Economic Bulletin

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GOOD news

The U.S. Department of Commerce has released its revised numbers for **gross domestic product** (GDP) for the first quarter of 1998. They show that the economy grew even faster than originally thought—the GDP growth rate was revised upward, from the preliminary estimate of 4.8 percent, to a seasonally adjusted annual pace of 5.4 percent. The revised rate is the highest since the second quarter of 1996. However, because of the effects of the General Motors strike and the Asian financial crisis, few analysts expect that the economy can continue at the current fast clip.

◆ The Conference Board announced that the **index of consumer confidence** rose to a 29-year high in June: an impressive 137.6 (May's number was 136.3). Of the 5,000 households surveyed, only 4.6 percent said that they feel that the economy will worsen later this year, and only 13.7 percent feel that jobs are "hard to get."

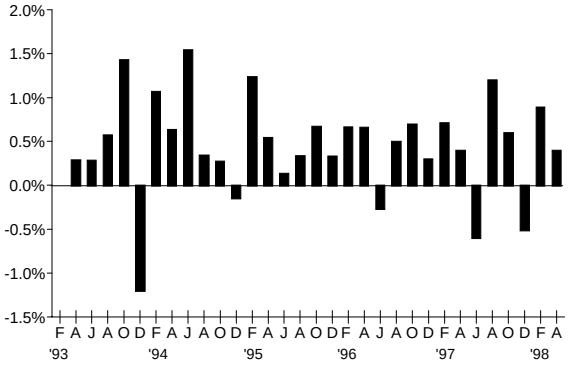
◆ The U.S. Department of Labor announced that the **producer price index (PPI)**, which measures inflation at the wholesale level, dropped in June, reducing the likelihood of consumer inflation in coming months. The PPI fell 0.1 percent in June after increasing 0.2 percent in May. The decline (the fourth this year) is due primarily to a 1.7 percent dip in energy prices. If the volatile food and energy sectors are excluded, June producer prices rose 0.2 percent. For the first half of the year, the index, excluding food and energy, rose at an annual rate of 1.4 percent.

◆ U.S. **automobile sales** rose an astounding 18.7 percent in June, the highest monthly sales rate since September 1986. Truck sales soared 28.2 percent and account for most of the increase, while car sales increased 11.1 percent. The seasonally adjusted annual sales rate in June is 16.5 million new vehicles, a rate that exceeds the record of 16.0 million set in 1986. Sales were spurred in part by incentives that drew consumers into U.S. showrooms.

BAD news

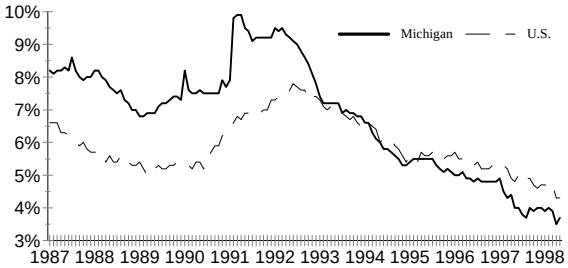
The **U.S. unemployment rate** rose in June to 4.5 percent (May's rate was 4.3 percent). The increase reflected a 29,000 decline in the number of manufacturing jobs, due to the General Motors strike and the dampening effect of the Asian financial crisis. While the economy added 205,000 new jobs last month, this was substantially fewer than the 300,000+ of both April and May. Although the employment report signals a slight cooling of the job market, there is no reason for serious concern—despite the decline, June's unemployment rate is one of the lowest of the decade.

Detroit–Ann Arbor CPI, Percentage Change from Two-Month Ago Period (not seasonally adjusted)



SOURCE: U.S. Bureau of Labor Statistics.

U.S. and Michigan Monthly Unemployment Rates (seasonally adjusted)



SOURCE: U.S. Bureau of Labor Statistics and Michigan Jobs Commission.

IN THIS ISSUE

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MONTHLY FOCUS

FUTURE TAX-SYSTEM CHALLENGES

A recent article in State Policy Reports warns that despite the current rosy fiscal picture, states may face budget shortfalls in coming years.[1] It claims that many state tax systems will be "obsolete" in the 21st century.

Nationally, most states are enjoying near ideal fiscal circumstances—the strong economy has increased tax revenue, allowing states to cut taxes and/or increase spending. State Policy Reports argues that these good times inevitably will end, because state taxes are not structured to shoulder the coming economic, demographic, and other long-term changes.

The article posits that even if the economy remains strong, tax revenues are bound to fall short in the future. Some of the reasons for this are the following:

◆ State tax systems were designed when goods, rather than services, were the center of economic activity. Today, the services sector dominates the economy, but it is not taxed via the sales tax or other levies. The Internet, e-mail, and other types of electronic commerce are also not taxed. The result is that tax revenue is not keeping up with economic growth and will fall even further behind in the future.

◆ The aging and retirement of the babyboomers means that revenue from income taxes will drop. Moreover, seniors qualify for certain tax credits not available to younger people, and they spend a larger proportion of their income on services (which are not taxed) rather than goods.

◆ Growing business mobility means that states increasingly must make their tax environment competitive in order to attract/retain industry. As a result, many states will limit the taxes they impose on new firms.

Elasticity

In this article, "elasticity" is defined as a measure of the extent to which state tax revenue is keeping up with growth in the state's personal income. Elasticity of 100 means that revenue growth is staying even with personal income growth—a good indicator that revenue will be sufficient to cover future spending needs without cutting programs. An "inelastic" tax system (one having a score lower than 100) means that tax revenue may be insufficient to cover future needs.

The exhibit shows elasticity in selected states. The national average is 96.2, meaning that the revenue of most states is unlikely to keep pace with personal income growth. At 94.3, Michigan's elasticity is lower than the national average and ranks 32d in the nation.

Conclusion

Together, increasing pressure on tax revenue and low elasticity are going to spell trouble for many states. State policymakers and officials will be well advised to start now rather than later to examine the ability of their fiscal system to bear the pressures ahead.

Elasticity Index for Selected States, FY 1996–97
(100 = revenue grows proportionally with personal income)

Rank among States	State	Index
1	Oregon	104.4
2	Idaho	103.3
3	Montana	103.2
4	Kentucky	103.1
5	Delaware	102.7
7	Ohio	102.0
10	California	101.5
11	Wisconsin	100.7
18	New York	98.5
19	New Jersey	98.5
21	Arizona	97.2
22	Massachusetts	96.9
24	Colorado	96.3
	United States	**96.2**
25	Rhode Island	96.1
30	Louisiana	94.7
31	Maryland	94.4
32	**Michigan**	**94.3**
33	Indiana	94.2
40	Pennsylvania	92.4
41	Illinois	92.0
42	Alaska	90.6
47	Florida	88.4
48	Texas	88.1
50	Nevada	87.5

SOURCE: *State Policy Reports.*

[1] *State Policy Reports*, "Problems with State and Local Finances?," State Policy Research, Inc., (Hilton Head, SC: SPR), Issue 8, Vol. 16, April 1998.

NEWS FROM THE STATE CAPITOL

INCOME TAX CUTS ON HOLD

Leaders of the Michigan House and Senate have announced that proposals to reduce the income tax rate are on hold. They are referring to two competing plans to lower the rate.

◆ The Democrat-lead House has introduced legislation (HB 5978) to cut the income tax rate by 0.1 percent annually for six years beginning in 1999. The bill is tie-barred to a resolution (HJR BB) to propose a constitutional amendment guaranteeing a minimum increase in funding each year for local governments and schools.

◆ The Republican-lead Senate has passed legislation (SBs 1079–83) to cut the income tax levy by 0.1 percent each year for five years beginning in 2000. These bills contain a school funding guarantee that requires the first 1.012 percent of the state's gross income tax revenue (before refunds) to be earmarked to education.

The leaders of both chambers recently made statements that neither proposal is likely to move before the November election. To do so would subject the proposals to the intense partisan politics typical of an election period. Despite the current impasse, it is plausible that one of the proposals, or some combination of the two, will pass before the end of the year.

LAWMAKERS PASS PERSONAL PROPERTY TAX EXEMPTION

The Michigan Legislature has passed a bill (SB 733) that will permit local government in a distressed area to exempt businesses from having to pay personal property tax (a levy on machinery and equipment) on new acquisitions. The bill is intended to promote economic development in depressed areas by allowing local governments (with state approval) to grant such exemptions. Governor Engler is expected to sign the bill into law, and it will become effective immediately.

The legislation will authorize local government in roughly 85 areas of the state to grant businesses a 100 percent exemption from taxes on new personal property. (Previously taxed personal property is not exempt.) Eligible districts include enterprise zones, brownfield redevelopment zones, industrial development districts, and other areas designated by the state as distressed.

This month's Economic Bulletin was written by Laurie A. Cummings, Senior Consultant for Economic and Education Policy, and Robert Kleine, Vice President and Senior Economist.

INFORMATION OF INTEREST

Senate Fiscal Agency, *Estimated State Spending and State Tax Collections by County, Fiscal Year 1995–96*, (Lansing, MI: SFA), April, 1998. 517/373-2767.

For each Michigan county, this 100+ page document provides estimates for FY 1995–96 (1) state spending (total and by state department); (2) income, sales, single business, transportation, education, lottery and beer/wine/liquor tax collections; and (3) such socioeconomic data as population, property value, millage rates, labor force statistics, and the number of state employees working in the county.

Crain Communications, Inc., *Automotive News: 1998 Market Data Book*, (Detroit, MI: Crain Communications, Inc.), May 27, 1998. 313/446-0361.

This 160-page periodical contains automotive market data for 1997 and 1998. It includes (1) production and sales information for cars and trucks for the worldwide and North American markets; (2) registration data for the United States, including top sellers by region, new-car and new-truck registration by state, and overall vehicle numbers; (3) 1998 car and truck prices, by manufacturer; (4) dealer data—specifically, their finances, advertising spending, and J.D. Power and Associates survey data on quality, customer satisfaction, and profitability; and (5) directories of automakers and national associations.

MICHIGAN REVENUE REPORT

June revenue collections increased 8.6 percent, the third consecutive strong monthly performance. All major revenue sources recorded solid gains.

Personal income tax withholding, although still showing a gain (4.7 percent above the year-ago level), was weaker than in April and May.

Sales tax collections increased 8.6 percent, the best growth in more than a year. Motor vehicle sales jumped 18.7 percent, as June was the best month for motor vehicle sales nationally since September 1986. All other sales tax collections were up 6.9 percent, about the same increase as last month. Use tax revenue, which can vary widely from month to month, was up only 2.7 percent.

Single business tax collections (including insurance) also enjoyed an usually large increase in June, 11.3 percent, following an even larger increase in May.

Lottery sales were up 4 percent in June, having fallen in May.

Tobacco tax revenue rose 6.9 percent in June and is down only 1.8 percent for the fiscal year. This may be a sign that the dampening effects of the big tax increase in 1994 and the accompanying increase in smuggling have abated.

June 1998 Revenue Collections (millions)

Source	June Collections	Percentage Change, Year-ago	Percentage Change, Year-to-Date	June 1997 Actual	FY 1997–98 Consensus Est. Less Tax Cuts (% Change)
Income tax					
Withholding	$508.3	4.7%	6.5%	$485.3	5.6%
Quarterly	138.8	6.0	13.6	130.9	10.9
Annual	13.8	213.6	21.2	4.4	14.9
Subtotal: gross income tax	660.9	6.5	8.6	620.6	6.8
Sales tax	509.9	8.6	4.1	469.4	3.5
Motor vehicles	84.8	18.1	7.1	71.8	—
Other	425.1	6.9	3.6	397.6	—
Use tax	103.3	13.6	2.7	90.9	1.0
Subtotal: sales/use/withholding	1,121.5	7.3	5.1	1,045.6	4.3
Tobacco tax	50.9	6.9	–1.8	47.6	–4.0
SBT	98.3	12.3	3.8	87.5	2.2
Insurance	–0.6	–300.0	–17.3	0.3	–17.7
Subtotal: SBT + insurance	97.7	11.3	2.3	87.8	0.7
State education property tax	33.9	21.9	0.2	27.8	5.0
Real estate transfer tax	21.0	14.1	20.1	18.4	11.5
Estate/inheritance tax	8.2	39.0	32.9	5.9	13.2
Intangibles tax	0.7	0.0	–43.8	0.7	–46.2
Severance tax	2.3	0.0	–14.3	2.3	–12.6
TOTAL	$1,488.8	8.6%	5.1%	$1,371.4	4.0%
Gross lottery sales (prel.)	$128.0	4.0%	3.4%	$123.1	

SOURCE: Senate Fiscal Agency.
NOTE: November is the first month of the new fiscal year for all revenue sources except the lottery.