



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

**FY 2004-05, FY 2005-06
AND FY 2006-07**

January 11, 2006



THE SENATE FISCAL AGENCY

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EXECUTIVE SUMMARY

ECONOMIC FORECAST

The U.S. economy, as measured by inflation-adjusted gross domestic product, is estimated to have grown at a rate of 3.6% in 2005 and will increase 3.0% in 2006 and 3.2% in 2007. Light vehicle sales are expected to have totaled 16.8 million units in 2005 and will decline to 16.4 million units in 2006 before rising to 16.5 million units in 2007. The unemployment rate is expected to have averaged 5.1% in 2005 and will average 5.2% in both 2006 and 2007, while the consumer price index is estimated to have risen 3.4% in 2005 and will grow 2.9% in 2006 and 1.9% in 2007.

The Michigan economy, as measured by inflation-adjusted personal income, is estimated to have increased 0.4% in 2005, but is expected to grow 0.6% in 2006 and 2.1% in 2007. Wage and salary employment is expected to have declined 0.6% in 2005, and will decline another 1.2% in 2006 and 0.5% in 2007.

REVENUE FORECAST

In fiscal year (FY) 2004-05, General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue totaled \$19.2 billion, representing a 2.9% increase from FY 2003-04. General Fund/General Purpose revenue was up 3.1% to \$8.29 billion, and SAF revenue increased 2.8% to \$10.91 billion.

In FY 2005-06, GF/GP and SAF revenue will total an estimated \$19.49 billion, which is up 1.5% from FY 2004-05. This revised estimate is \$34.4 million above the August 2005 consensus estimate. General Fund/General Purpose revenue will decline an estimated 0.5% to \$8.25 billion, while SAF revenue will increase 3.1% to \$11.25 billion.

In FY 2006-07, GF/GP and SAF revenue will total an estimated \$19.82 billion. This initial revenue estimate for FY 2006-07 is 1.7% above the revised estimate for FY 2005-06. General Fund/General Purpose revenue will remain essentially unchanged at \$8.25 billion, while SAF revenue is expected to increase 2.9% to \$11.57 billion.

YEAR-END BALANCE ESTIMATES

Based on the final accounting of FY 2004-05 revenue and expenditures, the FY 2004-05 GF/GP budget closed the fiscal year with a \$220.5 million balance. The FY 2004-05 School Aid Fund budget closed the fiscal year with a \$93.7 million balance. Pursuant to statutory requirements, both the GF/GP and School Aid Fund year-end balances will carry forward into FY 2005-06.

A comparison of the FY 2005-06 Senate Fiscal Agency (SFA) revenue estimate and enacted appropriations leads to a projected \$154.1 million FY 2005-06 GF/GP budget surplus. The SFA estimates that the FY 2005-06 School Aid Fund budget is in surplus by \$133.0 million.

An initial look ahead at the FY 2006-07 State budget leads to the conclusion that the GF/GP budget will be characterized by significant fiscal restraint. The combination of non-ongoing revenue items in the FY 2005-06 budget, phased-in business tax reductions, and continued employment declines will lead to very restrained growth in GF/GP appropriations during FY 2006-07. The FY 2006-07 School Aid Fund budget should experience appropriation growth around the rate of inflation based on current revenue and expenditure projections.

EXECUTIVE SUMMARY

SENATE FISCAL AGENCY ECONOMIC AND BUDGET SUMMARY

Economic Projections (Calendar Year)				
	2004 Actual	2005 Estimate	2006 Estimate	2007 Estimate
Real Gross Domestic Product (% change)	4.2%	3.6%	3.0%	3.2%
U.S. Consumer Price Index (% change).....	2.7%	3.4%	2.9%	1.9%
Light Motor Vehicle Sales (millions of units).....	16.9	16.8	16.4	16.5
U.S. Unemployment Rate (%)	5.5%	5.1%	5.2%	5.2%
Michigan Personal Income (% change)	1.8%	3.2%	3.5%	4.0%
Michigan Unemployment Rate (%)	7.1%	6.9%	7.4%	7.5%

Revenue Estimates General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) (Millions of Dollars)						
	<u>FY 2005-06 Estimate</u>			<u>FY 2006-07 Estimate</u>		
	Baseline	Tax Changes	Net Available	Baseline	Tax Changes	Net Available
Gen'l Fund/Gen'l Purpose	\$8,270.3	\$(24.0)	\$8,246.2	\$8,376.2	\$(124.4)	\$8,251.8
% Change	0.6%	---	(0.5)%	1.3%	---	0.1%
School Aid Fund.....	\$11,224.8	\$20.9	\$11,245.6	\$11,542.7	\$23.5	\$11,566.2
% Change	2.8%	---	3.1%	2.8%	---	2.9%
Total GF/GP and SAF.....	\$19,495.1	\$(3.1)	\$19,492.0	\$19,918.9	\$(100.9)	\$19,818.0
% Change	1.9%	---	1.5%	2.2%	---	1.7%
Revenue Limit - Under (Over):	<u>FY 2005-06 Estimate</u> \$5,540.6			<u>FY 2006-07 Estimate</u> \$6,156.1		

Year-End Balance Estimates (Fiscal Year, Millions of Dollars)			
	FY 2004-05 Actual	FY 2005-06 Estimate	FY 2006-07 Estimate
General Fund/General Purpose.....	\$220.5	\$154.1	N/A
School Aid Fund.....	93.7	133.0	N/A
Budget Stabilization Fund.....	2.0	2.1	2.2

ECONOMIC REVIEW AND OUTLOOK

State revenue, particularly tax revenue, depends heavily on economic conditions. This section presents the Senate Fiscal Agency's (SFA's) latest economic forecast for 2006 and 2007, as well as a summary of recent economic activity and estimates for the rest of 2005.

RECENT ECONOMIC HIGHLIGHTS

The third quarter of 2005 marked the 16th consecutive quarter of growth in inflation-adjusted Gross Domestic Product (GDP), and the 10th consecutive quarter in which GDP rose at a rate of at least 3.3%. Despite the strength in GDP growth, employment gains have been hampered by sustained increases in productivity and a variety of other economic shocks, particularly in energy prices. Inflation-adjusted GDP is estimated to have grown 3.6% in 2005, after rising 4.2% (the third highest rate since 1984) during 2004. In comparison, wage and salary employment rose 1.1% in 2004, less than in any year during the 1984-2000 period other than the recession years of 1991 and 1992, and is estimated to have grown by only 1.6% in 2005. Details for selected economic indicators for the last few years are presented in [Table 1](#) and [Table 2](#).

Michigan's gains in personal income and employment have lagged behind nearly every other state in the country. The reason Michigan has struggled so much compared with other states reflects 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 GDP, than during previous recessions primarily because of substantial increases in productivity, particularly productivity gains in the manufacturing sector. 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 ([Figures 2](#) and [3](#)).

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 8.0% 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 8.0% 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 (rising 1.4% in 2004 and falling an expected 0.4% in 2005) and domestic vehicle sales have comprised a decreasing share of total sales (from 83.5% in 2000 to 79.8% in 2004 and an expected 79.7% in 2005). When combined with substantial gains in productivity, the impact on employment has been particularly severe and Michigan has borne the majority of the impact because of its heavy reliance on the motor vehicle manufacturing sector. 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. Transportation equipment manufacturing comprises approximately one-half of Michigan's durable goods manufacturing employment and Michigan's motor vehicle manufacturing employment comprises nearly one-third of the nation's motor vehicle manufacturing employment.

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 in any other economic sector in Michigan, workers in the transportation equipment manufacturing sector purchase goods and services across the spectrum for their own consumption, and vehicle manufacturers are significant consumers of a variety of

goods and services as well. As a result, economic downturns (either from declining employment or from 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.

Many of the factors affecting job growth over the last few years are expected to continue to influence the economy over the forecast period. The principal factors affecting the economy are: 1) strong productivity growth; 2) inflationary pressures; 3) higher interest rates, weakness in the housing market, and changing credit conditions hampering consumption growth; and 4) weak investment growth. These factors also present risks to the forecast.

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

	2003	2004	2005	2006	2007
<u>United States</u>	Actual	Actual	Estimate	Estimate	Estimate
Nominal GDP					
(year-to-year growth)	4.3%	7.0%	6.4%	5.7%	5.8%
Inflation-adjusted GDP					
(year-to-year growth)	2.7%	4.2%	3.6%	3.0%	3.2%
Unemployment rate	6.0%	5.5%	5.1%	5.2%	5.2%
Inflation					
Consumer Price Index					1.9%
(year-to-year growth)	2.3%	2.7%	3.4%	2.9%	
GDP Implicit price deflator					2.6%
(year-to-year growth)	2.0%	2.6%	2.7%	2.6%	
Interest rates					
90-day Treasury bill	1.01%	1.38%	3.16%	4.47%	4.81%
Corporate Aaa bond	5.66%	5.63%	5.25%	6.16%	6.67%
Federal funds rate	1.13%	1.35%	3.21%	4.77%	5.23%
Light motor vehicle sales					
(millions of units)	16.6	16.9	16.8	16.4	16.5
Auto	7.6	7.5	7.7	7.8	7.9
Truck	9.0	9.4	9.1	8.6	8.7
Import Share	19.9%	20.2%	20.3%	22.1%	22.6%
<u>Michigan</u>					
Personal Income (millions)	\$318,491	\$324,134	\$334,633	\$346,353	\$360,090
Year-to-year growth	4.9%	1.8%	3.2%	3.5%	4.0%
Inflation-adjusted personal income (year-to-year growth)	2.9%	0.2%	0.4%	0.6%	2.1%
Wage & salary income (millions)	\$176,653	\$180,245	\$186,624	\$188,594	\$192,956
year-to-year growth	1.8%	2.0%	3.5%	1.1%	2.3%
Detroit Consumer Price Index (year-to-year growth)	2.0%	1.6%	2.9%	2.9%	1.8%
Wage & Salary Employment (thousands)	4,409.6	4,390.8	4,362.8	4,309.8	4,290.2
year-to-year growth	(1.5)%	(0.4)%	(0.6)%	(1.2)%	(0.5)%
Unemployment Rate	7.3%	7.1%	6.9%	7.4%	7.5%

Table 2

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

	2003	2004	2005	2006	2007
	Actual	Actual	Estimate	Estimate	Estimate
Gross Domestic Product (billions of dollars)	\$10,971.2	\$11,734.3	\$12,488.3	\$13,200.0	\$13,971.1
Year-to-year growth	4.8%	7.0%	6.4%	5.7%	5.8%
<i><u>Inflation-Adjusted GDP and Components</u></i>					
Gross Domestic Product (billions of 2000 dollars)	\$10,320.6	\$10,755.7	\$11,143.6	\$11,476.2	\$11,841.0
Year-to-year growth	2.7%	4.2%	3.6%	3.0%	3.2%
Consumption (billions of 2000 dollars)	\$7,306.6	\$7,588.6	\$7,863.6	\$8,087.5	\$8,364.6
Year-to-year growth	2.9%	3.9%	3.6%	2.8%	3.4%
Business fixed investment (billions of 2000 dollars)	\$1,085.0	\$1,186.7	\$1,288.7	\$1,392.6	\$1,471.9
Year-to-year growth	1.3%	9.4%	8.6%	8.1%	5.7%
Change in Business Inventories (billions of 2000 dollars)	\$15.5	\$52.0	\$19.6	\$26.2	\$30.8
Residential investment (billions of 2000 dollars)	\$509.4	\$561.8	\$600.8	\$584.7	\$562.3
Year-to-year growth	8.4%	10.3%	6.9%	(2.7)%	(3.8)%
Government spending (billions of 2000 dollars)	\$1,911.1	\$1,952.3	\$1,992.5	\$2,029.8	\$2,052.9
Year-to-year growth	2.8%	2.2%	2.1%	1.9%	1.1%
Net Exports (billions of 2000 dollars)	(\$521.4)	(\$601.3)	(\$628.2)	(\$639.2)	(\$622.0)
Exports (billions of 2000 dollars)	\$1,031.2	\$1,117.9	\$1,194.4	\$1,264.9	\$1,380.1
Imports (billions of 2000 dollars)	\$1,552.6	\$1,719.2	\$1,822.6	\$1,904.0	\$2,002.1
Personal income (year-to-year growth)	3.2%	5.9%	5.4%	6.3%	6.0%
Adjusted for Inflation	0.9%	3.2%	1.9%	3.2%	4.0%
Wage & salary income (year-to-year growth)	2.6%	5.4%	6.0%	4.8%	5.5%
Personal savings rate	2.1%	1.8%	-0.4%	0.5%	0.8%
Capacity utilization rate	75.7%	78.6%	79.8%	80.2%	81.7%
Housing starts (millions of units)	1.848	1.950	2.059	1.905	1.808
Conventional mortgage rates	5.8%	5.8%	5.9%	6.7%	7.2%
Federal budget surplus (billions of dollars, NIPA basis)	(\$382.7)	(\$406.5)	(\$342.6)	(\$374.5)	(\$383.3)

Figure 1

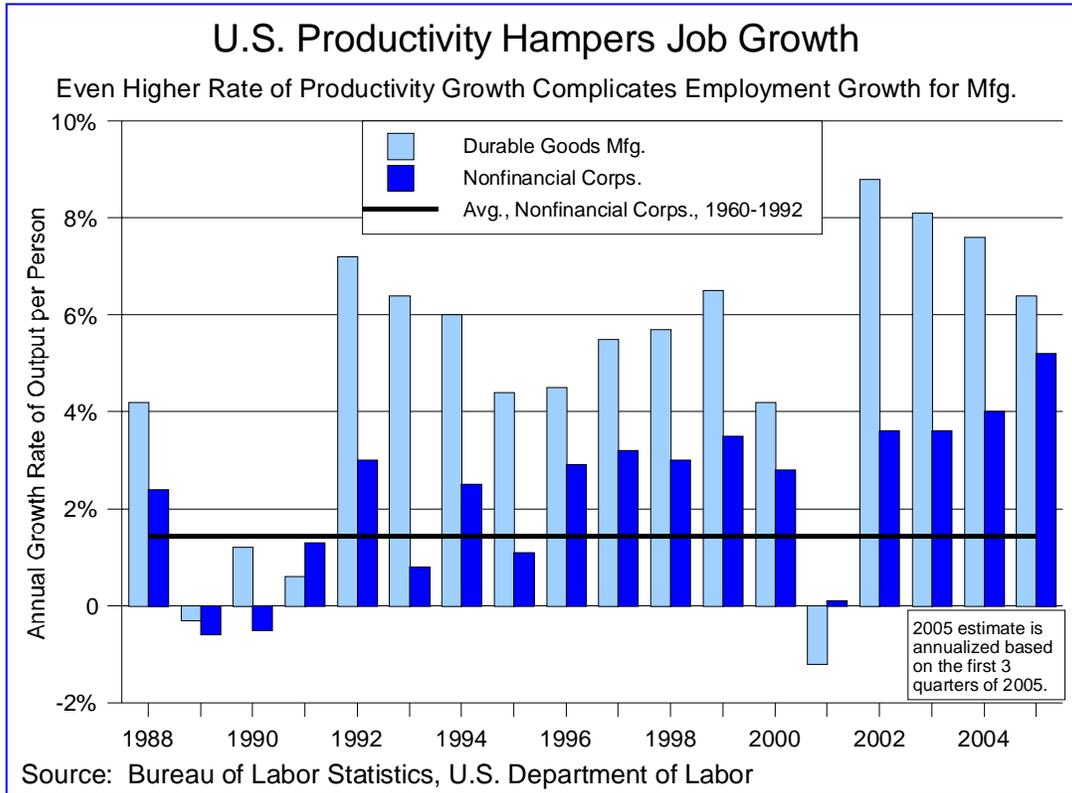


Figure 2

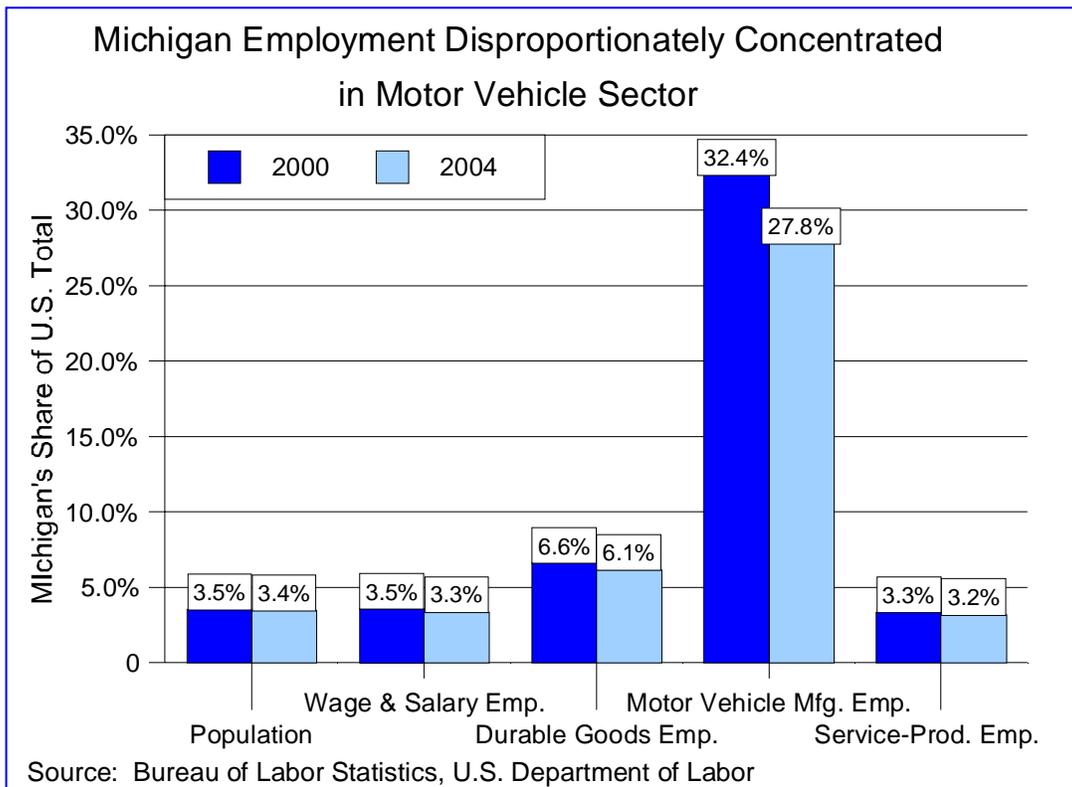
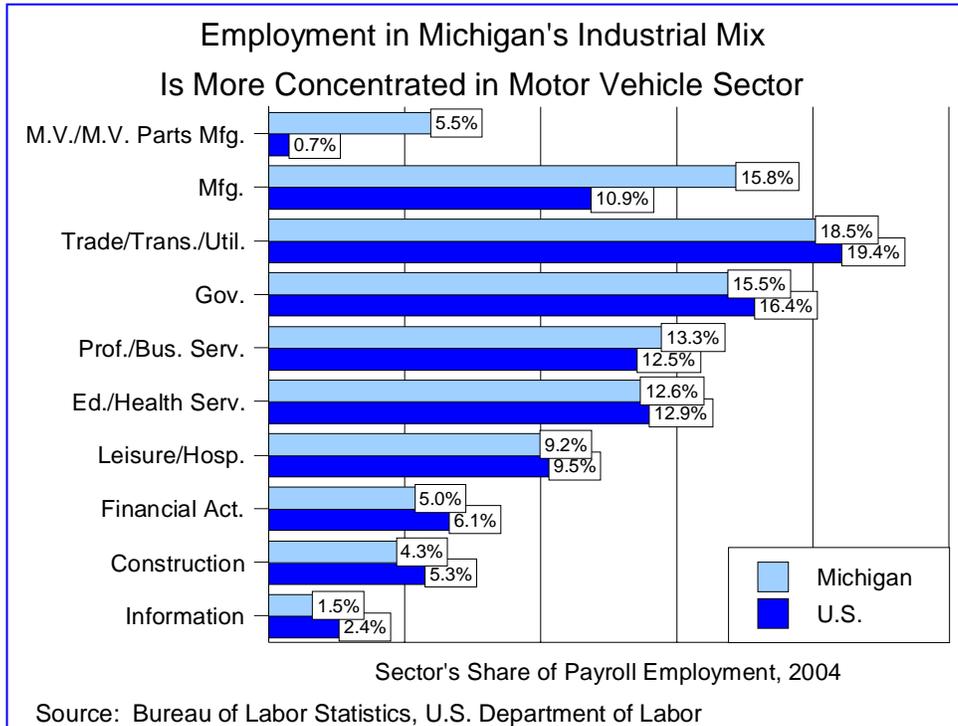


Figure 3



FORECAST SUMMARY

Both the U.S. and Michigan economies are expected to continue growing in 2006 and 2007 (Figure 4). 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 expected to have grown by 3.6% in 2005, followed by projected growth of 3.0% in 2006 and 3.2% in 2007. The modest decline in growth during 2006 reflects slightly slower growth in consumption and residential investment as interest rates continue to rise, energy prices remain high and home equity growth slows. The unemployment rate will rise slightly from an expected 5.1% during 2005 to 5.2% in 2006 and 2007.

In Michigan, both job growth and personal income growth are expected to remain below the national average and the historical state average (Figures 4 and 5). Furthermore, the sectors expected to exhibit the largest gains in employment generally pay wages below those in the sectors with the slowest growth (Figures 6 and 7). Inflation-adjusted personal income is expected to have risen by 0.4% in 2005, and is projected to grow 0.6% in 2006 and 2.1% in 2007. On an annual basis, wage and salary employment is expected to have fallen by 0.6% in 2005, the fifth consecutive year of decline. Wage and salary employment is predicted to continue to decline as productivity and competition continue to pressure businesses, particularly in the manufacturing sector, with employment falling by 1.2% in 2006 and 0.5% in 2007. Despite the surge in light vehicle sales in mid-2005, on an annual basis vehicle sales are expected to have remained fairly flat in 2005, declining from 16.9 million units in 2004 to 16.8 million units. A slightly larger decline, to 16.4 million units, is anticipated in 2006 and sales are expected to total 16.5 million units in 2007. Flat sales, combined with productivity improvements and declining market share for domestic vehicle manufacturers, will depress employment. As a result, the unemployment rate will increase from an expected 6.9% in 2005 to 7.4% in 2006 and 7.5% in 2007, keeping the Michigan unemployment rate above the national average.

Figure 4

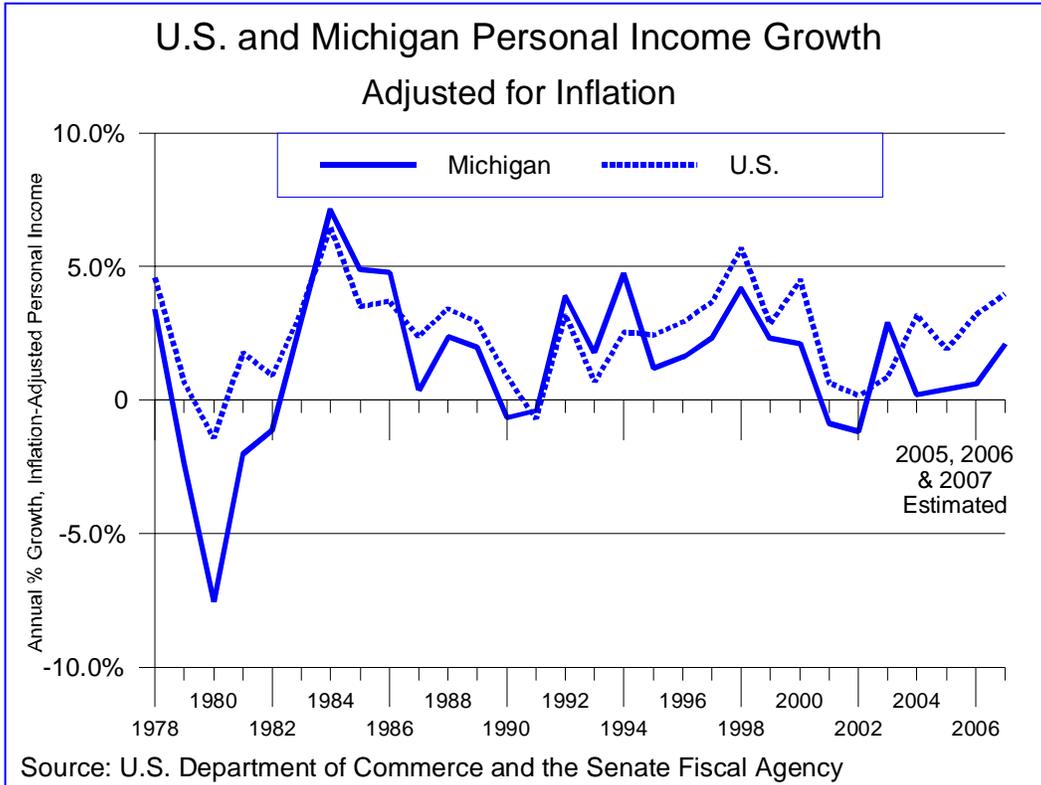


Figure 5

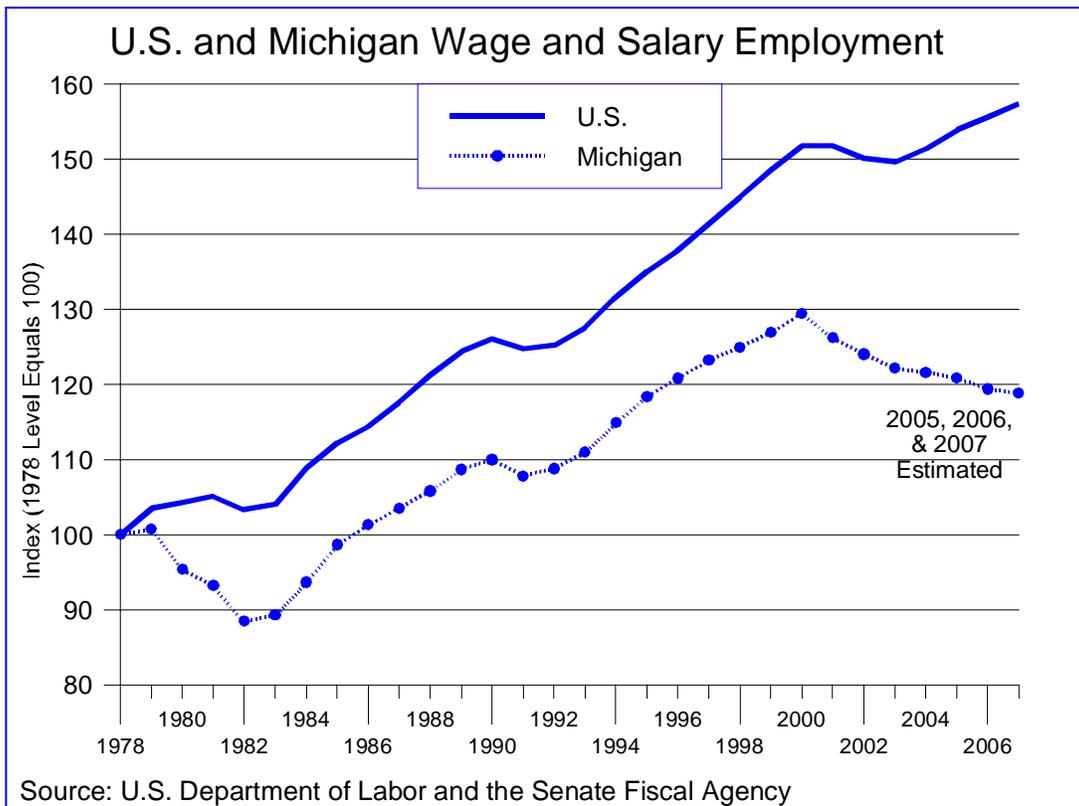


Figure 6

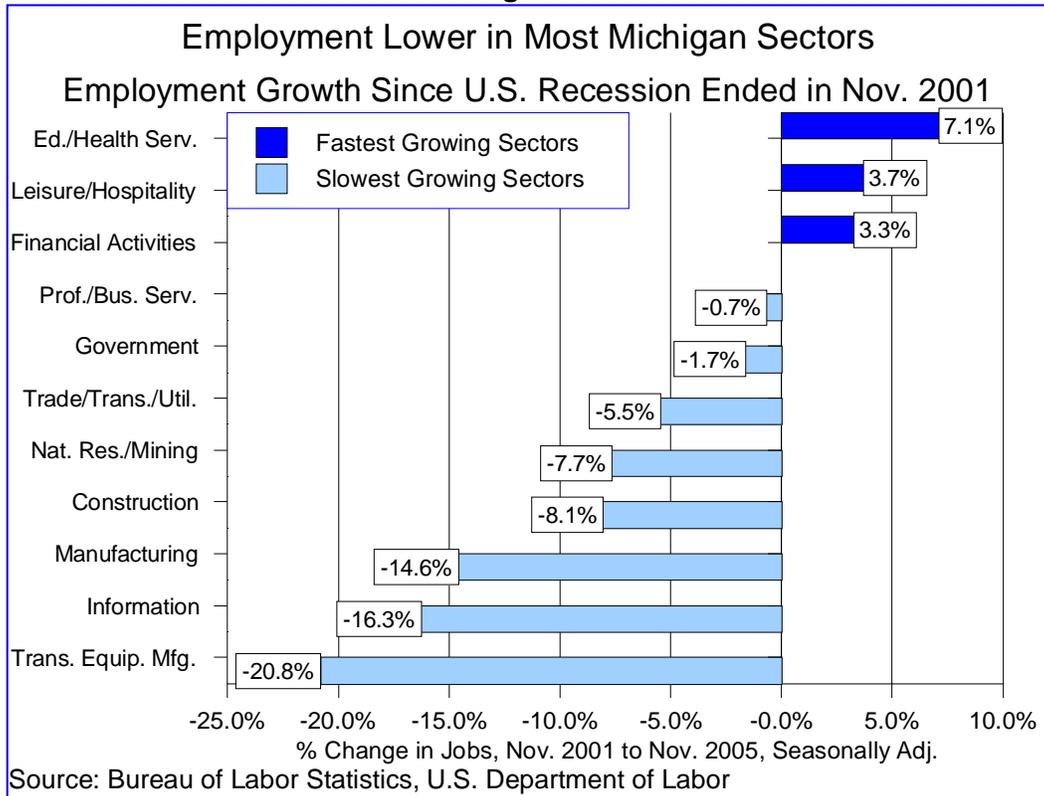
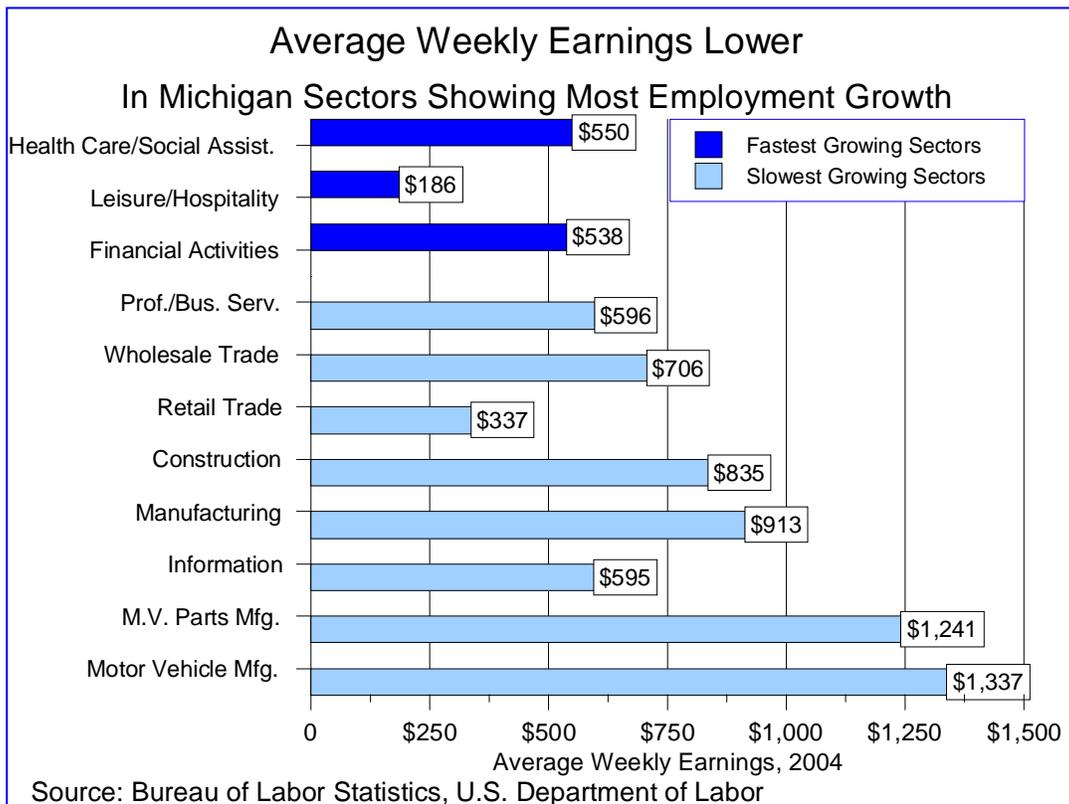


Figure 7



Compared with the August 17, 2005 consensus economic forecast, the U.S. forecast remains mostly unchanged. Light vehicles sales in 2005 and 2006 are slightly lower than expected in August although the forecast for inflation-adjusted GDP growth is unchanged. However, most key indicators for Michigan are lower in both 2005 and 2006. Although total wage and salary employment is expected to decrease in most quarters of the forecast, the declines reflect job losses in the manufacturing sector that will more than offset either stable employment levels or meager employment gains in most other sectors of the State economy. Michigan income measures also are expected to grow at a slower rate than forecasted in August. Consumer prices in 2006 are expected to rise more rapidly than was predicted in August, largely as a result of a number of factors, including higher energy prices, rising commodity prices, and greater pricing power due to the lower value of the dollar.

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 2006 and 2007 is based upon the following assumptions:

Monetary Policy. The Federal funds rate target is currently 4.25%, up 325 basis points from May 2004. The forecast assumes that inflationary concerns are present (discussed in the risks regarding 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 mid-2007, although at a somewhat slower rate than during the last 18 months, with the Federal funds rate reaching 5.0% at the end of the third quarter of 2006 and 5.25% by mid-2007.

Foreign Economies. Many of the U.S.'s key trading partners' economies are expected to grow more slowly than the U.S. economy grows during most of the forecast period. After declining only 0.5% during 2006, the dollar is expected to fall in value another 4.3% during 2007. As a result, the forecast predicts that the trade deficit will increase slightly in 2006 and remain at roughly 5.5% of GDP over the forecast period.

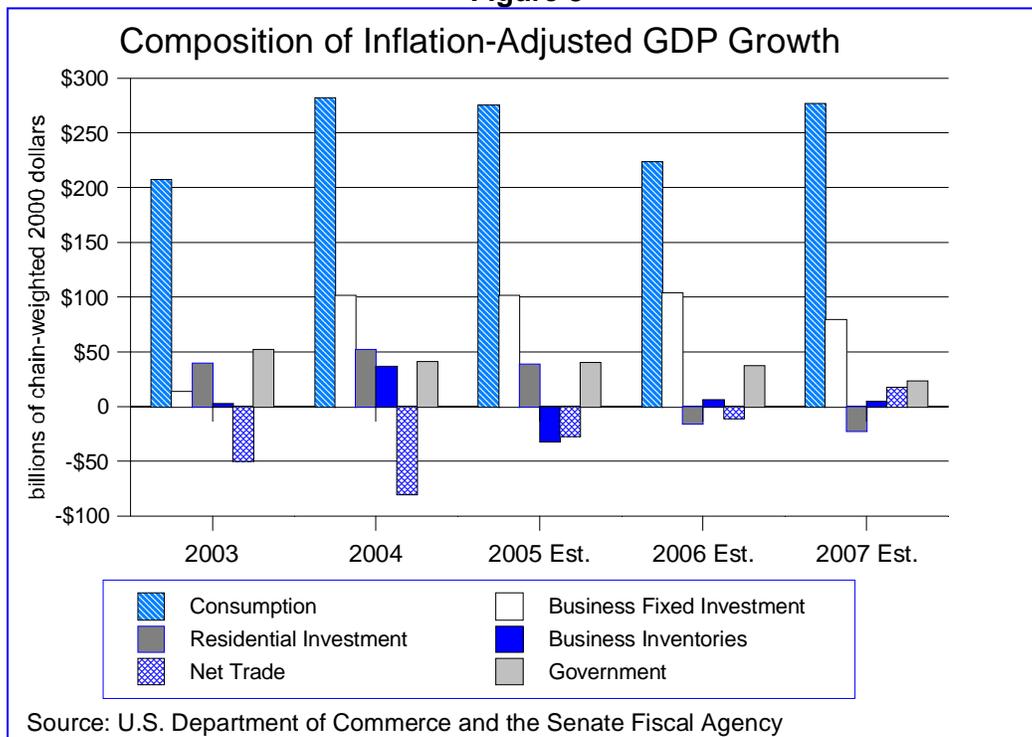
Oil and Energy Prices. The forecast expects oil prices to remain well above even recent historical averages in 2006 and 2007, remaining near \$65 per barrel throughout most of 2006. Oil prices are expected to decline slightly during 2007, although prices should still average near \$60 per barrel. Other energy prices also are expected to follow a similar pattern over the forecast period, although natural gas prices are expected to post a significant spike during the first quarter of 2006. Prices are anticipated to remain above historical averages for a variety of reasons, ranging from political instability in the Middle East to limited domestic refining capacity (which is essentially already at maximum) to growing domestic and worldwide energy demands. While higher energy prices will increase incentives to expand drilling and exploration activities, as well make alternative energy sources relatively more attractive, any supply increases from these factors are assumed to be "too little, too late" in that they will have little impact on markets during the forecast horizon.

Risks to the Forecast

All forecasts carry a certain amount of error, but the chances that a forecast will err substantially depend upon certain risks to economic fundamentals upon which the forecast is built. While recent years have offered a fair amount of economic uncertainty, the economic environment in 2006 exhibits even greater uncertainty. As a result, the current economic forecast faces 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 Open Market Committee will increase rates fairly steadily over the forecast period in an effort to return rates to levels consistent with historical averages and the underlying productivity in the economy, and that a proactive approach will be taken toward any inflationary pressures, which are expected to be significant and are discussed later in this section. The forecast assumes that much of the stimulus effect of fiscal policy has been exhausted and any growth in Federal spending will be restrained, particularly compared with historical levels (Figure 8). Government is expected to add only approximately 0.3 percentage point to economic growth in 2006 and only 0.2 percentage point in 2007. However, there is a significant risk that Federal spending will be higher than forecasted, which would increase economic growth above the forecasted level but also likely result in interest rates' being higher than forecasted as well. Such events could weaken both investment, particularly among firms that have borrowed heavily under variable rates, and export growth. Conversely, inflationary pressures could be lower than expected, resulting in lower interest rates and generally higher rates of consumption, investment, and export growth.

Figure 8



Consumer Behavior. Consumption growth remained moderate throughout the slowdown over the last four years, largely through increased borrowing and housing 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 substantial employment gains or stronger consumption growth. As a result, higher interest rates are likely to worsen the burden of servicing consumer debt. The burden of servicing consumer debt reached an all-time high in the first quarter of 2005, and a significant portion of debt at this point is variable-rate debt—meaning that the burden will increase if interest rates rise more rapidly than incomes rise. When combined with slow job growth, high energy prices, a declining value of the dollar, and modest personal income growth, consumption growth is not likely to rise significantly over the forecast period. Financial markets and housing prices are likely to provide significant incentives for consumers to increase the personal saving rate from its current negative levels, although the rate will remain near record lows if expected consumption

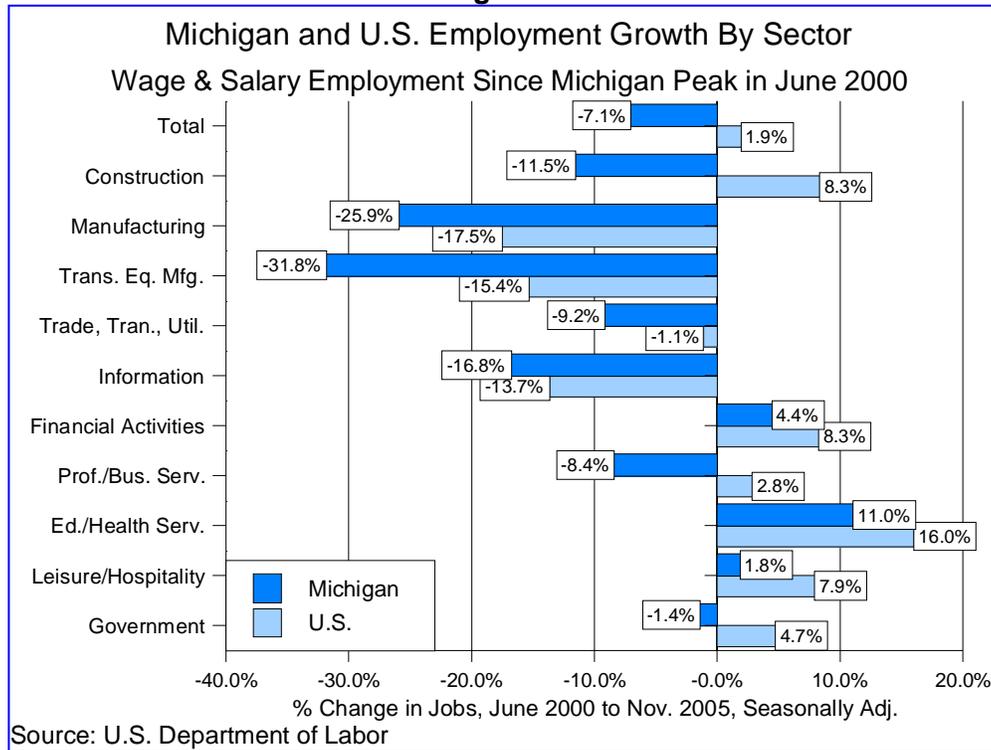
levels are generally correct. If the saving rate improves more than expected and/or higher interest rates have a greater effect than forecasted, both consumption growth and economic growth will be lower. Similarly, if the weak employment situation causes consumers to lose confidence in the economy, consumer spending (and thus economic growth) may be lower than expected.

Inflation. While the forecast expects a noticeable increase in the rate of inflation compared with recent years, the anticipated inflation rates are at or below the rates experienced during the 1990s and are below the rate in virtually every year during the 1980s. However, the dollar's value is expected to decline, increasing the price of imports and allowing domestic producers greater pricing power. Several surveys have indicated that producers feel more optimistic about being able to pass on price increases, particularly those attributable to high energy prices. Producers also are likely to face wage pressures, with compensation growing more rapidly than in recent years and productivity, while still exhibiting historically strong growth, growing more slowly than in recent years. Furthermore, continued economic 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 1) reasonably healthy growth in productivity, which may not be as strong as forecasted, 2) minimal wage growth or tightness in the labor market, which may be stronger than predicted, and 3) moderated declines in the value of the dollar, which may fall in value more rapidly than expected. These factors may 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. Furthermore, to the extent that the emphasis is on short-term inflation, the pattern seen in the forecast, where short-term interest rates rise much more rapidly than long-term rates, could be exacerbated and not only squeeze profits margins for banks and other financial intermediaries but also substantially reduce the willingness of lenders to lend. Should that happen, both consumption and investment could grow much more slowly than forecast, or even decline, given that borrowing has generally been fueling consumption gains in recent years and remains a significant source of funds for business investment. Such interest rate patterns, where short-term rates exceed long-term rates, appeared during December 2005 and are often viewed as a precursor to a recession.

Michigan's Dilemma. While over the last five years Michigan's employment situation has fared worse than the national average, and, in some cases or time periods within that range, worse than the situation in any other state ([Figure 9](#)), Michigan's performance is not particularly inconsistent with other states when this State's economic composition is considered. Generally, states with higher manufacturing concentrations have experienced weaker job performance over the last five years, because of 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.

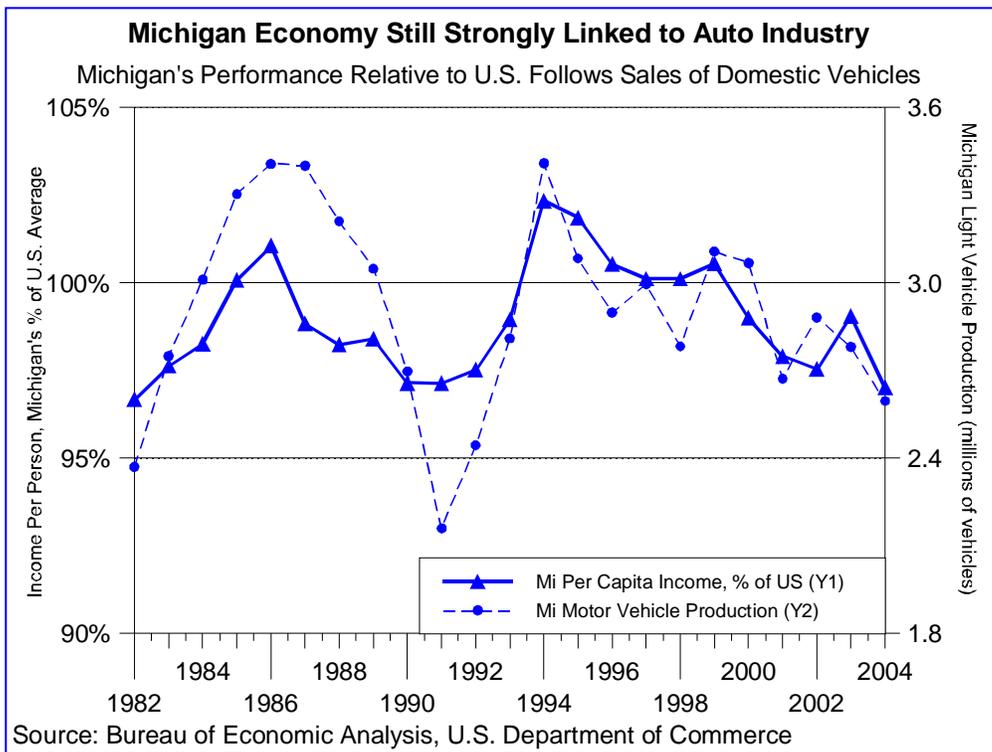
Figure 9



Rising interest rates, a near-zero savings rate, 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, reflecting the lack of pent-up demand that usually occurs during recessions, while the domestic share of the sales mix is expected to decline. Michigan's economic fortunes have historically been very closely linked with sales of domestically produced light vehicles (Figure 10), so it is unclear whether Michigan's employment situation would be much better even if productivity were not rising so rapidly in the motor vehicle sector. However, the combination of high productivity and declining market share has been particularly dramatic: On a seasonally adjusted basis, as of November 2005, Michigan had lost approximately one out of every three jobs (a decline of more than 111,000 jobs) in transportation equipment manufacturing that existed during the peak in June 2000.

Because of the number of individuals employed in transportation equipment manufacturing and the likelihood of continued substantial gains in productivity in the vehicle sector, it is probable that absent any shocks, the Michigan economy will spend years adjusting to the change. Offsetting a 10% annual decline in employment in the transportation equipment manufacturing sector essentially requires nearly 0.7% annual employment growth in the rest of the Michigan economy. Between 1995 and 2000, overall employment in Michigan grew only an average of 1.8% per year (and transportation equipment manufacturing employment over that period increased an average of 1.4% per year). For overall employment in Michigan to rise 1.8%, despite a 10% decline in transportation equipment manufacturing employment, employment in the rest of the Michigan economy would need rise by more than 2.5%, which has occurred only in three years since 1986 (and only in six of the last 25 years). Given that productivity improvements, changes in market share, and changing demographics are likely to result in a decline of around 5.0% per year in transportation equipment manufacturing employment over a number of future years, if employment in other sectors grows at the 1990-2004 average of 0.9% per year, Michigan will not reach the 2000 level of employment again until the year 2016.

Figure 10



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

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 final revenue for FY 2004-05 is presented along with the revised estimates for FY 2005-06 and the initial revenue estimates for FY 2006-07. 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 2004-05, GF/GP and SAF revenue increased 2.9% to \$19.2 billion. This increase was stronger than had been expected and was due in part to some one-time gains in both tax and nontax revenue. On a baseline basis, GF/GP and SAF revenue collections were up 4.5%, which marks the strongest baseline increase since FY 1999-2000.

In FY 2005-06, GF/GP and SAF revenue will increase an estimated 1.5% to \$19.49 billion, which represents a slowdown in the rate of growth compared with FY 2004-05. The key factors that will slow the pace of revenue growth in FY 2005-06 include: 1) employment in Michigan will continue to edge downward, 2) overall real economic growth, as measured by inflation-adjusted Michigan personal income, will not improve much, 3) the one-time boost in various revenue sources that helped increase FY 2004-05 revenue will not be repeated in FY 2005-06, and 4) the recently enacted tax cut for manufacturing businesses will reduce single business tax collections beginning in FY 2005-06.

In FY 2006-07, GF/GP and SAF revenue will total an estimated \$19.82 billion, which represents a 1.7% increase from the revised estimate for FY 2005-06. This projected rate of growth is up only slightly from the 1.5% rate of growth forecast for FY 2005-06. The revenue estimates are summarized in Table 3.

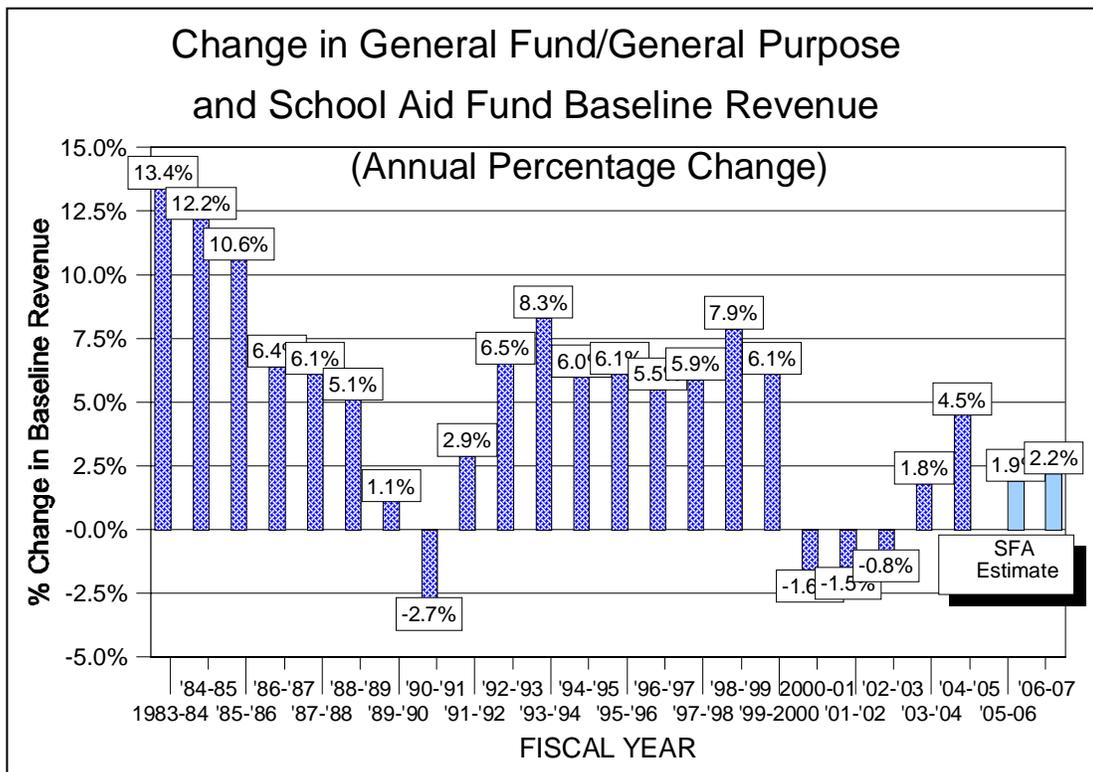
Historical Perspective

Figure 11 presents a historical overview of the percentage change in baseline GF/GP and SAF revenue since FY 1982-83. The period from FY 1992-93 to FY 1999-2000 marked a time of unprecedented steady growth as baseline revenue growth did not fall below 5.5% during these eight years. This period of fairly strong, consistent revenue growth came to an abrupt end as the recession hit Michigan in the second half of 2000. Baseline revenue then declined for three consecutive years: by 1.6% in FY 2000-01, 1.5% in FY 2001-02, and 0.8% in FY 2002-03. Baseline revenue began to increase again as it posted gains of 1.8% in FY 2003-04 and 4.5% in FY 2004-05. However, the improvement in the rate of revenue growth reached in FY 2004-05 is not expected to last. The pace of GF/GP and SAF baseline revenue growth is expected to slow to rates of 1.9% in FY 2005-06 and 2.2% in FY 2006-07.

Table 3

SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2005-06 AND FY 2006-07 GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND (Millions of Dollars)			
	FY 2004-05 Final	FY 2005-06 Revised Est.	FY 2006-07 Initial Est.
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	\$8,219.5	\$8,270.3	\$8,376.2
Tax Changes Not In Baseline	69.5	(24.0)	(124.4)
<u>Revenue After Tax Changes:</u>			
Net Income Tax	4,121.2	4,090.8	4,124.9
Single Business Tax & Insurance Tax	2,153.0	2,147.7	2,086.3
Other Taxes	<u>1,597.1</u>	<u>1,679.9</u>	<u>1,710.1</u>
Total Taxes	7,871.3	7,918.4	7,921.3
Nontax Revenue	417.7	327.8	330.5
TOTAL GF/GP REVENUE	\$8,289.1	\$8,246.2	\$8,251.8
SCHOOL AID FUND			
Baseline SAF	\$10,918.2	\$11,224.8	\$11,542.7
Tax Changes Not In Baseline	(8.5)	20.9	23.5
TOTAL SAF REVENUE	\$10,909.7	\$11,245.6	\$11,566.2
BASELINE GF/GP AND SAF REVENUE	\$19,211.7	\$19,495.1	\$19,918.9
Tax & Revenue Changes	(13.0)	(3.1)	(100.9)
GF/GP & SAF REV. AFTER CHANGES	\$19,198.7	\$19,492.0	\$19,818.0
<u>ADDENDUM:</u>			
Sales Tax	\$6,599.0	\$6,811.6	\$7,050.8
PERCENT CHANGE			
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	5.5%	0.6%	1.3%
<u>Revenue After Tax Changes:</u>			
Net Income Tax	3.6	(0.7)	0.8
Single Business Tax & Insurance Tax	4.6	(0.2)	(2.9)
Other Taxes	<u>1.7</u>	<u>5.2</u>	<u>1.8</u>
Total Taxes	3.5	0.6	0.0
Nontax Revenue	(4.3)	(21.5)	0.8
TOTAL GF/GP REVENUE	3.1%	(0.5)%	0.1%
SCHOOL AID FUND			
Baseline SAF	3.7	2.8	2.8
TOTAL SAF REVENUE	2.8%	3.1%	2.9%
BASELINE GF/GP AND SAF REVENUE	4.5	1.9	2.2
GF/GP & SAF REV. AFTER CHANGES	2.9%	1.5%	1.7%
<u>ADDENDUM:</u>			
Sales Tax	1.9%	3.2%	3.5%

Figure 11



FY 2004-05 FINAL REVENUE

Based on final book-closing data, GF/GP and SAF revenue totaled \$19.2 billion in FY 2004-05, 2.9% above the FY 2003-04 revenue level, as presented in Table 4. At the special Consensus Revenue Estimating Conference held in August 2005, it was estimated that GF/GP and SAF revenue would increase 0.9%; however, stronger-than-expected tax collections in the last quarter of the fiscal year, along with some unexpected positive revenue accrual adjustments that were made during the year-end book-closing process, resulted in the stronger-than-expected revenue levels in FY 2004-05. In total, GF/GP and SAF revenue in FY 2004-05 topped the August estimate by \$327.5 million. This level of revenue was due primarily to higher-than-anticipated revenue from the income tax, single business tax, estate tax, use tax, and State education property tax.

General Fund/General Purpose

General Fund/General Purpose revenue totaled \$8.29 billion in FY 2004-05, which was up 3.1% from FY 2003-04. Compared with the August 2005 consensus revenue estimate, the GF/GP revenue level was up \$256.0 million. This unexpected boost in GF/GP revenue was primarily due to additional revenue from the income, single business, use, estate, and insurance taxes, as shown in Table 4. About half of this increase in GF/GP revenue in FY 2004-05 reflects one-time events that will not occur again in FY 2005-06. These one-time boosts in GF/GP revenue include a large estate tax payment and payments resulting from audit judgments on prior-year business activity.

Table 4
FY 2004-05 FINAL REVENUE
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

			Change from FY 2003-04		\$ Change from 08/05 Consensus
	FY 2003-04 Final	FY 2004-05 Final	Dollar Change	Percent Change	
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue	\$7,992.9	\$8,433.3	\$440.4	5.5%	\$247.2
Tax Changes Not In Baseline Revenue After Tax Changes	49.3	(144.2)	(193.5)	---	8.8
<u>Personal Income Tax</u>					
Gross Collections	7,467.0	7,719.0	252.0	3.4	42.7
Less: Refunds	(1,594.2)	(1,610.8)	(16.6)	1.0	49.9
Net Income Tax Collections	5,872.8	6,108.2	235.4	4.0	92.6
Less: Earmarking to SAF Campaign Fund	(1,893.5)	(1,985.5)	(92.0)	4.9	6.8
	(1.5)	(1.5)	0.0	0.0	0.0
Net Income Tax to GF/GP	\$3,977.8	\$4,121.2	\$143.4	3.6%	\$99.4
<u>Other Taxes</u>					
Single Business Tax	1,827.6	1,903.5	75.9	4.2	17.8
Sales	102.1	99.1	(3.0)	(2.9)	(8.5)
Use	877.4	934.7	57.3	6.5	11.0
Cigarette	242.7	116.5	(126.2)	(52.0)	(1.0)
Insurance Company Premiums	230.3	249.5	19.2	8.3	13.2
Telephone & Telegraph	101.3	99.1	(2.2)	(2.2)	1.8
Estate	75.5	101.5	26.0	34.4	71.5
Oil & Gas Severance	57.1	66.7	9.6	16.8	1.7
Casino Wagering	3.2	42.2	39.0	---	(0.3)
All Other	110.6	137.3	26.7	24.1	22.3
Subtotal Other Taxes	\$3,627.8	\$3,750.1	\$122.3	3.4%	\$130.4
Total Nontax Revenue	436.4	417.7	(18.7)	(4.3)	27.1
GF/GP REV. AFTER TAX CHANGES	\$8,042.0	\$8,289.1	\$247.1	3.1%	\$256.0
SCHOOL AID FUND:					
Baseline Revenue	\$10,533.6	\$10,921.9	\$388.3	3.7%	\$66.3
Tax Changes Not In Baseline Revenue After Tax Changes	81.7	(12.2)	(93.9)	(114.9)	5.2
Sales Tax	4,716.7	4,805.7	89.0	1.9	(18.6)
Lottery Revenue	644.9	667.6	22.7	3.5	26.6
State Education Property Tax	1,824.5	1,914.6	90.1	4.9	66.6
Real Estate Transfer Tax	317.5	313.5	(4.0)	(1.3)	(2.5)
Income Tax	1,893.5	1,985.5	92.0	4.9	(6.8)
Casino Tax	95.8	97.6	1.8	1.9	(0.8)
Other Revenue	1,122.4	1,125.2	2.8	0.2	7.0
SAF REVENUE AFTER TAX CHANGES	\$10,615.3	\$10,909.7	\$294.4	2.8%	\$71.5
BASELINE GF/GP AND SAF	\$18,526.5	\$19,355.2	\$828.7	4.5%	\$313.5
Tax & Revenue Changes	130.9	(156.4)	(287.3)	---	14.0
GF/GP & SAF REV. AFTER CHANGES	\$18,657.4	\$19,198.7	\$541.3	2.9%	\$327.5
SALES TAX	\$6,473.5	\$6,599.0	\$125.5	1.9%	\$(25.5)
Note: In order to accurately compare FY 2003-04 and FY 2004-05 baseline revenue, the base year in this table is FY 2003-04.					

School Aid Fund

School Aid Fund earmarked revenue totaled \$10.91 billion in FY 2004-05, which was up 2.8% from the FY 2003-04 revenue level. Almost all of the major taxes earmarked to the SAF were up in FY 2004-05, compared with their FY 2003-04 level, including the sales (1.9%), income (4.9%), and State education property (4.9%) taxes. In addition, revenue from the lottery was up 3.5%. Compared with the consensus estimate adopted in August 2005, SAF revenue was up \$71.5 million; most of this increase was attributable to the State education property tax and lottery net earnings.

REVISED REVENUE ESTIMATES FOR FY 2005-06

General Fund/General Purpose and SAF revenue is expected to total \$19.49 billion in FY 2005-06, which is up 1.5%, or \$293.3 million, from FY 2004-05. Compared with the August 2005 consensus estimate, this revised estimate is up \$34.4 million. The revised GF/GP and SAF revenue estimates for FY 2005-06 are presented in Table 5.

General Fund/General Purpose

General Fund/General Purpose revenue will total an estimated \$8.25 billion, which is down 0.5%, or \$42.8 million, from FY 2004-05. This modest decline is attributable to four major factors: 1) given the relatively weak level of economic activity forecast for the Michigan economy in 2006, baseline revenue will experience only a modest increase of 0.6%, 2) a large estate tax payment and audit judgment tax payments totaling about \$90.0 million helped boost FY 2004-05 revenue, but will not be repeated in FY 2005-06, 3) the recently enacted business tax reduction package will lower single business tax revenue by at least \$58.0 million in FY 2005-06, and 4) the estate tax is now repealed so estate tax collections in FY 2005-06 will reflect late payments only and therefore will be down significantly. Offsetting at least a portion of these negative factors is a change in the earmarking of tobacco tax revenue which will distribute an additional \$110.0 million to GF/GP revenue in FY 2005-06 compared with FY 2004-05. This revised GF/GP revenue estimate is up \$36.7 million from the August 2005 consensus revenue estimate, excluding the impact of the recent cut in the single business tax cut, which was not included in the August consensus estimate.

Single Business Tax Cut. In December 2005, a business tax relief package was enacted into law. This legislation cut the single business tax effective January 1, 2006, by creating a new 15.0% refundable credit for industrial personal property, a new 100% credit for new personal property in Michigan that is used by industrial or high technology workers who are transferred to Michigan from other states or countries, and an increase in the weight applied to the sales portion of the apportionment factor from the current 90.0% to 92.5% on January 1, 2006, and 95.0% on January 1, 2008. While these changes will have revenue implications through FY 2009-10, they will reduce single business tax revenue an estimated \$58.0 million in FY 2005-06 and \$151.0 million in FY 2006-07. A more detailed description of the components of this overall business tax cut can be found on the Senate Fiscal Agency website: <http://senate.michigan.gov/sfa/>.

School Aid Fund

School Aid Fund revenue from earmarked taxes and the lottery is expected to total \$11.25 billion in FY 2005-06, which is up 3.1% from the FY 2004-05 level. This estimate is practically unchanged from the August 2005 consensus estimate as downward revisions in the sales and income tax revenue estimates were largely offset by upward revisions in the State education property tax and lottery revenue estimates. The SAF revenue estimate for FY 2005-06 also is summarized in Table 5.

Table 5
FY 2005-06 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	Change From FY 2004-05				\$ Change from 08-05 Consensus ¹⁾
	FY 2004-05 Final	FY 2005-06 Revised Est.	Dollar Change	Percent Change	
GENERAL FUND/GENERAL PURPOSE					
Baseline Revenue²⁾	\$8,219.5	\$8,270.3	\$50.8	0.6%	\$36.5
Tax Changes Not In Baseline Revenue After Tax Changes	69.5	(24.0)	(93.5)	---	0.2
<u>Personal Income Tax</u>					
Gross Collections	7,719.0	7,816.5	97.5	1.3	(95.9)
Less: Refunds	(1,610.8)	(1,695.0)	(84.2)	5.2	30.0
Net Income Tax Collections	6,108.2	6,121.5	13.3	0.2	(65.9)
Less: Earmarking to SAF Campaign Fund	(1,985.5) (1.5)	(2,029.2) (1.5)	(43.7) 0.0	2.2 0.0	24.5 0.0
Net Income Tax to GF/GP	\$4,121.2	\$4,090.8	\$(30.4)	(0.7)%	\$(41.4)
<u>Other Taxes</u>					
Single Business Tax	1,903.5	1,885.7	(17.8)	(0.9)	25.0
Sales	99.1	115.1	15.9	16.1	0.0
Use	934.7	963.7	29.1	3.1	0.0
Cigarette	116.5	226.8	110.3	94.7	(1.5)
Insurance Company Premiums	249.5	262.0	12.5	5.0	22.0
Telephone & Telegraph	99.1	83.3	(15.8)	(15.9)	2.0
Estate	101.5	8.0	(93.5)	(92.1)	0.0
Oil & Gas Severance	66.7	89.0	22.3	33.4	29.0
Casino Wagering	42.2	43.2	1.0	2.5	0.1
All Other	137.3	150.8	13.5	9.8	25.5
Subtotal Other Taxes	\$3,750.1	\$3,827.6	\$77.6	2.1%	\$102.1
Total Nontax Revenue	417.7	327.8	(89.9)	(21.5)	(24.0)
GF/GP REV. AFTER TAX CHANGES	\$8,289.1	\$8,246.2	\$(42.8)	(0.5)%	\$36.7
SCHOOL AID FUND:					
Baseline Revenue	\$10,918.2	\$11,224.8	\$306.7	2.8%	\$(2.5)
Tax Changes Not In Baseline Revenue After Tax Changes	(8.5)	20.9	29.4	---	0.2
Sales Tax	4,805.7	4,956.5	150.9	3.1	(73.1)
Lottery Revenue	667.6	694.8	27.2	4.1	27.5
State Education Property Tax	1,914.6	2,019.5	104.9	5.5	65.2
Real Estate Transfer Tax	313.5	312.0	(1.5)	(0.5)	(4.0)
Income Tax	1,985.5	2,029.2	43.7	2.2	(24.5)
Casino Tax	97.6	100.0	2.4	2.5	0.3
Other Revenue	1,125.2	1,133.6	8.3	0.7	6.3
SAF REVENUE AFTER TAX CHANGES	\$10,909.7	\$11,245.6	\$335.9	3.1%	\$(2.3)
BASELINE GF/GP AND SAF	\$19,137.7	\$19,495.1	\$357.4	1.9%	\$34.0
Tax & Revenue Changes	61.0	(3.1)	(64.1)	---	0.4
GF/GP & SAF REV. AFTER CHANGES	\$19,198.7	\$19,492.0	\$293.3	1.5%	\$34.4
SALES TAX	\$6,599.0	\$6,811.6	\$212.6	3.2%	\$(95.0)

1) The change from the August 2005 consensus revenue estimate does not reflect the impact of the new business tax cut because this tax change was not part of the August 2005 consensus revenue estimates.

2) The base year in this table is FY 2003-04.

FY 2006-07 INITIAL REVENUE ESTIMATES

The modest improvement in the level of economic activity forecast for Michigan's economy in 2007, coupled with the impact of the recently enacted business tax cut, will result in only a small increase in revenue in FY 2006-07. It is estimated that GF/GP and SAF revenue will total \$19.82 billion in FY 2006-07. This initial estimate of GF/GP and SAF revenue for FY 2006-07 represents an increase of 1.7%, or \$326.0 million, from the revised estimate for FY 2005-06, as presented in Table 6. Total GF/GP and SAF baseline revenue will increase at a projected rate of 2.2%, which will be up from the 1.9% increase estimated for FY 2005-06, but down from the 4.5% growth experienced in FY 2004-05.

General Fund/General Purpose Revenue

General Fund/General Purpose revenue will total an estimated \$8.25 billion in FY 2006-07. This represents only a 0.1%, or \$5.6 million, increase from the FY 2005-06 revised estimate. Anticipated increases in the revenue generated by the income, single business, use, insurance, and oil and gas severance taxes will be offset by the impact of the newly enacted cuts in the single business tax. On a baseline basis, GF/GP revenue is expected to increase 1.3% in FY 2006-07.

School Aid Fund

School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$11.57 billion in FY 2006-07, which represents a 2.9%, or \$320.6 million, increase from the revised estimate for FY 2005-06. This increase reflects a general improvement in the amount of revenue that will be collected from the sales, use, income, and State education property taxes, along with net lottery earnings.

The revenue estimates for some of the major GF/GP and SAF revenue sources are summarized below.

Income Tax. Net income tax revenue (gross collections less refunds) will total an estimated \$6.19 billion in FY 2006-07, which is up 1.2% from the revised estimate for FY 2005-06. The portion going to the SAF equals 25.9% of gross income tax collections and will total an estimated \$2.07 billion in FY 2006-07, representing an increase of 1.8%. The remainder of income tax revenue, which will total an estimated \$4.12 billion, will go to GF/GP revenue. This estimate for income tax revenue is based on the SFA economic forecast which anticipates that employment will continue to decline in 2007. The income tax estimate 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 \$3,400 on January 1, 2007. This will reduce income tax revenue about \$25.0 million in FY 2006-07.

Single Business Tax. The major components of the single business tax base, which includes compensation paid to workers, business profits, and gross receipts, are expected to improve only modestly, at best, in FY 2006-07 based on the economic forecast; however, these gains will be more than offset by the impact of the business tax cut. As a result, single business tax revenue will decline an estimated 3.8%, or \$72.4 million, in FY 2006-07. All single business tax revenue goes to the General Fund.

Sales Tax. Sales tax collections are expected to increase 3.5% in FY 2006-07 to \$7.05 billion. Of this total amount, \$5.14 billion will be earmarked to the SAF and \$123.0 million will go to GF/GP revenue. The remaining sales tax revenue will primarily go for revenue sharing and the Comprehensive Transportation Fund.

State Education Property Tax. The State education property tax is expected to generate \$2.12 billion in FY 2006-07, representing an increase of 4.7%. All of this revenue will go the SAF.

Lottery. Net lottery revenue will total an estimated \$697.8 million in FY 2006-07, which is up 0.4% from the revised level for FY 2005-06. All net earnings from the lottery go into the SAF.

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 2004-05 and FY 2005-06 is presented in Tables 7 and 8. 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 2004-05 and FY 2005-06 have been adjusted to reflect a baseline based on the FY 2004-05 tax structure.

The initial GF/GP and SAF baseline revenue estimate for FY 2004-05 was made in January 2004 at \$19.04 billion, as shown in Table 7. This estimate was left essentially unchanged until December 2004, when the estimate was lowered to \$18.74 billion. No significant changes were made to the estimate in January 2005, and in May 2005 the estimate was revised upward to \$18.81 billion. In August, the estimate was increased slightly to \$18.9 billion. Based on the final revenue for FY 2004-05, it is estimated that baseline revenue totaled \$19.1 billion. Compared with the initial estimate made in January 2004, the final GF/GP and SAF baseline revenue for FY 2004-05 is up \$94.2 million, or 0.5%.

For FY 2005-06, the initial GF/GP and SAF baseline revenue estimate was made in January 2005 at \$19.42 billion, as shown in Table 8. It was lowered slightly in May 2005 to \$19.38 billion and then was increased to \$19.46 billion in August 2005. Based on the SFA's revised estimates presented in this report, GF/GP and SAF baseline revenue for FY 2005-06 is estimated at \$19.5 billion. This revised estimate is up \$34.2 million, or 0.2%, from the August estimate, and compared with the initial estimate made in January 2005, this revised estimate is up \$76.3 million, or 0.4%.

Table 6
FY 2006-07 INITIAL REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	FY 2005-06 Revised Est.	FY 2006-07 Initial Est.	Change From FY 2005-06	
			Dollar Change	Percent Change
GENERAL FUND/GENERAL PURPOSE:				
Baseline Revenue	\$8,270.3	\$8,376.2	\$106.0	1.3%
Tax Changes Not In Baseline	(24.0)	(124.4)	(100.4)	---
<u>Revenue After Tax Changes</u>				
<u>Personal Income Tax</u>				
Gross Collections	7,816.5	7,954.5	138.0	1.8
Less: Refunds	(1,695.0)	(1,761.6)	(66.6)	3.9
Net Income Tax Collections	6,121.5	6,192.9	71.4	1.2
Less: Earmarking to SAF	(2,029.2)	(2,066.5)	(37.3)	1.8
Campaign Fund	(1.5)	(1.5)	0.0	0.0
Net Income Tax to GF/GP	\$4,090.8	\$4,124.9	\$34.1	0.8%
<u>Other Taxes</u>				
Single Business Tax	1,885.7	1,813.3	(72.4)	(3.8)
Sales	115.1	123.1	8.0	6.9
Use	963.7	1,008.6	44.9	4.7
Cigarette	226.8	224.3	(2.5)	(1.1)
Insurance Company Premiums	262.0	273.0	11.0	4.2
Telephone & Telegraph	83.3	81.5	(1.8)	(2.2)
Estate	8.0	0.0	(8.0)	(100.0)
Oil & Gas Severance	89.0	73.0	(16.0)	(18.0)
Casino Wagering	43.2	43.2	0.0	0.0
All Other	150.8	156.4	5.6	3.7
Subtotal Other Taxes	\$3,827.6	\$3,796.4	\$(31.2)	(0.8)%
Total Nontax Revenue	327.8	330.5	2.7	0.8
GF/GP REVENUE AFTER TAX CHANGES	\$8,246.2	\$8,251.8	\$5.6	0.1%
SCHOOL AID FUND:				
Baseline Revenue	\$11,224.8	\$11,542.7	\$317.8	2.8%
Tax Changes Not In Baseline	20.9	23.5	2.6	---
<u>Revenue After Tax Changes</u>				
Sales Tax	4,956.5	5,135.9	179.4	3.6
Lottery Revenue	694.8	697.8	3.0	0.4
State Education Property Tax	2,019.5	2,115.2	95.7	4.7
Real Estate Transfer Tax	312.0	302.0	(10.0)	(3.2)
Income Tax	2,029.2	2,066.5	37.3	1.8
Casino Tax	100.0	100.0	0.0	0.0
Other Revenue	1,133.6	1,148.8	15.2	1.3
SAF REVENUE AFTER TAX CHANGES	\$11,245.6	\$11,566.2	\$320.6	2.9%
BASELINE GF/GP AND SAF	\$19,495.1	\$19,918.9	\$423.8	2.2%
Tax & Revenue Changes	(3.1)	(100.9)	(97.8)	---
GF/GP & SAF REV. AFTER TAX CHANGES	\$19,492.0	\$19,818.0	\$326.0	1.7%
SALES TAX	\$6,811.6	\$7,050.8	\$239.2	3.5%
Note: FY 2004-05 is the base year for baseline revenue.				

Table 7
CHANGES IN SENATE FISCAL AGENCY
BASELINE REVENUE ESTIMATES FOR FY 2004-05
(Millions of Dollars)

Forecast Date	GF/GP	SAF	Total
January 10, 2004	\$7,998.9	\$11,044.6	\$19,043.5
January 14, 2004 ^{a)}	8,027.7	11,009.6	19,037.3
May 14, 2004	8,069.7	10,980.5	19,050.2
May 18, 2004 ^{a)}	8,075.6	10,965.9	19,041.5
December 1, 2004	7,840.1	10,781.3	18,621.4
December 3, 2004 ^{a)}	7,881.3	10,859.1	18,740.4
January 7, 2005	7,911.6	10,862.9	18,774.5
January 13, 2005 ^{a)}	7,909.8	10,865.1	18,774.9
May 9, 2005	7,880.8	10,824.2	18,705.0
May 19, 2005 ^{a)}	7,963.9	10,847.0	18,810.9
August 17, 2005	8,021.0	10,851.0	18,872.0
August 17, 2005 ^{a)}	8,046.4	10,851.7	18,898.1
January 10, 2006	8,219.5	10,918.2	19,137.7
<u>Change From Previous Estimate:</u>			
Dollar Change	\$173.1	\$66.5	\$239.6
Percent Change	2.2%	0.6%	1.3%
<u>Change From Initial Estimate:</u>			
Dollar Change	\$220.6	(\$126.4)	\$94.2
Percent Change	2.8%	(1.1)%	0.5%
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			
Note: Baseline base year equals FY 2004-05.			

Table 8
CHANGES IN SENATE FISCAL AGENCY
BASELINE REVENUE ESTIMATES FOR FY 2005-06
(Millions of Dollars)

Forecast Date	GF/GP	SAF	Total
January 7, 2005	\$8,151.8	\$11,267.0	\$19,418.8
January 13, 2005 ^{a)}	8,159.1	11,279.6	19,438.7
May 9, 2005	8,060.7	11,198.1	19,258.8
May 19, 2005 ^{a)}	8,152.9	11,231.7	19,384.6
August 17, 2005	8,234.2	11,225.8	19,460.0
August 17, 2005 ^{a)}	8,233.7	11,227.2	19,460.9
January 10, 2006	8,270.3	11,224.8	19,495.1
<u>Change From Previous Estimate:</u>			
Dollar Change	\$36.6	(\$2.4)	\$34.2
Percent Change	0.4%	0.0%	0.2%
<u>Change From Initial Estimate:</u>			
Dollar Change	\$118.5	(\$42.2)	\$76.3
Percent Change	1.5%	(0.4)%	0.4%
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			
Note: Baseline base year equals FY 2004-05.			

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 balance may be withdrawn.

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

Table 9 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 2005-06 and FY 2006-07. The BSF year-end balance as a percentage of GF/GP and SAF revenue is shown in Figure 12, and the estimated economic stabilization trigger calculations for FY 2005-06 and FY 2006-07 are presented in Table 10.

FY 2004-05

In FY 2004-05, the BSF had a beginning balance of \$81.3 million and during the year \$2.0 million in interest was earned. To help balance the FY 2004-05 budget, \$81.3 million was appropriated from the BSF to the General Fund, leaving only a \$2.0 million balance in the Fund at the end of the fiscal year.

FY 2005-06

Based on the SFA's revised estimates for personal income, transfer payments, and the Detroit Consumer Price Index (CPI), the budget stabilization formula triggers a payment out of the Fund equal to \$50.1 million, as shown in Table 10. While any transfers into or out of the Fund must be appropriated for them actually to occur, this transfer out of the Fund will not occur because the Fund balance will be only \$2.1 million by the end of FY 2005-06.

FY 2006-07

In FY 2006-07, real personal income less transfer payments is expected to increase, but by less than 2.0%, so no transfer into or out of the Fund will be triggered. With interest earnings, the balance in the BSF will total an estimated \$2.2 million by the end of FY 2006-07.

Table 9

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

Figure 12

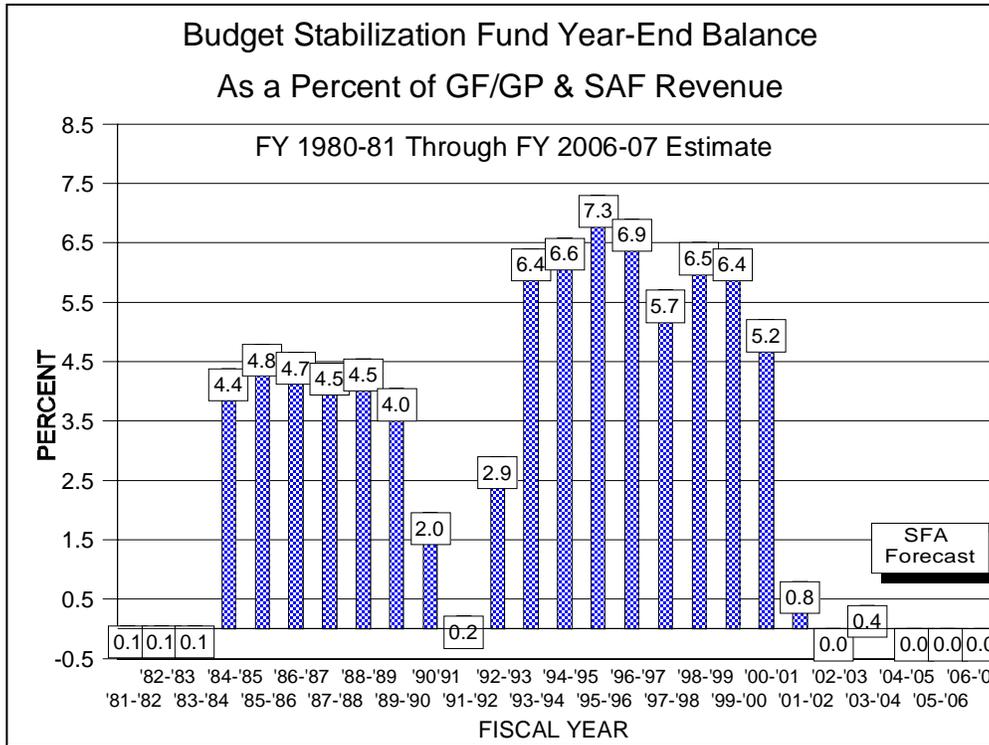


Table 10

**ESTIMATED BUDGET AND ECONOMIC STABILIZATION FUND TRIGGER
FY 2005-06 AND FY 2006-07
(Millions of Dollars)**

	CY 2004	CY 2005	CY 2006	CY 2007
Michigan Personal Income (MPI)	\$324,134	\$334,633	\$346,353	\$360,090
Less: Transfer Payments	48,956	51,363	55,508	59,060
Subtotal	\$275,178	\$283,270	\$290,845	\$301,030
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	1.837	1.878	1.940	1.981
Equals: Real Adjusted MPI	\$149,797	\$150,836	\$149,920	\$151,959
Percent Change from Prior Year	---	0.69%	(0.61)%	1.36%
Excess Over 2.0%	---	0.00%	0.00%	0.00%
	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07
Multiplied by: Estimated GF/GP Revenue	\$8,042	\$8,289	\$8,246.2	\$8,251.8
Equals: Transfer to the BSF		\$0.0	\$0.0	\$0.0
OR Transfer from the BSF		\$0.0	\$50.1	\$0.0

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

COMPLIANCE WITH STATE REVENUE LIMIT

Article IX, Section 26 of the Michigan Constitution establishes a limit on the amount of revenue State government may collect in any fiscal year. This section of the Constitution was adopted by a vote of the people in 1978 and the limit was first applicable in FY 1979-80. In the first 15 years this revenue limit was in effect (FY 1979-80 to FY 1993-94), the revenue limit was never exceeded. The largest gap between revenue and the limit occurred in FY 2003-04, when State revenue was \$4.4 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 2003-04, 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 2004-05, and will continue to remain well below the revenue limit in FY 2005-06 and FY 2006-07.

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 revenue level for FY 2004-05, the SFA's revised revenue estimate for FY 2005-06, and the SFA's initial revenue estimate for FY 2006-07, it is estimated that revenue subject to the constitutional revenue limit will remain well below the revenue limit for each of these fiscal years. The SFA's estimates of the State's compliance with the revenue limit for FY 2004-05, FY 2005-06, and FY 2006-07 are presented in Table 11.

FY 2004-05

In FY 2004-05, revenue subject to the revenue limit totaled an estimated \$24.8 billion. Based on Michigan personal income in calendar year 2003, the revenue limit equaled \$29.8 billion. As a result, it is estimated that revenue fell below the revenue limit by \$5.0 billion, or 16.8%, in FY 2004-05.

FY 2005-06

Based on the SFA's revised revenue estimates for FY 2005-06, it is estimated that revenue subject to the revenue limit will total \$25.2 billion. Michigan's personal income for 2004 generates a revenue limit for FY 2005-06 equal to \$30.8 billion. Based on these estimates for the revenue limit and revenue subject to the limit, it is estimated that revenue will fall below the limit by \$5.5 billion, or 18.0%, in FY 2005-06.

FY 2006-07

In FY 2006-07, the revenue limit will equal 9.49% of Michigan personal income for calendar year 2005 and based on the SFA's revised economic forecast, the revenue limit will equal an estimated \$31.8 billion. Based on the SFA's initial revenue estimate for FY 2006-07, revenue subject to the limit will equal an estimated \$25.6 billion. As a result, it is estimated that revenue will fall short of the revenue limit by \$6.2 billion, or 19.4%, in FY 2006-07.

Table 11

STATE'S COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT SECTION 26 OF ARTICLE IX OF THE STATE CONSTITUTION FY 2003-04 - FY 2006-07 ESTIMATE (Millions of Dollars)				
	FY 2003-04 Final	FY 2004-05 Estimate	FY 2005-06 Estimate	FY 2006-07 Estimate
Revenue Subject to Limit				
<u>Revenue:</u>				
General Fund/General Purpose (baseline)	\$7,992.9	\$8,219.5	\$8,270.3	\$8,376.2
Revenue Sharing (baseline)	1,580.6	1,618.3	1,654.0	1,703.3
School Aid Fund (baseline)	10,533.6	10,918.2	11,224.8	11,542.7
Transportation Funds	2,279.3	2,191.4	2,251.2	2,314.2
Other Restricted Non-Federal Aid Revenue	1,899.5	1,800.0	1,800.0	1,800.0
<u>Adjustments:</u>				
GF/GP Federal Aid	(32.0)	(35.7)	(35.0)	(35.0)
GF/GP Balance Sheet Adjustments	49.3	69.5	(14.0)	(124.4)
SAF Balance Sheet Adjustments	81.5	45.5	68.4	23.5
Total Revenue Subject to Limit:	\$24,384.7	\$24,826.7	\$25,219.7	\$25,600.5
Revenue Limit				
<u>Personal Income:</u>				
Calendar Year	CY 2002	CY 2003	CY 2004	CY 2005
Amount	\$303,745	\$314,460	\$324,134	\$334,633
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	\$28,825.4	\$29,842.3	\$30,760.3	\$31,756.7
1% of Limit	\$288.3	\$298.4	\$307.6	\$317.6
Amount Under (Over) Limit	\$4,440.7	\$5,015.6	\$5,540.6	\$6,156.1
% Below Limit	15.4%	16.8%	18.0%	19.4%

ESTIMATE OF YEAR-END BALANCES

This section of the Senate Fiscal Agency's (SFA's) report details the actual and estimated year-end balances of the General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) budgets for FY 2004-05 and FY 2005-06. This section of the report also contains a review of the major issues that the State will face in the development and enactment of the FY 2006-07 State budget.

Table 12 provides a summary of the actual year-end balances for the FY 2004-05 GF/GP and SAF budgets and the revised SFA estimates of the year-end balances for the FY 2005-06 GF/GP and SAF budgets. The final accounting of FY 2004-05 State revenue and expenditures has been completed and the FY 2004-05 GF/GP budget closed the fiscal year with a \$220.5 million year-end balance. Pursuant to statutory requirements, this year-end balance is carried forward into FY 2005-06. The FY 2004-05 SAF budget closed the fiscal year with a \$93.7 million year-end balance. Pursuant to statutory requirements, this year-end balance is carried forward into FY 2005-06.

Table 12

GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND ESTIMATED YEAR-END BALANCES (Millions of Dollars)		
	FY 2004-05 Actual	FY 2005-06 Estimate
General Fund/General Purpose	\$220.5	\$154.1
School Aid Fund	93.7	133.0

Based on the revised SFA revenue estimates and enacted and projected appropriations, the SFA now believes that the FY 2005-06 GF/GP budget is in surplus by \$154.1 million. The current SFA estimate of the FY 2005-06 SAF year-end balance is for a surplus of \$133.0 million.

The initial look ahead to the FY 2006-07 GF/GP budget situation leads to the conclusion that the combination of restrained revenue growth and non-ongoing revenue items built into the FY 2005-06 GF/GP budget will result in a restrained level of FY 2006-07 GF/GP appropriation growth. The FY 2006-07 SAF budget is likely to experience modest appropriation growth as the combination of FY 2005-06 surplus revenue and FY 2006-07 revenue growth should result in appropriation growth.

FY 2004-05 YEAR-END BALANCE

The Office of the State Budget released the Michigan Comprehensive Annual Financial Report for FY 2004-05 on January 4, 2006. The publication of this report marks the final accounting of FY 2004-05 revenue and expenditures for both the GF/GP and SAF budgets.

Table 13 provides a summary of the final accounting of FY 2004-05 GF/GP revenue, expenditures, and year-end balance. The fiscal year closed with a \$220.5 million balance. Based on current statutory and appropriation requirements, this entire year-end balance is carried forward into FY 2005-06. Actual FY 2004-05 GF/GP revenue totaled \$8.91 billion. This represents a \$131.2 million or 1.5% increase from the final level of FY 2003-04 GF/GP revenue. Actual FY 2004-05 GF/GP expenditures totaled \$8.69 billion. This represents an \$8.0 million or 0.1% decline from the final level of FY 2003-04 GF/GP expenditures.

Table 13
FY 2004-05
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	Book-closing January 2006
Revenue:	
Beginning Balance	\$ 0.0
Ongoing Revenue:	
Final Revenue Collections	8,289.1
Revenue Sharing Adjustments	<u>506.3</u>
Subtotal Ongoing Revenue	8,795.4
Non-Ongoing Revenue:	
Sale of Surplus State Property	17.2
Merit Award Trust Fund Transfer (PA 360 of 2004)	5.2
Tobacco Settlement Trust Fund Transfer (PA 360 of 2004)	1.8
Juror Compensation Fund Transfer	4.0
Judicial Technology Fund Transfer	1.5
Withdrawal from Budget Stabilization Fund (PA 188 of 2005)	<u>81.3</u>
Subtotal Non-Ongoing Revenue	111.0
Total GF/GP Revenue	<u>\$8,906.4</u>
Expenditures:	
Initial Enacted Appropriations	\$8,699.4
Supplemental Appropriations (PA 352 of 2004)	43.0
Supplemental Appropriations (PA 358 of 2004)	8.5
Supplemental Appropriations (PA 360 of 2004)	0.0
Supplemental Appropriations (PA 468 of 2004)	0.2
Supplemental Appropriations (PA 518 of 2004)	99.5
Supplemental Appropriations (PA 10 of 2005)	0.003
Supplemental Appropriations (PA 11 of 2005)	40.0
Supplemental Appropriations (PA 11 of 2005)	30.0
Supplemental Appropriations (PA 109 of 2005)	57.3
Supplemental Appropriations (PA 200 of 2005)	8.9
Supplemental Appropriations (PA 297 of 2005)	<u>0.0</u>
Subtotal Supplemental Appropriations	287.4
Executive Order 2005-7 (GF/GP Reductions)	(284.1)
Executive Order 2005-7 (Lapses/Revenue Shifts)	(11.9)
Net Year-End Appropriation Lapses	(46.4)
Write-Off of Prior-Year Receivables	41.5
Total GF/GP Expenditures	<u>\$8,685.9</u>
Year-End Balance	<u>\$ 220.5</u>

The final level of FY 2004-05 GF/GP revenue included two primary types of revenue. The first is ongoing revenue and the second is non-ongoing revenue. Ongoing revenue consists of the \$8.29 billion collected from ongoing State taxes, fees, permits, licenses, and Federal aid. In addition, the SFA defines ongoing revenue to include the additional \$506.3 million of sales tax revenue transferred to the GF/GP budget as a result of statutory changes in the level of revenue sharing payments made to cities, villages, townships, and counties. Non-ongoing revenue collected during the fiscal year totaled \$111.0 million. This revenue included an \$81.3 million transfer to the GF/GP budget from the Budget Stabilization Fund, \$17.2 million from the sale of surplus State property, and a variety of other transfers of State Restricted revenue to the GF/GP budget. The final accounting of ongoing FY 2004-05 GF/GP revenue represents an increase of \$256.0 million above the GF/GP consensus revenue estimate agreed to at the August 17, 2005, Consensus Revenue Estimating Conference.

The final level of FY 2004-05 GF/GP expenditures included the initial appropriation bills approved for the fiscal year, the enactment of 11 supplemental appropriation bills during the fiscal year, the approval of Executive Order 2005-7, year-end departmental appropriation lapses, and accounting adjustments that provided for the write-off of Federal revenue that was deemed by the State not to be collectable in the future. The initial GF/GP appropriations approved totaled \$8.7 billion, the GF/GP supplemental appropriations totaled \$287.4 million, and the Executive Order reductions totaled \$296.0 million. Net GF/GP appropriation lapses totaled \$46.4 million and the write-off of Federal revenue equaled \$41.5 million.

The final FY 2004-05 GF/GP year-end balance of \$220.5 million marks the largest GF/GP year-end appropriation balance since FY 1999-2000, when the year-end GF/GP balance totaled \$274.7 million. The size of the FY 2004-05 GF/GP year-end balance results from a combination of unanticipated revenue growth and expenditure restraint by the Legislature and the Governor. The carry-forward of the \$220.5 million FY 2004-05 GF/GP year-end balance into FY 2005-06 provides a significant cushion for unanticipated problems that may develop during the fiscal year.

Table 14 provides a summary of the final accounting of FY 2004-05 SAF revenue, expenditures, and year-end balance. The fiscal year closed with a \$93.7 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 2005-06 SAF revenue item. Actual FY 2004-05 SAF revenue totaled \$12.52 billion. This represents a \$150.7 million or 1.2% increase from the final level of FY 2003-04 SAF revenue. Actual FY 2004-05 SAF expenditures totaled \$12.43 billion, a \$131.1 million or 1.1% increase from the final level of FY 2003-04 SAF expenditures.

Table 14
FY 2004-05
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	Book-closing January 2006
Revenue:	
Beginning Balance	\$ 74.1
Final Revenue Collections	10,909.8
GF/GP Grant	164.2
GF/GP Grant (PA 518 of 2004).....	99.5
GF/GP Grant (EO 2005-7)	(99.5)
Federal Aid.....	1,321.6
School Bond Loan Fund Reform Proposal	41.1
Other Revenue Adjustments.....	12.9
Total Estimated Revenue	\$12,523.7
Expenditures:	
Enacted Appropriations.....	\$12,527.5
Executive Order 2005-7	(99.5)
Supplemental Appropriation (PA 98 of 2005)	39.1
Federal Funding Adjustments	(32.0)
Appropriation Lapses	(5.1)
Total Estimated Expenditures	\$12,430.0
Projected Year-End Balance	\$ 93.7

The final level of FY 2004-05 SAF revenue consisted of a \$74.1 million beginning balance carried forward from FY 2003-04, \$10.91 billion of State Restricted revenue transferred to the SAF budget, GF/GP grants to the SAF budget totaling \$164.2 million, \$1.32 billion of Federal funds appropriated, \$41.1 million of revenue from statutory changes in the School Bond Loan Fund program, and \$12.9 million of other revenue adjustments. The actual level of State Restricted revenue transferred to the SAF budget during FY 2004-05 is a \$285.0 million increase from the prior fiscal year. This increase in State Restricted revenue transferred to the SAF budget was mostly offset by the decline in the total GF/GP grant to the SAF budget during FY 2004-05 of \$213.6 million from the prior fiscal year.

The final level of FY 2004-05 SAF expenditures includes the initial appropriations for the fiscal year, an appropriation reduction contained in Executive Order 2005-7, an enacted supplemental appropriation, appropriation adjustments to reflect final Federal funding, and a year-end appropriation lapse.

FY 2005-06 YEAR-END BALANCE

Based on the revised SFA revenue estimate and enacted appropriations, the SFA now believes that the FY 2005-06 GF/GP budget is in surplus by \$154.1 million. This projected budget surplus equals 1.7% of the year-to-date level of GF/GP appropriations. Table 15 provides a summary of the FY 2005-06 GF/GP budget estimate. Projected FY 2005-06 GF/GP revenue totals \$9.14 billion, a \$229.3 million or 2.6% increase from the final level of FY 2004-05 GF/GP revenue. Projected FY 2005-06 GF/GP expenditures total \$8.98 billion, a \$295.7 million or 3.4% increase from the final level of FY 2004-05 GF/GP expenditures.

Table 15
FY 2005-06
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	January 2006 SFA Estimate
Revenue:	
Beginning Balance	\$ 220.5
Ongoing Revenue:	
Revenue Estimate	8,306.2
Single Business Tax Reductions	(58.0)
Revenue Sharing Adjustments	<u>547.9</u>
Subtotal Ongoing Revenue	8,796.1
Non-ongoing Revenue:	
Interest Earnings Tobacco Securitization	10.0
Land Sales	60.0
Agriculture Equine Fund Transfer to GF/GP	2.0
Rezonementation Fund Transfer to GF/GP	15.0
Comprehensive Transportation Fund Transfer to GF/GP	11.1
Financial Institutions Fund Transfer to GF/GP	15.0
State Services Fee Fund Transfer to GF/GP	<u>6.0</u>
Subtotal Non-Ongoing Revenue	119.1
Total Revenue	\$9,135.7
Expenditures:	
Initial Appropriations	\$8,975.7
Supplemental Appropriations (PA 226 of 2005)	1.0
Supplemental Appropriations (PA 297 of 2005)	4.9
Total Expenditures	\$8,981.6
Projected Year-End Balance	\$ 154.1

This projected level of FY 2005-06 GF/GP revenue includes three principal sources of revenue. These are a beginning balance carried forward from FY 2004-05, ongoing revenue, and non-ongoing revenue. The carry-forward balance from FY 2004-05 equals \$220.5 million. The original enacted FY 2005-06 GF/GP budget assumed a zero beginning balance carried forward from FY 2004-05. The estimate of ongoing revenue totals \$8.8 billion, which consists of \$8.3 billion of revenue estimated from State taxes, fees, permits and licenses, a \$58.0 million revenue reduction from the recent single business tax reductions for manufacturing companies, and \$547.9 million of sales tax revenue transferred to the GF/GP budget resulting from statutory changes in the level of revenue sharing payments to cities, villages, townships, and counties. The current SFA estimate of ongoing revenue, excluding the SBT cut enacted in December 2005, represents a \$36.7 million increase from the consensus revenue estimate agreed to on August 17, 2005. The current estimate of non-ongoing revenue totals \$119.1 million. The non-ongoing revenue sources include interest earnings from the portion of tobacco settlement revenue to be securitized, revenue generated from the sale of surplus State property, and the transfer of a variety of State Restricted revenue accounts to the GF/GP budget. The only change in the estimate of non-ongoing revenue from the original FY 2005-06 budget is a revision of the estimated interest earnings from the securitization of tobacco settlement revenue. The current SFA estimate of \$9.14 billion of FY 2005-06 GF/GP revenue represents a \$158.0 million increase from the total level of GF/GP revenue assumed in the original budget.

The enacted level of FY 2005-06 GF/GP appropriations is \$8.98 billion. This includes the original level of FY 2005-06 appropriations of \$8.975 billion and \$1.0 million of supplemental appropriations contained in Public Act 226 of 2005 and \$4.9 million of supplemental appropriations contained in Public Act 297 of 2005.

The fact that the SFA is projecting a \$154.1 million FY 2005-06 GF/GP budget surplus means that the Governor and the Legislature will not be forced to make adjustments to the enacted budget. Absent any action by the Legislature and the Governor to adjust revenue or expenditures, the projected budget surplus will continue to exist.

Based on the revised SFA revenue estimate and enacted appropriations, the SFA now believes that the FY 2005-06 SAF budget is in surplus by \$133.0 million. This projected budget surplus equals 1.0% of projected year-to-date appropriations. Table 16 provides a summary of the FY 2005-06 SAF budget estimate. Projected FY 2005-06 SAF revenue totals \$12.84 billion. This represents a \$318.5 million or 2.5% increase from the final level of FY 2004-05 SAF revenue. Projected FY 2005-06 SAF expenditures total \$12.71 billion. This represents a \$279.2 million or 2.2% increase from the final level of FY 2004-05 SAF expenditures.

The projected level of FY 2005-06 SAF revenue includes revenue from five principal sources. These include a beginning balance carried forward from FY 2004-05, State Restricted revenue deposited into the SAF, a GF/GP grant to the SAF, revenue from the statutory changes in the School Bond Loan Fund program, and appropriated Federal aid. The beginning balance of \$93.7 million represents the FY 2004-05 SAF year-end balance. This beginning balance was assumed to be zero in the original enacted budget. Restricted SAF revenue is now estimated at \$11.24 billion. This represents a \$2.3 million reduction from the August 17, 2005 consensus revenue estimate. The GF/GP grant to the SAF is \$62.7 million, which represents a decline of \$101.5 million from the level of the GF/GP grant to the SAF during FY 2004-05. The \$44.5 million of revenue generated from changes in the School Bond Loan Fund program and the \$1.39 billion of appropriated Federal aid represent no changes from the original budget.

Table 16
FY 2005-06
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	January 2006 SFA Estimate
Revenue:	
Beginning Balance	\$ 93.7
Consensus Revenue Estimate.....	11,245.7
Other Revenue Adjustments:	
GF/GP Grant.....	62.7
School Bond Loan Fund Reform Revenue	44.5
FY 2003-04 Revenue Receivable.....	3.0
Federal Revenue	1,392.6
Subtotal Other Revenue Adjustments	1,502.8
Total Revenue.....	\$12,842.2
Expenditures:	
Enacted Appropriations.....	\$12,757.2
Adjusted Cost Estimates.....	(48.0)
Total Expenditures.....	\$12,709.2
Projected Year-End Balance	\$ 133.0

The projected level of FY 2005-06 SAF expenditures includes the enacted appropriations of \$12.76 billion and projected savings of \$48.0 million resulting from revised estimates of the number of pupils enrolled in the K-12 system and revised estimates of local property taxes.

The fact that the SFA is projecting a \$133.0 million FY 2005-06 budget surplus means that the Legislature and the Governor will not be forced to make any adjustments to the enacted budget. Absent any action by the Legislature and the Governor to adjust enacted SAF revenue or expenditures, the surplus will remain in place during the fiscal year.

FY 2006-07 STATE BUDGET OUTLOOK

During the second week of February 2006, Governor Granholm will present her FY 2006-07 State budget recommendation to the Legislature. The budget recommendation will be based on the consensus revenue estimate to be agreed upon at the January 12, 2006, meeting of the Consensus Revenue Estimating Conference. Using the SFA's estimates of FY 2006-07 GF/GP and SAF revenue and the current level of FY 2005-06 GF/GP and SAF appropriations, one can look ahead at the general parameters that will focus the FY 2006-07 State budget debate.

In terms of the FY 2006-07 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 will result from the combination of very moderate GF/GP revenue growth, the use of non-ongoing revenue items that are supporting ongoing appropriations in the FY 2005-06 GF/GP budget, and built-in spending pressures in several budget areas.

Table 17 provides a brief summary of the general parameters that Governor Granholm will be facing as she develops her FY 2006-07 GF/GP budget recommendations. The table is built on the assumption of no change in current State tax policy, a freeze in FY 2006-07 GF/GP appropriations and a continued freeze in the level of revenue sharing payments to cities, villages, and townships. The revenue assumptions also include the carry-forward into FY 2006-07 of the entire estimated FY

2005-06 GF/GP budget year-end balance. These revenue assumptions lead to total FY 2006-07 GF/GP revenue of \$9.0 billion.

Table 17

FY 2006-07 BUDGET OUTLOOK GENERAL FUND/GENERAL PURPOSE (Millions of Dollars)	
	SFA Estimate
Projected Revenue	
Beginning Balance	\$ 154.1
Estimated Ongoing Revenue	8,251.8
Continue Revenue Sharing Freeze	592.6
Total Estimated Revenue	\$8,998.5
Potential Appropriations:	
Freeze of FY 2006-07 Appropriations at FY 2005-06 Level	\$8,981.6
Other Potential Funding Issues:	
Debt Service Funding Increases.....	50.0
Tobacco Securitization Debt Service	40.0
Civil Service Salary Increase	45.0
State Employee Health Insurance Increase	40.0
Fund State Employee Retirement Cost Increase	40.0
Adjusted FY 2006-07 GF/GP Appropriations.....	\$9,196.6
Potential Funding Imbalance	\$ (198.1)

If FY 2006-07 GF/GP appropriations were frozen at the current FY 2005-06 levels, they would equal \$8.98 billion. However, there are several appropriation areas that almost certainly will see GF/GP funding increases in the FY 2006-07 budget. These include debt service payments on the tobacco securitization bonds that are funding the recently enacted economic development plans of the State, debt service increases on bonds issued by the State Building Authority and General Obligation bonds, and the costs associated with negotiated contracts for State Civil Service employees. These cost increases include already-negotiated salary increases, projected health care cost increases, and projected increased contribution rates to the State Employees Retirement System. These funding increases, combined with a freeze in all other FY 2006-07 GF/GP appropriations at the FY 2005-06 level, led to total FY 2006-07 GF/GP appropriations of \$9.2 billion.

The combination of the SFA estimate of FY 2006-07 GF/GP revenue and a freeze in FY 2006-07 appropriations at the prior fiscal year level with certain specific adjustments, leads to potential FY 2006-07 GF/GP appropriations' exceeding estimated revenue by \$198.1 million. This potential budget scenario provides no funding increases for such budget areas as Medicaid caseloads or health care inflation in the Medicaid program, increasing costs of operating the State's prison system (outside of employee costs), and any funding increases for programs such as State aid to universities, community colleges, and revenue sharing payments to cities, villages, and townships.

Table 18 provides a similar look ahead at the FY 2006-07 SAF budget. As contrasted with the GF/GP budget, the potential outlook for the SAF budget is much brighter. The revenue assumptions include the SFA FY 2006-07 SAF revenue estimate, the carry-forward of the FY 2005-06 SAF year-end balance into FY 2006-07, a freeze in the GF/GP grant to the SAF at the current-year level, and a continuation of Federal funding at the current-year level. These assumptions lead to total estimated FY 2006-07 SAF revenue of \$13.15 billion. This level of revenue represents a \$445.3 million or 3.5% increase over the year-to-date level of FY 2005-06 SAF appropriations. This scenario should give the

Governor and the Legislature some level of flexibility as they develop the School Aid spending decisions for the coming fiscal year.

Table 18

FY 2006-07 BUDGET OUTLOOK SCHOOL AID FUND (Millions of Dollars)	
	SFA Estimate
Projected Revenue	
Beginning Balance	\$ 133.0
Estimated Ongoing Revenue	11,566.2
<u>Other Revenue Adjustments:</u>	
GF/GP Grant at FY 2005-06 Level	62.7
Federal Aid	1,392.6
Total Estimated Revenue	\$13,154.5
FY 2005-06 SFA Estimated Expenditures	\$12,709.2
Potential Appropriation Growth	\$ 445.3
Note: This represents a 3.5% potential appropriation increase.	