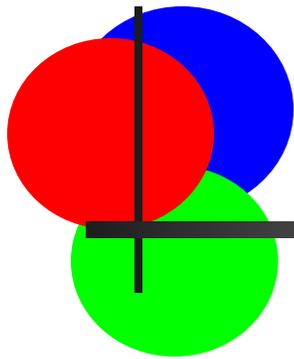


A Problem 10 Years in the Making



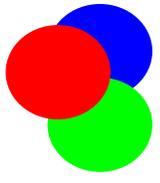
Prepared for:

**Representative Hobbs and Senator Gregory
Budget Town Hall**

March 10, 2011

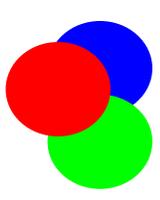


Mitchell E. Bean, Director



State Budget Shortfalls Caused By

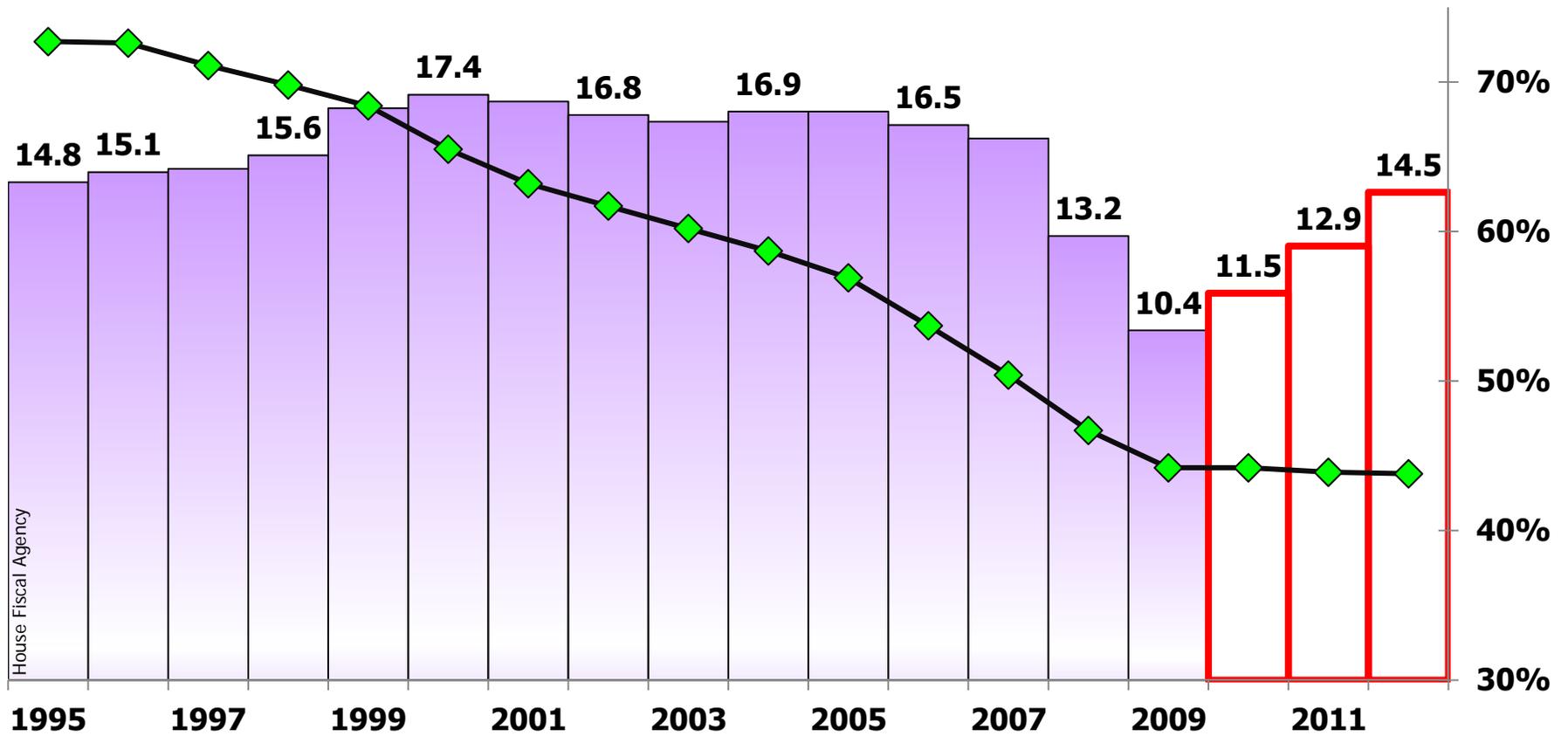
- **Severe economic contraction led by domestic auto industry**
- **State tax policy**
- **Increasing cost of Medicaid and corrections**
- **Chronic use of one-time fixes**

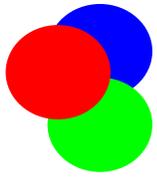


Big 3 Losing Market Share

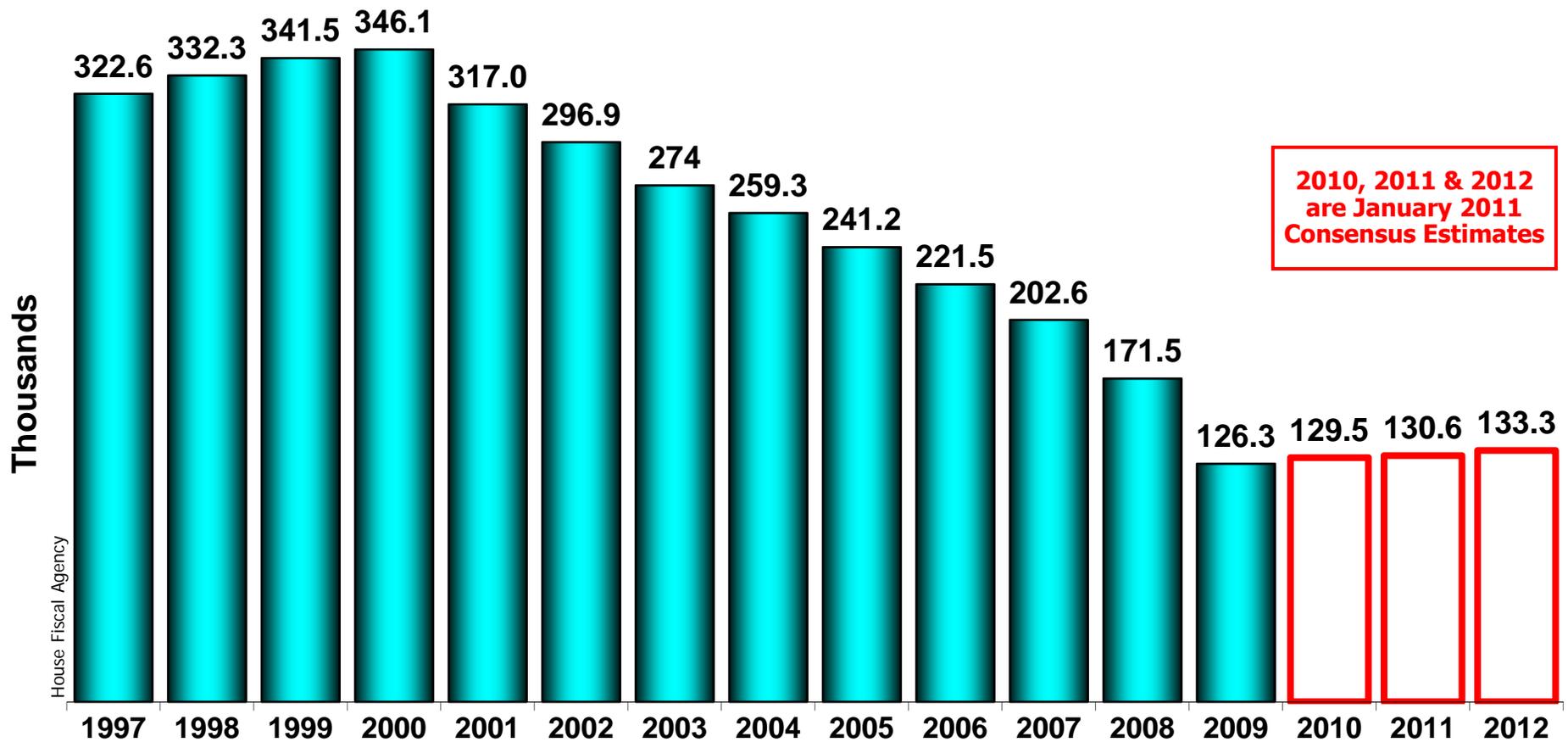
2010, 2011, & 2012
are January 2011
Consensus Estimates

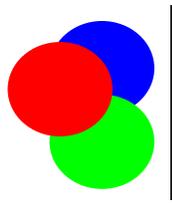
U.S. Light Vehicle Sales Big 3 Share



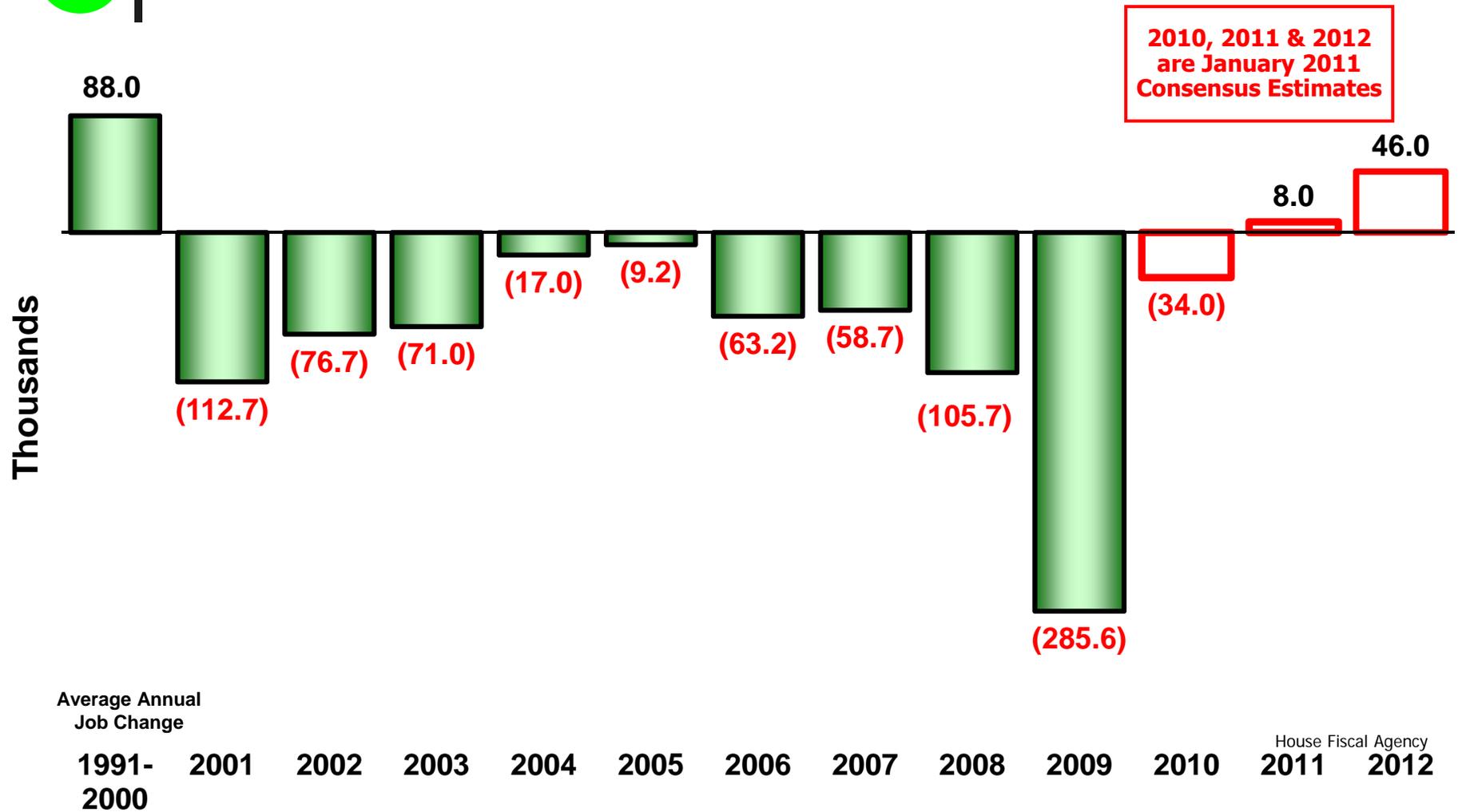


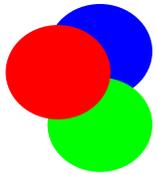
Michigan Vehicle Employment





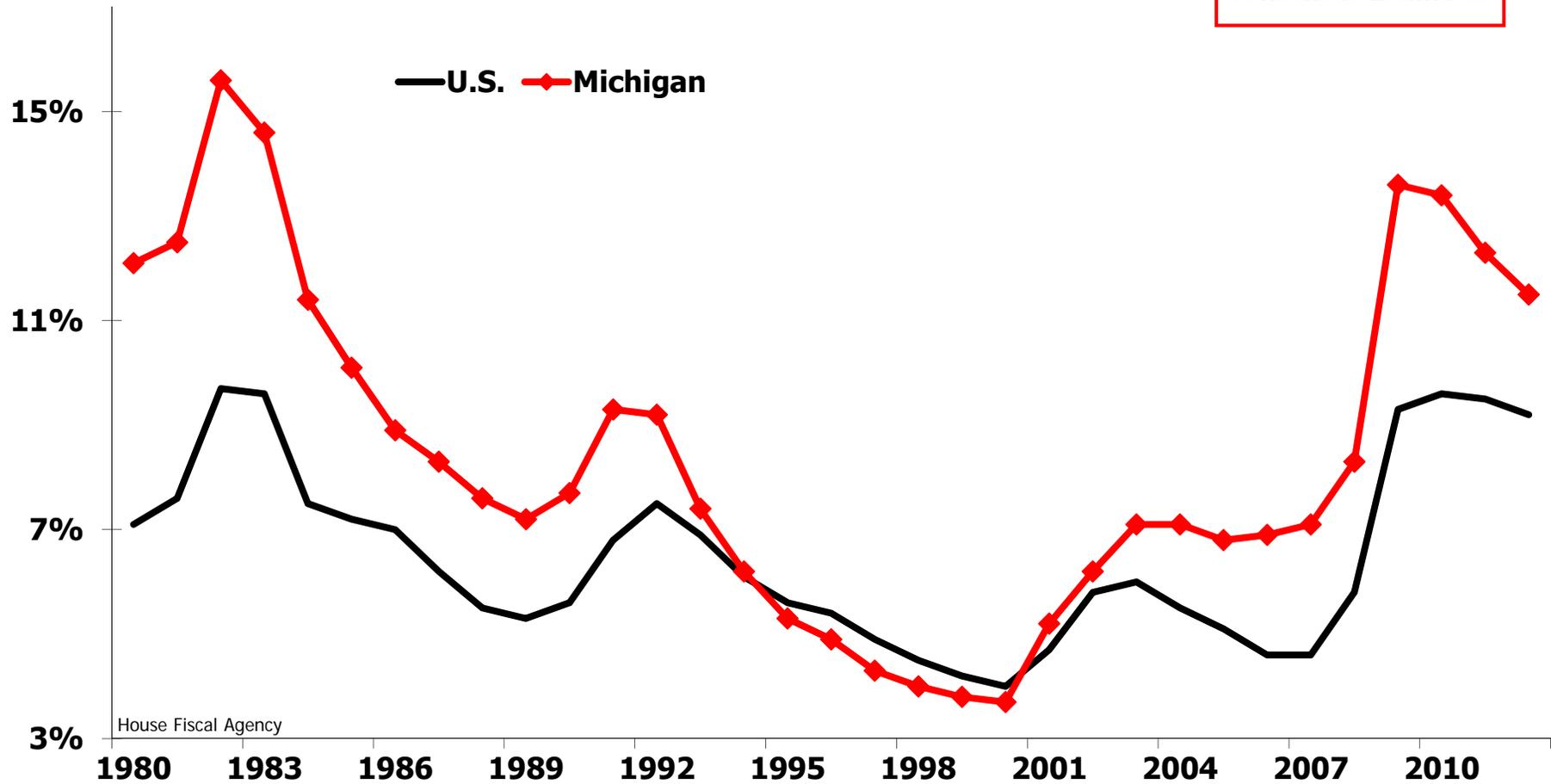
Job Change in Michigan

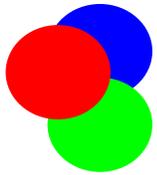




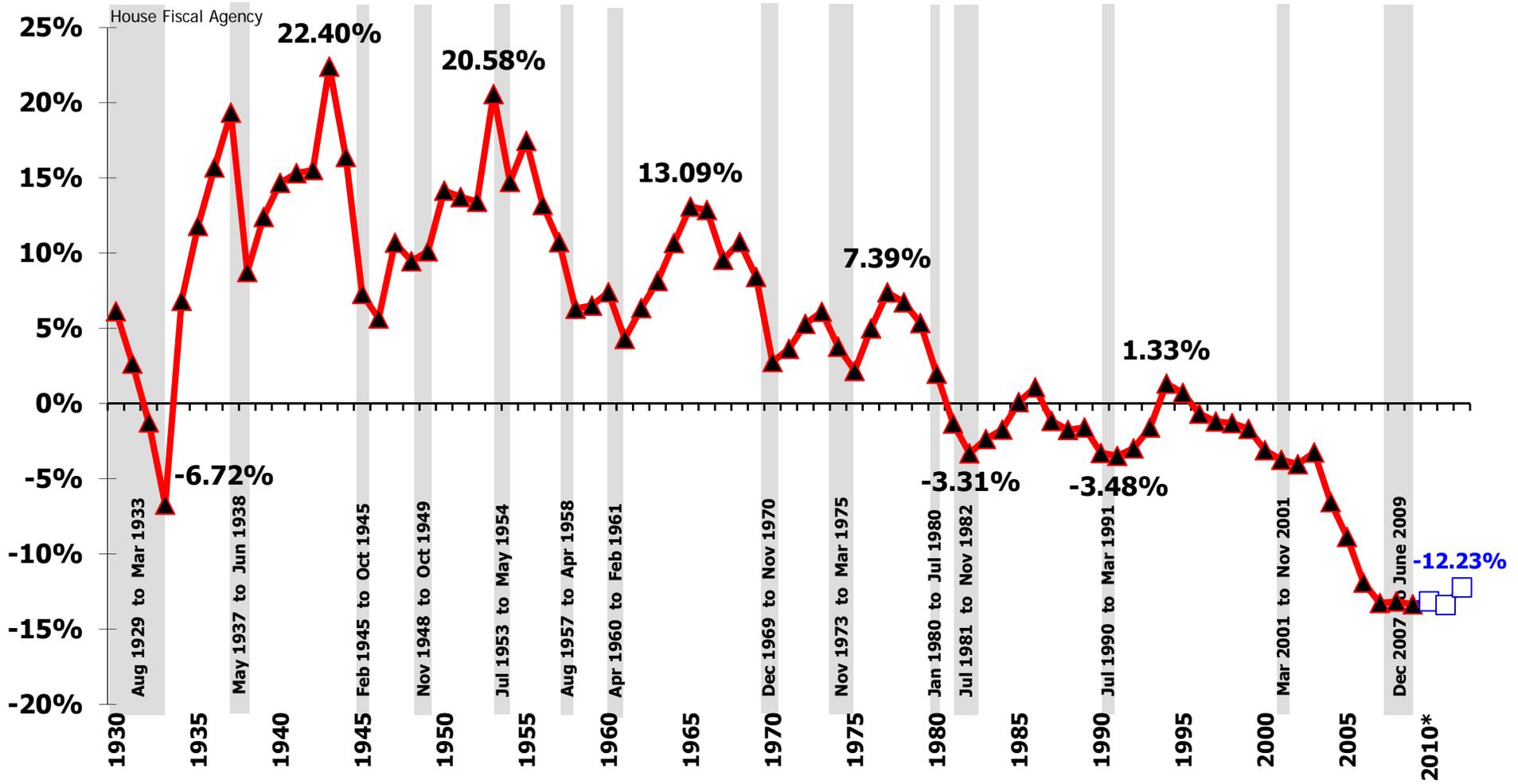
U.S. and Michigan Unemployment Rates

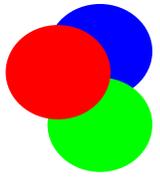
2010, 2011, and 2012 are January 2010 Consensus Estimates



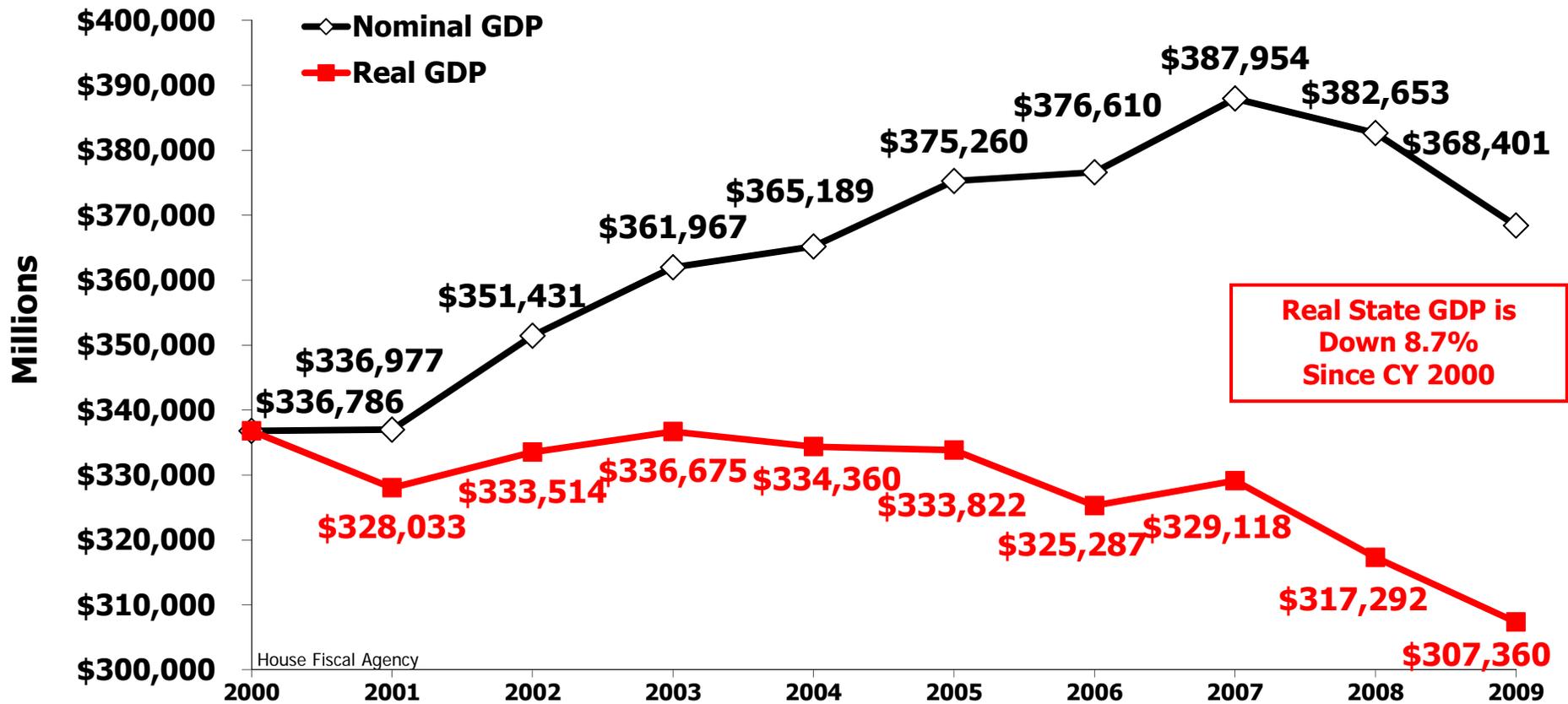


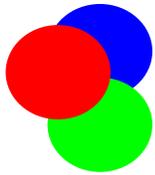
Michigan Per Capita Income Deviation from National Average



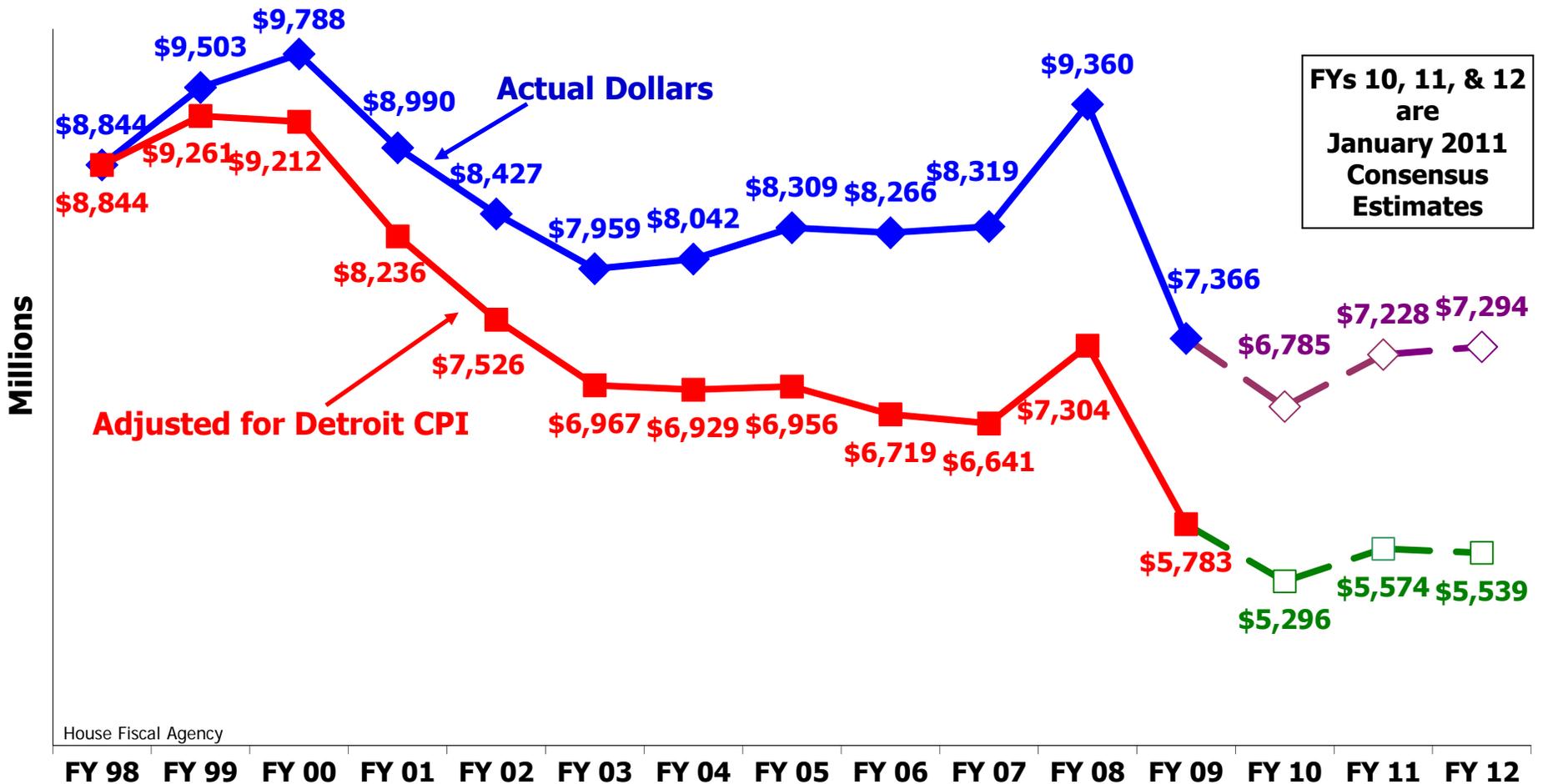


Real and Nominal State GDP

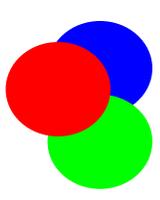




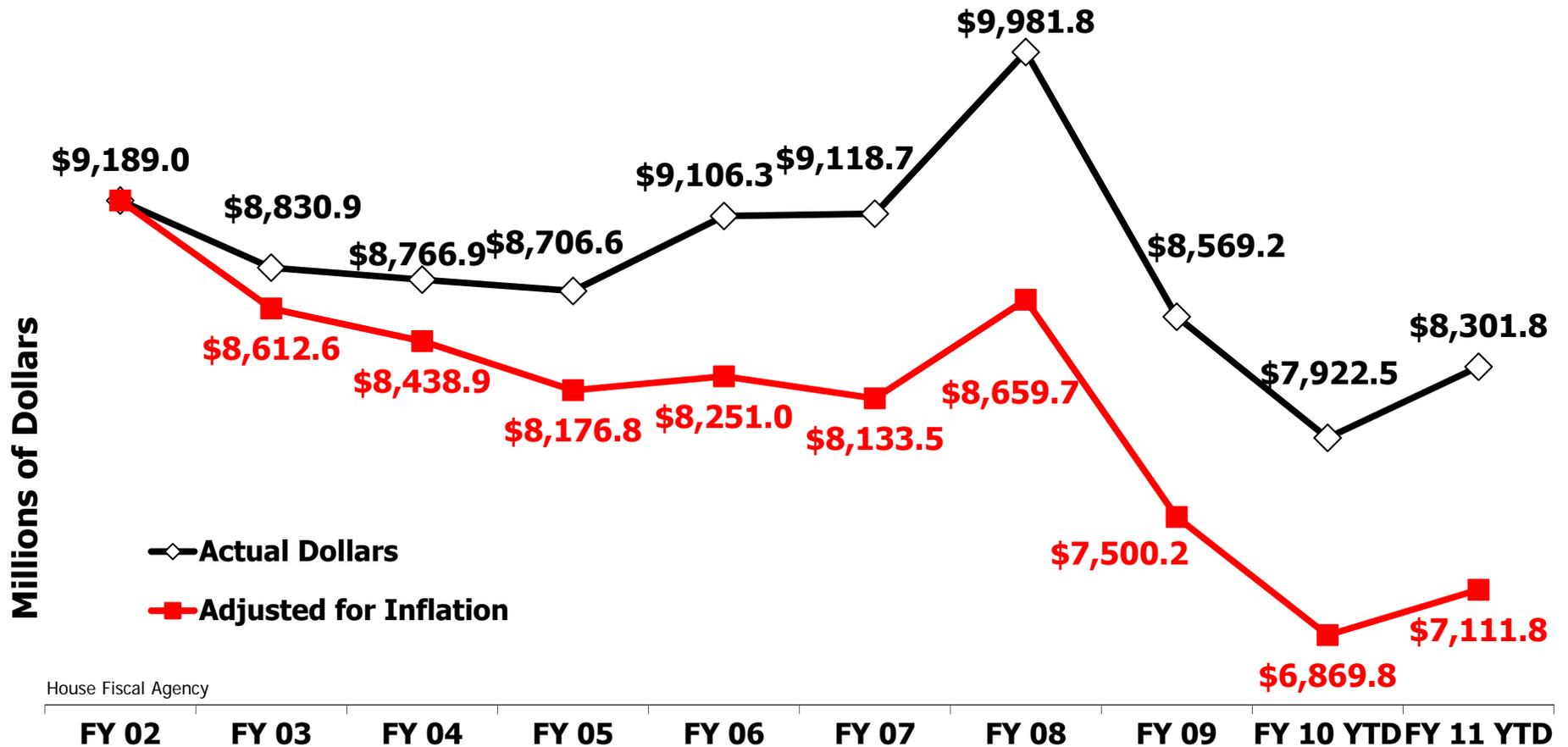
Inflation Adjusted GF/GP Revenue Down 40% Since FY 2000

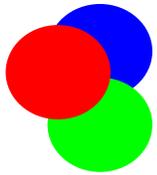


House Fiscal Agency

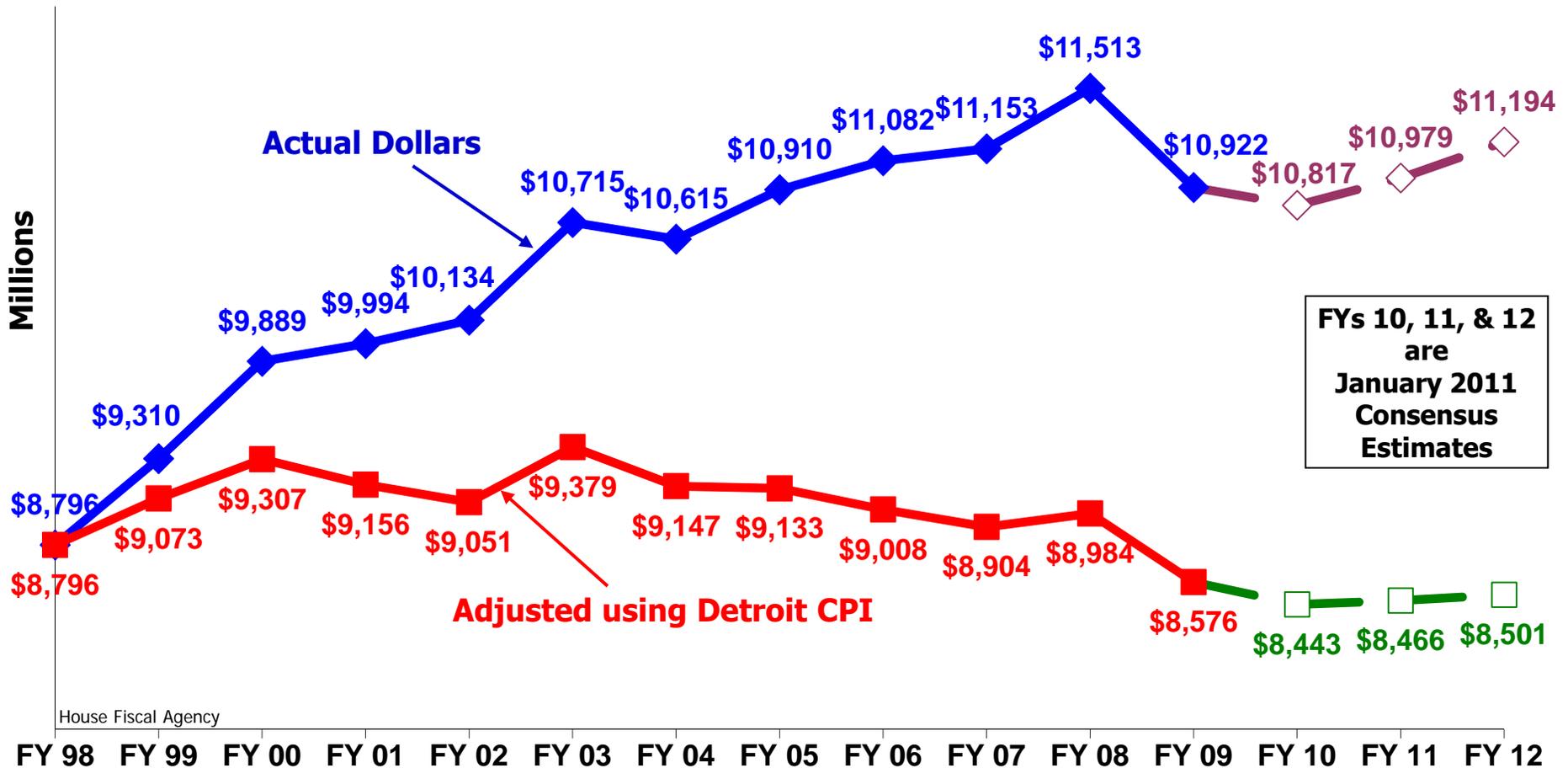


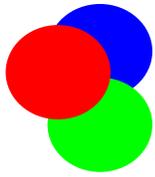
GF/GP Appropriations



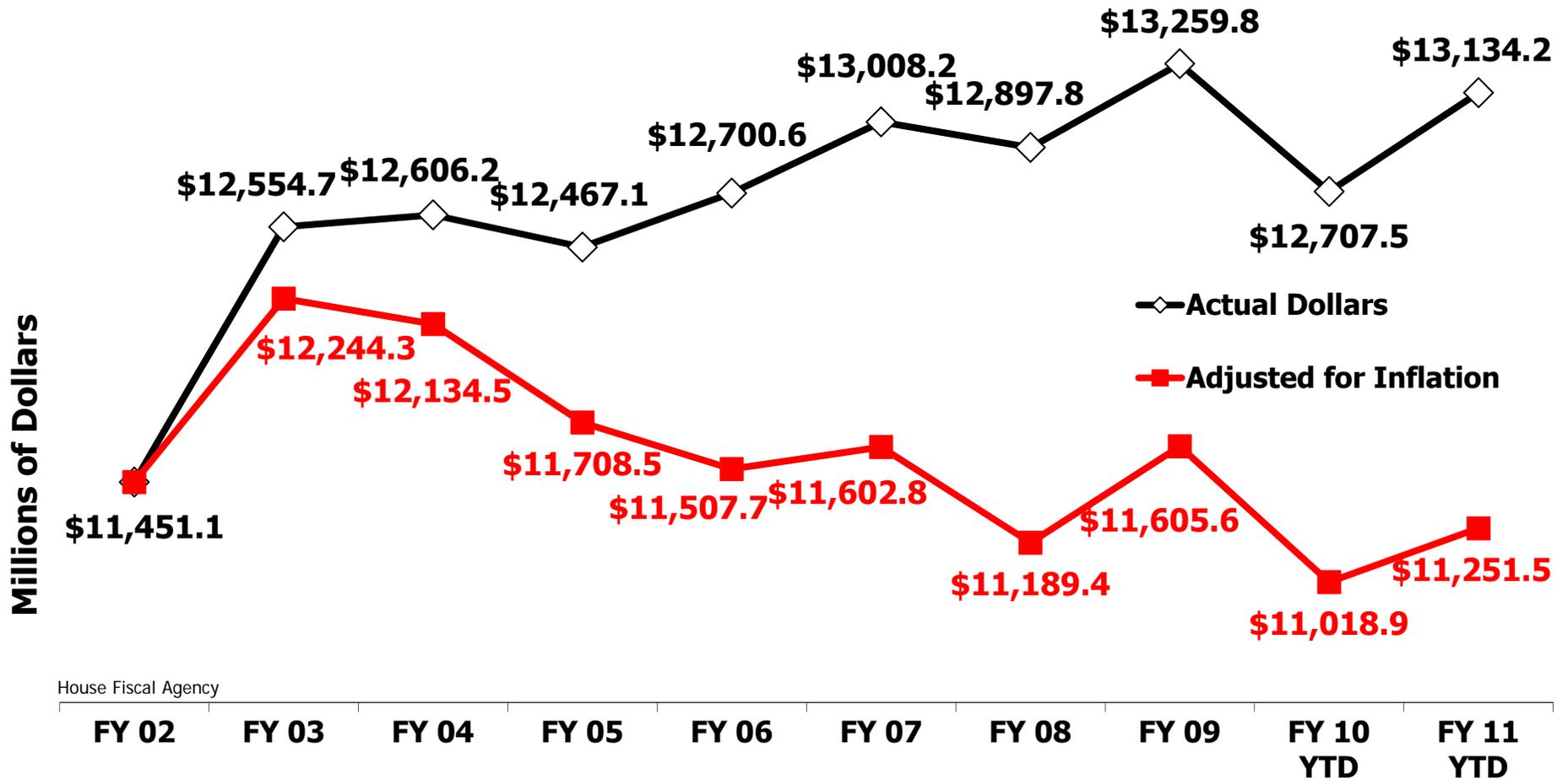


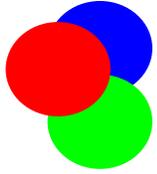
Inflation Adjusted SAF Net Revenue Down 8.7% Since FY 2000



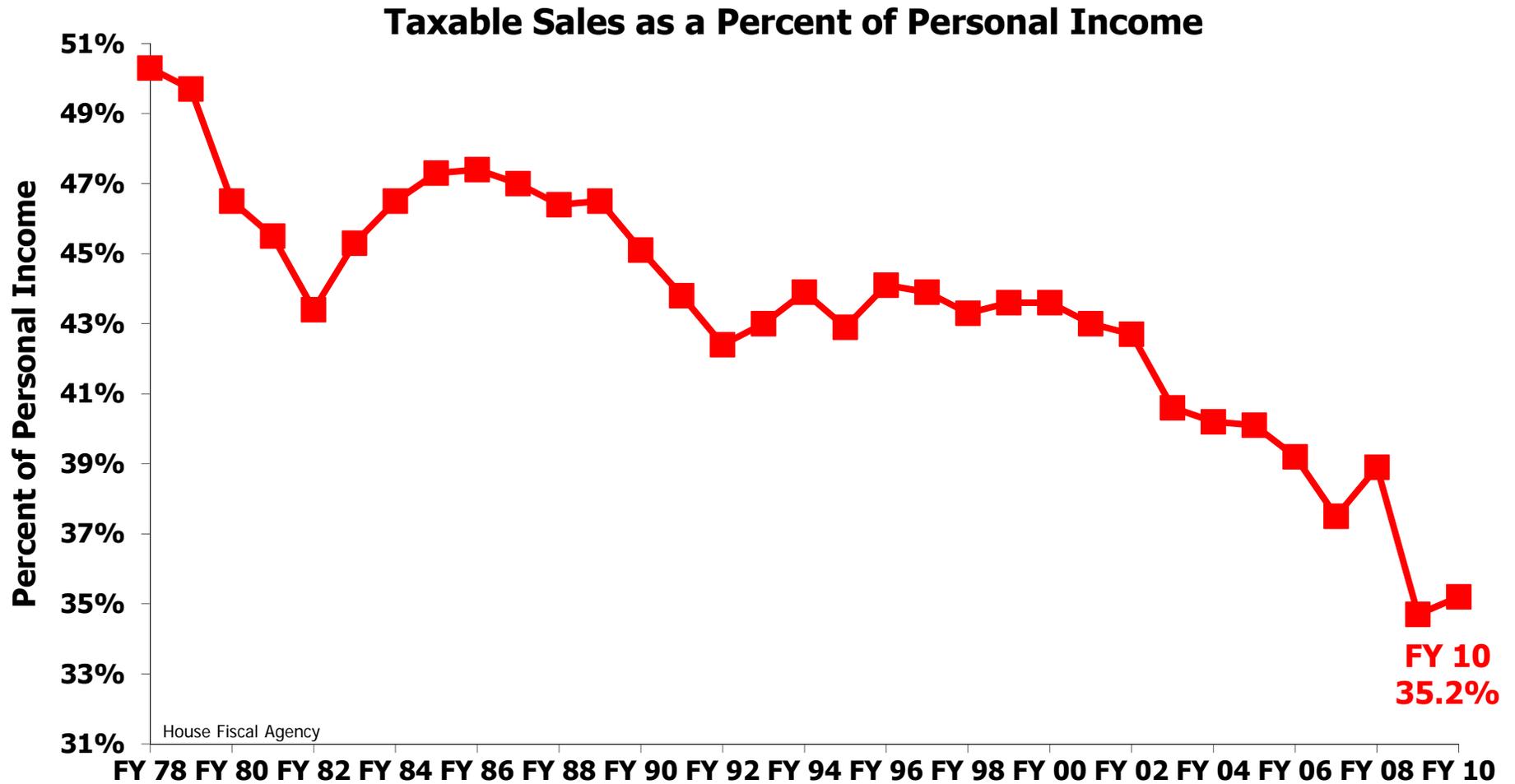


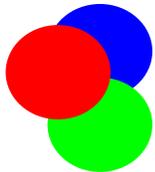
School Aid Budget Adjusted Gross Appropriations



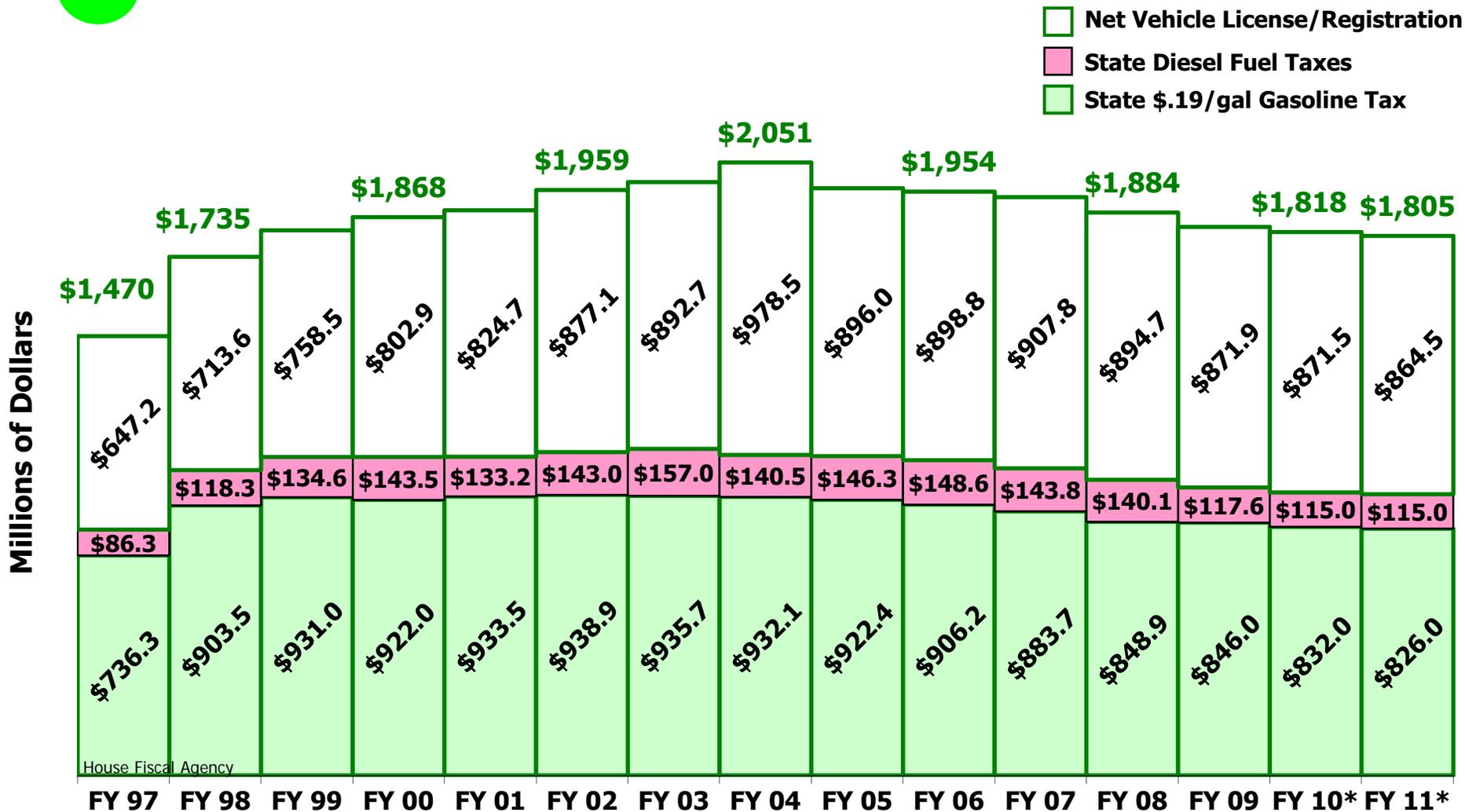


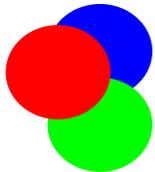
Sales/Use Tax Share Declining



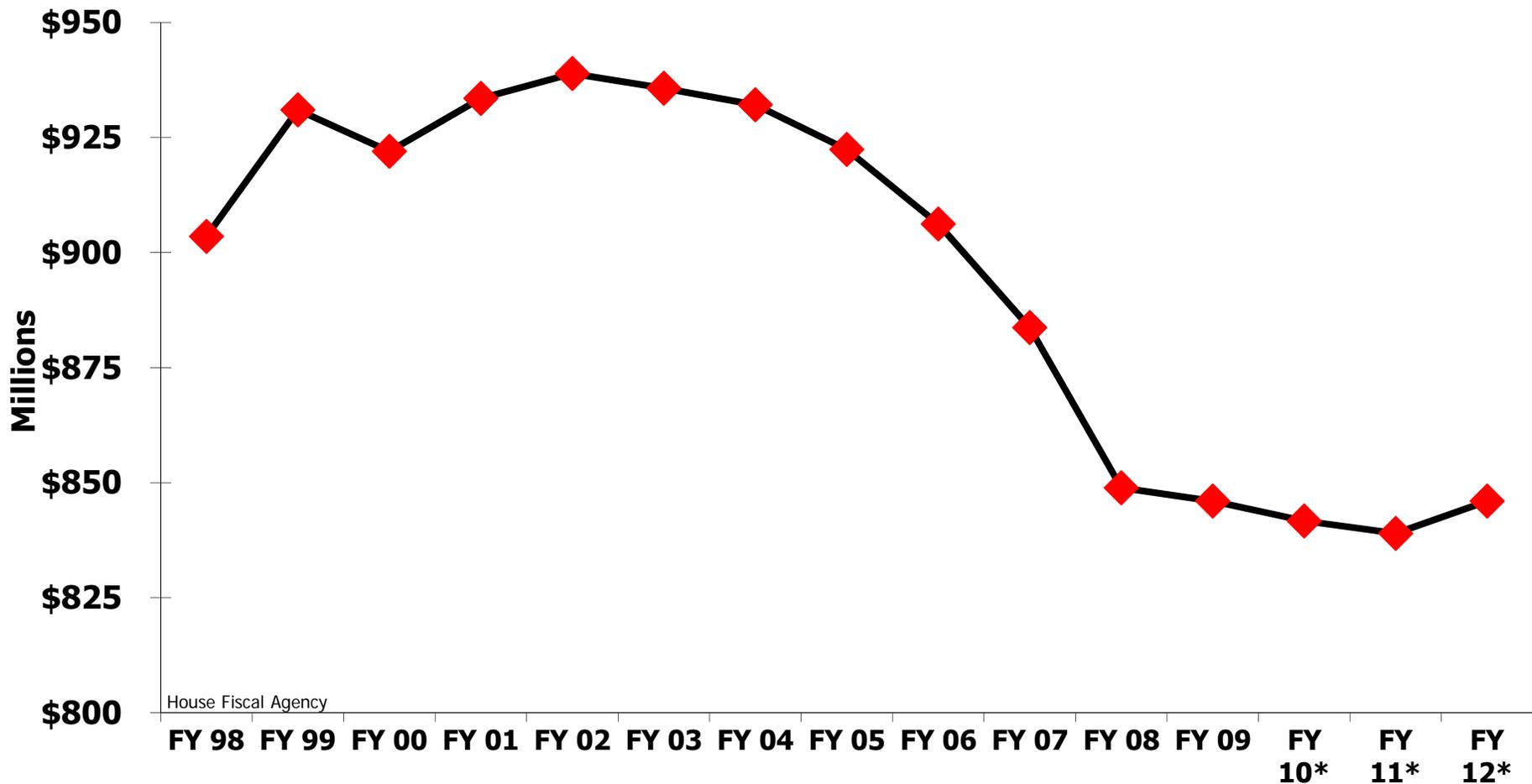


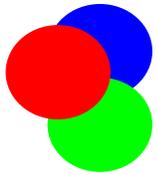
Transportation Revenue



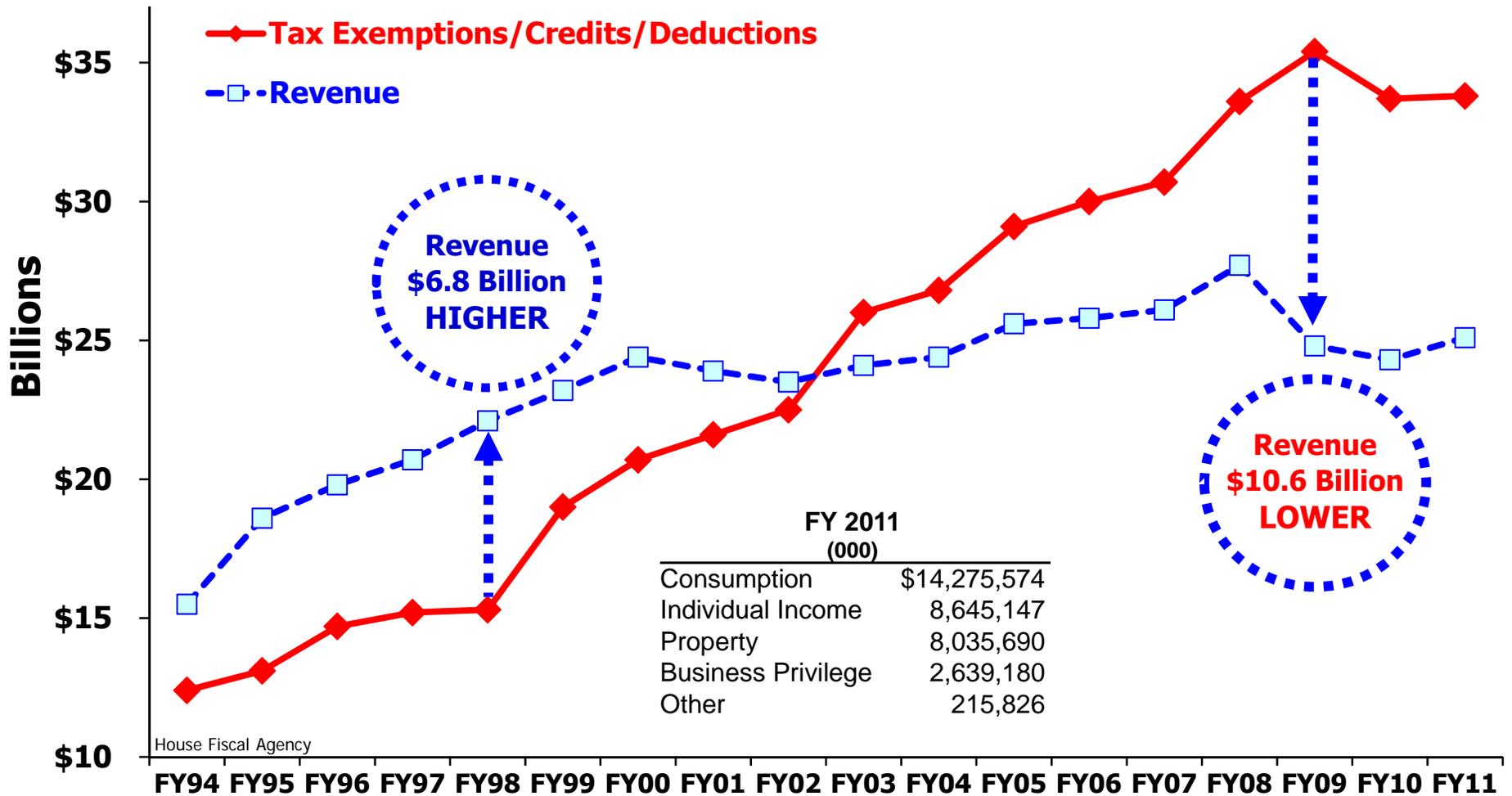


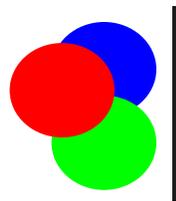
Michigan Gasoline Tax Revenue





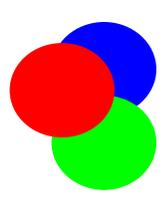
Impact of Tax Exemptions/Credits/Deductions





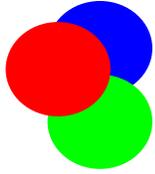
Why Consider Tax Expenditures?

- Tax expenditures are an alternative to direct spending.
- They can be used to effectively continue to spend tax dollars on policy initiatives while the budget is being reduced.
- They're "off-budget" for all practical purposes.
- Transparency and government accountability demand they be reported and evaluated.



Impact of Recent Tax Cuts on Future Revenues

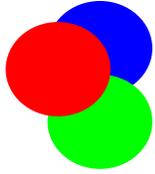
	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>
Reducing Michigan Income Tax Rate	\$0.0	\$0.0	\$0.0	(\$161.8)	(\$342.2)	(\$543.5)
Alternative Energy Credits - Income Tax	(\$16.0)	(\$22.6)	(\$24.2)	(\$18.9)	\$0.0	\$0.0
Michigan EITC	(\$140.0)	(\$341.0)	(\$357.0)	(\$378.0)	(\$400.7)	(\$424.8)
Eliminating MBT Surcharge	Eliminated in Tax Year 2017					
MBT Battery Credits (Assumes Maximum Used)	\$0.0	\$0.0	\$0.0	(\$40.0)	(\$268.0)	(\$278.0)
MBT Film Production Credit	(\$37.5)	(\$61.9)	(\$105.0)	(\$140.0)	(\$140.0)	(\$140.0)
Photovoltaic Technology - Facility & Manufacturing	\$0.0	\$0.0	(\$1.5)	(\$7.5)	(\$7.5)	(\$10.0)
Polycrystalline Manufacturing Credit	\$0.0	\$0.0	\$0.0	\$0.0	(\$20.0)	(\$25.0)
MBT Gross Receipt Changes	(\$115.8)	(\$80.5)	(\$93.4)	(\$117.8)	(\$129.9)	(\$132.7)
Decouple Bonus Depreciation/Production 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)
Use Tax Bad Debt Deduction Change (Court Case)	(\$2.0)	(\$25.5)	(\$16.6)	(\$17.1)	(\$17.7)	(\$18.4)
Angel Credit	\$0.0	\$0.0	(\$3.4)	(\$9.0)	(\$9.0)	(\$9.0)
Exempt Supplies for Cobo Center	\$0.0	\$0.0	(\$2.5)	(\$2.5)	(\$3.5)	(\$1.5)
Totals in Millions	(\$138.8)	(\$508.1)	(\$589.4)	(\$855.9)	(\$1,295.8)	(\$1,533.5)



Senior Tax Preferences

■ Income Tax

- Fully exempts social security, military, federal, state and local government pension/retirement income
- Exempts private pensions up to \$45,120 single/\$90,240 joint (TY 2009); indexed to inflation
 - Annual cost all pension income exemption = \$909 million
- Deduction for senior investment income \$10,058 single/\$20,115 joint; indexed to inflation
 - Annual cost = \$54 million



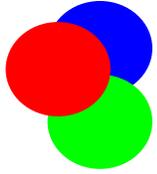
Senior Tax Preferences

■ Income Tax

- Additional Personal Exemption \$2,300 single/\$4,600 joint (TY 2009)
- Annual cost = \$40 million

■ Property Tax

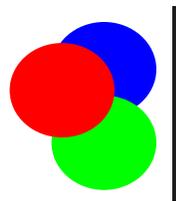
- Homestead Property Tax Credit
 - Under age 65 – credit is 60% of the amount by which property taxes exceed 3.5% of household income, up to a maximum of \$1,200
 - 65 and older – credit is 100% of the difference
Annual cost = \$320 million



Demographics

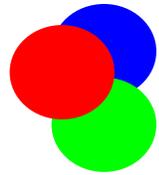
- **Michigan's population is aging**
 - **2000 – 12.3% pop age 65+**
 - **2010 – 12.8% pop age 65+**
 - **2020 – 16.0% pop age 65+**
 - **2030 – 19.5% pop age 65+**

- **Senior tax preferences will get more expensive**



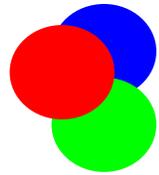
Fewer People Pay Income Tax

<u>All Filers</u>	<u>2000</u>	<u>2008</u>
Tax Liability < \$0	19.5%	25.6%
Tax Liability = \$0	8.0%	8.0%
<u>Tax Liability Between \$0 and \$100</u>	<u>6.1%</u>	<u>5.0%</u>
Tax Liability < \$100	33.6%	38.6%



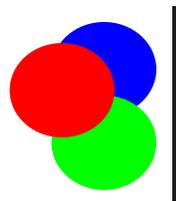
Refundable Credits on the Michigan Income Tax

- **Homestead Property Tax Credit (\$1,006.6 million in FY 2010-11)**
- **Earned Income tax Credit (\$353.8 million in FY 2010-11)**
- **Alternative Energy/Qualified Home Improvement Credit (\$23.6 million in FY 2010-11) – sunsets in 2012**
- **Adoption Credit (\$0.8 million in FY 2010-11)**
- **Stillbirth Credit (\$39,000 in FY 2010-11)**



Indexed Provisions of the Michigan Income Tax

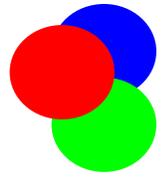
- **Personal Exemption**
- **Special Exemptions for Seniors and/or Disabled Individuals**
- **Special Exemption for Qualified Disabled Veterans**
- **Income Threshold for Pension Income Deduction**
- **Income Threshold for Deduction of Interest and Capital Gains Earned by Seniors**
- **Home Heating Credit**
- **Stillbirth Credit**



Impact of Shrinking Tax Base

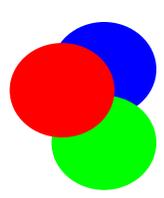
	<u>Income Tax Rate</u>	<u>Collections as Percent of State Personal Income</u>
FY 2000	4.0%	2.6%
FY 2010	4.35%	1.5%
Revenue Impact of Declining Base (In Millions of Dollars)		\$3,653.50

	<u>Sales and Use Tax Rate</u>	<u>Collections as Percent of State Personal Income</u>
FY 2000	6.0%	2.8%
FY 2010	6.0%	2.1%
Revenue Impact of Declining Base (In Millions of Dollars)		\$2,511.60



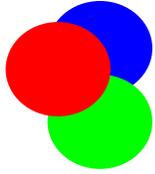
Structural Problems Began in Earnest in 2001

<u>Funding Source</u>	<u>\$ Amount in Millions</u>
■ Withdrawn from the BSF	\$1,264.0
■ SAF surplus	\$870.0
■ One-time revenue from changing SET collection dates	\$454.0
■ Other one-time revenue from various fund shifts and property sales	\$689.0
Total One-Time Revenue June 2001 to December 2002	\$3,277.0

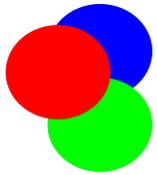


Structural Problems Continue in FY 2011

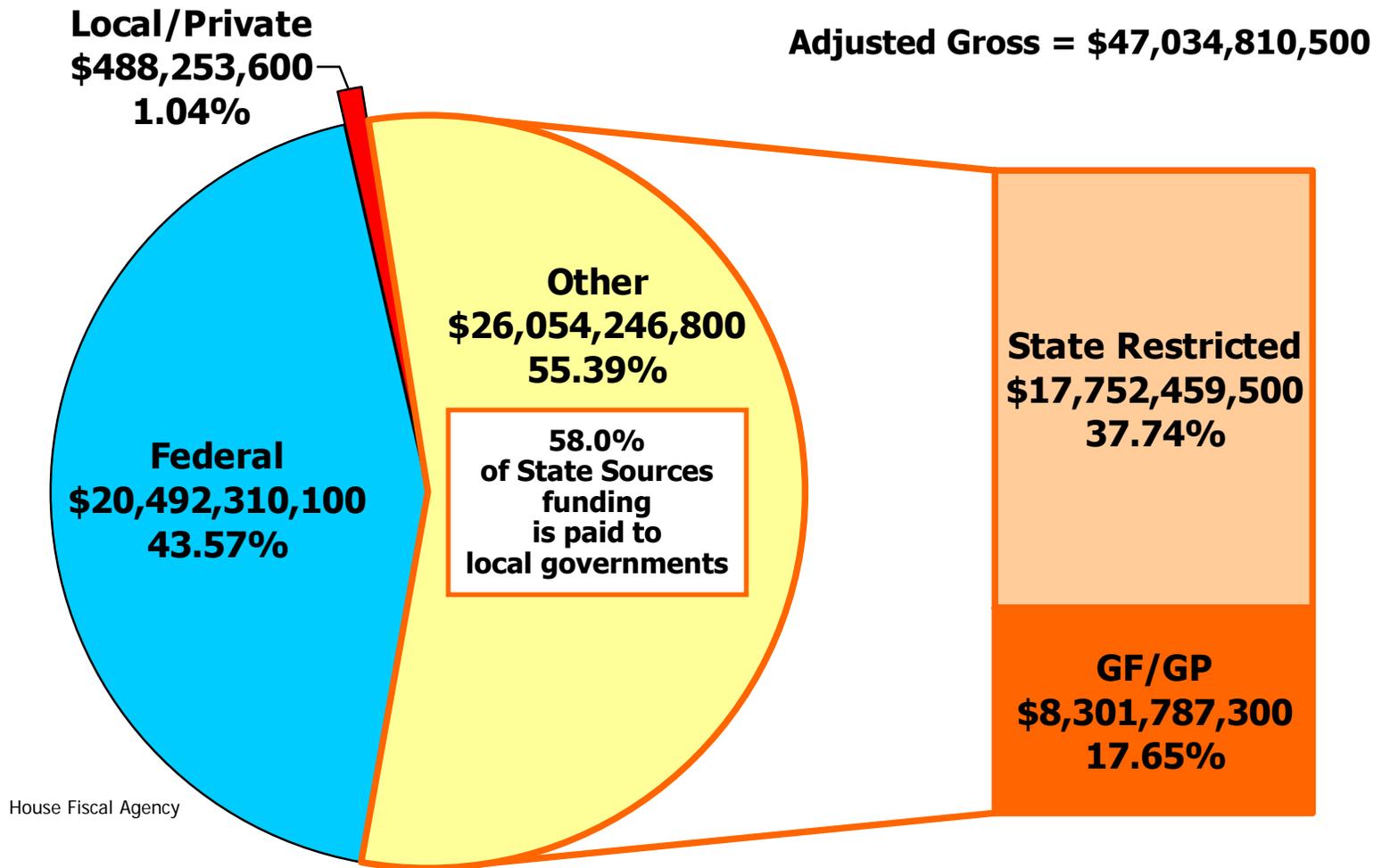
<u>Funding Source</u>	<u>\$ Amount in Millions</u>
■ Federal Funds	\$976.5
■ Tax Amnesty (\$88.8M in FY11 plus assumed \$20.5M loss in FY12)	\$109.3
■ Unclaimed Property (difference between FY11 and FY12)	\$107.0
■ Debt Service Restructuring (difference between FY11 and FY12)	\$162.2
■ Early Retirement (one-time replacement savings minus 3% phase-in)	\$24.0
■ County Revenue Sharing: Projected FY 2011-12 Increase	\$40.0
Total One-Time Funding Sources	\$1,419.0

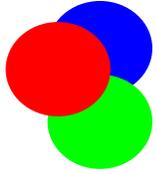


MICHIGAN'S CURRENT BUDGET



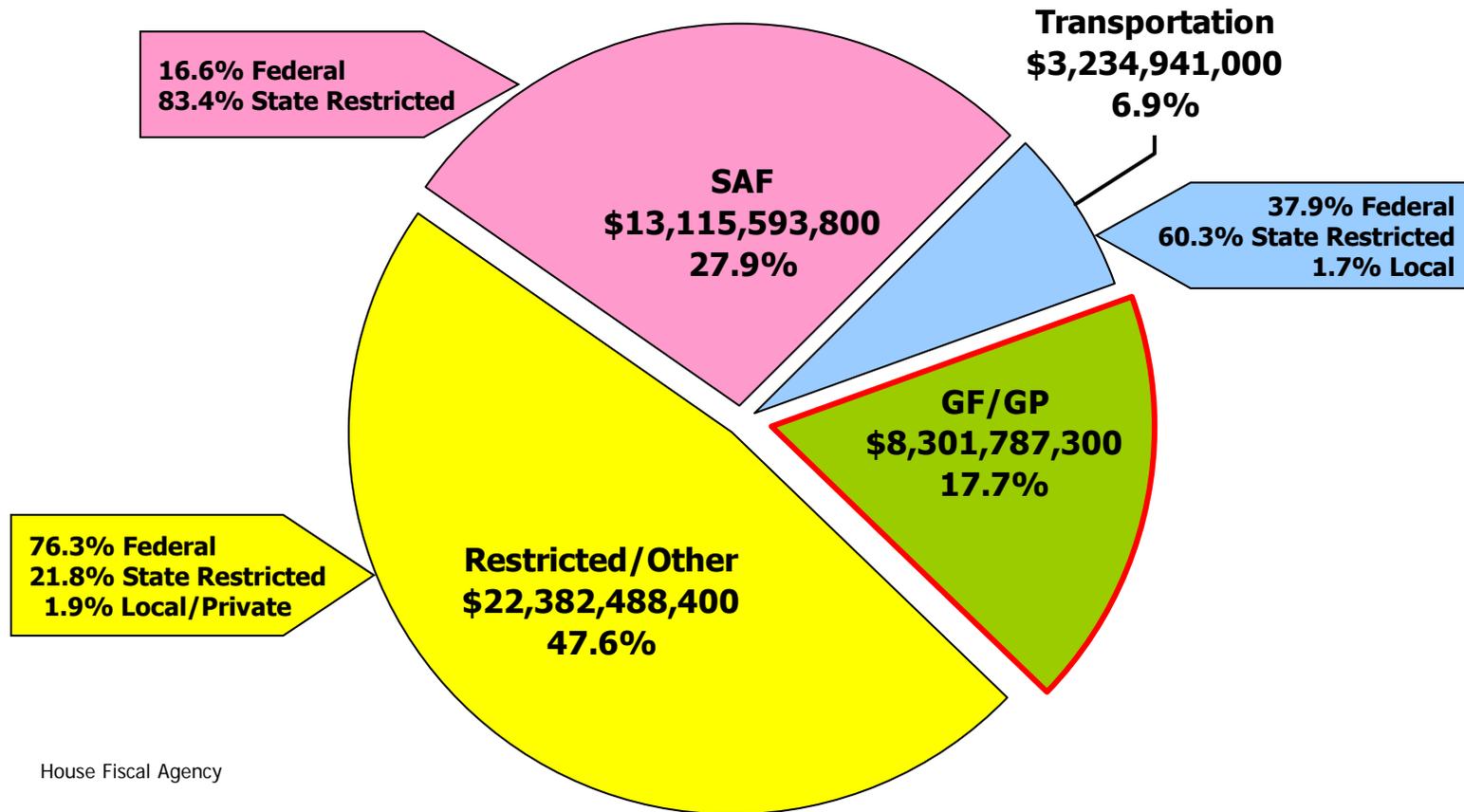
FY 2010-11 Budget Adjusted Gross Funding Sources



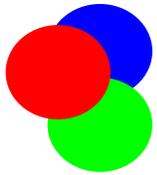


FY 2010-11 Appropriations Funding

Adjusted Gross = \$ 47,034,810,500

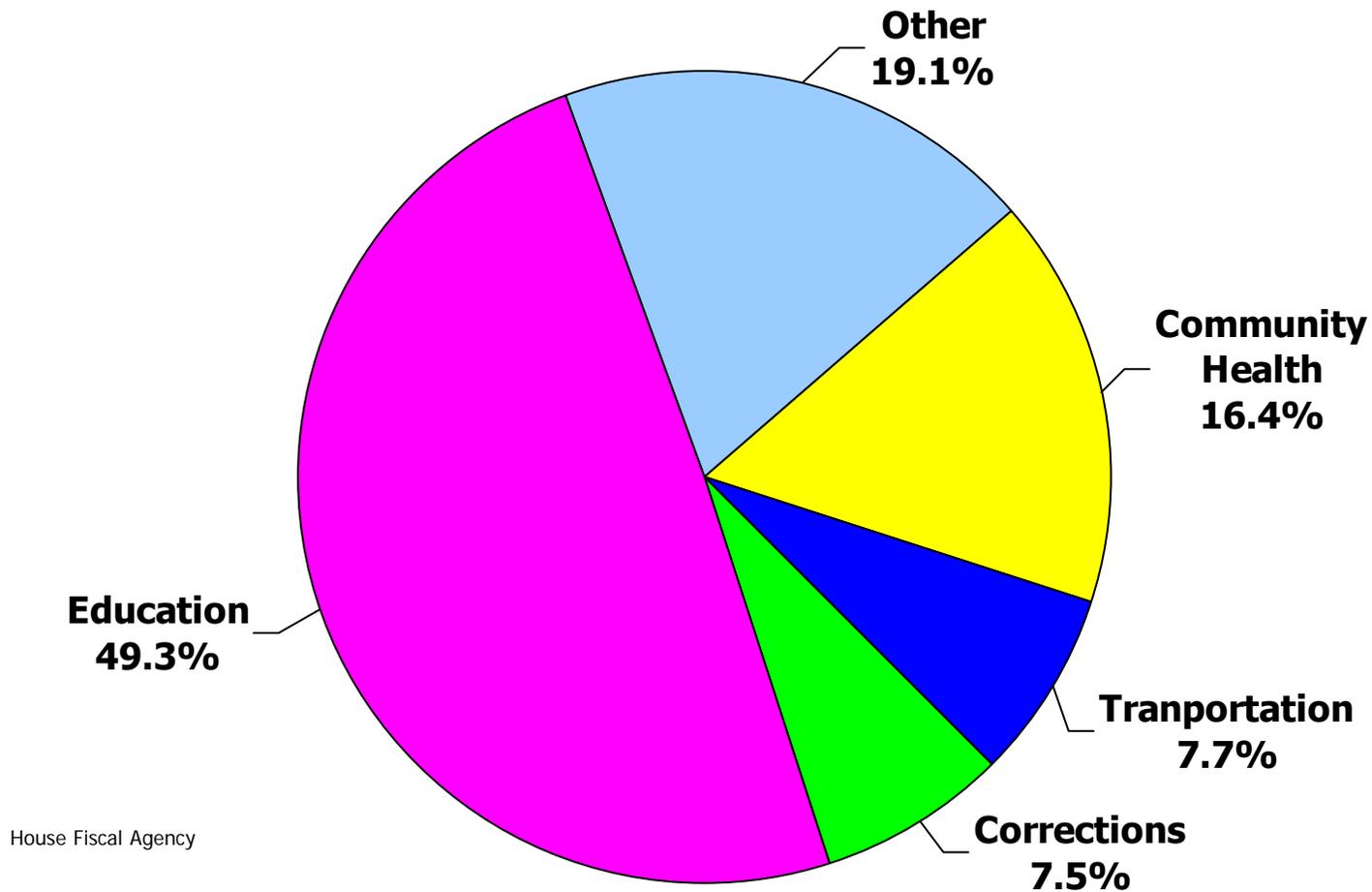


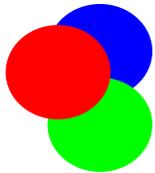
House Fiscal Agency



State Tax and Fee Revenue FY 2010-11

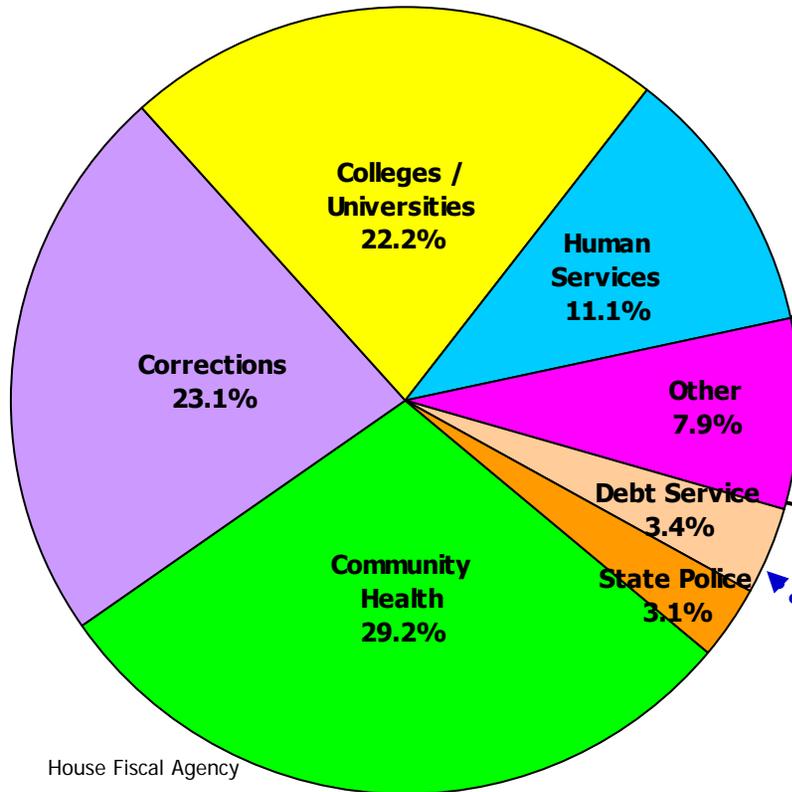
FY 2010-11 Total = \$26,054,246,800



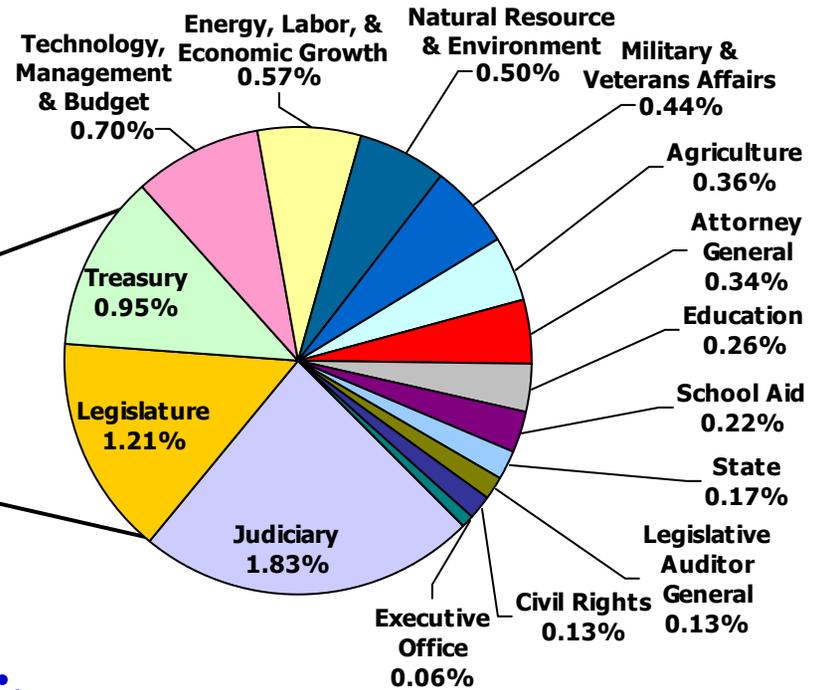


FY 2010-11 GF/GP

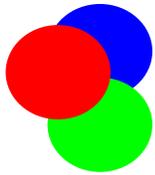
FY 2010-11 Total = \$8,301,787,300



House Fiscal Agency



3.4%
\$284 million
Debt Service and SBA Rent

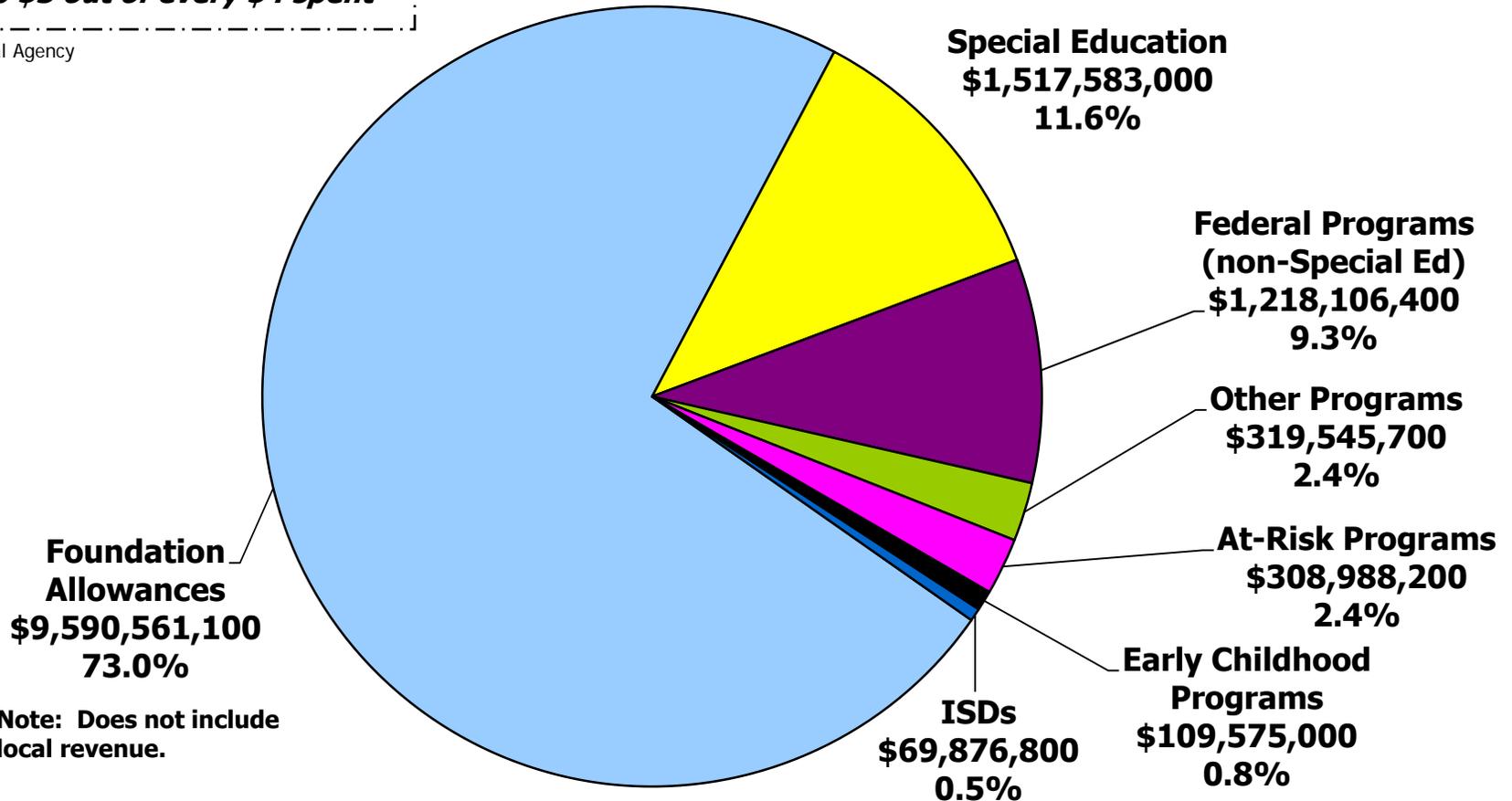


School Aid Major Spending Categories

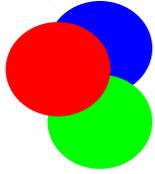
FY 2010-11 Total = \$13,134,236,200

*Foundation allowances
(used for school operations)
absorb \$3 out of every \$4 spent*

House Fiscal Agency

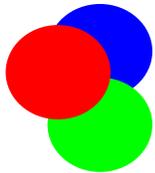


Note: Does not include local revenue.

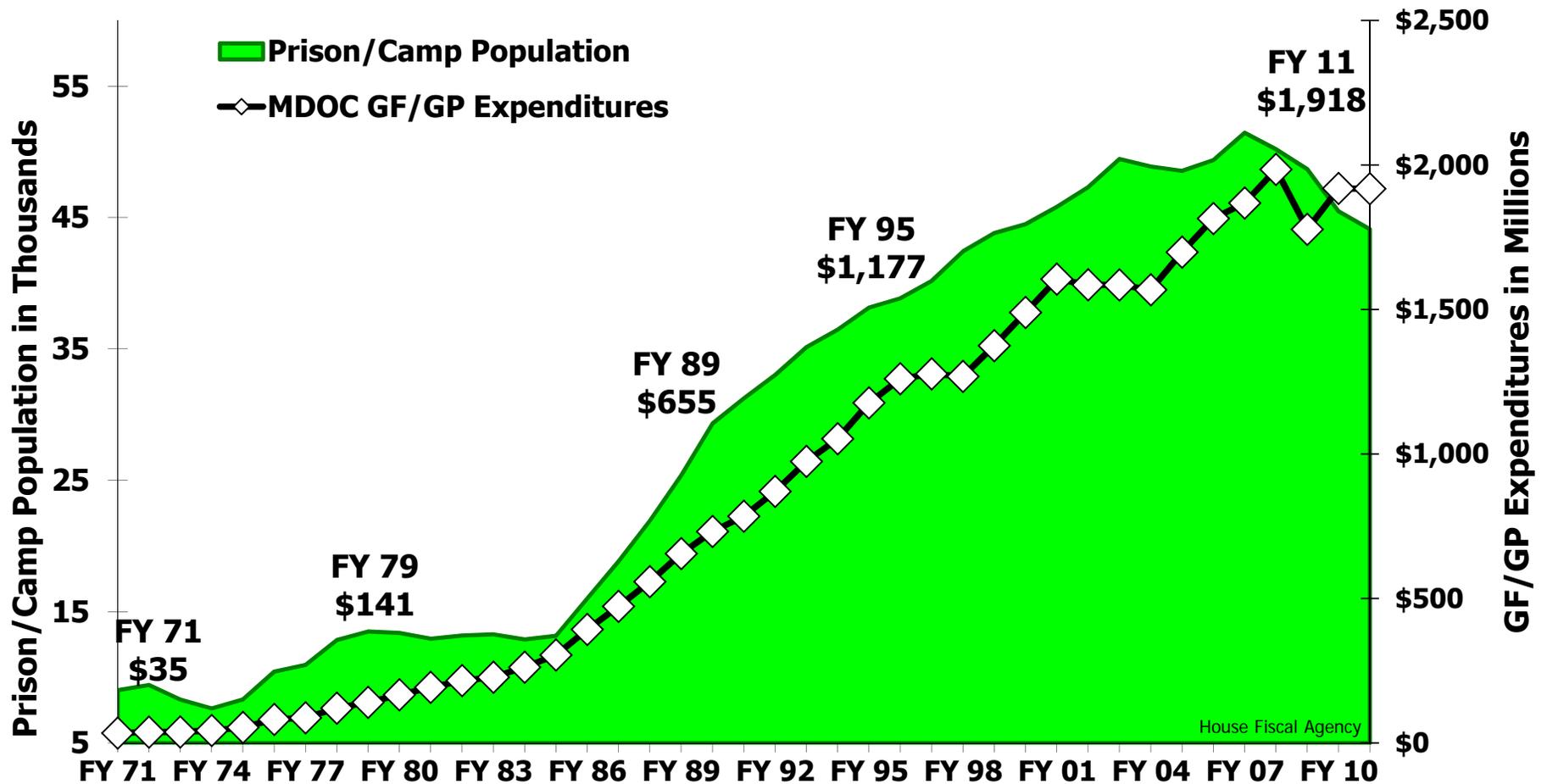


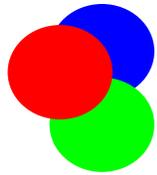
Medicaid Impact on Michigan Budget

- For FY 11, approximately 19.1% of Michigan GF/GP revenue is appropriated for Medicaid
- 1 of 6 Michigan residents were eligible for Medicaid in April 2009
- 42% of births and 70% of nursing home expenditures in Michigan are financed through Medicaid
- Total state and federal Medicaid appropriation is over \$11.5 billion in FY 11
- Since FY 1999-2000
 - 126.5% increase in Medicaid funding
 - 71.5% growth in Medicaid caseload (759,800 cases)

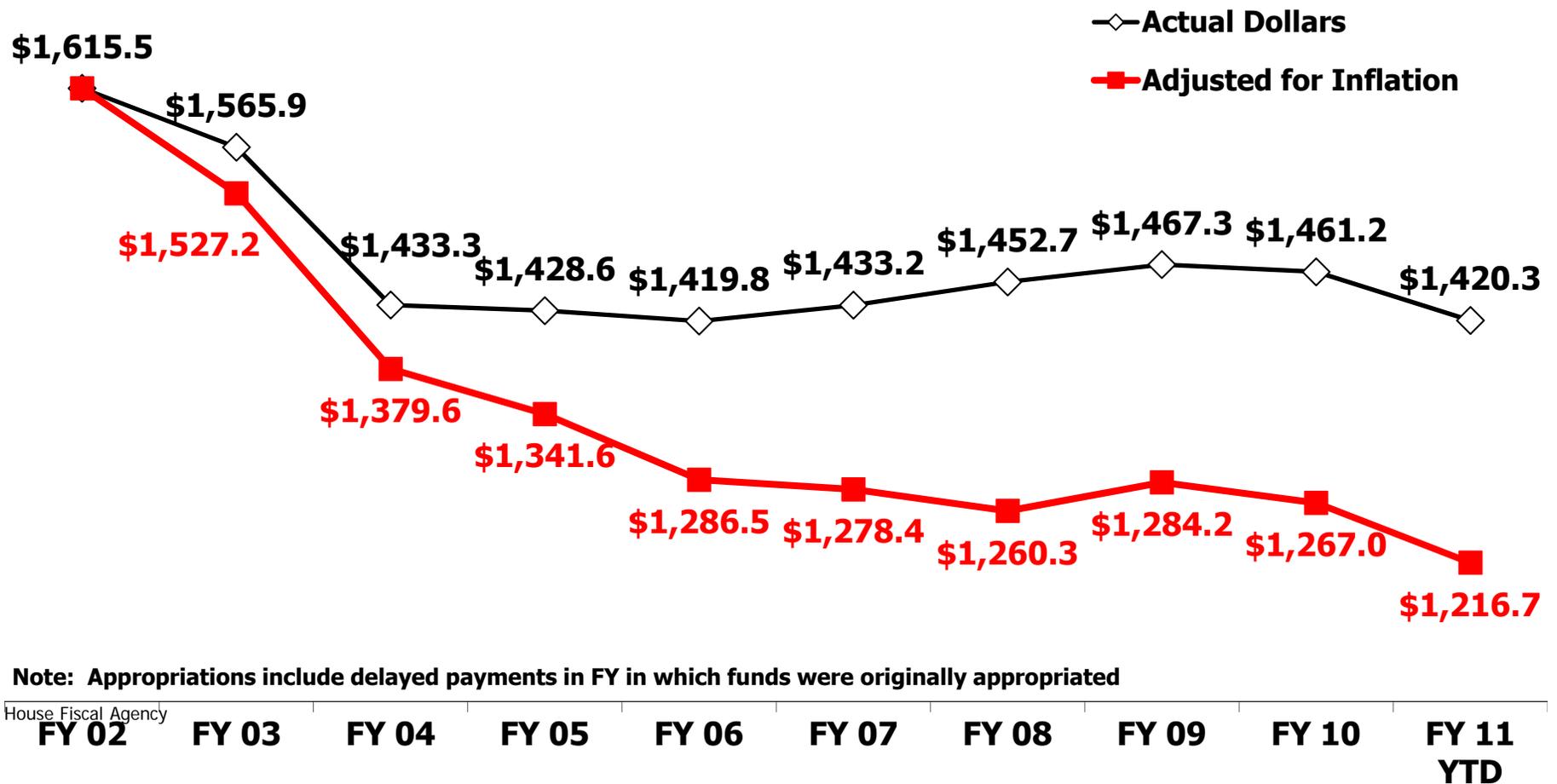


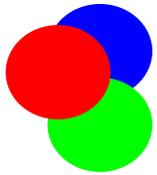
Corrections Budget Increases



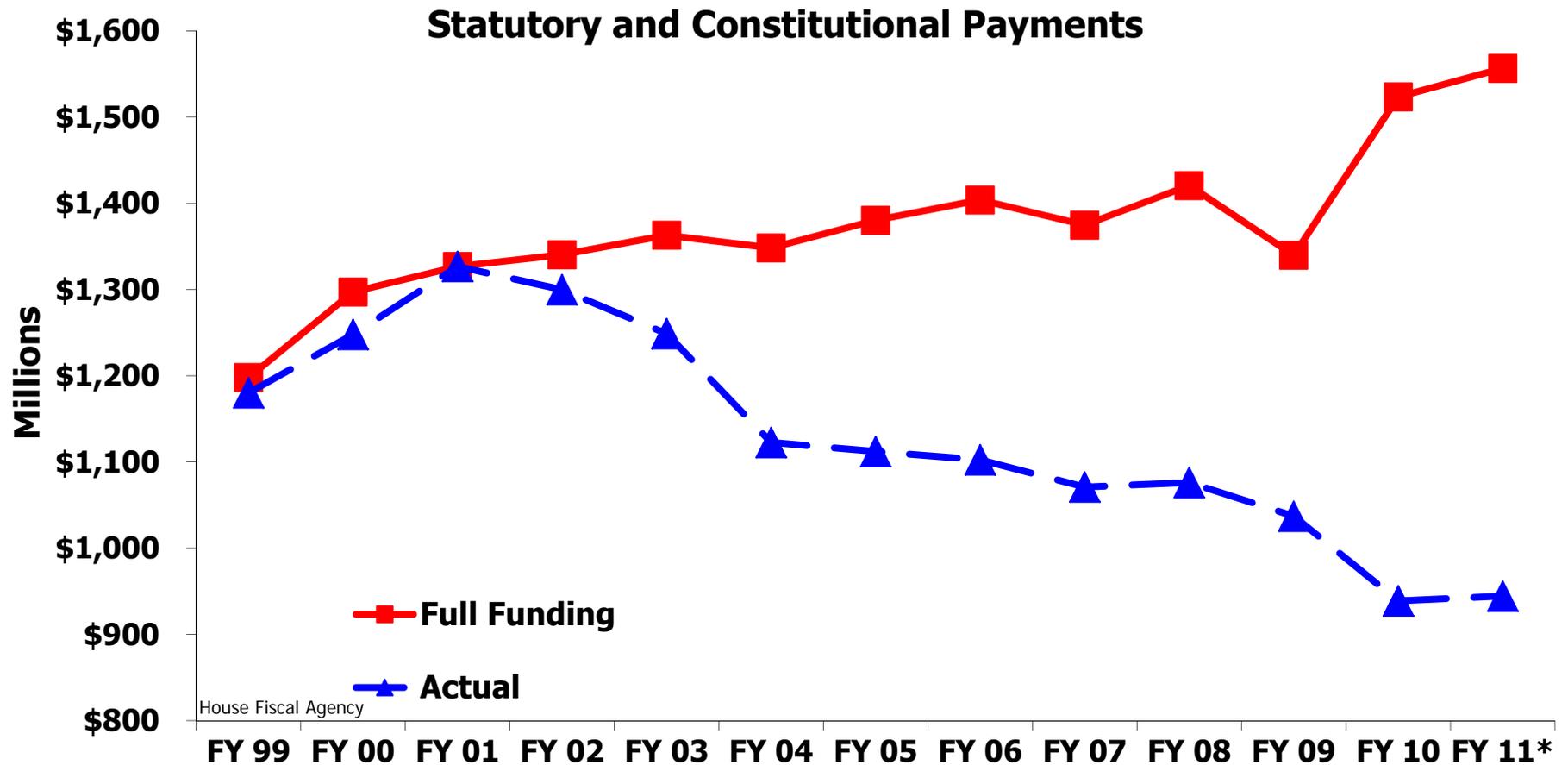


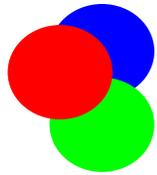
Total Appropriations for State University Operations





Revenue Sharing Payments to Cities, Villages, and Townships

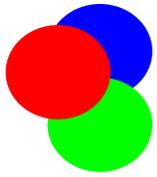




Property Value Growth Slowing

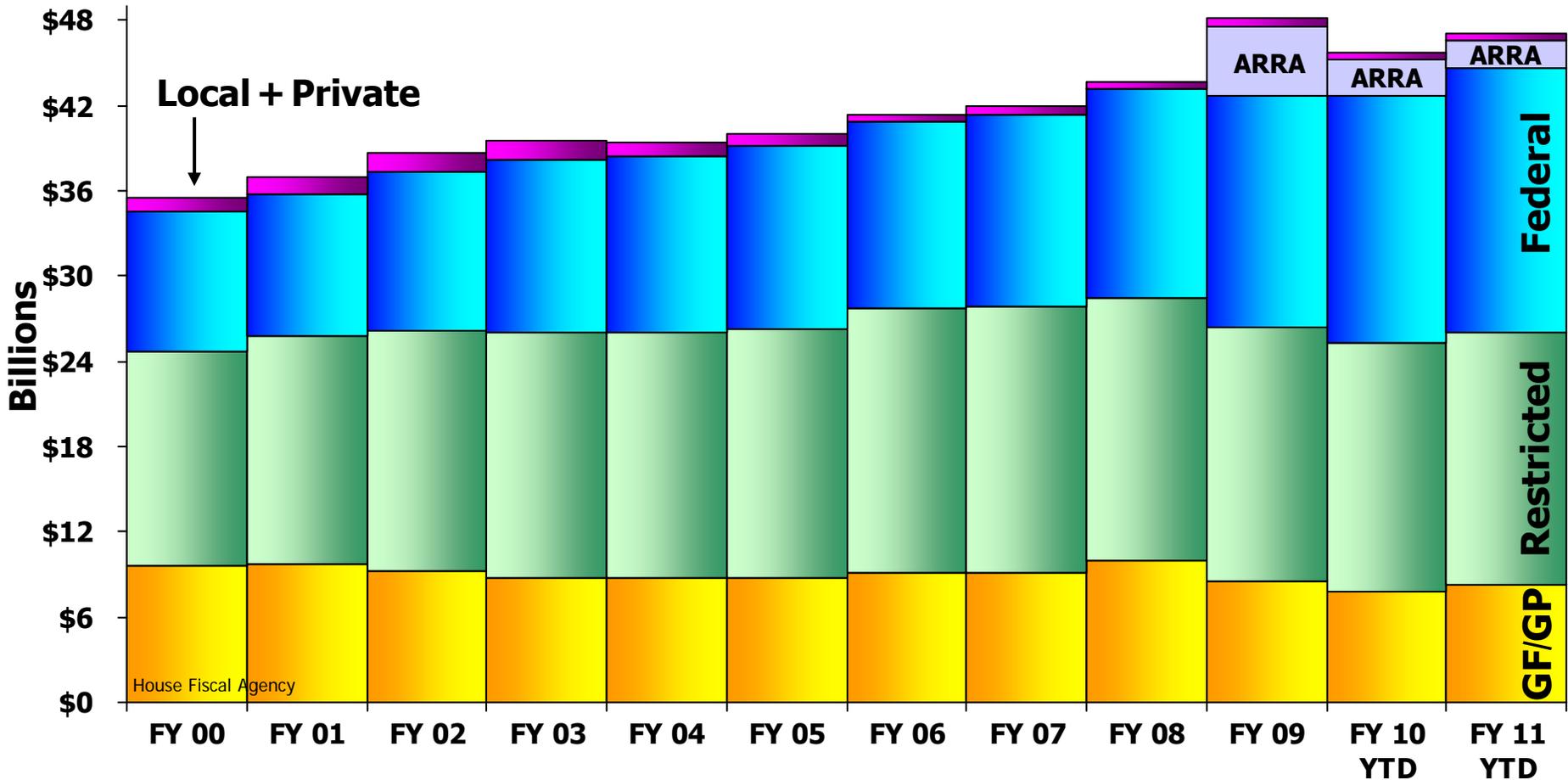
Yearly Change

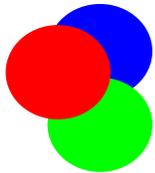
	<u>Inflation Rate Multiplier for Property</u>	<u>Total SEV Growth</u>	<u>Total Taxable Value Growth</u>
1997	2.8 %	8.2 %	5.7 %
1998	2.7 %	9.5 %	6.1 %
1999	1.6 %	9.9 %	6.0 %
2000	1.9 %	9.0 %	5.5 %
2001	3.2 %	10.0 %	7.1 %
2002	3.2 %	9.8 %	6.7 %
2003	1.5 %	7.5 %	4.8 %
2004	2.3 %	6.3 %	5.7 %
2005	2.3 %	5.9 %	5.6 %
2006	3.3 %	5.0 %	5.8 %
2007	3.7 %	3.8 %	5.2 %
2008	2.3 %	-1.1 %	1.4 %
2009	4.4 %	-5.4 %	-0.8 %
2010	-0.3 %	-9.2 %	-6.6 %
2011	2.5 %	N/A	-4.3 %



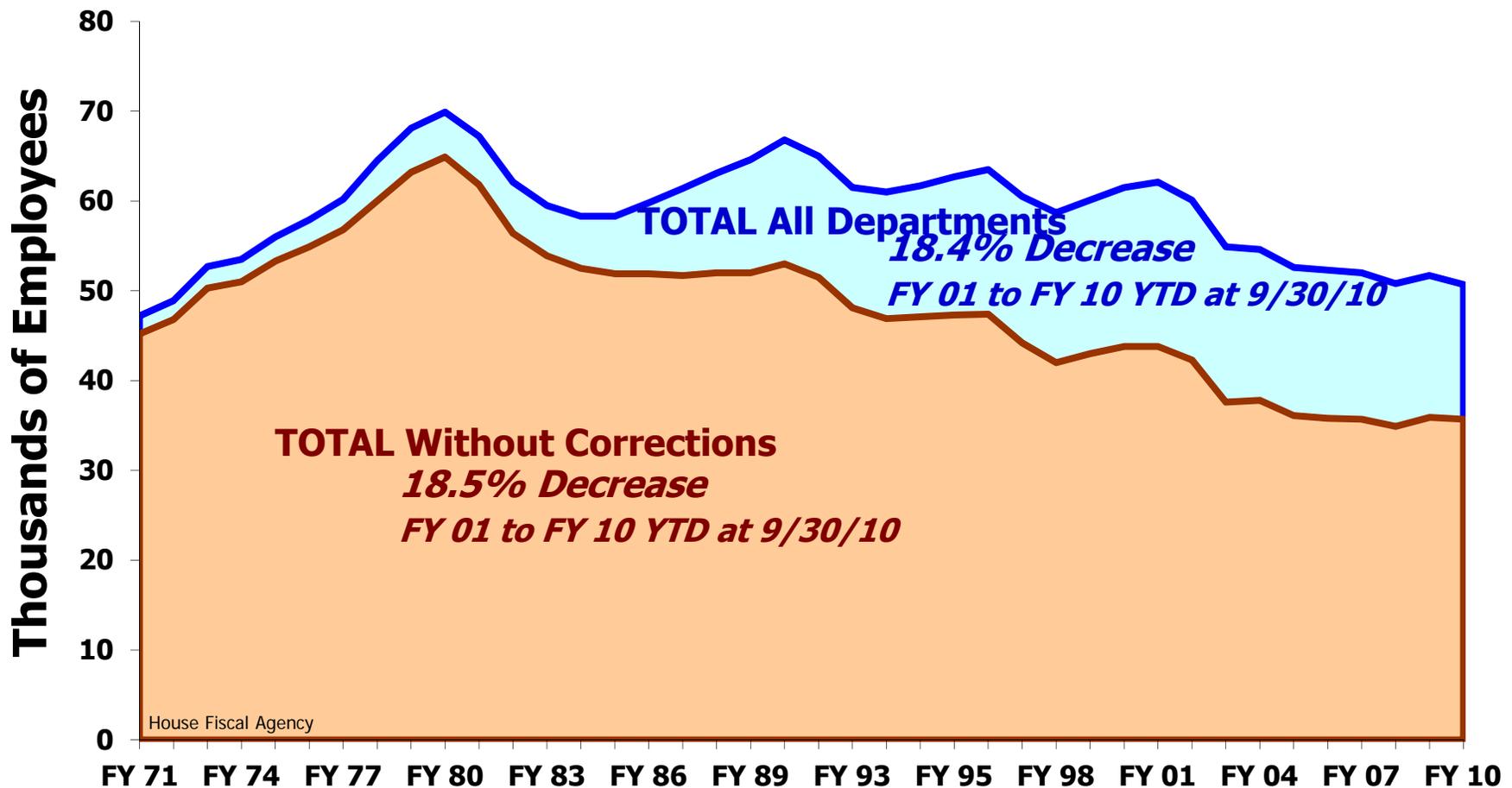
Adjusted Gross Appropriations by Fund Source

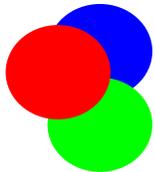
Excluding federal funds, FY 00 = FY 10 adjusted gross appropriations





Average Number of Classified State Employees

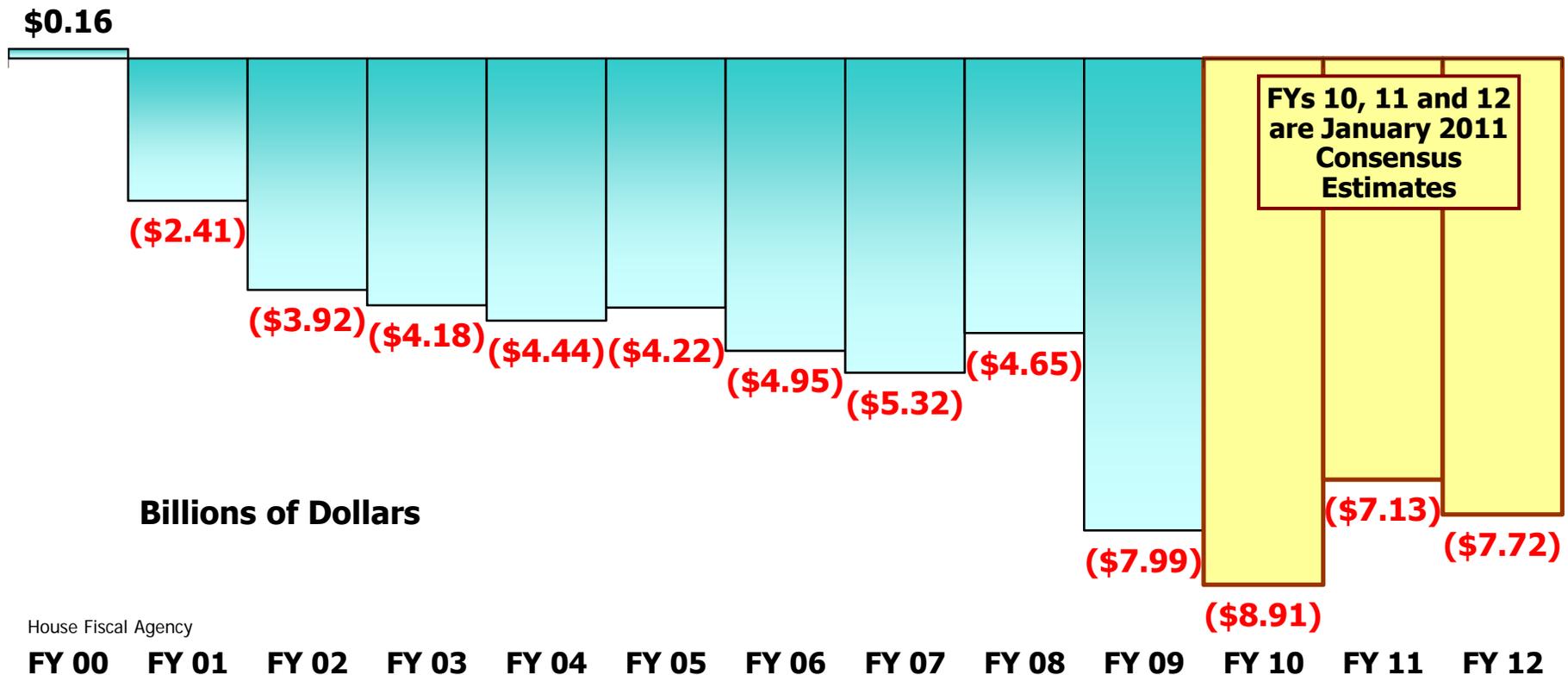




Constitutional Revenue Limit

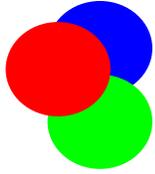
Average growth of Michigan personal income = 2.0% per year from 2000 through 2012

Average increase of Michigan revenue = 0.4% per year from 2000 through 2012

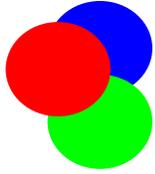


House Fiscal Agency

FY 00 FY 01 FY 02 FY 03 FY 04 FY 05 FY 06 FY 07 FY 08 FY 09 FY 10 FY 11 FY 12

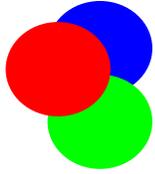


EXECUTIVE BUDGET RECOMMENDATION



Total Budget Cuts \$1,520.9 Million

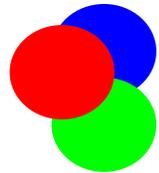
- Corrections (\$51.2 million)
- Community Health (\$212.6 million)
- Human Services (\$109.5 million)
- Higher Education (\$222.4 million)
- Statutory Revenue Sharing (\$143.9 million)
- State employee concessions (\$180.0 million)
- Other (\$63.2 million)
- School Aid reductions (\$538.1 million)



School Aid Cuts

- **Reduces Foundation Allowances by \$470 Per Pupil**
 - **Makes the FY 2011 \$170 per pupil reductions permanent by rolling the cut into the foundation allowance**
 - **Reduce all foundations by \$300 per pupil, for a total foundation allowance reduction of \$470 per pupil**
 - **Additional \$300 per pupil cut equals a savings of \$452.5 million**

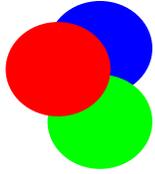
- **Certain Categorical Funding programs eliminated - totaling \$82.8 million**



School Aid Cuts

- **Intermediate School District (ISD) General Operations**
 - **Reduces payments by 5% or \$3.3 million**

- **School Aid Fund (SAF) Revenue Shifts Totaling \$1.1 Billion**
 - **Tax proposal reduces SAF revenue (\$597.1)**
 - **Budget proposal increases GF/GP transfer to SAF (\$393.9)**
 - **SAF revenue shifted into Community College budget (\$195.9) and Higher Education budget (\$699.7 million)**

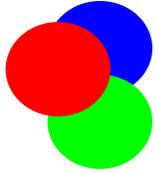


Higher Education

- **Each university's appropriation is reduced by 15% (\$222.4 million GF/GP)**

- **Tuition restraint incentive funding (\$83 million)**
 - **Funds would be paid only if a university held its FY 2011-12 resident undergraduate tuition/fee increases below the prior-five-year state average**

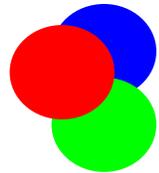
 - **Individual incentive amounts (based on average annual tuition/fee rate increase over the last five years) ranging from 5.1% to 9.8% of proposed FY 2012 appropriation amounts**



Revenue Sharing Cuts

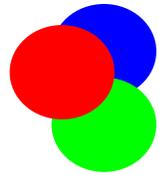
- **Statutory Revenue Sharing line item for cities, villages, and townships (CVT's) eliminated and replaced by Local Government Incentives Program**
 - **Revenue distributed to units that use "Best Practices" (details not yet released)**
 - **Net reduction in funding (\$107.1 million)**

- **County Revenue Sharing**
 - **Distributed on a pro-rata basis for those who qualify, and is reduced \$14.7 million from FY 2011**
 - **Total reduction from current law is \$51.7 million**



Other Cuts

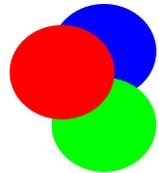
- **Retroactive 48 month lifetime limit for cash assistance recipients (FIP)**
 - **Will close 12,600 FIP cases generating \$77.4 million gross, \$65.0 million GF/GP, in savings**
 - **Graduate Medical Education (GME) reduced 40%, \$67.3 million Gross (\$22.8 million GF/GP)**
- **Reduce Fire Protection Grant reduces grant payments to local units with state property (\$1.6 million)**
- **Reduces state aid to libraries by \$2.3 million (DOE)**
 - **Additionally, the School Aid budget eliminates \$1.5 million in state aid to libraries**



Governor's Tax Plan

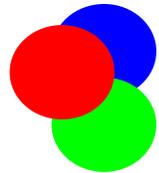
■ Net Revenue Reductions

- Reduce total revenue \$270.6 million in FY 2011-12 [GF/GP up \$326.5 million, SAF down \$597.1 million]
- Reduce total revenue \$64.0 million in FY 2012-13 [GF/GP up \$466.3 million, SAF down \$530.3 million]



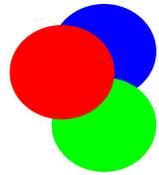
Business Tax Changes

- **Cut business taxes \$1.73 billion [86% net cut]**
- **Repeal the Michigan Business Tax (MBT taxes modified gross receipts and profits)**
- **Institute a 6% tax on business income for C corps only**
- **Honor existing firm-specific credits including MEGA, film, next energy, battery credits, etc.**
- **Keep ability to award more firm-specific credits until 2012**



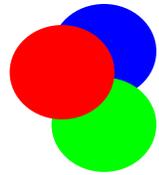
Personal Income Tax Changes

- **Increase personal income tax \$1.67 billion [30% net increase 2012]**
- **Freeze the income tax rate at 4.25% [increases revenue \$171.0 million]**
- **Eliminate private pension exemption [increases revenue \$699.5 million]**
- **Eliminate non-military public pension exemption [increases revenue \$209.7 million]**
- **Eliminate state earned income tax credit, EITC, [increases revenue \$373.7 million]**



Personal Income Tax Changes

- **Eliminate investment income exemption for seniors**
- **Eliminate special exemptions for seniors and UI and child deductions**
- **Eliminate all other major refundable and non-refundable credits except for the homestead property tax credit, the home heating credit, and the farmland preservation credit**
- **Eliminates credits and deductions for all voluntary contributions**
- **Create new Tax and Fee Reform Reserve Fund [FY 2012-13 = \$171 million, FY 2013-14 = \$380 million, FY 2014-15 = \$593 million, FY 2015-16 = \$719 million]**



Summary of Executive Recommendation

- **Cut services \$1.5 billion to address the budget shortfall**
- **Provide a \$1.7 billion [86%] net tax cut for business**
- **Replace business tax revenue with \$1.8 billion [30%] increased income tax revenue by eliminating income tax expenditures**
- **Freeze the income tax rate while phasing in a permanent earmark of 0.35% of taxable income [estimated \$719 million when fully phased in 2016] for a new Tax and Fee Reform Reserve Fund**

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