Citizens Research Council of Michigan

Michigan's Economic, Revenue and Budget Outlook

Rotary Club of Grand Haven

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July 12, 2010

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Citizens Research Council

- Founded in 1916
- Statewide
- Non-partisan
- Private not-for-profit
- Promotes sound policy for state and local governments through factual research – accurate, independent and objective
- Relies on charitable contributions of Michigan foundations, businesses, and individuals
- *www.crcmich.org*

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Is the Recession Over?

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The Recession is Over But The Recovery is Struggling

- The recession is over (at least for now) and output is growing again
- GDP, manufacturing, the stock market, and retail sales, all above recession lows
- But, we are not back to where we were
  - Output still below where it was at start of recession
  - Many key sectors remain depressed or are growing off extremely depressed levels
  - U.S. employment is still down over 7 million jobs
- **Recovery hit a soft patch around May and risks of double dip are increasing**

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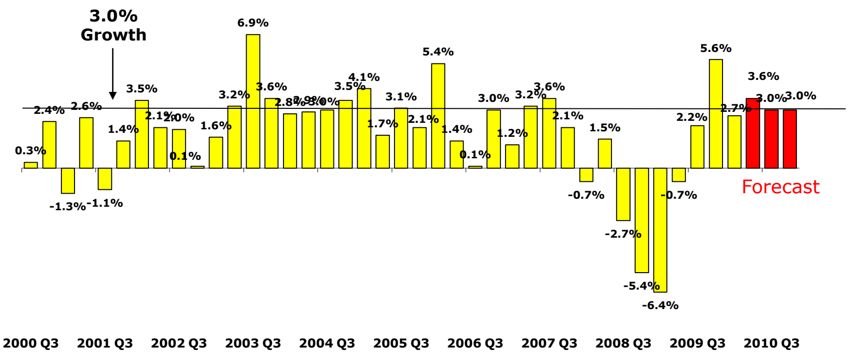
GDP Increasing Since 2009 Q3 and Expected to Grow Through 2010 Q4

Real GDP Growth



5 Figures are annualized percent change from preceding quarter in 2000 chained dollars.
Source: Bureau of Economic Analysis 6/25/10. Forecast from the Wall Street Journal June 2010 survey of forecasters.

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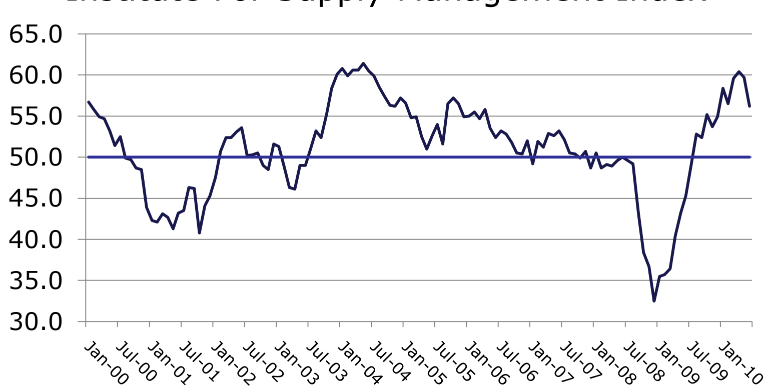
Manufacturing Has Been Growing But Growth Starting to Slow

Institute For Supply Management Index



6 Source: St. Louis Federal Reserve Bank FRED

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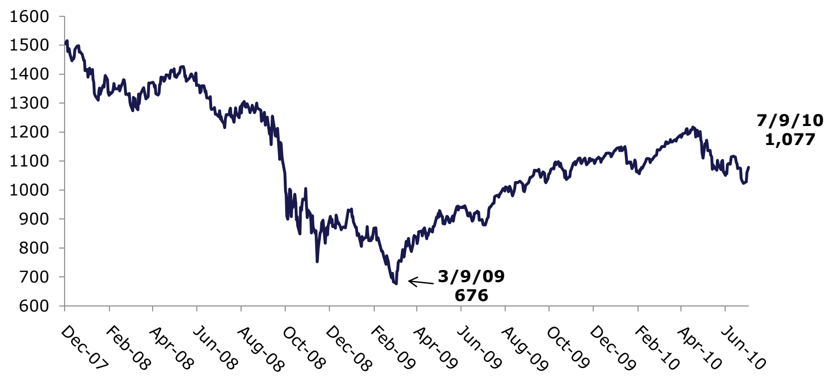
S&P 500 Up 59% From March 09 Low But Down 10% From April 10



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Source: Freelunch.com

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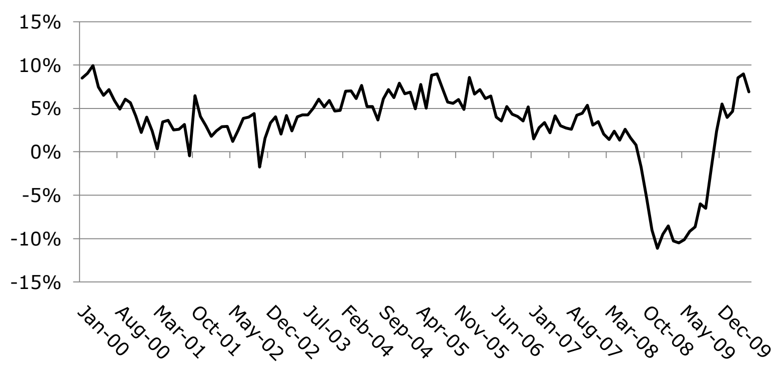
Retail Sales Plummeted But are Recovering

Retail Sales and Food Service
(Year over Year Pct Change)



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Source: Freelunch.com and CRC calculations

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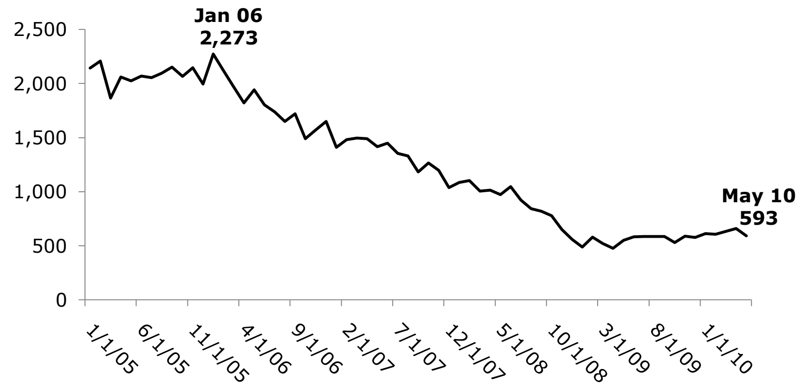
Housing Starts Still Down 70 Percent from Peak

New Privately Owned Houses Started (Thousands)



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Source: St. Louis Federal Reserve Bank -- FRED

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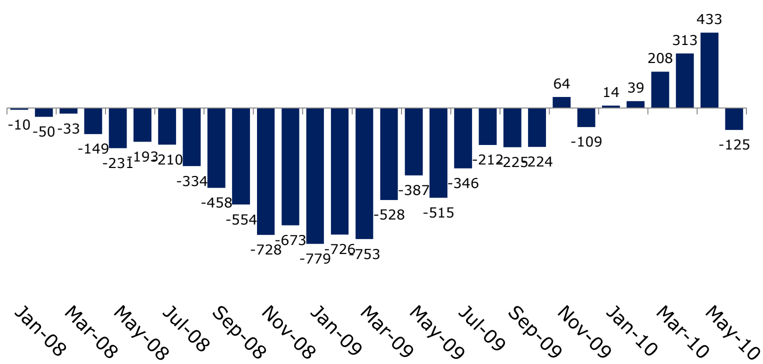
Employment Has Finally Turned But Still Down Over 7 million Jobs

Monthly Change in U.S. Employment (thousands)



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Source: Bureau of Labor Statistics

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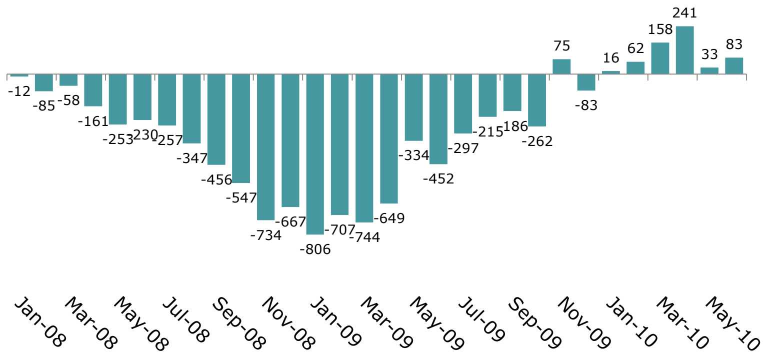
Employment Growth Slows From April When Census Workers Excluded

Monthly Change in U.S. Private Employment (thousands)



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Source: Bureau of Labor Statistics

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What is Happening in Michigan?

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The Last Decade Has Been an Economic Disaster for Michigan

	Growth 2000 to 2009 U.S.	Growth 2000 to 2009 Michigan	Michigan Rank
Population	8.8%	0.1%	51
Real Per Capita GDP*	9.7%	-3.8%	51
Employment	-0.7%	-17.1%	51
Real Per Capita Income	3.6%	-7.1%	51

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*GDP growth is for 2000 through 2008.

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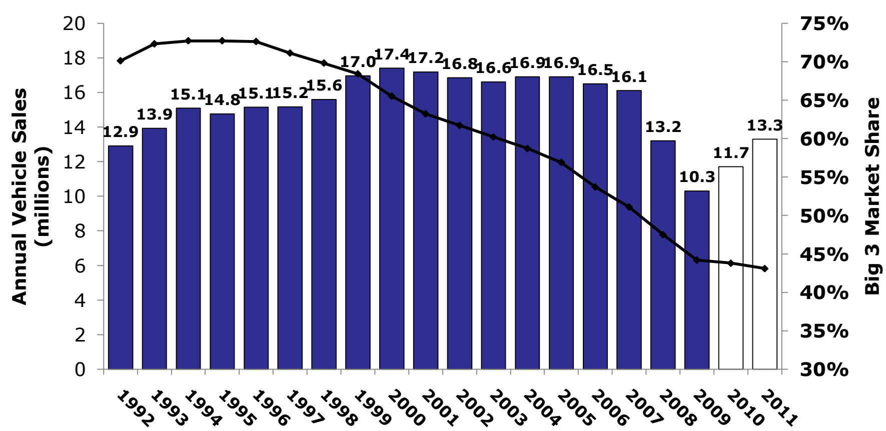
Big 3 Market Share Plummets



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Source: 2009-2011 sales are the May 2010 Cons. Estimates; 2009-2011 share RSQE.

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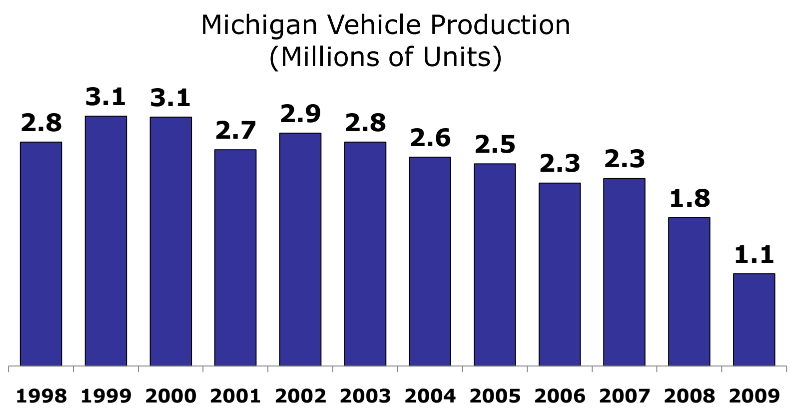
Michigan Vehicle Production Has Decreased Significantly



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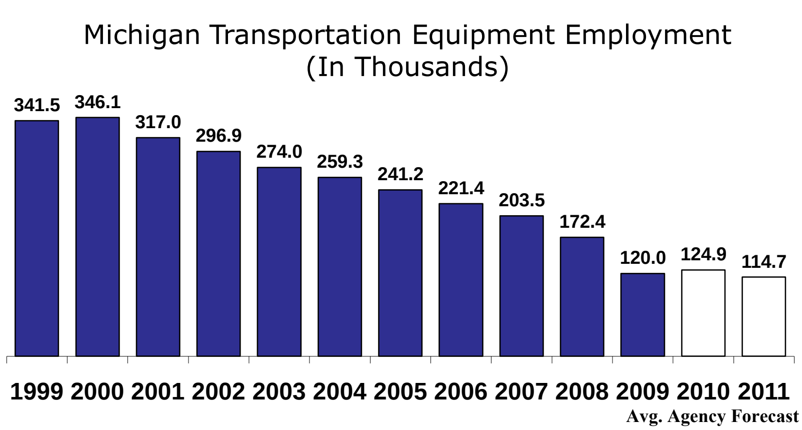
2 in 3 Auto Jobs Lost by 2011



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Source: Bureau of Labor Statistics. 2009-2011 estimates are the average of the 3 agency forecasts for the May 2010 Consensus Conference.

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Michigan's Manufacturing's Footprint Now Significantly Smaller

	2001 Q3	2009 Q3	% Change
Number of Establishments	17,924	14,135	-21.1%
Number of Employees	810,594	455,667	-43.8%
Total Wages Paid (000 $)	$9,528,420	$6,431,979	-32.5%

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Source: BLS – Quarterly Census of Employment and Wages.

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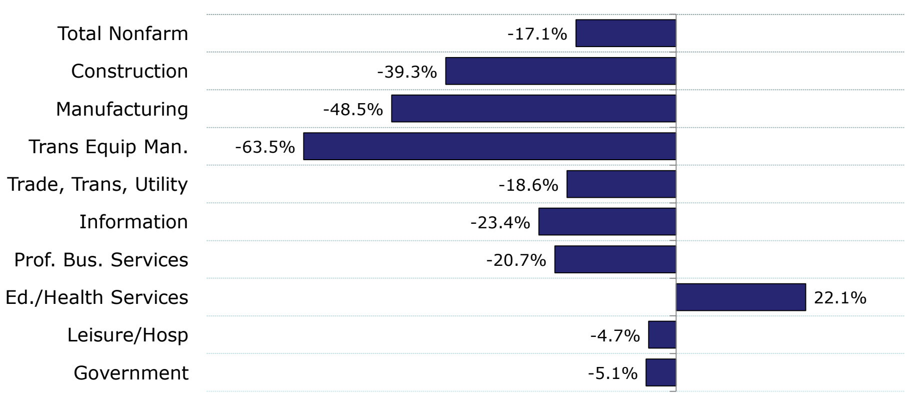
Almost Every Sector in Michigan Has Lost Jobs

2000 to 2009



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Source: Bureau of Labor Statistics. CRC calculations.

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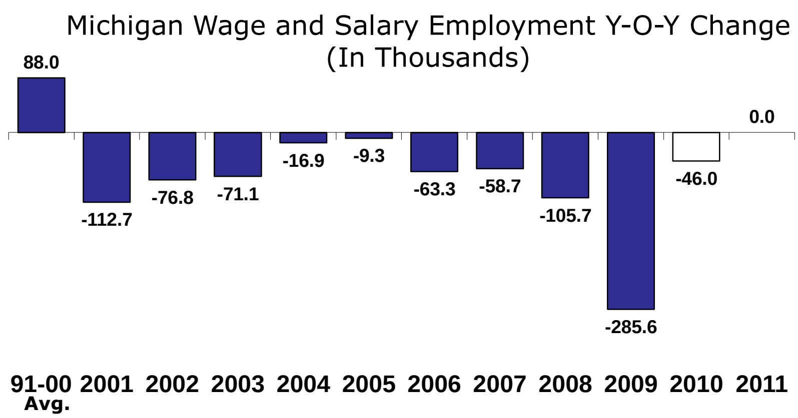
State Forecast –
No Job Growth for Michigan Yet



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Source: Bureau of Labor Statistics. 2010-2011 estimates are from the May 2010 Cons. Forecast.

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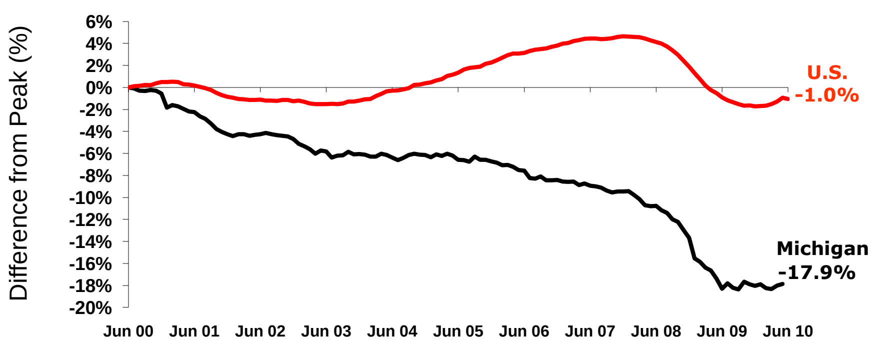
A Lost Decade of Michigan Employment

1 in 6 Jobs Lost Since June of 2000



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Note: Peak is calculated from Michigan's June 2000 Peak. Data are through March 2010.
Source: Bureau of Labor Statistics and CRC calculations.

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Unemployment is Widespread in Michigan

	May Unemployment Rate
Statewide	13.6%
Detroit MSA	14.7%
City of Detroit	22.9%
Grand Rapids MSA	10.9%
Holland/Grand Haven	11.8%
Grand Traverse County	12.1%
Marquette County	10.1%

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Source: Bureau of Labor Statistics; data are not seasonally adjusted except for statewide and the Detroit MSA.

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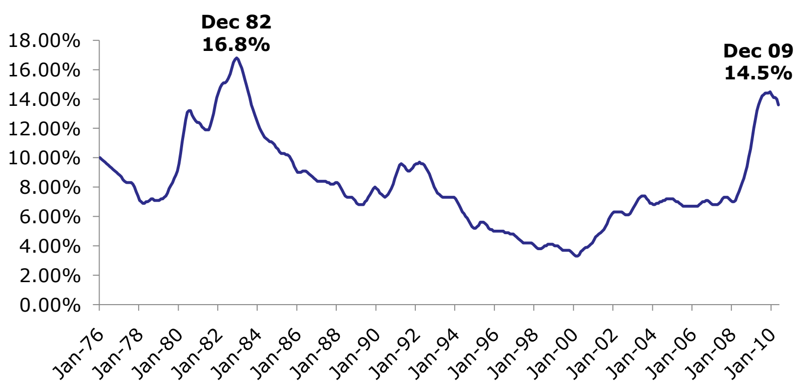
But Michigan's Unemployment Rate Appears to Have Peaked



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Source: U.S. Bureau of Labor Statistics

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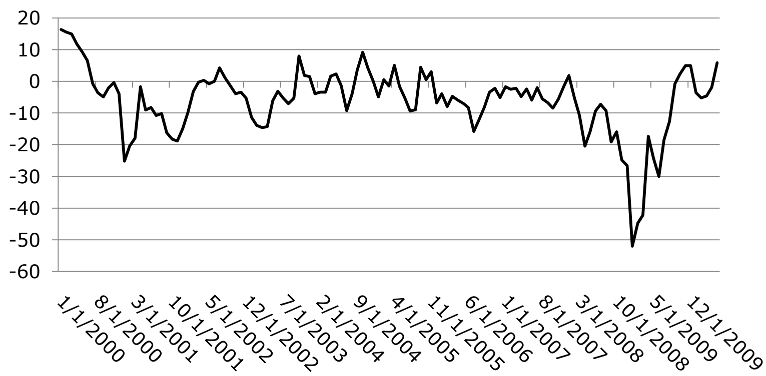
Michigan Employment Stable Since Sept 2009

Monthly Change in Michigan Employment (3 month avg. thousands)



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Source: U.S. Bureau of Labor Statistics; Job change since September 2009 is +1.9 thousand

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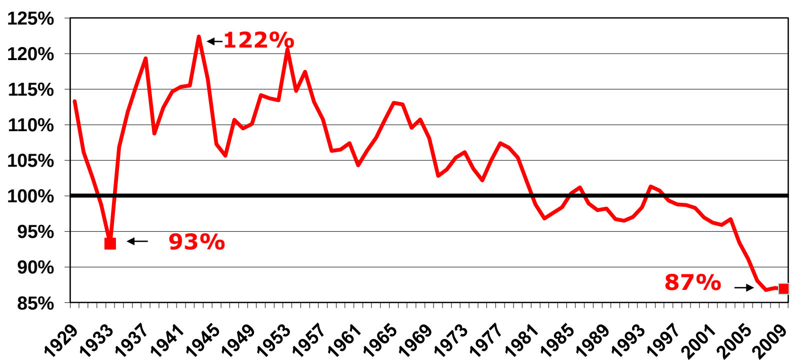
Michigan Has Become Poorer Relative to Other States

Michigan per Capita Income as a Percent of U.S. Per Capita Income
Rank has fallen from 20th in 2001 to 37th in 2009



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Source: CRC calculations from Bureau of Economic Analysis data. March 24, 2009 personal income release for years Prior to 1969. March 2010 release for years after 1969. Ranking excludes Washington D.C.

What Does This Mean for the Budget?

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State Spending From State Sources Down Sharply in Real Terms

- From FY 2000 to FY 2010
- Inflation up approx. 23%
- Total state spending up 22.5% but increases in federal aid drove increase; state spending from state sources up 2.3%
- Spending changes from state sources:
  - K-12 +8.2%
  - Community Colleges +0.7%
  - Universities/financial aid -13.7%
  - Revenue sharing -34%
  - Corrections +27.2%
  - Medicaid +49.9%

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Source: Senate Fiscal Agency.

Revenues Crash in 2009

Annual Growth Rates

	FY 2009	Projected FY 2010	Projected FY 2011
Sales Tax	-10.1%	1.3%	1.5%
Income Tax	-19.0%	-8.1%	2.9%
Use Tax	-19.0%	3.6%	1.5%
State Education Tax	-1.9%	-7.2%	-3.2%
Real Estate Transfer Tax	-26.2%	1.4%	10.2%
GF-GP	-21.3%	-9.6%	6.6%
School Aid	-5.1%	-1.6%	0.8%

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Note: Projected totals are the May 2010 Consensus Revenue Estimates.

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Stimulus Spending Has Been Supporting State Budgets

(millions of $)

	FY 2009	FY 2010	FY 2011 CSB
Total GF-GP Spending	$9,753.7	$9,151.8	$9,176.7
ARRA	$1,298.1	$1,071.3	$209.6
ARRA % of Budget	13%	12%	2%
Total SAF Spending	$13,139.6	$12,715.5	$12,773.9
ARRA	$597.5	$450.0	$185.5
ARRA % of Budget	5%	4%	1%

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Source Senate Fiscal Agency estimates adjusted by CRC. GF-GP spending totals have been increased by the ARRA amounts since the ARRA funds are replacing GF-GP spending.

FY2010 GF Cuts Were Severe

- Medicaid provider rates (cut 8% from original FY2009 level)
- Non-Medicaid CMH funding ($40M cut)
- Elimination of $238M from DHS budget
- Revenue Sharing to CVTs down 9.7%
- State employee concessions/layoffs (varied)
- Average of -8.4% cut (GF-GP) across all state departments
  - Some larger than others
  - Some areas protected from cuts per ARRA
- Scholarships to university students cut by two thirds (incl. elimination of Promise Grants)
- Budget also supported by $1.2 billion in stimulus funds

Schools Cut Significantly in FY 2010 as Well

- Ongoing FY 2010 SAF revenues projected to be $750 billion below FY 2008
- Enacted FY 10 Cuts:
  - $165 per pupil ($263M)
  - ISD reduction ($16M)
  - 20j veto ($52M)
  - Other Cuts ($35M)
- Proposed proration $127 per pupil ($212M) was rescinded
- Budget also supported by $450 million in stimulus funds

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Governor's Proposal for FY 2011 GF

Original Shortfall $1.1 Billion ($850M Due to phase-out of ARRA)

- Spending cuts ($433M)
  - Corrections reforms ($129M)
  - Retirement system changes ($98M)
  - Private college scholarships ($32M)
  - Rescind non-union pay bump ($18M)
  - Community Health ($39M)
  - Human Services ($39M)
- Non-recurring resources
  - Continuation of Medicaid match rate - $500M – **requires yet to be enacted federal legislation**
- Medicaid provider tax on physicians - $100M

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Changes to GF Situation Since Budget Presentation

- May revenue Changes
  - -$244 million in FY 2010
  - +$128 million in FY 2011
- FY 2010 now has a $220 million shortfall
- $500 million in additional FY 2011 stimulus funds assumed by Governor, Senate, and House very much in jeopardy
- Shortfall greater than $600 million (FY 10 shortfall plus loss of assumed stimulus funds) is roughly 8% of spending shortfall added to Gov proposed cuts is roughly 12% of FY 10 spending

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FY 2011 School Aid Budget

- Original Estimates put shortfall at $422 million for FY 11
- Gov recommended tax restructuring
  - Sales tax extended to consumer services & rate to 5.5%
  - 3 Year phase-out of MBT surcharge
  - Revenue in year 1 balances FY 11 budget
- Revenue estimating adjustments added $292 million to FY 2010 and $352 million to FY 2011 (eliminating shortfall)
- FY 2011 foundation allowance increased by $11 per pupil and $236 million remains in SAF
- SAF balance could be used to cover FY 2010 GF shortfall
- Retirement changes save $680M in FY 11 and $3.2B over next ten years

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Local Revenues Have Held Up Relatively Well Until Now

- To date, local property tax has helped to provide stability to local government revenue picture ~ 5% growth/yr ('00 – '07) and flat in 08 and 09
  - Going forward, this picture changes dramatically
  - Taxable value falls in 2010 and 2011
  - State revenues will not be positioned to help
- Coming out of the downturn, tax value growth capped (Prop. A) – restrains revenue growth
- Local cuts are coming and will be much more visible than many state cuts

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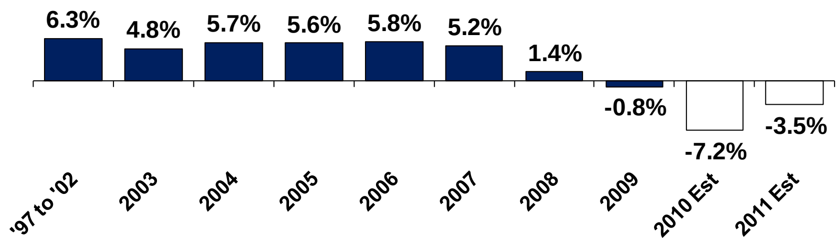
TV Growth Provided Stability But Taxable Value Now Falling

% Change in Total Taxable Value



Average

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Source: State Tax Commission and May 2010 Consensus Conference.

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What Reforms Have Been Proposed?

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Corrections

- Michigan's incarceration rate is 24% higher than the Midwest average
- Some reductions have begun: current population down 12% (6,300) from 2006 peak
- Gov's Exec Budget proposes reducing prison population by almost 10,000 (20%) between FY 10 and FY 11
- However, short-run savings limited by:
  - Reinvestment of resources to manage released inmates
  - High fixed costs in system
  - Slow reduction in employee head count
  - Less dangerous prisoners (i.e. cheaper to incarcerate) are the ones being released

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Retirement Changes

- Gov proposed early retirement incentive to state employees including:
  - Multiplier from 1.5% to 1.6%
  - Cap years of service at 30
  - No vision and dental if don't retire now
- 1 in 5 are eligible in most state departments (1 in 20 in corrections)
- State assuming 85% take rate (6,700 retire)
- 3% retirement contribution will be required for remaining employees in system
- Schools plan is similar with approx. 17,000 assumed to retire – Schools plan became law on May 20, 2010
- Without changes: Pension costs (including healthcare) for DB state employees increasing by 4 percentage points of payroll and for school employees 2.5 percentage points

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Proposed Public Employee Compensation & Healthcare Changes

- Gov: New employees hired after April 1 receive benefits under new state health plan and will contribute 20% of premium cost; 3% retirement contribution for state and school employees
- Speaker Dillon: Pool benefit coverage for all state, local, and school district employees
- Sen. Republicans: 2 Constitutional ballot proposals
  - Impose a 5% pay cut for all govt employees (incl. schools, comm. colleges, universities, etc.)
  - Require all govt employees pay 20% of premiums (about double what they pay now)
- BLM: reduce state employee comp to average of state workers in U.S.; adjust state employee premium contributions to national public sector average

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Other Potential Areas of Reform

- **Tax Structure** – Potential goals include: faster growth; more favorable to economic development; increased progressivity; additional revenues
- **Local Government Service Consolidation or Service Collaboration** – Increased service sharing among local governments, or outsourcing of service provision in an attempt to achieve cost savings
- **Investments in Areas Deemed Key for Economic Development** – Potential areas include infrastructure, higher education, targeted tax credits for key industries (e.g. film credits, battery credits)

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Will It Get Better?

- Economy starting to grow, **but there is no quick recovery from an 18% employment decline**
- Spending, primarily due to healthcare costs, poised to grow faster than revenues over long-term
  - Gap is 1.7% per year on average in SAF
  - Gap is 5.4% per year in GF-GP, exacerbated by scheduled tax cuts, esp. IIT rate cut
- Other states and federal government face similar challenges with healthcare, but Michigan's economic problems accelerate the problem for us
- Michigan's problems are long-term and structural we need to start thinking and planning longer-term

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