United States General Accounting Office

GAO

Report to the Chairman, Committee on Government Operations, House of Representatives

September 1992

MICHIGAN COMMUNITIES

Services Cut in Response to Fiscal Distress

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GAO United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-250425

September 29, 1992

The Honorable John Conyers, Jr.
Chairman, Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we examine the fiscal conditions and effects of declining revenues on local Michigan governments. You also asked that we conduct case studies in selected communities. The report examines the communities' fiscal health, identifies the range of local responses to economic conditions and shifting intergovernmental revenues, and discusses state actions to help local governments maintain public services.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 5 days from the date of this letter. At that time, we will send copies of this report to other congressional committees and subcommittees, and other interested parties.

Please contact me at (202) 512-7225 if you or your staff have any questions. Other major contributors to this report are listed in appendix II.

Sincerely yours,

Gregory J. McDonald
Director, Human Services Policy
and Management Issues

Executive Summary

Purpose

Local communities have been affected by changing economic conditions and declining revenues from the federal government. To determine how local governments are responding to these changes and to shifts in intergovernmental responsibilities, the Chairman, House Committee on Government Operations, requested that GAO examine the effects of declining revenues on local Michigan governments and conduct case studies in selected Michigan communities. GAO selected the cities of Detroit, Saginaw, and St. Clair Shores, and Saginaw County as case study locations. The purpose of the case studies was to (1) examine fiscal conditions, including the communities' responses to the elimination of general revenue sharing (GRS) in 1986, (2) identify the range of local responses to economic conditions and declines in intergovernmental revenues, and (3) determine whether state policies and actions helped local governments maintain public services.

Background

Local governments are the workhorses of domestic policy. In our intergovernmental system, the federal government looks to county and municipal governments to provide basic public services, such as police, fire, and public works. It also looks to them to help fulfill national domestic objectives, such as economic development and environmental protection.

Federal aid to both state and local governments increased from the early 1960s through the late 1970s. State revenues from the federal government dropped in 1981 and then grew overall from 1983 on. Local revenues from the federal government essentially continued a decline that began in the late 1970s. From 1978 through 1990, federal aid to state governments increased 20 percent overall, while federal aid to local governments declined 71 percent, to approximately the pre-GRS levels of the early 1970s. The diverging patterns of state and local revenues from the federal government reflect the growth of entitlement programs, such as Medicaid and Aid to Families With Dependent Children, for which federal aid is granted directly to the states. In addition, the Omnibus Budget Reconciliation Act of 1981 increased federal aid to state governments at the expense of federal aid going directly to local governments by creating several state-administered block grants. The Congress also discontinued many federal-local programs, such as the $4.6 billion per year GRS program, which was eliminated in 1986.

The recession and weak economy during the last 2 years caused dramatic fiscal changes in many states. Although federal payments to states have grown since 1983, the growth is primarily a reflection of federal matching payments for entitlement programs. Spending for these programs has tended to increase in response to recession-driven demands, thus placing stress on other state spending. To address these fiscal pressures, states implemented several types of reductions, including cuts in aid to local governments. These reductions and the recession placed even heavier burdens on some local governments to meet growing public service demands with their own revenues.

To gain insights into local fiscal trends and conditions in Michigan, GAO interviewed state and local officials and reviewed budgets and other relevant financial records. However, GAO was not able to precisely identify the communities' responses to the elimination of GRS because (1) GRS dollars were virtually indistinguishable from local revenues and (2) other factors, such as the recession and weak recovery, also contributed to local public service problems.

Results in Brief

The Michigan economy grew steadily each year through the economic recovery from 1982 through 1989. Despite this economic growth, the state was not able to offset growing fiscal pressures at the local level, including the loss of about $200 million in federal GRS funds beginning in fiscal year 1987. When the national and state economies weakened in 1990, Michigan faced a $310 million deficit and began making broad budget cuts. Growth in state aid slowed between fiscal year 1986 and fiscal year 1991, and for the first time in 10 years, Michigan reduced aid to local governments (by 3.5 percent adjusted for inflation) in fiscal year 1992. In addition, local communities faced a state-mandated freeze on property tax valuations for 1992.

The communities GAO studied used four strategies—improved administration, increased tax revenues, reductions in program spending, and postponement of capital investments—as fiscal coping mechanisms. These strategies were employed at different times and to different degrees. The more fiscally distressed communities—the cities of Detroit and Saginaw, and Saginaw County—had fewer options in response to lost revenues, weakened economies, and increased demands for public services. These communities had longer term structural problems and had exhausted some service cuts and revenue-raising strategies.

Detroit, Saginaw, and Saginaw County were using a combination of coping strategies for maintaining public service levels even during the state's economic growth in the 1980s. When revenues could not keep pace with expenditures, Detroit and Saginaw had to cut basic services, such as police and fire, and they began to postpone capital improvements in the early 1980s. In 1980 Saginaw County began reducing its general fund reserves and postponing capital improvements to maintain a balanced budget.

St. Clair Shores did not have the long-term structural distress of the other locations GAO visited, but still experienced mounting fiscal pressures. Voters in St. Clair Shores, displeased with the level of local taxes, changed the city charter in 1983 to reduce overall expenditures and force staffing cuts. Although growth in property tax collections is capped by the Michigan constitution, rising property values enabled St. Clair Shores to increase revenues, which offset some reductions in intergovernmental revenues. However, by 1990 St. Clair Shores' ability to maintain service levels was strained. In response, the community instituted fees for some public services, reduced library hours, reduced capital improvement projects, and delayed street and sewer projects designed to accommodate new development.

Principal Findings

Federal Aid for Local Public Services Fell in the 1980s

When domestic problems have been unresolved at lower levels of government, the federal government has often intervened through financial aid and regulation. In the 1960s and most of the 1970s, grants-in-aid spending reflected increased federal involvement in local public affairs. However, beginning in 1978, budget priorities shifted, and the federalism policies of the 1980s resulted in substantial reductions in federal aid to municipalities and counties. For example, termination of the GRS program in 1986 resulted in a loss of about $200 million to Michigan's local governments (see pp. 11-13).

State Budget Pressures Led to Cuts in Aid to Local Governments

The National Association of State Budget Officers reported in October 1991 that the weakened economy due to the recession caused states to implement several reductions, including cuts in aid to local governments. Michigan's budget plans during the 1990s included making cuts in programs, holding the line on taxes, freezing state salaries, and working toward a no-growth spending plan. Michigan's aid to local governments grew slowly between 1985 and 1991 and decreased in 1992. State assistance to local governments is tied closely with the Michigan economy, which began declining in 1990 (see pp. 19-20 and p. 23).

Communities Raise Taxes and/or Fees, but Still Have to Cut Public Services

Detroit, Saginaw, St. Clair Shores, and Saginaw County increased fees and/or raised some taxes, but the communities also had to cut public services. Because circumstances varied, some communities had to reduce expenditures and cut services sooner than others (see p. 25 and pp. 27-28).

Detroit has the highest tax burden in the state. It is the only Michigan city to have a utility tax, and its city income tax is the state's highest. Detroit also increased user fees. In fiscal year 1990, Detroit's deficit spending was about $46.5 million. For 1991 and 1992, city officials estimated the accumulated deficit would exceed $100 million. In 1991, Detroit cut 300 police positions, closed 1 of 5 health care centers, and closed 8 of 32 recreation centers. Detroit is planning additional cuts (see pp. 25 and 27).

In Saginaw, property tax rates have been frozen since 1978 as part of a property tax reform package. The city reduced its general fund reserves to keep pace with operating costs until the fund was almost exhausted in 1988 and the city faced going into receivership. Voters increased the city income tax and passed a $4 million bond issue to support buildings and parks in 1989. These actions brought the general fund balance back to between $3 and $4 million in 1990. Saginaw raised user fees for a range of services from building inspections to recreational fees. From 1980 through 1991 Saginaw downsized city government from 883 positions to 646, eliminated 18 emergency medical response positions and 34 police and fire positions, cut recreation expenditures 50 percent, and delayed equipment purchases and capital expenditures. If costs continue to rise, city officials said that they will again have to use the general fund reserves (see pp. 25 and 28).

In 1983, St. Clair Shores' voters amended the city's charter to reduce and cap the general tax rate from 16 mills to 8 mills and subsequently voted down requests for increased millage and other taxes. However, although property tax rates are capped, property tax collections have continued to rise due to higher assessed values. To raise additional revenues, St. Clair Shores raised local license and users' fees, and began charging for cleaning up gasoline spills and private sewer backups and for police time consumed in drunk driving arrests. The city also increased court fines and fees in 1991. As the recession caused further budget cuts, city officials delayed capital expenditures and reduced staffing through attrition (see pp. 25-26 and p. 28).

Saginaw County was able to maintain a balanced budget by reducing its general fund reserves through 1987. The county took several steps to reduce expenditures, including privatizing the county hospital and food service in the jail, eliminating indigent health care and park maintenance, reducing animal control and park staff, and closing a retirement facility for indigent senior citizens. In 1989 and 1990 the county increased several fees and voters approved a property tax for parks, the historical society, and recycling programs (see pp. 26 and 28).

The recession has further strained budgets, and communities predict additional service cuts (see pp. 27-28).

Recommendations

GAO is making no recommendations.

Agency Comments

As agreed, GAO did not request written comments but provided a draft of this report to officials representing the communities visited. GAO incorporated their comments as appropriate.

Contents

Figures

Abbreviations

GAO	General Accounting Office
GRS	general revenue sharing
SEV	state equalized valuation

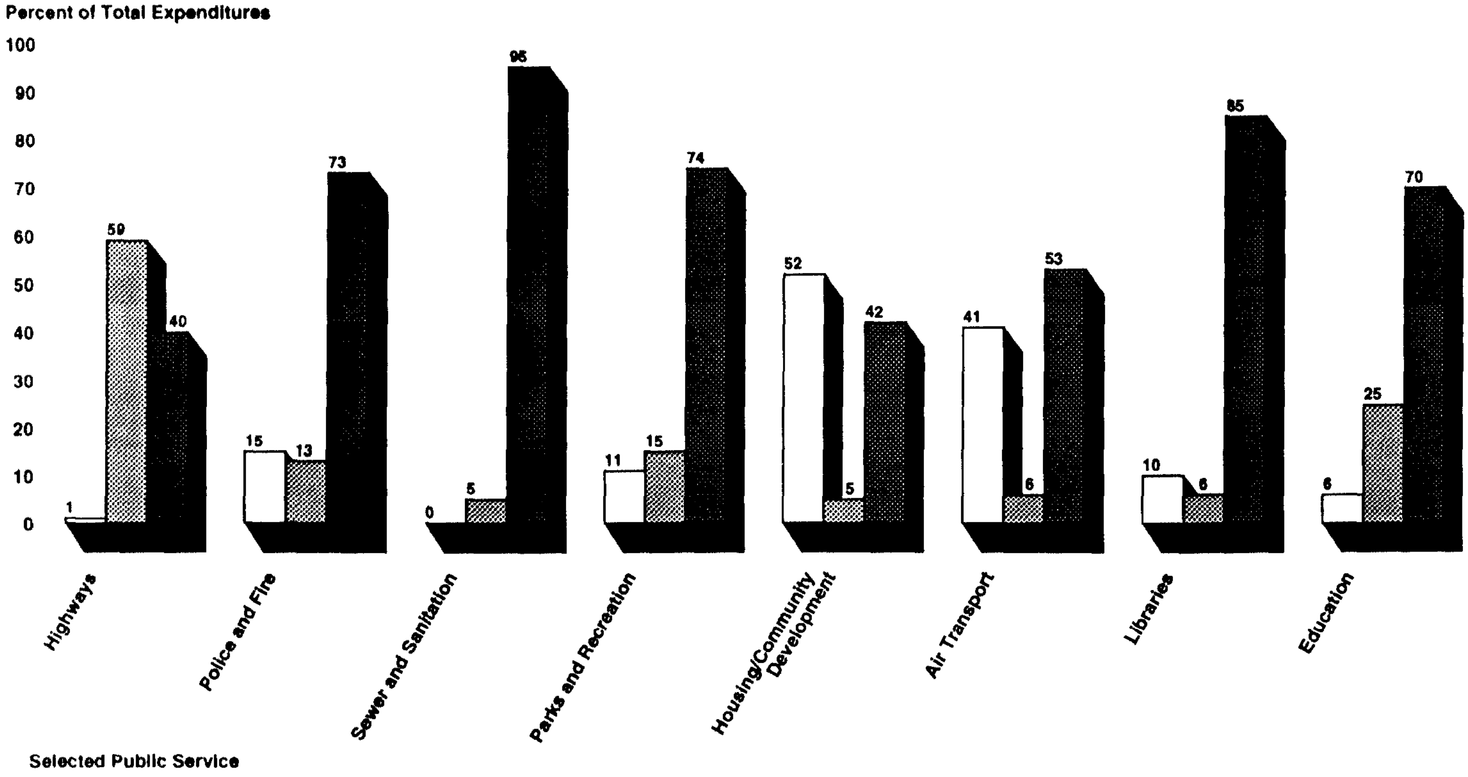
Introduction

Local governments are the workhorses of domestic policy, but they do not carry out their responsibilities alone. In our system of government, responsibilities are shared as well as divided among federal, state, and local governments. From the 1960s until the late 1970s, the federal government increased its activity in local public affairs, expanding the number and scope of federal grants-in-aid programs and increasing grant funding. As a result, general-purpose local governments, notably counties and municipalities, became more dependent on the federal government. Beginning in 1978 this trend reversed as federal aid to local governments decreased substantially. In 1986 the Congress repealed the $4.6 billion per year general revenue sharing (GRS) program. Local governments have had to adjust to shrinking federal support. Moreover, the recession and weak recovery during the last 2 years have added to the strain on local governments as many states cut aid to local governments while public service needs increased.

Local Governments Are Major Providers of Basic Public Services

Apart from a few programs, such as social security, the federal government is not a direct provider of domestic public services. Instead, the vast majority of these programs are implemented through a partnership among federal, state, and local governments. In this partnership, localities are the workhorses. In 1990, local governments led all levels of government in direct spending for police and fire protection, sewerage and sanitation, parks and recreation, air transportation, libraries, and education (see fig. 1.1.).

Figure 1.1: Percentage of Total Direct Expenditures for Selected Public Services, by Level of Government (FY 1990)



Note: Numbers may not add to 100 due to rounding.

Source: Bureau of the Census, Government Finances in 1989-90.

After Rising for Two Decades, Federal Aid to Local Governments Has Fallen

American public opinion strongly favors keeping the provision of public services at grass-roots levels. Yet public opinion has also supported federal financial and regulatory intervention, especially when problems are unresolved at lower levels of government. Problems unresolved at these levels have often spurred new federal initiatives that are reflected in federal grants-in-aid spending. Grants-in-aid spending reflected these increased federal commitments as federal aid to both state and local governments grew from the early 1960s through the late 1970s. While state revenues from the federal government have grown in most years from 1983 on, federal aid going directly to local governments has continued a decline that began in 1978. From 1978 through 1990, federal aid to state governments increased 20 percent overall, while federal aid to local governments decreased 71 percent to approximately the pre-GRS levels of the early 1970s (see fig. 1.2).

Figure 1.2: Intergovernmental Revenues to State Governments and Local Governments (1972-90)

Sources: Bureau of the Census and Bureau of Economic Analysis.

The changing federalism policies in the 1980s favored an enhanced role for states in the development and implementation of intergovernmental programs. These programs included some that had previously been federal-local.[1] Additionally, federal budget priorities favored defense and entitlement spending over programs for housing, economic development, and infrastructure. Since the latter kinds of programs were predominantly federal-local, direct aid to localities declined from 1978 through the 1980s until 1990, when measured in constant dollars per capita. Table 1.1 shows the percentage change in federal aid to local governments by program category from 1980 to 1990.

Table 1.1: Federal Aid to Local Governments (Constant 1982 Dollars Per Capita)

Type of federal aid	Fiscal year 1980	Fiscal year 1990	Percent change
Public welfare	$ 1.34	$ 1.71	27
Education	9.34	5.94	–36
GRS	25.54	0.00	–100
Highways	0.67	1.32	99
Housing and community development	20.64	24.69	20
Health and hospitals	1.14	1.30	14
Other	59.52	20.90	–65
Total	**$118.18**	**$55.86**	**–53**

Sources: Bureau of the Census and Bureau of Economic Analysis.

The Rise and Demise of GRS

Despite early congressional reservations, GRS was enacted as the State and Local Fiscal Assistance Act of 1972. Over its 14-year life, GRS provided over $82 billion to 39,000 state and local governments. Populous states, such as California, received as much as $9 billion in total aid, while rural states, such as Wyoming, received as little as $180 million. Michigan received $3.4 billion. GRS proved to be the least cumbersome and among the most popular of all federal aid programs, from the perspective of recipients. GRS served the aim of decentralization well because it gave recipients the broadest possible latitude to determine how to spend the funds.

In the 1980s, the federal government gave higher priority to federal tax cuts and reducing domestic spending than to sharing federal tax revenues with state and local governments. Moreover, by 1985, mounting federal deficits convinced the Congress that GRS—a nearly $5 billion a year item in the federal budget—was no longer viable. Neither the House nor the Senate fiscal year 1986 budget resolutions contained GRS funding, and the program ended in 1986.

[1] Federal-State-Local Relations: Trends of the Past Decade and Emerging Issues (GAO/HRD-90-34, Mar. 22, 1990).

GRS Was an Important Source of Funds for Local Public Services, Yet Measuring Its Effects Is Difficult

Virtually all evaluations of the GRS program show that its funds were used predominantly to support local public services and capital investments. For example, according to official use reports submitted to the Treasury Department, GRS helped primarily to maintain or improve local public services. A Brookings Institution monitoring study identified county spending on public transportation (roads, highways, and mass transit subsidies) as the program category most significantly affected by GRS. Public safety (police, fire, and corrections) ranked next among identifiable spending categories, followed by capital spending in primary and secondary education. Among municipalities, public safety spending was most affected. Public transportation and environmental protection (sewerage, sanitation, and water supply) ranked next.

These observations notwithstanding, precisely identifying GRS program effects on spending priorities in the communities we visited was difficult because funds were generally unrestricted. That is, GRS funds could be spent for most purposes for which the local government could legally spend its own revenues, making GRS dollars virtually indistinguishable from local revenues. We can, therefore, report the effects of GRS funds on local public services as described by local officials in the communities we visited. We cannot, however, link the loss of GRS dollars to public service problems with precision. This does not mean that general conclusions about the effect of the program's expiration cannot be drawn. The loss of such federal funds as GRS, and the recession and weak recovery, were factors contributing to general fiscal pressures that caused the public service problems we observed.

State-Local Strategies to Cope With Needs-Revenues Imbalances

Local governments can choose from a variety of coping strategies when public service needs exceed available resources. Management improvements that deliver services more efficiently and/or effectively help to maintain services with less revenue. Raising taxes is another option. In communities where tax bases are weak, this strategy is not without substantial costs to residents. It also can promote middle-class flight and exacerbate declining business investment. Other strategies—especially delays in infrastructure repair or construction or budget cuts in program staff or services—can produce a decline in public services.

States can help local governments when their public service needs exceed local revenues. Because of their superior constitutional positions, states have always been an important factor shaping local government. To varying degrees, states dictate local government structures and services, control local revenue raising, and direct administration of local programs. States also have the power to affect equity, effectiveness, efficiency, and accountability in local government institutions and public services.

Some state policies make it more difficult for communities to meet their basic public service responsibilities. Tax and expenditure limitations constrain service delivery. State-mandated programs that are not reimbursed also cause problems.

Other state policies can help. State assumption of services lifts responsibility from the shoulders of local governments. Through mandate reimbursement, states can compensate localities for the costs of oversight and administration of state regulations. [2]

Most directly, states can help local governments meet their public service responsibilities and lessen the impacts of declining federal aid through their grant-in-aid systems. However, as table 1.2 suggests, most growth in state aid was in health, public welfare, and education programs.

Table 1.2: State Aid to Local Governments (Constant 1982 Dollars Per Capita)

Type of state aid	Fiscal year 1980	Fiscal year 1990	Percent change
Public welfare	$ 49.89	$ 60.36	21
Education	293.54	328.88	12
Highways	23.14	22.89	-1
Health and hospitals	11.68	17.86	53
Other	76.25	91.59	20
Total[a]	**$454.50**	**$521.57**	**15**

[a]May include federal aid passed through to localities.

Sources: Bureau of the Census and Bureau of Economic Analysis.

According to the 1992 National Governors' Association Fiscal Survey of the States, the recession that started in the summer of 1990 and the weak recovery to date have resulted in severe fiscal strains on many state and local budgets. State revenues, which are sensitive to the economy, have been less than expected by most states. On the spending side, the economic downturn causes more people to seek assistance from the government. For example, Aid to Families With Dependent Children caseloads rose 24.1 percent from July 1989 to November 1991. Many states

[2]Legislative Mandates: State Experiences Offer Insights for Federal Action (GAO/HRD-88-75, Sept. 27, 1988).

have been forced to seek additional revenues and reduce expenditures to comply with balanced budget requirements.

Local governments are relying increasingly on local taxes, service charges, and user fees to fund their public service responsibilities. The National League of Cities reported that 85 percent of all cities it surveyed, in April and May 1991, raised or imposed new taxes or fees in the previous 12 months. Property taxes continue to be the mainstay of local government tax revenues, although their share of total local taxes has decreased from about 87 percent in the early 1960s to about 74 percent in 1990. [3]

Objectives, Scope, and Methodology

Our objectives in reporting on public services in Michigan local governments were to determine

- the condition of local public services in light of reductions in direct federal assistance to Michigan local governments and the expiration of GRS,
- the range of local government responses to these conditions, and
- whether state policies and actions have helped to offset public service problems.

To accomplish our first objective, we reviewed trends in federal-local aid and drew from our earlier research on trends in the intergovernmental system. We then visited four local governments in Michigan. We collected data on public services from local sources and state documents, and interviewed state and local officials to gain insights into local trends and conditions.

To accomplish our second objective, we examined local budgets and other relevant financial documents. We also spoke with public officials about the strategies that communities used to cope with their fiscal stress and declining federal aid.

To accomplish our third objective, we examined state aid and state policies to determine whether Michigan had replaced GRS or taken other steps to lessen the negative impacts of declining federal-local aid and the expiration of GRS.

[3] Intergovernmental Relations: Changing Patterns in State-Local Finances (GAO/HRD-92-87FS, Mar. 31, 1992).

Within Michigan, we selected the cities of Detroit, Saginaw, and St. Clair Shores, and Saginaw County—communities [4] (see fig. 1.3) that exhibited different levels of fiscal stress as indicated by socioeconomic and other statistical indicators. We also selected different sized local governments and different types of local governments (that is, cities and a county) to illustrate the impact of intergovernmental changes and economic conditions on units of government with different public service responsibilities.

As agreed, we did not request written comments but provided a draft of this report to officials representing the communities we visited. We incorporated their comments as appropriate.

We carried out our work between January and August 1992 in accordance with generally accepted government auditing standards.

[4] For purposes of this report, communities will refer to cities and counties because those local governments provide most public services (excluding education, see fig. 2.2).

Figure 1.3: Case Study Communities in Michigan

Weak Economies and Declining Aid Strain Local Public Services in Michigan

The Michigan economy grew through the economic recovery from 1982 to 1989 with increased employment and real income per capita, but declined in 1990 while the national economy slowed. Property values increased between 1982 and 1989, which is significant because Michigan communities depend heavily on property taxes to provide public services. However, not all of the state's cities shared equally in this prosperity.

Fiscal Disparities Affect Communities' Ability to Deliver Public Services

Fiscal disparities characterize the situation in which different communities tax their citizens and businesses at different levels to provide public services. This occurs because neither fiscal circumstances, financial resources, nor the need for public services are uniform across communities. Such disparities make it harder for some communities to provide adequate public services on their own. Often communities with the greatest needs have the least resources to meet them. In some communities, even very high tax rates can fail to produce revenues sufficient to meet service needs. When tax rates are already high relative to surrounding localities, raising them even higher is likely to encourage middle class flight and discourage business investment.

Michigan made economic progress over the past decade; however, this prosperity did not eliminate fiscal disparities. While Michigan's real (inflation-adjusted) income per capita grew 8.2 percent from 1979 to 1990, per capita income is about one-half the state average in Michigan's most distressed city [1] and about 4-1/2 times the state average in the least distressed city.

Another indicator of uneven economic conditions is the state's unemployment rate. The average state unemployment rate was 9.2 percent in 1991, but it varied widely among Michigan cities, ranging from 2.0 to 39.8 percent.

Fiscal disparities are also apparent among Michigan cities in the state equalized valuation (SEV) [2] per capita. SEV measures the property tax base of communities and indicates the local capacity to raise revenue through property taxes. Cities with low property values can be at a fiscal disadvantage. From 1980 through 1990, 31 of Michigan's 272 cities dropped

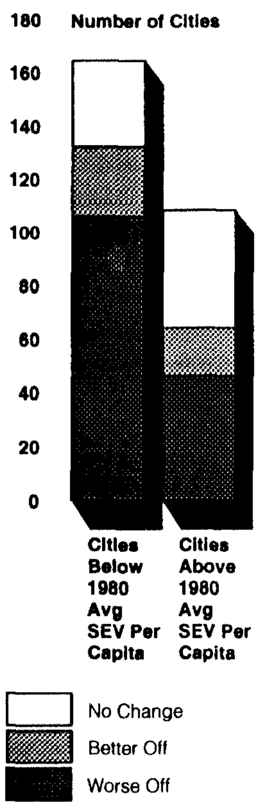
[1]Michigan ranks its 272 cities by relative level of distress using seven indicators—percentage of families below the poverty level, percentage of housing built before 1950, percentage unemployed, total taxes rate, percentage of change in state equalized valuation (SEV), SEV per capita, and income per capita.

[2]Property tax rates are applied to SEV to determine property taxes owed.

below one-third of the state average SEV per capita, [3] while only 12 rose above it.

Another measure of the widening differences in capacity to tax is illustrated by the extent to which wealthier cities became relatively better off than poorer ones compared with the average SEV per capita of all Michigan cities. As shown in figure 2.1, cities that had above average SEV per capita in 1980 were more likely to be relatively better off in 1990, while cities below the average were more likely to be relatively worse off.

Figure 2.1: Number of Michigan Cities Relatively Better or Worse Than State Average State Equalized Value Per Capita (1980-90)



Note: No change is defined as an increase or decrease in relative position of less than 5 percent. Data include villages.

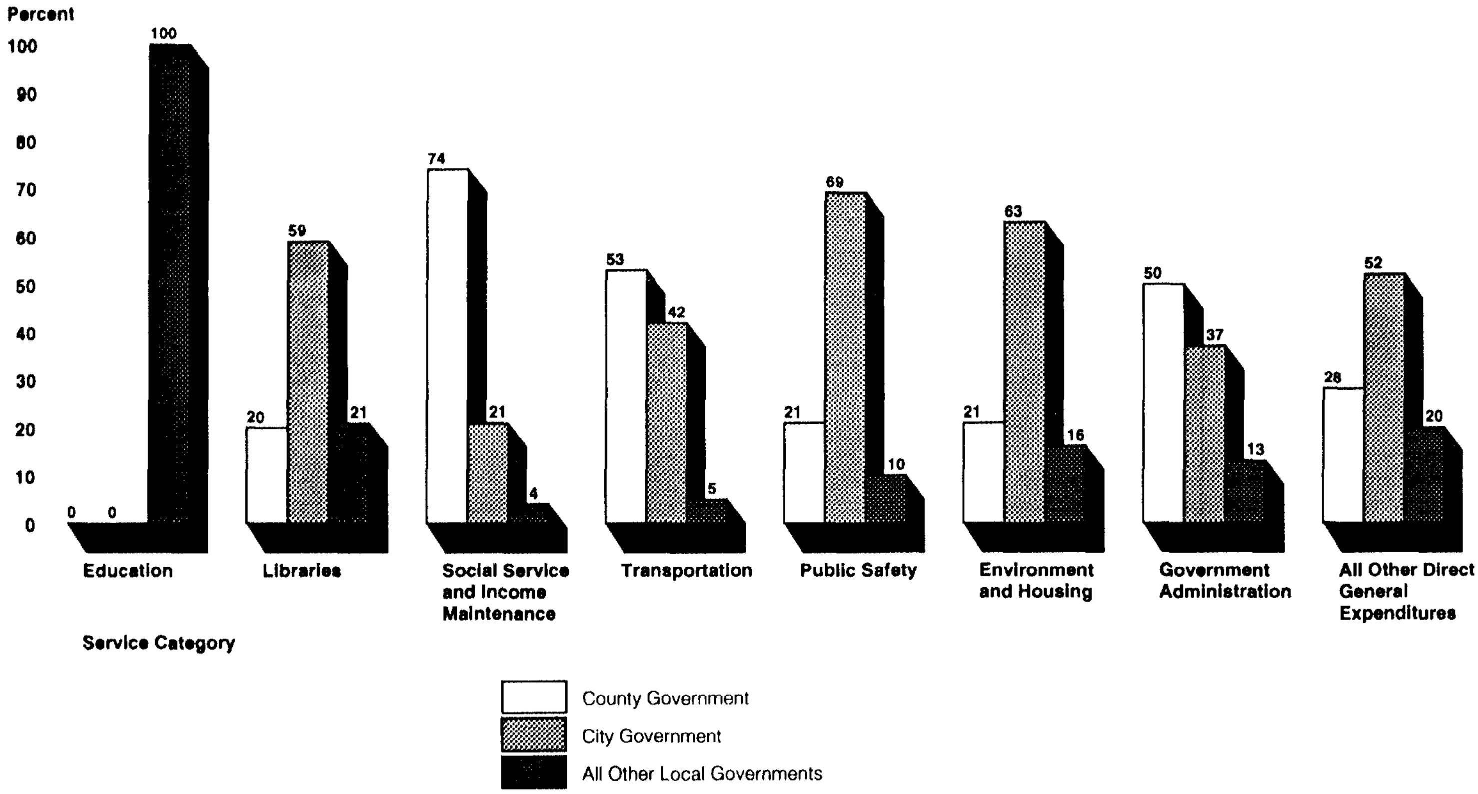
[3]While some of these cities are very small, a substantial portion of the statewide population resides in such cities. In 1990, 24 percent of Michigan's population resided in the 61 wealthiest cities (those over one-third above the state average SEV), and 31 percent resided in the 76 poorest cities (over one-third below the state average SEV).

Communities Have Significant Responsibilities but Limited Local Revenue Sources

Cities and counties in Michigan play a key role in delivering public services. In 1990, cities and counties provided 87 percent of total public services (excluding education), as shown in figure 2.2. [4] Cities are the dominant providers of police, fire, parks and recreation, libraries, and sanitation services. Counties provide primarily judicial, corrections, and health services. However, some local communities face service-delivery problems because of higher-than-average service needs, limited local revenue sources, and declining intergovernmental aid.

[4]Other local government units provide 13 percent of public services. School districts provide education, and special districts provide housing and community development and sewerage.

Figure 2.2: Percentage of Local Direct General Expenditure for Selected Services in Michigan, by Type of Government (FY 1990)



Notes: Villages are included with cities. Townships, school districts, and special districts comprise the other local governments grouping.

Numbers may not add to 100 due to rounding.

Source: Bureau of the Census, Government Finances, 1989-90.

Relief Through Property Tax Revenues Is Limited

Property tax is the single largest source of local government revenue in Michigan—contributing about two-thirds of locally generated revenue. However, the extent to which property taxes can be used to offset other revenue losses is limited in some cases. Some cities have declining tax bases and face declining local revenues unless tax rates increase. Historically, the sharpest tax rate increases have occurred in cities with the severest declines in their tax bases. But increases in tax rates can accelerate the flight of businesses and taxpayers, thereby exacerbating the community's problems.

Locations with rising property values receive more revenues, but the amount has been limited since 1978 by a state cap on inflation-induced property tax growth.[5] In addition, the state froze the SEV of existing real property at its 1991 level for 1992, reducing growth in property tax revenues at the local level.

Declining Aid Strains the Delivery of Public Services

From fiscal year 1978 to fiscal year 1990 (the latest data available), federal aid to Michigan's local governments declined, following national trends. In particular, when GRS expired, Michigan's local governments lost about $200 million annually. Michigan did not establish any programs to offset the loss of GRS funding to these governments. While many communities were fiscally strong enough to absorb these reductions, others were less able to do so.

While Michigan has long provided general aid to local governments, its general revenue sharing program (instituted in 1971) is based on collections of sales, personal income, single business, and intangible taxes.[6] As the Michigan economy slowed, funds available to local units were reduced. For example, if sales tax collections fall by 10 percent, locally shared revenues do likewise.

Communities Face Different Dilemmas in Balancing Needs and Revenues

Communities in Michigan vary widely in terms of their service needs, tax burdens, and relative distress. Some of this variation is illustrated by the socioeconomic indicators of Detroit, Saginaw, and St. Clair Shores as compared with the state average (see table 2.1).

[5]Michigan passed a constitutional amendment in 1978 that limits the growth in property taxes on existing property within a taxing entity to no more than the inflation rate increase as measured by the Consumer Price Index. Increases above this level must be voter approved.

[6]An intangible tax is a tax on interest income on wealth (other than property) and would include tax on accounts receivable, stocks, and bonds.

Table 2.1: Socioeconomic Indicators for Michigan and the Cities of Detroit, Saginaw, and St. Clair Shores

Indicator	Detroit	Saginaw	St. Clair Shores	State average
Poverty level (percentage of families 1980)	19.00	18.70	2.80	8.30
Pre-1950 housing percentage (1980)	74.30	65.10	17.10	41.20
Unemployment rate percentage (1990)	10.90	11.40	6.30	7.60
Total taxes rate (mills) (1990)	88.25	63.88	58.85	57.17
SEV percent change (1986-90)	6.00	-4.00	36.80	31.80
SEV per capita (1990)	$5,400	$7,680	$15,149	$15,051
Per capita income (1987)	$9,662	$9,178	$14,468	$11,973
Relative distress index rank (1991)[a]	4	10	220	•

[a]Michigan uses these indicators to rank the relative distress of cities. The lower the number, the more distressed that city is. Michigan does not include counties in this analysis.

A Michigan County Can Face Problems Similar to Cities

Counties have different public service responsibilities than cities, but face some of the same problems in coping with rising public service needs and declining revenues. Michigan does not rank counties on a relative distress index, but analysis of some indicators of distress show similar problems. For example, in 1991 Michigan's counties had SEVs per capita ranging from $7,346 to $38,074. Saginaw County's SEV per capita of $12,474 put it about 25 percent under the state average of $16,231.

Property taxes represented between 19 and 24 percent of general revenue in both Michigan cities and counties in fiscal year 1987 (the latest data available). However, cities can levy other taxes—such as city income tax—while counties cannot. Counties rely on fees, service charges, and miscellaneous sources [7] for most of their other local revenues. Declining state aid (tied to the slowed economy) put an added burden on budgets, such as in Saginaw County.

[7]Miscellaneous revenue sources vary among Michigan counties but include revenues from the sale of confiscated property and surplus equipment.

Local Governments' Actions Delayed, but Could Not Prevent, Public Service Cuts

At different times and to different degrees, the communities we studied increased local taxes and/or user fees, improved administration, postponed capital investments, and reduced program spending as they attempted to balance needs with resources. Spending cuts were achieved by such methods as reducing staffing, contracting out for services, and delaying equipment purchases. The four communities were able to delay most service cuts until the late 1980s or early 1990s. The nature of the cuts varied among cities, including reducing street sweeping to closing a health center.

Raising Local Taxes and Other Fees Delayed Some Service Reductions

Raising taxes and user fees helped delay some reductions in services, but the timing and size of the increases varied greatly among the four communities.

Detroit raised income and utility taxes and added a garbage tax over the last 20 years to meet expenses and maintain services. Detroit has the highest property tax rate in the state (about one and one-half times the state average in 1990).[1] Detroit established a city income tax in 1962, and raised it in 1968 and 1981. Detroit's income tax is now 2-1/2 times the state average.[2] Detroit is the only Michigan city eligible (population over 1 million) to have a utility tax. Detroit established the utility tax in 1970 and raised it in 1981. In 1977, Detroit also established a garbage tax. These tax increases helped the city maintain a balanced budget until fiscal year 1990, when service cuts became necessary.

Saginaw established a property tax in 1966. As part of a property tax reform package in 1978, property tax rates were frozen. Saginaw reduced the general fund balance to cover operating costs, but officials said that when GRS ended, the city had to make public service cuts. Another income tax increase in 1989 allowed the city to temporarily restore some services, such as restoring 10 police positions and reestablishing emergency medical services, although not to the same level as before the reductions.

A voters' mandate to cut taxes in 1983 limited St. Clair Shores' operating budget and forced it to reduce expenditures. Officials told us that the

[1]The average state property tax rate in 1990, including city, county, and school taxes, was 63.39 mills compared to 88.25 mills for Detroit. Of the 88.25 total mills, 31.00 mills goes to the city of Detroit for operating expenses. One mill equals one dollar of tax per $1,000 of State Equalized Valuation of property. SEV is 50 percent of the market value.

[2]Twenty Michigan cities have income taxes. Cities must meet legislative requirements, and voters must approve the income tax. The state average income tax is 1.2 percent for residents. Detroit has a rate of 3 percent for residents and 1-1/2 percent for nonresidents.

electorate has rejected proposals for additional taxes. Although restricted somewhat by the state constitution, rising property values in St. Clair Shores produced increased tax revenues annually. This growth and the use of other strategies helped minimize public service cuts until the early 1990s, when capital improvements were delayed and some services were reduced.

Counties are not allowed to levy an income tax; therefore, Saginaw County drew down its general fund reserve and implemented coping strategies in the 1980s. In the late 1980s the county had to make service cuts.

Raising Fees Provided Little Overall Help

The communities we studied raised fees, but in 1990 the fees represented only 3 to 5 percent of total revenues. The cities increased such fees as licenses and inspections, while Saginaw County increased such fees as court charges, deed registrations, county clerk services, and health department services.

Improved Administration Helped to Maintain Services

The four communities improved their administrative and program operations to help balance revenues and expenditures. Some improved operating efficiencies and substituted other funding sources for general fund expenditures, but all four increased reliance on private sector service providers.

To reduce expenditures, communities used the private sector to provide a wide variety of services at lower cost than would be provided using public employees. Detroit contracted for collection of parking and emergency medical service fees; some cleaning, maintenance, and security services; services at four city golf courses; and the operation of warming centers for the homeless. Saginaw contracted for the collection of parking fines, some garbage collection, and legal services. St. Clair Shores contracted for garbage collection, tree cutting services, golf course food services, and inspections for electric, heating, and plumbing. Saginaw County contracted for county jail food services, county hospital operations, mental health foster care homes, economic development activities, and janitorial services.

Postponing Capital Investments Was of Limited Long-Term Help

The communities postponed capital investments to cope with immediate budget pressures and maintain public services; however, these postponements were of limited long-term help.

Detroit issued bonds to fund capital investments except for the period 1980 to 1986, when the city lost its investment grade bond rating. During those years, Detroit used its general fund for capital expenditures, such as street lighting. Annual capital expenditures during that period were only \$2 to \$3 million, compared with about \$12 million in capital expenditures funded by bonds in 1987.

Saginaw postponed capital investments in the 1980s by delaying fire truck purchases and building repairs. In the early 1990s, Saginaw also postponed resurfacing roads to help enable maintenance of other public services.

In its effort to maintain services, St. Clair Shores in 1991 postponed street, water, and sewer projects aimed at economic development, expansion, and modernization. In 1992 and 1993, St. Clair Shores plans to postpone updating air conditioning and heating systems in city buildings, repairing roofs, and improving its ice rinks.

Saginaw County postponed capital investments as early as 1980, shifting the funds to maintain services. Between 1980 and 1992, the county postponed such investments as new jail construction, renovations to the health and human services building, purchases of automated police equipment, and replacement of emergency response equipment.

Despite postponing capital investments, all four communities made public services cuts in the late 1980s and/or early 1990s.

Cutting Programs and Basic Services Became Necessary

As budget pressures mounted, raising revenues, improving administration, and postponing capital improvements did not prevent service cuts. The communities made a wide variety of service cuts to cope with the effects of declining revenues due to the slow economy and other factors, such as the loss of GRS.

Detroit had difficulty balancing its budget, and in 1991 the city laid off 300 police officers, closed 8 of its 32 recreation centers, and closed 1 of its 5 health centers. A budget official told us that additional cuts are proposed as Detroit is in its third year of deficit spending in 1992.

Saginaw eliminated 18 emergency medical response positions, eliminated 34 police and fire positions, and cut recreation expenditures 50 percent in 1987. When the city raised the city income tax in 1989, it restored some services. However, emergency medical response teams were replaced with emergency first responders, who cannot provide the wide range of medical care previously provided. City officials said that the city restored 10 police positions because the crime rates had risen significantly. However, officials are concerned that fiscal pressures will force them to further reduce these services in the future.

St. Clair Shores discontinued the free cleanup of private sewer backups in 1986. In 1991, the city reduced street sweeping from seven or eight times annually to two or three times annually. Possible cuts of temporary staff in 1992 would reduce recreation services in such areas as parks, the senior citizens' center, and ice rinks.

Between 1989 and 1991, Saginaw County eliminated indigent health care, which shifted costs to hospitals; closed a 120-bed facility serving indigent senior citizens; and eliminated park maintenance. Other service cuts are planned as fiscal pressures mount.

Additional Funding Could Restore Some Services

All four communities told us that they could spend any additional funding immediately.

Detroit's priorities included restoring at least the 300 police officers laid off in 1991, reopening some recreation centers, and providing additional funds for the city's substance abuse agency.

Saginaw would use additional funding for maintaining 10 police positions, which may have to be cut again in the near future; repairing a downtown parking ramp critical to economic stability; cleaning up landfill problems; and supporting recycling.

St. Clair Shores' priority uses for additional funds include repairing streets and sewers, improving and repairing city buildings and parks, restoring police positions, and replacing and upgrading police and other city equipment.

Saginaw County's priorities include building a new jail, a new 911 center for emergency services, and a new senior citizens' center. Additionally, the

County would develop a treatment program for AIDS,[3] which is a major problem in the county, and a solid waste and recycling program to relieve growing landfill problems.

Conclusions

Although the loss of GRS contributed to local fiscal problems, a weak economy and state actions, such as a decline in the percentage of state aid and implementation of a freeze on property tax assessments, were also significant contributors to the fiscal problems and public service cuts we observed. Michigan did not take steps to offset the loss of GRS and, faced with its own budget constraints, slightly reduced state revenue sharing to local governments in fiscal year 1992. Communities had to cope with budget problems largely on their own. Implementing coping strategies helped delay public service cuts until the late 1980s and early 1990s. Although the communities had different priorities should additional funds become available, most would restore some previously reduced services and fund postponed capital investments.

[3]Acquired immunodeficiency syndrome.

Data Supporting Figures in Report Text

Table I.1: Intergovernmental Revenues to State Governments and Local Governments (1972-90) (Data for fig. 1.2)

	Billions of 1982 dollars	
Fiscal years	To state governments	To local governments
1972	$61.6	$13.7
1973	63.2	23.2
1974	58.4	23.0
1975	61.2	24.5
1976	80.9	28.4
1977	75.9	34.2
1978	70.7	38.1
1979	72.1	35.0
1980	74.5	30.8
1981	74.1	27.1
1982	63.8	22.4
1983	64.3	24.1
1984	67.5	22.4
1985	70.3	22.7
1986	74.0	23.0
1987	72.5	17.4
1988	74.8	16.6
1989	76.8	16.3
1990	84.8	11.2

Sources: Bureau of the Census and Bureau of Economic Analysis.

Table I.2: Number of Michigan Cities Relatively Better or Worse Than Average State Equalized Value Per Capita (1980-90) (Data for fig. 2.1)

	Number of Cities		
	Worse off	Better off	No change
Cities below 1980 avg SEV per capita	106	26	32
Cities above 1980 avg SEV per capita	46	18	44

Note: No change is defined as an increase or decrease in relative position of less than 5 percent. Data include villages.

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