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FISCAL TRENDS OF THE CITY OF DETROIT

The fiscal condition of Detroit city government and economic trends in the city are explored in Citizens Research Council Report No. 300, which is available on request. This Council Comments is the "Summary and Conclusion" portion of that 81-page report.

Following the population peak in the 1950s, the economic base of the City of Detroit began to erode. In spite of more than three decades of economic decline, the city government has managed to maintain fiscal solvency. In part, this has been accomplished through a series of revenue enhancements: new and increased city taxes, and a changing array of intergovernmental transfers to the city government. The city government has also periodically redefined its role based on revenue constraints, expanding programs in response to increased funding and restricting, even eliminating, programs and departments in response to funding constraints. After five consecutive years of budget surpluses between 1985 and 1989, the city experienced a deficit in 1990, and expects another deficit in 1991. The city is facing a third consecutive budget deficit in 1992. New or increased taxes, or additional federal or state aid are increasingly improbable solutions to the city's financial problems. The city will have to focus on various alternative means of reducing expenditures in order to maintain financial solvency in the years ahead.

Although the City of Detroit has incurred general fund deficits often in the past, risks associated with municipal deficits are more acute since adoption by the state of the local government fiscal responsibility act.

The Economy

The financial condition of the city government reflects underlying economic trends.

- * Population has declined steadily over the past 40 years, from a peak of 1.8 million in 1950 to 1,027,974 in 1990, a loss of 800,000 people. Only ten U.S. cities have a population of 800,000 or more.
- * Less than half of the population of Detroit is in the civilian labor force (the labor force participation rate is 49.6%). This is the lowest of the major U.S. cities and 15 percentage points below the state and regional rates.
- * The unemployment rate in Detroit is very high. The 1989 Detroit unemployment rate of 15.7% was the highest of major U.S. cities and more than double the median of those cities. It was also more than double the Detroit Metropolitan Statistical Area (MSA) rate and the state rate.

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- * Since 1972, employment in Detroit has declined significantly in manufacturing, wholesale, and retail trade (40-50%), while service employment increased by 3%. Tri-county employment increased in each industry group except manufacturing, but the proportion of employment in Detroit declined to 23% of manufacturing, 18% of wholesale and service, and 13% of retail jobs.
- * The number of business establishments in Detroit has also declined sharply and the decline is continuing. Since 1972, the numbers of manufacturing, wholesale, and retail establishments have declined by over 45% and the number of service establishments has declined by over 17%. In the three-county area, the numbers of business establishments in all categories has increased.
- * In 1990, only four of the top 13 largest employers in Detroit were for profit businesses; the remainder were governmental units and nonprofit health/ hospital organizations.
- * The population of the City of Detroit is relatively poor. The effective buying income of the median household (\$19,394) was the lowest of major U.S. cities and was more than 20% below the median.
- * Retail sales per capita in Detroit are also the lowest of major U.S. cities and less than half the median. Retail sales in Detroit are significantly weaker than income.
- * The number of housing units in Detroit has declined by 143,172 since 1960 and this trend is continuing. During the 1980s, housing demolition permits exceeded new construction permits by 41,800.

As the underlying economy of the city has declined, the city government has become increasingly reliant on local source revenues to support city services, primarily due to the decline in federal aid.

Revenues

The amount of aid that Detroit receives from the federal government has declined very substantially, both in total dollar amount and as a percent of the total city budget. In 1980, federal source revenues of \$392.9 million accounted for over 26% of the total city budget, but in 1991, federal source revenues of \$161.1 million account for only 8% of the total city budget. Federal revenue sharing and counter cyclical funding have been discontinued, and the amounts received for job training, community development block grants, housing subsidies, pollution control, mass transportation, health, and other grants have declined sharply. The city no longer receives any federal aid to the general fund, but does continue to receive federal support for specific programs.

The city has also received subsidies, grants, and other forms of assistance from the state government, including state revenue sharing, single business tax-inventory reimbursement, gas and weight taxes, state equity package, public health, mass transportation, and other grants. State source revenues have grown from \$269.1 million (18%) of the total city budget in 1980, to \$444.1 million (22%) in 1991. State revenue sharing, budgeted at \$247.3 million in fiscal 1991, provides 27% of budgeted general fund revenues. The loss of 14% of the city's population between 1980 and 1990 will have a significant impact on state revenue sharing payments, which

are based on population and relative tax effort. The state equity package, budgeted at \$41.7 million, and other state grants which support additional special programs, may be reduced in the state budget.

Revenues to fund city operations are increasingly derived from local sources: in fiscal 1980, local source revenues of \$828 million supported 56% of the total city budget, while in fiscal 1991, local source revenues of \$1.3 billion support 69% of the budget. In order to maintain city government revenues in the face of economic decline and fluctuating intergovernmental assistance, new forms of city taxation have been implemented, rates of existing taxes have been increased, and limitations on tax revenues have been raised or eliminated. A city income tax was adopted in 1962, and the rate has been increased twice since that time. The utility users' excise tax was adopted in 1970. A three-mill garbage tax was imposed in fiscal 1977, and voters have approved two mills for support of the Detroit Public Library. In fiscal 1990-91, Detroit residents pay a 3% resident municipal income tax, a 5% utility users' excise tax, and 30.908 mills of city property tax. These taxes are the basis of relative tax effort; Detroit's tax effort is 6.4 times the average paid by residents of other Michigan cities, villages, and townships. The total property tax rate in Detroit, including city, county, and schools, is 88.2 mills. This has increased by 11.4 mills since 1980.

Increases in the rate of the municipal income tax have been required to maintain the constant value of that revenue source. In 1989, the tax yield in real terms was about the same as in 1970, in spite of rate increases. The number of resident returns declined by 45% from 1970 to 1989. Nonresident returns declined by 27% from the peak in 1974. These figures reflect a decline in income and employment in Detroit.

High taxes depress property values and drive businesses and residents from the city. While nominal state equalized value (SEV) has remained relatively constant, in real terms SEV has declined significantly. There are fewer businesses, housing units, and residents left in the city to tax. Detroit's success in instituting new taxes and increasing the rates of existing taxes may well have contributed to the economic decline of the city, which in turn has led to efforts to further increase taxes.

Increasing local tax rates further or instituting new taxes would require changes in state law, which is difficult, as well as an affirmative vote of the people. Increasing the base of an existing tax would, under the Headlee Amendment to the state Constitution, require a corresponding reduction in the rate of the tax.

Revenue enhancement, which has been so effective in the past, does not appear feasible at this time. The fiscal 1991 deficit, estimated at \$45.3 million, will exhaust the budget stabilization fund. One-time accounting gimmicks may temporarily postpone the hard decisions on city services, but sooner or later the problems will have to be faced. And it is very likely that they will have to be addressed on the expenditure side.

Appropriations and Expenditures

In fiscal 1989, expenditures and transfers from the general fund totaled \$1.1 billion, or about \$1,070 for each resident of the city. Expenditures and transfers from the general fund in fiscal 1980 totaled \$777 million, or about \$646 per capita, while in fiscal 1970, the \$385 million in general fund expenditures and transfers represented \$255 per capita in nominal terms. In real

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(deflated) terms, general fund expenditures per capita grew from \$255 in fiscal 1970 to \$313 in fiscal 1980, and to \$355 in fiscal 1989.

Analysis of changes in budgeted appropriations over time shows that the largest percentage increases in general city agencies have occurred in the Arts, Historical, and Zoological Departments funded by the state equity grant; the Council of the Arts, also funded by state grants; the expanded Civic Center; and the legislative City Clerk and City Council. Changes in appropriations and expenditures over time indicate that at least some expenditures (arts and cultural) were clearly revenue driven.

Comparisons with the 18 other largest continental U.S. cities, excluding Washington, D.C., of per capita expenditures for specific city government functions, indicate that in fiscal 1989 Detroit ranked first (highest) in expenditures per capita for police, parks and recreation, and other government administration; second in housing and community development; third in health, financial administration, parking facilities, and sewerage; fourth in highways; fifth in solid waste management, and judicial and legal, and sixth in libraries. The only functions for which Detroit city government expenditures per capita were relatively low were fire (ranked 12th of 19) and air transportation (ranked 13th of 19). Comparison of expenditure levels with those of other very large cities indicates that Detroit spends relatively large amounts to provide services.

The city's ability to balance its budget is threatened by continued erosion of the tax base, the current recession, imminent depletion of the budget stabilization fund, the impact of the 1990 census on intergovernmental transfers, court challenges to the utility users' excise tax, efforts to redefine the state government's role, the city's increasing reliance on limited tax bonds which must be paid from general operating revenues, and other factors. Because of constraints on the revenue side of the budget, changes in expenditures offer the best opportunity to maintain fiscal solvency. There are several expenditure alternatives that should be considered.

Privatize "Privatization" encompasses several meanings: complete devolution of a previously public function to the private sector (see load shedding, below); contracting by the public sector with private companies for services that would still be paid by the government; allowing private companies and government work forces to compete for public work on a bid basis.

Certain City of Detroit functions could be "contracted out" with good result. Garbage collection, street repair, vehicle maintenance, data processing, city engineering, legal and other services could well be performed more effectively and efficiently by the private sector, on contract with the city.

General fund revenues subsidize the operation of the public lighting department; the city should investigate carefully the full costs of that department and of privatizing electric and street lighting services.

Load Shed Selective shedding of nonessential city activities is one long-term answer to structural financial pressures. The city has already divested the city jail and the city hospital. There may be other activities which can be eliminated from the city budget, either by convincing another level of government to assume control or by allowing the private sector to provide the service.

Public health services are arguably a county responsibility. Ambulance services are in many locations provided by private, for profit companies. The concept of public housing projects may have outlived its usefulness.

Down Size The number of city facilities that serve the public, such as branch libraries and recreation centers, should be limited to those that are needed and can be operated efficiently and effectively. It is not realistic for a city with a population of one million to try to maintain a service delivery system designed for a city of 1.8 million.

Regionalize Public transportation (which is heavily subsidized by the city general fund) and the water and sewerage system (which is self-supporting) could be regional, rather than city, responsibilities.

Major city parks such as Belle Isle (budgeted at 108 positions and \$4.9 million in 1990-91) and Rouge Park could become part of the existing regional parks authority.

In order to preserve cultural facilities in the face of state budget reductions, it may be necessary to consider regionalizing the financing, or the financing and administration, of these institutions. These agencies currently receive \$35.4 million annually in state and city funding.

Return to Basics The city government should reconsider its priorities and concentrate its resources and its efforts on basic services, to provide a safe and clean environment. The abundance of inexpensive housing that exists in Detroit could prove a significant attraction if neighborhoods were safe and clean. If the demand for existing housing were effectively stimulated, the trends of population and economic loss could be reversed.

Efficiency and Effectiveness Detroit has relatively high per capita spending for nearly all those city services which are comparable with services provided by other major cities. The city should evaluate carefully whether those and other services are being provided efficiently and effectively. Because revenue growth is constrained, Detroit should make every effort to insure that existing resources are used to maximum benefit.

Conclusion

It would appear that the only short-term option that Detroit officials have to address the fiscal problems of the city is to reduce expenditures and transfers from the general fund. Detroit needs to consider carefully what services its citizens require, whether other units of government or the private sector can effectively provide those services, and the appropriate scope and level of those services that must be financed and provided by the city government. Because Detroit's expenditures for most functions are relatively high, it is essential that the city evaluate carefully how effectively it is using the resources it now has. The great challenge is to identify and implement those reductions that have the least impact on essential city services, thereby protecting, as much as possible, the tax base and the quality of life in the city.

It is hoped that a realistic assessment of current conditions and the need to plan for the future will stimulate the city administration and city residents to find long-term solutions to some intractable problems.

CITY OF DETROIT GENERAL FUND
(in Millions of Dollars)

	1970	1980	1989
Revenues			
Current Year Property Tax	\$ 119.3	\$107.0	\$119.9
Municipal Income Tax	93.3	137.8	283.7
Utility Users' Excise Tax	0	37.4	51.2
State Aid	48.2	206.9	376.6
Federal Aid	28.4	91.2	12.7
All Other Revenues	<u>94.4</u>	<u>136.6</u>	<u>224.8</u>
Total Revenues	\$ 384.1	\$ 716.9	\$ 1,068.9
Expenditures			
Police Department	\$81.0	\$252.5	\$327.3
Fire Department	32.1	84.7	107.0
Department of Public Works	34.4	112.3	121.4
Health Department	30.8	44.8	72.3
Public Lighting Department	11.3	47.3	51.5
Parks and Recreation Department	14.8	37.4	47.7
All Other Expenditures	<u>180.5*</u>	<u>198.0</u>	<u>391.3</u>
Total Expenditures	\$ 384.9	\$ 777.0	\$ 1,118.5

*Includes pension and other fringe costs for all general fund personnel.

Source: Annual Financial Reports.