

# Michigan ROUNDUP

July 23, 1993

## Legislative and Political Week in Review

In what may be the most significant legislative votes in Michigan history, the state Senate and House excised school operating property taxes as of December 31, 1993, effectively eliminating school funding for FY 1994-95. The governor is expected to sign the bill.

No replacement revenues were specified, but the action will force lawmakers to vote on new revenue sources by next summer. The majority of the revenues will be replaced because they must be—without them the schools cannot operate. This vote can be viewed as either mass hysteria or brilliant statesmanship that will force the legislature finally to face up to school finance reform.

The legislature's action poses two huge questions: How will the revenue be replaced and how much will be replaced? School property taxes generate about \$6 billion. The state will save about \$750 million due to reduced property tax credits. Because of the large amount of money involved, replacement sources are limited. The only options are the state income tax, the single business tax, a statewide property tax, or a local option income tax. The voters could be asked to raise the sales tax, but a 6-cent increase to 10 percent would be required to fully replace the property tax. Extending the sales tax to all services would raise only \$1.4 billion, and sin taxes could not generate more than about \$500 million. Other options include reductions in a state budget already facing a \$500 million structural deficit for FY 1993-94 and reducing school district expenditures, possibly through consolidation.

A hypothetical revenue replacement package could include a statewide property tax of 15 to 20 mills and a one percent increase in the rates of the personal income tax and the single business tax plus some state and school district budget reductions.

This vote provides a major opportunity to improve the tax system and the fairness of school funding in Michigan. However, there will be myriad implications for the state budget, school districts, businesses, property values, homeowners and renters, and the state economy—many of which cannot be predicted with certainty at this time. Some of the key effects will include

- large increases in property values (assuming a statewide property tax is not used to replace most of the revenue);
- a major change in the distribution of the tax burden, (likely toward businesses, particularly real estate firms, and property owners);
- a loss of local control by school districts and reduced resources for the richer school districts; and
- significant cuts in the state budget.

The genie is out of the bottle; there is no turning back. Our elected officials now face difficult choices in raising taxes and redistributing school monies. The opportunities are great but so are the pitfalls. Partisan bickering or a major split in the education community could have disastrous consequences.

"If we fail, we ruin this institution," says House Co-speaker Paul Hillegonds. The stakes are high, not just for school teachers and children, but governance. The legislature creates for itself a Herculean task: Building from the ground up a new system of financing public education.

The public's rejection of Proposal A was construed as a vote of no confidence—no trust—in state politicians. Every tinkering with the current school finance system left interest groups less happy. The legislature concluded that given the options of change or status quo, the public and the interests would always favor inertia. The legislature is posing a radically different set of options: Change or chaos. Fear of the unknown suddenly seems less daunting. Every incentive for every stakeholder is to summon courage and innovation. That is a helluva paradigm shift.

—Craig Ruff, President, and Robert J. Kleine, Vice President and Senior Economist

NOTE: In the week's other major legislative action, the House concurred 56-46 with Senate-passed changes in HB 4156, which offers most motorists a six-month auto insurance premium rollback with annual savings averaging \$100. The action caps weeks of procedural and substantive wrangling.