

ECONOMIC OUTLOOK
AND
REVENUE ESTIMATES
FOR MICHIGAN



FISCAL YEARS
2001-02 AND 2002-03

HOUSE
FISCAL
AGENCY

Mitchell E. Bean, Director
May 2002

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 for fiscal year (FY) 2000-01, and the revised revenue estimates for FY 2001-02 and FY 2002-03. The estimates reported herein will be presented to the Consensus Revenue Estimating Conference on May 16, 2002, 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 2003, estimates of the Countercyclical Budget Stabilization Fund, state compliance with the Constitutional State Revenue Limit, and year-end balance estimates for 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.

TABLE OF CONTENTS

Executive Summary	1
U.S. Forecast	1
Michigan Forecast	1
State Revenues	2
State Revenue Limit	2
Year-End Fund Balances	2
Baseline and Actual Revenue Estimates	2
TABLE 1: HFA Revenue Estimates	3
TABLE 2: FY 2001-02 HFA Recommended Revisions	3
TABLE 3: FY 2002-03 HFA Recommended Revisions	3
Economic Review and Forecast	5
FIGURE 1: NAPM Index	6
FIGURE 2: Consumer Sentiment Index	6
Real GDP	6
FIGURE 3: Change in Real GDP	7
Interest Rates	7
Housing Market	7
Light Vehicle Sales	7
FIGURE 4: Light Vehicle Sales	8
Inflation: U.S.	8
Inflation: Michigan	8
FIGURE 5: Inflation Rates	9
Income Growth: U.S.	9
Income Growth: Michigan	9
FIGURE 6: Income Growth	9
FIGURE 7: Wage and Salary Employment Growth	10
Employment: U.S.	10
Employment: Michigan	10
FIGURE 8: Michigan Employment Growth	10
Unemployment: U.S.	11
Unemployment: Michigan	11
FIGURE 9: Unemployment Rates	11
Data Revisions: Michigan Employment and Personal Income	12
TABLE 2: Economic Variables	13

Risks and Uncertainties	15
Business Fixed Investment	15
Consumer Behavior	15
Government Policy	15
Monetary Policy	15
Fiscal Policy	16
GF/GP and SAF Revenues	17
TABLE 3: GF/GP Revenue Estimates	17
GF/GP Revenue by Source	18
Personal Income Tax	18
Sales and Use Taxes	18
Single Business and Insurance Taxes	18
GF/GP Baseline Tax Revenues	18
Total GF/GP Baseline Revenues	18
Actual GF/GP Revenues	18
SAF Revenue by Source	18
Sales and Use Taxes	18
Income Tax	18
TABLE 4: School Aid Fund Revenue Estimates	19
State Education Tax	19
Lottery Transfers and Casino Wagering Tax	19
Tobacco Taxes	19
Real Estate Transfer Tax	19
Total SAF Baseline Revenues	19
Actual SAF Revenues	20
HFA Estimates of Year-End Balances	20
TABLE 5: Year-End Balance Estimates	20
FIGURE 9: Budget Stabilization Fund	21
TABLE 6: Budget Stabilization Fund	21
BSF Year-End Balances	22
Compliance With State Revenue Limit	22
Implications of Exceeding State Revenue Limit	22
TABLE 7: Compliance With the State Revenue Limit	23
FIGURE 10: Constitutional Revenue Limit	24
TABLE 8: Constitutional Revenue Limit	24



EXECUTIVE SUMMARY

The pace of economic growth was weak at both the national and state levels in fiscal year (FY) 2000-01. While some of the current national economic news is encouraging, it is expected that Michigan's economy will continue to remain relatively weak in FY 2001-02. In FY 2002-03, Michigan's economy is forecast to improve and shrink the economic gap with the United States (U.S.). Based on final figures, baseline General Fund/General Purpose (GF/GP) revenues declined 4.3%, while School Aid Fund (SAF) revenues grew 1.2% in FY 2000-01. Baseline figures are used to evaluate growth due to underlying economic factors and do not include the effects of tax policy changes.

The House Fiscal Agency (HFA) expects economic growth for the U.S. and Michigan to improve during CY 2002 and CY 2003. Important aspects of the HFA forecast are summarized as follows.

U. S. Forecast

Real GDP growth will accelerate from 1.2% in CY 2001 to 2.4% in CY 2002. Real GDP is forecast to grow 3.3% in CY 2003.

Inflation, as measured by the Consumer Price Index (CPI), will decline from 2.8% in CY 2001 to 1.5% in CY 2002, then accelerate to 2.8% in CY 2003.

Light vehicle sales totaled 17.0 million units in CY 2001 and are forecast to fall to 16.3 million units in CY 2002, then increase to 16.6 million units in CY 2003.

The national unemployment rate, which was 4.8% in CY 2001, is forecast to increase to 5.7% in CY 2002, then fall to 5.4% in CY 2003. The unemployment rate was 5.6% in the first quarter and is expected to peak at just under 6.0% in the third/fourth quarter of CY 2002.

Interest rates on three-month T-bills averaged 3.4% in CY

2001 and are forecast to decline to 2.0% in CY 2002 before increasing to 3.6% in CY 2003.

Michigan Forecast

Michigan personal income increased 1.8% in CY 2001. Michigan's personal income growth for 2001 was ranked as the 49th lowest in the U.S. The rate of growth will remain weak at 2.7% in CY 2002 and then pick up to 5.0% in CY 2003.

Michigan's unemployment rate was 5.3% in CY 2001, and is forecast to increase to 6.3% in CY 2002, and moderately decline to 5.9% in CY 2003. Michigan's unemployment rate is expected to peak at 6.4% in the third/fourth quarter of CY 2002.

Inflation, as measured by the Detroit Consumer Price Index, was 2.7% in CY 2001 and is forecast to decline to 2.1% in CY 2002, then grow to 2.7% in CY 2003.

U State Revenues

Final total baseline GF/GDP and SAF revenues were \$19.0 billion in FY 2000-01, and are forecast to decline 0.4% to \$18.9 billion in FY 2001-02, followed by an increase of 4.4% to \$19.7 billion in FY 2002-03. Baseline revenues do not include prior-year fund balances or reflect the effects of recent tax policy changes.

Final total actual GF/GDP and SAF revenues were \$19.0 billion in FY 2000-01 and are forecast to decline \$411.0 million or 2.2% in FY 2001-02 and increase \$400.8 million or 2.2% to \$19.0 billion in FY 2002-03.

Actual revenues are resources available. Not included in actual revenues is the fiscal impact of 2002 PAs 243 and 244, the SET timing and rate reduction changes, which would increase SAF revenue by an estimated \$494.5 million in FY 2002-03. Under current law, the lottery prize payout rate will be reduced to 45% on January 1, 2003; this will reduce SAF revenues by an estimated \$145.0 million in FY 2002-03. Enactment of Senate Bill 1230 would prevent the lottery loss of \$145.0 million.

U State Revenue Limit

Final total state revenues are expected to be below the state revenue limit by \$2.5 billion in FY 2000-01 and are estimated to be under the limit by \$4.1 billion in FY 2001-02 and \$3.7 billion in FY 2002-03.

Final calculation of the state revenue limit is performed by the Auditor General.

U Year-End Fund Balances

The year-end GF/GDP balance was \$28.0 million in FY 2000-01. No year-end balance is estimated for FY 2001-02.

The School Aid Fund year-end balance was \$694.8 million in FY 2000-01. No year-end balance is estimated for FY 2001-02.

The Countercyclical Budget Stabilization Fund year-end balance was \$994.1 million in FY 2000-01 and is forecast to be \$448.5 million in FY 2001-02 and \$224.9 million in FY 2002-03.

U Baseline and Actual Revenue Estimates

Table 1 reports GF/GDP 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/GDP 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/GDP.

Tables 2 and 3 report HFA's GF/GDP and SAF recommended revisions for FY 2001-02 and FY 2002-03.

Table 1

HFA REVENUE ESTIMATE\$ (Millions of Dollars)

	Final FY 2000-01	HFA Estimate FY 2001-02	HFA Estimate FY 2002-03
<u>BASELINE</u>			
CF/GP	\$8,962.5	\$8,715.5	\$9,123.0
SAF	<u>9,994.0</u>	<u>10,159.9</u>	<u>10,589.9</u>
TOTAL	\$18,956.5	\$18,875.4	\$19,712.9
<u>ACTUAL</u>			
CF/GP	\$8,989.5	\$8,416.7	\$8,403.3
SAF	<u>9,994.0</u>	<u>10,143.9</u>	<u>10,558.1</u>
TOTAL	\$18,983.5	\$18,560.6	\$18,961.4

NOTE: Numbers may not add due to rounding.

Table 2

FISCAL YEAR 2001-02 HFA RECOMMENDED REVISIONS\$ (Millions of Dollars)

	January 2002 <u>Consensus</u>	HFA May 2002 <u>Recommendation</u>	Recommended <u>Revision</u>
<u>BASELINE</u>			
CF/GP	\$9,055.4	\$8,715.5	(\$339.9)
SAF	<u>10,233.4</u>	<u>10,159.9</u>	<u>(73.5)</u>
TOTAL	\$19,288.8	\$18,875.4	(\$413.5)
<u>ACTUAL</u>			
CF/GP	\$8,758.3	\$8,416.7	(\$341.6)
SAF	<u>10,213.4</u>	<u>10,143.9</u>	<u>(69.4)</u>
TOTAL	\$18,971.6	\$18,560.6	(\$411.0)

NOTE: Numbers may not add due to rounding.

Table 3

FISCAL YEAR 2002-03 HFA RECOMMENDED REVISIONS\$ (Millions of Dollars)

	January 2002 <u>Consensus</u>	HFA May 2002 <u>Recommendation</u>	Recommended <u>Revision</u>
<u>BASELINE</u>			
CF/GP	\$9,452.0	\$9,123.0	(\$329.0)
SAF	<u>10,632.6</u>	<u>10,589.9</u>	<u>(42.7)</u>
TOTAL	\$20,084.6	\$19,712.9	(\$371.7)
<u>ACTUAL</u>			
CF/GP	\$8,724.2	\$8,403.3	(\$320.9)
SAF	<u>10,596.6</u>	<u>10,558.1</u>	<u>(38.6)</u>
TOTAL	\$19,320.8	\$18,961.4	(\$359.4)

NOTE: Numbers may not add due to rounding.



ECONOMIC REVIEW AND FORECAST

This section presents a review and forecast of the economy. This forecast was used by the House Fiscal Agency to produce its updated revenue forecasts for FY 2001-02 and FY 2002-03.

The longest U.S. economic expansion on record ended in March 2001 as the economy slid into a recession. While the tragic events of September 11 were detrimental, the economy had begun to slow several months before. There are signals that the recession will be modest, and that positive growth will return in CY 2002 before picking up in CY 2003. Real GDP, which grew at a 1.2% rate in CY 2001, is forecast to grow by 2.4% in CY 2002 and by 3.3% in CY 2003.

Figure 1 shows the Institute for Supply Management Index (ISM), formerly the National Association of Purchasing Managers Index, from January 1999. An index number above 50 indicates a growing manufacturing sector, while a number below 50 suggests that the manufacturing sector is contracting.

Figure 1

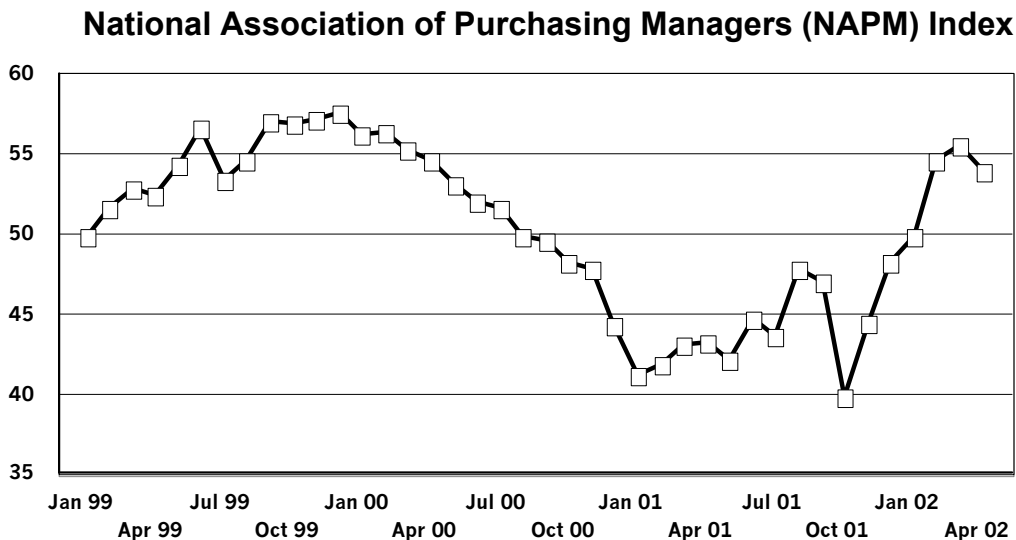
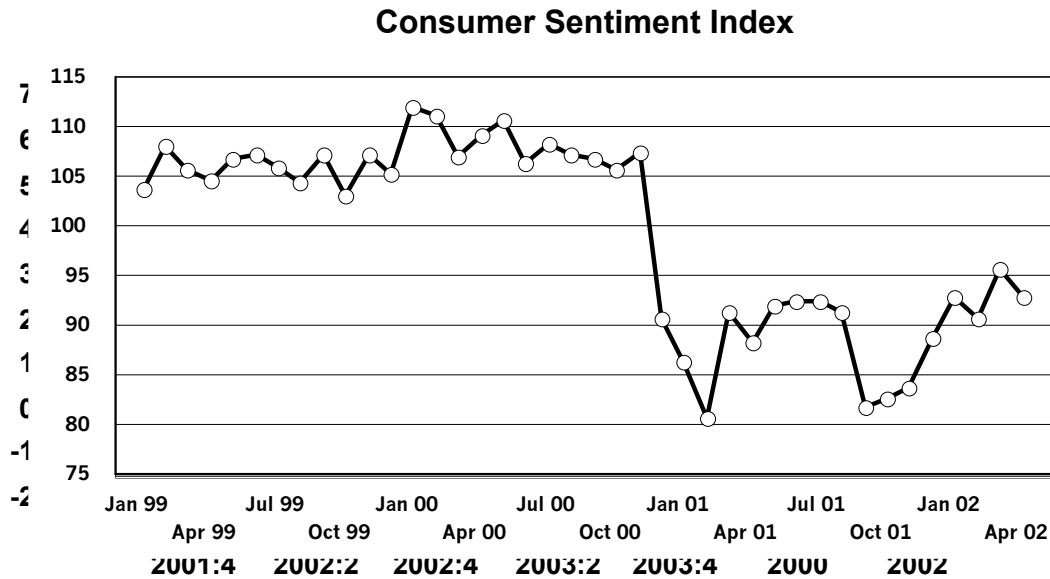


Figure 2



The index reached a peak in December 1999, and then began a downward trend. It fell below 50 in August 2000. After apparently bottoming out in January 2001, it started to recover but plummeted again following the terrorist attacks. However, since October 2001 the index has risen steadily to the point that even with a small drop in April 2002, the index stands at 53.9. This upward trend is encouraging and indicates that the manufacturing sector grew during the first quarter of 2002.

A 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.

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. Since that point, it has enjoyed a generally upward trend, although like the ISM Index, it dipped modestly in April 2002.

U Real GDP

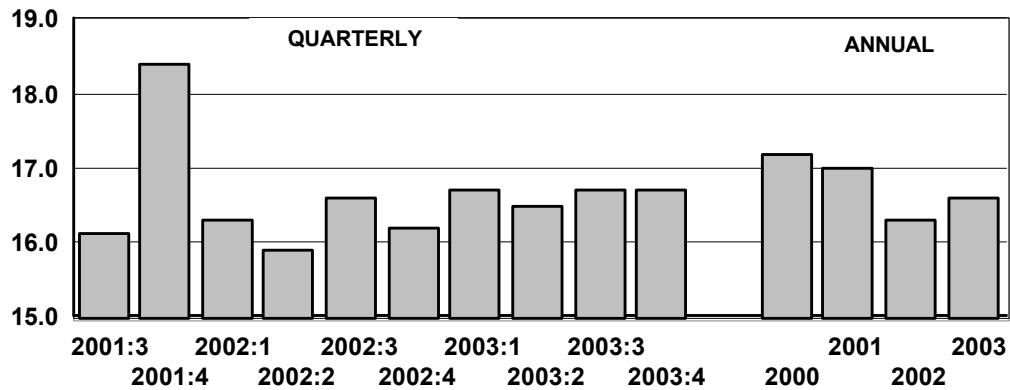
After falling by 1.3% during the third quarter of 2001, real GDP rose by 1.7% during the fourth quarter and posted an advance (which is subject to revision) 5.8% annual increase during the first quarter of 2002. Final sales of domestic product (GDP less inventories), which is a better measure of economic activity, grew at a 2.6% pace. However, only about one-half of the growth can be attributed to actual increases in production. (See Figure 3.)

Real GDP growth was 1.2% in CY 2001. Real GDP is forecast to increase 2.4% in CY 2002 and 3.3% in CY 2003.

The most significant factor in the current economic lull continues to be private investment. Gross private domestic investment declined 8.0% during CY 2001, and is expected to increase only 2.4% in CY 2002. In addition, nonresidential (business) investment fell 3.2% in CY 2001, and is anticipated to fall an additional 5.8% in CY 2002 before increasing 8.8% in CY 2003.

Figure 3

Light Vehicle Sales (Millions of Units)



Personal

consumption grew 3.1% during CY 2001. This rate is estimated to taper off to 2.6% in CY 2002 before returning to 3.1% in CY 2003.

Government spending at all levels increased by 3.6% in CY 2001, spurred by a 9.0% increase in Federal defense spending during the fourth quarter. State and local government spending increases are expected to remain modest in CY 2002 and CY 2003 due to budget constraints. Total overall government spending is anticipated to increase by 4.5% in CY 2002 before slowing to 2.2% in CY 2003.

U Interest Rates

The Federal Reserve lowered interest rates on eleven separate occasions during CY 2001, dropping the discount rate by 475 basis points to 1.25%. Throughout the forecast horizon, key interest rates are forecast to remain relatively low, although they should begin to rise during the latter part of CY 2002.

The federal funds rate averaged 3.9% in CY 2001 and is estimated to be 2.0% in CY 2002 before rising to 3.8% in CY 2003.

The

three-month Treasury bill rate averaged 3.4% in CY 2001 and is estimated to decline to 2.0% in CY 2002 before rising to 3.6% in CY 2003.

The conventional mortgage rate dropped to an average of 7.0% in CY 2001 and is estimated to remain steady at 7.0% in CY 2002 before rising to 7.5% in CY 2003.

U Housing Market

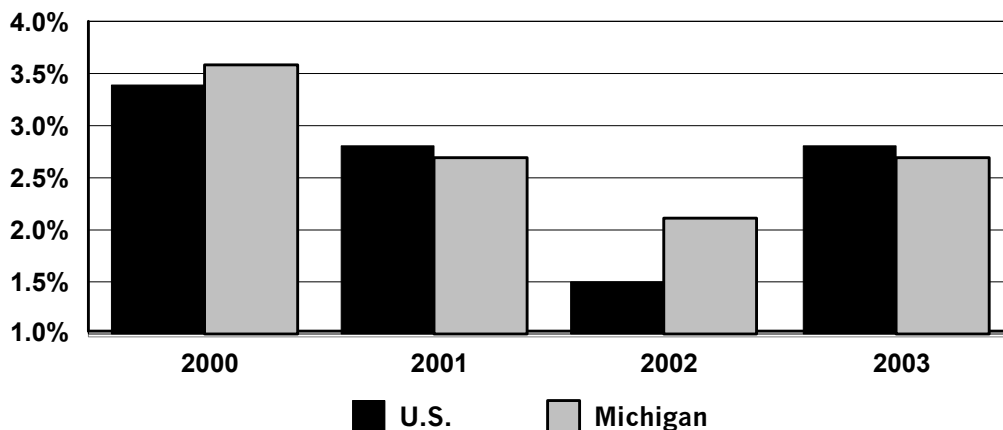
Housing starts, which include both single and multi-family units, increased to 1.61 million in 2001. The construction sector is expected to remain strong in CY 2002 as housing starts are anticipated to rise to 1.63 million units. During CY 2003, housing starts are predicted to decline to 1.57 million units.

U Light Vehicle Sales

Sales of light motor vehicles reached a record level in CY 2000, totaling 17.2 million units. Spurred by generous 0% financing offers during the latter half of CY 2001, light vehicle sales dipped only slightly to 17.0 million. Light vehicle sales are anticipated to drop 4.1% to 16.3 million units in CY 2002 before rising to 16.6 million units in CY 2003. (See Figure 4.)

Figure 4

Inflation Rates



Over the past several years there

has been a shift in sales away from cars and toward light trucks. This is expected to continue, so that by the end of the forecast period, light trucks will have claimed the majority share of light vehicle sales. Light trucks are expected to account for 50.3% percent of total sales in CY 2001, and 52.0% in both CY 2002 and CY 2003.

The import share of total light vehicle sales rose to 18.1% in CY 2001, and is expected to continue rising to 18.8% in CY 2002 before dropping to 17.1% in CY 2003.

An equally important aspect concerning the automotive industry is Michigan production of motor vehicles. After growing by 11.7% in CY 1999, motor vehicle production in Michigan fell by 1.3% in CY 2000 and by an additional 12.9% in CY 2001.

Thus, despite two record years of light vehicle sales in the U.S., Michigan's production of motor vehicles actually fell in response to the declining domestic market share.

U Inflation: U.S.

The change in input prices (such as energy prices, wages, and import prices) has generally remained moderate, and has

production costs. It is anticipated that inflation will remain low,

by historical standards, through the forecast period. (See Figure 5.)

The U.S. Consumer Price Index-Urban (CPI-U) is forecast to increase 1.5% in CY 2002, and 2.8% in CY 2003.

Crude oil prices, which dropped significantly during 2001, have begun increasing again in 2002—primarily due to

Benchmark West Texas intermediate crude, which began 2002 at under \$20 per barrel, rose to more than \$26 per barrel before easing off in April. It is anticipated that oil prices will remain below \$27 per barrel during CY 2002 and CY 2003.

U Inflation: Michigan

The cost of living in Michigan is measured by the Detroit Consumer Price Index for Urban Consumers (Detroit CPI-U). The Detroit CPI-U increased by 2.7% in CY 2001—slightly less than the national average. Inflation in Michigan is forecast to increase by 2.1% in CY 2002 and 2.7% in CY 2003.

Figure 5

Due to an expected increase in natural gas costs resulting from the end of the residential rate freeze, Michigan inflation is estimated to be higher than the U.S. in CY 2002.

U Income Growth: U.S.

Total U.S. personal income grew at a 3.7% rate in CY 2001. Personal income growth is forecast to drop to 3.6% in CY 2002 before increasing to 5.3% in CY 2003. (See Figure 6.)

Moderate growth in inflation contributed to a 1.2% rate of growth of U.S. real disposable income in CY 2001. It is

forecast that U.S. real disposable income growth will increase by 3.6% in CY 2002 and 2.8% in CY 2003.

UIncome Growth: Michigan

In contrast to the U.S., Michigan's total state personal income grew by only 1.8% in CY 2001. It is forecast that Michigan personal income will increase by 2.7% in CY 2002 and by 5.0% in CY 2003.

Figure 6

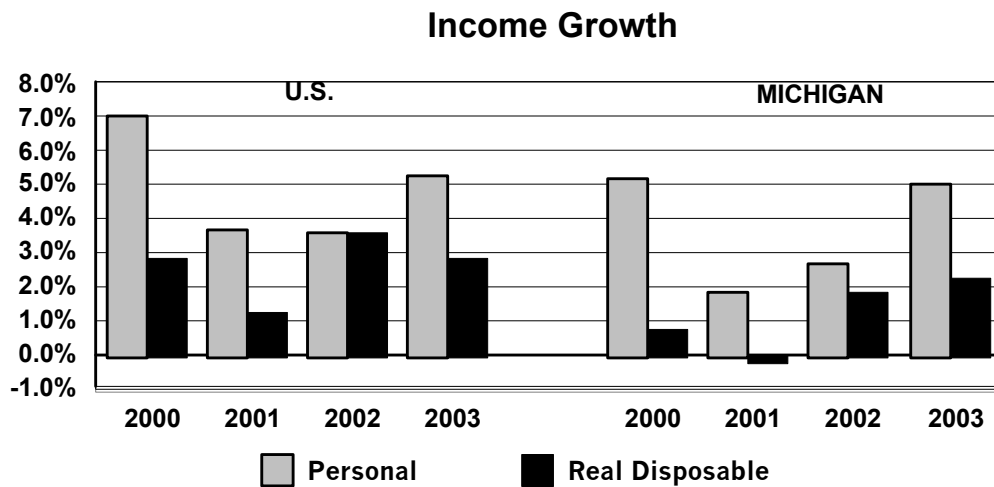
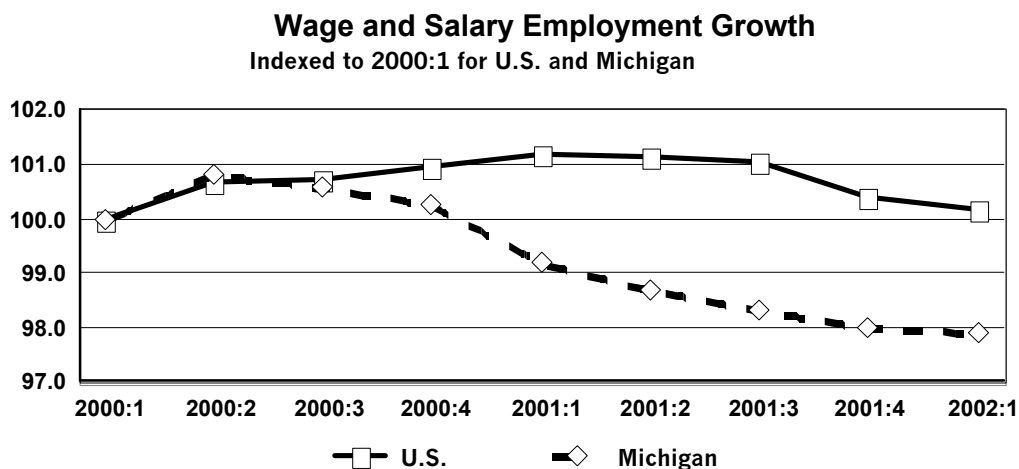


Figure 7



Michigan real disposable income actually fell by 0.2% in CY 2001 as even modest inflation more than offset gains in personal income. In CY 2002, real disposable income is forecast to grow by 1.8% before picking up to a 2.2% pace in CY 2003.

U Employment: U.S.

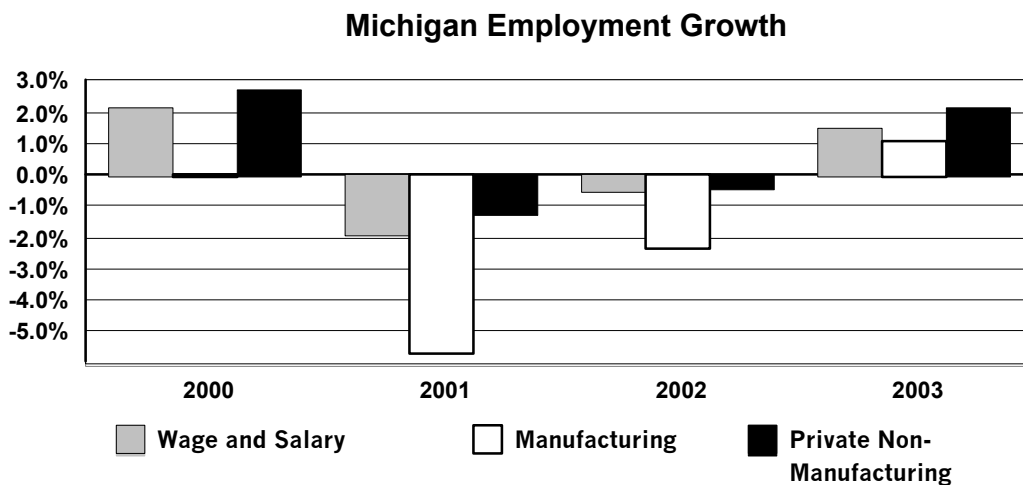
One critical reason underscoring the difference in income growth between the U.S. and Michigan is overall job growth. When indexed to the first quarter of 2000, wage and salary

employment in the U.S. increased slightly before tapering off in the fourth quarter of 2001. (See Figures 7 and 8.)

U Employment: Michigan

Indexed wage and salary employment in Michigan increased for only one quarter in 2000 before dropping steadily. The divergence between U.S. and Michigan illustrates that Michigan entered its economic downturn well before the nation as a whole.

Figure 8



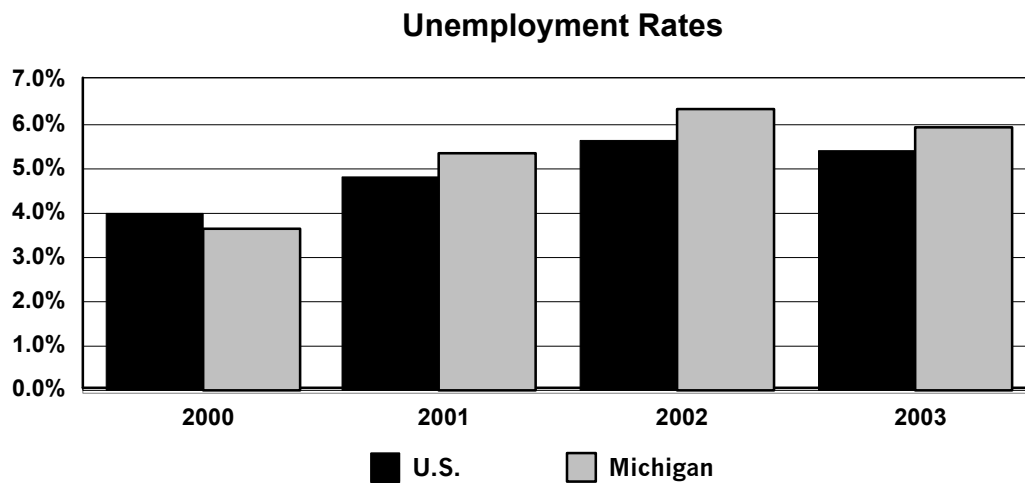
U Unemployment: U.S.

Non-farm payroll employment increased slightly in CY 2001, 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 was 4.8% in CY 2001, and is forecast to increase to 5.7% in CY 2002 before decreasing to 5.4% in CY 2003. (See Figure 9.)

U Unemployment: Michigan

As in the U.S., unemployment in Michigan is becoming a concern as job growth fell during CY 2001. As a result, the Michigan unemployment rate was 5.3% in CY 2001. The unemployment rate is forecast to rise to 6.3% in CY 2002 before dropping to 5.9% in CY 2003.

Figure 9



Data Revisions: Michigan Employment and Personal Income

The following table shows key Michigan economic data as reported at the time of the January 2002 Consensus Revenue Estimating Conference and the latest revisions from the Bureau of Labor Statistics and Bureau of Economic Analysis.

This data is key to interpreting the past and predicting the future of Michigan revenue—especially income tax revenue and sales and use tax revenue.

	As of January 2002		Current Data		
	<u>CY 2001</u>	<u>% Change from Prior Year</u>	<u>Revised CY 2001</u>	<u>% Change from Prior Year</u>	<u>Difference in % Changes</u>
Total Employment (thousands)	4,978	-0.8%	4,900	-2.3%	-1.5%
Wage and Salary Employment (thousands)	4,673	-0.2%	4,587	-1.9%	-1.7%
Personal Income (millions of dollars)	\$297,782	2.9%	\$295,108	1.8%	-1.1%
Wage and Salary Income (millions of dollars)	\$179,376	2.1%	\$175,680	0.5%	-1.6%
Disposable Income (millions of dollars)	\$256,877	3.6%	\$251,348	2.7%	-0.9%

Table 2
ECONOMIC VARIABLES

<u>U.S. FORECAST</u>				
<u>Variable</u>	<u>CY 2000</u>	<u>CY 2001</u>	<u>CY 2002</u>	<u>CY 2003</u>
Real GDP Growth	4.1%	1.2%	2.4%	3.3%
Rate of Interest, 3-Month Treasury Bill	5.8%	3.4%	2.0%	3.6%
Rate of Interest, Conventional Mortgage	8.1%	7.0%	7.0%	7.5%
Housing Starts (millions of units)	1.57	1.61	1.63	1.57
Light Vehicle Sales (millions of units)	17.2	17.0	16.3	16.6
Automobiles	8.9	8.4	7.8	8.0
Light Trucks	8.4	8.6	8.5	8.6
Import Share of Light Vehicle Sales	16.6%	18.1%	18.8%	17.1%
U.S. CPI-U—Percentage Change	3.4%	2.8%	1.5%	2.8%
U.S. Personal Income Growth	7.0%	3.7%	3.6%	5.3%
U.S. Unemployment Rate	4.0%	4.8%	5.7%	5.4%
<u>MICHIGAN FORECAST</u>				
<u>Variable</u>	<u>CY 2000</u>	<u>CY 2001</u>	<u>CY 2002</u>	<u>CY 2003</u>
Detroit CPI-U—Percentage Change	3.6%	2.7%	2.1%	2.7%
Michigan Personal Income Growth	5.2%	1.8%	2.7%	5.0%
Michigan Real Personal Income Growth	1.5%	-1.0%	0.6%	2.3%
Michigan Wage and Salary Income Growth	5.4%	0.5%	1.9%	5.4%
Michigan Unemployment Rate	3.6%	5.3%	6.3%	5.9%
Wage and Salary Employment Growth	2.1%	-1.9%	-0.5%	1.5%
Manufacturing Employment Growth	0.0%	-5.6%	-2.3%	1.1%
Services Employment Growth	3.9%	-1.2%	0.1%	3.1%
Wholesale & Retail Trade Employment Growth	1.6%	-1.7%	-0.9%	1.7%



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, there are always risks and uncertainties built into a forecast. The key risks in this forecast include business fixed investment, consumer behavior, and government policy.

Business Fixed Investment

The most significant risk factor for the economy is business fixed investment. Low capacity utilization in conjunction with weak profits are expected to outweigh low borrowing costs. Business fixed investment is expected to slightly contribute to economic growth in the second quarter of 2002, and pick up to a 4.5% pace in the second half of CY 2002. The business component of the economy, however, is volatile; steep declines are typically followed by sharp increases. A strong recovery in the business sector is not forecast until 2003. If business fixed investment comes back either sooner or later than anticipated in this forecast, it would effect the speed and degree of the recovery.

Consumer Behavior

Consumer behavior, to a significant degree, determines overall economic growth. Following robust gains in the fourth quarter of 2001 and the first quarter of 2002, consumption is forecast to slow to a 1.2% rate for the remainder of CY 2002. For CY 2002, personal consumption is forecast to grow 2.6%, followed by a 3.1% increase in CY 2003.

Consumer behavior is driven by consumer confidence, employment, and income. As previously mentioned, consumer sentiment has edged slightly higher. Stock market declines, due in part to the Enron profit restatement situation

spreading to other businesses, have dampened consumer confidence. In addition, significant increases in the unemployment rate posted in March and April will certainly put negative pressure on income and spending. Hence, if the pace of employment and income growth picks up more quickly than forecast, consumption and the overall economy will be stronger than estimated.

Government Policy

Monetary Policy. After eleven rate cuts in 2001 by the Federal Reserve (Fed), the discount rate has reached 1.25%—the lowest in more than 40 years—and the federal funds rate has been reduced to 1.75%. Built into the forecast are increases in both the discount rate and the federal funds rate during the third quarter of 2002, as the economy starts to expand.

Fiscal Policy. Built into the forecast is an expansionary fiscal policy, which consists of emergency spending, the fiscal stimulus package, and the tax act of 2001. These three items are estimated to add \$161.0 billion in FY 2001-02 and \$123.0 billion in FY 2002-03 to the economy. Fiscal policy, particularly defense spending, may increase at a faster rate than estimated—which would push up overall economic growth.



GF/GP AND SAF REVENUES

This section explains May 2002 House Fiscal Agency revenue estimates for GF/GP and School Aid Fund revenue by major revenue sources. Revenue estimates are based on the economic performance of the national and state key variables. As previously indicated, significant downward revisions in Michigan wage and salary employment, personal income, and wages and salaries are reflected in income tax revenue. The largest revenue revisions HFA is forecasting occur in income tax revenue—of which approximately 75% affects GF/GP revenue and 25% affects SAF revenue.

Revenue estimates are reported in Tables 3 and 4; the year-end balances for the major funds are included in Table 5. In addition, the budget stabilization fund is reported in Figure 9 and Table 6, and the state revenue limit calculation is included in Table 7, Figure 10, and Table 8.

Table 3
GF/GP REVENUE ESTIMATES (Millions of Dollars)

	Final			Fiscal Year 2002-03 over 2001-02	
	<u>FY 2000-01</u>	<u>FY 2001-02</u>	<u>FY 2002-03</u>	<u>%Change</u>	<u>\$Change</u>
Personal Income Taxes	\$4,791.7	\$4,585.8	\$4,835.4	5.4%	\$249.6
Sales and Use Taxes	966.4	993.0	1,057.8	6.5%	64.8
SBT and Insurance Taxes	2,223.0	2,259.0	2,364.7	4.7%	105.7
Other Taxes	<u>679.5</u>	<u>629.1</u>	<u>632.5</u>	0.6%	<u>3.5</u>
GF/GP Baseline Tax Revenues	\$8,660.6	\$8,466.9	\$8,890.4	5.0%	\$423.5
Non-Tax Revenue	<u>301.9</u>	<u>248.6</u>	<u>232.6</u>	-6.4%	<u>(16.0)</u>
Total GF/GP Baseline Revenues	\$8,962.5	\$8,715.5	9,123.0	4.7%	\$407.5
Adjustments to Baseline	<u>27.0</u>	<u>(298.8)</u>	<u>(719.7)</u>	140.9%	<u>(\$420.9)</u>
Actual GF/GP Revenues	\$8,989.5	\$8,416.7	\$8,403.3	-0.2%	(\$13.4)

NOTE: Numbers may not add due to rounding.

GF/GP Revenue by Source

U Personal Income Tax

Wage and salary income, after increasing 1.3% in FY 2000-01, is expected to post a 1.2% gain in FY 2001-02 and then pick up to a 4.9% pace in FY 2002-03. This will lead to faster growth in Michigan personal income and income tax revenues in FY 2002-03, relative to FY 2001-02.

Baseline GF/GP income tax revenue decreased 4.6% in FY 2000-01, and is forecast to decline 4.3% to \$4,585.8 million in FY 2001-02. Baseline GF/GP income tax revenues are then forecast to increase 5.4% in FY 2002-03 to \$4,835.4 million. Baseline revenues do not include the impact of decreasing the income tax rate to 4.1% in CY 2002 and 4.0% in CY 2003.

U Sales and Use Taxes

Continued growth in disposable income (which is forecast to increase 3.3% in FY 2001-02 and 5.1% in FY 2002-03) is expected to increase sales and use tax revenue. Baseline sales and use tax revenue totaled \$966.4 million in FY 2000-01, and is forecast to grow to \$993.0 million in FY 2001-02 and \$1,057.8 million or 6.5% in FY 2002-03.

U Single Business and Insurance Taxes

All Single Business Tax (SBT) revenues accrue to GF/GP. Net baseline business taxes (SBT plus insurance taxes) totaled \$2,223.0 million in FY 2000-01. Baseline business tax revenues are forecast to increase 1.6% to \$2,259.0 million in FY 2001-02 and 4.7% to \$2,364.7 million in FY 2002-03.

Baseline SBT revenues alone totaled \$2,022.3 million in FY 2000-01; they are forecast to increase 0.4% to \$2,030.0 million in FY 2001-02 and 4.7% to \$2,125.0 million in FY 2002-03. Baseline estimates do not include the full impact of the SBT rate cut, which will affect revenue collections.

U GF/GP Baseline Tax Revenues

Baseline GF/GP tax revenues totaled \$8,660.6 million in FY

2000-01. General Fund/General Purpose baseline tax revenues are estimated to decrease \$193.7 million or 2.2% to \$8,466.9 million in FY 2001-02 and increase \$423.5 million or 5.0% to \$8,890.4 million in FY 2002-03.

U Total GF/GP Baseline Revenues

Total baseline GF/GP revenues include baseline tax revenues and non-tax revenues. Final total GF/GP baseline revenues totaled \$8,962.5 million in FY 2000-01. General Fund/General Purpose baseline revenues are estimated to decrease by 2.8% to \$8,715.5 million in FY 2001-02 and increase 4.7% or \$407.5 million to \$9,123.0 million in FY 2002-03.

U Actual GF/GP Revenues

Actual GF/GP revenues take tax changes into account and are available for expenditure each year. Final actual GF/GP revenues were \$8,989.5 million in FY 2000-01; they are forecast to decline by 6.4% or \$572.8 million to \$8,416.7 million in FY 2001-02 and decline 0.2% or \$13.4 million to \$8,403.3 million in FY 2002-03.

S&AF Revenue by Source

U Sales and Use Taxes

Baseline sales tax revenue increased 1.2% in FY 2000-01; it is forecast to grow 2.6% in FY 2001-02 and 4.8% in FY 2002-03. Baseline use tax revenue is estimated to increase by 2.7% in FY 2001-02 and 4.0% in FY 2002-03. Combined sales and use tax revenue dedicated to the S&AF equaled \$5,075.9 million in FY 2000-01, and is forecast to increase 2.6% to \$5,206.9 million in FY 2001-02 and 4.8% to \$5,454.9 million in FY 2002-03.

U Income Tax

Approximately 25% of gross income tax revenue is dedicated to the School Aid Fund. Dedicated income tax revenue was \$1,955.3 million in FY 2000-01; it is forecast to decrease 3.0% to \$1,895.7 million in FY 2001-02 and increase 5.0% to \$1,990.1 million in FY 2002-03.

Table 4

SCHOOL AID FUND REVENUE ESTIMATES
(Millions of Dollars)

	Final			Fiscal Year 2002-03 over 2001-02	
	FY 2000-01	FY 2001-02	FY 2002-03	% Change	\$ Change
Sales and Use Tax	\$5,075.9	\$5,206.9	\$5,454.9	4.8%	248.0
Income Tax F earmark	1,955.3	1,895.7	1,990.1	5.0%	94.3

State Education Tax	1,489.6	1,567.0	1,642.6	4.8%	75.6
Lottery Transfers	587.0	605.0	610.0	0.8%	5.0
Tobacco Taxes	383.0	378.0	370.4	-2.0%	(7.6)
Real Estate Transfer Tax	252.9	240.0	252.4	5.2%	12.4
Other Taxes	<u>250.3</u>	<u>267.3</u>	<u>269.5</u>	0.8%	<u>2.2</u>
Baseline SAF Revenues	\$9,994.0	\$10,159.9	\$10,589.9	4.2%	\$430.0
Adjustments to Baseline	<u>0.0</u>	<u>(16.0)</u>	<u>(31.8)</u>	4.2%	<u>(\$15.9)</u>
Actual SAF Revenues (less GF/GP Transfer)	\$9,994.0	\$10,143.9	\$10,558.1	4.1%	\$414.2

NOTE: Numbers may not add due to rounding.

U State Education Tax

The 6-mill state education tax (SET) is dedicated to the SAF. Revenue from the SET was \$1,489.6 million in FY 2000-01. State Education Tax revenue is forecast to increase 5.2% to \$1,567.0 million in FY 2001-02 and 4.8% to \$1,642.6 million in FY 2002-03.

U Lottery Transfers and Casino Wagering Tax

Lottery revenue contributed \$587.0 million to the SAF in FY 2000-01. Due to a Big Game jackpot run up of over \$330 million, additional states joining the Big Game, and the introduction of new games, Lottery revenue to the SAF is projected to increase to \$605.0 million in FY 2001-02 and slightly increase to \$610.0 million in FY 2002-03. Casino/gaming tax revenue totaled \$75.4 million in FY 2000-01, and is forecast to increase to \$88.0 million in FY 2001-02 and FY 2002-03.

U Tobacco Taxes

Approximately 64.0% of gross tobacco tax revenue is dedicated to the School Aid Fund. The School Aid Fund received \$383.0 million from tobacco taxes in FY 2000-01. The demand for tobacco products is expected to decline slowly over the duration of the forecast. Total baseline tobacco tax revenues are expected to decrease to \$378.0 million in FY 2001-02 and \$370.4 million FY 2002-03.

U Real Estate Transfer Tax

Real estate transfer tax revenue is dedicated to the School Aid Fund. The transfer tax contributed \$252.9 million to the SAF in FY 2000-01; it is forecast to decrease to \$240.0 million in FY 2001-02 and increase to \$252.4 million in FY 2002-03.

U Total SAF Baseline Revenues

Total SAF baseline revenues were \$9,994.0 million in FY 2000-01. School Aid Fund baseline revenues are forecast to increase \$165.9 million or 1.7% to \$10,159.9 million in FY 2001-02 and \$430.0 million or 4.2% to \$10,589.9 million in FY 2002-03.

U Actual SAF Revenues

Actual SAF revenues represent own-source revenues available for expenditure each year, excluding prior year-end balances, and GF/GP transfers to SAF. Actual SAF revenues totaled \$9,994.0 million in FY 2000-01; revenues are forecast to increase \$149.9 million or 1.5% to \$10,143.9 million in FY 2001-02 and \$414.2 million or 4.1% to \$10,558.1 million in FY 2002-03.

It is important to note that two significant adjustments to the baseline figures for the SAF in FY 2002-03 are not included—a positive \$494.5 million due to the SET timing and rate reduction changes and a \$145.0 million reduction due to the current-law prize reduction percentage in the Lottery act.

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.

Fiscal Year 2001-02 estimates are based on year-to-date appropriations and HFA revenue estimates. Final FY 1998-99, FY 1999-2000, and FY 2000-01 figures are included.

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.

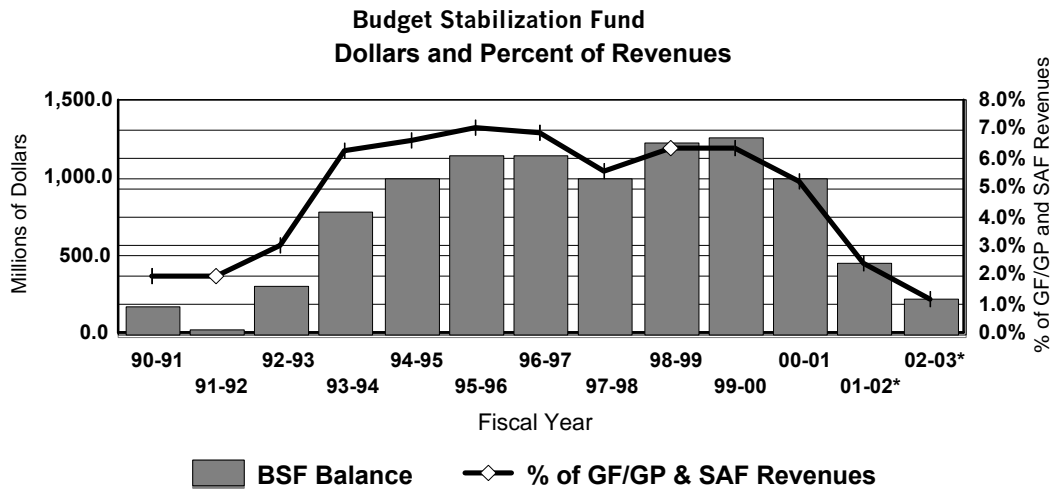
School Aid Fund revenues are restricted; hence, any year-end

balance is carried forward to the subsequent year.

Table 5
YEAR-END BALANCE ESTIMATES
(Millions of Dollars)

	<u>Final FY 1998-99</u>	<u>Final FY 1999-2000</u>	<u>Final FY 2000-01</u>	<u>Estimated FY 2001-02</u>
General Fund/General Purpose	\$55.2	\$211.8	\$28.0	\$0
School Aid Fund	\$274.3	\$853.4	\$694.8	\$0
Budget Stabilization Fund	\$1,222.5	\$1,264.4	\$994.1	\$448.5

Figure 9



*HFA estimates

Table 6
BUDGET STABILIZATION FUND: FY 1989-90 through FY 2002-03
(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	994.1
2001-02*	0.0	572.0	26.5	448.5
2002-03*	0.0	239.0	15.4	224.9

* HFA Estimates

NOTE: Numbers may not add due to rounding

B&F Year-End Balances

The Counter-Cyclical Budget and Economic Stabilization Fund (B&F), or the state's rainy day fund, is a reserve of cash to contribute to or withdraw from throughout the economic cycles. Table 6 shows deposits, withdrawals, interest earnings, and the year-end balance from FY 1989-90 through FY 2000-01. It also includes HFA estimates for FY 2001-02 through FY 2002-03.

The B&F balance at the end of FY 2000-01 was \$994.1 million. It is estimated to fall to \$448.5 million at the end of FY 2001-02 and to \$224.9 million at the end of FY 2002-03.

Figure 9 depicts the B&F fund balance and fund balance as a percent of total GF/GDP and SAF revenues from FY 1990-91 through FY 2002-03.

Through a combination of the trigger calculation (as determined by adjusted Michigan personal income growth) and the year-end GF/GDP transfers to the B&F, \$244.4 million was deposited into the B&F in FY 1998-99 and \$100.0 million was deposited into the B&F in FY 1999-2000.

In FY 1998-99, to continue with the settlement of the Durant case, \$73.7 million was withdrawn from the B&F and deposited into the SAF. In addition, in each fiscal year from FY 1999-2000 through FY 2007-08, \$32.0 million will be withdrawn from the B&F to finance payments to the school districts.

The second series of B&F withdrawals, which began in FY 1999-2000, deposited payments into the State Trunkline Fund. In FY 1999-2000, \$100.0 million was transferred to the State Trunkline Fund—\$37.1 million, the amount of the initial appropriation to the B&F and \$62.9 million, the year-end unreserved GF/GDP transfer to the B&F.

In addition, from FY 2000-01 through FY 2015-16, \$35.0 million will be withdrawn from the B&F and deposited into the State Trunkline Fund.

Due to the trigger calculation, payouts of \$223.7 million for FY 2001-02 and \$3.3 million for FY 2002-03 are forecast. A withdrawal from the B&F requires an appropriation.

Public Acts 112 and 161 of 2001 transferred \$270.0 million to GF/GDP in FY 2000-01. In addition, \$155.0 million will be transferred to GF/GDP in FY 2001-02, and up to \$350.0 million will be transferred to the SAF in FY 2001-02. Prior to book closing, the state budget director will determine the amount needed to balance the GF/GDP and SAF, and the transfer will be automatic.

Under Senate Bill 750 (S-1), \$350.0 million would be transferred to the SAF, as opposed to current law which states up to \$350.0 will be transferred at the end of FY 2001-02. Senate Bill 750 also would transfer \$207.0 million to GF/GDP at the end of FY 2002-03 and stop the series of \$35.0 million withdrawals for the State Trunkline Fund beginning in FY 2002-03.

A complete list of B&F historical data is available from the HFA upon request.

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.

Implications of Exceeding the State Revenue Limit

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

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

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 1999-2000 revenue limit calculation indicated that state revenue collections exceeded the revenue limit but the excess was under 1% of the revenue limit. However, the preliminary final FY 2000-01 revenue limit calculations shows that state revenue collections were well below the limit. In addition, for both FY 2001-02 and FY 2002-03, state

revenues are estimated to be substantially below the revenue limit, by \$4.08 billion and \$3.72 billion respectively.

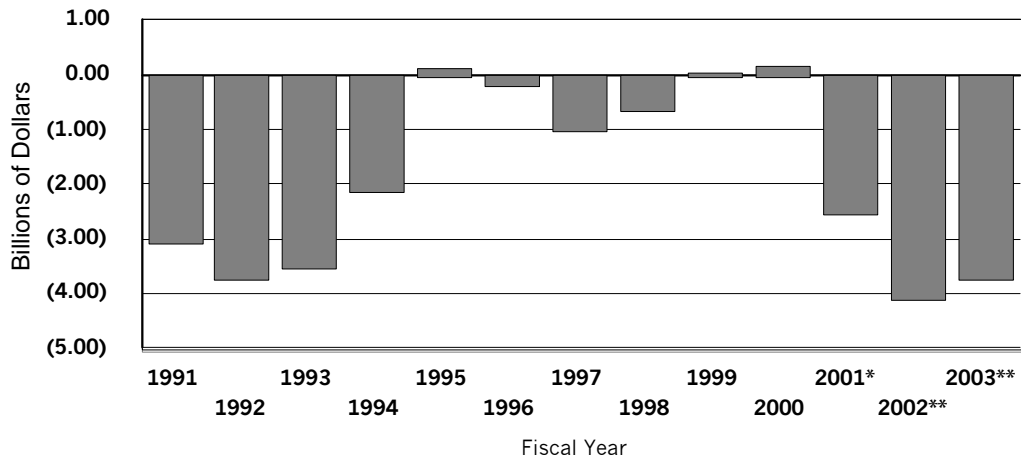
Table 7
COMPLIANCE WITH THE STATE REVENUE LIMIT
(Millions of Dollars)

<u>Revenue Limit Calculations</u>	<u>Final FY 1999-2000</u>	<u>Preliminary Final FY 2000-01</u>	<u>FY 2001-02</u>	<u>FY 2002-03</u>
Personal Income				
Calendar Year	CY 1998	CY 1999	CY 2000	CY 2001
Amount	\$255,039	\$277,296	\$289,869	\$295,108
X Limit Ratio	9.49%	9.49%	9.49%	9.49%
State Revenue Limit	\$24,203.2	\$26,315.4	\$27,508.6	\$28,005.7
Total Revenues Subject to Revenue Limit	24,361.4	23,803.5	23,424.9	24,283.8
Amount (Under) Over State Revenue Limit	\$158.2	(\$2,511.8)	(\$4,083.6)	(\$3,721.9)

NOTE: Numbers may not add due to rounding.

Figure 10

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



* Preliminary Final
** HFA Estimate

Table 8

**CONSTITUTIONAL REVENUE LIMIT: FY 1979-80 through FY 2002-03
(Billions of Dollars)**

Fiscal Year	(Under) or Over Limit		Fiscal Year	(Under) or Over Limit
1979-80	(\$0.53)		1991-92	(\$3.69)
1980-81	(\$1.17)		1992-93	(\$3.48)
1981-82	(\$1.41)		1993-94	(\$2.11)
1982-83	(\$1.32)		1994-95	\$0.11
1983-84	(\$0.24)		1995-96	(\$0.18)
1984-85	(\$0.01)		1996-97	(\$0.98)
1985-86	(\$0.37)		1997-98	(\$0.64)
1986-87	(\$0.84)		1998-99	\$0.02
1987-88	(\$1.35)		1999-2000	\$0.16
1988-89	(\$1.03)		2000-01*	(\$2.51)
1989-90	(\$1.76)		2001-02**	(\$4.08)
1990-91	(\$3.04)		2002-03**	(\$3.72)

* Preliminary Final
**HFA Estimates

Fourth Floor, North Tower, Anderson Building
124 North Capitol Avenue, Lansing, Michigan 48933

Mail to: P. O. Box 30014
Lansing, Michigan 48909-7514

Phone: 517-373-8080 FAX: 517-373-5874
www.house.state.mi.us/hfa



Mitchell E. Bean, Director
Bill Fairgrieve, Deputy Director

COMMUNITY HEALTH Bill Fairgrieve, Deputy Director

Medicaid Bill Fairgrieve, Senior Analyst
Mental Health–Substance Abuse Margaret Alston, Senior Analyst
Public Health–Aging Susan Frey, Senior Analyst

EDUCATION AND HUMAN SERVICES Hank Prince, Associate Director

Higher Education Hank Prince, Senior Analyst
Career Development–Consumer and Industry Services–
Michigan Strategic Fund Robert Schneider, Senior Analyst
Community Colleges–Department of Education Caven West, Fiscal Analyst
Family Independence Agency
Administration–Grants–Staffing Myron Freeman, Senior Analyst
Child and Family Services–Juvenile Justice Erin Black, Fiscal Analyst
School Aid Mary Ann Cleary, Senior Analyst; Laurie Cummings, Fiscal Analyst
Transportation William E. Hamilton, Senior Analyst

GENERAL GOVERNMENT Al Valenzio, Associate Director

Capital Outlay–Retirement–Supplementals Al Valenzio, Senior Analyst
Agriculture–Judiciary–Legislative Transfers Tim Aben, Senior Analyst
Attorney General–Auditor General–Civil Rights–Executive Office–
Information Technology–Legislature–Management and Budget Robin Risko, Senior Analyst
Civil Service–History, Arts, and Libraries–Lottery–State–Treasury Steve Stauff, Senior Analyst
Corrections–Bill Analysis System Marilyn Peterson, Senior Analyst
Clean Michigan Initiative–Environmental Quality–Federal Funds Monitoring–
Natural Resources–Natural Resources Trust Fund Kirk Lindquist, Senior Analyst
Public Safety: Military and Veterans Affairs–State Police Kyle I. Jen, Fiscal Analyst

ECONOMIC AND REVENUE FORECAST–TAX ANALYSIS Rebecca Ross, Senior Economist

Jim Stansell, Economist

FISCAL OVERSIGHT, AUDIT AND LITIGATION Myron Freeman, Senior Analyst

MANAGEMENT SUPPORT STAFF

Office Manager Sharon Risko, Administrative Assistant
Publications and Data Jeanne Dee, Administrative Assistant
Community Health–Corrections–Family Independence Agency–HFA Library Tumai Burris, Budget Assistant
Career Development–Community Colleges–Consumer and Industry Services–
Education–Higher Education–Michigan Strategic Fund–School Aid–
Transportation–HFA Internet Barb Endres, Budget Assistant
Agriculture–Capital Outlay–Environmental Quality–General Government–
History, Arts, and Libraries–Judiciary–Military and Veterans Affairs– Natural Resources–
Retirement–Revenue and Tax Analysis–State Police–Supplementals–Transfers–
Bill Analysis–Daily Calendar Julie Stapelman, Budget Assistant
Facilities Coordinator Tina Gee, Receptionist



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.state.mi.us/hfa