



**MICHIGAN'S
ECONOMIC OUTLOOK
AND BUDGET REVIEW**

**FY 2007-08, FY 2008-09,
AND FY 2009-10**

December 18, 2008



THE SENATE FISCAL AGENCY

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EXECUTIVE SUMMARY

ECONOMIC FORECAST

The U.S. economy, as measured by inflation-adjusted gross domestic product, is predicted to grow 1.1% in 2008, and then contract 2.4% in 2009 before growing 1.5% in 2010. Light vehicle sales are forecasted to decline to 13.1 million units in 2008 and 10.5 million units in 2009 before rising to 11.9 million units in 2010. The unemployment rate is expected to increase to 5.6% in 2008 and continue rising, to 8.2% in 2009 and 8.9% in 2010, while the consumer price index is estimated to grow by 4.0% in 2008, 0.8% in 2009, and 2.3% in 2010.

The Michigan economy, as measured by inflation-adjusted personal income, is estimated to fall 0.4% in 2008, followed by declines of 2.8% in 2009 and 1.2% in 2010. Wage and salary employment is predicted to decline 1.6% during 2008, followed by declines of 4.8% in 2009 and 2.6% in 2010.

REVENUE FORECAST

In fiscal year (FY) 2007-08, General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue totaled \$20.87 billion, which was up 7.2% from FY 2006-07. Most of this increase was due to the increase in the income tax rate and the surcharge on the new Michigan Business Tax. General Fund/General Purpose revenue increased 12.4% to \$9.35 billion and SAF revenue was up 3.3% to \$11.52 billion.

In FY 2008-09, the economic downturn is expected to have a significant negative impact on revenue. General Fund/General Purpose and SAF revenue will total an estimated \$19.65 billion, which is down 5.8% from FY 2007-08. This revised estimate is \$940.7 million below from the May 2008 consensus estimate. General Fund/General Purpose revenue is expected to decline 12.1% from the FY 2007-08 level to \$8.22 billion and SAF revenue is projected to edge down 0.7% to \$11.43 billion.

In FY 2009-10, GF/GP and SAF revenue will total an estimated \$19.21 billion. This initial estimate for FY 2009-10 is down 2.2% from the revised estimate for FY 2008-09. General Fund/General Purpose revenue will total an estimated \$7.84 billion, representing a decline of 4.6% from FY 2008-09, and SAF revenue will total an estimated \$11.37 billion, which is down 0.6%.

YEAR-END BALANCE ESTIMATES

Based on the accounting of State revenue and expenditures as of December 15, 2008, the Senate Fiscal Agency (SFA) is estimating that the FY 2007-08 GF/GP budget will close the year with a \$442.5 million balance. The FY 2007-08 SAF budget will close the year with a \$247.1 million balance.

A comparison of the SFA's FY 2008-09 revenue estimate with enacted and projected appropriations leads to a \$265.5 million GF/GP budget deficit. The SFA is now estimating that the FY 2008-09 SAF budget is in balance by \$27.5 million.

A review of the issues that the Governor and the Legislature will face in developing the FY 2009-10 State budget leads to the conclusion that, absent additional revenue, very significant reductions will have to be made in the GF/GP appropriations to ensure a balance between estimated revenue and appropriations. A look ahead at the FY 2009-10 SAF budget leads to the conclusion that a freeze in the level of SAF appropriations at the current-year level is likely. The major issue that could influence this outlook is the potential for a significant amount of fiscal relief that Michigan could receive as part of an economic stimulus package likely to be approved by the Federal Government in early 2009.

EXECUTIVE SUMMARY
SENATE FISCAL AGENCY
ECONOMIC AND BUDGET SUMMARY

| ECONOMIC PROJECTIONS (Calendar Year) | | | | |
|--|---------------|-----------------|-----------------|-----------------|
| | 2007 | 2008 | 2009 | 2010 |
| | Actual | Estimate | Estimate | Estimate |
| Real Gross Domestic Product (% change)..... | 2.0% | 1.1% | (2.4)% | 1.5% |
| U.S. Consumer Price Index (% change)..... | 2.8% | 4.0% | 0.8% | 2.3% |
| Light Motor Vehicle Sales (millions of units)..... | 16.1 | 13.1 | 10.5 | 11.9 |
| U.S. Unemployment Rate (%) | 4.6% | 5.6% | 8.2% | 8.9% |
| Real Michigan Personal Income (% change)..... | 2.1% | (0.4)% | (2.8)% | (1.2)% |
| Michigan Wage & Salary Employment (% change)..... | (1.5)% | (1.6)% | (4.8)% | (2.6)% |

| REVENUE ESTIMATES GENERAL FUND/GENERAL PURPOSE (GF/GP) AND SCHOOL AID FUND (SAF) (Millions of Dollars) | | | | | | |
|--|-----------------------------------|------------------------|--------------------------|-----------------------------------|------------------------|--------------------------|
| | <u>FY 2008-09 Estimate</u> | | | <u>FY 2009-10 Estimate</u> | | |
| | Baseline | Tax Changes | Net Available | Baseline | Tax Changes | Net Available |
| Gen'l Fund/Gen'l Purpose..... | \$7,605.7 | \$611.0 | \$8,216.7 | \$7,487.4 | \$355.2 | \$7,842.6 |
| % Change | (7.1) | --- | (12.1) | (1.6) | --- | (4.6) |
| School Aid Fund..... | 10,643.1 | 791.4 | 11,434.5 | 10,599.3 | 772.1 | 11,371.4 |
| % Change | (4.3) | --- | (0.7) | (0.4) | --- | (0.6) |
| Total GF/GP and SAF | 18,248.8 | 1,402.4 | 19,651.2 | 18,086.7 | 1,127.3 | 19,214.0 |
| % Change | (5.5) | --- | (5.8) | (0.9) | --- | (2.2) |
| | <u>FY 2008-09 Estimate</u> | | | <u>FY 2009-10 Estimate</u> | | |
| Revenue Limit - Under (Over): | \$6,487.7 | | | \$7,724.8 | | |

| YEAR-END BALANCE ESTIMATES (Fiscal Year, Millions of Dollars) | | |
|---|-------------------|-------------------|
| | FY 2007-08 | FY 2008-09 |
| | Estimate | Estimate |
| General Fund/General Purpose | \$442.5 | \$(265.5) |
| School Aid Fund | 247.1 | 27.5 |
| Budget Stabilization Fund | 2.2 | 2.2 |

ECONOMIC REVIEW AND OUTLOOK

State revenue, particularly tax revenue, depends heavily on economic conditions. This section presents the Senate Fiscal Agency's (SFA's) latest economic forecast for 2009 and 2010, as well as a summary of recent economic activity and estimates for the rest of 2008.

RECENT ECONOMIC HIGHLIGHTS

The National Bureau of Economic Research, the organization traditionally regarded as the authority for dating recessions, announced on November 28, 2008, that the U.S. economy had been in recession since December 2007. A casual survey of most economic indicators during 2008 would readily confirm that judgment: Virtually every major economic indicator has fallen substantially since the fourth quarter of 2007. Light vehicle sales declined from an annual rate of 16.0 million units in December 2007 to 10.1 million units in November 2008 ([Figure 1](#)). November 2008 ranked as the 10th-worst month in vehicle sales for statistics going back through 1976, and the worst month since October 1982. Adjusted for changes in population, light vehicle sales in October and November 2008 marked the two worst sales months ever in the available data (which begin in January 1976), and November's level was more than 13.4% below the third-worst month recorded: December 1981. Housing starts, which by the fourth quarter of 2007 had already fallen 49.3% from their January 2006 peak, fell another 31.3% between the fourth quarter of 2007 and October 2008 to an annual rate of 791,000 starts, the lowest level since statistics beginning in 1959 ([Figure 2](#)).

United States wage and salary employment peaked in December 2007, at 138.1 million workers, and by November 2008 had declined for 11 consecutive months (the third-longest string of consecutive declines since records beginning in 1939), and fallen by nearly 2.0 million jobs ([Figure 3](#)). The November 2008 employment decline of 533,000 jobs marked the fifth-largest monthly drop in employment since October 1945 and the largest decline since December 1974. The Dow Jones Industrial Average, which had already fallen during the two months prior to December 2007, declined 33.4% between December 2007 and November 2008, while the Standard and Poor's 500 Index dropped 40.3% over the same period. The 11-month decline in the Dow index represented the largest 11-month decline since September 1974, and only the second such decline since May 1938, while the decline in the S&P 500 Index represented the largest 11-month decline in the available history of the index (which starts in 1946).

There have been 11 recessions since 1945. They have lasted from six to 16 months, averaging 10 months in duration, and tended to exhibit a slower rate of contraction about halfway through the recession. However, 11 months into the current recession, the declines in the economy appear to be accelerating, rather than slowing. Employment declines averaged 72,200 jobs per month between January and May 2008, accelerated to 98,000 jobs per month from June to August, and averaged 418,700 jobs per month between September and November. Furthermore, the magnitude of November's employment decline was 32.3% greater than the decline reported for September and 66.6% greater than the October decline. Consumer sentiment, measured by the University of Michigan's Consumer Sentiment Index, fell 21.9% between January and July 2008, but dropped 18.1% in October alone. The November 2008 index value for consumer sentiment was the third-lowest reading in the 56-year history of the index and many components of the index exhibited the lowest values ever recorded ([Figure 4](#)). Retail sales have declined for four consecutive months, falling 6.0% between June 2008 and October 2008, while the monthly changes have been growing in magnitude, with sales down 0.7% in July, follow by declines of 0.8%, 1.5%, and 3.1%.

Figure 1

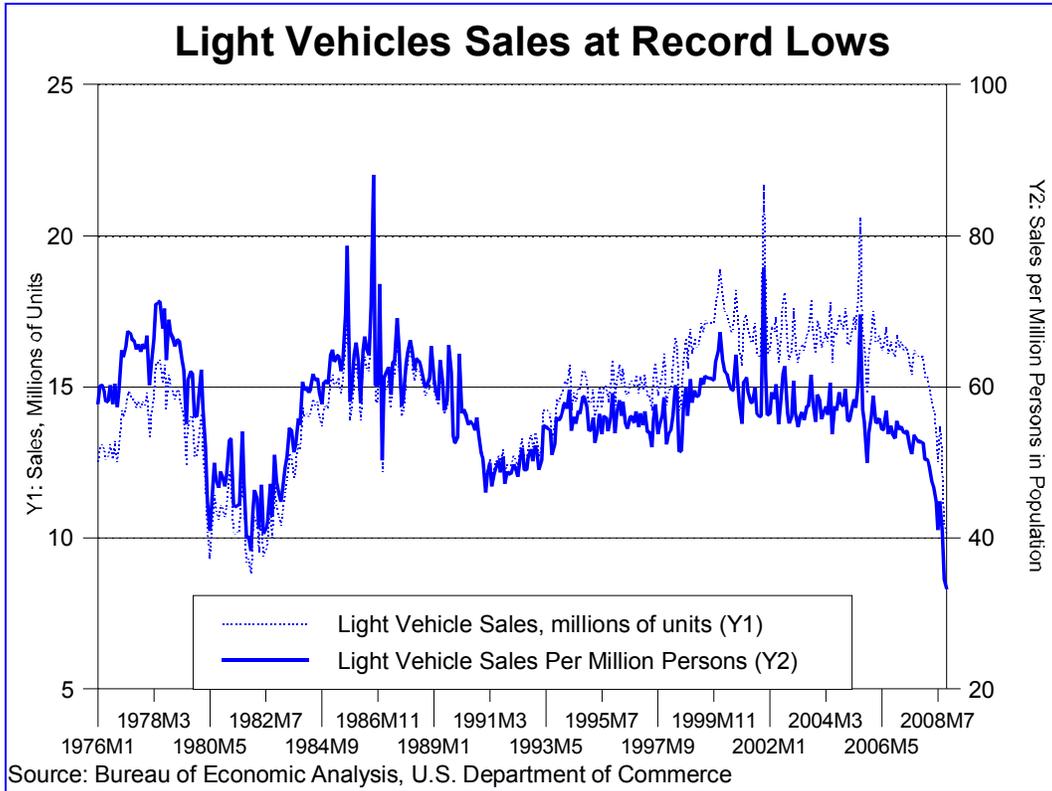


Figure 2



Figure 3

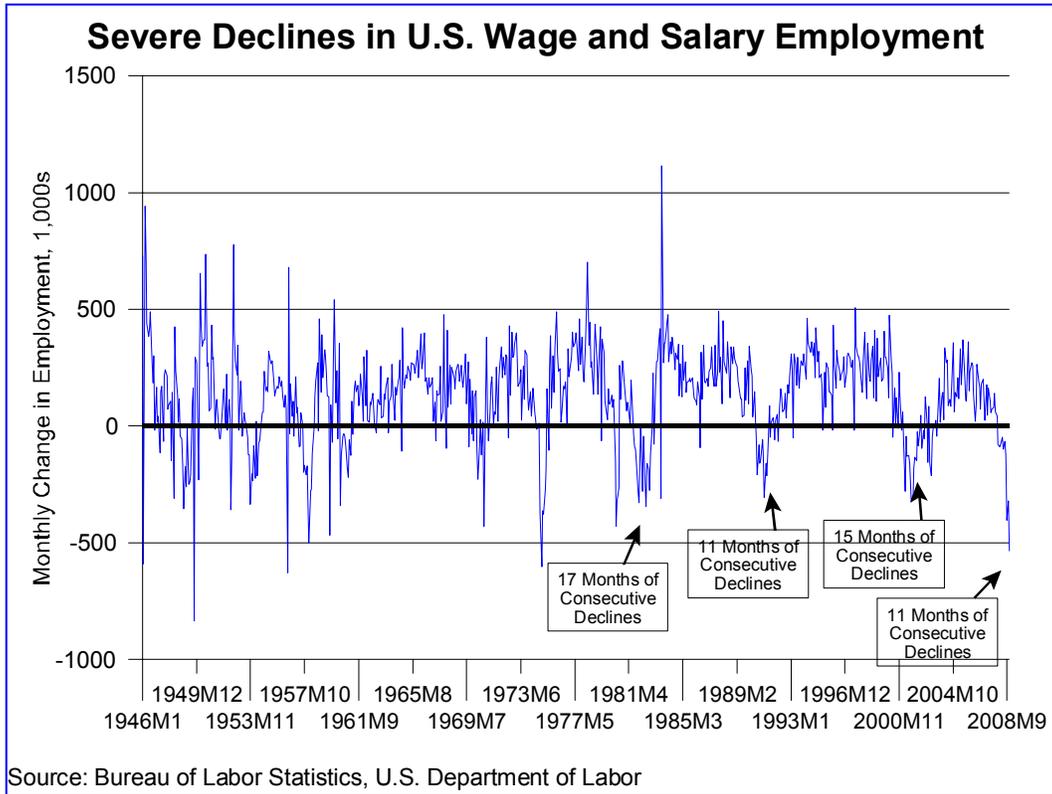
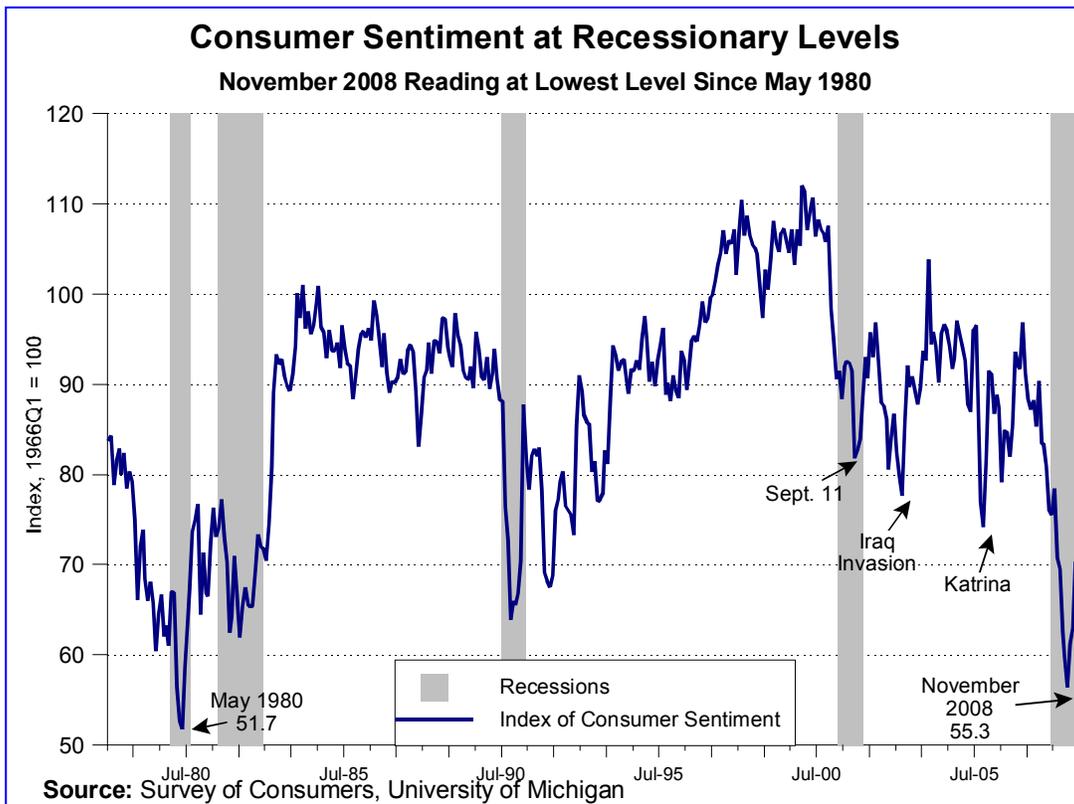


Figure 4



The most volatile economic factor of 2008 may have been inflation, particularly with respect to many of the component sectors that comprise most inflation indices. While overall inflation, as measured by the U.S. Consumer Price Index (CPI), appears to have increased 4.0% in 2008, the increase is still relatively moderate in historical perspective: slightly above rates during the 1990s and below those of most years in the 1980s. Inflation, as measured by the Gross Domestic Product (GDP) deflator, actually is expected to decline during 2008. However, the overall figures for these measures have been moderated by offsetting, and substantial, changes in their components. As oil prices rose from \$91.73 per barrel in December 2007 to \$133.93 in June 2008, the energy component of the CPI rose 18.1% between December 2007 and July 2008. As oil prices fell to \$57.44 per barrel in November 2008, the index dropped substantially and the October CPI figure for energy was only 2.6% above the December 2007 level. Food prices have consistently increased, with the October 2008 index up 5.8% from December 2007, while the cost of shelter in the CPI has remained stagnant, rising only 1.7% between December 2007 and October 2008. Housing prices, according to other measures, have posted substantial declines, with the Standard and Poor's/Case-Shiller 20-city seasonally adjusted composite index dropping 13.3% between December 2007 and September 2008.

The magnitude of the current collapse of many economic fundamentals is not unprecedented, but indicates that a severe recession is likely. Mild recessions tend to be associated with more traditional dislocations in the economy between production and consumption. Severe recessions are often associated with fundamental challenges to the underlying structure of the economy, such as the recessions in the 1950s and 1970s. Often these recessions have involved sharp spikes in inflation, particularly with energy prices; and frequently they have involved pressures associated with military conflicts, which have added uncertainty to both the economic and the political environments. More severe recessions or depressions, such as the panics of the 19th century and the Great Depression during the 1930s, have involved collapses in the prices of important economic fundamentals such as staple crops and/or housing, the failure of substantial financial institutions, and severe drops in the stock market as speculative bubbles collapsed. During the last three of these more severe collapses (the financial panics of 1873 and 1893, and the Great Depression), the duration of the economic contraction averaged more than four years.

The current economic situation bears many of the hallmarks of these earlier panics and depressions. Housing and commodity prices essentially have collapsed, prompting a massive sell-off in the stock market and bringing many banks to the brink of failure (Figures 5, 6, and 7). The London Interbank Offered Rate (LIBOR) measures the interest rates banks charge each other. As with all interest rates, the LIBOR is heavily influenced by inflationary concerns. However, the difference between the 90-day Treasury bill rate and the LIBOR rate can illustrate the level of risk banks perceive when lending money to other banks. Government bonds are frequently viewed as essentially risk-free assets, such that they need to offer a limited return, particularly in the short-term, in order to attract investors. Frequently, the return is simply guided by short-term inflation expectations, and in periods of higher growth when competing assets offer much higher returns, can rise if government deficits need to attract capital away from the private sector. During much of the 1990s and particularly during the mid-2000s, loans between banks were viewed almost as risk-free as government bonds, and the difference between interest rates for 90-day Treasury bills and the three-month LIBOR was very small (Figure 8). However, beginning with the housing meltdown and mortgage crises, the risk associated with financial lending has skyrocketed, with the spread between 90-day Treasury bills and the LIBOR rising from less than 20 basis points (0.2%) during much of the early 2000s to 340 basis points in October 2008. The spread in rates quadrupled late in 2007 with the initial financial crisis, and then more than tripled from those higher levels again in late 2008. In other cases, markets for some types of financial instruments have essentially vanished because there are few or no buyers willing to assume the risk associated with those instruments.

Figure 5

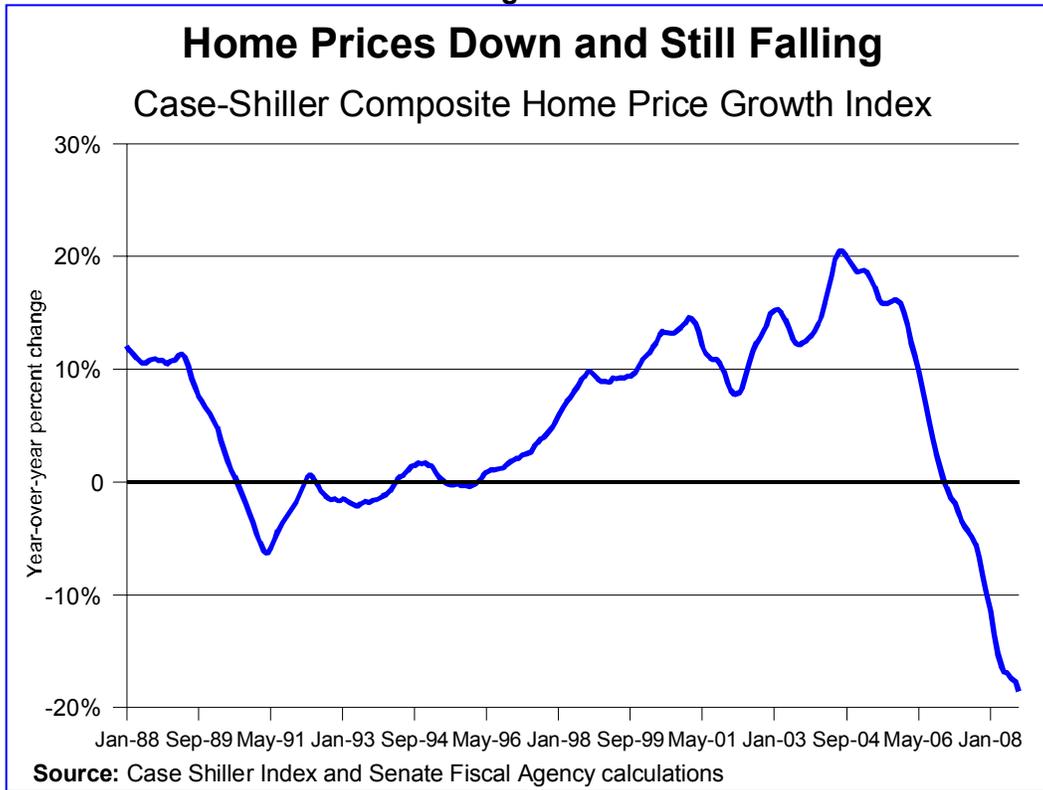


Figure 6

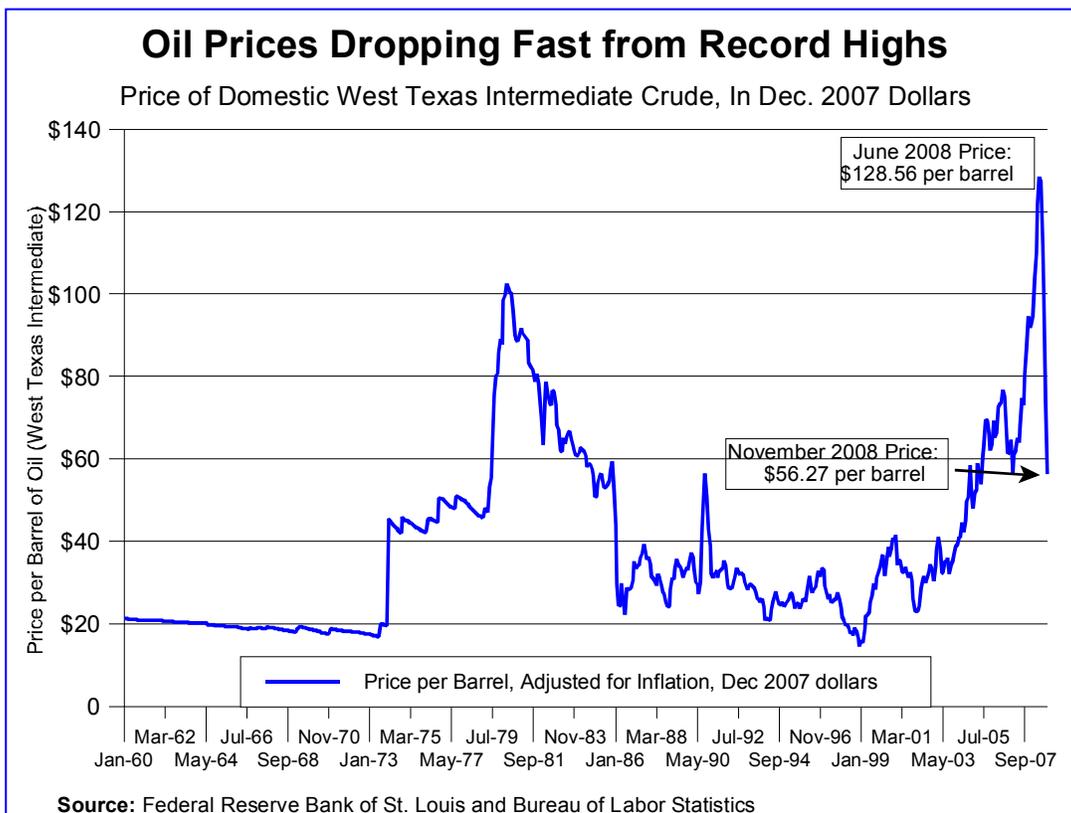


Figure 7

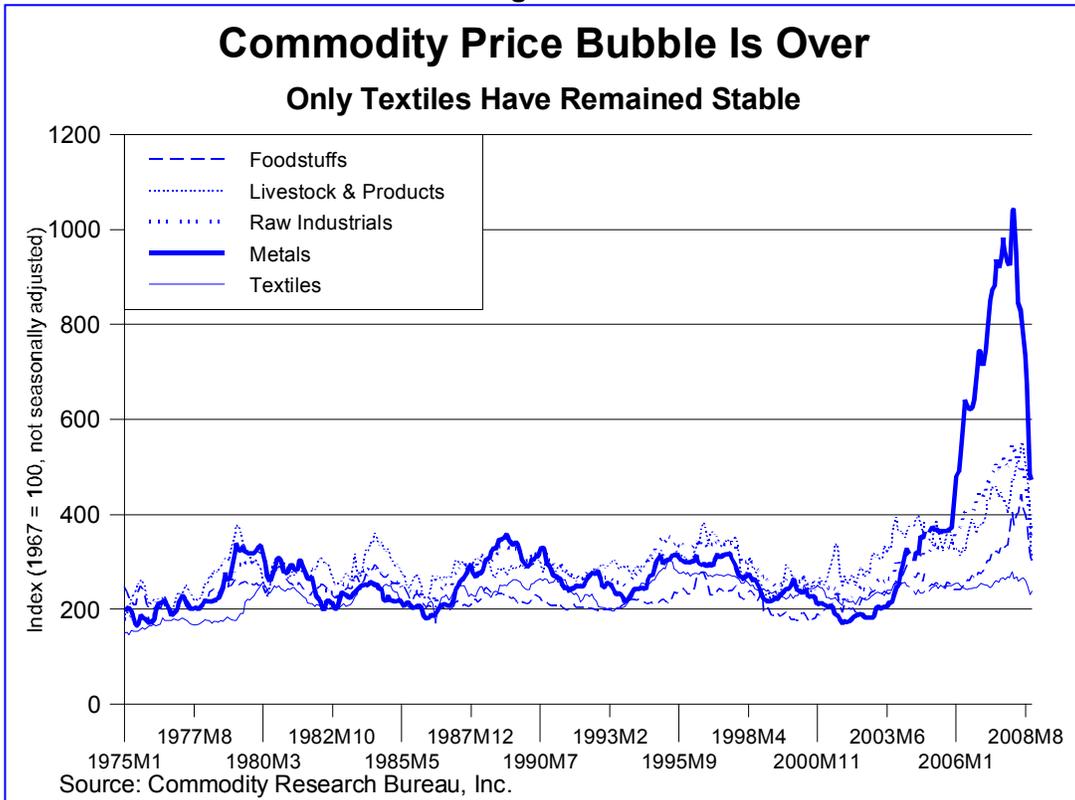
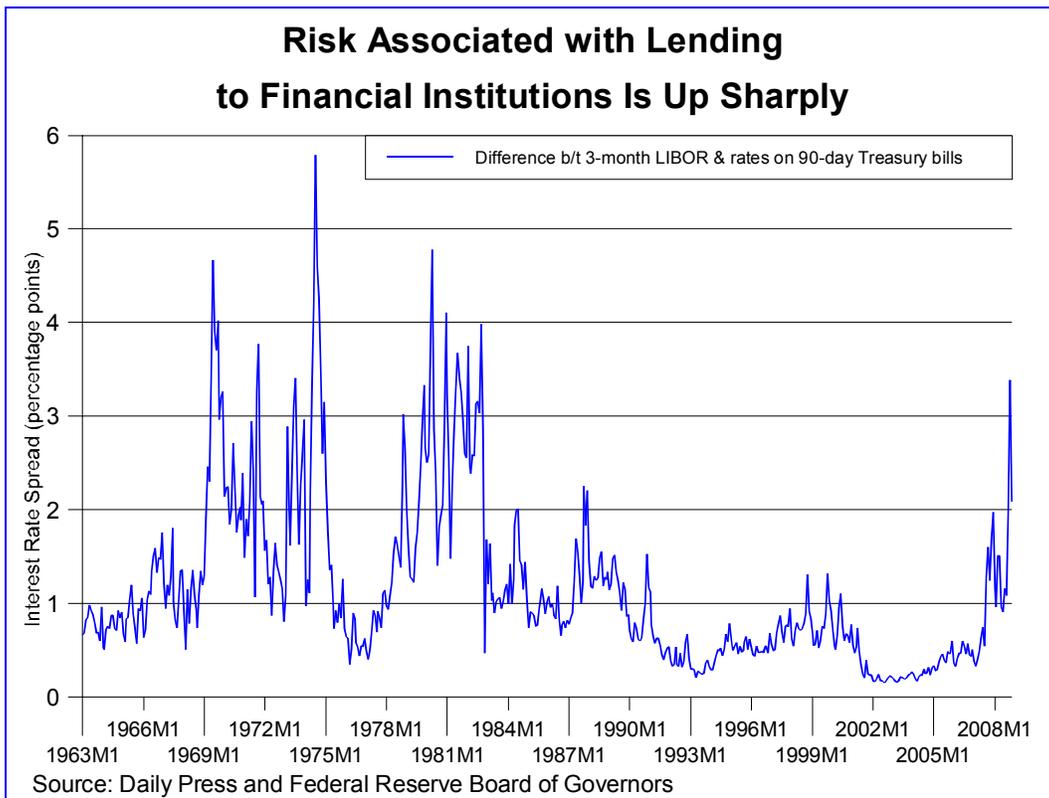


Figure 8



Details for selected economic indicators are presented in [Table 1](#) and [Table 2](#). The values presented reflect annual averages and thus the 2008 values understate the declines experienced in recent months because the annual averages also include the effects of early 2008 when economic conditions were more positive than in the last quarter of the year.

Table 1

| THE SENATE FISCAL AGENCY ECONOMIC FORECAST | | | | | |
|--|--------------------|--------------------|------------------|------------------|------------------|
| (Calendar Years) | | | | | |
| | 2006 Actual | 2007 Actual | 2008 Est. | 2009 Est. | 2010 Est. |
| <u>United States</u> | | | | | |
| Nominal GDP | | | | | |
| (year-to-year growth) | 6.1% | 4.8% | 3.5% | (0.9)% | 3.3% |
| Inflation-Adjusted GDP | | | | | |
| (year-to-year growth) | 2.8% | 2.0% | 1.1% | (2.4)% | 1.5% |
| Unemployment Rate | 4.6% | 4.6% | 5.6% | 8.2% | 8.9% |
| Inflation | | | | | |
| Consumer Price Index | | | | | |
| (year-to-year growth) | 3.2% | 2.8% | 4.0% | 0.8% | 2.3% |
| GDP Implicit Price Deflator | | | | | |
| (year-to-year growth) | 3.2% | 2.7% | 2.4% | 1.6% | 1.8% |
| Interest Rates | | | | | |
| 90-day Treasury bill | 4.73% | 4.36% | 1.38% | 0.35% | 0.87% |
| Corporate Aaa bond | 5.59% | 5.56% | 5.64% | 4.99% | 4.65% |
| Federal funds rate | 4.97% | 5.02% | 1.95% | 0.33% | 0.94% |
| Light Motor Vehicle Sales | | | | | |
| (millions of units) | 16.5 | 16.1 | 13.1 | 10.5 | 11.9 |
| Auto | 7.8 | 7.6 | 6.8 | 5.5 | 6.2 |
| Truck | 8.7 | 8.5 | 6.4 | 5.0 | 5.7 |
| Import Share | 22.4% | 23.3% | 29.6% | 33.0% | 34.7% |
| <u>Michigan</u> | | | | | |
| Personal Income (millions) | \$332,654 | \$345,885 | \$354,066 | \$345,709 | \$348,491 |
| Year-to-year growth | 2.3% | 4.0% | 2.4% | (2.4)% | 0.8% |
| Inflation-Adjusted Personal Income (year-to-year growth) | (0.8)% | 2.1% | (0.4)% | (2.8)% | (1.2)% |
| Wage & Salary Income (millions) | \$185,264 | \$188,062 | \$189,592 | \$178,167 | \$178,800 |
| Year-to-year growth | 0.8% | 1.5% | 0.8% | (6.0)% | 0.4% |
| Detroit Consumer Price Index (year-to-year growth) | 3.0% | 1.8% | 2.8% | 0.4% | 2.0% |
| Wage & Salary Employment (thousands) | 4,327.1 | 4,262.0 | 4,193.2 | 3,990.1 | 3,886.7 |
| Year-to-year growth | (1.4)% | (1.5)% | (1.6)% | (4.8)% | (2.6)% |
| Unemployment Rate | 6.9% | 7.2% | 8.2% | 10.6% | 11.3% |

Table 2

THE SENATE FISCAL AGENCY U.S. ECONOMIC FORECAST DETAIL
(Calendar Years)

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|--|------------|------------|------------|------------|-------------|
| | Actual | Actual | Estimate | Estimate | Estimate |
| Gross Domestic Product (billions of dollars) | \$13,178.4 | \$13,807.5 | \$14,297.6 | \$14,175.8 | \$14,645.6 |
| Year-to-year growth | 6.1% | 4.8% | 3.5% | (0.9)% | 3.3% |
| <i><u>Inflation-Adjusted GDP and Components</u></i> | | | | | |
| Gross Domestic Product (billions of 2000 dollars) | \$11,294.8 | \$11,523.9 | \$11,649.4 | \$11,367.9 | \$11,538.6 |
| Year-to-year growth | 2.8% | 2.0% | 1.1% | (2.4)% | 1.5% |
| Consumption (billions of 2000 dollars) | \$8,029.0 | \$8,252.8 | \$8,274.4 | \$8,148.6 | \$8,228.7 |
| Year-to-year growth | 3.0% | 2.8% | 0.3% | (1.5)% | 1.0% |
| Business Fixed Investment (billions of 2000 dollars) | \$1,318.2 | \$1,382.9 | \$1,419.2 | \$1,264.1 | \$1,196.9 |
| Year-to-year growth | 7.5% | 4.9% | 2.6% | (10.9)% | (5.3)% |
| Change in Business Inventories (billions of 2000 dollars) | \$42.3 | (\$2.5) | (\$39.1) | (\$93.3) | (\$1.1) |
| Residential Investment (billions of 2000 dollars) | \$552.9 | \$453.8 | \$359.7 | \$315.5 | \$352.0 |
| Year-to-year growth | (7.1)% | (17.9)% | (20.7)% | (12.3)% | 11.6% |
| Government Spending (billions of 2000 dollars) | \$1,971.2 | \$2,012.1 | \$2,068.2 | \$2,097.1 | \$2,111.7 |
| Year-to-year growth | 1.7% | 2.1% | 2.8% | 1.4% | 0.7% |
| Net Exports (billions of 2000 dollars) | (\$615.7) | (\$546.5) | (\$393.1) | (\$336.6) | (\$340.0) |
| Exports (billions of 2000 dollars) | \$1,314.8 | \$1,425.9 | \$1,531.8 | \$1,491.4 | \$1,533.1 |
| Imports (billions of 2000 dollars) | \$1,930.5 | \$1,972.4 | \$1,924.9 | \$1,828.0 | \$1,873.0 |
| Personal Income (year-to-year growth) | 7.1% | 6.0% | 4.0% | 1.5% | 1.0% |
| Adjusted for Inflation | 3.7% | 3.0% | (0.0)% | 0.7% | (1.3)% |
| Wage & Salary Income (year-to-year growth) | 6.3% | 5.6% | 3.3% | 0.4% | 1.1% |
| Personal Savings Rate | 0.7% | 0.6% | 1.8% | 4.8% | 4.5% |
| Capacity Utilization Rate | 80.9% | 81.0% | 79.0% | 72.5% | 73.4% |
| Housing Starts (millions of units) | 1.801 | 1.355 | 0.921 | 0.712 | 0.883 |
| Conventional Mortgage Rates | 6.4% | 6.3% | 6.0% | 5.6% | 5.4% |
| Federal Budget Surplus (billions of dollars, NIPA basis) | (\$155.0) | (\$218.9) | (\$439.4) | (\$762.2) | (\$1,007.2) |

The current recession reflects the influence of a number of economic phenomena that differ substantially from those of other recent recessions. The 1990-1991 recession largely reflected a slowdown induced by restrictive monetary policy to combat inflation that then was pushed into recession by a loss of business and consumer confidence (and thus spending) resulting from the Persian Gulf crisis. The 2001 recession largely reflected a pull-back in investment in the aftermath of Year 2000 technology investments that was pushed into recession by the collapse of inflated stock values for technology companies. In contrast, the current recession reflects a near collapse

in the prices of almost every real or financial asset and has been characterized by not only economic dislocation but an exaggeration of risk aversion among both investors and lenders. As a result, the current recession bears more resemblance to periods such as the 1979-1982 recession, when policy was endeavoring to break the economy from retaining high inflationary expectations, or the Great Depression, where lending and consumption collapsed in the aftermath of similar declines in asset prices. These periods were marked by a need for economic actors to develop new sets of economic expectations and to have time to adjust to those changed expectations.

Michigan's economy has spent the last eight years in recession, largely driven by the same fundamental restructuring that is affecting manufacturing globally. Manufacturing has experienced a significant surge in productivity, as the economy has become more competitive. Those factors have been complicated for Michigan as General Motors, Ford, and Chrysler also have lost market share, even as they have made productivity gains, leaving Michigan to lose employment due to both productivity and reduced demand. The rapid and drastic decline in automobile sales in late 2008 portends a long and difficult recession for Michigan and certainly one that may be more severe than any in the post-World War II period.

During the last decade, productivity has risen most significantly in economic sectors in which the Michigan economy is heavily concentrated (Figure 9). Sales for those industries have remained mostly flat or declined slightly, while Michigan's share of the market has declined markedly (Figure 10). Even after seven years of employment declines, especially within those areas where Michigan is most concentrated relative to other states, Michigan is still heavily dependent upon sectors that are highly cyclical and likely to continue to experience substantial gains in productivity and declines in employment. Based on 2007 data, Michigan represented 2.8% of the national economy (using Gross Domestic Product by state), yet comprised 4.4% of manufacturing goods employment and 5.4% of durable goods manufacturing employment. In 2007, transportation equipment manufacturing comprised approximately 42.9% of Michigan's durable goods manufacturing employment and Michigan's motor vehicle manufacturing employment comprised nearly one-fourth of the nation's motor vehicle manufacturing employment.

Another way to see how concentrated Michigan is on motor vehicle manufacturing is to examine the share of wage income paid to employees in sectors that produce motor vehicles. In 2007, wages and salaries paid to workers in the motor vehicle manufacturing sector comprised 1.1% of private sector wages and salaries paid nationally, but 9.5% of wages and salaries paid in Michigan (Figures 11 and 12). Furthermore, while it is more difficult to quantify, many of Michigan's nonmanufacturing sectors rely heavily, either directly or indirectly, on activity in the motor vehicle sector. Average wages in transportation equipment manufacturing are higher than in any other economic sector in Michigan, workers in the transportation equipment manufacturing sector purchase goods and services across the spectrum for their own consumption, and vehicle manufacturers are significant consumers of a variety of goods and services as well. As a result, economic downturns (from either declining employment or business profits) in the motor vehicle sector are transmitted and multiplied throughout the Michigan economy.

Figure 9

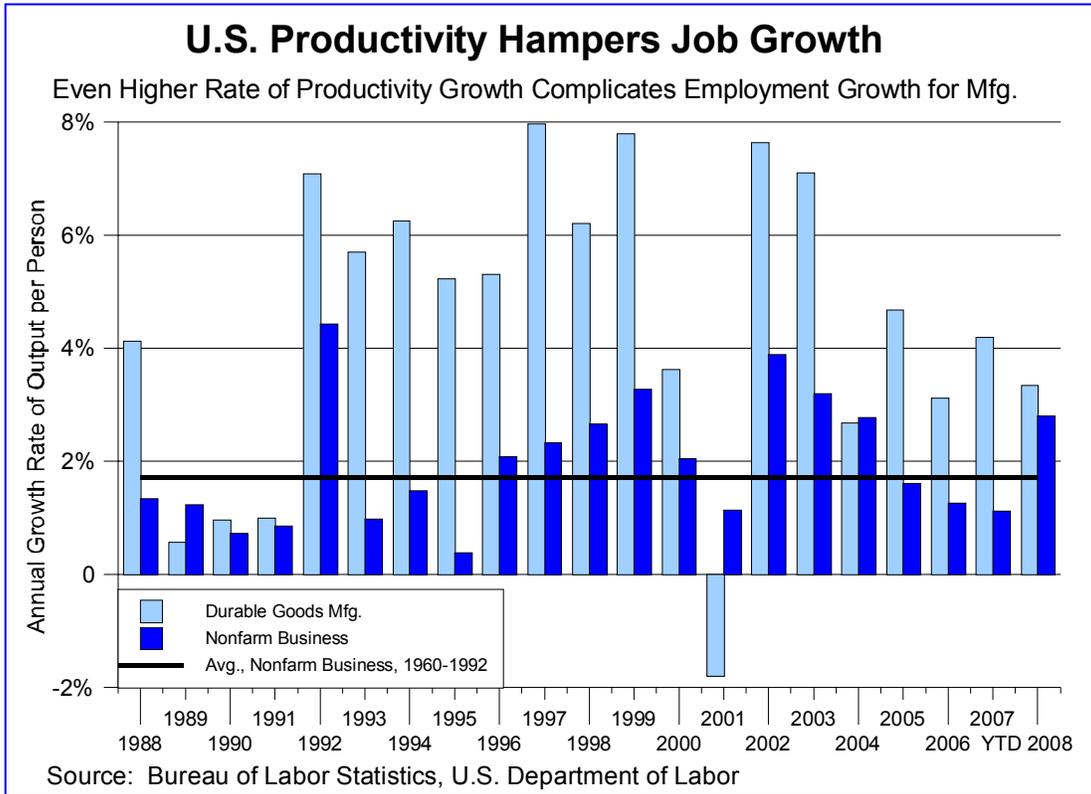


Figure 10

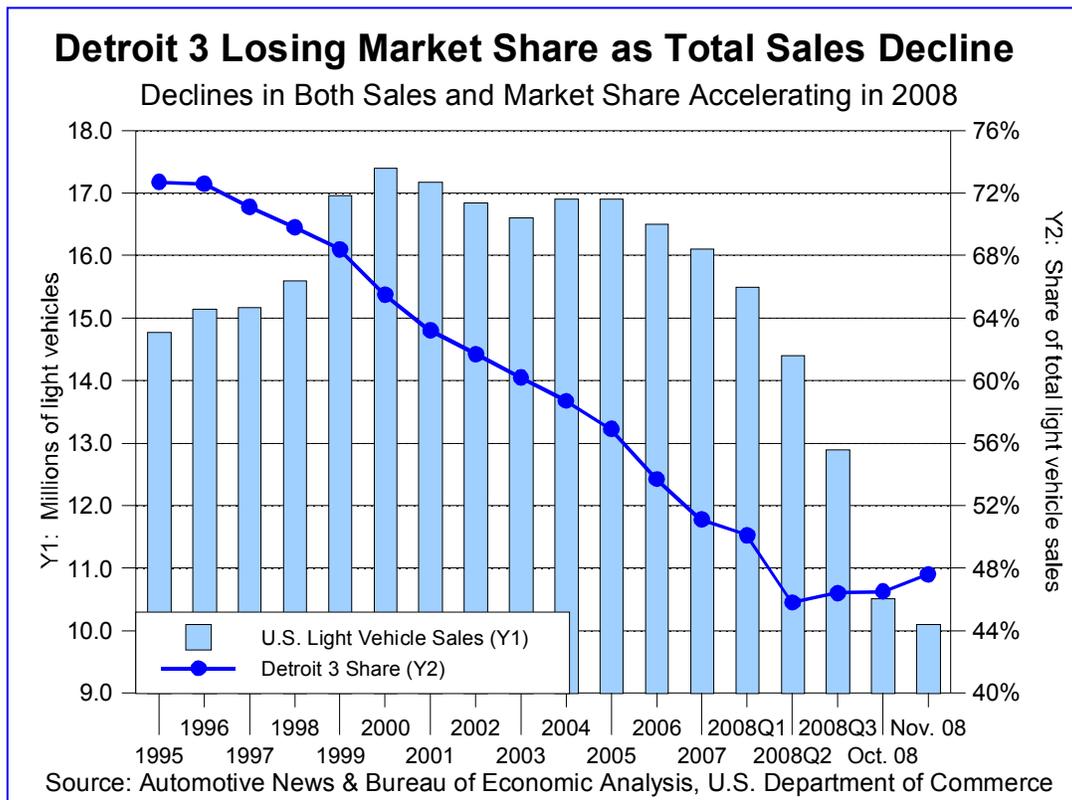


Figure 11

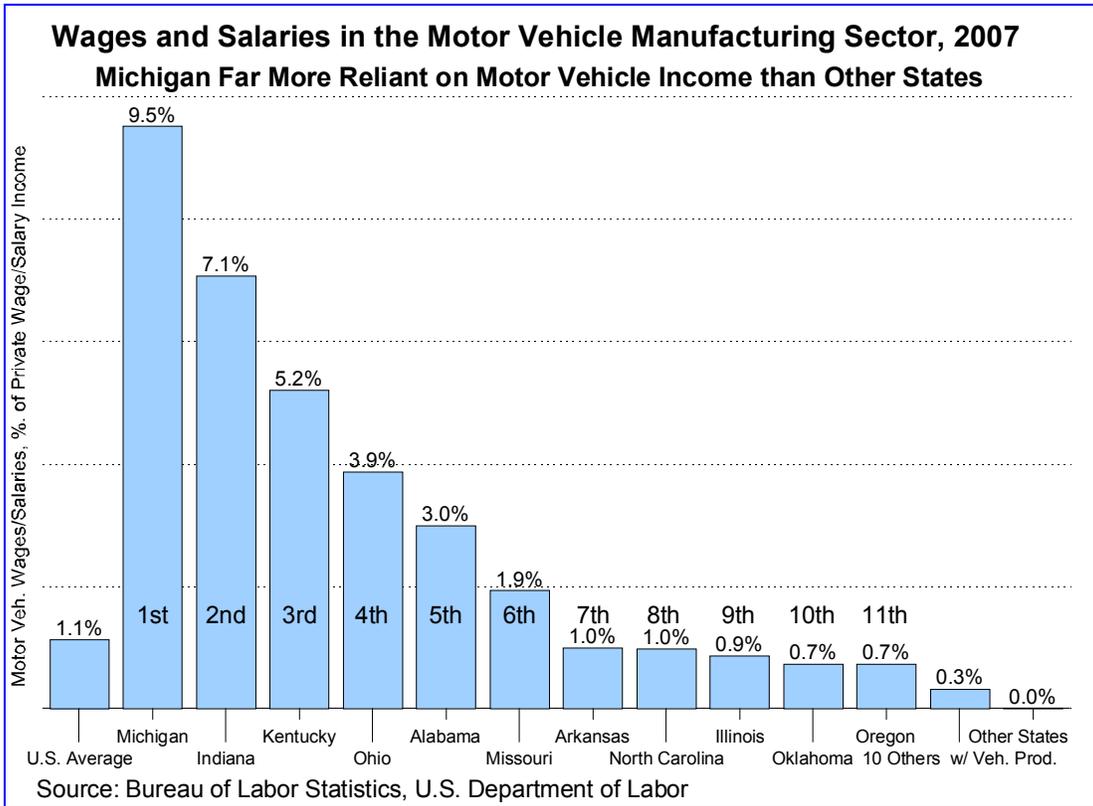
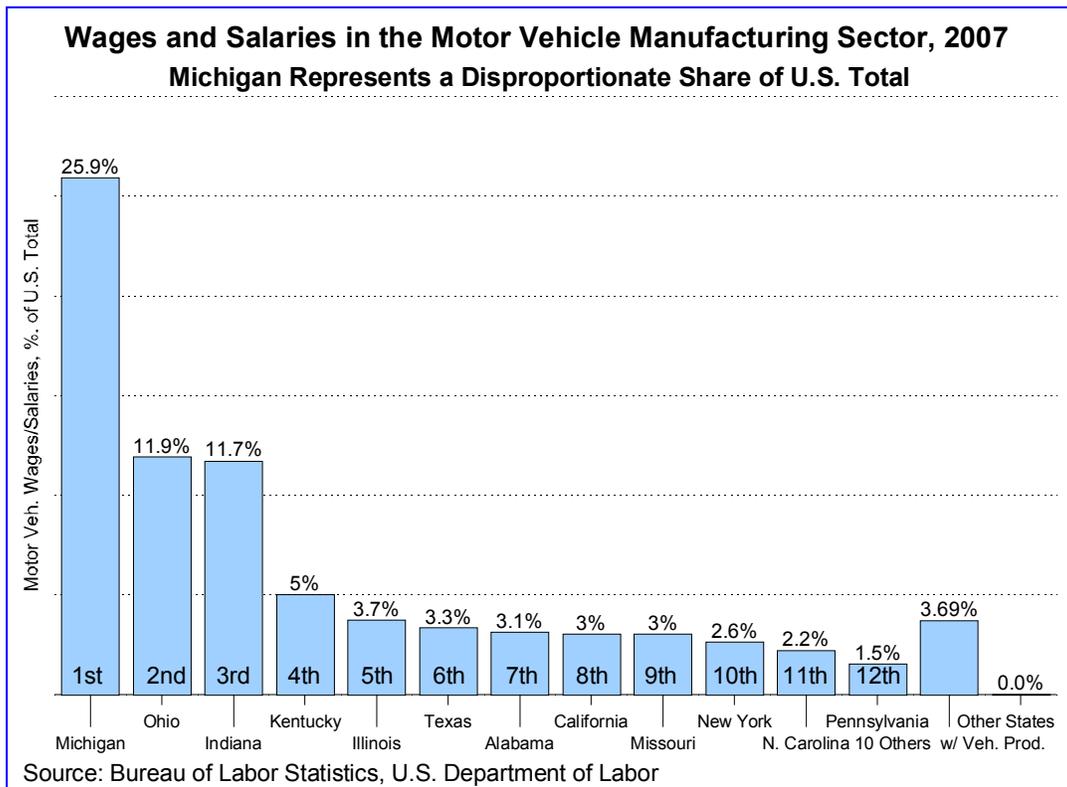


Figure 12

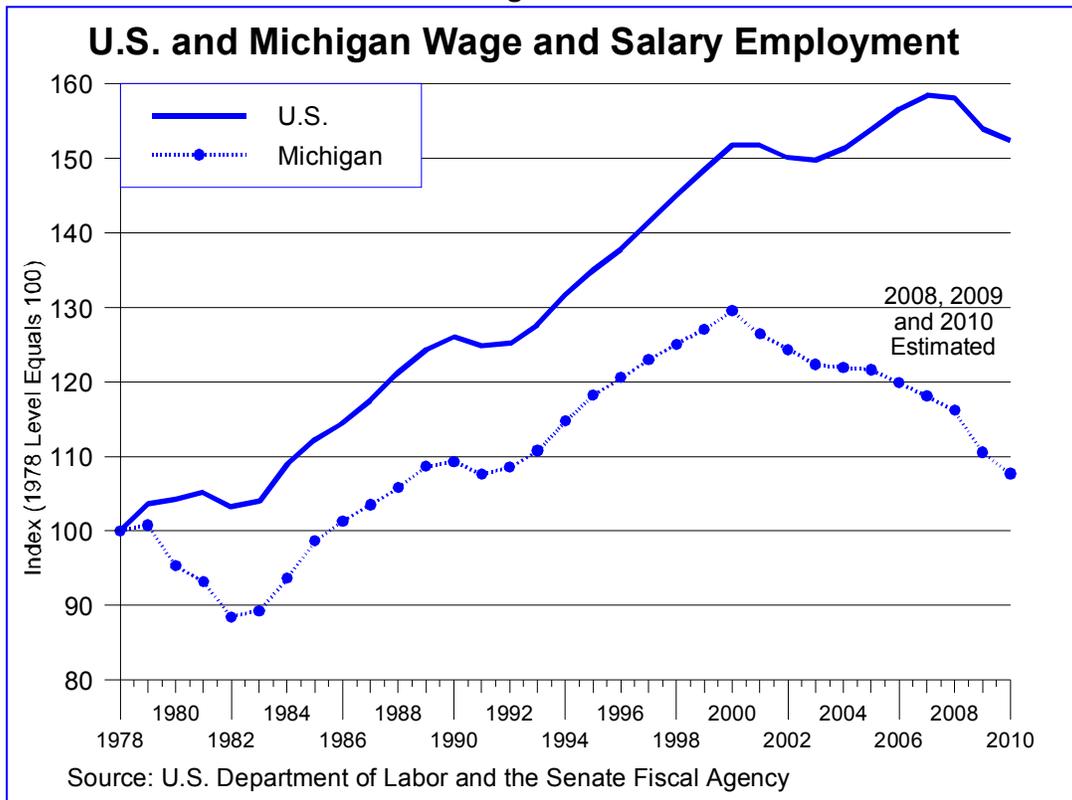


FORECAST SUMMARY

The U.S. economy is expected to contract in 2009 before exhibiting relatively weak growth in 2010, while the Michigan economy will remain in recession over the forecast period. Table 1 and Table 2 provide a summary of key economic indicators from the SFA's economic forecast, with references to recent years. Inflation-adjusted GDP is projected to rise 1.1% in 2008 and decline 2.4% in 2009, followed by an increase of 1.5% in 2010. The contraction during 2009 primarily reflects declines in consumption, including substantially lower light vehicle sales, and weak residential and business investment. The unemployment rate is expected to increase, from an expected 5.6% during 2008 to 8.2% in 2009 and 8.9% in 2010.

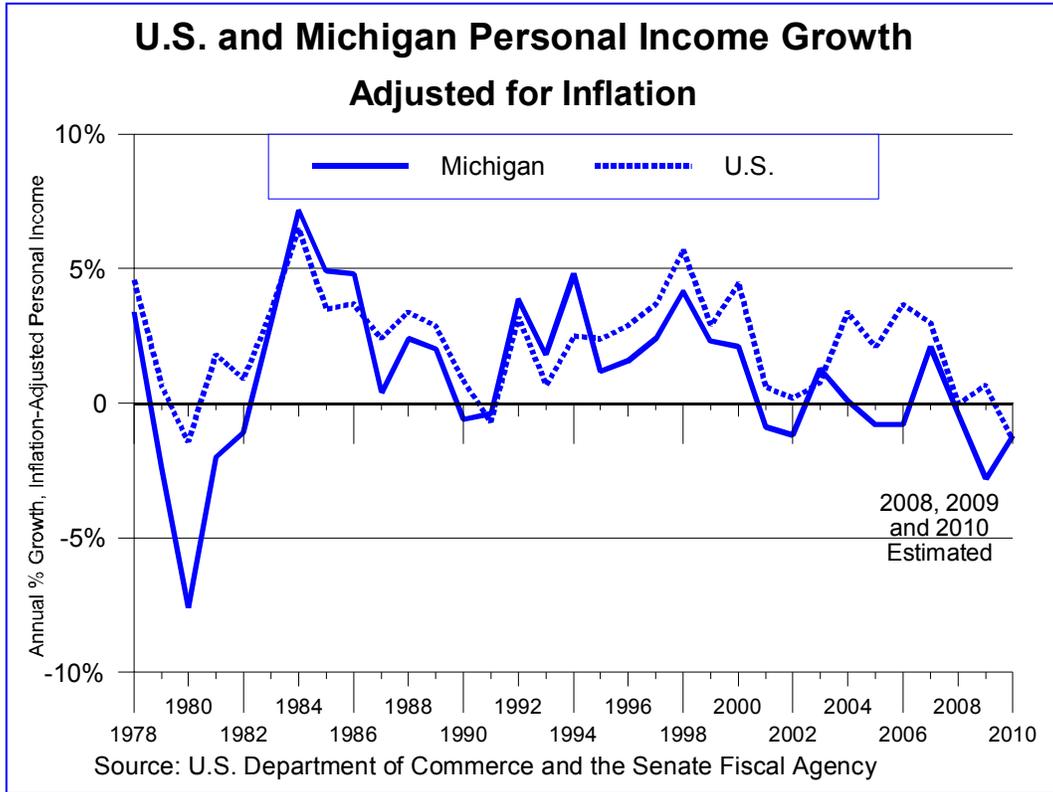
In Michigan, both job growth and personal income growth are expected to remain below the national average and the historical State average and to spend the forecast period in recession (Figures 13 and 14). Inflation-adjusted personal income is projected to fall 0.4% in 2008, followed by a drop of 2.8% in 2009 and 1.2% in 2010. After employment falls an expected 4.8% during 2009, the rate of employment declines should begin tapering during 2010, although employment is still forecast to decline 2.6%. The declines in wage and salary employment will extend the period of employment declines to 10 consecutive years, the longest period on record. These declines will reflect continued high productivity and competitive pressures, particularly in the manufacturing sector, but will be amplified by the global recession and the financial crisis. Nationally, light vehicle sales are expected to decline to 13.1 million units in 2008 and 10.5 million units in 2009, before rising to 11.9 million units in 2010. Declining vehicle sales, combined with productivity improvements and declining market share for domestic vehicle manufacturers, will depress employment and labor force participation. In Michigan, as a result, the unemployment rate will increase from 8.2% in 2008 to 10.6% in 2009 and 11.3% in 2010, keeping the Michigan unemployment rate well above the national average.

Figure 13



Compared with the May 16, 2008, Consensus Economic Forecast, both the U.S. and Michigan forecasts for 2008 and 2009 are considerably weaker. Income and employment growth is weaker at both the State and national levels, and unemployment is higher than was forecast in May. Inflation measures are expected to be lower than was predicted in May.

Figure 14



FORECAST ASSUMPTIONS AND RISKS

Assumptions

Forecasting the behavior of the economy requires making assumptions about the behavior of certain key economic variables. The current SFA forecast for 2009 and 2010 is based upon the following assumptions:

Monetary Policy. As of the beginning of December 2008, the Federal funds rate target was 1.0%, down 325 basis points from the beginning of the year. Most of the reduction in the rate was expected in the May 2008 consensus estimate and reflects the Federal Reserve Board of Governor's concerns regarding liquidity constraints arising from the slowdown in the housing market and the collapse of many financial markets. The forecast assumes that inflation will remain minimal and that there is some risk of deflation, particularly during early 2009, reflecting both the slower economy and the rapid drop in energy prices. The Federal Reserve is expected to do what it can to stimulate the economy, but with the Federal funds rate lowered on December 16, 2008, to a floating target between 0 and 25 basis points, there is little more that monetary policy can do in terms of lowering short-term rates. Such a low rate is expected to be viewed by the Federal Reserve Board with substantial discomfort and, as a result, interest rates are anticipated to increase minimally at the first sign of improvement in the economy, expected in the second half of 2009. Increases in the Federal funds rate are expected to be minimal over the forecast period, as the Federal Reserve

seeks to increase rates without reducing relatively anemic growth rates. The Federal funds rate thus is predicted to remain at current levels through much of 2009, reaching 0.50% by the end of 2009 and 1.5% by the end of 2010.

Foreign Economies. Many of the U.S.'s key trading partners' economies are expected to grow more slowly than the U.S. economy during 2009 and most of 2010. After an expected decline of 4.6% during 2008, the dollar is expected to rise in value 7.6% during 2009 before falling 2.0% during 2010. Much of the 2009 increase in the value of the dollar will reflect substantial appreciation in the currency during the latter half of 2008 and the first quarter of 2009. As a result, the forecast predicts that the trade deficit will finish the forecast period roughly where it is currently, improving during 2008 and 2009 and then growing again in 2010.

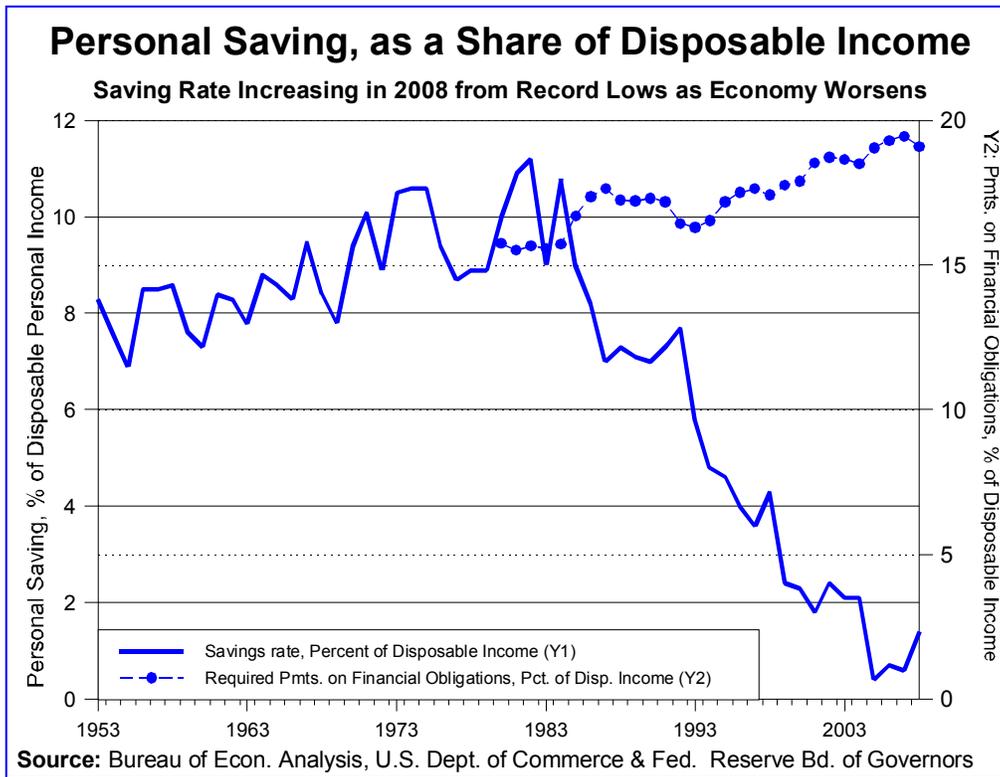
Oil and Energy Prices. The forecast expects oil prices to remain at current levels through much of 2009, averaging slightly over \$50 a barrel, down substantially from the \$130-per-barrel averages of the summer of 2008. As the economy improves somewhat in 2010, the price of West Texas intermediate crude is expected to rise, averaging near \$80 per barrel. Other energy prices are expected to follow roughly the same pattern over the forecast period.

Risks to the Forecast

All forecasts carry a certain amount of error, but the chances that a forecast will err substantially depends upon certain risks to economic fundamentals upon which the forecast is built. The May 2008 forecast highlighted the increased amount of uncertainty facing the economy during 2008 and the heightened risk of recession. The challenge for the current forecast is to determine when the current volatility in the markets will subside and when the economy will make the adjustments required to grow again. Such turning points are notoriously difficult to predict, and this determination is made more difficult by the degree of uncertainty regarding adjustments different sectors will make to the changed economic and financial landscape. The current economic forecast faces a number of risks, with many suggesting that in inflation-adjusted terms, the economy could be weaker than forecasted and the recession could last much longer than predicted.

Consumer Behavior. Consumption growth remained moderate throughout the slow recovery during the first part of the decade, largely through increased borrowing and housing refinance activity. Households generally felt wealthier, despite flat or declining inflation-adjusted wages, because the stock market was improving and home values were soaring. Consumers continued to load on debt, spending in excess of income, even as higher interest rates worsened the burden of servicing consumer debt ([Figure 15](#)). That burden reached an all-time high in the fourth quarter of 2006 and has remained near that level. Weak financial markets and declining housing prices have now induced consumers to rein in their spending. As a result, the saving rate is expected to rise over the forecast from its recent zero-to-negative levels. Under the forecast, the saving rate will spike briefly to as high as 5.5% in early 2009 and then decline to slightly more than 4.0%, a level consistent with the rate in the mid-1990s. However, consumers will need to save at a far higher rate than this to offset their losses in home equity and the stock market, although consumer saving is expected to be hampered by limited income growth and high debt burdens. If the saving rate improves more than expected, such as to levels experienced during the 1980s, both consumption growth and economic growth will be lower. Conversely, consumers could return to their spending habits of the 2000s and growth would be stronger than forecasted.

Figure 15



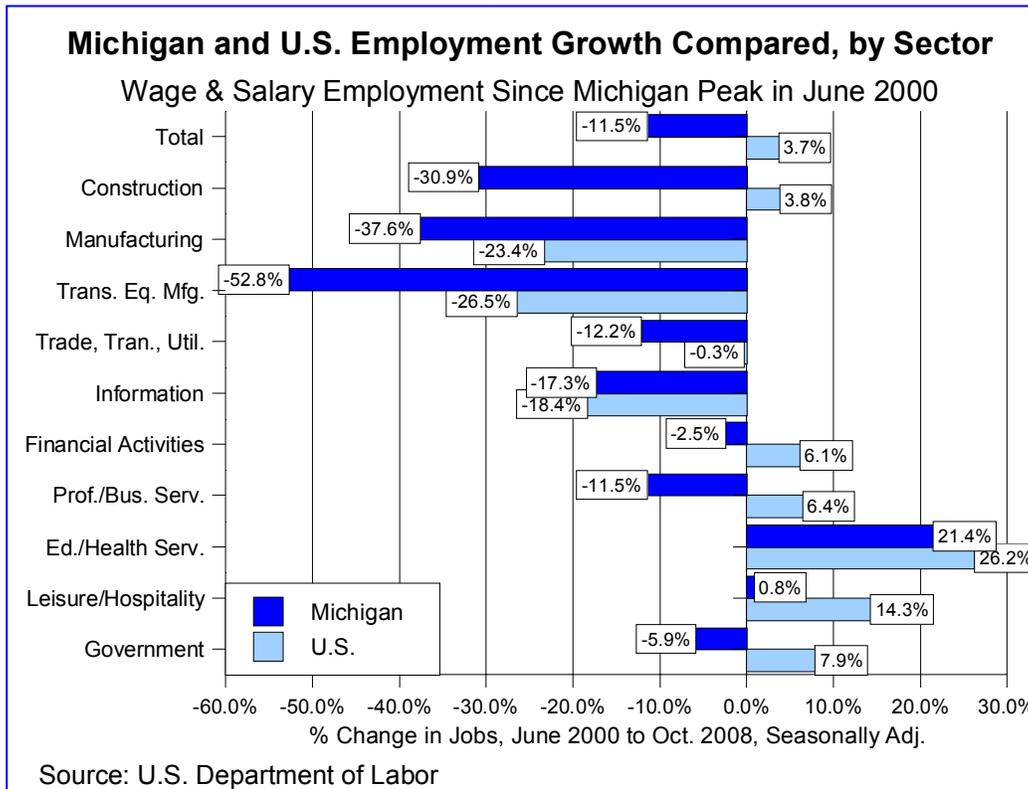
Additionally, consumers have reacted very negatively to recent economic news even though many factors, such as the unemployment rate and inflation, have averaged much lower levels than experienced during recessions such as those in the 1970s and 1980s. While the drops in confidence reflect the relative changes, if the economic situation worsens to levels exhibited in some previous recessions, then confidence in the economy is likely to explore new lows and both consumer spending and investment (and thus economic growth) may be lower than expected.

Inflation. One of the positive aspects in the forecast concerns inflation. Rising energy prices during early 2008 took a heavy toll on business and consumer costs as well as consumer attitudes. Lower energy prices and slower rates of price growth in other sectors should help both improve consumer attitudes and reduce the strain on consumer budgets. However, if energy prices begin rising sooner or more rapidly than expected, such increases likely will reduce growth and/or prolong the recession. Similarly, gains in the dollar during late 2008 and early 2009 are expected to help keep the cost of imported goods and services lower. However, if the value of the dollar drops more rapidly, particularly in 2010, it will add upward pressure to prices by increasing the cost of imports and allowing domestic producers greater pricing power.

The International Economy. Export growth during 2008 largely supported the economy in the face of rising energy and food prices and steadily increasing job losses. However, most foreign economies are currently in recession and many of the U.S.'s major trading partners are experiencing slowdowns more severe than those expected for the U.S. A stronger dollar will improve the competitiveness of foreign imports, but with consumers facing declining incomes and job losses and pursuing higher saving rates, the stronger dollar may not help other countries as much as it would otherwise. If the dollar drops more rapidly than expected or other countries' recoveries are stronger or occur sooner, export growth may improve. Similarly, if other countries remain in recession longer than expected, the slowdown in the U.S. economy will be lengthened.

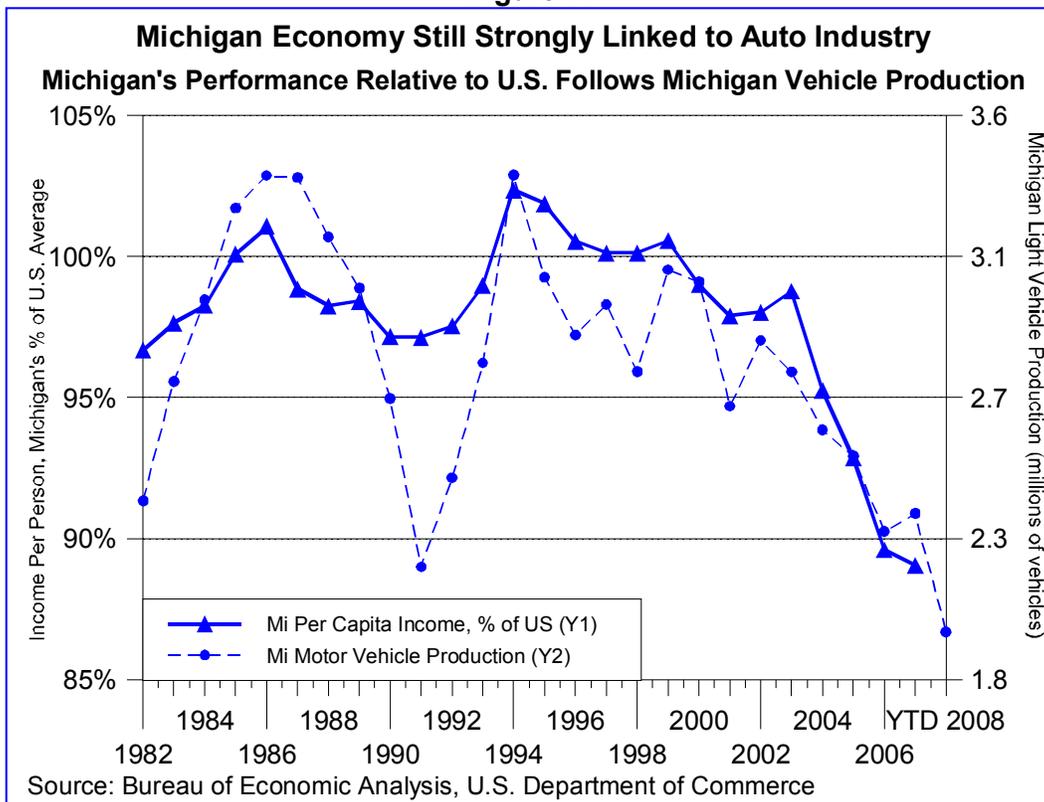
Michigan's Situation. Over the last eight years Michigan's employment situation has fared worse than the national average, and, in some cases or time periods within that range, worse than any other state (Figure 16). Nevertheless, Michigan's performance is not particularly inconsistent with other states when Michigan's economic composition is considered. Generally, states with higher manufacturing concentrations (particularly in the transportation equipment manufacturing sector) have experienced weaker job performance over the last eight years, both because of the economic changes occurring in this sector and because of the dependence of other sectors within those states on manufacturing activity. As indicated earlier, productivity gains have made American manufacturing firms more profitable and more competitive, but have reduced the need for hiring additional employees to meet increased demand.

Figure 16



Weak markets for housing, credit and employment, high energy prices, and substantial debt burdens are expected to exert a dragging force on any increases in demand over the forecast period. Vehicle sales are expected to remain substantially below the levels experienced over the last two decades, while the domestic share of the sales mix is expected to continue declining. Michigan's economic fortunes historically have been very closely linked with sales of domestically produced light vehicles (Figure 17), so it is unclear whether Michigan's employment situation would be much better even if productivity were not rising so rapidly in the motor vehicle sector. However, the combination of high productivity and declining market share has been particularly dramatic: On a seasonally adjusted basis, as of October 2008, Michigan had lost more than one-half of the jobs (52.8%, a decline of nearly 187,000 jobs) in transportation equipment manufacturing that existed during the peak in July 2000.

Figure 17



Complicating the economic landscape, much of the downsizing in the domestic transportation equipment manufacturing sector actually has led auto companies to close facilities in other states more often than in Michigan. While those states were already less reliant on transportation equipment manufacturing, the changes have made them even less dependent. However, this "retreat-to-the-core" strategy means that Michigan's economy has become less reliant on transportation equipment manufacturing at a slower rate than the rest of the country. As a result, while that strategy has preserved more transportation equipment manufacturing jobs in Michigan than might otherwise have been saved, it means that the Michigan economy is likely to remain far more vulnerable to swings in the domestic vehicle manufacturing industry than other states. When compounded by the drastic decline in light vehicle sales expected over the forecast period, it is not surprising that Michigan will remain in recession over this period. As identified in versions of this report prepared for earlier forecasts, even with something approximating normal employment growth in Michigan, it is unlikely that Michigan will reach the level of employment reported in June 2000 again until some time well after the year 2026. Given that those forecasts were prepared before the current recession, it is exceedingly likely that the date when the previous peak will be surpassed has been pushed even farther into the future.

The dilemma for Michigan is that for the economy and tax revenue to improve, employment gains need to occur. However, given Michigan's reliance on the automobile industry and manufacturing and the forecast for demand, employment gains are likely to occur only if productivity growth declines. On the other hand, lower productivity growth will impede the ability of Michigan businesses to compete and to be profitable. Therefore, Michigan is faced with the dilemma that if productivity improves, there will be very little pressure to create additional jobs, although Michigan businesses will be better able to thrive; while if productivity growth falls, there will be a short-term improvement in employment that is likely to be lost as Michigan businesses find it more difficult to compete in the market with firms that are enjoying productivity improvements.

For Michigan, the biggest risks to the forecast are that vehicle sales are even lower than forecasted, that market shares for Michigan-based vehicle manufacturers fall more rapidly than predicted, that Michigan vehicle production is reduced more rapidly and/or by greater amounts than expected, and that the economic slowdown at the national level takes a greater toll on the consumption of nonvehicle-related goods and services provided by Michigan. For eight years, the fundamental changes occurring in manufacturing across the globe combined with falling market shares for Michigan manufacturers to keep Michigan in an employment recession. With the U.S. and world economies entering the most substantial recession experienced in decades, Michigan's opportunities to emerge from its own recession have been reduced. The speed at which Michigan will emerge from the employment recession will depend upon the strength of the markets for Michigan goods and services and how rapidly Michigan producers transform their businesses. However, the faster the transformation is and the slower the national and international economies are, the steeper the decline in Michigan employment will be in the near term.

THE FORECAST FOR STATE REVENUE

This section of the Budget Status Report presents the Senate Fiscal Agency's (SFA's) estimates for General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue. The preliminary year-end revenue for FY 2007-08 is presented along with the revised estimates for FY 2008-09 and the initial revenue estimates for FY 2009-10. The revenue estimates for each of these fiscal years include the estimates for baseline revenue, which measures what the revenue would be without any changes in the State's tax structure, and net revenue, which equals baseline revenue adjusted for the impact of all enacted tax changes. In addition, this revenue represents the revenue generated from ongoing revenue sources and does not include any revenue included in the GF/GP or SAF budgets from one-time revenue adjustments, transfers, or other nonreoccurring revenue items. The one-time revenue adjustments and transfers used to balance the GF/GP and SAF budgets in FY 2007-08 and FY 2008-09 are discussed in the last section of this report.

REVENUE OVERVIEW

The preliminary final GF/GP and SAF revenue for FY 2007-08, along with the revised estimates for FY 2008-09 and the initial estimates for FY 2009-10 are presented in Table 3 and are summarized below.

FY 2007-08 Preliminary Final Revenue:

- GF/GP and SAF revenue totaled \$20.87 billion, which was up 7.2% from FY 2006-07.
- Most of this increase was due to the increase in the income tax rate and the increase in revenue generated from the new Michigan Business Tax.
- On a baseline basis, GF/GP and SAF revenue was up only 0.5% in FY 2007-08.
- GF/GP and SAF revenue exceeded the consensus revenue estimate adopted in May 2008 by \$328.2 million.

FY 2008-09 Revised Revenue Estimate:

- GF/GP and SAF revenue will total an estimated \$19.65 billion in FY 2008-09.
- This revised estimate represents a decline of 5.8% (\$1.2 billion) from FY 2007-08.
- This projected decline in revenue is due primarily to very weak economic activity, but also is due to the negative repercussions of some tax policy changes.
- Compared with the May 2008 consensus revenue estimates, the revised estimate for FY 2008-09 is down \$940.7 million.

FY 2009-10 Initial Revenue Estimate:

- GF/GP and SAF revenue is expected to total \$19.21 billion in FY 2009-10.
- This initial estimate for FY 2009-10 is down 2.2% (\$437.1 million) from the revised estimate for FY 2008-09.
- Ongoing weakness in economic activity is the main reason behind this decline; however, some tax policy changes also contribute to this projected fall in revenue.

Table 3

| SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2008-09 AND FY 2009-10 GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND (Millions of Dollars) | | | |
|--|---|--|--|
| | FY 2007-08 Preliminary Final | FY 2008-09 Revised Estimate | FY 2009-10 Initial Estimate |
| GENERAL FUND/GENERAL PURPOSE | | | |
| Baseline Revenue | \$8,186.0 | \$7,605.7 | \$7,487.4 |
| Tax Changes Not In Baseline | 1,162.6 | 611.0 | 355.2 |
| <u>Revenue After Tax Changes:</u> | | | |
| Net Income Tax | 5,056.2 | 4,403.0 | 4,004.8 |
| SBT, MBT, & Insurance Tax | 2,394.9 | 2,021.6 | 2,027.5 |
| Other Taxes | 1,533.0 | 1,442.6 | 1,467.8 |
| Total Taxes | 8,984.1 | 7,867.2 | 7,500.1 |
| Nontax Revenue | 364.5 | 349.5 | 342.5 |
| TOTAL GF/GP REVENUE¹⁾ | \$9,348.6 | \$8,216.7 | \$7,842.6 |
| SCHOOL AID FUND | | | |
| Baseline SAF | 11,121.0 | 10,643.1 | 10,599.3 |
| Tax Changes Not In Baseline | 397.8 | 791.4 | 772.1 |
| TOTAL SAF REVENUE | \$11,518.8 | \$11,434.5 | \$11,371.4 |
| BASELINE GF/GP & SAF REVENUE | 19,307.0 | 18,248.8 | 18,086.7 |
| Tax & Revenue Changes | 1,560.4 | 1,402.4 | 1,127.3 |
| GF/GP & SAF REV. AFTER CHANGES | \$20,867.4 | \$19,651.2 | \$19,214.0 |
| <u>ADDENDUM:</u> | | | |
| Sales Tax | \$6,770.8 | \$6,570.0 | \$6,593.0 |
| | PERCENT CHANGE | | |
| GENERAL FUND/GENERAL PURPOSE | | | |
| Baseline Revenue | (0.3)% | (7.1)% | (1.6)% |
| <u>Revenue After Tax Changes:</u> | | | |
| Net Income Tax | 16.8 | (12.9) | (9.0) |
| SBT, MBT, & Insurance Tax | 17.4 | (15.6) | 0.3 |
| Other Taxes | (2.6) | (5.9) | 1.7 |
| Total Taxes | 13.1 | (12.4) | (4.7) |
| Nontax Revenue | (2.3) | (4.1) | (2.0) |
| TOTAL GF/GP REVENUE | 12.4% | (12.1)% | (4.6)% |
| SCHOOL AID FUND | | | |
| Baseline SAF | 1.0 | (4.3) | (0.4) |
| TOTAL SAF REVENUE | 3.3% | (0.7)% | (0.6)% |
| BASELINE GF/GP & SAF REVENUE | 0.5 | (5.5) | (0.9) |
| GF/GP & SAF REV. AFTER CHANGES | 7.2% | (5.8)% | (2.2)% |
| <u>ADDENDUM:</u> | | | |
| Sales Tax | 3.3% | (3.0)% | 0.4% |
| ¹⁾ The Single Business Tax (SBT) was replaced with the Michigan Business Tax (MBT) effective January 1, 2008. As a result, FY 2007-08 includes revenue from both the SBT and the MBT and FY 2008-09 and FY 2009-10 include revenue only from the MBT. | | | |

Historical Perspective

The percentage changes in baseline GF/GP and SAF revenue for FY 2008-09 and FY 2009-10 are compared with the actual growth rates experienced during the preceding 20 years in Figure 18. The declines in baseline revenue estimated for FY 2008-09 and FY 2009-10 not only represent the first such declines since baseline revenue fell for three consecutive years from FY 2000-01 through FY 2002-03, but also represent the most severe declines during this time frame. In fact, the 5.5% decline estimated for FY 2008-09 represents a much deeper decline than the 2.7% decrease experienced in FY 1990-91 and the combined decline of about 4.0% experienced in the three-year period from FY 2000-01 through FY 2002-03. The projected decline in baseline revenue, particularly in FY 2008-09, reflects the fact that the current economic recession is expected to be much worse than was experienced in the previous two recessions.

Figure 19 compares the FY 2008-09 and FY 2009-10 estimates for both the GF/GP and SAF revenue from ongoing sources with their respective levels for each of the fiscal years since the Proposal A school finance tax reforms were put in place. General Fund/General Purpose revenue peaked in FY 1999-2000 and then declined for three consecutive years due to a faltering economy and cuts to the income tax and the Single Business Tax. As a result, GF/GP revenue fell to about \$8.0 billion in both FY 2002-03 and FY 2003-04. After remaining at about \$8.3 billion from FY 2004-05 through FY 2006-07, GF/GP revenue jumped to \$9.3 billion in FY 2007-08 due to the increase in the income tax rate and the adoption of, and subsequent increase in, the Michigan Business Tax. The significant decline in GF/GP revenue forecast for FY 2008-09, will reduce GF/GP revenue to its lowest level since FY 2003-04 and the additional decline estimated for FY 2009-10 will lower GF/GP revenue to its lowest level during this 15-year-period. In sharp contrast to the path GF/GP revenue has taken during this period, SAF-earmarked revenue has been on a fairly smooth upward trend and even though the economic downturn is expected to reduce SAF revenue in both FY 2008-09 and FY 2009-10, by the end of FY 2009-10 SAF revenue is expected to remain above the revenue level in FY 2006-07.

Figure 18

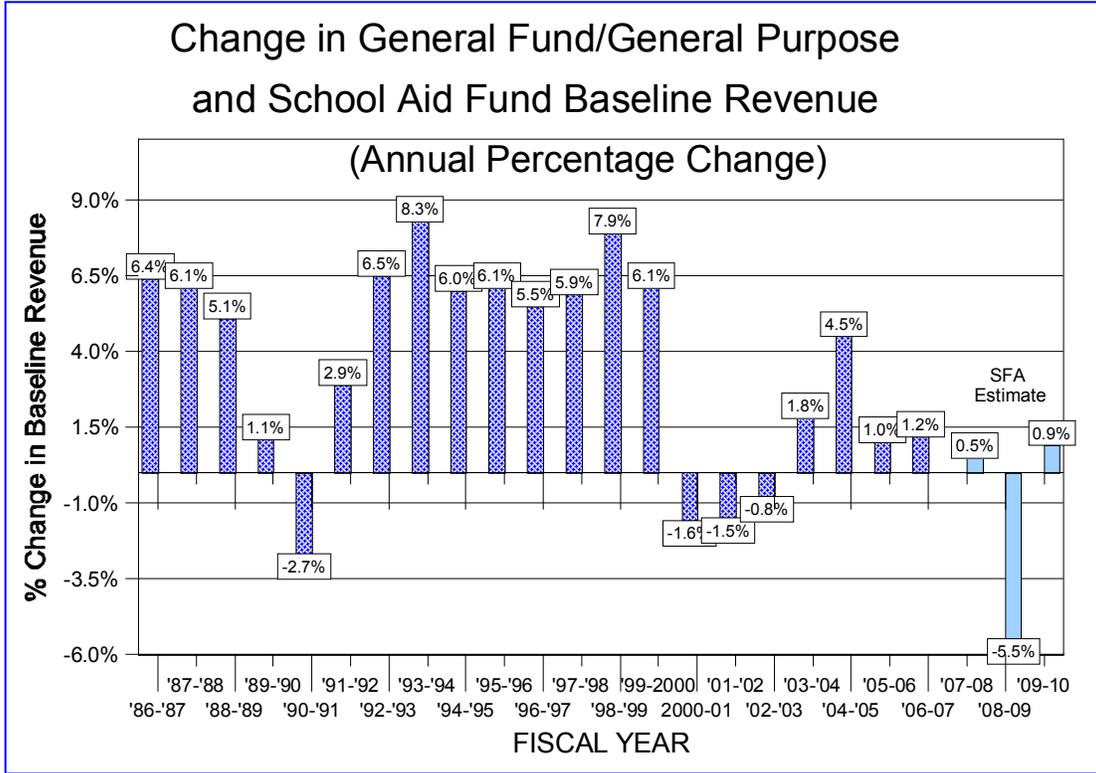
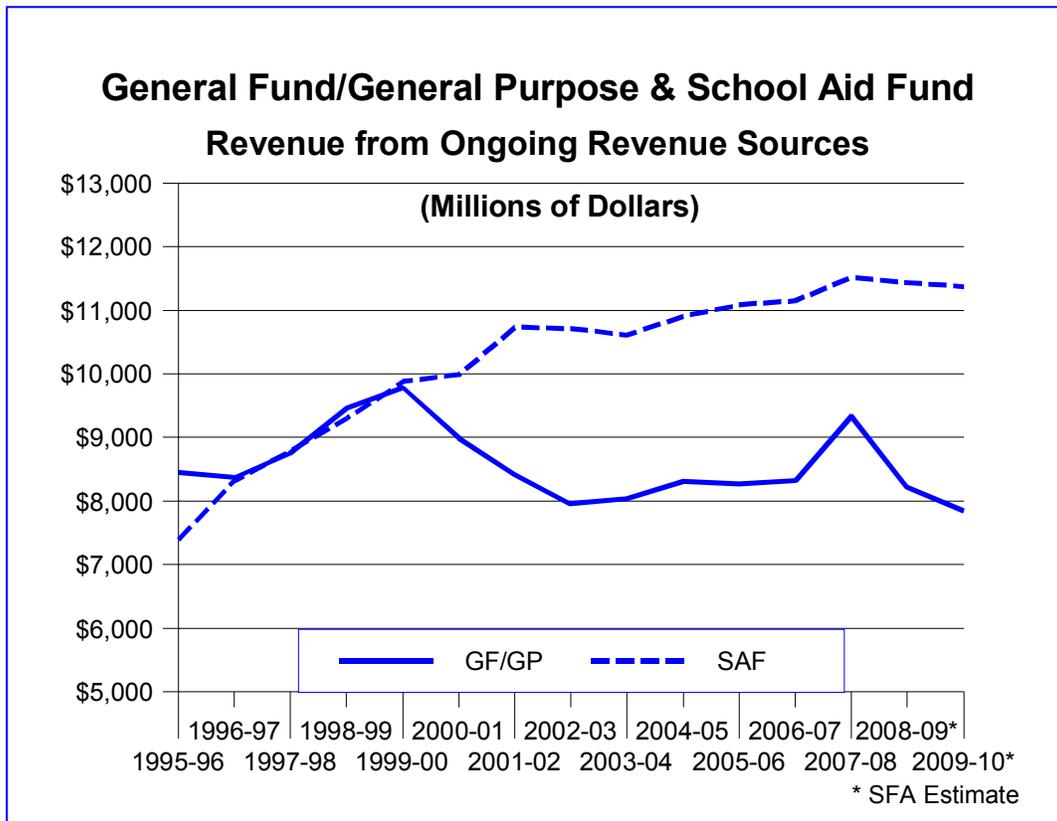


Figure 19



FY 2007-08 PRELIMINARY YEAR-END REVENUE

Based on preliminary year-end book-closing revenue data, GF/GP and SAF revenue from ongoing revenue sources totaled \$20.87 billion in FY 2007-08, which was up a very strong 7.2% from the FY 2006-07 revenue level, as presented in [Table 4](#). While GF/GP and SAF revenue was expected to be up significantly in FY 2007-08 due largely to the enacted tax increases, it came in even higher than was anticipated. The preliminary final revenue level topped the May 2008 consensus revenue estimate by \$328.2 million. Most of this unexpected growth in revenue came from the sales, use, Michigan Business, and State education taxes. Adjusting for the tax changes and the other enacted revenue adjustments, baseline revenue was up only 0.5% in FY 2007-08.

Tax Policy Changes

The strong 7.2% increase in GF/GP and SAF revenue in FY 2007-08 was due in large part the increase in the income tax rate and the adoption of the new Michigan Business Tax.

Income Tax Rate Increase. The income tax rate was increased from 3.9% to 4.35% effective October 1, 2007. This increase generated an estimated \$744.4 million in new revenue in FY 2007-08 and all of this revenue went to the General Fund.

Michigan Business Tax. A major business tax restructuring went into effect in FY 2007-08 as the Single Business Tax was repealed effective January 1, 2008, and replaced with the new Michigan Business Tax. The Single Business Tax was a modified value-added tax and the Michigan Business Tax includes a business income tax, a modified gross receipts tax that resembles a value-added tax, and numerous tax credits that are applied to the combined income/gross receipts tax liability. This business tax restructuring also included some reductions in property taxes on personal property. An expansion of the use tax to include some services also was enacted when the income tax rate was increased, but was subsequently repealed just when it was supposed to go into effect. To help replace the revenue that was anticipated from the expansion of the use tax, a surcharge was added to the Michigan Business Tax equal to 21.99% of the combined business income/gross receipts tax liability before credits. It is estimated that the new Michigan Business Tax generated \$624.9 million more than the Single Business Tax would have generated had it been in effect for all of FY 2007-08. Most of this new revenue is due to the surcharge on the Michigan Business Tax.

General Fund/General Purpose

General Fund/General Purpose revenue totaled \$9.35 billion in FY 2007-08, which was up 12.4% from FY 2006-07. This preliminary year-end revenue level is \$184.6 million above the May 2008 consensus revenue estimate. This increase from the May consensus revenue estimate was due primarily to unexpected increases in the single business, sales, use, oil and gas severance, and the new Michigan Business Tax. A breakdown of GF/GP revenue for FY 2007-08 is presented in [Table 4](#).

School Aid Fund

The tax and lottery revenue earmarked to the SAF totaled \$11.52 billion in FY 2007-08, which was up 3.3% from the FY 2006-07 revenue level. This increase was primarily due to growth in sales and casino tax revenue. Compared with the May 2008 consensus revenue estimate, SAF revenue was up \$143.8 million, due largely to better-than-expected collections from the sales, use, State education, and industrial facility taxes. The preliminary final SAF revenue for FY 2007-08 also is presented in [Table 4](#).

Table 4
FY 2007-08 PRELIMINARY FINAL REVENUE
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

| | FY 2006-07 Final | FY 2007-08 Preliminary Final | Change from FY 2006-07 | | \$ Change from 05/08 Consensus |
|--|---------------------|------------------------------------|------------------------|-------------------|--------------------------------------|
| | | | Dollar Change | Percent Change | |
| GENERAL FUND/GENERAL PURPOSE: | | | | | |
| Baseline Revenue | \$8,279.7 | \$8,255.4 | \$(24.3) | (0.3)% | --- |
| Tax Changes Not In Baseline | 38.0 | 1,093.1 | 1,055.1 | --- | --- |
| <u>Revenue After Tax Changes</u> | | | | | |
| <u>Personal Income Tax</u> | | | | | |
| Gross Collections | 8,129.4 | 8,995.4 | 866.0 | 10.7 | (4.0) |
| Less: Refunds | (1,687.3) | (1,820.5) | (133.2) | 7.9 | 5.0 |
| Net Income Tax Collections | 6,442.1 | 7,174.9 | 732.8 | 11.4 | 1.0 |
| Less: Earmarking to SAF Campaign Fund | (2,110.2) (1.2) | (2,117.2) (1.5) | (7.0) (0.3) | 0.3 25.0 | 0.9 0.0 |
| Net Income Tax to GF/GP | \$4,330.7 | \$5,056.2 | \$725.5 | 16.8% | \$1.9 |
| <u>Other Taxes</u> | | | | | |
| Single Business Tax | 1,816.1 | 640.6 | (1,175.5) | (64.7) | 80.0 |
| Michigan Business Tax | 0.0 | 1,525.3 | --- | --- | 50.0 |
| Sales | 83.2 | 82.9 | (0.3) | (0.4) | 10.7 |
| Use | 920.0 | 918.0 | (2.0) | (0.2) | 26.0 |
| Cigarette | 225.4 | 213.8 | (11.6) | (5.1) | (2.2) |
| Insurance Company Premiums | 223.8 | 229.0 | 5.2 | 2.3 | (15.0) |
| Telephone & Telegraph | 87.3 | 79.0 | (8.3) | (9.5) | 0.0 |
| Estate | 0.7 | 0.0 | (0.7) | (100.0) | 0.0 |
| Oil & Gas Severance | 72.0 | 99.0 | 27.0 | 37.5 | 13.0 |
| Casino Wagering | 46.1 | 12.7 | (33.4) | --- | (4.2) |
| All Other | 139.4 | 127.6 | (11.8) | (8.5) | 0.0 |
| Subtotal Other Taxes | \$3,614.0 | \$3,927.9 | \$313.9 | 8.7% | \$158.4 |
| Total Nontax Revenue | 373.0 | 364.5 | (8.5) | (2.3) | 24.2 |
| GF/GP REV. AFTER TAX CHANGES | \$8,317.7 | \$9,348.6 | \$1,030.9 | 12.4% | \$184.6 |
| SCHOOL AID FUND: | | | | | |
| Baseline Revenue | \$11,149.7 | \$11,263.2 | \$113.5 | 1.0% | --- |
| Tax Changes Not In Baseline | 3.4 | 255.7 | 252.3 | 7,419.2 | --- |
| <u>Revenue After Tax Changes</u> | | | | | |
| Sales Tax | 4,768.5 | 4,926.3 | 157.8 | 3.3 | 89.5 |
| Lottery Revenue | 748.9 | 740.7 | (8.2) | (1.1) | (8.5) |
| State Education Property Tax | 2,081.0 | 2,088.3 | 7.3 | 0.4 | 60.0 |
| Real Estate Transfer Tax | 237.5 | 175.0 | (62.5) | (26.3) | (14.0) |
| Michigan Business Tax | 0.0 | 341.0 | --- | --- | 0.0 |
| Income Tax | 2,110.2 | 2,117.2 | 7.0 | 0.3 | (0.9) |
| Casino Tax | 106.7 | 112.1 | 5.4 | 5.1 | (8.7) |
| Other Revenue | 1,100.3 | 1,018.2 | (82.1) | (7.5) | 26.4 |
| SAF REV. AFTER TAX CHANGES | \$11,153.1 | \$11,518.9 | \$365.7 | 3.3% | \$143.8 |
| BASELINE GF/GP AND SAF | \$19,429.5 | \$19,518.6 | \$89.2 | 0.5% | --- |
| Tax & Revenue Changes | 41.4 | 1,348.8 | 1,307.4 | --- | --- |
| GF/GP & SAF REV. AFTER CHNGS | \$19,470.9 | \$20,867.4 | \$1,396.6 | 7.2% | \$328.2 |
| SALES TAX | \$6,552.2 | \$6,770.8 | \$218.6 | 3.3% | \$122.0 |

Note: FY 2006-07 is the base year for baseline revenue.

REVISED REVENUE ESTIMATES FOR FY 2008-09

General Fund/General Purpose and SAF revenue is expected to total \$19.65 billion in FY 2008-09, which represents a decrease of 5.8% from FY 2007-08. This anticipated significant reduction in revenue is based on the contraction in economic activity forecast for 2009. All of the major taxes earmarked to the GF/GP and/or SAF budgets, including the income, sales, use, State education, and tobacco taxes, are expected to experience a decline in revenue during FY 2008-09 compared with FY 2007-08. This revised estimate of GF/GP and SAF revenue for FY 2008-09 is down \$940.7 million from the May 2008 consensus estimate, on which the enacted budgets were based. On a baseline basis, GF/GP and SAF revenue is projected to fall 5.5% in FY 2008-09. The revised GF/GP and SAF revenue estimates for FY 2008-09 are summarized in Table 6.

Tax Policy Changes

New tax policy changes that will have their initial revenue impact during FY 2008-09 include two new tax credits: an earned income tax credit and film-related tax credits.

Earned Income Tax Credit. A new earned income tax credit, administered through the income tax, went into effect for the 2008 tax year; therefore, eligible taxpayers will claim this credit for the first time when they file their 2008 tax returns in 2009. This Michigan earned income tax credit equals 10.0% of the Federal earned income tax credit for the 2008 tax year and then increases to 20.0% of the Federal credit beginning in 2009. It is estimated that this new credit will reduce income tax revenue \$148.6 million in FY 2008-09 and all of this loss will reduce GF/GP revenue.

Film Credits. Three Michigan Business Tax credits related to film industry activity were enacted in 2008. Film production companies may claim 1) a production credit, which allows the companies to receive a refundable credit equal to 40.0% of their direct production expenditures in Michigan, 2) a job training credit equal to 50.0% of qualified expenses incurred in training workers for film industry jobs, and 3) an infrastructure credit equal to 25.0% of cost to construct a film-related production facility. These credits are expected to reduce Michigan Business Tax revenue directly by \$120.7 million in FY 2008-09; however, the new business activity these credits will attract will generate new income, sales, and Michigan Business Tax receipts totaling an estimated \$21.6 million. Therefore, the new film credits will result in a net overall reduction in revenue equal to an estimated \$99.1 million in FY 2008-09, as shown in Table 5.

Table 5

| ESTIMATED FISCAL IMPACT OF NEW MICHIGAN BUSINESS TAX FILM CREDIT | | |
|---|-------------------|-------------------|
| (Millions of Dollars) | | |
| Tax Affected | FY 2008-09 | FY 2009-10 |
| <u>Direct Impact</u> | | |
| <u>Michigan Business Tax:</u> | | |
| Production Cost Credit..... | (\$113.0) | (\$226.0) |
| Job Training Credit..... | (1.6) | (3.2) |
| Infrastructure Credit..... | <u>(6.1)</u> | <u>(12.2)</u> |
| Subtotal Film Credits..... | (120.7) | (241.4) |
| <u>Secondary Impact</u> | | |
| Individual Income Tax..... | \$6.1 | \$12.2 |
| Sales Tax..... | 13.0 | 26.0 |
| Michigan Business Tax..... | <u>2.5</u> | <u>5.0</u> |
| Subtotal..... | \$21.6 | \$43.2 |
| Net Fiscal Impact..... | (\$99.1) | (\$198.2) |
| <u>Fiscal Impact by Fund:</u> | | |
| GF/GP..... | (110.0) | (220.1) |
| SAF..... | 10.9 | 21.9 |

General Fund/General Purpose

General Fund/General Purpose revenue will total an estimated \$8.22 billion in FY 2008-09, which is down 12.1% or \$1.13 billion from FY 2007-08. This large decline primarily reflects the serious economic downturn, but the new earned income and film tax credits described above also contribute to this projected revenue decline. This revised estimate for GF/GP revenue is \$668.0 million below the May 2008 consensus revenue estimate. The major weakness in GF/GP revenue in FY 2008-09 is expected to be the revenue generated by the income tax. Continued declines in employment, the stock market, dividend payments, and other investment income and capital gains, will reduce gross income tax collections an estimated 6.2%. Making the situation even worse, income tax refunds also are expected to increase, due in part to the new earned income tax credit (described above). As can be seen in [Figure 19](#), the decline in GF/GP revenue in FY 2008-09 is expected basically to eliminate the increase in revenue that was generated in FY 2007-08 from the income tax increase and the boost in business tax revenue.

School Aid Fund

School Aid Fund revenue from earmarked taxes and the lottery is expected to total \$11.43 billion in FY 2008-09, which represents a decline of 0.7% or \$84.4 million from the FY 2007-08 level. The revenue derived from most of the major earmarked taxes is expected to decline in FY 2008-09 due to the weak level of economic activity forecast, including the sales, use, State education, real estate transfer, income, and tobacco taxes. In addition, the net revenue generated by the lottery is expected to fall from its FY 2007-08 level. Offsetting some of the projected declines will be an increase in the earmarking to the SAF from the Michigan Business Tax. Statute specifies that in FY 2008-09, the Michigan Business Tax earmarking will increase to \$729.0 million from the \$341.0 million transferred in FY 2007-08. This large increase in the amount of Michigan Business Tax revenue earmarked to the SAF is designed to reimburse the SAF for increased School Aid payments that will have to be made to local school districts beginning in FY 2008-09 due to new personal property tax exemptions from the local school 18-mill property tax that were a component of the overall enacted business tax reform. On a baseline basis, SAF revenue is expected to be down 4.3% in FY 2008-09. This revised estimate for SAF-earmarked revenue is \$272.8 million below the May 2008 consensus revenue estimate, and the major downward revisions occurred in the income tax, sales tax, real estate transfer tax, and lottery revenue estimates. The revised SAF revenue estimates for FY 2008-09 are summarized in [Table 6](#).

Table 6
FY 2008-09 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

| | FY 2007-08 Preliminary Final | FY 2008-09 Revised Est. | Change from FY 2007-08 | | \$ Change from 05/08 Consensus |
|---|------------------------------------|----------------------------|------------------------|-------------------|--------------------------------------|
| | | | Dollar Change | Percent Change | |
| GENERAL FUND/GENERAL PURPOSE: | | | | | |
| Baseline Revenue | \$8,186.0 | \$7,605.7 | \$(580.4) | (7.1)% | --- |
| Tax Changes Not In Baseline | 1,162.6 | 611.0 | (551.5) | --- | --- |
| <u>Revenue After Tax Changes</u> | | | | | |
| <u>Personal Income Tax</u> | | | | | |
| Gross Collections | 8,995.4 | 8,440.9 | (554.5) | (6.2) | (614.8) |
| Less: Refunds | (1,820.5) | (2,056.5) | (236.0) | 13.0 | (10.4) |
| Net Income Tax Collections | 7,174.9 | 6,384.4 | (790.5) | (11.0) | (625.2) |
| Less: Earmarking to SAF | (2,117.2) | (1,979.9) | 137.3 | (6.5) | 131.6 |
| Campaign Fund | (1.5) | (1.5) | 0.0 | 0.0 | 0.0 |
| Net Income Tax to GF/GP | \$5,056.2 | \$4,403.0 | \$(653.2) | (12.9)% | \$(493.6) |
| <u>Other Taxes</u> | | | | | |
| Single Business Tax | 640.6 | 0.0 | (640.6) | (100.0) | 0.0 |
| Michigan Business Tax | 1,525.3 | 1,781.6 | 256.3 | 16.8 | (150.0) |
| Sales | 82.9 | 89.5 | 6.6 | 8.0 | (0.2) |
| Use | 918.0 | 876.7 | (41.3) | (4.5) | (0.7) |
| Cigarette | 213.8 | 209.2 | (4.7) | (2.2) | (2.4) |
| Insurance Company Premiums | 229.0 | 240.0 | 11.0 | 4.8 | (20.0) |
| Telephone & Telegraph | 79.0 | 71.0 | (8.0) | (10.1) | (4.0) |
| Estate | 99.0 | 63.0 | (36.0) | (36.4) | (20.0) |
| Oil & Gas Severance | 12.7 | 5.8 | (6.9) | (54.3) | 5.8 |
| Casino Wagering | 127.6 | 127.5 | (0.1) | (0.1) | 0.0 |
| All Other | 3,927.9 | 3,464.2 | (463.7) | (11.8) | (191.4) |
| Subtotal Other Taxes | \$640.6 | \$0.0 | \$(640.6) | (100.0)% | \$0.0 |
| Total Nontax Revenue | 364.5 | 349.5 | (15.0) | (4.1) | 17.2 |
| GF/GP REV. AFTER TAX CHANGES | \$9,348.6 | \$8,216.7 | \$(1,131.9) | (12.1)% | \$(668.0) |
| SCHOOL AID FUND: | | | | | |
| Baseline Revenue ¹⁾ | \$11,121.0 | \$10,643.1 | \$(477.9) | (4.3)% | --- |
| Tax Changes Not In Baseline | 397.8 | 791.4 | 393.5 | --- | --- |
| <u>Revenue After Tax Changes</u> | | | | | |
| Sales Tax | 4,926.3 | 4,777.9 | (148.4) | (3.0) | (55.0) |
| Lottery Revenue | 740.7 | 681.0 | (59.7) | (8.1) | (66.6) |
| State Education Property Tax | 2,088.3 | 2,020.5 | (67.8) | (3.2) | 5.0 |
| Real Estate Transfer Tax | 175.0 | 157.0 | (18.0) | (10.3) | (20.0) |
| Michigan Business Tax | 341.0 | 729.0 | 388.0 | 113.8 | 0.0 |
| Income Tax | 2,117.2 | 1,979.9 | (137.3) | (6.5) | (131.6) |
| Casino Tax | 112.1 | 119.3 | 7.2 | 6.4 | 0.7 |
| Other Revenue | 1,018.2 | 969.8 | (48.4) | (4.8) | (5.3) |
| SAF REV. AFTER TAX CHANGES | \$11,518.8 | \$11,434.5 | \$(84.4) | (0.7)% | \$(272.8) |
| BASELINE GF/GP AND SAF | \$19,307.0 | \$18,248.8 | \$(1,058.3) | (5.5)% | --- |
| Tax & Revenue Changes | 1,560.4 | 1,402.4 | (158.0) | --- | --- |
| GF/GP & SAF REV. AFTER CHNGS | \$20,867.4 | \$19,651.2 | \$(1,216.3) | (5.8)% | \$(940.7) |
| SALES TAX | \$6,770.8 | \$6,570.0 | \$(200.8) | (3.0)% | \$(75.0) |

¹⁾ FY 2007-08 is the base year for baseline revenue.

FY 2009-10 INITIAL REVENUE ESTIMATES

The level of economic activity in Michigan is expected to contract again in FY 2009-10, albeit at a slower rate than is expected in FY 2008-09, and combined with expected increases in the impacts from the new tax credits that are going into effect in FY 2008-09 will reduce GF/GP and SAF revenue again in FY 2009-10. Total GF/GP and SAF revenue will be an estimated \$19.21 billion in FY 2009-10, which represents a decline of 2.2% or \$437.1 million from the revised estimate for FY 2008-09. On a baseline basis, GF/GP and SAF revenue is expected to fall 0.9% in FY 2009-10. The initial estimate of GF/GP and SAF revenue for FY 2009-10 is summarized in [Table 7](#).

Tax Policy Changes

No new tax policy changes have yet been enacted that will go into effect in FY 2009-10; however, the fiscal impact of the two new tax credits that initially will occur in FY 2008-09, will experience a significant increase in FY 2009-10.

Earned Income Tax Credit. The earned income tax credit increases from 10.0% of the Federal income tax liability to 20.0% beginning in the 2009 tax year. This means that the earned income tax credits claimed for the 2009 tax year on the income tax returns that will be filed in FY 2009-10 will be much larger than they will be in FY 2008-09. In addition, it is estimated that the economic downturn will push more taxpayers down into the income levels that are eligible for the earned income tax credit. As a result, it is estimated that the earned income tax credit will reduce income tax revenue an estimated \$323.0 million in FY 2009-10, which is up significantly from the \$148.6 million cost expected in FY 2008-09.

Film Credits. The cost of the film credits also is expected to increase significantly in FY 2009-10. Other states that have recently adopted film credits similar to Michigan's, but none of which are as generous as Michigan's credits, have experienced a significant increase in film activity during the second full year the credits have been available. As a result, it is estimated that the net revenue loss due to this State's film credits will double in FY 2009-10 to \$198.2 million from the \$99.1 million cost estimated for FY 2008-09, as shown in [Table 5](#).

General Fund/General Purpose Revenue

General Fund/General Purpose revenue will total an estimated \$7.84 billion in FY 2009-10. This represents a decline of 4.6% or \$374.1 million from the revised estimate for FY 2008-09. As shown in [Figure 19](#), the initial estimate for FY 2009-10 is lower than the level in any other fiscal year during the past 15 years. The rate of decline is not as large as is projected for FY 2008-09, but the reasons for the projected decline are the same: poor economic activity coupled with the loss of tax revenue due to the second-year impacts of the earned income tax credit and film tax credits, as described above. The initial GF/GP revenue estimates for FY 2009-10 are summarized in [Table 7](#).

School Aid Fund

School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$11.37 billion in FY 2009-10, which represents a decline of 0.6% or \$63.1 million from the revised estimate for FY 2008-09. This projected decline will be due primarily to declines in the income and State education taxes, coupled with only very weak growth in the sales and use tax revenue. The initial SAF revenue estimates for FY 2009-10 are summarized in [Table 7](#).

Table 7
FY 2009-10 INITIAL REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

| | FY 2008-09 Rev. Est. | FY 2009-10 Initial Est. | Change from FY 2008-09 | |
|---|-------------------------|----------------------------|------------------------|-------------------|
| | | | Dollar Change | Percent Change |
| GENERAL FUND/GENERAL PURPOSE: | | | | |
| Baseline Revenue: | \$7,605.7 | \$7,487.4 | \$(118.3) | (1.6)% |
| Tax Changes Not In Baseline: | 611.0 | 355.2 | (255.8) | --- |
| Revenue After Tax Changes: | | | | |
| <u>Personal Income Tax</u> | | | | |
| Gross Collections | 8,440.9 | 8,136.7 | (304.2) | (3.6) |
| Less: Refunds | (2,056.5) | (2,203.0) | (146.5) | 7.1 |
| Net Income Tax Collections | 6,384.4 | 5,933.7 | (450.7) | (7.1) |
| Less: Earmarking to SAF | (1,979.9) | (1,927.4) | 52.5 | (2.7) |
| Campaign Fund | (1.5) | (1.5) | 0.0 | 0.0 |
| Net Income Tax to GF/GP | \$4,403.0 | \$4,004.8 | \$(398.2) | (9.0)% |
| <u>Other Taxes</u> | | | | |
| Single Business Tax | 0.0 | 0.0 | 0.0 | --- |
| Michigan Business Tax | 1,781.6 | 1,783.5 | 1.9 | 0.1 |
| Sales | 89.5 | 112.0 | 22.5 | 25.2 |
| Use | 876.7 | 880.7 | 4.0 | 0.5 |
| Cigarette | 209.2 | 204.2 | (4.9) | (2.4) |
| Insurance Company Premiums | 240.0 | 244.0 | 4.0 | 1.7 |
| Telephone & Telegraph | 71.0 | 75.0 | 4.0 | 5.6 |
| Oil & Gas Severance | 63.0 | 68.0 | 5.0 | 7.9 |
| Casino Wagering | 5.8 | 0.0 | (5.8) | (100.0) |
| All Other | 127.5 | 127.9 | 0.4 | 0.3 |
| Subtotal Other Taxes | \$3,464.2 | \$3,495.3 | \$31.1 | 0.9% |
| Total Nontax Revenue | 349.5 | 342.5 | (7.0) | (2.0) |
| GF/GP REVENUE AFTER TAX CHANGES | \$8,216.7 | \$7,842.6 | \$(374.1) | \$(4.6) |
| SCHOOL AID FUND: | | | | |
| Baseline Revenue: | \$10,643.1 | \$10,599.3 | \$(43.8) | (0.4)% |
| Tax Changes Not In Baseline: | 791.4 | 772.1 | (19.3) | --- |
| Revenue After Tax Changes: | | | | |
| Sales Tax | 4,777.9 | 4,794.9 | 17.0 | (0.4) |
| Lottery Revenue | 681.0 | 681.0 | 0.0 | --- |
| State Education Property Tax | 2,020.5 | 1,988.1 | (32.4) | (1.6) |
| Real Estate Transfer Tax | 157.0 | 162.0 | 5.0 | 3.2 |
| Michigan Business Tax | 729.0 | 734.6 | 5.6 | 0.8 |
| Income Tax | 1,979.9 | 1,927.4 | (52.5) | (2.7) |
| Casino Tax | 119.3 | 121.6 | 2.3 | 1.9 |
| Other Revenue | 969.8 | 961.8 | (8.0) | (0.8) |
| SAF REVENUE AFTER TAX CHANGES | \$11,434.5 | \$11,371.4 | \$(63.1) | (0.6)% |
| BASELINE GF/GP AND SAF | \$18,248.8 | \$18,086.7 | \$(162.0) | (0.9)% |
| Tax & Revenue Changes | 1,402.4 | 1,127.3 | (275.1) | --- |
| GF/GP & SAF REV. AFTER TAX CHANGES | \$19,651.2 | \$19,214.0 | \$(437.1) | (2.2)% |
| SALES TAX | \$6,570.0 | \$6,593.0 | \$23.0 | 0.4% |

Note: FY 2007-08 is the base year for baseline revenue.

Major General Fund and School Aid Fund Taxes in FY 2008-09 and FY 2009-10

Income Tax. The income tax will generate an estimated \$6.38 billion in FY 2008-09, which represents a decline of 11.0% from FY 2007-08, and income tax revenue will fall an additional 7.1% in FY 2009-10 to an estimated \$5.93 billion. These declines will be due to sharp falls in employment and income, and the new earned income tax credit. These projected declines in income tax revenue will reduce both GF/GP revenue and SAF revenue. The SAF receives 23.3% of the gross income tax collections (withholding, quarterly, and annual payments), while the GF/GP budget receives 76.7% of gross collections, plus the negative impact of all income tax refunds, including the cost of income tax credits paid out in refunds.

Sales Tax. The severe economic downturn will have negative repercussions on consumer and business spending in 2009, and not much improvement is expected in 2010. As a result, sales tax receipts will fall an estimated 3.0% in FY 2008-09 to \$6.57 billion and then edge up a modest 0.4% to \$6.59 billion in FY 2009-10. Most of the sales tax revenue is earmarked to the SAF (73.3%) and most of the remainder goes to local government revenue sharing payments, the Comprehensive Transportation Fund, and the General Fund. The amount going to revenue sharing includes both constitutional and statutory earmarkings, but over the past several years a significant portion of the amount earmarked statutorily has been diverted to the General Fund. This is discussed further in the last section of this report.

Use Tax. Use tax collections will decrease an estimated 4.5% in FY 2008-09 to \$1.31 billion and then edge up a modest 0.5% in FY 2009-10 to an estimated \$1.32 billion. The GF/GP budget receives two-thirds of use tax revenue and the remaining one-third goes to the SAF.

Tobacco Taxes. Tax collections from the cigarette and other tobacco products taxes will total an estimated \$1.05 billion in FY 2008-09, which represents a decrease of 2.2% from FY 2007-08. In FY 2009-10, tobacco tax revenue is expected to decline another 2.4% to \$1.02 billion. Tobacco tax revenue is earmarked to several different funds including the General Fund and the SAF.

Casino Tax. The State's tax on casinos equals an 8.1% permanent tax on gross gaming receipts plus a temporary rate of 4.0% that each of the three Detroit casinos must pay until they begin operating in their new permanent casinos. All of the revenue generated from the permanent 8.1% tax goes to the SAF, while the revenue from the temporary 4.0% tax goes to the GF/GP budget (3.5%) and the Agriculture Equine Industry Development Fund (0.5%). Two of the three Detroit casinos are now in their permanent facility and the third is expected to be in its permanent facility sometime in the winter of 2009. As a result, after totaling \$126.1 million in FY 2007-08, casino tax revenue will total an estimated \$125.9 million in FY 2008-09 and \$121.6 million in FY 2008-09. The SAF share will increase from \$112.1 million in FY 2007-08 to \$119.3 million in FY 2008-09 and \$121.6 million in FY 2009-10. The GF/GP share will drop from \$12.7 million in FY 2007-08 to \$5.8 million in FY 2008-09 and then to zero in FY 2009-10.

State Education Property Tax. After remaining relatively flat in FY 2007-08, State education property tax revenue is expected to decline 3.2% in FY 2008-09 as continued weakness in the housing sector is expected to further reduce property values. These negative economic forces will ease somewhat in FY 2009-10, but State education property tax revenue is still expected to decline another 1.6% to \$1.93 billion.

Lottery. The economic downturn also is expected to have a negative impact on lottery revenue. After totaling \$740.7 million in FY 2007-08, net lottery revenue is expected to decline 8.1% to \$681.0 million and then remain at this level in FY 2009-10. All of the net revenue generated by the lottery is earmarked to the SAF.

Michigan Business Tax. The Michigan Business Tax generated \$1.87 billion in FY 2007-08. Given that it was the initial year for this tax and the first quarterly payment was not due until April, it was in effect only for a portion of the year. Fiscal year 2008-09 will mark the first full year of this tax and, as a result, total collections will jump an estimated 34.5% to \$2.51 billion. This revised estimate is down \$150.0 million from the May consensus estimate due to the projected economic downturn. In FY 2009-10, Michigan Business Tax revenue will total an estimated \$2.52 billion, essentially unchanged from the FY 2008-09 estimate. According to the law, the SAF will receive \$729.0 million of this business tax revenue in FY 2008-09 and then, in subsequent years, this earmarking will be indexed to the percentage change in the U.S. Consumer Price Index, which will push up the earmarking to the SAF to an estimated \$734.9 million in FY 2009-10.

SENATE FISCAL AGENCY BASELINE REVENUE FORECAST HISTORY

The history of the Senate Fiscal Agency's and consensus estimates for GF/GP and SAF baseline revenue for FY 2007-08 and FY 2008-09 is presented in Tables 8 and 9. Baseline estimates are used to track the forecast history for these two fiscal years in order to avoid the wide swings in revenue estimates that occur when tax changes are enacted. In addition, in order to provide an accurate comparison, all of the previous baseline estimates made for FY 2007-08 and FY 2008-09 have been adjusted to reflect a common base year.

The initial GF/GP and SAF baseline revenue estimate for FY 2007-08 was made in January 2007 at \$19.65 billion, as shown in Table 8. This estimate was lowered by \$359.6 million at the May 2007 Consensus Revenue Estimating Conference. In December 2007, the SFA's revised the estimate down another \$254.4 million to \$19.03 billion, which was essentially the estimate adopted at the January 2008 Consensus Revenue Estimating Conference. In May 2008, the estimate was revised down only slightly. The preliminary final estimate equals \$19.31 billion, which is up \$278.2 million or 1.4% from the May estimate. Compared with the SFA's initial estimate made in January 2007, FY 2007-08 GF/GP and SAF baseline revenue is down \$340.8 million or 1.7%.

The Senate Fiscal Agency's initial GF/GP and SAF baseline revenue estimate for FY 2008-09 of \$19.24 billion was made in December 2007, as shown in Table 9. The estimate adopted at the January 2008 Consensus Revenue Estimating Conference was down \$9.1 million from the SFA's estimate and then at the May 2008 Conference the estimate was lowered another \$259.7 million. Based on the revised economic outlook, the SFA has lowered the GF/GP and SAF baseline estimate another \$721.4 million to \$18.25 billion. This latest significant revision to the FY 2008-09 GF/GP and SAF baseline revenue estimate is \$990.2 million or 5.1% below the SFA's original estimate made in December 2007.

Table 8
CHANGES IN SENATE FISCAL AGENCY
BASELINE REVENUE ESTIMATES FOR FY 2007-08
(Millions of Dollars)

| Forecast Date | GF/GP | SAF | Total |
|---|--------------|------------|--------------|
| January 16, 2007 | \$8,224.1 | \$11,423.7 | \$19,647.8 |
| January 18, 2007 ^{a)} | 8,275.6 | 11,392.6 | 19,668.2 |
| May 17, 2007 | 8,163.4 | 11,146.7 | 19,310.1 |
| May 18, 2007 ^{a)} | 8,141.1 | 11,147.1 | 19,288.2 |
| December 21, 2007 | 8,020.1 | 11,013.7 | 19,033.8 |
| January 18, 2008 ^{a)} | 8,024.0 | 11,008.7 | 19,032.7 |
| May 14, 2008 | 8,059.5 | 10,931.1 | 18,990.6 |
| May 16, 2008 ^{a)} | 8,051.5 | 10,977.3 | 19,028.8 |
| Preliminary Final | 8,186.0 | 11,121.0 | 19,307.0 |
| <u>Change From Previous Estimate:</u> | | | |
| Dollar Change | \$134.5 | \$143.7 | \$278.2 |
| Percent Change | 1.7% | 1.3% | 1.4% |
| <u>Change From Initial Estimate:</u> | | | |
| Dollar Change | \$(38.1) | \$(302.7) | \$(340.8) |
| Percent Change | (0.5)% | (2.6)% | (1.7)% |
| Note: Baseline base year equals FY 2007-08. | | | |
| ^{a)} Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury. | | | |

Table 9
CHANGES IN SENATE FISCAL AGENCY
BASELINE REVENUE ESTIMATES FOR FY 2008-09
(Millions of Dollars)

| Forecast Date | GF/GP | SAF | Total |
|---|--------------|------------|--------------|
| December 21, 2007 | \$8,089.5 | \$11,149.5 | \$19,239.0 |
| January 18, 2008 ^{a)} | 8,094.4 | 11,135.5 | 19,229.9 |
| May 14, 2008 | 8,032.1 | 10,899.8 | 18,931.9 |
| May 16, 2008 ^{a)} | 8,032.6 | 10,937.6 | 18,970.2 |
| December 18, 2008 | 7,605.7 | 10,643.1 | 18,248.8 |
| <u>Change From Previous Estimate:</u> | | | |
| Dollar Change | \$(426.9) | \$(294.5) | \$(721.4) |
| Percent Change | (5.3)% | (2.6)% | (3.8)% |
| <u>Change From Initial Estimate:</u> | | | |
| Dollar Change | \$(483.8) | \$(506.4) | \$(990.2) |
| Percent Change | (6.0)% | (4.5)% | (5.1)% |
| Note: Baseline base year equals FY 2007-08. | | | |
| ^{a)} Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury. | | | |

BUDGET STABILIZATION FUND

The Counter-Cyclical Budget and Economic Stabilization Fund (BSF) was established by Public Act 76 of 1977. The BSF is a cash reserve to which the State, in years of economic growth, adds revenue, and from which, in years of economic recession, the State withdraws revenue. The Fund's purposes are to mitigate the adverse effects on the State budget of downturns in the business cycle and to reserve funds that can be available during periods of high unemployment for State projects that will increase job opportunities.

The requirements for contributions to and withdrawals from the BSF are established in State law. By statute, revenue may be added to the BSF when Michigan personal income, less transfer payments and adjusted for inflation, increases by more than 2.0%. When the growth in real personal income less transfer payments is over 2.0%, the pay-in to the BSF is equal to the percentage growth in excess of 2.0% multiplied by the total General Fund/General Purpose (GF/GP) revenue.

Funds may be transferred out of the BSF for budget stabilization purposes when Michigan personal income less transfer payments, adjusted for inflation, decreases on a calendar-year basis. The withdrawal equals the percentage decline in adjusted real personal income multiplied by the annual GF/GP revenue. Thus, funds contributed to the BSF in growth years are used to supplement current revenue during a recession, reducing the need either to increase taxes or to reduce State services in a time of poor economic conditions.

Withdrawals from the BSF also are permitted for State job creation programs in times of high unemployment. When the State's unemployment rate averages between 8.0% and 11.9% during a calendar quarter, 2.5% of the balance in the BSF may be withdrawn during the subsequent quarter and appropriated for projects that will create job opportunities. If the unemployment rate averages 12.0% or higher for a calendar quarter, up to 5.0% of the BSF balance may be withdrawn.

In order for any payment into or out of the BSF actually to occur under either the personal income or the unemployment rate formula described above, the payment must be appropriated by the Legislature. In addition, the Legislature may appropriate transfers into or out of the BSF even if the formulas do not trigger a transfer. For example, in FY 1998-99, the Legislature appropriated a transfer into the BSF of \$55.2 million in response to the personal income formula; however, the Legislature also appropriated to the BSF the ending balance of the General Fund/General Purpose budget, which equaled \$189.2 million. Also in FY 1998-99, the Legislature appropriated the transfer of \$73.7 million from the BSF to the School Aid Fund to finance scheduled payments to K-12 school districts required under the *Durant* court case.

Table 10 presents the recent history of the BSF in terms of actual transfers into and out of the Fund, interest earnings, and year-end balances from FY 1998-99 through FY 2007-08. Also presented in this table are the SFA's estimates for FY 2008-09 and FY 2009-10. The BSF year-end balance as a percentage of GF/GP and SAF revenue is shown in Figure 20, and the estimated economic stabilization trigger calculations for FY 2008-09 and FY 2009-10 are presented in Table 11.

FY 2007-08

In FY 2007-08, the BSF had a beginning balance of \$2.1 million. During the fiscal year there were no payments into or out of the Fund, but with interest earnings it is estimated that the ending balance will total \$2.2 million at the close of FY 2007-08.

FY 2008-09 and FY 2009-10

Based on the SFA's revised estimates for personal income, transfer payments, and the Detroit Consumer Price Index (CPI), the budget stabilization formula triggers payments out of the Fund equal to \$524.8 million in FY 2008-09 and another \$64.9 million in FY 2009-10, as shown in Table 11. Given that there is only \$2.2 million in the BSF and given that no additional transfers into the BSF were appropriated as part of the FY 2008-09 enacted budget, no transfers out of the BSF are anticipated in either FY 2008-09 or FY 2009-10.

Table 10

| BUDGET AND ECONOMIC STABILIZATION FUND TRANSFERS, EARNINGS AND FUND BALANCE FY 1998-99 TO FY 2009-10 ESTIMATE (Millions of Dollars) | | | | |
|--|---------------|------------------------|----------------|---------------------|
| Fiscal Year | Pay-In | Interest Earned | Pay-Out | Fund Balance |
| 1998-99 | \$244.4 | \$51.2 | \$73.7 | \$1,222.5 |
| 1999-00 | 100.0 | 73.9 | 132.0 | 1,264.4 |
| 2000-01 | 0.0 | 66.7 | 337.0 | 994.2 |
| 2001-02 | 0.0 | 20.8 | 869.8 | 145.2 |
| 2002-03 | 9.1 | 1.8 | 156.1 | 0.0 |
| 2003-04 | 81.3 | 0.0 | 0.0 | 81.3 |
| 2004-05 | 0.0 | 2.0 | 81.3 | 2.0 |
| 2005-06 | 0.0 | 0.0 | 0.0 | 2.0 |
| 2006-07 | 0.0 | 0.1 | 0.0 | 2.1 |
| Senate Fiscal Agency estimates: | | | | |
| 2007-08 | 0.0 | 0.1 | 0.0 | 2.2 |
| 2008-09 | 0.0 | 0.1 | 0.0 | 2.2 |
| 2009-10 | 0.0 | 0.1 | 0.0 | 2.3 |

Figure 20

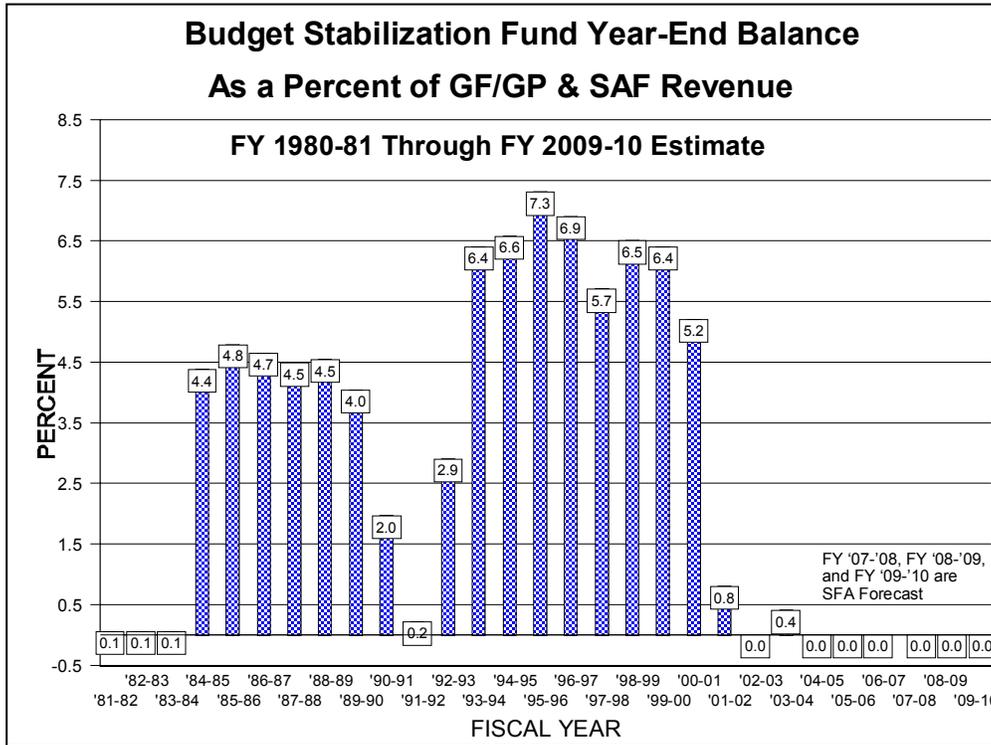


Table 11

| ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER | | | |
|--|----------------|-------------------|-------------------|
| FY 2008-09 AND FY 2009-10 | | | |
| (Millions of Dollars) | | | |
| | CY 2008 | CY 2009 | CY 2010 |
| Michigan Personal Income (MPI) | \$354,066 | \$345,709 | \$348,491 |
| Less: Transfer Payments | 64,525 | 69,447 | 71,995 |
| Subtotal | \$289,541 | \$276,262 | \$276,496 |
| Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1) | 2.027 | 2.066 | 2.085 |
| Equals: Real Adjusted MPI | \$142,842 | \$133,718 | \$132,612 |
| Percent Change from Prior Year | | (6.39)% | (0.83)% |
| Excess Over 2.0% | | 0.00% | 0.00% |
| | | FY 2008-09 | FY 2009-10 |
| Multiplied by: Estimated GF/GP Revenue | | \$8,216.7 | \$7,842.6 |
| Equals: Transfer to the BSF | | 0.0 | 0.0 |
| OR Transfer from the BSF | | \$524.8 | \$64.9 |

Note: Numbers may not add due to rounding.
CY = Calendar Year; FY = Fiscal Year

COMPLIANCE WITH STATE REVENUE LIMIT

Article IX, Section 26 of the Michigan Constitution establishes a limit on the amount of revenue State government may collect in any fiscal year. This section of the Constitution was adopted by a vote of the people in 1978 and the limit was first applicable in FY 1979-80. In the first 15 years this revenue limit was in effect (FY 1979-80 to FY 1993-94), the revenue limit was never exceeded. The largest gap between revenue and the limit occurred in FY 2006-07, when State revenue was \$5.3 billion below the revenue limit. In FY 1994-95, State revenue exceeded the revenue limit, for the first time, by \$109.6 million. This was due to new State revenue being generated as part of the school financing reform that was enacted in 1994. In FY 1995-96 through FY 1997-98, revenue fell below the revenue limit again. In FY 1998-99 and FY 1999-2000, revenue exceeded the limit, but not by enough to require refunds to be paid to taxpayers. In FY 2000-01 through FY 2006-07, revenue fell well below the revenue limit. Based on the Senate Fiscal Agency's (SFA's) latest economic forecast and revenue estimates, it is estimated that revenue subject to the revenue limit remained well below the revenue limit in FY 2007-08 despite increases in the income and Michigan business taxes, and in FY 2008-09 and FY 2009-10, the gap between revenue and the revenue limit is expected to get even larger.

THE REVENUE LIMIT

The revenue limit specifies that for any fiscal year, State government revenue may not exceed a certain percentage of Michigan personal income. The Constitution requires that the limit be calculated each year using the percentage that State government revenue in FY 1978-79 was of Michigan personal income in calendar year 1977. This calculation equals 9.49%. Therefore, for any fiscal year, State government revenue may not exceed 9.49% of Michigan total personal income for the calendar year prior to the calendar year in which the fiscal year begins. For instance, in FY 2008-09, State government revenue may not exceed 9.49% of personal income for calendar year 2007. Given that Michigan personal income for 2007 equaled an estimated \$345,885 million, the revenue limit for FY 2008-09 is \$32,825 million.

State government revenue subject to the limit includes total State government tax revenue and all other State government revenue, such as license fees and interest earnings. For purposes of the limit, State government revenue does not include Federal aid. Personal income is a measure of the total income received by individuals, including wages and salaries, proprietors' income, interest and dividend income, rental income, and transfer payments. It is the broadest measure of overall economic activity for the State of Michigan and is estimated by the U.S. Department of Commerce's Bureau of Economic Analysis.

REQUIREMENTS IF REVENUE LIMIT IS EXCEEDED

If final revenue exceeds the revenue limit, the Constitution and State law provide procedures to deal with this event. If revenue exceeds the limit by less than 1.0%, the excess revenue must be deposited into the Budget Stabilization Fund. If the revenue limit is exceeded by 1.0% or more, the excess revenue must be refunded to income tax and business taxpayers, on a pro-rata basis. These refunds would be given to taxpayers who file an annual income tax or Michigan Business Tax return in the following fiscal year, because these taxpayers would have made withholding and quarterly estimated payments during the fiscal year when the revenue limit was exceeded. The law requires that these refunds occur in the fiscal year following the filing of the report which determines that the limit was exceeded. This report for any particular fiscal year is typically issued in the spring following the end of the fiscal year.

REVENUE LIMIT COMPLIANCE PROJECTIONS

Based on the preliminary final revenue estimates for FY 2007-08 and the SFA's revised revenue estimates for FY 2008-09 and initial estimates for FY 2009-10, it is estimated that revenue subject to the constitutional revenue limit will remain well below the revenue limit for each of these fiscal years. The SFA's estimates of the State's compliance with the revenue limit for each of these three fiscal years are presented in Table 12.

FY 2007-08

In FY 2007-08, the revenue limit is equal to 9.49% of Michigan's personal income in calendar year 2006. According to the U.S. Department of Commerce's Bureau of Economic Analysis, Michigan personal income for 2006 was \$341.1 billion. The revenue limit is 9.49% of this personal income level, which equals \$32.4 billion. Based on the preliminary final revenue estimates for FY 2007-08, revenue subject to the limit will total \$27.6 billion. As a result, it is estimated that revenue subject to the limit will fall below the revenue limit in FY 2007-08 by \$4.8 billion or 14.7%. This estimated gap between the revenue limit and revenue subject to the limit is smaller than it was in FY 2006-07, due to the enacted increases in the income and Michigan business taxes.

FY 2008-09

In FY 2008-09, the revenue limit is equal to 9.49% of Michigan's personal income in calendar year 2007. The Federal government's initial estimate of Michigan personal income in calendar 2007 is \$345.9 billion, so the revenue limit is equal to \$32.8 billion for FY 2008-09. Based on the SFA's revised revenue estimates for FY 2008-09, revenue subject to the revenue limit will equal an estimated \$26.3 billion. As a result, it is estimated that revenue subject to the limit will fall below the limit by \$6.5 billion or 19.8% in FY 2008-09.

FY 2009-10

In FY 2009-10, the revenue limit will equal an estimated \$33.6 million. This estimate is based on the SFA's estimate of Michigan personal income in calendar year 2008. Based on the SFA's initial revenue estimate for FY 2009-10, revenue subject to the revenue limit is expected to total \$25.9 billion. As a result, revenue is expected to fall below the revenue limit by \$7.7 billion, or 23.0%, in FY 2009-10.

Table 12

**COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT
SECTION 26 OF ARTICLE IX OF THE STATE CONSTITUTION
FY 2006-07 THROUGH FY 2009-10 ESTIMATE
(Millions of Dollars)**

| | FY 2006-07 Final | FY 2007-08 Estimate | FY 2008-09 Estimate | FY 2009-10 Estimate |
|--|-----------------------------|--------------------------------|--------------------------------|--------------------------------|
| Revenue Subject to Limit | | | | |
| <u>Revenue:</u> | | | | |
| General Fund/General Purpose (baseline) | \$8,279.7 | \$8,186.0 | \$7,605.7 | \$7,487.4 |
| Revenue Sharing (baseline) | 1,611.7 | 1,665.5 | 1,624.6 | 1,607.1 |
| School Aid Fund (baseline) | 11,149.7 | 11,121.0 | 10,643.1 | 10,599.3 |
| Transportation Funds | 2,119.3 | 2,090.0 | 2,050.0 | 2,075.0 |
| Other Restricted Non-Federal Aid Revenue | 2,935.4 | 3,000.0 | 3,000.0 | 3,000.0 |
| <u>Adjustments:</u> | | | | |
| GF/GP Federal Aid | (18.8) | (20.0) | (20.0) | (20.0) |
| GF/GP Balance Sheet Adjustments | 38.0 | 1,162.6 | 642.0 | 355.2 |
| SAF Balance Sheet Adjustments | 3.4 | 397.8 | 791.4 | 772.1 |
| Total Revenue Subject to Limit | \$26,118.4 | \$27,602.9 | \$26,336.8 | \$25,876.1 |
| Revenue Limit | | | | |
| <u>Personal Income:</u> | | | | |
| Calendar Year | CY 2005 | CY 2006 | CY 2007 | CY 2008 |
| Amount | \$331,304 | \$341,075 | \$345,885 | \$354,066 |
| Revenue Limit Ratio | 9.49% | 9.49% | 9.49% | 9.49% |
| Revenue Limit | \$31,440.7 | \$32,368.0 | \$32,824.5 | \$33,600.9 |
| 1.0% of Limit | 314.4 | 323.7 | 328.2 | 336.0 |
| Amount Under (Over) Limit | \$5,322.4 | \$4,765.1 | \$6,487.7 | \$7,724.8 |
| Percent Below Limit | 16.9% | 14.7% | 19.8% | 23.0% |

ESTIMATE OF YEAR-END BALANCES

This section of the Senate Fiscal Agency's (SFA's) report provides details of the estimated year-end balances of the General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) budgets for FY 2007-08 and FY 2008-09. This section of the report also contains a review of the issues that the Governor and the Legislature will be facing in the development and enactment of the FY 2009-10 State budget.

Table 13 provides a summary of the estimated year-end balances for the FY 2007-08 and FY 2008-09 GF/GP and SAF budgets. The final accounting of revenue and expenditures for FY 2007-08 has not been completed, but the SFA is estimating that when the FY 2007-08 book-closing process is completed, the GF/GP budget will have a \$442.5 million year-end balance and the SAF budget will close with a \$247.1 million year-end balance. Pursuant to statutory authorization, the final level of the FY 2007-08 GF/GP and SAF year-end balances will carry forward into FY 2008-09. A comparison of the SFA estimates of FY 2008-09 GF/GP revenue and enacted and projected appropriations leads to a \$265.5 million budget deficit. A comparison of the current SFA estimates of FY 2008-09 SAF revenue and enacted and projected appropriations leads to a \$27.5 million positive balance.

Table 13

| GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND ESTIMATED YEAR-END BALANCES (Millions of Dollars) | | |
|---|--------------------------------|--------------------------------|
| | FY 2007-08 Estimate | FY 2008-09 Estimate |
| General Fund/General Purpose | \$442.5 | \$(265.5) |
| School Aid Fund | \$247.1 | \$ 27.5 |

The initial look ahead at the FY 2009-10 GF/GP budget leads to the conclusion that absent an increase in State taxes or any fiscal relief provided by the Federal government, the level of FY 2009-10 GF/GP appropriations will have to be reduced significantly below the FY 2008-09 levels in order to ensure a balance between estimated revenue and appropriations. In regard to the FY 2009-10 SAF budget, absent an increase in State taxes, the level of FY 2009-10 SAF appropriations will have to be modestly reduced below the FY 2008-09 levels to ensure a balance between estimated revenue and appropriations.

FY 2007-08 YEAR-END BALANCE

The Office of the State Budget (OSB) is expected to complete the final accounting of FY 2007-08 State revenue and expenditures by December 31, 2008. Once the final accounting is completed, the State will publish the FY 2007-08 Comprehensive Annual Financial Report.

Based on the year-to-date accounting of FY 2007-08 GF/GP revenue and expenditures, the SFA is now estimating that the GF/GP budget will close the fiscal year with a \$442.5 million balance. The SFA is now estimating that the FY 2007-08 SAF budget will close the year with a \$247.1 million balance.

Table 14 provides a summary of the current SFA estimate of a \$442.5 million year-end balance in the FY 2007-08 GF/GP budget. Pursuant to statutory requirements, the actual level of the year-end balance will carry forward and be available as an FY 2008-09 revenue source. The \$442.5 million year-end balance estimate represents a considerable improvement over the estimates used

in August 2008 when the FY 2008-09 GF/GP budget was developed assuming a \$139.4 million FY 2007-08 GF/GP year-end balance. The improvements in the actual level of the FY 2007-08 GF/GP year-end balance over this time period result from a combination of higher-than-estimated State revenue collections and higher-than-anticipated year-end appropriation lapses.

Table 14
FY 2007-08
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

| | SFA Estimate |
|---|---------------------|
| Revenue: | |
| Beginning Balance..... | \$ 259.1 |
| <u>Ongoing Revenue:</u> | |
| Ongoing Revenue Estimate | 9,348.6 |
| Revenue Sharing Freeze | 576.1 |
| Shift of Short-Term Borrowing Costs to School Aid Fund..... | <u>22.8</u> |
| Subtotal Ongoing Revenue | 9,947.5 |
| <u>One-Time Revenue:</u> | |
| Sale of Northville State Property | 22.9 |
| Juror Compensation Fund Transfer to General Fund | 2.3 |
| Comprehensive Transportation Fund Transfer to General Fund | 5.0 |
| Transportation Economic Development Fund Transfer to General Fund | 13.0 |
| Financial Institutions Fund Shift to General Fund | 2.0 |
| Tobacco Settlement Refinancing (PA 101 of 2008) | <u>60.0</u> |
| Subtotal One-Time Revenue | 105.2 |
| Total Estimated Revenue..... | \$10,311.8 |
| Expenditures: | |
| Initial Enacted Appropriations | \$9,856.3 |
| Supplemental Appropriations: | |
| Public Act 98 of 2008 | 60.0 |
| Public Act 113 of 2008 | 41.2 |
| Public Act 278 of 2008 | 0.002 |
| Public Act 279 of 2008 | <u>83.3</u> |
| Subtotal Supplemental Appropriations | 184.5 |
| Projected Year-End Appropriation Lapses | (171.5) |
| Total Projected Expenditures..... | \$9,869.3 |
| Projected Year-End Balance..... | \$442.5 |

It now appears that actual FY 2007-08 GF/GP revenue collections will exceed the May 2008 consensus revenue estimates by \$184.6 million and actual GF/GP expenditures will be \$120.0 million below the previous estimate. The combination of the unanticipated revenue collections and spending restraint from higher-than-anticipated year-end appropriation lapses pushed the level of the FY 2007-08 GF/GP year-end balance up by \$304.6 million from the previous estimate.

On the revenue side of the FY 2007-08 budget ledger, the SFA is now estimating that revenue will total \$10.3 billion. This represents a \$1.1 billion or 11.6% increase from the final level of FY 2006-07 GF/GP revenue. The major explanation for this large revenue increase is the increases in the rate of the State income tax and the enactment of a surcharge on the Michigan Business Tax both enacted in the fall of 2007.

The major components of the FY 2007-08 GF/GP revenue total include a \$259.1 million balance carried forward from FY 2006-07, \$9.9 billion of revenue from ongoing sources, and \$105.2 million of revenue from a variety of one-time sources.

On the expenditure side of the FY 2007-08 budget ledger, the SFA is now estimating that expenditures will total \$9.9 billion. This represents an \$885.1 million or 9.9% increase from the final level of FY 2006-07 GF/GP expenditures.

The major components of the FY 2007-08 GF/GP expenditure total include the initial appropriations for the fiscal year, which totaled \$9.9 billion; enacted supplemental appropriations, which totaled \$184.5 million; and year-end appropriation lapses, which totaled \$171.5 million. The largest portion of the year-end appropriation lapses appears to be related to a significant overestimation of the number of individuals eligible to receive State-financed benefits through programs administered by the Department of Human Services. The \$171.5 million estimate of FY 2007-08 year-end appropriation lapses exceeds the \$136.1 million of appropriation lapses at the close of FY 2006-07.

Table 15 provides a summary of the current SFA estimate of a \$247.1 million FY 2007-08 year-end balance in the SAF budget. Pursuant to statutory requirements, the actual level of the year-end balance will carry forward and be available as an FY 2008-09 revenue source. The \$247.1 million year-end balance estimate represents a considerable improvement over the estimates used in August 2008 when the FY 2008-09 SAF budget was developed assuming a \$68.6 million FY 2007-08 SAF year-end balance. The improvements in the actual level of the FY 2007-08 SAF year-end balance over this time period result from a combination of higher-than-estimated State revenue collections and higher-than-anticipated year-end appropriation lapses.

Table 15
FY 2007-08
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

| | SFA Estimate |
|--|---------------------|
| Revenue: | |
| Beginning Balance | \$ 82.4 |
| Ongoing Revenue Estimate | 11,518.8 |
| GF/GP Grant to School Aid Fund | 29.1 |
| Federal Revenue..... | 1,377.7 |
| Total Estimated Revenue | \$13,008.0 |
| Expenditures: | |
| Initial Enacted Appropriations..... | \$13,006.0 |
| Budget Adjustments: | |
| Public Act 112 of 2008 | (108.2) |
| Midland Property Tax and Enbridge Energy Pipeline Settlements..... | 12.9 |
| Federal Funding Expenditure Adjustment | (98.3) |
| Projected Year-End Appropriation Lapses | (51.5) |
| Total Projected Expenditures | \$12,760.9 |
| Projected Year-End Balance | \$ 247.1 |

It now appears that actual FY 2007-08 SAF revenue collections will exceed the May 2008 consensus revenue estimates by \$143.8 million and actual SAF expenditures will be \$34.7 million below the previous estimate. The combination of the unanticipated revenue collections and lower-than-

estimated actual expenditures pushed the level of the FY 2007-08 GF/GP year-end balance up by \$178.5 million from the previous estimate.

On the revenue side of the FY 2007-08 SAF budget ledger, the SFA is now estimating that revenue will total \$13.0 billion. This represents a \$44.0 million or 0.3% decrease from the final level of FY 2006-07 GF/GP revenue. The major components of the FY 2007-08 SAF revenue total include an \$82.4 million balance carried forward from FY 2006-07; \$11.5 billion of State Restricted SAF revenue; \$29.1 million from a GF/GP grant to the SAF budget; and \$1.4 billion of Federal aid.

On the expenditure side of the FY 2007-08 budget ledger, the SFA is now estimating that expenditures will total \$12.8 billion. This represents a \$208.7 million or 1.6% decline from the final level of FY 2006-07 SAF expenditures. The decline in actual expenditures can be primarily attributed to a 28,500-pupil drop in the number of K-12 students funded through the funding formula which more than offset the \$96-per-pupil funding increase included in the budget.

FY 2008-09 YEAR-END BALANCE

During August 2008, the Legislature approved and the Governor signed into law FY 2008-09 GF/GP and SAF budgets that were balanced between estimated revenue and appropriations. Economic conditions, both in the United States and in Michigan, have changed considerably since the original enactment of the budget. These economic changes have resulted in a significant downward revision in the estimates of FY 2008-09 GF/GP and SAF revenue. The decline in FY 2008-09 estimated revenue has been somewhat offset by larger-than-anticipated year-end balances carried forward from FY 2007-08. The combination of lower FY 2008-09 estimated revenue partially offset by higher balances carried forward from the prior fiscal year has resulted in a projected imbalance in the FY 2008-09 GF/GP budget.

Table 16 provides a summary of the current SFA estimate of a \$265.5 million deficit in the FY 2008-09 GF/GP budget. The size of this projected budget deficit reflects the \$134.0 million of GF/GP appropriation reductions enacted by the Legislature on December 10, 2008, with the approval of Executive Order 2008-21. The Governor and the Legislature will be forced to take action during the balance of the fiscal year to eliminate the remaining projected budget deficit. This action is likely to include the use of fiscal relief provided to all states as part of a Federal economic stimulus package likely to be approved by the United States Congress during January 2009 and signed into law by President-Elect Barack Obama.

On the revenue side of the FY 2008-09 GF/GP budget ledger, the SFA is now estimating that revenue will total \$9.3 billion. This represents a \$1.0 billion or 10.0% decline from the estimated final level of FY 2007-08 GF/GP revenue. The current FY 2008-09 GF/GP revenue estimate is down \$400.8 million from the estimate assumed in the original enacted budget. This \$400.8 million revenue decline consists of a \$667.9 million decline in the estimate of ongoing revenue and a \$36.0 million decline in the projected savings from a freeze in revenue sharing payments. These revenue declines are partially offset by a \$303.1 million increase in the level of the year-end balance carried forward from FY 2007-08.

On the expenditure side of the FY 2008-09 GF/GP budget ledger, the SFA is now estimating that expenditures will total \$9.5 billion. This represents a \$321.5 million or 3.3% decline from the estimated final level of FY 2007-08 GF/GP expenditures. The Legislature on December 10, 2008, approved Executive Order 2008-21, which reduced FY 2008-09 GF/GP appropriations by \$134.0 million.

Table 16
FY 2008-09
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

| | SFA Estimate |
|--|---------------------|
| Revenue: | |
| Beginning Balance..... | \$ 442.5 |
| Ongoing Revenue: | |
| SFA Revenue Estimate | 8,216.7 |
| Revenue Sharing Freeze..... | 535.5 |
| Revenue Sharing Increase (2.0%)..... | (8.1) |
| Revenue Sharing Hold Harmless Payments | (12.8) |
| Shift of Short-Term Borrowing Costs to School Aid Fund | 45.0 |
| Subtotal Ongoing Revenue | 8,776.3 |
| One-Time Revenue: | |
| Treasury-Insurance Escheats Revenue | 25.0 |
| Treasury-Secondary Collections..... | 6.0 |
| 21st Century Jobs Fund Transfer to General Fund | 10.0 |
| Tourism Borrowing Transfer to General Fund | 10.0 |
| TEDF Transfer to General Fund | 6.0 |
| Sale of Surplus State Property-Northville | 6.5 |
| Subtotal One-Time Revenue | 63.5 |
| Total Estimated Revenue..... | \$9,282.3 |
| Expenditures: | |
| Initial Appropriations | \$9,701.4 |
| Pending Supplemental Appropriations: | |
| Records Center Lease Funding (OSB Request, 8-18-08)..... | 0.4 |
| Executive Order 2008-21..... | (134.0) |
| Lapse from Contract Savings | (20.0) |
| Total Projected Expenditures..... | \$9,547.8 |
| Projected Year-End Balance..... | \$ (265.5) |

Table 17 provides a summary of the current SFA estimate of a \$27.5 million balance in the FY 2008-09 SAF budget. The SFA is estimating this positive balance in the SAF budget in spite of several major changes in the revenue and expenditure assumptions that were used during the initial approval of the budget in August 2008. These changes include a higher balance carried forward from FY 2007-08, a reduction in the estimate of FY 2008-09 SAF revenue, and a reduction in the estimated costs of funding the SAF funding formula.

On the revenue side of the FY 2008-09 SAF budget ledger, the SFA is now estimating that revenue will total \$13.3 billion. This represents a \$276.4 million or 2.1% increase from the estimated final level of FY 2007-08 SAF revenue. The current SFA estimate is down \$94.5 million from the estimate assumed in the original enacted budget. This \$94.5 million revenue decline consists of a \$272.9 million decline in the estimate of FY 2008-09 SAF revenue partially offset by a \$178.4 million increase in the level of the year-end balance carried forward from FY 2007-08.

On the expenditure side of the FY 2008-09 SAF budget ledger, the SFA is now estimating that expenditures will total \$13.3 billion. This represents a \$122.0 million or 0.9% decline from the estimated level of FY 2007-08 SAF expenditures. The SFA expenditure estimate assumes \$122.0 million of reduced formula funding costs from greater-than-anticipated reductions in the number of

pupils enrolled in school during the fall of 2008, higher-than-anticipated collections from the local school property tax levied on nonhomestead properties, and a reduced estimate of the cost of property tax breaks provided in State-authorized renaissance zones.

Table 17
FY 2008-09
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

| | SFA Estimate |
|---|---------------------|
| Revenue: | |
| Beginning Balance | \$ 247.1 |
| SFA Revenue Estimate | 11,434.5 |
| GF/GP Grant | 40.8 |
| Federal Aid | 1,562.0 |
| Total Estimated Revenue | \$13,284.4 |
| Expenditures: | |
| Initial Appropriations | \$13,378.9 |
| Projected Formula Funding Lapse | (122.0) |
| Total Projected Expenditures | \$13,256.9 |
| Projected Year-End Balance | \$ 27.5 |

The decline in the number of pupils enrolled in the fall of 2008 reinforces a continuing trend in pupil count declines in recent years. The FY 2008-09 enacted SAF budget was developed assuming a 26,254 decline in pupils. The actual fall 2008 pupil count revealed an additional decline of 5,768 pupils, bringing the total decline from the prior year to 32,022 pupils. This 1.9% decline in pupils represents the largest annual decline in pupil counts since the State began funding K-12 schools on a per-pupil basis following the passage of Proposal A in March 1994.

FY 2009-10 STATE BUDGET OUTLOOK

Governor Granholm is required to submit her recommendation for the FY 2009-10 State budget to the Legislature no later than February 13, 2009. The budget recommendation will be balanced between estimated revenue and appropriations. Due to a continuing decline in FY 2009-10 GF/GP and SAF revenue estimates, the budgets submitted to the Legislature by the Governor will likely include significant reductions in appropriations. These reductions could be eliminated or reduced, if the State of Michigan receives fiscal relief as part of an economic stimulus package currently being formulated in Washington, D.C. This section of the report will first examine the outlook of the FY 2009-10 GF/GP and SAF budgets assuming no Federal fiscal relief, and then will discuss the potential Federal revenue that could come from an economic stimulus package.

Table 18 provides an overview of the outlook for the FY 2009-10 GF/GP budget. This outlook points to a \$1.5 billion imbalance between estimated revenue and appropriations. This estimate is developed using several key assumptions. The first assumption is that the projected FY 2008-09 GF/GP deficit of \$265.5 million is not eliminated and the imbalance is carried forward into FY 2009-10. The second assumption is that FY 2009-10 GF/GP appropriations are frozen at the current-year levels and the only adjustments made to the budget are a series of statutorily required appropriation adjustments. Combining these assumptions with the SFA estimate of FY 2009-10 GF/GP revenue, leads to a \$1.5 billion imbalance between revenue and appropriations. This potential budget imbalance equals 16.0% of the current-year level of GF/GP appropriations.

Table 18
FY 2009-10
GENERAL FUND/GENERAL PURPOSE
BUDGET OUTLOOK
(Millions of Dollars)

| | SFA Estimate |
|--|---------------------|
| Potential Revenue: | |
| Beginning Balance..... | \$ (265.5) |
| FY 2009-10 SFA Revenue Estimate | 7,842.7 |
| Revenue Sharing Freeze (Updated 12-9-08) | 535.6 |
| Shift of Short-Term Borrowing Costs to School Aid Fund | 45.0 |
| Total Estimated Revenue..... | \$8,157.8 |
| Potential Expenditures: | |
| Freeze Appropriations at FY 2008-09 Level..... | \$9,547.8 |
| Statutory Appropriation Adjustments: | |
| Medicaid Federal Match Rate Savings | (260.0) |
| Medicaid Caseload, Cost, and Utilization Adjustments | 150.0 |
| Michigan Promise Grant Cost Increase | 60.0 |
| County Revenue Sharing Phase-In | 49.4 |
| Tobacco Securitization Debt Service Cost Increase..... | 39.0 |
| State Employee Economics | 60.0 |
| Other Debt Service Increases..... | 40.0 |
| Subtotal Statutory Appropriation Increases..... | 138.4 |
| Total Potential Expenditures | \$9,686.2 |
| Imbalance Revenue Less Expenditures | \$(1,528.4) |

The SFA estimate of FY 2009-10 GF/GP revenue of \$7.8 billion is a decline of \$374.0 million or 4.5% from the estimated level of FY 2008-09 revenue. The FY 2009-10 GF/GP revenue estimate is \$1.5 billion or 16.1% below the estimated final level of GF/GP revenue recorded during FY 2007-08.

The SFA is estimating that if FY 2009-10 GF/GP appropriations are frozen at the current-year level and only adjusted for statutory and caseload costs, appropriations will total \$9.7 billion. The statutory and caseload cost adjustments include savings from an increase in the Federal Medicaid match rate to be received by the State, increased costs associated with the Medicaid program, increased costs of funding the Michigan Promise Grant program, increased costs related to revenue sharing payments to counties, increased debt service costs for tobacco securitization borrowing, increased costs associated with salary, health care, and retirement benefits for State employees, and other increases in State debt service payments. These appropriation assumptions include a freeze in payments to universities and community colleges, a freeze in revenue sharing payments to cities, villages, and townships, and a freeze in all other GF/GP-funded programs.

Table 19 provides an overview of the outlook for the FY 2009-10 SAF budget. This outlook points to a \$105.1 million imbalance between estimated revenue and appropriations. This estimate is developed using several key assumptions. The first assumption is the SFA estimate of FY 2009-10 SAF revenue. The second assumption is that FY 2009-10 SAF appropriations are frozen at the current year funding levels adjusted for anticipated savings from lower pupil counts and savings from other formula cost factors. This analysis assumes that the basic per-pupil funding through the foundation allowance will be frozen at the current-year levels. The modest imbalance of \$105.1 million in the FY 2009-10 SAF budget using these assumptions equals 0.8% of the current-year level of SAF appropriations.

Table 19
FY 2009-10
SCHOOL AID FUND
BUDGET OUTLOOK
(Millions of Dollars)

| | SFA Estimate |
|--|---------------------|
| Potential Revenue: | |
| Beginning Balance | \$ 27.5 |
| FY 2009-10 SFA Revenue Estimate..... | 11,371.5 |
| GF/GP Grant | 40.8 |
| Federal Aid..... | 1,562.0 |
| Total Estimated Revenue | \$13,001.8 |
| Potential Expenditures: | |
| Freeze of Appropriations at Projected FY 2008-09 Expenditure Level | \$13,256.9 |
| Projected FY 2009-10 Reduction in Formula Funding Costs | (150.0) |
| Total Potential Expenditures | \$13,106.9 |
| Imbalance Revenue Less Expenditures | \$ (105.1) |

POTENTIAL FEDERAL FISCAL RELIEF

As discussed previously, the outlook for the FY 2009-10 GF/GP and SAF budgets is not favorable. Absent increases in State tax rates or increases in aid from the Federal government, significant reductions will have to be made in both the GF/GP and the SAF budgets to ensure a balance between revenue and appropriations. The most significant imbalance is in the FY 2009-10 GF/GP budget.

Governor Granholm has made it publicly known that she will not be recommending general tax increases to the Legislature. This means that the only way of avoiding significant reductions in FY 2009-10 GF/GP appropriations rests with the potential for fiscal relief provided by the Federal government.

The Democratic majorities in the United States Congress and President-Elect Barack Obama are currently discussing the framework of a Federal stimulus package. Such a stimulus package, which is likely to be enacted into law in January or February 2009, is expected to include direct fiscal relief for states, infrastructure grants for transportation, water, sewage and education facilities, extension of unemployment insurance coverage, middle class tax reductions, business tax relief through job creation tax credits, and other potential ideas to stimulate the economy. The exact form of a Federal stimulus package is unknown at this time, but the passage of such a package in the early days of 2009 is almost assured.

The key to the Michigan State budget is the amount of direct fiscal relief to states that is included in the overall stimulus package. This direct aid to states is part of the package to help states avoid severe reductions in appropriations that would lead to layoffs of state employees and reductions in local government programs funded by the states. The discussion today in Washington, D.C. is that the direct fiscal relief to the states will range between a minimum of \$50.0 billion and a maximum of \$100.0 billion. This fiscal relief to the states likely will be paid out during FY 2008-09 and FY 2009-10.

Table 20 provides a summary of the amount of revenue that the State of Michigan could receive from a Federal fiscal relief program to states of between \$50.0 billion and \$100.0 billion. The table provides two options that might be considered to distribute the fiscal relief to states. The first

option is a per capita distribution and the second option is a temporary increase in the Federal Medicaid match rate paid to states. Under the per capita option, the State of Michigan would receive 3.3% of the total Federal fiscal relief. This would amount to a range of fiscal relief to Michigan of between \$1.7 billion and \$3.3 billion. If the fiscal relief were distributed through a temporary increase in the Medicaid match rate, the State of Michigan would receive between \$2.0 billion and \$4.0 billion.

Table 20

| POTENTIAL RANGE OF FEDERAL FISCAL RELIEF TO MICHIGAN (Billions of Dollars) | | |
|---|--|---------|
| | Total Amount of Federal Fiscal Relief | |
| | \$50.0 | \$100.0 |
| Michigan's Share of Total Relief | | |
| <u>Type of Distribution Formula</u> | | |
| Per Capita | \$ 1.7 | \$ 3.3 |
| Enhanced Medicaid Match Rate | \$ 2.0 | \$ 4.0 |

As illustrated in Table 20, the amount of Federal fiscal relief that Michigan could receive represents a significant amount of new funding in the State budget. Even the low-end estimate of \$1.7 billion would be more than enough new revenue to plug any potential imbalances in the FY 2009-10 GF/GP and SAF budgets. The concern regarding the Federal fiscal relief, outside of the potential long-term impact of the increased borrowing by the Federal government to finance the fiscal relief, is that it will come to the states on a temporary basis, likely over two fiscal years. The Governor and the Legislature will have to weigh carefully how the Federal fiscal relief is appropriated in order to avert imbalances in future GF/GP and SAF budgets when the Federal fiscal relief is no longer available.