Senate Fiscal Agency

Issue Paper

PAPERS EXAMINING CRITICAL ISSUES
FACING THE MICHIGAN LEGISLATURE

THE MICHIGAN STATE BUDGET
FISCAL YEAR 2000-01 THROUGH FISCAL YEAR 2005-06
SIX YEARS OF SIGNIFICANT CHANGE

by

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INTRODUCTION

The State of Michigan, beginning in 2000, began experiencing an economic slowdown that has had a substantial impact on balancing the State budget. The combination of a downturn in the Michigan economy, and slow or negative growth in State revenue collections, has forced the Governor and the Michigan Legislature to make significant adjustments to the State budget in order to ensure a balance between revenue and expenditures.

This Senate Fiscal Agency (SFA) issue paper provides an overview of the Michigan budget for the period of fiscal year (FY) 2000-01 through FY 2005-06. The paper includes a detailed review of State revenue collections and appropriations over this time period along with a look at the changing nature and costs of the State of Michigan workforce.

STATE REVENUE

The amount of revenue collected by the State is largely dependent on the performance of the State's economy, as well as the structure of the State's major taxes. The growth in State revenue collections during the FY 2000-01 through FY 2005-06 period was affected by both economic conditions and changes in the structure of State taxes. State revenue includes revenue from State taxes, fees, permits, and licenses, as well as very significant amount of Federal funds.

Table 1 provides a summary of the growth in State revenue for the period FY 2000-01 through FY 2005-06. Overall State revenue collections increased by 10.2% over this six-fiscal year period. Different components of the State's revenue base experienced significantly different levels of change over this time period. Total tax revenue increased by 8.0% while nontax revenue increased by 31.8%, primarily a result of Federal revenue growth.

Michigan's 10.2% growth in revenue over this time period contrasts with that of Michigan's two neighbors to the south, Ohio and Indiana. As illustrated in Table 2, state revenue collections increased in Ohio by 30.4% and in Indiana by 33.2% over the same period.

Table 1

TOTAL REVENUE BY MAJOR SOURCE
FY 2000-01 TO FY 2005-06
(Millions of Dollars)

	FY 2000-01	FY 2005-06	Dollar Change	Percentage Change
Taxes				
Personal Income	$7,282	$7,060	$(222)	(3.0)%
Sales and Use	6,486	8,052	1,566	24.1
Single Business	2,023	1,886	(137)	(6.8)
State Education Property	1,490	2,004	514	34.5
Tobacco Products	596	1,169	573	96.1
All Other Taxes	4,528	4,028	(500)	(11.0)
Subtotal Taxes	**$22,405**	**$24,199**	**$1,794**	**8.0**
Nontax Revenue				
Federal Aid	10,002	13,180	3,178	31.8%
Tobacco Settlement Proceeds	261	252	(10)	(3.7)
Licensing and Permitting	392	438	46	11.7
All Other Nontax	2,083	674	(1,409)	(32.8)
Subtotal Nontax	**$12,738**	**$14,543**	**$1,805**	**14.2**
Total Revenue	**$35,143**	**$38,741**	**$3,598**	**10.2**

Source: Michigan Comprehensive Annual Financial Reports

Table 2

STATE REVENUE COLLECTION COMPARISON
FY 2000-01 TO FY 2005-06
(Millions of Dollars)

	Revenue Collected			
	FY 2000-01	**FY 2005-06**	**Dollar Change**	**Percentage Change**
Michigan	$35,143	$38,741	$3,598	10.2%
Ohio	20,929	27,292	6,363	30.4
Indiana	9,052	12,061	3,009	33.2

Source: Michigan Comprehensive Annual Financial Reports; Indiana State Budget Agency http://www.in.gov/sba/budget/; Ohio Comprehensive Annual Financial Reports http://www.obm.ohio.gov/finrep/cafr/cafr01.asp

Tax Revenue

The beginning of the FY 2000-01 through FY 2005-06 period in Michigan was marked by a slight downturn in tax revenue, reflective of the lagging economic landscape and enacted tax policy changes. Fiscal year 2003-04 signaled an increase in the tax revenue collected by the State, which rose by 1.7% from the previous fiscal year. This increase was largely spurred by a July 2004 tobacco tax increase. Between FY 2000-01 and FY 2005-06, Michigan tax revenue rose by 8.0%, with the range of growth varying by source. Personal income tax revenue decreased by 3.0%, reflecting tax rate adjustments, job loss in the State, and prolonged periods of high unemployment, while revenue from the single business tax also fell, dropping 6.8% due to rate reductions and economic conditions (Table 1). In spite of a slow economic climate, Michigan's revenue from sales and use taxes increased by 24.1%. Collections from the State education property tax and taxes on tobacco products experienced major growth, increasing by 34.5% and 96.1%, respectively. The rise in State education property tax revenue was driven by the increase in the value of property in the State. Increases to the revenue generated by the tobacco taxes can be attributed to increases in tobacco tax rates.

Significant changes in the rate and base of major State taxes heavily influenced the amount of State revenue collected over this six-year period. As Table 3 shows, major rate and base changes occurred in the income tax, single business tax, tobacco taxes, and casino tax, resulting in a $4.9 billion cumulative revenue loss. The following provides a summary of these tax rate and base changes and discusses their revenue impact on the State budget.

Table 3

STATUTORY REVENUE ADJUSTMENTS
FY 2000-01 TO FY 2005-06
(Millions of Dollars)

Tax Changes	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2000-01 to FY 2005-06 Total
Income Tax	($423)	($544)	($713)	($750)	(932)	($940)	($4,302)
Single Business Tax	(328)	(432)	(430)	(433)	(460)	(580)	(2,663)
Tobacco Tax		57	287	380	$592	589	1,905
Casino Tax				4	49	49	102
Total Net Tax Changes	**($751)**	**($919)**	**($856)**	**($799)**	**($751)**	**($882)**	**($4,958)**

Source: Estimates adopted by the Senate Fiscal Agency, House Fiscal Agency, and the Michigan Department of Treasury

Income Tax

In 1999, after seven consecutive years of economic growth and increases in State revenue, the Michigan Legislature approved the annual reduction of Michigan's personal income tax rate. This action decreased the Michigan personal income tax rate from 4.4% to 3.9% in 0.1% increments beginning on January 1, 2000, and ending in 2004. After the initial approval, it was decided that the plan could be accelerated, reducing the calendar year 2000 rate by 0.2%, or the combined value of the originally scheduled 2000 and 2001 cuts, while leaving the schedule of subsequent 0.1% per-year reductions in place.

As Table 4 illustrates, the annual reduction of Michigan's personal income tax rate had an immediate effect on State revenue collections. It is estimated that the initial 0.2% cut from the 4.4% rate to the 4.2% rate reduced General Fund/General Purpose (GF/GP) revenue for FY 1999-2000 by $247.0 million. Since the rate change became effective, the State of Michigan has lost an estimated $3.9 billion in personal income tax revenue.

Table 4

EFFECTS OF PERSONAL INCOME TAX RATE CHANGES
(Millions of Dollars)

	FY 1998-99	FY 1999-2000	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2000-01 to FY 2005-06 Total
Tax Rate Phased-In Reduction (Effective Jan. 1, except 2004, effective July 1)	4.4%	4.2%	4.2%	4.1%	4.0%	3.9%	3.9%	3.9%	
Rate Change Effect on State Revenue....................................		($247)	($354)	($448)	($598)	($63)	($810)	($818)	($3,091)
Personal Exemption (Changes effective Jan. 1, Indexed for inflation).....................................			$2,900	$3,000	$3,100	$3,100	$3,200	$3,300	
Credits Enacted.........................			Education Savings Accounts	Adoption Credit, Federal Tax Changes		Donated Auto Credit			
Income Tax Total Revenue Loss			**($423)**	**($544)**	**($713)**	**($750)**	**($932)**	**($940)**	**($4,302)**

Source: Estimates adopted by the Senate Fiscal Agency, House Fiscal Agency, and Michigan Department of Treasury

In 1998, one year before the rate reductions were enacted, lawmakers made the decision to increase the personal exemption for Michigan taxpayers as well as index the personal exemption to the rate of inflation. Therefore, in 1998, the personal exemption increased by $200, while the inflationary increase produced an additional $100 increase. As a result, the personal exemption was increased to $2,800 for the 1998 tax year from $2,500 in 1997. In calendar year 2006, the personal exemption for a Michigan taxpayer, indexed to inflation, was $3,300.

During the period between FY 2000-01 and FY 2005-06, various tax credits also were implemented (Table 4). As a whole, the expansion of credits and exemptions resulted in a loss of over $448.0 million in revenue to the State by FY 2005-06. Combined, these changes to the personal income tax rate, the indexing of the personal exemption to the rate of inflation, and the expansion of credits and exemptions resulted in a cumulative revenue loss of approximately $4.3 billion to the State of Michigan over the six-year period.

The majority of the revenue collected by the State from personal income taxes is deposited into Michigan's GF/GP budget, with 25.9% of gross collections before refunds deposited in the K-12 School Aid Fund (SAF).

Single Business Tax

In addition to the personal income tax phased-in rate reduction, the Michigan Legislature initiated the single business tax (SBT) phase-out in 1999. This tax policy change, made retroactive to January 1, 1999, involved the phase-out of Michigan's 2.3% SBT. The policy reduced the SBT at the rate of 0.1% per year with the expectation that over the following 23 years the tax would be completely phased out and Michigan would institute a new, modified business tax.

In FY 2000-01, the SBT rate had dropped to 2.0%, representing an estimated loss of $310.0 million in State revenue for the fiscal year in comparison to the revenue that could have been raised had the SBT remained at 2.3% (Table 5). Following the FY 2002-03 Consensus Revenue Estimating Conference in May 2002, the decision was made to freeze the scheduled single business tax rate reduction in an effort to decelerate the loss of revenue to the State. The SBT rate of 1.9% was held constant through FY 2005-06 and remains at this rate through the end of 2007, when the SBT Act will be repealed as the result of citizen-initiated legislation. As of January 1, 2008, the new Michigan business tax (MBT) will take effect. As Table 5 shows, between FY 2000-01 and FY 2005-06, the reduction of the SBT rate in Michigan equated to roughly $2.6 billion in lost revenue to the State. The SBT rate adjustment accounted for $2.3 billion of this total revenue loss.

Table 5

EFFECTS OF SINGLE BUSINESS TAX RATE CHANGES
(Millions of Dollars)

Single Business Tax	FY 1998-99	FY 1999-2000	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2000-01 to FY 2005-06 Total
Tax Rate Phased-In Reduction (Effective Jan. 1)	2.2%	2.1%	2.0%	1.9%	1.9%	1.9%	1.9%	1.9%	
Rate Change Effect on State Revenue	($88)	($209)	($310)	($409)	($388)	($387)	($403)	($405)	$2,302
Credits Enacted				Iron Ore Tax Credit, Federal Tax Change	Gross Receipts Filing Threshold Increased to $350,000	Federal & State Research Grant Exemption, Donated Auto Credit, Phased Partial Exemption for Employee Health Care Costs, Apprenticeship Credit	Small Business New Worker Credit (2005 only)	Manufacturing Personal Property Tax 15% Refundable Credit, In-Sourcing Jobs Personal Property Tax Credit, Apportionment Sales Factor Increase	
SBT Total Revenue Loss			**($328)**	**($432)**	**($430)**	**($433)**	**($460)**	**($580)**	**($2,663)**

Source: Estimates adopted by the Senate Fiscal Agency, House Fiscal Agency, and Michigan Department of Treasury

Along with the SBT rate reductions, a number of tax credits also were implemented between FY 2000-01 and FY 2005-06 (Table 5). Together, the expansion of credits and exemptions within the SBT resulted in a loss of over $361.0 million in revenue to the State. The expansion of credits and exemptions combined with the SBT rate reduction resulted in a revenue loss of approximately $2.7 billion to the State of Michigan between FY 2000-01 and FY 2005-06. All of the revenue collected from Michigan's SBT is deposited into the State's GF/GP budget.

Since the adoption of reductions to Michigan's SBT and personal income tax in 1999, the State's revenue collections have fallen significantly below forecasted levels. Collectively, the rate reductions and credit and exemption expansions to these two taxes has led to a loss of an estimated $7.0 billion between FY 2000-01 and FY 2005-06.

Tobacco Taxes

Between FY 2000-01 and FY 2005-06, Michigan's tobacco products tax was increased on two separate occasions. The Michigan Legislature raised the State's cigarette tax from $0.75 per pack to $1.25 per pack in FY 2001-02 (effective August 1, 2002) in order to help balance the GF/GP and SAF budgets. As Table 6 shows, this increase represented an added $57.0 million in the revenue collected in FY 2001-02 and an additional $287.0 million in FY 2002-03.

Table 6

EFFECTS OF TOBACCO TAX RATE CHANGES
(Millions of Dollars)

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2000-01 to FY 2005-06 Total
Tobacco Tax						
Tobacco Tax Increase	+$0.75 to $1.25		+$1.25 to $2.00			
Rate Change Effect on State Revenue	**$57**	**$287**	**$380**	**$592**	**$589**	**$1,905**

Source: Estimates adopted by the Senate Fiscal Agency, House Fiscal Agency, and Michigan Department of Treasury

In response to the budget problems facing the State in FY 2003-04 and FY 2004-05, the Michigan Legislature again approved an increase to Michigan's tobacco products tax in June 2004. Effective July 1, 2004, the cigarette tax rose from $1.25 per pack to $2 per pack, the second-highest state cigarette tax in the nation. The cigarette tax increase, combined with increased revenue from the tax on other tobacco products (including chewing tobacco and cigars) and the tobacco inventory tax, yielded an estimated $380.0 million in additional State revenue in FY 2003-04 (Table 6).

Between FY 2000-01 and FY 2005-06, the amount of revenue collected by Michigan through the tobacco products tax rose by 96.0%, with the tax increases resulting in an estimated $1.9 billion in additional revenue to the State.

Revenue collected from the tobacco tax is distributed through a fairly complex formula. A majority of the proceeds from the cigarette tax goes into the SAF (41.6%) and the Medicaid Benefits Trust Fund (31.9%). The remaining revenue from the cigarette tax is divided among the GF/GP budget (19.8%), the Healthy Michigan Fund (3.8%), the Health and Safety Fund (2.4%), and Wayne County Indigent Health Care (0.6%). Additionally, the revenue collected from other tobacco products and from the inventory tax is divided between the Medicaid Benefits Trust Fund (75.0%) and the GF/GP budget (25.0%).

Casino Tax

Along with the increase to the tobacco products tax, the Michigan Legislature raised the State's casino and gaming tax to bolster the State's revenue collections during ongoing budgetary shortfalls in FY 2003-04 and FY 2004-05. Effective September 1, 2004, Public Act 306 of 2004 amended the Michigan Gaming Control and Revenue Act to impose a wagering tax of 6.0% on a casino licensee's Adjusted Gross receipts from gaming, in addition to the existing 18.0% wagering tax, until the casino is fully operational and in a permanent location. This legislation also provides for increases in the additional wagering tax if the casino is not fully operational. This tax affects the three non-Indian casinos located in Detroit.

The 6.0% increase raised the State's share of the wagering tax from 8.1% to 12.1%. This added an estimated $4.0 million to the State's revenue collections in FY 2003-04. For FY 2004-05, the first full year that the increased tax was in effect, it raised an estimated $49.0 million in additional revenue for the State of Michigan (Table 7).

Table 7

EFFECTS OF CASINO TAX RATE CHANGES
(Millions of Dollars)

	FY 2003-04	FY 2004-05	FY 2005-06	FY 2003-04 to FY 2005-06 Total
Casino Tax Increase	Increase from 8.1% to 12.1%			
Rate Change Effect on State Revenue	**$4**	**$49**	**$49**	**$102**

Source: Estimates adopted by the Senate Fiscal Agency, House Fiscal Agency, and Michigan Department of Treasury

Of the additional revenue from the wagering tax, one-third is allocated to the City of Detroit, seven-twelfths to the General Fund, and one-twelfth to the Agriculture Equine Industry Development Fund (AEIDF). The revenue collected by the State on casinos in temporary locations is projected to decline in the coming years. Once a casino is certified to be fully operational, the additional tax rate will be reduced to 1.0%, all of which will go to the City of Detroit. One of the three casinos opened in its permanent facility on October 2, 2007, and a second is expected to open its new building on January 1, 2008. It is still not clear when the last one will be in its permanent facility, perhaps sometime during FY 2008-09.

The 2004 law also imposes higher additional tax rates on casinos failing to become fully operational by July 1, 2009: 7.0% in 2009, 8.0% in 2010, and 9.0% in 2011. The revenue from this increase is to be divided among the city, the AEIDF, and the General Fund in varying proportions.

Effect of Federal Taxes on Michigan Revenue

In June 2001, President Bush and the U.S. Congress enacted the largest reduction to Federal taxes since 1982. As a component of the Economic Growth and Tax Relief Reconciliation Act of 2001, these cuts primarily affected the Federal individual income and estate taxes. In Michigan, the State's income and estate taxes are directly tied to key aspects of the Federal income and estate taxes, including key definitions, measures of income, and tax credits. The Federal tax cuts enacted in 2001 changed these key Federal tax components on which Michigan's taxes are based; therefore, Michigan's taxes also were affected by the Federal tax cuts and will continue to be affected until FY 2010-11, when the tax cuts are set to expire.

Michigan's personal income tax is determined according to the formula for Federal Adjusted Gross income (AGI). Therefore, the changes to Federal AGI also affected Michigan's income tax revenue. It is also important to note that the cut in the Federal income tax rates had no direct impact on Michigan's income tax because Michigan's tax rate is determined by the State Legislature.

As Table 8 demonstrates, changes in the credits and exemptions used to determine AGI had a negative impact on the State's revenue collections. These special tax provisions included educational expenses, individual retirement arrangements (IRAs) and pensions, and credits for adoptions. Together, they represented a loss of nearly $200.0 million in State revenue from personal income taxes between FY 2001-02 and FY 2005-06.

Table 8

IMPACT OF THE 2001 FEDERAL TAX CHANGES ON MICHIGAN'S TAX REVENUE
(Millions of Dollars)

Federal Tax Changes	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2001-02 to FY 2005-06 Total
Personal Income Tax	($23)	($41)	($48)	($45)	($42)	($199)
Single Business Tax	(5)	(5)	(5)	(5)	(5)	(25)
Estate Tax	(9)	(45)	(129)	(305)	(180)	(668)
Total Loss in State Revenue Due to Federal Tax Changes						**($892)**

Source: Estimates adopted by the Senate Fiscal Agency, House Fiscal Agency, and Michigan Department of Treasury

The Federal Economic Growth and Tax Relief Reconciliation Act of 2001 also included phasing out the estate tax and phasing out the state death tax credit by 2006. While Michigan's estate tax did not increase the tax burden on an estate, it captured some of the tax revenue that otherwise would have gone to the Federal government. As a result of these changes, the revenue from Michigan's estate tax declined beginning in FY 2001-02 and was eliminated in 2005. Michigan's estate tax, which generated about $155.0

million in FY 2000-01, lost an estimated $668.0 million in revenue between FY 2001-02 and FY 2005-06 as a result of the changes at the Federal level (Table 8).

A third aspect of the 2001 Federal tax cuts that had an impact on the State's revenue collections was the effect of the Federal tax changes on the calculation of the SBT. These changes, coupled with the Federal Job Creation and Worker Assistance Act of 2002, which also included changes that affected Michigan's SBT base, resulted in the loss of an estimated $25.0 million in revenue to the State between FY 2001-02 and FY 2005-06.

In sum, changes made to the Federal tax code during 2001 and 2002 have led to a loss of an estimated $892.0 million in State revenue between FY 2001-02 and FY 2005-06. This loss in revenue has primarily affected the GF/GP budget in Michigan.

Nontax Revenue

Nontax revenue during the six-year period between FY 2000-01 and FY 2005-06 grew by just under $2.0 billion: an overall increase of 14.2% (Table 1). This growth can be largely attributed to a 31.8% increase in Federal revenue received and appropriated in the State budget. This growth in Federal revenue helped offset some of the pressures facing the overall State budget in the second half of this six-year period. Just as the amount of Federal funds received increased, so did the percentage of Federal funds appropriated in the Michigan budget. In FY 2000-01, Federal funds made up 27.1% of the total Adjusted Gross appropriations. As Table 9 shows, by FY 2005-06, 31.9% of total Adjusted Gross appropriations were from Federal funds.

Table 9

FEDERAL FUNDS APPROPRIATED IN THE MICHIGAN BUDGET
(Millions of Dollars)

Fiscal Year	Federal Funds Appropriated	Total Michigan Budget Adjusted Gross Appropriations	Federal Funds as Percentage of Total Adjusted Gross
FY 2000-01	$10,002.2	$36,953.3	27.1%
FY 2001-02	11,242.9	38,751.3	29.0
FY 2002-03	12,226.7	39,553.1	30.9
FY 2003-04	12,361.6	39,115.3	31.6
FY 2004-05	12,856.5	39,909.5	32.2
FY 2005-06	13,179.9	41,322.7	31.9%
Change from FY 2000-01 to FY 2005-06	**$3,177.7**		
% Increase of Federal Funds	**31.8%**		

Source: Senate Fiscal Agency

The State Revenue Limit

In 1978, the Michigan voters approved a constitutional amendment (Article IX, Section 26) to limit the amount of revenue the State could collect in a given year. The State revenue limit prohibits the State government from collecting revenue that exceeds 9.49% of Michigan personal income for the calendar year prior to the calendar year in which the State's fiscal year begins. For example, in FY 2005-06, total State revenue could not exceed 9.49% of the total personal income for calendar year 2004. The revenue subject to the limit includes total State government tax revenue and revenue from all other State sources including fees, permits, licenses, and interest earnings. Federal funds appropriated in the State budget are excluded from the revenue limit.

Since the revenue limit was placed in the State Constitution, Michigan's total State revenue exceeded the revenue limit three times: in FY 1994-95, FY 1998-99, and FY 1999-2000. The Constitution provides that if actual revenue exceeds the limit by greater than 1.0%, the amount of revenue in excess of the limit must be refunded to taxpayers. If actual revenue exceeds the limit by less than 1.0%, the amount of revenue in excess of the limit must transferred to the Budget and Economic Stabilization Fund. During the three fiscal years in which the revenue limit was exceeded, the amount of the excess revenue was less than 1.0%.

Table 10 provides a summary of the State's compliance with the revenue limit for the period FY 1999-2000 through FY 2005-06. Actual revenue collections exceeded the revenue limit by $159.7 million in FY 1999-2000. By FY 2005-06, actual revenue collections had fallen to $4.9 billion under the revenue limit. This change in compliance with the revenue limit over this six-fiscal year period helps underscore the downsizing of State government that has occurred in recent years. Everything else being equal, one would probably anticipate that governmental spending would grow in an amount equal to the growth in State personal income. Michigan's decline in recent years has resulted in a declining State tax burden in relation to the size of the Michigan economy.

Table 10

STATE'S COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT
(Millions of Dollars)

Fiscal Year	Actual Amount Under/(Over) Limit
1999-2000	($159.7)
2000-01	2,406.2
2001-02	3,917.1
2002-03	4,181.5
2003-04	4,440.7
2004-05	4,215.5
2005-06	4,946.2

Source: Senate Fiscal Agency

STATE APPROPRIATIONS

Changes in State Appropriations

The recent economic problems in the State coupled with statutory changes in State taxes resulted in relatively restrained growth in State appropriations during the period FY 2000-01 through FY 2005-06. The level of overall State appropriation growth during this time period was supported by significant growth in the level of Federal funds received by the State and appropriated in the budget. This section of the report discusses recent trends in State appropriations.

Overall State Appropriation Growth

Table 11 provides a summary of Michigan's level of Adjusted Gross appropriations for the period FY 2000-01 through FY 2005-06. Adjusted Gross appropriations are the broadest measure of State appropriations and include all fund sources. This level of appropriations grew by 11.8% over the six-fiscal year period, or at an average annual growth rate of 2.4%.

Table 11

ADJUSTED GROSS APPROPRIATION HISTORY
(Millions of Dollars)

Fiscal Year	Appropriations	Dollar Change	Percent Change
FY 2000-01	$36,953.3	$1,535.6	4.3%
FY 2001-02	38,751.3	1,798.0	4.9
FY 2002-03	39,553.1	801.8	2.1
FY 2003-04	39,115.3	(437.8)	(1.1)
FY 2004-05	39,909.5	794.2	2.0
FY 2005-06	41,322.7	1,413.2	3.4
Change from FY 2000-01 to FY 2005-06.............................		**$4,369.4**	**11.8%**

Source: Senate Fiscal Agency

Table 12 provides a summary of Michigan's State Spending from State Resources appropriations for the period FY 2000-01 through FY 2005-06. State Spending from State Resources appropriations are the Adjusted Gross level of appropriations less appropriations supported by Federal and local and private revenue sources. This level of appropriations increased by 7.5% over the six-fiscal year period, or at an average annual growth rate of 1.5%. The actual level of State Spending from State Resources appropriations declined in FY 2002-03 and FY 2003-04 before growing modestly in FY 2004-05 and FY 2005-06.

Table 12

STATE SPENDING FROM STATE RESOURCES APPROPRIATION HISTORY (Millions of Dollars)			
Fiscal Year	**Appropriations**	**Dollar Change**	**Percent Change**
FY 2000-01	$25,761.6	$1,182.6	4.8%
FY 2001-02	26,086.8	325.2	1.3
FY 2002-03	26,020.5	(66.3)	(0.3)
FY 2003-04	25,802.5	(218.0)	(0.8)
FY 2004-05	26,285.3	482.8	1.9
FY 2005-06	27,704.0	1,368.7	5.2
Change from FY 2000-01 to FY 2005-06..............................		**$1,942.4**	**7.54%**

Source: Senate Fiscal Agency

The measure of State appropriations that has experienced the most impact from economic conditions and tax reductions in recent years is General Fund/General Purpose (GF/GP) appropriations. This measure of appropriations is defined as State Spending from State Resources appropriations less State Restricted revenue. The GF/GP level of appropriations is commonly considered the measure of appropriations that is under the most control of the Legislature and the Governor. Table 13 provides a summary of GF/GP appropriations for the period FY 2000-01 through FY 2005-06. Appropriations decreased by 7.1% over this six-fiscal year period. The appropriations supported by GF/GP revenue were most significantly affected by the recent tax policy changes discussed earlier in this report.

Table 13

GENERAL FUND/GENERAL PURPOSE APPROPRIATION HISTORY (Millions of Dollars)			
Fiscal Year	**Appropriations**	**Dollar Change**	**Percent Change**
FY 2000-01	$9,744.4	$136.7	1.4%
FY 2001-02	9,189.3	(555.1)	(5.7)
FY 2002-03	8,830.9	(358.4)	(3.9)
FY 2003-04	8,770.1	(60.8)	(0.7)
FY 2004-05	8,702.8	(67.3)	(0.8)
FY 2005-06	9,056.6	353.8	4.1
Change from FY 2000-01 to FY 2005-06..............................		**($687.8)**	**(7.1)%**

Source: Senate Fiscal Agency

Departmental Appropriation Growth

As illustrated in Table 11, Adjusted Gross appropriations grew by 11.8% from FY 2000-01 through FY 2005-06. Individual programs within the State budget experienced considerably different levels of growth during that time period. Comparing Adjusted Gross appropriations in FY 2000-01 with the appropriations in FY 2005-06 is complicated by the fact that numerous programs that had been appropriated in one department in FY 2000-01 were appropriated in a different department in FY 2005-06. In order to show accurately the change in departments' appropriations over this time period, adjustments need to be made in these types of appropriations.

Table 14 adjusts the FY 2000-01 Adjusted Gross appropriations so that they are comparable to the appropriation structure in place during FY 2005-06. The major adjustments on the table reflect the establishment of three new departments: The Departments of History, Arts, and Libraries, Labor and Economic Growth, and Human Services. Departments that existed in FY 2000-01 and were eliminated include the Departments of Career Development, Consumer and Industry Services, and Library of Michigan, and the Family Independence Agency. Other adjustments include the movement of a significant amount of Federal funds from the Department of Education to the K-12 School Aid budget and the movement of debt service appropriations on State Building Authority bonds from the Capital Outlay budget to the Department of Treasury budget.

Table 15 provides a summary and comparison of the actual level of Adjusted Gross appropriations for each budget area for FY 2000-01, as adjusted for program transfers, and FY 2005-06. Total Adjusted Gross appropriations increased from $36.9 billion in FY 2000-01 to $41.3 billion in FY 2005-06. During FY 2005-06 the largest individual appropriations by budget area were the K-12 School Aid budget, $12.7 billion, followed by the Department of Community Health at $10.5 billion. These two budgets accounted for 56.2% of the total Adjusted Gross appropriations in FY 2005-06.

The range of growth in Adjusted Gross appropriations from FY 2000-01 to FY 2005-06, by budget area, varies considerably. Appropriations for the Strategic Fund Agency increased by 191.6%, and appropriations for the Secretary of State and the Department of State Police increased by 41.1% and 31.9%, respectively. On the other end of the scale, appropriations for the Department of Education declined by 45.2%, appropriations for revenue sharing payments declined by 29.0%, and appropriations to the Department of History, Arts, and Libraries declined by 32.5%.

The large increase in appropriations to the Michigan Strategic Fund primarily reflects the appropriation in FY 2005-06 of $400.0 million of revenue for economic development programs through the 21st Century Jobs Fund. These appropriations were financed by the borrowing against future State of Michigan tobacco settlement revenue. The appropriation increase in the Secretary of State is primarily attributable to a reclassification of fund sources that did not result in program expansions. The appropriation increase in the Department of State Police can be primarily attributed to substantial increases in the amount of Federal funds available for homeland security programs.

Table 14

FY 2000-01 ADJUSTED GROSS APPROPRIATIONS
ACTUAL AND ADJUSTED FOR PROGRAM TRANSFERS
(Actual Dollars)

	FY 2000-01 Actual	Adjustments	FY 2000-01 Adjusted
Agriculture	$107,213,600		$107,213,600
Attorney General	52,415,364		52,415,364
Capital Outlay	455,771,100	$(276,934,600)	178,836,500
Career Development	532,137,600	(532,137,600)	0
Civil Rights	15,200,900		15,200,900
Civil Service	30,260,600		30,260,600
Clean Michigan Initiative	136,340,100	(136,340,100)	0
Community Colleges	325,011,719		325,011,719
Community Health	8,572,238,500		8,572,238,500
Consumer and Industry Services	543,729,600	(543,729,600)	0
Corrections	1,699,566,400		1,699,566,400
Education	929,476,900	(708,941,400)	220,535,500
Environmental Quality	392,605,600	136,340,100	528,945,700
Executive	5,651,200		5,651,200
Family Independence Agency	3,719,799,800	(3,719,799,800)	0
Higher Education	1,910,550,908		1,910,550,908
History, Arts, and Libraries	0	74,381,700	74,381,700
Human Services	0	3,719,799,800	3,719,799,800
Judiciary	233,305,500		233,305,500
Labor and Economic Growth	0	1,049,281,000	1,049,281,000
Legislature	106,420,700	13,450,100	119,870,800
Legislative Auditor General	13,450,100	(13,450,100)	0
Library of Michigan	39,916,700	(39,916,700)	0
Management and Budget (Operations)	102,981,700		102,981,700
Military Affairs	103,401,000		103,401,000
Natural Resources (Operations)	257,942,100		257,942,100
Natural Resources (Trust Fund)	38,240,400		38,240,400
School Aid	10,892,285,000	708,941,400	11,601,226,400
State	134,073,400	(7,878,800)	126,194,600
State Police	410,618,450		410,618,450
Strategic Fund	168,654,800		168,654,800
Transportation	3,026,013,725		3,026,013,725
Treasury (Debt Service)	91,570,500		91,570,500
Treasury (Operations)	350,950,800	276,934,600	627,885,400
Treasury (Revenue Sharing)	1,555,462,000		1,555,462,000
Total Adjusted Gross Appropriations	**$36,953,256,766**	**$0**	**$36,953,256,766**

Source: Senate Fiscal Agency

Table 15

ADJUSTED GROSS APPROPRIATIONS BY BUDGET AREA (Actual Dollars)				
	FY 2000-01 Adjusted	**FY 2005-06**	**Dollar Difference**	**% Change**
Agriculture	$107,213,600	$110,684,200	$3,470,600	3.2%
Attorney General	52,415,364	52,339,700	(75,664)	(0.1)
Capital Outlay	178,836,500	236,575,500	57,739,000	32.3
Civil Rights	15,200,900	13,674,900	(1,526,000)	(10.0)
Civil Service	30,260,600	30,270,700	10,100	0.0
Community Colleges	325,011,719	281,552,400	(43,459,319)	(13.4)
Community Health	8,572,238,500	10,527,543,600	1,955,305,100	22.8
Corrections	1,699,566,400	1,884,510,400	184,944,000	10.9
Education	220,535,500	120,957,400	(99,578,100)	(45.2)
Environmental Quality	528,945,700	438,692,700	(90,253,000)	(17.1)
Executive	5,651,200	5,375,500	(275,700)	(4.9)
Higher Education	1,910,550,908	1,734,443,900	(176,107,008)	(9.2)
History, Arts, and Libraries	74,381,700	53,201,200	(21,180,500)	(28.5)
Human Services	3,719,799,800	4,529,373,700	809,573,900	21.8
Judiciary	233,305,500	252,968,400	19,662,900	8.4
Labor and Economic Growth	1,049,281,000	1,237,257,700	187,976,700	17.9
Legislature	119,870,800	127,638,400	7,767,600	6.5
Management & Budget	102,981,700	81,094,000	(21,887,700)	(21.3)
Military Affairs	103,401,000	120,978,800	17,577,800	17.0
Natural Resources	257,942,100	277,299,900	19,357,800	7.5
Natural Resources (Trust Fund)	38,240,400	39,357,900	1,117,500	2.9
School Aid	11,601,226,400	12,700,614,500	1,099,388,100	9.5
State	126,194,600	178,078,400	51,883,800	41.1
State Police	410,618,450	541,724,200	131,105,750	31.9
Strategic Fund	168,654,800	491,717,700	323,062,900	191.6
Transportation	3,026,013,725	3,424,910,200	398,896,475	13.2
Treasury (Debt Service)	91,570,500	89,001,400	(2,569,100)	(2.8)
Treasury (Operations)	627,885,400	637,268,900	9,383,500	1.5
Treasury (Revenue Sharing)	1,555,462,000	1,103,626,325	(451,835,675)	(29.0)
Total Adjusted Gross Appropriations	**$36,953,256,766**	**$41,322,732,525**	**$4,369,475,759**	**11.8%**

Source: Senate Fiscal Agency

Funding for education programs, K-12 School Aid, community colleges, and higher education grew less than the average over the time period. Appropriations for K-12 School Aid increased by 9.5% and appropriations for community colleges and higher education declined by 13.4% and 9.2%, respectively. State revenue sharing payments over the time period declined by 29.0%. This decline is primarily attributed to the elimination of statutory revenue sharing payments to counties. Counties offset this loss of revenue sharing appropriations with revenue that resulted from a change in the collection date of county property taxes.

The changes in Adjusted Gross appropriations over FY 2000-01 through FY 2005-06 are best summarized by Table 16. This table provides the relative shares of Adjusted Gross appropriations for the Departments of Community Health and Human Services versus the shares for K-12 School Aid, community colleges, higher education, and revenue sharing payments. Over this six-fiscal year period, Adjusted Gross appropriations for Community Health and Human Services increased from 33.3% of the total budget to 36.4%. Over the same period, Adjusted Gross appropriations for K-12 School Aid, community colleges, higher education, and revenue sharing payments declined from 41.6% of the total budget to 38.3%. The general priorities in the budget led to increased spending for health care and welfare programs at the expense of education spending and aid to local government.

Table 16

SHARE OF ADJUSTED GROSS APPROPRIATIONS
FY 2000-01 AND FY 2005-06
(Millions of Dollars)

Budget Area	FY 2000-01	FY 2000-01 % of Total	FY 2005-06	FY 2000-01 % of Total
Community Health	$8,572.2	23.2%	$10,527.5	25.5%
Human Services	3,719.8	10.1	4,529.4	11.0
Subtotal	$12,292.0	33.3%	$15,056.9	36.4%
K-12 School Aid	11,601.2	31.4	12,700.6	30.7
Community Colleges	325.0	0.9	281.6	0.7
Higher Education	1,910.6	5.2	1,734.4	4.2
Revenue Sharing	1,555.5	4.2	1,103.6	2.7
Subtotal	$15,392.3	41.6%	$15,820.2	38.3%
Total Appropriations	**$36,953.3**	**100.0%**	**$41,322.7**	**100.0%**

Source: Senate Fiscal Agency

Federal Funds

While Adjusted Gross appropriations grew only by 11.8% over the six-year period from FY 2000-01 through FY 2005-06, the fact that Federal funds appropriated in the budget have significantly increased over the same period acted as a cushion in the overall State budget. Table 17 provides a brief summary of the major appropriations of Federal funds in the budget for FY 2000-01 and FY 2005-06. The level of Adjusted Gross appropriations supported by Federal funds increased from $10.0 billion or 27.1% of Adjusted Gross appropriations in FY 2000-01 to $13.2 billion or 31.9% of Adjusted Gross appropriations in FY 2005-06. At the end of the period, Federal funds accounted for 54.0% of the appropriations in the Department of Community Health and 71.4% of the appropriations in the Department of Human Services. The fate of the State budget in many budget areas is directly tied to the availability of Federal funds authorized by the United States Congress.

Table 17

FEDERAL FUNDS APPROPRIATED IN STATE BUDGET
(Millions of Dollars)

Budget Area	FY 2000-01	% of Adjusted Gross Appropriations	FY 2005-06	% of Adjusted Gross Appropriations
Community Health	$4,511.4	52.6%	$5,689.0	54.0%
Human Services	2,332.7	62.7	3,233.6	71.4
Transportation	916.2	30.3	1,210.7	35.3
Education Programs	1,037.5	7.4	1,469.9	9.9
Labor and Economic Growth	778.3	74.2	882.9	71.4
All Other Programs	426.1	6.6	693.8	10.3
Total Federal Funds	**$10,002.2**	**27.1%**	**$13,179.9**	**31.9%**

Source: Senate Fiscal Agency

THE STATE OF MICHIGAN WORKFORCE

Size of State Workforce

In FY 2000-01, the State of Michigan employed 63,158 full-time equated (FTE) employees. This number steadily dropped to the FY 2005-06 level of 53,824. This decrease in the State's workforce can be explained by a number of events, including hiring freezes and the FY 2002-03 early-out retirement plan for State employees.

Table 18 provides a summary of the changes in the State's workforce between FY 2000-01 and FY 2005-06. Roughly 3,000 employees retired during FY 2000-01 and approximately 5,000 additional employees retired during FY 2002-03 under an early-out retirement plan that was offered during a four-month window of July 1, 2002, to November 1, 2002.[1]

[1] Michigan Civil Service Commission

Table 18

AVERAGE FTE BY FISCAL YEAR FY 2001-02 to FY 2005-06	
Fiscal Year	**Average Number of FTEs**
2000-01	63,158
2001-02	60,881
2002-03	55,505
2003-04	54,615
2004-05	54,859
2005-06	53,824

Source: State of Michigan Department of Civil Service Annual Workforce Reports

A component of Governor Engler's FY 2002-03 budget recommendations, the early-out plan called for a replacement ratio of one-to-four, providing that for every four employees who retired, only one, on average, would be replaced. Although this plan was the eighth early retirement option offered to State employees since 1984, it was among the most significant. Figure 1 demonstrates the evident impact of early employment options on employment. Each year with an early retirement option shows a decline in the number of State employees. Despite these decreases, the number of employees tended to rise quickly after the options expired and departments hired new employees to compensate for their depleted workforce. The most recent early retirement window during 2002-03 demonstrates this dramatic decline and is significant in that it was not followed by a steady rise in employment numbers due to the four-to-one ratio requirement.

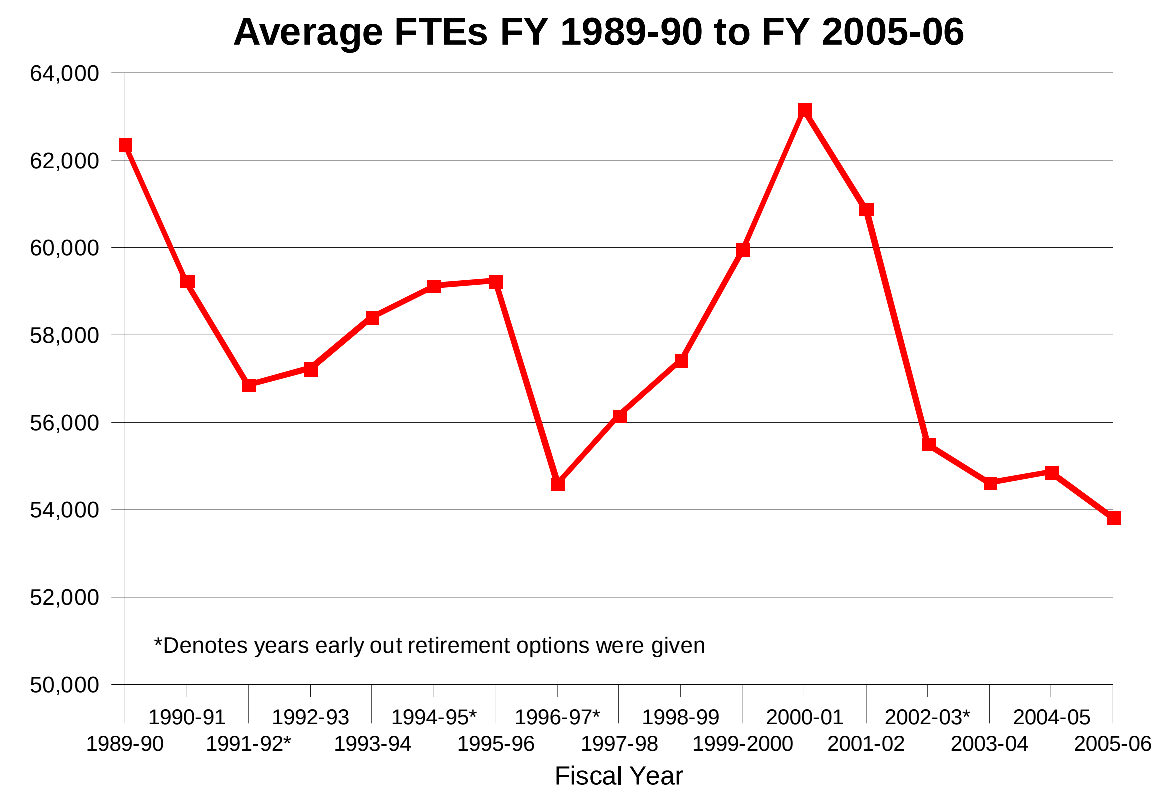
In addition to diminishing the size of the State workforce, the early-out retirement plan decreased the average salary of State employees. The average annual salary of a State FTE employee grew by only 1.1% at the start of this period (Table 19). This reduction is primarily due to the departure of high wage earners who took advantage of the early retirement option and their replacement with much lower (entry-level) wage earners.

A second factor explaining the shrinking State workforce is the hiring freeze that was enacted in FY 1991-92. Part of an effort to help balance the State budget during an economic recession, the hiring freeze has been continued in all subsequent fiscal years leading up to the present and is imposed on all State departments and agencies. The hiring freeze language (found in each year's appropriation bills) prohibits departments from hiring additional employees or filling vacancies other than those subject to exceptions granted by the State Budget Director.

In 2000, it was estimated that the hiring freeze had resulted in a net loss of 13,343 employees. Between FY 1991-92, when the hiring freeze was enacted, and FY 1999-2000, 37,505 new employees were hired and 50,848 employees left the State workforce.

In contrast, 33,540 employees left the State workforce between FY 2000-01 and FY 2005-06 and 20,515 new employees were hired. This means that the State of Michigan had a net loss of 13,025 employees during the six-year period -- roughly the same number of employees lost in the nine years before FY 2000-01 that were under the same hiring freeze structure.[2]

Figure 1



Source: Department of Civil Service Annual Workforce Reports FY 1989-90 to FY 2005-06

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[2] Michigan Department of Civil Service Annual Workforce Reports, FY 1991-92 to FY 2005-06

Cost of the State Workforce[3]

While the number of State employees has declined, Michigan's annual expenditures on the State workforce have steadily increased. As Table 19 illustrates, the average FTE salary and the total State Classified Employee Payroll have continued to rise as the number of employees statewide dropped between FY 2000-01 and FY 2005-06.

Table 19

FTE SALARY BY FISCAL YEAR
FY 2000-01 – FY 2005-06

Fiscal Year	Number of Employees Statewide	Average FTE Salary	% Change in Average Salary	Average FTE Salary Including Fringe Benefits	% Change in Avg. Salary Including Fringe Benefits	Total State Classified Payroll
FY 2000-01	63,158	$42,640		$60,996		$3,785,000,000
FY 2001-02	60,881	43,722	2.5%	62,113	1.8%	3,920,000,000
FY 2002-03	55,505	44,221	1.1	65,971	6.2	3,816,000,000
FY 2003-04	54,615	45,885	3.8	69,896	5.9	3,758,000,000
FY 2004-05	54,859	48,235	5.1	74,381	6.4	4,170,000,000
FY 2005-06	53,824	49,462	2.5	77,816	4.6	4,412,000,000

Source: State of Michigan Department of Civil Service Annual Workforce Reports

During the six years from FY 2000-01 through FY 2005-06, the State classified payroll as a percentage of total State expenditures also grew (Table 20). For FY 2005-06, State classified payroll comprised 11.0% of the State's total expenditures, up 0.6% from FY 2000-01 and gaining 1.1% from the period's low in FY 2004-05.

Table 20

EMPLOYEE COSTS AS PERCENTAGE OF STATE TOTAL EXPENDITURES
(Millions of Dollars)

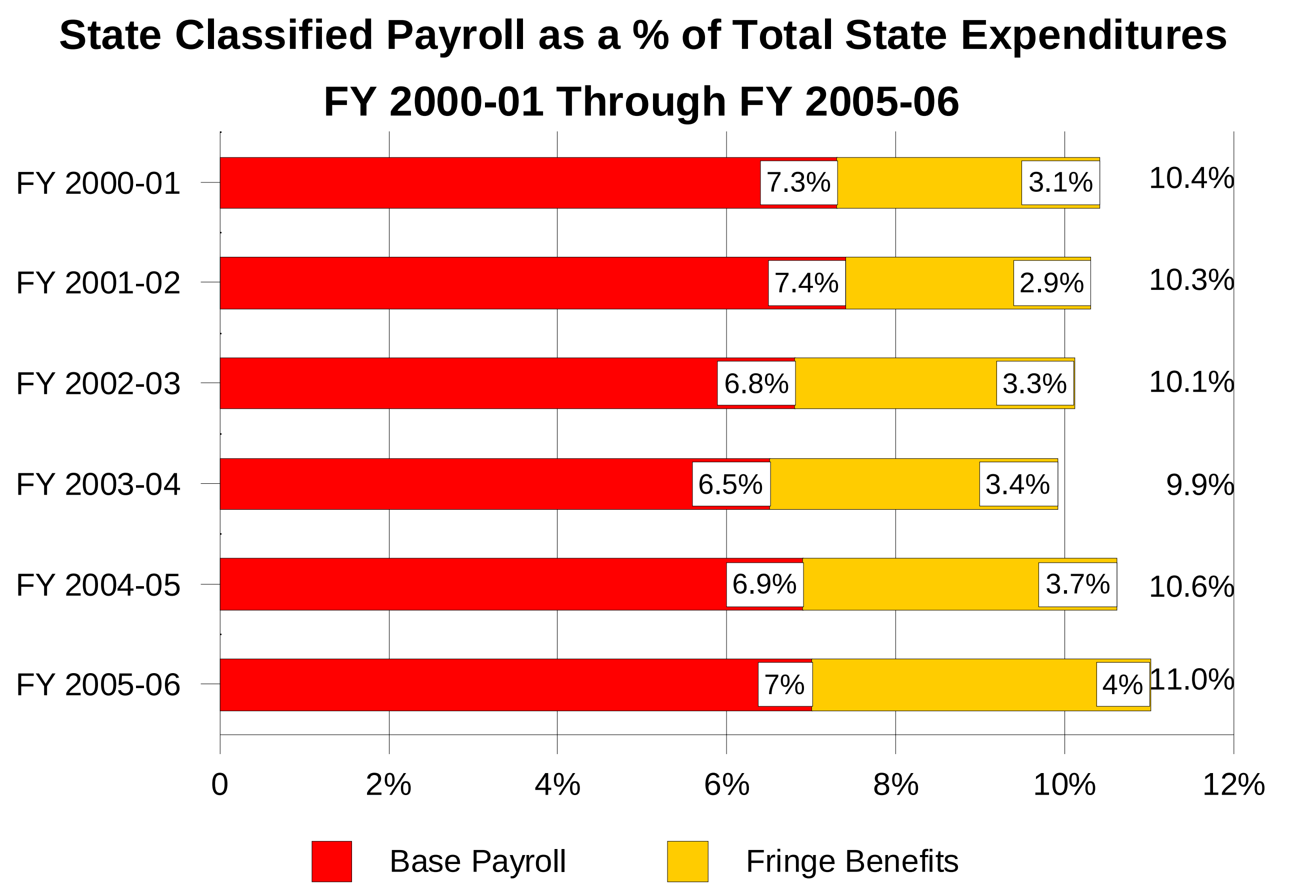
Fiscal Year	State Employee Wages and Benefits Total	Total State Expenditures	Percent
FY 2000-01	$3,785	$36,487	10.4%
FY 2001-02	3,920	37,969	10.3
FY 2002-03	3,816	37,956	10.1
FY 2003-04	3,758	37,940	9.9
FY 2004-05	4,170	39,221	10.6
FY 2005-06	4,412	39,999	11.0

Source: Michigan Department of Civil Service Annual Workforce Reports

[3] All Information in "Cost of the State Workforce" section provided by Michigan Department of Civil Service Annual Workforce Reports, FY 1991-92 to FY 2005-06

When the payroll for the State workforce is examined, it is important to determine what proportion of the expenditures are contributing to the actual employee base payroll and which are going toward fringe benefits such as health care and retirement. As Figure 2 demonstrates, even though State classified payroll as a percentage of total State expenditures increased over the six-year period, the actual amount that the State spent on individual wages and salaries remained relatively steady since FY 2000-01. The 0.6% and 0.3% drops during FY 2002-03 and FY 2003-04 can be explained by the early-out retirement options, when average salaries were driven down by the departure of primarily high wage-earning State employees.

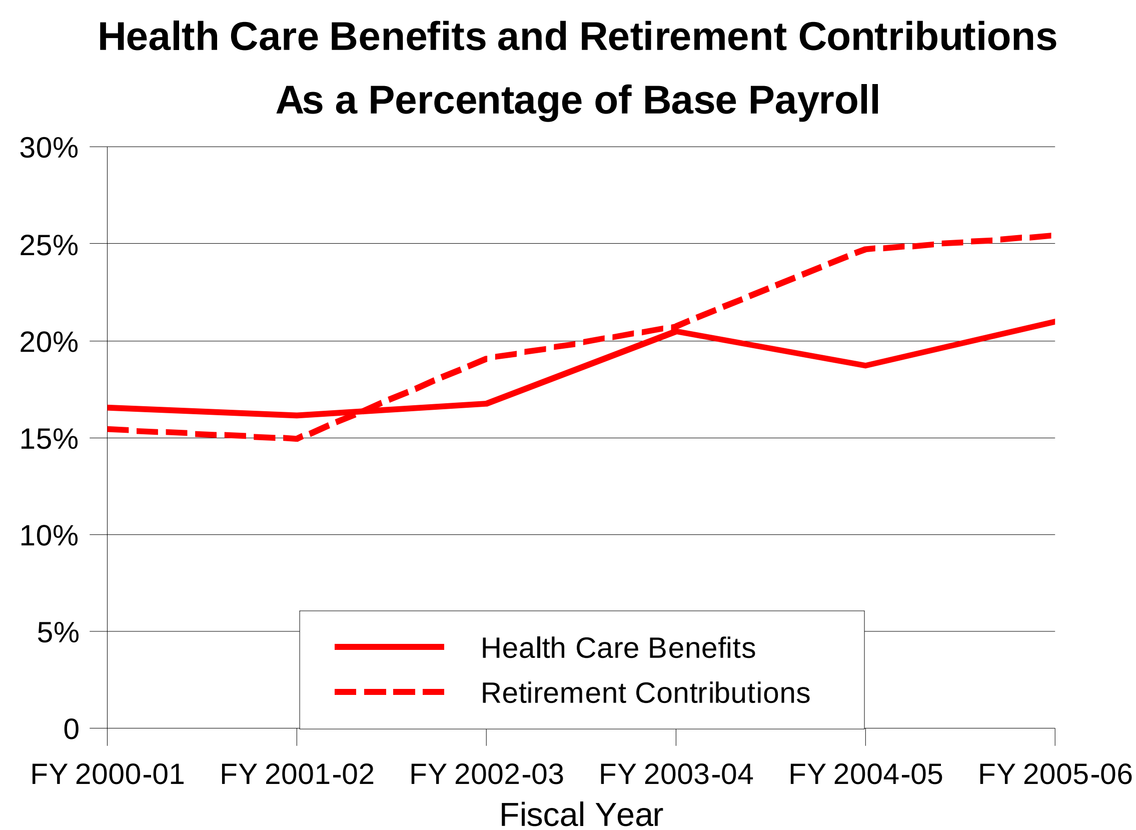
Figure 2



Source: Michigan Civil Service Annual Workforce Reports

Over the period from FY 2000-01 to FY 2005-06, the amount that the State contributed toward the State workforce fringe benefits continued to increase, growing to 4.0% in FY 2005-06. Figure 3 illustrates how health care and State contributions toward employees' retirement have begun to dominate the State workforce payroll. In FY 2005-06, State contributions toward State employee retirements accounted for 25.44% of the base payroll while health care contributions made up 20.97% of the base payroll. This means that even though the average State employee earned a salary of $49,653 in take-home wages, the total amount that the State of Michigan contributed after including employees' fringe benefits was on average $77,816.

Figure 3

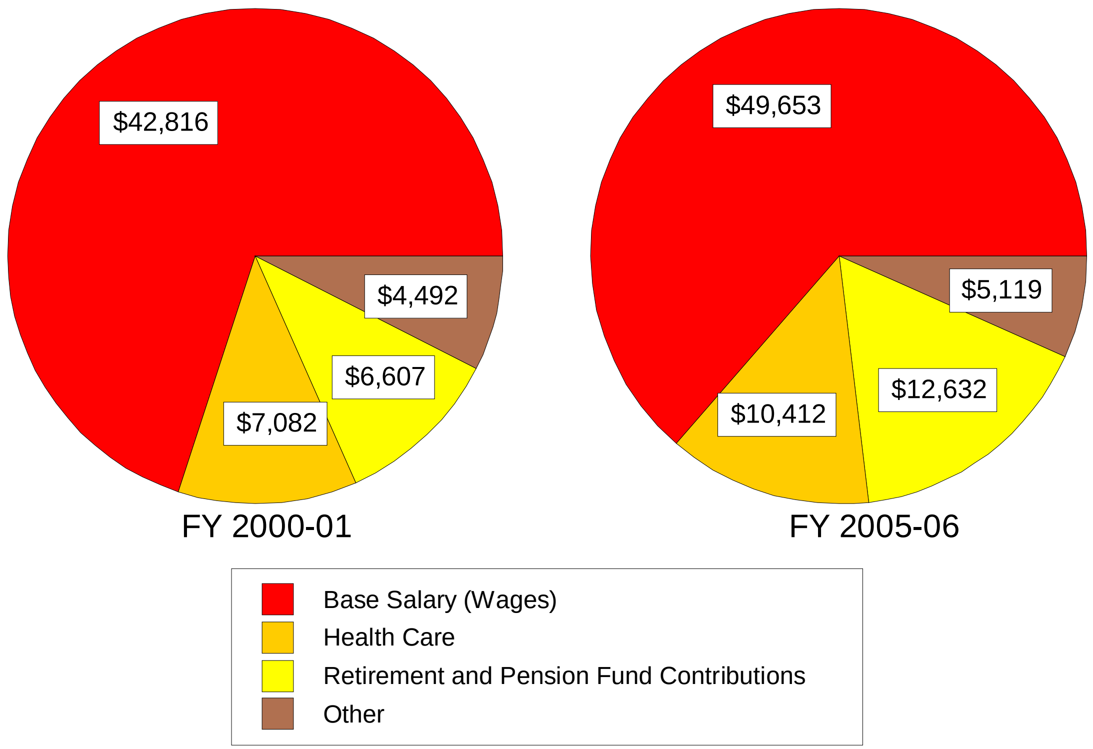


Source: Michigan Civil Service Annual Workforce Reports

Between FY 2000-01 and FY 2005-06, even as the State's workforce saw dramatic decreases, the proportion of base payroll dedicated to employee health care benefits grew from 16.54% to 20.97%, and the proportion dedicated to pension contributions grew from 15.43% to 25.44%, a jump of 4.43% and 10.01%, respectively (Figure 4).

Figure 4

Cost of State Employees



Source: Michigan Civil Service Annual Workforce Reports

These rising costs have been of concern for a number of years, as evidenced by the 401(k) Defined Contribution Retirement Plan for State employees hired on or after March 31, 1997. Under this plan, retirement benefits for State employees are made up of a State contribution of 4.0% of gross salary as well as a State match of up to 3.0% of an individual employee's contribution. State employees hired before March 31, 1997, fall under a Defined Benefit Retirement Plan in which retirement benefits depend upon years of service and a predetermined formula. Even with the implementation of the Defined Contribution Plan, the State's workforce expenditures continue to rise disproportionately to the number of workers employed.

State employee wage adjustments also contribute to the State's expenditures on its workforce. Contracts for State employees are usually negotiated every third year and any wage increases are subject to annual approval by the Legislature. Table 21 provides a summary of the annual wage adjustments for the State classified service since 1997.

Table 21

SUMMARY OF WAGE ADJUSTMENTS
STATE CLASSIFIED CIVIL SERVICE
FY 1997-98 TO FY 2006-07

Date	Percent Increase	Lump Sum Payments	Total of Base Wage Increase	Total Net Additional Costs
October 1, 1997	3.0%		$74,373,564	$91,884,837
October 1, 1998	3.0	$150	70,729,881	85,679,128
October 1, 1999	3.0		67,176,183	70,575,563
October 1, 2000	2.0		71,365,615	85,784,873
October 1, 2001	2.0	$375	74,264,397	90,984,774
October 1, 2002	2.0		51,589,607	65,140,376
October 1, 2003	3.0		69,039,426	93,550,677
October 1, 2004	4.0		96,047,856	131,155,231
October 1, 2005	1.0		37,762,968	41,324,339
April 9, 2006	1.0			
October 1, 2006	2.0		77,516,083	99,060,147
April 8, 2007	2.0			

Source: Michigan Office of the State Employer

In December 1998, the Civil Service Commission (CSC) approved a three-year collective bargaining agreement for FY 1999-2000, FY 2000-01, and FY 2001-02. While contractual provisions such as changes in health care benefits begin on January 1 at the start of the calendar year, wage increases do not become effective until October 1 at the onset of the State's fiscal year. The 1998 negotiations included a base wage increase of 3.0% for FY 1999-2000 and an increase of 2.0% for FY 2000-01 for all State classified employees. For FY 2001-02, all State employees excluding those classified as Institutional received an increase of 2.0% in addition to a lump sum payment of $375. State Institutional Employees, represented by AFSCME, received a base wage increase of 4.5% for FY 2001-02, with no lump sum payment. These contract negotiations resulted in a net additional cost to the State of $247.3 million.

The contract negotiated between the representative unions and the Office of State Employer for January 1, 2002, through December 31, 2004, included FY 2002-03, FY 2003-04, and FY 2004-05. During this period, hourly rates for State employees were increased by 2.0% at the start of FY 2002-03, 3.0% at the start of FY 2003-04, and 4.0% at the start of FY 2004-05, for a total increase of 9.0% during the contract period and a net additional cost to the State of $289.8 million.

In December 2004, the CSC approved a three-year collective bargaining agreement covering FY 2005-06, FY 2006-07, and FY 2007-08. The contract calls for wage increases applied at six-month intervals, first in October and again in April. These increases will result in an approximate increase of 10.4% during the three-year period. In FY 2005-06, employee wages rose 1.0% in October 2005 and again in April 2006. For FY 2006-07 and FY 2007-08, the wage increase is set at 2.0% for October 2006, April and October 2007, and April 2008. For FY 2005-06 and FY 2006-07, the full-year cost of the wage adjustments is only partially represented due to the phase-in method. The amounts of $41,324,339 in FY 2005-06 and $99,060,147 in FY 2006-07 represent approximately 75.0% of the total cost incurred by the State. These costs do not include the wage increases set for FY 2007-08 that began on October 1, 2007.

State Employee Concessions

Due to continuing declines in State revenue, Governor Granholm did not fund the proposed employee wage increases in her FY 2003-04 budget recommendations. Instead, the State Employer negotiated concessions from employee unions to offset a portion of the anticipated cost increases. State employees agreed to concessions in the form of banked leave time in FY 2003-04 and again during FY 2004-05.

During these banked leave time periods, employees continued to work 40 hours per week; however, their base pay was reduced by two hours each week, to a maximum reduction of 104 hours. The two hours per week for which State employees were not paid were placed into a separate banked leave time account and did not count toward an employee's regular annual leave cap. The accumulated banked leave time hours may be used as regular annual leave or remain in the employee's banked leave time account until separation from State employment, at which time the State will make a contribution to the employee's 401(k) or 457 retirement plan for the banked leave time hours.

The banked leave time concession during FY 2003-04 equated to a 5.0% pay reduction for State employees; however, employees did receive their 3.0% base wage adjustment that had been previously negotiated (Table 21). The amount saved from this provision in FY 2003-04 was an estimated $150.0 million.

In January 2005, the banked leave time provision agreed to by State employees continued in the same manner as in FY 2003-04; however, the second concession required employees to bank, on average, what amounted to 3.2 hours per pay period. This equated to a 4.0% pay reduction but again employees were able to retain their previously negotiated raise of 4.0% in their base pay (Table 21). The second concession of banked leave time hours saved $147.3 million in FY 2004-05.

State employee concessions during FY 2003-04 also included a furlough program. The furlough program required full-time State employees to take 40 hours of unpaid leave in FY 2003-04. This unpaid leave time equated to a 1.9% pay reduction for State employees. All employees, except essential employees, were furloughed without pay on January 2, 2004. The remaining 32 hours of unpaid furlough leave were scheduled by the employees themselves subject to the same requirements as apply to annual leave. The furlough program did not affect employees' retirement service credit, longevity payments, step increases, holiday pay, sick and annual leave time accruals, benefit levels, or insurance premiums. The amount saved from this program in FY 2003-04 was an estimated $56.0 million.

The State implemented a final cost-saving measure in FY 2003-04 in the form of the initial suspension of performance pay awards authorized by CSC Rule 5-3.4(c)(2). An estimated 3,000 employees were eligible for performance pay awards in FY 2003-04. State employees eligible for these awards are not included in step increase schedules but rather are given awards based on performance evaluations. The savings that resulted from suspending these performance pay awards in FY 2003-04 were an estimated $5.0 million. Performance pay awards for those eligible to receive annual lump sum payment awards have not been reinstated since FY 2003-04.

CONCLUSION

The economic conditions in the State of Michigan over the past seven years have caused considerable stress on the State budget. State revenue growth was restrained by a slowdown in the Michigan economy coupled with statutory reductions in the rates of the individual income tax and the single business tax. Total State revenue increased by only 10.2% over the six-fiscal year period of FY 2000-01 through FY 2005-06.

The restrained growth in State revenue also resulted in a modest level of growth in State appropriations. Total State appropriations increased by only 11.8% over the period of FY 2000-01 through FY 2005-06. State appropriations increased above the average growth level in such major budget areas as the Department of Community Health and the Department of Human Services. Actual declines in State appropriations over this time period were recorded in payments to community colleges and universities, as well as revenue sharing payments to cities, villages, townships, and counties. The spending priorities observed in the FY 2000-01 through FY 2005-06 period are likely to continue in the near future unless fundamental changes are made in State fiscal policies.

The number of State employees and the cost associated with them have changed significantly in recent years. The number of full-time equated State employees declined from 63,158 in FY 2000-01 to 53,824 in FY 2005-06. The driving factor behind this drop in employees was two early retirement programs enacted in FY 2000-01 and FY 2002-03. These early retirement programs resulted in the retirement of almost 8,000 State employees and many of those who retired were not replaced with new employees. While the number of State employees has declined in recent years, the total cost associated with the workforce has continued to increase. Total wage and benefit cost of State employees increased from $3.8 billion in FY 2000-01 to $4.4 billion in FY 2005-06. This represents a 16.6% increase in total employee costs over six fiscal years at the same time the number of employees declined by 14.8%. The cost increase of State employees is being driven by increased salaries combined with fringe benefit cost increases. In FY 2005-06, employee salaries accounted for 63.5% of the total employee cost with fringe benefit costs making up the remaining 36.5%. The fastest-growing component of fringe benefit costs in recent years has been the cost of contributions to the State Employees Retirement System. These costs in FY 2005-06 were equal to 25.4% of total employee costs.