

The Need for Greater
Revenue Sharing with
Michigan Cities

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I. Introduction

Both state revenue sharing and the distribution of Act 51 money to local units have declined significantly over the past decade. This decline in state revenue has coincided with a decline in property values and tax revenue during the Great Recession. While common to many Michigan cities, this drop in available revenue has led to a significant problem for the City of Hillsdale, as it has not been able to properly maintain its local road system. One of the first priorities for the state's surplus should be to restore Michigan's commitment to its cities.

Thomas Jefferson made clear that much of our governance should come at the local level. As he put it in 1816 in his letter to Joseph Cabell:

Let the national government be entrusted with the defence of the nation, and its foreign and federal relations; the State governments with the civil rights, laws, police, and administration of what concerns the State generally; the counties with the local concerns of the counties, and each ward direct the interests within itself. It is by dividing and subdividing these republics from the great national one down through all its subordinations, until it ends in the administration of every man's farm by himself; by placing under everyone what his own eye may superintend, that all will be done for the best.

Michigan has a long history of declaring the importance of local government. The Home Rule City Act of 1909 precluded the state government from dissolving a city without a vote of the local residents. Section 34 of Article VII of the 1963 Constitution requires that provisions of the constitution concerning cities "shall be liberally construed in their favor." One way of acknowledging the importance of local units of government was the establishment of revenue sharing, whereby the state government collects revenue statewide and returns the revenue to cities, villages, and townships.

II. Revenue Sharing

The State Constitution provides for revenue sharing to local units under Section 10 of Article IX. The state is required to distribute 15% of all the sales tax revenues collected on tangible personal property at the 4% rate to cities, villages, and townships. (The 1994 amendment to Section 8, which increased the sales tax to 6%, excluded the additional 2% from revenue sharing under Section 10.) In addition to constitutional revenue sharing, the Revenue Sharing Act, PA 140 of 1971, provides for additional revenue sharing.

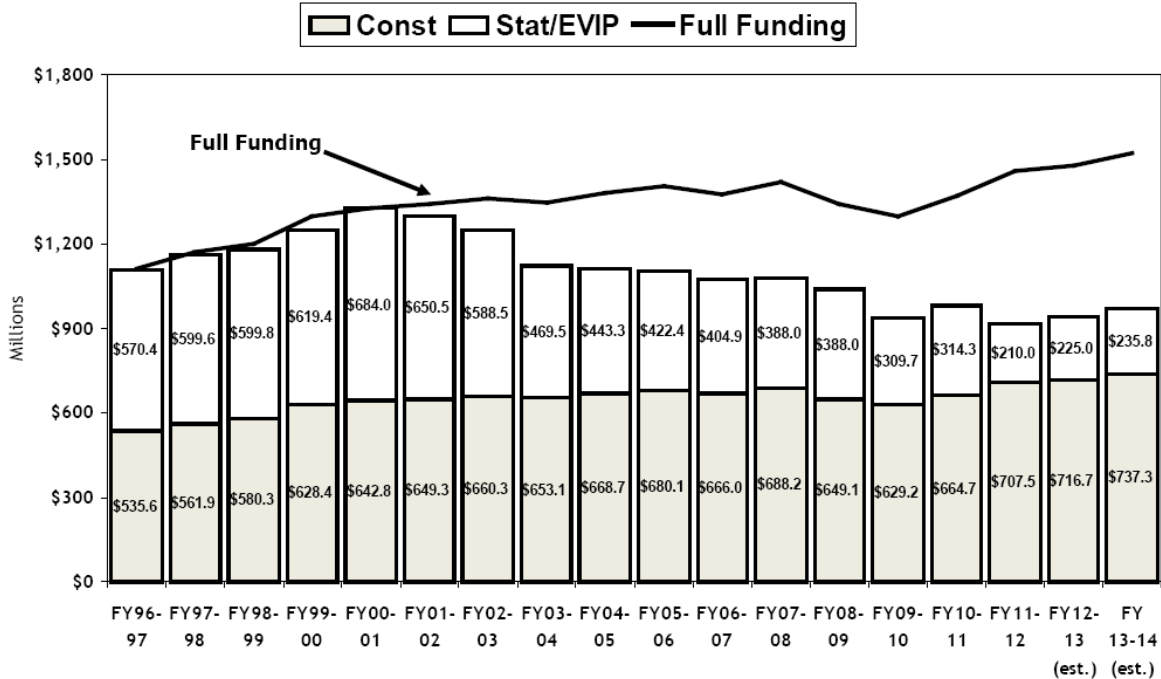
According to the House Fiscal Agency, legislative budget negotiations for the FY 2012 budget "led to the elimination of statutory revenue sharing and the creation of an Economic Vitality Incentive Program (EVIP) " This is an attempt to reward local units for "best practices."

Attachment #1 shows the decline in revenue sharing over the fiscal years 1997 and its comparison to what would be full-funding to cities, villages, and townships under the Revenue Sharing Act. (This would be 15.96% of the first four percent of the sales tax.) The attachment is from a House Fiscal Agency Report from July 2013.

Notice the large gap between what would be expected under the Revenue Sharing Act and what was actually appropriated. Statutory revenue sharing, including EVIP payments, declined from a peak of

\$684 million in FY 2001 to \$210 million in FY 2012. Total revenue sharing fell from a peak of \$1.326 billion in FY 2001 to \$917.5 million in FY 2012. These figures are in nominal dollars.

Attachment 1: Total Constitutional and Statutory/EVIP Revenue Sharing Payments to CVTs



*EVIP replaced Statutory Revenue Sharing in FYs 2011-12, 2012-13, and 2013-14.

7/23/2013

House Fiscal Agency

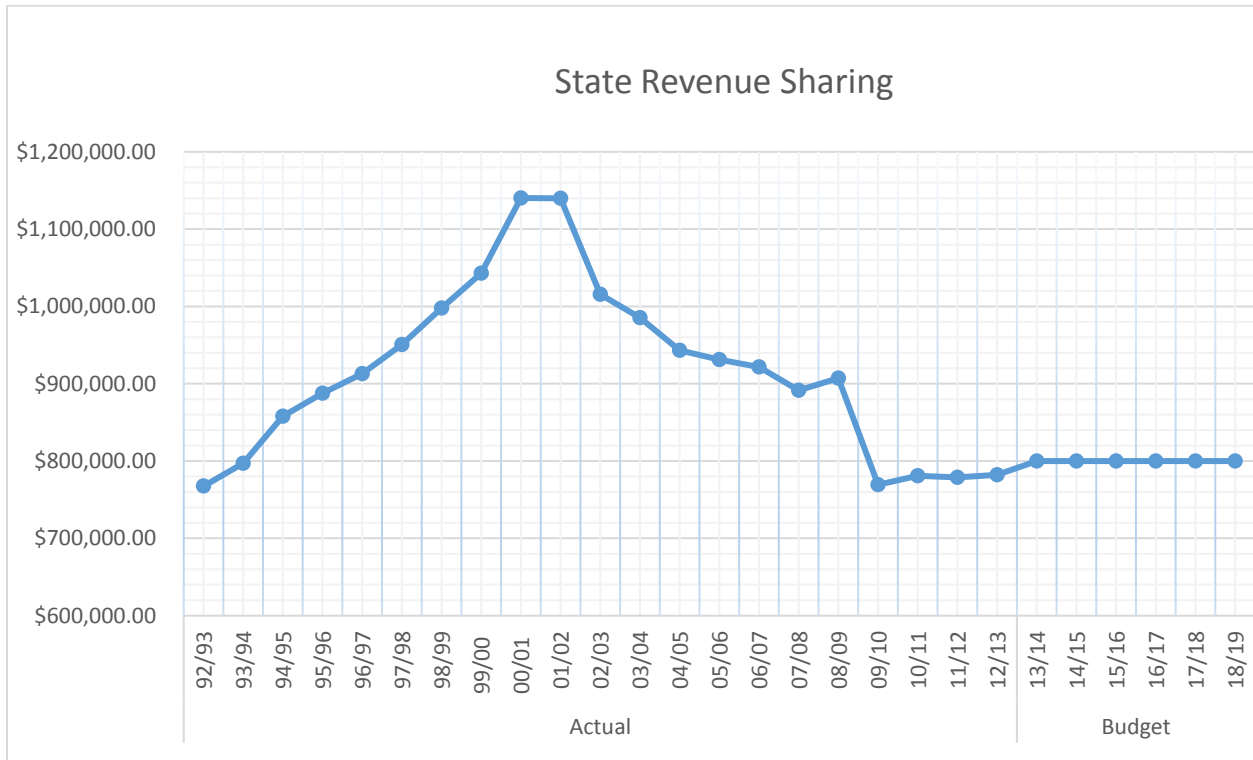
The latest numbers for FY 2013 and FY 2014 from the Department of Treasury show that state-wide revenue sharing, while increasing marginally, will still be 26% below in nominal dollars what it was in FY 2001.

Table 1
State-wide Revenue Sharing FY 2013-FY 2014

	FY 2013	FY 2014
Constitutional	\$722,153,482	\$745,543,410
EVIP/Statutory	\$224,760,611	\$235,485,268
Total	\$946,914,093	\$981,028,678
% Change From Prior Year	3.20%	3.60%

The numbers for the City of Hillsdale are consistent with this decline in state revenue sharing. State revenue sharing peaked at \$1.14 million in FY 2001 and declined to \$769,000 in FY 2010. It slightly recovered to \$782,000 by FY 2013, still 31.4% below revenue sharing in FY 2001 in nominal dollars.

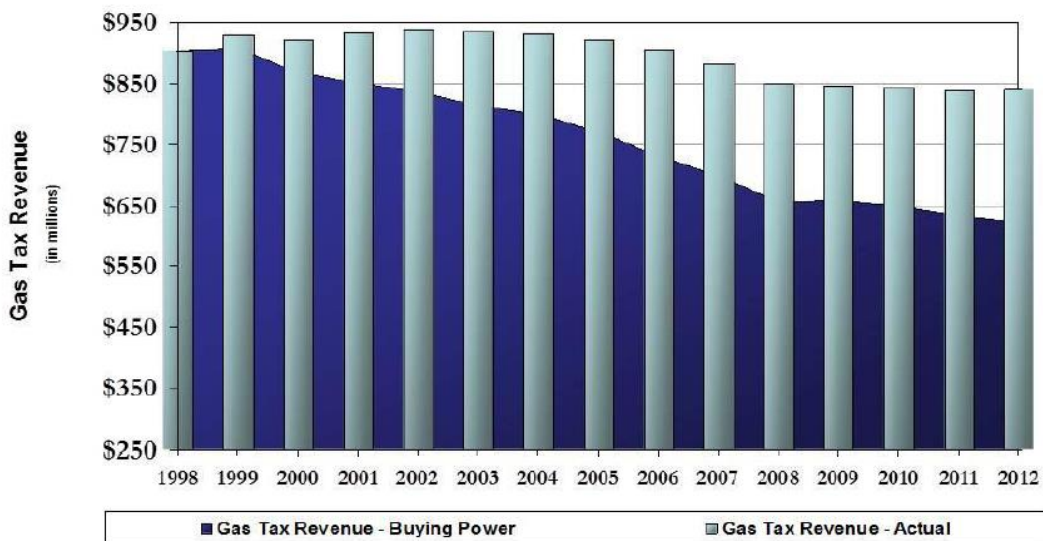
Attachment #2
Hillsdale City Revenue Sharing



III. Local Road Maintenance and Act 51 Distributions

The Governor has been a longtime advocate of improving the State’s road system. In his 2011 special message he pointed out the long term decline in Gasoline Tax Revenue as shown in Attachment #3.

Attachment #3
Gas Tax Revenue –
Actual vs. Buying Power



Local units of government are able to maintain their roads through the distribution of the Gasoline Tax that is collected statewide. These distributions are made under Act 51 of the Public Acts of 1951. The decline in gas tax revenue noted in Attachment 3 has led to problems with local road maintenance.

The City of Hillsdale is receiving less Act 51 money than it did a decade ago, again in nominal dollars. This can be seen in Table 2 and Attachment #4 below. The City’s total Act 51 money peaked in FY 2004 at \$604,778 and declined to \$529,968 in FY 2010. It recovered slightly to \$550,000 by FY 2013, still 9% less than its peak in nominal dollars.

What is most important for the City is its ability to use Act 51 revenues on its local roads, as these have fallen into disrepair. Local road Act 51 money also peaked in FY 2004, at \$149,610. It declined to \$131,681 in FY 2010 and has recovered slightly to \$135,000 in FY 2013.

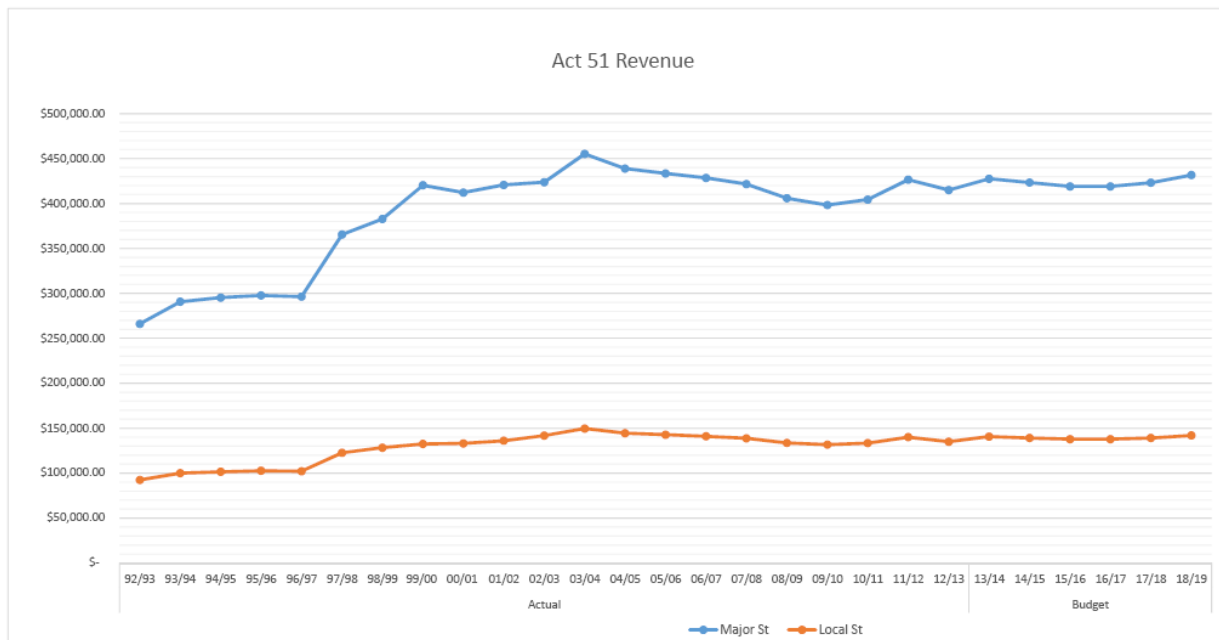
Table 2

Hillsdale Act 51 History (in thousands of dollars)

Fiscal Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Major Streets	455	438	433	428	421	405	398	404	426	415
Local Streets	149	144	142	140	138	133	131	133	140	135
Total	604	583	576	569	560	539	529	537	566	550

Attachment #4

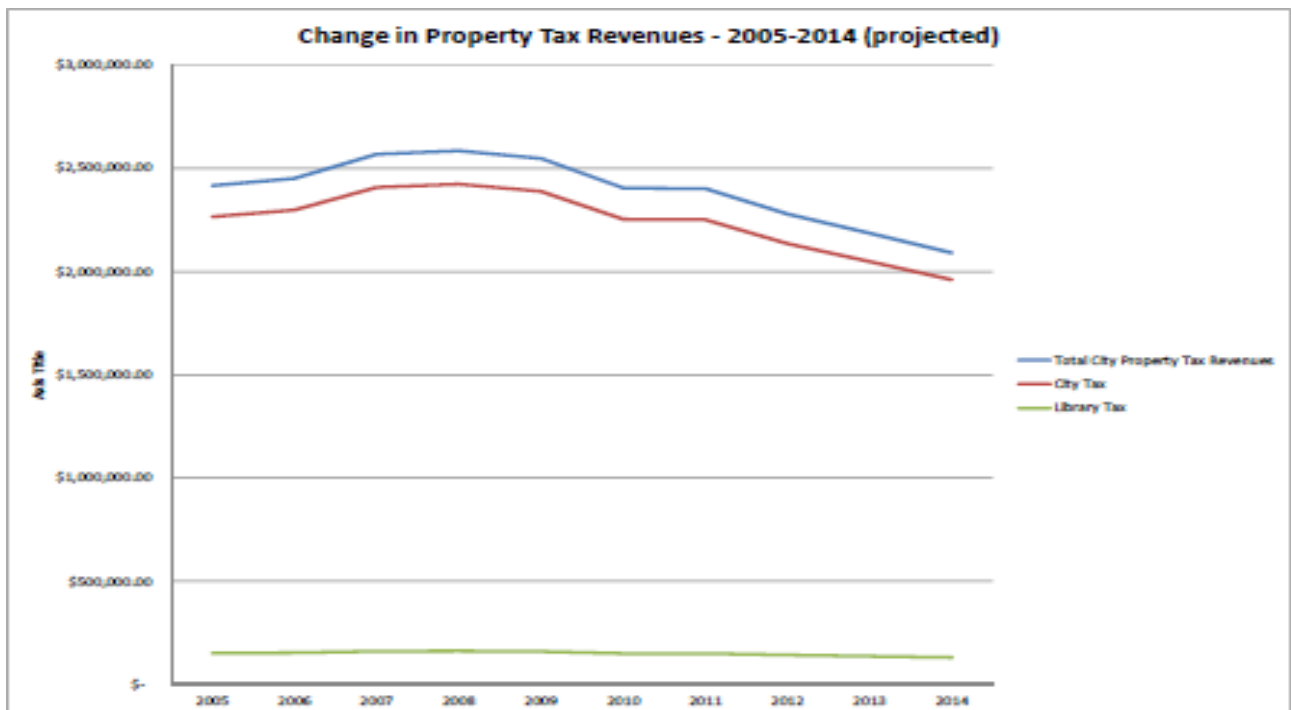
Hillsdale City Act 51 Revenue



IV. City of Hillsdale Property Tax Revenue

Hillsdale's property tax revenues have also been in decline as The Great Recession drove down property values. City property taxes peaked at \$2,424,496 in 2004 and declined to \$2,049,137 in 2013, a drop of 15.5% in nominal terms. The City expects a further drop to \$1,960,619 in 2014.

Attachment #5
Decline in Hillsdale Property Tax Revenue



It is important to note that in 1994, Section 3 of Article IX was amended to limit the annual increase in taxable value of property to no more than the rate of inflation or 5%, whichever is less, until the property is sold. Thus, after a reduction in property values, the property tax base of a city will increase more slowly than will the market values. At the time of the amendment it was assumed property value would continually increase, at least at the rate of inflation. This has had the unintended consequence of limiting the ability of a city to replace its tax revenue from a recession strong enough to affect the property market.

The City of Hillsdale is particularly limited in its ability to raise revenue. The only local revenue source is the property tax or the levy of an income tax under the Uniform City Income Tax Act. A major portion of Hillsdale's property tax base is exempt from the property tax base, and as noted in a City Income Tax Feasibility Study in 2012, a property tax in Hillsdale would place an undue burden on non-exempt owners:

"Hillsdale has a high percentage of tax exempt property, which means other property owners would have to shoulder the burden of the [property] tax. This places an unfair burden on property owners who are not tax-exempt, and has a poor correlation between the users of the public good (streets) and the individuals and businesses who would pay for the good (taxable property owners). One could easily argue that the use of streets by owners of tax exempt properties is no less impactful than the use by owners of taxable properties. If the City were to decide to use a special millage to fund streets, the millage rate required to generate \$1.1 million in property tax revenues would be approximately 7.3 mills. This represents almost 50% of the general operating millage of the City, and would put a much heavier burden on taxable property owners."

The \$1.1 million figure is the usual cost of repairing a mile of local road including sewer and storm water system. While Hillsdale has been able to meet its general obligations, such as police and fire, in the midst of the combined revenue reductions, it has done so at the expense of its local roads. As noted in the study quoted above:

"The economic consequences of failing streets are easily compounded into other areas: fewer employers are attracted to the City, which means there are fewer jobs. Devaluation of real estate means the overall tax base for funding other public services, such as police and fire, declines as well. Homeowners frustrated with excessive runoff on their properties put less effort into maintaining the property, which makes the City look even less appealing, and reduces property values. Crumbling streets result in higher costs to everyone in the form of car repairs, longer commute times, increased dust and mud, as well as increased risk of accidents when swerving to avoid potholes."

V. Conclusion

Given the long term decline in Revenue Sharing and Act 51 funds and the reduction in property tax base, a priority of the state should be to restore its commitment to its local governments. In particular, it should use some of the projected surplus to return revenue sharing to full statutory funding. It should also remove constraints on local governments in Act 51 that limit their ability to maintain local roads. This is particularly crucial for the City of Hillsdale, which has been able to maintain its fiscal integrity in the face of this revenue decline by limiting its infrastructure maintenance. Hillsdale is now faced with

infrastructure problems that are beyond its capacity to raise revenue locally and that put a drag on economic development.

About the Author: The author is President of Hillsdale Policy Group, Ltd, and the William E. Simon Professor of Economics and Public Policy and the Director of Economics at Hillsdale College. He is the author of *A Capitalist Manifesto: Understanding Market Economy and Defending Liberty*, and has published numerous works on public policy issues. He has served in several policy positions, including Michigan's Deputy State Treasurer, member of the Michigan State Board of Education, President of the Board of Trustees of Lake Superior State University and Congressman Nick Smith's Washington Chief-of-Staff. Dr. Wolfram received his Ph.D. in Economics from the University of California at Berkeley and has taught at the University of California at Davis, Mount Holyoke College, Washington State University, and the University of Michigan at Dearborn.