

# The Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy >> University of Michigan

Michigan Public  
Policy Survey January 2013

## Local leaders support reforming Michigan's system of funding local government

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This report presents the views of Michigan's local government leaders regarding both the state's system of funding local government and their jurisdictions' ability to provide public services in the aftermath of the Great Recession. The findings are based on responses to statewide surveys of local government leaders in the Spring 2012 wave of the Michigan Public Policy Survey (MPPS).

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>> The **Michigan Public Policy Survey (MPPS)** is conducted by the **Center for Local, State, and Urban Policy (CLOSUP)** at the University of Michigan in partnership with the **Michigan Association of Counties, Michigan Municipal League, and Michigan Townships Association**. The MPPS takes place twice each year and investigates local officials' opinions and perspectives on a variety of important public policy issues. Respondents to the MPPS this wave include county administrators and board chairs, city mayors and managers, village presidents and managers, and township supervisors, clerks, and managers from over 1,300 general purpose local governments across the state.

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# CLOSUP

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## Key Findings

- Despite years of retrenchment among Michigan's local governments, most local leaders are satisfied with the current package of services their jurisdictions deliver. However, many have concerns about the future.
  - » Fewer than half (43%) of local leaders believe the system of funding local government in Michigan will allow them to maintain their current package of services in the future, even if the economy continues to improve over the coming years. This declines to less than one quarter (22%) of leaders among the state's largest jurisdictions.
  - » Beyond just maintaining current services, the outlook is even worse in terms of *improving* services or adding new ones in the future. Overall, only 26% of all local leaders think the current funding system will allow improvements to current services or provision of new services in their jurisdictions. This drops to just 14% of leaders among the largest jurisdictions.
- A majority of Michigan's local officials (58%) believe there is need for significant reform of the state's system of funding local government. In the state's largest jurisdictions—those that have faced the greatest fiscal challenges over the last decade—77% of leaders believe the system needs significant reform.
- Among the 58% who agree that significant reform is needed in Michigan's system for funding local government, targets for reform abound:
  - » 89% say the gas tax is an important target for reform;
  - » 83% point to the sales tax for significant reform;
  - » 82% think reform of the Headlee Amendment is important, while 81% say Proposal A needs reform;
  - » 80% indicate a need to reform constitutional revenue sharing;
  - » 64% say the Economic Vitality Incentive Program (EVIP) needs reform, including 90% of leaders in those jurisdictions that are eligible for EVIP funds.
  - » Smaller, but still significant, percentages believe local income taxes (47%) and regional taxation (42%) are important targets for reform.

## Background: fiscal crisis spread during 2009-10, then retreated starting in 2011, resulting in a “new normal” of reduced government and an uncertain future

Over the last decade, local government in Michigan has experienced widespread retrenchment, with employment levels (excluding education and hospital employment) down about 8.6% from their peak in 2001.<sup>1</sup> Driven by falling revenues and rising costs, local jurisdictions have been forced to adjust to a “new normal” by right-sizing to live within their reduced means. For hundreds of local jurisdictions, the process of retrenchment continues today, as their fiscal health continues to spiral downward. However, as the national economy has continued its slow improvement following the Great Recession, many local governments in Michigan may—for the time being, at least—be emerging from this period of retrenchment.<sup>2</sup>

Local governments began facing ongoing cuts in state revenue sharing in the early 2000s, and then faced property tax declines beginning later in the decade after the housing sector collapsed, even as costs to provide services continued to rise. The Michigan Public Policy Survey (MPPS) program was launched in the spring of 2009, and has documented local government retrenchment since then, using responses from local government leaders in its annual spring surveys of fiscal health and budget policy.

The last four MPPS spring surveys found that the local government fiscal crisis grew more widespread in 2009 and 2010 before beginning to reverse course in earnest in 2011. The MPPS’s summary indicator of fiscal health asks Michigan’s local government leaders whether their jurisdictions are *better able* or *less able* to meet their fiscal needs, compared to the prior year. The percentages of all jurisdictions that said they were *less able* to meet their fiscal needs grew from 52% in 2009 to 61% in 2010, before easing back to 48% in 2011, and receding further to 34% in 2012. (It is worth noting that these percentages tend to be even higher when looking at just the state’s largest jurisdictions in terms of population size, especially for those with greater than 30,000 residents.)

The MPPS surveys have also tracked local governments’ responses to the fiscal crisis, which include increasing reliance on general fund balances and rainy day funds to cover revenue shortfalls, cutting staff, cutting services, and cutting costs through both intergovernmental cooperation and through shifting personnel costs (such as health care and retirement benefits) to be paid increasingly by public employees themselves (see *Table 1*). These and related actions, taken together, have resulted in the widespread retrenchment of local government during the past decade.

**Table 1**  
Percentage of jurisdictions reporting various budgetary and operational changes, from 2009-2012\*

	2009	2010	2011	2012
% of all jurisdictions planning to increase reliance on general fund balance(% of jurisdictions with >30,000 residents)	44% (64%)	49% (63%)	36% (38%)	34% (38%)
% of all jurisdictions decreasing staff numbers overall (% of jurisdictions with >30,000 residents)	<i>not asked</i>	27% (85%)	23% (75%)	19% (60%)
% of all jurisdictions planning to decrease amount of services provided (% of jurisdictions with >30,000 residents)	24% (48%)	29% (63%)	21% (50%)	15% (34%)
% of all jurisdictions planning to increase intergovernmental cooperation (% of jurisdictions with >30,000 residents)	32% (61%)	38% (79%)	40% (85%)	40% (76%)
% of all jurisdictions planning to increase employees’ share of premiums, deductibles and/or co-pays on health insurance (% of jurisdictions with >30,000 residents)	<i>not asked</i>	33% (71%)	30% (86%)	30% (81%)

\* Notes: (1) due to wording changes in the questionnaire items between 2010 and 2011, percentages from 2011-12 may be slightly underestimated in their relative comparison to the first two years’ data; (2) percentages for 2009 for increasing reliance on general fund balance also include increasing reliance on “rainy day” funds (these were split into separate questions after 2009).



But as the state's economy has improved slowly in the aftermath of the Great Recession and more of Michigan's local governments currently report that they are either holding steady or are better able to meet their fiscal needs, a new question presents itself: will local governments be able to sustain their operations at this "new normal" level, or will they face further retrenchment if the state's system of funding local government does not keep up with rising costs in the future?

The Spring 2012 MPPS asked local leaders to look ahead and give their views on this important question, and on whether or not they thought the state's system of funding local government needs significant reform. This report presents their responses.

For more information on various aspects of the system of funding local government, see the "Outline of the Michigan Tax System" prepared by the Citizens Research Council of Michigan.<sup>3</sup> In addition, two other reports from differing viewpoints provide further background regarding state-imposed tax limitations that cap local government revenue growth: a report prepared by Plante Moran for the Michigan Municipal League<sup>4</sup> and one by the Anderson Economic Group.<sup>5</sup>

## Despite recent challenges, most local leaders have a positive outlook on two key aspects of current fiscal health

While there are a few high-profile cases of extreme fiscal decline, most local governments in Michigan appear to have managed their way through the recent economic downturn in ways that have largely preserved their fiscal health, according to responses to the MPPS. It seems likely that efforts to reduce costs through the budgetary and operational strategies outlined above have helped local governments weather the fiscal storm, although the outcome for many Michigan communities includes fewer local services, fewer public employees to provide services, and delayed improvement—or even just maintenance—of public infrastructure

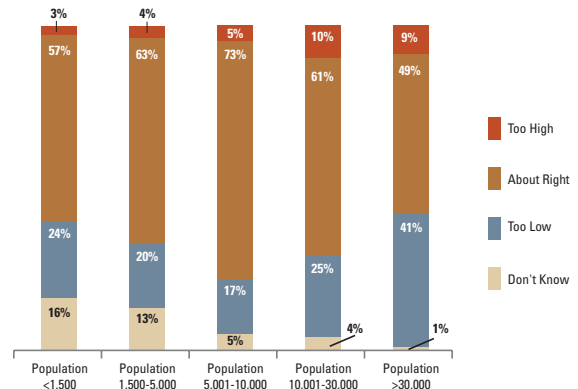
According to the Government Finance Officers Association, local governments, regardless of size, should “maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures” to “mitigate current and future risks (e.g. revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates.”<sup>6</sup>

In Michigan, despite increasing their reliance on general fund balances to help deal with fiscal challenges over the last few years, 61% of local leaders overall say their general fund balances were “about right” in terms of desired levels as of 2012 (and another 5% even say their balances were “too high”). Overall, 23% say their balances were “too low” as of 2012.

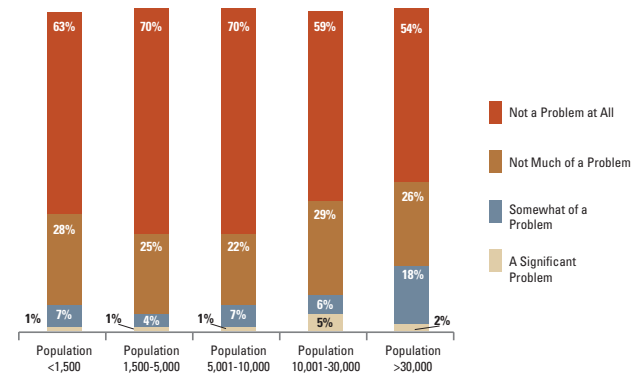
As with many indicators of fiscal health, the situation tends to be worse in the state’s larger jurisdictions, as shown in *Figure 1*. For instance, while 24% of leaders from the state’s smallest jurisdictions (those with fewer than 1,500 residents) believe their general fund balances were too low, this concern was expressed by 41% of leaders in the largest jurisdictions (those with greater than 30,000 residents).

Similarly, most Michigan local officials also report that they are not particularly concerned with their jurisdictions’ cash flow or ability to pay bills in a timely manner. Only 1% of jurisdictions overall report that cash flow is a significant problem, while 7% say it is somewhat of a problem. By comparison, 26% say it is not much of a problem, and 65% believe it is not a problem at all for their jurisdictions. Again, larger jurisdictions are more likely to report concerns about cash flow. For instance, while just 8% of leaders from the smallest jurisdictions say cash flow is a problem (somewhat or significant), this increases to 20% of leaders from the largest jurisdictions (see *Figure 2*).

**Figure 1**  
Local leaders’ assessments of their jurisdictions’ unreserved general fund balances, by population size



**Figure 2**  
Local leaders’ assessments of their jurisdictions’ cash flow, by population size



Note: Figure does not display “don’t know” response category



## Most leaders are also satisfied with their jurisdiction’s current package of services

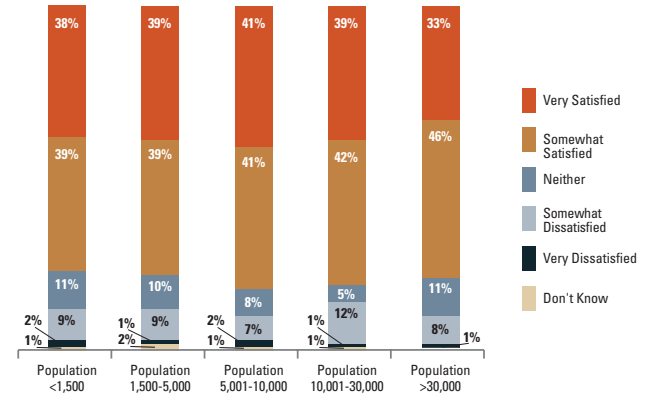
In spite of cuts in local services over the last few years, there is widespread satisfaction among local leaders regarding the package of services their jurisdictions still deliver today. More than three-quarters (79%) of local officials overall say they are either somewhat satisfied or very satisfied with their current service offerings. And in this case, there are not significant differences by community size, as high levels of satisfaction with the array of services currently provided are found across all categories of jurisdiction sizes (see *Figure 3*).

Furthermore, 79% of local leaders also believe that their citizens are also satisfied with the current package of local services provided as of 2012.

Two factors may help explain the high level of satisfaction among local leaders. First is the nature of service cuts that generally appear to have been implemented. While many counties, cities, and large jurisdictions have completely eliminated specific services in recent years, the overall percentage of Michigan’s local governments that have taken this relatively drastic action is fairly low, with less than 10% overall reporting complete service eliminations in each of the last two MPPS surveys. Instead, it may be that most cuts in services have been less severe in nature. These types of service cuts could have resulted, for example, in longer periods between mowing grass in parks, longer average response times for police and fire services, less frequent filling of potholes in public streets, and so on, but with the services themselves preserved at some level. It is possible that service cuts may have been more extreme if local governments hadn’t also been cutting costs by shifting benefits expenses such as health care and retirement funding to be paid increasingly by employees themselves.

Second, as noted above, local governments may have helped themselves avoid more drastic service cuts over the last few years by increasing the number and/or scope of their cooperative efforts with neighboring jurisdictions to provide services jointly while sharing in the costs. Out of an extensive list of policy actions surveyed on each of the last three annual MPPS spring questionnaires, intergovernmental cooperation has been either the most common, or the second most common action local leaders planned for upcoming years (see *Table 1*). Most local leaders have been satisfied with these intergovernmental approaches, which they believe have been largely successful at achieving goals such as cost savings or service improvements.<sup>7</sup> The choice to cooperate may have helped prevent further instances in which local governments would otherwise have needed to completely eliminate specific services, or to have to cut ongoing services more drastically than they actually have.

**Figure 3**  
Local leaders’ satisfaction with package of services their jurisdictions currently offer, by population size



Note: Figure does not display “don’t know” response category

## Though local governments may be holding their own for now, there is concern about the future

Although many local leaders have expressed increasing optimism about their ability to meet current financial needs compared to prior years, they also express significant concern when looking to the future. As costs continue to rise, many officials worry that revenues will not keep pace, due in part to limits on property tax revenues established in the Michigan Constitution’s Headlee Amendment and in Proposal A. Though some local governments have been able to stabilize their current operations at reduced funding levels, there is concern that the state’s system of funding local government will come up short and force a new round of local government retrenchment in the future.

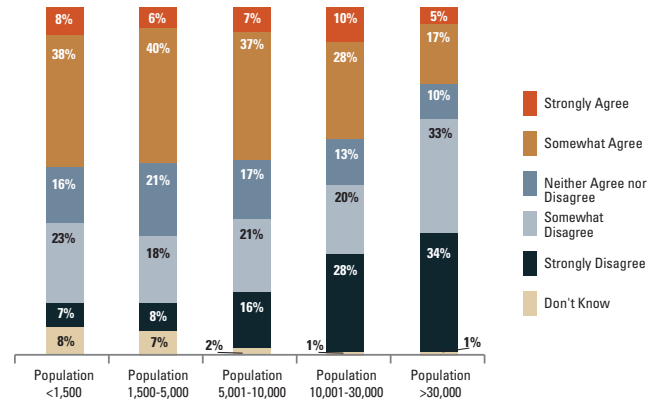
The MPPS asked local leaders whether or not they believe Michigan’s system of funding local government will provide adequate revenue in the coming years (assuming the economy continues to improve) to allow them to maintain the package of services they currently provide. Fewer than half (43%) believe that the funding system will allow them to maintain their current package of services in the future, even with continued economic improvement.

Optimism on this issue is found primarily in Michigan’s smaller jurisdictions, which tend to offer a smaller package of services, and also tended to face less extensive financial problems over the last decade. Meanwhile, the outlook is particularly pessimistic in the state’s largest jurisdictions, where only 22% of leaders believe the funding system will allow them to maintain their current levels of service provision. Further, a full 67% of leaders in the state’s largest jurisdictions believe the system will force further service cuts in the future, absent some other intervening factors (see *Figure 4*).

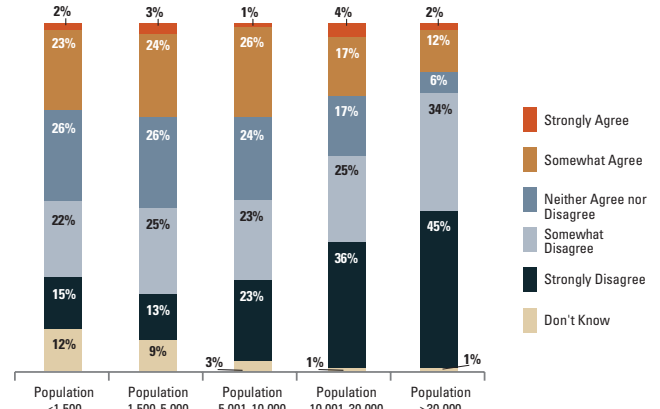
And the outlook is even more foreboding when local leaders are asked whether the current funding system would allow them to improve current services or to introduce new services in the future. These new or improved services might include, for example, launching new economic development initiatives (e.g., placemaking), reducing public safety response times, or significantly improving roads or other public infrastructure.

Overall, only 26% of officials believe Michigan’s system of funding local governments will provide adequate revenue to allow for improvement of current services or addition of new services in the

**Figure 4**  
Local leaders’ assessments of ability to maintain jurisdictions’ current package of services in the future, by population size



**Figure 5**  
Local leaders’ assessments of ability to improve jurisdictions’ current package of services in the future, by population size



future. Among the state’s largest jurisdictions, only 14% believe the current system of funding will allow them to improve or add to their package of services in the future (see *Figure 5*). And these responses are based on a scenario in which the economy continues to *improve* in the future, making outlooks even bleaker if Michigan’s economy were to take another turn for the worse anytime soon.



## There is widespread belief in the need to reform the current system of funding local government

Following questions about their ability to maintain or to improve services in the future, respondents to the MPPS were also asked whether they agree or disagree that the system for funding local government in Michigan needs significant reform. Overall, a majority of local officials (58%) agree that there is a need for significant reform, including 23% who strongly agree (see *Figure 6a*). While another 21% are neutral, saying they neither agree nor disagree, only 16% disagree that the system is currently in need of significant reform.

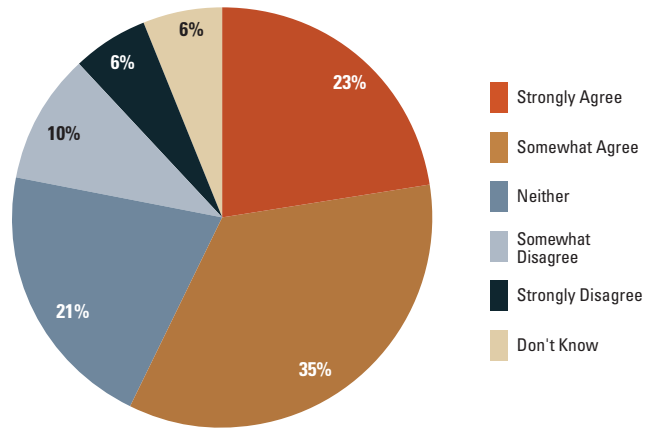
Given that larger jurisdictions have faced more severe fiscal challenges over the last decade, it is not surprising that belief in the need to reform the system of funding local government is more common in the state’s larger communities. Among local leaders from the largest jurisdictions, 77% agree the system needs significant reform, including 51% who strongly agree (see *Figure 6b*). Still, even among the state’s smallest jurisdictions, a majority (52%) agrees that significant reforms are necessary.

By jurisdiction type, 83% of city leaders believe the system needs significant reform, as do 78% of county leaders, 68% of village leaders, and 48% of township leaders.

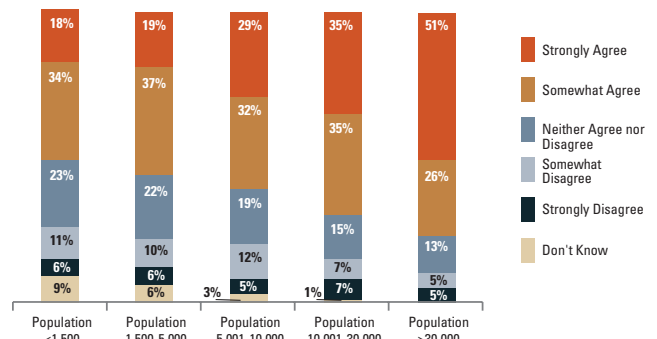
By region, 70% of local leaders in Southeast Michigan support reform, compared to 63% in the Upper Peninsula, 58% in the West-Central region of the Lower Peninsula, 56% in the Southwest, and 49% in both the Northern Lower Peninsula and in the East-Central region of the Lower Peninsula.

Meanwhile, there are only slight differences by partisan identification of Michigan’s local leaders. Those who identify themselves as Independents (63%) and Democrats (62%) are slightly more likely to believe significant reform of local government funding is necessary. However, a majority of Republican officials (55%) also believe the system needs significant reform.

**Figure 6a**  
Local leaders’ opinions on the need to reform Michigan’s system of funding local governments



**Figure 6b**  
Local leaders’ opinions on the need to reform Michigan’s system of funding local governments, by population size





## There are also high levels of support for reforming almost all major parts of the funding system

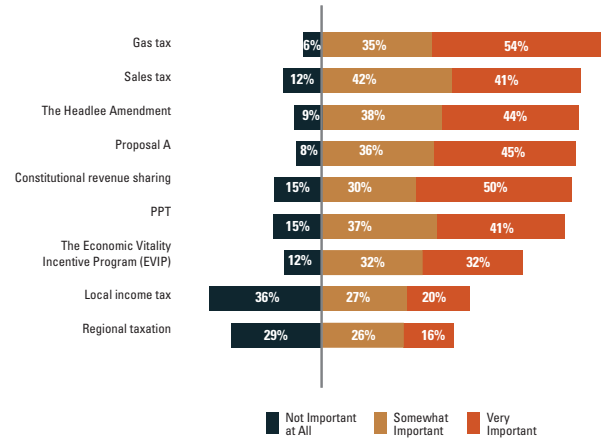
Among the 58% of respondents who believe the system of funding needs reform, local leaders were then asked whether it is very important, somewhat important, or not important at all to reform a number of specific aspects of the funding system. As shown in *Figure 7*, there is widespread support among these local leaders for reform of most of the funding system’s major components.

Among potential areas of reform to sources of local government funding, the state’s gas tax has the most widespread support (89%) among the 58% of local leaders overall who think the current funding system is broken. This corresponds to one of the policy initiatives Governor Rick Snyder highlighted in his recent 2013 State of the State address. Widespread support for reform is also expressed for the sales tax (83%), the Headlee Amendment (82%), Proposal A (81%), constitutional revenue sharing (80%), and the Personal Property Tax (78%). It should be noted, however, that this question was asked in the spring, before the PPT was revised at the end of 2012.

In addition, the Economic Vitality Incentive Program (EVIP)—which replaced the former statutory revenue sharing program—is also a target for reform among a majority (64%) of local leaders who think the current system is broken, including 90% of these leaders who are from jurisdictions that are eligible to receive EVIP funds.

The MPPS also found significant support, but at much lower levels, for reforming the local income tax (47%), and for regional taxation (42%).

**Figure 7**  
Local leaders’ assessments of the importance of significant reform to various sources of local government funding (among those who see need for significant reform)



Note: Figure does not display “don’t know” response category





## Reform recommendations cover wide range with no specific consensus, though many call for increased funding levels

The MPPS survey also offered a follow-up open-ended question to all respondents who think the system of funding local government needs significant reform. This question asked how the system should be reformed, and in particular, what specific reforms the respondent considered to be most important. While not necessarily representative of the entire MPPS sample, 385 local leaders provided approximately 800 suggestions, covering a wide range of territory from changing distribution formulas and technical details in specific taxes, to increasing local control over funding and flexibility in choosing funding sources, enhancing stability and predictability of funding to allow better long-range planning, reducing administrative burdens, complexity, and unintended consequences, eliminating unfunded mandates from the state, changing rates and bases of taxes, and much more. Sometimes recommendations were made on each side of an issue, such as increasing the sales tax rate and decreasing the sales tax rate. Although it is difficult to quantify and bring order to such a large and diverse set of suggestions, perhaps the most common theme that emerged was the need for increasing funding of local government.

When coded into discrete subject areas, the most common recommendations focused on issues related to property taxes, particularly the Headlee Amendment and Proposal A. Within this area, the bulk of suggestions related to either eliminating the Headlee Amendment, eliminating Proposal A, or reforming these laws in order to provide more funding. Recommendations for reform included easing the current revenue caps, removing or easing automated millage rollbacks, allowing millage rollups, and/or finding ways to deal with the previously unforeseen effects of the housing sector collapse and the resulting drop in property tax revenues.

The next most common set of recommendations focused on the sales tax, with specific emphasis on increasing the rate of the tax, increasing the tax base (adding services, food, internet sales, etc.), and/or allowing local sales taxes or local control of the state sales tax revenues.

Issues related to revenue sharing, including constitutional revenue sharing and EVIP, were the third most common area respondents feel is in most important need of reform. Within this area, suggestions clustered around: providing more funding, more stability and predictability, and/or eliminating EVIP by either restoring the prior version of statutory revenue sharing available to a wider set of local governments or by simply moving the EVIP funds into the existing constitutional revenue sharing program. Suggestions from County leaders included making counties eligible for revenue sharing again. Quite a few comments from other leaders also focused on frustrations with EVIP forcing local governments to “jump through hoops,” penalizing jurisdictions by not providing EVIP funds for jurisdictions that had already enacted reforms that EVIP later incentivized, or getting less funding than they got in the statutory program even while needing to do more work to get these reduced funds.

Comments on the Personal Property Tax focused largely on the need to replace the funds that might be lost in reforming the tax. The second most common type of suggestion here was to leave the PPT as it was without any significant reforms. (Again, note that this question was asked before the PPT was reformed in late 2012.)

On the Gas Tax, again, most suggestions focused on the need for additional revenue, including a number of recommendations to change how the tax is calculated to be based on the price, not volume of the purchase. A number of suggestions also focused on reforming the formula for distributing and using gas tax revenues at the local level.

To give a sense of the verbatim suggestions provided by some of Michigan's local leaders, below are a number of examples dealing with various aspects of the funding system.

### Voices Across Michigan

#### Quotes from local leaders regarding their recommendations for funding reforms

- "The combination of Proposal A and Headlee are killers. Allowing property values to drop greater than the rate of inflation, but not to be able to rebound in a similar manner is unfair."
- "I would revise Proposal A to get rid of the tax rate differences between homestead and non-homestead and eliminate the caps. I would revise the Headlee amendment so that millage rates could both be rolled back and rolled up without a vote of the people."
- "Giving local municipalities the ability to levy a local sales tax would significantly change our financial landscape and our dependence on property taxes. Alternatively, making it easier to impose a local income tax would have the same impact because we have so many commuter employees. It's a bit like a three-legged stool. Right now we only have the ability to collect revenues from one leg of the stool and as a result the whole system is unbalanced. Making it possible to levy a local sales tax—or easier to levy an income tax—would re-balance the stool and allow us to reduce property tax rates."
- "Sales Tax needs to be looked at. There are states around us that have 8% goods and services. Why can't we go with a 4% goods and services?"
- "Revenue Sharing has been cut for many years. We should remove the State of Michigan from the collection of sales tax and return the tax directly to communities."
- "Need some sort of revenue sharing guarantee for future years so we can do some planning. Too often we are guessing on revenue sharing when the budget is adopted. Revenue sharing declines have significantly impacted our community... The current system of reducing millage amounts over time, coupled with property tax rates that have not kept up with inflation, really hurts a community like ours with a small amount of used home sales and few new ones."
- "EVIP needs a complete overhaul. The idea isn't bad but a one-size doesn't fit all. Most of the required initiatives are already being done because they were the right thing to do. Now things are being required like they're new ideas."
- "The gas tax is inadequate to build or maintain streets and roads due to slower economy and alternative fuels, etc. Fuel tax should be a percentage of actual sale, not so many cents per gallon."
- "Remove limits to local government taxation and allow the citizens to vote their level of service that they wish to fund. Highly recommend that Michigan Cities have income tax options, if needed, to tie the implementation of income taxes to property tax reductions."

## Conclusion

Michigan's local governments have worked their way through a period of retrenchment, driven by falling revenue and rising costs, and many may be emerging to a "new normal" characterized by reduced service and staffing levels. While hundreds of jurisdictions continue to face fiscal decline, in the last two years more and more local leaders report that their jurisdictions are either holding their own or are even improving in terms of their ability to meet their own fiscal needs. And on two important aspects of fiscal health—general fund balances and cash flow—most local leaders provide generally positive reports.

Perhaps somewhat surprisingly, despite this period of retrenchment, most local leaders also say they are satisfied with the package of services their jurisdictions still deliver. However, new concerns arise regarding their ability to maintain these current services going forward. Even if the economy continues to improve in the coming years, fewer than half (43%) of Michigan's local leaders believe they will be able to maintain their present service offerings based on the state's current system of funding local governments. In the state's largest jurisdictions, only 22% think they will be able to maintain their new normal level of services. The outlook is even worse in terms of their ability to improve current services or to add new services under today's funding system.



One key driver of concerns is the tax caps that limit property tax revenue increases, established in the Headlee Amendment and Proposal A. However, among the 58% of local leaders overall who think the funding system needs significant reform, large majorities believe each of the major parts of the system needs reform, including the gas tax, the sales tax, revenue sharing, and other aspects in addition to Headlee and Proposal A.

Without changes to the funding system for local governments, today's "new normal" may turn out to be a temporary reprieve before a new period of retrenchment, again driven by revenue levels that don't keep pace with rising costs. While no particular consensus emerged from local leaders' suggestions for how to reform the system, clearly a new focus on reform and the funding needs for local government would be welcomed by the state's local leaders.

## Notes

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## Survey background and methodology

The MPPS is a biannual survey of each of Michigan's 1,856 units of general purpose local government, conducted once each spring and fall. While the spring surveys consist of multiple batteries of the same "core" fiscal, budgetary and operational policy questions and are designed to build-up a multi-year time-series of data, the fall surveys focus on various other topics.

In the Spring 2012 iteration, surveys were sent by the Center for Local, State and Urban Policy (CLOSUP) via the internet and hardcopy to top elected and appointed officials (including county administrators and board chairs, city mayors and managers, village presidents and managers, and township supervisors, clerks, and managers) from all 83 counties, 277 cities, 256 villages, and 1,240 townships in the state of Michigan.

The Spring 2012 wave was conducted from April 9-June 18, 2012. A total of 1,329 jurisdictions in the Spring 2012 wave returned valid surveys, resulting in a 72% response rate by unit. The margin of error for the survey as a whole is +/- 1.43%. However, the margin of error may differ for analyses that include only a subset of respondents. The key relationships discussed in the above report are statistically significant at the p<.05 level or below, unless otherwise specified. Missing responses are not included in the tabulations, unless otherwise specified. Data are weighted to account for non-response. Contact CLOSUP staff for more information.

Detailed tables of the data analyzed in this report are available online, broken down three ways: by jurisdiction type (county, city, township, or village); by population size of the respondent's community; and by the region of the respondent's jurisdiction. See the MPPS homepage: <http://closup.umich.edu/mpps.php>.

*The survey responses presented here are those of local Michigan officials, while further analysis represents the views of the authors. Neither necessarily reflects the views of the University of Michigan, or of other partners in the MPPS.*

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