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Public Sector Reports

Michigan ECONOMIC BULLETIN

The Good News

➤ Following the 0.4 percent gain in March and a modest increase of 0.1 percent in April, national **personal income** rose 0.5 percent in May, the largest gain so far this year.

➤ **Consumer spending** rose a whopping 1.1 percent in May, with gains recorded in the services, durable goods, and nondurable goods categories. The news was especially good in that the increase outpaced the month's income gain and indicates rebounding consumer confidence.

➤ Mid-June **domestic auto sales** stood at a seasonally adjusted 6.5 million units (annual rate), up 3.1 percent from the 6.3 million-unit pace posted in the previous 30 days, but down from the 6.7 million rate recorded during the same period last year.

➤ In the housing market, **sales of existing homes** rose at a seasonally adjusted annual rate of 3.5 million units in May, up 6 percent from April's figure and 5 percent above the year-ago level.

➤ The modest 0.3 percent gain in May's **consumer price index** eased fears fostered by the earlier release of the month's producer price figures—a 0.6 percent increase that indicated that inflation could again become a problem.

➤ In its biggest jump in nearly a year, **industrial output** rose 0.5 percent in May. The rise—the second consecutive monthly gain—was spurred by growth in consumer goods production. The expansion is likely to continue: Factory **orders for durable goods** rose a robust 3.8 percent in May (from April), with substantial gains in orders for transportation, defense, and capital goods equipment.

➤ U.S. **nonfarm payroll employment** increased by 59,000 in May, the first gain since June 1990. Most categories recorded small gains, some for the first time in more than a year, including manufacturing (still down 4.2 percent from a year ago) and construction (down 9.7 percent from 1990).

➤ The **Michigan unemployment rate** declined to 9.1 percent in June, the figure's third consecutive monthly decline (see graph below, right).

The Bad News

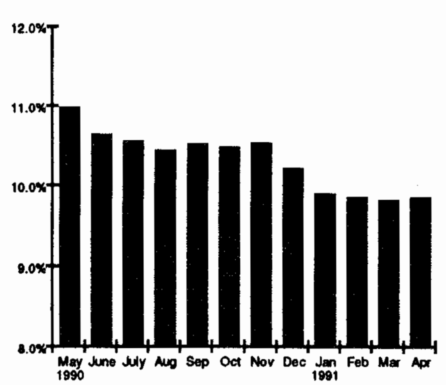
➤ The revised estimate for first-quarter real GNP showed the nation's **production of goods and services** declining at a 2.8 percent annual rate, to $4.124 trillion. **Consumer spending, investment, and inventories** were revised slightly downward, while exports increased a bit.

➤ The U.S. **civilian unemployment rate** jumped from 6.9 percent in May to 7.0 percent in June, the highest rate since 1986. At the beginning of the current recession in July 1990, the unemployment rate was 5.5 percent.

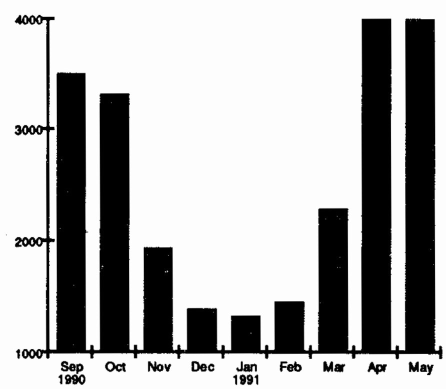
IN THIS ISSUE

MICHIGAN ECONOMIC INDICATORS

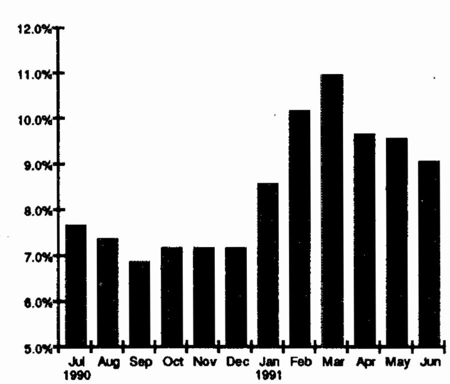
Michigan Effective Mortgage Rates (75% loan-to-value ratio, 25-year maturity)



Housing Permits Authorized in Michigan (not seasonally adjusted)



Michigan Monthly Unemployment Rates



SOURCES: Federal Home Loan Bank of Indianapolis, U. S. Census Bureau, and MESC.

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Michigan's Share of Federal Dollars

Background

In a recent issue of *State Policy Reports*, per capita federal expenditures in each of the fifty states were calculated for the following budget areas: total expenditures, direct payments to individuals, procurements, salaries and wages, and grants to state and local governments. These comprise 96.7 percent of all federal dollars spent in the states. Overall, federal outlays in Michigan are far below the national average. In FY 1990 per capita federal expenditures in Michigan totaled $3,142, 79.1 percent of the national average, 47th among the states.

Michigan ranks low in all but one of the spending areas examined. Procurements ($183 per capita) and federal wage and salary payments ($262 per capita) fall at the bottom of the national rankings (49th and 47th, respectively). This is not surprising, as Michigan does not have a sizable defense industry or large amounts of federal public lands, the main determinants of spending in these areas.

What may come as a surprise to some is Michigan's low rank in the grants category, which is a function of each state's AFDC and Medicaid programs. Michigan receives $511 per capita for grants, which ranks us 29th nationally. While our state provides relatively high AFDC benefits to a comparatively large proportion of its population, the state has low per capita spending for Medicaid programs relative to other states. The latter is the result of (1) tight certificate of need (CON) restrictions (for nursing homes) and a low number of available beds, both of which limit the amount of obtainable federal funds for high-cost nursing homes; (2) comparatively low reimbursement rates to nursing homes and physicians; and (3) a high proportion of recipients who are children. (Children require relatively lower funding levels than the elderly poor.)

Michigan ranks high in direct payments to individuals (mainly Social Security, Medicare, federal employee retirement benefits, and food stamps). In this category, Michigan received federal dollars totaling $2,116 per capita, 107 percent of the national average, and 8th in the nation. This is likely due to the relatively low out-migration by retirees, a slow-growing population, a relatively high number of food stamp recipients.

Although direct payments comprise the largest share of FY 1990 federal spending in the states (49.6 percent versus 18.8 percent for procurement, 14.6 percent for salaries and wages, and 13.4 percent for grants), the extremely low level of spending in the other combined budget areas resulted in the relatively low total inflow of federal dollars to our state.

Does Michigan Deserve More?

Federal spending can play a significant role in a state's economy. For example, if Michigan had received the national average level of per capita federal dollars, the state could have employed 255,000 more workers, which would have represented a 6.4 percent increase in nonagricultural employment in Michigan for 1990.

Does Michigan receive its fair share of federal funds? On a per capita basis, the answer is obviously no. Several other criteria, however, could be used to evaluate whether the state should receive more federal funding.

One oft-cited standard holds that a state should receive federal monies equal to the amount it remits in the form of federal taxes. On this basis Michigan does not receive adequate compensation: In FY 1990 Michigan paid $4,184 per capita in taxes, or 3.77 percent of all federal tax revenues, but received 2.95 percent of total federal dollars spent in the states. This criterion, however, ignores an important factor, namely, need.

Need may arise from either a lack of ability to pay for programs from existing state revenues or higher concentrations of populations at which programs are aimed. In relation to the former, some states may suffer from low tax bases, which limits the amount of revenue that they can collect on their own. Measured in this manner, Michigan does not receive its fair share, as our ability to tax is below the national average. Some states may be receiving more federal dollars than they remit because of low levels of personal income. This restricts the amount of taxes paid to the federal government, which is primarily dependent on income taxes for revenue. In 1990, Michigan per capita personal income ranked 21st among the states (or 98.2 percent of the national average), which could account for some of the disparity between the state's receipt of federal funds versus those paid in.

If federal funds flowed to states with larger populations targeted by federal programs, more funding would go, for example, to states that have larger numbers of school-age children or a concentration of qualified researchers able to discharge defense-related tasks. It is difficult to quantify whether Michigan's "needs" are underfunded using this criterion, as it would require an evaluation of each federally funded program in relation to state demographics.

(Continued on page 4.)

Resolution of the FY 1991–92 Budget and the CAD

Agreement was finally reached on the both FY 1990–91 state budget and the capital acquisition deduction (CAD) to the state's single business tax (SBT). The resolution of these issues leaves legislators free to conclude negotiations on the FY 1991–92 budget; conference committees are scheduled to begin meeting July 11, with the entire budget process set to be completed by month's end.

● ***The Budget*** The FY 1990–91 budget includes $178.9 million in executive order cuts and $183.5 million in supplementals. This brings the current fiscal year's total general fund/general purpose (GF/GP) budget to $7.8 billion, or $100 million above the FY 1989–90 level. The Treasury Department estimates that total school aid fund (SAF) and GF/GP revenues will reach $9.3 million, $234 million below the most recent estimate and $734 million less than last summer's statutory estimate (refer to page 4). We estimate that actual revenues could fall $50 million short of these projections.

● ***The CAD*** The state's revenue position could improve due to the resolution reached by the administration and House Democrats regarding the CAD, which if left unresolved could have added $300 million to the revenue shortfall. Senate Bill 69 (H-1) (discussed in last month's *Bulletin*) was the vehicle used to bring about the deal. Rather than use a site-specific property tax credit, the agreement allows a proportion of all newly purchased tangible property (defined as property depreciated, amortized, or subject to accelerated capital cost recovery for federal filing purposes) to be deducted from a firm's SBT base. Also included was the so-called double-double provision, which will (1) apportion each firm's deductible property based on a three-factor formula that double weights Michigan sales in relation to the other two factors, Michigan property and payroll, which will each be weighted 25 percent, and (2) apportion the overall SBT base according to a 50/25/25 percent sales/payroll/property factor. (Again, sales will be double weighted.) The two provisions will be fully phased in by FY 1993.

Small businesses received additional tax relief in the agreement, as the threshold for filing an SBT return will be raised from its current $40,000 to $100,000 by FY 1992. This will reduce the number of small businesses that are required to file an SBT return even though they have no tax liability.

The Michigan Department of Treasury estimates that the legislation initially will raise tax revenues: in calendar year 1990, an increase of $31 million is expected. When fully phased in, however, the deduction and higher filing threshold are expected to cost the state $44 million (compared to the estimated $300 million loss that would have occurred in the current fiscal year).

House Democrats were able to include language in the legislation that provides that if the CAD is eliminated as the result of a petition drive, the associated revenues would be used to finance property tax relief (if approved by voters).

(Continued from page 3.)

Comment

Could Michigan increase its share of federal funding relative to other states? Because the state does not have a large defense industry or a significant amount of federal lands, procurement spending and federal salary and wage payments are not likely to rise much. Procurement spending is a relatively small percentage of total funding and is likely to decrease in the future. The ability to secure these funds is also subject to politics. Since Michigan is set to lose two congressional seats as the result of redistricting, our ability to attract these funds could decline.

The state could increase federal dollars received in the grants area by increasing reimbursement rates for physicians, hospitals, and nursing homes, which would increase federal matching funds, or by loosening CON requirements for nursing homes. (This is being achieved for hospitals as the result of the newly instituted voluntary hospital contributions program.) There may be some loosening of CON requirements in the future, but this, in addition to increasing reimbursements, would require additional state spending in a time of tight budgets and limited revenue growth.

Any improvement in Michigan's position would be the result of federal spending shifting away from defense and toward direct expenditures due to both the aging of the population and rising health care costs and their consequent effect on Social Security and Medicare payouts. It is doubtful, however, that changes in state policy will result in more than a marginal increase in federal aid.

PUBLICATION OF INTEREST

Advisory Commission on Intergovernmental Relations, ***Representative Expenditures: Addressing the Neglected Dimension of Fiscal Capacity***, #M-174 (Washington, D.C.: the Commission), December 1990.

This report estimates state-local expenditure needs for the fifty states based on workload and cost factors and makes comparisons between actual expenditures and each state's ability to raise revenues. The report also estimates that Michigan must make a fiscal effort (levy taxes) at a rate 12 percent above the national average in order to meet overall needs.

Each month we expect that revenue collections cannot get worse, but they do. May (April activity) was a particularly bad month for state revenue collections.

Personal income tax withholding collections increased an uninspiring 0.3 percent (preliminary data) above the year-ago level. Quarterly and annual payments, which had been running slightly below year-ago levels, plummeted 68.7 percent in May. The cause for this decline is not yet known, but it could reflect the effect of the recession on those small businesses subject to the personal income tax.

Sales and use tax collections continued weak in May, declining 0.7 percent below the year-ago level. Motor vehicle related collections fell 10.8 percent; excluding these, sales and use tax collections rose 1.5 percent. The consumer continues to be cautious, and a turnaround is not expected in the near future.

The single business tax (SBT) continues to be the major revenue problem due, in part, to the court ruling expanding the capital acquisition deduction to out-of-state investment. SBT collections declined 24.4 percent in May and are down 19 percent for the second quarter. Some of this weakness is due to the economy, but the major factor appears to be that multistate firms are claiming out-of-state investment on their tax return, thereby eliminating or sharply reducing their tax liability. The problem was resolved this month (see page 3), although the state may still have to seek redress from the courts to collect owed revenues. At stake is more than $300 million in the current fiscal year.

Lottery sales slumped an estimated 2.4 percent in May, and year-to-date sales are slightly below the year-ago level.

The Department of Treasury (which now prepares revenue estimates) has reduced the FY 1990–91 estimate for general fund-general purpose and school aid fund revenue by $234 million (to $9,325.9 million).

The estimate for the SBT was reduced by $90 million; the income tax, $68 million; sales and use taxes, $63.7 million; interest earnings, $37.5 million; and lottery, $15 million. The only significant increase in projected revenues was $38 million for the insurance premiums tax.

The new revenue estimates appear reasonable, although they could be about $50 million low if the economy shows any improvement in the next month or two.

MONTHLY TAX COLLECTIONS (dollars in thousands)

Type of Revenue	Preliminary May 1991	% Change from Last Year	Past 3 Months' Collections	% Change from Last Year	FY 1990–91 Year-to-Date	% Change from Last Year
Personal Income Tax						
Withholding	$304,904	0.2%	$965,955	–1.5%	$2,449,999	1.7%
Quarterly and Annual Payments	47,676	–68.7	348,772	–11.8	523,221	–8.9
Gross Personal Income Tax	352,580	–22.8	1,314,727	–4.5	2,973,220	–0.3
Less: Refunds	–222,076	–10.5	–767,208	1.2	–985,930	4.3
Net Personal Income Tax	130,504	–37.4	547,519	–11.5	1,987,290	–2.5
Sales and Use Taxes	253,234	–0.7	714,035	–1.4	1,784,389	0.1
Motor Vehicles	40,972	–10.8	100,889	–15.2	232,860	–10.1
Single Business Tax	236,589	–24.4	417,493	–18.9	1,029,237	–11.5
Cigarette Tax	21,160	–0.6	60,018	–3.8	145,421	–0.9
Public Utility Taxes	0	—	10	—	71,671	2.6
Oil and Gas Severance	4,009	9.7	11,892	4.8	30,266	12.6
Lottery[a]	37,660	–2.4	123,150	–0.4	316,470	–0.7
Penalties and Interest	615	NM	19,091	59.1	46,686	30.6
SUW—Annuals and Undistributed[b]	6,567	190.7	20,782	64.9	28,305	55.1
Other Taxes[c]	88,615	79.5	217,346	27.3	326,665	24.9
TOTAL TAXES (GF & SAF)[d]	$778,049	–12.6%	$2,131,336	–6.5%	$5,766,400	–1.6%
Motor Fuel Tax[e]	$49,846	–2.5%	$158,677	–2.3%	$385,623	–1.5%

SOURCE: Data supplied by Michigan Department of Treasury.
NM = Not meaningful
[a]The state share of lottery collections is estimated to be 40.7 percent, based on the average profit to the state for fiscal year 1989–90. The previous year's figures are adjusted to the current year's profit margin; the percentage change reflects the increase in ticket sales.
[b]These revenues are distributed to the sales, use, and withholding (SUW) accounts when final numbers for the month are reconciled.
[c]Includes intangibles, inheritance, foreign insurance premium, corporate organization, and industrial and commercial facilities taxes.
[d]Excluded are beer and wine, liquor, and horse racing taxes, which are not collected by the Department of Treasury.
[e]The motor fuel tax is restricted to the Transportation Fund.

Public Sector Consultants, Inc.