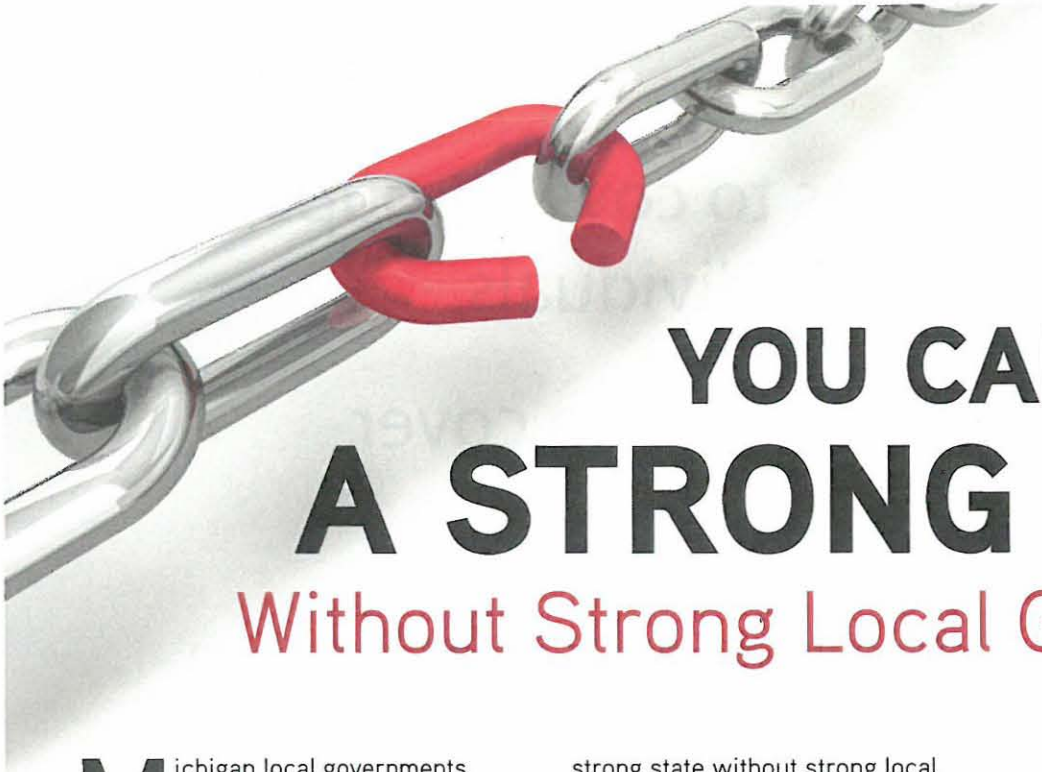

By Robert Kleine

YOU CAN'T HAVE A STRONG STATE

Without Strong Local Governments

Michigan local governments have been battered financially more than local governments in any other state. From 2000-2011, Michigan local government employment (excluding education) fell 11.4 percent. Local governments are creatures of the state but state government's response to the crisis has been to pile on.

The taxable value of property fell 13.1 percent from 2008 to 2012 with many municipalities suffering much larger losses. Taxable value fell 46.3 percent in Pontiac, 42.4 percent in Flint, and 42 percent in Harper Woods. The state's only response has been to cut revenue sharing. In FY 2001, revenue sharing payments totaled $1.559 billion. The FY 2014 budget appropriates $1.1 billion for revenue sharing but only the constitutional share—$737 million—is guaranteed. The remainder is contingent on local governments meeting specific objectives—such as requiring their employees to pay more for health care and sharing services with other local governments.

There are currently 11 municipalities and 6 school districts under some form of state supervision, of which 11 have an emergency financial manager (including 3 school districts).

Michigan badly needs an urban policy to address the myriad problems facing local governments. It has often been said, but it's true: you cannot have a strong state without strong local governments. There is little question that Detroit's bankruptcy is a major negative for economic development in the state. As one municipal finance expert said about Detroit (and it applies to all Michigan municipalities), "Lack of a supportive relationship between city officials and the state was an issue that lingered too long."

Discussed below are the major problems facing Michigan's local governments and potential solutions to these problems. Most of these problems are widely recognized but there appears to be little will in Lansing to address them.

PROBLEM ONE: Legacy Costs

Legacy costs are crushing local governments. MSU recently released an excellent report on these costs, titled "Funding the Legacy: The Cost of Municipal Employees Retirement Benefits to Michigan Communities" (March 2013, *Scorsone and Bateson).* The report estimates the unfunded pension liability at about $2 billion and the unfunded liability for retiree health care at about $10 billion.

One solution to the pension problem would be for the state to issue bonds to cover the unfunded liability. Local governments would be responsible for paying the principal and interest on the bonds. The state set a precedent for this by issuing $3 billion in bonds to pay back the money the state borrowed from the federal government to pay unemployment benefits. In exchange, local units would be required to join the state pension system or MERS, to place new employees in a defined contribution plan or a hybrid plan, and to limit the multiplier to no more than two for benefits earned in the future.

The unfunded liability for health benefits could be reduced or eliminated by a combination of prefunding, a state bond issue, and increased costs for retirees.

PROBLEM TWO: Cuts to Revenue Sharing

Revenue sharing cuts have played a major role in creating a fiscal crisis in many communities. The state should restore at least $500 million per year of the cuts and adopt a new revenue sharing formula that uses population, per capita income, the property base per capita, and a measure of essential services. This would be affordable for the state in the short run as large budget surpluses are expected for at least the next three years. For the long term, the income tax rate could be increased from the current 4.35 percent to 4.6 percent, which would raise $545 million. (The rate was 4.6 percent from 1976 to 1993.)

If the Legislature does not act, an option would be to gather signatures for an initiated statute or amendment.

PROBLEM THREE: Paying for Police and Fire Services

The loss of police and fire protection contributes to a downward economic spiral. Michigan has lost 2,315 police officers since 2001 and 1,800 firefighters.

One solution would be to enact legislation setting up regional police and fire districts funded by a regional millage which would relieve considerable pressure on municipal budgets.

PROBLEM FOUR: Revenue Sources

The state has limited the revenue raising ability of local governments, placing too much reliance on property taxes. From 2008 to 2012, taxable value statewide fell 13.1 percent with a much larger decline in cities and in Southeast Michigan.

There are two potential solutions. First, allow counties to piggyback on the state income tax—up to 1 percent to be collected and distributed by the state. This would generate $2.2 billion. The amount returned to locals would be based on the amount collected in each jurisdiction and population. Maryland's 23 counties and Baltimore City impose a personal income tax which is administered and collected by the state. For the majority of counties, the rate is between two and three percent. Maryland's local governments receive $4 billion from the tax (Maryland largely has county government). Michigan cities collect $200 million from the income tax imposed by 22 cities.

A second option would be for the Legislature to allow a 1 percent local option sales tax which would generate about $1.4 billion if imposed by all counties.

PROBLEM FIVE: Municipal Competition

Local competition for economic development can be destructive. In many cases it leads to reduced taxes and lower services, and few new jobs.

A potential solution would be to enact a regional tax base sharing program whereby governments in the region shared the growth in commercial and industrial property as is done in the Minneapolis-St. Paul area. In addition, most local tax incentives should be eliminated and possibly replaced with regional incentives.

PROBLEM SIX: Too Many Units of Government

Michigan has too many local governments, a common problem in the Midwest. Michigan has 2,876 local units. Maryland has 402, and Virginia has 455.

A potential solution would be to convene a constitutional convention to reorganize government. The goal should be to have more regional governments and to reduce the number of school districts. Without these reforms Michigan will continue to have more than its share of distressed communities, and the state economy will continue to lag behind other states. Michigan ranks 35th in per capita income, 12 percent below the national average. In 2000, the state ranked 17th, with per capita income about 3 percent below the national average.

Lou Glazer, president of Michigan Future Inc., an Ann Arbor-based nonprofit economic development organization, said he does not believe cities can cut their way to prosperity. He notes that many businesses, especially technology-based firms, are looking for communities where workers want to live. "The most successful central cities in the country have high taxes but also high services and amenities. People are willing to pay higher taxes to get something in return," Glazer said.

These reforms are long overdue. It is time for the governor and the Legislature to turn their attention from reducing business taxes and cutting budgets to revitalizing our communities. This is the only path to a strong, vibrant economy.

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During the last decade, Lake Isabella has been forced to use more of its limited resources to appease the bureaucratic demands of Lansing. While compliance demands from the state have increased, the village has been completely excluded from state funding sources such as EVIP; funding to maintain streets has shrunk; capital improvements to our street network can be accomplished only via special assessment; and we were forced (under a supposed cost-saving measure) to relinquish control of our elections to our townships.

Despite these obstacles, and the needless prodding into our operations, we have been able to continually fulfill our mission. I am proud to say that the level of services we provide is higher today than it was a decade ago, with a smaller staff.

We could be doing so much more if Lansing were a partner. The hard truth is that Lake Isabella has done what countless other municipalities have done—planned, prioritized, and found creative ways to provide services with declining resources. As the saying goes, the proof is in the pudding. When our community was asked to rate the quality of service they receive from various levels of government, 52 percent rated services from the state as "fair" or "poor" versus nearly 60 percent who rated the service they receive from the village as "excellent" or "good."

Tim Wolff, Lake Isabella Village Manager, CPM, ICMA-CM, Chair, Michigan Municipal League Land Use and Economic Development Policy Committee