Craig Ruff • *President*
William R. Rustem • *Senior Vice President*
Robert J. Kleine, Laurie Cummings, and Alec Rodney • *Editors*
Vol. 3, No. 11 • November 1993

Public Sector Reports

Michigan ECONOMIC BULLETIN

The Good News

➤ October **motor vehicle sales** increased 4.5 percent over October 1992 sales while registering a seasonally adjusted annual rate of 13.9 million units. The Big 3 all gained market share over the previous year's level: General Motors led the way, increasing its share from 33.3 to 34.7 percent of the U.S. market. Most Japanese makers lost market share as the strong yen continued to force them to charge higher prices than their domestic competitors.

➤ The government reported that September **new home sales** increased 20.8 percent over revised August sales to a seasonally adjusted annual rate of 762,000 units. Sales of existing homes and housing starts also have shown gains in recent months.

➤ The **index of leading economic indicators** increased 0.5 percent in September, following a revised 0.9 percent increase in August. The index is designed to foretell the strength of the economy in the coming six months. Six of the 11 indicators rose, including money supply, orders for consumer goods, building permits, and stock prices.

➤ October **retail sales** jumped 1.5 percent, the largest increase since April and the seventh consecutive monthly rise. Automobiles and housing-related purchases led the surge.

The Bad News

➤ The **U.S. unemployment rate** increased to 6.8 percent in October after remaining at 6.7 percent for two straight months. The economy added 177,000 jobs for the month. Notably, factory payrolls increased for the first time this year, adding 12,000 workers. At the same time factory workers' average weekly hours increased to 41.6, suggesting that manufacturers are still cautious about the economic recovery and would rather pay existing workers overtime wages than expand their work force. Temporary-help companies added 69,000 of the 114,000 new service industry jobs.

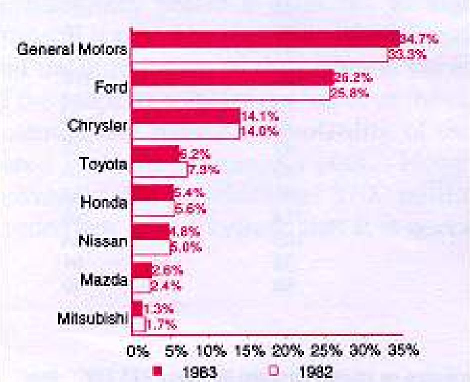
➤ **Michigan's unemployment rate** rose in October to a seasonally adjusted 6.9 percent, putting the state above the national average for the first time this year. The October rate surpassed the September rate by 0.2 percentage points. Total employment rose by 18,000 to 4.37 million, but the number of people looking for work rose by 28,000. The increase in job seekers is seen as a sign that individuals are confident in the economy's recovery.

➤ The Conference Boards index of **consumer confidence**, which reads between 85 and 100 when the economy is strong, dropped to 59.4 in October, from a revised 63.8 September reading. The index has declined 17 points since January. Respondents revealed increasing pessimism about future economic and employment prospects; nevertheless, current consumer spending continued to grow.

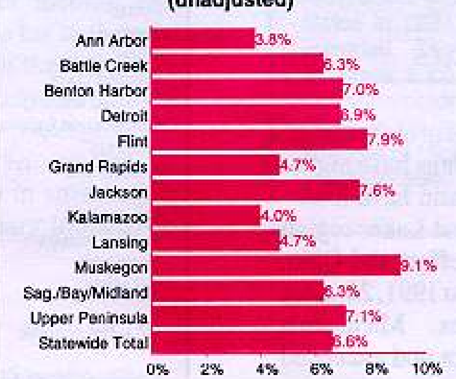
IN THIS ISSUE

MICHIGAN ECONOMIC INDICATORS

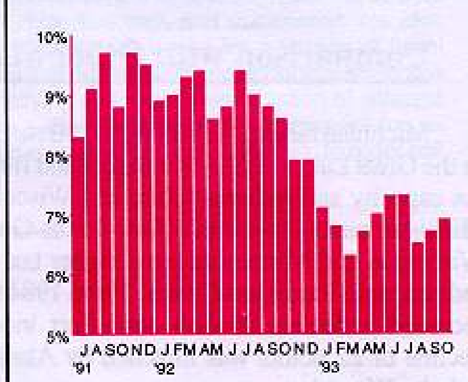
Percentage of Total U.S. Car Market, October 1992 and October 1993



Unemployment Rates in Major Michigan Labor Markets, September 1993 (unadjusted)



Michigan Monthly Unemployment Rates (seasonally adjusted)



SOURCES: *Wall Street Journal* and Michigan Employment Security Commission.

Public Sector Consultants, Inc.
Knapp's Centre • 300 S. Washington Sq. • Suite 401
Lansing, MI 48933-2134 • (517) 484-4954

Tax Effort and Tax Capacity Measures for Michigan

The Advisory Commission on Intergovernmental Relations (ACIR) recently released its report on state revenue capacity and effort for 1991. Released every two or three years, this report provides measures of each state's ability to raise revenue and the extent to which a state uses its available tax bases. *Tax capacity* measures how much tax revenue a state could generate if it levied national average tax rates. *Tax effort* is determined by comparing a state's actual tax revenues with its estimated capacity to raise revenue, indexed to the national average. These measures are superior to traditional measures such as personal income because they provide a measure of a state's ability to export taxes.

In many states, personal income and tax capacity are closely correlated, but there can be important differences in states that have a large tourist industry relative to the overall economy and states with significant energy resources. For example, per capita personal income in Hawaii is 11 percent above the national average, but their tax capacity is 37 percent above the national average. Per capita income in Wyoming is 11 percent below the national average, but the state's tax capacity is 34 percent above the national average. Michigan's per capita income is 2 percent below the national average, and its tax capacity is 6 percent below the national average.

Historical Trends

Michigan's tax capacity reached its peak in 1979 at 104, 4 percent above the national average. (These measures were first calculated in 1975.) The severe recession of the early 1980s lowered the tax capacity index to 90 in 1983. The index reached 96 in 1986, before slipping back to 94 in 1991.

Historically, Michigan has been a high tax state. Its tax effort index peaked at 129 in 1984, due in large part to a large temporary increase in the state income tax. Michigan's tax effort has declined steadily since 1984, falling to 112 in 1988 and 107 in 1991. When the index for 1993 is calculated it is likely to be below the 1991 level.

Comparison with Other States

Michigan ranks 25th among the 50 states in tax capacity. In the Great Lakes region Minnesota and Illinois have higher tax capacity and Indiana, Ohio, and Wisconsin have lower. Michigan ranks 7th in tax effort. In the Great Lakes region Wisconsin and Minnesota have higher tax effort and Ohio, Indiana, and Illinois have lower. From 1984 to 1991, 26 states recorded a decline in their tax effort index. Michigan's decline of 22 points was matched by Alaska and exceeded only by Wyoming.

Comparisons of Selected Taxes

The overall measures of tax capacity and tax effort disguise wide variations among taxes. As shown in the exhibit Michigan ranks low in tax effort for general sales taxes, selective sales taxes (particularly on beer and wine), severance taxes, and all other taxes, and high for property taxes, license taxes, and the inheritance tax (which has been repealed). Michigan is also listed as having a very high corporate income tax burden, but this is misleading as Michigan levies a modified value-added tax, the single business tax (SBT), rather than a corporate income tax. The Michigan SBT has a much broader base than a corporate income tax and replaced a number of other taxes when enacted in 1976.

Tax capacity does not vary much among the various taxes. Among the major taxes, the property tax has the lowest capacity (89), which explains, in part, the high level of property taxes in Michigan.

Conclusion

Measures of tax capacity and tax effort provide states with useful information about their tax systems and can be helpful in policy debates. For example, the high tax effort for the property tax and the low effort for the sales tax provides strong supporting evidence for the state's efforts to reduce property taxes and raise sales taxes. These data also allow useful comparisons with other states to determine if taxes rates are out of line with those in surrounding states.

Tax Capacity and Tax Effort for Selected Taxes, 1991

Tax Source	Tax Capacity	Tax Effort
General sales	97	69
Selective sales	98	71
Motor fuels	99	93
Tobacco products	114	99
Alcoholic beverages	99	91
Spirits	104	107
Beer	99	76
Wine	73	79
License taxes	105	117
Personal income	99	104
Corporation Income	92	192
Property	89	150
Residential	80	NA
Farm	47	NA
Comm./ind.	114	NA
Public utilities	103	NA
Severance	38	64
All other	98	40

NA = Not available

Source: Advisory Commission on Intergovernmental Relations, RTS 1991: *State Revenue Capacity and Effort*, M-187, Washington, D.C.: September 1993.

School Finance Reform

On Thursday, November 18, the House Bipartisan Team (HBT) reached agreement on a plan to replace the revenue lost due to enactment of PA 145 (SB 1) and to distribute the monies to school districts. There are substantial differences from Governor Engler's proposal. The key difference is that the House plan includes both a statutory and a ballot proposal.

The statutory plan includes an increase in the income tax rate from 4.6 to 6 percent, an increase in the single business tax (SBT) rate from 2.35 to 2.95 percent, a 16-mill property tax on homesteads, and a 20-mill property tax on nonhomestead property. The ballot proposal would increase the sales tax from 4 to 6 percent, increase the income tax rate from 4.6 to 5.3 percent, eliminate the increase in the SBT rate, and impose a 9-mill tax on homestead property.

There are several other important differences between the governor's and the HBT proposals. The HBT proposal includes a 1.1 percent rather than 4 percent property transfer tax and no increase compared with a 50-cent increase in the cigarette tax, and it extends the sales tax to interstate telephone calls. The HBT plan also increases the personal income tax exemption from $2,100 to $3,000, provides additional relief for renters, and does not eliminate the homestead property tax credit.

On the distribution side the HBT plan costs about $700 million more than the governor's plan. This is due mainly to a more generous foundation grant—$5,000 compared with $4,500—and a guaranteed 3 percent increase in revenue compared to 1 to 2 percent in the governor's plan.

To help pay for this increased spending the HBT plan proposes to cut the state budget by about $175 million and use $130 million in revenue growth from current sources.

Our view is that this is a solid proposal. Most important, it insures that schools will be funded even if the voters turn down the ballot proposal. The voters will only decide whether they prefer a sales tax to higher income and property taxes. The inclusion of the income tax in the mix and the elimination of the cigarette tax and the reduction of the property transfer tax improve the equity and growth potential and reduce the volatility of this package compared with the governor's plan. However, we are not convinced that an additional $700 million in spending is needed nor do we believe that it is necessary to increase the personal income tax exemption to $3,000, which would be the second highest in the nation for a family of four; a $400 or $500 increase would be sufficient in our view. Also, we would like to see an adjustment in the foundation grant to reflect regional differences in cost. A $5,000 grant is much too high for some districts and barely adequate for others.

The taxation and education committees are scheduled to consider this plan soon, with the expectation that it will be reported to the House floor before Thanksgiving.

Publications of Interest

Advisory Commission on Intergovernmental Relations, ***Significant Features of Fiscal Federalism, Volume 2: Revenues and Expenditures*** (Washington, D.C.: ACIR, September 1993).

This annually released data book is part of the ACIR's efforts to monitor the financial workings of the U.S. federal system. It contains data (primarily 1991 data) collected by the U.S. Bureau of the Census, the Bureau of Economic Analysis, the U.S. Office of Management Budget, and other sources. The revenues and expenditures of federal, state, and local governments are summarized in detail for the United States as a whole and for individual states. It also contains information about the types of government services provided, their costs, and which governments provide them. Economic and demographic changes affecting government operations are also provided. The report can be used for a variety of analytic purposes, including comparison of welfare spending by state or a profile of a given state's revenues and expenditures. To order call 202/653–5640.

Advisory Commission on Intergovernmental Relations, ***RTS 1991: State Revenue Capacity and Effort*** (Washington, D.C.: ACIR, September 1993).

This document provides information on states' potential revenues (revenue capacity) and the proportion of these potential revenues they use (effort). These widely used statistics and some related ones (such as tax capacity, fiscal effort, and tax bases) are included in tables for all U.S. states in 1991. Historical data and summaries are also provided. The statistics are useful for a variety of fiscal analyses, such as finding the fiscal and economic strengths of a state or identifying over- or underutilization of different revenue sources. (See page 2 of this document for an analysis of Michigan's tax effort and capacity.) To order call 202/653–5640.

October revenue collections (preliminary data) provide no clear signal about the future direction of state finances, but our interpretation is that the economy and revenues continue to grow at a steady, modest rate.

Most encouraging are sales and use tax collections, which increased 6.7 percent above the year-ago level. Sales tax collections excluding motor vehicles, jumped a robust 10 percent. Motor vehicle collections increased only 4.4 percent, a weaker than expected gain, but motor vehicle sales remain strong and future increases should be larger. The volatile use tax fell 6.5 percent. The year-to-date increase of 9.1 percent is overstated due to the acceleration of collections begun last summer. The actual increase is about 6.5 percent.

Personal income tax withholding collections increased an estimated 2 percent, which does not track with the strength of the economy. This weak performance is likely due to a change in the timing of collections. SBT collections declined 2.3 percent, but again this could be due to a change in the timing of collections, as payments are due on the last day of the month.

Lottery collections increased 12.5 percent due, in part, to a large increase in sales of instant game tickets. The current Lotto game, which was has been unpopular and less profitable than the previous game, will be replaced in December.

Last month we reported that FY 1992–93 revenues are expected to exceed the consensus revenue estimate by about $100 million. This still appears to be a reasonable estimate.

MONTHLY TAX COLLECTIONS (dollars in thousands)

Type of Revenue	Preliminary October 1993	% Change from Last Year	Past 3 Months' Collections	% Change from Last Year	FY 1992–93 Year-to-Date	% Change from Last Year
Personal Income Tax						
Withholding	$398,504	2.1%	$744,555	5.2%	$4,656,017	5.6%
Quarterly and Annual Payments	12,390	22.9	123,404	4.9	755,518	3.6
Gross Personal Income Tax	410,894	2.6	867,959	5.1	5,411,535	5.3
Less: Refunds	–13,388	13.7	–60,176	47.0	–1,271,800	2.3
Net Personal Income Tax	397,506	2.3	807,783	2.9	4,139,735	6.3
Sales and Use Taxes	312,667	6.7	613,534	9.6	3,516,710	9.1
Motor Vehicles	54,682	4.4	99,756	11.7	524,775	7.8
Single Business Tax	118,915	–2.3	271,953	26.3	1,733,323	13.3
Cigarette Tax	20,848	1.5	38,438	–9.1	239,560	–2.5
Public Utility Taxes	11	0.0	113,572	NM	205,585	40.1
Oil and Gas Severance	2,840	–18.7	6,803	–8.8	39,379	–6.6
Lottery[a]	44,004	12.5	123,620	7.7	435,900	2.1
Penalties and Interest	1,015	14.3	10,029	53.9	90,967	24.2
SUW—Annuals and Undistributed[b]	12,037	280.8	4,510	–577.8	42,028	97.3
Other Taxes[c]	45,465	–30.4	65,369	–9.0	505,187	–9.2
TOTAL TAXES (GF & SAF)[d]	$955,308	2.1%	$2,055,611	10.6%	$10,992,378	7.8%
Motor Fuel Tax (e)	$64,609	0.6%	$135,422	10.2%	$737,110	4.1%

SOURCE: Data supplied by Michigan Department of Treasury.
NM = Not meaningful
[a]The state share of lottery sales is 38 percent (FY 1993). 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.
[e]The motor fuel tax is restricted to the Transportation Fund.