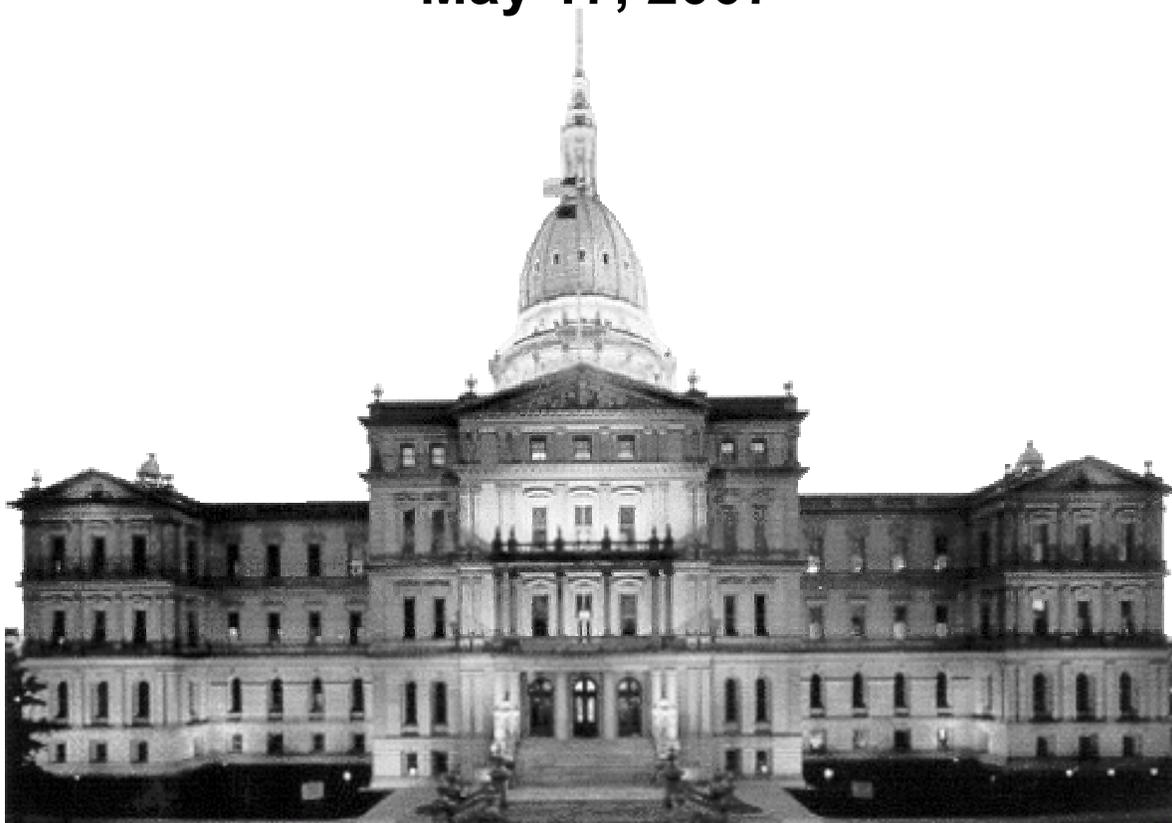




**MICHIGAN'S  
ECONOMIC OUTLOOK  
AND BUDGET REVIEW**

**FY 2006-07 AND FY 2007-08**

**May 17, 2007**



# THE SENATE FISCAL AGENCY

The Senate Fiscal Agency is governed by a board of five members, including the majority and minority leaders of the Senate, the Chairperson of the Appropriations Committee of the Senate, and two other members of the Appropriations Committee of the Senate appointed by the Chairperson of the Appropriations Committee with the concurrence of the Majority Leader of the Senate, one from the minority party.

The purpose of the Agency, as defined by statute, is to be of service to the Senate Appropriations Committee and other members of the Senate. In accordance with this charge, the Agency strives to achieve the following objectives:

1. To provide technical, analytical, and preparatory support for all appropriations bills.
2. To provide written analyses of all Senate bills, House bills, and Administrative Rules considered by the Senate.
3. To review and evaluate proposed and existing State programs and services.
4. To provide economic and revenue analysis and forecasting.
5. To review and evaluate the impact of Federal budget decisions on the State.
6. To review and evaluate State issuance of long-term and short-term debt.
7. To review and evaluate the State's compliance with constitutional and statutory fiscal requirements.
8. To prepare special reports on fiscal issues as they arise and at the request of members of the Senate.

The Agency is located on the 8th floor of the Victor Office Center. The Agency is an equal opportunity employer.



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## ***ACKNOWLEDGEMENT***

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## **EXECUTIVE SUMMARY**

### **ECONOMIC FORECAST**

The U.S. economy, as measured by inflation-adjusted gross domestic product, is predicted to grow 1.9% in 2007 and 2.9% in 2008. Light vehicle sales are forecasted to decline slightly to 16.3 million units in 2007 before rising back to 16.6 million units in 2008. The unemployment rate is expected to increase slightly to 4.7% in both 2007 and 2008, while the consumer price index is estimated to grow by 2.1% in 2007 and 2.2% in 2008.

The Michigan economy, as measured by inflation-adjusted personal income, is estimated to decline 0.4% in 2007 before growing 0.1% in 2008. Wage and salary employment is predicted to decline 1.9% during 2007 and to fall another 1.7% in 2008.

### **REVENUE FORECAST**

Lower-than-expected tax collections during the first half of fiscal year (FY) 2006-07 and economic activity forecast through FY 2007-08 that is weaker than was forecasted in January 2007, translate into a downward revision in the revenue estimates for both FY 2006-07 and FY 2007-08.

In FY 2006-07, General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue will total an estimated \$19.31 billion, which is down 0.2% from FY 2005-06. Compared with the January 2007 consensus estimate, this revised estimate is down \$149.1 million. General Fund/General Purpose revenue will total an estimated \$8.22 billion, which is down 0.5% from last year, and SAF revenue will increase an estimated 0.1% to \$11.09 billion. Compared with the January 2007 consensus estimate, the GF/GP revenue estimate is down \$6.7 million and the SAF revenue estimate is down \$142.4 million.

In FY 2007-08, GF/GP and SAF revenue will total an estimated \$18.2 billion, which is down 5.8% from the revised estimate for FY 2006-07. This significant decline is due to the repeal of the single business tax at the end of 2007. If it is assumed that single business tax revenue is fully replaced, then FY 2007-08 GF/GP and SAF revenue will total an estimated \$19.42 billion, representing a 0.6% increase from FY 2006-07. General Fund/General Purpose revenue will decline an estimated 15.9% to \$6.91 billion due to the repeal of the single business tax. If this business tax revenue is fully replaced, then GF/GP revenue will equal an estimated \$8.13 billion. School Aid Fund revenue will increase an estimated 1.8% to \$11.28 billion. Compared with the January consensus estimate, the GF/GP revenue estimate has been lowered \$95.3 million and the SAF estimate has been reduced \$248.3 million.

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

Based on the Senate Fiscal Agency's (SFA's) revised estimates of FY 2006-07 revenue and actual and projected appropriations, the SFA now believes that the GF/GP budget is in deficit by \$221.9 million. A comparison of estimated FY 2006-07 SAF revenue and appropriations leads to a projected \$197.4 million deficit.

Comparing the Governor's FY 2007-08 GF/GP appropriation recommendations with current law estimated revenue, adjusted for an assumed full replacement of the single business tax, results in a \$912.2 million deficit. A comparison of the FY 2007-08 SAF appropriation recommendations of the Governor and current law estimated revenue results in a \$576.8 million deficit. The Governor's FY 2007-08 budget recommendations included several proposed tax increases that have not been factored into these projected budget deficits.

**EXECUTIVE SUMMARY**

**SENATE FISCAL AGENCY  
ECONOMIC AND BUDGET SUMMARY**

<b>ECONOMIC PROJECTIONS (Calendar Year)</b>				
	<b>2005 Actual</b>	<b>2006 Actual</b>	<b>2007 Estimate</b>	<b>2008 Estimate</b>
Real Gross Domestic Product (% change).....	3.2%	3.3%	1.9%	2.9%
U.S. Consumer Price Index (% change).....	3.4%	3.2%	2.1%	2.2%
Light Motor Vehicle Sales (millions of units).....	16.9	16.5	16.3	16.6
U.S. Unemployment Rate (%) .....	5.1%	4.6%	4.7%	4.7%
Real Michigan Personal Income (% change).....	0.5%	0.1%	(0.4)%	0.1%
Michigan Wage & Salary Employment (% change).....	(0.1)%	(1.1)%	(1.9)%	(1.7)%

<b>REVENUE ESTIMATES GENERAL FUND/GENERAL PURPOSE (GF/GP) AND SCHOOL AID FUND (SAF) (Millions of Dollars)</b>						
	<b><u>FY 2006-07 Estimate</u></b>			<b><u>FY 2007-08 Estimate</u></b>		
	<b>Baseline</b>	<b>Tax Changes</b>	<b>Net Available</b>	<b>Baseline</b>	<b>Tax Changes</b>	<b>Net Available</b>
Gen'l Fund/Gen'l Purpose.....	\$8,258.5	\$(35.2)	\$8,223.2	\$8,266.1	\$(1,351.3)	\$6,914.9
% Change .....	0.9%	---	(0.5)%	0.1%	---	(15.9)%
School Aid Fund.....	\$11,092.1	\$(4.4)	\$11,087.6	\$11,266.7	\$17.9	\$11,284.5
% Change .....	0.0%	---	0.1%	1.6%	---	1.8%
Total GF/GP and SAF.....	\$19,350.5	\$(39.6)	\$19,310.5	\$19,532.8	(1,333.4)	\$18,199.4
% Change .....	0.4%	---	(0.2)%	0.9%	---	(5.8)%
	<b><u>FY 2006-07 Estimate</u></b>			<b><u>FY 2007-08 Estimate</u></b>		
Revenue Limit - Under (Over):	\$5,415.9			\$7,372.4		

	<b>FY 2005-06 Actual</b>	<b>FY 2006-07 Estimate</b>	<b>FY 2007-08 Estimate</b>
General Fund/General Purpose.....	\$2.5	\$(221.9)	\$(912.2)
School Aid Fund.....	0.0	(197.4)	(576.8)
Budget Stabilization Fund.....	2.0	2.1	2.1

## **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, since the first quarter of 2006, the economy slowed markedly, averaging an annualized growth rate of only 2.1%. The slowdown has reflected lower levels of consumption, a substantial decline in residential investment spending, and for the last six months, weak business investment spending. Residential investment spending has fallen 16.7% over the last year. 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 interest 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%, 1.7%, and 1.8% in 2004, 2005, and 2006, respectively, 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 the gains of 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](#), although productivity has slowed in the last year, productivity has continued to rise in the durable goods manufacturing sector, a sector in which Michigan industry is disproportionately concentrated ([Figures 2](#) and [3](#)).

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

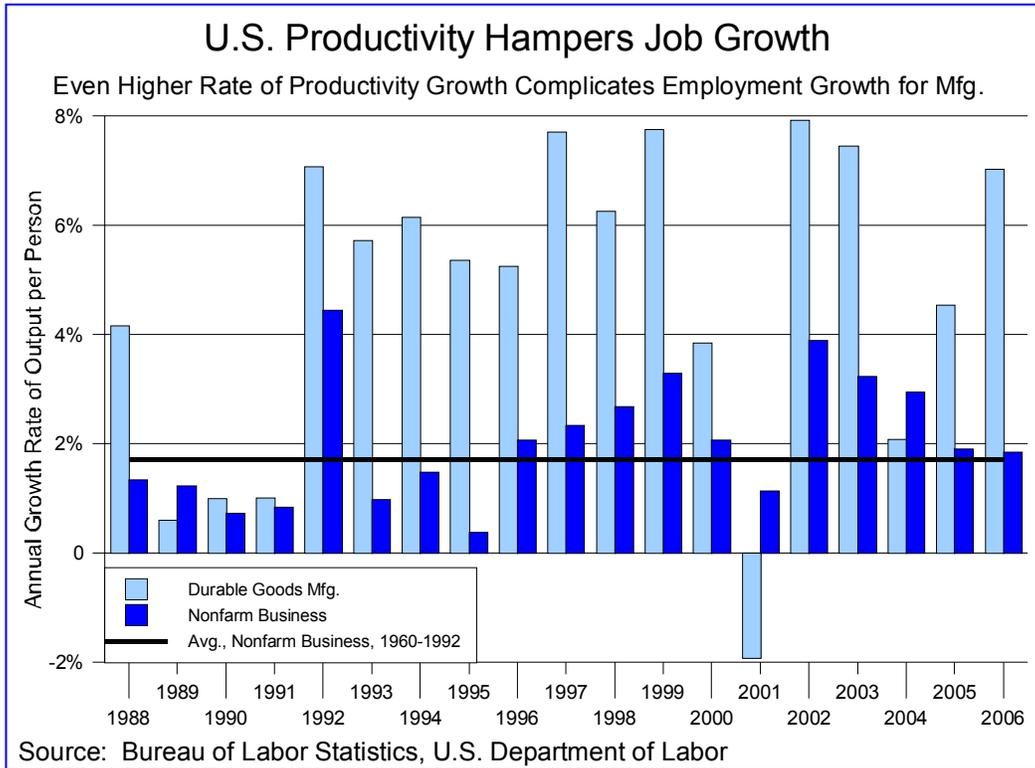
<b>United States</b>	<b>2004 Actual</b>	<b>2005 Actual</b>	<b>2006 Actual</b>	<b>2007 Estimate</b>	<b>2008 Estimate</b>
Nominal GDP (year-to-year growth)	6.9%	6.3%	6.3%	4.3%	5.3%
Inflation-Adjusted GDP (year-to-year growth)	3.9%	3.2%	3.3%	1.9%	2.9%
Unemployment Rate	5.5%	5.1%	4.6%	4.7%	4.7%
<b>Inflation</b>					
Consumer Price Index (year-to-year growth)	2.7%	3.4%	3.2%	2.1%	2.2%
GDP Implicit Price Deflator (year-to-year growth)	2.8%	3.0%	2.9%	2.3%	2.4%
<b>Interest Rates</b>					
90-day Treasury bill	1.37%	3.15%	4.73%	4.95%	5.03%
Corporate Aaa bond	5.63%	5.23%	5.59%	5.64%	6.18%
Federal funds rate	1.35%	3.22%	4.97%	5.38%	5.66%
<b>Light Motor Vehicle Sales</b>					
(millions of units)	16.9	16.9	16.5	16.3	16.6
Auto	7.5	7.7	7.8	7.6	7.7
Truck	9.4	9.3	8.7	8.8	8.9
Import Share	20.2%	20.1%	22.4%	24.3%	25.0%
<b>Michigan</b>					
Personal Income (millions)	\$320,261	\$331,349	\$341,710	\$347,012	\$354,387
Year-to-year growth	2.2%	3.5%	3.1%	1.6%	2.1%
Inflation-Adjusted Personal Income (year-to-year growth)	0.6%	0.5%	0.1%	-0.4%	0.1%
Wage & Salary Income (millions)	\$180,313	\$183,670	\$186,405	\$185,605	\$186,138
Year-to-year growth	2.0%	1.9%	1.5%	-0.4%	0.3%
Detroit Consumer Price Index (year-to-year growth)	1.6%	2.9%	3.0%	2.0%	2.0%
Wage & Salary Employment (thousands)	4,394.7	4,390.3	4,341.1	4,257.6	4,186.6
Year-to-year growth	(0.4)%	(0.1)%	(1.1)%	(1.9)%	(1.7)%
Unemployment Rate	7.0%	6.8%	6.9%	7.4%	7.8%

Table 2

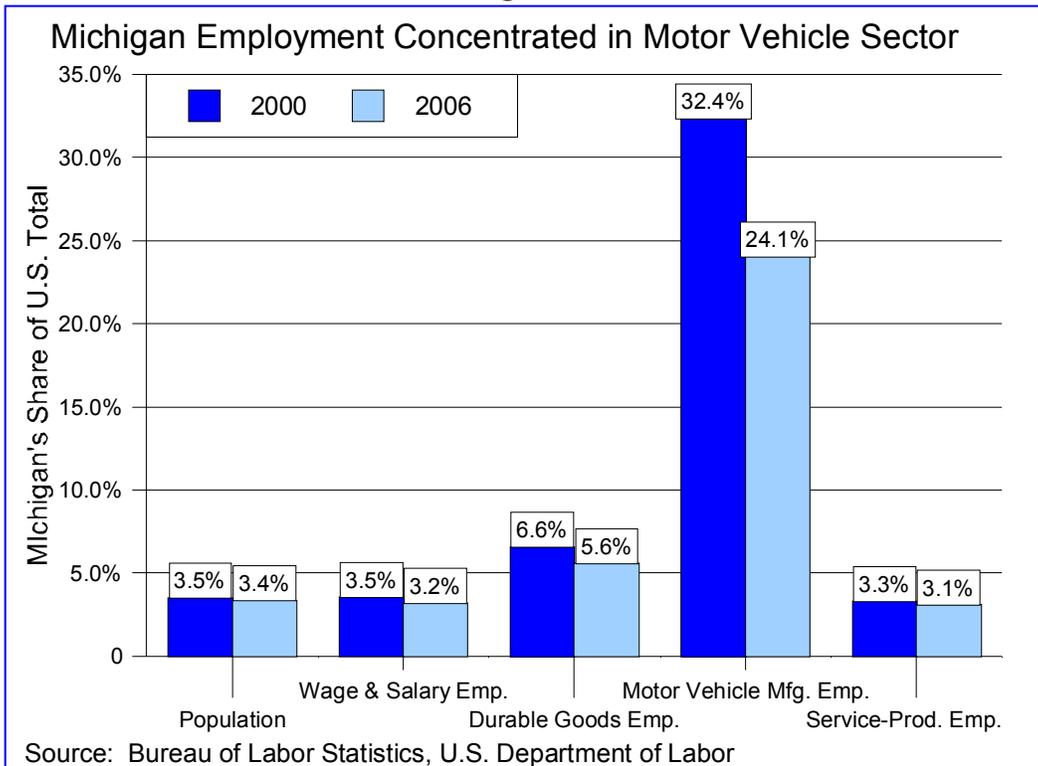
**THE SENATE FISCAL AGENCY U.S. ECONOMIC FORECAST DETAIL**  
(Calendar Years)

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>Actual</b>	<b>Actual</b>	<b>Actual</b>	<b>Estimate</b>	<b>Estimate</b>
Gross Domestic Product (billions of dollars)	\$11,712.5	\$12,455.8	\$13,246.6	\$13,810.5	\$14,546.8
Year-to-year growth	6.9%	6.3%	6.3%	4.3%	5.3%
<i><u>Inflation-Adjusted GDP and Components</u></i>					
Gross Domestic Product (billions of 2000 dollars)	\$10,703.5	\$11,048.6	\$11,415.3	\$11,636.1	\$11,967.9
Year-to-year growth	3.9%	3.2%	3.3%	1.9%	2.9%
Consumption (billions of 2000 dollars)	\$7,577.1	\$7,841.2	\$8,091.4	\$8,329.4	\$8,568.9
Year-to-year growth	3.9%	3.5%	3.2%	2.9%	2.9%
Business Fixed Investment (billions of 2000 dollars)	\$1,145.8	\$1,223.8	\$1,312.4	\$1,354.7	\$1,414.6
Year-to-year growth	5.9%	6.8%	7.2%	3.2%	4.4%
Change in Business Inventories (billions of 2000 dollars)	\$53.4	\$19.6	\$43.2	\$19.9	\$31.6
Residential Investment (billions of 2000 dollars)	\$559.9	\$608.0	\$582.2	\$493.1	\$499.2
Year-to-year growth	9.9%	8.6%	(4.2)%	(15.3)%	1.2%
Government Spending (billions of 2000 dollars)	\$1,940.6	\$1,958.0	\$1,998.4	\$2,045.4	\$2,077.0
Year-to-year growth	1.9%	0.9%	2.1%	2.4%	1.5%
Net Exports (billions of 2000 dollars)	(\$590.9)	(\$619.2)	(\$618.1)	(\$594.9)	(\$602.9)
Exports (billions of 2000 dollars)	\$1,120.4	\$1,196.1	\$1,302.8	\$1,406.4	\$1,513.4
Imports (billions of 2000 dollars)	\$1,711.3	\$1,815.3	\$1,920.9	\$2,001.3	\$2,116.2
Personal Income (year-to-year growth)	6.2%	5.2%	6.3%	4.9%	5.0%
Adjusted for Inflation	3.4%	1.7%	2.9%	2.8%	2.8%
Wage & Salary Income (year-to-year growth)	5.5%	5.1%	6.3%	4.9%	5.1%
Personal Savings Rate	2.0%	(0.4)%	(1.1)%	(1.5)%	(1.4)%
Capacity Utilization Rate	78.1%	80.2%	81.7%	80.9%	81.7%
Housing Starts (millions of units)	1.956	2.068	1.801	1.396	1.490
Conventional Mortgage Rates	5.8%	5.9%	6.4%	6.4%	6.7%
Federal Budget Surplus (billions of dollars, NIPA basis)	(\$382.0)	(\$309.2)	(\$153.6)	(\$171.5)	(\$219.2)

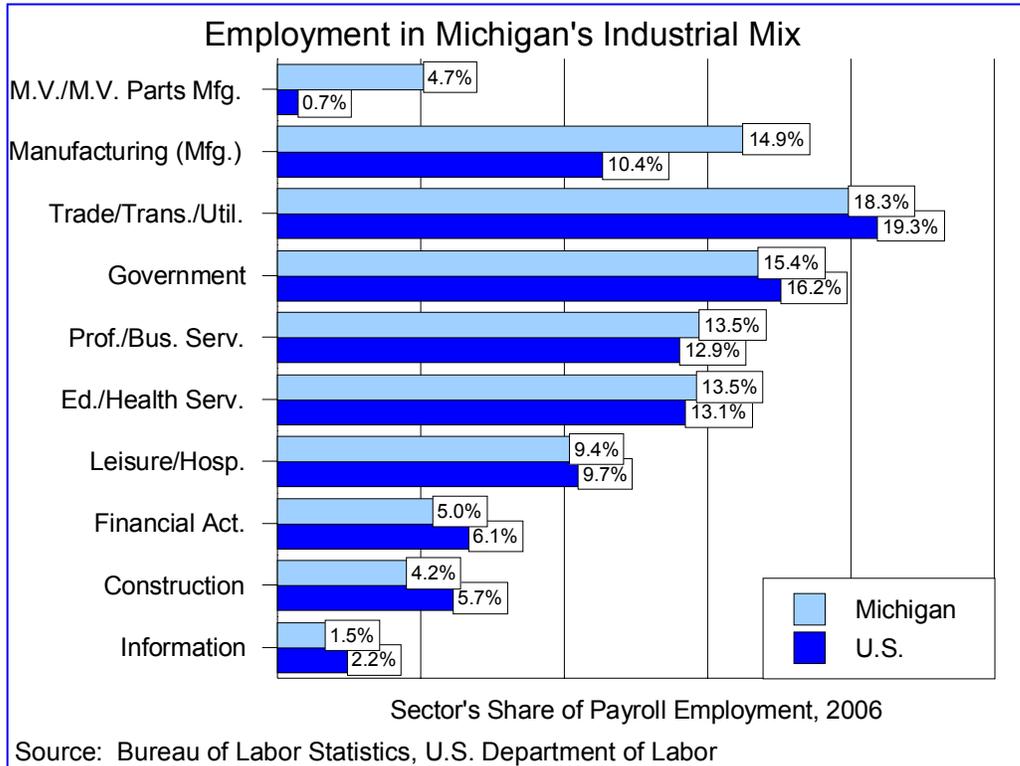
**Figure 1**



**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 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 43.3% 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 1.3% of private sector wages and salaries paid nationally, but 10.7% of wages and salaries paid in Michigan ([Figure 4](#)). As a result, economic downturns (from either declining employment or business profits) in the motor vehicle sector are transmitted and multiplied throughout the Michigan economy, just as any national or local economic shock is transmitted through the affected economies, but will have a greater proportional impact on Michigan than any other state or the nation as a whole ([Figure 5](#)).

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) 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.

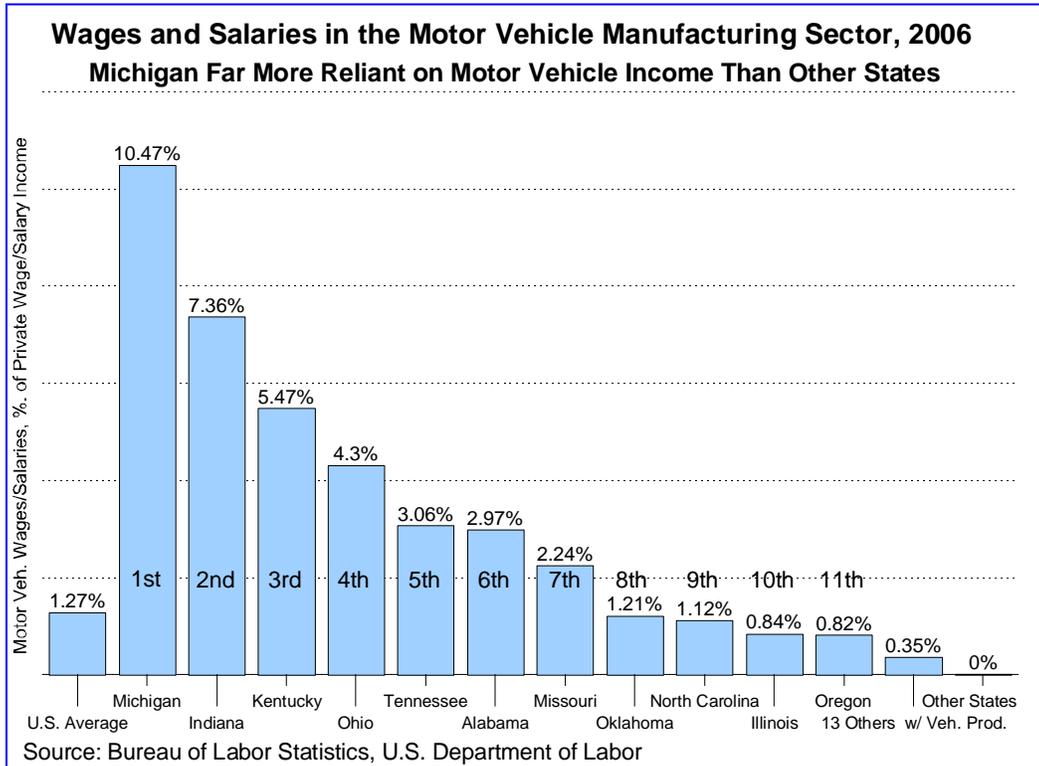
### **FORECAST SUMMARY**

Both the U.S. and Michigan economies are expected to continue growing in 2007 and 2008 ([Figure 6](#)). [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 1.9% in 2007 and 2.9% 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 6 and 7](#)). Furthermore, the sectors expected to exhibit the largest gains in employment generally pay wages below those in the sectors with the slowest growth ([Figures 8 and 9](#)). Inflation-adjusted personal income is projected to fall 0.4% in 2007 before growing a meager 0.1% in 2008. On an annual basis, wage and salary employment is forecasted to fall 1.9% in 2007 and 1.7% 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 16.6 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 6.9% in 2006 to 7.4% in 2007 and 7.8% in 2008, keeping the Michigan unemployment rate above the national average.

Compared with the January 18, 2007, Consensus Economic Forecast, the U.S. forecast is slightly weaker in 2007 while the Michigan forecast is noticeably weaker. 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 January, and are now expected to decline during 2007. Inflation measures in 2007 are expected to rise at about the same levels predicted in January, although the underlying economic pressures to increase inflation are expected to be more substantial.

**Figure 4**



**Figure 5**

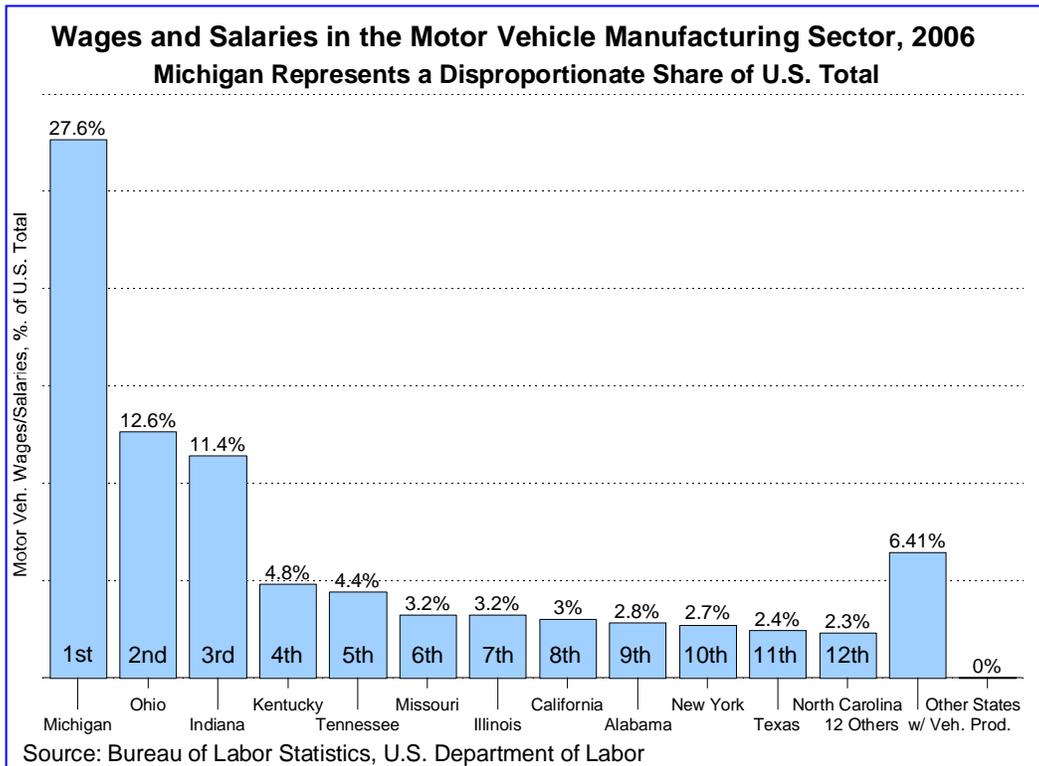


Figure 6

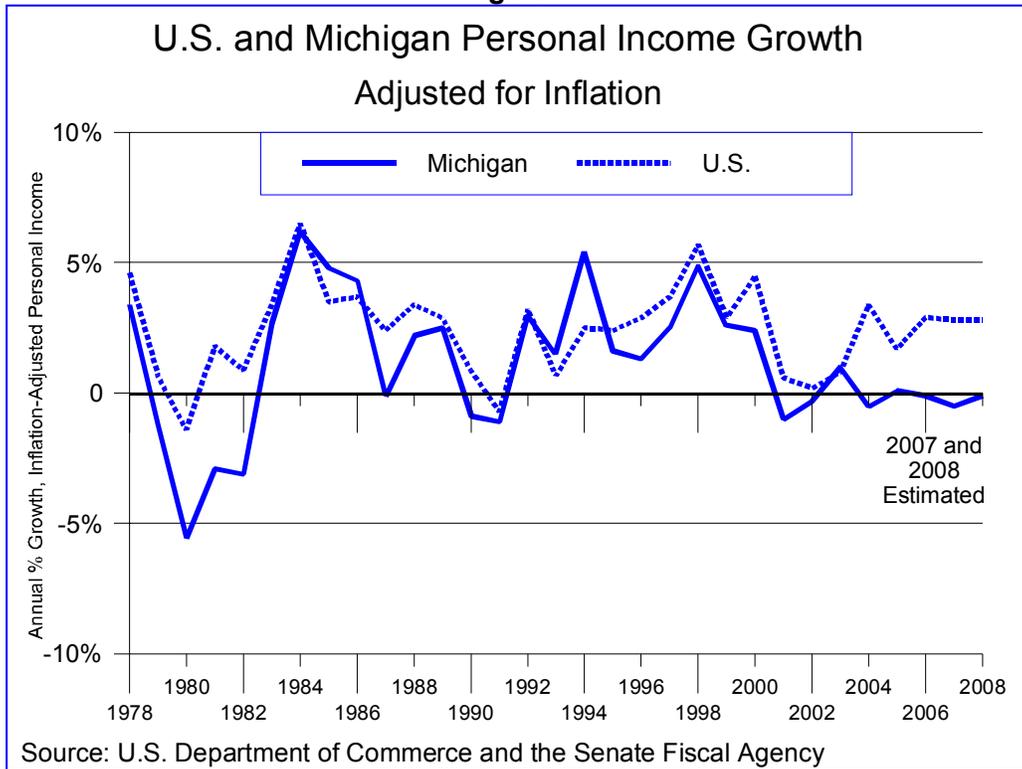
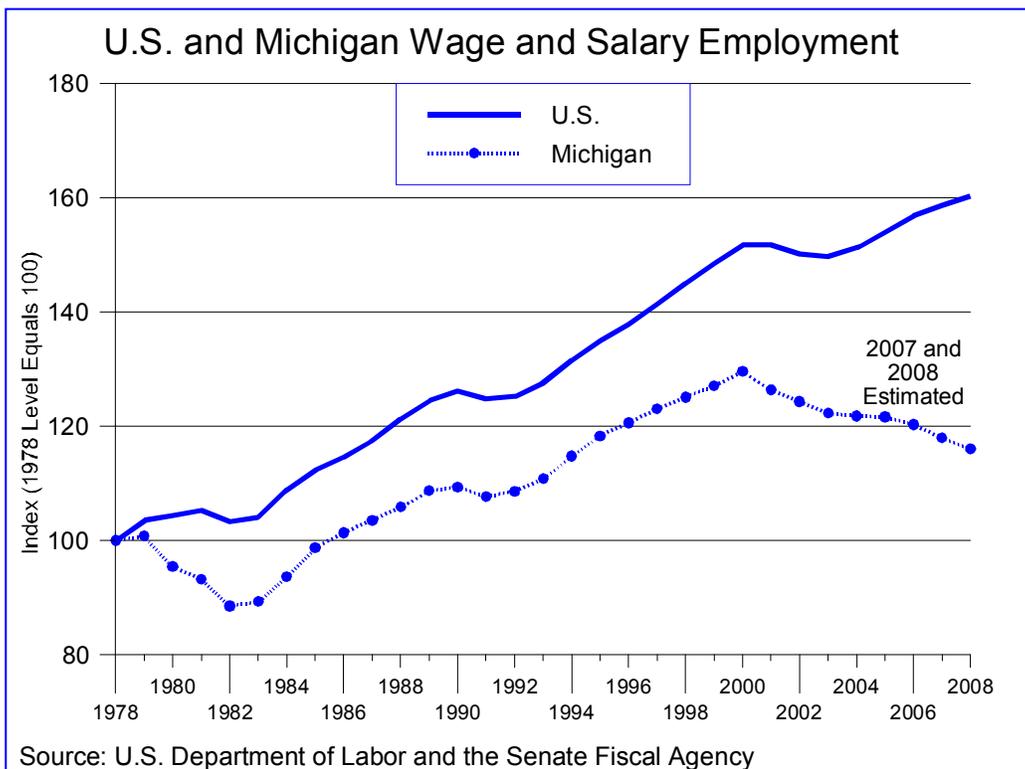
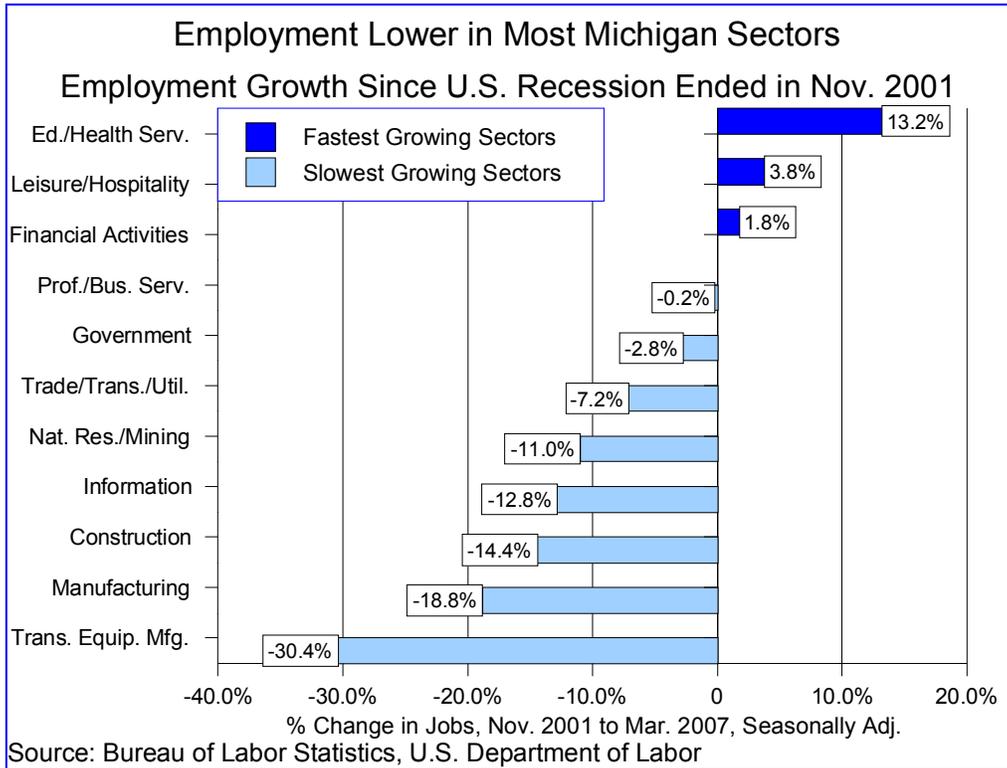


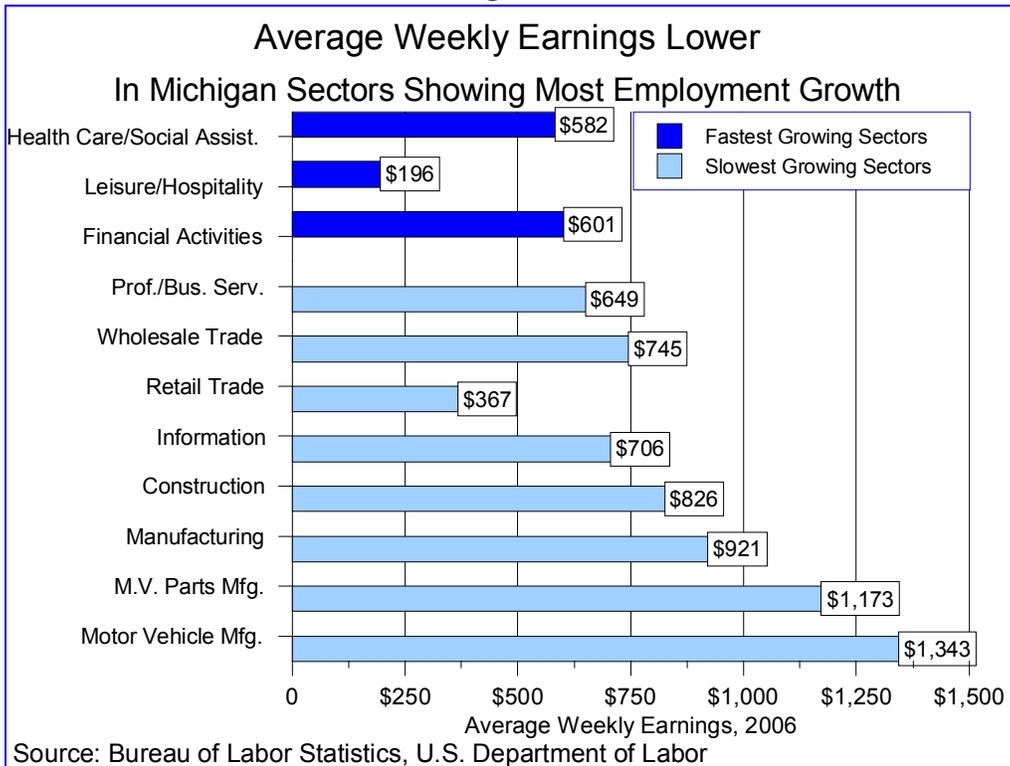
Figure 7



**Figure 8**



**Figure 9**



## **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 2.0% during 2006, the dollar is expected to fall in value another 1.9% during 2007 and 2.9% during 2008. As a result, the forecast predicts that the trade deficit will decrease slightly in 2007 and increase slightly in 2008, remaining at slightly more than 5.0% of GDP over the forecast period.

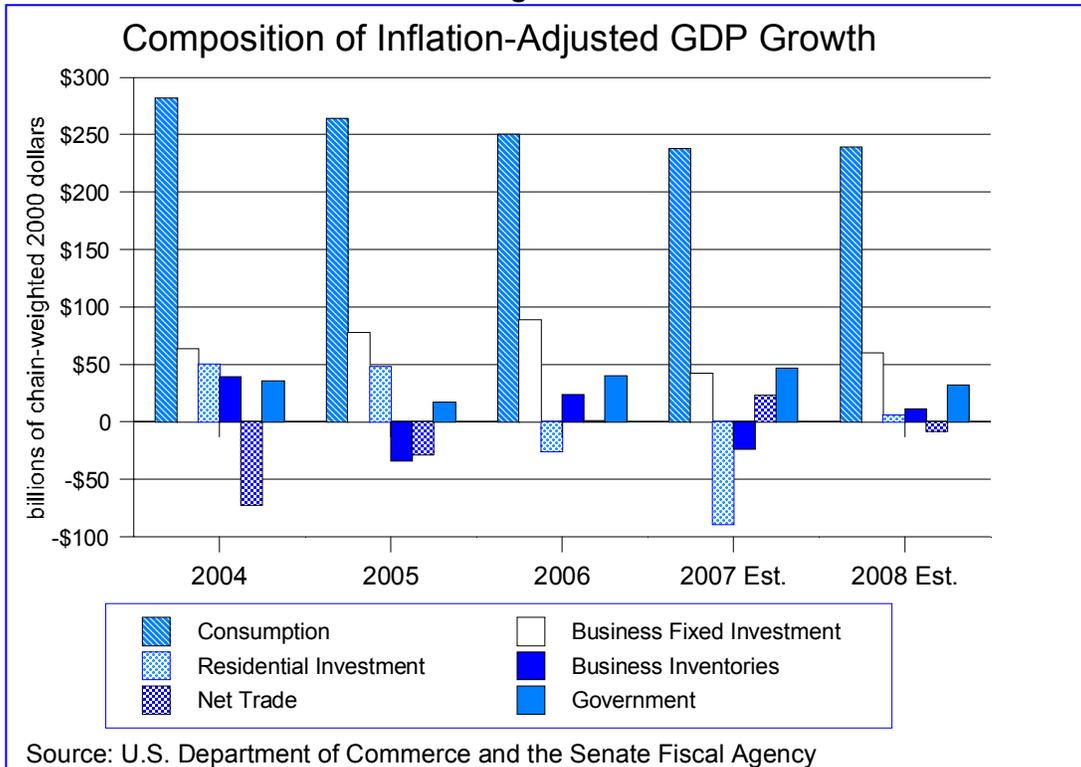
**Oil and Energy Prices.** The forecast expects oil prices in 2007 and 2008 to remain stable, but well above even recent historical averages, with the price of West Texas intermediate crude above \$65-per-barrel through virtually all of the forecast horizon. Other energy prices are expected to follow 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 fiscal policy will be expansionary and generally greater than in recent years ([Figure 10](#)). 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.

Figure 10



**Consumer Behavior.** Consumption growth remained moderate throughout the slow recovery over the last four years, largely through increased borrowing and residential refinancing 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, minor improvements in business investment growth, and an improvement in residential investment during 2008, 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 remained at that level throughout the rest of 2006. 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. Weak financial markets and declining 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 will be lower. Similarly, if the weak employment situation causes consumers to lose confidence in the economy, consumer spending (and thus economic growth) may be lower than expected.

**Inflation.** While the forecast expects 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. Additionally, productivity in nonmanufacturing sectors has shown a marked slowdown in recent quarters, adding to the cost pressures producers are experiencing. Continued economic growth, even relatively weak 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 a slower economy: 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 also creating significant difficulties for the financial sectors that invested heavily in the refinancing boom of the last few years. These financial sectors are largely dependent upon interest payments locked in at low rates and inflation will result in those loans' being repaid with substantially devalued dollars. Furthermore, to the extent that the emphasis is on short-term inflation, the pattern seen in the forecast, where short-term interest rates rise much more rapidly than long-term rates, could be exacerbated and not only squeeze 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 11](#)), 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 12](#)), 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 March 2007, Michigan had lost approximately four out of every

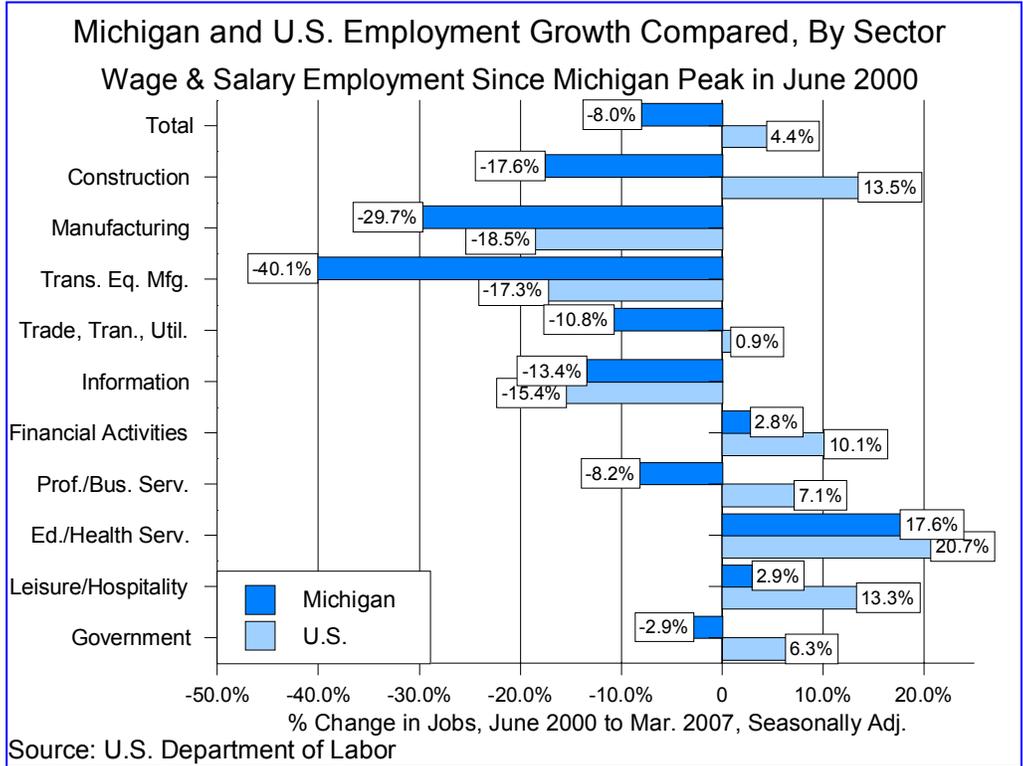
10 jobs (a decline of more than 142,100 jobs) in transportation equipment manufacturing that existed during the peak in June 2000.

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.

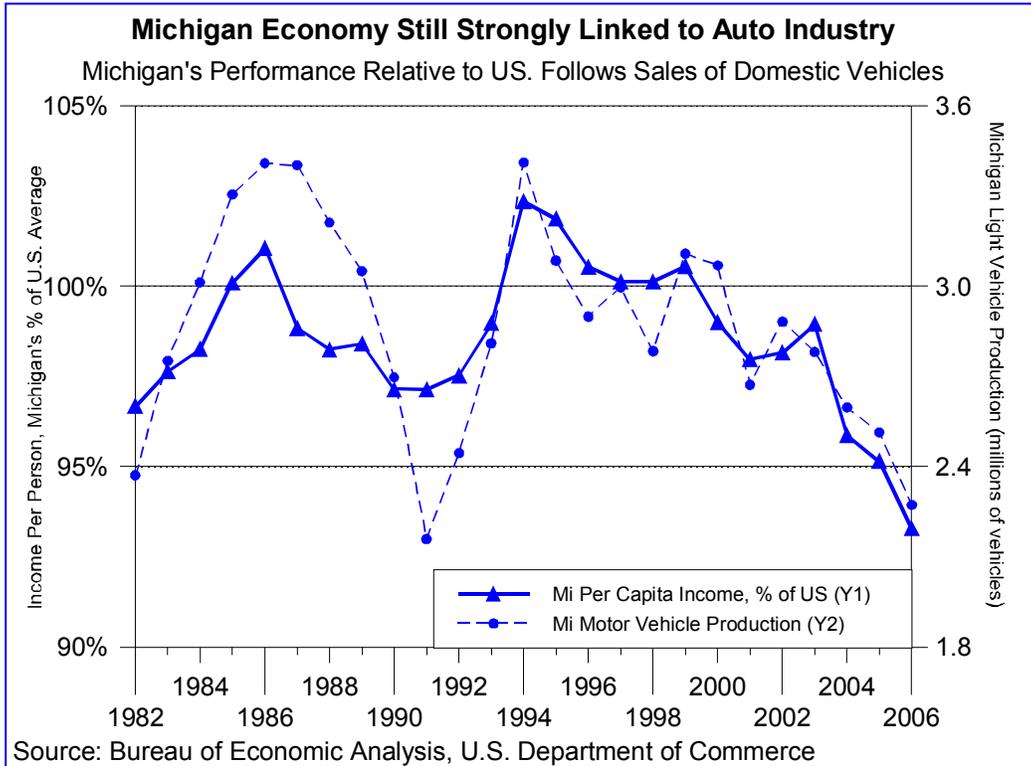
Because of the number of individuals employed in transportation equipment manufacturing and the likelihood of continued substantial gains in productivity in the vehicle sector, it is likely that absent any shocks, the Michigan economy will spend years adjusting to the change. Offsetting a 10.0% annual 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 after 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 for their product, 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 11**



**Figure 12**



## **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 and School Aid Fund revenue. The revised revenue estimates for FY 2006-07 and FY 2007-08 are presented. 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**

At the January 2007 Consensus Revenue Estimating Conference, the estimate of General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue for FY 2006-07 was lowered by \$556.1 million. Based on actual revenue collections during the first half of FY 2006-07, and the SFA's estimated level of economic activity during the second half of the fiscal year, it is clear that the revenue estimates need to be lowered further. Weaker-than-expected economic activity, including the housing slump, has had negative repercussions on many of the major taxes, including the sales, single business, real estate transfer, and State education property taxes. As a result, GF/GP and SAF revenue in FY 2006-07 is now expected to total \$19.31 billion. This is down 0.2% from the \$19.35 billion that was collected in FY 2005-06, and represents a downward revision from the January 2007 consensus revenue estimate of \$177.4 million.

The revenue estimate for FY 2007-08 also is being reduced. Based on the SFA's revised economic forecast, GF/GP and SAF revenue will total an estimated \$18.2 billion in FY 2007-08. This revised estimate is down 5.8% from the revised estimate for FY 2006-07 due largely to the repeal of the single business tax on December 31, 2007. If it is assumed that the single business tax revenue is fully replaced, which is by no means a sure thing, then the revised estimate for FY 2007-08 represents a slight 0.6% increase from the FY 2006-07 estimate. Compared with the January 2007 consensus revenue estimate, this revised estimate for FY 2007-08 is down \$343.6 million. The revenue estimates for FY 2006-07 and FY 2007-08 are summarized in Table 3.

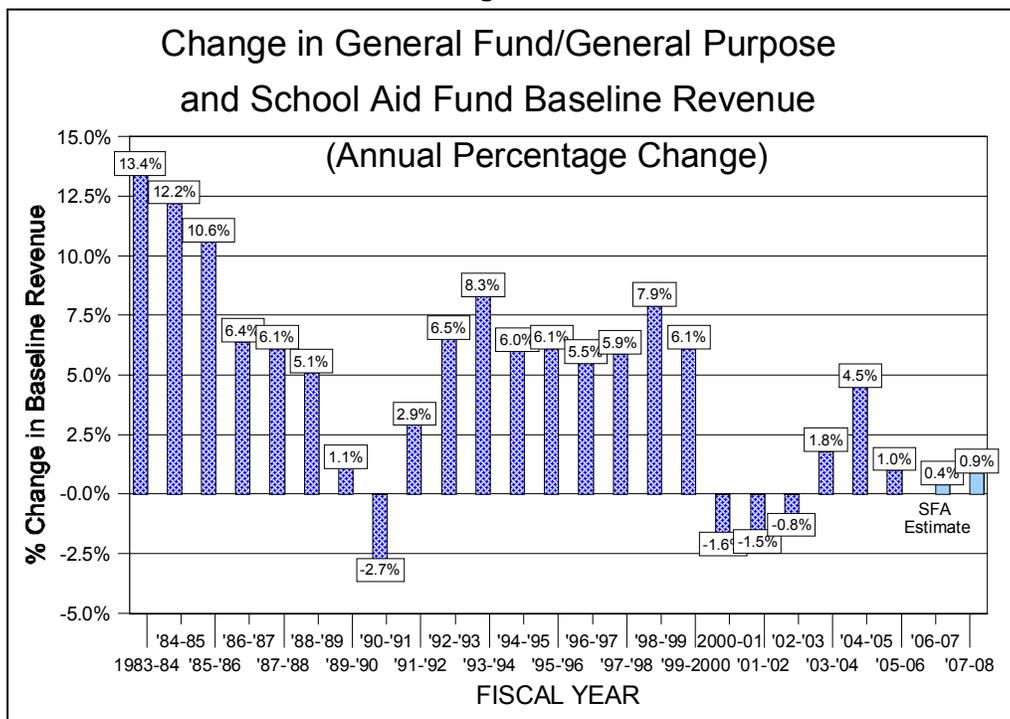
### ***Historical Perspective***

From a historical perspective, the revenue projections for FY 2006-07 and FY 2007-08 reflect very weak growth rates. Figure 13 presents a historical overview of the percentage change in baseline GF/GP and SAF revenue since FY 1982-83. The baseline growth rates for FY 2006-07 and FY 2007-08 are estimated at 0.4% and 0.9%, respectively. These growth rates are down significantly from the 6.5% rate of growth averaged from FY 1992-93 to FY 1999-2000, but are still above the actual declines in baseline revenue experienced in FY 2000-01 to FY 2002-03. The apparent recovery to stronger growth in FY 2003-04 and FY 2004-05, with growth rates of 1.8% and 4.5%, respectively, was short lived as FY 2005-06 baseline revenue growth slowed to 1.0%. As a result, the revised baseline growth rate for FY 2006-07 of 0.4% reflects the weakest rate of growth since the three consecutive years of actual declines beginning in FY 2000-01. The FY 2007-08 revised growth rate of 0.9% basically brings the rate of growth back up to the FY 2005-06 level.

Table 3

<b>SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2006-07 AND FY 2007-08</b>			
<b>GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND</b>			
<b>(Millions of Dollars)</b>			
	<b>FY 2005-06</b>	<b>FY 2006-07</b>	<b>FY 2007-08</b>
	<b>Final</b>	<b>Revised Est.</b>	<b>Revised Est.</b>
<b>GENERAL FUND/GENERAL PURPOSE</b>			
Baseline Revenue	\$8,181.0	\$8,258.5	\$8,266.1
Tax Changes Not In Baseline	85.1	(35.2)	(1,351.3)
<u>Revenue After Tax Changes:</u>			
Net Income Tax	4,184.0	4,238.6	4,186.1
Single Business Tax & Insurance Tax <sup>1)</sup>	2,061.4	2,071.4	855.0
Other Taxes	1,571.1	1,575.3	1,559.2
Total Taxes	7,816.5	7,885.3	6,600.3
Nontax Revenue	449.6	337.9	314.6
<b>TOTAL GF/GP REVENUE<sup>1)</sup></b>	<b>\$8,266.1</b>	<b>\$8,223.2</b>	<b>\$6,914.9</b>
<b>SCHOOL AID FUND</b>			
Baseline SAF	11,089.7	11,092.1	11,266.7
Tax Changes Not In Baseline	(7.6)	(4.4)	17.9
<b>TOTAL SAF REVENUE</b>	<b>\$11,082.0</b>	<b>\$11,087.7</b>	<b>\$11,284.6</b>
<b>BASELINE GF/GP &amp; SAF REVENUE</b>	<b>19,270.6</b>	<b>19,350.5</b>	<b>19,532.8</b>
Tax & Revenue Changes	77.5	(39.6)	(1,333.4)
<b>GF/GP &amp; SAF REV. AFTER CHANGES</b>	<b>\$19,348.1</b>	<b>\$19,310.9</b>	<b>\$18,199.4</b>
<u>ADDENDUM:</u>			
Sales Tax	\$6,638.1	\$6,582.3	\$6,676.3
<b>PERCENT CHANGE</b>			
<b>GENERAL FUND/GENERAL PURPOSE</b>			
Baseline Revenue	0.5%	0.9%	0.1%
<u>Revenue After Tax Changes:</u>			
Net Income Tax	1.5	1.3	(1.2)
Single Business Tax & Insurance Tax	(4.7)	0.5	(58.7)
Other Taxes	(2.2)	0.3	(1.0)
Total Taxes	(0.9)	0.9	(16.3)
Nontax Revenue	7.6	(24.8)	(6.9)
<b>TOTAL GF/GP REVENUE</b>	<b>(0.5)%</b>	<b>(0.5)%</b>	<b>(15.9)%</b>
<b>SCHOOL AID FUND</b>			
Baseline SAF	1.5	0.0	1.6
<b>TOTAL SAF REVENUE</b>	<b>1.6%</b>	<b>0.1%</b>	<b>1.8%</b>
<b>BASELINE GF/GP &amp; SAF REVENUE</b>	<b>1.0</b>	<b>0.4</b>	<b>0.9</b>
<b>GF/GP &amp; SAF REV. AFTER CHANGES</b>	<b>0.7%</b>	<b>(0.2)%</b>	<b>(5.8)%</b>
<u>ADDENDUM:</u>			
Sales Tax	0.6%	(0.8)%	1.4%
<sup>1)</sup> Includes revenue loss from 12/31/07 repeal of the SBT. This repeal will reduce SBT and insurance tax revenue an estimated \$1,218.8 million in FY 2007-08. If the SBT and insurance revenue were fully replaced, the GF/GP revenue estimate for FY 2007-08 would equal \$8,133.7 million, a decrease of 1.1% from the revised estimate for FY 2006-07 and total GF/GP and SAF revenue would equal \$19,418.2 million, representing a 0.6% increase.			

**Figure 13**



**REVISED REVENUE ESTIMATES FOR FY 2006-07**

General Fund/General Purpose and SAF revenue is expected to total \$19.31 billion in FY 2006-07, which is down 0.2% from FY 2005-06. This revised revenue estimate is \$177.4 million below the estimate adopted at the January 2007 Consensus Revenue Estimating Conference. The major reason for this downward revision is that tax collections during the first half of FY 2006-07 came in weaker than forecasted. The slower-than-expected level of economic activity has had a particularly noticeable negative impact on sales and single business tax collections, while the slowdown in the housing market has reduced real estate transfer tax collections and also slowed State education property tax collections. This slowdown in tax collections to date is not expected to be made up in the second half of the fiscal year. In fact, as explained in the first section of this report, economic activity is now expected to grow at a slower pace for the remainder of 2007 than was originally estimated in January. As a result, it is estimated that tax collections will continue to come in below the estimates made in January for the remainder of FY 2006-07. The revised GF/GP and SAF revenue estimates for FY 2006-07 are summarized in [Table 4](#).

***General Fund/General Purpose***

General Fund/General Purpose revenue will total an estimated \$8.22 billion, which is down 0.5% or \$42.9 million from the final level for FY 2005-06. Tax collections, which account for about 95.0% of GF/GP revenue from ongoing sources, will increase an estimated 0.9% or \$68.8 million from FY 2005-06, while nontax revenue will fall an estimated 24.8% or \$111.7 million. Compared with the January consensus estimates, the GF/GP revenue estimate is being revised downward by \$6.7 million.

**GF/GP Consumption Tax Revenue.** Tax collections from consumption taxes will be down an estimated 1.6% from FY 2005-06, which represents a downward revision from the January consensus estimate of \$66.1 million. Most of this downward revision is in sales and use tax receipts. Actual sales tax collections through April are down about \$40.0 million from the January 2007 consensus estimate and the deterioration in these receipts is expected to continue in the

second half of the year. As a result, the estimate for total sales tax collections has been revised downward by \$150.0 million and the GF/GP portion of sales tax revenue is down \$42.5 million. The weak economy and high level of unemployment are causing consumers who have lost their jobs to cut back on their spending and consumers who are still employed to become more cautious financially. In addition, the weakness in the housing sector is having negative repercussions on sales tax collections because, with the slowdown in housing sales, consumers are purchasing fewer household appliances and other house-related items.

**GF/GP Other Tax Revenue.** Among the "Other Taxes" category, downward revisions in the single business, insurance, and oil and gas severance taxes, will be largely offset by an increase in tax penalty and interest payments.

**GF/GP Nontax Revenue.** Most of the 24.8% decline in nontax revenue expected in FY 2006-07 will be due to a one-time boost in miscellaneous revenue in FY 2005-06, which will not be repeated in FY 2006-07.

### ***School Aid Fund***

School Aid Fund revenue from earmarked taxes and the lottery is expected to total \$11.09 billion in FY 2006-07, which is practically unchanged from the \$11.08 billion generated in FY 2005-06. Increases in the income, State education, and casino taxes, along with the revenue from the lottery, will be offset by declines in the sales, real estate transfer, tobacco, and industrial facilities taxes. This revised estimate for SAF revenue is down \$142.4 million from the January consensus estimate. Most of this downward revision is due to weaker-than-expected sales tax collections. The sales tax estimate has been reduced by \$150.0 million for FY 2006-07 and the SAF portion of this reduction is \$110.0 million. Other taxes whose revenue estimates were revised downward include the use, State education, and real estate transfer taxes. The SAF revenue estimate for FY 2006-07 is summarized in [Table 4](#).

### **Major General Fund and School Aid Fund Taxes**

**Income Tax.** Income tax revenue came in stronger than expected during the first half of FY 2006-07. Income tax payments are expected to be up 1.3% from FY 2005-06 and are being revised upward from the January consensus estimate by \$57.8 million. An increase in earnings per worker, lump sum payments to some motor vehicle industry workers who took early buy outs, and continuing growth in the stock market all contributed to higher-than-expected income tax payments. While the rate of growth is expected to slow in the second half of the fiscal year, the slowdown will not be strong enough to offset the gains made so far. The SAF receives 25.9% of gross income tax collections and the remaining amount of income tax revenue goes to the General Fund.

**Single Business Tax.** The State's major business tax will total an estimated \$1.86 million in FY 2006-07, which is up 1.0% from FY 2005-06. Compared with the January consensus estimate, this represents a downward revision of \$10.0 million. All of the single business tax revenue goes to the General Fund.

**Sales Tax.** During the first half of FY 2006-07, sales tax collections are trailing the January expected level by over \$40.0 million. During the second half of FY 2006-07, sales tax collections are expected to continue to lag behind the January consensus estimate. As a result, the estimate of sales tax revenue in FY 2006-07 has been reduced by \$150.0 million from the January consensus estimate to \$6.58 billion. This represents an 0.8% decline from the sales tax level in FY 2005-06. The SAF receives 73.3% of sales tax revenue and the remaining amount goes for revenue sharing to local units of government, the Comprehensive Transportation Fund, and GF/GP revenue.

**Table 4**

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

	FY 2005-06 Final	FY 2006-07 Revised Estimate	Change from FY 2005-06		\$ Change from 01/07 Consensus
			Dollar Change	Percent Change	
<b>GENERAL FUND/GENERAL PURPOSE:</b>					
<b>Baseline Revenue</b>	\$8,181.0	\$8,258.5	\$ 77.5	0.9%	\$(6.7)
<b>Tax Changes Not In Baseline</b>	85.1	(35.2)	(120.3)	---	(28.3)
<b><u>Revenue After Tax Changes</u></b>					
<u>Personal Income Tax</u>					
Gross Collections	7,849.9	8,042.8	192.9	2.5	105.0
Less: Refunds	(1,625.7)	(1,715.7)	(90.0)	5.5	(20.0)
Net Income Tax Collections	6,224.2	6,327.1	102.9	1.7	85.0
Less: Earmarking to SAF	(2,038.9)	(2,087.0)	(48.1)	2.4	(27.2)
Campaign Fund	(1.3)	(1.5)	(0.2)	15.4	0.0
Net Income Tax to GF/GP	\$4,184.0	\$4,238.6	\$54.6	1.3%	\$57.8
<u>Other Taxes</u>					
Single Business Tax	1,841.9	1,860.3	18.4	1.0	(10.0)
Sales	85.9	93.6	7.7	9.0	(10.9)
Use	917.0	921.0	4.0	0.4	(22.0)
Cigarette	229.0	227.4	(1.6)	(0.7)	(1.6)
Insurance Company Premiums	219.5	211.1	(8.4)	(3.8)	(15.0)
Telephone & Telegraph	83.5	78.0	(5.5)	(6.6)	0.0
Estate	0.6	0.0	(0.6)	(100.0)	0.0
Oil & Gas Severance	81.5	62.0	(19.5)	(23.9)	(4.0)
Casino Wagering	45.0	47.1	2.1	4.6	
All Other	128.6	146.2	17.6	13.7	19.0
Subtotal Other Taxes	\$3,632.5	\$3,646.7	\$14.2	0.4%	\$(44.5)
Total Nontax Revenue	449.6	337.9	(111.7)	(24.8)	(20.0)
<b>GF/GP REV. AFTER TAX CHANGES</b>	<b>\$8,266.1</b>	<b>\$8,223.2</b>	<b>\$(42.9)</b>	<b>(0.5)%</b>	<b>\$(6.7)</b>
<b>SCHOOL AID FUND:</b>					
<b>Baseline Revenue</b>	\$11,089.7	\$11,092.1	\$2.4	0.0%	\$(135.0)
<b>Tax Changes Not In Baseline</b>	(7.6)	(4.4)	3.2	---	(7.4)
<b><u>Revenue After Tax Changes</u></b>					
Sales Tax	4,831.3	4,790.5	(40.8)	(0.8)	(110.0)
Lottery Revenue	688.0	710.0	22.0	3.2	8.0
State Education Property Tax	2,003.5	2,062.1	58.6	2.9	(32.4)
Real Estate Transfer Tax	297.7	231.2	(66.5)	(22.3)	(13.0)
Income Tax	2,038.9	2,087.0	48.1	2.4	27.2
Casino Tax	104.1	109.1	5.0	4.8	0.0
Other Revenue	1,118.6	1,097.8	(20.7)	(1.9)	(22.2)
<b>SAF REV. AFTER TAX CHANGES</b>	<b>\$11,082.0</b>	<b>\$11,087.7</b>	<b>\$5.7</b>	<b>0.1%</b>	<b>\$(142.4)</b>
<b>BASELINE GF/GP AND SAF</b>					
<b>Tax &amp; Revenue Changes</b>	<b>77.5</b>	<b>(39.6)</b>	<b>(117.1)</b>	<b>---</b>	<b>(35.7)</b>
<b>GF/GP &amp; SAF REV. AFTER CHANGES</b>	<b>\$19,348.1</b>	<b>\$19,310.9</b>	<b>\$(37.2)</b>	<b>(0.2)%</b>	<b>\$(177.4)</b>
SALES TAX	\$6,638.1	\$6,582.3	\$(55.8)	(0.8)%	\$(150.0)

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.

**State Education Property Tax.** The State education property tax revenue is expected to total \$2.06 billion in FY 2006-07. This represents a 2.9% increase from FY 2005-06, but is down \$32.4 million from the January 2007 consensus revenue estimate. The major reason for this downward revision is the ongoing slump in the housing market, which reduces the number of housing transactions and slows the growth in the property tax base.

**Real Estate Transfer Tax.** The slowdown in the housing market also is having a negative impact on the revenue generated by the real estate transfer tax. In FY 2006-07, the real estate transfer tax is expected to total \$231.2 million. This represents a 22.3% reduction from the FY 2005-06 level and is down \$13.0 million from the January 2007 consensus revenue estimate.

### **REVISED REVENUE ESTIMATES FOR FY 2007-08**

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. In addition to the weak level of economic activity, overall revenue growth also will be depressed in FY 2007-08 due to the repeal of the single business tax. Under current law, the single business tax will be repealed at the end of 2007 and to date no new replacement business tax or taxes have been enacted. As a result of these factors, under current law, total GF/GP and SAF revenue will experience a significant decline in FY 2007-08 equal to an estimated 5.8% or \$1.11 billion, for a total of \$18.2 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 \$19.42 billion, which represents a modest increase of 0.6% from the FY 2006-07 revised estimate. The details of the GF/GP and SAF revenue estimate for FY 2007-08, based on the repeal of the single business tax that will occur under current law, are summarized in Table 5.

The revised revenue estimate for FY 2007-08 GF/GP and SAF revenue is down \$343.6 million from the January consensus estimate. This significant reduction in the FY 2007-08 revenue estimate is due to two major factors: 1) Tax collections are now expected to come in weaker in FY 2006-07 than originally expected in January 2007, so tax collections for FY 2007-08 will grow off of a lower base than was originally forecast, and 2) economic activity in 2008 is now expected to be slower than was estimated in January 2007, which also will result in slower revenue growth.

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

General Fund/General Purpose revenue will total an estimated \$6.91 billion in FY 2007-08. This represents a 15.9% or \$1.31 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 \$8.13 billion, which is 1.1% below the revised estimate for FY 2006-07. This decrease 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 \$11.28 billion in FY 2007-08, which represents an increase of 1.8%, or \$196.9 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.

Table 5

**FY 2007-08 REVISED REVENUE ESTIMATES  
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND  
(Millions of Dollars)**

	FY 2006-07 Revised Est.	FY 2007-08 Revised Est.	Change from FY 2006-07		\$ Change from 01/07 Consensus
			Dollar Change	Percent Change	
<b>GENERAL FUND/GENERAL PURPOSE:</b>					
<b>Baseline Revenue</b>	\$8,258.5	\$8,266.1	\$7.6	0.1%	\$(112.2)
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(35.2)	(1,351.3)	(1,316.1)	---	16.9
<u>Personal Income Tax</u>					
Gross Collections	8,042.8	8,043.4	0.6	0.0	(37.0)
Less: Refunds	(1,715.7)	(1,768.7)	(53.0)	3.1	0.0
Net Income Tax Collections	6,327.1	6,274.7	(52.4)	(0.8)	(37.0)
Less: Earmarking to SAF Campaign Fund	(2,087.0) (1.5)	(2,087.1) (1.5)	(0.1) 0.0	0.0 0.0	9.6 0.0
Net Income Tax to GF/GP	\$4,238.6	\$4,186.1	\$(52.5)	(1.2)%	\$(27.4)
<u>Other Taxes</u>					
Single Business Tax <sup>1)</sup>	1,860.3	697.2	(1,163.1)	(62.5)	(3.4)
Sales	93.6	97.8	4.2	4.5	(9.3)
Use	921.0	939.3	18.3	2.0	(40.7)
Cigarette	227.4	223.4	(4.1)	(1.8)	(1.8)
Insurance Company Premiums <sup>1)</sup>	211.1	157.8	(53.3)	(25.2)	(11.7)
Telephone & Telegraph	78.0	72.0	(6.0)	(7.7)	0.0
Estate	0.0	0.0	0.0	---	0.0
Oil & Gas Severance	62.0	59.5	(2.5)	(4.0)	(4.0)
Casino Wagering	47.1	18.6	(28.5)	(60.5)	
All Other	146.2	148.6	2.4	1.6	17.0
Subtotal Other Taxes	\$3,646.7	\$2,414.2	\$(1,232.5)	(33.8)%	\$(53.9)
Total Nontax Revenue	337.9	314.6	(23.3)	(6.9)	(14.0)
<b>GF/GP REV. AFTER TAX CHANGES<sup>1)</sup></b>	<b>\$8,223.2</b>	<b>\$6,914.9</b>	<b>\$(1,308.4)</b>	<b>(15.9)%</b>	<b>\$(95.3)</b>
<b>SCHOOL AID FUND:</b>					
<b>Baseline Revenue</b>	\$11,092.1	\$11,266.7	\$174.6	1.6%	\$(245.9)
<b>Tax Changes Not In Baseline Revenue After Tax Changes</b>	(4.4)	17.9	22.3	---	(2.4)
Sales Tax	4,790.5	4,859.5	68.9	1.4	(157.4)
Lottery Revenue	710.0	707.0	(3.0)	(0.4)	(2.4)
State Education Property Tax	2,062.1	2,176.7	114.6	5.6	(27.0)
Real Estate Transfer Tax	231.2	236.1	4.9	2.1	(20.0)
Income Tax	2,087.0	2,087.2	0.2	0.0	(9.6)
Casino Tax	109.1	118.4	9.2	8.5	0.0
Other Revenue	1,097.8	1,099.8	2.0	0.2	(31.9)
<b>SAF REV. AFTER TAX CHANGES</b>	<b>\$11,087.7</b>	<b>\$11,284.6</b>	<b>\$196.9</b>	<b>1.8%</b>	<b>\$(248.3)</b>
<b>BASELINE GF/GP AND SAF</b>	<b>19,350.5</b>	<b>19,532.8</b>	<b>182.2</b>	<b>0.9</b>	<b>(358.1)</b>
Tax & Revenue Changes	(39.6)	(1,333.4)	(1,293.8)	---	14.5
<b>GF/GP &amp; SAF REV. AFTER CHANGES<sup>1)</sup></b>	<b>\$19,310.9</b>	<b>\$18,199.4</b>	<b>\$(1,111.6)</b>	<b>(5.8)%</b>	<b>\$(343.6)</b>
SALES TAX	\$6,582.3	\$6,676.3	\$94.0	1.4%	\$(215.0)

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

1) Includes revenue loss from 12/31/07 repeal of the SBT. This repeal will reduce SBT and insurance tax revenue an estimated \$1,218.8 million in FY 2007-08. If the SBT and insurance revenue is fully replaced, the GF/GP revenue estimate for FY 2007-08 equals \$8,133.7 million, a decrease of 1.1% from the revised estimate for FY 2006-07, and total GF/GP and SAF revenue will equal \$19,418.2 million, representing a 0.6% increase.

## Major General Fund and School Aid Fund Taxes

**Repeal of the Single Business Tax.** The major tax issue affecting GF/GP revenue in FY 2008-09 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. Most of the single business tax paid by businesses is deposited into the single business tax account, but the single business tax paid by insurance companies is deposited into the separate insurance company tax account. All revenue from both the single business tax and insurance company tax is earmarked to GF/GP revenue. In terms of the tax on insurance companies, Michigan-based insurers pay the single business tax and insurers 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 insurer's home state would assess on a Michigan-based insurer). 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 would equal \$1.86 billion in FY 2007-08 and insurance tax revenue would equal \$216.0 million. Under current law, however, the scheduled repeal of the single business tax will reduce single business tax collections an estimated \$1.16 billion and insurance tax receipts an estimated \$58.2 million, for a total revenue reduction of \$1.22 billion.

**Income Tax.** Income tax revenue will total an estimated \$6.27 billion in FY 2007-08, which represents a decrease of 0.8% or \$52.4 million from the FY 2006-07 revised estimate. The SAF receives 25.9% of gross income tax collections (collections before refunds), and this portion will equal an estimated \$2.09 billion in FY 2007-08. The GF/GP share of the income tax will total an estimated \$4.19 billion. Compared with the January 2007 consensus estimate, this revised income tax estimate is down \$37.0 million, of which \$27.4 million represents the reduction to the General Fund share and \$9.6 million is the reduction to the SAF.

**Sales Tax.** Sales tax collections are expected to increase a modest 1.4% in FY 2007-08 to \$6.68 billion. This revised estimate is down \$215.0 million from the January 2007 consensus revenue estimate. Of the total estimated sales tax, \$4.86 billion will be earmarked to the SAF and an estimated \$97.8 million will go to the General Fund. Most of the remaining sales tax revenue 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 \$1.41 billion in FY 2007-08, representing an increase of 2.0% from the revised estimate for FY 2006-07. This revised estimate is down \$61.0 million from the January 2007 consensus estimate. The GF/GP share, which equals two-thirds of use tax revenue, will total an estimated \$939.3 million, down \$40.7 million from the January estimate, and the SAF share, equal to one-third of the total, will equal to \$469.7 million, which is \$20.3 million below the January estimate. The projected 2.0% increase in use tax collections in FY 2007-08, overstates the true strength anticipated in use tax collections due to the fact that some one-time refunds resulting from tax audits were paid in FY 2005-06 and are 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, which factors out these refunds, use tax collections are expected to be up only 0.9% in FY 2007-08.

**Tobacco Taxes.** Tax collections from the cigarette and other tobacco products taxes will total an estimated \$1.12 billion in FY 2007-08, which represents a decrease of 1.8% from the revised estimate for FY 2006-07. This is a downward revision of \$9.0 million from the January 2007

consensus estimate. Of the total amount of tobacco tax revenue estimated for FY 2007-08, the SAF will receive \$446.3 million and \$223.4 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 facilities, 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 5.6%. Compared with the January 2007 consensus estimate, this revised estimate is down \$27.0 million.

**Lottery.** Net lottery revenue will total an estimated \$707.0 million in FY 2007-08, which is down 0.4% from the revised level for FY 2006-07. This reflects a \$2.4 million downward revision from the January 2007 estimate.

### **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 2006-07 and FY 2007-08 is presented in [Tables 6](#) and [7](#). 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 2006-07 and FY 2007-08 have been adjusted to reflect a common base year.

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 6](#). This estimate was increased about \$85.0 million at the January 2006 Consensus Revenue Estimating Conference and then was nudged up another \$26.0 million at the May 2006 Conference. In January 2007, the estimate was reduced \$538.8 million to \$19.49 billion. The Senate Fiscal Agency's revised estimates presented in this report, lower GF/GP and SAF baseline revenue \$141.7 million or 0.7% from the January 2007 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 \$570.3 million or 2.9%.

The Senate Fiscal Agency's first estimate of GF/GP and SAF baseline revenue for FY 2007-08 was \$18.87 billion and it was made in January 2007. The revenue estimate history for FY 2007-08 is presented in [Table 7](#). At the January 2007 Consensus Revenue Estimating Conference, an estimate of \$19.89 billion was adopted. The Senate Fiscal Agency's revised estimates presented in this report lower the GF/GP and SAF baseline revenue estimate \$358.1 million or 1.8% from the January 2007 consensus estimate.

**Table 6**

<b>CHANGES IN SENATE FISCAL AGENCY BASELINE REVENUE ESTIMATES FOR FY 2006-07 (Millions of Dollars)</b>			
<b>Forecast Date</b>	<b>GF/GP</b>	<b>SAF</b>	<b>Total</b>
January 11, 2006	\$8,361.0	\$11,559.9	\$19,920.9
January 12, 2006 <sup>a)</sup>	8,420.8	11,584.7	20,005.5
May 15, 2006	8,473.1	11,541.3	20,014.4
May 17, 2006 <sup>a)</sup>	8,484.3	11,546.8	20,031.1
January 16, 2007	8,201.4	11,266.4	19,467.8
January 18, 2007 <sup>a)</sup>	8,265.2	11,227.1	19,492.3
May 17, 2007	8,258.5	11,092.1	19,350.6
<u>Change From Previous Estimate:</u>			
Dollar Change	\$(6.7)	\$(135.0)	\$(141.7)
Percent Change	(0.1)%	(1.2)%	(0.7)%
<u>Change From Initial Estimate:</u>			
Dollar Change	\$(102.5)	\$(467.8)	\$(570.3)
Percent Change	(1.2)%	(4.0)%	(2.9)%
<b>Note:</b> Baseline base year equals FY 2005-06.			
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			

**Table 7**

<b>CHANGES IN SENATE FISCAL AGENCY BASELINE REVENUE ESTIMATES FOR FY 2007-08 (Millions of Dollars)</b>			
<b>Forecast Date</b>	<b>GF/GP</b>	<b>SAF</b>	<b>Total</b>
January 16, 2007	\$8,326.7	\$11,543.7	\$19,870.4
January 18, 2007 <sup>a)</sup>	8,378.2	11,512.6	19,890.8
May 17, 2007	8,266.0	11,266.7	19,532.7
<u>Change From Previous Estimate:</u>			
Dollar Change	\$(112.2)	\$(245.9)	\$(358.1)
Percent Change	(1.3)%	(2.1)%	(1.8)%
<u>Change From Initial Estimate:</u>			
Dollar Change	\$(60.7)	\$(277.0)	\$(337.7)
Percent Change	(0.7)%	(2.4)%	(1.7)%
<b>Note:</b> Baseline base year equals FY 2005-06.			
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			

## **BUDGET STABILIZATION FUND**

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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 the total General Fund/General Purpose (GF/GP) revenue.

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

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

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

Table 8 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 2005-06. Also presented in this table are 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 14, and the estimated economic stabilization trigger calculations for FY 2006-07 and FY 2007-08 are presented in Table 9.

### **FY 2005-06**

In FY 2005-06, the BSF had a beginning balance of \$1.95 million and during the year an estimated \$0.06 million in interest was earned, leaving an ending balance of \$2.01 million.

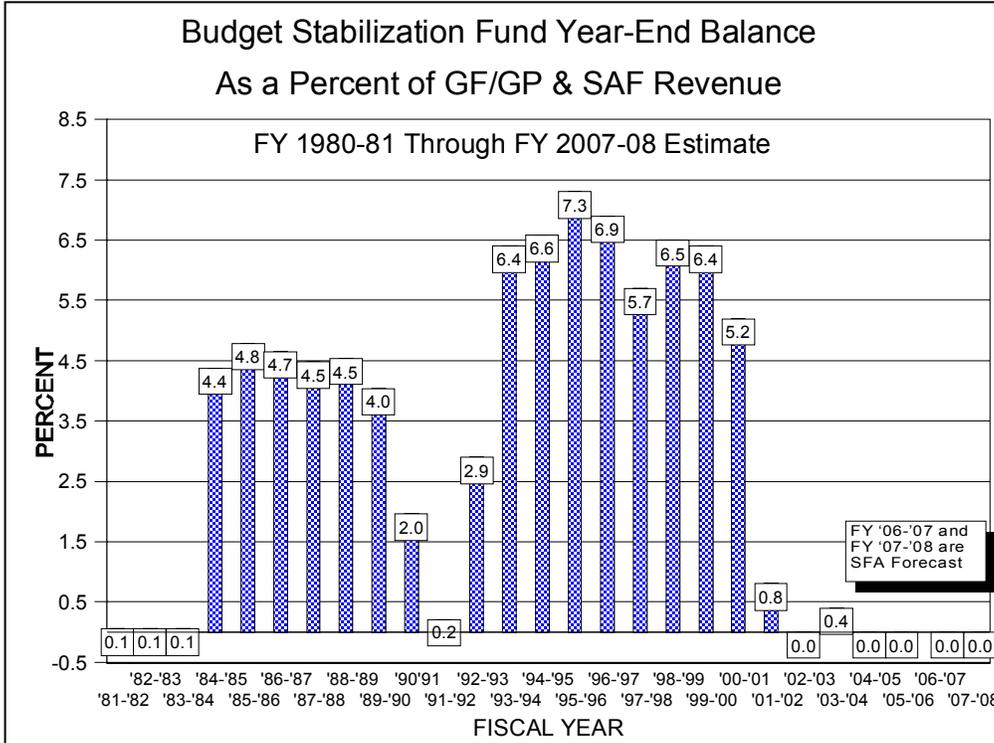
**Table 8**

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

**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 \$79.9 million in FY 2006-07 and another \$47.6 million in FY 2007-08, as shown in Table 9. While any transfers into or out of the Fund must be appropriated for them actually to occur and given that there is only \$2.0 million currently in the Fund, no transfers out of the BSF will occur through FY 2007-08 and the BSF balance will total an estimated \$2.1 million at the end of both FY 2006-07 and FY 2007-08.

**Figure 14**



**Table 9**

<b>ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER FY 2006-07 AND FY 2007-08 (Millions of Dollars)</b>			
	<b>CY 2006</b>	<b>CY 2007</b>	<b>CY 2008</b>
Michigan Personal Income (MPI)	\$341,709	\$347,012	\$354,687
Less: Transfer Payments	54,993	58,147	61,418
Subtotal	\$286,716	\$288,865	\$293,269
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	1.948	1.982	2.026
Equals: Real Adjusted MPI	147,185	\$145,755	\$144,753
Percent Change from Prior Year		(0.97)%	(0.69)%
Excess Over 2.0%		0.00%	0.00%
		<b>FY 2006-07</b>	<b>FY 2007-08</b>
Multiplied by: Estimated GF/GP Revenue		\$8,223.2	\$6,914.9
Equals: Transfer to the BSF		\$0.0	0.0
OR Transfer from the BSF		\$79.9	47.6

**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' 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 preliminary year-end data for FY 2005-06, and the SFA's revised revenue estimates for FY 2006-07 and 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 10.

### **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 \$4.9 billion, or 16.1%, in FY 2005-06.

### **FY 2006-07**

Based on Michigan's personal income for calendar year 2005, the revenue limit in FY 2006-07 is equal to \$31.4 billion. Revenue subject to the limit will equal an estimated \$26.0 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 \$5.4 billion, or 17.2%, 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. Based on data from the U.S. Department of Commerce's Bureau of Economic Analysis, the preliminary estimate of Michigan personal income for 2006 is equal to \$341.7 billion. The revenue limit will equal 9.49% of this personal income level, which amounts to \$32.4 billion. Based on the SFA's revised revenue estimates for FY 2007-08, revenue subject to the limit will total \$25.1 billion. As a result, it is estimated that revenue subject to the limit will fall below the revenue limit in FY 2007-08 by \$7.4 billion or 22.7%. This estimate includes the loss of \$1.2 billion 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 revenue limit in FY 2007-08 by an estimated \$6.2 billion or 19.0%.

**Table 10**  
**COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT**  
**SECTION 26 OF ARTICLE IX OF THE STATE CONSTITUTION**  
(Millions of Dollars)

	FY 2004-05 Final	FY 2005-06 Preliminary	FY 2006-07 Estimate	FY 2007-08 Estimate <sup>1)</sup>
<b>Revenue Subject to Limit</b>				
<u>Revenue:</u>				
General Fund/General Purpose (baseline)	\$8,163.3	\$8,181.0	\$8,258.5	\$8,266.1
Revenue Sharing (baseline)	1,618.3	1,645.5	1,611.2	1,634.2
School Aid Fund (baseline)	10,914.6	11,089.7	11,092.1	11,266.7
Transportation Funds	2,215.9	2,182.5	2,225.6	2,245.3
Other Restricted Non-Federal Aid Revenue	2,609.9	2,665.9	2,900.0	3,000.0
<u>Adjustments:</u>				
GF/GP Federal Aid	(35.7)	(20.1)	(23.0)	(23.0)
GF/GP Balance Sheet Adjustments	145.5	85.1	(35.2)	(1,351.3)
SAF Balance Sheet Adjustments	(5.0)	(7.6)	(4.4)	17.9
<b>Total Revenue Subject to Limit</b>	<b>\$25,626.8</b>	<b>\$25,822.0</b>	<b>\$26,024.8</b>	<b>\$25,055.9</b>
<b>Revenue Limit</b>				
<u>Personal Income:</u>				
Calendar Year	<b>CY 2003</b>	<b>CY 2004</b>	<b>CY 2005</b>	<b>CY 2006</b>
Amount	\$314,460	\$324,134	\$331,304	\$341,710
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	\$29,842.3	\$30,760.3	\$31,440.7	\$32,428.3
1.0% of Limit	298.4	307.6	314.4	324.3
<b>Amount Under (Over) Limit</b>	<b>\$4,215.5</b>	<b>\$4,938.3</b>	<b>\$5,415.9</b>	<b>\$7,372.4</b>
Percent Below Limit	14.1%	16.1%	17.2%	22.7%
<sup>1)</sup> 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 \$26,274.7 million, which will fall below the revenue limit by an estimated \$6,153.6 million or 19.0%				

***ESTIMATE OF YEAR-END BALANCES***

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Based on the economic and revenue estimates outlined earlier in this report, along with enacted and projected State appropriations, the Senate Fiscal Agency (SFA) has revised its estimates of the FY 2006-07 and FY 2007-08 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) year-end balances. This section of the report discusses the year-end balances, and addresses the issues that members of the Legislature are facing as they attempt to complete action on the State budget.

Table 11 provides a summary of the SFA's estimates of the FY 2006-07 and FY 2007-08 year-end balances of the GF/GP and SAF budgets. Based on the current SFA revenue estimates along with enacted and projected State appropriations, the FY 2006-07 GF/GP budget is in deficit by \$221.9 million. Based on the current SFA revenue estimates along with enacted State appropriations, the FY 2006-07 SAF budget is in deficit by \$197.4 million. Based on a comparison of the FY 2007-08 revenue estimates with the appropriation recommendations of the Governor, the FY 2007-08 GF/GP budget is in deficit by \$912.2 million. This estimate assumes that the Legislature enacts a dollar-for-dollar replacement of the single business tax. Based on comparison of the FY 2007-08 SAF revenue estimates with the appropriation recommendations of the Governor, the FY 2007-08 SAF budget is in deficit by \$576.8 million.

**Table 11**

<b>GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND ESTIMATED YEAR-END BALANCES (Millions of Dollars)</b>		
	<b>FY 2006-07 Estimate</b>	<b>FY 2007-08 Estimate</b>
General Fund/General Purpose	\$(221.9)	\$(912.2)
School Aid Fund	\$(197.4)	\$(576.8)

***FY 2006-07 YEAR-END BALANCE***

The downward revisions in the estimates of GF/GP and SAF revenue, along with increased appropriations resulting from expenditure pressures, have resulted in significant deficits in both the FY 2006-07 GF/GP and SAF budgets. For the past three months, Governor Granholm and the Legislature have been debating different proposals to eliminate these projected budget deficits. While legislation has been approved to reduce the size of both the projected GF/GP and SAF budget deficits, significant deficits still exist.

Table 12 provides a summary of the current SFA estimate of a \$221.9 million GF/GP budget deficit. This estimate of the year-end balance is based on the current SFA revenue estimate, enacted appropriations, pending supplemental appropriations, and the approval of appropriation reductions in Executive Order 2007-3.

On the revenue side of the FY 2006-07 GF/GP budget ledger, the SFA now believes that final GF/GP revenue will total \$8.9 billion. This projected level of FY 2006-07 GF/GP revenue represents a \$151.6 million or 1.7% decrease from the final level of FY 2005-06 GF/GP revenue collections. The FY 2006-07 estimated revenue includes \$2.5 million of surplus revenue carried forward from FY 2005-06; \$8.2 billion of ongoing revenue; \$540.5 million from a statutory freeze in revenue sharing payments to cities, villages, townships, and counties; \$5.0 million from the sale of surplus State of Michigan property; \$22.8 million from the shifting of short-term borrowing costs to

the SAF budget; \$7.8 million from a forensic center settlement; \$4.0 million from a transfer from the Liquor Purchase Revolving Fund; \$7.0 million from a transfer of consumer finance fees; \$35.7 million of revenue resulting from Executive Order 2007-3; \$7.2 million of revenue from a transfer from the State Campaign Fund; and \$22.7 million from tobacco settlement revenue payments not assumed in the original budget. The current SFA estimate of ongoing GF/GP revenue represents a \$6.7 million decline from the January 2007 consensus revenue estimate.

On the expenditure side of the FY 2006-07 GF/GP budget ledger, the SFA now believes that final FY 2006-07 appropriations will total \$9.1 billion. This represents a \$72.8 million or 0.8% increase from the final level of FY 2005-06 GF/GP appropriations. This projected final level of appropriations includes the original FY 2006-07 appropriations, the enacted supplemental appropriations contained in Public Act 3 of 2007, and the appropriation reductions contained in Executive Order 2007-3. The final level of projected appropriations also includes pending supplemental appropriations recommended by the Office of State Budget and projected additional supplemental appropriations needed to cover funding shortfalls in the Departments of Community Health and Human Services. The appropriation numbers also reflect the negative appropriations contained in the Senate-passed version of Senate Bill 220, which is currently pending in conference committee.

**Table 12**  
**FY 2006-07**  
**General Fund/General Purpose**  
**Revenue, Expenditures, and Year-End Balance**  
**(Millions of Dollars)**

	<b>May 2007 SFA Estimate</b>
<b>Revenue</b>	
Beginning Balance .....	\$ 2.5
Ongoing Revenue Estimate .....	8,223.2
Revenue Sharing Freeze .....	540.5
Land Sales .....	5.0
Shift of Short-Term Borrowing Costs to School Aid Fund .....	22.8
Forensic Center Settlement Revenue .....	7.8
Liquor Purchase Revolving Fund Transfer to General Fund .....	4.0
Consumer Finance Fees Transfer to General Fund .....	7.0
Executive Order 2007-3 (Revenue Items) .....	35.7
State Campaign Fund Transfer .....	7.2
Tobacco Settlement Revenue Increase .....	22.7
<b>Total Revenue</b>	<b>\$8,878.4</b>
<b>Expenditures</b>	
Enacted Appropriations .....	\$9,222.8
Supplemental Appropriations (Public Act 3 of 2007) .....	17.6
Proposed Supplemental Appropriations (February 2007) .....	211.8
Proposed Supplemental Appropriations (Corrections Health Care) .....	23.3
Proposed Supplemental Appropriations (Pension Health Shift) .....	22.3
Projected Supplemental Appropriations (Medicaid Shortfall) .....	93.0
Projected Supplemental Appropriations (Human Services Shortfall) .....	32.0
Pending Supplemental Appropriations (S.B. 220 (S-1)) .....	(248.3)
Executive Order 2007-3 (Appropriation Reductions) .....	(274.2)
<b>Total Expenditures</b>	<b>\$9,100.3</b>
<b>Projected Year-End Balance</b> .....	<b>\$(221.9)</b>

This projected GF/GP budget deficit of \$221.9 million equals 2.4% of projected appropriations. The Governor and the Legislature are currently considering options to eliminate the remaining projected budget deficit.

Table 13 provides a summary of the current SFA estimate of a \$197.4 million SAF budget deficit. This estimate of the year-end balance is based on the current SFA revenue estimate, enacted appropriations, and projected year-end appropriation lapses. If this projected FY 2006-07 SAF budget deficit were eliminated by a pro-rata reduction in School Aid payments, the pro-rata reduction would equal \$113 per pupil.

	<b>May 2007 SFA Estimate</b>
<b>Revenue</b>	
Beginning Balance .....	\$ 0.0
Ongoing Revenue Estimate .....	11,087.6
GF/GP Grant .....	35.0
Federal Aid .....	1,411.2
PSERS Retirement Contribution Rate (Mark to Market).....	175.6
PSERS Interest Only on Unfunded Accrued Liability .....	86.4
<b>Total Revenue</b> .....	<b>\$12,795.8</b>
<b>Expenditures</b>	
Enacted Appropriations.....	\$13,093.8
Midland Property Tax Case .....	24.8
Refinance of Debt Service Payments (PA 6 of 2007).....	(40.4)
Reduction of Various Categorical Grants (PA 6 of 2007) .....	(5.0)
Appropriation Lapses .....	(80.0)
<b>Total Expenditures</b> .....	<b>\$12,993.2</b>
<b>Projected Year-End Balance</b> .....	<b>\$ (197.4)</b>
<b>Note:</b> The \$197.4 million deficit equates to a \$113 per-pupil pro-rata reduction.	

On the revenue side of the FY 2006-07 SAF budget ledger, the SFA now believes that final SAF revenue will total \$12.8 billion. This projected level of FY 2006-07 SAF revenue represents a \$135.9 million or 1.1% increase from the final level of FY 2005-06 SAF revenue collections. The FY 2006-07 estimated revenue includes \$11.1 billion of ongoing restricted SAF revenue, a \$35.0 million GF/GP grant to the SAF, \$1.4 billion of Federal aid, \$175.6 million of revenue from a change in the valuation of assets in the Public School Employees Retirement System, and \$86.4 million from a change in the calculation of payments into the Public School Employees Retirement System. The current SFA estimate of ongoing SAF revenue represents a \$142.4 million decline from the January 2007 Consensus Revenue Estimating Conference estimate.

On the expenditure side of the FY 2006-07 SAF budget ledger, the SFA now believes that final SAF expenditures will total \$13.0 billion. This projected level of FY 2006-07 SAF expenditures represents a \$325.8 million or 2.6% increase from the final level of FY 2005-06 SAF expenditures. This estimated level of SAF expenditures includes \$13.1 billion of original appropriations, an expenditure increase of \$24.8 million resulting from the settlement of a property tax appeal case in Midland, \$40.5 million of savings from the refinancing of outstanding debt, a \$5.0 million reduction

in various categorical grant programs, and a projected \$80.0 million appropriation lapse from pupil count adjustments and changes in taxable property values.

On April 30, 2007, Robert Emerson, State Budget Director, notified local school districts and public school academies that estimated FY 2006-07 SAF revenue would fall \$213.0 million short of funding the enacted level of appropriations. This estimate was based on preliminary data supplied to the Budget Director by the State Treasurer. The Budget Director's letter of April 30, 2007, was transmitted pursuant to Section 11(3) of the State School Aid Act. This section requires that the Budget Director give a 30-day notice to the Legislature of a projected imbalance in the SAF budget. If at the end of the 30-day period the Legislature does not increase revenue to the SAF budget, a pro-rata reduction will be implemented to eliminate the projected deficit. The pro-rata reduction needed to eliminate a projected \$213.0 million SAF budget deficit is \$122 per pupil. The current SFA estimate is that the projected SAF budget deficit is \$197.4 million, which would require a \$113-per-pupil pro-rata reduction.

If the Legislature and the Governor fail to increase revenue to the SAF budget by May 30, 2007, the pro-rata reduction necessary to eliminate the actual FY 2006-07 SAF budget deficit, following the Consensus Revenue Estimating Conference, will take effect. This pro-rata reduction would reduce the State Aid payments to be distributed to local school districts and public school academies in June, July, and August 2007.

### ***FY 2007-08 YEAR-END BALANCE***

Governor Granholm submitted her FY 2007-08 State budget recommendations to the Legislature on February 8, 2007. These recommendations were based on the consensus revenue estimate agreed to in January 2007, a significant level of proposed tax policy changes, and recommended appropriations. The tax policy changes included in the Governor's budget recommendation have not been enacted by the Legislature. The status of legislative action on the FY 2007-08 GF/GP and SAF appropriations is still in the preliminary stages of debate. In order to provide updated estimates on the status of the FY 2007-08 GF/GP and SAF budgets, the SFA estimates compare current law estimated revenue with the appropriation recommendations of the Governor. The SFA estimates also assume that the Legislature enacts a replacement for the single business tax that would generate the same revenue as the repealed business tax.

Based on these assumptions, the SFA believes that the FY 2007-08 GF/GP budget is in deficit by \$912.2 million and the FY 2007-08 SAF budget is in deficit by \$601.8 million. These sizeable projected budget deficits will force the Legislature to make significant changes in current State tax policy and/or significantly reduce appropriations below the level recommended by the Governor. These changes in some form will need to be enacted by September 30, 2007, to ensure that the Legislature enacts an FY 2007-08 State budget that is balanced between estimated revenue and enacted appropriations.

Table 14 provides a summary of the SFA's estimate of a \$912.2 million deficit in the FY 2007-08 GF/GP budget. The SFA is now estimating that current law ongoing GF/GP revenue will total \$6.9 billion. This represents a \$95.3 million decline from the January 2007 consensus revenue estimate. A continuation of a freeze in revenue sharing payments to cities, villages, and townships will provide a \$540.3 million GF/GP revenue increase. The Governor also has recommended a \$2.0 million transfer from financial institution funds to the General Fund budget, a \$22.8 million GF/GP revenue saving from shifting a portion of cash flow borrowing costs to the SAF budget, and \$13.0 million of transportation economic development fund revenue shifted to the General Fund. This represents \$7.5 billion of total GF/GP revenue. A full dollar-for-dollar replacement of single business tax revenue from a new business tax would increase GF/GP revenue by \$1.2 billion.

This assumption of a full replacement of single business tax revenue is not agreed upon as this report is written. These assumptions would result in potential GF/GP revenue of \$8.7 billion.

**Table 14**  
**FY 2007-08**  
**General Fund/General Purpose**  
**Revenue, Expenditures, and Year-End Balance**  
**(Millions of Dollars)**

	<b>May 2007 SFA Estimate</b>
<b>Revenue</b>	
Beginning Balance.....	\$ 0.0
Ongoing Revenue Estimate.....	6,914.9
<u>Recommended Revenue Adjustments:</u>	
Revenue Sharing Freeze .....	540.3
Financial Institutions Fund Transfer to General Fund.....	2.0
Shift of Short-Term Borrowing Costs to School Aid Fund.....	22.8
Transportation Economic Development Revenue to General Fund ...	13.0
Subtotal Recommended Revenue Adjustments.....	578.1
Full Replacement of Single Business Tax Revenue .....	1,219.0
<b>Total Estimated Revenue</b> .....	<b>\$8,712.0</b>
<b>Expenditures</b>	
Governor's Appropriation Recommendation .....	\$9,624.2
<b>Total Expenditures</b> .....	<b>\$9,624.2</b>
<b>Projected Year-End Balance</b> .....	<b>\$ (912.2)</b>

The Governor's FY 2007-08 GF/GP appropriation recommendations total \$9.6 billion. This level of appropriations exceeds the assumed level of revenue by \$912.2 million. The Governor's budget eliminated this projected deficit with a variety of tax increases that have yet to be enacted by the Legislature. The largest of these proposed tax increases was a 2.0% excise tax on certain services provided to consumers and business. This projected budget deficit of \$912.2 million is equal to 9.5% of the Governor's appropriation recommendations.

Table 15 provides a summary of the SFA's estimate of a \$576.8 million deficit in the FY 2007-08 SAF budget. The SFA is now estimating that ongoing SAF revenue will total \$11.3 billion. This represents a decline of \$248.3 million from the January 2007 consensus revenue estimate. Estimated revenue to the SAF budget from all sources is \$12.7 billion. This includes a \$35.0 million GF/GP grant to the SAF budget, \$1.4 billion of Federal aid, and \$15.0 million from an expansion of the Keno lottery game.

The Governor's FY 2007-08 SAF appropriation recommendation is \$13.3 billion. The level of projected appropriations will be reduced by \$84.6 million as a result of a change in debt service payments financed with SAF revenue and by \$25.0 million due to a reduction in expected pupil counts and special education costs. The Governor's appropriation recommendation was highlighted by a \$175 increase in the per-pupil basic foundation allowance and a \$195.0 million increase in the proposed funding of preschool programs for at-risk children.

The projected FY 2007-08 SAF budget deficit of \$576.8 million is equal to 4.3% of the Governor's appropriation recommendation. The Governor's budget recommendation provided for \$191.2 million of increased SAF revenue from various tax increases. These proposed tax increases have not been considered by the Legislature.

**Table 15**  
**FY 2007-08**  
**School Aid Fund**  
**Revenue, Expenditures, and Year-End Balance**  
**(Millions of Dollars)**

	<b>May 2007 SFA Estimate</b>
<b>Revenue</b>	
Beginning Balance .....	\$ 0.0
Ongoing Revenue Estimate .....	11,284.5
GF/GP Grant .....	35.0
Federal Aid .....	1,410.1
Expanded Club Keno Lottery Game .....	15.0
<b>Total Estimated Revenue .....</b>	<b>\$12,744.6</b>
<b>Expenditures</b>	
<b>Governor's Appropriation Recommendations .....</b>	<b>\$13,431.0</b>
Change in Debt Service Payments .....	(84.6)
Revised Pupil Counts/Special Education Costs .....	(25.0)
<b>Total Expenditures .....</b>	<b>\$13,321.4</b>
<b>Projected Year-End Balance .....</b>	<b>\$ (576.8)</b>