

**ECONOMIC OUTLOOK
AND
REVENUE ESTIMATES
FOR MICHIGAN**



**FISCAL YEARS
2003-04 AND 2004-05**

HOUSE
FISCAL
AGENCY

Mitchell E. Bean, Director

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FOREWORD

The House Fiscal Agency (HFA) is pleased to present this report to members of the Michigan House of Representatives. The purpose of the report is to inform members of the final General Fund/General Purpose and School Aid Fund revenue estimates for fiscal year (FY) 2002-03, the revised revenue estimates for FY 2003-04, and the initial revenue estimates for FY 2004-05. The estimates reported herein will be presented to the Consensus Revenue Estimating Conference on January 14, 2004, and will be used to facilitate the consensus estimating process.

This report includes HFA analyses of important factors that will affect state and national economies through the year 2005, estimates of the Countercyclical Budget Stabilization Fund, state compliance with the Constitutional State Revenue Limit, and year-end balance estimates for the General Fund/General Purpose and the School Aid Fund.

Rebecca Ross, Senior Economist, and Jim Stansell, Economist, are the authors of this report. Jeanne Dee prepared the report for publication.

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EXECUTIVE SUMMARY

According to the National Bureau of Economic Research, the national economic recovery started at the end of 2001. Since the recovery began, high productivity gains have outpaced economic growth, and this has dampened national employment. Michigan's wage and salary employment has generally trended downward since the beginning of 2001.

The House Fiscal Agency (HFA) expects the current national recovery to accelerate in calendar year (CY) 2004, then slow moderately in CY 2005. Employment gains in Michigan are expected to lag the gains at the national level. Important aspects of the HFA forecast are summarized as follows.

U. S. Forecast

Real GDP growth is forecast to increase 4.6% in CY 2004, up from the 3.1% pace anticipated in CY 2003, and then 3.9% in CY 2005.

Inflation, as measured by the Consumer Price Index (CPI), is forecast to increase 1.9% in CY 2004, then accelerate to 2.5% in CY 2005.

Light vehicle sales are anticipated to total 16.5 million units in CY 2003, and are forecast to increase to 16.9 million units in CY 2004 and CY 2005. The import share of light vehicles is forecast to be 19.2% in CY 2004 and 19.0% in CY 2005.

The *national unemployment rate*, which is anticipated to be 6.0% in CY 2003, is forecast to decrease to 5.6% in CY 2004, then fall to 5.1% in CY 2005. The unemployment rate peaked at 6.2% in the second quarter of CY 2003.

The *federal funds rate*, which currently is 1.0%, is forecast to increase by 50 basis points in March, May, and August of 2004.

Michigan Forecast

Michigan personal income is anticipated to increase 2.6% in CY 2003. The rate of growth is forecast to increase to 4.8% in CY 2004 and then pick up to 6.0% in CY 2005.

The *Michigan unemployment rate* is anticipated to be 7.1% in CY 2003. It is forecast to remain at 7.1% in CY 2004 and decline to 6.2% in CY 2005. Michigan's unemployment rate is expected to peak at 7.5% in the fourth quarter of CY 2003.

Inflation, as measured by the Detroit Consumer Price Index, is anticipated to increase 2.3% in CY 2003, is forecast to increase 1.9% in CY 2004, and 2.4% in CY 2005.

■ **State Revenues**

Total baseline GF/GP and SAF revenues were \$18.2 billion in FY 2002-03, and are forecast to increase 2.1% to \$18.6 billion in FY 2003-04 and 4.0% to \$19.3 billion in FY 2004-05. Baseline revenues do not include prior-year fund balances or reflect the effects of recent tax policy changes.

Total actual GF/GP and SAF revenues were \$18.6 billion in FY 2002-03 and are forecast to decrease \$180.1 million or 1.0% to \$18.5 billion in FY 2003-04, then increase \$406.0 million or 2.2% to \$18.9 billion in FY 2004-05. Actual revenues are resources available and include the impact of tax changes.

■ **State Revenue Limit**

Total state revenues are expected to be below the state revenue limit by \$4.57 billion in FY 2002-03, by \$5.21 billion in FY 2003-04, and by \$5.48 billion in FY 2004-05. Final calculation of the state revenue limit is performed by the Auditor General.

■ **Year-End Fund Balances**

The year-end GF/GP balance was \$114.5 million in FY 2001-02. The year-end balance for FY 2002-03 was \$174.0 million.

The School Aid Fund year-end balance was \$237.0 million in FY 2001-02. The year-end balance for FY 2002-03 was \$113.7 million.

The Countercyclical Budget Stabilization Fund year-end balance was \$145.2 million in FY 2001-02, and zero balance is forecast for both FY 2002-03 and FY 2003-04.

■ **Baseline and Actual Revenue Estimates**

Table 1 reports GF/GP and SAF revenues in terms of baseline and actual revenues.

Baseline revenues do not include the impact of partial-year policy changes or certain policy changes that have only recently occurred. Baseline estimates are comparable across fiscal years and demonstrate the changes to state revenues that are driven by changes in the economy.

Actual GF/GP revenues capture the effects of all policy changes and represent resources actually available. Actual SAF revenues do not include beginning fund balances or transfers from the BSF or GF/GP.

Table 1

HFA REVENUE ESTIMATES (Millions of Dollars)

	Final FY 2002-03	FY 2003-04	FY 2004-05
<u>BASELINE</u>			
GF/GP	\$7,935.9	\$8,023.0	\$8,390.9
SAF	10,255.1	10,547.1	10,914.2
TOTAL	\$18,191.0	\$18,570.1	\$19,305.0
<u>ACTUAL</u>			
GF/GP	\$7,925.5	\$7,828.5	\$7,857.7
SAF	10,714.7	10,631.6	11,008.4
TOTAL	\$18,640.2	\$18,460.1	\$18,866.1

NOTE: Numbers may not add due to rounding.



ECONOMIC REVIEW AND FORECAST

This section presents the economic forecast used by the House Fiscal Agency to produce its updated revenue forecast for FY 2003-04 and initial revenue forecast for FY 2004-05.

The longest U.S. economic expansion on record ended in March 2001 as the economy slid into a brief, eight-month recession that ended in November 2001. Although the recession was modest, economic growth remained weak and unstable throughout CY 2002 and the early part of CY 2003. However, real GDP grew at an annual rate of 8.2% during the third quarter of 2003, and there are many positive signs that the economy will continue to grow. It is forecast that real GDP will grow 3.1% in CY 2003, 4.6% in CY 2004, and 3.9% in CY 2005.

Figure 1 shows the Institute of Supply Management (ISM) Index dating back to January 1999. An index number above 50 indicates a growing manufacturing sector, while a number below 50 suggests that the manufacturing sector is contracting. The index reached a peak in December 1999, then fell below 50 in August 2000 and remained below 50 until February 2002. After peaking in June 2002, the index began to drop again. By September, the index had fallen below 50, where it remained before jumping to 54.7 in December. After starting off 2003 by falling for four consecutive months, the ISM index began a strong upward trend, and finished the year at a 20-year high.

A somewhat similar story is portrayed in **Figure 2**, which shows the University of Michigan Index of Consumer Sentiment. Consumer sentiment is a driving force behind personal consumption expenditures, which represent almost two-thirds of GDP. Thus, even though the ISM index began to fall in early 2000, consumers remained cautiously optimistic about the economy.

Although the consumer sentiment index remained at historically high levels throughout most of CY 2000, it nosedived in December 2000 and continued falling until February 2001. Like the ISM index, consumer sentiment rebounded somewhat through August 2001 before plunging again in September 2001. It is important to note that most of the surveys that comprise each month's index had already been completed prior to the September 11 attacks.

Following the September 2001 low, consumer sentiment generally increased for the next eight months before reaching a peak in May 2002. Concern about the state of the economy caused the index to drop for next five months. After hitting a ten-year low in October 2002, the index finished the year by rising for two consecutive months.

Like the ISM index, the index of consumer sentiment began 2003 with a three-month drop before rebounding in April and May. Since then,

however, consumer sentiment has remained mixed, and the index has undergone small monthly changes.

Figure 1

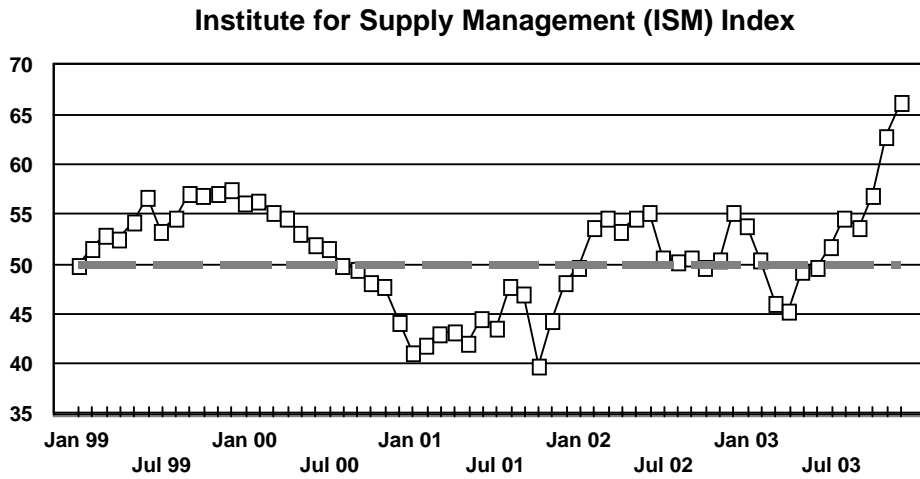


Figure 2

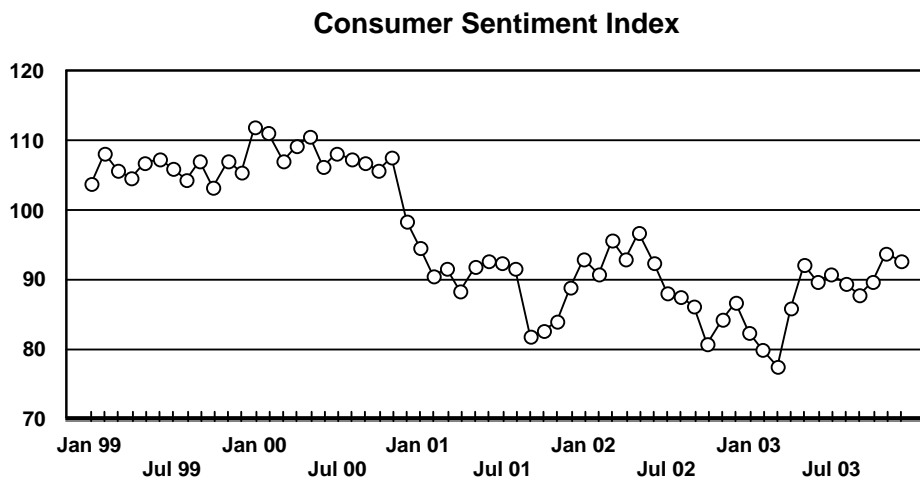
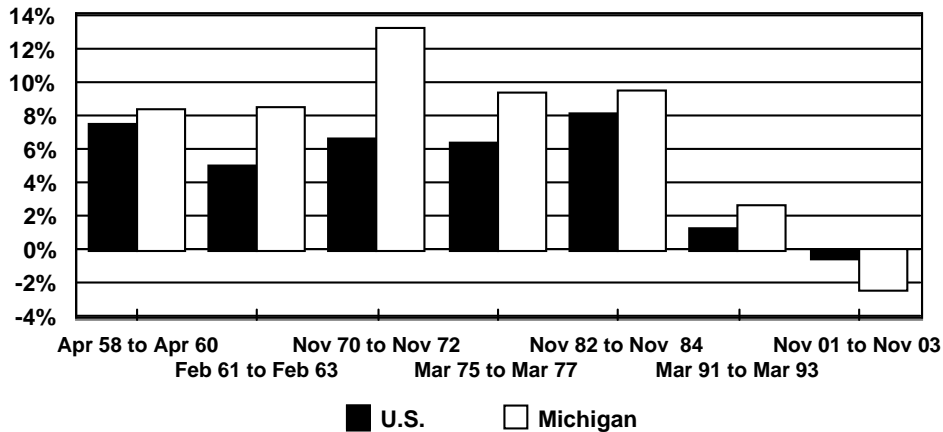


Figure 3

**Percent Change in Employment
24 Months After the End of the Recession**



Unlike the ISM index, which measures manufacturing activity, consumer sentiment has not risen dramatically over the past few months. Thus, while the business sector remains poised to continue expanding the economy, consumers appear to be less confident about overall economic conditions. This divergence probably can be traced to the performance of the labor market following the end of the 2001 recession.

Figure 3 illustrates the percentage change in employment over a two-year period following the end of a recession for the past seven recessions dating back to the late 1950s. Following the previous six recessions, employment growth for the U.S. and Michigan was always positive, and generally robust. Since the most recent recession ended in November 2001, the employment change has been slightly negative for the U.S. and significantly negative for Michigan.

It is this characteristic that separates the current recovery from those following previous recessions, and might explain why consumer sentiment has remained restrained in spite of recent favorable economic news.

■ **Real GDP**

After rising 8.2% during the third quarter of 2003, real GDP is expected to grow 3.9% in the fourth quarter. Although growth thus far in CY 2003 has been uneven, the annual growth rate in real GDP is expected to total 3.1% for the full year after growing 2.2% in CY 2002.

Real GDP growth in CY 2004 is forecast to be 4.6% before diminishing slightly to 3.9% in CY 2005.

Personal consumption, which accounts for almost two-thirds of real GDP, advanced at 3.4% during CY 2002. This rate is estimated to taper off to 3.1% in CY 2003. As the economy picks up, personal consumption is predicted to increase 3.6% in CY 2004 and 3.4% in CY 2005.

The GDP component showing the most significant improvement in CY 2003 is private residential investment. After growing 4.9% during CY 2002, private residential investment is estimated to rise 9.0% in CY 2003. Much of this increase can be attributed to historically low levels of interest rates which have spurred not only housing starts, but several rounds of refinancing as well.

Figure 4

Percent Change in U.S. Real GDP

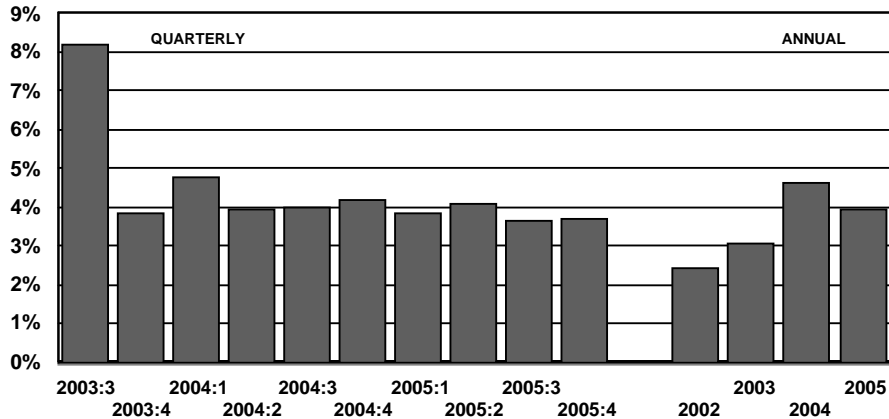
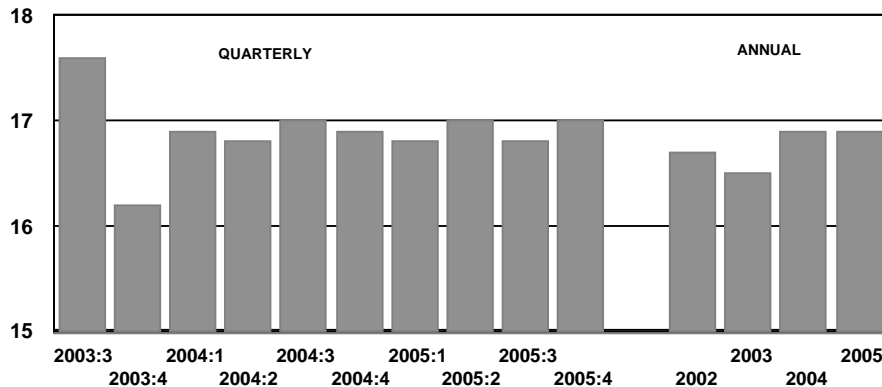


Figure 5

Light Vehicle Sales
(Millions of Units)



■ **Light Vehicle Sales**

The generous rebates and special financing offers that have become commonplace during the past few years continued well into CY 2003. Despite incentives, sales of light motor vehicles in CY 2003 are expected to total 16.5 million units, well below CY 2000's record level of 17.2 million units. *Light vehicle sales* are anticipated to total 16.9 million units in both CY 2004 and CY 2005.

Over the past several years there has been a shift in sales away from cars and toward light trucks. This trend is expected stabilize, and the share of light trucks is expected to remain roughly

constant throughout the forecast period. *Light trucks* are expected to account for 53.7% percent of total sales in CY 2003, and 54.0% in both CY 2004 and CY 2005.

The *import share of total light vehicle sales* was 19.7% in CY 2002. The import share is forecast to increase to 20.2% in CY 2003 before declining to 19.2% in CY 2004 and 19.0% in CY 2005.

■ **Inflation: U.S.**

The overall increase in input prices (such as energy prices, wages, and import prices) has generally remained moderate, and has helped to

hold down production costs. Although energy prices are expected to rise, increases in worker productivity should allow inflation to remain low, by historical standards, through the forecast period.

The factors noted are expected to lead to an average annual increase in the *U.S. Consumer Price Index-Urban* (CPI-U) of 2.3% in CY 2003, 1.9% in CY 2004, and 2.5% in CY 2005.

■ **Inflation: Michigan**

The cost of living in Michigan, is measured by the *Detroit Consumer Price Index for Urban Consumers* (Detroit CPI-U). Preliminary data suggest an increase of 2.3% in CY 2003. Inflation rates in Michigan are forecast to be 1.9% in CY 2004 and 2.4% in CY 2005.

■ **Income Growth: U.S.**

Total *U.S. personal income* is estimated to grow by 3.2% in CY 2003. Personal income growth is

forecast to increase by 5.2% in CY 2004 and 6.2% in CY 2005.

Federal tax cuts and moderate growth in inflation will contribute to an anticipated 2.5% rate of growth of *U.S. real disposable income* in CY 2003. It is forecast that U.S. real disposable income growth will rise by 4.8% in CY 2004, and by 3.0% in CY 2005.

■ **Income Growth: Michigan**

In contrast to the U.S., Michigan's total *state personal income* growth is estimated at only 2.6% in CY 2003. It is forecast that Michigan personal income will increase by 4.8% in CY 2004 and by 6.0% in CY 2005.

Michigan real disposable income is estimated to grow 1.7% in CY 2003, slightly below the 2.5% increase posted in CY 2002. In CY 2004, real disposable income is forecast to grow by 4.2% before settling back to 2.7% in CY 2005.

Figure 6

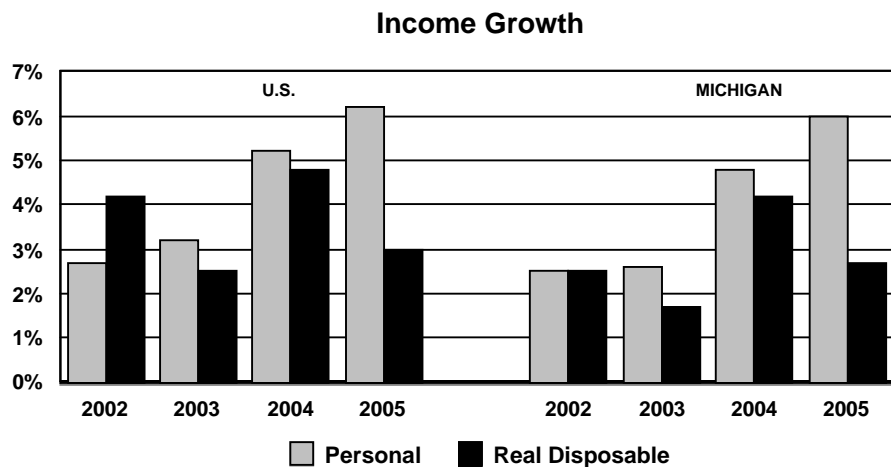
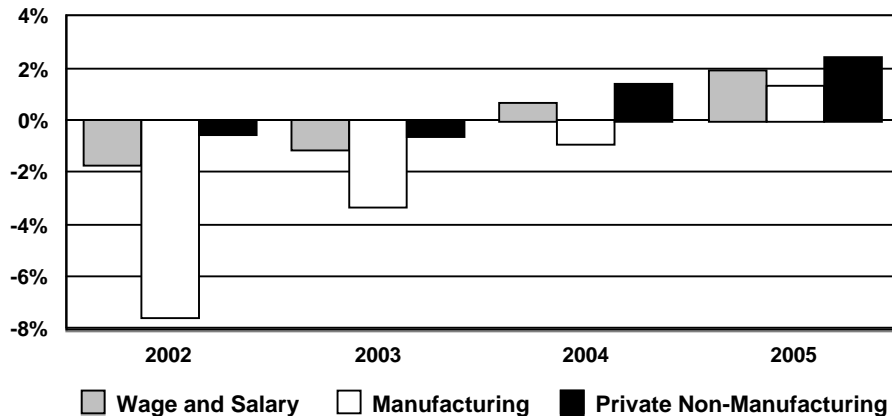


Figure 7

Michigan Employment Growth



■ **Employment: U.S.**

One critical reason underscoring the difference in income growth between the U.S. and Michigan is overall job growth. Some of this difference is due to Michigan’s reliance on the manufacturing sector for jobs. As previously noted, job growth over the past two years has been significantly more negative in Michigan than for the country as a whole.

■ **Employment: Michigan**

The Michigan economy has endured a weak labor market over the past three years. In CY 2002, wage and salary employment dropped by 1.7%; private nonmanufacturing employment fell by 0.5% while manufacturing employment declined by 7.5%.

Michigan wage and salary employment is forecast to fall by 1.1% in CY 2003 before growing by 0.7% in CY 2004 and 1.9% in CY 2005.

Michigan manufacturing employment is forecast to drop by 3.3% in CY 2003 and 0.9% in CY 2004 before rebounding to 1.3% in CY 2005. Although the most significant declines are

concentrated in the motor vehicle industry, employment declines are also spread throughout the rest of the manufacturing sector.

Michigan private nonmanufacturing employment is expected to decline by 0.6% in CY 2003, before growing by 1.4% in CY 2004 and 2.4% in CY 2005.

■ **Unemployment: U.S.**

Non-farm payroll employment increased slightly in CY 2003, but was unable to keep pace with the growth of the labor force, resulting in an increase in the unemployment rate.

The *U.S. unemployment rate* is estimated to be 6.0% in CY 2003, and is forecast to decrease to 5.6% in CY 2004 before dropping further to 5.1% in CY 2005.

■ **Unemployment: Michigan**

Michigan’s unemployment rate is predicted to be 7.1% in CY 2003, up from 6.2% in CY 2002. The unemployment rate is forecast to remain at 7.1% in CY 2004 before dropping to 6.2% in CY 2005.

Table 2

ECONOMIC FORECAST VARIABLES

	Calendar 2002 Actual	Calendar 2003 Estimated	% Change from Prior Year	Calendar 2004 Estimated	% Change from Prior Year	Calendar 2005 Estimated	% Change from Prior Year
<u>United States</u>							
Real Gross Domestic Product (Billions of 1996 dollars)	\$9,439.9	\$9,729.2	3.1%	\$10,180.0	4.6%	\$10,580.9	3.9%
Implicit Price Deflator GDP (1996 = 100)	110.7	112.4	1.6%	113.8	1.2%	116.1	2.0%
Consumer Price Index (1982-84 = 100)	179.9	184.1	2.3%	187.7	1.9%	192.4	2.5%
Personal Consumption Deflator (1992 = 100)	111.1	113.2	1.9%	115.1	1.7%	117.6	2.2%
3-month Treasury Bills Interest Rate (Percent)	1.6%	1.0%		1.9%		3.2%	
Aaa Corporate Bonds Interest Rate (Percent)	6.5%	5.7%		5.8%		6.0%	
Unemployment Rate - Civilian (Percent)	5.8%	6.0%		5.6%		5.1%	
Light Vehicle Sales (Millions of units)	16.7	16.5	-1.4%	16.9	2.6%	16.9	0.2%
Passenger Car Sales (Millions of units)	8.1	7.6	-5.7%	7.8	2.0%	7.8	0.3%
Light Truck Sales (Millions of units)	8.6	8.8	2.6%	9.1	3.2%	9.1	0.2%
Import Share of Light Vehicles (Percent)	19.7%	20.2%		19.2%		19.0%	
Personal Income (Billions of current dollars)	\$8,922.2	\$9,205.9	3.2%	\$9,688.8	5.2%	\$10,293.7	6.2%
Real Disposable Income (Billions of 1996 dollars)	\$7,032.2	\$7,206.8	2.5%	\$7,549.6	4.8%	\$7,776.4	3.0%
<u>Michigan</u>							
Wage and Salary Employment (Thousands)	4,476.5	4,425.1	-1.1%	4,454.4	0.7%	4,538.5	1.9%
Unemployment Rate (Percent)	6.2%	7.1%		7.1%		6.2%	
Personal Income (Millions of current dollars)	\$303,745	\$311,679	2.6%	\$326,729	4.8%	\$346,284	6.0%
Real Personal Income (Millions of 1982-84 dollars)	\$169,719	\$170,298	0.3%	\$175,237	2.9%	\$181,443	3.5%
Real Disposable Income (Millions of 1982-84 dollars)	\$150,275	\$152,868	1.7%	\$159,335	4.2%	\$163,618	2.7%
Wages and Salaries (Millions of current dollars)	\$173,529	\$175,081	0.9%	\$180,638	3.2%	\$189,397	4.8%
Detroit Consumer Price Index (1982-84 = 100)	179.0	183.0	2.3%	186.5	1.9%	190.9	2.4%



RISKS AND UNCERTAINTIES

An economic forecast is based on the best information available at the time the forecast is made. Because information and foresight are not perfect, risks and uncertainties are inherent in any forecast. The key risks in this forecast stem predominantly from uncertainties surrounding the labor market and productivity, the manufacturing sector, and Michigan's motor vehicle industry.

Labor Market and Productivity

Recovery from the most recent national recession has been characterized by economic growth and high productivity gains with ongoing losses in the job market. Since August, however, national non-farm payroll employment has increased on average by 98,000 (adjusted for the California grocery strike) jobs per month—weak by historical measures, but certainly an improvement from the early stages of the recovery.

In Michigan, the labor market has yet to turn around. Michigan wage and salary employment has generally declined since the first quarter of CY 2001—the most recent data indicates that Michigan wage and salary employment declined by 26,200 in the third quarter of CY 2003.

Productivity increased 2.4% on average between 1996 and 2001. After increasing at 4.4% in CY 2003, output per hour is estimated to increase 4.0% in 2004 and 2.3% in 2005. Businesses will continue to push for productivity increases, but increased hiring is expected to take over as the main factor in producing more output.

This forecast assumes that the national labor market will continue to improve, while the Michigan labor market will post modest employment gains beginning in the first quarter of 2004. If the labor market does not turn around as estimated, both the national economy and Michigan's economy could grow slower than anticipated and revenue growth would be adversely affected.

Manufacturing Sector

The manufacturing sector at the national level has improved over the last several months, but the Midwest manufacturing sector remains weak despite a strong showing in September.

Exports affect the manufacturing sector, and the value of the dollar relative to other currencies affects the competitiveness of U.S. manufacturers in the world market. This forecast assumes that as the economy improves and the value of the dollar declines, the manufacturing sector at both the national and state level will improve.

Michigan manufacturing employment is forecast to decline in CY 2004 and improve somewhat in CY 2005. If the manufacturing sector improves sooner than forecast, Michigan's employment and revenue will be higher than estimated.

Michigan's Motor Vehicle Industry

A significant component of Michigan's economy is the level and composition of light motor vehicle sales. Light vehicle sales are anticipated to be 16.5 million units in CY 2003 and are forecast to be 16.9 million in CY 2004 and in CY 2005. The import share of light vehicles was 20.2% in CY 2003 and is forecast to decrease to approximately 19% in CY 2004 and in CY 2005. The value of the dollar relative to other currencies is expected to continue to decline, which will make import vehicles less attractive.

Although a higher level of domestically-produced motor vehicle sales would generally be considered positive for Michigan, the benefit to Michigan may be muted. As reported by the *Detroit News*, the 2003 market share of the big three auto manufacturers—General Motors, Ford, and DiamlerChrysler—declined to an all-time low 60.3%. In addition, Michigan motor vehicle production declined 3.7% in FY 2002-03. Transplants (vehicles with a foreign nameplate that are made in the U.S.) have steadily gained in market share over the past several years. These transplants are expected to increase production capacity in the next few years, while the big three are expected to reduce capacity.

If the Michigan-produced market share of motor vehicles is less than anticipated, then Michigan's economy and revenue growth would be lower than estimated.



GF/GP AND SAF REVENUES

Revenue estimates are based on the economic performance of key components of national and state economies discussed in the preceding section. This section explains January 2004 House Fiscal Agency revenue estimates for GF/GP and School Aid Fund revenue by major revenue sources. It provides revenue estimates, year-end balances for the major funds and the budget stabilization fund, and the state revenue limit calculation.

GF/GP Revenue

■ ***GF/GP Baseline Tax Revenues***

Baseline GF/GP tax revenue totaled \$7,644.8 million in FY 2002-03. *General Fund/General Purpose baseline tax revenues* are estimated to increase \$179.4 million or 2.3% to \$7,824.2 million in FY 2003-04 and \$367.9 million or 4.7% to \$8,192.1 million in FY 2004-05.

■ ***Total GF/GP Baseline Revenues***

Total baseline GF/GP revenues include baseline tax revenues and non-tax revenues. *Total GF/GP baseline revenues* were \$7,935.9 million in FY 2002-03. General Fund/General Purpose baseline revenues are estimated to increase \$87.1 million or 1.1% to \$8,023.0 million in FY 2003-04 and \$367.9 million or 4.6% to \$8,390.9 million in FY 2004-05.

■ ***Actual GF/GP Revenues***

Actual GF/GP revenues take tax changes into account and are available for expenditure each year. *Actual GF/GP revenues* totaled \$7,925.5 million in FY 2002-03; they are forecast to

decline by \$97.0 million or 1.2% to \$7,828.5 million in FY 2003-04 then increase \$29.2 million or 0.4% to \$7,857.7 million in FY 2004-05.

SAF Revenue

■ ***Total SAF Baseline Revenues***

Total SAF baseline revenues were \$10,255.1 million in FY 2002-03. *School Aid Fund baseline revenues* are forecast to increase \$292.0 million or 2.8% to \$10,547.1 million in FY 2003-04 and \$367.1 million or 3.5% to \$10,914.2 million in FY 2004-05.

■ ***Actual SAF Revenues***

Actual SAF revenues represent own-source revenues available for expenditure each year, excluding prior year-end balances, GF/GP transfers to SAF, and BSF transfers to the SAF. *Actual SAF revenues* totaled \$10,714.7 million in FY 2002-03; revenues are forecast to decrease \$83.1 million or 0.8% to \$10,631.6 million in FY 2003-04 and increase \$376.8 million or 3.5% to \$11,008.4 million in FY 2004-05.

Table 3

GF/GP REVENUE ESTIMATES (Millions of Dollars)

	Final			FY 2004-05 over 2003-04	
	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>% Change</u>	<u>\$Change</u>
Personal Income Taxes	\$3,955.9	\$4,037.3	\$4,297.3	6.4%	\$260.0
Sales and Use Taxes	876.1	937.3	960.9	2.5%	23.6
SBT and Insurance Taxes	2,114.0	2,150.5	2,240.0	4.2%	89.5
Other Taxes	<u>698.6</u>	<u>699.1</u>	<u>693.9</u>	-0.8%	<u>(5.3)</u>
GF/GP Baseline Tax Revenues	\$7,644.8	\$7,824.2	\$8,192.1	4.7%	\$367.9
Non-Tax Revenue	<u>291.1</u>	<u>198.8</u>	<u>198.8</u>	0.0%	<u>0.0</u>
Total GF/GP Baseline Revenues	\$7,935.9	\$8,023.0	8,390.9	4.6%	\$367.9
Adjustments to Baseline	<u>(10.4)</u>	<u>(194.5)</u>	<u>(533.2)</u>	174.1%	<u>(\$338.7)</u>
Actual GF/GP Revenues	\$7,925.5	\$7,828.5	\$7,857.7	0.4%	\$29.2

NOTE: Numbers may not add due to rounding.

Table 4

SCHOOL AID FUND REVENUE ESTIMATES (Millions of Dollars)

	Final			FY 2004-05 over 2003-04	
	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>% Change</u>	<u>\$ Change</u>
Sales and Use Tax	\$5,091.6	\$5,263.2	\$5,491.1	4.3%	227.9
Income Tax Earmark	1,846.9	1,907.2	2,003.4	5.0%	96.1
State Education Tax	1,672.8	1,739.1	1,785.0	2.6%	45.9
Lottery Transfers	676.9	674.5	678.5	0.6%	4.0
Tobacco Taxes	489.0	479.5	471.4	-1.7%	(8.2)
Real Estate Transfer Tax	275.5	275.0	275.0	0.0%	0.0
Other Taxes	<u>202.4</u>	<u>208.5</u>	<u>209.8</u>	0.6%	<u>1.3</u>
Baseline SAF Revenues	\$10,255.1	\$10,547.1	\$10,914.2	3.5%	\$367.1
Adjustments to Baseline	<u>459.6</u>	<u>84.5</u>	<u>94.3</u>	<u>11.6%</u>	<u>\$9.8</u>
Actual SAF Revenues	\$10,714.7	\$10,631.6	\$11,008.4	3.5%	\$376.8

NOTE: Numbers may not add due to rounding.

Table 5

YEAR-END BALANCE ESTIMATES (Millions of Dollars)

	<u>Final FY 2001-02</u>	<u>Final FY 2002-03</u>	<u>Estimated FY 2003-04</u>
General Fund/General Purpose	\$114.5	\$174.0	\$0.0
School Aid Fund	\$237.0	\$113.7	\$0.0
Budget Stabilization Fund	\$145.2	\$0.0	\$0.0

HFA Estimates of Year-End Balances

Table 5 reports House Fiscal Agency estimates of year-end balances for GF/GP, the SAF, and the BSF for FY 2003-04, and includes final FY 2001-02, and 2002-03 figures.

Budget Stabilization Fund estimates are based on current balance estimates provided by the Michigan Department of Treasury and HFA estimates of future deposits and interest earned.

School Aid Fund revenues are restricted; hence, any year-end balance is carried forward to the subsequent year.

BSF Year-End Balances

The Counter-Cyclical Budget and Economic Stabilization Fund (BSF), or the state's rainy day fund, is a reserve of cash to contribute to or withdraw from throughout economic and budget cycles. Table 6 shows deposits, withdrawals, interest earnings, and the year-end balance from FY 1989-90 through FY 2002-2003. It also

includes HFA estimates for FY 2003-04 and FY 2004-05. Figure 8 depicts the BSF fund balance and fund balance as a percent of total GF/GP and SAF revenues from FY 1990-91 through FY 2004-05.

■ ***FY 2002-03***

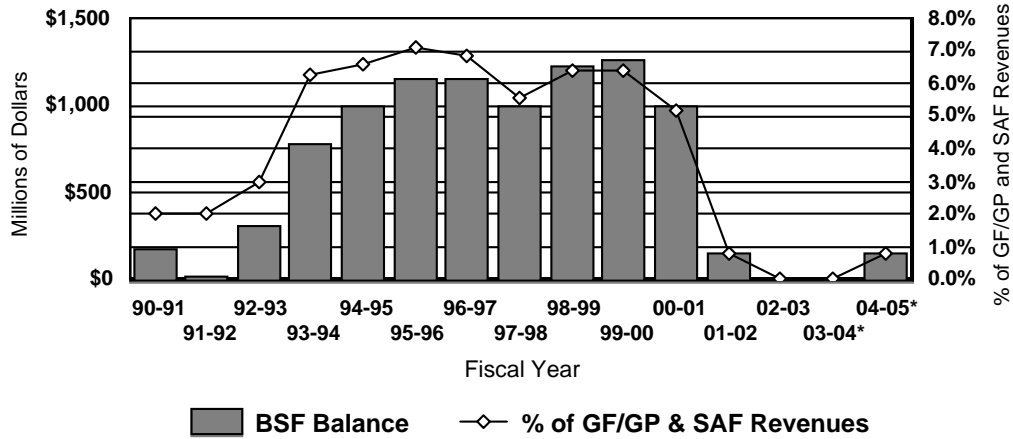
The BSF balance was eliminated at the end of FY 2002-03. Withdrawals consisted of the following: \$32.0 million to the SAF for the Durant settlement and \$124.1 million to GF/GP.

■ ***FY 2003-04 and FY 2004-05***

The BSF trigger calculation, which is based on Michigan personal income less transfer payments adjusted for inflation and actual or net GF/GP revenue, indicates that no pay-in or withdrawal is determined for FY 2003-04. However, the trigger calculation shows a \$67.7 million pay-in for FY 2004-05. In addition, under the Tobacco Products Tax Act, 17.808% of the cigarette tax and 18.4% of the other tobacco products tax is earmarked to the BSF for FY 2004-05 through FY 2006-07. This pay-in is estimated at \$153.6 million in FY 2004-05.

Figure 8

**Budget Stabilization Fund
Dollars and Percent of Revenues**



*HFA estimates

Table 6

**BUDGET STABILIZATION FUND
(Millions of Dollars)**

<u>Fiscal Year</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Interest Earned</u>	<u>Balance</u>
1989-90	\$0.0	\$69.9	\$35.8	\$385.1
1990-91	0.0	230.0	27.1	182.2
1991-92	0.0	170.1	8.1	20.1
1992-93	282.6	0.0	0.7	303.4
1993-94	460.2	0.0	11.9	775.5
1994-95	260.1	90.4	57.7	1,003.0
1995-96	91.3	0.0	59.2	1,153.6
1996-97	0.0	69.0	67.8	1,152.4
1997-98	0.0	212.0	60.1	1,000.5
1998-99	244.4	73.7	51.2	1,222.5
1999-2000	100.0	132.0	73.9	1,264.4
2000-01	0.0	337.0	66.7	994.2
2001-02	0.0	869.8	20.8	145.2
2002-03	0.0	156.1	10.9	0.0
2003-04*	0.0	0.0	0.0	0.0
2004-05*	153.6**	0.0	0.0	153.6

NOTE: Numbers may not add due to rounding

* HFA Estimates

**Statutory (2002 PA 503) Deposit of Tobacco Tax Monies

Compliance with the State Revenue Limit

Article IX, Section 26 of the *Michigan Constitution*, which was approved by the vote of the people in 1978, sets a limit on the amount of revenue collected by the state in any fiscal year. As provided for in the Constitution, the revenue limit is calculated as 9.49% of total state personal income, which is the broadest measure of state economic activity, in the previous full calendar year prior to the fiscal year in which the revenues are measured. The revenue to be considered in the revenue limit includes not only state taxes, but also fees, licenses, and interest earned. Federal aid is not included in the revenue limit calculation.

established in this section by 1% or more, the excess revenues shall be refunded pro rata based on the liability reported on the Michigan income tax and single business tax (or its successor tax or taxes) annual returns filed following the close of such fiscal year. If the excess is less than 1%, this excess may be transferred to the State Budget Stabilization Fund. . . .

Implications of Exceeding the State Revenue Limit

Article IX, Section 26, *Constitution of the State of Michigan*, provides that:

Furthermore, the state is prohibited from spending any current-year revenue in excess of the limit established in Section 26 by Article IX, Section 28.

The final FY 2001-02 revenue limit calculation indicated that state revenue collections were \$3.92 billion below the revenue limit. In addition, for FY 2002-03 through FY 2004-05, state revenues are estimated to be substantially below the revenue limit, by \$4.57 billion, \$5.21 billion, and \$5.48 billion respectively.

. . . For any fiscal year in the event that Total State Revenues exceed the limit

Table 7

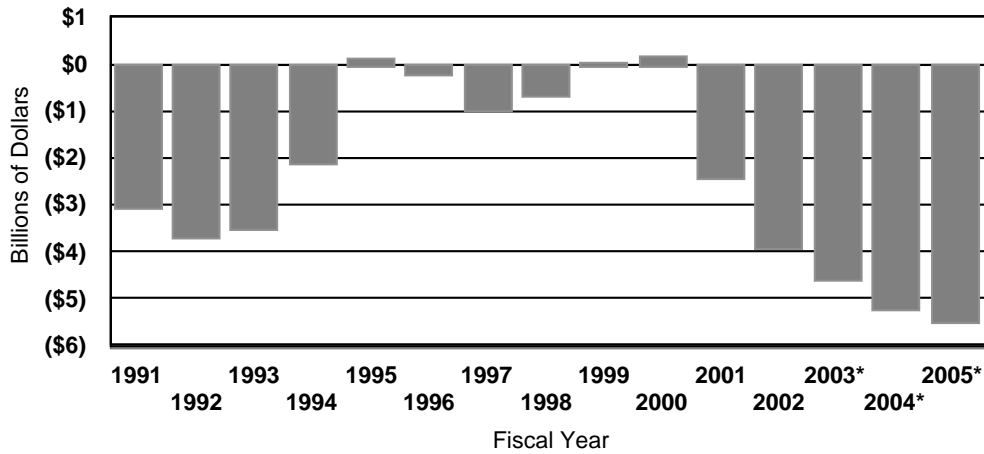
**COMPLIANCE WITH THE STATE REVENUE LIMIT
(Millions of Dollars)**

<u>Revenue Limit Calculations</u>	<u>Final FY 2001-02</u>	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>
Personal Income				
Calendar Year	CY 2000	CY 2001	CY 2002	CY 2003
Amount	\$289,390	\$297,609	\$303,745	\$311,679
Multiplied by Limit Ratio	<u>9.49%</u>	<u>9.49%</u>	<u>9.49%</u>	<u>9.49%</u>
State Revenue Limit	\$27,463.1	\$28,243.1	\$28,825.4	\$29,578.3
Total Revenues Subject to Revenue Limit	<u>23,546.0</u>	<u>23,669.6</u>	<u>23,612.5</u>	<u>24,095.6</u>
Amount (Under) Over State Revenue Limit	(\$3,917.1)	(\$4,573.5)	(\$5,212.9)	(\$5,482.7)

NOTE: Numbers may not add due to rounding.

Figure 9

**Constitutional Revenue Limit
Amount Under or Over Limit**



* HFA Estimate

Table 8

**CONSTITUTIONAL REVENUE LIMIT
(Billions of Dollars)**

<u>Fiscal Year</u>	<u>(Under) or Over Limit</u>	<u>Fiscal Year</u>	<u>(Under) or Over Limit</u>
1979-80	(\$0.53)	1992-93	(\$3.48)
1980-81	(\$1.17)	1993-94	(\$2.11)
1981-82	(\$1.41)	1994-95	\$0.11
1982-83	(\$1.32)	1995-96	(\$0.18)
1983-84	(\$0.24)	1996-97	(\$0.98)
1984-85	(\$0.01)	1997-98	(\$0.64)
1985-86	(\$0.37)	1998-99	\$0.02
1986-87	(\$0.84)	1999-00	\$0.16
1987-88	(\$1.35)	2000-01	(\$2.41)
1988-89	(\$1.03)	2001-02	(\$3.92)
1989-90	(\$1.76)	2002-03*	(\$4.57)
1990-91	(\$3.04)	2003-04*	(\$5.21)
1991-92	(\$3.69)	2004-05*	(\$5.48)

* HFA Estimates



Additional copies of this report can be obtained from:

House Fiscal Agency
P.O. Box 30014
Lansing, MI 48909-7514
(517) 373-8080
FAX (517) 373-5874
www.house.mi.gov/hfa