CITIZENS RESEARCH COUNCIL OF MICHIGAN

"The right to criticize government is also an obligation to know what you're talking about."
Lent Upson, First Director of the Citizens Research Council

May 24, 2023

State Revenue Estimates are Way Down, but Budgets Won't Need Fixing

In a Nutshell

- Updated state revenue forecasts suggest GF/GP revenue will decline by more than $4.3 billion across FY2023, FY2024, and FY2025.
- Those revenue downgrades are almost entirely attributable to the major tax reductions enacted in March and April.
- The revenue adjustments will be "much ado about nothing" for state lawmakers as they finalize the state's budget in the coming months. The budgets that have passed the House and Senate are already largely in line with these new estimates.

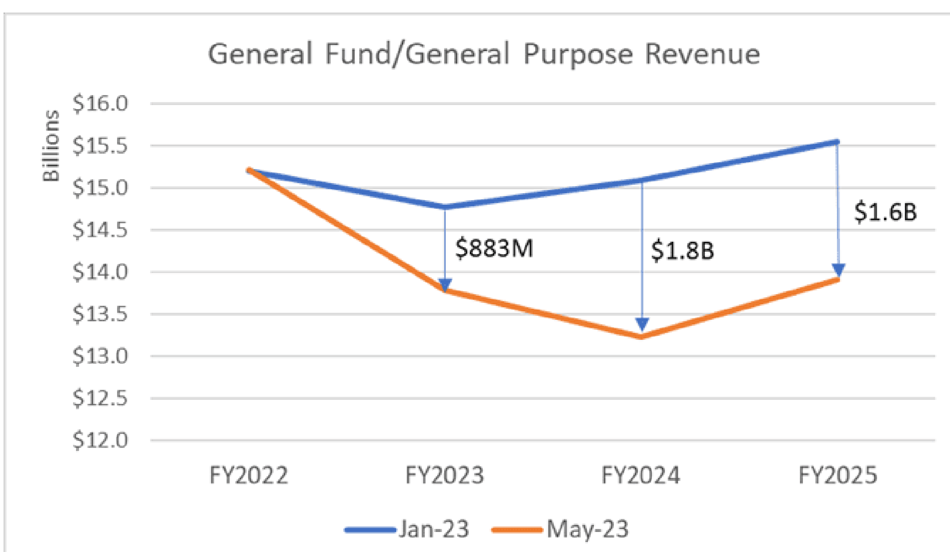
Both the House and the Senate have already passed their own spending plans for the Fiscal Year (FY)2024 state budget, paving the way for conference committees to iron out the differences between the two chambers' proposals over the coming months.

A critical first step in that process was taken last Friday when state economists gathered to revise state revenue estimates on which that final budget will be based. At first blush, those revisions seemed ominous, with the state's discretionary General Fund/General Purpose (GF/GP) revenue down more than 10 percent in both FY2024 and FY2025.

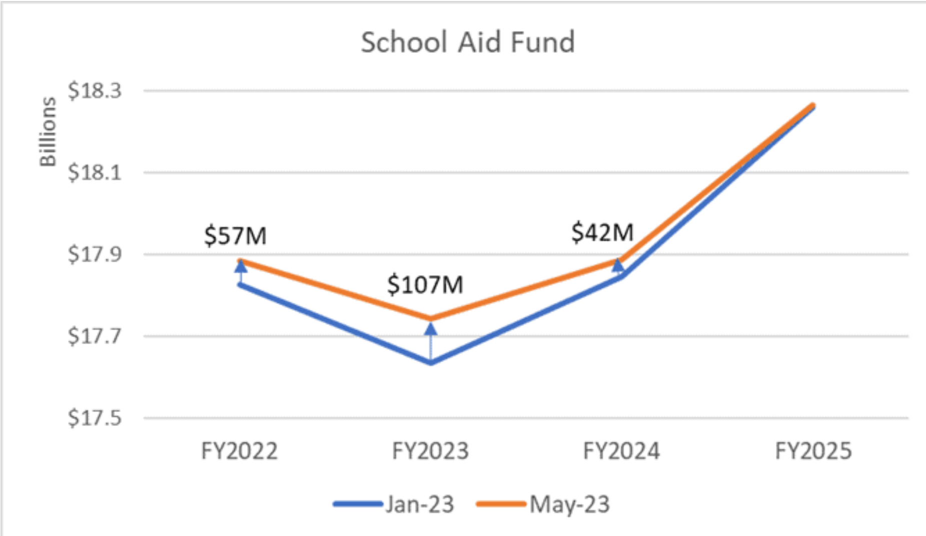
However, these downgrades in the revenue forecast were very much expected, and virtually all of the revenue adjustments can be tied to tax reductions implemented in recent months. The good news for those with a stake in state budget decisions: those revenue downgrades are already built into the legislative budgets that have been passed to date. Thus, the projections won't force any extra budget trimming while the House and Senate work on resolving their budget differences.

Large Decline in GF/GP Revenues is Projected

As noted, the major revisions to the revenue forecasts were concentrated within GF/GP revenue. The consensus estimates from last week expect GF/GP revenue to decline by $883 million in FY2023, a drop of 6.7 percent from the estimate from January 2023. The revenue decline then grows to $1.8 billion in FY2024 (12.3 percent drop) and $1.6 billion in FY2025 (10.5 percent drop) from the January estimates.



Summary of Revenue Revisions



Source: Consensus Revenue Estimating Conference Executive Summary, May 2023

Revisions were much more muted for the state's other major revenue fund – the School Aid Fund (SAF). Revenue forecasts for the SAF, which is used to finance K-12 school spending as well as some community college and university operations, were virtually unchanged from January. Forecasts for FY2022, FY2023, and FY2024 were revised upward, but by less than a half-percent overall. Those small revisions will have little overall impact on budget decision-making related to the $17.9 billion in School Aid Fund revenue available for FY2024.

GF/GP Downgrade is Attributable to Recent Tax Cuts

If it had been unexpected, a decline of more than 10 percent of GF/GP revenue would typically necessitate major budget reductions statewide; but in this case, it was no secret that this revenue drop was coming. In March and April, several major tax reductions were enacted into law, highlighted by Public Act 4 of 2023. The new law reduces the Individual Income Tax liability for certain retirement and pension income, raises the state's Earned Income Tax Credit for low-income households, and temporarily redirects Corporate Income Tax revenue from the General Fund to newly created special funds for business attraction, community development, and housing purposes. The Department of Treasury also confirmed in March that the state Individual Income Tax rate would temporarily drop from 4.25 percent to 4.05 percent for tax year 2023 as the result of a rate cut trigger that's part of state law.

All told, these and other tax policy changes are expected to reduce GF/GP revenue by more than $1 billion in FY2023, just over $1.9 billion in FY2024, and almost $1.4 billion in FY2025.

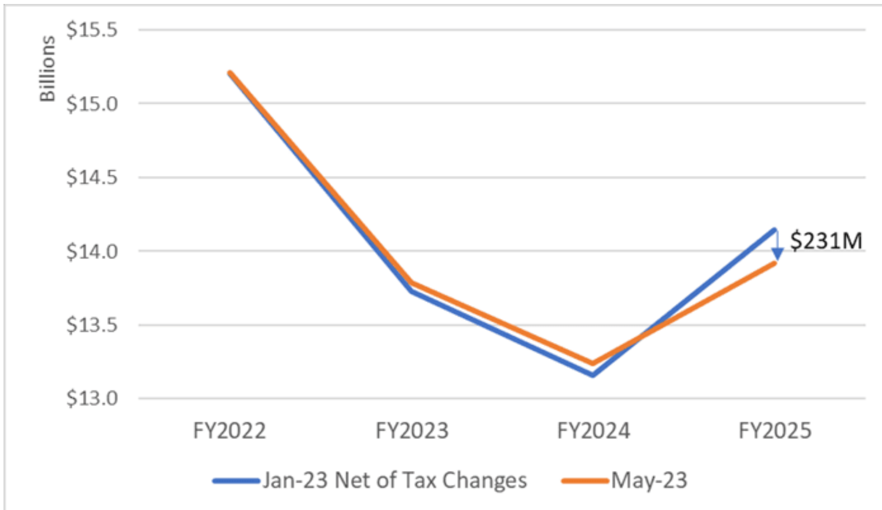
GF/GP Revenue Reductions from Tax Policy Changes (in millions)

	FY2023	FY2024	FY2025
Income Tax One-Time Rate Cut	$428.2	$218.7	
CIT Revenue Redirection	$600.0	$600.0	$600.0
Earned Income Tax Credit Increase		$768.0	$384.0
Tax Treatment of Retirement Income		$281.0	$350.0
Delivery/Installation Charges Exemption	$18.0	$62.9	$63.8
Total Revenue Foregone	**$1,046.2**	**$1,930.6**	**$1,397.8**

Source: CREC Economic and Revenue Forecasts, FY2023, FY2024, FY2025, May 2023

Since these changes were enacted in March and April, they were not built into the January 2023 GF/GP revenue estimates; but they are now included in the revised May 2023 revenue estimates. If the January estimates are first adjusted for these tax policy changes, GF/GP revenue estimates are virtually unchanged between January and May with the exception of a $231 million revenue dip in FY2025. In short, the revenue revisions are almost entirely driven by these tax policy changes.

Another View: GF/GP Revenue Revisions after Accounting for Tax Changes



Source: Research Council calculations based on data from Consensus Revenue Estimating Conference Executive Summary, May 2023

Revised Revenue Forecasts Are Already Built into Legislative Budgets

Most of the tax changes were first proposed as part of Governor Whitmer's February Executive Budget proposal. As such, her budget proposal largely assumed that these revenue reductions would occur. There are two exceptions: the Governor's budget did not assume the implementation of the one-time Individual Income Tax rate cut ($647 million one-time revenue loss) or the exemption of delivery and installation charges from the state's Sales Tax and Use Tax (annual revenue loss of about $64 million). However, her budget proposal did assume the loss of $800 million in revenue tied to a recommended one-time income tax rebate; a proposal that's now off the table. In the end, then, the revenue outlook on which the Executive Budget was based mirrors the new projections from last week.

Like the Governor's budget, the budgets passed by both the House and Senate also factored in the revenue impact of the tax policy changes. On the whole, then, budget plans coming out of both chambers already align with the new revenue projections. Enacting any of the budget plans offered by the Governor, House, or Senate can be accomplished within the updated revenue estimates without creating an unsustainable "budget cliff" for FY2025. The table below illustrates this by comparing ongoing GF/GP spending and utilization within each of the respective budget plans.

Ongoing GF/GP Utilization in Budget Proposals

	Governor	House	Senate
Ongoing Appropriations	$12,903.8	$12,649.4	$12,159.0
Other Ongoing Adjustments	$623.3	$623.7	$614.7
FY24 Ongoing GF/GP	**$13,527.1**	**$13,273.1**	**$12,773.7**
Added DHHS caseload savings	-$50.0	-$50.0	-$50.0
Back out one-time fund shift			$700.0
FY25 Continuation Budget GF/GP	**$13,477.1**	**$13,223.1**	**$13,423.7**

Source: Senate figures from Senate Fiscal Agency, May Consensus Revenue Year-End Balance Estimates Based on Senate Budgets, May 19, 2023; Governor and House figures compiled from State Budget Office and House Fiscal Agency budget documents along with review of House-passed budget bills.

In the table, "Ongoing Appropriations" reflect GF/GP appropriations that are permanent in nature and will carry into the FY2025 budget, leaving out appropriations designated as one-time. "Other Ongoing Adjustments" include statutory revenue sharing payments, human services caseload adjustments, and other known revenue/spending adjustments that draw on GF/GP revenue but are not direct GF/GP appropriations. The table shows ongoing GF/GP utilization for FY2024 ranges from $12.7 billion in the Senate-passed budgets to $13.5 billion in the Executive Budget. GF/GP revenue is now expected to be around $13.2 billion in FY2024, so final appropriations above this level would draw down on what is expected to be a $2.6 billion GF/GP fund balance available at the start of the fiscal year.

Looking ahead to FY2025, two adjustments are made to FY2024 ongoing spending to determine GF/GP needs for a "continuation budget" with no new spending enhancements or reductions. First, additional savings for human services caseloads (Medicaid, public assistance programs) are factored into the figures based on consensus caseload estimates approved at last week's consensus conference. Second, the FY2024 Senate-passed budgets tap into $700 million of the state's American Rescue Plan allocation in order to offset GF/GP funding within the Corrections budget. Since this isn't sustainable next year, another $700 million is added to the Senate GF/GP amount to back out this one-time fund shift.

GF/GP revenue for FY2025 is now estimated at $13.9 billion. If the final FY2024 budget contains ongoing GF/GP appropriations in the range of the three existing budget proposals, ongoing revenue would be sufficient to grow the FY2025 budget by between $440 million to $690 million (or between 3.3 and 5.2 percent). For perspective, last week's consensus economic forecast suggests Detroit Consumer Price Index inflation will be about 2.5 percent in FY2025, so there would be room for the budget to grow faster than inflation.

In short, while the budget outlook for FY2025 will not be as rosy as the outlook in February, the state's budget remains in structural balance even after the significant revenue declines tied to recent tax relief plans. The large downward revision in GF/GP revenue should pose little challenge to the legislative appropriators in wrapping up their work on the FY2024 budget.

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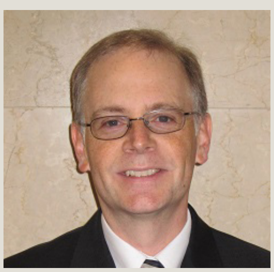

Bob is in his second stint with the Citizens Research Council, having worked for the organization from 2013 to 2015. He has spent most of his time in state government, having worked in the Office of Health and Human Services – State Budget Office and as Associate Director for the non-partisan Michigan House Fiscal Agency (HFA). He has extensive expertise and has provided non-partisan advice and analysis on state policy and budget matters in areas including corrections, human services, and transportation. Prior to joining HFA, he was a research assistant and project manager from 1994 to 1996 for Public Policy Associates, a Lansing-based policy research and consulting firm. He also served for two years within the Michigan Department of State working on department budget and financial issues.

Bob received his B.S. in Economics from Central Michigan University and his M.A. in Economics from Michigan State University.

Founded in 1916, the Citizens Research Council of Michigan works to improve government in Michigan. The organization provides factual, unbiased, independent information concerning significant issues of state and local government organization, policy, and finance. By delivery of this information to policymakers and citizens, the Citizens Research Council aims to ensure sound and rational public policy formation in Michigan. For more information, visit www.crcmich.org.

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