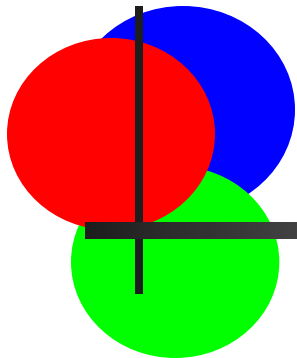
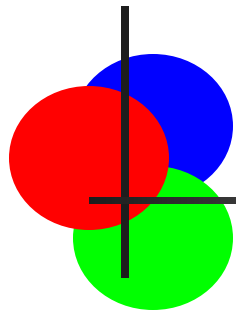


Michigan's Financial Forecast



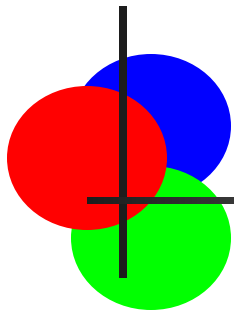
2009 MLA Annual Conference
November 4, 2009

Mark P. Haas
Chief Deputy Treasurer
Michigan Department of Treasury

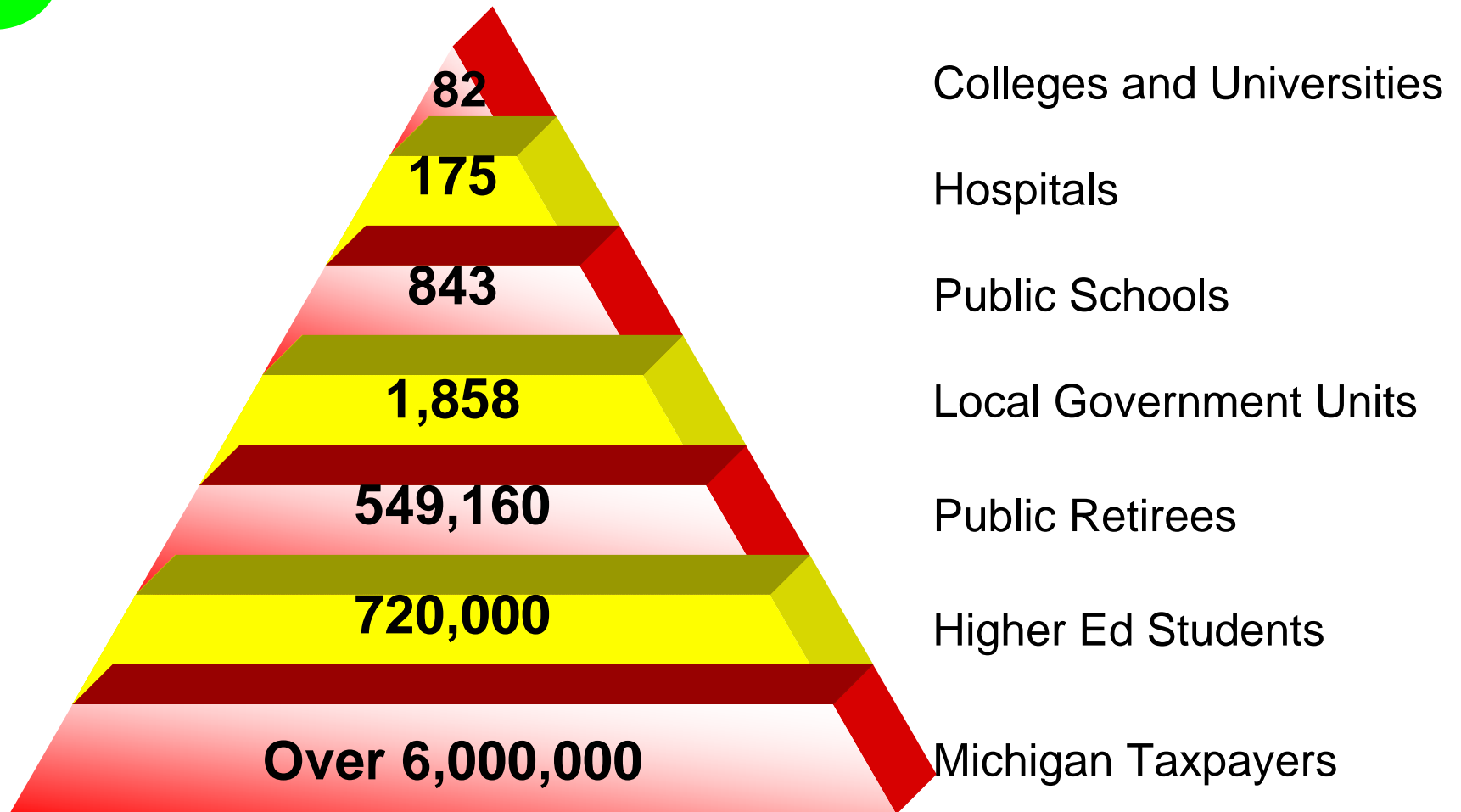


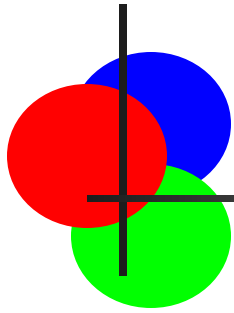
Treasury Responsibilities

- ▶ Tax Administration
- ▶ Tax and Debt Collection
- ▶ Financial Management
- ▶ Local Government Services
- ▶ Financing Higher Education
- ▶ Investing All State Funds



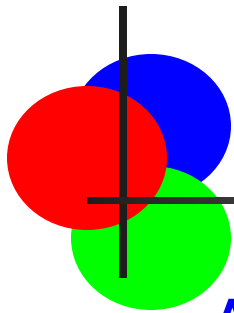
Treasury Customers





Treasury's Commitment

- ▶ Maintain the State's financial integrity.
- ▶ Fair and consistent administration of tax laws.
- ▶ Provide efficient and effective professional services.
- ▶ Provide access to financial resources for higher education, K-12, local government, and hospitals.

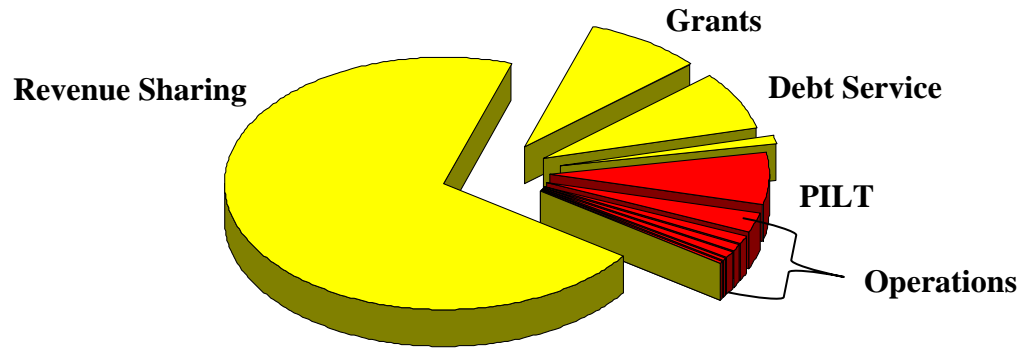


2010 Treasury Budget

All Funds \$1,548,257.3

(\$s in millions)

General Fund (GF) \$135,597.7

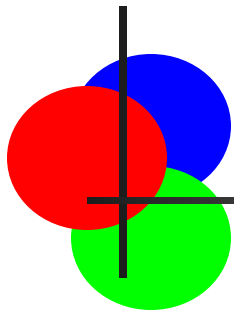


Pass Through Funds

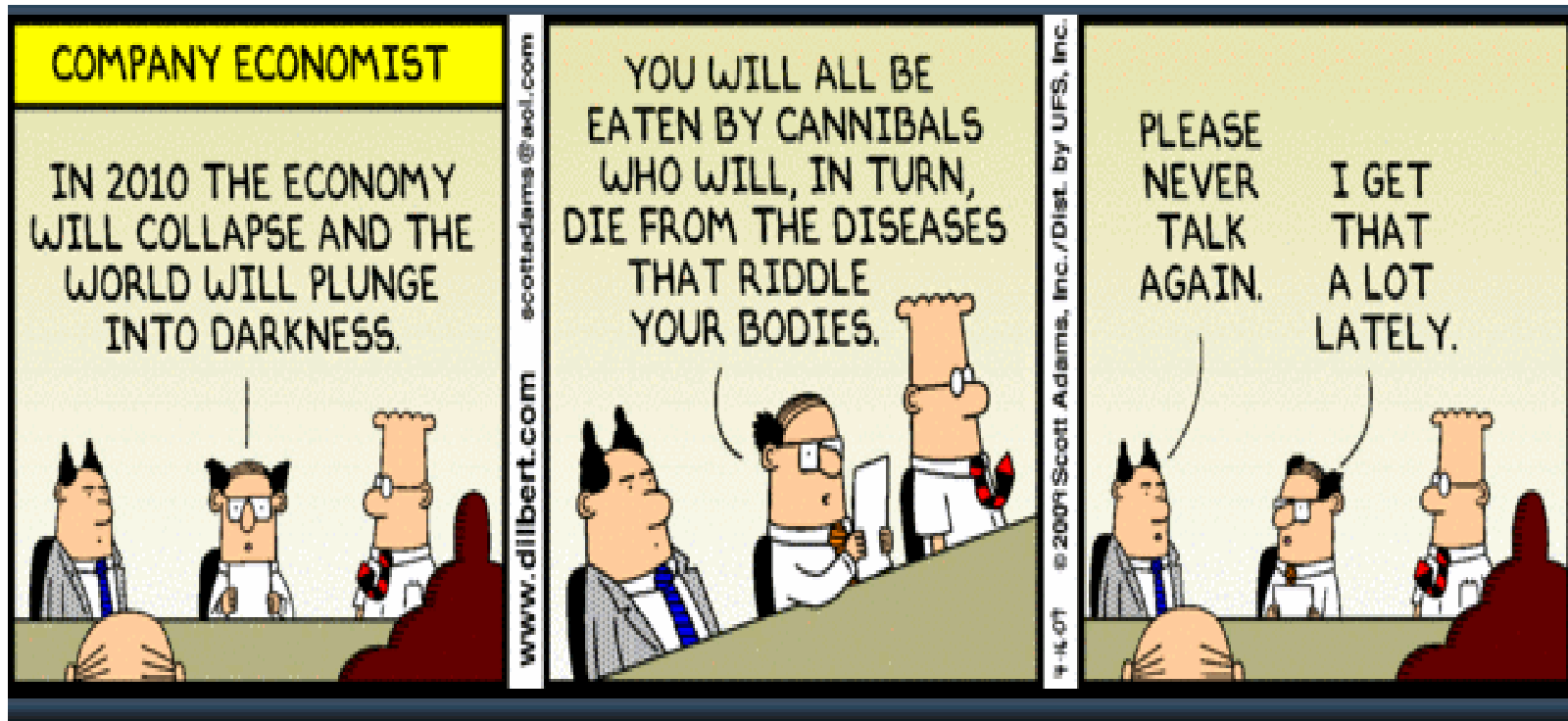
Revenue Sharing	\$1,133.7
Grants	\$103.8
Debt Service	\$82.2
Payments in Lieu of Taxes	\$14.4
	<hr/>
	\$1,334.1

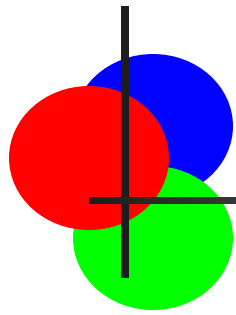
Operations Funding

Revenue Generation	\$120.6
Student Financial	\$37.5
Investments	\$16.7
Local Government	\$17.4
Customer Service	\$12.1
State Banking	\$7.1
Revenue Forecasting	\$1.5
Bond Finance	\$1.3
	<hr/>
	\$214.2



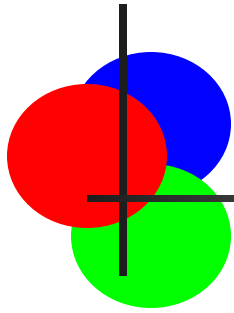
Don't Shoot the Messenger



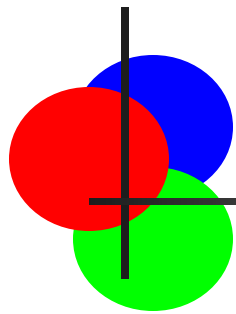


Topics Covered

- ▶ National Economic Outlook
- ▶ Michigan Economic Forecast
- ▶ State Budget and Fiscal Update
- ▶ Michigan Budget Process

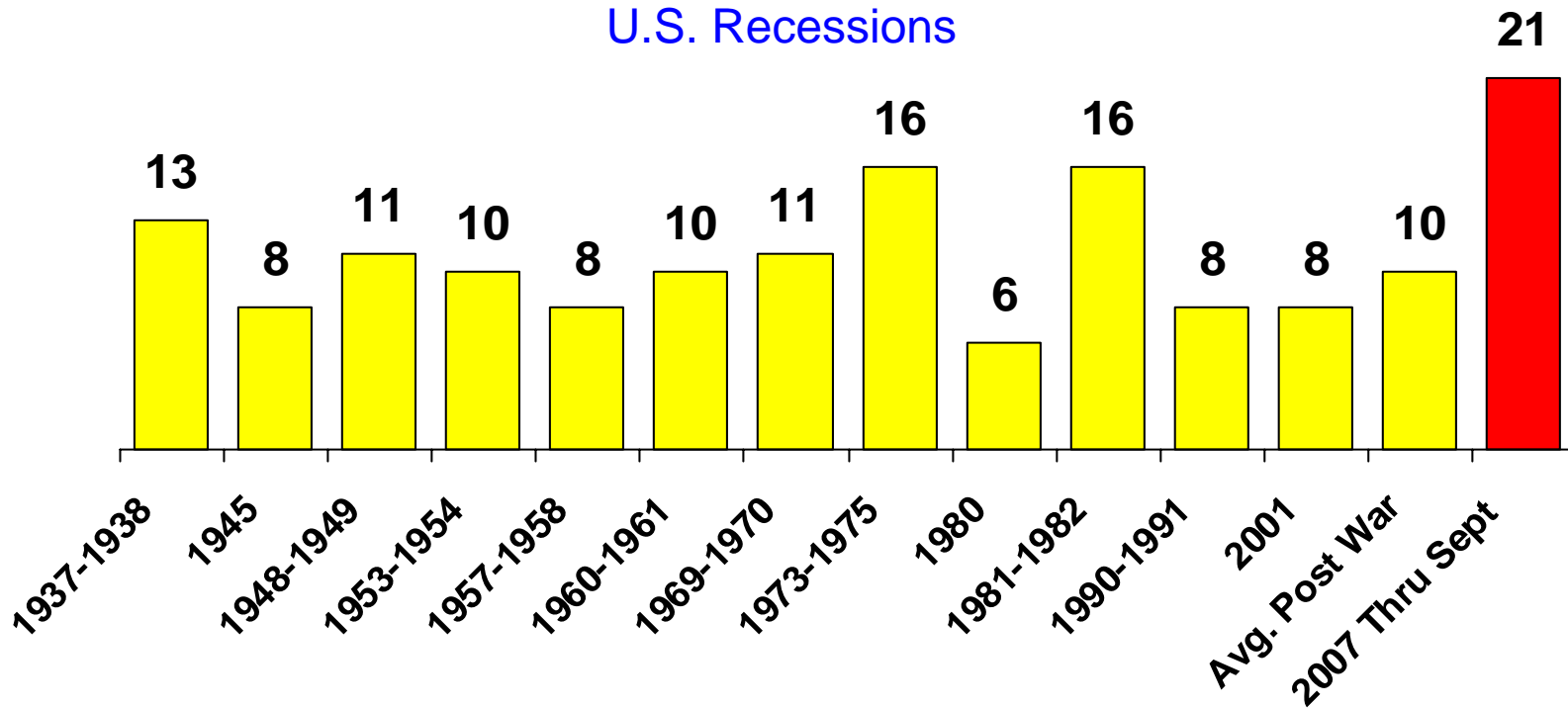


How Bad is the Recession?

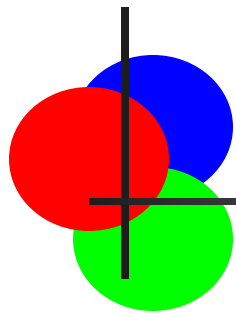


Current Recession Already Longest Since Great Depression

Number of Months from Peak to Trough
U.S. Recessions

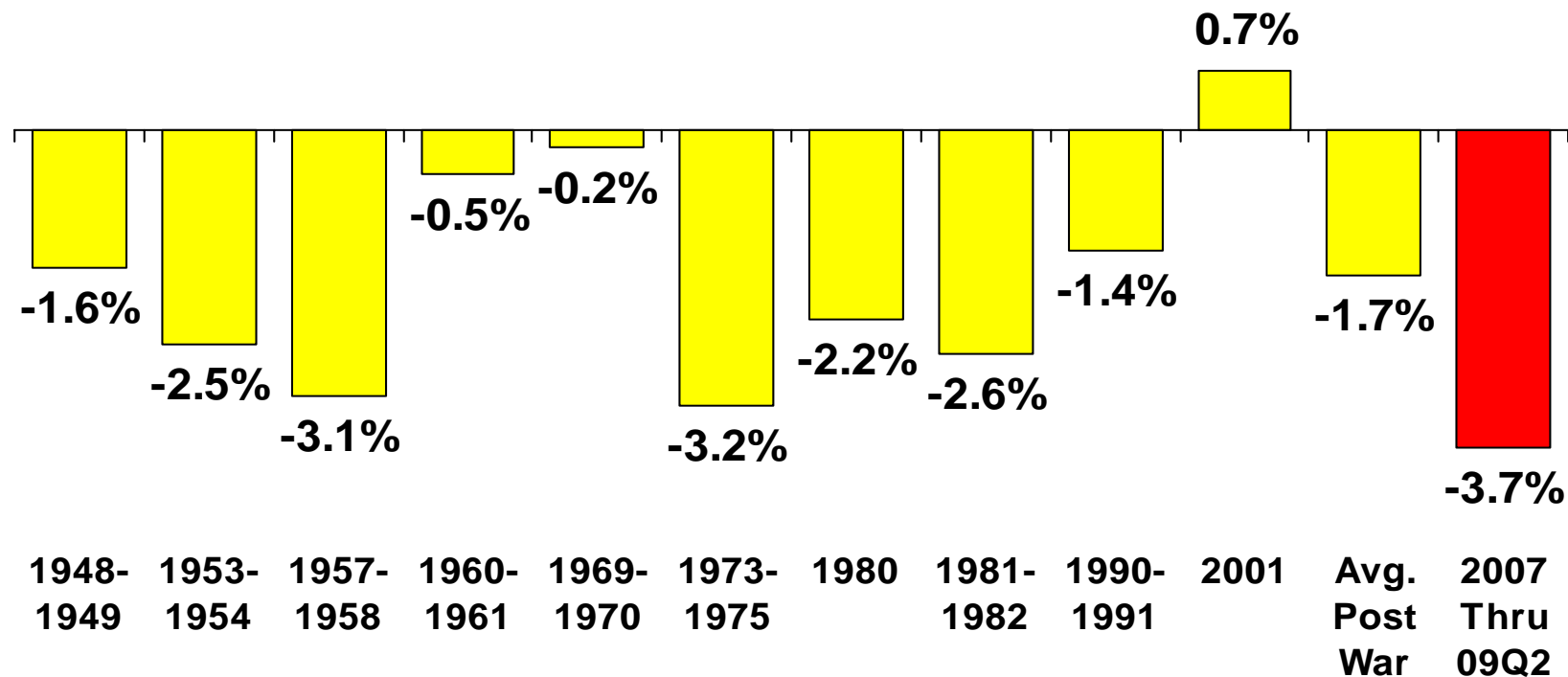


Source: NBER

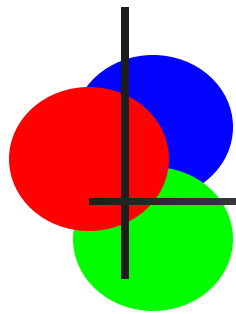


Current Recession GDP Decline Already the Steepest on Record

Percent Change, Economy Peak to Trough

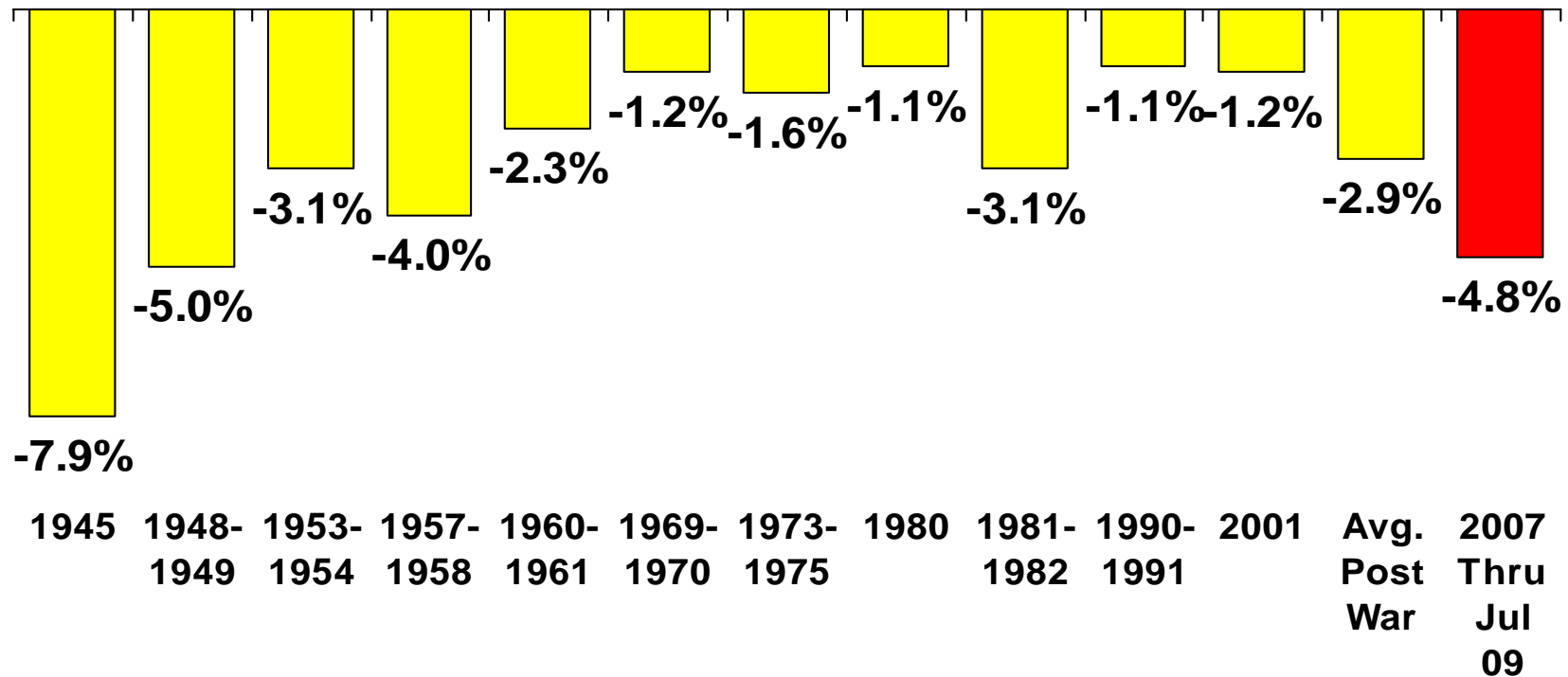


Source: Bureau of Economic Analysis, U.S. Department of Commerce.
Data not available for 1937-38 and 1945 recessions.

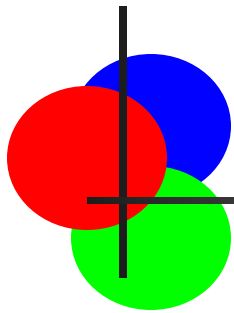


Current Recession Employment Decline Nearly Second Steepest

Percent Change, Economy Peak to Trough

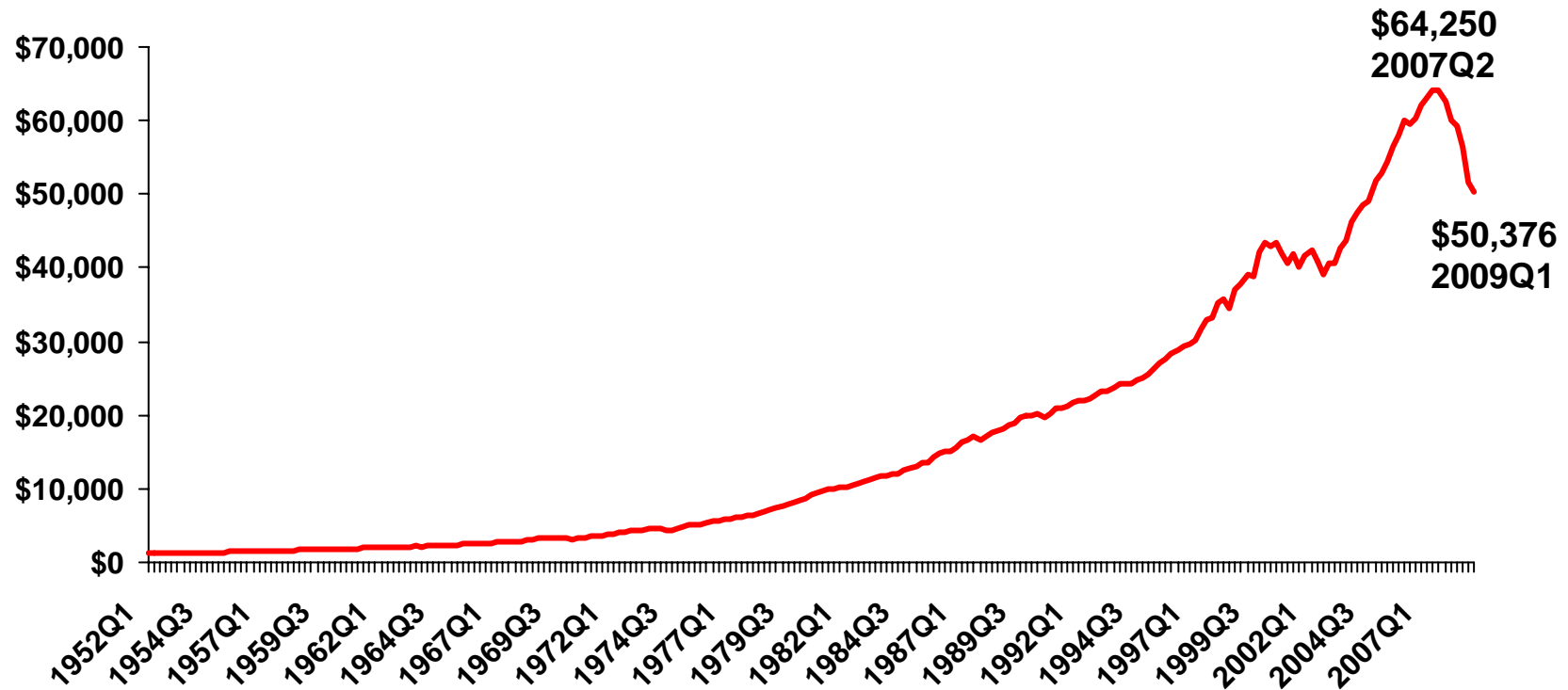


Source: Bureau of Economic Analysis, U.S. Department of Commerce. Data not avail for 1937-38 recession.

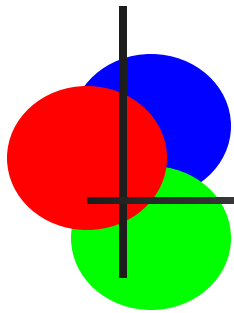


Net Worth Drops 22 Percent from Peak

Net Worth Outstanding, Households and Nonprofit Organizations
(billions)



Source: freelunch.com (Federal Reserve Bank Flow of Funds).

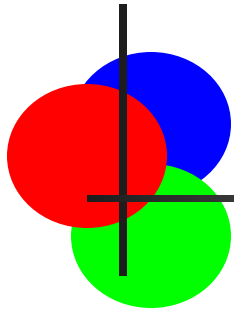


One for the Record Books

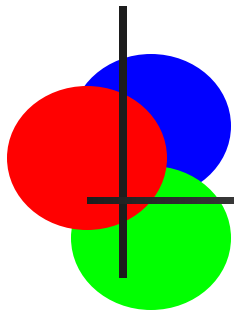
Calendar 2009 Estimate

	April 2008 Forecast	Aug 2009 Forecast	Comments
Light Vehicle Sales (millions)	15.2	10.3	Lowest Since 1970
Housing Starts (million units)	1.131	0.59	Lowest Back to 1959
US Unemployment Rate	5.8%	9.2%	Highest Since 1983
US Payroll Employment (% chg)	0.4%	-3.7%	Lowest Back to 1940
US Personal Income (% chg)	3.6%	-2.0%	Lowest Since 1938

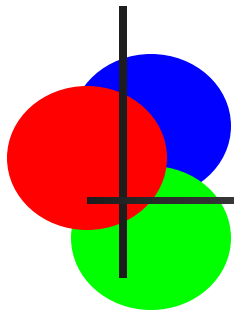
Source: Estimates Compare April 2008 and Aug 2009 Global Insight Forecasts



Is the Recession over?

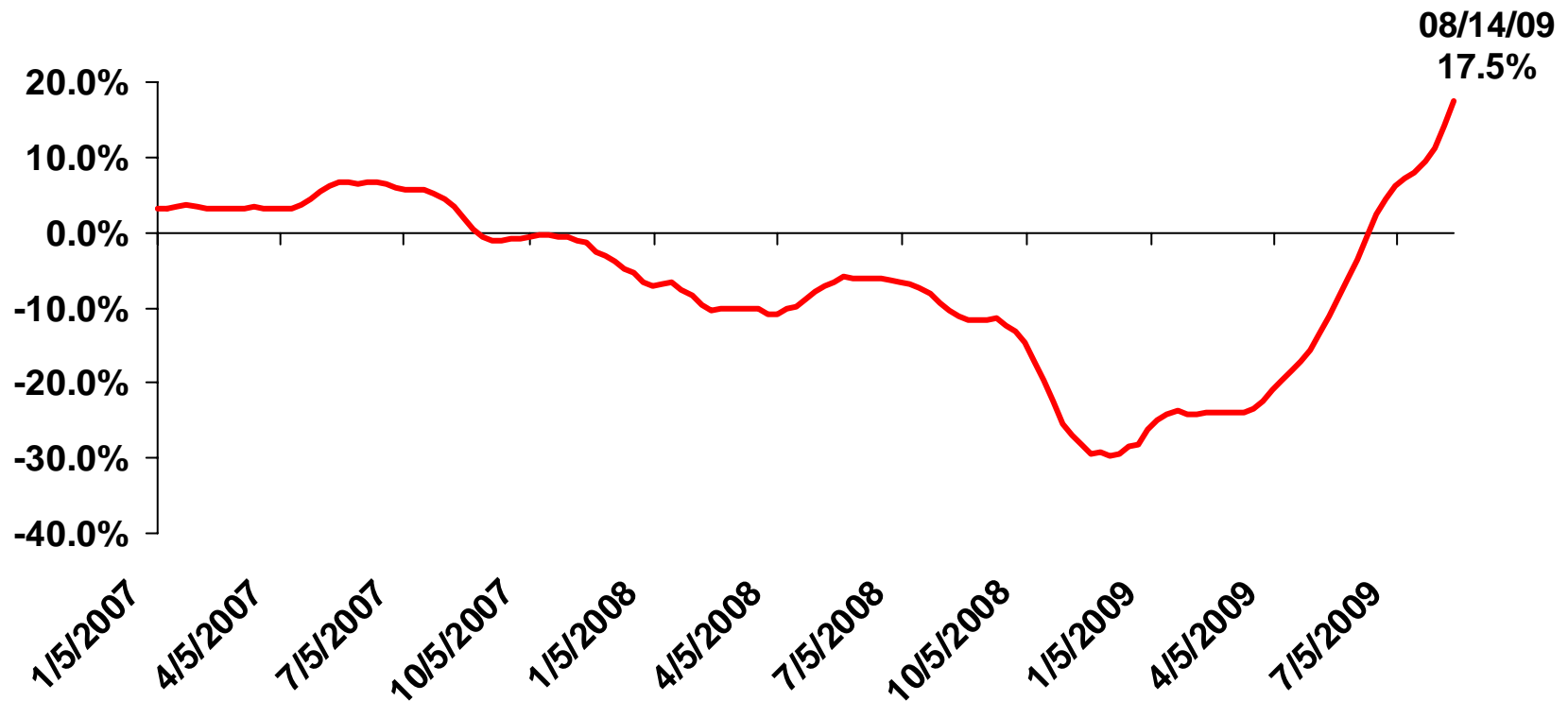


"It's true, Caesar. Rome is declining, but I expect it to pick up in the next quarter."

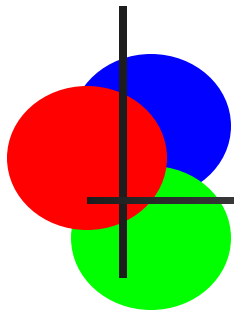


Leading Indicators Point to Imminent National Recovery

Weekly Leading Index, Smoothed Annual Growth Rate

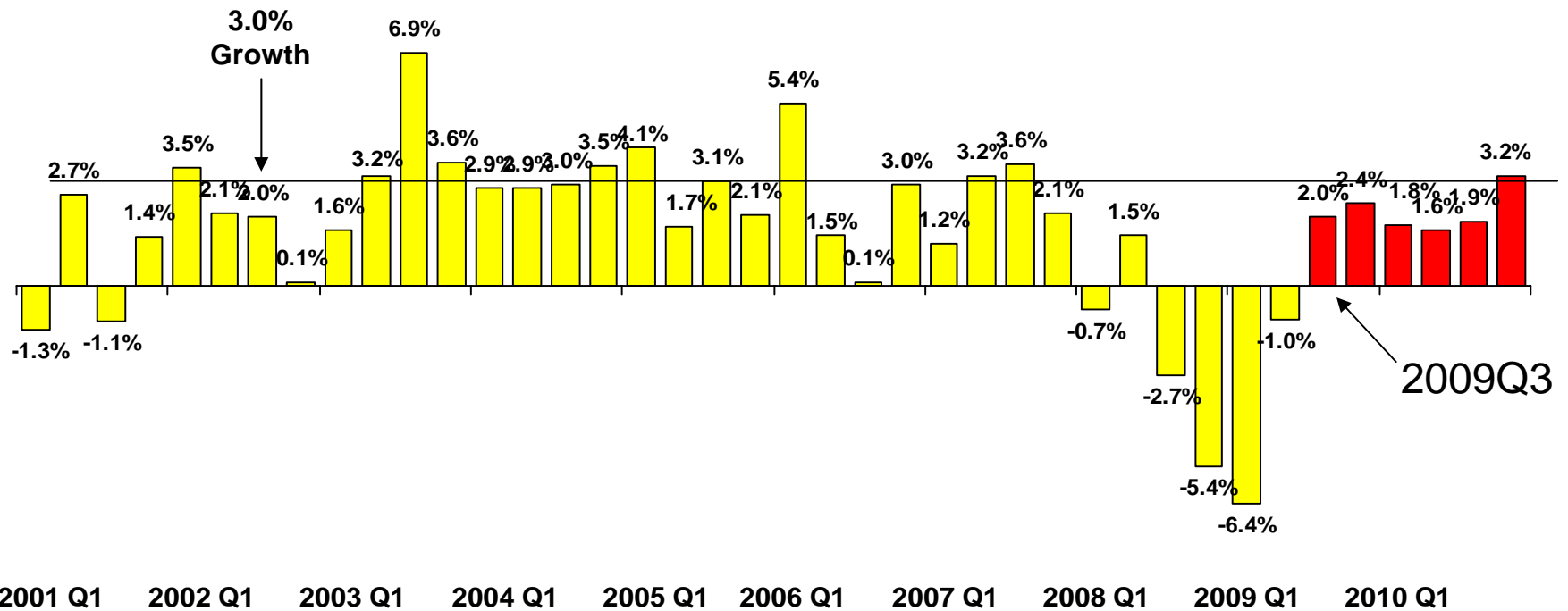


Source: Economic Cycle Research Institute.



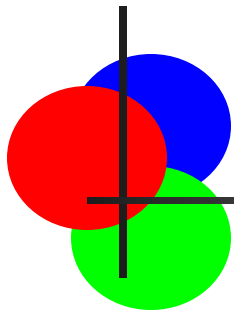
Some See Recovery This Quarter

Real GDP Growth

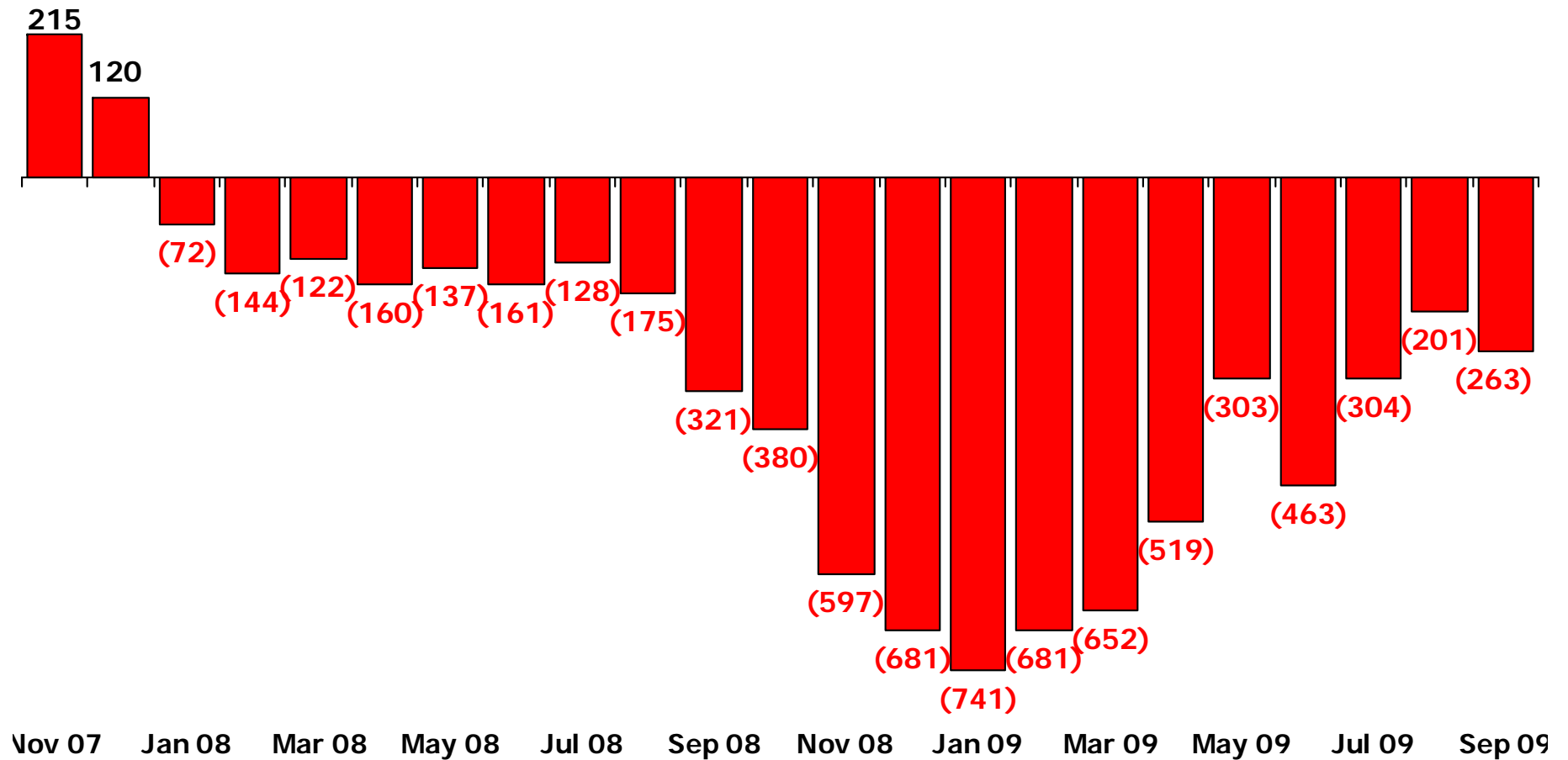


Figures are annualized percent change from preceding quarter in 2005 chained dollars.

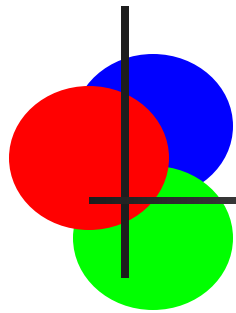
Source: Bureau of Economic Analysis. Forecast quarters in red are the August 2009 Global Insight forecast.



U.S. Has Lost 7.2 Million Jobs Since December 2007

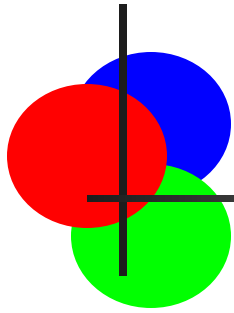


Source: U.S. Bureau of Labor Statistics, U.S. Department of Labor

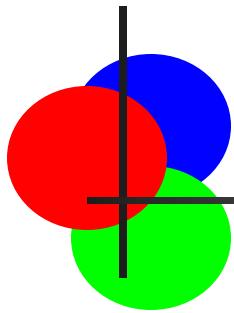


Blue Chip Economists' Take on the Recovery

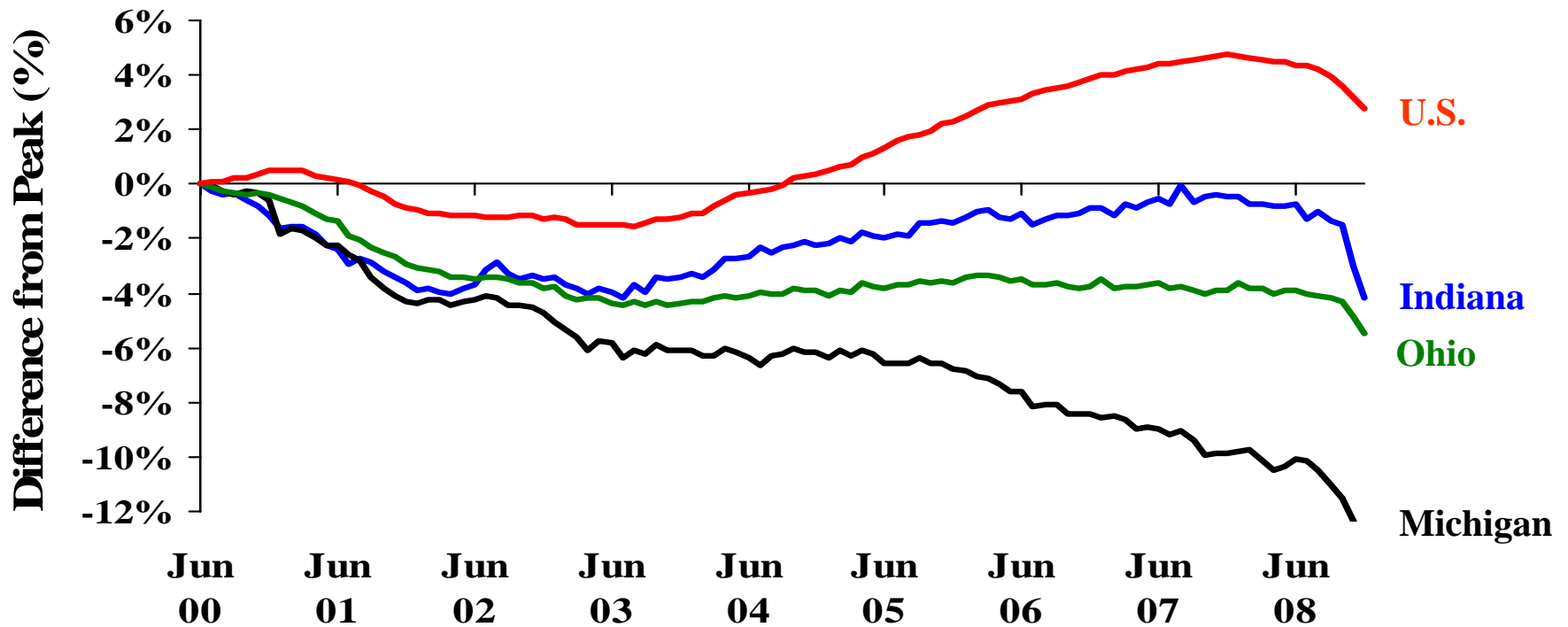
- ▶ 90 percent say recovery will begin next quarter.
- ▶ Almost two-thirds see U-shaped recovery.
 - ▶ 17 percent see V-shaped recovery
 - ▶ 17 percent see W-shaped recovery
- ▶ Unemployment rate will peak slightly above 10 percent but will fall very slowly.
 - ▶ 70 percent see jobless rate above 7 percent until at least first half of 2012



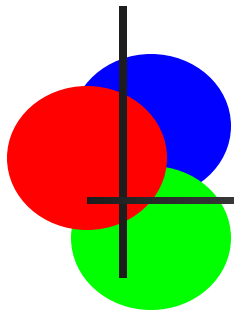
What about Michigan?



Michigan Employment Did Not Recover During This Expansion

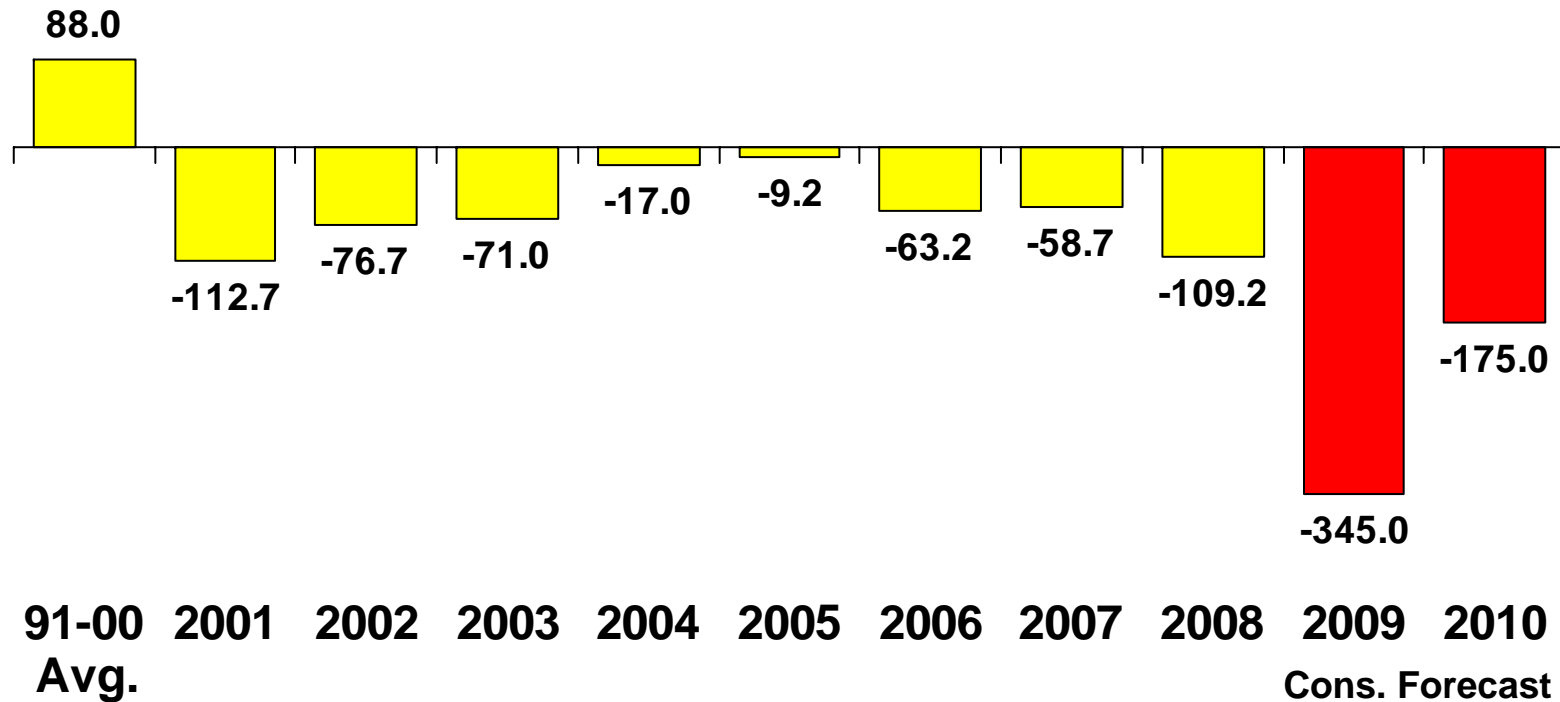


Note: Peak is calculated from Michigan's June 2000 Peak.

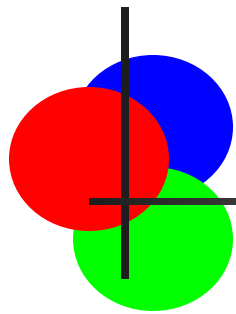


Michigan Loses 1 Million Jobs

Michigan Wage and Salary Employment Y-O-Y Change
(In Thousands)

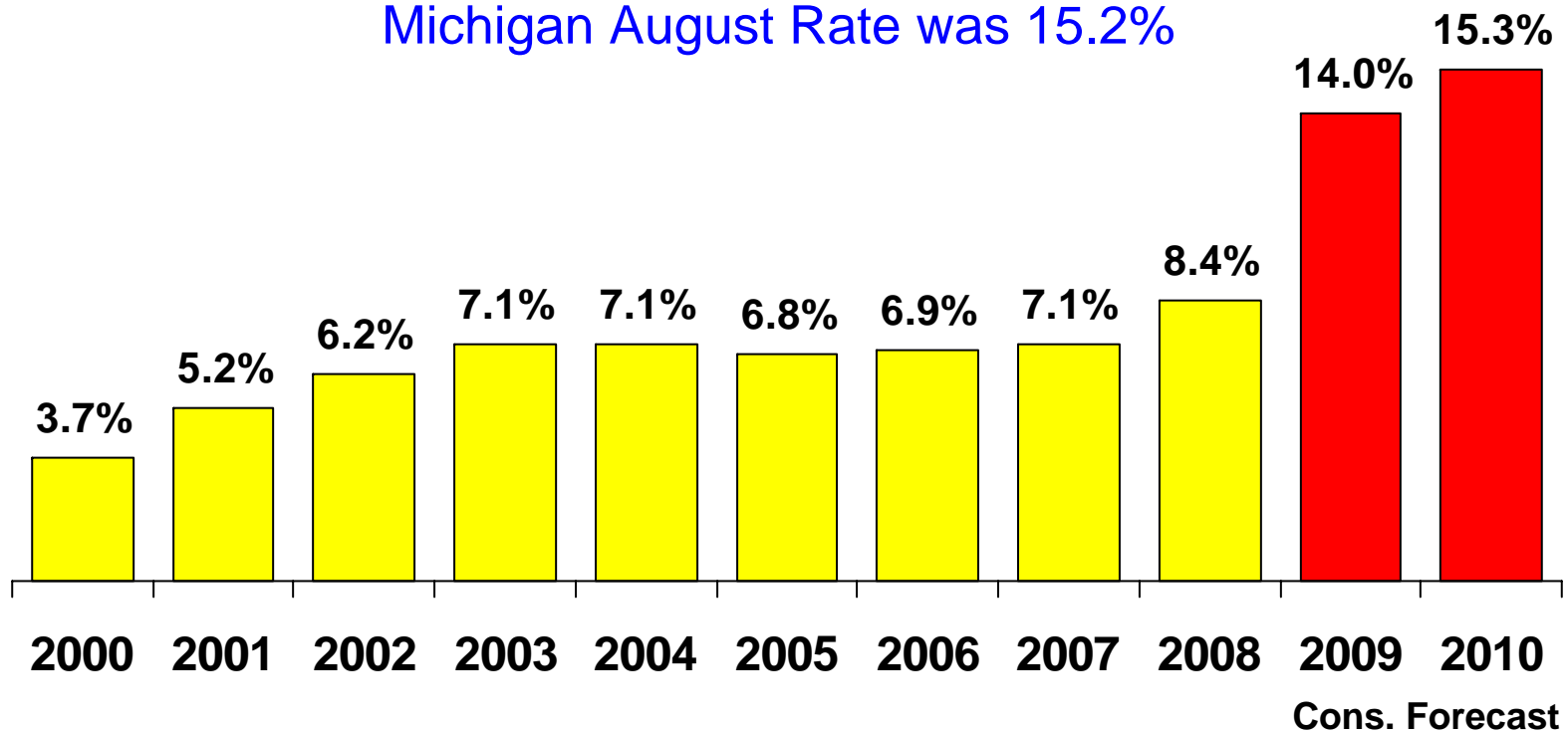


Note: Bureau of Labor Statistics. 2009-2010 estimates are from the May 2009 Consensus forecast.

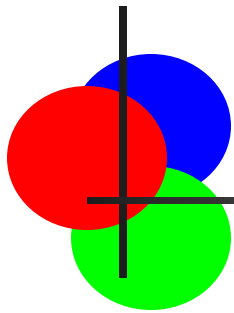


Michigan Unemployment Rate To Rise Sharply

Michigan August Rate was 15.2%

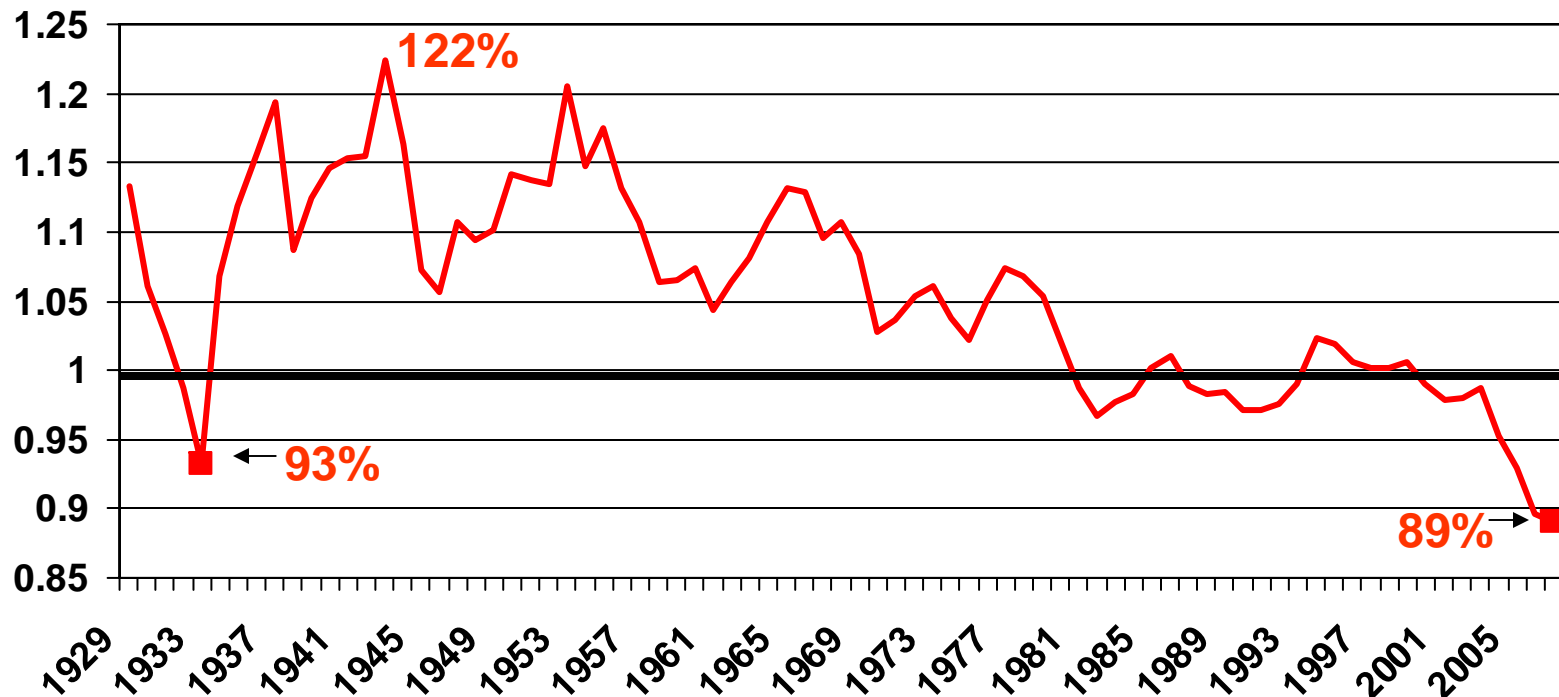


Source: Bureau of Labor Statistics and May 2009 Consensus Forecast



Michigan Personal Income Falling Relative to U.S.

Michigan per Capita Income as a Percent of U.S. Per Capita Income



Source: Department of Treasury calculations from Bureau of Economic Analysis data.

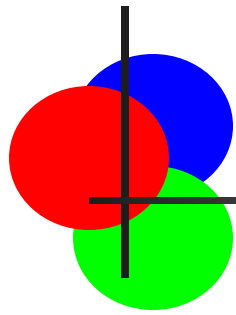


Michigan Home Building Falls Precipitously

New Private Housing Units Authorized in Michigan

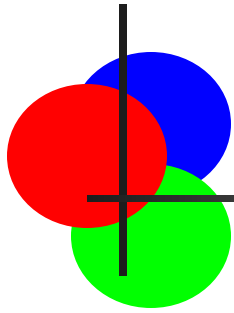
<u>Year</u>	<u>Detroit PMSA</u>	<u>Ann Arbor</u>	<u>Grand Rapids</u>	<u>Lansing</u>	<u>Total</u>
2004	22,990	2,708	6,886	2,206	54,721
2005	17,326	1,676	5,826	2,121	45,328
2006	9,592	775	4,278	1,231	29,191
2007	4,325	565	1,866	768	17,767
2008	2,590	347	1,064	383	10,911
2009 YTD	640	96	378	124	3,613

Source: U.S. Department of Commerce. 2009YTD through July.

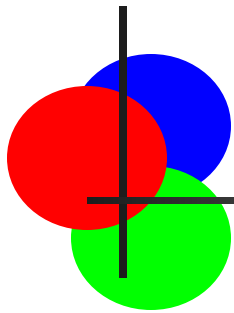


Industry Restructuring 25-Year Recovery Cycle

- ▶ 1960 → New England Textile Industry
- ▶ 1980 → Pittsburgh Steel Industry
- ▶ 2000 → Michigan Auto Industry



How do the State and Local Budgets Look?



Difficult Economic Times

Reduce Revenue Growth

Cause

▶ Recession



Effect

Employment Loss and
Income Loss

▶ Housing Boom/Bust

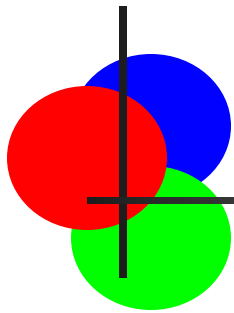


Credit Crisis and
Consumption Drop

▶ Auto Industry/
Restructuring

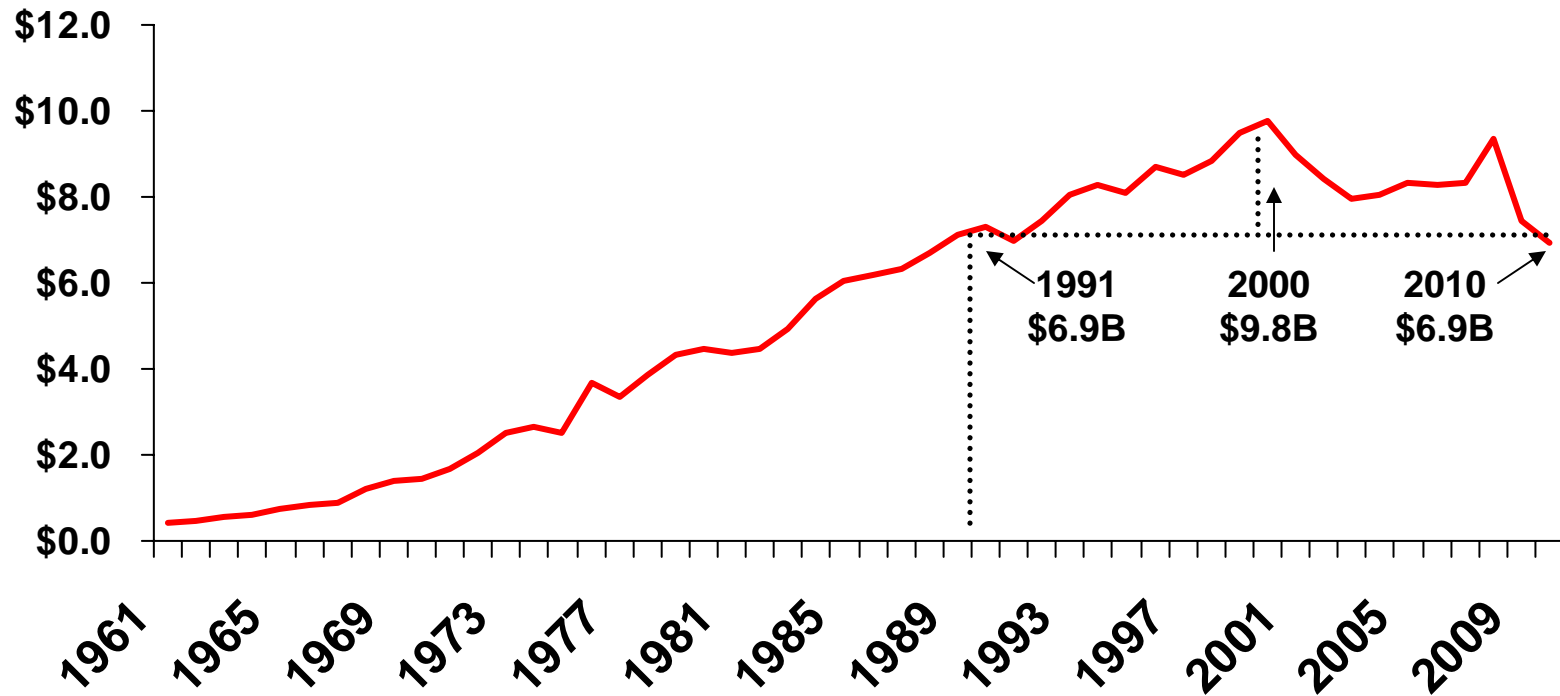


Relative Decline in
Personal Income

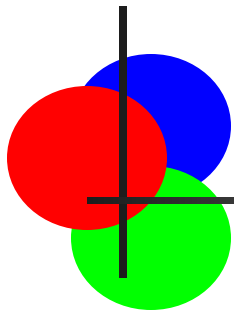


State GF-GP Revenue at FY '91 Level Down 19% Since 2000

Billions of Dollars

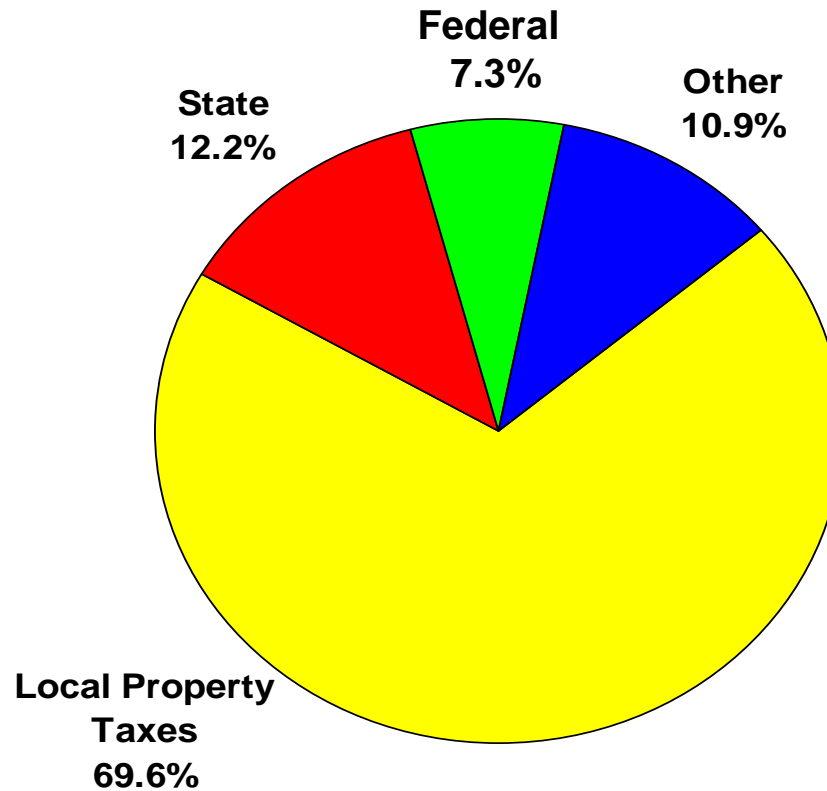


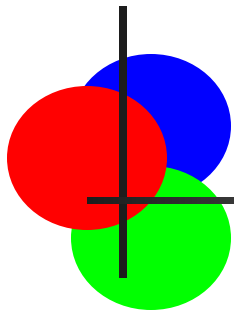
Note: GF-GP figures are presented on a Consensus basis. 2009 and 2010 are estimates.



Most Local Revenue From Property Taxes

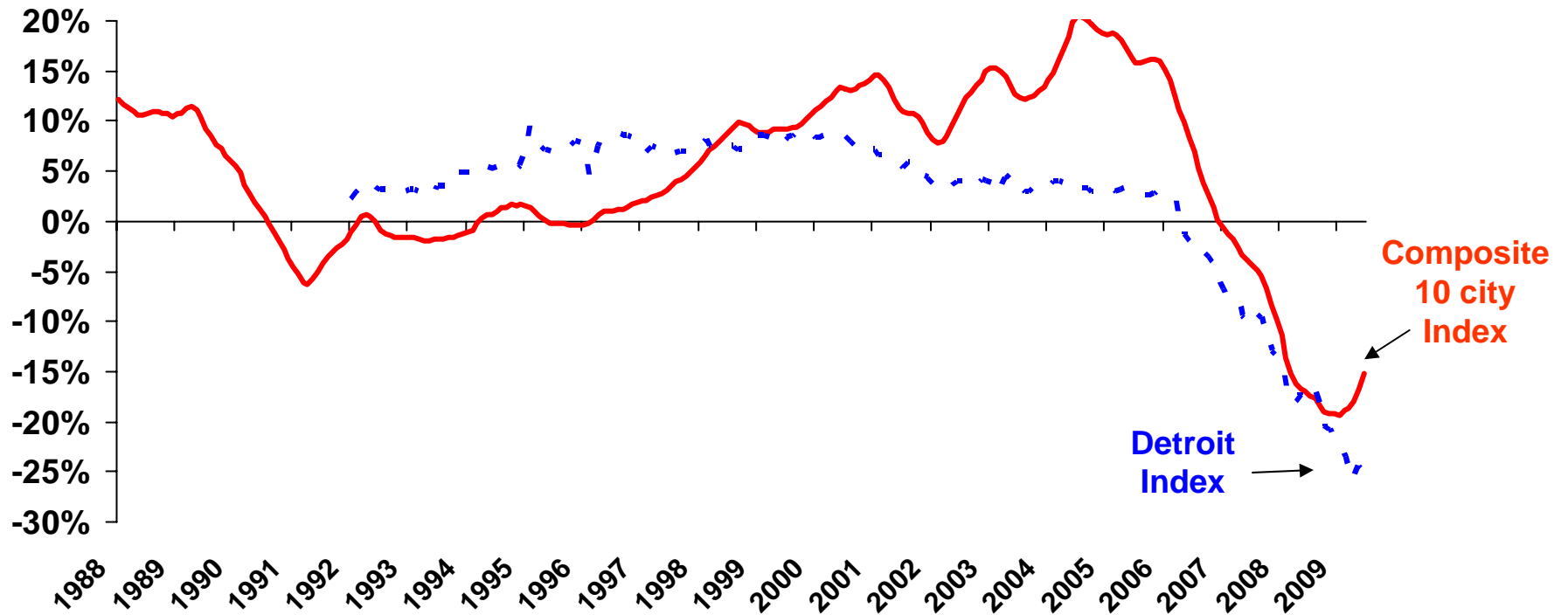
FY 2009 Taxes Total \$24.8 Billion

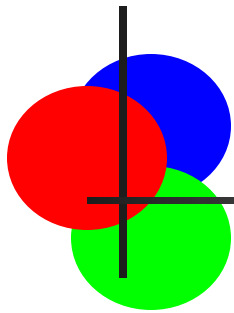




Home Prices Still Falling

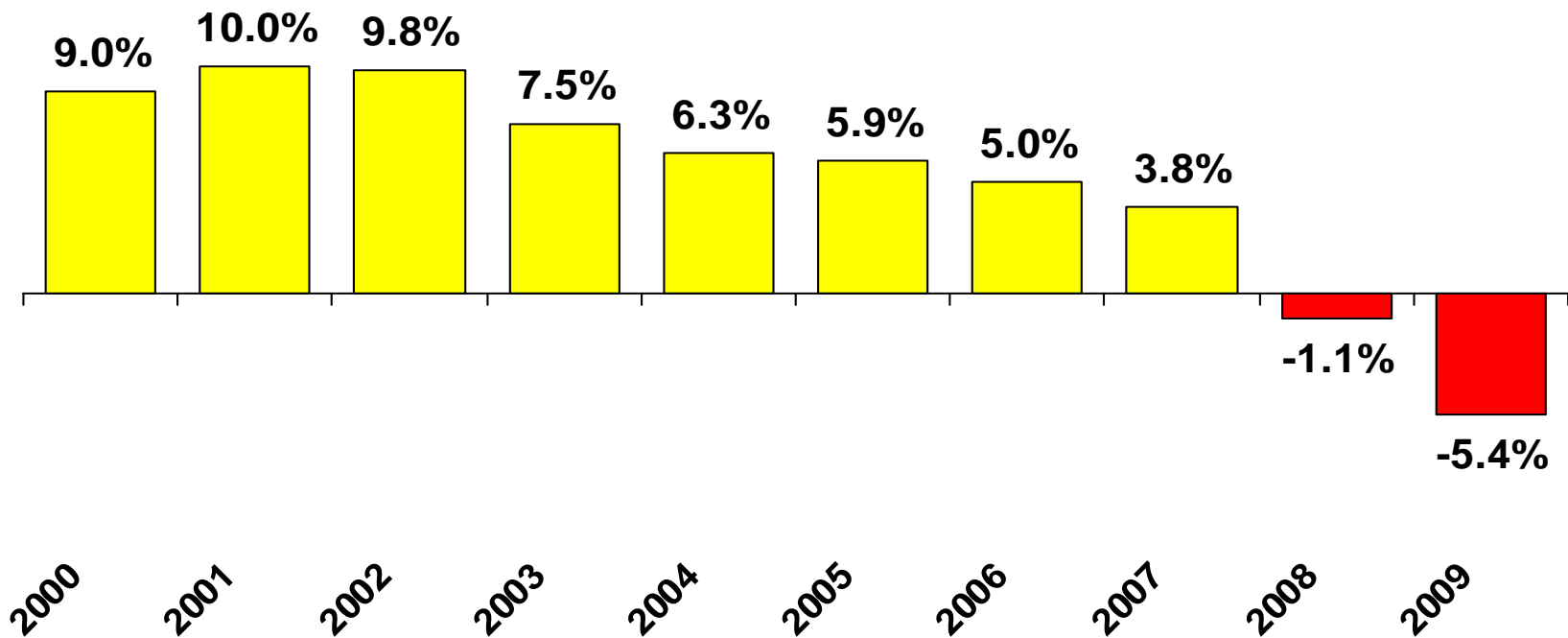
Case-Shiller Composite Home Price Y-O-Y Growth



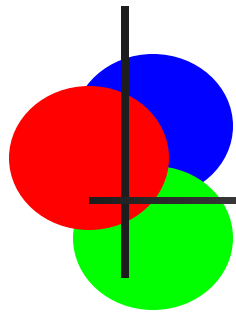


Total State SEV Declines for 2nd Year in a Row

% Change in Total Real and Personal SEV

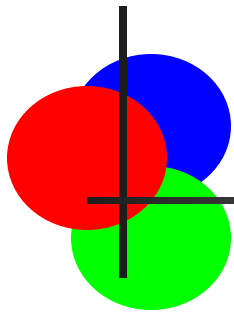


Source: State Tax Commission



Local Revenue Sharing Cut 30% Last Seven Years

	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>
Cities, Villages, & Townships	\$1,327	\$1,300	\$1,249	\$1,123	\$1,112	\$1,103	\$1,071	\$1,076	\$1,037
Counties	\$229	\$218	\$203	\$182	\$0	\$0	\$0	\$0	\$3
Total Revenue Sharing	\$1,556	\$1,517	\$1,451	\$1,305	\$1,112	\$1,103	\$1,071	\$1,076	\$1,040

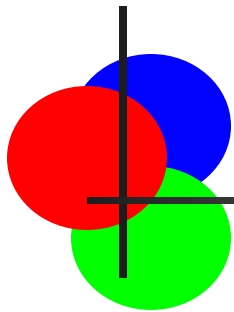


Fiscal Year 2009

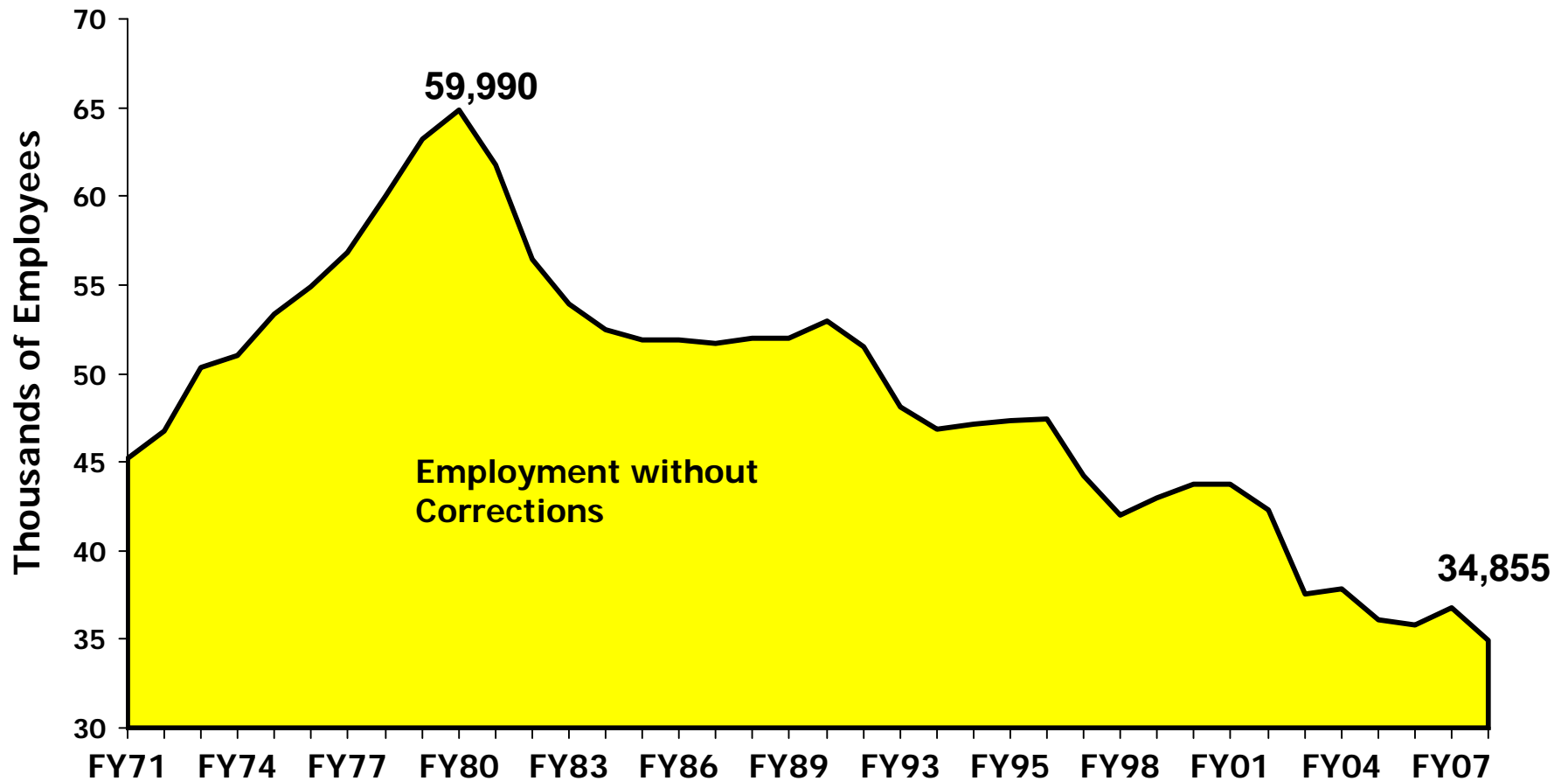
General Fund/General Purpose

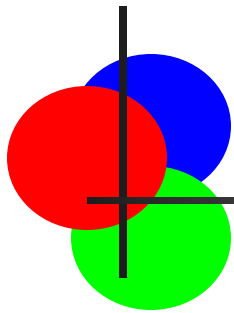
	<u>Millions</u>
	<u>FY 2009</u>
Beginning Balance	\$457.9
Consensus Revenues	\$7,435.3
Other Resources	<u>\$760.4</u>
Total Estimated Resources	\$8,653.6
Initial Appropriation	\$9,701.4
Pending Supplementals	\$295.2
EO-2008-21 & EO 2009-22	(\$431.6)
Other Reductions	<u>(\$26.9)</u>
Total Spending	\$9,538.1
Projected Year End Balance	<u>(\$884.5)</u>
ARRA Funding	\$1,229.9
Projected Balance after ARRA	\$345.4

Source: Senate Fiscal Agency.



25,000 Fewer Non-Corrections State Employees since 1978



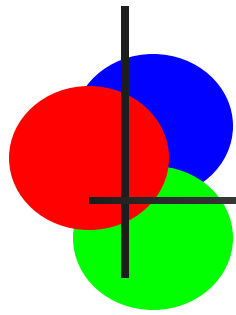


Michigan State Government

12,000 Fewer Employees than 1978

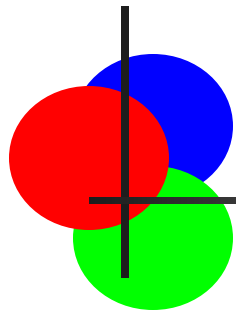
<u>Fiscal Year</u>	<u>Governor</u>	<u>Number State Employees</u>	<u>Non-Corrections State Employees</u>	<u>Corrections Employees</u>
1973	Milliken	52,673	50,316	2,357
1978	Milliken	64,456	59,990	4,466
1989	Blanchard	64,560	52,038	12,522
2000	Engler	61,493	43,841	17,652
2008	Granholm	50,799	34,855	15,944
% Change 1978-2008		-21%	-42%	257%
% Change 2000-2008		-17%	-20%	-10%

Source: Michigan Department of Treasury



Local Governments Facing Similar Budget Problems

- ▶ Revenue from State and Federal sources not growing.
- ▶ Property tax revenue growing slower.
- ▶ Spending pressures increasing.
- ▶ Difficult to downsize.
- ▶ Federal stimulus aid helping.



Summary:

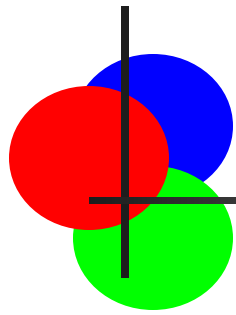
State and Local Budget Problems

▶ Lower Revenues

- ▶ Income Tax
- ▶ Sales Tax
- ▶ Gas Tax
- ▶ Property Tax

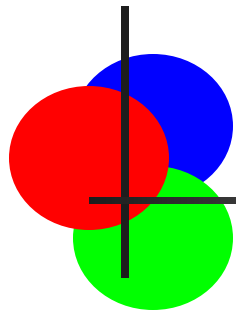
▶ Spending Pressures

- ▶ Higher social services
- ▶ Deferred maintenance increases future costs



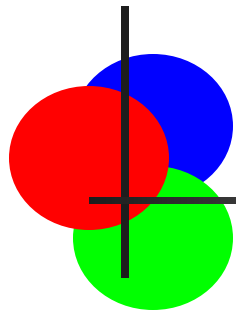
Understanding Government Finances in Michigan

- ▶ The economy affects revenue collections and spending pressures.
- ▶ Recent trends have made it difficult for local governments to balance budgets.
- ▶ Budget decisions are made well in advance of current time period.
- ▶ Looking ahead at trends can make you more effective in competing for scarce resources.



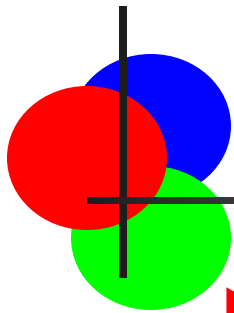
How Budget Spending Decisions are Made





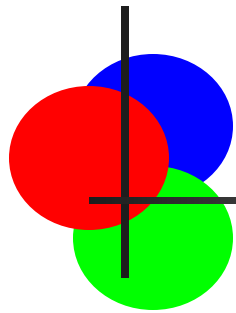
The Budget Process is Inherently Political

The goal of the budget process is to
balance competing priorities
to meet the essential needs of the
Citizens of the state/city.



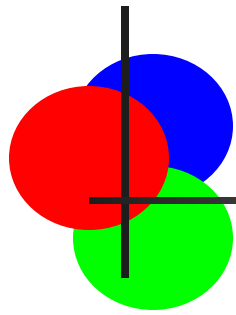
Executive and Legislative Roles

- ▶ Michigan Constitution and statute provide that executive and legislative branches share power and responsibility for the state budget process.
 - ▶ Governor submits a balanced budget.
 - ▶ Governor and Legislature maintain a balanced budget.



State Constitution Requires a Balanced Budget

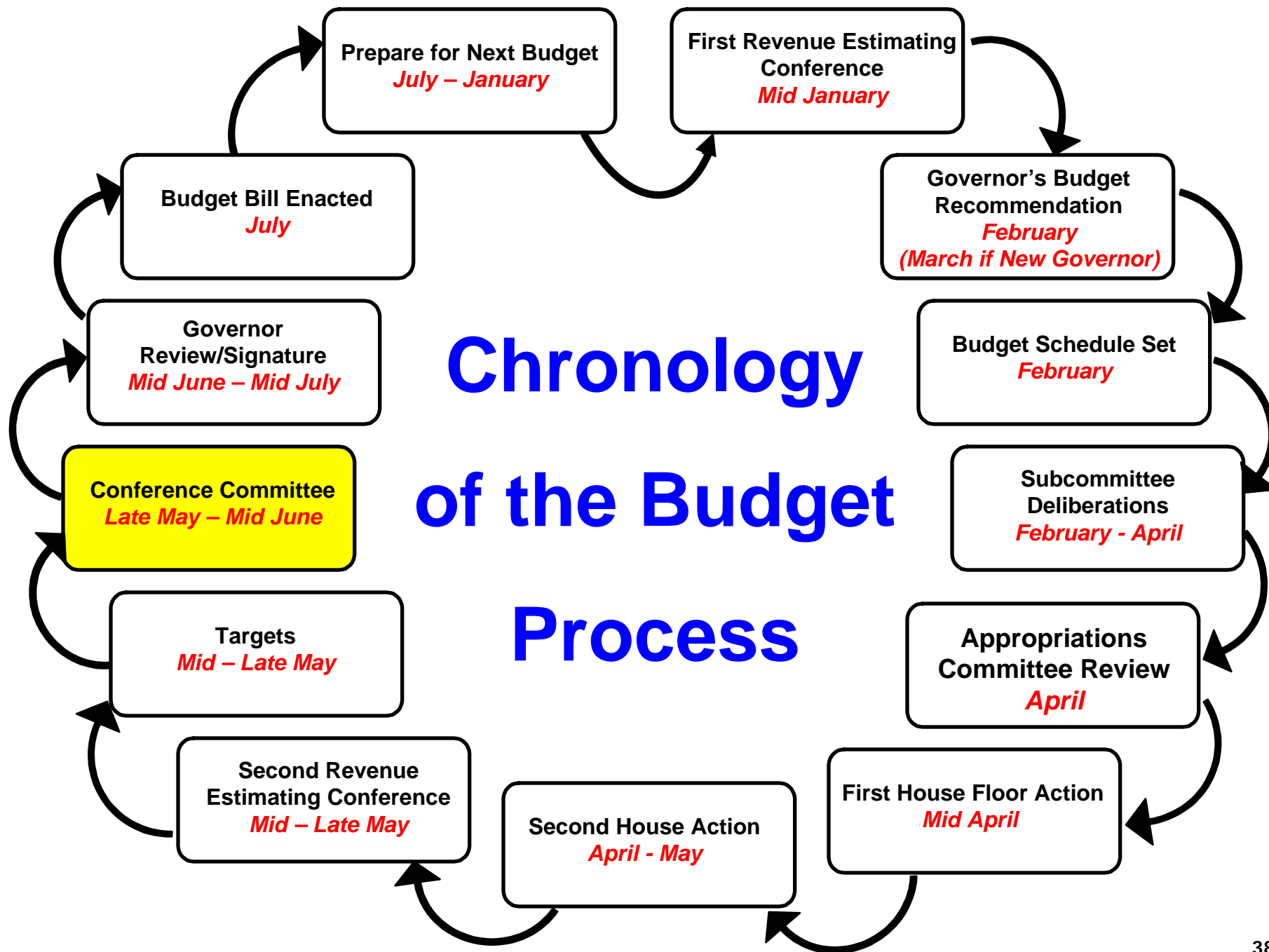
Article V, Section 18: “The governor shall submit to the legislature ... a budget for the ensuing fiscal period ... setting forth in detail, for all operating funds, the proposed expenditures and estimated revenue of the state. Proposed expenditures from any fund shall not exceed the estimated revenue thereof....”

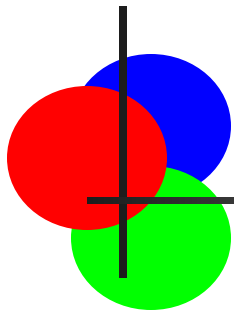


Legislative Power and Responsibility

- ▶ Legislature has the power to tax and borrow.
- ▶ Legislature has the power to control spending.
- ▶ APPROPRIATIONS
are an authority, not a mandate, to spend.
- ▶ APPROPRIATIONS
are state law while they are in effect.

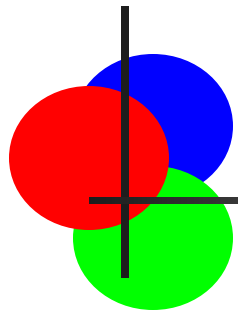
Chronology of the Budget Process





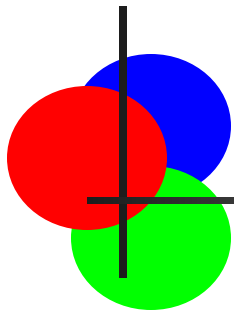
Appropriations Conference Committee

- ▶ Conference committee consists of:
 - ▶ **Three members from the House**
 - ▶ **Three members from the Senate**
- ▶ Only matters of difference may be considered.
- ▶ If agreement is reached, conference committee report is presented to both chambers.
- ▶ Conference committee report must be accepted or refused as presented; it cannot be amended on the floor.
- ▶ If conference report is accepted, bill is enrolled and presented to the Governor for signature.



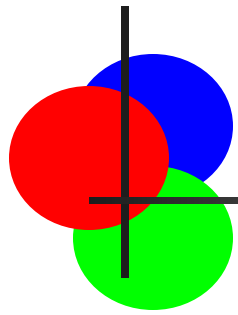
The Budget Process is Inherently Political

The goal of the budget process is to
balance competing priorities
to meet the essential needs of the
Citizens of the state/city.



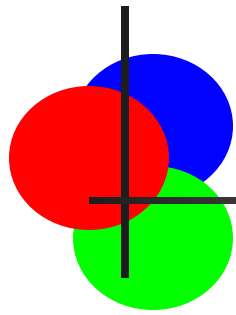
Adjustments to the Budget

- ▶ Adjustments to the budget can be made by
 - ▶ **Transfer (Administrative or Legislative)**
 - ▶ Makes adjustments within a budget.
 - ▶ May increase or decrease a line item.
 - ▶ **Supplemental Appropriations Bill**
 - ▶ Makes adjustments between budgets.
 - ▶ May increase or decrease spending.
 - ▶ **Executive Order**
 - ▶ Used when actual revenue falls below anticipated revenue.
 - ▶ Constitutional power allows Governor to reduce expenditures authorized by appropriations.



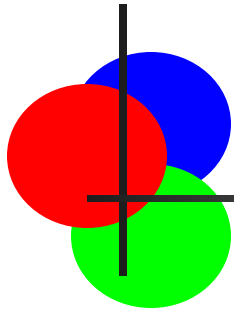
Getting Heard in the Budget Process

- ▶ Start Early.
- ▶ Understand competing demands for funding.
- ▶ Monitor the budget request through the entire Executive and Legislative processes.
- ▶ Plan for multi-year time frame.



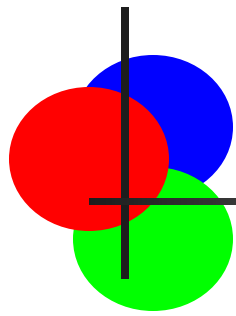
Specific Michigan State Budget Practices

- ▶ Strong Executive Branch influence.
- ▶ Strong Legislative Appropriations Committees.
- ▶ Large number of appropriation bills.
- ▶ Consensus revenue estimating process.
- ▶ Incremental changes in budget.
- ▶ Strong threat of line-item veto.



Budget Considerations

- ▶ Available revenues.
- ▶ Baseline spending needs.
- ▶ State agency recommendations.
- ▶ Governor's spending priorities.
- ▶ Legislative spending priorities.
- ▶ Successful advocacy.
- ▶ Politics.

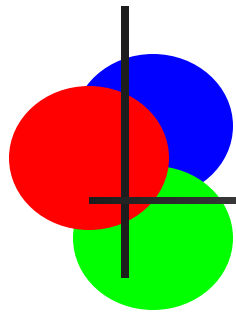


Revenues Have Not Kept Up With Costs

Annual Growth

	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 00-08</u>
Sales Tax	1.2%	1.4%	-0.3%	0.8%	1.9%	0.6%	-1.3%	3.4%	7.9%
Income Tax	-5.5%	-9.7%	-4.7%	1.1%	4.0%	1.9%	3.5%	12.2%	1.1%
SBT/MBT	-13.0%	-1.9%	-7.1%	-0.1%	3.6%	-1.1%	-3.7%	35.8%	6.1%
RETT	-1.6%	0.1%	8.9%	15.2%	-1.2%	-5.1%	-20.2%	-28.5%	-33.9%
Gasoline Tax	1.4%	0.6%	-0.4%	-0.4%	-1.1%	-1.7%	-2.5%	-3.9%	-7.9%
GF-GP	-8.2%	-6.3%	-5.6%	1.0%	3.3%	-0.5%	0.6%	12.5%	-4.4%
S&L Govt Prices	3.4%	2.1%	3.9%	3.8%	6.2%	5.9%	4.6%	6.3%	42.6%

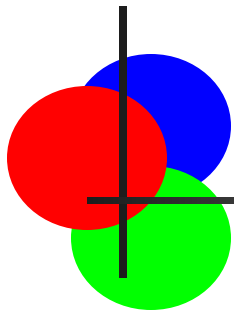
Note: State and local price growth is measured using the state and local government price deflator as published by The U.S. Bureau of Economic Analysis.



Long Term Spending Pressures

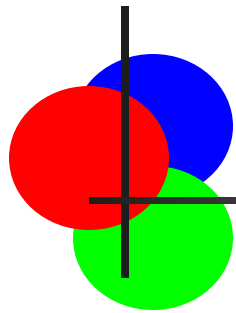
- ▶ Healthcare costs are key driver of spending:
 - ▶ Nearly 1 in 3 GF dollars will be spent for healthcare for current and retired employees (up from 1 in 5).
 - ▶ K-12 retiree healthcare costs will grow 11.9% per year.
 - ▶ Medicaid expected to grow 10.1% per year through FY 17.

- ▶ School aid population will decline 1.7% per year through FY 17 lowering costs, but difficult for school districts to manage declining enrollment.



Long-Term Revenue Pressures

- ▶ Income tax rate begins to fall from current rate of 4.35% in FY 2012. Rate is 3.9% for FY 2016. Rate differential currently represents \$744 million per year.
- ▶ Accounting rule FASB 109 credit costs \$40 million to \$60 million per year starting in 2015 to 2019; \$60 million to \$90 million for next 5 years and \$100 million to \$150 million for the subsequent 5 years.
- ▶ MBT surcharge is repealed effective January 1 of 2017 (if personal income grows in any of the prior 3 years); surcharge currently raises \$722 million per year.
- ▶ Tobacco tax and gasoline tax fall from year to year as consumption declines.



Fiscal Year 2010

General Fund/General Purpose

	<u>Millions</u> <u>FY 2010</u>
Beginning Balance	\$0.0
Consensus Revenues	\$6,949.7
Other Resources	\$763.3
Total Estimated Resources	\$7,713.0
Gov's Approp Recommendations	\$9,522.6
Projected Year End Balance	(\$1,809.6)
Governor's Proposed Tax & Fee Increases	\$166.4
ARRA Funding Remaining From FY 09	\$189.6
ARRA Funding for FY 10	\$973.0

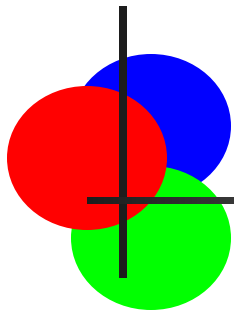
Source: Senate Fiscal Agency



Balancing FY 2011 Will Be Difficult

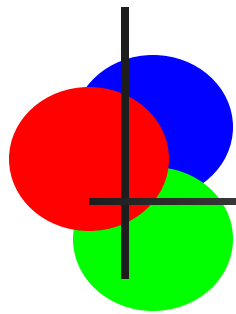
	<u>Millions</u>
FY 2010 Consensus Revenue	\$6,949.7
4% Revenue Growth	\$278.0
Other Resources (assume FY 10 Amt)	\$763.3
Subtotal	<u>\$7,991.0</u>
Rec Tax & Fee Incr. in FY 10 Budget grown 4%	<u>\$173.1</u>
Total Estimated Resources	\$8,164.0
Gov's Approp Rec for FY 10	<u>\$9,522.6</u>
Projected Year End Balance*	(\$1,358.6)

** There will likely be FY 11 ARRA funding but levels are unknown at this time.*



What Does Michigan Need to Do?

- ▶ Consolidate government services at both the state and local level.
- ▶ Reform the state's tax structure so that it will grow with the State's economy and not discourage economic growth.
- ▶ Slow the growth of government healthcare and tax expenditures.
- ▶ Maintain or increase the investment in education.



Many Units of Government

▶ Local Governments

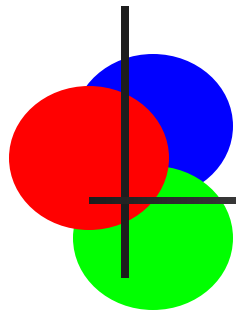
- ▶ 83 Counties
- ▶ 275 Cities
- ▶ 258 Villages
- ▶ 1,240 Townships

▶ K-12 Schools

- ▶ 551 Local School Districts
- ▶ 230 Charter Schools
- ▶ 57 Intermediate School Districts

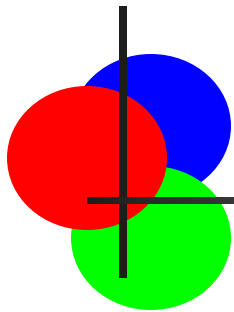
▶ Colleges and Universities

- ▶ 15 Public Universities
- ▶ 29 Community Colleges

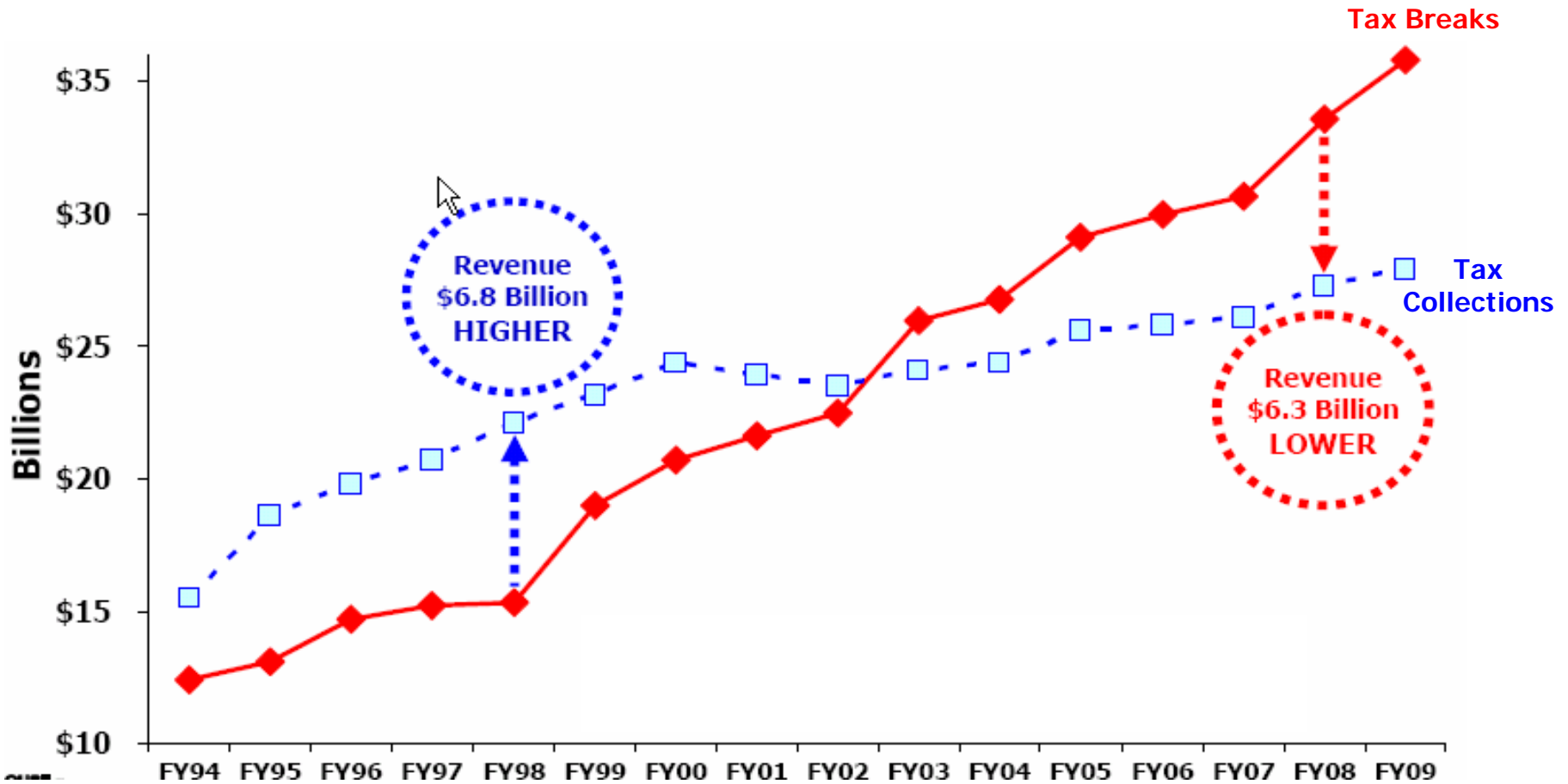


Three Types of State Spending: Grants, Services, and Tax Breaks

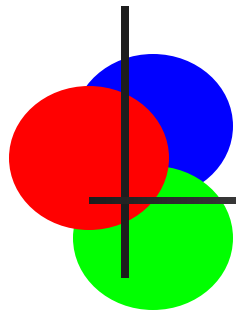
- ▶ Grants - \$15.3 Billion
 - ▶ Services - \$13.1 Billion
 - ▶ Federal Funds - \$14.9 Billion
 - ▶ Tax Expenditures - \$35.8 Billion
-
- ▶ Pensions and Retirement Benefits



Tax Breaks / Expenditures Larger Than Tax Credits



Source: House Fiscal Agency



Recent Tax Changes

Reduce Future Revenue

- ▶ Generous film production credits enacted to encourage production in Michigan.
- ▶ Battery Credits enacted to encourage production of batteries for hybrid cars in Michigan.
- ▶ Earned Income Tax Credit provides \$140 million in 2009 and \$315 million in 2010.