

SPECIAL ADVISORY

Improving economic prospects and a higher state income tax rate will contribute to a General Fund overage ranging between \$120 million and \$150 million in the current fiscal year. A combination of lower welfare caseload requirements and higher tax revenues could generate a General Fund overage of \$250-\$290 million in fiscal year 1983-84. As of July 29, 1983, year-to-date net tax collections for the state were \$690 million greater than for fiscal year 1981-82. Based on current rates of increase in economic activity, we anticipate that net state General Fund and Restricted Fund revenues in fiscal 1982-83 will be approximately \$900 million above last year's level.

The increase in General Fund-General Purpose (GF-GP) revenues will account for roughly \$385 million of the \$900 million. After deducting the higher expenditure commitments of the current budget year, General Fund revenues will exceed General Fund requirements by \$120-\$150 million. This includes \$50 million in scheduled lapses and assumes program levels and spending requirements will remain at their present authorizations. Since the Department of Management and Budget determines the number and amount of payments that will fall within the budget year, the official amount reported at the conclusion of fiscal 1982-83 could vary considerably. If realized, this \$120-\$150 million would mark the first actual overage since fiscal year 1979 when General Fund revenues exceeded expenditures by \$113 million.

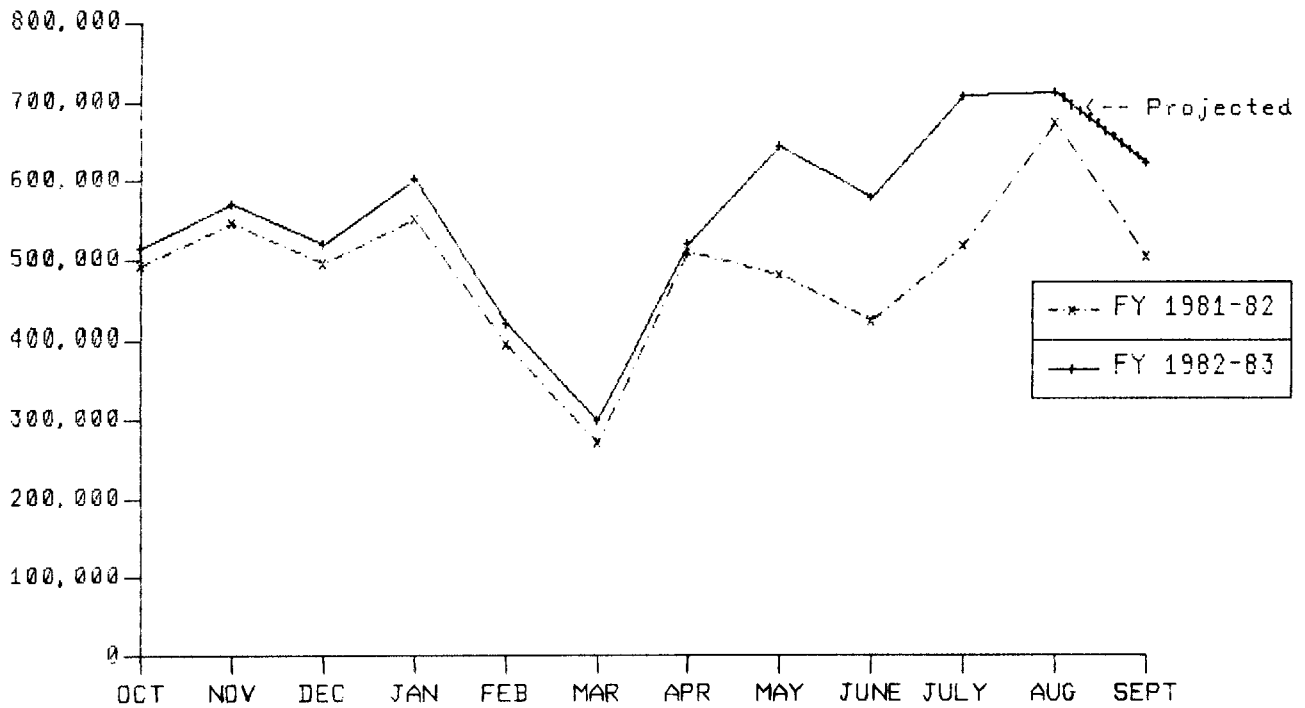
This excess of revenues over expenditures provides an extra degree of flexibility to the state's budget process and helps restore a modicum of stability to that process. Considering the list of outstanding government obligations, this excess cannot legitimately be labeled as a surplus. While portions of the income tax increase were dedicated to reversing some of the accounting practices necessitated by three consecutive years of inadequate cash reserves, no plans have been formulated to repay \$190 million in interfund borrowing. Neither has the state adopted a schedule for resuming contributions into the state retirement systems rather than paying interest on the amounts not deposited. For the state to have a genuine surplus of funds, revenue would have to be available to restore these amounts and to pay off \$500 million in general obligation bonds and \$330 million in school district and other notes.

Nonetheless, the greater flexibility provided by an excess of revenues over General Fund obligations in fiscal years 1982-83 and 1983-84 creates the opportunity to exercise a variety of strategic fiscal options. Executive and legislative leaders will be given the chance to consider repaying interfund borrowing, eliminating portions of the state's debt, or reducing future borrowing requirements. It could also be used to expand programs or entitlements. However, if the economy falls back into recession, this could generate liabilities which would drain the state's financial resources or create another deficit.

The primary reason for the higher revenue level is, of course, the higher income tax rate which became effective April 1, 1983 (Figures 1 and 2). Without the additional revenue from the higher income tax rate, the state would have faced a deficit of about \$625 million at year end despite the recent improvement in economic conditions.

PUBLIC SECTOR CONSULTANTS, INC.

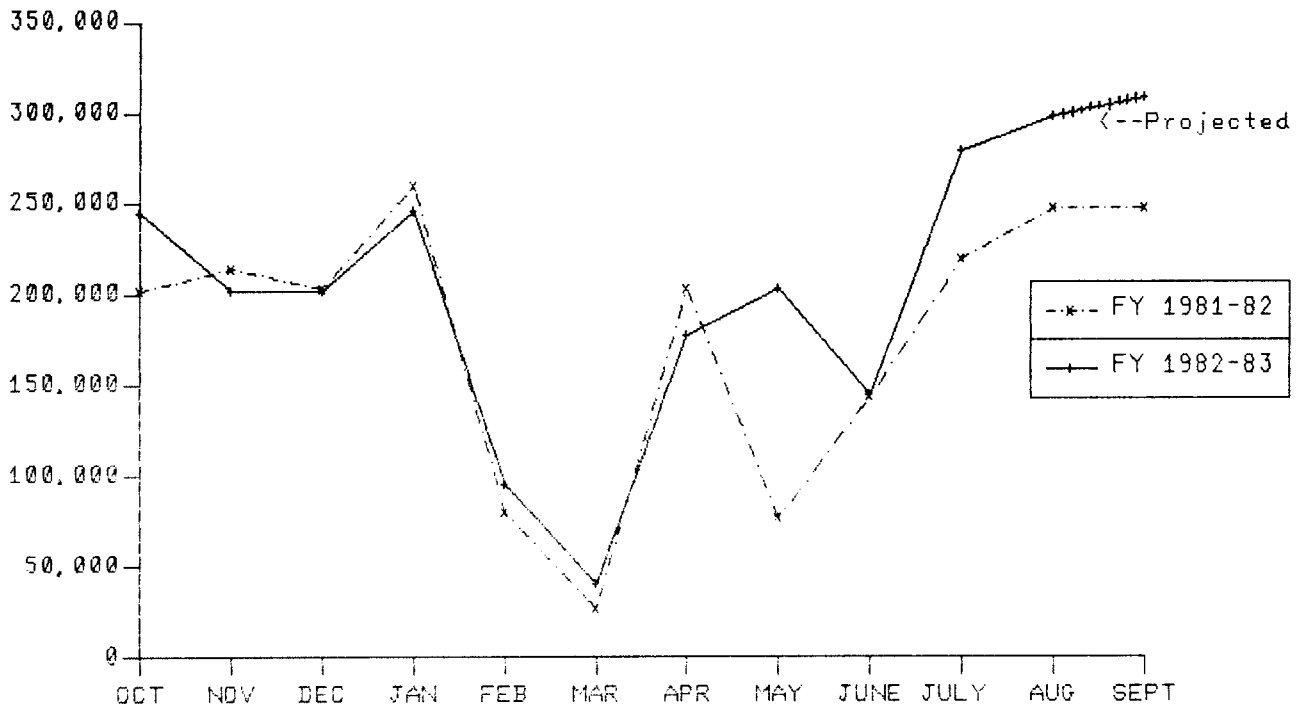
MICHIGAN TOTAL NET TAX COLLECTION BY MONTH AND YEAR
 FISCAL YEAR 1981-82 COMPARED TO FISCAL YEAR 1982-83
 (\$ in 000s)



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FIGURE 1

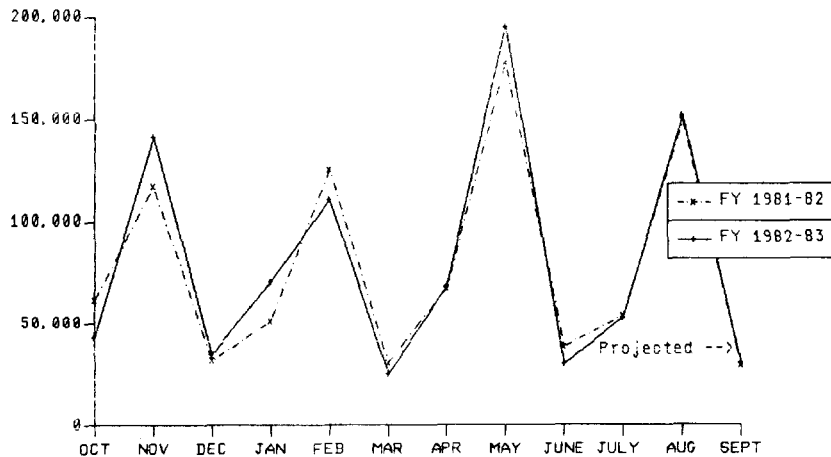
MICHIGAN NET INCOME TAX COLLECTION BY MONTH AND YEAR
 FISCAL YEAR 1981-82 COMPARED TO FISCAL YEAR 1982-83
 (\$ in 000s)



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FIGURE 2

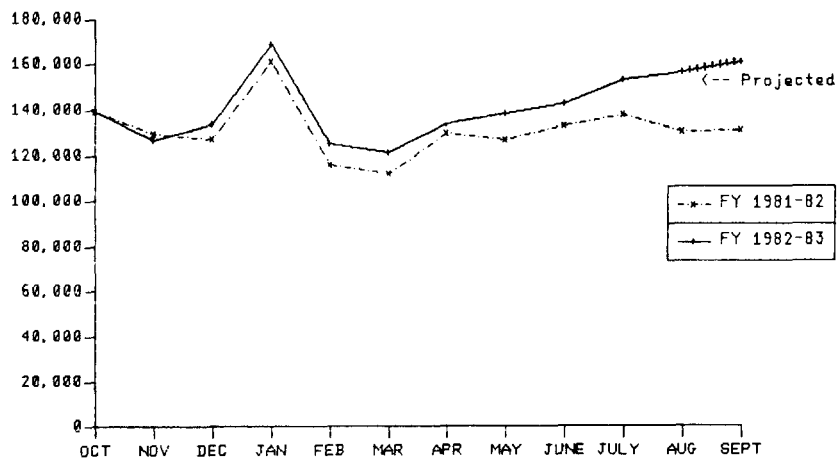
MICHIGAN NET SINGLE BUSINESS TAX COLLECTION BY MONTH AND YEAR
 FISCAL YEAR 1981-82 COMPARED TO FISCAL YEAR 1982-83
 (\$ in 000s)



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FIGURE 3

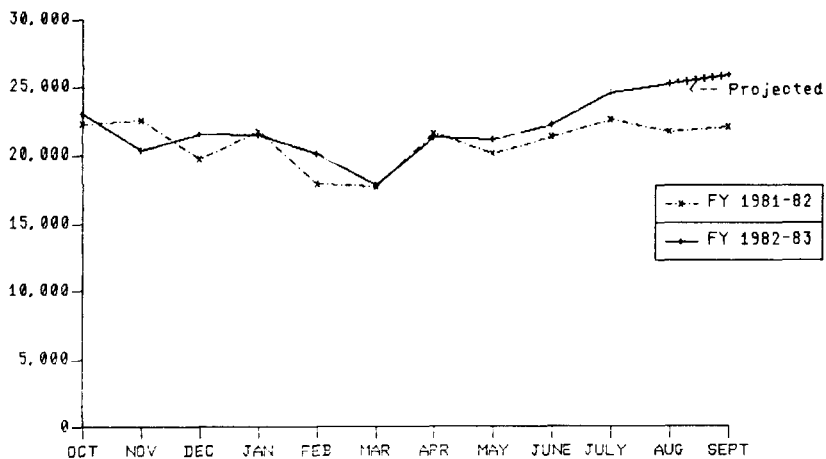
MICHIGAN NET SALES TAX COLLECTION BY MONTH AND YEAR
 FISCAL YEAR 1981-82 COMPARED TO FISCAL YEAR 1982-83
 (\$ in 000s)



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FIGURE 4

MICHIGAN NET USE TAX COLLECTION BY MONTH AND YEAR
 FISCAL YEAR 1981-82 COMPARED TO FISCAL YEAR 1982-83
 (\$ in 000s)



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FIGURE 5

Three factors determine the level of income tax revenues: (1) the tax rate, (2) the number of people working, and (3) their occupational distribution. Since the number of people working this year is roughly the same as last, the higher tax rate and the improved employment in high-wage manufacturing industries have primarily been responsible for the increase in net income tax receipts.

Michigan levies more than 20 different kinds of taxes in addition to charging for permits and licensing fees. However, the four largest taxes -- the individual income, sales, use, and single business tax -- account for 80% of General Fund revenue. The improved revenue flow is consequently due in part to higher sales, use, and single business tax receipts.

The recession seriously eroded business profitability, a fact very clearly shown in the data on single business tax (SBT) collections (Figure 3). For the year as a whole, SBT collections will run about \$20 million above the 1982 level.

The sales and use taxes track current economic conditions. They started to grow faster during the second quarter of calendar 1983. This was mostly due to the larger number of employed people and was reinforced by consumers who depleted their savings to finance new purchases. This situation cannot be sustained unless consumers increase their borrowing to finance purchases. Given a restrictive monetary policy and the heavy borrowing requirements of the federal government, major increases in consumer credit demand could drive up interest rates, stifling consumer spending and threatening continuation of the recovery.

As a consequence, the pace of the recovery is slowing. The economy will continue to grow during the third and fourth calendar quarters, but at a less torrid pace than in the second. Most of the future improvements in sales and use tax receipts will depend primarily on continued improvements in employment.

In sum, a projected General Fund overage of \$120-\$150 million in fiscal 1982-83 and \$250-\$290 million in fiscal 1983-84 is a concrete indication of an improving state fiscal climate. However, it does not mark the conclusion of Michigan's fiscal difficulties. The state's economic and industrial base have been ravaged by a wide variety of structural defects and marketplace changes. The road to economic and fiscal health is a protracted one which could take up to a decade.