

State Notes

TOPICS OF LEGISLATIVE INTEREST

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History of State Revenue Limit By Gary S. Olson, Director

On November 7, 1978, the voters of Michigan approved an initiative to amend the Michigan Constitution referred to as the Tax Limitation, or Headlee, Amendment. One of the key provisions of this constitutional amendment was a limit on the maximum amount of State revenue that could be collected by the State during any particular fiscal year. This constitutional revenue limit has now been in place for 28 years. On November 7, 2006, the voters of Michigan may have an opportunity to vote on changes to this longstanding constitutional revenue limit and to place a new limit on the growth in State spending. A citizen initiative to amend the State Constitution, referred to as the Stop Overspending (SOS) Michigan Constitutional Initiative, is currently pending before the Secretary of State for certification to appear on the November general election ballot. This article provides a historical overview of the existing constitutional revenue limit and analyzes the State's compliance with the revenue limit over the past 28 years.

State Constitutional Revenue Limit

The State constitutional revenue limit (Article IX, Section 26 of the State Constitution) caps the maximum amount of State revenue that can be collected in any State fiscal year at a percentage of Michigan personal income reported during the calendar year that is prior to the calendar year in which the final year begins. The percentage was established using fiscal year (FY) 1978-79 State revenue as the base fiscal year and dividing that amount by the actual level of Michigan personal income reported in calendar year 1977. This ratio was calculated as 9.49%. State revenue is defined as all State-generated revenue including taxes, fees, permits, licensing revenue, and other miscellaneous revenue sources. The Federal revenue received by the State and appropriated in the budget is not counted in this definition of State revenue.

The State revenue limit essentially established the amount of revenue collected in FY 1978-79 as the maximum amount of State revenue that may be collected in each future fiscal year, adjusted for future growth in Michigan personal income. As long as the total amount of State revenue collected in any fiscal year is less than 9.49% of the Michigan personal income reported during the prior calendar year, the State is in compliance with this constitutional revenue limit.

The constitutional revenue limit also provides for the procedures that must be followed if actual State revenue collections in any fiscal year exceed the maximum amount allowed under the revenue limit. The Constitution provides that any revenue collected that exceeds the revenue limit by 1.0% or more, must be refunded to individual income and single business taxpayers. State law provides that if actual State revenue collections in any fiscal year exceed the maximum amount allowed by less than 1.0%, the excess revenue may be deposited into the Budget Stabilization Fund.

State's Compliance with Revenue Limit

Table 1 provides a summary of the State's compliance with the constitutional revenue limit for the period FY 1979-80 through FY 2006-07. During this 28-year-period, actual State revenue collections have exceeded the constitutional revenue limit during three fiscal years: FY 1994-95, FY 1998-99, and FY 1999-2000. In each of these fiscal years the amount by which actual

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revenue collections exceeded the revenue limit was less than 1.0% and therefore there was no requirement to refund excess revenue to income and single business taxpayers.

Table 1

State's Compliance with Constitutional Revenue Limit Sec. 26, Article IX, State Constitution of 1963 (Millions of Dollars)			
Fiscal Year	Constitutional Revenue Limit	Actual Revenue Collections	Amount Under/(Over) Limit
1979-80	\$7,396.8	\$6,870.1	\$ 526.7
1980-81	8,215.7	7,043.0	1,172.7
1981-82	8,763.0	7,348.9	1,414.1
1982-83	9,424.9	8,103.5	1,321.4
1983-84	9,488.1	9,243.5	244.6
1984-85	9,867.7	9,861.6	6.1
1985-86	10,857.3	10,483.8	373.5
1986-87	11,736.6	10,891.9	844.7
1987-88	12,822.2	11,472.3	1,349.9
1988-89	13,439.5	12,087.9	1,351.6
1989-90	14,513.4	12,363.1	2,150.3
1990-91	15,351.4	12,311.9	3,039.5
1991-92	16,228.2	12,540.6	3,687.6
1992-93	16,583.8	13,435.3	3,148.5
1993-94	17,624.2	15,473.2	2,151.0
1994-95	18,475.8	18,585.4	(109.6)
1995-96	19,982.0	19,798.8	183.2
1996-97	21,672.2	20,694.3	977.9
1997-98	22,712.4	22,072.3	640.1
1998-99	23,186.8	23,208.5	(21.7)
1999-00	24,203.2	24,362.9	(159.7)
2000-01	26,315.4	23,909.2	2,406.2
2001-02	27,463.1	23,546.0	3,917.1
2002-03	28,243.1	24,061.6	4,181.5
2003-04	28,825.4	24,384.7	4,440.7
2004-05	29,842.3	25,626.8	4,215.5
2005-06	30,760.3	26,211.0	4,549.3
2006-07	31,807.1	27,121.1	4,686.0

Sources: FY 1979-80 through FY 2004-05 numbers are from Annual Reports from the Department of Management and Budget. FY 2005-06 and FY 2006-07 estimates are from the May 2006 Consensus Revenue Estimating Conference.

The data in Table 1 clearly show how the volatility of actual revenue collections affects the revenue limit. During periods of economic slowdown in Michigan, actual revenue collections tend to fall significantly under the constitutional revenue limit. This can be best observed during the FY 1980-81 through FY 1982-83 period, the FY 1989-90 through FY 1993-94 period, and the FY 2000-01 through FY 2006-07 period. Tax policy changes also have had an impact on the State's compliance with the revenue limit. The State approved a major increase in the rate of the State income tax in calendar year 1983 and this tax rate increase significantly affected the State's compliance with the revenue limit during FY 1984-85. On the other hand, the State approved significant reductions in the rates of the income and single business taxes beginning



in calendar year 2000 and these tax reductions, along with a very significant prolonged State economic slump in the calendar year 2000 through calendar year 2006 period, have put actual State revenue collections significantly under the revenue limit in recent years. Based on the current estimate of FY 2006-07 State revenue, revenue collections will be almost \$4.7 billion under the revenue limit. This estimated level of FY 2006-07 State revenue equals 8.09% of calendar year 2005 Michigan personal income.

The other major factor that has had an impact on the State's compliance with the revenue limit over the past 28 years is the voter approval of a constitutional amendment on March 15, 1994, which significantly changed the way the State funds local K-12 public schools. The passage of Proposal A on this date reduced local funding for K-12 public schools and offset this loss of local property tax revenue with increases in State revenue. While the overall impact of Proposal A was a net reduction in State and local taxes, Proposal A did result in significant increases in State taxes that are subject to the constitutional revenue limit. This means that State tax revenue that now is being used to fund K-12 public schools was not part of the original calculation of State revenue that led to the 9.49% of Michigan personal income revenue limit.

Table 2 provides a summary of the State's actual compliance with the constitutional revenue limit for the period FY 1993-94 through FY 2006-07 and the State's compliance with the revenue limit adjusted for the additional State revenue raised to offset reductions in local property taxes under Proposal A. These State tax increases under Proposal A are very significant and are estimated to total \$6.3 billion in FY 2006-07. During FY 2006-07, after adjusting for the Proposal A revenue increases, estimated State revenue is \$11.0 billion under the constitutional revenue limit. Using this adjusted amount, estimated FY 2006-07 State revenue equals 6.2% of calendar year 2005 Michigan personal income.

Table 2

State's Compliance with Constitutional Revenue Limit Sec. 26, Article IX, State Constitution of 1963 Adjusted for Proposal A Revenue Increases (Millions of Dollars)			
Fiscal Year	Actual Amount Under/(Over) Limit	Proposal A Revenue Increases	Revenue Limit Compliance Adjusted
1993-94	\$2,151.0	\$1,300.1	\$3,451.1
1994-95	(109.6)	3,867.1	3,757.5
1995-96	183.2	4,093.1	4,276.4
1996-97	977.9	4,240.2	5,218.1
1997-98	640.1	4,492.0	5,132.1
1998-99	(21.7)	4,725.0	4,703.3
1999-00	(159.7)	4,988.0	4,828.3
2000-01	2,406.2	5,194.7	7,600.9
2001-02	3,917.1	5,415.4	9,332.6
2002-03	4,181.5	5,530.0	9,711.5
2003-04	4,440.7	5,818.2	10,258.9
2004-05	4,215.5	5,984.2	10,199.7
2005-06	4,549.3	6,131.3	10,680.6
2006-07	4,686.0	6,326.1	11,012.1

Source: Senate Fiscal Agency calculations.



Summary and Conclusions

When the voters of Michigan in 1978 approved a constitutional limit on the amount of State revenue that could be collected during any fiscal year in 1978, the intent was to limit the size of State government in the future. As this analysis has shown, the actual size of State government, as measured by State revenue, has been significantly reduced over the past 28 years. During FY 2006-07, estimated State revenue collections will be under the constitutional revenue limit by approximately \$4.7 billion or 12.3%. Adjusting for the State tax increases that were used to offset local tax reductions contained in Proposal A of 1994, estimated State revenue in FY 2006-07 will be under the constitutional revenue limit by \$11.0 billion or 35%.

As the State's voters consider the proposed Stop Overspending Michigan Constitutional Initiative on the November 7, 2006, ballot to reduce the size of State government, it is important to understand that over the past 28 years since the passage of the Tax Limitation Amendment, the size of State government has been significantly reduced.