



DISTRIBUTION OF STATE AID TO MICHIGAN SCHOOLS

In March 1994, state voters approved a ballot proposal (Proposal A) to amend the 1963 Michigan Constitution, ushering in one of the final pieces of a new public K-12 education finance system. Proposal A, along with a host of statutory changes adopted in late 1993 and early 1994, completely altered how state and local public resources for K-12 education are collected and distributed to public school districts. The new system shifted primary responsibility for financing schools from local districts to the state government. It decreased the role of local property taxes and increased the role of state taxes, primarily through an increase in the sales tax rate. School funding centralization at the state level was accompanied by the replacement of a power equalization program with a per-pupil foundation grant program to allocate state aid to local districts. The foundation grant program with its constitutional per-pupil revenue floor established by Proposal A also centralized decision making about the amount of per-pupil revenue that each school district receives (i.e., its foundation grant) and the annual adjustments made to each districts' foundation grant. Thus, since the mid-1990s, state officials, not local voters and school officials, determine the amount of per-pupil revenue each district receives.

Since its implementation in state Fiscal Year 1995 (FY1995), a major policy directive of the foundation grant has been greater equity in the distribution of per-pupil general operating revenues across school districts. In this sense, equity is defined as the same per-pupil revenue amount (total state and local) regardless of student characteristics (e.g., wealth, learning ability, race etc.) and/or district characteristics (e.g., geographic location, type, costs, etc.). Beginning with the initial grant amounts established in FY1995 and over the past 16 years, considerable progress has been made towards the goal of greater equity as the gap between the lowest and highest per-pupil grants has been narrowed. Despite this progress, absolute equity has not been achieved and

a large gap still exists. Per-pupil revenue equalization gains were the greatest in the years immediately following Proposal A, FY1995 to FY2000, when state School Aid Fund revenue growth was the strongest. Smaller and less frequent gains have been achieved in subsequent years.

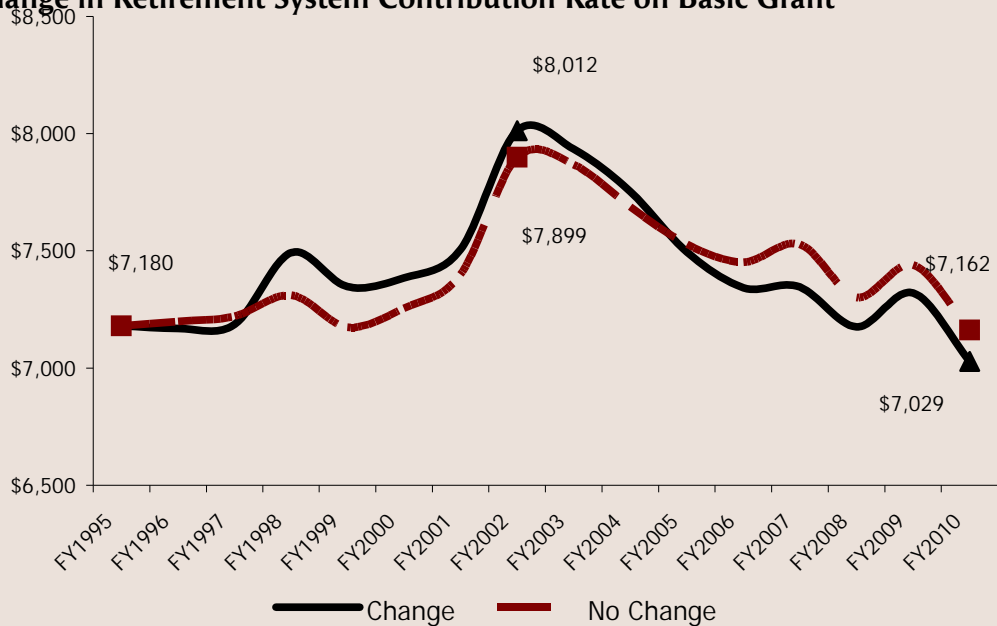
Per-pupil revenue equalization has been achieved over the years almost exclusively through policies designed to raise the floor (i.e., provide greater annual increases to the lowest foundation grants). In FY1995, 307 traditional public school districts received foundation grants less than the basic or target amount. By FY2010, 396 districts (of 551 districts) received the target per-pupil amount. In terms of the spread between the lowest and highest foundation grants, equalization reduced the gap from approximately \$6,300 per pupil in FY1995 to about \$5,000 per pupil in FY2010.

Efforts to increase the funding for the lowest revenue districts resulted in different per-pupil revenue growth rates across foundation grants. Because of the disparate growth districts, the lowest foundation grants have seen growth relative to inflation since FY1995, but the growth rates of the higher foundation grants have trailed inflation since Proposal A's implementation. However, during the last ten-year period as Michigan's economy struggled and state education revenue growth has been constrained, inflation outpaced foundation grant growth for all districts. Today, the inflation-adjusted amount of the foundation grant in many school districts is below where it was in FY1995, but there is much more equity across districts.

The purchasing power of a district's foundation grant has been affected by the growth in the required employer contributions to the retirement system which finances school employee pension and retiree health benefits. Since 1995, school districts have been entirely responsible for this cost and the em-



Chart A
Effect of Change in Retirement System Contribution Rate on Basic Grant



* Basic grant adjusted using U.S. Consumer Price Index (state fiscal year basis) and MPSERS contribution rate

employer contribution rate has exhibited a long-term upward trend. In some years, the rate grew more rapidly than growth in the foundation grant, thus requiring larger shares of the foundation grant to be dedicated to financing the retirement contribution. The increase in the rate between FY1995 and FY2010, when compared to the growth in the foundation grant over this period and after adjusting for inflation, effectively reduced the purchasing power of the foundation grant (see **Chart A**).

Under the foundation grant program, the amount of a district's grant is only part of the equation that determines the total general operating revenues available to that district. Of equal, if not greater, importance is the number of students enrolled in the district. At the district level, declining enrollment trends, both in the near- and long-term, can have profound effects on the amount of overall resources available. Enrollment levels are affected by many things, including the broad demographic and eco-

nomics factors affecting statewide enrollment numbers, the competition for students from other traditional public schools and charter schools, and the alternatives to public education, such as private schools and homeschooling. Over 60 percent of school districts have experienced some degree of enrollment decline between FY1995 and FY2009, with a good portion of these seeing enrollment declines of 10 percent or more (see **Table A**). In FY2009, nearly as many children were educated in declining districts as

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Table A
Enrollment Changes in Traditional Public School Districts: FY1995 to FY2009

<u>Enrollment Change</u>	<u>Number of Districts</u>	<u>Percent of Districts</u>	<u>Total Enrollment</u>	<u>Percent of Students</u>
Decline >33%	50	9.1	141,553	9.4
Decline 10% to 33%	186	33.8	339,183	22.4
Decline 0.1% to 10%	<u>98</u>	17.8	<u>245,087</u>	16.2
Subtotal	334	60.7	725,823	48.0
Increase 0% to 10%	87	15.8	283,431	18.7
Increase 10% to 33%	83	15.1	293,493	19.4
Increase > 33%	<u>47</u>	8.5	<u>210,857</u>	13.9
Subtotal	217	39.3	787,781	52.0

Source: Center for Educational Performance and Information

growing districts when compared against enrollment levels of FY1995. State policies intended to help districts cope with the fiscal challenges resulting from declining enrollments (e.g., supplemental grant funding and changes to enrollment counts) have had little impact because of the great, and growing, number of districts that experience enrollment losses each year and, in some cases, the magnitude of the

issue in districts hardest hit by year-over-year declines.

Combining the inflation-adjusted growth in districts' foundation grants with enrollment changes since Proposal A reveals the effects of both factors on total operating revenues. **Table B** provides a summary of the interaction of enrollment changes and foundation grant changes from FY1995 to FY2009 and their

cumulative effect on the growth in total foundation revenue by type of traditional public school district. When enrollment and foundation grant changes are combined, a total of 273 districts, nearly half of all traditional public school districts, have seen a decline in their inflation-adjusted total foundation revenue between FY1995 and FY2009.

The near-singular pursuit of per-

Table B
Changes in Enrollment, Foundation Grant, and Total Foundation Revenue by District Type: FY1995 to FY2009 (FY2009 Dollars)

	<u>Enrollment</u>		<u>Real Per-Pupil Foundation Grant</u>		<u>Total Foundation Revenue</u>	
	<u>Decline</u>	<u>Gain</u>	<u>Decline</u>	<u>Gain</u>	<u>Decline</u>	<u>Gain</u>
City	18	8	19	7	18	8
Suburban	47	102	93	56	56	93
Rural	269	107	80	296	199	177
Total	334	217	192	359	273	278

Source: Center for Educational Performance and Information; Senate Fiscal Agency; U.S. Bureau of Labor Statistics, Consumer Price Index (state fiscal year basis); CRC calculations.

pupil revenue equalization as the primary policy objective of policymakers in implementing the Proposal A financing system has meant that other policy goals have been largely unaddressed. Greater amounts of funding have been directed to districts with low per-pupil revenues before Proposal A; however, these were not the poorest districts as measured by average household income and/or per-pupil property wealth. Thus, the poorest districts did not benefit the most from the policies intended to address equity.

In addition to district wealth, annual foundation grant adjustments ignored other important district characteristics, such as racial composition. Districts with high concentrations of minority students, which also struggle academically, did not receive the greatest percentage increases under Proposal A. Furthermore, the overall finances in many of these districts have been adversely affected by significant enrollment declines over the years.

Have Michigan's efforts to equalize per-pupil funding resulted in improved academic performance? This is a question that academicians and researchers looking at school finance reforms in many states have sought to answer for some time. Generally, such inquiries have struggled to establish a long-term and definitive connection between financial resources (inputs) and student academic performance (outputs), especially when examining changes to school finance systems. Proposal A provided an opportunity to examine this rela-

tionship in a new light because of the dramatic changes involved. Michigan State University economist Leslie Papke's, Ph.D. on-going research suggests that students in school districts that benefited the greatest from per-pupil revenue equalization (i.e., received the greatest revenue increases) saw larger increases on standardized tests than students from like districts that received fewer resources over time. Furthermore, the observed improvements were greatest for districts with lower test scores initially. Dr. Papke's research adds evidence to counter the popular contention that simply adding more resources to schools will not yield significant student improvements. It should be noted, however, that this research also revealed that the resources needed to effect relatively modest changes in student performance are substantial.

Funding for public K-12 education under Proposal A's school finance system is entering a new phase. In the near-term, this new phase is characterized by a reduction in the aggregate state revenue base in FY2009 and FY2010; revenue growth that trails the projected growth in spending each year; and an increasing number of students being educated in declining enrollment districts. At the same time and in this era of resource constraints, public schools are being asked to educate children to a higher standard, to improve student outcomes, to increase graduation rates, and to prepare kids for success in a globally-competitive workforce or post-secondary education. Over the long run, state policymakers must decide

whether the current finance system will enable schools to meet specified performance benchmarks and ensure a competitive state well into the future.

The period from 1995 to 2010 provides an opportunity to take stock and evaluate how the state's school finance system responded to major changes affecting the state's population and economy. This examination is particularly important given the current fiscal challenges facing the state budget and the allocation of scarce resources among competing services and programs, including funding for K-12 public education. Given the fiscal realities of today and the evidence provided by the past 16 years under Proposal A, the timing may be right to consider school finance reform.

Further, school finance reform is unlikely to occur on its own; rather it is likely to be paired with a much broader education agenda, such as governance/management reforms; a renewed focus on student performance; and/or efforts to provide greater and more diverse educational choice. It is also very likely that school finance reform will accompany changes in another public policy arena, such as state and local taxes, akin to Proposal A's objective to reduce property taxation. Regardless of the motivation for reform or how changes to the state's school finance system are packaged, some key questions arising from the experiences under Proposal A will help guide the debate and discussions about possible modi-

fications or alternatives to the current system.

Contemplating changes to the system, policymakers and voters likely will face some fundamental choices that touch upon the issues of local control, intergovernmental fiscal matters, state and local tax policy, and the relationship between funding and student performance. Examples of the choices that policymakers and voters might consider include:

- Should the degree of funding centralization at the state level be reduced to allow some amount of local control over the amount of operating revenues available each year to educate children?
- Given the recent cuts in state

aid to all school districts in response to the economic downturn, should districts at least have the ability to replace these resources locally?

- Does it make sense to prevent higher revenue districts from raising additional revenue to support more spending in order to further enhance per-pupil revenue equity on a statewide basis?
- In a revised system, should the basic formula for distributing general operating revenues to districts include an adjustment to mitigate the effects of declining student enrollments?
- Should this basic formula take into account the added costs of educating certain student

populations as opposed to addressing these costs through categorical grants?

- Should policymakers and voters pursue further reductions in the per-pupil funding gap between lower- and higher-revenue districts? If so, how long should it take to achieve these equity gains? What is a reasonable cost?
- Should additional funding, when it becomes available, be targeted towards low-performing districts, where the gains might be greater? Alternatively, should additional funding go to those districts already performing at the top?