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Growth of State-directed Grant Funding Erodes Local Schools’ Flexibility to Respond to Student Needs

In a Nutshell

- Lawmakers have been loading up recent state School Aid budgets with funding for a growing catalog of new initiatives that align with their particular policy priorities and preferences.
- State-directed grant funding provides less budgetary discretion to local school leaders who are best attuned to the myriad challenges facing their students today.
- The increased presence of categorical grants in the state K-12 budget should prompt
- The increased presence of categorical grants in the state K-12 budget should prompt lawmakers to reflect on the advantages and disadvantages of the current shift towards funding schools via these grants and some of the unintended consequences that have arisen with increased emphasis on state-directed funding.

Increasingly, state policymakers appear to believe that local school officials need their help in determining the best use for nearly \$19 billion in state funding that flows through the annual state K-12 budget. Lawmakers have been loading up recent state School Aid budgets with funding for a growing catalog of new initiatives that align with their particular policy priorities and preferences. While policymakers are certainly in their right to express their preferences through these funding decisions, they must recognize that doing so means much less budgetary discretion for local school leaders who are best attuned to the myriad challenges facing their students today.

State budget writers have shown a growing preference to fund new and expanded “categorical grants” – funding dedicated to specific programs and services outside of Michigan’s primary student-centric funding model. The issue here is not with increased state investments in well-established weighted-student funding for “at-risk” students or students with disabilities. Those revenue streams are designed to provide more equitable student-level funding by driving additional per-pupil resources (weights) to schools that enroll students with the highest needs.

The problem with expanded categorical funding arises when the state creates new initiatives that operate outside of the primary student-focused, weighted funding model. These programs often do not match the highest needs of every district and take away local spending discretion. The steady growth in the number and amount of School Aid Fund dollars directed toward “new” categorical grants is effectively eroding the foundational funding of local school budgets. Each state dollar appropriated for categorical grants means one less dollar that might flow through the state’s student-focused funding model.

This is exactly what happened with the current-year K-12 spending plan. State lawmakers expanded categorical funding in the FY2025 School Aid budget, while providing zero increase to the discretionary \$9,608 per-pupil foundation allowance. By choosing categorical grant funding increases over a base funding increase, state budget writers were able to set K-12 spending priorities based on their policy preferences and goals, not

necessarily those of Michigan's 836 local traditional and charter school districts.

It should come as no surprise to anybody familiar with public K-12 education that public schools across the state currently face myriad challenges, including academic recovery related to COVID-19 disruptions, staffing every classroom with a highly-qualified and credentialed teacher, tackling chronic absenteeism, and narrowing persistently high achievement gaps across students from different backgrounds. Similarly unsurprising, the scope and severity of the challenges vary from district to district. From Alcona to Midland to Zeeland, local school leaders are best positioned to tailor services to meet their students' needs. Their ability to address those needs is constrained when a growing share of state budget resources are directed to programming or services that don't match up with their students' greatest needs.

Background

Michigan's K-12 education finance system is characterized by the highly centralized nature for raising school operating revenue. Notably, 1994's Proposal A school finance reforms shifted responsibility for raising the lion's share of K-12 operating revenues from local property taxes to state-levied taxes. Immediately following these reforms, the state/local school funding mix flipped from about one-third (state) / two-thirds (local) to two-thirds (state) / one-third (local). At the same time, Proposal A placed strict limits on the ability of local districts to raise additional school revenues from their taxpayers. Combined, the shift in funding responsibility and tax limitations effectively means that state policymakers control the purse strings for every school district in the state.

State-level control over local school revenues is largely exercised through the appropriations decisions reflected in the School Aid budget; Lansing budget writers determine how to allocate \$19 billion of constitutionally- and statutorily-restricted School Aid Fund each year. Lansing has two primary ways of distributing these resources: the per-pupil foundation allowance established as part of Proposal A, base funding intended to cover the basic costs of education (teacher salaries, textbooks, materials, and more); and categorical funding targeted to specific purposes (programs for "at-risk" students, programs for English language learners, special education services, and more).

Over the 30-year period since the adoption of Proposal A, a consistent state funding priority for both Republicans and Democrats in charge of crafting the School Aid budget has been to eliminate the wide per-pupil funding disparities that existed between districts. Over time, and often at great cost to the School Aid Fund, Michigan policymakers were able to narrow the foundation allowance gap. Eventually, the state equalized foundation allowances in 2022 at \$8,700 per student. With these foundation allowance gaps eliminated, the state budget writers have shifted their priorities away from the base funding mechanism in favor of more and expanded categorical funding.

The Good and Bad of Categorical Grants

Categorical grants have become a cornerstone of Michigan K-12 funding, not to mention a growing piece of the overall school funding pie. These grants aim to address targeted needs, such as special education, early literacy, or technology integration. While they bring significant benefits, they also come with notable challenges for local officials responsible setting district- and school-level budget priorities.

On the positive side, categorical grants can ensure that state resources are directed toward well-defined priorities, such as services for low-income students or students with disabilities. This targeted funding helps address gaps that might otherwise go overlooked through general base funding structures.

These grants come with strict guidelines on how funds must be spent, promoting accountability and transparency. Schools must report how they use the funds, which can ensure that money is allocated effectively and not used on unrelated expenses.

Many categorical grants are designed to reduce disparities by directing funds to underserved populations. While base foundation funding aims to supply every public school student with an adequate/equal level finan-

cial resources, many grants often focus on concepts of equitable student funding for underserved populations. Districts serving students with the greatest needs receive additional resources. For instance, “at-risk” grants focus on schools in low-income areas, helping to level the playing field for students facing economic challenges.

Any perceived advantages of using state-directed grants to fund public schools must be weighed against the budgetary tradeoffs that accompany this method of sharing limited state financial resources with schools. One major drawback of categorical grants is their rigid nature. Schools are required to use the funds only for the specified purpose, even if their most pressing needs lie elsewhere. For instance, a school struggling with staff recruitment and retention may not benefit from a technology grant if it cannot reallocate the funds to address the most pressing concern (e.g., increasing teacher compensation to retain and attract staff) (.

Applying for and managing categorical grants is time-consuming and resource-intensive. Schools must navigate complex application processes and comply with detailed reporting requirements, diverting attention and resources away from teaching and learning. These administrative burdens may be onerous for small and rural districts with limited central office staff.

Categorical grants often provide temporary funding for specific programs, leading to sustainability challenges. When grant funds expire, schools may struggle to maintain these programs or services, leaving them vulnerable to disruptions. This is exactly what happened when state lawmakers decided to establish a new one-time per-student mental health grant in FY2023. The state funding, initially approved for a two-year period, was largely used to hire additional nurses, counselors, and other staff. After the grant funding was exhausted last year, schools had to decide whether the services would continue to be supported locally.

While categorical grants aim to reduce disparities, they can sometimes create inequities. Districts with more experienced grant writers or better resources may secure more funding, leaving under-resourced schools at a disadvantage. Finally, it must be noted that Michigan has a strong tradition of local home rule – the idea of giving local governments the ability to organize government and exercise powers as local leaders see fit. Concepts of local control and home rule are engrained in the K-12 education system, e.g., independent local school boards, separate taxing authority (until 1994). Categorical grants deemphasize local control because they are based state priorities. When these priorities do not align with the unique needs of local schools, this disconnect can result in inefficient use of resources or frustration among educators and administrators.

Grant Funding Up, Way Up

While the foundation allowance remains the single largest funding source for school operations, as well as the largest slice of the state School Aid budget, the recent growth of categorical grants has diminished the overall role the foundation allowance plays in district finances. State-directed grants have become a larger component of the overall financial picture of Michigan schools over the past 10 years. Policy choices definitely played a role here, but it is also worth noting that the expanded use of grant funding in the K-12 budget was made possible, in part, by the unexpected state revenue boom following the COVID pandemic and multi-billion-dollar School Aid Fund budget surpluses. The fund’s strong fiscal position presented Lansing officials with budget choices around “what” to fund with the additional ongoing state dollars, but also “how” to allocate those dollars to schools.

Even before this period of growth, Michigan was already a heavy user of categorical funding in K-12 education in a national context. States use a combination of base funding and grant funding to provide public K-12 schools with the financial resources to operate programs. Not surprisingly, states have taken varying approaches to categorical grants; some rely on them heavily and others barely or not at all. Even before the documented growth of grant funding over the recent 10-year period, a 2013 examination of the national landscape revealed that Michigan was already a heavy user of this manner of school funding. The study found that Michigan employed 50 categorical grants, compared to the median state with just 10 grants. Further, as a percentage of total state K-12 spending, Michigan allocated 20 percent towards grants compared to 12 percent for the median state.

In FY2015, the state K-12 budget equaled \$12.1 billion (net of federal funds) spread across a total of 68 indi-

vidual line-item appropriations. Further, the state committed \$9.0 billion (75 percent of the total) towards the foundation allowance, with only 25 percent directed to several categorical grants.

The expanded role of School Aid Fund grants is evident by looking at the current composition of the state K-12 education budget. For FY2025, the budget contains a total of 128 different line item appropriations totaling \$18.4 billion (net of federal funds). Of this total, \$10.3 billion (56 percent) is appropriated across four line items used to finance the state's portion of the per-pupil foundation allowance. (Note: The local share of each district's foundation allowance derived from local millages does not flow through the state budget. But again, the focus of this essay is the distribution of "state" dollars.) The remaining \$8 billion of the K-12 budget, or 44 percent, went to funding 124 different line items.

Looking back, there has been substantial growth in the raw number of programs and initiatives competing for the limited state dollars flowing through the K-12 budget, and while total K-12 funding has increased over this period, the foundation allowance is becoming a smaller and smaller slice of the pie.

The state's prioritization of categorical grants in the FY2025 budget is particularly noteworthy. For the first time since FY2012, lawmakers did not provide an increase to the per-pupil foundation grant, instead opting to increase funding in several other areas. For context, the last time the foundation allowance did not see an increase, the state was facing over a billion-dollar General Fund structural budget deficit. In fact, state tax and spending reforms enacted to address the ongoing budget hole required each district to take a \$470 per-student cut to its foundation grant. Today, the state's finances are much healthier. But instead of directing resources to a base funding increase this year, lawmakers chose to invest in student safety and mental health, early literacy programs, teacher recruitment and retention strategies, access to universal no-cost school meals, and expanded pre-school.

Final Thoughts

Categorical grants undoubtedly play an important role in public education, helping to address specific challenges and support targeted initiatives. However, their rigid requirements, administrative demands, and potential to exacerbate inequities highlight the need for a more balanced approach to school funding. By combining limited categorical grants with more flexible funding options, Michigan can ensure each public school has the appropriate mix of resources needed to address both immediate priorities and long-term goals.

Next week, the state legislature will receive Governor Whitmer's FY2026 School Aid budget proposal. It will allocate \$19 billion in state-sourced spending across a multitude of programs and services for Michigan's 1.4 million public schoolchildren. In addition to focusing on "what" gets funded in the governor's budget proposal, lawmakers should also examine "how" funding is allocated to districts. The increased presence of categorical grants in the state K-12 budget should prompt lawmakers to reflect on the advantages and disadvantages of the current shift towards funding schools via these grants and some of the unintended consequences that have arisen with increased emphasis on state-directed funding.

ABOUT THE AUTHOR

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Craig is the Research Council's Research Director and primary researcher of education and school finance issues. Prior to becoming Research Director, Craig served as the Director of State Affairs and as a Senior Research Associate. During his graduate school studies, he worked for the Council as a Lent Upson-Loren Miller Fellow from 1993 to 1995. Before joining the Council in 2006, Craig worked for ten years as a fiscal analyst at both the Senate Fiscal Agency and the House Fiscal Agency. He previously worked for the Michigan Department of State, Office of Policy and Planning and the United States Environmental Protection Agency in Chicago.

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