



***MICHIGAN'S FISCAL CRISIS  
DEMANDS REVENUE SOLUTIONS***

**Talking Points**

**SUMMARY POINTS**

***THE TENTATIVE HOUSE/SENATE BUDGET AGREEMENT FOR THE CURRENT FISCAL YEAR, WHICH THE GOVERNOR HAS INDICATED SHE WILL ACCEPT, WILL NOT FULLY SOLVE THE BUDGET PROBLEMS; RESTING LARGELY ON ONE-TIME FIXES, IT PUSHES THE PROBLEM INTO THE NEXT FISCAL YEAR***

***THE SOLUTION TO THE CURRENT BUDGET DEFICIT MUST BE REVENUE RESTRUCTURING NOT CUTS TO PUBLIC SERVICES***

***THE SOLUTION TO THE CURRENT BUDGET DEFICIT MUST BE PART OF RESTORING AN ADEQUATE, STABLE AND FAIR REVENUE STRUCTURE***

***SENATE AND HOUSE LEADERS MUST GO BACK TO WORK ON A SOLUTION THAT IS BASED ON NEW REVENUES, NOT ONE-TIME FIXES AND CUTS TO PROGRAMS AND SERVICES***

**DETAILED TALKING POINTS**

***MICHIGAN'S LONG TERM BUDGET PROBLEMS HAVE NOT BEEN ADDRESSED***

- The reported agreement, which consists of selling approximately \$400 million in bonds secured by future tobacco settlement revenues, drawing down balances in several restricted funds, and implementing program reductions only addresses a small part of Michigan's out-year structural deficit;
- The tentative solution to the state's FY2007 budget deficit will significantly exacerbate what had been identified as a \$1.5 billion deficit in FY2008, raising the shortfall for the fiscal year beginning October 1st to approximately \$2 billion ;
- While recent reports suggest that the legislature may approve tax and fee increases that would address as much as \$1.5 billion of this anticipated shortfall, governmental reforms and additional program budget cuts will undoubtedly be on the table as FY2008 budget negotiations continue;
- Michigan's structural deficit is driven in large measure by health care and Department of Corrections costs that are likely to continue to outpace revenue growth and will likely amount to several hundred million dollars per year for the foreseeable future.

## ***THE NEED FOR LEGISLATIVE ACTION IS STILL URGENT***

Michigan's budget crisis is not simply a financial storm that can be weathered until the state's economy picks up again. It has much deeper roots in unwise tax cuts and the structural deterioration of the state's revenue system. Even if the state's economy returns to health, revenues will not return to their former levels. Revenues will continue to decline, another budget crisis will hit, and more program and service cuts will be required.

- FY2008 is close at hand and, constitutionally, the state budget must be balanced every year;
- The state's bond rating has been damaged and must be quickly restored to an acceptable score;
- Public services that are critical to the safety, health and economic wellbeing of Michigan's citizens are at risk;
- Delay will only make the problems worse in coming years.

## ***THE SOLUTION MUST BE REVENUE RESTRUCTURING***

### **Spending cuts have already harmed Michigan's public services and business climate**

State services and programs have already been reduced by substantial amounts.

- Nearly \$4 billion in reductions have been made since 2001

Those cuts are hurting people, local governments, and Michigan's economic prospects:

- State government employs fewer people today than it has at any point since the early 1970s yet services must be provided for 1.3 million more residents;
- Funding for local government has been cut by 62 percent:
  - Michigan has fewer law enforcement officers than it did when terrorists struck our nation on 9-11-2001; there are 1,600 fewer police officers on our streets
  - Local property tax payers are feeling the pressure to make up the losses
- Funding for public schools has been reduced, many schools are struggling with larger class sizes, schools in some communities have closed, and some districts are facing bankruptcy;
- Higher education funding has been reduced by 22 percent, forcing students and their families to endure double digit tuition increases;
- Cuts of over \$2.9 billion in health care have resulted in Michigan residents, including children and frail, sick and elderly adults, not receiving the care they need because fewer doctors and nursing homes accept Medicaid patients;
- Reductions of 18 percent in human services have resulted in a weakened child welfare system and a frayed safety net for persons who need help in meeting their basic needs.

### **More cuts to programs and services are unacceptable.**

- More program cuts will result in a drastic decline in the quality of life for our residents and our businesses.
- Reductions of the magnitude needed to address the projected deficits Michigan is now facing would require wholesale elimination of programs, closure of institutions such as prisons and universities, more harm to local governments, and more harm to Michigan's business climate.

### **Michigan can afford revenue restructuring**

- According to the U.S. Census Bureau, Michigan ranked 25th in the nation in state and local tax revenue as a share of personal income for FY2003-2004;
- General Fund revenue as a share of personal income has declined by over 38 percent since 1990;

## ***SOLVE THE STRUCTURAL REVENUE PROBLEM AND THE BUDGET CRISIS TOGETHER***

The current budget crisis is not a one time problem that can be managed with short term spending cuts and a couple of new "sin" taxes and will not go away with the next upturn in the economy. It is structurally rooted in long term demographic, economic, and social trends. It is also rooted in years of poorly crafted state policy decisions. The short-term patches that policy makers used in the last few years to move the problem off into the (hopefully better) future can't bridge the gap between revenues and spending this time.

The structural problem is that Michigan no longer has a revenue system that can produce enough revenues to fund the quality public services that citizens expect from state government.

The contributing factors are:

### **Economic trends have dramatically changed Michigan's base of taxable economic activities**

Michigan's base of taxable economic activities is very different than it was a few decades back:

- Smaller base of goods producing industries
- A declining auto industry
- A large and growing services sector

### **Demographic trends have driven demand for more public spending:**

- Aging of the population, with the associated growth in demand for services for the elderly
- Technological innovation, which creates a demand for new public services (such as publicly funded wireless internet access)
- Growth of health care costs at a rate that exceeds the inflation rate
- A high rate of growth in the criminal justice and corrections systems
- The growth in demand for protection of the environment
- The increasing complexity of economic activity and crime, which pushes up the cost of regulating business and enforcing the law

### **Policymakers have cut taxes without updating Michigan's revenue system:**

Michigan's tax system was designed to generate revenues from a goods producing economy. Today, half of the state's economic activity is in the service sector.

- Policymakers have not adequately updated Michigan's tax structure to tax service businesses as well as goods producing businesses. (Michigan does tax utilities, shoe repair and tuxedo rental)
  - Michigan currently taxes 26 out of 168 services; according to a survey by the Federation of Tax Administrators
  - On average, states tax 55 services—more than twice as many as Michigan taxes
- Cumulative state tax cuts since 1994 reduced state revenue in Fiscal Year 2006 by \$3.2 billion
- General fund revenue is lower than it was in 1996, without adjusting for inflation

In combination, these trends and policy decisions set the stage for a budget crisis that would come sooner or later even if Michigan's economy had grown at a reasonable rate. The economic slowdown brought it on sooner and made it resistant to a temporary budget cut solution.

## ***REVENUE RESTRUCTURING MUST BE ADEQUATE, STABLE, AND FAIR***

### **Adequate**

- Revenue restructuring must provide sufficient revenues to sustain public services at current levels
- Michigan's SBT revenue represents nearly one-quarter of Michigan's General Fund revenue. A Single Business Tax (SBT) replacement must raise the same amount of revenue that the SBT currently generates, and a replacement plan must not shift the burden from business to families and individuals.

### **Stable**

- Revenue restructuring must provide for revenue flows that are resistant to the influence of faster paced social, economic and demographic changes (a higher cigarette tax is a poor choice because smoking is in decline)

### **Fair**

- Michigan's most vulnerable individuals and families must not be harmed by revenue restructuring.
  - Michigan's tax structure is highly regressive and places a much greater burden on low and moderate-income taxpayers.
  - Michigan's income tax is applied to families well below the poverty level. Michigan ranks 5th worst among the states with respect to its income tax threshold.
  - A mother with two children begins paying Michigan income tax when her income is only \$10,800; the federal poverty level for that family is \$15,577.

## ***REVENUE RESTRUCTURING OPTIONS ARE BEING DISCUSSED***

### **Several proposals for increasing revenues are under consideration. Among them are:**

- Increase the state personal income tax rate
- Replace the Single Business Tax with a Michigan Business Tax that would lower the tax rate paid by business, but broaden the base;
- Extend the sales to certain luxury items and discretionary services
- Retain Michigan's share of the federal estate tax by taxing estates worth more than \$2 million (approximately 400 estates per year);
- Increase the liquor mark-up
- Eliminate certain tax loopholes

### **Move to a graduated income tax or add an upper income bracket to Michigan's tax structure**

- A graduated income tax would make Michigan's tax system more fair, as well as raise additional revenues
- Either change requires an amendment to the state constitution, which stipulates a flat tax.