School Finance in Michigan

Adult Learning Institute

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October 21, 2014
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- Statewide
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- Promotes sound policy for state and local governments through factual research
- Relies on charitable contributions of Michigan foundations, businesses, and individuals
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Short History Lesson: Proposal A
School Finances Before Proposal A

- Schools were financed **locally**, 
- More than two-thirds of operating revenue raised from local property tax 
- Local voters chose spending level through property tax elections 
- State played minor role through property tax “equalization” formula 
- State aid not sufficient enough to fully “equalize” spending across all districts
Wealthy Districts Outspent Poor Districts Nearly 3 to 1 in FY1994

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury
Problems with Finance System

Previous efforts to reform school finance and property tax had little success

**Problem:** School property taxes were rising faster than inflation and income resulting in pressure to reform

**Problem:** Wealthier districts greatly outspent poorer districts, often with lower tax rates

**Problem:** Property tax role in funding schools
Objectives of Reform

- Reduce, but not eliminate, disparities in per-pupil funding
- Reduce, but not eliminate, reliance on property tax to fund schools (i.e., rate reduction)
- Centralize school funding at state level (i.e., replace local property tax with state taxes)
- Limit property tax growth at parcel level (i.e., cap on taxable value growth)

Solution:

*Blow up system and start anew with Proposal A*
Proposal A School Finance Reforms

*What did we end up with?*

- State-run K-12 financing system
  - State/local mix - from 30%/70% to 70%/30%
  - Adopt per-pupil “foundation grant” - Lansing sets annual per-pupil spending
- Immediate reduction in reliance on property tax
  - From 34 mills to 6 mills (homeowners)
- Immediate reduction in per-pupil revenue disparities and new structures to further reduce disparities
- Cap on individual parcel taxable value growth – limit to lesser of 5% or inflation
What Proposal A Did Not Address

- Special Education: Per-pupil spending has risen significantly, as have spending disparities across intermediate school districts

- District capital costs: Still funded locally even after Proposal A and considerable variation (unmet need)
Special Ed Per-Pupil Spending Variation

\textit{Difference Twice as Much}

Per-Pupil Spending by ISD in FY2010

\textbf{State Average} $13,802

Source: MDE, Report SE-4096; Center for Educational Performance Information; CRC calculations.
Capital Needs Across all Districts

Need over twice as great in poorest school districts

**Distribution of Capital Need Across Michigan**

<table>
<thead>
<tr>
<th>Quintile</th>
<th>Ave. Property Wealth/Pupil</th>
<th>Capital Need/Pupil</th>
<th>% of Statewide Need</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$69,172</td>
<td>$8,172</td>
<td>34</td>
</tr>
<tr>
<td>2</td>
<td>$121,088</td>
<td>$5,587</td>
<td>15</td>
</tr>
<tr>
<td>3</td>
<td>$150,540</td>
<td>$4,979</td>
<td>19</td>
</tr>
<tr>
<td>4</td>
<td>$204,317</td>
<td>$4,166</td>
<td>19</td>
</tr>
<tr>
<td>5</td>
<td>$308,284</td>
<td>$3,677</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: *Adequacy, Equity, and Capital Spending in Michigan Schools: The Unfinished Business of Proposal A*
School Finances Today: Trends and Challenges
Quick Quiz: School Funding

Question: What role does the lottery play in funding public schools?

A. 50 percent
B. 25 percent
C. 10 percent
D. Less than 5 percent
Answer: D – less than 5 percent

2014 Operating Funding for Public Schools (millions)

Total: $16.5 Billion

Source: Senate Fiscal Agency reports
# The Last Decade Was an Economic Disaster for Michigan

<table>
<thead>
<tr>
<th></th>
<th>Growth 2000 to 2010</th>
<th>Michigan</th>
<th>Michigan Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>U.S.</td>
<td>Michigan</td>
<td>Rank</td>
</tr>
<tr>
<td>Population</td>
<td>9.6%</td>
<td>-0.8%</td>
<td>51</td>
</tr>
<tr>
<td>Real Per Capita GDP</td>
<td>5.0%</td>
<td>-10.4%</td>
<td>51</td>
</tr>
<tr>
<td>Employment</td>
<td>-1.5%</td>
<td>-17.4%</td>
<td>51</td>
</tr>
<tr>
<td>Real Per Capita Income*</td>
<td>4.9%</td>
<td>-5.6%</td>
<td>50</td>
</tr>
</tbody>
</table>

* Nevada is the 51st rank state.
Going Back to 2000 Michigan Trails
U.S. By a Wide Margin

Cumulative Change in Employment Since April 2000

U.S. 5.5%
MI -11.3%

Nominal Revenues Nearing FY08 Level
But Real Revenues Still Down

Combined GF/SAF Revenues (2000 = 100)

Nominal
FY08=106.2

Real
FY08=87.4

Real
FY16= 80.5

Nominal
FY16=109.4

Source: Revenue data from Senate Fiscal Agency and May 2014 Consensus estimates. Indexing and inflation adjustment CRC calculations. Inflation adjustment done using Detroit CPI-U based on fiscal year.
## State Spending From State Resources

**Down in Most Categories**

<table>
<thead>
<tr>
<th>Category</th>
<th>FY 2002 (millions$)</th>
<th>FY 2013 (millions$)</th>
<th>Nominal % Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicaid/DCH</td>
<td>$3,066</td>
<td>$4,976</td>
<td>62.3%</td>
</tr>
<tr>
<td>Corrections</td>
<td>$1,653</td>
<td>$2,009</td>
<td>21.5%</td>
</tr>
<tr>
<td>Human Services</td>
<td>$1,230</td>
<td>$1,117</td>
<td>-9.2%</td>
</tr>
<tr>
<td>K-12</td>
<td>$11,221</td>
<td>$11,244</td>
<td>0.2%</td>
</tr>
<tr>
<td>Community College</td>
<td>$320</td>
<td>$294</td>
<td>-8.2%</td>
</tr>
<tr>
<td>Universities/Fin Aid</td>
<td>$1,941</td>
<td>$1,302</td>
<td>-32.9%</td>
</tr>
<tr>
<td>Revenue Sharing</td>
<td>$1,517</td>
<td>$1,084</td>
<td>-28.6%</td>
</tr>
<tr>
<td>All Other</td>
<td>$5,139</td>
<td>$5,787</td>
<td>12.6%</td>
</tr>
<tr>
<td>Total</td>
<td>$26,087</td>
<td>$27,812</td>
<td>6.6%</td>
</tr>
<tr>
<td>U.S. CPI - U</td>
<td>178.9</td>
<td>232.7</td>
<td>30.1%</td>
</tr>
</tbody>
</table>

Source: Senate Fiscal Agency. “State Spending From State Resources Appropriations Totals Compared to Selected Budget Areas.” and “State Budget Overview – February 14, 2013”
General Fund Problems Spill Over

Decisions reduce funding for schools

General Fund Transfers and Cost Shifts - School Aid Fund

effect of increasing income tax earmark to SAF

Source: Michigan Department of Education; House Fiscal Agency
K-12 Funding Growth Lags Inflation

Comparison of K-12 State Funding Percentage Increases and Detroit CPI

*In FY 08-09, $341 million of State funding was added to offset lower local tax revenues from changes in the Mi Business Tax; without this, State funding declined 5.8 percent.

Senate Fiscal Agency

09/29/2013
Michigan Contributes More of its Income to K-12 Education than the US Average

Total State and Local K-12 Education Spending as Share of Personal Income: US and MI

Source: U.S. Census Bureau
Michigan at the US Average

TOTAL STATE AND LOCAL PER-PUPIL REVENUE: FY2012

Source: U.S. Census Bureau
Current Challenges
Factors Affecting K-12 Finances

*Structural Issues*
- Changing demographics
- Improving recovery from Great Recession
- Growing legacy costs

*Policy Decisions*
- Growth in number of educational providers
  - Increase in number of charters
  - New cyber and online options
- State tax policy decisions
- State budget decisions
- Dealing with fiscal distress
State Funding for Public Schools Up $1B

Most of the increase is for retirement costs

Source: Senate Fiscal Agency and House Fiscal Agency reports
MPSERS Costs and the Foundation Grant

Estimated impact on districts receiving minimum grant

Source: Senate Fiscal Agency and House Fiscal Agency Reports; Office of Retirement Services
Since 2003: Era of Declining Enrollment

*Trend expected to continue*

**Statewide Pupil Membership**

- Membership from FY1995 to FY2016
- Change FY2003 to FY2014: -11%

*FY2014 through FY2016 based on January 2014 consensus estimates*
Number of Districts Growing Despite Declining Enrollment

Michigan School Districts and Pupil Membership

Source: Michigan Department of Education
Note: Excludes Intermediate School Districts (56 in 2012)
Declining Enrollment . . . Not Just an Urban Issue

<table>
<thead>
<tr>
<th>Enrollment Change from Fall 2003 to Fall 2012</th>
<th>City</th>
<th>Suburb</th>
<th>Town</th>
<th>Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain</td>
<td>10</td>
<td>50</td>
<td>10</td>
<td>55</td>
</tr>
<tr>
<td>Loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>greater than 50%</td>
<td>3</td>
<td>0</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>25% to 50%</td>
<td>5</td>
<td>14</td>
<td>5</td>
<td>61</td>
</tr>
<tr>
<td>10% to 25%</td>
<td>8</td>
<td>25</td>
<td>44</td>
<td>114</td>
</tr>
<tr>
<td>0 to 10%</td>
<td>8</td>
<td>46</td>
<td>23</td>
<td>57</td>
</tr>
<tr>
<td>Districts with Loss</td>
<td>24</td>
<td>85</td>
<td>73</td>
<td>238</td>
</tr>
<tr>
<td>Total # of Districts</td>
<td>34</td>
<td>135</td>
<td>83</td>
<td>293</td>
</tr>
<tr>
<td>Total Pupil Loss / % Loss</td>
<td>133,520</td>
<td>24,756</td>
<td>23,244</td>
<td>38,271</td>
</tr>
<tr>
<td></td>
<td>-32%</td>
<td>-4%</td>
<td>-12%</td>
<td>-12%</td>
</tr>
</tbody>
</table>
Some Large Urban Districts Experience Massive Enrollment Loss
Effects of Declining Enrollment

Two narratives

• State-level effects
  • Fewer students in the system allows the per-pupil foundation grant to increase, even if there are no new dollars in the system

• District-level effects
  • Per-pupil foundation grant might increase, **BUT**
  • Effects of grant increase are offset by the loss of students – result in fewer resources overall
  • Challenges of “managing down” when majority of costs are relatively fixed in near term
### Fiscal Distress Growing

*Record number of deficit districts in 2012*

<table>
<thead>
<tr>
<th>Fund Balance as % of Revenue</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statewide Average</td>
<td>10.81%</td>
<td>9.34%</td>
<td>7.19%</td>
<td>8.42%</td>
<td>8.96%</td>
<td>8.37%</td>
</tr>
<tr>
<td>0% to 5%</td>
<td>57</td>
<td>63</td>
<td>73</td>
<td>44</td>
<td>50</td>
<td>78</td>
</tr>
<tr>
<td>5% to 10%</td>
<td>106</td>
<td>108</td>
<td>99</td>
<td>101</td>
<td>117</td>
<td>127</td>
</tr>
<tr>
<td>10% to 15%</td>
<td>114</td>
<td>119</td>
<td>131</td>
<td>127</td>
<td>136</td>
<td>106</td>
</tr>
<tr>
<td>Above 15%</td>
<td>249</td>
<td>231</td>
<td>211</td>
<td>237</td>
<td>201</td>
<td>186</td>
</tr>
<tr>
<td>Districts</td>
<td>526</td>
<td>521</td>
<td>514</td>
<td>509</td>
<td>502</td>
<td>497*</td>
</tr>
<tr>
<td>Deficit (Negative)</td>
<td>21</td>
<td>29</td>
<td>36</td>
<td>41</td>
<td>47</td>
<td>42</td>
</tr>
</tbody>
</table>

Source: Michigan School Business Officials; Michigan Department of Education (deficit districts).
Note: Traditional public school districts only (excludes ISDs and PSAs). Not all districts reporting for 2012-13.
Range of State Responses

• For majority of districts in distress, current Deficit Elimination Plan process functions well
• However, for those hardest hit, state lacks consistent policy and responses have varied:
  • “Charterized” districts (Muskegon Heights and Highland Park)
  • Dissolution used for two districts (Buena Vista and Inkster)
  • PA 436 used for Detroit (emergency manager) and Pontiac (consent agreement)
• State needs “Early Warning” system
Consequences of Current Approach

- Interruption of student learning – sometimes abruptly and at mid-year
- Some state responses “socialize” deficit elimination solutions through the provision of additional funds
- Under dissolution scenario (new option), the learning environment that students are assigned to may not be any better than the dissolved district
- Diminished accountability for state taxes used to finance K-12 education
Recommendations
Examine Declining Enrollment

1. For those districts hardest hit, establish policy and early warning strategies to head off “death spiral”

2. Restore state strategies designed to ease immediate negative effects of declining enrollment

3. Reconsider state messaging – consolidation vs. expansion of educational providers

4. Reexamine the structure of the per-pupil foundation grant
   - Recognize that there are “school-based” costs
   - Differentiate foundation grant to take into account student/school characteristics
Address Special Education Challenges

1. **Reduce reliance** on local property tax as primary funding source
2. To reduce widening per-pupil funding disparities, **greater centralization in funding decisions** would be required (similar to Proposal A)
3. Equalizing per-pupil funding would require significant amount of **additional state resources** (with minimum tax effort requirement), as “raising the bottom” would be only acceptable method
Adopt New Policy for Fiscally Distressed Districts

1. Move away from current ad hoc approach and establish a **clear, transparent, and consistent policy** based on early intervention

2. Acknowledge that some districts would need **additional resources** (financial and technical) to address their financial challenges - these dollars should come earlier, but with “strings attached” to avoid recurring problems

3. There must be an **educational component**, not merely a financial solution
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