State Economic, Revenue, and Budget Update

Presented to Clients of the Michigan Legislative Consultants

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http://www.senate.michigan.gov/sfa/

Real GDP

- 2.2% increase forecast for 2010, followed by a 2.7% increase in 2011.

- Since the Great Depression, only 1946 exhibited a larger decline in GDP than the 2.6% decline expected in 2009.

Consumer Confidence

- November 2008 reading was the third lowest in 50^{+}-year history of Index. Although it has risen about 10-15 points since then, the average has remained low – below the levels experienced during the 1979-82 recession.

- Six out of seven of consumers expect inflation-adjusted income declines in 2010.

Light Vehicle Sales

- 2009 total of 10.4 million units is the worst year since at least 1970.

- 2010 forecast of 11.2 million units is up 8.7% from 2009, but down 32.5% from the 2002-2007 average of 16.6 million units. Light vehicle sales are expected to total 12.5 million units in 2011, an increase of 11.6%.

- In the mid-1990s, the Detroit 3 sold 73.0% of total U.S. light vehicle sales (about 11 million units), compared with 45.7% (about 4.8 million units) during 2009.

Retail Sales

- Retail sales fell 10.3% between June 2008 and December, the largest drop since records started in 1947 (the second largest drop was 9.6%). November 2009 sales were down 7.3% from May 2008 peak.

- Retail sales have risen for two consecutive months, but November 2009 sales were still only on par with the December 2005 level.

U.S. Housing Starts

- April 2009 housing starts were at their lowest level since records began in 1959, 7.0% below the previous record low set in January 2009. Starts have been higher since April, but November starts were 12.4% below the level one year ago.

- April 2009 housing starts were down 80.0% from the January 2006 peak. November 2009 starts remained down 74.4% from the January 2006 peak, but were up 19.8% from the April 2009 level.

- Starts are expected to rise 22.4% in 2010, and another 54.9% in 2011.

Michigan Housing Activity

- New housing authorizations in 2008 were down 88.1% from the 2004 level in the Detroit metropolitan area and 80.1% statewide.

U.S. Labor Market

- The economy has lost 7.2 million payroll jobs in the last 24 months, the largest drop since modern records began in 1939.

- The 3.4 million jobs lost between November 2008 and March 2009 ranks as the largest five-month decline, 500,000 jobs more than the May-September 1945 decline when the wartime production was halted.

- Payroll employment declines have averaged 100,200 jobs per month between August 2009 and December 2009, better than the 648,300 average during the first four months of 2009.

Michigan Labor Market

- Since peaking in June 2000, payroll employment has declined in 87 of the last 113 months.

- On an annual basis, payroll employment has declined for eight consecutive years -- the longest decline on record, and is expected to continue declining through both 2009, 2010, and 2011.

- Payroll employment is expected to have dropped by 6.8% in 2009, and will decline 2.2% in 2010 and 0.9% in 2011.

- As of November 2009, Michigan had lost 840,900 payroll jobs from the June 2000 peak -- a decline of 17.9%.

- As of November 2009, transportation equipment manufacturing employment in Michigan was down 66.1% from its July 2000 peak, a decline of 233,300 jobs.

- Job losses in transportation equipment manufacturing account for 27.7% of total Michigan job losses through November 2009.

- Michigan transportation equipment manufacturing employment is expected to continue declining in 2009, 2010, and 2011 with employment in the fourth quarter of 2011 down 74.2% (260,900 jobs) from the level in the second quarter of 2000.

- The July 2009 gain of 22,700 jobs reflected the first payroll employment increase since June 2008 and the largest monthly gain since January 2000. Despite increases in two of the last five months, November payroll employment was still down 0.4% from the July 2009 level.

Michigan Personal Income

- Michigan personal income is expected to decline 2.7% in 2009 (without adjustment for inflation) and rise 1.0% in 2010 and 1.7% in 2011.

- The 2.7% decline in nominal personal income in 2009 would be the first decline since 1958 and the worst drop since 1945.

Signs of an Economic Turn Around?

- After declining six consecutive months in a row between June and December 2008, retail sales have risen in three of the last four months, and November 2009 sales were up 5.1% compared with December 2008.

Signs of an Economic Turn Around? (continued)

- Nationally, home prices rose at a 9.4% annual rate in June 2009, the first increase since May 2006 and have now risen for five consecutive months. In Detroit, prices have risen at an average annual rate of 15.6% for three consecutive months, the first increases since February 2006.

- Despite weakness in the job markets, most nonmanufacturing sectors in Michigan are exhibiting higher year-over-year increases in average weekly earnings. Increases in average earnings for November ranged from 6.7% in health care/social assistance jobs to 7.8% in the information sector, and 7.3% in the leisure/hospitality sector. Average earnings in durable manufacturing were up 2.6%, while in nondurable manufacturing average earnings were up 7.8%

Consensus Revenue Estimates

General Fund/General Purpose (GF/GP)

- **FY 2008-09:** Revenue from ongoing sources totaled $7.4 billion, which is down by $2.0 billion or 21.3% from FY 2007-08.

- **FY 2009-10:** Revenue from ongoing sources will total $6.9 billion, which is down $467.2 million or 6.3% from FY 2008-09. Over two fiscal years, GF/GP revenue has declined by $2.5 billion or 26.3%.

  The major reasons for these steep revenue declines are the impact of the economic recession on Michigan, the severe difficulties in the motor vehicle sector, and changes in Michigan tax laws, such as the new earned income tax credit and the tax subsidies to the film industry.

- **FY 2010-11:** Revenue from ongoing sources will total $7.0 billion, which is up $70.0 million or 1.0% from the FY 2009-10.

School Aid Fund (SAF)

- **FY 2008-09:** Earmarked tax and lottery revenue will total $10.9 billion, which is down by $590.7 million or 5.1% from FY 2007-08.

- **FY 2009-10:** Earmarked tax and lottery revenue will total $10.5 billion, which is down by $464.1 million or 4.2% from FY 2008-09. Over two fiscal years, SAF revenue has declined by $1.1 billion or 9.2%.

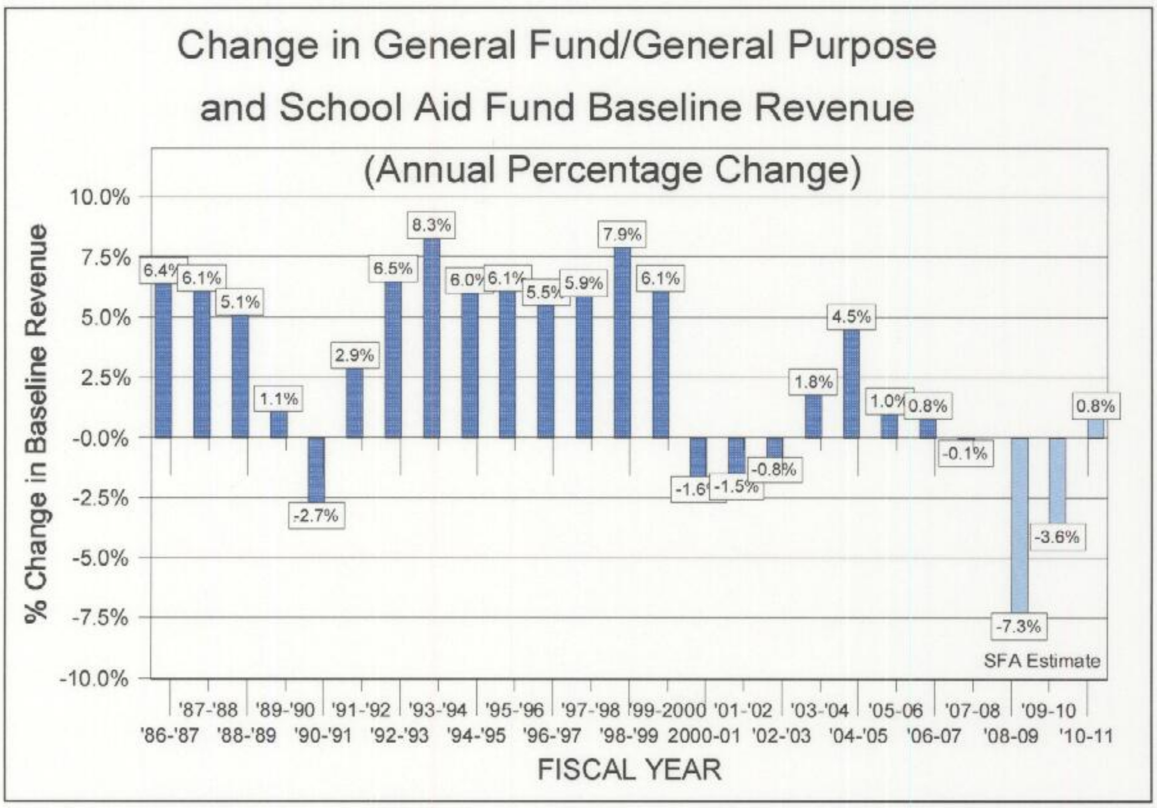
- **FY 2010-11:** Earmarked tax and lottery revenue will total $10.5 billion, which is up $22.4 million or 0.2% from FY 2009-10.

Table 1

Annual Percentage Changes in State Revenue			
	FY 2008-09	FY 2009-10	FY 2010-11
Income Tax	(19.0)%	(9.9)%	1.4%
Sales Tax	(10.1)	(3.2)	0.9
Use Tax	(19.2)	2.7	1.5
Michigan Business Tax	N/A	(1.4)	0.4
State Education Property Tax	(1.9)	(8.1)	(4.0)
General Fund/General Purpose	(21.3)	(6.3)	1.0
School Aid Fund	(5.1)	(4.3)	0.2

Based on January 2010 consensus revenue estimates.

Figure 1



Constitutional State Revenue Limit

Section 26 of Article IX of the State Constitution of 1963, limits State revenue collections to a maximum of 9.49% of the level of Michigan Personal Income. This Constitution provision, put in place by Michigan voters in 1978, limits the size of State government to the level that occurred in FY 1978-79.

During FY 1999-2000, actual State revenue collections exceeded the constitutional revenue limit by $159.7 million. Actual fiscal year 1999-2000 revenue equaled 9.55% of Michigan Personal Income.

During FY 2009-10, State revenue collections are estimated to be $8.9 billion under the constitutional revenue limit. Estimated FY 2008-09 revenue will equal 6.93% of Michigan Personal Income.

This means that the size of State government in Michigan over the past nine fiscal years has contracted in a very significant manner. The Legislature and the Governor could raise State taxes by $8.9 billion currently and still not be over the constitutional revenue limit. The current level of State revenue collected is now 26.9% under the constitutional revenue limit.

This decline in State revenue over the past 10 fiscal years results from a combination of tax reductions enacted into law, i.e., income tax rate reduction, earned income tax credit, film credit, and the fact that the current tax base of the State is not responsive to economic activity.

Fiscal Year 2008-09 State Budget Update

Based on a preliminary accounting of State revenue and expenditures, the FY 2008-09 GF/GP and SAF budgets both closed the fiscal year with positive balances. The FY 2008-09 GF/GP budget closed the fiscal year with a \$176.7 million balance and the FY 2008-09 SAF budget closed the fiscal year with a \$229.1 million balance. The balances in both the GF/GP and the SAF budgets will carry forward and become a revenue source in the FY 2009-10 budgets.

The key to balancing both the FY 2008-09 GF/GP and SAF budgets was the sizeable amount of temporary Federal funds that the State received under provisions of the American Recovery and Reinvestment Act of 2009 (ARRA).

Federal ARRA funds offset \$974.0 million of GF/GP expenditures in FY 2008-09. These ARRA funds supported 11.5% of the total GF/GP expenditures during the fiscal year. Absent the Federal ARRA funding, the FY 2008-09 GF/GP budget would have closed the fiscal year with a \$797.3 million deficit.

Federal ARRA funds provided a \$597.5 million revenue source for the FY 2008-09 SAF budget. These ARRA funds supported 4.5% of the total SAF expenditures during the fiscal year. Absent the Federal ARRA funding, the FY 2008-09 SAF budget would have closed the fiscal year with a \$368.4 million deficit.

Final FY 2008-09 GF/GP expenditures represented a \$1.4 billion or a 14.4% decline from FY 2007-08 expenditures. Of this total expenditure decline, \$974.0 million relates to the appropriation of Federal ARRA funding. Final FY 2008-09 SAF expenditures represented a \$378.7 million or a 3.0% increase from FY 2008-09 expenditures. This funding increase is attributable to the \$597.5 million of Federal ARRA funding in the budget.

Fiscal Year 2009-10 State Budget Update

Based on the January 11, 2010, consensus revenue estimates and enacted and projected appropriations, both the FY 2009-10 GF/GP and SAF budgets are in balance. The SFA is estimating that the FY 2009-10 GF/GP budget is in balance by $72.7 million and the FY 2009-10 SAF budget is in balance by $53.7 million.

During the summer and fall of 2009, the Governor and the Legislature were debating FY 2009-10 budget imbalances that totaled $1.8 billion in the GF/GP budget and $1.0 billion in the SAF budget. These projected budget imbalances were eliminated with a combination of substantial appropriation reductions and the appropriation of additional Federal funds available under provisions of ARRA.

The FY 2009-10 GF/GP budget imbalance of $1.8 billion was eliminated by the approval of the Legislature of $842.8 million of reductions from the Governor's recommended appropriation levels and the appropriation $1.0 billion of Federal ARRA funding. The level of FY 2009-10 GF/GP appropriations approved by the Legislature represented a $735.1 million or an 8.4% reduction from the final level of FY 2008-09 appropriations.

Major FY 2009-10 GF/GP appropriation reductions from the Governor's recommendations include:

1. Elimination of the Michigan Promise Grant: $140.0 million
2. Reductions in Revenue Sharing Payments: $148.0 million
3. Reductions in Human Services Funding: $141.4 million
4. Reductions in Community Health Funding: $124.9 million
5. Reductions in Economic Development Funding: $37.5 million

The FY 2009-10 SAF budget imbalance of $1.0 billion was eliminated by the approval of the Legislature of $312.1 million of appropriation reductions, the appropriation of $450.0 million of Federal ARRA funding and the carry forward of surplus SAF funds from the prior fiscal year.

The major FY 2009-10 reductions to K-12 School Aid appropriations include a $165-per-pupil funding reduction and a 20.0% reduction in State funding for Intermediate School Districts. The $165-per-pupil funding reduction equates to an average 2.3% reduction for local school districts. The level of FY 2009-10 SAF appropriations approved by the Legislature represents a $424.1 million or a 3.2% reduction from the final level of FY 2008-09 appropriations.

Fiscal Year 2010-11 State Budget Outlook

Governor Jennifer Granholm is expected to submit her detailed recommendations on the FY 2010-11 State budget to the Legislature on February 11, 2010. Based on the January 11, 2010, consensus revenue estimates, it is clear that absent significant increases in State revenue, the Governor's FY 2010-11 appropriation recommendations for both the GF/GP and SAF budgets will require significant reductions to the levels of appropriations currently in place.

While the FY 2010-11 GF/GP and SAF revenue estimates call for slight increases in revenue from the prior fiscal year, both the GF/GP and SAF budgets will be affected by the phase-down of Federal funds available under ARRA. Federal ARRA funding supported $1.1 billion of GF/GP appropriations in FY 2009-10 and only $209.6 million will be available in FY 2010-11. Federal ARRA funding supported $450.0 million of SAF appropriations in FY 2009-10 and only $184.1 million will be available in FY 2010-11.

Assuming a freeze in FY 2010-10 GF/GP appropriations and no new tax increases, the FY 2010-11 GF/GP budget is facing a potential imbalance of $1.2 billion. This imbalance equates to 12.6% of projected appropriations.

Assuming a freeze in FY 2010-11 SAF appropriations and no new tax increases, the FY 2010-11 SAF budget is facing a potential imbalance of $426.0 million. Eliminating this imbalance with a per-pupil funding reduction equates to $270 per pupil.

In many respects, the Governor and the Legislature are facing the same issues regarding the FY 2010-11 State budget that they faced in balancing the FY 2009-10 State budget. That is a question between appropriation reductions and increases in State taxes. During FY 2009-10 substantial Federal ARRA funds helped eliminate a significant portion of the budget imbalance. Absent a second Federal stimulus, the same issues that delayed the passage of the FY 2009-10 State budget are likely to surface during the legislative debate on the FY 2010-11 budget.

Table 2

American Recovery and Reinvestment Act Funding Assumed in Michigan State Budget (Millions of Dollars)	
FY 2008-09	
General Fund/General Purpose	$1,298.1
School Aid Fund	597.5
Total	$1,895.6
FY 2009-10	
General Fund/General Purpose	$1,071.3
School Aid Fund	450.0
Total	$1,521.3
FY 2010-11	
General Fund/General Purpose	$209.6
School Aid Fund	185.5
Total	$395.1
Three Year Totals	
General Fund/General Purpose	$2,579.0
School Aid Fund	1,233.0
Grand Total	**$3,812.0**
Restricted Federal Aid Programs:	
Transportation Projects	$912.3
K-12 Special Education Programs	426.4
K-12 At-Risk Programs	465.1
Workforce Training Programs	273.2
Environmental Cleanup Projects	248.6
Low Income Home Weatherization Programs	244.0
Food Assistance Programs	150.5
Energy Programs	120.5
Unemployment Assistance	86.0
All Other Restricted Programs	182.2
Subtotal Restricted Programs	3,108.8
Total Appropriated ARRA Funding	**$6,920.8**