STATE BUDGET UPDATE

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

Economic Update

Real Gross Domestic Product (GDP)

The National Bureau of Economic Research has released a report stating that the United States economic recession ended in June 2009. This economic trough marks the end of a recession that began in December 2007 and lasted for 18 months. This makes the past recession the longest recession in the United States since World War II.

Real GDP has grown over the past year. Real GDP increased by 1.6% in the 3rd Quarter of 2009, by 5.0% in the 4th Quarter of 2009, by 3.7% in the 1st Quarter of 2010, and by 1.7% in the 2nd Quarter of 2010.

The State of Michigan's official economic forecast is for Real GDP to increase by 3.1% in 2010 and by 2.9% in 2011. Real GDP declined by 2.4% in 2009.

Consumer Confidence

Consumer confidence, as measured by the Thomson Reuters/University of Michigan index, dropped to a one-year low in the most recent reading. The current level of consumer confidence is an improvement over the levels recorded in 2008 and 2009, but is still at very low levels. This issue likely will lead to restrained growth in the United States economy.

Light Vehicle Sales

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

2010 forecast of 11.7 million units is up 12.5% from 2009, but down 29.5% from the 2002 through 2007 average of 16.6 million units. Light vehicle sales are expected to total 13.3 million units in 2011, an increase of 13.7% over 2010.

In the mid-1990s, the Detroit 3 companies sold 73.0% of the total U.S. light vehicle sales (about 11 million units). During 2010 the Detroit 3 companies' market share will be about 43.0% of light vehicle sales (about 5 million units).

Retail Sales

Retail sales fell by 10.3% between June 2008 and December 2008, the largest drop since records started in 1947.

Retail sales have improved since December 2008, but sales are still relatively weak in an historical context. Retail sales in July 2010 are up 7.7% from March 2009, but down 1.2% from April 2010. July 2010 retail sales are down 4.1% from the June 2008 peak.

Housing Starts

April 2009 housing starts were at the lowest level since records began in 1959. Housing starts have been higher since April 2009. The August 2010 housing start level is 25.4% above the April 2009 low point. However, the current level of housing starts has declined by 12.0% over the past four months.

Housing starts are expected to rise by 21.8% in 2010 and by 65.2% in 2011. In spite of this rapid growth in housing starts, the 2011 housing start level will be 35.0% below the average level of housing starts recorded in the 2000 through 2007 period.

United States Labor Market

The economy lost 8.4 million payroll jobs between December 2007 and December 2009, the largest drop since modern records began in 1939.

Payroll jobs have increased by 723,000 jobs or 0.6% since December 2009. Payroll employment increased for five consecutive months (January through May 2010) before declining for the past three months (June through August 2010).

Michigan Labor Market

On an annual basis, payroll employment has declined for nine consecutive years, the longest decline on record. Payroll employment is estimated to decline by 1.2% in 2010 and remain flat in 2011.

As of August 2010, Michigan has lost 859,300 payroll jobs from the June 2000 peak, a decline of 18.3%. Job loss in the manufacturing sector accounts for 442,600 of the total jobs lost since June of 2000 or 51.5% of the total payroll employment decline.

Hourly jobs in the transportation equipment manufacturing sector have declined by 226,000 or 64.0% from the June 2000 peak.

The total level of payroll employment in Michigan during August 2010 is roughly equal to the number of jobs that existed in the State during 1988.

Michigan Personal Income

Michigan personal income declined by 3.0% in 2009 (without adjusting for inflation) and is expected to increase by 1.2% in 2010 and 2.6% in 2011.

The 3.0% decline in nominal personal income in 2009 was the first decline since 1958.

Michigan personal income per capita, compared with the national average, has dropped dramatically in recent years. During 2000, Michigan personal income per capita ranked 18th among the states. During 2009, Michigan personal income per capita ranked 37th among the states. The 2010 ranking of Michigan personal income per capita is anticipated to be 40th among the states. Michigan has moved from an above-average wealth state to a state ranked in the bottom 10 of the states in terms of income over the past decade.

Signs of Economic Turnaround?

The United States economic recession has ended. The future level of economic growth is likely to be restrained by a combination of historically low consumer confidence, historically slow growth in employment, and continuing problems in the housing sector.

National retail sales, housing starts, and auto sales have all improved recently, but are still below long-term historical growth levels.

Michigan payroll employment is basically flat over the past 12 months. This is considerable improvement over the 6.9% job loss recorded in 2009.

Revenue Estimate Update

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 $6.7 billion, which is down by $710.7 million or 9.6% from FY 2008-09. Over two fiscal years, GF/GP revenue has declined by $2.7 billion or 28.9%.

FY 2010-11: Revenue from ongoing sources will total $7.1 billion, which is up $441.8 million or 6.6% from FY 2009-10. A significant portion of the FY 2009-10 revenue decline and the FY 2010-11 GF/GP revenue increase involves timing regarding payments of tax refunds under the Michigan Business Tax.

There are two major reasons for the steep decline in GF/GP revenue in FY 2008-09 and FY 2009-10. The first reason is the steep drop in employment in Michigan, coupled with the fact that a significant number of these jobs were high paying manufacturing jobs. The second reason involves enacted tax policy changes. Over the past two fiscal years, changes in tax laws -- such as the earned income tax credit and the subsidies to the film industry – have had a significant impact on GF/GP revenue.

School Aid Fund (SAF)

FY 2008-09: Earmarked tax and lottery revenue totaled $10.9 billion, which is down by $588.0 million or 5.1%.

FY 2009-10: Earmarked tax and lottery revenue will total $10.7 billion, which is down by $172.3 million or 1.6% from FY 2008-09. Over two fiscal years, SAF revenue has declined by $760.1 million or 6.6%.

FY 2010-11: Earmarked tax and lottery revenue will total $10.8 billion, which is up by $83.0 million or 0.8%.

State Revenue Update

Since the official consensus revenue estimates of the State were agreed upon in May 2010, actual revenue collections of both GF/GP and SAF revenue have slightly exceeded the consensus estimates. The official consensus revenue estimates will be revised in early January 2011.

Recent State Revenue History

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. During FY 1999-2000, actual State revenue collections exceeded the limit by $159.7 million. Revenue equaled 9.55% of Michigan personal income.

During FY 2009-10, State revenue collections are estimated to be $8.8 billion under the constitutional revenue limit. Estimated FY 2009-10 revenue will equal 6.96% of Michigan personal income.

This means the size of State government in Michigan over the past decade has declined in a very significant manner. The Governor and the Legislature could raise state taxes by $8.8 billion and still not be over a constitutional revenue limit that was exceeded a decade ago.

A significant portion of this decline in State revenue over the past decade is related to the large increases in the level of State tax expenditures. These tax deductions, exclusions, and credit totaled $14.1 billion or 57.8% of total State revenue in FY 1999-2000. During FY 2009-10, State tax expenditures are estimated to total $26.2 billion or 107.5% of total State tax revenue.

The combination of the economic collapse in the State over the past decade and the growth in State tax expenditures has resulted in a situation that total State revenue has decreased by $29.8 million or 0.1% over the past decade. This is the fundamental cause of the problems in the State budget in recent years.

Fiscal Year 2009-10 State Budget Update

Over the past month, the Governor and the Legislature took action to ensure that the FY 2009-10 State budget was balanced between estimated revenue and expenditures. When the final accounting of FY 2009-10 revenue and expenditures is completed, both the GF/GP and SAF budgets should close the fiscal year with a modest positive year-end balance.

The FY 2009-10 GF/GP budget was balanced due to a transfer of $208.4 million of surplus SAF revenue. Depending on the actual level of revenue and appropriations, a modest surplus of between $50.0 million and $100.0 million should exist when the final accounting of revenue and expenditures is completed.

The FY 2009-10 SAF budget is expected to close the year with a surplus of between $150.0 million and $200.0 million when the final accounting of revenue and expenditures is completed.

The key factor in the ability of the Governor and the Legislature to balance the FY 2009-10 State budget involves the use of temporary Federal funds. These temporary Federal funds were available under provisions of the American Recovery and Reinvestment Act of 2009 (ARRA). During FY 2009-10 ARRA funds supported $1.2 billion of GF/GP appropriations and $450.0 million of SAF appropriations. These Federal ARRA funds helped the State offset the impact of a 9.6% decline in GF/GP revenue and a 1.6% decline in SAF revenue.

The enacted FY 2009-10 State budget did include significant reductions in appropriations from the prior fiscal year. These appropriations reductions included the elimination of the $140.0 million Michigan Promise Grant scholarship program, $148.0 million in reductions to human services programs, $141.4 million reduction in community health programs, $148.0 million reduction in revenue sharing payments to units of local government, and a $154-per-pupil reduction in State aid to local school districts.

Fiscal Year 2010-11 State Budget Update

The Michigan Legislature completed action on the FY 2010-11 State budget on September 29, 2010. The enacted budget contains no changes in State tax policy and is balanced with a combination of appropriation reductions, the appropriation of temporary Federal funds and one-time revenue sources.

The major appropriation reductions in the enacted budget include a 2.8% reduction in operations funding for universities; modest reductions in the Corrections, Human Services, and Community Health budgets; and modest reductions in the operating budgets for most State departments, the Judiciary, and the Legislature. Revenue sharing payments to units of local government, State operations funding for community colleges and State-financed support for K-12 education programs are frozen at the current-year funding levels.

The appropriation of temporary Federal funds is an important component in the FY 2010-11 State budget. A total of $680.0 million of temporary Federal funding has resulted in a reduction in GF/GP appropriations in the Medicaid budget. The Department of Human Services budget is being supported by $239.0 million of temporary Federal funding. The FY 2010-11 K-12 SAF budget includes $500.6 million of temporary Federal funds.

One-time revenue items assumed in the FY 2010-11 State budget include: $168.0 million from statutory changes regarding the treatment of unclaimed property, $87.9 million from a tax amnesty program, and $11.0 million from the transfer of surplus one-time restricted revenue accounts.

The combination of the expected elimination of the temporary Federal funds and the elimination of one-time revenue sources is expected to put significant pressure on the FY 2011-12 State budget.

Fiscal Year 2011-12 State Budget Outlook

The newly elected Governor and the newly elected members of the Michigan Legislature will face significant challenges in terms of developing a FY 2011-12 State budget.

The major issue impacting on the FY 2011-12 State budget outlook involves the expected elimination of Federal funds that have been used to balance the State budget in FY 2008-09, FY 2009-10, and FY 2010-11.

During FY 2008-09, FY 2009-10, and FY 2010-11, approximately $4.6 billion of temporary Federal funds have been used to help balance both the GF/GP and SAF budgets. The expectation is that these Federal funds will not be available to states in FY 2011-12.

The FY 2010-11 enacted GF/GP budget includes $919.0 million of temporary Federal funds and $240.8 million of revenue from one-time sources. In addition, based on current law, the rate of the State income tax will decline from 4.35% to 4.25% on October 1, 2011. This income tax rate reduction will reduce FY 2011-12 GF/GP revenue by $150.0 million. The combination of the temporary Federal funds, the one-time revenue sources, and the reduction in the income tax rate equals over $1.3 billion. This represents 15.7% of the enacted FY 2010-11 GF/GP appropriations.

The FY 2010-11 enacted SAF budget includes $500.6 million of temporary Federal funds and $26.1 million of revenue from one-time sources. In addition, the FY 2010-11 SAF budget assumes the spend down of $70.0 million of a projected beginning balance during the fiscal year. The combination of the temporary Federal funds, the one-time revenue sources, and the spend down of the beginning balance equals $596.7 million. This represents 4.5% of the enacted FY 2010-11 SAF appropriations.

This FY 2011-12 does not take into account any cost pressures in the budget including employee costs, health care costs, and potential caseload adjustments in the budget. The budget challenges facing Michigan in FY 2011-12 are large.