Fiscal Conditions of Local and Regional Governments in Seven Midwestern States:

Ohio, Indiana, Michigan, Illinois, Wisconsin, Iowa, & Kentucky

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Overview

The current fiscal conditions for local and regional governments in Ohio, Indiana, Michigan, Illinois, Wisconsin, Iowa, and Kentucky is less than stable and the future outlook is not promising.

Overall, the evidence suggests that each of these states has a large, but shrinking, manufacturing base resulting in higher unemployment rates than last year. Consequently, state and local income tax revenue will decline. In addition, sales tax revenue for states and ultimately local government revenue by way of revenue sharing and other forms of state aid will decline as consumer and business spending continues to decrease. The reduction in consumer and business spending slows state gross domestic product, which in turn, results in slower growth in revenue sources that are elastic. To combat the reduction in revenue and cover the unanticipated deficit, many states are spending down their fund balances. Smaller fund balances and lower than anticipated revenue for state governments translates into fewer dollars in state aid and revenue sharing for local and regional governments.

The above summary is based on the information that follows, which highlights state employment levels and unemployment rates, state gross domestic product, and local revenue sources.

Employment and Unemployment[1]

From November 2007 to November 2008, nonfarm wage and salary employment decreased in all these states except Iowa where employment increased by 0.8 percent. Michigan's employment decreased by 2.7 percent, almost twice the national rate of 1.4

[1] United States Department of Labor, Bureau of Labor Statistics (2008, December) Region and State Employment and Unemployment (Monthly) News Release, http://www.bls.gov/news.release/laus.nr0.htm)

percent leaving Michigan with the nation's highest unemployment rate of 9.6 percent (up from 7.4 percent in November 2007). According to the Bureau of Labor Statistics, Michigan and Wisconsin have experienced a *significant* reduction in employment levels. For example, from November 2007 to November 2008, these states lost 112,700 and 32,200 jobs, respectively.

Moreover, the unemployment rates in all seven states have increased in the past year (November 2007 to November 2008). For example, in November 2007, Indiana, Illinois, Kentucky, and Ohio had unemployment rates at or below 5.7 percent and by the end of 2008, those rates climbed to 7 percent or higher; Wisconsin's unemployment is 5.6 percent up from 4.8 percent in 2007; and Iowa's unemployment rate increased from 3.8 to 4.3 percent.

State GDP[2]

From 2002 to 2007, the United States gross domestic product (GDP) [in real dollars] grew by 14.9 percent. Iowa and Kentucky grew at or above the rate, whereas the other states growth was slower than national growth. Illinois, Indiana, and Wisconsin grew between 9 and 10 percent, Ohio's GDP grew at 6.7 percent, and Michigan's growth was stagnate at 1.2 percent. Over this period, Iowa and Kentucky were the only states to experience an average annual growth over 2 percent; Illinois, Indiana, Ohio, and Wisconsin grew, on average, between 1.1 and 1.6 percent a year, and Michigan's annual growth averaged 0.2 percent, with three years [2004, 2006, and 2007] of negative growth. In fact, in 2006 Michigan, Indiana, and Ohio had negative growth but GDP in Indiana and Ohio improved in 2007, but by less than 0.5 percent.

A major factor contributing to the slow to no growth in this region is the decline in the manufacturing base and industrial production. In December 2008, the Federal Reserve Bank of Chicago[3] reported that both the Midwest Manufacturing Index and the industrial production index for manufacturing decreased in November 2008 by 1.6 percent and 1.5 percent, respectively. From November 2007 to November 2008, output for the region decreased by 10.8 percent whereas output for the United States declined by 7.4 percent.

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[2] United States Department of Commerce, Bureau of Economic Analysis. http://www.bea.gov/regional/index.htm#gsp, http://www.bea.gov/newsreleases/regional/gdp_state/gsp_newsrelease.htm

[3] Federal Reserve Bank of Chicago (2008, December) http://www.chicagofed.org/economic_research_and_data/files/cfmmi_november2008.pdf

Government Revenue Sources[4]

Local government revenues come from a variety of sources including own source revenues (mainly property), charges for services, and utilities. From 2005 to 2006, tax revenue (including income, property, sales) for local and regional governments in this region were either stagnate or decreased from the previous year. However, from 2005 to 2006, local government tax revenues in Kentucky increased 10 percent. In addition, revenue from local government charges remained constant or declined in real dollars, except in Illinois where charges are up 32 percent from the previous year. Finally, local utility revenues have increased for municipalities in all seven states with the lowest real growth of 8.5 percent (Illinois) and the largest increase of 23 percent (Kentucky).

Another source, and a major one, for local governments is state aid. States generate revenue through property, income, and sales taxes, and charges and fees and share a portion of these revenues with local and regional governments. In most state, except Michigan, state aid increased from 2005 to 2006. The state of Michigan has reduced state aid for several years in a row.

Although state aid has been increasing, fund balances for states have been decreasing. According to the National Association of State Budget Officers Fall 2008 Fiscal Survey of the States, fund balances as a percent of expenditures have declined nationally leaving states with fewer dollars to cover unintended deficits or emergencies. For this region, the fund balances for five of the states in this region are less than 5 percent and three of these states' (Illinois, Michigan, and Wisconsin) fund balances are less than 2 percent. In fact, Michigan is one of two states in the United States with a fund balance approaching zero and Iowa and Indiana are two of the 16 states in the nation with a balance over 10 percent.

Overall, except for local utility revenues, revenue growth for municipalities in these states is stagnate or declining, especially in Michigan where real revenue is down four percent in three years.

[4] United States Department of Commerce, Bureau of the Census, http://www.census.gov/govs/www/estimate.html

Summary

Overall, the fiscal outlook in this region is worsening. Indiana, Iowa, and in some instances Kentucky, are faring better than the other states, with all the states better off than Michigan. However, if Michigan is any indication of the fiscal conditions to come to other states, then revenues for local governments in this region are likely to decline, particularly revenue from the states. As a result, local governments will be forced to spend down fund balances and/or cut spending.