



Extension Bulletin E-1724, May 1983 • By Lynn R. Harvey*
 COOPERATIVE EXTENSION SERVICE • MICHIGAN STATE UNIVERSITY

THE SITUATION

Financing Michigan's 529 K-12 and 45 K-6/8 public school districts has become a central public policy issue. Michigan's cyclical economy, especially the recession of the past several years, has resulted in state budget cuts for education and other state funded programs. This has placed an increased burden on local school districts to meet the rising costs of public education.

The issue of financing education has been further complicated by a decline in K-12 enrollments, increasing property values, or in some cases, decreasing values, voter resistance to pass additional school millages and a decline in federal aid. High unemployment in Michigan during the past several years has resulted in more demand for state resources to help people cope with the effects of the recession. This has forced the state to re-allocate funds formerly spent for education.

Various proposals by citizens and the legislature aimed at school finance reform have been placed before state voters during the past decade, and all have met the same fate — defeat. Obtaining consensus on

* Extension Specialist, State & Local Government, Michigan State University.

The author wishes to express his appreciation to Elizabeth Colombo, House Democratic Education Office; Mary Douglass, Extension Associate; Bernie Ferres, Dept. of Agricultural Economics; Al E. House, Extension Specialist, Dept. of Agricultural Economics, M.S.U.; and Beth Moore, Extension Specialist, Family Living Education and NRPP, M.S.U. for their review and comments.

Cover designed by Karen A. Bean, Extension Specialist, Agricultural and Natural Resources Education Institute.

the question "how should our public schools be financed?" remains a challenge to legislators, school administrators, and voters.

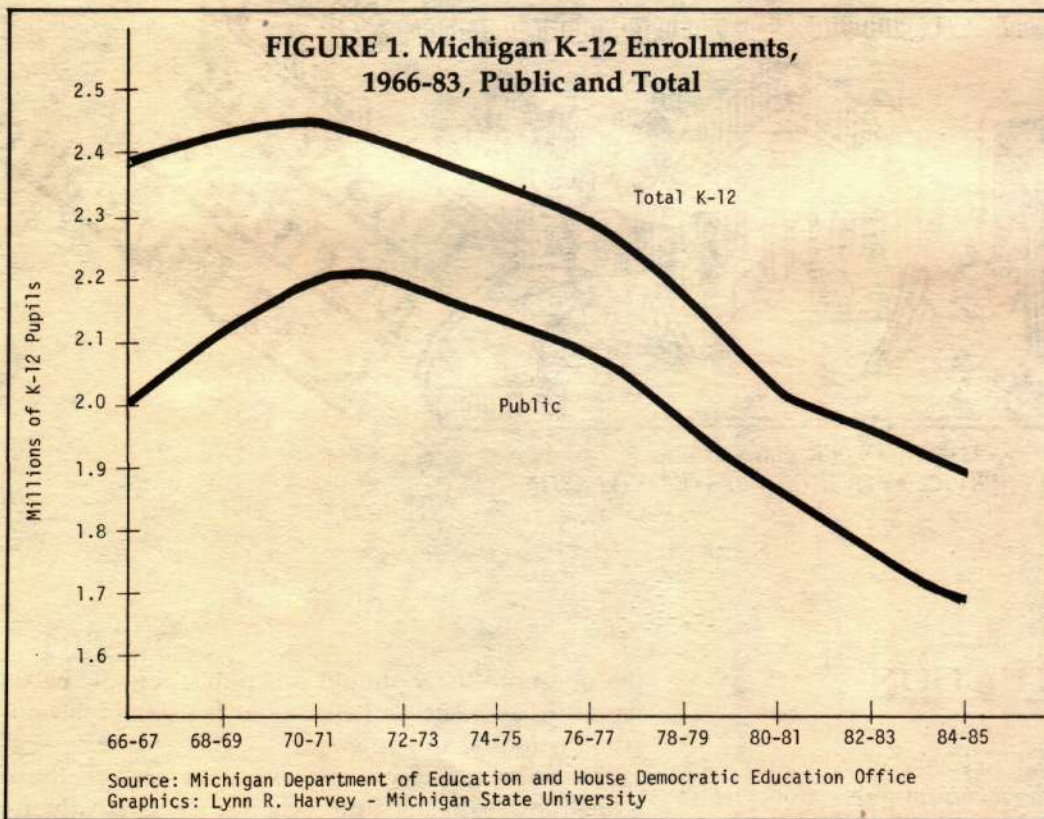
The following discussion examines each of these issues and explains how schools are currently financed. Alternative financing options and related issues are dealt with in the final section of the bulletin.

DECLINING ENROLLMENTS¹

After two decades of moderate growth, Michigan's public school enrollments began declining with the 1972-73 school year (Figure 1). Public school enrollments peaked during the 1971-72 school year at 2.2 million pupils (includes intermediate school district enrollments). The public school enrollment for the 1982-83 school year is 1.760 million pupils, a decline of approximately 32,000 students from the 1981-82 school year. The enrollment in private schools is estimated at 209,000 students for the current year. The projected public school enrollment for 1983-84 is 1.716 million pupils.

Elementary school enrollments are predicted to continue to decline through the 1984-85 school year. Middle school enrollments will remain relatively static through the 1983-84 school year and then begin a decline which will level off during the 1988-89 school year. High school enrollments (grades 9-12) are predicted to decline through the 1991-92 school year.

¹ State Department of Education and House Democratic Education Office Projections-1983.



The projections of declining enrollments are based on the assumptions that such factors as drop-out rates, non-public enrollment, out-migration and birth rates, continue at the same rate.

The closing of schools due to declining enrollments has become an emotional community issue. School boards struggle with the decision of which schools to close and how to use the excess capacity. Some school districts have chosen to use empty classrooms to meet community needs for senior citizens, day-care centers, and recreation. Other districts have sold entire school buildings — frequently for use by private schools.

Not all school districts are experiencing a decline in enrollments. Districts facing increased enrollments, such as several in northern Michigan, have to obtain the necessary support from voters for financing new and expanded facilities.

SCHOOL REVENUE SOURCES

The total cost for public K-12 education in Michigan will exceed \$5 billion for the 1982-83 school year. Michigan ranks 22nd among the 50 states when comparing expenditures for education as a percent

of personal income. Revenue to finance the K-12 education is derived from a combination of federal, state and local sources. The Federal contribution to financing elementary and secondary education has remained relatively constant for the past fifteen years (4-6% of total). Shifts have occurred in the proportion of local and state funding percentages (Table 2). For the 1966-67 school year, state sources provided 49.0% of total revenue for public K-12 education, but only 37.8% in 1981-82.

Local revenue sources, especially the property tax, have been providing an increasing proportion of total funds needed to operate public secondary and elementary schools in Michigan. Local sources provided 46.2% of revenue in 1966-67 but will provide 57.9% for 1982-83.

Local Sources

The shift in burden from state to local is the result of several factors. The economic condition of the state has not permitted the state to increase funding for schools to keep pace with inflationary pressures. Secondly, increased property values due to inflation have increased revenues for local districts. Since taxing base wealth is taken into account in the member-

TABLE 1. Total School Revenue by Source (percent).²

	1966-67	1968-69	1974-75	1979-80	1981-82	1982-83
Federal	4.8	3.9	4.7	6.2	5.2	5.0
State	49.0	48.0	45.6	45.8	37.8	37.1
Local	46.2	48.0	49.7	48.0	57.0	57.9

² Data supplied by the State Department of Education, Department of Management and Budget and House Democratic Education Office. State rebates such as property tax credits are included as a part of the state's share.

ship aid formula, a topic discussed on page 4, many school districts have found that as the State Equalized Value³ (SEV) of the district increases, membership aid decreases. This results in local school districts assuming an increasing share of the financial burden. Since 1972, SEV in the state has increased 120%. While the membership aid formula is adjusted annually by the Legislature, adjustments were insufficient to keep some districts from going "out-of-formula" each year.

Local school districts and the intermediate districts levy three primary types of millage: allocated,⁴ voted operating, and debt retirement.

The current recession in Michigan has tended to stabilize property value — some communities are experiencing a decline in property values. The stabilization or decline in SEV will slow the rate of schools going "out-of-formula." On the other hand, the slowing of the SEV in a district will result in less revenue yield from the property tax, and less total revenue for "out-of-formula" districts.

State Support

State support of K-12 education will exceed \$1.97 billion for the 1982-83 school year. State monies are provided to public schools through the property tax credit program, and through the distribution of state aid monies.

³ The Michigan Constitution requires that real and personal property be assessed and equalized at 50% of True Cash Value for taxing purposes. A "mill" is defined as \$.001 or \$1.00 per \$1,000 of State Equalized Value.

⁴ Article IX, Section 6 of the Michigan Constitution provides that the total amount of general *ad valorem* taxes levied upon real and personal property shall not exceed 15 mills (18 mills in cases where county voters have altered the limitation). Millage levied in excess of the 15 mills must be voted by the electorate. The 15 mills is referred to as allocated millage and is split by the County Tax Allocation Board between the county, townships, local school districts and the intermediate school district. State law provides that county voters may establish an allocation at a "fixed" amount for a period not to exceed 20 years.

Property Tax Credits

The Homestead Property Tax Credit Program and the Farmland and Open Space Preservation Program contribute to the support of local K-12 education since qualifying taxpayers receive reimbursement for a portion of their property taxes which exceed a certain percentage of household income. Since school taxes represent the largest portion of a property tax bill (68% of total property taxes paid in 1982), property tax credits, in effect, reduce the property tax paid to local schools and intermediate districts. Property tax credits attributed to public schools exceeded \$348 million in 1982. Figure 2 shows the effect of property tax credits, which are paid from the state's general fund, on the source of funding for K-12 education.

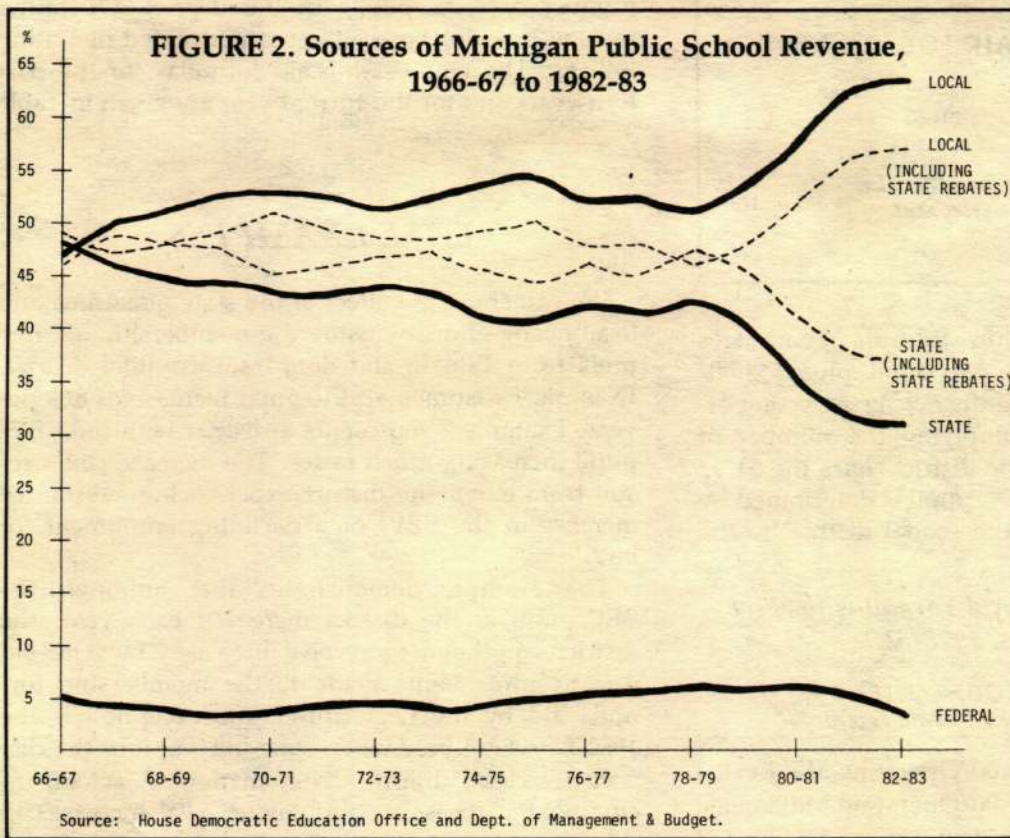
State School Aid Fund

Distribution of monies from the State School Aid Fund (SSAF) to local school districts will exceed \$1.6 billion for the 1982-83 school year. Monies are distributed to local districts as categorical aid and on a membership formula basis. The SSAF is comprised of revenue from several sources.

Michigan's Constitution provides that 60% of all the sales tax revenues collected in the state be deposited in the State School Aid Fund (SSAF).⁵ Two cents from every package of cigarettes sold in Michigan by law is deposited in the SSAF. Effective May 1982, all net revenues from the lottery are deposited in the State School Aid Fund. The balance of School Aid Fund revenues are derived from: (1) the excise tax on liquor, (2) the state's contribution for partial revenue loss by local school districts for industrial facilities exemptions granted by local governments and (3) transfers from the state's general fund. A small portion of the SSAF is federal aid targeted for specific purposes.

The size of the school aid fund each year is determined by the financial resources of the state. Educa-

⁵ Article IX, Section 8 and 11, Michigan Constitution.



tion competes with various other state programs and needs. Table 2 provides a breakdown of SSAF revenue and the percentage contribution of each to the 1982-83 school aid fund.

Categorical Aid — Local school districts receive state aid for categorical programs. Categoricals include special programs for underachieving pupils, transportation, special education, vocational education, bilingual education, media centers, school aged parents program and professional development for teachers. In 1982-83, the state will also allocate funds

to districts with high non-school operating property taxes under a unique "municipal overburden" formula.

The state funds categorical programs by paying a portion of either total or "added" costs of the estimated or actual amount by which special costs exceed comparable costs of regular programs. In other cases, funds are allocated on a flat amount or per professional.

Membership Aid — Since the 1973-74 school year, membership aid to local schools has been distributed on an "equal yield" or "equal dollar for equal effort" formula basis. The formula is adjusted annually by the Legislature. The formula is designed to *equalize funding* among school districts in the state.

The membership formula incorporates a STATE GUARANTEE from which the taxing effort of a local district is subtracted. If the STATE GUARANTEE is greater than the LOCAL EFFORT, the district will receive the difference as membership state aid. If the LOCAL EFFORT, that is, the district's ability to raise revenue from the property tax, exceeds the STATE GUARANTEE, the district is said to be "out-of-formula." Currently, 199 or 34% of the state's 574 districts are "out-of-formula." While the membership formula has been improved each year, the rapid increase in the SEV of some districts have resulted in additional districts going "out-of-formula."

TABLE 2. 1982-83 State School Aid Fund.

Source	Million \$	% of Total
Sales Tax	942.423	58.12
General Fund Transfer	405.400	25.00
Lottery	205.400	12.67
Cigarette Tax	24.455	1.50
Industrial Facility Exemption	23.455	1.45
Liquor Excise	19.586	1.20
Other	0.951	.06
TOTAL	1,621.618	100.00

MEMBERSHIP AID FORMULA

$$\begin{array}{l} \text{State} \\ \text{Guarantee} \end{array} + \begin{array}{l} \text{Local} \\ \text{Effort} \end{array} = \text{State Aid}$$

$$\begin{array}{l} \text{Per Pupil Amount} \\ + \text{Guarantee Per} \\ \text{Mill} \times \text{Operating} \\ \text{Mills of District} \end{array} - \begin{array}{l} \text{SEV/Pupil of District} \\ \times \text{Operating Millage} \end{array} = \text{State Aid}$$

The 1982-83 membership formula guarantees every school district \$328 per pupil plus \$54.00/operating mill levied by the district. Local taxing effort is determined by multiplying the number of operating mills levied by the district *times* the SEV/pupil in the district. The SEV/pupil is determined by dividing the total SEV of the school district by the

TABLE 3. Membership Aid Formulas for Five School Years, 1978-82.

SCHOOL YEAR	Per Pupil	STATE GUARANTEE + Guarantee/Mill Levied
1978-79	\$374	+ \$40.00/Operating Mill Levied
1979-80	\$325	+ \$43.00/Operating Mill Levied
1980-81	\$357	+ \$46.24/Operating Mill Levied
1981-82	\$360	+ \$50.55/Operating Mill Levied
1982-83	\$328	+ \$54.00/Operating Mill Levied

number of K-12 pupils in the district. Operating millage includes both allocated and voted operating millage. The membership aid formulas for the past four years and for the current year are given in Table 3.

CASE EXAMPLES

We can show the effect of the state guarantee and local taxing effort by using the membership aid formula from Table 3 and data from a school district. Example 1 assumes a SEV/pupil increase of 8% per year. Example 2 represents a district with the SEV/pupil increasing much faster. The increase could result from either the district experiencing substantial increase in the SEV, or a declining enrollment, or both.

The example demonstrates that although the SEV/pupil in the district increased each year, the district continued to receive increases in state aid due to adjustments made to the membership formula aid by the Legislature. The exception is the 1982-83 school year when state aid/pupil in the district decreased due to a combination of factors, including the recession and higher SEV increases in the district compared to other districts.

In Example 2, the district experienced a rapid increase in SEV/pupil, resulting in decreasing state

Example 1:

School Year	District SEV/Pupil	Operating Millage of District	Per Pupil Property Tax Operating Revenue	State Formula Guarantee	State Aid
1978-79	\$30,000	25 mills	\$ 750.00	\$1,274.00	\$524.00
1979-80	32,400	25 mills	810.00	1,400.00	590.00
1980-81	34,992	25 mills	874.80	1,513.00	638.20
1981-82	37,791	25 mills	949.78	1,623.75	673.97
1982-83	40,814	25 mills	1,020.35	1,678.00	657.65

Example 2:

School Year	District SEV/Pupil	Operating Millage of District	Per Pupil Property Tax Operating Revenue	State Formula Guarantee	State Aid
1978-79	\$40,000	30 mills	\$1,200.00	\$1,474.00	\$274.00
1979-80	44,000	30 mills	1,320.00	1,615.00	295.00
1980-81	52,000	30 mills	1,560.00	1,744.20	184.20
1981-82	61,500	30 mills	1,845.00	1,876.50	31.50
1982-83	66,200	30 mills	1,986.00	1,948.00	0.00

aid. Local taxes exceeded the state guarantee in the 1982-83 school year and the district went "out-of-formula."

Funding of the membership aid formula depends upon the economic condition of the state and the state's ability to meet its financial obligations. The formula does not determine the total amount of money allocated.

FEDERAL AID

As Table 1 (page 3) indicated, federal support for public K-12 education in the state has ranged between 4-6% of total. Federal Aid is used for the funding of Title I compensatory education, special education for handicapped, school lunch and nutrition and special grants.

FINANCING ALTERNATIVES

The issue of reforming the current method of K-12 school finance has been controversial — What should be the balance between local and state? Does equal dollars per pupil provide equity in education? Is the property tax an equitable means of providing revenue for financing local schools? If the state is to assume a larger share of K-12 financing, where does the money come from? Should schools be financed by increasing the income tax, sales tax, business taxes, or other taxes or in some combination? Is there a tradeoff between local control and increased state financing?

While the property tax is sometimes viewed as inappropriate to finance the local share, it does provide a stable revenue for local districts. Removing reliance on the property tax and switching to increased state funding does introduce uncertainty of school financing due to the volatility of the Michigan economy. Revenue from taxes such as income, sales and business is related to the strength of the economy and thus is subject to fluctuation.

One alternative is to increase the sales tax and target the increased revenue for school funding. The

sales tax is a constitutional tax requiring electorate approval to increase the rate of the tax. In recent years, several proposals have been presented to Michigan voters to increase the sales tax and provide property tax rollback or relief; each proposal has been defeated by voters.

Most policy observers agree that any increase in state taxation to fund education must include a corresponding reduction in local property taxes.

Consolidation may be a forced alternative for districts which experience a substantial decline in enrollments and a shrinking tax base.

CONCLUSION

Michigan has been a leader in public school finance since the principle of "free public education" was introduced in the 1787 Northwest Ordinance. The balance in funding between local and state is a complex problem which has to deal with the issues of equity, equality and quality of education.

The recession of the past several years has reduced the state's ability to fund K-12 education since state revenues have not kept pace with the demands for the funding of state programs, services, and aid to local governments. The decline in federal aid and grants adds additional stress to the funding of public education.

Declining enrollments complicate the funding issue. The passage of millage renewals and increases is becoming increasingly difficult. With only 30% of Michigan families having children enrolled in public schools, the millage and local funding will remain a contested issue.

Considerable consolidation of school districts took place during the 1940's, 50's and 60's, when the number of districts declined from 6,775 in 1930 to 718 districts in 1968.⁶ Declining enrollments and funding problems experienced by local districts has the potential to renew the consolidation movement.

⁶ *Education In the States: Historical Development and Outlook*, Michigan State Department of Education, 1967, pgs. 603-605.

MICHIGAN STATE UNIVERSITY



COOPERATIVE
EXTENSION
SERVICE

MSU is an Affirmative Action/Equal Opportunity Institution. Cooperative Extension Service programs are open to all without regard to race, color, national origin, or sex.

Issued in furtherance of cooperative extension work in agriculture and home economics, acts of May 8, and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Gordon E. Guyer, Director, Cooperative Extension Service, Michigan State University, E. Lansing, MI 48824.

This information is for educational purposes only. Reference to commercial products or trade names does not imply endorsement by the Cooperative Extension Service or bias against those not mentioned. This bulletin becomes public property upon publication and may be reprinted verbatim as a separate or within another publication with credit to MSU. Reprinting cannot be used to endorse or advertise a commercial product or company.

1P-20M-5:83-DP-KMF-KC, Price 25¢, Single Copy Free to Michigan Residents.