Senate Fiscal Agency

State Notes

TOPICS OF LEGISLATIVE INTEREST

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DISTRIBUTIONAL IMPACTS OF REVENUE SHARING CUTS

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Article IX, Section 10 of the Michigan Constitution of 1963 requires the State to distribute 15% of sales tax revenues collected at a 4% tax rate to cities, villages, and townships on a population (per capita) basis.[1] The Legislature also supplements these constitutional revenue sharing payments with additional funds, referred to as statutory revenue sharing payments. Statutory revenue sharing includes counties among the local units of government that may receive payments, and the payments are distributed through a set of formulas that have changed over the years. Public Act (P.A.) 532 of 1998, the current law governing how statutory revenue sharing payments are to be distributed, fundamentally revised the way the State distributed revenue sharing payments to local units of government, beginning with fiscal year (FY) 1998-99. Prior to the changes, statutory revenue sharing payments were distributed under three mechanisms: a per-person formula, an inventory reimbursement formula, and a relative tax effort formula. The new mechanism in P.A. 532 distributes revenue sharing payments through three equally weighted formulas: a population-type formula, an inverse taxable value formula, and a yield equalization formula. To ease the transition to the new formulas, P.A. 532 phases them in over a 10-year period. (That is, the portion of statutory revenue sharing payments based on the new formulas ranges from 10% in FY 1998-99 to 90% in FY 2006-07.)

Statutory revenue sharing payments are subject to appropriation by the Legislature. The current statute places a cap on the amount of money that can be distributed through statutory revenue sharing payments, at an amount equal to 21.3% of sales tax collections at a 4% tax rate. (Combined with constitutional payments, maximum revenue sharing payments equal 36.3% of sales tax collections at a 4% tax rate.) This amount is often referred to as "fully funded" revenue sharing payments. In many years, the Legislature has not appropriated the "fully funded" amount to revenue sharing payments, effectively providing the General Fund with additional unrestricted revenues (if the amount collected for statutory revenue sharing exceeds the amount appropriated). In most years since FY 1989-90, revenue sharing payments have been below the "fully funded" amount (Table 1). For FY 1998-99 and later, P.A. 532 provides that any reductions from "fully funded" revenue sharing payments must reduce payments made under the new distribution formulas before reducing any other statutory payments. In other words, the amount available for statutory revenue sharing must be distributed first under the old formula (subject to the applicable ratio under the formula phase-in schedule). The balance is distributed according to the new formula.

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[1]Although the sales tax rate was increased from 4% to 6% in 1994, the revenue sharing requirement does not apply to the revenue collected from the additional 2%.

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Table 1
Fully Funded and Actual Restricted Revenue Sharing Payments
Actual FY 1989-90 through Estimated FY 2002-03
(millions of dollars)

Fiscal Year	Estimated Fully Funded	Percent Change	Actual Restricted	Percent Change	Enacted Reductions
1989-90	$1,029.0		$1,029.0		$0.0
1990-91	1,028.0	(0.1)%	1,017.3	(1.1)%	(10.7)
1991-92[a)]	1,038.5	1.0%	926.3	(8.9)%	(112.2)
1992-93	1,078.0	3.8%	1,032.5	11.5%	(45.5)
1993-94	1,166.1	8.2%	1,111.6	7.7%	(54.5)
1994-95	1,236.1	6.0%	1,169.1	5.2%	(67.0)
1995-96	1,342.2	8.6%	1,260.9	7.9%	(81.3)
1996-97	1,300.9	(3.1)%	1,300.4	3.1%	(84.6)
1997-98	1,359.8	4.5%	1,359.2	4.6%	0.0
1998-99	1,404.4	3.3%	1,380.7	1.5%	(23.6)
1999-2000	1,520.8	8.3%	1,462.5	5.9%	0.0
2000-01	1,555.5	2.3%	1,555.5	6.4%	0.0
2001-02[b)]	1,586.6	2.0%	1,523.6	(2.0)%	(63.0)
2002-03[b)]	1,644.2	3.6%	1,523.6	0.0%	(120.6)

a) In FY 1991-92 the reduction affected the State but not local units because of different fiscal years. Due to forward funding, $112.2 million was shifted into the State's next fiscal year, but was only postponed for local units.
b) Estimated

The phase-in of the new formulas was intended to smooth the change in the distribution formulas, since the distribution of revenue sharing payments between local units is significantly different between the old and new mechanisms. Under the old distribution formula, local units tended to receive more if their tax rates were relatively high, while under the new distribution mechanism a wide variety of factors affects how much a local unit will receive, with population being the most important factor. Payments under the population-type formula rise with an increase in population, while payments under the inverse taxable value formula increase if population increases or if taxable value falls. Payments under the yield equalization formula rise with increases in tax rates, up to 20 mills, or with decreases in taxable value. Consequently, high tax rate units fared best under the old formula, while high population-low taxable value units fare best under the new system.

In FY 1997-98, revenue sharing payments were “fully funded” for a total of $1,361.5 million, compared with an estimated FY 2002-03 "fully funded" amount of $1,644.2 million and actual restricted revenue sharing funding of $1,523.6 million (Table 2). In aggregate, total “fully funded” revenue sharing payments (constitutional plus

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statutory) will have increased 20.8% and actual payments will have grown 11.9% between FY 1997-98 and FY 2002-03, while “fully funded” statutory payments will have increased 20.8% and actual statutory payments will have risen 5.6%. To illustrate the distributional changes from moving to the new formula, if FY 2002-03 revenue sharing payments were “fully funded”, statutory payments to Chelsea Township in Washtenaw County would be 17.0% lower in FY 2002-03 than in FY 1997-98, while statutory payments to Sheridan Township in Clare County would be 889.8% higher.

Table 2
Revenue Sharing Payments, FY 1997-98 to FY 2002-03 Distribution Between Major Formula Components & Comparison with "Fully Funded" Amounts
(millions of dollars)

	FY 1997-98	FY 1998-99	FY 1999-2000	FY 2000-01	Est. FY 2001-02	Est. FY 2002-03
Constitutional	$561.9	$580.3	$628.4	$642.8	$655.6	$679.4
Statutory						
Counties	$200.6	$200.6	$214.3	$228.7	$217.5	$211.5
Cities, Villages & Townships	$597.3	$599.8	$619.4	$684.0	$650.5	$632.6
Old Formula	$597.3	$582.8	$587.9	$560.5	$527.0	$495.9
New Formula	$0.0	$17.0	$31.6	$123.5	$123.4	$136.7
Statutory Total	$797.9	$800.4	$833.7	$912.7	$868.0	$844.2
Restricted Total	$1,359.8	$1,380.7	$1,462.1	$1,555.5	$1,523.6	$1,523.6
"Fully Funded" Amount	$1,359.8	$1,404.3	$1,520.7	$1,555.5	$1,586.6	$1,644.2
Enacted Reductions	$0.0	($23.6)	$0.0	$0.0	($63.0)	($120.6)
Effective Reductions[1)]	$0.0	($23.6)	($58.6)	$0.0	N/A	N/A
Percent of Statutory Payments to Cities, Villages & Townships (Excl. Detroit) Distributed Under New Formula						
Statutory Requirement[2)]	0.0%	10.0%	20.0%	30.0%	40.0%	50.0%
Actual	0.0%	5.2%	8.9%	30.0%	32.5%	37.6%

1) Effective reductions are the difference between "fully funded" revenue sharing payments and what was appropriated based on receipts once all revenues had been collected. In contrast, enacted reductions are the difference between the appropriated amount and the forecast of "fully funded" revenue sharing payments at the time the appropriation was made.
2) Excluding appropriation limit.

As noted above, reductions in statutory revenue sharing payments are first subtracted from the new distribution formulas. Therefore, such reductions have two effects: 1) they change the distribution of payments between units compared with what the distributions would be if payments were "fully funded", and 2) they delay the phase-in to the new distribution that occurs under the new formula. As a result of the second effect, the changes in payments to local units become more drastic each year as the new formulas continue to phase-in, especially if the Legislature subsequently chooses to “fully fund” revenue sharing payments. At a minimum, in FY 2007-08, when the new formulas would presumably comprise 100% of the statutory distribution mechanism, the year-to-year change in revenue sharing payments will be very significant for many units.

In FY 2002-03, “fully funded” statutory revenue sharing payments would be distributed on a 50%/50% basis between the old and new formulas. The legislative appropriation, however, removes $120.6 million from "fully funded" statutory revenue sharing payments, which represents a 7.3% reduction in total revenue sharing payments (constitutional plus statutory) and a 12.5% reduction in total statutory payments. The impact of this reduction, as well as the reduction in FY 2001-02, essentially moves revenue sharing payments back to a distribution more similar to that in FY 2000-01, when the split was 70% under the old formula and 30% under the new formulas.

The change in this distribution is significant for many local units. For example, compared with "fully funded" revenue sharing payments in FY 2002-03, the reduction will have no impact on the City of Olivet, in Eaton County, or on the City of St. Louis, in Gratiot County, while Bingham Township, in Clinton County, will experience a 54.5% decline in its statutory revenue sharing payments and Oscoda Township, in Iosco County, will experience a 44.2% decline. If the portion of statutory payments attributable to the old formula were removed, the reduction from "full funding" would have an even greater impact, with neither St. Louis nor Olivet experiencing any reduction in payments while the City of River Rouge, in Wayne County, would experience a 75.3% reduction in its payments under the new formula and Oscoda Township would experience a 74.8% decline.

Given that the average "fully funded" revenue sharing payment to a township in FY 2002-03 is expected to be about $333,850, of which only about $54,500 is the payment under the new formula, such large percentage declines do not represent a significant amount of money for most units. However, for many units, particularly cities, where (excluding Detroit) the average "fully funded" revenue sharing payment is more than $2.1 million, the distributional changes can be significant. While cities such as Olivet and St. Louis would experience no reduction in payments under the revenue sharing appropriation, the City of Pontiac would lose $1.9 million (a 47.1% decline in new formula payments and an 11.5% decline in total payments) and the City of Grand Rapids would lose $2.1 million (a 24.4% decline in new formula payments and a 6.9% decline in total payments) compared with "full funding".

Reducing statutory revenue sharing below the full funding level in one year also can create impacts extending into the future. Part of the new distribution formulas includes a cap on how fast revenue sharing payments may grow from one fiscal year to the next for local units that did not experience at least a 10% increase in population between the 1990 and 2000 Federal Census. For units subject to this cap, if the payments would increase more than 8% from one year to the next, the extra is taken away and distributed to more slowly growing units. An exception to the cap enabled units with significant population growth to receive a substantial increase in revenue sharing payment in FY 2000-01, once the payments were based on the 2000 Census. However, the language permanently exempts these local units from the cap rather than exempting them for only FY 2000-01.

In years when statutory revenue sharing payments are not "fully funded", as indicated above, the decrease is not uniform across all local units. Consequently, in any future fiscal year, particularly one in which statutory revenue sharing payments are "fully funded", those units receiving the largest decreases under the statutory reductions in the prior year are the ones most likely to find their payments limited by the 8% cap. The 8% cap actually creates a double difficulty for these local units. Because these units are also the ones that benefit most from the new formula, as the new formula is phased in, they also would be the units most likely to receive a larger increase in revenue sharing payments. Thus, the reduction in statutory revenue sharing payments in the prior year not only generates a lower base for these units, exaggerating the growth in payments, but the phase-in of the new formula exacerbates the impact of the cap by attempting to provide significant payment growth to the same units. As a result of these two effects, a reduction in “fully funded” revenue sharing payments in one year will reduce statutory revenue sharing to some local units for many years afterward.

The 8% cap also delays the phase-in to the new formulas in a manner similar to the reductions in statutory revenue sharing payments. The cap payments distributed to slower-growth local units are most likely to be distributed to those units that are hurt by the phase-in to the new formula and receive more under the old distribution formula. Thus, reductions in statutory revenue sharing below the “full funding” level not only shift the phase-in of the new formula back in time, they create greater cap payments in future years as well, which also retards the implementation of the new distribution formulas.

The current statute does not indicate how statutory revenue sharing payments are to be distributed in FY 2007-08. Presumably, all statutory payments will be distributed under the new formulas, completing the logical next step in the phase-in of the new formula. Under the assumption that the history of limiting statutory revenue sharing payments below the "full funding" level will continue through FY 2007-08, statutory revenue sharing payments in FY 2007-08 could see significant distributional changes from the previous year, because there would no longer be an old formula distribution pattern to fall back upon and the previous year is not likely to exhibit the 90%/10% split suggested by statute.