Ideas for Reforming Statutory State Revenue Sharing

By Eric Lupher

On February 18, Citizens Research Council of Michigan President Eric Lupher presented to the General Government subcommittee of the House Appropriations Committee a new report with ideas for reforming statutory state revenue sharing. The following are highlights of the new report.

Unrestricted state revenue sharing is a program somewhat unique to Michigan. Most other states' revenue sharing programs are for restricted purposes. In Michigan, the state provides restricted funding with local governments for education, highways, courts, liquor enforcement, mental health care, and other services. Only a few distribute state collected tax revenues to local governments for their unrestricted use.

Although grouped as a single state revenue sharing program, Michigan's revenue sharing program is really comprised of two parts:

1) constitutional revenue sharing that is distributed on a per capita basis, and
2) statutory revenue sharing that has been distributed on a need basis since the early 1970s.

Statutory Revenue Sharing: An Indefensible Program

The statutory revenue sharing program has suffered severe reductions in funding since 2001, with over $6 billion diverted for other state purposes. Statutory state revenue sharing funding in 2014 was down 78 percent from what it would have been had the program been funded as directed by statute.

The program today is indefensible in regards to which governments are getting funded while others are not; and the amounts distributed to those that do receive funding. Reforms were enacted in 1998 to move away from the Relative Tax Effort and send funding to the governments that lack the capacity to fund services from their own revenues. The 1998 reforms have long since been abandoned and there is little basis upon which the state could distribute new funding if it were made available.

CRC took a step back when assessing this program to reflect on the purpose of local governments and the state's interest in properly functioning local governments. On the first

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question, it is CRC's assessment that local government exists to manage the interaction between people. It is on this basis that we can explain increases in the types of services provided and the intensity of those services as we find more people in close proximity to one another.

Two answers are apparent for the second question. The state relies on local governments to serve as the host for the people and businesses that make up the state. Beyond the optics of being an attractive place to live and work, state tax revenues from sales, income, and business activity taxes are more robust when the state economy prospers. The state must work in partnership with local governments for this to occur.

Additionally, the state cares about protecting the health and safety of the residents of the state. This is not done by funding the state police. The state relies on local governments to provide these services. It is in the state's interest to have well-functioning local public safety officers serving Michigan's communities.

Path 1: Fiscal Capacity

In accordance with this reasoning, the new report provides two paths for state policymakers to consider should they opt to reform the statutory state revenue sharing program.
The first path measures needs by assessing the factors that contribute to the ability to yield tax revenues and the factors that create higher demand for services. It would create a formula that measures the fiscal capacity of each city, village, and township and sends funding to those local governments with the greatest needs. Fiscal capacity can be measured in two ways:

1) the ability to raise funding from local tax sources, and
2) the ability to meet the service demands that are placed on local governments.

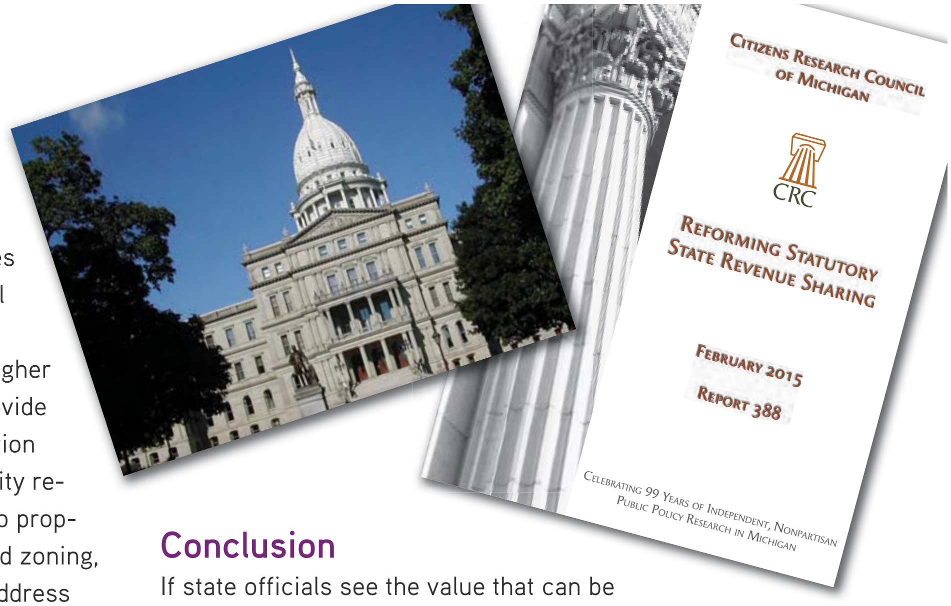
Past efforts to address the needs of local governments—the 1971 Relative Tax Effort formula and the 1998 tax base equalizing reforms—focused solely on the first measure: helping local governments with tax bases insufficient for funding services solely from local taxation. The fiscal capacity of local governments also varies because governments with higher density levels must provide more services. Higher population density requires local governments to provide more services to people—policing, parks and recreation programs, library services, etc. Higher building density requires local governments to provide more services to properties—fire protection, refuse collection, planning and zoning, etc. An ideal revenue sharing program designed to address fiscal capacity would help communities with relatively small tax bases and would help communities with relatively high density levels, but would provide the most help to communities with relatively small tax bases and relatively high density levels.

Path 2: Economic Activity Requiring Strong Local Presence

The second path may be approached in two ways. An approach that focuses on the state's interest in local governments as the host for the people and businesses that contribute to the state's tax bases would focus on the types of economic activities that require a strong local government presence. While agriculture and forestry are vital to the state's economy, they require very little local government services. Instead, the state would reward local governments for hosting economic activities such as manufacturing, commerce, retail, health care, and tourism. This approach would tie state and local economic development interests together far better than is currently the case.

Alternate Path 2: Restricted Statutory Revenue Sharing

An alternative approach would transition the statutory program from unrestricted state revenue sharing—in which local governments are without restrictions on how they use the funding—to a restricted revenue sharing program tied to public safety programs. Funding in this approach would be distributed based on the public service activities that keep police, fire, and emergency medical service providers busy. Statistics such as crime responses, traffic monitoring, fire suppression, accident responses, and calls for medical assistance generally are reported to the state already. This approach would use those statistics to fund the public safety agencies with the greatest needs.



Conclusion

If state officials see the value that can be created by partnering the state's revenue raising strengths with the vital services provided by Michigan's local governments, they will resume funding state revenue sharing. State policymakers realized some 45 years ago that per capita distributions of state funding do not adequately direct funding to the communities with the greatest needs. Any one of these ideas for reforming statutory state revenue sharing can go a long way toward helping many of Michigan's cities that are struggling the most.

To view the full report, visit crcmich.org.

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