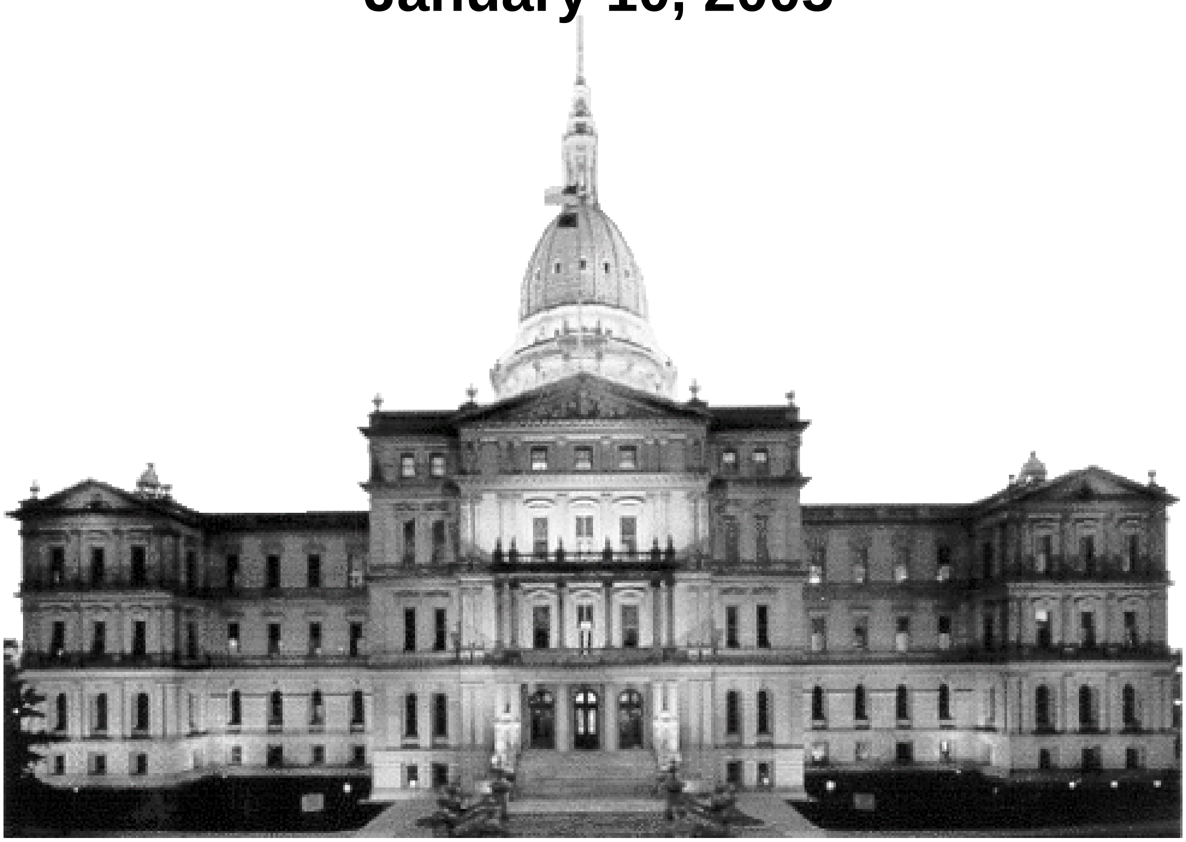
Senate Fiscal Agency

MICHIGAN'S ECONOMIC OUTLOOK AND BUDGET REVIEW

FY 2003-04, FY 2004-05 AND FY 2005-06

January 10, 2005



Gary S. Olson, Director – Lansing, Michigan – (517) 373-2768 – TDD (517) 373-0543
www.senate.michigan.gov/sfa

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Gary S. Olson, Director
Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536
Telephone (517) 373-2767; TDD (517) 373-0543
Internet Home Page http://www.senate.michigan.gov/sfa

ACKNOWLEDGEMENT

This Economic Outlook and Budget Review was prepared and written by Gary S. Olson, Director, Jay Wortley, Senior Economist, and David Zin, Economist, of the Senate Fiscal Agency. Karen Hendrick, Executive Secretary, coordinated the production of this report.

TABLE OF CONTENTS

EXECUTIVE SUMMARY

ECONOMIC FORECAST

The U.S. economy, as measured by inflation-adjusted gross domestic product, will increase at an estimated rate of 3.2% in 2005 and 3.0% in 2006, after increasing an estimated 4.4% in 2004. Light vehicle sales will total 16.7 million units in 2004, and rise to 16.8 million units in 2005 and 17.0 million in 2006. The unemployment rate will be 5.5% in both 2004 and 2005, before increasing slightly to 5.7% in 2006.

The Michigan economy, as measured by inflation-adjusted personal income, increased at an estimated rate of 0.9% in 2004 and is expected to increase 2.1% in 2005 and 3.0% in 2006. Wage and salary employment is expected to post modest gains of 0.3% in 2005 and 0.7% in 2006, after declining an estimated 1.1% in 2004.

REVENUE FORECAST

In FY 2003-04, General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue totaled $18.7 billion, which was down 0.1% from fiscal year (FY) 2002-03. General Fund/General Purpose revenue was up 1.1% to $8.0 billion and SAF revenue was down 0.9% to $10.6 billion. In FY 2004-05, GF/GP and SAF revenue will total an estimated $18.8 billion, which is up 0.5% from FY 2003-04. This revised estimate is up $31 million from the December 2004 consensus estimate. General Fund/General Purpose revenue will decline an estimated 2.1% to $7.9 billion and SAF revenue will increase an estimated 2.5% to $10.9 billion. In FY 2005-06, GF/GP and SAF revenue will total an estimated $19.4 billion, representing a 3.6% increase from the revised estimate for FY 2004-05. General Fund/General Purpose revenue will increase an estimated 3.4% to $8.1 billion and SAF revenue will increase an estimated 3.7% to $11.3 billion.

YEAR-END BALANCE ESTIMATES

Based on a final accounting of FY 2003-04 revenue and expenditures, the FY 2003-04 GF/GP budget closed the fiscal year with an $81.3 million balance. Pursuant to statutory requirements this balance was deposited into the Budget Stabilization Fund. The FY 2003-04 School Aid Fund budget closed the fiscal year with a $74.1 million balance. This balance was carried forward into FY 2004-05.

A comparison of the FY 2004-05 Senate Fiscal Agency (SFA) revenue estimate with enacted and projected appropriations leads to a projected $405.9 million FY 2004-05 GF/GP budget deficit. Governor Granholm is expected to make recommendations to the Legislature regarding the elimination of this budget deficit about the same time she submits her FY 2005-06 budget message to the Legislature on February 10, 2005. The SFA is now estimating that the FY 2004-05 School Aid Fund budget is in surplus by $74.2 million.

An analysis of the issues that will be facing the Governor and the Legislature as they begin work on the FY 2005-06 State budget leads to sharp differences between the potential status of the GF/GP and School Aid Fund budgets. Absent any change in tax policy, the FY 2005-06 GF/GP budget will be characterized by significant fiscal restraint. This fiscal restraint is caused by the combination of restrained GF/GP revenue growth, the elimination of a modest amount of non-ongoing revenue built into the FY 2004-05 GF/GP budget, and funding issues in the State Medicaid program. The outlook for the FY 2005-06 School Aid Fund budget looks considerably brighter as it appears that revenue will exist under the current budget policy for a modest increase in School Aid Fund appropriations.

EXECUTIVE SUMMARY

SENATE FISCAL AGENCY
ECONOMIC AND BUDGET SUMMARY

Economic Projections
(Calendar Year)

	2003 Actual	2004 Estimate	2005 Estimate	2006 Estimate
Real Gross Domestic Product (% change)	3.0%	4.4%	3.2%	3.0%
U.S. Consumer Price Index (% change)	2.3%	2.7%	2.6%	2.6%
Light Motor Vehicle Sales (millions of units)	16.6	16.7	16.8	17.0
U.S. Unemployment Rate (%)	6.0%	5.5%	5.5%	5.7%
Michigan Personal Income (% change)	4.1%	2.7%	4.5%	5.4%
Michigan Unemployment Rate (%)	7.3%	6.7%	6.9%	7.0%

Revenue Estimates
General Fund/General Purpose (GF/GP) and School Aid Fund (SAF)
(Millions of Dollars)

	FY 2004-05 Estimate			FY 2005-06 Estimate		
	Baseline	Tax Changes	Net Available	Baseline	Tax Changes	Net Available
Gen'l Fund/Gen'l Purpose	$8,125.4	$(255.4)	$7,870.0	$8,367.2	$(231.8)	$8,135.4
% Change	2.3%	---	(2.1)%	3.0%	---	3.4%
School Aid Fund	$10,866.6	16.8%	$10,883.4	$11,271.5	13.0%	$11,284.5
% Change	3.2%	---	2.5%	3.7%	---	3.7%
Total GF/GP and SAF	$18,992.0	$(238.6)	$18,753.4	$19,638.7	$(218.8)	$19,419.9
% Change	2.8%	---	0.5%	3.4%	---	3.6%

	FY 2004-05 Estimate	FY 2005-05 Estimate
Revenue Limit - Under (Over):	$5,678.2	$5,819.7

Year-End Balance Estimates
(Fiscal Year, Millions of Dollars)

	FY 2003-04 Actual	FY 2004-05 Estimate	FY 2005-06 Estimate
General Fund/General Purpose	$0.0	$(405.9)	n/a
School Aid Fund	74.1	74.2	n/a
Budget Stabilization Fund	81.3	82.6	85.6

ECONOMIC REVIEW AND OUTLOOK

State revenue, particularly from taxes, depends heavily on economic conditions. This section reviews the Consensus Economic Forecast for 2004 and 2005, agreed to on December 3, 2004, as well as the Senate Fiscal Agency's latest economic forecast for 2006, and a summary of recent economic activity.

RECENT ECONOMIC HIGHLIGHTS

Although the United States economy has been growing for three years, since the recession ended in November 2001, employment growth has been hampered by sustained increases in productivity and a variety of other economic shocks, particularly in energy prices. Selected economic indicators for the last few years are presented in Table 1 and Table 2 and are briefly discussed in the Senate Fiscal Agency's *Michigan's Economic Outlook and Budget Review, FY 2003-04 and FY 2004-05 Revised* forecast released December 1, 2004.

Michigan's gains in personal income and employment have lagged behind those of nearly every other state in the country. The reason Michigan has struggled so much compared with other states involves the economic changes occurring in certain sectors of the economy combined with Michigan's industrial mix. Nationally, job losses during the recession were more severe, compared with the drop in inflation-adjusted Gross Domestic Product (GDP), than during previous recessions primarily because of substantial increases in productivity. Similarly, job growth during the recovery has been slowed by continued high productivity. As seen in Figure 1, productivity has been increasing rapidly in recent years, particularly in durable goods manufacturing, a sector in which Michigan industry is disproportionately concentrated.

Productivity gains provide a number of positive economic benefits, including lower product prices and greater income growth in the future. However, productivity offers a transitory negative economic effect with its impact on job growth. For example, with stable sales, an 8% increase in productivity in one year (such as experienced in durable goods manufacturing over the 2002-2003 period) means that a firm could reduce its labor force by 8% that year and still produce the output needed to meet demand. In the case of Michigan's largest industry--transportation equipment manufacturing--total sales of light vehicles have remained fairly flat (falling almost 3% between 2001 and 2003 and then rising an estimated 1.9% by 2006) and domestic vehicle sales have comprised a decreasing share of total sales (from 83.5% in 2000 to an estimated 78.5% in 2006). In 2001, the year the U.S. economy mostly spent in recession, Michigan represented 3.2% of the national economy, yet produced 5.2% of manufacturing goods and 6.9% of durable goods. Approximately one-half of Michigan's durable goods manufacturing employment is in transportation equipment manufacturing, and Michigan motor vehicle manufacturing employment comprises nearly one-third of the nation's motor vehicle manufacturing employment (Figure 2).

While more difficult to quantify, many of Michigan's nonmanufacturing sectors rely heavily, either directly or indirectly, on activity in the motor vehicle sector. Average wages in transportation equipment manufacturing are higher than wages in any other economic sector in Michigan, workers in the sector will purchase goods and services across the spectrum for their own consumption, and vehicle manufacturers are significant consumers of a variety of goods and services as well. As a result, economic downturns (from either declining employment or declining business profits) in the vehicle sector are transmitted and multiplied throughout the Michigan economy, just as any national or local economic shock is transmitted through the affected economies.

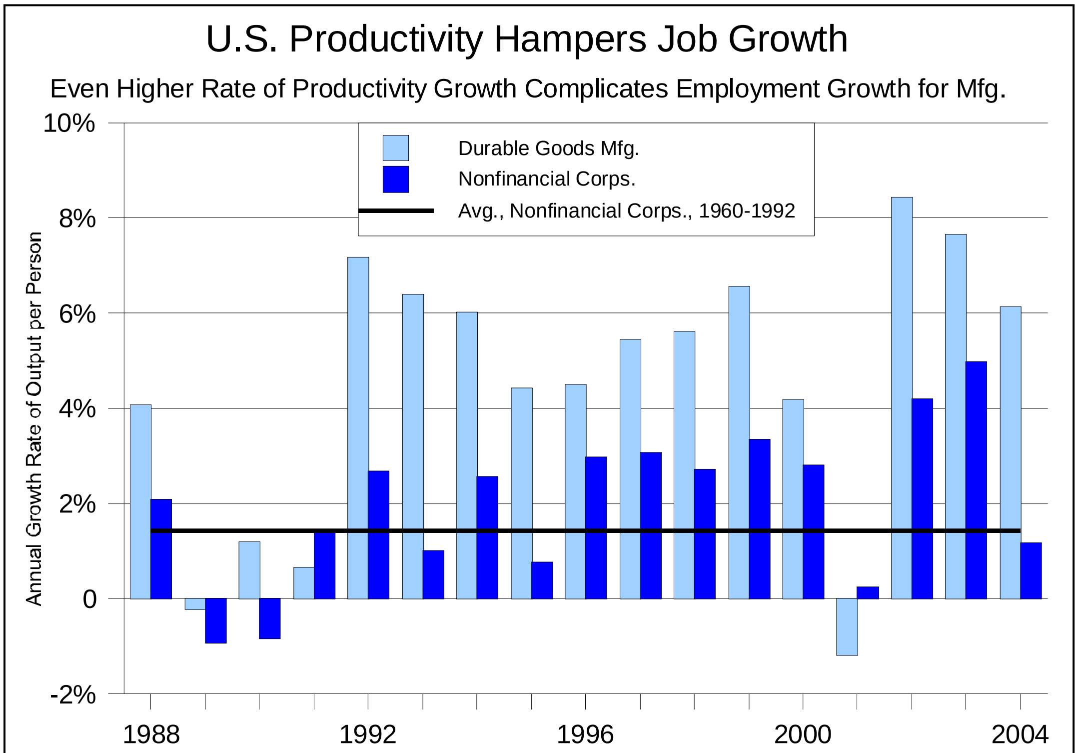
Table 1

THE SENATE FISCAL AGENCY ECONOMIC FORECAST (Calendar Years)					
United States	**2002 Actual**	**2003 Actual**	**2004 Estimate**	**2005 Estimate**	**2006 Estimate**
Nominal GDP					
(year-to-year growth)	3.5%	4.9%	6.5%	5.4%	5.5%
Inflation-adjusted GDP					
(year-to-year growth)	1.9%	3.0%	4.4%	3.2%	3.0%
Unemployment rate	5.8%	6.0%	5.5%	5.5%	5.7%
Inflation					
Consumer Price Index					
(year-to-year growth)	1.6%	2.3%	2.7%	2.6%	2.6%
GDP Implicit price deflator					
(year-to-year growth)	1.7%	1.8%	2.1%	2.2%	2.4%
Interest rates					
90-day Treasury bill	1.61%	1.01%	1.40%	2.40%	3.89%
Corporate Aaa bond	6.49%	5.66%	5.60%	5.70%	6.40%
Federal funds rate	1.67%	1.13%	1.34%	2.89%	4.88%
Light motor vehicle sales					
(millions of units)	16.8	16.6	16.7	16.8	17.0
Auto	8.1	7.6	7.4	7.4	7.5
Truck	8.7	9.0	9.3	9.4	9.5
Michigan					
Personal Income (millions)	$302,019	$314,460	$323,046	$337,434	$355,802
Year-to-year growth	0.9%	4.1%	2.7%	4.5%	5.4%
Inflation-adjusted personal income (year-to-year growth)	(1.6)%	2.1%	0.9%	2.1%	3.0%
Wage & salary income (millions)	$173,339	$176,493	$177,698	$184,190	$191,181
year-to-year growth	0.1%	1.8%	0.7%	3.7%	3.8%
Detroit Consumer Price Index					
(year-to-year growth)	2.6%	2.0%	1.8%	2.4%	2.4%
Wage & Salary Employment					
(thousands)	4,477.8	4,411.8	4,364.6	4,375.5	4,406.4
year-to-year growth	(1.7)%	(1.5)%	(1.1)%	0.3%	0.7%
Unemployment Rate	6.2%	7.3%	6.7%	6.9%	7.0%

Table 2

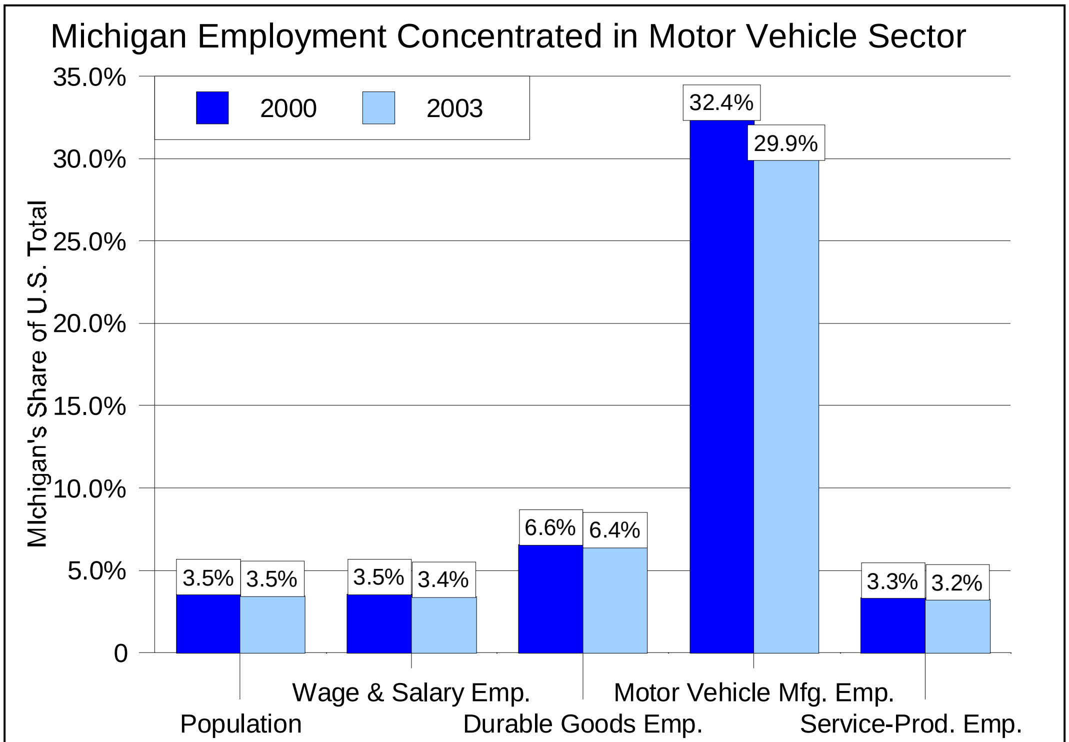
THE SENATE FISCAL AGENCY U.S. ECONOMIC FORECAST DETAIL (Calendar Years)	2002 Actual	2003 Actual	2004 Estimate	2005 Estimate	2006 Estimate
Gross Domestic Product					
(billions of dollars)	$10,487.0	$11,004.0	$11,719.8	$12,358.1	$13,038.6
Year-to-year growth	3.5%	4.9%	6.4%	5.4%	5.5%
Inflation-Adjusted GDP and Components					
Gross Domestic Product					
(billions of 2000 dollars)	$10,074.8	$10,381.3	$10,838.2	$11,185.2	$11,519.8
Year-to-year growth	1.9%	3.0%	4.4%	3.2%	3.0%
Consumption					
(billions of 2000 dollars)	$7,123.4	$7,355.6	$7,629.0	$7,884.4	$8,154.9
Year-to-year growth	3.1%	3.3%	3.7%	3.3%	3.4%
Business fixed investment					
(billions of 2000 dollars)	$1,075.6	$1,110.8	$1,223.3	$1,332.3	$1,409.3
Year-to-year growth	(8.9%)	3.3%	10.1%	8.9%	5.8%
Change in Business Inventories					
(billions of 2000 dollars)	$11.7	($0.8)	$46.9	$44.7	$37.7
Residential investment					
(billions of 2000 dollars)	$470.0	$511.2	$560.8	$556.1	$536.2
Year-to-year growth	4.8%	8.8%	9.7%	(0.8%)	(3.6%)
Government spending					
(billions of 2000 dollars)	$1,837.9	$1,909.4	$1,950.7	$1,991.6	$2,026.4
Year-to-year growth	4.4%	2.8%	2.2%	2.1%	1.7%
Net Exports					
(billions of 2000 dollars)	($472.1)	($518.5)	($582.3)	($622.6)	($633.6)
Exports (billions of 2000 dollars)	$1,012.3	$1,031.8	$1,222.2	$1,195.3	$1,271.0
Imports (billions of 2000 dollars)	$1,484.4	$1,550.3	$1,704.5	$1,818.0	$1,904.6
Personal income					
(year-to-year growth)	1.8%	3.2%	5.0%	5.5%	5.8%
Adjusted for Inflation	0.2%	0.9%	2.2%	2.8%	3.1%
Wage & salary income					
(year-to-year growth)	0.7%	2.6%	4.4%	4.8%	4.6%
Personal savings rate	2.0%	1.4%	0.7%	0.4%	0.3%
Capacity utilization rate	75.6%	74.8%	77.0%	77.3%	77.0%
Housing starts (millions of units)	1.705	1.848	1.943	1.868	1.784
Conventional mortgage rates	6.4%	5.8%	5.8%	6.1%	7.0%
Federal budget surplus					
(billions of dollars, NIPA basis)	($276.8)	($407.6)	($395.1)	($375.2)	($354.6)

Figure 1



Source: Bureau of Labor Statistics, U.S. Department of Labor.

Figure 2



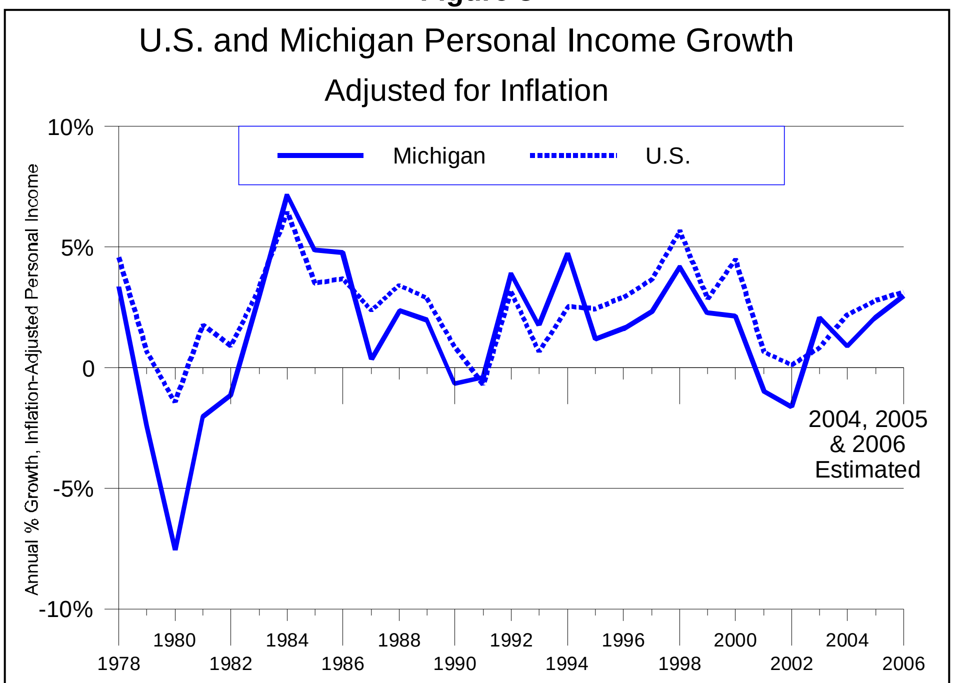
Source: Bureau of Labor Statistics, U.S. Department of Labor.

The factors affecting job growth over the last few years are expected to continue to influence the economy over the forecast period. The primary factors that affect the economy (and present risks to the forecast) are: 1) strong productivity growth; 2) declines or weak growth in business and consumer confidence, particularly with regard to current high expectations for the economy that are unlikely to be realized; 3) consumption growth being hampered by high debt burdens, particularly once interest rates begin rising, and significant incentives to increase saving; 4) production overcapacity; and 5) weak growth in exports.

FORECAST SUMMARY

The forecast presented here for 2004 and 2005 reflects the December 3, 2004, Consensus Economic Forecast. Both the U.S. and Michigan economies are expected to continue growing in 2005 and 2006 (Figure 3). 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 estimated to have grown by 4.4% in 2004, and is projected to grow by 3.2% in 2005 and 3.0% in 2006. The modest decline in growth during 2006 reflects slightly slower growth in business investment and residential investment as interest rates continue to rise. The unemployment rate will rise slightly from 5.5% during 2004 and 2005 to 5.7% in 2006.

Figure 3



Source: U.S. Department of Commerce and the Senate Fiscal Agency

In Michigan, economic activity will mirror the national economy over the forecast period, although both job growth and personal income growth are expected to remain below average (Figures 3 and 4). Furthermore, the sectors expected to exhibit the largest gains in employment generally pay wages below those in the slowest growing sectors (Figures 5 and 6). Inflation-adjusted personal income increased an estimated 0.9% in 2004 and is expected to increase 2.1% in 2005 and 3.0% in 2006. Wage and salary employment fell an estimated 1.1% in 2004 and will increase an estimated 0.3% in 2005 and 0.7% in 2006. Such job growth represents an improvement from the 2.5%, 1.7%, and 1.5% declines in wage and salary employment experienced in 2001, 2002, and 2003, respectively. The very modest gains in employment forecast for 2005 and 2006 will not be strong enough to keep to unemployment from increasing from 6.7% in 2004 to 6.9% in 2005 and 7.0% in 2006, keeping Michigan above the national average.

Figure 4

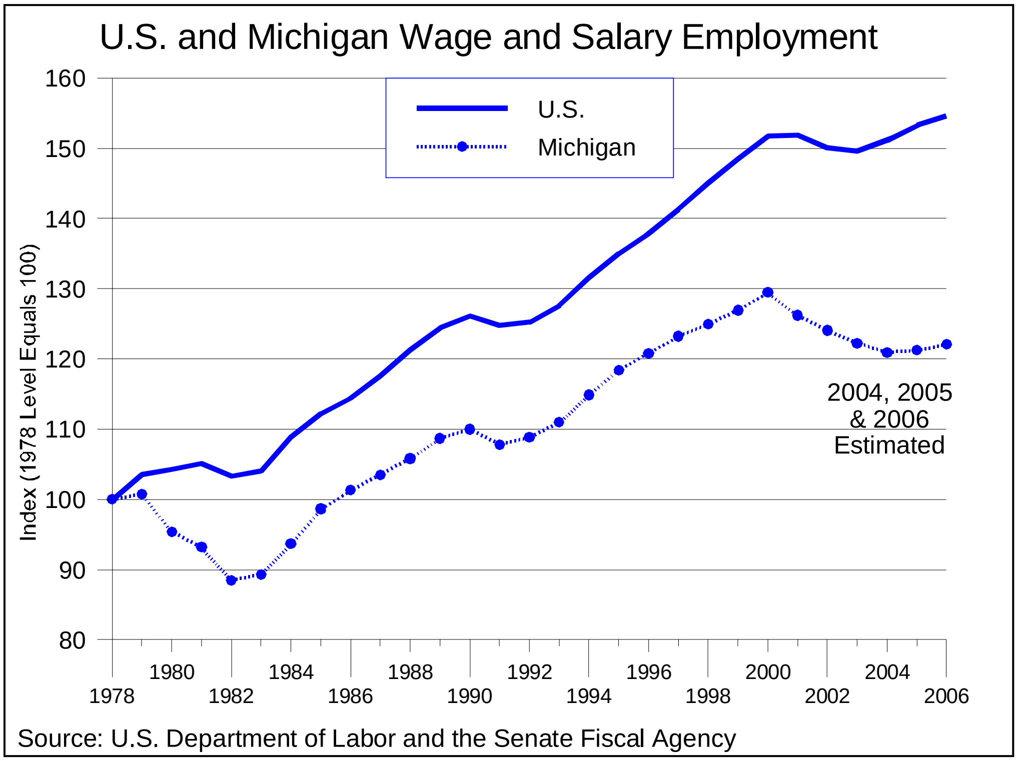


Figure 5

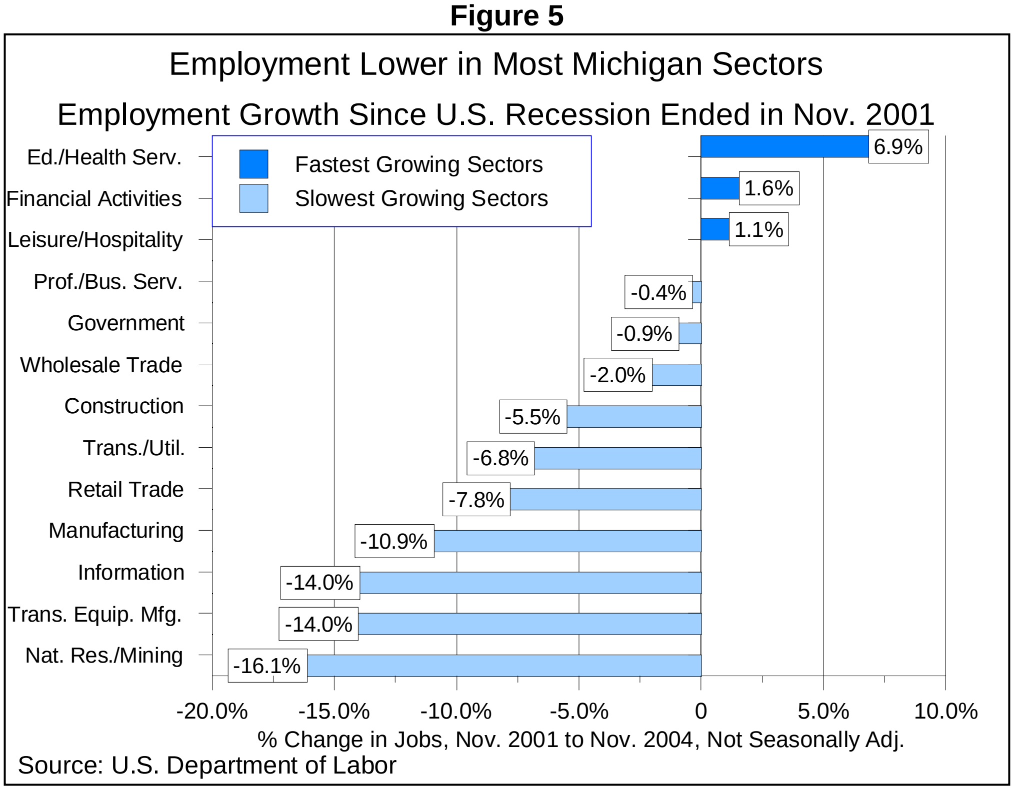
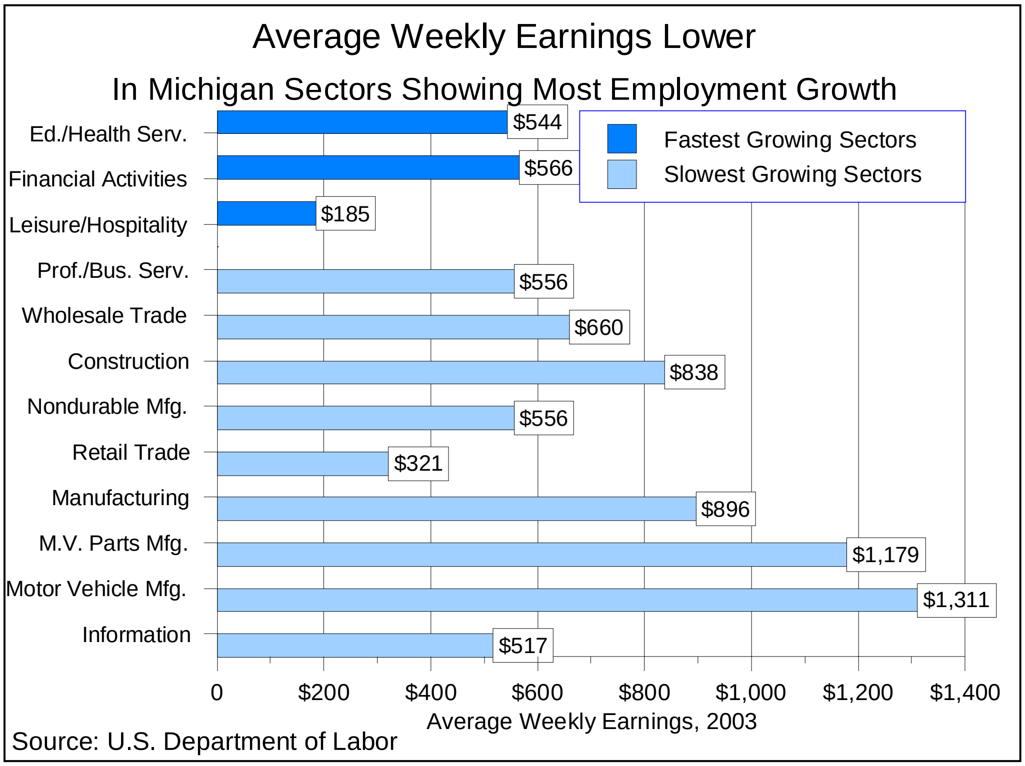


Figure 6



FORECAST ASSUMPTIONS AND RISKS

Forecasting the behavior of the economy requires making assumptions about the behavior of certain key economic variables. The current SFA forecast for 2005 and 2006 is based upon the following assumptions:

Monetary Policy. The Federal funds rate is currently 2.25%, up 100 basis points from May 2004. The forecast assumes that inflationary concerns are rising (discussed below in the risks related to inflation), and that the Federal Reserve Board will act on those concerns. Furthermore, as the economy continues growing and Federal deficits remain high, competition for capital will increase. As a result, interest rates are anticipated to continue rising consistently through 2005 and 2006. Additional increases and steeper increases will increase the Federal funds rate from 2.25% at the end of 2004 to 3.75% at the end of 2005 and 6.0% by the end of 2006.

Foreign Economies. Many of the U.S.'s key trading partners' economies are expected to grow slightly more slowly than the U.S. economy during most of the forecast period. The dollar is expected to continue to decline in value, falling 3.8% in 2005 and 3.2% in 2006. Combined with tepid economic growth for the U.S.'s major trading partners, it is forecasted that while a lower dollar will encourage exports and restrain imports, the dollar will not decline enough to keep the trade deficit from growing, although the trade deficit will increase by less than in recent years. As a result, the forecast predicts the trade deficit will continue to increase in both years, although the increase will be more rapid in 2005, when foreign growth is more below the U.S. level.

Oil and Energy Prices. The forecast expects oil prices to decline slightly in 2005, from about $50 per barrel in the fourth quarter of 2004, and stabilize around $45 per barrel during the forecast period. Other energy prices also are expected to follow a similar pattern over the forecast period, although natural gas prices are expected to post a seasonal spike during the first quarter of 2005.

Prices are expected to remain above historical averages for a variety of reasons, ranging from political instability in the mid-East to limited domestic refining capacity (which is essentially already at maximum) to growing domestic and worldwide energy demands.

Consumer Behavior. Consumption growth remained moderate throughout the slowdown over the last three years, largely through increased borrowing and refinance activity. As a result, little, if any, pent-up demand exists in the consumer sector. While the economy is expected to improve, much of the growth in GDP will reflect productivity improvements and improving investment rather than employment gains and stronger consumption growth. As a result, higher interest rates are likely to worsen the burden of servicing consumer debt and, when combined with slow job growth and modest personal income growth, will keep consumption growth from rising significantly more rapidly than in recent years. The current forecast expects that the personal savings rate will likely be driven lower in order to support the expected consumption levels.

Risks to the Forecast

All forecasts carry a certain amount of error, but the chances that a forecast will err substantially depends upon certain risks to economic fundamentals upon which the forecast is built. The uncertain economic environment in 2004 causes the current economic forecast to face a number of risks, most suggesting that in inflation-adjusted terms, the economy could be weaker than forecasted.

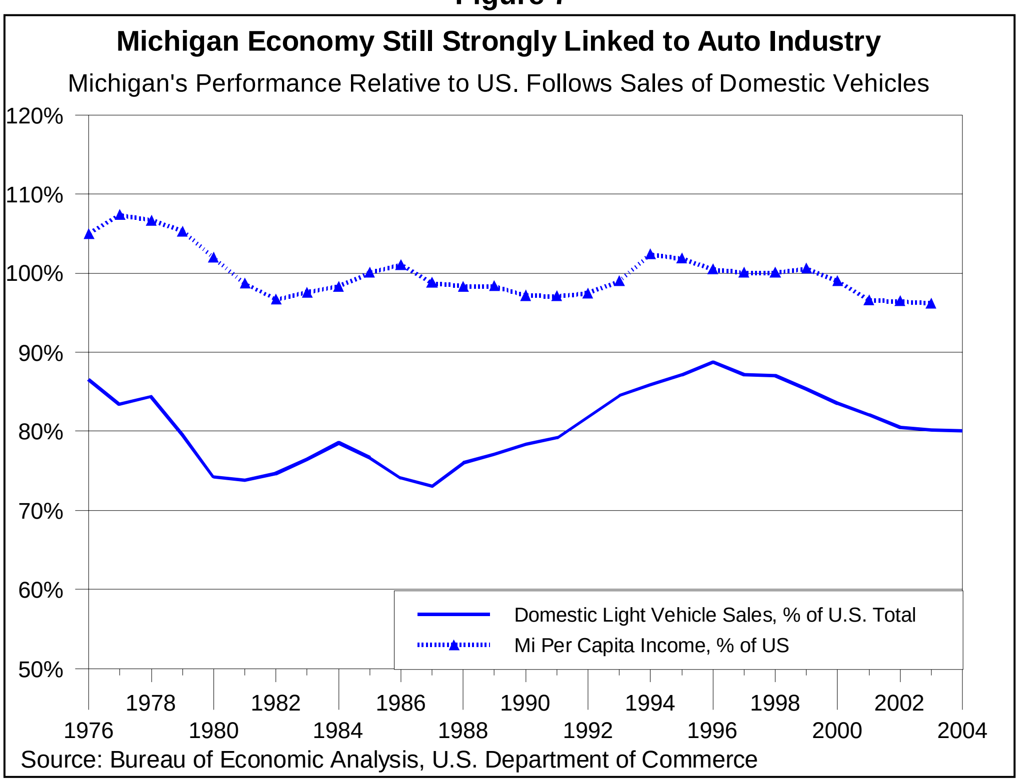
Monetary and Fiscal Stimulus. The forecast assumes that the Federal Reserve will steadily increase rates over the forecast period in an effort to return rates to levels consistent with historical averages and to take a proactive approach to inflationary pressures, which are expected to be significant (as discussed later in this section). The forecast assumes that much of the stimulus effect of fiscal policy has been exhausted and that any growth in Federal spending will be restrained, particularly in 2006. Government is expected to add only approximately 0.3 percentage points to economic growth in 2006. However, there is a significant risk that Federal spending will be higher than forecasted, which would increase economic growth above the forecasted level and likely result in interest rates also being higher than forecasted. Such events could weaken both investment and export growth.

Economic Expectations. One risk to the forecast relates to the interaction between actual economic developments and business and consumer expectations. While overall confidence has recently been stagnant, consumer and business expectations for a number of key economic variables are improving. Confidence levels for business and consumers both are consistent with the expectations exhibited during the late 1990s. Concerns regarding the Federal deficit and the trade deficit appear to be minimal and the dollar’s devaluation is generally being regarded as a positive development. Forecasts of very strong economic growth in the coming two years are not uncommon. However, the economy might not live up to such high expectations. Many of the economic changes forecasted or currently taking place bring both positive and negative developments. In this forecast, employment growth is expected to remain moderate, particularly given the strength of the growth forecasted in GDP. As a result, the economy may perform well but not as well as expected or in the manner expected, similar to the phenomenon that has occurred over the last two years. If a substantial-enough number of consumers and businesses respond to the failure of the economy to live up to their expectations by cutting back on spending, selling assets, etc., then economic growth could be slower and any gains in employment would be much less.

Inflation. While the forecast expects a noticeable increase in the rate of inflation, compared with recent years, the expected inflation rates are at or below those experienced during the 1990s and are below the rate in virtually every year during the 1980s. As indicated above, both the Federal government and the Federal Reserve Board have provided a significant amount of fiscal and monetary stimulus to the economy, and while the forecast has interest rates rising, generally the rate still would be considered expansionary. The dollar's value is expected to decline, increasing the price of imports and allowing domestic producers greater pricing power. Furthermore, higher growth also will put substantial demands for additional energy in virtually every sector of the economy. With the petroleum refining sector operating at nearly 100% capacity even during the slowdown, global energy demand rising, and oil production somewhat strained in the near future, energy prices may be substantially greater than forecasted even without external shocks. Inflation is largely held down in the forecast by reasonably healthy growth in productivity, which may not be as strong as forecasted, and minimal wage growth, which might be stronger than forecasted. These factors might combine to produce substantial inflationary pressures. Significant inflation could be particularly problematic for the economy, not only resulting in more rapid and larger interest rate increases from the Federal Reserve but also creating significant difficulties for the financial sectors that invested heavily in the refinancing boom of the last few years. These financial sectors are largely dependent upon interest payments locked in at low rates and inflation will result in those loans being repaid with substantially devalued dollars.

Michigan's Dilemma. As indicated in Figure 7, Michigan's economic fortunes have historically been very closely linked with sales of domestically produced light vehicles. Demand for domestic automobiles and productivity growth have been the driving forces for the Michigan motor vehicle sector. Over the forecast period, rising interest rates, a savings rate that is almost zero, inflationary pressures, and substantial debt burdens are expected to exert a dragging force on any increases in demand over the forecast period. Vehicle sales are expected to remain fairly flat, while the domestic share of the sales mix is expected to decline. Therefore, it is unclear whether Michigan's employment situation would be much better even if productivity were not rising so rapidly in the motor vehicle sector.

Figure 7



While over the last four and a half years Michigan's employment situation has fared worse than the national average--and in some cases or time periods within that range, worse than any other state (Figure 8)--Michigan's performance is not particularly inconsistent with other states when this State's economic composition (Figure 9) is considered. Generally, states with higher manufacturing concentrations have experienced weaker job performance over the last four and a half years (Figure 10), because of both the economic changes occurring in that sector and 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.

Michigan's dilemma is that for the economy to improve, employment gains need to occur. However, given this State's reliance on the automobile industry and manufacturing and the forecast for demand, employment gains are likely to occur only if productivity growth declines. Lower productivity growth, however, will impede the ability of Michigan businesses to compete. Therefore, if productivity improves, there will be very little pressure to create additional jobs, although Michigan businesses will be better able to thrive; on the other hand, if productivity growth falls, there will be a short-term improvement in employment that is likely to be lost as Michigan businesses find it more difficult to compete in the market with firms that are enjoying productivity improvements. The current forecast essentially assumes that the State's economy will follow a path between these extremes, generating modest employment gains, and maintaining modest profits and competitiveness.

Figure 8

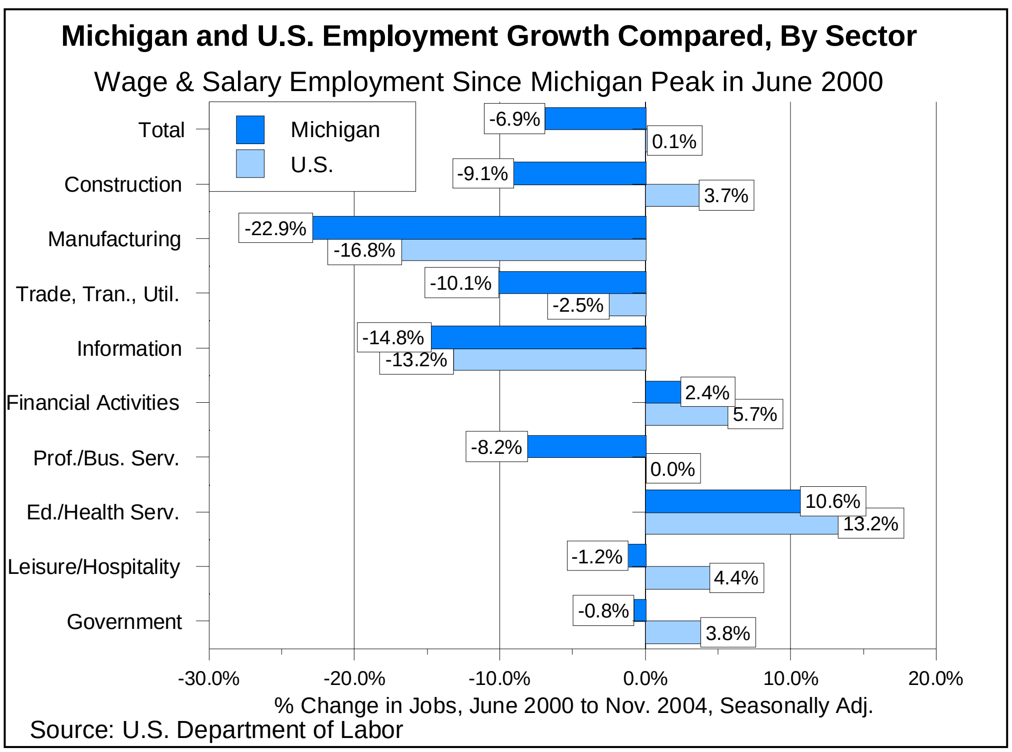


Figure 9

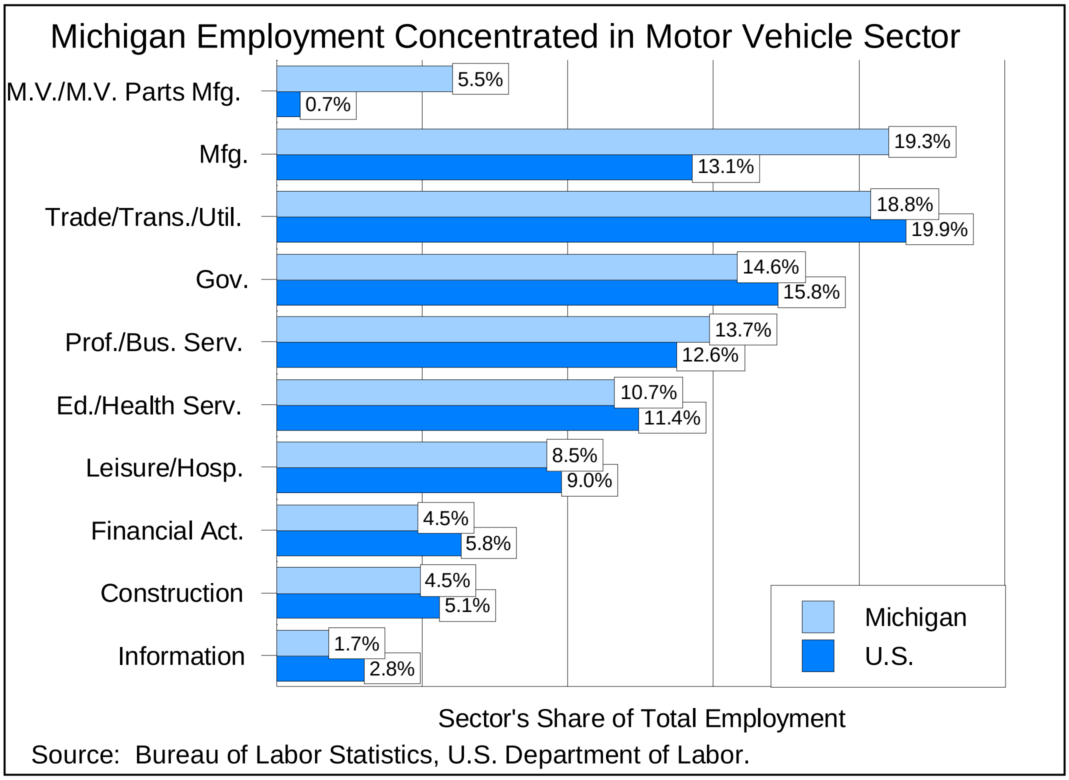
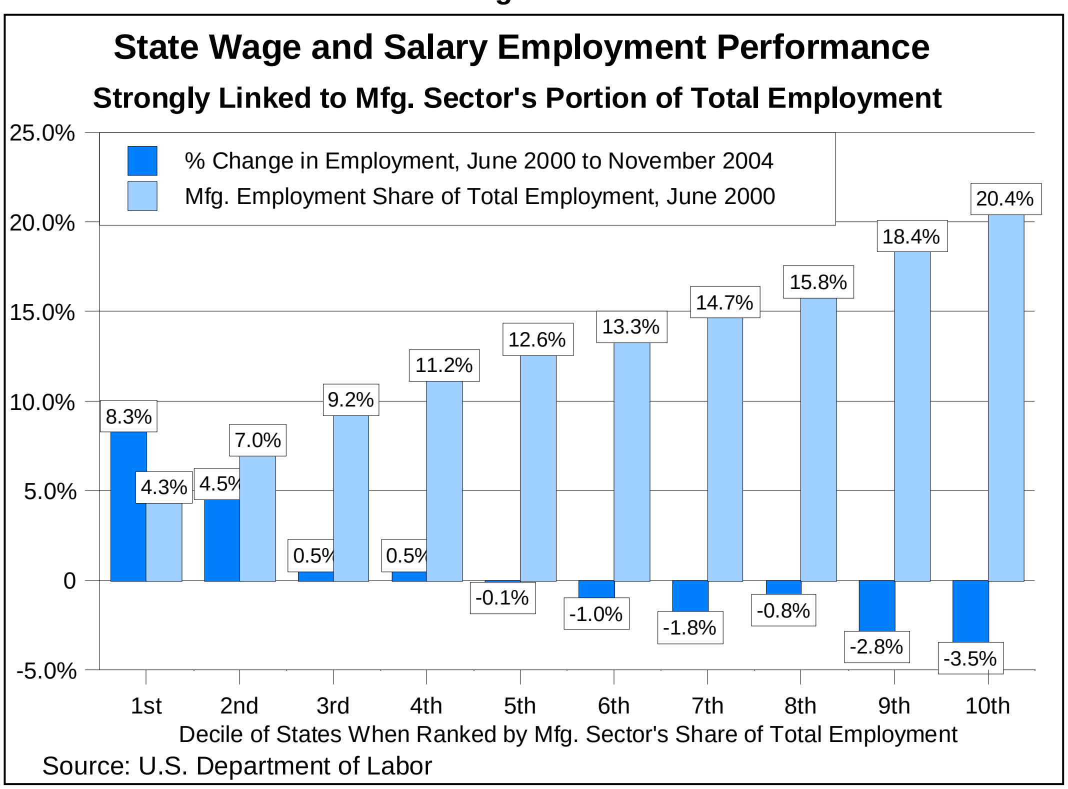


Figure 10



BUDGET STABILIZATION FUND

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

The requirements for contributions to and withdrawals from the BSF are established in State law. By statute, revenue may be added to the BSF when Michigan personal income, less transfer payments and adjusted for inflation, increases by more than 2%. When the growth in real personal income less transfer payments is over 2%, the pay-in to the BSF is equal to the percentage growth in excess of 2% multiplied by the total General Fund/General Purpose (GF/GP) revenue.

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

Withdrawals from the BSF also are permitted for State job creation programs in times of high unemployment. When the State's unemployment rate averages between 8.0% and 11.9% during a calendar quarter, 2.5% of the balance in the BSF may be withdrawn during the subsequent quarter and appropriated for projects that will create job opportunities. If the unemployment rate averages 12% or higher for a calendar quarter, up to 5% of the BSF may be withdrawn.

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

Table 3 presents the recent history of the BSF in terms of transfers into and out of the Fund, interest earnings, and year-end balances. Also presented in this table are the estimates for FY 2004-05 and FY 2005-06. The BSF year-end balance as a percentage of GF/GP and SAF revenue is shown in Figure 11, and the estimated economic stabilization trigger calculations for FY 2004-05 and FY 2005-06 are presented in Table 4.

FY 2003-04

The BSF began FY 2003-04 with a zero balance. Public Act 309 of 2004 required that any balance in the General Fund/General Purpose budget at the end of FY 2003-04 be transferred to the BSF. Based on the final budget figures for FY 2003-04, the GF/GP budget ended with a balance of $81.3 million and this amount was transferred to the BSF.

FY 2004-05 AND FY 2005-06

Based on the SFA's revised estimates for personal income, transfer payments, and the Detroit Consumer Price Index, it is estimated that the BSF budget stabilization formula will not trigger any payment into or out of from the BSF in FY 2004-05 or FY 2005-06. Assuming that the money transferred into the BSF in FY 2003-04 remains in the Fund during FY 2004-05 and FY 2005-06, it is estimated that with interest earnings the balance will grow to $82.6 million at the end of FY 2004-05 and $85.6 million at the end of FY 2005-06.

Table 3

ECONOMIC AND BUDGET STABILIZATION FUND
TRANSFERS, EARNINGS AND FUND BALANCE
FY 1998-99 TO FY 2005-06
(millions of dollars)

Fiscal Year	Pay-In	Interest Earned	Pay-Out	Fund Balance
1998-99	$244.4	$51.2	$73.7	$1,222.5
1999-00	100.0	73.9	132.0	1,264.4
2000-01	0.0	66.7	337.0	994.2
2001-02	0.0	20.8	869.8	145.2
2002-03	09.1	1.8	156.1	0.0
2003-04	81.3	0.0	0.0	81.3
Senate Fiscal Agency estimates:				
2004-05	81.3	1.3	0.0	82.6
2005-06	82.6	3.0	0.0	85.6

Figure 11

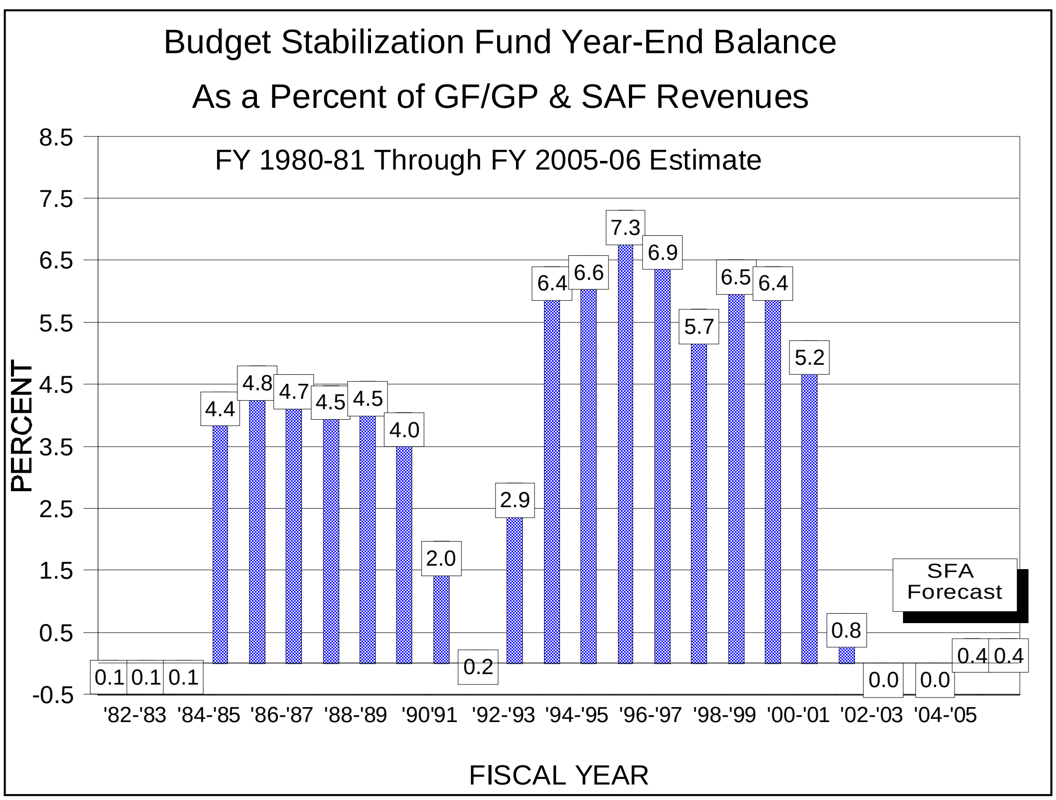


Table 4

ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER FY 2004-05 AND FY 2005-06 (millions of dollars)			
	CY 2004	**CY 2005**	**CY 2006**
Michigan Personal Income (MPI)	$323,046	$337,434	$355,802
Less: Transfer Payments	48,908	51,686	54,586
Subtotal	$273,138	$285,748	$301,216
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	1.837	1.855	1.929
Equals: Real Adjusted MPI	$149,231	$151,551	$156,132
Percent Change from Prior Year		1.55%	3.02%
Excess Over 2%		0.00%	1.02%
Amount Under 0%		0.00%	0.00%
		FY 2004-05	**FY 2005-06**
Multiplied by: Estimated GF/GP Revenue		$7,870.0	$8,023.7
		FY 2004-05	**FY 2005-06**
Equals: Transfer from the BSF		0.00	0.00
OR Transfer to the BSF		0.00	0.00

THE FORECAST FOR STATE REVENUE

This section of the Budget Status Report presents the Senate Fiscal Agency's (SFA's) estimates for General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue. The preliminary final revenue for FY 2003-04 is presented along with the revised estimates for FY 2004-05 and the initial revenue estimates for FY 2005-06. 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 from the previous fiscal year, and net revenue, which reflects the impact of enacted tax changes.

REVENUE OVERVIEW

In FY 2003-04, GF/GP and SAF revenue decreased 0.1% to $18.66 billion. Continued weak economic activity combined with the ongoing reductions in the income and estate taxes, resulted in a 1.0% decline in GF/GP and SAF tax collections; however, this loss in tax revenue was partially offset by an unexpected boost in nontax revenue that was revealed during the year-end book-closing process. On a baseline basis, GF/GP and SAF revenue collections were up 1.7%, which marks the first increase since FY 1999-2000.

As presented in the first section of this report, the pace of Michigan's economic activity is expected to begin to pick up modestly in 2005 and continue to improve through 2006. As a result, baseline GF/GP and SAF revenue is expected to post a 2.8% increase in FY 2004-05. The full year impact of reducing the income tax rate to 3.9% on July 1, 2004, along with the final phase of the elimination of the estate tax and the loss of several one-time gains in revenue that occurred in FY 2003-04, will slow the growth in net GF/GP and SAF revenue to an estimated 0.5% in FY 2004-05, to $18.75 billion.

In FY 2005-06, GF/GP and SAF revenue will total an estimated $19.42 billion, which represents a 3.6% increase from the revised estimate for FY 2004-05. This estimate is based on the forecast that Michigan's economy will experience a modest improvement in the level of activity during 2006. The revenue estimates are summarized in Table 5.

Historical Perspective

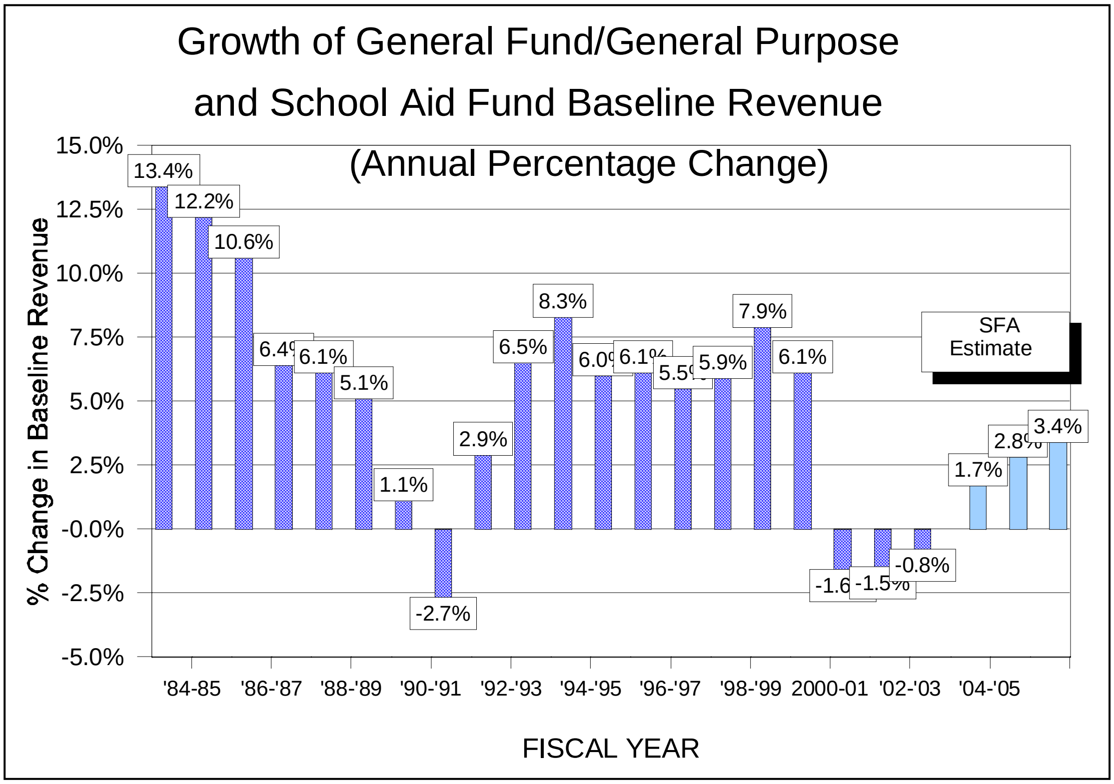
Figure 12 presents an historical overview of the percentage change in baseline GF/GP and SAF revenue since FY 1982-83. From FY 1982-83 to FY 1999-2000, baseline GF/GP and SAF revenue increased at an average annual rate of 6.2%. The period from FY 1992-93 to FY 1999-2000 marked a period of unprecedented steady growth as baseline revenue growth did not fall below 5.5% during these eight years. This remarkable period of fairly strong, consistent revenue growth came to an abrupt end as the recession hit Michigan in the second half of 2000, and has not yet experienced a definite recovery. As a result, baseline revenue fell for three consecutive years: by 1.6% in FY 2000-01, 1.5% in FY 2001-02, and 0.8% in FY 2002-03. It now appears that GF/GP and SAF baseline revenue experienced modest growth of 1.7% in FY 2003-04, and it is estimated that baseline revenue will continue to grow at rates of 2.8% in FY 2004-05 and 3.4% in FY 2005-06.

Table 5

SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2004-05 AND FY 2005-06
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	FY 2003-04 Preliminary Final	FY 2004-05 Revised Est.	FY 2005-06 Initial Est.
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	$7,940.9	$8,125.4	$8,367.2
Tax Changes Not In Baseline	100.5	(255.4)	(231.8)
Revenue After Tax Changes:			
Net Income Tax	3,977.7	3,919.2	4,051.5
Single Business Tax & Insurance Tax	2,057.9	2,094.9	2,135.0
Other Taxes	1,569.8	1,499.0	1,607.6
Total Taxes	7,605.4	7,513.1	7,794.1
Nontax Revenue	435.9	356.9	341.3
TOTAL GF/GP REVENUE	**$8,041.3**	**$7,870.0**	**$8,135.4**
SCHOOL AID FUND			
Baseline SAF	10,353.7	10,866.6	11,271.5
Tax Changes Not In Baseline	361.1	16.8	13.0
TOTAL SAF REVENUE	**$10,714.8**	**$10,883.4**	**$11,284.5**
BASELINE GF/GP AND SAF REVENUE	**18,470.6**	**18,992.0**	**19,638.7**
Tax & Revenue Changes	186.5	(238.6)	(218.8)
GF/GP & SAF REV. AFTER CHANGES	**$18,657.1**	**$18,753.4**	**$19,419.9**
ADDENDUM:			
Sales Tax	$6,473.5	$6,707.8	$7,007.9
		PERCENT CHANGE	
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	1.6%	2.3%	3.0%
Revenue After Tax Changes:			
Net Income Tax	(0.4)	(1.5)	3.4
Single Business Tax & Insurance Tax	(0.8)	1.8	1.9
Other Taxes	(0.4)	(4.5)	7.2
Total Taxes	(0.1)%	(1.2)%	3.7%
Nontax Revenue	25.9	(18.1)	(4.4)
TOTAL GF/GP REVENUE	**1.1%**	**(2.1)%**	**3.4%**
SCHOOL AID FUND			
Baseline SAF	1.7	3.2	3.7
TOTAL SAF REVENUE	**(0.9)%**	**2.5%**	**3.7%**
BASELINE GF/GP AND SAF REVENUE	1.7	2.8	3.4
GF/GP & SAF REV. AFTER CHANGES	**(0.1)%**	**0.5%**	**3.6%**
ADDENDUM:			
Sales Tax	0.8%	3.6%	4.5%

Figure 12



FY 2003-04 FINAL REVENUE

Based on final book-closing data, GF/GP and SAF revenue totaled $18.66 billion in FY 2003-04, which was down 0.1% from the FY 2002-03 revenue level, as presented in <u>Table 6</u>. While revenue collections were down in FY 2003-04 from the prior year, they were not down by as much as estimated at the December 3, 2004, Consensus Revenue Estimating Conference. The information available at that time suggested that GF/GP and SAF revenue was down 0.8%; however, an unexpected boost in revenue was revealed in December during the year-end book-closing process. These book-closing adjustments boosted FY 2003-04 GF/GP and SAF revenue $137 million. This stronger-than-expected level of revenue was due to larger-than-anticipated revenue from some nontax revenue sources and stronger-than-expected year-end collections from the State education property, real estate transfer, income, single business, and insurance taxes.

General Fund/General Purpose

General Fund/General Purpose revenue totaled $8.0 billion in FY 2003-04, which was up 1.1% from FY 2002-03. Compared with the December 3, 2004, consensus revenue estimate, the GF/GP revenue level is up $73 million. This unexpected boost in GF/GP revenue since the December 3, 2004, Consensus Revenue Estimating Conference, was primarily due to additional revenue from the income, single business, and insurance taxes, as shown in <u>Table 6</u>.

Table 6

FY 2003-04 PRELIMINARY FINAL REVENUE GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND (Millions of Dollars)	FY 2002-03 Final	FY 2003-04 Preliminary Final	Change From FY 2002-03: Dollar Change	Change From FY 2002-03: Percent Change	$ Change from 12/04 Consensus
GENERAL FUND/GENERAL PURPOSE					
Baseline Revenue	$7,815.8	$7,940.9	$125.1	1.6%	$31.3
Tax Changes Not In Baseline	141.9	100.5	(41.4)	---	42.0
Revenue After Tax Changes					
Personal Income Tax					
Gross Collections	7,361.1	7,466.7	105.6	1.4	7.1
Less: Refunds	(1,550.5)	(1,594.2)	(43.7)	2.8	10.9
Net Income Tax Collections	5,810.6	5,872.5	61.9	1.1	18.0
Less: Earmarking to SAF	(1,847.8)	(1,893.4)	(45.6)	2.5	0.2
Campaign Fund	(1.9)	(1.4)	0.5	(26.3)	0.1
Net Income Tax to GF/GP	$3,960.9	$3,977.7	$16.8	0.4%	$18.3
Other Taxes					
Single Business Tax	1,842.9	1,827.6	(15.3)	(0.8)	41.3
Sales	63.6	102.0	38.4	60.4	(0.8)
Use	819.6	877.4	57.8	7.1	(1.0)
Cigarette	289.2	242.7	(46.5)	(16.1)	0.9
Insurance Company Premiums	231.1	230.3	(0.8)	(0.3)	9.3
Telephone & Telegraph	124.2	101.3	(22.9)	(18.4)	0.0
Estate	98.6	75.5	(23.1)	(23.4)	(0.5)
Oil & Gas Severance	47.9	57.1	9.2	19.2	2.7
Casino Wagering	0.0	3.2	3.2	---	0.0
All Other	133.4	110.6	(22.8)	(17.1)	(0.5)
Subtotal Other Taxes	$3,650.5	$3,627.7	$(22.8)	(0.6)%	$51.4
Total Nontax Revenue	346.3	435.9	89.6	25.9	3.6
GF/GP REVENUE AFTER TAX CHANGES	**$7,957.7**	**$8,041.3**	**$83.6**	**1.1%**	**$73.3**
SCHOOL AID FUND					
Baseline Revenue	10,353.7	10,529.7	176.0	1.7	(0.0)
Tax Changes Not In Baseline	361.1	86.0	(275.1)	(76.2)	63.6
Revenue After Tax Changes					
Sales Tax	4,681.4	4,716.8	35.4	0.8	(2.3)
Lottery Revenue	586.0	644.9	58.9	10.1	0.0
State Education Property Tax	2,127.5	1,824.5	(303.0)	(14.2)	59.3
Real Estate Transfer Tax	275.5	317.5	42.0	15.2	3.4
Income Tax	1,847.8	1,893.4	45.6	2.5	(0.2)
Casino Tax	90.9	95.8	4.9	5.4	(0.4)
Other Revenue	1,105.7	1,122.8	17.1	1.5	3.8
SAF REVENUE AFTER TAX CHANGES	**$10,714.8**	**$10,615.7**	**$(99.1)**	**(0.9)%**	**$63.6**
BASELINE GF/GP AND SAF	18,199.2	18,470.6	271.4	1.7	31.3
Tax & Revenue Changes	473.3	186.5	(286.8)	(60.6)	105.6
GF/GP & SAF REV. AFTER CHANGES	**$18,672.5**	**$18,657.1**	**$(15.4)**	**(0.1)%**	**$136.9**
SALES TAX	$ 6,422.6	$ 6,473.5	$ 50.9	0.8%	$(3.1)

Note: FY 2003-04 is the base year for baseline revenue.

School Aid Fund

School Aid Fund earmarked revenue totaled an estimated $10.62 billion in FY 2003-04, which was down 0.9% from the FY 2002-03 revenue level. While the income, sales, use, real estate transfer, and casino taxes, along with the lottery, were all up in FY 2003-04, they were not up enough to offset the 14.2% decline in the revenue generated from the State education property tax. This significant decline in State education property tax revenue resulted from the acceleration in the due date which took effect in the summer of 2003 and generated a one-time boost in revenue totaling $454.0 million in FY 2002-03. Compared with the consensus estimate adopted on December 3, 2004, SAF revenue is up $64.0 million, of which $59.0 million was in additional State education property tax collections.

REVISED REVENUE ESTIMATES FOR FY 2004-05

General Fund/General Purpose and SAF revenue is expected to total $18.75 billion in FY 2004-05, which is up 0.5% from FY 2003-04. Compared with the December 3, 2004 consensus estimate, this revised estimate is up $31 million. Given that the economic forecast for 2005 presented in this report is the economic forecast adopted at the December 3, 2004, Consensus Revenue Estimating Conference, this revision is not due to changes in the economic forecast, but results from the unexpected boost in certain tax collections in FY 2003-04 during the book-closing process. As described above, GF/GP and SAF revenue realized an unexpected $137 million boost in FY 2003-04. While it is estimated that over $100 million of this revenue reflected a one-time boost in revenue not to be repeated in FY 2004-05, about $31 million is expected to be ongoing. This upward revision includes a $20 million increase in single business tax revenue, $9 million in insurance tax revenue, and $2 million in oil and gas severance tax revenue. The revised GF/GP and SAF revenue estimates for FY 2004-05 are presented in Table 7.

General Fund/General Purpose

General Fund/General Purpose revenue will total an estimated $7.87 billion, which is down 2.1% from FY 2003-04. Most of this decrease from the FY 2003-04 revenue level will be due to three major factors: 1) a $120 million decline in the amount of tobacco tax revenue earmarked to the General Fund; 2) a $37 million decline in estate tax revenue due to the ongoing phased repeal of this tax; and 3) a $59 million decline in income tax revenue due primarily to the full-year impact of reducing the income tax rate to 3.9% on July 1, 2004. Partially offsetting these revenue declines will be a $40 million increase in casino wagering tax revenue due to the recent increase in the tax rate. This revised GF/GP revenue estimate is up $31 million from the December 3, 2004, consensus revenue estimate and all of this increase is due to the revisions made to the single business, insurance company, and oil and gas severance taxes described above.

School Aid Fund

School Aid Fund revenue from earmarked taxes and the lottery is expected to total $10.88 billion in FY 2004-05, which is up 2.5% from the FY 2003-04 level. This estimate is unchanged from the December 3, 2004, consensus estimate. The major year-end adjustment made to FY 2003-04 SAF revenue was a $59 million increase in State education property tax collections, but it appears that all of this increase was due to an acceleration in tax collections and, therefore, it is not expected to have any positive impact on State education property tax collections in FY 2004-05. The SAF revenue estimate for FY 2004-05 is also summarized in Table 7.

Table 7

FY 2004-05 REVISED REVENUE ESTIMATES GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND (Millions of Dollars)					
			Change from FY 2003-04		
	FY 2003-04 Preliminary Final	FY 2004-05 Revised Estimate	Dollar Change	Percent Change	$ Change from 12/04 Consensus
GENERAL FUND/GENERAL PURPOSE					
Baseline Revenue	$7,940.9	$8,125.4	$184.5	2.3%	$43.6
Tax Changes Not In Baseline	100.5	(255.4)	(355.8)	---	(12.3)
Revenue After Tax Changes					
Personal Income Tax					
Gross Collections	7,466.7	7,538.1	71.4	1.0	0.0
Less: Refunds	(1,594.2)	(1,660.7)	(66.5)	4.2	0.0
Net Income Tax Collections	5,872.5	5,877.4	4.9	0.1	(0.0)
Less: Earmarking to SAF	(1,893.4)	(1,956.7)	(63.3)	3.3	0.0
Campaign Fund	(1.4)	(1.5)	(0.1)	7.1	0.0
Net Income Tax to GF/GP	$3,977.7	$3,919.2	$(58.5)	(1.5)%	$0.0
Other Taxes					
Single Business Tax	1,827.6	1,855.6	28.0	1.5	20.0
Sales	102.0	117.1	15.1	14.8	0.0
Use	877.4	912.9	35.5	4.0	0.0
Cigarette	242.7	122.8	(119.9)	(49.4)	0.0
Insurance Company Premiums	230.3	239.3	9.0	3.9	9.3
Telephone & Telegraph	101.3	95.3	(6.0)	(5.9)	0.0
Estate	75.5	39.0	(36.5)	(48.3)	0.0
Oil & Gas Severance	57.1	55.0	(2.1)	(3.7)	2.0
Casino Wagering	3.2	42.9	39.7	1,240.6	0.0
All Other	110.6	114.0	3.4	3.1	0.0
Subtotal Other Taxes	$3,627.7	$3,593.9	$(33.8)	(0.9)%	$31.3
Total Nontax Revenue	435.9	356.9	(79.0)	(18.1)	0.0
GF/GP REVENUE AFTER TAX CHANGES	**$8,041.3**	**$`7,870.0**	**$(171.3)**	**(2.1)%**	**$31.3**
SCHOOL AID FUND					
Baseline Revenue	10,529.7	10,866.6	336.9	3.2	2.4
Tax Changes Not In Baseline	86.0	16.8	(69.2)	(80.4)	(2.4)
Revenue After Tax Changes					
Sales Tax	4,716.8	4,887.9	171.1	3.6	0.0
Lottery Revenue	644.9	649.9	5.0	0.8	0.0
State Education Property Tax	1,824.5	1,850.9	26.4	1.4	0.0
Real Estate Transfer Tax	317.5	310.0	(7.5)	(2.4)	0.0
Income Tax	1,893.4	1,956.7	63.3	3.3	(0.0)
Casino Tax	95.8	98.0	2.2	2.3	0.0
Other Revenue	1,122.8	1,130.0	7.2	0.6	0.0
SAF REVENUE AFTER TAX CHANGES	**$10,615.7**	**$10,883.4**	**$267.7**	**2.5%**	**(0.0)%**
BASELINE GF/GP AND SAF	18,470.6	18,992.0	521.4	2.8	46.0
Tax & Revenue Changes	186.5	(238.6)	(425.1)	---	(14.7)
GF/GP & SAF REV. AFTER CHANGES	**$18,657.1**	**$18,753.4**	**$ 96.3**	**0.5%**	**$31.3**
SALES TAX	$ 6,473.5	$ 6,707.8	$234.3	3.6%	$ 0.0

Note: FY 2003-04 is the base year for baseline revenue.

FY 2005-06 INITIAL REVENUE ESTIMATES

The modest improvement in the level of economic activity forecast for Michigan's economy in 2005 and 2006 will help boost revenue in FY 2005-06. It is estimated that GF/GP and SAF revenue will total $19.4 billion in FY 2005-06. This initial estimate of FY 2005-06 revenue represents an increase of 3.6%, or $667.0 million from the revised estimate for FY 2004-05, as presented in Table 8. Total GF/GP and SAF baseline revenue will increase at a projected rate of 3.4%, which will mark its strongest increase since FY 1999-2000.

General Fund/General Purpose Revenue

General Fund/General Purpose revenue will total an estimated $8.1 billion in FY 2005-06. This represents a 3.4%, or $265.0 million, increase from the FY 2004-05 revised estimate. This increase will be fueled by increases in the income, single business, use, and tobacco taxes; however, these revenue gains will be partially offset by declines in the estate, and oil and gas severance taxes. In addition, telephone and telegraph tax collections are expected to decline $10 million due primarily to a new income property valuation procedure that will be in effect for the first time. On a baseline basis, GF/GP revenue is expected to increase 3.0% in FY 2005-06.

Income Tax. Income tax revenue going to the General Fund will total an estimated $4.05 billion, which represents an increase of 3.4% from the FY 2004-05 level. This will mark the strongest growth in income tax collections since FY 1999-2000, due to the anticipated improvement in earnings and employment and the fact that the income tax rate will not be below the previous year's level for the first time in six years. This estimate for income tax revenue also reflects an increase in the personal exemption, which is indexed to changes in the consumer price index. Based on the estimate for the consumer price index, it is estimated that the personal exemption will increase $100 to $3,300 on January 1, 2006. This will reduce income tax revenue about $25 million in FY 2005-06.

Single Business Tax. The major components of the single business tax base, which includes compensation paid to workers, business profits, and gross receipts, are all expected to improve in FY 2005-06 due to the forecasted modest increase in the pace of economic activity. As a result, single business tax revenue is expected to increase 1.9% to $1.89 billion in FY 2005-06.

Estate Tax. The estate tax is totally repealed for deaths occurring after December 31, 2004, but because the tax is due nine months after the date of death, estate tax revenue will continue to be collected through FY 2004-05, and to the extent that some returns are filed late, it is expected that a small amount of about $10.0 million also will be collected in FY 2005-06.

Tobacco Tax. The law that enacted the increase in the cigarette and other tobacco products taxes, effective July 1, 2004, also included a shift in the earmarking of tobacco tax revenue from the Medicaid Benefits Trust Fund to the GF/GP budget beginning in FY 2005-06. This earmarking change will boost GF/GP revenue an estimated $112 million in FY 2005-06.

School Aid Fund

School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated $11.28 billion in FY 2005-06, which represents a 3.7%, or $401.0 million increase from the revised estimate for FY 2004-05. This increase reflects a general improvement in most of the taxes that are earmarked to the SAF.

Sales Tax. Sales tax collections are expected to increase 4.5% in FY 2005-06 to $7.0 billion. Of this total amount, $5.1 billion will be earmarked to the SAF.

State Education Property Tax. The State education property tax is expected to generate $1.95 billion in FY 2005-06, representing an increase of 5.4%.

Lottery. Net lottery revenue will total an estimated $662 million in FY 2005-06, which is up 1.9% from the revised level for FY 2004-05.

Table 8

FY 2005-06 INITIAL REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	FY 2004-05 Revised Estimate	FY 2005-06 Initial Estimate	Change from FY 2004-05 Dollar Change	Change from FY 2004-05 Percent Change
GENERAL FUND/GENERAL PURPOSE				
Baseline Revenue	$8,125.4	$8,367.2	$241.8	3.0%
Tax Changes Not In Baseline	(255.4)	(231.8)	23.6	9.2
Revenue After Tax Changes				
Personal Income Tax				
Gross Collections	7,538.1	7,812.4	274.3	3.6
Less: Refunds	(1,660.7)	(1,731.4)	(70.7)	4.3
Net Income Tax Collections	5,877.4	6,081.0	203.6	3.5
Less: Earmarking to SAF	(1,956.7)	(2,028.0)	(71.3)	3.6
Campaign Fund	(1.5)	(1.5)	0.0	0.0
Net Income Tax to GF/GP	$3,919.2	$4,051.5	$132.3	3.4%
Other Taxes				
Single Business Tax	1,855.6	1,890.7	35.1	1.9
Sales	117.1	123.3	6.2	5.3
Use	912.9	945.7	32.9	3.6
Cigarette	122.8	232.1	109.3	89.0%
Insurance Company Premiums	239.3	244.3	5.0	2.1
Telephone & Telegraph	95.3	85.0	(10.3)	(10.8)
Estate	39.0	10.0	(29.0)	(74.4)
Oil & Gas Severance	55.0	52.0	(3.0)	(5.5)
Casino Wagering	42.9	43.8	0.9	2.1
All Other	114.0	115.6	1.6	1.4
Subtotal Other Taxes	$3,593.9	$3,742.6	$148.7	4.1%
Total Nontax Revenue	356.9	341.3	(15.6)	(4.4)
GF/GP REVENUE AFTER TAX CHANGES	**$7,870.0**	**$8,135.4**	**$265.4**	**3.4%**
SCHOOL AID FUND				
Baseline Revenue	10,866.6	11,271.5	405.0	3.7
Tax Changes Not In Baseline	16.8	13.0	(3.9)	(22.9)
Revenue After Tax Changes				
Sales Tax	4,887.9	5,107.1	219.3	4.5
Lottery Revenue	649.9	662.3	12.4	1.9
State Education Property Tax	1,850.9	1,950.2	99.3	5.4
Real Estate Transfer Tax	310.0	305.0	(5.0)	(1.6)
Income Tax	1,956.7	2,028.0	71.3	3.6
Casino Tax	98.0	100.0	2.0	2.0
Other Revenue	1,130.0	1,131.9	1.9	0.2
SAF REVENUE AFTER TAX CHANGES	**$10,883.4**	**$11,284.5**	**$401.1**	**3.7%**
BASELINE GF/GP AND SAF	18,992.0	19,638.7	646.7	3.4
Tax & Revenue Changes	(238.6)	(218.8)	19.8	(8.3)
GF/GP & SAF REV. AFTER TAX CHANGES	**$18,753.4**	**$19,419.9**	**$666.5**	**3.6%**
SALES TAX	$ 6,707.8	$ 7,007.9	$300.1	4.5%

Note: FY 2003-04 is the base year for baseline revenue.

SENATE FISCAL AGENCY BASELINE REVENUE FORECAST HISTORY

The history of the Senate Fiscal Agency's and consensus estimates for GF/GP and SAF baseline revenue for FY 2003-04 and FY 2004-05 is presented in Tables 9 and 10. Baseline estimates are used to track the forecast history for these two fiscal years in order to avoid the wide swings in revenue estimates that occur when tax changes are enacted. In addition, in order to provide an accurate comparison, all of the previous baseline estimates made for FY 2003-04 and FY 2004-05 have been adjusted to reflect a baseline based on the FY 2003-04 tax structure.

The initial estimate for FY 2003-04 GF/GP and SAF baseline revenue was made in December 2002 at $19.36 billion, as shown in Table 9. The sluggish level of economic activity lasted longer than originally estimated, and as a result, the revenue estimates were lowered in May 2003 and again in October 2003 by a very significant amount. The estimate was essentially unchanged in January 2004 and then lowered modestly in May and December of 2004. The Senate Fiscal Agency's revised revenue level presented in this report, based on final revenue data, increased GF/GP and SAF baseline revenue $31 million or 0.2% compared with the December 2004 consensus estimate; however, compared with the initial estimate made in December 2002, the revised final estimate of GF/GP and SAF baseline revenue for FY 2003-04 is down $885 million or 4.6%.

The initial GF/GF and SAF baseline revenue estimate for FY 2004-05 was made in January 2004 at $19.26 billion, as shown in Table 10. This estimate was left essentially unchanged in May 2004, but in December 2004, the estimate was lowered to $18.96 billion. The Senate Fiscal Agency's revised estimates presented in this report, increase GF/GP and SAF baseline revenue $34 million or 0.2%; however, compared with the initial estimate made in January 2004, the revised estimate of GF/GP and SAF baseline revenue for FY 2003-04 is down $269 million or 1.4%.

Table 9

CHANGES IN SENATE FISCAL AGENCY BASELINE REVENUE ESTIMATES FOR FY 2003-04 (Millions of Dollars)			
Forecast Date	**GF/GP**	**SAF**	**Total**
December 19, 2002	$8,371.0	$10,984.2	$19,355.2
January 14, 2003[a)]	8,324.3	10,915.7	19,240.0
May 8, 2003	8,324.5	10,838.9	19,163.4
May 13, 2003[a)]	8,341.6	10,831.0	19,172.6
October 13, 2003	7,942.0	10,620.4	18,562.4
October 14, 2003[a)]	7,914.7	10,592.0	18,506.7
January 10, 2004	7,899.6	10,651.9	18,551.5
January 14, 2004[a)]	7,917.7	10,590.8	18,508.5
May 14, 2004	7,939.3	10,545.1	18,484.4
May 18, 2004[a)]	7,948.2	10,541.7	18,489.9
December 1, 2004	7,909.6	10,529.7	18,439.3
December 3, 2004[a)]	7,909.6	10,529.7	18,439.3
January 7, 2005	7,940.9	10,529.7	18,470.6
Change From Previous Estimate:			
Dollar Change	$31.3	$0.0	$31.3
Percent Change	0.4%	0.0%	0.2%
Change From Initial Estimate:			
Dollar Change	($430.1)	($454.5)	($884.6)
Percent Change	-5.1%	-4.1%	-4.6%

a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.

Note: Baseline base year equals FY 2003-04.

Table 10

CHANGES IN SENATE FISCAL AGENCY BASELINE REVENUE ESTIMATES FOR FY 2004-05 (Millions of Dollars)			
Forecast Date	**GF/GP**	**SAF**	**Total**
January 10, 2004	$8,212.7	$11,048.3	$19,261.0
January 14, 2004[a)]	8,241.5	11,013.3	19,254.9
May 14, 2004	8,283.5	10,984.2	19,267.7
May 18, 2004[a)]	8,289.4	10,969.6	19,259.0
December 1, 2004	8,053.9	10,785.0	18,838.9
December 3, 2004[a)]	8,095.1	10,862.8	18,957.9
January 7, 2005	8,125.4	10,866.6	18,992.0
Change From Previous Estimate:			
Dollar Change	$30.3	$3.8	$34.1
Percent Change	0.4%	0.0%	0.2%
Change From Initial Estimate:			
Dollar Change	($87.3)	($181.7)	($269.0)
Percent Change	-1.1%	-1.6%	-1.4%

a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.

Note: Baseline base year equals FY 2003-04.

COMPLIANCE WITH STATE REVENUE LIMIT

Article IX, Section 26 of the Michigan Constitution establishes a limit on the amount of revenue State government may collect in any fiscal year. This section of the Constitution was adopted by a vote of the people in 1978 and the limit was first applicable in FY 1979-80. In the first 15 years this revenue limit was in effect (FY 1979-80 to FY 1993-94), the revenue limit was never exceeded. The largest gap between revenue and the limit occurred in FY 2002-03, when State revenue was $4.2 billion below the revenue limit. In FY 1994-95, State revenue exceeded the revenue limit, for the first time, by $109.6 million. This was due to the new State revenue being generated as part of the school financing reform that was enacted in 1994. In FY 1995-96, FY 1996-97, and 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 2002-03, revenue fell well below the revenue limit. Based on the SFA's latest economic forecast and revenue estimates, it is estimated that revenue subject to the revenue limit remained well below the limit in FY 2003-04, and will continue to remain well below the revenue limit in FY 2004-05 and FY 2005-06.

THE REVENUE LIMIT

The revenue limit specifies that for any fiscal year, State government revenue may not exceed a certain percentage of Michigan personal income. The Constitution requires that the limit be calculated each year using the percentage that State government revenue in FY 1978-79 was of Michigan personal income in calendar year 1977. This calculation equals 9.49%. Therefore, for any fiscal year, State government revenue may not exceed 9.49% of Michigan total personal income for the calendar year prior to the calendar year in which the fiscal year begins. For instance, in FY 2002-03, State government revenue could not exceed 9.49% of personal income for calendar year 2001. Given that Michigan personal income for 2001 equaled $297,609 million, the revenue limit for FY 2002-03 was $28,243 million.

State government revenue subject to the limit includes total State government tax revenue and all other State government revenue, such as fees, licenses, 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%, the excess revenue must be deposited into the Budget Stabilization Fund. If the revenue limit is exceeded by 1% or more, the excess revenue must be refunded to income tax and single business tax (SBT) payers, on a pro rata basis. These refunds would be given to taxpayers who file an annual income tax or SBT return in the following fiscal year, because these taxpayers would have made withholding and quarterly estimated payments during the fiscal year when the revenue limit was exceeded. The law requires that these refunds occur in the fiscal year following the filing of the report which determines that the limit was exceeded. This report for any particular fiscal year is typically issued in the spring following the end of the fiscal year.

REVENUE LIMIT COMPLIANCE PROJECTIONS

Based on the final revised revenue level for FY 2003-04, and the SFA's revised revenue estimates for FY 2004-05 and initial revenue estimate for FY 2005-06, Table 11 provides a summary of the estimates of the State's compliance with the revenue limit for each of these fiscal years.

FY 2003-04

In FY 2003-04, revenue subject to the revenue limit equaled an estimated $24,054 million. Based on data from the U.S. Department of Commerce, Michigan's personal income in 2002 equaled $303,745 million, which means the revenue limit equaled $28,825 million. As a result, it is estimated that revenue subject to the revenue limit fell below the revenue limit by $4.8 billion, or 16.6%, in FY 2003-04.

FY 2004-05

Based on the SFA's revised revenue estimates for FY 2004-05, it is estimated that revenue subject to the revenue limit will total $24,164 million. The revenue limit will equal an estimated $29,842 million, based on the U.S. Department of Commerce's estimate of Michigan personal income in 2003. As a result, revenue is expected to fall below the revenue limit by $5.7 billion, or 19.0%, in FY 2004-05.

FY 2005-06

In FY 2005-06, it estimated that revenue subject to the revenue limit will total $24,837 million, based on the SFA's initial revenue estimates. The revenue limit will equal an estimated $30,657 million, based on the SFA's estimate of personal income in 2004. As a result, it is estimated that revenue subject to the revenue limit will fall below the revenue limit by $5.8 billion, or 19.0%, in FY 2005-06.

Table 11

STATE'S COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT
Section 26 of Article IX of the State Constitution
(millions of dollars)

	FY 2002-03 Final	FY 2003-04 Estimate	FY 2004-05 Estimate	FY 2005-06 Estimate
Revenue Subject to Limit				
Revenue:				
General Fund/General Purpose (baseline)	$7,943.6	$7,940.9	$8,125.4	$8,367.2
Revenue Sharing (baseline)	1,598.0	1,580.6	1,626.9	1,690.0
School Aid Fund (baseline)	10,255.6	10,529.7	10,866.8	11,271.5
Transportation Funds	2,243.3	2,279.3	2,216.2	2,271.6
Other Restricted Non-Federal Aid Revenue	1,600.2	1,602.6	1,602.6	1,602.6
Adjustments:				
GF/GP Federal Aid	(57.2)	(66.1)	(35.0)	(35.0)
GF/GP Balance Sheet Adjustments	8.9	100.5	(255.4)	(343.5)
SAF Balance Sheet Adjustments	459.2	86.0	16.8	13.0
Total Revenue Subject to Limit:	$24,061.6	$24,053.5	$24,164.1	$24,837.4
Revenue Limit				
Personal Income:				
Calendar Year	**CY 2001**	**CY 2002**	**CY 2003**	**CY 2004**
Amount	$297,609	$303,745	$314,460	$323,046
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	$28,243.1	$28,825.4	$29,842.3	$30,657.1
1% of Limit	282.4	288.3	298.4	306.6
Amount Under (Over) Limit	$4,181.5	$4,771.9	$5,678.2	$5,819.7

CY = Calendar Year

ESTIMATE OF YEAR-END BALANCES

This section of the Senate Fiscal Agency's (SFA's) report provides details of the actual and estimated year-end balances of the General Fund/General Purpose (GF/GP) budget and the School Aid Fund (SAF) budget for FY 2003-04 and FY 2004-05. This section of the report also contains a review of the major issues that the State will face in the development and the enactment of the FY 2005-06 State budget.

Table 12 provides a summary of the actual year-end balances for the FY 2003-04 GF/GP and SAF budgets and the revised SFA estimates of the year-end balances in the FY 2004-05 GF/GP and SAF budgets. The final accounting of FY 2003-04 State revenues and expenditures has been completed and the FY 2003-04 GF/GP budget closed the fiscal year with an $81.3 million year-end balance. Pursuant to statutory requirements in Public Act 309 of 2004, this final GF/GP year-end balance was transferred and deposited into the Budget Stabilization Fund. The FY 2003-04 SAF budget closed the fiscal year with a $74.1 million year-end balance. Pursuant to statutory requirements in the State School Aid Act, this year-end balance carries forward into FY 2004-05.

Table 12

GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND ESTIMATED YEAR-END BALANCES (Millions of Dollars)

	FY 2003-04 Actual	FY 2004-05 Estimate
General Fund/General Purpose	$0.0	$(405.9)
School Aid Fund	74.1	74.2

Based on the revised SFA revenue estimates and enacted and projected State appropriations, the SFA now believes that the FY 2004-05 GF/GP budget is in deficit by $405.9 million. The current estimate of the FY 2004-05 SAF year-end balance is for a surplus of $74.2 million.

The initial look ahead to the FY 2005-06 GF/GP budget situation leads to the conclusion that substantial adjustments will have to be made to current State budget policy in order to ensure a balance between estimated revenue and appropriations. The FY 2005-06 SAF budget is likely to have relatively modest growth if all of the revenue and appropriation policies currently in place are continued for another fiscal year.

FY 2003-04 YEAR-END BALANCE

The Office of the State Budget released the Michigan Comprehensive Annual Financial Report for FY 2003-04 on December 27, 2004. The publication of this report marks the final accounting of FY 2003-04 revenues and expenditures for both the GF/GP and SAF budgets.

Table 13 provides a summary of the final accounting of FY 2003-04 GF/GP revenues, expenditures, and year-end balance. The fiscal year closed with an $81.3 million year-end balance. Pursuant to provisions contained in Public Act 309 of 2004 this year-end balance was transferred to the Budget Stabilization Fund as part of the final book-closing process. Actual FY 2003-04 GF/GP revenues totaled $8.78 billion. This represented a $166.3 million or 1.9% decline from the final level of GF/GP revenues accounted for in FY 2002-03. Actual FY 2003-04 GF/GP expenditures totaled $8.69 billion. This represented a $70.6 million or 0.8% decline from the final level of GF/GP expenditures accounted for in FY 2002-03.

Table 13

FY 2003-04 GENERAL FUND/GENERAL PURPOSE REVENUES, EXPENDITURES, AND YEAR-END BALANCE (Millions of Dollars)	Final
Revenues:	
Beginning Balance	$ 174.0
Ongoing Revenues:	
Final Revenue Collections	8,041.3
Revenue Sharing Reductions	275.9
Subtotal Ongoing Revenues	8,317.2
Non-ongoing Revenues:	
Transfer from Employment Security Fund (PA 84 of 2003)	10.0
Unrestricted Federal Aid	169.0
Executive Order 2003-23 (Work Project Lapse to GF/GP)	31.0
Executive Order 2003-23 (Restricted Revenue Lapse to GF/GP)	69.9
Lapse of Prior-Year Airport Improvement Funds (PA 237 of 2003)	4.1
Subtotal Non-ongoing Revenues	284.0
Total Estimated Revenues	**$8,775.2**
Expenditures:	
Initial Enacted Appropriations	$8,886.4
Supplemental Appropriations:	
Supplemental Appropriations (PA 173 of 2003)	0.5
Supplemental Appropriations GF/GP to SAF (PA 236 of 2003)	45.6
Supplemental Appropriations (PA 237 of 2003)	81.4
Supplemental Appropriations (PA 46 of 2004)	0.1
Supplemental Appropriations GF/GP to SAF (PA 185 of 2004)	50.1
Supplemental Appropriations (PA 309 of 2004)	(76.2)
Supplemental Appropriations (PA 360 of 2004)	(16.7)
Subtotal Supplemental Appropriations	84.8
Executive Order 2003-23 (GF/GP Reductions)	(200.9)
Other Book-closing Adjustments	11.3
Projected Net Appropriation Lapses	(87.7)
Total Estimated Expenditures	**$8,693.9**
Preliminary Year-End Balance	**$81.3**
Transfer to Budget Stabilization Fund	**$81.3**
Final Year-End Balance	**$0.0**

The final level of FY 2003-04 GF/GP revenues included three primary types of revenue. The first was $174.0 million of surplus revenue carried forward from FY 2002-03. The second primary source of revenue was $8.32 billion of ongoing revenues collected from State taxes and fees and revenues directed to the GF/GP budget from a reduction in the level of statutory revenue sharing payments to cities, villages, townships, and counties. The third primary source of revenue was $284.0 million of non-ongoing revenues. The largest source of this non-ongoing revenue was unrestricted Federal aid received by the State. Other sources of non-ongoing revenues included transfers from restricted revenue accounts to the GF/GP budget and the lapsing of work project accounts to the GF/GP budget.

The final level of FY 2003-04 GF/GP expenditures included four primary types of expenditures. The initial series of FY 2003-04 GF/GP appropriations totaled $8.89 billion. Seven supplemental appropriation bills had the overall impact of increasing GF/GP appropriations by $84.8 million. Executive Order 2003-23 reduced enacted GF/GP appropriations by $200.9 million and the net level of GF/GP appropriation lapses and other book-closing adjustments reduced the final level of expenditures by $76.4 million.

Public Act 309 of 2004 transferred the final FY 2003-04 GF/GP year-end balance to the Budget Stabilization Fund. This deposit of $81.3 million marks the first significant deposit into the Budget Stabilization Fund since a $100.0 million deposit into the Fund was made during FY 1999-2000.

Table 14 provides a summary of the final accounting of FY 2003-04 SAF revenue, expenditures, and year-end balance. The fiscal year closed with a $74.1 million year-end balance. Pursuant to provisions of the State School Aid Act this year-end balance was carried forward and becomes available as an FY 2003-04 SAF revenue item. Actual FY 2003-04 SAF revenues totaled $12.37 billion. This represented a $211.5 million or a 1.7% decline from the final level of SAF revenue accounted for in FY 2002-03. Actual FY 2003-04 SAF expenditures totaled $12.3 billion. This represented a $171.9 million or 1.4% decline from the final level of SAF expenditures accounted for in FY 2002-03.

Table 14

FY 2003-04
SCHOOL AID FUND
REVENUES, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

Revenues:	**Final**
Beginning Balance	$ 113.7
Ongoing Revenue Estimate	10,624.8
Other Revenue Adjustments:	
General Fund/General Purpose Grant	282.1
General Fund/General Purpose Grant (PA 236 of 2003)	45.6
General Fund/General Purpose Grant (PA 185 of 2004)	50.1
Subtotal GF/GP Grant to SAF	377.8
Federal Aid	1,256.7
Total Estimated Revenue	**$12,373.0**
Expenditures:	
Enacted Appropriation (PA 521 of 2002)	$12,636.9
Supplemental Appropriations (PA 158 of 2003)	(92.8)
Supplemental Appropriations (PA 236 of 2003)	2.7
School Aid Proration Reduction ($74 per pupil)	(131.1)
Projected Appropriation Lapses	(116.8)
Total Estimated Expenditures	**$12,298.9**
Projected Year-End Balance[1)]	**$ 74.1**

[1)] Transfer to School Aid Stabilization Fund subaccount pursuant to Sec. 11a of the State School Aid Act.

The final level of FY 2003-04 SAF revenue included four primary sources of revenue. The first was $113.7 million of surplus revenue carried forward from FY 2002-03. The second primary source of revenue was $10.62 billion of ongoing revenue collected from State revenues restricted to the SAF. The third primary revenue source was GF/GP grants to the SAF budget which totaled $377.8 million. The final revenue source was $1.2 billion of Federal education aid appropriated in the SAF budget.

The final level of FY 2003-04 SAF expenditures included four primary types of expenditures. The initial series of FY 2003-04 SAF appropriations totaled $12.64 billion. Two enacted supplemental appropriations reduced expenditures by $90.1 million. A pro-rata reduction in State aid to local districts of $74 per pupil reduced expenditures by $131.1 million and year-end appropriation lapses totaled $116.8 million.

FY 2004-05 YEAR-END BALANCE

Based on the revised SFA revenue estimate and enacted and projected appropriations the SFA now believes that the FY 2004-05 GF/GP budget is in deficit by $405.9 million. This projected deficit equals 4.5% of projected FY 2004-05 GF/GP expenditures. It is now anticipated that Governor Granholm will present a proposal to eliminate this budget deficit at about the same time she presents her FY 2005-06 budget recommendation to the Legislature on February 10, 2005.

Table 15 provides a summary of the SFA estimate of FY 2004-05 GF/GP revenues, expenditures, and year-end balance. Projected FY 2004-05 GF/GP revenues totals $8.52 billion. This represents a $258.2 million or 2.9% decline from the final level of FY 2003-04 GF/GP revenue. Projected FY 2004-05 GF/GP expenditures total $8.92 billion. This represents a $229.0 million or 2.6% increase from the final level of FY 2003-04 GF/GP expenditures.

The projected level of FY 2004-05 GF/GP revenue includes two primary sources of revenue. The first is $8.41 billion of ongoing revenue which includes revenue collected from State taxes and fees, revenue resulting from a freeze in State revenue sharing payments to cities, villages, and townships and revenue resulting from the elimination of statutory revenue sharing payments to counties. Also included in the ongoing revenue base are adjustments to revenues from reduced borrowing costs and a pharmaceutical tax credit not anticipated to be used. The second primary source of FY 2004-05 GF/GP revenue is $105.9 million of non-ongoing revenue. This includes revenue generated from the sale of surplus State property and several transfers of State restricted revenue to the GF/GP budget.

The projected level of FY 2004-05 GF/GP expenditures includes enacted and projected State appropriations. The original enacted appropriations for the fiscal year total $8.7 billion. Still pending before the Legislature is a portion of the Capital Outlay budget that should result in a $6.2 million GF/GP appropriation. Three supplemental appropriations totaling $151.0 million have already been enacted and the SFA is projecting that a supplemental appropriation of $67.0 million will be needed in the Department of Community Health budget to fund a projected shortfall in the State Medicaid budget. This Medicaid funding shortfall results primarily from anticipated Medicaid caseloads exceeding the levels assumed in the original budget.

The $405.9 million FY 2004-05 GF/GP budget deficit estimated by the SFA will lead to action by the Governor and the Legislature to eliminate this projected budget deficit. Pursuant to Article V, Section 20, of the State Constitution of 1963, the Governor is required to recommend to the Legislature appropriation reductions to eliminate any projected budget deficit. The Constitution provides that this appropriation reduction, which typically is in the form of an Executive Order to reduce appropriations, must be transmitted to the Legislature when it becomes apparent that estimated revenues have fallen below the amount that was assumed in the enacted budget. Any Executive Order appropriation reduction submitted to the Legislature by the Governor would take effect only after it is approved by majority votes of both the House and Senate Appropriation Committees. Based on discussions with the Office of the State Budget, the SFA is expecting that this Executive Order appropriation recommendation from the Governor will be transmitted to the Legislature at about the same time the Governor transmits her FY 2005-06 budget recommendation to the Legislature.

Table 15

FY 2004-05 GENERAL FUND/GENERAL PURPOSE REVENUES, EXPENDITURES, AND YEAR-END BALANCE (Millions of Dollars)	SFA Estimate
Revenues:	
Beginning Balance	$ 0.0
Ongoing Revenues:	
Consensus Revenue Estimate	7,870.0
Revenue Sharing Freeze	328.8
Suspension of County Revenue Sharing Payments	182.3
Adjustment of Interfund Borrowing Costs	20.0
Pharmaceutical Tax Credit Adjustment	10.0
Subtotal Ongoing Revenues	8,411.1
Non-ongoing Revenues:	
Sale of Surplus Northville Property	52.0
Sale of Surplus School Forest Lands	18.0
Sale of Fairlawn Surplus Property	2.6
Sale of Maxey Center Surplus Property	2.9
Sale of Macomb/Oakland Center	1.9
Sale of Detroit Plaza Building	6.0
Comprehensive Transportation Fund Transfer	10.0
Juror Compensation Fund Balance Transfer	4.0
General Tobacco Settlement Transfer	7.0
Judicial Technology Improvement Fund Transfer	1.5
Subtotal Non-ongoing Revenues	105.9
Total GF/GP Revenues	**$8,517.0**
Expenditures:	
Initial Enacted Appropriations	$8,699.4
Capital Outlay Target Appropriation	6.2
Supplemental Appropriations (PA 352 of 2004)	43.0
Supplemental Appropriations (PA 358 of 2004)	8.5
Supplemental Appropriation (PA 518 of 2004)	99.5
Projected Medicaid Funding Shortfall	67.0
Lapse from Building Occupancy Charges	(0.7)
Total GF/GP Expenditures	**$8,922.9**
Projected Year-End Balance	**$ (405.9)**

The Governor and the Legislature have several basic options that could be used to eliminate this projected $405.9 million GF/GP budget deficit. These include:

Appropriation Reductions: The Executive Order appropriation reduction process allows the Governor, with the approval of the House and Senate Appropriation Committees, to reduce any enacted FY 2004-05 appropriations. The only appropriations that cannot be reduced are appropriations made pursuant to constitutional requirements.

Revenue Enhancements: Increasing State revenues through tax or fee increases is also an option that can be used to eliminate projected budget deficits. Any potential tax or fee increases would have to be authorized by the Legislature and signed into law by the Governor.

Restricted Revenue Transfers to the General Fund: Transferring State restricted revenues to the GF/GP budget and using these revenues either to augment GF/GP revenues or to substitute for appropriations now funded with GF/GP revenues is an option that could be used to eliminate the deficit. This type of transfer could include the $81.3 million of revenue currently in the Budget Stabilization Fund.

While the FY 2004-05 GF/GP budget is in a projected deficit situation, the picture is brighter for the status of the FY 2004-05 SAF budget. The SFA now believes that a $74.2 million surplus exists in the FY 2004-05 SAF budget. Table 16 provides the summary of the SFA estimate of FY 2004-05 SAF revenues, expenditures, and year-end balance. Projected FY 2004-05 SAF revenues total $12.6 billion. This represents a $196.2 million or 1.6% increase from the final level of FY 2003-04 SAF revenues. Projected FY 2004-05 SAF expenditures total $12.49 billion. This represents a $196.1 million or a 1.6% increase from the final level of FY 2003-04 SAF expenditures.

Table 16

FY 2004-05
SCHOOL AID FUND BUDGET
REVENUES, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Revenues:	
Beginning Balance	$ 74.1
Ongoing Estimated Restricted Revenues	10,883.4
Other Revenue Adjustments:	
GF/GP Grant	165.2
GF/GP Grant (PA 518 of 2004)	99.5
Federal Aid	1,353.6
Reimbursement for Local Tax Collections	(4.6)
Payment in Lieu of Taxes	(2.0)
Subtotal Other Revenue Adjustments	1,611.7
Total Estimated Revenues	**$12,569.2**
Expenditures:	
Enacted Appropriations	$12,527.4
Reduction of Homestead Audit Savings	26.6
Reduction of Personal Property Tax Audit Savings	14.5
Enhanced Tax Enforcement Savings	(3.5)
Appropriation Lapse (Pupils/Taxable Value)	(70.0)
Total Estimated Expenditures	**$12,495.0**
Projected Year-End Balance	**$ 74.2**

The projected level of FY 2004-05 SAF appropriations includes four primary funding sources. The first is a $74.1 million beginning balance carried forward from FY 2003-04. The second is the $10.88 billion of ongoing restricted SAF revenues. The third revenue source is two enacted GF/GP grants to the SAF which total $264.7 million. The final FY 2004-05 SAF revenue source is $1.35 billion of Federal education aid appropriated in the budget. On the expenditure side of the FY 2004-05 SAF budget ledger, estimated expenditures total $12.5 billion. This consists of the appropriations contained in the initial School Aid appropriation bill and $32.4 million of projected appropriation lapses from a combination of pupil estimates and taxable valuation changes from the levels assumed in the initial SAF appropriation bill.

FY 2005-06 STATE BUDGET OUTLOOK

On February 10, 2005, Governor Granholm will present her FY 2005-06 State budget recommendation to the Legislature. This budget recommendation will be based on the consensus revenue estimate to be agreed upon at the January 13, 2005, meeting of the Consensus Revenue Estimating Conference. Using SFA's estimates of FY 2005-06 GF/GP and SAF revenues and the current level of FY 2004-05 GF/GP and SAF appropriations, we can look ahead at the general parameters that will apply to the FY 2005-06 State budget debate.

In terms of the FY 2005-06 GF/GP budget, the Governor and the Legislature are likely facing another budget year that will be characterized by significant fiscal restraint. This fiscal restraint results from a combination of very moderate GF/GP revenue growth, the use of several one-time revenue items built into the FY 2004-05 GF/GP budget, fund source shifts in the Medicaid budget, and spending pressures in other budget areas.

Table 17 provides a brief summary of the issues that Governor Granholm is facing as she attempts to formulate an FY 2005-06 GF/GP budget recommendation. The table is built on the assumption of no change in current State tax policy combined with a freeze in FY 2005-06 GF/GP appropriations and State revenue sharing appropriations at the levels currently appropriated in FY 2004-05. These assumptions lead to estimated revenue available to support FY 2005-06 GF/GP appropriations of $8.71 billion.

Table 17

FY 2005-06 BUDGET OUTLOOK
GENERAL FUND/GENERAL PURPOSE
(Millions of Dollars)

	SFA Estimate
Projected Revenues:	
Beginning Balance	$ 0.0
Estimated Ongoing Revenues	8,135.4
Other Revenue Adjustments:	
Continue Revenue Sharing Freeze	364.2
Continue County Revenue Sharing Suspension	182.0
Interfund Borrowing Cost Adjustment	20.0
Pharmaceutical Tax Credit Adjustment	10.0
Total Estimated Revenues	**$8,711.6**
Potential Appropriations:	
Freeze of FY 2005-06 Appropriations at FY 2004-05 Level	$8,922.9
Other Potential Funding Issues:	
Debt Service Funding Increases	50.0
Medicaid Federal Funding Changes	210.0
Medicaid Tobacco Tax Distribution Shift	112.0
Medicaid Reimbursement Rates	72.0
State Employee Pay Package	28.1
Adjusted FY 2005-06 GF/GP Appropriations	**$9,395.0**
Potential Funding Imbalance	**$ (683.4)**

The current level of FY 2004-05 GF/GP appropriations is $8.92 billion. Even if FY 2005-06 GF/GP appropriations are frozen at the current-year levels, several potential funding issues will need to be addressed. These funding issues include an estimated GF/GP funding increase of $50 million for debt service payments on bonds issued by the State Building Authority and General Obligation bonds. Governor Granholm will be presenting an FY 2005-06 compensation package for State Civil Service employees that is estimated to increase FY 2005-06 GF/GP expenditures by $28.1 million above the compensation levels currently in place. This funding increase will have an impact on the budget unless the Legislature rejects or modifies the negotiated pay package. Finally, three funding issues will force GF/GP spending increases in the State Medicaid budget if current Medicaid policies are continued. These three Medicaid funding issues are an estimated $210.0 million GF/GP funding increase to offset losses of Federal Medicaid funds resulting from a continuing phase-out of intergovernmental financing mechanisms; an estimated $112.0 million GF/GP funding increase to adjust for the redirection by statute of tobacco tax revenues from the Medicaid Benefits Trust Fund to the GF/GP budget, and a $72.0 million GF/GP increase to fund the second year of a two-year increase in Medicaid reimbursement rates for health maintenance organizations and community mental health boards as required by the Federal government.

These potential funding increases will push the potential FY 2005-06 GF/GP appropriations to $9.4 billion, which is $683.4 million above the SFA estimate of available FY 2005-06 GF/GP revenues. This budget outlook assumes no other increases in FY 2005-06 GF/GP appropriations. Obvious spending increase pressures will exist in several budget areas, which are likely to include higher education and community colleges, medical costs in a variety of programs across the budget, and the cost of State employee health care and retirement contribution rates not attributable to the negotiated pay increase.

Table 18 provides a similar look ahead at the FY 2005-06 SAF budget. As contrasted with the GF/GP budget, the potential outlook for the SAF budget is much brighter. The FY 2004-05 SAF budget does not contain any non-ongoing revenue items and no funding shifts are expected to have an impact on FY 2005-06 SAF appropriations. A comparison of the SFA estimate of FY 2005-06 SAF revenue with a freeze in FY 2005-06 SAF appropriations at the FY 2004-05 level leads to $482.0 million of revenue for potential SAF appropriation growth. This would equate to FY 2005-06 SAF appropriation growth of 3.9%.

Table 18

FY 2005-06 BUDGET OUTLOOK
SCHOOL AID FUND BUDGET
(Millions of Dollars)

	SFA Estimate
Projected Revenue:	
Beginning Balance	$ 74.2
Estimated Ongoing Revenues	11,284.5
Other Revenue Adjustments:	
GF/GP Grant at FY 2004-05 Level	264.7
Federal Aid	1,353.6
Total Estimated Revenues	**$12,977.0**
FY 2004-05 SAF Estimated Expenditures	**$12,495.0**
Potential Appropriation Growth	**$482.0**
Note: This represents a 3.9% potential appropriation increase	