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November 18, 1987

Public Sector Reports

PUBLIC POLICY ADVISOR

MICHIGAN SCHOOL FINANCE: A PROPOSAL FOR REFORM

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> "Today, education is perhaps the most important function of state and local governments. . . . It is a principal instrument in awakening the child to cultural values, in preparing him for later professional training, and in helping him to adjust normally to his environment. Such an opportunity, where the state has undertaken to provide it, is a right which must be made available to all on equal terms."[1]

Introduction

No institution touches the life of every American as closely or is as important to the nation's future as public schooling. A free, public education has been one of our most cherished rights from the founding of the nation; it has been important in Michigan since before statehood. For almost as long as Michigan policy makers have been supporting public education, they have been grappling with how to fund it adequately and equitably. There is now consensus that property taxes as a source of school funding have reached an upper limit in Michigan and that schools will have to look elsewhere. The current school finance system also results in significant inequity among school districts (see Exhibit 1). This paper

- examines the history of Michigan school finance and school finance reform aimed at addressing the problems of adequate and equitable funding;
- specifies criteria for successful reform;
- discusses how Michigan and other states fund public education;
- reviews school finance reform proposals; and
- recommends what we believe is a politically workable school finance reform plan.

History

Michigan's commitment to public education is historically evident, beginning with the Federal Land Ordinance of 1785. The ordinance provided that the proceeds from the sale of one section of land in each township of the Northwest Territory should be reserved to support public schools. As additional support, in the early 1800s Michigan's territorial government instituted lotteries, property taxes, a student head tax, and "rate bills" (tuition); none raised much revenue because the territorial population was small, and many impoverished settlers opposed the imposition of any tax.

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[1] Brown v. Board of Education (1954), U.S. Supreme Court.

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EXHIBIT 1

CURRENT SYSTEM
DISTRIBUTION OF REVENUE PER PUPIL
1986-1987

Revenue Per Pupil	Number of Districts	Percentage of Districts	Number of Pupils	Percentage of Pupils
$5,500+	6	1.1	18,670	1.1
$4,500 - $5,499	12	2.1	22,367	1.4
$4,000 - $4,499	14	2.5	79,457	4.8
$3,500 - $3,999	34	6.0	103,121	6.2
$3,000 - $3,499	83	14.7	404,230	24.4
$2,500 - $2,999	246	43.5	808,211	48.7
$2,000 - $2,499	160	28.3	220,220	13.3
Below $2,000	10	1.8	3,582	0.2
TOTAL	565	100.0	1,679,858	100.1

SOURCE: Michigan School Finance Commission, Educational Quality in the 21st Century, September 1987.

[a]Revenue is defined as local property tax plus formula dollars. Retirement and categorical grants for programs such as special education and transportation are not included.

In 1836, Michigan's first constitution recognized that land values varied greatly among townships; it provided that all proceeds from the sale of one section of land per township, as required by the 1785 land ordinance, be placed in a state fund--the primary school fund--and the interest be distributed on a per-pupil basis to all school districts in the state. This was an innovative measure; in other states, this money had been given directly to the townships.

The Michigan School Act of 1837 provided another source of support for schools by permitting districts that had insufficient money to pay their teachers' salaries to impose a tax on property for that purpose. *Property taxes, therefore, were recognized as a legitimate source of school finance from Michigan's first year of statehood.* This means of funding public education immediately set off a controversy that continues today.

Throughout the remainder of the nineteenth century and the first two decades of the twentieth, revenue from the Primary School Interest Fund and steadily increasing property taxes supported public schools. Many educators, however, saw the need for school aid reform, especially to equalize support among districts. In 1907, a small amount of state aid was granted to property poor districts. In 1925, legislation passed that set aside five percent of the Primary School Interest Fund for equalization purposes, but this act was overturned by the state supreme court. State aid legislation passed in 1927 and 1929 provided $2 million to be distributed to schools to try to offset financial inequities. This attempt at direct state aid foreshadowed the dramatic changes of the next few years.

The devastating effect of the Great Depression led to a 1932 constitutional amendment limiting local property taxes to fifteen mills, the practical result of which was to halve the support available for public schools, making state school aid a matter of survival. One year later, large-scale state aid to schools became a reality. Up to $15 million in sales tax revenue was allocated to public schools. By the beginning of World War II, state aid financed by the sales tax had become a significant factor in school support. In addition, the distribution formula was weighted to provide more support for school districts with low property tax bases than for property rich districts. Local property taxes, however, remained the main source of school revenue.

The postwar population boom strained school resources. Rising property taxes, state aid from a variety of sources (primarily the sales tax), and revenue from the Primary School Interest Fund could not keep pace with education needs. In addition, the disparity between rich and poor districts was widening.

In 1946, to secure long-term financial aid, educators joined cities and townships in a successful campaign to amend the state constitution to guarantee that part of sales tax revenue would go to local governments; these, in turn, apportioned half that revenue to school districts. Unfortunately, the money was inadequate to meet school needs and did little to reduce inequities among districts.

The new state constitution of 1963, while making sweeping reforms in some aspects of state government, made few changes in funding for schools. In 1968, the legislature and the Michigan Department of Education recognized the school funding and equity dilemmas and authorized the School Finance and Educational Opportunity in Michigan study. The resulting massive report concluded that over the years the state had chosen not to tax property, leaving that revenue source to local government. The effect was to shift the primary burden of school finance to local property taxes, thereby widening the gap in educational opportunity between school districts. The report recommended that the state act on its right to tax property and distribute the revenues from a statewide property tax to school districts on a per-pupil basis. The recommendation was not adopted.

In 1971, Governor William Milliken presented to the legislature a set of proposals to reform school finance that would have increased reliance on the state income tax and business value added tax[2] and diminished reliance on local property taxes. Although they won some legislative support, these proposals were unpopular with voters and were shelved.

Passage of a 1972 ballot proposal would have shifted primary responsibility for financing education to state government by limiting the number of mills that could be raised locally and increasing state income tax revenues to replace lost local property tax revenues. This proposal was also soundly defeated.

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[2]A tax levied on the value added to a product or service during the processing of that product or service. This value takes the form of labor, interest, depreciation, and profits.

In the wake of that defeat, the 1973 school aid bill included a formula aimed at partially equalizing state aid. However, reliance on local property taxes continued to ensure inadequate funding and inequities.

In 1978, in response to the taxpayers' revolt against ever-increasing local property taxes, the legislature passed the tax limitation (Headlee) amendment to the constitution. It limits local property taxes and prohibits state revenue from exceeding ten percent of Michigan personal income.

Another amendment on the 1978 ballot would have eliminated property taxes for school support and instituted an educational voucher system; the voters turned it down. Three years later, an amendment to cut property taxes and raise the sales tax to five percent for school support was also defeated. Since 1972, only one (the Headlee amendment) of ten proposals to alter the Michigan tax structure has passed, and it barely did so; only 52.5 percent of those voting approved the measure.

The debate about inequities in school funding and overreliance on property taxes continues. Concern has escalated in recent years, and the issue is currently being widely studied in an effort to find solutions.

Criteria for School Finance Reform

Successful school finance reform would ensure equal access to quality education across the state and would provide adequate school operating revenue now and in the future, reducing reliance on the local property tax. A school finance reform plan meeting the following criteria would achieve the goals of successful reform. The first three criteria are essential: The plan must provide more equal distribution of revenues, meet the tax limitation requirements of the constitution, and be politically feasible. Five other criteria are probably necessary if a reform plan is to win sufficient political support: It must provide property tax relief, reduce reliance on property taxes, establish minimum standards of quality, maintain local control, and allow local enhancement. The final two criteria are desirable but not essential: A plan should improve the progressivity of the tax system and maintain or improve its stability. These criteria are discussed below.

Provide More Equal Distribution of Revenues

Proponents of school finance reform agree that the unequal distribution of revenues among school districts under the current system must be addressed. For example, Detroit levies 36 mills for operating purposes and spends $3,460 per pupil (including aid of $2,134 per pupil from the state). In contrast, Grosse Pointe levies only 31.6 mills for operating purposes and spends $5,090 per student (with no aid from the state). The difference between the two districts is that Detroit has $25,375 in property (SEV) behind each child, and Grosse Pointe has $147,700 behind each child. This type of disparity encourages people to move from poor districts to the richest district they can afford, both for lower taxes and better education. Those left behind pay higher taxes and may receive a poorer education. This tends to increase the disparities among school districts.

Meet Tax Limitation Requirements

The 1978 Headlee tax limitation amendment to the state constitution increased the complexity of school finance reform. The amendment limits state revenues to ten percent of Michigan personal income. Although the limit was nearly exceeded in FY 1984-85, current state revenues are well below that level. A two-cent increase in the sales tax to replace local property tax revenues would likely push revenues above the limit in the near future, requiring the state to refund the excess tax revenue to the taxpayers. Thus, a constitutional amendment to increase the sales tax also would have to amend the tax limitation section to accommodate the tax shift. Any statutory (legislative) approach to school finance reform would have to operate within the confines of the tax limitation amendment.

Political Feasibility

Although there is broad agreement that the current system is flawed, a fairer school finance system may not be enough to carry a proposal to victory. No matter how brilliant its conception, a proposal with little chance for approval by the legislature or the voters does nothing but raise false hopes. Experience suggests that Michigan voters are unlikely to approve any reform that alters the tax structure. They prefer the devil they know to the one they don't; as mentioned, since 1972 Michigan voters have rejected nine of ten proposals to cut, shift, limit, or otherwise alter taxes. Most of the rejected proposals would have shifted the tax burden from the property tax to the state sales tax. The latter, a productive revenue raiser, is under-utilized in Michigan compared with other states, and raising the sales tax would be less unpopular than raising other major taxes. Voters have consistently defeated tax shift proposals because they do not trust government. They believe that any property tax relief they may receive eventually will be taken away, leaving them without relief and with a higher sales or income tax. Legislators are aware of voter opposition to changes in the tax structure--two state senators were recalled after voting an income tax increase in 1983--and are reluctant to jeopardize their political futures to reform the school finance system.

A recent poll commissioned by the House Republican Task Force on Property Tax and School Finance Reform reaffirms the public's opposition to a shift from the property tax to other taxes. A uniform statewide property tax was the most popular alternative revenue source, but opposition exceeded support by two percentage points. The poll showed the most unpopular revenue source was the local sales tax, which was opposed by 68 percent of those surveyed and supported by only 26 percent. A state sales tax, a local income tax, a sales tax on services, and a state income tax increase were also opposed by large margins.

Provide Property Tax Relief

Michigan property taxes (before credits) are among the highest in the nation; there is widespread agreement that reductions are needed. School finance reform that does not address the public perception that property taxes are too high would not be agreeable to voters. The fact is, however, that no one in the state bears an onerous property tax burden relative to income because of the state's generous property tax credit program. The existence of this program complicates property tax relief proposals because, under its provisions, for every one dollar reduction in property taxes, senior citizens lose one dollar of their tax credit, and other eligible taxpayers lose 60 cents. One option is to provide relief by expanding the current credit program, but many oppose this option because of its lack of visibility to the taxpayers.

Some consideration also must be given to property tax relief for business, because almost any replacement revenues will be paid by business as well as homeowners. In 1986, about 36 percent of all property taxes were paid by business (excluding agriculture). The business community is concerned about the property tax burden, and to win its support, a proposal almost certainly will have to include fair tax treatment for business.

Reduce Reliance on Property Taxes

K-12 education is the heaviest user of property taxes, which provide about 60 percent of total K-12 revenue. Property taxes have reached such high levels in many districts that it is difficult to win voter approval for millage increases. When the economy slows and property values stabilize or fall, school districts have few options for additional revenue. More state aid or access to local income or sales taxes could increase options for school financing and provide more flexibility. See Exhibit 2 for a comparison of property taxes levied by schools and other units of local government as well as their growth; of all property taxes levied in Michigan in 1985, schools accounted for 70.2 percent, and their share has increased since then.

EXHIBIT 2

PROPERTY TAXES LEVIED
BY UNITS OF LOCAL GOVERNMENT IN MICHIGAN
1976-1985

Year	County	Township	City	Village	Schools[a]	Total	Schools As Percentage of Total
1976	$341,809,874	$ 78,555,164	$571,117,889	$17,705,094	$1,951,535,539	$2,960,723,560	66.9%
1977	369,748,301	90,448,407	586,803,227	19,028,270	2,141,067,590	3,207,095,795	66.7
1978	400,216,948	100,893,360	620,978,965	20,665,548	2,342,118,946	3,484,873,767	67.2
1979	447,480,398	118,691,157	677,378,261	23,189,289	2,622,638,970	3,889,378,075	67.4
1980	504,459,513	134,301,785	736,984,688	26,162,457	3,009,469,346	4,411,377,789	68.2
1981	554,531,717	156,528,425	786,309,940	28,622,088	3,372,394,314	4,898,386,484	68.8
1982	581,142,131	161,778,563	811,269,198	29,618,314	3,588,710,099	5,172,518,305	69.4
1983	589,176,286	148,086,395	811,594,903	30,454,279	3,607,966,747	5,187,278,610	69.5
1984	602,934,822	149,591,156	829,251,561	31,495,564	3,761,001,902	5,374,275,005	70.0
1985	626,063,517	154,260,830	853,998,331	31,771,856	3,926,766,884	5,592,861,418	70.2
Percentage Increase 1976-1985	83.2%	96.4%	49.5%	79.5%	101.2%	88.9%	
Percentage Increase 1976-1985 Adjusted for Inflation[b]	-7.6%	4.5%	-20.5%	-4.6%	7.0%	0.5%	

SOURCE: Michigan Department of Treasury, State Tax Commission, Lansing.

[a]Includes K-12 districts, intermediate school districts, and community colleges.

[b]As measured by Detroit Consumer Price Index.

Assure Minimum Standards of Quality

One of the major purposes of school finance reform is to provide an adequate education for every child in Michigan. A more equal distribution of revenues will help achieve this, but more money is not the only answer. There also must be stricter standards for promoting students to a higher grade and for awarding a high school diploma. A comprehensive school reform plan should provide some method to assure that every graduating student receives an adequate minimum level of education. This paper is directed at the issue of more equal distribution of financial resources under the assumption that a minimum level of funding is the necessary first step toward a minimum level of educational quality.

Maintain Local Control

Local control has been a key issue in every debate about school finance reform. Those who oppose plans to substitute a state-level tax for local property taxes often use loss of local control as their main argument. Voters do not want to lose the right to send a message to government with their vote. Local school districts currently have considerable autonomy in determining their education programs and budgets. However, because in-formula school districts[3] receive substantial state support, the state exercises varying degrees of control over curriculum, transportation, and other matters in those districts. Certainly, local control of school financing would be reduced under most school reform proposals because they would reduce the amount of millage subject to local voter approval. Any school finance reform that drastically decreased local control would not be popular with voters.

Allow Local Enhancement

Some educators and parents are concerned about making the K-12 education system too equal. They fear that leveling resources will promote mediocrity, although most of the current proposals include "hold-harmless" provisions to protect high-spending districts from having to decrease expenditures per pupil. A good case can be made for allowing school districts to vote a limited number of mills for program enrichment. The voters in a school district should not be prevented from voluntarily taxing themselves more to provide higher quality education.

Improve Progressivity of the Tax System[4]

Property taxes, on which public school financing is dependent, are generally considered to be regressive, although in Michigan they are much less so because of the state property tax credit. Trading the property tax for the

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[3] An in-formula school district is one that raises less in education funds per pupil than the state school aid formula guarantees; therefore, the district receives state aid.

[4] A progressive tax is one that takes a larger proportion of the income of high-income persons than of low-income persons. A regressive tax takes a larger portion of the income of low-income persons than of high-income persons.

sales tax would do little for the progressivity of the tax system; a shift to the income tax would increase progressivity. Expanding the base of the sales tax to include services would be more progressive than increasing the rate of the tax.

Maintain or Improve Stability of the Tax System

Property taxes generally are a very stable source of revenue for school districts and other local governments because the value of property seldom declines; since 1958, state equalized property values have declined only twice: in 1962 and 1976. (The 1976 decline was due to the exemption of business inventories from the tax base.) The sales tax also would be a stable education revenue source; since 1958 it has declined only once, in 1982. There is little difference between the two taxes in terms of growth. Over this 28-year period, property values increased 479 percent, while sales tax collections (adjusted for rate changes, but not base changes) increased 475 percent. The income tax is less stable than the property tax or sales tax but has more growth potential; adjusted for rate changes, income tax collections increased at an average annual rate of 8.8 percent from 1968 (first full year) to 1986, compared with an average annual collection rate increase of about 6.5 percent for the property tax and sales tax.

School Aid Formulas in Other States

The types of state school aid formulas most commonly used are foundation formulas, guaranteed tax base formulas, percentage equalizing formulas, and guaranteed yield formulas. All are similar in that each allocates some state funds according to pupils per district; they differ in their effects on equalizing resources among school districts. Most states use a combination of two or more formulas to achieve some measure of "power equalization," that is, to reduce the disparity of resources among districts having vastly different property values.

Almost all states use foundation formulas, which allocate state aid according to district school costs. If the number of students per district is used as the measure of cost, more money is allocated to the districts having more students in average daily attendance. Other cost measures are teacher salaries, average number of students in each grade, and transportation. Nebraska uses a foundation formula that allocates state aid according to number of students in each grade, guaranteeing $162 per pupil in kindergarten, $323 per pupil in grades 1-6, $388 per pupil in grades 7-8, and $453 per pupil in grades 9-12. North Carolina adjusts district foundation funds according to differences in average teacher salaries.

The foundation grant alone does nothing to equalize resources among school districts, so most states that use this type of formula tie the grants to required minimum local millages. With a set local millage, districts that have high property values raise more from their own sources than do districts having low property values; the higher own-source revenue districts receive less state aid. Other states allocate only a portion of their state aid through the foundation formula and use some additional method to equalize resources. Texas, for example, supplements its foundation formula with equalization aid for districts having property wealth less than the statewide average.

Guaranteed tax base formulas distribute aid according to the difference between the actual district property tax base per pupil and an amount set by the state as a guaranteed property tax base per pupil. For example, in Wisconsin, districts receive aid calculated on the difference between their actual wealth per pupil and the guaranteed tax base. Districts with low values of property wealth per pupil receive more than districts with higher values of property wealth per pupil. To reward local effort, the difference between actual and guaranteed wealth is multiplied by the local tax rate. This type of formula reduces the disparity in resources among districts.

States that use percentage equalizing formulas allocate funds to local school districts based on the ratio of district property wealth to total state property wealth. In Rhode Island, for example, a state support ratio is derived for each district by comparing the property wealth of the district to that of the state. This ratio is multiplied by a basic grant per pupil to determine state aid. This method of funding allocates more state aid to districts having below-average property wealth.

States that use guaranteed yield formulas promise districts a given amount of state aid for each mill of local property tax they levy. Such states base state school aid on local tax effort and usually also on the number of pupils in average daily attendance. Colorado, for example, guarantees a yield of $60.12 per pupil per mill of local tax effort; a district receives the guaranteed amount from a combination of state aid and district property wealth. A similar formula is used in Michigan. Guaranteed yield programs decrease the disparity in resources among school districts because districts with high property values raise more of their money through local millages and, therefore, receive less state aid.

Michigan School Finance System

About 58 percent of Michigan's state school aid is distributed through a combined guaranteed yield and foundation formula. The remainder is in the form of categorical grants, such as grants for special education, transportation, and school employee retirement. The formula is based on a power-equalizing concept; that is, it is intended to distribute resources for education in a way that reduces disparity among districts. Equalization of resources is achieved by basing school aid on a guaranteed yield of $350 per student, plus $75.10 per student per mill, less the amount of revenue raised locally. Districts with high property value per student raise more locally than do districts with low property value per student and receive less aid. Districts that raise more locally than the amount guaranteed from the state are out of formula and receive no state formula funds. School districts must meet curriculum and class size requirements to receive the full guarantee.

An example of how the current school aid formula equalizes resources among some school districts is the comparison between Benton Harbor and St. Joseph. (See Exhibit 3.) Although St. Joseph has SEV per pupil almost three times that of Benton Harbor and both districts have similar millage rates, spending per pupil is slightly higher in Benton Harbor because the district receives $1,891 per pupil from the state, while St. Joseph, an out-of-formula district, receives only $34 per pupil.

EXHIBIT 3

COMPARISON OF BENTON HARBOR AND ST. JOSEPH
SCHOOL DISTRICT REVENUES, FY 1985-1986

School District	Spending Per Pupil	SEV Per Pupil	Operating Millage	Local and Federal Revenue Per Pupil	State Aid Per Pupil
Benton Harbor	$3,412	$31,865	32.72	$1,434	$1,891
St. Joseph	3,294	90,063	33.96	3,245	34

If the differences in SEV per pupil are too large, however, the school aid formula cannot equalize resources. For example, in Oakland County, the Birmingham school district is able to spend much more than the Ferndale district while levying a much lower millage because the SEV per pupil is $186,213 in Birmingham and only $40,630 in Ferndale. (See Exhibit 4.)

EXHIBIT 4

COMPARISON OF BIRMINGHAM AND FERNDALE
SCHOOL DISTRICT REVENUES, FY 1985-1986

School District	Spending Per Pupil	SEV Per Pupil	Operating Millage	Local and Federal Revenue Per Pupil	State Aid Per Pupil
Birmingham	$6,049	$186,213	28.25	$5,851	$ 64
Ferndale	3,776	40,603	42.10	2,068	1,639

Weaknesses

Michigan's school finance system has some grave weaknesses. It leaves large education revenue disparities among districts, resulting in low quality education in many; it leads to a substantial and growing number of out-of-formula districts; and it encourages excessive local reliance on the property tax.

Although Michigan's school aid formula improves the distribution of resources for education among districts, a wide disparity in property values still results in a similar disparity in district school revenues. For example, one mill levied in Bridgman (Berrien County) raises $715 per pupil, while one mill levied in Quincy (Branch County) raises $50 per pupil. In 1986, Bridgman public schools, having state equalized valuation (SEV) per pupil of $715,000, received local, state, and federal education funds of $7,154 for each student; while Quincy public schools, with SEV per pupil of $50,000, received only $2,238 for each student.

In a number of districts, local millage rates and revenues have been escalating faster than school aid formula grants; this has resulted in a growing number of out-of-formula districts. About 31 percent of Michigan's school districts raise more than the guaranteed formula amount and receive only categorical funding from the state.

School officials in some out-of-formula districts expect imminent education budget difficulties because their revenues depend solely on voter-approved millage renewals and increases. They argue that unless the formula is adjusted to include the poorer out-of-formula districts, these districts may have trouble raising enough revenue through property taxes to maintain their programs.

A guaranteed yield formula such as Michigan's encourages local districts to rely inordinately on property taxes because their state aid depends in part on local tax effort. The growing number of out-of-formula districts indicates that many Michigan voters want more education than can be supported by state funds, which means even greater reliance on property taxes because local governments have few revenue alternatives. Only six states raise a larger percentage than Michigan does of K-12 school funds from local sources. In 1985, 92 percent of local own-source revenue in Michigan was raised by property taxes, which were fourth highest in the nation.

Because local residents decide by vote how much to tax themselves to support education, the extreme reliance on property taxes in Michigan suggests that school finance problems are likely to worsen. In times of a weak economy or falling property values, voters are unlikely to pass the millages necessary to maintain education programs. Even in prosperous times, the property tax is unpopular. Existing high millage levels make it unlikely that future increases in education expenditures can be financed by increasing property taxes. In addition, the school-age population is declining; this means that fewer voters than in earlier years derive a direct benefit (that is, an education for a child of their own) from approving school millages. The ratio of older to younger people is predicted to widen in the years ahead; as it does, the number of direct beneficiaries will continue to decline. The negative results of this demographic shift are somewhat offset by the decreased costs resulting from fewer children requiring education.

Advantages

Some advantages of Michigan's school finance system are that it leaves expenditure decisions to local districts, it rewards local tax effort, and it reduces somewhat the disparity among school district resources.

Although districts must meet some minimum requirements to receive formula aid, they are free to allocate that aid as they see fit. Local control over education expenditures improves the likelihood that millages will be renewed and increased and that local voters will be satisfied with the education they buy with their tax dollars.

As explained, the Michigan school aid formula does encourage local tax effort in two ways. First, a school district is guaranteed more aid if its millage is higher. Second, funds provided through the formula are low compared to what some districts desire (and are able) to raise from their own sources.

Although significant disparity in revenue available for education still exists among districts, the situation would be much worse if funds were allocated without an equalizing formula.

Review of Current School Finance Proposals

The legislative issue likely to receive the most attention this fall is school finance reform. Several task forces have been formed to study this issue; three have made recommendations. The three reports, a proposal by state Senator Rudy Nichols, and a Senate Joint Resolution to put a reform proposal before the voters are described and commented on below.

House Republican Task Force on Property and School Finance Reform. The key findings of the task force are that (1) the property tax is obsolete and unfair as the major source of funds for operating the public school system in this state and (2) the vast differences in property values among local school districts produce intolerable inequities in the financial resources available to pupils. According to the task force, state aid formulas have not been able to correct these inequities.

The task force recommends that in the November 1988 election the voters be presented with an amendment to the state constitution that would include the following provisions.

- All school operating millage would be terminated. It would be replaced with up to eight mills collected and retained locally and a fixed eight mills collected locally and sent to a state trust fund (to be called SAFE, State Account for Education), which would replace the school aid fund. Local voters could approve up to four additional mills (for a total of 20 mills) or a personal income tax of up to .5 percent (collected by the state).

- The sales tax would be increased from four percent to six percent, and the revenues would be used to fund K-12 education.

- There would be a basic grant of $2,750 per pupil in the first year (except where this would produce very high or low increases compared with current funding), and the grant would be indexed in subsequent years to gross national product (GNP) growth. Districts that receive no more money than they do currently would receive an enhancement of $150 per pupil the first year. No district would receive an increase above current funding of more than $300 per pupil.

Citizens Property Tax Commission. The commission, made up of members appointed by the Senate, finds that Michigan's current system of funding primary and secondary education is in need of major change. Despite the growth in state spending in recent years, state government's share of funding for K-12 education declined from 45.8 percent to 33.8 percent during the last decade. Large differences in educational opportunity, as measured either by property values per pupil or by expenditures per pupil, exist throughout the state. Also, Michigan's property tax system has become one of the most onerous in the country.

The commission makes a number of recommendations and suggestions concerning property tax. Two are particularly relevant to school finance reform.

- The state should replace the current school aid formula with a per-pupil expenditure for K-12 education, sufficient to guarantee a level of education that would "allow students to function adequately in the state's future." A specific amount is not given, but the report suggests $3,000 per pupil as the state average.

- The committee suggests, but does not recommend, that revenue to fund this grant could be raised by increasing the sales and use tax by two cents and by eliminating tax expenditures, such as the exemption of most services from the sales tax.

Michigan School Finance Commission (MSFC). This commission was appointed by the State Board of Education and included representatives from government, labor, business, and education. The commission makes a number of recommendations concerning the quality of education, but only those regarding school finance will be discussed in this paper.

- The state should establish an "Educational Trust Fund" with an initial contribution of $200 million to be used to improve the quality of education. The money would come from (1) earmarking 0.1 percent of the income tax (50 percent of federal tax reform windfall revenue), (2) prudently reducing the state and school employee pension funds, (3) eliminating some categoricals, (4) eliminating social security payments (currently paid for by the state for school employees) for out-of-formula districts, and (5) if needed, increasing the cigarette tax.

- A minimum annual general fund/general purpose (GF/GP) transfer to the school aid fund should be set equal to the 1986-1987 ratio of GF/GP school aid to the total GF/GP budget.

- An amendment to the state constitution should be voted on that would (1) increase the state sales and use tax from four percent to six percent, (2) levy 23 mills statewide on all commercial, industrial, utility, and developmental property, (3) allow school districts to levy up to 18 mills without voter approval on residential, agricultural, and timber cutover property--with the millage rate not to exceed 25 mills (up to seven additional mills would be permitted on residential and agricultural property if approved by local voters), and (4) exempt residential energy payments from the sales tax.

- If the constitutional amendment were to fail, the statewide industrial and commercial property tax revenue should be shared among all school districts, phased in over ten years.

- The current power equalizing school aid formula should be retained, but the flat per-student grant should be eliminated and the categorical grants for social security and transportation folded into the membership formula. No school district would receive an increase of more than 15 percent (at 18 mills) in the first year or suffer a decrease of more than five percent. The power equalizing formula would guarantee $123 per mill per pupil.

Nichols Proposal. State Senator Rudy Nichols is advancing a school finance reform plan to correct the major problems with current financing: inequity among districts, inadequate state support for education, and high property taxes. His proposal would do the following.

- Replace local school millages over four years with a uniform statewide property tax of 20 mills. Local school districts would be allowed to levy up to four additional mills for operating purposes. Districts that need to levy more than four mills to reach their current per-pupil level of financing would be allowed to do so.

- Provide state aid of $3,000 per student to each district.

- Earmark one-third of the growth in general fund/general purpose state revenue each year (except transportation funds) to education.

- Reduce circuit breaker property tax relief payments by one-half.

- Eliminate new property tax exemptions and abatements for business and industry.

Senate Joint Resolution (SJR E). Senators Dan DeGrow and William Sederburg introduced a resolution calling for an amendment[5] to the Michigan Constitution that would limit school district millage to 17 mills, permit up to 4 additional mills subject to local voter approval, and increase the state sales tax from four percent to six percent.[6]

Comment

Except for the Nichols plan, these proposals would all reduce school millage rates and replace the revenue by increasing the sales tax. The most comprehensive recommendations come from the Michigan School Finance Commission, which, unlike the other studies, proposes to retain the current power equalizing formula, although with major modifications. The MSFC study prudently recognizes the difficulty of winning voter approval for a school finance reform plan involving a tax shift and proposes a backup plan to share industrial and commercial property taxes among all school districts; this would not require voter approval. Although tax sharing is a reasonable proposal, it fails to meet most of the criteria discussed earlier in this paper, particularly the need for property tax relief and reduced reliance on property taxes. It is unlikely that any proposal requiring a tax shift could win voter approval.

The effect of the Nichols plan would be to reduce Michigan property taxes significantly without shifting the school finance burden to another tax. Instead, there would be a shift from local to state responsibility for school finance. This shift would not require voter approval, making the Nichols proposal more politically feasible than some of the others. There may be strong opposition to the Nichols proposal from districts levying less than 20 mills, because school property taxes would increase in those districts, and

[5]The resolution will have to be approved by a two-thirds vote of both houses to place the amendment on the ballot.

[6]Another proposal that would shift the school finance burden from local governments to the state is now being considered by House and Senate Republicans. This reform would replace local property taxes with a statewide property tax of 20 mills and would require only legislative rather than voter approval. The implications of this reform on school revenue have not yet been estimated, and legislation has not yet been introduced.

from districts concerned about loss of local control. The plan also would require the state to change its funding priorities; more state aid to schools would mean less for welfare, health, and other state-supported programs.

Recommendations and Conclusion

As the history section of this paper makes clear, education financing has been a concern in Michigan for 150 years. There have been several changes in the method of financing, but the central issues of the unequal distribution of resources and overreliance on property taxes have been intractable problems. At the core of the matter, as with most issues, are money and politics. Large sums are needed to reform the system, and the legislature and governor have been unwilling to raise this money without asking for voter approval. The distribution of revenue is also intertwined in local politics and the conflict between rich and poor school districts.

Recommendations

Our view is that only a legislative solution is feasible [although a vote may be required to change the constitutional tax limit (Headlee amendment)]. The voters do not have enough trust in government to approve a school finance reform plan. We propose that a school reform plan be adopted that would do the following:

- Gradually reduce school millage rates over five to ten years to no more than 18 mills for operating purposes for in-formula districts

- Permit a five mill local option for education enhancement

- Tax all commercial and industrial property at the state level and redistribute 50 percent of these monies to districts. Redistribute the other 50 percent to localities on the same basis as it was collected.[7] This plan could be phased in over several years. (Exhibit 5 shows the magnitude of the various classes of property and the revenue raised per mill.) Assessment of this property would probably best be done at the state level, although this is not essential.

- Guarantee each district a basic amount per student less a deduction calculated by a formula explained below; the formula we propose would reduce the local share of school aid funding and reliance on the property tax, while providing enough funds to each district to assure at least a minimum level of educational quality.

- Eventually revise the school aid funding formula to reflect measures of need, such as district dropout rates, number of single-parent households served by a district, and local cost of living.[8] The

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[7]The constitution does not allow differential property tax rates. Therefore, 50 percent cannot be taxed at the state level and 50 percent at the local level.

[8]A related issue is whether differences among districts should be
(Footnote Continued)

EXHIBIT 5

1987 STATE EQUALIZED VALUATIONS, BY CATEGORY
(dollars in thousands)

Category	Amount	Revenue Per Mill of Property Tax
Residential	$63,653,287	$63,653
Commercial	15,738,555	15,738
Personal property[a]	14,501,217	14,501
Industrial	10,529,154	10,529
Agricultural	6,215,406	6,215
Timber cutover	423,411	423
Developmental	193,677	194
TOTAL	$111,254,718	$111,255

SOURCE: Department of Treasury, State Tax Commission, Lansing, May 26, 1987.

[a]Almost all personal property is commercial or industrial.

formula could include a basic per-pupil grant plus aid based on district need.

Proposed Formula[9]

In 1988 (or the first year of the program), state aid for each district would be $3,000 (adjusted for inflation since 1987), less the amount that could be raised locally at a millage rate of 30 (deduct) mills. The deductible amount would fall by two mills each year until year seven of the program. Each year thereafter, school aid would equal $3,000 per pupil (adjusted for inflation since 1987), less the amount that could be raised locally at 18 mills.

Districts levying less than the number of deduct mills each year would not be allowed to reduce the amount of local contribution by lowering their millage. For example, in the first year, a school district levying 25 mills with $40,000 SEV per pupil would receive $3,000 - [40,000 x 30 mills] = $1,800 in state school aid. If that district were allowed to lower its millage, it could reduce it to ten mills and still raise the $2,200 per pupil the district currently spends (10 mills x $40,000 SEV = $400 + $1,800 state grant =

(Footnote Continued)
reflected in the school aid formula. It certainly costs more to educate a child in Detroit than in the Upper Peninsula. However, reflecting these differences would be very complex and subject to considerable error. This matter warrants further study.

[9]The mathematical formula we propose is not included here. Please call PSC if you desire a full technical explanation of our proposed formula.

$2,200). Districts levying more than 18 mills would be required to reduce that millage gradually to 18 by the seventh year of the program if they want to receive state school aid. (A five-mill local option would be allowed in any year for educational enhancement.)

High-millage districts--those levying more than 32 mills (the average statewide millage rate) and raising more than $3,000 per pupil in 1987 from their property tax--would receive no state school aid. However, the state would reimburse these districts for millage rate reductions, to a minimum of 18 mills (plus five mills for enrichment if the local desires), in increments of two or three mills each year.

Exhibit 6 illustrates how this school aid formula would work. Napoleon Community Schools in Jackson County currently levies 26.65 mills for school operations. This raises $1,225 per pupil in local revenue. Napoleon also receives $1,037 per pupil in state aid,[10] which results in total state and local aid of $2,262. Under the PSC proposal, Napoleon would receive slightly

EXHIBIT 6

PSC PROPOSED FORMULA,
NAPOLEON COMMUNITY SCHOOLS

Year	1987	1988	1989	1990	1991	1992	1993	1994
Formula deduct millage level	32	30	28	26[a]	24	22	20	18
Local revenue per pupil (SEV/pupil x millage)[b]	1,225	1,262	1,301	1,306	1,242	1,242	1,099	1,018
State aid/pupil[c]	1,528	1,668	1,816	1,971	2,133	2,133	2,482	2,670
Total state and local revenue/pupil	2,753	2,931	3,117	3,278	3,376	3,376	3,581	3,688

SOURCE: Public Sector Consultants, Inc.

[a]Napoleon's current millage is 26.25. Therefore, it would not have to reduce its millage until 1990, the year the deduct millage phasedown reaches 26. In subsequent years, however, to be eligible for state aid, Napoleon would be required to reduce its millage to keep pace with the deduct level.

[b]SEV is assumed to grow at three percent per year.

[c]The amount guaranteed by the state is adjusted three percent for inflation per year.

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[10]This $1,037 per pupil includes categorical funds. We are proposing no changes in categorical grants, although a case can be made for rolling some of them into the formula.

more aid in 1987 (year one) from the state, reduce its property tax levy by two mills per year beginning in 1990, and have revenue of $3,000 per pupil (adjusted for inflation) by 1990 and each year thereafter. In 1991, Napoleon's local aid share would begin to drop, falling from 44 percent of total state and local school aid in 1987 to 28 percent in 1994.

Cost/Revenue

The cost of this program when fully implemented would be about $1.5 billion per year (in 1987 dollars).

The revenue to pay for this new method of financing would come from (1) the current school aid fund, (2) gradually increasing the personal income tax rate to no more than 5.4 percent, (3) gradually increasing the single business tax (SBT) rate to no more than 2.8 percent, (4) extending the sales tax to certain services, such as auto repair, accounting, and computer services, (5) earmarking 60 percent of the use tax for school aid (six-year phase-in), (6) taxing commercial and industrial property statewide (50 percent would be available for redistribution), and (7) savings from the homestead property tax credit as school property tax rates are reduced. (See Exhibit 7.)

EXHIBIT 7

REVENUE SOURCES, PSC SCHOOL FINANCE REFORM
(dollars in millions)

Source	Year 1 (1987)	Year 6 (1987 dollars)
Income tax	$85 (.1%)	680 (.85%)
SBT	64 (.1%)	288 (.45%)
Sales tax on services	100-200	100-200
Statewide taxation of commercial and industrial property--50%[a]	309	325
Earmark 60% of use tax[b]	40	240
Savings from property tax relief program	35	250

SOURCE: Public Sector Consultants, Inc.

NOTE: The numbers in parentheses indicate the proposed increase in the tax rate.

[a]Assuming a rate of 30 mills in year one and of 25 mills in year six.

[b]Ten percent would be earmarked in year one and 60 percent in year six.

One potential problem with this program is that the transfer of revenues from the local to the state level could cause the state to exceed the constitutional tax limit. Revenues are currently about $1.4 billion below the limit, but this cushion could narrow sharply in the future. Raising the limit to accommodate this reform plan would require a constitutional amendment, which would likely be easier to pass than one shifting taxes. The vote could take place after the reform program was already under way, giving voters the opportunity to judge the merits of the plan in operation. Failure to win voter approval to change the state revenue limit would require program adjustments, such as enactment of a local income tax option, but would not necessarily kill the program.

Conclusion

State policy makers are committed to quality public education for all Michigan children. The current system of financing schools limits the state's ability to realize that commitment. Demographic and political pressures indicate that higher local property taxes are not the solution to the problem of adequate school funding and that a move away from local property tax-based funding is necessary to assure quality education in each district.

We believe that school finance reform is necessary to continue to provide quality education in wealthy districts and to improve education in districts with less wealth. Recent school finance reform plans address the issues of funding and equality, but none are likely to be politically attainable. Our proposed reform would reduce reliance on the local property tax and improve equity without requiring voter approval; it is thus more likely to be implemented. The plan we propose would take effect over a number of years, allowing the public to see the positive effects of the changes as they are occurring and thereby increasing public support.