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**Political Assessment of
Proposed Tobacco Product Tax Increase**
State of Michigan

Jan. 24, 1993

Tax Status

- Current cigarette tax is 25 cents per pack; no current tax on other tobacco products
- March 15, 1994, special election ballot would increase cigarette tax by 50 cents to 75 cents per pack and create a 16 percent tax on the wholesale price of other tobacco products
- If the ballot proposal fails, an alternative statutory school finance plan automatically takes effect, increasing the cigarette tax by 15 cents to 40 cents per pack and creating a 16 percent tax on the wholesale price of other tobacco products

Executive Summary

On March 15, 1994, Michigan voters will decide either to pass a ballot proposal that would, among other things, raise the state's sales tax from 4 percent to 6 percent, or instead, to leave in place a statutory 1.6 percent increase in the state's income tax. Either way, taxes on cigarettes are going up. With the ballot proposal, taxes on cigarettes would rise by 50 cents per pack, from 25 cents to 75 cents. With the statutory plan, the increase is 15 cents per pack, from 25 cents to 40 cents.

The need for this revenue plug is the result of legislation adopted earlier in the year that eliminated local property taxes and, in so doing, created a \$6.6 billion budget shortfall needed for school funding. When legislators were unable to agree on a solution to the problem, they opted on Christmas Eve to let the voters choose between Gov. John Engler's (R) and the Senate Republicans' plan for an increase in the sales tax or the House Democratic plan, which focused on a 1.6 percent increase in the income tax rate.

Many lay the responsibility for this problem at the governor's feet and consider a rejection of his ballot plan as a vote of no confidence in his administration. With the governor up for reelection this year, the political dynamics change and the stakes are higher. However, traditional Republican forces such as the state Chamber and the Michigan Manufacturers Association are showing little inclination to support the governor (financially at least) in this fight, although it remains to be seen whether their support will materialize once the battle lines are drawn and real pressure is exerted.

We recently met with a number of key players on both sides of the debate and came away with two observations: First, the fight is being cast by insiders as a battle between the governor and the tobacco industry. Experts we met with are expecting the tobacco forces to spend anywhere from \$4 million to \$6 million to defeat the ballot. Second, if all things are equal, voters will choose overwhelmingly for an increase in the sales tax as compared to an increase in the income tax.

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Executive Summary (cont.)

A poll last week by the Detroit *Free Press* seems to confirm this point. Fifty-two percent of those surveyed indicated they supported the ballot plan, while 23 percent opposed and 24 percent were undecided. But as Co-Speaker Curtis Hertel (D) described it, "If the voters will actually examine the two plans, they will see that the statutory plan is slightly less disgusting than the ballot proposal."

Thus, the question for the tobacco industry: Is there enough time to mount a campaign that demonstrates the difference between the two plans? Provided the financial resources are available, we believe that there is. (Based on our conversations, we estimate the necessary financial commitment at approximately \$1.5 million if a highly targeted campaign plan is adopted. Organized labor can be expected to lend organizational support, but little financial aid.) However, time is the most critical resource at this point.

Background

For the last 10 years, there have been numerous efforts by the state legislature to adjust what many in the state felt was an inequitable property tax. Last year, the legislature, to the surprise of many and at the urging of Gov. Engler, repealed most of the state's property tax. In so doing, they left the state with virtually no funding for its schools.

For several months, Senate Republicans and the governor wrestled with the House over a plan to rectify the situation. Since the governor had campaigned on a promise to reduce state property taxes by 20 percent, many felt the problem was really the governor's to solve. However, the governor's principal component for a financial offset was an unpalatable and regressive 2 percent increase in the state sales tax. The House Democrats felt that a much more practical and fairer solution would be a 1.4 percent income tax increase.

On Dec. 24, 1993, a deal was struck whereby the Republican plan would be offered to the voters in the form of a ballot proposal (as required by the state constitution since it includes an increase in the sales tax). At the same time, both houses approved the statutory plan, which would take effect only as a fallback in case the ballot plan was voted down.

While there are numerous differences between the Democrats' statutory plan and the Republicans' ballot approach (see Exhibit 1), the principal issue seems to be sales vs. income tax. Not to be overlooked, however, is a 2 percent state property transfer tax included in the ballot proposal vs. a 1 percent property transfer tax in the statutory plan. Note: the Senate was considering last week reducing the transfer tax from 2 percent to 1 percent to mollify objections to the ballot initiative by the Realtors. Co-Speaker Hertel confided that if they were successful, the House would move to eliminate the tax entirely from the statutory plan. The other significant issue besides the cigarette tax is that the statutory plan calls for a 0.4 percent increase in the single business tax.

Historically, ballot initiatives have failed time after time over the last 10 years. Last year's proposal to increase the sales tax passed in 78 counties, but was overwhelmingly defeated in five conservative suburban counties around Detroit, subsequently killing the initiative. As noted above, a Detroit *Free Press* poll last week showed 52 percent of Michigan residents favored the ballot, while only 23 percent opposed and 24 percent were undecided. Interestingly, the poll did not measure likely voters or probe their understanding of the issue.

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We believe the ballot proposal can be defeated. The first step is an immediate financial commitment so the effort can get underway as soon as possible. The second step is to retain a campaign consultant (not necessarily from Michigan) who is experienced in targeted organizational efforts, including voter ID, get-out-the-vote drives and coalition building. The third step is to retain a local pollster familiar with the state's voting dynamics, political apparatus, demographics and voting tendencies. The fourth step is to retain a media consultant capable of producing and airing counterattack spots in very short order. The fifth step is to recruit a local spokesperson, such as former state senator Dick Hedley or Wayne County executive Ed McNamara, who may be willing to serve as a public crusader on this issue.

The strategy should be: **CONFUSION**. Every time the governor or the Republicans try to cast the issue as a simple choice between income taxes and sales taxes, the coalition must respond by showing 17 business loopholes in the ballot initiative. The issue also should be one that casts the ballot as favorable only to businesses and wealthy individuals with annual incomes in excess of \$80,000.

Up to one-half of the financial resources should be held in reserve for a media buy over the last 10 days. Brief but early media buys should be considered only to discourage the opposition. One-fourth of the organizational funds should be spent early on voter identification and turnout, primarily through direct mail.

It should be noted that the people to whom we spoke believe the governor will have difficulty raising more than a million dollars for this effort. However, it is unlikely that organized labor (including the MEA) will be willing to contribute heavily to defeat the ballot proposal since this is an election year and they will be trying to save as much money as possible for the fall campaign.

As mentioned previously, the state's political pundits have already characterized this as a campaign between the governor and the tobacco industry. Note: when we arrived in Lansing, we noticed a luncheon meeting taking place between Hurst Marshall of RJ Reynolds, Bob McAdam and Bob Pruett of the Tobacco Institute, Scott Fisher of Philip Morris and members of the AFL-CIO and the Michigan Education Association.

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Key Players

Gov. John Engler (R)

Up for reelection in 1994, Gov. Engler is committed to winning the vote in favor of the ballot.
Note: Lt. Gov. Connie Binsfeld (R) is not considered a major player.

State Sen. Dick Posthumus (R)

Michigan Senate Majority Leader

John Arundel

Legislative Director, Office of Sen. Dick Posthumus

John and Dick say the ballot plan is the best deal they could get and is far better for job creation and economic growth than the income-tax-increasing statutory plan. If the Governor loses the ballot fight, John and Dick think the Governor will lose his reelection campaign. John says the issue will come down to income tax vs. sales tax. John knows of no money planned to support the ballot, though he said there may be some from Realtors, manufacturers and the Chamber. Note: State Senate Minority Leader Arthur J. (Art) Miller Jr. (D), as one of only 16 Democrats in the 22-Republican-controlled Senate, is not considered a player.

State Rep. Curtis Hertel (D)

Co-Speaker of the Michigan House of Representatives

Daniel J. (Danny) Loepp

Chief of Staff, Office of the Speaker

Danny supports the statutory plan, but not openly. He says if you make more than \$80,000 per year and smoke (about 14 percent of the people), you should vote for the ballot plan. Danny thinks labor is going to lay back somewhat, but will do some behind-the-scenes work. He says AFL is willing to be out front. He predicts Realtors will be fractured and probably will stay out of it, but that local governments will oppose the ballot. Danny believes the ballot will go down despite the recent poll showing 52 percent in favor. He says none of the seniors have had the issue explained to them and Engler is low on money. According to Danny, tobacco money (\$4 million to \$9 million) is key to defeating this, combined with money from labor (maybe \$500,000 to \$1 million). He says the Governor will have a hard time raising \$1 million, though businesses are likely to contribute.

State Rep. Paul E. Hillegonds (R)

Co-Speaker of the Michigan House of Representatives

Paul has worked very closely w/ Co-Speaker Hertel on the statutory plan.

John Thodis

Michigan Manufacturers Association

Jim Barrett

Michigan Chamber of Commerce

Julius Maddox

Michigan Education Association

Owen Beiber

Michigan Chapter, AFL-CIO

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Exhibit 1

Key Provisions of School Finance Plans

	Current	Ballot	Statutory
Income Tax	4.6%	4.4%	6.0%
Sales Tax	4%	6%	4%
Homestead Property Tax	34 mills	6 mills	12 mills
Non-homestead Property Tax	34 mills	24 mills	24 mills
Single Business Tax	2.35%	2.35%	2.75%
Cigarette Tax	25 cents	75 cents	40 cents
Other Tobacco Products	0%	16%(a)	16%(a)
State Property Transfer Tax (b)	0%	2%	1%
Income Tax Exemption	\$2,100	\$2,100	\$3,000
Renter Credit	17%	20%	20%
Keno (c)	no	yes	yes
Enrichment Mills	varies	3 mills	2-7.75 mills(d)
Assessment Limit	no	lower of 5 percent or inflation rate	no
TOTAL REVENUE GENERATED	\$7 billion	\$6.6 billion	\$6.7 billion
Impact on State Budget		-\$199	\$41
Foundation Grant	none	\$4,200-\$5,000	\$4,200-\$5,000

(a) Tax is on wholesale price

(b) some counties currently impose a 0.1 percent property transfer tax

(c) not technically part of either proposal, but Lottery Bureau has indicated that will game regardless of which plan takes effect.

(d) allowable rates depend on state equalized valuation per pupil, can be levied on ISD basis or by school district.

(e) may not be required if portion of \$900 million carry over from FY 1994 is transferred from the school aid fund to the general fund.

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