Gerald Faverman, Ph.D. • *Chairman of the Board*
Robert J. Kleine • *Editor*
Vol. 1, No. 1 • March 1991

Public Sector Reports

Michigan ECONOMIC BULLETIN

The Good News

- **Interest rates** have continued to decline: On February 1, the Federal Reserve once again lowered the *discount rate* (to 6 percent); *prime lending rates* are down to 9 percent, and *3-month treasury bills* are below 6 percent.

- The **producer price index** declined a seasonally adjusted 0.1 percent in January, precipitated by declines in food and energy prices.

- December's **Detroit-Ann Arbor consumer price index** fell 0.5 percent from the figure posted in October, due primarily to large declines in energy costs. For all of 1990, prices were up 5.2 percent, slightly less than the national annual increase of 5.3 percent. (See graph below.)

➤ The **index of leading indicators** rose by 0.1 percent in December, its first increase since June and a sign that the economy could pull out of the recession in the second half of the year. Positive contributors included higher stock prices, a rising average workweek, and more orders for plant and equipment; there was evidence, however, of continued weakness in the consumer and housing sectors.

- The **merchandise trade deficit** stood at $28.9 billion in the fourth quarter of 1990, down from $29.8 billion in the third quarter. For all of 1990, the deficit was $108.7 billion, down from $114.9 billion in 1989 and the lowest annual deficit since 1984.

➤ Michigan **personal income** grew by 1.6 percent in the third quarter of 1990, the eighth largest increase posted among the states. Further growth is not expected in the fourth quarter due to declines in the manufacturing sector, where most of the third-quarter income gain was recorded.

The Bad News

- In the second 10 days of February, **sales of domestically produced motor vehicles** declined by 10.6 percent from the year-ago figure to 290,822 units. Car sales fell by 9.2 percent and truck sales by 13.2 percent. In January motor vehicle sales declined 25.5 percent.

- In the fourth quarter of 1990, **GNP** declined by a seasonally adjusted, annual rate of 2.2 percent ($22.4 billion), primarily caused by deteriorating motor vehicle sales (see Year-End Roundup).

- **Retail sales** fell 0.9 percent in January, following a decline of 1.5 percent in December. Total 1990 sales were $1,799.4 billion, up 3.8 percent from the 1989 total.

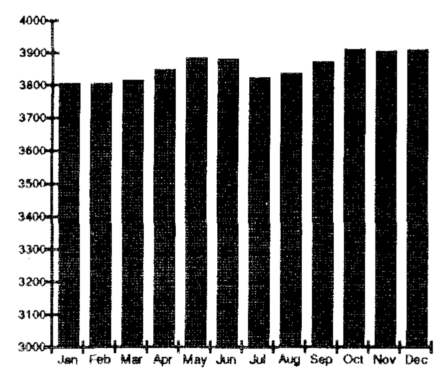
- The **unemployment rate** rose nationally in January to 6.2 percent from December's 6.1 percent mark. In Michigan, the January unemployment rate was 7.2 percent, down from December's rate of 7.3 percent.

➤ The number of **housing permits** authorized in Michigan stood at 1,397 in December, a 30-percent decline from the 1,994 recorded in November.

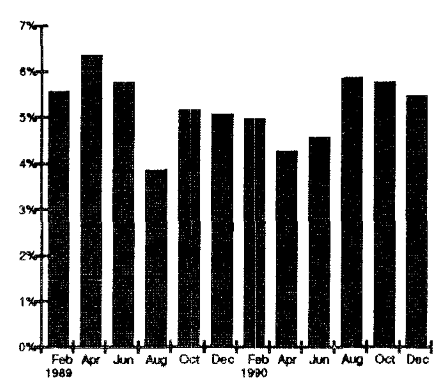
IN THIS ISSUE

MICHIGAN ECONOMIC INDICATORS

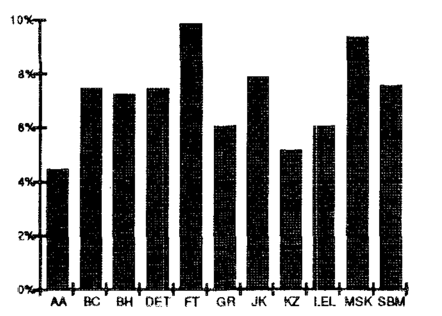
1990 Nonagricultural Employment (in thousands, not seasonally adjusted)



Detroit-Ann Arbor CPI, % Change from Previous Year (annual rates)



1990 Average Unemployment Rates, Michigan MSAs



AA: Ann Arbor; BC: Battle Creek; BH: Benton Harbor; DET: Detroit; FT: Flint; GR: Grand Rapids; JK: Jackson; KZ: Kalamazoo; LEL: Lansing-East Lansing; MSK; Muskegon; SBM: Saginaw-Bay City-Midland.

SOURCE: U.S. Department of Commerce, Bureau of Labor Statistics.

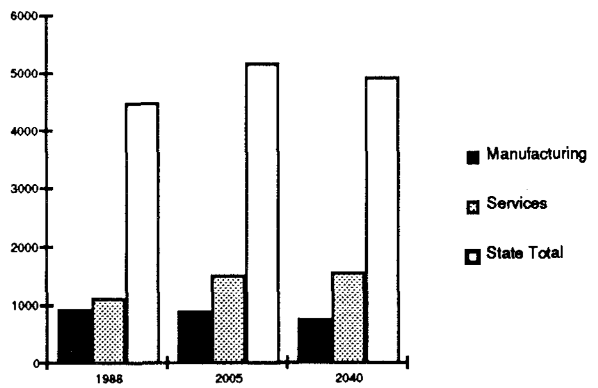
Public Sector Consultants, Inc.
Knapp's Centre • 300 S. Washington Sq. • Suite 401
Lansing, MI 48933-2134 • (517) 484-4954

Income and Employment to the Year 2040

A useful report from the Bureau of Economic Analysis (BEA), U.S. Department of Commerce, contains employment and income projections by industry for each of the fifty states as well as the region and nation. The report also contains national, regional, and statewide population projections.

Total **employment** in Michigan is projected to rise to 5.2 million by 2005 and fall to 4.9 million by 2040. The drop in the number of jobs over this period mirrors the national trend and will be caused by the overall drop in population resulting from declining birth rates as well as a greater percentage of the population reaching retirement age.

Michigan Employment (in thousands)



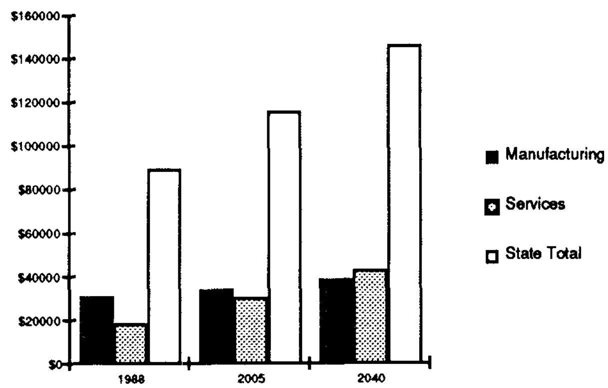
As during the last decade, the predicted trend in manufacturing jobs is continued decline, while growth is expected within the service industry. Between 1988 and 2005 an increase of 678,400 jobs is predicted statewide, with all industries except manufacturing experiencing employment growth.

The picture will be reversed between 2005 and 2040, when the total number of jobs is expected to drop by nearly 246,000, with declines predicted in nearly all industries. Only agricultural services, forestry, and fisheries; wholesale trade; and services are anticipated to experience employment gains.

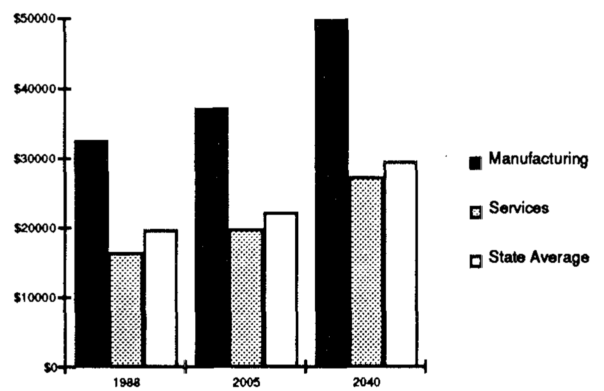
For the entire forecast period (1988–2040) Michigan is predicted to experience a net gain of 432,600 jobs. The rise is centered in the service industry where the increase is expected to total 443,000 jobs. This will be partially offset by 170,000 fewer jobs in durable goods manufacturing.

Also during the period, total **earnings** in services are predicted to grow at a higher annual rate (1.6 percent) than either manufacturing (0.4 percent) or the statewide average (0.9 percent). But because of the expected increase in the number of workers in services, the rise in service industry earnings will not be sufficient to push average **earnings per worker** above the statewide average. Average earnings per worker in services are predicted to grow from $16,596 in 1988—83 percent of the statewide average of $19,938—to $27,442 in 2040—92 percent of the $29,648 statewide average. (All figures are stated in 1982 dollars.) Earnings per worker in manufacturing are predicted to rise from 1988's $32,734 (164 percent of the statewide average) to $49,987 (169 percent of the statewide average) by 2040.

Total Earnings (in millions of 1982 dollars)



Average Earnings per Worker (in 1982 dollars)



BEA Regional Projections to the Year 2040, Volume 1: States, can be obtained by sending $7.50 to the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

MICHIGAN ECONOMIC BULLETIN
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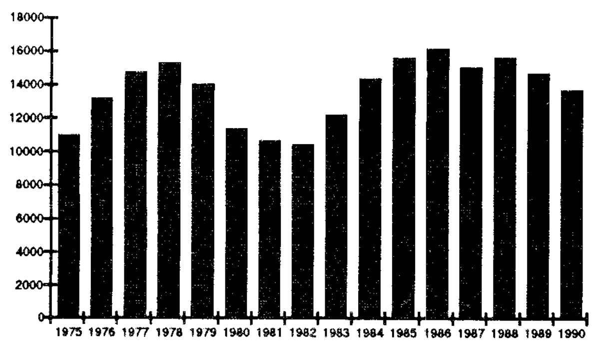
Year-End Roundup

Major Setbacks in the Auto Industry

➤ December **car production** fell 21.8 percent to the lowest level for that month since 1951. In the fourth quarter, car production was off 12.1 percent, falling to the lowest level since 1982. For all of 1990, car production was off 11.1 percent to 6,075,331 units and **truck production** fell 11.4 percent to 3,803,130 units. **Total production** of 9,878,461 units was the lowest since 1983. *Big Three* car production fell 16.5 percent, while production by *transplant manufacturers* increased 16.1 percent to 1.32 million units.

➤ U.S. **sales of cars and light trucks** declined 4.8 percent to 13,842,338 units in 1990. *The Big Three's* share fell from 67.9 percent in 1989 to 66 percent in 1990. GM captured 35.7 percent; Ford, 21 percent; and Chrysler, 9.3 percent. Chrysler barely edged Honda for third place. The Honda Accord was the top selling vehicle, easily outpacing the second-place Ford Taurus. *Japan* increased its share of total sales from 25.3 percent to 27.6 percent; *Europe* was unchanged at 4.9 percent.

Annual Motor Vehicle Sales, 1975–90
(in thousands of units)



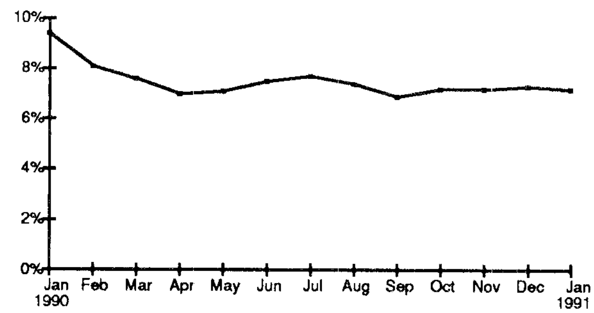
Michigan Corporate Taxes Rank Among Top Ten

➤ In a recently released Wisconsin study comparing the taxes on corporations in six industries in 19 states, Michigan **corporate taxes** ranked 6th highest. All the Great Lakes states (including Minnesota) were evaluated. Indiana (1) and Minnesota (4) ranked above Michigan, while Ohio (7), Illinois (16), and Wisconsin (17) ranked below. The complete study is available on request; contact Bob Kleine at 517/484-4954.

Michigan Employment Picture Appears Relatively Stable

➤ For all of 1990, the Michigan **unemployment rate** averaged 7.5 percent, up from 7.1 percent for 1989.

Michigan Unemployment
(not seasonally adjusted)



➤ **Nonagricultural employment** averaged 3,899,700 workers in 1990, an increase of 37,700 (one percent) from the 1989 figure of 3,862,000. A majority of the gains occurred in the first half of the year.

➤ Recently released census data show that in 1989 Michigan ranked 48th among the states in its **number of state and local government employees** per 10,000 residents; only New Hampshire and Connecticut ranked lower. Michigan had 458 employees per 10,000 residents, 11.6 percent below the U.S. average of 518. In terms of average monthly **compensation for state and local government workers**, Michigan ranked 6th in 1989, below Alaska, California, New York, Connecticut, and New Jersey. Michigan's average monthly wage of $2,593 was 13.1 percent above the U.S. average.

➤ The Bureau of Labor Statistics recently released **household employment data** for the eleven largest states. Of the states surveyed (California, Florida, Illinois, Massachusetts, Michigan, New Jersey, New York, North Carolina, Ohio, Pennsylvania, and Texas), only Michigan had a January 1991 unemployment rate (7.2 percent) that was lower than the rate it posted in January 1989 (8.1 percent). Michigan had posted the highest January 1990 rate. Massachusetts recorded the greatest increase in unemployment; 4 percentage points from 4.6 percent in January 1990 to 8.6 percent in January 1991 (the highest rate posted for the month).

Fiscal 1992 Federal Budget

On February 4 President Bush presented his FY 1992 budget recommendations to Congress, beginning the arduous process of hammering out a budget agreement. The proposal calls for expenditures of $1,446 billion (up 2.6 percent from FY 1991) and projects revenues of $1,165 billion (6.7 percent above this year), resulting in an estimated budget deficit of $281 billion ($343 billion if Social Security funds are excluded). Of note is the elimination of Gramm-Rudman deficit targets, which were replaced last year with spending caps in each general budget area; this does away with the need for last-minute reductions if revenue projections fall short of expected levels due to an economic downturn.

A Return to Realistic Economic Assumptions

One distinctive aspect of the administration's budget is the economic assumptions used to forecast spending and revenue trends. In the past, administration forecasts have painted a much rosier picture of the economy than those of government agencies [such as the Congressional Budget Office (CBO)] or private sector groups (such as the *Blue Chip Economic Indicators*, an average forecast based on a survey of 50 private economists).

For 1991, however, administration estimates are in line with, and in some cases more conservative than, the CBO and the *Blue Chip* forecasts. The administration projections for 1992 indicate that they expect a swifter, more robust recovery from the recession than the *Blue Chip* consensus, but only slightly better than the CBO forecast.

An Old Story: The "New" Federalism

A major surprise in President Bush's proposal is the manner in which the states are slated to receive funding. Line-item funding would be eliminated in favor of block grants issued for programs in general budget areas. On the positive side, this would give states greater flexibility to implement the types of specific programs they deem necessary, likely resulting in a decline in administrative paperwork. On the negative side, block grant funding weakens constituents' ability to lobby for specific programs, thereby increasing the probability that funding could be reduced in the future. As a political scientist recently remarked in the *Wall Street Journal*, "It's much easier to fight for immunization grants for children than for block grants for public health."

According to the National Governors' Association, proposed block grant funding to states totals $15 billion in FY 1992, which is about the same or less than FY 1991 appropriations in all potential block grant areas except welfare administrative expenses (which would increase). As the exhibit illustrates, potential block grant programs in Michigan would receive an estimated $794.3 million in funds in FY 1992 (up $2.5 million, or 0.3 percent, from the FY 1991 enacted level); funding would rise to $812.3 million by FY 1995, for a FY 1991–95 average annual increase of 0.6 percent. In general budget areas, FY 1992 funding would increase for housing and urban development and Justice Department programs. The biggest individual loser would be the low-income energy assistance program, with its 1992 funding slated to be cut by 41 percent from the FY 1991 level; by FY 1995, an additional 36 percent would be eliminated from the program's budget.

Potential Outlays for Michigan Block Grant Programs
(dollars in millions)

Department Programs	Enacted FY 1991	Proposed FY 1991	Proposed FY 1995
Education	$48.3	$46.7	$37.0
Environmental Protection Agency	101.8	95.0	51.0
Health and Human Service:			
State welfare administration expenses, Medicaid, AFDC, and Food Stamps	226.8	257.6	337.5
Social Services block grant	104.4	104.4	104.4
Low-income home energy assistance program	95.3	56.2	22.3
SUBTOTAL	426.5	418.2	464.2
Housing and Urban Development	203.0	219.3	242.8
Justice	12.2	15.1	17.3
TOTAL	$791.8	$794.3	$812.3

SOURCE: National Governors' Association.

Can the BSF Solve Michigan's Budget Problems?

Activity in the capitol continues to focus on resolving the state's budget crisis. Governor Engler's original proposal sought to trim expenditures by an extra $265 million (in addition to the $536 million already cut) and use $103 million from the Budget Stabilization Fund (BSF). The administration now proposes to withdraw $140 million from the BSF in light of the worsening deficit picture.

The House Democratic plan calls for both an FY 1991 spending reduction and a withdrawal from the BSF, each totaling $333 million, and other one-time adjustments of $333 million. The Democrats also propose to cut baseline spending by $1 billion over the next two years.

The governor's budget plan is coupled with a strategy for property tax relief. After it is fully phased in in FY 1993, the Engler plan would cost the state an estimated $1.2 billion annually.

House Democrats were scheduled to announce their own property tax relief plan on February 6 but were forced to withdraw it due to a Michigan Court of Appeals ruling on the capital acquisition deduction (CAD). Expected additional revenues from the CAD were the primary source of funding for their proposal; since Democrats have stated they will not submit a plan without specifying how to finance it, they withdrew theirs after the court's decision.

Budget disagreement revolves on two main issues: (1) the tradeoff between education and spending on social programs and (2) the size of any withdrawal from the BSF. The first matter, which involves the role of government and the combination and extent of services it provides, is primarily political.

The second concern has broader fiscal implications, namely, the timing and magnitude of any cuts made in a given fiscal year versus the creditworthiness of the state once a withdrawal is made. Those arguing against large BSF withdrawals point out that this is a short-term solution to the state's expenditure problem—the size of this year's withdrawal will need to be matched by (at least) an equivalent cut in spending or increase in revenues next year. In addition, a large reduction in the fund increases the degree of the state's credit risk in the eyes of the financial community, which would raise the cost of any borrowing that the state needs to undertake in the coming year(s). Therefore, the administration argues that withdrawals from the BSF should be kept to a minimum.

Favoring rainy day withdrawals is the argument that doing so would allow the pain of spending cuts to be spread over time; this option allows a range of alternative spending cut options. In addition, some point out that the BSF was created with the specific intention of dealing with the current type of situation.

Both arguments have merit; we therefore refer to both in our proposed solution to the current budget dilemma. First, we recommend that there be two BSF withdrawals of $200 million each, one in FY 1991 and another in FY 1992. Second, expenditures will need to be trimmed by about $100–180 million, with the remainder of the deficit dealt with by using accounting adjustments and delayed payments. Next, we advocate expenditures be frozen at FY 1991 (baseline) levels for at least the next two years. Finally, we propose that any tax relief plan be phased in over four years and any growth in revenues (above those necessary to compensate locals for loss of school operating revenues) be used to refinance the BSF.

These are only suggestions; because the process of dealing with deficits is a painful one, any action taken—including those proposed here—is certain to find detractors. However, unless agreement is reached soon, balancing the budget may become politically impossible because the required cuts will be too deep; a 5-percent cut at the beginning of the year translates to a 10-percent reduction at mid-year.

PUBLICATIONS OF INTEREST

Bureau of Labor Statistics, U.S. Department of Labor, "Consumer Expenditures in 1989," *News*, November 30, 1990. This annual report contains expenditure data by type of purchase, household (before tax) income levels, and age group. The BLS also issues a quarterly summary of the survey; microdata are available on computer tape. For more information, contact the Division of Consumer Expenditure Surveys, BLS, Room 4216, Washington, DC 20212, or call 202/272-5260.

Senate Fiscal Agency, *1990 Statistical Report* (Lansing: the Agency, January 1991). A "must read" document for anyone interested in state finances, this report contains historical and current budget and budget-related data, as well as intergovernmental and general economic statistics. For more information, call the agency at 517/373-2767.

Bureau of the Census, U.S. Department of Commerce, *Government Finances: 1988–89 (Preliminary Report)*, #GF–89–5P (Washington D.C.: U.S. Government Printing Office, September 1990). Contains expenditures and revenues for state and local governments, by type, for each of the states and the District of Columbia.

Michigan Revenue Report

As expected, January collections (December activity) were very weak. This is particularly important, as January is the largest revenue month of the year.

Personal income tax withholding collections slipped 3.2 percent below the year-ago average; however, there were four Fridays (paydays) in December 1990 and five in December 1989. Adjusted for this difference, collections were an estimated 2.3 percent above the year-ago level.

Sales and use tax collections in January fell 1.4 percent below the year-ago level, due in large part to a 7.2 percent decline in motor vehicle related collections. However, collections were not quite as weak as these numbers indicate as there was a large one-time use tax payment in January 1990. Adjusted for this, sales and use tax collections rose an estimated 1.7 percent. Sales tax collections excluding motor vehicles increased 2.9 percent.

Single business tax collections plummeted 18.5 percent from the year-ago level. Although this revenue source has been weak in recent months, this sharp decline may overstate the weakness in the tax. Because payments are due the last day of the month, a change in the collection pattern can distort monthly comparisons.

Lottery collections in January (preliminary data) fell an estimated 6 percent below the year-ago level. Collections for the first four months of the year trail the year-ago take by 4.7 percent.

State revenues will continue to be weak in the next few months, as evidenced by recent declines in motor vehicles sales and a weakening labor market.

Actually, state revenues are holding up a little better than might be expected given the weakness in the economy. A major reason is the contract agreement the UAW and the auto manufacturers signed last fall. The agreement provides laid-off workers with about 85 percent of the regular take-home pay for up to three years. More than 100,000 auto workers laid off temporarily or indefinitely are receiving these benefits, and the number is likely to increase in the next few months.

Based on collections for the first three months, we continue to expect general fund/general purpose and school aid fund revenues to increase about 2 percent in the current fiscal year. However, at this point most of the risks appear to be on the downside.

MONTHLY TAX COLLECTIONS (dollars in thousands)

Type of Revenue	Preliminary January 1991	% Change from Last Year	Past 3 Months' Collections	% Change from Last Year	FY 1990–91 Year-to-Date	% Change from Last Year
Personal Income Tax						
Withholding	$434,739	2.3%[a]	$1,134,813	3.2%	$1,134,813	3.2%
Quarterly and Annual Payments	125,100	8.9	162,285	1.5	162,285	1.5
Gross Personal Income Tax	559,839	3.7[a]	1,297,098	2.9	1,297,098	2.9
Less: Refunds	–5,589	–81.5	–32,274	–30.9	–32,274	–30.9
Net Personal Income Tax	554,250	8.8[a]	1,264,374	4.3	1,264,374	4.3
Sales and Use Taxes	314,689	–1.4	840,856	1.7	840,856	1.7
Motor Vehicles	27,108	–7.2	102,084	0.0	102,084	0.0
Single Business Tax	128,793	–18.5	423,173	–4.7	423,173	–4.7
Cigarette Tax	20,662	0.5	64,889	0.1	64,889	0.1
Public Utility Taxes	0	—	71,648	2.6	71,648	2.6
Oil and Gas Severance	4,499	29.0	14,303	23.3	14,303	23.3
Lottery[b]	38,240	–6.0	113,924	–4.1	154,328	–4.7
Penalties and Interest	1,133	NM	12,856	–29.3	12,856	–29.3
SUW—Annuals and Undistributed[c]	4,000	NM	7,943	NM	7,943	NM
Other Taxes[d]	26,225	–5.0	82,208	7.0	82,208	7.0
TOTAL TAXES (GF & SAF)[e]	$1,093,850	1.3%[a]	$2,897,993	1.8%	$2,936,578	1.7%
Motor Fuel Tax[f]	$51,221	–9.1%[a]	$164,433	–1.8%	$164,433	–1.8%

SOURCE: Data supplied by Michigan Department of Treasury.
NM = Not meaningful
[a]Adjusted to reflect difference in number of Fridays (paydays).
[b]The state share of lottery collections is estimated to be 40.7 percent, based on the average profit to the state for the fiscal year 1989–90. The previous year's figures are adjusted to the current year's profit margin; the percentage change reflects the increase in ticket sales.
[c]These revenues are distributed to the sales, use, and withholding (SUW) accounts when final numbers for the month are reconciled.
[d]Includes intangibles, inheritance, foreign insurance premium, corporate organization, and industrial and commercial facilities taxes.
[e]Excluded are beer and wine, liquor, and horse racing taxes, which are not collected by the Department of Treasury.
[f]The motor fuel tax is restricted to the Transportation Fund.

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