Economic Bulletin

GOOD news The state reported that Michigan's average weekly wage went up 5.1 percent in 1994, to $554. The increase, driven by strong manufacturing employment and bonuses, was the largest since 1984 and outpaced the Detroit area inflation rate, which rose 3.2 percent for the year. Separately, the U.S. Commerce Department reported that Michigan personal income grew 7.5 percent through the first three quarters of 1994; the national growth rate was 4.6 percent.

◆ The U.S. Commerce Department estimates that real gross domestic product (GDP)—the value of goods and services produced in the country—grew at a 4.5 percent annual rate in the fourth quarter of 1994. For the entire year GDP grew 4 percent, the biggest increase since 1984.

BAD news U.S. passenger vehicle sales were down 2 percent from January 1994 to January 1995. The reported seasonally adjusted annualized sales rate of 15 million units may be understated, however, because new reporting dates exclude some month-end sales. December's sales rate was 15.6 million units. Car sales dipped 4.1 percent, while light truck sales edged up one percent. Of the major U.S. and Japanese automobile makers, only Ford and Toyota posted increases. The Big Three's combined market share dropped 0.7 percent from January 1994.

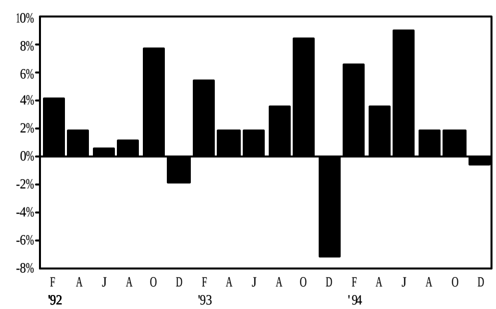
◆ The state unemployment rate rose sharply, from 4.6 percent in December to 5.5 percent in January. Employment was down 41,000, due mainly to post-holiday layoffs. Michigan's rate continues to rank well among the 11 largest states—only North Carolina, Ohio, and Illinois posted lower rates in January. Seven of the 11 states, including Michigan, did post higher rates than in December. The year-ago (January 1994) state unemployment rate was 7.4 percent.

◆ The U.S. unemployment rate increased for the first time since July 1994, improving from 5.4 percent in December to 5.7 percent in January. The number of people looking for work rose significantly faster than the number of jobs created; the latter, at 134,000, was the smallest increase since January 1994. Although manufacturing and construction posted healthy increases (39,000 and 27,000 new jobs, respectively), the service sector experienced the smallest increase in nearly two years (53,000 jobs).

Michigan Monthly Unemployment Rates
(seasonally adjusted)

SOURCE: Michigan Employment Security Commission.

Detroit–Ann Arbor CPI, Percentage
Change from Two-month Ago Period



SOURCE: Bureau of Labor Statistics.

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February 1995

MONTHLY FOCUS

PESO'S PLUNGE HITS HOME

by Anna Mann, PSC Intern

The crash of the Mexican peso may seem remote to most Americans, but it is not just Mexico's problem. The following explains the currency's demise and how a financial shock elsewhere in the world can cause tremors in the United States.

On December 20, 1994, the peso began a decline in value (a *devaluation*) that has left the Mexican government scrambling. The devaluation began as part of a deliberate effort by the Mexican government to make the goods they sell to other nations less expensive and reduce the country's balance of payments deficit. The devaluation has snowballed, however, and the peso's value in the international market is now dangerously low.

Implications for the U.S.

The Mexican economic crisis undoubtedly has affected the U.S. economy. The effect is all the more pronounced because passage of the North American Free Trade Agreement (NAFTA) strengthened ties between the two economies. The fall of the peso could mean losses of billions of dollars in U.S. exports and hundreds of American jobs. Moreover, the U.S. tourist industry, especially in border states, could suffer, as tourists head to Mexico for relatively inexpensive vacations and travel.

Likewise, Wall Street is feeling the fall of the peso. According to the *Detroit Free Press*, this could cause problems for "Middle America's pension funds, mutual funds, retirement plans and insurance portfolio[s]."[1] The investments most likely to be affected are those that depend on U.S. exports to Mexico or those that have been made directly in Mexican businesses. Mexico's economic woes also may accelerate the already problematic illegal immigration of Mexicans into the United States.

Effect on Michigan

Even Michigan is not isolated from the effect of the Mexican crisis. Some Michigan producers, including the Big Three, may see greater wage competition from Mexico—because Mexican wages now are worth less. The problem is that "with or without a bailout, Mexican workers in dollar terms have just taken a 50-percent pay cut."[2] This will make Michigan products that much more expensive relative to Mexico's and may cause a drop in Michigan exports.

Falling Mexican wages mean not only that Mexican citizens will be less expensive to employ, they also will not be able to purchase as many American goods as before the crisis. For example, the cost to Mexican car buyers of imported cars has risen 30 percent because many more pesos now are required to equal an American dollar.[3] This prices many of our southern neighbors out of the market and will decrease sales for Michigan vehicle manufacturers. The long-term implication could be that some Michigan jobs are lost.

Conclusion

The Mexican currency crisis demonstrates how the problems of our trading partners become our problems. Although the peso's devaluation will not have a major effect on the U.S. economy, it will cause harm in many subtle ways, and this explains the U.S. government's efforts to provide billions in bailout money. This crisis should be recognized as a warning signal that the United States must be concerned about the economic health of its trading partners. Indeed, in a global economy, there is little choice.

[1] *Detroit Free Press*, "Just Say Yes to U.S. Intervention in Mexico Because It Benefits Michigan, " January 3, 1995.

[2] *Detroit Free Press*, "Michigan Firms Expect Profits, But Later Rather Than Sooner," February 1, 1995.

[3] *Detroit Free Press*, "Rising Interest Rates Put Check on Auto Sales," February 7, 1995.

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NEWS FROM THE STATE CAPITOL

TAX CUTS MOVE THROUGH LEGISLATURE

Gov. John Engler's tax cut proposal is moving through the legislature at a fast clip. In his 1995 State of the State address, the governor announced a plan to cut $1.5 billion in income, business, and intangibles taxes over the next five years (see the January 1995 *Michigan Economic Bulletin* for details) and urged legislative passage by February 16, one month from the day he announced it.

Since the announcement, additional relief—for taxpayers paying college tuition—has been proposed. The relief would be in the form of a $5,000 credit for people paying tuition to Michigan higher education institutions, both private and public. The credit would be allowable, however, only for tuition paid to colleges and universities that keep their tuition increases at or below the rate of inflation.

At the time of writing, only cuts in the single business tax (SBT), the state's primary business tax, have been approved by both legislative chambers. (We anticipate that by the time this *Bulletin* is published, most if not all of the tax cut proposals likely will have passed both the House and the Senate.)

Both agreed with the governor's proposal to eliminate Social Security, unemployment insurance, and workers' compensation payments from the SBT apportionment formula, which has the effect of lowering the business tax base.

FY 1995–96 RECOMMENDED BUDGET RELEASED

Governor Engler has released his proposed FY 1995–96 budget. It provides for $8.5 billion in general fund/general purpose (GF/GP) spending, a 4.7 percent increase over the current fiscal year. (GF/GP funds, or the "general fund" is the portion of the state budget that is not earmarked and over which lawmakers have control.) The governor said that the budget, which assumes that his tax cut proposals pass, is "tight" and stated that "improving our schools continues to be my first priority."

Under the governor's proposals, K–12 schools will receive the full funding promised under last year's Proposal A. Most schools will receive a per pupil increase of $166 over this year's funding, and the poorest districts will receive larger increases. Appropriations for state universities will increase 4.7 percent from the current year, FY 1994–95, with most receiving a 3 percent increase; financial aid programs will receive a 9.6 percent increase.

This budget marks the first time since Governor Engler took office that state spending will have outpaced the inflation rate. The spending increase results from rising price tags for corrections and Medicaid programs. The governor is recommending that the Department of Corrections receive an 8.1 percent GF/GP increase; by FY 1996–97 the department's operating budget will account for 15 percent of the total GF/GP budget. For the Medicaid budget the governor recommends $340 million in additional GF/GP funding, primarily to support federally mandated programs that will receive less federal funding in FY 1995–96 and to cover cost increases.

The Michigan Jobs Commission also is slated for a large GF/GP increase: 314.1 percent. The hike comes about primarily because the governor recommends transfer to the commission, from other departments, of school aid monies for job training programs. Without the transfers, the commission's GF/GP increase would be 12.6 percent.

The governor assumes that FY 1995–96 general fund revenues will be 4.6 percent higher than in the current year and that School Aid Fund revenues will be 4.7 percent higher. His recommended budget is about $300 million under the Headlee revenue limit, which restricts the amount that the state can collect in taxes and fees. In the coming fiscal year, all revenue sources bound to school finance reform are expected to increase over the current year except for proceeds from the tobacco tax, which are expected to fall.

In the coming months the legislature will debate and modify the governor's recommendations. Hearings on the budget already have begun, and legislative leaders have called for completing work on the budget by June 16.

Continued on page 4

MICHIGAN REVENUE REPORT

Because of problems created by the state's new computer system (MAIN), no revenue reports have been published during the current fiscal year, which began on October 1, 1994. However, the Department of Management and Budget recently released estimated actual collections for the first three months of FY 1994–95.

Total GF/GP and School Aid Fund (SAF) revenue is up 34.8 percent for the three-month period. Most of this increase is due, however, to the new school aid revenue measures enacted last year. Adjusted for these new revenues and the reduction in the income tax rate, collections for the first quarter of FY 1994–95 are up 5.4 percent. This may slightly understate revenue growth, because the reductions in the SBT and the income tax on pensions, both of which passed last year, are not reflected in this estimate.

Adjusted for tax rate changes, the following collections are up: sales tax, an estimated 5.2 percent; use tax, 7.7 percent; SBT, 4.2 percent; and personal income tax withholding, 10 percent. Tobacco tax collections, adjusted for the 50-cent per pack increase, are down 17.5 percent; this figure is just slightly more than we expected.

Other than the income tax, collections appear to be a little weaker than generally expected. The picture could change, however, when more complete data become available.

Continued from page 3.

MORE BUDGET NEWS

- Speculation that a gas tax increase would be part of the recommended budget proved incorrect. The governor has said, however, that he will propose the increase at a later date.
- The governor proposes raising fees for hunting and fishing licenses; the Department of Natural Resources will work out the specifics.
- In regard to state government employment, the governor recommends that the general hiring freeze remain in effect for all departments except Corrections. Although no general reductions in state employment are planned, it is likely that changes in operations will cause layoffs in some departments.
- The governor proposes various fee increases, to support some state programs. For example, a fee levied on criminals would be raised $20, to $60 for felons and $50 for misdemeanants; the revenue will support programs for crime victims.
- Although funding for higher education will increase about 4.7 percent, the governor has recommended closing Highland Park Community College. The college has had chronic financial difficulties, and state officials say it has failed to get its affairs in order.

PUBLICATIONS OF INTEREST

Senate Fiscal Agency, *1992 Statistical Report* (Lansing, Mich.: SFA, November 1992).

This annual publication contains a wealth of current and historical data on the state budget and related topics. Information on each departmental budget (e.g., Corrections, Social Services) is available. The 170 pages of data include caseloads, college and university enrollments, and other measures of the level of service provided by each department. The report also contains certain basic economic information on Michigan and United States. To order, contact the SFA at P.O. Box 30036, Lansing, MI 48909-7536; 517 / 373-2767.

U.S. Department of Commerce, Bureau of the Census, *County and City Data Book, 1994* (Washington, D.C.: GPO, 1994).

This 1,000+ page book contains a wide variety of information. There are data about states, counties, cities, townships, and some smaller jurisdictions. In addition, many of the results from the 1990 Census of Population and Housing are provided, including labor-force and journey-to-work data. Among the other subjects about which data are presented are agriculture, crime, education, government finances, health, income, vital statistics, and industry. The book, which is a supplement to the popular *Statistical Abstract of the United States*, is also available on CD-ROM and diskettes. To order, call 301 / 763-4100.