



PROSPECTS FOR SCHOOL AID IN THE ECONOMIC RECOVERY

The FY2003 Executive Budget proposal for K-12 school aid provides the financial ingredients to avoid reducing spending in FY2003 and thereafter. However, it is unlikely that surpluses or other financial cushions will be available in the next 2 or 3 years to help weather an economic downturn, should another one occur in the near future. This State Budget Note discusses the prospects for state school aid, the largest category in the state budget, for the next 5 years and presents a scenario to finish the process of managing through the current budget problem.

The Gap

Current estimates for the current fiscal year FY2002 reveal a gap of \$773 million between school aid revenues and appropriations. This operating deficit is covered by using the entire School Aid Fund balance of \$694.8 million carried forward from FY2001 and \$78.2 million of Rainy Day Fund revenues. Since consensus revenue forecasts for FY2003 indicate an increase of only \$383 million, additional one-time revenues will be needed to avoid cutting FY2003 spending below FY2002 levels.

The Current Budget

The FY2003 budget proposal not only covers the remaining gap, but provides enough year to year revenue growth to permit raising the per pupil foundation allowance guarantee from \$6,500 to \$6,700 as previously determined in the initial three-year school aid bill passed in 2000. One-time revenues from the Rainy Day Fund and from advancing the due date of the State Education Tax in 2003 to the summer for all taxpayers (many already pay the tax in the summer) are incorporated in the budget. The Rainy Day Fund will provide \$350 million to the School Aid Fund in FY2002, with \$272 million carrying over into FY2003 to help support spending.

The State Education Tax change is accomplished in two steps. First, the tax will be due in the summer of 2003. For that year only, the tax rate will be reduced from 6 to 5 mills for all taxpayers. The due date shift produces a

one-time gain to the School Aid Fund of \$494 million. The one-time revenue sources, combined with regular School Aid Fund revenue, finance the proposed FY2003 spending and produce an ending surplus of \$146 million to carry into FY2004. Second, in 2004, the tax rate will be restored to six mills.

The Future

With a continuation of the economic recovery as projected, revenues will probably grow by 4 to 5 percent.¹ **Table 1** (on page 2) summarizes recent school aid revenue and spending and provides illustrative projections to FY2008. The assumed rate of increase in revenues is 4.5 percent, the midpoint of the likely growth range, and it is assumed that all available revenue will be spent each year beginning in FY2004. The projections indicate that expenditures would be essentially flat in FY 2004 and could grow by 3 percent in FY2005 in the scenario. After the 2-year period of transition, revenue and spending growth would be equal.

These figures demonstrate that the proposal to get through FY2003 provides the potential of successfully managing through the economic downturn without any year-to-year reductions in spending. However, spending growth for the FY2003 through FY2005 period will be very constrained, below the likely overall rate of inflation for the period. Stronger revenue growth assumptions produce more favorable spending potential. If revenues were to grow at 6 percent per year, although unlikely, spending could grow by 1.4 percent and 4.5 percent in fiscal years 2004 and 2005 respectively.

The decisions about the FY2004 and FY2005 school aid revenue and spending plans will be left to the new governor and legislature. The revenue constraints of the existing earmarked revenue sources are likely to be in the ap-

¹ School Aid Fund yearly revenue growth averaged over 6 percent from FY1995 through FY2000.

State Budget Notes

Table 1
School Aid Fund Revenue and Expenditure Summary
Fiscal Years 1995 through 2008 (projected)
(\$ in millions)

	<u>Fiscal Year</u>	<u>Base Revenues*</u>	<u>Percent Change</u>	<u>Onetime Revenues/ Resources^</u>	<u>Available Resources</u>	<u>Percent Change</u>	<u>School Aid Spending</u>	<u>Percent Change</u>	<u>Ending Fund Balance</u>	<u>Spending In Excess Of Base Revenues</u>
Actual	1995	\$7,698.6			\$7,698.6		\$7,978.7		\$144.7	\$280.1
	1996	8,243.9	7.1	\$144.7	8,388.7	9.0	8,312.0	4.2	119.2	68.1
	1997	8,679.3	5.3	119.2	8,798.5	4.9	8,605.7	3.5	193.1	(73.6)
	1998	9,274.2	6.9	405.1	9,679.3	10.0	9,398.9	9.2	272.8	124.7
	1999	9,949.7	7.3	272.8	10,222.4	5.6	9,644.5	2.6	572.8	(305.2)
	2000	10,479.3	5.3	572.8	11,052.2	8.1	10,056.6	4.3	853.4	(422.8)
	2001	10,571.7	0.9	853.4	11,425.1	3.4	10,892.3	8.3	694.8	320.6
Planned	2002	10,646.8	0.7	1,044.8	11,691.6	2.3	11,419.8	4.8	271.8	773.0
	2003	11,062.0	3.9	765.5	11,827.5	1.2	11,681.3	2.3	146.2	619.3
Projected	2004	11,538.9	4.3 [#]	146.2	11,685.1	(1.2)	11,685.1	0.0	0.0	146.2
	2005	12,037.2	4.3 [#]		12,037.2	3.0	12,037.2	3.0	0.0	0.0
	2006	12,557.9	4.3 [#]		12,557.9	4.3	12,557.9	4.3	0.0	0.0
	2007	13,102.1	4.3 [#]		13,102.1	4.3	13,102.1	4.3	0.0	0.0
	2008	13,670.7	4.3 [#]		13,670.7	4.3	13,670.7	4.3	0.0	0.0

* Taxes and other earmarked revenue sources, federal revenue, General Fund grant to School Aid Fund.

^ Fund balances from previous year, Rainy Day Fund revenues, tax date change revenue gains.

[#] An assumed increase of 4.5 percent in dedicated taxes and other non-tax sources (e.g. Lottery) produces a 4.3 percent increase in total revenues when General Fund grant, federal, and Durant Settlement payments are included at their FY2003 levels.

proximate order of magnitude in the scenario. Barring tax rate changes, the only revenue sources controlled by state policymakers are the General Fund grant to the School Aid Fund (assumed to remain at the current \$198 million throughout the period, although \$79.5 million of the General Fund grant in FY2003 is financed from a one-time revenue source and may be at risk after FY2003) and one-time revenue sources such as the Rainy Day Fund and carryover School Aid Fund balances (assumed to provide no resources beyond FY2004).

One-time Revenues

Over the 4-year period FY2001-FY2004, the State will have used nearly \$1.9 billion of one-time sources including \$1,015 million of School Aid Fund balances, \$350 million of Rainy Day Fund revenues, and the one-time effect of changing the collection date of the State Education Tax totaling \$494 million. Spending growth during the same period will be \$1.1 billion from the beginning to end of the period, an increase of 9.9 percent.

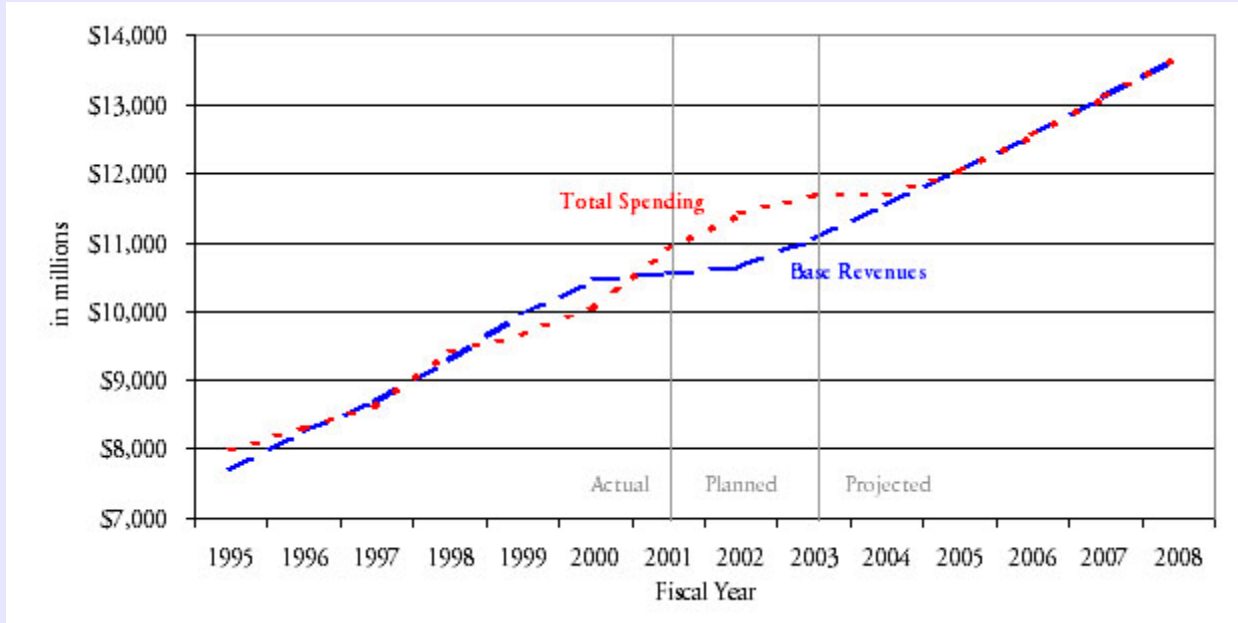
School Aid Surplus

Chart 1 depicts the ebb and flow of school finance during the post-Proposal A period. A substantial surplus was built up in the School Aid Fund during the early years and recently has served as a sort of Rainy Day Fund for school aid. But that cushion will be totally gone by the end of the current fiscal year and additional one-time resources are now proposed to prevent school spending from declining. The chart also illustrates that the operating

State Budget Notes

Chart 1

School Aid Base Revenues and Spending



deficits in FY2002 and FY2003 can be eliminated by FY2005.

Foundation Allowance

Table 2 includes data on the changes in the per-pupil foundation allowance. The allowance is the most significant part of school aid, accounting for 83 percent of total aid to schools from the State if the proposed budget for FY2003 is approved. If the increase in school aid spending between fiscal years 2003 and 2005 as projected in the scenario is used entirely to increase the per pupil foundation allowance, the pro-

posed \$6,700 basic allowance for FY2003 could only increase to about \$6,900 by FY2005. Revenue growth of 6 percent in both years would permit the per pupil allowance to increase to about \$7,100 by FY2005, if the entire increase were

allocated for that purpose. Because of general inflation and anticipated increased health insurance costs local districts will face tight budget constraints as the State works its way out of the structural deficit.

Table 2

**School Aid Per Pupil Foundation Allowance History
Fiscal Year 1995 through FY2003 (Proposed)**

	<u>Minimum Guarantee</u>	<u>Percent Change</u>	<u>Basic Allowance</u>	<u>Percent Change</u>	<u>Hold Harmless Allowance</u>	<u>Percent Change</u>
1995	\$4,200		\$5,000		\$6,500	
1996	4,506	7.3	5,153	3.1	6,653	2.4
1997	4,816	6.9	5,308	3.0	6,808	2.3
1998	5,124	6.4	5,462	2.9	6,962	2.3
1999	5,170	0.9	5,462	0.0	6,962	0.0
2000	5,700	10.3	5,700	4.4	7,200	3.4
2001	6,000	5.3	6,000	5.3	7,500	4.2
2002	6,500	8.3	6,500	8.3	7,800	4.0
2003	6,700	3.1	6,700	3.1	8,000	2.6
Total Change						
1995-2003	\$2,500	59.5	\$1,700	34.0	\$1,500	23.1

BOARD OF DIRECTORS

AMANDA VAN DUSEN, Chairman
W. FRANK FOUNTAIN, Vice Chairman
JEFFREY K. WILLEMMAIN, Treasurer
VERNICE DAVIS ANTHONY
RALPH W. BABB JR.
JEFFREY D. BERGERON
J. EDWARD BERRY
WILLIAM M. BRODHEAD
GARY L. COLLINS
TERENCE M. DONNELLY
RANDALL W. EBERTS
KELLY M. FARR
EUGENE A. GARGARO
MARYBETH S. HOWE
HAROLD KRIVAN
DANIEL T. LIS
IRVING ROSE
S. MARTIN TAYLOR
KENT J. VANA
ROBERT J. VITITO
GAIL L. WARDEN
RICHARD C. WEBB
RICHARD T. WHITE
MARTIN B. ZIMMERMAN
EARL M. RYAN, President



Citizens Research Council of Michigan
38777 Six Mile Road, Suite 201A
Livonia, Michigan 48152-2660

Policy Considerations

Chart 2 displays the shares of FY2003 School Aid Fund revenue by major source. In future economic slowdowns, school aid revenues are likely to soften and even decline on a year-to-year basis, given the sensitivity of the sales, use and income taxes to the economy. The substantial cushion available in the current slowdown has been used effectively to prevent reductions in spending. A program to rebuild the School Aid Fund balance or alternatively, the State's Rainy Day Fund, should be considered to prepare to manage through the next downturn.

Chart 2

Shares of FY2003 School Aid Revenue

