Governor Snyder's FY 2012 Budget and Tax Proposal

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- 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
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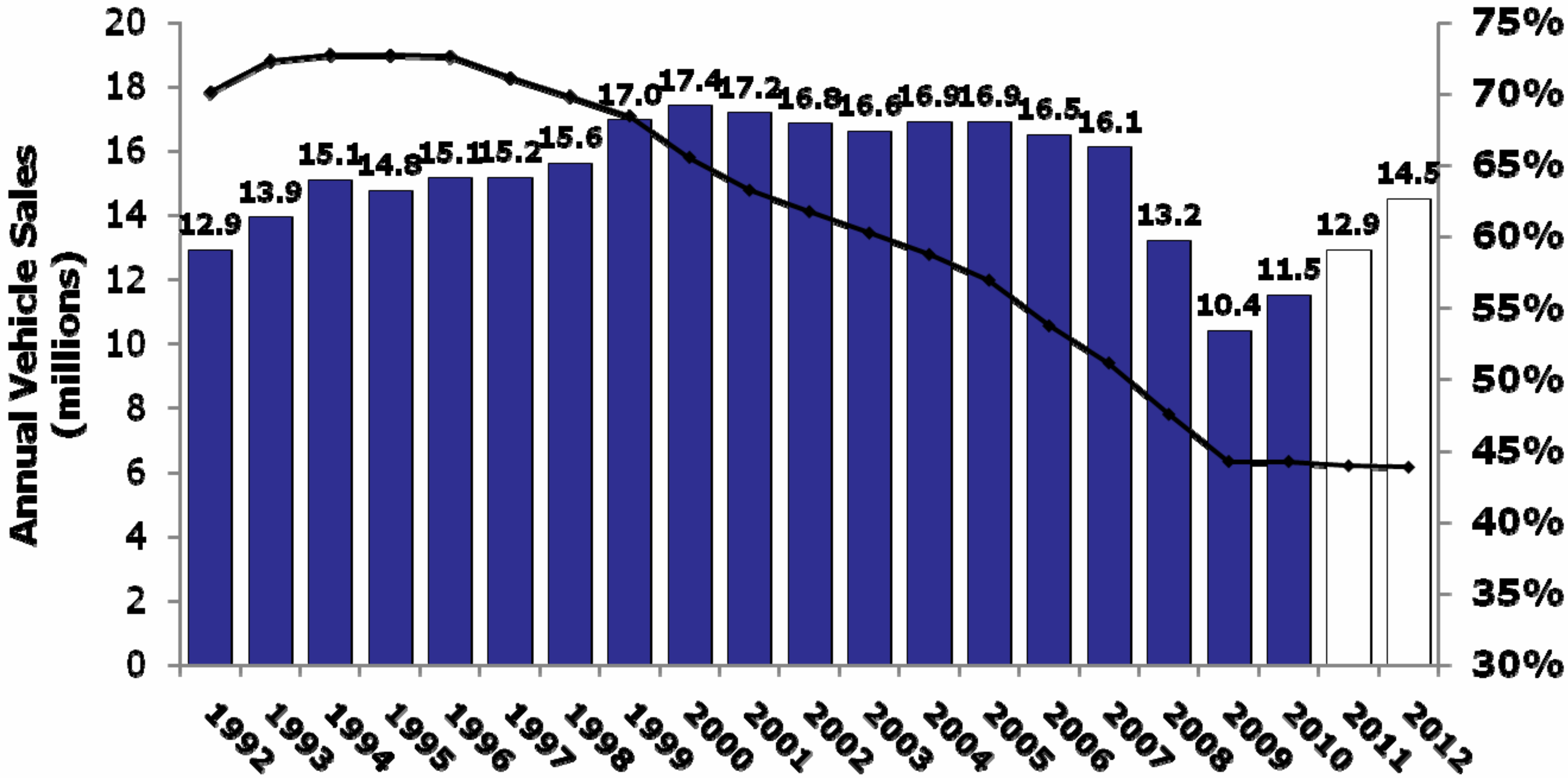
Michigan's Budget Environment

The Last Decade Was an Economic Disaster for Michigan

	Growth 2000 to 2009 U.S.	Growth 2000 to 2009 Michigan	Michigan Rank
Population	8.8%	0.1%	51
Real Per Capita GDP*	5.7%	-8.4%	50
Employment	-0.7%	-17.1%	51
Real Per Capita Income	3.6%	-7.1%	51

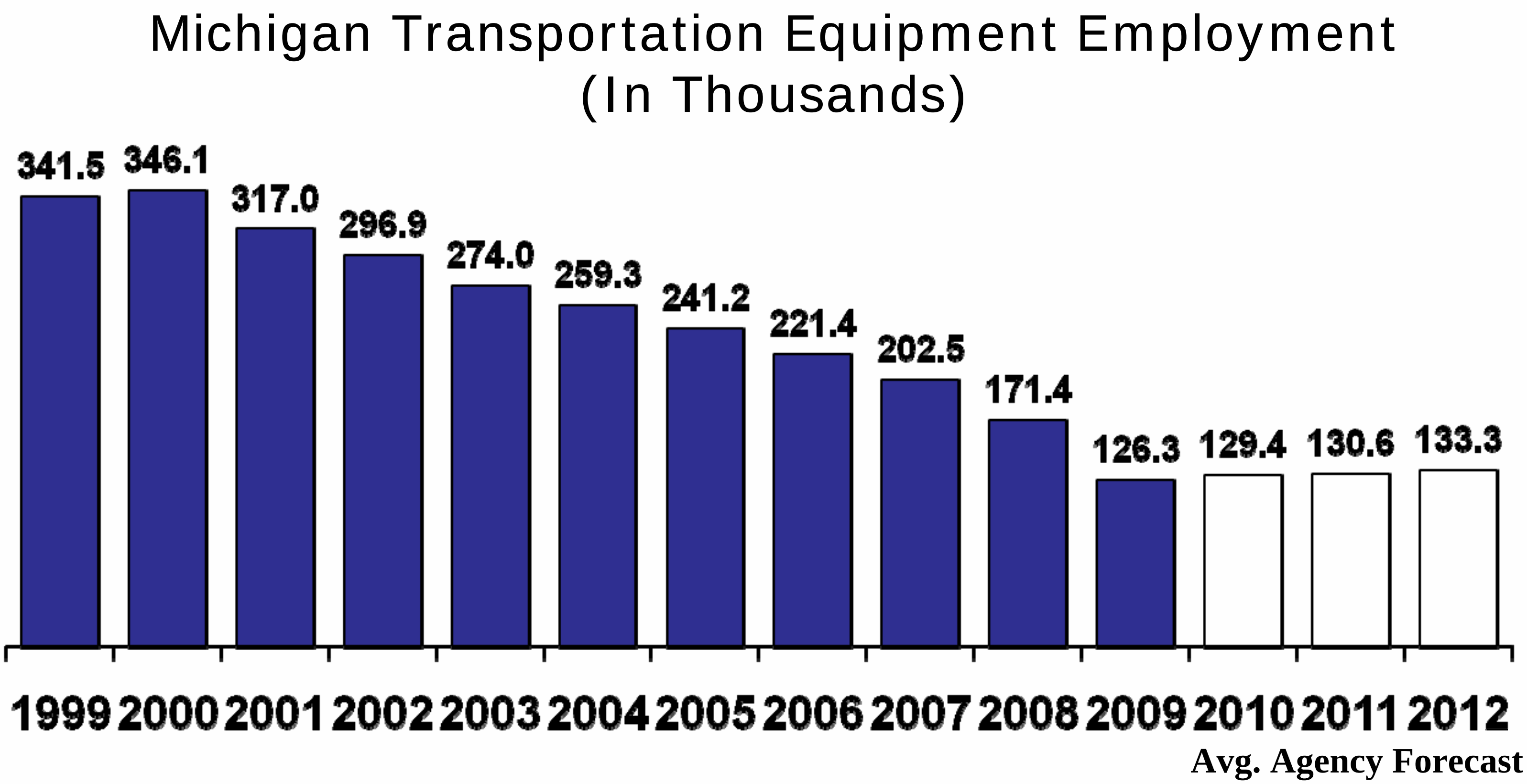
*Georgia is the 51st ranked state.

Big 3 Market Share Plummets



Source: 2010-2012 sales are the Jan 2011 Cons. Estimates; 2010-2012 share MI Dept of Treasury

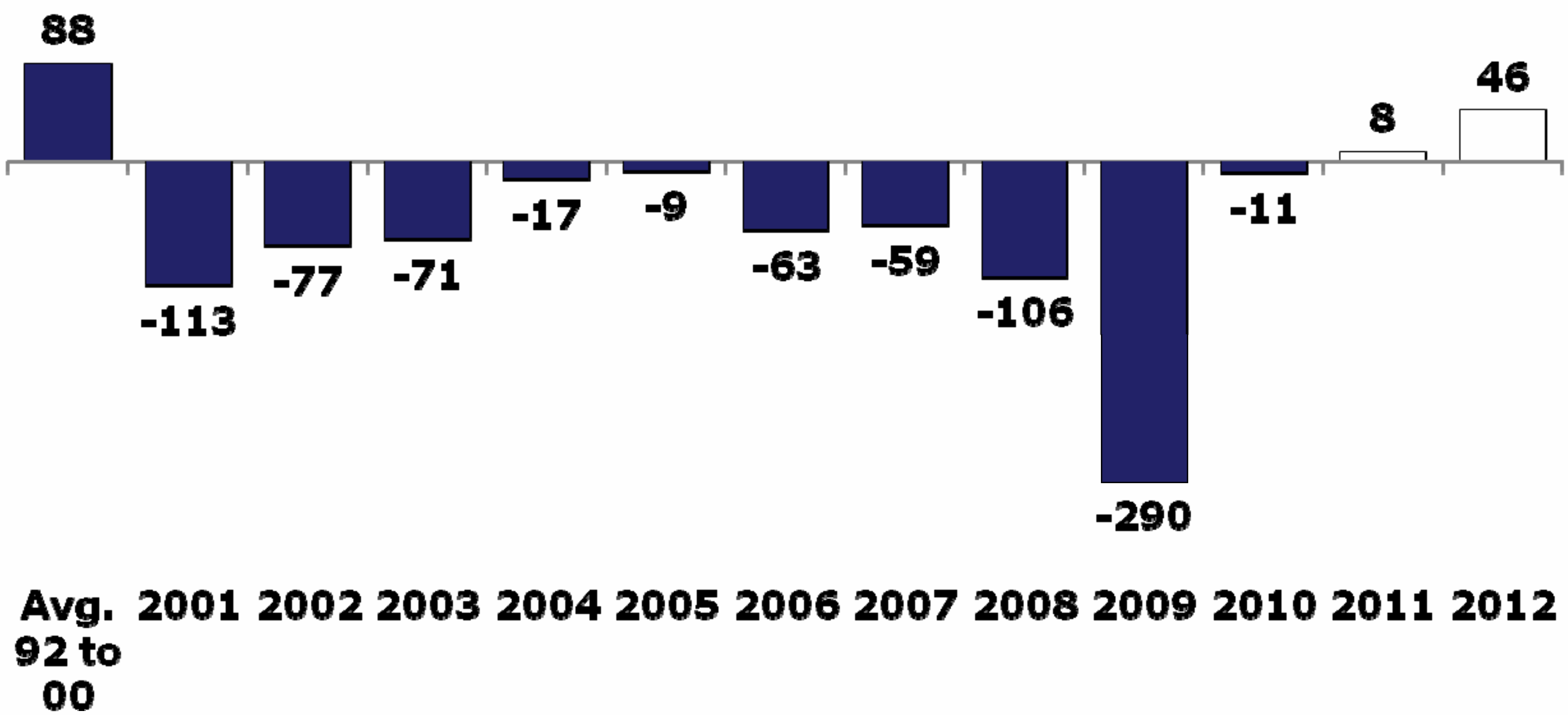
2 in 3 Auto Jobs Lost by 2011



Source: Bureau of Labor Statistics. 2010-2012 estimates are the January Consensus estimates.

Michigan Employment Fell For 10 Straight Years

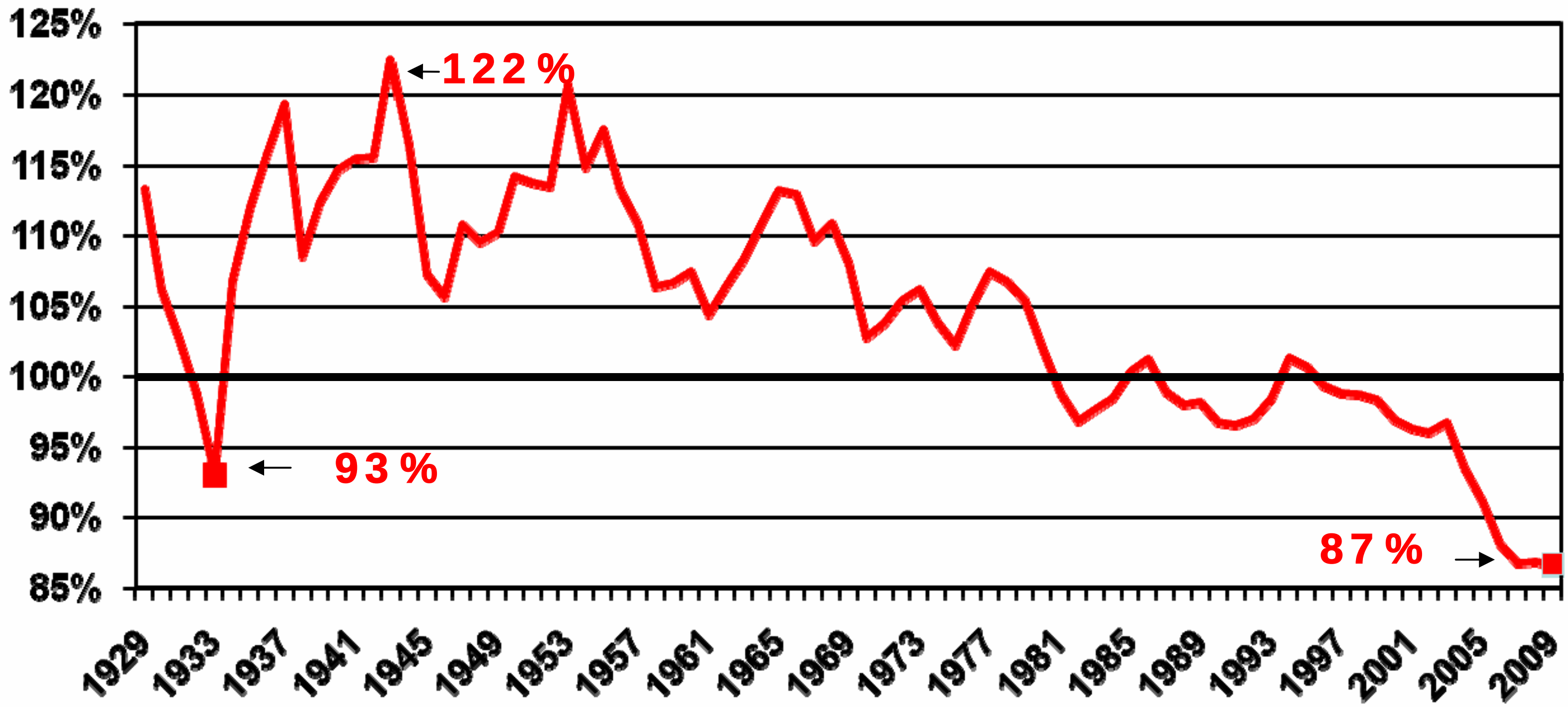
Annual Change in Wage and Salary Employment (000)



Source: Bureau o f Labor Statistics and CRC calculations. FY 2011 and FY 2012 are the January 2011 Consensus totals.

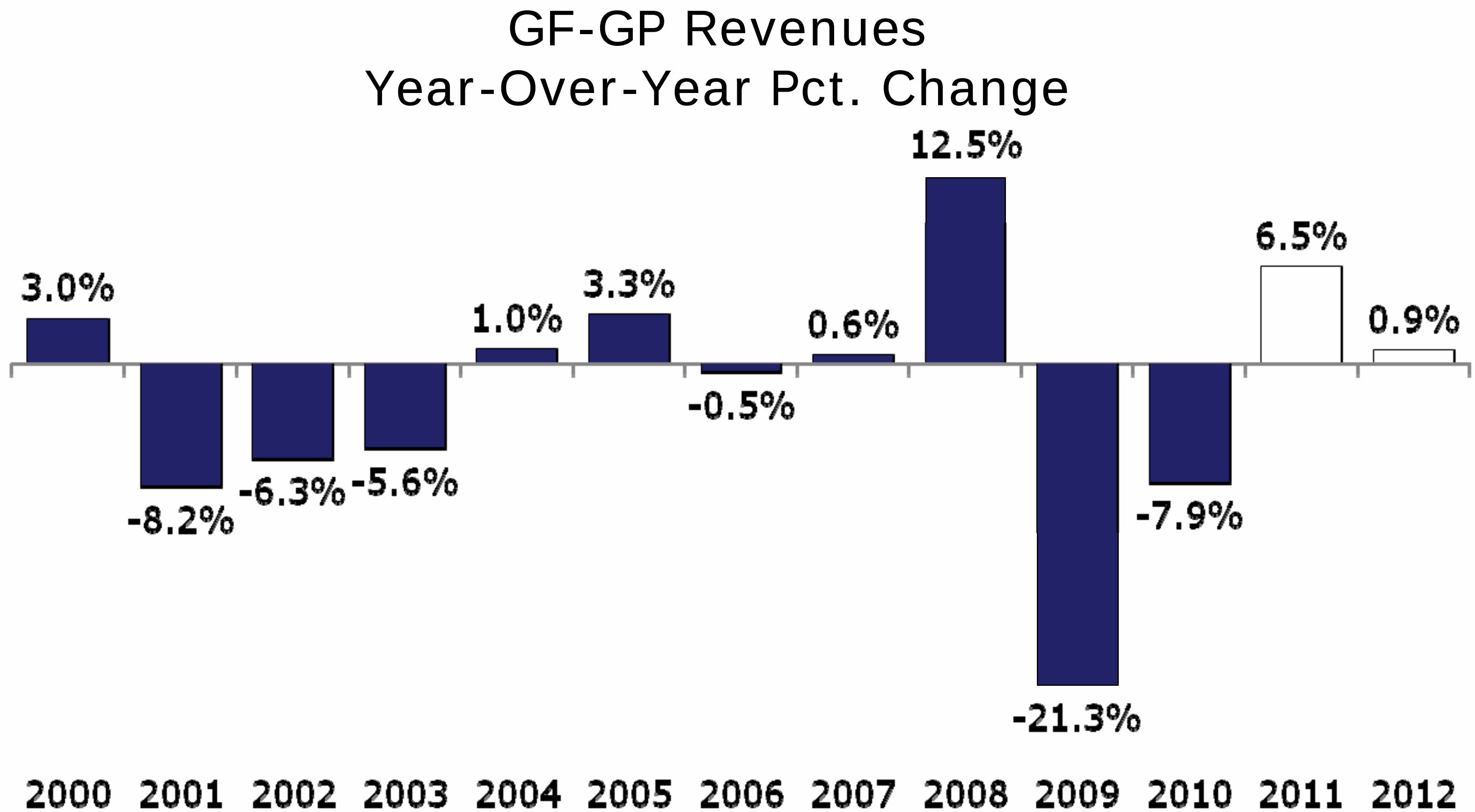
Michigan Has Become Poorer Relative to Other States

Michigan per Capita Income as a Percent of U.S. Per Capita Income
Rank has fallen from 20th in 2001 to 37th in 2009



Source: CRC calculations from Bureau of Economic Analysis data. September 2010.

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



Source: Michigan Department of Treasury. FY 2011 and FY 2012 are the January 2011 Consensus totals.

Governor Snyder's Budget Proposal

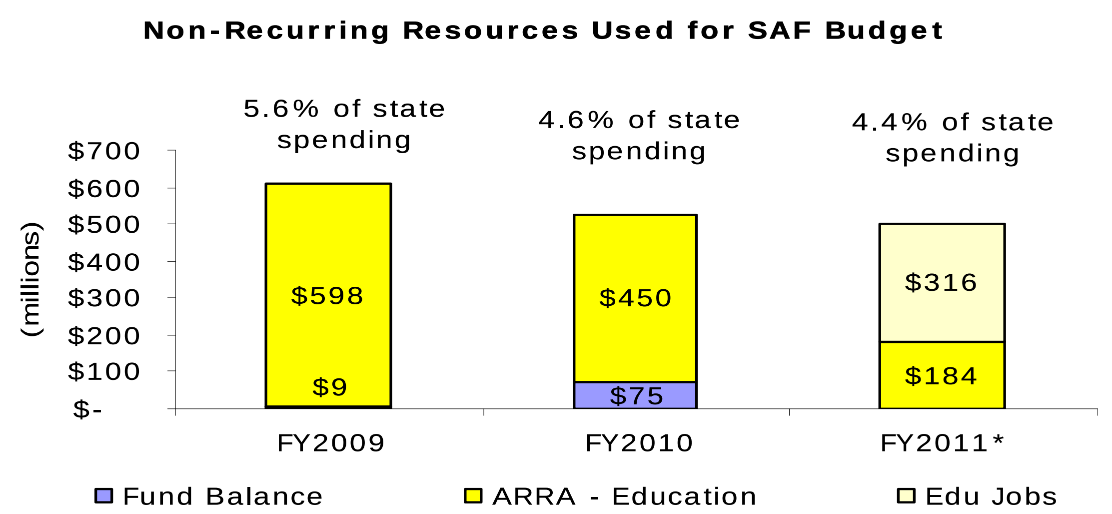
Defining the FY2012 GF Problem

Loss of Federal $ and Cost Increases Contribute

- FY2012 on-going revenues: $8.2B
- Current-year spending with adjustments: $9.6B
- Major adjustments include:
  - $900M in temp. federal (mostly stimulus)
  - $193M caseload increase in Human Services and Community Health
  - $98M increase in debt service payments
  - $105M increase in employee costs/early out
- Bottom line: $1.4B structural imbalance in GF

FY2012 SAF Budget in Much Better Shape

Despite Use of Non-Recurring Resources



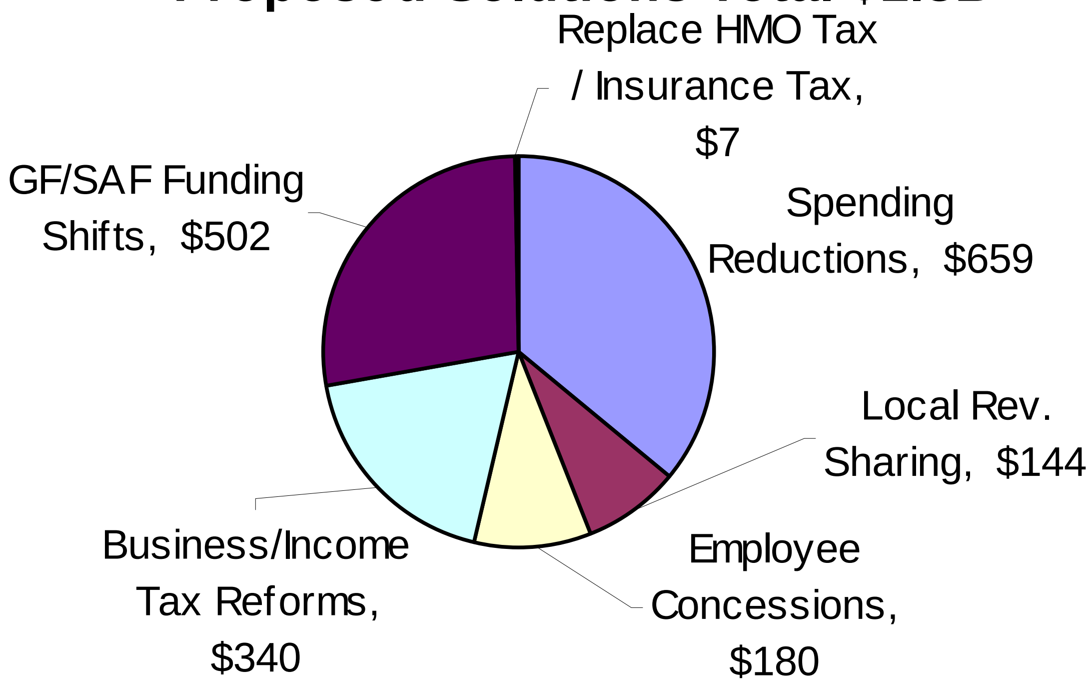
Fund Balance = $247 million at 10/1/08. State spending excludes federal.

* Based on enacted budget as of 7/10 and projected Edu Jobs funding.

“Balanced” Budget by Using $500M of SAF Reserves

Mix of Proposed Solutions to Address $1.4B Gap

Proposed Solutions Total $1.8B



Savings Offset By $260M in New Investments

Source: Senate Fiscal Agency

State Education Funding Act

Funding for K-12 through Higher Ed

- Education appropriations contained in single budget
- K-12 no longer has exclusive claim to School Aid Fund resources – shifts $896M to colleges and universities
- Overall reduction of $1B (6.7%)
- After removal of temporary federal funding, cuts $566M (4.4%) in spending from state resources (GF and SAF)

Total Education Funding (millions)

	K-12	Community Colleges	Higher Education	Total
FY2011	$ 12,954	$ 296	$ 1,578	$ 14,829
FY2012	$ 12,174	$ 296	$ 1,362	$ 13,832
Change	*$ (781)*	*$ -*	*$ (216)*	*$ (997)*

Source: Executive Budget for Fiscal Years 2012 and 2013

K-12 Education

No Federal $ and After Funding Shifts - $470 Hard Cut

- Expiration of one-time federal funds: $170 per pupil ($267M)
- Foundation reduction: $300 per pupil ($453M)
- Elimination/reduction of various categoricals ($86M)
- Retirement rate – 20.7% to 24.5% (add'l $245 per pupil)

	FY2011	FY2012	Change
Min. Grant	$ 7,316	$ 6,846	$ (470)
Basic Grant	$ 8,489	$ 8,019	$ (470)
Max. Grant	$ 8,489	$ 8,019	$ (470)

Effective Per-Pupil Reduction: $715 (10%)

Source: Executive Budget for Fiscal Years 2012 and 2013

Higher Education/Community Colleges

- Public universities – uniform 15% cut ($213M), plus cut of 5% to 10% ($83M) - varies by school
  - Restoration of $83M based on tuition restraint (less than 7.1% in FY2012)
- Consolidates all need-based financial aid
  - New "Pathways" scholarship – up to $875/yr
- Community college funding held constant ($296M)
- Total of $896M in SAF revenue ($567 per-pupil cut in K-12 funding)

School Funding Issues Raised

- Earmarking of state revenue – tax restructuring
  - Reduces amount of tax receipts dedicated to School Aid Fund (SAF)
  - Shifts $500M in tax revenue to GF/GP
  - Provides executive and legislative branch with more discretionary resources
  - Related change - proposal breaks with past practice of reserving SAF resources for K-12 education and now funds higher education from these resources as well

State Employee Compensation

- Net increase of $105M to fund employee costs, primarily related to retirement (pension and OPEB)
  - Retirement contributions increase from 37.4% to 50.9% of payroll for defined benefit employees
- After adjusting for required employee costs (above), $180M GF savings reflected in budget – to be negotiated later
- Budget includes $200M to address future unfunded health care liabilities for state retirees, which are currently funded with current dollars

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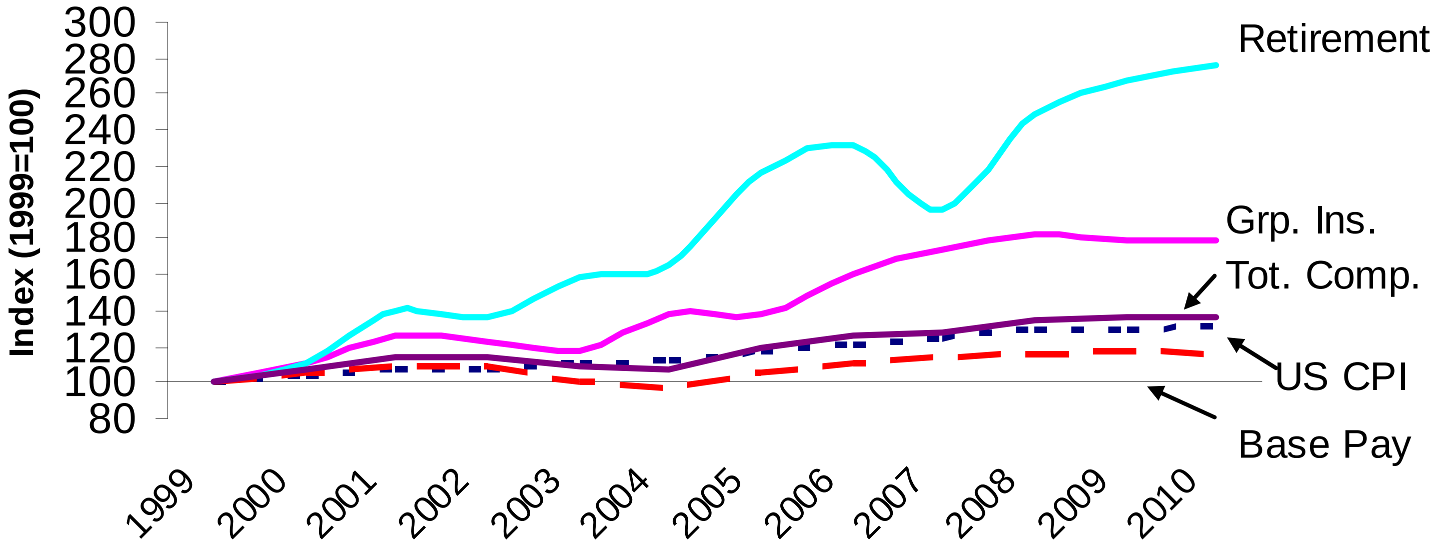
Budget Proposal Takes Aim at Cost Drivers

Retirement Contributions and Insurance Costs Drive Total State Personnel Expenses



Source: State of Michigan Workforce Reports

Getting $180M GF in Employee Compensation Savings

- Total compensation (FY2010): $4.8B
  - For every dollar cut, $.50 in GF savings
  - Salaries/wages (63% of total), insurance (14%), and retirement contributions (18%)
- Contracts for state unions go through FY2012 complicating the process of achieving savings in FY2012
- Possible solutions:
  - Equivalent to 12% cut in salary ($6,700 per employee)

  or

  - Change insurance cost-share (80/20): $39M
  - 5% wage cut: $76M

State Revenue Sharing Payments Cut

- Since 2001, statutory revenue diverted to help balance GF budget
  - ~ 1,200 units (cities, villages, twps.) no longer receive statutory payments
- Eliminates entire $292M in remaining statutory payments to 600 units
  - $200M to all units (1,800) based on new formula
  - Details of formula still TBD
  - Overall cut, $101M (34%)
- County revenue sharing cut by 34% for 50 counties currently getting payments
- Revenue sharing cuts combined with property value declines will put significant stress on local budgets

Assessing the Structural Integrity

Progress Towards Solving the Structural Deficit

- Lack of non-recurring resources to achieve balance
- Cuts spending significantly
  - K-12 education
  - Higher education
  - Employee compensation
- New tax structure likely to grow faster than existing one
- Provides look into future (FY2013) – balanced budget
- Major costs drivers – healthcare (Medicaid, state employees and retirees, corrections, school

Governor Snyder's Tax Proposal

Policy Objectives – Business Tax

"Michigan's current system of business taxes, particularly the Michigan Business Tax (MBT), is highly complex, and includes an intricate web of incentives, credits, and deductions that unfairly favors some businesses or industries over others, hurts Michigan businesses and hampers growth. Replacing the MBT with a simple, fair, and efficient corporate income tax will even the playing field and enable all businesses, industries, large and small, to grow and create jobs."

(source: Michigan Department of Treasury webpage)

Policy Objectives – Income Tax

“Further, Governor Snyder believes all taxpayers should pay the same rate regardless of their source of income.... The Governor recommends broadening the base to which the individual income tax is applied....

Consistent with his simple, fair approach to the Corporate Income Tax, the Governor also recommends that all credits and deductions related to the individual income tax, with the exception of the personal exemption, the exemption for individuals with disabilities, special provisions dealing with military personnel, the homestead property tax credit and a few other subtractions be eliminated. These changes are

MBT Overview

- **Business income tax** of 4.95% & tax of 0.8% on **gross receipts** less purchases from other firms
- **Surcharge** of 21.99% before credits
- **Profits** apportioned to Michigan based on percent of sales occurring in Michigan
- Significant **credits** for compensation paid to Michigan workers (0.37%), investment in Michigan (2.9%) and Michigan R&D (1.9%); comp & investment credits capped at 52% of liability & all 3 capped at 65%
- Other significant credits include **MEGA, brownfields, personal property, film, and battery**
- Numerous other smaller credits
- **Financial institutions** and **insurance companies** have different tax bases

Corporate Tax Overview

- **6% flat rate income tax** only on corporate entities
- Apportionment still based on Michigan sales
- All credits (except small business alternate credit) are eliminated
- **Honors existing commitments** ($500 million in FY 13) made through signed agreements (MEGA $116M; battery $293M; brownfield $50M, film $25M; other $16M)
- Future economic development incentives awarded through appropriations process
- **Insurance** and **financial institution** taxes essentially unchanged

Income Tax Changes

- Rate fixed at **4.25%**
- **Private and public pension exemption** is eliminated
- **Personal exemption** phased-out for higher income ($75k single; $150k joint)
- **Special exemptions** for seniors ($2,300), children ($600), and unemployment comp ($2,300) repealed
- **Credits repealed** include: EITC, city income tax, public contribution, homeless/foodbank, community foundation, college tuition
- **Homestead property tax credit** – credit lowered for seniors and raised for individuals; income phase-out lowered

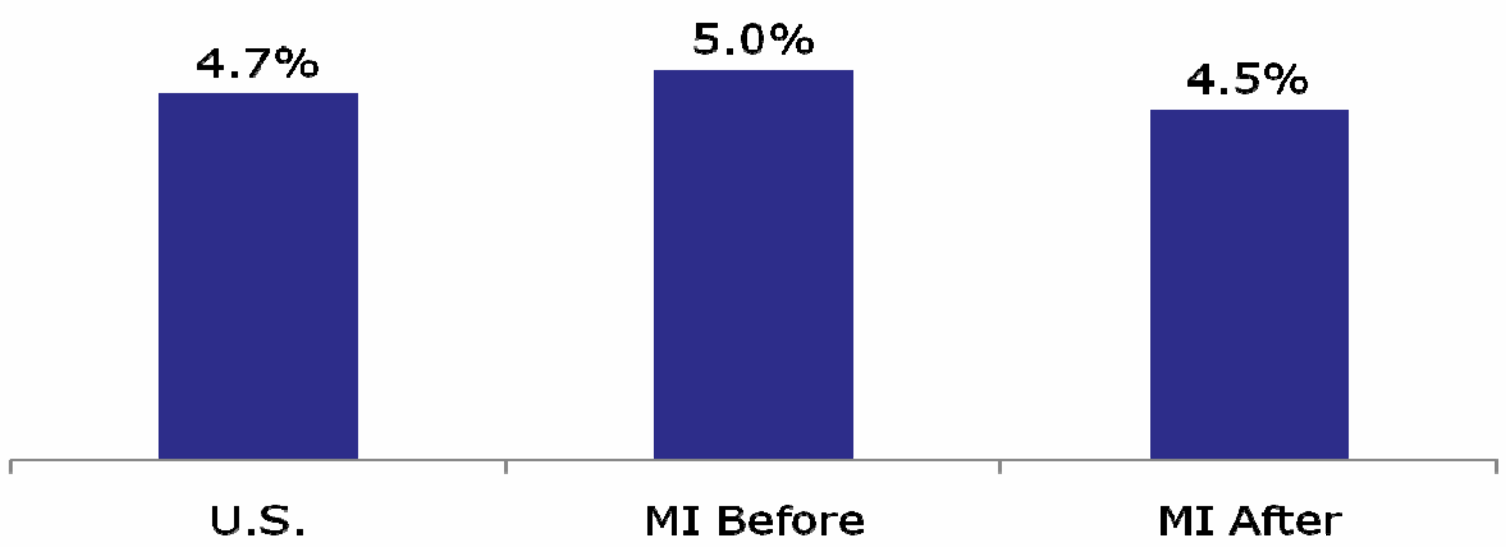
Summary of Tax Changes

	FY 2012	FY 2013
MBT Current Law	$2,170.0	$2,024.0
Revenues from Proposed Reforms		
MBT (4th quarter 2011 and annual pymts)	$900.2	$0.0
New Corp Tax	$194.8	$292.7
Bus. Tax Under Budget Proposal	$1,095.0	$292.7
Net Business Tax Cut	($1,075.0)	($1,731.3)
Income Tax Increases	$820.9	$1,863.8
Net Impact Proposed Changes	($254.1)	$132.5 *

* Budget Indicates $100 million of FY 2013 revenues will be reserved for tax cuts

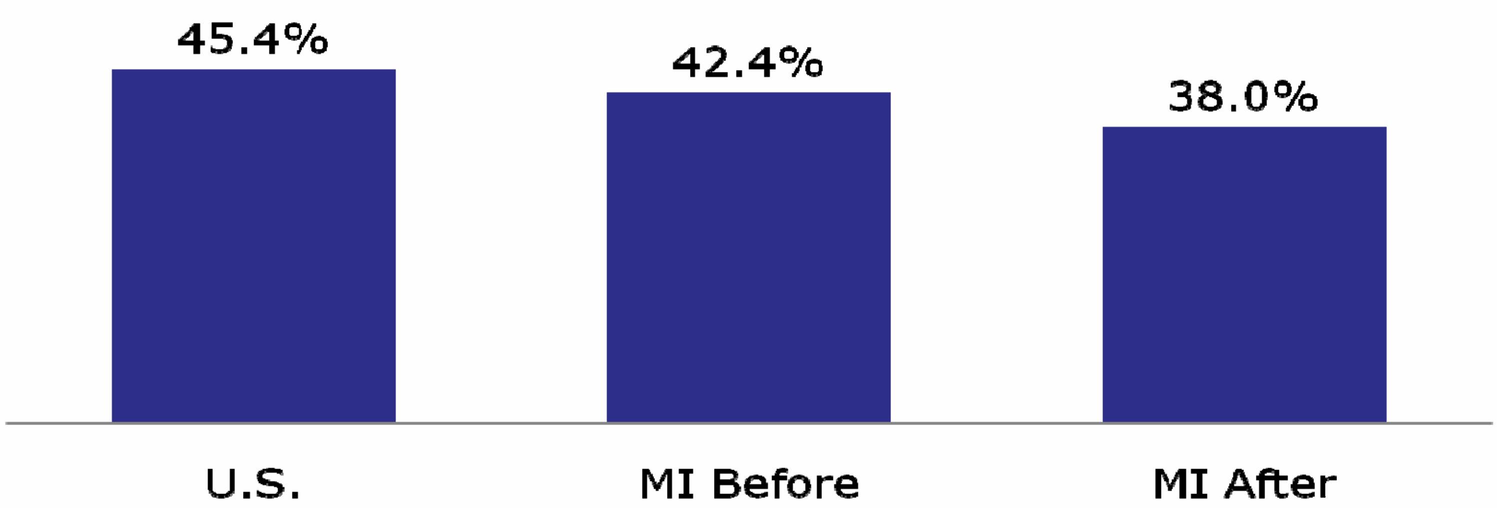
Source: FY2012 Executive Budget

Michigan's S&L Business Taxes as % of GSP Would fall from 19th to 35th Highest



Source: Council on State Taxation. Totals are for 2009. Estimates for after tax change based on CRC calculations.

S&L Business Taxes as % of All State and Local Taxes from 35th to 45th Highest



Source: Council on State Taxation. Totals are for 2009. Estimates for after tax change based on CRC calculations.

Who Pays the MBT?

- Statutory incidence of the MBT is on corporate and non-corporate entities
- Ultimately, burden of any tax is borne by individuals
- Possible ways MBT burden is borne by individuals:
  - Lower rate of return on capital for shareholders and other capital owners
  - Reduced wages received by workers
  - Higher prices paid by consumers
- While it is reasonable to assume that most of the MBT burden is borne through a reduced rate of return on capital for those doing business in Michigan, this has not been established empirically, so while a reasonable conjecture, it is an assumption

How Would the Statutory Burden on Business Change?

- **MBT to corporate tax represents an 86% cut** in FY 13. Looking at all state and local taxes paid by businesses (using COST estimates) roughly a 10% cut.

- **Non-corporate entities** currently subject to MBT and individual income tax; they now would only be subject to individual income tax (**go from tax disadvantaged to tax advantaged**)

How Would the Statutory Burden on Business Change (cont)?

- Large cut means that most businesses should pay less – however, **loss of personal property tax credit means that some firms will pay more**, especially multistate manufacturing firms based in Michigan
- **MBT** has significant credits for Michigan based activity in **an attempt to export the tax**; rescinding these credits means the share of tax cut received by out-of-state firms likely greater than share of MBT they pay

How Does the Burden Change on Individuals?

- Income tax increases concentrated among **seniors** (loss of pension exemption, reduction in HPTC) and **low-income individuals with wage income**

- EITC approx. $350M claimed by over 700,000 Michigan taxpayers; MI credit started in 2008

Tax impacts are for a full tax year.

How Does the Burden Change on Individuals (cont)?

- While repealing the pension exemption is a move towards treating taxpayers with similar income similarly, the repeal of exemption represents a **significant tax increase on seniors** ($800M)

- Repeal of non-refundable credits raises individual taxes by $85 million with increase concentrated among those paying city income taxes ($32M) and those making contributions to certain charities ($45M)

Tax impacts are for a full tax year.

Will the Tax Changes Improve Economic Growth?

Positive Impacts

- The new lower tax should increase the return on capital invested in Michigan leading to greater investment and economic growth (assuming MBT is a tax on capital)
- Money appropriated for economic development will work to offset the effect of removing investment credits
- Simpler and lower business tax should improve Michigan's reputation among businesses, encouraging firms to invest here

Economic Impact Continued

Negative Impacts

- Overall tax change is revenue neutral: tax increase on seniors and low income workers will reduce their consumption which has a negative impact on Michigan's economy
- Repeal of EITC reduces return to low wage workers for participating in the labor market
- Tax relief will be spread across new investment and existing capital, while this improves fairness, tax relief for existing capital does not improve growth

Economic Impact Continued

Negative Impacts (continued)

- Repeal of personal property tax credit means that taxes for some types of investment may be higher than under the MBT
- Repeal of brownfield credit and loss of personal property tax credit will reduce the incentive to invest in urban areas

Economic Impact Bottom Line

- Overall impact is unclear: tax change will improve Michigan's reputation in the business community and increase the rate of return for investing in Michigan

- If this effect is greater than the drag on consumption from the higher income taxes, overall changes should have a net positive impact on growth

Other Factors To Consider

- The new business tax will be easier to administer for both taxpayers and the state
- There is merit in moving economic development from tax expenditures to the appropriations process
- The constitutionality of taxing public pensions and phasing-out the personal exemption for high income taxpayers will likely be challenged in court
- Shifting $1.8B in taxes from businesses to individuals will make Michigan's tax system more regressive

Other Factors To Consider

- Removal of the pension exemption will improve growth rate of the income tax and will increase equity among income tax payers, but it represents a large tax increase on seniors
- The income tax will grow faster under the proposed changes because Michigan's population is aging and pension income will represent an increasing share of Michigan personal income.
- In the long run, low-income households could come out ahead if the tax changes lead to significantly higher economic growth

Challenges Faced By Local Governments

Spending and Revenue Pressures

Revenue Pressures

- Declining property tax base
- Reductions to state revenue sharing
- Property tax caps
- Anti-tax climate

Spending Pressures

- Wage and salary costs
- Healthcare costs for active and retired employees
- Pension costs
- Aging infrastructure

Governor's Local Government Proposals

Revenue Sharing

- Reduce statutory revenue sharing by 1/3
- Require "accountability and transparency" and produce citizens guide to finances and a dashboard
- Consolidate services
- Address employee compensation including changes to retirement plans & new hires to 80/20 split on healthcrae

Emergency Manager (PA 4 of 2011)

- Increase ability of Treasurer to declare emergency
- If emergency found:
  - All governing powers vested in Emergency Manager
  - Exempt from collective bargaining and can break contracts
  - Can recommend consolidation or disincorporation

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