



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

FY 2005-06, FY 2006-07, & FY 2007-08

January 16, 2007



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 3.3% in 2006 and is predicted to grow 2.1% in 2007 and 2.8% in 2008. Light vehicle sales are expected to have totaled 16.5 million units in 2006 and are forecasted to decline slightly to 16.3 million units in 2007 before rising back to 16.5 million units in 2008. The unemployment rate is estimated to have averaged 4.6% in 2006 and expected to increase slightly to 4.7% in both 2007 and 2008, while the consumer price index is estimated to have risen 3.3% in 2006 and is expected to grow by 2.2% in 2007 and 2.7% in 2008.

The Michigan economy, as measured by inflation-adjusted personal income, is estimated to have increased 1.1% during 2006, but is predicted to grow only 0.6% in both 2007 and 2008. Wage and salary employment is estimated to have declined 0.6% during 2006 and forecasted to fall another 1.1% in 2007 and 0.7% in 2008.

REVENUE FORECAST

In fiscal year (FY) 2005-06, General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue totaled \$19.35 billion, representing a 0.7% increase from FY 2004-05. General Fund/General Purpose revenue was down 0.5% to \$8.27 billion and SAF revenue increased 1.6% to \$11.08 billion.

In FY 2006-07, GF/GP and SAF revenue will total an estimated \$19.43 billion, which is up 0.4% from FY 2005-06. This revised estimate is \$589.6 million below the May 2006 consensus estimate. General Fund/General Purpose revenue will decline an estimated 1.3% to \$8.16 billion, while SAF revenue will increase 1.6% to \$11.26 billion. Compared with the May 2006 consensus estimate, the GF/GP revenue estimate is \$300.8 million lower and the SAF revenue estimate is \$288.7 million lower.

In FY 2007-08, GF/GP and SAF revenue will total an estimated \$18.51 billion. This initial revenue estimate for FY 2007-08 is down 4.7% from the revised estimate for FY 2006-07, largely reflecting the repeal of the single business tax, effective December 31, 2007. Assuming the single business tax revenue is fully replaced, GF/GP and SAF revenue will equal an estimated \$19.75 billion. General Fund/General Purpose revenue will decline 14.9% to an estimated \$6.95 billion due to the repeal of the single business tax. With the full replacement of this business tax revenue, GF/GP revenue would total \$8.18 billion, representing a 0.2% increase. School Aid Fund revenue will increase an estimated 2.7% to \$11.56 billion.

YEAR-END BALANCE ESTIMATES

Based on the accounting of State revenue and expenditures as of January 8, 2007, the Senate Fiscal Agency (SFA) is estimating that the FY 2005-06 General Fund/General Purpose budget will close the year with a \$7.0 million balance. The FY 2005-06 School Aid Fund budget will close the year with a zero balance.

A comparison of the SFA's FY 2006-07 revenue estimate with enacted and projected appropriations leads to a projected \$489.7 million GF/GP budget deficit. Governor Granholm is expected to make recommendations to the Legislature regarding the elimination of this budget deficit at the time she submits her FY 2007-08 State budget recommendations to the Legislature in early February 2007. The SFA now is estimating that the FY 2006-07 SAF budget is in deficit by \$367.7 million. Under provisions of the State School Aid Act, this projected budget deficit will be eliminated by a \$218-per-pupil reduction in State aid to local school districts unless the Governor and the Legislature agree to an alternative plan to eliminate the deficit.

An analysis of the issues that the Governor and the Legislature will face in developing and enacting an FY 2007-08 State budget is complex. The combination of restrained revenue growth and the elimination of the single business tax on January 1, 2008, will result in significant challenges in the development and enactment of the FY 2007-08 State budget. The resolution of the FY 2006-07 GF/GP and SAF budget deficits also will have a significant impact on the final form that the FY 2007-08 State budget takes.

ECONOMIC REVIEW AND OUTLOOK

State revenue, particularly tax revenue, depends heavily on economic conditions. This section presents the Senate Fiscal Agency's latest economic forecast for 2007 and 2008, as well as a summary of recent economic activity.

RECENT ECONOMIC HIGHLIGHTS

Between the end of the 2001 recession (fourth quarter of 2001) and the third quarter of 2005, inflation-adjusted Gross Domestic Product (GDP) grew at an average rate of 3.2% per year. Since the second quarter of 2003, when national wage and salary employment began to increase steadily, inflation-adjusted GDP grew at an average annual rate of 3.8%. Much of this growth was fueled by high productivity and a strong housing market that largely offset the dragging effects of high and volatile energy prices, uncertainty resulting from various international political disputes, and restrained investment growth.

However, during the second and third quarters of 2006, the economy slowed markedly; averaging only an annualized growth rate of 2.3%. The slowdown has reflected lower levels of consumption and a substantial decline in residential investment spending, which fell at an annual rate of 11.1% during the second quarter of 2006 and 18.6% during the third quarter. The strong housing market enabled consumers to reduce saving and consume more even as employment growth was hampered by sustained productivity improvements and numerous energy price shocks. As the housing market has deteriorated and interests rates have risen, consumers have needed to adjust their behavior and consumption has suffered as a result. Details for selected economic indicators for the last few years are presented in [Table 1](#) and [Table 2](#).

The effect of high productivity on employment has been substantial since the 2001 recession. During the 1983-1989 and 1993-2000 recoveries, productivity increased by an average of approximately 2.0% per year, while wage and salary employment grew by an average of 2.6% per year. Those figures compare with a long-term average over the 1960-1992 period of annual productivity increases of 1.7% and employment gains of 2.2% per year. However, between 2001 and 2006, productivity averaged more than 3.0% per year and employment rose by only 0.5% per year. As overall productivity has declined in recent years, employment growth has strengthened. Wage and salary employment rose 1.1% in 2004 and 1.5% in 2005, and is estimated to have increased 1.4% in 2006, compared with average annual increases of 3.0% during 1983-1989 and 2.5% during 1993-2000.

Michigan's gains in personal income and employment have lagged behind nearly every other state in the country and occasionally trailed all of the states. The fact that 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 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](#)).

Table 1

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

	2004	2005	2006	2007	2008
United States	Actual	Actual	Estimate	Estimate	Estimate
Nominal GDP (year-to-year growth)	6.9%	6.3%	6.3%	4.8%	5.9%
Inflation-Adjusted GDP (year-to-year growth)	3.9%	3.2%	3.3%	2.1%	2.8%
Unemployment Rate	5.5%	5.1%	4.6%	4.7%	4.7%
Inflation					
Consumer Price Index (year-to-year growth)	2.7%	3.4%	3.3%	2.2%	2.7%
GDP Implicit Price Deflator (year-to-year growth)	2.8%	3.0%	2.9%	2.6%	3.0%
Interest Rates					
90-day Treasury bill	1.37%	3.15%	4.73%	4.92%	5.12%
Corporate Aaa bond	5.63%	5.23%	5.59%	6.04%	6.54%
Federal funds rate	1.35%	3.22%	4.97%	5.40%	5.66%
Light Motor Vehicle Sales (millions of units)	16.9	16.9	16.5	16.3	16.5
Auto	7.5	7.7	7.8	7.7	7.8
Truck	9.4	9.3	8.7	8.7	8.7
Import Share	20.2%	20.1%	22.2%	22.8%	23.3%
Michigan					
Personal Income (millions)	\$320,418	\$331,304	\$345,103	\$353,567	\$364,418
Year-to-year growth	2.1%	3.4%	4.2%	2.5%	3.1%
Inflation-Adjusted Personal Income (year-to-year growth)	0.5%	0.5%	1.1%	0.6%	0.6%
Wage & Salary Income (millions)	\$180,319	\$183,652	\$190,120	\$190,764	\$193,754
Year-to-year growth	2.0%	1.8%	3.5%	0.3%	1.6%
Detroit Consumer Price Index (year-to-year growth)	1.6%	2.9%	3.0%	1.8%	2.4%
Wage & Salary Employment (thousands)	4,394.7	4,384.0	4,358.1	4,310.2	4,280.3
Year-to-year growth	(0.3)%	(0.2)%	(0.6)%	(1.1)%	(0.7)%
Unemployment Rate	7.0%	6.7%	6.8%	7.6%	7.7%

Table 2

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

	2004	2005	2006	2007	2008
	Actual	Actual	Estimate	Estimate	Estimate
Gross Domestic Product (billions of dollars)	\$11,712.5	\$12,455.8	\$13,238.4	\$13,869.3	\$14,686.8
Year-to-year growth	6.9%	6.3%	6.3%	4.8%	5.9%
<i><u>Inflation-Adjusted GDP and Components</u></i>					
Gross Domestic Product (billions of 2000 dollars)	\$10,703.5	\$11,048.6	\$11,409.6	\$11,647.7	\$11,968.3
Year-to-year growth	3.9%	3.2%	3.3%	2.1%	2.8%
Consumption (billions of 2000 dollars)	\$7,577.1	\$7,841.2	\$8,084.8	\$8,287.2	\$8,513.9
Year-to-year growth	3.9%	3.5%	3.1%	2.5%	2.7%
Business Fixed Investment (billions of 2000 dollars)	\$1,145.8	\$1,223.8	\$1,318.8	\$1,402.6	\$1,469.9
Year-to-year growth	5.9%	6.8%	7.8%	6.4%	4.8%
Change in Business Inventories (billions of 2000 dollars)	\$53.4	\$19.6	\$47.7	\$29.5	\$29.7
Residential Investment (billions of 2000 dollars)	\$559.9	\$608.0	\$586.1	\$526.4	\$519.3
Year-to-year growth	9.9%	8.6%	(3.6)%	(10.2)%	(1.4)%
Government Spending (billions of 2000 dollars)	\$1,940.6	\$1,958.0	\$1,998.9	\$2,037.3	\$2,065.0
Year-to-year growth	1.9%	0.9%	2.1%	1.9%	1.4%
Net Exports (billions of 2000 dollars)	(\$590.9)	(\$619.2)	(\$632.6)	(\$624.8)	(\$609.8)
Exports (billions of 2000 dollars)	\$1,120.4	\$1,196.1	\$1,299.0	\$1,399.3	\$1,507.2
Imports (billions of 2000 dollars)	\$1,711.3	\$1,815.3	\$1,931.5	\$2,024.1	\$2,117.0
Personal Income (year-to-year growth)	6.2%	5.2%	6.4%	5.3%	5.3%
Adjusted for Inflation	3.4%	1.8%	3.0%	3.0%	2.5%
Wage & Salary Income (year-to-year growth)	5.5%	5.1%	6.4%	4.8%	5.3%
Personal Savings Rate	2.0%	(0.4)%	(0.9)%	(0.2)%	(0.3)%
Capacity Utilization Rate	78.1%	80.2%	82.0%	82.4%	83.0%
Housing Starts (millions of units)	1.956	2.068	1.836	1.564	1.547
Conventional Mortgage Rates	5.8%	5.9%	6.4%	6.7%	7.1%
Federal Budget Surplus (billions of dollars, NIPA basis)	(\$382.0)	(\$309.2)	(\$173.8)	(\$274.9)	(\$279.4)

Figure 1

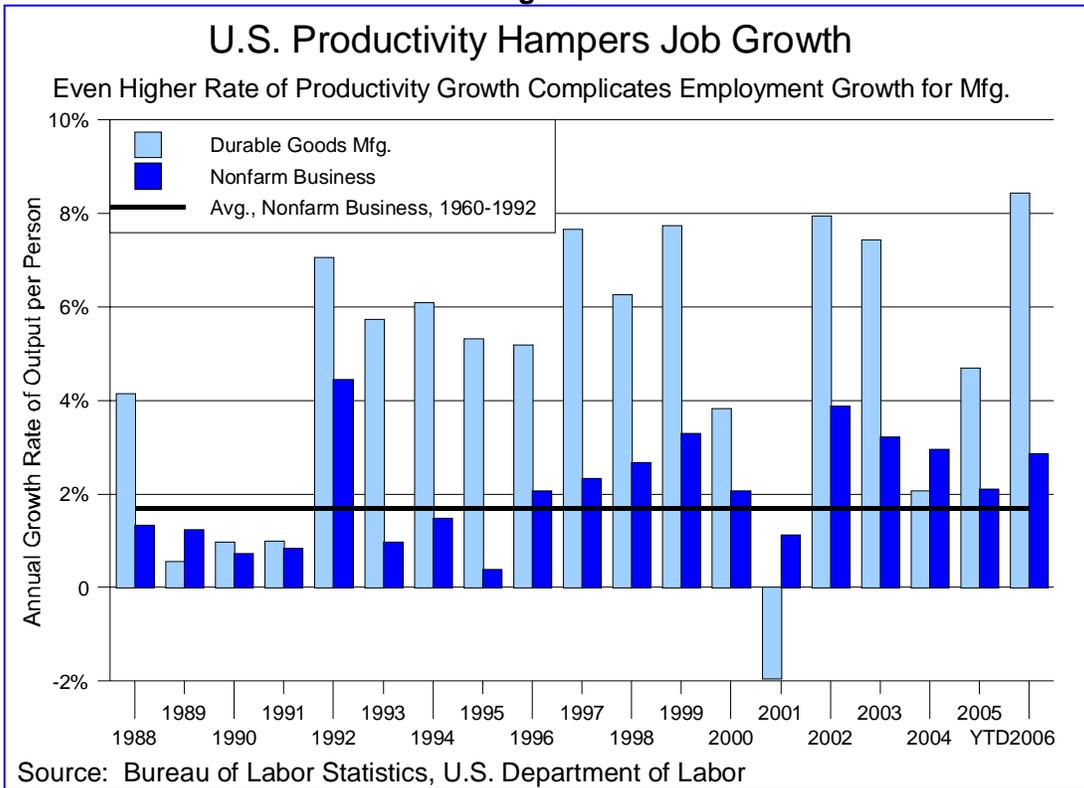


Figure 2

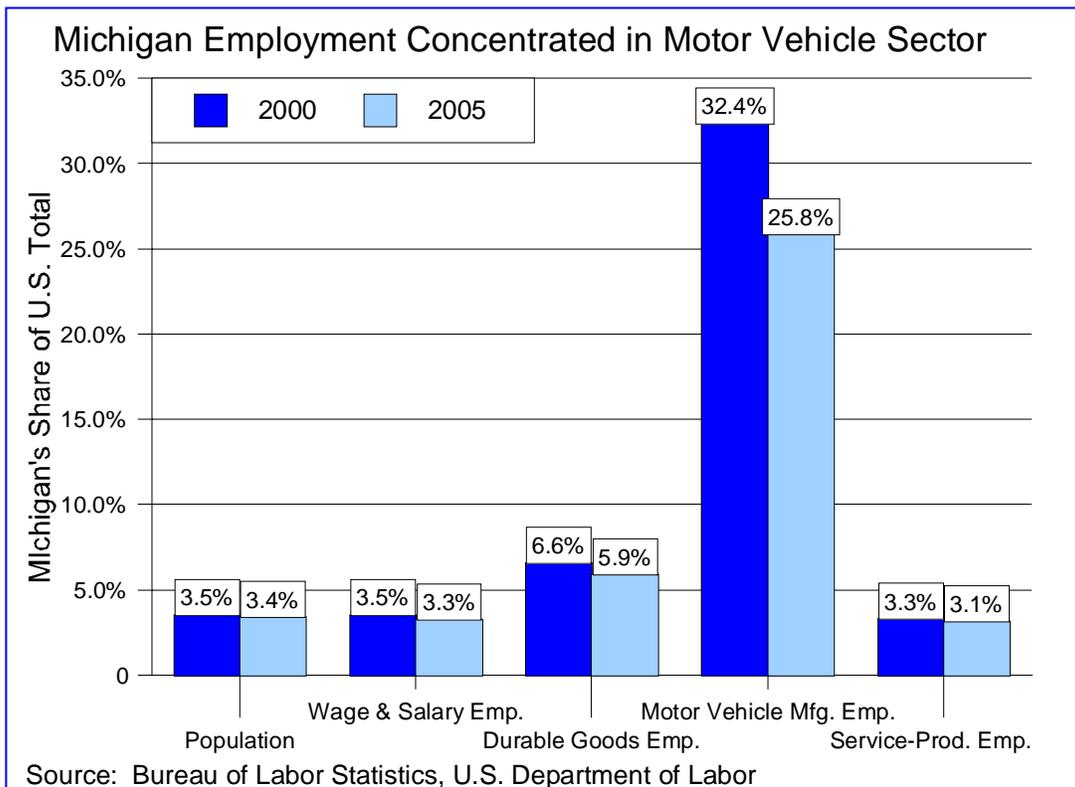
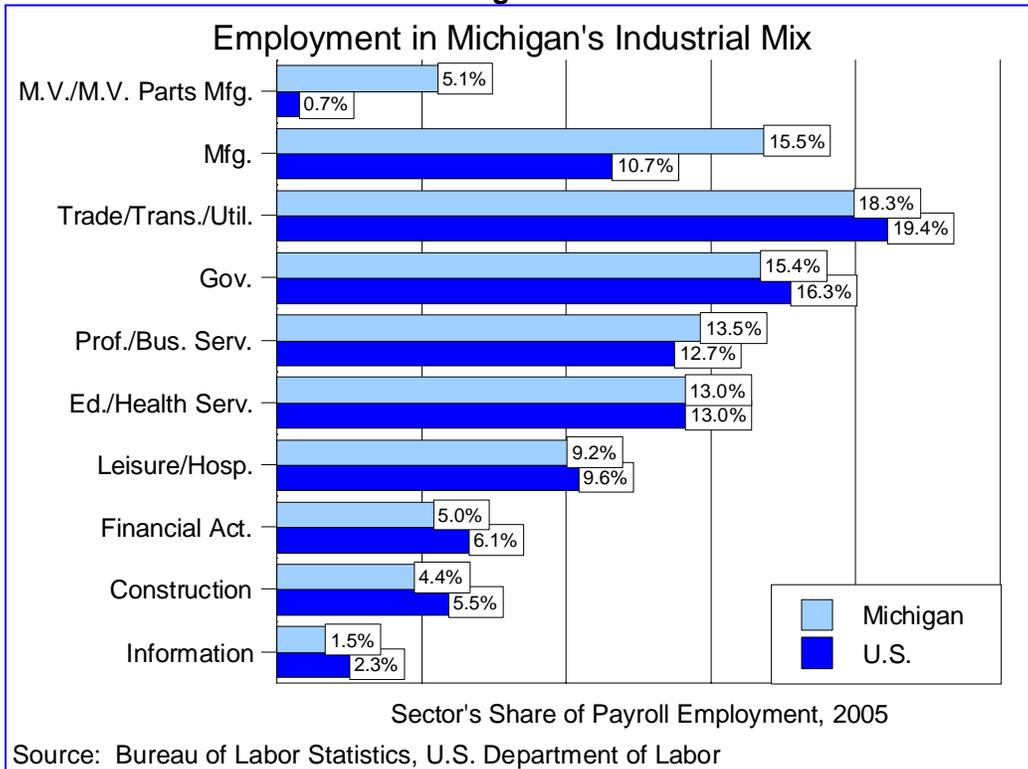


Figure 3



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 while vehicle sales of the domestic manufacturers (primarily DaimlerChrysler, Ford, and General Motors) have comprised a decreasing share of total sales (from 68.1% in 2000 to 56.5% in 2006).

As indicated earlier, productivity has risen most significantly in economic sectors in which the Michigan economy is heavily concentrated. Sales for those industries have largely remained flat, while Michigan's share of the market has declined. Even after six years of employment declines, especially within those areas where Michigan is most concentrated relative to other states, Michigan is still heavily dependent upon sectors that are highly cyclical and likely to continue to experience substantial gains in productivity and declines in employment. Based on data through November 2006, Michigan represented 3.2% of the national economy, yet comprised 4.6% of manufacturing goods employment and 5.6% of durable goods manufacturing employment. Transportation equipment manufacturing comprises approximately 44.0% of Michigan's durable goods manufacturing employment and Michigan's motor vehicle manufacturing employment comprises nearly one-fourth 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. In 2005, wages and salaries paid to workers in the motor vehicle manufacturing sector comprised 1.6% of private sector wages and salaries paid nationally, but 12.9% of wages and salaries paid in Michigan. As a result, economic downturns (either from declining employment or from declining business profits) in the motor 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, and which present risks to the forecast, 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.

FORECAST SUMMARY

Both the U.S. and Michigan economies are expected to continue growing in 2007 and 2008 (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 projected to grow 2.1% in 2007 and 2.8% in 2008. The decline in growth during 2007 primarily reflects lower residential investment although nearly all major economic sectors will grow more slowly in 2007 than during 2006. The unemployment rate is expected to increase negligibly, from 4.6% during 2006 to 4.7% in 2007 and 2008.

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 projected to rise 0.6% in 2007 and 2008. On an annual basis, wage and salary employment is forecasted to fall 1.1% in 2007 and 0.7% in 2008, extending the decline in employment to eight consecutive years. These declines will largely reflect continued high productivity and competitive pressures, particularly in the manufacturing sector. Nationally, light vehicle sales are expected to decline slightly, from 16.5 million units in 2006 to 16.3 million units in 2007. Light vehicle sales are expected to rise minimally in 2008, back to 16.5 million units. Essentially flat sales, combined with productivity improvements and declining market share for domestic vehicle manufacturers, will depress employment and labor force participation. In Michigan, as a result, the unemployment rate will increase from 6.8% in 2006 to 7.6% in 2007 and 7.7% in 2008, keeping the Michigan unemployment rate above the national average.

Compared with the May 17, 2006, Consensus Economic Forecast, both the U.S. and Michigan forecasts are somewhat weaker in 2007. While total wage and salary employment in Michigan is expected to decrease in every quarter 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 other sectors of the State economy. Michigan income measures also are expected to grow at a slower rate than forecasted in May. Consumer prices in 2007 are expected to rise more slowly than was predicted in May, largely as a result of declines in pressures at the national level and slightly lower energy prices.

Figure 4

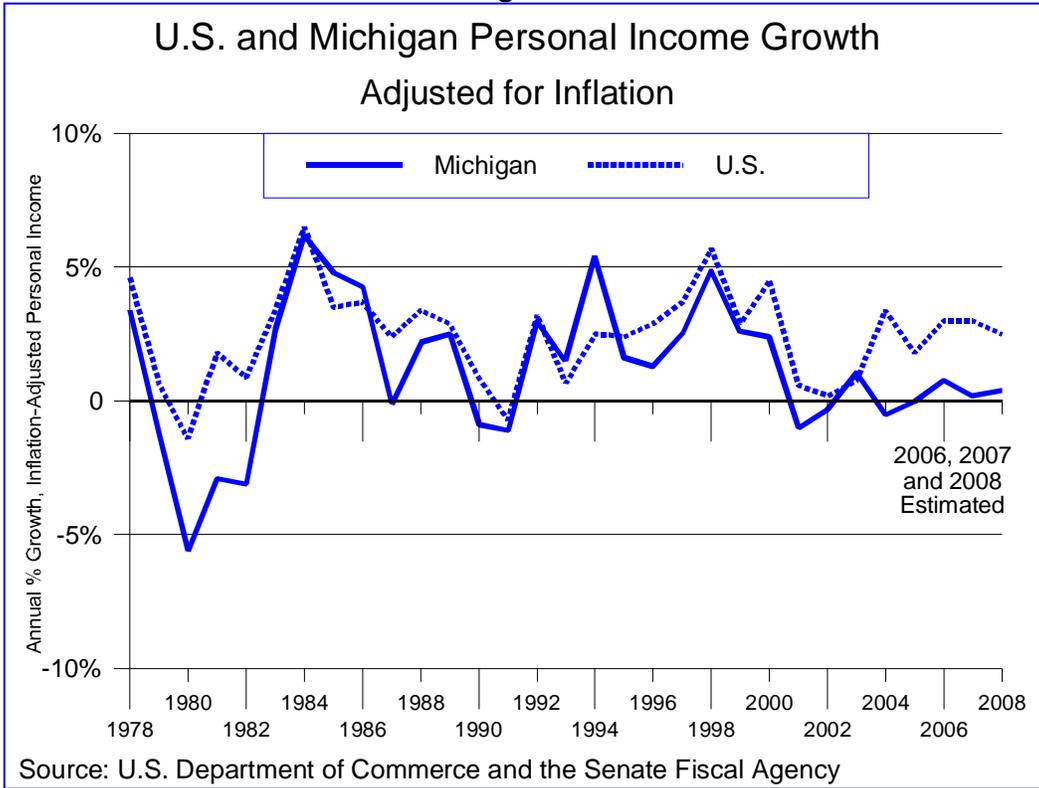


Figure 5

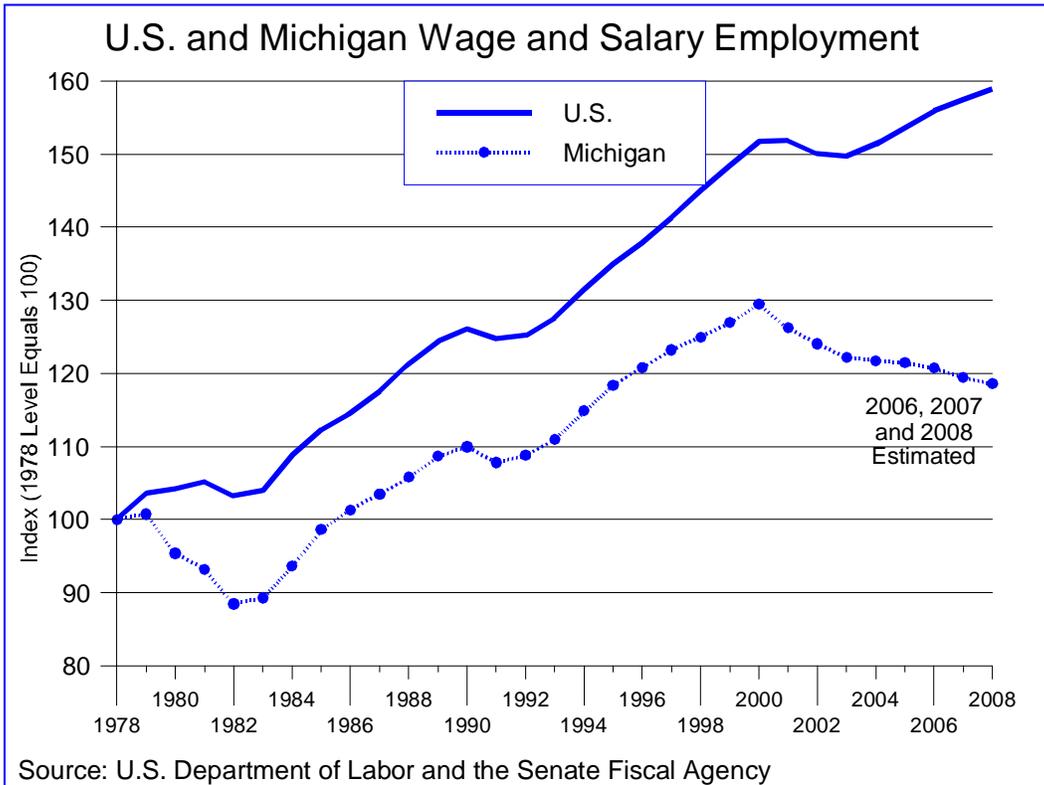


Figure 6

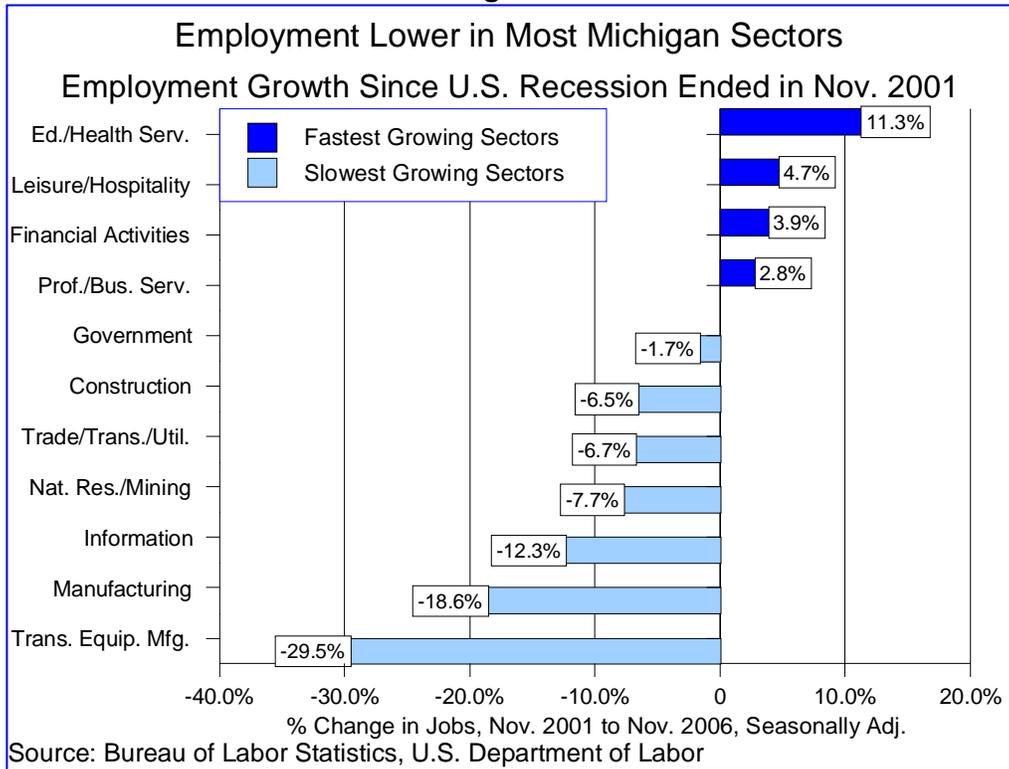
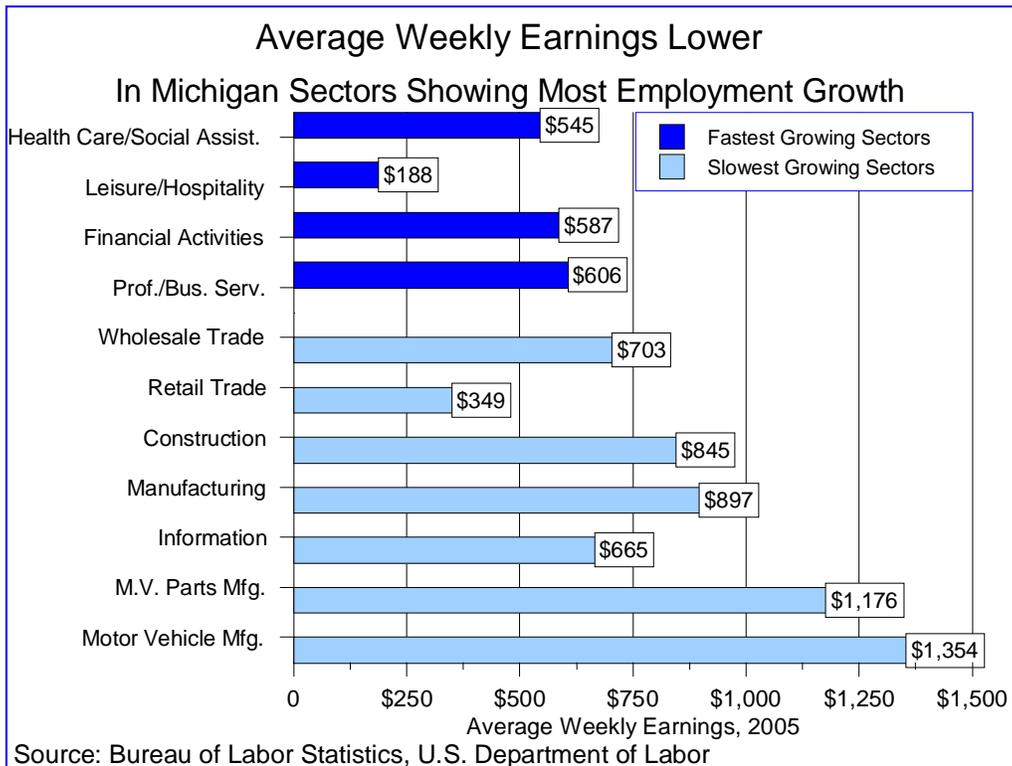


Figure 7



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 2007 and 2008 is based upon the following assumptions:

Monetary Policy. The Federal funds rate target is currently 5.25%, up 425 basis points from May 2004. The forecast assumes that inflationary concerns are present (discussed in the assumptions for 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 two years, with the Federal funds rate reaching 5.50% in mid-2007 and 5.75% by mid-2008.

Foreign Economies. Many of the U.S.'s key trading partners' economies are expected to grow more rapidly than the U.S. economy during 2007, while the U.S. economy will grow at a slightly faster rate during 2008. After declining only 2.1% during 2006, the dollar is expected to fall in value another 5.6% during 2007 and another 2.7%. As a result, the forecast predicts that the trade deficit will decrease slightly in 2007 and 2008 and remain at slightly more than 5.0% of GDP over the forecast period.

Oil and Energy Prices. The forecast expects oil prices in 2007 and 2008 to remain stable, but well above even recent historical averages, with the price of West Texas intermediate crude above \$57 per barrel throughout the forecast horizon. Other energy prices are expected to follow a similar pattern over the forecast period. 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. While higher energy prices will heighten incentives to increase 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.

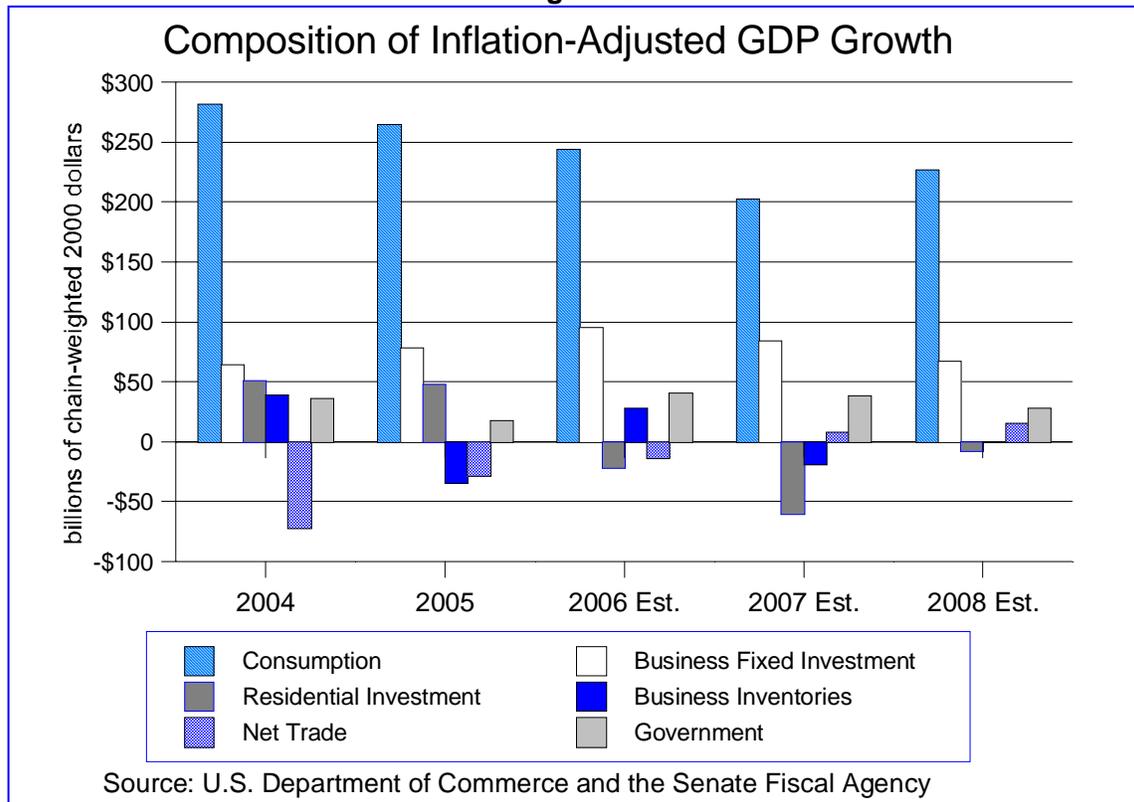
Risks to the Forecast

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 2007 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 keep interest rates very stable over the forecast period, with rates remaining at levels consistent with historical averages and the underlying productivity in the economy. Furthermore, the Federal Reserve Open Market Committee is expected to take a proactive approach toward any 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 compared with historical levels ([Figure 8](#)). Government is expected to add only approximately 0.3 percentage point to economic growth in 2007 and only 0.2 percentage point in 2008. 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. 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 investment growth rather than substantial employment gains or stronger consumption growth. Therefore, higher interest rates are likely to worsen the burden of servicing consumer debt and pose a risk to rising investment supporting the economy. The burden of servicing consumer debt reached an all-time high in the second quarter of 2006 and essentially remained at that level in the third quarter. A significant portion of debt is variable-rate debt -- meaning that the burden will increase if interest rates rise more quickly than income. When combined with slow job growth, continued 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 predicted 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 would 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 the rate of inflation to be lower in 2007 and 2008, compared with 2006, the declines are heavily influenced by stable energy prices at levels below those experienced during 2006. To some extent the pattern in energy prices causes most inflationary measures to mask other significant upward pressures on inflation in the economy. 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 are likely also to face wage pressures that will be compounded by the fact that productivity, while still exhibiting historically strong growth, is growing more slowly than in recent years. Nonmanufacturing productivity in particular has shown a marked slowdown in recent quarters. 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 moderate growth in productivity, which may not be as strong as forecasted; minimal wage growth, which may be stronger than predicted; slower employment growth, which may be stronger than predicted; and moderate 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 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 profit 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 persisted in most months of 2006. When this type of pattern appears, it is often viewed as a precursor to a recession.

Michigan's Dilemma. While over the last six 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 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 (particularly in the transportation equipment manufacturing sector) have experienced weaker job performance over the last five years, both because of the economic changes occurring in that sector and because of the dependence of other sectors within those states on manufacturing activity. As indicated earlier, productivity gains have made American manufacturing firms more profitable and more competitive, but have reduced the need for hiring additional employees to meet increased demand.

Rising interest rates, a near-zero saving 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 historically have 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 2006, Michigan had lost approximately four out of every 10 jobs (a decline of more than 137,500 jobs) in transportation equipment manufacturing that existed during the peak in June 2000.

Complicating the economic landscape, much of the downsizing in the domestic transportation equipment manufacturing sector actually has led auto companies to close facilities in other states more often than in Michigan. While those states were already less reliant on transportation equipment manufacturing, the changes have made them even less dependent. However, this "retreat-to-the-core" strategy means that Michigan's economy has become less reliant on transportation equipment manufacturing at a slower rate than the rest of the country. As a result, while that strategy has preserved more transportation equipment manufacturing jobs in Michigan than might otherwise have been saved, it means that the Michigan economy is likely to remain far more vulnerable to swings in the domestic vehicle manufacturing industry than other states.

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 likely that absent any shocks, the Michigan economy will spend years adjusting to the change. Offsetting a 10.0% 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 10.0% 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 in transportation equipment manufacturing employment of 10.0% or more a year 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 some time around the year 2020.

The dilemma for Michigan is that for the economy and tax revenue to improve, employment gains need to occur. However, given Michigan's reliance on the automobile industry and manufacturing and the forecast for demand, employment gains are likely to occur only if productivity growth declines. However, 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 successfully balances these extremes, although it will lean more to the high-productivity/low employment growth end, with employment declining slightly and businesses still able to earn modest profits while remaining mostly competitive.

Figure 9

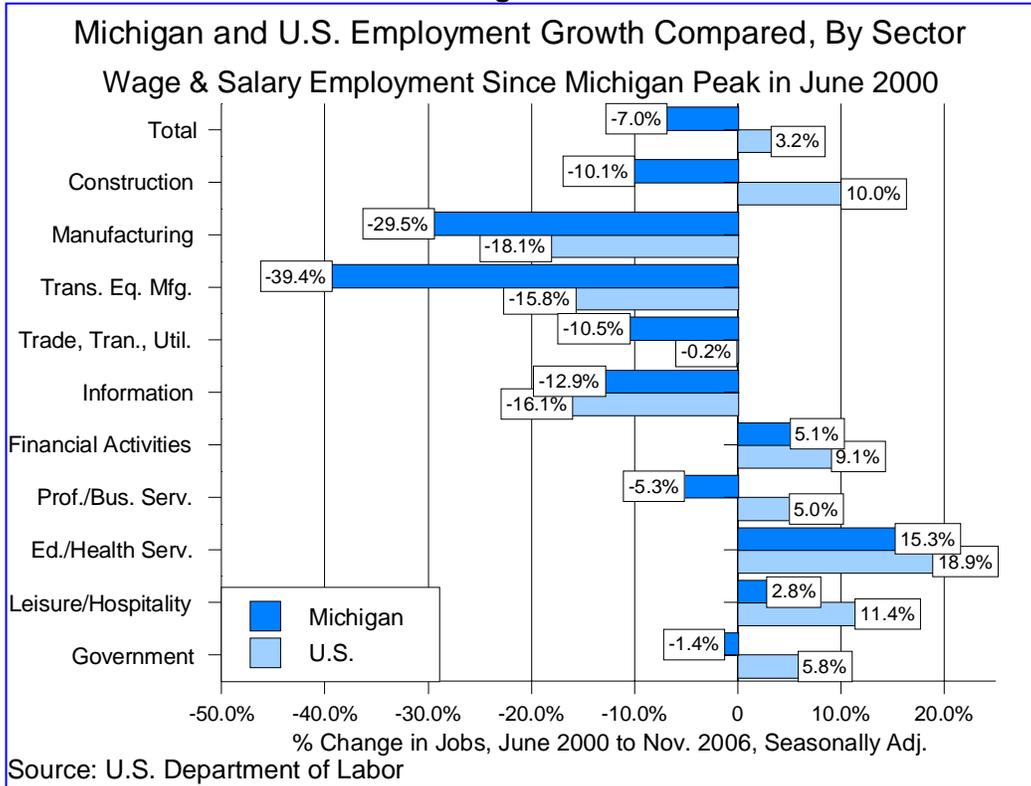
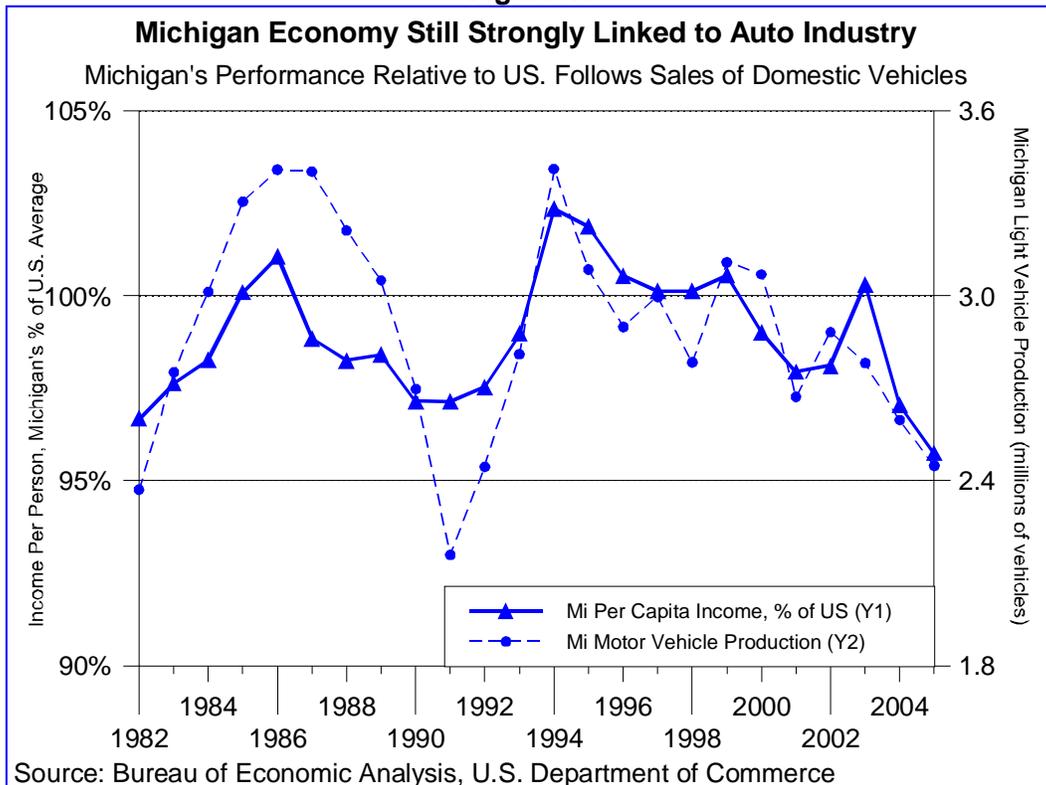


Figure 10



THE FORECAST FOR STATE REVENUE

SENATE FISCAL AGENCY REVENUE ESTIMATES

This section of the Budget Status Report presents the Senate Fiscal Agency's (SFA's) estimates for General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue. The preliminary year-end revenue for FY 2005-06 is presented along with the revised estimates for FY 2006-07 and the initial revenue estimates for FY 2007-08. The revenue estimates for each of these fiscal years include the estimates for baseline revenue, which measures what the revenue would be without any changes in the State's tax structure, and net revenue, which equals baseline revenue adjusted for the impact of all enacted tax changes.

REVENUE OVERVIEW

In FY 2005-06, GF/GP and SAF revenue edged up 0.7% to \$19.35 billion. Continued declines in wage and salary employment led to very weak levels of collections for some of the State's major GF/GP and SAF taxes. The revenue generated from income tax withholding payments and sales and use taxes was up collectively only 0.1% in FY 2005-06 and single business tax receipts fell 3.7% due in part to a new partial credit for personal property taxes paid by manufacturing businesses. Given that taxes account for almost 95% of GF/GP and SAF revenue, this weakness in tax collections was the major factor contributing to the overall weak gain in revenue in FY 2005-06. On a baseline basis, GF/GP and SAF revenue collections were up 1.0%, which is down from the increases posted in FY 2003-04 and FY 2004-05 of 1.8% and 4.5%, respectively.

As presented in the first section of this report, Michigan's economic activity is expected to remain lackluster in 2007 and 2008, as employment is expected to continue to decline. As a result, baseline GF/GP and SAF revenue is expected to post a modest 1.0% increase in FY 2006-07, which is unchanged from the FY 2005-06 growth rate. Enacted tax reductions, however, will slow the growth in net available revenue to 0.4%, which will result in GF/GP and SAF revenue of an estimated \$19.43 billion.

In FY 2007-08, GF/GP and SAF revenue will total an estimated \$18.51 billion, which represents a 4.7% decrease from the revised estimate for FY 2006-07. The major reason for this sharp decline in anticipated GF/GP and SAF revenue is the scheduled repeal of the single business tax at the end of 2007. At this time, no tax has been enacted to replace the single business tax. If the single business tax revenue is fully replaced, then GF/GP and SAF revenue will edge up 1.5% in FY 2007-08 to \$19.75 billion. The revenue estimates for FY 2006-07 and FY 2007-08 are summarized in [Table 3](#).

Historical Perspective

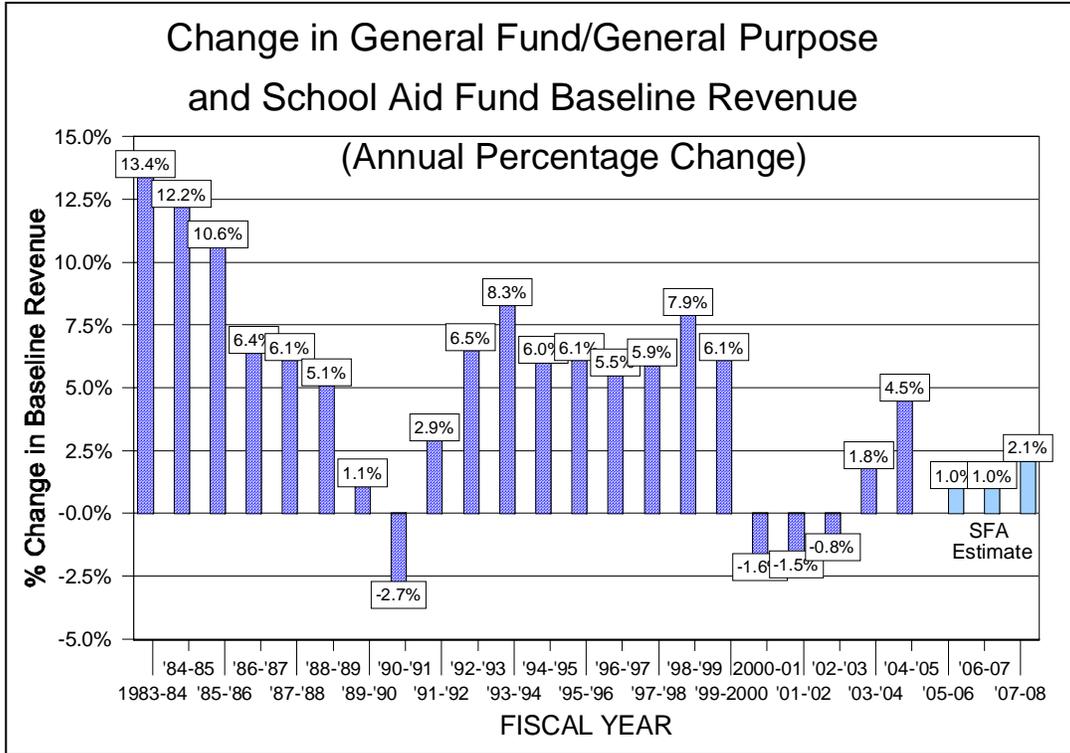
From a historical perspective, the revenue projections for FY 2006-07 and FY 2007-08 reflect very weak growth rates. [Figure 11](#) presents a historical overview of the percentage change in baseline GF/GP and SAF revenue since FY 1982-83. From FY 1992-93 to FY 1999-2000, baseline revenue growth averaged 6.5% and 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 baseline revenue actually declined for three consecutive years from FY 2000-01 to FY 2001-02. Revenue growth finally turned positive again in FY 2003-04 with a gain of 1.8% and then it increased 4.5% in FY 2004-05. Preliminary fiscal year-end revenue data for FY 2005-06 reveal that GF/GP and SAF baseline revenue was up only 1.0% in FY 2005-06, and it is estimated that baseline revenue will increase 1.0% in FY 2006-07.

and 2.1% in FY 2007-08. While these estimates of revenue growth are better than experienced during the first part of this decade, they are well below the rates of growth experienced in the 1990s and in FY 2004-05.

Table 3

SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2006-07 AND FY 2007-08 GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND (Millions of Dollars)			
	FY 2005-06 Preliminary Final	FY 2006-07 Revised Estimate	FY 2007-08 Initial Estimate
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	\$8,182.4	\$8,201.4	\$8,326.7
Tax Changes Not In Baseline	84.3	(38.5)	(1,379.2)
<u>Revenue After Tax Changes:</u>			
Net Income Tax	4,183.6	4,167.4	4,203.8
Single Business Tax & Insurance Tax ¹⁾	2,061.4	2,073.3	845.9
Other Taxes	<u>1,569.1</u>	<u>1,589.2</u>	<u>1,593.2</u>
Total Taxes	7,814.1	7,830.0	6,642.9
Nontax Revenue	452.6	332.9	304.6
TOTAL GF/GP REVENUE¹⁾	\$8,266.7	\$8,162.9	\$6,947.5
SCHOOL AID FUND			
Baseline SAF	\$11,089.8	\$11,266.4	\$11,543.7
Tax Changes Not In Baseline	(7.6)	(2.8)	19.0
TOTAL SAF REVENUE	\$11,082.1	\$11,263.6	\$11,562.8
BASELINE GF/GP AND SAF REVENUE	\$19,272.1	\$19,467.7	\$19,870.4
Tax & Revenue Changes	76.7	(41.3)	(1,360.2)
GF/GP & SAF REV. AFTER CHANGES	\$19,348.8	\$19,426.4	\$18,510.2
<u>ADDENDUM:</u>			
Sales Tax	\$6,638.1	\$6,773.3	\$6,945.4
PERCENT CHANGE			
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	0.5%	0.2%	1.5%
<u>Revenue After Tax Changes:</u>			
Net Income Tax	1.5	(0.4)	0.9
Single Business Tax & Insurance Tax	(4.7)	0.6	(59.2)
Other Taxes	<u>(2.4)</u>	<u>1.3</u>	<u>0.2</u>
Total Taxes	(1.0)	0.2	(15.2)
Nontax Revenue	8.4	(26.4)	(8.5)
TOTAL GF/GP REVENUE	(0.5)%	(1.3)%	(14.9)%
SCHOOL AID FUND			
Baseline SAF	1.5%	1.6%	2.5%
TOTAL SAF REVENUE	1.6%	1.6%	2.7%
BASELINE GF/GP AND SAF REVENUE	1.0	1.0	2.1
GF/GP & SAF REV. AFTER CHANGES	0.7%	0.4%	(4.7)%
<u>ADDENDUM:</u>			
Sales Tax	0.6%	2.0%	2.5%
1) Includes revenue loss from December 31, 2007, repeal of the SBT. This repeal will reduce SBT and insurance tax revenue an estimated \$1,235.1 million in FY 2007-08. If the SBT and insurance revenue is fully replaced, the GF/GP revenue estimate for FY 2007-08 will equal \$8,182.6 million, an increase of 0.2% from the revised estimate for FY 2006-07 and total GF/GP and SAF revenue will equal \$19,754.4 million, representing a 1.6% increase.			

Figure 11



FY 2005-06 PRELIMINARY YEAR-END REVENUE

Based on preliminary year-end book-closing revenue data, GF/GP and SAF revenue totaled \$19.35 billion in FY 2005-06, which was up 0.7% from the FY 2004-05 revenue level, as presented in [Table 4](#). This preliminary year-end revenue level for FY 2005-06 is down \$206.3 million from the consensus estimate adopted at the May 2006 Consensus Revenue Estimating Conference.

General Fund/General Purpose

General Fund/General Purpose revenue totaled \$8.27 billion in FY 2005-06, which was down 0.5% from FY 2004-05. This preliminary year-end revenue level is \$90.4 million below the May 2006 consensus revenue estimate. This decline in GF/GP revenue from the May 2006 Consensus Revenue Estimating Conference was primarily due to unforeseen weakness in some of the major taxes, including the income and use taxes. In addition, some of the nontax revenue levels also fell below expectations. A breakdown of FY 2005-06 GF/GP and SAF revenue is presented in [Table 4](#).

School Aid Fund

The revenue earmarked to the SAF totaled an estimated \$11.08 billion in FY 2005-06, which was up 1.6% from the FY 2004-05 revenue level. Almost all of the major taxes earmarked to the SAF experienced an increase in the revenue they generated compared with their FY 2004-05 level; however, these increases were generally not as strong as had been estimated in May 2006. In fact, the preliminary year-end SAF revenue level for FY 2005-06 was \$115.9 million below the consensus revenue estimate adopted in May 2006. Weaker-than-expected revenue sources included the sales, use, State education, real estate transfer, and income taxes, along with the revenue from the lottery. The preliminary year-end SAF revenue for FY 2005-06 also is presented in [Table 4](#).

Table 4

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

	FY 2004-05 Final	FY 2005-06 Preliminary Final	Change from FY 2004-05		\$ Change from 05/06 Consensus
			Dollar Change	Percent Change	
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue	\$8,163.3	\$8,205.1	\$41.7	0.5%	\$(119.6)
Tax Changes Not In Baseline Revenue After Tax Changes	145.5	61.6	(83.8)	---	29.1
<u>Personal Income Tax</u>					
Gross Collections	7,719.0	7,849.9	130.9	1.7	(83.8)
Less: Refunds	(1,610.8)	(1,626.0)	(15.2)	0.9	53.0
Net Income Tax Collections	6,108.2	6,223.9	115.7	1.9	(30.8)
Less: Earmarking to SAF Campaign Fund	(1,985.6) (1.5)	(2,039.0) (1.3)	(53.4) 0.2	2.7 (13.3)	19.8 0.2
Net Income Tax to GF/GP	\$4,121.1	\$4,183.6	\$62.5	1.5%	\$(10.8)
<u>Other Taxes</u>					
Single Business Tax	1,913.5	1,841.9	(71.6)	(3.7)	(21.0)
Sales	109.2	85.9	(23.3)	(21.3)	(20.3)
Use	934.8	917.0	(17.8)	(1.9)	(24.1)
Cigarette	116.5	229.0	112.5	96.6	(6.3)
Insurance Company Premiums	249.5	219.5	(30.0)	(12.0)	(15.5)
Telephone & Telegraph	99.1	83.5	(15.6)	(15.7)	0.5
Estate	101.5	0.6	(100.9)	(99.4)	(0.4)
Oil & Gas Severance	66.7	81.5	14.8	22.2	(12.5)
Casino Wagering	42.2	45.0	2.8	---	0.9
All Other	137.1	126.6	(10.5)	(7.7)	(14.1)
Subtotal Other Taxes	\$3,770.0	\$3,630.5	\$(139.5)	(3.7)%	\$(112.8)
Total Nontax Revenue	417.7	452.6	34.9	8.4	33.1
GF/GP REV. AFTER TAX CHANGES	\$8,308.9	\$8,266.7	\$(42.2)	(0.5)%	\$(90.4)
SCHOOL AID FUND:					
Baseline Revenue	\$10,914.6	\$11,073.0	\$158.4	1.5%	\$(99.8)
Tax Changes Not In Baseline Revenue After Tax Changes	(5.0)	9.2	14.1	(285.1)	(16.1)
Sales Tax	4,805.7	4,831.3	25.6	0.5	(52.4)
Lottery Revenue	667.6	688.0	20.4	3.1	(20.5)
State Education Property Tax	1,914.5	2,003.5	89.0	4.6	(6.5)
Real Estate Transfer Tax	313.5	297.7	(15.8)	(5.0)	(22.3)
Income Tax	1,985.6	2,039.0	53.4	2.7	(19.8)
Casino Tax	97.6	104.1	6.5	6.7	2.1
Other Revenue	1,125.1	1,118.6	(6.6)	(0.6)	3.6
SAF REV. AFTER TAX CHANGES	\$10,909.7	\$11,082.1	\$172.4	1.6%	\$(115.9)
BASELINE GF/GP AND SAF	\$19,078.0	\$19,278.1	\$200.1	1.0%	\$(219.3)
Tax & Revenue Changes	140.5	70.8	(69.7)	---	13.0
GF/GP & SAF REV. AFTER CHANGES	\$19,218.5	\$19,348.9	\$130.4	0.7%	\$(206.3)
SALES TAX	\$ 6,599.1	\$ 6,638.1	\$ 39.0	0.6%	\$ (71.5)
Note:	In order to provide an accurate comparison of FY 2004-05 and FY 2005-06 baseline revenue, the base year in this table is FY 2004-05.				

REVISED REVENUE ESTIMATES FOR FY 2006-07

General Fund/General Purpose and SAF revenue is expected to total \$19.43 billion in FY 2006-07, which is up 0.4% from FY 2005-06. This revised revenue estimate is \$589.7 million below the estimate adopted at the May 2006 Consensus Revenue Estimating Conference. This significant reduction in the FY 2006-07 revenue estimate is due to two major factors: 1) Tax collections came in weaker than expected in FY 2005-06, so tax collections for FY 2006-07 are growing off of a lower base than was originally forecast in May 2006, and 2) economic activity in 2007 is now expected to be slower than was estimated at the May 2006 consensus conference, which means that revenue growth also will be slower. The revised GF/GP and SAF revenue estimates for FY 2006-07 are summarized in [Table 5](#).

General Fund/General Purpose

General Fund/General Purpose revenue will total an estimated \$8.16 billion, which is down 1.3% or \$103.8 million from FY 2005-06. Most of this anticipated decline in GF/GP revenue from FY 2005-06 to FY 2006-07 will be due to a 26.4% or \$119.7 million decline in nontax revenue that will more than offset a projected very modest increase in revenue from taxes of 0.2% or \$15.8 million. The major reason for the very small increase in tax revenue is that the weak economy will translate into weak growth in the bases of the major taxes, including the income and single business taxes. In addition to the weak growth rates in the tax bases, the revenue growth is expected to be even weaker due to some tax structure changes. Net income tax revenue going to the General Fund will be essentially flat on a baseline basis, but an increase in the personal exemption from \$3,300 to \$3,400 on January 1, 2007, will pull income tax collections down about \$24.0 million and, as a result, the net income tax revenue going to the GF/GP budget in FY 2006-07 is expected to decline 0.4% or \$16.2 million. In addition, the slow level of economic activity accompanied by a decline in business profits is expected to translate into a meager 0.3% increase in single business tax revenue in FY 2006-07. General Fund/General Purpose nontax revenue is expected to decline in FY 2006-07 due in large part to a \$74.0 million increase in the amount transferred from unclaimed property in FY 2005-06, which is not expected to be repeated in FY 2006-07. Compared with the May 2006 consensus revenue estimate, this revised estimate for FY 2006-07 GF/GP revenue is down \$300.8 million.

School Aid Fund

School Aid Fund revenue from earmarked taxes and the lottery is expected to total \$11.26 billion in FY 2006-07, which is 1.6% above the FY 2005-06 level. Increases in the sales, use, income, State education, and casino taxes, will be partially offset by declines in the real estate transfer, tobacco, and industrial facilities taxes. In addition, lottery revenue is expected to increase a modest 0.4% in FY 2006-07. While most of the major taxes earmarked at least in part to the SAF are expected to increase in FY 2006-07, their rates of increase are generally less than was estimated in May 2006. As a result, this revised estimate of SAF revenue for FY 2006-07 represents a downward revision of \$288.8 million from the May 2006 consensus estimate. Most of this downward revision is in the sales, income, and State education tax revenue estimates. The SAF revenue estimate for FY 2006-07 is summarized in [Table 5](#).

Table 5
FY 2006-07 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	FY 2005-06 Preliminary Final	FY 2006-07 Revised Estimate	Change from FY 2005-06		\$ Change from 05/06 Consensus
			Dollar Change	Percent Change	
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue	\$8,182.4	\$8,201.4	\$19.0	0.2%	\$(298.1)
Tax Changes Not In Baseline Revenue After Tax Changes	84.3	(38.5)	(122.8)	---	(2.7)
<u>Personal Income Tax</u>					
Gross Collections	7,849.9	7,930.4	80.5	1.0	(213.5)
Less: Refunds	(1,626.0)	(1,703.9)	(77.9)	4.8	54.1
Net Income Tax Collections	6,223.9	6,226.5	2.6	0.0	(159.4)
Less: Earmarking to SAF Campaign Fund	(2,039.0) (1.3)	(2,057.8) (1.3)	(18.8) 0.0	0.9 0.0	55.3 0.2
Net Income Tax to GF/GP	\$4,183.6	\$4,167.4	\$(16.2)	(0.4)%	\$(103.9)
<u>Other Taxes</u>					
Single Business Tax	1,841.9	1,848.3	6.4	0.3	(47.6)
Sales	85.9	95.6	9.7	11.3	(17.8)
Use	917.0	940.7	23.7	2.6	(37.7)
Cigarette	229.0	225.1	(3.9)	(1.7)	(6.2)
Insurance Company Premiums	219.5	225.0	5.5	2.5	(21.0)
Telephone & Telegraph	83.5	77.5	(6.0)	(7.2)	(2.5)
Estate	0.6	0.0	(0.6)	(100.0)	0.0
Oil & Gas Severance	81.5	68.0	(13.5)	(16.6)	(8.0)
Casino Wagering	45.0	47.7	2.7	6.0	
All Other	126.6	134.7	8.1	6.4	(13.2)
Subtotal Other Taxes	\$3,630.5	\$3,662.5	\$32.1	0.9%	\$(151.4)
Total Nontax Revenue	452.6	332.9	(119.7)	(26.4)	(45.6)
GF/GP REV. AFTER TAX CHANGES	\$8,266.7	\$8,162.9	\$(103.8)	(1.3)%	\$(300.8)
SCHOOL AID FUND:					
Baseline Revenue	\$11,089.8	\$11,266.4	\$176.6	1.6%	\$(263.2)
Tax Changes Not In Baseline Revenue After Tax Changes	(7.6)	(2.8)	4.8	---	(25.6)
Sales Tax	4,831.3	4,930.6	99.3	2.1	(136.0)
Lottery Revenue	688.0	690.9	2.9	0.4	(21.1)
State Education Property Tax	2,003.5	2,074.8	71.3	3.6	(41.2)
Real Estate Transfer Tax	297.7	280.0	(17.7)	(5.9)	(31.0)
Income Tax	2,039.0	2,057.9	18.9	0.9	(55.3)
Casino Tax	104.1	110.4	6.3	6.0	6.3
Other Revenue	1,118.6	1,119.0	0.5	0.0	(10.5)
SAF REVENUE AFTER TAX CHANGES	\$11,082.1	\$11,263.6	\$181.4	1.6%	\$(288.8)
BASELINE GF/GP AND SAF	\$19,272.1	\$19,467.7	\$195.6	1.0%	\$(561.4)
Tax & Revenue Changes	76.7	(41.3)	(118.0)	---	(28.3)
GF/GP & SAF REV. AFTER CHANGES	\$19,348.8	\$19,426.4	\$ 77.6	0.4%	\$(589.7)
SALES TAX	\$ 6,638.1	\$ 6,773.3	\$135.2	2.0%	\$(185.4)
Note: In order to provide an accurate comparison of FY 2005-06 and FY 2006-07 baseline revenue, the base year in this table is FY 2005-06.					

FY 2007-08 INITIAL REVENUE ESTIMATES

The continuing decline in employment, which will temper the growth in wage and salary income and overall personal income in 2007 and 2008, will hold down the rate of growth in GF/GP and SAF revenue to a rather low level again in FY 2007-08. However, under current law, the single business tax will be repealed at the end of 2007 and to date no new replacement business tax or tax package has been enacted. As a result, under current law GF/GP and SAF revenue will experience a significant decline in FY 2007-08 equal to an estimated 4.7% or \$916.2 million for a total of \$18.51 billion. If it is assumed that single business tax revenue is fully replaced by some new tax, then FY 2007-08 GF/GP and SAF revenue will total an estimated \$19.75 billion, which represents a modest increase of 1.5% from the FY 2006-07 revised estimate. The initial estimate of GF/GP and SAF revenue for FY 2007-08, based on the repeal of the single business tax that will occur under current law, is summarized in Table 6.

General Fund/General Purpose Revenue

General Fund/General Purpose revenue will total an estimated \$6.95 billion in FY 2007-08. This represents a 14.9% or \$1.22 billion decrease from the FY 2006-07 revised estimate. This sharp decrease will be due primarily to the repeal of the single business tax at the end of 2007. If it is assumed that the single business and insurance tax collections are fully replaced, then GF/GP revenue will total an estimated \$8.18 billion, which is only 0.2% above the revised estimate for FY 2006-07. This very meager increase in GF/GP revenue even if single business and insurance tax revenue is fully replaced will be due to continued weak economic growth, which in particular will depress the rate of growth in income tax revenue. In addition, a triggered reduction in the casino tax rate also is expected to reduce casino tax revenue going to the General Fund.

School Aid Fund

School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$11.56 billion in FY 2007-08, which represents an increase of 2.7%, or \$299.2 million from the revised estimate for FY 2006-07. This increase reflects modest improvement in most of the taxes that are earmarked to the SAF.

Major General Fund and School Aid Fund Taxes

Repeal of the Single Business Tax. The major tax issue affecting GF/GP revenue in FY 2007-08 is the single business tax. Under current law, the single business tax is scheduled to be repealed effective December 31, 2007, and at this time, no tax has been enacted to replace any of this revenue. Revenue generated from the single business tax is earmarked to the GF/GP budget and is collected through two components: the single business tax and an insurance company tax. In terms of the tax on insurance companies, Michigan-based insurance companies pay the single business tax and insurance companies that are based in some other state but operate in Michigan pay the greater of the single business tax or the retaliatory tax (a tax on out-of-state insurance companies equal to the tax an insurance company's home state would assess on a Michigan-based insurance company). All single business and retaliatory tax payments made by insurance companies are recorded in the insurance tax account. On a baseline basis (maintaining the tax through FY 2007-08) it is estimated that single business tax revenue will equal \$1.85 billion in FY 2007-08 and insurance tax revenue will equal \$229.5 million. Under current law, however, the scheduled repeal of the single business tax will reduce single business tax collections an estimated \$1.19 billion and insurance tax receipts an estimated \$48.0 million, for a total revenue reduction of \$1.25 billion.

Income Tax. Income tax revenue will total an estimated \$6.30 billion in FY 2007-08, which represents an increase of 1.2% or \$73.0 million from the FY 2006-07 revised estimate. The SAF receives 25.9% of gross income tax collections (collections before refunds) and this will equal an estimated \$2.09 billion in FY 2007-08. The GF/GP share of the income tax will total an estimated \$4.20 billion.

Sales Tax. Sales tax collections are expected to increase 2.5% in FY 2007-08 to \$6.95 billion. Of this total amount, \$5.06 billion will be earmarked to the SAF and \$103.4 million will go to the General Fund. Most of the remaining amount is earmarked constitutionally and statutorily for revenue sharing payments to local governments, but over the past several years, a significant portion of the amount earmarked statutorily has been diverted to the General Fund.

Use Tax. Use tax collections will total an estimated \$1.46 billion in FY 2007-08. The GF/GP share, which equals two-thirds of use tax revenue, will total an estimated \$976.6 million and the remaining one-third, equal to \$488.3 million, is earmarked to the SAF. Use tax collections are expected to increase 3.8% in FY 2007-08, but this overstates the true projected strength in use tax collections due to the fact that some one-time refunds resulting from tax audits were paid in FY 2005-06 and is expected to continue to be paid in FY 2006-07 and FY 2007-08, but the amount of these refunds is expected to decline significantly in FY 2007-08. On a baseline basis, use tax collections are expected to be up 2.7% in FY 2007-08.

Tobacco Taxes. Tax collections from the cigarette and other tobacco products taxes will total an estimated \$1.13 billion in FY 2007-08, which represents a decrease of 2.0% from the revised estimate for FY 2006-07. Of this amount, the SAF will receive \$454.3 million and \$220.6 million will go into GF/GP revenue.

Casino Tax. Currently, the State's tax on casinos is equal to 12.1% of gross receipts from gaming. The State's tax was increased from 8.1% to 12.1% in 2004. All of the revenue generated from the original 8.1% tax goes to the SAF, while the revenue from the 4.0 percentage point increase goes to the GF/GP budget (3.5%) and the Agriculture Equine Industry Development Fund (0.5%). A provision in the law that increased the tax rate by 4.0 percentage points requires that this increase be eliminated for each of the three Detroit casinos when their permanent facilities are fully operational. It appears that during FY 2007-08, at least two of the casinos will be operating from their permanent facility so their tax rate is expected to be reduced back to 8.1%. As a result, it is estimated that the revenue generated from the casino tax will decline to an estimated \$131.6 million in FY 2007-08 from an estimated \$164.9 million in FY 2006-07. The SAF will continue to receive the revenue generated from the tax of 8.1%, so its casino revenue is expected to increase from \$110.4 million in FY 2006-07 to \$116.4 million in FY 2007-08, due to anticipated growth in casino wagering, particularly as two of the three casinos begin operating from their new facilities. On the other hand, casino revenue going to the General Fund will decline from an estimated \$47.7 million in FY 2006-07 to \$13.3 million in FY 2007-08 and the revenue earmarked to the Equine Fund will fall from \$6.8 million in FY 2006-07 to an estimated \$1.9 million in FY 2007-08.

State Education Property Tax. The State education property tax is expected to generate \$2.18 billion in FY 2007-08, representing an increase of 5.1%.

Lottery. Net lottery revenue will total an estimated \$696.1 million in FY 2007-08, which is up only 0.8% from the revised level for FY 2006-07.

Table 6
FY 2007-08 INITIAL REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	FY 2006-07 Revised Est.	FY 2007-08 Initial Est.	Change From FY 2006-07	
			Dollar Change	Percent Change
GENERAL FUND/GENERAL PURPOSE:				
Baseline Revenue	\$8,201.4	\$8,326.7	\$125.3	1.5%
Tax Changes Not In Baseline Revenue After Tax Changes	(38.5)	(1,379.2)	(1,340.7)	---
<u>Personal Income Tax</u>				
Gross Collections	7,930.4	8,071.7	141.3	1.8
Less: Refunds	(1,703.9)	(1,772.2)	(68.3)	4.0
Net Income Tax Collections	6,226.5	6,299.5	73.0	1.2
Less: Earmarking to SAF Campaign Fund	(2,057.8) (1.3)	(2,094.4) (1.3)	(36.6) 0.0	1.8 0.0
Net Income Tax to GF/GP	\$4,167.4	\$4,203.8	\$36.4	0.9%
<u>Other Taxes</u>				
Single Business Tax ¹⁾	1,848.3	664.4	(1,183.9)	(64.1)
Sales	95.6	103.4	7.8	8.2
Use	940.7	976.6	35.9	3.8
Cigarette	225.1	220.6	(4.6)	(2.0)
Insurance Company Premiums ¹⁾	225.0	181.5	(43.5)	(19.3)
Telephone & Telegraph	77.5	72.6	(4.9)	(6.3)
Estate	0.0	0.0	0.0	---
Oil & Gas Severance	68.0	65.0	(3.0)	(4.4)
Casino Wagering	47.7	13.3	(34.4)	(72.1)
All Other	134.7	141.7	7.0	5.2
Subtotal Other Taxes	\$3,662.5	\$2,439.1	\$(1,223.5)	(33.4)%
Total Nontax Revenue	332.9	304.6	(28.3)	(8.5)
GF/GP REVENUE AFTER TAX CHANGES¹⁾	\$8,162.9	\$6,947.5	\$(1,215.4)	(14.9)%
SCHOOL AID FUND:				
Baseline Revenue	\$11,266.4	\$11,543.7	\$277.4	2.5%
Tax Changes Not In Baseline Revenue After Tax Changes	(2.8)	19.0	21.8	---
Sales Tax	4,930.6	5,056.3	125.7	2.5
Lottery Revenue	690.9	696.1	5.2	0.8
State Education Property Tax	2,074.8	2,180.1	105.3	5.1
Real Estate Transfer Tax	280.0	294.0	14.0	5.0
Income Tax	2,057.9	2,094.5	36.6	1.8
Casino Tax	110.4	116.4	6.0	5.5
Other Revenue	1,119.0	1,125.4	6.4	0.6
SAF REVENUE AFTER TAX CHANGES	\$11,263.6	\$11,562.8	\$299.2	2.7%
BASELINE GF/GP AND SAF	\$19,467.7	\$19,870.4	\$402.7	2.1%
Tax & Revenue Changes	(41.3)	(1,360.2)	(1,318.9)	---
GF/GP & SAF REV. AFTER TAX CHANGES¹⁾	\$19,426.4	\$18,510.2	\$(916.2)	(4.7)%
SALES TAX	\$ 6,773.3	\$ 6,945.4	\$ 172.1	2.5%

Note: FY 2005-06 is the base year for baseline revenue.

1) Includes revenue loss from December 31, 2007, repeal of the SBT. This repeal will reduce SBT and insurance tax revenue an estimated \$1,235.1 million in FY 2007-08. If the SBT and insurance revenue is fully replaced, the GF/GP revenue estimate for FY 2007-08 will equal \$8,182.6 million, an increase of 0.2% from the revised estimate for FY 2006-07 and total GF/GP and SAF revenue will equal \$19,745.4 million, representing a 1.6% increase.

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 2005-06 and FY 2006-07 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 2005-06 and FY 2006-07 have been adjusted to reflect a common base year.

The initial estimate for FY 2005-06 GF/GP and SAF baseline revenue was made in January 2005 at \$19.42 billion, as shown in Table 7. The revenue estimates were lowered slightly in May 2005, but then were revised up beyond the initial estimate at a special consensus revenue conference in August 2005. The estimate was increased slightly in January 2006 and another small increase was adopted in May 2006. The revised revenue level presented in this report, based on preliminary year-end revenue data from the Department of Treasury, reduces the GF/GP and SAF baseline revenue \$209.3 million or 1.1% from the May 2006 consensus estimate; however, compared with the initial estimate made in January 2005, the revised preliminary final estimate of GF/GP and SAF baseline revenue for FY 2005-06 is down \$140.7 million or 0.7%.

The initial GF/GP and SAF baseline revenue estimate for FY 2006-07 was made in January 2006 at \$19.92 billion, as shown in Table 8. This estimate was increased about \$85 million at the January 2006 Consensus Revenue Estimating Conference and then was nudged up another \$26.0 million at the May 2006 Conference. The Senate Fiscal Agency's revised estimates, presented in this report, lower GF/GP and SAF baseline revenue \$563.3 million or 2.8% from the May 2006 consensus estimate. Compared with the initial estimate made in January 2006, the Senate Fiscal Agency's revised estimate of GF/GP and SAF baseline revenue for FY 2006-07 is down \$453.1 million or 2.3%.

Table 7
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 16, 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 11, 2006	8,270.3	11,224.8	19,495.1
January 12, 2006 ^{a)}	8,247.2	11,205.4	19,452.6
May 15, 2006	8,290.0	11,172.1	19,462.1
May 17, 2006 ^{a)}	8,314.6	11,172.8	19,478.4
January 16, 2007	8,205.1	11,073.0	19,278.1
<u>Change From Previous Estimate:</u>			
Dollar Change	\$(109.5)	\$(99.8)	\$(209.3)
Percent Change	(1.3)%	(0.9)%	(1.1)%
<u>Change From Initial Estimate:</u>			
Dollar Change	\$53.3	\$(194.0)	\$(140.7)
Percent Change	0.7%	(1.7)%	(0.7)%
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 2006-07
(Millions of Dollars)

Forecast Date	GF/GP	SAF	Total
January 11, 2006	\$8,376.2	\$11,542.7	\$19,918.9
January 12, 2006 ^{a)}	8,436.0	11,567.5	20,003.5
May 15, 2006	8,488.3	11,524.1	20,012.4
May 17, 2006 ^{a)}	8,484.3	11,546.8	20,031.1
January 16, 2007	8,201.4	11,266.4	19,467.8
<u>Change From Previous Estimate:</u>			
Dollar Change	\$(282.9)	\$(280.4)	\$(563.3)
Percent Change	(3.3)%	(2.4)%	(2.8)%
<u>Change From Initial Estimate:</u>			
Dollar Change	\$(159.6)	\$(293.5)	\$(453.1)
Percent Change	(1.9)%	(2.5)%	(2.3)%
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			
Note: Baseline base year equals FY 2005-06.			

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 2.0%. When the growth in real personal income less transfer payments is over 2.0%, the pay-in to the BSF is equal to the percentage growth in excess of 2.0% multiplied by 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 annual GF/GP revenue. Thus, funds contributed to the BSF in growth years are used to supplement current revenue during a recession, reducing the need either to increase taxes or to reduce State services in a time of poor economic conditions.

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

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

Table 9 presents the recent history of the BSF in terms of actual transfers into and out of the Fund, interest earnings, and year-end balances from FY 1998-99 through FY 2004-05. Also presented in this table are the preliminary year-end data for FY 2005-06, along with the SFA's estimates for FY 2006-07 and FY 2007-08. 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 2006-07 and FY 2007-08 are presented in Table 10.

FY 2005-06

In FY 2005-06, the BSF had a beginning balance of \$2.0 million and during the year an estimated \$0.1 million in interest was earned, leaving an ending balance of \$2.1 million.

FY 2006-07 and FY 2007-08

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 \$2.1 million in FY 2006-07, but does not trigger any transfers into or out of the Fund in FY 2007-08, as shown in Table 10. While any transfers into or out of the Fund must be appropriated for them actually to occur, no transfer was enacted as part of the FY 2006-07 enacted budget. As a result, it is estimated that the BSF balance will total \$2.2 million at the end of FY 2006-07 and \$2.3 million at the end of FY 2007-08.

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
2007-08	0.0	0.1	0.0	2.3

Figure 12

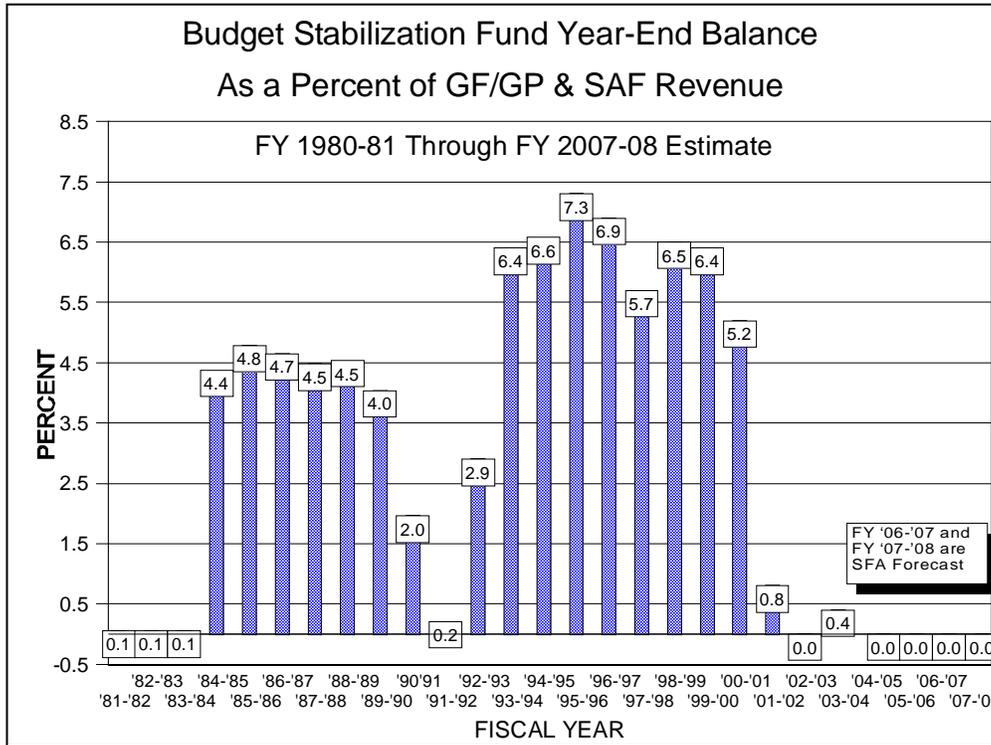


Table 10

ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER FY 2006-07 AND FY 2007-08 (Millions of Dollars)			
	CY 2006	CY 2007	CY 2008
Michigan Personal Income (MPI)	\$345,103	\$353,567	\$364,418
Less: Transfer Payments	54,887	58,385	61,619
Subtotal	\$290,216	\$295,182	\$302,799
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	1.948	1.982	2.027
Equals: Real Adjusted MPI	\$148,982	\$148,943	\$149,368
Percent Change from Prior Year	0.24%	(0.03)%	0.29%
Excess Over 2.0%	0.00%	0.00%	0.00%
		FY 2006-07	FY 2007-08
Multiplied by: Estimated GF/GP Revenue	\$8,266.7	\$8,162.9	\$6,947.5
Equals: Transfer to the BSF		\$0.0	\$0.0
OR Transfer from the BSF		\$2.1	\$0.0
Note: Numbers may not add due to rounding. CY = Calendar Year; FY = Fiscal Year			

COMPLIANCE WITH STATE REVENUE LIMIT

THE 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 new State revenue being generated as part of the school financing reform that was enacted in 1994. In FY 1995-96 through FY 1997-98, revenue fell below the revenue limit again. In FY 1998-99 and FY 1999-2000, revenue exceeded the limit, but not by enough to require refunds to be paid to taxpayers. In FY 2000-01 through FY 2004-05, 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 revenue limit in FY 2005-06 and will remain well below the limit in FY 2006-07 and FY 2007-08.

REVENUE LIMIT CALCULATION

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 2006-07, State government revenue may not exceed 9.49% of personal income for calendar year 2005. Given that Michigan personal income for 2005 equaled \$331,304 million, the revenue limit for FY 2006-07 is \$31,441 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 1.0%, the excess revenue must be deposited into the Budget Stabilization Fund. If the revenue limit is exceeded by 1.0% or more, the excess revenue must be refunded to income tax and 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 final data for FY 2004-05, preliminary year-end data for FY 2005-06, and the SFA's revised revenue estimates for FY 2006-07 and initial estimates for FY 2007-08, 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 2005-06 through FY 2007-08 are presented in Table 11.

FY 2004-05

Based on final data from the Department of Management and Budget, revenue subject to the revenue limit totaled an estimated \$25.6 billion in FY 2004-05 and, based on Michigan's personal income for calendar year 2003, the revenue limit equaled \$29.8 billion. As a result, revenue fell below the revenue limit by \$4.2 billion, or 14.1%, in FY 2004-05.

FY 2005-06

Based on preliminary year-end data for FY 2005-06, it is estimated that revenue subject to the revenue limit totaled \$25.9 billion. Michigan's personal income for 2004 established a revenue limit equal to \$30.8 billion for FY 2005-06. Therefore, based on the preliminary year-end estimate for revenue subject to the limit and the actual level for the revenue limit, it appears that revenue fell below the limit by \$4.8 billion, or 15.7%, in FY 2005-06.

FY 2006-07

Based on Michigan's personal income for calendar year 2005, the revenue limit in FY 2006-07 will equal \$31.4 billion. Revenue subject to the limit will total an estimated \$26.3 billion in FY 2006-07, based on the SFA's revised revenue estimates. As a result, it is estimated that revenue will fall short of the revenue limit by \$5.2 billion, or 16.4%, in FY 2006-07.

FY 2007-08

In FY 2007-08, the revenue limit will equal 9.49% of Michigan's personal income in calendar year 2006. The SFA estimates that Michigan's personal income equaled \$345.1 billion in 2006, so the revenue limited is estimated at \$32.8 billion. Based on the SFA's initial revenue estimates for FY 2007-08, revenue subject to the limit will total \$25.6 billion. As a result, it is estimated that revenue subject to the limit will fall below the revenue limit in FY 2007-08 by \$7.2 billion or 21.9%. This estimate includes the loss of \$1.2 billion that will be lost in FY 2007-08 due to the enacted repeal of the single business tax effective December 31, 2007. If all of this revenue is replaced by some other tax or taxes, then revenue subject to the revenue limit will fall below the limit in FY 2007-08 by an estimated \$5.9 billion or 18.1%.

Table 11

**COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT
SECTION 26 OF ARTICLE IX OF THE STATE CONSTITUTION
(Millions of Dollars)**

	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08
	Final	Preliminary	Estimate	Estimate¹⁾
<u>Revenue Subject to Limit:</u>				
Revenue:				
General Fund/General Purpose (baseline)	\$8,163.3	\$8,182.4	\$8,201.4	\$8,326.7
Revenue Sharing (baseline)	1,618.3	1,645.9	1,659.6	1,698.4
School Aid Fund (baseline)	10,914.6	11,089.8	11,266.4	11,543.7
Transportation Funds	2,215.9	2,238.5	2,313.0	2,390.0
Other Restricted Non-Federal Aid Revenue	2,609.9	2,750.0	2,900.0	3,000.0
Adjustments:				
GF/GP Federal Aid	(35.7)	(20.0)	(20.0)	(20.0)
GF/GP Balance Sheet Adjustments	145.5	51.3	(41.3)	(1,379.2)
SAF Balance Sheet Adjustments	(5.0)	(7.0)	(7.6)	19.0
Total Revenue Subject to Limit:	\$25,626.8	\$25,930.9	\$26,271.5	\$25,578.6
<u>Revenue Limit:</u>				
Personal Income:				
Calendar Year	CY 2003	CY 2004	CY 2005	CY 2006
Amount	\$314,460	\$324,134	\$331,304	\$345,103
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	\$29,842.3	\$30,760.3	\$31,440.7	\$32,750.3
1.0% of Limit	298.4	307.6	314.4	327.5
Amount Under (Over) Limit	\$4,215.5	\$4,829.4	\$5,169.2	\$7,171.7
Percent Below Limit	14.1%	15.7%	16.4%	21.9%
¹⁾ If the SBT and insurance tax revenue is fully replaced in FY 2007-08, then the revenue subject to the revenue limit will equal an estimated \$26,813.7 million, which will fall below the revenue limit by an estimated \$5,936.6 million.				

ESTIMATE OF YEAR-END BALANCES

This section of the Senate Fiscal Agency's (SFA's) report provides details of the estimated year-end balances of the General Fund/General Purpose (GF/GP) budget and School Aid Fund (SAF) budget for FY 2005-06 and FY 2006-07. This section of the report also contains a review of the issues that the Governor and the Legislature will be facing in the development and enactment of the FY 2007-08 State budget.

Table 12 provides a summary of the estimated year-end balances for the FY 2005-06 and FY 2006-07 GF/GP and SAF budgets. The final accounting of revenue and expenditures for FY 2005-06 has not been completed, but the SFA is estimating that when the FY 2005-06 book-closing process is completed, the GF/GP budget will have a \$7.0 million year-end balance and the SAF budget will close with a zero year-end balance. Pursuant to statutory authorization, the final level of the FY 2005-06 GF/GP and SAF year-end balances will carry forward into FY 2006-07. A comparison of the current SFA estimates of FY 2006-07 GF/GP revenue and expenditures leads to a projected \$489.7 million budget deficit. A comparison of the current SFA estimates of FY 2006-07 SAF revenue and expenditures leads to a projected \$367.7 million budget deficit.

The initial look ahead at the FY 2007-08 GF/GP budget leads to the conclusion that substantial adjustments will have to be made on either the revenue side or the expenditure side of the budget to ensure a balance between estimated revenue and appropriations. In regard to the FY 2007-08 SAF budget, appropriation growth will be limited due to continued projected weakness in State revenue collections dedicated to the SAF. The final parameters of both the FY 2007-08 GF/GP and SAF budgets will depend to a large degree on the decisions that are made to eliminate the projected FY 2006-07 budget deficits.

Table 12

GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND ESTIMATED YEAR-END BALANCES (Millions of Dollars)		
	FY 2005-06 Estimate	FY 2006-07 Estimate
General Fund/General Purpose	\$7.0	\$(489.7)
School Aid Fund	0.0	(367.7)

FY 2005-06 YEAR-END BALANCE

As of January 8, 2007, the Office of the State Budget (OSB) had not completed the final accounting of FY 2005-06 revenue and expenditures. Once this final accounting is completed, the State will publish the FY 2005-06 Comprehensive Annual Financial Report. State law requires that a preliminary unaudited accounting of FY 2005-06 revenue and expenditures be transmitted to the Legislature by January 29, 2007, and that the Comprehensive Annual Financial Report be published by April 1, 2007.

Based on the year-to-date accounting of FY 2005-06 GF/GP revenue and expenditures, the SFA is now estimating that the GF/GP budget will close the year with a \$7.0 million balance. The SFA is estimating that the FY 2005-06 SAF budget will close the year with a zero balance.

Table 13 provides a summary of the current SFA estimate of a \$7.0 million year-end balance in the FY 2005-06 GF/GP budget. Pursuant to statutory requirements the actual level of the FY 2005-06 year-end balance will carry forward and be available as an FY 2006-07 GF/GP revenue source.

This \$7.0 million FY 2005-06 GF/GP year-end balance estimate is \$102.6 million lower than the estimate developed in July 2006 that was the basis for the FY 2006-07 GF/GP budget.

Table 13
FY 2005-06
General Fund/General Purpose
Revenue, Expenditures, and Year-End Balance
(Millions of Dollars)

	Jan. 2007 SFA Estimate
Revenue	
Beginning Balance.....	\$ 220.5
Ongoing Revenue Estimate.....	\$8,266.7
Revenue Sharing Adjustments	543.0
Total Revenue	\$9,030.2
Expenditures	
Initial Appropriations	\$8,975.7
<u>Enacted Supplemental Appropriations:</u>	
PA 226 of 2005	1.0
PA 297 of 2005	4.9
PA 4 of 2006	0.0
PA 153 of 2006	22.2
PA 176 of 2006	0.0
PA 345 of 2006	52.8
Subtotal Supplemental Appropriations	80.9
Enacted Appropriations	\$9,056.6
<u>Book-Closing Adjustments:</u>	
Corrections Overexpenditure	19.6
Human Services Overexpenditure	42.9
State Police Overexpenditure	6.6
Appropriation Lapses	(98.1)
Other Book-Closing Adjustments	(4.4)
Total Book-Closing Adjustments	(33.4)
Total Expenditures	\$9,023.2
Projected Year-End Balance	\$ 7.0

Projected FY 2005-06 GF/GP revenue will total \$9.03 billion. This represents a \$123.8 million or 1.4% increase over the final level of FY 2004-05 GF/GP revenue. Projected FY 2005-06 GF/GP expenditures will total \$9.02 billion. This represents a \$337.3 million or 3.9% increase over the final level of FY 2004-05 GF/GP expenditures.

The projected level of FY 2005-06 GF/GP revenue includes three principal types of revenue. The first is \$220.5 million of surplus revenue carried forward from FY 2004-05. The second is \$8.27 billion of ongoing revenue. This estimate of ongoing FY 2005-06 revenue represents a \$53.9 million or 0.6% decline from the final level of FY 2004-05 ongoing revenue collections. The third type of revenue collected is \$543.0 million from a freeze in revenue sharing payments to cities, villages, and townships.

The projected level of FY 2005-06 GF/GP expenditures includes three principal types of expenditures. The first is the \$8.98 billion of initial appropriations approved at the beginning of the fiscal year. During the fiscal year, a total of six supplemental appropriation bills were enacted; in total, the books increased GF/GP appropriations by \$80.9 million. The final type of expenditure

adjustment involves book-closing adjustments. These include approximately \$98.1 million of appropriation lapses offset by a total of \$69.1 million of appropriation overexpenditures in the Departments of Corrections, Human Services, and State Police. Other miscellaneous book-closing adjustments are expected to increase the final level of the year-end balance by \$4.4 million.

Table 14 provides a summary of the SFA estimate of a zero balance in the FY 2005-06 SAF budget. Pursuant to statutory requirements, the actual level of the FY 2005-06 year-end balance will carry forward and be available as an FY 2006-07 SAF revenue source. This zero FY 2005-06 year-end balance estimate is \$93.8 million lower than the estimate developed in July 2006 that was the basis for the FY 2006-07 SAF budget.

Table 14
FY 2005-06
School Aid Fund
Revenue, Expenditures, and Year-End Balance
(Millions of Dollars)

	Jan. 2007 SFA Estimate
Revenue:	
Beginning Balance.....	\$ 93.7
Ongoing Revenue Estimate.....	11,082.1
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.....	<u>1,392.6</u>
Subtotal Other Revenue Adjustments.....	1,502.8
Total Revenue.....	12,678.6
Expenditures:	
Enacted Appropriations.....	\$12,757.2
Supplemental Appropriation (PA 342 of 2006).....	(56.5)
Bookclosing Adjustments.....	(22.1)
Total Expenditures.....	\$12,678.6
Projected Year-End Balance.....	\$ 0.0

Projected FY 2005-06 SAF revenue will total \$12.68 billion. This represents a \$154.9 million or 1.2% increase over the final level of FY 2004-05 SAF revenue. Projected FY 2005-06 SAF expenditures will total \$12.68 billion. This represents a \$248.6 million or 2.0% increase over the final level of FY 2004-05 SAF expenditures.

The projected level of FY 2005-06 SAF revenue includes four principal sources of revenue. The first is \$93.7 million of surplus revenue carried forward from FY 2004-05. The second is \$11.08 billion of ongoing revenue. This estimate of ongoing revenue represents a \$172.3 million or 1.6% increase from the final level of FY 2004-05 ongoing revenue collections. Other revenue adjustments include \$62.7 million of GF/GP revenue, \$44.5 million of revenue from an enacted reform in the School Bond Loan Fund, and \$3.0 million of revenue receivable from a prior fiscal year. The final source of SAF revenue is \$1.39 billion of appropriated Federal revenue.

The projected level of FY 2005-06 SAF expenditures includes three principal types of expenditures. The first is the \$12.76 billion of appropriations approved at the beginning of the fiscal year. During the fiscal year a supplemental appropriation bill was enacted, reducing SAF

appropriations by \$56.5 million. Finally, a variety of book-closing accounting adjustments are expected to reduce overall final expenditures by \$22.1 million.

FY 2006-07 YEAR-END BALANCE

During August 2006, the Legislature approved and the Governor signed into law FY 2006-07 GF/GP and SAF budgets that were balanced between estimated revenue and expenditures. Due to the continuing weakness in the Michigan economy since August 2006 along with several adjustments to the enacted budget, the SFA now is estimating that both the FY 2006-07 GF/GP and SAF budgets are significantly in deficit. The SFA estimates that the FY 2006-07 GF/GP budget is in deficit by \$489.7 million and the FY 2006-07 SAF budget is in deficit by \$367.7 million. This projected combined budget deficit of \$857.4 million will have to be addressed by the Governor and the Legislature early in 2007.

Table 15 provides a summary of the SFA estimate of a \$489.7 million deficit in the FY 2006-07 GF/GP budget. Three principal factors lead to this projected budget deficit: a reduced level of a budget balance carried forward from the prior fiscal year, a substantial downward revision in the estimate of ongoing revenue, and a projected revenue shortfall in tobacco settlement revenue.

Table 15
FY 2006-07
General Fund/General Purpose
Revenue, Expenditures, and Year-End Balance
(Millions of Dollars)

	Jan. 2007 SFA Estimate
Revenue	
Beginning Balance.....	\$ 7.0
Ongoing Revenue Estimate.....	8,162.8
Revenue Sharing Freeze.....	567.3
<u>Non-Ongoing Revenue Adjustments:</u>	
Land Sales.....	28.0
Shift of Short-Term Borrowing Costs to School Aid Fund.....	22.8
Liquor Purchase Revolving Fund Transfer to GF/GP.....	4.0
Consumer Finance Fees Transfer to GF/GP.....	7.0
Subtotal Non-Ongoing Revenue.....	61.8
Total Revenue	\$8,798.9
Expenditures	
Enacted Appropriations.....	\$9,222.8
Tobacco Settlement Revenue Shortfall.....	65.8
Total Expenditures	\$9,288.6
Projected Year-End Balance.....	\$ (489.7)

Projected FY 2006-07 GF/GP revenue totals \$8.80 billion. This represents a \$231.3 million or 2.6% decline from the projected level of FY 2005-06 revenue. The FY 2006-07 revenue estimate includes revenue carried forward from FY 2005-06, ongoing revenue, and non-ongoing revenue adjustments. The estimate of revenue carried forward from FY 2005-06 is now \$7.0 million. This represents a \$102.6 million decline from the level assumed in the enacted budget. The current SFA estimate of ongoing revenue is \$8.16 billion. This estimate represents a \$300.9 million or 3.6% decline from the May 2006 consensus revenue estimate, which was the basis of the enacted budget. The current SFA estimate of FY 2006-07 GF/GP ongoing revenue is \$103.9 million or a 1.3% decline from the projected level of FY 2005-06 ongoing revenue.

The SFA has adjusted its estimate of the GF/GP revenue generated from a freeze in revenue sharing payments to cities, villages, and townships. This estimate is now \$567.3 million, or \$17.7 million below the level assumed in the enacted budget. Other miscellaneous adjustments to sources of non-ongoing revenue total a decline of \$13.0 million from the level assumed in the enacted budget. In total, the current estimate of FY 2006-07 GF/GP revenue represents a decline of \$424.2 million from the level assumed in the enacted budget.

Projected FY 2006-07 GF/GP expenditures total \$9.29 billion. This represents a \$241.0 million or 2.7% increase from the projected level of FY 2005-06 expenditures. The estimated level of FY 2006-07 GF/GP expenditures includes the \$9.22 billion of appropriations currently enacted and a \$65.8 million expenditure problem resulting from an overappropriation of tobacco settlement revenue. The enacted FY 2006-07 GF/GP budget made certain assumptions regarding a resolution of a dispute between Michigan and two of the major companies involved in the tobacco settlement agreement. It was assumed that this payment dispute would be resolved in Michigan's favor during FY 2006-07. Based on information the SFA received from the Office of the Attorney General, it now looks like this dispute will not be resolved during the fiscal year. This results in a \$65.8 million overappropriation of tobacco settlement revenue.

On the expenditure side of the FY 2006-07 GF/GP budget, the SFA also is monitoring potential spending problems in several State departments. The fact that the Departments of Corrections, Human Services, and State Police overspent their FY 2005-06 appropriations leads to concerns about the adequacy of their FY 2006-07 appropriations. This issue, combined with the potential impact of the continuing struggles in the Michigan economy on certain needs-based programs, bears close monitoring in the months ahead. At this time, the SFA estimates assume that State departments will make adjustments in programmatic spending to live within their current levels of GF/GP appropriations.

The projection of a \$489.7 million FY 2006-07 GF/GP budget deficit provides an indication of the challenges that Governor Granholm and the Legislature will face in balancing the budget in the months ahead. The options available to eliminate the deficit include appropriation reductions, revenue increases, and other potential adjustments. The size of the deficit, which equates to 5.3% of the enacted appropriations, leads to a significant challenge. The other factor to consider in meeting this challenge is that as of January 1, 2007, one quarter of the fiscal year already was completed. This means that the potential budget-balancing yield from appropriation reductions or revenue increases is diminished as final decisions to balance the budget are delayed.

Table 16 provides a summary of the SFA estimate of a \$367.7 million deficit in the FY 2006-07 SAF budget. Four principal factors lead to this projected budget deficit: 1) a reduced level of budget balance carried forward from the prior fiscal year, 2) a substantial downward revision in the estimate of ongoing revenue, 3) the settlement of a large property tax assessment case, and 4) other adjustments in the enacted budget.

Projected FY 2006-07 SAF revenue totals \$12.71 billion. This represents a \$31.2 million or 0.2% increase from the projected level of FY 2005-06 revenue. The estimate of revenue carried forward from FY 2005-06 is now zero. This represents a \$93.8 million decline from the level assumed in the enacted budget. The current SFA estimate of ongoing revenue is \$11.28 billion. This represents a \$288.8 million or 2.5% decline from the May 2006 consensus revenue estimate, which was the basis of the enacted budget. The SFA is estimating that FY 2006-07 SAF revenue will be reduced by \$17.2 million as a result of the settlement of a large property tax assessment case in Midland County. The revenue loss represents the impact on the six-mill State education property tax from the assessment settlement.

Table 16
FY 2006-07
School Aid Fund
Revenue, Expenditures, and Year-End Balance
(Millions of Dollars)

	Jan. 2007 SFA Estimate
Revenue	
Beginning Balance	\$ 0.0
Consensus Revenue Estimate	11,280.8
Midland Property Tax Case	(17.2)
GF/GP Grant.....	35.0
Federal Aid	1,411.2
Total Revenue	\$12,709.8
Expenditures	
Enacted Appropriations	\$13,093.8
Midland Property Tax Case	44.2
Appropriation Lapses.....	(60.5)
Total Expenditures	\$13,077.5
Projected Year-End Balance.....	\$ (367.7)

Projected FY 2006-07 SAF expenditures total \$13.08 billion. This represents a \$399.5 million or 3.2% increase from the projected level of FY 2006-07 expenditures. There are two assumed changes to the enacted level of FY 2006-07 SAF appropriations. The first is a \$44.2 million expenditure impact from the property tax assessment case in Midland County. This additional spending in the SAF budget results from the State's picking up the local revenue loss from the property tax case to ensure that the local school district gets its full funding of the basic foundation allowance. The second expenditure adjustment involves revised cost estimates of funding the basic foundation allowance and special education costs. The actual expenditure of appropriations on these programs is affected by the number of pupils enrolled in school and the taxable value of property in the State. The SFA is now estimating \$60.5 million savings from these adjustments. The largest factor in the savings is that the number of pupils enrolled in school during the fall of 2006 appears to be 7,800 lower than the level assumed in the budget. The enacted budget assumed a 7,000 pupil reduction from the prior school year and the actual reduction is approximately 14,800.

The State School Aid Act, which provides for the appropriation of funds to K-12 school districts, public school academies, and intermediate school districts, contains a mechanism to eliminate the projected \$367.7 million SAF budget deficit. This mechanism is a prorated reduction in the basic foundation allowance. The prorated reduction is triggered after the State Treasurer notifies the State Budget Director of a projected deficit in the SAF budget. The State Budget Director then notifies the Legislature of the prorated reduction. The prorated reduction then will take effect after 30 calendar days, unless the Legislature enacts an alternative plan to balance the SAF budget. If the projected FY 2006-07 SAF budget deficit is eliminated with this prorated reduction, the reduction equates to \$218 per pupil. The enacted FY 2006-07 SAF budget provides for a \$210 increase in the basic foundation allowance above the level funded in FY 2005-06.

FY 2007-08 KEY BUDGET ISSUES

Governor Granholm is required to submit her recommendations for the FY 2007-08 State budget to the Legislature by February 10, 2007. The SFA estimate of restrained revenue growth in FY 2007-08 combined with difficult-to-avoid spending pressures in the State budget will lead to major challenges facing the Governor and the Legislature as the FY 2007-08 State budget is developed and enacted. The FY 2007-08 budget also will be affected by decisions made to replace revenue lost as a result of the repeal of the single business tax on December 31, 2007. The final parameters of the FY 2007-08 GF/GP and SAF budgets will be significantly affected by decisions made by the Governor and the Legislature to eliminate sizable deficits in the FY 2006-07 budget. Almost certainly, decisions made to eliminate the FY 2006-07 budget deficits will continue into FY 2007-08 and help shape the final form of the enacted budget.

Of the potential issues facing the FY 2007-08 GF/GP budget, the first significant issue involves the level of business taxes collected. During FY 2006-07, the SFA is estimating that GF/GP revenue from the combination of the single business tax and the insurance company premium tax will total \$2.07 billion. Under current law, with the single business tax repealed on December 31, 2007, the single business tax and the insurance company premium tax will contribute \$845.9 million in GF/GP revenue in FY 2007-08. This represents a GF/GP revenue decline of \$1.23 billion. The resolution of the business tax replacement package will be a key factor in determining the condition of the FY 2007-08 GF/GP budget.

Table 17 provides an overview of the potential problems facing the FY 2007-08 GF/GP budget. The table assumes that FY 2007-08 GF/GP revenue will total \$8.78 billion. This number includes the SFA's FY 2007-08 GF/GP revenue estimates, combined with the assumption of full replacement of business tax revenue, and an additional freeze in the amount of revenue sharing payments to cities, villages, and townships. If this \$8.78 billion of FY 2007-08 GF/GP revenue is compared with the current level of FY 2006-07 GF/GP appropriations of \$9.22 billion, an imbalance of \$438.3 million results.

Table 17

FY 2007-08 Budget Outlook General Fund/General Purpose (Millions of Dollars)	
	Jan. 2007 SFA Estimate
Projected Revenue	
Beginning Balance	\$ 0.0
Estimated Ongoing Revenue	6,947.5
Full SBT Revenue Replacement Assumption.....	1,235.1
Revenue Sharing Freeze Continuation	601.9
Total Estimated Revenue	\$8,784.5
Potential Appropriations	
Freeze of FY 2007-08 Appropriations at FY 2006-07 Levels	<u>\$9,222.8</u>
Potential Imbalance.....	\$ (438.3)
<u>Other Potential Funding Issues:</u>	
Tobacco Securitization Debt Service Payments	\$ 49.0
Tobacco Settlement Revenue for 21 st Century Jobs Fund	75.0
Increased Debt Service on State GO and SBA Bonds	40.0
Economic Costs of State Employee Salary and Fringe Benefits	130.0
Subtotal Appropriations	\$9,516.8
Imbalance Between Revenue and Appropriations	<u><u>\$(732.3)</u></u>

The level of FY 2007-08 GF/GP appropriations will be affected by several other factors, as well. These factors include \$49.0 million of debt service payments on tobacco securitization bonds, the dedication of an additional \$75.0 million of tobacco settlement revenue to the 21st Century Jobs Fund, a projected \$40.0 million increase in debt service payments on General Obligation and State Building Authority bonds, and \$130.0 million of projected State civil service employee costs resulting from already-negotiated State employee salary packages and projected fringe benefit costs. Adding these appropriation items leads to a \$732.3 million imbalance between projected FY 2007-08 GF/GP revenue and appropriations. This budget outlook assumes no funding increases for universities and community colleges and does not include funding for potential inmate population increases in the Department of Corrections or caseload increases the Department of Community Health. During FY 2007-08 potential GF/GP cost increases in the Medicaid budget are expected to be largely offset by an increase in the Federal Medicaid match rate received by Michigan.

In summary, the FY 2007-08 GF/GP budget likely will be marked by significant fiscal restraint. The final parameters of the budget will be determined by the resolution of the business tax replacement debate combined with decisions made to balance the FY 2006-07 GF/GP budget. Absent significant overall increases in State revenue, as a result of tax policy changes, the FY 2007-08 GF/GP budget likely will be characterized by reductions in State appropriations.

Table 18 provides an overview of the potential problems facing the FY 2007-08 SAF budget. The table assumes that FY 2007-08 SAF revenue will total \$13.0 billion. This number includes the SFA's FY 2007-08 SAF revenue estimate, an assumed continuation of the \$35.0 million GF/GP grant to the SAF enacted in FY 2006-07, and a continuation of the level of Federal aid appropriated in FY 2006-07. Comparing this level of FY 2007-08 SAF revenue with a freeze in the level of SAF appropriations at the FY 2006-07 level leads to a \$68.5 million imbalance. As previously discussed regarding the outlook for the FY 2007-08 GF/GP budget, the final level of the FY 2007-08 SAF budget will depend on decisions made to eliminate the projected \$367.7 million deficit in the FY 2006-07 SAF budget.

Table 18

FY 2007-08 Budget Outlook School Aid Fund (Millions of Dollars)	
	Jan. 2007 SFA Estimate
Projected Revenue	
Beginning Balance.....	\$ 0.0
Estimated Ongoing Revenue.....	11,562.8
GF/GP Grant at FY 2006-07 Level.....	35.0
Federal Aid	1,411.2
Total Estimated Revenue.....	\$13,009.0
Potential Appropriations	
Freeze FY 2007-08 Appropriations at FY 2006-07 Levels.....	\$13,077.5
Estimated Imbalance with Appropriation Freeze	\$ (68.5)