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The Headlee Amendment—Aid to Local Government

by Robert Kleine, Vice President and Senior Economist

Last week the Engler administration agreed to an out-of-court settlement in the *Oakland County* v. *Department of Mental Health* case. State officials conceded that the current method of accounting for the payments for community mental health services as local aid violates the Headlee amendment (Article 9, Section 30) to the Michigan Constitution, and local government gave up claims to correct the violation retroactively. The state will be required to increase its assistance to local governments by about $400 million, beginning in FY 1992–93. The settlement came as a surprise and may have been prompted by information that a negative ruling was likely.

Article 9, Section 30 of the state constitution provides that "the proportion of total state spending paid to all units of local government, taken together as a group, shall not be reduced below the proportion in effect in fiscal year 1978–79." The Department of Management and Budget (DMB) calculated this proportion as 41.6 percent. In arriving at this figure, state spending for state-owned and state-operated facilities for the mentally ill and developmentally disabled were not treated as state spending to local units of government because at that time no community mental health board had assumed the responsibility for providing such care.

In 1980 these expenditures were reclassified as state spending paid to local units of government because (1) the recession was driving up spending on state programs such as welfare and threatening to reduce payments to locals below the required 41.6 percent and (2) the state was anticipating transferring more responsibility and funds to community mental health boards. In September 1981 the Department of Mental Health (DMH) offered county community mental health boards the opportunity to enter into shared management contracts that transferred to the boards a share of the responsibility for planning and coordinating all public mental health services, including planning and coordination of in-patient and residential facilities. Under these contracts, the state paid to the county mental health boards the cost of serving county residents in in-patient and residential facilities, and, in turn, the county repaid that same amount to the DMH within 45 days. After September 1981 the DMH offered county community mental health boards the opportunity to enter into full management contracts, which transferred to the county the complete responsibility for providing mental health services.

In response to a request from a legislator, the attorney general in 1982 ruled that where the county willingly assumed the responsibility for providing mental health services the resultant state expenditures must be considered state spending paid to a local unit of government, and that Article 6, Section 29 of the constitution (requiring the state to pay for local government mandates) was not violated because the county was not required to take over any new service but did so at its option. A 1984 law allowed the state to count these expenditures as payments to local governments if the unit of local government had exercised an option that resulted in the state incurring these costs on the unit of local government's behalf or in their stead.

Oakland County established a county community mental health board in the early 1980s but did not enter into either a full or shared management contract with the DMH despite numerous negotiations. In 1985 Oakland County filed suit (*County of Oakland* v. *Michigan Department of Mental Health, Director of Michigan Department of Mental Health, and Michigan Department of Management and Budget)* alleging that classifying state funds to state-owned and state-operated facilities for the care of mentally ill and developmentally disabled as state spending paid to local units of local government violated Article 9, Section 30 of the state constitution. Both the state circuit court and the court of appeals ruled for the plaintiff. The Court of Appeals ruled: "We agree with plaintiffs and the trial court that the provision of mental health care services is a state obligation for the reasons advanced by plaintiffs. Hence, we agree that the state money, even though technically paid to a local unit of local government, remains state spending because the county is merely discharging the state's obligation." The court of appeals' ruling was appealed to the state supreme court, but the settlement was reached before the court ruled.

The agreement will insure that the FY 1992–93 budget will again be tight. The expenditures in question amount to about $410 million. The governor's proposed FY 1991–92 budget recommended that locals receive 44.25

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percent of total state spending. However, this included $525 million in reimbursement for the governor's property tax cut. Given that the FY 1991–92 budget is more than $500 million out of balance, this tax cut likely will not be approved. If the mental health payments also are removed from the local side, the state will fall $340 million short of meeting its obligation to local governments. This assumes the savings from eliminating the property tax cut are not spent. If those savings (net of $278 million—$525 million less tax credits of $247 million) are spent on state programs, the shortfall increases to about $450 million.) Making up the shortfall will require offsetting reductions in state spending. The money for locals could be raised by increasing taxes, but this is unlikely for two reasons. First, John Engler will not support a tax increase. Second, a tax increase of $580 million would be required to offset a $340 million shortfall. The reason the required tax increase is larger than the Section 30 shortfall is that 41.6 percent of the new monies must be paid to local governments, as well as used to cover the current shortfall. (See the exhibit below for various Section 30 calculations.) The actual requirements for FY 1992–93 could vary considerably depending on the composition of the budget.

If state spending is reduced in order to increase payments to local units, the losers from the agreement will be state agencies such as Social Services, Mental Health, Public Health, and Corrections and state universities; the winners will be school districts, community colleges, and other units of local governments that receive aid from the state.

One option is for the state to count as local spending Social Security payments to school districts, which will total $343 million in FY 1990–91. To date, these payments have not been counted as local spending, as until recently they were paid directly to the Social Security Administration; they now are paid to the school districts. Another option is for the state to pass a property tax relief plan and count the reimbursement to local governments as local aid. This was not what the Headlee supporters had in mind, as local governments would receive no additional monies. It may be an acceptable outcome, however, as it increases the chances for state-financed property tax relief.

Section 30 Calculations
(dollars in millions)

	Budget Estimate	Budget Excluding Property Tax Relief	Budget Excluding Mental Health Payments ($410 million)	Property Tax Savings Spent on State Programs	$341 million Tax Increase
State spending from state sources	$14,197	$13,672	$13,672	$13,950	$14,013
Payments to locals	$6,282	$5,757	$5,347	$5,347	$5,688
Section 30 percentages	44.25%	42.1%	39.1%	—	—
Required spending (41.6 percent)	$5,906	$5,688	$5,688	$5,803	$5,829
Surplus/shortfall	$326	$69	–$341	–$456	–$141[a]

[a]To make up this amount would require an additional tax increase of $241 million for a total tax increase of $582 million to cover the $341 million shortfall in payments to local units.