State Notes

TOPICS OF LEGISLATIVE INTEREST

May/June 2004

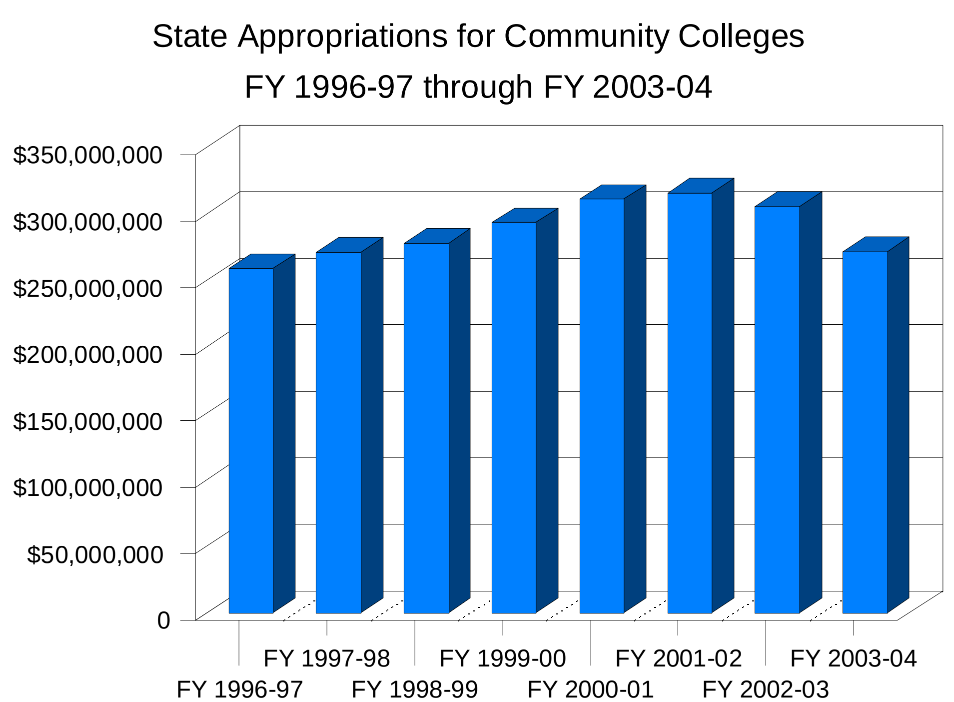
Senate Fiscal Agency

The Link between State Funding and the Commission on Higher Education and Economic Growth
by Mike Hansen, Chief Analyst

Governor Jennifer Granholm recently appointed 40 members to a new Commission on Higher Education and Economic Growth headed by Lt. Governor John Cherry. The Commission is charged with finding ways to double the percentage of people who get college degrees in order to propel Michigan to higher levels of economic growth. While the Commission has yet to meet, and therefore has yet to develop formal policy objectives, it appears that the emphasis will be on increasing college enrollments to serve both the State's manufacturing industries and the new technology-based businesses it hopes to attract.

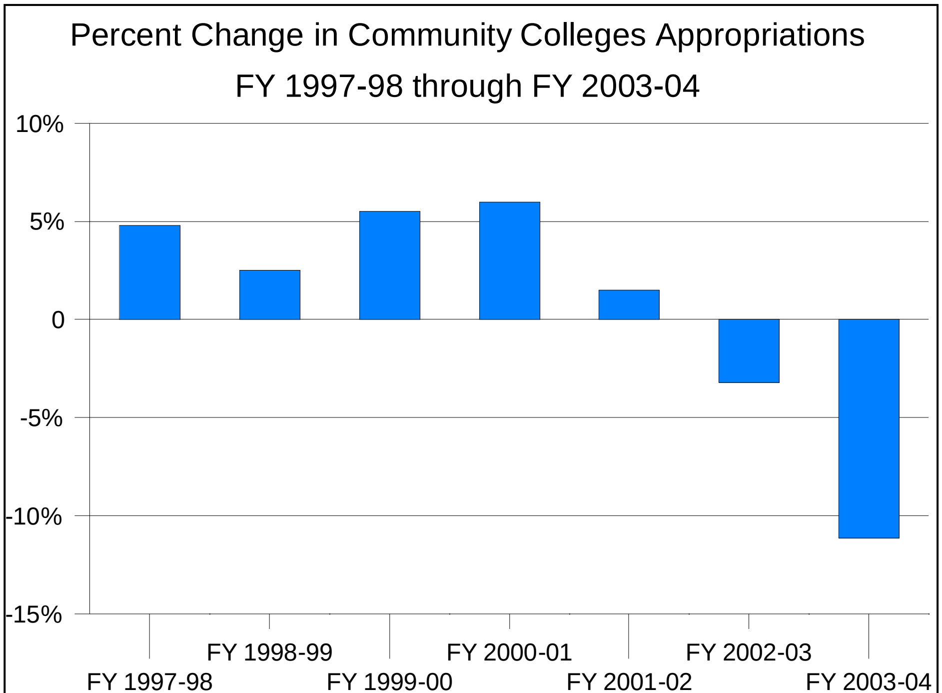
The work of the Commission will be framed against a backdrop of decreasing State appropriations for the State's higher education system. State funding for community colleges, for example, is at its lowest level since fiscal year (FY) 1997-98, and has declined by 14% since its high in FY 2001-02 (Figures 1 and 2). At the same time, State policy-makers have enacted "tuition restraint" incentives that provide a 3% increase in State funding if schools agree to keep tuition increases below the rate of inflation. These constraints on college budgets are occurring, ironically, during a time of increasing college enrollments, up nearly 15% in the last three years (Figure 3).

Figure 1



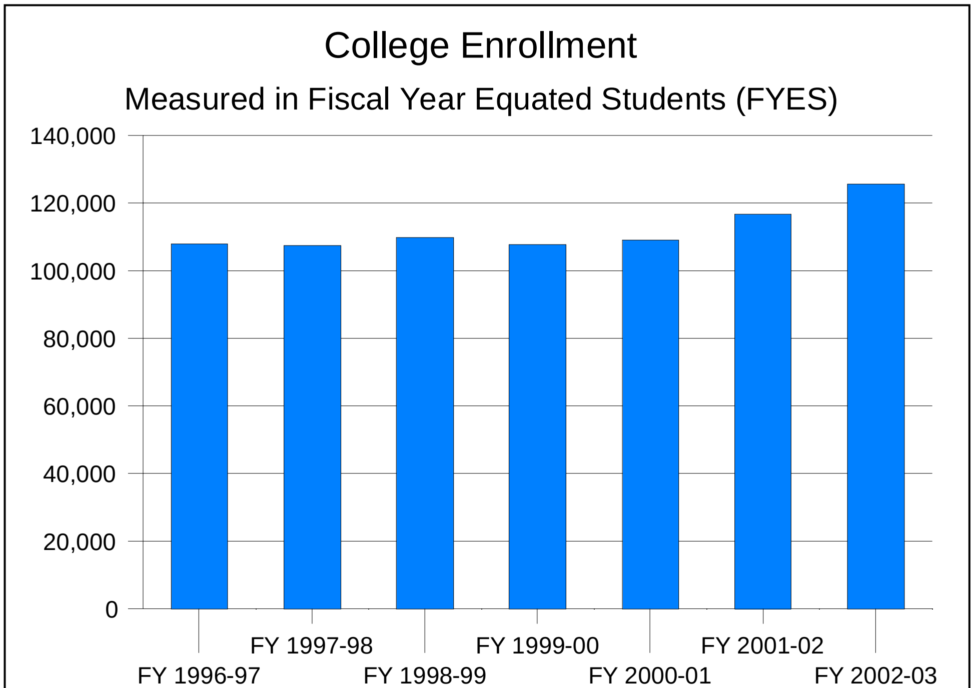
Source: Senate Fiscal Agency

Figure 2



Source: Senate Fiscal Agency

Figure 3



Source: Activities Classification Structure, Michigan Department of Labor & Economic Growth

Since community colleges receive only approximately one third of their revenue from tuition, at some level there is a disincentive to increase enrollment, as each additional student brings with him or her only about a third of the cost of his or her education. This dilemma becomes more apparent during times of declining State financial support. Given this situation, colleges are often tempted either to cap enrollment (which tends to be an unpopular decision among locally elected college boards of trustees) or to reduce high-cost programs. In other words, if a college can teach freshman English for $4 per student contact hour, while it costs maybe $15 to teach computer assisted design (CAD) or dental hygiene, then the advice from college budget officers is to teach more English and less CAD as a way of saving money. Indeed, from a budgetary standpoint, a college acts rationally when it limits the availability of expensive programs, and increases the availability of less expensive programs. Ultimately, a program's cost structure, and the accompanying financial pressures of the institution, begin to dictate the type of curricula offered. The State's public policy interest of producing a workforce for high-skill, high-demand jobs takes a back seat to the demands placed on a school by a funding structure that favors teaching English over welding.

Data on program costs and enrollments tend to support such a shift in program offering decisions. Of the six general instructional categories, courses under the grouping Trade, Industrial, and Technical are the most expensive to operate (Table 1). Interestingly, these are the very classes that have seen a fairly significant decline in enrollment over the past three years. Similarly, General Education classes are among the least expensive to offer, and here, enrollments have increased. In addition, while the Health Occupations curriculum is relatively expensive, and enrollments in this category also have increased, anecdotal evidence suggests that nursing and related programs are being offered due to their high demand, with costs being offset (subsidized) by other, less expensive, programs. While these data do not suggest a direct cause and effect (i.e., the market might be influencing enrollment decisions), it is clear that under the current structure, the State "pays" the college the same whether it offers English or nursing. In this sense, then, there is no connection between the State's public policy objectives and State funding.

It remains to be seen whether the new Commission on Higher Education and Economic Growth addresses some of the financial constraints that may be dictating college course offerings. The linkage between public policy objectives of a well trained and well educated work force for Michigan's "advanced manufacturing and new technology based businesses" and the State's funding of these programs, needs to be better explored. The State's current funding structure does not advance such a correlation.

Table 1

Academic Programs Enrollment and Costs				
	2000-01	**2001-02**	**2002-03**	**% Change FY 2000-01 to FY 2002-03**
Enrollment				
General	58,934	64,732	69,709	18.3%
Business & Public Service	24,159	25,013	26,075	7.9
Trade, Industrial, Technical	9,102	8,247	8,034	(11.7)
Health Occupations	7,924	8,545	9,925	25.3
Developmental and Preparatory	8,279	9,761	11,400	37.7
Human Development	733	504	462	(37.0)
Total	109,131	116,802	125,605	15.1%
Costs / Contact Hour				
General	$5.09	$4.95	$4.89	(3.9)%
Business & Public Service	5.86	5.93	6.19	5.6
Trade, Industrial, Technical	8.02	9.09	9.36	16.7
Health Occupations	8.05	7.86	7.58	(5.8)
Developmental and Preparatory	4.1	4.74	4.62	12.7
Human Development	4.9	4.45	4.75	(3.1)
Total	$5.77	$5.77	$5.76	(0.2)%

Source: Activities Classifications Structure, Michigan Department of Labor and Economic Growth

State Notes

TOPICS OF LEGISLATIVE INTEREST

May/June 2004

Michigan's Recent Tobacco Tax Increase
by Jay Wortley, Senior Economist

On June 24, 2004, the Legislature passed and the Governor signed into law increases in Michigan's taxes on cigarettes and other tobacco products. These increases are intended to help solve budget problems facing State government in fiscal year (FY) 2003-04 and FY 2004-05. This article provides a brief summary of the major components of these recent tax increases.

Table 1

Cigarette Tax Rates by State (as of July 1, 2004)

State	Cents/Pack	Rank	State	Cents/Pack	Rank
Alabama	42.5	37	Montana	70	23
Alaska	100	13	Nebraska	64	25
Arizona	118	11	Nevada	80	20
Arkansas	59	27	New Hampshire	52	34
California	87	19	New Jersey	205	1
Colorado	20	44	New Mexico	91	18
Connecticut	151	4	New York	150	6
Delaware	55	30	North Carolina	5	50
District of Columbia	100	13	North Dakota	44	36
Florida	33.9	42	Ohio	55	30
Georgia	37	39	Oklahoma	23	43
Hawaii	140	8	Oregon	118	11
Idaho	57	28	Pennsylvania	135	9
Illinois	98	17	Rhode Island	171	3
Indiana	55.5	29	South Carolina	7	49
Iowa	36	40	South Dakota	53	33
Kansas	79	21	Tennessee	20	44
Kentucky	3	51	Texas	41	38
Louisiana	36	40	Utah	69.5	24
Maine	100	13	Vermont	119	10
Maryland	100	13	Virginia [1)]	20	44
Massachusetts	151	4	Washington	142.5	7
Michigan	**200**	**2**	West Virginia	55	30
Minnesota	48	35	Wisconsin	77	22
Mississippi	18	47	Wyoming	60	26
Missouri	17	48	U.S. Average	75.9	---

[1)] Virginia's tax rate is scheduled to increase from 2.5 cents to 20 cents effective 8-1-04.

Source: The Federation of Tax Administrators, National Center for Tobacco-Free Kids, and Michigan Senate Fiscal Agency.

Cigarette Tax

The cigarette tax was increased $0.75 per pack from $1.25 to $2.00 per pack, effective July 1, 2004. As shown in Table 1, this pushed up Michigan's cigarette tax rate to the second highest among the states, and made it higher than the cigarette tax in any of Michigan's neighboring states by more than $1 per pack. Assuming that all of this tax increase is reflected in the retail price of cigarettes, the average price for a pack of cigarettes in Michigan will jump up 16% to over $5 per pack. In response to this price increase, it is estimated that cigarette sales in Michigan will decline in FY 2004-05 to 573 million packs from the 674 million packs that were expected to be sold under the old tax rates. The revenue that will be lost due to the decline in the number of packs of cigarettes that will be purchased in Michigan will be more than offset by the 60% increase in the tax rate. As a result, it is estimated that the $0.75 per pack increase in the cigarette tax rate will generate a net increase in revenue equal to $64 million in FY 2003-04, $302 million in FY 2004-05, and $298 million in FY 2005-06, as shown in Table 2.

Table 2

Tobacco Tax Increases
Estimated Net New Revenue
(dollars in millions)

Fiscal Year	Cigarette Tax	Other Tobacco Products Tax	Inventory Tax	Total Tobacco Taxes
FY 2003-04	$63.8	$3.3	$30.0	$97.1
FY 2004-05	302.0	11.6	0.0	313.6
FY 2005-06	297.6	11.5	0.0	309.1

Source: Estimates adopted by the Senate Fiscal Agency, House Fiscal Agency, & Treasury Department.

Other Tobacco Products Tax

Michigan also taxes other tobacco products, such as chewing tobacco and cigars. The tax on these other tobacco products is based on their wholesale price. The newly enacted law raises the tax rate 12 percentage points from 20% of the wholesale price to 32%, effective July 1, 2004. It is estimated that under the old 20% tax rate, this tax would have generated $21 million annually. The new tax rate will increase the other tobacco products tax revenue by an estimated $3.3 million in FY 2003-04, $11.6 million in FY 2004-05, and $11.5 million in FY 2005-06, as shown in Table 2.

Inventory Tax

The cigarette and other tobacco products taxes are collected by tobacco wholesalers at the time they sell tobacco products to their customers, which primarily include retailers. As a result, beginning July 1, 2004, all tobacco products sold by wholesalers will be taxed at the new higher rates; however, the tobacco products held by retailers on July 1, 2004, were taxed at the old rate. In order to ensure that all tobacco products sold by retailers after June 30, 2004, are taxed at the new tax rates, a special tax on tobacco inventories also is needed. Therefore, products purchased by retailers before July 1, and still in their possession on July 1, will be assessed a special inventory tax. This tax equals the enacted tax rate increases ($0.75 per pack of cigarettes and 12% of the wholesale price of other tobacco products). Retailers will be required to file a report detailing the inventory of tobacco products they held on July 1, 2004, and must transmit this report, along with the tax payment, to the Department of Treasury by August 1, 2004. It is estimated that this inventory tax will generate $30 million in FY 2003-04.

Tax Collection Allowance

Tobacco wholesalers collect the tobacco taxes and then remit the tax receipts to the Treasury Department. In order to cover the costs they incur when collecting the State's tobacco products taxes, wholesalers are allowed to keep 1.5% of the tax they collect. It is estimated that wholesalers would have realized about $13.1 million in collection fees in FY 2004-05 if the tax rates had not changed. With the increases in the tax rates, since wholesalers now will be collecting more tobacco tax revenue, the amount they will receive for collecting the tax also will increase. It is estimated that the new higher tax rates will boost the wholesalers' collection allowance by $4.8 million in FY 2004-05 to a total of $17.9 million.

Earmarking of Tobacco Tax Revenue

The distribution of tobacco tax revenue is fairly complicated. Not only is the revenue distributed to six different budget areas, but the revenue derived from four pieces of the cigarette tax rate ($0.75, $0.30, $0.20, and the new $0.75) is distributed differently. To help simplify the discussion of the tobacco tax distribution, Table 3 summarizes the distribution of tobacco tax revenue, in aggregate, under both the old and the new tax rates. Before the recent tax increases were enacted, about 55% of tobacco tax revenue was earmarked to the School Aid Fund and about 32% went to the General Fund. The remaining revenue went to the Healthy Michigan Fund (6.0%), Health and Safety Fund (3.1%), Medicaid Benefits Trust Fund (2.9%), and Wayne County (0.7%). The distribution among these funds is changing under the new tax rates in three major ways:

1) 100% of the revenue generated from the increases in the tax rates ($0.75 per pack of cigarettes and 12% of the wholesale price of other tobacco products) will go into the Medicaid Benefits Trust Fund beginning in the last quarter of FY 2003-04 through the end of FY 2004-05. In FY 2005-06, 75% of this revenue will go into the Medicaid Benefits Trust Fund and 25% will go into the General Fund.

2) As part of the tobacco tax increase that went into effect in August 2002, a portion of the revenue that otherwise would have gone to the General Fund (about $154 million in FY 2004-05) was scheduled instead to go into the Budget Stabilization Fund (BSF) beginning in FY 2004-05 through FY 2006-07. Under the new law, this revenue is moved from the BSF to the Medicaid Benefits Trust Fund.

3) The percentage distributions contained in the law for the old $1.25 cigarette tax rate in combination with the reduction in the revenue that will be generated by the old cigarette tax rate ($1.25 per pack) due to the anticipated decline in the volume of tobacco sales in Michigan, create some funding shifts among the General Fund and some of the other funds that receive tobacco tax revenue.

As shown in Table 3, the major change in how tobacco tax revenue is distributed under the new tax rates compared with the old tax rates is that much more money is dedicated to the Medicaid Benefits Trust Fund. In FY 2003-04, while net new tobacco tax revenue totals an estimated $97 million, the Medicaid Benefits Trust Fund receives an additional $132 million and the General Fund loses $35 million, compared with the distribution under the old tax rates. In FY 2004-05, the major distributional changes increase Medicaid Benefits Trust Fund revenue by $480 million, while the $154 million originally earmarked to the Budget Stabilization Fund is eliminated. In FY 2005-06, the Medicaid Benefits Trust Fund and the General Fund will split the revenue generated from the increases in the tax rates, 75% and 25%, respectively, and the share of the revenue from the old tax rate earmarked to the BSF is eliminated. As a result, in FY 2005-06, tobacco tax revenue going to the Medicaid Benefits Trust Fund will increase $360 million, General Fund revenue will increase $105 million, and no tobacco tax revenue will be earmarked to the BSF.

Table 3

Enacted Tobacco Tax Increase
Estimated Revenue Increase and Distribution
FY 2003-04, FY 2004-05, AND FY 2005-06
(dollars in millions)

	Previous Tax Rates	New Tax Rates	Net New Tobacco Tax Revenue
FY 2003-04			
General Fund/General Purpose	$286.2	$251.7	($34.5)
School Aid Fund	479.6	480.5	0.9
Health & Safety	27.2	27.4	0.2
Healthy Michigan	52.6	50.7	(1.9)
Wayne County	6.2	6.2	0.0
Medicaid Trust	25.1	157.4	132.3
Budget Stabilization Fund	0.0	0.0	0.0
Total	**$876.8**	**$973.9**	**$97.1**
FY 2004-05			
General Fund/General Purpose	$128.0	$118.9	($9.1)
School Aid Fund	472.7	476.5	3.8
Health & Safety	26.8	27.9	1.1
Healthy Michigan	51.8	42.9	(8.9)
Wayne County	6.1	6.4	0.3
Medicaid Trust	24.7	505.0	480.3
Budget Stabilization Fund	154.0	0.0	(154.0)
Total	**$864.1**	**$1,177.6**	**$313.5**
FY 2005-06			
General Fund/General Purpose	$126.1	$231.1	$105.0
School Aid Fund	465.8	469.4	3.6
Health & Safety	26.4	27.5	1.1
Healthy Michigan	51.1	42.3	(8.8)
Wayne County	6.0	6.3	0.3
Medicaid Trust	24.3	384.0	359.7
Budget Stabilization Fund	151.8	0.0	(151.8)
Total	**$851.5**	**$1,160.6**	**$309.1**

Source: Estimates adopted by the Senate Fiscal Agency, House Fiscal Agency, & Treasury Department.

State Notes

TOPICS OF LEGISLATIVE INTEREST

May/June 2004

Senate Fiscal Agency

The Ups and Downs of Michigan's Tax Burden

by David Zin, Economist

In June 2000, Michigan employment began declining as the nation began to enter a recession. Tax revenue, on a year-over-year basis, began exhibiting consistent declines as the employment situation worsened and a variety of tax cuts continued to be implemented. Despite a forecasted improvement in the economy during 2004 and 2005, Michigan's combined General Fund and School Aid Fund revenue in fiscal year (FY) 2004-05 is expected to be 4.4% below FY 1999-2000 revenue. While employment declines also affected the growth of personal income, personal income continued to increase, although at a slower rate. Michigan personal income increased 0.3% in 2001, 1.5% in 2002, and 2.5% in 2003, after growth of 4.9% in 1999 and 5.8% in 2000. The combined impact of growing personal income and declining revenue indicates that the average State tax burden in Michigan has fallen in recent years.

The average State tax burden for Michigan can be calculated by dividing State tax revenue by Michigan personal income. The analysis here uses a broader measure of tax burden than just tax revenue because, in some cases, changes have been made in the State fiscal structure to replace more general tax revenue with more specific user charges and fees. In 1978, Michigan residents voted to limit constitutionally the amount of revenue the State may collect during a year. Revenue subject to the limit includes total State government tax revenue and all other State government revenue, such as fees, licenses, and interest earnings. This analysis uses the revenue subject to the constitutional limit when evaluating the tax burden in Michigan. (As a result, the issue might be more correctly characterized as an average revenue burden rather than an average tax burden, although the latter phrase will be used.)

In calculating the constitutional limit for any fiscal year, State government revenue may not exceed 9.49% of Michigan total personal income for the calendar year prior to the calendar year in which the fiscal year begins. For instance, in FY 2002-03, State government revenue could not exceed 9.49% of personal income for calendar year 2001. However, this lagged structure of comparing revenue from one period with income in a different period is not useful for calculating the average burden on residents. The analysis here compares fiscal year revenue with the corresponding fiscal year personal income.

Table 1 reports revenue subject to the constitutional limit, personal income, and the tax burden of that revenue (also depicted in Figure 1), assuming that all revenue was received from Michigan residents. Given the amount of tourism in the Michigan economy, changes in how multistate activity is allocated to Michigan under the single business tax, ownership of property by non-Michigan residents and other similar factors, the calculation overstates the burden of Michigan's tax structure on Michigan residents by an unknown amount. Disregarding the overstatement, Michigan's average tax burden has generally fallen during economic slowdowns and risen during expansions. The average burden reached its lowest level during FY 1991-92, at 6.61%, and its highest level during FY 1997-98, at 8.46%. Since FY 1997-98, the average burden has declined, to 7.9% in both FY 2001-02 and FY 2002-03. Based on the estimates from the May 2004 Consensus Revenue Estimating Conference, the burden will continue to decline through FY 2004-05, with the average tax burden representing 7.64% of personal income in FY 2003-04 and 7.38% in FY 2004-05.

Table 1

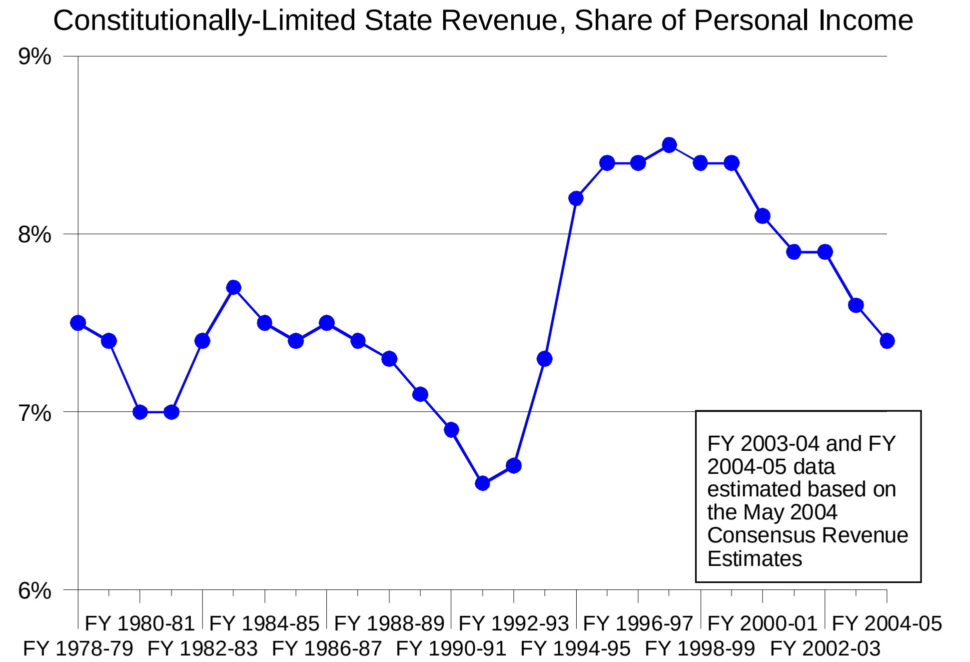
State Revenue and Michigan Personal Income
FY 1978-79 to Estimated FY 2004-05
(dollar amounts in millions)

Fiscal Year	Fiscal Year Personal Income	State Revenue Subject to Constitutional Limit	Revenue Share of Personal Income
FY 1978-79	$87,544.3	$6,598.3	7.5%
FY 1979-80	93,264.5	6,870.1	7.4%
FY 1980-81	101,114.3	7,043.0	7.0%
FY 1981-82	104,607.8	7,348.9	7.0%
FY 1982-83	109,161.5	8,103.5	7.4%
FY 1983-84	120,635.0	9,243.5	7.7%
FY 1984-85	131,315.5	9,861.6	7.5%
FY 1985-86	140,997.5	10,483.8	7.4%
FY 1986-87	145,969.8	10,891.9	7.5%
FY 1987-88	154,343.8	11,472.3	7.4%
FY 1988-89	166,095.5	12,087.9	7.3%
FY 1989-90	174,410.8	12,363.1	7.1%
FY 1990-91	179,535.5	12,311.9	6.9%
FY 1991-92	189,585.5	12,540.9	6.6%
FY 1992-93	199,577.3	13,435.3	6.7%
FY 1993-94	213,412.5	15,473.2	7.3%
FY 1994-95	226,192.5	18,585.4	8.2%
FY 1995-96	234,309.0	19,798.8	8.4%
FY 1996-97	245,822.8	20,694.3	8.4%
FY 1997-98	260,778.3	22,072.3	8.5%
FY 1998-99	274,917.5	23,208.5	8.4%
FY 1999-00	291,484.5	24,362.9	8.4%
FY 2000-01	294,536.5	23,909.2	8.1%
FY 2001-02	298,152.5	23,546.0	7.9%
FY 2002-03	304,414.8	24,061.6	7.9%
FY 2003-04*	313,733.9	23,962.1	7.6%
FY 2004-05*	330,451.0	24,383.4	7.4%

***Note:** Estimated based on May 2004 consensus revenue estimates.

Source: Michigan Department of Management & Budget, U.S. Department of Commerce, Senate Fiscal Agency

Figure 1



Source: Michigan Dept. of Mgmt. & Budget, U.S. Department of Commerce, Senate Fiscal Agency

Revenue subject to the constitutional limit increased significantly between FY 1992-93 and FY 1994-95 because of the adoption of Proposal A by the voters in March 1994. Proposal A transferred a significant portion of the funding for public schools in Michigan from local property taxes to the State through the imposition of a State property tax and an increase in the sales tax rate from 4% to 6%, and was supplemented by the imposition of several other new taxes and a decrease in the individual income tax rate. Virtually all of the revenue increases related to Proposal A were dedicated to the School Aid Fund, while the income tax reduction primarily affected the General Fund.

As total revenue has declined, revenue earmarked to the School Aid Fund has continued to grow. Maintaining growth in earmarked School Aid Fund revenue has meant that the average burden of supporting the School Aid Fund has remained relatively stable since the adoption of Proposal A. Given that the total average tax burden has declined while the burden of earmarked School Aid Fund revenue has remained constant, the result has been a significant decline in the burden of supporting non-School Aid Fund operations of State government (Table 2 and Figure 2). The non-School Aid Fund average tax burden essentially reflects the burden of State government operations (including revenue sharing support to local units of government), and has declined in almost every year since FY 1983-84, when the burden averaged 6.07% of personal income, to an estimated 4.02% in FY 2004-05.

During the FY 1993-94 to FY 1998-99 period, non-School Aid Fund revenue (excluding the General Fund grant to the School Aid Fund) averaged 4.95% of personal income. Compared with the estimated non-School Aid Fund burden of 4.0% of personal income, FY 2004-05 taxes and fees are estimated to be $3.1 billion below what they would have been if Michigan's burden had remained at the same level as during the mid-to-late-1990s.

Table 2

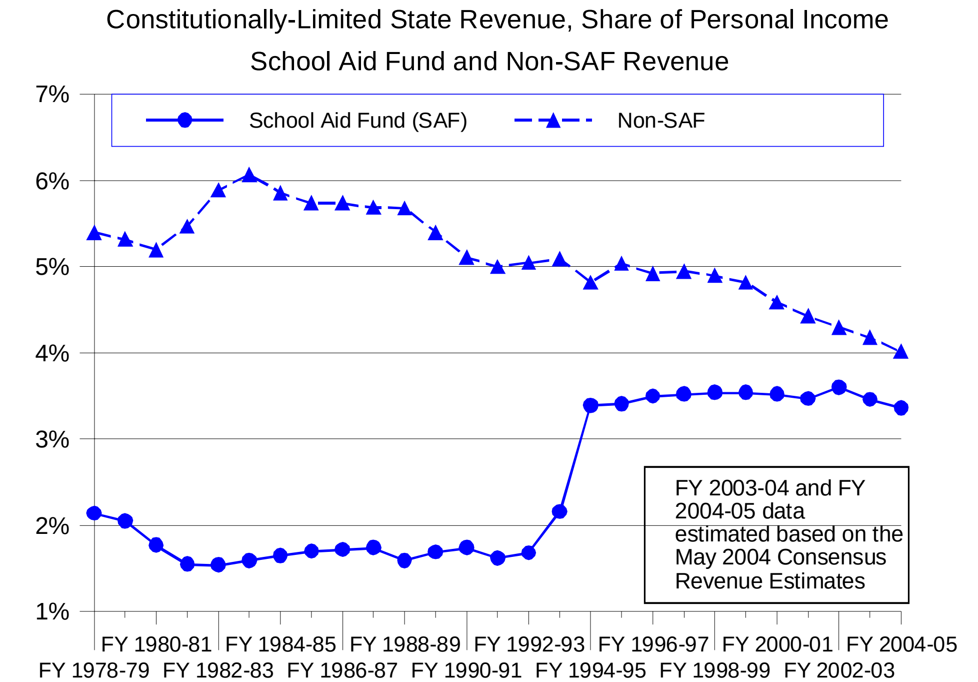
Revenue to Support School Aid Fund and Other State Spending, Share of Personal Income FY 1978-79 to Estimated FY 2004-05

Fiscal Year	School Aid Fund Revenue	Non-School Aid Fund Revenue
FY 1978-79	2.1%	5.4%
FY 1979-80	2.0%	5.3%
FY 1980-81	1.8%	5.2%
FY 1981-82	1.6%	5.5%
FY 1982-83	1.5%	5.9%
FY 1983-84	1.6%	6.1%
FY 1984-85	1.7%	5.9%
FY 1985-86	1.7%	5.7%
FY 1986-87	1.7%	5.7%
FY 1987-88	1.7%	5.7%
FY 1988-89	1.6%	5.7%
FY 1989-90	1.7%	5.4%
FY 1990-91	1.7%	5.1%
FY 1991-92	1.6%	5.0%
FY 1992-93	1.7%	5.1%
FY 1993-94	2.2%	5.1%
FY 1994-95	3.4%	4.8%
FY 1995-96	3.4%	5.0%
FY 1996-97	3.5%	4.9%
FY 1997-98	3.5%	4.9%
FY 1998-99	3.5%	4.9%
FY 1999-00	3.5%	4.8%
FY 2000-01	3.5%	4.6%
FY 2001-02	3.5%	4.4%
FY 2002-03	3.6%	4.3%
FY 2003-04*	3.5%	4.2%
FY 2004-05*	3.4%	4.0%

***Note:** Estimated based on May 2004 consensus revenue estimate.

Source: Michigan Department of Management & Budget, U.S. Department of Commerce, Senate Fiscal Agency

Figure 2



Source: Michigan Dept. of Mgmt. & Budget, U.S. Department of Commerce, Senate Fiscal Agency