

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

**FY 2013-14, FY 2014-15,  
FY 2015-16, and FY 2016-17**

**December 19, 2014**



# THE SENATE FISCAL AGENCY

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3. To review and evaluate proposed and existing State programs and services.
4. To provide economic and revenue analysis and forecasting.
5. To review and evaluate the impact of Federal budget decisions on the State.
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## ***ACKNOWLEDGEMENT***

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## **EXECUTIVE SUMMARY**

### **ECONOMIC FORECAST**

The U.S. economy, as measured by inflation-adjusted gross domestic product, after growing 2.3% during 2014, is predicted to expand 3.0% in both 2015 and 2016, and 2.7% in 2017. Light vehicle sales are forecasted to rise from 16.4 million units in 2014, to 16.8 million units in 2015, and 17.1 million units in both 2016 and 2017. The unemployment rate is expected to fall from 6.2% in 2014 to 5.7% in both 2015 and 2016, and then rise to 5.8% in 2017; while the consumer price index is estimated to increase 0.8% in 2015, and 1.1% in both 2016 and 2017.

The Michigan economy, as measured by inflation-adjusted personal income, is estimated to grow 3.4% in 2015, 3.1% in 2016, and 2.6% in 2017, after rising 2.8% in 2014. Wage and salary employment is predicted to continue growing, increasing 1.3% during 2015, 1.1% in 2016, and 1.0% in 2017.

### **REVENUE FORECAST**

Preliminary final fiscal year (FY) 2013-14 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue totaled \$20.5 billion, down 1.5% from FY 2012-13. The decrease reflects an improving economy that was more than offset by greater-than-expected refunds under the Michigan Business Tax and Individual Income Tax. Combined GF/GP and SAF revenue for FY 2013-14 is \$301.6 million below the May 2014 consensus estimate.

In FY 2014-15, the economy will grow more rapidly than in FY 2013-14. As a result, General Fund/General Purpose and SAF revenue will total an estimated \$21.5 billion, a 4.6% increase from FY 2013-14. However, the lower base from which revenue is growing results in an FY 2014-15 forecast that is \$212.2 million below the May 2014 consensus estimate.

In FY 2015-16, GF/GP and SAF revenue will total an estimated \$22.1 billion, a 3.1% increase from FY 2014-15 and \$372.6 million below the May 2014 consensus estimate. General Fund/General Purpose revenue will total an estimated \$9.9 billion, an increase of 3.0% from FY 2014-15 that reflects slower employment growth and the initial revenue reductions attributable to personal property tax reform, while SAF revenue will rise to an estimated \$12.2 billion, a 3.2% increase.

In FY 2016-17, GF/GP and SAF revenue will total an estimated \$22.6 billion. This initial estimate for FY 2016-17 is 1.9% higher than the revised estimate for FY 2015-16. As revenue losses related to personal property tax reform increase, General Fund/General Purpose revenue will total an estimated \$10.0 billion, an increase of 1.0% from FY 2015-16, while SAF revenue will rise to an estimated \$12.6 billion, a 2.7% increase.

### **YEAR-END BALANCE ESTIMATES**

Based on the accounting of State revenue and expenditures as of December 15, 2014, the Senate Fiscal Agency (SFA) is estimating that the FY 2013-14 GF/GP budget will close the fiscal year with a \$358.8 million balance. The SFA estimates that the FY 2013-14 SAF budget will close the fiscal year with a \$375.9 million balance.

A comparison of the SFA's FY 2014-15 revenue estimates with enacted and projected appropriations leads to a negative \$162.2 million GF/GP year-end balance. The SFA is now estimating that the FY 2014-15 SAF budget will end the year with a \$172.7 million balance. The negative GF/GP ending balance would need to be resolved during FY 2014-15, which could be achieved by a shift of revenue from other fund sources or reduced spending.

Looking ahead at the FY 2015-16 budget, if the SFA's FY 2015-16 GF/GP revenue estimate is compared with FY 2015-16 GF/GP estimated expenditures that freeze ongoing and one-time spending at the FY 2014-15 level and are adjusted for caseload changes, there is a projected negative GF/GP balance of \$186.4 million. If the SFA's FY 2015-16 SAF revenue estimate is compared with the FY 2015-16 SAF estimated expenditures that adjust the FY 2014-15 level of funding for estimated pupils and other costs, there is a projected SAF surplus of \$326.5 million.



**ECONOMIC REVIEW  
AND OUTLOOK**



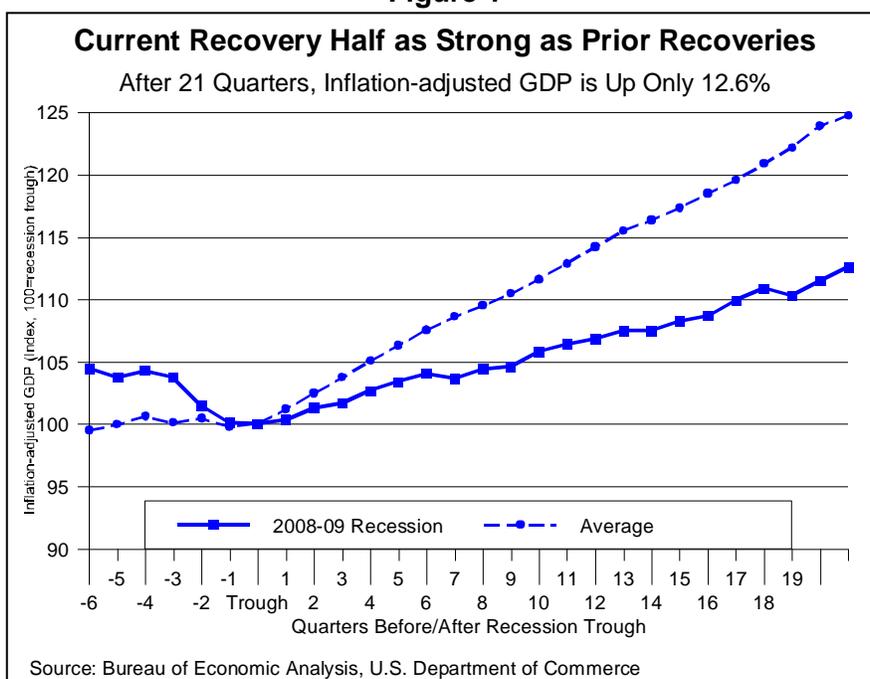
## ECONOMIC REVIEW AND OUTLOOK

State revenue, particularly tax revenue, depends heavily on economic conditions. This section presents the Senate Fiscal Agency's (SFA's) latest economic forecast for 2015, 2016, and 2017, as well as a summary of recent economic activity.

### RECENT U.S. ECONOMIC HIGHLIGHTS

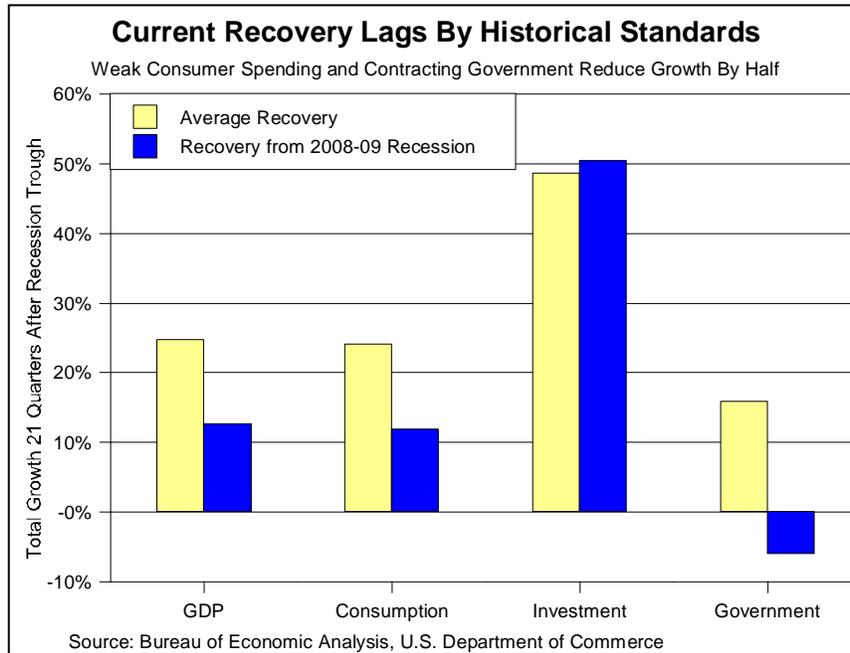
Since the 2008-2009 recession, generally regarded as the most severe economic contraction in more than 70 years, the economy has grown slowly. Many fundamental economic factors remain well below their prerecession peaks, and even factors that have recovered have done so more slowly than during almost any other post-World War II recovery. As of the third quarter of 2014, the economy had been in recovery for 21 quarters after the recession trough in the second quarter of 2009. Four recoveries since World War II have lasted 21 quarters or more, and at this point the current recovery is approximately half as strong as the average of those recoveries.

**Figure 1**

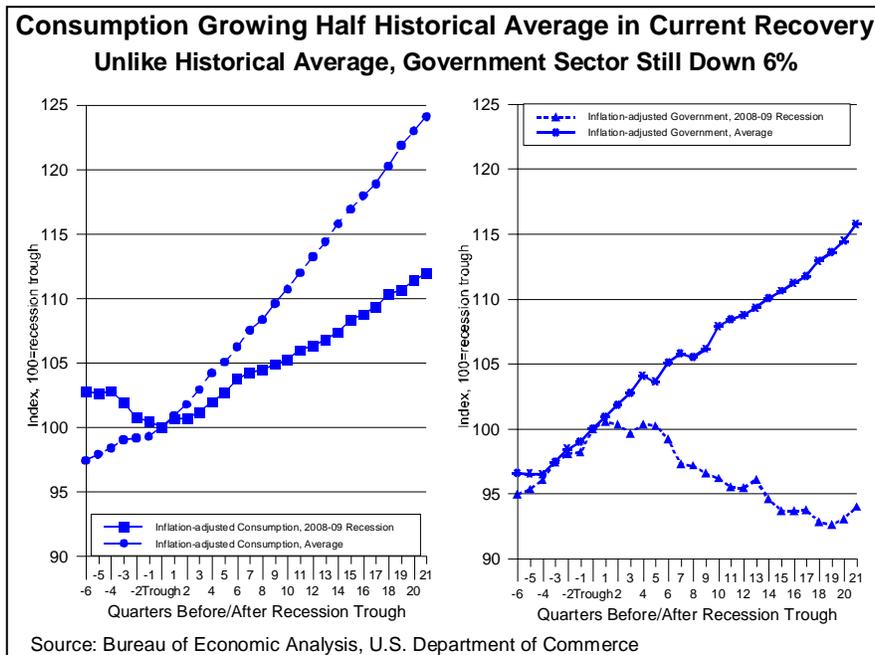


While the second and third quarters of 2014 posted the strongest consecutive quarters of growth in inflation-adjusted Gross Domestic Product (GDP) since the last two quarters in 2003, inflation-adjusted GDP in the third quarter of 2014 was only 7.8% above the level during the fourth quarter of 2007, when the recession began, and only 12.6% above the level in the second quarter of 2009, when the economy finished contracting (Figure 1). As a result, the economy has averaged only 2.3% annual growth since the end of the recession, compared with an average of 4.3% annual growth over the other four recoveries. Consumption expenditures, which on average account for two-thirds of economic activity, have also exhibited weak growth relative to historical standards, with the current recovery averaging 2.2% annual growth, compared with a historical average of 4.2% growth (Figure 2). Furthermore, consumption growth has been offset by the contracting government sector, which has declined at an average annual rate of 1.1% compared with the historical average of 2.8% growth (Figure 3).

**Figure 2**



**Figure 3**



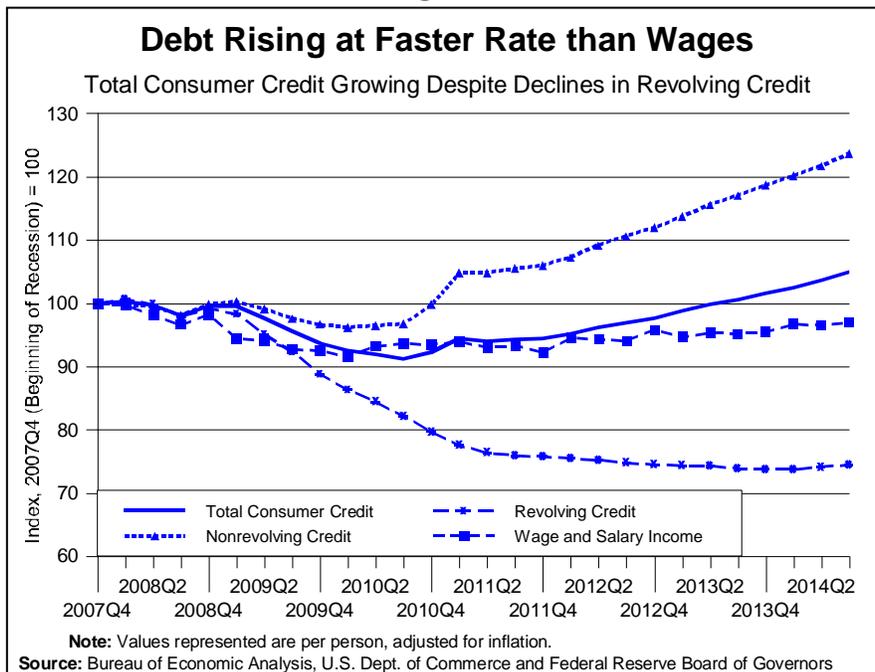
Over the current recovery, much of the growth in the economy has reflected increases in inventories: goods produced but not sold. For example, during the first three quarters of 2014, increases in inventories accounted for 80.3% of the increase in inflation-adjusted GDP. While inventory accumulation is generally regarded as good, at least if it is intended, without increased consumption to support the additional production, inventory increases do not represent a sustainable way to expand the economy. Inventory increases contributed 1.4 percentage points toward the 4.6% growth rate reported in the second quarter of 2014, and in the third quarter, a one-time boost in Federal defense expenditures contributed 0.7 percentage point toward the 3.9% growth rate exhibited in the third quarter of 2014. Thus, while more sustainable components of the

economy, such as investment and consumption, have improved during 2014, adjusting for the behavior of inventories and one-time government spending lowers the growth rate to a more modest rate.

Consumption growth has remained weak for a variety of reasons, and many of the increases have reflected increased purchases of motor vehicles. Consumers have remained risk-averse about spending, especially for big-ticket items and nonessential purchases, as employment growth has remained weak and wage increases have been negligible. Motor vehicle purchases have been an exception due to factors ranging from rising fuel costs' encouraging the purchase of more fuel-efficient vehicles to the marked increase in the age of the vehicle fleet to the return to vehicle loans to subprime borrowers. Light vehicle sales reached a 17.4 million unit annual rate in August 2014, the highest rate since January 2006, and year-to-date sales in 2014 are on track to almost match the 2006 total. Replacement consumption, where consumers replace durable goods that have simply grown so old that they are no longer considered viable, has accounted for a significant portion of the growth in consumption spending. Durable goods consumption generally accounts for approximately 8.5% of the economy and 12.3% of consumption spending, but during the first three quarters of 2014 accounted for 34.4% of the economic growth and 53.1% of the growth in consumption spending.

Despite the weak growth in consumer spending compared to historical standards, spending has generally been rising at a faster rate than wage and salary income. Since the recession trough, inflation-adjusted consumption spending has risen by an average of 2.2% per year, while inflation-adjusted wage and salary income has risen by an average of 1.6% per year. Over the first three quarters of 2014, this pattern has changed and incomes have grown more rapidly than spending, as inflation-adjusted consumption spending rose at an annual rate of 2.0%, compared with a 2.9% rate of increase in inflation-adjusted wage and salary income. Despite the increase in wage income, consumption growth also appears to be significantly driven by increased borrowing, with outstanding consumer debt rising at an annual rate of 7.3% during the first three quarters of 2014 (Figure 4).

Figure 4

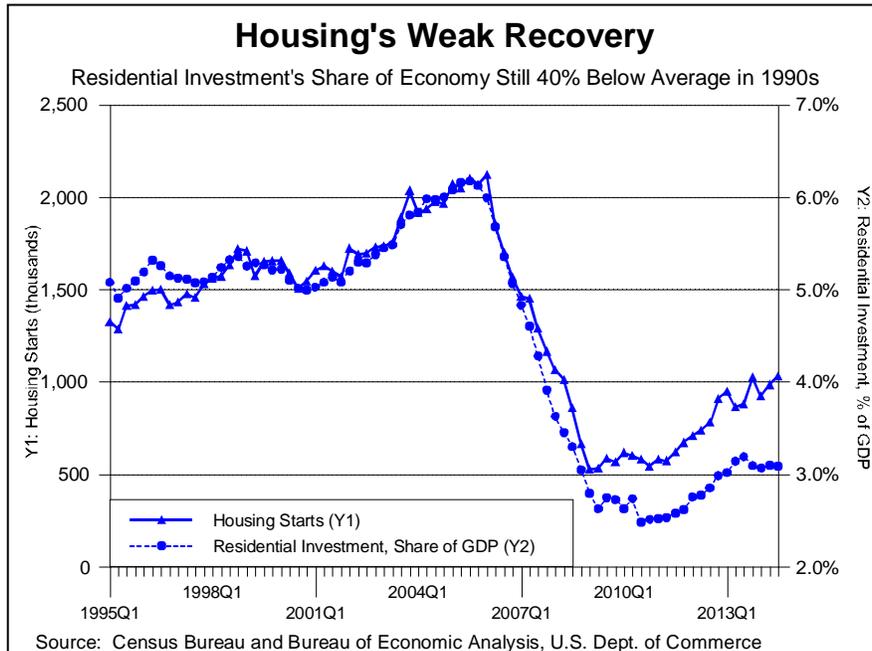


Payroll employment in the United States continued to decline for months after the end of the recession in June 2009, falling by approximately 1.3 million jobs by February 2010. Despite employment gains during the last four years, payroll employment did not reach the pre-recession peak until May 2014 and as of November 2014 payroll employment has averaged only 1.6% annual growth since the February 2010 trough. However, payroll employment growth has accelerated in recent months, with September, October and November 2014 all exhibiting the strongest year-over-year growth since April 2006.

The unemployment rate fell from a peak of 10.0% in October 2009, to 5.8% in November 2014. However, through 2013, the labor force grew much more slowly than the working age population and declines in the unemployment rate often reflected a stagnant or declining labor force as much as increased employment. Between 2007 and 2013, the labor force averaged 0.2% per year annual growth while in November 2014, the labor force was 0.7% larger than in November 2013. As of September 2014, total employment had surpassed the pre-recession peak of November 2007 and the November 2014 level of total employment set an all-time record.

The housing market, which counts as residential investment rather than consumption spending, improved substantially in 2014, although it remains weak by almost any historical measure (Figure 5). Housing starts are projected to total approximately 1.0 million units in 2014, an increase of 8.9% from 2013 and the fifth consecutive annual increase in starts. However, despite the increases, 2014 will represent the seventh-weakest year of housing starts (based on data available back to 1959), above only the years 2008 through 2013. Housing starts in 2014 also will be 51.3% below the pre-recession peak of 2.1 million starts in 2005. Furthermore, residential construction as a share of GDP continues to remain at record lows. Between 1995 and 2003, residential investment represented approximately 5.2% of inflation-adjusted GDP. At the recession low for housing starts, in the first quarter of 2009, residential construction comprised 2.8% of GDP, and has averaged only 3.1% of GDP during 2014. In addition, the data suggest that the housing starts that are occurring have lower inflation-adjusted values than those before the recession.

Figure 5



Productivity, as measured by output per worker in the nonfarm business sector, rose at an average annual rate of 3.5% in the second quarter of 2014 and 2.9% in the third quarter, well above the 2.1% average rate during the 1985 to 2005 period, and up from the 1.2% rate during 2012 and the 0.7% increase in 2013. In manufacturing, productivity during the third quarter of 2014 was up 3.1% from the third quarter of 2013, the strongest year-over-year growth since the first quarter of 2011. The productivity gains reflect improvement in nonresidential investment, which has exhibited between 4.3% and 5.3% growth from the year-ago level over each of the last four quarters, compared with only 1.5% to 2.2% growth in the four quarters before that. As nonresidential investment continues to improve, productivity gains should also continue to increase. Productivity gains increase output and income, especially in the long run, but reduce the need for additional workers.

Details for selected economic indicators are presented in [Table 1](#) and [Table 2](#).

**Table 1**  
**THE SENATE FISCAL AGENCY ECONOMIC FORECAST**  
**(Calendar Years)**

	2013	2014	2015	2016	2017
	Actual	Estimate	Estimate	Estimate	Estimate
<b><u>United States</u></b>					
Nominal GDP (year-to-year growth)	3.7%	3.9%	4.7%	4.8%	4.4%
Inflation-Adjusted GDP (year-to-year growth)	2.2%	2.3%	3.0%	3.0%	2.7%
Unemployment Rate	7.4%	6.2%	5.7%	5.7%	5.8%
Inflation					
Consumer Price Index (year-to-year growth)	1.5%	1.7%	0.8%	1.1%	1.1%
GDP Implicit Price Deflator (yr.-to-yr. growth)	1.5%	1.6%	1.6%	1.7%	1.7%
Interest Rates					
90-day Treasury Bill	0.06%	0.03%	0.31%	1.38%	2.27%
10-year Treasury Bill	2.35%	2.57%	2.74%	3.19%	3.39%
Corporate Aaa Bond	4.23%	4.21%	4.24%	4.47%	4.63%
Federal Funds Rate	0.11%	0.09%	0.40%	1.68%	2.77%
Light Motor Vehicle Sales (millions of units)					
Auto	15.5	16.4	16.8	17.1	17.1
Truck	7.6	7.7	7.9	8.0	8.0
Import Share	7.9	8.7	8.9	9.0	9.1
	21.8%	21.1%	20.5%	20.3%	20.2%
<b><u>Michigan</u></b>					
Personal Income (millions)	\$386,471	\$402,755	\$420,125	\$438,630	\$456,138
Year-to-year growth	1.4%	4.2%	4.3%	4.4%	4.0%
Inflation-Adjusted Personal Income (year-to-year growth)	(0.2%)	2.8%	3.4%	3.1%	2.6%
Wage & Salary Income (millions)	\$195,203	\$204,776	\$211,734	\$218,379	\$225,102
Year-to-year growth	2.9%	4.9%	3.4%	3.1%	3.1%
Detroit Consumer Price Index (year-to-year growth)	1.6%	1.4%	0.9%	1.3%	1.4%
Wage & Salary Employment (thousands)	4,104.5	4,135.1	4,188.3	4,235.9	4,278.3
Year-to-year growth	1.8%	0.7%	1.3%	1.1%	1.0%
Unemployment Rate	8.8%	7.4%	6.9%	6.8%	6.7%

Table 2

<b>THE SENATE FISCAL AGENCY U.S. ECONOMIC FORECAST DETAIL</b>					
<b>(Calendar Years)</b>					
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
	<b>Actual</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
Gross Domestic Product (billions of dollars)	\$16,768.1	\$17,415.9	\$18,229.1	\$19,104.9	\$19,951.6
Year-to-year growth	3.7%	3.9%	4.7%	4.8%	4.4%
<i><u>Inflation-Adjusted GDP and Components</u></i>					
Gross Domestic Product (billions of 2009 dollars)	\$15,710.3	\$16,067.2	\$16,547.4	\$17,049.4	\$17,502.5
Year-to-year growth	2.2%	2.3%	3.0%	3.0%	2.7%
Consumption (billions of 2009 dollars)	\$10,699.7	\$10,946.8	\$11,272.5	\$11,645.8	\$12,011.1
Year-to-year growth	2.4%	2.3%	3.0%	3.3%	3.1%
Business Fixed Investment (billions of 2009 dollars)	\$1,990.6	\$2,114.5	\$2,251.0	\$2,377.8	\$2,501.5
Year-to-year growth	3.0%	6.2%	6.5%	5.6%	5.2%
Change in Business Inventories (billions of 2009 dollars)	\$63.5	\$67.1	\$38.3	\$62.0	\$59.9
Residential Investment (billions of 2009 dollars)	\$488.4	\$498.3	\$554.0	\$609.1	\$657.2
Year-to-year growth	11.9%	2.0%	11.2%	9.9%	7.9%
Government Spending (billions of 2009 dollars)	\$2,894.5	\$2,887.0	\$2,899.2	\$2,934.2	\$2,979.7
Year-to-year growth	(2.0%)	(0.3%)	0.4%	1.2%	1.6%
Net Exports (billions of 2009 dollars)	(\$420.5)	(\$443.3)	(\$461.7)	(\$585.1)	(\$733.3)
Exports (billions of 2009 dollars)	\$2,019.8	\$2,083.0	\$2,176.6	\$2,282.0	\$2,380.8
Imports (billions of 2009 dollars)	\$2,440.3	\$2,526.3	\$2,638.3	\$2,867.2	\$3,114.1
Personal Income (year-to-year growth)	2.0%	3.9%	4.7%	5.3%	4.6%
Adjusted for Inflation	0.5%	2.2%	3.9%	4.2%	3.4%
Wage & Salary Income (year-to-year growth)	2.7%	4.3%	4.0%	4.3%	4.0%
Personal Saving Rate	4.9%	5.1%	5.6%	5.9%	5.7%
Capacity Utilization Rate	77.9%	79.1%	79.6%	80.3%	79.7%
Housing Starts (millions of units)	0.925	1.007	1.179	1.314	1.419
Conventional Mortgage Rates	4.0%	4.2%	4.4%	4.7%	5.0%
Federal Budget Surplus (billions of dollars, NIPA basis)	(\$705.6)	(\$579.8)	(\$615.3)	(\$619.3)	(\$643.9)

### **RECENT MICHIGAN ECONOMIC HIGHLIGHTS**

Michigan's economy spent the 2000 to 2010 period in recession, largely driven by the same fundamental restructuring that affected manufacturing globally. Manufacturing experienced, and continues to experience, a significant surge in productivity driven by increased competition in the economy. For Michigan, the effect of productivity improvements has been substantial for at least three reasons: 1) there was more room for productivity improvements in the durable goods and motor vehicle manufacturing sectors than in many other sectors, 2) Michigan was, and remains, very disproportionately concentrated in motor vehicle manufacturing, and 3) the motor vehicle industry has become one of the most competitive sectors of the economy. For Michigan, those factors were

complicated as General Motors, Ford, and Chrysler lost market share over most of the last decade, leaving Michigan to lose employment from both higher productivity and reduced demand. The impact on the Michigan economy was exacerbated by the rapid and drastic decline in automobile sales in late 2008 and during 2009, reflecting national collapses in sectors such as construction, real estate, and finance.

However, the drag from the manufacturing sector on Michigan's economy appears to have bottomed out and the recovery in vehicle sales nationally has helped Michigan's economic situation. Manufacturing employment in Michigan rose by 110,300 jobs (25.1%) between June 2009, when the U.S. recession ended, and October 2013. However, Michigan manufacturing employment has remained essentially unchanged since October 2013, with October 2014 manufacturing employment up less than 1.0% from November 2013 and barely 0.6% since February 2014. Employment in the transportation equipment manufacturing sector increased by 41.0% between June 2009 and January 2013, accounting for 47,000 (42.6%) of the manufacturing jobs Michigan gained and 21.8% of the total jobs added in Michigan. Like total manufacturing employment, Michigan transportation equipment manufacturing employment has remained relatively flat since late 2013.

The unemployment rate declined from a high of 14.2% in August 2009 to 7.1% in October 2014, although the decline was partially attributable to the departure of approximately 88,630 individuals from the labor force in addition to the employment gain of 246,900 jobs. The bulk of the employment gain occurred early in 2014, with October 2014 employment 109,750 jobs above the level in October 2013, but only 13,800 jobs above May 2014.

### **FORECAST SUMMARY**

During 2015, both the U.S. and Michigan economies are expected to expand at a slightly faster rate than during 2014. The U.S. and Michigan economies are forecast to exhibit both income and employment growth during 2015 and later years, although Michigan is generally expected to grow more slowly than the nation as a whole. [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 3.0% in 2015, slightly more than the estimated 2.3% increase in 2014, and continue expanding about the same rate over the rest of the forecast period, rising 3.0% during 2016 and 2.7% in 2017. The expansion over the forecast period primarily reflects tepid consumption growth and improvements in business and residential investment that will more than offset the drag on the economy from increased imports and relatively stagnant public sector growth.

Employment gains over the forecast period will be muted, particularly compared with prior recoveries, because, while productivity growth is expected to be less than what was exhibited during the last decade, consumer demand is not likely to grow much more rapidly than productivity. Furthermore, business investment is expected to continue to focus on equipment and software, which generally replace capital for labor, although investment in structures, which represents new facilities, is also expected to exhibit significant growth. The U.S. unemployment rate is expected to decrease from 6.2% during 2014, to 5.7% in 2015 and 2016, before rising slightly in 2016 to 5.8%.

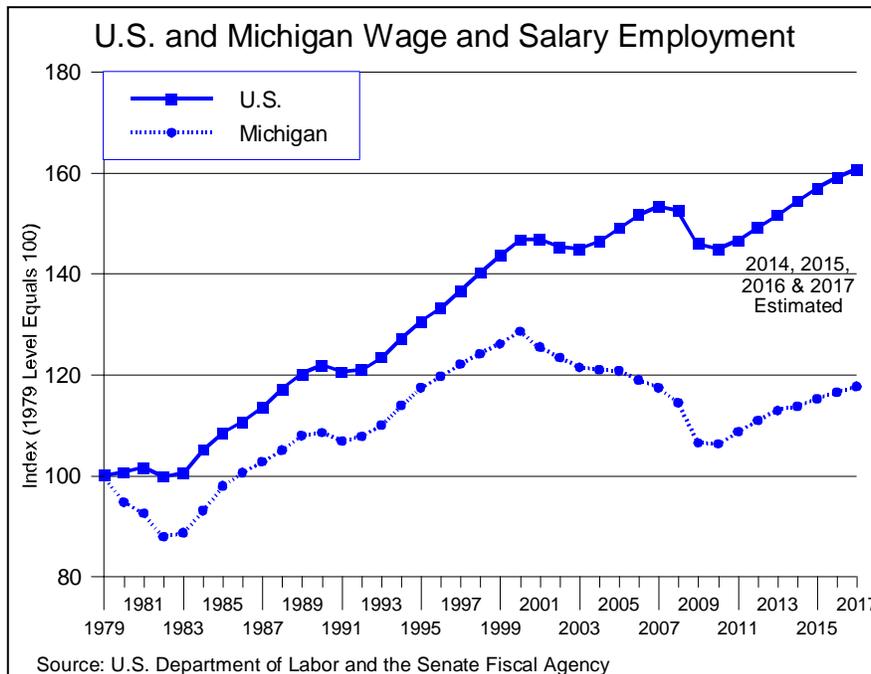
Inflation is not anticipated to be a concern over the forecast period. The U.S. Consumer Price Index is anticipated to increase 1.7% in 2014, followed by increases of 0.8% in 2015, and 1.1% in both 2016 and 2017. Export growth is expected to be tempered in the near term by increases in the value of the dollar as the Federal Reserve begins raising interest rates in mid-2015. Productivity, weak domestic consumer demand, and substantial weakness in the labor market will

help keep labor costs low, with unit labor costs expected to increase 0.4% in 2015, 0.6% in 2016, and 0.7% in 2017.

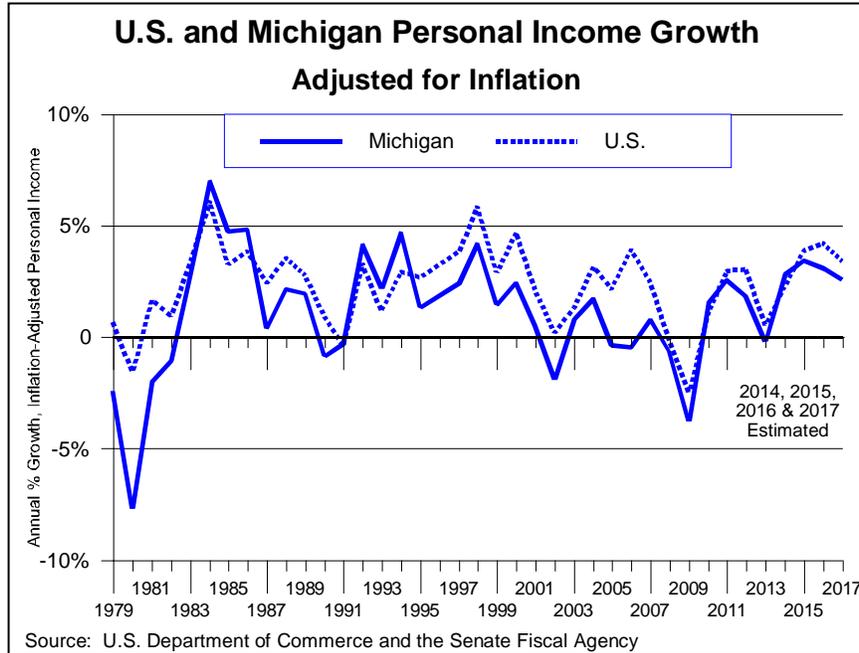
In Michigan, both job growth and personal income growth are expected to remain below the national average (despite outperforming the national average in both 2010 and 2011) and the historical State average (Figures 6 and 7). Inflation-adjusted personal income is projected to increase 3.4% in 2015, after a predicted 2.8% increase during 2014, and then increase 3.1% in 2016 and 2.6% in 2017. Payroll employment is expected to increase 1.3% in 2015, almost double the 0.7% growth rate estimated for 2014, and then increase more slowly, rising 1.1% in 2016 and 1.0% in 2017. Private sector gains in employment during 2015 and 2016 are expected to be fairly modest, although above the nearly flat employment predicted in the government sector (Figure 8). Nationally, light vehicle sales are expected to increase from an estimated 16.4 million units in 2014 to 16.8 million units in 2015, and 17.1 million units in both 2016 and 2017. In Michigan, higher vehicle sales, stability in the housing market, and an improved national economy are expected to allow the unemployment rate to slowly decline, from 7.4% in 2014 to 6.9% in 2015, 6.8% in 2016, and 6.7% in 2017.

Compared with the May 15, 2014, Consensus Economic Forecast, the U.S. forecast is unchanged in 2015 and slightly weaker in 2016, while the Michigan forecast is slightly stronger in both 2015 and 2016. However, neither the U.S. nor the Michigan forecast exhibits particularly strong economic growth. Weak employment growth, weak income growth, and slowdowns in overseas economies will temper the pace of the U.S. and Michigan recoveries during the forecast period. However, improved vehicle sales and stronger profitability in Michigan's vehicle sector will provide stability to the Michigan employment situation.

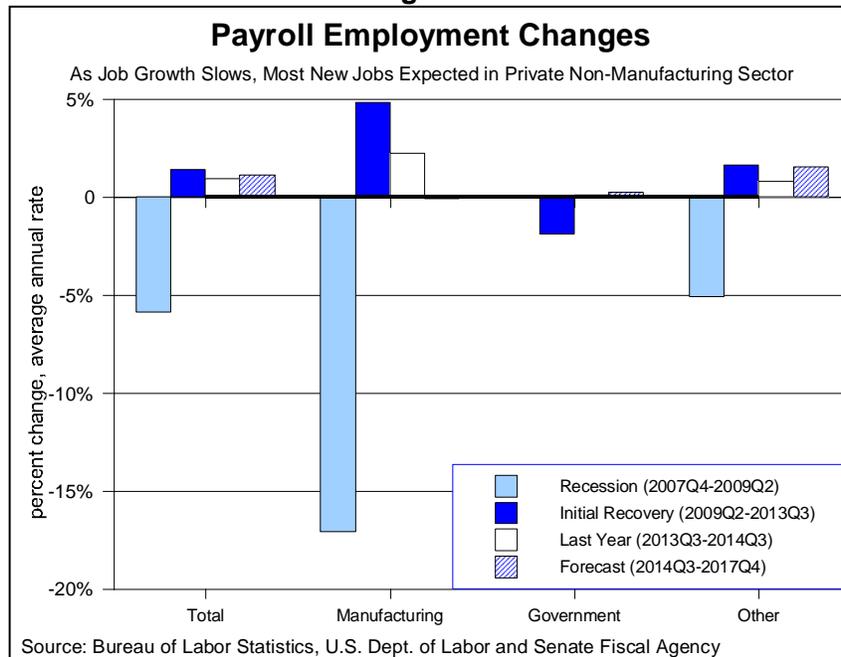
**Figure 6**



**Figure 7**



**Figure 8**



**FORECAST RISKS**

Forecasting the behavior of the economy requires making assumptions about the behavior of certain key economic variables. As a result, all forecasts carry a certain amount of error. However, unexpected changes in economic fundamentals often represent the greatest source of error. The challenge for the current forecast is to determine when the economy will complete the adjustments required to exhibit consistent growth. Such turning points are difficult to predict and adjustments after financial collapses such as occurred during the 2008-2009 recession often take longer than after recessions not associated with financial collapses.

**Consumer Behavior.** The economy of the last 30 years has been largely powered by strong growth in consumer spending. While saving rates fell and debt levels increased through the 1980s and 1990s, over much of the last decade those trends became even more magnified, despite flat or declining inflation-adjusted wages. Weak financial markets and declining housing prices during and after the 2008-2009 recession have induced consumers to rein in their spending, pushing the saving rate significantly higher. However, not only did consumers need to save at a far higher rate than exhibited to offset their losses in home equity and in the stock market, but over the last four quarters the saving rate has declined again and outstanding debt has begun increasing. Limited income growth and high debt burdens will impede consumers' ability to increase saving and/or significantly increase consumption. If the saving rate improves more than expected, such as to levels experienced during the 1980s, both consumption growth and economic growth will be substantially lower. Conversely, consumers could return to their spending habits of the late 2000s and, if capital markets accommodated higher demands for additional credit, growth would be stronger than forecasted.

Historically, consumption has represented approximately 70.0% of GDP. As a result, even small deviations in consumption can have a significant impact on the economy. During the 2008-2009 recession, consumption dropped significantly: on an annual basis, the drop was the largest percentage decline since 1942, and the largest peacetime decline since 1938. However, personal income fell more slowly over that time period, indicating that consumers engaged in a large amount of precautionary saving: reducing consumption by more than accounted for by actual income changes. As consumption has improved, much of the increase is estimated to reflect delayed purchases, particularly for replacement purposes, that did not occur because of consumers' economic anxiety during the recession. As the job market has stabilized, consumers have renewed replacement consumption, but it is unclear how much real growth in the underlying consumption trend is actually occurring. If consumer spending primarily represents deferred purchases and consumers continue spending in the near future only at replacement rates, then as income grows, saving rates will rise and the economic recovery will be weaker than if consumers spent at a rate above what is necessary to meet replacement needs.

The durability of consumer spending represents the primary determinant of the accuracy of the forecast. As indicated earlier, purchases of motor vehicles have dominated consumption growth during much of 2013 and 2014. Furthermore, consumer expenditures have risen more rapidly than incomes since mid-2011, and especially for much of the past year. The forecast assumes that consumers will slightly increase their saving rates and that consumption will be limited by flat wages and limited access to and/or use of additional increases in debt, especially as interest rates rise. To the extent that this perspective is not accurate and consumers assume more debt and accept lower saving rates, or that wages rise more rapidly than predicted, consumption is likely to be stronger than expected and the economy will grow more rapidly than expected.

**The Labor Market.** While the Michigan unemployment rate has declined since 2009, reduced labor market participation has played a greater role in lowering the Michigan unemployment rate than what has occurred in the national rate. Job gains have helped reduce the unemployment rate, but a significant factor causing the unemployment rate to decline over this period has been the withdrawal of individuals from the labor force. Individuals who have a job or are actively seeking work are counted as participating in the labor force, and the unemployment rate reflects the number of individuals who do not have a job and are actively seeking work divided by the size of the labor force.

Labor force participation can decline for a variety of reasons, ranging from individuals' choosing to permanently retire, to discouraged unemployed individuals' giving up searching for a job. Regardless of the reasons for their departure from the labor force, the withdrawal has implications for the economy. To the extent that such individuals remain out of the labor force, they generally face more limited income growth and reduce the pool of workers from which businesses can hire, potentially

putting upward pressure on wages. On the other hand, to the extent that these individuals have only temporarily left the labor force, while they still face limited income growth, they represent a somewhat hidden group of unemployed individuals who will depress wages as the economy continues to recover.

How those who are not part of the labor force behave over the forecast period has important implications for the economy and the forecast. To the extent that these individuals face limited incomes and reduced income growth, consumption and investment are depressed, lowering economic growth and reducing tax revenue. To the extent that these individuals enter (or re-enter) the labor force, the unemployment rate is not likely to decrease much and may actually increase. To the extent these individuals find employment, the economy will improve, but at the expense of reduced income gains that other workers might realize from an improving economy. As a result, both nationally and in Michigan, the large number of individuals who have left the labor force represent a factor that may exert a substantial slowing effect on the future growth of the economy. The forecast assumes that the labor force will increase at a slightly greater rate than population, but at a slower rate than new jobs will be created. As a result, employment gains are anticipated but wage growth is expected to be relatively modest.

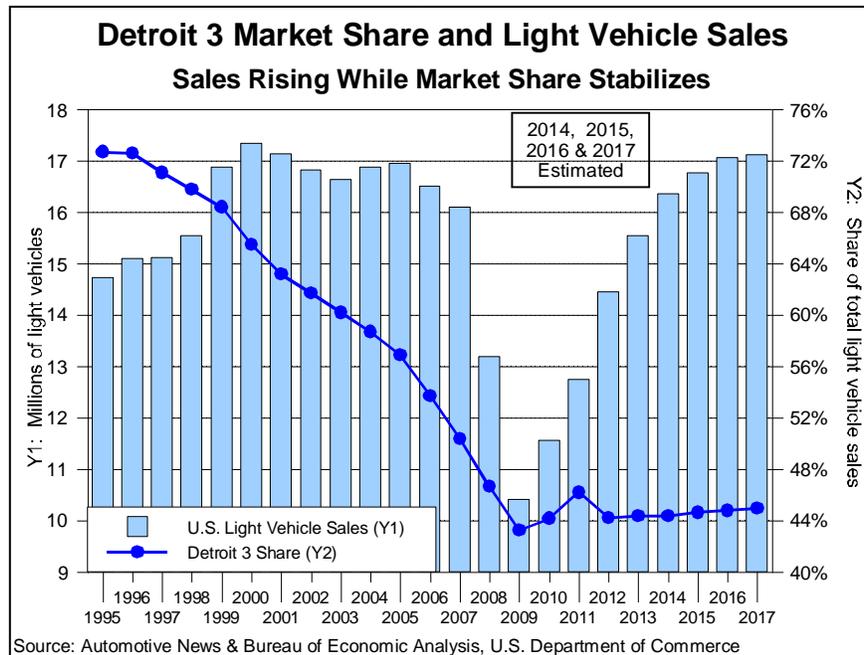
**Michigan's Situation.** While over the last decade Michigan's employment situation fared worse than the national average, and, in some cases or time periods within that range, worse than any other state, Michigan's performance was not particularly inconsistent with other states' when Michigan's economic composition is considered. Generally, states with higher manufacturing concentrations (particularly in the transportation equipment manufacturing sector) experienced weaker job performance during the last decade, both because of the economic changes occurring in that 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.

Weak markets for housing, credit, and employment, coupled with high energy prices and substantial debt burdens, are expected to exert a dragging force on any increases in demand over the forecast period. For Michigan, both employment gains and improvements in economic growth will be restrained by slowing growth in vehicle sales, as little growth is expected beyond replacement demand, the vehicle manufacturing sector is expected to continue to exhibit strong productivity gains, and sales levels are nearing the levels experienced in much of the last decade. On the other hand, compared with the prior decade, the Detroit 3 share of the sales mix is expected to remain fairly stable ([Figure 9](#)). Michigan's economic fortunes historically have been very closely linked with sales of domestically produced light vehicles ([Figure 10](#)).

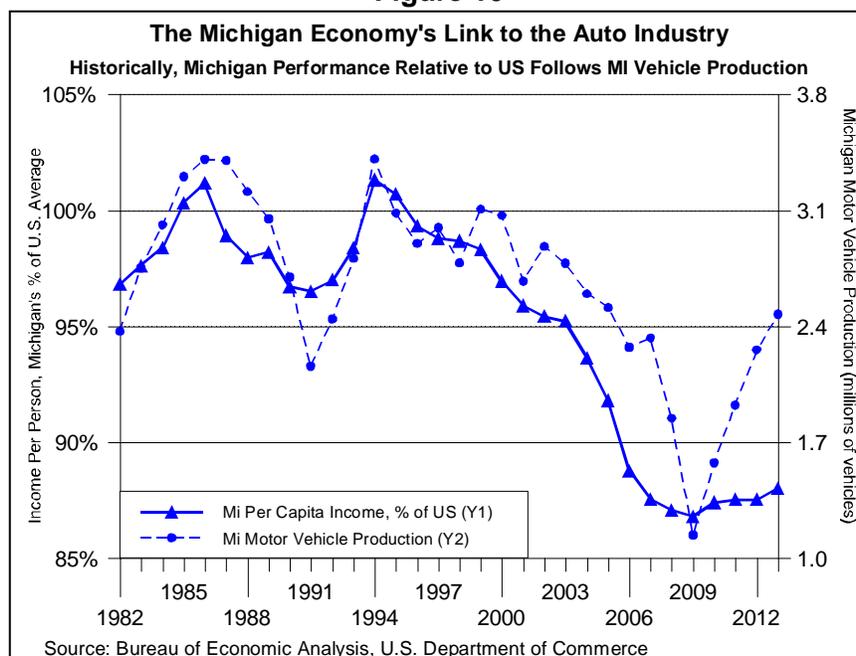
Despite the improvement forecasted in vehicle sales, and the renewed profitability of domestic automobile manufacturers, much of the additional demand can be met with existing employees, and low capital costs combined with meaningful productivity growth mean few incentives to increase hiring significantly. As a result, although as of June 2009, Michigan had lost more than two-thirds of the jobs (68.2%, a decline of approximately 241,300 jobs) in transportation equipment manufacturing that existed at the May 2000 peak, the majority of those jobs will never return and any gains in employment in the near future are likely to be muted. In fact, the forecast does not anticipate Michigan payroll employment returning to the January 2008 level (the U.S. pre-recession peak) on a sustained basis until sometime during 2016. As identified in versions of this report prepared for earlier forecasts, even with something approximating normal employment growth in Michigan, and despite the fact that as of October 2014 Michigan had regained 320,400 of the 861,600 jobs lost between April 2000 and March 2010, it is unlikely that Michigan will reach the level of total employment reported in April 2000 (the prerecession peak) again until sometime in the next decade.

The forecast expects employment levels in the transportation equipment manufacturing sector to increase slightly through 2015, but to remain relatively flat in both 2016 and 2017. Overall employment in Michigan is expected to grow slightly, with virtually all of the growth in private sector employment. However, for both the economy and State tax revenue to improve markedly, more substantial employment gains in the economy as a whole will need to occur. While increased profitability in the vehicle industry has stabilized much of the Michigan economy, significant and sustained growth at both the national and statewide levels is unlikely to occur until the housing industry experiences a meaningful recovery and consumers exhibit improved debt-to-income ratios and growing wages.

**Figure 9**



**Figure 10**



**FORECAST FOR  
STATE REVENUE**



## **THE FORECAST FOR STATE REVENUE**

This section of the Economic Outlook and Budget Review 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 2013-14 is presented along with the revised estimates for FY 2014-15 and FY 2015-16 and the initial revenue estimates for FY 2016-17. 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, the revenue estimate represents the revenue generated from ongoing revenue sources and generally does not include any revenue included in the GF/GP or SAF budget from one-time revenue adjustments, transfers, or other nonrecurring revenue items. The revenue adjustments and transfers used to balance the GF/GP and SAF budgets in FY 2013-14, FY 2014-15, and FY 2015-16 are discussed in the last section of this report.

### **REVENUE OVERVIEW**

The preliminary final GF/GP and SAF revenue for FY 2013-14, along with the revised estimates for FY 2014-15 and FY 2015-16, and the initial estimates for FY 2016-17 are presented in Table 3 and are summarized below.

#### **FY 2013-14 Preliminary Final Revenue**

- GF/GP and SAF revenue is expected to total \$20.5 billion in FY 2013-14.
- This year-end estimate for FY 2013-14 declined 1.5% or \$318.3 million from the actual revenue for FY 2012-13, in contrast to the 3.5% growth rate in FY 2012-13.
- The revenue projected for FY 2013-14 is lowered significantly by adjustments for Michigan Business Tax refunds for certificated credits and individual income tax refunds. Partially offsetting this decline, the revenue estimate is increased because \$110.0 million in transfers of sales tax revenue from the General Fund to the Michigan Transportation Fund and the Aeronautics Fund that occurred in FY 2012-13 will not occur in FY 2013-14 and approximately \$40.0 million in insurance tax payments due to the conversion of Blue Cross Blue Shield from a tax-exempt nonprofit to a nonprofit mutual insurer.
- The preliminary final estimate for FY 2013-14 is \$301.6 million below the May 2014 consensus revenue estimate.

#### **FY 2014-15 Revised Revenue Estimate**

- GF/GP and SAF revenue is expected to total \$21.5 billion in FY 2014-15.
- This revised estimate for FY 2014-15 is up 4.6% or \$953.2 million from the revised estimate for FY 2013-14. The projected revenue increase in FY 2014-15 reflects continued economic growth forecast for the year.
- The revised estimate for FY 2014-15 is \$212.2 million below the May 2014 consensus revenue estimate.

#### **FY 2015-16 Revised Revenue Estimate**

- GF/GP and SAF revenue is expected to total \$22.1 billion in FY 2015-16.
- The revised estimate for FY 2015-16 is up 3.1% or \$663.7 million from the revised estimate for FY 2014-15.

- The revised estimate for FY 2015-16 is \$372.6 million below the May 2014 consensus revenue estimate.
- As in FY 2014-15, the revenue increase in FY 2015-16 reflects improvements in the level of economic activity.

### **FY 2016-17 Initial Revenue Estimate**

- GF/GP and SAF revenue is expected to total \$22.6 billion in FY 2016-17.
- This initial estimate for FY 2016-17 is up 1.9% or \$425.7 million from the revised estimate for FY 2015-16.
- As in FY 2015-16, the revenue increase in FY 2016-17 reflects growth in Michigan economic activity, although at a slower rate than in FY 2014-15 and FY 2015-16.

### **Historical Perspective**

- Net GF/GP and SAF revenue is forecast to increase each year during the forecast period. The projected growth rates are 4.6% in FY 2014-15, 3.1% in FY 2015-16, and 1.9% in FY 2016-17. These changes compare with an average decline of 1.1% per year for the FY 1999-2000 to FY 2009-10 period.
- The revised estimate for GF/GP revenue from ongoing sources in FY 2013-14 is 15.5% (\$1.65 billion) below the record FY 1999-2000 level and 12.7% (\$1.3 billion) below the most recent peak reached in FY 2007-08. In FY 2014-15, ongoing GF/GP revenue is forecast to be 10.0% (\$1.1 billion) below the FY 1999-2000 level. Through FY 2016-17, GF/GP revenue is expected to remain below the FY 2007-08 recent peak, climbing to within 3.3% (\$336.0 million) of that amount.
- In FY 2013-14, School Aid Fund revenue from ongoing sources is only 0.2% (\$26.6 million) below the FY 2007-08 record high for that Fund. In FY 2014-15, ongoing SAF revenue will surpass the previous record SAF revenue in FY 2007-08 by 2.9% (\$336.8 million). Growth is projected to continue in FY 2015-16 and FY 2016-17, with SAF revenue estimated at \$714.3 million or 6.2% above the FY 2007-08 record level in FY 2015-16, and \$1.0 billion or 9.1% above the record level in FY 2016-17.

Baseline revenue growth (using the updated FY 2013-14 base) is forecast at 3.9% in FY 2014-15 and 3.2% FY 2015-16, declining slightly to 3.0% in FY 2016-17. Figure 11 presents the percentage changes in baseline GF/GP and SAF revenue from FY 1986-87 through the initial estimate for FY 2016-17. During this 31-year period, GF/GP and SAF baseline revenue declined during three periods of time: FY 1990-91; three consecutive fiscal years beginning in FY 2000-01; and FY 2008-09 and FY 2009-10. The decline in FY 1990-91 was 2.7% and the total decline from FY 2000-01 through FY 2002-03 was about 3.8%. While these declines in baseline revenue caused serious budget problems, they represented relatively small revenue declines compared with the 9.1% decline in FY 2008-09 and additional 2.1% decline in FY 2009-10. It is estimated that GF/GP and SAF baseline revenue increased by only 0.2% in FY 2013-14. Growth is expected at approximately 3.9% in FY 2014-15 and 3.2% in FY 2015-16. An increase of 3.0% in baseline revenue is forecast for FY 2016-17.

Table 3

<b>SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2013-14 THROUGH FY 2016-17</b>				
<b>GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND</b>				
<b>(Millions of Dollars)</b>				
	<b>FY 2013-14</b>	<b>FY 2014-15</b>	<b>FY 2015-16</b>	<b>FY 2016-17</b>
	<b>Prelim. Final</b>	<b>Revised Est.</b>	<b>Revised Est.</b>	<b>Initial Est.</b>
<b>GENERAL FUND/GENERAL PURPOSE</b>				
Baseline Revenue <sup>1)</sup>	\$9,756.3	\$10,180.6	\$10,517.2	\$10,864.0
Tax Changes Not In Baseline	(728.6)	(563.3)	(613.7)	(862.9)
<u>Revenue After Tax Changes:</u>				
Net Income Tax	5,690.0	5,889.7	6,100.2	6,333.7
MBT, Corp. Income Tax, SBT & Insur. Tax	499.8	860.7	892.3	931.3
Other Taxes	2,441.0	2,505.9	2,546.3	2,393.5
Total Taxes	8,630.8	9,256.3	9,538.8	9,658.5
Nontax Revenue	396.9	361.0	364.7	342.5
<b>TOTAL GF/GP REVENUE</b>	<b>\$9,027.7</b>	<b>\$9,617.3</b>	<b>\$9,903.5</b>	<b>\$10,001.0</b>
<b>SCHOOL AID FUND</b>				
Baseline SAF	\$11,531.7	\$11,937.0	\$12,301.7	\$12,636.8
Tax Changes Not In Baseline	(45.5)	(87.3)	(74.5)	(81.4)
<b>TOTAL SAF REVENUE</b>	<b>\$11,486.3</b>	<b>\$11,849.7</b>	<b>\$12,227.3</b>	<b>\$12,555.3</b>
<b>BASELINE GF/GP AND SAF REVENUE</b>	<b>\$21,288.0</b>	<b>\$22,117.6</b>	<b>\$22,818.9</b>	<b>\$23,500.8</b>
Tax & Revenue Changes	(774.1)	(650.6)	(688.2)	(944.4)
<b>GF/GP &amp; SAF REV. AFTER CHANGES</b>	<b>\$20,513.9</b>	<b>\$21,467.0</b>	<b>\$22,130.7</b>	<b>\$22,556.4</b>
SALES TAX	\$7,345.9	\$7,620.9	\$7,910.8	\$8,167.3
<b>PERCENT CHANGE</b>				
<b>GENERAL FUND/GENERAL PURPOSE</b>				
Baseline Revenue	(2.0%)	4.3%	3.3%	3.3%
<u>Revenue After Tax Changes:</u>				
Net Income Tax	(4.1)	3.5	3.6	3.8
MBT, Corp. Income Tax, SBT & Insur. Tax	(48.0)	72.2	3.7	4.4
Other Taxes	7.9	2.7	1.6	(6.0)
Total Taxes	(5.7)	7.2	3.1	1.3
Nontax Revenue	(2.6)	(9.0)	1.0	(6.1)
<b>TOTAL GF/GP REVENUE</b>	<b>(5.6%)</b>	<b>6.5%</b>	<b>3.0%</b>	<b>1.0%</b>
<b>SCHOOL AID FUND</b>				
Baseline SAF	2.2	3.5	3.1	2.7
<b>TOTAL SAF REVENUE</b>	<b>1.9%</b>	<b>3.2%</b>	<b>3.2%</b>	<b>2.7%</b>
<b>BASELINE GF/GP AND SAF REVENUE</b>	<b>0.2</b>	<b>3.9</b>	<b>3.2</b>	<b>3.0</b>
<b>GF/GP &amp; SAF REV. AFTER CHANGES</b>	<b>(1.5%)</b>	<b>4.6%</b>	<b>3.1%</b>	<b>1.9%</b>
SALES TAX	2.7%	3.7%	3.8%	3.2%
<sup>1)</sup> FY 2012-13 is the base year for baseline revenue. The FY 2012-13 base year is used in this table and Table 4 for the purpose of comparisons. Elsewhere in the report, the revised FY 2013-14 baseline estimates are used. The change in the baseline affects the size of tax adjustments. It does not change net revenue estimates for any year.				

Figure 11

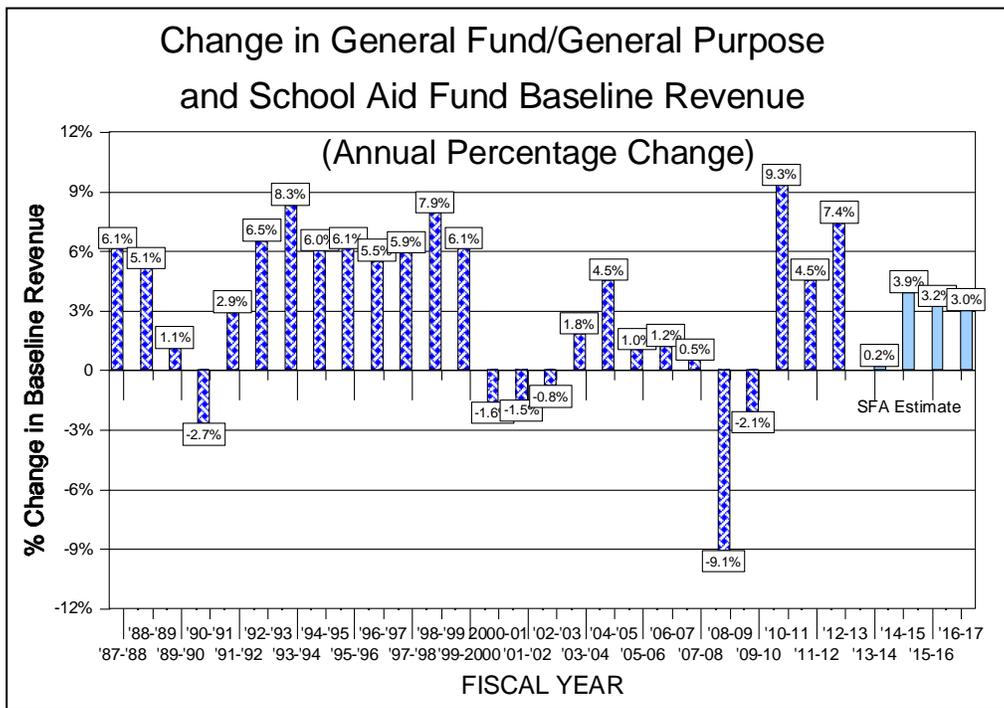


Figure 12 compares the FY 1995-96 through FY 2016-17 estimates for both the GF/GP revenue and the SAF revenue from ongoing sources with their respective levels for each of the fiscal years since the Proposal A school finance tax reforms were put in place. General Fund/General Purpose revenue peaked in 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 (SBT). In FY 2007-08, GF/GP revenue jumped to \$9.3 billion due to the increase in the income tax rate and the adoption of, and subsequent increase in, the Michigan Business Tax (MBT). The significant decline in GF/GP revenue experienced during the recession of FY 2008-09 and FY 2009-10 reduced GF/GP revenue to its lowest level since FY 1991-92, as shown in Figure 13, which displays ongoing General Fund revenue beginning in FY 1963-64. With the growth estimated over the forecast period, ongoing GF/GP revenue in FY 2014-15 will be approximately 10.0% (or \$1.1 billion) below the peak GF/GP revenue level in FY 1999-2000 (without accounting for inflation). The estimated GF/GP revenue of \$9.9 billion in FY 2015-16 remains 7.3% below the peak, and initial estimates for FY 2016-17 are 6.4% below peak levels. In inflation-adjusted terms, however, FY 2016-17 GF/GP revenue is 6.8% (or \$631.2 million) below the FY 1967-68 level.

In contrast to the swings in the path of GF/GP revenue over the last decade, SAF-earmarked revenue has been on a fairly smooth upward trend, even though the economic downturn reduced SAF revenue in FY 2008-09 and FY 2009-10 and tax code reforms reduced revenue in FY 2011-12. Ongoing SAF revenue is expected to grow consistently through the forecast period. In FY 2016-17, SAF revenue is predicted to be approximately 69.8% (\$5.2 billion) above the revenue level in FY 1995-96 (without accounting for inflation) and 9.0% (\$1.3 billion) below if adjusted for inflation, as shown in Figure 14.

Figure 12

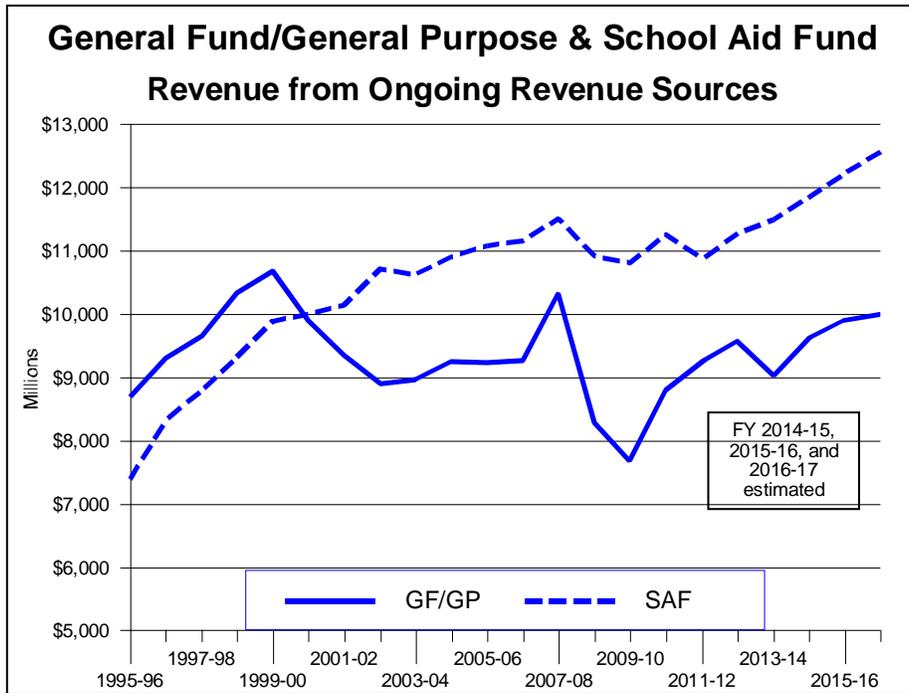


Figure 13

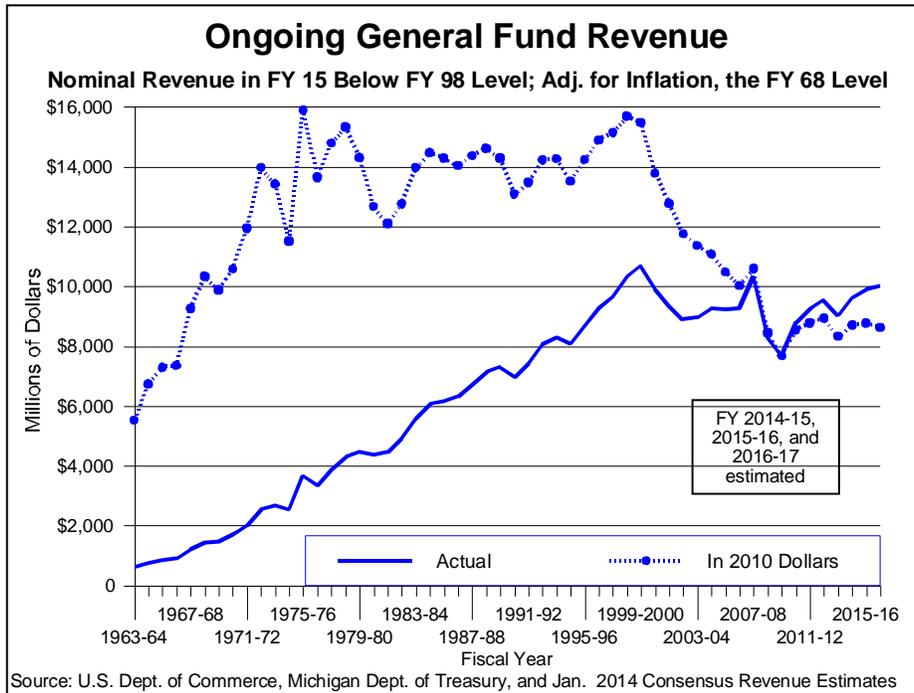
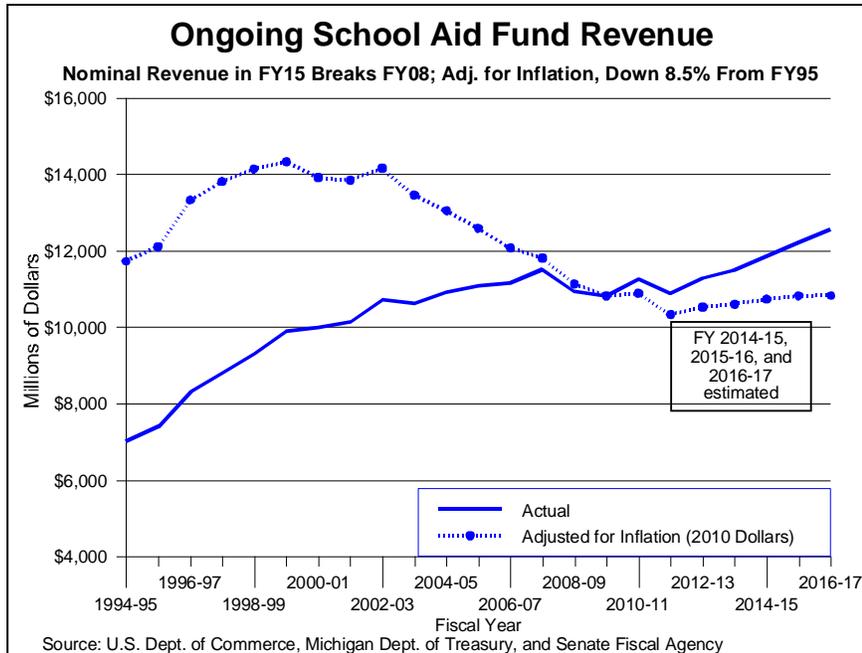


Figure 14



**FY 2013-14 PRELIMINARY YEAR-END REVENUE**

- General Fund/General Purpose and SAF revenue decreased an estimated 1.5% in FY 2013-14 compared with FY 2012-13.
- The revenue decrease in FY 2013-14 primarily reflects substantial increases in refunds paid under the Michigan Business Tax and Individual Income Tax.

Based on preliminary year-end book-closing revenue data, GF/GP and SAF revenue from ongoing revenue sources totaled \$20.5 billion in FY 2013-14, which is 1.5% below the FY 2012-13 revenue level, as presented in Table 4. The decline in FY 2013-14 reflected shifts that increased revenue in FY 2012-13 and reduced collections in FY 2013-14. These one-time changes included Federal tax changes that moved State revenue from FY 2013-14 into FY 2012-13 in anticipation of the "fiscal cliff", the timing of claims and processing of MBT refunds that were lower than expected in FY 2012-13 and higher than expected in FY 2013-14, and a large year-end accrual for individual income tax refunds that reduced FY 2013-14 revenue. Although payroll employment and personal income are increasing, noneconomic issues and some tax policy changes reduced revenue in FY 2013-14. The preliminary final revenue level is \$301.6 million below the May 2014 consensus revenue estimate. Most of the revenue decline from the May 2014 estimates reflects additional MBT refunds, which increased by \$171.3 million from the May 2014 consensus estimate. This change resulted in MBT refunds of an unprecedented \$773.5 million in FY 2013-14. Net individual income tax revenue was down \$191.6 million from the May 2014 estimate due to weak withholding and a large negative, year-end accrual for individual income tax refunds. Baseline GF/GP and SAF revenue increased 0.2% in FY 2013-14. However, one-time noneconomic factors and revenue adjustments to account for tax policy changes reduced the growth rate to a negative 1.5%.

**Tax Policy Changes**

Several tax policy changes affected revenue in FY 2013-14. These included continued revenue reductions due to MBT credits, changes in the law related to Blue Cross Blue Shield of Michigan that affects the tax on insurers, the first full year of a phased-in exemption on the trade-in value of

a motor vehicle, and the implementation of new legislation (Public Act 3 of 2014) that will reduce collections of unpaid business taxes.

**Business Tax Reform.** Some business taxpayers continue to file under the MBT Act in order to claim refundable tax credits, under an "option" tax. The value of these MBT credits is expected to total \$773.3 million in FY 2013-14. The cost of the refundable credits is offset to a small extent by collection under the option tax of \$39.5 million in FY 2013-14.

**Reduction of Personal Liability for Unpaid Business Taxes Due.** Public Act 3 of 2014, which took effect on February 6, 2014, is expected to reduce GF/GP and SAF tax revenue by \$67.7 million in FY 2013-14. Public Act 3 narrowed the definition of the responsible party from whom the Department of Treasury can recover unpaid business taxes and restricted the circumstances under which recovery can be pursued. In FY 2013-14, these changes are estimated to have reduced GF/GP revenue by \$39.6 million, SAF revenue by \$28.1 million, and other funds, primarily constitutional revenue sharing, by \$4.7 million.

**Insurance Tax Changes.** The 2012 legislation that allowed Blue Cross Blue Shield of Michigan to change from a tax-exempt nonprofit firm to a nonprofit mutual insurer has been implemented and is estimated to have increased GF/GP revenue by \$40.0 million during FY 2013-14.

**Sales Tax.** Public Act 160 of 2013 provides an exemption that excludes a portion of the trade-in value of a motor vehicle, watercraft, or recreational vehicle from the sales tax, imposing the so-called sales tax on the difference. While the exemption will be phased in over many years, the first revenue impacts occurred during FY 2013-14, lowering sales tax revenue by \$22.1 million, with the SAF bearing \$16.2 million of the reduction. The revenue loss from this exemption will increase in future years as the phase-in progresses.

**State Education Tax.** The phase-in of personal property tax reform, which began in January 1, 2014, reduced SAF revenue from the State Education Tax by an estimated \$9.9 million in FY 2013-14. Proposal 1 was approved by the voters in August 2014; thus, the phase-in of personal property tax changes will continue and future State revenue will be reduced.

### **General Fund/General Purpose**

- General Fund/General Purpose revenue totaled an estimated \$9.0 billion in FY 2013-14, which is down 5.6% or \$534.8 million from FY 2012-13.
- Compared with the May 2014 consensus estimate, GF/GP revenue for FY 2013-14 has been revised downward by \$291.6 million.

General Fund/General Purpose revenue is lower in FY 2013-14 than in the prior year. While the economy is estimated to have grown during 2014, individual income tax withholding is lower than expected and annual payments under the individual income tax are expected to decline 29.8% in FY 2013-14 from the FY 2012-13 level. In FY 2012-13, annual payments increased 68.0% as a result of a strong stock market and many taxpayers taking capital gains and/or receiving dividend payments in anticipation of potential tax changes associated with the "fiscal cliff" crises at the end of 2012. While a portion of this decline also reduces SAF revenue, the majority of the decline reduces GF/GP revenue.

Table 4

**FY 2013-14 PRELIMINARY FINAL REVENUE  
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND  
(Millions of Dollars)**

	FY 2012-13 Final	FY 2013-14 Prelim. Final	Change from FY 2012-13		\$ Change from 05/14 Consensus
			Dollar Change	Percent Change	
<b>GENERAL FUND/GENERAL PURPOSE:</b>					
<b>Baseline Revenue<sup>1)</sup></b>	\$9,957.4	\$9,756.3	(\$201.1)	(2.0%)	(\$120.0)
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(394.9)	(728.6)	(333.7)	---	(171.6)
<u>Personal Income Tax</u>					
Gross Collections	9,964.5	9,909.5	(55.0)	(0.6)	(39.3)
Less: Refunds	(1,694.2)	(1,895.6)	(201.4)	11.9	(152.4)
Net Income Tax Collections	8,270.3	8,014.0	(256.3)	(3.1)	(191.6)
Less: Earmarking to SAF Campaign Fund	(2,338.5) (0.8)	(2,323.2) (0.8)	15.3 0.0	(0.7) 0.0	45.7 0.2
Net Income Tax to GF/GP	\$5,931.0	\$5,690.0	(\$241.0)	(4.1%)	(\$145.8)
<u>Other Taxes</u>					
Corporate Income Tax	783.1	906.4	123.3	15.7	26.5
Michigan Business Tax	(75.8)	(723.3)	(647.5)	854.2	(171.3)
Sales	1,003.5	1,135.0	131.5	13.1	0.8
Use	838.3	928.3	90.0	10.7	9.3
Cigarette	187.9	192.9	5.0	2.7	5.9
Insurance Company Premiums	301.4	362.2	60.8	20.2	15.7
Telephone & Telegraph	46.5	48.0	1.5	3.2	3.0
Oil & Gas Severance	59.5	61.0	1.5	2.5	(6.0)
All Other	79.8	30.4	(49.4)	(61.9)	(64.1)
Subtotal Other Taxes	\$3,224.2	\$2,940.9	(\$283.3)	(8.8%)	(\$180.2)
Total Nontax Revenue	407.3	396.9	(10.4)	(2.6)	34.4
<b>GF/GP REV. AFTER TAX CHANGES</b>	<b>\$9,562.5</b>	<b>\$9,027.7</b>	<b>(\$534.8)</b>	<b>(5.6%)</b>	<b>(\$291.6)</b>
<b>SCHOOL AID FUND:</b>					
<b>Baseline Revenue<sup>1)</sup></b>	\$11,279.6	\$11,531.7	\$252.1	2.2%	(\$9.4)
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(10.0)	(45.5)	(35.5)	---	(0.6)
Sales Tax	5,206.2	5,349.4	143.2	2.8	48.9
Use Tax	432.4	464.6	32.2	7.4	5.1
Lottery Revenue	734.3	734.1	(0.2)	(0.0)	(40.9)
State Education Property Tax	1,771.1	1,804.2	33.1	1.9	16.2
Real Estate Transfer Tax	202.3	233.4	31.1	15.4	0.0
Income Tax	2,338.5	2,323.2	(15.3)	(0.7)	(45.7)
Casino Tax	110.7	106.9	(3.8)	(3.4)	(1.1)
Other Revenue	474.2	470.5	(3.7)	(0.8)	7.5
<b>SAF REV. AFTER TAX CHANGES</b>	<b>\$11,269.7</b>	<b>\$11,486.3</b>	<b>\$216.6</b>	<b>1.9%</b>	<b>(\$10.0)</b>
<b>BASELINE GF/GP AND SAF</b>	21,237.0	21,288.0	51.0	0.2	(129.4)
Tax & Revenue Changes	(404.8)	(774.1)	(369.3)	----	(172.2)
<b>GF/GP &amp; SAF REV. AFTER CHNGS</b>	<b>\$20,832.2</b>	<b>\$20,513.9</b>	<b>(\$318.3)</b>	<b>(1.5%)</b>	<b>(\$301.6)</b>
SALES TAX	\$7,153.8	\$7,345.9	\$192.1	2.7%	\$60.9

<sup>1)</sup> FY 2012-13 is the base year for baseline revenue.

The cost of refundable credits preserved after the elimination of most parts of the MBT increased in FY 2013-14. Previously awarded refundable tax credits will reduce tax revenue by approximately \$773.3 million in FY 2013-14. Similarly, although Corporate Income Tax (CIT) revenue is expected to grow 15.7%, the loss of revenue from the refundable tax credits will more than offset those gains and payments under the MBT option tax. Combined MBT and CIT revenue is expected to decline by \$524.2 million in FY 2013-14. The revised GF/GP revenue estimate for FY 2013-14 is summarized in [Table 4](#).

### **School Aid Fund**

- School Aid Fund revenue from all earmarked taxes and the lottery totaled \$11.5 billion in FY 2013-14, which is up 1.9% or \$216.6 million from FY 2012-13.
- This preliminary final SAF revenue for FY 2013-14 is \$10.0 million below the May 2014 consensus revenue estimate.

The 1.9% increase in SAF revenue in FY 2013-14 reflects growth in revenue of 2.8% from the sales tax and a decline of 0.7% in the individual income tax. Revenue from the Real Estate Transfer Tax increased by 15.4% due to housing market improvement. The State Education Tax grew by 1.9% as property values recovered. Revenue from the use tax increased by 7.4%. Lottery revenue, however, was flat as new games were delayed. In FY 2013-14, the SAF was only 0.2% or \$26.6 million below the previous peak revenue, experienced in FY 2007-08. The preliminary final SAF revenue for FY 2013-14 is summarized in [Table 4](#).

### **FY 2014-15 REVISED REVENUE ESTIMATES**

- General Fund/General Purpose and SAF revenue are projected to total an estimated \$21.5 billion in FY 2014-15, an increase of 4.6% in FY 2014-15 compared with FY 2013-14.
- The revenue increase in FY 2014-15 reflects improving economic conditions and fewer revenue reductions than in FY 2013-14.

The level of economic activity in Michigan is expected to increase more rapidly in FY 2014-15 than during FY 2013-14. Total GF/GP and SAF revenue will reach an estimated \$21.5 billion in FY 2014-15, an increase of 4.6% or \$953.2 million from the preliminary final figure for FY 2013-14. Baseline GF/GP and SAF revenue is expected to increase 3.9% in FY 2014-15, reflecting faster growth than in the prior year. The revised estimate of GF/GP and SAF revenue for FY 2014-15 is summarized in [Table 5](#).

### **Tax Policy Changes**

As in FY 2013-14, tax policy changes are expected to reduce revenue during FY 2014-15, with the most significant reduction coming from business tax credits.

**Business Tax Reform.** The value of refundable MBT credits is estimated to be somewhat lower in FY 2014-15, declining from \$773.3 million in FY 2013-14 to \$517.8 million in FY 2014-15. These credits reduce GF/GP revenue.

**Insurance Tax Changes.** As mentioned previously, the 2012 legislation that allowed Blue Cross Blue Shield of Michigan to change from a tax-exempt nonprofit firm to a nonprofit mutual insurer will increase GF/GP revenue. The first full-year impact is expected in FY 2014-15, and will increase GF/GP revenue by an estimated \$75.0 million.

**Sales Tax.** The revenue reduction due to phase-in of the partial sales tax exemption based on the value of trade-in vehicles is projected to increase to \$33.1 million in FY 2014-15. This change reduces GF/GP revenue by \$4.0 million, School Aid Fund revenue by \$24.3 million, and other funds, primarily constitutional revenue sharing, by \$4.8 million. Sales tax exemptions granted by Public Act 211 of 2013 on over-the-counter medicine for human use that is dispensed under a prescription will reduce sales tax revenue by \$9.0 million in FY 2014-15; of this amount, \$1.5 million is GF/GP, \$6.6 million is SAF, and \$0.9 million affects other funds.

**Use Tax.** A major use tax refund will reduce revenue by \$69.2 million in FY 2014-15. This refund will decrease GF/GP revenue by \$46.1 million and SAF revenue by \$23.1 million.

**Reduction of Personal Liability for Unpaid Business Taxes Due.** The impact of Public Act 3 of 2014, which narrowed the definition of the responsible party from whom the Department of Treasury can recover unpaid business taxes and restricted the circumstances under which recovery can be pursued, is expected to result in a revenue reduction of \$111.7 million in FY 2014-15, a larger reduction than in the prior year. These changes are estimated to reduce GF/GP revenue by \$61.3 million, SAF revenue by \$43.3 million, and other funds, primarily constitutional revenue sharing, by \$7.1 million in FY 2014-15.

**Tax Offer-in-Compromise.** Public Act 240 of 2014 allows the Department of Treasury to compromise with a taxpayer on the payment of a tax if there is a doubt as to the liability of the tax or the collectability of the tax, or the Federal government has accepted a compromise of Federal tax for the same tax years. These changes are estimated to reduce tax collections by \$7.8 million in FY 2014-15. This will reduce GF/GP collections by \$4.3 million, School Aid Fund revenue by \$3.2 million, and other funds by \$0.3 million in FY 2014-15.

**State Education Tax.** The phase-in of personal property tax reform, which began in January 1, 2014, is estimated to reduce SAF revenue from the State Education Tax by \$10.0 million in FY 2013-14.

**Driver Responsibility Fees.** The option for a person subject to certain Driver Responsibility Fees to perform community service instead of paying fees is projected to reduce GF/GP revenue by \$10.0 million. The phase-out of some fees will reduce revenue by another \$1.5 million in FY 2014-15.

### **General Fund/General Purpose Revenue**

- General Fund/General Purpose revenue will total an estimated \$9.6 billion in FY 2014-15, an increase of 6.5% or \$589.6 million from FY 2013-14.
- The revised GF/GP estimate is \$208.7 million below the May 2014 consensus revenue estimate.

Continued economic growth during 2015 will result in increased tax collections during FY 2014-15. Baseline GF/GP revenue is expected to increase 4.4%. Fewer negative adjustments to GF/GP revenue, primarily due to a lower estimate for MBT refunds, are expected to accelerate GF/GP growth to 6.5% in F 2014-15. The revised GF/GP revenue estimates for FY 2014-15 are summarized in [Table 5](#).

**Table 5**  
**FY 2014-15 REVISED REVENUE ESTIMATES**  
**GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND**  
**(Millions of Dollars)**

	FY 2013-14 Prelim. Final	FY 2014-15 Revised Est.	Change from FY 2013-14		\$ Change from 05/14 Consensus
			Dollar Change	Percent Change	
<b>GENERAL FUND/GENERAL PURPOSE:</b>					
<b>Baseline Revenue<sup>1)</sup></b>	\$9,732.2	\$10,156.6	\$424.4	4.4%	(\$111.8)
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(704.6)	(539.3)	165.3	---	(96.9)
<u>Personal Income Tax</u>					
Gross Collections	9,909.5	10,234.6	325.1	3.3	(68.2)
Less: Refunds	(1,895.6)	(1,907.0)	(11.4)	0.6	(110.0)
Net Income Tax Collections	8,014.0	8,327.6	313.6	3.9	(178.2)
Less: Earmarking to SAF Campaign Fund	(2,323.2) (0.8)	(2,437.1) (0.8)	(113.9) 0.0	4.9 0.0	16.0 0.2
Net Income Tax to GF/GP	\$5,690.0	\$5,889.7	\$199.7	3.5%	(\$162.0)
<u>Other Taxes</u>					
Corporate Income Tax	906.4	941.7	35.3	3.9	34.7
Michigan Business Tax	(723.3)	(475.0)	248.3	----	(46.0)
Sales	1,135.0	1,194.8	59.8	5.3	7.8
Use	928.3	933.3	5.0	0.5	(19.1)
Cigarette	192.9	183.3	(9.6)	(5.0)	0.3
Insurance Company Premiums	362.2	414.0	51.8	14.3	18.0
Telephone & Telegraph	48.0	47.5	(0.5)	(1.0)	2.5
Oil & Gas Severance	61.0	56.0	(5.0)	(8.2)	(12.5)
All Other	30.4	71.0	40.6	133.8	(35.9)
Subtotal Other Taxes	\$2,940.9	\$3,366.6	\$425.7	14.5%	(\$50.2)
Total Nontax Revenue	396.9	361.0	(35.9)	(9.0)	3.5
<b>GF/GP REV. AFTER TAX CHANGES</b>	<b>\$9,027.7</b>	<b>\$9,617.3</b>	<b>\$589.6</b>	<b>6.5%</b>	<b>(\$208.7)</b>
<b>SCHOOL AID FUND:</b>					
<b>Baseline Revenue<sup>1)</sup></b>	\$11,531.7	\$11,937.0	\$405.2	3.5%	\$36.1
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(45.5)	(87.3)	(41.8)	---	(39.7)
Sales Tax	5,349.4	5,546.0	196.6	3.7	52.7
Use Tax	464.6	466.7	2.1	0.5	(9.5)
Lottery Revenue	734.1	750.0	15.9	2.2	(26.0)
State Education Property Tax	1,804.2	1,840.0	35.8	2.0	(1.3)
Real Estate Transfer Tax	233.4	245.0	11.6	5.0	(0.3)
Income Tax	2,323.2	2,437.1	113.9	4.9	(16.0)
Casino Tax	106.9	111.0	4.1	3.8	(1.0)
Other Revenue	470.5	453.9	(16.6)	(3.5)	(2.2)
<b>SAF REV. AFTER TAX CHANGES</b>	<b>\$11,486.3</b>	<b>\$11,849.7</b>	<b>\$363.4</b>	<b>3.2%</b>	<b>(\$3.6)</b>
<b>BASELINE GF/GP AND SAF</b>	21,264.0	22,093.6	829.6	3.9	(75.8)
Tax & Revenue Changes	(750.1)	(626.5)	123.5	----	(136.6)
<b>GF/GP &amp; SAF REV. AFTER CHNGS</b>	<b>\$20,513.9</b>	<b>\$21,467.0</b>	<b>\$953.2</b>	<b>4.6%</b>	<b>(\$212.2)</b>
SALES TAX	\$7,345.9	\$7,620.9	\$275.0	3.7%	\$71.8

<sup>1)</sup> FY 2013-14 is the base year for baseline revenue.

### **School Aid Fund**

- School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$11.8 billion in FY 2014-15, which is up 3.2% or \$363.4 million from the preliminary final figure for FY 2013-14.
- This revised SAF revenue estimate for FY 2014-15 is \$3.6 million below the May 2014 consensus revenue estimate.

The forecasted increase in SAF revenue reflects growth in every major revenue source. Baseline SAF revenue is expected to increase by 3.5%. The Real Estate Transfer Tax is expected to increase by 5.0% and income tax contributions to the SAF are projected to increase by 4.9%. Sales tax revenue allocated to the SAF, its largest revenue source, is expected to increase by 3.7% over the prior year. New lottery games are expected to have a minor impact on increasing SAF revenue, while revenue from the State Education Tax is expected to increase by 2.0% from the FY 2013-14 level. The revised SAF revenue estimates for FY 2014-15 are summarized in Table 5.

### **FY 2015-16 REVISED REVENUE ESTIMATES**

Michigan's economy is expected to continue growing during FY 2015-16, with personal income growing more rapidly than in FY 2014-15. Total GF/GP and SAF revenue will reach an estimated \$22.1 billion in FY 2015-16, an increase of 3.1% or \$663.7 million from the revised estimate for FY 2014-15. On a baseline basis, GF/GP and SAF revenue is expected to increase 3.2% in FY 2015-16, reflecting continued improvements in State economic activity. The revised estimate of GF/GP and SAF revenue for FY 2015-16 is summarized in Table 6.

### **Tax Policy Changes**

Tax policy changes affecting FY 2015-16 revenue are quite similar to those affecting FY 2014-15. The largest adjustments are again due to MBT refunds.

**Business Tax Reform.** Revenue in FY 2015-16 will be reduced by the ongoing MBT credits, but the expected reduction of \$521.0 million in FY 2015-16 is only slightly larger than the reduction in FY 2014-15. All of the impact of these credits reduces GF/GP revenue.

**Insurance Tax Changes.** Blue Cross Blue Shield's conversion to a nonprofit mutual insurer will increase GF/GP revenue by an estimated \$75.0 million, the same amount as in FY 2014-15.

**Sales Tax.** The revenue reduction due to phase-in of the partial sales tax exemption based on the value of trade-in vehicles is projected to increase to \$39.8 million in FY 2015-16. This change reduces GF/GP revenue by \$4.8 million, School Aid Fund revenue by \$29.2 million, and other funds by \$5.8 million. The ongoing impact of Public Act 211 of 2013 sales tax exemptions on prescription-ordered, over-the-counter medicine will reduce sales tax revenue by \$9.0 million in FY 2015-16; of that amount, \$1.5 million is GF/GP, \$6.6 million is SAF, and \$0.9 million affects other funds, primarily constitutional revenue sharing.

**Personal Property Tax Reform.** FY 2015-16 is the first year that use tax revenue will be earmarked for payments to local governments for reimbursement of property tax revenue losses due to the phase-in of personal property tax exemptions. In FY 2015-16, \$96.1 million of use tax revenue will be restricted for these local payments, resulting in a reduction of \$96.1 million in GF/GP revenue. This revenue loss will be offset in part by the implementation of the Essential

Services Assessment, a tax on manufacturing personal property that is otherwise exempt from property taxation. In its first year, the Essential Services Assessment will increase GF/GP revenue by \$20.0 million. The State Education Tax also will be reduced by the expanding tax exemptions, which will reduce SAF revenue by \$20.9 million.

**Reduction of Personal Liability for Unpaid Business Taxes Due.** The changes in corporate officer responsibility for certain unpaid taxes are expected to decrease revenue by \$116.0 million in FY 2015-16, a larger reduction than in the prior year. These changes are estimated to reduce GF/GP revenue by \$63.8 million, SAF revenue by \$44.9 million, and other funds, primarily constitutional revenue sharing, by \$7.3 million in FY 2015-16.

**Tax Offer-in-Compromise.** The ability of the Department of Treasury to compromise with a taxpayer on the payment of a tax (under Public Act of 240 of 2014) is estimated to reduce tax collections by \$7.8 million in FY 2015-16, the same amount as in FY 2014-15. This will reduce the GF/GP collections by \$4.3 million, School Aid Fund revenue by \$3.2 million, and other funds by \$0.3 million in FY 2015-16.

### **General Fund/General Purpose Revenue**

General Fund/General Purpose revenue will total an estimated \$9.9 billion in FY 2015-16, an increase of 3.0% or \$286.2 million from the revised estimate for FY 2014-15. Baseline GF/GP revenue is expected to increase 3.3%. The revised GF/GP revenue estimates for FY 2015-16 are summarized in Table 6.

### **School Aid Fund**

School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$12.2 billion in FY 2015-16, an increase of \$377.6 million, or 3.2%, from the revised estimate for FY 2014-15. The forecasted increase in SAF revenue again reflects growth in all major earmarked revenue sources, plus the additional impact from several new lottery games. Total SAF revenue in FY 2015-16 is projected to exceed the peak reached in FY 2007-08 by \$714.4 million. The SAF revised revenue estimates for FY 2015-16 are summarized in Table 6.

**Table 6**  
**FY 2015-16 REVISED REVENUE ESTIMATES**  
**GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND**  
**(Millions of Dollars)**

	FY 2014-15 Revised Est.	FY 2015-16 Revised Est.	Change from FY 2014-15		\$ Change from 05/14 Consensus
			Dollar Change	Percent Change	
<b>GENERAL FUND/GENERAL PURPOSE:</b>					
<b>Baseline Revenue<sup>1)</sup></b>	\$10,156.6	\$10,493.2	\$336.6	3.3%	(\$215.6)
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(539.3)	(589.7)	(50.4)	---	(126.2)
<u>Personal Income Tax</u>					
Gross Collections	10,234.6	10,573.7	339.1	3.3	(129.9)
Less: Refunds	(1,907.0)	(1,955.0)	(48.0)	2.5	(136.8)
Net Income Tax Collections	8,327.6	8,618.7	291.1	3.5	(266.7)
Less: Earmarking to SAF Campaign Fund	(2,437.1) (0.8)	(2,517.7) (0.8)	(80.6) 0.0	3.3 0.0	30.8 0.2
Net Income Tax to GF/GP	\$5,889.7	\$6,100.2	\$210.5	3.6%	(\$235.7)
<u>Other Taxes</u>					
Corporate Income Tax	941.7	977.3	35.6	3.8	22.8
Michigan Business Tax	(475.0)	(500.0)	(25.0)	5.3	(43.5)
Sales Use	1,194.8	1,242.7	47.9	4.0	6.7
Cigarette	933.3	905.6	(27.7)	(3.0)	(86.0)
Insurance Company Premiums	183.3	181.0	(2.3)	(1.3)	1.2
Telephone & Telegraph	414.0	425.0	11.0	2.7	15.5
Oil & Gas Severance	47.5	47.0	(0.5)	(1.1)	3.0
All Other	56.0	57.0	1.0	1.8	(13.5)
	71.0	103.0	32.0	45.1	(18.0)
Subtotal Other Taxes	\$3,366.6	\$3,438.6	\$72.0	2.1%	(\$111.8)
Total Nontax Revenue	361.0	364.7	3.7	1.0	5.7
<b>GF/GP REV. AFTER TAX CHANGES</b>	<b>\$9,617.3</b>	<b>\$9,903.5</b>	<b>\$286.2</b>	<b>3.0%</b>	<b>(\$341.8)</b>
<b>SCHOOL AID FUND:</b>					
<b>Baseline Revenue<sup>1)</sup></b>	\$11,937.0	\$12,301.7	\$364.7	3.1%	(\$0.2)
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(87.3)	(74.5)	12.8	---	(30.6)
Sales Tax	5,546.0	5,757.7	211.7	3.8	52.7
Use Tax	466.7	500.8	34.1	7.3	5.0
Lottery Revenue	750.0	762.0	12.0	1.6	(23.0)
State Education Property Tax	1,840.0	1,866.1	26.1	1.4	(32.8)
Real Estate Transfer Tax	245.0	255.0	10.0	4.1	(4.1)
Income Tax	2,437.1	2,517.7	80.6	3.3	(30.8)
Casino Tax	111.0	115.0	4.0	3.6	0.0
Other Revenue	453.9	453.0	(0.9)	(0.2)	2.2
<b>SAF REV. AFTER TAX CHANGES</b>	<b>\$11,849.7</b>	<b>\$12,227.3</b>	<b>\$377.6</b>	<b>3.2%</b>	<b>(\$30.8)</b>
<b>BASELINE GF/GP AND SAF</b>	\$22,093.6	\$22,794.9	\$701.3	3.2%	(\$215.8)
<b>Tax &amp; Revenue Changes</b>	(626.5)	(664.2)	(37.7)	---	(156.8)
<b>GF/GP &amp; SAF REV. AFTER CHNGS</b>	<b>\$21,467.0</b>	<b>\$22,130.7</b>	<b>\$663.7</b>	<b>3.1%</b>	<b>(\$372.6)</b>
<b>SALES TAX</b>	\$7,620.9	\$7,910.8	\$289.9	3.8%	\$71.8

<sup>1)</sup> FY 2013-14 is the base year for baseline revenue.

## **FY 2016-17 INITIAL REVENUE ESTIMATES**

Michigan's economy is expected to continue growing during FY 2016-17. Personal income will grow at a faster rate than in FY 2015-16, although growth in wage and salary employment is projected to slow slightly. Total GF/GP and SAF revenue will reach an estimated \$22.6 billion in FY 2016-17, an increase of 1.9% or \$425.7 million from the revised estimate for FY 2015-16. On a baseline basis, GF/GP and SAF revenue is expected to increase 3.0% in FY 2016-17, reflecting continued improvements in State economic activity. The initial estimate of GF/GP and SAF revenue for FY 2016-17 is summarized in [Table 7](#).

### **Tax Policy Changes**

Tax policy changes affecting FY 2016-17 expand significantly above those affecting FY 2015-16, primarily due to the impact of personal property tax reform. Use tax revenue of \$380.6 million in FY 2016-17 will be restricted for reimbursements of local revenue losses due to increasing exemptions of personal property from property taxation. This will result in a \$380.6 million reduction in GF/GP revenue. This will be offset in part by the Essential Services Assessment which will increase GF/GP revenue by \$73.1 million. The SAF also will be affected by personal property tax reform. The State Education Tax will be reduced by \$21.1 million due to the phase-in of additional tax exemptions. Michigan Business Tax refunds will decrease GF/GP revenue by \$515.5 because of the continuing payment of refundable tax credits. The insurance tax paid by Blue Cross Blue Shield of Michigan as a nonprofit mutual insurer will increase revenue to the General Fund by \$75.0 million. The sales tax exemption on motor vehicle trade-ins will reduce revenue by approximately \$47.0 million, of which \$34.5 million is a reduction to the SAF. The phase-out of driver responsibility fees will reduce GF/GP revenue by \$23.0 million. Changes in the lottery games are expected to increase SAF revenue by approximately \$40.0 million. The impact of changes in corporate officer liability for certain unpaid taxes will reduce revenue by \$119.6 million, consisting of a GF/GP reduction of \$65.8 million, an SAF reduction of 46.2 million, and a loss to other funds (primarily constitutional revenue sharing) of \$7.7 million.

### **General Fund/General Purpose Revenue**

General Fund/General Purpose revenue will total an estimated \$10.0 billion in FY 2016-17, an increase of 1.0% or \$97.5 million from the revised estimate for FY 2015-16. Baseline GF/GP revenue is expected to increase 3.3%. The initial GF/GP revenue estimates for FY 2016-17 are summarized in [Table 7](#).

### **School Aid Fund**

School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$12.6 billion in FY 2016-17, an increase of \$328.0 million, or 2.7%, from the revised estimate for FY 2015-16. The forecasted increase in SAF revenue reflects growth in all major earmarked revenue sources, plus growth in the lottery. Total SAF revenue in FY 2016-17 is projected to exceed the peak reached in FY 2007-08 by \$1.0 billion or 9.1%. The initial SAF revenue estimates for FY 2016-17 are summarized in [Table 7](#).

Table 7

**FY 2016-17 INITIAL REVENUE ESTIMATES  
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND  
(Millions of Dollars)**

	FY 2015-16 Revised Est.	FY 2016-17 Initial Est.	Change from FY 2015-16	
			Dollar Change	Percent Change
<b>GENERAL FUND/GENERAL PURPOSE:</b>				
<b>Baseline Revenue<sup>1)</sup></b>	\$10,493.2	\$10,840.0	\$346.8	3.3%
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(589.7)	(838.9)	(249.2)	---
<u>Personal Income Tax</u>				
Gross Collections	10,573.7	10,932.9	359.2	3.4
Less: Refunds	(1,955.0)	(1,995.0)	(40.0)	2.0
Net Income Tax Collections	8,618.7	8,937.9	319.2	3.7
Less: Earmarking to SAF Campaign Fund	(2,517.7) (0.8)	(2,603.4) (0.8)	(85.7) 0.0	3.4 0.0
Net Income Tax to GF/GP	\$6,100.2	\$6,333.7	\$233.5	3.8%
<u>Other Taxes</u>				
Corporate Income Tax	977.3	1,006.3	29.0	3.0
Michigan Business Tax	(500.0)	(500.0)	0.0	0.0
Sales	1,242.7	1,284.0	41.3	3.3
Use	905.6	656.5	(249.1)	(27.5)
Cigarette	181.0	177.4	(3.6)	(2.0)
Insurance Company Premiums	425.0	435.0	10.0	2.4
Telephone & Telegraph	47.0	46.5	(0.5)	(1.1)
Oil & Gas Severance	57.0	59.0	2.0	3.5
All Other	103.0	160.1	57.2	55.45
Subtotal Other Taxes	\$3,438.6	\$3,324.8	(\$113.8)	(3.3%)
Total Nontax Revenue	364.7	342.5	(22.2)	(6.1)
<b>GF/GP REV. AFTER TAX CHANGES</b>	<b>\$9,903.5</b>	<b>\$10,001.0</b>	<b>\$97.5</b>	<b>1.0%</b>
<b>SCHOOL AID FUND:</b>				
<b>Baseline Revenue<sup>1)</sup></b>	\$12,301.7	\$12,636.8	\$335.1	2.7%
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(74.5)	(81.4)	(6.9)	---
Sales Tax	5,757.7	5,945.8	188.1	3.3
Use Tax	500.8	518.6	17.8	3.6
Lottery Revenue	762.0	765.0	3.0	0.4
State Education Property Tax	1,866.1	1,898.9	32.8	1.8
Real Estate Transfer Tax	255.0	259.0	4.0	1.6
Income Tax	2,517.7	2,603.4	85.7	3.4
Casino Tax	115.0	117.5	2.5	2.2
Other Revenue	453.0	447.1	(5.9)	(1.3)
<b>SAF REV. AFTER TAX CHANGES</b>	<b>\$12,227.3</b>	<b>\$12,555.3</b>	<b>\$328.0</b>	<b>2.7%</b>
<b>BASELINE GF/GP AND SAF</b>	\$22,794.9	\$23,476.8	\$681.9	3.0%
Tax & Revenue Changes	(664.2)	(920.4)	(256.2)	---
<b>GF/GP &amp; SAF REV. AFTER CHNGS</b>	<b>\$22,130.7</b>	<b>\$22,556.4</b>	<b>\$425.7</b>	<b>1.9%</b>
<b>SALES TAX</b>	\$7,910.8	\$8,167.3	\$256.5	3.2%

<sup>1)</sup> FY 2013-14 is the base year for baseline revenue.

## **MAJOR GENERAL FUND & SCHOOL AID FUND TAXES IN FY 2013-14 THROUGH FY 2016-17**

**Individual Income Tax.** The income tax generated an estimated \$8.0 billion in FY 2013-14, which represents a decrease of 3.1% from FY 2012-13. Slower growth in wage and salary employment during 2014 may account for weakness in withholding. However, individual income tax revenue also was depressed by a large year-end accrual that increased the amount of tax refunds by \$152.4 million, and by the implementation of reduced corporate officer liability for unpaid business taxes. The decline also is due in part to the impact of the Federal "fiscal cliff" which caused some taxpayers to realize capital gains in late 2012, increasing FY 2012-13 revenue on a one-time basis. Compared with May 2014 consensus revenue estimates, the revised individual income tax estimate for FY 2014-15 is down \$178.2 million and the revised estimate for FY 2015-16 is down \$266.7 million. These changes in income tax revenue will affect both GF/GP revenue and SAF revenue. The School Aid Fund receives 23.8% of gross income tax collections (withholding, quarterly, and annual payments), while the GF/GP budget receives 76.2% of gross collections, and incurs the negative impact of all income tax refunds (or the positive impact of reduced refunds), including the refund payments for the homestead property tax credit and the earned income tax credit (both of which are reduced substantially by the tax reform legislation enacted in 2011).

**Sales Tax.** As employment has stabilized and the economy has continued to grow, consumers and businesses have become less cautious, increasing spending on items subject to the sales tax. While consumption is forecast to increase, the increases are predicted to remain below those experienced in a typical economic recovery. As a result, sales tax revenue will total an estimated \$7.3 billion in FY 2013-14, which is 2.7% above the level in FY 2012-13. Sales tax collections are expected to exceed the projected rate of inflation, rising 3.7% in FY 2014-15, to \$7.6 billion, and 3.8% in FY 2015-16, to \$7.9 billion. Generally, these increases are below the average growth experienced during the 1990s, but are substantially above the growth rates experienced during much of the last decade. Compared with May 2014 consensus revenue estimates, the revised sales tax estimate for FY 2014-15 is \$71.8 million higher and the revised estimate for FY 2015-16 is up \$71.8 million. Most of the sales tax revenue is earmarked to the SAF (73.3%) and the remainder goes to local government revenue sharing payments, the Comprehensive Transportation Fund, and the General Fund. The amount going to revenue sharing includes only constitutional revenue sharing; to reflect the significant portion of sales tax revenue earmarked in statute for revenue sharing that has been diverted to the General Fund, this report allocates all of the statutory revenue sharing earmark to the General Fund and shows the appropriation for statutory revenue sharing as a revenue reduction on the balance sheet, as discussed in the last section of this report.

**Use Tax.** Use tax collections, which reflect the taxes levied on a variety of activities ranging from spending at hotels and motels, to telephone service (both residential and business), to the purchase of business equipment in other states for use in Michigan, can be volatile. Based on preliminary final revenue, use tax revenue increased 9.6% in FY 2013-14; however, tax policy changes will reduce use tax revenue dramatically in future years. The growth rate slows due to rising interest rates that will make business investment more expensive, major use tax refunds that will reduce revenue by \$69.2 million in FY 2014-15, and tax policy changes that, beginning in FY 2015-16, reflect the impact of personal property tax reforms approved by the voters in August 2014. The personal property tax reforms will divide use tax collection into a State share and a local community stabilization share; under Public Act 80 of 2014, the local share will be levied by the Local Community Stabilization Authority to reimburse municipalities for eligible revenue losses attributable to the exemption of personal property from property taxes. Michigan statute restricts use tax revenue of \$96.1 million in FY 2015-16 and \$380.6 million in FY 2016-17 to the Local Community Stabilization Authority. Use tax receipts will total an estimated \$1.4 billion in FY 2014-15, an increase of 0.5% from the preliminary final estimate for FY 2013-14, \$1.4 billion in FY 2015-16, an

increase of 0.5%, and \$1.2 billion in FY 2016-17, a decrease of 16.4%. Compared with the May 2014 consensus revenue estimates, the FY 2013-14 estimate for use tax collections has been revised upward by \$43.0 million, the FY 2014-15 estimate is up \$46.1 million, and the revised FY 2015-16 estimate is down \$81.0 million. Currently, the GF/GP budget receives two-thirds of use tax revenue and the remaining one-third goes to the SAF. This will change in beginning in FY 2015-16 when the SAF will still receive one-third of total use tax revenue, but what was formerly the GF/GP share will be divided between the State General Fund and the Local Community Stabilization Authority. Payments to the Local Community Stabilization Authority start at \$96.1 million in FY 2015-16, rise to \$380.6 million in FY 2016-17, and increase annually to over \$500.0 million in FY 2021-22.

**Tobacco Taxes.** Tax collections from the cigarette and other tobacco products taxes will total an estimated \$909.4 million in FY 2014-15, a decrease of 3.3% from FY 2013-14. In FY 2015-16, tobacco tax revenue is expected to decline another 1.2%, to \$898.2 million, before falling 2.0% in FY 2016-17, to \$880.5 million. The decline in total tobacco tax revenue masks a change in the composition of tobacco tax revenue that is expected to continue, as cigarette tax revenue declines more rapidly than total tobacco tax revenue, and revenue from taxes on other tobacco products (cigars, noncigarette smoking tobacco, and smokeless tobacco) actually increases. Tobacco tax collections also will be reduced by the reimbursement of costs related to the transition from paper to digital tax stamps. The reimbursements to the distribution firms that apply the tax stamps include the cost of stamping machines under the original legislation (Public Act 298 of 2014) and the cost of case-packing equipment, which was added by Public Act 298 of 2014. In addition, \$3.0 million of the former GF/GP share of the tobacco tax will be transferred to the Michigan State Capitol Historic Site Fund for operation, maintenance, and restoration of the State Capitol Building and grounds pursuant to Public Act 272 of 2014. These tobacco tax changes will reduce collections by \$10.0 million in FY 2014-15 (\$4.4 reduction in GF/GP revenue, \$3.9 million reduction in SAF revenue, and \$2.7 million reduction in other funds). The reduction will decline to \$5.0 million in FY 2015-16 as a portion of the reimbursements is completed.

**Casino Tax.** The State's tax on casinos equals 8.1% of gross gaming receipts and is directed to the SAF. In FY 2013-14, casino tax revenue totaled an estimated \$106.9 million, a reduction of 3.4% from FY 2012-13. As the economy continues to improve and the novelty of the Ohio casinos opened in 2013 declines, a portion of the lost casino tax revenue will be recovered. As a result, casino tax revenue is expected to recover in FY 2014-15, rising 3.8% to \$111.0 million. Growth is expected to continue in the subsequent years, with projected increases in the casino tax revenue of 3.6% in FY 2015-16 and 2.2% in FY 2016-17.

**State Education Property Tax.** Weakness in the housing sector drove State Education Tax (SET) revenue down each year from FY 2007-08 to FY 2012-13. Recovery in the housing market and taxable values resulted in growth in this tax beginning in FY 2013-14, when collections increased by 1.9%, to \$1.8 billion. As the housing market improves in later years, SET revenue is expected to increase 2.0% in FY 2014-15, 1.4% in FY 2015-16, and 1.8% in FY 2016-17. All of the revenue generated by the State Education Tax is earmarked to the SAF.

**Lottery.** Net lottery revenue was \$731.1 million in FY 2013-14, slightly below FY 2012-13. Revenue growth is expected to return during the forecast period as new games are introduced. Lottery revenue is expected to increase 2.2% in FY 2014-15, to \$750.0 million, and 1.6% in FY 2015-16, to \$762.0 million. Growth of 0.4% (net revenue of \$765.0 million) is forecast for FY 2016-17. All of the net revenue generated by the lottery is earmarked to the SAF.

**Michigan Business Tax/Corporate Income Tax.** Legislation adopted in May 2011 repealed the MBT for most taxpayers beginning January 1, 2012. Corporate taxpayers began paying the Corporate Income Tax (CIT), which generates about 40% as much revenue as what was received

under the MBT. Under the CIT, unincorporated businesses and "pass-through" entities such as S-corporations, partnerships, and many limited liability companies (LLCs) do not pay any separate business tax to the State. Those businesses that continue to pay the MBT do so in order to retain the ability to claim substantial refundable credits awarded in previous years. As a result, over the forecast period, MBT revenue will be negative, reflecting refund payments. The CIT is expected to grow over the forecast period, as profits improve, although the CIT is expected to be a more volatile tax than the MBT.

Michigan Business Tax refunds are expected to have a significant negative impact on business tax revenue over the forecast period. After totaling approximately \$773.3 million in FY 2013-14, estimated MBT credits are projected to reduce State revenue by more than \$500.0 million each year over the forecast period. However, several factors make it difficult to produce reliable estimates of MBT credit refunds. Although no new credits are being awarded, the Michigan Strategic Fund board from time to time amends previously awarded credits to adjust the terms based on the individual circumstances of eligible companies. These adjustments tend to increase the refund amounts in the near term, although in some cases the amendments may reduce the number of years for which a business is eligible for a credit. Additionally, eligible businesses have considerable flexibility as to when they will submit claims for credits, including credits for prior tax years. The credits are processed by the Michigan Strategic Fund agency that is responsible for reviewing compliance with the terms of the credits and issuing credit certificates to companies that have qualified. Furthermore, once the credit certificates are issued the taxpayer has some flexibility as to when to file an original or amended return that claims the credit. Once the return is submitted to Treasury, if there are issues requiring an audit or review (which could relate to the credit or to other aspects of the taxpayer's return), processing of the credit may be delayed. These revisions, timing, and processing issues create uncertainty in the estimates.

Because of the magnitude of these MBT credits, their unpredictable nature can result in large swings in General Fund revenue. A significant portion of the MBT credits that will be claimed in future years includes credits approved by the Michigan Economic Growth Authority (MEGA). Based on data from the Michigan Strategic Fund, the value of credits authorized under the MEGA program has increased substantially since 2011 as shown by the bars in [Figure 15](#). The value of credits approved in FY 2014-15 through FY 2016-17 increased 26%, but in some later years (2028 and 2029), the potential value of authorized credits more than doubled. The Michigan Strategic Fund forecasts how many of these authorized credits are likely to actually be claimed, and since 2011 the estimated use of credits also has roughly doubled as illustrated by the lines in [Figure 15](#). The difficulty for the revenue estimate is that in any given year, in addition to the timing and processing issues mentioned above, the estimate of use may be incorrect. For example, regardless of when credits are claimed and processed, although the Michigan Strategic Fund forecasts that only \$388.2 million of MEGA credits authorized for 2015 will be claimed, the State may ultimately be required to pay anywhere from zero to \$615.1 million of the credits authorized for 2015.

Since 2011, the total of MEGA credits authorized for use over the 2015 to 2032 period, but not yet claimed, has increased from \$4.9 billion to \$6.5 billion. Similarly, use has also been forecasted to increase, so that the amount of credits that are expected to be paid from those authorizations has grown from \$1.7 billion to \$4.9 billion. These credits reduce General Fund revenue and represent a significant portion of the Fund available in any given year. Based on preliminary final FY 2013-14 revenue, MBT credits reduced General Fund revenue by \$773.3 million, or approximately 8.6%, and approximately \$224.0 million of these refunds were posted as part of the accruals process that occurred after the fiscal year ended. Under the current forecast, MEGA credits (which represent a portion of the total credits that may be claimed), are predicted to total 4.0% of General Fund

revenue in FY 2014-15, and 3.8% in both FY 2015-16 and FY 2016-17, although the total potential credits (the credits authorized) represent as much as 6.4% of General Fund revenue (Figure 16).

Figure 15

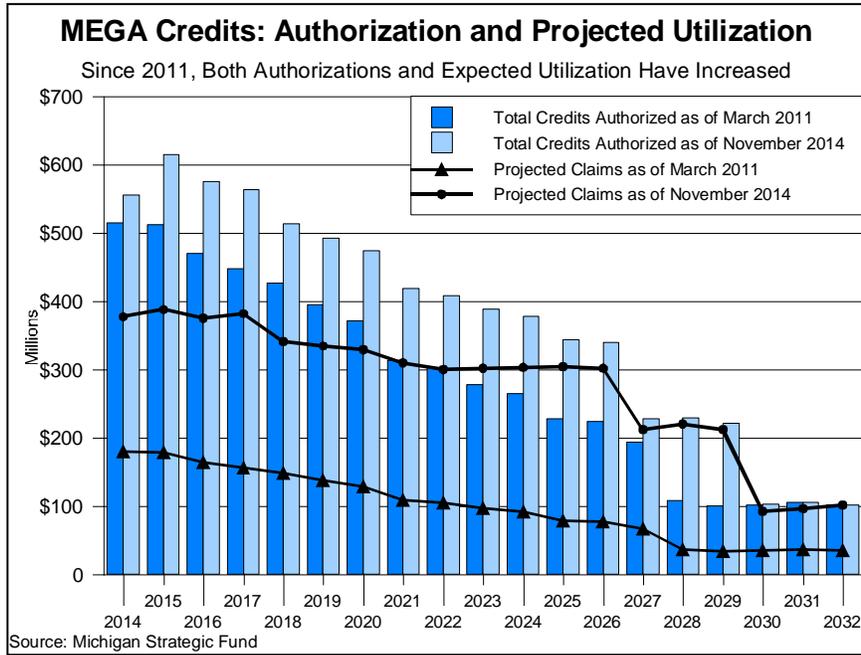
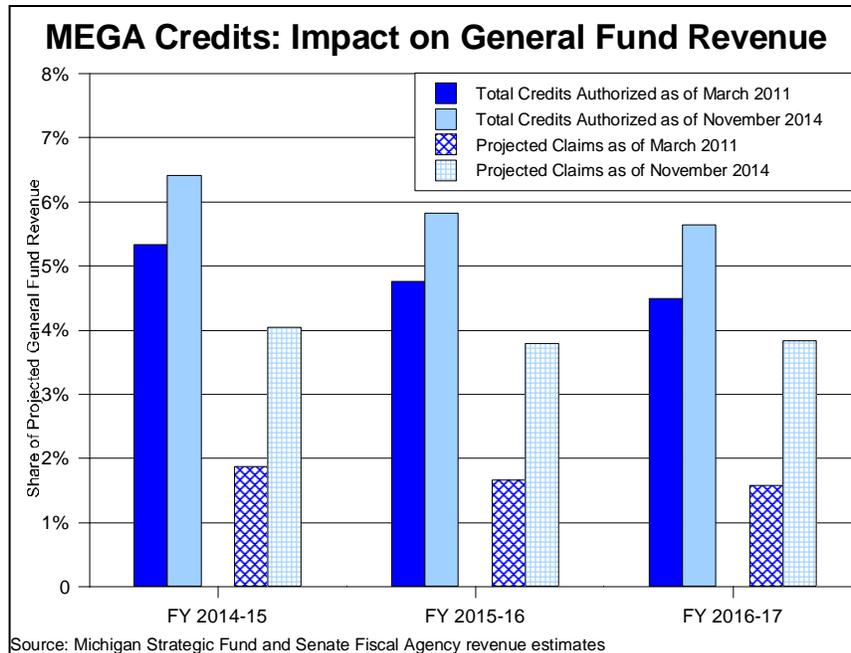


Figure 16



When these credits will be claimed and processed, as well as the amount that will be claimed, has little to no relationship with economic fundamentals and thus is essentially impossible to predict. Even if accurate predictions were possible, the variable nature of these credits still may lead to large swings in revenue from year-to-year. The data suggest that these swings in revenue could be substantial and exert a significant impact on General Fund revenue.

Other tax policy changes also have affected business tax revenue. Public Act 3 of 2014 reduced the ability of the Department of Treasury to recover certain unpaid business taxes from corporate officers, partners, or other parties. These changes, which became effective in FY 2013-14, are estimated to reduce CIT revenue by \$31.0 million in FY 2014-15, \$32.4 million in FY 2015-16, and \$33.4 million in FY 2016-17.

In FY 2013-14, CIT revenue grew 15.8%, but increased MBT credits and remaining refunds for the SBT and MBT resulted in net business tax revenue from the MBT, CIT, and SBT declining 79.2% in FY 2013-14, to only \$137.6 million. The revised estimate for business taxes in FY 2014-15 is \$446.7 million, which is \$21.3 million below the May 2014 consensus estimate. Net revenue from business taxes (the MBT and CIT plus remaining refunds under the SBT) is projected to increase by 4.6% in FY 2015-16 to \$467.3 million and grow 6.2% to \$496.3 million in FY 2016-17. All tax revenue from the CIT, MBT and SBT, as well as credits or refunds against these taxes, is allocated to the General Fund.

### **REVENUE TRENDS**

Revenue collections depend on both tax laws and economic conditions. Over time, different taxes tend to exhibit certain average growth rates, although these growth rates are often affected substantially by changes in the law. As a result, the forecast attempts to examine baseline revenue growth, which reflects the growth in revenue that would occur absent any changes to the law. However, the tax law assumed when computing a baseline is updated every year. Maintaining a common baseline over a long period of time could quickly become unwieldy and the difference between baseline and actual net collections would become so large that it would be difficult to estimate the revenue or even compare the two measures.

In any given year, actual revenue from any tax will generally deviate from the average growth rates, and the strength of forecasts largely depends on the ability to estimate these deviations. The inherent uncertainty of the future means that longer-term trend growth rates are less accurate than the more detailed forecast data for earlier fiscal years. Furthermore, history indicates that not only will the economy likely deviate from trends over this period but the Legislature is likely to enact various changes to the State's tax laws.

Based on a longer-term view of Michigan's economy for FY 2017-18 and FY 2018-19, net GF/GP revenue is expected to increase 4.7% in FY 2017-18, to \$10.5 billion, while SAF revenue will increase 3.0%, to \$12.9 billion. In FY 2018-19, net GF/GP revenue is expected to increase 3.5%, to \$10.8 billion, while SAF revenue will increase 3.2%, to \$13.3 billion.

### **SENATE FISCAL AGENCY BASELINE REVENUE FORECAST HISTORY**

Tables 8, 9, and 10 present the history of the Senate Fiscal Agency's and consensus estimates for GF/GP and SAF baseline revenue for FY 2013-14, FY 2014-15, and FY 2015-16. Baseline estimates are used to track the forecast history for these fiscal years in order to avoid the wide swings in revenue estimates that occur when tax changes are enacted for a particular fiscal year after the initial revenue estimates have been calculated for that fiscal year. In addition, in order to provide an accurate comparison, all of the previous baseline estimates made for FY 2013-14, FY 2014-15, and FY 2015-16 have been adjusted to reflect a common base year.

The Senate Fiscal Agency's initial GF/GP and SAF baseline revenue estimate for FY 2013-14 of \$20.1 billion was made in December 2011, as shown in Table 8. The estimate adopted at the January 2012 Consensus Revenue Estimating Conference was \$694.9 million above the SFA's

estimate. At the May 2012 consensus conference, the estimate was reduced by \$413.2 million. At the January 2013 consensus conference, the estimate was reduced again by \$133.4 million, and then increased by \$269.9 million at the May 2013 conference. The January 2014 consensus conference reduced the estimate by \$25.2 million. The estimate was then reduced by \$151.8 million at the May 2014 consensus conference. Preliminary final revenue for FY 2013-14 equals \$20.2 billion, down \$144.0 million from the May 2014 estimate. Compared with the SFA's initial estimate in December 2011, preliminary final 2013-14 GF/GP and SAF baseline revenue is up \$97.2 million or 0.5%.

**Table 8**  
**CHANGES IN SENATE FISCAL AGENCY**  
**BASELINE REVENUE ESTIMATES FOR FY 2013-14**  
(Millions of Dollars)

Forecast Date	GF/GP	SAF	Total
December 28, 2011	\$8,892.4	\$11,224.3	\$20,116.7
January 14, 2012 <sup>a)</sup>	9,426.7	11,384.8	20,811.6
May 9, 2012	8,989.5	11,446.0	20,435.5
May 16, 2012 <sup>a)</sup>	8,903.1	11,495.3	20,398.4
December 28, 2012	8,744.6	11,400.4	20,145.0
January 11, 2013 <sup>a)</sup>	8,812.2	11,452.8	20,265.0
May 13, 2013	9,017.1	11,474.2	20,491.3
May 15, 2013 <sup>a)</sup>	9,044.3	11,490.6	20,534.9
December 19, 2013	9,148.1	11,620.1	20,768.2
January 10, 2014 <sup>a)</sup>	8,932.9	11,576.8	20,509.7
May 13, 2014	8,756.8	11,539.3	20,296.1
May 15, 2014 <sup>a)</sup>	8,816.7	11,541.2	20,357.9
December 19, 2014	8,682.2	11,531.7	20,213.9
<u>Change From Previous Estimate:</u>			
Dollar Change	(\$134.5)	(\$9.5)	(\$144.0)
Percent Change	(1.5%)	(0.1%)	(0.7%)
<u>Change From Initial Estimate:</u>			
Dollar Change	(\$210.2)	\$307.4	\$97.2
Percent Change	(2.4%)	2.7%	0.5%
<sup>a)</sup> Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			
<b>Note:</b> Baseline base year equals FY 2012-13; baseline revenue reflects full earmark of sales tax revenue to revenue sharing.			

The initial GF/GP and SAF baseline revenue estimate for FY 2014-15 was made in December 2012 at \$20.4 billion, as shown in [Table 9](#). This estimate was increased by \$420.6 million at the January 2013 Consensus Revenue Estimating Conference, and then increased again by \$319.3 million at the May 2013 Consensus Revenue Estimating Conference. The January 2014 consensus conference increased the estimate by \$157.9 million; then the May 2014 consensus estimate decreased by \$252.1 million. The Senate Fiscal Agency's revised estimate for FY 2014-15 presented in this report reduces the baseline estimate by \$68.2 million below the May 2014 consensus estimate, to \$21.0 billion.

The initial GF/GP and SAF baseline revenue estimate for FY 2015-16 was made in December 2013, as shown in [Table 10](#). At that time, baseline revenue in FY 2015-16 was estimated at \$22.4 billion. This estimate was decreased by \$177.5 million at the January 2014 Consensus Revenue Estimating Conference, and decreased another \$308.7 million at the May 2014 Consensus Revenue Estimating Conference. The Senate Fiscal Agency's revised estimate for FY 2015-16

presented in this report reduces the baseline estimate by \$210.0 million below the May 2014 consensus estimate, to \$21.7 billion.

**Table 9**  
**CHANGES IN SENATE FISCAL AGENCY**  
**BASELINE REVENUE ESTIMATES FOR FY 2014-15**  
**(Millions of Dollars)**

<b>Forecast Date</b>	<b>GF/GP</b>	<b>SAF</b>	<b>Total</b>
December 28, 2012	\$8,803.6	\$11,629.9	\$20,433.5
January 11, 2013 <sup>a)</sup>	9,068.4	11,785.7	20,854.1
May 13, 2013	9,174.2	11,803.0	20,977.2
May 15, 2013 <sup>a)</sup>	9,343.6	11,829.8	21,173.4
December 19, 2013	9,529.0	11,993.3	21,522.3
January 10, 2014 <sup>a)</sup>	9,395.1	11,936.2	21,331.3
May 13, 2014	9,169.6	11,891.4	21,061.0
May 15, 2014 <sup>a)</sup>	9,178.3	11,900.9	21,079.2
December 19, 2014	9,074.0	11,937.0	21,011.0
<u>Change From Previous Estimate:</u>			
Dollar Change	(\$104.3)	\$36.1	(\$68.2)
Percent Change	(1.1%)	0.3%	(0.3%)
<u>Change From Initial Estimate:</u>			
Dollar Change	\$270.4	\$307.1	\$577.5
Percent Change	3.1%	2.6%	2.8%
<sup>a)</sup> Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			
<b>Note:</b> Baseline base year equals FY 2012-13; baseline revenue reflects full earmark of sales tax revenue to revenue sharing.			

**Table 10**  
**CHANGES IN SENATE FISCAL AGENCY**  
**BASELINE REVENUE ESTIMATES FOR FY 2015-16**  
**(Millions of Dollars)**

<b>Forecast Date</b>	<b>GF/GP</b>	<b>SAF</b>	<b>Total</b>
December 19, 2013	\$9,970.3	\$12,394.9	\$22,365.2
January 10, 2014 <sup>a)</sup>	9,850.3	12,337.4	22,187.7
May 13, 2014	9,571.0	12,263.0	21,834.0
May 15, 2014 <sup>a)</sup>	9,577.1	12,301.9	21,879.0
December 19, 2014	9,367.3	12,301.7	21,669.0
<u>Change From Previous Estimate:</u>			
Dollar Change	(\$209.8)	(\$0.2)	(\$210.0)
Percent Change	(2.2%)	0.0%	(1.0%)
<u>Change From Initial Estimate:</u>			
Dollar Change	(\$603.0)	(\$93.2)	(\$696.2)
Percent Change	(6.0%)	(0.8%)	(3.1%)
<sup>a)</sup> Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			
<b>Note:</b> Baseline base year equals FY 2012-13, baseline revenue reflects full earmark of sales tax revenue to revenue sharing.			



**BUDGET  
STABILIZATION FUND**



## ***BUDGET STABILIZATION FUND***

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The Counter-Cyclical Budget and Economic Stabilization Fund (BSF) was established by Public Act 76 of 1977, and subsequently included in the Management and Budget Act, Sections 351 to 359. The BSF, which also is known as the "Rainy Day Fund", 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 balance in the BSF is limited to 10.0% of the combined level of General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue. A balance at the end of a fiscal year higher than that amount is required to be rebated to individual income tax payers on returns filed after the end of that fiscal year.

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 (e.g., Social Security income, Medicaid benefits, and worker's compensation) 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 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.

To calculate the pay-in, the amount of real personal income growth over 2.0% in the prior calendar year is applied to the amount of General Fund revenue in the prior fiscal year. For example, the calculated pay-in for FY 2014-15 is based on personal income growth from calendar year 2013 to 2014 and GF/GP revenue in FY 2013-14. Different years are used to calculate a potential pay-out. A pay-out in FY 2014-15 depends on the change in personal income from calendar year 2014 to calendar year 2015 and the amount of GF/GP revenue in FY 2014-15.

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. In FY 2013-14, the Legislature transferred \$194.8 million from the BSF to the new Settlement Administration Fund for use as part of the

resolution of the Detroit bankruptcy. At the same time, an amendment to the Michigan Trust Fund Act was enacted to require the deposit of \$17.5 million from tobacco settlement revenue to the BSF annually for the 21 years from FY 2014-15 through FY 2034-35 to repay that transfer.

Table 11 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 2012-13. Also presented in this table are the SFA's estimates for FY 2013-14, FY 2014-15, FY 2015-16, and FY 2016-17. The BSF year-end balance as a percentage of GF/GP and SAF revenue is shown in Figure 17, and the estimated economic stabilization trigger calculations for FY 2014-15, FY 2015-16, and FY 2016-17 are presented in Table 12.

#### **FY 2013-14**

The BSF ended FY 2012-13 with an estimated balance of \$505.6 million. During FY 2013-14, \$75.0 million was appropriated to the Fund, although there was no statutory requirement for an appropriation. As part of the State contribution toward resolving the Detroit bankruptcy, Public Act 188 of 2014 provided for the transfer of \$194.8 million from the BSF to the newly created Settlement Administration Fund. Public Act 187 of 2014 appropriated \$194.8 million from the Settlement Administration Fund to the City of Detroit retirement systems, conditioned on the satisfaction of the criteria in the legislation. Interest earnings are estimated at \$2.5 million in FY 2013-14, resulting in an estimated ending balance of \$388.3 million.

#### **FY 2014-15, FY 2015-16, and FY 2016-17**

Based on the SFA's revised estimates of personal income, transfer payments, and the Detroit Consumer Price Index (CPI), the statutory formula triggers payments into Fund in FY 2014-15, FY 2015-16, and FY 2016-17.

In FY 2014-15, two deposits to the BSF have been enacted already. The annual budget (Public Act 252 of 2014) appropriated \$94.0 million to the BSF in FY 2014-15. In addition, Public Act 186 amended the Michigan Trust Fund Act to require the deposit of \$17.5 million of tobacco settlement revenue in the BSF annually from FY 2014-15 through FY 2034-35 to reimburse the BSF for the payment to the Detroit retirement systems. Based on growth in inflation-adjusted personal income, under the statutory formula, the deposit to the BSF, if appropriated by the Legislature, would be \$194.8 million in FY 2014-15, only coincidentally the same amount as the State contribution from the BSF for the Detroit retirement systems. This is \$83.3 million above the amounts already appropriated to the BSF in FY 2014-15.

The pay-in to the BSF is estimated at \$60.2 million in FY 2015-16 and \$101.7 million in FY 2016-17. A deposit of \$17.5 million each year already is required under the Trust Fund Act. The additional payments to the BSF, if appropriated by the Legislature, are estimated at \$42.7 million in FY 2015-16 and \$84.2 million in FY 2016-17.

If the additional formula deposits are appropriated, the year-end balance in the BSF is estimated at \$586.0 million in FY 2014-15, \$652.1 million in FY 2015-16, and \$763.6 million in FY 2016-17 as show in Table 11. If the additional formula deposits are not appropriated, the year-end fund balances are estimated at \$502.7 million in FY 2014-15, \$525.2 million in FY 2015-16, and \$550.6 million in FY 2016-17.

Table 11

<b>BUDGET AND ECONOMIC STABILIZATION FUND TRANSFERS, EARNINGS AND FUND BALANCE FY 1998-99 TO FY 2015-16 ESTIMATE (Millions of Dollars)</b>				
<b>Fiscal Year<sup>a)</sup></b>	<b>Pay-In</b>	<b>Interest Earned</b>	<b>Pay-Out</b>	<b>Fund Balance</b>
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
2007-08	0.0	0.1	0.0	2.2
2008-09	0.0	0.0	0.0	2.2
2009-10	0.0	0.0	0.0	2.2
2010-11	0.0	0.0	0.0	2.2
2011-12	362.7	0.2	0.0	365.1
2012-13	140.0	0.5	0.0	505.6
<b>Senate Fiscal Agency estimates:</b>				
2013-14 <sup>b)</sup>	\$75.0	\$2.5	\$194.8	\$388.3
2014-15 <sup>c)</sup>	194.8	2.9	0.0	586.0
2015-16 <sup>d)</sup>	60.2	5.9	0.0	652.1
2016-17 <sup>e)</sup>	101.7	9.8	0.0	763.6
<p><sup>a)</sup> For FY 1998-99 to FY 2012-13 the table shows the actual appropriated pay-in and pay-out to the BSF and the interest earned as reported in the State of Michigan Comprehensive Annual Financial Report. FY 2013-14 includes enacted legislation and estimated interest earnings. FY 2014-15 to FY 2016-17 show the estimated total pay-in, pay-out, and interest earnings, based on the statutory formula.</p> <p><sup>b)</sup> Pay-in was appropriated in Public Act 59 of 2013. Pay-out is the transfer of \$194.8 million in FY 2013-14 per PA 188 of 2014 from the BSF to the Settlement Administration Fund related to the Detroit bankruptcy.</p> <p><sup>c)</sup> The estimated formula pay-in (coincidentally the same amount as the Detroit transfer) totals \$194.8 million in FY 2014-15. PA 252 of 2014 appropriated \$94.0 million and PA 186 of 2014 requires the deposit of \$17.5 million of tobacco settlement revenue to the BSF in FY 2014-15 as the first repayment of the withdrawal related to the Detroit bankruptcy. This leaves a difference of \$83.3 million in FY 2014-15 between the amounts already appropriated and the estimated formula pay-in.</p> <p><sup>d)</sup> There is a difference of \$42.7 million between the estimated formula pay-in of \$60.2 million in FY 2015-16 and the \$17.5 million deposit authorized by PA 186 of 2014.</p> <p><sup>e)</sup> There is a difference of \$84.2 million between the estimated formula pay-in and the \$17.5 million authorized by PA 186 of 2014.</p>				

Figure 17

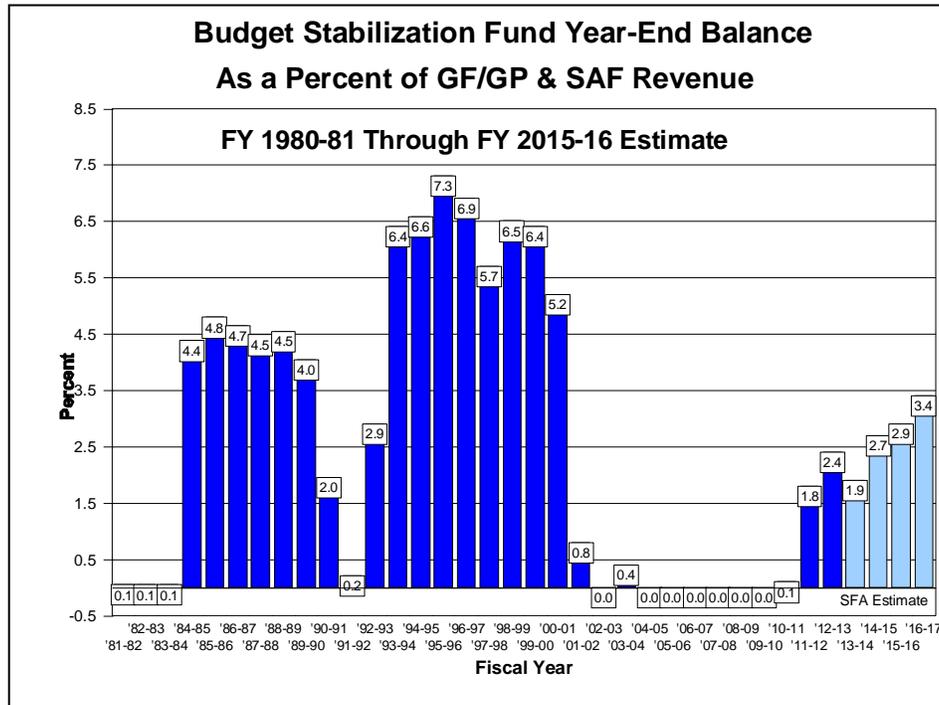


Table 12

**ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER  
FY 2014-15, FY 2015-16, and FY 2016-17  
(Millions of Dollars)**

	CY 2013	CY 2014	CY 2015	CY 2016	CY 2017
Michigan Personal Income (MPI)	\$386,471.2	\$402,754.8	\$420,125.0	\$438,630.0	\$456,138.0
Less: Transfer Payments	83,546	87,233	92,817	97,578	102,223
Subtotal	\$302,925	\$315,522	\$327,308	\$341,052	\$353,915
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	2.210	2.210	2.234	2.259	2.290
Equals: Real Adjusted MPI	\$137,089	\$142,789	\$146,538	\$150,975	\$154,568
Percent Change from Prior Year		4.16%	2.63%	3.03%	2.38%
Excess Over 2.0%		2.16%	0.63%	1.03%	0.38%
		<b>FY 2013-14</b>	<b>FY 2014-15</b>	<b>FY 2015-16</b>	<b>FY 2016-17</b>
Multiplied by: Estimated GF/GP Revenue		\$9,027.7	\$9,617.3	\$9,903.5	\$10,001.0
Equals: Transfer to the BSF			\$194.8	\$60.2	\$101.7
OR Transfer from the BSF			\$0.0	\$0.0	\$0.0

**Note:** Numbers may not add due to rounding. Table does not include dollars transferred to or from the BSF at the discretion of the Legislature, which are separate from the calculated trigger.

CY = Calendar Year; FY = Fiscal Year

**COMPLIANCE WITH  
STATE REVENUE LIMIT**



## **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. 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 and then remained well below the revenue limit in FY 2007-08 despite increases in the income and Michigan business tax rates. In the past, the largest gap between revenue and the limit occurred in FY 2008-09, when State revenue was \$8.0 billion below the revenue limit. For the future, it is estimated that the size of this gap will be exceeded during FY 2014-15, FY 2015-16, and FY 2016-17, with the amount that State revenue is below the limit forecast to increase to \$10.0 billion in FY 2016-17. Revenue remained substantially below the limit for FY 2009-10 through FY 2012-13. Based on the SFA's latest economic forecast and revenue estimates, it is estimated that revenue subject to the revenue limit will continue to remain well below the revenue limit in FY 2013-14 through FY 2016-17.

### **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, which equaled 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 example, in FY 2009-10, State government revenue could not exceed 9.49% of personal income for calendar year 2008. Given that Michigan personal income for 2008 equaled \$349.6 billion at the time compliance was determined, the revenue limit for FY 2009-10 was \$33.2 billion.

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 payers of individual income and business taxes, on a pro rata basis. These refunds would be given to taxpayers who file an individual income tax return or a Michigan Business Tax or Corporate Income 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 preliminary final revenue for FY 2013-14 and the SFA's revenue estimates for FY 2014-15, FY 2015-16, and FY 2016-17, revenue subject to the constitutional revenue limit is estimated to remain well below the limit for each of these fiscal years as illustrated in [Figure 18](#). The SFA's estimates of the State's compliance with the revenue limit are presented in [Table 13](#).

#### **FY 2013-14**

In FY 2013-14, the revenue limit equaled 9.49% of Michigan's personal income in calendar year 2012. The Bureau of Economic Analysis estimate of Michigan personal income in calendar year 2012 equaled \$381.3 billion, resulting in a revenue limit of \$36.2 billion for FY 2013-14. Based on the final revenue estimates for FY 2013-14, revenue subject to the revenue limit will equal an estimated \$27.3 billion, and will fall below the limit by \$8.9 billion, or 24.5%, in FY 2013-14. The gap between estimated revenue and the limit increased during FY 2013-14 due to the decline of 0.4% in revenue subject to the limit, compared to a 6.5% increase in personal income in 2012. The 2012 growth in personal income increased the FY 2013-14 revenue limit by \$2.2 billion.

#### **FY 2014-15**

The U.S. Department of Commerce Bureau of Economic Analysis estimate for Michigan personal income during 2013 equals \$386.5 billion, which results in a revenue limit equal to \$36.7 billion in FY 2014-15. This is an increase of \$489.4 million in the revenue limit. Based on the SFA's revised revenue estimates for FY 2014-15, revenue subject to the revenue limit will equal an estimated \$28.4 billion, which is an increase of \$1.1 billion from FY 2013-14. Revenue subject to the revenue limit will fall below the limit by an estimated \$8.2 billion, or 22.5%, in FY 2014-15. Revenue subject to the limit is estimated to increase 4.1% in FY 2014-15, compared with the 1.4% increase in personal income during 2013. With revenue growth higher than increases in personal income, the amount by which the State is under the revenue limit declines.

#### **FY 2015-16**

The Senate Fiscal Agency estimates that personal income in Michigan during 2014 will equal \$402.8 billion, and as a result, the revenue limit will equal \$38.2 billion in FY 2015-16, an increase of \$1.5 billion over FY 2014-15. Based on the SFA's initial revenue estimates for FY 2015-16, revenue subject to the revenue limit will equal an estimated \$29.3 billion. State revenue subject to the revenue limit will be below the limit by an estimated \$8.9 billion, or 23.4%, in FY 2015-16.

#### **FY 2016-17**

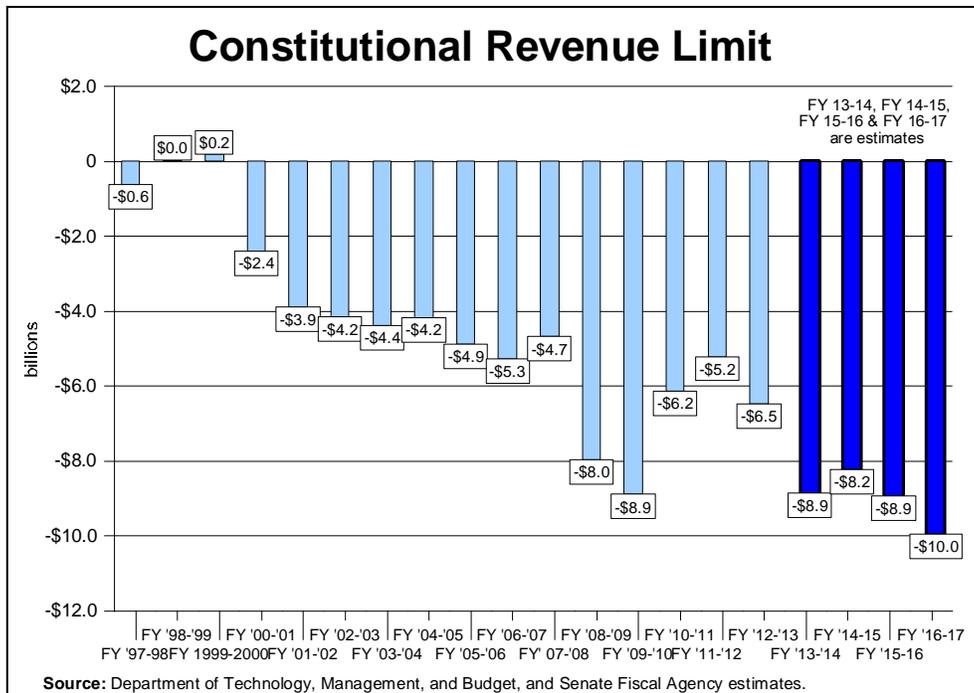
The Senate Fiscal Agency estimates that personal income in Michigan during 2015 will equal \$420.1 billion, and as a result, the revenue limit will equal \$39.9 billion in FY 2016-17. Based on the SFA's initial revenue estimates for FY 2016-17, revenue subject to the revenue limit will equal an estimated \$29.9 billion. State revenue subject to the revenue limit will fall below the limit by an estimated \$10.0 billion, or 25.0%, in FY 2016-17. The loss of use tax revenue due to personal property tax reform largely accounts for the significant increase in the amount by which State revenue is projected to be below the limit in FY 2016-17.

Table 13

**COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT  
SECTION 26 OF ARTICLE IX OF THE STATE CONSTITUTION  
FY 2012-13 THROUGH FY 2016-17 ESTIMATE  
(Millions of Dollars)**

	FY 2012-13 Final	FY 2013-14 Estimate	FY 2014-15 Estimate	FY 2015-16 Estimate	FY 2016-17 Estimate
<b>Revenue Subject to Limit</b>					
<b>Revenue:</b>					
Gen'l Fund/Gen'l Purpose (baseline)	\$9,957.4	\$9,756.3	\$10,180.6	\$10,517.2	\$10,891.4
Constitutional Revenue Sharing (baseline)	722.2	756.4	779.3	809.8	837.2
School Aid Fund (baseline)	11,279.6	11,531.7	11,937.0	12,301.7	12,636.8
Transportation Funds	2,099.7	2,160.7	2,178.6	2,198.5	2,218.6
Other Restricted Non-Federal Aid Revenue	3,809.5	3,923.8	4,041.5	4,162.7	4,287.6
<b>Adjustments:</b>					
GF/GP Federal Aid	(22.5)	(36.6)	(30.0)	(30.0)	(30.0)
GF/GP Balance Sheet Adjustments	(394.9)	(728.6)	(563.3)	(613.7)	(862.9)
SAF Balance Sheet Adjustments	(10.0)	(45.5)	(87.3)	(74.5)	(81.4)
<b>Total Revenue Subject to Limit</b>	<b>\$27,441.0</b>	<b>\$27,318.2</b>	<b>\$28,436.4</b>	<b>\$29,271.7</b>	<b>\$29,897.3</b>
<b>Revenue Limit</b>					
<b>Personal Income:</b>					
Calendar Year	CY 2011	CY 2012	CY 2013	CY 2014	CY 2015
Amount	\$358,152	\$381,314	\$386,471	\$402,755	\$420,125
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%	9.49%
Revenue Limit	\$33,988.6	\$36,186.7	\$36,676.1	\$38,221.4	\$39,869.9
1.0% of Limit	339.9	361.9	366.8	382.2	398.7
<b>Amount Under (Over) Limit</b>	<b>\$6,547.6</b>	<b>\$8,868.5</b>	<b>\$8,239.7</b>	<b>\$8,949.7</b>	<b>\$9,972.5</b>
Percent Below Limit	19.3%	24.5%	22.5%	23.4%	25.0%
CY = Calendar Year; FY = Fiscal Year					

Figure 18





**ESTIMATE OF  
YEAR-END BALANCES**



**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 2013-14 and FY 2014-15. This section also outlines projections for the FY 2015-16 State budget.

Table 14 provides a summary of the estimated year-end balances for the FY 2013-14, FY 2014-15, and FY 2015-16 GF/GP and SAF budgets. Although there were some unanticipated negative revenue adjustments during the ongoing book-closing process, there are still significant year-end balances in both the GF/GP and SAF budgets for FY 2013-14. The final accounting of FY 2013-14 revenue and appropriations has not been completed, but the SFA is estimating that when the final book-closing occurs, the GF/GP budget will have a \$358.8 million balance and the SAF budget will have a \$375.9 million balance. A comparison of the SFA estimate of FY 2014-15 revenue with actual and projected appropriations leads to a negative \$162.2 million GF/GP balance and a positive \$172.7 million year-end SAF balance.

The outlook for FY 2015-16 points to a negative GF/GP budget ending balance of \$186.4 million and a positive SAF ending balance of \$326.5 million.

**Table 14**

<b>GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND ESTIMATED YEAR-END BALANCES (Millions of Dollars)</b>			
	<b>FY 2013-14 Estimate</b>	<b>FY 2014-15 Estimate</b>	<b>FY 2015-16 Estimate</b>
General Fund/General Purpose	\$358.8	(\$162.2)	(\$186.4)
School Aid Fund	\$375.9	\$172.7	\$326.5

**FY 2013-14 YEAR-END BALANCE ESTIMATES**

Pursuant to provisions of the Management and Budget Act (Public Act 431 of 1984), the State Budget Director is required to publish preliminary, unaudited financial statements for the State General Fund and the School Aid Fund within 120 days after the end of the fiscal year. A comprehensive annual financial report (commonly referred to as the CAFR) is required within six months after the end of the fiscal year. This means that preliminary financial statements are not due until the end of January, and the final financial report is not due until the end of March.

Neither of these financial reports is currently available, but based on year-to-date accounting reports of FY 2013-14 GF/GP revenue and expenditures from the State Budget Office and the Department of Treasury, the SFA is estimating that the GF/GP budget will close the FY 2013-14 fiscal year with a \$358.8 million balance. The SFA is estimating that the FY 2013-14 SAF budget will close the fiscal year with a \$375.9 million balance.

The first column of Table 15 provides a summary of the current SFA estimate of a \$358.8 million balance in the FY 2013-14 GF/GP budget. Pursuant to statutory requirements, the actual level of the year-end balance will carry forward and be available as an FY 2014-15 revenue source. In fact, during the development of the FY 2014-15 budget, an estimated FY 2013-14 carry-forward amount of \$438.2 million in GF/GP revenue was built into the budget for FY 2014-15, so this revised amount falls \$79.4 million below the originally estimated amount.

On the revenue side of the FY 2013-14 GF/GP budget ledger, the SFA is now estimating that revenue will total \$10.0 billion. This represents a \$187.3 million or 1.8% decrease from the final

level of FY 2012-13 GF/GP revenue. The current SFA estimate of ongoing GF/GP revenue represents a \$291.6 million decrease from the May 2014 consensus revenue estimate. It is important to recognize that a significant portion of the decrease can be attributed to the fact that the estimate for Michigan Business Tax (MBT) revenue had been expected to be a negative \$556.5 million due primarily to the impact of the redemption of certificated credits issued to various businesses by the Michigan Strategic Fund Agency under now-expired provisions of the MBT Act. Using the most recent financial reports from the Department of Treasury, net MBT revenue for FY 2013-14 was a negative \$723.3 million due to several large accruals that appeared during the book-closing process, resulting in a decrease of \$171.3 million in the forecasted amount. There were other revenue sources, primarily individual income tax withholding and refunds, that also closed the year under the forecasted amount. The combination of these factors resulted in the \$291.6 million decrease in revenue from the May 2014 consensus revenue estimate.

On the expenditure side of the FY 2013-14 GF/GP budget ledger, the SFA is now estimating that expenditures will total \$9.6 billion, which includes an appropriation to the Budget Stabilization Fund of \$75.0 million and an appropriation of \$230.0 million to the Roads and Risks Reserve Fund. The \$9.6 billion of expenditures represents a \$640.4 million or 7.1% increase from the final level of FY 2012-13 GF/GP expenditures.

As Table 15 indicates, enacted supplemental appropriations for FY 2013-14 totaled \$16.4 million but this consists of various offsetting positive and negative amounts, including \$215.3 million GF/GP in the Department of Transportation for priority road projects and special winter road maintenance, and Medicaid expansion savings of \$87.8 million. The negative supplemental appropriations for FY 2013-14 included Public Act 356 of 2014, which reduced GF/GP funding in the Departments of Community Health and Human Services by \$42.0 million to reflect caseload and cost adjustments agreed upon at the May 2014 Consensus Revenue Estimating Conference. Other adjustments to the Department of Community Health budget included \$72.3 million for actuarial soundness requirements related to the use tax on Medicaid managed care plans, and \$101.2 million to offset the Health Insurance Claims Assessment (HICA) revenue shortfall. There were also larger-than-usual estimated year-end lapses of \$244.4 million, primarily in the Department of Community Health, which accounted for \$181.9 million of the total lapses.

The first column of Table 16 provides a summary of the FY 2013-14 SFA estimate of a \$375.9 million 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 2014-15 revenue source. As mentioned previously, the FY 2014-15 budget was developed assuming that funds carried forward from FY 2013-14 would be used for FY 2014-15 appropriations. When the FY 2014-15 budget was developed, the assumption was that \$294.8 million would be available at the FY 2013-14 year-end and carried forward; the estimate now is that \$375.9 million is available, or \$81.1 million more than earlier projected. The additional \$81.1 million in the estimated year-end balance comes from two sources: slightly lower projected revenue and lower anticipated costs resulting in lapses.

On the revenue side of the FY 2013-14 SAF budget ledger, the SFA is now estimating that revenue will total \$14.0 billion. This represents a \$512.4 million or 3.8% increase from the final level of FY 2012-13 SAF revenue; in FY 2013-14 there was \$155.8 million more in Federal aid than in FY 2012-13, along with a new revenue source of \$156.0 million from the MPERS Reserve Fund, and growth in the SAF. The current SFA estimate of ongoing SAF revenue for FY 2013-14 (excluding GF/GP and Federal revenue) represents a \$10.0 million decrease from the May 2014 consensus revenue estimate. The estimate also includes \$85.9 million in Managed Care Use Tax revenue.

On the expenditure side of the FY 2013-14 SAF budget ledger, the SFA is now estimating that expenditures will total \$13.6 billion. This represents a \$428.5 million or 3.3% increase from the final level of FY 2012-13 SAF expenditures. The estimated final level of FY 2013-14 SAF expenditures

includes the initial ongoing K-12 appropriation of \$13.2 billion, \$193.0 million in one-time K-12 appropriations, K-12 cost adjustments of a negative \$109.3 million, enacted supplementals totaling \$69.8 million, and estimated K-12 year-end lapses of \$110.0 million. It should also be noted that the estimated final level of FY 2013-14 SAF expenditures includes \$398.1 million of appropriations to the Community Colleges and Higher Education budgets.

### **FY 2014-15 YEAR-END BALANCE ESTIMATES**

On June 11 and 12, 2014, the Michigan Legislature completed action on the initial set of FY 2014-15 appropriation bills. The FY 2014-15 initially enacted budget was balanced based on the May 2014 consensus estimates. At the time the initial budget was enacted, the SFA was projecting only a \$4.3 million year-end balance in the GF/GP budget. The current SFA estimate of the FY 2014-15 GF/GP year-end balance is a negative \$162.2 million. At the same time, based on the May 2014 consensus revenue estimate, the SFA was projecting a \$0.2 million year-end balance in the SAF budget. The current SFA estimate of the FY 2014-15 SAF year-end balance is \$172.7 million.

The second column of Table 15 provides a summary of the current SFA estimate of a negative \$162.2 million year-end balance in the FY 2014-15 GF/GP budget. The decrease in the projected level of the FY 2014-15 GF/GP year-end balance results primarily from a smaller carry-forward balance from FY 2013-14 (\$79.4 million less than expected) and an estimated decrease of \$208.7 million from the revenue amount estimated at the May 2014 consensus revenue conference.

On the revenue side of the FY 2014-15 GF/GP budget ledger, the SFA is now estimating that revenue will total \$9.9 billion. This estimate includes a projected \$358.8 million balance carried forward from FY 2013-14, \$9.6 billion of revenue from ongoing sources, an \$8.8 million revenue reduction due to a one-time appropriation for State revenue sharing, and an adjustment of \$38.1 million to account for Venture Michigan Fund tax credit vouchers that the Department of Treasury estimates may be redeemed in FY 2014-15. The total estimated GF/GP revenue of \$9.9 billion represents a \$124.8 million, or 1.2%, decrease from the FY 2013-14 estimate. The current SFA estimate of FY 2014-15 GF/GP revenue represents a \$208.7 million decrease from the May 2014 consensus revenue estimate. This downward revision in revenue is primarily the result of assuming that the FY 2013-14 personal income tax book-closing adjustments are carried forward.

On the expenditure side of the FY 2014-15 GF/GP budget ledger, the SFA is now estimating that expenditures will total \$10.0 billion. This total includes \$9.3 billion of ongoing appropriations in the initial appropriation bills, \$207.0 million in one-time appropriations in the initial appropriation bills, \$284.6 million of initial one-time appropriations in the Department of Transportation, a one-time appropriation of \$94.0 million to the Budget Stabilization Fund, an enacted supplemental of \$30.0 million, \$150.5 million for actuarial soundness related to the managed care use tax, \$187.6 million to offset the estimated HICA revenue shortfall, \$110.0 million of savings related to caseload and cost changes in the Departments of Community Health and Human Services, \$22.0 million of revenue remaining in the Roads and Risks Reserve Fund, and \$50.0 million of estimated year-end lapses. Since the initial budget was passed, one GF/GP supplemental appropriation for the Department of State Police has been enacted: \$30.0 million for disaster assistance for flooding and deep frost emergencies.

The second column in Table 16 provides a summary of the current SFA estimate of a \$172.7 million year-end balance in the FY 2014-15 SAF budget. The increase in the projected level of the FY 2014-15 SAF year-end balance (\$172.5 million more than originally estimated) results primarily from a larger carry-forward balance from FY 2013-14 (\$81.1 million more than expected) while revenue is estimated to decrease slightly by \$3.6 million from the amount estimated at the May 2014 consensus revenue conference. In addition, costs in FY 2014-15 are now estimated to be \$93.9 million lower than appropriated.

On the revenue side of the FY 2014-15 SAF budget ledger, the SFA is now estimating that revenue will total \$14.4 billion. This estimate includes a \$375.9 million balance carried forward from FY 2013-14, \$11.8 billion of State Restricted SAF revenue, a \$114.9 million GF/GP grant to the SAF budget, and \$1.8 billion of ongoing Federal aid. The estimate also includes \$18.0 million transferred from the MPERS Retirement Obligation Reform Reserve Fund to support the FY 2014-15 SAF budget. The current SFA estimate of total FY 2014-15 SAF revenue represents a \$364.9 million or 2.6% increase from the projected level of FY 2013-14 SAF revenue. The current estimate of FY 2014-15 State Restricted SAF revenue is \$3.6 million lower than the May 2014 consensus estimate. The estimate also includes \$196.4 million in managed care use tax revenue.

On the expenditure side of the FY 2014-15 SAF budget ledger, the SFA is now estimating that expenditures will total \$14.2 billion. This expenditure estimate includes \$13.5 billion of ongoing K-12 appropriations in the initial appropriation bill, \$376.2 million in one-time appropriations in the initial appropriation bill, and negative cost adjustments totaling \$93.9 million. The \$93.9 million in reduced anticipated expenditures stems from fewer pupils than estimated (savings of \$28.0 million), adjustments in taxable values and associated impacts (savings of \$42.0 million), lower special education costs than anticipated (savings of \$22.0 million), and other adjustments. It also should be noted that the estimated level of FY 2014-15 SAF expenditures includes \$402.1 million of appropriations to the Community Colleges and Higher Education budgets. The projected level of FY 2014-15 SAF expenditures represents a \$568.1 million or 4.2% increase from the projected level of FY 2013-14 SAF expenditures.

### **FY 2015-16 STATE BUDGET OUTLOOK**

Pursuant to statutory requirements, the Governor must submit a detailed FY 2015-16 State budget recommendation to the Legislature no later than February 11, 2015. This State budget recommendation will continue the debate on the FY 2015-16 State budget. On February 5, 2014, Governor Snyder presented his FY 2014-15 budget and his projections for FY 2015-16. The Legislature subsequently enacted an FY 2014-15 State budget and included language within that budget expressing intent to provide FY 2015-16 appropriations that would be the same as those for FY 2014-15, with adjustments for caseload, costs, economic factors, and available revenue.

The estimated FY 2014-15 GF/GP revenue and expenditures produce a projected negative ending balance of \$162.2 million. Pursuant to law, this negative ending balance must be eliminated because the State of Michigan has a balanced budget requirement in the State Constitution. If it is assumed that this negative ending balance is resolved, and that a zero beginning balance is carried forward into FY 2015-16, and if FY 2015-16 appropriations are essentially frozen at FY 2014-15 levels, with adjustments for caseload and costs in the Departments of Community Health and Human Services, there will be an FY 2015-16 projected year-end GF/GP balance of a negative \$186.4 million. The third column of Table 15 outlines these assumptions.

On the revenue side of the FY 2014-15 budget ledger, the SFA is projecting that total estimated GF/GP revenue will equal \$9.8 billion. This estimate assumes a beginning balance of zero and ongoing revenue of \$9.9 billion, which represents a decrease of \$341.8 million from the May 2014 consensus estimate. This downward revision in revenue is again primarily the result of assuming that the FY 2013-14 personal income tax book-closing adjustments are carried forward, along with a predicted slowing in the economy for FY 2015-16. The total GF/GP revenue estimate also assumes a continuation of State revenue sharing payments at the FY 2014-15 level plus \$3.4 million to account for the estimated cost of counties projected to exhaust their revenue sharing reserve funds and return to the State-paid program.

On the appropriation side of the FY 2015-16 budget ledger, the SFA estimate assumes the continuation of appropriations at the FY 2014-15 levels for both ongoing and one-time GF/GP appropriations. Adjustments are then made to: remove the FY 2014-15 appropriation to the Budget Stabilization Fund; include \$155.0 million for actuarial soundness and \$187.0 million for the estimated HICA revenue shortfall for FY 2015-16; recognize Department of Community Health and Department of Human Services caseload and cost changes that would decrease spending by \$110.0 million; and include an estimate of \$50.0 million for year-end lapses. These assumptions lead to total estimated FY 2015-16 GF/GP expenditures of \$10.0 billion and a projected year-end GF/GP balance of a negative \$186.4 million.

The third column of Table 16 provides a summary of the SFA's outlook for the FY 2015-16 SAF budget. A comparison of current law SAF revenue and a continuation of FY 2014-15 funding levels, adjusted for estimated pupils and costs, leads to a \$326.5 million FY 2015-16 projected year-end balance.

On the revenue side of the FY 2015-16 SAF budget outlook, the SFA is estimating that revenue will total \$14.5 billion. This estimate assumes a carry-forward of \$172.7 million from FY 2014-15, a decrease in the level of School Aid Fund revenue of \$30.8 million from the May 2014 consensus forecast, a GF/GP grant of \$125.9 million, no transfer from the MPSERS Retirement Obligation Reform Reserve Fund (compared with the FY 2014-15 transfer of \$18.0 million), and estimated Federal aid of \$1.8 billion. The estimate also includes \$208.3 million in managed care use tax revenue.

On the appropriation side of the FY 2015-16 SAF budget outlook, the SFA is estimating that a continuation appropriation level of ongoing funding will equal \$14.2 billion. This funding level assumes that SAF appropriations of \$404.1 million for community colleges and universities are continued and that roughly one-half of the one-time K-12 appropriations (\$197.1 million out of \$376.2 million in FY 2014-15) are continued. One-time funding items that are not continued for this analysis include the additional payment toward MPSERS liabilities (\$108.0 million), the final *Durant* bonds payment (\$39.5 million), an updating of teacher certification tests (\$1.8 million), and funding for an online nutrition education program (\$1.2 million). In addition, the SFA estimate of a continuation level of K-12 funding takes into account updated estimates as to the number of students in local school districts and preliminary estimates of local property tax valuations, special education costs, debt service costs, and MPSERS rate cap costs (which in May 2014 were projected to increase \$239.6 million above FY 2014-15 costs, but which are now projected to increase \$108.7 million due to a lower estimate for pupils and special education costs, continued adjustments to taxable values, and other refinements in estimated costs).

A comparison of projected FY 2015-16 SAF current law revenue and a continuation of current spending leads to an estimated ending balance of \$326.5 million, which equates to roughly \$218 on a per-pupil basis. Again, this estimate assumes a continuation of both ongoing and one-half of the one-time appropriations, no transfer of funds from the MPSERS Reform Reserve Fund, the same level of GF/GP support as in FY 2014-15, and continued SAF support of \$404.1 million for community colleges and universities.

One revenue source that may be available to appropriate in the K-12 budget in the future, if necessary or desired, is the MPSERS escrow account, which has accumulated since July 1, 2010. This account received employee 3.0% contributions as prescribed under Public Act 75 of 2010, and today totals more than \$500.0 million. During 2012, discussions of calculations related to prefunding retiree health care in the MPSERS plan noted that appropriations from the escrow account likely would be necessary in order to keep a structurally balanced K-12 budget. However, a clarification from the courts may be necessary as to the availability of the funds in this account, before their expenditure.

## **HICA AND USE TAX SUMMARY**

The Health Insurance Claims Assessment (HICA) was reduced from 1.0% to 0.75% on July 1, 2014. The HICA is applied to medical claims with certain exemptions (such as federally run programs like Medicare and Veterans' Administration health services).

A 6.0% Medicaid managed care use tax was reinstated effective April 1, 2014. This tax applies to Medicaid managed care organizations that provide physical health and behavioral health services to the "regular" Medicaid population as well as the Medicaid expansion population. Because two-thirds of this use tax revenue goes to the General Fund and one-third to the School Aid Fund, the reinstatement of the tax affects both the General Fund and the School Aid Fund.

The Federal government requires states to pay actuarially sound rates to Medicaid managed care organizations. When a change in policy increases or decreases costs to Medicaid managed care organizations, the State must adjust the capitation rates paid to those organizations. The 6.0% use tax effectively increases costs to such organizations by about 6.0%; therefore, payment rates were increased by that amount on April 1, 2014. The use tax will increase State revenue and thus managed care costs by \$589.3 million in FY 2014-15. The payment rates for Medicaid managed care organizations were increased by \$589.3 million Gross in FY 2014-15, at a cost of \$150.5 million GF/GP, with the rest being Federal Medicaid matching funds.

The balance sheets for both the GF/GP budget and the SAF reflect each of these policy changes. General Fund revenue is increased by \$171.8 million in FY 2013-14, \$392.9 million in FY 2014-15, and \$417.0 million in FY 2015-16 to reflect the General Fund portion of the Medicaid managed care use tax. School Aid Fund revenue is increased by \$85.9 million in FY 2013-14, \$196.4 million in FY 2014-15, and \$208.3 million in FY 2015-16 to reflect the School Aid Fund portion of the Medicaid managed care use tax.

The GF/GP balance sheet also includes the GF/GP portion of the actuarial soundness adjustment for the Medicaid managed care use tax: \$72.3 million in FY 2013-14, \$150.5 million in FY 2014-15, and \$155.0 million in FY 2015-16.

Finally, the GF/GP balance sheet includes the cost of filling the GF/GP shortfall caused by the difference between the actual estimated HICA revenue and the budgeted amount: \$101.2 million in FY 2013-14, \$187.6 million in FY 2014-15, and \$187.0 million in FY 2015-16. The shortfall increased from earlier estimates due to the reduction in the HICA rate from 1.0% to 0.75%.

## **CONCLUSION**

Although the FY 2013-14 estimated GF/GP and SAF year-end balances appear to be quite healthy, at \$358.8 million and \$375.9 million, respectively, all of those funds will be needed to balance the FY 2014-15 GF/GP and SAF budgets. Compared with the GF/GP budget, the SAF budget is in better shape, with estimated positive ending balances for all three fiscal years displayed in this analysis. School Aid Fund revenue is essentially unchanged from the May 2014 consensus revenue conference, reflecting, in part, the growth in State sales tax revenue. The GF/GP budget is estimated to end both FY 2014-15 and FY 2015-16 with negative balances but these negative balances could be mitigated by replacing GF/GP revenue with other available fund sources, including tobacco settlement revenue. Tables 15 and 16 summarize the projected year-end balances for all three fiscal years, for the GF/GP and School Aid Fund budgets, respectively.

The FY 2013-14 estimated ending balances may change when the State's final comprehensive annual financial report is published, which is not required by law until the end of March 2015, but is

expected in early January 2015. To the extent that the FY 2013-14 numbers change due to pending accruals or other issues, the ending balances for FY 2014-15 and FY 2015-16 will be affected. Also, to the extent that policy changes are enacted during 2015, the projected ending balances could be improved or worsened. For example, legislation could be enacted to resolve the road funding issue, which could allow the diversion of GF/GP revenue from the Department of Transportation budget to other areas, but there is also the possibility that other State revenue sources could be affected by the road funding issue and would have a negative impact on the State GF/GP budget.

All of the estimated year-end balances in this report are based on the Senate Fiscal Agency's revenue projections, which the SFA will take to the January 16, 2015, Consensus Revenue Estimating Conference. At that time, a consensus will be reached among the SFA, the House Fiscal Agency, and the State Treasurer regarding the revenue estimates to be used for the development of the FY 2015-16 State budget, as well as for subsequent fiscal years.

**Table 15**  
**FY 2013-14, FY 2014-15, AND FY 2015-16**  
**GENERAL FUND/GENERAL PUURPOSE (GF/GP)**  
**REVENUE, EXPENDITURES AND YEAR-END BALANCE ESTIMATES**  
**(Millions of Dollars)**

	FY 2013-14	FY 2014-15	FY 2015-16
<b>Revenue:</b>			
Beginning Balance .....	\$1,186.6	\$358.8	\$0.0
<u>Ongoing Revenue:</u>			
May 2014 Consensus Revenue Estimate .....	\$9,319.3	\$9,826.0	\$10,245.3
SFA Estimated Revenue Change .....	(291.6)	(208.7)	(341.8)
SFA Revenue Estimate .....	\$9,027.7	\$9,617.3	\$9,903.5
<u>Other Revenue Adjustments:</u>			
Revenue Sharing Payments.....	(370.6)	(459.2)	(462.6)
Shift of Short-Term Borrowing Costs to School Aid Fund .....	1.2	2.5	4.0
Managed Care Use Tax (PA 161 of 2014) .....	171.8	392.9	417.0
Subtotal Ongoing Revenue.....	\$8,830.1	\$9,553.5	\$9,861.9
<u>Non-Ongoing Revenue:</u>			
One-Time Appropriation for Revenue Sharing .....	(26.0)	(8.8)	(8.8)
Venture Michigan Fund Adjustment .....	0.0	(38.1)	(38.1)
<b>Total Estimated GF/GP Revenue.....</b>	<b>\$9,990.7</b>	<b>\$9,865.4</b>	<b>\$9,815.0</b>
<b>Expenditures:</b>			
Initial Ongoing Appropriations.....	\$8,952.0	\$9,255.9	\$9,327.8
Initial One-Time Appropriations .....	307.9	207.0	207.0
Initial One-Time Appropriations for Transportation.....	121.3	284.6	284.6
One-Time Appropriation to Budget Stabilization Fund .....	75.0	94.0	0.0
One-Time Appropriation to Roads and Risks Reserve Fund ...	230.0	0.0	0.0
Enacted Supplementals.....	16.4	30.0	0.0
Actuarial Soundness Adjustment for Managed Care Use Tax ..	72.3	150.5	155.0
Health Insurance Claims Assessment Revenue Shortfall .....	101.2	187.6	187.0
SFA Estimated DCH and DHS Caseload/Cost Adjustments....	0.0	(110.0)	(110.0)
Roads and Risks Reserve Fund Balance .....	0.0	(22.0)	0.0
Estimated Year-End Lapses.....	(244.4)	(50.0)	(50.0)
<b>Total Estimated GF/GP Expenditures .....</b>	<b>\$9,631.9</b>	<b>\$10,027.6</b>	<b>\$10,001.4</b>
<b>Projected Year-End GF/GP Balance .....</b>	<b>\$358.8</b>	<b>(\$162.2)</b>	<b>(\$186.4)</b>

Table 16

**FY 2013-14, FY 2014-15, AND FY 2015-16  
SCHOOL AID FUND (SAF)  
REVENUE, EXPENDITURES AND YEAR-END BALANCE ESTIMATES  
(Millions of Dollars)**

	FY 2013-14	FY 2014-15	FY 2015-16
<b>Revenue:</b>			
Beginning Balance .....	\$292.0	\$375.9	\$172.7
<b>Ongoing Revenue:</b>			
May 2014 Consensus Revenue Estimate .....	\$11,496.3	\$11,853.3	\$12,258.1
SFA Estimated Revenue Change .....	(10.0)	(3.6)	(30.8)
SFA Revenue Estimate .....	\$11,486.3	\$11,849.7	\$12,227.3
<b>Other Revenue Adjustments:</b>			
General Fund/General Purpose Grant .....	95.0	95.0	95.0
Federal Ongoing Aid .....	1,764.5	1,808.2	1,808.2
MPERS/Education Reserve Fund .....	156.0	18.0	0.0
Reimbursement from GF for PPT Reform.....	0.0	19.9	30.9
Managed Care Use Tax (PA 161 of 2014).....	85.9	196.4	208.3
Subtotal Ongoing Revenue.....	\$13,587.7	\$13,987.2	\$14,369.7
<b>Non-Ongoing Revenue:</b>			
General Fund/General Purpose Grant .....	54.9	0.0	0.0
Federal Race to the Top Challenge Grant .....	51.7	0.0	0.0
Venture Michigan Fund Adjustment.....	0.0	(11.9)	(11.9)
<b>Total Estimated School Aid Fund Revenue .....</b>	<b>\$13,986.3</b>	<b>\$14,351.2</b>	<b>\$14,530.5</b>
<b>Expenditures:</b>			
Initial Ongoing Appropriations.....	\$13,168.8	\$13,494.1	\$13,494.1
January 2014 Consensus Cost Adjustments.....	(109.3)	0.0	0.0
May 2014 MPERS and Other Cost Adjustments .....	0.0	0.0	239.6
December 2014 SFA Estimated Cost Adjustments.....	0.0	(93.9)	(130.9)
Partially Fund Community Colleges with School Aid Fund .....	197.6	197.6	197.6
Partially Fund Higher Education with School Aid Fund .....	200.5	200.5	200.5
Subtotal Ongoing Appropriations.....	\$13,457.6	\$13,798.3	\$14,000.9
Initial One-Time Appropriations .....	193.0	376.2	197.1
Enacted Supplementals.....	69.8	0.0	0.0
MPERS Funding for Universities.....	0.0	4.0	6.0
Subtotal One-Time Appropriations .....	\$262.8	\$380.2	\$203.1
Estimated Year-End Lapses.....	(110.0)	0.0	0.0
<b>Total Estimated School Aid Fund Expenditures .....</b>	<b>\$13,610.4</b>	<b>\$14,178.5</b>	<b>\$14,204.0</b>
<b>Projected Year-End School Aid Fund Balance .....</b>	<b>\$375.9</b>	<b>\$172.7</b>	<b>\$326.5</b>







