

Section 3: Operations

Chapter 12: Municipal Service Options

Introduction

A principal responsibility of local government policy bodies is to determine the mix of community services to provide to local residents. While variation or mix of services is noted among municipal governments, each unit makes four basic decisions about services:

1. method of organization, production and provision;
2. quantity of services to be produced and provided;
3. quality of services to be delivered; and
4. how to pay for services provided.

These decisions are somewhat interdependent, but can be addressed separately.

The basket of services provided by municipalities to residents varies widely in Michigan. Citizen expectation as to what services are desired beyond the basic constitutional duties of assessing property, collecting property taxes and administering elections are articulated through the political process and imbedded in the city charter.

The Home Rule City Act requires the provision of police, fire, sewer, and water services to residents. Note, the key word is “provision;” the Act does not require the city to be the “producer” but in most circumstances, cities both produce and provide the varied sets of urban services.

As both a producer and provider of selected services such as police, fire, recreation, sewer, water, and other utilities, excess capacity is often present, thus enabling the city to become a seller of services to neighboring local units. As adjacent jurisdictions increase in population, and migration from the central city to surrounding areas occurs, cities and villages may find themselves in a situation of

seeking other service production and provision partners due to economic constraints.

This chapter is intended to provide municipal officials with both a conceptual framework and practical guidelines for exploring ways to provide municipal services other than through self-production and provision.

Community Service Production and Provision Options

Communities, given a choice, would prefer to self-produce and provide municipal services. Any other option to service provision increases transaction costs (negotiating with someone else, public or private) and local officials perceive a loss of control when joining with other units for service provision.

Why Seek Alternatives to Self-Production of Service?

Communities explore alternatives to self-production and provision when faced with excess service capacity, financial stress, capacity constraints (financial or human capital), spillover benefits or costs associated with the service, or as a means of sharing risk.

For example, fire protection and emergency service production requires significant financial investment in equipment and accessories, training of personnel, and management. Once the fire suppression or emergency response capacity is generated, excess capacity is often created since emergencies do not occur frequently or regularly.

Communities with excess capacity attempt to sell a portion of the capacity to neighbors, thus a buyer-seller relationship is established.

City government, as a population center, historically became the producer and provider of fire services, and in many cases, sold fire suppression activity to neighboring townships. As a practical matter, a city would be unwilling to sell services to an area outside of the incorporated territory if they lacked the capacity or were unable to obtain compensation to cover the marginal costs of the additional service requirements.

Intergovernmental contracting

The buy-sell, or intergovernmental contracting, method to obtain municipal services is by far the most common method of service provision once self-production is not feasible.

Joint production arrangements and intergovernmental contracting for services represent cost-effective means to obtain services or provide services to units lacking the financial capacity. The key to developing viable and enduring intergovernmental arrangements is to develop a concise and detailed intergovernmental agreement.

Intergovernmental arrangements require patience, perseverance, compromise, and most of all, an open mind.

Joint Service Production through Authorities

Joint production of service may take several forms. A municipality may join forces with an adjacent community to provide services such as fire, police, ambulance, sewer, water, emergency dispatch, solid waste, land use planning, building inspection, and recreation, to name a few.

The city may join with neighboring local governments to establish a special assessment district with a defined service district. Increasingly, local units are creating authorities as a means of producing and providing a service and sharing both financial and associated risks.

Privatization of Services

When adequate private market options are available to the community, service provisions may be privatized. Solid waste collection is a service that a large percentage

of Michigan municipal governments have privatized.

Consolidation of services

A final option is the consolidation of municipal services.

Three types of consolidation exist:

- functional,
- geographic, and
- political.

Functional consolidation might include specific service functions such as fire, police, sewer/water, assessing, road maintenance, or solid waste collection. Such arrangements would involve two or more local government units with each legislative body appointing representatives to an oversight board.

The consolidation of school districts is an example of geographical consolidation.

The political boundaries of a consolidated school district are not consistent with the general-purpose governments, but cut across boundaries. So, a separate governing body (school board) is established to provide oversight.

The most difficult consolidation to achieve is political; that is, merging two or more separate units of government into a new government.

The most recent example is the consolidation in the Upper Peninsula of the cities of Iron River and Stambaugh and the village of Mineral Hills. This merger was approved by voters on November 2, 1999 and took effect July 1, 2000. The new city was called Iron River.

Another example of political consolidation is Battle Creek Township and the city of Battle Creek, although technically the merger between the city and township was accomplished through annexation. As one would expect, political consolidation is difficult to achieve since a sense of community and community identity is involved.

Legal Authority for Contracting and Alternative Delivery Systems

The State of Michigan has permissive legislation enabling local governments to

engage in contracting, consolidation and joint ventures for service provision. Basically, if a local government unit has the authority to engage in the provision of a service to residents, the entity may provide the service through a contractual arrangement (public or private).

The Legislature has enacted a number of intergovernmental statutes specific to municipal services, such as fire, police, sewer, water, and other utilities.

In 1967, during a specifically called session of the Legislature, two broad intergovernmental statutes to facilitate intergovernmental contracting and cooperation were enacted. The Urban Cooperation Act (1967 PA 7) and Intergovernmental Transfers of Functions and Responsibilities Act (1967 PA 8) are frequently used for buy-sell contracts and joint production arrangements for a variety of community services. The popularity of the two statutes is in part due to the flexibility of the laws permitting local governments to tailor agreements to the specific needs of the communities. The two statutes do not provide taxation authority, thus necessitating contracting parties to negotiate the terms, conditions, financing, and method of cost-sharing for the services exchanged or provided.

The Emergency Services Authority Act (1988 PA 57) provides general-purpose governments with the ability to create a special unit of government (an authority) to provide police, fire or emergency service for a unit or in a multiple arrangement. The advantage of creating an “authority” to produce and provide the service is that the new entity is an independent body with its own appointed board, bylaws, and capacity to levy millage in support of the enterprise. Levying millage to support an authority requires voter approval.

Obstacles to Contracting and Joint Ventures

Joint or contractual partnerships may be impeded due to the transaction costs, (the costs of reaching joint decisions). The fear over the perceived loss of control, turf

protection, “skeletons in the closet,” uncertainty of the sustainability of the joint agreement, and the perception that “hidden agendas” are present may constrain viable partnerships from materializing. Local residents and public officials often shy away from joint production arrangements due to the perception that service quality and quantity will change once the unit engages in a joint or contractual venture.

Methods of Cost Allocation under Joint Production Arrangements

The method of sharing and allocating cost shares under a joint production or contractual arrangement is often critical to the success and failure of joint ventures. A necessary step in negotiating sustainable joint ventures involves developing a clear rationale as to why a particular cost allocation method has been selected.

Allocating cost shares is a separate decision from selecting a method to finance the service. In joint production arrangements, sharing costs and generating monies needed to finance a service become somewhat muddled. The strengths and weaknesses of a number of cost allocation methods will be discussed to illustrate how the distributional consequences change under each method.

Relating Benefits to Costs

A basic guiding principle in allocating cost shares is: where possible, relate benefits (services received) to the costs of production and provision. Identifying service demand gets complicated with services such as police, fire, emergency response services, or economic development. Other services such as sewer and water, streets, sidewalks, curb/gutters, street lighting, inspection, tax assessing, etc., lend themselves to easier identification of beneficiaries and demand.

Factors to Consider in Allocating Cost Shares

Buy-sell, contractual, or co-production/provision arrangements for providing community services present a challenge to both the producer (seller) and buyer. The

seller is concerned about covering the total costs of producing and providing services, maintaining service capacity and establishing the price to charge for the services rendered.

Buyers, on the other hand, are concerned about not being overcharged for the service since many municipal services are provided in a monopoly environment.

A variety of options are available to local governments when it comes to allocating cost shares under joint ventures and co-production arrangements. Units that are similar in size and demographic composition and engage in joint ventures will find that an equal division of cost shares presents no problems. The more dissimilar communities are when entering into joint production arrangements, the more creative they need to be to insure equity in cost sharing. Developing a weighted cost share formula that includes factors that influence demand is most fair. This type of “weighted” formula works well with services such as fire, police, ambulance, library and recreation. Population density, congestion, household income or other demographics may influence demand.

Population may be the appropriate factor in determining cost shares for jointly produced planning and development services. Or, a combination of population and tax base could be used since the output from planning and development has applicability to a wide variety of users (governments, private firms and individuals).

Jointly produced infrastructure services, such as sewer and water, present less of a challenge. Variable costs are easily identified and are related to consumption.

Units contracting for services are also concerned with whether the supplier of services will accommodate their specific needs.

Financing Joint Ventures

Financing joint ventures represents a critical decision point, for the selected finance method has far-reaching distributional consequences (who benefits and who pays

the costs). Local governments can use general fund revenues, extra-voted property taxes, special assessment, user fees, third party payments, grants and donations/contributions to fund community services. Each financing strategy carries issues that need to be resolved by the body politic.

General fund revenues are used to finance services that are made available to all community residents. Units engaging in co-production arrangements for service provision often use general fund monies (if available) to support such activities, but with stressed budgets, local governments have sought alternative sources of funding.

Extra-voted property taxes have become a common means of supporting local services and are a way to expand service delivery. Local governments frequently go to the voters requesting additional millage levies for police and fire protection, library, buildings, recreation, new technology acquisition, emergency services and 911, all aimed at maintaining or expanding the level of output of services. Extra-voted revenues become restricted revenues and are treated as special revenue funds (meaning that their use is limited for a specific activity).

Special assessment levies are the financing strategy most municipalities prefer. Special assessment districts are formed when the beneficiaries of a service or public improvement are clearly identifiable, such as the case of streets, sidewalks, street lighting, drains and curb/gutters. Increasingly, local governments use the special assessment districts to provide fire, police, ambulance, and recreation services. Technically, special assessment levies are not considered property taxes, although property value is used as the base upon which the levy is assessed.

User fees and service charges, in large part, eliminate the problem of benefits not being related to costs of the service received. Beginning in the mid-1980s, local governments began to rely more on user fees and service charges to support community services. This was especially true after the

demise of the federal revenue sharing program in 1986 as units scrambled to replace federal monies. User fees increase administrative costs due to collection, monitoring and accounting, but help to regulate demand for the service.

User fees are increasingly being used to support fire run calls, selected police services (such as obtaining an accident report for an insurance carrier) and ambulance calls. Even if a governmental unit is producing and providing a service through the general fund or special millage, local units may assess a user fee.

Third party payments can partially support services such as emergency services, police, fire and ambulance. Homeowner and auto insurance policies, in most cases, contain provisions for reimbursing policyholders for costs incurred in ambulance transport and fire suppression calls. Though local governments incur additional costs in billing customers who use emergency services, third party payments can assist in offsetting costs for service provision. If a unit decides to bill residents or users of emergency services for emergency response, an informational campaign is needed to inform citizens of the new strategy. Residents may have to check with their insurance carriers to see if such coverage is provided or if a rider can be purchased. Charging users for emergency services permits a service provider to charge non-community residents for services used.

Obviously, local governments can combine financing options to provide community services. Utilizing extra-voted millage to support a service does not preclude the use of third party payments. Or a base level of service can be financed through general fund revenue and additional services through the collection of user fees and service charges. Local officials need to examine each revenue option and determine which method matches their community's needs.

Past Relationships Impact Joint Agreements

Joint production arrangements and buy-sell agreements are influenced positively or negatively by intergovernmental relationships. Municipalities often find that border disputes (annexation), conflict over economic development location, and past disagreements inhibit the capturing of benefits from joint relationships. The passage of the Conditional Land Transfer Act, 1984 PA 425, was adopted in part to create a cooperative spirit between adjacent communities and to minimize conflict related to annexation by the sharing of rents from economic development projects.

One of the key roles that elected officials can assume is that of "intergovernmental leader." Political boundaries often become walls even when the lowering of the barrier would result in mutual economic and service gains for both jurisdictions. Building relationships with neighboring jurisdictions is the first step in addressing intergovernmental production and provision options.

Based on materials provided by **Lynn R. Harvey** (retired) professor and extension specialist for state and local government, Department of Agricultural Economics at Michigan State University.