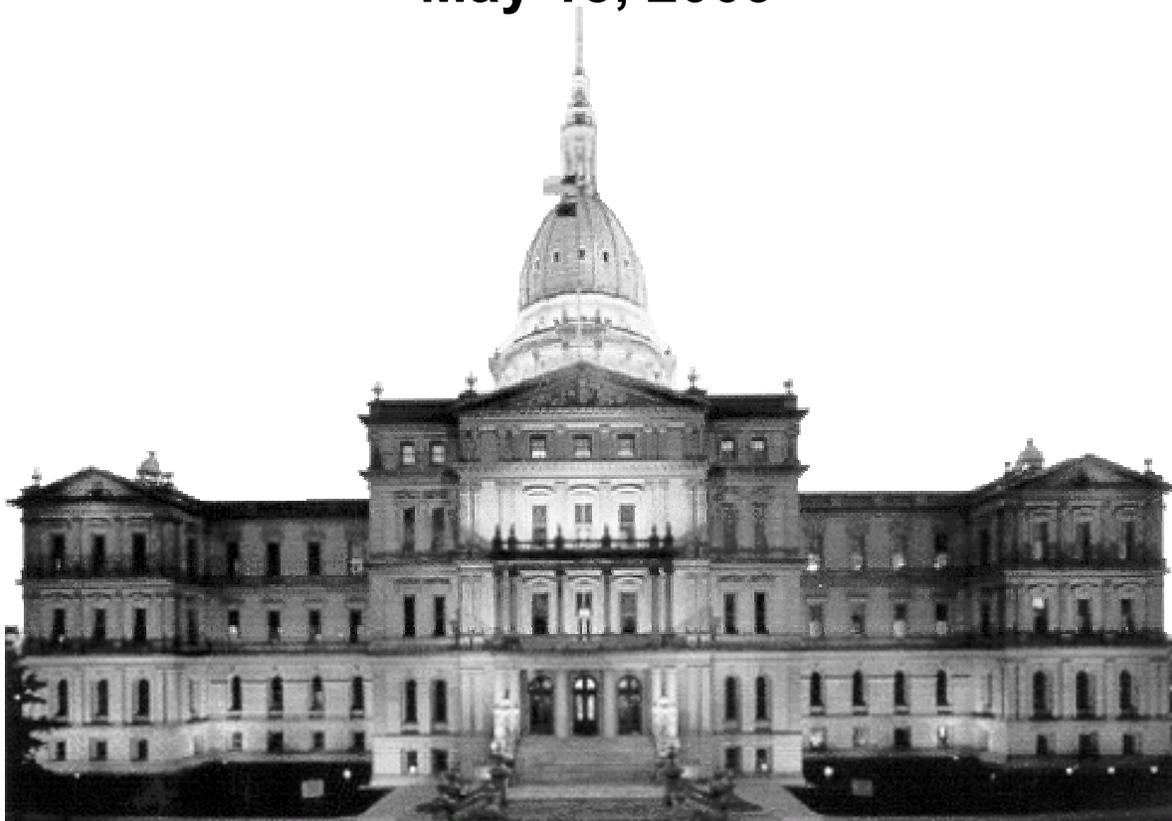




**MICHIGAN'S
ECONOMIC OUTLOOK
AND BUDGET REVIEW**

FY 2008-09 AND FY 2009-10

May 13, 2009



THE SENATE FISCAL AGENCY

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

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

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

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



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EXECUTIVE SUMMARY

ECONOMIC FORECAST

The U.S. economy, as measured by inflation-adjusted gross domestic product, is predicted to contract 4.0% in 2009 before growing a meager 0.3% in 2010. Light vehicle sales are forecasted to decline from 13.2 million units in 2008 to 9.3 million units in 2009 before rising to 10.5 million units in 2010. The unemployment rate is expected to increase from 5.8% in 2008 to 9.2% in 2009 and 10.6% in 2010, while the consumer price index is estimated to decline by 0.8% in 2009 and increase by 2.9% in 2010.

The Michigan economy, as measured by inflation-adjusted personal income, is estimated to decline 3.4% in 2009 and 6.1% in 2010, following the 0.2% decline experienced in 2008. Wage and salary employment is predicted to fall 8.8% during 2009 and 7.2% in 2010.

REVENUE FORECAST

In fiscal year (FY) 2008-09, the economic recession is proving to be much more severe than expected and this is having a significant negative impact on revenue. General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue will total an estimated \$18.3 billion in FY 2008-09, which is down 12.2% or \$2.5 billion from FY 2007-08. This revised estimate is down \$1.3 billion from the January 2009 consensus estimate. General Fund/General Purpose revenue will decline an estimated 20.7% to \$7.4 billion and SAF revenue will decrease 5.3% to \$10.9 billion.

By the end of FY 2009-10, Michigan's economy is expected to experience renewed economic growth, but it will not be strong enough to generate an overall growth in revenue compared with FY 2008-09. As a result, GF/GP and SAF revenue will total an estimated \$17.1 billion in FY 2009-10, representing a decline of 6.8% or \$1.2 billion from the revised estimate for FY 2008-09. Compared with the January 2009 consensus estimate, this revised estimate for FY 2009-10 is down \$2.1 billion. General Fund/General Purpose revenue is expected to drop 9.3% to \$6.7 billion and SAF revenue is expected to decline 5.1% to \$10.3 billion.

Revenue subject to the revenue limit will remain well below the limit in both FY 2008-09 and FY 2009-10.

YEAR-END BALANCE ESTIMATES

Based on the revised Senate Fiscal Agency (SFA) revenue estimates and enacted and projected appropriations, the SFA is estimating that the FY 2008-09 General Fund/General Purpose budget will close the fiscal year with a \$931.0 million deficit. This projected deficit will be eliminated by the appropriation of Federal revenue available under provisions of the American Recovery and Reinvestment Act of 2009 (ARRA). A comparison of the FY 2008-09 SFA revenue estimates and enacted and projected School Aid Fund appropriations leads to a \$465.3 million deficit. This projected deficit also will be eliminated by the use of Federal ARRA funds.

Comparing the SFA's FY 2009-10 revenue estimate with the revenue and appropriation recommendations contained in the Governor's FY 2009-10 GF/GP budget recommendations leads to a \$1.5 billion deficit. A comparison of the SFA's FY 2009-10 SAF revenue estimate with the Governor's recommended level of SAF appropriations leads to a \$948.3 million projected deficit. The FY 2009-10 GF/GP and SAF projected deficits are expected to be eliminated with a combination of appropriation reductions and the use of Federal funds available under provisions of ARRA.

EXECUTIVE SUMMARY

**SENATE FISCAL AGENCY
ECONOMIC AND BUDGET SUMMARY**

ECONOMIC PROJECTIONS (Calendar Year)				
	2007 Actual	2008 Actual	2009 Estimate	2010 Estimate
Real Gross Domestic Product (% change).....	2.0%	1.1%	(4.0)%	0.3%
U.S. Consumer Price Index (% change).....	2.8%	3.8%	(0.8)%	2.9%
Light Motor Vehicle Sales (millions of units).....	16.1	13.2	9.3	10.5
U.S. Unemployment Rate (%)	4.6%	5.8%	9.2%	10.6%
Real Michigan Personal Income (% change).....	2.2%	(0.2)%	(3.4)%	(6.1)%
Michigan Wage & Salary Employment (% change).....	(1.4)%	(2.6)%	(8.8)%	(7.2)%

REVENUE ESTIMATES GENERAL FUND/GENERAL PURPOSE (GF/GP) AND SCHOOL AID FUND (SAF) (Millions of Dollars)						
	<u>FY 2008-09 Estimate</u>			<u>FY 2009-10 Estimate</u>		
	Baseline	Tax Changes	Net Available	Baseline	Tax Changes	Net Available
Gen'l Fund/Gen'l Purpose.....	\$7,035.8	\$386.9	\$7,422.6	\$6,573.1	\$161.3	\$6,734.4
% Change	(13.9)	---	(20.7)	(6.6)	---	(9.3)
School Aid Fund.....	10,307.9	595.4	10,903.4	9,790.1	557.3	10,347.5
% Change	(8.4)	---	(5.3)	(5.0)	---	(5.1)
Total GF/GP and SAF.....	17,343.7	982.3	18,326.0	16,363.2	718.6	17,081.9
% Change	(10.7)	---	(12.2)	(5.7)	---	(6.8)
	<u>FY 2008-09 Estimate</u>			<u>FY 2009-10 Estimate</u>		
Revenue Limit - Under (Over):	\$7,837.9			\$9,897.2		

YEAR-END BALANCE ESTIMATES (Fiscal Year, Millions of Dollars)			
	FY 2007-08 Actual	FY 2008-09 Estimate	FY 2009-10 Estimate
General Fund/General Purpose.....	\$457.9	\$(931.0)	\$(1,528.1)
School Aid Fund.....	247.1	(465.3)	(948.3)
Budget Stabilization Fund	2.2	2.2	2.3

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 2009 and 2010, as well as a summary of recent economic activity.

RECENT U.S. ECONOMIC HIGHLIGHTS

The National Bureau of Economic Research, the organization traditionally regarded as the authority for dating recessions, announced on November 28, 2008 that the U.S. economy had been in recession since December 2007. A casual survey of most economic indicators during 2008 would readily confirm that judgment: Virtually every major economic indicator fell substantially from the fourth quarter of 2007. Inflation-adjusted gross domestic product (GDP) has declined rapidly during the last six months, falling at a 6.3% annual rate in the fourth quarter of 2008, while the advance estimate for the first quarter of 2009 was a decline of 6.1% ([Figure 1](#)). The 3.3% drop in inflation-adjusted GDP since the second quarter of 2008 ranks as the largest three-quarter decline since at least 1946. As of the first quarter of 2009, the 2.6% drop in inflation-adjusted GDP over the last four quarters ranked as the third-worst four-quarter drop since at least 1946, ranking slightly behind the third quarter of 1982, when the four-quarter drop in GDP was 2.7%, and the first quarter of 1958, when the drop was 3.0%. Quarterly data are not available before 1947, but if the 2.6% decline from the first quarter of 2008 to the first quarter of 2009 were a calendar-year decline, it would rank as the sixth-worst year in modern records that go back to 1930, only surpassed by the depression years of 1930, 1931, 1932, and 1938, and the postwar contraction of 1946.

The magnitude of the collapse of many economic fundamentals is not unprecedented, but indicates a severe recession is likely. Milder recessions tended to be associated with more traditional dislocations in the economy as production and consumption changed at different rates. Severe recessions, such as the recessions of the 1950s and 1970s, are often associated with fundamental challenges to the underlying structure of the economy. Often these recessions have involved sharp spikes in inflation, particularly with energy prices; and frequently have involved pressures associated with military conflicts, which have added uncertainty to both the economic and political environments. More severe recessions or depressions, such as the panics of the 19th century and the Great Depression during the 1930s, have involved collapses in the prices of important economic fundamentals such as staple crops and/or housing, the failure of substantial financial institutions, and severe drops in the stock market as speculative bubbles collapsed. During the last three of these more severe collapses, the duration of the economic contraction averaged more than four years.

The current economic situation bears many of the hallmarks of these earlier panics and depressions. Housing and commodity prices essentially collapsed in late 2008, prompting a massive sell-off in the stock market and bringing many banks to the brink of failure ([Figure 2](#)). The collapse was vastly more severe than any economic contraction in the last 60 years and bears more resemblance to the declines at the beginning of the Great Depression. For example, in the 16 months after the stock market peaked in September 1929, the Dow Jones Industrial Average fell 51.2%, compared with a 49.3% decline between October 2007 and February 2009. The most recent decline of a similar magnitude over such a period of time was the 33.2% decline between July 1973 and November 1974.

Figure 1

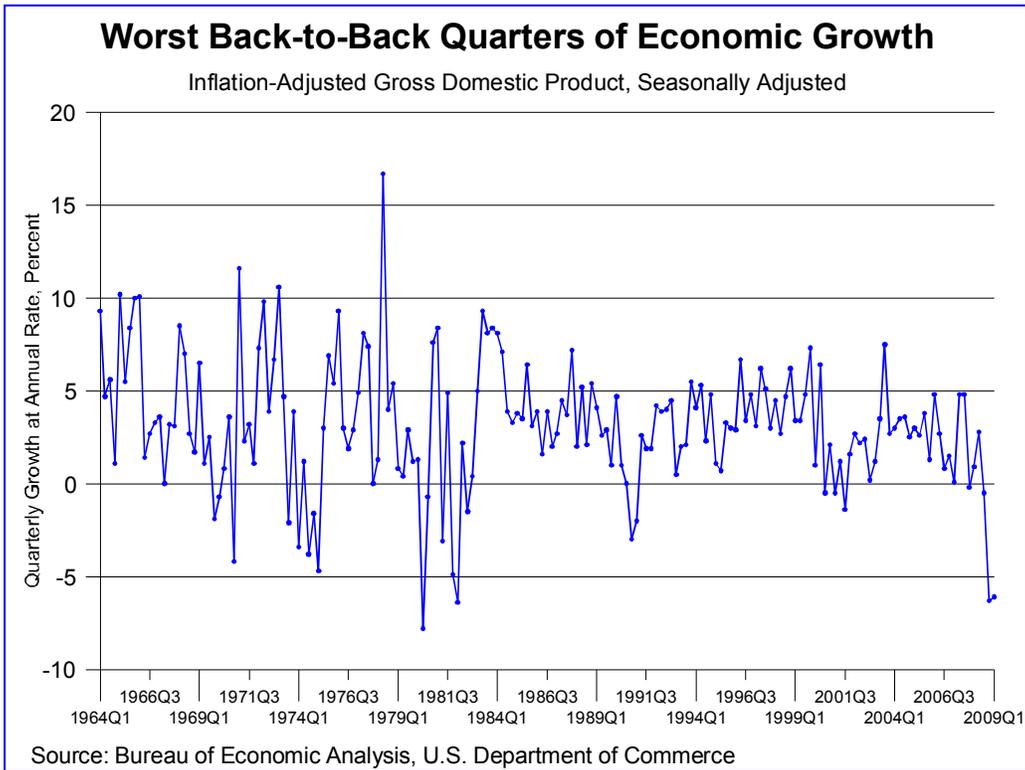
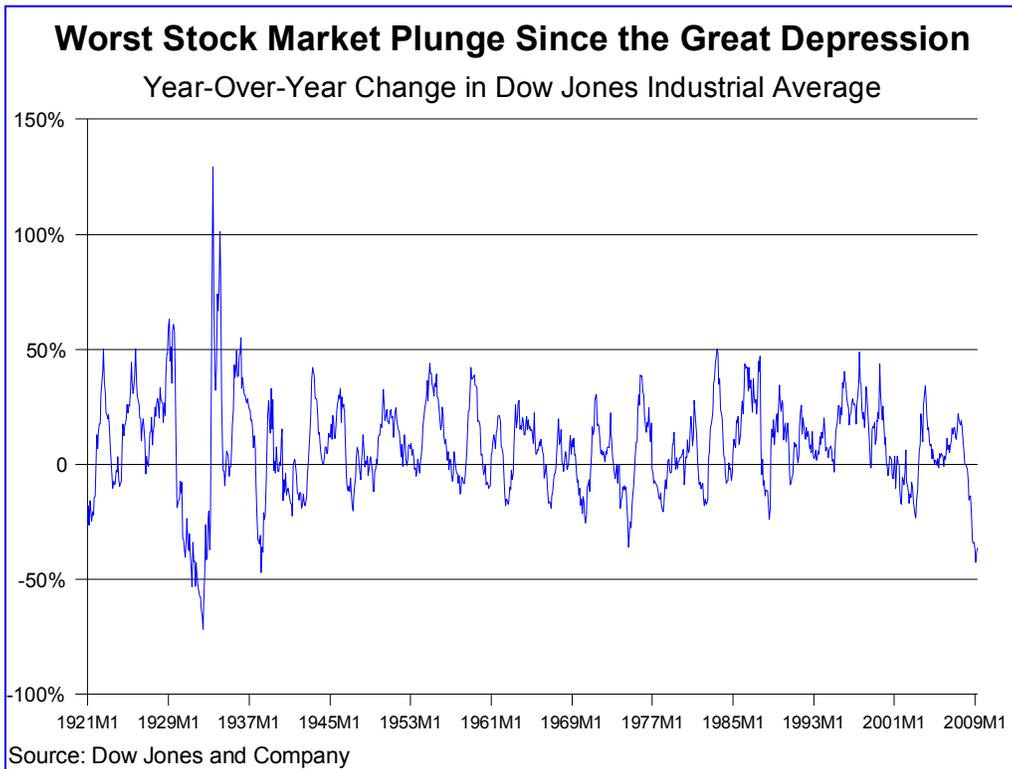


Figure 2



Economic factors underlying the GDP figures demonstrate both the breadth and the magnitude of the recent decline in the U.S. economy. Light vehicle sales dropped from an annual rate of 16.0 million units in December 2007 to 9.1 million units in February 2009, a 43.0% decline ([Figure 3](#)). February 2009 ranked as the second-worst month in vehicle sales for records going back through 1976, and the worst month since December 1981. Adjusted for population, light vehicle sales in January, February, and March 2009 marked the three worst sales months ever in the available data, and February's level (29.7 vehicles per 1,000 persons) was more than 22.4% below the worst month recorded before the current contraction: December 1981 (38.3 units per 1,000 persons). Housing starts, which by the fourth quarter of 2007 had already fallen 49.3% from their January 2006 peak, fell another 42.7% between the fourth quarters of 2007 and 2008, and then dropped another 20.7% in the first quarter of 2009. Housing starts in January 2009 were at an annual rate of 488,000 starts, the lowest level since records started in 1959 and down 78.5% from the January 2006 peak, and totaled only 510,000 units in March 2009 ([Figure 4](#)).

U.S. wage and salary employment peaked in December 2007, at 138.1 million workers, and by March 2009 had declined for 15 consecutive months, which tied with the 1982 recession as the second-longest string of consecutive declines since records began in 1939. During these 15 months, U.S. wage and salary employment declined nearly 5.1 million jobs ([Figure 5](#)). The January 2009 employment decline of 741,000 jobs marked the second-largest monthly drop in employment since October 1945 and the largest decline since October 1949. The January decline followed a 681,000-job drop in December 2008, which represents the third-largest monthly employment decline since October 1945. The loss of 5.1 million jobs since December 2007 is also the most severe decline in employment on record, easily outdistancing the second-largest decline: the 3.4 million job decline in 1945 as production associated with World War II ended. Even if the declines are not required to be continuous, the loss of 5.1 million jobs still ranks as the largest decline over a 15-month period, vastly surpassing not only the post-World War II decline but also third-largest decline--the loss of 2.8 million in 1981-1982. More simply, the decline in employment between December 2007 and March 2009 is nearly unsurpassed since the early years of the Great Depression, regardless of how the comparisons are constructed. The only exception would be the percentage decline from the peak: In September 1945, job loss represented 8.1% of employment; in June 1958, the loss was 4.2%; and July 1949, the loss was 3.9%. As of March 2009, the 5.1 million job losses were continuing and represented 3.7% of employment at the December 2007 peak.

The Dow Jones Industrial Average, which had already fallen during the two months before December 2007, declined 46.8% between December 2007 and February 2009, while the Standard and Poor's (S&P's) 500 Index dropped 48.8% over the same period. The 14-month decline in the Dow index represented the largest 14-month decline since March 1938. (Of the other 19 declines that exceed the December 2007-February 2009 decline, all occurred between September 1930 and November 1932.) The decline in the S&P 500 index represented the largest 14-month decline in the available history of the index (which starts in 1946).

Figure 3

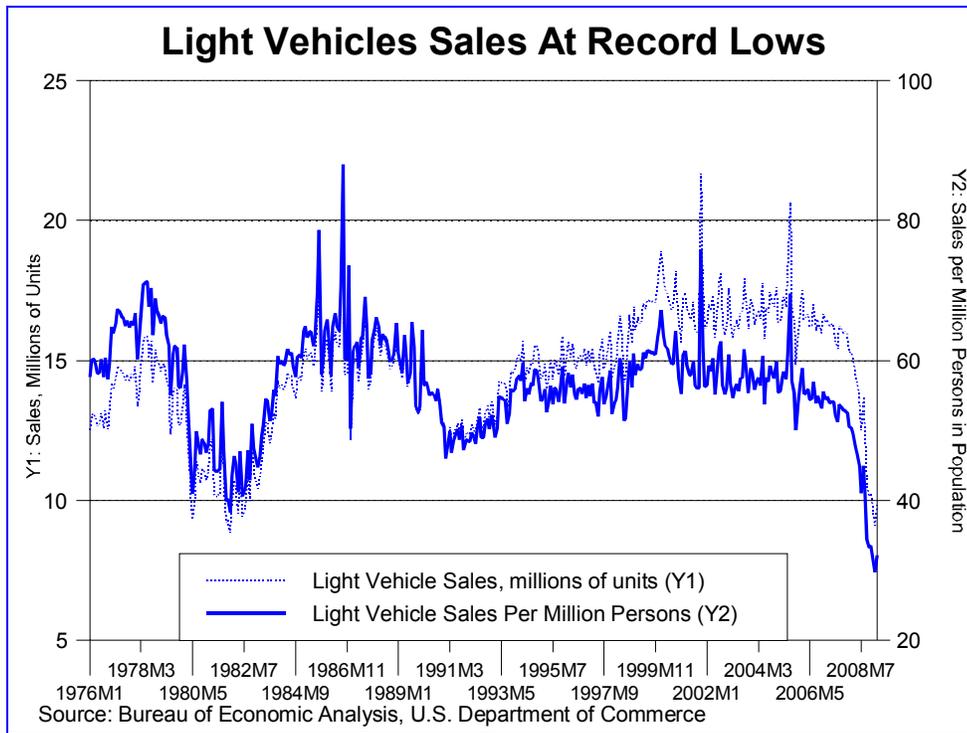


Figure 4

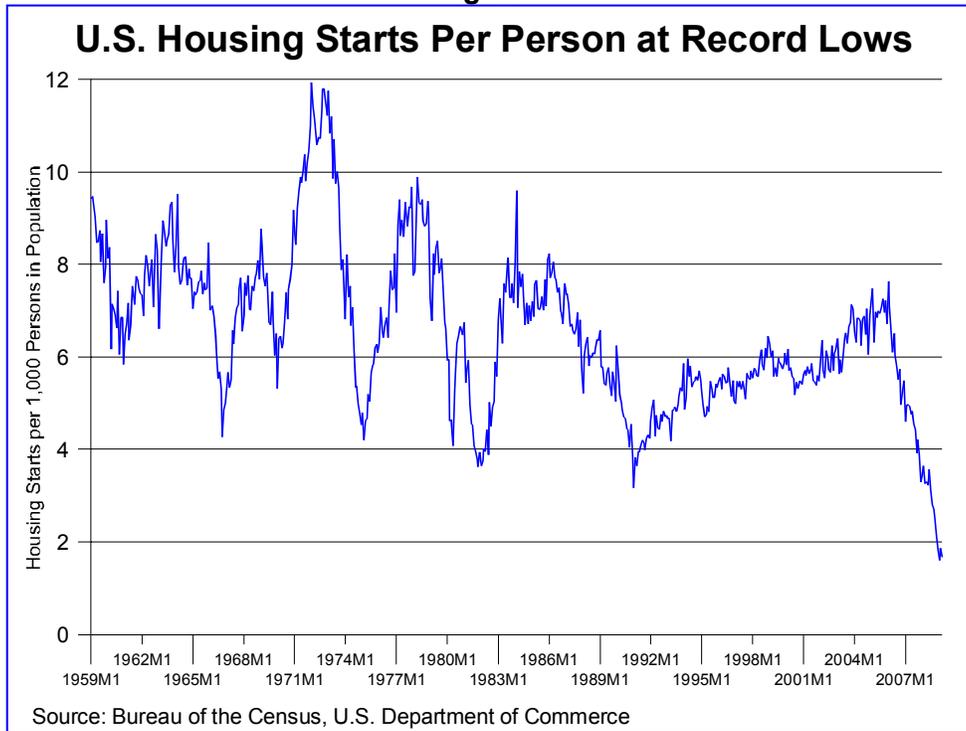
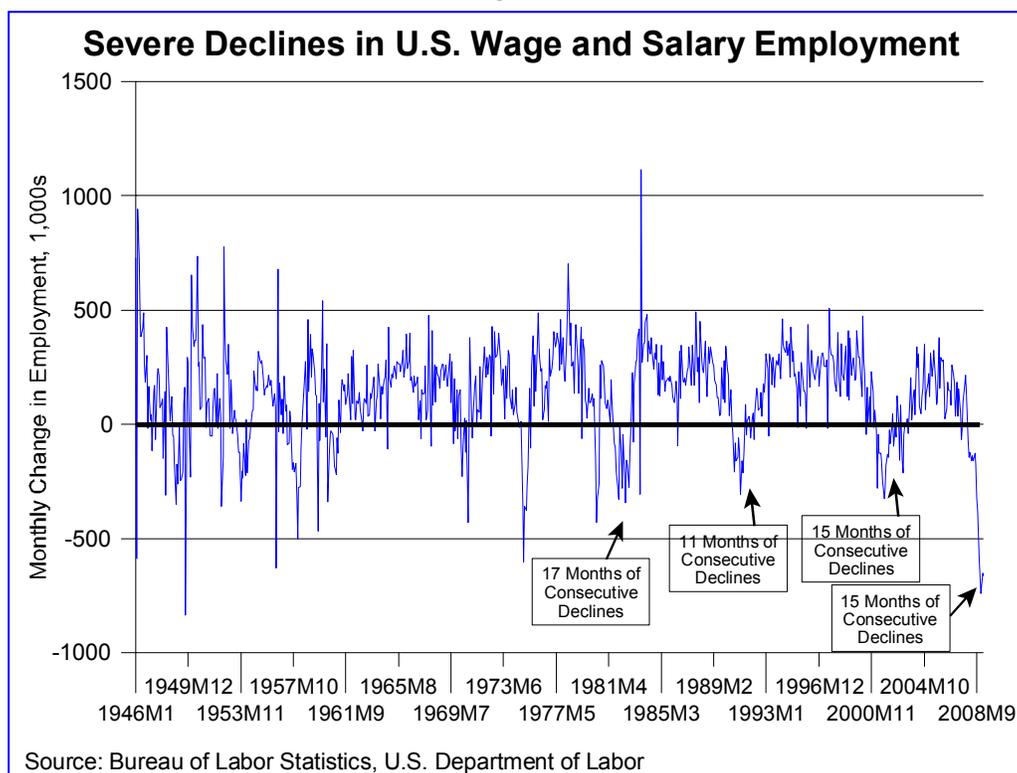


Figure 5

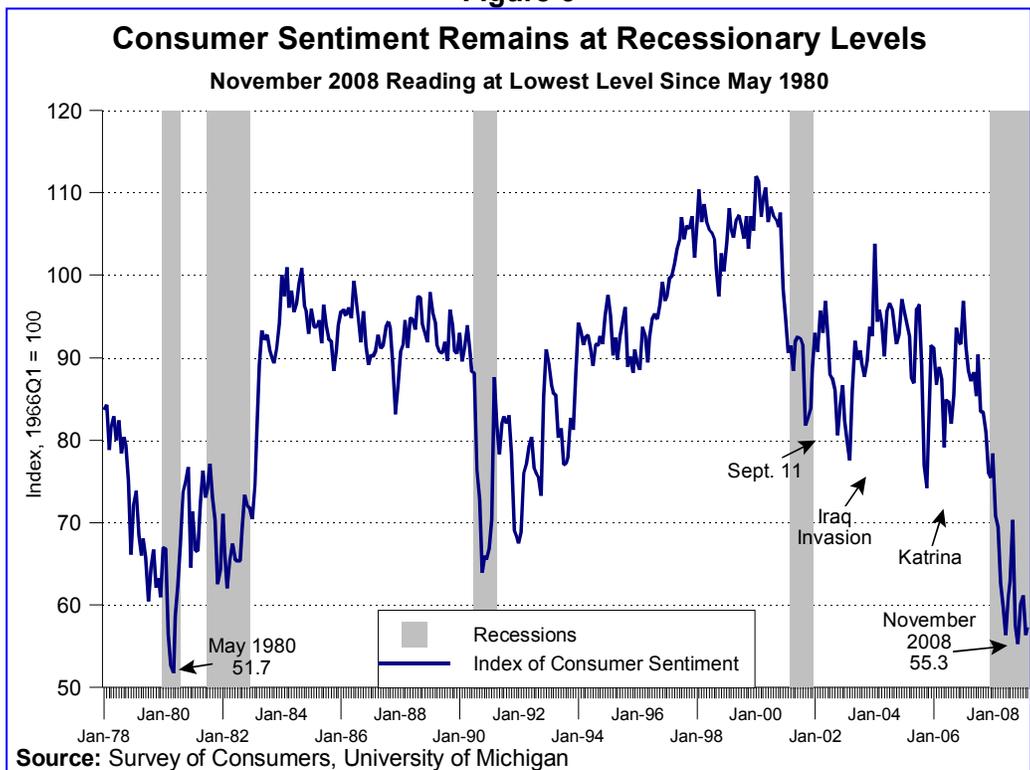


Since 1945, recessions have lasted from six to 16 months and averaged 10 months in duration, generally starting to exhibit a slower rate of contraction about halfway through the recession. However, 15 months into the current recession, the declines in the economy appear to be accelerating, rather than slowing. Employment declines averaged 137,375 jobs per month between January and August 2008, accelerating to 350,500 jobs per month during September and October, and averaged 666,600 jobs per month between November 2008 and March 2009. March's employment decline totaled 663,000, a figure virtually identical to the 667,500 average monthly decline in employment during the previous four months. Consumer sentiment, measured by the University of Michigan's Consumer Sentiment Index, fell 21.9% between January and July 2008, but dropped 18.1% in October alone. The November 2008 index value for consumer sentiment was the third-lowest reading in the 56-year history of the index and many components of the index exhibited the lowest values ever recorded. In 2009, the February and March values for the index have been virtually unchanged from the November 2008 level (Figure 6). Retail sales declined for six consecutive months between June and December 2008, falling 11.8% as the monthly changes increased in magnitude. While retail sales improved in January, by 1.7%, recent months have exhibited a steady weakening, with February growing only 0.3% and March falling by 1.2%.

The most volatile economic factor of 2008 may have been inflation, particularly with respect to many of the component sectors that comprise most inflation indices. While overall inflation, as measured by the U.S. Consumer Price Index (CPI), increased 3.8% in 2008, the increase is still relatively moderate in historical perspective: slightly above rates during the 1990s and below those of most years in the 1980s. Inflation, as measured by the gross domestic product deflator, increased 2.2% during 2008. However, the overall figures for these inflation measures have been moderated by offsetting, and substantial, changes in the components of the inflation measures. As oil prices rose from \$91.73 per barrel in December 2007 to \$133.93 in June 2008, the energy component of the CPI rose 16.0% between December 2007 and July 2008. As oil prices fell, to \$39.16 per barrel by

February 2009, the index also dropped substantially, and by March 2009 the CPI figure for energy was actually 20.3% below the December 2007 level. Food prices have consistently increased, with the March 2009 index up 5.7% from December 2007, while the cost of shelter in the CPI has remained relatively stagnant, rising only 2.0% between December 2007 and March 2009. Housing prices, as measured by other methods, have posted substantial declines, with the Standard and Poor's/Case-Shiller 20-city seasonally adjusted composite index dropping 21.9% between December 2007 and March 2009 ([Figure 7](#)).

Figure 6



Another way to examine the economy involves government bonds and inter-bank lending. Government bonds are frequently viewed as essentially risk-free assets, such that they need to offer a limited return, particularly in the short term, in order to attract investors. Financial institutions also lend to each other, as well as transact with the government, and the London Interbank Offered Rate (LIBOR) measures the interest rates banks charge each other. The difference between the 90-day Treasury bill rate and the LIBOR can illustrate how risky banks view transactions with each other and thus measure the security of the economy's financial system. During much of the 1990s and particularly during the mid-2000s, loans between banks were viewed almost as risk-free as government bonds, and the difference between interest rates for 90-day Treasury bills and the three-month LIBOR was very small ([Figure 8](#)). However, beginning with the housing meltdown and mortgage crises, the risk associated with financial lending has skyrocketed, with the spread between 90-day Treasury bills and the LIBOR rising from less than 20 basis points (0.2%) during much of the 2000s to 340 basis points in October 2008. In other cases, markets for some types of financial instruments have essentially vanished because there are few or no buyers willing to assume the risk associated with those instruments. With extensive government intervention, the measure has improved although banks still view lending to each other as fairly risky compared with much of the last 20 years.

Figure 7

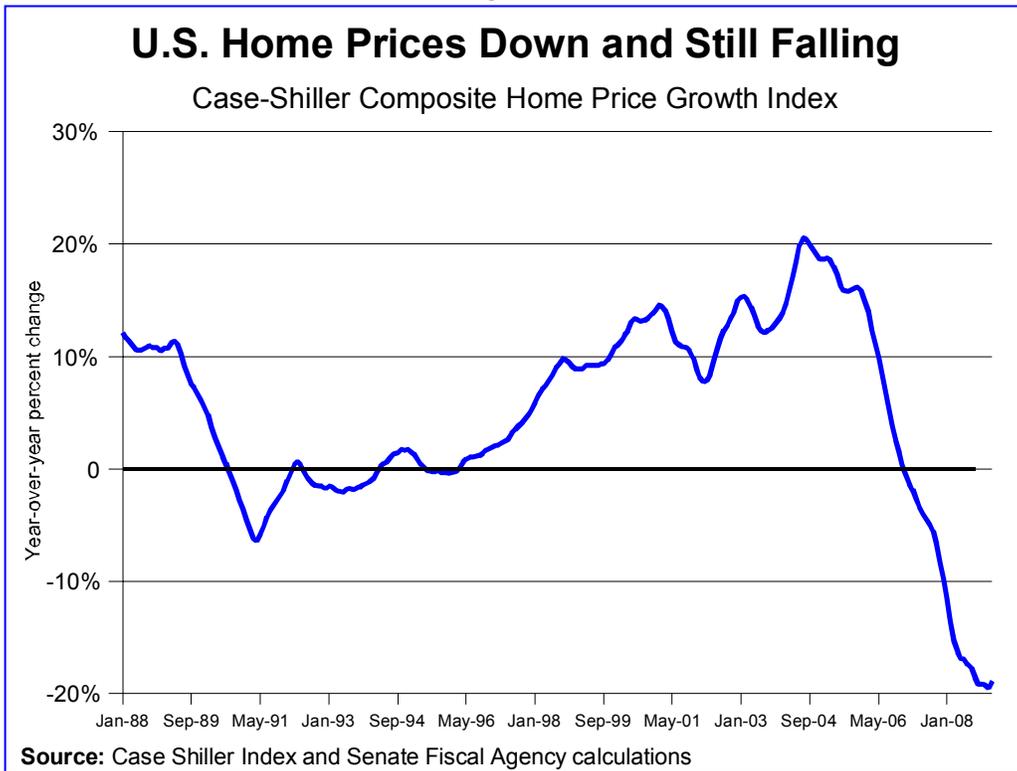
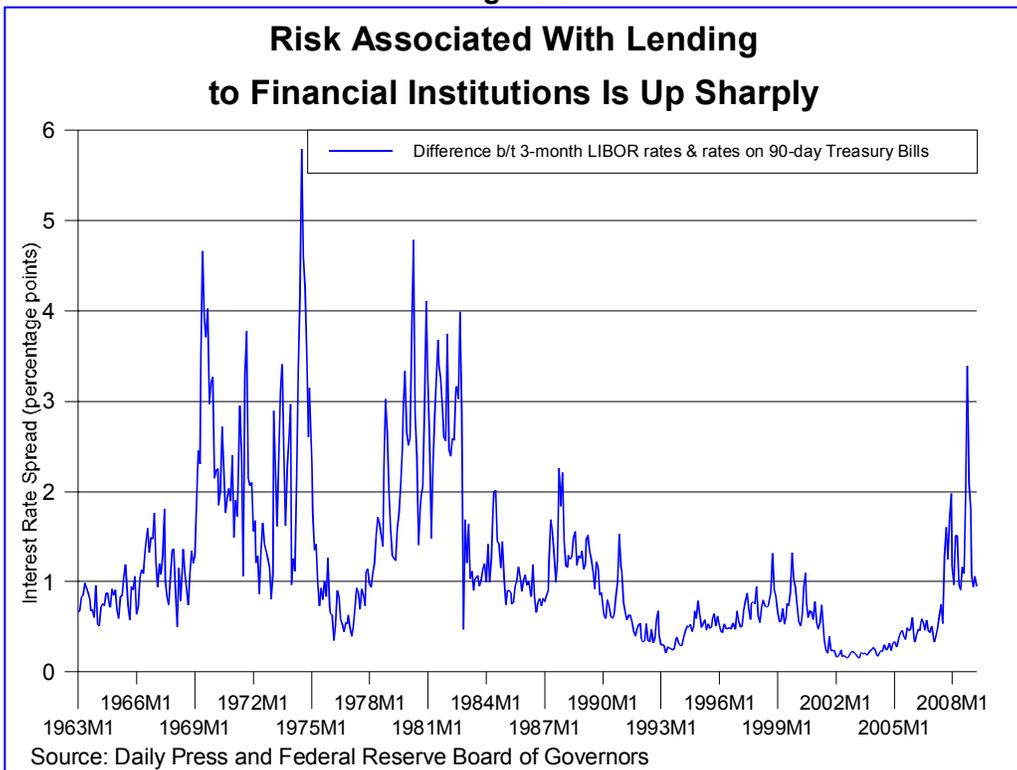


Figure 8



Details for selected economic indicators are presented in Table 1 and Table 2. The values presented reflect annual averages and thus the 2008 values understate the declines experienced in recent months because the annual averages also include the effects of early 2008 when economic conditions were more positive than in the last quarter of the year. Similarly, because of the rapid decline in some factors during 2009, the 2010 annual averages overstate the weakness in the economy, as will be discussed later under the State of Michigan economic forecast.

The current recession reflects the influence of a number of economic phenomena that differ substantially from other recent recessions. The 1990-91 recession largely reflected a slowdown induced by restrictive monetary policy to combat inflation that was then pushed into recession by a loss of business and consumer confidence (and thus spending) resulting from the Persian Gulf crisis. The 2001 recession largely reflected a pull-back in investment in the aftermath of Year 2000 technology investments that was pushed into recession by the collapse of inflated stock values for technology companies. In contrast, the current recession reflects a near collapse in the prices of almost every real or financial asset and has been characterized by not only economic dislocation but also an exaggeration of risk aversion among both investors and lenders. As a result, the current recession bears more resemblance to periods such as the 1979-82 recession, when policy was endeavoring to break the economy from retaining high inflationary expectations, or the Great Depression, when lending and consumption collapsed in the aftermath of similar declines in asset prices. These periods were marked by a need for economic actors to develop new sets of economic expectations and have time to adjust to those changed expectations.

Table 1

THE SENATE FISCAL AGENCY ECONOMIC FORECAST (Calendar Years)					
	2006 Actual	2007 Actual	2008 Actual	2009 Estimate	2010 Estimate
United States					
Nominal GDP (year-to-year growth)	6.1%	4.8%	3.3%	(2.1)%	1.3%
Inflation-Adjusted GDP (year-to-year growth)	2.8%	2.0%	1.1%	(4.0)%	0.3%
Unemployment Rate	4.6%	4.6%	5.8%	9.2%	10.6%
Inflation					
Consumer Price Index (year-to-year growth)	3.2%	2.8%	3.8%	(0.8)%	2.9%
GDP Implicit Price Deflator (year-to-year growth)	3.2%	2.7%	2.2%	1.9%	1.0%
Interest Rates					
90-day Treasury bill	4.73%	4.36%	1.37%	0.25%	0.41%
Corporate Aaa bond	5.59%	5.56%	5.63%	5.11%	4.62%
Federal funds rate	4.97%	5.02%	1.92%	0.18%	0.30%
Light Motor Vehicle Sales					
(millions of units)	16.5	16.1	13.2	9.3	10.5
Auto	7.8	7.6	6.8	4.7	5.4
Truck	8.7	8.5	6.4	4.6	5.1
Import Share	22.4%	23.3%	25.6%	34.5%	33.3%
Michigan					
Personal Income (millions) Year-to-year growth	\$332,617 2.3%	\$345,940 4.0%	\$353,113 2.1%	\$337,434 (4.4)%	\$323,611 -4.1%
Inflation-Adjusted Personal Income (year-to-year growth)	(0.8)%	2.2%	(0.2)%	(3.4)%	(6.1)%
Wage & Salary Income (millions) Year-to-year growth	\$185,261 0.8%	\$188,116 1.5%	\$187,914 (0.1)%	\$171,889 (8.5)%	\$160,306 (6.7)%
Detroit Consumer Price Index (year-to-year growth)	3.0%	1.8%	2.3%	(1.1)%	2.1%
Wage & Salary Employment (thousands) Year-to-year growth	4,327.1 (1.4)%	4,268.4 (1.4)%	4,159.2 (2.6)%	3,793.4 (8.8)%	3,520.6 (7.2)%
Unemployment Rate	6.9%	7.1%	8.4%	14.2%	16.9%

Table 2

THE SENATE FISCAL AGENCY U.S. ECONOMIC FORECAST DETAIL					
(Calendar Years)					
	2006	2007	2008	2009	2010
	Actual	Actual	Actual	Estimate	Estimate
Gross Domestic Product (billions of dollars)	\$13,178.4	\$13,807.5	\$14,264.6	\$13,964.2	\$14,143.2
Year-to-year growth	6.1%	4.8%	3.3%	(2.1%)	1.3%
<i>Inflation-Adjusted GDP and Components</i>					
Gross Domestic Product (billions of 2000 dollars)	\$11,294.8	\$11,523.9	\$11,652.0	\$11,191.6	\$11,222.1
Year-to-year growth	2.8%	2.0%	1.1%	(4.0%)	0.3%
Consumption (billions of 2000 dollars)	\$8,029.0	\$8,252.8	\$8,272.1	\$8,097.0	\$8,137.2
Year-to-year growth	3.0%	2.8%	0.2%	(2.1%)	0.5%
Business Fixed Investment (billions of 2000 dollars)	\$1,318.2	\$1,382.9	\$1,405.4	\$1,168.3	\$1,032.7
Year-to-year growth	7.5%	4.9%	1.6%	(16.9%)	(11.6%)
Change in Business Inventories (billions of 2000 dollars)	\$42.3	(\$2.5)	(\$29.0)	(\$112.2)	(\$15.9)
Residential Investment (billions of 2000 dollars)	\$552.9	\$453.8	\$359.5	\$277.8	\$298.6
Year-to-year growth	(7.1%)	(17.9%)	(20.8%)	(22.7%)	7.5%
Government Spending (billions of 2000 dollars)	\$1,971.2	\$2,012.1	\$2,070.2	\$2,139.5	\$2,179.4
Year-to-year growth	1.7%	2.1%	2.9%	3.3%	1.9%
Net Exports (billions of 2000 dollars)	(\$615.7)	(\$546.5)	(\$390.2)	(\$374.6)	(\$421.0)
Exports (billions of 2000 dollars)	\$1,314.8	\$1,425.9	\$1,514.1	\$1,289.4	\$1,280.0
Imports (billions of 2000 dollars)	\$1,930.5	\$1,972.4	\$1,904.3	\$1,664.0	\$1,701.0
Personal Income (year-to-year growth)	7.1%	6.0%	3.9%	0.1%	(1.0%)
Adjusted for Inflation	3.7%	3.0%	0.0%	0.9%	(3.8%)
Wage & Salary Income (year-to-year growth)	6.3%	5.6%	3.0%	(0.7%)	(0.7%)
Personal Savings Rate	0.7%	0.6%	1.8%	5.7%	4.3%
Capacity Utilization Rate	80.9%	80.6%	77.6%	68.9%	70.8%
Housing Starts (millions of units)	1.801	1.355	0.906	0.447	0.659
Conventional Mortgage Rates	6.4%	6.3%	6.0%	5.0%	4.9%
Federal Budget Surplus (billions of dollars, NIPA basis)	(\$201.1)	(\$229.3)	(\$521.5)	(\$1,025.4)	(\$1,607.4)

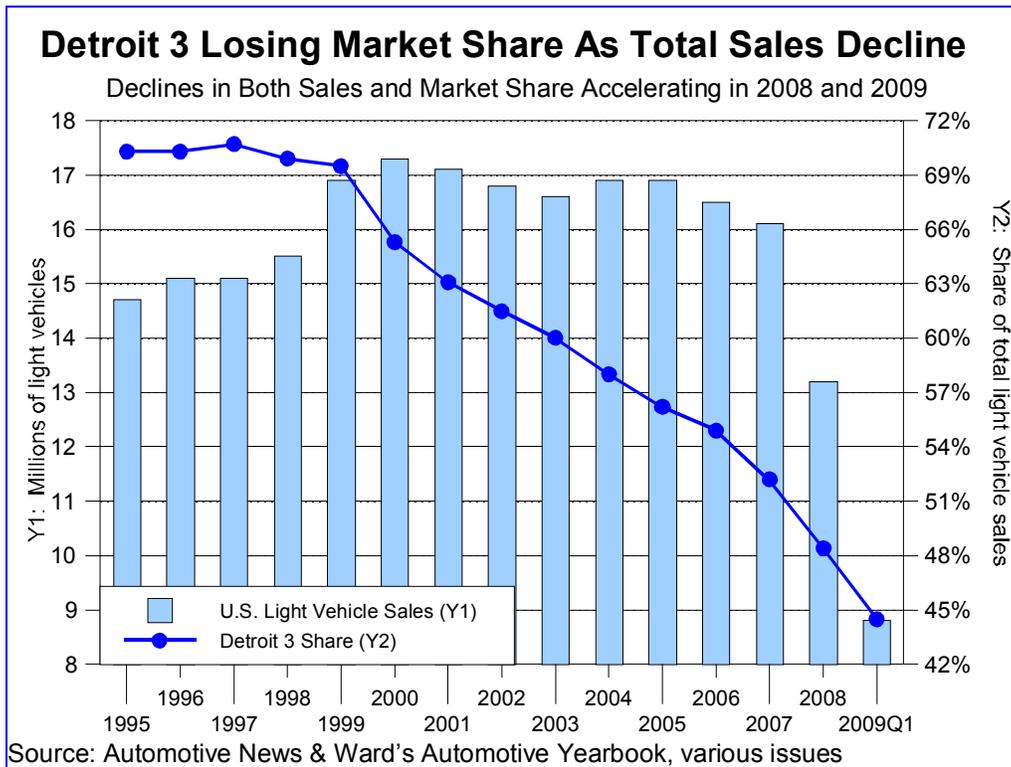
RECENT MICHIGAN ECONOMIC HIGHLIGHTS

Michigan's economy has spent the last nine years in recession, largely driven by the same fundamental restructuring that is affecting manufacturing globally. Manufacturing has experienced a significant surge in productivity, as the economy has become more competitive. For Michigan, the effect of productivity improvements has been substantial, particularly given that there was more

room for improvement in the durable goods and motor vehicle manufacturing sectors to be implemented than in many other sectors, that Michigan is very disproportionately concentrated in motor vehicle manufacturing, and that the motor vehicle industries have become one of the most competitive sectors of the economy. Those factors have been complicated for Michigan as General Motors, Ford, and Chrysler have also lost market share, even as they have made productivity gains, leaving Michigan to lose employment from both productivity and reduced demand. The rapid and drastic decline in automobile sales since late 2008 portends a long and difficult recession for Michigan and certainly one that may be more severe than any in the post-World War II period.

During the last decade productivity has risen most significantly in economic sectors in which the Michigan economy is heavily concentrated, such as the motor vehicle industry. Motor vehicle sales have remained mostly flat or experienced slight declines, while Michigan's share of the market has declined markedly (Figure 9). Even after eight years of employment declines, Michigan is still heavily dependent upon sectors that are highly cyclical and likely to continue to experience substantial gains in productivity and declines in employment. Based on data through 2007, Michigan represented 2.8% of the national economy (using gross domestic product by state), yet comprised 4.3% of manufacturing goods employment and 5.2% of durable goods manufacturing employment. In 2007, transportation equipment manufacturing comprised approximately 39.4% of Michigan's durable goods manufacturing employment and Michigan's motor vehicle manufacturing employment comprised approximately one-fourth of the nation's motor vehicle manufacturing employment.

Figure 9



Another way to see how concentrated Michigan is on motor vehicle manufacturing is to examine the share of wage income paid to employees in sectors that produce motor vehicles. In 2007, wages and salaries paid to workers in the motor vehicle manufacturing sector comprised 1.1% of

private sector wages and salaries paid nationally, but 9.6% of wages and salaries paid in Michigan. Furthermore, while it is more difficult to quantify, many of Michigan's nonmanufacturing sectors rely heavily, either directly or indirectly, on activity in the motor vehicle sector. Average wages in transportation equipment manufacturing are higher than in any other economic sector in Michigan, workers in the transportation equipment manufacturing sector purchase goods and services across the spectrum for their own consumption, and vehicle manufacturers are significant consumers of a variety of goods and services as well. As a result, economic downturns in the motor vehicle sector are transmitted and multiplied throughout the Michigan economy, just as any national or local economic shock is transmitted through the affected economies, but will have a greater proportional impact on Michigan than on any other state or the nation as a whole.

FORECAST SUMMARY

The U.S. economy is expected to contract in 2009 before exhibiting relatively weak growth in 2010, while the Michigan economy will remain in recession over the forecast period. Table 1 and Table 2 provide a summary of key economic indicators from the SFA's economic forecast, with references to recent years. Inflation-adjusted GDP is projected to decline 4.0% in 2009, followed by an increase of 0.3% in 2010. The contraction during 2009 primarily reflects declines in consumption, including substantially lower light vehicle sales, and weak residential and business investment. The unemployment rate is expected to increase, from 5.8% during 2008 to 9.2% in 2009 and 10.6% in 2010.

In Michigan, both job growth and personal income growth are expected to remain below the national average and the historical State average and to spend the forecast period in recession (Figures 10 and 11). Inflation-adjusted personal income fell 0.2% in 2008, but is expected to decline even more rapidly over the forecast period, dropping 3.4% in 2009 and 6.1% in 2010. The rate of employment declines should begin tapering during 2010, after falling an expected 8.8% during 2009, although employment is still forecast to decline 6.7% in 2010. The declines in wage and salary employment will extend the period of employment declines to 10 consecutive years, the longest period on record. These declines will reflect continued high productivity and competitive pressures, particularly in the manufacturing sector, but will be amplified by the global recession and the financial crisis. Nationally, light vehicle sales are expected to decline from 13.2 million units in 2008 to 9.3 million units in 2009, before rising to 10.5 million units in 2010. Declining vehicle sales, combined with productivity improvements and declining market share for domestic vehicle manufacturers, will depress employment and labor force participation. In Michigan, as a result, the unemployment rate will increase from 8.4% in 2008 to 14.2% in 2009 and 16.9% in 2010, keeping the Michigan unemployment rate above the national average.

Compared with the January 9, 2009, Consensus Economic Forecast, both the U.S. and Michigan forecasts for 2009 and 2010 are considerably weaker. Income and employment growth are weaker at both the State and national levels, and unemployment is higher than was forecast in January. Inflation measures are expected to be lower than was predicted in January, with some price measures actually declining.

Figure 10

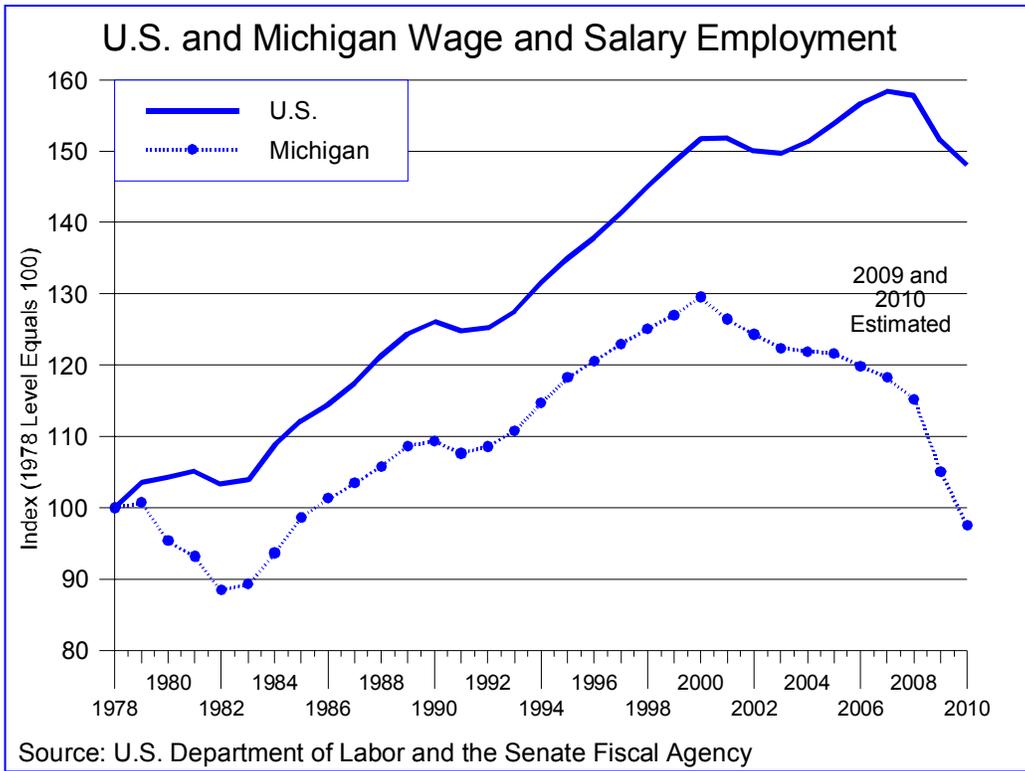
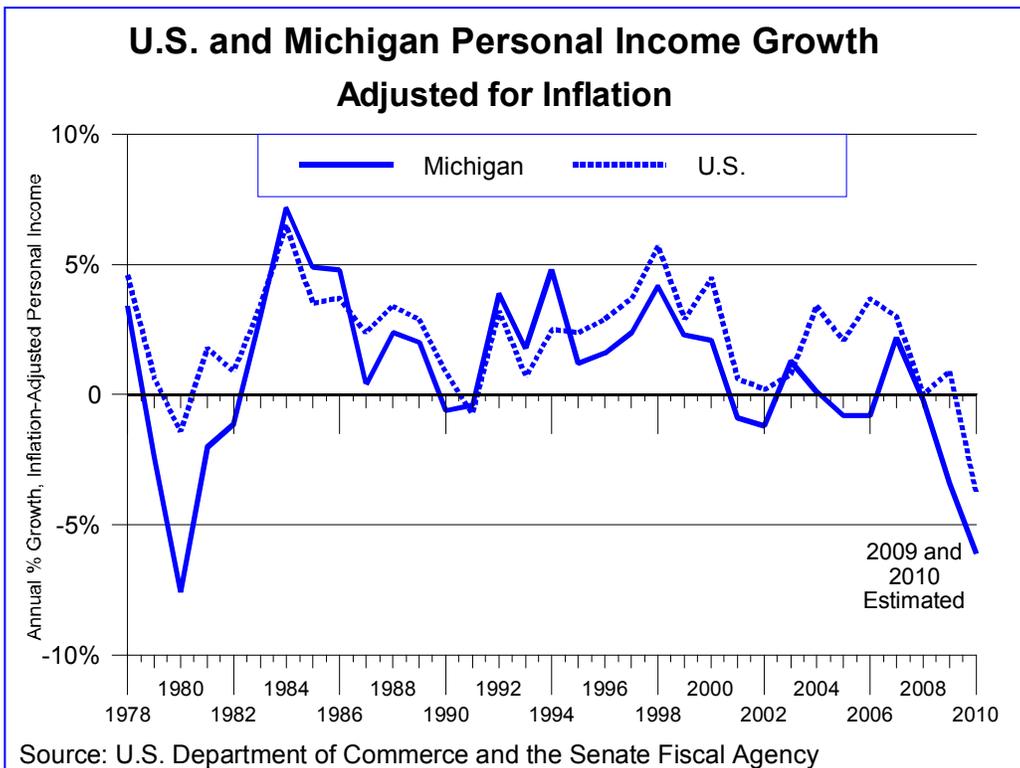


Figure 11



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 2008 and 2009 is based upon the following assumptions:

Monetary Policy. As of the beginning of January 2009, the Federal funds rate target was a range between 0.0% and 0.25%, down 400 to 425 basis points from the prior January, reflecting the Federal Reserve Board's concerns regarding liquidity constraints arising from the slowdown in the housing market and the collapse of many financial markets. The forecast assumes that inflation will remain minimal and that there is some risk of deflation, particularly during early 2009, reflecting both the slower economy and the rapid drop in many energy prices. The Federal Reserve Board is expected to do what it can to stimulate the economy, but with the Federal funds rate effectively equal to zero, there is little more that monetary policy can do in terms of lowering short term rates. Such a low rate is expected to be viewed by the Federal Reserve Board as unsustainable and, as a result, interest rates are anticipated to increase at the first sign of a sustained improvement in the economy. Even then, increases in the Federal funds rate are expected to be minimal over the forecast period, as the Federal Reserve seeks to increase rates without reducing relatively anemic growth rates. The Federal funds rate thus is predicted to remain in the 0.0% and 0.25% range through 2009 and much of 2010, reaching 0.50% by the end of 2010.

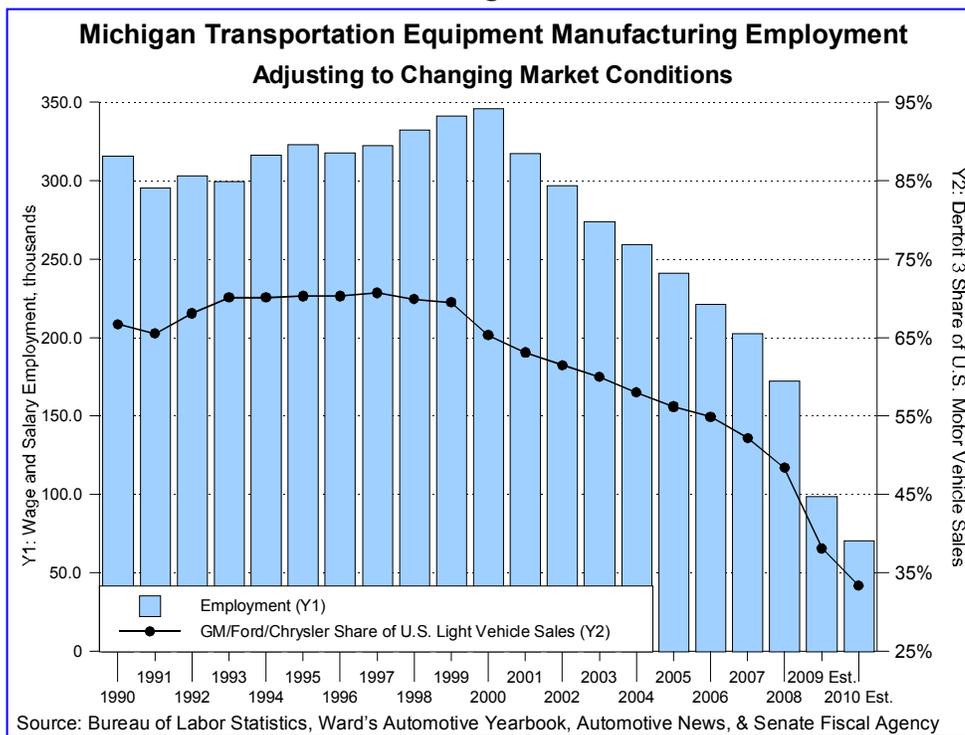
Foreign Economies. Many of the U.S.'s key trading partners' economies are expected to grow more slowly than the U.S. economy during 2009 and most of 2010. A relatively stronger and more stable U.S. economy is expected to result in the dollar rising 13.5% in value during 2009 before falling 6.1% during 2010. Much of the 2009 increase in the value of the dollar will reflect the substantial appreciation in the currency during the second half of 2008 and the first quarter of 2009. As a result of declines in domestic consumption of imported goods, the forecast predicts that the trade deficit will improve slightly during 2009, but then the stronger value of the dollar will result in the deficit growing in 2010.

Oil and Energy Prices. The forecast expects oil prices to remain at current levels through much of 2009, averaging about \$40 a barrel, down substantially from the \$130-per-barrel averages of the summer of 2008. As the economy improves somewhat in 2010, the price of West Texas intermediate crude is expected to rise, averaging near \$60 to \$70 per barrel. Other energy prices are expected to follow roughly the same pattern over the forecast.

Motor Vehicle Manufacturing Sector. For Michigan, the biggest risks to the forecast relate to how the current financial restructurings of General Motors, Ford, and Chrysler proceed, compounded by issues regarding whether vehicle sales are even less than forecasted, market shares for Michigan-based vehicle manufacturers fall more rapidly than predicted, Michigan vehicle production is reduced more rapidly and/or by greater amounts than expected, and the economic slowdown at the national level takes a greater toll on the consumption of nonvehicle-related goods and services provided by Michigan. The current forecast assumes that all three Michigan-based vehicle manufacturers shed a substantial number of jobs over the next year. Whether employment reduction occurs through a rapid downsizing, a "surgical bankruptcy" as described in the news media, or a longer, drawn-out bankruptcy process affects the timing of the job losses more than the ultimate employment levels expected in the industry. The forecast expects the majority of job losses to occur during 2009, with transportation equipment manufacturing employment bottoming out at a level roughly 75% to 80% below the July 2000 peak ([Figure 12](#)). While such a reduction is substantial and drastic, it is not inconsistent with the three adjustments the manufacturers must accommodate: 1) exhibiting productivity levels, particularly in the number of hours per vehicle, that

are consistent with other firms in the industry, 2) the reduced level of vehicle sales in the near future, and 3) declines in market share, which may be exacerbated by the current financial difficulties and the path followed through the bankruptcy process. Compared with 2000, when the industry needed to reduce the hours per vehicle by approximately one-third, sales are currently at levels roughly 45% below the 2000 level, and the market share has already declined by nearly a factor of one-third. The sum of these effects is consistent with a 75% decline in vehicle manufacturing employment for Michigan's vehicle manufacturers. If Michigan is to have a sustainable vehicle manufacturing industry, it will have to make these adjustments. The current economic situation has made it imperative for the adjustments to be made sooner rather than later and the forecast expects that those changes will largely be completed by mid-2010.

Figure 12



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 challenge for the current forecast is not only to determine when the current volatility in the markets will subside and when the economy will make the adjustments required to have the economy growing again, but to gauge accurately the timing and magnitude of the changes occurring in the vehicle market—from both a producer and a consumer side. Turning points in economic activity are notoriously difficult to predict, and the current forecast is made more difficult by the large degree of uncertainty regarding what adjustments different sectors will make to the changed economic and financial landscape.

Many economic factors are expected to remain volatile over the next few years and thus present risks to the forecast. These factors include: 1) weakness in the housing market, and how it will influence both consumer behavior and credit market liquidity; 2) high levels of risk aversion in financial markets and how it will affect wealth, consumer and business borrowing, and investment;

3) the international economy, in terms of the severity and duration of the slowdowns in other countries, and in terms of what happens to the value of the dollar as it faces downward pressure from a substantial trade deficit and upward pressure due to the substantial Federal budget deficits that are projected; and 4) the degree to which consumers increase their savings in response to the economic collapse, particularly as they attempt to compensate for stock market losses, declines in housing values, and protect against job uncertainty.

Consumer Behavior. Consumption growth remained moderate throughout the slow recovery during the first part of the decade, largely through increased borrowing and housing refinance activity. Households generally felt wealthier, despite flat or declining inflation-adjusted wages, because the stock market was improving and home values were soaring. Consumers continued to load on debt, spending in excess of income, even as higher interest rates worsened the burden of servicing consumer debt (Figure 13). The burden of servicing consumer debt reached an all-time high in the fourth quarter of 2006 and has remained near that level. Weak financial markets and declining housing prices have now induced consumers to rein in their spending. As a result, the savings rate is expected to rise over the forecast period from its recent zero-to-negative levels. Under the forecast, the savings rate will spike in early 2009 and then return to a level consistent with the mid-1990s. However, consumers will need to save at a far higher rate than this to offset their losses in home equity and the stock market, although consumers' saving is expected to be hampered by limited income growth and high debt burdens. If the saving rate improves more than expected, such as to levels experienced during the 1980s, both consumption growth and economic growth will be lower. Conversely, consumers could return to their spending habits of the 2000s and growth would be stronger than forecasted.

Inflation. If energy prices begin rising sooner or more rapidly than expected, such increases will likely reduce growth and/or prolong the recession. Similarly, gains in the dollar during late 2008 and early 2009 are expected to help keep the cost of imported goods and services lower. However, if the value of the dollar drops more rapidly, particularly in 2010, it will add upward pressure to prices by increasing the price of imports and allowing domestic producers greater pricing power.

The International Economy. A stronger dollar will improve the competitiveness of foreign imports, but with consumers facing declining incomes and job losses and pursuing higher savings rates, the stronger dollar may not help other countries as much as it would otherwise. If the dollar drops more rapidly than expected or other countries' recoveries are stronger or occur sooner, export growth may improve. Similarly, if other countries remain in recession longer than expected, it will lengthen the slowdown in the U.S. economy.

Michigan's Situation. While over the last eight years Michigan's employment situation has fared worse than the national average, and, in some cases or time periods within that range, worse than any other state (Figure 14), Michigan's performance is not particularly inconsistent with that of other states when Michigan's economic composition is considered. Generally, states with higher manufacturing concentrations (particularly in the transportation equipment manufacturing sector) have experienced weaker job performance over the last eight years, both because of the economic changes occurring in that sector and because of the dependence of other sectors within those states on manufacturing activity. As indicated earlier, productivity gains have made American manufacturing firms more profitable and more competitive, but have reduced the need for hiring additional employees to meet increased demand.

Figure 13

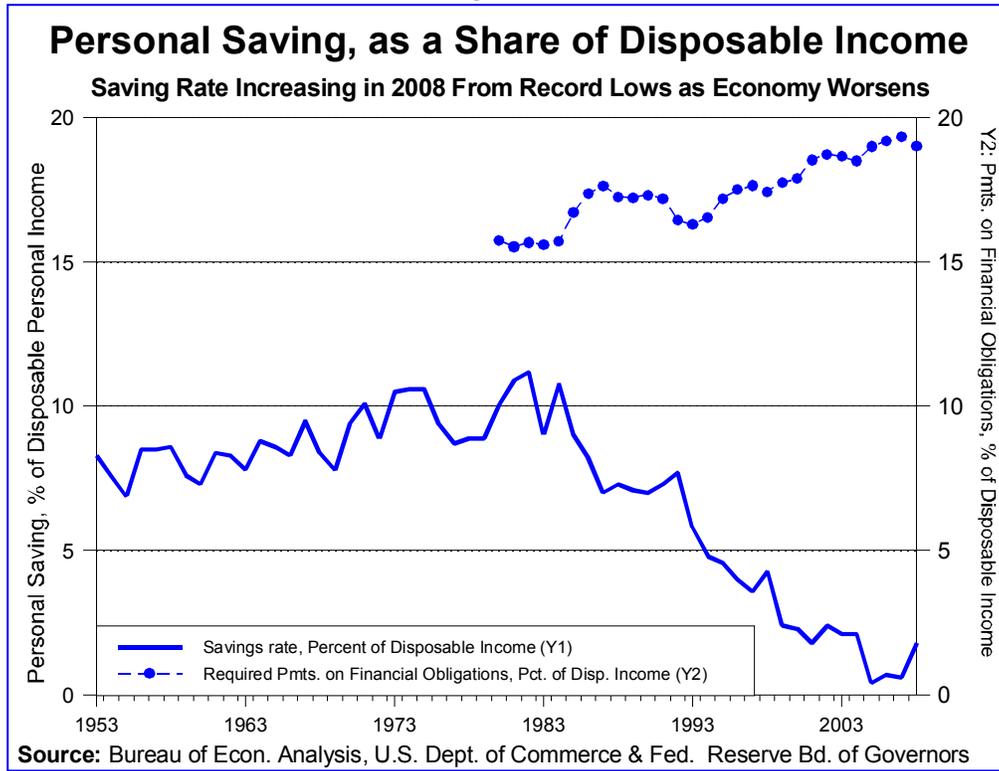
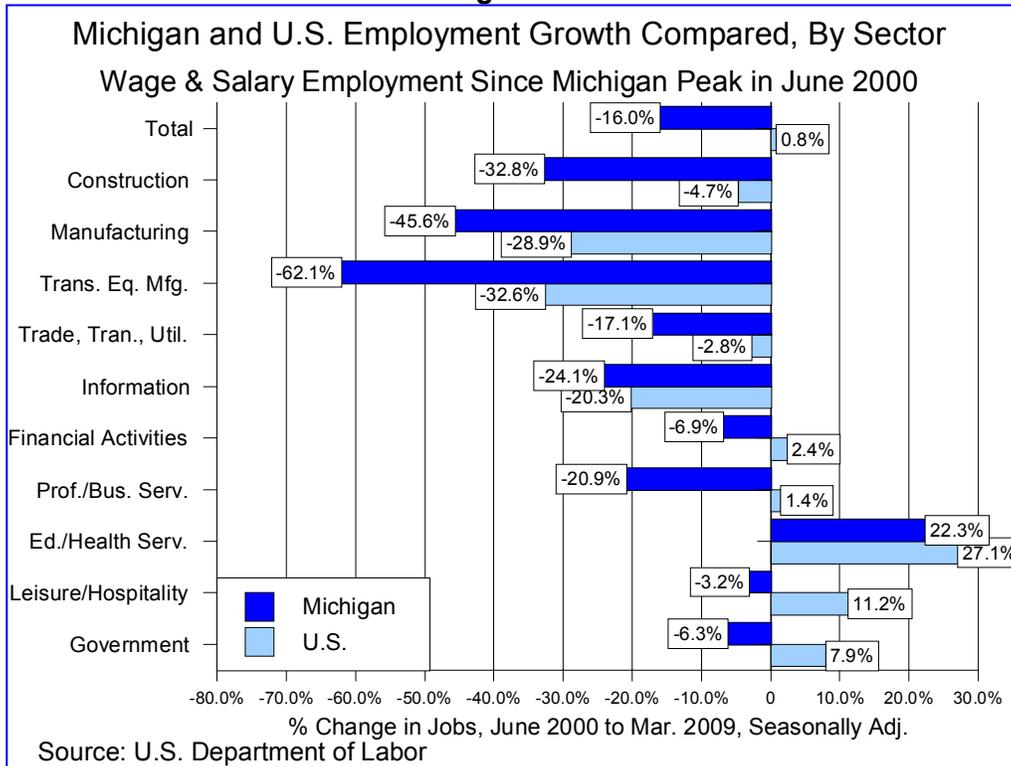
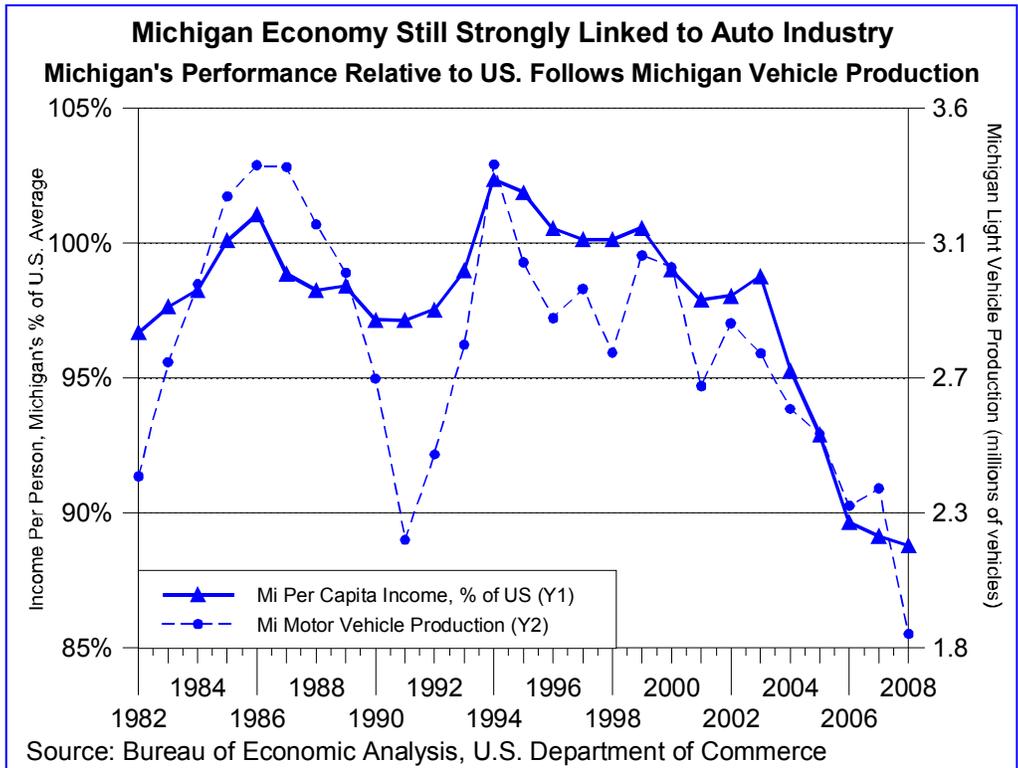


Figure 14



Weak markets for housing, credit and employment, rising food prices, and substantial debt burdens are expected to exert a dragging force on any increases in demand over the forecast period. Vehicle sales are expected to remain substantially below the levels experienced over the last two decades, while the domestic share of the sales mix is expected to continue declining. Michigan's economic fortunes historically have been very closely linked with sales of domestically produced light vehicles (Figure 15), so it is unclear whether Michigan's employment situation would be much better even if productivity were not rising so rapidly in the motor vehicle sector. However, the combination of high productivity and declining market share has been particularly dramatic: On a seasonally adjusted basis, as of March 2009, Michigan had lost almost two-thirds of the jobs (62.2%, a decline of nearly 219,700 jobs) in transportation equipment manufacturing that existed during the peak in July 2000.

Figure 15



For eight years, the fundamental changes occurring in manufacturing across the globe combined with falling market shares for Michigan manufacturers to keep Michigan in an employment recession. With the U.S. and world economies experiencing the most substantial recession in decades, Michigan's opportunities to emerge from its own recession have been reduced. The speed at which Michigan will emerge from the employment recession will depend upon the strength of those markets and how rapidly Michigan producers transform their businesses. The more rapid the transformation and the slower the national and international economy, the steeper will be the decline in Michigan employment in the near term. Given the forecast, and historical patterns of recovery, even with something approximating normal employment growth in Michigan, it is unlikely that Michigan will reach the level of employment reported in December 2008 again until some time after the year 2021, while regaining the level of employment reported for June 2000, the record high, will likely take more than two decades.

THE FORECAST FOR STATE REVENUE

This section of the Budget Status Report presents the Senate Fiscal Agency's (SFA's) estimates for General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue. The revised estimates for both FY 2008-09 and FY 2009-10 are presented. The revenue estimates for each of these fiscal years include the estimates for baseline revenue, which measures what the revenue would be without any changes in the State's tax structure, and net revenue, which equals baseline revenue adjusted for the impact of all enacted tax changes. In addition, this revenue represents the revenue generated from ongoing revenue sources and does not include any revenue included in the GF/GP or SAF budgets from one-time revenue adjustments, transfers, or other nonrecurring revenue items. Any one-time revenue adjustments and transfers included in the GF/GP and SAF budgets for FY 2008-09 and FY 2009-10 are discussed in the last section of this report.

REVENUE OVERVIEW

The revised estimates for FY 2008-09 and FY 2009-10 are presented in Table 3 and are summarized below.

FY 2008-09 Revised Revenue Estimate

- GF/GP and SAF revenue will total an estimated \$18.3 billion in FY 2008-09.
- This revised estimate represents a decline of 12.2% or \$2.5 billion from FY 2007-08.
- This projected sharp decline in revenue is due primarily to very weak economic activity, but also is due in part to the negative repercussions from some new tax credits that are having their initial negative fiscal impacts in FY 2008-09.
- Compared with the January 2009 consensus revenue estimate, the revised estimate for FY 2008-09 is down \$1.3 billion.

FY 2009-10 Revenue Estimate

- GF/GP and SAF revenue is expected to total \$17.1 billion in FY 2009-10.
- This revised estimate for FY 2009-10 is down 6.8% or \$1.2 billion from the revised estimate for FY 2008-09.
- As in FY 2008-09, this significant decline in revenue will be primarily due to continued weak economic activity and the negative impacts from the new tax credits.
- The revenue projected for FY 2009-10 marks the second consecutive year of very significant declines. The combined decline in GF/GP and SAF revenue projected for FY 2008-09 and FY 2009-10 is \$3.8 billion or 18.2%, compared with FY 2007-08.

Historical Perspective

- Baseline GF/GP and SAF revenue will plummet an estimated 10.7% in FY 2008-09 and then fall another 5.7% in FY 2009-10. These declines are much steeper than the declines experienced in FY 1990-91 and FY 2000-01 through FY 2001-03.
- In FY 2009-10, GF/GP revenue from ongoing sources will fall below its peak level reached in FY 1999-2000 by \$3.1 billion or 31.2%.
- School Aid Fund revenue from ongoing sources will fall to its lowest level in FY 2009-10 since FY 1999-2000 and will drop below its FY 2007-08 peak level by \$1.2 billion or 11.7%.

Table 3

SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2008-09 AND FY 2009-10 GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND (Millions of Dollars)			
	FY 2007-08 Final	FY 2008-09 Revised Estimate	FY 2009-10 Revised Estimate
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	\$8,168.2	\$7,035.8	\$6,573.1
Tax Changes Not In Baseline	1,191.4	386.9	161.3
<u>Revenue After Tax Changes:</u>			
Net Income Tax	5,106.6	4,164.2	3,357.7
SBT, MBT, & Insurance Tax	2,348.6	1,653.4	1,756.8
Other Taxes	1,530.8	1,267.6	1,284.5
Total Taxes	8,986.1	7,085.2	6,399.0
Nontax Revenue	373.7	337.4	335.4
TOTAL GF/GP REVENUE	\$9,359.7	\$7,422.6	\$6,734.4
SCHOOL AID FUND			
Baseline SAF	\$11,248.6	\$10,307.9	\$9,790.1
Tax Changes Not In Baseline	264.6	595.4	557.3
TOTAL SAF REVENUE	\$11,513.1	\$10,903.4	\$10,347.4
BASELINE GF/GP & SAF REVENUE	\$19,416.8	\$17,343.7	\$16,363.2
Tax & Revenue Changes	1,456.0	982.3	718.6
GF/GP & SAF REV. AFTER CHANGES	\$20,872.8	\$18,326.0	\$17,081.8
<u>ADDENDUM:</u>			
Sales Tax	\$6,773.3	\$6,196.7	\$5,891.9
PERCENT CHANGE			
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	(0.3)%	(13.9)%	(6.6)%
<u>Revenue After Tax Changes:</u>			
Net Income Tax	17.9	(18.5)	(19.4)
SBT, MBT, & Insurance Tax	15.1	(29.6)	6.3
Other Taxes	(2.7)	(17.2)	1.3
Total Taxes	13.1	(21.2)	(9.7)
Nontax Revenue	0.2	(9.7)	(0.6)
TOTAL GF/GP REVENUE	12.5%	(20.7)%	(9.3)%
SCHOOL AID FUND			
Baseline SAF	1.0%	(8.4)%	(5.0)%
TOTAL SAF REVENUE	3.2%	(5.3)%	(5.1)%
BASELINE GF/GP & SAF REVENUE	0.5%	(10.7)%	(5.7)%
GF/GP & SAF REV. AFTER CHANGES	7.2%	(12.2)%	(6.8)%
<u>ADDENDUM:</u>			
Sales Tax	3.4%	(8.5)%	(4.9)%

While a consistent history of GF/GP and SAF revenue measured in terms of both baseline revenue and revenue from ongoing sources goes back only to the mid-1980s, given the magnitude of the fall in revenue expected during FY 2008-09 and FY 2009-10, it is probably accurate to say that the current revenue contraction is unprecedented in modern times. [Figure 16](#) presents the percentage

changes in baseline GF/GP and SAF revenue from FY 1986-87 through the revised estimates for FY 2008-09 and FY 2009-10. During this 24-year period, GF/GP and SAF baseline revenue declined during two periods of time – FY 1990-91 and three consecutive fiscal years beginning in FY 2000-01. The decline in FY 1990-91 was 2.7% and the total decline from FY 2000-01 through FY 2002-03 was about 3.8%. While these declines in baseline revenue caused serious budget problems, they represent relatively small revenue declines compared with the declines estimated for FY 2008-09 and FY 2009-10. Baseline revenue is expected to plummet 10.7% in FY 2008-09, and then another 5.7% in FY 2009-10. These two years combined are expected to experience a contraction in GF/GP and SAF baseline revenue equal to 15.8%.

Figure 16

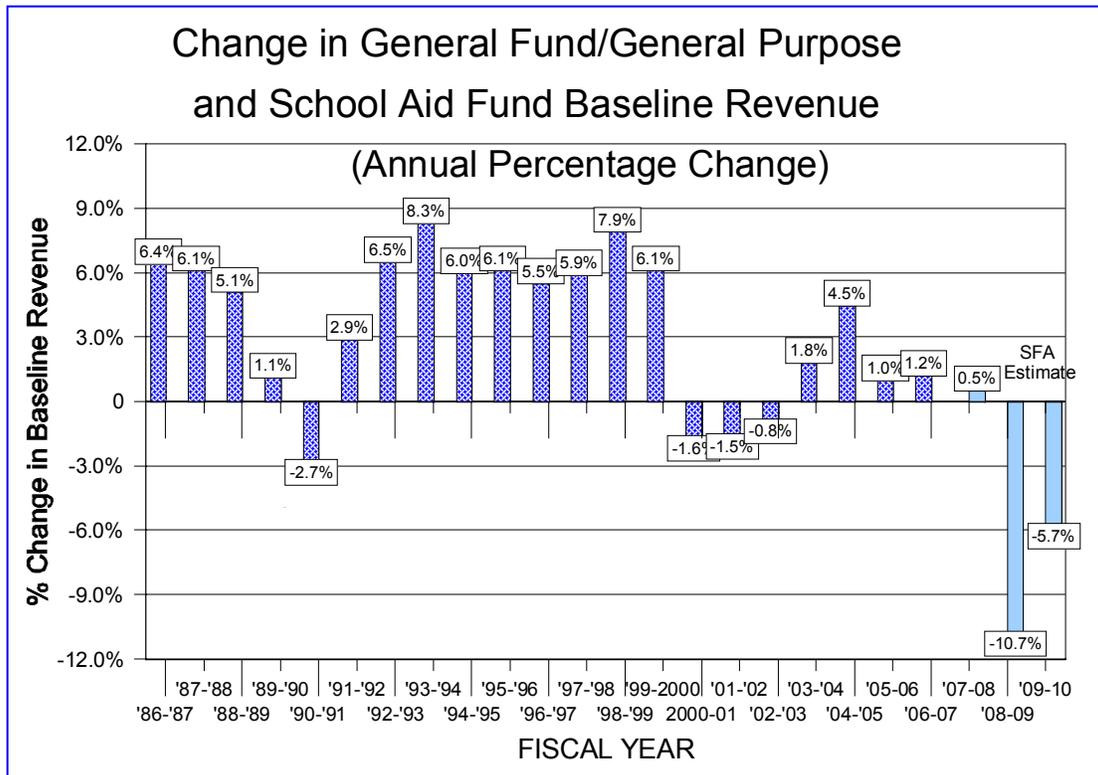
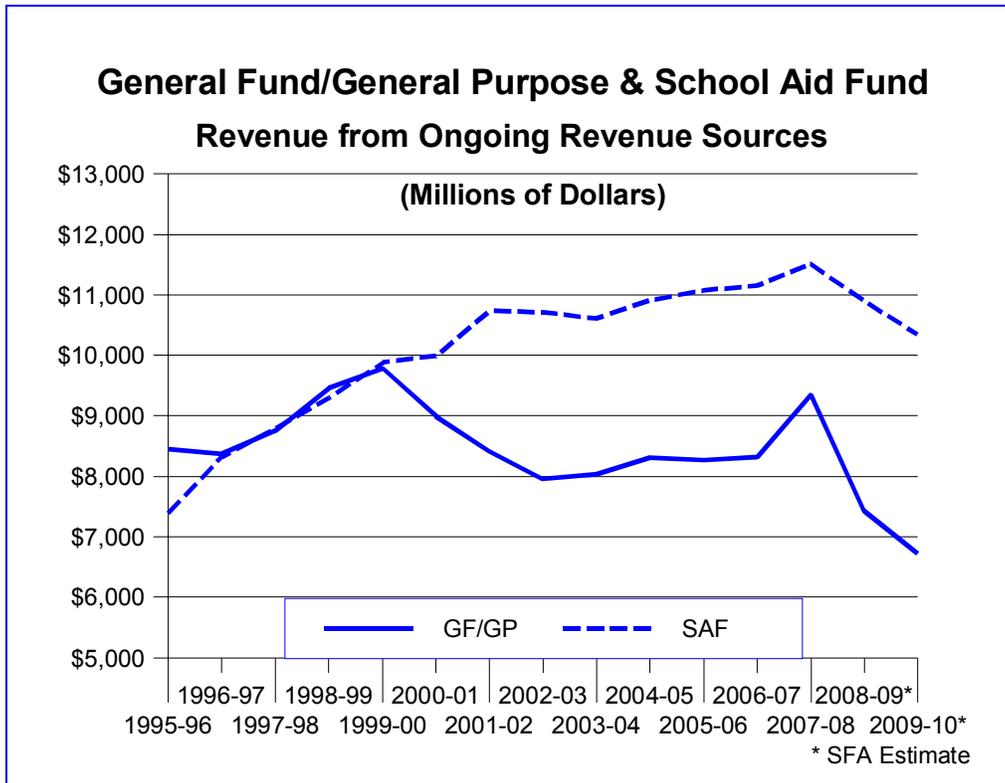


Figure 17 compares the FY 2008-09 and FY 2009-10 estimates for both GF/GP revenue and SAF revenue from ongoing sources with their respective levels for each of the fiscal years since the Proposal A school finance tax reforms were put in place. General Fund/General Purpose revenue peaked in FY 1999-2000 and then declined for three consecutive years due to a faltering economy and cuts to the income tax and the Single Business Tax. As a result, GF/GP revenue fell to about \$8.0 billion in both FY 2002-03 and FY 2003-04. After remaining at about \$8.3 billion from FY 2004-05 through FY 2006-07, GF/GP revenue jumped to \$9.3 billion in FY 2007-08 due to the increase in the income tax rate and the adoption of, and subsequent increase in, the Michigan Business Tax. The significant decline in GF/GP revenue forecast for FY 2008-09, will reduce GF/GP revenue to its lowest level since FY 2003-04, and the additional decline estimated for FY 2009-10 will lower GF/GP revenue to its lowest level during this 15-year-period. In fact, the estimated level for FY 2009-10 is below the FY 2002-03 level by 15.4% or \$1.2 billion and is down from the FY 1995-96 level by about 20.0% or \$1.7 billion.

Figure 17



FY 2008-09 REVISED REVENUE ESTIMATES

- General Fund/General Purpose and SAF revenue will decline an estimated 12.2% in FY 2008-09 compared with FY 2007-08.
- Most of this decline will be due to the economic recession, but some State and Federal tax policy changes will also pull down revenue in FY 2008-09.

The very large 12.2% reduction in GF/GP and SAF revenue projected for FY 2008-09 reflects the sharp economic downturn that Michigan is currently experiencing. All of the major taxes earmarked to the GF/GP and/or SAF budgets, including the income, sales, use, State Education, and the combined Michigan Business Tax/Single Business Tax, are expected to experience declines in revenue during FY 2008-09 compared with FY 2007-08. This revised estimate of GF/GP and SAF revenue for FY 2008-09 is down \$1.3 billion from the January 2009 consensus estimate. On a baseline basis, GF/GP and SAF revenue is projected to fall 10.7% in FY 2008-09. The revised GF/GP and SAF revenue estimates for FY 2008-09 are summarized in Table 4.

Table 4
FY 2008-09 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	FY 2007-08 Final	FY 2008-09 Revised Est.	Change from FY 2007-08		\$ Change from 01/09 Consensus
			Dollar Change	Percent Change	
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue ¹⁾	\$8,168.2	\$7,035.8	\$(1,132.5)	(13.9)%	\$(608.6)
Tax Changes Not In Baseline Revenue After Tax Changes	1,191.4	386.9	(804.5)	---	(274.8)
<u>Personal Income Tax</u>					
Gross Collections	9,015.8	8,199.4	(816.4)	(9.1)	(353.7)
Less: Refunds	(1,790.3)	(2,126.9)	(336.6)	18.8	(75.0)
Net Income Tax Collections	7,225.5	6,072.5	(1,153.0)	(16.0)	(428.7)
Less: Earmarking to SAF Campaign Fund	(2,117.7) (1.2)	(1,906.8) (1.5)	210.9 (0.3)	(10.0) 25.0	82.7 0.0
Net Income Tax to GF/GP	\$5,106.6	\$4,164.2	\$(942.4)	(18.5)%	\$(346.0)
<u>Other Taxes</u>					
Single Business Tax	573.8	(213.2)	(787.0)	(137.2)	(170.0)
Michigan Business Tax	1,551.6	1,607.8	56.2	3.6	(249.9)
Sales	76.5	54.8	(21.8)	(28.4)	(12.1)
Use	911.6	751.7	(159.9)	(17.5)	(93.3)
Cigarette	212.9	203.6	(9.3)	(4.4)	(5.1)
Insurance Company Premiums	223.2	258.8	35.6	15.9	20.0
Telephone & Telegraph	80.8	74.0	(6.8)	(8.4)	0.0
Oil & Gas Severance	97.1	63.0	(34.1)	(35.1)	(3.0)
Casino Wagering	15.4	3.6	(11.8)	(76.6)	(0.5)
All Other	136.5	117.0	(19.5)	(14.3)	(13.5)
Subtotal Other Taxes	\$3,879.4	\$2,921.0	\$(958.4)	(24.7)%	\$(527.4)
Total Nontax Revenue	373.7	337.4	(36.3)	(9.7)	(10.0)
GF/GP REV. AFTER TAX CHANGES	\$9,359.7	\$7,422.6	\$(1,937.1)	(20.7)%	\$(883.4)
SCHOOL AID FUND:					
Baseline Revenue ¹⁾	\$11,248.6	\$10,307.9	\$(940.6)	(8.4)%	\$(451.3)
Tax Changes Not In Baseline Revenue After Tax Changes	264.6	595.4	330.8	---	(14.0)
Sales Tax	4,928.1	4,504.3	(423.7)	(8.6)	(215.6)
Lottery Revenue	740.7	670.1	(70.6)	(9.5)	(30.0)
State Education Property Tax	2,079.7	1,980.2	(99.5)	(4.8)	(30.0)
Real Estate Transfer Tax	169.8	108.3	(61.5)	(36.2)	(36.0)
Michigan Business Tax	341.0	729.0	388.0	113.8	0.0
Income Tax	2,117.7	1,906.8	(210.9)	(10.0)	(82.7)
Casino Tax	112.1	107.3	(4.8)	(4.3)	(6.6)
Other Revenue	1,024.1	897.3	(126.8)	(12.4)	(64.4)
SAF REV. AFTER TAX CHANGES	\$11,513.1	\$10,903.4	\$(609.7)	(5.3)%	\$(465.3)
BASELINE GF/GP AND SAF	19,416.8	17,343.7	(2,073.1)	(10.7)	(1,059.9)
Tax & Revenue Changes	1,456.0	982.3	(473.7)	---	(288.8)
GF/GP & SAF REV. AFTER CHNGS	\$20,872.8	\$18,326.0	\$(2,546.8)	(12.2)%	\$(1,348.7)
SALES TAX	6,773.3	6,196.7	(576.6)	(8.5)	(295.0)

¹⁾ FY 2007-08 is the base year for baseline revenue.

Tax Policy Changes

New tax policy changes by both the State and Federal governments will have negative impacts on revenue in FY 2008-09. These major new tax policy changes include the State’s earned income tax credit and film tax credits, and the Federal increase in tobacco taxes, and tax changes included in the Federal American Recovery and Reinvestment Act (ARRA) of 2009.

Earned Income Tax Credit. A new earned income tax credit, administered through the income tax, went into effect for the 2008 tax year; therefore, eligible taxpayers claimed this credit for the first time when they filed their 2008 tax returns in 2009. This Michigan earned income tax credit equals 10.0% of the Federal earned income tax credit for the 2008 tax year and then increases to 20.0% of the Federal credit beginning in 2009. It is estimated that this new credit will reduce income tax revenue \$145.0 million in FY 2008-09 and all of this loss will be incurred by GF/GP revenue.

Film Credits. Three Michigan Business Tax (MBT) credits related to film industry activity were enacted in 2008. Film production companies may claim 1) a production credit, which allows the companies to receive a refundable credit equal to 40.0% of their direct production expenditures in Michigan, 2) a job training credit equal to 50.0% of qualified expenses incurred in training workers for film industry jobs, and 3) an infrastructure credit equal to 25.0% of the cost to construct a film-related production facility. An additional MBT credit may be granted by the Michigan Economic Growth Authority (MEGA). These credits are expected to reduce MBT revenue directly by \$107.5 million in FY 2008-09; however, the new business activity these credits will attract will generate new income, sales, and MBT receipts totaling an estimated \$19.1 million. Therefore, the new film credits will result in a net overall reduction in revenue equal to an estimated \$88.4 million in FY 2008-09, as shown in Table 5.

Table 5

ESTIMATED FISCAL IMPACT OF NEW MICHIGAN BUSINESS TAX FILM CREDIT		
(Millions of Dollars)		
Tax Affected	FY 2008-09	FY 2009-10
<u>Direct Impact</u>		
<u>Michigan Business Tax:</u>		
Production Cost Credit.....	(\$100.0)	(\$150.0)
Job Training Credit.....	(1.4)	(2.4)
MEGA Credit.....	(1.6)	(1.6)
Infrastructure Credit.....	(4.5)	(6.0)
Subtotal Film Credits.....	(107.5)	(160.0)
<u>Secondary Impact</u>		
Individual Income Tax.....	\$5.4	\$8.1
Sales Tax.....	11.5	17.3
Michigan Business Tax.....	2.2	3.3
Subtotal.....	\$19.1	\$28.7
Net Fiscal Impact.....	(\$88.4)	(\$131.3)
<u>Fiscal Impact by Fund:</u>		
GF/GP.....	(98.2)	(145.9)
SAF.....	9.8	14.6

Federal Tobacco Tax Increase. On April 1, 2009, the Federal government increased its cigarette tax \$0.61 per pack. This increase in the Federal tax will boost the price of cigarettes and therefore reduce the number of packs that will be purchased. Michigan’s tax on cigarettes is \$2 per pack, so this decline in the sale of cigarettes will reduce Michigan’s cigarette tax revenue an estimated \$30.0 million in FY 2008-09. The Federal tax on other tobacco products was also increased

effective April 1, 2009; however, due to the fact that Michigan's tax on other tobacco product's 32.0% of the wholesale price, the Federal tax increase is expected to boost Michigan's tax revenue an estimated \$1.0 million in FY 2008-09. Therefore, it is estimated that Michigan's tobacco tax revenue will decline a net \$29.0 million in FY 2008-09 due to the increase in the Federal tobacco tax and this loss in revenue will affect the following budget areas: School Aid Fund revenue will decline \$12.5 million, GF/GP revenue will fall \$5.7 million, and most of the remaining loss in tobacco tax revenue will reduce the Medicaid Trust Fund.

Federal Stimulus Tax Changes. The Federal American Recovery and Reinvestment Act of 2009 includes a number of tax reductions, some of which will have an impact on Michigan tax revenue. These changes include such items as an increase in the earned income tax credit and an income tax exemption for the first \$2,400 in unemployment compensation. These various tax changes will reduce Michigan's tax revenue an estimated \$52.9 million in FY 2008-09 and most of this will reduce General Fund revenue.

General Fund/General Purpose

- General Fund/General Purpose revenue will total an estimated \$7.4 billion in FY 2008-09, which is down 20.7% or \$1.9 billion from FY 2007-08.
- Compared with the January 2009 consensus estimate, GF/GP revenue for FY 2008-09 has been revised down by \$883.4 million.

The significant 20.7% decline in GF/GP revenue forecast for FY 2008-09 is primarily due to the severe economic recession, which is expected to have a negative impact on the revenue collections for almost all of the GF/GP earmarked taxes. In addition, all of the \$145.0 million that is expected to be refunded to taxpayers through the new earned income tax credit will reduce GF/GP revenue and the new film credit will lower GF/GP revenue an estimated \$98.2 million in FY 2008-09. As can be seen in [Figure 17](#), the projected decline in GF/GP revenue in FY 2008-09 will more than eliminate the increase in revenue realized in FY 2007-08, which was largely due to the increases in the income tax and Michigan Business Tax rates. The revised GF/GP revenue estimate for FY 2008-09 is summarized in [Table 4](#).

School Aid Fund

- School Aid Fund revenue from earmarked taxes and the lottery is expected to total \$10.9 billion in FY 2008-09, which represents a decline of 5.3% or \$609.7 million from FY 2007-08.
- This revised SAF revenue estimate is down \$465.3 million from the January 2009 consensus estimate.

School Aid Fund revenue is expected to decline by a sharp 5.3% in FY 2008-09 due to the weak level of economic activity. In particular, the severe declines in employment and housing activity will pull down the revenue collected from all of the key revenue sources that fund the SAF, including the sales, use, State Education, real estate transfer, income, and tobacco taxes. In addition, the net revenue generated by the lottery is expected to decline \$70.6 million or 9.5% from FY 2007-08. Offsetting some of the projected declines will be an increase in the earmarking to the SAF from the Michigan Business Tax. Statute specifies that in FY 2008-09, the Michigan Business Tax earmarking will increase to \$729.0 million from the \$341.0 million transferred in FY 2007-08. This large increase in the amount of Michigan Business Tax revenue earmarked to the SAF is designed to reimburse the SAF for increased School Aid payments that will have to be made to local school districts beginning in FY 2008-09 due to new personal property tax exemptions from the local

school 18-mill property tax that were a component of the overall enacted business tax reform. The revised SAF revenue estimate for FY 2008-09 is summarized in [Table 4](#).

FY 2009-10 REVISED REVENUE ESTIMATES

- General Fund/General Purpose and SAF revenue will total an estimated \$17.1 billion in FY 2009-10, which is down 6.8% or \$1.2 billion from the revised estimate for FY 2008-09.
- This revised estimate is down \$2.1 billion from the January 2009 consensus estimate.

While economic activity in Michigan is expected to show very modest renewed growth by the second half of FY 2009-10, it will not be strong enough to turn revenue growth positive. In addition, the reductions in revenue due to tax policy changes will have even greater impacts in FY 2008-09, as discussed below. The revised estimates for FY 2009-10 GF/GP and SAF revenue are summarized in [Table 6](#).

Tax Policy Changes

No new tax policy changes that will go into effect in FY 2009-10 have yet been enacted; however, the fiscal impacts of the earned income tax credit, film tax credits, Federal tobacco tax increase, and the Federal ARRA, are all expected to increase in FY 2009-10 compared with their impacts in FY 2008-09. The FY 2009-10 estimated fiscal impacts of each of these tax policy changes are discussed below.

Earned Income Tax Credit. The earned income tax credit increases from 10.0% of the Federal income tax liability to 20.0% beginning in the 2009 tax year. This means that the earned income tax credits claimed for the 2009 tax year on the income tax returns that will be filed in FY 2009-10 will be much larger than in FY 2008-09. In addition, it is anticipated that the economic recession will push more taxpayers down into the income levels that are eligible for the earned income tax credit. As a result, it is projected that the earned income tax credit will reduce income tax revenue an estimated \$320.0 million in FY 2009-10, significantly more than the \$145.0 million cost expected for FY 2008-09.

Film Credits. The cost of the film credits also is expected to increase significantly in FY 2009-10. Other states that adopted film credits similar to Michigan's, none of which are as generous as Michigan's credits, experienced a significant increase in film activity during the second full year the credits were available. As a result, it is estimated that the net revenue loss due to Michigan's film credits will increase to \$131.3 million in FY 2009-10 from the \$88.4 million cost estimated for FY 2008-09, as shown in [Table 5](#).

Federal Tobacco Tax Increase. In FY 2009-10, Michigan's tobacco tax collections will reflect the full-year negative impact of the increase in the Federal tobacco tax, which went into effect on April 1, 2009. As a result, in FY 2009-10, Michigan's tobacco tax collections will be lower than they otherwise would be by an estimated \$56.6 million. General Fund/General Purpose revenue will be down \$11.1 million, SAF revenue will be down \$24.4 million, and various other funds will be down \$21.1 million.

Federal Stimulus Tax Changes. The tax changes that were part of ARRA will reduce Michigan tax revenue an estimated \$69.3 million in FY 2009-10. The General Fund will incur an estimated \$64.5 million of this loss in revenue, and these tax changes will reduce SAF revenue an estimated \$4.8 million.

Table 6
FY 2009-10 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	FY 2008-09 Revised Est.	FY 2009-10 Revised Est.	Change from FY 2008-09		\$ Change from 01/09 Consensus
			Dollar Change	Percent Change	
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue ¹⁾	\$7,035.8	\$6,573.1	\$(462.7)	(6.6)%	\$(931.0)
Tax Changes Not In Baseline	386.9	161.3	(225.6)	---	(269.0)
<u>Revenue After Tax Changes</u>					
<u>Personal Income Tax</u>					
Gross Collections	8,199.4	7,427.6	(771.8)	(9.4)	(877.5)
Less: Refunds	(2,126.9)	(2,341.0)	(214.1)	10.1	(62.6)
Net Income Tax Collections	6,072.5	5,086.6	(985.9)	(16.2)	(940.1)
Less: Earmarking to SAF	(1,906.8)	(1,727.4)	179.4	(9.4)	204.1
Campaign Fund	(1.5)	(1.5)	0.0	0.0	0.0
Net Income Tax to GF/GP	\$4,164.2	\$3,357.7	\$(806.5)	(19.4)%	\$(736.0)
<u>Other Taxes</u>					
Single Business Tax	(213.2)	(60.0)	153.2	(71.9)	(60.0)
Michigan Business Tax	1,607.8	1,565.4	(42.4)	(2.6)	(237.4)
Sales	54.8	64.0	9.2	16.8	(29.7)
Use	751.7	770.7	19.0	2.5	(117.3)
Cigarette	203.6	192.7	(10.9)	(5.4)	(11.1)
Insurance Company Premiums	258.8	251.4	(7.4)	(2.9)	9.0
Telephone & Telegraph	74.0	73.0	(1.0)	(1.4)	0.0
Oil & Gas Severance	63.0	65.0	2.0	3.2	(3.0)
Casino Wagering	3.6	0.0	(3.6)	(100.0)	0.0
All Other	117.0	119.2	2.2	1.9	(9.5)
Subtotal Other Taxes	\$2,921.0	\$3,041.3	\$120.3	4.1%	\$(459.0)
Total Nontax Revenue	337.4	335.4	(2.0)	(0.6)	(5.0)
GF/GP REV. AFTER TAX CHANGES	\$7,422.6	\$6,734.4	\$(688.2)	(9.3)%	\$(1,200.1)
SCHOOL AID FUND:					
Baseline Revenue ¹⁾	\$10,307.9	\$9,790.1	\$(517.8)	(5.0)%	\$(916.0)
Tax Changes Not In Baseline	595.4	557.3	(38.2)	---	(32.4)
<u>Revenue After Tax Changes</u>					
Sales Tax	4,504.3	4,280.5	(223.9)	(5.0)	(450.5)
Lottery Revenue	670.1	650.0	(20.1)	(3.0)	(52.0)
State Education Property Tax	1,980.2	1,864.2	(116.0)	(5.9)	(95.0)
Real Estate Transfer Tax	108.3	118.3	10.0	9.2	(31.0)
Michigan Business Tax	729.0	721.7	(7.3)	(1.0)	(12.4)
Income Tax	1,906.8	1,727.4	(179.4)	(9.4)	(204.1)
Casino Tax	107.3	103.6	(3.7)	(3.4)	(11.8)
Other Revenue	897.3	881.7	(15.6)	(1.7)	(91.6)
SAF REV. AFTER TAX CHANGES	\$10,903.4	\$10,347.4	\$(556.0)	(5.1)%	\$(948.4)
BASELINE GF/GP AND SAF	\$17,343.7	\$16,363.2	\$(980.5)	(5.7)%	\$(1,846.9)
Tax & Revenue Changes	982.3	718.6	(263.7)	---	(301.4)
GF/GP & SAF REV. AFTER CHNGS	\$18,326.0	\$17,081.8	\$(1,244.2)	(6.8)%	\$(2,148.4)
SALES TAX	\$6,196.7	\$5,891.9	\$(304.8)	(4.9)%	\$(615.0)

¹⁾ FY 2007-08 is the base year for baseline revenue.

General Fund/General Purpose Revenue

- General Fund/General Purpose revenue will total an estimated \$6.7 billion in FY 2009-10, which is down 9.3% or \$688.2 million from FY 2008-09.
- Compared with the January 2009 consensus revenue estimate, this revised GF/GP estimate is down \$1.2 billion.

As shown in Figure 17 this revised estimate for FY 2009-10 is much lower than the GF/GP revenue level for any other fiscal year during the past 15 years. The 9.3% rate of decline projected for FY 2009-10 is not as severe as the 20.7% decline forecast for FY 2008-09, but the reasons for the projected decline are the same: very weak economic activity coupled with the loss of tax revenue due to the second-year impacts of the earned income tax credit and film tax credits, as described above. The revised GF/GP revenue estimate for FY 2009-10 is summarized in Table 6.

School Aid Fund

- School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$10.3 billion in FY 2009-10, which is down 5.1% or \$556.0 million from the revised estimate for FY 2008-09.
- This revised SAF revenue estimate for FY 2009-10 is down \$948.4 million from the January 2009 consensus revenue estimate.

The projected 5.1% decline in SAF revenue in FY 2009-10 will be due primarily to declines in the revenue generated from the income, sales, and State Education taxes, although the revenue from most of the other earmarked taxes is also expected to be down in FY 2009-10. In addition, net lottery revenue will be down an estimated \$52.0 million in FY 2009-10. The revised SAF revenue estimate for FY 2009-10 is summarized in Table 6.

Major General Fund and School Aid Fund Taxes in FY 2008-09 and FY 2009-10

Income Tax. The income tax will generate an estimated \$6.1 billion in FY 2008-09, which represents a decline of 16.0% from FY 2008-09, and in FY 2009-10 it is estimated that income tax revenue will fall an additional 16.2% to \$5.1 billion. These declines will be due to sharp falls in employment, wage and salary income, and, particularly in FY 2008-09, income from dividends and interest. Income tax revenue also will be negatively affected by an increase in refunds, which will be spurred by the new earned income tax credit and increases in the homestead property tax credits. Even though property values, and therefore property taxes, are expected to decline in both years, incomes on average are expected to decline at an even faster rate. This also will boost homestead property tax credits. These projected declines in income tax revenue will reduce both GF/GP revenue and SAF revenue. The SAF receives 23.3% of gross income tax collections (withholding, quarterly, and annual payments), while the GF/GP budget receives 76.7% of gross collections, and incurs the negative impact of all income tax refunds, including the refund payments for the homestead property tax credit and the new earned income tax credit

Sales Tax. The severe economic downturn will cause both consumers and businesses to cut back on their spending and this will have negative repercussions on sales tax receipts. In FY 2008-09, sales tax revenue will total an estimated \$6.2 billion, which is down 8.5% from FY 2007-08. In FY 2007-08, sales tax revenue totaled almost \$6.8 billion and was up 3.4% from FY 2006-07. In FY 2009-10, sales tax collections are expected to decline again by 4.9% to \$5.9 billion. These declines in sales tax collections forecast for FY 2008-09 and FY 2009-10 are much more severe than the declines experienced during the past 30 years. Since FY 1997-98, sales tax collections have declined only in three fiscal years and the steepest of these declines was a drop of 1.5% in

FY 1981-82. Compared with January 2009 consensus revenue estimates, the revised sales tax estimate for FY 2008-09 is down \$295.0 million and the revised estimate for FY 2009-10 is down \$615.0 million. Most of the sales tax revenue is earmarked to the SAF (73.3%) and most of the remainder goes to local government revenue sharing payments, the Comprehensive Transportation Fund, and the General Fund. The amount going to revenue sharing includes both constitutional and statutory earmarkings, but over the past several years a significant portion of the amount earmarked statutorily has been diverted to the General Fund. This is discussed further in the last section of this report.

Use Tax. The economic recession will also have a negative impact on use tax collections, as spending is expected to be down in such areas as hotels and motels, telephone service (both residential and business), and business equipment purchased in other states for use in Michigan. The slowdown in spending in these key areas, along with a large refund payment that was made at the beginning of FY 2008-09, will reduce use tax collections an estimated 18.1% to \$1.1 billion in FY 2008-09. In FY 2009-10, spending will remain weak on the key items taxed under the use tax, but no large refund payment is expected. As a result, use tax receipts will total an estimated \$1.15 billion in FY 2009-10, representing an increase of 2.5% from the revised estimate for FY 2008-09. Compared with the January consensus revenue estimates, the estimate for use tax collections has been revised down by \$140.0 million in FY 2008-09 and \$176.0 million in FY 2009-10. The GF/GP budget receives two-thirds of use tax revenue and the remaining one-third goes to the SAF.

Tobacco Taxes. Tax collections from the cigarette and other tobacco products taxes will total an estimated \$1.0 billion in FY 2008-09, which represents a decrease of 5.2% from FY 2007-08. In FY 2009-10, tobacco tax revenue is expected to decline another 5.8% to \$962.4 million. These estimated declines reflect the ongoing steady decline in tobacco consumption, plus the more abrupt downward shift in consumption over the next two years due to the recent increase in the Federal tobacco tax, which is discussed in more detail earlier in this section. Tobacco tax revenue is earmarked to several different funds including the General Fund and the SAF.

Casino Tax. The State's tax on casinos equals an 8.1% permanent tax on gross gaming receipts plus a temporary rate of 4.0% that each of the three Detroit casinos must pay until they begin operating in their new permanent casinos. All of the revenue generated from the permanent 8.1% tax goes to the SAF, while the revenue from the temporary 4.0% tax goes to the GF/GP budget (3.5%) and the Agriculture Equine Industry Development Fund (0.5%). At the beginning of FY 2008-09, two of the three Detroit casinos were in their permanent facility and the third casino recently moved into its permanent facility and is waiting to be approved. As a result, after totaling \$129.7 million in FY 2007-08, casino tax revenue will total an estimated \$114.2 million in FY 2008-09 and \$103.6 million in FY 2009-10. The SAF share will fall from \$112.1 million in FY 2007-08 to an estimated \$107.3 million in FY 2008-09 and \$103.6 million in FY 2009-10. The GF/GP share will decline from \$15.4 million in FY 2007-08 to \$3.6 million in FY 2008-09 and then to zero in FY 2009-10.

State Education Property Tax. After remaining relatively flat in FY 2007-08, State education property tax revenue is expected to decline 4.8% to \$2.0 billion in FY 2008-09 as continued weakness in the housing sector is expected to further reduce property values. These negative economic forces will continue to erode property values in 2010 and, as a result, State Education Tax revenue is expected to decline 5.9% in FY 2009-10 to \$1.9 billion. All of the revenue generated by the State Education Tax is earmarked to the SAF.

Lottery. The economic downturn also is expected to have a negative impact on lottery revenue. After totaling \$740.7 million in FY 2007-08, net lottery revenue is expected to decline 9.5% to \$670.1 million and then decline to \$650.0 million in FY 2009-10. All of the net revenue generated by the lottery is earmarked to the SAF.

Michigan Business Tax. The Michigan Business Tax generated \$1.9 billion in FY 2007-08. Given that it was the initial year for this tax and the first quarterly payment was not due until April 2008, and that no annual payments were paid during this initial year, these collections by no means reflect a full year's activity. Fiscal year 2008-09 will mark the first full year of this tax and, as a result, total collections will jump an estimated 23.5% to \$2.34 billion. This revised estimate is down \$249.9 million from the January 2009 consensus estimate, as actual collections during the first half of FY 2008-09 were below the estimated amount. In FY 2009-10, Michigan Business Tax revenue will total an estimated \$2.29 billion, down 2.1% from the revised estimate for FY 2008-09. According to the law, the SAF will receive \$729.0 million of this business tax revenue in FY 2008-09 and then, in subsequent years, this earmarking will be indexed to the percentage change in the U.S. Consumer Price Index (CPI) during the previous fiscal year. The U.S. CPI is expected to decline by an estimated 0.5% in FY 2008-09, so the amount of the Michigan Business Tax that will be earmarked to the SAF will decline to an estimated \$721.7 million in FY 2009-10. All remaining Michigan Business Tax revenue goes to the General Fund.

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 2008-09 and FY 2009-10 is presented in Tables 7 and 8. Baseline estimates are used to track the forecast history for these two fiscal years in order to avoid the wide swings in revenue estimates that occur when tax changes are enacted for a particular fiscal year after the initial revenue estimates have been calculated for that fiscal year. In addition, in order to provide an accurate comparison, all of the previous baseline estimates made for FY 2007-08 and FY 2008-09 have been adjusted to reflect a common base year.

The Senate Fiscal Agency's initial GF/GP and SAF baseline revenue estimate for FY 2008-09 of \$19.24 billion was made in December 2007, as shown in Table 7. The estimate adopted at the January 2008 Consensus Revenue Estimating Conference was \$9.1 million below the SFA's estimate, and then at the May 2008 Conference the estimate was lowered another \$259.7 million to \$18.97 billion. At the January 2009 consensus conference, the estimate was lowered again by \$567 million to \$18.4 billion. Based on the revised economic outlook and actual tax collections through April 2009, the SFA has substantially lowered the GF/GP and SAF baseline estimate another \$1.06 billion to \$17.34 billion. This latest revision to the FY 2008-09 GF/GP and SAF baseline revenue estimate is \$1.9 billion or 9.9% below the SFA's original estimate made in December 2007.

The initial GF/GF and SAF baseline revenue estimate for FY 2009-10 was made in December 2008 at \$18.09 billion, as shown in Table 8. This estimate was raised by \$124.0 million to \$18.2 billion at the January 2009 Consensus Revenue Estimating Conference. The Senate Fiscal Agency's revised estimate for FY 2009-10 presented in this report reduces the baseline estimate \$1.8 billion from the January 2009 consensus estimate to \$16.4 billion.

Table 7
CHANGES IN SENATE FISCAL AGENCY
BASELINE REVENUE ESTIMATES FOR FY 2008-09
(Millions of Dollars)

Forecast Date	GF/GP	SAF	Total
December 21, 2007	\$8,089.5	\$11,149.5	\$19,239.0
January 18, 2008 ^{a)}	8,094.4	11,135.5	19,229.9
May 14, 2008	8,032.1	10,899.8	18,931.9
May 16, 2008 ^{a)}	8,032.6	10,937.6	18,970.2
December 18, 2008	7,605.7	10,643.1	18,248.8
January 9, 2009 ^{a)}	7,644.4	10,759.3	18,403.7
May 13, 2009	7,035.8	10,307.9	17,343.7
<u>Change From Previous Estimate:</u>			
Dollar Change	(\$608.6)	(\$451.4)	(\$1,060.0)
Percent Change	(7.6)%	(4.1)%	(5.6)%
<u>Change From Initial Estimate:</u>			
Dollar Change	(\$1,053.7)	(\$841.6)	(\$1,895.3)
Percent Change	(13.0)%	(7.5)%	(9.9)%
Note: Baseline base year equals FY 2007-08.			
^{a)} Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			

Table 8
CHANGES IN SENATE FISCAL AGENCY
BASELINE REVENUE ESTIMATES FOR FY 2009-10
(Millions of Dollars)

Forecast Date	GF/GP	SAF	Total
December 18, 2008	\$7,487.4	\$10,599.3	\$18,086.7
January 9, 2009 ^{a)}	7,504.1	10,706.2	18,210.3
May 13, 2009	6,573.1	9,790.1	16,363.2
<u>Change From Previous Estimate:</u>			
Dollar Change	(\$931.0)	(\$916.1)	(\$1,847.1)
Percent Change	(12.4)%	(8.6)%	(10.1)%
<u>Change From Initial Estimate:</u>			
Dollar Change	(\$914.3)	(\$809.2)	(\$1,723.5)
Percent Change	(12.2)%	(7.6)%	(9.5)%
Note: Baseline base year equals FY 2007-08.			
^{a)} Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			

BUDGET STABILIZATION FUND

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

The requirements for contributions to and withdrawals from the BSF are established in State law. By statute, revenue may be added to the BSF when Michigan personal income, less transfer payments and adjusted for inflation, increases by more than 2.0%. When the growth in real personal income less transfer payments is over 2.0%, the pay-in to the BSF is equal to the percentage growth in excess of 2.0% multiplied by the total General Fund/General Purpose (GF/GP) revenue.

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

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

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

Table 9 presents the recent history of the BSF in terms of actual transfers into and out of the Fund, interest earnings, and year-end balances from FY 1998-99 through FY 2007-08. Also presented in this table are the SFA's estimates for FY 2008-09 and FY 2009-10. The BSF year-end balance as a percentage of GF/GP and SAF revenue is shown in Figure 18, and the estimated economic stabilization trigger calculations for FY 2008-09 and FY 2009-10 are presented in Table 10.

FY 2007-08

In FY 2007-08, the BSF had a beginning balance of \$2.1 million. During the fiscal year there were no payments into or out of the Fund, but with interest earnings the ending balance totaled \$2.2 million at the close of FY 2007-08.

FY 2008-09 and FY 2009-10

Based on the SFA's revised estimates for personal income, transfer payments, and the Detroit Consumer Price Index (CPI), the budget stabilization formula triggers payments out of the Fund equal to \$596.7 million in FY 2008-09 and another \$457.6 million in FY 2009-10, as shown in Table 10. Given that there is only \$2.2 million in the BSF and given that no additional transfers into the BSF were appropriated as part of the FY 2008-09 enacted budget, no transfers out of the BSF are anticipated in either FY 2008-09 or FY 2009-10.

Table 9

BUDGET AND ECONOMIC STABILIZATION FUND TRANSFERS, EARNINGS AND FUND BALANCE FY 1998-99 TO FY 2009-10 ESTIMATE (Millions of Dollars)				
Fiscal Year	Pay-In	Interest Earned	Pay-Out	Fund Balance
1998-99	\$244.4	\$51.2	\$73.7	\$1,222.5
1999-00	100.0	73.9	132.0	1,264.4
2000-01	0.0	66.7	337.0	994.2
2001-02	0.0	20.8	869.8	145.2
2002-03	0.0	1.8	147.0	0.0
2003-04	81.3	0.0	0.0	81.3
2004-05	0.0	2.0	81.3	2.0
2005-06	0.0	0.0	0.0	2.0
2006-07	0.0	0.1	0.0	2.1
2007-08	0.0	0.1	0.0	2.2
Senate Fiscal Agency estimates:				
2008-09	0.0	0.0	0.0	2.2
2009-10	0.0	0.1	0.0	2.3

Figure 18

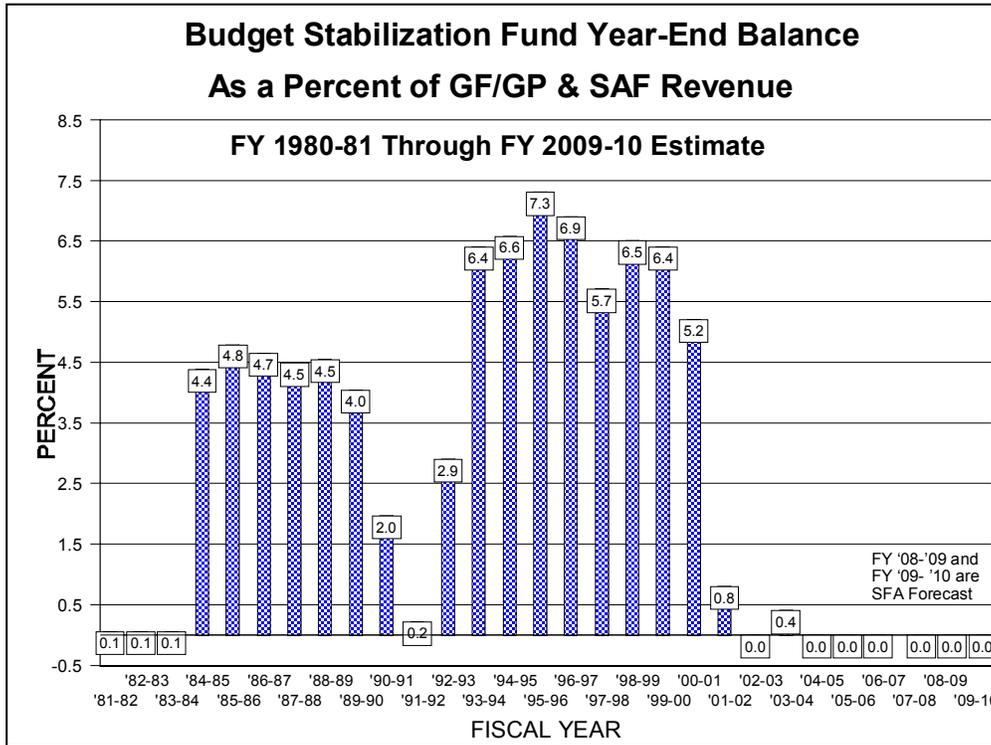


Table 10

ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER			
FY 2008-09 AND FY 2009-10			
(Millions of Dollars)			
	CY 2008	CY 2009	CY 2010
Michigan Personal Income (MPI)	\$353,113	\$337,434	\$323,611
Less: Transfer Payments	65,131	71,297	74,706
Subtotal	\$287,983	\$266,137	\$248,905
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	2.027	2.037	2.044
Equals: Real Adjusted MPI	\$142,073	\$130,652	\$121,773
Percent Change from Prior Year		(8.04)%	(6.80)%
Excess Over 2.0%		0.00%	0.00%
		FY 2008-09	FY 2009-10
Multiplied by: Estimated GF/GP Revenue		\$7,422.6	\$6,734.4
Equals: Transfer to the BSF		\$0.0	\$0.0
OR Transfer from the BSF		\$596.7	\$457.6
Note: Numbers may not add due to rounding.			
CY = Calendar Year; FY = Fiscal Year			

COMPLIANCE WITH STATE REVENUE LIMIT

Article IX, Section 26 of the Michigan Constitution establishes a limit on the amount of revenue State government may collect in any fiscal year. This section of the Constitution was adopted by a vote of the people in 1978 and the limit was first applicable in FY 1979-80. In the first 15 years this revenue limit was in effect (FY 1979-80 to FY 1993-94), the revenue limit was never exceeded. The largest gap between revenue and the limit occurred in FY 2006-07, when State revenue was \$5.3 billion below the revenue limit. In FY 1994-95, State revenue exceeded the revenue limit, for the first time, by \$109.6 million. This was due to new State revenue being generated as part of the school financing reform that was enacted in 1994. In FY 1995-96 through FY 1997-98, revenue fell below the revenue limit again. In FY 1998-99 and FY 1999-2000, revenue exceeded the limit, but not by enough to require refunds to be paid to taxpayers. In FY 2000-01 through FY 2006-07, revenue fell well below the revenue limit and then remained well below the revenue limit in FY 2007-08 despite increases in the income and Michigan business tax rates. Based on the SFA's latest economic forecast and revenue estimates, it is estimated that revenue subject to the revenue limit will continue to remain well below the revenue limit in FY 2008-09 and FY 2009-10.

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 2008-09, State government revenue may not exceed 9.49% of personal income for calendar year 2007. Given that Michigan personal income for 2007 equaled \$344,885 million, the revenue limit for FY 2008-09 is \$32,825 million.

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

REQUIREMENTS IF REVENUE LIMIT IS EXCEEDED

If final revenue exceeds the revenue limit, the Constitution and State law provide procedures to deal with this event. If revenue exceeds the limit by less than 1.0%, the excess revenue must be deposited into the Budget Stabilization Fund. If the revenue limit is exceeded by 1.0% or more, the excess revenue must be refunded to income tax and business taxpayers, on a pro rata basis. These refunds would be given to taxpayers who file an annual income tax return or a Michigan Business Tax 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 2008-09 and FY 2009-10, it is estimated that revenue subject to the constitutional revenue limit will remain well below the revenue limit for each of these fiscal years. The SFA's estimates of the State's compliance with the revenue limit for FY 2008-09 and FY 2009-10 are presented in Table 11.

FY 2007-08

In FY 2007-08, the revenue limit equaled 9.49% of Michigan's personal income in calendar year 2006. According to the U.S. Department of Commerce's Bureau of Economic Analysis, Michigan personal income for 2006 was \$341.1 billion, and so the revenue limited equaled \$32.4 billion. Based on the final revenue for FY 2007-08, revenue subject to the limit totaled \$27.7 billion. As a result, revenue subject to the limit fell below the revenue limit by \$4.7 billion or 14.4%. This gap between the revenue limit and revenue subject to the limit is slightly smaller than it was in FY 2006-07, due to the enacted increases in the income and Michigan business taxes in FY 2007-08.

FY 2008-09

In FY 2008-09, the revenue limit will equal 9.49% of Michigan's personal income in calendar year 2007. The U.S. Department of Commerce's Bureau of Economic Analysis' initial estimate of Michigan personal income in calendar 2007 equaled \$345.9 billion, so the revenue limit is estimated at \$32.8 billion for FY 2008-09. Based on the SFA's revised revenue estimates for FY 2008-09, revenue subject to the revenue limit will equal an estimated \$25.0 billion. As a result, it is estimated that revenue subject to the limit will fall below the limit by \$7.8 billion or 23.9% in FY 2008-09.

FY 2009-10

The U.S. Department of Commerce estimates that personal income in Michigan during 2008 equaled \$353.1 billion, and as a result, the revenue limit will equal \$33.5 billion in FY 2009-10. Based on the Senate Fiscal Agency's revised revenue estimates for FY 2009-10, revenue subject to the revenue limit will equal an estimated \$23.6 billion. As a result, revenue subject to the revenue limit will fall below the revenue by an estimated \$9.9 billion, or 29.5% in FY 2009-10.

Table 11

**COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT
SECTION 26 OF ARTICLE IX OF THE STATE CONSTITUTION
FY 2006-07 THROUGH FY 2009-10 ESTIMATE
(Millions of Dollars)**

	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
	Final	Final	Estimate	Estimate
Revenue Subject to Limit				
<u>Revenue:</u>				
General Fund/General Purpose (baseline)	\$8,279.7	\$8,168.2	\$7,035.8	\$6,573.1
Revenue Sharing (baseline)	1,611.7	1,665.5	1,557.6	1,468.4
School Aid Fund (baseline)	11,149.7	11,248.6	10,307.9	9,790.1
Transportation Funds	2,119.3	2,068.4	2,045.0	2,030.0
Other Restricted Non-Federal Aid				
Revenue	2,935.4	3,124.4	3,075.0	3,050.0
<u>Adjustments:</u>				
GF/GP Federal Aid	(18.8)	(14.8)	(17.0)	(17.0)
GF/GP Balance Sheet Adjustments	38.0	1,191.4	386.9	161.3
SAF Balance Sheet Adjustments	3.4	264.6	595.4	557.3
Total Revenue Subject to Limit	\$26,118.4	\$27,716.3	\$24,986.6	\$23,613.2
Revenue Limit				
<u>Personal Income:</u>				
Calendar Year	CY 2005	CY 2006	CY 2007	CY 2008
Amount	\$331,304	\$341,075	\$345,885	\$353,113
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	\$31,440.7	\$32,368.0	\$32,824.5	\$33,510.4
1.0% of Limit	314.4	323.7	328.2	335.1
Amount Under (Over) Limit	\$5,322.4	\$4,651.7	\$7,837.9	\$9,897.2
Percent Below Limit	16.9%	14.4%	23.9%	29.5%

ESTIMATE OF YEAR-END BALANCES

Based on the economic and revenue forecasts outlined earlier in this report, along with enacted and projected State appropriations, the Senate Fiscal Agency (SFA) has revised its estimates of the FY 2008-09 and FY 2009-10 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) year-end balances. This section of the report discusses the year-end balances and addresses the issues the members of the Legislature are facing as they attempt to complete action on the FY 2009-10 State budget.

On February 12, 2009, Governor Granholm presented her FY 2009-10 State budget recommendations to the Legislature. The numbers contained in the Governor's budget recommendation were based on the consensus revenue estimates agreed to on January 9, 2009, recommended increases in State taxes and fees, substantial reductions in both GF/GP and SAF appropriations, and the use of one-time Federal stimulus funding. The Governor's budget recommendation was balanced between estimated revenue and recommended appropriations pursuant to constitutional requirements.

Since the Governor introduced the FY 2009-10 State budget to the Legislature in February 2009, several factors have experienced significant changes that will directly influence the final decisions to be made by the Legislature on the budget. First, the SFA has significantly revised downward the January 2009 consensus estimates of FY 2008-09 and FY 2009-10 GF/GP and SAF revenue. These downward revisions in the revenue estimates are directly tied to the rapid deterioration of economic conditions both in the United States as a whole, and specifically, in Michigan. The second major factor that is likely to influence final decisions by the Legislature on the State budget involves funding from the Federal government. The United States Congress completed action and President Obama signed into law the American Recovery and Reinvestment Act of 2009 (ARRA) on February 17, 2009. The ARRA will provide Michigan with significant amounts of additional Federal funds that can and will be used to help balance both the FY 2008-09 and FY 2009-10 GF/GP and SAF budgets.

Based on the SFA analysis of revenue, appropriations, and ARRA funding, the Legislature will be forced to make significant adjustments in the Governor's FY 2009-10 GF/GP and SAF budget recommendations to ensure a balance between estimated revenue and enacted appropriations. The remainder of this section of the report outlines in detail the SFA estimates of year-end budget balances.

Table 12 provides a summary of the SFA's estimates of the FY 2008-09 and FY 2009-10 year-end balances of the GF/GP and SAF budgets. Based on current SFA revenue estimates along with enacted and projected State appropriations, the FY 2008-09 GF/GP budget is in deficit by \$931.0 million. Based on current SFA revenue estimates along with enacted and projected appropriations, the FY 2008-09 SAF budget is in deficit by \$465.3 million. A comparison of the SFA's estimates of current law revenue and the Governor's recommendations for tax policy changes along with the Governor's appropriation recommendations, leads to the conclusion that the FY 2009-10 GF/GP budget is in deficit by \$1.5 billion. A comparison of the SFA estimates of current law revenue and the Governor's recommendations for tax policy changes along with the Governor's appropriation recommendations, leads to the conclusion that the FY 2009-10 SAF budget is in deficit by \$948.3 million. A significant amount of these projected budget deficits likely will be eliminated by the use of one-time Federal funding appropriated under the provisions of ARRA.

Table 12

GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND ESTIMATED YEAR-END BALANCES (Millions of Dollars)		
	FY 2008-09 Estimate	FY 2009-10 Estimate
General Fund/General Purpose	\$ (931.0)	\$ (1,528.1)
School Aid Fund	(465.3)	(948.3)

FY 2008-09 YEAR-END BALANCE

On May 5, 2009, the Governor presented to the Legislature and the Legislature approved Executive Order 2009-22. Passage of this Executive Order reduced FY 2008-09 GF/GP appropriations by \$297.6 million. The Legislature also is taking action to reduce appropriations in the legislative branch and the judicial branch by an additional \$6.9 million. The SFA estimate of the FY 2008-09 GF/GP year-end balance after these appropriation reductions are taken into account, leads to a projected remaining budget deficit of \$931.0 million. Table 13 provides a detailed summary of the SFA's estimate of the FY 2008-09 GF/GP year-end balance.

This projected FY 2008-09 GF/GP budget deficit is based on the SFA revenue estimate, and actual and pending State appropriations, and does not factor in any Federal funds available under the ARRA. It is almost certain that ARRA funding will be used to eliminate the projected budget deficit.

On the revenue side of the FY 2008-09 GF/GP budget ledger, the SFA now believes that the final GF/GP revenue will total \$8.6 billion. This projected level of total GF/GP revenue represents a \$1.7 billion or 16.5% decline from the final level of FY 2007-08 GF/GP revenue. The FY 2008-09 GF/GP revenue total includes \$457.9 million of surplus revenue carried forward from FY 2007-08, \$8.1 billion of ongoing estimated revenue, and \$57.0 million of GF/GP revenue from one-time revenue sources.

The level of ongoing FY 2008-09 GF/GP revenue now estimated by the SFA represents a \$777.0 million decline from the ongoing revenue estimated following the January 2009 Consensus Revenue Estimating Conference.

On the expenditure side of the FY 2008-09 GF/GP budget ledger, the SFA now believes that final GF/GP expenditures will total \$9.6 billion. This projected level of FY 2008-09 GF/GP expenditures represents a \$321.0 million or 3.2% decline from the final level of FY 2007-08 GF/GP expenditures. The \$9.6 billion of projected GF/GP expenditures includes \$9.7 billion of appropriations enacted at the beginning of the fiscal year, appropriation reductions of \$134.0 million contained in Executive Order 2008-21, appropriation reductions of \$297.6 million contained in Executive Order 2009-22, \$307.4 million of pending supplemental appropriations not yet enacted into law, and projected \$20.0 million GF/GP savings from changes in State contracting procedures.

The \$931.0 million projected FY 2008-09 GF/GP budget deficit will almost certainly be eliminated by the appropriation of Federal funds allocated to the State of Michigan under provisions of ARRA. Michigan is eligible to receive \$289.9 million of ARRA funding from the State Fiscal Stabilization component of ARRA and \$868.0 million from the enhanced Federal Medicaid match rate component of ARRA. These Federal funds are available to be used to eliminate the remaining projected budget deficit. The use of these Federal funds for this purpose is consistent with statutory provisions of ARRA. This approach will leave \$226.8 million of Federal ARRA funding available to help balance the FY 2009-10 GF/GP budget.

Table 13
FY 2008-09
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Revenue:	
Beginning Balance.....	\$457.9
Ongoing Revenue:	
SFA Revenue Estimate	7,422.6
Revenue Sharing Savings	482.2
Use Tax on HMOs (PA 440 of 2008).....	161.5
Shift of Short-Term Borrowing Costs to School Aid Fund	45.0
Subtotal Ongoing Revenue	8,111.3
One-Time Revenue:	
Treasury-Insurance Escheats Revenue	25.0
Treasury-Secondary Collections.....	6.0
21st Century Fund Transfer to General Fund.....	10.0
Tourism Borrowing Transfer to General Fund	10.0
TEDF Transfer to General Fund	6.0
Subtotal One-Time Revenue	57.0
Total Estimated Revenue.....	\$8,626.2
Expenditures:	
Initial Appropriations	\$9,701.4
Enacted Supplemental Appropriations:	
Public Act 279 of 2008	0.0
Public Act 286 of 2008.....	0.0
Public Act 553 of 2008.....	0.0
Public Act 3 of 2009.....	0.0
Public Act 7 of 2009.....	0.0
Public Act 23 of 2009.....	0.0
Pending Supplemental Appropriations	307.4
Executive Order 2008-21.....	(134.0)
Executive Order 2009-22.....	(297.6)
Lapse from Contract Savings	(20.0)
Total Projected Expenditures.....	\$9,557.2
Projected Year-End Balance.....	\$(931.0)
Federal American Recovery and Reinvestment Act Funding:	
ARRA-State Fiscal Stabilization Fund.....	289.8
ARRA-Federal Medicaid Match Rate	868.0
Total Federal ARRA Funding.....	\$1,157.8
Projected Year-End Balance After ARRA Funding	\$226.8

Table 14 provides a summary of the pending FY 2008-09 supplemental appropriations. It is anticipated that these supplemental appropriation items will be approved by the Legislature in the near future. All of the pending supplemental appropriations are based on recommendations from the Office of the State Budget.

Table 14
FY 2008-09
PENDING GF/GP SUPPLEMENTAL APPROPRIATION REQUESTS
(Millions of Dollars)

Budget Area (Item)	
History, Arts, and Libraries (Records Center Lease).....	\$0.6
Corrections (Parole Funding Increase).....	20.0
Community Health (Switch QAAP to Use Tax).....	152.9
Community Health (Caseload/Utilization Adjustments).....	62.1
Community Health (School-Based Health Services).....	16.5
Community Health (One-Time Facility Closure Costs).....	8.0
Human Services (Caseload/Utilization Adjustments).....	11.9
School Aid Fund (Increase GF/GP Grant to SAF).....	44.2
Treasury (Blackstone Settlement Funding Shift).....	(2.0)
Judiciary (Negative Funding Adjustment).....	(2.8)
Legislature (Negative Funding Adjustment).....	(3.5)
Legislative Auditor General (Negative Funding Adjustment).....	(0.5)
Total Pending Supplemental Appropriation Requests	\$307.4

Table 15 provides a summary of the SFA estimate of a \$465.3 million FY 2008-09 SAF budget deficit. This deficit estimate is based on a comparison of estimated revenue, enacted appropriations, and projected final SAF expenditures.

On the revenue side of the FY 2008-09 SAF budget ledger, the SFA now believes that the final SAF revenue will total \$12.8 billion. This projected level of total SAF revenue represents a \$210.5 million or 1.6% decline from the final level of FY 2007-08 SAF revenue. The FY 2008-09 SAF revenue total includes \$247.1 million of surplus revenue carried forward from FY 2007-08, \$10.9 billion of restricted SAF revenue, an \$85.0 million GF/GP grant to the SAF budget, and \$1.6 billion of Federal aid.

The level of total FY 2008-09 SAF revenue represents a \$421.1 million decline from the SAF revenue estimate following the January 2009 Consensus Revenue Estimating Conference.

On the expenditure side of the FY 2008-09 SAF budget ledger, the SFA now believes that final SAF expenditures will total \$13.3 billion. This projected level of FY 2008-09 SAF expenditures represents a \$501.9 million or 3.9% increase from the final level of FY 2007-08 SAF expenditures. The \$13.3 billion of projected SAF expenditures includes \$13.4 billion of appropriations enacted at the beginning of the fiscal year and \$116.1 million of appropriation reductions resulting from a variety of formula-funding adjustments including pupil counts and taxable property values.

The \$465.3 million projected FY 2008-09 SAF budget deficit will almost certainly be eliminated by the appropriation of Federal funds allocated to the State under provisions of ARRA. Michigan is eligible to receive \$1.3 billion of funding from the State Fiscal Stabilization Fund component of ARRA. These funds are to be used to maintain FY 2008-09 operational appropriations at the level originally enacted in the fiscal year. Therefore, Michigan will use \$465.3 million of the \$1.3 billion of total funding available to support education programs in FY 2008-09. The remaining \$837.1 million of these ARRA State Fiscal Stabilization funds will be used to avoid reductions in education programs in FY 2009-10.

Table 15
FY 2008-09
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Revenue:	
Beginning Balance	\$247.1
SFA Revenue Estimate	10,903.4
GF/GP Grant	85.0
Federal Aid	1,562.0
Total Estimated Revenue	\$12,797.5
Expenditures:	
Initial Appropriations	\$13,378.9
<u>Formula Funding Adjustments:</u>	
Taxable Values/MBT/TIFA	(53.6)
Reduced Pupil Counts	(40.0)
Renaissance Zone Reimbursements	(22.0)
CEPI Reductions	(1.5)
School Bond Loan Fund Adjustment	1.0
Subtotal Formula Funding Adjustments	(116.1)
Total Projected Expenditures	\$13,262.8
Projected Year-End Balance	\$(465.3)
Federal American Recovery and Reinvestment Act Funding:	
ARRA - State Fiscal Stabilization Fund	\$1,302.4
Remaining ARRA- State Fiscal Stabilization Fund in FY 2009-10.....	\$837.1

FY 2009-10 YEAR-END BALANCE

As illustrated in Table 16, the SFA now believes that substantial reductions will have to be made in the FY 2009-10 GF/GP and SAF budget recommendations submitted by Governor Granholm in February 2009. It is now the responsibility of the Legislature to make adjustments in the FY 2009-10 State budget to ensure a balance between estimated revenue and enacted appropriations.

Table 16 provides the details of the SFA estimate of a \$1.5 billion FY 2009-10 GF/GP budget deficit. This estimate is developed assuming a carry-forward of ARRA funding not used in FY 2008-09, the SFA estimate of ongoing revenue, an assumed reduction in revenue sharing payments to local units of government, increases in State taxes and fees as recommended in the Governor's budget, and appropriations as recommended by the Governor. The \$1.5 billion deficit estimate does not take into account additional Federal ARRA funding that has been allocated to Michigan during FY 2009-10.

On the revenue side of the FY 2009-10 GF/GP budget ledger, the SFA now believes that GF/GP revenue will total \$7.9 billion. This projected level of total GF/GP revenue represents a \$694.3 million or 8.0% decline from the estimated level of total FY 2008-09 GF/GP revenue. The FY 2009-10 GF/GP revenue total includes \$226.8 million of Federal ARRA funding carried forward from FY 2008-09, \$7.5 billion of ongoing estimated revenue, and \$166.4 million of revenue adjustments recommended by the Governor. The ongoing revenue assumes a continuation of the reductions in revenue sharing payments to local units of government recently implemented in

Executive Order 2009-22. The revenue adjustments recommended by the Governor include tax and fee increases proposed in her overall FY 2009-10 State Budget Message.

The level of ongoing GF/GP revenue now estimated by the SFA represents an \$911.0 million decline from the level of the ongoing revenue estimated following the January 2009 Consensus Revenue Estimating Conference.

On the expenditure side of the FY 2009-10 GF/GP budget ledger, the SFA now projects total appropriations at \$9.5 billion. This projection includes the \$9.0 billion of GF/GP appropriations recommended in the Governor’s State Budget Message along with a \$500.0 million GF/GP funding shift to remove Federal funds assumed in the Governor’s budget. It is important to note that the Governor’s FY 2009-10 GF/GP appropriation recommendations did include \$607.5 million of appropriation reductions. The majority of these recommended GF/GP appropriation reductions were in the Departments of Corrections, Community Health, Higher Education, and Human Services.

Table 16
FY 2009-10
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Revenue:	
Beginning Balance.....	\$226.8
Ongoing Revenue:	
SFA Revenue Estimate	6,734.4
Revenue Sharing Savings	424.5
Shift of Short-Term Borrowing Costs to School Aid Fund	45.0
Use Tax on HMOs (PA 440 of 2008).....	<u>334.8</u>
Subtotal Ongoing Revenue	7,538.7
Other Revenue Adjustments:	
Revenue Enhancements (Governor's Recommendation).....	129.1
Liquor License Revenue Increases (Governor's Recommendation).....	24.1
Tax Enforcement (Governor's Recommendation)	<u>13.2</u>
Subtotal Other Revenue Adjustments	166.4
Total Estimated Revenue.....	<u>\$7,931.9</u>
Expenditures:	
Governor's Appropriation Recommendations.....	\$8,960.0
Adjustment for Assumed Federal Stimulus Funding	<u>500.0</u>
Total Projected Expenditures.....	<u>\$9,460.0</u>
Projected Year-End Balance.....	<u>\$(1,528.1)</u>
Federal American Recovery and Reinvestment Act Funding:	
ARRA-Federal Medicaid Match Rate	\$949.0
Projected Year-End Balance After ARRA Funding	<u>\$(579.1)</u>

In addition to the \$213.9 million of ARRA funding carried forward from FY 2008-09, the State of Michigan is allocated \$949.0 million of additional ARRA funding in FY 2009-10. This Federal funding, resulting from a temporary increase in the Federal Medicaid match rate, can be used to alleviate the projected \$1.5 billion GF/GP budget deficit. If the Governor and the Legislature choose to use the entire amount of FY 2009-10 ARRA funding of \$949.0 million to help balance the GF/GP budget, this will leave a shortfall of \$579.1 million remaining. This shortfall will almost

certainly be addressed by the enactment of GF/GP appropriation reductions beyond the \$607.5 million already assumed in the Governor’s budget recommendation. The deficit will grow by an additional \$166.4 million if the Legislature does not enact any of the tax and fee increases recommended by the Governor.

Table 17 provides a summary of the SFA estimate of a \$948.3 million FY 2009-10 SAF budget deficit. This deficit estimate is based on a comparison of estimated and recommended revenue and enacted appropriations.

Table 17
FY 2009-10
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Revenue:	
Beginning Balance	\$0.0
SFA Revenue Estimate.....	10,347.5
GF/GP Grant.....	40.8
Revenue Enhancements.....	45.8
Tax Enforcement.....	4.4
Lottery Revenue Increase.....	15.0
Federal Aid.....	1,561.8
Total Estimated Revenue	\$12,015.3
Expenditures:	
Governor's Appropriation Recommendation.....	12,963.6
Total Potential Expenditures	\$12,963.6
Projected Year-End Balance	\$(948.3)

On the revenue side of the FY 2009-10 SAF budget ledger, the SFA now believes that SAF revenue will total \$12.0 billion. This projected level of total SAF revenue represents a \$782.2 million or 6.1% decline from the estimated level of FY 2008-09 SAF revenue. The FY 2009-10 SAF revenue total includes \$10.3 billion of restricted SAF revenue, a \$40.8 million GF/GP grant to the School Aid Fund, \$45.8 million from proposed revenue increases included in the Governor’s Budget Message, \$4.4 million of additional revenue from increased tax enforcement, \$15.0 million of increased revenue from the State Lottery, and \$1.6 billion of Federal funding.

On the expenditure side of the FY 2009-10 SAF budget ledger, the Governor has recommended SAF appropriations of \$13.0 billion. This SAF appropriation recommendation by the Governor includes \$164.2 million of appropriation reductions. The largest of these appropriation reductions is a \$59 reduction in the foundation allowance funding for school districts. Other reductions recommended by the Governor include a 20.0% reduction in operating funding for intermediate school districts.

The Governor and the Legislature will have to address this potential \$948.3 million budget deficit by a combination of appropriation reductions, the use of one-time available Federal ARRA funding, or additional revenue increases. As previously stated, Michigan will receive a total of \$1.3 billion of ARRA funding from the State Fiscal Stabilization Fund that must be used to avoid operating reductions in the K-12 budget, and the budgets of universities and community colleges. It is assumed that \$465.3 million of this funding will be used to eliminate the projected FY 2008-09 SAF

budget deficit. Pursuant to Federal requirements, the remaining ARRA funds of \$837.1 million will be used in the K-12 budget in FY 2009-10 and the higher education budget.

Table 18 provides a summary of the anticipated uses of the Federal ARRA State Fiscal Stabilization funding that must be used by the State to support operating appropriations in K-12 school districts, universities, and community colleges. Absent any additional appropriation reductions not already assumed in the Governor’s budget, the remaining \$837.1 million of ARRA funding will not be enough to meet the requirements of the Federal law. The requirements would include using the Federal funds to eliminate the \$948.4 million FY 2009-10 SAF budget deficit and the restoration of operating funding reductions for K-12 school districts and intermediate school districts included in the Governor’s budget. In addition, the Federal statute would require restoration of the proposed reductions to the operating funding of universities included in the Governor’s budget.

Table 18

DISTRIBUTIONS FROM THE STATE FISCAL STABILIZATION FUND K-12 SCHOOL DISTRICTS AND UNIVERSITIES (Millions of Dollars)	
Total Available State Fiscal Stabilization Education Funding	\$1,302.4
<u>Use of Funding:</u>	
FY 2008-09 K-12 Revenue Shortfall	(465.3)
Remaining Funds for FY 2009-10	837.1
<u>Potential FY 2009-10 Uses of Remaining Funds:</u>	
FY 2009-10 K-12 Revenue Shortfall	(948.4)
FY 2009-10 K-12 Restore \$59 Foundation Allowance Reductions in Gov's Budget	(113.3)
FY 2009-10 K-12 Restore ISD Reduction in Gov's Recommendation	(16.3)
FY 2009-10 Higher Education Restore 3.2% Reduction in Gov's Recommendation	(46.6)
FY 2009-10 Restore Cuts to MSU Cooperative Extension and Ag. Experiment Station	(32.0)
Subtotal	\$(1,156.6)
Shortfall in State Fiscal Stabilization Funding in FY 2009-10	\$(319.5)

These potential uses of the \$837.1 million of Federal ARRA State Fiscal Stabilization funds available in FY 2009-10 exceed the level of funding by \$319.5 million. Pursuant to Federal statutory requirements, the State of Michigan then will be forced to proportionally reduce programs to offset the shortfall in Federal ARRA funding. The bottom line is that, based on the SFA revenue estimates, it does not appear that sufficient State and Federal funding will be available to avoid reductions in education operational programs below the level appropriated in FY 2008-09.

FY 2010-11 BUDGET OUTLOOK

While the Governor and the Legislature are currently focusing their attention on eliminating large budget deficits in FY 2008-09 and soon will begin final discussions on the FY 2009-10 State budget, it is important not to lose sight of the challenges that will likely face the State budget during FY 2010-11. There appears to be little doubt that the FY 2009-10 GF/GP and SAF budgets will heavily rely on the use of one-time Federal ARRA funding to balance. Based on the SFA analysis of the FY 2009-10 GF/GP budget, the potential exists that the budget will be supported by over \$1.1 billion of Federal ARRA funding. The FY 2010-11 GF/GP budget will receive only an additional \$239.0 million of Federal ARRA funding. Therefore, the potential loss of non-ongoing Federal ARRA funding in the FY 2010-11 GF/GP budget will equal \$923.9 million. This equates to approximately 12.1% of the estimated FY 2009-10 GF/GP ongoing revenue.

A similar situation is likely to occur in the FY 2010-11 SAF budget as extensive use of one-time Federal ARRA funding also will lead to a significant funding cliff in FY 2010-11. The challenge facing the Governor and the Legislature in crafting an FY 2009-10 State budget is to develop a multiyear approach to the budget that will stretch a significant amount of Federal ARRA funding into FY 2010-11. This approach will require large reductions in FY 2009-10 appropriations beyond the significant reductions already included in the Governor's budget recommendation. The Governor's and the Legislature's ability to meet this challenge likely will set the stage for a State budget in future fiscal years that looks very different from the budget currently in place.