

STATE BUDGET UPDATE



Mary Ann Cleary, Deputy Director, HFA
Kathryn Summers, Chief Analyst, SFA

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<http://www.house.mi.gov/hfa/>
<http://www.senate.michigan.gov/sfa/>

Real GDP

- 3.7% decline forecast for 2009, followed by 0.8% increase in 2010.
- Since the Great Depression, only 1946 exhibited a larger decline in GDP than the forecast for 2009.
- The expected decline in real GDP of five to six consecutive quarters would be longer than the previous record of three quarters, set in both 1953-54 and 1974-75.

Consumer Confidence

- November reading third lowest in 50⁺-year history of Index.
- Majority of consumers expect inflation-adjusted income declines in 2009.

Light Vehicle Sales

- 2009 forecast of 10.8 million units would be the worst year since at least 1970.
- 2009 forecast is down 26.7% from 2008, and down 42.2% from the 2002-2007 average of 16.6 million units.
- In the mid-1990s, the Detroit 3 sold 73.0% of total U.S. light vehicle sales (about 11 million units), compared with 48.0% (about six million units) in 2008.
- February 2009 light vehicle sales were the second worst since modern records started in January 1976. The 9.1 million unit annual rate was only 250,000 units above the record low in December 1981.
- January 2009 motor vehicle production was down 68.2% from January 2008 and down 72.6% from the recent peak in July 2008. January 2009 production was down 56.1% from the previous record low set in December 2008. March 2007 production is still down 36.5% from December 2008.
- In Michigan, light vehicle production in January 2009 was down 55.8% from the previous record low set in November 2008 and 72.7% below the 2007 average. Automobile production was down 81.2% from the previous record low set in September 2007 and 86.8% below the averages in 2007 and 2008. March 2009 production remained 21.7% below the November 2008 level.

Retail Sales

- Retail sales fell 10.3% between June 2008 and December, the largest drop since records started in 1947 (the second largest drop was 9.6%). April 2009 sales were down 11.6% from June 2008.
- The six-consecutive-month decline in retail sales ties the 1953 record for the longest continuous decline.

U.S. Housing Starts

- January 2009 housing starts were at their lowest level since records began in 1959, 16.8% below the previous record low set in December 2008. March 2009 starts were still 8.6% below the December 2008 level.
- January 2009 housing starts were down 79.5% from the January 2006 peak, and were down 57.2% since June 2008. March 2009 starts remained down 77.6% from the January 2006 peak.

Michigan Housing Activity

- New housing authorizations in 2008 were down 87.9% from the 2004 level in the Detroit metropolitan area and 80.6% statewide.

U.S. Labor Market

- The economy has lost 5.7 million payroll jobs in the last 16 months, the largest drop since modern records began in 1939.
- The 3.4 million jobs lost between November 2008 and March 2009 ranks as the largest five-month decline, 500,000 jobs more than the May-September 1945 decline when the wartime production was halted.
- Payroll employment has declined for 16 consecutive months, the second longest decline since modern records began in 1939.

Michigan Labor Market

- Since peaking in June 2000, payroll employment has declined in 81 of the last 105 months.

Michigan Labor Market (continued)

- On an annual basis, payroll employment has declined for eight consecutive years -- the longest decline on record, and is expected to continue declining through both 2009 and 2010.
- Payroll employment is expected to drop by 8.3% in 2009 and 4.6% in 2010.
- As of March 2009, Michigan had lost 750,900 payroll jobs from the June 2000 peak -- a decline of 16.0%.
- Michigan's payroll employment has declined for nine consecutive months, the third longest decline since before 1990. The loss of 242,900 jobs over that period accounts for 32.3% of all jobs lost over the last eight years.
- Michigan's payroll employment decline of more than 150,000 in the last four months exceeds the 129,000 jobs lost during the 11-month consecutive decline during 2001 and accounts for 20.0% of the jobs lost since June 2000.
- By the fourth quarter of 2010, Michigan's payroll employment is expected to be down 1,186,300 jobs (25.3%) from the peak in the second quarter of 2000 and down 581,200 jobs (14.2%) from the fourth quarter of 2008.
- As of March 2009, transportation equipment manufacturing employment in Michigan was down 65.1% from its July 2000 peak, a decline of 230,000 jobs.
- Job losses in transportation equipment manufacturing account for 32.2% of total Michigan job losses.
- Michigan's transportation equipment manufacturing employment is expected to continue declining in 2009 and 2010, with employment in the fourth quarter of 2010 down 77.9% (274,000 jobs) from the level in the second quarter of 2000.

Michigan Personal Income

- Michigan personal income is expected to decline 3.9% in 2009 (without adjustment for inflation) and decline another 2.8% in 2010.
- The 3.9% decline in nominal personal income in 2009 would be the first decline since 1958 and the worst drop since 1945.

Consensus Revenue Estimates

General Fund/General Purpose (GF/GP)

- **FY 2008-09:** Revenue from ongoing sources will total an estimated \$7.4 billion, which is down 20.6% or \$1.9 billion from FY 2007-08.
- **FY 2009-10:** Revenue will decline another 6.5% or \$485.6 million to an estimated \$6.9 billion.
- The major reasons for these declines are the economic recession (which is expected to have a particularly negative impact on income tax revenue) and the difficulties in the motor vehicle sector, combined with legislative changes such as the new earned income and film credits.

School Aid Fund (SAF)

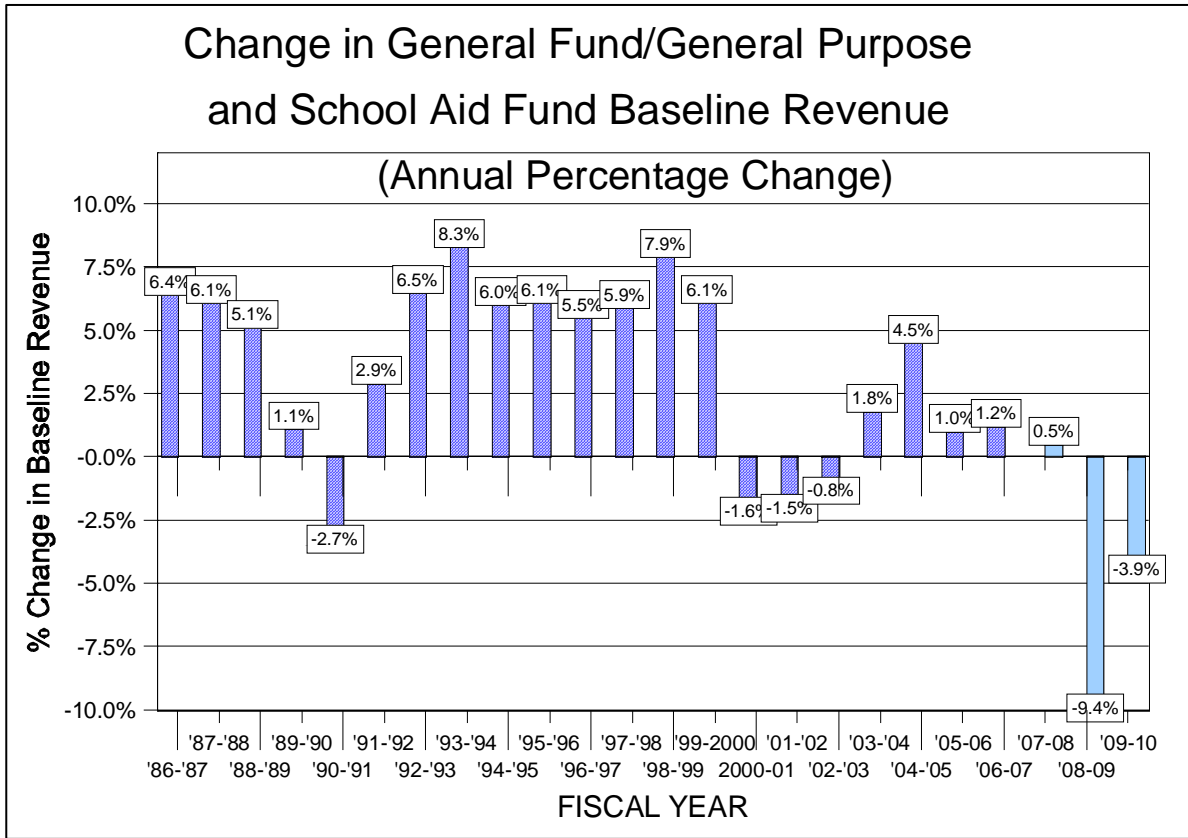
- **FY 2008-09:** Earmarked tax and lottery revenue will total an estimated \$10.9 billion, which is down 4.9% or \$569.2 million from FY 2007-08.
- **FY 2009-10:** SAF revenue will decline 3.5%, or \$380.7 million, to an estimated \$10.6 billion.
- The economic recession will reduce sales, use, income, State Education, and real estate transfer tax revenue in FY 2008-09, but much of these declines in revenue will be offset by a statutory increase in the Michigan Business Tax earmark to the SAF.

Earned Income Tax Credit will reduce GF/GP revenue an estimated \$140.0 million in FY 2008-09 and \$320.0 million in FY 2009-10.

Film Credit will result in a net revenue loss of an estimated \$88.4 million in FY 2008-09 and \$131.3 million in FY 2009-10.

Actual revenue collections in January through April 2009 have fallen approximately \$652.0 million below the level assumed in the January 2009 consensus estimate.

Figure 1



Fiscal Year 2008-09 State Budget Update

The FY 2008-09 General Fund/General Purpose (GF/GP) budget is estimated to be in deficit by \$974.5 million using the consensus revenue estimates that were revised on May 15, 2009. This projected deficit includes the \$304.4 million of GF/GP appropriation reductions approved by the Legislature on May 5, 2009, contained in Executive Order 2009-22.

The remaining FY 2008-09 GF/GP budget deficit likely will be eliminated by the use of one-time Federal funds available as a result of the passage of the American Recovery and Reinvestment Act of 2009 (ARRA).

The State of Michigan will receive approximately \$1.2 billion of Federal funds from ARRA that could be used to balance the FY 2008-09 GF/GP budget.

The ARRA provides restrictions on what appropriation reductions Michigan could enact to help reduce this projected budget deficit. Operating funding for K-12 school districts, community colleges, and universities cannot be reduced under provisions of ARRA. Michigan cannot change eligibility under the Medicaid program for the next two fiscal years.

The FY 2008-09 School Aid Fund budget is estimated to be in deficit \$429.0 million using the consensus revenue estimates that were revised on May 15, 2009.

The Governor and the Legislature likely will eliminate this projected deficit using available ARRA funding. The receipt of these Federal funds eliminates the State's ability to reduce the base per pupil funding, at least in FY 2008-09.

Fiscal Year 2009-10 State Budget Update

Governor Granholm presented her recommendations for the FY 2009-10 State budget to the Legislature on February 12, 2009. These budget recommendations were based on the January 2009 consensus revenue estimates. The Governor's budget recommendation was balanced using a combination of tax and fee increases, appropriation reductions, and the use of a portion of one-time ARRA funding.

Given the May 15, 2009 consensus revenue estimates, the Governor's budget recommendation will have to be significantly adjusted. The projected FY 2009-10 GF/GP budget deficit, before the use of any one-time ARRA funding, is estimated at \$1.7 billion. The FY 2009-10 School Aid Fund budget deficit, before the use of any one-time ARRA funding, is estimated at \$764.0 million. However, if the \$59 per pupil and ISD 20% reductions are restored, the deficit grows to \$875.0 million, and these amounts presume passage of the Governor's proposed tax increases (which generate \$65.2 million for the SAF in FY 2009-10).

These projected budget deficits in the GF/GP and School Aid Fund budgets will have to be addressed by any combination of appropriation reductions, other tax increases, or the use of one-time ARRA funding.

As is the case in FY 2008-09, it appears the Governor and the Legislature will not be able to reduce operational funding for education programs and eligibility for Medicaid. Michigan will receive \$984.9 million of ARRA funding in FY 2009-10 that could be used to balance the FY 2009-10 GF/GP budget.

Operational funding for community colleges, universities, and K-12 school districts in FY 2008-09 and FY 2009-10 likely will be frozen at the current funding levels under provisions of ARRA, though funded with a combination of State and Federal dollars. However, categorical grants may be reduced.

The use of the one-time ARRA funding to help balance the FY 2008-09 and FY 2009-10 State budgets will lead to significant budget problems in FY 2010-11 when the temporary ARRA funding expires. Depending on the revenue situation, operational or categorical funding in the Education budgets potentially could be reduced in FY 2010-11.

American Recovery and Reinvestment Act Update

President Obama on February 17, 2009, signed into law the American Recovery and Reinvestment Act (ARRA). The ARRA provides for \$787.0 billion of stimulus to the national economy including \$500.0 billion of spending increases and \$287.0 billion of tax reductions.

The Michigan State budget will receive over \$7.0 billion of direct Federal funding through different provisions of the ARRA.

Of these Federal funds, \$2.3 billion will be available to help eliminate State budget deficits in FY 2008-09 and FY 2009-10 and \$1.3 billion will be available to ensure stable operational funding in K-12 school districts, community colleges, and universities in FY 2008-09, FY 2009-10, and FY 2010-11.

Michigan has already appropriated approximately \$3.0 billion of ARRA funding for transportation projects, funding for at-risk students and special education programs in K-12 school districts, weatherization programs for low-income home owners, pollution control and drinking water projects, job training programs, increased food assistance payments, and numerous other programs.

Bottom Line for K-12/School Aid

Given the revenue estimates from the May revenue estimating conference, and not assuming any of the Governor's proposed tax increases, after using all available Federal ARRA money, the School Aid budget looks to be in deficit at least an estimated \$113.0 million in FY 2009-10. And, that amount does not include restoring anything from the Governor's proposed reductions except for the \$59 per pupil reduction and the 20% ISD Section 81 cut. Therefore, if the Legislature and Governor decide to restore 20j cuts for example (which were \$10 million), the deficit would increase to \$123.0 million.

The list of potential draws on the Federal money include any of the cuts proposed in the Governor's budget (like 20j, declining enrollment for small, rural districts, Great Parents/Great Start ISD program, Adult Education, Bilingual Education, etc., which total about \$54.0 million) and the cuts proposed to MSU's Cooperative Extension Service and Agriculture Experiment Station (which total about \$20.2 million). Therefore, if all of the proposed cuts listed above were funded, that would mean the School Aid deficit would grow to about \$200.0 million in 2009-10, because funding those items would require more of the Federal ARRA money, which already isn't enough to hold the budgets harmless from 2008-09 to 2009-10.

Looking one year further, into 2010-11, even with strong revenue growth, because the Federal ARRA funding is gone, there will be a sizeable deficit to deal with, if relatively strong cuts to expenditures aren't made in 2009-10, or if additional revenues don't become available. For a ballpark figure, we are estimating 2010-11 to be in deficit (again, without cuts in programs or additional tax revenue) by about \$375.0 million.

Conclusion: there is a strong potential for categorical grants to be reduced or eliminated in 2009-10, perhaps in excess of the anticipated deficit, in order to be in better position for 2010-11 and avoid a very large "cliff". Reductions will have to occur in the absence of additional revenues. Large categorical grants in K-12 include At-Risk (\$310 million), School Readiness (\$103 million), Vocational Education (\$30 million), and Adult Education (\$20 million).