



CITIZENS RESEARCH COUNCIL OF MICHIGAN

# Important Issues Facing Michigan

Detroit Athletic Club

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- 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
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# Important Issues Facing Michigan

- Michigan's economy
- State and local budgets
- Tax structure
- Fiscal health of local governments
- Public sector compensation
- Where do we go from here?



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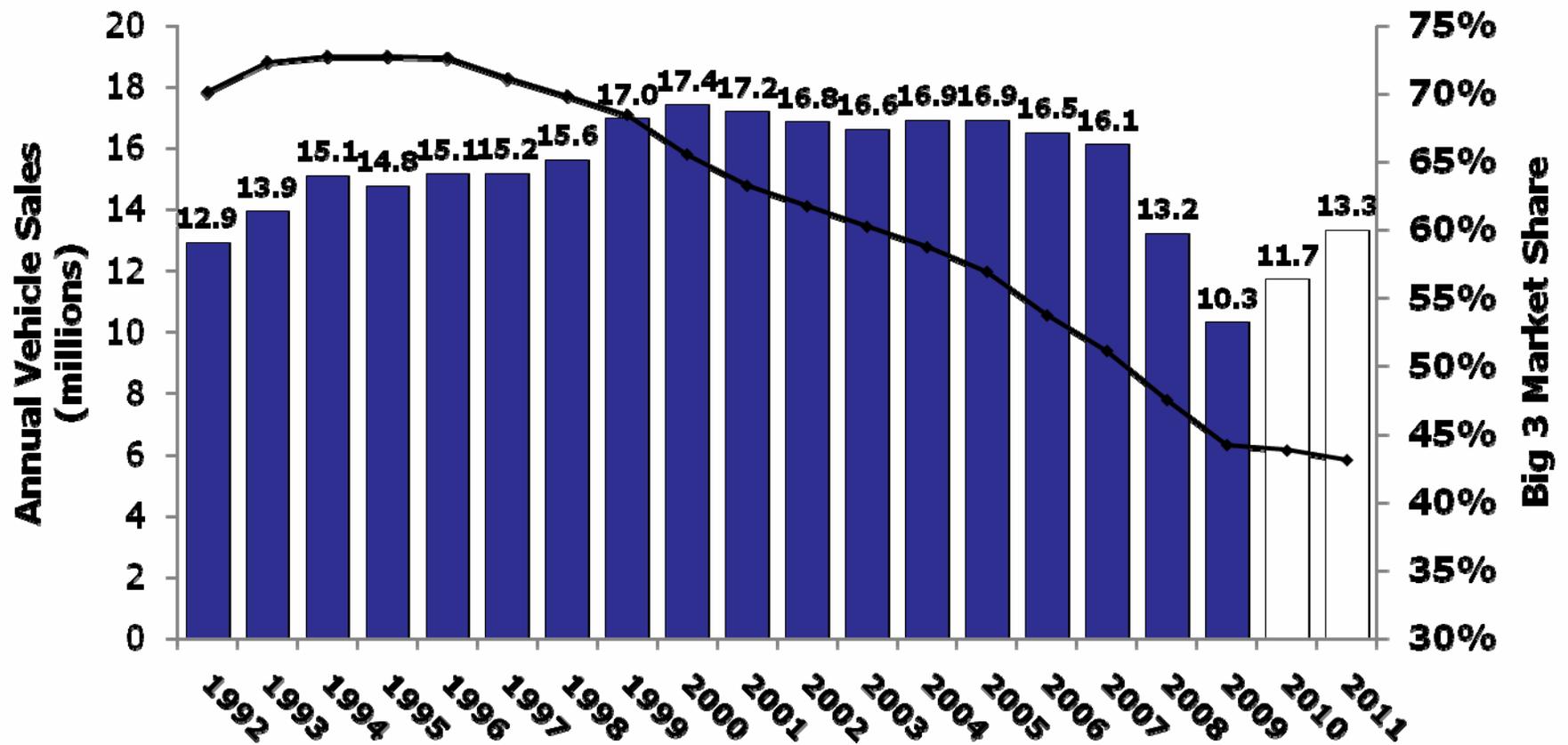


## The Last Decade Has Been an Economic Disaster for Michigan

	<u>Growth 2000 to 2009</u>		<u>Michigan</u>
	<u>U.S.</u>		<u>Rank</u>
Population	8.8%		51
Real Per Capita GDP*	9.7%		51
Employment	-0.7%		51
Real Per Capita Income	3.6%		51



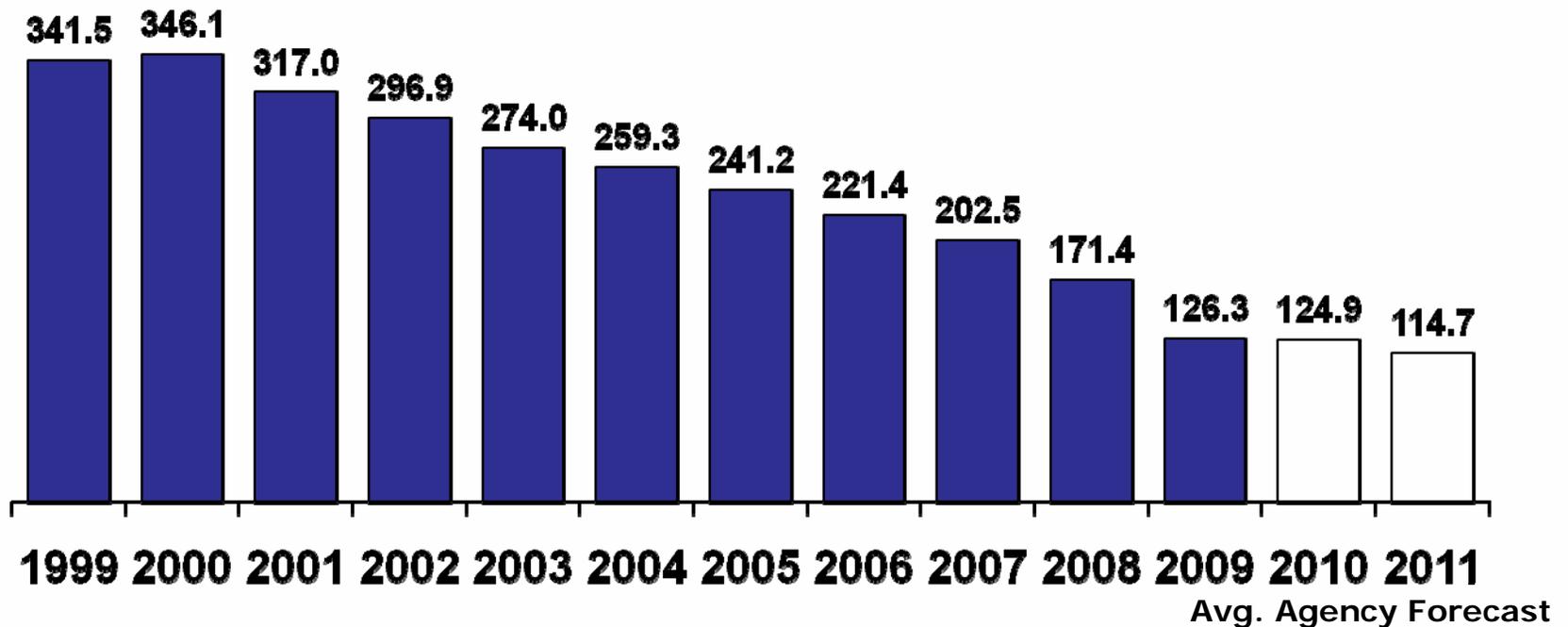
# Big 3 Market Share Plummet





## 2 in 3 Auto Jobs Lost by 2011

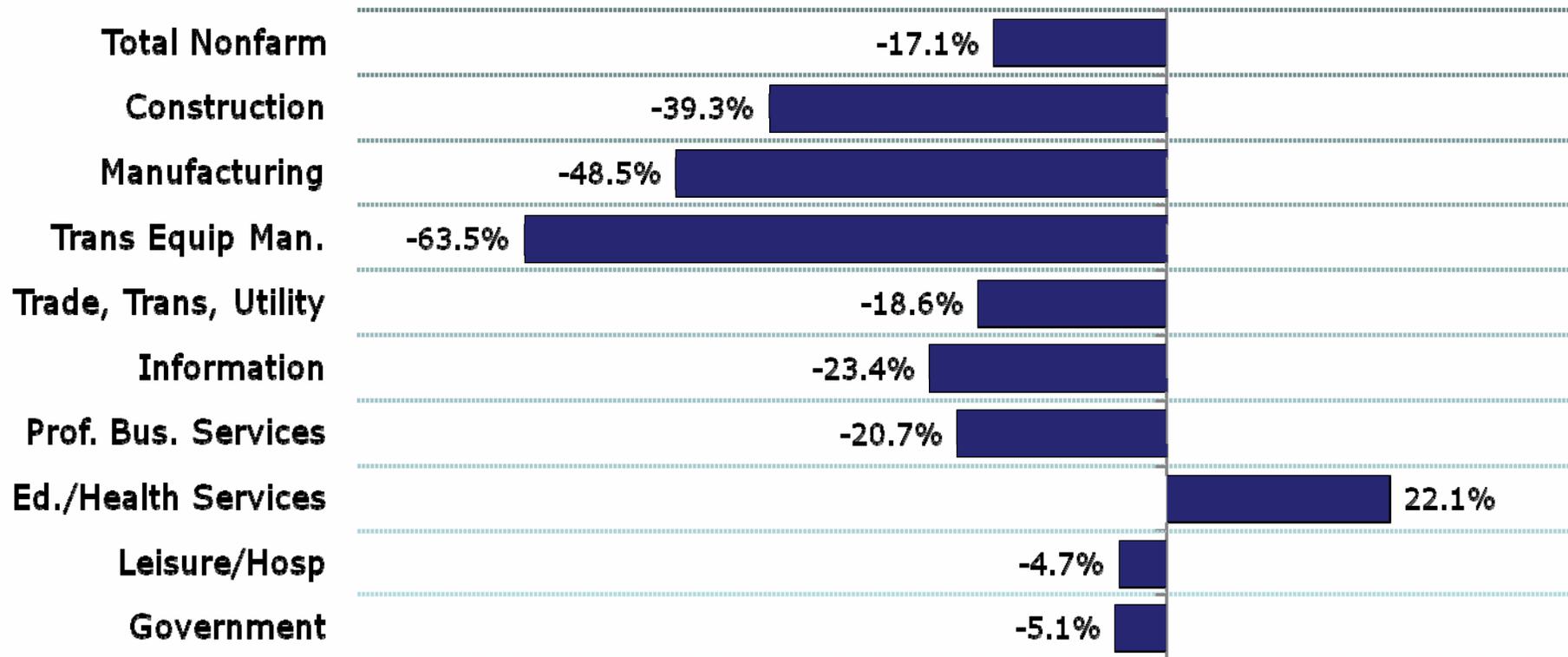
Michigan Transportation Equipment Employment  
(In Thousands)





# Almost Every Sector in Michigan Has Lost Jobs

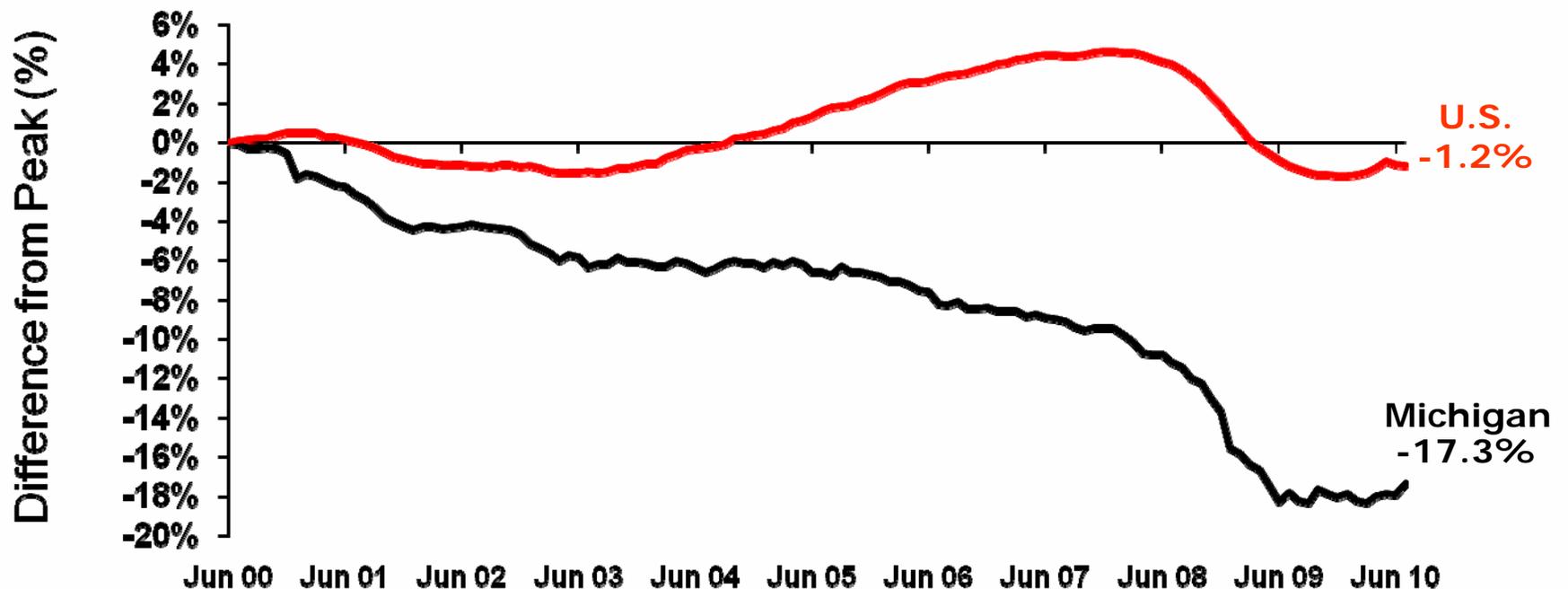
## 2000 to 2009





# A Lost Decade of Michigan Employment

## 1 in 6 Jobs Lost Since June of 2000

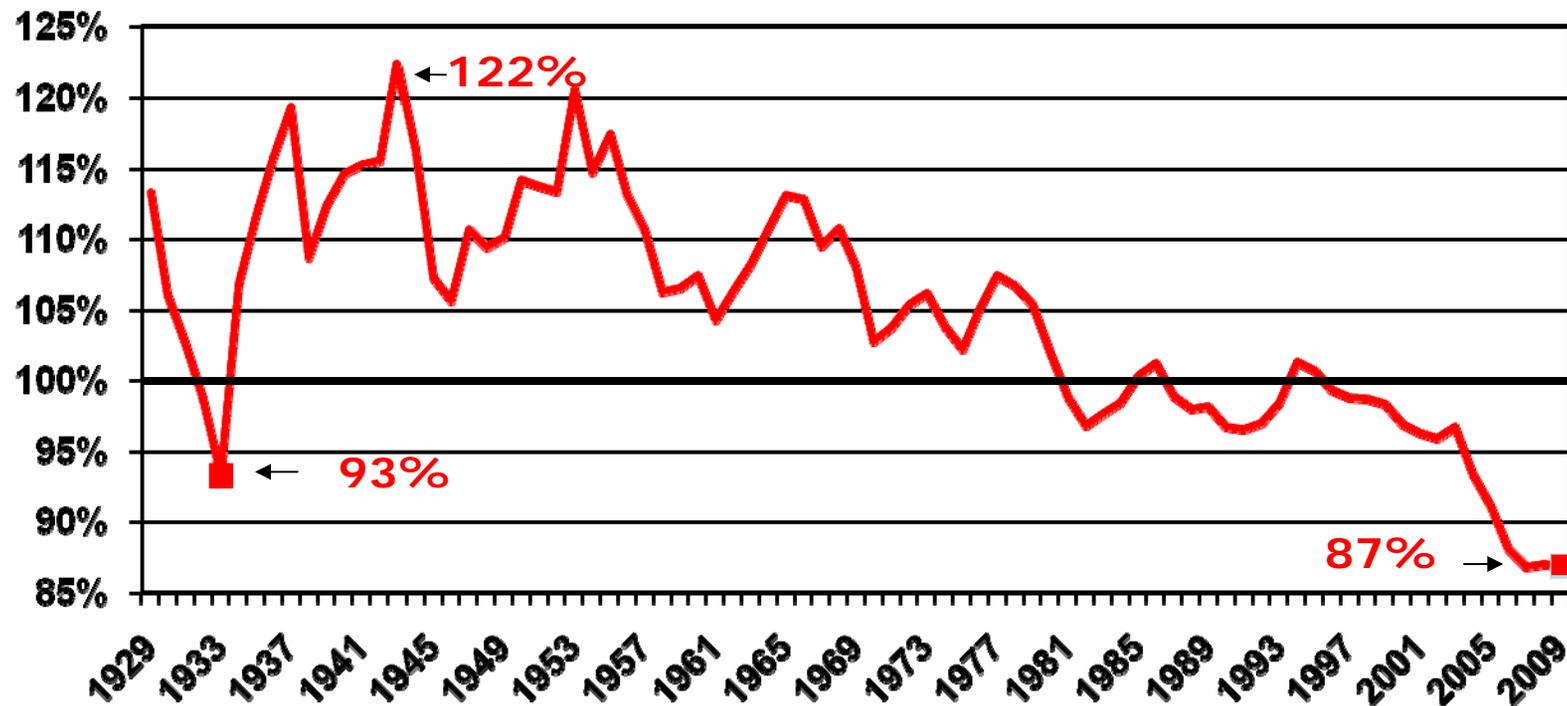


- 9 Note: Peak is calculated from Michigan's June 2000 Peak. Data are through July 2010.  
Source: Bureau of Labor Statistics and CRC calculations.



## 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 2009





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## State Spending Changes FY 00 to FY 10

- Inflation up approx. 23%
- Total state spending up 22.5% but increases in federal aid drove increase; state spending from state sources up 2.3%
- Spending changes from state sources:
  - K-12 +8.2%
  - Community Colleges +0.7%
  - Universities/financial aid -13.7%
  - Revenue sharing -34%
  - Corrections +27.2%
  - Medicaid +49.9%



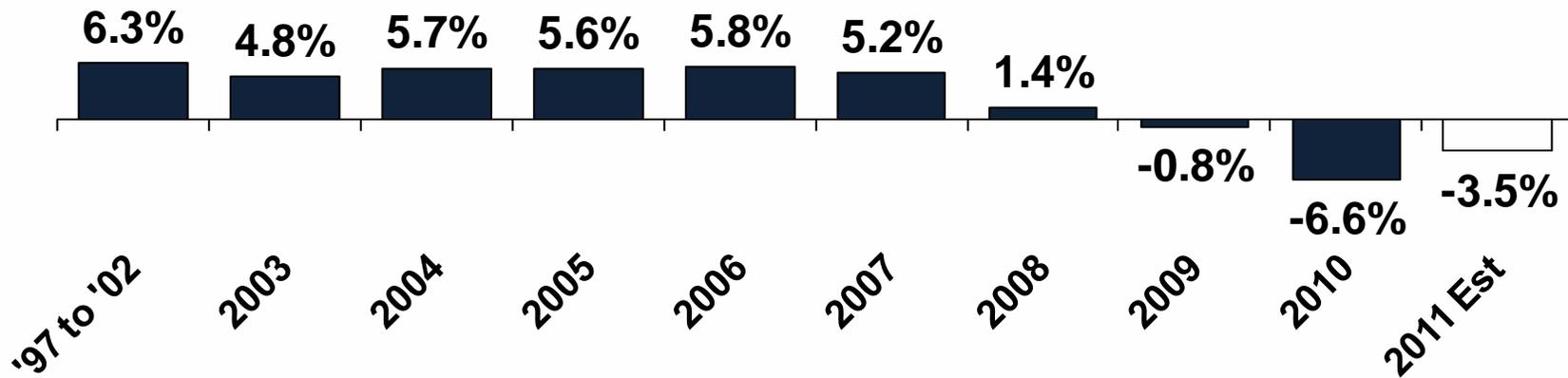
## State Has Been Cutting the Budget

- FY 2010 significant cuts to Medicaid, higher education, revenue sharing, human services and K-12
- FY 2011 \$1B GF budget shortfall was primarily due to end of ARRA funds
  - Fed's have extended additional aid for FY 11
  - Significant cuts (\$500M+) will still be needed for GF
  - No additional cuts needed for SAF
- FY 2012 GF will have a large gap again
  - End of federal stimulus (approx. \$600M)
  - IIT rate cut (approx. \$170M)
  - Other proposed one-time for FY 11: amnesty (\$90M); unclaimed property (\$165M); liquor distribution (\$100M)



# TV Growth Had Been Providing Local Govts With Better Revenue Growth

% Change in Total Taxable Value



Average



# Outlook for Local Governments in SE Michigan is Grim

% Change in Total Taxable Value

<u>County</u>	<u>2000 to 2008</u>	<u>2008 to 2010</u>	<u>2000 to 2010</u>
Livingston	75%	-10%	57%
Macomb	51%	-13%	32%
Monroe	39%	-8%	28%
Oakland	46%	-15%	24%
St. Clair	46%	-11%	30%
Washtenaw	62%	-7%	50%
Wayne	42%	-12%	25%
CPI	25%	2%	27%



## Local Cuts Will Be More Noticeable

- Michigan's state budget has been struggling for 10 years but most citizens have limited exposure to state spending (Medicaid, corrections, higher ed, welfare)
- Some local governments have been struggling for years due to population loss and Headlee limits on revenue growth, but others saw robust growth due to new construction
- As local governments pull back cuts will be more visible: police, fire, libraries, parks



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# State & Local Tax Burden Close to National Average

## But State Share Has Fallen While Local Has Increased

	FY 2000			FY 2008		
	State	Local	Total	State	Local	Total
<b>Michigan</b>						
Income	2.5%	0.2%	2.7%	2.1%	0.1%	2.2%
Sales	2.6%	0.0%	2.6%	2.4%	0.0%	2.4%
Property	0.6%	2.7%	3.3%	0.6%	3.4%	4.0%
Corp Income	0.8%	0.0%	0.8%	0.7%	0.0%	0.7%
Other	1.3%	0.1%	1.4%	1.3%	0.2%	1.5%
<b>Total</b>	<b>7.8%</b>	<b>3.0%</b>	<b>10.8%</b>	<b>7.1%</b>	<b>3.7%</b>	<b>10.8%</b>
<b>U.S. Avg</b>						
Income	2.4%	0.2%	2.6%	2.3%	0.2%	2.5%
Sales	2.1%	0.5%	2.6%	2.0%	0.5%	2.5%
Property	0.1%	2.9%	3.0%	0.1%	3.2%	3.4%
Corp Income	0.4%	0.0%	0.4%	0.4%	0.1%	0.5%
Other	1.5%	0.4%	1.9%	1.6%	0.5%	2.1%
<b>Total</b>	<b>6.6%</b>	<b>4.0%</b>	<b>10.6%</b>	<b>6.4%</b>	<b>4.5%</b>	<b>10.9%</b>



## 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 and BLM have 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
  - 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)
<b>Totals</b>	<b>(\$138.8)</b>	<b>(\$555.4)</b>	<b>(\$630.4)</b>	<b>(\$838.5)</b>	<b>(\$1,262.7)</b>	<b>(\$1,491.3)</b>

(1) Totals if full amount used



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## Many Local Governments are in Fiscal Danger

- Combination of falling property taxes and declining state revenue sharing has pushed many local governments to the brink raising important questions:
  - How can we increase collaboration, service sharing, or other methods of providing government services more efficiently?
  - Is Public Act 72 adequate to cover all local fiscal emergencies?
  - Should Chapter 9 bankruptcy ever be considered?
  - What else can be done to improve the fiscal health of local governments?



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## Public Sector and Private Sector Differences

- More difficult to get productivity improvements from capital in public sector due to labor intensive nature of work
- Revenue drops in private sector result from a drop in demand for product, in public sector demand for product often increases when revenues fall
- Nationally public sector workers are: more likely to be unionized (40% vs. 10%), more likely to be administrative and professional (two-thirds vs. half), and more likely to have retiree healthcare (roughly  $\frac{3}{4}$  vs.  $\frac{1}{4}$ ) and defined benefit plans
- In low skill jobs wages tend to exceed private sector and in high skill jobs wages tend to lag



## Employee Benefit Costs

- Benefit costs for active and retired public employees threaten to crowd out other priorities
- Unfunded liability for health benefits for public school employees alone is over \$26 billion
- Many local governments have significant shortfalls as well
- Taxpayers are unlikely to want to pay higher taxes to support benefits for public workers if they are deemed significantly more generous than what taxpayers in general receive
- Constitution protects pension but not OPEB benefits



## Some Significant Reforms Have Been Made

- State of Michigan employees switch to 401k and significantly slower health care vesting in 1997
- State employee share of healthcare premium costs was increased from 5% to 10% in 2009
- As of 4/10 new state employees pay 20% of premiums
- School retirement changes save \$3.3 billion over 10 years
  - Requires 3% employee contribution to retiree healthcare fund (being litigated)
  - Hybrid plan for new employees replaces old DB plan: raises retirement age; changes calc for final comp from 3 to 5 years; eliminates COLA; employee contributes 6.4% of salary



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## Where Do We Go From Here?

- Budget crisis will be ongoing due to one-time money in state budget, falling property taxes at local level, enacted state tax cuts, and rising healthcare costs
- Michigan's economy will rebound when the U.S. economy rebounds, but there is no quick recovery from an 18% employment decline
- Michigan needs to think more strategically about the public sector:
  - What do we want to invest in?
  - Where are we going to spend less?
  - What impact will these changes have on economic development?
  - How will we pay for the services we choose?



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