



Michigan's Budget and Economy: Progress and Challenges

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Outline

- Update on national economy
- Michigan economy: where we were, and where we're going now
- Michigan's budget: impact of the Great Recession on revenues and spending; where do we go now?
- Tax policy and the state budget: PPT and homestead credit
- Longer-run outlook: positive trends, but budget challenges remain



Update on National Economy



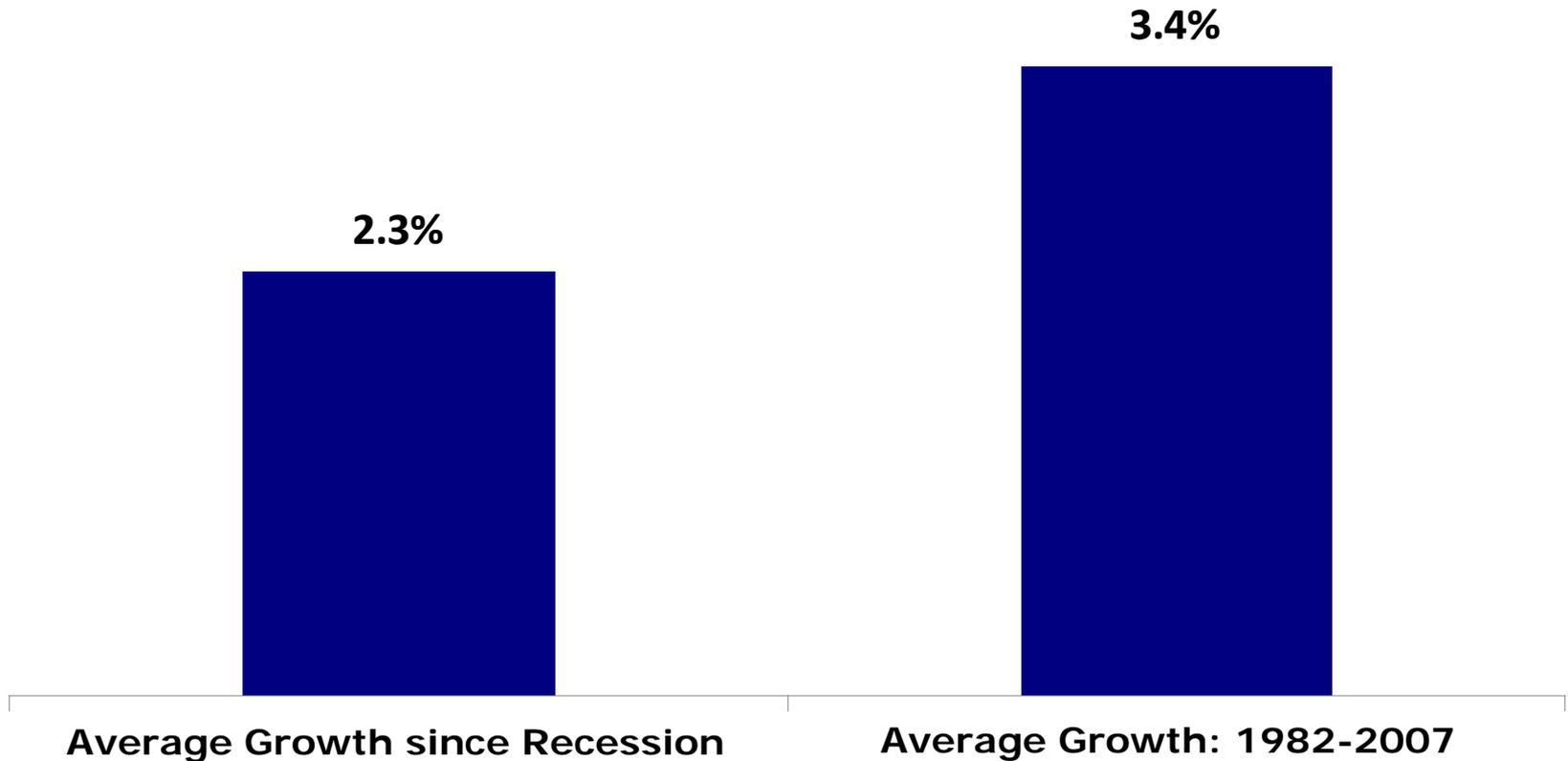
Output has Been Growing for 4 Years

Real GDP Growth





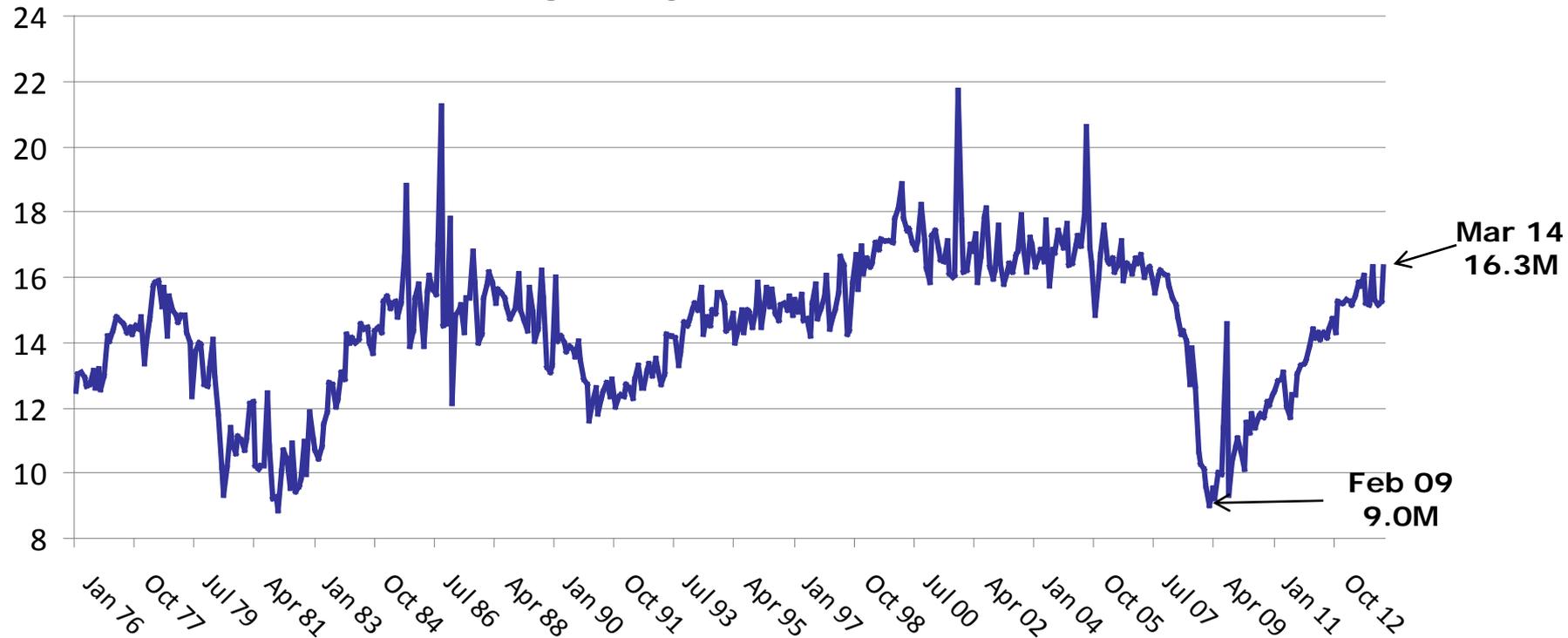
But Growth Has Been Slow





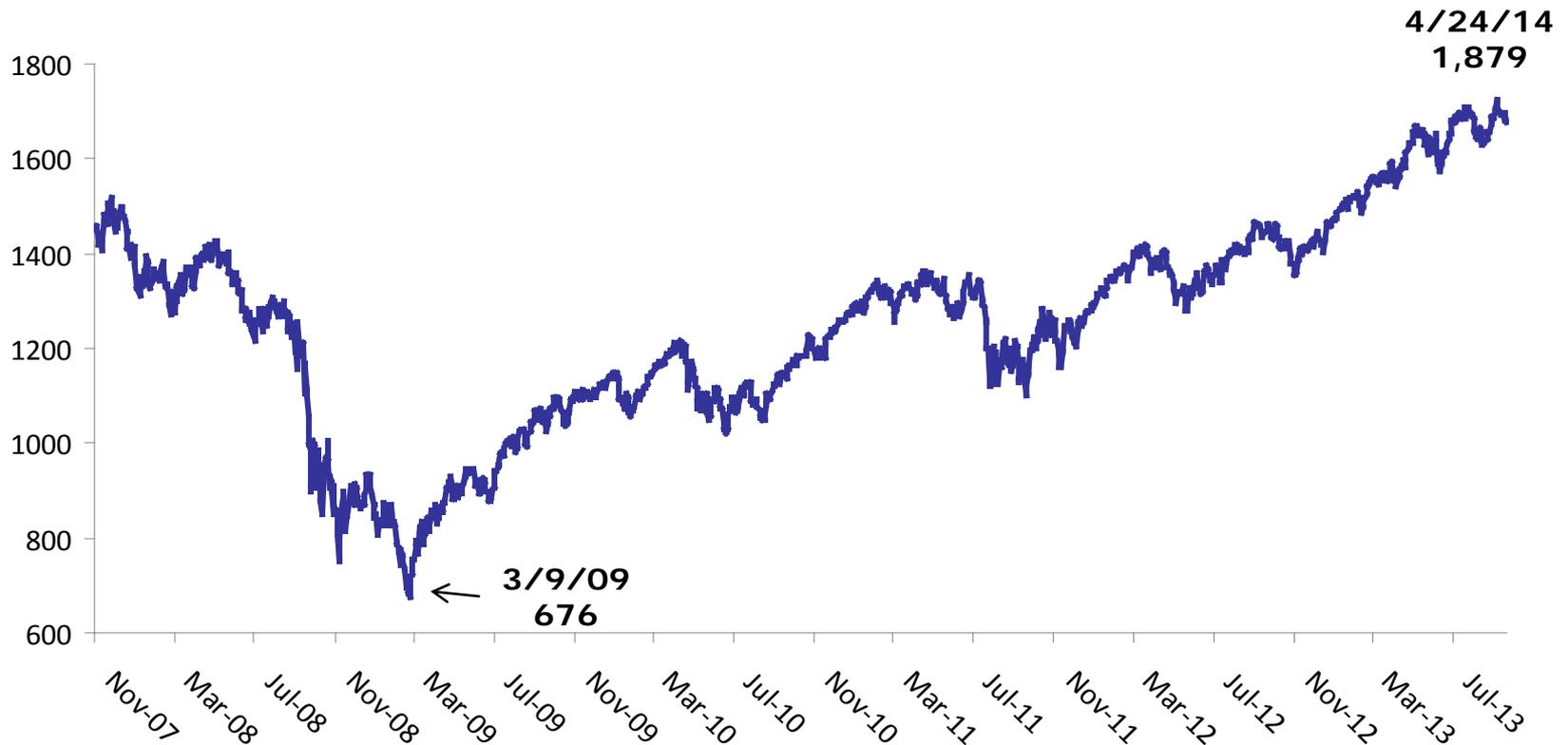
Vehicle Sales Are Back to Pre-recession Levels

Monthly Light Vehicle Sales
(Seasonally Adjusted Annual Rate)





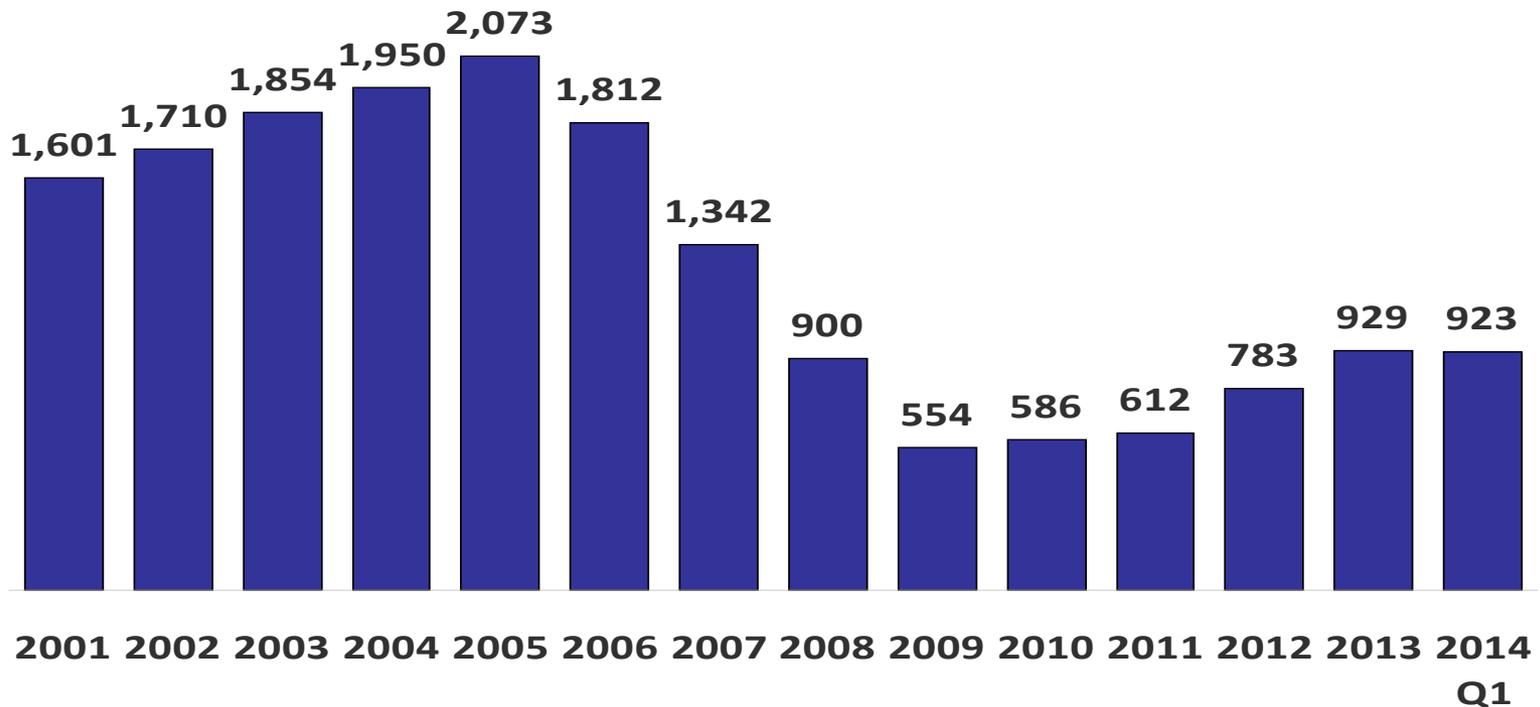
S&P 500 Up 178% From March 09 Low





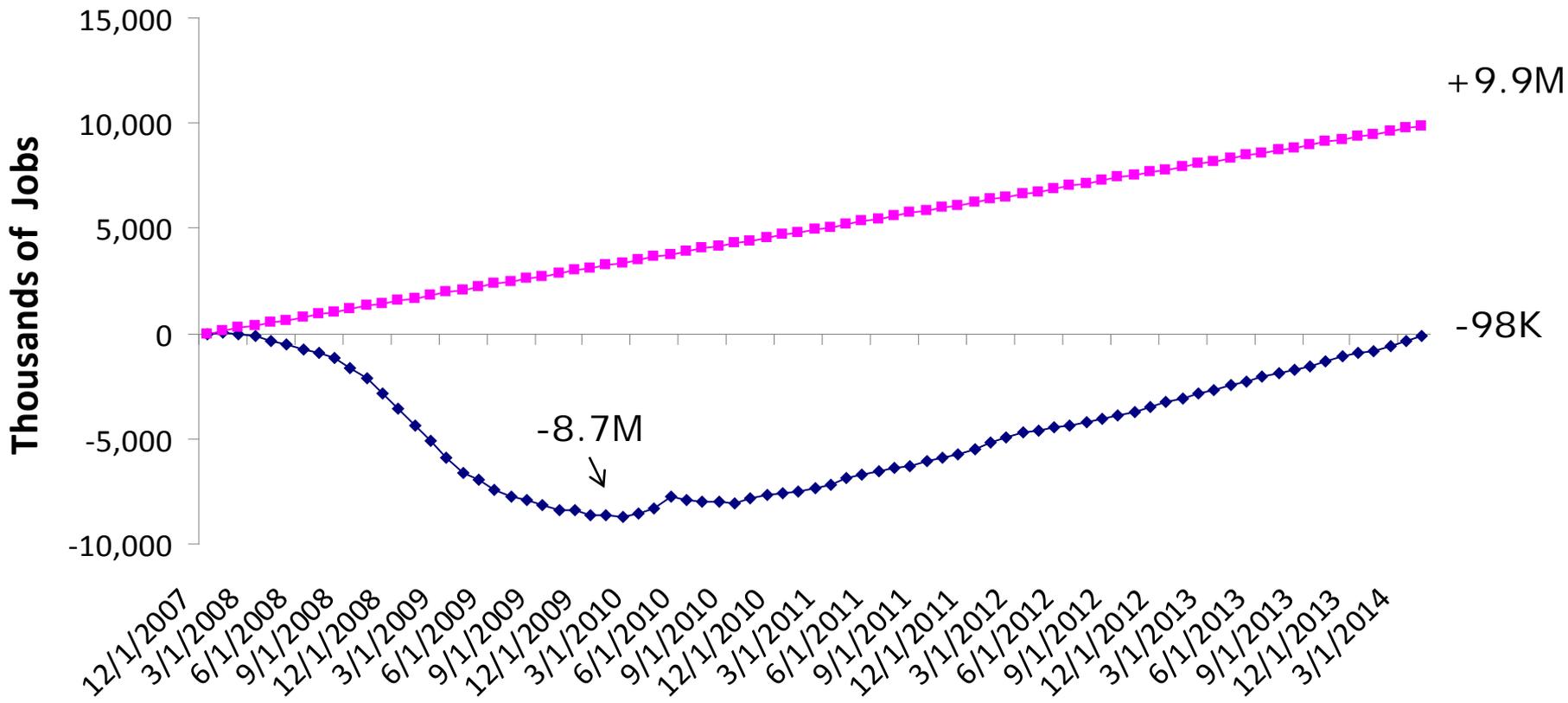
Housing Starts Begin to Recover But Have a Long Way to Go

Total New Privately Owned Houses Started (000s)





Employment Growing with Labor Force But Not Regaining Lost Jobs

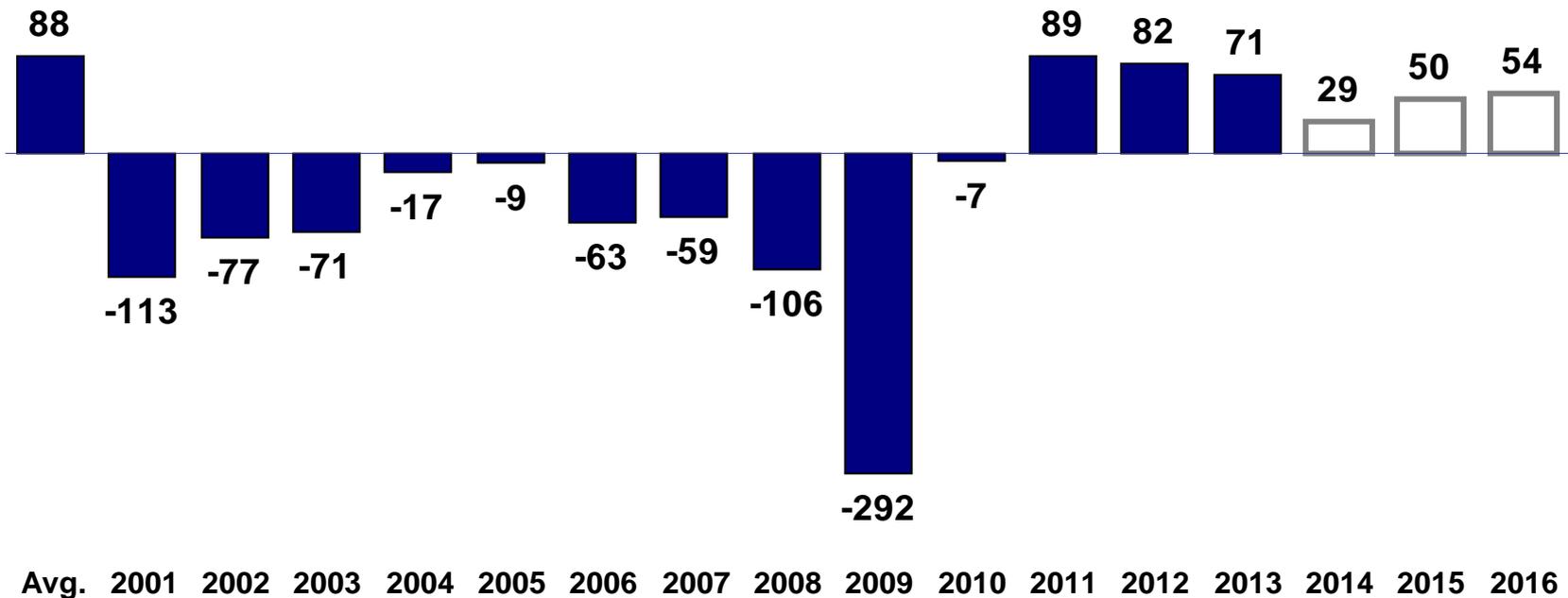




Michigan's Economy: Climbing Out of the Great Recession

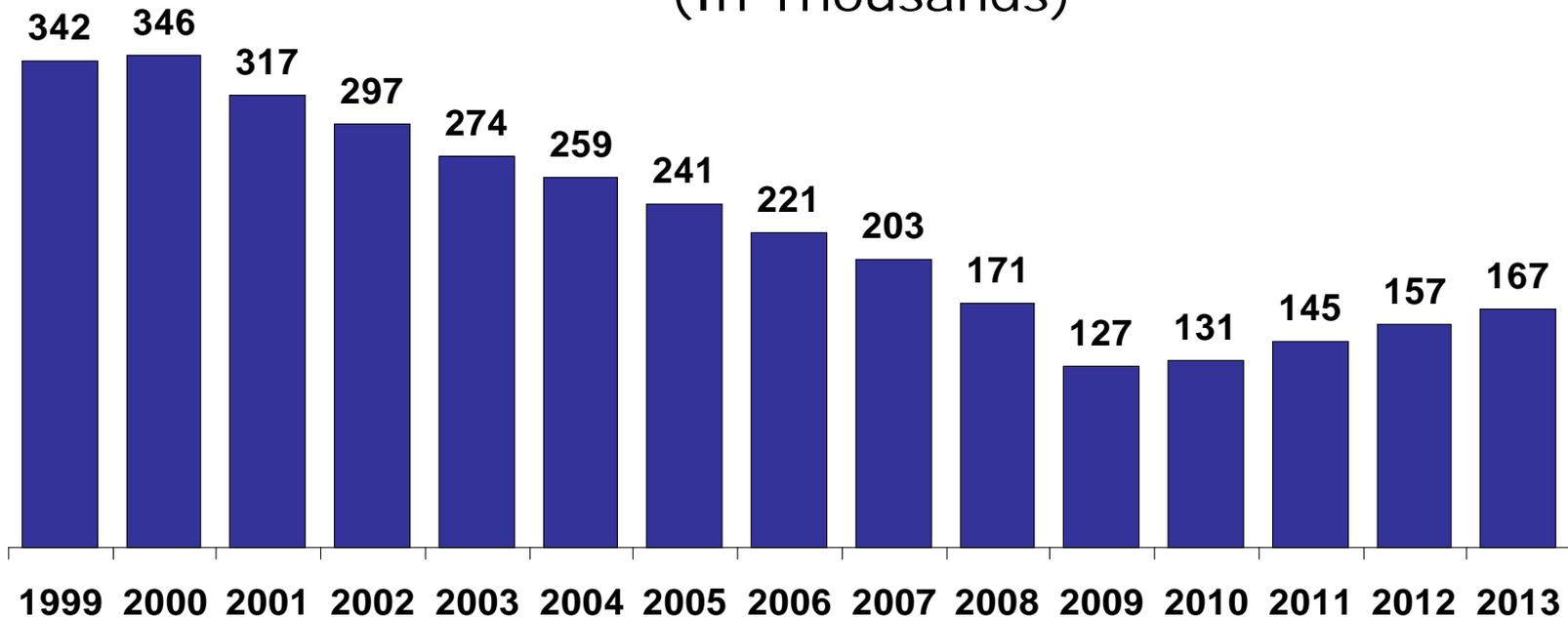


Solid Job Growth Forecast For Michigan



After Tremendous Decline Vehicle Employment is Growing

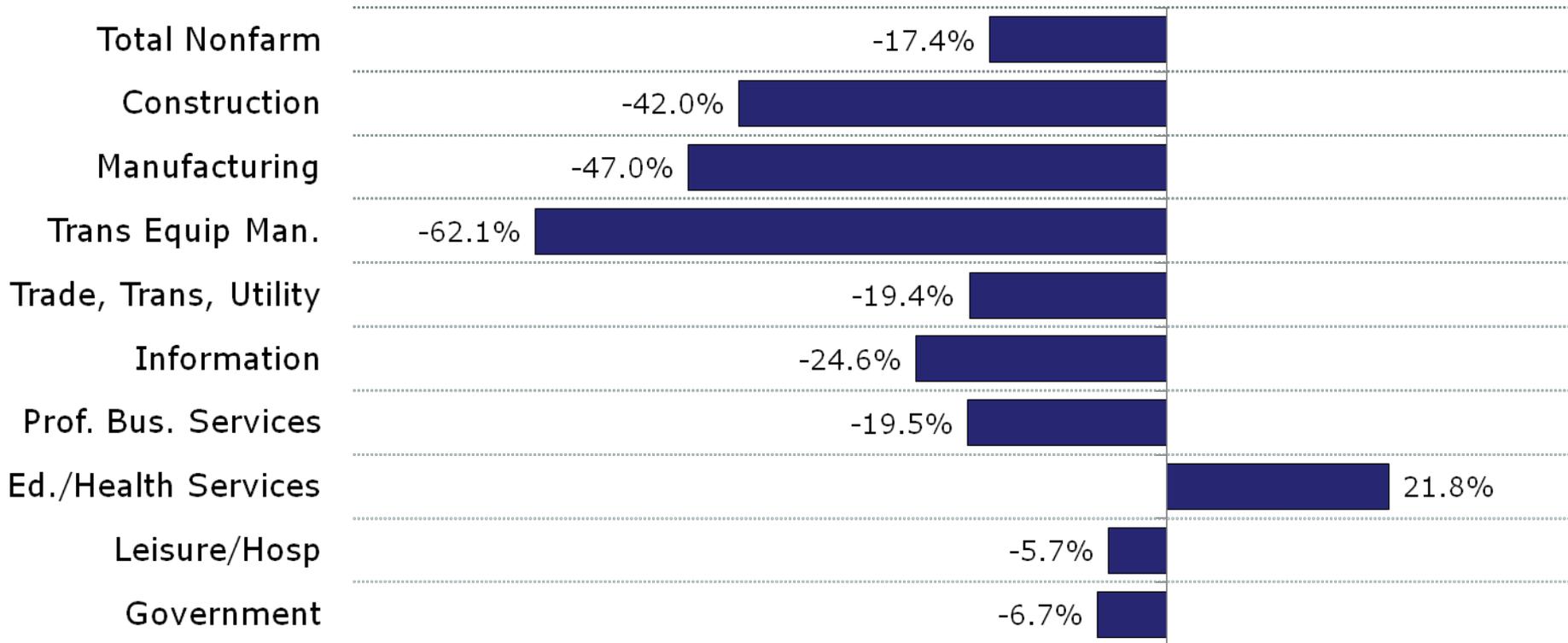
Michigan Transportation Equipment Employment
(In Thousands)





Almost Every Sector in Michigan Lost Jobs in Michigan's Lost Decade

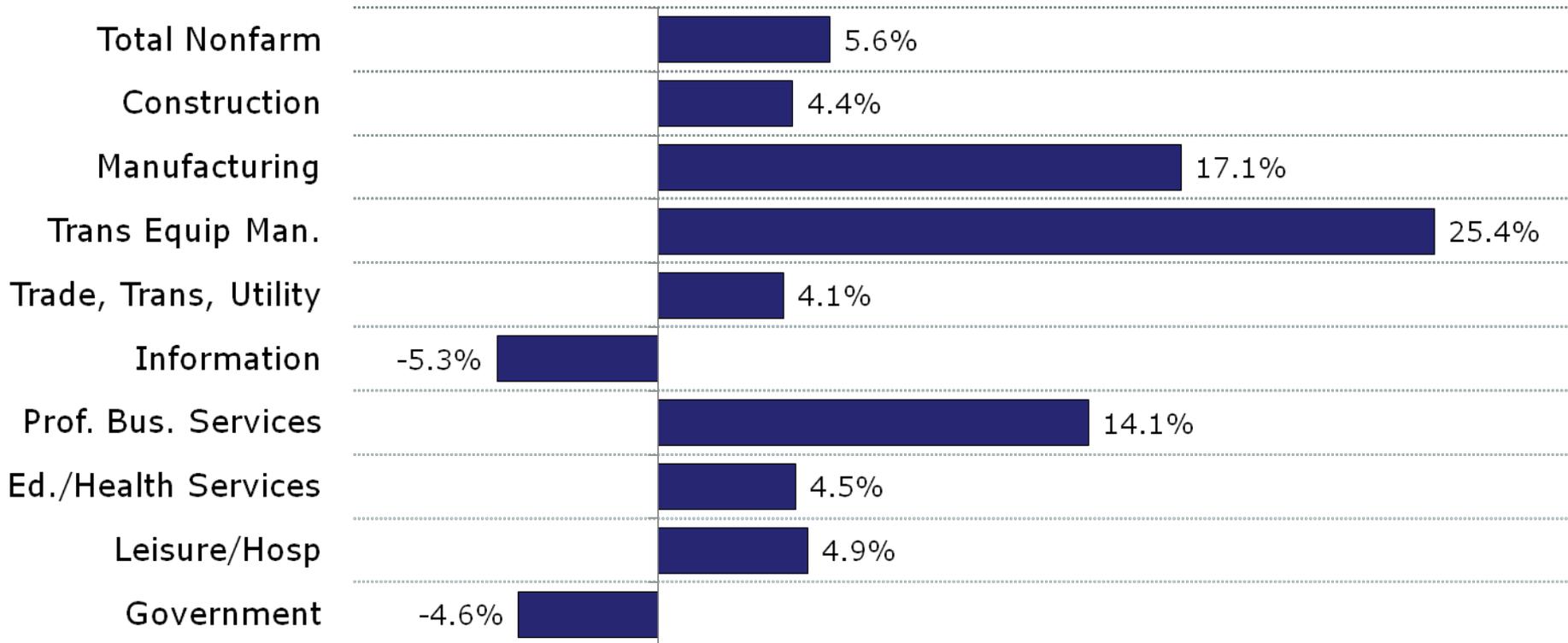
2000 to 2010





Michigan Has Added Jobs Over Past 3 Years

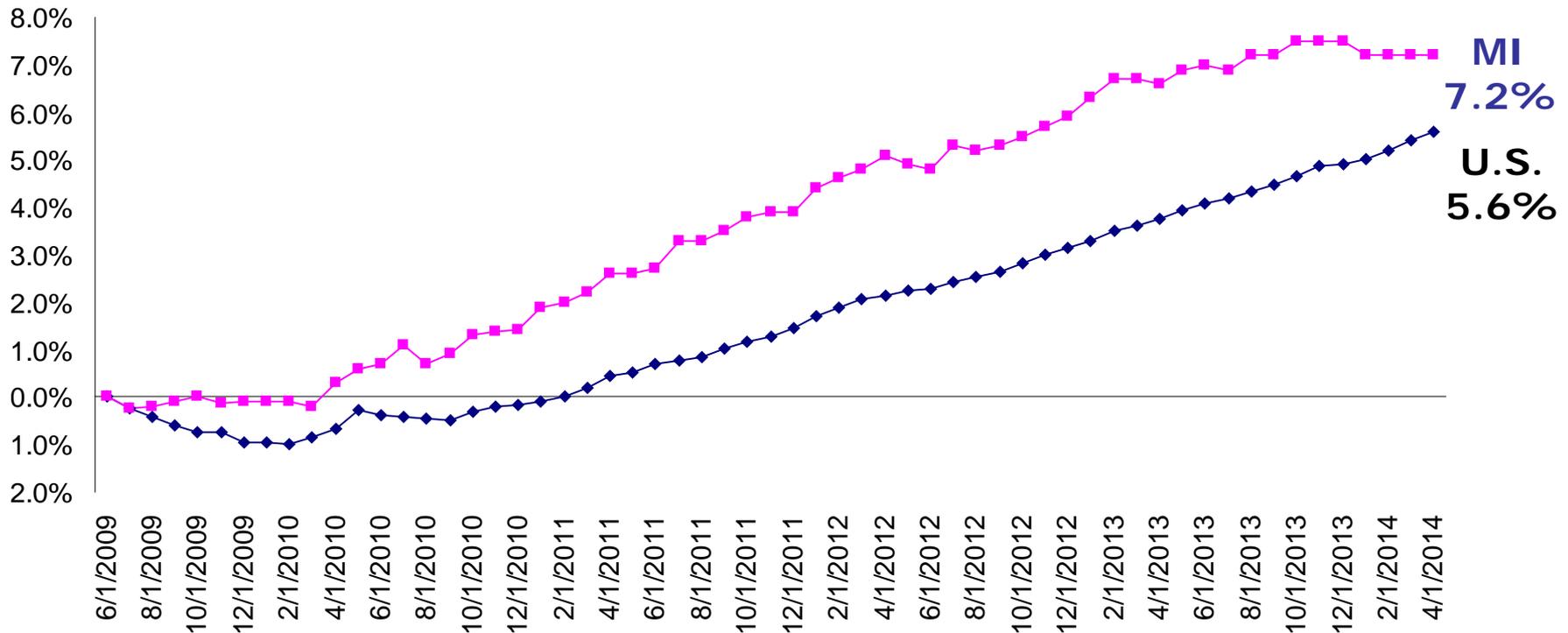
2010 to 2013





Michigan Employment Has Grown Faster Than U.S. Since Recession End

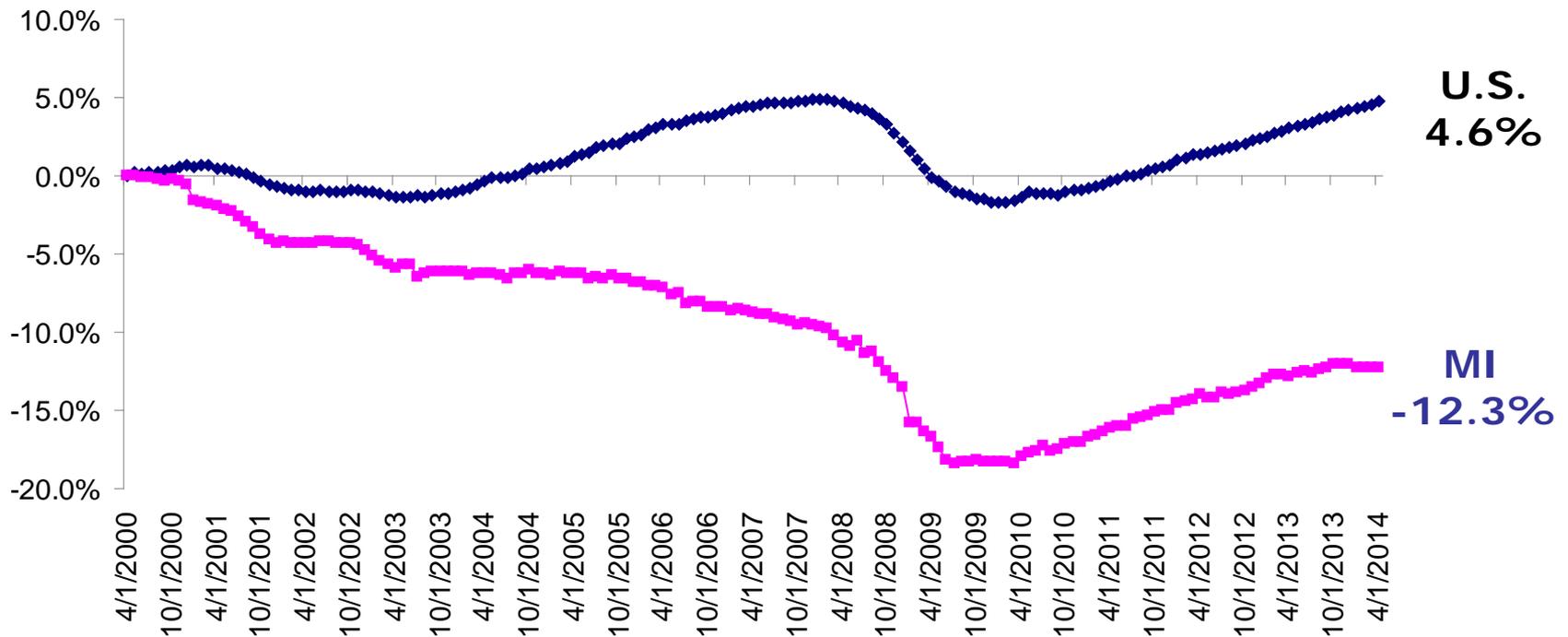
Cumulative Change in Employment Since June 2009





Going Back to 2000 Michigan Trails U.S. By a Wide Margin

Cumulative Change in Employment Since April 2000



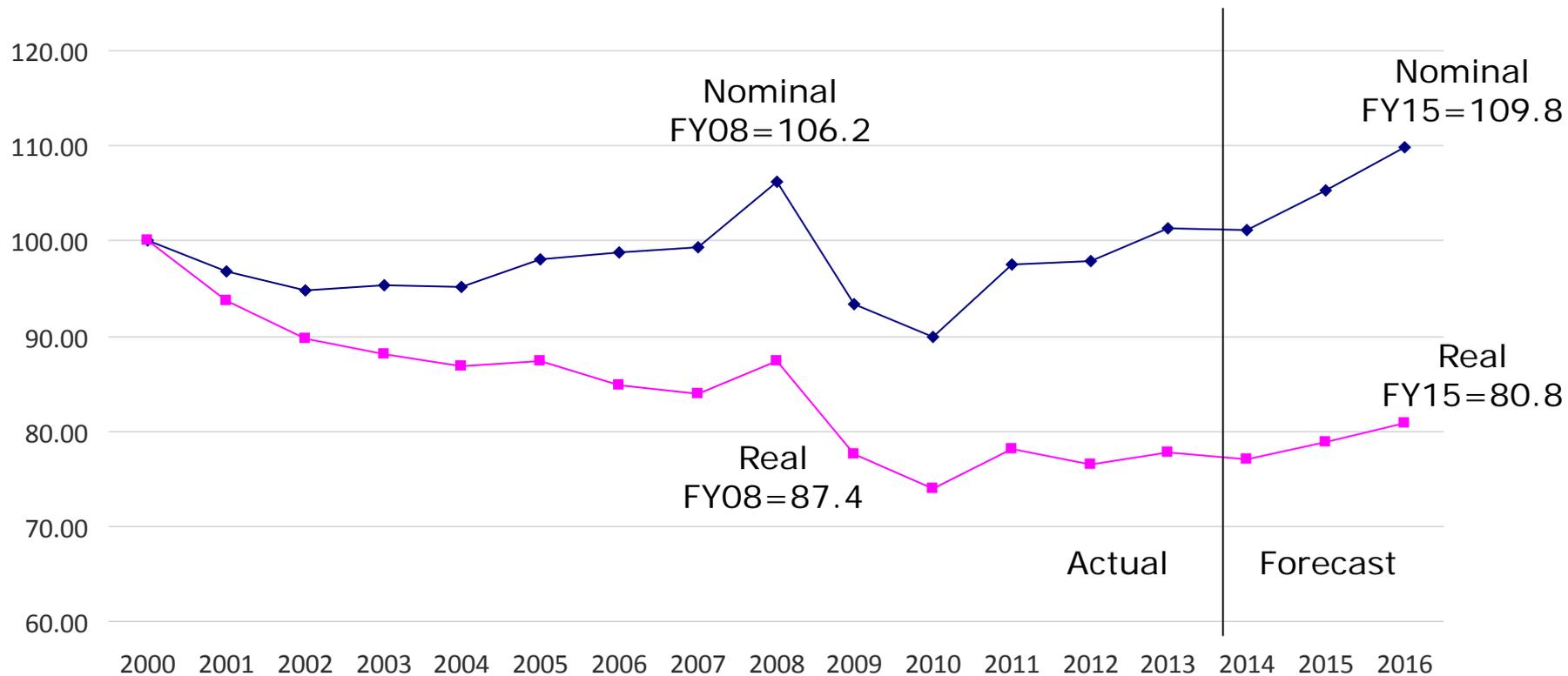


Michigan's Budget Picture: Impact and Aftermath of Recession



Nominal Revenues Back at 08 Level But Real Revenues Still Down

Combined GF/SAF Revenues (2000 = 100)





The Economists Giveth... and the Economists Taketh Away

January 2014 Revenue Projections: Gains from May 2013 Forecast

	<u>FY2013</u>	<u>FY2014</u>	<u>FY2015</u>	<u>Total Gain</u>
GF/GP	\$373.6	\$126.3	\$206.2	\$706.1
Percent Change	4.1%	1.3%	2.1%	
SAF	\$56.0	\$89.9	\$119.1	\$265.0
Percent Change	0.5%	0.8%	1.0%	
	Combined Gain:			\$971.1

May 2014 Revenue Projections: Losses from January 2014 Forecast

	<u>FY2013</u>	<u>FY2014</u>	<u>FY2015</u>	<u>FY2016</u>	<u>Total Gain</u>
GF/GP		(\$253.2)	(\$220.5)	(\$290.3)	(\$764.0)
Percent Change		-2.6%	-2.2%	-2.8%	
SAF		(\$63.7)	(\$78.5)	(\$80.1)	(\$222.3)
Percent Change		-0.6%	-0.7%	-0.6%	
		Combined Loss:			(\$986.3)

Revenues Going Forward

Uncertainty with Regard to Business Tax Revenue

- Michigan Business Tax credits: When will outstanding “certificated credits” get cashed in?
 - FY2013: Expected \$490M outflow; actual was \$75M
 - Will FY2013 credits be claimed now?
 - Or will they never be claimed?
- Corporate Officer Liability: How will new law affect revenues? Estimated at \$67M in FY2014, \$104M in FY2015
- New Corporate Income Tax: Level and stability of revenue from this new tax



Michigan Taxes Now Below Average Per Capita and as Share of Income

State and Local Taxes

Year	Per Capita			Per \$1,000 of Personal Income		
	U.S. (2011\$)	MI (2011\$)	MI as % of U.S.	U.S.	MI	MI as % of U.S.
1979	\$2,898	\$3,310	114.2%	\$100.10	\$108.50	108.4%
1989	\$3,459	\$3,631	105.0%	\$103.20	\$110.40	107.0%
1999	\$3,940	\$4,074	103.4%	\$103.10	\$108.50	105.2%
2011	\$4,295	\$3,655	85.1%	\$103.40	\$100.80	97.5%



Michigan Taxes as a Percent of Income Have Fallen Sharply

	2000			2008			2011		
	<u>State</u>	<u>Local</u>	<u>S&L</u>	<u>State</u>	<u>Local</u>	<u>S&L</u>	<u>State</u>	<u>Local</u>	<u>S&L</u>
Income	3.3%	0.2%	3.5%	2.0%	0.1%	2.1%	2.0%	0.1%	2.1%
Sales	2.6%	0.0%	2.6%	2.7%	0.0%	2.7%	2.7%	0.0%	2.7%
Property	0.6%	2.7%	3.3%	0.7%	3.7%	3.4%	0.5%	3.3%	3.8%
Other	1.3%	0.1%	1.4%	1.5%	0.1%	2.6%	1.4%	0.1%	1.5%
Total	7.8%	3.0%	10.8%	6.9%	4.0%	10.7%	6.6%	3.5%	10.1%

Current Budget Situation

- After decade of budget constraints, available fund balances coming into FY2015 and the promise of healthy revenue growth in future years
- Stability shifts decision-making from “how to cut” to “how to spend”
 - Restore previous budget cuts?
 - Revise budget priorities with new programs?
 - Save dollars today for future “rainy days”?
 - Reduce revenues through tax reductions?
- Retirement legacy costs are still an issue, but state close to clearing the hurdle caused by 2008 financial crisis
- Challenges remain, including a permanent solution to the state’s road funding issues



Governor's Proposal

Large Fund Balances Drawn Down During FY2015

	GF/GP		School Aid Fund	
	<u>FY2015</u>	<u>FY2016</u>	<u>FY2015</u>	<u>FY2016</u>
Beginning Balance	\$666.9	\$41.2	\$351.6	\$84.2
<u>Revenues</u>				
Consensus Revenue Estimates	\$10,046.5	\$10,535.6	\$11,931.8	\$12,338.2
Revenue Sharing Adjustment	(\$488.0)	(\$459.2)		
Tax Reforms (PPT, Homestead Credit)	(\$102.7)	(\$144.4)	(\$10.0)	(\$20.9)
Other Revenues/Adjustments	\$4.0	\$5.0	\$2,006.2	\$1,988.2
Total Adjusted Revenues	\$9,459.8	\$9,937.0	\$13,928.0	\$14,305.5
<u>Expenditures</u>				
Ongoing Appropriations	\$9,449.0	\$9,648.2	\$13,478.8	\$13,790.7
One-Time Transportation Allocation	\$254.0			
Other One-Time Recommendations	\$140.5	\$23.3	\$268.5	
BSF/Health Savings/MPERS deposits	\$242.0	\$122.0	\$50.0	
SAF: Higher Education			\$398.1	\$398.1
Total Expenditures	\$10,085.5	\$9,793.5	\$14,195.4	\$14,188.8
Ending Balance	\$41.2	\$184.7	\$84.2	\$200.9

All figures in millions

Note: Balance estimates as of February release of Governor's budget proposal based on January revenue estimates.



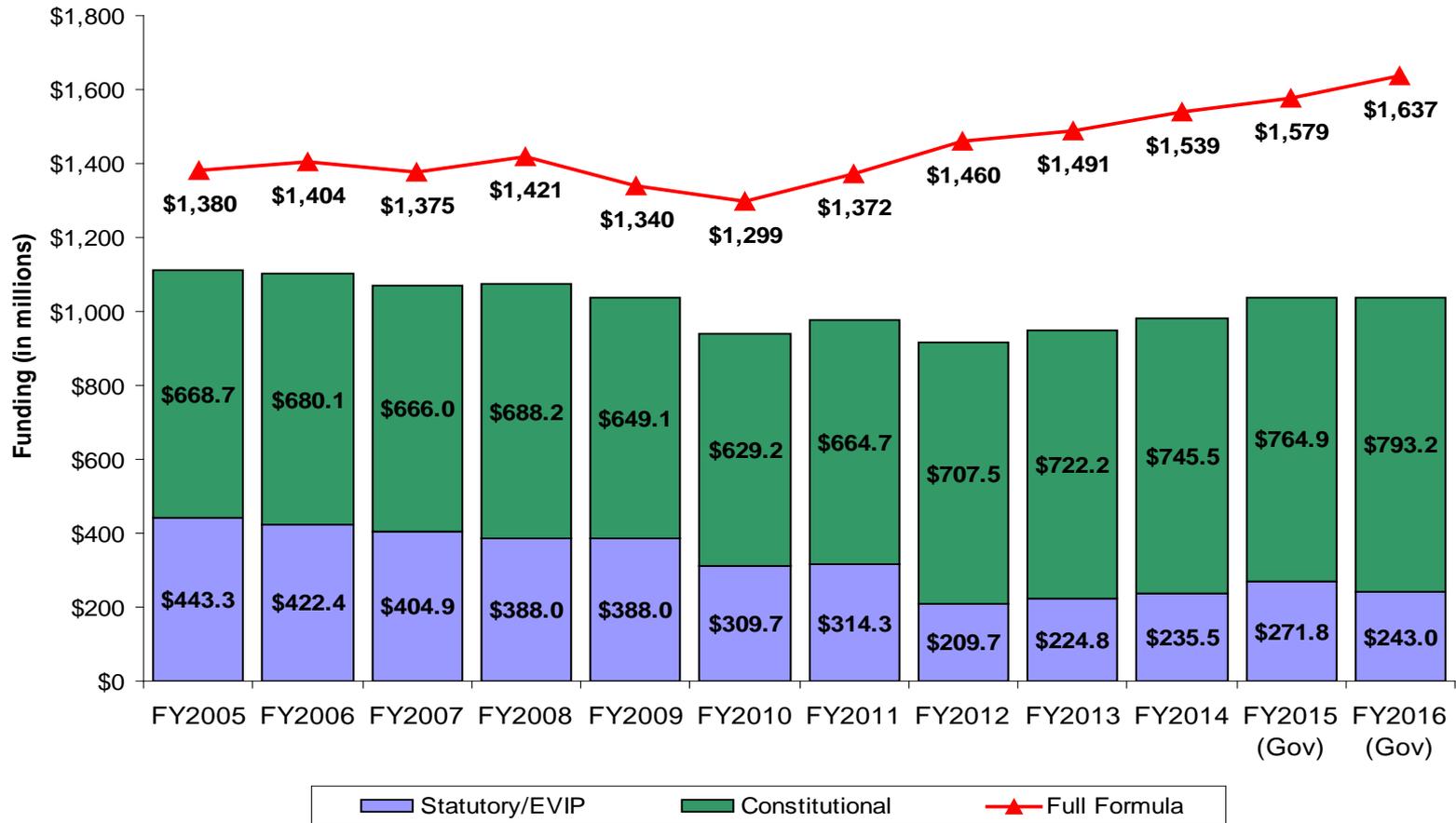
Major Budget Increases for FY2015

Revenue Sharing, K-12, and Higher Education See Increases in Governor's Budget

- **Local Revenue Sharing:** 45% increase to counties (\$65M); remaining \$56M to eligible municipalities
- **K-12 Education:** 3.2% boost in Governor's proposal
 - Foundation allowance: \$150 million increases funding by between \$83 and \$111 per pupil
 - Increase of \$270 million to cover unfunded pension liability costs
 - Second round increase (\$65M) for pre-K program
- **Higher Education:** \$77M provides for 6% increase for university operations
 - Half of increase distributed on performance criteria
 - Tuition increases capped at 3.2% to receive performance-based funding

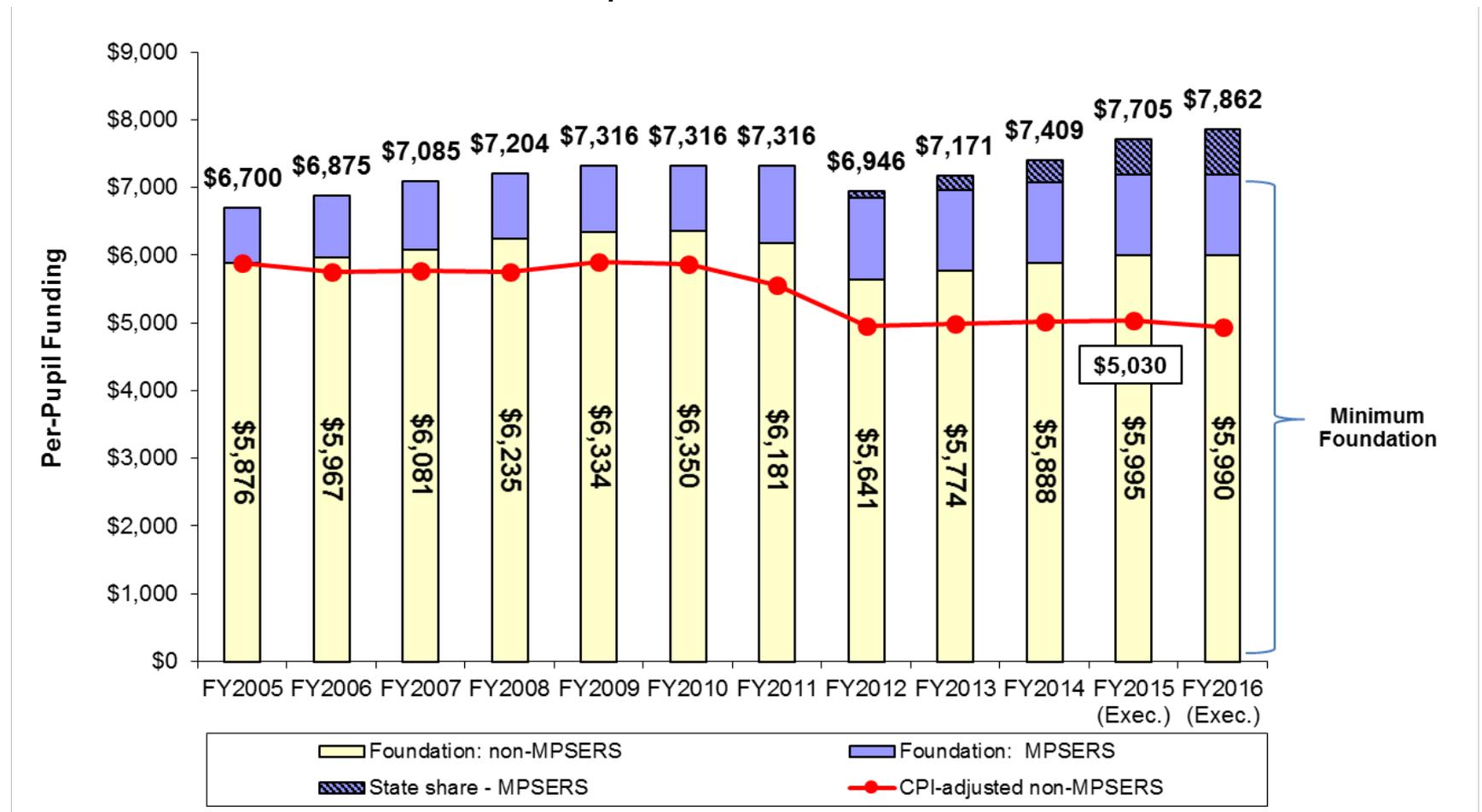
Recent History of Revenue Sharing

Cities, Villages, and Townships – Payment vs. Formula



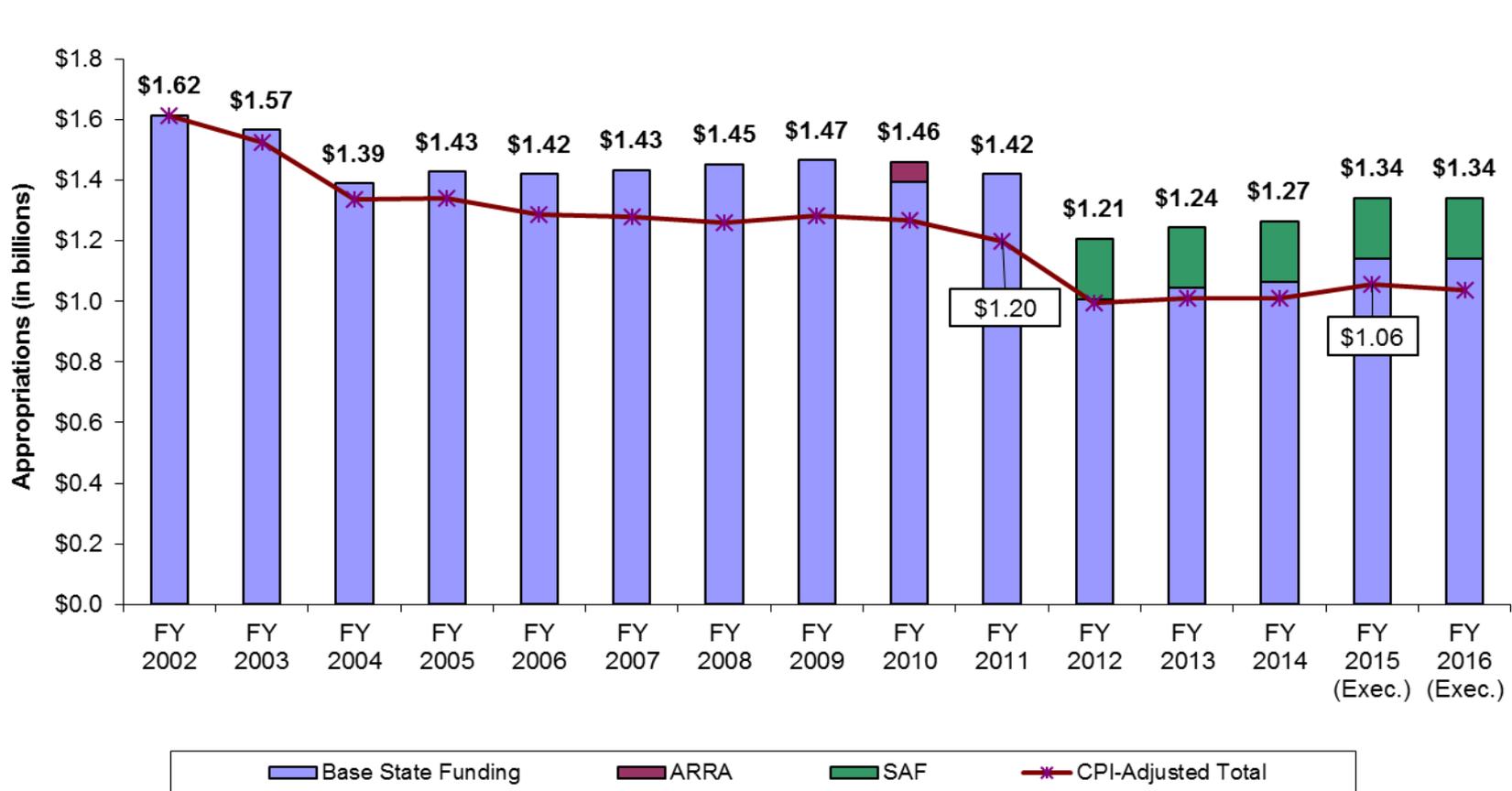
Effects of MPSERS Costs on Foundation Grant

Estimated Impact on Minimum Grant



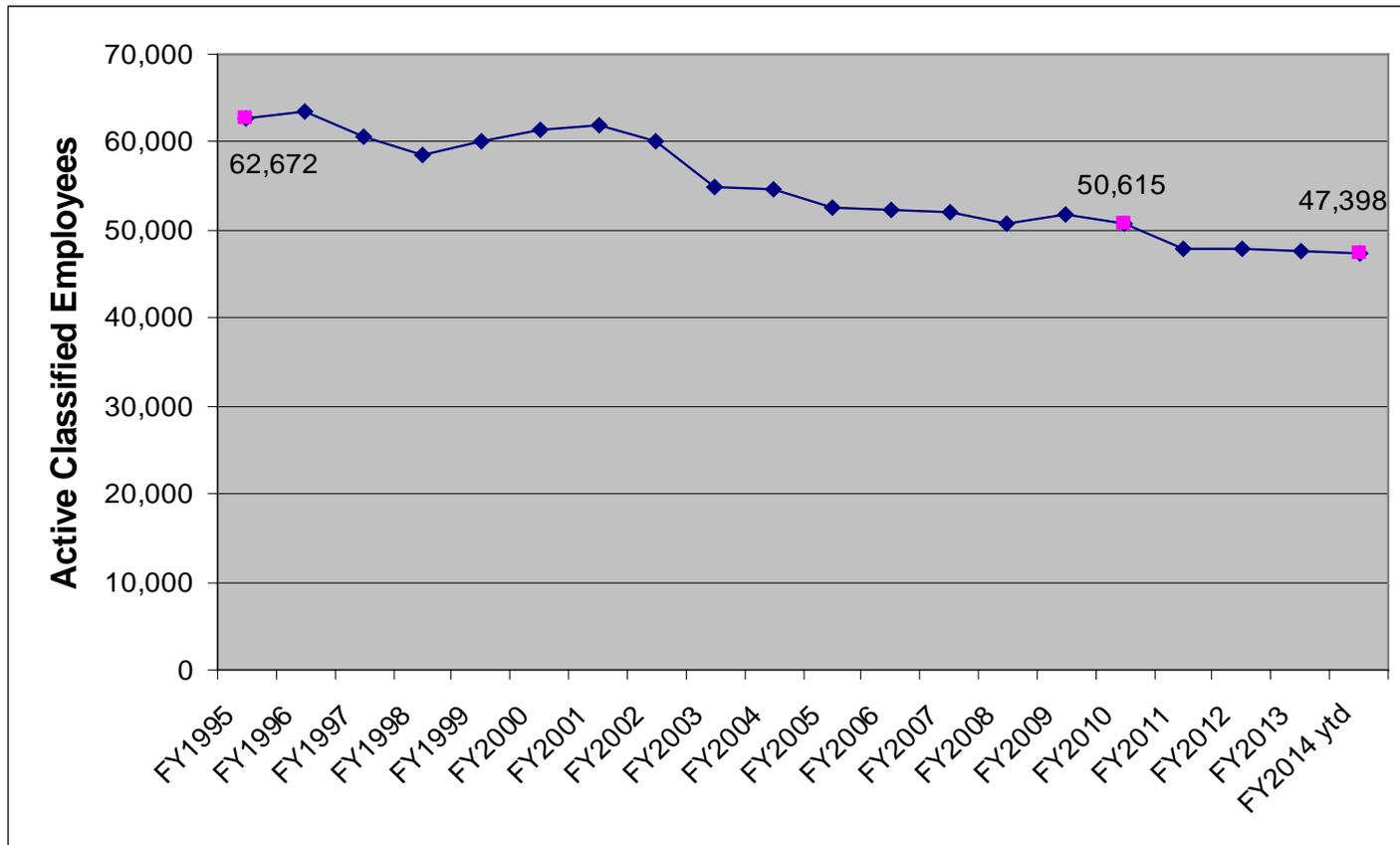
University Operations Funding

With Increase, Still Below FY2011 Level by 6%



Active Classified State Workforce

Down 24% from FY1995 and 6% from FY2010

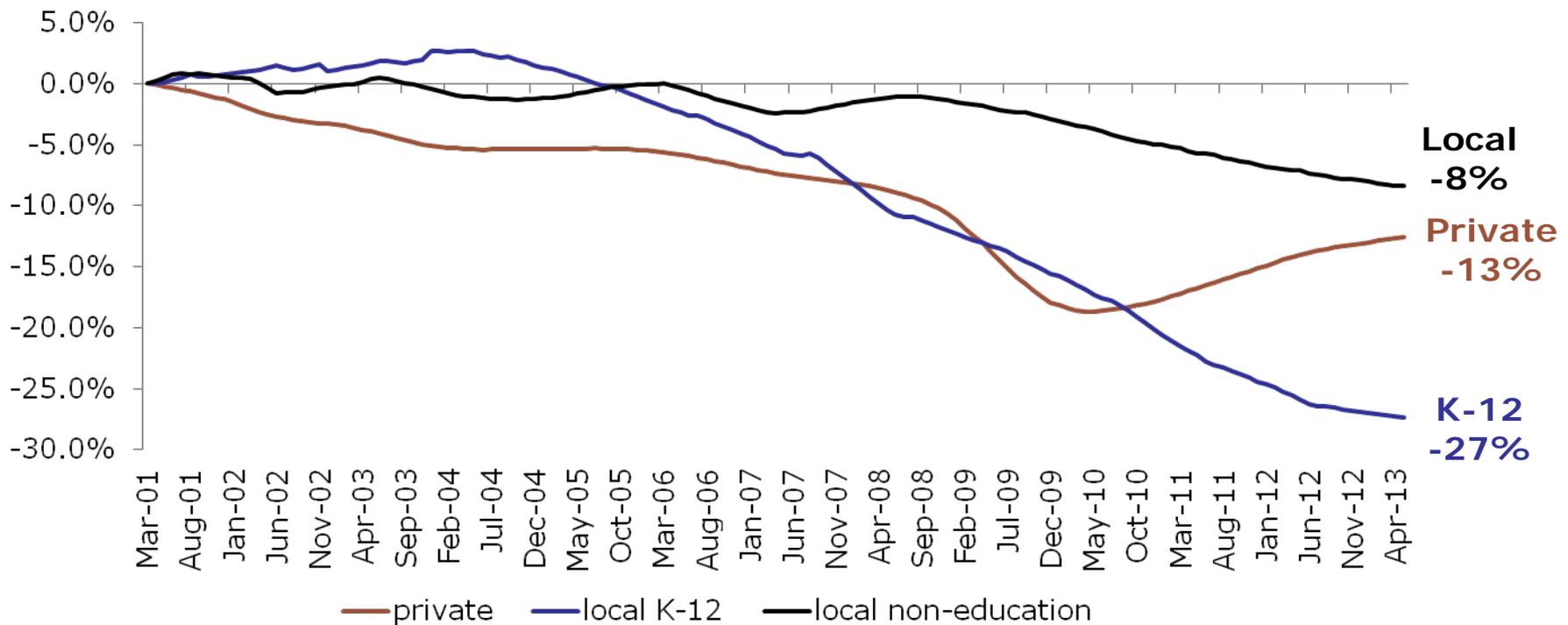


Source: Department of Civil Service, Annual Workforce Reports



K-12 and Local Employment Still Falling While Private Employment Recovering

Cumulative Change in Employment Since March 2001



Transportation Funding

Governor proposes stop-gap funding for FY2015

- No proposal for permanent new road revenues; FY2014 proposal to raise motor fuel taxes and vehicle registration fees was not acted upon by the legislature
- Governor proposes one-time GF/GP appropriation of \$254M to buffer current dedicated transportation revenues:
 - \$139M to be used to match federal aid
 - \$115M for state trunkline road and bridge needs (no PA 51 distribution to local road agencies)
- House plan: Modify gasoline tax, increase diesel fuel tax, earmark 1% of state use tax to roads, certain fee increases; hope to generate earmark of ~\$500 million



GF/GP Support for Transportation

Status of Current Funding

- Already appropriated for FY2014: \$121M in GF/GP for roads and first installment (\$115M) from Roads and Risks Reserve Fund
- House and Senate recently settled on additional supplemental funding for FY2014:
 - \$100M for winter road maintenance (through Act 51 formula)
 - \$115M for priority road projects (unspent funds may be shared by state and local road agencies)
- Summary of one-time funding:
 - FY2014: \$451 million
 - FY2015: ??? (Governor: \$254M; House: \$450M)
 - FY2016: so far \$0



Funding Reserved for City of Detroit

\$17.5 Million in Tobacco Settlement Revenue

- Funding will come out of tobacco revenues to Michigan under settlement agreement with tobacco companies
- Budget impact: Tobacco dollars are used in the DCH budget to help finance Medicaid; additional allocation requires backfilling with GF/GP
- Indications are that commitment will continue over 20 year period
- Alternative proposal: take present value of this funding stream (\$194M) and provide upfront funding from Budget Stabilization Fund

Savings for Future Needs

- Planned FY2014 deposit of \$140M into state's Budget Stabilization Fund adds to current \$506M balance
- Governor would deposit additional \$120M in FY2015 to bring BSF balance to \$766M by end of FY2015 – about 3.5% of combined GF/GP and SAF revenues
- Governor renews proposal to deposit one-half of Medicaid expansion savings to Health Savings Subfund: \$122 million in both FY2015 and FY2016
- New revenue estimates make it much less likely that Legislature approves these deposits
- Will BSF be tapped as part of Detroit bankruptcy plan?



Tax Policy and the State Budget

Homestead Property Tax Credit

Governor Proposes Expanded Eligibility for Credit

- Credit against the state income tax for households with property tax bills that are relatively high compared to household income
- Governor's proposal expands eligibility in two ways beginning in tax year 2013:
 - Household resources: cap raised from \$50,000 to \$60,000
 - Income threshold: credit would equal a portion of property tax payment minus 3.0% of household resources (down from 3.5%)
- Revenue impact: estimated at \$102.7 million annually
- 2014 challenge: Reaching those not currently eligible for the credit who won't file for it on 2013 return

Personal Property Tax Reforms

Phase-out of PPT through 2023

- Small taxpayers: less than \$80,000 in true cash value; effective tax year 2014
- “Eligible manufacturing personal property”: eligible for industrial processing exemption under sales tax; tax phased out between tax years 2016 and 2023

Phase-out Schedule for Existing Eligible Personal Property

		Tax year							
		2016	2017	2018	2019	2020	2021	2022	2023
Year placed in service	2005	☒	☒	☒	☒	☒	☒	☒	☒
	2006		☒	☒	☒	☒	☒	☒	☒
	2007			☒	☒	☒	☒	☒	☒
	2008				☒	☒	☒	☒	☒
	2009					☒	☒	☒	☒
	2010						☒	☒	☒
	2011							☒	☒
	2012								☒
	2013	☒	☒	☒	☒	☒	☒	☒	☒

☒ = exempt from personal property tax



Reimbursement to Local Units

Recent legislation aimed to provide 100% reimbursement

- Portion of existing **Use Tax** will be levied by a new Local Community Stabilization Authority with revenue dedicated to local reimbursement
 - Initial revenues of \$96.1M in FY16 grow to \$572.6M in FY28; 1% growth thereafter
 - No loss threshold to qualify for reimbursement
- **State Essential Services Assessment** replaces local option; assessed on exempted C&I personal property at rate of 2.4 mills phased down to 0.9 mills as property ages
- Reimbursement to local units will reflect actual losses from PPT exemptions
- Everything (exemptions, tax changes, reimbursement) is subject to August 2014 vote



Long-Run Outlook for State Budget: Budget Risks

Budget Risks Pose Challenges

The Impact of "What Ifs" in Out Years

- Transportation Funding: If no permanent road funding solution is achieved, GF/GP contributions may continue to be needed to fill gaps
- Health Insurance Claims Assessment: Shortfall in Medicaid budget will persist without either a revenue fix or offsetting cuts
- Personal Property Tax Reforms: if approved by voters, GF/GP impacts escalate in out years
- Inflation: even a continuation budget will incur inflationary costs



GF/GP Going Forward

Transportation and HICA bring potential deficits

	<u>FY2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>
Beginning Balance	\$1,186.6	\$340.1	(\$275.2)	(\$606.6)	(\$912.5)
<u>Revenues</u>					
Estimated Available Revenues (May estimates)	\$8,922.1	\$9,342.0	\$9,791.1	\$10,218.8	\$10,606.4
Personal Property Tax Reforms		(\$19.9)	(\$107.0)	(\$349.5)	(\$373.7)
Total Adjusted Revenues	\$8,922.1	\$9,322.1	\$9,684.1	\$9,869.3	\$10,232.7
<u>Expenditures</u>					
Governor's GF/GP Appropriations (except roads)	\$9,357.0	\$9,583.4	\$9,671.5	\$9,648.2	\$9,841.2
BSF/Health Savings Contributions	\$75.0	\$0.0	\$0.0	\$0.0	\$0.0
<u>Budget Pressures</u>					
GF/GP for Roads	\$336.6	\$254.0	\$254.0	\$254.0	\$254.0
GF/GP for HICA Shortfall		\$100.0	\$90.0	\$80.0	\$70.0
2% Adjustment in FY17 and FY18				\$193.0	\$196.8
Total Projected Expenditures	\$9,768.6	\$9,937.4	\$10,015.5	\$10,175.2	\$10,362.0
Ending Balance with Pressures	\$340.1	(\$275.2)	(\$606.6)	(\$912.5)	(\$1,041.8)
Ending Balance with 2% Only	\$340.1	(\$175.2)	(\$162.6)	(\$134.5)	\$60.2

All figures in millions

Note: FY2017 and FY2018 revenue estimates based on long-run estimates from May 2014 Consensus Revenue Estimating Conference.

Long-Run Outlook

- Budget is structurally balanced, but challenges remain
- Any budget surplus has largely been accounted for in the short run; little “excess revenues” to spend or give back without offsetting spending cuts or revenue growth
- Continues to build up reserves in both BSF and new Health Savings Subfund, but additional deposits will be needed to achieve goal of 6-8% of revenues
- Looking forward, if economy and revenues cooperate, picture looks much brighter in FY2018 and beyond



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