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Summary Digest of Michigan Tax Study Staff Reports

As a public service the Research Council has prepared this digest of a staff report to the Michigan State Tax Study Committee. The Committee is considering basic changes in the state's tax structure and these digests have been prepared to inform the public as to what is being considered by the Committee. It should be emphasized that the material presented is a digest of the staff report to the Committee and does not represent the findings or opinions of the Michigan Tax Study Committee, its citizens advisory committee, or the Research Council.

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April 21, 1958

THE REVENUE POSITION OF LOCAL GOVERNMENTS LOCAL GOVERNMENT REVENUES, TRENDS AND COMPARISONS

The past 35 years have witnessed some major changes in the pattern of local government revenues in the United States. From 1922 to 1956 locally levied taxes dropped from 80 to 56 per cent of local general revenues, and the share represented by intergovernmental revenue (largely state aid) rose from 8 per cent to 30 per cent. Charges and miscellaneous revenues, after a sharp decline during the depression of the thirties, have regained the position which they had assumed prior to the depression.

Local units of government in the United States have experienced an increasing diversification of the local tax base. Sales and gross receipts and other non-property taxes produced 3 per cent of all local taxes in 1922 but 13 per cent in 1956, the property tax having accounted for the remainder of local tax receipts in each of the two years. In absolute terms, of course, the productivity of the property tax greatly increased. In 1922 it produced \$2.97 billion, compared with \$5.85 billion in 1948 and \$11.28 billion in 1956. The property tax is still the mainstay of the local revenue system.

Michigan cities and villages are less dependent on taxes and considerably more dependent on intergovernmental and miscellaneous revenues than the aggregate of all United States municipalities. The fact that Michigan cities and villages derive a smaller proportion of their revenues from taxes than do their counterparts in the nation as a whole and that this proportion has declined more rapidly in this State is probably attributable to the virtual absence in Michigan of municipal powers to impose non-property taxes, the relative inelasticity of the property tax, and the higher-than-average contributions of the State to city and village revenues.

Taxes account for about the same proportion of total general revenues for school districts and counties in Michigan as they do in the United States, generally. Local

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school districts in this State, however, obtain approximately half of their revenues in the form of shared taxes and grants, compared to 43.5 per cent for all school districts.

The most outstanding contrast between Michigan and national percentages occurs in the case of townships. On a nationwide basis, townships raise about two-thirds of their general revenues from taxes, while in Michigan the proportion is less than one-fifth. Correspondingly, townships in Michigan received about two-thirds to three-quarters of their revenue in the form of state aid, while nationally the intergovernmental sums constituted around one-fourth of township revenues. For Michigan townships, taxes since 1952, and miscellaneous revenues since 1948, have been increasing proportions of township revenues. A comparison of Michigan with the seven other states chosen for comparative purposes in the Michigan Tax Study shows that Michigan townships and school districts receive less revenue percentage-wise from the property tax and more revenue from intergovernmental payments than in any of the other seven states. These relative shifts have resulted from the increased need for revenues on the part of some of the more heavily populated Michigan townships, but do not alter the favored position which townships occupy in having the largest share of their revenue needs met by the State of Michigan remitting sales and intangible tax collections to them.

COUNTY FINANCES

Between 1948 and 1955 every type of county revenue and expenditure increased substantially. In current dollars, total county revenues increased 89.9 per cent and total county expenditures 76.1 per cent during that period. That county revenues have increased more than county operation expenditures is explained by two factors: (a) counties have incurred and are paying increased debt obligations; and (b) counties are allocating a greater proportion of their income to capital outlays than in the past.

Wide variations exist among counties in their revenue structures and expenditure distribution. For purposes of analysis, Michigan counties may be grouped into six geo-economic types: urban, farm, farm-urban, mineral, forest-upper peninsula, and forest-lower peninsula. Looking first at percentage dependence on revenue sources, it is evident that the urbanized, more populous counties secure a larger proportion of their revenues from local sources (property taxes and fees) than do the other types of counties. Mineral counties levied the highest per capita property taxes, with urban counties second highest. Per capita intergovernmental revenues showed considerable variation. It may be supposed that this distribution of funds between counties results chiefly from the State formula distributing highway funds to counties. An important element in that formula is road mileage, a factor which would favor the less densely populated "out-state" counties. About fifty per cent of total county expenditures were allocated for highways in all classes of counties, except urban and mineral which spent the greatest percentage share of their outlays on the welfare-health function. Upper peninsula counties, however, had the highest

per capita welfare-health expenditures. Generally speaking, Michigan counties spend about two-thirds of their total outlays on two functions – welfare-health and highways. Per capita total revenues and total expenditures were lowest in urban and farm-urban counties and highest in mineral and forest-lower counties.

CITY AND VILLAGE FINANCES

The revenues of Michigan cities and villages increased substantially between 1948 and 1955 – total revenue rose from about \$177 million to nearly \$279 million, or an increase of 57.2 per cent over 1948. If, however, 1955 revenues are reduced to constant dollars (1948), the picture is greatly modified; total general revenues show a percentage increase of only 18.6 per cent (\$177 million to \$210 million). When 1955 property tax collections are reduced to 1948 dollars they show an increase of only one-half of one per cent and it becomes apparent that property tax revenues in Michigan municipalities have barely managed to keep up with the inflationary spiral of government costs. (Throughout the report U.S. Department of Commerce price deflators applying specifically to state and local government finances are used in preference to the Consumer's Price Index.)

Available statistics indicate that there has been no great change in the expenditure pattern of municipal units in the State. Furthermore, when both population and inflationary factors are held constant, the increases in municipal expenditures themselves appear to be small. The latter comparison is, however, of limited value because today's expenditures must be met in terms of current dollars. The inability of the property tax to keep abreast of needs has left municipal units with three alternatives for increasing revenues:

1. Secure additional revenues from shared taxes. However, the fluctuations in yields of these taxes and the determination of the distribution formulas are clearly beyond the control of municipalities.

2. Secure additional revenues from fees, charges for services, and other miscellaneous sources. The percentage increase in this revenue category has, in fact, been large (133.9 per cent from 1948 to 1955), but even now less than one-fourth of the general revenue of Michigan municipalities comes from this source.

3. Borrow to meet the costs of increased services and improvements. There is every indication that municipalities have also used this avenue to more money. In Detroit, the Dodge Committee found that the city has in recent years increasingly incurred debt obligations for purposes that previously were financed on a pay-as-you-go basis; e.g., capital improvements.

An analysis of the revenues and expenditures of individual municipalities grouped by population class for the fiscal years 1951 and 1956 was made. This analysis showed that there appears to be a direct relationship between population size and dependence on the property tax – the larger the municipality the greater the percentage of

total general revenue derived from the property tax, except in the case of Flint and Grand Rapids. There is an inverse relationship between the size of unit and percentage of revenue from shared taxes, again noting the Flint and Grand Rapids exception. Municipalities in every population class but one (2,500 to 10,000) secured a small proportion of their revenues from the property tax in 1956 than in 1951. Over the same period, State-collected locally-shared taxes became a slightly larger proportion of municipal revenues or remained at about the same percentage.

In per capita terms, as well as percentages, property tax revenues seem to be directly related to the size of the unit, except for the marked divergence of Flint and Grand Rapids from the pattern. Between 1951 and 1956 per capita property tax revenues increased for every population class. The change was relatively small for the 100,000 to 250,000 class and comparatively large for the 2,500 to 10,000 class.

Per capita total expenditures for the five common functions (general control, public safety, streets and highways, health, and recreation and library) do not vary as much as might be expected. There is remarkably little variation in the population classes from 2,500 up to 250,000. Detroit's per capita figures are substantially higher, while the figures for the two smaller classes are lower. Generally speaking, there is a direct relationship between size and per capita expenditures for public safety, health, and recreation and library, while there appears to be an inverse relationship for street and highway expenditures.

The material presented in this section supports the idea that Michigan municipalities are in a difficult position. It is not easy to single out those units that are the most hard-pressed, but it does appear that incorporated units under 2,500 are not in particularly difficult financial straits. A long-range solution to municipal financial problems in Michigan is clearly needed to enable cities and villages to provide services required of them and still remain solvent.

TOWNSHIP FINANCES

The financial position of a vast majority of the 1,264 townships in Michigan is comparatively favorable. The heavy reliance of the townships on State aid has already been referred to. Townships receive about two-thirds of their general revenues from State-imposed shared taxes – chiefly the sales and intangibles taxes. The relative dependence on shared taxes varies with population size. Townships with over 15,000 population secured about one-third of their 1956 revenues from this source while smaller townships received from three-fifths to three-fourths of their total 1956 revenues from shared taxes.

The percentage increase in total townships revenues from 1948 to 1955 was 78.7 per cent. Property taxes increased 104.1 per cent; shared taxes, 57.7 per cent; and miscellaneous revenues, 263.0 per cent. The constant dollar increase in total revenues from 1948 to 1955 was 34.8 per cent. The relatively large percentage increase in miscellaneous revenues can be explained chiefly by the rapid population growth

in townships, growth which has produced substantial sums from building permits, fees, and licenses. The percentage increase in the property tax from 1948 to 1955 attests to the elasticity of the tax as a source of revenue for townships. A random sample of 77 townships revealed that property taxes constituted a larger share of township revenues in 1956 than in 1951. In 1956, townships over 15,000 were the only class to secure a greater share of their revenues from property taxes than from shared taxes.

However, townships generally, and the larger ones especially, have utilized the property tax to a greater and greater extent in recent years. How much more productive this revenue source can be to the townships remains to be seen, but in the sample of 77 townships, 34 did not levy a property tax in 1951. By 1956, the number not imposing any property tax levy dropped to 26. In 1955, there were six counties in the State in which none of the townships levied any property tax.

The bulk of townships expenditures go for three functions: general control, public safety, and roads. In 1955, townships spent 65.9 per cent of their total selected expenditures of over \$16 million on public safety and roads. The road function alone constituted about 40 per cent of this outlay and was the largest single functional expenditure. This outlay for public safety and street and highway functions shows the impact of urbanization on the township form of government in Michigan. Since townships are not empowered to perform general road functions themselves, the moneys spent for this category are paid to the county on a contractual basis and the county road commissions actually perform the work within the township limit. Townships, of course, do not share in the motor vehicle highway fund revenues. It is a mark of their very favorable financial position that from the sales and intangibles tax receipts returned by the State, together with locally raised revenues, they can allocate substantial sums to street and highway expenditures.

An additional factor indicating the general fiscal soundness of townships is their cash balances at the end of the fiscal year. Obviously, cash balances are subject to a variety of influences and chance occurrences, unexpended cash on hand from sale of bonds, for example. However, the consistently high level of these figures, when taken together with the conditions presented earlier, indicate the financial plente which most Michigan townships enjoy.

SCHOOL FINANCES

The fact that on January 1, 1958, there were 2,645 operating school districts in the State of Michigan (a decline of 1,992 from January 1, 1953) places a full treatment of the finances of these units beyond the scope of this report. In addition, other groups are devoting considerable time and effort to this subject. This report is limited, therefore, to only a few selected aspects of school finances in the State.

School revenues increased substantially from 1948 to 1956. Calculated in current dollars the percentage increases in this period were 159.0 per cent for total rev-

enues – 195.8 per cent for property taxes and 129.7 per cent for State grants. Two trends may be noted during this eight-year period. First, there has been a constant increase in the proportion of total school revenues derived from the property tax. The second trend, which has contributed to the first, has been the rapid rise in the outstanding debt of school districts. In both actual and per capita terms school debt more than quadrupled from 1948 to 1956. Since this bonded indebtedness is secured by the property tax it is understandable that school tax levies (and collections) have risen to meet the interest and principal requirements of the added obligations. This debt increase undoubtedly reflects the attempt of school districts to meet the demands of expanded enrollments. To what extent further increases may occur depends on the fiscal ability of the unit and taxpayer willingness to approve the increases. Clearly, these factors vary greatly from district to district.

An analysis of data applying to the school districts of the 20 Michigan cities with a 1950 population in excess of 25,000 showed that property taxes constituted a greater percentage of total school district revenues in 1956 than in 1951 and that this percentage was greater than the State-wide figure for school districts of all sizes. In general, it may be observed that local fiscal effort for education is lowest in such heavily industrialized districts as Detroit, Grand Rapids, Hamtramck, and Bay City, and highest in primarily residential suburban cities.

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