



Challenges Ahead in
Balancing the State
Budget

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School Community Health Alliance of Michigan
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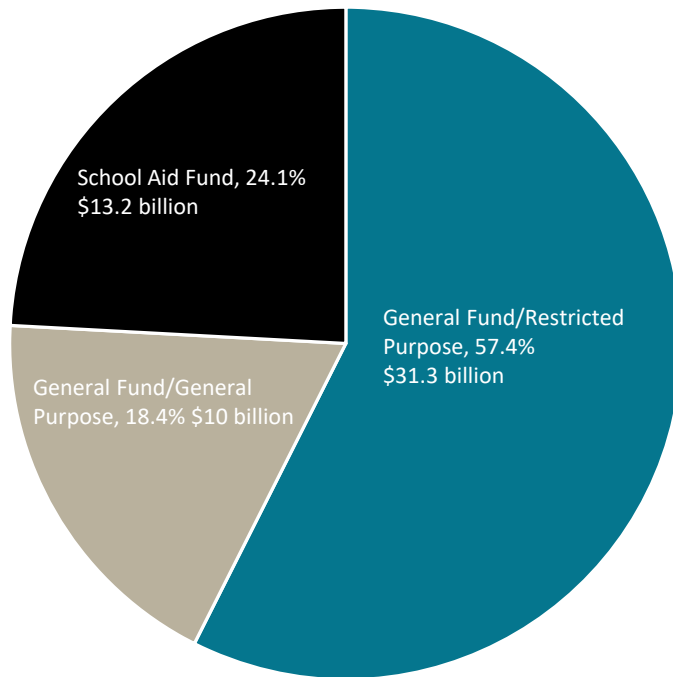
Citizens Research Council

- 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 from Michigan foundations, businesses, and individuals
- *www.crcmich.org*

The Current State of the Budget

The State Budget

Disposition of Michigan Revenues, FY2018

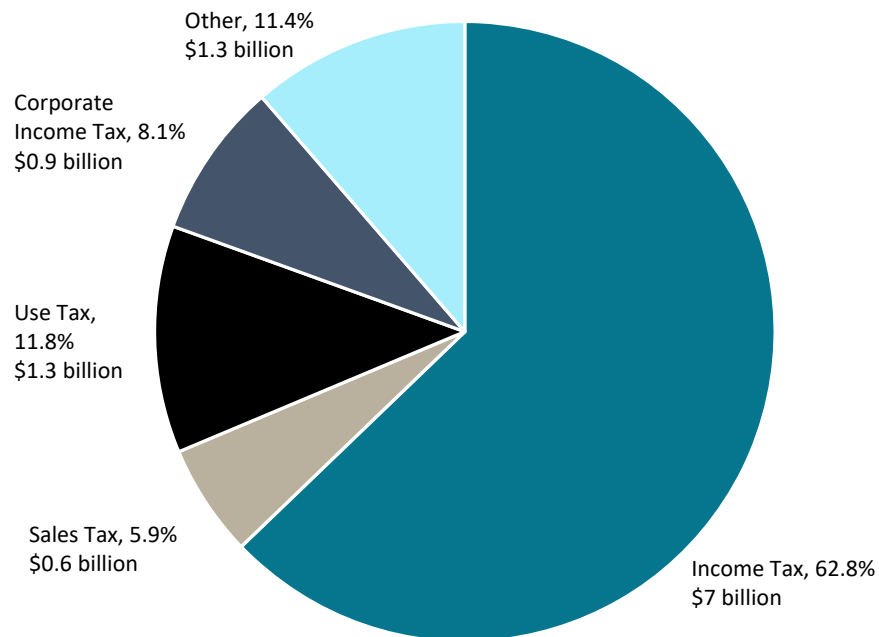


Source: House Fiscal Agency

- The state has two main accounts: the General Fund and the School Aid Fund
 - The General Fund has restricted accounts and the General Purpose fund
 - General Fund/General Purpose revenues are the state's primary discretionary account

Sources of General Fund Revenue

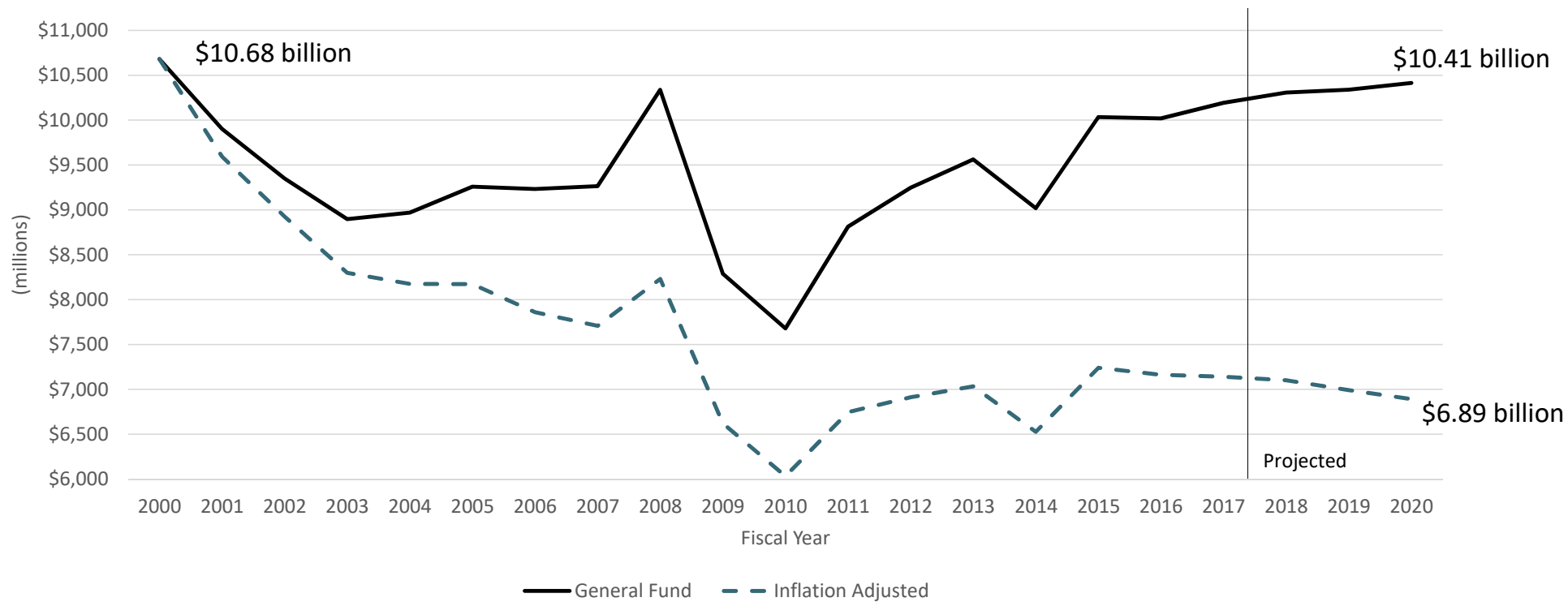
Sources of General Fund Tax Revenues, FY2016



Source: Michigan Annual Report of the Treasurer

- The Personal Income Tax is responsible for nearly two-thirds of General Fund revenue
- Despite rivaling the PIT in total collections, the Sales Tax only contributes about 6% to the General Fund

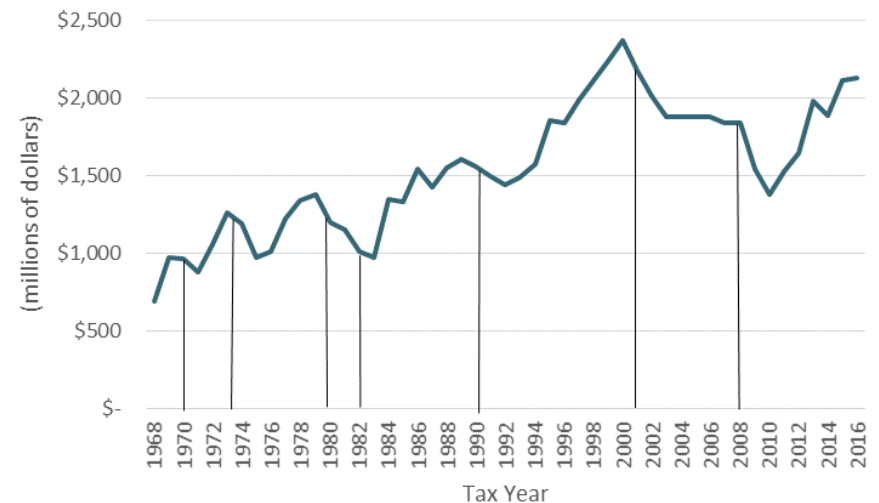
General Fund Purchasing Power Declining



Reliance on the Income Tax

- The Income Tax = two-thirds of the General Fund
 - Because Income Tax revenue shifts with economic conditions, this means the General Fund is strongly tied to the economy
- Small economic contractions reduced Income Tax Revenues 5%, large declines by 25%
 - A decline could cut General Fund revenues anywhere from 4.5% to 20%

Inflation-Adjusted Income Tax Revenues Per Unit and National Recessions



Source: Michigan CAFRs and Federal Reserve Economic Data; calculations by CRC

Over the next decade, bills will
come due faster than we can
expect revenues to grow

Tax Credits

- Michigan Business Tax replaced by the Corporate Income Tax in 2011
- Tax credits granted while the MBT was in effect continue to divert large amounts of revenue from the General Fund

MEGA Tax Credits

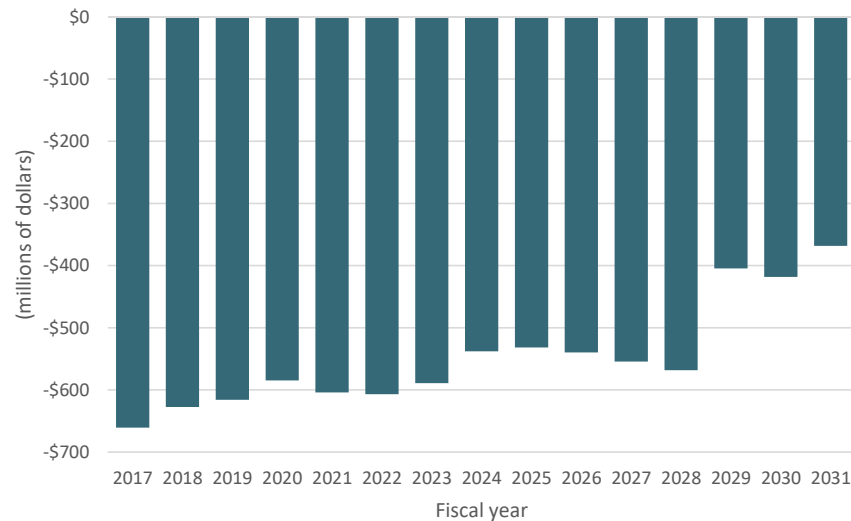
- Negotiated with businesses, active for up to 20 years
 - Last agreement will be in effect through 2032
- Projected liability between \$5 and \$9 billion over next 15 years
 - The cost of credits could increase depending on the type of credit; job retention credits are the most expensive
- Will reduce revenue by more than \$500 million annually until 2029
 - Exact amounts for individual years are hard to project
 - Compliance verification takes time, and credits are not always claimed immediately

Other Tax Credits

- The **Brownfield Tax Credit** will average \$35 million annually over the next 6 years
- **Farmland Preservation Credits** will divert \$1.5 million annually with no sunset date
- The **Polycrystalline Energy Credit** is expected to lower revenues \$20 million annually over the next six years
- The **Renaissance Zone Tax Credit** will drain an average of \$3 million a year for the next six years

Total Effect of MBT Credits

Expected MBT Tax Credit Revenue Effect



Source: Department of Treasury and Michigan Strategic Fund

- More than \$9 billion in tax credits between now and 2032
- Year to year variation on compliance verification and when companies claim credits adds pressure to the budget
- Will divert more than \$500 million annually for the next decade

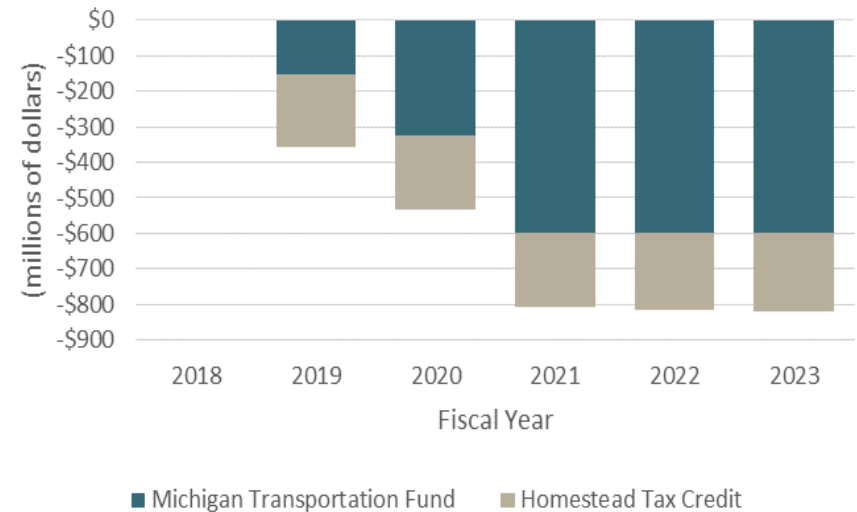
2015 Transportation Funding Package

- Will divert \$600 million annually from the General Fund to the Michigan Transportation Fund
 - FY2019 with \$150 million
 - FY2020 increases to \$325 million
 - FY2021 up to \$600 million
- Increases Homestead Property Tax Credit
 - Will reduce Income Tax revenue by about \$200 million annually
 - Broadens eligibility up to households with an annual income of \$60,000 and below
 - Designed to offset the increased tax burden on low-income families due to the increase in fuel taxes and registration fees

Transportation Funding Package

- Will lower General Fund revenues by \$800 million a year
- No funding mechanism
 - It was assumed that continued economic growth would increase tax revenues to pay for the diversion

Transportation Funding and Homestead Tax Credit Diversion Projections, FY2018-FY2023



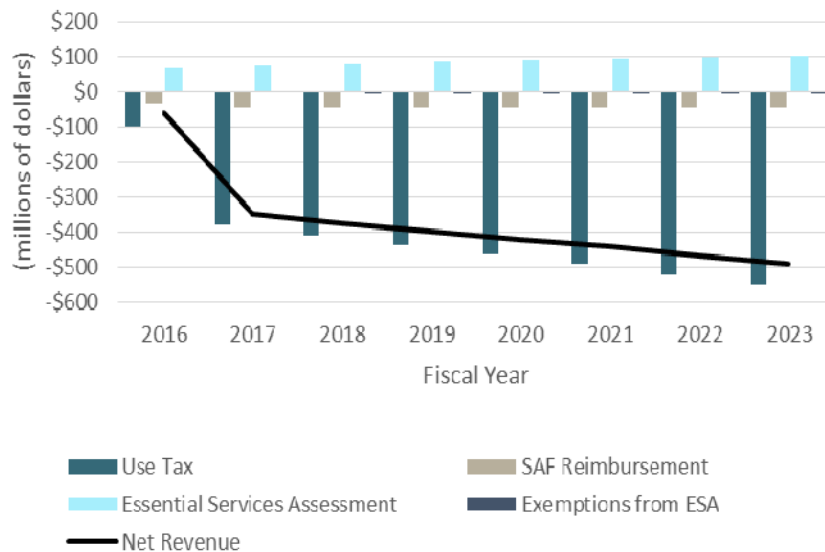
Source: Senate Fiscal Agency

Personal Property Tax Reform

- Exemptions to the Personal Property Tax for certain industrial equipment
 - Reimbursement to localities for foregone revenues comes out of the General Fund share of the Use Tax
 - The legislation also reimbursed the School Aid Fund for lost revenues
- To recoup some of the revenues, the reform also created the Essential Services Assessment

Personal Property Tax Reform

Projected PPT Revenue Effects, FY2016-FY2023



Source: Senate Fiscal Agency

- The ESA revenue does not come close to offsetting the net diversions
- In FY2017, the net reduction due to the reform will be \$350 million
- The costs are expected to increase, reaching nearly \$500 million in FY2023, when the phase-in is complete

Health Insurance Claims Assessment and the Medicaid Managed Care Organization Use Tax

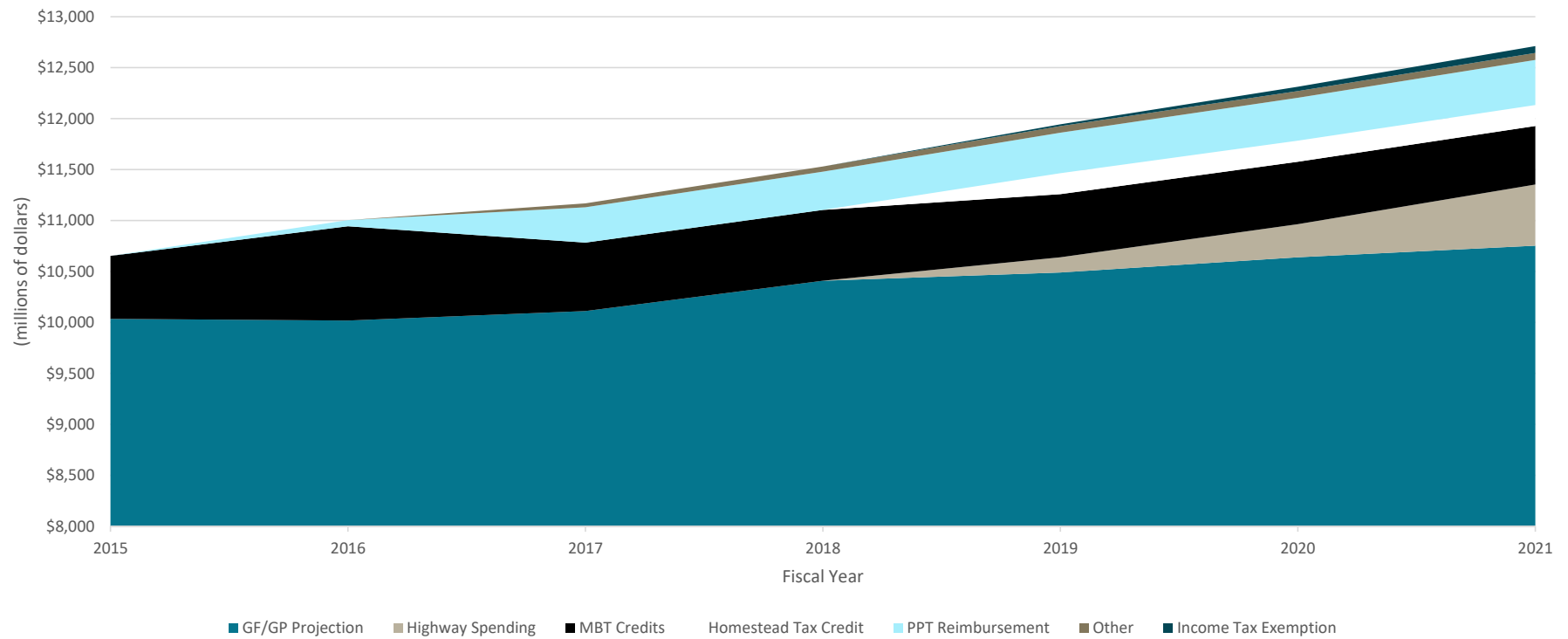
- In 2015, the federal government told the state to end its Use Tax on Medicaid Managed Care Organizations by the end of 2016
- The Use Tax was used to exploit a loophole in federal Medicaid spending, which allowed MCOs to bring in more money than was taxed
- It raised \$253 million annually, and brought in additional federal dollars
- The Health Insurance Claims Assessment rate, a tax on paid health service claims, included a clause which triggered an increase in the rate from .75% to 1% if the Use Tax was repealed, but is set to expire in 2020
- The combined loss of General Fund revenue would be close to \$500 million

Other Revenue Losses

- The removal of **Driver Responsibility fees** will reduce revenues \$48 million annually once fully phased out
- The state's new **limits on Corporate Officer Liabilities** will lower collections by more than \$60 million annually.
- The **phase-out of the "tax-on-the-difference"** provision will lower revenues by nearly \$12 million a year by 2023.
- The exemption of **over-the-counter medications** and **data center equipment** from the Sales and Use Tax lower collections another \$10 million each year.
- Collections of the Sales and Use Tax from **aviation fuel will be diverted to the State Aeronautic Fund**, diverting an additional \$15 million annually by FY2023.

Revenue Outlook

Projected General Fund Revenue and Diversions, FY2015-FY2021

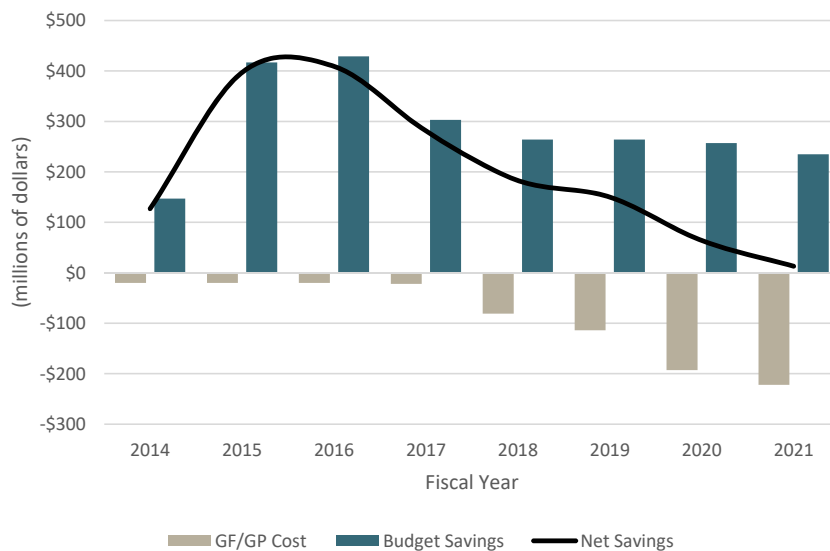


Sources: Senate Fiscal Agency, House Fiscal Agency, and the CREC

This doesn't account for spending pressures that are coming

The Healthy Michigan Plan

Projected Healthy Michigan Plan Net Savings, FY2014-FY2021



Source: House Fiscal Agency

- In addition to the benefits of increased insurance coverage, the Healthy Michigan Plan, Michigan's component of the Medicaid Expansion, saves the state money on prisoner health services and mental health care
- The state is required to start paying on the HMP in 2017, while savings are beginning to decline
- The state can continue or terminate the HMP – either way, state costs will increase

Michigan Indigent Defense Commission

- In an effort to overhaul its indigent defense system, the state created the MIDC to set new standards for public defense
- To meet Headlee Amendment requirements, the state will have to pay a portion of local government changes
- With early cost estimates from local governments, this is estimated to be a \$46 million cost to the state
- Future changes in standards could increase compliance costs, and the amount the state is required to pay

Other Budget Hurdles

Revenue Earmarking

- While the state budget is \$56 billion, certain restrictions limit where money can go and how it can be used; 63% of tax revenues were earmarked
 - Constitutional restrictions: 2 cents per dollar of the sales tax are constitutionally directed to the School Aid Fund as an example
 - Legislative restrictions: these include changes like the PPT reimbursements.
 - Federal spending: federal grant money is generally tied to a specific purpose
- While some of these rules are changeable (particularly legislative restrictions), fights over changing revenue disbursement are more difficult because they require changing statutes and deciding new funding levels
- This also means that increases in revenue might not mean proportional increases in General Fund revenue

Income Tax Changes

- As part of the transportation package, the Income Tax is scheduled to change in two material ways:
 - The tax rate will decrease when revenue growth is larger than 1.425 times the rate of inflation, beginning in 2023
 - This might lower the Income Tax rate in the long term
 - There is no equivalent provision to increase the Income Tax rate
 - The cost will depend on future increases beyond the inflation rate
 - The size of the personal exemption also was indexed to inflation, and will increase once the indexed value (\$3,700 in 2012 dollars) surpasses \$4,000.
 - Will reduce revenues on the Income Tax by millions

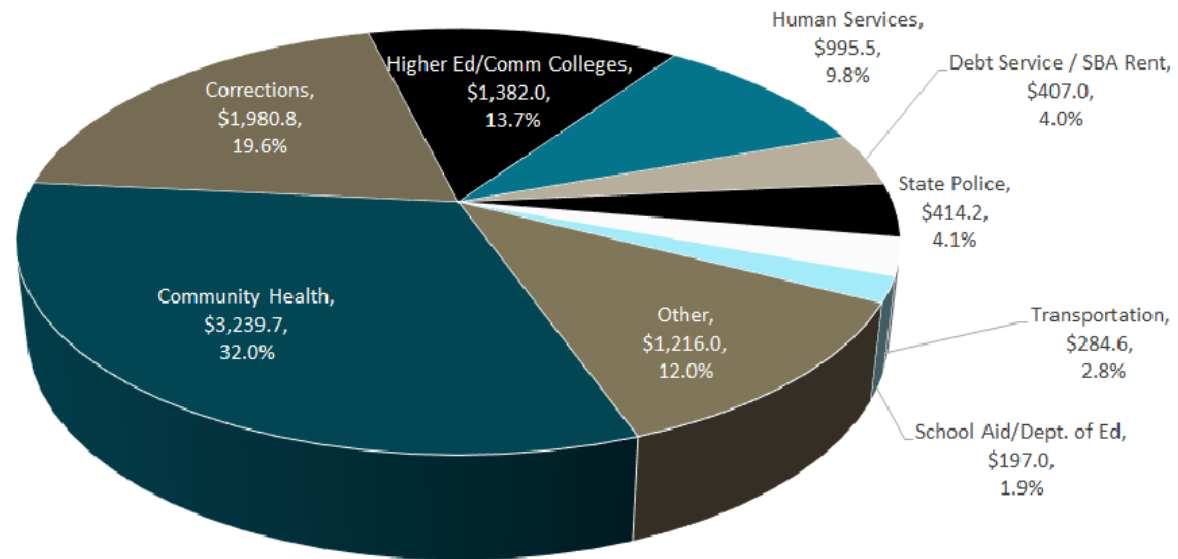
What spending categories are at risk?

Cut Services

- Nearly 80% of taxes sent to Lansing are distributed to other service providers
 - Medicaid
 - Higher education and community colleges
 - State revenue sharing to counties, cities, villages, and townships
 - Human service providers
- Cuts would come on top of cuts made from 2002 – 2012
 - Many entities that benefit from state funding feel like they're still in recovery

Services funded through the General Fund

FY2014-15 GF/GP Appropriations
(millions of dollars)



Increase Taxes

- Probably looking at significant tax changes
- Would have to focus on taxes not constitutionally dedicated
 - i.e., not sales or use taxes



Undo Statutory Commitments

- Don't fund roads from General Fund
- Cut or end local government personal property tax revenue reimbursements
- End Medicaid expansion
 - Not because it is failing, but because the state cannot afford it
- Undo Income Tax provisions that would increase personal exemption or scale back tax rate



Questions?

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