



PUBLIC POLICY ADVISOR

School Finance Reform Ballot Proposals A and B: Description and Analysis

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On November 7, Michigan voters will approve or disapprove two ballot proposals that could change the method of financing K-12 education in Michigan. Proposal A raises the sales and use taxes from 4 percent to 4.5 percent, restricts constitutionally this revenue and current school aid revenue for K-12 education, and increases funding for K-12 education. Proposal B increases the sales tax from 4 percent to 6 percent, restricts constitutionally this revenue and current school aid revenue for K-12 education, provides property tax relief and a new system for setting school millage rates, and writes a new school aid distribution formula into the constitution.

The voters can vote for one or both of the proposals, and the one that receives the most votes (above 50 percent) will take effect. This paper outlines the provisions in each proposal and discusses in depth the advantages and disadvantages and the potential effects of both.¹

PROPOSAL A—DESCRIPTION

- Increases the sales tax from 4 percent to 4.5 percent (effective January 1, 1990).
- Restricts current and new revenue constitutionally to the school aid fund, including the current general fund appropriation.
- Increases school funding by \$237 million in FY 1989–90 and \$390 million in FY 1990–91. Future funding will increase as the school aid fund increases.
- Separate legislation will reduce funding for school districts if core curriculum and school improvement plans are not adopted. (Included in Section 19 of FY 1990 school aid act, P.A. 197 of 1989.)

PROPOSAL A—ANALYSIS

Advantages

1. *Is simple to understand.*

A major advantage of Proposal A is that it will be easy for the average voter to understand. This is very important, as the voter almost always votes no when confused.

¹ For a more detailed analysis and a district by district comparison see Senate Fiscal Agency, *An Analysis of House Joint Resolution I: School Finance/Property Tax Reform in Michigan*, August 1989.

2. *Increases funding for schools.*

The proposal provides more money for K-12 education; an estimated \$237 million in FY 1989-90 and \$390 million in FY 1990-91. In the future, this amount will grow as the sales and use taxes grow. In the past ten years (FY 1978-79 to FY 1988-89), these taxes increased at an average annual rate of 5.9 percent.

3. *Increases, by a small amount, the sales tax, which is underutilized in Michigan and less unpopular than other taxes.*

The increase in the sales tax from 4 percent to 4.5 percent is small and will keep the rate in Michigan below the rates in surrounding states. There are 18 states with a sales tax rate of 4.5 percent or lower (of 45 states that levy a sales tax), but only 5 states (excluding 4 without a state or local tax) that have a combined state and local rate of 4.5 percent or less.

Another way to compare Michigan's use of sales taxes with other states is to calculate sales (and gross receipts) taxes collections as a percent of personal income. This is shown in Exhibit 1. Michigan sales taxes in FY 1986-87 (the latest data available) were 3.07 percent of personal income, ranking the state 45th. The national average was 4.1 percent. Raising the tax rate to 4.5 percent would increase the percentage to 3.3 percent, and change Michigan's rank to 43rd (based on 1986-87 data).

4. *Replaces the existing annual general fund/general purpose (GF/GP) K-12 appropriation with a restricted revenue source.*

This could have important consequences for schools. In the past, the GF/GP contribution has varied widely, from \$945 million in 1980 to \$360 million in 1983 to \$600 million in 1990. The GF/GP appropriation has declined from 20 percent of the total GF/GP budget in FY 1979-80 to 7.2 percent in FY 1988-89. Proposal A replaces the GF/GP contribution with a fairly stable revenue source that likely will increase, on average, 4 to 5 percent annually. As a result, schools would not suffer large funding reductions during recessions or receive large increases during economic expansions. However, the legislature could provide a general fund appropriation in addition to the dedicated revenue. The funding provided by this proposal, therefore, should be considered a minimum.

A final point is that a general fund contribution still might be needed for mid-year adjustments to the school aid fund estimate. That is, differences in projected revenues and actual revenues could result in an automatic general fund appropriation.

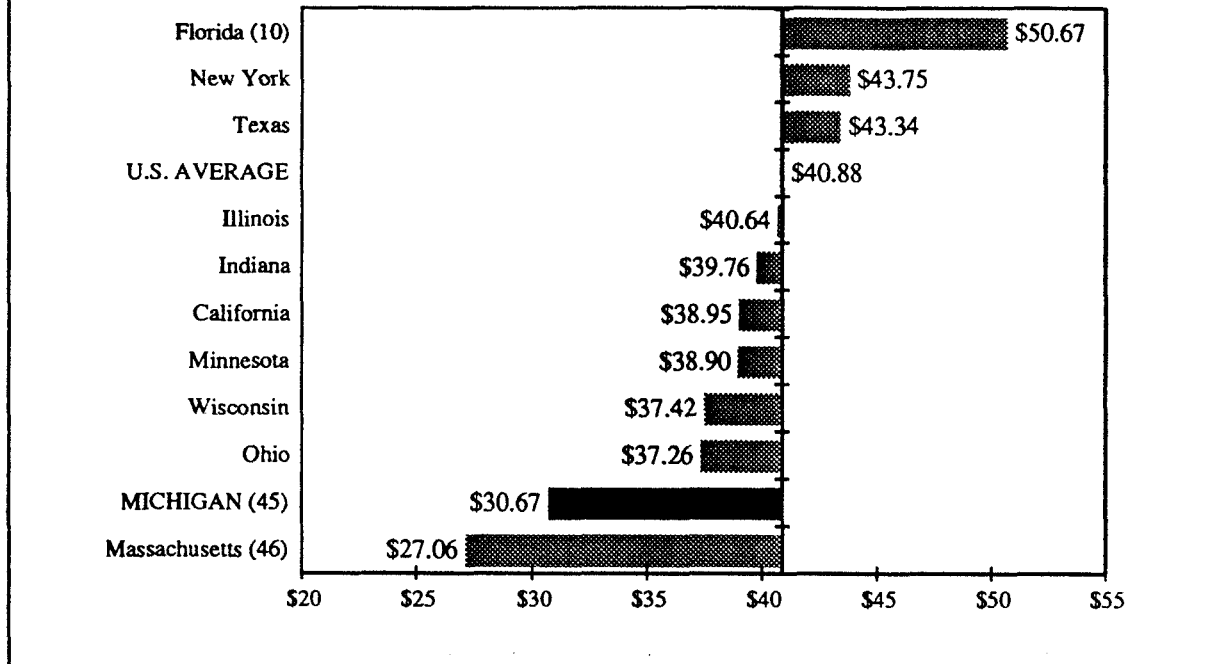
Disadvantages

1. *Does not provide property tax relief or address the problem of the 50-mill limit.*

A major disadvantage of Proposal A is that it does not provide property tax relief. One of the main problems with Michigan's current system of financing education is that too much reliance is placed on the property tax. In Michigan, local governments pay 64.8 percent of the cost of K-12 education, and all this money comes from the local property tax. In only five states do local governments pick up a larger share of the cost of K-12 education. Nationwide, local governments cover an average of about 50 percent

EXHIBIT 1

State-Local Sales Tax
Per \$1,000 Personal Income, FY 1986-87



of total costs. It follows that property taxes in Michigan are among the highest in the nation. As shown in Exhibit 2, property taxes in the state are 4.56 percent of personal income (FY 1986-87), ranking Michigan 9th. The U.S. average is 3.44 percent. Residential property tax rates are even higher. The U.S. Department of Housing and Urban Development has calculated the effective property tax on single family homes with FHA-insured mortgages for 1987. Michigan's effective rate is 2.1 percent (\$2,100 on \$100,000 home), 4th highest in the nation.

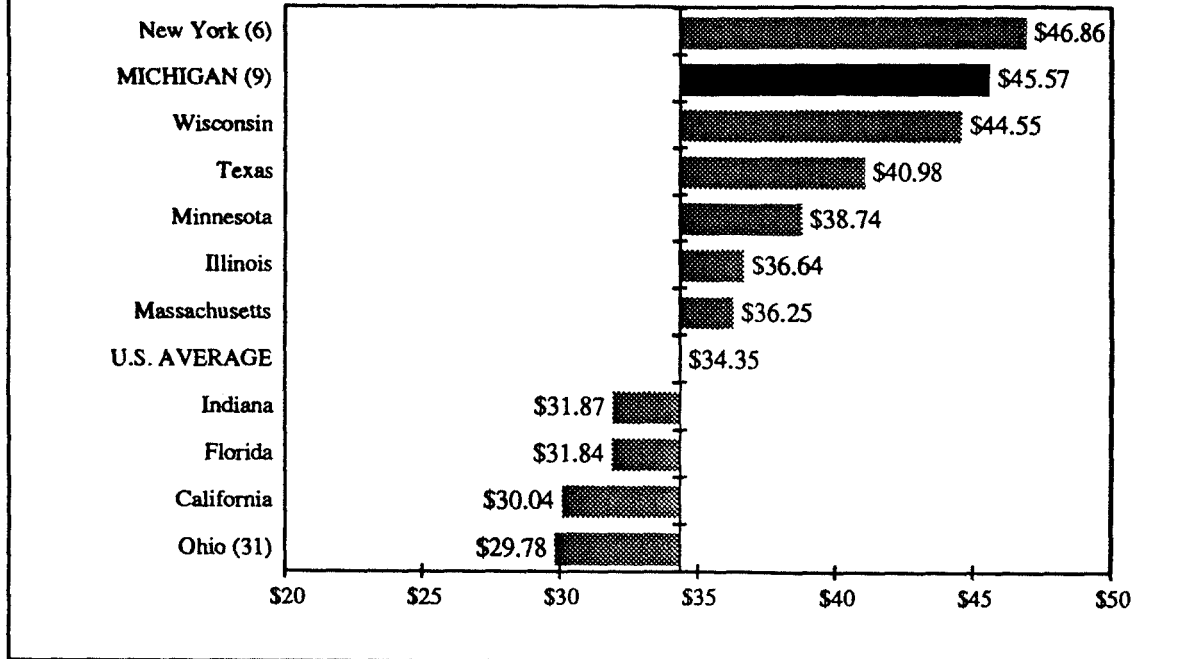
Michigan, however, has one of the most generous property tax relief programs in the nation. For tax year 1986, homestead property tax credits were \$617 million, about 20 percent of residential and agricultural property taxes. Anyone with a high property tax relative to income receives a generous credit, significantly alleviating the property tax burden for many taxpayers. Despite this generous program, the perception is that property taxes are too high and that relief is needed.

High property taxes create three problems for school districts. First, voters are reluctant to vote for millage increases; second, some districts are running out of room to raise millage rates because of the constitutional limit of 50 mills for noncharter jurisdictions; and third, in recent years large businesses such as General Motors have begun to challenge property tax assessments, resulting in lost revenues for school districts.

Fourth, the courts have declared unconstitutional school finance systems that rely less on the property tax than Michigan; the most recent example is Texas. The inequalities in Michigan's system are large enough that the system may not be able to withstand a legal challenge.

EXHIBIT 2

State-Local Property Tax
Per \$1,000 Personal Income, FY 1986-87



For these reasons there is a need to reduce the schools reliance on the property tax. If Proposal A is approved by the voters, it will leave a large part of the problem unsolved, and there will be additional ballot proposals in the future designed to reduce property taxes.

2. *Does not specify how the new money is to be spent.*

Proposal A does not specify how the new revenues are to be allocated. It appears likely that the new money will be used to improve the current school aid formula. House Bill 4837, which has passed the House and is currently in the Senate Appropriations Committee, increases the school aid formula to \$310 plus \$94 per mill per student for FY 1989-90. (The current formula is \$310 plus \$83.61 per student.) The lack of a specific distribution formula could hurt Proposal A's chances for approval, as the voters do not trust government. Although all the new money is restricted to K-12 education, lack of a distribution plan will make many voters and school officials leery.

3. *Does not reduce disparities in resources among districts.*

One of the major reasons that our system of financing schools needs to be reformed is the unequal distribution of resources. For example, Detroit has a tax base [state equalized valuation (SEV)] of \$27,763 per pupil, levies 42.4 mills for operations, and spends \$3,855 per pupil (FY 1989-90). Neighboring Birmingham has a tax base of \$267,445 per pupil, levies 28.33 mills for operations, and spends \$7,832 per pupil. The state aid formula provides 70 percent of Detroit's total revenue and none of Birmingham's,

but Birmingham is able to spend more than twice as much per pupil. This gap will widen in the future because property values in Birmingham will increase faster than property values in Detroit and state aid to Detroit (under the current system). Proposal A does little to reduce this disparity. Detroit could receive \$350 to \$400 more per pupil and Birmingham will receive nothing, but spending in Birmingham still will be double spending in Detroit, and the gap will widen each year.

4. Increases taxes.

Proposal A will increase taxes by about \$300 million in FY 1989-90 and \$420 million in FY 1990-91. A tax increase is always unpopular with the voters, but this increase is moderate, amounting to only .3 of one percent of personal income. This new revenue will count against the constitutional revenue limit (9.44 percent of Michigan personal income), but revenues currently are about \$1.5 billion below the limit.

5. Increases the sales tax, which is regressive and hits low-income persons harder than high-income persons.

From a tax policy perspective, Proposal A is flawed because the sales tax imposes a heavier relative burden on low-income persons than on high-income persons. As shown in Exhibit 3, a 0.5 percent sales tax would amount to about 0.3 percent of the income of persons earning between \$5,000 and \$9,999 but only about 0.15 percent of the income of persons earning more than \$40,000.

EXHIBIT 3

Estimated Effect of One-Half and Two Percent Sales Tax by Income Class

	0-\$5,000	\$5,000-9,999	\$10,000-14,999	\$15,000-19,999	\$20,000-29,000	\$30,000-39,999	\$40,000 and Over
Average income before taxes	\$2,344	\$7,388	\$12,426	\$17,341	\$24,676	\$34,283	\$61,693
Taxable consumption ^a	\$4,461 ^b	\$4,169	\$5,990	\$7,408	\$9,745	\$12,147	\$18,751
One-half percent sales tax applied to taxable consumption	\$22	\$21	\$30	\$37	\$49	\$61	\$94
Two percent sales tax applied to taxable consumption	\$89	\$83	\$120	\$148	\$195	\$243	\$375
One-half percent sales tax as percentage of income	0.95%	0.275%	0.25%	0.2%	0.2%	0.175%	0.15%
Two percent sales tax as percentage of income	3.8%	1.1%	1.0%	0.8%	0.8%	0.7%	0.6%
Addendum: utilities as percentage of income	48.2%	16.7%	11.3%	8.5%	6.7%	5.6%	3.8%

SOURCE: United States Department of Labor, *Consumer Expenditure Survey: Results from 1986* (Washington, D.C.: April 1988).

^aExcludes food, shelter, utilities, and other nontaxable items.

^bConsumption exceeds income because of unreported income and financing of consumption out of savings and debt.

The income tax would be a fairer revenue source, as it levies a larger relative burden on high-income persons than on low-income persons. However, political and public opposition to an income tax is much greater than opposition to a sales tax.

On balance, Proposal A is relatively harmless and should generate no vociferous opposition. If the proposal is approved, K-12 education will receive about a 5 percent increase in funding (\$390 million added to current spending of \$7.2 billion), but the proposal is seriously deficient because it does not reduce property taxes or provide a long-term solution to the inequitable distribution of revenues among districts.

PROPOSAL B—DESCRIPTION

- Increases sales tax from 4 percent to 6 percent (effective January 1, 1990).
- Provides a new system for setting school millage rates.
 1. The state would levy 14 mills on business property and 9 mills on residential and agricultural property.
 2. Each district would levy a "local foundation millage" of at least 8 mills. The local millage would be set at the level needed to generate the "state per pupil guarantee." In the case of East Lansing this number is \$5,046, which is FY 1989-90 spending of \$4,748 per pupil plus a guarantee of \$298 per pupil. The state guarantees each district \$2,700 per pupil. Therefore, East Lansing would need to levy enough mills to generate \$2,346 per pupil (\$5,046 minus \$2,700). Based on East Lansing's estimated SEV per pupil of about \$130,000 for 1990-91, this would require 17.75 mills. Combined with the state millage, East Lansing would levy 26.75 mills on residential property and 31.74 mills on business property—providing 12.85 mills relief for residents and 7.85 mills relief for businesses.

The statewide millage and the local millage would not require voter approval or renewal. Exhibit 4 explains how to calculate the new millage rate for an in-formula school and an out-of-formula school district.

3. Local districts would have the option of levying four additional mills (equalized at state average SEV per pupil), with local voter approval. For most districts these mills would not be included in the 50-mill limit.
 4. Neither the state nor local foundation mills would be subject to the Headlee rollback provision (Section 31, Article IX of the Michigan constitution), which requires property tax rates to be cut if assessments increase faster than inflation.
- Reduces average millage rate by 12.9 mills (\$1.135 billion gross property tax reduction, \$900 million net of property tax credits) for homeowners and 7.9 mills (\$393 million) for businesses.
 - Restricts current and new revenue constitutionally to a new fund, the State Account for Education (SAFE). The existing general fund appropriation would be replaced by dedicating 54 percent of the

EXHIBIT 4

Calculation of Millage Reduction for FY 1990-91

In-Formula District

1. FY 1989-90 levied operating millage	39.6 mills
2. Statewide millage rate	9 mills residential 14 mills business
3. Calculation of local foundation millage (minimum of 8 mills)	
a. FY 1990-91 revenue per pupil	\$5,046
Less:	
b. Per pupil revenue guarantee	\$2,700
Equals:	
c. Revenue per pupil to be generated by local foundation millage	\$2,346
d. Local foundation millage : 1990-91 SEV per pupil times x mills = \$2,346	\$2,346 divided by \$132,000 SEV = 17.75 mills
4. Millage reduction	
a. FY 1989-90 millage	39.6 mills
Less:	
b. Statewide millage	9 mills residential 14 mills business
Less:	
c. Local mills needed to generate revenue guarantee	17.75 mills
Equals:	
d. Millage reduction	12.85 mills residential 7.85 mills business

Out-of-Formula District

1. FY 1989-90 levied operating millage	37.8 mills
2. Statewide millage rate	9 mills residential 14 mills business
3. Calculation of local foundation millage (minimum of 8 mills)	
a. FY 1990-91 revenue per pupil	\$3,809
Less:	
b. Per pupil revenue guarantee (in Proposal B)	\$2,700
Equals:	
c. Revenue per pupil to be generated by local foundation millage	\$1,109
d. Local foundation millage (\$105,000 SEV per pupil guarantee on first 8 mills and \$85,000 SEV guarantee for all additional mills)	
(1) Revenues to be raised by locals at minimum: \$105,000 x 8 mills	\$840
(2) Additional revenue needed: \$1,109 - \$840	\$269
(3) Additional mills needed to raise \$269 per pupil: \$85,000 x mill rate = \$269	3.16 mills
(4) Total local mills (minimum + excess)	11.16
4. Millage reduction	
a. FY 1989-90 millage	37.8 mills
Less:	
b. Statewide millage	9 mills residential 14 mills business
Less:	
c. Local mills needed to generate revenue guarantee	11.16
Equals:	
d. Millage reduction	17.64 mills residential 12.64 mills business

SOURCE: Public Sector Consultants, Inc.

existing 4 percent use tax and 25 percent of existing nonauto sales tax collections. This is about \$100 million more than dedicated by Proposal A.

- Increases school funding by \$237 million in calendar year 1990 and \$287 million in FY 1990–91 and subsequent years.
 1. In 1990–91 the state would pay each district a basic grant of \$2,700. In addition, districts with 1989–90 per pupil revenue below \$3,190 would receive an increase of \$350 per pupil. Districts spending above this amount would receive an increase of \$250 to \$350. Exhibit 5 explains how to calculate per pupil aid under Proposal B.

EXHIBIT 5

Calculation of FY 1990–91 Revenue Per Pupil under Proposal B

Add revenue per pupil in 1989–90	\$3,400.00
and	
\$350 if revenue per pupil was \$3,190 or less,	
or	
\$350 minus 33 cents for every \$10 that spending exceeds \$3,190.	
THEREFORE:	
$[(\$3,400 - \$3,190) / 10 \times .033] = \6.93	
$\$350 - \$6.93 = \$343.07$	<u>343.07</u>
TOTAL REVENUE IN FY 1990–91	\$3,743.07

SOURCE: Public Sector Consultants, Inc.

2. The first eight local mills levied by a district would be equalized at \$105,000 SEV per pupil, and each local mill above eight would be equalized at \$85,000. The four optional mills would be equalized at the state average SEV per pupil.
 3. The state would be required to provide a 10 percent increase in FY 1990–91 funding for special education, transportation, vocational education, and intermediate school districts.
 4. In future years, the basic grant and equalization levels of \$105,000 and \$85,000 would be increased by the rate of increase in revenues in the SAFE fund.
 5. The legislature could revise or eliminate this new formula with a two-thirds vote of both chambers. The legislature could not change the property tax provisions.
- Subjects the net tax increase to the constitutional revenue limit; but the total increase in state revenues would not be subject to the limit.
 - Allows school districts to use the current levy (after 1989) or the levy in 1989, whichever is higher, for purposes of the 50-mill noncharter property tax limit. This prevents other units of government from using freed up mills.

- Is tie-barred to five statutory tax bills (which have been enacted) that provide additional property tax credits for low-income senior citizens and renters, utility sales tax relief for low-income persons, and revisions to the property tax abatement acts.
- Would require the State Board of Education to submit a report to the legislature every five years with recommendations for improving school performance.
- Separate legislation will reduce funding for school districts if core curriculum and a school improvement plan are not adopted.

PROPOSAL B—ANALYSIS

Advantages

1. *Provides substantial property tax relief and caps property taxes for school districts.*

Proposal B provides a \$1,528 million reduction in local property taxes, which is about 33 percent of school property taxes and 20 percent of total property taxes. This is partially offset by a \$235 million loss of property tax credits by homeowners, reducing net property tax relief to about \$1.3 billion. This relief would reduce Michigan property taxes from 4.6 percent of personal income to 3.6 percent of personal income (estimated on the basis of FY 1986–87 data) and change Michigan's rank from 9th highest to 23rd highest.

The proposal places a cap on school millage rates that average 20.9 mills for residential and agriculture property and 25.9 mills for business property, plus 4 additional mills that may be voted locally. The cap will vary for each district depending on individual circumstances. Generally, higher-spending districts will end up with higher millage rates than low-spending districts. For example, the Lansing school district, which spends \$3,469 per pupil, will have a cap of 20.2 mills on residential property (plus 4 locally voted mills), and the neighboring Waverly school district, which spends \$5,042 per pupil, will have a cap of 26.6 mills (plus 4). Currently, Lansing levies 37.78 mills for operating purposes, and Waverly levies 34.75 mills. This provision will increase the fairness of the school financing system and reduce somewhat the attractiveness of higher-spending (often suburban) districts compared with lower-spending (often urban) districts. This could have a small effect on stemming the outmigration from the cities to the suburbs.

2. *Provides relief for most districts pressing against the 50-mill limit.*

A major problem for many school districts is that millage rates have reached such a high level that they are pushing against the constitutional limit of 50 mills for noncharter property taxes. The amendment includes language that would require a district to calculate its 50-mill cap using the number of mills it levied in 1989 (prior to millage reduction). If a district were at the 50-mill cap prior to passage, the reduction in school millage rates would not allow other taxing units to raise their millage rates. The exception is the 4 local option mills, which, in most cases, would be exempt from the 50-mill limit.

The passage of Proposal B would eliminate the 50-mill limit as a concern for most school districts, as the state would be providing a much larger share of spending, and school property tax rates would be capped.

3. *Replaces the property tax, which is overutilized in Michigan, with the sales tax, which is underutilized.*

As explained above, Michigan overutilizes the property tax and underutilizes the sales tax. The passage of Proposal B largely would correct this imbalance. The property tax would fall from 4.6 to 3.6 percent of personal income, changing Michigan's rank from 9th highest to 23rd highest, which is only about 6 percent above the U.S. average of 3.4 percent of personal income (1986–87 data). Increasing the sales tax rate from 4 percent to 6 percent would increase sales (and gross receipts) taxes from 3.07 percent of personal income to about 4.08 percent and change Michigan's rank among the states (including the District of Columbia) from 45th to 25th highest (estimated on the basis of FY 1986–87 data). Michigan also would be exactly equal to the U.S. average of 4.09 percent.

4. *Increases funding for K-12 education.*

Both proposals A and B generate more money for K-12 education, but Proposal A provides more money than does Proposal B. The former increases school funding by \$237 million in FY 1989–90 and \$390 million in FY 1990–91 (increases in future years depend on growth in sales taxes and other taxes restricted to the school aid fund [SAFE]). The latter increases funding by an estimated \$237 million the first year and \$287 million in FY 1990–91, and future increases are also dependent on growth in the school aid fund.

5. *Increases state support for K-12 education.*

As mentioned above, only five states provide less state support (as a percentage of total expenditures) to K-12 education than does Michigan, and this share has declined from a high of about 50 percent twenty years ago. In FY 1978–79, prior to the deep recession of the early 1980s, the state provided 45 percent of total support for K-12 education. Support reached a low of 32.6 percent, before rebounding to about 39 percent in FY 1987–88. Support has fallen in the last ten fiscal years due to healthy increases in local property taxes. (See Exhibit 6.) If Proposal B is approved, the state will provide an estimated 77.3 percent of funding for schools (including the statewide property tax). Only Hawaii (which has one statewide school district) provides a higher level of support.

6. *Provides a more stable revenue source for most districts.*

Statewide the property tax is more stable than the sales tax, although both grow at about the same rate over the long term. (Both revenue sources increased 428 percent over the past thirty years.) In some districts, however, the property tax is very volatile. One example is counties with a heavy dependence on agriculture. Due to the weak agriculture sector in the mid-1980s, property values in several counties actually declined for one or two years. In Huron County, property values declined 8.5 percent in 1987 and 4.5 percent in 1988. The school aid fund is largely immune to such declines, as its major revenue sources have declined only twice in the past 25 years, 0.1 percent in 1980 and 1.7 percent in 1982. (Excluding the 1975 decline due to exemption of food.) These modest declines resulted from the worst recession since the Great Depression.

EXHIBIT 6

Sources of School Operating Revenue, Percent of Total, Selected Years

Fiscal Year	Local	State	Federal and Other
1966-67	45.7%	49.2%	5.1%
1970-71	50.9	44.9	4.2
1975-76	53.8	40.9	5.3
1978-79	49.4	45.1	5.5
1979-80	52.2	42.4	5.3
1980-81	58.8	35.5	5.8
1981-82	62.9	32.6	4.5
1982-83	63.1	33.0	3.8
1983-84	60.3	36.0	3.7
1984-85	59.5	36.7	3.8
1985-86	57.9	38.3	3.8
1986-87	57.7	39.2	3.1
1987-88	57.6	39.5	2.9
1988-89	60.0	37.2	2.8
1989-90 (Est.)	60.1	37.3	2.4

SOURCES: Michigan Department of Education and Department of Management and Budget.

The shift in funding from the local property tax to the state school aid fund (SAFE) will be a major benefit to school districts that depend on a volatile industry for a large share of their revenue.

7. *Reduces disparities in resources among districts.*

Michigan's school finance system has some serious weaknesses. It leaves large revenue disparities among districts, resulting in low quality education in many, and it produces a substantial number of out-of-formula districts (about 30 percent of all districts). As indicated in Exhibit 7, about 12 percent of students are in districts that spend \$2,600 or less per pupil, and 18.8 percent are in districts that spend \$3,500 or more per pupil. The dramatic differences between out-of-formula and in-formula districts can be seen in exhibits 8 and 9. In FY 1987-88 in-formula districts spent an average of \$2,753 per pupil and levied an average of 32 mills, while out-of-formula districts spent an average of \$3,908 per pupil and levied an average of only 27.4 mills. This large disparity is explained by the average SEV per pupil of \$52,678 in in-formula districts and \$174,116 in out-of-formula districts. The difference is too large for the state school aid formula to equalize without a significant increase in funding—\$1.5 billion to bring spending per pupil in in-formula districts up to the level of spending in out-of-formula districts.

Proposal B will reduce modestly the disparities in spending by increasing funding more for low-spending districts than for high-spending districts, by levying a statewide property tax and redistributing these monies, and by guaranteeing \$105,000 SEV per pupil for the first 8 mills (the local foundation millage), \$85,000 for all mills above 8, and the state average SEV for the 4 local option mills. The Senate Fiscal Agency estimates that the gap in per pupil spending of a district that spends 25 percent above the mean

EXHIBIT 7

Selected Characteristics of Michigan School Districts, FY 1987-88

Revenue Level	Average Revenue per Pupil	Number of Districts	Percentage of Students	Average Size (number of students)	Average SEV/pupil	Average Operating Millage
\$ 0 - 2,300	\$2,116	31	1.4	735	\$79,139	22.4
2,300.01 - 2,600	2,453	125	11.0	1,454	55,997	27.7
2,600.01 - 2,900	2,741	170	20.9	2,035	57,825	31.1
2,900.01 - 3,200	3,035	113	38.6	5,666	62,635	34.7
3,200.01 - 3,500	3,335	43	9.4	3,644	81,105	35.9
3,500.01 - 3,800	3,630	25	7.0	4,649	109,642	33.5
3,800.01 - 4,100	3,920	14	2.0	2,348	161,552	28.5
4,100.01 +	6,100	42	9.8	3,858	318,731	27.6
TOTAL	\$3,067	563	100.0	2,947	\$85,680	30.7

TOTAL NUMBER OF STUDENTS: 1,659,117

SOURCE: Michigan Department of Education.

EXHIBIT 8

Selected Characteristics of Michigan In-Formula School Districts, FY 1987-88

Revenue Level	Average Revenue per Pupil	Number of Districts	Percentage of Students	Average Size (number of students)	Average SEV/pupil	Average Operating Millage
\$ 0 - 2,300	\$2,116	21	1.4	872	\$61,942	24.1
2,300.01 - 2,600	2,452	112	12.9	1,510	50,834	28.0
2,600.01 - 2,900	2,737	147	23.3	2,071	50,239	31.8
2,900.01 - 3,200	3,035	96	46.9	6,380	54,495	35.8
3,200.01 - 3,500	3,328	28	102	4,744	59,103	39.7
3,500.01 - 3,800	3,612	6	5.4	11,681	55,378	43.4
3,800.01 - 4,100	0	0	0	0	0	0
4,100.01 +	0	0	0	0	0	0
TOTAL	\$2,753	410	100.0	3,188	\$52,678	32.0

TOTAL NUMBER OF STUDENTS: 1,307,253

SOURCE: Michigan Department of Education.

EXHIBIT 9

**Selected Characteristics of Michigan Out-of-Formula
School Districts, FY 1987-88**

Revenue Level	Average Revenue per Pupil	Number of Districts	Percentage of Students	Average Size (number of students)	Average SEV/pupil	Average Operating Millage
\$ 0 - 2,300	\$2,022	10	1.4	502	\$115,253	18.7
2,300.01 - 2,600	2,464	13	3.6	973	100,475	24.7
2,600.01 - 2,900	2,769	23	11.8	1,805	106,306	26.7
2,900.01 - 3,200	3,036	17	7.9	1,633	108,602	28.9
3,200.01 - 3,500	3,349	15	6.8	1,592	122,177	29.0
3,500.01 - 3,800	3,636	19	13.1	2,428	126,177	30.4
3,800.01 - 4,100	3,921	14	9.3	2,348	161,552	28.5
4,100.01 +	6,100	42	46.1	3,858	318,731	27.6
TOTAL	\$3,908	153	100.0	2,300	\$174,116	27.4

TOTAL NUMBER OF STUDENTS: 351,864

SOURCE: Michigan Department of Education.

relative to per pupil spending of a district that spends 25 percent below the mean will be reduced from \$713 to \$593 in FY 1990-91 if Proposal B is adopted. After five years, however, the gap increases to \$753 but is still below what it would be if Proposal B were not approved. The increase occurs because districts are allowed to keep SEV growth on all locally levied mills, and property values generally are growing faster in higher-spending districts than is the state school aid fund. Proposal B also, in effect, brings all districts into formula, as every district receives a basic grant of \$2,700 (plus the guarantee of \$250 to \$350 per pupil) and sets its millage rate to make up the difference between this amount and FY 1989-90 revenue per pupil.

It is unlikely that school district resources ever will be totally equalized, but this proposal makes a good start by helping districts whose resources are below average. Our view is that the best to be hoped for is that the low-resource districts will be brought up to a reasonable level and the growth of spending in the high-spending districts will be slowed. Overall, we believe that the proposal would improve significantly the equity of school financing.

Disadvantages

- 1. Is complex and difficult for voters to understand.*

The proposal will be very difficult for the average voter to understand—it is difficult enough for the average economist. Proposal B requires 15 pages of constitutional language compared with 3 pages for Proposal A. Voters are distrustful of government and unlikely to vote for something they do not understand. This is the main reason for being pessimistic about this proposal's chances of passing. As shown in Exhibit

10, seven school finance reform and property tax relief proposals have been turned down by the voters in the past 17 years.

EXHIBIT 10

**Proposed Amendments to State Constitution:
School Finance Reform and Property Taxes**

Proposal	Date	Percentage For	Percentage Against
School finance reform (increase income tax plan)	November 1972	42.2%	57.8%
School voucher plan	November 1978	25.7	74.3
Reduce property taxes (Tisch)	November 1978	37.3	62.7
Reduce property taxes (Tisch)	November 1980	44.2	55.8
School finance reform (Smith-Bullard)	November 1980	21.2	78.8
Reduce property taxes and raise sales taxes	November 1980	25.7	74.3
Reduce property taxes and raise sales tax	May 1981	27.9	72.1

SOURCE: State of Michigan, *Michigan Manual*, 1987-88.

2. Increases the sales tax, which is more regressive than the property tax (after homestead property tax credits).

As discussed above, the sales tax is regressive as it takes a larger share of a low-income person's income than of high-income person's income. The property tax also is regressive, as it has a similar effect. However, relative to total wealth, the property tax generally is viewed by most economists as less regressive than the sales tax. Also, in Michigan the state provides property tax credits that make the effect of the tax nearly proportional at middle-income levels (for those who claim the credit). This is shown in Exhibit 11.

Property taxes for persons claiming the state credit are an estimated 14.2 percent of income for households earning \$5,000 and only 4.6 percent for households earning between \$45,000 and \$50,000. The property tax credits reduce the burden to 8.9 percent for the \$5,000 income household and 4 percent for the \$45,000-\$50,000 income household.²

² The state property tax credit refunds 60 percent of all property taxes in excess of 3.5 percent of household income. Senior citizens, handicapped, and the blind receive even more generous credits.

EXHIBIT 11

**Effect of State Property Tax Credits on Property Tax Burden,
by Income Class**

Household Income	Property Taxes as Percent of Income ^a	Property Taxes after Credits as Percent of Income
\$5,000	14.2%	8.9%
10,000	8.8	5.9
20,000	6.3	4.7
30,000-35,000	5.2	4.3
45,000-50,000	4.6	4.0

SOURCE: Calculated by Public Sector Consultants from data in *Analysis of the Michigan Individual Income Tax for 1986*, July 1989, Michigan Department of Treasury, Table 8, p. 19.

^aFor nonsenior citizen households that claim the state property tax credit.

The regressivity of the sales tax would be reduced by House Bill 4309 (P.A. 117 of 1989), which is tie-barred to the passage of Proposal B. This act will exclude from sales taxation the heat or electricity sold to households with incomes below 150 percent of the federal poverty level. As can be seen in Exhibit 3, utilities are one of the most regressive components of the sales tax.

The sales tax is less unpopular with taxpayers than is the property tax, as the sales tax often is viewed as voluntary and is paid in small amounts. Switching from the property tax, which is overutilized in Michigan, to the sales tax, which is underutilized, will improve the balance of the tax system but will make the state-local tax structure more regressive.

3. *Increases the federal tax burden of some Michigan taxpayers.*

The 1986 federal tax reform act eliminated the deductibility for state and local sales taxes. As a result, the switch from the property tax, which is deductible for federal tax purposes, to the sales tax, which is not deductible, will cost Michigan taxpayers an estimated \$100 million in additional federal income taxes. Affected will be the estimated 35 percent of Michigan taxpayers who itemize deductions for federal tax purposes.

For example, assume a household earning \$40,000 pays \$400 in sales taxes and receives property tax relief of \$400. Assuming a marginal tax rate of 28 percent, this household would pay \$112 more in federal income taxes. What on the surface appears to be an even trade-off is actually a \$112 tax increase. One positive aspect of this is that, because higher income persons are more likely to itemize than low-income persons, the progressivity of the tax system will be increased by providing more relative tax relief to low-income households than to high-income households.

4. *Increases, somewhat, the instability of school funding.*

The sales tax is more subject to ups and downs than the property tax, although both grow at the same rate over the long term. The Senate Fiscal Agency has calculated that between 1968 and 1989 the sales tax and property tax grew at the same rate, but the average difference in annual growth rates was 5.2 percentage points, and the sales tax was somewhat more volatile than the property tax.³

As the local school districts' basic per pupil revenue guarantee is tied to increases in the school aid fund, school funding would become more sensitive to the economic cycle. This is a relatively minor disadvantage, however, as for many individual districts the state school aid fund is likely to be a more stable source of revenue than the local property tax.

5. *Raises millage rates and lowers revenue of some high-spending school districts.*

Many high-spending school districts will be opposed to Proposal B because they will receive less money than they would have under the current system, and their taxpayers will receive little property tax relief. In addition, future growth in revenues will be reduced due to the statewide property tax. For example, Birmingham will receive an estimated \$739 less per pupil in FY 1990-91 than under the current system, and their millage rate will be reduced only 2.15 mills on residential property and will increase 2.8 mills on business property.

There are an estimated 66 districts, all out-of-formula, that will receive less revenue per pupil in FY 1990-91 if Proposal B passes than under the current system. Twelve of these districts are located in fast-growing Oakland County.

6. *Increases taxes for many senior citizens and renters.*

Many senior citizens will pay higher taxes because their reduction in property taxes will be offset dollar for dollar by a reduction in their homestead property tax credit (seniors receive a 100 percent refund for all property taxes above a specified percentage of household income), and they will pay the higher state sales tax. Renters will pay higher taxes because their property taxes are included in their rent and most landlords are unlikely to reduce rents when property taxes fall.

Both groups will benefit from enacted legislation tie-barred to Proposal B. Currently, renters are allowed to count 17 percent of their rent as property taxes; this will be increased to 20 percent. Senior citizens earning less than \$20,000 will receive additional homestead credits, as the sliding scale formula will be improved. For example, seniors earning less than \$3,000 currently receive a 100 percent rebate of all property taxes. The new law will provide this relief for all seniors earning less than \$5,000.

³ The standard deviation of the sales tax was 4.998, and the standard deviation of the property tax was 3.8797 (calculated by Public Sector Consultants).

In addition, taxpayers with income below 150 percent of the federal poverty level will receive a sales tax exemption for electricity and heating fuel or a \$60 refundable income tax credit. These relief provisions will cost an estimated \$135 million. This will shield most low income seniors and renters from higher taxes, but middle and higher income households in these two groups will pay higher taxes.

7. *Includes a provision under which the legislature will be able to change the distribution formula with a two-thirds vote.*

Many critics of Proposal B are seizing on this provision as a reason to vote no. The provision is unusual in that it allows the constitution to be changed without a general election. The language applies only to the spending guarantees, not to the property tax provisions.

The purpose of this provision is to allow the legislature some flexibility to deal with changing conditions. It is probably unwise to write the school aid formula into the constitution, but many legislators believed this was necessary to reassure voters and win approval of this proposal. This provision was a compromise to leave some room to maneuver, but it may turn out to be the Achilles' heel of Proposal B.

8. *Increases taxes.*

There will be a net tax increase of about \$510 million in FY 1989-90 and \$225 million in FY 1990-91. A tax increase is always unpopular with the voters, but as with Proposal A, this increase is moderate, amounting to only .14 of one percent of personal income (FY 1990-91). This new revenue will count against the constitutional revenue limit (9.49 percent of Michigan personal income), but revenues are currently more than \$1.5 billion below the limit. The tax limit provision of the constitution is amended so that the sales tax increase is included, but the net property tax reduction is excluded, leaving the net tax increase subject to the limit.

On balance, Proposal B would improve Michigan's school financing system. The proposal provides substantial property tax relief, increases state support for K-12 education, and distributes funds in a more equitable manner. However, it still leaves large disparities in spending among school districts, contains many complex provisions, increases the regressivity of the state-local tax system, and does nothing to ensure that the quality of education in Michigan will improve.

Proposal B is far from perfect, but until the climate is right for major reform, it may be the only chance to make some improvements in our method of financing K-12 education.

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