



CITIZENS RESEARCH COUNCIL OF MICHIGAN

Michigan's New Normal: Our State's Economic, Revenue, and Budget Situation

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The State of the National Economy



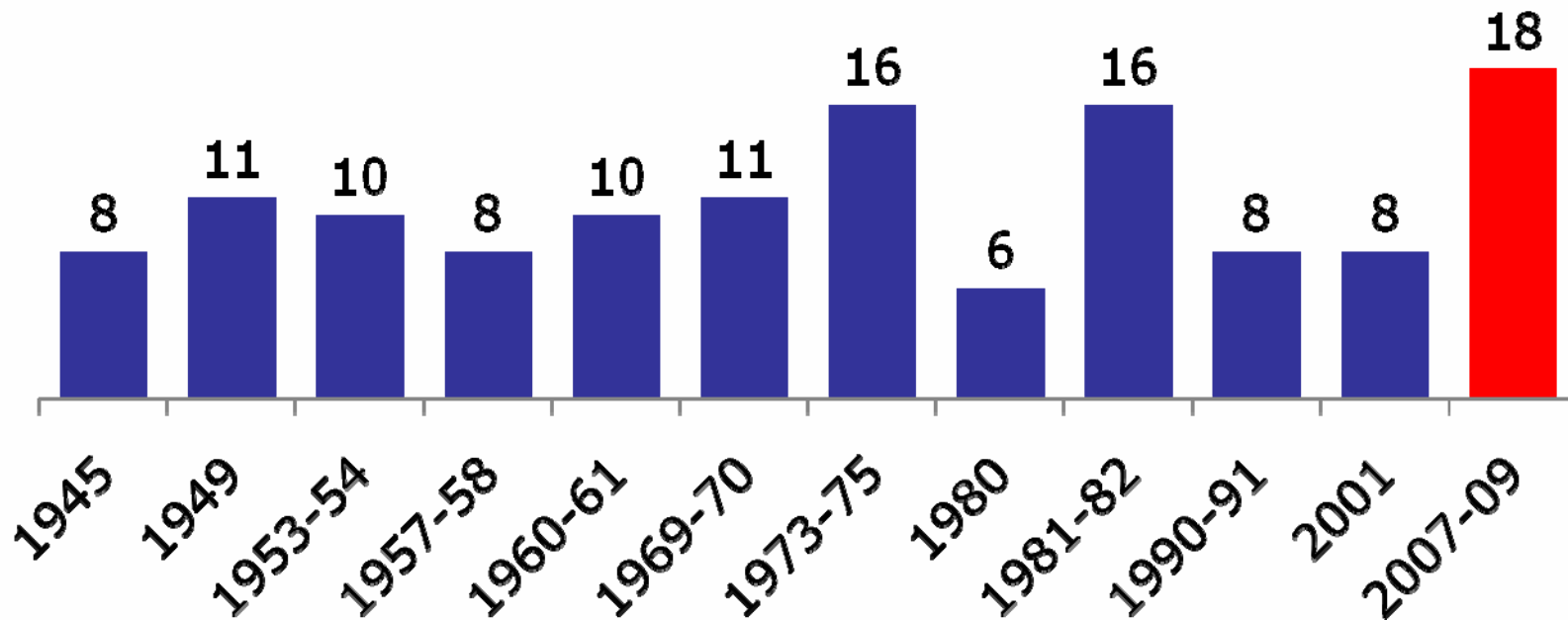
Recession is Over – Sort of...

- National recession ran from December 07 to June 09
- National recession lasted 18 months, longest post-war recession
- Output has been growing since 2009Q3
- It took 6 quarters of growth to reach old peak
- Job growth has been minimal making it feel like the recession is still occurring
- While economic recovery has been disappointing and uneven, growth appears to be improving



2009 Recession Set Post War Record

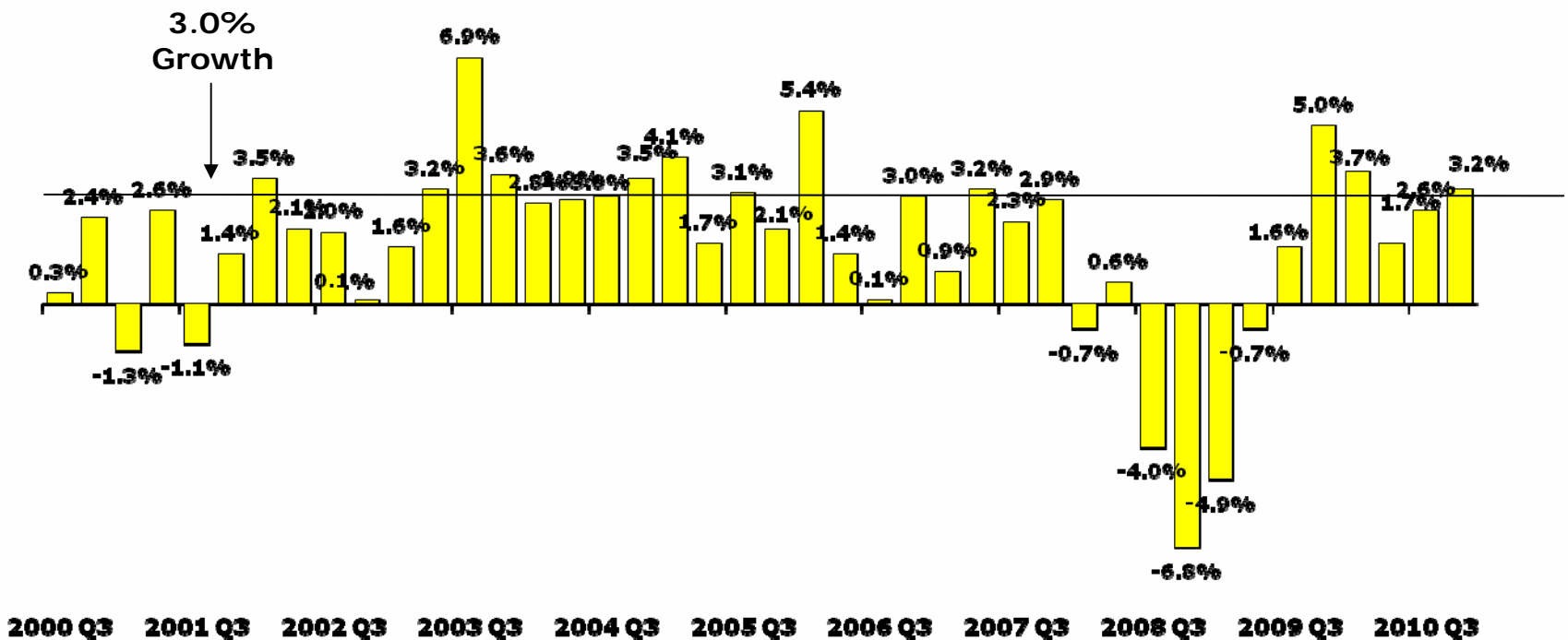
Recession Length in Months





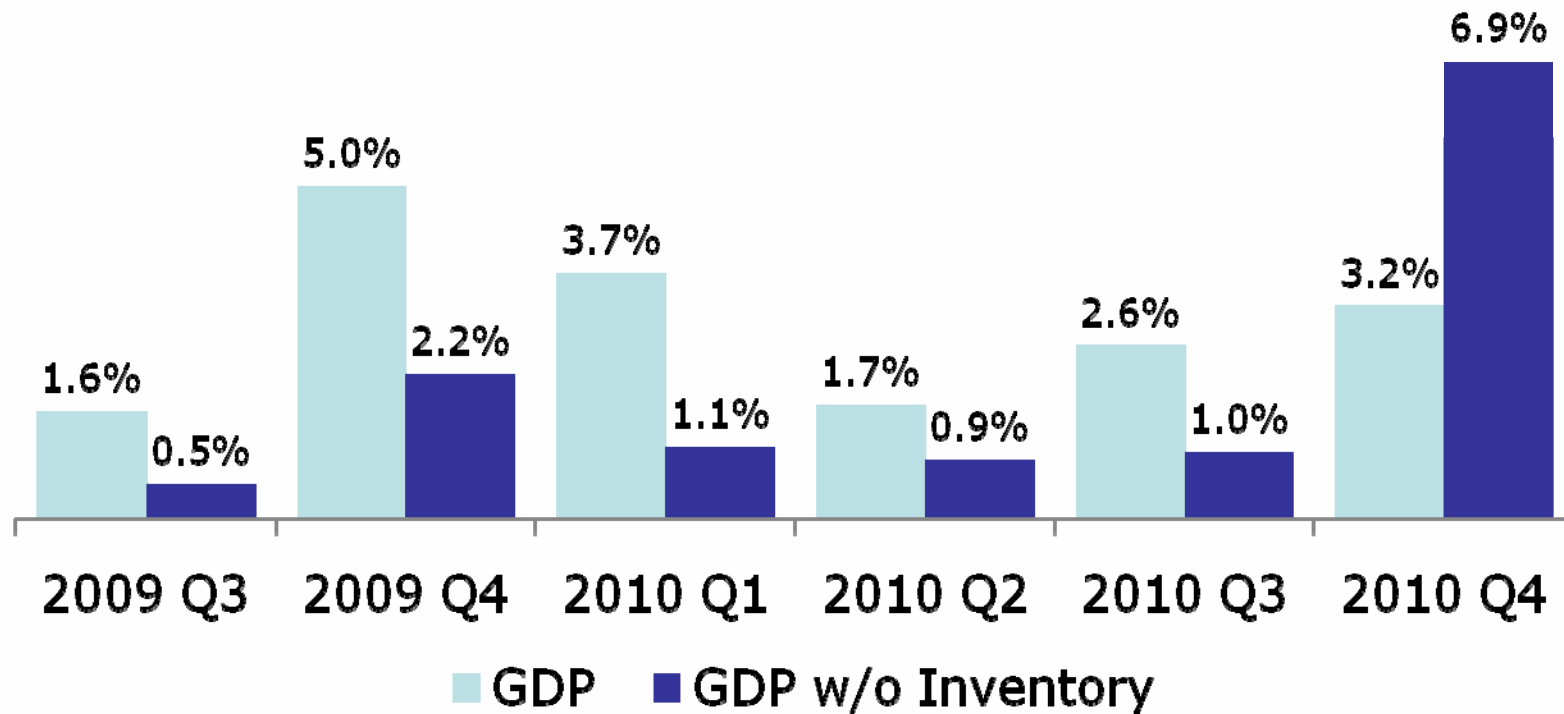
GDP Has Grown for 6 Straight Quarters

Real GDP Growth





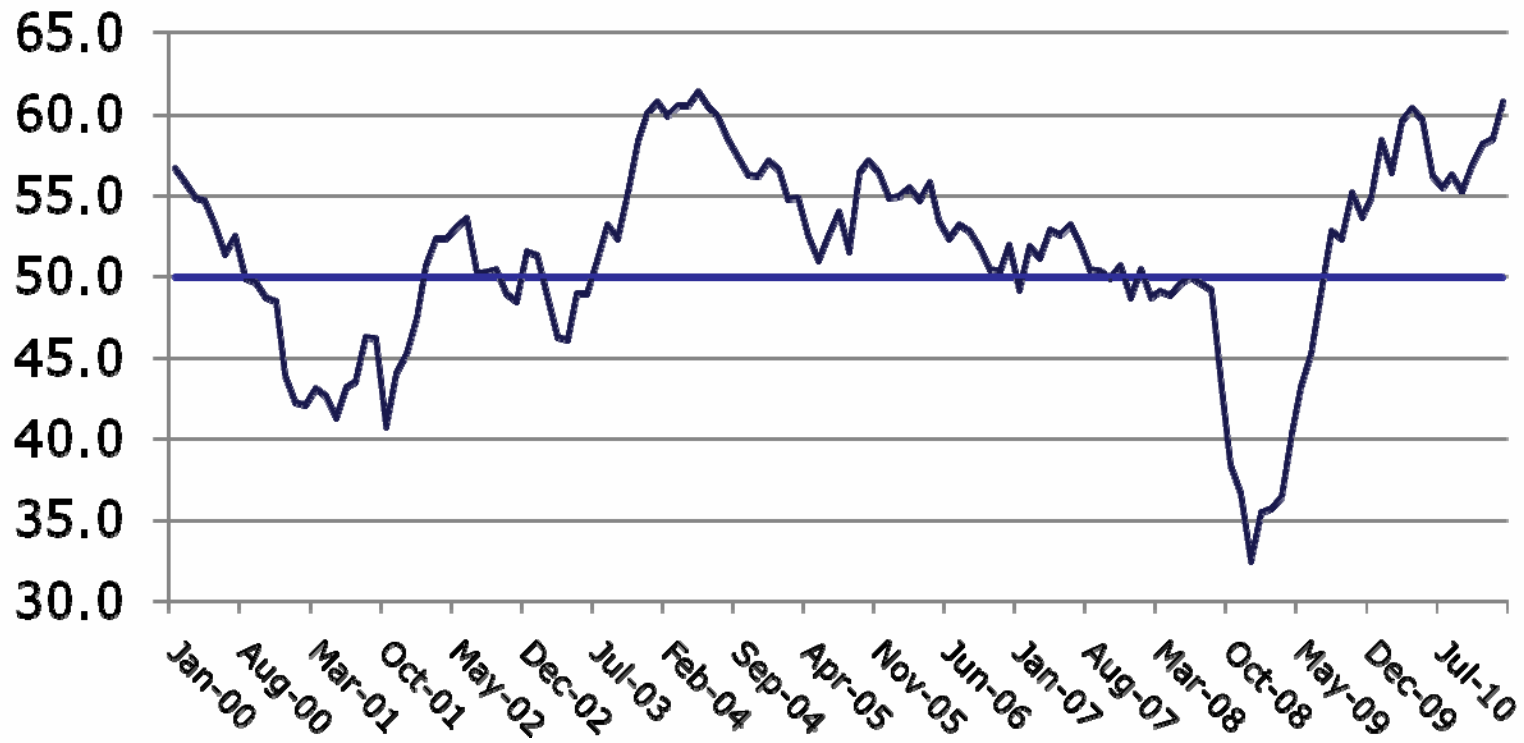
Inventory Restocking Drove Much of Recovery Until 2010 Q4





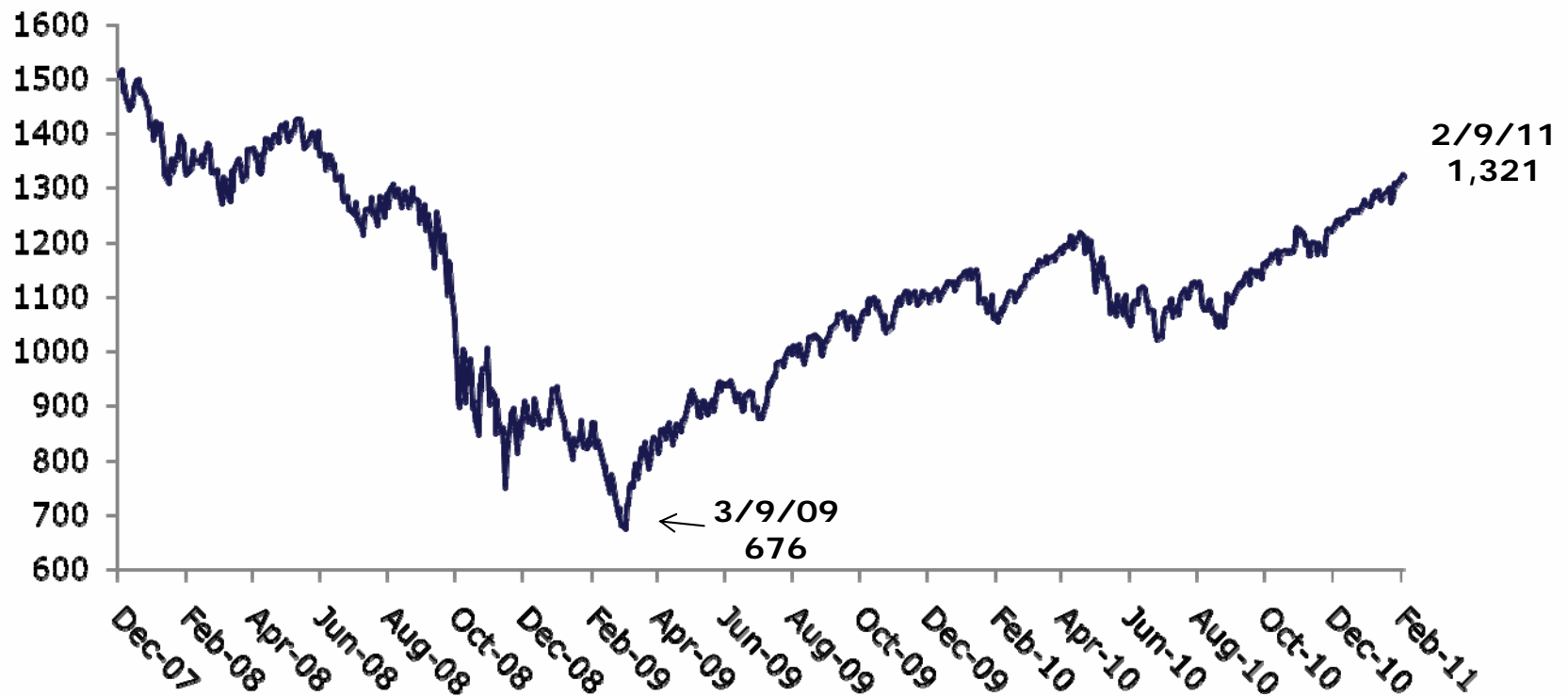
Manufacturing Has Been Growing

Institute For Supply Management Index





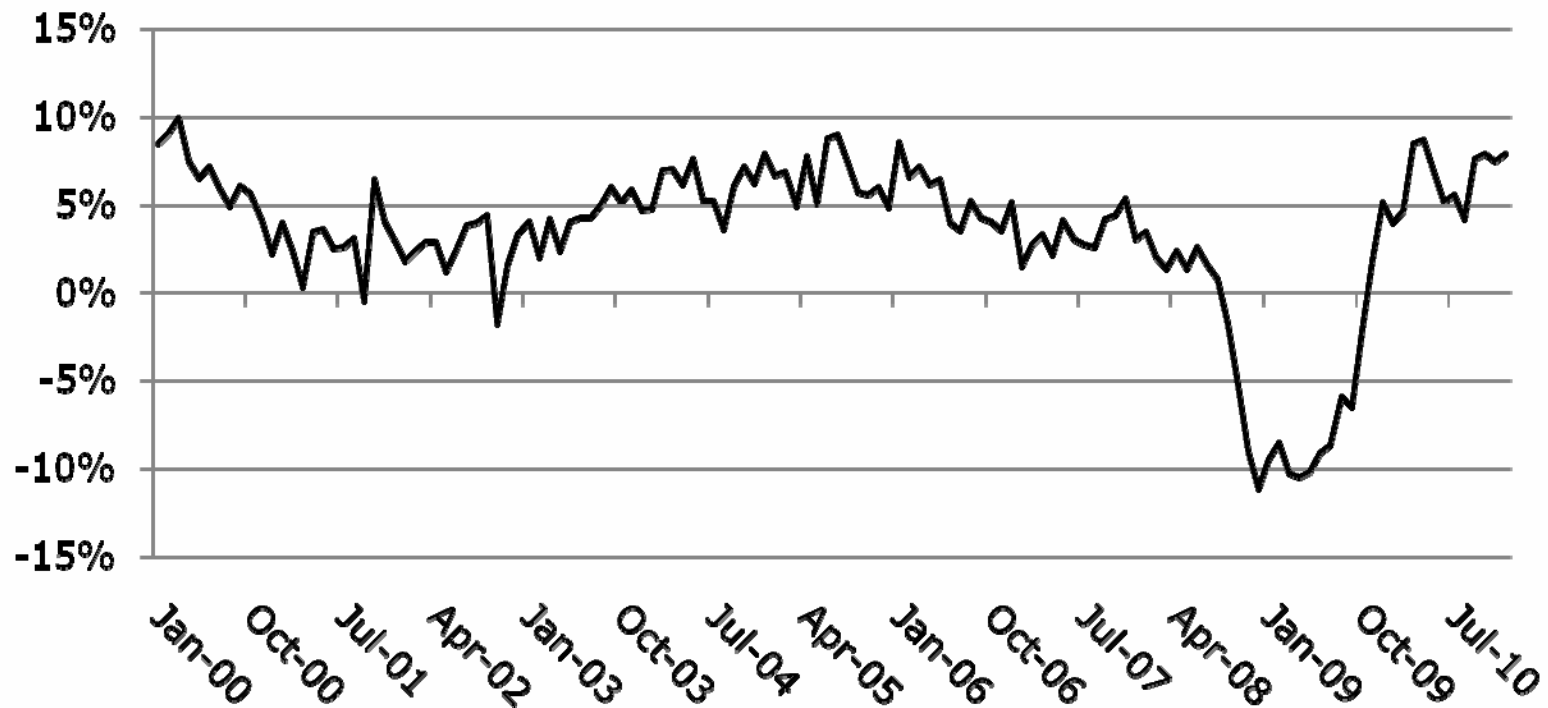
S&P 500 Up 95% From March 09 Low But Still Down 9% From January 2008





Retail Sales Have Been Recovering

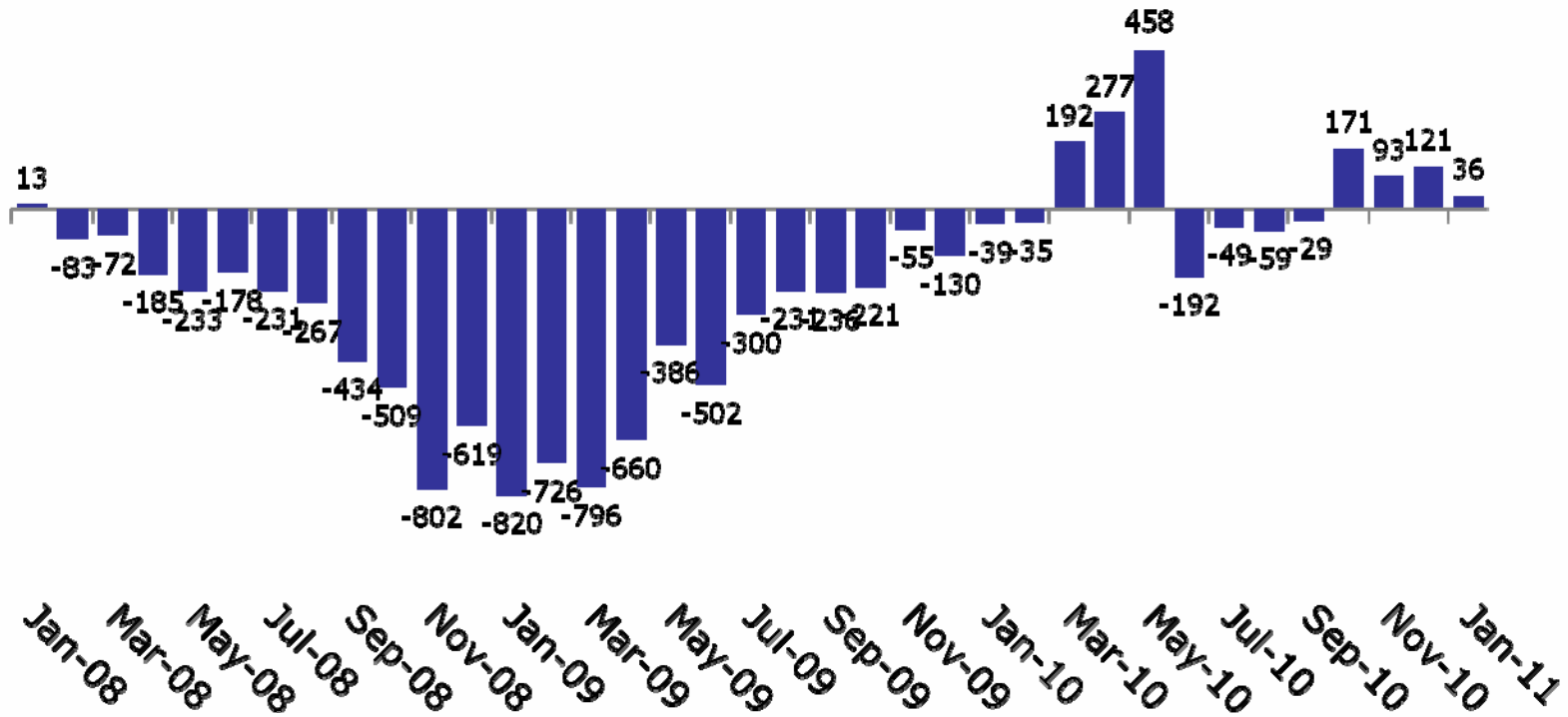
Retail Sales and Food Service
(Year over Year Pct Change)





The U.S. Has Not Recovered the 8 Million Jobs Lost in the Recession

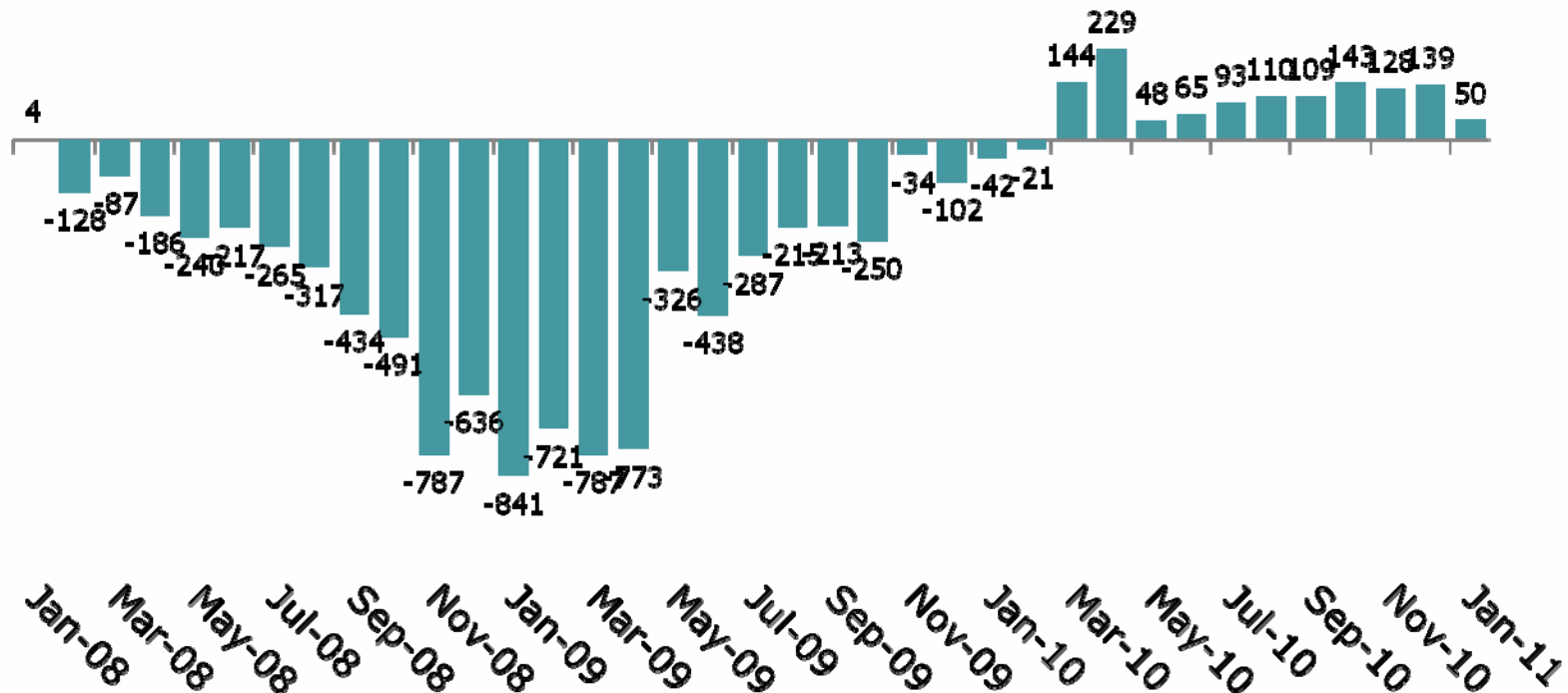
Monthly Change in Total U.S. Employment (thousands)





Employment Growth Has Been Disappointing

Monthly Change in U.S. Private Employment (thousands)





What is Happening in Michigan?

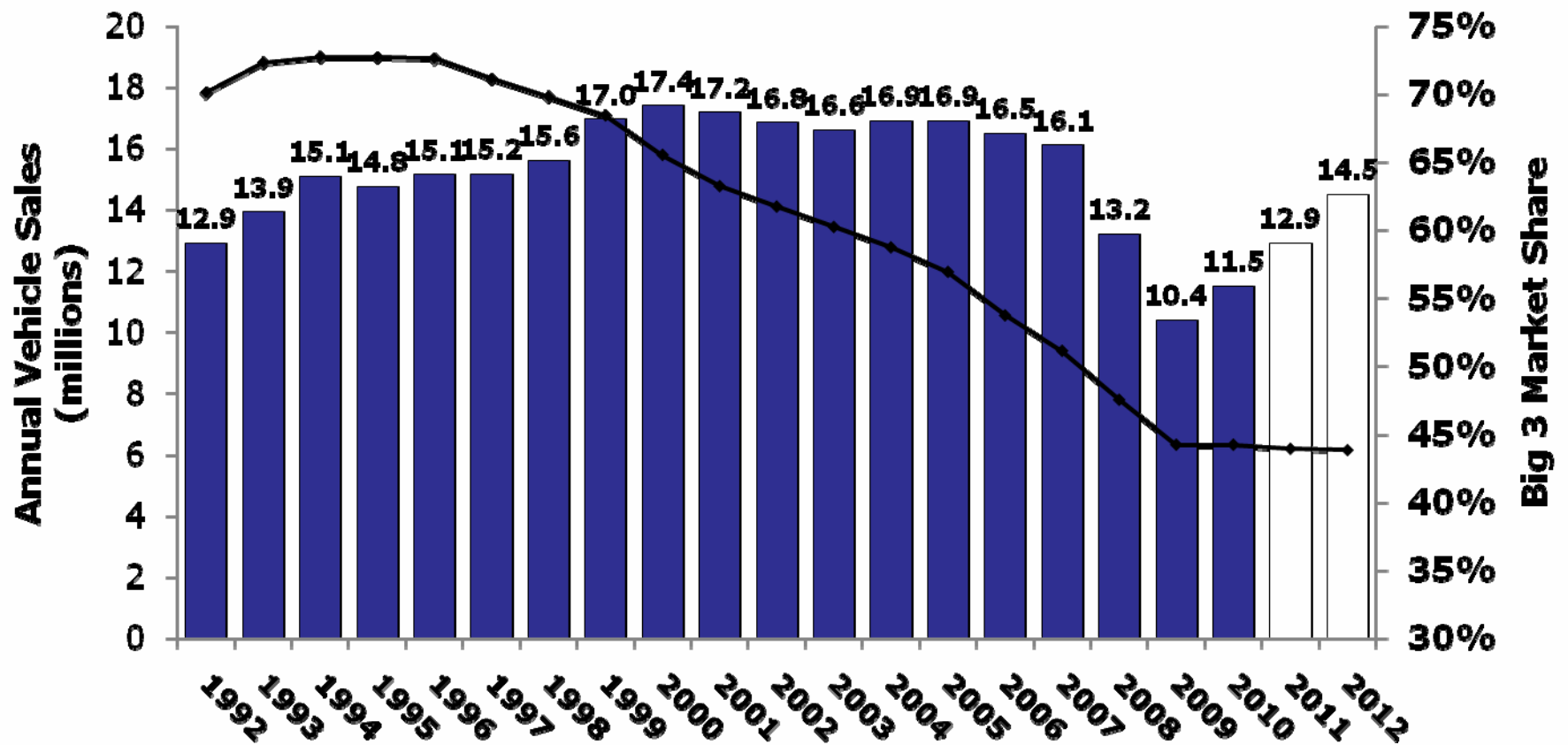


The Last Decade Was an Economic Disaster for Michigan

	Growth 2000 to 2009		Michigan
	<u>U.S.</u>	<u>Michigan</u>	<u>Rank</u>
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



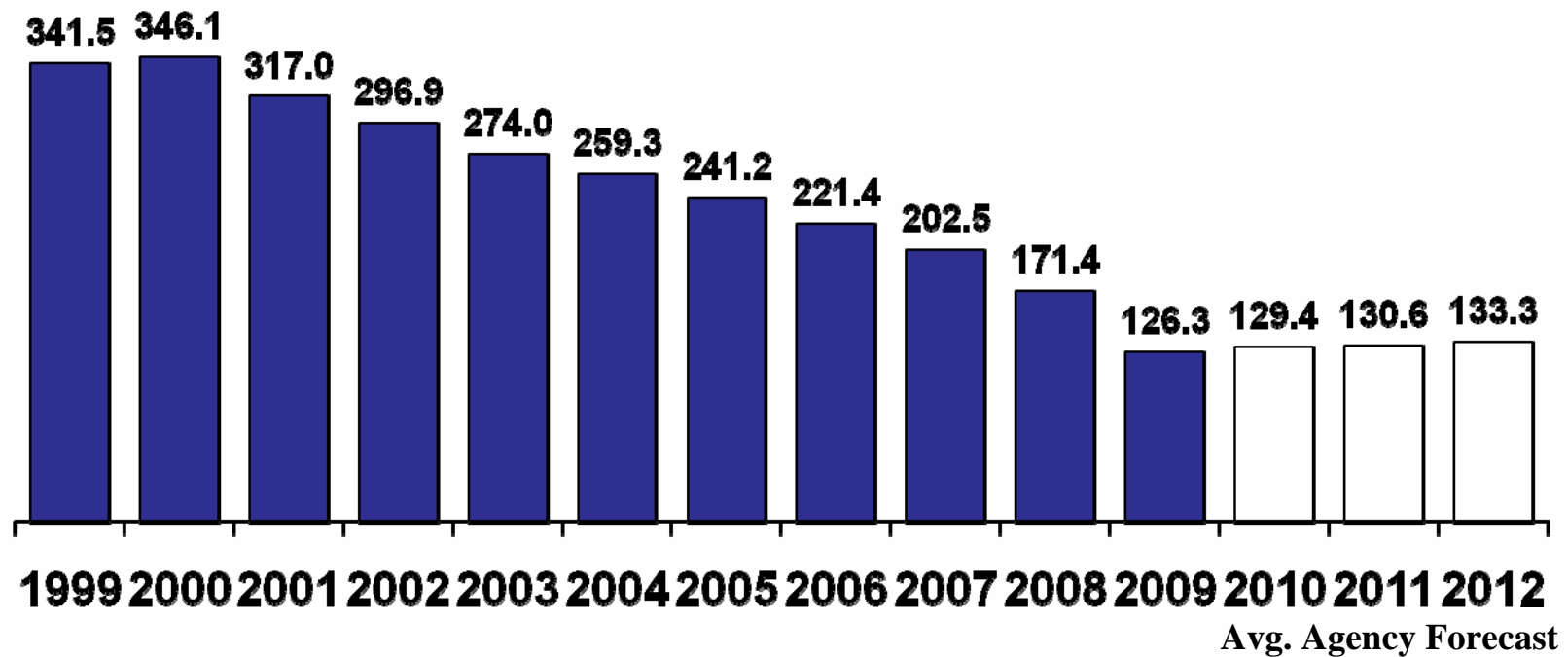
Big 3 Market Share Plummet





2 in 3 Auto Jobs Lost by 2011

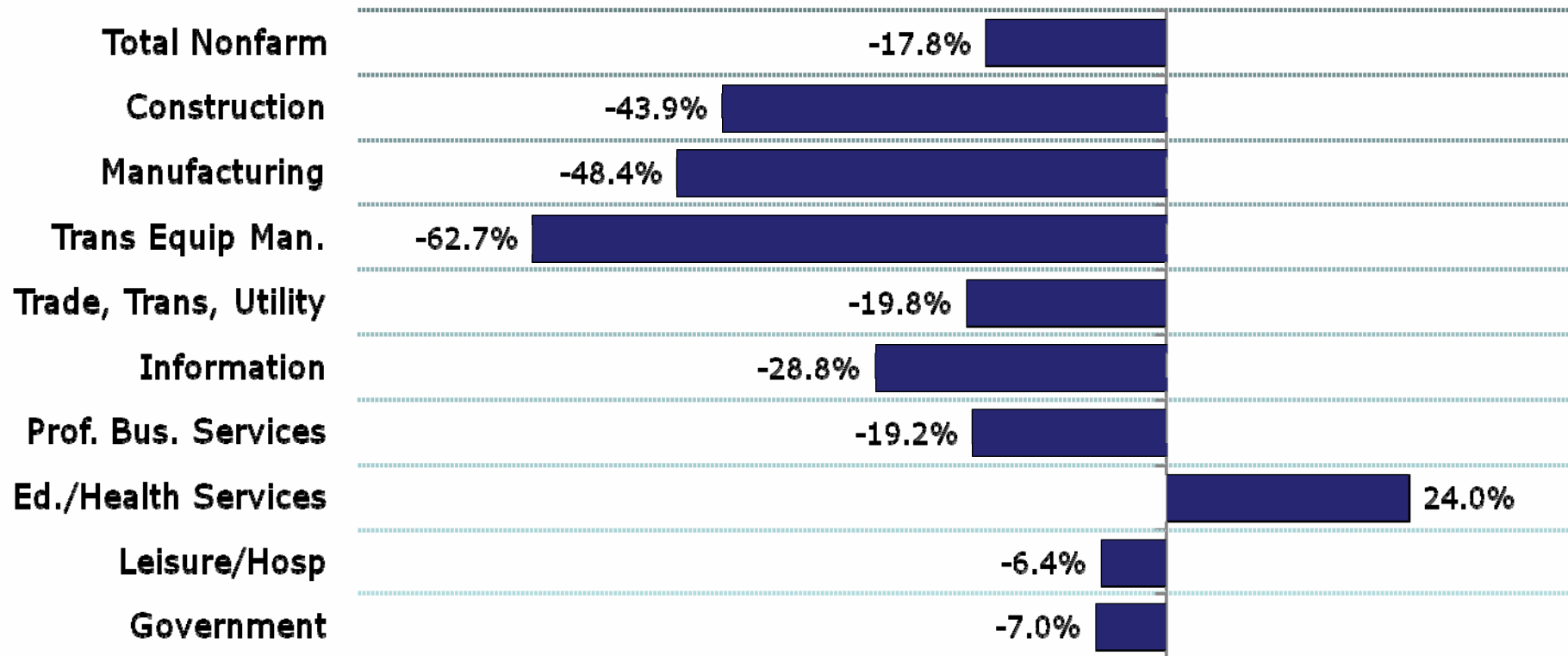
Michigan Transportation Equipment Employment
(In Thousands)





Almost Every Sector in Michigan Has Lost Jobs

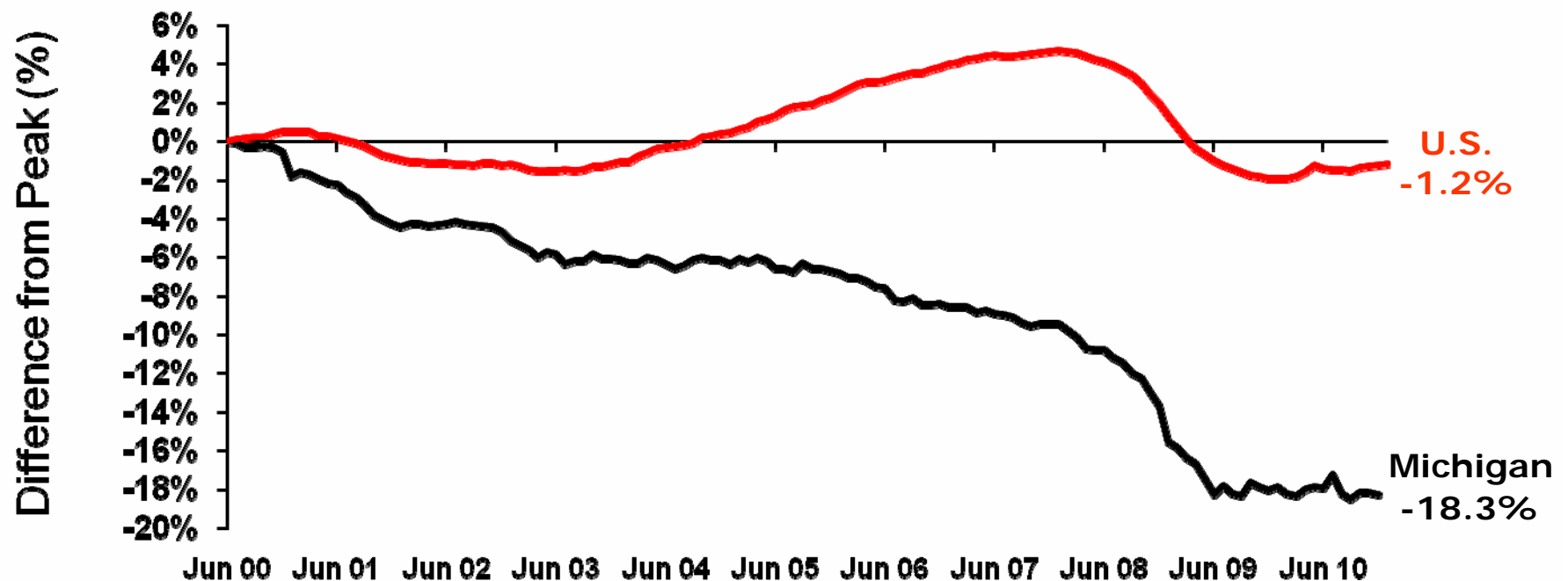
2000 to 2010





A Lost Decade of Michigan Employment

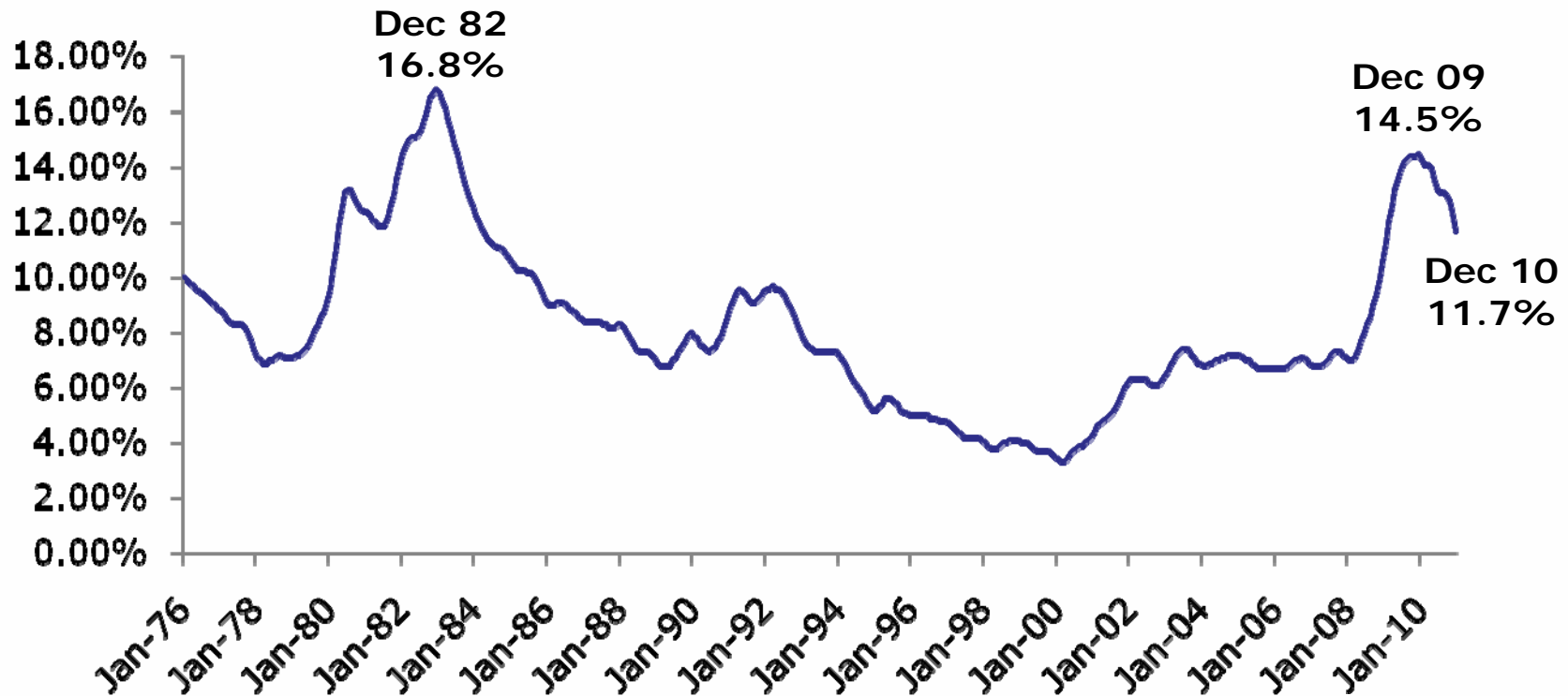
1 in 6 Jobs Lost Since June of 2000



18 Note: Peak is calculated from Michigan's June 2000 Peak. U.S. Data through Jan. 2011 & MI Data Dec 2010.
Source: Bureau of Labor Statistics and CRC calculations.



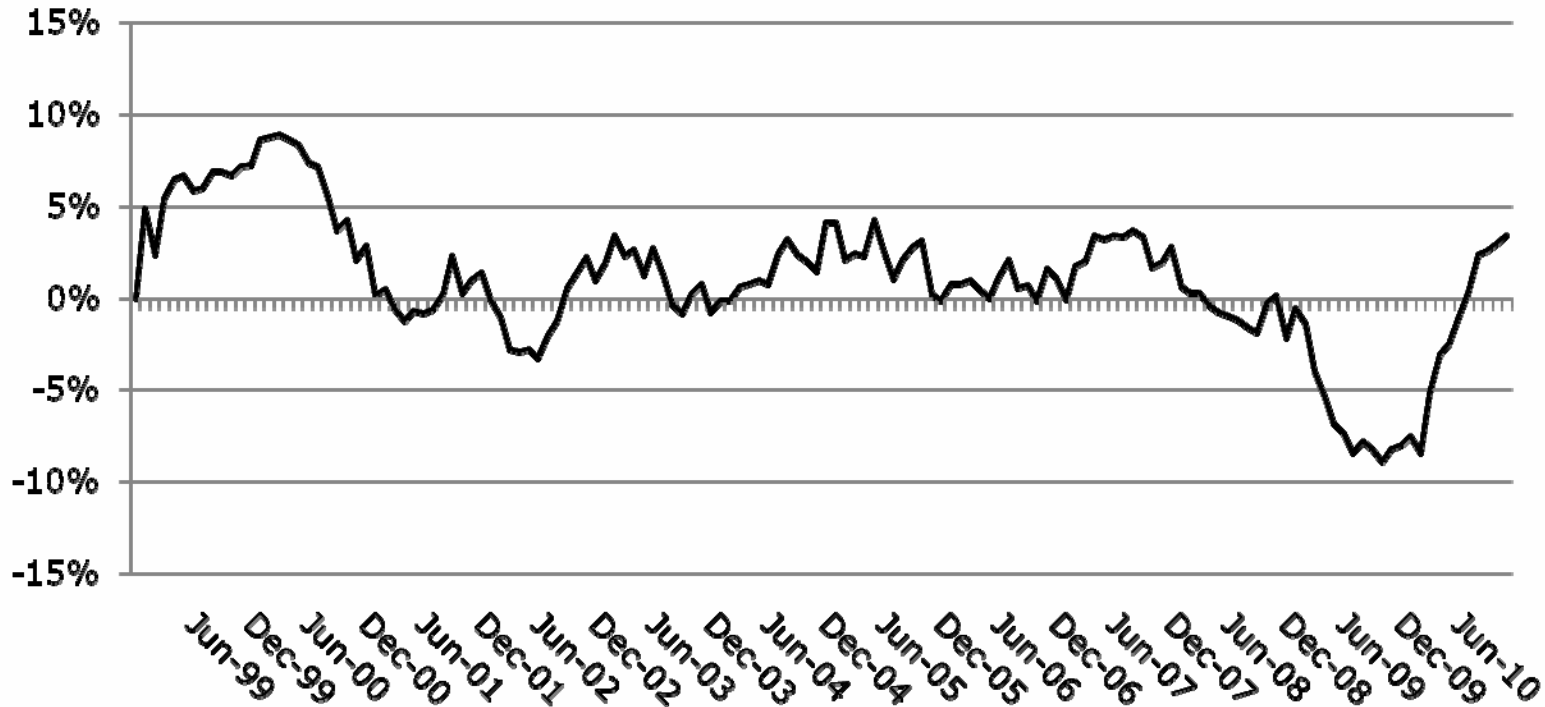
But Michigan's Unemployment Rate Appears to Have Peaked





Income Tax Withholding Growth Suggests Wages Are Growing Again

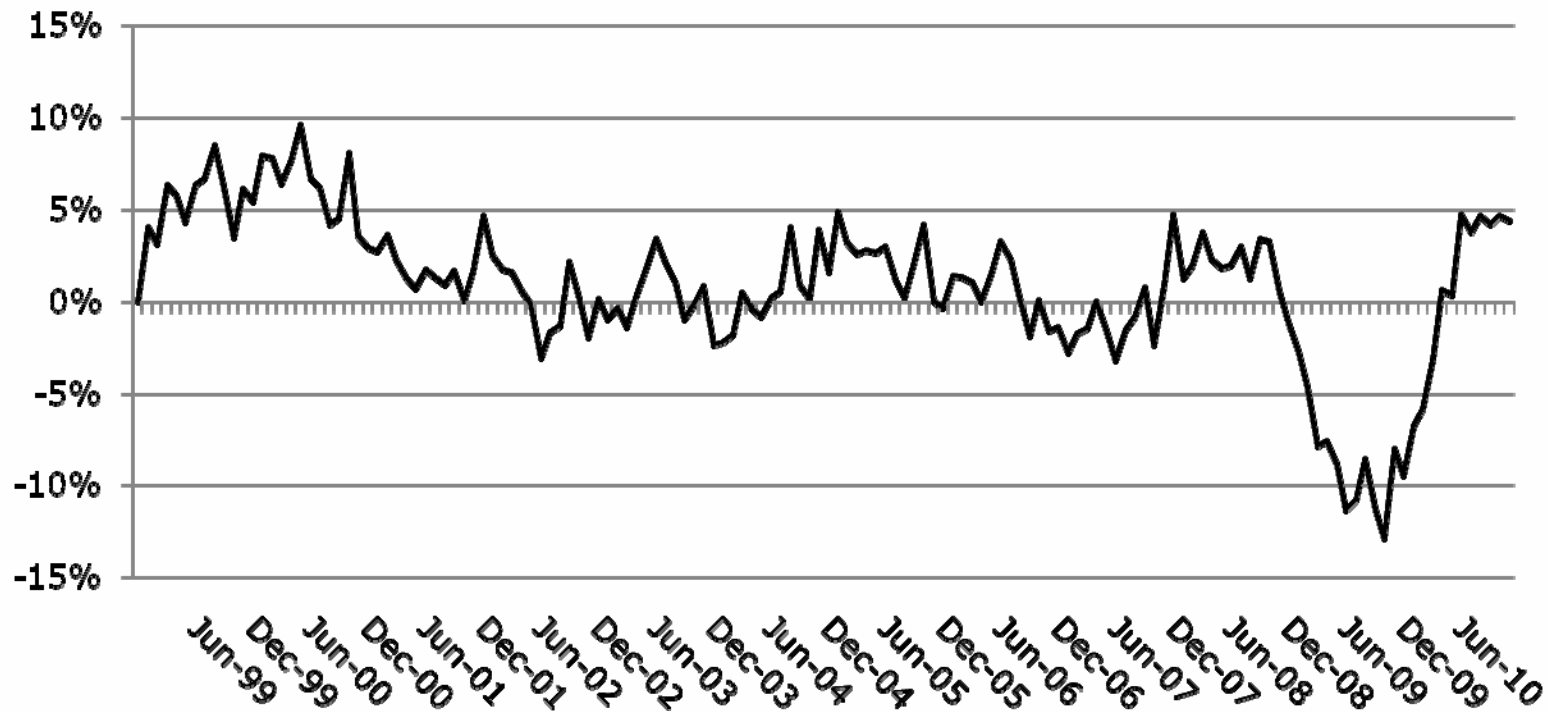
(Y-O-Y % Change 6 Month Average)





Sales Tax Growth Suggests Improvement in Confidence and Disposable Income (and Increase in Gas Prices)

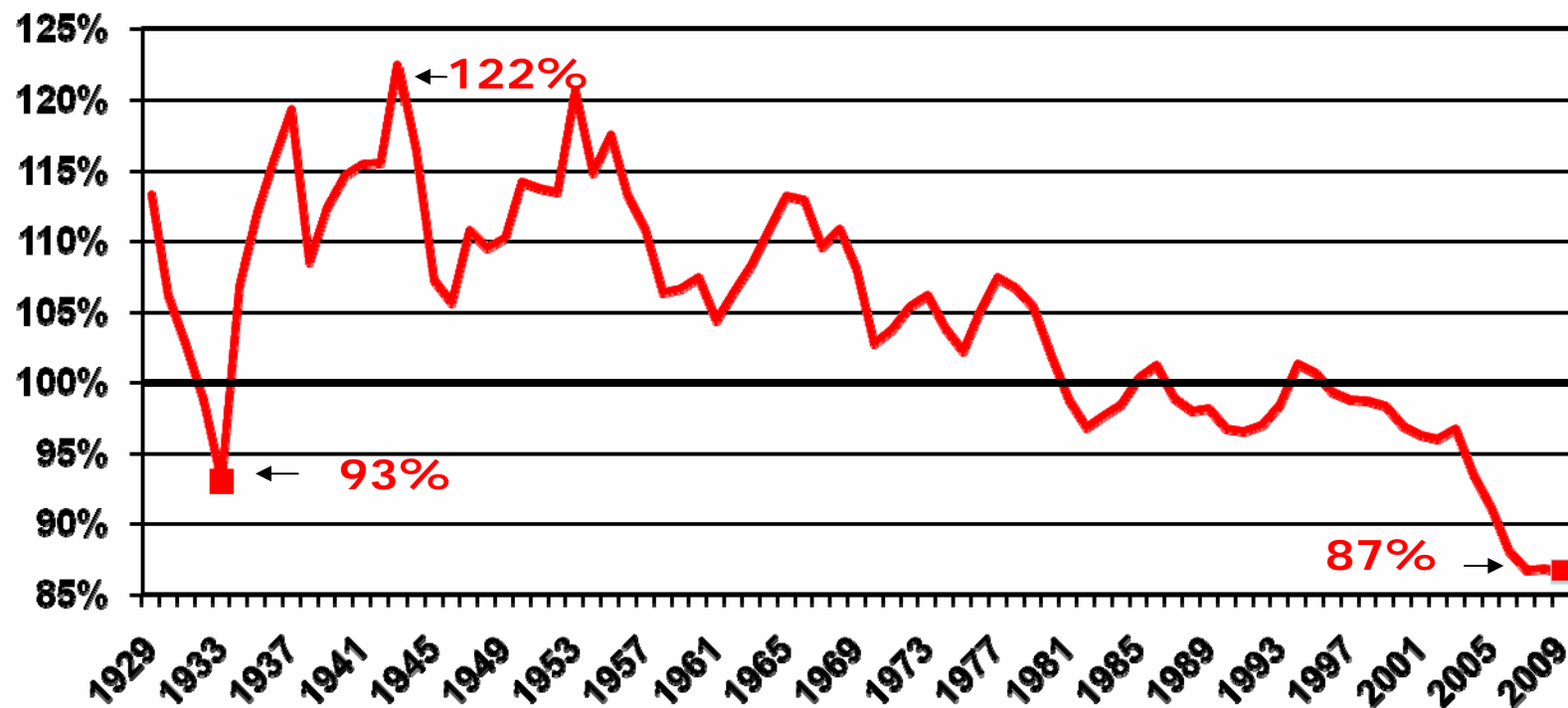
(Y-O-Y % Change 6 Month Average)





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

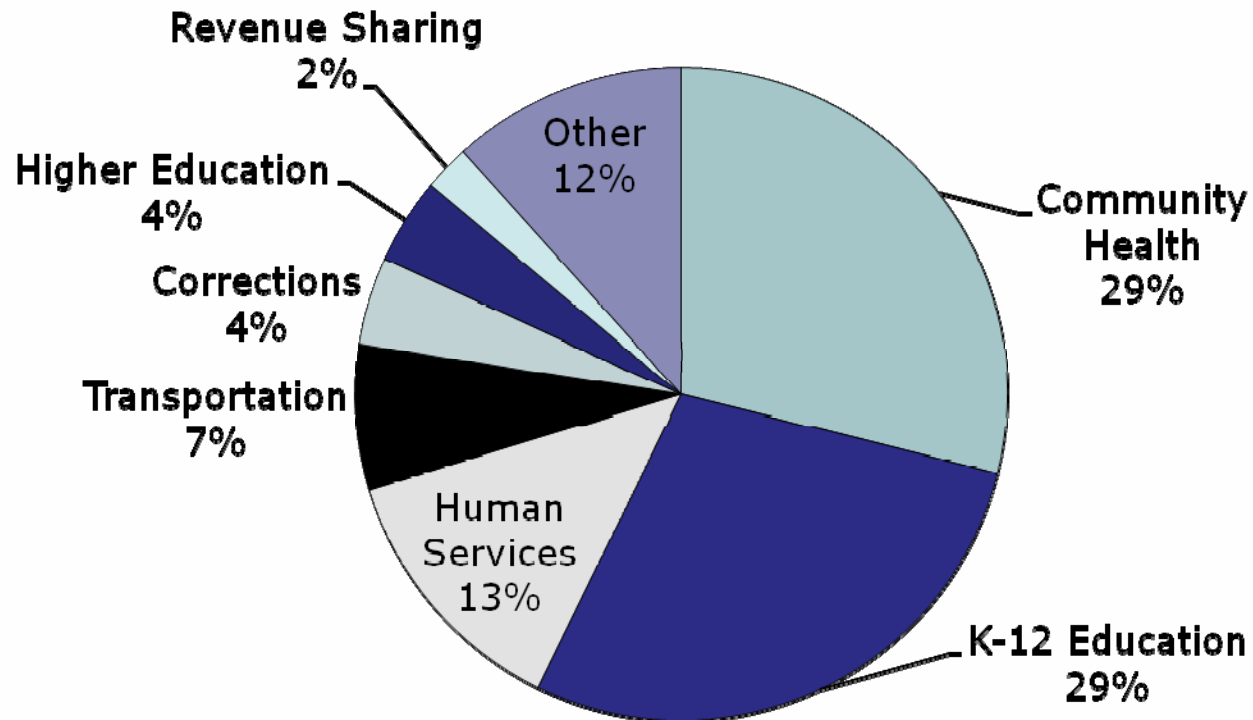




What Does This Mean for the Budget?



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
 - Higher ed – universities and community colleges
 - 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
- Healthcare is everywhere in budget and is the leading cost driver



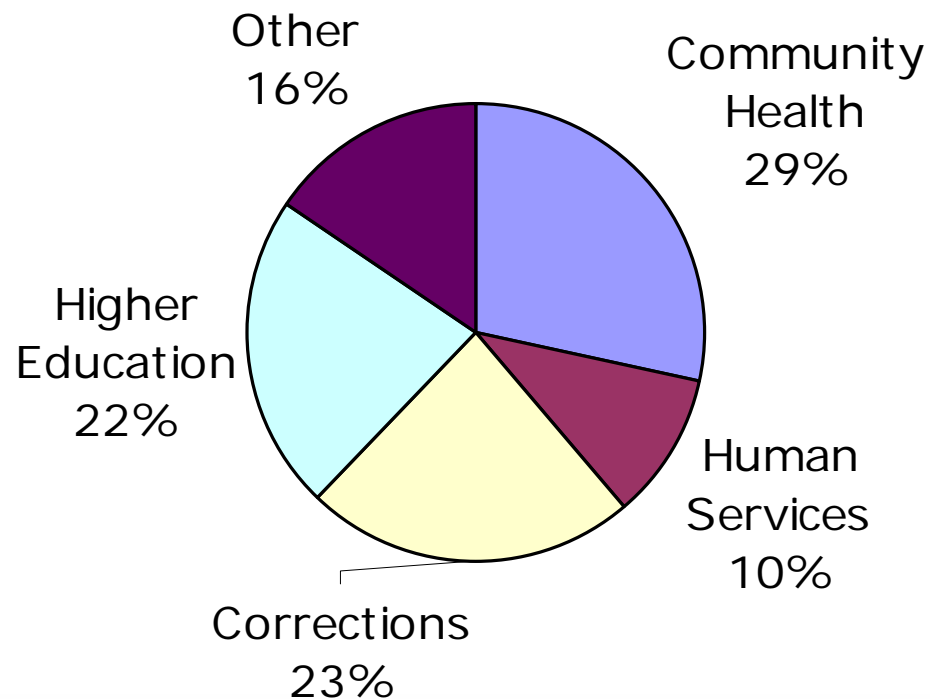
State Spending From State Sources Down Sharply in Real Terms

- From FY 2000 to FY 2010
- Inflation up approx. 27.8%
- Total state expenditures up 31% but increases in federal aid drove increase; state spending from state sources up 3.1%
- Spending changes from state sources:
 - K-12 +6.3%
 - Community Colleges -2.2%
 - Universities/financial aid -16.2%
 - Revenue sharing -34%
 - Corrections +29.1%
 - Medicaid +27%



GF-GP Shortfall over \$1 Billion FY 2010 GF-GP Totals \$8.1 Billion

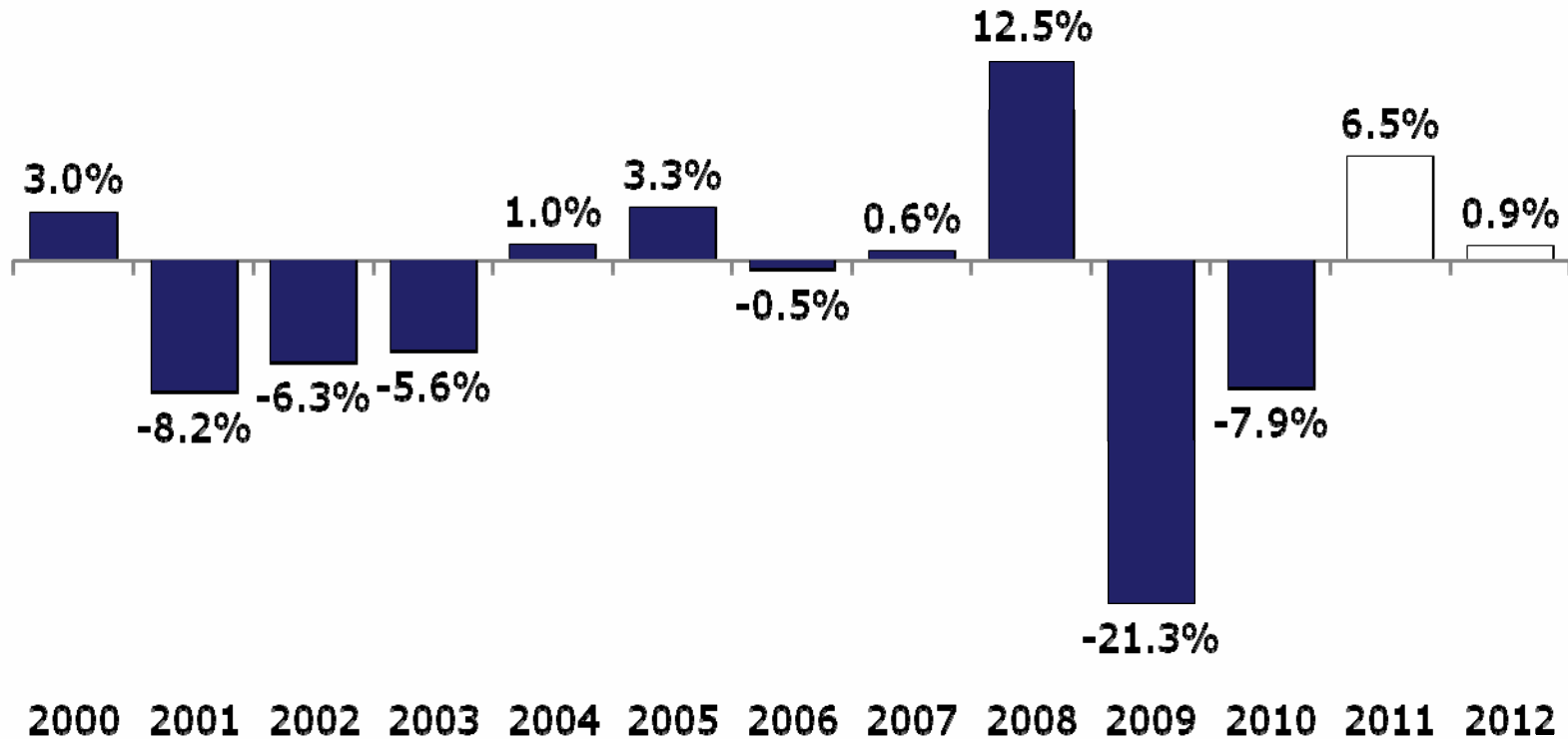
General Fund Appropriations - FY2010





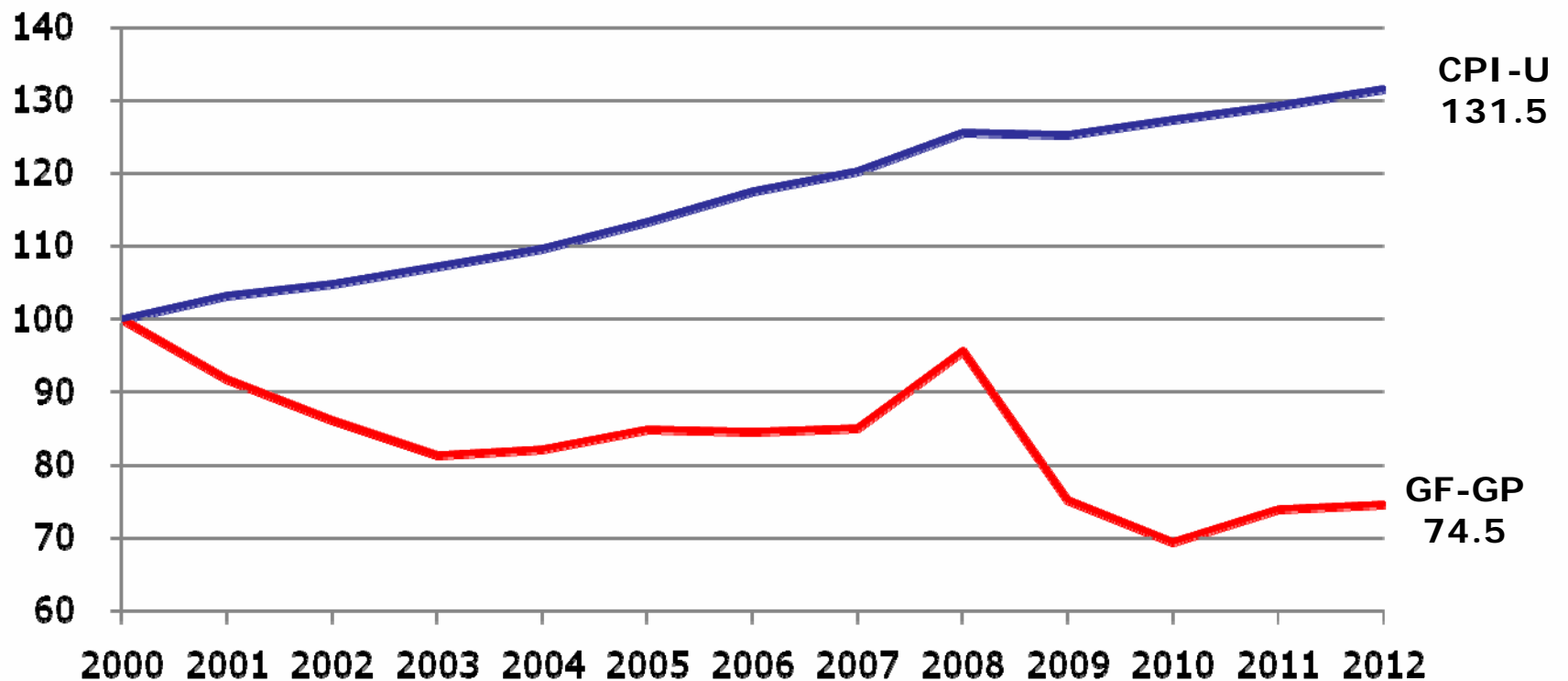
GF-GP Revenues Drop Sharply in FY 2009 and FY 2010

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





Since 2000 GF-GP Down 25% While CPI-U Up 31%





Higher Education Has Not Been Spared

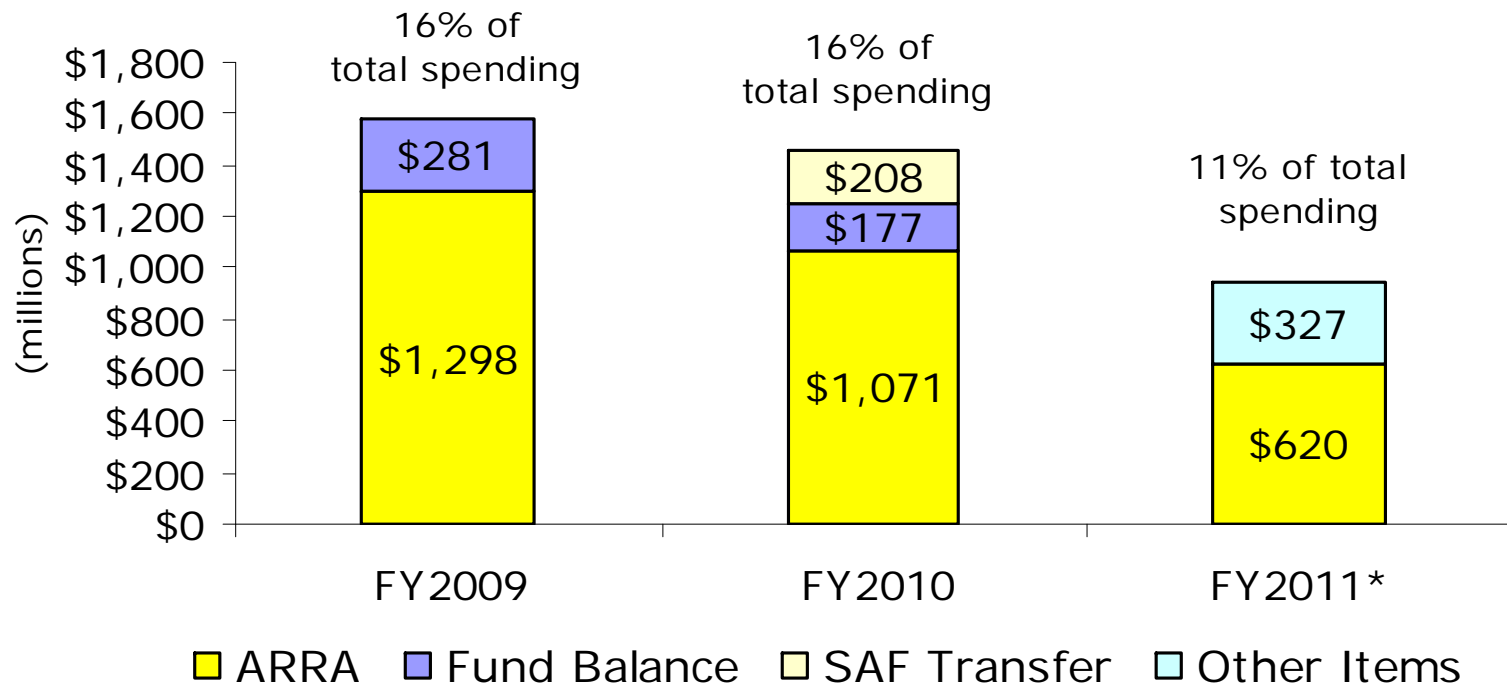
- Higher education spending down 17% between FY 01 and FY 11
- State spending on financial aid has been cut by 62% since 2001
- Michigan merit scholarship was eliminated
- CPI-U grew 25% between 2001 and 2011
- NMU's appropriation was 12% lower in FY 2011 compared to FY 2001 while the number of students was up 16% -- appropriation per student is down 24%



"Balanced" Budget Achieved

Heavy Reliance on One-Timers

GF/GP Budget: Non-Recurring Resources Used



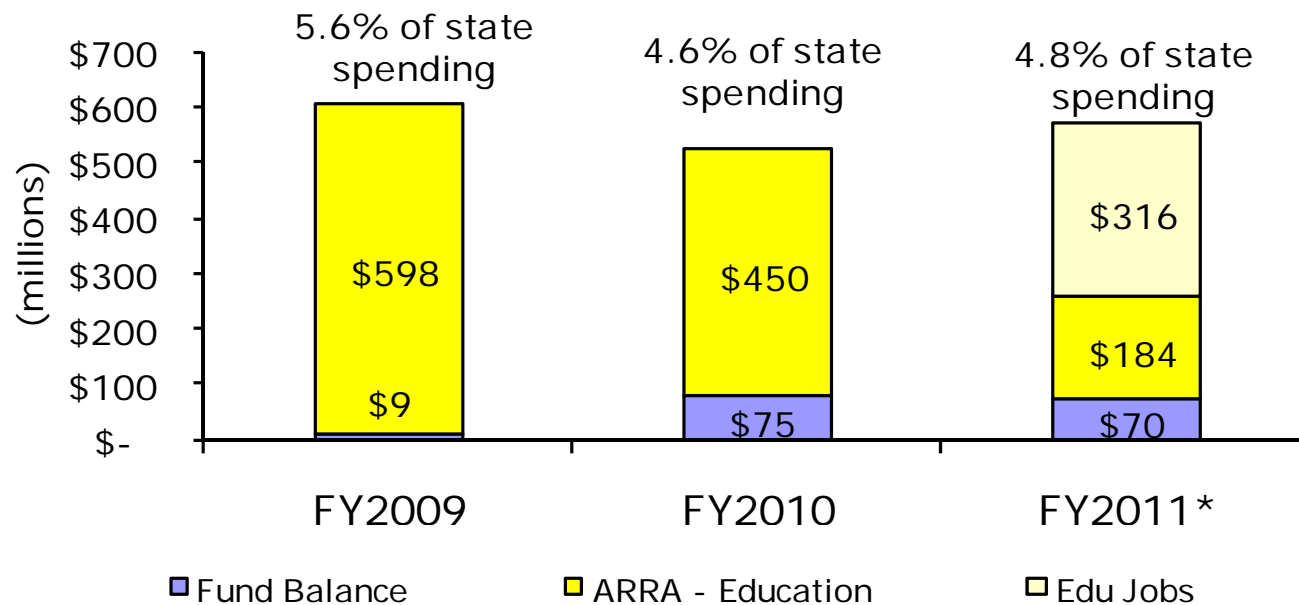
*Based on projected spending

- Based on May 2010 Consensus Revenue Estimate
- Fund balance = \$458 million on 10/1//08



Schools Face Revenue "Cliff" in FY2012

Non-Recurring Resources Used to Balance SAF Budget



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

* Based on enacted budget as of July 2010.



What is the State Budget Outlook?

- FY 2012 GF shortfall is at least \$1.1 billion (approx. 11% of total)
- Shortfall may rise depending on decisions on business tax reform and federal decisions on Michigan Medicaid policies
- School Aid Fund is “balanced” but schools must contend with declining enrollment, rapidly rising retirement costs and the potential diversion of funds to support the GF

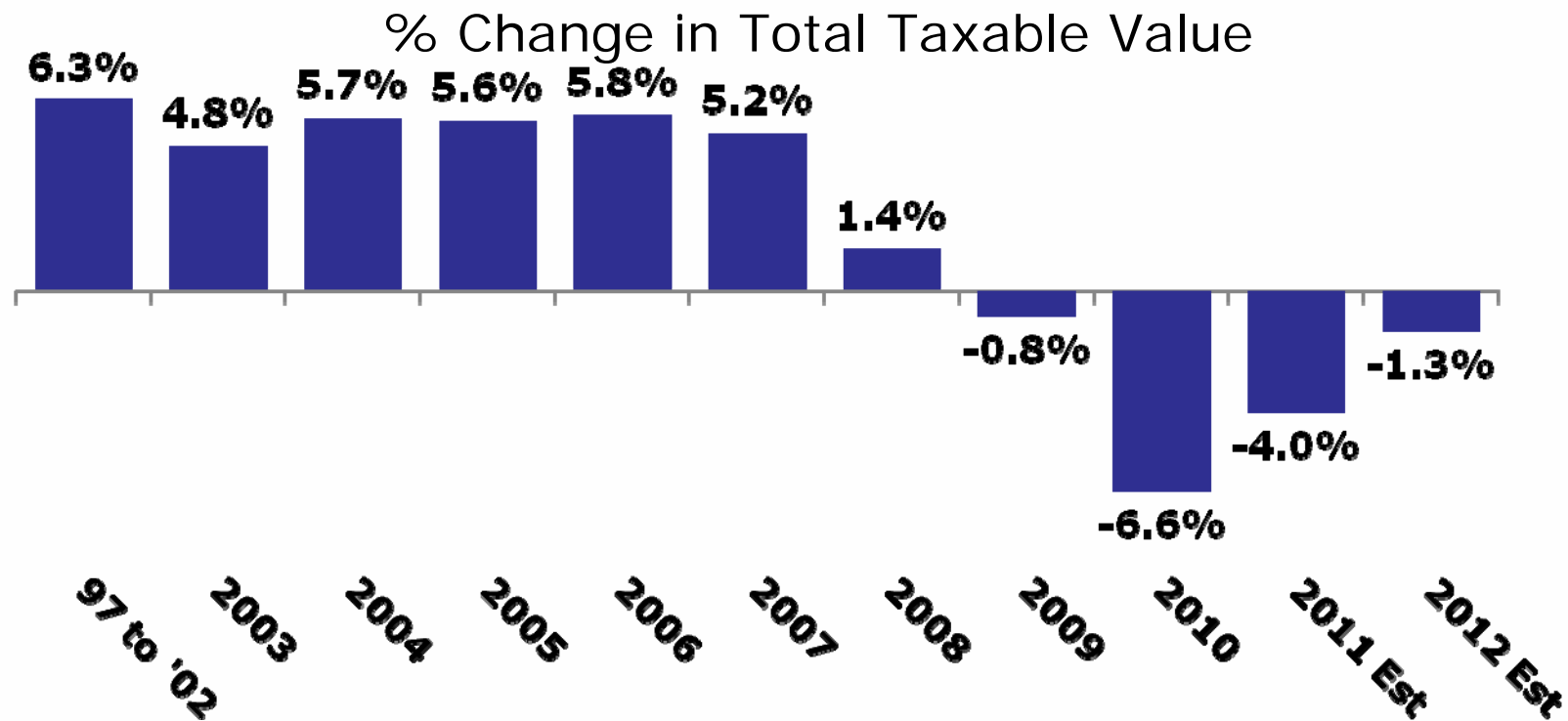


What About Local Governments?

- In aggregate, locals fared relatively better over the last decade due to strong property value growth
- Growth was not uniform
- Taxable value has fallen sharply over the past two years particularly in SE Michigan
- Statutory revenue sharing has been cut and remaining funds very much at risk
- Structure of property tax in Michigan prevents revenue recovery even if values recover
- Legacy costs for retiree pension and healthcare payments are a significant issue for many local governments



Property Taxes Had Held Up Well But That Has Changed



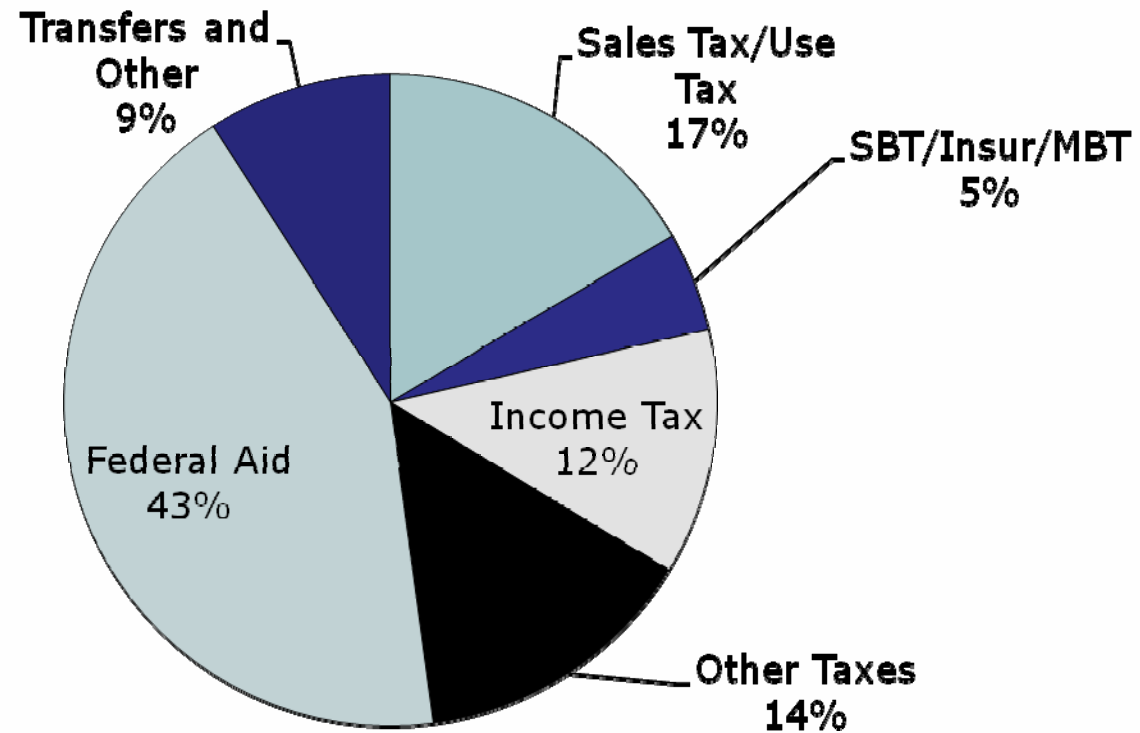
Average



Issues With Michigan's Tax Structure



Where Do State Revenues Come From? FY 2010 Revenues Total \$44.0 Billion





Issues With State's Major Taxes

- **Income Tax** – Comprises roughly $\frac{1}{4}$ of Michigan tax revenue
 - Rate scheduled to begin falling in Oct 2011
 - Most retirement income exempt – will slow growth in base as population ages
 - Switch to a progressive structure would increase growth rate of tax but would also increase volatility and may have negative economic consequences if rates are high; requires constitutional amendment
- **Sales/Use Tax** – Comprises roughly $\frac{1}{3}$ of Michigan tax revenue
 - Base as a share of economy has been shrinking
 - Michigan taxes relatively few services – Gov Granholm and BLM have previously proposed expanding base to include more



Issues With State's Major Taxes

- **MBT** – Represents roughly 10% of state's taxes
 - Tax is complicated, unpopular, and unique among states
 - Originally designed to be revenue neutral with SBT, but with addition of surcharge represented a significant tax increase
 - Business income a significant component of new base makes tax more volatile – original full year estimate was \$3B current estimate for FY 10 is \$1.9B
- **Property Taxes** – represent roughly 9% of state taxes and roughly 90% of local taxes
 - Dropping rapidly as housing prices fall but drops vary widely across jurisdictions
 - Taxable value cap and Headlee will prevent tax from rebounding faster than inflation even if prices rebound faster



Significant Tax Cuts are in the Pipeline

	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>
Reducing Michigan IIT Rate	\$0.0	\$0.0	\$0.0	(\$150.0)	(\$329.0)	(\$522.5)
Alternative Energy Credits IIT	(\$16.0)	(\$46.0)	(\$55.3)	(\$42.0)	\$0.0	\$0.0
Michigan EITC	(\$140.0)	(\$325.0)	(\$338.0)	(\$358.3)	(\$379.8)	(\$402.6)
Eliminating MBT Surcharge		Eliminated in Tax Year 2017		(\$715 million)		
MBT Battery Credits(1)	\$0.0	\$0.0	\$0.0	(\$40.0)	(\$268.0)	(\$278.0)
MBT Film Credits & Infrastructure(2)	(\$37.5)	(\$100.0)	(\$125.0)	(\$125.0)	(\$125.0)	(\$125.0)
Polycrystalline Manuf. Credit	\$0.0	\$0.0	\$0.0	\$0.0	(\$25.0)	(\$25.0)
Photovoltaic Tech	\$0.0	(\$0.8)	(\$9.8)	(\$12.5)	(\$12.5)	(\$15.0)
MBT Gross Receipt Changes	(\$115.8)	(\$80.5)	(\$93.4)	(\$117.8)	(\$129.9)	(\$132.7)
Decouple from depr/prod activities	\$172.5	\$23.4	\$19.2	\$45.3	\$52.3	\$60.0
Historic preservation credits	\$0.0	\$0.0	(\$5.0)	(\$8.6)	(\$9.6)	(\$10.6)
Promise Zones	\$0.0	(\$1.0)	(\$4.0)	(\$10.0)	(\$15.0)	(\$20.0)
Use Tax Bad Debt Deduction Change	(\$2.0)	(\$25.5)	(\$16.6)	(\$17.1)	(\$17.7)	(\$18.4)
Exempt supplies for Cobo Center	\$0.0	\$0.0	(\$2.5)	(\$2.5)	(\$3.5)	(\$1.5)
Totals	(\$138.8)	(\$555.4)	(\$630.4)	(\$838.5)	(\$1,262.7)	(\$1,491.3)

(1) Totals if full amount used



What About Legacy Costs?

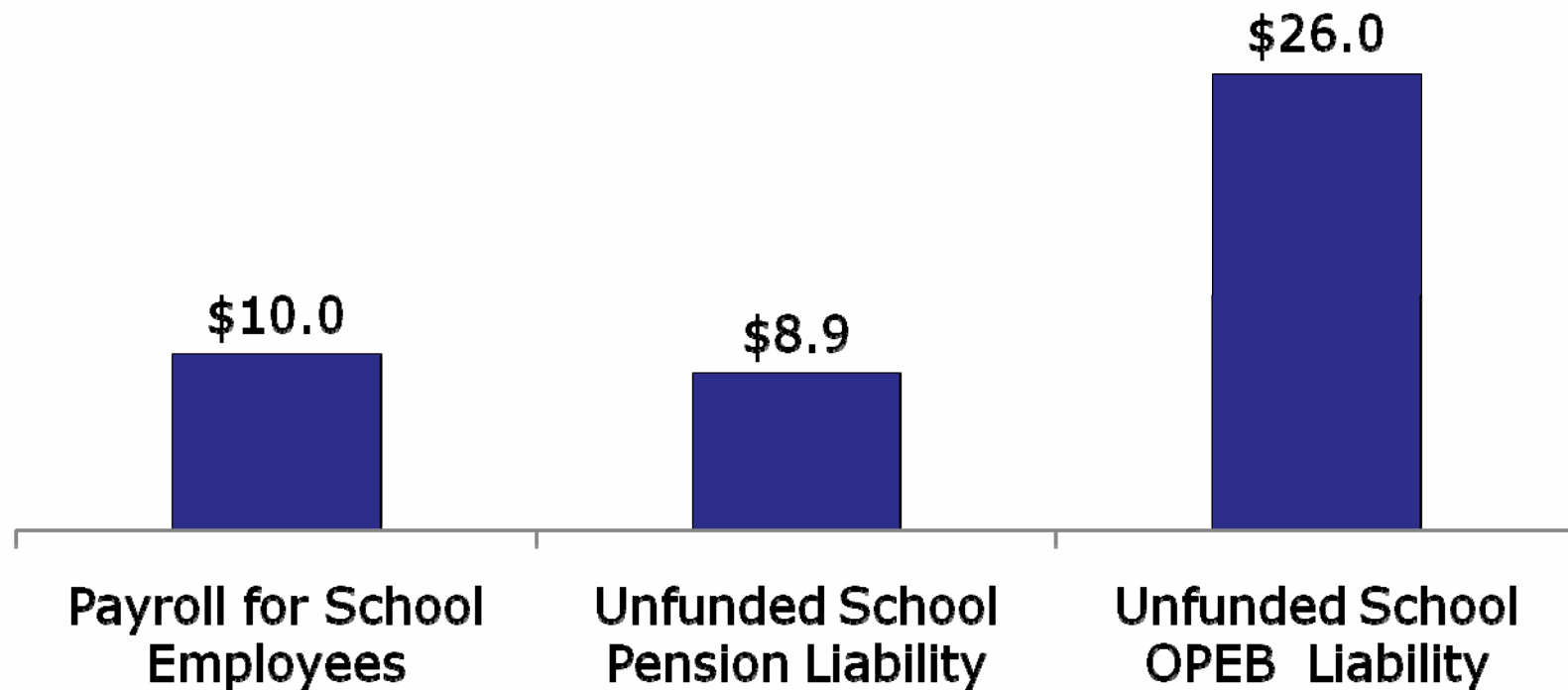


Issues With Employee Legacy Costs

- The state, school districts, and many local governments provide retiree healthcare on a “pay-as-you-go” basis.
- Rapidly rising healthcare costs and increasing numbers of retirees are making this cost rise rapidly
- Many Michigan governments also have DB pension plans – 10 years of returns below the actuarially assumed rate has left many of these plans with significant shortfalls
- Legacy costs are a difficult issue in government budgets – represent a future cost for services provided in the past



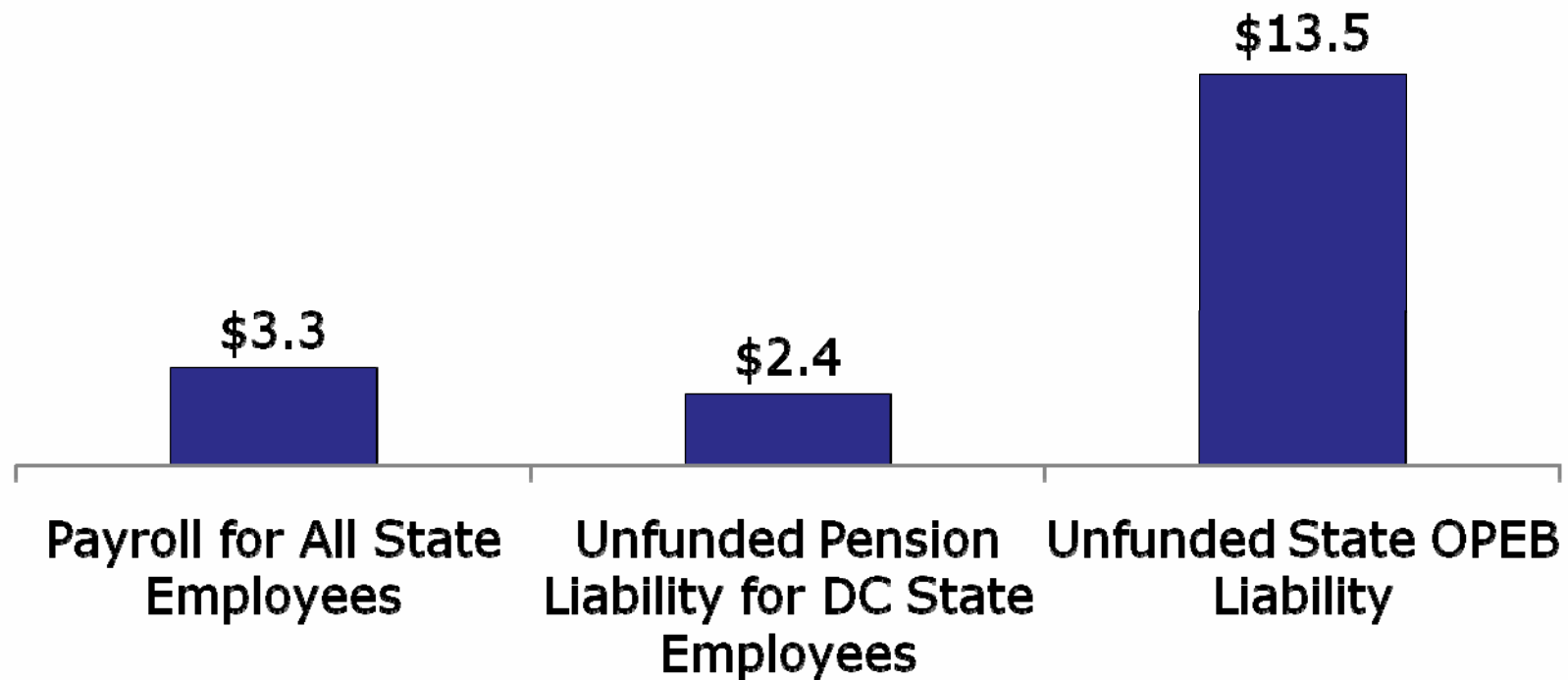
Unfunded Pension and OPEB Liability Totals \$34.9 Billion for Schools



Source: 2009 MPSERS CAFR; Note: MPSERS covers K-12 and community college employees



Unfunded Pension and OPEB Liability Totals \$15.9 Billion for State Employees





State Retirement Plan Switch Shows Potential Savings

<u>Fiscal Year</u>	<u>State Employee DB Plan Rate (%)</u>	<u>State Employee DC Plan Rate (%)</u>	<u>DC Cost Advantage</u>
1999	5.29%	6.22%	-0.93%
2000	5.36%	6.10%	-0.74%
2001	4.60%	6.12%	-1.52%
.	.	.	.
.	.	.	.
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2008	20.00%	6.37%	13.63%
2009	18.84%	6.65%	12.19%
2010	21.36%	6.65%	14.71%



What is the bottom line?

- Michigan's economy is finally improving, **but there is no quick recovery from an 18% employment decline**
- While private sector is starting to improve, the worst is ahead for the public sector
- Economic recovery will help but will not fix budget problems for the state and local governments:
 - End of stimulus has a far bigger effect on revenues than the improvement in revenues from expected economic growth
 - Enacted tax cuts and tax structure issues will constrain revenue growth going forward
 - Legacy costs and other healthcare drivers will provide continuing spending pressures



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