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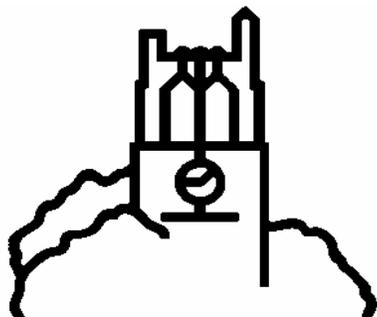
# ***Staff Paper***

## **Economic Implications of the Transfer of Functions Legislation**

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## **Economic Implications of the Transfer of Functions Legislation**

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## INTRODUCTON

Recent introduction of HB 4780 and its companion pieces of legislation (HB 4781-4788) has raised a number of questions about the appropriate level of government to deliver services to Michigan residents. Essentially, under provisions contained in the bill, elections, tax collections, and assessment functions would be transferred from “rural” townships to the county where the township is located. The bill defines a rural township as a township or charter township unit with population less than 10 thousand, or population between 10 and 20 thousand but does not provide police and fire on a 24-hour basis and sewer and water services to more than 50% of its residents. The Michigan Township Association (MTA) expects that 95% of Michigan townships would be subject to this legislation.

The bill has elicited strong responses from both sides of the issue. Some newspaper editorial boards and policy think tanks across the State have positioned in favor of the bill, citing potential costs savings and a uniform service level. County and township boards statewide, conversely, have passed resolutions opposing HB 4780, and both MTA and Michigan Association of Counties (MAC) have taken positions against the bill.<sup>1</sup> Those in opposition contend that it is smaller units of government that can continue to provide these services more efficiently, economically, and at a better quality. They also make the argument that moving services to the higher tier county government replaces existing service capacity at the township level and promotes less citizen access and accountability.

Given the importance of the topic, Michigan State University’s State and Local Government Program decided to undertake a financial analysis to determine the potential implications of the proposed policy change<sup>2</sup>. This article describes the process and findings from that research. The focus was placed on the financial impact of the policy and does not address other potential implications of the policy.

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<sup>1</sup> Although the MAC Board has officially opposed the legislation, they continue to examine provisions of the bill in individual workgroups. They seek to introduce flexibility into the legislation by making portions optional or incentive driven.

<sup>2</sup> The MSU State and Local Government Program holds an official neutral position with regards to the proposed legislation

## **CURRENT PROPERTY ASSESSMENT PROCESS IN MICHIGAN**

The property assessment process has historically been assigned to the township and city governments in Michigan. An 1846 revised statute established the township supervisor as the chief assessor of the township. The township board, if the Township Supervisor does not have the appropriate credentials, has the right to hire assessors who would work for the Township Supervisor. The same law (from a 1958 revision) allows the township board to hire an independent firm to assist in the appraisal process. Under the General Property Tax (P.A. 206 of 1893), the state requires certain training and credentials for those who will undertake the assessment of property.

Thus, it is the responsibility of city and township assessors to determine individual parcel property values. The county and county boards of commissioner's current duties, via an equalization department, is in the area of property equalization. The equalization process is to determine the total value of classes of township and city property, and not individual parcel values. Each year, county equalization departments undertake sales and appraisal studies to assure property values for all cities and townships within the county are treated equally and uniformly. The equalization department undertakes this annual process to assist county boards of commissioners' (pursuant to Section 34 of Michigan's General Property Tax Act) in determining whether each of class or real and personal property for each city and township located in the county is set at an average level of 50 percent of true cash value. There are six classes of real property to be equalized by the county: agricultural, commercial, industrial, residential, timber-cutover, and developmental, along with the personal property. During this process, any inequities between county jurisdictions arising from either an over or under assessment of a property class are corrected.

If in determining the total value of a property class, the county assessed value as determined by the equalization department differs from local city or township assessed value, the county applies an equalization factor against that class of property. A separate county equalization factor is determined for each of the seven classes of property. A county equalization factor of 1.00 indicates that the value of a class of property within township or city is equal 50 percent of true

cash value. A factor less than 1.00 deducts value from the class, while a factor greater than 1.00 will add value to the property class. When multiplied against the assessed value determined by the city or township assessor, the equalization factor will add or deduct from the value of a class of property. The system acts as a check and balances system regarding the process of assessment and equalization. In some instances, county equalization staff may perform assessment functions under contract for a township or city located within the county if asked to do so.

The state also computes what it believes are the assessed values for each class of property within a county. Like the county equalization of township and city property classes, the purpose of state equalization is to assure that counties across the state have their assessments set at 50 percent of true cash value. If the state equalized values are different than the county assessed values, the State Tax Commission may also impose factors on the county assessed value. The county board may appeal this decision.

Within this complex web of local city or township, county, and state level assessment and equalization, the individual property owner does have a chance to appeal their assessed property value. Although the first avenue for a property owner to appeal is the local assessor (where board or council resolution permits), the appeals process may ultimately be handled through the township or city board of review. The board of review offers an avenue for an individual property owner to appeal an assessment. Most City charters or resolutions will dictate board of review composition and meeting times, whereas townships must look to state legislation for these details.

## **ECONOMICS OF PROPERTY ASSESSMENT**

At the heart of this debate are several important issues. Among the most important is the issue of the economies of scale associated with the cost and quality of local government services.

Economies of scale refer to the relationship between the inputs that are used to generate government services and either productivity or cost measures. The productivity of government services is one format which can be used to measure economies of scale. In this instance, a comparison is made between inputs and outputs. For example, the relationship between the number of 911 dispatch employees and the volume of calls handled. If the number of dispatchers is increased by 10%, but the call volume that can be handled increases by 20%, we would state that economies of scale does exist in that service area. If the call volume that could be handled only increased by 10% or less, it would then be the case that either no or actual diseconomies of scale existed.

For governments, a good measure of outputs often does not exist. Therefore, economies of scale is typically measured using the relationship between costs and inputs. So, using an example from 911 dispatch, the comparison would be made between numbers of dispatch employees and expenditures. If the number of employees rose by 10% (for example through some type of consolidation) and costs rose less than 10%, the case for economies of scale could potentially be made.

The key factor in economies of scale analysis is that the comparison is made between governments that are essentially providing the same service and service level. Service level, if it is dramatically different, can potentially be controlled for in a research design. Other important factors to consider, and that have a major impact on the existence of economies of scale, include geography, population density, similarity of service level, capital intensity and number of governments. For example, the nature of the physical boundaries of two or more governments will have an important impact on the costs of providing service.

Economic and public finance research point to several general findings about economies of scale in local government services. Most research findings point to the existence of economies of

scale in capital intensive, but not labor intense governmental services. Therefore, the least cost size for providing police is generally smaller than the size needed to provide sewer and water services. This is generally true because as the consolidation of jurisdictions occurs there is still a need to maintain the same of officers to cover the geography and population dimensions of the new community. For an infrastructure service, depending on the capacity of the physical plant, services can be extended to a greater population and geographic base at lower cost due to the existence of major fixed costs. The other consideration, not unlike in the private sector, is the existence of economies of scale for skill intensive positions. For example, a certain position may be required on only a part time basis due to its specialized nature. Community cooperation to provide such a service may be shared at a lower cost to all. It is also important to note that economies of scale may be present for certain sizes of communities, but no others. In other words, economies of scale is not constant across the community spectrum in all cases.

These general research findings, while useful as a starting point, cannot provide an exact answer to any specific service for any given community. In 1997, Georgia State University released a report on economies of scale in property assessment in the state of Georgia<sup>3</sup>. Their findings were that, on average, a 10% increase in assessment volume led to a 3% increase in cost. This would indicate there were economies of scale. In context, Georgia property assessment is done at the county level and most Georgia counties are geographically small. A Michigan specific feasibility or policy analysis is necessary. Consequently for HB 4780, a determination of cost and quality implications should assist policymakers in understanding the potential implications of transferring elections, tax collection, and equalization from township governments to county government.

Indianan, through an initiative called the Indiana Project for Efficient Local Government, also examined the question economies of scale in property assessment<sup>4</sup>. The initiative found a project cost savings of \$11 to \$13 million from the consolidation of the assessment function from townships to counties. However, this cost savings was based on the results from only two Indiana counties and thus is very unlikely to be robust from an economic or statistical basis.

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<sup>3</sup> Sjoquist, David and Mary Beth Walker. "Economies of Scale in Property Tax Assessment". Fiscal Research Report No.97-2, September 1997.

<sup>4</sup> <http://www.indianachamber.com/localgov/>

The current analysis only focuses on the issue of property assessment and potential cost savings due to a transfer of functions. The service areas of tax collection and elections are not addressed in this article. This omission is due to the fact that we were unable to compile sufficient data on the cost of provision of these service areas.

For a service such as property assessment, several factors are critical in determining whether economies of scale and subsequent cost savings exist. A major question of the capacity of county governments to absorb new employees, and equipment is necessary to answer. If excess capacity in facilities and personnel does not exist, new costs must be absorbed by county governments in order to undertake this function.

To assist in this discussion the State and Local Government Program at Michigan State University sent a questionnaire to county equalization departments across Michigan. The survey was designed to elicit responses on the county capacity to extend assessment services to qualified townships, as well as provide estimated costs of such action. The equalization departments were also asked to share any perceived benefits and drawbacks of proposed legislation. It is hoped these results will shed light on one area of concern in HB 4780 as state and local leaders continue to debate this issue.

The current service provision landscape includes a range of options that townships have selected. These options include providing assessment services in-house, contracting with a private provider or using the county government. A 2005 survey of local governments by the Citizens research Council of Michigan revealed the following pattern of assessment service delivery: 69% of townships reported directly providing the assessing service in-house, 10% reported using the county government for the service and 19% reported using a private provider. Thus, already township governments have examined the delivery of the assessment service and decided that other options such as county or private provision may be more economical.

## SURVEY RESPONSE DEMOGRAPHICS

Thirty-two, or roughly 39 percent of Michigan counties responded to the survey, accounting for 508 township governments. This sample represents nearly 60 percent of total State Equalized Value (SEV) across Michigan and approximately 58 percent of township SEV. Survey coverage also includes all geographic, economic, demographic regions in Michigan (see map). For purposes of this study, the coverage is more than adequate for a comprehensive examination of the assessment issue.

**Table 1: Characteristics of Counties Responding to Survey**

Region	Counties	Townships	2007 County SEV	2007 Township SEV
Central	9	147	52,114,455,967	31,560,230,045
North	6	68	11,106,651,848	10,480,593,518
Southeast	7	141	159,041,966,659	81,836,490,127
Southwest	7	120	42,138,857,775	29,193,017,550
U.P	3	32	3,586,337,806	2,493,860,594
<b>Total-Survey</b>	<b>32</b>	<b>508</b>	<b>\$267,988,270,055</b>	<b>\$155,564,191,834</b>
Total-State	83	1,242	453,108,709,674	267,107,170,186

In general, the complexity of assessment services increases as a county becomes more populated. Mandated functions and service expectations in heavier populated areas increase staffing levels and push spending higher than the more sparsely populated counties. Therefore, it is sensible to group and examine the survey results based on county population. Three groups were created, counties with: (1) populations less than 30,000, (2) population between 40,000 and 111,000, (3) and population greater than 145,000.

Counties were also asked to provide information on the size and operation of equalization departments. As expected, the number of employees and costs rise as the size of the county rises. The average salaries rise due to the complexity of equalization task necessary. This information provided a useful benchmark in determining the potential impact of the policy change.

**Table 2: County Equalization Staffing and Average Costs**

County Population	Counties	Averages				
		Employees	Personnel Cost	Operating Cost	Total Cost	Salary
< 30,000	11	3.55	\$167,004	\$31,390	\$198,394	\$47,104
40,000 – 111,000	9	4.53	\$270,417	\$50,966	\$321,383	\$59,724
>145,000	12	16.29	\$1,120,470	\$297,951	\$1,418,421	\$68,776

## FINANCIAL ANALYSIS AND PROJECTED COSTS

Our analysis focused on the cost of providing the property assessment function. Some perspective is required in order to place the economics of property assessment in its appropriate context. Property assessment consumes a very small portion of local government budgets. Generally, it is in the range of 2-4 percent of the total local government budget. This is far below the resources expended on service areas such as police and fire protection, water and sewer service, jails and human services. At the same time, property assessment is a critical function that provides the basis for the majority of local government taxes collected.

As discussed in a previous section, the economics of property assessment transfers will be partly determined by the existence of excess labor and physical capacity. Table 3, based on the survey, reveals that the majority of counties indicated they would not have the physical or labor capacity to respond to the need to provide the new assessment service. In the labor capacity arena, only 2 counties in the largest size category indicated that would have adequate staffing. In the physical capacity area, which would include office space, the vast majority of counties reported they did not have the capacity for the potential new assessment service. These results point towards the potential difficulty in achieving large cost savings from the shift of functions from township to county government.

**Table 3: County Capacity to Perform Township Assessing Functions**

County Population	Physical Capacity		Labor Capacity		Estimated New Employees Needed*				
	Yes	No	Yes	No	1-2	3-5	5-10	11-20	20+
< 30,000	2	9	0	11	2 counties	6 counties	1 county		
40,000 - 111,000	2	7	0	9		6 counties	1 county		
>145,000	2	10	2	10		1 county	2 counties		3 counties

\* Not every county replying to survey supplied estimated number of employees. Estimates may include additional contracted personnel, as well as new county staff.

In table 4, the financial results of the analysis are presented. The township cost calculations are based on a fiscal database collected by the Michigan Department of Treasury for township government costs. The total county costs are based on the county’s response to the administered survey. For the financial analysis, the results reflect the response of 19 counties. Not all counties provided estimates of the costs of providing the assessment function for township government. Despite the smaller sample size, it is still believed that these estimates provide policy makers with a benchmark from which to gauge the potential implications of the proposed policy change.

**Table 4: Estimated Assessment Costs**

County Population	Estimated Annual Assessing Expenditures	
	Total County*	Total Township**
< 30,000	\$2,637,209	\$1,967,008
40,000 - 111,000	\$1,655,000	\$2,039,984
>145,000	\$11,805,857	\$10,678,060
TOTAL	\$16,098,066	\$14,685,052

\* A total of 20 counties reported estimated costs to extend assessing services to all townships countywide.

\*\* Compiled from Michigan Municipal League's F-65 database.

In two of the three categories, county government would be unable to provide the property assessment function at a lower cost than township governments. In the middle category, the cost estimates are for a negligible level of savings. In total, total assessment costs in this sample would rise nearly 10 percent or to the figure of \$16 million. This provides preliminary evidence for the hypothesis that labor intensive services such as property assessment are less likely to exhibit cost savings as the size of government responsible for the function changes. This cost analysis does not address several important issues such as the inclusion of capital costs including equipment, office furniture and computers.

## CONCLUSION

Relative to the property assessment function, several arguments have been put forward as to why such a function is better located at the county level. The first argument is that there are cost savings to be uncovered due to the economies of scale associated with such a function. A larger government with a broader jurisdictional base can undertake the function at a lower cost. The second argument is that the “quality” of assessment services can be better and more uniformly provided at the county level as opposed to the township level. The issue of assessment quality and revenue potential was not addressed in this study.

The findings of this research indicate that the evidence is weighted towards the unlikelihood of significant cost savings from the implementation of House Bill 4780 as currently written based on responses from a sample of Michigan counties. This does not imply that cost savings are not feasible in the property assessment service area. In some communities, townships may be able to transfer the property assessment function to county government or even another government entity. Some townships have already chosen this route or are working with private providers. These communities have uncovered cost savings or better service through this type of arrangement. We also recognize that other arguments related to the “quality” of property assessment have been put forward and we make no claim to have assessed the evidence supporting or opposing such claims. Ideally, we would take the next step in this analysis and use secondary data on property assessment volume of activity and cost to determine the economies of scale question using econometric and statistical analysis.

Our research points to several important factors that policy makers should consider in determining the course of HB 4780 and associated legislation. In the first instance, if economies of scale and cost savings are the target, such savings seem elusive within this particular service area. MSU and other public finance research has been put forward citing the possible cost savings from cooperation in capital intensive and high skill intensive area such as fire protection, water and sewer provision, road construction, information technology.

At the same time, such research reveals that a voluntary, incentive-based, approach is likely to yield better results than a mandated approach. While mandates have an appropriate use, in many cases they force many communities to undertake changes in service provision that are neither economical nor equitable. Note the increasing use of incentives and information in the environmental regulation arena rather than mandates. Public finance economics points to incentives, as opposed to mandates, as a better tool to achieve the same ends.