Reforming Michigan's Broken State Revenue Sharing Program

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for Michigan Municipal League
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- Promotes sound policy for state and local governments through factual research – accurate, independent and objective

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The State's Interest in Local Government

The state is the sum of its parts

To live in Michigan, by definition you live in:
- One of the counties
- One of the school districts
- A city or township

State can only succeed if those local governments succeed

Why do we have local government?

Our answer:

- To manage the interaction between people.

Where there is more people, we need more government

What is the state's interest in an effective provision of local government services?

Our answers:

- Local government provide a venue in which economic activity takes place. State taxes are levied on that economic activity.

- Local governments provide services for the health and safety of Michigan residents and guests

Do you have a different response?

Justification for a Significant State Role in Raising/Sharing Revenues

Why do we have Statutory State Revenue Sharing?

- Other state revenue sharing programs dedicated to funding specific services
  - School Aid
  - Act 51 Highway Funding
  - Court Funding

- **State Revenue Sharing** is distributed for general purpose of funding city/village/township operations

Why do we have State Revenue Sharing?

- Not <u>State Aid</u>
  - Would imply state revenues sufficiently plentiful that they could be put to good use helping the finances of local governments.
  - Would assume that local governments were in need of assistance and since each revenue sharing distribution was designed to send funding to all units of local government, that all local governments were in need of assistance.

Address Variances in Fiscal Capacity

- Ensure adequate provision of certain services
  - Schools (K-12 and community college), Highways, Courts, liquor enforcement

- Support economic activity taxed by the state
  - State funding from sales, use, personal income, corporate income taxes
  - Local governments host manufacturing, commerce, tourism

- Provide minimal quality of life
  - Assist in provision of minimum service levels
  - Avoid exorbitant tax rates

Discontinuance or Preemption of Local Taxes

- A series of agreements made over the years in which state policymakers agreed to serve in a revenue raising capacity for local governments
  - Capitalize on revenue raising capabilities at state level
    - Intangibles tax (1939) – exempted intangible property from local taxation
    - Income taxes (1967) – preempted cities from levying local tax
    - Single Business Tax (1975) – ended several local taxes
    - Sales tax – Proposal A (1994)
  - Achieve economic development goals
    - Exempt inventory properties from property tax base (1975)
    - Exempt personal properties from property tax base (2012)

Recognition that the State has Placed Revenue Raising Restrictions on Local Governments

- State shared revenues seen as quid pro quo for inability of local governments to raise their own revenues

- Tax Limitations
  - Tax rate provisions – limits individual and collective property tax rates
  - Headlee Amendment – requires voter approval for increase in tax rates or levy of new taxes above 1978 levels

- Very few local-option taxes authorized to Michigan local governments

Scarcity of Local-Option Taxes

- Income taxes – 18 states
  - 24 of 276 Michigan cities levy (not counties, villages, townships, etc.)
- Sales taxes – 37 states
- Motor fuel taxes – 11 states
- Vehicle-Related tax (license or registration) – 37 states
  - Authorized only to the RTA in Michigan (not levied)
- Utility taxes – 18 states
  - Only Detroit
- Alcohol taxes – 8 states
- Cigarette taxes – 13 states
- Medical Marijuana – 6 states
- Adult Use Marijuana – 8 states
- Casino Gambling taxes – 15 states
  - Only Detroit

Assessment of Revenue Funding and Distribution Methods

State Revenue Sharing

- Biggest problem is the lack of funding relative to the statutory targets
  - Major cuts from 2002 to 2011
  - Since 1998, cumulative revenue sharing losses to local governments total more than $8 billion
  - Shortfall was almost $900 million in FY2018
- Distribution of **Statutory** funding based on prior year
  - No rhyme or reason to how much distributed to each municipality
  - Similarly sized and situated governments receiving different amounts
  - Population changes counted in 2020 census will force hard decisions

State Revenue Sharing, FY1981 - FY2018

(Millions of Dollars)

■ Constitutional   ■ Statutory   ■ Unfunded
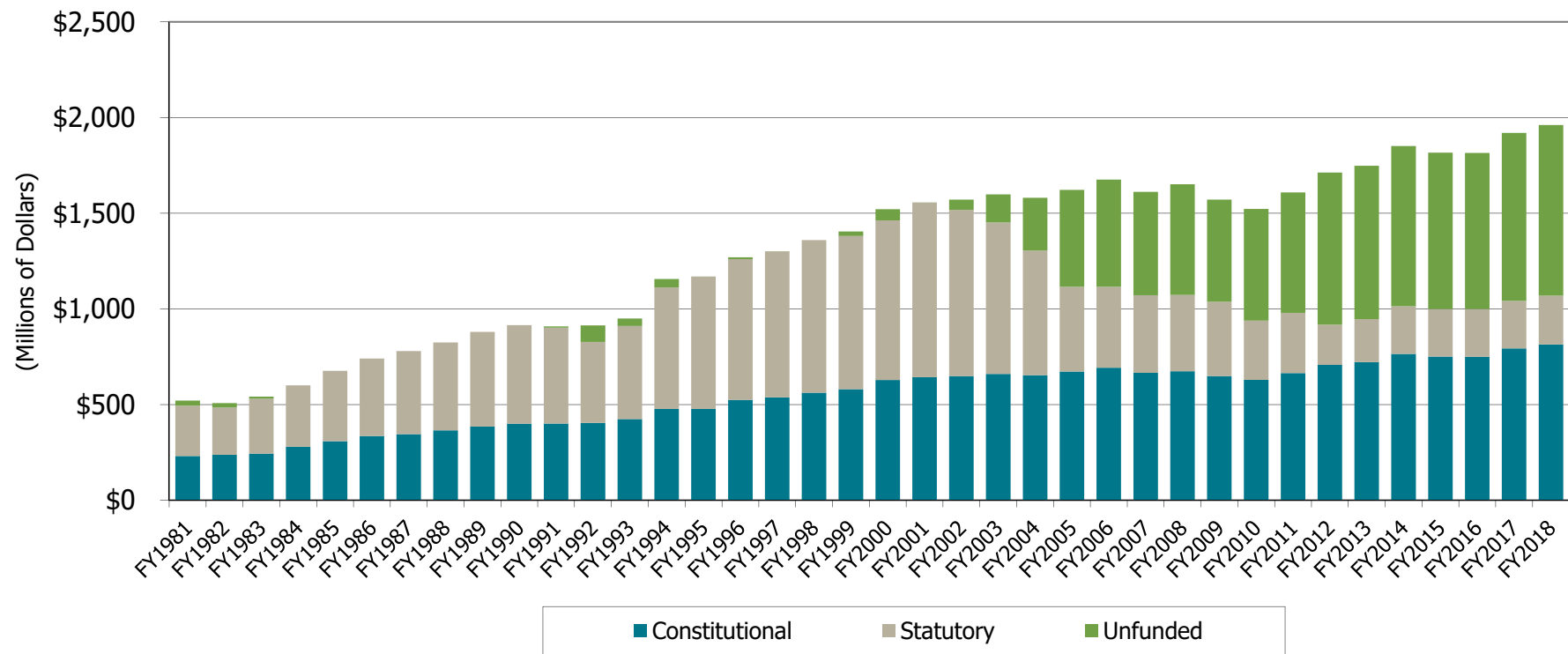
Most secure funding source uses most flawed revenue distribution method

- Revenue Sharing distribution becoming increasingly inefficient
  - Total amount available for distribution constrained by budget agreements
  - Growth of Sales Tax revenue requires increasing amounts to be distributed as constitutional revenue sharing

- Per capita distribution inefficient
  - Per capita distribution reflects responsibility for basic services
  - It assumes:
    - Equal demand for government services by each resident
    - Equal inability to service that demand with locally raised tax revenue

- Distribution does little to recognize variances in fiscal capacity
  - Does not reflect
    - Population density or
    - Wealth of communities to pay for their own services

State Revenue Sharing

- Real problem is that formulas have been abandoned

- If funding is resumed, we need to decide how to distribute it

- 1971 & 1999 weighted distributions began an attempt to recognize variances

- Distribution must recognize variances in fiscal capacity

- Basis of distribution further weakened by 2020 census

Measuring Fiscal Capacity

Fiscal Capacity
Ability to Raise Revenues

- Problem #1 – very large disparity in ability of local governments to raise revenue from their own tax bases

- Taxable Value per Capita
  - Average = $31,871 per person
  - Median = $30,958 per person
  - Highest = $1,423,511 in Pointe Aux Barques Township in Huron County
  - Smallest = $5,693 in Kinross Township in Chippewa County

Taxable Value per Capita

Taxable Value per Capita

Statewide average = $31,871
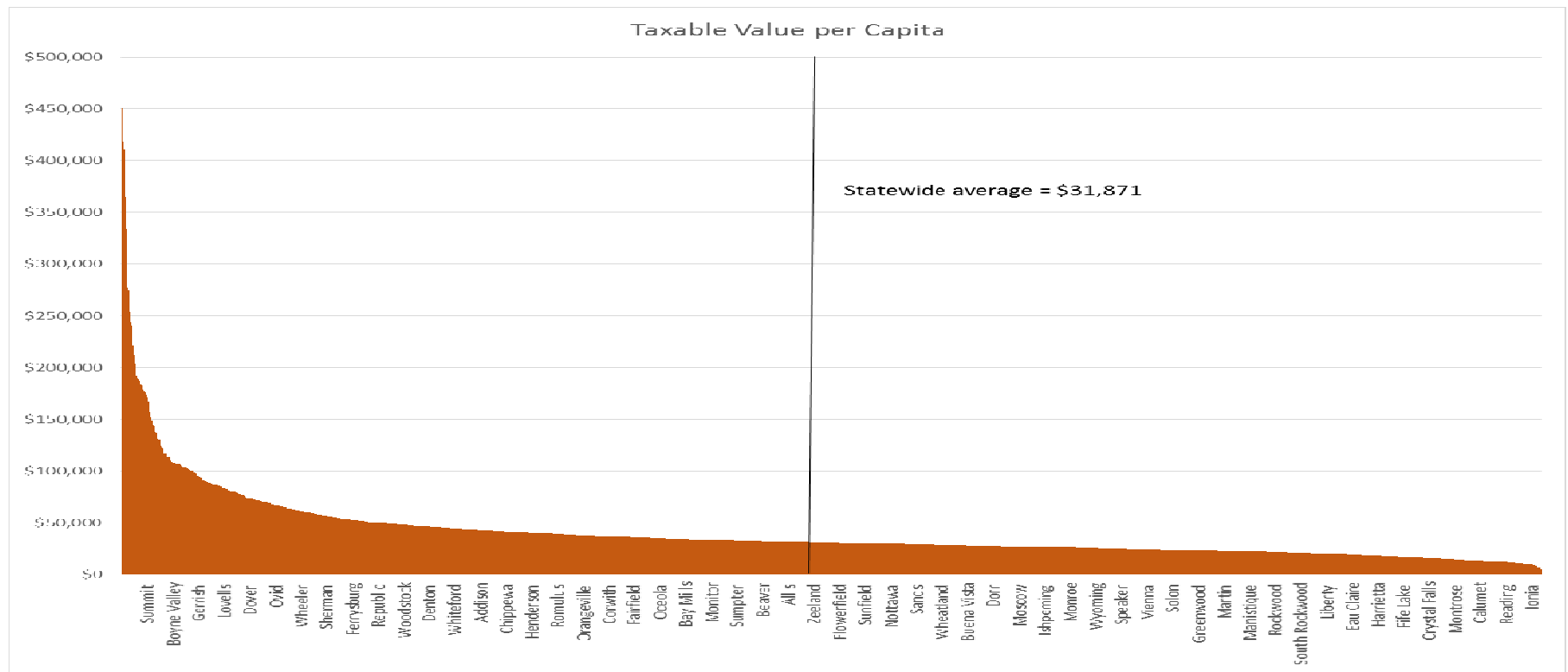
Fiscal Capacity
Service Demands

- Problem #2 – Some local governments are simply expected to provide more services

- Greater density = greater demand for services
  - Population density
  - Housing/building density
  - Local ordinances
  - Planning and zoning
  - Police and fire protection
  - Refuse collection
  - Transit services
  - Parks
 - Etc.

Fiscal Capacity
Population / Housing Density

- Population Density
    - Average = 175 people per square mile
    - Median = 100 people per square mile
    - Largest = 10,751 people/square mile in Hamtramck
    - Smallest = less than 1 person/square mile in 5 U.P. townships

- Housing Density
    - Average = 80.2 housing units per square mile
    - Median = 37.1 housing units per square mile
    - Largest = 4,139.5 housing units/square mile in Hamtramck
    - Smallest = 1 house per square mile in Seney Township in Schoolcraft County

Population Density

Michigan CVT Population Density

Statewide Average - 175 people per square mile
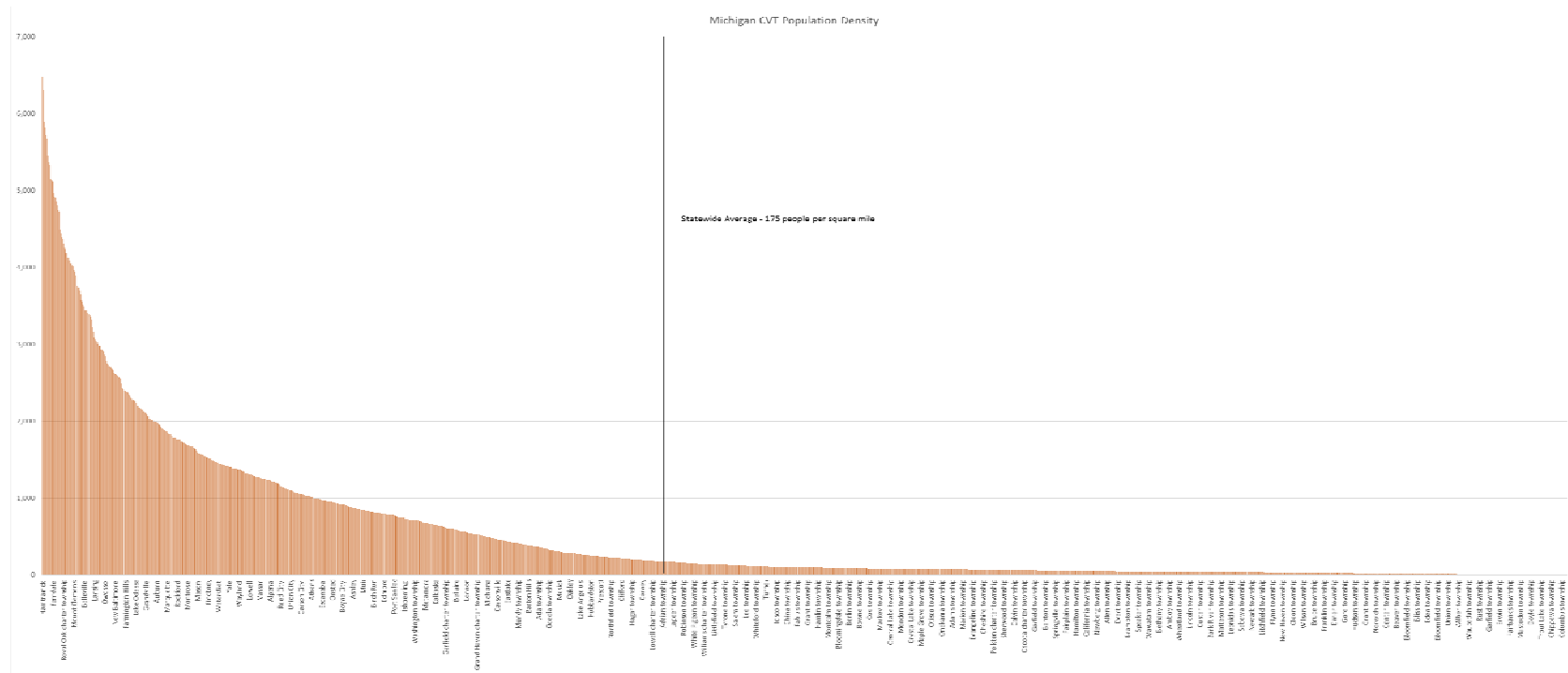
Revenue Raising Abilities and Service Demands
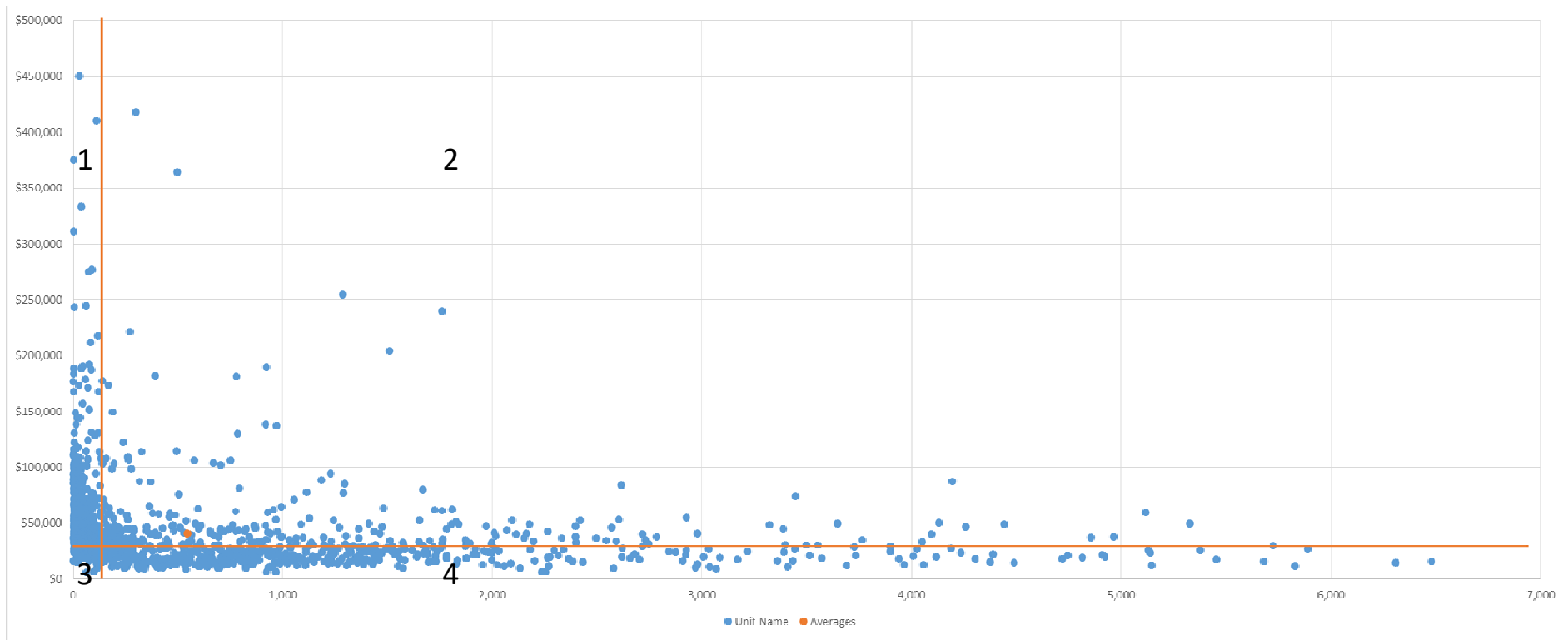
The Numbers by Quadrant

1. Below Average Density & Above Average Taxable Value per Capita (upper left): 604
   Number of Units as Percent of all Local Governments: 34%
   Population: 1,056,921
   Population as Percent of State Total: 11%

2. Above Average Density & Above Average Taxable Value per Capita (upper right): 235
   Number of Units as Percent of all Local Governments: 13%
   Population: 3,030,165
   Population as Percent of State Total: 31%

3. Below Average Density & Below Average Taxable Value per Capita (lower left): 446
   Number of Units as Percent of all Local Governments: 25%
   Population: 1,140,657
   Population as Percent of State Total: 12%

4. Above Average Density & Below Average Taxable Value per Capita (lower right): 488
   Number of Units as Percent of all Local Governments: 28%
   Population: 4,918,292
   Population as Percent of State Total: 50%

The Challenge of State Revenue Distribution

- Absolutely no justification for sharing state revenue with governments in quadrant #1

- A formula that shares revenues with governments in quadrants #2, #3, and #4
    - With emphasis on funding governments in #4
    - Governments with smallest tax bases and highest demands for services

Potential Reforms

State Revenue Sharing

- Fund state revenue sharing and distribute in meaningful way
  - Investigate ability to distribute constitutional funding with weighted formula
  - Reinitiate use of 1997 formula or design new formula

- OR Provide enhanced taxing authority
  - Consider local-option sales, income, utility user, sin taxes
  - Consider authority at county or regional level

- OH, AND Change service delivery model
  - Empower more service delivery at county level
    - To achieve economies of scale and economies of skill
    - To better enable CVTs to focus on quality of life in their own communities

Conclusion

Disadvantages of a major state role

- Violates the fundamental and sound principle of good government
  - That responsibility for raising money should accompany the pleasure of spending it.
- Earmarking hamstrings state budget makers
- Per capita distribution bears no relationship to need
- Increased Dependence
- Lack of Accountability
- Loss of Local Control

Citizens Research Council of Michigan

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