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Public Sector Reports

Michigan REVENUE REPORT

The Michigan economy is in a mild recession, and this is reflected in the weak performance of state revenues for the past several months. There was no sign of improvement in July collections (June activity). The effect on oil prices of the invasion of Kuwait by Iraq ended any hope that the economy will improve in the next few months. Personal income tax withholding collections increased only 0.5 percent above the July 1989 level, but the underlying economic activity may not be quite as weak as this suggests; a better indicator is the 3.6 percent increase for the last three months, although growth likely will be somewhat slower than this during the next few months.

Sales and use tax collections increased by only 1.8 percent, as consumers remain cautious. Motor vehicle collections continued to lag, declining 5.4 percent from the year-ago level. Sales tax collections increased only 0.4 percent, but the volatile use tax (excluding motor vehicles) increased 12 percent, the second consecutive large increase. The sales tax is the better measure of consumer spending, as business spending comprises a large share of the use tax.

Single business tax collections showed improvement in July, increasing 6.1 percent. This apparent strength, however, may be due to a change in the collection pattern: The tax is due on July 31. An accurate assessment cannot be made until August collections are analyzed.

Table 1. Monthly Tax Collections

Dollars in Thousands

Type of Revenue	Preliminary July 1990	% Change from Last Year	Past 3 Months' Collections	% Change from Last Year	FY 1989–90 Year-to-Date	% Change from Last Year
Personal Income Tax						
Withholding	$366,523	0.5%	$1,009,054	3.6%	$3,113,742	3.1%
Quarterly and Annual Payments	8,999	–22.4	261,527	–3.1	683,390	1.7
Gross Personal Income Tax	375,522	–0.2	1,270,581	2.2	3,797,132	2.9
Less: Refunds	–23,329	67.2	–300,942	22.2	–998,230	10.4
Net Personal Income Tax	352,193	–2.8	969,639	–2.8	2,798,902	0.4
Sales and Use Taxes	282,528	1.8	813,908	3.1	2,341,924	3.8
Motor Vehicles	47,702	–5.4	146,333	–1.9	359,254	–3.2
Single Business Tax	191,144	6.1	561,989	–4.3	1,412,678	–4.2
Cigarette Tax	21,705	–8.8	66,482	–2.1	191,991	–2.7
Public Utility Taxes	9,548	–43.2	9,681	–42.7	79,543	–2.5
Oil and Gas Severance	3,361	–10.8	10,157	–10.6	33,394	6.0
Lottery[a]	34,522	–0.9	110,723	–5.7	354,753	–0.9
Penalties and Interest	481	–32.6	13,399	0.9	49,011	7.0
SUW—Annuals and Undistributed[b]	3,304	–61.9	2,063	–78.7	18,018	–25.7
Other Taxes[c]	12,805	–4.9	81,023	8.0	291,733	–6.8
TOTAL TAXES (GF & SAF)[d]	$911,591	1.1%	$2,639,064	–1.7%	$7,571,939	0.1%
Motor Fuel Tax[e]	$59,377	1.4%	$173,183	0.8%	$513,388	0.9%

SOURCE: Data supplied by Michigan Department of Treasury.

NM=not meaningful

[a]Lottery collections run one month behind other tax collections due to a reporting lag; June lottery collections are included in this month's report. The state share of lottery collections is estimated to be 40.9 percent, based on the average profit to the state for the fiscal period ended May 31, 1990. 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.

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Lottery collections declined 0.9 percent in June and, coincidentally, are off 0.9 percent year-to-date. There will be a large increase reported in July sales because of a $21 million Lotto jackpot, but this may be offset in September by a drop in sales compared to 1989 when that month saw a large jackpot.

Overall, July collections are slightly lower than expected, indicating that the revenue shortfall for FY 1989–90 will be about $200 million, $25 million higher than PSC estimated last month.

Monthly Focus: Monetary Policy

More than ever, attention is focusing on the Federal Reserve Board because it will influence the direction of the national economy. Actions by the Fed also affect the state economy, as the monetary authority in large part determines the course of interest rates and prices.

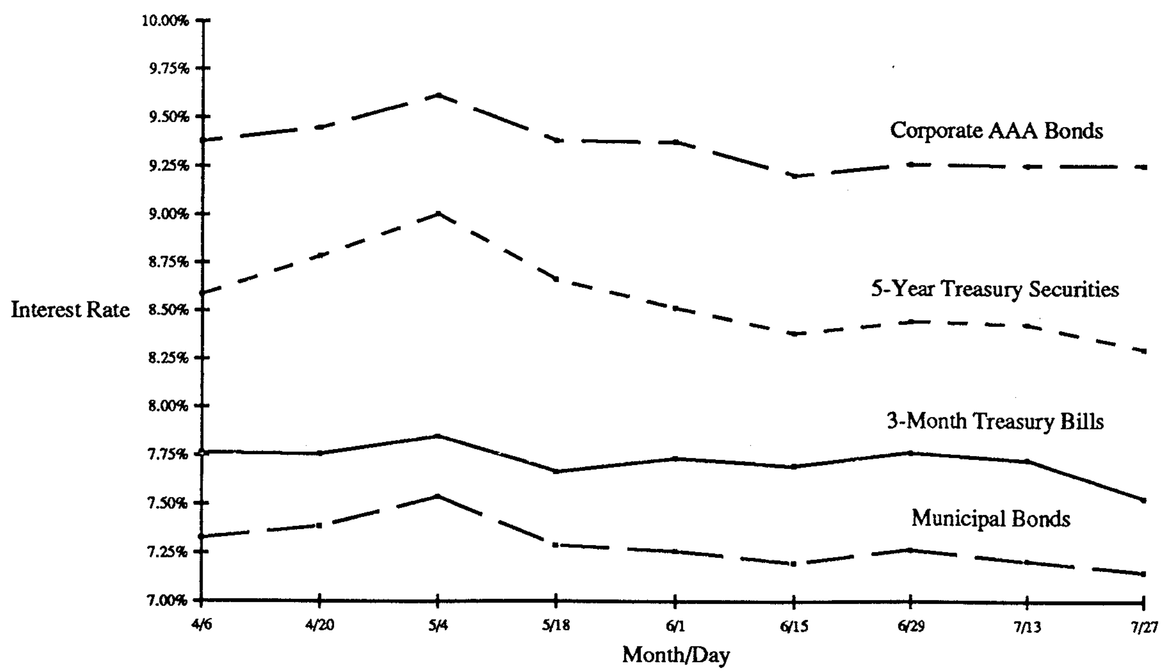
Fed Chairman Alan Greenspan has been faced with a dilemma of late: Although the economy is showing signs of weakness, and credit has been abnormally tight, inflation still has not abated; this imposes on the Fed the task of allowing interest rates to fall without further fueling inflationary fears. The Fed seemed to be doing relatively well at this precarious balancing act; long-term interest rates have been declining since May, and the market responded favorably to another mid-July decline in rates (refer to Exhibit 2).

Now, however, the economic effects of actions in the Middle East have left the Fed in a proverbial "catch-22." Energy costs, which had been declining slightly in recent months, already are skyrocketing; further increases almost are assured as oil stockpiles are being gobbled up in anticipation of shortages and further price increases. If the economy were somewhat stronger, the Fed's usual response to such an occurrence would be to tighten credit, partially offsetting the rise in oil prices and preventing inflation from spreading throughout the economy. Now, however, a hike in interest rates could prove disastrous to the already weak economy and likely push it further into recession. The alternatives—to continue to allow interest rates to decline or to do nothing—could result in a replay of the stagflation (increased inflation at a time of declining or negative economic growth) of the 1970s and early 1980s.

Although the Fed still is very concerned about inflation, given the precarious position of the economy, it is likely that it will err on the side of expanding the money supply too much.

Exhibit 2

Interest Rates and Yields on Securities (average of daily rates), Selected Dates, 1990



SOURCE: Federal Reserve Bank of St. Louis, *U.S. Financial Data*, June 14, 1990, and August 2, 1990.