



CITIZENS RESEARCH COUNCIL OF MICHIGAN

# Michigan's Economic, Revenue, and Budget Situation

Jeffrey Guilfoyle, President  
Citizens Research Council of Michigan  
Town Hall Meeting  
May 2011

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# **The State of the National Economy**



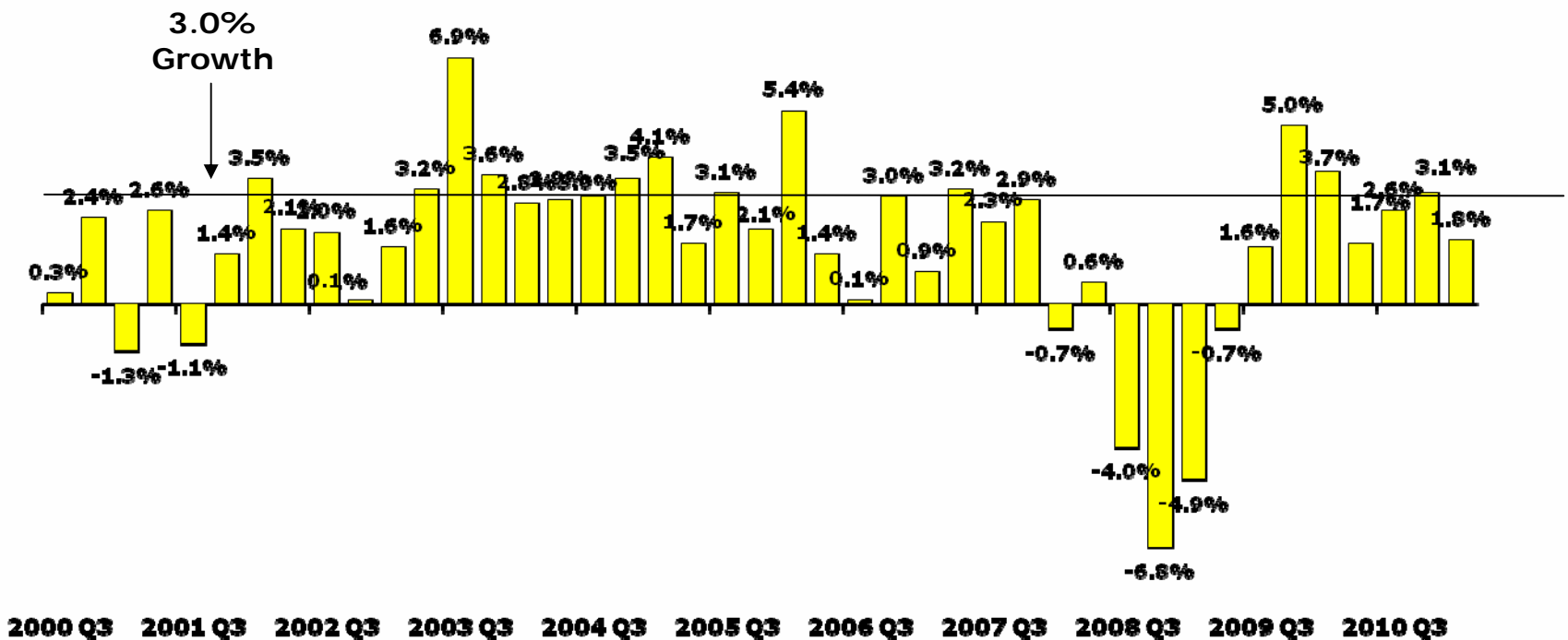
## Recession is Over – Sort of...

- 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 had been minimal making it feel like the recession was still ongoing
- Economic recovery has been disappointing and uneven, employment finally improving, but uncertain if employment growth will be sustained



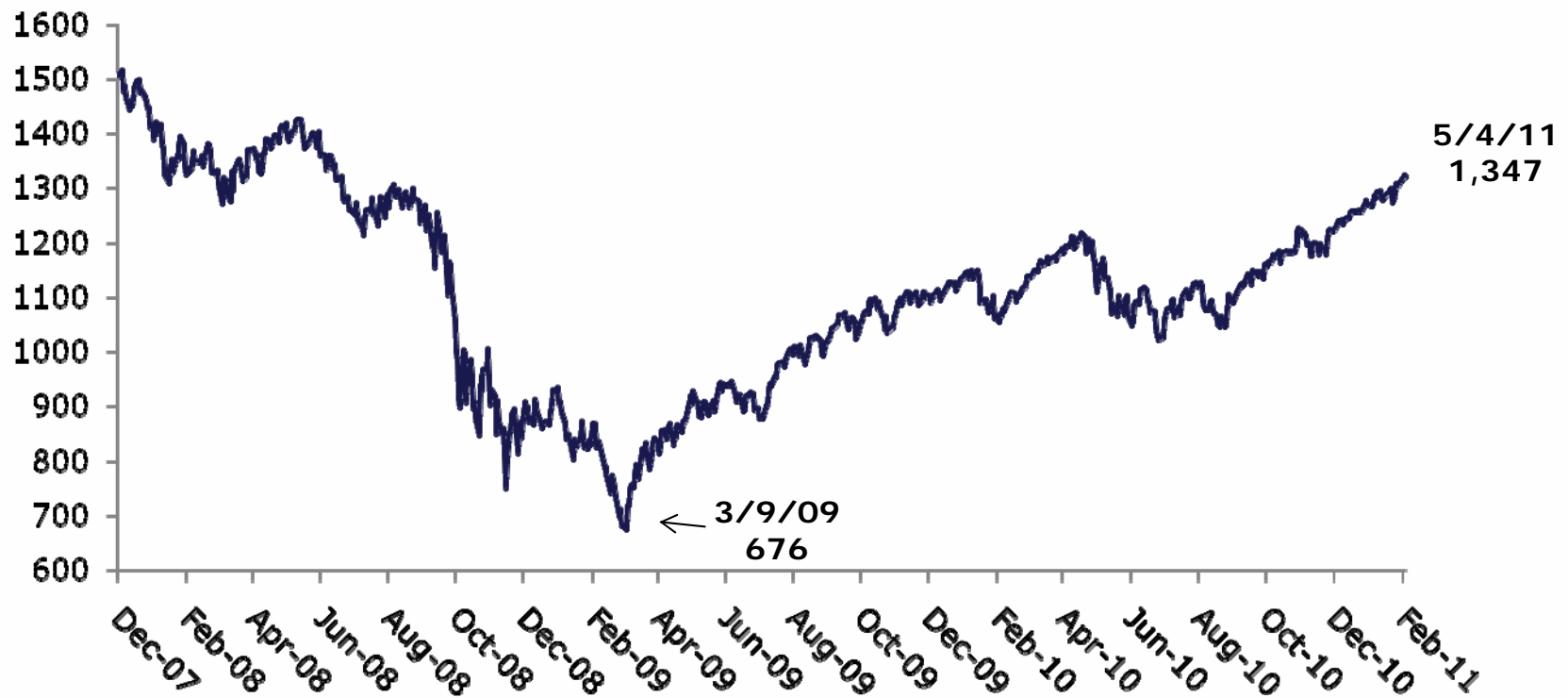
# GDP Has Grown for 7 Straight Quarters But 2011Q1 Reading Was Disappointing

Real GDP Growth



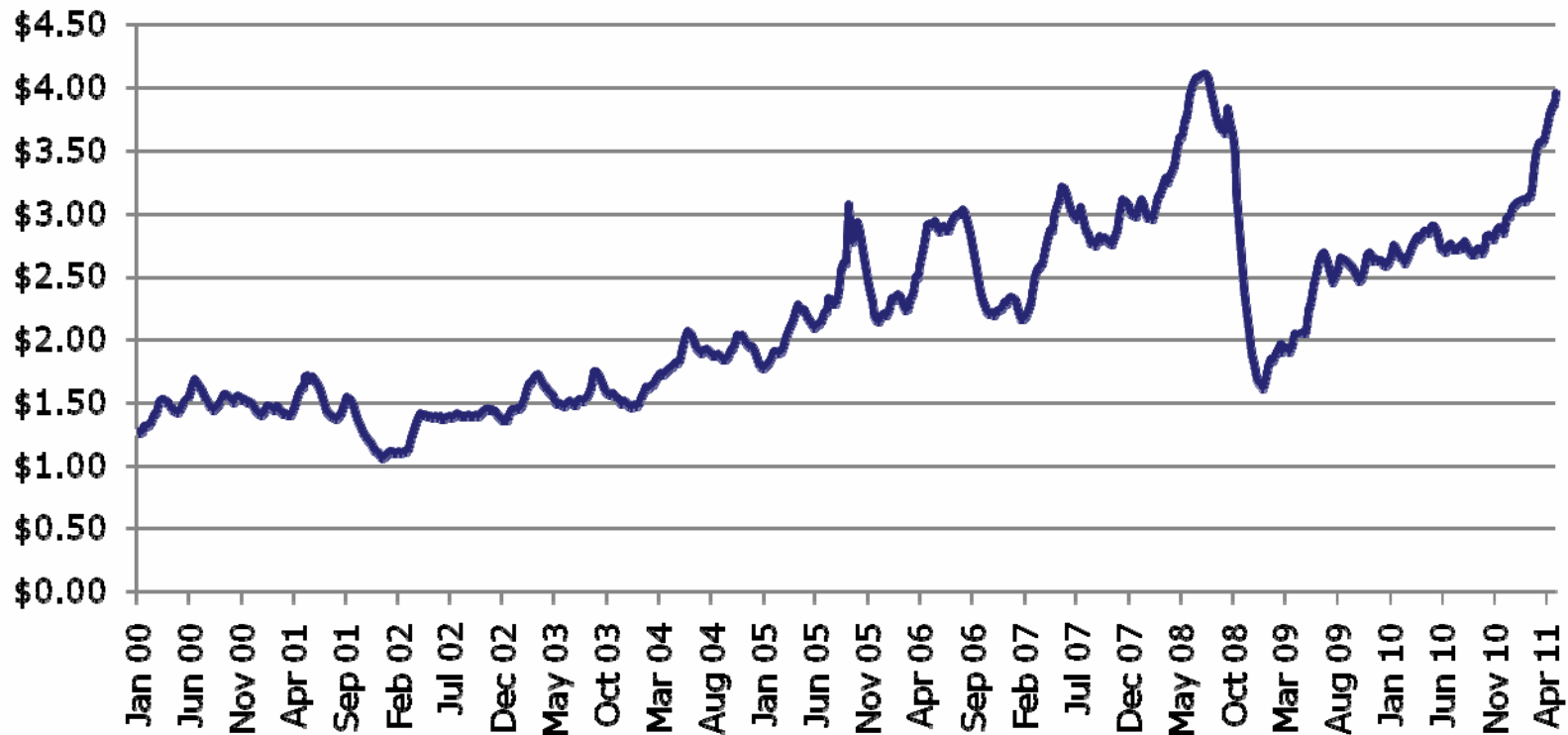


# S&P 500 Up 97% From March 09 Low But Still Down 7% From January 2008





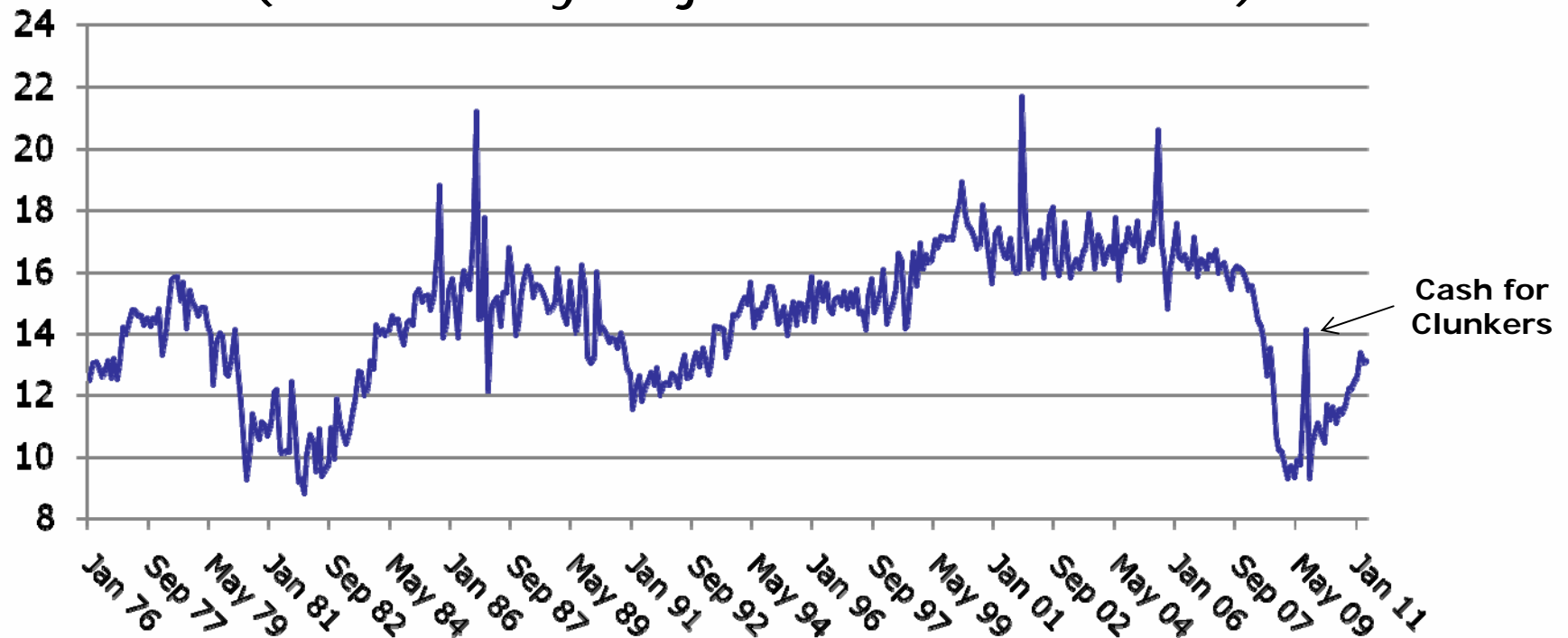
# Gas Prices Have Rapidly Become Something to Worry About





# Vehicle Sales Are Slowly Recovering

Monthly Light Vehicle Sales  
(Seasonally Adjusted Annual Rate)

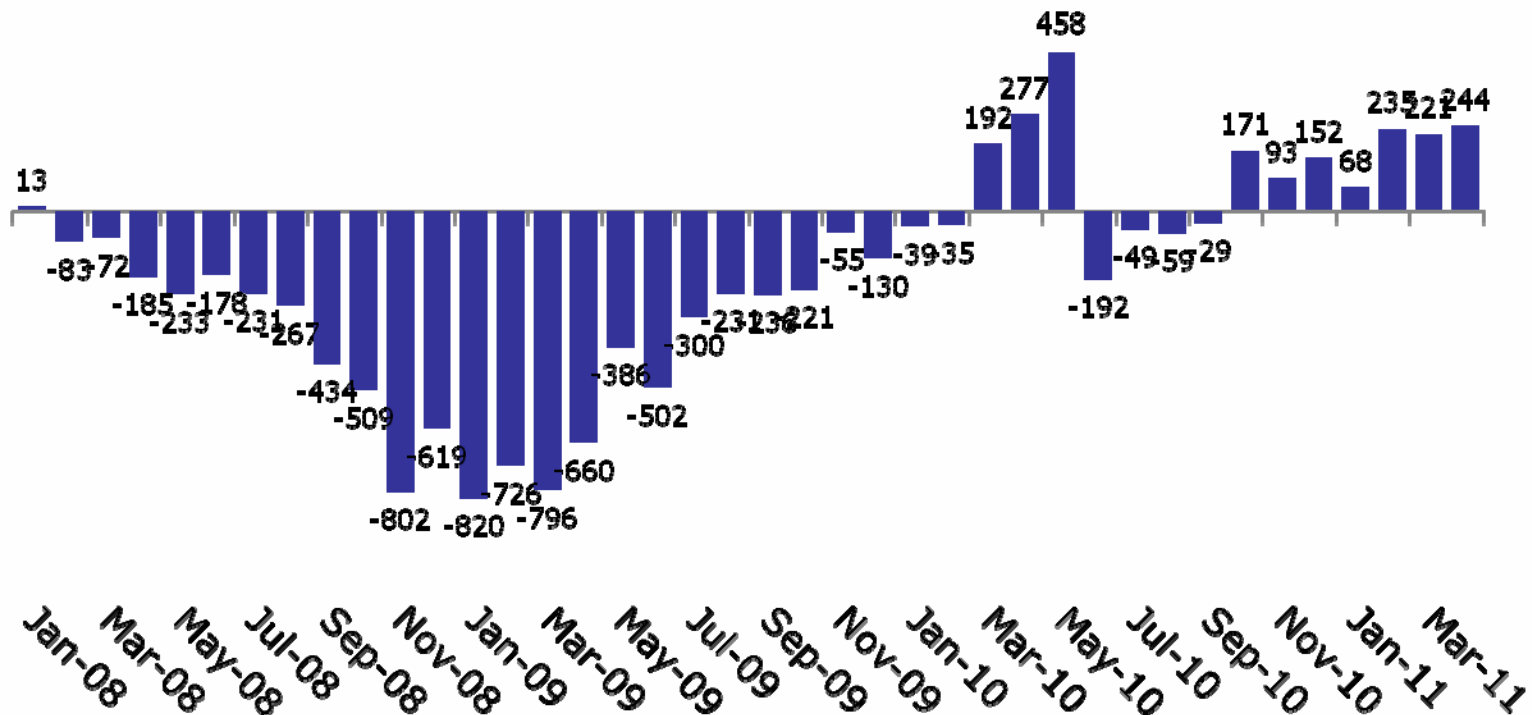






# The U.S. Has Not Recovered the 8 Million Jobs Lost in the Recession

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





## Economic Outlook

- Economic recovery is still unsteady
- Positives:
  - Employment finally growing
  - Strong stock market recovery
  - Commodity prices may be peaking
- Negatives
  - 1<sup>st</sup> quarter GDP was disappointing
  - Gasoline prices are a major concern
  - Unemployment claims have tipped up
- Economic and employment growth should remain positive, but significant debate among analysts over the speed



# **What is Happening in Michigan?**

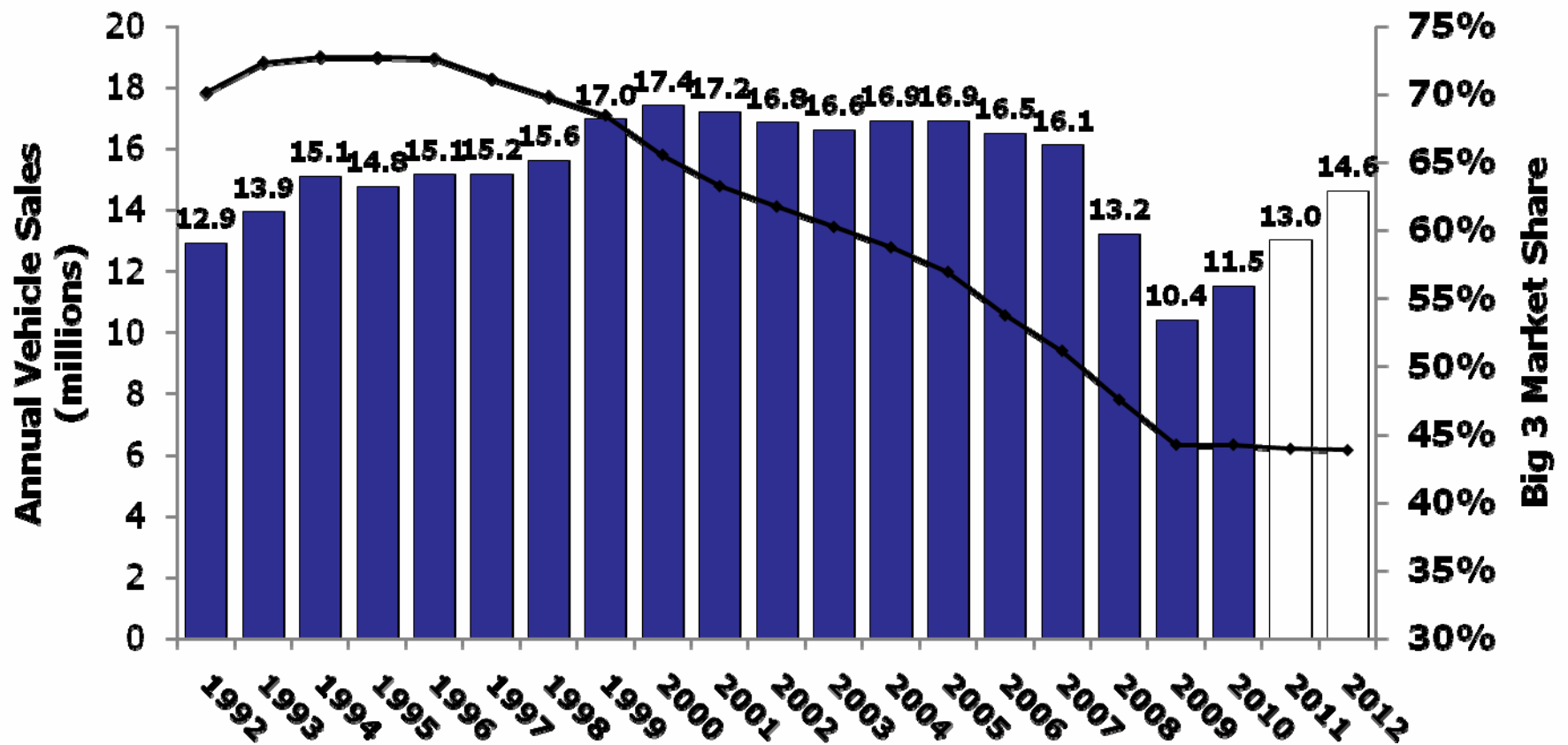


## The Last Decade Was an Economic Disaster for Michigan

	<u>U.S.</u>	<u>Michigan</u>	<u>Rank</u>
Population	9.5%	-0.2%	51
Real Per Capita GDP*	4.7%	-11.9%	51
Employment	-1.5%	-17.4%	51
Real Per Capita Income**	5.7%	-4.4%	50



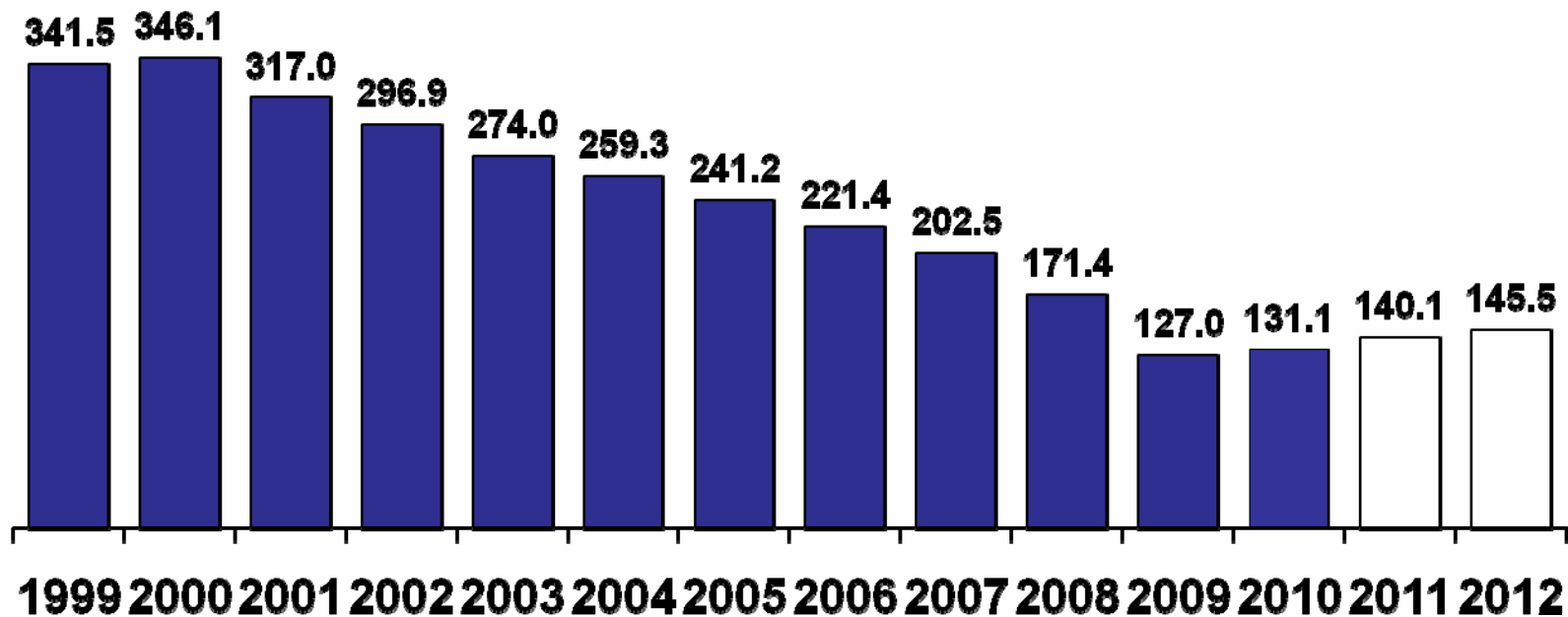
## Big 3 Market Share Plummet





## 2 in 3 Auto Jobs Lost

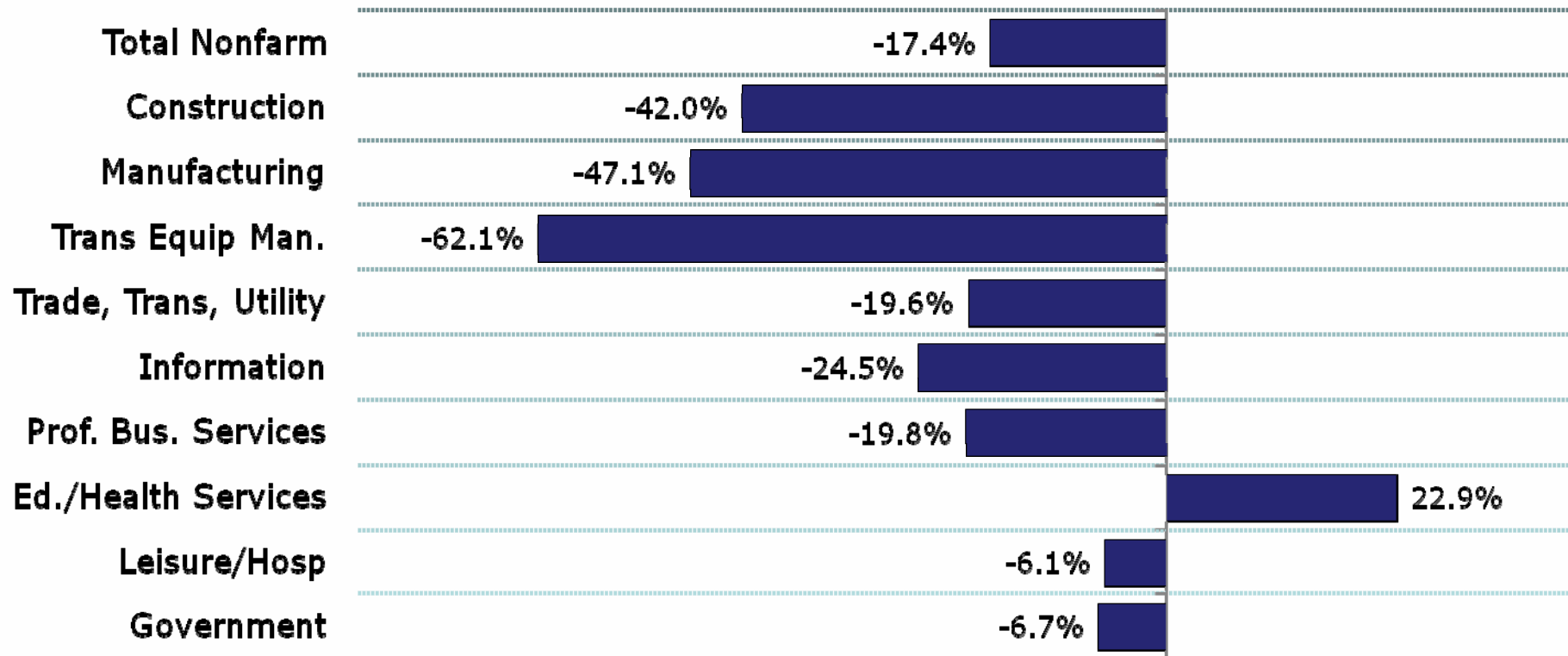
Michigan Transportation Equipment Employment  
(In Thousands)





# Almost Every Sector in Michigan Has Lost Jobs

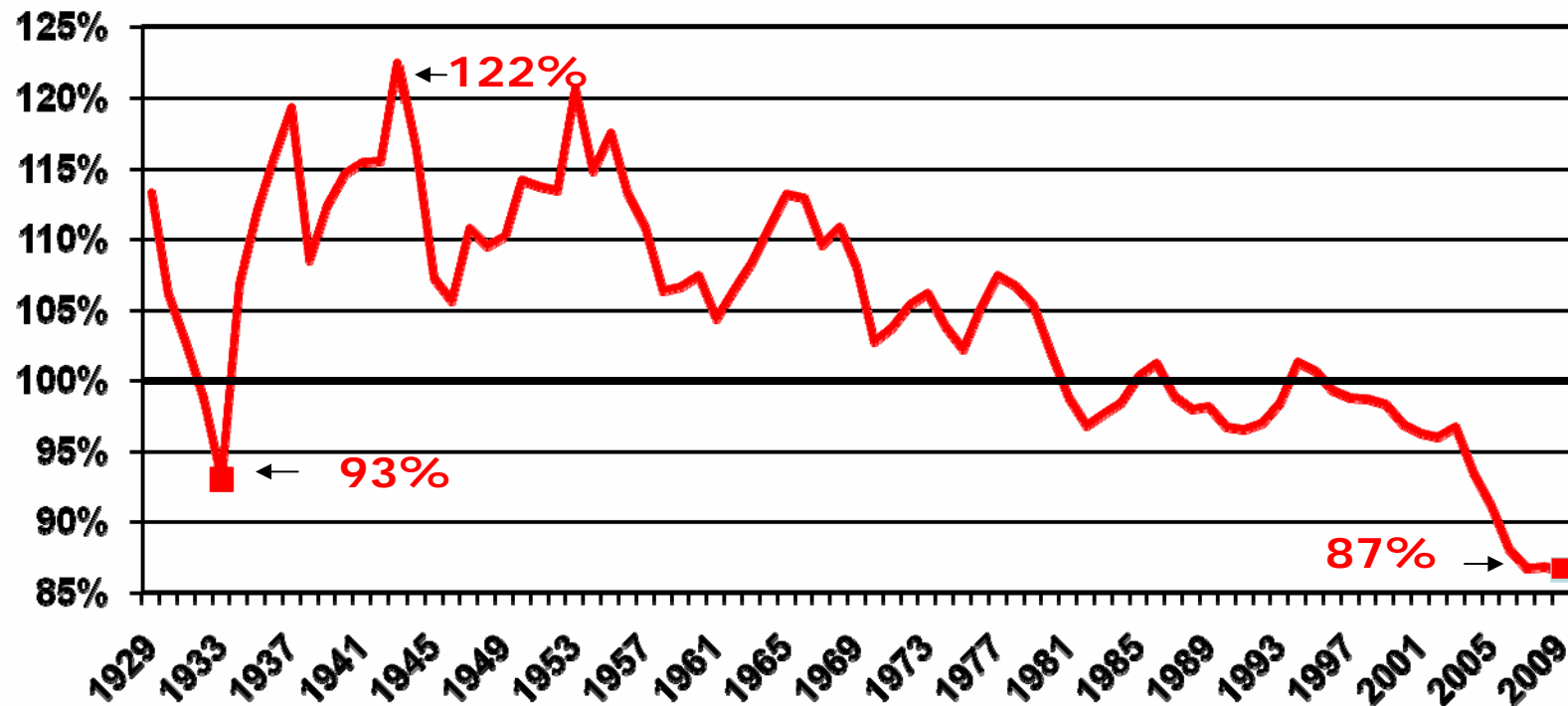
## 2000 to 2010





## Michigan Has Become Poorer Relative to Other States

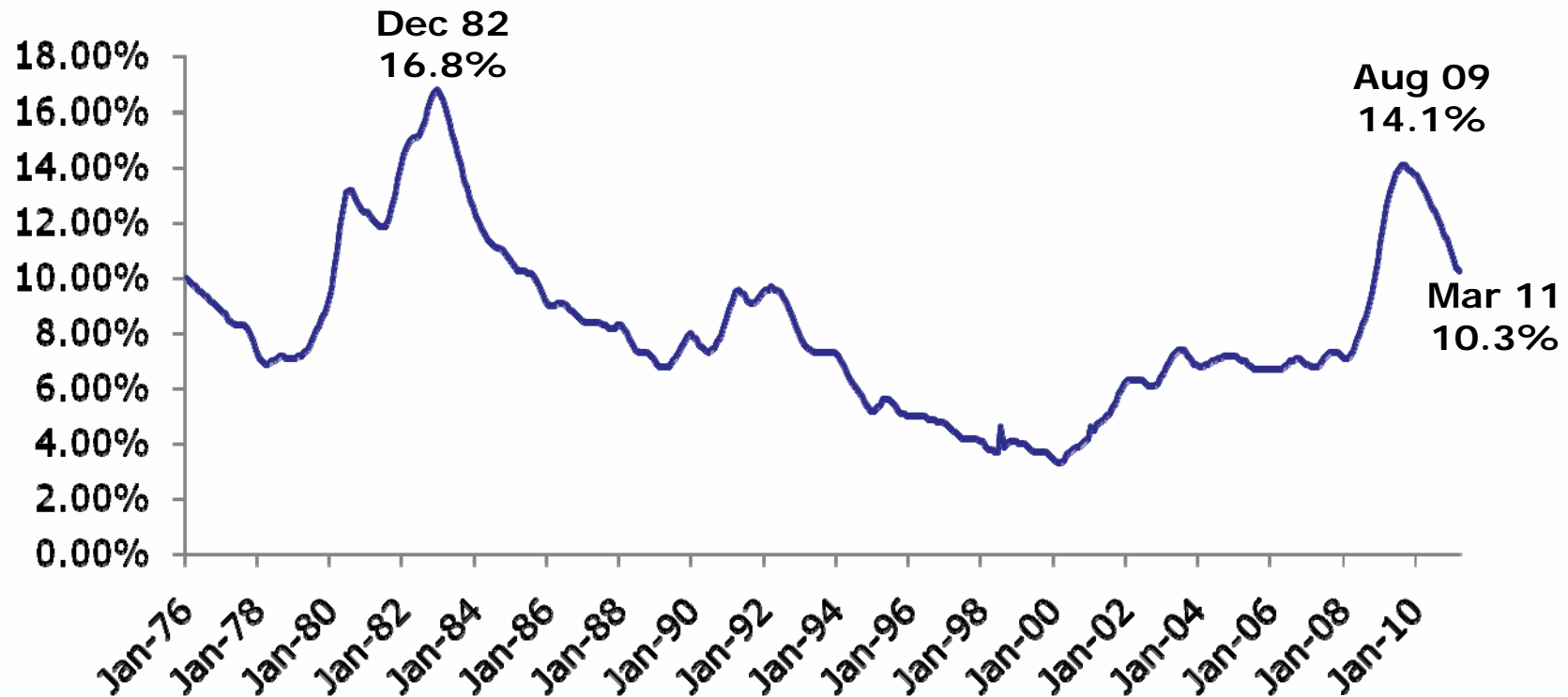
Michigan per Capita Income as a Percent of U.S. Per Capita Income Rank has fallen from 20<sup>th</sup> in 2001 to 37<sup>th</sup> in 2010







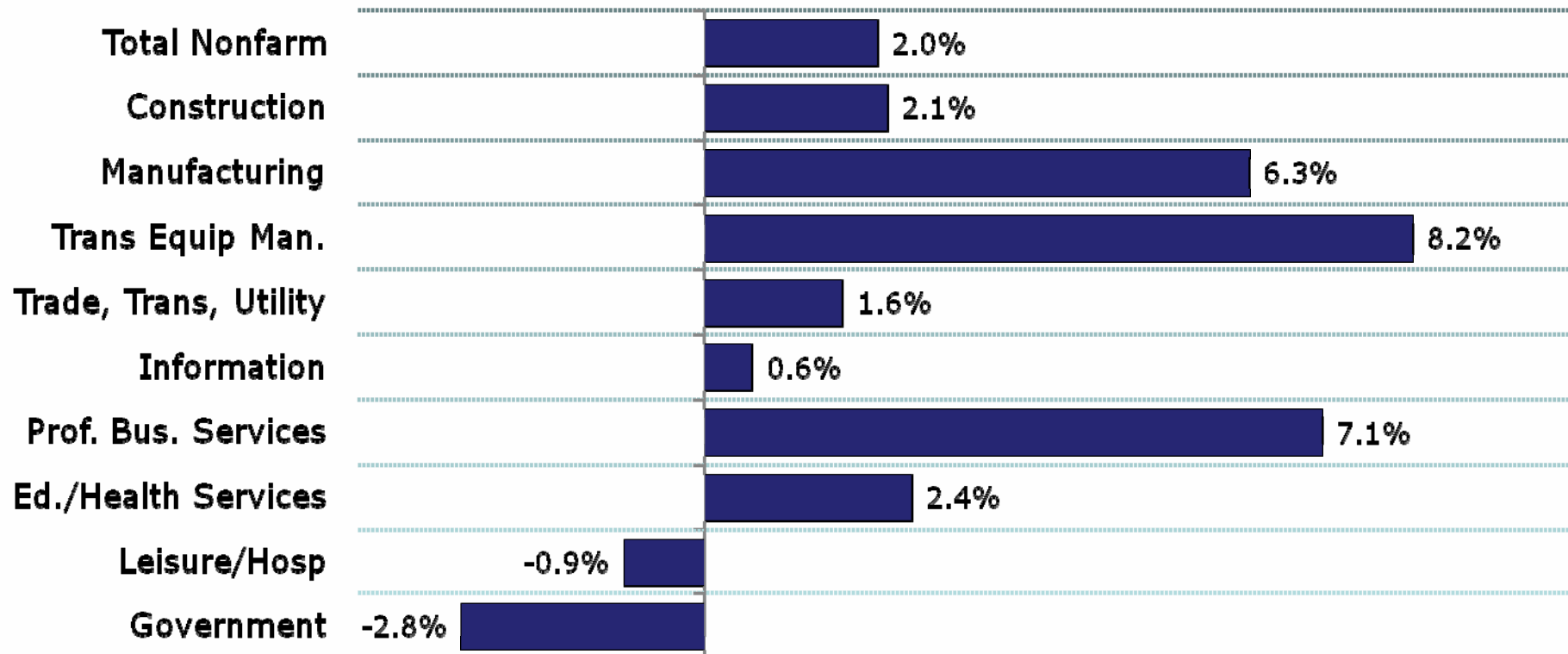
# Michigan's Unemployment Rate Steadily Improving





# Michigan Has Added Jobs in Last 12 Months

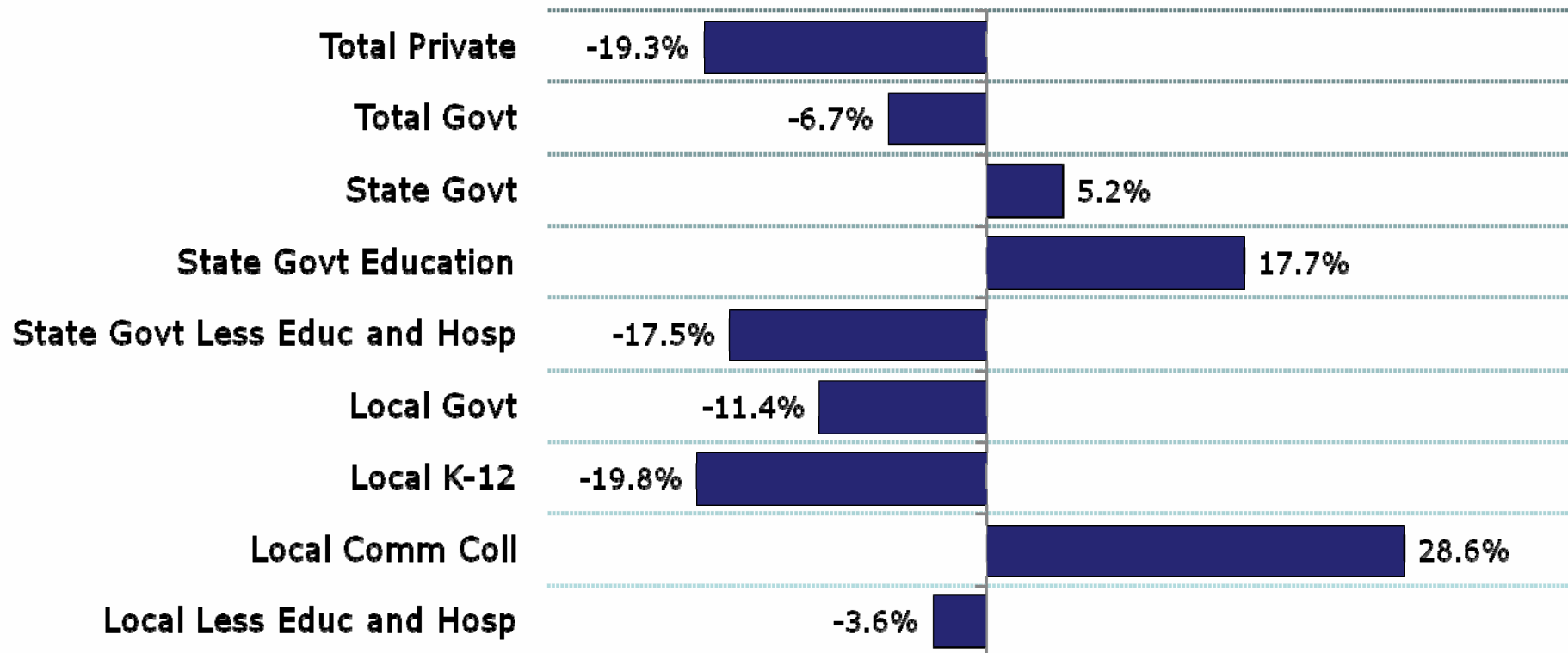
## March 2010 to March 2011





# Public Sector Employment Changes Vary Significantly By Sector

**2000 to 2010**



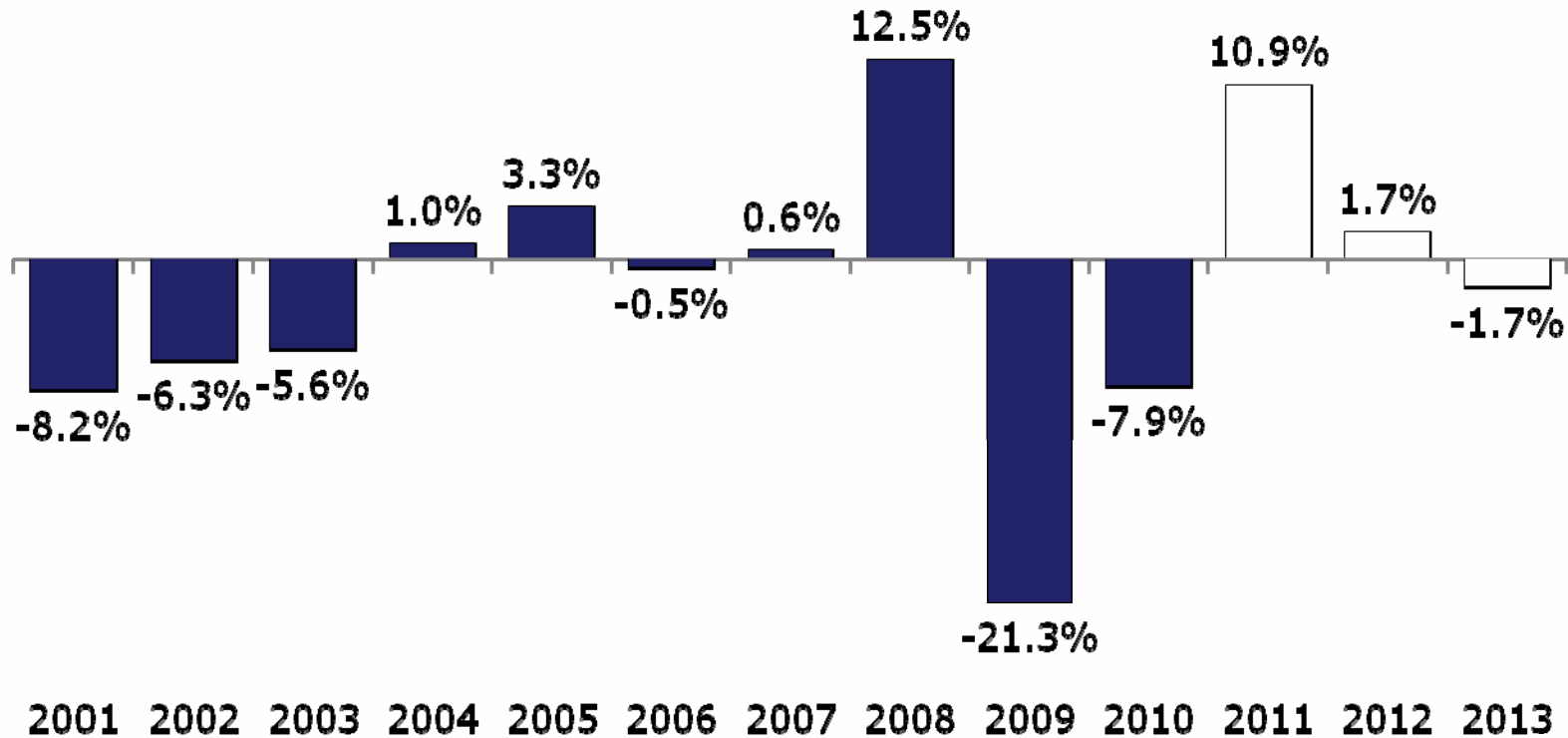


# State Revenue Outlook



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

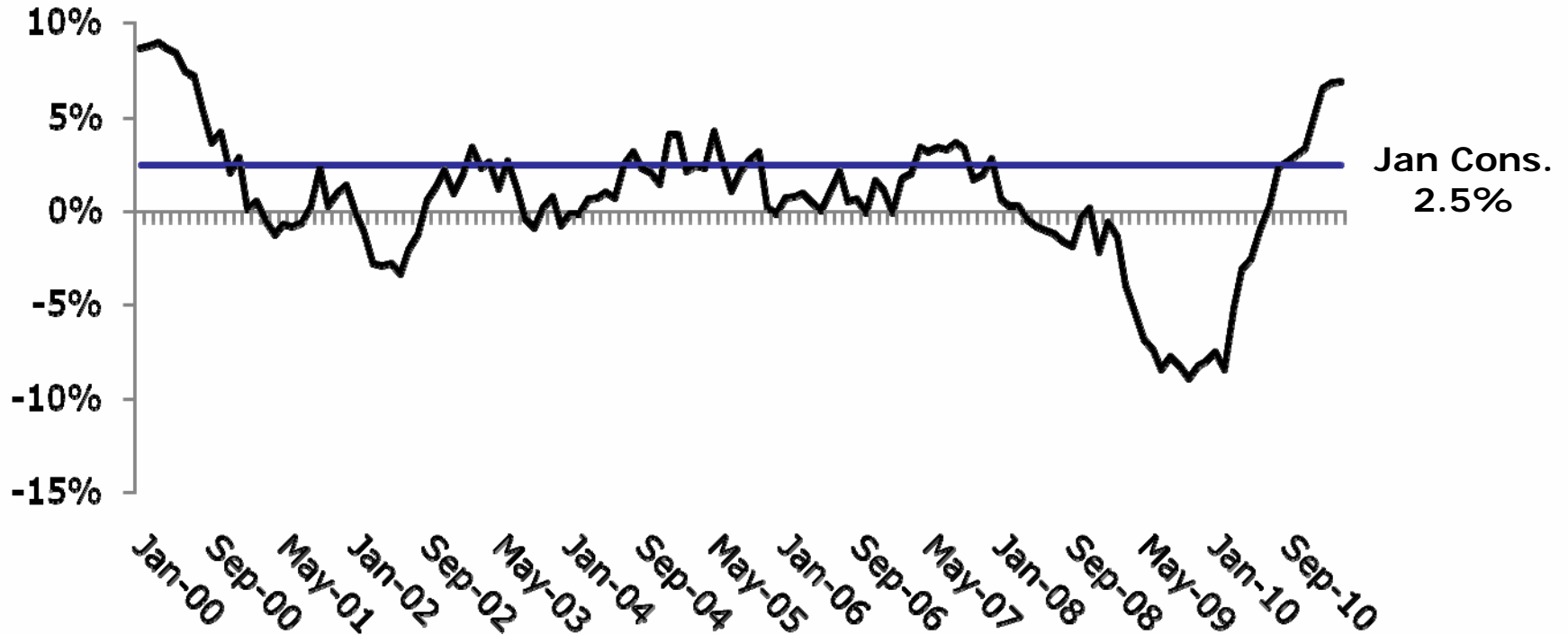
GF-GP Revenues  
Year-Over-Year Pct. Change





# Income Tax Withholding Growth Suggests Wages Are Growing Again

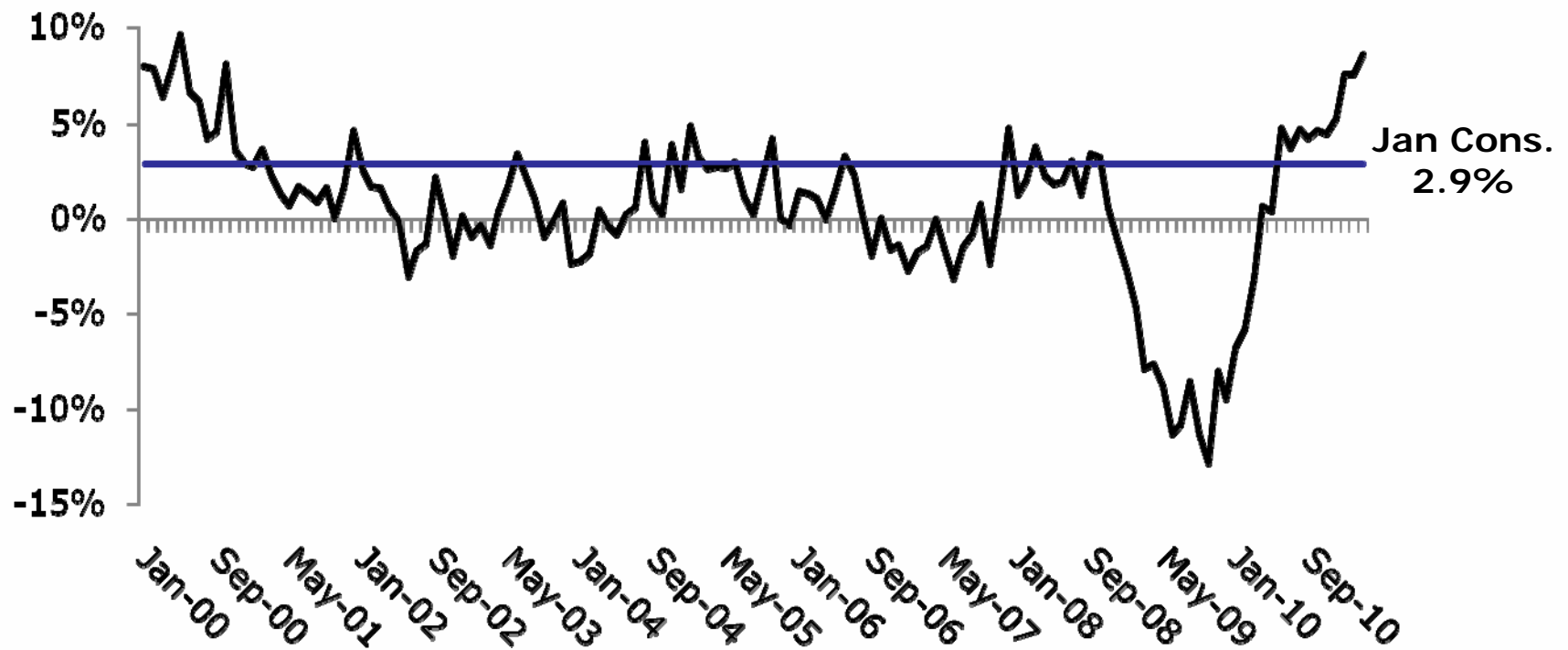
(Y-O-Y % Change 6 Month Average)





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

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





# **Governor Snyder's Budget Proposal**





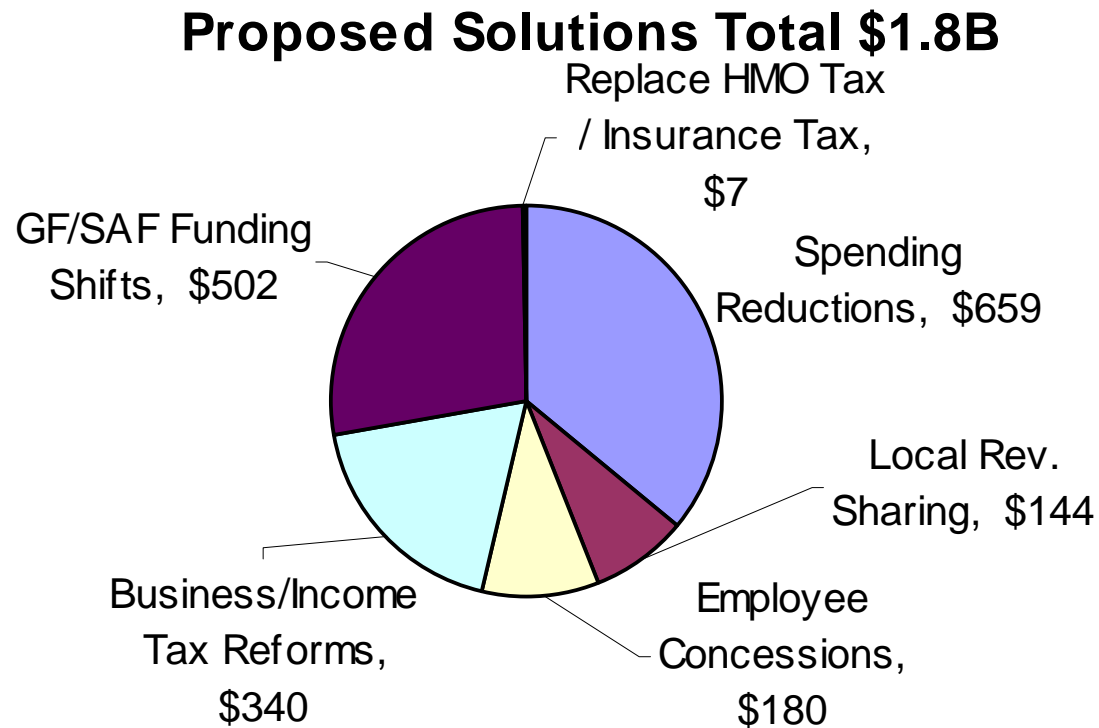
## **Defining the FY2012 GF Problem**

*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



# Mix of Proposed Solutions to Address \$1.4B Gap

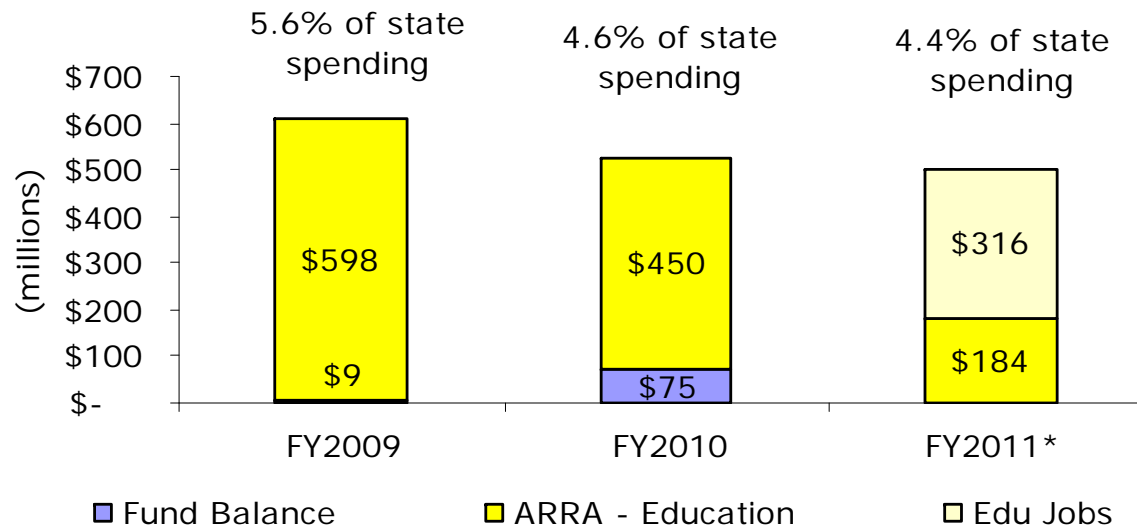


***Savings Offset By \$260M in New Investments***



# FY2012 SAF Budget in Much Better Shape *Despite Use of Non-Recurring Resources*

Non-Recurring Resources Used for SAF Budget



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*



# 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)

	<b>K-12</b>	<b>Community Colleges</b>	<b>Higher Education</b>	<b>Total</b>
FY2011	\$ 12,954	\$ 296	\$ 1,578	\$ 14,829
FY2012	\$ 12,174	\$ 296	\$ 1,362	\$ 13,832
<i>Change</i>	\$ (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)

	<b>FY2011</b>	<b>FY2012</b>	<b>Change</b>
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%)*



## 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

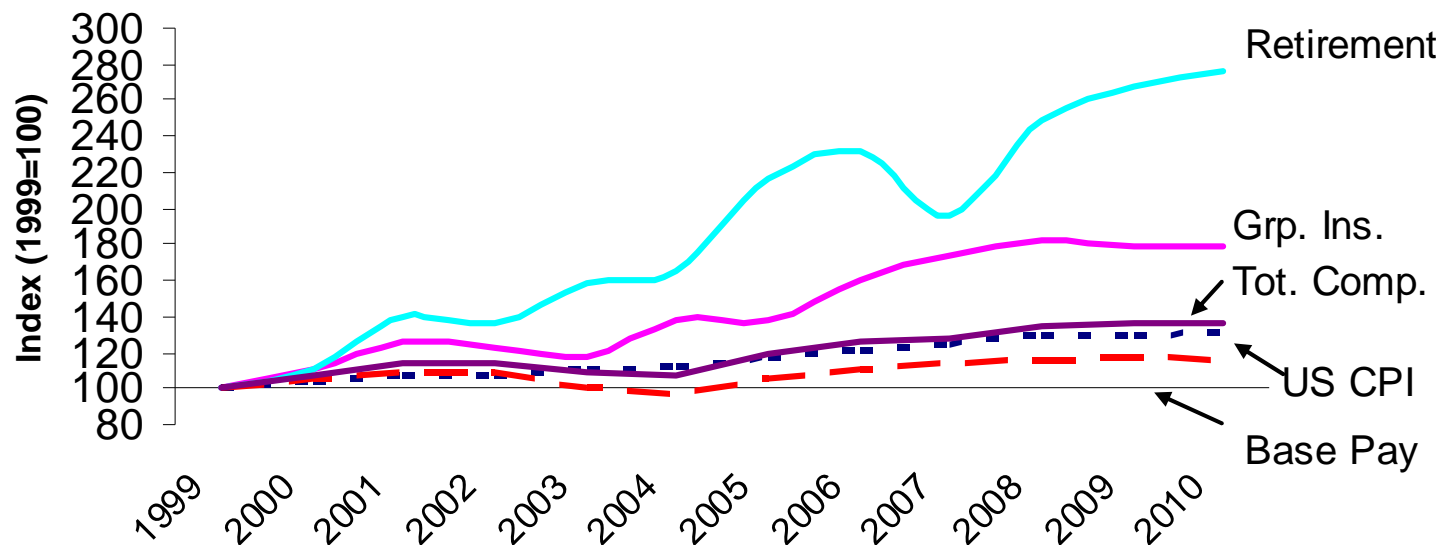
- Net increase of \$105M to fund employee costs, primarily related to retirement (pension and OPEB)
  - Retirement contributions increase from 37.4% to 50.9% of payroll for defined benefit employees
- After adjusting for required employee costs (above), \$180M GF savings reflected in budget – to be negotiated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





# 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
  - 18 unpaid furlough days: \$66M



## 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
- 35 • 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 employees, etc.) still to be addressed



# Governor Snyder's Tax Proposal



## Stated Objectives

**Business Tax Objectives:** Simple fair, efficient, even playing field, enable businesses to grow and create jobs

**Income Tax Objectives:** Simple, fair, broader base, tax all income the same regardless of source



## **Business Tax Key Features**

- Replace MBT (gross receipts less purchases and business income) with a corporate income tax
- Repeal all credits (except one small business credit)
- Exempt noncorporate entities (e.g. partnerships, LLCs, S-corps, etc.)
- Lower business tax burden with a \$1.6 billion cut



## Income Tax Key Features

- Pause scheduled rate rollback at 4.35% until 2013 then rate falls to 4.25% and stays there
- EITC lowered to 6% (Gov's proposal recommended repeal); most other credits (city income, public contribution, etc.) eliminated
- Reduction in pension exemption (Gov's plan recommended repeal)
- Phase-out personal exemption for high income taxpayers (\$75k/\$150k)
- Net tax increase of \$1.4 billion (down from \$1.8B)





## Pension Provisions

- For taxpayers **born before 1946** (i.e. turn 66 in 2011) **no change in retirement or pension exemptions** from current law
- Taxpayers **born 1946 to 1952** (i.e. turn 59 to 65 in 2011):
  - **Exemption for retirement income eliminated while taxpayer is under 67** (but SS exemption retained) – but new \$20k/\$40k pension income exemption added
  - **After 67 \$20k/\$40k exemption applies to all income**, SS exemption retained; \$20k/\$40k exemption phased out for high income taxpayers (\$75k/\$150k)
- **Born after 1952** (i.e. will not turn 59 until after 2011)
  - **Pension exemption eliminated** (but SS exemption retained) **until taxpayer is 67**
  - **After 67, \$20k/\$40k exemption applied against all income including SS**
  - Exemption phased out for high income taxpayers (\$75k/\$150k)



## Summary of Tax Changes Enacted by Legislature

	<u>FY 2012</u>	<u>FY 2013</u>
MBT Current Law	\$2,159.0	\$1,990.6
Revenues from New Tax Law		
MBT (4th quarter 2011 and annual pymts)	\$604.5	\$0.0
New Corp Tax	\$460.2	\$342.9
Bus. Tax Under New Tax Law	<u>\$1,064.7</u>	<u>\$342.9</u>
Net Business Tax Cut	(\$1,094.3)	(\$1,647.7)
Income Tax Increases	<u>\$559.1</u>	<u>\$1,423.7</u>
Net Impact Tax Law Changes	(\$535.2)	(\$224.0)
GF	\$154.7	\$438.0
SAF	(\$689.9)	(\$662.1)



# Will the Tax Changes Improve Economic Growth?

## Positive Impacts

- Lower tax on most businesses will spur investment
- Simpler tax will ease compliance and improve Michigan's reputation
- Dollars appropriated for economic development will spur some investment

## Negative Impacts

- Revenue neutral change limits economic impact (offset by senior and low-income tax increases)
- Some multistate Michigan based firms pay more, so investment incentive works the other way
- Repeal of some credits (personal property, brownfield, etc) works against investment



## May Consensus Revenue Conference Changes

- FY 2011 revenue estimates increased by \$428M (\$296M GF; \$132M SAF)
- FY 2012 revenue estimates increased by \$499M but tax plan cost up by \$306M (compared to budget proposal) so net increase \$193M (\$147M GF; \$46 SAF);
- FY 2013 up \$564M but enacted tax plan up \$356M so set increase \$207M (\$184M GF; \$23M SAF)



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