

## Michigan's March Toward Solvency: A Job Well Done

*With the conclusion of the 1980-1982 recession Michigan has shown renewed signs of economic recovery. Fiscal restraint, tax increases, and prudent use of new revenues has helped this state stage an even more vigorous fiscal recovery. If current budgeting and revenue mechanisms remain intact, Michigan will be able to eliminate all its previous fiscal problems and achieve total fiscal health by 1986.*

Few states in the nation were as severely affected by the 1980-82 recession as Michigan. Our repeated budget cuts and tax increases were a reflection of the serious financial straits state government found itself in. Despite these drastic measures, in January 1983 Governor Blanchard reported that Michigan still faced a \$1.3 billion cash imbalance and \$823 million of debt accumulated from unsound accounting practices.

In a unique and innovative approach to solving the state's fiscal problems, Michigan raised its cigarette excise tax by 10¢ per pack (from 11¢ per pack to 21¢) in May 1982. The additional revenue was deposited in a newly created Working

Capital Reserve Fund. This fund was established to help redress Michigan's critical cash flow shortage, thereby reducing the state's dependency on short-term borrowing to cover current payments.

A second measure was enacted to eliminate the estimated \$823 million in accumulated debt. When the individual income tax rate was increased from 4.6% to 6.35% on March 29, 1983, 0.25 percentage points of the increase were dedicated toward paying off this debt. This revenue was deposited in a specially created account known by the acronym of SAFRA, the State Accounting and Fiscal Responsibility Account.

## Cigarette Taxes and the Working Capital Reserve Fund

Of the taxes collected on cigarettes, 9¢ per pack is distributed to Michigan's General Fund and 2¢ per pack to the School Aid Fund. In May 1982, when the cigarette tax was increased by an additional 10¢ per pack, the increase was dedicated to the Working Capital Reserve Fund. This fund accumulated \$53.8 million in its initial year, fiscal year 1981-1982. Total cigarette tax collections increased by only \$35.175 million compared to the previous fiscal year due to

the decline in the number of cigarette packs sold. This decline in sales caused a drop in revenues to the General Fund and the School Aid Fund. As shown in the table, cigarette sales fell by 12.2% in that fiscal year. Thus, while the Working Capital Reserve Fund gained \$53.8 million as a consequence of the tax increase, the School Aid Fund and the General Fund lost approximately \$18.6 million from lower sales.

# Michigan Cigarette Sales and Total Cigarette Tax Receipts

Fiscal Years 1973-83 (amounts in millions)

<u>Fiscal Year</u>	<u>Tax Rate</u>	<u>Revenue</u>	<u>Cigarette Sales (packs)</u>	<u>% Change from Previous Year</u>
1972-73	11¢	\$132.304	1,202.764	+ 2.8%
1973-74	11¢	136.677	1,242.518	+ 3.3
1974-75	11¢	135.560	1,232.364	- 0.8
1975-76 <sup>a</sup>	11¢	139.648	1,269.527	+ 3.0
1976-77	11¢	140.261	1,275.000	+ 0.4
1977-78	11¢	140.740	1,279.454	+ 0.3
1978-79	11¢	140.365	1,276.045	- 0.3
1979-80	11¢	141.206	1,283.691	+ 0.6
1980-81	11¢	152.828	1,389.343	+ 8.2
1981-82	21¢ (5/1/82)	188.003	1,220.178	- 12.2
1982-83	21¢	242.068	1,152.511	- 5.5

<sup>a</sup> Fiscal Year 1975-76 was 15 months. Numbers have been adjusted to a 12-month basis to make them comparable. Unadjusted, 15-month figures are as follow: revenue -- \$174.560 million; sales -- 1,586.9 million packs.

Sales declined again (-5.5%) in 1983, reflecting in part the continued impact of the 1982 state tax increase and the effect of doubling the federal cigarette tax, from 8¢ per pack to 16¢, on January 1, 1983. Compared to revenue levels of fiscal year 1980-1981, this 1982-1983 decline in sales cost the School Aid Fund and the General Fund \$19.5 million. Lower sales also reduced the amount of revenue flowing into the Working Capital Reserve Fund. However, since the higher tax rate was effective for the full 12 months of the fiscal year instead of only 5 months as in fiscal year 1981-1982, this fund realized annual revenues of \$115.3 million.

The decline in sales had an additional result. Cigarettes are subject to the state sales tax as well as to cigarette taxes. As cigarette sales fell, the state lost \$6.8 million in sales tax revenue in fiscal year 1981-1982 and another \$7.0 million in fiscal year 1982-1983, with these losses distributed 60%-40% between the School Aid Fund and General Fund, respectively. The cumulative revenue

losses to these funds were \$25.4 million in fiscal 1981-1982 and \$26.5 million in fiscal 1982-1983. These losses were largely offset by the improvement in Michigan's credit rating which resulted in lower interest charges on Michigan bonds and on state-guaranteed school district notes.

Higher taxes are only one of several reasons for the recent and large decline in cigarette sales. Higher cigarette retail prices, recession, a reduction in the number of smokers due to population outmigration, greater health care concerns, and increased public intolerance for smoking have also taken a toll on cigarette sales. If cigarette sales continue to decline, the cigarette tax will provide a less dependable source of revenue. The 1983 decline in Michigan cigarette sales was more than twice the 2.5% national rate of decline. However, the 735 million pack drop nationally in cigarette sales was the largest decline since the 368 million pack sales drop following the Surgeon General's 1964 report on smoking and cancer.

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# SAFRA and the Income Tax Surcharge

The 0.25 percentage points of the Michigan individual income tax dedicated to SAFRA represented the second of two initiatives aimed at covering previous fiscal inadequacies. Under current statute, this surcharge will expire whenever the \$800 plus million accumulated debt is repaid or by September 30, 1986, whichever is sooner.

In the 1982-1983 fiscal year SAFRA had revenues of \$109.1 million. Government projections of SAFRA revenues are \$176.9 million for fiscal year 1983-1984, \$197.7 million for fiscal year 1984-1985, and \$203.0 million for fiscal year 1985-1986. To date, collections are running about 10% ahead of projections. This increases the probability that the surcharge will expire earlier than scheduled.

## Impact on the State's Fiscal Problems: A Most Promising Augury

Both the Working Capital Reserve Fund and SAFRA are achieving their objectives. Michigan's cash flow position has improved significantly since the Working Capital Reserve Fund was created. The worst monthly cash flow shortage for fiscal year 1983-84 is projected to occur in June. At that time, the combined General Fund and School Aid Fund will show a negative balance of about \$100.6 million. Inclusion of the \$500 million from short-term notes would still boost this amount to only \$600.6 million, less than half the \$1.3 billion deficit of January 1983.

SAFRA revenues have also been used to substantially correct Michigan's accounting deficiencies. During the past recession Michigan managed to conform to

the constitution's balanced budget requirement by resorting to accounting practices which allowed early crediting of revenues and late recognition of expenditures. Correction of these accounting inconsistencies will show up on the accounting ledgers as a one-time increase in expenditures for affected programs. The Voluntary Home Heating Assistance Program and General Assistance Medical Program were corrected last year at a cost of \$48.1 million. The state Medicaid Program is scheduled for correction this year at an estimated cost of \$128.4 million and the Income Tax Refund Account is expected to be corrected in late fiscal year 1984-1985 or early fiscal year 1985-1986 at a projected cost of \$764.0 million.

## Summary and Conclusion

The combination of budget cuts, tax increases, and creation of the special-purpose Working Capital Reserve Fund and of SAFRA have enabled Michigan to make great strides in regaining its fiscal health. These measures exacted some costs on the economy itself, as evidenced by reductions in General Fund and School Aid Fund revenues. However, these reductions were more than counter-balanced by net increases in state revenue, increases which have helped this state stage a strong and unusually rapid recovery in the year or so these measures have been in effect. The extraordinary success of the Working Capital Reserve Fund and of SAFRA has pulled Michigan back from the brink of bankruptcy in record time. It is likely that by early 1986 Michigan will be able to close the books on a decade-long period of unsound and unbalanced budgets.



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**Federal Cigarette Tax Collections and Per Capita  
Consumption for Selected Years: 1865-1983**

Year Ending June 30	Rate per 1,000	Collections (\$000)	Consumption** (million cigarettes)	Cigarettes per capita
1865	\$1.20	15	20	0.6
1870	1.50	21	14	0.4
1880	1.75	715	408	8
1890	50	1,117	2,234	35
1900	1.50	3,953	2,635	35
1910	1.08*	7,921	7,334	80
1920	3.00	151,262	50,421	477
1930	3.00	359,816	119,939	977
1940	3.00	533,043	177,681	1,349
1941	3.25	616,745	189,768	1,426
1942	3.25	704,933	218,902	1,622
1943	3.50†	835,231	244,220	1,823
1944	3.50	903,958	258,274	1,947
1945	3.50	836,058	238,874	1,808
1946	3.50	1,072,799	306,514	2,191
1947	3.50	1,145,262	327,218	2,282
1948	3.50	1,208,199	345,200	2,364
1949	3.50	1,232,728	352,208	2,371
1950	3.50	1,242,845	355,099	2,390
1951	3.50	1,293,966	369,705	2,434
1952	4.00‡	1,474,060	385,427	2,502
1953	4.00	1,586,782	396,695	2,535
1954	4.00	1,513,740	378,433	2,380
1955	4.00	1,504,196	376,048	2,322
1956	4.00	1,549,045	387,260	2,346
1957	4.00	1,610,908	402,726	2,397
1958	4.00	1,668,208	417,050	2,437
1959	4.00	1,771,125	442,780	2,544
1960	4.00	1,863,561	468,553	2,645
1961	4.00	1,923,540	479,394	2,664
1962	4.00	1,956,527	488,437	2,668
1963	4.00	2,010,524	502,959	2,707
1964	4.00	1,976,674	495,073	2,626
1965	4.00	2,069,695	516,958	2,702
1966	4.00	2,006,499	516,138	2,663
1967	4.00	2,023,090	524,946	2,680
1968	4.00	2,066,159	522,555	2,640
1969	4.00	2,082,106	520,310	2,603
1970	4.00	2,036,101	511,666	2,534
1971	4.00	2,149,527	539,577	2,648
1972	4.00	2,151,158	542,623	2,631
1973	4.00	2,221,019	562,735	2,702
1974	4.00	2,383,038	594,881	2,835
1975	4.00	2,261,116	570,294	2,698
1976	4.00	2,434,831	619,118	2,905
1977	4.00	2,279,246	596,256	2,778
1978	4.00	2,374,085	609,546	2,816
1979	4.00	2,356,110	615,117	2,821
1980	4.00	2,604,364	605,765	2,752
1981	4.00	2,488,221	633,328	2,796
1982	4.00	2,496,112	632,235	2,757
1983	8.00*	3,424,357	599,821	2,591

\*Rate shown above is based on wholesale price of more than \$2.00 per 1,000. The rate on cigarettes selling wholesale at \$2.00 or less per 1,000 was 54 cents per 1,000, but virtually all cigarettes were taxed under the higher rate of \$1.08 per 1,000.

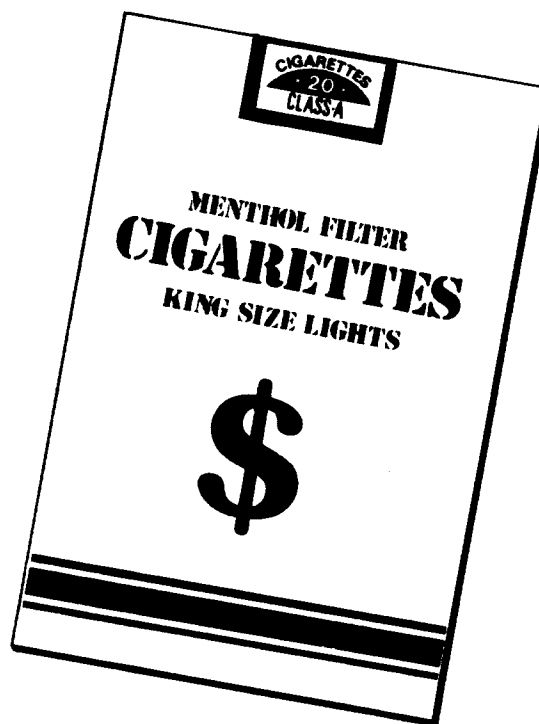
\*\*Figures prior to 1960 are based upon dollar collections; from 1960 on figures shown are "tax paid removals."

†For the first 4 months of the fiscal year, the rate was \$3.25 per 1,000.

‡For the first 4 months of the fiscal year, the rate was \$3.50 per 1,000.

\*For the first 6 months of the fiscal year, the rate was \$4.00 per 1,000.

SOURCE: **Tax Burden on Tobacco: Historical Compilation**, Vol. 18  
(Washington, D.C.: The Tobacco Institute, 1983).



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