

Michigan ECONOMIC BULLETIN

The Good News

- ▶ Spurred by increases in nearly every sector, February retail sales rose a healthy 1.3 percent from January's level and were 4.6 percent higher than in February 1991. The gain was the second consecutive monthly increase in the figure. January's sales—originally recorded as a 0.3 percent gain—were revised upward to a 2.1 percent increase.
- ▶ Another sign that the economy may be stirring from its doldrums, the nation's **index of leading economic indicators**—designed to foretell the state of the economy in the coming six months—increased 0.9 percent in January, its largest increase since February of last year. The gain was led by positive contributions of seven of its eleven components. (Index data are available with a one-month lag.)
- ▶ Fourth-quarter **gross domestic product (GDP)** rose at a revised annual rate of 0.8 percent, slightly higher than the 0.3-percent rate originally announced. The component exhibiting the best performance was net exports; a third-quarter deficit of \$31.1 billion fell to \$17.6 billion in the fourth quarter. Residential investment rose slightly, while consumption, nonresidential investment, and government spending declined.
- ▶ In the first ten days of March, **motor vehicles sales** increased 23 percent above the year-ago period. Domestic passenger car sales increased 14.8 percent to an annual rate of 6.4 million units, the best performance in several months.

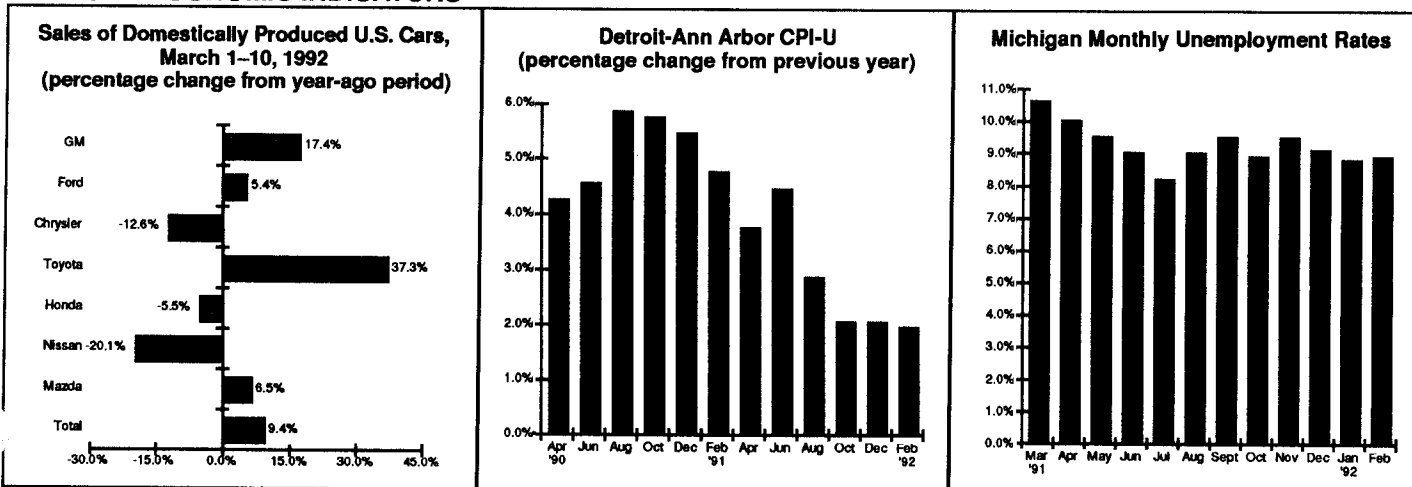
The Bad News

- ▶ Michigan posted an **unemployment** rate of 9 percent in February, up from the January rate of 8.9 percent, with both the work force and number employed declining. The **national unemployment** rate rose as well—from 7.1 percent in January to 7.3 percent in February—primarily the result of the entry and re-entry of workers into the labor force.
- ▶ Referred to as “disheartening” and “disturbing,” the **consumer confidence** index dropped close to four points in February to 43.3, its lowest level in 17 years (the level of consumer confidence in 1985=100).
- ▶ Once the bright spot in the national economy, the export sector now appears to be the victim of the global downturn: The **U.S. trade deficit** rose for the second consecutive month in December (there is a two-month lag in the reporting of monthly trade figures), the result of a 2.2-percent decline in exports (including a 10.3-percent plunge in sales of autos abroad) and a 2.3-percent rise in imports. A positive note: During 1991, the trade gap narrowed to \$66.2 billion, down \$35.5-billion decline from 1990.

IN THIS ISSUE

Federal Tax Cut Plans	p. 2
Publications of Interest	p. 2
New Revenue Estimates; Inheritance and Income Tax Legislation; State Savings Bonds	p. 3
Michigan Revenue Report	p. 4

MICHIGAN ECONOMIC INDICATORS



SOURCES: *Automotive News*, Bureau of Labor Statistics.

Federal Tax Cut Proposals

Tax cut proposals are extremely popular among many elected officials as they attempt to curry favor with voters and get the economy moving before election day. These officials contend that tax cuts will induce consumer spending and investment and speed economic recovery.

President Bush's budget contains a number of modest tax cuts. Nearly 80 million middle- and low-income tax filers could be affected immediately by the president's proposal to reduce the amount withheld from employees' paychecks. Another proposal is an investment tax allowance that would permit businesses to write off an additional 15 percent of the purchase price of equipment acquired this year. Bush also proposes a \$500 increase in the personal exemption for each child under age 19 to help financially strapped families. Other major proposals of Bush's tax plan include: a nonrefundable credit of up to \$5,000 for first-time home buyers; a capital gains tax cut; deductions for real estate developers for losses on rental property; penalty-free withdrawals from IRAs for medical care, education, and first-time home buyers; a cut in taxes on equipment purchases for some industries; and credits for research and experimentation expenses.

Bush's plan would cost around \$48 billion over the next five years, to be funded by a combination of mandatory spending cuts and nonincome tax revenue increases.

The House Democratic plan includes a tax credit equal to 20 percent of payroll taxes for two years. At most, families would receive \$400, while individuals would receive only \$200. For families with incomes under \$21,000, there is an additional increase in the earned income tax credit. The House plan proposes a capital gains tax cut (smaller than Bush's), an investment tax allowance, passive loss rules on real estate, and repeal of excise taxes.

The five-year cost of the plan is \$93.5 billion. The House has turned to the wealthy for funding; it has approved a new top income tax rate of 35 percent for individuals with taxable income above \$85,000 and joint filers with income above \$145,000; a 10-percent surtax on individual taxable income over \$1 million; and limits on deductions and personal exemptions for high-income taxpayers.

The Senate's tax bill, though similar to the House bill in advocating tax cuts for middle- and low-income earners, capital gains tax cuts, benefits for IRA accounts, and incentives for businesses, differs in some of the methods used to accomplish these goals. This plan, which costs about \$70.9 billion over the next five years, includes a permanent, nonrefundable, middle-class tax cut aimed at families with children. The \$300 credit is for children under age 16 in families with taxable income under \$50,000. Families

with incomes between \$50,000 and \$70,000 would receive a partial credit. The Senate also proposes a progressive system for taxing capital gains, rather than the House's simple exemption of gains resulting from inflation. In addition to penalty-free withdrawals from IRA accounts, the Senate bill includes full deductibility for \$2,000 in contributions per year for all wage earners. To finance these tax cuts, the Senate bill asks for a higher tax rate for the wealthy by creating an income tax rate of 36 percent for individuals with taxable income above \$150,000 and joint filers with income above \$175,000.

Comment

Despite the election year popularity of tax cuts among politicians, many economists believe that cuts could be detrimental to the economy. Not only could such measures lead to an increase in our deficit, but economists claim that tax cuts would come too late to counter the recession and would result in increased inflation. In addition, public opinion polls show little support for tax cuts, with many taxpayers preferring to see savings from cuts in defense spending going toward deficit reduction or health and education.

PUBLICATIONS OF INTEREST

Advisory Commission on Intergovernmental Relations (Report #M-179), "State Taxation of Interstate Mail Order Sales: Estimates of Revenue Potential 1990-92" *State Tax Notes* (Fairfax, Virginia: Tax Analysts, February 24, 1992), pp. 268-74.

This article provides an update to previous ACIR reports on this subject (published in 1986 and 1987). Potential state and combined state and local revenue estimates for 1990, 1991, and 1992 are provided for the fifty states and the District of Columbia; revenues for each jurisdiction are based on a nexus-adjusted tax base. Revenue projections also are provided under the assumptions of \$5 million and \$10 million *de minimus* rules.

Robert J. Kleine, *U.S. State-Local Tax Systems: How Do They Rate?* (Lansing, Mich.: Public Sector Consultants, Inc., March 1992).

This report—a new edition of 1985 and 1988 publications—discusses the criteria for a high-quality state-local tax system, develops a rating for all fifty states for each of these criteria, and ranks the states accordingly. The criteria used to evaluate tax systems are the extent to which they are balanced, broad-based, equitable, adequate and efficient, and simple to comply with and administer.

New Revenue Estimates; Inheritance and Income Tax Legislation; State Savings Bonds

New Revenue Estimates

Due to concern over the state's continuing sluggish economic performance, Senate Fiscal Agency (SFA) Director Gary Olson requested another revenue consensus conference. Although state law does not require another conference until May, it allows any of the three participants—the House Fiscal Agency (HFA), the SFA, and the administration (through the Department of Management and Budget)—to call a special meeting.

The purpose of this meeting was to review the estimates for current fiscal year general fund/general purpose (GF/GP) and school aid fund (SAF) revenues discussed at the January conference (refer to January's *Economic Bulletin*). At the earlier meeting, consensus was not reached, as the HFA refused to adopt numbers agreed to by the SFA and administration. Since that time, all participants have issued revised estimates of revenues that are less than one percentage point apart (refer to exhibit below). The consensus forecast is for growth of GF/GP revenues of 3.3 percent and SAF revenues of 2.1 percent; combined GF/GP and SAF revenues are expected to rise by 3 percent, a slightly higher rate than the 2-percent gain forecast by Public Sector Consultants, Inc.

Inheritance Tax

Voting 32-6, the Senate in early March passed Senate Bill (SB) 1, which would eliminate the state's inheritance tax. Introduced by Senator Nick Smith (R-Addison) for the third time in as many sessions, the legislation would replace the inheritance levy with a "pick up" tax equal to the maximum deduction allowed for state death taxes against federal estate tax liabilities. The current \$100,000 exemption for filing the tax would be doubled to \$200,000 beginning May 15, 1995. If enacted, the law would cost the state an estimated \$18 million in lost revenues in FY

1995, \$67 million in FY 1996, and \$85 million in FY 1997. A caveat contained in the bill, however, would allow the state to realize a one-time revenue gain of \$63 million in FY 1992 by changing the filing requirement from its current nine months after a death occurs to two months and raising the penalty and late fee for failing to file, requesting an extension, or filing a late return. A substitute to the bill that would have provided exemptions to the inheritance tax for family-owned businesses or farms and cost the state \$10 million in revenues failed on a 9-20 vote. SB 1 now awaits action in the House Taxation Committee.

Income Tax

Representative David Robertson (R-Grand Blanc) is the main sponsor of legislation (House Bill 5497) that would increase the state personal income tax deduction from the current \$2,100 to \$5,052 and allow future deductions to rise with the inflation rate. The exemption is based on the rate allowed in 1967 (\$1,200) adjusted for the rise in inflation since that time. The bill is pending in the House Taxation Committee.

State Savings Bonds

Two bills introduced by Representative Kirk Profit (D-Ypsilanti)—HBs 5584 and 5585—would allow the state to sell \$1 billion of general obligation (GO) bonds and have the revenue from the issues dedicated to funding capital outlay and renovation projects at Michigan higher education institutions. The bonds would be financed through the sale of savings bonds to the public, at least 10 percent of which would be available in \$100 and \$250 denominations. Because GO bonds are backed by the full taxing authority of the state, they would require voter approval. The bills are currently pending in the House Committee on Colleges and Universities.

FY 1991-92 Consensus Revenue Forecast
(dollars in millions)

Estimate Source	Revenue Level			Percentage Growth		
	GF/GP	SAF	Combined	GF/GP	SAF	Combined
Administration (3/6/92)	\$7,174.9	\$2,195.5	\$9,370.4	3.0%	1.4%	2.6%
HFA (3/9/92)	7,226.2	2,212.9	9,439.1	3.7	2.2	3.4
SFA (3/11/92)	7,160.3	2,197.7	9,358.0	2.8	1.5	2.5
Consensus (3/13/92)	7,200.0	2,209.4	9,409.4	3.3	2.1	3.0

SOURCE: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Michigan Revenue Report

February revenue collections (largely January activity) were disappointing, particularly since the year-ago period was weakened by the Gulf War. Personal income tax withholding declined 3.3 percent from the year-ago level. However, adjusted for accelerated withholding and an extra Friday (payday) this year, collections were about even with the year-ago period.

Sales and use tax collections declined 1.2 percent. This understates the weakness, however, as motor vehicle collections increased 16.2 percent from the year-ago period when showrooms were empty due to the Gulf War. Excluding motor vehicles, sales and use tax collections declined 3.7 percent.

Single business tax collections fell 23.1 percent due to continued processing of backlogged refunds. In the last

three months refunds totaled \$93.6 million compared with \$18.3 million in the year-ago period. Excluding refunds, collections were still down 7.1 percent.

Lottery sales continue to exceed expectations. Sales increased an estimated 6.2 percent in February (adjusted for an extra day, sales were up 3.3 percent) and are up 4.1 percent for the year.

Last month we lowered our GF/GP and school aid fund revenue estimate by about \$100 million to \$9.323 billion, a growth rate of about 2 percent. This estimate still appears reasonable, but if the next two or three months are not better than February, another reduction in the estimate will be required.

MONTHLY TAX COLLECTIONS (dollars in thousands)

Type of Revenue	Preliminary February 1992	% Change from Last Year	Past 3 Months' Collections	% Change from Last Year	FY 1991-92 Year-to-Date	% Change from Last Year
Personal Income Tax						
Withholding	\$339,378	-3.3%	\$1,158,416	1.0%	\$1,511,600	2.2%
Quarterly and Annual Payments	8,352	11.1	147,446	-11.5	152,555	-11.6
Gross Personal Income Tax	347,730	-3.0	1,305,862	-0.6	1,664,155	0.8
Less: Refunds	-150,340	-15.3	-191,065	-8.5	-206,674	-5.4
Net Personal Income Tax	197,390	9.0	1,114,797	0.0	1,457,481	1.7
Sales and Use Taxes	239,243	-1.2	806,895	0.2	1,060,613	-0.9
Motor Vehicles	34,881	16.2	96,152	2.9	132,851	0.7
Single Business Tax	144,219	-23.1	298,986	-23.7	505,551	-17.4
Cigarette Tax	20,479	6.4	60,382	-3.5	84,003	-1.8
Public Utility Taxes	0	0	65,156	17.1	72,477	1.1
Oil and Gas Severance	3,236	-20.5	10,803	-18.6	14,439	-21.4
Lottery ^a	38,002	6.2	118,913	5.0	198,089	4.1
Penalties and Interest	840	79.9	15,879	11.1	22,220	10.9
SUW—Annuals and Undistributed ^b	10,653	-539.5	3,354	-46.8	11,816	57.5
Other Taxes ^c	37,256	5.9	100,299	1.1	134,931	14.8
TOTAL TAXES (GF & SAF)^d	\$691,318	-1.7%	\$2,122,728	-3.3%	\$3,363,531	-2.1%
Motor Fuel Tax ^e	\$57,243	6.2%	\$183,647	11.3%	\$230,160	3.3%

SOURCE: Data supplied by Michigan Department of Treasury.

NM = Not meaningful

^aThe state share of lottery sales is 40.1 percent (FY 1991). The previous year's figures are adjusted to the current year's profit margin; the percentage change reflects the increase in ticket sales.

^bThese revenues are distributed to the sales, use, and withholding

(SUW) accounts when final numbers for the month are reconciled.

^cIncludes intangibles, inheritance, foreign insurance premium, corporate organization, and industrial and commercial facilities taxes.

^dExcluded are beer and wine, liquor, and horse racing taxes, which are not collected by the Department of Treasury.

^eThe motor fuel tax is restricted to the Transportation Fund.

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