



CITIZENS RESEARCH COUNCIL OF MICHIGAN

Michigan's Economic, Revenue, and Budget Situation

Jeffrey Guilfoyle, President
Citizens Research Council of Michigan
Women in Finance Conference
May 2011

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*



The State of the National Economy



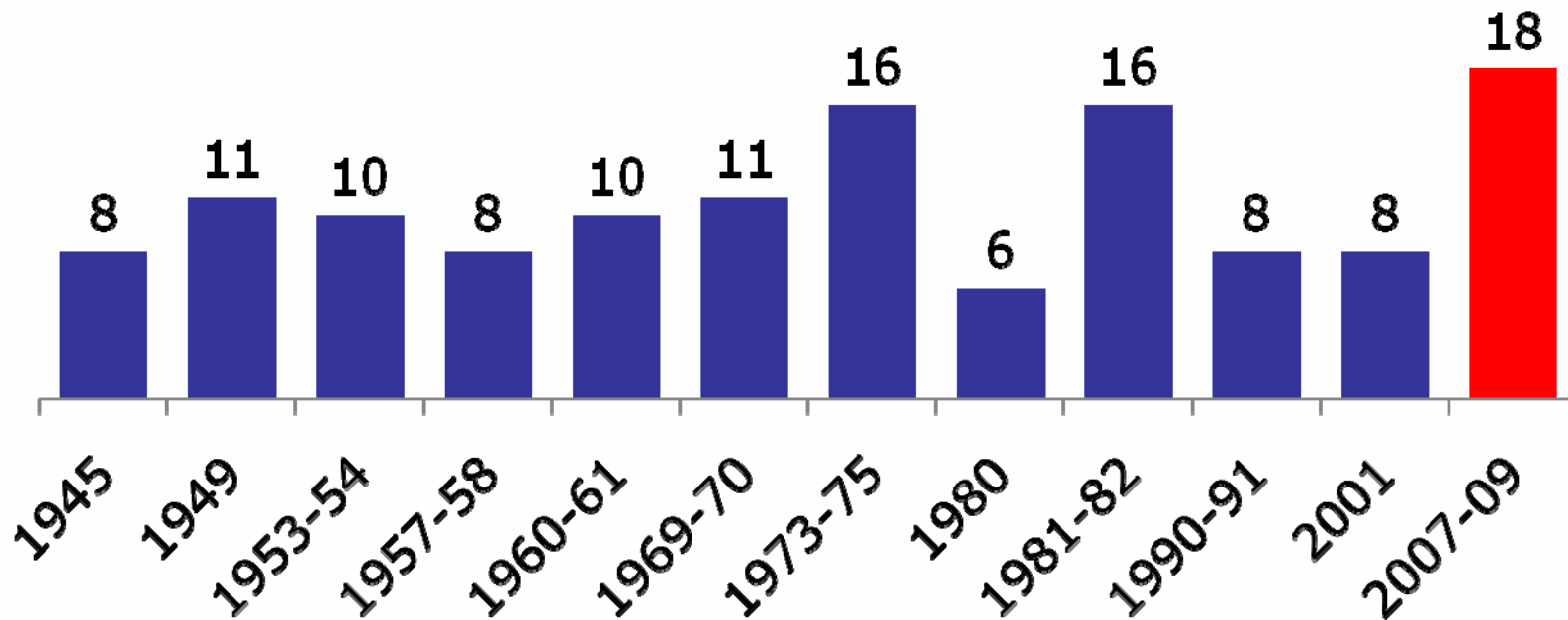
Recession is Over – Sort of...

- 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



2009 Recession Set Post War Record

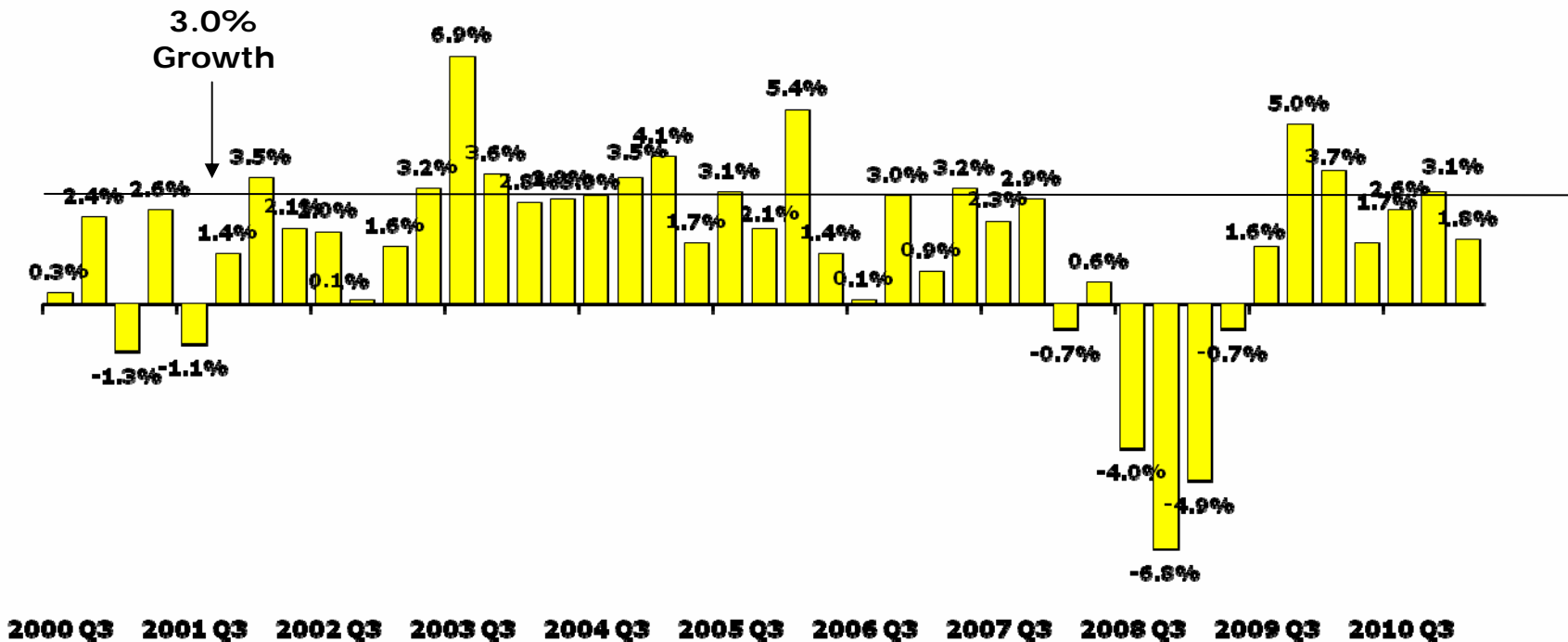
Recession Length in Months





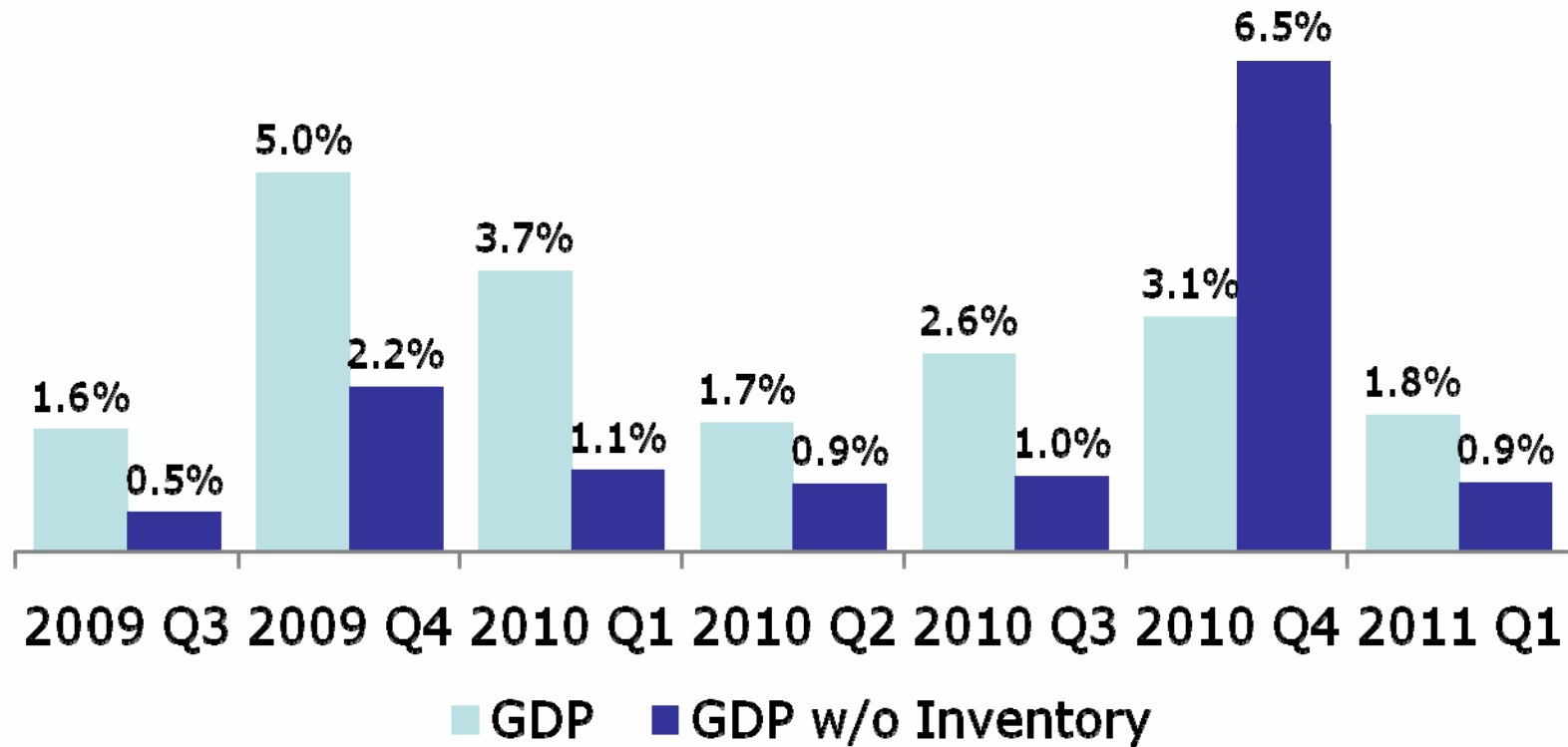
GDP Has Grown for 7 Straight Quarters But 2011Q1 Reading Was Disappointing

Real GDP Growth





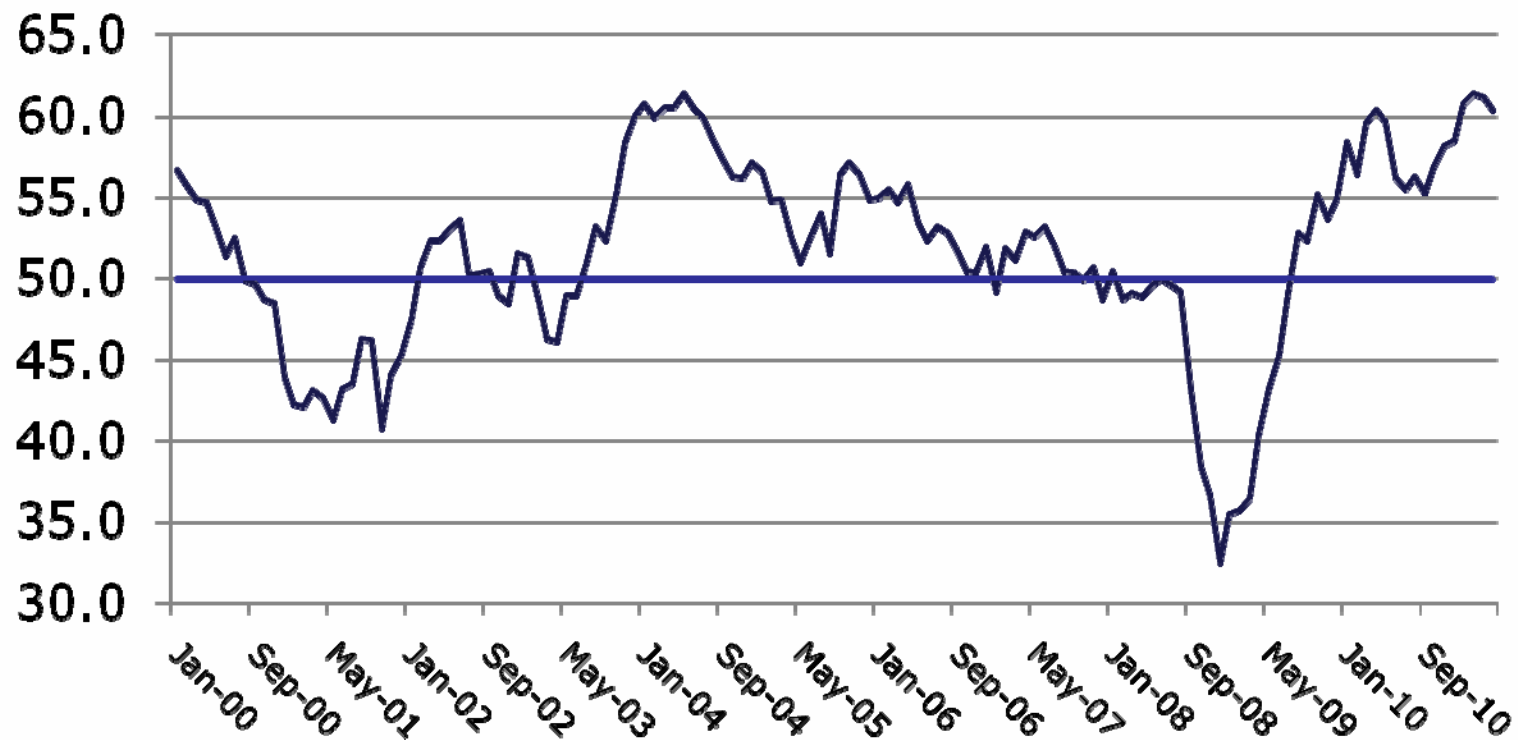
Inventory Restocking Has Been Supporting the Recovery





Manufacturing Has Been Growing

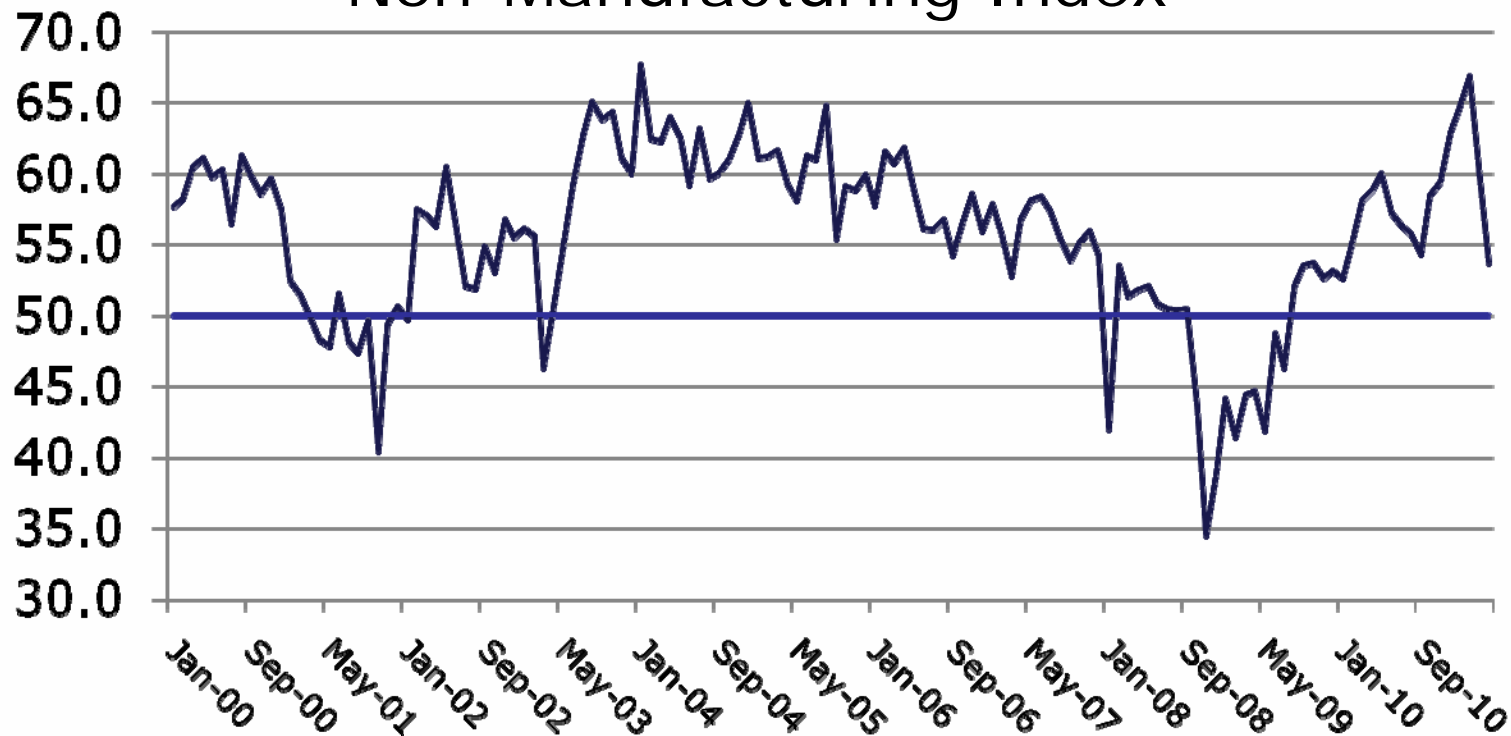
Institute For Supply Management Index MFR Index





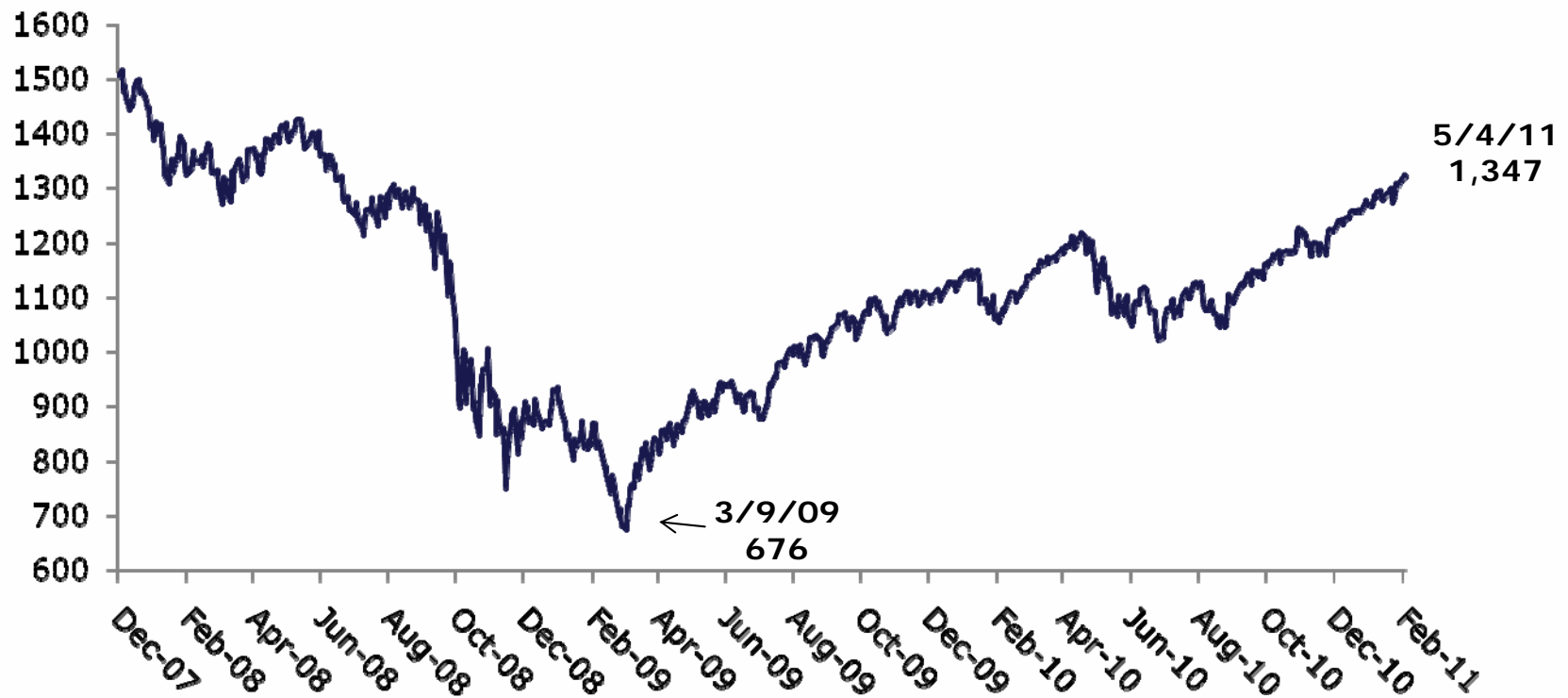
Non-Manufacturing Drop Taken By Some as Sign Recovery Slowing

Institute For Supply Management Index
Non-Manufacturing Index



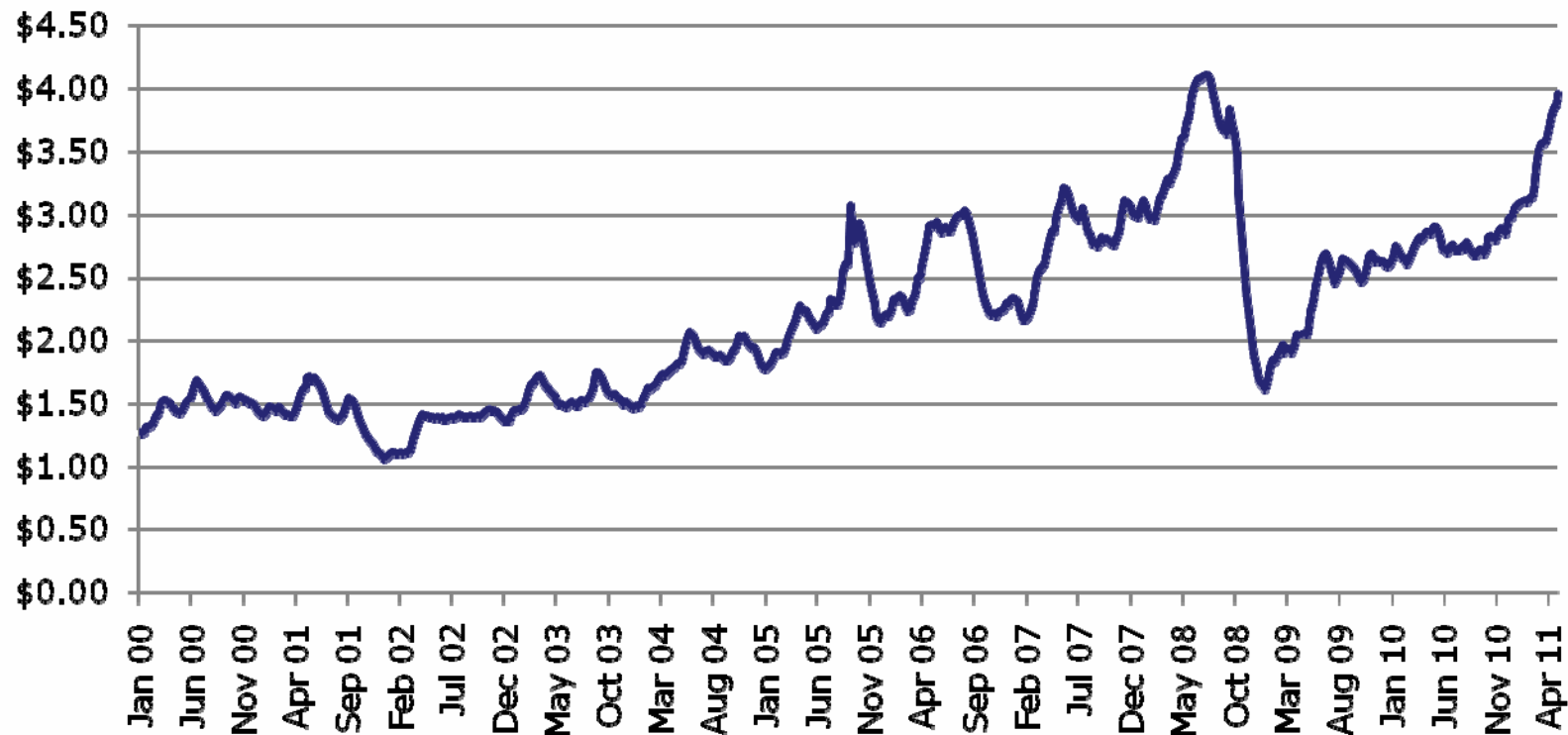


S&P 500 Up 97% From March 09 Low But Still Down 7% From January 2008





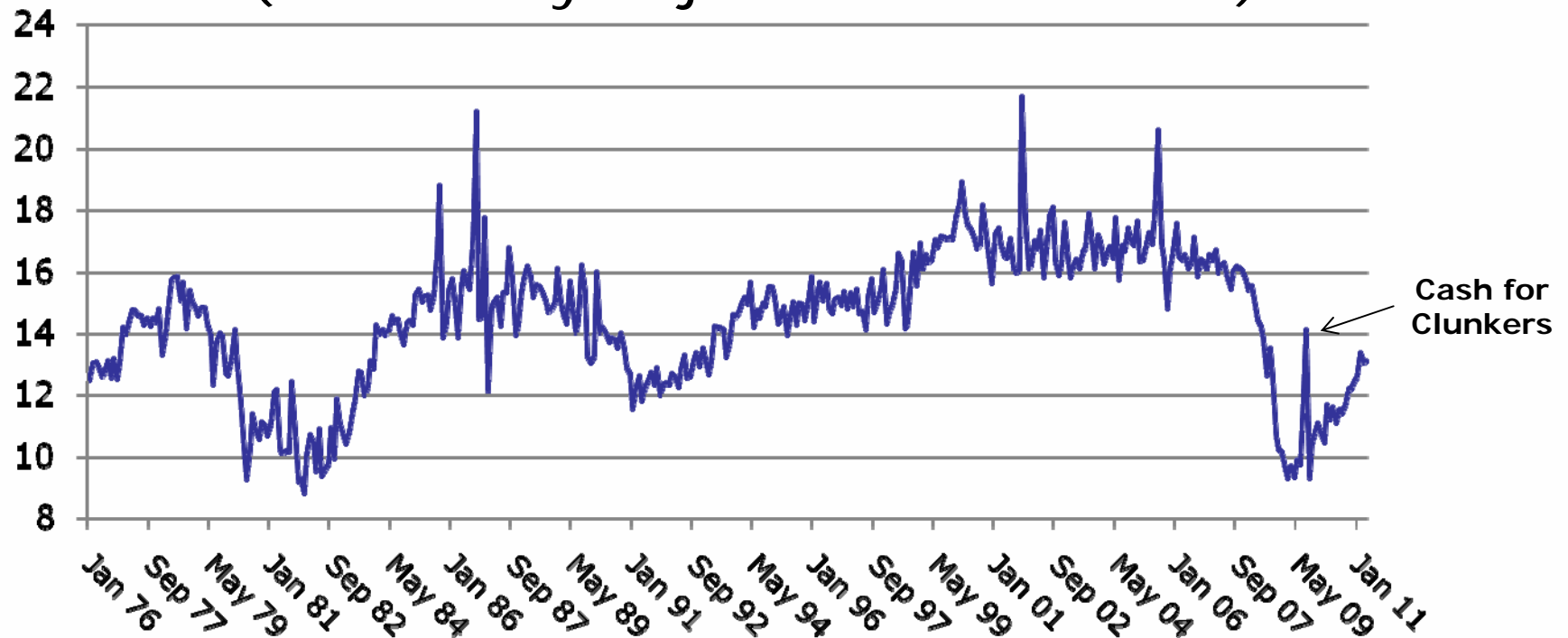
Gas Prices Have Rapidly Become Something to Worry About





Vehicle Sales Are Slowly Recovering

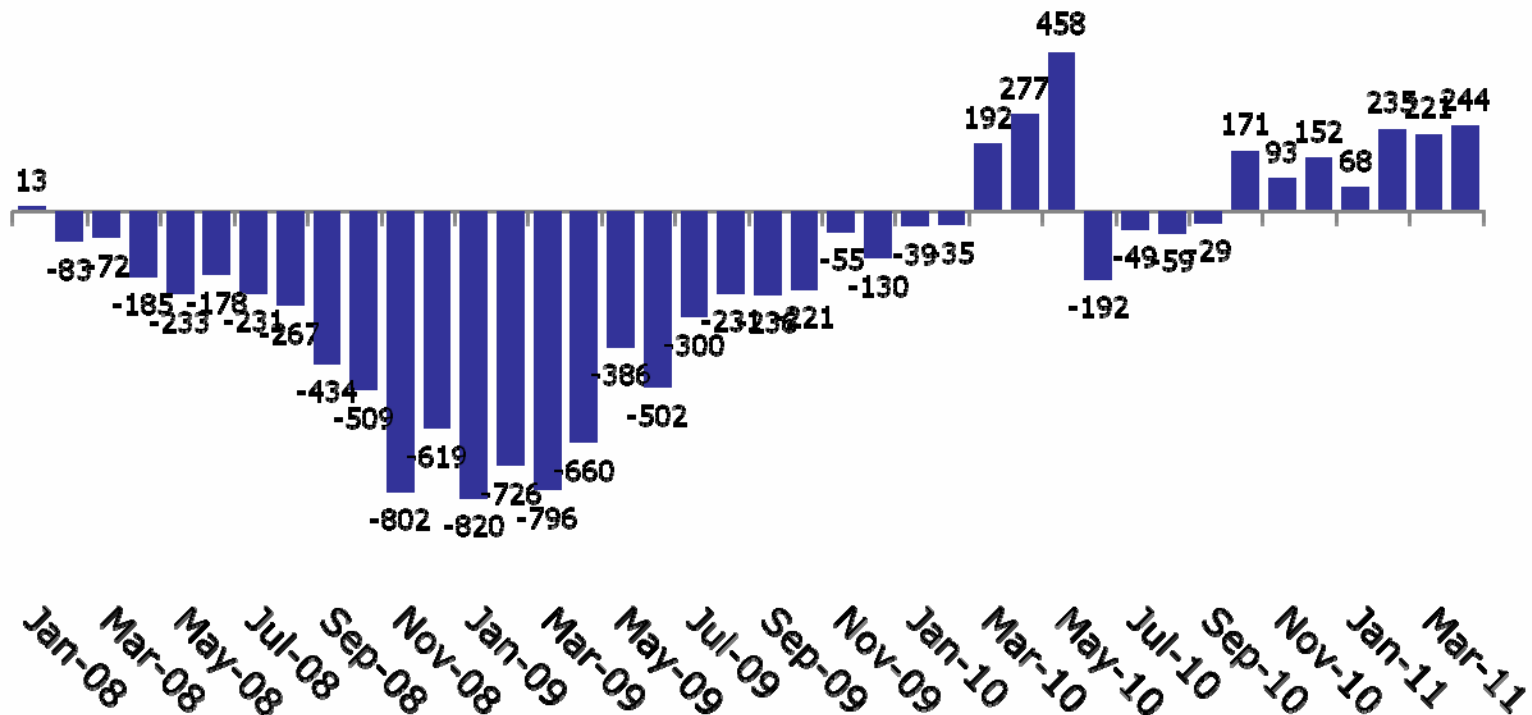
Monthly Light Vehicle Sales
(Seasonally Adjusted Annual Rate)





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

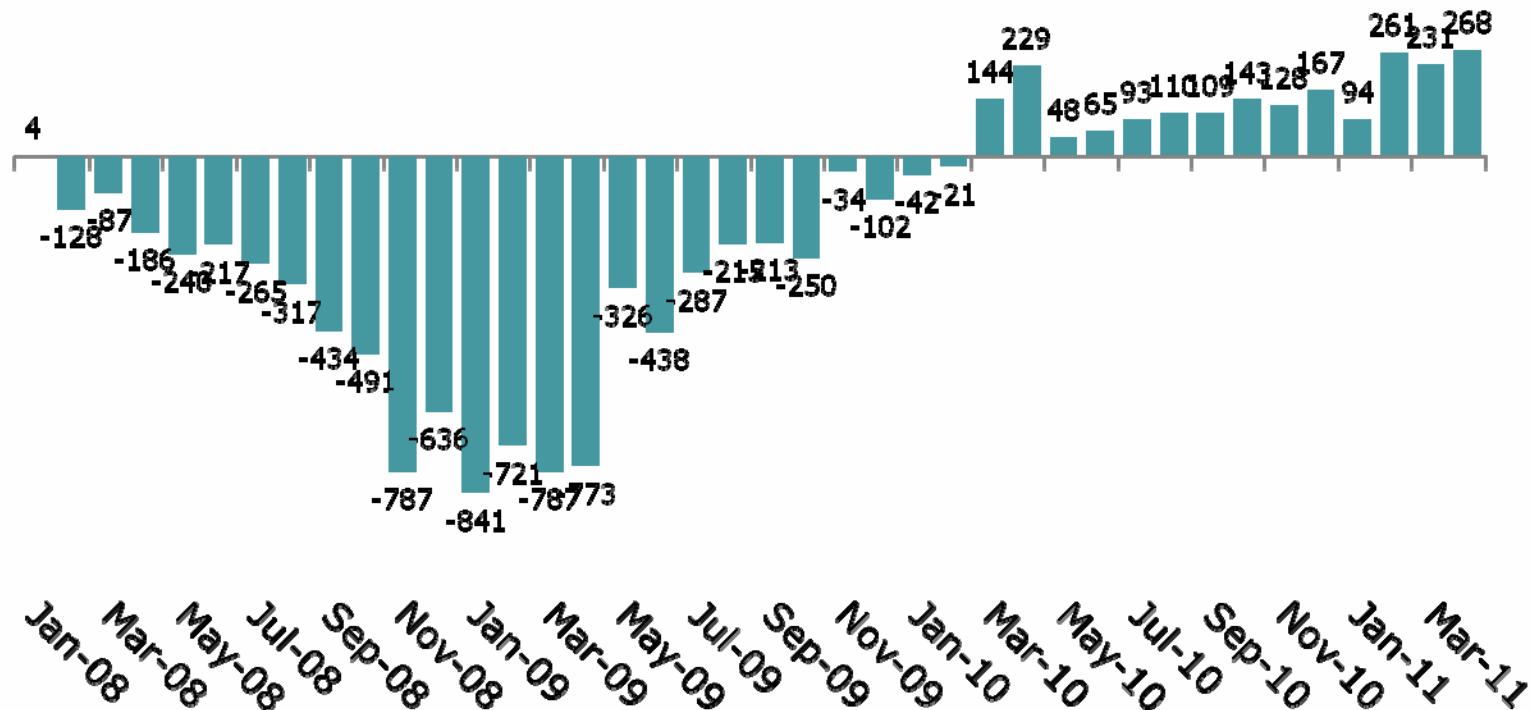
Monthly Change in Total U.S. Employment (thousands)





Employment Growth Has Been Disappointing (But Better Lately)

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





Economic Outlook

- Economic recovery is still unsteady
- Positives:
 - Employment finally growing
 - Strong stock market recovery
 - Commodity prices may be peaking
- Negatives
 - 1st 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?

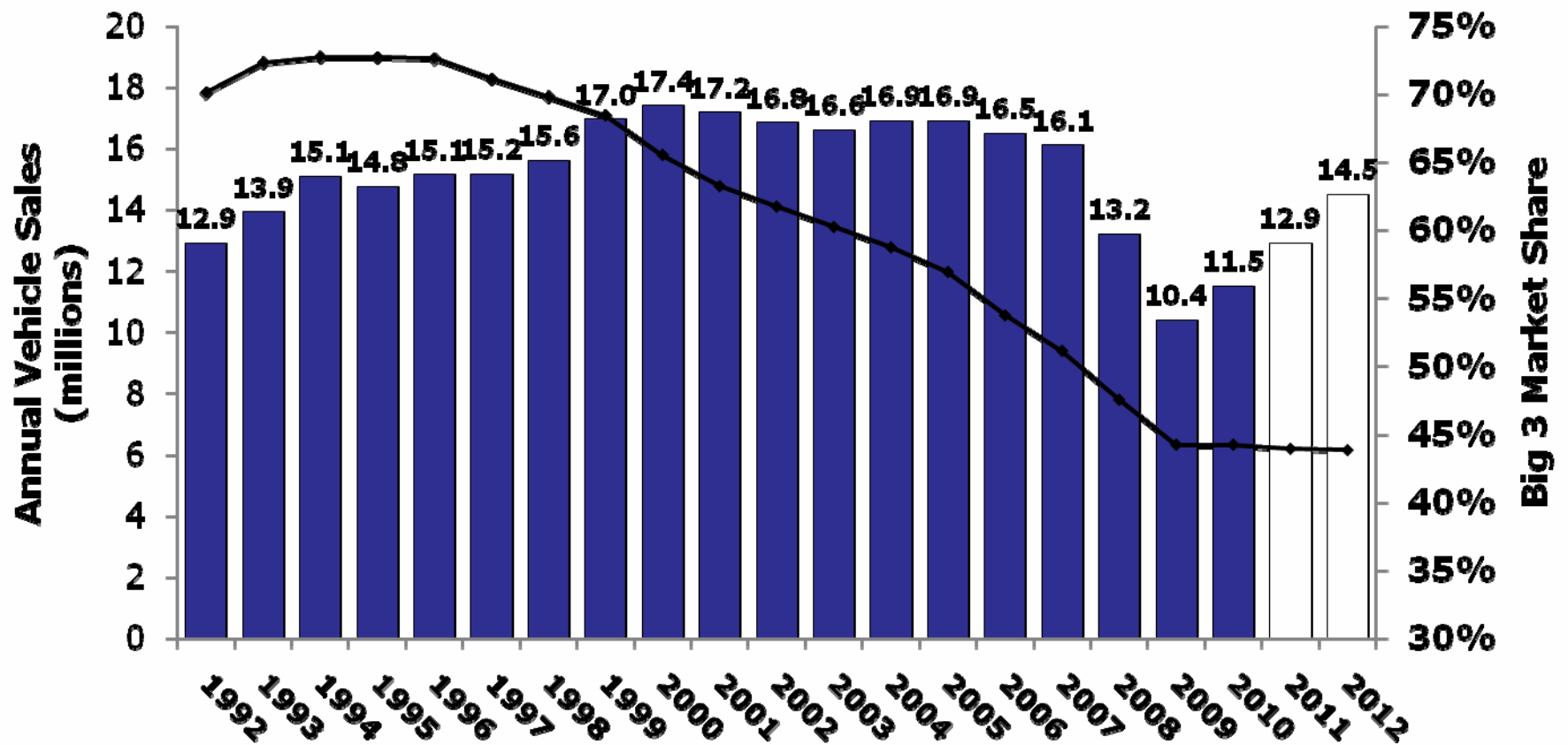


The Last Decade Was an Economic Disaster for Michigan

	<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



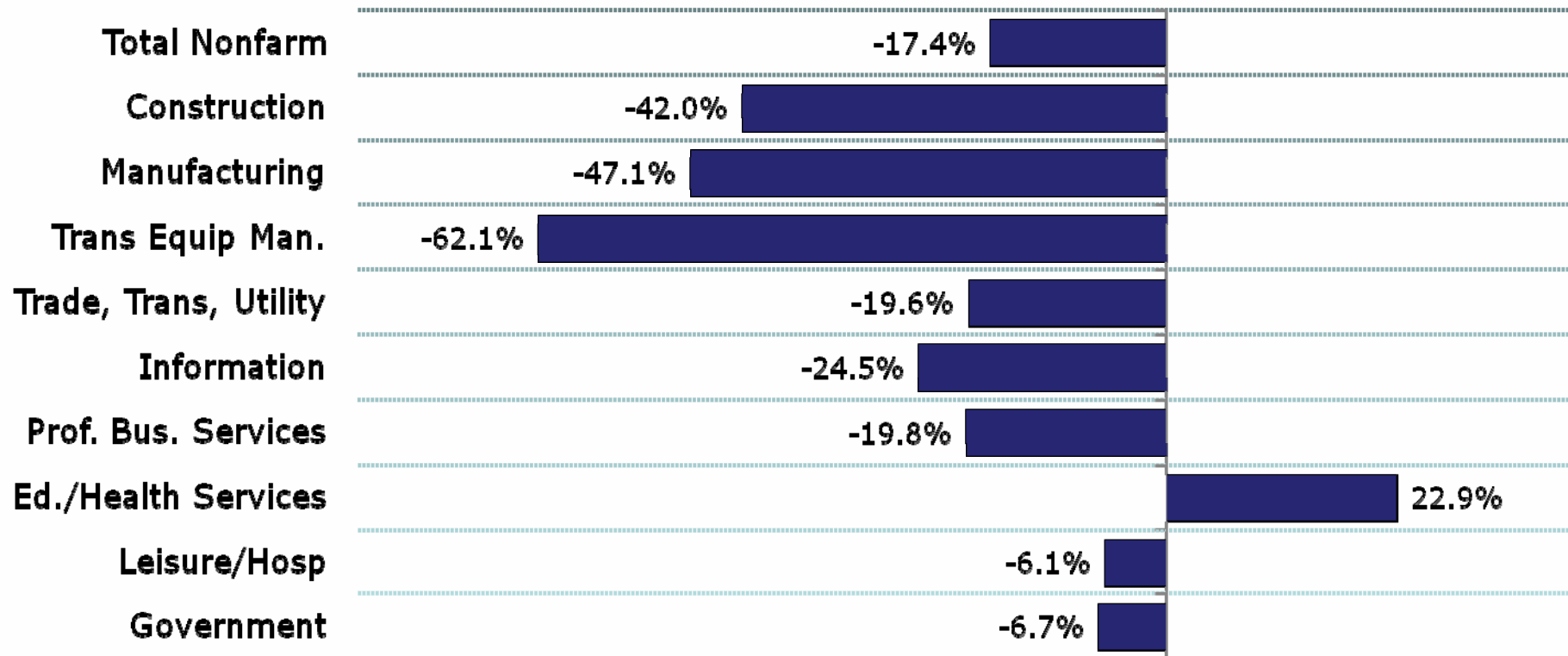
Big 3 Market Share Plummet





Almost Every Sector in Michigan Has Lost Jobs

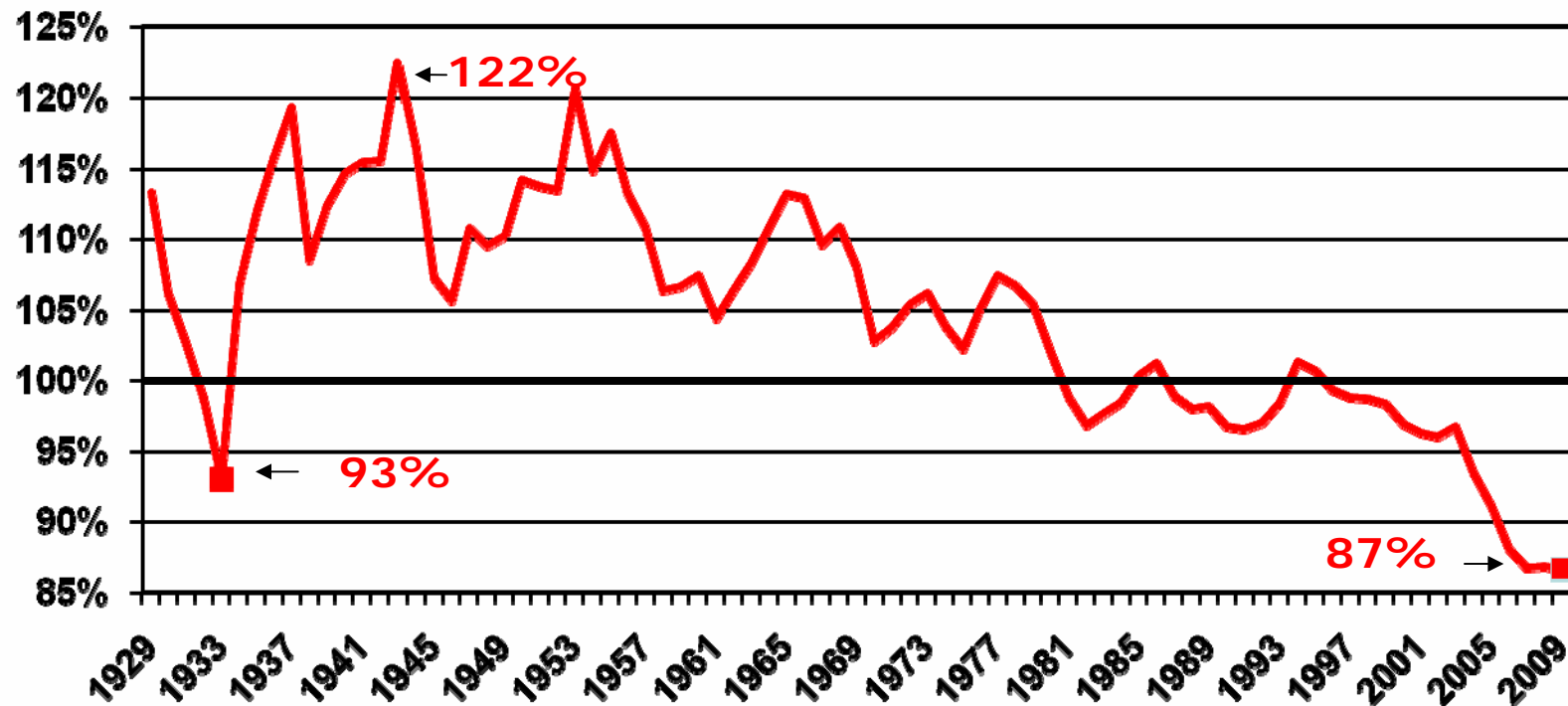
2000 to 2010





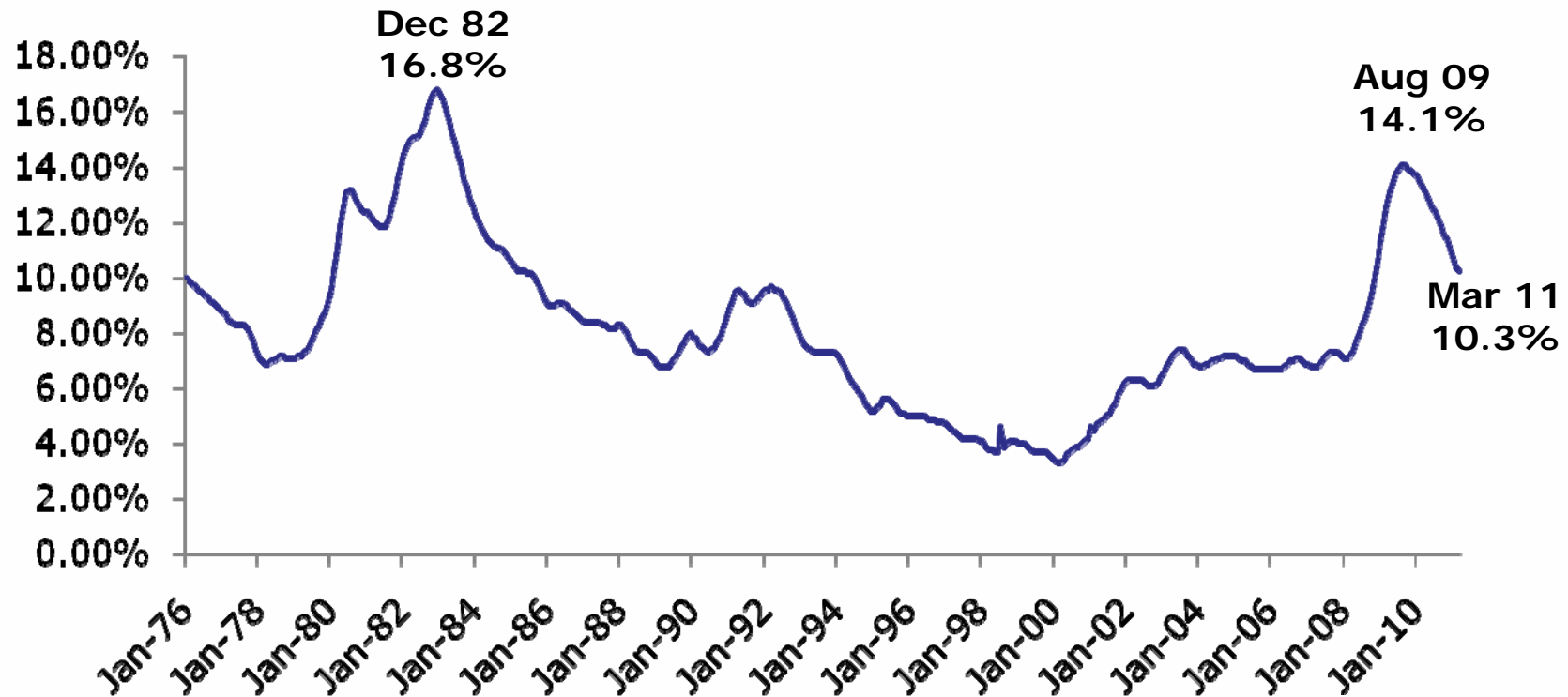
Michigan Has Become Poorer Relative to Other States

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





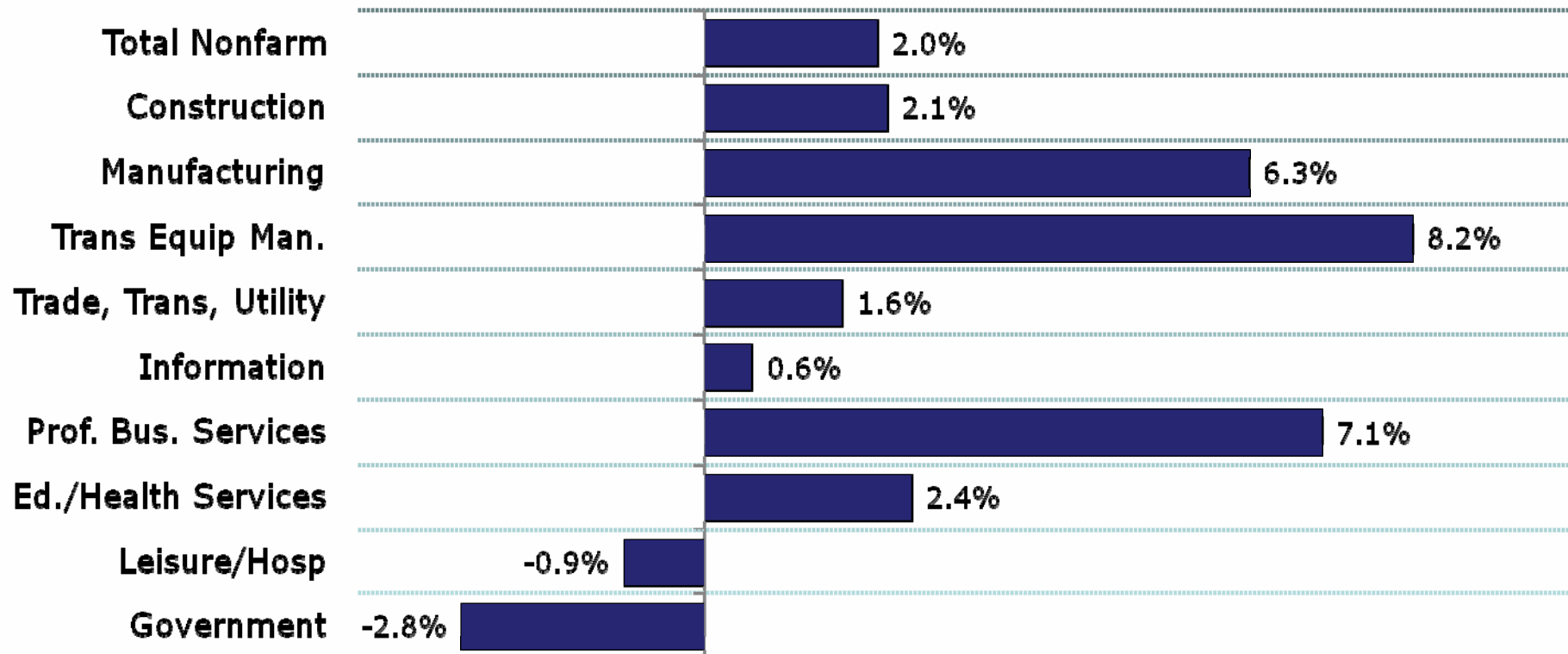
Michigan's Unemployment Rate Steadily Improving





Michigan Has Added Jobs in Last 12 Months

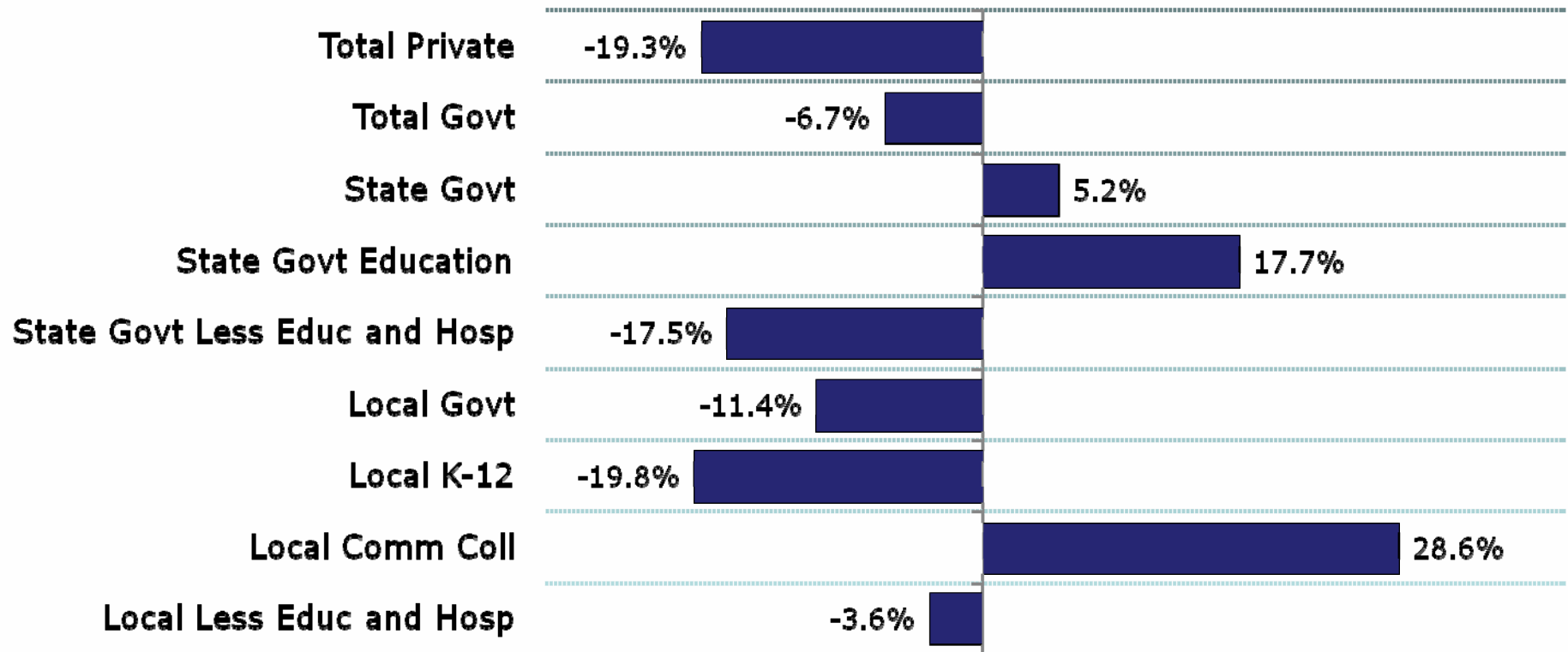
March 2010 to March 2011





Public Sector Employment Changes Vary Significantly By Sector

2000 to 2010



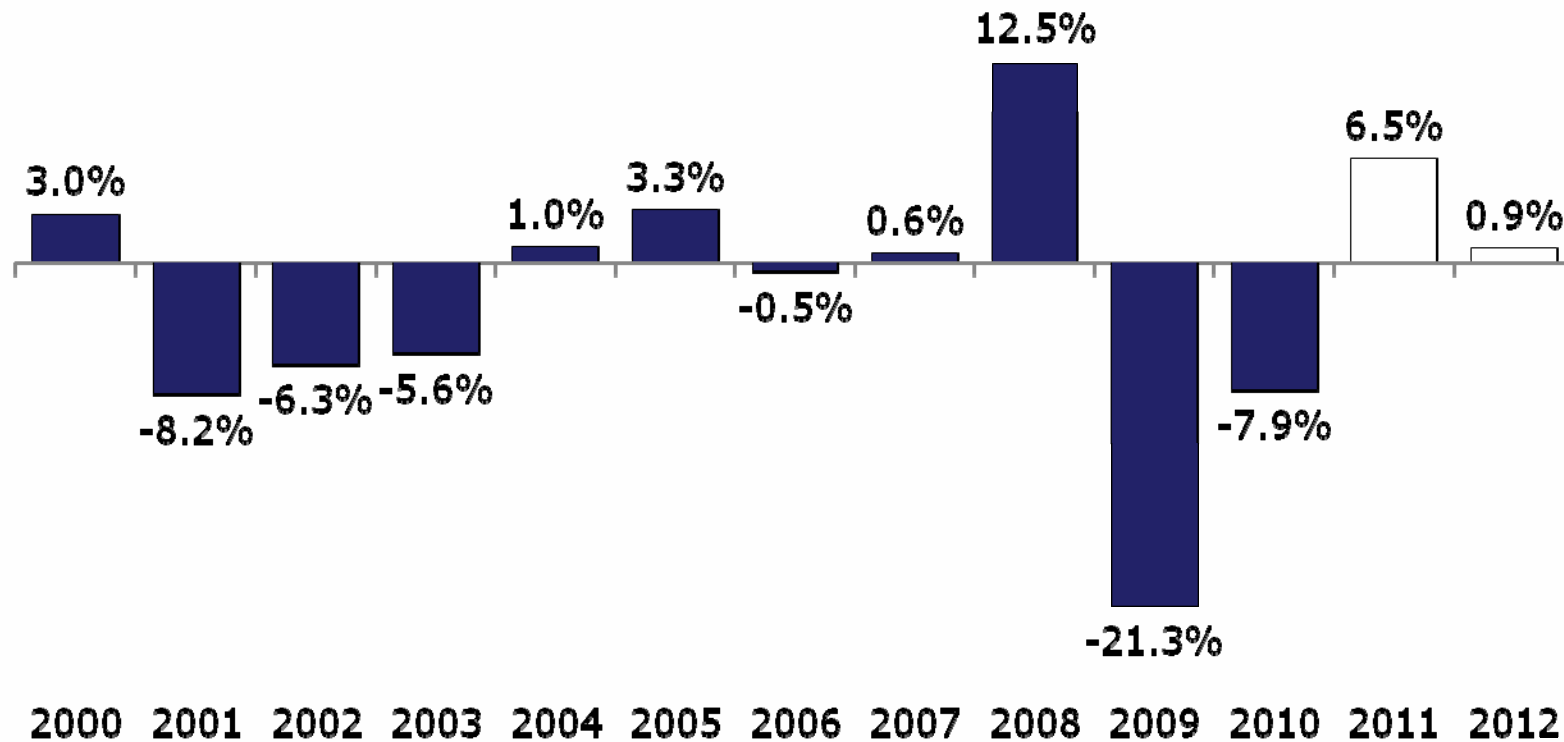


State Revenue Outlook



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

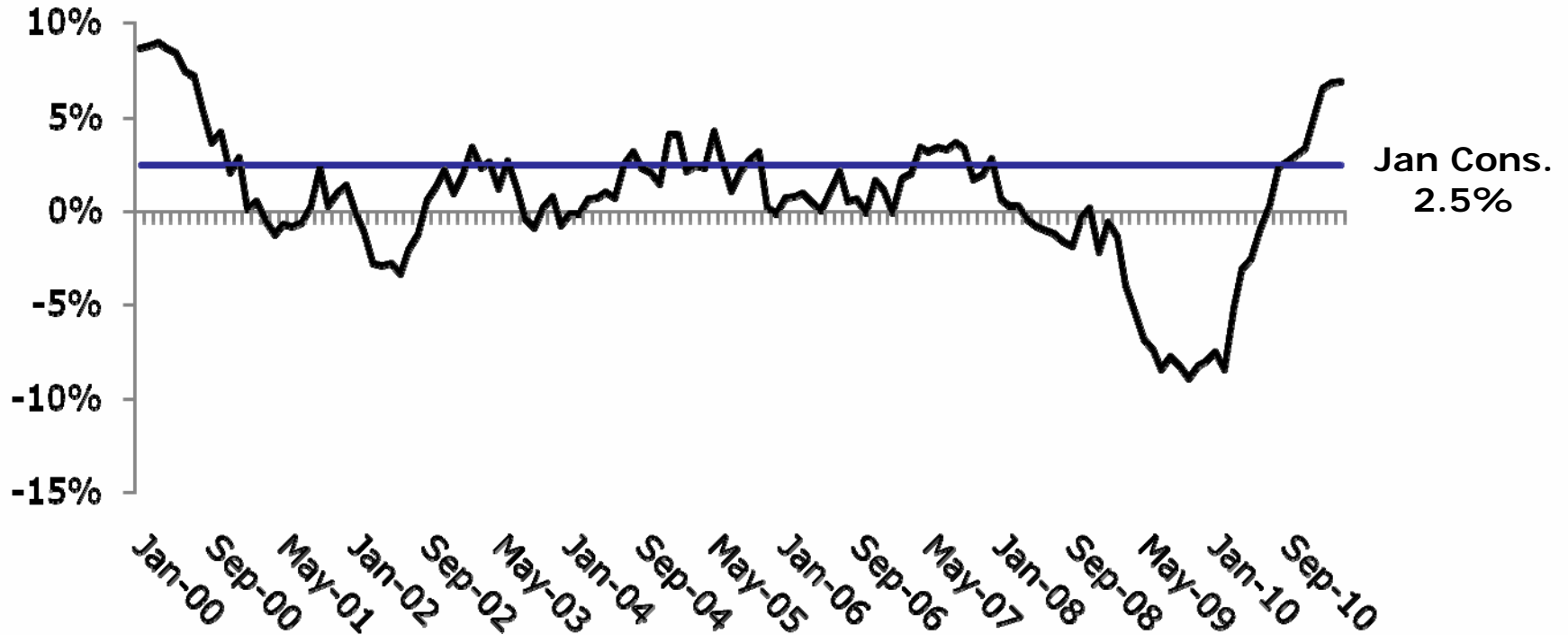
GF-GP Revenues
Year-Over-Year Pct. Change





Income Tax Withholding Growth Suggests Wages Are Growing Again

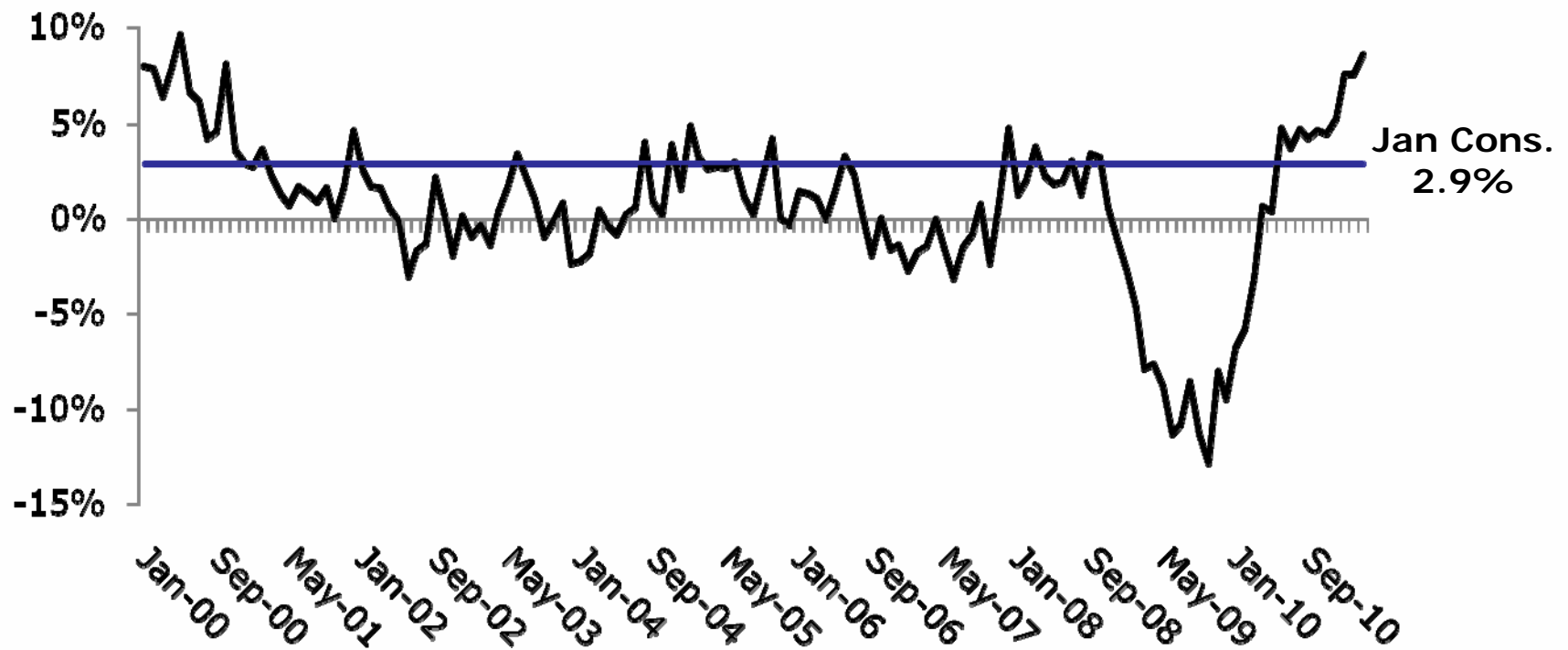
(Y-O-Y % Change 6 Month Average)





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

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





Changes to Revenue Outlook Expected in May

- Revenue forecast for FY 11 and FY 12 likely to be revised upward, perhaps significantly
- Any FY 11 revision is “one-time” revenue
- Extra revenue may be used for:
 - Restoring part of proposed cuts
 - Tax relief/reform (e.g. avoid pension increase, add business tax credits to reform proposal, etc.)
 - Addressing any shortfalls in assumed FY 11 revenues (e.g. tax amnesty & unclaimed property)
 - Address any FY 11 budget problems that arise (e.g. unemployment trust fund, Medicaid, etc.)
 - Reduce expected employee concessions
 - Deposit to BSF



Governor Snyder's Budget Proposal



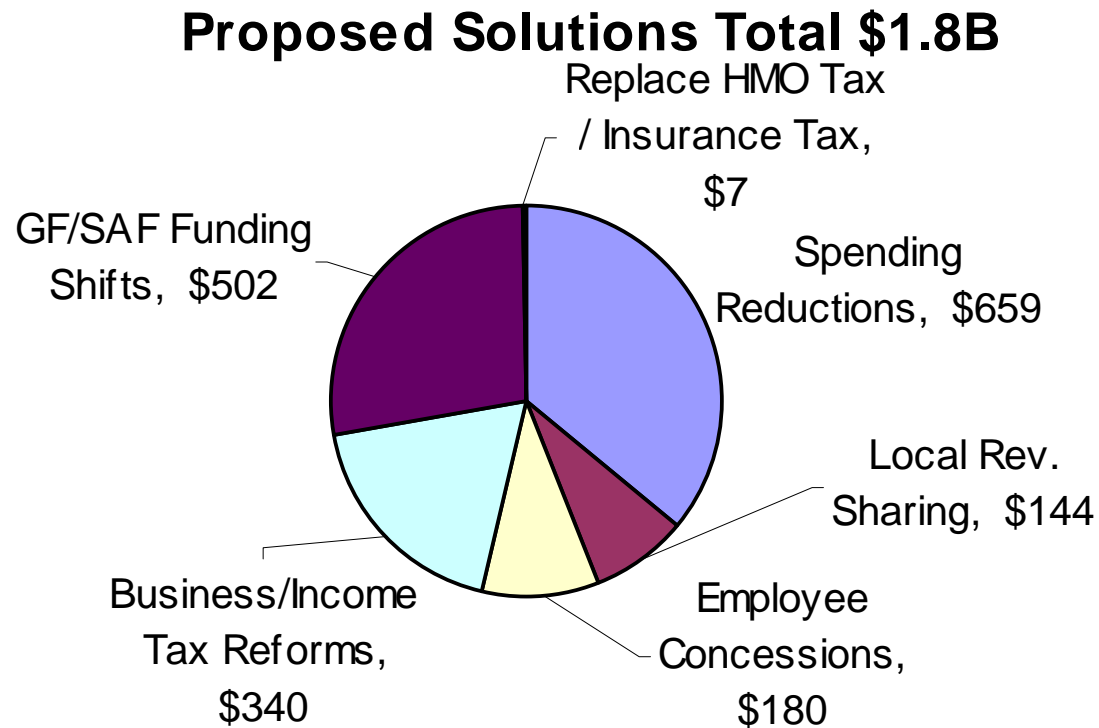
Defining the FY2012 GF Problem

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

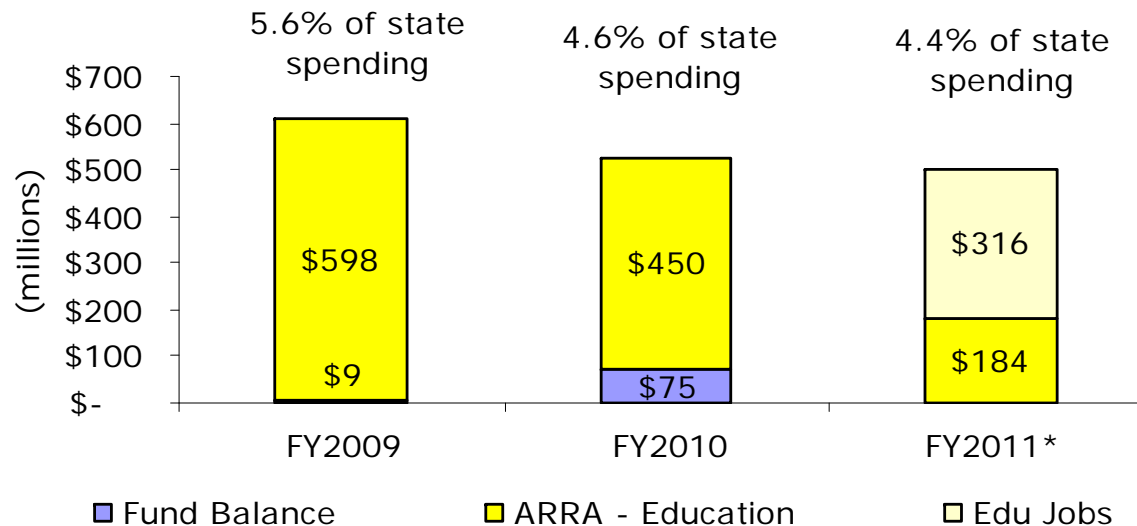


Savings Offset By \$260M in New Investments



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)

	K-12	Community Colleges	Higher Education	Total
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)

	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%)



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



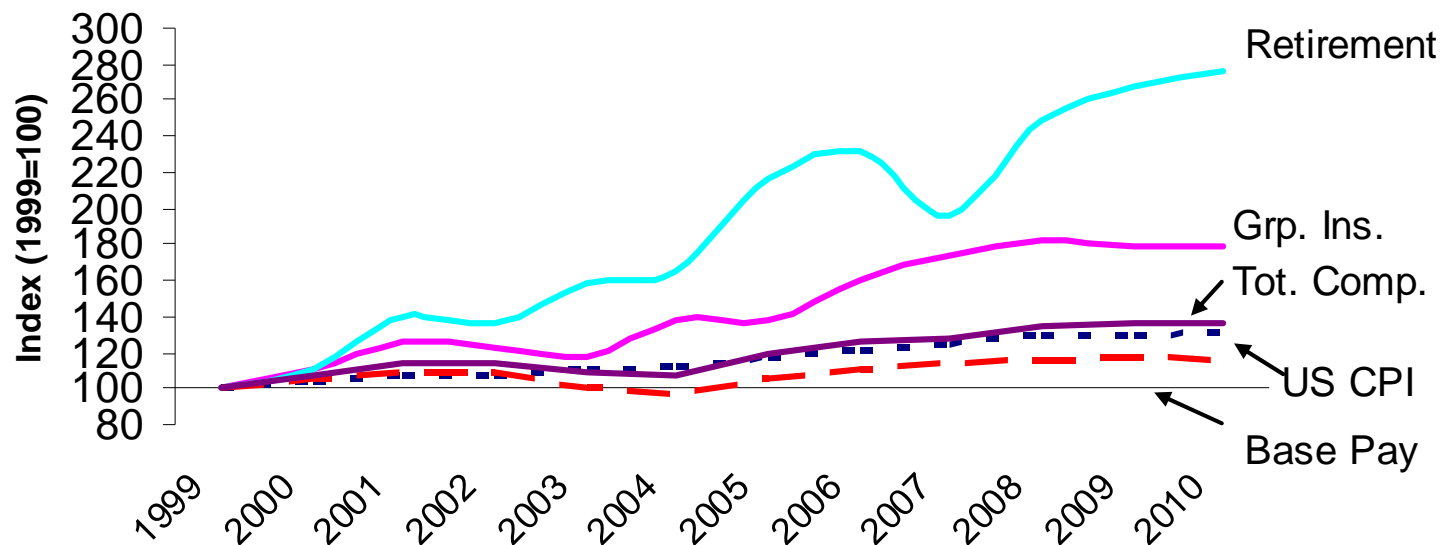
State Employee Compensation

- 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
- 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
- Lower tax burden with a \$1.7 billion cut



Income Tax Key Features

- Pause scheduled rate rollback at 4.25%
- Repeal most credits including the EITC
- Eliminate public and private pension exemption
- Phase-out personal exemption for high income taxpayers
- Net tax increase of \$1.8 billion



Summary of Tax Changes

	<u>FY 2012</u>	<u>FY 2013</u>
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	<u>\$194.8</u>	<u>\$292.7</u>
Bus. Tax Under Budget Proposal	\$1,095.0	\$292.7
Net Business Tax Cut	(\$1,075.0)	(\$1,731.3)
Income Tax Increases	<u>\$820.9</u>	<u>\$1,863.8</u>
Net Impact Proposed Changes	(\$254.1)	\$132.5 *

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



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



Where is the Tax Plan Now?

- Leadership deal would restore much of the pension exemption (taxpayers 67+ held harmless; 60 to 66 get \$20k/\$40k exemption; younger than 60 get \$20k/\$40k at 67) – will require additional budget cutting
- Homestead property tax credit scaled back (but expanded for those under \$20k income)
- EITC may be replaced with \$50 per child credit
- Talk of restoring some business tax credits



CITIZENS RESEARCH COUNCIL OF MICHIGAN

The Citizens Research Council of Michigan is supported by gifts and grants of all sizes coming from many different donors including:

- Foundations
- Businesses
- Organizations
- Individual Citizens like you

We hope you will consider supporting CRC. For more information or to donate, contact us at:

Citizens Research Council of Michigan
38777 Six Mile Road
Livonia, MI 48152

(734) 542-8001
www.crcmich.org



CRC Publications are available at:

www.crcmich.org

Providing Independent, Nonpartisan Public Policy
Research Since 1916