

May 4, 2020

Michigan's Personal Income Tax During Pandemic

By James M. Hohman

Summary

The COVID-19 pandemic will cause state income tax collections to fall and could cause spending on Medicaid to increase.

Main text word count: 736

Eventually the worldwide COVID-19 pandemic will run its course, and how long that takes will matter to the fiscal challenges Michigan's state government will face. For example, the personal income tax is its largest revenue source. Right now, it's unclear how much the pandemic will cause state income tax collections to decrease as people stay home and lose earned income.

Here is some context for potential declines: During the last recession, income tax revenue dropped from \$8.16 billion in fiscal year 2007-08 to \$6.82 billion the year after, a 16% drop. A 16% decline in today's income tax revenue would be a \$2.04 billion decrease, which would take income tax revenues back to fiscal year 2013-14 levels.

The state treasury will get some stability from unemployment benefits, which are subject to state income taxes. The federal government's \$600-per-week boost in these payments will thus have an inadvertent benefit of mitigating the state's income tax losses.

Some parts of the state budget will be left unscathed from income tax decreases while others will be harder hit. A portion of income tax revenue — \$468 million this year and \$600 million next year — is dedicated to the transportation budget. Those amounts are etched into law, so they're going to be allocated this way regardless of whether revenues decline. Another 27% of income tax revenue goes to conventional school districts and charter schools, with smaller amounts going to community colleges and state universities. Declines in revenue would mean less money for those institutions.

The bulk of income tax revenue, however, lacks any strings. Personal income taxes generate 65% of the state's unrestricted general funds. This money gets spent for hundreds of different purposes, but the largest allocations are to prisons, Medicaid and state universities.

Prison spending won't be affected immediately, though maybe they will need extra money for patient treatment and safety measures for corrections officers, given that inmates have been infected by the virus.

Higher education's portion of the income tax is up to lawmakers. State universities may struggle, over the short term, to attract incoming students or to get current students to enroll again in the fall term. But that doesn't



COVID-19 means less money for state government from the income tax.

mean that state taxpayers need to fill in the gaps. Additional payments from state taxpayers in the past have done little to stop the cost increases at state universities, and even if they had, universities may seem like less of a priority than other demands on state resources right now.

As people lose their jobs or employers are unable to weather the shutdown, more of them may be eligible for Medicaid. The pandemic may also cause more people who were already eligible to apply for the program to do so. This will increase demands on state assistance currently paid for by personal income taxes.

Michigan pays an annual amount to medical groups for people to be covered by Medicaid, and it makes those groups responsible for ensuring that the people in their care receive the services they need. If the number of people in Medicaid needing treatment for COVID-19 goes up significantly, hospitals and physicians would be responsible for the extra expense, not the state. It would cause some fiscal stress to hospitals and physicians, because the reimbursement payments hospitals and physicians receive from Medicaid are less than the costs they incur in providing services.

The state should already be expecting enrollment in Medicaid to escalate, as it did during previous recessions. It will get some help from national lawmakers, as recent spending bills have increased the federal government's share of Medicaid spending. But not all Medicaid services will benefit; the amount of federal matching funds will not increase for services given to the Medicaid expansion population, which is to say, people who were made eligible for Medicaid under the Affordable Care Act. So, the state faces another kind of uncertainty. Some of the increased demand for Medicaid-funded services will come from people who were eligible under the old rules. The state will be eligible for increased federal funds for these people. But it will also be paying more for services for people who became eligible for Medicaid when state lawmakers loosened the rules on who qualifies, and there will be no additional federal money for those patients. Right now, it's not clear how much each group will need in new services as a result of COVID-19.

Regardless of what happens with Medicaid, the pandemic will put pressure on both personal income tax revenues and the services they pay for. But it's worth noting that decreases in state revenue, demands for more prison spending, and increases in Medicaid caseloads will all be smaller if the pandemic passes quickly.

There are going to be additional strains on state finances from the orders to intentionally shut down sections of the economy to slow the spread of the COVID-19 coronavirus. The income tax is just one facet of it.

#####

James M. Hohman is the director of fiscal policy at the Mackinac Center for Public Policy, a research and educational institute headquartered in Midland, Michigan. Permission to reprint in whole or in part is hereby granted, provided that the author and the Mackinac Center are properly cited.

The pandemic will put pressure on both personal income tax revenues and the services they pay for.

Attention Editors and Producers

Viewpoint commentaries are provided for reprint in newspapers and other publications. Authors are available for print or broadcast interviews. Electronic text is available for this Viewpoint at mackinac.org/pubs/viewpoints.

Please contact:

Holly Wetzel
Communications Coordinator
989-698-1927
wetzel@mackinac.org

140 West Main Street
P.O. Box 568
Midland, Mich. 48640

Mackinac.org
Facebook.com/MackinacCenter
Twitter.com/MackinacCenter