

MEMORANDUM



DATE: September 20, 2011
TO: House Appropriations Committee
FROM: Mary Ann Cleary, Director *MAC*
RE: Economic and Budget Update

This memo provides an update on the U.S. and Michigan economies and the state budget. In spite of the numerous negative reports regarding the national economy, Michigan's current economic performance and revenue collections remain consistent with the estimates from the May Consensus Revenue Estimating Conference (CREC). A number of uncertainties remain, however, regarding future economic performance and budget issues.

Economic Update

U.S. Economy

Since May, international and national developments stemming from the European debt crisis, fiscal policy tightening, and a stalling labor market have put the U.S. economic forecast into question. As a result, many economic forecasting entities have sharply reduced their national forecasts for economic activity, as measured by Gross Domestic Product (GDP), for Calendar Year (CY) 2011, CY 2012, and CY 2013—by approximately one percentage point per year. In conjunction with those downward revisions, many forecasting entities have increased their estimates of the probability of a national recession.

Michigan Economy

Manufacturing activity and light motor vehicle sales have held up relatively well compared to other economic indicators. The Chicago Federal Reserve Bank's Midwest Manufacturing Index indicates that the Midwest states have outperformed the nation as a whole in manufacturing activity. Based on data from the Bureau of Labor Statistics (BLS) and Chicago Federal Reserve calculations, Michigan's nonfarm payroll employment in the first half of the this year (July year-to-date) grew 1.9%, ranking fourth in the nation in growth of nonfarm payroll jobs. The May CREC estimate for Michigan nonfarm payroll employment growth is 1.7% for CY 2011.

General Fund/General Purpose and School Aid Fund Revenue

Fiscal year-to-date State revenue collections are up \$215 million relative to the May CREC estimates: \$115 million in General Fund/General Purpose (GF/GP) revenue and \$100 million in School Aid Fund (SAF) revenue. Annual and quarterly income tax payments and the Michigan business tax (MBT) account for a majority of the increase from May estimates.

Balance Sheet Update

General Fund/General Purpose

The revised GF/GP estimated ending balances are \$300.9 million for FY 2010-11 and \$69.1 million for FY 2011-12. These estimates do not account for any of the potential additional revenue above the May CREC estimates described above.

The FY 2010-11 balance is \$46.4 million higher than the May target agreement estimate, and the FY 2011-12 balance is \$63.0 million higher than the May estimate. The FY 2010-11 change reflects additional information on the revenue adjustments and a preliminary State Budget Office (SBO) estimate of \$47.9 million in Department budget lapses. The FY 2011-12 change results from a larger carry forward and an estimated savings of \$19.8 million from State Building Authority (SBA) bond sales.

We are monitoring a number of potential issues that could affect GF/GP revenues or appropriations: unemployment insurance (UI) loan interest payments, a potential TANF work participation penalty, proposed liquor tax repeal (SB 331), proposed elimination of driver responsibility fees (SB 166), proposed changes to personal property taxes (SB 34), and the Supreme Court cases on the recently enacted tax changes.

Revised GF/GP balance sheets for FYs 2010-11 and 2011-12 are attached. Note that two significant GF/GP items for FY 2011-12 remain on the balance sheet, but have not yet been incorporated into actual appropriation amounts. A reduction of \$145.0 million tied to state employee concessions is assumed; negotiations on state employee contracts are reportedly at an impasse. Also, an appropriation increase of \$140.0 million to begin prefunding Other Postemployment Benefits (OPEB) for state employees is assumed; see the accompanying memo on this topic for further explanation.

School Aid

The SAF estimated ending balances are \$645.9 million for FY 2010-11 and \$0.2 million for FY 2011-12. These estimates are unchanged from the May target agreements estimate and do not account for any of the potential additional revenue above the May CREC estimates described above.

We have recently been made aware of two issues that negatively impact School Aid appropriations but are not yet reflected on the current balance sheet. FY 2010-11 nonhomestead (NHS) taxable values for Detroit and Pontiac are currently running below estimates because of a large number of foreclosures. The drop in NHS taxable value for these communities will result in the State's share of the foundation allowances increasing by an estimated total of \$23 million. This development will impact the FY 2011-12 budget by a similar amount.

Additionally, there is a potential risk of another shortfall to School Aid appropriations related to the large number of outstanding tax tribunal cases involving NHS property values. If all the currently pending cases were settled in favor of the plaintiffs, this would result in added costs of approximately \$40 million for FY 2011-12.

Over the next couple of months additional information will become available regarding the impact of pupil counts, NHS taxable values, and special education costs on cost estimates that may result in changes to the current estimates. Attached is the current SAF balance sheet.

Summary

While the State's economic situation seems to be roughly consistent with the May CREC estimates, the national economy has slowed down considerably. State revenues continue to track slightly above May estimates, but any downturn in Michigan's economy would result in weaker than expected revenue collections in the coming months. While the Michigan economy is running somewhat ahead of national indicators, a national economic weakening could potentially have implications for the State.

As discussed above, there are a number of outstanding issues that would result in negative impacts to the budget. I would therefore advise the Legislature to use caution in appropriating additional revenues until more concrete information on those issues is available.

Please call if you have questions regarding this information.

Attachments

General Fund/General Purpose Balance Sheet
Millions of \$

	<u>FY 2010-11</u>	<u>FY 2011-12</u>
Beginning Balance	\$187.2	\$300.9
 <u>Projected Revenues</u>		
May 2011 Consensus Revenue Estimate	\$7,524.1	\$7,651.0
Adjustment for Tax Plan (HBs 4361/4362)	0.0	154.7
Subtotal	\$7,524.1	\$7,805.7
 <u>Revenue Adjustments</u>		
Revenue Sharing savings	\$514.9	\$652.5
Revenue Sharing one-time funding	0.0	(30.0)
Use Tax on Medicaid managed care	380.6	0.0
Tax Amnesty	62.0	(49.8)
Unclaimed property reforms	176.0	35.0
Other revenue adjustments	45.7	35.6
Subtotal	\$1,179.2	\$643.3
 Total GF/GP Resources Available	 \$8,890.5	 \$8,749.9
 <u>Projected Expenditures</u>		
FY 2010-11 year-to-date appropriations	\$8,386.2	
Pending adjustments:		
Medicaid Benefits Trust Fund (potential disallowances)	213.8	
Unemployment Insurance interest payment	38.3	
DMVA - Ford funeral expenses	0.1	
State Police - additional ARRA revenue	(0.9)	
Year-end lapses (preliminary SBO estimate)	(47.9)	
 FY 2011-12 year-to-date appropriations (line items)		\$8,275.2
FY 2011-12 one-time boilerplate appropriations		171.5
Deposit to Budget Stabilization Fund		255.8
Pending adjustments:		
Auditor General boilerplate appropriation		0.9
DCH: Electronic Health Records		1.4
DTMB: Collins Road lease		0.8
Estimated savings: SBA bond sale		(19.8)
Assumed state employee concessions		(145.0)
OPEB prefunding (ongoing GF/GP portion)		140.0
Total GF/GP Expenditures	\$8,589.6	\$8,680.8
 Estimated Ending Balance	 \$300.9	 \$69.1

School Aid Balance Sheet
Millions of \$

	<u>FY 2010-11</u>	<u>FY 2011-12</u>
Beginning Balance	\$255.9	\$645.9
 <u>Projected Revenues</u>		
May 2011 Consensus Revenue Estimate	\$11,111.5	\$11,335.3
Adjustment for Tax Plan (HBs 4361/4362)	0.0	(689.9)
<i>Subtotal</i>	<u>\$11,111.5</u>	<u>\$10,645.4</u>
 Revenue Adjustments		
General Fund/General Purpose Grant	\$18.6	\$118.6
Other Revenue	29.3	(8.0)
Federal Aid	2,178.4	1,653.3
<i>Subtotal</i>	<u>\$2,226.3</u>	<u>\$1,763.9</u>
 Total Resources Available	 \$13,593.7	 \$13,055.2
 <u>Projected Expenditures</u>		
Adjusted appropriations PA 62 (HB 4325)	\$12,947.8	\$12,659.1
Total K-12 Expenditures	<u>\$12,947.8</u>	<u>\$12,659.1</u>
 Community Colleges SAF transfer	 \$0.0	 \$195.9
Higher Education SAF transfer	\$0.0	\$200.0
 Estimated Ending Balance	 \$645.9	 \$0.2