State Notes
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Distributional Effects of the Decline in Statutory Revenue Sharing to Cities, Villages, and Townships
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State revenue sharing provides payments of State revenue to eligible local governments. There are two basic types of revenue sharing programs: constitutional and nonconstitutional (often called "statutory") revenue sharing. Funding for nonconstitutional formula revenue sharing for cities, villages, and townships (CVTs) has declined 69.0% from the peak appropriation of $797.3 million in fiscal year (FY) 1997-98. Although appropriations for formula statutory revenue sharing for CVTs increased from the FY 2011-12 low point of $210.0 million to $248.8 million in FY 2014-15, and eligibility was expanded in FY 2014-15, only 587 out of 1,773 CVTs are eligible for statutory revenue sharing today, compared with FY 2000-01 when all CVTs received statutory revenue sharing. Eligibility and nonconstitutional revenue sharing payments to CVTs are still influenced by statutory revenue sharing reforms of 1998 (which were only partially implemented), the relative tax effort formula in effect prior to those reforms, and the methods used for implementing reductions in revenue sharing appropriations. Considering statutory and constitutional revenue sharing payments together is important to understanding the distribution of State revenue sharing appropriations. Although under current budget bill boilerplate 1,183 CVTs are no longer eligible for statutory revenue sharing, those local units receive a larger share of total revenue sharing appropriations than they did in FY 2002-03 due to the growth in constitutional revenue sharing relative to statutory revenue sharing payments.

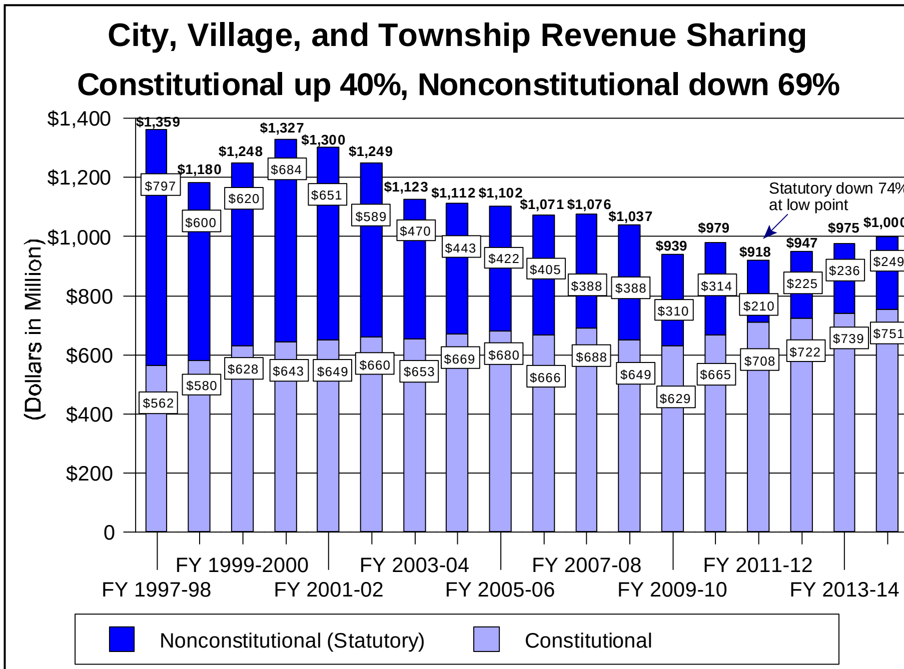
Background

Constitutional revenue sharing pays 15.0% of collections from the sales tax levied at a 4.0% rate to cities, villages, and townships, distributed on a per capita basis. (The remaining 2.0% of the 6.0% sales tax is deposited in the School Aid Fund.) All CVTs receive these payments, which were approximately $76.19 per capita in FY 2014-15. Counties are not eligible for constitutional revenue sharing. Nonconstitutional revenue sharing for cities, villages, and townships currently is established annually in budget bill boilerplate. The sales tax earmark for statutory revenue sharing remains in statute and is subject to appropriation. The sales tax earmark is not effective because the funds have not been appropriated. The statutory formula for distributing nonconstitutional CVT revenue sharing expired in FY 2006-07 and had not been fully funded since FY 2000-01.

Previously, a CVT received a greater portion of revenue sharing payments as its millage increased relative to the statewide average. In the 1990s, there were growing concerns about the revenue sharing formula, including that this "relative tax effort formula" gave an incentive for local governments to ask voters for increased millage rates. After lengthy review, a revised revenue sharing formula was adopted in 1998. The 1998 formula was intended to replace the relative tax effort formula after a phase-in period from FY 1998-99 to FY 2006-07. Only three years or 30.0% of the phase-in was completed. Fiscal year 2000-01 was the last year that the earmark under the 1998 formula was fully funded for CVTs. Payments that year became the starting point for a series of cuts to statutory revenue sharing. The history of appropriations for statutory revenue sharing to CVTs is shown in Figure 1. At the low point, statutory revenue sharing appropriations were $210.0 million in FY 2011-12, 73.7% below the peak program funding. At that point, the number of eligible local units also had declined by 72.6%. During the same period, the appropriations for constitutional revenue sharing grew in most years. Since FY 1997-98, constitutional revenue sharing has increased 40.0%.

This history of growth in constitutional revenue sharing that is received by all CVTs and the method by which declines in the statutory revenue sharing program were implemented still influence eligibility and payment amounts today.

Figure 1



Source: Senate Fiscal Agency

Reduction Method Limited Eligibility

Beginning in FY 2003-04, legislation implemented the reductions in statutory revenue sharing by specifying a uniform percentage reduction that each CVT would receive in the *total* of its statutory and constitutional revenue sharing payments compared with its prior-year allocation. This applied an equal percentage reduction to revenue sharing payments to all CVTs. It was considered a fair way to implement the reductions because most CVTs experienced an equal percentage reduction in total revenue sharing payments.

Over time, however, the percentage reductions to local units could not stay equal using this method. The constitutional portion of a CVT's payment could not be reduced. In fact, in most of the years since FY 2003-04, the constitutional revenue sharing payments grew as sales tax revenue continued to increase. Any payment reduction had to come from the statutory payment. For local units that had relatively small statutory payments relative to the size of their constitutional payments, the statutory payment could be reduced to zero, then reduced no farther. At that point, some CVTs began receiving only constitutional revenue sharing payments, which introduced deviations in percentage increases and decreases among different local units.

This can be seen in a comparison of the total revenue sharing payments to four local units of government: Detroit, Chelsea, Milton Township, and Chikaming Township. Milton and Chikaming each last received statutory revenue sharing payments in FY 2002-03, although they differ in that

Milton had population growth in the 2010 U.S. Census, while Chikaming experienced population loss. Detroit and Chelsea both continually received statutory revenue sharing, but Chelsea had population growth in 2010 while Detroit had population loss. This is summarized in Table 1.

Table 1

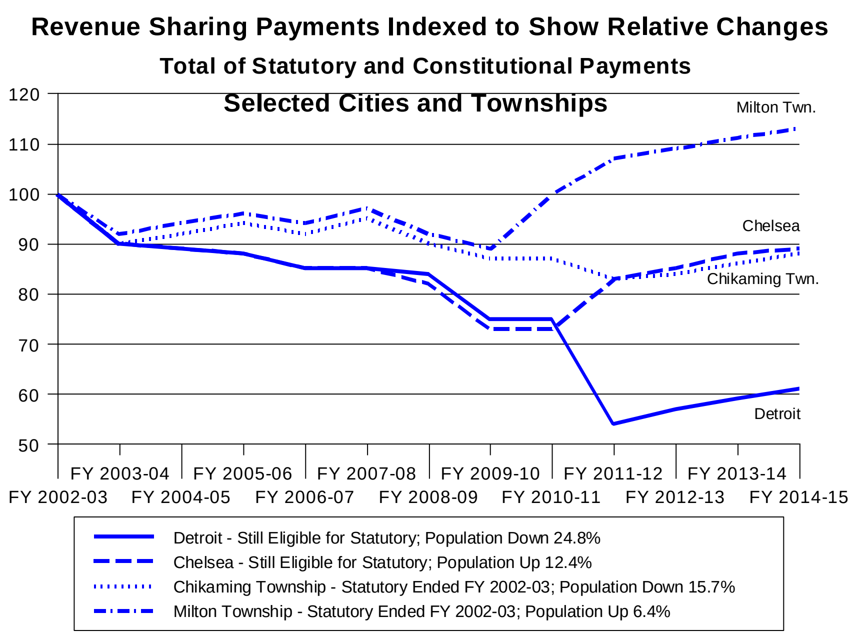
Population Change and Statutory Revenue Sharing Status For Selected Local Governments

	2010 Population Increase/(Decrease)	Still Receives Statutory
Chelsea, Washtenaw County	12.4%	Yes
Detroit, Wayne County	(24.8)%	Yes
Milton Township, Antrim County	6.4%	No; last payment in FY 2002-03
Chikaming Township, Berrien County	(15.7)%	No; last payment in FY 2002-03[a)]

a) Chikaming received a census adjustment payment in FY 2010-11.

Figure 2 compares the statutory and constitutional revenue sharing payments to these four local units of government. The payments are compared on an index, to show the relative changes in the payments from year to year. In FY 2002-03, the base year for this chart and for the percentage reductions, these four CVTs all received both constitutional and statutory revenue sharing payments. Neither Milton nor Chikaming received a statutory revenue sharing payment after FY 2002-03 (except for a census adjustment payment to Chikaming in FY 2010-11). Although revenue sharing reductions began in FY 2001-02, FY 2002-03 is used for the base year for these comparisons because it was the base for the equal percentage reductions that followed for most years from FY 2003-04 to FY 2009-10.

Figure 2



Source: Senate Fiscal Agency

The impact of the equal percentage reductions in the total of statutory and constitutional revenue sharing payments shows in FY 2003-04. Both Chelsea and Detroit received a 10.0% cut in the total of statutory and constitutional revenue sharing from FY 2002-03 to FY 2003-04. Neither Milton Township nor Chikaming Township received statutory revenue sharing beginning in FY 2003-04, but Chikaming had a larger percentage reduction in FY 2003-04 than Milton, because Chikaming's statutory payment was a larger share (9.9%) of its total revenue sharing payment in FY 2002-03, compared with Milton's (7.9%). In percentage terms, the reduction for Chikaming was almost as significant as that for Detroit and Chelsea.

From FY 2003-04 to FY 2009-10, the payments for Milton and Chikaming moved together, either increasing or decreasing, with the changes in constitutional revenue sharing. In FY 2010-11, the new 2010 population figures were used for revenue sharing payments for the first time. Here the lines for Milton and Chikaming diverge. Milton's population grew 6.4% from 2000 to 2010 and its constitutional revenue sharing payments increased in FY 2010-11 due to both sales tax growth and the once-in-a-decade implementation of new population data. Chikaming Township had a decline in population of 15.7%. To cushion the drop in payments, statutory revenue sharing payments in FY 2010-11 included an additional amount to local units that otherwise would have seen a decline in the total of constitutional and statutory revenue sharing from FY 2009-10 to FY 2010-11. This one-year census adjustment payment protected Chikaming from the decline in FY 2010-11; however, the decrease in constitutional revenue sharing payments to Chikaming was effective in FY 2011-12. After the implementation of the population adjustments, the paths for Milton and Chikaming continued to move together with changes in constitutional revenue sharing.

From FY 2003-04 to FY 2007-08, payments to Chelsea and Detroit declined together as equal percentage reductions in the total of statutory and constitutional revenue sharing payments continued. A one-year adjustment in FY 2008-09 that paid an additional 2.0% of a CVT's prior-year statutory payment caused the paths of these two cities to diverge. The impact of this payment on a CVT's total payment varied depending on the relative size of the local unit's statutory and constitutional payments. Fiscal year 2009-10 returned to the policy of equal percentage reductions in the total of statutory and constitutional revenue sharing payments.

In FY 2010-11, U.S. census data from 2010 were used for the first time to calculate constitutional revenue sharing payments. The budget for that fiscal year set statutory revenue sharing such that each CVT received 100% of the total of its FY 2009-10 statutory and constitutional payments (or a lower percentage of that total, if constitutional revenue sharing in FY 2010-11 was less than initially estimated, which was not the case). This resulted in the payment of additional statutory payments called census adjustment payments to local units that had declining population, whether they were otherwise eligible for statutory revenue sharing or not. For a local unit that had increasing population and still received statutory revenue sharing, the statutory revenue sharing payment was reduced for one year by the amount of the increase in constitutional revenue sharing. Figure 2 shows that Chikaming Township (as mentioned previously), Chelsea, and Detroit all had total payments in FY 2010-11 equal to those in FY 2009-10. Detroit's (and Chikaming's) statutory revenue sharing was increased for one year to make up for the impact of declining population on its constitutional payment. For Chelsea, its population grew, which increased its constitutional payment and decreased its statutory payment. Due to the payment anomalies introduced by the FY 2010-11 census adjustments, FY 2009-10 has been the base year for determining statutory revenue sharing payments to individual CVTs in the budgets for FY 2011-12 to FY 2015-16.

The Economic Vitality Incentive Program and Subsequent Program Changes

In FY 2011-12, statutory revenue sharing was changed to the Economic Vitality Incentive Program (EVIP), which required compliance with certain reporting and planning requirements in order for a local government to receive full payment. The total appropriation for statutory revenue sharing was reduced 33.3% in FY 2011-12 and additional local units (those that had received a statutory payment of less than $4,500 in FY 2009-10) became ineligible for the program. This reduced the number of local units eligible for the program from 558 in FY 2009-10 to 486 in FY 2011-12. Eligibility remained stable in FY 2012-13 and FY 2013-14.

The program name, eligibility, and formula were revised again in FY 2014-15. The renamed City, Village, and Township Revenue Sharing program extended eligibility to all CVTs with a population of more than 7,500 in addition to those CVTs that had received a statutory revenue sharing payment of more than $4,500 in FY 2009-10. This revision made an additional 101 local units (100 townships and one city) eligible for statutory revenue sharing payments. The payment formula also was revised to add a per capita component. Each eligible CVT that complied with accountability and transparency requirements received the greater of 78.51044% of its FY 2009-10 payment or $2.64659 per capita.

In FY 2014-15, 12 years after leaving statutory revenue sharing, Milton Township received 113% of its FY 2002-03 payments, benefitting from its population gain and a 13.7% increase in sales tax collections over this period. In contrast, Chikaming, which lost statutory revenue sharing the same year, received only 88.0% of its FY 2002-03 amount in FY 2014-15. This decline was due to the township's population loss in the 2010 census, a portion of which was offset by sales tax growth that increased the per capita amount paid for the remaining population.

For Detroit and Chelsea, their greater reliance on statutory revenue sharing caused them to take larger cuts in total payments from FY 2003-04 to FY 2009-10. By FY 2009-10 and before the implementation of the 2010 census data, Detroit was receiving only 75.0% of its FY 2002-03 payments and Chelsea only 73.0%. The impact of a 24.8% reduction in population from 2000 to 2010 combined with a 33.3% reduction in statewide appropriations for statutory revenue sharing, cut Detroit's total revenue sharing in FY 2011-12 to nearly half (54.0%) of what it had been in FY 2002-03. Chelsea fared much better in FY 2011-12 due to its 15.7% population growth. In FY 2014-15, Chelsea's total revenue sharing was 89.0% of its FY 2002-03 amount, slightly higher than Chikaming Township's and well above Detroit's 54.0%.

Distribution of Revenue Sharing Reductions

The impact of the cutbacks in statutory revenue sharing has affected every local unit since FY 2000-01. The severity of the State cuts has been mitigated for CVTs with growth in population that increased their constitutional revenue sharing. Local units that received proportionally less statutory revenue sharing in the early part of the 2000s also have fared better. These were the units that did not do as well under the 1998 reform and the prior relative tax effort system. They typically had taxable value per capita higher than the statewide average and/or lower than average millage rates. These CVTs also have experienced cuts, but because the statutory revenue sharing payments were a smaller part of their total, the growth in constitutional revenue sharing has reduced the impact of the statutory revenue sharing cuts. This is illustrated in Table 2, which shows the distribution of cities, villages, and townships in terms of the relationship of their FY 2013-14 revenue sharing payments compared to their payments in FY 2002-03. This compares the distribution prior to the expansion of statutory revenue sharing in FY 2014-15.

Table 2

Total of Constitutional and Statutory Revenue Sharing Payments
Distribution of Payment Changes from FY 2002-03 to FY 2013-14

Constitutional Plus Statutory FY 2013-14 As a Percent of FY 2002-03	Number of Cities	Number of Villages	Number of Townships	Total Local Units	Average Population Percent Change	Statutory Recipients in FY 2013-14[a]	New Statutory Recipients in FY 2014-15[a]
Under 70%	34	45	11	90	(16.3%)	62	3
70% to 79%	167	129	44	340	(5.2)	280	0
80% to 89%	60	50	226	336	(3.5)	103	14
90% to 99%	14	19	439	472	(0.3)	27	27
100% to 109%	1	7	324	332	6.0	5	21
110% or More	3	4	196	203	21.6	3	40
Total	**279**	**254**	**1,240**	**1,773**		**480**	**105**

[a] The counts are based on actual payments to recipients. In FY 2013-14, 486 local units were eligible for statutory revenue sharing; however, six did not qualify for any payment. In FY 2014-15, 101 local units were newly eligible, but several other local units qualified for payments for the first time.

The table shows how the changes in revenue sharing from FY 2002-03 to FY 2013-14 (before the expansion of eligibility in FY 2014-15) affected cities, villages, and townships. There are CVTs in each distributional category, so it is not easy to make general statements that hold true by type of local unit. However, with 75.1% of all revenue sharing appropriations distributed on a per capita basis through constitutional revenue sharing in FY 2014-15 compared with 45.5% in FY 2002-03, CVTs with increasing population have fared better than other local units with flat or declining population. For CVTs that received over 110.0% of their FY 2002-03 payment in FY 2013-14, all local units in that category had an increasing population. Only three of the CVTs that fared the best since FY 2002-03 received statutory revenue sharing in FY 2013-14. In contrast, of the 90 CVTs that fared the worst since FY 2002-03 and receive payments less than 70.0% of what they received at that time, 89 had a declining population and 62 were eligible for statutory revenue sharing. The situation of local units in the middle groups, those with payments in FY 2013-14 between 70.0% and 110% of the FY 2002-03 amount, is more complicated, with changes depending on the relative impact of population changes and the share of statutory payments as a share of total revenue sharing.

In FY 2014-15, statutory revenue sharing was expanded to add 101 local units to eligibility. These local governments, however, are not necessarily the ones that were most hurt by the declines in statutory revenue sharing. Sixty-one of the newly eligible local units were already receiving more total revenue sharing in FY 2013-14 than they had received in FY 2002-03, placing them in the top 30.0% of CVTs in terms of payment growth.

Local units that no longer receive any statutory revenue sharing received a greater share of total State revenue sharing appropriations in FY 2014-15 than they received in FY 2002-03. The share of total revenue sharing received by these local units increased from 13.6% in FY 2002-03 to 17.1% in FY 2014-15 as constitutional revenue sharing with its straight per capita distribution has become the primary method of distributing State revenue sharing dollars. In FY 2002-03, 52.9% of revenue sharing was distributed through constitutional revenue sharing. In FY 2014-15, constitutional revenue sharing was 75.1% of total CVT revenue sharing. Given the significance of constitutional revenue sharing, CVTs with population growth from 2000 to 2010 were more likely to receive larger total revenue sharing payments in FY 2013-14 than in FY 2002-03.

A Note on Statutory Revenue Sharing in FY 2015-16

The enacted budget for FY 2015-16 maintains the eligibility and distribution formula in effect for FY 2014-15. The appropriation of statutory revenue sharing is $248.8 million in FY 2015-16, the same amount as in FY 2014-15.

Conclusion

The reductions in statutory revenue sharing since FY 2000-01 affected all CVTs. If the funds had been available and appropriated for this purpose according to the statutory formula in effect through FY 2006-07, all CVTs would have received more State funding than actually was paid. Given that this was not the case, the distributional impacts of the cuts that were made can inform revenue sharing policies.

The degree to which a local unit's total revenue sharing payments have been reduced since 2002-03 depends on the size of a local unit's statutory payment that year relative to its total revenue sharing payment (statutory plus constitutional) and the change in the local unit's population at the 2010 census. The interaction of these factors and the method of reducing revenue sharing payments used from FY 2003-04 to FY 2008-09, mean that individual CVTs have had quite different changes in total revenue sharing between FY 2002-03 and FY 2014-15. The earlier that a local unit lost statutory revenue sharing, the more it was insulated from the cuts to that program by growth in sales tax revenue and thus constitutional revenue sharing payments. Units that were no longer eligible for statutory revenue sharing received a greater share of total revenue sharing payments in FY 2014-15 (17.1%) than they received in FY 2002-03 (13.6%). Those CVTs that received higher statutory payments under the prior statutory revenue sharing formulas (due to higher tax effort and lower than average taxable values) experienced the greatest cuts. Constitutional revenue sharing now constitutes 75.1% of all CVT revenue sharing. Local units with population growth measured in the 2010 census generally have had the greatest growth in total revenue sharing.

The expansion of eligibility for statutory revenue sharing in FY 2014-15 was facilitated by the appropriation of $5.8 million to cover the increased payments due to per capita payments under the statutory program. If appropriations for statutory revenue sharing remain constant, expanding eligibility or revising the formula to increase payments for any one set of local units would reduce payments to another group. The phase-in of any distributional changes would need to be considered as would the ability of local units to absorb payment reductions. Cities, villages, and townships that have experienced declining taxable values as well as declining revenue sharing payments may have comparatively less ability to raise local revenue to cover any shortfall. Many alternative policies could be considered, but the choice depends on the goals of the revenue sharing program, how "fairness" is defined, and what is determined to be the best use of State funds available for statutory revenue sharing.