

FIXING MICHIGAN'S TAX LIMITATION SYSTEM: STEPS TO AVOID DETROIT/FLINT-STYLE FISCAL CRISES

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I. INTRODUCTION	217
<i>A. The Roots of Michigan's Local Government Fiscal Crisis.....</i>	217
<i>1. Detroit and Flint's Woes are Symptoms of a More</i> <i>Systematic Problem that Threatens Many Communities</i> <i>in Michigan</i>	217
<i>2. Thesis: Un-Level Playing Field Created by Headlee and</i> <i>Proposal A Threatens Our Communities</i>	218
<i>B. Overview</i>	219
II. BACKGROUND	220
<i>A. What are the Headlee Amendment and Proposal A?</i>	220
<i>1. Headlee Amendment</i>	220
<i>2. Proposal A</i>	221
<i>B. Where did the Headlee Amendment and Proposal A Come</i> <i>From?</i>	222
<i>1. Brief Overview of Tax and Expenditure Limitation (TEL)</i> <i>Constitutional Amendments</i>	222
<i>2. Michigan's Experience with TELs</i>	223
<i>3. State and National Anti-Tax Movements</i>	224
<i>4. Assumptions About Inflation and Property Values that</i> <i>Shaped the Headlee Amendment and Proposal A</i>	225
<i>C. Troubled Times in Michigan Communities.....</i>	227
<i>1. An Unsustainable Path for Central Cities and Older</i> <i>Suburbs.....</i>	228
<i>2. Growing Calls for Action.....</i>	228
III. ANALYSIS	230
<i>A. How Have Headlee and Proposal A Affected "Built-Out"</i> <i>versus Developing Communities?</i>	230
<i>1. The Struggle to Realize Revenue Growth in Built-Out</i> <i>Communities.....</i>	230
<i>2. Implications for Communities.....</i>	232

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B. How Has Legislation Implementing § 31 and § 3 Affected Built-Out Communities?	232
1. Public Act 532 of 1978 – Statutory Framework for Implementing Headlee	232
2. Public Act 145 of 1993 – Elimination of Headlee Rollups ..	233
3. Public Act 415 of 1994 – Statutory Framework for Implementing Proposal A	234
C. How Have Post-Headlee/Proposal A Court Decisions Affected Built-Out Communities?	235
1. WPW Acquisition Co. v. City of Troy	235
2. Toll Northville LTD v. Township of Northville	236
D. Evidence of the Impact of Headlee and Proposal A on Built-Out Communities	237
1. Revenue Growth in Build-Out Communities Versus Newer Exurbs	237
2. Inflation Caps and Rollbacks Prevent Cities from Realizing a Return on Their Investments	238
E. Opportunities for Reform	239
1. Tax and Expenditure Limitations (TEL) in the U.S.	239
2. Colorado Adjusts TABOR to Address New Realities	240
3. Michigan Should Follow Colorado's Example and Ditch Headlee Rollbacks	241
4. Revise Headlee's Local Funding Floor to Account for Proposal A	242
5. Level the Playing Field by Helping Built-Out Communities Raise New Revenue	243
6. Help Cities Raise Revenue and Increase Utilization of their Existing Infrastructure	243
IV. CONCLUSION	245
A. Headlee and Proposal A Together are Tax Limitation Overkill ..	245
B. Failing to Act Endangers Older Communities and Harms Critical State Interests	246
C. Reconciling Voters' Dueling Impulses to Limit Taxes While Expanding Services	247

I. INTRODUCTION

A. *The Roots of Michigan's Local Government Fiscal Crisis*1. *Detroit and Flint's Woes are Symptoms of a More Systematic Problem that Threatens Many Communities in Michigan*

In recent years, Michigan has become an epicenter of national concern about the fiscal and economic viability of aging urban communities.¹ Culminating decades of social, economic and fiscal strife, Detroit in 2013 became the largest city in American history to file for bankruptcy.² In 2015, news about lead-tainted drinking water in Flint drew international attention to the decay of one of Michigan's major urban communities and its shocking effect on the lives of local residents.³ The Detroit Public Schools, the state's largest school district, has been under intermittent state control since 1999⁴ and in June 2016, the district required a \$617 million infusion of state funds in order to avoid bankruptcy.⁵

Public outrage and media scrutiny have focused on the immediate causes of these crises and the inability of leaders at all levels of government to formulate an effective response.⁶ What remains largely unexplored, however, are the root causes of the fiscal distress which drove the local governance crises that swept through Detroit and Flint and present similar risks to numerous other communities across

1. See PEW CHARITABLE TRUSTS, *AFTER MUNICIPAL BANKRUPTCY: LESSONS FROM DETROIT AND OTHER LOCAL GOVERNMENTS* 1–14 (Aug. 2015).

2. Monica Davey & Mary Williams Walsh, *Billions in Debt, Detroit Tumbles Into Insolvency*, N.Y. TIMES, July 18, 2013, at A1.

3. Julie Bosman, *Why It Won't Be Easy or Cheap to Fix Flint's Water Crisis*, N.Y. TIMES, Feb. 11, 2016, at A13; Oliver Laughland & Ryan Felton, *"It's all just poison now": Flint reels as families struggle through water crisis*, THE GUARDIAN (Jan. 24, 2016), <http://www.theguardian.com/us-news/2016/jan/24/flint-michigan-water-crisis-lead-poisoning-families-children>.

4. Curt Guyette, *After six years and four state-appointed managers, Detroit Public Schools' debt has grown even deeper*, DETROIT METRO TIMES (Feb. 25, 2015), <http://www.metrotimes.com/detroit/after-six-years-and-four-state-appointed-managers-detroit-public-schools-debt-is-deeper-than-ever/Content?oid=2302010>.

5. Alan Pyke, *Detroit Public Schools Face Bankruptcy: "We're Running out of Money in April"*, THINKPROGRESS (Jan. 6, 2016), <http://thinkprogress.org/economy/2016/01/06/3736565/detroit-public-schools-fiscal-crisis/>. Jonathan Oosting & Shawn D. Lewis, *Snyder Signs \$617M DPS Bailout*, DETROIT NEWS (June 21, 2016), <http://www.detroitnews.com/story/news/politics/2016/06/21/snyder-detroit-public-schools-rescue-package/86194084/>.

6. See *supra* notes 1–5.

Michigan.⁷ Analysts thus far have framed the “lessons of the Detroit bankruptcy” in terms of how states can head off future municipal bankruptcies through better monitoring of local finances and early intervention.⁸ Rarely have commentators focused on whether state policies played a role in creating the fiscal conditions which led to the crises in Detroit and Flint.⁹

Instead, analysts tend to view the fiscal crises in Detroit, Flint, and other insolvent communities across the nation as by-products of local mismanagement, imprudent investment decisions, historic economic trends, or a combination thereof.¹⁰ While a host of factors unquestionably contributed to that distress, the evidence also suggests that Michigan’s constitutional tax and revenue limitations, established under the 1978 Headlee Amendment (“Headlee”) and Proposal A of 1994 (“Prop A”), have played a significant role in undermining the financial viability of older cities, both urban and suburban.¹¹

2. *Thesis: Un-Level Playing Field Created by Headlee and Proposal A Threatens Our Communities*

Operating together, Headlee and Prop A profoundly restrict the ability of certain local governments to raise revenue to deal with rising costs and the needs of their populations, and all but shut down the capacity of older cities to invest in their futures.¹² To address the looming insolvency of numerous local governments, relatively modest

7. John Bebow, *Years of missed warnings before Flint River switch*, BRIDGE (Feb. 17, 2016), <http://bridgemi.com/2016/02/years-of-missed-warnings-before-flint-river-switch/> (quoting officials who stated that cost concerns, driven by Flint’s financial crisis, may have overshadowed worries about the safety of using water draw from the Flint River).

8. See PEW CHARITABLE TRUSTS, *supra* note 1, at 2–10.

9. Searches of articles linking Detroit’s bankruptcy to state municipal finance policies yielded very few articles on point, except see Patrick F. McGow, *Municipal Finance After the Detroit Bankruptcy*, MICH. BAR J., at 30, 31 (Sept. 2015).

10. See Scott Beyer, *Will Detroit’s Dubious Bankruptcy Affect the Future of Municipal Finance?*, AMERICAN INTEREST (Jan. 9, 2015), <http://www.the-american-interest.com/2015/01/09/will-detroits-dubious-bankruptcy-affect-the-future-of-municipal-finance/>; Thomas J. Fitzpatrick, IV, *Hot Topic: What’s at Stake in the Detroit Bankruptcy*, FOREFRONT 16, 17 (Nov. 7, 2013); Frank Shafroth, *Schooling in Municipal Bankruptcy*, GMU MUN. SUSTAINABILITY PROJECT (Aug. 27, 2015), <https://fiscalbankruptcy.wordpress.com/2015/08/27/schooling-in-municipal-bankruptcy/>; Wayne H. Winegarden, *Going Broke One City at a Time: Municipal Bankruptcies in America*, PAC. RES. INST. 3, 4 (Jan. 2014).

11. Frank W. Audia & Denise A. Buckley, *System Failure: Michigan’s Broken Municipal Finance Model*, PLANTE MORAN, PLLC, 6–8 (2004).

12. *Id.*

constitutional or legislative changes could put local governments on a more stable financial footing, while leaving intact constitutional safeguards that protect taxpayers from sharp rises in property taxes and limit the growth in the size of state government.

B. Overview

This paper defines the Headlee Amendment and Proposal A and places them in the context of similar tax and expenditure limitations ("TELs") enacted across the United States beginning in the first half of the nineteenth century.¹³ TELs typically emerge in the aftermath of economic crises as the public seeks to restrict the ability of state legislatures to raise taxes, spend public funds, or incur debt.¹⁴ Once the crisis recedes, however, courts, legislatures, and other government actors find ways to circumvent these limitations.¹⁵

The discussion then turns to how Michigan's courts and state legislature have interpreted Headlee and Proposal A and to evidence of the impact of these policies on older, fully-developed cities in comparison to their newer, less urbanized counterparts. Finally, this paper explores opportunities for constitutional and legislative reform that can ease revenue-growth restrictions on cities without undermining taxpayer protections that are essential to the purpose of Headlee and Proposal A.

These reforms draw on the ideas of local government finance experts in Michigan, practitioners in the field, and the example of reforms enacted in Colorado, home of the country's most restrictive constitutional TEL regime.¹⁶ Colorado voters in 2005 temporarily suspended and permanently relaxed portions of the Taxpayer Bill of Rights (TABOR) when it became clear that these provisions were preventing the state from carrying out critical functions of government.¹⁷ In light of the financial crises in Detroit, Flint, and a growing number of older cities, is it time for Michigan to follow Colorado's lead and amend its TEL regime and make other policy adjustments that enable local units of government to capture a greater share of the taxable value of the communities whose public goods they are charged with protecting? The data and analysis presented in this paper suggest the answer is yes.

13. Susan P. Fino, *A Cure Worse than the Disease? Taxation and Finance Provisions in State Constitutions*, 34 RUTGERS L.J. 959, 959-73 (2003).

14. *Id.* at 959.

15. *Id.* at 959-60.

16. Therese J. McGuire & Kim S. Reuben, *The Colorado Revenue Limit: The Economic Effects of TABOR*, ECON. POL. INST. at 2 (Mar. 2006).

17. *Id.* at 4.

II. BACKGROUND

A. *What are the Headlee Amendment and Proposal A?*

1. *Headlee Amendment*

Approved by voters on November 7, 1978, the Headlee Amendment added ten new sections to Article IX of the Michigan Constitution.¹⁸ The purpose of the Headlee Amendment, as summarized in Section 25, was generally to limit the size of state government and its capacity to raise taxes on the people of Michigan.¹⁹ Among numerous provisions, the Amendment imposes a series of limitations on the level of taxation imposed by state and local governments, as well as restrictions on state spending, based on the level of such taxation and spending in the Amendment's baseline year of 1978.²⁰

Proponents of the Headlee Amendment perceived that taxation and spending had reached unacceptable levels²¹ and included in the Amendment provisions which sought to control both the size and growth of state and local revenues and the ability of the state government to spend or borrow above prescribed limits.²² Section 26 includes language that limits the state's collection of revenue to the proportion of total personal income that the state government took in during the 1978–79 fiscal year.²³ In years when state revenues exceed this limit by 1% or more, Section 26 requires that the state refund those dollars to Michigan taxpayers on a pro rata basis.²⁴

Section 31 bars local governments from levying any new tax not previously authorized, or from increasing existing tax rates above authorized levels without a vote of the people.²⁵ In years when a community's total property tax assessment grows by more than the rate of inflation, Headlee requires an offsetting reduction in the local government's maximum authorized tax rate, so the revenues actually

18. MICH. CONST. art. IX, §§ 25–34 (1978).

19. *Id.* at § 25.

20. *Id.*

21. Ted Roelofs, *Michigan Tax Facts, Part 8: What would Richard Headlee think today?*, BRIDGE (Oct. 2, 2014), <http://bridgemi.com/2014/10/michigan-tax-fact-part-8-what-would-richard-headlee-think-today/>.

22. MICH. CONST. art. IX, § 25.

23. *Id.* at § 26.

24. *Id.*

25. *Id.* at § 31.

collected grow by no more than inflation.²⁶ Revenue growth caused by higher property assessments related to new construction or property improvements does not count toward the Headlee limit.²⁷

These tax-rate reductions, which came to be known as "Headlee rollbacks" occurred frequently after 1978, especially during periods when real estate values increased much faster than general inflation in the economy.²⁸ A difficulty arose when the Headlee requirements failed to protect property taxpayers from local tax assessment increases following an increase in real estate values.²⁹ Rollbacks typically generated relatively small tax refunds and were paid to property owners regardless of whether they experienced an increase in their assessment.³⁰

2. *Proposal A*

The Michigan Legislature placed Proposal A on the ballot in an attempt to address, at one time, inequities in public school funding and concerns about rising property tax rates that were among the highest in the nation.³¹ Broadly speaking, Proposal A exchanged a cut in property taxes for an increase in the state sales tax from 4% to 6%, an increase in the excise tax on cigarettes and a new real estate transfer tax.³² These new revenues were used to offset the loss of funding to public schools caused by the reduction in property taxes.³³ In addition to expanding the state's role in funding K-12 public education, Proposal A limited how much property taxes on an individual parcel could rise in a given year to the lesser of 5% or the rate of inflation.³⁴

The Headlee Amendment controlled growth in size of government and impeded tax rate increases, but it failed to protect individuals from

26. *Id.*

27. *Id.*

28. SOUTHEAST MICH. COUNCIL GOV'TS, *Running on Empty: SEMCOG's Local Government Revenue Task Force Report*, 6 (2014).

29. *Id.* at 6.

30. *Id.*

31. Chastity Pratt Dawsey, *A brief history of Proposal A; or how we got here*, BRIDGE (Apr. 29, 2014), <http://bridgemi.com/2014/04/a-brief-history-of-proposal-a-or-how-we-got-here/>.

32. Proposal A retained the elimination of real and personal property taxes that dedicated public school operations achieved by the Stabenow Amendment, enacted as PUBLIC ACT 145 of 1993. See Paul N. Courant & Susanna Loeb, *Centralization of School Finance in Michigan*, 16 J. POL'Y ANALYSIS & MGMT. No. 1, 114–118 (1997); Kathryn Summers, *The Basics of School Funding*, SENATE FISCAL AGENCY 6–9 (July 2015) (summarizing policy changes that shifted the burden of funding public school operations from a primarily local responsibility to an 80% state-funded activity).

33. Summers, *supra* note 32.

34. *Id.* at 8.

dramatic property tax spikes based on rising property values.³⁵ Anti-tax crusaders came to see this feature as a major shortcoming of the Headlee Amendment and continued to agitate for constitutional changes that would control the growth in property taxes.³⁶ In 1993, during a debate on a proposal to cut property taxes, then-State Senator Debbie Stabenow proposed an amendment to eliminate all property taxes that supported K-12 public education.³⁷ Unexpectedly, the amendment passed and quickly became law, setting in motion the development of Proposal A as a means of providing an alternative funding source for public education.³⁸

The final version of Proposal A, which was approved by the voters on March 15, 1994, not only lowered property taxes but also restricted the growth of property-tax assessments, thus providing relief from year-over-year tax increases about which anti-tax activists and many property owners had complained for decades.³⁹ Proposal A accomplished this by limiting the growth of the "taxable value of each parcel of property adjusted for additions and losses" to the lesser of 5% or inflation.⁴⁰ This meant that an individual property's "taxable value" could not increase by more than the rate of general inflation in the economy, except upon a transfer of the property when it would be assessed at 50% of the property's "true cash value," or roughly one-half of its purchase price.⁴¹

B. Where did the Headlee Amendment and Proposal A Come From?

1. Brief Overview of Tax and Expenditure Limitation (TEL) Constitutional Amendments

The Headlee Amendment and Proposal A fall within a well-established tradition in the U.S. in which the public seeks to address a crisis that it perceives to have been created by the excesses of state legislatures.⁴² As political scientist Susan Fino has illustrated, periodic economic and financial crises dating back as far as the Panic of 1837

35. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28.

36. Julie Berry Cullen & Susanna Loeb, *School finance reform in Michigan: evaluating Proposal A*, in HELPING CHILDREN LEFT BEHIND: STATE AID AND THE PURSUIT OF EDUCATIONAL EQUITY 215-50 (MASS INST. TECH. 2004).

37. *Id.* at 222.

38. *Id.*

39. MICH. CONST. art. IX, § 3.

40. *Id.*

41. *Id.* See MICH. COMP. LAWS ANN. § 211.27a (West 1994) (applicable implementing legislation).

42. Fino, *supra* note 13.

have triggered voter-approved constitutional amendments aimed at preventing state legislatures from raising taxes, issuing debt, or spending state revenue on certain projects.⁴³

Triggered by a series of banking policy maneuvers by President Andrew Jackson and subsequent responses by private British and American banks,⁴⁴ the Panic of 1837 involved a banking crisis and deep recession that jeopardized the financial stability of numerous American states. States defaulted on debts they had incurred to finance infrastructure, known at the time as “internal improvements.”⁴⁵ The public responded with a variety of voter-initiated constitutional amendments barring states from issuing debt or otherwise limiting state legislatures’ ability to support public or private investments in infrastructure.⁴⁶

2. *Michigan’s Experience with TELs*

Michigan, which entered the union in 1837, also fell victim to the Panic of 1837 and defaulted on its debts in 1842.⁴⁷ Voters responded by approving constitutional amendments in 1843 and a new constitution in 1850 that contained limitations on the state’s powers to issue debt and barred the state from investing in internal improvements.⁴⁸ In the years that followed, a pattern developed across the U.S. in which economic or financial crises spurred voters to approve constitutional tax and expenditure limitations (referred to in the literature as “TELs”).⁴⁹ The crises would subside and eventually state legislatures, the courts, or the voters, would variously circumvent, relax or repeal the TELs.⁵⁰

43. *Id.*

44. See Richard Hildreth, *BANKS, BANKING, AND PAPER CURRENCIES* 91 (1840); Bray Hammond, *BANKS AND POLITICS IN AMERICA: FROM THE REVOLUTION TO THE CIVIL WAR* 451–499 (1957); Peter Temin, *THE JACKSONIAN ECONOMY* (1969).

45. Fino, *supra* note 13, at 967–68.

46. *Id.* at 969. For a detailed discussion of state responses, quoted in Fino, see Carter Goodrich, *The Revulsion Against Internal Improvements*, 10 J. ECON. HIST. 145 (1950).

47. Fino, *supra* note 13, at 974.

48. *Id.* at 976.

49. See Richard Briffault, *Foreward: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907 (2003); Cynthia B. Faulhaber, “No New Taxes:” Article 9, Section 31 of the Michigan Constitution Twenty Years After Adoption, 46 WAYNE L. REV. 211 (2000); David S. Gamage & Darren Shanske, *The Trouble with Tax Increase Limitations*, 6 ALB. GOV’T L. REV. 50 (2013).

50. See Stewart E. Sterk & Elizabeth S. Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301 (1991) (quoted in Fino, *supra* note 13 at 959).

Michigan's experience follows this pattern, although Headlee and Proposal A remain intact and continue to exert significant influence on fiscal and economic policy in the state.⁵¹ Nonetheless, it is important to recognize that constitutionally-imposed limitations on the legislative power to tax, spend or incur debt operate amid the electorate's contradictory impulses to control taxes and government spending while insisting on ever higher levels of public services.⁵² Opinion survey data, for example, reveals that Republican voters' continued interest in shrinking government and cutting taxes comes with a disorienting preference for increased spending on Social Security, Medicare, education, and infrastructure.⁵³ As the recent debate on how to finance the rebuilding of Michigan's roads suggests, the public appears to resist new taxes but at the same time does not want to pay for road repairs with cuts in public services.⁵⁴ The road package as finally approved appears to fund road repairs inadequately by relying on a dubious mix of modest tax increases, unspecified budget cuts, and income tax rollbacks postponed until next decade.⁵⁵

3. *State and National Anti-Tax Movements*

Efforts to pass the Headlee Amendment and Proposal A emerged in the context of economic challenges which voters sought to address by imposing limits on the ability of state and local lawmakers to raise taxes

51. See Dawsey, *supra* note 31; HOUSE FISCAL AGENCY, *Economic Outlook and Revenue Estimates for Michigan, FY 2014–15 through FY 2016–17*, 19–20 (2015).

52. See Fino, *supra* note 13, at 985 (summarizing scholarship on the public's conflicting tendencies to insist on limited government and tax cuts while demanding growing government services).

53. George Packer, *The Republican Class War: In 2016, will conservatives finally face the realities of inequality?*, NEW YORKER, Nov. 9, 2015, at 26–28.

54. David Eggert, *Michigan voters defeat tax hike in debate over road funding*, SALON (May 6, 2015, 3:00 AM), http://www.salon.com/2015/05/06/michigan_voters_defeat_tax_hike_in_debate_over_road_funding/.

55. For a range of views on this policy see Jim Townsend, *Michigan Road Funding Bill: How we got a bad deal*, DETROIT FREE PRESS (Nov. 4, 2015, 11:14 AM), <http://www.freep.com/story/opinion/contributors/2015/11/04/michigan-road-funding-bill-how-we-got-bad-deal/75136578/>; Kevin Cotter, *Michigan roads plan gets the job done right*, DETROIT FREE PRESS (Nov. 5, 2015, 10:42 PM), <http://www.freep.com/story/opinion/contributors/2015/11/05/michigan-roads-deal/75233050/>; Nolan Finley, *Politics of road deal are baffling*, DETROIT NEWS (Nov. 8, 2015, 12:02 AM), <http://www.detroitnews.com/story/opinion/columnists/nolan-finley/2015/11/08/finley-roads-politics/75373330/>.

or expand government spending.⁵⁶ The concern in both instances centered on a weak economy coupled with rising prices, as captured in the so-called Misery Index, and escalating property taxes.⁵⁷ The anti-tax movement of the 1970s that produced California's Proposition 13 and the Headlee Amendment grew out of voter frustration with so-called "stagflation," rising real estate taxes and a declining faith in government institutions.⁵⁸

Proposition A followed the 1991–92 recession and drew momentum from continued concern about property tax levels and rising animus toward government embodied in the term-limits movement.⁵⁹ In both the 1970s and early 1990s, the Misery Index was substantially higher than it had been in the previous decade, suggesting that voters may have been motivated in part by disappointment in the relative performance of the economy.⁶⁰

4. *Assumptions About Inflation and Property Values that Shaped the Headlee Amendment and Proposal A*

The Headlee Amendment and Proposal A won approval in an era when prices in the general economy were rising at a much faster rate than they had in previous decades. Inflation as measured by the Consumer Price Index (CPI) rose at an average annual rate of 7.08%

56. Dawsey, *supra* note 31; see also Kevin C. Kennedy, *The First Twenty Years of the Headlee Amendment*, 76 U. DET. MERCY L. REV. 1031 (1999).

57. A gauge of economic conditions first proposed by the economist Arthur Okun summed up the monthly unemployment and annualized inflation rates. See Fred Dews, "Misery Index" at Lowest Level Since 1950s, BROOKINGS (Jan. 11, 2016), <http://www.brookings.edu/blogs/brookings-now/posts/2016/01/misery-index-lowest-level-since-1950s>.

58. Fino, *supra* note 13 at 984–85 (summarizing scholarship on the origins of the 1970s tax revolt that range from complaints about the economy, to the level of taxation to the perceived unfairness of the tax system). See *Stagflation: What Is It, What Causes It, and Can It Happen Again?*, ABOUT.COM (Feb. 16, 2016), <http://useconomy.about.com/od/glossary/g/stagflation.htm> (summarizing stagflation concept); Alan S. Blinder & Jeremy B. Rudd, *The Supply-Shock Explanation of the Great Stagflation Revisited*, NAT'L BUREAU ECON. RES. (Dec. 2008), <http://www.nber.org/papers/w14563> (evaluating the causes of 1970s stagflation).

59. Dawsey, *supra* note 31; see also GIDEON DORON & MICHAEL HARRIS, TERM LIMITS 113–19 (Lexington Books 2001).

60. See *United States Misery Index: How Miserable do you Feel?*, U.S. MISERY INDEX, <http://www.miseryindex.us/> (last visited Feb. 21, 2016). During the 1960s, the Misery Index (MI) averaged 7.1% but rose to an average of 13.3% during the 1970s. Conditions improved in the mid-1980s, with the MI dropping down to 8.9% in 1986, but then rose again to between 10 and 11% in the early 1990s (author's calculations).

during the 1970s compared to just 2.36% in the 1960s.⁶¹ While inflation cooled beginning in the mid-1980s, the CPI averaged nearly 6% per year during the twenty-five years leading up to the approval of Proposal A in 1994.⁶²

With prices rising so quickly, the concept of restricting government revenues or property tax assessments to inflation must have seemed to be a reasonable approach to restraining the growth of the government and protecting taxpayers without crippling essential public services. In fact, officials who advocated putting the “[5%] or inflation” limitation on taxable value increases assumed inflation would exceed 5% and wanted to ensure that property owners’ tax bills would grow at a slower rate.⁶³

In a similar fashion, expectations about rapidly rising real estate values influenced the framers of the Headlee Amendment and Proposal A.⁶⁴ Throughout most of the twentieth century, real property values rose in a pattern that roughly tracked the movement of prices in the general economy.⁶⁵ Real estate prices in the 1970s, however, departed from this pattern.⁶⁶ As shown in Robert Shiller’s landmark analysis of real estate prices, the 1970s and 1980s each saw sustained housing booms during which real estate prices far outpaced the rate of inflation.⁶⁷ It was in this environment that Michigan property taxpayers, like their counterparts across the country, grew increasingly alarmed about the rising tax assessments that accompanied these real estate price spikes.⁶⁸

The economic and political environment that produced Headlee and Proposal A included recession, potent inflation, unpredictable and unpopular property tax spikes, and a skepticism about the government’s capacity to address these concerns. While the first and last of these conditions undoubtedly still apply, has the time has come to change Michigan’s TEL regime in order to free up resources for struggling communities and enable Michigan to compete in the global economy?

61. BUREAU OF LAB. STAT., U.S. DEP’T OF LAB., CPI DETAILED REP., DATA FOR SEPT. 2015, TABLE 24 (2015).

62. *Id.*

63. Interview with Howard Ryan, chief legislative liaison, Mich. Dep’t of Treasury (October 29, 2015) (served on State Senate staff during the development of Proposal A); see also SOUTHEAST MICH. COUNCIL GOV’TS, *supra* note 28, at 8.

64. Fino, *supra* note 13.

65. See Robert J. Shiller, *A History of Home Values*, N.Y. TIMES (Aug. 26, 2006), http://www.nytimes.com/imagepages/2006/08/26/weekinreview/27leon_graph2.html.

66. *Id.*

67. *Id.*

68. Fino, *supra* note 13, at 985.

C. Troubled Times in Michigan Communities

The economic and financial problems that plagued the City of Detroit over the past five decades had, until recently, been confined to Detroit and a handful of smaller urban centers, such as Saginaw and Flint, which have struggled to counteract the forces of deindustrialization, urban sprawl, racism, middle-class flight, and urban isolation.⁶⁹ But Detroit's bankruptcy may not be an anomaly, as numerous other communities near fiscal breakdown.⁷⁰ While it remains unlikely that large numbers of more affluent communities will enter bankruptcy, in 2015, thirteen municipalities and five school districts were under financial restructuring requirements specified in the state's emergency management law.⁷¹ The law requires financially troubled communities to pursue such steps prior to seeking bankruptcy protection.⁷²

The financial troubles facing Michigan local governments appear to result from a combination of factors including high pension and retiree healthcare costs, and decreasing revenues.⁷³ What the *Detroit Free Press* editorial board terms a "legacy of promises" includes also commitments to sometimes costly economic development initiatives whereby a city agrees to forgo years of tax revenues in exchange for new or expanded commercial or industrial development.⁷⁴ This phenomenon speaks once again to the conflicting priorities of the residents who elect the local and state leaders charged with overseeing these communities and the state. Voters look to government to provide a wide range of services and to undertake efforts to revitalize local and regional economies.⁷⁵ At the same time, voters have locked in through the Headlee Amendment and

69. *Restoring Prosperity: The State role in Revitalizing America's Older Industrial Cities*, BROOKINGS INST. (2007), http://www.brookings.edu/~media/Research/Files/Reports/2007/5/metropolitanpolicy-vey/20070520_oicMI.PDF.

70. *Will Your City or Township Be Next?*, DETROIT FREE PRESS, May 20, 2012, at A17.

71. McGow, *supra* note 9, at 28, 30.

72. *Id.*

73. Ted Roelofs, *New rankings find fiscal troubles for city halls across Michigan*, BRIDGE (May 16, 2013), <http://bridgemi.com/2013/05/new-rankings-find-fiscal-troubles-for-city-halls-across-michigan/>.

74. DETROIT FREE PRESS, *supra* note 70.

75. See Sue Stetler, *SEMCOG/MAC citizen survey results: Majority of respondents say economy is better, but more work still left to do*, SOUTHEAST MICH. COUNCIL GOV'TS (Aug. 19, 2015), <http://smcg.informz.net/informzdataservice/onlineversion/ind/bWFpbGluZ2luc3RhbmNIaWQ9NDk3NjEwMCZzdWJzY3JpYmVyaWQ9MTAyNDA1NTEzMQ==>.

Proposal A, a system that severely restricts revenue growth and enables the state government to reduce its commitment to funding local needs.

1. *An Unsustainable Path for Central Cities and Older Suburbs*

The political momentum for changing this system may emerge as a steadily increasing number of communities and school districts, from diverse areas of the state, find that they cannot meet their expenses and are sinking into unsustainable indebtedness. The Michigan Department of Treasury publishes lists of school districts and communities with negative fund balances. Forty-four school districts ended 2014 with a fiscal deficit⁷⁶ out of a total of 541 districts statewide.⁷⁷ Thirty-seven cities, townships, villages and counties in Michigan qualified for an updated “fiscal watch list,” according to the municipal finance watchdog group call Munnetrix.⁷⁸

Unfunded pension and retiree healthcare benefit obligations represent a significant portion of municipal indebtedness.⁷⁹ In 2014, 35% of Michigan municipalities that participate in the Municipal Employees Retirement System managed to fund their pension and retiree healthcare obligations at less than 70% of their projected liabilities.⁸⁰ Importantly, these fiscally-threatened school districts and communities span the entire state and transcend socioeconomic and racial boundaries.⁸¹

2. *Growing Calls for Action*

For more than a decade, local units of government in Michigan have been warning the public and state policy makers about the rising levels of

76. Memorandum from Brian J. Whiston to House and Senate K-12 Appropriations Subcomms., *Quarterly Report to the Legislature on Deficit Districts*, MICH. DEP’T EDUC., Attachment A (Sept. 16, 2015) (on file with author). An additional thirteen Headlee Amendment schools also ran full-year deficits in Fiscal Year 2014.

77. *Number of Public School Districts in Michigan*, MICH. DEP’T EDUC., http://www.michigan.gov/documents/numbsch_26940_7.pdf (last visited Nov. 5, 2015).

78. See *Municipal Local Government Directory*, MUNNETRIX, <https://www.munetrix.com/Michigan/Municipalities> (last visited Feb. 22, 2016); Roelofs, *supra* note 73.

79. Ted Roelofs, *A problem 50 years in the making: How retirement debt swallowed Michigan towns*, MLIVE (Nov. 12, 2013), http://www.mlive.com/politics/index.ssf/2013/11/how_retirement_debt_swallowed.html.

80. MUN. EMP. RETIREMENT SYS., SUMMARY REPORT OF THE 69TH ACTUARIAL VALUATIONS AS OF DEC. 31, 2014 (Sept. 22, 2015), http://www.mersofmich.com/Portals/0/Assets/ActuarialReport/annual_actuarial_report-2014.pdf.

81. *Id.*

fiscal stress among communities and school districts.⁸² The statewide association of cities and villages, the Michigan Municipal League, began calling for change in the wake of cuts to state revenue sharing to municipalities in the early 2000s.⁸³ The Michigan Constitution mandates the provision of 15% of state sales tax revenue to townships, cities, and villages based on the population of each community.⁸⁴ State statute also provides for an additional 21.3% of such revenue to local governments, but allows the legislature the discretion to shift those funds to other purposes.⁸⁵ In 2002 this "statutory revenue sharing" peaked at \$660 million, but the legislature annually began shifting its funding to other priorities.⁸⁶ Statutory revenue sharing fell to just \$215 million in 2011,⁸⁷ and the cumulative revenue loss reached \$6.2 billion in 2014.⁸⁸

Compounding this decline in state support has been a sharp drop in real and personal property values and property tax assessments in Michigan since the Great Recession of 2008.⁸⁹ The value of real and personal property declined by 13.1% between 2008 and 2012, and revenue from property taxes fell by 9.9% during the same period.⁹⁰ While property values have recovered somewhat in the last few years, the tax bases of many local governments have lagged behind, especially in older, fully-developed communities across the state.⁹¹

In November 2014, the Southeast Michigan Council of Governments (SEMCOG) published an influential report that explored the disparate impact of Michigan's property tax limitation system on fully-developed urban and suburban cities versus newer communities that have grown up

82. *Revenue Sharing Fact Sheet*, MICH. MUN. LEAGUE, <http://www.mml.org/advocacy/2014-revenue-sharing-factsheet.html> (last visited Nov. 8, 2015).

83. *Id.*

84. MICH. CONST. art. IX, § 10 (allocating to local governments the first 15% of revenue from the state sales tax on tangible personal property).

85. MICH. COMP. LAWS ANN. § 141.913(19) (West 2006).

86. Shannon Murphy, *State revenue sharing cuts reshape city governments in Michigan*, MLIVE (Oct. 16, 2011, 7:08 AM), http://www.mlive.com/news/index.ssf/2011/10/state_revenue_sharing_cuts_res.html.

87. *Id.* Fiscal Year 2015–16 statutory revenue Headlee Amendment will be \$249 million. See Jim Stansell, *UPDATED REVENUE SHARING ESTIMATES*, HOUSE FISCAL AGENCY, (Sept. 24, 2015), http://www.house.mi.gov/hfa/PDF/Revenue_Forecast/Revenue_Sharing_Details_Sept.2015.pdf.

88. Stansell, *supra* note 87.

89. *Ad Valorem Property Tax Report*, MICH. DEP'T TREASURY, (2014), http://www.michigan.gov/documents/treasury/625_2014_Ad_Valorem_Property_Tax_Report_485906_7.pdf.

90. *Id.*

91. *Id.*

on the fringe of the metropolitan area in recent decades.⁹² SEMCOG reviewed southeast Michigan municipal data between 1994 and 2014 and found that, after accounting for inflation, the tax bases of cities in the region fell by 30% to 50% during the period.⁹³ Meanwhile, the tax capacity of townships in southeast Michigan grew in real terms by between 10% and 240%.⁹⁴

New development and population growth account for the rapid tax-base expansion in the townships.⁹⁵ While built-out cities would not be expected to grow at the rate of their newer counterparts, the dramatic losses in tax capacity reflect the impact of the state's tax limitation scheme, which prevents fully developed cities from capturing new revenue from the increases in the value of its property.⁹⁶ This problem is not unique to southeast Michigan but it appears to be most severe in this region. Statewide, cities saw their tax capacity drop by 15% in real terms, compared to an increase for townships of over 60%.⁹⁷

The factors that drive this disconnect between a community's property value and its capacity to raise revenue from that value are the central inquiry of this note. It is difficult to predict when or whether policy makers, or the voters themselves, may decide to address the financial woes of local governments. But there is little doubt about the significance of this problem for older developed cities.

III. ANALYSIS

A. *How Have Headlee and Proposal A Affected "Built-Out" versus Developing Communities?*

1. *The Struggle to Realize Revenue Growth in Built-Out Communities*

For purposes of understanding how Headlee and Proposal A affect some communities differently than others, the crucial variable to consider is not the community's location, urban or suburban character, or the median income, poverty rate, socio-economic status or racial make-up of its residents. What matters most is whether a city, village, or

92. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28, at 7. The author wishes to thank Bill Anderson, principal author of the SEMCOG study, for generously sharing his insights concerning these issues.

93. *Id.* at 13.

94. *Id.*

95. *Id.* at 12.

96. *Id.*

97. *Id.* at 12–13.

township has sufficient open space to accommodate new construction, because, under the Michigan Constitution, new buildings may be taxed at 50% of their true cash value.⁹⁸ None of the constitutional or statutory restrictions on the growth in a property's taxable value or a community's taxable assessment, contained in Proposal A and Headlee, applies to new construction.⁹⁹

The three sources of property tax revenue growth for any community include: (1) rising values on existing properties, (2) "additions" or new construction to existing properties, and (3) the transfer of a property whereupon the Michigan Constitution lifts the growth restriction on taxable value and the owner pays taxes on 50% of the property's true cash value.¹⁰⁰ This arrangement harms older "built-out" communities because Headlee and Proposal A, acting together, limit a community's ability to realize new revenue from the first and third sources of revenue growth.¹⁰¹ Meanwhile, the second source occurs relatively infrequently in fully-developed communities.¹⁰²

Proposal A specifically limits how much a property's assessed value may grow in a given year to the lesser of 5% or the rate of inflation, regardless of the rise in the property's market value.¹⁰³ The transfer of a property triggers a so-called "pop-up" of that property's taxable value to align with its market value.¹⁰⁴ If, however, a sufficient number of property transfers occur in a year, the Headlee Amendment then requires that a community's maximum authorized property tax rate be reduced, so that overall revenue to the community does not rise by more than the inflation rate.¹⁰⁵ Taken together, the three sources of property tax growth available to built-out communities are unlikely to provide revenue growth that exceeds the extremely low levels of inflation in the general economy.¹⁰⁶

98. MICH. CONST. art. IX, § 3 (1994), § 31 (1978).

99. *Id.*

100. *Id.*

101. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28, at 15.

102. *Id.*

103. MICH. CONST. art. IX, § 3 (1994).

104. Property is taxed at 50% of true cash value. *See id.*

105. MICH. CONST. art. IX, § 31 (1978).

106. General price inflation has remained very low by historical standards in recent years. For example, during the period of November 2014 to November 2015, inflation averaged 0.5%. *See Consumer Price Index - January 2016*, BUREAU OF LAB. STATS. (Jan. 2016), <http://www.bls.gov/news.release/pdf/cpi.pdf>.

2. *Implications for Communities*

The mandated low rate of revenue growth in built-out communities creates a series of problems. First, older cities must compete for residents and business investment with newer developing communities that have sprung up in recent decades on the fringes of our metropolitan areas.¹⁰⁷ But older cities must do so with a significant handicap, because their newer counterparts are able to capitalize on open space, which can accommodate new construction that is not subject to Headlee and Proposal A revenue restrictions.¹⁰⁸ This rapid revenue growth allows new communities to keep property tax rates relatively low.¹⁰⁹ Rational homebuyers can hardly resist moving to newly developing communities that offer the same or better amenities as their urban and inner suburban counterparts, at often substantially lower tax rates.¹¹⁰ It should be noted that while a portion of the revenue growth realized by newer communities must be devoted to serving new residences and businesses,¹¹¹ these same communities also do not have decades of accrued employee pension and retiree health care liabilities that further prevent older cities from offering the same value proposition to residents and businesses.¹¹²

B. *How Has Legislation Implementing § 31 and § 3 Affected Built-Out Communities?*

1. *Public Act 532 of 1978 – Statutory Framework for Implementing Headlee*

Enacted in 1978 following voter approval of the Headlee Amendment, P.A. 532, among other provisions, defined key terms and

107. Between 2000 and 2010, metro Detroit lost 3.5% of its population, while the population of new communities on the region's fringe, so-called "exurbs," rose by 27%. See Todd Gardner & Matthew C. Marlay, *Population Growth in the Exurbs Before and Since the Great Recession*, URBAN INST. (2012).

108. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28, at 15–16.

109. Admittedly, this advantage depends somewhat on the type of new construction occurring in the community. For an in-depth analysis of the fiscal impact of different development patterns, see THE SUBURB READER 482–83 (Becky M. Nicolliades & Andrew Wiese, eds., 2006).

110. See Myron Orfield, AMERICAN METROPOLITICS: THE NEW SUBURBAN REALITY (2002). For the seminal work on the concept of residents' behaving as rational consumers, see Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418–20 (1956).

111. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28, at 12.

112. Alexis Stephens, *About Pension Funds*, NEXT CITY (Sep. 3, 2014).

created a mechanism for rolling back the maximum authorized tax rate for a unit of local government.¹¹³ That mechanism was the “millage reduction fraction” (MRF), a means of calculating the reduction in a community’s maximum authorized millage rate that would be required to bring a community’s revenue growth down to the inflation rate.¹¹⁴ Each year the new MRF is multiplied by the prior year’s MRF, creating a compound millage reduction fraction (CMRF) that is used to set a community’s maximum tax rate.¹¹⁵

The law defined “new construction” as “property not in existence on the immediately previous tax day and not replacement construction.”¹¹⁶ While the statute included in new construction “the physical addition of equipment or furnishings to the existing building,” the law did not define the replacement of existing buildings as new construction.¹¹⁷ The implications of this language are clear: because the great majority of construction activity in built-out communities involves redevelopment and the repair or replacement of buildings, PA 532 included property value increases associated with most redevelopment in the total assessed valuation for purposes of calculating a community’s millage reduction fraction. In other words, property value increases created by redevelopment are usually included in the calculations that often result in a reduction in a community’s tax base. This kind of problem rarely confronts newly developing communities because most of their development qualifies as “new construction” and associated value increases are excluded from the MRF calculation.

2. *Public Act 145 of 1993 – Elimination of Headlee Rollups*

Between 1978 and 1993, the law allowed communities to recapture a portion of tax base lost as a result of a prior year’s Headlee rollback.¹¹⁸ In a year when a city’s total assessed value increased by less than the rate of inflation, its MRF would be greater than one¹¹⁹ and the city’s maximum millage rate could increase by that amount.¹²⁰ Advocates characterized

113. MICH. COMP. LAWS ANN. § 211.34d (West 2016).

114. *See id.* § 211.34d(2)–(16). The calculation currently is: (Total Taxable Value in the Prior Year) – Losses x Inflation / (Total Taxable Value in the Current Year) – Additions.

115. *See id.* § 211.34d(8).

116. *See id.* § 211.34d(1)(b)(iii).

117. *See id.*

118. Audia, *supra* note 11, at 6.

119. *See supra* note 106 for MRF calculation.

120. Audia, *supra* note 11, at 6.

Headlee rollups as a corrective that would counter balance the effect of the loss in tax capacity caused by rollbacks.¹²¹

In 1993, the Michigan Legislature passed P.A. 145, which prevented a local government's MRF from exceeding one, and thereby prevented communities from rolling up their maximum tax rate.¹²² This provision, which permanently locks in tax base losses from rollbacks, is especially harmful to built-out communities because built-out communities lack alternative ways to expand their revenue bases. Local governments retain the ability to raise tax rates above the level established by the compound millage reduction fraction, but they must first obtain voter approval.¹²³

3. *Public Act 415 of 1994 – Statutory Framework for Implementing Proposal A*

Following the approval of Proposal A on March 15, 1994, the State Legislature on Christmas Eve of that year passed legislation to implement Proposal A that, among other things, included language that equated "taxable value," a previously undefined term, with the well-understood term, "assessed valuation of property as finally equalized," popularly known as state equalized value or SEV.¹²⁴ This meant that local governments would tax property based on its capped taxable value until such property was transferred, at which point the property would be uncapped and taxed at 50% of its true cash value.¹²⁵ This provision also reduced the likelihood of future Headlee rollbacks.¹²⁶

By equating taxable value and SEV, the law not only insulated individual property owners from tax increases that exceeded inflation, it also made Headlee rollbacks less common, because a community's taxable value could only exceed inflation if a sufficient number of uncapped transferred properties raised the community's total value beyond inflation.¹²⁷ Without P.A. 415, older communities in particular would have borne a perverse double burden of not being permitted to realize tax base growth due to Proposal A, while still being at risk of continued Headlee rollbacks based on the community's SEV growth,

121. *Id.*

122. MICH. COMP. LAWS ANN. § 211.34d(2)(7) (West 2016).

123. *See id.* § 211.34d(6).

124. *See id.* § 211.34d(1)(d). The popular version of this term was "state equalized value," a phrase with which virtually any real property owner in Michigan would be familiar.

125. *See id.* § 211.34d(1)(d).

126. *Headlee Rollbacks and the Constitutionality of Public Act 415*, CITIZENS RES. COUNCIL MICH. (Jan. 1996).

127. *Id.*

which often exceeded inflation.¹²⁸ At least one commentator questioned the constitutionality of this provision of PA 415, pointing out that Proposal A had not amended the section of the Michigan Constitution that defines SEV and that, therefore, the Legislature lacked the authority to change the meaning of a term from its accepted definition at the time the voters approved the Headlee Amendment in 1978.¹²⁹ Critics of Michigan's municipal finance system contend, on the other hand, that since the Legislature equated taxable value and SEV, it should have excluded uncapped SEVs from Headlee MRF calculations, so that communities could avoid rollbacks altogether.¹³⁰

C. How Have Post-Headlee/Proposal A Court Decisions Affected Built-Out Communities?

1. WPW Acquisition Co. v. City of Troy

The City of Troy raised the taxable value of a commercial property by 13% based on its contention that the enhanced value of the property, caused by an increase in its occupancy, constituted an "addition" and, therefore, was not subject to Proposal A's cap on taxable values.¹³¹ Seeking a declaratory judgment to invalidate the assessment, the building owner asserted that the city's action violated Proposal A's taxable value cap.¹³² The Court held that the Legislature's designation of an occupancy increase as an "addition" was inconsistent with a reasonable understanding of the drafters' and voters' intent with respect to Proposal A.¹³³ The Court reasoned that "additions" was a term of art defined in the General Property Tax Act at the time of the passage of Proposal A, and that the Legislature did not have the authority to change that definition, particularly because the language of Proposal A did not direct it to do so.¹³⁴

The decision in *WPW* is significant for several reasons. First, it closed off yet another avenue by which fully-developed communities could realize revenue growth in excess of the rate of inflation.¹³⁵ Second,

128. *Id.*

129. *Id.*

130. Audia, *supra* note 11, at 6.

131. *WPW Acquisition Co. v. City of Troy*, 643 N.W.2d 564, 566 (Mich. 2002).

132. *Id.*

133. *Id.* at 567–68.

134. *Id.* at 568.

135. See William H. Durham, *Strict Construction Limiting "Additions" to Michigan Ad Valorem Tax Cap in WPW Acquisition Co. v. City of Troy*, 8 ST. & LOC. TAX LAW. 141 (2013).

the Court's reasoning signaled that it would strictly interpret the terms used in Proposal A and other constitutional provisions, and potentially limit the ability of the legislative or executive branches to loosen the revenue restrictions imposed by the people.¹³⁶ Finally, in emphasizing the legislature's limited power to define constitutional terms, *WPW* raised further questions about the constitutionality of the legislature's decision to equate SEV with taxable value.¹³⁷ SEV, or technically "assessed value as finally equalized," was clearly a term of art in 1994 that, under the Court's reasoning, could not be redefined by the legislature absent an amendment to the Michigan Constitution.¹³⁸

In response to the *WPW* decision, the Michigan legislature approved Senate Bill 114, signed into law by the governor as Public Act 164 of 2014, which repealed the statutory language that defined occupancy-rate increases as "additions."¹³⁹ The measure also addresses a gap in the *WPW* ruling by clarifying that drops in occupancy may not be considered "losses" for the purpose of calculating a property's taxable value.¹⁴⁰

2. *Toll Northville LTD v. Township of Northville*

The Court returned to the definition of "additions" when it took up the issue of whether water, sewer, energy, and other utilities installed by a private developer could be taxed as an addition under the General Property Tax Act and Proposal A.¹⁴¹ The developer sought a declaratory judgment to prevent Northville Township from increasing the taxable value of its property based on the value added by the utility installation.¹⁴² Affirming two lower court rulings and citing *WPW*, the Court held that the legislature's definition of "additions" was an unconstitutional expansion of the term's accepted meaning when Proposal A was approved.¹⁴³ Following the approval of Proposal A, the legislature in 1994 amended section 211.34d of the General Property Tax Act to add "public services" to the list of "additions" that would be excluded from the taxable value cap.¹⁴⁴ Northville Township, citing this

136. See Sterk, *supra* note 50 (discussing the common pattern where legislatures and governors, sometimes with the support of the courts, endeavor to loosen the restrictions of tax and expenditure limitations).

137. See CITIZENS RES. COUNCIL MICH., *supra* note 126.

138. *Id.*

139. See MICH. COMP. LAWS ANN. § 211.34d (West 2016).

140. *Id.* See MICH. SENATE FISCAL AGENCY, *Analysis of S.B. 114* (Jan. 1, 2015).

141. *Toll Northville LTD v. Twp. of Northville*, 743 N.W.2d 902, 907–08 (Mich. 2008).

142. *Id.* at 904.

143. *Id.* at 908.

144. MICH. COMP. LAWS ANN. § 211.34d(1)(b)(vii) (West 2016).

section of the law, raised the taxable value of the property in question in excess of the Proposal A cap.¹⁴⁵ In this instance, the Court found that prior to the approval of Proposal A, the legislature had narrowed the definition of “additions” by deleting the phrase, “improvements caused by new construction,” thereby excluding public services from the list of construction activities that could be deemed an addition.¹⁴⁶ The Court held that with the approval of Proposal A, this new legislative definition of “additions” became the accepted constitutional meaning of the word and, thus, beyond the legislature’s reach to amend in statute.¹⁴⁷

Other than further solidifying the Court’s signal that it would strictly interpret constitutional terms, the holding in *Toll* had little direct effect on built-out communities because older communities typically already have basic infrastructure in place. The only discernable impact was that the decision effectively reduced the cost of new development in rural areas that surround the older suburbs, creating a further competitive advantage for new communities.¹⁴⁸

D. Evidence of the Impact of Headlee and Proposal A on Built-Out Communities

1. Revenue Growth in Build-Out Communities Versus Newer Exurbs

The Citizen Research Council of Michigan (CRC)¹⁴⁹ released data on the effect of the Headlee Amendment and Proposal A on statewide property tax revenues, which shows that Headlee appears to have slowed statewide property tax collections so that they grew at below the rate of inflation between 1979 and 1994, the year of Proposal A’s approval.¹⁵⁰ Between 1994 and 2009, overall tax collections grew at roughly the rate of inflation and then fell precipitously in the wake of the Great Recession.¹⁵¹

145. *Toll*, 743 N.W.2d at 904.

146. *Id.* at 907.

147. *Id.* at 907–08.

148. *The Michigan Tax Tribune: An Overview for Municipal Officials and Practitioners*, MICH. MUN. LEAGUE, <https://www.mml.org/pdf/iptreports/tax-tribunal-5-26-2011.pdf> (last visited Jan. 18, 2016).

149. CRC is a private nonprofit, nonpartisan public policy research organization based in Livonia, Michigan.

150. CITIZENS RES. COUNCIL MICH., 2015 OUTLINE OF THE MICHIGAN TAX SYSTEM 53 (2015).

151. *Id.*

In its “Running on Empty” report released in 2014, the Southeast Michigan Council of Governments summarized a detailed study of the revenue and tax base growth of cities and townships since the mid-1990s.¹⁵² The report reveals that, statewide, the tax bases and revenues of largely rural townships grew much more rapidly than their urban and suburban counterparts.¹⁵³ Excluding the effect of millage rate changes, township revenue between 1996 and 2013 grew by 93%, almost twice the rate of inflation; meanwhile, cities grew their revenue by only 36% during the same period.¹⁵⁴ In inflation adjusted terms, the tax base of cities in Michigan shrunk by 15% between 1996 and 2013.¹⁵⁵ While cities across the state are suffering tax base loss, the problem is especially severe in southeast Michigan, where virtually every city in the region had less tax capacity in 2013 than it had in 1994, and some inner suburban communities have lost over 50% of their tax base.¹⁵⁶

2. Inflation Caps and Rollbacks Prevent Cities from Realizing a Return on Their Investments

All this is occurring despite decades of redevelopment and placemaking initiatives aimed at restoring economic vibrancy to inner cities and older suburbs.¹⁵⁷ While not all redevelopment strategies have been successful, even when communities generate new investment, very little of that growth gets taxed because, under the Headlee Amendment, only new construction meets the definition of “additions.”¹⁵⁸ Because so little redevelopment gets classified as an addition, growth in Michigan’s cities at most adds new revenue at the rate of inflation and, if a sufficient number of property transfers occur, may trigger rollbacks in the community’s maximum authorized millage rate.¹⁵⁹

152. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28.

153. *Id.* at 10.

154. *Id.*

155. *Id.*

156. *Id.* at 12.

157. See the Michigan Economic Development Corporation’s extensive website on redevelopment and place-making initiatives at <http://www.michiganbusiness.org/community/development-assistance/> and the Brookings’s Institution’s report on the challenges of struggling urban areas at http://www.brookings.edu/~media/Research/Files/Papers/2010/5/18-shrinking-cities-mallach/0518_shrinking_cities_mallach.PDF.

158. See *WPW Acquisition Co. v. City of Troy*, 643 N.W.2d 564, 566–68 (Mich. 2002); see also *Toll Northville LTD v. Twp. of Northville*, 743 N.W.2d 902, 907 (Mich. 2008).

159. Because of the way Headlee is worded and the language in PA 145, millage rate rollbacks become permanent, unless a local government can convince its electorate to

It is difficult to escape the conclusion that Michigan's experiment with tax limitations has created a system in which older, urbanized communities are at best mired in the status quo while many are destined for financial crisis.¹⁶⁰ What prudent mayor or city manager would invest in a city's future when it is clear that inflation-adjusted tax-base growth is a virtual impossibility and could perversely trigger a rollback of the community's tax capacity?

The SEMCOG data also indicates Headlee and Proposal A have impeded built-out communities' efforts to recover from the Great Recession.¹⁶¹ With general price inflation hovering near zero,¹⁶² older communities that have lost over 10% of their tax base in just the past few years will need many years of consistent growth to recoup their losses and, again, still may fall victim to a rollback.¹⁶³

E. Opportunities for Reform

1. Tax and Expenditure Limitations (TEL) in the U.S.

Thirty states operate under some form of statewide tax or expenditure limitations (TEL), with the majority (twenty-three) employing only spending limitations.¹⁶⁴ A few states, including Michigan, have adopted revenue limitations alone, while Colorado, Oregon, and Oklahoma restrict both spending and revenue.¹⁶⁵ Many more states (forty-six), including Michigan, have adopted constitutional or legislative restrictions on local property tax levies.¹⁶⁶

Analysts broadly agree that Colorado's Taxpayer Bill of Rights (TABOR) is the most restrictive statewide TEL in the country.¹⁶⁷

raise the maximum tax rate. See MICH. CONST. art. IX, § 31; MICH. COMP. LAWS ANN. § 211.34d(2)(7) (West 2016).

160. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28, at 10.

161. *Id.* at 24.

162. See *Current U.S. Inflation Rates: 2006–2016*, U.S. INFLATION CALCULATOR (Feb. 19, 2016), <http://www.usinflationcalculator.com/inflation/current-inflation-rates/> (indicating that the U.S. Consumer Price Index was below 1% in 2013 and 2014 and 1.4% in 2016).

163. See Otniel Chis & Eric Luper, CITIZENS RES. COUNCIL MICH., TRENDS IN MICHIGAN LOCAL GOVERNMENT FISCAL HEALTH 42 (Oct. 1, 2015).

164. Bert Waisanen, *State Tax and Expenditure Limits*, NAT'L CONF. ST. LEGISLATURES (2010), <http://www.ncsl.org/research/fiscal-policy/state-tax-and-expenditure-limits-2010.aspx>.

165. *Id.*

166. *State and Local Tax Policy: What are tax and expenditure limits?*, TAX POL'Y CTR. (Aug. 20, 2009), <http://www.taxpolicycenter.org/briefing-book/state-local/fiscal/limits.cfm>.

167. McGuire, *supra* note 16.

Enacted by the voters in 1992, TABOR shares a number of features with the Headlee Amendment and Proposal A.¹⁶⁸ It requires that tax increases may only be approved by a vote of the people and restricts the growth in state and local revenue and spending.¹⁶⁹ Under TABOR, revenue may grow by no more than the rate of inflation plus population growth.¹⁷⁰ When revenue exceeds the TABOR limit, the state must refund the excess revenue to taxpayers, unless voters authorize the legislature to spend the money.¹⁷¹

2. *Colorado Adjusts TABOR to Address New Realities*

As originally passed, TABOR based the annual limit on the *lesser* of the prior year's revenues or the amount of revenue permitted by TABOR.¹⁷² During recessions, state revenues typically drop and, thus, TABOR can permanently lower Colorado's revenue baseline.¹⁷³ This became known in Colorado as the "ratchet-down" effect, and critics complained loudly when, in the aftermath of a recession in 2001, the state's revenue limit dropped and prevented investments in public education and other critical services.¹⁷⁴

Frustration with TABOR's "inflation [plus] population" revenue cap and ratchet-down effect grew in the early 2000s following the enactment of Amendment 23, an amendment to the state constitution that required the Colorado legislature to annually increase funding for K-12 education by the rate of inflation plus 1%.¹⁷⁵ Amendment 23 called for increased investment at precisely the time that TABOR was shrinking state revenue and spending.¹⁷⁶ Voter concerns about TABOR finally led to the 2005 passage of Referendum C, which suspended for five years the TABOR revenue and spending limits and permanently eliminated the ratchet down effect by basing future revenue on TABOR limits alone.¹⁷⁷

168. *Id.*

169. Iris J. Lav & Erica Williams, *A Formula for Decline: Lessons from Colorado for States Considering TABOR*, CTR. ON BUDGET AND POL'Y PRIORITIES (Mar. 15, 2010).

170. *Id.*

171. Memorandum from Kate Watkins to the Long-Term Fiscal Stability Comm. (Jul. 6, 2009) (on file with Colorado Legislature).

172. Iris J. Lav, *Fixing TABOR's Ratchet Will Not Repair TABOR*, CTR. ON BUDGET AND POL'Y PRIORITIES (Apr. 10, 2008).

173. *Id.*

174. Watkins, *supra* note 171, at 3.

175. GREAT EDUC. COLO., *Amendment 23 FAQs*, <http://www.greateducation.org/statistics-faqs/funding-faqs/amendment-23/> (last visited Jan. 18, 2016).

176. *Id.*

177. Watkins, *supra* note 171, at 3.

3. *Michigan Should Follow Colorado's Example and Ditch Headlee Rollbacks*

While the operational specifics and scope of the Headlee Amendment and TABOR differ, the example of Colorado's decision to pause and relax its revenue limitation is worthy of consideration. In Michigan, revenue limits and ratchet-down effects operate at the local level in the form of Headlee's rollback provision, which is triggered whenever local property tax growth exceeds inflation. This has the effect of permanently ratcheting down the local tax base.¹⁷⁸

Operational specifics aside, what matters is whether conditions have changed in Michigan such that the time has come to amend Headlee to respond to those new circumstances. The framers of Headlee and TABOR may not have anticipated how serious economic downturns, near-zero inflation and subsequent constitutional amendments would affect the operation of their policies. Colorado voters responded to these conditions with modest but significant changes to TABOR.¹⁷⁹

Coming in the midst of the 1970s real estate price boom, Headlee's rollback provision grew out of a belief in permanent real estate price appreciation and high inflation in the general economy.¹⁸⁰ Headlee could not have imagined the kind of real estate price meltdown that attended the Great Recession,¹⁸¹ nor the virtual disappearance of general price inflation from the U.S. economy.¹⁸² In light of these new realities, do Headlee rollbacks, which deny cities badly-needed revenue gains, continue to make sense?

Policy analysts at the National Conference of State Legislatures and Minnesota House Fiscal Analysis Department have emphasized the importance of adjusting constitutional revenue and expenditure limitations to account for new realities, including subsequent constitutional amendments.¹⁸³ Just as TABOR did not contemplate Colorado's Amendment 23, Headlee did not anticipate the approval of Proposal A, which would prove much more effective than Headlee

178. Lav, *supra* note 169.

179. TABOR continues to have vocal critics who assert that its revenue and spending limits are fundamentally flawed. See Lav, *supra* note 169. At the same time, its continued existence testifies to a continued level of support among Coloradans.

180. See Interview with Howard Ryan, *supra* note 63.

181. Otniel, *supra* note 163, at 35.

182. BUREAU OF LAB. STATS., *supra* note 106.

183. See Bill Marx & Paul Wilson, *Issue Brief: Revenue and Expenditure Limits*, FISCAL ANALYSIS DEPT. MINN. HOUSE REPS. 3 (Feb. 2004); Waisanen, *supra* note 164.

rollbacks at protecting property owners from sudden property tax increases.¹⁸⁴

4. *Revise Headlee's Local Funding Floor to Account for Proposal A*

In addition to rendering Headlee rollbacks superfluous, Proposal A also undermined another provision of Headlee that was designed to ensure that the state government, when faced with its own revenue limitation, would not reduce its support for local governments.¹⁸⁵ The Headlee amendment, inserted into the Michigan Constitution Article IX Section 30, required the state to provide units of local government no less than the proportion of state funding that it gave them in fiscal year 1978–79.¹⁸⁶ The approval sixteen years later of Proposal A virtually nullified this provision, because Proposal A shifted responsibility for funding public education from localities to the state.¹⁸⁷ State funding for “local units of government, taken as a group,” rose to well over 60% of total state revenue, far above the Section 30 floor of 49%.¹⁸⁸

With such a large cushion against falling below the Section 30 minimum, state government began cutting funding for local governments, especially beginning in the 2000s when the effects of a weakened economy and extensive tax cuts drained the state budget.¹⁸⁹ The result has been a dramatic reduction in funding for local governments, in transportation, revenue sharing, public health, public education, and other areas.¹⁹⁰ These cuts, which include a cumulative reduction in revenue sharing of over \$6 billion, have compounded the municipal finance crisis facing many local governments.¹⁹¹

The solution is to recognize, as the NCSL has recommended, that constitutional revenue limitations need to be adjusted when a subsequent constitutional amendment changes the funding relationship between state and local government.¹⁹² The centralization in Lansing of tax collection for public education does not reduce the need of local governments to police their streets or provide other essential services. To restore the

184. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28, at 16.

185. *Id.* at 17–23.

186. MICH. CONST. art. IX, § 30.

187. *See id.* art. IX, §§ 8 & 11.

188. *See id.* art. IX, § 30. Local units of government included a broad class of entities including school districts, cities, counties, villages and townships.

189. SOUTHEAST MICH. COUNCIL GOV'TS, *supra* note 28, at 19–23.

190. *Id.*

191. Otniel, *supra* note 163, at 82–3.

192. Waisanen, *supra* note 164.

balance of funding between state and local governments, the constitution could be amended so that 1) non-educational local units of government receive at least the same proportion of state revenues that they received in fiscal year 1978–79, and 2) the state is barred from transferring funds out of the school aid fund or from funding non-educational programs with school aid fund dollars.

5. Level the Playing Field by Helping Built-Out Communities Raise New Revenue

Options for empowering fiscally endangered older cities are not limited to constitutional revisions to Headlee. The legislature could enact a provision to broaden the eligibility of communities that are permitted to enact special assessments that do not count toward a community's constitutional millage limit.¹⁹³ For example, the Police and Fire Protection Act of 1951, as amended, permits townships of any size and cities with less than 15,000 in population to levy a special assessment to cover the costs of public safety services.¹⁹⁴

Senate Bill 109 would remove this population limit and allow cities of any size to levy such assessments with the approval of the local electorate.¹⁹⁵ Such legislation would not only place cities on an equal plane with townships, but it would provide greater flexibility for communities to address public safety costs, which typically consume a high proportion of municipal budgets.¹⁹⁶

6. Help Cities Raise Revenue and Increase Utilization of their Existing Infrastructure

Detroit and Flint have infrastructure designed to serve populations twice their current size and exemplify the “build and abandon” cycle that

193. The author wishes to thank Chris Hackbarth, director of legislative affairs for the Michigan Municipal League (MML) and Anthony Minghine, chief operating officer of the MML, for pointing out this opportunity. Interview with Chris Hackbarth (Feb. 19, 2016). Under *Graham v. City of Saginaw*, 27 N.W.2d 42 (Mich. 1947), special assessments were not deemed to count toward a community's constitutional millage limit.

194. MICH. COMP. LAWS ANN. § 41.810 (West 2016).

195. S. 109, 98th Leg., Reg. Sess. (Mich. 2015).

196. The costs of providing police and fire protection services typically consume over 50% of a community's budget. See Ted Roelofs, *In Some Cities, It's Cash that's Burning*, BRIDGE (May 22, 2012), <http://bridgemi.com/2012/05/in-some-cities-its-cash-thats-burning/>.

has befallen communities in the industrial Midwest and elsewhere.¹⁹⁷ But even without major population loss, many built-out cities in Michigan have excess infrastructure capacity that could be used to raise revenue and cover the community's capital costs. Meanwhile, outward development pressures continue to spur new construction in nearby townships that lack infrastructure or the capacity to provide other needed public services.¹⁹⁸

Wishing to avoid heated battles over annexation, a growing number of cities, villages and townships are entering into so-called "PA 425 contracts," whereby a city with excess infrastructure capacity agrees to supply a nearby developing township with, say, municipal water and sewer along with a full complement of other municipal services.¹⁹⁹ In exchange, the residents of the township pay the city's full property tax rate.²⁰⁰ Municipal leaders express support for the program but complain that it rarely leads to coordinated land use and infrastructure planning and point to instances where rural townships elect to build new infrastructure next to cities that have excess capacity.²⁰¹

To enable cities to more fully utilize their current infrastructure and cut down on the building of redundant systems in neighboring communities, city leaders have begun to call for requiring "universal" PA 425 agreements.²⁰² This involves empowering a city with excess infrastructure capacity to define, based on state certification, an area beyond its borders that would be deemed a potential service area. New development requiring infrastructure or other public services within the service area could not proceed unless the community enters into a PA 425 agreement to source its infrastructure or services from the city.²⁰³

197. Michaela Krauser, *With a Population in Free Fall, Detroit Turns to Planned Shrinkage*, NEXT CITY (June 28, 2012), <https://nextcity.org/daily/entry/with-a-population-in-free-fall-detroit-turns-to-planned-shrinkage>.

198. *Regional Forecast*, SOUTHEAST MICH. COUNCIL GOV'TS (Mar. 2012), <http://semcog.org/Plans-for-the-Region/Regional-Forecast>.

199. Such agreements are authorized under the PA 425 of 1984, MICH. COMP. LAWS ANN. § 124.21 (West 2016). See Ellen M. Bassett, LAND USE PLANNING AND COOPERATION UNDER MICHIGAN'S CONDITIONAL LAND TRANSFER ACT 1-29 (JUNE 26, 2006).

200. *Id.*

201. *Id.* at 15.

202. Interview with Chris Hackbarth, *supra* note 193.

203. *Id.*

IV. CONCLUSION

A. Headlee and Proposal A Together are Tax Limitation Overkill

Despite being separated by sixteen years, the Headlee Amendment and Proposal A addressed the same basic concern: sharp and unexpected increases in property taxes brought on by rapidly escalating real estate values in the 1970s and early 1990s.²⁰⁴ When it became clear even after Headlee that individual property tax assessments could still increase at double-digit rates, voters in 1994 enacted Proposal A, and finally secured protection from steep annual increases in their property tax bills.²⁰⁵

Few at the time recognized that Proposal A would largely obviate the need for Headlee's rollback provisions because individual property taxpayers were protected by Proposal A's limitation on annual taxable value growth.²⁰⁶ Few also appeared to realize that Proposal A would deny older, built-out cities virtually any real, inflation-adjusted growth, because such communities have little open space for new construction not subject to taxable value caps.²⁰⁷ Moreover, uncapped revenue growth resulting from real estate transfers may trigger a Headlee rollback of the community's maximum authorized millage rate, permanently ratcheting down a city's revenue capacity.²⁰⁸

Given Proposal A's effectiveness at protecting taxpayers, the harm of permanently ratcheting down a city's revenue and the evident fiscal vulnerability of Michigan's older cities, the time has come to consider a range of constitutional and statutory changes that would address the unintended consequences created by enactment of both Headlee and Proposal A. These include:

- (1) Repealing provisions of the Headlee Amendment that require rollbacks of a community's maximum authorized tax rate;²⁰⁹ and
- (2) Specifying that the proportion of state revenue shared with non-educational local units of government not drop below levels provided in fiscal year 1978–79.²¹⁰

204. Dawsey, *supra* note 31; see also TAX POL'Y CTR., *supra* note 166.

205. Interview with Howard Ryan, *supra* note 63.

206. See CITIZENS RES. COUNCIL MICH., *supra* note 126 at 2 (for the lone example obtained by the author of a commentator mentioning this issue).

207. The author found no contemporary analysis of Proposal A that mentioned this concern.

208. CITIZENS RES. COUNCIL MICH., *supra* note 126.

209. MICH. CONST. art. IX, § 31 (1978).

But these changes would not eliminate the structural disadvantages for older, built-out communities inherent in Michigan's constitutional property tax and revenue limitation scheme. To further level the playing field, the state should consider eliminating provisions that unfairly limit cities' abilities to enact special assessments for public safety.²¹¹ In addition, analysts at the Michigan Municipal League and elsewhere have suggested creating so-called "universal" PA 425 agreements that enhance the ability of a fully-developed city to partner with neighboring townships to maximize the utilization of the city's infrastructure. This creates another means of enabling built-out communities to grow revenue by maximizing utilization of their existing infrastructure and other public service capacity.

B. Failing to Act Endangers Older Communities and Harms Critical State Interests

The crises in Detroit and Flint have their origins in a wide array of historical and macroeconomic factors that do not uniformly apply to other municipalities in Michigan.²¹² Still, the fiscal distress that plagues these communities is not unique to Michigan's largest urban centers. Older, built-out cities across the state are suffering from the unintended consequences of Headlee and Proposal A, and state officials would do well not to wait for the next significant economic downturn to enact policies to address these concerns.²¹³

The experiences of the City of Detroit, its school district and the City of Flint make clear that the human cost of failing to act can be enormous and the fiscal impact of delay can reach across the entire state.²¹⁴ Seeking to avoid a prolonged bankruptcy that could harm the state's economy and require increased social welfare spending, the Michigan legislature in 2014 appropriated \$195 million to support a "grand bargain" that enabled

210. See *id.* § 30.

211. Interview with Chris Hackbarth, *supra* note 193.

212. See Thomas J. Sugrue, *The Origin of the Urban Crisis* 1–432 (1996); Eric Reed, *The Economic Origins of Flint, Michigan's Turmoil: Why Austerity Has Failed*, THE STREET (Jan. 24, 2016), <http://www.thestreet.com/story/13433198/1/the-economic-origins-of-flint-michigan-s-turmoil-why-austerity-has-failed.html>.

213. Audia, *supra* note 11.

214. See Matthew Dolan et al, *Snyder to propose \$195M more for Flint water crisis*, DETROIT FREE PRESS (Feb. 9, 2016), <http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/gov-propose-195m-flint-water-crisis/80065974/>; Jonathan Oosting, *Michigan House approves \$195 million for Detroit 'grand bargain' bankruptcy deal*, MLIVE (May 22, 2014), http://www.mlive.com/lansing-news/index.ssf/2014/05/michigan_detroit_grand_bargain.html.

a relatively swift resolution of Detroit's bankruptcy.²¹⁵ Confronting a similar situation in June 2016, the state legislature provided over \$600 to retire the Detroit Public Schools' debt rather than allow the district to declare bankruptcy.²¹⁶

C. Reconciling Voters' Dueling Impulses to Limit Taxes While Expanding Services

Headlee and Proposal A fit within a long historic pattern in which the public responds to an economic or financial crisis with tax or expenditure limitations designed to reign in the power of the legislature.²¹⁷ This is then followed by a period of retrenchment where public officials in various branches and at all levels undermine those limitations, often because of practical difficulties with the TEL, the disappearance of the crisis or the emergence of conflicting priorities.²¹⁸ Imbedded in this pattern are the public's dueling impulses to limit taxation while continuing to demand increased levels of public services.

The reforms suggested here will hardly resolve this political conflict but, nonetheless, they offer a pragmatic means of reconciling these impulses by tailoring the tax limitation policy to the specific problem it was largely designed to address, while minimizing the unintended consequences of Michigan's tax and revenue limitation scheme which pose such a severe threat to our communities.

215. Oosting, *supra* note 5.

216. Oosting, *supra* note 5; see also Paul Egan et al, *Snyder budget: Money for DPS fix could be heavy lift*, DETROIT FREE PRESS (Feb. 10, 2016), <http://www.freep.com/story/news/local/michigan/detroit/2016/02/10/michigan-budget-2017-flint/80165840/>.

217. Fino, *supra* note 13.

218. *Id.* at 979.