Legislative Analysis

REVISE BUDGET STABILIZATION FUND PROVISIONS

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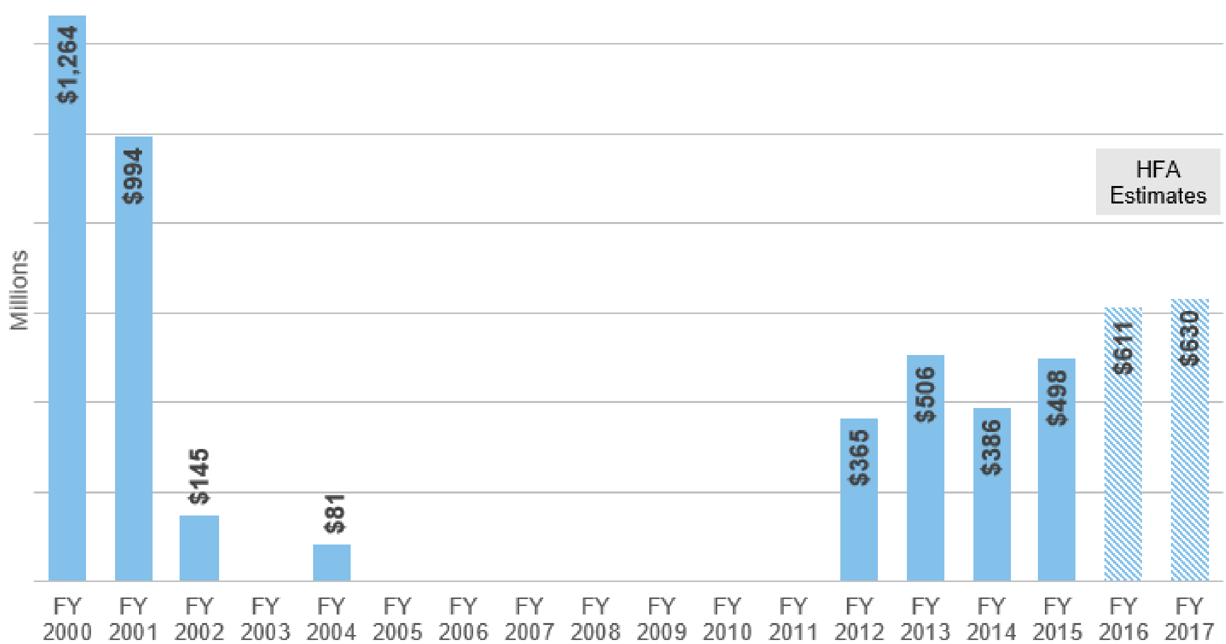
House Bill 5847 (H-1) as reported from committee
Sponsor: Rep. Pscholka
Committee: Appropriations

Complete to 9-21-16

BACKGROUND INFORMATION:

Michigan's Counter-Cyclical Budget Economic Stabilization Fund, commonly referred to as the Budget Stabilization Fund (BSF) or Rainy Day Fund, was created in 1977 to help alleviate the need for major budget-balancing actions during economic downturns. Statutory provisions governing the fund provide for calculated fund pay-ins or pay-outs each year based on annual personal income growth (adjusted for inflation and transfer payments), although actual transfers into and out of the fund have been implemented through specific legislative actions: deposits via appropriations bill, withdrawals via statutory amendment.[1]

Budget Stabilization Fund Year-End Balance



[1] For additional background information on the BSF, see this 2013 HFA report: http://www.house.michigan.gov/hfa/PDF/Alpha/Budget_Stablilzation_Fund_FiscalForum_Feb2013.pdf.

As shown in the chart above and the Appendix to this analysis, the BSF's peak balance was $1.3 billion in FY 1999-2000. That balance was quickly depleted following the 2001 recession. More recently, an estimated fund balance of $630 million has been re-established for FY 2016-17, equal to about 2.8% of combined General Fund and School Aid Fund revenue.[2] National-level budget observers recommend building a Rainy Day Fund balance of anywhere between 5% and 15% of revenue during times of economic growth.

A recent study released by George Mason University implies the need for a balance at the larger end of that range.[3] The study found that Michigan would need a balance equal to 13% of General Fund revenue to avoid budget reductions during a typical economic downturn. Additional funds would be needed to offset School Aid Fund revenue losses. For FY 2016-17, 13% of estimated combined General Fund and School Aid Fund revenue equates to $2.9 billion.

BILL SUMMARY:

House Bill 5847 (H-1) would amend the Management and Budget Act to revise provisions governing the BSF. Major changes are as follows:

Deposit of unassigned funds: The bill would require that, beginning with FY 2016-17, at least 25% of the ending unassigned General Fund balance would be appropriated and deposited into the BSF. The deposit would occur in the first quarter of the subsequent fiscal year. (A similar provision is included in the FY 2016-17 enacted state budget.) An unassigned fund balance is created by either year-end GF/GP lapses or GF/GP revenue exceeding projections, or both.

The bill would make no changes to the calculations for determining when deposits should be made into the fund (when annual personal income growth is above 2%) and the size of those deposits (annual personal income growth less 2%, times total GF/GP revenue).

Fund withdrawals: Currently, statute provides for a BSF pay-out when the annual personal income growth rate is less than 0%, with the amount to be transferred out of the fund limited to the negative growth rate multiplied by GF/GP revenue for that fiscal year. In practice, however, withdrawals during economic downturns have been larger than the amount allowed under the statutory provisions and have, therefore, been accomplished by amending the statute to provide for the withdrawal.

This bill would instead provide that, in years with a negative personal income growth rate, as estimated at a revenue estimating conference, the Legislature could appropriate up to 25% of the available fund balance in the fiscal year ending during the calendar

[2] In addition to deposits made from GF/GP revenue, the state is also depositing $17.5 million per year into the BSF from tobacco settlement proceeds, to repay the fund for a $195 million payment from the fund toward the City of Detroit bankruptcy settlement in FY 2013-14.

[3] Source: http://mercatus.org/publication/weathering-next-recession-how-prepared-are-50-states.

year with negative growth. If the state experienced consecutive years of negative personal income growth, up to 25% of the original balance (prior to the first withdrawal) could be withdrawn for each corresponding fiscal year. That is, the fund would be depleted over four years if the state experienced four consecutive years of negative personal income growth and the maximum amount was withdrawn each year.

The bill would explicitly prohibit withdrawals from the fund for a fiscal year ending in a calendar year with personal income growth greater than 0%, and the Executive Budget could not recommend a withdrawal in such a year.

Appropriations acts: The bill would explicitly require the Legislature to provide for transfers into or out of the fund through an appropriations act (consistent with current practice in the case of transfers into the fund).

Cap on fund balance: The bill would increase the cap on the balance of the fund from 10% of combined GF/GP and School Aid Fund revenue to 15% of that combined revenue amount. The current provision requiring any amount in the fund exceeding the cap to be rebated to taxpayers through individual income tax returns is retained.

Other changes contained in the bill are as follows:

- Modifies the definition of "Adjusted personal income" so both personal income and the consumer price index are measured on a calendar year basis.
- Deletes provisions related to past one-time BSF withdrawals, required deposits of GF/GP balances (replaced by the language described above requiring deposit of 25% of GF/GP lapses), and certain appropriation adjustments made for FY 2000-01 (Sec. 397).
- Deletes a limit (1% of GF/GP revenue) on adjustments made to transfer amounts based on revisions to economic data.
- Modifies the requirement that BSF pay-ins or pay-outs be estimated as part of the consensus revenue estimating conference to reference the "maximum allowable" pay-out from the fund under the new provisions.
- Deletes language allowing for withdrawals from the BSF for capital outlay and other purposes when the state's unemployment rate is 8% or more (Sec. 353).

MCL 18.1302 to 18.1367b

FISCAL IMPACT:

The bill would have no direct fiscal impact on the state, as it would neither increase nor decrease overall state revenues or expenditures. It could potentially, however, increase deposits to the BSF, due to the requirement that 25% of the ending General Fund unassigned balance be deposited into the fund each year, thereby lowering state expenditures during times of economic growth and increasing (i.e., requiring less reduction in) expenditures during times of economic downturn. Since FY 1999-2000, GF/GP lapses have averaged $120 million per year, which would equate to an annual BSF deposit of $30 million. Larger deposits would have occurred in years in which GF/GP revenues exceeded projections, while deposits would have been lower than 25% of lapses if revenues were below projections.

Additionally, the provisions allowing for withdrawal of 25% of the BSF balance per year during an economic downturn (via appropriations act) could result in the Legislature and Governor withdrawing funds at a more moderate rate than in the past, when large withdrawals have been made via statutory amendment early in a downturn (although the statutory amendment option would still be available). This would potentially require larger budget balancing actions in the first year or two years of an economic downturn but moderate the need for such actions in subsequent years of a downturn. Historically, the state has generally experienced two to three years of revenue losses following a downturn.

Finally, in the event substantial deposits were made in future years, the bill would allow for a larger balance to accumulate in the BSF to be utilized in a future economic downturn. Based on estimated FY 2016-17 revenue amounts, the bill would increase the cap on the fund's balance from $2.3 billion (10%) to $3.4 billion (15%).

Fiscal Analyst: Kyle I. Jen

APPENDIX
Budget Stabilization Fund History
Millions of Dollars

Fiscal Year	Beginning Balance	Deposits	Withdrawals	Interest Earned	Ending Balance
1977-78	0.0	108.7		6.2	114.9
1978-79	114.9	104.1		22.1	241.1
1979-80	241.1		263.7	32.1	9.5
1980-81	9.5		16.3	9.2	2.4
1981-82	2.4			0.6	3.0
1982-83	3.0			0.2	3.2
1983-84	3.2			0.2	3.4
1984-85	3.4	340.9	34.2	30.8	340.9
1985-86	340.9	30.6	14.7	28.2	385.0
1986-87	385.0		24.8	24.1	384.3
1987-88	384.3		20.4	29.2	393.1
1988-89	393.1		11.9	38.0	419.2
1989-90	419.2		69.9	35.8	385.1
1990-91	385.1		230.0	27.1	182.2
1991-92	182.2		170.1	8.1	20.1
1992-93	20.1	282.6		0.7	303.4
1993-94	303.4	460.2		11.9	775.5
1994-95	775.5	260.1	90.4	57.7	1,003.0
1995-96	1,003.0	91.3		59.2	1,153.6
1996-97	1,153.6		69.0	67.8	1,152.4
1997-98	1,152.4		212.0	60.1	1,000.5
1998-99	1,000.5	244.4	73.6	51.3	1,222.5
1999-00	1,222.5	100.0	132.0	73.9	1,264.4
2000-01	1,264.4		337.0	66.7	994.2
2001-02	994.2		869.8	20.8	145.2
2002-03	145.2		156.1	10.9	0.0
2003-04	0.0	81.3		0.0	81.3
2004-05	81.3		81.3	2.0	2.0
2005-06	2.0			0.0	2.0
2006-07	2.0			0.1	2.1
2007-08	2.1			0.1	2.2
2008-09	2.2			0.0	2.2
2009-10	2.2			0.0	2.2
2010-11	2.2			0.0	2.2
2011-12	2.2	362.7		0.2	365.1
2012-13	365.1	140.0		0.5	505.6
2013-14	505.6	75.0	194.8	0.4	386.2
2014-15	386.2	111.5		0.3	498.1
2015-16*	498.1	112.5		0.5	611.1
2016-17*	611.1	17.5		0.9	629.5

*HFA estimates