



CAPITOL REPORT

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MAKING SENSE OF THE NON-SENSICAL: PERSPECTIVES ON MICHIGAN'S BUDGET FIASCO

We at Kelley Cawthorne have held off for longer than we would have liked in giving you the inside scoop on where the State's \$1.75 billion tax and budget mess is and where it's headed. We had thought . . . day after day . . . that any report to you might be outdated . . . and wrong . . . within hours of our sending it to you. We thought that at some time a comprehensive breakthrough could come and render obsolete anything we told you.

Now no substantial breakthrough appears imminent. In some ways, the three parties to the debate – Governor, Senate, House – appear as far from an agreement as they were six months ago. In fact, some sources claim Governor Granholm, Senate Majority Leader Mike Bishop, and House Speaker Andy Dillon have not met as a group in weeks, a truly astonishing fact if accurate.

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Let's dissect the current mess player-by-player:

Governor Granholm: her early proposal to impose a 2% sales tax on services got virtually no support from either party or either chamber. Many observers contend that, until yesterday, she was not specific on what new tax proposal she would support and in what amount. Yesterday, she said she wouldn't accept anything less than a \$1.45 billion tax hike that would include raising the State income tax from 3.9% to 4.6% plus raising other taxes. Further, she said she would veto any continuation budget beyond October 1st if a revenue bill was not attached. One major problem, however, is that even if a last minute deal is struck on taxes, there's very little time to draft nineteen different departmental budgets for 2007-08, especially if \$300 million or more in spending cuts are required. Critics also note that even though the Governor now has a list of 58 possible spending "reforms" she has not yet fully committed to any of them, frustrating legislative Republicans who are insistent that tax hikes be linked to "reforms". Still, the Governor has been forthright in recognizing that cost cutting alone is not the way to move Michigan forward.

Senate Republicans: Majority Leader Mike Bishop has had to carefully straddle a line in his own caucus between anti-tax hardliners and those members who know that realistically . . . in the final analysis . . . some kind of income tax increase is inevitable. GOP senators insist on teacher health care and pension reforms that some say could save \$200 million annually, but Gov. Granholm will be under huge pressure from the MEA to hold firm in opposing the present version of that legislation. At least two Republican senators are known to be weak on the issue and that means Bishop faces possible in-house defections on a key issue. Bishop this week offered to take up a vote on a 4.3% income tax. The Senate leader had earlier insisted that House Dems, as the party of the Governor and in control of that chamber, be the first to take up the income tax hike. Senate Dems rejected the offer and noted that the Republican wish list of reforms was both vague and unrealistic.

House Democrats: Speaker Andy Dillon had tried valiantly to craft a compromise solution but is beset by huge problems both within his own party and with the House Republican minority. Detroit Dems say anything less than a 4.6% income tax is unacceptable and have made it tougher for both Speaker Dillon and Gov. Granholm to agree to anything less. Also, ten Democrats elected from “swing districts” have steadfastly refused to vote “yes” or “no” on a tax increase, saying that Republican votes are necessary to achieve a truly bi-partisan outcome. Republicans badly want to get them on record as a “yes” and recognize that the only way to do it is by withholding GOP votes. Meantime, some of Dillon’s Dem colleagues have thrown out revenue solutions which have no realistic chance of helping the State’s near term fiscal mess, such as the graduated income tax, racinos, and a sales tax increase, all of which require a vote of the people that could not be held until at least early next year. Finally, House Minority Leader Craig DeRoche has become increasingly intransigent in his position, leaving Dillon to try to scratch out a deal with break-away Republicans who number anywhere from three to ten depending on who’s doing the counting. These GOP reps are trying to craft a deal that would exchange their income tax votes for increased school aid to lower spending districts. Whether the Senate would ever buy into that solution is a major question.

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So, where are we? Kelley Cawthorne said as early as last Spring in one of these *Capitol Reports* that a budget deal would not be reached until shortly before September 30th. Maybe we were too optimistic. A shut down on October 1st is now a very real possibility. On the other hand, tremendous pressure for a deal will only mushroom in the coming days. Late this afternoon (Wednesday), House Dems unveiled still a new proposal for a “comprehensive” solution.

At some point, an increase in the income tax seems inevitable. That some services may be added to the sales tax is a very real possibility, but it’s difficult to know exactly which ones. It also seems to us likely that at some point the MEA will have to back down, at least partially, on teacher health care reforms. We doubt that, even if new taxes are OK’d, there is time to complete writing of a state budget by October 1st, so the most likely outcome – short of a shut down – is a tax hike approved before September 30th but a budget completed after that date, the Governor’s veto threats notwithstanding.

During last weekend's marathon House session, which lasted into Sunday evening, your Kelley Cawthorne team was present at the Capitol, vigilant and active on behalf of our clients. We'll be keeping you posted . . . as best as we can.

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