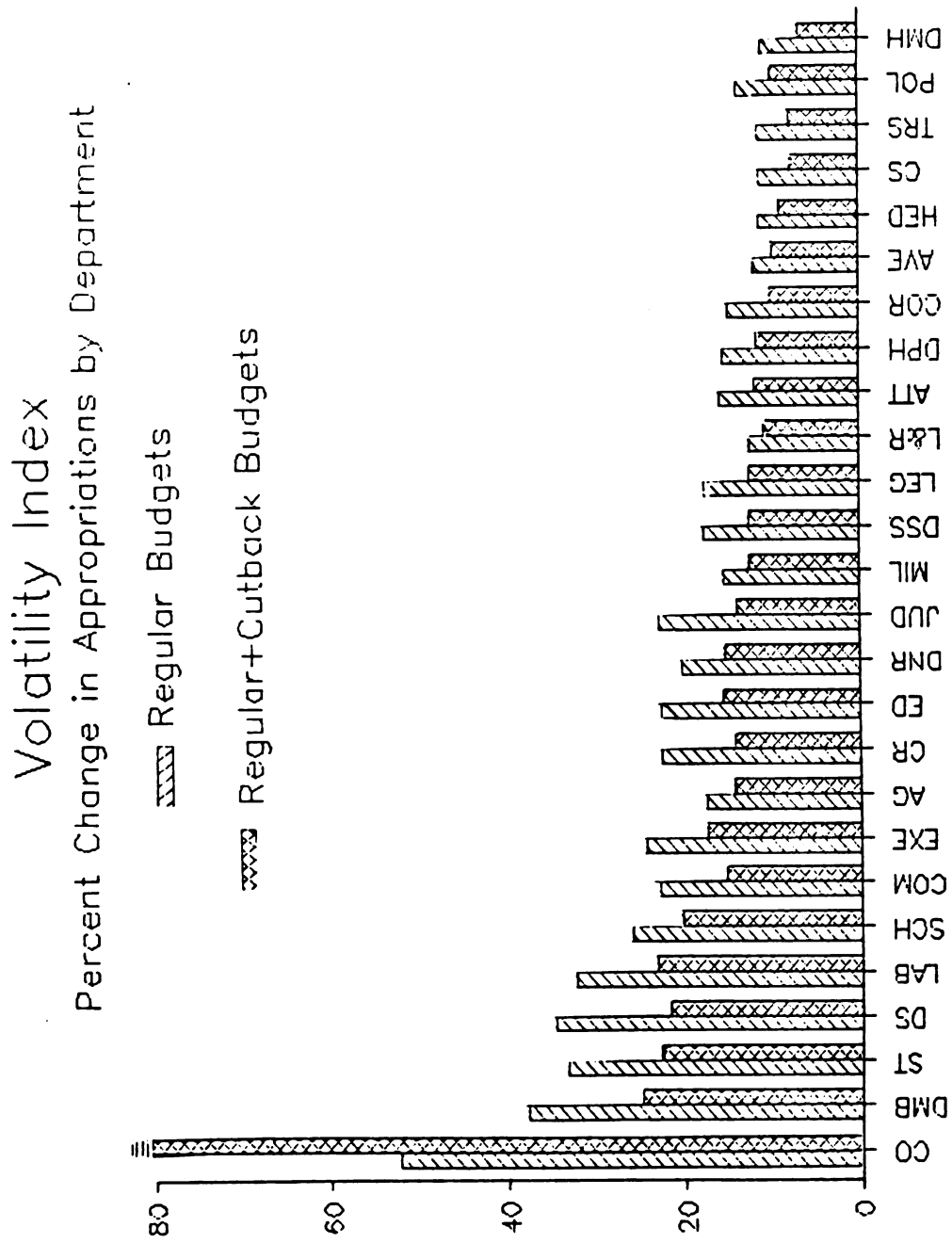
Standard Deviation 93.48

Standard Deviation
(less Capital Outlay) 4.17

Source: State of Michigan. Executive Budgets,
1963-1984 and various Executive Orders.

Note: See Appendix A for explanation of
abbreviations.

Figure 5.1



Source: State of Michigan. Executive Budgets, 1963-1984 and various Executive Orders.

volatile in normal times are also those that are more volatile in cutback periods. The relative lack of change in rank order, however, does mask some differences in those categories which sustained relatively more change under the cutback budgets. This only becomes apparent when the percentage differences are examined and compared to the regular budget ordering. In this case, five categories: the Department of Agriculture, the Executive, School Aid, and the Departments of Treasury and Corrections change positions by five or more ranks.

Budget categories were then grouped by deviation from the mean. As extreme changes in the capital outlay category greatly distorted the calculations, separate computations were made for the standard deviation, with and without this category. Budget categories lying outside two standard deviations from the mean on the smaller scale were then selected for the analysis. These were: Capital Outlay, Debt Service, the Department of Management and Budget, the Departments of State and Labor, and the Department of Commerce. All exceeded a value of 8.34.

Data was then analyzed for each of these budget categories across the twenty-one regular and thirteen cutback budgets. As with the budget totals data, dummy variables were used to assess the impact of the cutback budgets. Results of these analyses are reported in Tables 5.3 through 5.9. Analysis of these results follows each table.

Capital Outlay. This budget category is clearly the

most volatile of all. That this is so is not surprising. Capital outlay is that part of the budget devoted to large-scale construction and maintenance of long-term additions to the state's fixed assets. Such projects may range from prisons to waterways and include such costs as planning, site acquisition and development, engineering studies, remodeling and repair, fire protection, energy conservation, as well as those for actual construction (Office of the Budget, n.d.).

Capital outlay is also the classic pork barrel. As one informant described it, "capital outlay is probably the most political, sensitive budget area there is."

Because these projects tend to be large, discreet, efforts, budgeting patterns tend to be lumpy even in normal times. These characteristics also tend to make the capital outlay budget most vulnerable to budgetary cutbacks. If times are bad, acquisition of a new whatever can simply be delayed until more money is available. For example, in fiscal year 1982-83, when Michigan was still in the grips of the recent recession, capital outlay appropriations were cut sixty percent below those of the previous year and a mid-year executive order reduced the amount almost another 100 percent. From a budget of \$63 million in 1981-82, capital outlay appropriations in mid-1983 had been reduced to \$355,000. In the following fiscal year, 1983-84 which was the first up-swing year in the recovery, appropriations for capital outlay were restored to almost \$58 million, an enormous increase.

Capital outlay expenditures also may not evenly reflect prior year appropriations, as appropriations tend to be made for the needs of the current year which may differ significantly from the previous year. Although funds for longer term projects are appropriated in annual increments in the context of a multi-year authorization which is "not to exceed" a certain amount, the mix of projects naturally changes each year.

These conditions are reflected in the results seen in Table 5.3. The R^2 for the cluster of models never exceeds twenty percent and is lowest (nine percent) when all budgets, regular and cutback, are included in the equation. Even in normal times, appropriations in the prior year account for only about twenty percent of the variation in expenditures.

Coefficients in these models vary considerably from those reported for budget totals (Table 5.1). Here we find that base for the combined regular and cutback budgets at a statistically significant \$44.5 million but it is only about \$40 million for the regular budgets alone. Indeed, the base is higher (about \$49 million) for the cutback budgets alone, but none of the changes are significant. Spending in the cutback budgets tends to be at a slightly higher rate (\$.34 per \$1.00 appropriated--also statistically significant) than for the regular budgets (\$.18), but the difference is not quite significant at the .05 level. The complex version mirrors the relationships in the base change and marginal change models but it is not statistically significant.

Table 5.3

LINEAR MODEL. COEFFICIENT ESTIMATES
Capital Outlay Expenditures 1964-1984

(N=34)									
Budget Model	Base	-----Margin-----		-----Additive Dummy-----		-Multiplicative- Dummy		R2	f
		Slope	t	Base	SE	Slope	t		
Cochrane-Orcutt Estimation									
Simple	44,452,800	4.18M	.19	.11	1.71			.09	2.93
Base									
Change	49,107,300	4.27M	.20	.11	1.85	-8,776,570	4,417,110	.20	3.44M
Marginal									
Change	41,358,500	3.63M	.34	.13	2.59M			.20	3.50M
Complex	44,755,100	2.96M	.26	.22	1.29	-4,000,700	11,418,500	.20	2.30

*Significant at the .05 level.

Source: State of Michigan. Executive Budgets, 1964-1984 and various Executive Budgets.

Part of the reason for the curious estimates found in these models may lie in the fact that appropriations for capital outlay showed annual reductions in fourteen out of the thirty-four budgets. Only five of these were cutback budgets.

Debt Service. Debt service is that part of the budget devoted to payment of principal and interest on state debts. For the purpose of this analysis it also includes transfers and grants such as payments to the State Employees' Retirement Fund, workers' compensation insurance premiums, grants for community development training, regional planning, and other projects. Like capital outlay, these features also tend to make this category a political porkbarrel. Debt service is separately itemized in some budgets and is combined with grant and transfers in others. Therefore, for the purpose of this analysis, both categories were combined. It is important to remember this because in the cutback orders, cutbacks in grants largely accounted for the reductions in this combined category. The results of the regression analysis on this data are shown in Table 5.4.

Although the R^2 s for the OLS estimates suggest that the model explains about one-fourth of the variance in expenditures, the errors are suspiciously serially correlated. Alternative results produced with the Cochrane-Orcutt technique show virtually no explanation at all. The model is not useful with this data. Why this should be so is not entirely clear. However, if we compare the percentage change in appropriations the previous year

with the percentage change in expenditures for the following year, we find that both are negative or positive in only thirteen of the budgets. Of the others, five show no change, and the remainder show mixed patterns, i.e., when appropriations increase, expenditures decrease, and vice versa. Moreover, a decrease in appropriations matched with an increase in expenditures occurred twice as often as the reverse, i.e., an increase in appropriations matched with a decrease in expenditures.

Management and Budget. The budget category showing the third highest percentage change between the regular and cutback budgets was the Department of Management and Budget. Estimates for this category are reported in Table 5.5

Unlike some of the other budget categories analyzed in this chapter, data for the Department of Management and Budget responded to Ordinary Least Squares estimation without evidence of serial correlation. Therefore, it is these estimates which are discussed here.

As the name implies, the Department of Management and Budget is that unit in Michigan State Government charged with development of the state budget and with management of state properties including office services and purchasing as well as oversight of management practices. Three huge retirement systems are managed by the department including those for public school, state and municipal employees. In addition, under the departmental umbrella function a number of specialized commissions such as those for toxic substance control, the arts, Indian affairs, women and Spanish

Table 5.5
 LINEAR MODEL. COEFFICIENT ESTIMATES
 Department of Management and Budget Expenditures 1964-1984

(N=34)																		
Budget Model	Base	t	-----			t	-----			Base	-----			-----			R2	f
			Slope	SE	Margin		SE	Slope	SE		Dummy	t	SE	Dummy	t			

Ordinary Least Squares																		
Simple	61,674,200	2.19M	8.52	.60	14.28M											.87	203.93M	
Base																		
Change	61,253,900	1.50	8.52	.63	13.49M		535,450	37,027,500	.01							.87	98.68M	
Marginal																		
Change	60,953,800	2.12M	8.42	.68	12.39M							.23	.74	.31		.87	99.05M	
Complex	81,204,100	1.44	8.10	1.03	7.87M		-276,037	65,823,900	-.42	.68	1.31	.52				.87	64.27M	

MSignificant at the .05 level.

Source: State of Michigan. Executive Budgets, 1963-1983 and various Executive Budgets.

speakers. The departmental director is appointed directly by the governor.

In this data set, the cluster of models show a high degree of explained variation between expenditures and prior year appropriations, and all of the equations are statistically significant at the .05 level. While only the base in two of these models is statistically significant, all of the slopes are. They show that this department was a growth area for all thirty-four budgets, i.e., DMB officials spent about \$8.52 for each dollar appropriated to their department in the prior year's budget but that this dropped ten cents (i.e., to \$8.42) when the cutback budgets are taken alone. One obvious reasons for this is that the department experienced cutbacks in appropriations in two-thirds (nine) of the thirteen cutback budgets.

If we consider only the regular budgets (although the slope change here is not statistically significant), the department spent \$8.65 for each dollar appropriated in the prior budget year, and the standard error is actually larger. This may be explained by the fact that in the years up to 1971-72, there is a clear pattern of slight overspending in every budget. The department also received a substantial increase (250 percent) in appropriations in 1973-74, the year its reorganization took effect, and other increases (91 percent each) in 1977-78 and 1982-83. Given the lumpiness of this data, it is somewhat surprising that the model works as well as it does here.

Following the Department of Management and Budget, the

budget category showing the greatest difference in change between the regular and cutback budgets is the Department of State.

Department of State. Inclusion of the Department of State in this list comes as a bit of a surprise. When one thinks of this department one thinks of activities that are quintessential obligations of state government: administration of elections and vehicle registration and driver licensing. The department also controls the state seal and is responsible for maintaining the state museum and archives. Not the sort of thing likely to promote volatile budgetary behavior. It is one of the smaller departments in state government and its head, the Secretary, is elected and a constitutional officer of the state.

Estimates derived from this data are reported in Table 5.6. Once again the cluster of models show a fairly high degree of explanation, i.e., the R^2 s stand at 63 percent and all are statistically significant.

Like the overall budget totals (Table 5.1), the base for the twenty-one budgets alone is a slight bit higher (\$2,293,666 million) than that of the thirteen cutback budgets (\$2,254,840 million), and the combined thirty-four budgets are in between. These base changes are small and they are only partly statistically significant, i.e., the change for the twenty-one regular budgets registers only a t-value of .07.

What is interesting about these models is the marginal change. As we can see in the simple model, only \$.61 is

spent for each dollar appropriated in the prior year. This return on public investment seems extraordinarily inefficient until we observe that in nineteen of the thirty-four budgets, expenditures for this department were actually less than the prior year's appropriations. Only eleven of these budgets were cutback budgets. The remainder reflect, in part, economies that this department was able to achieve through implementation of a staggered automobile registration system, implementation of a rather sophisticated workload planning process based on anticipated transactions in the department's 234 branch offices, and installation of what the department calls an intelligent terminal process in its source data entry systems located in its branch offices for the various licensing and registration programs which it must administer.

There is virtually no change in the margin when the effects of the regular and cutback budgets are separated out and the change is not statistically significant.

The relative uniformity of these estimates suggest that this department is, in effect, exercising cutback management across regular budgets and cutback budgets and that this spending behavior does not change in good times or bad. It is a kind of reverse pareto optimality. As their budget director described it, "We would innovate so long as (the innovations) did something for the citizenry that we were dealing with and the cost either remained the same or hopefully was reduced."

The model is somewhat more successful with this data as well in that slightly more indicators are statistically

significant even though the overall explained variation is somewhat lower than with the DMB data. And, although the budget-by-budget change in appropriations is still great enough to place this department in the most volatile quartile, the amount of change is declining as we progress lower on the list. Whether this is a satisfactory reason will be seen when we analyze the fifth and sixth categories on the list. We turn to the fifth, the Department of Labor, now.

Department of Labor. The Department of Labor showed the next largest change between regular and cutback budgets. Data on this department is reported in Table 5.7.

As the name suggests, this department monitors working conditions in the state and promotes employee interests. Among its responsibilities are administration of the workers' compensation program, development of information on employment and economic development, and administration of occupational safety, disability, and rehabilitation programs. The department has a large labor relations and mediation program as well as specialized offices serving handicappers, youth and women. A large amount of federal funds flow through this department because the Michigan Employment Security Commission (MESC), its Advisory Council and Appeals Board are organizationally part of the department although autonomous. The MESC administers the unemployment insurance benefits program described in Chapter Four for eligible workers and maintains statewide offices to match job openings with job seekers. Like the head of the

Table 5.7

LINEAR MODEL. COEFFICIENT ESTIMATES
Department of Labor Expenditures 1964-1984

Budget Model	(N=34)												
	-----Margin-----				-----Additive Dummy-----				-Multiplicative-				
	Base	t	Slope	SE	t	Base	SE	t	Slope	SE	t	R2	f
Ordinary Least Squares													
Simple	305,879	.15	1.04	.08	13.03*							.85	169.83*
Base													
Change	-3,475,570	-1.16	1.09	.08	13.14*	4,666,120	2,781,720	1.63				.86	91.29*
Marginal													
Change	-253,563	-.13	.99	.08	11.87*				.17	.10	1.63	.86	90.74*
Complex	-2,313,560	-.61	1.04	.12	8.72*	2,883,580	4,485,620	.64	.09	.17	.51	.86	59.45*

*Significant at the .05 level.

Source: State of Michigan. Executive Budgets, 1964-1984 and various Executive Orders.

Department of Management and Budget, the director of the Department of Labor is directly appointed by the governor.

Although the OLS estimates for the marginal change and complex versions of the model suggest that serial correlation might be present, analysis nevertheless focuses on the OLS estimates because the correlation problem is slight and is not apparently present in the other two models. Here we find that the simple model shows a high degree of explained variance (eighty-five percent) in expenditures and that the variation is statistically significant. The model also shows a statistically significant marginal change such that for every dollar appropriated in the prior year, \$1.04 cents was spent. Thus, although this department was among the more volatile fluctuators between regular and cutback budgets, the overall effect on the department suggests that growth was nearly static. This is so because, despite the fact that the department showed spending at a rate of \$1.16 per each dollar appropriated in the regular prior year budgets as compared to \$.99 for the cutback budgets, the change was not statistically significant.

So the model, in this case, remains useful although the explained variance for the marginal change and complex models is probably a bit inflated because of the slight serial correlation. There is also some fall off in overall statistical significance for all the indicators.

Department of Commerce. The final data set considered in this chapter is that of the Department of Commerce.

Estimates are reported in Table 5.8.

Although the Michigan Department of Commerce is considered a regulatory agency because it is charged with oversight of the state utilities, financial institutions, corporations and securities, liquor control and energy consumption, there is another side of the department which is concerned with a form of resource development. This includes tourism, international trade, housing, economic and community development and related job development. Except for housing, these latter responsibilities have grown substantially in the last decade. The department is one of the more diverse in state government. Its director is appointed directly by the governor.

All versions of this model yield a very high degree of explained variance, ninety-three to ninety-five percent. These coefficients are all statistically significant.

Spending in this department across all thirty-four budgets is at \$.97 for each dollar appropriated in the prior year. When we test for change in this rate between the regular budgets and the cutback, we find an annual increase of about twelve percent in good times, (i.e., a statistically significant \$1.12 per dollar appropriated in the prior year) compared to \$.94 in the cutback budgets. This relationship is repeated in the complex model, but only the slope of the cutback budgets is significant. Compared to the other budget categories analyzed, budget behavior in the Department of Commerce more closely approximates that of the total state budget. That may result from the smaller amount

Table 5.8

LINEAR MODEL. COEFFICIENT ESTIMATES
Department of Commerce Expenditures 1964-1984

Budget Model	(N=34)				--Additive Dummy--				--Multiplicative--			
	Base	t	Slope	SE	Margin	t	Base	SE	t	Slope	SE	t
Ordinary Least Squares												
Simple	1,938,620	.99	.97	.05	19.81*							
Base												
Change	-3,892,620	-1.42	1.02	.05	21.04*	2.79*	6,582,760	2,359,510				
Marginal												
Change	184,948	.10	.94	.04	21.70*				.18	.05	3.36*	
Complex	-660,898	-.20	.95	.06	14.90*	.31	1,211,800	3,935,310	.16	.09	1.67	

*Significant at the .05 level.

Source: State of Michigan. Executive Budgets, 1964-1984 and various Executive Orders.

of volatility present in the Commerce data.

So what can be said of this model? How adequately does it handle explanation of budgetary behavior in periods of fiscal stress? One means of summarizing the previous discussion would be to compare the range of R^2 s reported and the frequency of statistically significant coefficient estimates across each of the models. That is summarized in Table 5.9 below.

As we can see with the budget totals, the model holds firm at a high level of explanation (.97) with the budget totals simple model and is virtually the same with the base and marginal change models. All are statistically significant. While the base in the cutback models is not significant, the marginal change is. Altogether, three-fourths of the indicators show statistical significance.

We really have two basic questions here: 1) whether the linear model holds the Michigan data and 2) whether it is still significant under cutback conditions. When we consider the GF/GP Totals (all twenty-five categories) we find the model shows a high degree of explanation but that the cutbacks are only significant at the margin. There is no significant change in the base.

Although the cutbacks in personnel and programming seemed devastating, especially during the 1980-83 depression, the greater foundation of state spending was not eroded. Changes between the regular and cutback budgets are significant only at the margin.

When we consider the more extreme cases selected on the

basis of volatility, we find that the model breaks down. The six budget subcategories in Table 5.9 are arranged in terms of declining volatility and, except the DMB models, there is a trend shown in this data: as the volatility declines, the explained variance increases. Like the Totals models, these six show no significant changes between the regular and cutback budgets. Like the R2s, the slopes do not become significant until the data regularizes and there is no significance in the slope change between the regular and cutback budgets until the last (Commerce).

Clearly with these more volatile budget subcategories, the model works, but less well. Compared to the Totals models, there is a fall off in explained variance as well as in statistical significance. Something else is going on. Of course, firmer conclusions could be drawn if all twenty-five categories were analyzed in this fashion. That will be the subject of subsequent research.

V. Summary

In this chapter we have tested the hypothesis that the linear model as first developed by Davis, Dempster, and Wildavsky (1966) as interpreted by Hoole, Handley and Ostrom (1979) is an inadequate explanation of budgetary behavior in periods of fiscal stress, i.e., there is no relationship between expenditures totals and the total appropriation as a fixed percentage of the prior budget in a cutback period. The analysis shows that the model and its variations explain changes in the total budget well and shows that these changes came primarily at the margins. It is not adequate

for subsets of the budget which display greater volatility generally and in deviation between regular and cutback budgets.

Although the linearity feature is perhaps the most important aspect of incrementalism, it is only one dimension of the theory. Another aspect is the fair shares concept. Whether fair shares holds under conditions of cutback is the initial focus of the next chapter.

Notes to Chapter Five

1. Some scholars argue that the cyclical nature of the budgetary process is such that lagged endogenous variables implicitly occur in the equation nevertheless.

An additional shortcoming of the Durbin-Watson test is its uncertainty zones, i.e., areas in the four-point scale within which the researcher has difficulty deciding whether autocorrelation is a problem. In order to avoid this dilemma, conventional strategy was adopted: the upper limit of the uncertainty zone was used as the cut-off point.

Chapter Six

Findings: Fair Shares and Marginality

I. Introduction

In the previous chapter we evaluated the argument that the linear model, that classic expression of the budgetary decision process first formulated by Davis, Dempster and Wildavsky (1966), is no longer servicable when dealing with budgetary cutbacks. We found that the model does retain a measure of utility for the total state budget, but breaks down under the extreme conditions existing in some categories of the total state budget.

In this chapter we proceed to evaluate two other features of incrementalism, fair shares and marginality, which have also been thought to collapse as cutbacks eroded more and more of the budget. We will discuss the more interesting issue, fair shares, first.

As first outlined in Chapter Four, fair shares is the concept that budget decisions are reflections of attitudes that agencies ought to receive some appropriate portion of the total revenues available to the system. Agencies that continue to receive a given, or larger, piece of the pie are thought to prosper.

In this analysis we use the fair shares model developed by Natchez and Bupp (1973) as interpreted by Hoole, Handley and Ostrom (1979):

$$E_t = b P_{t-1} + e_t \quad (1)$$

where E = expenditure total

b = a fixed percentage

P = the total budget for the system

e = the error term

As with the linear model, the statistical procedures and constraints discussed in the previous chapter apply here as well. In the first set of estimations, we used the basic ordinary least squares (OLS) technique which produces values for a constant and a slope for exactly the same reason given in the previous chapter: comparability. Dummy variables for intercept and slope were used to assess the effects of the cutback budgets. These procedures are summarized as follows:

$$\text{Simple: } E_t = a_1 + b_1 P_{t-1} + e_{1t} \quad (2)$$

$$\begin{aligned} \text{Complex: } E_t = a_2 + b_2 P_{t-1} + gD_2 + \\ gD_3(P_{t-1}) + e_{2t} \end{aligned} \quad (3)$$

where E = expenditure total

a = constant (intercept)

b = a fixed percentage

P = the total budget for the 25 budget categories

g = estimate of the dummy variable

D = a dummy variable where

1 = regular budgets

0 = cutback budgets

e = the error term (factors not in the equation)

As serial correlation was also a problem with these models, they were re-estimated using the Cochrane-Orcutt

technique. Again, the assumption was that the autocorrelation was a first-order autoregression.

With these models, however, heteroscedacity is potentially a more conspicuous problem. Because we are comparing shares of a single unit which range considerably in size, i.e., the amount claimed by the smallest budget category (the Executive Office) in the 1983-84 budget was only slightly more than .1 percent of the largest budget category (Department of Social Services), it was thought that some means should be used to reduce potential distortion of the estimates caused by the extremes in relative size. Therefore, the models were re-estimated a third time, this time for weighted least squares. The weight used was the base, P_{t-1} . Although correction procedures were used, serial correlation continued to be a problem. Estimates for two-thirds of the budget categories continue to be plagued with serial correlation, although it is the complex model which is largely troublesome. Serial correlation appears in the simple model versions of only eight budget categories, but indications are that the degree of serial correlation in five of these cases is small.

If we discount the estimates of the seventeen categories apparently biased by serial correlation in one or both models, we are left with eight: agriculture, the departments of civil rights and civil service, the higher education fund, the departments of labor, management and budget, military affairs, natural resources, and public health. In four of these remaining cases, neither of the

models is statistically significant so no conclusions can be drawn from them. These four are: the higher education fund and the departments of labor, management and budget, and natural resources.

Thus, although the fair shares model shows some statistical significance for sixteen of the twenty-five (sixty-four percent) budget categories, residual serial correlation limits analysis of all but four: the departments of agriculture, civil rights, civil service, and public health. These estimates are reported in Table 6.1.

II. Initial Findings

In first evaluating the linear model, estimates were first obtained for an overall average, the totals of the twenty-five budget categories. Because we are testing for shares of the overall in this model, however, that is not possible. Therefore the benchmark data taken is that budget category of the remaining four which is found to be closest to the average reported on the volatility index appearing in chapter five. That category is the Department of Public Health.

Public Health. This department is charged with administration of programs designed to promote and protect what the state constitution calls a "primary public concern," the health of the people of Michigan. Among its responsibilities are: prevention of communicable and chronic diseases, assistance to local health programs, management of health programs for special needs populations such as crippled children, licensing and regulation of health

Table 6.1

FAIR SHARES MODEL. COEFFICIENT ESTIMATES
 Departmental Expenditures 1964-1984

(N = 34)

Department/ Fund	Intercept (Base)	t	Slope (Margin)	SE	t	R ²	f

Weighted Least Squares							
Agriculture							
Simple	4,928,270	2.28*	.00290	.00054	5.35*	.78	105.46*
Complex: Reg	3,622,991	-.26	.00346	.00068	.88	.88	68.95*
Complex: Cut	4,333,680	1.85	.00286	.00056	5.10*	.88	68.95*
Civ Rights							
Simple	8,724,670	6.42*	.00016	.00018	.91	.17	5.96*
Complex: Reg	6,687,741	.52	.00049	.00007	.32	.42	6.65*
Complex: Cut	6,536,570	5.21*	.00047	.00019	2.52*	.42	6.65*
Civ Service							
Simple	-375,651	-.93	.00163	.00010	15.78*	.96	523.18*
Complex: Reg	-402,352	-.04	.00168	.00017	.52	.94	135.30*
Complex: Cut	-371,123	-.55	.00159	.00016	9.84*	.94	135.30*
Public Health							
Simple	-13,213,400	-1.83	.02242	.00184	12.20	.92	345.63*
Complex: Reg	-16,919,950	-.12	.02466	.00259	1.08	.92	97.99*
Complex: Cut	-15,671,700	-1.51	.02187	.00249	8.77*	.92	97.99*

*Significant at the .05 level.

Source: State of Michigan. Executive Budgets, 1963-64 through 1983-84 and various Executive Orders.

services and facilities including substance abuse programs, administration of some federally funded programs such as hospital construction, and other programs.

As we can see in Table 6.1, the fair shares model shows a high degree of explained variance (.92) between expenditures as a share of the total appropriation in the prior year and that this level holds when varied to differentiate between the regular and cutback budgets. This lack of change in goodness of fit does not coincide with the hypothesis, so we have a bit of evidence that the concept of fair shares may perhaps hold in the cutback process.

While the intercepts are all negative, (and may indicate other problems), they are not statistically significant. What is significant is the slope. Here values are reported to the fifth decimal point to show the tiny marginal change. This is necessary because we are looking for marginal change in a fraction of the budget based on a change in the entire GF/GP total. The spending estimates are \$.02 per dollar appropriated in the prior year, slightly higher in the regular budgets, lowest in the cutback and in between for the combined (simple model). This is as expected. The marginal difference between the regular and cutback budgets, however, is not significant. The standard error shows a small increase (.001) over that of the error for the simple model.

Having established a benchmark, we move to the remaining categories, again using the volatility index to order the analysis. According to that criterion the order

is: the departments of civil rights, civil service, and agriculture.

Civil Rights. This department, among the smallest third of the twenty-five budget categories, is one of five departments in Michigan State Government headed by an appointed commission. The commission is constitutionally established and appoints the departmental director.

The department is responsible for investigating alleged discrimination incurred by individuals because of religion, race, color, national origin, as well as handicap, marital status, sex and age.

With this data, the R^2 rises conspicuously. Prior appropriations for all categories only account for seventeen percent of this department's expenditures in the simple model, but the coefficient more than doubles with the addition of the dummy variables to forty-two percent. All of these values are statistically significant. If we compare the shares received by this department under the regular and cutback budgets, we see a tiny change, dropping to .0047 per dollar appropriated, but the change is not significant. As expected, the error rises under the cutback situation.

Compared to the other budget categories in this analysis, the fare shares model has less explanatory value for Department of Civil Rights data. This is primarily because the coefficient of determination is significantly lower.

We now turn to the next category in this initial analysis. That is the Department of Civil Service.

Civil Service. This department, like the Department of Civil Rights, is headed by a constitutionally established commission. The commission appoints the departmental chief, the State Personnel Director. Its primary obligation is the maintenance and promotion of the state merit system which covers classified civil servants who account for the vast majority of state employees.

With this data, the fair shares model accounts for more explained variability than with any other in this analysis. The level of appropriations for the system accounts for ninety-six percent of the variation in expenditures by this department. This statistic drops slightly in the complex model and all are highly significant. The coefficients show that civil service nets about two mills (.0016) per dollar appropriated for the system. As expected, this amount rises in the regular budgets and falls under cutback conditions. The error increases a bit in the complex model.

Like the public health data, there is no statistical significance in the base or slope change between the regular and cutback budgets, lending further evidence to the notion that fair shares continues to play a role in cutback budgeting.

Agriculture. Like the Department of Civil Rights, the Department of Agriculture is relatively small and headed by a commission. Unlike the Civil Rights Commission, however, the agriculture commission is not constitutionally established. The commission appoints the department's director. As the name suggests, this department is charged

with promoting agricultural production and marketing, food inspection, and protecting the state's foods from pestilence and disease, as well as related programs.

The fair shares model shows a high degree of explained variance for the simple model, i.e., about seventy-eight percent, and this coefficient rises another ten percent in the complex model. The slope coefficient for the simple model shows that agriculture spends about three mills for each dollar appropriated for the whole. As with the other previously reported, this value falls between spending in the regular and cutback budgets. Once again, the change in base and margin between the regular and cutback budgets is not statistically significant.

We would conclude that the fair shares model is most useful in explaining budgetary decisions for the Department of Civil Service, fairly useful for agriculture and public health, and somewhat less useful for the Department of Civil Rights data.

Summary. Given the statistical problems with the data, we can say less about the value of the fair shares model than of the linear. A comparison between the simple and the complex models is only possible with a few budget categories because the remainder continue to show serial correlation and/or are not statistically significant. There is nothing in this slim evidence, however, to suggest that fair shares does not continue to be honored in cutback times.

III. A Closer Look at Shares

A conspicuous problem with this analysis is the lack of any substantive comments which can be made about the policy question: is budgeting more redistributive rather than distributive during cutback times. Because slope coefficients were only reported in Table 6.1 for the few data sets showing statistical significance, real analysis of this question is yet to be made. The most interesting answers still need to be teased out.

One way to do this is to use a different form of analysis in which average cuts are compared to average expenditures. This is what has been done in Tables 6.2 and 6.3. Departments and funds are rank ordered according to the size of their fair shares expressed as average expenditures in the regular budgets and the size of their average cuts. Comparison is made by calculating the ratio of cuts to expenditures.

Shares in the Regular Budgets. The distribution seen in Table 6.2 comes as no surprise. That social services ranks first in budgetary spending is well known. Although some of the services remain subject to hot political controversy, its major role in consumption of the state budgetary dollar in Michigan is well known. Nor does it come as any surprise that higher education and mental health should be among the top grouping.

That the smaller budget categories, e.g., the departments of civil rights, licensing and regulation, and the attorney general, are found in the lower end of the spectrum is also unremarkable. The same may be said of those in the middle.

Table 5.2

Rank Order by Department of
Average Expenditures (1963-1984),
Average Executive Order Reduction (1970-1983)
(in millions),
and Ratio of Reductions to Expenditures

Rank	Department	Average Expenditure	Department	Average Cut	Department	Out to Expenditure Ratio
1	Soc Services	952.59	Soc Services	50.22	Cap Outlay	.0912
2	School Aid	503.16	School Aid	23.17	Labor	.1764
3	Higher Ed	405.48	Higher Ed	21.06	State	.1550
4	Mental Hlth	279.94	Cap Outlay	15.06	Agriculture	.1248
5	Debt Service	93.39	Mental Hlth	9.37	Lic & Reg	.1129
6	Connections	90.39	St Police	3.94	Pub Health	.0921
7	St Police	63.91	Pub Health	3.69	Civil Service	.0785
8	Cap Outlay	53.55	Labor	2.91	Nat Resource	.0760
9	Pub Health	44.93	Connections	2.68	Commerce	.0751
10	Treasury	41.12	Debt Service	2.68	Atty Gen	.0736
11	Manag & Bud	31.29	Nat Resource	2.25	Manag & Bud	.0626
12	Education	29.89	Commerce	2.02	St Police	.0501
13	Nat Resource	29.62	Manag & Bud	1.96	Soc Services	.0599
14	Commerce	26.91	Treasury	1.62	Civil Rghts	.0508
15	Legislature	23.44	Agriculture	1.51	Education	.0492
16	Judiciary	21.69	Education	1.47	School Aid	.0460
17	Labor	16.50	State	1.01	Exec Office	.0455
18	Agriculture	12.10	Legislature	.77	Mil Affairs	.0440
19	State	5.12	Lic & Reg	.63	Higher Ed	.0425
20	Atty Gen	5.84	Judiciary	.56	Treasury	.0394
21	Lic & Reg	5.58	Atty Gen	.43	Mental Hlth	.0335
22	Mil Affairs	5.00	Civil Serv	.30	Legislature	.0328
23	Civil Rghts	4.33	Civil Rghts	.22	Connections	.0297
24	Civil Serv	3.82	Mil Affairs	.22	Debt Service	.0287
25	Exec Office	1.98	Exec Office	.09	Judiciary	.0259

Source: State of Michigan. Executive Budgets 1964-1984, Department of Management and Budget, Lansing, and Executive Orders Binder, Legislative Service Bureau Library, Lansing.

Table 6.3
Average Executive Order Reduction (1970-1983) by
Average GF/GP Expenditures (1964-1984)

Average Expenditures	Average Reduction				
	Smallest Fifth	Second Fifth	Third Fifth	Fourth Fifth	Top 20 Percent
Smallest Fifth	Exec Office Civil Rights Civil Serv Mil Affairs	Lic & Reg			
Second Fifth	Atty Gen	Judiciary State	Agriculture	Labor	
Third Fifth		Legislature Education	Manag & Bud Commerce Nat Resource		
Fourth Fifth			Treasury	Corrections Pub Health St Police	Cap Outlay
Top 20 Percent				Debt Service	Mental Hlth Higher Ed School Aid Soc Services

Source: State of Michigan. Executive Budgets, 1964-1984, Department of Management and Budget, Lansing, and Executive Orders Binder, Legislative Service Bureau Library, Lansing.

What is interesting about this list is that the general distribution is as predictable as it is. This says something about the fair shares concept, i.e., that it does produce a distribution which would be recognizable to many who deal with Michigan state budgets. (See, e.g., any of the pie charts included in the various editions of the Budget Message of the Governor.)

Shares in the Budget Cuts. Table 6.2 also shows the relative order of the budget cuts. There is a remarkable similarity to the listing in the expenditure column. This is demonstrated in Table 6.3 which shows the strong clustering on the diagonal. Those units which show smallest expenditures tend to be those with smallest cuts and those with large budgets sustained the largest average cuts. This general ordering, however, does not provide the finer detail needed to adequately test the hypothesis. That detail is provided by the ratio information in Table 6.2.

These tables allow us to draw some conclusions about the redistribution argument, Hypothesis 2b: those programs with the strongest political bases are least likely to be cut.

We had expected that constitutionally established units such as the legislative and judicial branches would receive proportionately smaller cuts compared to the executive branch. We find that this is only partially so. While the judiciary suffered the least of all and the legislature experienced the fourth smallest, the executive departments, i.e., the departments of civil service and civil rights,

which are governed by constitutionally based commissions, fared less well.

We also hypothesized that executive departments headed by elected officials such as the attorney general and secretary of state would receive proportionately less cuts. This was true with the Department of the Attorney General but not true with the Department of State, although the attorney general, in comparison to the other departments was not spared.

Finally, we also hypothesized that executive branch departments such as mental health and social services which serve less organized and less affluent groups would receive proportionately more cuts. This also was apparently not the case but social services fared less well than mental health. This is not to say that these departments did not sustain major cuts. Quite the opposite is true. Table 6.3 shows us that. But these cuts still left these departments maintaining their relative position in the budget pie.

Higher education and school aid, while also receiving huge cuts, maintained relative position. But in terms of the cut to expenditure ratio, higher education actually experienced smaller cuts than the school aid fund.

Of course, such a ratio of averages over twenty years hides the changing position over time of the various budget categories. For example, school aid expenditures were larger relative to the whole in the 1960s when enrollments were larger than they were in the late 1970s and early 1980s when most of the cuts took place. Averaging in the earlier

years makes it appear that their cut to expenditure ratio is less than it was. A fairer way to calculate the ratio might have been to obtain a ratio for each of the thirteen cutback budgets and then calculate an average from that.

The Vulnerability Issue. In the research design chapter (Chapter Three), we had also hypothesized that retrenchment would be directed at the most vulnerable parts of the budget such as discretionary programs like libraries and maintenance. The fair shares model, as it was subsequently worked out, does not adequately test this issue, although it is a real one in cutback research. What the previous tables (6.2 and 6.3) tell us is only which budget categories were more vulnerable to budget pinioning. As Table 6.2 suggests, these are capital outlay and the departments of labor, state, agriculture, and licensing and regulation.

Addressing the question of program vulnerability requires a different approach. This will be taken up later in the chapter.

Summary. How good is the fair shares model? We found that the fair shares model applies somewhat indifferently with the Michigan state government data. The statistical goodness of fit criterion worked well with only a few of the budget categories, but with those four seemed to be quite robust.

Is the fair shares concept honored in the cutback process? We found that the largest budget categories tended to maintain their position although sustaining large cuts.

Similarly, the smallest ranked spending category (the executive office) also received the smallest average cuts. In between, although there was some shuffling of position (see Table 6.4), the change was small if we keep Table 6.3 in perspective. Therefore, we can say that the fair shares concept tends to be honored in cutback as well as in regular times so far as Michigan state government is concerned. (1)

IV. Comparing the Linear and Fair Shares Models

As is apparent in the preceding tables in this and the previous chapter, the linear and fair shares models perform differently with different budget category data. Even so, an interesting question remains to be answered. That is, which is better? Given the statistical problems encountered with the fair shares model, can any comparison be made?

One way to answer this question is to compare the budget categories which did emerge with statistically significant R^2_s in the fair shares model with the same categories analyzed with the linear model. In order to do this, however, we must take into consideration that the fair shares coefficients reported in Table 6.1 are weighted. Therefore, linear model data for the pertinent categories was re-estimated using weighted least squares. In this case, however, the weight used is the lag of the appropriation, not quite the same as the weight used in the fair shares model which is the lag of the total appropriation. Nevertheless this produces somewhat more comparable data than a comparison of weighted and non-weighted data. The results of the weighted linear model are reported in Table 6.5.

Table 6.4

Fair Shares: Relative Position
Average Expenditures v. Average Cuts
(number of positions)

Maintained	Lost	Gained
Social Services	Labor (9)	Corrections (4)
School Aid	Capital Outlay (4)	Debt Service (4)
Higher Education	Agriculture (3)	Education (4)
Executive Office	Civil Service (2)	Judiciary (4)
	Commerce (2)	Treasury (4)
	Licensing and Reg (2)	Legislature (3)
	Nat Resources (2)	Mgmt & Budget (2)
	Public Health (2)	Att General (1)
	State (2)	Civil Rights (1)
		Mental Health (1)
		Mil Affairs (1)
		State Police (1)

Source: State of Michigan. Executive Budgets, 1964-1984
and various Executive Orders.

Table 6.5

LINEAR MODEL. COEFFICIENT ESTIMATES
Departmental Expenditures 1964-1984

(N = 34)

Department/ Fund	Intercept (Base)	t	Slope (Margin)	SE	t	R ²	f

Weighted Least Squares							
Agriculture							
Simple	21,511,300	4.56*	-.15860	.08	-1.84	.08	2.37
Complex: Reg	21,626,271	.35	-.15929	.15	-.30	.08	.79
Complex: Cut	20,726,600	3.96	-.11522	.16	-.70	.08	.79
Civ Rights							
Simple	9,835,790	5.59*	.06458	.11	.51	.14	4.89*
Complex: Reg	9,052,502	.97	.15788	.05	-.44	.30	3.77*
Complex: Cut	7,729,030	5.70*	.17897	.11	1.56	.30	3.77*
Civ Service							
Simple	10,017,200	2.88*	.07912	.16	.44	.03	.95
Complex: Reg	8,411,795	.38	.10188	.07	-.23	.06	.53
Complex: Cut	8,214,360	2.96*	.11919	.19	.63	.06	.53
Public Health							
Simple	22,278,300	1.52	.76118	.18	4.20*	.57	59.76*
Complex: Reg	14,523,260	.52	.91365	.12	.21	.86	56.48*
Complex: Cut	9,547,220	.84	.98842	.14	6.17*	.86	56.48*

*Significant at the .05 level.

Source: State of Michigan. Executive Budgets, 1964-1984 and various Executive Orders.

A comparison of these coefficients with those reported for the same categories in Table 6.1 shows that the fair shares model is superior to the linear model. The mean value of the R^2 s reported for the fair shares model (simple and complex) is .75 and all are statistically significant, while the mean value for those of the linear model is .28 and only half are significant. This is congruent with the findings of Hoole, Handley and Ostrom (1979) who reported higher values for the fair shares models than for the linear (which they call incremental), although their results showed far less difference between the models.

The observation that the fair shares model is superior to the linear model should not be construed as a contradiction of prior comments that the fair shares model produced statistically weak results. It only means that the linear model is more broadly applicable with the Michigan data, but that the fair shares model produces better results in the narrower range of cases where it is useful.

V. Program Vulnerability

In retrenchment budgeting, are cutbacks directed at the most vulnerable parts of the budget? In one sense the question answers itself, for if anything is cut, surely it was vulnerable. It seems that the question more properly ought to be, what kinds of things tend to be cut when the going gets tough? Although the analysis thus far has identified the departments and funds which were more vulnerable, it says nothing about the distribution of those

cuts within departments.

Since analyzing all cuts across all departments was not possible, a sample was selected. The budgets of three departments representing highest, mean and least cuts were inspected and compared across the last seven cutback budgets encompassing Executive Orders 1980-03, 1981-08, 1981-09, 1982-04, 1982-06, 1982-13 and 1983-05. The percentage change in appropriation level each represented over the prior level was then totalled and a rank order determined. That is reported in Table 6.6 as the cutback budgets column. However, during this period, some departments also received sizeable increases a few months later in the regular budgets which tended to mitigate the savagery of the executive orders. For example, the appropriation for the Department of Commerce in the 1980-81 budget represented a sixty-seven percent increase over the appropriation level of the prior budget, taking into account the cutback of the 1980-03 executive order. The increase for the Department of Labor for the same period represented just over 110 percent. On the other hand, there were others which took continuing cuts, even in the regular budgets. For example, in the 1980-81 budget, the Department of Agriculture took almost an eight percent cut on top of the two percent cut received in the 1980-03 executive order, and a twenty-three percent cut received in the 1979-80 budget.

No doubt there was a whipsaw effect, but it seems that a truer test of where the cuts were made would only be revealed by looking at the total appropriation trend during

Table 6.6

Percentage Change in Appropriations: 1980-1984

Rank	Department	Outback Budgets	Department	All Budgets
1	Debt Service	-3.95	Education	43.28
2	Judiciary	5.41	School Aid	32.00
3	Legislature	-7.80	Agriculture	.00
4	Corrections	-9.33	Civil Rights	12.54
5	Mental Health	-11.48	State	14.19
6	Civil Service	-12.57	Higher Ed	30.04
7	Civil Rights	-16.78	State Police	30.50
8	Social Services	-17.87	Legislature	30.78
9	Mil Affairs	-19.85	Public Health	36.75
10	Treasury	-21.22	Mental Health	40.33
11	Commerce	-21.43	Mil Affairs	41.23
12	Att General	-23.23	Treasury	44.43
13	State Police	-23.49	Debt Service	45.50
14	Manag & Budget	-24.99	Executive Office	45.78
15	Higher Ed	-28.70	Att General	46.19
16	Nat Resources	-32.96	Civil Service	53.31
17	Public Health	-32.96	Social Services	55.25
18	Education	-33.17	Corrections	63.00
19	Lic & Regulation	-38.27	Lic & Regulation	67.05
20	Executive Office	-40.83	Nat Resources	70.13
21	Labor	-43.51	Judiciary	93.56
22	Agriculture	-59.84	Commerce	107.52
23	School Aid	-67.32	Manag & Budget	109.66
24	State	-73.16	Labor	183.82
25	Capital Outlay	-105.03	Capital Outlay	16146.62
	Total	-24.08	Total	26.66

Source: State of Michigan. Executive Budgets 1980-1984
and various Executive Orders.

this crucial period. Accordingly, similar percentages were totalled for all budgets, regular plus cutback, beginning with the 1979-80 budget and continuing through 1983-84. This represents twelve budgets and this rank ordering is reported in the right-hand column of Table 6.6.

Three departments representing highest, mean and lowest cuts were then identified from this column and their budgets inspected for types of programmatic cuts. As cuts in the departments of labor and education were confounded with federal budget activity, and school aid and capital outlay were not applicable, the departments of agriculture and management and budget were selected as those representing highest and lowest cuts. Although showing a somewhat higher value than the statewide total, the Department of Public Health was selected as representing the mean.

The following analysis is based on an examination of the gubernatorial requests contained in the Executive Budget and the executive orders for each of the identified fiscal years. This shift from focus on expenditures was necessitated for this part of the analysis because the rationale for the recommendations is documented and part of the public record. It was thought to provide a fuller picture of executive intent when assessing program vulnerability.

Highest Cuts. If we compare the 1983-84 requests with the actual appropriation levels for the 1978-79 fiscal year, GF/GP funding for the Department of Agriculture dropped twenty-eight percent. GF/GP appropriation levels for Fiscal

Year 1978-79 were almost \$27 million and GF/GP recommendations for the 1983-84 period were \$19.5 million. While the department undoubtedly achieved some savings through a reorganization which occurred during this period, when we look at program shares of the total departmental GF/GP budget, we find that almost all categories had increased. The reason for this apparent anomaly was the phase-out in this period of an enormous program the department had to mount to respond to the PPB (polybrominated biphenyl) contamination disaster which began in the early 1970s. By 1978-79, the department's need to provide pre-market biopsies and PPB analysis of dairy cows en route to slaughter, as well as test, quarantine and indemnify contaminated livestock and poultry accounted for more than a third of the department's GF/GP budget.

The other area that showed the largest cuts were those associated with meat, food and dairy inspection. There was a thirteen percent decline in spending (not taking into account inflation), only part of which was absorbed by increased federal activity in the area of meat inspection and the departmental reorganization. Nevertheless, these activities wound up with a larger share (twenty-six percent) of the departmental budget in 1983-94 than they had in the 1978-79 appropriation (just under twenty-two percent).

Of line items which were specifically identified for reductions in these budgets, perhaps the most frequently occurring referred to cuts in research whether for pest eradication programs, user surveys, incentive grants,

gasohol development, animal diseases, or others.

Average Cuts. At the median among state departments and funds, the Michigan Department of Health total GF/GP recommendation stood forty percent over its 1978-79 appropriation. During this period, the department also began a major reorganization, the chief beneficiary being the local health services office, whose share of the total departmental budget rose from about eleven percent in 1978-79 to almost nineteen percent in the 1983-84 recommendations. This office serves as the "central conduit" between the state department and local health units throughout the state and supervises a cost sharing program, among other duties.

Although the reorganization of this department presents the same data analysis problems as the reorganization of state government in the mid 1960s, it appears that the most vulnerable programs in this department were those appropriation units associated with disease prevention, communicable disease control and adult health, which suffered about a ten percent loss in the share of the departmental pie. Part of this was made possible through the absorption of a fairly large chronic disease program by county health departments. The second largest loser was the health care resources appropriation unit which oversees development and regulation of health facilities and licenses emergency medical services, among other responsibilities. The share loss was just over five percent for this period. The third largest share loss was incurred by the Division of

Services to Crippled children.

An inspection of itemized cuts in these budgets shows that the department was initially able to shift monies out of some units such as disease prevention and control because federal funds became available to service them. The second layer of cuts was taken more directly through administrative staff reductions in most of the department's units. Thereafter, we see cuts proposed with substitution of licensing, certification and user fees and cost shifts to local governments, followed by another round of staff reductions.

Least Cuts. The department selected to represent those with least cuts was the Department of Management and Budget. Comparing the 1983-84 request with the 1978-79 appropriation, this department's GF/GP funds increased about sixty-eight percent. The Department of Management and Budget was created in 1973 out of the old Department of Administration and the Bureau of Programs and Budget which, until that time, had been housed in the Executive Office. The department is organized into eleven major offices and bureaus ranging from those assisting the governor with policy formulation and planning such as the offices concerned with budget preparation and revenue and tax analysis to those more directly concerned with management of state operations, such as the Office of the State Employer, the Facilities Bureau and the Bureau of Retirement Systems. The department is also the umbrella for an assortment of special agencies such as the Commission on Services to the

Aging and the Council for the Arts and is home for the state lottery bureau. As with most departments, GF/GP funds support only part of these activities.

Continuing the data analysis procedure used in this section in which the shares of the various appropriation units are compared across time and then ranked according to gain or loss, we find that the losing units, in order of their percentage loss were: the volunteer commission, the child care council, the criminal justice office, the management science bureau, arts council, crime victims' compensation board, the support office for the various special boards and commissions, and the Indian Affairs Commission. These were followed by several units directly concerned with departmental administration: accounting, office services, building/facilities/technical services, and purchasing. Following these were the Spanish Speaking Affairs Commission, the Women's Commission, the Office of Revenue and Tax Analysis, and the Office of the Budget. Units which improved their shares over this period were the office concerned with comprehensive health planning, the office of the state employer which formulates policies on classified employee compensation and working conditions and consults with employee unions, the commission on the aging and its companion community and nutrition service, the department's administrative services unit and the director's office.

Like the other departments analyzed in this section, the Department of Management and Budget reorganized during

this period. For example, some shrinkage, such as the volunteers unit, occurred when federally related programs such as the VISTA program, ran into disfavor in 1980-81. Others such as the Veterans' Affairs office were largely grant programs and were shifted into a centrally administered grant category for budgetary purposes. Still others such as the Office of Intergovernmental Relations were transferred to different departments.

Not all changes reflected changed intradepartmental priorities, however. Some also reflected policy preferences of the new governor which caused this department to lose some jurisdiction to the Department of Treasury.

Summary. The purpose in reviewing line items of these departmental budgets was to see whether discretionary parts such as maintenance and capital funding would show proportionately deeper cuts as the departments in this distribution showed increasing cuts.

While comparison across the sample departments is not particularly satisfactory because the departments are engaged in quite different activities and the extreme case, the Department of Agriculture, is in its position largely because of declining need to address a critical issue external to the fiscal crisis, some useful information can be drawn from an analysis of these budgets.

The maintenance question, for example, is not supported. The Department of Management and Budget, the agency responsible for maintaining state properties, reduced the Property Management unit's share only slightly (three

percent) during this critical period. At the beginning of the time period, this unit accounted for about 22.5 percent of the department's budget and that share declined only slightly in the 1983-84 request.

The capital funding question, however, is supported, but not in this section because capital outlay for these departments is considered as a separate budget unit. It is addressed elsewhere in this study and we have shown that capital funding is indeed the first to be cut.

Analysis in this section does tend to confirm the hypothesis that "soft" areas are hit: research in agriculture, prevention programs in health, and programs for some specialized groups such as volunteers, artists, crime victims, and Native Americans.

VI. Marginality

In this section we investigate a third dimension of incrementalism, the marginality question. As discussed in Chapter Four, the hypothesis here is that marginal change to the previous year's budgetary base is an inadequate description of budgetary outcomes in a cutback period partly because expenditures no longer are closely associated with a fixed percentage of the agency's budget for the prior year, and partly because interest on the part of policymakers shifts from the margin to the base. We argued that this seemed to imply two different tests, one for change in magnitude of the margin and another for change in focus from the margin to the base.

Magnitude. Analysis of the magnitude question requires

that we return to the linear model data discussed in Chapter Five. Here our attention is focused on the regression coefficient and its standard error. Specifically, we refer to the marginal change version of the linear model:

$$E_t = a_3 + b_3A_{t-1} + gD_3(A_{t-1}) + e_{3t} \quad (4)$$

where E = expenditure total

a = constant

b = a fixed percentage of the prior budget

A = the total appropriations

g = estimate of the dummy variable

D = a dummy variable where

1 = regular budgets

0 = cutback budgets

What constitutes a test of the hypothesis here poses something of a logical problem which needs to be mentioned before proceeding. If marginal change in the regular budgets is significant, what sort of change must be observed in the cutback budgets if marginality is not predictive? If there is no change, or if the change is not significant, then it means that the marginal condition is the same in the cutback budgets as in the regular and that marginality is still operative. If there is marginal change and it is significant, however, that may still mean that marginality is still operative. That is the case, unless the change in the cutback budgets is smaller than in the regular, has a larger error, and is significant. In that case we can say that the marginality argument has less force, but we cannot entirely accept the null hypothesis.

Given the hypothesis, we would expect the marginal coefficients of the regular budgets to be statistically significant and the coefficients of the cutback budgets to be significant as well, but smaller and to have a greater error term compared to those of the regular budgets. The results are reported in Table 6.7. OLS estimates are reported for all categories because we are not concerned with goodness of fit properties here.

The results do not support the hypothesis (and a few of the categories, e.g., the executive office, show curious results, doubtless owing to some lumpiness in the data). Although in nineteen of the twenty-five budget categories the cutback coefficient is smaller than the regular coefficient, of these nineteen the standard error increases in only six cases. And of these six, only two of the changes are statistically significant. These are higher education and natural resources.

So, it appears that marginal change continues to be an adequate descriptor of spending behavior in a cutback period, but only to the extent that marginal change is significant in regular budgets. In our data set that is true in all but one category (the executive office). However, whether we finally reject the marginality argument may depend on the corollary question, i.e., does interest shift from the margin to the base. That is what we turn to now.

Table 6.7

LINEAR MODEL. COEFFICIENT ESTIMATES
Departmental Expenditures 1964-1984

Department/ Fund	Regular			Cutback		
	Margin	SE	t	Margin	SE	t
Ordinary Least Squares						
Agriculture	.72	.07	-.21	.73	.09	7.77*
Att General	1.05	.02	5.99*	.92	.02	45.91*
Civ Rights	.99	.02	3.74*	.91	.02	36.80*
Civ Service	.96	.04	1.66	.90	.04	22.36*
Commerce	1.12	.05	3.36*	.94	.04	21.70*
Corrections	1.13	.02	6.71*	1.00	.02	62.37*
Education	.45	.01	-.04	.45	.10	4.46*
Exec Office	.06	.46	-.84	.45	.62	.72
Higher Ed	.98	.03	2.84*	.89	.04	23.33*
Judiciary	1.09	.05	2.26*	.97	.04	22.26*
Labor	1.16	.10	1.63	.99	.08	11.87*
Legislature	.95	.02	2.84*	.89	.02	42.39*
Lic & Reg	1.12	.04	3.51*	.97	.04	24.90*
Mgmt & Budget	8.65	.74	.31	8.42	.68	12.39*
Mental Health	1.08	.02	5.64*	.98	.02	48.15*
Mil Affairs	.92	.04	.72	.89	.07	13.00*
Nat Resources	1.01	.06	2.09*	.89	.07	12.76*
Public Health	1.09	.05	3.09*	.95	.05	20.83*
School Aid	.81	.06	.38	.79	.08	10.36*
Social Services	1.04	.02	5.65*	.91	.02	40.55*
State	.62	.07	.15	.61	.09	6.87*
State Police	1.03	.02	5.27*	.93	.02	43.27*
Treasury	3.48	.47	-1.48	4.18	.51	8.21*
Debt Service	.50	.15	-.88	.63	.21	3.04*
Capital Outlay	.49	.12	-.84	.59	.18	3.34*

*Significant at the .05 level.

Source: State of Michigan. Executive Budgets, 1964-1984
and various Executive Orders.

Interest in Base. If interest of policymakers shifts from the margin to the base, then we would expect to see statistically significant base changes in the linear model. This would be especially persuasive if the significant base changes were accompanied by smaller but significant marginal changes.

Here we return to an analysis of the base change linear model described in Chapter Five. An inspection of the estimates shows that thirteen of the twenty-five categories show a significant change in the base between the regular and the cutback budgets. However, when we inspect comparable estimates for the complex model in which marginal changes and base changes interact together, the significance largely disappears. None of the complex model estimates show a significant base change together with a significant slope (margin) change. It is largely the slope itself that remains significant, not the slope change nor the base change. Therefore, we have no statistical evidence that in periods of cutback the focus of policymakers turns from the increment to the base. It is possible, however, that such interest might have been manifested in other ways which would not necessarily emerge in a statistical analysis. One component of the budget process which was thought to demonstrate this was the management plan. We hypothesized that if interest shifted to the base, management plans would have required additional program documentation when the cutback process became more critical.

In January 1976 when Michigan was in the midst of one

of its periodic recessions, the governor presented an executive budget developed for the first time along target budget concepts. This approach, designed to ferret out spending priorities, required each department to submit requests based on 95, 100, and 108 percent support levels of prior year appropriations, not including inflation, and to rank programs according to priority (Budget Message of the Governor).

This approach continued until May 1980 when threatened adoption of a popular tax cut initiative forced policymakers to look for better ways to divine base spending levels for state programs. According to a directive issued to departmental directors at that time, "...experience with the target approach used for the the past few years has shown that, while it has enhanced our ability to examine state programs and priorities within the range established by the targets, it hasn't provided analytical data of comparable quality to support budgetary decisions when reductions below the lowest target were required, as during development of the FY81 budget," (Department of Management and Budget 1980:1).

The target approach was replaced with a "priority budgeting approach." This approach required departments to determine minimum operating levels for all programs and rank preferences for any spending increments which might be possible above the minimum.

So we do have some support for this test of the hypothesis that in periods of cutback the focus of

budgetmakers turns from the increment to the base. It is interesting to note, however, that the new procedures invoked in the management plans for FY 1982 were justified because of a perceived tax revolt, not because of darkening economic conditions. Indeed, the directive stated that the new tools would be needed to aid adjustment in the coming economic recovery.

We also hypothesized that if interest turned from the increment to the base, then we would see evidence that briefing papers prepared for legislative appropriations subcommittee hearings should contain additional program explanation compared to those of prior years.

In interviews conducted with representatives of the House and Senate Fiscal Agencies--units which provide staff support for the appropriations committees--and analysts in the Bureau of the Budget who responded to queries from the fiscal agencies during the fiscal crisis, response was of a different order.

These analysts thought that the nature of the requests for information did not change substantially during the budget cut period, but where they searched for answers did. For example, one analyst who worked closely with a department receiving substantial federal funds said the problem of untangling the web of federal, restricted state, and GF/GP funds supporting some programs was so difficult that it was simply easier to search for programs that were more exclusively identified with state general fund monies and cut those programs. Thus, the nature of the information

provided shifted from largely programmatic information to a combination of program content and funding source.

Another analyst argued that he had to seriously re-think whole modes of service delivery, not questioning so much the program base as its manner of provision. This analyst also implied that, as the need to cut became greater and budget office analysts became more aggressive in targeting new areas for axing, legislative response became less concerned with broad economic policy, more issue specific.

Perhaps the most senior of these analysts, certainly one with long experience in his position, argued that legislative requests for information, and subsequent budget reduction decisions, were initially predicated on program priority. But as the need for cuts continued, legislative policymakers actually sought less information.

"...as we got to the end, we had been through so many of these reductions and cuts, I think the political process, along with the frustration, stepped in and all at once there was a leadership decision saying, 'All right, let's go right across the board. Everybody suffers the same amount and therefore you're not getting treated any differently than the other department, agency or institution.' I think that's what happened."

There is a hint of a difference in response here, i.e., that the legislature was less interested in systematic information change or expansion as the fiscal crisis deepened. It is the exhaustion factor: exhaustion of energy, resources, and mistrust of information. Those implications will be discussed in the concluding chapter.

We also hypothesized that in cutback periods, particularly more severe ones, if interest shifted from the margin to the base, it would not be a direct shift, but it would be discernible. It would proceed from an initial stage of disbelief in which there is an attempt to maintain business as usual (May and Meltsner, 1981, argue this way) or to resort to quick fixes, followed by later stages in which there is more serious concern with the base.

In interviews with key players and observers of this process, it was apparent that some did accept the notion of initial disbelief. As one member of the governor's budget team expressed it,

"As we entered the downturn, I did not believe that the degree of economic recession in this state would be as severe as it turned out to be.... As it persisted--and this may be difficult for people to believe--I was constantly surprised (and it's difficult to be constantly surprised) about the fact that the economy continued to turn down.

So, the longer it became as the numbers got worse, you were forced into a recognition of how bad things were and clearly as we were even dragged within the administration into believing how bad things were, then people on the outside became more aware. But I do think that it took an awful long time going into the recession before people became convinced how bad it was."

This view was repeated by a leading appropriations committee member, a member of the governor's political party, who explained it this way:

"We relied on four different sources for our revenue projections: the House Fiscal Agency, the Senate Fiscal, the University of Michigan and the DMB. Of those four, the U of M's was the most conservative. And when the revenues started to fall, they fell below what the most conservative estimates were and they were hard

to believe. Everybody was sure that in the next two months the economy was going to come back. Nobody looked on it as though it was going to get worse. Everybody kept on being optimistic. But it didn't get any better. It kept getting worse, worse and worse. I could even see the governor aging in the process. At first he was all smiles and then even he got to the point of being frustrated."

But others disagreed. The essential argument among the dissenters was that some knew about the problems all along. The divergence in that opinion was 1) just how large the group was and, 2) if they knew, why things were allowed to get so far out of control, the idea being that anyone rational would not wittingly pursue such agony.

This view was heard from a key appropriations committee member, an influential reporter, and also from several lobbyists. As the committee member observed, "The insiders in the legislature--the fifteen percent who do all the work--and in the executive branch knew what was going on but the rest never really came to grips with the issue."

It is on this last point, however, that opinion further divides. While the committee member suggests that his colleagues would not "come to grips with the issue", others were more specific. As the reporter put it, "The attitude was one of general sympathy (for the governor) against a political backdrop of what was do-able and what wasn't politically. I think that tax increases were not anything they wanted to do as (was subsequently) proved. They wouldn't do it for him."

Still others contend that not only was understanding there, but also intended action. As one analyst said,

"It was a conscious, deliberate policy and not an accident. You need to not blame somebody like (the budget director) because they understood what they were doing. This is not an accident. This is not an error. This is not a thing of 'Oh, my goodness, we've overestimated the budget.' This is just a guise of that."

As suggested in Chapter Four, opinion also sharply divided on the role of the governor. One view commonly attributed to the governor's successor, was that the governor really did not know what was going on. According to this notion, the governor had become the pawn of his budget director who had usurped some tactical power and then was unable to wield sufficient strategic power to build the coalition necessary to extricate the state from its financial problems. One analyst, a well known consultant, was particularly critical of this view. As he said,

"(the governor) made the decision that (the previous governor was Eisenhower and that he was a tool of the budget director who had too much power. Therefore he was going to make the Treasurer more powerful than the budget director. The budget people thought that (the previous governor) always had great power. The view of Eisenhower as a fuddy duddy and a tool is just b-----. Eisenhower was a man of strong intellect and great power. He always wanted to operate through straws. (The previous governor) was the same way. His secretary once got angry at me because I said that he was a great dissembler and pulled off the greatest sham in the history of the state by making people think he was a dummy when, in fact, when he called in his chief ministers in a room with him he was boss. (The present governor) thought that he was watching Eisenhower the dummy. He didn't understand that the real Eisenhower was a man of direction and power. They simply decided to let someone else take the heat. That's what you're paid for at the second level."

Although the captured governor thesis seems least credible (but perhaps most powerful considering who

espoused it), the other theories are both plausible interpretations of the events. The constant surprise theory can be argued if one takes a fairly narrow view of the budget process and does not consider its broader political and sociological context.

The knowledgeable insiders theory is also arguable if one accepts that lack of consensus on solutions prevented the state's leadership from articulating a coherent budget policy. For there were mixed signals all along the way. An analysis of the governor's budget messages, budget office directives, press accounts, and interviews with key players and observers of the process shows little coherence in policy. For example, if we accept one observer's assessment that analysis of the deep fiscal crisis of the early 1980s should begin with an understanding of the events beginning in the early to mid-1970s, we have to recognize that from the beginning, Michigan policymakers were being wise and unwise all at the same time. Virtually the same policymakers who introduced the state to the wonderland of "Chinese bookkeeping" were also those who adopted and implemented shortly thereafter the state budget stabilization fund, the first of its kind in the nation. The latter, an innovative response showing keen understanding of the state's intrinsic economic condition, appears on the scene just about the time as we see some of the worst features of budgetary ad hocmanship being adopted.

There are other examples: this period which saw adoption of thirteen executive orders implementing budget

cuts also saw a continuing practice of giving back taxes. According to one observer, between the adjustments, abatements, reductions in the sales tax and so forth, there were about twenty corrections. Or another: even as a state delegation was going to Wall Street to borrow money in the fall of 1981, the governor was proposing a property tax cut. Or another: the governor who in January of 1982 was foreseeing a better economy and saying with great satisfaction that no tax increases would be needed was cutting the budget and asking for a tax increase three months later.

While imposing categories on history is risky and best done tentatively, it is possible to argue that there was a period of make-believe beginning in the mid-1970s when budgeters first resorted to quick fixes. Certainly the decision to use the accounting tricks and to extend the fiscal year by three months in order to balance the budget belong in this category. That was followed by a period characterized by internal dissention and confusion which probably began sometime in early 1979. The governor said that budget formulation was tough, but when the budget was passed his budget director said it was the best ever. There were squabbles in the legislature about the stabilization fund and disagreements in DMB about the Michigan model estimates. In retrospect, the white flag was showing by the summer of 1980 when the legislature failed to adopt a budget, gave the budget director "czar-like" powers and went on a going rate for three months. The six-month period

which followed, i.e., January-June 1981, showed a mild economic recovery and probably gave a false sense of security, because in the quarter which followed, i.e., the fall of 1981, we hear brave words and see activity which looks like a call to circle the wagons. The Speaker is quoted as saying that there will be no negotiation on budget cuts, that he does not blame the governor. "We're all in this together," he says, but clearly the governor is having second thoughts. In December he announces he has had enough and will not stand for re-election.

By January 1982 the siege is on for those who must still lead and the leadership is stonewalling. The budget director announces that the state has a balanced budget. "We have always had a balanced budget," he says. He also says accounting reforms are "impossible." The governor says a better economy is coming and no new taxes are needed. But the state's bond rating is dropping and unemployment now averages over sixteen percent. By March cracks in the public posture begin to be evident. The budget director starts to distance himself from the governor's no-tax policy and by May the political scene is one of public dissention and fights. Bond rating houses are threatening, local government officials are protesting, public unions are fighting the civil service commission, and legislators begin to publicly doubt the governor's ability to handle the crisis. A tax increase is passed but it is only temporary and is passed with great difficulty. Just how difficult it was is revealed in the following anecdotes:

"I remember so well the difficulty they had in getting the votes. That's why the temporary one percent income tax was introduced. They had to go until four o'clock in the morning to get the votes. I remember that the governor had to come across the street and drag somebody out of a hotel room and bring him back to get the final vote. So it was tough." (A lobbyist)

"Of course we did do that temporary increase in 1982 at the end. We stayed up all night. I'll never forget that because my office mate was the one who broke. We were there about three hours trying to get one vote and I was down in the office sitting there when he walked in the room. I asked him, 'Well, what a----- caved?' And he didn't answer and I knew then and there it was him. He just kept on walking. And about two hours before that he told me that one member was weakening and that I should go and talk to him." (A prominent legislator)

It is possible to argue that this is the point at which policymakers finally become seriously concerned with the base. It is seven years since they first resorted to the quick fixes. By August the budget director is announcing that the economy has collapsed and that he is leaving. He also says the worst is yet to come. Indeed, reports issued shortly thereafter show that auto sales are the worst in twenty-four years. The fall of 1982 is Michigan's nadir. Unemployment goes over seventeen percent, another budget cut is ordered, and the legislature passes the budget late only to be told by the fiscal agencies that it is already in trouble. Only a rescue by foreigners (a consortia of Japanese banks), saves the state's budget.

Resignation and resolve only appear in January 1983 with a new governor and by admission of some legislative leaders that a continued tax increase is needed. But the deep divisions persist and although a tax increase is

finally voted there are great costs. Two Senators who supported it are recalled by their constituents and others in the House are threatened.

Thus, the hypothesis is partially sustained. There was a shift in interest, but not from the margin to the base. The quick-fix mentality associated with the business-as-usual approach of budgeting at the margin did continue. Rather, the focus broadened to include issues associated with the base.

Finally, we hypothesized that as the attention of policymakers became more absorbed in the base, we would expect the role of structural constraints to take on increasing importance. Although there is scholarly disagreement about what actually constitutes the base, our approach was to see it as a collection of rules or constitutional, statutory and procedural requirements which are or may be intervening variables affecting budget decisions. This approach permitted us to use several different measures for this hypothesis.

1) We expected to see attempts to secure constitutional protection of program budgets and fund allocation. Article XII, Sections 1 and 2 of the Michigan Constitution provide for amendment to the state constitution either by legislative proposal or by petition of the electors. In either case, they must be subsequently approved by a vote of the people. Although there were attempts (The Headlee Amendment was conspicuously successful) during this period to amend the constitution by

petition as a review of Appendix B shows, it was thought that a review of the legislative proposals would provide a better trend line, since it was expected that these proposals would be more numerous. Since proposed constitutional amendments are considered as joint resolutions and may be introduced in either house, journals of both the House and Senate for the period 1977-1984 were inspected. The results are reported in Table 6.8

Table 6.8

House and Senate Joint Resolutions Involving
Some Limitation on the State Budgeting Process

Year	# Introduced	# Passed Legislature
1977	5	0
1978	3	0
1979	10	0
1980	13	1
1981	10	1
1982	13	0
1983	6	0
1984	10	1

Source: State of Michigan. House and Senate Journals, 1977-1984.

We can see that there were indeed increased attempts to limit the budget process in some way. Almost half (44 percent) of these proposals, however, were not to protect program budgets and fund allocation. They were designed to directly limit the taxing authority of government either through property tax limitation, income tax limitation or extension of the referendum to tax acts passed by the legislature. Doubtless many of these were a calculated legislative response to a property tax limitation initiative which was being circulated during some of these years. Of

those which had specific programmatic bias, most sought to protect funds for education which were especially dependent on property tax revenues. A few had environmental protection/land use purposes and one protected crime deterrence programs. Several, e.g., proposals for a budget stabilization fund, were designed to put into the constitution what already existed, or was about to be put, in statute.

Table 6.8 shows that most of these proposals were not passed by the legislature. The vast majority were simply printed and held in committee. There were various reasons for this, but an analysis of that is beyond the scope of this study.

In our exploration of increased importance of the base, another measure also seemed useful. We thought we might see greater use of certain procedures such as unit voting rules to secure passage of budgets cuts.

That was indeed the case in one major respect. By constitutional requirement, an executive order mandating budget cuts must be either completely accepted or completely rejected. It may not be amended. That tended to have two effects. It forced much more emphasis on prior, informal negotiation and it tended to ensure that, once those agreements had been worked out, the executive order would be passed because cutback decisions were largely worked out before anything was submitted to a formal vote. A legislative staff member described the process this way:

"(The governor) had been around many, many years and he knew how to walk over before an order even came out. At that time X was director of management and budget. He'd come over and talk to the Speaker of the House and the Majority Leader of the Senate, the two appropriations committee chairmen, the two vice chairs, and they would sit down and work out some type of agreement."

But one of those appropriations committee members saw it this way:

"I don't want you to think that the legislature had that big an input. It was really the executive. They called I would say 90 percent of the cuts.... We reacted to their proposals."

But once the deals has been made, the formal rules were invoked. In only five out of eighteen tries, did the governor have to revise an order once the deals had been cut.

We also speculated the obvious, i.e., that as the fiscal crisis grew, the need to serve the primary rule in state budgeting--the constitutionally mandated balanced budget requirement--would be increasingly evident through a larger number of executive orders to implement budget reductions.

That was indeed the case, and the incidence of these executive orders is documented in Chapter Four and in Appendix B.

In some cases, mandated lapses (also described in Chapter Four) were part of these executive orders. One respondent who was formerly in charge of a legislative fiscal agency described just how unexpectedly useful the mandated lapse was:

"Every year there are more than 5,000 separate accounts that all the state General Fund is divided into. It is an impossibility for a department director to expend to the last dime every one of his accounts. In a certain number of them he's going to have money left over for a number of legitimate reasons, e.g., contracts don't materialize, a project gets off the ground later than they anticipated, maybe supplies cost less than anticipated, maybe there is less travel, etc. So there are normal lapses. They ran about \$20-\$25 million for the total GF/GP.

"Now when you come into a budget deficit situation...you put a directive out to the directors that you are going to have x amount of lapses at the end of the year. You can get them any way you want, e.g., not filling positions, curtailing travel, etc. Actually what you're saying to them is, 'We need x amount of money out of your budget that has to be there at the end of the year. We think you're the best judge of where that can come from. So you find out where the money is and you make sure that you have x dollars at the end of the fiscal year.' And in most cases we required that they report back as to where they were going to take it, i.e., they all had to come up with a plan for lapsing.

The other thing it did for the state is that many departments had little cookie jars where they'd get money in a fund and then at the end of the year they'd ask for a transfer out of this fund. The lapse plans showed us where most of those were. After the first year we kept a good record of where those came from."

Finally, we expected that as interest in the base became more important we would see greater incidence of judicial activity and/or advisory opinions concerning attempts to raid protected funds.

In an interview with the head of the Advisory Opinion Section of the Department of the Attorney General, we were told that so far as advisory opinions were concerned, such was not the case. He argued that the constitutionally dedicated funds, e.g., the school aid special fund and the

highway fund, were never touched. He also said that if the statutorily protected areas were, they there for the legislature to change, if desired.

Although this respondent was correct if we view "protected" funds as only special purpose funds, but we see something else if we broaden the definition to include funds (or simply programs) fed with general purpose monies because there were indeed several examples of judicial activity and/or advisory opinions generated as a result of the budget cuts. A review of the annotations to Article 5, Section 20 (MCLA) of the state constitution shows that:

- ° In 1975 the Attorney General said that school aid funds could be cut even if such cuts distorted the outcomes of the state school aid formula.

- ° In 1979, the Attorney General said that mandated lapses were not legally binding unless followed up with a proper executive order.

- ° In 1983, the Michigan Association of Governmental Employees won a case which forced the state Civil Service Commission to keep its agreements about wage increases.

- ° In 1984, the Michigan Association of Counties lost a suit contending that revenue-sharing funds had to be honored in the cutback as well as in initial distribution. The court found that "the governor would have discretion to reduce expenditures of some agencies to a greater extent than others."

In addition, we do know of one instance where a raid was proposed and a stand-off occurred. That was in the

case of the public school employees' retirement funds. An early executive order in 1975 proposed to take \$11 million dollars from these funds in order to balance the budget and the teachers union effectively scotched it.

Although court rulings did not save some of the early cuts in the fiscal crisis, later rulings which did affect two key departments were a direct outgrowth of departmental experience with the budget cuts of the fiscal crisis. As a former Director of the Department of Mental Health put it:

"We (now) have tremendous constraints in our correctional and mental health systems through court orders. We've basically taken those two systems off the table for any future reductions without buying major legal issues. For example in this department, we're arrested literally in our institutional system at the highest level we've ever been staffed."

These findings suggest that structural constraints did indeed take on increasing importance as the interest of legislators became more absorbed in the base. There were some attempts to secure constitutional protection of program budgets and fund allocation, but more concern with saving the taxpayers' pocketbook. Special voting procedures were invoked, as was the fundamental rule of all, the balanced budget requirement. Judicial decisions also played a role in protecting programs.

But, in another sense, structural constraints were also critical throughout the whole process. This is especially true with the balanced budget requirement. That triggered the executive orders which, in turn, shaped the budget cutbacks from beginning to end.

It is ironic that the structural constraints which triggered the process also locked the state into positions with little maneuverability left. If anything, the fiscal crisis produced even more of them leaving policymakers with less room than ever to manage the next crisis. More about this will be discussed in the concluding chapter.

Summary. During cutback periods there was evidence that policymakers became interested in the base because there was increased demand for zero-based justification of programs as evidenced in changed management plan requirements and because structural constraints take on increasing importance. But marginal change and the behavior associated with did not disappear during cutback budgeting periods.

The margin still remained the most statistically significant aspect of the budget based on our analysis of the linear model. When immersed in the base, policymakers did not abandon the resort to quick fixes which are characteristic of early crisis behavior. That is because they are stuck with them. Only improved economic conditions and a changed or chastened policy leadership forced into changes by financial forces external to the state brought about abandonment of the quick fix policies.

VII. Summary

In this chapter we have shown that two other dimensions of budget theory, the concepts of fair shares and marginal change, are not invalidated in the cutback process. Although the goodness of fit model which was used to test

the hypothesis performs well only under limited conditions, other approaches show us that fair shares continues to be honored on the broadest levels when we compare change across departments. However, when we look within particular departments there is some support for the argument that activities such as research and prevention programs which have less immediate impact, and advocacy areas serving historically less established groups do tend to suffer. We also found that although policymakers become more interested in the base, marginal change is still a strong descriptor of budgetary behavior when comparing budgets in good times and bad.

Note to Chapter Six

1. Critics may wonder why fair shares continue to describe cutback decisions when the twenty-year history of Michigan budgeting shows considerable change over time among the various policy areas (see, e.g., Table 4.5 which describes percentage expenditures at ten-year intervals across the twenty-one year research period). That is because the fair shares measure used here is an average by department and fund across the time periods. Unfortunately, while averages depict generalities, they also disguise anomalies which are sometimes of greater interest.

Chapter Seven

Findings: Other Dimensions

I. Introduction

Chapters Five and Six reported findings about the best known aspects of budgetary theory and what happens when tested under conditions of fiscal stress. At least three other dimensions of the theory remain to be examined however: the circumstances of the annual cycle, the issue of budgetary roles and centralization and the role of the budget itself. That is what we turn to now.

II. The Annual Cycle

As we mentioned in Chapter Two, Wildavsky (1975) has argued that the annual budget cycle breaks down when financial resources dwindle and their availability becomes less regular. The annual budget cycle is interrupted by the need to recast the budget. Therefore, in our research design we hypothesized that there would be no timely relationship between authorization of expenditures and actual programming of funds. We expected that payments and transfers to operating units would become erratic during cutback periods when compared to more normal budgeting times. We proposed to test this hypothesis two ways: through analysis of fund payouts and inspection of the incidence of executive orders mandating budget cutbacks. In this case, our interest focused on the period 1976-79 which was a growth (or recovery) period and the 1980-83 cutback period which followed.

Payouts from Funds. We looked at payouts from two

categories: the school aid fund, which is actually called a fund, and payments to institutions of higher education. These payouts are shown in Table 7.1. We can see that the payments to colleges and universities remained regular and stable through the first, normal period, but begin to fluctuate with the 1979-80 fourth quarter payment when payments were cut, a pattern which was repeated in each of the following three fiscal years with an ever enlarging cut the final quarter. Payments in the final two fiscal years, particularly 1982-83, are conspicuously uneven.

Unlike the higher education payouts, those from the school aid fund are bimonthly instead of quarterly, and the installments are slightly uneven even in good times. Normally, each payment would amount to about sixteen percent of the total, a pattern which is apparent in 1976-77, the base year. Beginning the following fiscal year, however, we begin to see erosion in the first installment. It is only fourteen percent of the total and this percentage falls to six percent in 1983-84. Other than the 1982-83 fourth quarter payment which dropped to seven percent of the annual total, however, it is the drop in first installment payments which is most conspicuous.

The reason for this is not difficult to find. First installments of state aid are paid to Michigan's schools in the summer. Like the final quarterly payments to the state's colleges and universities, these education payments are made toward the end of the state's fiscal year when revenues and expenditures have to balance. Given the

Table 7.1

Payouts to Institutions of Higher Education
(in millions)

Fiscal Year	Total	-----Installment-----			
		First	Second	Third	Fourth
1976-77	\$464.50	116.10	116.10	116.10	116.10
1977-78	516.70	129.20	129.20	129.20	129.20
1978-79	575.50	143.90	143.90	143.90	143.90
1979-80	623.20	157.50	157.50	157.50	150.70
1980-81	576.10	148.50	148.50	148.50	130.70
1981-82	530.20	166.80	166.80	166.80	29.80
1982-83	732.20	248.80	3.10	273.70	206.70
1983-84	709.90	177.50	177.50	230.60	124.30

Source: Robert Endriss, Department of Management and Budget, Lansing, MI.

* * * * *

School Aid Fund Payouts
(in millions)

Fiscal Year	Total	-----Installment-----					
		First	Second	Third	Fourth	Fifth	Sixth
1976-77	1,095.20	180.70	191.10	192.90	173.60	172.80	184.10
1977-78	1,258.40	179.20	214.40	221.00	214.90	212.10	216.80
1978-79	1,457.70	179.50	290.40	280.70	257.30	230.10	219.70
1979-80	1,484.40	188.30	288.40	272.70	265.50	241.30	228.20
1980-81	1,296.50	157.30	274.50	259.60	213.70	200.50	190.90
1981-82	1,254.60	165.10	245.00	232.10	217.90	199.20	195.30
1982-83	1,185.60	85.30	233.60	226.40	84.20	302.20	253.90
1983-84	1,371.20	85.60	265.00	258.00	245.60	220.00	297.00

Source: State of Michigan. State Aid Financial Status Reports, Department of Education, Lansing.

percentage of the GF/GP budget these funds represent and the timing of their outflow, it is not surprising that state policymakers would utilize them to help even the balance.

Analysis of this data tends to support the hypothesis that there is no timely relationship between authorization of expenditure and actual programming of funds, although the evidence is not so strong as the hypothesis suggests. Payouts were made regularly, but the amounts of the payouts fluctuated, particularly during the 1982-83 fiscal year when the fiscal crisis was at its worst. Furthermore, there is some evidence of volatility in the school aid payment even in good times, i.e., first installment payments began to fall off even in 1977-78, two years before the cuts began to be seen in the higher education payouts and three years before the generalized crisis began to be felt throughout state government.

Incidence of Executive Orders. In operationalizing this hypothesis, we also expected to see greater incidence of executive orders mandating budget cuts in the crisis period because of the need to keep the budget in balance. And this is, indeed, the case. As inspection of Table 3.2 shows, there are no executive orders mandating cuts in the 1976-79 period, but ten in the 1980-83 crisis period which followed. Of the ten, seven were subsequently approved by the legislature.

The executive orders are absolute indicators of a fiscal crisis, for without a crisis it is virtually inconceivable that a governor would issue such an order. So,

in a sense, this is the too obvious measure, but they also demonstrate a breakdown in the annual budget cycle and, therefore, lend further support to the hypothesis.

Summary. Our indicators partially support Wildavsky's assertion that there is a breakdown in the annual budget cycle in that there was need for repetitive budgeting and because the amounts of funds available tended to fluctuate with the depth of the crisis. We found, however, that actual programming of funds, though much reduced, continued on schedule.

III. Budgetary Roles and Centralization

As we mentioned in Chapter Three, theorists looking at decisionmaking behavior in times of cutback have disagreed about what happens to traditional roles in the budget process, i.e., whether the legislature and the executive, particularly the fiscal office, continue to exert power in their customary ways. Questions are raised not only about the relationship between the legislature and the executive, but about the role of the budget office versus the other departments within the executive branch, and the role of the director's office versus the other units within a department as well. Levine and Rubin (1980:15) argue that central control is fragmented under stress; Bozeman and Straussman (1982:511) say centralized control increases. The debate poses something of a crucial test. Because it was anticipated that such role shifts would not necessarily be apparent from analysis of budget data, the inquiry shifted into other areas.

Enhanced Budget Office Power? We argued that if the role of the executive fiscal agency becomes more important in fiscal crises, then we would expect to see certain departures from business as usual.

Directives from the Budget Office. Although any bureaucrat knows that directives are sometimes ignored, they can measure certain kinds of activity. According to sources within the Department of Management and Budget, the amount of communication from the department to the other state agencies increased significantly during the fiscal crisis. These directives tended to be of three types: 1) There was the broad requirement first used in the 1981-82 budget instituting minimum operating levels. This was a mandate forcing program managers to identify spending levels below which a program could not serve its purpose. 2) There were specific directives issued early on in the crisis instituting freezes on such things as hiring and out-of-state travel. 3) Finally, there were the open-ended orders asking department managers to find new ways to reduce spending. These tended to be questions: are there things that could be postponed? Could programs be reduced? These mid-year inquiries also made further use of program ranking, a procedure first introduced into the regular budget process in 1976-77.

Of course, a flurry of directives in itself is not an indicator of actual centralization, but as part of a pattern of other indicators it may tell us something. And there were other indicators.

Complaints about Unilateral DMB Action. Here, protests were directed not so much at the fiscal office as at its director (once described by a journalist as "...sort of a wizard jumping all around and flapping his arms and carrying on"). Evidence of this was found in published newspaper accounts where at least one newspaper went so far as to describe the budget director as acting like a "czar." Evidence also tended to emerge indirectly from interviews, where opinions about why such unilateral action happened were more divergent than that it happened at all. One view held that unpopular decisions had to be made and the budget director took the immediate heat to protect his boss. As one lobbyist put it, "his job was to make the governor look as good as he could."

Another perspective, this one offered by a journalist, suggested that action shifted to the executive, particularly the DMB, because the legislature let it happen. As he said, "There were dirty things that needed to be done and (they thought that) it was better to let (the governor and his budget officer) do them." This attitude also emerges when the role of the legislature in the fiscal crisis is examined. It is discussed more fully later in the chapter.

Still a third explanation was offered by a former colleague of the budget director. He argued that the budget director made many preemptive decisions simply because the budget director "...knew the governor better than most of the other directors. He would know in advance what the governor is likely to approve.... So the governor's budget

reflected the governor's priorities."

Finally, a fourth version, this one offered by one of the directors on the receiving end of some of those decisions, suggests that the budget director made some unilateral tactical decisions as part of a longer range strategy to force other decisions and because that was his decision style. "Probably the budget director knew that when he was throwing out cuts that he knew couldn't materialize, that was a way to get into some other places...that was his knack of doing it or the way he approached it."

Thus there is some confirmation that the budget agency appeared to occupy more time and space in the decisionmaking agenda during the cutback period. But there are still other aspects of the centralization issue to consider. One of these concerns the role of negotiations between individual departments, lobbyists and the appropriations committees during the fiscal crisis which we turn to now.

The role of negotiation. Another test of the centralization hypothesis surely lies in the role of negotiation. For if decisionmaking becomes more centralized as fiscal crisis deepens, then negotiations must collapse or at least become less important. We probed a variety of individuals who were intimately involved in budgetary deliberations during the crisis on this question. All had been in key positions from the early 1970s onward and had seen the fiscal crisis develop from its origins.

Not unexpectedly, their answers appeared to be on all

sides of the question. Like blindmen first feeling the elephant, their answers seemed to reflect the part of the creature they were touching. Yet, as we probed further, it became apparent that some might have been describing different stages of the crisis. That suspicion was confirmed by a senior executive, one who had held several different cabinet-level positions during that period.

Because he had been in the inner decision-making circle during the entire budget cutting process from those in the mid-1970s to the crisis cuts in the early 1980s, we asked him to describe that process. In his words:

"There were tiers of decisions (beginning with) the kitchen cabinet, i.e., a select group of people who had been with the Governor over the years.... (They) reflected various philosophies of government from conservative to liberal and had some smattering of experience in the departments, but we didn't have the day-to-day implications. So that was a weakness--Point One--which didn't serve the governor well.

The second step would be presenting that to the Quadrant which, at times, would become an extended Quadrant which would be the four leaders, the chairs of the (appropriations) committees and--when all hell broke loose--when people who were substantively involved in the budget, e.g., the subcommittee chairs or standing committee chairs, would express concern about what was happening to their programs, we'd get a whole roomful of people.

As you went down that line, the decisions became tougher. Obviously, because you had people who had a vested interest in policy and early on many of the decisions had been made by the top five people and their respective aides or maybe the top eight people. But as the cuts became more difficult, then you saw people like X come in who asked tougher questions because they were very concerned about the implications of the cuts.

I think that there was an inevitable approach. We would go into these discussions--I think it was particularly the last two or three executive orders before the tax was passed--there was almost a

resignation that the best you could do was to ward off five or ten or fifteen or twenty percent (of the cuts), but in the final analysis there was almost a panic.

Even at that point, I don't think that the rank and file executive branch people, the department directors or deputies had much impact. We would go into those meetings after discussion, generally internally in the executive branch, one with the leadership, maybe the extended leadership, and the deal would be cut. And we always had the budget director in the background putting the package together. Sometimes frankly, from my point of view, not being totally honest about it--maybe he couldn't be in those circumstances--but not telling everybody what the total implications were. Maybe he couldn't be, because it was like trying to play poker, he was trying to get everyone to show their hand in order to get a package that may have been \$200 or \$300 million dollars."

So, according to him the character of the negotiations depended on the phase of the crisis. In his view, the initial decisions, particularly those made in the earlier crisis of 1974-75 were derived from priorities established in the executive branch. According to him, "Much of the discussion in the executive branch really dictated the final decision in the legislative branch all the way through the budget process with the exception of two services: education and mental health."

As the crisis deepened and the magnitude of the cuts became more controversial, he went on to say, negotiations became more serious. "The four leaders from the two respective caucuses of each house and the Governor would regularly sit down and talk about issues...started looking for some relatively painless ways to reduce in anticipation of a turnaround."

Then, in the latter, deepest phase of the crisis, the character of negotiations changed again. As he said,

"Towards the end when we were hitting a billion dollars in cuts and it became clear that the reliance on accounting maneuvers couldn't bail us out anymore, then I think we got into sheer panic. At that time, from my point of view, the elected leadership relied too heavily on the appointed leadership, particularly the budget director, to propose what would be draconian cuts and then to come back and restore part of those." This view was corroborated in part by key legislators serving in leadership positions on the appropriations committees. As one said, "I don't want you to think that the legislature had that big an input. It was really the executive. They called I would say ninety percent of the cuts. The decisions were largely made by (the budget director)."

In different ways these legislators also said they were less interested in negotiation, particularly with lobbyists and agency representatives. As one said, "We knew we had to cut and we knew they'd resist it." Another complained that when he would not listen to certain lobbyists, "they went around me to my subcommittee members because they didn't want to hear my message." Somewhat predictably, the lobbyists insisted that they were listened to as much as usual. More than sheer bravado, however, it was probably true in at least one case as the lobbyist represented a group whose interests one of the legislators strongly advocated. The lobbyist had information that the legislator needed in order to argue against cuts in a particular service area. "They (the legislators) were suffering

together with the lobbyists. The interest groups were unhappy, the lawmakers were unhappy." He characterized his relationship with the legislator during that period as "handholding."

Alone among the non-lobbyists, one fiscal agency analyst working in a different area of the budget tended to support this view. According to him, legislators were more open to negotiation and persuasion during the fiscal crisis because they wanted to minimize the political costs of cutting the budget. He said the legislators looked for areas to cut where there was no consensus. "One could cut there and get some support and some negative fallout, but it would cancel out."

It was not possible to obtain a clear answer to the question whether there were actually fewer hearings and for those that did occur, if they were briefer. As one appropriations committee member said, most of the big agreements were worked out beforehand and the details settled in the subcommittees. The appropriations committees served largely to ratify those decisions.

It was clear, however, that the role of negotiations did seem to change. Its nature depended on the stage of the fiscal crisis.

Control of Information by the Budget Office? While some legislative staff who were interviewed claimed quite vigorously that the chief budget officer (the director of the Department of Management and Budget--DMB) at times deliberately withheld information, particularly news about

downturns in revenue flows, legislative fiscal agency personnel denied that they were ever driven to deal only with DMB personnel because DMB was calling the shots.

This response from the fiscal agency personnel seemed to spring from several different rationale. One concerned their pride of turf. As one analyst put it, "Here in Michigan, we've always had direct access to all the state agencies. I mean Direct Access. And if we didn't, we'd raise a little hell."

Another concerned the unique force that the crisis exerted on information as the emergency worsened. It was the toothpaste tube phenomenon. While pressure in the middle forced some information down, other inside intelligence came oozing out the top. As a former fiscal agency director, said,

"In some cases I think we probably received more (information) for a couple of basic reasons. If you're going to cut me and I can show you somewhere else to get some money, you're maybe not going to cut me quite as much.... So you would get those kinds of suggestions out of the clear blue sky from people who would say, 'How about doing this,' or 'How about doing that.' They would come in a number of ways, into the staff or the legislators who would send them back to the staff for review. I remember one executive order we put together a whole book of ideas: list after list of items that you could do. These were things that had just come in from everywhere."

"On the other hand (and I'm not talking about the appointed people--you can control their comments), there's a tremendous number of people in departments and a department can't do a whole lot on some items without going down into those areas. When you get into there, people perceive what's going to happen and if they don't like what's going to happen, sometimes they give you a phone call. We used to receive quite a few from people who did not want to be quoted. It was very simple. (They'd say) 'I wonder if anyone is thinking about doing this. If you do, you know it's going to be

devastating. Boy, I'd sure hate to see this. Do you know of anyone who's talking about it?' So you would find out more about it."

There were other reasons offered as well for the increased amount of information available during the crisis. One analyst said that the general confusion generated by the crisis forced him to look beyond his usual channels of information. Whereas in normal times he would receive much of his information about departmental activities from DMB or the departmental budget office, during the fiscal crisis he felt constrained to talk much more to departmental program officers as well, "...to get some sense of priorities not only as a check on DMB to make sure that they weren't just cutting something that they'd been after for a long time or simply looking at numbers and cutting," but also to protect the appropriations subcommittee members from potential embarrassment. As he explained,

"We had to be sensitive to programs that had been fairly recently established by legislative mandate. So in order to get good information to the subcommittees it was really worth looking at both sides because just to rely on DMB...well, at the hearing the department people could come in and say, 'We understand that we have to take this percentage cut. Now there are certain priorities that the legislature deems important or we have certain statutory mandates that our director or board or commission feels are more important than others and DMB doesn't understand or is out to get us, or etc.'"

Therefore, centralization may have been clearly evident in other areas, but in terms of information control by the budget office, it was mixed. Temptation to suppress information was there. The budget director hid bad news about evaporating revenues presumably because it was

embarrassing and made him look incompetent. It also created image problems for his governor. Departmental directors and bureau chiefs hid information about cookie jars because cookies gave them flexibility and some vestige of power. But response was fairly swift and dramatic. Legislators, nervous about revenue information shutoff, went to outside sources. Civil servants, nervous about short-circuiting programs and jobs, went to legislative fiscal staff. As DMB's threats to slash programs and jobs came close, talking increased. So did letters to the editors of newspapers.

So we can say there was mixed support for this test. The budget office did attempt to exert more control over information, but its efforts were partially undermined by those who perceived the controls would undercut their own power and control.

Diminished Power for Program Managers? We also hypothesized that if centralization were occurring, the role of program managers would become less important in the budget process. We would expect to find program managers expressing reluctance to assume any greater involvement in the budget process as the fiscal crisis worsened.

Here again a sample was taken, this time from three different departments at the average to high end of the cut spectrum as shown on Table 6.6. These were the Department of Public Health, selected again for its position near the mean, and the Departments of Mental Health and Public Health. Interviews were conducted with program managers in three different areas: a service area and two staff areas:

budgeting and evaluation.

The purpose here was rather modest: to see whether any alienation toward the budget process occurred at all among program managers in departments experiencing moderate to large expenditure reductions. And we found some, but it was leavened with pragmatism, not bitterness. After all, these were survivors.

Indicators of this reaction varied and, not surprisingly, were conditioned by the such factors as the managerial style of the department directors above them, the career stage of the managers themselves, and their functional positions in their department's hierarchy. One saw himself as simply doing as he was told. He said that the decisions regarding cuts in his department were made "top down". Managers were simply told how much was to be taken out of the bureau's budget and they would then convene the program managers and they would sit down together and work out the cuts. This manager was nearing retirement and seemed to be saying that he had been a loyal soldier to the end.

Another manager said some attempts were made initially to secure participatory decisions in her department. But, according to her, "That was perceived as an exercise in futility because people didn't see how anything that we suggested was used. After awhile, when it didn't seem as though that input process was having a direct linkage to the decisions that were made, it got kind of farcical, i.e., why should anybody bother." This manager said that the basis on

which most cuts were made in her department seemed largely driven by personalities. For example, a program director's position which was deleted early on was occupied by an individual who was not liked. His supervisor thought he was "someone who would be difficult to have work for other people." In order to ease him out his position was eliminated. But it was clear to the respondent who related this episode that the decision was not driven by financial considerations because the program was funded with federal dollars. Eliminating that position saved no GF/GP funds.

Not surprisingly, the manager of a budget unit reflected least alienation, largely because his work required him to take a departmental-wide view of his organization. While he argued that his unit should have been protected from cuts because of the extra work required of them, his overview position as fiscal advisor to the department director made him realize that his unit had to take a fair share of the cuts.

This small probe into the views of mid-level managers and their response to fiscal crisis is additional evidence that some centralization did occur. The differing perspectives which conditioned their assessments, however, suggests that this area merits further research. There are further insights to be gained here for organizational theory in the larger question of managerial response to crisis.

A Receding Role for the Legislature? If centralization were occurring, we also hypothesized that the role of the legislators would thereby become less important. We thought

we might find evidence for this, for example, in statements by lobbyists that legislators were less interested in listening to their positions. Certainly there was some justification for this. As we noted in our preceding discussion on the changing role of negotiations, one key legislator deeply involved in the budget slashing said bluntly that lobbyists were listened to less during this period. But the lobbyists we interviewed disagreed. They did not feel (or would not admit) that legislators were less willing to listen to them. (Some lobbyists did say, however, that they tended to hold back on requests because they knew funds were short, but made themselves available to legislators if needed.)

The view of fiscal agency analysts privy to these interactions was also mixed. Some said the lobbyists "got more", some said less.

It became apparent that this measure of centralization was poor. Although designed to test for weakened power, the responses it elicited were confounded with pride of turf ("Of course the legislators listened to us") on one hand and boredom and frustration ("after the twentieth followup, they would start to say no") on the other. Another indicator was needed.

As it turned out there were two. One was the passage of Public Act 268 of 1980. In this act, unprecedented in the history of the state, the legislature gave the governor through his chief financial officer, the power to operate the state budget for three months. Faced with enormous

revenue uncertainties, fearful of a coming election and harassed by a pending tax cut initiative, the legislature gave up its power of the purse to the executive budget director. As one insider, a former DMB official said, "It was a complete abdication of responsibility."

The other measure is found in a comparison of paired rejected and approved executive orders. As we mentioned in Chapters Three and Four, the large majority of executive orders mandating budget cuts were passed as submitted by the governor. (See especially Table 4.2.) In five cases out of the eighteen, however, the legislature chose to reject the orders despite prior negotiations. A comparison of the orders which were subsequently submitted shows some interesting changes. These are indicated in Table 7.2.

These suggest that the legislature made an effort to reassert power in the two years which followed. The 1981 paired orders taken up in September of that year show the legislature protecting higher education, mental health and the school aid fund and approving cuts \$25 million less than what the governor had initially proposed. Coming on the heels of a slight economic recovery and voter rejection of the tax cutting Proposal A, the legislature perhaps felt encouraged to resume the charge.

There was at least one insider who argued that, as things got tighter, legislative participation in decision making actually expanded because of resentment by some legislators who had not been involved in prior cutback decisions. In this respondent's view, this demand for

Table 7.2

Comparison of Paired Rejected and Approved Executive Orders

-----Executive Orders-----						
Direction of Change	1974-10 1974-11	1975-11 1975-12	1981-07 1981-08	1982-03 1982-04	1982-11 1982-12	
Proposed Cut	DMH	Total	Total	Total		
Reduced	DPH	COR	HED	HED		
	SCH	L&R	DMH	SCH		
	ST	DMH	SCH	REV		
		SCH				
		DSS				
		CO				
No Change	AG DMB ATT MIL CR DSS COM POL ED TRS EXE DS HED LAB L&R		AG L&R ATT DMB CR MIL CS DNR COM DPH COR DSS ED ST EXE POL JUD TRS LAB DS LEG REV	EXE	Total HED SCH REV	
Proposed Cut	Total	AG DMB		AG DMB		
Increased	COR	ATT MIL		ATT DMH		
	JUD	CR DNR		CR MIL		
	LEG	CS DPH		CS DNR		
	DNR	COM ST		COM DPH		
	CO	ED POL		COR DSS		
		EXEC TRS		ED ST		
		HED REV		LAB POL		
		LAB		L&R TRS		
Not Included	CS REV	JUD LEG DS	CO	JUD LEG DS CO	AG DMB ATT DMH CR MIL CS DNR COM DPH COR DSS ED ST EXE POL JUD TRS LAB DS LEG CO L&R	

Source: Based on analysis of Table 3.2

participation arose because of pressure exerted on them by lobbyists and departments which were feeling the impact of cuts, particularly in education and social services, that had already been taken, and their argument that "the revenue side of the question" had not been considered. That, in turn, fueled demands by other legislators who feared that the revenue issue would be opened.

The following pair also shows the legislature acting to protect higher education and school aid, but this time cutting mental health in favor of protecting local revenue sharing funds. This pair, taken up in the spring of 1982, was also cut, the final version being about \$140 million less than what was first proposed. It was during this time that the budget director was beginning to distance himself from the governor's tax policies and the legislature, perhaps smelling blood, may have decided to carve a little flesh for itself as well.

The final pair, those considered in September 1982, show no change. The version finally approved is identical to the prior version which was initially rejected, but the legislature promised school district officials to restore their cuts before the end of the schools' fiscal year. By this time, the state was in its worst fiscal throes. Unemployment was over seventeen percent, the budget director had concluded that the economy had collapsed and that the worst was yet to come. He had announced his resignation. Did no change in the executive order mean abdication again or merely despair? It is difficult to know.

As the discussion on the changing nature of negotiation showed, the role of the legislature seemed to change with the degree of duress. The worse things became the more likely the legislature seemed to go along with centralizing forces. By the fall of 1982, however, it is not clear around whom the forces were centralizing.

Summary. So we have some further bits of evidence that the role of the budget office became more important during the fiscal crisis. As Bozeman and Straussman (1982) suggested, the budget office did accrete more power. The amount of communication did increase between the Department of Management and Budget and the other agencies of state government. The posture presented by the state's budget director in making many of the cutback decisions invited frequent comment, some of it derisive. The role of negotiations changed during the crisis, but when things got really bad, they broke down. The budget office seemed to take the upper hand, although there was mixed evidence about its ability to control information flow. There is also some corroboration for this hypothesis from program managers who saw centralization tendencies in their own organizations. Finally, we saw that the legislature itself was vulnerable, but its abandonment of power was not uniform nor consistent.

Certainly, the sheer volume of press coverage on the Department of Management and Budget during the fiscal crisis is an additional index of activity. It is an interesting footnote here that the budget director actually appointed a senior capital area journalist as his spokesperson during

the height of the fiscal crisis. Such appointments in state agencies are somewhat rare, usually being found in the governor's office, top legislative positions, and perhaps the state supreme court.

IV. The Role of the Budget

The final hypothesis we sought to test in this study concerned the role of the budget. As a prime tool of governance, the budget serves such varied purposes as planning, management, control, and communication. However, as we observed in Chapter Two, various scholars have argued that these traditional uses change in a cutback period. Schick (1980), for example, says that budget-related planning decreases because events are perceived to be out of control and Caiden and Chapman (1982) found little evidence that policymakers were willing to face up to their budget crises, no systematic response. These suggest that not only planning, but also management falls by the wayside. We proposed to evaluate this proposition with several different tests.

Diminished Budget-Related Planning? If planning deteriorates in a fiscal crisis because of the sense that events are out of control, we might expect to see decreased and/or delayed completion of management program documentation for forthcoming budgets. Management plans, as described in Chapter Six, explain the way departments propose to spend their appropriations during the coming fiscal year. They consist of a half-dozen forms providing detailed information such as comprehensive descriptions of

programs, analysis of possible alternatives, and narrative justifications. In these plans, managers also describe each program's history and performance as well as the resources used to fund the program. In addition, there is a summary ranking of all departmental programs in descending order of priority.

Hundreds of management plans are used to develop budget recommendations every fiscal year. They are developed during the spring once policy guidelines have been issued and are reviewed by DMB and the legislative fiscal agencies during the summer prior to development of the interim budget in early fall. We thought delays might be particularly evident during the period April 1 through August 1 when such activity normally takes place.

In order to assess this, we interviewed prominent analysts in both fiscal agencies, an individual who had occupied a key position in DMB during the fiscal crisis, and a budget officer in a department which had received major cuts. The fiscal agency analysts confirmed that delay was indeed the case. As one observed,

"Some of them came in quite late and even after (submission) there had to be some revision because the budget numbers were cranked down even before it was released to the legislature in January. So there was delay and they were usually pretty much useless right after they were released..."

What turned out to be interesting about this question, however, was not the matter of delay in submitting the management plans, but the disagreement among respondents concerning the value of the management plans in making cutback

decisions. We had supposed that management plans, being roadmaps for program spending, would also serve as guidelines for retrenchment. Not so. We encountered only two who claimed to use them in making cutback decisions. One was a legislator, a ranking appropriations committee member, and the other was a budget officer in one of the executive branch departments, but even she said they were of doubtful use in the final analysis.

When this situation was described to a senior member of the executive service who had been intimately involved in the budget reductions, he said the plans still suffered from what he called the "Washington Monument Syndrome," a reference to hostage items, i.e., those treasures which would be destroyed if the fortress is invaded. As he said,

"My perception is that it was a mixed bag.... Either the plans themselves were not valid to begin with, or other people in positions never took them seriously and when forced to cut back, made other decisions. In any event the management plans then weren't honest plans."

So this test turned out to be less useful than we might have supposed. Management plans in Michigan government are rather new and, at the time of the fiscal crisis, had been in place for just a few years. As the principal vehicles of the budget planning process in state government, they were not fully established. Therefore, the fact that they were not used much by those involved with the cutback process (with the exception of the legislator) says either that this particular instrument was weak, or that the critics were wrong to imply that budgetary planning per se was as established as it was. If budgetary planning itself is not well established, reasons

other than fiscal crisis might account for its diminution. It seems that we may have the effects of both arguments here.

Established or not, the fact remains that the crisis made budgetary planning and management chancy. As one analyst recalled,

"...it was very difficult to plan and manage when the budget was basically a roulette wheel. You just didn't know. On the other side, people were saying, 'Well, you're just not trying hard enough.' So you had to go back and re-evaluate. You had to go back if you're the program manager and be able to seriously address the question of 'How can I carry out my mandate for my program at a 90 percent level, or an 80 percent level, rather than saying I just can't do this because I just don't know how much money I have. I'm constantly reacting and I never know how much I'm going to have until it's too late.' It took a lot of day-to-day operating in which they had to prioritize because those activities which were absolutely essential had to be somehow identified and carried out."

Procedures other than those found in the management plan were used to make the cutbacks. Priorities identified in the plans were often ignored. Timing of the cuts, amount of money needed, availability (e.g., lack of federal strings), annoying the smallest number all seemed to figure more prominently in the cutbacks than priority of need as established in the management plans.

No Systematic Response to Crisis? A common complaint seen in the fiscal stress literature is that governments facing budget problems are incapable of systematic response. There seems to be no commitment to facing budget problems. These complaints have been expressed by analysts reviewing fiscal crises not only at state and local levels, but at the federal and international levels as well. The complaints were also heard in Michigan. How true the allegations were,

however, seemed to be a critical, ultimate question which deserved multiple measures. We identified several:

Incidence of "creative accounting" procedures? If actual funds were not available to balance the books, temporary paper shifts might make it appear so until actual funds became available. That policymakers in Michigan resorted to these techniques to balance the budget has already been documented in Chapter Four. Use of these procedures began in the 1975 fiscal year and continued on through the end of 1982.

Just why policymakers should have resorted to these techniques at this time is an interesting subsidiary question. General theory heard on the street holds that political leaders believed the fiscal crisis was a passing thing and that patchup techniques would do. Almost everyone we talked to recalled the wishfulness of the period, i.e., the conviction among legislators, bureaucrats, forecasters, even the press that the bookkeeping magic was temporary because "things are going to improve."

But an alternative explanation has been suggested by VerBurg and Press (1982). They argue that Michigan became involved in these practices because the governor was a captive of his predilection for professional advice and the professionals could not agree. Like V. O. Key's earlier lament, the larger social welfare questions could not be resolved with economic rationality. This is an interesting argument and nothing we encountered refutes it. But there is some evidence, as we shall show later in the chapter,

that decisionmaking turned fundamentally political when the cutmaking went deeper and faster.

Whatever the motivation, however, for some who had been deeply involved there was an aura, in retrospect, of defiance. As one former DMB official said,

"I think that some of them (i.e., the creative accounting procedures) were probably the most creative issues that we have dealt with in some time and if one is looking for an apology you're not going to get one. The issue that government was faced with at the time was...whether we would continue to reduce services that at least this particular governor thought he could not reduce and at the same time was unable to get a tax bill through, or adopt the alternative of creative accounting."

This same official argued that, if creative accounting were defined as departures from generally accepted accounting principles, then DMB was not guilty, because one generally accepted accounting principle is that agencies should follow the law. According to him, in only one instance did DMB stretch the law by accruing thirteen months of revenues against twelve months of expenditures, which was also an irony because generally accepted accounting principles recommend accrual. The remainder were all sanctioned by statute. Thus, as he pointed out, "The legislature was an equal partner in utter manipulation."

Incidence of quick fixes? A close relative of creative accounting, the quick fix is here understood to involve a lightning raid on reserves such as use of special purpose funds to balance the budget. As we documented in Chapter Four and Appendix B, this field was also visited by the budget marauders. At various times, they tapped the Motor

Vehicle Accident Claims Fund, the Veterans' Trust Fund, the Uninsured Motorist Fund, the Recreational (Kammer) Trust Fund, the Liquor Control Commission revolving fund and the teachers' pension fund contingency reserve.

As one of the respondents observed, none of this was illegal. Indeed the concept of tapping reserves is justifiable and underlies the establishment of the Budget Stabilization Fund. The problem with tapping these other reserves, however, is that they were meant for other purposes and using them shows the degree to which planned response to the fiscal crisis fell short.

Criticism by outsiders that state is unrealistic? If there were no commitment to facing budget problems and no systematic response to the budget crisis, then we supposed that we would find substantial criticism to this effect from outsiders. Political leaders are always subject to criticism from the competition within the political system and finding allegations to this effect would prove little. However, if outside agencies without the proverbial ax to grind were saying these things, then perhaps there would be some merit to the criticism.

Foreigners looking at problems in the American states often wonder why federal, i.e., national, agencies would not be more concerned with the fiscal fortunes of the individual states. But the logic of the federal system as it is played out in the United States is such that little coordinated effort is ever brought to bear on such problems. It is true that some federal agencies, e.g., the U.S. Department of

Labor through federal assistance with the Unemployment Insurance Trust Fund, did become involved and, of course, the Congressional delegation was distinctly aware. But on the whole the federal government seemed rather oblivious to Michigan's dilemma. Indeed, policymakers at the federal level were making cuts in their own budget which had deleterious effects on the states just at a time when Michigan could least afford to sustain those losses. The brief break in this oblivion was poignantly illustrated when the Detroit Free Press chose to make front page news of President Reagan's admission in February 1982 that Michigan was in a "first class depression."

If the national political agencies were somewhat oblivious, however, the national financial markets were not. Their continuing pressures noted in Chapter Four and in Appendix B in lowering the state's bond rating and ultimate refusal to lend the state any more short term funds were probably the single most important force for reform.

Changes in fiscal forecasting and other procedures? If, as the critics supposed, fiscal crisis begets no systematic response nor commitment to facing budget problems, then we might expect to see no changes in such things as overall fiscal forecasting procedures, budget monitoring or program management documentation. Was this the case in Michigan?

Forecasting. Interviews with various individuals suggest that the record is mixed here. As mentioned in Chapter Four and Appendix B, the State of Michigan had access to revenue forecasts through various sources,

including those put together by the legislative fiscal agencies and DMB's Office of Revenue and Tax Analysis. Nevertheless, in direct response to the earlier fiscal crisis in 1974-75, the state moved to negotiate a contract with the University of Michigan to provide even more sophisticated forecast data on a regular basis through the well-known Michigan Model.

Even so, as subsequent events proved, the data proved inadequate given the size of the crisis which ensued. Some individuals we interviewed suggested that, partly as a result of this experience, the state has now de-emphasized use of forecasting models. As one said, "...it is still an imprecise science, somewhat of an art trying to predict the future and not something that we can sit down and say, 'Gee, if we'd only done this we would have known.'"

But others suggested that the state came to de-emphasize the models for other reasons as well. As a consulting fiscal analyst said,

"One thing I do know is that when X took over from (the previous director of DMB), he didn't like numbers. That was strange for someone who was heading up a department like DMB. He didn't trust the sort of analysis produced by economic forecasting. That wasn't important to him. Politics was what was important to the new administration. Really good analysis didn't seem that important."

Thus, we see that there was an attempt early on to respond systematically, but that the unreliability of one important technique, forecasting, eventually undermined that determination at least in that respect.

Budget monitoring and program management documentation.

Here, everyone we spoke to said that the continuing instability in revenue flows made systematic budget management during the crisis a virtual impossibility. But the experience produced sound afterthoughts. Although it came too late to help with the big crisis but certainly was occasioned by it, Public Act 431 of 1984, the Management and Budget Act, required departments to report encumbrances and receivables on at least a monthly basis and further centralized the accounting system within departments and throughout the system. According to several sources, by 1985 the State of Michigan was planning a systemwide upgrade of its general accounting system which would improve the capacity of the Office of the Budget and the legislative fiscal agencies to monitor the budget throughout the fiscal year.

No overall fiscal policy changes? We also reasoned that if there were no systematic response to the fiscal crisis, then we should find no overall fiscal policy changes such as tax innovation or disengagement from identifiable expenditure programs.

Here again the Michigan response was mixed. On one hand, we see a clear attempt to deal with the fluctuating revenue situation with the creation of the Budget Stabilization Fund in 1977. Adopted at the end of the 1974-75 recession, it was a clear attempt to set spending limits and, at the same time, provide a countercyclical hedge on recession through its savings provisions. Yet events proved the fund to be hopelessly inadequate to

buttress sagging revenues in the later recession which occurred a few years later, and serious questions were raised whether a fund large enough to cover such a gap would be politically feasible. As the head of DMB's tax unit said,

"All told, if we added up all the cuts in the executive orders and the cuts that were made before the executive even presented the budget and what the legislature cut after the presentation, there were probably over \$2 billion in spending reductions made from original plans over that period of time. It would be politically irresponsible and would be irresponsible to the people of the state to have a fund sitting there with \$2 billion dollars in it. I don't think we could reasonably get beyond \$500-750 million in the fund without creating demands that the money be used for tax cuts or something like funding higher education or other special needs."

Subsequent events proved him right, as in 1986 the legislature began taking funds out of the stabilization fund for prison construction, drawing the fund down to about \$350 million. Some thought the fund needed to remain at about \$800 million, or about ten percent of the General Fund and School Aid Fund budget.

Ultimately, or at least in the mid-term, there were also increases in the income tax and cigarette tax. Although the initial effort at raising the income tax was undeniably a case of too little too late, the increase, though temporary, did mark a fiscal change. And part of it was innovative. One-fourth of one percent of the increase was dedicated to a special fund, the State Accounting and Fiscal Responsibility Account (SAFRA) to pay off the state's accumulated debt. Also innovative was dedicating the cigarette tax increase to a Working Capital Reserve Fund to recharge the state's cash flow, thus lessening Michigan's

need for short-term borrowing. Both were needed changes.

Our respondents were less clear about the second issue: disengagement from identifiable expenditure programs. None were able to point to specific programs which were eliminated. Their responses tended to speak to other dimensions such as what was not begun. As one legislator said,

"I think that for a long time there were very few new programs started. New programs really had to show their worth. Before that, when we were on the upswing, people would get an idea and they'd come in and we would generally find some money for that idea. But at the end, that wasn't happening at all. You could come in with ideas, but it better be an idea how to save money. There were very few new programs that were undertaken."

Or focus on better management. Another respondent said he thought the fiscal crisis produced deeper internal review of programs. Whereas some programs might have been allowed to limp along because they "weren't broke," the crisis forced managers to review almost everything.

It may seem surprising that none of the respondents could actually identify programs that had clearly been abandoned. But that was not the major purpose of this study. That finding only emerged when we probed for evidence of fiscal policy changes as a measure of the impact of fiscal crisis on the role of the budget.

Substantively, however, it may have meant something else. As one tax analyst wistfully observed,

"They go on and on. Each program has its constituency and it becomes very difficult to impact it. Despite the fact that there were tremendous economic pressures, it's amazing the small amount of impact that it had on the budget. It impresses me even to this day that the

programs were so resilient, so able to protect their turf through the political process. It's amazing, it really is. Even though they (the managers) can't show you why the programs work, they're very successful at getting those numbers maintained."

In fact, a definitive statement of what indeed was abandoned requires further research. What we can say, however, is that there were some fiscal policy changes. There were some short term, albeit reluctantly adopted, tax increases. But the impact of the one change which may have the longest term effect, i.e., the creation of the budget stabilization fund, is still too new to be assessed.

Focus on remediation only? We thought that the nature of the response to the crisis might finally be tested in an assessment of the discussion, particularly within the appropriations committees, at the time. Was it centered on remediation rather than reform? If remediation only, then the critics might be right. Systematic response would suggest a broader search for reform.

Of all the questions we asked, this one elicited probably the most uniform and emphatic replies: remediation. Lobbyists, analysts, legislators, journalists all said the same thing. A lobbyist: "There was no detailed argumentation. It was absolutely a case of putting out fires." A fiscal analyst: "There tended to be a concentration over the top issues and not really getting into much more detail after that...they weren't quite as interested as usual in going through the whole--like leave the rest of it alone and concentrate on where we have to swing the axe." A legislator: "They were not interested in

long term solutions." Another legislator: "It was a case of putting out fires. That's all it was." A journalist:

"The budget director would show up to present his latest doomsday report that we'd all go over there and we'd write about that, but to the extent that a full appropriations committee would sit down for a serious discussion of this, no, it was basically the budget director making a presentation and a handful of questions being asked of him and that was the end of it. Then, maybe if something serious had to be done, I'm sure he and maybe two or three of his people went over and talked to (the chairman of the House Appropriations Committee) and they talked to various other characters over there and they struck the damn press then--if they did--with the seriousness of it. And they did it. That's what came out. That's what got marked up."

It was the fiscal analyst who provided the most perceptive analysis, however. His response is worth reporting in full. According to him,

"The fiscal crisis had a rationality of its own. I don't think it can be understood outside of the political context. If one looks at it strictly from an academic viewpoint it would make no sense at all as to what got cut and what didn't get cut, i.e., who and why.

It would have to be looked at in a political context because when legislators are looking at cutting back programs which they personally may have championed or that they were particularly proud of, the cost of cutting is very high. That's where the politics really comes in. There was an executive order cut, for example, that the two appropriations committees rejected because it cut into some very sensitive areas that they just wouldn't do. They just wanted to be consulted a little more. It seems to me that there was something in higher education that year that they particularly objected to, and of course, during that time there was a Republican governor and both houses were controlled by the Democrats and the Democrats were saying that the governor is just picking on the programs which would impact in Democratic areas or in urban areas of southeast Michigan or Grand Rapids or Flint. A lot of times it just became a Viking smash and grab affair, i.e., wherever you can find money--whoever is vulnerable--would get stomped on.

I don't think anyone could build any kind of a model

unless these political factors are strongly included. I don't want to imply that there was no rationality to it, just that it's a political rationality.

But I think a really important aspect of all this from the appropriations committee perspective was information overload. They were getting hit with so much from the department, the lobbyists and interest groups as to why their program should not be cut and why, if they cut that program, Michigan would go to hell and people are going to drop dead on the streets, that after awhile they just couldn't deal with it. It was just too much. So they had to look at some other process. At that point when everyone was hitting them, they had no other way to make a decision which was the tried and true way but the political factors. That's a real important key to understanding why of two perfectly good programs, one got cut and one didn't. If one looks at that they might be able to see more of what happened and to understand what happened. But they understand that they could cut this program because, for example, that the Governor's a Republican and this is a Republican program, or the other way around.

Yes, the ultimate rule is twenty-one votes (what it takes to pass something in the Senate). You can ask all the other questions you want, but the final criterion is twenty-one votes."

V. Summary.

In this chapter we have looked at three final controversies about the impact of fiscal crisis on budget theory: whether it affects the annual cycle, budgetary roles, and the role of the budget itself.

We found that there is a breakdown in the annual cycle, and that funds are partially reprogrammed. This is what Wildavsky would have predicted. But we found that payment schedules, however partial the payment, tended to hold firm. Thus the engine continued to fire, but on lower octane. We also found that the executive fiscal agency tended to gain power, a hypothesis of increased centralization advanced by Bozeman and Straussman. We found little evidence for Levine

and Rubin's assertion that scarce resources fragment authority. We did find that the role of the legislature became more ambivalent. Its abandonment of power, however, was not uniform nor consistent.

Finally, regarding the role of the budget, we found some erosion in the use of the budget as a planning tool as suggested by Schick. Management plans were not completed on time and were regularly disregarded in deciding cutbacks, raising questions about the degree to which they were useful in the first place in the budget building process. The use of the management plans for management purposes was chancy at best.

Response to the fiscal crisis was mixed. In the beginning there were elements of a systematic response. The rainy day budget stabilization fund was created early on and there were efforts to buy into high level fiscal forecasting. But adhocmanship permeated the entire process and clearly got worse at the end. This lends only some support to the Caiden and Chapman notion that response to budget crisis is non-systematic. For in Michigan, there was an attempt at systematic response at the beginning and more at the very end. Confusion was the dominant theme in the middle. Insiders themselves admit that the approach was limited and criticism by outsiders, especially from national financial interests not interested in the internal political forces was evident. Centralized budget monitoring was weak but eventually the state moved to improve it with the adoption of the Management and Budget Act of 1984.

Fiscal policy changes came but too little and too late to stop real agony. Eventually, however, they--together with an improving economic situation--had an effect. And it was unclear what programs, if any, the state relinquished. That certainly needs further research.

Chapter Eight

Summary and Conclusions

I. Introduction

This study explored the applicability of some aspects of budgeting theory when applied to decision-making in a crisis environment. Data from the State of Michigan was selected because this state must budget in the country's most volatile economic conditions, making it an unusually good extreme test of the propositions.

On November 8, 1985 the governor of Michigan declared "solvency day", having retired a \$1.7 billion debt from the most volatile budgetary era in its history. This governor, elected in 1982 on a platform of fiscal reform and economic recovery, had ended the crisis at some political cost. Forced to push through a tax increase, he lost two supportive Senators through recalls and, consequently, party control of the Senate. He had to issue an executive order mandating further budget cuts in 1983. He had to lead an angered, poorer citizenry and preside over a demoralized bureaucracy. He was faced with weakened educational systems and court challenges on lowered patient/ or inmate/staff ratios in state institutions. Infrastructure, i.e., highways, bridges, dams, and sewer and water lines, always vulnerable in a frost-zone state and neglected through maintenance cuts were in substantial need of attention. But the governor was re-elected in 1986, vindicating some of these decisions.

These were some of the political, economic and social

fallout from the fiscal crisis. Some had been remedied rather quickly and some still needed to be addressed. But what had been learned?

II. What Has Been Learned: the View from the Experts

We asked many of our respondents what they felt had been learned from the fiscal crisis. Not surprisingly, their responses tended to reflect their positions in government. But the responses did cluster around several themes.

Fiscal Policy. Several respondents thought that some key decisions made in the mid-1970s proved to be extremely wise citing, for example, adoption of the reserve fund, the Budget Stabilization Fund. Although they admitted that controversy continues about how large the fund should be, and whether the fund should be used for other purposes, they thought its adoption was vindicated. At least one respondent felt the crisis also showed the wisdom of passing the Single Business Tax (SBT) in 1975. Adopted as a substitute for the corporate income tax which was extremely volatile, the SBT probably kept the state's deficit from reaching a further \$500 million in this person's opinion.

Several also thought less reliance should be placed on fiscal forecasting models, or if continued, a more conservative bias was needed. The science, they said, was still too inexact to be really useful.

Mixed Success for Budgeting. Although some said the need continued for more prudent budgetary planning, particularly for ways to plan for dramatic changes, some

thought that budgeting in state government emerged stronger in two respects: it was more program focused and, so far as some interim decisions were concerned, had more credibility. Sheer politics may have determined the cuts when the marrow was reached, but at least one thought early and mid-run decisions were influenced in her department by management plans and thereby reinforced their legitimacy.

Others thought that the budgetary decision process still failed them when decisions had to be made across departments, an echo of the Key (1940) concern, and left no insights about where the important services were if the state should have to face a zero growth situation.

Leadership is Critical. Because of these concerns, several said that the fiscal crisis underlined the critical importance of leadership, particularly gubernatorial leadership. Strong leadership on the part of the governor was needed not only to articulate commitment to key service areas but also to direct the charge on tax increases, if needed. It could be done in a first term. The experience showed that the legislature was unlikely to take the initiative there.

Fears about Future Capacity. While one respondent said with some satisfaction that the fiscal crisis had stopped the trend toward big government, several others expressed concerns about the capacity of what remained to deal with outcomes of the fiscal crisis in three critical areas:

- ° Loss of key personnel in higher education,
- ° Regulatory, certification and investigatory

activities in licensing and regulation, labor and education, and

- ° Social liabilities in case of a future crisis.

Studies have shown that unemployment has always been left a little higher after each fiscal crisis in Michigan. In the fall of 1986, people on some form of income transfer or assistance based on economic need, or on unemployment insurance, were estimated to exceed ten percent of the population. At the same time, state budgets were at their leanest. If another recession were to occur, social liabilities would balloon and the state would be ill prepared to cope with them.

The Continuing Need to Diversify the Economy. Although Michigan had made progress in this area, the fiscal crisis reinforced a simple truth that everyone had known for a long time, i.e., that the economy needed further diversification. It was still too automobile dependent.

III. What We Learned: The Results of the Study

Received budget theory is still partly useful in conditions of fiscal stress. When we looked at the various components of contemporary budget theory, we found that half of it held up rather well in conditions of fiscal stress as experienced in Michigan during the twenty-one year period, 1963-1984. The components that tended to erode were in the area of the annual cycle, budgetary roles and the role of the budget, although these were admittedly the areas of most subjective analysis. The components which were tested are:

Linearity. The analysis shows that the linear model as developed by Davis, Dempster and Wildavsky (1966) and interpreted by Hoole, Handley and Ostrom (1979) and its variations as developed in this study explain changes in the total budget well. These changes came primarily at the margins. The model functioned less well with subsets of the budget displaying greater volatility generally and substantial deviation between regular and cutback budgets. But these were extremes within an extreme case and their relative rarity should not tempt us to conclude that the linear component necessarily, therefore, is useless.

The State of Michigan riffed twelve percent of its employees and made cuts in a relatively short time that constituted almost a quarter of the GF/GP budget. However, in general, the core of state programs continued. For this core, expenditures still looked a lot like appropriations in the prior budget year and the model was still robust.

Fair Shares. The concept of fair shares was not undermined in the cutback process. Although the goodness of fit model as developed by Natchez and Bupp (1973, as interpreted by Hoole, Handley and Ostrom, 1979) did not perform well with this data, other techniques showed that fair shares continues to be supported on the broadest levels when we compared change across departments.

This is somewhat surprising when we consider that the bureaucratically articulated preferences seen in the management plans were apparently ignored. We would have expected that these preferences would reinforce fair shares.

It is also surprising when we consider that other less-fiscal factors figured in the distribution decisionmaking. According to our respondents, these were:

- ° The size of cut needed and its companion factor, annoying the fewest in the neighborhood.
- ° Timing of cuts, i.e., at certain times of the year some accounts were simply fuller than others and thus more easily siphoned.
- ° The recent-commitment commitment, i.e., the tendency to avoid cutting into decisions newly settled.
- ° Exhaustion and information overload.
- ° Pure partisanship, i.e., when nothing else is possible, take it from the other party's larder.

In some measure this can be attributed to that other critical factor, i.e., structural constraints, which put different types of restrictions on the whole process. Court orders prevented cutbacks in state penal and mental health institutions. Legal mandates required adequate notice of cuts in social services payments. Federal match formulas and other restrictions tended to limit choices that could be made across departments and funds. These perhaps forced cuts from some categories more than would otherwise have been the case. What the independent impact of these constraints might have been, however, is difficult to assess as some were added throughout the process and clearly as a result of the crisis.

The effect of the court decisions and attorney general

opinions, in particular, was mixed. Some tended to increase rigidity in the budgeting process while others helped to make it more flexible. For example, the court decisions fixing staff ratios in state institutions imposed often crucial constraints and tended to reinforce the trend of adopting ever more constraints. Two which encouraged flexibility were the 1975 attorney general's opinion which held that school aid funds were not protected from cuts even if their impact distorted school aid formulas, and the 1984 court decision which held that guaranteed revenue sharing with local governments (the Headlee Amendment warrantee) did not extend to cutbacks. It is possible that these two decisions do more to guarantee that funding cuts will be taken from the schools and from revenue sharing funds than any other factor because in handing them down the courts have clearly given "permission" to look for cuts in these areas.

There was only minor support for the reverse redistribution argument i.e., that the powerful are protected and the weak succumb (Schick 1983 and Lipson and Lavin 1980). Within departments there was some evidence that activities having less immediacy such as research and development and those serving weaker groups did tend to suffer. Also, across divisions of government, finer shades of marginal change did show some protection for constitutionally established units such as the legislative and judicial branches.

Marginality. Marginal change is still a strong descriptor of budgetary behavior when comparing budgets in growth periods and cutback. The findings showed there is

heightened interest in the base in cutback times. However, they do not fully uphold Bozeman and Straussman's (1982), Schick's (1983), or May and Meltsner's (1981) thesis that in these periods the focus of budget policymakers turns from the increment to the base.

The Michigan behavior shows concern with both the margin and the base. Some interest in the base existed in the beginning, i.e., some of the most serious attempts to introduce economic rationality into the cutback process were taken early on in the crisis, and some of the "quick fix" behavior associated with marginal change decisions carried on through to the end. It may be that Michigan's historically volatile economy forced policymakers to deal with the base at an earlier stage than theory would otherwise have predicted. Or, perhaps our time frame is too short. A retrospective look across several decades might show us that, at some point, there was a shift in concern from increment to the base. Or, it may mean that volatile economies produce budgetmakers who are a bit different from the norm, i.e., who may take less for granted.

Where evidence is strongest for the Straussman/Bozeman/Schick/May/Meltsner thesis is in the impact of rules on the cutback decision process. If we regard the base as a collection of rules or constitutional, statutory and procedural requirements which are or may be intervening variables affecting budget decisions, the analysis shows that they shaped a good deal of the budgetary outcomes, procedurally and substantially. Indeed, as we just

mentioned in our discussion of fair shares, it may be their effects that largely voided the Schick redistribution argument.

Annual Cycle. There is some breakdown in this dimension of budgetary theory. Funds were clearly reprogrammed adding further corroboration to the Wildavsky notion that in periods of cutback there is greater incidence of repetitive budgeting. But payment schedules, however partial, tended to hold firm.

Some might argue that here as well, our time frame is too limited, i.e., that we may not have enough information of a precise enough character to appreciate when different consequences happen. At some point, a sharp cutback would surely affect payment schedules. It is our suspicion, however, that Michigan bureaucracy being as professional as it is, payments would continue on a regular basis down to the last shared mil.

Centralization. The traditional interplay of budgetary roles between the executive and legislative did change somewhat. The executive fiscal agency did tend to gain power. The role of the legislature became more ambivalent but its abandonment of power was not uniform nor consistent.

These findings do not uphold the Levine and Rubin (1980) thesis that under stress, the strategies of budgetary politics weaken central control just when it is needed most. For this data, at least, scarce resources did not fragment authority. On the contrary, Bozeman and Straussman's (1982) argument is supported. In periods of cutback, the budgetary

process did become more centralized. Knott's (1981) observations are also supported. Negotiations between the individual departments and the legislative body became less important.

We also found some similarities to Meltsner's (1971) findings that policymakers faced with scarce resources practiced "politics of avoidance," in that efforts were made to take cuts from the least politically costly sources, and from the fewest sources, in order to avoid conflict. There was also a tendency in the reform administration which followed to keep the peace by deliberately underestimating revenue and overestimating expenses.

Role of the Budget. Our analysis shows that the traditional uses of the budget for planning, management, and control changed, but not entirely predictably. Schick (1980) hypothesized that budget-related planning would diminish in a period of fiscal uncertainty because of the sense that events are out of control. We found that policymakers developed a most innovative planning instrument, the budget stabilization fund, in the midst of one crisis. Then, however, they proceeded to ignore the management plans, so useful in budget building, when it came time to cut back in the next crisis.

Schick also said that the use of the budget for control would increase in stressful times. We found that to be true in the sense that the ultimate rule, the balanced budget requirement, drove budgetary decisions again and again. Because of this, and because of the ever changing cuts

resulting, the budget itself became a vehicle which hit and overran management and planning. In this sense, we found no corroboration for Alexander's (1984) thesis that the budget becomes a stabilizing instrument to accommodate uncertainties arising from changing legislative priorities and a shifting economy. Quite the contrary, the budget became a destabilizing force itself.

We did find some support for the Caiden and Chapman (1982) thesis that there is no commitment to facing budget problems and no systematic response to budget crisis. We found that use of ad hoc remedies riddled the entire process. Insiders admitted that there was too much focus on the fires of the moment. Pressures from outside financial interests were critical in forcing the state to deal with its financial problems. But fiscal policy changes did come, even though in small and tardy doses. Eventually they, together with a new administration--and an improving economy--helped to restore order.

IV. Questions Raised: Implications for Political Science, Policy Analysis and Public Budgeting.

The foregoing suggests mixed support for the predictive value of contemporary budget theory in conditions of fiscal stress. The findings also suggest we need to take a longer look at several key questions.

A. *Are structural constraints in budgeting helpful policy tools in the long run?* What is the impact of the increasing predilection for rigid budgeting frameworks such as caps and distribution formulas? Michigan had a

constitutional balanced budget requirement and a line-item veto. Neither prevented the state from getting into a financial quagmire that lasted almost a decade. On the other hand, had they not been there, would the situation have been worse?

There were also numerous other constitutional, statutory, and timing constraints in Michigan which tended to direct the focus of cuts into higher education and, especially, school aid. This occurred just at a time when the state needed to tool up for increasing technological competition from other states and abroad. Although these policy areas ended up taking their fair share of cuts, some argue that these were precisely the areas that needed protection to buffer Michigan's economic decline and, perhaps, generate a resurgence. Spending in these areas might prevent further growth of what some see as an underclass in Michigan society and thereby protect the social base which supports its democratic institutions.

Why does a polity like Michigan have so many budgetary constraints? There are some (see, e.g., Krauthammer 1988) who argue that societies are naturally drawn toward extremes in times of crisis. That may explain why the anthropologist Malinowsky found that in times of uncertainty, rules and ritual become more important. It may be that the volatile economy which Michigan inhabits has produced an environment in which many budgetary rules are a natural response. In other societies, the same uncertainties have produced other forms of authoritarianism, but in a liberal democratic

society like Michigan's, budgetary rules are one permissible manifestation.

It may also be that increased dependence on rules is a natural response to a political environment in which the leadership constitutionally charged with control of the budget is immobilized by lack of consensus on what to protect and fearful of exercising other options (e.g., raising taxes). There is some evidence of this at the federal level with the Gramm-Rudman-Hollings legislation.

The irony is that our attempts to control our environment may be more destabilizing than the uncertainty we seek to eliminate. Like the programmed trading which destabilized the stock market, numerous budgetary rules may have added more uncertainty than the environment they were designed to order.

B. *What does budgetary planning look like when planning for decline or dramatic change?* Another question that arises from this study concerns the real validity of the management plans for deciding cutbacks. The evidence in our sample was divided. Most respondents we talked to said the plans were not used. A few said they were. A bigger sample is needed to determine where and under what conditions these kinds of plans proved helpful and the threshold at which they were disregarded.

A further question relates to the reserve. In the mid-1970s Michigan lawmakers adopted a Budget Stabilization Fund. The experience of the fiscal crisis showed that it clearly was a good idea but inadequate. Controversy now

centers on how large the reserve should be. If Michigan's economy is such that it will continue to experience dramatic change, should the reserve be larger than normal? What is normal? How much would be larger? Respondents said that there were political limits to economic caution.

Do democratic institutions have to be more prudent than the people they serve? If not, then the reserve need be only about four percent of the GF/GP (or \$214 million at 1984 revenue estimates), which is approximately the current propensity to save in the United States. On the other hand, the low propensity of Americans to save is often cited as an economic danger to the economy. From an institutional viewpoint, the Federal Reserve system requires banks to reserve 16.25 percent of their total deposits.

Given 1984 GF/GP revenue estimates, a rainy day fund of the size required by the Federal Reserve would be about \$865 million. Do states with volatile economies like Michigan's need to adopt a banking model? Do such states need to think in terms of a kind of monetarist policy as well as fiscal policy?

Further, given the reinforcement that this study supplies to the centralization thesis, do we need to expand our theories about budgeting under crisis to take into account centralization's next of kin, the leadership issue? If legislatures tend to be ambivalent at best or incapacitated at worst when confronting fiscal crises, do we need to identify and demand new roles for those executives who are left with the task? Do we need new expectations

regarding those executives who must deal with such crises? There are some (see, e.g., Behn 1980a) who call for the ultra-rational leader, one who can specify an organization's goals, programs and resources, persuasively mobilize staff and constituency for change, and know at what point the resource decline will level off. Our study shows that such leadership in government is unlikely. Even Behn (1980b) in other articles has had second thoughts.

What seems more practical is a revision in our thinking about fiscal strategy, one which builds on existing knowledge and lays fewer claims on heroic statesmanship. In a recent study for the Organisation for Economic Cooperation and Development (OECD), Schick (1986) found that several countries have adapted to fiscal stress within existing budgeting frameworks by allowing fiscal demands rather than program needs to drive the budget. This is what Michigan did and we saw how destabilizing it was. What is different about the approaches described in the OECD study is the use of multiyear budgeting, especially for forecasting expenditure estimates. While forecasting is chancy business as we have just shown, forecasting expenditures may be somewhat more predictable than forecasting revenue.

States like Michigan are still left with the problem of forecasting demand on welfare services and unemployment compensation (the reverse side of revenue downturn). New insights, however, can be gained from this alternative emphasis on multi-year expenditures and their consequences for revenue needs. Policymakers and citizens alike can have

a better understanding of the coming consequences of budgetary decisions, even if the extremes such as we found in Michigan in 1980-82 are never likely to be fully predictable or controllable.

This strategic shift would also place more emphasis on another role of the budget, one mentioned earlier in this study. The budget could be used much more effectively in its communication role to say something about future directions of government based on projections of current policies. In doing so, we might shift our budgeting perspective a bit to the future. This could bolster some of the budget's more traditional uses for planning, management and control when cutback comes.

A legislature committed to the annual budget process could still use some of the features of expenditure projection analysis. The perspectives gained could enhance insight into current year decisions.

C. *What should budgetary management look like when dealing with decline or dramatic change?* Another finding in Schick's (1988:530) OECD study was that fiscal stress did not cause tightening of financial controls by central fiscal units. The dominant adjustment was toward managerial flexibility under the theory that resources would be more intelligently distributed by the manager in charge and the destructive consequences to morale which cutback brings would be mitigated.

Although the Michigan legislature was roundly criticized by financial houses for abdicating responsibility

to the state's budget director in the fall of 1980, it may be that the legislature was acting in the most intelligent way possible by granting the budget director the flexibility he needed to deal with a rapidly changing revenue environment. If so, this challenges some of our thinking about centralization in that the legislature devolved some power to the budget director. It also raises some questions about legislative responsibility in democratic separation-of-power regimes. Is such devolution to be encouraged?

D. *What is the role of information in a crisis?* A corollary to the budgeting questions above concerns the role of information in dealing with crisis. Given the enormous capacity of information technology to supply data, but given its cost, the unreliability of forecasts and the ambivalence exhibited by some decisionmakers toward receiving more information generally in the worst of the crisis, is there a role for better information in a crisis? What kind? At what point?

E. *What is the role of state government in a globalizing economy?* It can be argued that the fiscal crisis was not truly of Michigan's making--although the state's response in some respects made it worse. Some of the most significant pressures leading to the resolution of the crisis were also external to the state. Therefore, what role if any, remains to state government? If the state's economy is dominated by multinational corporations locked in international competition with other multinationals far

away, and the state's fiscal capacity is shaped by decisions in Washington and Wall Street, are its political structures adequate for dealing with these realities?

What can we reasonably expect of our state leaders in such a situation? As one writer recently noted,

"Of all the lessons (the former governor) learned in his years in office, the relationship between the economy and his political agenda was to become the most salient.... 'He learned in his later years the implications of the economy as a political issue,' said (his former budget director).... 'If anything led to his retirement, it was his frustration over that.'" (Broder 1982:26).

Budgeting lies at the heart of politics and governance. This study illustrates that part of contemporary budgeting theory still works in conditions of fiscal stress. Much of budgetary change still remains linear and significant at the margin. Fair shares still holds. But we must expand our theory to account for changes in the annual cycle, budgetary roles and the role of the budget itself in crisis.

APPENDIX A

Abbreviations

The following is a list of abbreviations used in some tables and figures in the text:

<u>Abbreviation</u>	<u>Full Name</u>
AVE	Average (of 25 categories)
AG	Department of Agriculture
ATT	Department of the Attorney General
CO	Capital Outlay
COM	Department of Commerce
COR	Department of Corrections
CR	Department of Civil Rights
CS	Department of Civil Service
DMB	Department of Management and Budget
DMH	Department of Mental Health
DNR	Department of Natural Resources
DPH	Department of Public Health
DS	Debt Service
DSS	Department of Social Services
ED	Department of Education
EXE	Executive (Governor's) Office
HED	Higher Education Fund (universities and colleges)
JUD	Judiciary
LAB	Department of Labor
LEG	Legislature
L&R	Department of Licensing and Regulation
MIL	Department of Military Affairs
POL	Department of State Police
REV	State Revenue Sharing with Local Units of Government
SCH	School Aid Fund
ST	Department of State
TRS	Department of Treasury

Appendix B

A Selected Chronology of Events Surrounding Michigan's Fiscal Crises: 1963-1984

1963-64--Michigan adopts a new constitution, the fourth in the history of the state.

1965-66--The executive branch is restructured effective January 1, 1966 in the Reorganization Act of 1965, Public Act 380.

1969-70--The House Fiscal Agency is established. (The Senate Fiscal existed prior to this.)

January, 22, 1969. William Milliken is sworn in as governor.

The United Auto Workers strike General Motors during 1970.

1970-71--Revenue depletion caused by the record-length autoworkers' strike strains the state budget. Lawmakers increase the state income tax rate from 2.6 to 3.9 percent (a 50 percent increase for both business and individuals), reduce property tax credits saving \$60 million, generate another \$22 million through accelerated tax collections, and borrow \$45 million from the Motor Vehicle Accident Claims Fund.

November 17, 1970. An executive order is issued mandating budget reductions in the amount of \$41 million. The order also mandates the Liquor Control Commission to defer payments to vendors by one month, saving state \$18 million.

January 1971. The House Fiscal Agency requests all departments to submit detailed descriptions of ongoing programs with intent of implementing a program/budgeting system. The governor's office asks forbearance as a similar plan is already being developed there (House Fiscal Agency 1976).

February 18, 1971. An executive order is issued requiring \$34.73 million in budget cuts.

June 2, 1971. An executive order mandates \$10 million in budget cuts.

1971-72--Property tax credits are restored to former levels (House Taxation Committee 1983).

August 1971. A law goes into effect increasing the state income tax from 2.6 to 3.9 percent to aid education and balance the budget (Davis 1982).

1972-73--A good recovery year. Buoyed by the expanding economy, the 1971 tax increase generates record revenues. GF/GP spending increases 13 percent. The executive office introduces a program budget evaluation system. The fiscal year ends with surplus of \$200 million (House Taxation Committee 1983). The governor proposes a tax cut (1).

1973-74--The \$200 surplus from the prior year is used to balance the budget. Michigan begins to feel the initial effects of tax cuts for individuals (circuit breaker, personal exemption) and business (intangibles, inventory credit) (House Taxation Committee 1983). The cuts are partially effective in 1973 and fully effective in 1974. The surplus permits significant expansion in the FY 74 budget and policymakers create an expenditure base larger than the revenue base that was being trimmed (1). The recession that is to last into early 1977 begins (The Detroit Free Press, January 25, 1977).

The Senate changes its appropriations procedures. The sheer complexity of the state budget plus the fiscal crisis forces the Senate Appropriations Committee to give its subcommittees more power and this tends to democratize the process. With that comes more staff, particularly more professionals (2).

The Department of Management and Budget is created by executive order by combining the Department of Administration and the Executive Office's Budget Bureau.

1974-75--Michigan's public revenues are now experiencing the full impact of the tax cuts plus a franchise fee cut, income tax exemptions for pensions, and a sales tax credit. In addition, Michigan also begins to feel the effects of the Arab oil embargo.

November 5, 1974. Voters remove the sales tax on food and prescription drugs. Lawmakers respond by replacing lost revenues with increased income taxes, raising the rate 50 percent from 3.9 to 4.6 percent.

December 4, 1974. The governor issues an executive order mandating \$66.93 million in budget cuts. The legislature does not approve.

December 16, 1974. The legislature approves a revised executive order. Total cut is \$78.20 million.

March 4, 1975. An executive order is issued mandating \$31.50 million in budget cuts.

June 30, 1975. Anticipating an end-of-year deficit, state budgeters change the method of accounting for sales, use and withholding taxes accruing an additional \$200 million (or one month's) revenues (The Detroit News, December 1, 1985),

finds an additional \$51 million of unobligated capital outlay money (House Taxation Committee 1983), and borrows from the Veteran's Trust Fund and the Uninsured Motorist Fund to make up the shortfall (Bryan and Howard 1979). The state begins what becomes popularly known as "Chinese bookkeeping." (1)

1975. Attempted introduction of a legislatively sponsored program evaluation zero-base budget system.

1975-76--The previous tax cuts continue. The economy is in a recession. Short-term borrowing adds \$68 million. Utility property tax collections are put on an accrual basis yielding \$60 million. An "extraordinary" lapse by the Department of Social Services (DSS) saves \$55.3 million. Teachers' pension fund contingency reserves are used, adding \$34.6 million (House Taxation Committee 1983).

The Michigan Economic Action Council is created. The Council recommends adoption of a budget stabilization fund.

The state signs a contract with the University of Michigan's Research Seminar in Quantitative Economics to develop the Michigan model for forecasting tax revenue and the Michigan economy (1). This model builds on work that had been originally funded with state research grants in the mid-1960s (Hanieski 1981).

August 1975. The need to cover a looming deficit among other things forces lawmakers to adopt the Single Business Tax. The tax adds a one-time cash flow boost of \$240 million (Bryan and Howard, 1979, say \$210 million) because the state "overlaps the final annual payments on the repealed corporate franchise tax, one of the taxes which was replaced, with the quarterly estimates of the SBT" (1).

October 29, 1975. The governor issues an executive order mandating \$149.50 million in budget cuts. The legislature does not approve.

December 9, 1975. The legislature approves an executive order mandating \$123.70 million in budget cuts.

January 1976. The governor presents the 1976-77 executive budget developed for the first time according to target budget concepts. In this approach, each department submits requests based on 95, 100, and 108 percent support of prior year appropriations, not including inflation. Programs are also ranked according to priority. (Budget Message of the Governor for Fiscal Year 1976-77:1)

May 14, 1976. Just six weeks before the end of the budget year, Michigan extends its fiscal year by three months (to September 30), adding \$207 million (the Oakland Press says it was \$267 million). In addition, \$50 million is borrowed

from the state veterans' trust fund.

These adjustments (including the accounting shifts and fund borrowings mentioned above) amount to \$758.6 million, or about one-fourth of the total annual budget. While the books are closed with a \$28 million surplus, there is a negative cash flow in GF/GP monies approaching \$400 million at times during the year (Bryan and Howard 1979). State officials congratulate themselves on "exceptionally good management" by the executive branch departments and the legislature, saying that the surplus was predicted and is a result of good management and lower than expected welfare caseloads (The State Journal, January 13, 1977).

1976-77--Prior tax cuts are retained. The fiscal year ends with a \$68.4 million surplus.

Fall 1976. The Michigan Efficiency Task Force, a nonprofit corporation set up at the governor's request and funded by scores of Michigan labor and business groups, reports findings on operations of state government. Among the observations: "In general, the Task Force was favorably impressed with the overall management of the affairs of the State of Michigan and with the quality and dedication of government personnel" (cited in Heckman 1983). But the report calls for various cost-cutting projects and a follow-up study by the same group three years later will show that only some of the recommendations are implemented, the remainder being resisted by various state colleges and state agencies including the legislature (Detroit News, May 3, 1979).

January 24, 1977. The governor presents the executive budget. He asks that the legislature not return to the old fiscal year because, "it would reverse the one-time gain made possible by extending the 1975-76 year and eliminate the program improvements I am proposing in this budget." The governor also asks that legislators heed cash flow problems and not commit all revenues to program demands. In addition, the governor asks that the GF/GP budget be considered in context with the school aid fund in order to have a more comprehensive view of state spending (Budget Message of the Governor for Fiscal Year 1977-78:1).

Spring 1977. Michigan lawmakers adopt a budget stabilization fund. As the FY 78 budget is being written, some lawmakers are so concerned that funds be restored to programs cut in 75-76, that they argue the full-formula funding of stabilization fund should not be allowed (1).

1977-78--The governor introduces the budget with glowing predictions for the economic future. The Director of the Department of Management and Budget (DMB) calls the new budget, "The Road to Recovery and Stability." For the first time in several years, the budget includes new programs such

as an urban youth job program and more money for higher education and social services (Detroit Free Press, January 25, 1977), but the prior tax cuts are continued. There is a shift to accrual accounting for Medicaid. Reforms in the Single Business Tax cost the state \$20 million but the Stabilization Fund collects \$108.7 million which, with interest and no payouts, nets the state almost \$115 million (House Taxation Committee 1983).

January 5, 1978. The governor predicts a good year; says good times should last through the third quarter of 1980. He is said to be considering a modest tax cut or rebate (The State Journal).

January 23, 1978. The governor presents his budget message, again asking the legislature not to allocate all available revenues to increasing program expenditures. He again asks the legislature to take a more comprehensive view of the state budget by combining the GF/GP and School Aid Fund recommendations (Budget Message of the Governor for the Fiscal Year 1978-79:1).

April 1978. Realizing that their revenue estimates were too high, lawmakers confront the possibility that \$200 million will have to be cut from their budget bills. A local newspaper reports, "Just as in every other year--early versions far exceed recommendations from Gov. William Milliken and the projected revenues for the fiscal year." (The State Journal, April 24, 1978).

The state borrows \$200 million in general obligation notes to bolster cash flow (The Detroit News, December 1, 1985).

September 29, 1978. Despite party opposition the governor signs a revenue measure increasing license-plate fees by thirty percent and adding a two cents-per-gallon fuel tax (Davis 1982).

November 1978. The governor orders cuts in hiring, equipment purchases, out-of-state travel, and tells department heads to prepare for a four percent cut. The Detroit News (November 23, 1978) quotes the governor as saying, "I must act now to anticipate an economic downturn in order to meet the constitutional obligations of a balanced budget." The budget director says there is a 50-50 chance of a recession, but if it comes it will not be so severe as the one in 1975.

1978-79--A quiet fiscal year. There is no consensus to change prior tax cuts and they continue.

November 7, 1978. The constitutional Tax Limitation (Headlee) Amendment, a question placed on the ballot by voter initiative, is passed.

January 29, 1979. The governor presents his 1979-80 budget. He refers to difficulties in formulation because of economic uncertainties and expresses pleasure that no general tax increase is needed (Budget Message of the Governor for Fiscal Year 1979-80).

April 1979. Ballooning costs in Medicaid, the program paying medical and prescription costs for about nine percent of the state's population, force an emergency meeting of lawmakers to confront a possible shortfall of \$20-\$30 million in state revenues (The State Journal, April 22, 1979).

Spring 1979. Budgeters borrow \$25 million from the Liquor Control Commission revolving fund.

May 1979. The governor recommends cuts of \$100 million in his own proposed budget for the 1979-80 fiscal year. The largest proposed cut would come from the home-heating assistance plan which helps the poor pay fuel costs. Legislators are beginning to criticize the governor for not submitting a realistic budget in the first place (Detroit News, May 22, 1979).

June 1979. About 8.5 percent, or 781,386, of the state's population is now receiving welfare benefits (Hollister 1982a).

July 15, 1979. The state budget director, in commenting on the 1979-80 budget passed by the legislature, is pleased with the outcome. "Absolutely, it's the best we've ever done," (Detroit Free Press, July 15, 1979).

Social Services are cut \$80 million to balance the budget (The State Journal, July 18, 1979).

July 27, 1979. The House Minority Leader accuses the Speaker of secretly raiding the Budget Stabilization Fund in order to balance the budget (The State Journal).

Another \$104.1 million is put in the Stabilization Fund which now shows a balance of \$241.1 million. The state borrows \$450 million in short-term loans (House Taxation Committee 1983).

1979-80--Previous tax cuts continue and the Tax Limitation (Headlee) Amendment also takes effect (3); borrowing from the Kammer Trust Fund yields \$26 million, from Budget Stabilization Fund another \$263.6 million (4); the Single Business Tax is now put on an accrual system yielding another \$159 million and insurance premium accruals produce another \$31 million (5) and short term borrowing brings in another \$500 million (House Taxation Committee 1983).

November 11, 1979. In order to close an anticipated \$300

million gap in the budget, the governor asks department heads to identify 20 percent cuts in their budgets for the 1980-81 budget, with the understanding that not all cuts would be used. The budget director says, "The plan will not necessarily mean equal pain for everyone." Department heads are warned not to play games. Response from directors is grim (The State Journal).

January 21, 1980. The governor presents his 1980-81 budget. Again he refers to difficulties of formulation but expresses pleasure that the budget can provide for health, safety, and welfare of Michigan's citizens, saying "I am particularly pleased that, for the ninth straight year, my budget recommendations include no general tax increase," (Budget Message of the Governor for the Fiscal Year 1981).

January 22, 1980. Detroit News headlines say hundreds face layoffs in state's tight budget.

January 23, 1980. The Detroit Free Press announces that "the real sacrifices proposed by the Milliken administration in its 1981 state budget will be made by the poor, the unemployed, the outlaws and the outcasts." Of the \$171 million in proposed cuts, \$127 million will come from social services programs.

January 23, 1980. The State Journal reports disagreements in revenue projections between the state's budget office and the University of Michigan model makers.

May 4, 1980. The welfare caseload is now up to 218,000 and Michigan's budget problems are compounded by news that Congress will cut \$125 million or more, mostly in revenue sharing, to help balance the federal budget. Newspapers say Michigan "feels ignored by rest of the nation" (The State Journal).

Capitol observers point out that adoption of the tax limitation (Headlee) amendment, which requires 41 percent of state revenues to be shared with local governments, is forcing policymakers to take funds out of education programs in order to keep up with social services demands (The State Journal, May 4, 1980).

May 16, 1980. State budgeters reveal that the drop in income tax withholding collections is almost twice as bad as the June 1975 dip, previously the worst month on record. The state budget director says the decline comes as a surprise and that budget cuts will be large. "There will be no sacred cows" (Detroit Free Press).

May 21, 1980. The governor says, "Things continue to look very bad." Newspapers say education programs will bear half of the next round of budget cuts (The State Journal).

May 28, 1980. An executive order is issued mandating \$97.50 million in budget cuts.

June 5, 1980. The Detroit Free Press reports state revenues are plunging. The budget director says the dearth of funds will force the state to spend less in 1981 than in 1980, forcing program cuts of \$600 million in real dollars. The Michigan Senate adopts new budgeting procedures which require targets to be set before appropriations are approved. The House declines to introduce the same innovation.

June 10, 1980. The Detroit Free Press reports Standard and Poor's Corporation drops Michigan's bond rating from AA to A plus. Some estimate the drop will increase interest costs up to one-half percent.

June 10, 1980. Officials at the Michigan Unemployment Security Commission (MESC) say the state may have to borrow over \$1 billion to cover jobless benefits (The State Journal).

July 9, 1980. Michigan's "red ink worsens" and budget officials say "there's nothing left to cut." Fiscal authorities are said to be studying bookkeeping tricks to eliminate the red ink (The Detroit News).

July 24, 1980. Michigan's deficit catapults to \$120 million. Over 13 percent are on welfare. Faced with a deficit or more cuts, officials say they will opt for accounting manipulation, even if it raises interest rates (The Detroit News).

July 30, 1980. The governor asks state workers to take days off with no pay (Davis 1982).

September 30, 1980. Unable to formulate and adopt a budget for the coming fiscal year, lawmakers pass an interim measure, Public Act 268, equal to one-fourth of the going rate for the previous fiscal year. The state budget director is given extraordinary allotment powers with special 5-member committees of the House and Senate acting in an advisory capacity.

1980-81--Previous tax cuts are continued. By the time the budget winds through the legislative approval process in mid-summer, it is \$473.3 leaner than what the governor proposes in January. Further executive orders and mandated lapses carve out another \$148.7 million. The Kammer Fund is tapped for another \$46.2 million and capital outlay for another \$46.7 million (6). Also, \$20.1 million is taken from the Railroad Delinquent Tax Fund and \$16.9 million from the Budget Stabilization Fund. These raids yield \$129.9 million. Medicaid expenditures are shifted back to a cash basis, adding \$87.4 million more. Short-term borrowing

provides \$500 million more (House Taxation Committee 1983).

The Citizens Research Council (1982) estimates that the obligations payable at the end of the fiscal year exceed cash by \$750 million.

October 16, 1980. The Detroit News says Michigan's financial woes worsen just when the economy was supposed to be improving. Lawmakers abandon plans to pass a full-year budget and begin to operate on a 90-day continuation budget instead. This causes the state's bond rating to fall from AA to A.

October 25, 1980. Faced with a cash crunch, Michigan delays payments to most of its contractors. Banks cut off the state's short-term credit. The Chief Deputy Treasurer says no one will lend money to the state because there is no annual budget available to show how the funds would be repaid.

November 4, 1980. Voters defeat a radical property tax-cut (Tisch) proposal which some claim would cost the state \$2 billion.

December 1980. Another \$26 million is borrowed from the recreational land acquisition (Kammer) trust fund.

January 26, 1981. The governor presents his executive budget for 1981-82, saying it is "one of the most arduous and painful experiences we have ever shared." He notes that formulation of this budget proceeded from a new approach based on minimum operating levels defined as "the level of support below which no constructive contribution toward a program's goals and objectives could be made." The budget includes a proposal for reductions in property taxes (Budget Message of the Governor for Fiscal Year 1982).

In retrospect, a member of the House Appropriations Committee calls the budget message "optimistic, upbeat" and sees the budget as a "modest restoration" budget. He faults the governor for endorsing the President's supply-side economics (Hollister 1981b).

1981. Michigan adopts Public Act 18, a statute which regularizes appropriation, allocation and expenditure procedures and provides for overall legislative oversight of the budgetary process.

January 27, 1981. Budget analysts report that a budget shortfall is likely but that most of it will be covered by bond interest, good management, and "adjustments in the methods of reporting expenditures and projected appropriations." Yet, \$21 million more in cuts are likely (The State Journal).

February 1981. A member of the House Appropriations Committee charges that the governor's budget is "built on sand. The assumptions are faulty and already in question" (Hollister 1981).

February 1981. Michigan borrows \$500 million to cover its obligations for the remainder of the fiscal year (The Oakland Press, December 20, 1981).

April 1981. The legislature adopts the 1981-82 budget three months earlier than usual. A key member of the House Appropriations Committee says the legislature, stung by criticism for delayed passage of the previous budget, passed the budget too quickly so that local units of government and educational institutions could plan for the coming year. (Hollister 1981b)

April 2, 1981. The American Society For Public Administration announces a series of workshops on managing fiscal stress.

June 7, 1981. Newspapers announce that Michigan's economy brightens. Employment gains and unemployment declines to 11.5 percent (The Detroit News).

June 1981. Michigan changes its accounting method for Medicaid back to the cash method, thereby voiding \$71 million in accrued obligations for that fiscal year (The Oakland Press, December 20, 1981).

June 24, 1981. State agencies are ordered to return \$40 million in previously appropriated funds to keep the budget balanced. An \$80 million shortfall is predicted, three-fourths from welfare costs generated by the previous year's high unemployment (Detroit Free Press).

July 28, 1981. The Citizens Research Council blasts Michigan's cash-flow management procedures. Their report states the cash-flow problem is a growing, accumulating financial deficit that must be refinanced each year. The deputy budget director agrees it is a "legitimate, significant problem" but that "corrective action is " 'a difficult concept to sell' to the Legislature when times are tough" (The Detroit News).

September 1981. State budget officers go to Wall Street to request an additional \$500 million in short-term notes for the third year in a row. Saloman Brothers, Inc., the main underwriter, demands huge budget cuts in return. The state budget director also promises Moody's Investors' Service to correct the state's accounting practices. Promises are also made to reduce the cash-flow deficit by at least \$100 million, or about one-fifth of the cash deficit (The Oakland Press, December 20, 1981).

September 2, 1981. The governor convenes talks with key lawmakers, anticipating an end-of-fiscal-year deficit of \$135 million. Education and local government revenue sharing are expected to be prime target areas. The Governor is expected to propose a new property tax cut plan for homeowners, farmers, business and industry (The Lansing State Journal).

September 16, 1981. The governor issues an executive order cutting \$125.90 million from the budget. The Legislature rejects it.

September 29, 1981. The Senate seeks to avoid deep cuts in education by attempting to use a \$21 million railroad subsidy fund. Efforts fail when lawmakers learn that some of the fund is already committed elsewhere (Lansing State Journal, September 30, 1981).

September 30, 1981. The Legislature faces a marathon session to fund the end-of-year deficit. Legislators want to protect education programs from further cuts, but argue that if cuts have to be made, they "...should make the cuts even across the board" (The State News).

The Legislature approves a revised executive order cutting \$101.80 million from the state budget.

Analysts learn that the proposed property tax cut plan will make school districts absorb 35 percent of the slashes without assistance from state funds (The Lansing State Journal, September 30, 1981).

1981-82--The budget year begins with \$167 surplus tagged for property tax relief if Proposal A is approved by voters, but this surplus evaporates as the economy worsens and previously approved tax cuts remain. The legislature adopts a budget \$187.2 million less than what the governor recommends. A shortfall of \$669 million has to be made up. Actions to balance include: accrual of oil and gas tax collections and beer and wine tax collections totalling \$9.3 million. The legislature adopts a six-month tax increase to the end of September 1982 yielding \$286 million. Twenty-five percent of this is pledged by the governor to correct book keeping manipulation. Capital outlay is cut \$13.4 million; mandated lapses capture another \$31.8 million. Four executive orders totalling \$778 million are issued. A cigarette tax increase of 10 cents per pack adds \$54 million but that is set aside for accounting corrections (actually to accrue the property tax credit liability over 7-8 years) in a Working Capital Reserve Account also created this year. There is more short-term borrowing in the amount of \$500 million, the maximum allowed by lending institutions (even through the constitution allows more), but it costs the state \$94 million to do so. The fiscal year ends with a year end balance of \$13 million (House Taxation Committee 1983).

Other actions to reduce the imbalance involve changing accounting procedures for utility bills of welfare recipients to cash basis which temporarily erases \$19 million in liabilities. In addition, \$80 million in fourth-quarter payments to universities are withheld with understanding that this would be paid the following year (Citizens Research Council 1982).

A further \$88 million in GF/GP funds is "saved" by substituting federal funds and user fees in programs administered by the Departments of Social Services and Mental Health (Citizens Research Council 1982).

Michigan experiences a mild economic recovery in the first half of 1981 (Wall Street Journal, August 6, 1982).

Fall 1981. The governor offers a package of bills aimed at stimulating economic recovery. Elements focus on regulatory relief to business, increasing capital availability, bettering the tax structure for business, and improving state business assistance programs.

October 1, 1981. The federal Omnibus Reconciliation Act takes effect forcing Michigan to reduce its state budget by \$50 million. The impact of social services reductions is such that 35,000 people have ADC grants cut or ended; 25,000 suffer cuts or cessation of food stamps; 18,000 lose CETA jobs; 50,000 lose unemployment and trade readjustment act benefits (Hollister 1982a).

October 12, 1981. The Brazer Report, the first comprehensive study of Michigan's finances in twenty-five years, is released. The report finds that Michigan is not a high tax burden state, that business taxes dropped from 42 percent of revenue in 1957 to 29 percent in 1982 and concludes that there is no justification nor demand for major changes in the state's tax structure. Diversification is the key to a more stable economy (Brazer and Laren 1981 and Hollister 1983a).

October 15, 1981. The governor withdraws his proposal for property tax cuts (The Detroit News, October 16, 1981).

October 16, 1981. Only two weeks into the fiscal year, Michigan finds its budget already \$270 in arrears. The cause is pressure by New York City bonding houses which disapproved of the means by which Michigan closed its books on the 1980-81 fiscal year by accounting for Medicaid payments on a cash basis.

The Speaker of the House, a Democrat, refuses to blame the Republican administration for the new crisis. He says, "We were all a part of it" (The Detroit News).

October 21, 1981. The Michigan Capitol Area Chapter of the American Society For Public Administration inaugurates a meeting series on impacts of state and federal budget cuts.

October 21, 1981. Public Sector Consultants, a Lansing-area firm, claims that the coming 1981-82 budget is \$650 million out of balance, more than twice official estimates. The deficit is attributed to federal budget cuts, declining auto sales (the lowest in 23 years), high interest rates, and a growing welfare caseload caused by the continuing recession. Calling the coming year the "toughest year of the century," the firm's director says, "We're not calling people names with this.... Michigan is just in a situation where it has no control of what is happening to it" (The Detroit News) (7).

October 22, 1981. Just weeks into the new fiscal year, legislators approve the governor's executive order proposing a \$270 million budget cut. The Speaker of the House says, "It'll be tough, hard, difficult, but we all agree that we have to do it. I don't see how the amount (of the order) is negotiable, and there's no way to make major changes in it" (The Detroit Free Press).

November 30, 1981. The state's cash flow is estimated to be \$200 million in deficit. November returns on October income tax withholding collections are \$30 million below estimates. The state budget director issues a memo to all department heads asking for a voluntary spending reduction of four percent (The Oakland Press, December 20, 1981).

December 9, 1981. The state budget director, appearing before the Senate Appropriations Committee, says Michigan cannot change its Medicaid accounting methods and return to accrual because there are no funds to do so.

December 15-17, 1981. The Legislature passes a \$155 million tax-cut bill. Lawmakers agree to borrow another \$46 million from the Kammer trust fund to help balance the 1980-81 books (The Oakland Press, December 20, 1981).

December 20, 1981. Michigan's credit rating drops to lowest in the nation, only exceeded by Puerto Rico. Newspapers say the state's lifeline to loans is about to be severed (Oakland Press).

December 22, 1981. The governor announces he will not seek re-election (Davis 1982).

January 11, 1982. Newspapers announce that Michigan is "\$600 million in the hole." Fiscal experts say it is a "hidden deficit" caused by accounting changes and a state law which permitted one fiscal year to be stretched to 15 months. In addition to the hidden deficit, experts say Michigan owes \$500 million plus \$70 million in interest in

short-term notes to New York banks. The state also owes \$502 million plus \$30 million in interest to various restricted funds. The budget director says, "We have a balanced budget. We have always had a balanced budget. We do have a cash deficit. The reason we have the deficit is accrual accounting," (The Detroit News).

January 24, 1982. The governor continues to oppose any general tax increases. He is expected to propose a 10 percent increase in GF/GP spending, primarily to make up cuts in education, but also for revenue sharing and economic development projects. The increase is based on forecasts for gradually improving economic conditions, (The Detroit News).

January 25, 1982. The governor presents his executive budget for fiscal year 1982-83. He is optimistic that an economic recovery will develop "midway through the fiscal year," and that the "recovery will allow us to restore our support for some critical areas in which we have had to make substantial cuts over the last two years." He asserts that, through difficult decision making, "we have balanced our budget each year as required by the State Constitution," (Budget Message of the Governor for Fiscal Year 1983).

February 25, 1982. President Reagan admits that Michigan is in a "first-class depression." The national unemployment rate stands at 8.5 percent; Michigan's at 14.9 percent, (Detroit Free Press).

February 27, 1982. Michigan delays \$225 million in payments to schools, colleges, universities and local governments because of cash flow problems. The state budget director, state treasurer, and several legislators meet with Wall Street lenders to reassure them that Michigan will meet its loan repayment schedules, (The Detroit Free Press).

March 3, 1982. The state budget director says about Wall Street lenders: "They have immense power over this state. If they drop my rating and I can't borrow, then we can't pay our bills in October, we have payless paydays, we have chaos," (The Detroit News).

March 4, 1982. "State's woes deepening." February tax collections are \$38 million below revised estimates. The state budget director says, "there is no escaping the fact that the short-run outlook is not good and that the effect of national factors on the state economy and on state government will be substantially more severe than we had anticipated," (The State Journal).

The state budget director is said to be backing away from the governor's no-tax-increase policy. He says, "We're

looking at everything and not ruling anything out," (Detroit News).

March 7, 1982. The governor proposes a "rescue plan": a budget cut of \$451 million, the largest in Michigan's history. The legislature rejects it. The governor also asks employee concessions of \$20 million, a 10-cent cigarette tax to be earmarked for a cash-flow fund, and a one percent increase in the personal income tax for six months (Hollister 1982a and 1983a).

March 29, 1982. Unemployment in Michigan now stands at 16.1 percent. Attempts by Michigan and other recession-bound states to balance budgets will curb spending by both taxpayers and governments, slowing the national economic recovery and President Reagan's drive to shift new fiscal responsibilities on the states (Business Week).

April 1982. Welfare recipients now total 1.09 million, or nearly 12 percent of the population. Michigan is among the top five states in sending tax dollars to Washington and last in receiving them. Legislators regard the governor's proposals as "politically distasteful" because they call for budget cuts and a tax increase in an election year. Even so, some believe the governor has understated the problem (Hollister 1982a).

April 7, 1982. The legislature approves a revised executive order. Budget cuts now total \$308 million.

April 28, 1982. The Michigan Senate rejects the governor's plan which the House has approved to raise income taxes from 4.6 to 5.6 percent until September 30. A Senator is quoted as saying, "You know, these people are looking for any excuse to vote the thing down, what with reapportionment and this being an election year. And if they can't think up an excuse on their own, darn it, it looks like the governor is giving it to them," (Detroit Free Press, May 9, 1982).

May 1982. The legislature approves a hike in the cigarette tax and earmarks the increase for rebuilding cash reserve accounts (Wall Street Journal, August 6, 1982).

May 5, 1982. The state budget director says the governor absolutely will not issue another budget-cutting executive order until the Senate votes again on his proposed tax increase (Detroit Free Press, May 9, 1982).

May 7, 1982. Moody's Investors Service, Inc., a principal Wall Street financial analysis group, says it will lower Michigan's credit rating (Detroit Free Press, May 9, 1982).

May 9, 1982. The state budget director's projections are no longer trusted; the governor's effectiveness to manage the fiscal crisis is in doubt. Critics say the budget director

and the governor's office are issuing inconsistent statements. Many believe the governor is crying wolf. The director of the Board of Michigan Businessmen calls the governor's threat to cut school aid, "another political ploy." The Senate Majority Leader says, "In spite of everything we've said and everything we've done, there's still a vast body of people out there who don't believe this state is in a crisis.... It obviously doesn't help matters that this body (the Senate) doesn't believe the governor," (Detroit Free Press).

May 17, 1982. In an all-night session, the legislature finally approves a temporary six-month tax increase (Public Act 155).

May 20, 1982. The legislature approves \$50 million in budget cuts. Rumors persist that the governor reduced the original request to \$50 million in order to gain Senate votes on a tax increase. The governor endorses a ballot proposal permitting voters to decide to cut school property taxes in exchange for an increase in the state sales tax (Detroit Free Press, May 21, 1982).

May 27, 1982. Local government leaders charge that schools, local governments, and state colleges and universities have taken the brunt of state budget cuts, that the state has violated the terms of the Headlee Amendment. They say that state government has made no major layoffs, major reorganizations nor significant reordering of spending priorities. A budget office spokesperson says layoffs of more than 100 persons have occurred in only eight departments: Commerce, Education, Labor, Mental Health, Natural Resources, State, Social Services and the State Police (Lansing State Journal).

June 3, 1982. Key lawmakers and budget officers meet with Moody Investment rating officials in New York City. They are told that credit worthiness is determined by evaluations of four criteria: debt level, financial operations, administrative/governmental effectiveness, and the general economy. They are told that Michigan is regarded as a "low debt state...below the average in relationship to other states." They are also told that Michigan's financial operations are too dependent on the performance of the auto industry but that the state government is well regarded for acting responsibly to the fiscal crisis. In short, Michigan is given credit for controlling what it can control (Hollister memo to Speaker Bobby Crim, June 7, 1982).

July 19, 1982. A prominent Michigan economist says the gloom in the economy may break by the end of the year. Lower wage contracts negotiated in the auto industry are seen as making the area more competitive and technological innovations in other industries are key (Lansing State Journal).

August 6, 1982. In a wide-ranging analysis of Michigan's fiscal crisis, the Wall Street Journal faults adoption of the Economic Stabilization Fund as postponing the need for budget discipline, making eventual adjustments more painful.

August 10, 1982. The State Civil Service Commission reverses its April 1982 decision to approve a five-percent pay increase for 17,000 state workers and decides to delay the increase until the beginning of the new fiscal year. Three public employee unions file suit that the commission has violated constitutionally set procedures for setting civil service wages.

August 11, 1982. The state budget director announces he will leave state government at the end of the year.

August 19, 1982. The state budget director says Michigan's economy will not improve for at least two more years. "Our economy has collapsed," he says. "The '83 budget is painful, even worse than the '82 budget. And the worst is still not here."

The governor says he will ask for another \$150 million cut before the end of the fiscal year. Auto sales are now the worst in 24 years, interest rates remain high and state tax collections remain low. Cuts are predicted to hit local governments, schools, and colleges and universities because state departments are at the end of their fiscal year and have spent all their money (Detroit Free Press).

September 1982. A consortia of five Japanese banks agree to back the state in borrowing \$500 million (Washington Post, September 7, 1982). State officials turn to Japan after U. S. banks refuse to lend Michigan any more money. Japanese banks charge a \$60 million credit fee (The Detroit News, December 1, 1985).

September 1, 1982. The Citizens Research Council of Michigan issues a highly critical report on state budget practices, 1975-1982. The analysis says deficit spending practices began during the 1975-76 recession and now hide an estimated \$1 billion debt.

September 1, 1982. The legislature rejects a proposed executive order mandating \$150 million in budget cuts.

September 2, 1982. Facing further demands on the state for welfare assistance, the legislature approves transfer of \$70 million from the Medicaid fund to General Assistance and Aid to Dependent Children by emptying the Medicaid fund; it subsequently passes supplemental appropriation of \$70 million to cover Medicaid payments (Hollister 1982b).

September 15, 1982. A revised executive order still

totalling \$150 million in budget cuts from higher education, school aid and revenue sharing is approved by the legislature. School districts extract a promise from legislators to restore their cuts by June 30 the following year, thus sparing them no actual loss within their fiscal year which runs from July 1 to June 30 (Hollister 1982c).

September 22-29, 1982. The legislature passes a 1982-83 budget, ten weeks later than usual. The GF/GP target approved is \$4.6 billion, the same as the 1980 budget and, in "real" dollars, 20 percent less than the 1980 budget. The state budget director says, "This is the tightest, most constrained budget ever." A "major war" developing between education and social services for what remains of the budget is quelled when ADC grants are cut to levels below the surrounding state average (Hollister 1982b, 1983a and The Lansing State Journal, September 29, 1982).

1982-83. Borrowing of another \$500 million in short-term monies is made possible by action of a consortia of five Japanese banks which produce a letter of credit (House Taxation Committee 1983). The legislature adopts a budget almost \$500 million under the governor's recommendation. Another \$225 million cut is proposed by the governor's executive order, and another .25 percent increase in the cigarette tax (yielding \$112 million) to further supplement the Capital Reserve Account for accounting corrections (House Taxation Committee 1983).

The legislature also approves an additional 1.5 percent increase in the income tax (which is expected to bring in another \$675 million) for six months only. According to one analyst, "In retrospect, in terms of how the politics played out with (the governor) in 1983, it is clear that letting the tax come off in September 1982 probably was a very bad thing to do." This increase raised the personal income tax rate from 4.6 to 6.35 percent (1).

October 13, 1982. The Senate Fiscal Agency Director tells the Senate leadership that the 1982-83 budget is already \$170 in deficit even though the budget officers claim the budget is still in balance.

October 22, 1982. A Lansing State Journal headline says "State Budget Ink Already Red." The deputy budget director says improvements in the economy are near."

November 2, 1982. A new governor is elected. Democrats will now control the executive and the legislature.

December 15, 1982. The Senate Appropriations Committee approves continued use of a cash accounting system for Medicaid payments. The state budget director says, "We don't have any other choice," but recommends the incoming administration change to accrual as soon as possible

(Lansing State Journal).

December 2, 1982. Senate Fiscal Agency analysts say Michigan's deficit is twice what was predicted. The state is more than \$300 million in debt. The national economic recovery has had no impact on Michigan's tax revenues nor welfare caseloads (Detroit Free Press).

December 22, 1982. The outgoing state budget director says Michigan's economy is "in a free-fall; we're going to need a permanent tax increase...the governor-elect has no option but to increase taxes." Unemployment rates now stand at 17.2 percent (Lansing State Journal).

December 28, 1982. In testimony to the in-coming governor's Michigan Financial Crisis Council, the Senate Fiscal Agency Director says that each one percent increase in the state unemployment rate translates to over \$100 million in added GF/GP deficit. He says that the current cumulative deficit approaches \$2 billion.

January 8, 1983. The Michigan Financial Crisis Council issues its report calling for urgent action. The Council says that the cash flow deficit is \$750 million, that the state may be unable to pay its bills by February. Democratic leaders in the legislature say a tax increase is the only solution; Republicans say a case is yet to be made.

January 1983. Michigan now owes the federal government \$2.2 billion in loans for unemployment benefits. The state makes new efforts to stimulate economic development through assistance programs, tax policies, and a more aggressive presence in Washington (State Legislatures).

January 10, 1983. The new governor sets an immediate hiring freeze, defers aid payments to schools, colleges and universities, and revenue sharing with local governments.

January 28, 1983. The governor calls for more program cuts and a 1.75 percent increase in the state income tax, moving the tax from 4.6 to 6.35 percent, the highest flat rate of any state in the nation, the District of Columbia excepted. But national experts say the overall tax picture is still moderate (Detroit Free Press).

February 1983. Legislators point out that Michigan continues to be a net donor of funds to the federal government. Tax contributions exceed assistance by \$7 billion, more than the state's General Fund budget. Estimates are that the President's New Federalism has cost Michigan \$3.2 billion in federal support. Welfare rolls now include 15 percent of the population; 20,000 workers per month exhaust unemployment insurance (Hollister 1983a).

March 1983. Public Sector Consultants say the new governor

will be forced to continue cash-flow gimmicks and delayed aid payments to educational institutions and local governments because revenue generated by the income-tax increase will not flow into the Treasury until the last half of the fiscal year (The Lansing State Journal).

March 29, 1983. The legislature, with help of only one Republican lawmaker, passes a temporary personal income tax increase which is tied to the unemployment rate, and a special .25 percent increase in the cigarette tax to fund corrections caused by accounting deviations (Public Act 15 of 1983). The package is expected to raise \$3.2 billion in revenue over three years.

March 30, 1983. An executive order is issued totalling \$225 million in budget cuts. Major targets are social services, education, and construction.

Spring 1983. Of the nation's five most expensive state-supported universities, three are now in Michigan: the University of Michigan, Michigan State University, and Wayne State University (Hollister 1983b). Proposals emerge to limit the legislature to a part-time body, make the legislature one house, reduce legislative pay, lower taxes, and make any legislatively sponsored tax increase virtually impossible (Hollister 1983b).

April 21, 1983. The new governor delivers his executive budget for 1983-84, three months later than normal. Analysts note that the budget reflects the most pessimistic forecasts for revenue flows and expenditure demands. He says, "We have begun the long and arduous process of restoring Michigan's fiscal balance. We have taken the first of the many steps that will be necessary to ensure financial solvency" (Budget Message of the Governor for Fiscal Year 1984 and Hollister 1983b).

May 1983. Standard and Poors analysts tell Michigan leaders that the state has been removed from the S and P "credit watch" list (Hollister memo to Democratic Caucus Members, May 5, 1983).

June 15, 1983. The Citizens Research Council of Michigan issues a report on the state fiscal plan saying that 1980-83 problems stem from 1977-79 policy failures when the state failed to repair damage from the 1975-76 recession. Instead, all funds were committed to current or future spending.

1983-84-- Michigan rewrites its accounting and budgeting acts and puts them in a consolidated package, Public Act 431 of 1984. Although most see this as a consolidation, reforms are included. For example, by this act departments have to report encumbrances and receivables at least monthly and these have to be recorded on the central accounting system and reported against the pertinent appropriation account.

All revenues also have to be reported against each source of financing. It is anticipated that this system will take two years to implement, but when in place will give the appropriations committees much clearer ability to monitor the flow of dollars (Kennedy & Harris 1985:12).

The governor signs PA 236 of 1983 which requires the state to pay interest when state aid payments are delayed (Bowman 1984). The new law is intended as a disincentive for the state to use a delay in state aid payments as an alternative short-term credit mechanism.

January 1, 1984. The income tax drops to 6.1 percent as scheduled by law.

February 1984. Republicans take control of the Senate in replacing two recalled Democratic Senators who supported the tax increase. Twelve Representatives also faced recall petitions.

July 10, 1984. The author of the tax-cut initiative passed in 1978 charges that the state is welshing on its requirement to share 41 percent of its income with local governments by redefining state mental health programs as local. The redefinition "cheats" school districts and local governments out of \$300-\$400 million annually (The Detroit News).

September 1984. The income tax drops to 5.35 percent. State borrowing drops by \$50 million from \$500 million and Michigan's credit rating improves (December 1, 1985).

March 29, 1985. Public Act 431 of 1984, the Management and Budget Act, goes into effect.

September 1985. Michigan gains the highest short-term credit rating in the nation, borrowing only \$350 million to offset cash-flow problems. The state no longer needs outside credit backing and can borrow on its own security. The long-term credit rating for the state, however, remains lowest among the states (The Detroit News, December 1, 1985).

November 6, 1985. One of the leading investment banking firms raises Michigan's general obligation (long-term) debt rating from mid-BAA to mid-A stable, putting Michigan in the "low risk" investment category for the first time in several years," (The Lansing State Journal, November 7, 1985).

November 8, 1985. The governor declares "solvency day" having retired a \$1.7 billion debt. The unemployment rate remains at 10.3 percent (The Detroit News, December 1, 1985).

November 9, 1986. General Motors announces new layoffs of 18,750 workers. Experts say it will cost the state \$1.5 billion in revenues (The Lansing State Journal).

Notes to Appendix B

1. Interview with Douglas Drake, Director of the Office of Revenue and Taxation, Department of Management and Budget, and former Democratic Staff Director to the House Taxation Committee, September 25, 1986.
2. Interview with Leo Kennedy, Supervisor, Research Division, Legislative Service Bureau, October 4, 1984.
3. Heckman (1981b) puts this at \$60.8 million saved in mandated lapses and \$79 million in executive order reductions).
4. Heckman (1981b) puts this figure at \$204.6 million.
5. Heckman (1981b) says accounting adjustments in changing from cash to accrual saved \$165.4 million.
6. Heckman (1981b) says that by not setting aside funds for the capital outlay reserve, \$27 million was saved.
7. This private firm founded in 1980 specializes in policy analysis and gained a fair amount of celebrity during the fiscal crisis with its economic forecasts. Its "Fiscal Awareness Service" offers independent but informed and detailed running commentary on Michigan's revenues and expenditures, among other things.

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