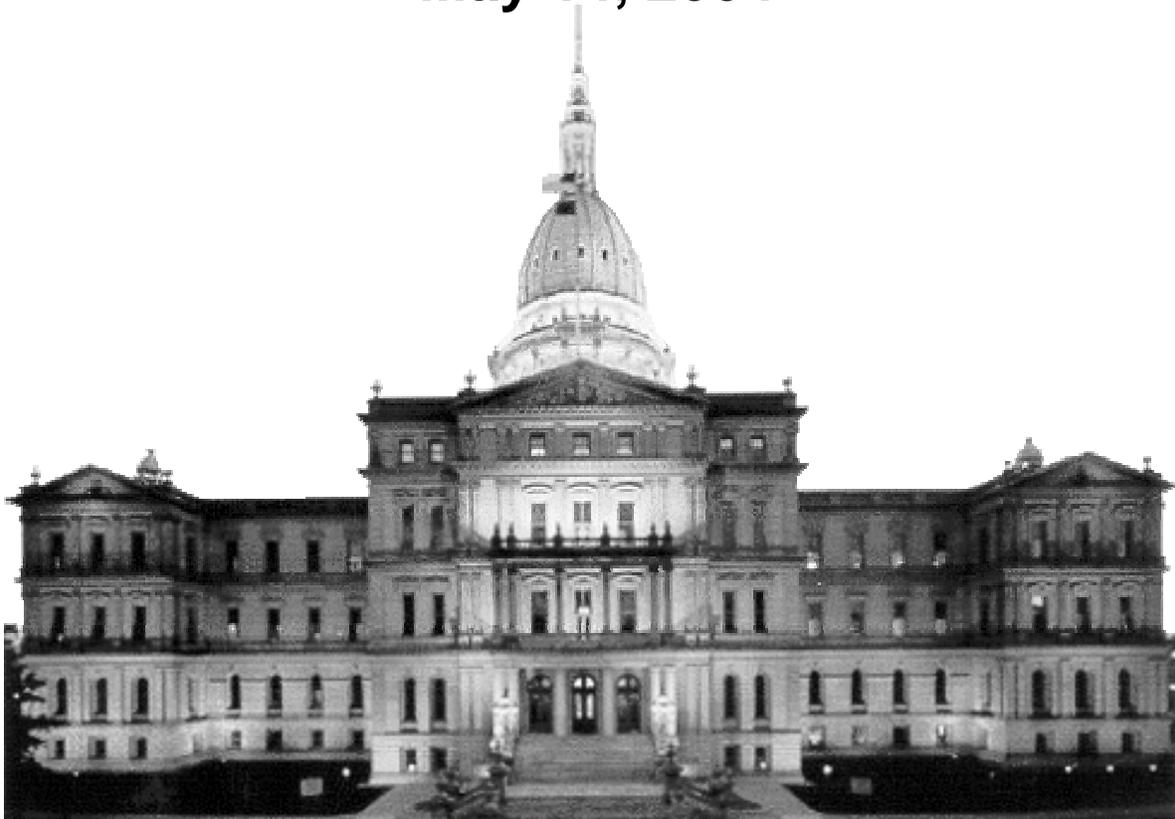




**MICHIGAN'S
ECONOMIC OUTLOOK
AND BUDGET REVIEW
ISSUE 2004-2**

FY 2003-04 and FY 2004-05

May 14, 2004



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.



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

TABLE OF CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY	1
THE ECONOMIC REVIEW AND OUTLOOK	3
RECENT ECONOMIC HIGHLIGHTS	3
FORECAST SUMMARY	4
FORECAST ASSUMPTIONS AND RISKS	10
THE BUDGET STABILIZATION FUND	13
FY 2002-03	13
FY 2003-04	14
FY 2004-05	14
THE FORECAST FOR STATE REVENUES	17
SENATE FISCAL AGENCY REVENUE ESTIMATES	17
REVENUE OVERVIEW	17
REVISED REVENUE ESTIMATES FOR FY 2003-04	19
FY 2004-05 REVISED REVENUE ESTIMATES	22
SENATE FISCAL AGENCY BASELINE REVENUE FORECAST HISTORY	25
COMPLIANCE WITH STATE REVENUE LIMIT	27
THE REVENUE LIMIT	27
REQUIREMENTS IF REVENUE LIMIT IS EXCEEDED	27
REVENUE LIMIT COMPLIANCE PROJECTIONS	28
ESTIMATE OF YEAR-END BALANCES	30
FY 2003-04 YEAR-END BALANCE	30
2004-05 BUDGET BALANCES	33

ACKNOWLEDGEMENT

This Budget Status Report was prepared and written by Gary S. Olson, Director, Jay Wortley, Senior Economist, and David Zin, Economist, of the Senate Fiscal Agency. Karen Hendrick prepared the graphs, performed the word processing, and coordinated the production of this report.

EXECUTIVE SUMMARY

Economic Forecast

After increasing 3.1% in 2003, inflation-adjusted gross domestic product (GDP) is forecasted to grow 4.6% in 2004 and 3.6% in 2005. The improvement in the rate of growth, particularly during 2004, largely reflects expected improvements in business investment. Light motor vehicle sales will increase from 16.6 million units in 2003 to 16.6 million units in 2004 and 17.0 million units in 2005. Sluggish growth in employment is expected to moderate decreases in the unemployment rate that might be expected given the rate of growth in GDP, with the unemployment rate declining from 6.0% in 2003 to 5.5% in 2004 and 2005. Inflation, as measured by the Consumer Price Index (CPI), is anticipated to increase relative to the last few years, but will remain contained relative to levels during the 1980s and 1990s, as prices rise 2.7% in 2004 and 3.1% in 2005. Prices are expected to rise primarily because of issues related to the declining value of the dollar and inflationary pressures for energy, food, and raw materials slightly more than offsetting the effect of productivity improvements. The forecast assumes that the Federal Reserve Board will begin increasing interest rates in June 2004: slowly at first, but more rapidly as annualized inflation-adjusted GDP growth becomes stronger and more consistent, increasing concerns about the amount of expansionary monetary and fiscal stimulus present in the economy.

Over the next two years, the Michigan economy is expected to follow a pattern similar to the national economy, although economic activity will generally lag behind the national average. Inflation-adjusted personal income is estimated to rise 0.5% in 2004 and 2.9% in 2005, after rising 0.4% in 2003. The forecast predicts that a number of factors will temper job growth and even increase unemployment, with wage and salary employment falling 0.6% in 2004 before rising 1.4% in 2005. The 2005 increase in wage and salary employment would represent the first annual increase since 2000. The unemployment rate is expected to fall to 6.7% in 2004 and 6.6% in 2005, from 7.1% in 2003.

Revenue Forecast

In FY 2003-04, General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue will total an estimated \$18.4 billion, which is down 1.5% from FY 2002-03. This revised estimate is \$46 million below the January 2004 consensus estimate. GF/GP revenue will decline an estimated 1.1% to \$7.87 billion, while SAF revenue is expected to decline 1.7% to \$10.53 billion. The decline in GF/GP revenue will be due to ongoing reductions in the income and estate taxes, while the decrease in SAF revenue reflects the one-time boost in FY 2002-03 revenue due to the acceleration in the due date of the State education property tax.

In FY 2004-05, GF/GP and SAF revenue will total an estimated \$18.82 billion, representing an increase of 2.3% from FY 2003-04. This estimate is essentially unchanged from the January 2004 consensus estimate. GF/GP revenue will total an estimated \$7.85 billion, representing a slight decline of 0.2% from FY 2003-04, and SAF revenue will total an estimated \$10.97 billion, which is up 4.2% from FY 2003-04.

Year-End Balance Estimates

Based on the Senate Fiscal Agency's (SFA's) revised estimates of FY 2003-04 revenue and actual and projected State appropriations, the SFA now believes that the FY 2003-04 GF/GP budget is in deficit by \$100.3 million. A significant portion of this projected budget deficit can be attributed to spending pressures in the State Medicaid program. A comparison of the SFA's FY 2004-05 GF/GP revenue estimate with the Governor's recommended level of FY 2004-05 GF/GP appropriations and recommended tax policy changes leads to a \$99.9 million deficit. The majority of this budget deficit can be attributed to spending pressures in the State Medicaid program.

The revised SFA revenue estimate also alters the estimates of the projected FY 2003-04 and FY 2004-05 year-end School Aid Fund balances. The SFA is now estimating that the FY 2003-04 School Aid Fund budget is in deficit by \$60.6 million. Pursuant to requirements in the State School Aid Act, this projected deficit could be eliminated by a \$34 per pupil reduction in FY 2003-04 State aid payments to school districts. A comparison of the SFA's FY 2004-04 School Aid Fund revenue estimate with the appropriation recommendation of the Governor leads to a \$14.1 million deficit.

EXECUTIVE SUMMARY

**SENATE FISCAL AGENCY
ECONOMIC AND BUDGET SUMMARY**

Economic Projections (Calendar Year)				
	2002 Actual	2003 Actual	2004 Estimate	2005 Estimate
Real Gross Domestic Product (% change).....	2.2%	3.1%	4.6%	3.6%
U.S. Consumer Price Index (% change)	1.6%	2.3%	2.7%	3.1%
Light Motor Vehicle Sales (millions of units).....	16.8	16.6	16.8	17.0
U.S. Unemployment Rate (%).....	5.8%	6.0%	5.5%	5.5%
Michigan Personal Income (% change).....	1.5%	2.5%	3.2%	6.1%
Michigan Unemployment Rate (%).....	6.2%	7.3%	6.7%	6.6%

Revenue Estimates General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) (Dollars in Millions)						
	<u>FY 2003-04 Estimate</u>			<u>FY 2004-05 Estimate</u>		
	Baseline	Tax Changes	Net Available	Baseline	Tax Changes	Net Available
Gen'l Fund/Gen'l Purpose	\$8,067.1	\$(199.5)	\$7,867.6	\$8,411.3	\$(558.0)	\$7,853.3
% Change.....	1.6%	---	(1.1)%	4.3%	---	(0.2)%
School Aid Fund	10,449.7	79.0	10,528.7	10,888.8	80.6	10,969.4
% Change.....	1.9%	---	(1.7)%	4.2%	---	4.2%
Total GF/GP and SAF	18,516.8	(120.5)	18,396.3	19,300.1	(447.4)	18,822.7
% Change.....	1.7%	---	(1.5)%	4.2%	---	2.3%
Revenue Limit - Under (Over):	<u>FY 2003-04 Estimate</u> \$4,875.4			<u>FY 2004-05 Estimate</u> \$5,095.5		

Year-End Balance Estimates (Fiscal Year, Millions of Dollars)			
	FY 2002-03 Actual	FY 2003-04 Estimate	FY 2004-05 Estimate
General Fund/General Purpose	\$174.0	\$(100.3)	\$(99.9)
School Aid Fund	113.7	(60.6)	(14.1)

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 2004 and 2005, as well as a summary of recent economic activity.

RECENT ECONOMIC HIGHLIGHTS

Both the U.S. and Michigan economies have struggled since Michigan's employment began contracting in June 2000 and the U.S. entered a recession in March 2001. While the National Bureau of Economic Research (NBER), traditionally regarded as the authority for dating stages of the business cycle, announced that the national recession had ended in November 2001, job growth and many other economic indicators have remained low or even at recessionary levels. The growth rate for inflation-adjusted Gross Domestic Product (GDP) increased from 0.5% in 2001 to 2.2% in 2002 and 3.1% in 2003. Over this period, however, wage and salary employment declined approximately 2.1%, or more than 2.7 million jobs. Wage and salary employment has generally increased since August 2003, although the rate has been substantially slower than during previous recoveries. As of April 2004, wage and salary employment was 1.1 million jobs above the August 2003 level, with 625,000 of those jobs appearing during March and April. The unemployment rate rose from 4.0% in 2000, the lowest level since 1969, to 6.0% in 2003, the highest annual rate since 1993.

Michigan's economy, particularly the Michigan job market, declined even more drastically than did the national economy. Michigan wage and salary employment peaked in June 2000, nine months before the national recession began. As of February 2004, Michigan wage and salary employment remained in decline, with employment approximately 324,000 jobs, or 6.9%, below the June 2000 peak. While Michigan wage and salary employment increased by 5,900 jobs in March 2004, several one-month increases have occurred since June 2000, many considerably larger than 5,900 jobs. At this point, the data do not yet support the idea that Michigan's wage and salary employment trends have reversed, as appears to be the case with national figures. These job losses have helped push the seasonally-adjusted unemployment rate in Michigan from 3.1% in the first quarter of 2000, the lowest level since 1966, to 7.6% in the last quarter of 2003, the highest level since December 1992.

Lower employment also has reduced Michigan incomes. Inflation-adjusted Michigan personal income increased 0.4% in 2003, the first increase since 2000, when inflation-adjusted personal income rose 2.3%. Inflation-adjusted Michigan personal income fell 2.3% in 2001 and 1.1% in 2002. Inflation remained moderate in 2003, with prices in the Detroit Consumer Price Index rising only 2.0%, after increases of 2.7% and 2.6% in 2001 and 2002, respectively.

While the economic slowdown since mid-2000 to a large degree reflected a number of singular economic shocks, ranging from the rapid collapse of speculative stock market valuations to corporate scandals, terrorist attacks, and foreign military actions, many of these factors will continue to affect, though somewhat indirectly, the economy through 2004 and even 2005. These events, as well as a number of other circumstances, will cause the economy to differ from the forecast presented here. The most significant of these risk factors reflect: 1) the effects on consumption, investment, and stock markets of differences between actual and expected economic performance; 2) inflation; 3) consumption growth being hampered by high debt burdens, particularly once interest rates begin rising, and 4) productivity growth. These factors are discussed in more detail later in this section.

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

	2001	2002	2003	2004	2005
United States	Actual	Actual	Actual	Estimate	Estimate
Nominal GDP (year-to-year growth)	2.9%	3.8%	4.8%	7.2%	7.1%
Inflation-adjusted GDP (year-to-year growth)	0.5%	2.2%	3.1%	4.6%	3.6%
Unemployment rate	4.7%	5.8%	6.0%	5.5%	5.5%
Inflation					
Consumer Price Index (year-to-year growth)	2.8%	1.6%	2.3%	2.7%	3.1%
GDP Implicit price deflator (year-to-year growth)	2.4%	1.5%	1.7%	2.5%	3.4%
Interest rates					
90-day Treasury bill	3.48%	1.64%	1.03%	1.19%	2.48%
Corporate Aaa bond	7.08%	6.49%	5.66%	5.60%	5.94%
Federal funds rate	3.88%	1.67%	1.13%	1.33%	2.83%
Light motor vehicle sales (millions of units)					
Auto	17.1	16.8	16.6	16.8	17.0
Truck	8.4	8.1	7.6	7.5	7.7
	8.7	8.7	9.0	9.2	9.4
Michigan					
Personal Income (millions)	\$295,146	\$299,449	\$306,820	\$316,640	\$335,903
Year-to-year growth	0.3%	1.5%	2.5%	3.2%	6.1%
Inflation-adjusted personal income (year-to-year growth)	-2.3%	-1.1%	0.4%	0.5%	2.9%
Wage & salary income (millions)	\$173,091	\$173,421	\$175,599	\$178,726	\$187,555
year-to-year growth	-1.4%	0.2%	1.3%	1.8%	4.9%
Detroit Consumer Price Index (year-to-year growth)	2.7%	2.6%	2.0%	2.7%	3.1%
Wage & Salary Employment (thousands)	4,555.9	4,477.8	4,411.8	4,385.7	4,445.7
year-to-year growth	-2.5%	-1.7%	-1.5%	-0.6%	1.4%
Unemployment Rate	5.3%	6.2%	7.3%	6.7%	6.6%

FORECAST SUMMARY

Both the U.S. and Michigan economies are expected to grow in 2004 and 2005, and at a higher rate than in recent years. Table 1 provides a summary of key economic indicators from the SFA's economic forecast, with references to recent years, while Table 2 provides additional detail regarding the U.S. forecast. Inflation-adjusted GDP is projected to grow by 4.6% in 2004 and 3.6% in 2005 (Figure 1). Most of the improvement in the growth rate from 2003 is expected to reflect greater business investment, including increases in inventories (Figure 2).

Table 2

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

	2001	2002	2003	2004	2005
	Actual	Actual	Actual	Estimate	Estimate
Gross Domestic Product (billions of dollars)	\$10,100.8	\$10,480.8	\$10,987.9	\$11,777.5	\$12,615.8
Year-to-year growth	2.9%	3.8%	4.8%	7.2%	7.1%
<u>Inflation-Adjusted GDP and Components</u>					
Gross Domestic Product (billions of 2000 dollars)	\$9,866.6	\$10,083.0	\$10,398.0	\$10,874.8	\$11,261.1
Year-to-year growth	0.5%	2.2%	3.1%	4.6%	3.6%
Consumption (billions of 2000 dollars)	\$6,904.6	\$7,140.4	\$7,365.2	\$7,669.2	\$7,938.4
Year-to-year growth	2.5%	3.4%	3.1%	4.1%	3.5%
Business fixed investment (billions of 2000 dollars)	\$1,176.8	\$1,092.6	\$1,125.5	\$1,244.5	\$1,365.7
Year-to-year growth	-4.5%	-7.2%	3.0%	10.6%	9.7%
Change in Business Inventories (billions of 2000 dollars)	(\$36.0)	\$5.7	(\$0.7)	\$47.7	\$56.7
Residential investment (billions of 2000 dollars)	\$448.5	\$470.3	\$505.3	\$523.5	\$510.3
Year-to-year growth	0.4%	4.9%	7.4%	3.6%	-2.5%
Government spending (billions of 2000 dollars)	\$1,768.9	\$1,836.9	\$1,898.4	\$1,926.4	\$1,935.6
Year-to-year growth	2.7%	3.8%	3.3%	1.5%	0.5%
Net Exports (billions of 2000 dollars)	(\$398.1)	(\$470.5)	(\$509.1)	(\$540.4)	(\$537.3)
Exports (billions of 2000 dollars)	\$1,039.0	\$1,014.2	\$1,034.7	\$1,125.1	\$1,226.9
Imports (billions of 2000 dollars)	\$1,437.1	\$1,484.7	\$1,543.8	\$1,665.5	\$1,764.2
Personal income (year-to-year growth)	3.4%	2.3%	3.3%	4.4%	5.9%
Adjusted for Inflation	0.5%	0.7%	1.0%	1.6%	2.7%
Wage & salary income (year-to-year growth)	2.4%	0.6%	2.4%	3.9%	5.1%
Personal savings rate	1.7%	2.3%	2.1%	0.6%	-0.6%
Capacity utilization rate	77.4%	75.6%	74.8%	78.5%	80.7%
Housing starts (millions of units)	1.603	1.705	1.848	1.861	1.802
Conventional mortgage rates	7.0%	6.4%	5.8%	5.8%	6.2%
Federal budget surplus (billions of dollars, NIPA basis)	\$45.4	(\$258.6)	(\$440.4)	(\$533.7)	(\$428.3)

Figure 1

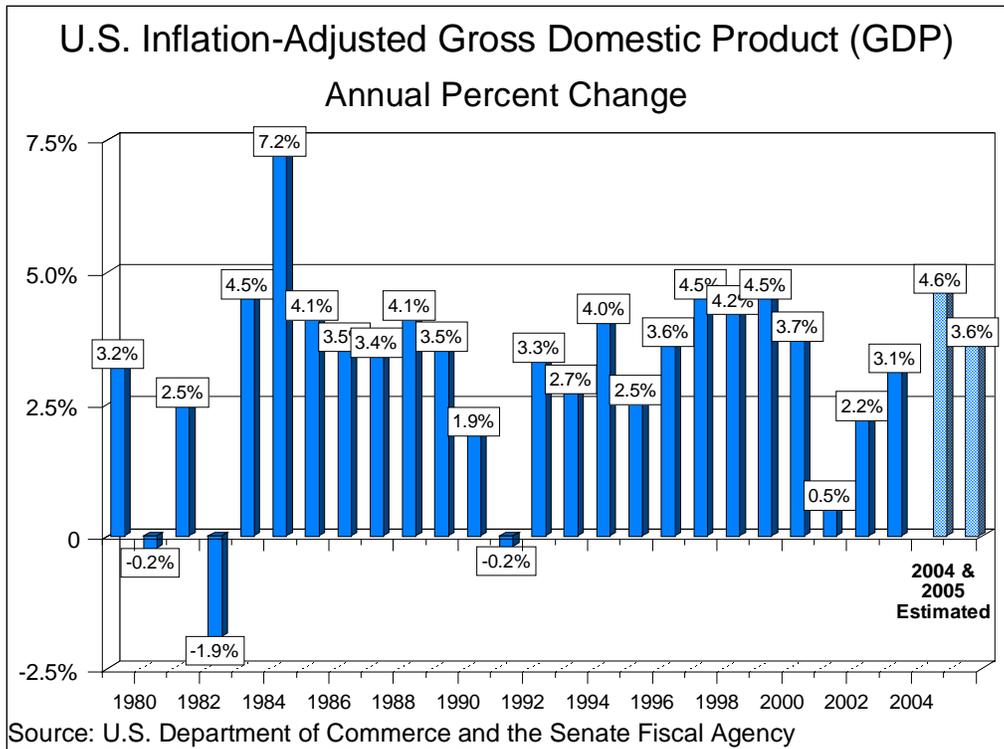
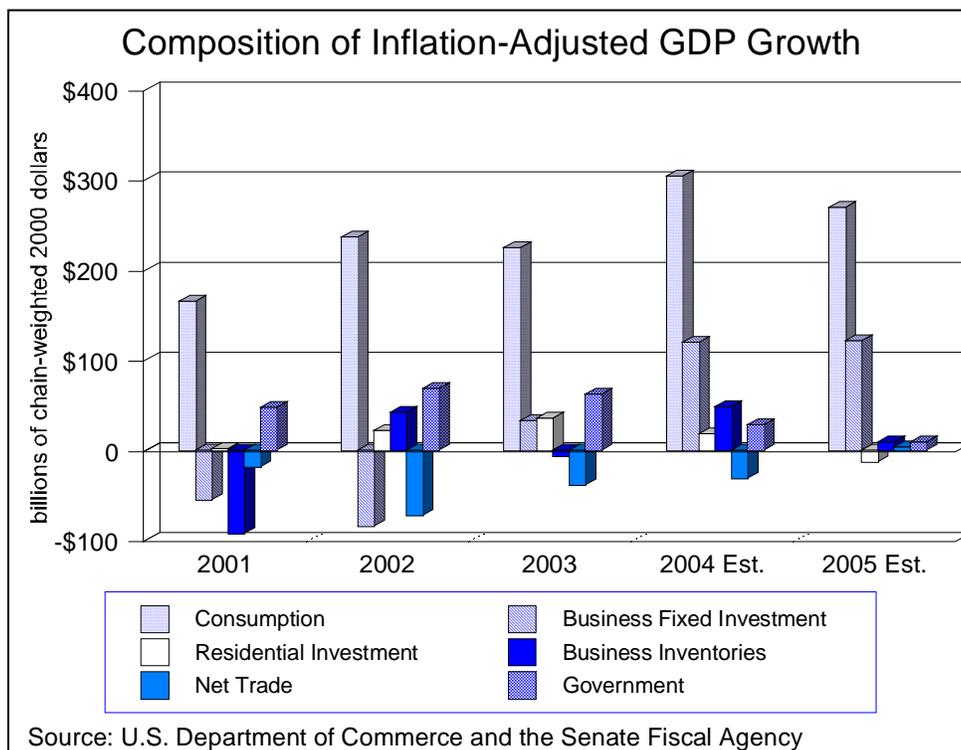


Figure 2



Under the forecast, consumption is expected to grow moderately and monetary policy will become more restrictive in response to a number of inflationary pressures. Government expenditures will contribute little to economic activity as large boosts in spending and additional tax breaks are not expected to occur. By 2005, growth in government spending will be limited, resulting in a substantially reduced contribution to the overall growth rate—a stark comparison to 2001, when declines in business investment and inventory accumulation essentially wiped out the contribution of consumption, leaving the overall growth rate almost entirely attributable to government spending. Businesses began to build inventories and increase investment in the fourth quarter of 2003, and inventory accumulation is expected to reach a stable rate by the middle of 2004. A declining dollar will improve the U.S. trade balance, suggesting net exports will become a smaller drag on the economy and domestic sellers will enjoy slightly more pricing power. The unemployment rate will decrease from 6.0% in 2003 to 5.5% in 2004 and 2005.

In Michigan, economic activity will lag behind the national pickup considerably, primarily because employment growth will lag behind the national average ([Figure 3](#)) and the fastest growing sectors generally pay lower wages than those in stagnant and/or declining sectors ([Figures 4 and 5](#)). Inflation-adjusted personal income is expected to increase 0.5% in 2004 and 2.9% in 2005, compared with a 0.4% increase in 2003 ([Figure 6](#)). However, improvements in wage and salary employment will have difficulty offsetting the steep declines during 2003, such that the annual average for wage and salary employment is forecasted to decline 0.6% in 2004, before rising 1.4% in 2005. The annual increase in wage and salary employment in 2005 would be the first increase since 2000. Low-to-moderate growth in auto sales will combine with productivity improvements to temper declines in the unemployment rate, with the unemployment rate falling from 7.3% in 2003 to 6.7% in 2004 and 6.6% in 2005. The unemployment rate is expected to remain at least one full percentage point above the national average over the forecast period. Changes in Michigan prices are expected to parallel the changes in the national average over the forecast period.

Compared with the January 2004 Consensus Economic Forecast for 2004 and 2005, the U.S. economy is generally about the same while the Michigan economy is slightly weaker, particularly in wage and salary employment growth. For example, the estimate for inflation-adjusted GDP remains 4.6% in 2004, while the 2005 estimate is reduced negligibly from 3.7% to 3.6%. Light vehicle sales are estimated to remain at the January 2004 forecast level of 16.8 million units in 2004, while the 2005 forecast is increased from 16.9 million units to 17.0 million units. The forecasted U.S. unemployment rate is revised downward slightly in 2004, from 5.6% to 5.5%, while the 2005 forecast is revised upward slightly, from 5.3% to 5.5%. For Michigan, the January 2004 forecast estimated that wage and salary employment would rise 0.5% in 2004, compared with the revised estimate of a 0.6% decline. The increase forecasted for wage and salary employment during 2005 is revised downward from 1.8% to 1.4%. The January 2004 forecast for inflation-adjusted personal income also is revised downward in both years, with the increase in 2004 lowered from 2.6% to 0.5% and the increase in 2005 lowered from 3.4% to 2.9%. The forecast for the Michigan unemployment rate during 2004 is lowered from 7.2% to 6.7%, while the 2005 forecast is increased from 6.4% to 6.6%.

Figure 3

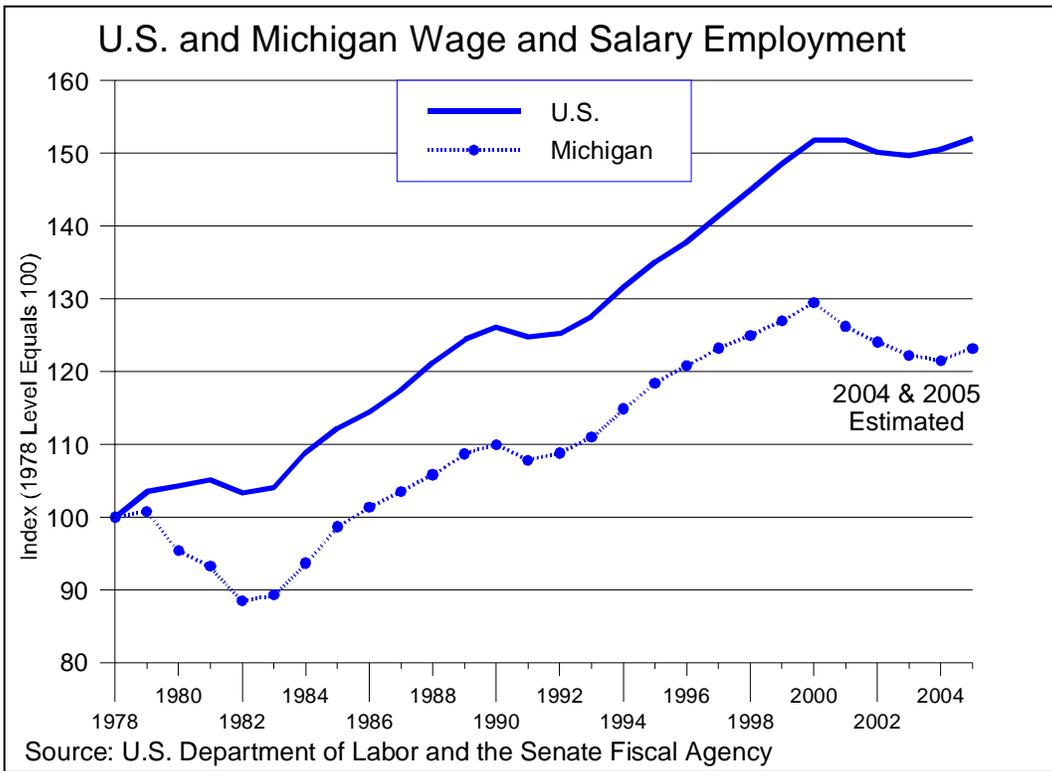


Figure 4

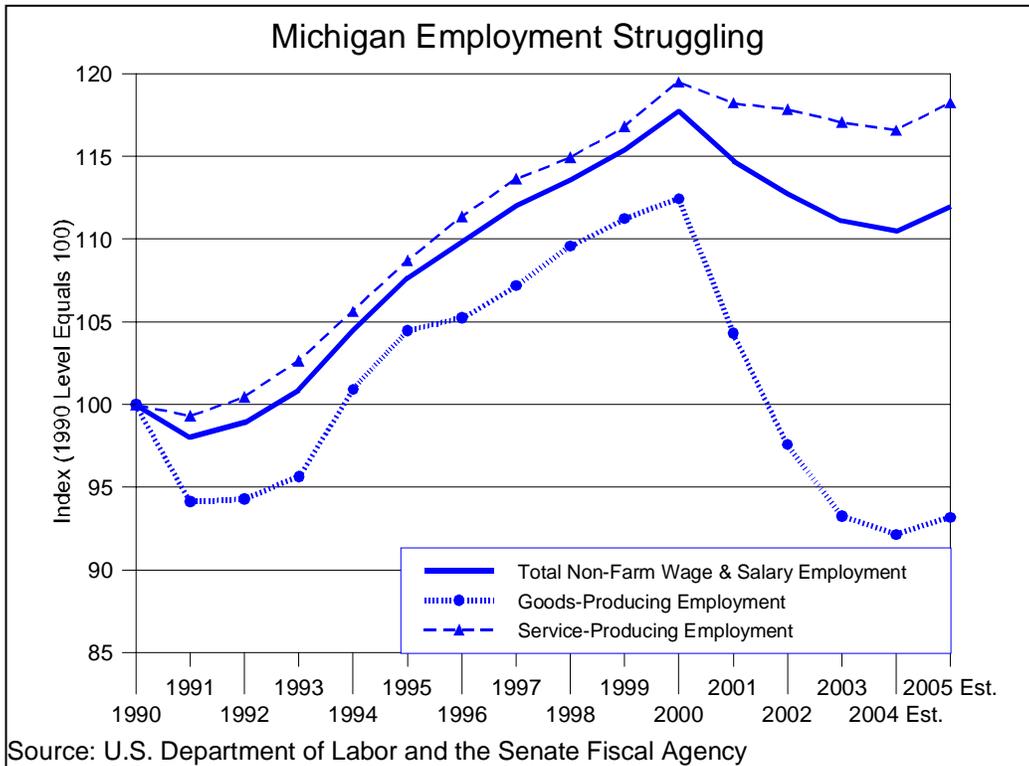


Figure 5

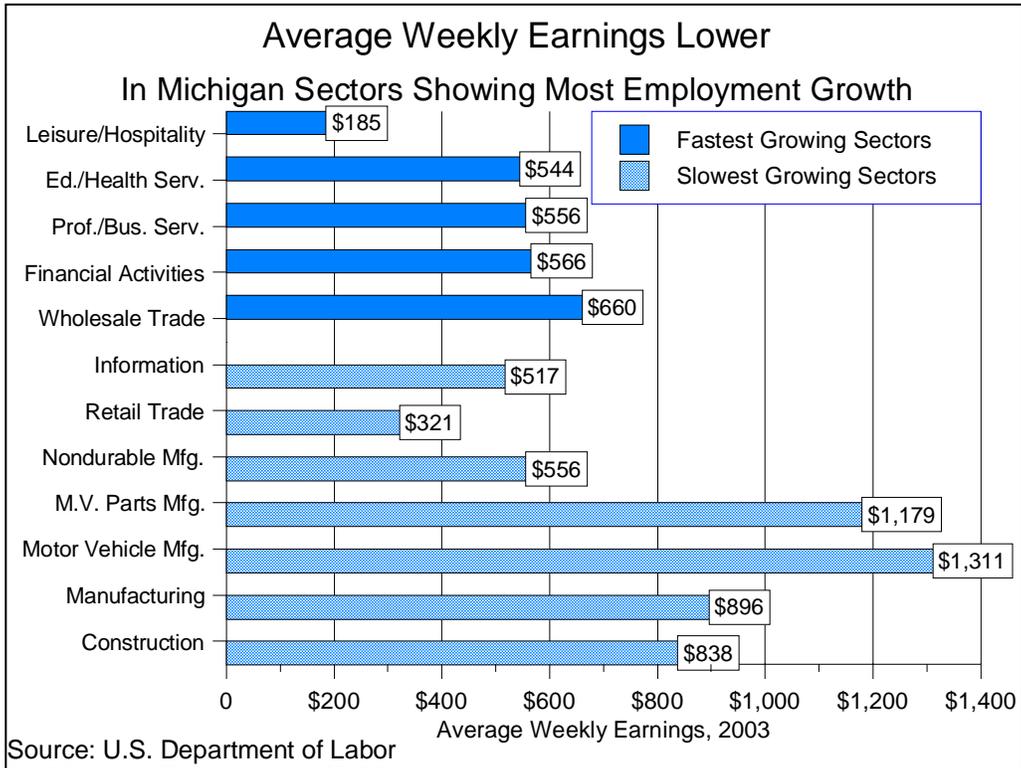
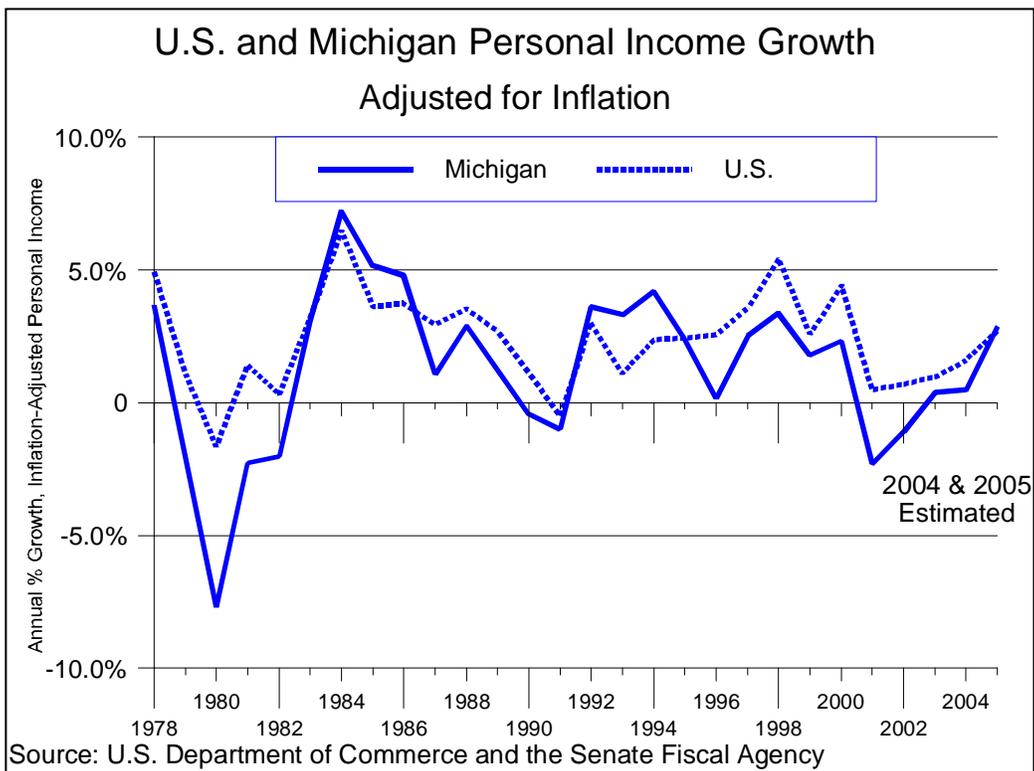


Figure 6



FORECAST ASSUMPTIONS AND RISKS

Forecasting the behavior of the economy requires making assumptions about the behavior of certain key economic variables. The current SFA forecast for 2004 and 2005 is based upon the following assumptions:

Monetary Policy. The Federal funds rate is currently 1.0%, the lowest level in more than 40 years. The forecast assumes that inflationary concerns are rising and the recovery is strong enough that the Federal Reserve Board will act on those concerns without worrying significantly about plunging the economy into recession. The business sector's willingness to borrow is expected to increase but will be tempered by mediocre growth in sales, strong productivity improvements from prior investments, and significant production overcapacity. However, inflationary pressures are expected to grow due to a number of factors (discussed below), and as a result, interest rates are anticipated to begin rising during the second quarter of 2004. Additional and steeper increases will begin during the fourth quarter of 2004, with the Federal funds rate rising to 2.0% by the end of 2004 and 3.50% by the end of 2005.

Foreign Economies. Many of the U.S.'s key trading partners' economies are expected to grow slightly more slowly than the U.S. economy grows during most of the forecast period. The dollar is expected to continue declining in value, falling 9.0% in 2004, and 2.5% in 2005. Combined with tepid economic growth for the U.S.'s major trading partners, the net effect will be that the dollar's value is forecasted to continue to restrain export growth and encourage imports, although by less than in recent years. As a result, the forecast predicts that the trade deficit will continue to increase during 2004 before showing a slight improvement in 2005.

Fiscal Policy. The forecast assumes that by 2004 the additional fiscal stimulus created by counter-cyclical Federal policy and the spending resulting from the September 11, 2001, terrorist attacks is effectively exhausted, leaving inflation-adjusted government spending to increase 1.5% in 2004 and 0.5% in 2005. Much of the remaining increase in 2004 will reflect military funding demands related to the conflict in Iraq. While the annual Federal budget deficit will peak at \$533.7 billion in 2004, the budget is expected to remain in deficit through the forecast period. As a result, not only will the total amount of Federal debt increase, but as interest rates rise the burden of servicing the debt will rise also. The current forecast does not anticipate that the Federal debt will significantly dampen the ability of the private sector to respond to the stimulative effects of the deficit or that significant budgetary changes will occur to accommodate the higher debt service burden.

Oil and Energy Prices. The forecast expects oil prices to decline slightly through 2004, from the current high level of about \$37.50 per barrel (expected average price during the second quarter of 2004) to \$34 per barrel in the fourth quarter of 2004, when the price is expected to stabilize during the forecast period. Other energy prices also are expected to follow a similar pattern over the forecast period, although natural gas prices are expected to post a seasonal spike during the first quarter of 2005. Prices are expected to remain above historical averages for a variety of reasons, ranging from political instability in the Middle East to limited domestic refining capacity, which is essentially already at maximum, to growing domestic and worldwide energy demands.

Consumer Behavior. Consumption growth remained moderate throughout the slowdown over the last three years, largely through increased borrowing and home 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 and improving investment rather than employment gains. As a result, higher interest rates are likely to worsen the burden of servicing consumer debt and, when combined with slow job growth and modest personal

income growth, will keep consumption growth from rising significantly faster than in recent years. The current forecast expects that the personal saving rate will likely be driven very low in order to support the expected consumption levels.

Business Inventories and Business Investment. The forecast assumes that the business sector will build on improvements posted in late 2003, with inflation-adjusted business fixed investment rising 10.6% in 2004, then slowing slightly to 9.7% in 2005 as higher interest rates begin curbing businesses' appetite for additional borrowing. Inventory accumulation is assumed to occur, although at lower levels than during the 1998-2000 period and at a level more consistent with the 1988-1996 period. Under the forecast, productivity increases will slow relative to the rate of growth in consumption, pushing capacity utilization rates higher. Capacity utilization rates are assumed to have bottomed in 2003, and will rise from 74.8% in 2003 to 78.5% in 2004 and 80.7% in 2005.

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. The uncertain economic environment in 2004 causes the current economic forecast to face a number of risks, most suggesting that inflation-adjusted economic activity could be weaker than forecasted.

Monetary and Fiscal Stimulus. Both the Federal government and the Federal Reserve Board have done much to stimulate the economy over the 2001-2004 period. On the fiscal policy side, the forecast assumes that much of the stimulus effect has been exhausted and that Federal spending will remain mostly restrained, particularly in 2005. However, there is a significant risk that Federal spending will be higher than forecasted and both consumption and interest rates may be higher than forecasted. Such events could weaken both investment and export growth, as well as result in higher inflation and less job growth. The forecast assumes that there is little response to the changes in monetary policy during much of forecast period, with investment dominated by replacement activity. Substantial overcapacity is expected to combine with demands to improve corporate net worth and profits to reduce the incentive to acquire more debt. However, if business investment improves rapidly and inflation appears more likely, the Federal Reserve could tighten interest rates more quickly than forecasted. Such actions would primarily lower the forecast for growth in 2005.

Economic Expectations. One risk to the forecast relates to the interaction between and business and consumer expectations and actual economic developments. While overall confidence recently has been stagnant, confidence is generally improving in regard to a number of economic factors over the next year or two in both the business and consumer sectors. Aside from recent jitters, the stock market appears to reflect confidence that corporate profits are improving and will continue to do so. Furthermore, concern regarding Federal deficits seems to be minimal and the dollar's devaluation is generally being regarded as a positive development. Forecasts of very strong economic growth in the coming two years are not uncommon. However, the economy may not live up to such high expectations. Many of the economic changes forecasted or currently taking place bring both positive and negative developments. In this forecast, employment growth is expected to remain moderate, particularly given the strength of the growth forecasted in GDP. As a result, the economy may perform well but not perform as well as expected or in the manner expected. If a substantial enough number of consumers and businesses respond to the failure of the economy to live up to their expectations by cutting back on spending, selling assets, etc., then the economic recovery forecasted here could be slower and take much longer.

Inflation. While the forecast expects a noticeable increase in the rate of inflation, compared with 2002 and the last part of 2003, the anticipated inflation rates are at or below the rates experienced during the 1990s and are below the rates in virtually every year during the 1980s. As indicated above, both the Federal government and the Federal Reserve Board have provided a significant amount of fiscal and monetary stimulus to the economy. The dollar's value is expected to decline, increasing the price of imports and allowing domestic producers greater pricing power. Furthermore, higher growth also will put substantial demands for additional energy in virtually every sector of the economy. With the petroleum refining sector operating at nearly 100% capacity even during the slowdown, energy prices may be substantially greater than forecasted even without external shocks. A number of agricultural and health concerns are likely to keep upward pressure on food prices in the near future. Inflation is largely held down in the forecast by reasonably healthy growth in productivity, which may not be as strong as forecasted, and minimal wage growth, which may be stronger than forecasted. 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 a high rate of inflation would result in those loans' being repaid with substantially devalued dollars.

BUDGET STABILIZATION FUND

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

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

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

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

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

Table 3 presents the history of the BSF in terms of transfers into and out of the Fund, interest earnings, and year-end balances. Also presented in this table are the final levels for these items for FY 2002-03, along with the revised estimates for FY 2003-04 and FY 2004-05. The BSF year-end balance as a percentage of GF/GP and SAF revenue is shown in Figure 7, and the estimated economic stabilization trigger calculations for FY 2003-04 and FY 2004-05 are presented in Table 4.

FY 2002-03

The BSF began FY 2002-03 with a balance of \$145 million. During the year, \$9.1 million was transferred into the BSF from the State Trunkline Fund to return the unused portion of a \$69 million transfer that had been made in FY 1996-97 from the BSF to the Trunkline Fund. The interest earned on the funds in the BSF during FY 2002-03 totaled \$1.8 million. As a result of the

beginning balance, the transfer from the State Trunkline Fund, and the interest earnings, there was a total of \$156.1 million available in the BSF in FY 2002-03. Of this amount, \$32 million was transferred to the School Aid Fund to finance the ongoing *Durant* payments to schools, and the remaining \$124.1 million was transferred to the General Fund/General Purpose budget. The BSF ended FY 2002-03 with a zero balance, which marked the first time in the history of the BSF that it ended a fiscal year with no money.

FY 2003-04

Based on the SFA's revised forecast of Michigan personal income, transfer payments, and the Detroit Consumer Price Index, the economic pay-in/pay-out formula does not trigger any transfers into, or out of, the BSF, and the balance in the BSF will remain at zero in FY 2003-04.

FY 2004-05

Under current law, the BSF will receive an estimated \$154 million in FY 2004-05 due to a provision in the distribution formulas for the cigarette and other tobacco products taxes. In FY 2001-02, the cigarette tax was increased \$0.50 per pack from \$0.75 to \$1.25. The distribution provisions included in the law enacting this cigarette tax increase specified that the revenue generated from approximately \$0.22 per pack (74.2% of \$0.30 of the \$0.50 increase) would be distributed to the General Fund/General Purpose budget in FY 2001-02 through FY 2003-04 and in FY 2007-08 and each fiscal year thereafter. For FY 2004-05 through FY 2006-07, the law requires that the revenue generated from this portion of the cigarette tax be deposited into the BSF. A similar provision is included in the distribution of the revenue from the other tobacco products tax, requiring 18.4% of that tax revenue to be transferred to the BSF in each of the three years beginning in FY 2004-05. It is estimated the total transfer from the cigarette and other tobacco products taxes will equal \$154 million in FY 2004-05. Under existing law, this deposit into the BSF will happen automatically. In addition, it is estimated that the economic pay-in/pay-out formula will not trigger any transfers into or out of the BSF in FY 2004-05, as shown in Table 4. Therefore, based on the estimated transfer from the tobacco tax revenue, plus some interest earnings, the BSF will close FY 2004-05 with an estimated balance of \$156 million.

Table 3

**ECONOMIC AND BUDGET STABILIZATION FUND
TRANSFERS, EARNINGS AND FUND BALANCE
FY 1977-78 TO FY 2004-05
(millions of dollars)**

Fiscal Year	Pay-In	Interest Earned	Pay-Out	Fund Balance
1977-78	\$108.7	\$6.2	\$0.0	\$114.9
1978-79	104.1	22.1	0.0	241.1
1979-80	0.0	32.1	263.7	9.5
1980-81	0.0	9.2	16.3	2.4
1981-82	0.0	0.6	0.0	3.0
1982-83	0.0	0.2	0.0	3.2
1983-84	0.0	0.2	0.0	3.4
1984-85	340.9	30.8	34.2	340.9
1985-86	30.6	28.2	14.7	385.1
1986-87	0.0	24.1	24.8	384.4
1987-88	0.0	29.2	20.4	393.1
1988-89	0.0	38.0	11.9	419.2
1989-90	0.0	35.8	69.9	385.1
1990-91	0.0	27.1	230.0	182.2
1991-92	0.0	8.1	170.1	20.1
1992-93	282.6	0.7	0.0	303.4
1993-94	460.2	11.9	0.0	775.5
1994-95	260.1	57.7	90.4	1,003.0
1995-96	91.3	59.2	0.0	1,153.6
1996-97	0.0	67.8	69.0	1,152.4
1997-98	0.0	60.1	212.0	1,000.5
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	994.1
2001-02	0.0	20.8	869.8	145.1
2002-03	9.1	1.8	156.1	0.0
Senate Fiscal Agency estimates:				
2003-04	\$0.0	\$0.0	\$0.0	\$0.0
2004-05	154.0	2.1	0.0	156.1
Summary of Appropriated Pay-Outs:				
		FY 2000-01	FY 2001-02	FY 2002-03
<u>School Aid Fund:</u>				
<i>Durant</i> Payments		\$ 32.0	\$ 32.0	\$ 32.0
Other Withdrawal		0.0	350.0	0.0
Subtotal SAF		\$ 32.0	\$382.0	\$ 32.0
Trunkline Fund		35.0	35.0	0.0
General Fund		270.0	452.8	124.1
Total		\$337.0	\$869.8	\$156.1

a) Pay-in equals GF/GP share of cigarette tax revenue from \$0.30 of the \$0.50 per pack increase that went into effect August 2002.

Figure 7

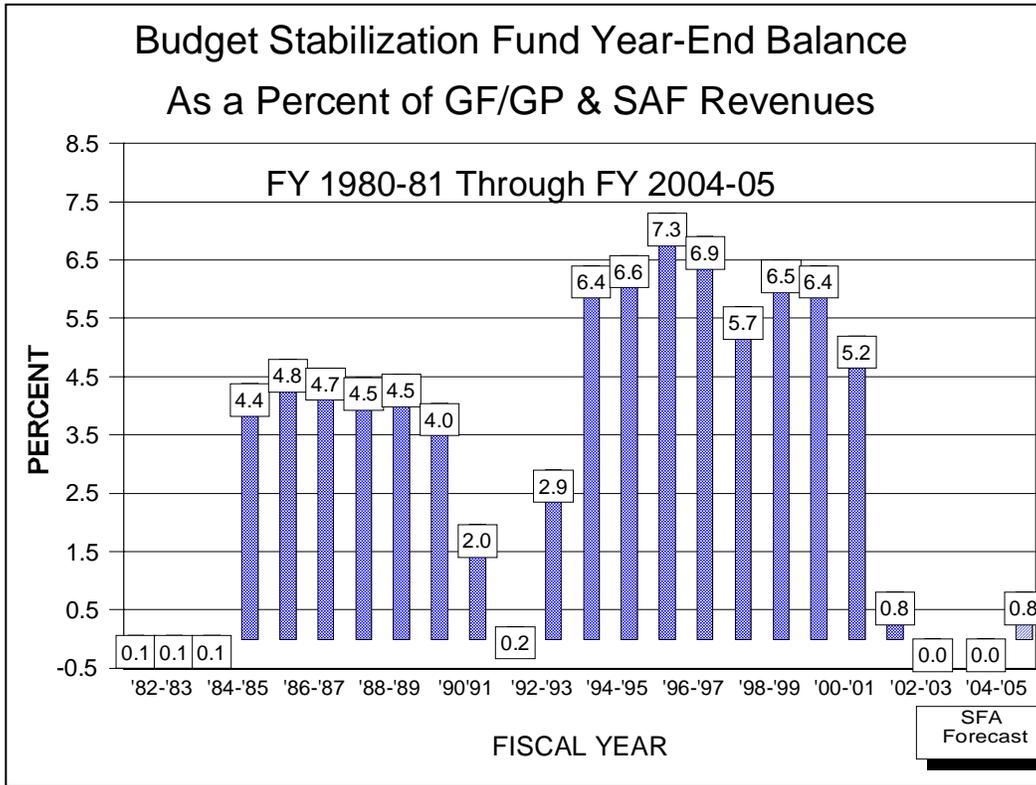


Table 4

ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER FY 2003-04 AND FY 2004-05 (millions of dollars)			
	CY 2003	CY 2004	CY 2005
Michigan Personal Income (MPI)	\$312,537	\$322,540	\$342,162
Less: Transfer Payments	50,818	53,765	57,225
Subtotal	\$261,719	\$268,775	\$284,937
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	1.814	1.841	1.896
Equals: Real Adjusted MPI	144,277	145,994	150,283
Percent Change from Prior Year	-0.97%	1.19%	2.94%
Excess Over 2%	0.00%	0.00%	0.94%
Amount Under 0%	0.97%	0.00%	0.00%
		FY 2003-04	FY 2004-05
Multiplied by: Estimated GF/GP Revenue		\$7,867.6	\$7,853.3
		FY 2003-04	FY 2004-05
Equals: Transfer from the BSF		0.00	0.00
OR Transfer to the BSF		0.00	0.00

THE FORECAST FOR STATE REVENUE

SENATE FISCAL AGENCY REVENUE ESTIMATES

This section of the Budget Status Report presents the Senate Fiscal Agency's (SFA's) estimates for General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue. The revised estimates for FY 2003-04 and FY 2004-05 are presented. The revenue estimates for each of these fiscal years include the estimates for baseline revenue, which measures what revenue would be without any changes in the State's tax structure from the previous fiscal year, and net revenue, which estimate the revenue after the impact of all enacted tax changes.

REVENUE OVERVIEW

The highlights of the revised estimates of GF/GP and SAF revenue for FY 2003-04 and FY 2004-05 are summarized below and are presented in Table 5.

General Fund/General Purpose Revenue – In FY 2003-04, GF/GP revenue will total an estimated \$7.87 billion. This represents a 1.1% decline from the final level for FY 2002-03. Compared with the January 2004 consensus estimate, this revised estimate is up \$10 million. In FY 2004-05, GF/GP revenue is expected to total \$7.85 billion, which represents a decline of 0.2% from the revised estimate for FY 2003-04. While the improvement in economic activity forecast for 2005 will help boost baseline revenue 4.3% in FY 2004-05, the enacted tax reductions will essentially offset this baseline revenue gain. This revised estimate for FY 2004-05 is \$31 million above the January 2004 consensus estimate.

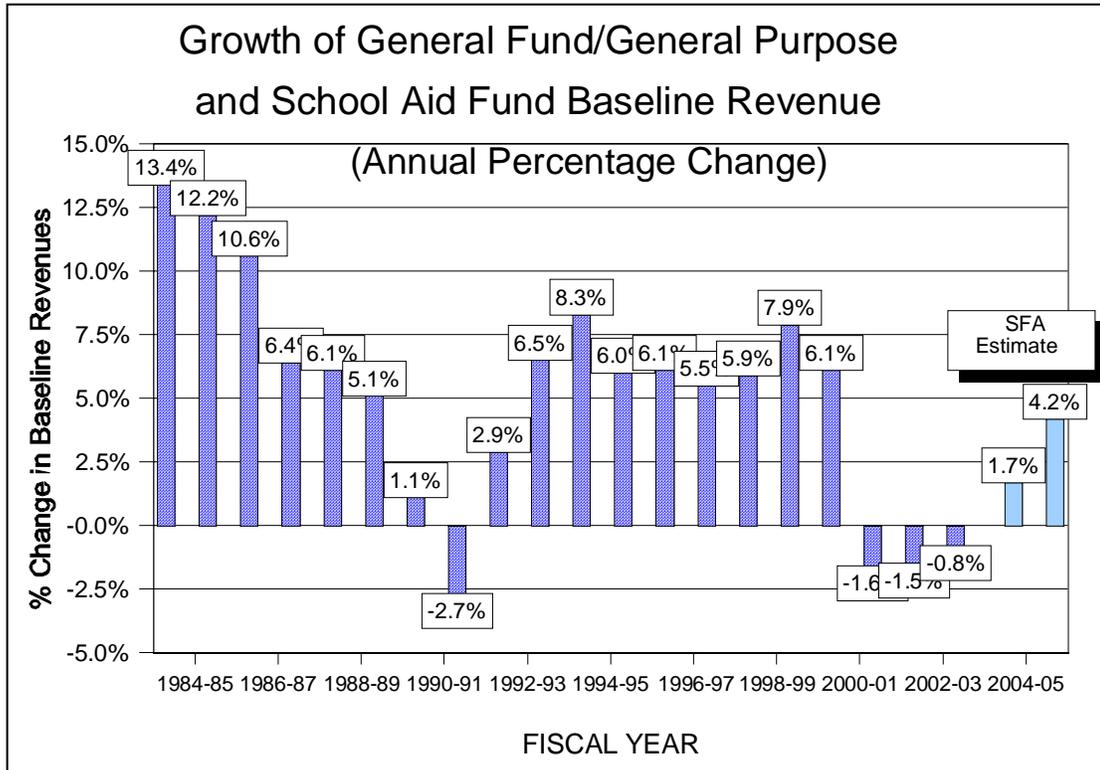
School Aid Fund – In FY 2003-04, SAF earmarked revenue will total an estimated \$10.53 billion, which represents a decrease of 1.7% from the revenue level in FY 2002-03. This revised estimate is down \$56 million from the January 2004 consensus estimate and most of this downward revision is due to weaker-than-expected sales tax collections. In FY 2004-05, earmarked SAF revenue will total an estimated \$10.97 billion, which is an increase of 4.2%. This revised estimate for FY 2004-05 is \$29 million below the January estimate.

Figure 8 presents an historical overview of the percentage change in baseline GF/GP and SAF revenue since FY 1982-83. It is estimated that baseline GF/GP and SAF revenue will increase 1.7% in FY 2003-04 and 4.2% in FY 2004-05. While these projected increases are much improved from the actual declines in baseline revenue experienced for three consecutive years from FY 2000-01 to FY 2002-03, they still lag behind the growth rates in baseline revenue experienced in the latter half of the 1980s and through much of the 1990s.

Table 5

SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2003-04 AND FY 2004-05 GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND (dollars in millions)			
	FY 2002-03 Final	FY 2003-04 Revised Est.	FY 2004-05 Revised Est.
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	\$7,943.6	\$8,067.1	\$8,411.3
Tax Changes Not In Baseline	14.1	(199.5)	(558.0)
<u>Revenue After Tax Changes:</u>			
Net Income Tax	3,960.9	3,958.0	4,033.1
Single Business Tax & Insurance Tax	2,074.0	2,085.7	2,193.5
Other Taxes	1,576.5	1,598.1	1,447.9
Total Taxes	7,611.4	7,641.8	7,674.5
Nontax Revenue	346.3	225.8	178.8
TOTAL GF/GP REVENUE	\$7,957.7	\$7,867.6	\$7,853.3
SCHOOL AID FUND			
Baseline SAF	10,255.6	10,449.7	10,888.8
Tax Changes Not In Baseline	459.2	79.0	80.6
TOTAL SAF REVENUE	\$10,714.8	\$10,528.7	\$10,969.4
BASELINE GF/GP AND SAF REVENUE	18,199.2	18,516.8	19,300.1
Tax & Revenue Changes	473.3	(120.5)	(477.4)
GF/GP & SAF REV. AFTER CHANGES	\$18,672.5	\$18,396.3	\$18,822.7
<u>ADDENDUM:</u>			
Sales Tax	\$6,422.6	\$6,510.7	\$6,820.7
PERCENT CHANGE			
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	(4.1)%	1.6%	4.3%
<u>Revenue After Tax Changes:</u>			
Net Income Tax	(6.4)	(0.1)	1.9
Single Business Tax & Insurance Tax	(6.2)	0.6	5.2
Other Taxes	(4.6)	1.4	(9.4)
Total Taxes	(6.0)	0.4	0.4
Nontax Revenue	5.3	(34.8)	(20.8)
TOTAL GF/GP REVENUE	(5.6)%	(1.1)%	(0.2)%
SCHOOL AID FUND			
Baseline SAF	1.5	1.9	4.2
TOTAL SAF REVENUE	5.7	(1.7)	4.2
BASELINE GF/GP AND SAF REVENUE	(1.0)	1.7	4.2
GF/GP & SAF REV. AFTER CHANGES	0.6%	(1.5)%	2.3%
<u>ADDENDUM:</u>			
Sales Tax	(0.3)%	1.4%	4.8%

Figure 8



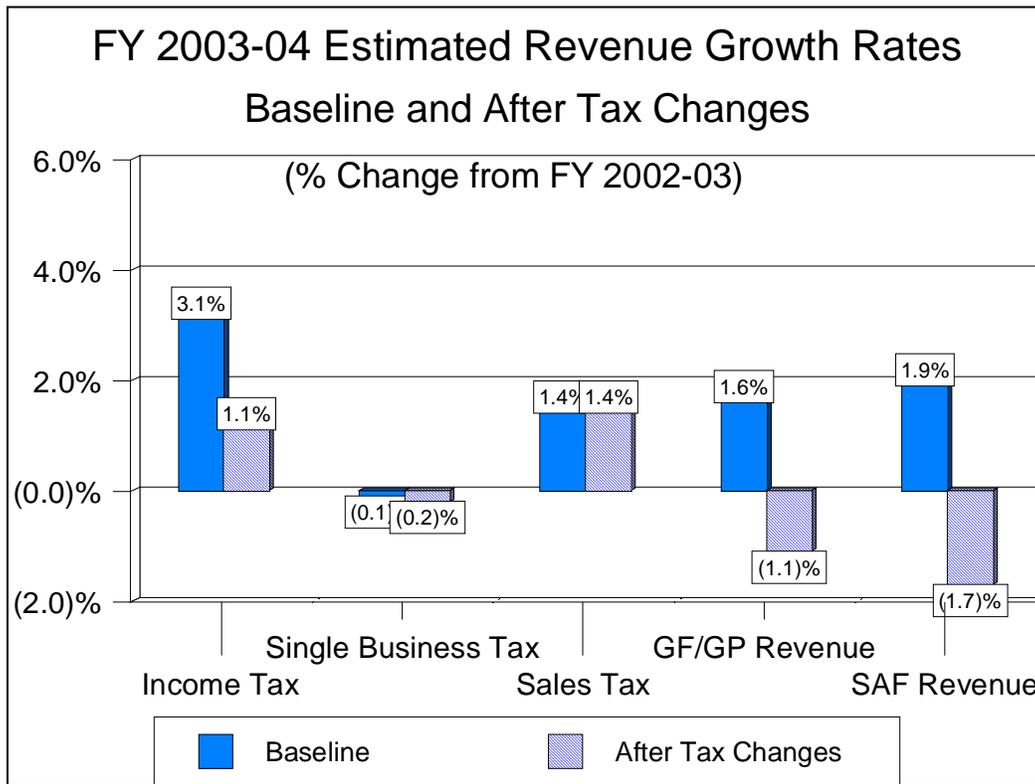
REVISED REVENUE ESTIMATES FOR FY 2003-04

The Michigan economy is starting to show signs of increased activity, and this renewed growth is expected to continue to improve during the remainder of FY 2003-04. This should help boost tax collections, particularly the revenue generated from Michigan's major taxes, including the income, sales, and single business taxes. On a baseline basis, GF/GP and SAF revenue will increase an estimated 1.7% in FY 2003-04, which will mark the strongest rate of growth since FY 1999-2000. However, the impact of the enacted tax changes will more than offset the anticipated gain in revenue from the renewed economic growth. The enacted tax reductions include primarily the last step in the five-year phased reduction in the income tax rate and the ongoing phased elimination of the estate tax. As a result, in FY 2003-04, net GF/GP and SAF revenue will total an estimated \$18.4 billion, which represents a 1.5% decline from the FY 2002-03 revenue level. This will mark the fourth consecutive fiscal year that net combined GF/GP and SAF revenue has fallen below the previous year's level. Compared with the January 2004 consensus estimate, this revised estimate of GF/GP and SAF net revenue is down \$46 million. These revised estimates are based on the SFA's revised economic outlook, as well as actual tax collections through April 2004. The revised revenue estimates for FY 2003-04 are presented in [Table 6](#) and a comparison of baseline revenue and revenue after the impact of the tax cuts for the major taxes and overall GF/GP and SAF budgets in FY 2003-04 is presented in [Figure 9](#).

Table 6
FY 2003-04 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(dollars in millions)

	FY 2002-03 Final	FY 2003-04 Revised Est.	Change From FY 2002-03		\$ Change from 01/04 Consensus
			Dollar Change	Percent Change	
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue	\$7,943.6	\$8,067.1	\$ 123.5	1.6%	\$ 21.5
Tax Changes Not In Baseline	14.1	(199.5)	(213.6)	---	(11.5)
Revenue After Tax Changes:					
<u>Personal Income Tax</u>					
Gross Collections	7,361.1	7,514.5	153.4	2.1	58.0
Less: Refunds	(1,550.5)	(1,640.9)	(90.4)	5.8	(4.2)
Net Income Tax Collections	5,810.6	5,873.6	63.0	1.1	53.8
Less: Earmarking to SAF	(1,847.8)	(1,914.1)	(66.3)	3.6	(14.6)
Campaign Fund	(1.9)	(1.5)	0.4	(21.1)	0.0
Net Income Tax to GF/GP	\$3,960.9	\$3,958.0	\$(2.9)	(0.1)%	\$39.2
Other Taxes					
Single Business Tax	1,842.9	1,838.7	(4.2)	(0.2)	(40.0)
Sales	63.6	98.4	34.8	54.6	(15.8)
Use	819.6	855.1	35.5	4.3	16.7
Cigarette	289.2	286.2	(3.0)	(1.0)	0.0
Insurance Company Premiums	231.1	247.0	15.9	6.9	0.0
Telephone & Telegraph	124.2	120.6	(3.6)	(2.9)	0.0
Estate	98.6	65.0	(33.6)	(34.1)	(5.0)
Oil & Gas Severance	47.9	56.0	8.1	16.9	13.0
All Other	133.4	116.8	(16.6)	(12.4)	2.0
Subtotal Other Taxes	\$3,650.5	\$3,683.8	\$ 33.3	0.9%	\$(29.2)
Total Nontax Revenue	346.3	225.8	(120.5)	(34.8)	0.0
GF/GP REV AFTER TAX CHNGS	\$7,957.7	\$7,867.6	\$(90.1)	(1.1)%	\$10.0
SCHOOL AID FUND:					
Baseline Revenue	\$10,255.6	\$10,449.7	\$ 194.1	1.9%	\$(45.7)
Tax Changes Not In Baseline	459.2	79.0	(380.2)	(82.8)	(10.0)
Revenue After Tax Changes:					
Sales Tax	4,681.4	4,744.0	62.6	1.3	(80.7)
Lottery Revenue	586.0	630.0	44.0	7.5	(5.0)
State Education Property Tax	2,127.5	1,745.2	(382.3)	(18.0)	0.0
Real Estate Transfer Tax	275.5	288.7	13.2	4.8	14.0
Income Tax	1,847.8	1,914.1	66.3	3.6	14.6
Casino Tax	90.9	95.5	4.6	5.1	1.0
Other Revenue	1,105.7	1,111.2	5.5	0.5	0.3
SAF REV. AFTER TAX CHNGS	\$10,714.8	\$10,528.7	\$(186.1)	(1.7)%	\$(55.7)
BASELINE GF/GP AND SAF	\$18,199.2	\$18,516.8	\$ 317.6	1.7%	\$(24.2)
Tax & Revenue Changes	473.3	(120.5)	(593.8)	(125.5)	(21.5)
GF/GP & SAF REV. AFTER CHNGS	\$18,672.5	\$18,396.3	\$(276.2)	(1.5)%	\$(45.7)
SALES TAX	\$6,422.6	\$6,510.7	\$ 88.1	1.4%	\$(110.0)
Note: Baseline revenue in this table is based on FY 2002-03 to provide an accurate comparison of the revenue in these two fiscal years.					

Figure 9



General Fund/General Purpose

On a baseline basis, GF/GP revenue will increase an estimated 1.6% in FY 2003-04, which will mark its strongest rate of growth since FY 1999-2000. Despite the delay in the final scheduled reduction in the income tax rate from January 1, 2004, to July 1, 2004, which will help boost revenue, the modest increase in GF/GP baseline revenue will be more than offset by various tax reductions, including the full year impact in 2004 of cutting the income tax rate to 4.0% in 2003, and the ongoing phased elimination of the estate tax. As a result, it is estimated that net GF/GP revenue will fall 1.1%, or \$90 million, in FY 2003-04 to \$7.87 billion. Compared with the January 2004 consensus revenue estimate, GF/GP revenue has been revised upward \$10 million.

Income Tax. Approximately half of GF/GP revenue comes from the income tax. In FY 2003-04, it is estimated that the portion of income tax revenue going into GF/GP revenue will total \$3.96 billion, which represents a slight decline of 0.1% from FY 2002-03. This revenue includes \$77 million from the delay in cutting the income tax rate to 3.9% from January 1, 2004, to July 1, 2004.

Single Business Tax. The other major source of GF/GP revenue is the single business tax. In FY 2003-04, single business tax revenue will total an estimated \$1.84 billion, which is down 0.2% from FY 2002-03. Compared with the January 2004 consensus revenue estimate, the single business tax revenue estimate has been lowered \$40 million.

Estate Tax. Michigan's estate tax is equal to the maximum credit allowed on the Federal estate tax for state death taxes. However, the Federal government is phasing out its estate tax by 2010 and is phasing out the state death tax credit by 2005. As a result, the revenue Michigan receives from its estate tax is getting smaller each year and will be totally eliminated in FY 2005-06. In FY

2003-04, the phased reduction in the Federal credit will reduce Michigan's estate tax revenue an estimated 33.6% or \$34 million, to \$65 million, compared with the FY 2002-03 revenue level. All estate tax revenue goes into GF/GP revenue.

School Aid Fund

School Aid Fund revenue from earmarked taxes and the lottery is expected to increase 1.9% on a baseline basis in FY 2003-04 compared with the FY 2002-03 level, but net revenue after all enacted tax changes is expected to be down 1.7% to \$10.53 billion. This difference in baseline and net SAF revenue for FY 2003-04 is due to the acceleration in the due date of State education property tax in FY 2002-03, which generated an estimated \$450 million in one-time revenue in FY 2002-03. The growth in ongoing SAF revenue sources in FY 2003-04 will not be large enough to offset this large one-time revenue boost in FY 2002-03, so SAF revenue is expected to fall in FY 2003-04 compared with FY 2002-03. These revised estimates for SAF earmarked taxes and lottery revenue are down \$56 million from the January 2004 consensus revenue estimate. The SAF revenue estimate for FY 2003-04 also is summarized in [Table 6](#).

Sales Tax. So far in FY 2003-04, sales tax collections have been falling behind the estimate adopted at the January 2004 Consensus Revenue Estimating Conference. As a result, the estimate of total sales tax revenue has been reduced by \$110 million to \$6.51 billion. Approximately 73% of sales tax revenue is earmarked to the SAF, and based on this revised estimate of total sales tax collections, the estimate of sales tax revenue that will be earmarked to the SAF has been lowered by \$81 million to \$4.74 million in FY 2003-04. This sales tax revenue will account for an estimated 45% of the SAF earmarked tax and lottery revenue in FY 2003-04.

State Education Property Tax. The State education property tax will generate an estimated \$1.75 billion in FY 2003-04. On a baseline basis, this represents an increase of 2.2%, but because of the additional \$450 million in one-time revenue this tax generated in FY 2002-03, net State education property tax revenue including the impact of all tax changes, will be down an estimated 18.0% in FY 2003-04 from the FY 2002-03 level. This estimate of State education property tax revenue is unchanged from the January consensus estimate.

Lottery. All revenue from the lottery, after paying prizes and expenses, goes into the SAF. In FY 2003-04, net lottery revenue is expected to total \$630 million, which is up 7.5% from the FY 2002-03 level. This increase will be due to the new club keno and pull tab games. While these new games will generate about \$60 million in additional lottery revenue, some of their activity will be at the expense of other Lottery games. As a result, it is estimated that these new games will generate about \$40 million in net new lottery revenue in FY 2003-04.

FY 2004-05 REVISED REVENUE ESTIMATES

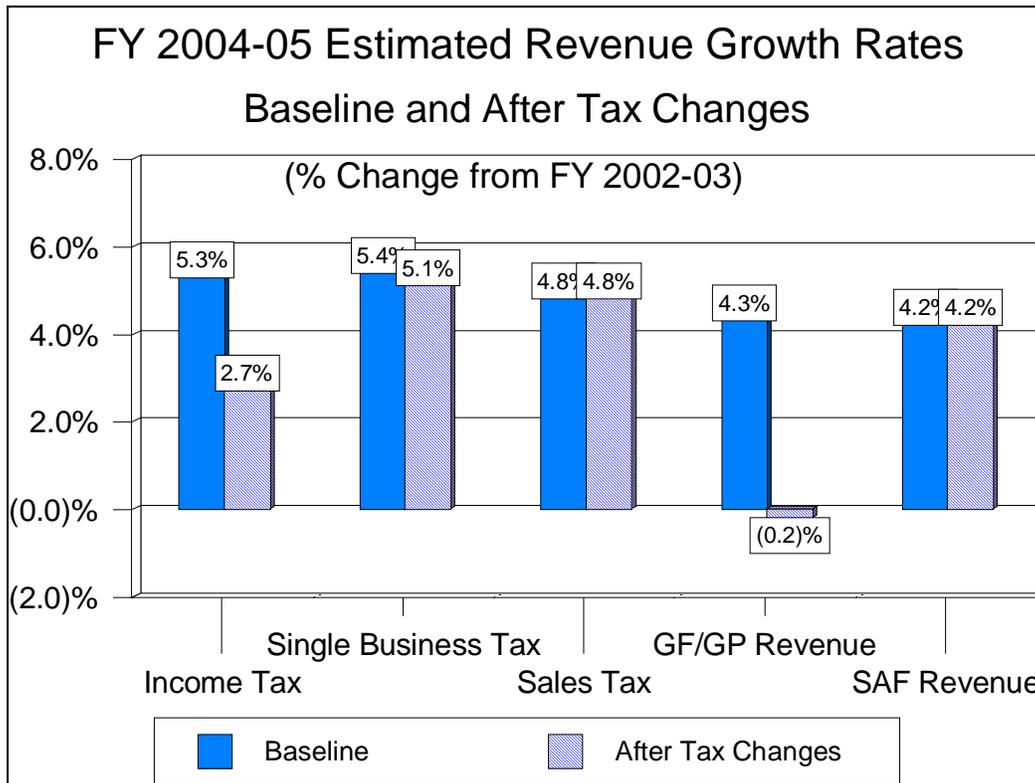
The economic growth forecast for 2004 is expected to carry over into 2005 but at a slightly faster pace. This improved level of economic activity will help boost tax revenue, particularly for the income, sales, use, and single business taxes. As a result, in FY 2004-05, it is estimated that GF/GP and SAF revenue will total \$18.82 billion, which represents a \$426 million, or 2.3%, increase from the revised estimate for FY 2003-04, as presented in [Table 7](#). The estimated FY 2004-05 baseline and after-tax-cut revenue growth rates for the major taxes and the GF/GP and SAF are compared in [Figure 10](#).

Table 7

FY 2004-05 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(dollars in millions)

	FY 2003-04 Revised Est.	FY 2004-05 Revised Est.	Change from FY 2003-04		\$ Change from 1/04 Consensus
			Dollar Change	Percent Change	
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue	\$8,067.1	\$8,411.3	\$ 344.2	4.3%	\$ 42.0
Tax Changes Not In Baseline	(199.5)	(558.0)	(358.6)	179.8	(11.4)
Revenue After Tax Changes:					
<u>Personal Income Tax</u>					
Gross Collections	7,514.5	7,708.8	194.3	2.6	54.0
Less: Refunds	(1,640.9)	(1,674.7)	(33.8)	2.1	(1.4)
Net Income Tax Collections	5,873.6	6,034.1	160.5	2.7	52.6
Less: Earmarking to SAF	(1,914.1)	(1,999.5)	(85.4)	4.5	(13.6)
Campaign Fund	(1.5)	(1.5)	0.0	0.0	0.0
Net Income Tax to GF/GP	\$3,958.0	\$4,033.1	\$ 75.1	1.9%	\$ 39.0
Other Taxes					
Single Business Tax	1,838.7	1,932.5	93.8	5.1	(30.0)
Sales	98.4	112.3	13.9	14.1	(7.1)
Use	855.1	884.4	29.3	3.4	16.7
Cigarette	286.2	128.0	(158.2)	(55.3)	0.0
Insurance Company Premiums	247.0	261.0	14.0	5.7	0.0
Telephone & Telegraph	120.6	120.6	0.0	0.0	0.0
Estate	65.0	34.0	(31.0)	(47.7)	0.0
Oil & Gas Severance	56.0	50.0	(6.0)	(10.7)	10.0
All Other	116.8	118.6	1.8	1.5	2.0
Subtotal Other Taxes	\$3,683.8	\$3,641.4	\$ (42.4)	(1.2)%	\$ (8.5)
Total Nontax Revenue	225.8	178.8	(47.0)	(20.8)	0.0
GF/GP REV. AFTER TAX CHNGS	\$7,867.6	\$7,853.3	\$ (14.3)	(0.2)%	\$ 30.6
SCHOOL AID FUND:					
Baseline Revenue	\$10,449.7	\$10,888.8	\$ 439.1	4.2%	\$(29.3)
Tax Changes Not In Baseline	79.0	80.6	1.7	2.1	0.0
Revenue After Tax Changes:					
Sales Tax	4,744.0	4,970.5	226.5	4.8	(58.7)
Lottery Revenue	630.0	635.0	5.0	0.8	0.0
State Education Property Tax	1,745.2	1,858.2	113.0	6.5	0.0
Real Estate Transfer Tax	288.7	287.0	(1.7)	(0.6)	14.0
Income Tax	1,914.1	1,999.5	85.4	4.5	13.6
Casino Tax	95.5	98.8	3.3	3.5	1.5
Other Revenue	1,111.2	1,120.4	9.2	0.8	0.3
SAF REV. AFTER TAX CHNGS	\$10,528.7	\$10,969.4	\$ 440.7	4.2%	\$(29.3)
BASELINE GF/GP AND SAF	\$18,516.8	\$19,300.1	\$ 783.3	4.2%	\$ 12.7
Tax & Revenue Changes	(120.5)	(477.4)	(356.9)	----	(11.4)
GF/GP & SAF REV. AFTER CHNGS	\$18,396.3	\$18,822.7	\$ 426.4	2.3%	\$ 1.3
SALES TAX	\$6,510.7	\$6,820.7	\$ 310.0	4.8%	\$(80.0)
Note: Baseline revenue in this table is based on FY 2002-03 to provide an accurate comparison of the revenue in these two fiscal years.					

Figure 10



General Fund/General Purpose Revenue

General Fund/General Purpose baseline revenue will increase an estimated 4.3% in FY 2004-05, led by increases in the income, single business, use, and insurance taxes. This gain in baseline revenue, however, will be more than offset by enacted tax and earmarking changes, including the full-year impact of being at a 3.9% income tax rate, the final phase of the elimination of the estate tax, and the scheduled earmarking of a portion of GF/GP tobacco tax revenue to the Budget Stabilization Fund. After taking into account these enacted tax changes, it is estimated that FY 2004-05 GF/GP revenue will total \$7.85 billion, which represents a 0.2%, or \$14 million, reduction from the revised estimate for FY 2003-04. This revised estimate is up \$31 million from the January consensus estimate.

Income Tax. Income tax revenue going to the General Fund will total an estimated \$4.03 billion, which will be up 1.9% from the FY 2003-04 level. On a baseline basis, net income tax collections after refunds, are expected to be up 5.3%, but baseline revenue will be reduced due to the fact that the tax rate will be at 3.9% for all of FY 2004-05, compared with 4.0% for the first three quarters of FY 2003-04. In addition, it is estimated that the personal exemption, which is automatically indexed to changes in the consumer price index, will increase \$100 to \$3,200 on January 1, 2005. This will reduce income tax revenue about \$33 million.

Single Business Tax. The major components of the single business tax base, which includes compensation paid to workers, business profits, and gross receipts, are all expected to improve in FY 2004-05 due to the expected increase in the pace of economic activity. However, some of this increase will be offset by an increase in the amount claimed through the investment tax credit, which is another key component of the single business tax. As a result, single business tax revenue is expected to increase 5.1% to \$1.93 billion in FY 2004-05. This estimate includes the

estimated \$9.9 million that will be foregone due to the new partial exemption for health care-related costs.

Estate Tax. Estate tax revenue will fall to an estimated \$34 million, a drop of 48%, due to the continuing phase-out of the tax.

Cigarette Tax. When the cigarette tax was increased \$0.50 per pack in August 2002, the enacted amendments provided that, for FY 2004-05 through FY 2006-07, the General Fund share of the increased revenue would be transferred instead to the Budget Stabilization Fund. As a result, it is estimated that this provision in the law will reduce GF/GP cigarette tax revenue by an estimated \$154 million in FY 2004-05.

School Aid Fund

School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$10.97 billion in FY 2004-05, which represents a 4.2%, or \$441 million, increase from the revised estimate for FY 2003-04. This increase reflects a general improvement in most of the taxes that are earmarked to the SAF. This revised estimate is down \$29 million from the January 2004 consensus estimate due primarily to downward revisions in the sales tax revenue estimate.

Sales Tax. The sales tax revenue estimate has been revised down \$80 million in FY 2004-05, compared with January 2004 consensus revenue estimate. As a result, sales tax collections are expected to total \$6.82 billion, which is up 4.8% from the revised level for FY 2003-04. Of this total amount, \$4.97 billion will be earmarked to the SAF, marking the sales tax the single largest source of revenue for the SAF.

State Education Property Tax. The State education property tax is expected to generate \$1.86 billion in FY 2004-05, representing an increase of 6.5%.

Lottery. Net lottery revenue will total an estimated \$635 million in FY 2004-05, which is only 0.8% above the revised level for FY 2003-04. The new keno and pull tab games are expected to generate net new revenue of \$50 million.

SENATE FISCAL AGENCY BASELINE REVENUE FORECAST HISTORY

The history of the Senate Fiscal Agency's and consensus estimates for GF/GP and SAF baseline revenue for FY 2003-04 and FY 2004-05 is presented in Tables 8 and 9. Baseline estimates are used to track the forecast history for these two fiscal years in order to avoid the wide swings in revenue estimates that occur when tax changes are enacted. In addition, in order to provide an accurate comparison, all of the previous baseline estimates made for FY 2003-04 and FY 2004-05 have been adjusted to reflect a baseline based on the FY 2002-03 tax structure.

The initial estimate for FY 2003-04 GF/GP and SAF baseline revenue made in December 2002 was \$19.39 billion, as shown in Table 8. The sluggish level of economic activity lasted longer than originally estimated, and as a result, the revenue estimates were lowered in May 2003 and October 2003, and then they were essentially unchanged at the January 2004 Consensus Revenue Estimating Conference. The Senate Fiscal Agency's revised estimates presented in this report decreased GF/GP and SAF baseline revenue \$24 million, or 0.1%, from the January estimate. Compared with the initial estimate made in December 2002, the SFA's latest revised estimate of GF/GP and SAF baseline revenue for FY 2003-04 is down \$871 million or 4.5%.

For FY 2004-05, the initial estimate was made in December 2003, and at that time the SFA estimated that GF/GP and SAF baseline revenue would equal \$19.29 billion. In January 2004, this estimate was lowered slightly by \$6 million. The SFA's latest estimates increase the GF/GP and SAF revenue estimate for FY 2004-05 by \$13 million. As a result, compared with the initial estimate made in December 2003, the revised estimate of GF/GP and SAF baseline revenue is up only \$7 million.

Table 8

CHANGES IN SENATE FISCAL AGENCY BASELINE REVENUE ESTIMATES FOR FY 2003-04 (millions of dollars)			
Forecast Date	GF/GP	SAF	Total
December 19, 2002	\$8,498.8	\$10,888.8	\$19,387.6
January 14, 2003 ^{a)}	8,452.1	10,820.3	19,272.4
May 8, 2003	8,452.3	10,743.5	19,195.8
May 13, 2003 ^{a)}	8,469.4	10,735.6	19,205.0
October 13, 2003	8,069.8	10,525.0	18,594.8
October 14, 2003 ^{a)}	8,042.5	10,496.6	18,539.1
January 10, 2004	8,027.4	10,556.5	18,583.9
January 14, 2004 ^{a)}	8,045.5	10,495.4	18,540.9
May 14, 2004	8,067.1	10,449.7	18,516.8
Change From Previous Estimate:			
Dollar Change	\$21.6	(\$45.7)	(\$24.1)
Percent Change	0.3%	(0.4)%	(0.1)%
Change From Initial Estimate:			
Dollar Change	(\$431.7)	(\$439.1)	(\$870.8)
Percent Change	(5.1)%	(4.0)%	(4.5)%
Note: Baseline base year equals FY 2002-03.			
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Treasury Department.			

Table 9

CHANGES IN SENATE FISCAL AGENCY BASELINE REVENUE ESTIMATES FOR FY 2004-05 (millions of dollars)			
Forecast Date	GF/GP	SAF	Total
January 10, 2004	\$8,340.5	\$10,952.9	\$19,293.4
January 14, 2004 ^{a)}	8,369.3	10,917.9	19,287.3
May 14, 2004	8,411.3	10,888.8	19,300.1
Change From Previous Estimate:			
Dollar Change	\$42.0	(\$29.1)	\$12.8
Percent Change	0.5%	(0.6)%	0.0%
Change From Initial Estimate:			
Dollar Change	\$70.8	(\$64.1)	\$6.7
Percent Change	0.8%	(0.6)%	0.0%
Note: Baseline base year equals FY 2002-03.			
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Treasury Department.			

COMPLIANCE WITH STATE REVENUE LIMIT

Article IX, Section 26 of the Michigan Constitution establishes a limit on the amount of revenue State government may collect in any fiscal year. This section of the Constitution was adopted by a vote of the people in 1978 and the limit was first applicable in FY 1979-80. In the first 15 years this revenue limit was in effect (FY 1979-80 to FY 1993-94), the revenue limit was never exceeded. The largest gap between revenue and the limit occurred in FY 2002-03, when State revenue was \$4.2 billion below the revenue limit. In FY 1994-95, State revenue exceeded the revenue limit, for the first time, by \$109.6 million. This was due to the new State revenue being generated as part of the reform of school financing that was enacted in 1994. In FY 1995-96, FY 1996-97, and FY 1997-98, revenue fell below the revenue limit once again. In FY 1998-99 and FY 1999-2000, revenue exceeded the limit, but not by enough to require refunds to be paid to taxpayers. In FY 2000-01 through FY 2002-03, revenue fell well below the revenue limit. Based on the SFA's latest economic forecast and revenue estimates, it is estimated that revenue subject to the revenue limit will remain well below the limit in both FY 2003-04 and FY 2004-05.

THE REVENUE LIMIT

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

State government revenue subject to the limit includes total State government tax revenue and all other State government revenue, such as fees, licenses, and interest earnings. For purposes of the limit, State government revenue does not include Federal aid. Personal income is a measure of the total income received by individuals including wages and salaries, proprietors' income, interest and dividend income, rental income, and transfer payments. It is the broadest measure of overall economic activity for the State of Michigan and is estimated by the U.S. Department of Commerce's Bureau of Economic Analysis.

REQUIREMENTS IF REVENUE LIMIT IS EXCEEDED

If final revenue exceeds the revenue limit, the Constitution and State law provide procedures to deal with this event. If revenue exceeds the limit by less than 1%, the excess revenue must be deposited into the Budget Stabilization Fund. If the revenue limit is exceeded by 1% or more, the excess revenue must be refunded to income tax and single business tax (SBT) payers, on a pro rata basis. These refunds would be given to taxpayers who file an annual income tax or SBT return in the following fiscal year, because these taxpayers would have made withholding and quarterly estimated payments during the fiscal year when the revenue limit was exceeded. The law requires that these refunds occur in the fiscal year following the filing of the report which determines that the limit was exceeded. This report for any particular fiscal year is typically issued in the spring following the end of the fiscal year.

REVENUE LIMIT COMPLIANCE PROJECTIONS

Based on the SFA's revised revenue estimates for FY 2003-04 and FY 2004-05, Table 10 provides a summary of the estimates of the State's compliance with the revenue limit for each of these fiscal years, along with the final revenue limit levels for FY 2002-03.

FY 2002-03

In FY 2002-03, revenue subject to the revenue limit equaled \$24,062 million. Based on data from the U.S. Department of Commerce, Michigan's personal income equaled \$297,609 million in 2001, which means the revenue limit equaled \$28,243 million for FY 2002-03. As a result, revenue subject to the limit fell under the revenue limit by \$4.2 billion, or 14.8%, in FY 2002-03.

FY 2003-04

Based on the SFA's revised revenue estimates for FY 2003-04, revenue subject to the revenue limit will total an estimated \$23,950 million, and based on the U.S. Department of Commerce's preliminary estimate of personal income in 2002, the revenue limit is expected to total \$28,825 million. As a result, it is estimated that revenue will remain well below the revenue limit, and in fact the gap between revenue subject to the limit and the revenue limit is expected to increase to \$4.87 billion, or 16.9%.

FY 2004-05

Based on the SFA's revised revenue estimates for FY 2004-05, it is estimated that revenue subject to the revenue limit will total \$24,564 million. The revenue limit will equal an estimated \$29,660 million in FY 2004-05, based on the SFA's estimate of personal income for 2003. As a result, revenue is expected to fall below the revenue limit by \$5.1 billion, or 17.2%, in FY 2004-05.

Table 10

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
	Final	Final	Estimate	Estimate
Revenue Subject to Limit:				
Revenue:				
General Fund/General Purpose (baseline)	\$8,280.1	\$7,943.6	\$8,067.1	\$8,411.3
Revenue Sharing (baseline)	1,517.3	1,598.0	1,592.3	1,660.9
School Aid Fund (baseline)	10,105.3	10,255.6	10,449.7	10,888.8
Transportation Funds	2,172.4	2,206.8	2,315.6	2,259.5
Other Restricted Non-Federal Aid Revenue	1,260.8	1,636.7	1,450.0	1,450.0
Adjustments:				
GF/GP Federal Aid	(24.7)	(47.2)	(30.0)	(20.0)
GF/GP Balance Sheet Adjustments	201.7	8.9	(3.5)	(202.3)
SAF Balance Sheet Adjustments	33.1	459.2	108.8	116.1
Total Revenue Subject to Limit:	\$23,546.0	\$24,061.6	\$23,950.0	\$24,564.3
Revenue Limit:				
Personal Income:				
Calendar Year	CY 2000	CY 2001	CY 2002	CY 2003
Amount	\$289,390	\$297,609	\$303,745	\$312,537
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	\$27,463.1	\$28,243.1	\$28,825.4	\$29,659.8
1% of Limit	274.6	282.4	288.3	296.6
Amount Under (Over) Limit	\$3,917.1	\$4,181.5	\$4,875.4	\$5,095.5

ESTIMATE OF YEAR-END BALANCES

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 2003-04 and FY 2004-05 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) year-end balances. This section of the report also addresses the issues that members of the Legislature are facing as they attempt to complete action on the FY 2004-05 State budget.

Table 11 provides a summary of the SFA's estimates of the FY 2003-04 and FY 2004-05 year-end balances of the GF/GP and SAF budgets. Based on current SFA revenue estimates and SFA assumptions concerning appropriations, the FY 2003-04 GF/GP budget is in deficit by \$100.3 million and the FY 2003-04 SAF budget is in deficit by \$60.6 million. Assuming passage of the FY 2004-05 appropriations and tax policy changes as recommended by the Governor on February 12, 2004, the FY 2004-05 GF/GP budget is in deficit by \$99.9 million and the FY 2004-05 SAF budget is in deficit by \$14.1 million. These projected FY 2003-04 and FY 2004-05 budget deficits mean that action will have to be taken by the Governor and the Legislature to eliminate the projected deficits.

Table 11

GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND ESTIMATED YEAR END BALANCES (millions of dollars)		
	FY 2003-04 Estimate	FY 2004-05 Estimate
General Fund/General Purpose	\$ (100.3)	\$ (99.9)
School Aid Fund	\$ (60.6)	\$ (14.1)

FY 2003-04 YEAR-END BALANCE

During December 2003, Governor Granholm and the Legislature developed and approved a comprehensive proposal to eliminate projected FY 2003-04 GF/GP and SAF budget deficits. This plan included appropriation reductions and revenue increases. The enactment of this plan eliminated these projected deficits. Based on the revised SFA revenue estimates and projections of supplemental appropriation needs and appropriation lapses, both the FY 2003-04 GF/GP and SAF budgets are now back in deficit. The deficits are modest in size, but will have to be addressed by the Governor and the Legislature in the weeks ahead.

Table 12 provides a detailed summary of the SFA estimate of a \$100.3 million FY 2003-04 GF/GP budget deficit. There are several factors that contribute to this projected budget deficit. These factors include:

Consensus Revenue Estimate. The SFA is now estimating that the GF/GP ongoing revenue will exceed the January 2004 consensus estimate by \$10.0 million. This positive revenue news is offset by several other revenue factors.

Sale of Northville Property. The current budget assumes that the State will generate \$64.5 million from the sale of the former Northville State Hospital property in Northville. This sale has not been finalized and the current estimate of the Department of Management and Budget suggests that the sale of the property only will generate \$50.0 million. There is still considerable concern as to whether this sale can be closed by September 30, 2004. If this sale is not closed by this date,

the \$50.0 million now assumed in the FY 2003-04 GF/GP budget will not be realized until FY 2004-05.

Table 12
FY 2003-04
GENERAL FUND/GENERAL PURPOSE
REVENUES, EXPENDITURES, AND YEAR END BALANCE
(millions of dollars)

	May 2004 SFA Estimate
Revenue:	
Beginning Balance	\$ 174.0
Ongoing Revenue Estimate	7,792.8
<u>Other Revenue Adjustments:</u>	
Income Tax Rate Pause (PA 239 of 2003)	77.0
Single Business Tax Health Care Base Phase-Out (PA 240 of 2003)	(2.2)
Transfer from Employment Security Fund (PA 84 of 2003)	10.0
Revenue Sharing Reductions	282.5
Sale of Property (Detroit Plaza Building)	12.1
Sale of Property (Northville State Hospital)	50.0
Sale of Property (Macomb Center, S.B. 874)	3.0
Unrestricted Federal Aid	169.0
Driver Responsibility Legislation (PA 165 of 2003)	24.2
Drivers License Fee Legislation (PA 152 of 2003)	25.9
Enhanced Enforcement of Delinquent Taxes	55.1
Escheats Law Revision	15.0
Executive Order 2002-23 (Work Project Lapse to GF/GP)	31.0
Executive Order 2003-23 (Restricted Revenue Lapse to GF/GP)	69.9
Teacher Certification Fee Revenue to GF/GP	1.0
Lapse of Prior Year Airport Improvement Funds (H.B. 4367)	4.1
Tobacco Tax Increase Impact on FY 2003-04 (as proposed by Governor)	11.8
Total Other Revenue Adjustments	\$ 839.4
Total Estimated Revenue	\$8,806.2
Expenditures:	
Enacted Appropriations	\$8,886.8
<u>Supplemental Appropriations:</u>	
Supplemental Appropriations (PA 237 of 2003)	81.4
Supplemental Appropriations GF/GP to SAF (PA 236 of 2003)	45.6
Executive Order 2003-23 (GF/GP Reductions)	(200.9)
Higher Education Supplemental (PA 237 of 2003)	52.4
Medicaid Supplemental Appropriation	116.2
Projected Appropriation Lapses	(75.0)
Total Estimated Expenditures	\$8,906.5
Projected Year-End Balance	\$ (100.3)

Driver Responsibility Legislation. As part of the original action on the FY 2003-04 GF/GP budget, a statute to increase certain fees and fines on drivers was enacted. This so-called Driver Responsibility legislation was originally estimated to generate \$65.0 million of FY 2003-04 GF/GP revenue. The current SFA estimate of the revenue generated from this legislation is \$24.2 million. This revenue reduction results from two factors. First, the Secretary of State was unable to implement this program by the start of the fiscal year. The program did not get up and running until after January 2004. The second reason for the revenue reduction is a statutory change in the

program that eliminated certain fines for drivers not having proof of insurance with them while operating a motor vehicle. These two factors have reduced the expected FY 2003-04 GF/GP revenue from this legislation by \$40.8 million.

Medicaid Supplemental Appropriations. The State Medicaid program has been spending funds at a rate faster than expected under the FY 2003-04 appropriated level. Therefore, absent any changes in Medicaid policies, a supplemental appropriation will need to be enacted to ensure that the program has adequate funding to close out the fiscal year. The SFA is currently estimating this funding shortfall at \$116.2 million. This funding shortfall can be attributed to higher caseloads, cost increases resulting from the failure of the Federal government to approve a pending State waiver, and higher-than-budgeted pharmaceutical costs.

Appropriation Lapses. The SFA is now estimating that net FY 2003-04 GF/GP appropriation lapses will total \$75.0 million. These projected appropriation lapses will have the impact of offsetting some of the other budget pressures the State is now facing.

The FY 2003-04 GF/GP deficit of \$100.3 million will have to be addressed by the Governor and the Legislature in the weeks ahead. The actual level of the deficit will be determined once the FY 2003-04 GF/GP consensus revenue estimates are finalized on May 18, 2004, and there is agreement on the final level of the Medicaid supplemental appropriation. The SFA estimate of a \$100.3 million FY 2003-04 GF/GP budget deficit equals 1.1% of projected GF/GP expenditures.

Table 13 provides a summary of the SFA estimate of a \$60.6 million FY 2003-04 SAF budget deficit. Based on provisions of the State School Aid Act this projected budget deficit would be automatically eliminated by a pro-rata reduction of \$34 per pupil in State school aid payments to local districts, public school academies, and intermediate school districts. The Governor and the Legislature could take alternative action to eliminate this projected deficit that would not involve this automatic pro-rata reduction of \$34 per pupil. This projected FY 2003-04 SAF budget deficit results primarily from a \$55.7 million reduction in the SFA's estimate of SAF revenue from the January 2004 consensus revenue estimate. This downward revision in the revenue estimate is primarily a result of reductions in the estimate of revenue generated from the sales tax. This projected SAF deficit also is affected by the amount of net appropriation lapses at the close of the fiscal year. This level of appropriation lapses results from revisions in the actual number of pupils to be funded during the fiscal year, lapses of the State funding appropriated for the Freedom to Learn program, changes in the estimates of local property tax valuations, and changes in revenue generated from the audits of personal property taxes.

Table 13
FY 2003-04
SCHOOL AID FUND
REVENUES, EXPENDITURES, AND YEAR END BALANCE
(millions of dollars)

	May 2004 SFA Estimate
Revenue:	
Beginning Balance.....	\$ 113.7
Ongoing Revenue Estimate.....	10,528.7
Other Revenue Adjustments:	
General Fund/General Purpose Grant	282.1
General Fund/General Purpose Grant (PA 236 of 2003)	45.6
Personal Property Tax Amnesty	1.2
Enhanced Enforcement of Delinquent Taxes	28.6
Total Other Revenue Adjustments	\$ 357.5
Federal Aid	1,316.7
Total Estimated Revenue.....	\$12,316.6
Expenditures:	
Enacted Appropriation (PA 521 of 2002).....	\$12,696.9
Supplemental Appropriations (PA 158 of 2003)	(92.8)
Supplemental Appropriations (PA 236 of 2003)	2.7
Homestead Exemption Audit (PA 105 of 2003).....	(50.7)
School Aid Proration Reduction (\$74 per pupil)	(131.1)
Projected Appropriation Lapses	(47.8)
Total Estimated Expenditures.....	\$12,377.2
Projected Year-End Balance.....	\$ (60.6)

FY 2004-05 BUDGET BALANCES

On February 12, 2004, Governor Granholm presented her recommendations to the Legislature for the FY 2004-05 GF/GP and SAF budgets. The Legislature is currently in the process of acting on these budget recommendations. This process is expected to be completed by the end of June 2004. The Governor's budget recommendation was based on the consensus revenue estimates agreed to in January 2004. The Governor's budget also included revenue generated from proposed increases in the rate of the cigarette tax, the enactment of a new State estate tax to replace revenue from the phase-out of the Federal estate tax, and an increase in the retail price of liquor. The Legislature has yet to take action on these revenue increases recommended by the Governor. Absent any policy changes, the Governor's FY 2004-05 appropriation recommendation for the Medicaid program will also have to be adjusted. These adjustments are a direct result of increased spending in the Medicaid program during the current fiscal year. The Governor's FY 2004-05 SAF budget recommendation will have to be adjusted because of changes in estimates of SAF revenues from the consensus estimate agreed to in January 2004.

Table 14 provides a summary of the SFA's estimate of a \$99.9 million FY 2004-05 GF/GP budget deficit. This estimate assumes that the Legislature enacts FY 2004-05 GF/GP appropriations at the level recommended by the Governor and the Medicaid budget is adjusted to reflect the additional expenditures resulting from the FY 2003-04 base spending adjustments. The following information provides more details on the changes in the budget compared with the recommendations of the Governor:

Table 14
FY 2004-05
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR END BALANCE
(millions of dollars)

	May 2004 SFA Estimate
Revenue:	
Beginning Balance.....	\$ 0.0
Ongoing Estimated Revenue.....	7,853.3
<u>Enacted Revenue Adjustments:</u>	
Enhanced Tax Enforcement Revenue.....	85.1
Driver Responsibility Legislation.....	76.6
Driver License Fee Legislation.....	25.0
Escheats Law Change.....	15.0
Subtotal Enacted Revenue Adjustments.....	\$ 201.7
<u>Revenue Adjustments Proposed by the Governor:</u>	
Increase Liquor Markup to 74%.....	31.8
Freeze Revenue Sharing.....	348.5
Suspend County Revenue Sharing Payments.....	182.8
Adjust Interfund Borrowing Costs.....	20.0
Subtotal Proposed Revenue Adjustments.....	\$ 583.1
Total Estimated Revenue.....	\$8,638.1
Expenditures:	
Governor's Appropriation Recommendation.....	8,655.0
Medicaid Base Funding Shortfall.....	83.0
Total Estimated Expenditures.....	\$8,738.0
Projected Year-End Balance.....	\$ (99.9)

Consensus Revenue Estimates. The SFA estimate of FY 2004-05 GF/GP revenues is now \$30.6 million above the January 2004 consensus revenue estimate. This consensus revenue estimate was the basis for the Governor's overall budget recommendation.

Driver Responsibility Legislation. As previously discussed, the amount of FY 2003-04 GF/GP revenue to be generated from the driver responsibility legislation has been revised downward. The SFA is now estimating that this legislation will result in FY 2004-05 GF/GP revenue of \$76.6 million. This represents a decrease of \$44.9 million from the estimate assumed in the Governor's budget recommendation.

Medicaid Funding Issues. The SFA is now estimating that funding the FY 2004-05 Medicaid policies included in the Governor's budget will require \$83.0 million of GF/GP appropriations above the level recommended by the Governor. This funding increase results from adjustments made to the base funding needs in the Medicaid program during FY 2003-04. This FY 2004-05 GF/GP funding increase in Medicaid could be eliminated by policy changes that would reduce Medicaid expenditures. Absent any policy changes, the Legislature will have to increase GF/GP appropriations for the Medicaid program above the level recommended by the Governor.

The projected \$99.9 million FY 2004-05 GF/GP budget deficit represents 1.1% of the GF/GP appropriations recommended by the Governor.

Table 15 provides a summary of the SFA's estimate of a \$14.1 million FY 2004-05 SAF budget deficit. This projected budget deficit results from a \$29.3 million downward revision in the estimate of SAF revenues from the January 2004 consensus revenue estimate. This downward revision in the SAF revenue estimate is partially offset by a \$15.0 million projected appropriation lapse. This lapse is a result of an adjustment in the estimated number of pupils to be funded. This projected FY 2004-05 SAF deficit of \$14.1 million represents 0.1% of the FY 2004-05 SAF appropriations as recommended by the Governor.

Table 15
FY 2004-05
SCHOOL AID FUND BUDGET
REVENUE, EXPENDITURES, AND YEAR END BALANCE
(millions of dollars)

	May 2004 SFA Estimate
Revenue:	
Beginning Balance	\$ 0.0
Ongoing Estimated Restricted Revenue	10,969.4
<u>Other Revenue Adjustments:</u>	
GF/GP Grant	131.8
Federal Aid	1,314.4
Enhanced Tax Enforcement Revenue.....	35.5
<u>Proposed Revenue Adjustments:</u>	
Liquor Markup Increase	1.7
Payment in Lieu of Taxes	(2.0)
Subtotal Other Revenue Adjustments	\$1,481.4
Total Estimated Revenue	\$12,450.8
Expenditures:	
Governor's Recommendation	\$12,479.9
Projected Appropriation Lapses	(15.0)
Total Estimated Expenditures	\$12,464.9
Projected Year-End Balance	\$ (14.1)

The final legislative action on the FY 2004-05 State budget over the next several weeks is likely to hinge on final decisions on the tax policy changes recommended by the Governor. A total of \$390.8 million of FY 2004-05 GF/GP appropriations is supported by the tax policy changes recommended by the Governor. This includes \$265 million from the proposed increase in tobacco taxes, \$94.0 million from the proposed estate tax increase, and \$31.8 million from the proposed liquor price markup. If these tax policy changes are not enacted, the Legislature will be forced to develop alternative revenue increases or reduce appropriations below the level recommended by the Governor to keep the FY 2004-05 State budget in balance.