Gerald Faverman, Ph.D. • *Chairman of the Board*
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Public Sector Reports

Michigan ECONOMIC BULLETIN

The Bad News

The **motor vehicle** industry continued depressed in February and into early March: U.S. passenger car sales declined 14.7 percent from the year-ago mark (the lowest February in 12 years), and import sales fell 20.8 percent. Motor vehicle production was down 25 percent. Chrysler produced no cars during one week of February, a first-ever event among major producers.

The **auto industry** continued its abysmal showing into the first ten days of March. Adjusted for one less selling day, total car and truck sales fell 17.4 percent from the same time last year. Actual sales of autos were down 24.8 percent, sales of domestics fell 21.9 percent, and imports dropped 34.4 percent.

The nation's **unemployment rate** rose to a seasonally adjusted 6.5 percent in February, up from January's revised 6.2 percent mark. In Michigan, the February rate was 9.8 percent, up from January's 7.2 percent rate.

Although **producer prices** declined 0.6 percent overall in February, when food and energy are excluded the rise was 0.4 percent. This could cause the Federal Reserve to reconsider its current credit-easing policy.

Nationally, state **claims for unemployment insurance** rose to their highest level in more than eight years. For the week ended March 9, 519,000 claims were filed, up 9.5 percent from the previous week's 474,000.

The Good News

Spurred by an increase in auto purchases, **retail sales** rose 0.8 percent in February. January's figure was revised downward to 1.4 percent (originally reported as a drop of 0.9 percent).

Privately owned **housing starts** rose by a whopping 16 percent annual rate in February—to 989,000 units—up from January's revised mark of 850,000 units. Starts of single-family units, which rose 18 percent, accounted for most of the increase. (All figures are adjusted for seasonal variation.)

After adjusting for seasonal variation, **consumer prices** rose at an annual rate of only 0.2 percent in February, half the rate of increase recorded in January. Energy prices declined by 4 percent, while food costs fell by 0.2 percent. The Detroit–Ann Arbor CPI rose by 0.8 percent over December's figure (see graph below).

A preliminary report from the University of Michigan's Institute for Social Research shows that **consumer confidence** rose to 88 percent during the beginning of March, up from 70.4 percent in February and nearly as high as its pre–Gulf War level.

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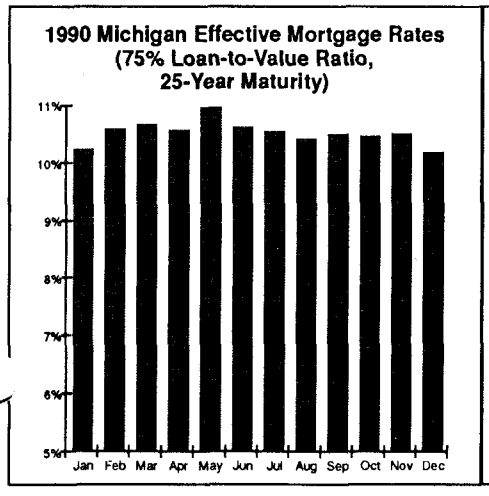
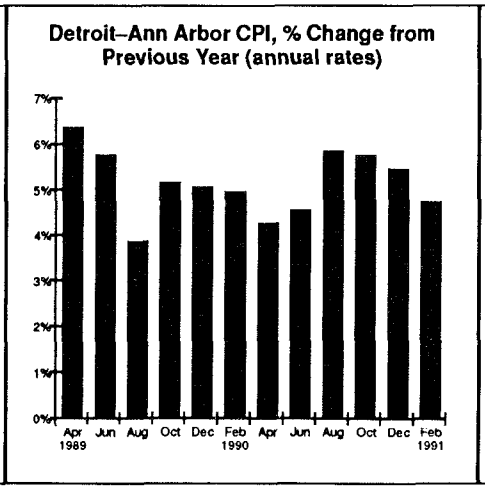
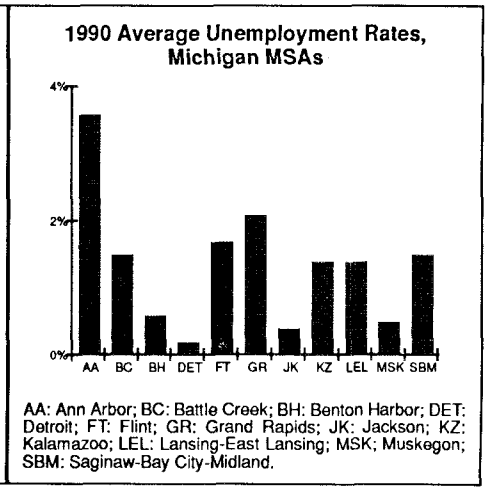
MICHIGAN ECONOMIC INDICATORS







SOURCES: Federal Home Loan Bank of Indianapolis and Bureau of Labor Statistics, U.S. Department of Commerce.

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Michigan Sectoral Employment in 1990

The recession in the Michigan economy was largely unacknowledged by economists until the fourth quarter of 1990. The reason? Through the early summer, the labor market—usually the first to weaken during a downturn—remained relatively stable through the third quarter. Close examination of the data, however, reveals that trouble spots existed as early as last spring, albeit in a somewhat different form than we are used to observing.

One indicator of recession was the services sector. Although it posted the greatest job gains among sectors during the year (see exhibit), most of the increase occurred in the first six months of the year. The rise in the first half of 1990 was 3.9 percent over the same period in 1989, but a final half comparison shows only a 1.9 percent increase over 1989. This is especially worrisome in Michigan, where the shift from a manufacturing-dominated economy has meant increasing dependence on the services sector for employment.

A second warning sign was the decline in construction jobs, which had been relatively stable until mid-year. Employment in the first half of 1990 rose by 4.9 percent over the same period in 1989, but there was a decline of 0.4 percent in the final six months as compared to 1989.

At the same time wage growth was weakening. Tax revenues indicated that income was not rising rapidly enough to keep pace with inflation, which resulted in reduced spending (indicated by diminished sales tax collections). Also, since businesses learned in the previous recession to keep inventories lean, they did not have to cut production and lay off workers as early as they had during the last downturn. (Single Business Tax revenues, down during the second quarter from the same period in 1989, indicated that demand was indeed declining.) The result? Low and falling real wages caused demand to drop and eventually led to an employment decline.

The recession now has hit the labor market full force. Michigan unemployment rose from a seasonally adjusted rate of 7.2 percent in January to 9.8 percent in February. Total nonagricultural employment rose by just less than 27,000 jobs, or 0.7 percent, for the entire year (see exhibit). The manufacturing sector experienced the greatest decline in jobs lost (31,100, or 3.2 percent from the previous year), due to a significant drop-off in durable goods production employment. There were more trade jobs available (an increase of 21,800, or 2.4 percent) than in 1989, but 85.5 percent of the growth was due to increases in traditionally low-paying jobs at retail trade firms.

Michigan Employment in Selected Sectors, 1989 and 1990, and Percentage Change (employment in thousands)

	Statewide Annual Average		Number Change	Percentage Change
	1989	1990		
Mining	10.3	9.3	(1.0)	-9.7%
Construction	139.9	140.0	0 1	0.1
Manufacturing	971.3	940.2	(31.1)	-3.2
Durable Goods	734.1	707.4	(26.7)	-3.6
Office Furniture	16.9	16.9	0.0	0.0
Industrial Machinery and Equipment	128.9	126.4	(2.5)	-1.9
Motor Vehicles and Equipment	289.5	276.9	(12.6)	-4.4
Nondurable Goods	237.2	232.8	(4.4)	-1.9
Chemicals and Allied Products	44.2	44.4	0.2	0.5
Transportation and Public Utilities	155.3	157.1	1.8	1.2
Trade	922.6	944.4	21.8	2.4
Wholesale	196.0	199.3	3.3	1.7
Retail	726.6	745.1	18.5	2.5
FIRE	187.4	191.1	3.7	2.0
Insurance Carriers	42.6	43.4	0.8	1.9
Services	912.2	938.5	26.3	2.9
Health	294.7	304.8	10.1	3.4
Business	174.1	175.4	1.3	0.7
Government	623.2	628.6	5.4	0.9
Federal	60.1	61.4	1.3	2.2
State	161.7	165.8	4.1	2.5
Local	401.4	401.4	0.0	0.0
TOTAL NONAGRICULTURAL	3,922.3	3,949.2	26.9	0.7
TOTAL PRIVATE	3,299.1	3,320.6	21.5	0.7
GOODS PRODUCING	1,121.6	1,089.4	(32.2)	-2.9
SERVICE PRODUCING	2,800.8	2,859.7	58.9	2.1

Source: Bureau of Research and Statistics, Michigan Employment Security Commission.

Overview of Michigan Budget Appropriations, Fiscal Year 1991–92

The 1991–92 Executive Budget follows through on John Engler's pledges to downsize state government, reduce property taxes, and make education the highest budget priority. The general fund/general purpose (GF/GP) recommendation for FY 1991–92 is $8,056.7 million, 4.4 percent above projected spending for the current fiscal year. The budget, however, includes $525 million for property tax relief; net of this amount, spending is 2.4 percent below FY 1990–91. In reality, comparisons with the previous fiscal year are meaningless because the FY 1990–91 budget is far from complete. The legislature and governor still need to reach agreement on actions to eliminate a potential deficit of $820 million (of which $310 million is a carryover from FY 1989–90).

The FY 1991–92 budget is based on the ***economic assumptions*** that the current recession will be mild and short lived, with the recovery beginning in the second quarter of 1991; interest rates will be lower and inflation slightly lower in 1991 than in 1990; real GNP will decline by 0.2 percent in 1991 (with all of the decrease occurring in the first half of the year) and then will rise by 2.9 percent in 1992; and motor vehicle sales will slump 8.5 percent in 1991 and then rise in 1992 by 7.8 percent.

With regard to ***spending***, the Engler budget assumes that his recommendations to balance the FY 1990–91 budget, including the January 14 Executive Order rejected by the legislature, will be approved. His proposal also assumes that the remaining budget gap will be closed by (1) changing the treatment of income tax credits for a one-time revenue gain of $366 million; (2) savings of $32 million in property tax credits resulting from the property tax relief program; and (3) transferring $213 million from the Budget Stabilization Fund (BSF).

With respect to ***revenues***, the governor's budget assumes that GF/GP and School Aid Fund (SAF) revenues for FY 1991–92 will increase 4.9 percent, to $10,033 million. After accounting and accrual adjustments, GF/GP and SAF revenues for FY 1991–92 are estimated at $10,918 million.

This is an education and property tax budget. Education is allocated an additional $296.4 million (64 percent of the new money in the budget), and $525 million is allocated for property tax relief ($278 million net of reductions in homestead property tax credits). The only other areas receiving increases are capital outlay, debt service, and health. The large additions for education and property tax relief are financed by a $335 million reduction in spending on social services and a $47.8 million decline in regulatory spending.

The largest recommended increases (in percentage terms) are: Treasury, 15.5 percent; Library of Michigan, 9.4 percent; capital outlay, 6.3 percent; and community colleges, 4.9 percent. The large increase in Treasury is due to the proposed transfer of the $10.7 million Senior Citizens Cooperative Housing Tax Exemption program from the Department of Management and Budget. The largest recommended reductions are: Commerce, 50.5 percent; Labor, 50.1 percent; Civil Rights, 20.5 percent; Agriculture, 13.9 percent; and Social Services, 13.7 percent.

Total state spending for FY 1991–92 is recommended at $19,365 million, 6.9 percent above the projected level for FY 1990–91. Excluding property tax relief, the proposed increase is 4 percent. Federal aid is estimated at $4.78 billion, a rise of 4.6 percent.

Several major issues face the governor and the legislature. (1) What form will property tax relief take and how should it be funded? (2) How deep should the spending cuts for social programs be, and should the General Assistance program be eliminated? (3) Will state employees receive the 4 percent increase approved by the Civil Service Commission? (4) What actions should be taken to eliminate the large deficit in the FY 1990–91 budget? (5) How deep should the cuts be in arts and economic development programs?

PUBLICATIONS OF INTEREST

National Association of State Budget Officers, ***State Aid to Local Government 1990*** (Washington, D.C.: NASBO, February 1991). For more information, contact NASBO at 400 N. Capitol St., Suite 295, Washington, D.C., 20001-1572 (202/624-5382). The study costs $25.

National Governors' Association, National Conference of State Legislatures, and National Association of State Budget Officers, ***The President's 1992 Budget: Impact on the States*** (Washington, D.C.: NGA, NCSL, NASBO, February 1991). For more information, contact NASBO (above), NCSL [same address, Suite 500, (202/624-5400)], or NGA [same address, Suite 250, (202/624-5300)]. The report costs $20.

Senate Fiscal Agency, ***Governor Engler's FY 1991–92 Budget: Summary and Analysis of Major Recommendations*** (Lansing, MI: the Agency), forthcoming. The annual report provides a detailed description of the overall budget and that for each department. Includes historical comparisons, employment recommendations, and DMB and SFA revenue forecasts. For a copy of the report, contact the SFA at P.O. Box 30036, Lansing, MI, 48909-7536 (517/373-2767).

Michigan Revenue Report

As expected, revenue collections in February (January activity) were very weak.

Sales and use tax collections declined 1.3 percent, due largely to a 20.8 percent decline in motor vehicle collections. Excluding motor vehicles, collections increased 2.4 percent.

Single Business Tax collections declined 11.3 percent in February and are down 8.7 percent in the last three months. This weakness reflects, in large part, the losses suffered by the auto manufacturers. Little improvement is likely for the next few months.

The only major revenue source that showed some strength was personal income tax withholding, as collections rose 4.6 percent above the year-ago level. Part of this strength, however, was due to three state paydays in January, rather than the normal two.

Lottery sales increased 5.3 percent in February (preliminary data), the first rise in several months, but year-to-date collections are 3.3 percent below a year ago.

We expect January and February to be the weakest months of the fiscal year. With the war in the Persian Gulf over and interest rates falling, the consumer is likely to spend a little more freely. Economic problems remain, however, particularly in the financial and motor vehicle sectors, and the recession is not yet over.

In its latest financial report to the legislature (and in the recently released FY 1991–92 budget), the Department of Management and Budget reduced its FY 1990–91 general fund/general purpose and school aid fund estimate by about $100 million, due mainly to a $105 million reduction in estimated Single Business Tax collections. A $33 million drop in the estimate for income tax collections was offset by increases in several other revenue sources. The revised figure is about 2 percent above FY 1989–90 collections, adjusted for one-time revenue items. PSC has been assuming a 2 percent increase in FY 1990–91 revenues for several months. As indicated in the March ***Bulletin***, our view is that most of the risks are on the downside, and a further revenue shortfall of $100 million would not be a surprise.

The administration currently is projecting a budget deficit of $820 million (after 9.2 percent cuts). This includes a carryover deficit from FY 1989–90 of $310 million.

MONTHLY TAX COLLECTIONS (dollars in thousands)

Type of Revenue	Preliminary February 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	$344,653	4.6%	$1,146,077	3.6%	$1,477,686	3.4%
Quarterly and Annual Payments	7,520	–56.5	166,647	–3.3	172,583	–3.4
Gross Personal Income Tax	352,173	1.1	1,312,724	2.6	1,650,269	2.6
Less: Refunds	–177,495	26.5	–208,741	16.3	–218,489	16.4
Net Personal Income Tax	174,678	–16.8	1,103,983	0.4	1,431,780	0.8
Sales and Use Taxes	231,359	–1.3	798,156	–0.3	1,065,294	0.6
Motor Vehicles	30,018	–20.8	91,472	–11.4	131,992	–5.7
Single Business Tax	179,954	–11.3	392,756	–8.7	613,020	–5.5
Cigarette Tax	19,252	–1.7	62,571	–0.4	85,402	1.2
Public Utility Taxes	0	—	55,645	2.4	71,656	2.6
Oil and Gas Severance	4,071	3.2	13,274	19.7	18,374	18.2
Lottery[a]	34,829	5.3	110,349	–2.0	188,601	–3.3
Penalties and Interest	467	NM	14,297	–15.2	20,028	–15.7
SUW—Annuals and Undistributed[b]	5,086	–31.0	13,735	106.1	14,931	164.4
Other Taxes[c]	35,195	149.4	99,253	38.8	117,573	29.3
TOTAL TAXES (GF & SAF)[d]	$684,811	–5.3%	$2,585,838	–0.9%	$3,592,386	0.3%
Motor Fuel Tax[e]	$53,883	–6.1%	$164,980	3.3%	$222,894	–2.6%

SOURCE: Data supplied by Michigan Department of Treasury.
NM = Not meaningful
[a]The state share of lottery collections is estimated to be 40.7 percent, based on the average profit to the state for FY 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.
[b]These revenues are distributed to the sales, use, and withholding (SUW) accounts when final numbers for the month are reconciled.
[c]Includes intangibles, inheritance, foreign insurance premium, corporate organization, and industrial and commercial facilities taxes.
[d]Excluded are beer and wine, liquor, and horse racing taxes, which are not collected by the Department of Treasury.
[e]The motor fuel tax is restricted to the Transportation Fund.

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