



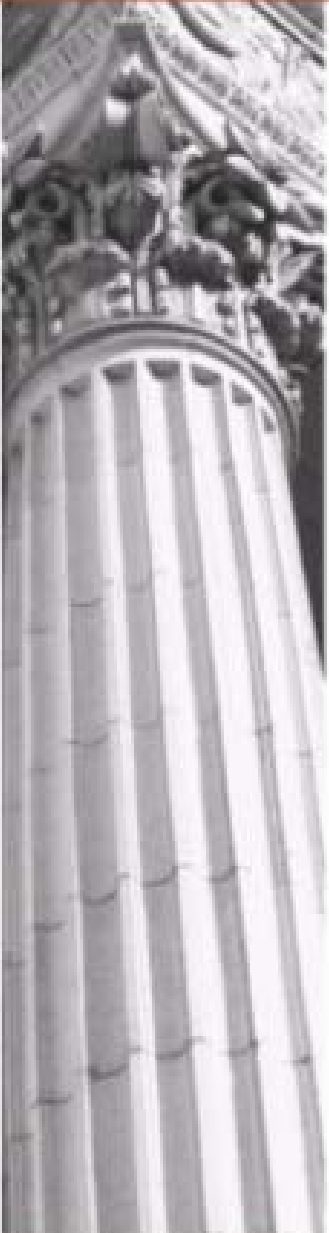
Education Finance in Michigan

University of Michigan

September 22, 2010

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Citizens Research Council

- Founded in 1916
- Statewide
- Non-partisan
- Private not-for-profit
- Promotes sound policy for state and local governments through factual research – accurate, independent and objective
- Relies on charitable contributions of Michigan foundations, businesses, and individuals
- *www.crcmich.org*



Outline

- School Finance Background
- Recent Michigan Economic Performance
- School budget outlook
- Policy Issues to Consider



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Quick Note on Michigan Property Taxes

- Property assessed at 50% of true cash value – called “state equalized value” (SEV)
- Tax base is called “taxable value” (TV) – can be less than SEV because TV cannot grow faster than inflation
- 1 mill generates \$1 of tax on \$1,000 of TV
- TV and SEV start out equal – afterwards SEV grows at rate of true cash value while TV grows at rate of inflation (unless TCV grows less than inflation)
- When property sells TV “pops up” to SEV amount

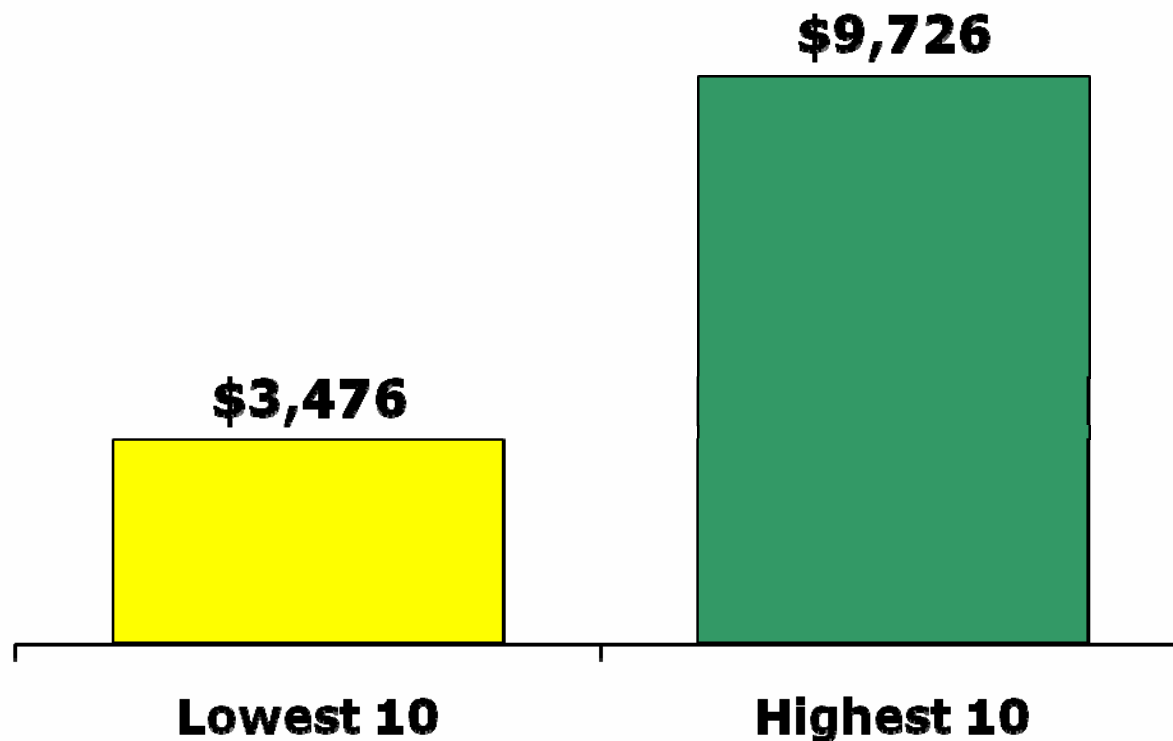


School Spending Before Reform

- State uses district power equalization, but richest one-third of districts get no aid from state
- Rich districts greatly outspend poor districts, often with lower tax rates
- 80 percent of K-12 revenue raised locally through property tax
- Local voters choose spending level through property tax elections
- School property taxes were rising faster than inflation and income resulting in pressure to reform
- Kalakaska Schools close in March of 1993



Rich Schools Out Spent Poor Schools More Than 3 to 1 In 1993-1994





School Reform -- Taxes

- Local school operating tax repealed – averaged 33.9 mills before reform
- Replacement taxes:
 - Sales tax 4% to 6%
 - 6 mill statewide property tax
 - 18 mill non-homestead local tax
 - Cigarette tax from \$0.25 to \$0.75 (OTP 0% to 16%)
 - Real estate transfer tax 0% to 0.75%
 - Taxable value cap imposed – limits assessment growth to lesser of 5% or inflation

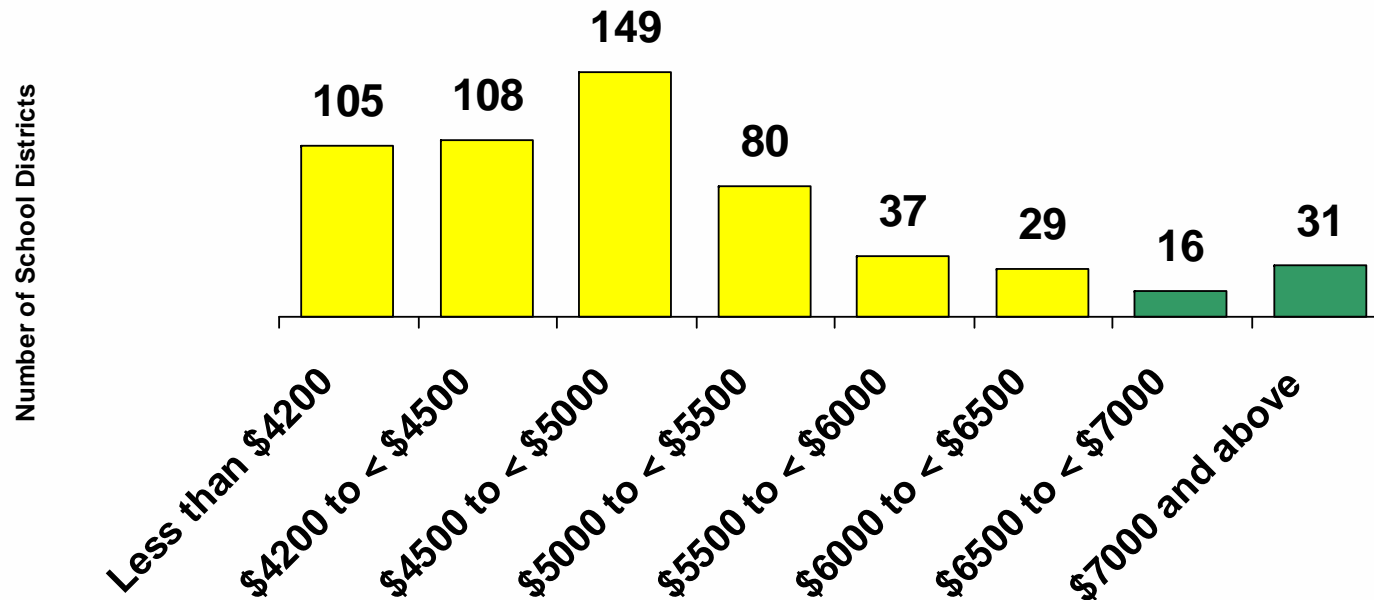


School Reform -- Spending

- Spending goes from a local decision to a state set amount
- Schools are funded on a per pupil basis
- Top spending schools allowed to keep old spending levels – some required to levy “hold harmless” millages
- Bottom spending districts receive per pupil increases
- No adjustment is made for district costs
- Local districts cannot choose to spend more than the amount set by the state
- School choice enacted shortly after Proposal A



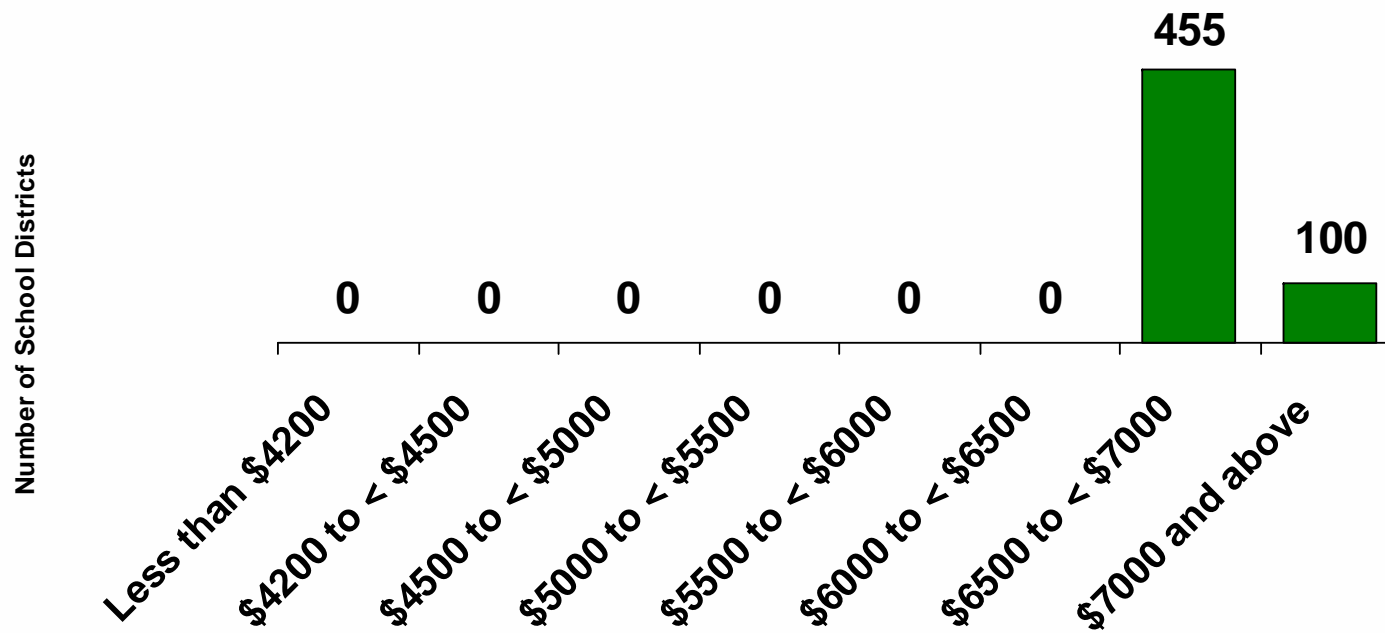
Before School Finance Reform 508 Districts Below \$6,500 Per Pupil



Base Revenue Per Pupil FY 1994



After School Finance Reform No Districts Below \$6,500 Per Pupil



Foundation Allowance Per Pupil FY 2002

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury



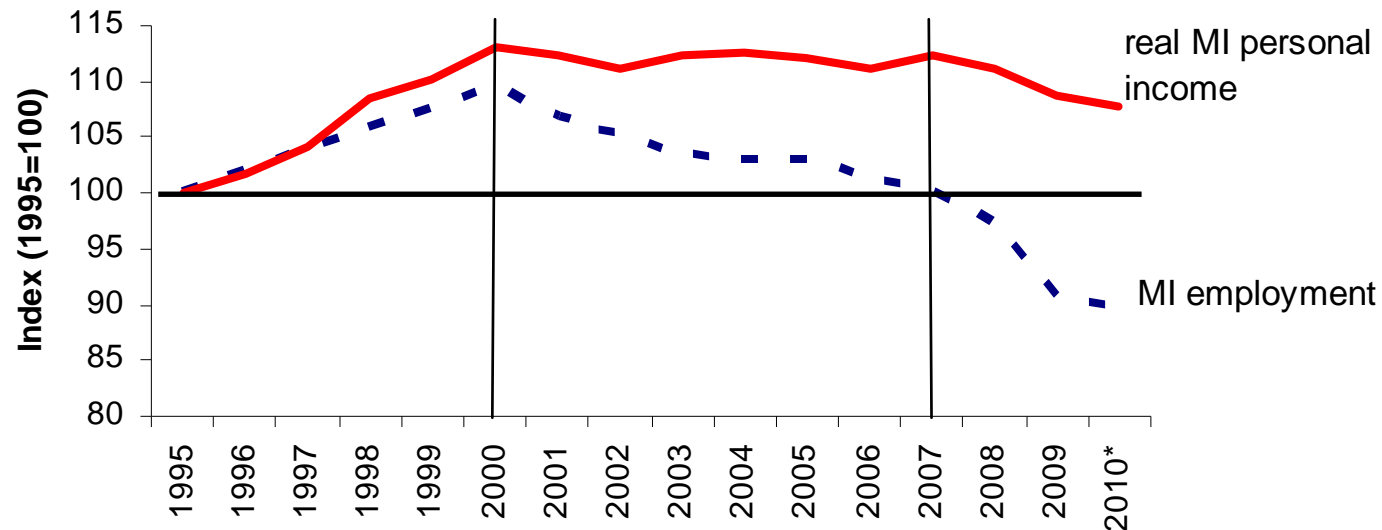
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Three Distinct Periods of Economic Growth Since Proposal A

Michigan Employment and Real Personal Income Growth





“It was the best of times, it was the worst of times . . .” *State Revenue Performance Since Prop. A*

Annualized Growth Rates: FY1997 to FY2009

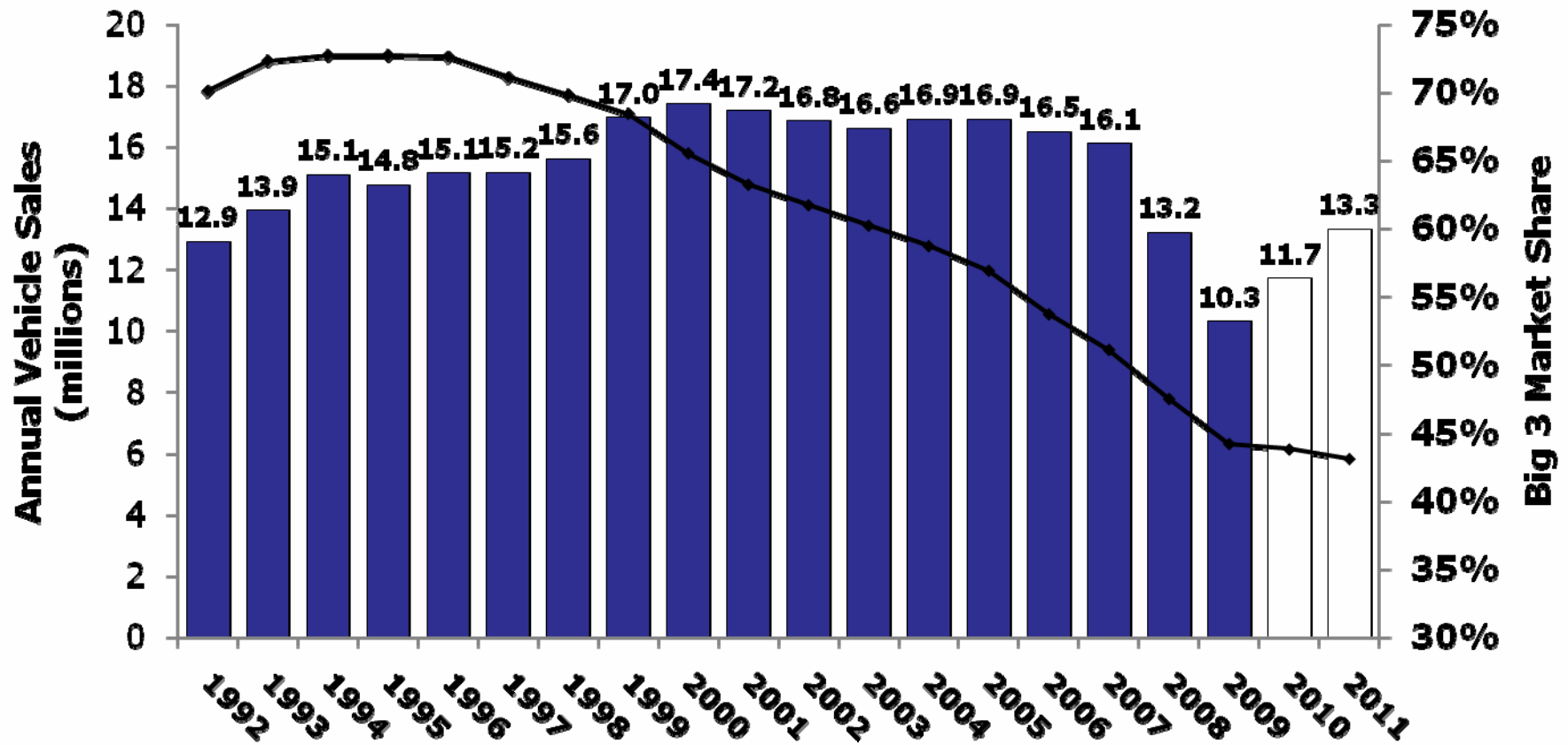
	FY1997 to <u>FY2000</u>	FY2001 to <u>FY2008</u>	FY2008 to <u>FY2009</u>
REVENUES			
State Taxes	6.2%	2.0%	-8.6%
Lottery Transfer	1.7%	3.4%	-2.2%
General Fund Transfer	4.6%	-31.6%	123.5%*
Total State-Source School Aid Fund	5.9%	1.5%	-7.8%
Michigan Personal Income	5.6%	2.2%	-3.0%
U.S. CPI	2.2%	2.8%	-0.3%

Source: Michigan Department of Education; U.S. Dept. of Commerce; U.S. Dept. of Labor; May 2010 Consensus Revenue Estimates adjusted for personal property tax exemptions

* Note: GF transfer increased from \$35 million to \$78 million



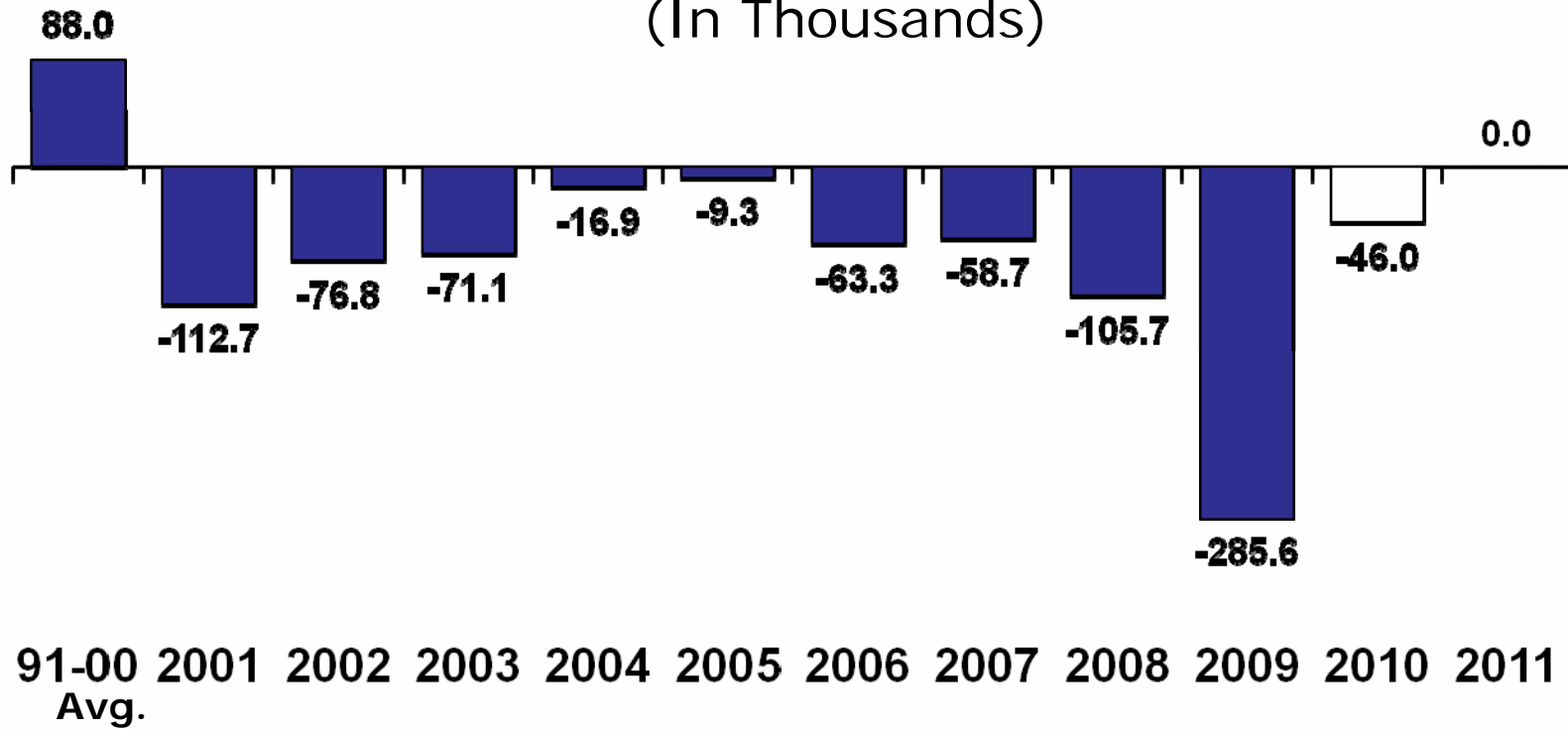
Big 3 Market Share Plummet





Michigan Employment Declines for 10 Years

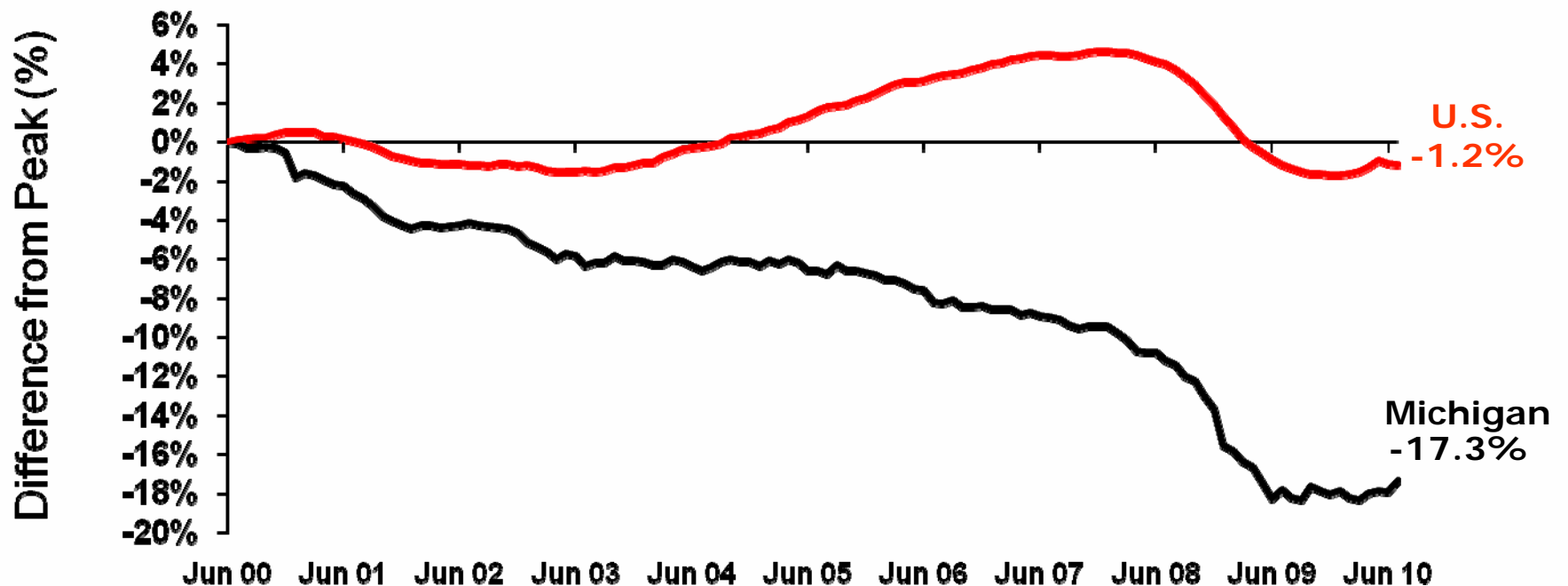
Michigan Wage and Salary Employment Y-O-Y Change
(In Thousands)





A Lost Decade of Michigan Employment

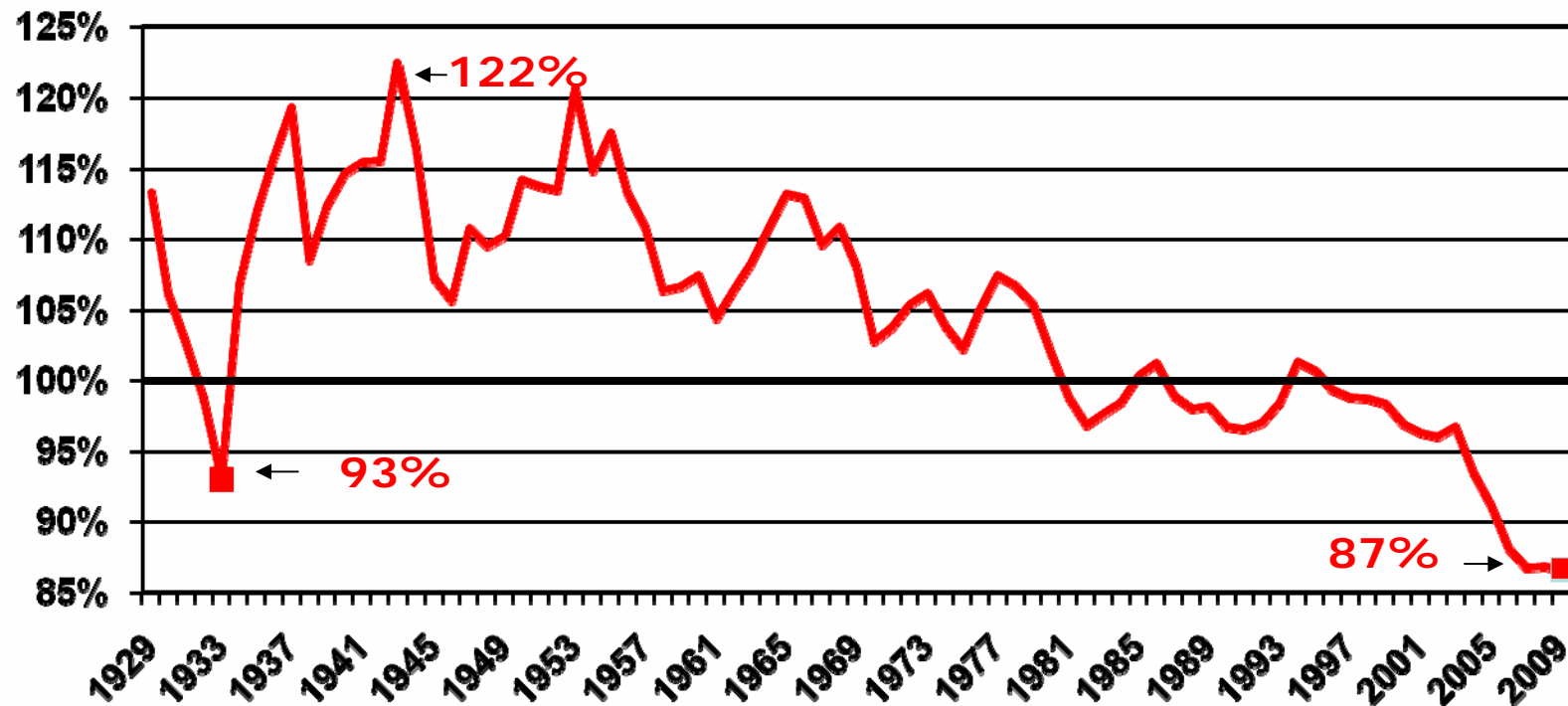
1 in 6 Jobs Lost Since June of 2000





Michigan Has Become Poorer Relative to Other States

Michigan per Capita Income as a Percent of U.S. Per Capita Income Rank has fallen from 20th in 2001 to 37th in 2009





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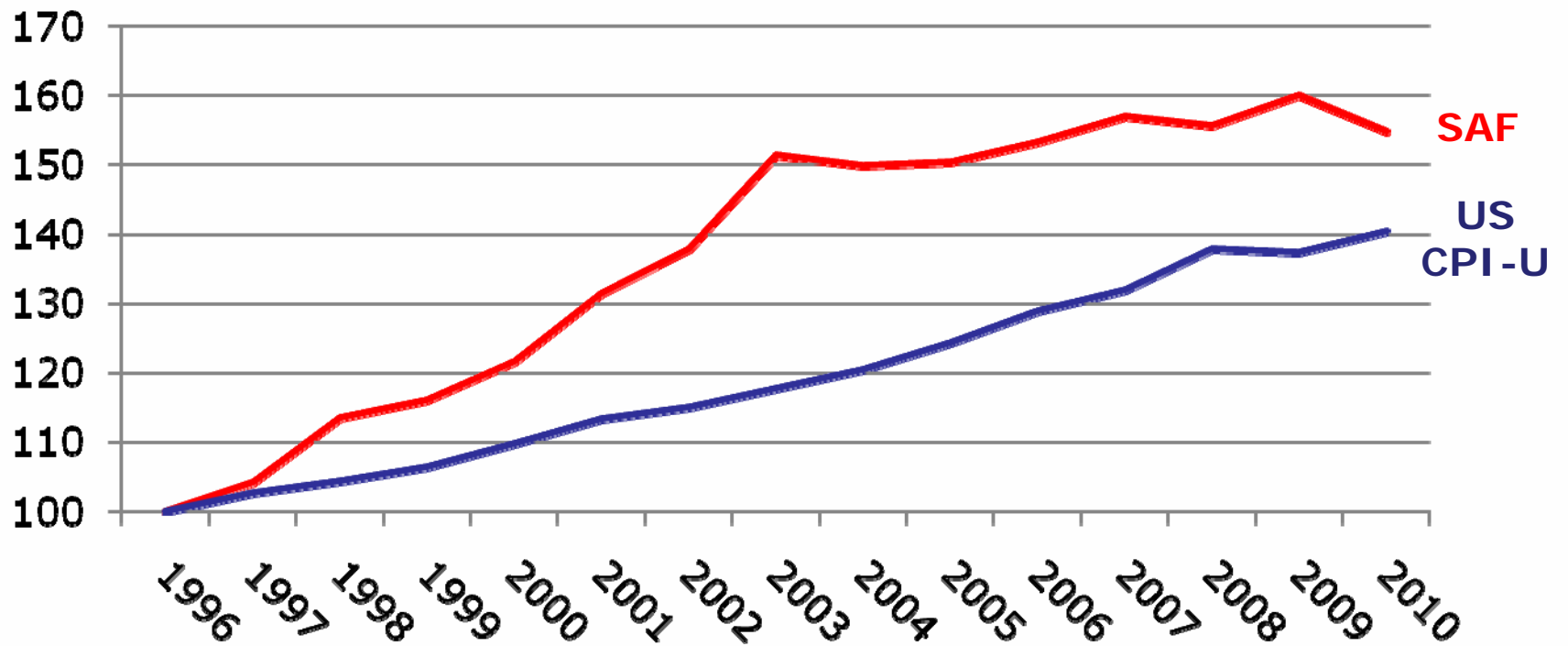


School Budget Issues

- School budgets are dealing with several major issues
 - Economic decline, especially 2009 drop, has lowered revenues below current expenditure base
 - Structure of school taxes make them likely to grow slower than overall economy over the long run
 - Most districts facing declining pupil counts – increases amount per pupil statewide, but difficult to manage down



Spending Grows Faster than Inflation FY 96 to FY 01 Slower FY 01 to FY 10





Revenues Crash in 2009

Annual Growth Rates

	<u>FY 2009</u>	<u>Projected FY 2010</u>	<u>Projected FY 2011</u>
Sales Tax	-10.1%	1.3%	1.5%
Income Tax	-19.0%	-8.1%	2.9%
Use Tax	-19.0%	3.6%	1.5%
State Education Tax	-1.9%	-7.2%	-3.2%
Real Estate Transfer Tax	-26.2%	1.4%	10.2%
GF-GP	-21.3%	-9.6%	6.6%
School Aid	-5.1%	-1.6%	0.8%



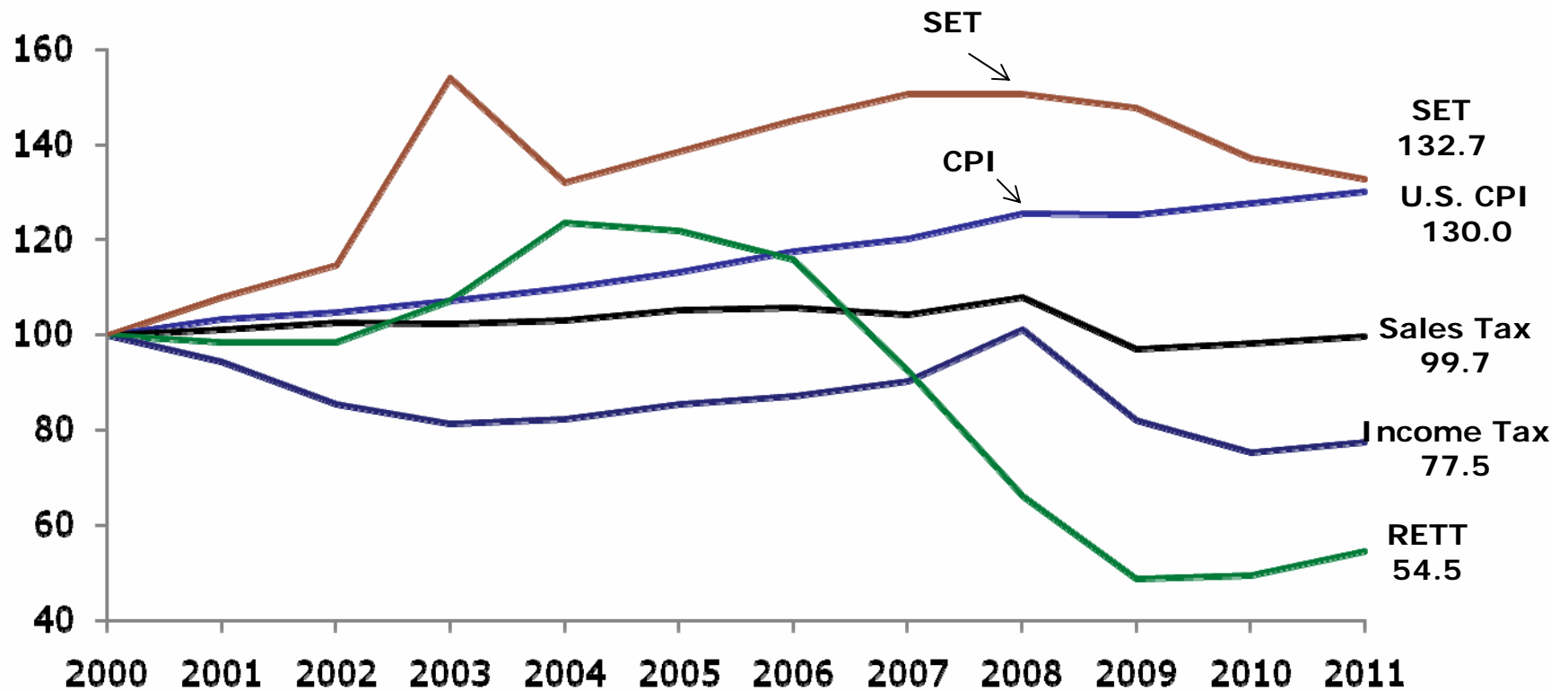
FY 2010 Budget Balancing Measures

- Ongoing FY 2010 SAF revenues projected to be \$0.7 billion below FY 2008
- Enacted FY 10 Cuts:
 - \$165 per pupil (\$263M)
 - ISD reduction (\$16M)
 - 20j veto (\$52M)
 - Other Cuts (\$35M)
- Stimulus money in budget:
 - FY 09 \$600M ARRA
 - FY 10 \$450M ARRA
 - FY 11 \$184M ARRA plus \$316M "new" stimulus



Major SAF Revenue Sources Fail to Keep Pace with Inflation Since 00

Totals Indexed so that FY 2000 Total = 100

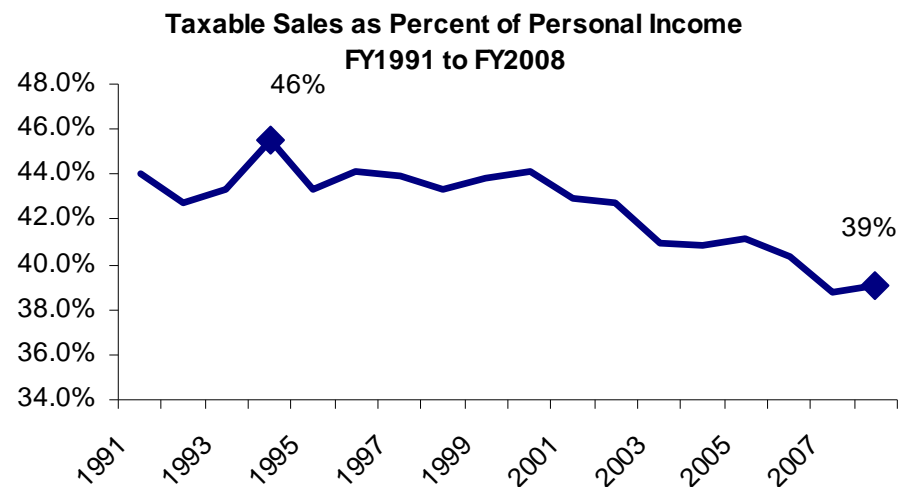


Note: 2010 and 2011 totals are the May 2010 Consensus estimates.



What are the Long-Term Problems?

- **Sales Tax** – largest single source of funding for schools
 - Primarily on goods and few services
 - Services growing section of economy (healthcare) thus sales tax share of economy shrinking



Source: State of Michigan; US Dept of Commerce

Equivalent to \$1 billion in SAF revenue



What are the Long-Term Problems?

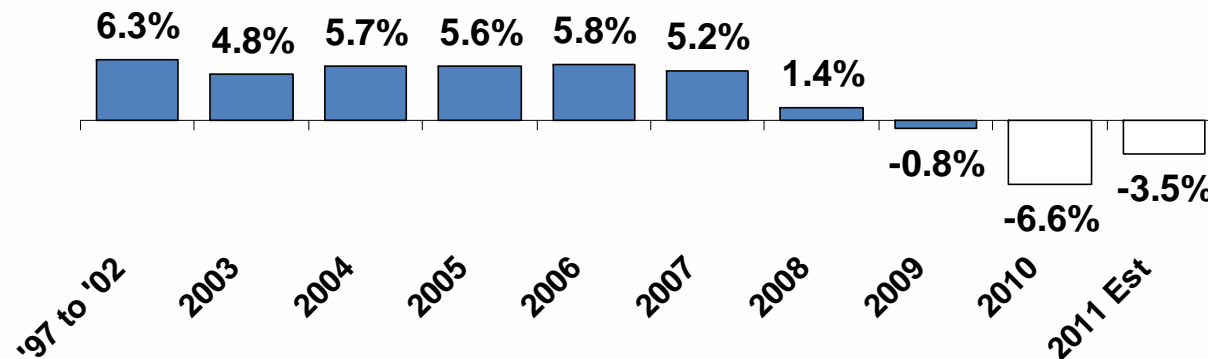
- **Income Tax** – structural, tax policy, and demographic issues
 - Structural: flat rate tax, less progressive than graduated rate structure, income growth at top
 - Tax Policy: schools protected from recent and future rate reductions (however did not benefit from increases)
 - Tax Policy/Demographic: “senior preferences”
 - very generous treatment of retirement income
 - property tax credit/EITC (GF impact only)



What are the Long-Term Problems?

- **Property Taxes** – previously stable revenue source will decline with near-term erosion of taxable values
 - During recovery growth will be constrained by current tax limitations (capped at inflation if values escalate faster)
 - SET is second largest state source with income tax decline

% Change in Total Taxable Value





Revenue Stability Issues Contribute to Long-Term Fiscal Imbalance

Projected Growth in Total Public Education Revenues and Spending: FY2008 to FY2017
(Dollars in Millions)

	Operating Revenues	Spending Pressures	Cumulative Deficit	Annual Increment
FY2008	\$17,729	\$17,729	\$0	
FY2009	18,095	18,444	(349)	(\$349)
FY2010	18,584	19,281	(697)	(\$348)
FY2011	19,153	20,152	(1,000)	(\$303)
FY2012	19,741	21,092	(1,351)	(\$351)
FY2013	20,349	22,083	(1,734)	(\$383)
FY2014	20,977	23,129	(2,152)	(\$418)
FY2015	21,627	24,234	(2,606)	(\$454)
FY2016	22,300	25,401	(3,101)	(\$495)
FY2017	22,995	26,636	(3,641)	(\$540)
Annualized Growth Rate	3.0%	4.7%		

Note: Original projections included in CRC Report 349, *Michigan's Fiscal Future*, 2008.



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School Finance Policy Issues

- Tax structure
 - Are more revenues needed in short run?
 - Should structure be changed to increase chance that revenues will grow as fast as economy?
 - Should changes be made to spur economic development
- Cost pressures
 - Should more be done to address retirement and health care costs?
- Should remaining spending gaps between districts be addressed?



School Finance Policy Issues

- Capping high spending districts
 - Should equality be the goal or is it adequacy?
 - End of local control over expenditures
- Capital finance issues
 - Inequity persists among facilities
 - Competition for pupils based on infrastructure
- Managing declining enrollment
 - Detroit from 141,000 pupils in 2005 to 85,000 in 2010
 - Should effects of pupil declines be phased in?
 - Should charter schools/school choice be limited?



School Finance Policy Issues

- Efficiency of service provision
 - Should districts be consolidated or more services shared?
 - Should consolidation/collaboration be imposed by the state or left up to local districts?
 - Should savings remain in local district or be assumed in state budget assumptions?
- School district costs
 - Should funding formula attempt to adjust for higher cost districts (e.g. at risk or cost of living)?



Constitutional vs. Statutory Issues

- Constitutional Issues
 - Max sales tax rate
 - Prohibition against graduated income tax
 - Taxable value cap
 - Language prohibiting aid to private schools
 - Education “encouraged”
 - Pension protection
 - Floor on spending
- Statutory issues
 - Income tax rate
 - Taxation of services
 - Number of school districts and service sharing issues
 - Funding formulae
 - Level of funding



Questions?



Thank You

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