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ABSTRACT

Unlike many other states, Michigan's school-finance reform was triggered not by a lawsuit but by legislative action that eliminated the property tax as a revenue source for public schools. Changes included an increase in the sales tax from 4 to 6 cents and a move to a foundation grant formula, which included a state foundation-allowance target for lower revenue districts. This paper provides a brief history of the last 25 years of finance reform in Michigan and then examines the short-term effects on revenues and expenditures of local school districts. Methodology involved analysis of 5 years of revenue and expenditure data (1990/91-1994/95) from the Michigan Department of Education for all school districts. Although the wealthier districts now rely more heavily on state funding, they still receive a substantial number of local dollars generated by the 18-mill levy on nonhomestead property and hold-harmless mills. The data also show that there is greater horizontal equity in terms of dollars per pupil going to the school districts. Data show that, after the reform, districts spent more for employee benefits and less for purchased services and instructional supplies. Questions remain about the stability of the new funding sources and the ability of the state to fully fund schools in the future. (Contains 4 tables and 12 references.) (LMI)

RE-INVENTING EDUCATION:

TRANSFORMING FINANCIAL SUPPORT FOR MICHIGAN SCHOOLS

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RE-INVENTING EDUCATION:

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Almost every state has undergone school finance reform within the last decade. Much of the reform occurred because a lawsuit had been filed challenging the equity of the funding system. Michigan's recent experience with finance reform is unique in several ways. There was no lawsuit; the reform was triggered by legislative action which eliminated the property tax as a revenue source for public schools. The remedy was determined by a successful ballot proposal to amend Michigan's constitution. This paper discusses a brief history of the events surrounding the finance reform and then examines the short term effects on revenues and expenditures of local school districts.

A Brief History of Michigan School Finance

In 1973, in response to the *Serrano v Priest* (California, 1971), SB110, known as the Bursley Act, was signed into law (Caesar, McKerr & Phelps, 1974). The Bursley Act provided for state aid to school districts based on an equal yield concept. In theory, districts that levied the same number of mills received the same number of combined local and state dollars regardless of the district's property wealth or state equalized value (SEV). Thus, in keeping with the *Serrano* decision, the disparities in funding among school districts would be the result of local choice in approving millages and not the result of differences in the property wealth of the district. Problems occurred when the SEV of districts with high property wealth exceeded the State's ability to fully fund equalization efforts and disparities grew. In addition, property tax rates varied considerably from district to district.

According to Sielke (1996), 1993-94, millage rates for operating purposes varied from a low of 7.8 mills to a high of 45.67 mills with a state average of 33.39 mills. Total school district property wealth varied from a low of $15,057,180 to a high of $6,442,484,436. Clearly taxpayer inequities existed. Further, disparities existed in terms of available dollars for students. In 1993-94, per pupil local and state revenues varied from $3,277 to $10,358.

During the 1970s, problems associated with school finance became linked to taxpayer rebellion against property taxes. In Michigan, 11 proposals to limit property taxes and/or place spending limits on school districts were placed before the public between 1972 and 1992. Only one proposal passed - the Headlee Amendment, which became P.A. 35 of 1979. This proposal imposes tax limits on all governmental units and also included a provision that prohibits the State from mandating activities on local governments that are not reimbursed. This amendment plays a key role in the unfolding of the 1994 finance reform package.

Michigan School Finance in 1993

Finance reform efforts in Michigan closely align themselves with the theory of agenda setting as described by Odden and Wohlstetter (1992). According to this theory, developed by Cobb and Elder, "issues are placed on formal policy agendas through the dynamic interplay of 'triggering mechanisms' . . . and 'initiators'" (Odden and Wohlstetter, p. 356). Triggering mechanisms can be unanticipated human events, technological changes that provide new ways to solve problems, changes in demographics or fiscal conditions, and "biases in the distribution of resources leading to such things as teachers' strikes or lawsuits" (p. 356). Initiators can be identified as exploiters, who work for personal gain; reactors who respond to events, do-gooders who respond in order to make better public policy and re-adjusters who wish to redistribute resources more evenly. Initiators may fall into more than one category.

Vergari (1995) documents the events that triggered Michigan's finance reform. Vergari points to two triggering mechanisms that she terms manufactured crises. One such crisis was the early closing of the Kalkaska schools because operating funds ran out. In terms of agenda setting theory, the triggering mechanism, the early closing of the school district, was a result of unbalanced resources among school districts in the state. Kalkaska was a low millage and, therefore, a low revenue district. Administrators, board members and the community decided to provide a good program for 135 days rather than what might be a poor program for the required 180 days. The leaders of that school district could probably be labeled do-gooders and re-adjusters. As Vergari (1995) aptly points out, however, there were other options available to the district other than closing its doors 45 days early, but the closing focused attention on the problems of low revenue districts where voters repeatedly refused to raise property taxes.

The second crisis Vergari (1995) refers to occurred in July 1993. Republican Governor John Engler had made a campaign promise to reduce property taxes. In what Vergari refers to as "an unmistakable form of brinkmanship" (p. 239), Democratic Senator and would be gubernatorial candidate Debbie Stabenow proposed abolishing the property tax for school operations. Both houses approved the bill. In agenda setting theory, we may think of this triggering mechanism as an unanticipated event, but more reasonably it was a response to the changing fiscal conditions that lead to taxpayer reluctance to approved millage increases to support increased public school operations. Difficulty arises in trying to categorize the initiators. On the one hand, the initiators could be viewed as do-gooders who wanted to make better public policy or as re-adjusters who wanted a better balance in the distribution of resources. One cannot overlook, however, the category of exploiter, as both the Governor and the contender for the Governorship played high stakes poker. Senator Stabenow raised the ante, and the Governor called the bluff. Property taxes were eliminated and finance reform in Michigan was underway.

Proposal A: Finance Reform for Michigan

In March 1994, Michigan voters approved the Constitutional amendment called Proposal A by a 69 to 31 margin (Kearney, 1994). A few matters of importance need to be noted. First of all, Proposal A allowed for replacement of all revenue lost through the legislative approval to eliminate property taxes that was approved in July 1993. Proposal A called for an increase in sales tax and increases in some other taxes. ***Some*** property taxes were restored in order to make replacement of those dollars possible. Secondly, the legislature approved a statutory backup plan that would require a two percent increase in income taxes and the restoration 6 more mills of property taxes on homestead property that would fall into place if Proposal A did not pass. So, one way or the other, there was going to be a restoration of some property taxes and an increase in either sales tax or income tax regardless of the outcome of Proposal A.

Revenue Changes

Under Michigan's new finance plan, sales taxes were increased from 4 to 6 cents. The two cent increase in sales tax is the major source of revenue replacement. The two cents is earmarked for education along with 60% of the original four cents. There is additional earmarking of other taxes such as some taxes on income, taxes on tobacco, liquor, and profit from the state lottery. (See Kearney, 1994; Addonizio, Kearney & Prince, 1995, for greater detail.)

Some property taxes are still being levied. The state levies 6 mills on all property. Because of the aforementioned Headlee Amendment with its tax limitations, the state could not levy all of the required taxes. School districts, therefore, are required to levy 18 mills on non-homestead property in order to receive their full foundation allowance. (Homestead property is defined as primary residence; all other property is non-homestead.) All districts, with local voter approval, may levy up to three enhancement mills through the 1996-97 school year. After that, regional enhancement mills, based on intermediate school districts, will be available with voter approval. Additionally, districts that were receiving more than $6,500 in state and local revenues in 1993-94, may ask voters to approve hold harmless millage.

In addition to reducing property taxes, property assessment increases have been capped at the rate of inflation or 5 percent, whichever is less, until the property is sold. Once the property is sold, the taxable value reverts to 50 percent of market value.

<u>Allocation Changes</u>

In order to allocate funds to local school districts more equitably, a move from a guaranteed tax base, "equal yield-reward for local effort," state aid formula to a foundation grant was made. Each local district's original foundation allowance was calculated based on 1993-94 state and local revenues. Almost all categorical grants were rolled into the foundation allowance along with the dollars the state had paid into the retirement fund that year. Beginning with the 1994-95 school year, local districts are responsible for all costs for FICA and retirement. At the same time, the State set a *state foundation allowance **target*** for lower revenue districts. This was set at $5,000 for the first year. Because the State did not have enough funding to bring all lower revenue districts up to the targeted allowance, districts were divided into funding tiers: Districts below $4,200 were raised to $4,200; districts between $4,200 and $6,500 were increased (inversely) on a sliding scale ranging from $160 per student to $250 per student; and districts above $6,500 were increased by $160 per student. Categorical at-risk funding, which is based on the number of students eligible to FREE lunch under federal guidelines, is available for districts below the $6,500 level.

Beginning with the 1995-96 school year and continuing, the ***target*** state foundation allowance increases by the per pupil amount determined by the revenue consensus committee. The committee is comprised of three people representing the Governor's office, the House, and the Senate. A revenue consensus conference is held in January and in May or June to determine the number of dollars that are available for schools and to calculate the index for increasing the foundation allowance. Districts below the state targeted foundation allowance receive up to twice the per student increase until they reach the targeted state foundation allowance. Districts above the state foundation allowance receive the per student allowance determined by the revenue consensus committee. Because all districts receive at least the per pupil increase, there will always be a range between district revenues.

It is important to note that the legislature in devising the funding plan made three important policy decisions (Kearney, 1994). One of these decisions was to bring the low revenue districts up to the state foundation allowance gradually. Another decision was to not level down the high revenue districts. The third decision was that there would be no "retroactive equity" (p. 37). In other words, many of the low revenue districts were that way because voters had refused to approve more millage and the state aid formula rewarded for local effort. Therefore, it was believed that those who had previously refused to tax themselves at a higher rate should not be rewarded now.

Thus far we have examined the last 25 years of school finance in Michigan, the events leading up to finance reform, and a brief description of how schools are now funded in Michigan. Now we will examine the immediate effects of the reform.

Effects of the Reform

Revenue

In order to assess the effects of finance reform, five years of revenue and expenditure data for all Michigan school districts were collected from the Michigan Department of Education. These data are for four years prior to finance reform and the first year of reform. Data for 1995-96 should be available in December or January; however, foundation allowance data were made available for 1993-94. 1994-95, 1995-96 and (projected) 1996-97.

Table 1 shows the effect of the reform on revenues. Prior to the reform, 64.1 percent of local school district revenues were from local sources - the local property tax, while only 29 percent came from state sources. In 1994-95, a shift in sources of revenue occurs with local support dropping to 17.7 percent and state support increasing to 76 percent. Local revenues come from the required 18 mill levy on non-homestead property.

For the purpose of analysis, districts have been divided into four funding tiers. Tier 1 is composed of the 31 districts that had revenues below $4,200 in 1993-94 and were raised to that amount. Tier 2 is composed of the 262 districts that had 1993-94 revenues between $4,200 and

TABLE 1
Revenue Changes

Sources of Revenue as a Percentage of Total for All Districts

	1990-91	1991-92	1992-93	1993-94	1994-95
Local	63.8	64.6	64.7	64.1	17.7
State	29.3	28.7	28.4	29.0	76.0
Federal	3.3	3.5	3.8	3.8	3.5
Other	3.6	3.2	3.1	3.1	2.8
n*	524	523	523	524	523

Sources of Revenue as a Percentage of Total for All Districts by Funding Level - 1993-94

	Tier 1	Tier 2	Tier 3	Tier 4
Local	57.2	54.7	72.0	90.5
State	34.5	38.2	21.6	3.5
Federal	5.5	4.0	3.3	3.0
Other	2.8	3.1	3.1	3.0
n	31	262	184	47

Sources of Revenue as a Percentage of Total for All Districts by Funding Level - 1994-95

	Tier 1	Tier 2	Tier 3	Tier 4
Local	18.0	12.5	18.9	41.7
State	74.7	80.9	75.2	53.4
Federal	4.8	3.7	3.1	2.8
Other	2.5	2.8	2.8	2.1
n	31	262	183	47

* *n* varies due to unavailability of complete revenue and expenditure data for some districts in some years.

Source: Computed by author from information from Michigan Department of Education.

$5,000 (the state's target base allowance). Tier 3 is composed of the 184 districts that had 1993-94 revenues between $5,000 and $6,500; and tier 4 is composed of the 47 districts that had 1993-94 revenues above $6,500.

By reviewing the revenue data by funding tiers, we can see the effects of state wide averaging. In 1993-94 the sources of local revenue actually varied from 54.7 percent to as high as 90.5 percent. In tier 4, the very high revenue per pupil districts, the districts had exceeded the membership allowance under the old funding formula because they could raise more dollars locally than the said aid formula would fund. These districts were eligible for minimal state categorical funding. Table 1 shows that while districts in Tier 4 now rely more heavily on state funding, they still receive a substantial number of local dollars generated by the 18 mill levy on non-homestead property and hold harmless mills.

Skepticism exists regarding the stability of revenue sources for schools. Perhaps one of the greatest advantages of the property tax is its stability; its inelasticity makes it far less vulnerable to changes in the economy. As Kearney (1995, p. 180) points out, "a downturn in the business cycle likely would result in a corresponding downturn in state sales tax revenues and, in turn raise serious questions about the state's ability to fund the schools at the projected level of revenue need." The automobile industry is the best indicator of the business cycle in Michigan. Kearney (1995) points out that cycles of growth generally do not exceed three years. The last four years, automobile production has been in a growth cycle. "Thus, Michigan appears due, if not overdue, for a decline in the business cycle and a consequent slowdown in economic and revenue growth" (Kearney, 1995, p. 181). For the school year 1995-96, the increase at the state base foundation allowance was $153 per pupil, or an approximate 3 percent increase. The increase for the current year at the base is $155 per pupil, or again an approximate 3 percent increase. Of course, under the funding system, districts at the bottom receive twice the increase, giving those districts an actual increase that is greater that 3 percent. However, those districts above the state foundation allowance receive only the dollar per pupil increase; the district with the most dollars per pupil actually receives an increase of approximately 1.5 percent. The question becomes, if this is the size of the increase that is given in good economic times, what will be the increase, if any, in less favorable economic times?

Allocation Changes

One of the goals of finance reform is to reduce the disparities in state and local dollars available to school districts. Table 2 shows the changes in school district foundation allowances for the first three years of finance reform. The 1993-94 column is the calculation performed by the Michigan Department of Treasury to give each district its beginning foundation allowance. This amount included 1993-94 state and local revenues, including most state categorical grants with the addition of the retirement dollars the state had paid for that school district's employees in 1993-94. Table 2 shows that the minimum foundation allowance has been increased by twice the per pupil increase for the 1995-96 and 1996-97 school years. Table 2 also shows that the highest revenue district is receiving only the per pupil increase. Table 2 shows us that the range is decreasing while both the mean and the median are increasing. The coefficient of variation, rated by Odden and Picus (1992) as a good measure of equity, was calculated. A coefficient of zero is complete equity; a coefficient of less than 0.1 indicates an equitable situation (Odden & Picus,

TABLE 2
Changes in District Foundation Allowances
1993-94 through 1996-97

	1993-94*	1994-95	1995-96	1996-97
Minimum	$3,398	$4,200	$4,506	$4,816
Maximum	$10,290	$10,450	$10,607	$10,762
Range	$6,892	$6,250	$6,101	$5,946
Mean	$4,955	$5,184	$5,401	$5,615
Median	$4,664	$4,896	$5,138	$5,308
Mode	N/A	$4,200	$4,506	$5,308
Coefficient of Variation	0.21	0.19	0.18	0.16

n = 524

1994-95 State Basic Foundation Allowance = $5,000
1995-96 State Basic Foundation Allowance = $5,153
1996-97 State Basic Foundation Allowance = $5,308

*Pre-Finance Reform. This number is the state and local dollars calculated by the Michigan Department of Treasury to determine each district's base foundation allowance.

Source: Computed by author from information from Michigan Department of Education.

1992). Table 2 shows us that the coefficient of variation is decreasing indicating that greater equity in terms of revenues per pupil is being achieved. The coefficient of 0.16 for 1996-97 indicates a condition close to equitable.

It is interesting to note that the mode for 1994-95 and 1995-96 was the foundation allowance for the lowest revenue districts, of which there are 31. For 1996-97, however, the mode is the state basic foundation allowance. For the current school year, 47 districts will have reached the targeted state allowance. The plan appears to be working in bringing greater horizontal equity in terms of dollars per pupil to school districts. The effects of enhancement mills have not been included in these calculations, however. Since they are not equalized, districts with higher SEVs per pupil would have more dollars per pupil to spend thereby impacting horizontal equity. At risk dollars, which are intended to provide vertical equity, have not been evaluated for this paper.

Changes in District Spending

A discussion of the effects of finance reform would be incomplete without at least a cursory look at how expenditures have been impacted. Table 3 shows percentage of expenditures for all districts by object. The most noticeable change is in the benefits area. While increased percentages in this area for 1990-91 through 1992-93 could be caused by increased costs for fringe benefits or increased fringe benefit packages, the jump in 1993-94 and 1994-95 is a reflection the assumption of local district responsibility for all mandated benefits - FICA and retirement. Full payment for FICA became a district responsibility in 1993-94; retirement

TABLE 3
School District Expenditures by Object

Expenditures are expressed as a percentage of total.

	1990-91	1991-92	1992-93	1993-94	1994-95
Salaries	65.7	66.3	71.1	63.8	60.6
Benefits	12.7	12.8	13.6	17.7	21.3
Purchased Services	7.3	7.0	6.5	6.0	5.9
Supplies	5.4	5.4	5.1	4.8	4.7
Capital Outlay	3.2	2.8	2.4	2.2	2.6
Other	2.0	2.0	1.8	1.7	1.3
Transfers	2.0	3.6	3.8	3.4	3.3
n	524	523	524	524	523

n varies due to unavailability of complete revenue and expenditure data for some districts in some years.

Errors in addition due to rounding.

Source: Computed by author from information from Michigan Department of Education.

responsibility was added in 1994-95. Table 3 shows that the only other area of increase is forcapital outlay, but that increase follows a steady four year decline in expenditures for that object. Of additional interest is the decline in expenditures for purchased services. Public Act 112 of 1994, which was passed after Proposal A, was expected to encourage districts to privatize services. The data do not appear to indicate that this is happening.

Tables 4 and 5 show expenditures by object for 1993-94 and 1994-95. However, these tables divide the expenditures into instructional expenses and support expenses by funding tier. In Michigan, instruction includes all expenses for classroom instruction including basic K-12 programs, special education, vocational education, and other added needs such as at-risk students, and gifted and talented students. Support expenditures include all administration, transportation, business services, maintenance and operations, non-classroom support services for students and staff (counseling, professional development, etc. These are general fund operating expenses and under Michigan's Accounting Code do not include expenditures for food service, athletics, debt retirement, building and site funds, and sinking funds.

In reviewing Tables 4 and 5, the same increases in expenditures can be noted. The increase in benefits occurs across all funding tiers. Instructional salaries decrease as a percentage of expenditures with the higher funding tiers, and support salaries increase. Further investigation is needed to see if this is an indication of more counselors, media specialists, curriculum directors or administrators. The decline in percentage of the budget used for instructional supplies is consistent across all funding tiers. It is always interesting to see how little of a school district's budget is spent on actual classroom textbooks, supplies, and materials as these are the

TABLE 4
1993-94 School District Expenditures by Funding Tier

Expenditures are expressed as a percentage of total.

	Tier 1	Tier 2	Tier 3	Tier 4
INSTRUCTION				
Salaries	46.5	45.7	44.1	41.5
Benefits	13.0	12.2	11.7	11.4
Purch. Srvcs.	1.1	0.8	0.9	0.5
Supplies	2.6	2.3	2.0	2.1
Other	0.5	0.3	0.3	0.2
SUPPORT				
Salaries	17.1	18.1	20.1	21.4
Benefits	5.2	5.4	6.0	6.6
Purch. Srvcs.	4.9	4.9	5.4	5.5
Supplies	2.8	2.6	2.6	2.7
Other	1.2	1.5	1.3	1.4
Capital Outlay	2.1	3.1	2.0	3.0
Transfers	3.2	3.6	3.4	3.6
n	31	262	184	47

Errors in addition due to rounding.

Source: Computed by author from information from Michigan Department of Education.

TABLE 5
1994-95 School District Expenditures by Funding Tier

Expenditures are expressed as a percentage of total.

	Tier 1	Tier 2	Tier 3	Tier 4
INSTRUCTION				
Salaries	45.4	44.9	43.2	41.5
Benefits	16.1	15.4	14.9	14.2
Purch. Srvcs.	0.8	0.9	0.9	0.7
Supplies	2.7	2.4	2.1	1.9
Other	0.2	0.3	0.3	0.1
SUPPORT				
Salaries	16.3	17.2	19.0	20.3
Benefits	6.1	6.4	6.9	7.8
Purch. Srvcs.	4.8	5.0	5.3	5.4
Supplies	2.3	2.5	2.6	2.7
Other	1.1	1.1	1.1	1.1
Capital Outlay	2.8	2.7	2.4	2.7
Transfers	1.4	1.4	1.4	1.2
n	31	262	183	47

Errors in addition due to rounding.

Source: Computed by author from information from Michigan Department of Education.

discretionary dollars that building principals and school site teams are "allowed" to make decisions regarding their use.

Conclusion

Finance reform in Michigan became a reality due to legislative actions spearheaded by a Democratic Senator who wanted to be governor. The total elimination of property taxes for a brief time forced a ballot proposal that amended the Michigan Constitution. Changes in revenue sources and in the distribution of those revenues have been effected. Of great concern are the questions that remain as to the stability of the new funding sources and the ability of the State to fully fund schools in the future. The data show that there is greater horizontal equity in terms of dollars per pupil going to school districts. Hirth (1994) found in an analysis of equity trends in Michigan, Indiana and Illinois that there appears to be no one best way to allocate dollars to schools. States seem to be trading allocation options: one gives up a reward for effort formula and a different state adopts that method or another gives up the foundation allowance approach and a different state adopts it.

If we return to the theory of agenda setting for a moment, we must remember that our initiators were politicians and each had his/her vision of what schools should be in Michigan. Senator Debbie Stabenow, in an unpublished handout, described her vision. Stabenow called her platform the "The 3 R's: A Framework for Education *Reform* in Michigan." Stabenow's 3 R's were: Revitalize local schools, Reduce the bureaucracy, and Require the basics. Her vision for revitalizing schools was to provide for school-based decision-making, create charter schools, and create schools of choice. School finance is mentioned under "Require the basics" as item III. C.1. Stabenow's vision is to "reduce disparity in funding among districts with a weighted foundation grant." This does not seem to be much of a plan for one who set the wheels in motion to eliminate the major source of funding for schools.

The Governor's plan was called "Our Kids Deserve Better." Engler's plan is much more detailed and lengthy; however, like Stabenow, his first and second recommendations are to provide for schools of choice and for charter schools. Although Engler lists increasing accountability by providing bonuses for good performance and sanctions for poor performance, it is not until page six (point eight out of nine points) that he mentions assuring "an adequate and equitable allocation of resources to all schools." Engler did, however, provide a plan for replacing the lost revenue.

Michigan school district leaders are faced with many challenges that carry direct or indirect financial implications. Like it or not charter schools and schools of choice will force administrators to become more entrepreneurial. Administrators are going to have to take a harder look at how resources are now being used and how they might be better used in the future. Increases in dollars going to schools are barely keeping up with inflation. But, it is quite clear that finance reform in Michigan means relief for taxpayers, minimal annual dollar increases, and the expectation to do more.

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