

No. 984

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### SCHOOL FINANCE CONSTITUTIONAL AMENDMENT PROPOSALS

For the past two years, there has been an ongoing discussion of elementary-secondary school finance reform at the state level. The legislature placed two school finance proposals on the ballot to be voted on at a special election on November 7, 1989 (Proposals A and B).

This **Council Comments** analyzes the two proposals. A more detailed twelve-page report (**No. 296**) is available upon request.

#### I. PROPOSAL A

**Tax Changes.** Proposal A calls for the sales and use taxes to increase from 4% to 4.5% effective January 1, 1990, with the proceeds earmarked to the school aid fund. For a full fiscal year, this would generate an estimated \$400 million additional revenue. If approved by the voters, the proposal would be in effect for three quarters of the fiscal years thus generating \$300 million for 1989-90. The first full year the sales tax and use tax would be in effect is 1990-91, when it is estimated they will generate \$421 million.

Dedication of a number of existing revenues to the school aid fund would be changed from a statutory to a constitutional basis. Additional existing general fund revenues would be dedicated constitutionally to the school aid fund. These would include: (1) effective October 1, 1989, an additional 25% of the existing 4% sales tax, excluding auto related sales tax revenue, (2) lottery interest earnings and (3) beginning January 1, 1990, 5% of the existing 4% use tax. These earmarked funds are intended to replace the existing general fund supplement to the school aid fund.

**Allocation Changes.** The new revenue will be allocated by legislative appropriation. There has been action in the House allocating \$400 million on a full year basis, but the appropriation is prorated to reflect nine months collections (\$300 million) in 1989-90. The House would allocate \$214 million to the per pupil membership formula and \$86 million for programs intended to improve the quality of Michigan public education. The Senate has not yet acted upon the allocation bills.

It is not anticipated that there will be any substantive change in the existing power-equalizing per pupil membership formula. The existing 1989-90 membership formula guarantees an in-formula district levying 33.3 mills for operations (the 1988-89 state average) per pupil revenue of \$3,094. Assuming the additional revenue included in the House proposal is used to increase the 1989-90 per mill guarantee of \$83.61P it is estimated that the gross allowance for the state-average district would increase approximately \$216 per pupil to \$3,310.

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**Tax and Revenue Limitation.** In 1978o the voters adopted a comprehensive tax and revenue limitation proposal (Headlee) which amended one section and added 10 new sections to the State Constitution. There are specific provisions in Proposal A that impact the tax limitation provisions. For example, the proceeds from the additional 0.5% additional sales and use taxes would be included in calculating compliance with the state revenue limit provided for in Article IX, Section 26.

Article IX, Section 30 requires that the proportion of total state spending to all local units of government shall not be reduced below the proportion in effect in 1978-79. The proportion is 41.6% and the additional 0.5% sales and use taxes proceeds may be used in meeting this requirement.

## II. PROPOSAL B

Proposal B is a complex proposal that would add approximately 2,800 words to the present Michigan Constitution which is estimated to be 20,000 words in length. Under Proposal 6, the State Constitution would be amended in the following manner:

- An increase in the sales and use taxes from 4% to 6% would be effective January 1, 1990.
- Beginning with the 1990 summer property tax levy, the state would levy a nine-mill property tax on non-business property and a 14-mill property tax on business property.
- Local school districts would be required to levy a foundation millage in addition to the state levy on all property classes. Neither the state property tax rate nor the local foundation property tax rate would require voter approval.
- Local districts would have the option, with voter approval, of levying up to four additional mills.
- State and local foundation millages would be exempt from the provisions of the tax limitation amendment (Headlee) including the millage roll-back provision.
- A state account for education fund (SAFE) would be established and the existing school aid fund abolished. Specific state revenues would be dedicated to SAFE and specific general fund revenues would be earmarked for K-12 education outside of SAFE.
- A basic per pupil membership formula would be established.
- State funding for special education, transportation, vocational education, and intermediate school districts would be increased 10% in 1990-91 over 1989-90.

**Tax Changes.** The principal tax changes contained in Proposal B would increase sales and use tax rates from 4.1% to 6% (effective January 1, 1990), and there would be a statewide levy of nine mills on non-business property and 14 mills on business property.

Each school district would levy a foundation millage that is determined by a formula using that district's 1990-91 revenue guarantee per pupil derived from the local property tax and state membership aid. For most non-urban area districts, the foundation millage is estimated to be eight mills. It is estimated that the 1989-90 statewide average local school operating property tax will be approximately 33.8 mills. By comparison under Proposal B, the combined state and local tax is estimated to be 21.1 mills on non-business property and 26.1 mills on business property.

It is estimated that the sales and use taxes increase will generate \$1.7 billion in 1990-91. These revenues would be offset by \$1.4 billion in net property tax reductions (\$994 million individual and \$416 million business). Thus, the net tax increase is estimated to be \$274 million, although the earmarking of additional general fund monies will make an estimated \$300 million to \$310 million in additional funds available for education in 1990-91.

**Allocation Changes.** Each school district would have a guaranteed per pupil revenue for the 1990-91 fiscal year. Per pupil revenue is a combination of state membership aid, and local property tax revenue. For those districts with a 1989-90 per pupil revenue of \$3,190 or less, the 1990-91 per pupil guarantee would be \$350 above the 1989-90 guarantee. Districts with more than \$3,190 per pupil in 1989-90 would receive a per pupil increase of between \$250 and \$350. The sliding scale would be based on a statutory formula that would provide the lower amount to high expenditure districts.

The 1990-91 constitutionally guaranteed formula would function as follows:

- The state would provide a flat \$2,700 per pupil grant for all pupils. For low expenditure districts this grant would be reduced when necessary to maintain the \$350 per pupil increase.
- There would be a guarantee in state and local funds of \$105 per operating mill levied for the first eight mills of local foundation millage.
- There would be a guarantee in state and local funds of \$85 per operating mill for additional foundation millage.
- The four extra-voted mills would be equalized at the statewide average SEV per pupil for that year (for 1989-90 it is estimated this will be about \$78 per mill).

Using the above elements, **Table 1** shows the 1990-91 effect of the proposal on three hypothetical school districts. The three districts would experience a property tax reduction although the business property owners in district C would receive only a modest reduction of 3/10ths of a mill. Note that district A would receive a grant of \$2,328

rather than \$2,700. This occurs because the district would be restricted to a per pupil increase of \$350 for a 1990-91 per pupil guarantee of \$3,168 and would levy eight foundation mills.

**Tax and Revenue Limitations and Statutory Requirements.** A number of Headlee provisions are affected by Proposal B. They include the millage rollback provision, the state revenue limit, and the proportion of state spending required to go to local units of government.

There are five bills tie-barred to Proposal B. The proposal could not be submitted to a vote of the people unless the five bills were enacted into law, which has occurred. Three of the acts amend property tax abatements for industrial and commercial businesses. The other two provide sales tax, rental, and property tax credits for renters, seniors, and low income citizens.

**Table 1**

**Estimated Effect of Proposal B on Three School District Situations**

	District		
	<u>A</u>	<u>B</u>	<u>C</u>
<u>1989-90</u>			
SEV per pupil	\$60,000	\$60,000	\$175,000
Operating millage	30	40	25
Basic revenue per pupil	\$ 2,818	\$ 3,654	\$ 4,375
 <u>1990-91</u>			
SEV/pupil (assumes 6% growth)	\$63,600	\$63,600	\$185,500
Foundation millage	8	13.3	10.7
Total millage-non business*	17	22.3	19.7
Per pupil state grant	\$ 2,328	\$ 2,700	\$ 2,700
Per pupil equalization revenue	\$ 840	\$ 1,289	\$ 1,985
Guaranteed per pupil revenue**	\$ 3,168	\$ 3,989	\$ 4,685

\* Total millage for business will be 5 additional mills.

\*\* Proposal B requires a \$350 increase for A. The increase for B is set at \$335 and for C at \$310 for the purpose of this presentation.

Source: CRC calculations.