Remarks of Douglas C. Drake

March 16, 2010

Good morning.

My name is Douglas C. Drake, and I'm a state retiree and serve as the Chair of the State Employees Retirement System Board, appointed first by Governor Engler, and re-appointed several times by him and by Governor Granholm.

During my career I worked for the Michigan House of Representatives on issues of taxation and economic policy and I'm proud to say that I helped with many major pieces of legislation then, and later in my career with the Treasury and the State Budget Office. I was also the developer and contributor to a number of chapters in Michigan at the Millennium.

I want to talk to you today about the state budget proposals to tax public and private pensions and other types of retirement income, as well as to eliminate the Earned Income Tax Credit for the working poor.

I'm not proud of what has been proposed in this year's budget.

Balancing the budget on the backs of the working poor and the retired in Michigan is bad enough from a policy perspective. It is worse when the reality is that the budget proposes to tax the working poor and retired to finance still more tax relief for Michigan businesses.

Aside from being bad public policy, at least some of the tax proposals, in my opinion and experience, violate provisions of the state constitution, and may even create potential federal constitutional issues of equal protection. Still worse, I submit to you that the proposed additional tax relief for Michigan businesses isn't even needed or justified.

Business taxes in Michigan are already average, either slightly above or slightly below depending on interpretations of various studies. One of the most commonly cited, by the Tax Foundation, cites Michigan as having the 17^{th} best business tax climate in 2010. Arguably, many of those ranked above us are not serious competitors for Michigan's manufacturing base.

Alaska, for example would not be a great place for an auto assembly plant. Neither would North or South Dakota, or Wyoming or Montana. In fact, one of the key secrets of tax policy for these states is that by levying severance taxes on the value of oil, coal and other natural resources extracted from the ground and shipped around the country, they get us to actually pay taxes for them.

Michigan's history over the last 50 years or so has been one of continuously lowering total business taxes, especially for new investment: virtually no new plants have been built in this state without substantial tax breaks.

From a state tax only on C corporations prior to 1957, to the Michigan Business Activities Tax in place from 1957 to 1968, to the Corporate Income Tax in effect from 1968 to 1975, from the SBT in effect from 1975 to 2007, to the unloved MBT in place today, one of the key factors of business taxation in Michigan has been a struggle between C corps and other forms of business organization over the **distribution** of the business share of taxation in Michigan.

I would suggest to you that history has shown that the corporate income tax has not been a good choice for Michigan's highly cyclical manufacturing based economy, and I would remind you, that the tax rate of the Single Business Tax was never increased over its thirty plus year history-despite multiple recession periods during that time—that is not a statement that could be made about our corporate income tax experience.

Let me turn now to some specifics about the history of taxing retirement income in Michigan.

When Michigan's Constitution was re-written in 1963 and approved by the people, Article IX (the taxation section) contained the following section"

"Sec 24. The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby."

How did Michigan go from non-impairment of public pensions to the generous treatments of retirement income in place today?

First, when the state income tax was adopted in 1967, a few short years after the Constitution was adopted, AND WITH MANY CON-CON DELEGATES SERVING IN THE LEGISLATURE --- there was widespread belief that this constitutional language barred subjecting public pensions to the income tax.

The various public pension system acts had exemption language added to them, as did the state income tax act.

To the best of my knowledge, this exemption was never litigated.

What was litigated, through the federal courts was the issue of equal treatment for federal civilian and military pensions. In the Davis case, the federal courts ruled that if Michigan public pensions were exempted, these other pensions had to be exempted as well.

Subsequent to that action, the Legislature over time added exemptions for other types of retirement income as well, which is how we got to where we are today.

Given the state and federal constitutional roots of these exemptions, it is specious to argue that we go back today. Any attempt to remove these exemptions is guaranteed to create litigation that at best would delay their implementation and create a budget hole and at worst might require HUGE retroactive refunds.

I will be glad to answer your questions and can be available for further discussion.