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STATE REVENUE FORECASTS: A MATTER OF CONCERN

by Robert Kleine

Tax relief and tax reform are at the top of the legislature's agenda in the current session. The Senate has passed a bill to reduce the personal tax rate from 4.6 to 4.4 percent. The governor has proposed a program to provide a $100 property tax credit for about two million homeowners, to be offset mainly by imposing higher taxes on banks and insurance companies and eliminating property tax credits for households earning more than $50,000 a year. The House Democrats are dragging their feet on the Senate income tax rate reduction and House Speaker Gary Owen has vowed to block it until the Senate approves the governor's property tax relief plan. Senate Majority Leader John Engler has characterized the governor's plan as "meaningless" and nothing more than a tax shift that will result in businesses passing the costs on to consumers. While this political dance has been taking place, legislative efforts are under way to develop a proposal for comprehensive changes in the property tax and the current K-12 school finance system. This important effort, however, has taken a backseat to a struggle for political advantage between Democrats and Republicans and the executive and legislative branches on the tax relief/reform issues.

The truth is that neither the rollback nor property tax relief plan offers the type of tax reform that is needed; and more important, the whole debate is ignoring a crucial variable--the current and future condition of the state's finances.

Public Sector Consultants has consistently advised against reducing the income tax rate (a) because we believe that any changes in the economy are likely to be on the downside and (b) because of uncertainty about how much revenue Michigan will pick up from federal tax reform.

A recent analysis of state revenue collections has heightened our concern. Collections from the lottery, single business tax, and sales and use taxes are well short of the governor's projections. (As a partial offset to this shortfall, collections from annual and quarterly income tax payments are running above projections.) If revenue sources continue to perform for the remainder of this fiscal year at the same rate as they have for the first five months, general fund-general purpose and school aid fund revenues (hereafter referred to collectively as the general fund) could be about $150 million short of the governor's budget estimate. The budget shortfall for next fiscal year (1987-88) could be even more serious. If revenues do not pick up in the seven remaining months of the current fiscal year (1986-87), but the projected growth rates for the next fiscal year (1987-88) are accurate, general fund revenues will fall about $200 million short of the budget estimate now being used for budget formulation. If revenue growth continues at <u>current</u> rates through FY 1987-88, general fund revenues will fall about $400 million below the budget estimates for next fiscal year.

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There is no clear evidence that the economy will perk up significantly, but revenue growth should improve somewhat in the remaining months of this fiscal year due to seasonal and technical factors. While the Department of Management and Budget (DMB) is still confident that revenues will meet estimates, there is a strong possibility that revenues will fall $100 million to $125 million short of the governor's budget estimate in the current fiscal year and $200 million to $250 million short in FY 1987-88. All these estimates assume that the revenue windfall from federal tax reform will be returned to the taxpayers through an income tax rollback.

We believe that public policy leaders in the legislature and the executive branch should turn their efforts to balancing the budget and place continued fiscal stability at the top of the priority list. The longer action is delayed, the more difficult the potential budget cuts. Assuming no significant additional supplemental enactments are needed beyond those already requested, the cuts required to balance the current budget may not be severe, as DMB now is projecting a year-end surplus of $28 million (March 24, 1987 financial report to the legislature). Further, other fiscal adjustments can likely be made without severe dislocations. If we are correct and there is a shortfall of as much as $250 million in FY 1987-88, a cut of about 3 percent would be required in the recommended general fund budget.

One potential source of funds to balance the budget is the Budget Stabilization Fund, which has a balance of more than $375 million. Transfers from the fund are triggered by a formula based on changes in real Michigan personal income, and current calculations indicate that payouts from the fund will not be triggered by the formula. However, the legislature could change the law to allow monies to be transferred to the general fund, as was done for prison construction.

A quick recognition of the problem of a revenue shortfall and early resolution will be in everyone's best interest; cuts in critical state programs can be minimized, program instability avoided, our improved credit rating protected and Wall Street reassured, and efforts to improve our business climate will not be undermined by a new state fiscal crisis.