



CITIZENS RESEARCH COUNCIL OF MICHIGAN

Michigan Budget and Tax Overview

March 9, 2010

Wayne State University

Jeffrey Guilfoyle, President

Citizens Research Council of Michigan

www.crcmich.org / jguilfoyle@crcmich.org



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*



Overview of Michigan Budget



Michigan Budgeting – Quick Overview

- Budgets allocate scarce resources across competing priorities – it is by nature a political exercise
- Governor is required by the Constitution to present a “balanced budget” to the state legislature – but proposal can assume law changes
- The Governor proposes the budget and the legislature enacts – but governor can line item veto



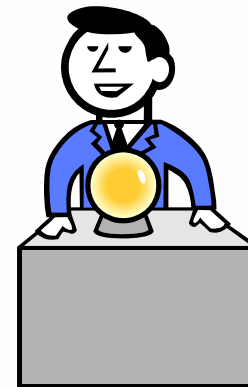
Budget Calendar (If Everything Goes Well)

- **January** – 1st Consensus Conference
- **February** – Governor presents budget
- **Spring** – Budget hearings – budget bills should pass each house
- **May** – 2nd Consensus Conference
- **June** – Target setting
- **July** – Conference committees and budget enactment
- **October 1** – Start of state's fiscal year



Revenue Estimating

- Michigan uses a Consensus process between administration and House and Senate Fiscal Agencies
- Keeps budget debate on policy rather than arguing over how much money is available
- State agencies work with U of M's national and state economic models





Revenue Estimating Challenges

- Very difficult to predict turning points
- Models are designed to predict marginal changes – not as effective with major shifts
- Penalty for being too optimistic much greater than the penalty for being too pessimistic
- Revenues are very volatile month to month – when do you hit the panic button if they are short
- The economic data are often revised after the fact



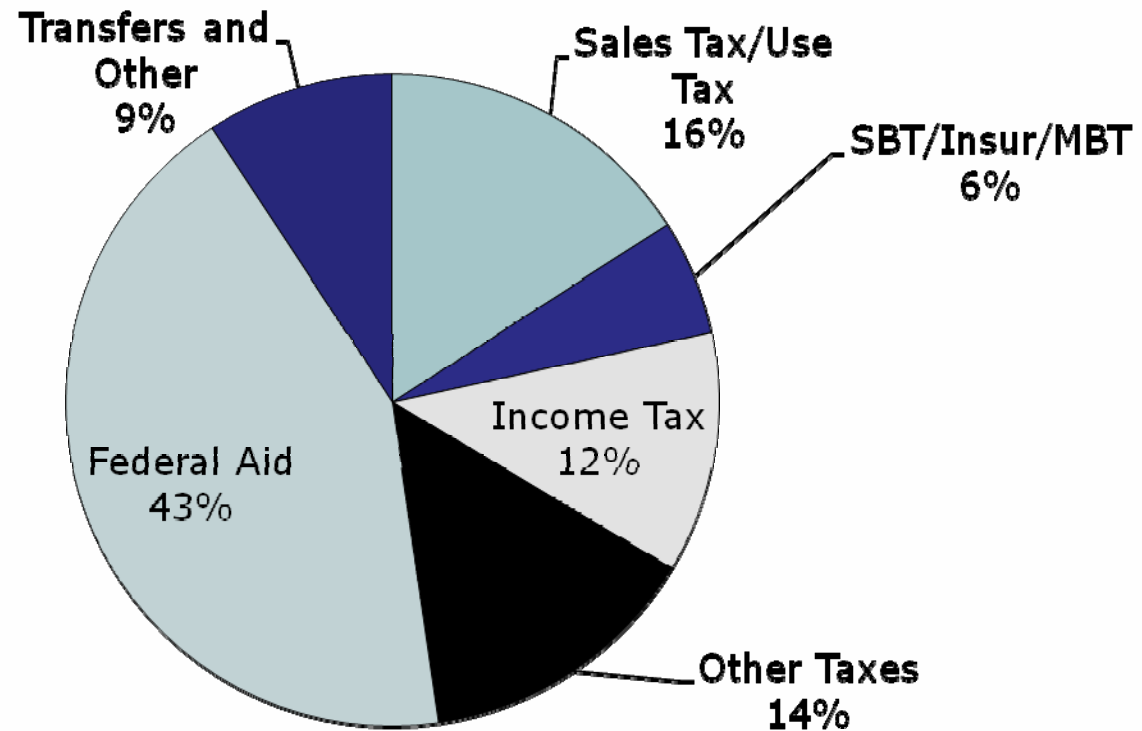


What Happens if there is a Shortfall?

- State Treasurer notifies governor in writing of a problem
- Governor can issue Executive Order cuts or try to pass a “negative supplemental”
 - EO cuts require majority of appropriation committees, but are limited in the types of adjustments that can be made
 - Negative supplementals can do more, but require majorities of both houses and governor’s signature
- Budget cutting process is painful, and you do not want to cry wolf, but delays limit options and make balancing harder

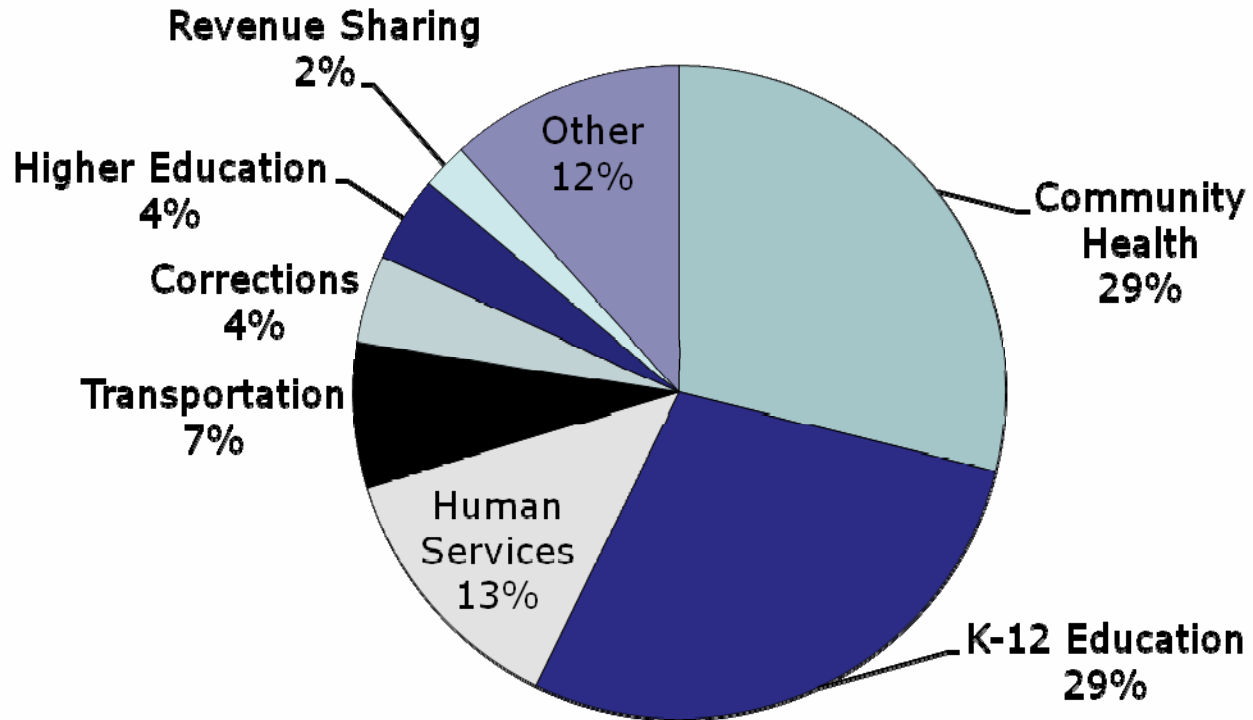


Where Does the Money Come From? FY 2010 Revenues Total \$44.0 Billion





Where Does the Money Go? FY 2010 Spending By Category



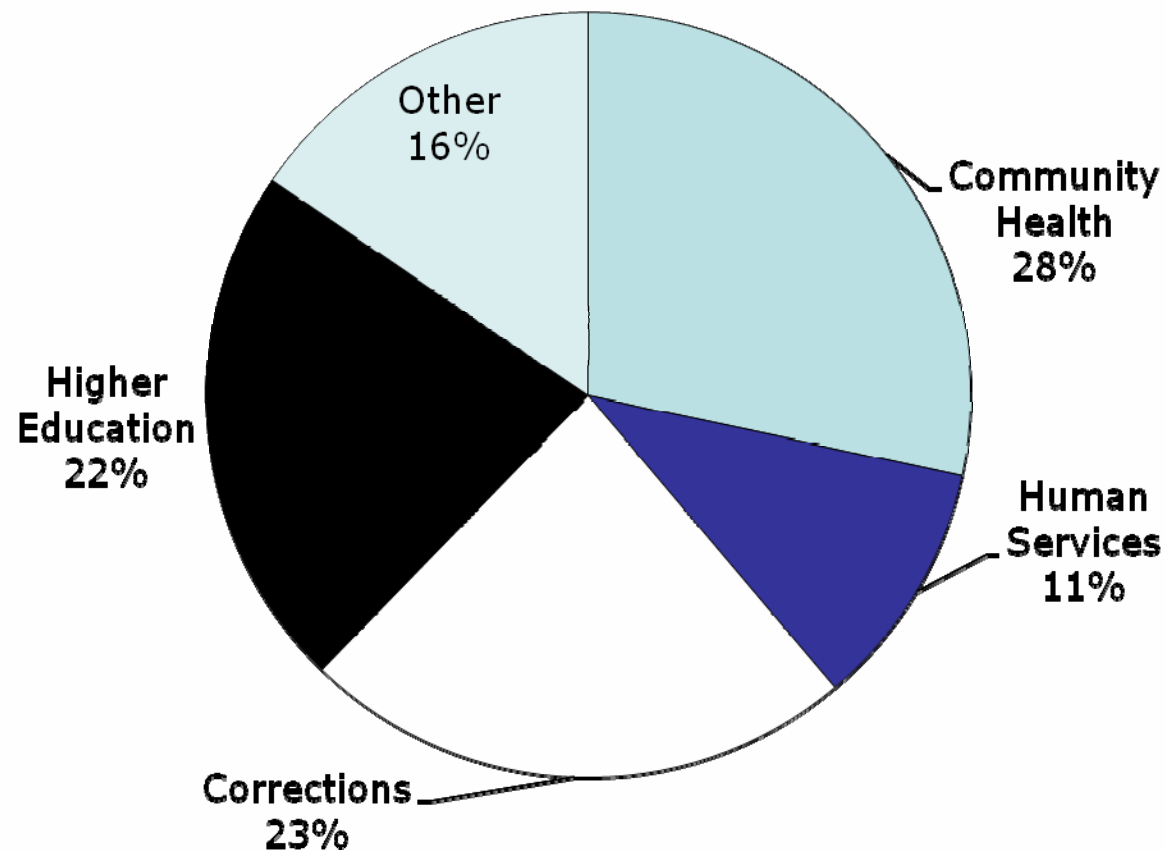


Important Budget Facts

- State is mostly a pass-through entity – most money sent elsewhere:
 - School Aid – local school districts
 - Medicaid – doctors, hospitals, nursing homes
 - Human Services – welfare payments to individuals, daycare providers, etc.
 - Transportation – road funds to counties and cities
 - Revenue Sharing – unrestricted aid to general purpose governments
- Salaries of state employees represent only 11% of the budget
- Unrestricted (GF) spending represents roughly 1/5th of state spending
- 11 • Healthcare is everywhere in budget and is the leading cost driver



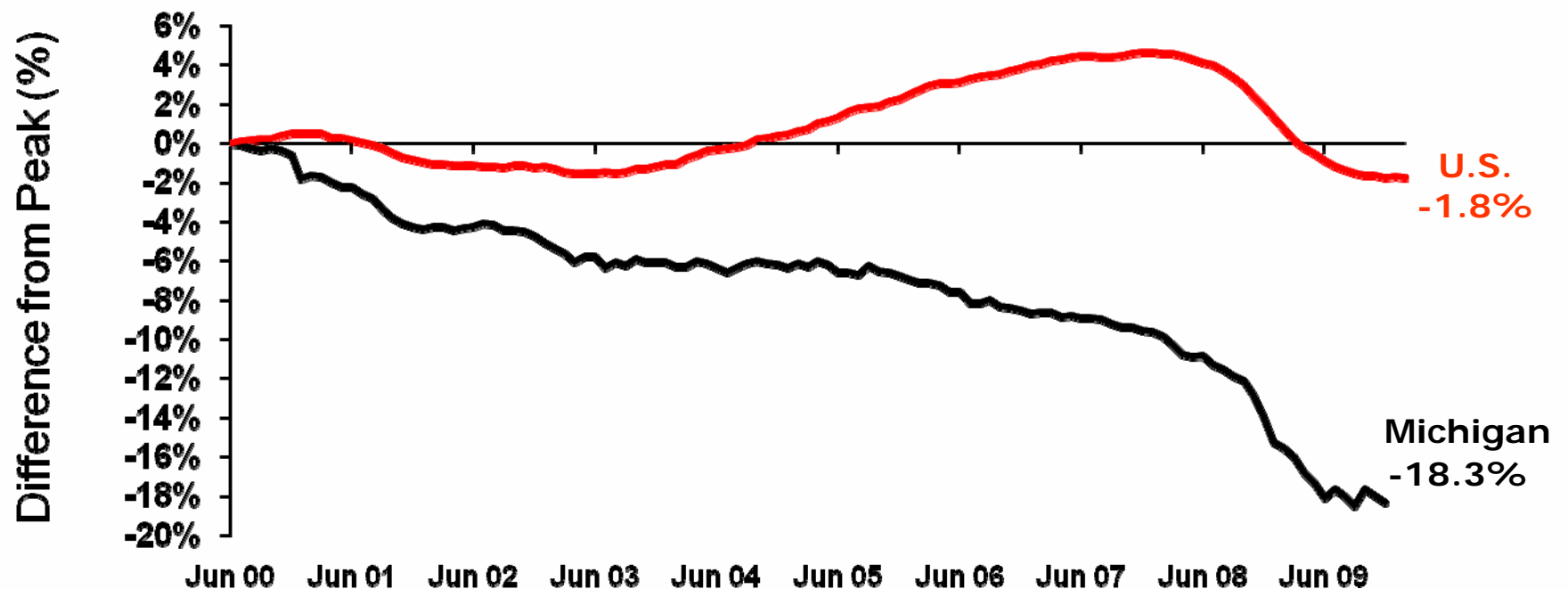
Unrestricted (GF) Spending FY 2010 Budget Totals \$8.1B



Source: FY 2011 Executive Budget



A Lost Decade of Michigan Employment (1 in 6 jobs lost with 1/3 of loss in last 12 months)

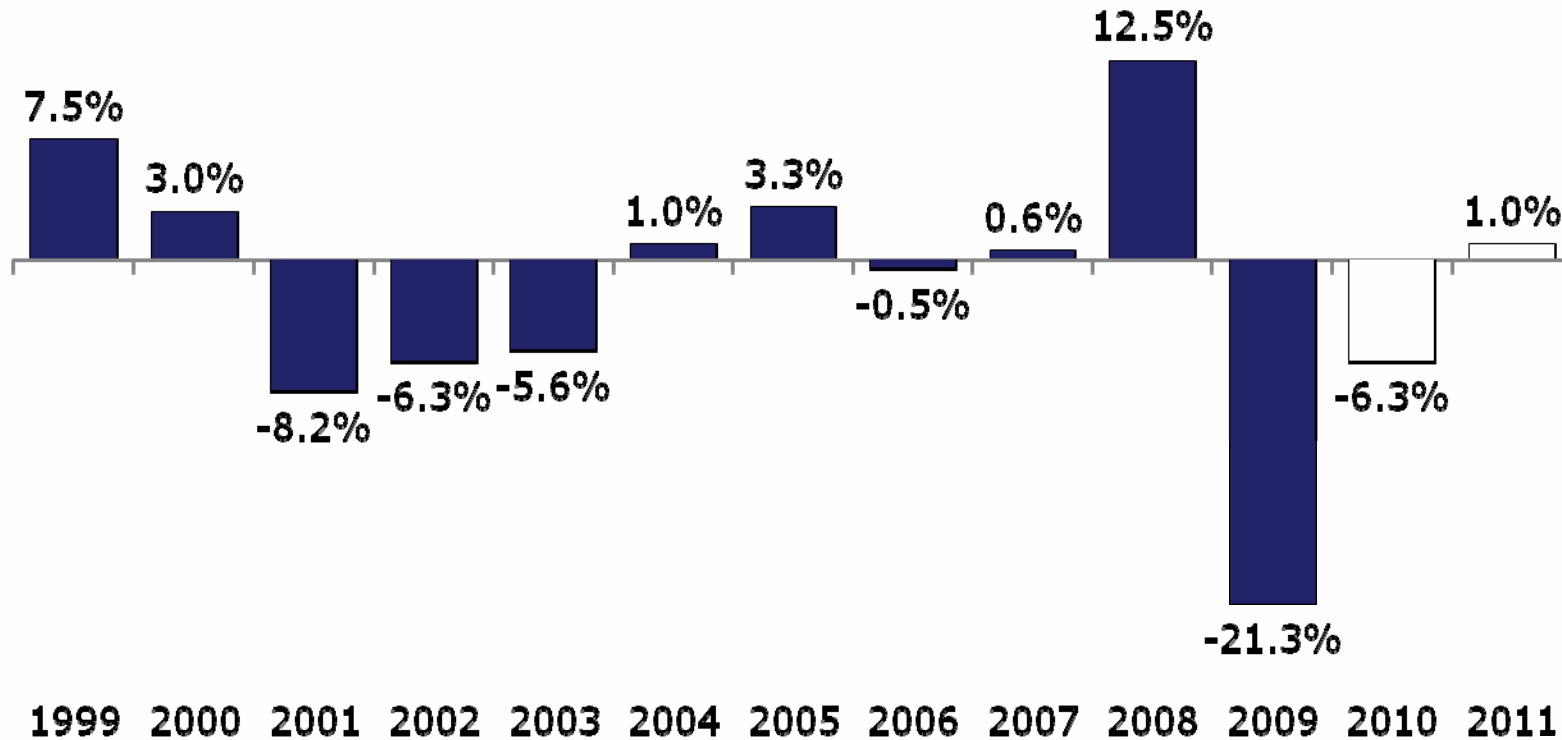


13 Note: Peak is calculated from Michigan's June 2000 Peak. Michigan data through December 2009.
Source: Bureau of Labor Statistics



GF-GP Revenues Drop Sharply in FY 2009 and FY 2010

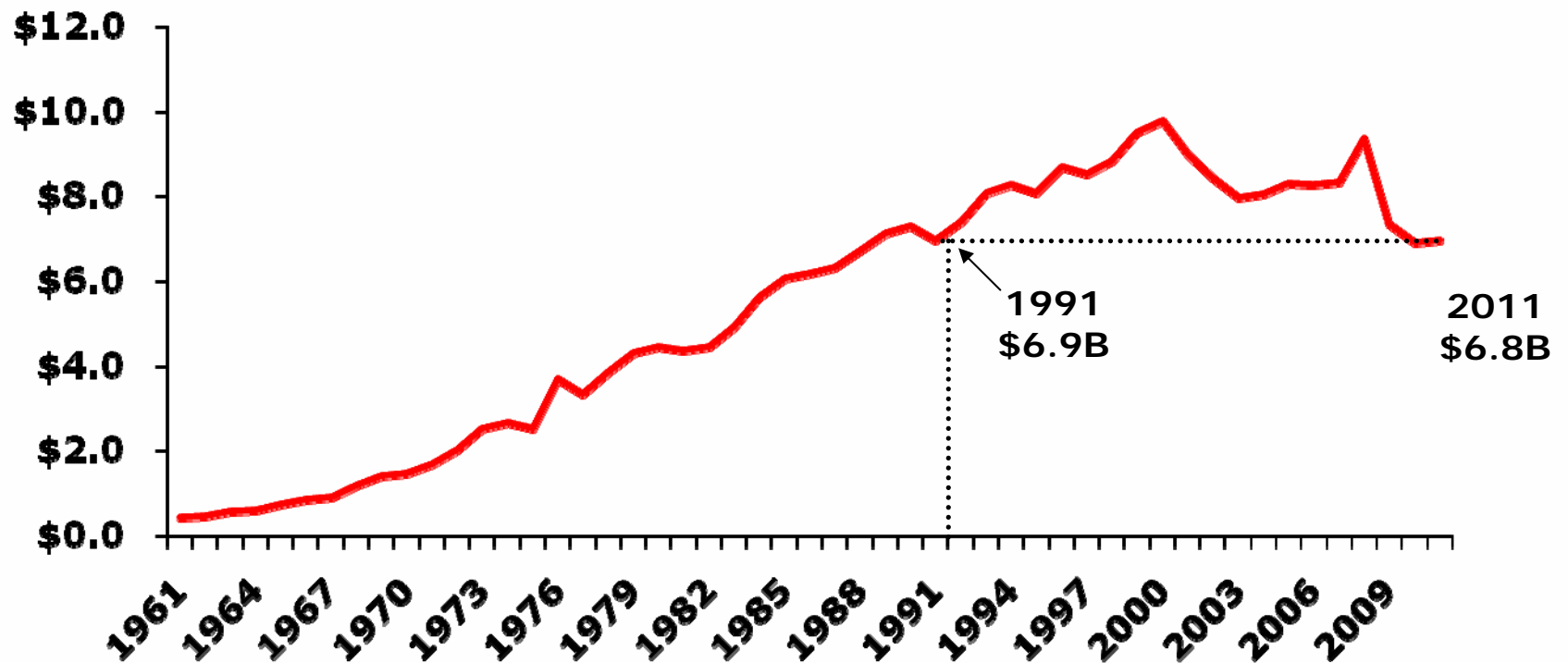
GF-GP Revenues
Year-Over-Year Pct. Change





FY 2011 Nominal GF-GP at FY 91 Level

Billions of Dollars





Stimulus Spending Has Been Supporting State Budgets

(millions of \$)

	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011 CSB</u>
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%

Projected GF-GP Shortfall \$1,160.0

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%

Projected SAF Shortfall \$422.0



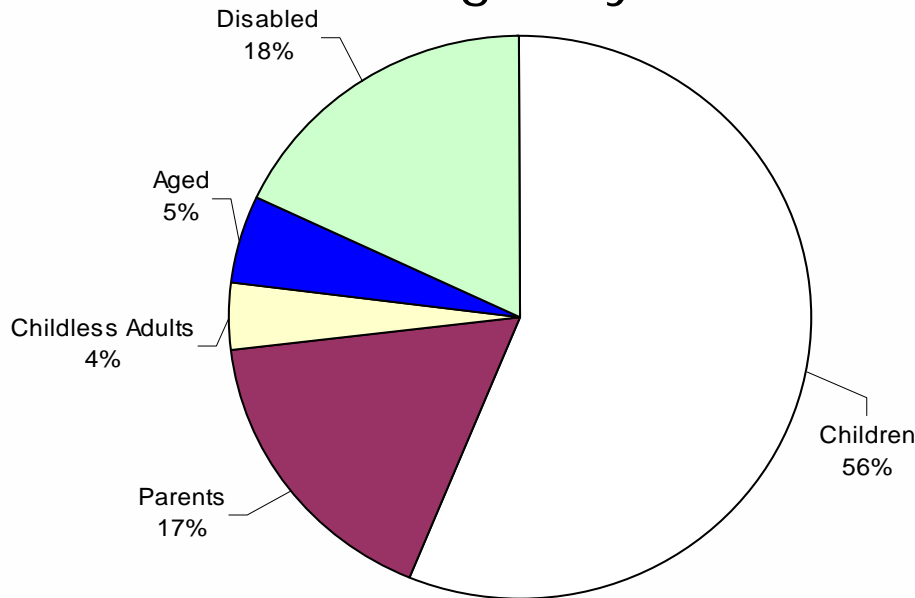
Medicaid

- Medical care for 1 in 7 Michigan citizens
- Future spending growth pressures nearly 8% annually
- Some state revenues dedicated to Medicaid do not grow—Tobacco Settlement revenues, Cigarette Tax
- Others lag behind the overall growth in program
- General Fund requirements expected to grow nearly 11% annually – far faster than any tax
- Federal match currently around \$2.40 for each state dollars spent



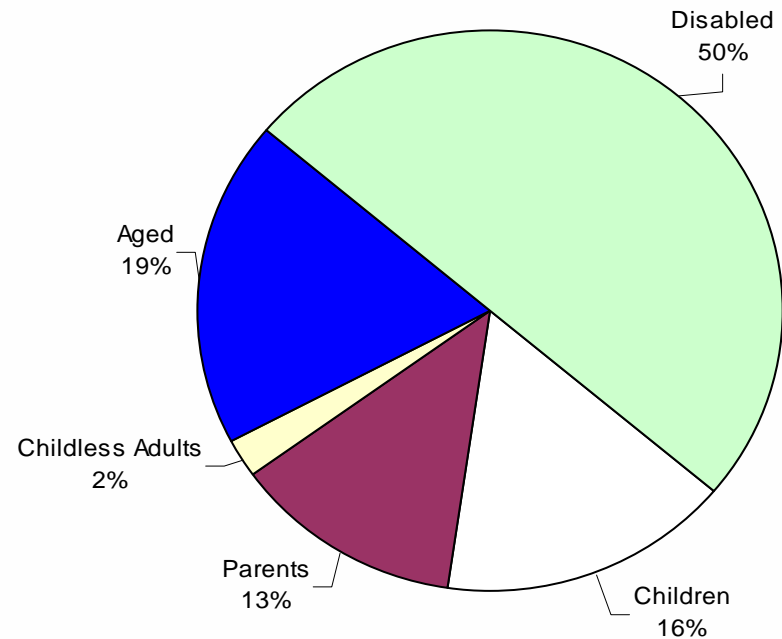
Majority of Medicaid Spending is for Elderly and Disabled Adults

Eligibility



- 56% are children
- 23% are aged or disabled

Spending



- 69% for disabled or aged
- Less than 20% for children



Corrections

- Largest state-operated program
- 30% of state employees
- 45 prisons and camps
- \$30,000 per prisoner cost per year
- Incarceration rate 47% higher than Great Lakes neighbors-the result: \$500 million higher costs
- Population has fallen from 51,454 in 2006 to 45,184
- Governor has proposed reducing pop to 35,500 in 2011
- As population falls, Michigan looking to house out-of-state inmates



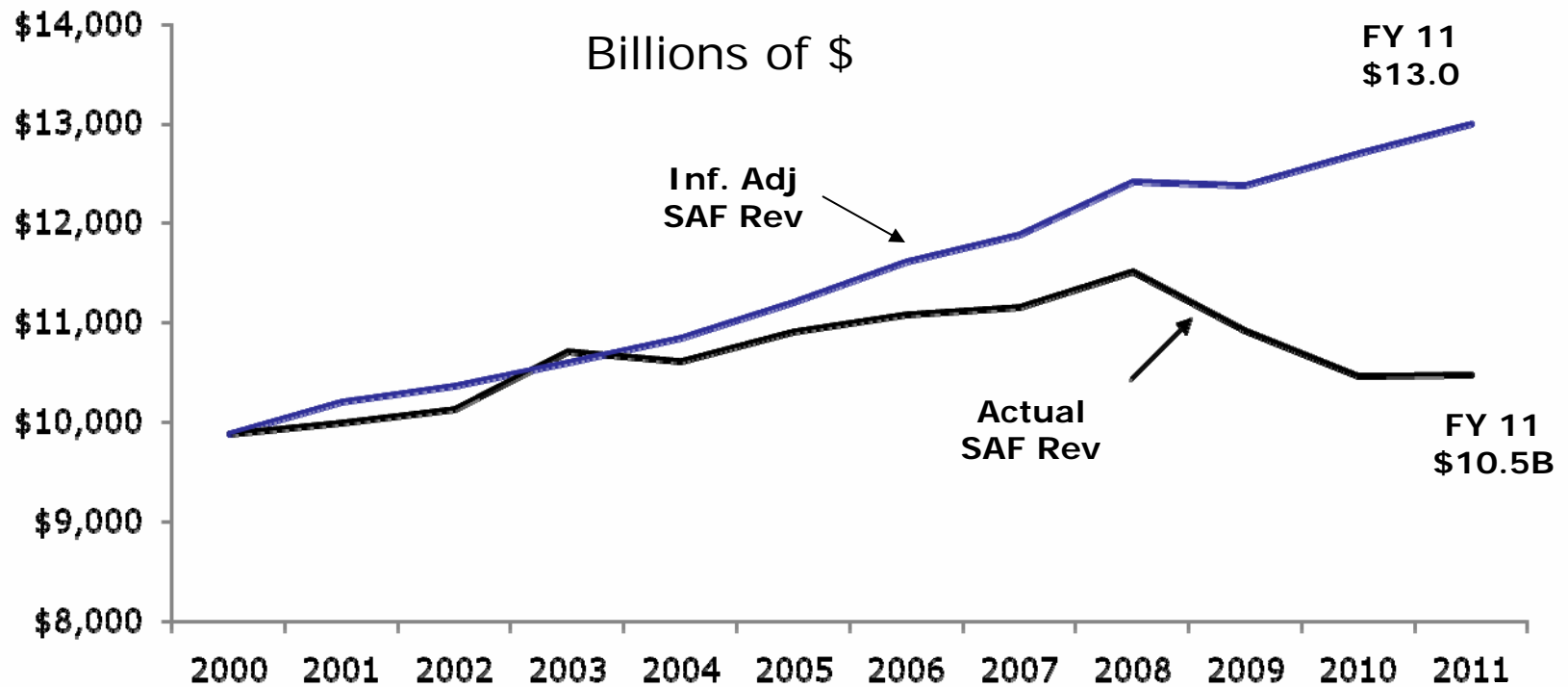
Michigan's Incarceration Rate

States with at least 500 Prisoners per 100,000 Residents



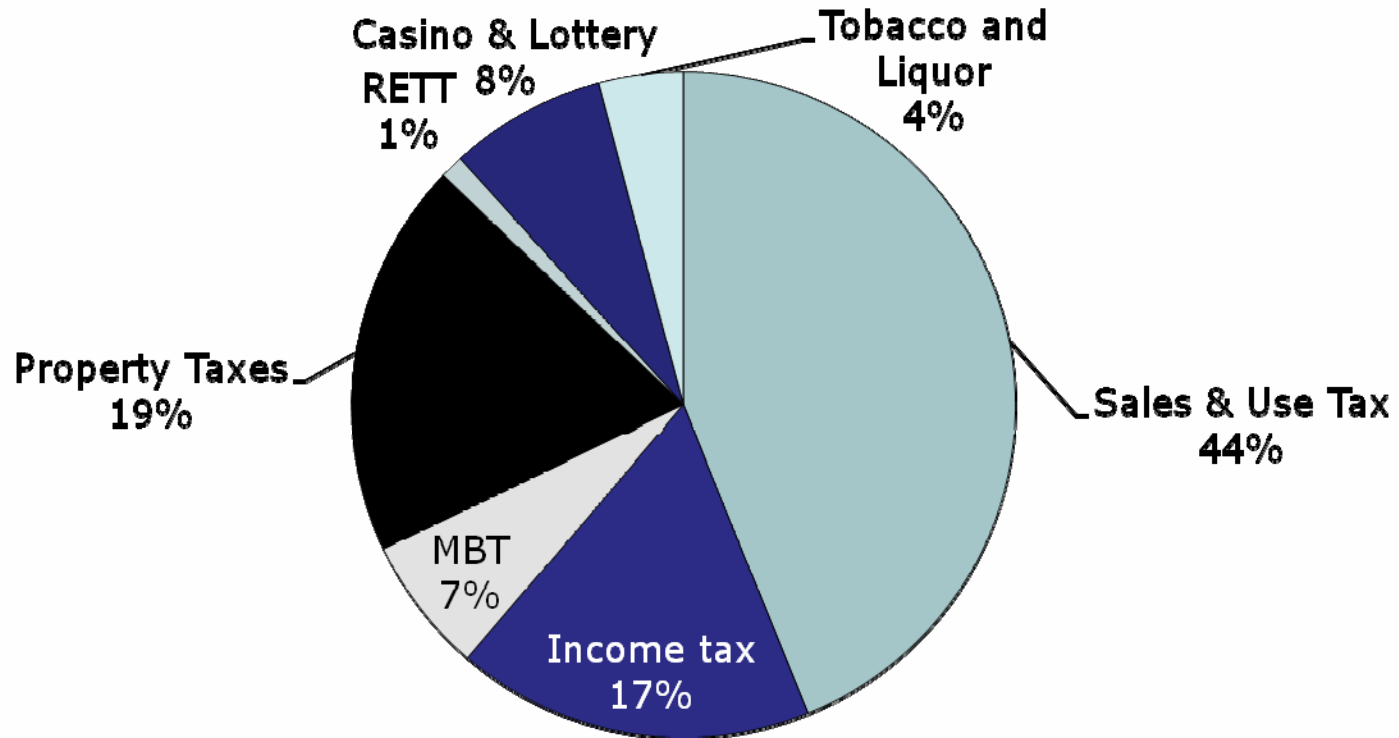


SAF Revenues Trail Inflation By \$2.5 Billion Since 2000





Sources of State School Aid Revenue (Totals \$10.9B in FY 2009)





FY 2010 School Aid Fund Budget Balancing Measures

- Ongoing FY 2010 SAF revenues projected to be \$1.0 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
- Stimulus money in budget:
 - FY 09 \$600M
 - FY 10 \$450M
 - FY 11 \$184M (remainder of funds)



Gov's SAF Solution

\$420M Problem in FY2011

- Tax Restructuring – two parts
 - Expand sales tax base to group of services @ 5.5%
 - Reduce existing rate of sales and use taxes to 5.5%
 - Net effect: \$729M
- Begin two-year elimination of Michigan Business Tax Surcharge
 - Net effect: (\$174M)
- Overall: \$554M to avert \$250 per-pupil reduction
- Also proposing early retirement program for school employees, savings retained locally (\$600M) to help offset expected increase in retirement rate



Spending Growth Over the Last Decade

- Between FY 2000 and FY 2010 state dollars spent on:
 - Community health up 25% and Medicaid pop up 60% (now 17% of state residents)
 - Corrections up 27% and corrections pop up 5%
 - Higher ed down 13.7% while FTE enrollment up 13%
 - Comm College spending up 1% and FTE enrollment up 50%
 - K-12 up 8% while enrollment down 6%
 - Rev share to local govts down 33%
- Between FY 2000 and FY 2008 total state government spending in Michigan grew 26% 2nd slowest rate in nation and less than ½ national average (59%)



FY2011 GF: Another \$1B Deficit

FY2011 General Fund Budget (millions)

Available GF Revenue	\$	7,828
FY2010 Spending Base	\$	8,128
Corrections		26
Human Services caseload		118
Employee economic inc.		140
FY2010 ARRA \$		1,057
FY2011 ARRA \$		(209)
FMAP inc. - Medicaid		(232)
DCH caseload		(184)
Other adj.		71
Est. FY2011 Spending Base	\$	8,915
Shortfall	\$	(1,087)



Governor's Proposal

Mix of Short- and Long-Term Fixes for GF

- 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
- Medicaid provider tax on physicians - \$100M



Ongoing Budget Challenges

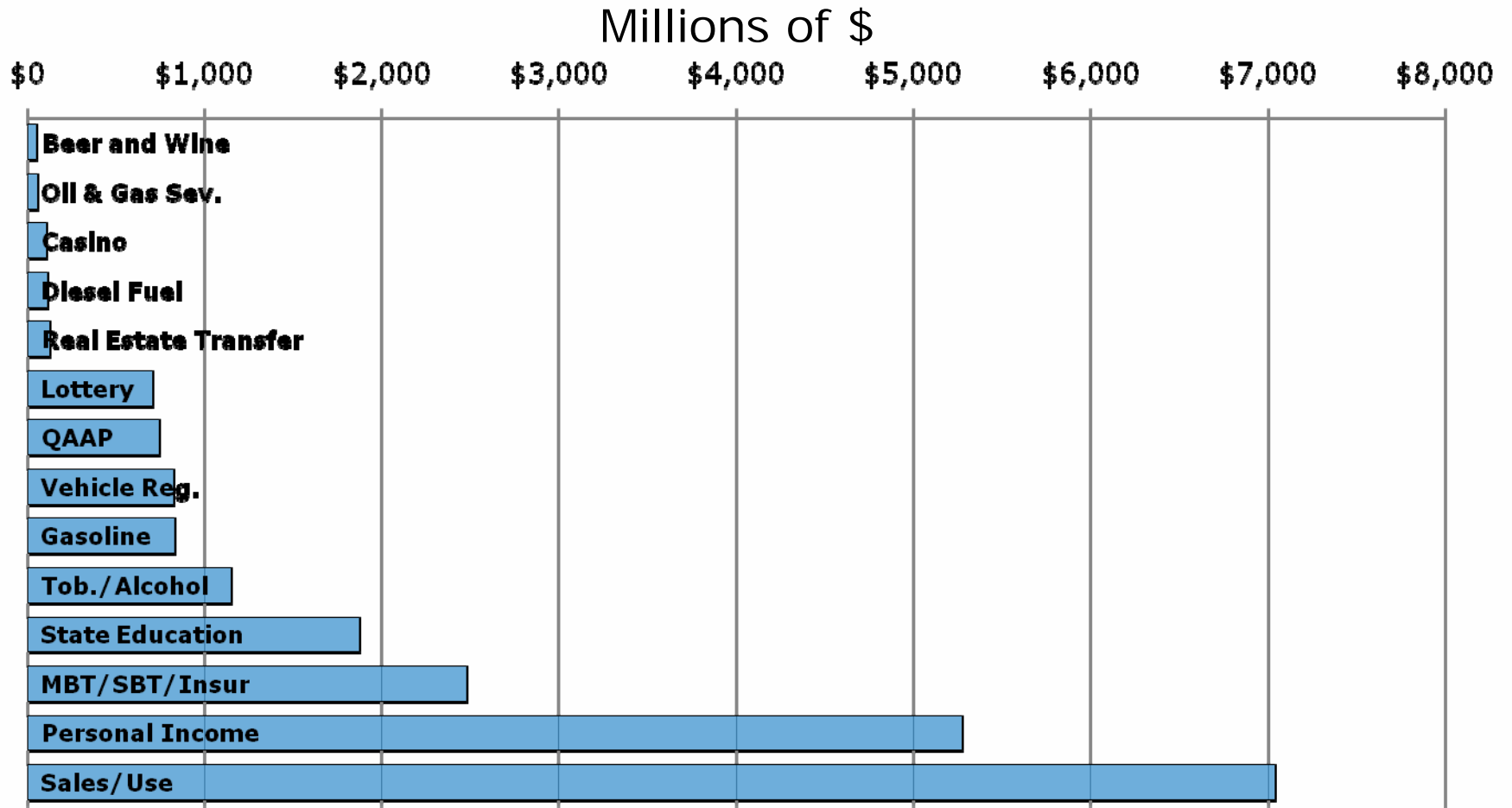
- Budget cliff in FY 2012 when ARRA revenues expire and IIT rate starts to fall
- Balancing social safety net concerns with desire to make investments for economic development when revenues are declining
- Healthcare costs in budget will continue to cause spending pressures to grow faster than revenues
- Aging workforce has an impact on costs side and on revenue side



Overview of Michigan Taxes



Major State Taxes





Michigan's Major Taxes

- **Individual Income Tax**
 - Raised \$5.9 billion in FY 2009 – down 19% from FY 2008
 - Approx. 3/4 to GF-GP and 1/4 to schools
 - Tax base starts with federal AGI
 - Tax rate reduced from 4.4% in 1999 to 3.9% in 2005; Raised back to 4.35% in late 07; scheduled to fall again in late 2011
 - 41 states have an income tax; 6 with a flat rate
 - Homestead property tax credit if property taxes exceed 3.5 percent of income



Michigan's Major Taxes

- **Sales Tax**

- Raised \$6.1 billion in FY 2009 – down 10.1% from FY 2008
- Tax on retail sales of 6%
- 73% to schools; 16% to local governments; 1% to transportation and 10% GF-GP
- 45 states have general sales tax; median state rate is 5.5%; median of maximum combined state/local rate is 7.25%
- Base as a percent of personal income is shrinking

- **Use Tax**

- Raised \$1.1 billion in FY 2009 (down 19.2%)
- Tax on use and storage of personal property
- 6.0 percent rate - 1/3 to schools; 2/3 to GF-GP



Michigan's Major Taxes

State Education Tax

- Raised \$2.1 billion in FY 2009 (down 1.9%)
- Statewide property tax of 6 mills on all property
- Money goes to K-12 schools
- Taxable value cap has cushioned impact of house price declines, but will be little help going forward

• Tobacco

- Cigarette rate raised to \$1.25 in August 2002
- Increased to \$2.00 in July 2004 (ranks 4th highest among state taxes)
- Other tobacco products 32% of wholesale price
- Raised \$1.0 billion in FY 2009



Michigan's Major Taxes

- **State Lottery and Detroit Casinos**
 - All lottery to SAF, Casinos to SAF and GF-GP
 - Lottery raises approx. \$725 million, casino tax \$120 million
 - Casino tax rate increased from 18% to 24% in September of 2003 (State gets roughly 1/2) but rate has fallen back to 18% as casinos opened their permanent facilities



Michigan Business Tax

- Started January of 2008, replaced the SBT
- Tax base for most firms is modified gross receipts taxes at 0.8% and business income taxed at 4.95%
- Insurance companies taxed at 1.25% of direct premiums and financial institutions at 0.235% of assets
- Special taxing provisions lower burden for small businesses



Michigan Business Tax

- The MBT has a number of large credits
 - Refundable credit 35 percent of personal property taxes, plus some personal property tax relief enacted along with MBT
 - Credit for 0.37 percent of Michigan compensation paid
 - Credit for 2.9 percent of Michigan investment
 - R&D credit equal to 1.9 percent of Michigan R&D development expenses
 - Comp plus investment credit cannot exceed 52% of liability
 - Comp, investment, and R&D cannot exceed 65% of liability
- Surcharge enacted in December 2007 to replace repealed use tax on services



Majority of Tax Revenue is Earmarked (Sources)

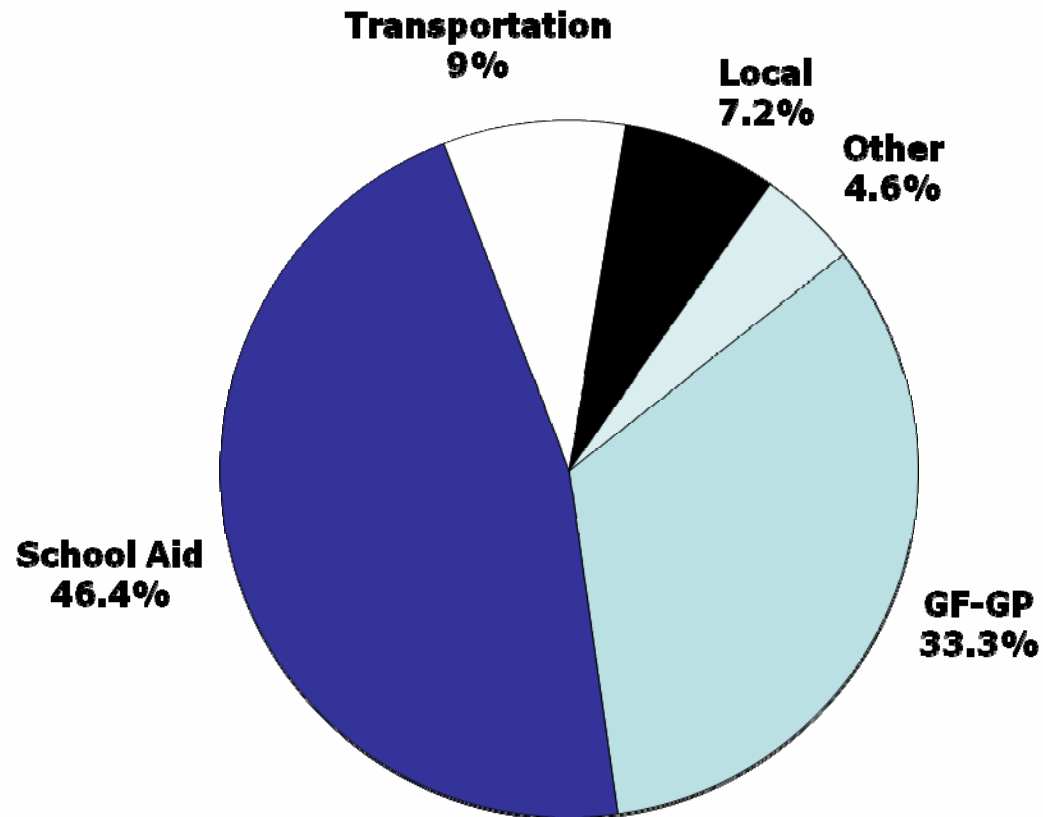
FY 2010 Millions

<u>Tax</u>	<u>Amount</u>	<u>Earmarked Amount</u>	<u>% Earmarked</u>
Income	\$5,273.3	\$1,778.9	34%
Sales	\$5,894.5	\$5,340.4	91%
Use	\$1,143.0	\$381.0	33%
SBT/MBT/Insur	\$2,479.4	\$726.7	29%
Tobacco	\$981.8	\$784.8	80%
Other	<u>\$5,241.2</u>	<u>\$5,001.0</u>	<u>95%</u>
Total	\$21,013.2	\$14,012.8	67%



Most Earmarking is for Schools (Uses)

FY 2010 Taxes Total \$21.0 Billion





Michigan Taxing Authority

- **State**
 - **Constitutional:** property tax, sales tax, fuel tax, some restrictions on income tax
 - **Statutory:** income tax, Michigan business tax, oil & gas, alcohol, tobacco, lottery, motor vehicle registration
- **Local**
 - **Constitutional:** property
 - **Statutory:** income



Constitutional Taxing Provisions

- **Income Tax**
 - Prohibits graduated rate or base
- **Sales Tax**
 - Sets maximum rate at 6 percent
 - Earmarks 73% to education
 - Earmarks 10% to cities, townships, and villages
- **Motor Fuels**
 - Restricts for transportation purposes



Constitutional Taxing Provisions

- **Property Tax**

- Sets maximum rate
- Limits assessment to 50% of true cash value
- Limits assessment increases to inflation
- Requires 3/4 vote of legislature to raise school operating taxes

- **Revenue Limit**

- Restricts total state revenues to a fixed share of the State's personal income



State & Local Tax Burden Close to National Average

But State Share Has Fallen While Local Has Increased

	FY 2000			FY 2007		
	State	Local	Total	State	Local	Total
Michigan						
Income	2.5%	0.2%	2.7%	1.9%	0.1%	2.0%
Sales	2.6%	0.0%	2.6%	2.3%	0.0%	2.3%
Property	0.6%	2.7%	3.3%	0.7%	3.6%	4.3%
Corp Income	0.8%	0.0%	0.8%	0.5%	0.0%	0.5%
Other	1.3%	0.1%	1.4%	1.6%	0.2%	1.7%
Total	7.8%	3.0%	10.8%	7.0%	3.9%	10.9%
U.S. Avg						
Income	2.4%	0.2%	2.6%	2.3%	0.2%	2.5%
Sales	2.1%	0.5%	2.6%	2.1%	0.5%	2.6%
Property	0.1%	2.9%	3.0%	0.1%	3.2%	3.3%
Corp Income	0.4%	0.0%	0.4%	0.5%	0.1%	0.5%
Other	1.5%	0.4%	1.9%	1.6%	0.5%	2.1%
Total	6.6%	4.0%	10.6%	6.5%	4.5%	11.0%



Issues to Consider When Evaluating Taxes

- **Broad tax base and low rates** – minimizes distortions to the economy
- **Horizontal Equity** – Are similar taxpayers taxed similarly?
- **Growth Potential** – Will the tax grow compared to the underlying economy?
- **Stability** – How volatile will the tax be on a year-to-year basis?
- **Degree of Progressivity** – How does the tax rate vary with income?
- **Impact on Economic Development** – To what extent does tax affect labor market participation or capital formation?



Michigan Tax Topics Being Debated

- **Sales Tax on Services** – Gov's rec includes an expansion of the sales tax to consumer services and a cut in the rate to 5.5%
- **Progressive Income Tax Rate** – Should Michigan switch to a progressive rate and if so, how progressive should the rate be?
- **MBT Surcharge** – Enacted to replace the repealed service tax from 2007, there is significant interest in repealing this tax
- **Economic Development Incentives** – To what extent should the state use targeted tax incentives to lure businesses and industry to Michigan?



CRC Publications are available at:

www.crcmich.org

Providing Independent, Nonpartisan Public Policy
Research Since 1916