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CRC

Distribution of State Aid to Michigan Schools

August 2011

Report 371

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Public K-12 Education in Michigan

In 2010, Michigan residents found public primary and secondary education confronted with a number of challenges:

- State revenues were falling;
- Local revenue growth were stagnating;
- K-12 education service providers were facing escalating cost pressures, with annual growth rates outpacing the projected growth in available resources;
- The amount of federal education funding spiked as result of the American Recovery and Reinvestment Act of 2009 (ARRA) and produced a budgetary "cliff" when the additional dollars expired; and
- School district organization and service provision structures were being reviewed with the goals of reducing costs and increasing efficiencies.

Because of the critical importance of education to the state, its economy, and its budget, the Citizens Research Council of Michigan (CRC) planned a long-term project researching education in Michigan with an emphasis on the current governance, funding, and service provision structures and their sustainability.

Public education has been governed largely the same way since its inception in the 1800s. It is important to review the current organization of school districts and structure of education governance, as well as to review new and different ways to organize and govern public education, to determine if Michigan's governance structure meets today's needs. The school finance system has been revamped on a more regular basis throughout history. Changes have been made to address a host of concerns, including per-pupil revenue disparities, revenue-raising limitations of state and local tax systems, as well as taxpayer discontent with high property taxes. Michigan's current finance system was last overhauled in 1994 with the passage of Proposal A, providing sufficient experience to reconsider the goals of the finance reforms and determine whether the system has performed as originally contemplated.

In addition to analyzing education governance and revenues, it is important to review cost pressures facing districts and how education services are provided in Michigan. School budgets are dominated by personnel costs, the level of which are largely dictated by decisions made at the local level. Local school operating revenues are fixed by decisions and actions at the state and federal levels, but local school officials are tasked with making spending decisions and matching projected spending levels with available resources. However, those local decisions are often impacted by state laws (e.g., state law requires districts to engage in collective bargaining, to participate in the state-run retirement system, and to serve special education students through the age of 25). The freefall of the Michigan economy since the 2001 recession has impacted all aspects of the state budget, including K-12 education, and requires state and local officials to review how things are done in an attempt to increase revenues and/or reduce costs.

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Citizens Research Council Education Project

In 2009, CRC was approached by a consortium of education interests and asked to take a comprehensive look at education in Michigan. CRC agreed to do this because of the importance of education to the prosperity of the state, historically and prospectively, and also because of the share of the state budget that education demands. Education is critical to the state and its citizens for many reasons: 1) A successful democracy relies on an educated citizenry. 2) Reeducating workers and preparing students for the global economy are both crucial to transforming Michigan's economy. 3) Education is vital to state and local budgets. 4) Public education represents a government program that many residents directly benefit from, not to mention the indirect benefits associated with living and working with educated people. As with all CRC research, findings and recommendations will flow from objective facts and analyses and will be made publicly available. Funding for this research effort is being provided by the education consortium and some Michigan foundations. CRC is still soliciting funds for this project from the business and foundation communities.

The goal of this comprehensive review of education is to provide the necessary data and expertise to inform the education debate in Lansing and around the state. This is a long-term project that will take much of the focus of CRC in 2010 and into 2011. While an overall project completion date is unknown, CRC plans to approach the project in stages and release reports as they are completed. Topic areas CRC plans to study include education governance, K-12 revenues and school finance, school district spending analyses, public school academies (PSAs) and non-traditional schools, school district service provision and reorganization, and analyses of changes to Michigan's educational system.

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Summary

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.

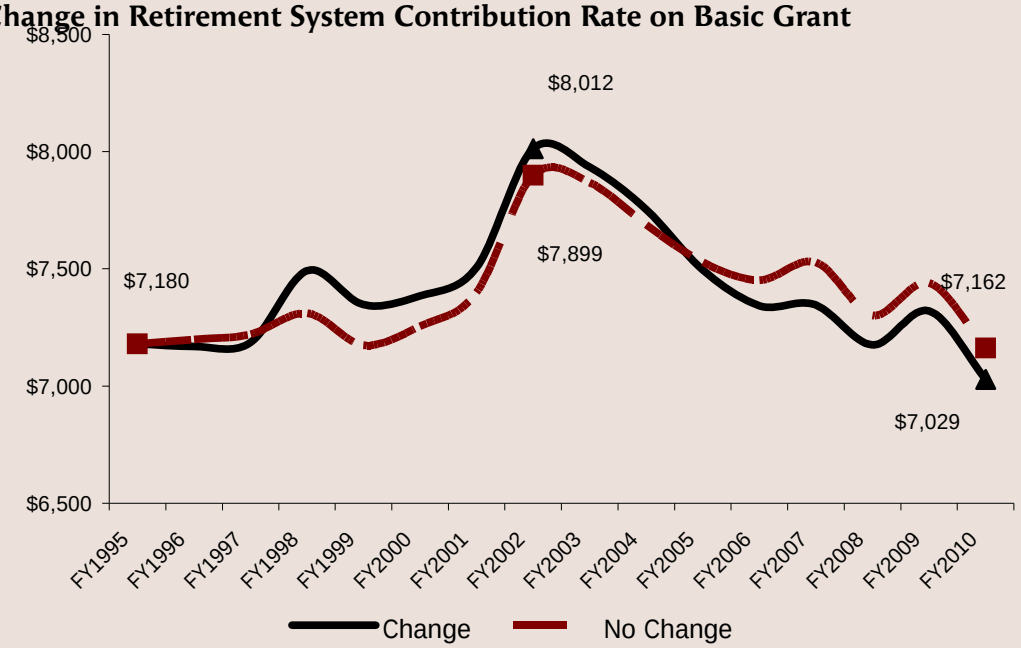
Since its implementation in state Fiscal Year 1995 (FY1995), a major policy directive of the foundation grant has been greater equity in the distribution of per-pupil general operating revenues across school districts. In this sense, equity is defined as the same per-pupil revenue amount (total state 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 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

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

Source: Senate Fiscal Agency; Office of Retirement Services, US Bureau of Labor Statistics

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 economic 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 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

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

Enrollment Change	Number of Districts	Percent of Districts	Total Enrollment	Percent of Students
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%	98	17.8	245,087	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%	47	8.5	210,857	13.9
Subtotal	217	39.3	787,781	52.0

Source: Center for Educational Performance and Information

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-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 be-

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

	Enrollment		Real Per-Pupil Foundation Grant		Total Foundation Revenue	
	Decline	Gain	Decline	Gain	Decline	Gain
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.

fore 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 relationship 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 modifications 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?

Distribution of State Aid to Michigan Schools

Introduction

Michigan continues to grapple with the fiscal after effects of the worst economic decline since the Great Depression – state tax revenues witnessed two consecutive years of decline in Fiscal Year 2009 (FY2009) and FY2010 in response to massive employment and personal income losses. These revenue declines and their impacts on the state budget were made worse by the effects of previously agreed-to tax policy changes that came on-line simultaneously. Fortunately, over the near-term, policymakers had the benefit of substantial amounts of federal funds to mitigate the reduction in state tax revenues. While some state budget cutting did take place over the recent period, the full effects of the Great Recession have not been incorporated into the state budget. Entering FY2012, however, these temporary resources are exhausted and revenues have not rebounded to their pre-recessionary levels. Thus, further budget modifications are necessary to align state spending with available resources.

Part of a Series on Public Education in Michigan

This report is part of a series on public education in Michigan and the second in the series on the wide-reaching topic of school finance. In September 2010, CRC issued its first finance report, *State and Local Revenues for Public Education in Michigan*, explaining Michigan's school finance structure and analyzing potential reforms. This report, a follow-up to that report, focuses on the distributional effects of the state and local revenues raised and dedicated to K-12 education.

Other reports include the primer in the series released in January 2010, *Public Education Governance in Michigan*, which describes the complex governance structure and functions carried out by all three levels of government: federal, state, and local. Since January 2010, CRC has released the following reports: *Nontraditional K-12 Schools in Michigan*, which explores the role of charter, parochial, and other means of educating children outside of the public school system; *Early Childhood Education*, which discusses the value of investing in preschool and kindergarten programs; *Child Care and the State*, which describes child care options and average costs and reports what is known about the effects of various child care arrangements on children's development; and *Reform of K-12 School District Governance and Management in Michigan*, which analyzes different models for governing education systems. Future papers will discuss education policy issues, such as school district organization and responses to districts that find themselves in deficit, in more detail.

Concurrently, a new cohort of state lawmakers and a new governor are assuming control over the state's finances, including financing public K-12 education services provided to approximately 1.5 million school children in 775 independent school districts across the state. These decision makers inherit a public K-12 education finance system that dates back to the mid-1990s and the major statutory and constitutional changes enacted at the time. While significant economic and demographic changes have occurred since that time, the state's financing system has remained largely intact – the major sources of revenues and the primary method of distributing those revenues have undergone few structural modifications. Despite the dearth of systemic changes, K-12 finances, whether measured in the aggregate or at the per-pupil level, have been noticeably affected by the changes in the state's population and its economic well-being. Also, funding for individual school districts (and school children) has been affected by reforms in policy and law.

Funding for public K-12 education under the school finance system created by 1994's statewide ballot Proposal A is entering a new phase. In the near-term, this new phase is characterized by a reduction

in the aggregate state revenue base of dedicated education taxes; 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.

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 part of a much broader education agenda, such as governance/management reform, efforts to provide greater and more diverse educational choice, or another policy-related subject, such as Proposal A's reduction in property taxes or broad state/local tax restructuring. Regardless of the motivation for reform, much can be gleaned from the current finance system when changes in per-pupil funding are examined through a variety of lenses.

In a previous report CRC examined the performance of the resources, in the aggregate and individually, dedicated to finance education since enactment of Proposal A and the prospects for growth, stability and adequacy.[1] As a follow up, this report looks at the distribution of those resources to school districts at the per-pupil level. The primary focus of this paper is the main allocation method used to distribute general operating revenues (state and local) to school districts for serving general education students – the foundation grant program. Although very important, this report gives less attention to how state dollars are targeted for specific educational purposes (i.e., categorical funding). It examines the history and origins of the foundation grant and the major public policy goals it was intended to address. It evaluates the progress made towards these goals and identifies other common public policy objectives not directly addressed by the state's foundation program. Attention is paid to the secondary effects, perhaps unintended, resulting from the singular pursuit of the stated policy goals. It discusses what would be involved in future efforts to further narrow the per-pupil revenue gap between lower- and higher-revenue districts. The report also examines evidence that per-pupil funding increases have resulted in higher student achievement in those districts that benefited the most from funding equalization.

Background

Over the last 200 years, the role of state governments in financing K-12 education has expanded dramatically. Early on, the role of state governments was simply to authorize schools to generate their own local support, primarily through the property tax. State responsibility for financing public education grew incrementally over the years as states endeavored to make sure that all schools provided at least a minimal program. The role of state finances in local public education expanded further when it became clear that the locally dominated system, financed by property taxes, produced extreme variations in support for schools at very different levels of tax effort (i.e., property tax rates). In the early part of the 20th century, state aid to local schools increased with efforts to equalize per-pupil revenue across district.

In the 1920s, states accounted for 17 percent of total education revenues while local sources accounted for 83 percent. State governments' role continued to increase and reached nearly 50 percent by the mid 1980s, while the local share declined to 44 percent (with federal funding contributing roughly 6 percent). The pattern changed during the late-1980s and early-1990s, when the state share declined slightly and the local share increased. Since that time, the state/local shares have fluctuated somewhat, with the state regaining the primary role and local revenues assuming a slightly smaller role. Throughout the most recent period, the federal share showed consistent annual growth in response to the passage and implementation of the No Child Left Behind Act of 2001.[2]

In 2008 (the latest nationwide data available), public elementary and secondary school districts throughout the United States spent $506.8 billion for current operations and $68.7 billion for capital purposes (capital outlay and debt financing). Of the total revenue used to finance education outlays (operations and capital), the states accounted for 48 percent, local school districts 44 percent, and the federal government 8 percent.[3] There was some variation among the states in terms of relative shares; however, generally, states are responsible for nearly half of all school revenues. Although local sources account for substantial amounts, in many cases, the states largely control these resources through limitations placed on the type(s) and amount of local taxes available to finance schools. State financing control of K-12 public education, whether by direct or indirect means, is a modern reality in the United States.

Models of Unrestricted State Aid

States primarily distribute state-raised revenues to school districts, with minor amounts being directly allocated to individual schools, teachers, or other entities. States employ a number of methods to allocate revenues to individual districts and in many cases, state school-aid systems consist of multiple components designed to serve different purposes. Depending on the state, local districts can receive state support through a mix of different programs, creating a complex system of intergovernmental revenue sharing. Each program can have its own unique funding source, eligibility criteria, and allocation method.

Today, there are two primary methods to distribute state aid: general (block) grants and categorical grants. General grants are provided to local districts with few strings attached, allowing districts to allocate funds as they see fit. These funds are usually used to support school districts' general operations. With categorical grants, the state specifies how the funds it distributes are to be used. While some states distribute a large portion of state aid on

a categorical basis (because state aid plays a relatively minor role compared to the role played by local revenue sources), Michigan relies heavily on the concept of general assistance. In state FY2011 nearly 90 percent of the total state-source School Aid Fund revenue is distributed to local districts through the foundation program. The balance of state school funding allocated through the state School Aid Fund budget, and all federal funding, is distributed as categorical grants to districts.

States use three models to distribute unrestricted resources to local school districts: flat grants, full state funding, and equalization programs. These broad categorizations can be further refined into subcategories, which can hide considerable variation among the states. The diversity observed among individual financing systems results from the various economic, cultural, political, and demographic differences among states and the fact that these public financing systems are not developed, and do not operate, in a vacuum. Instead, each state's unique system is very sensitive to these factors, both at inception and throughout the life of the system. Each system has its own set of advantages and disadvantages.

As the name implies, a *flat grant* system provides all school districts in a state with a fixed amount of state aid per pupil. This is one of the oldest forms of state aid; however, its use today is limited to a few states. In such a scheme, the state determines the resources for distribution and makes a simple calculation dividing the resources by the number of pupils to arrive at an equal per-pupil grant. This straightforward mathematical calculation does not take into account local revenue or unique needs of the students in each district.

By design, a flat grant system does not seek to equalize the property wealth disparities that exist across districts. These wealth disparities, when paired with the property tax as the major revenue source for schools, result in per-pupil property tax revenue disparities among districts, which, in turn, contribute to spending disparities. Under a flat grant system, a district with a high property tax base per pupil or high tax effort would receive the same per-pupil grant from the state as a low wealth or low effort district.

In state Fiscal Year 2011 nearly 90 percent of the total state-source School Aid Fund revenue is distributed to local districts through the foundation program. The balance of state school funding allocated through the State School Aid Fund budget annually, and all federal funding, is distributed as categorical grants to districts.

Hawaii is the only state that operates a true *full state funding system*. The premise of such a system is that education is a state responsibility and funding should completely fall to this level of government. Technically, because there is only a single school district in Hawaii, there is no state aid distribution formula. Other states are divided geographically into multiple, distinct local school districts, thereby necessitating use of a formula. Because of its single school district, full funding responsibility falls to the state level in Hawaii and there is no need to equalize the amount of funding generated at the individual school district level.

The third broad category of state aid programs, *equalization programs*, is the most widely used in the United States. (See **Objectives of Fiscal Equalization** on page 5.) These programs are characterized by an effort to equalize per-pupil revenue disparities between high property- wealth districts and low property-wealth districts. Equalization occurs through two distinct methods of distributing state aid or some combination of the two: *foundation programs* and *power equalizing programs.* While equalizing property wealth disparities across districts is a key objective of each program, these programs can be designed to pursue other goals, such as providing every student with revenue sufficient to provide an adequate education based on a fairly specific definition of the term "adequate".

Objectives of Fiscal Equalization

While there have been many changes in the fiscal relationship between state government and local schools over the years, local property taxes have always played a role in education finances. Faced with few other options to generate sufficient revenues locally to satisfy their portion of the total, schools historically relied upon the property tax as the major own-source revenue. Other minor local-source revenues help finance school operations to varying degrees, but at much lower levels. The property tax has served as the primary funding source for all types of local governments, including schools, in the United States for years.

Heavy reliance on the property tax as the primary funding mechanism for schools has disadvantages because individuals will sort themselves by income (reflected in property wealth), resulting in communities that are segregated by property wealth. Such stratification can be stark at the extremes, resulting in very wealthy neighborhoods and very poor neighborhoods. Under such a scenario, property taxes levied at uniform rates across vastly different tax bases will generate major revenue disparities at the per-pupil level and result in inequities in service provision among school districts.

The school funding systems in some states that generate substantial funding disparities have been challenged in state courts and declared unconstitutional based on equal protection language contained those states' constitutions. The first such case arose in California in 1971.[a]

Legal challenges and the threat of such challenges have resulted in state governments playing a larger role in education finances since the early 1970s. A primary objective of changes to state aid programs over the last 40 years has been to temper, or equalize, the inequities that develop from a system of heavy property tax reliance. This is commonly referred to as wealth neutrality.

In addition to the primary goal of wealth neutrality, school finance equalization has other objectives.

- A common goal is to achieve greater taxpayer equity, defined as the equal treatment of taxpayers. Equity is achieved when state school aid programs provide equal per-pupil revenue amounts to local school districts with the same property tax rates, but with much different property wealth. Taxpayer equity does not require districts to choose a specific tax rate and does not guarantee equal per-pupil revenues, but it does treat taxpayers equally.
- Equalization also can seek to provide a certain level of education (defined by a specific per-pupil revenue amount) in each school district. Equalization in this manner will consider the jurisdictional differences in the costs of providing services to the student population and the school finance system will be structured to provide the resources to accommodate the specific education level (e.g., what might be termed adequate or reasonable).
- Another goal of equalization can be absolute equity – the same level of education to all students in a state. If costs of education are uniform across districts, this goal can be achieved by ensuring equal per-pupil revenue in all districts throughout a state. However, because the costs of educating children can vary considerably based on student characteristics, local labor markets and other relevant factors, absolute equalization may require that some districts receive more state aid than others to ensure that all students receive the same education.[b]

Regardless of the ultimate goal, equalization is accomplished through weakening the relationship between district property wealth and per-pupil resources available at the individual district level. This is achieved through state aid systems financed by state taxation. These systems achieve equalization by providing proportionately more assistance to lower-wealth districts than they provide to wealthier districts. Systems also can be designed to constrain the revenue-raising ability of wealthier districts.

If wealth neutrality is the ultimate public policy goal, this can be achieved by way of full state funding of public education (Hawaii example). Under such a model, perfect equality in per-pupil spending can be achieved by completely removing the fiscal capacity of local districts from the school finance system. The need for state aid to equalize local fiscal capacity is negated when the state assumes the entire responsibility for funding education. The disadvantage of such a financing model is that it is inefficient because it eliminates any local discretion over the educational services (in the form of per-pupil spending) provided in each local community based on the community's preferences. Under systems in which absolute equality exists in per-pupil spending, some taxpayers will have to consume more educational services than they desire, while others will consume less than their preferred level.

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[a] *Serrano v. Priest* (5 Cal.3d 584; 1971)

[b] Andrew Reschovsky, *Fiscal Equalization and School Finance*, National Tax Journal, March 1994.

Foundation Programs

Most states tend to favor the foundation program approach as the primary method for distributing state aid. In 2007, 42 states and the District of Columbia used some form of foundation program as the basis of their school funding system.[4] In its simplest form, the program sets a target amount of resources per unit (teacher, classroom, or pupil) and a required local property tax rate. Foundation programs effectively set a revenue floor for each school district. State aid is then distributed to local districts to fund the difference between the state-determined target and the revenue that the state-required local property tax generates. As a result, state aid amounts vary from district to district based on each district's target and the property wealth of the individual community. In this sense, state aid equalizes revenue because it is both sensitive to the educational needs of individual districts and to variations in property wealth. At this point, the similarities in states' foundation programs cease.

Michigan does not address differences across pupils and districts through its foundation program, but instead it uses categorical grants in an attempt to meet such differences.

Foundation programs across the United States vary in terms of the specifics of the different programs. First, states differ on how they set the main feature of the foundation program, the revenue target. This might be an amount determined by the state to represent an adequate education or it might be based on a particular rationale (e.g., pupil-teacher ratio and salaries, actual spending by school districts, or past spending by districts). States generally express the foundation target as an amount per pupil. States can vary in how they count pupils. For example, Michigan uses a blended count based on the current year's fall student enrollment figure (75 percent) and the previous year's February enrollment figure (25 percent). Other states employ multi-year averaging and different weightings for certain students to arrive at enrollment counts used in their foundation programs.

A second difference among the states has to do with adjustments applied to the foundation target to ensure that districts with greater need receive a larger foundation grant. States vary in the different factors used and the weights applied to each. Different weights are based on the costs associated with certain pupils, services, or district characteristics. Michigan does not address differences across pupils and districts through its foundation program, but instead it uses categorical grants in an attempt to meet such differences.

Third, states measure local fiscal capacity differently in order to equalize state aid under their foundation programs. Because the primary local revenue source is the property tax, per-pupil assessed property value is the metric that generally describes fiscal capacity. While there is some consistency in the revenue source, the structure of the property tax (e.g., different assessment methods, exemptions, rates, credits, etc.) in individual states differs. In addition to property wealth, some states use income as a measure of local fiscal capacity.[5] Michigan school districts do not have access to local income taxes to finance K-12 education, but Ohio uses a local income tax to partially support school districts.

States also differ in the degree to which they make local-option taxes available to their local school districts. In some cases, individual districts are allowed to levy additional taxes to augment resources received through the foundation grant. Most often, some kind of cap is associated with the ability to supplement the foundation grant with locally-raised revenues. Michigan's finance system provides two local-option property taxes, but only one is available to all districts. One option is the hold harmless tax that only allows districts with per-pupil revenue above $6,500 in FY1995 to levy supplemental taxes to maintain their previous spending levels. The second option, open to all districts, involves a regional property tax. At the request of one or more of its constituent districts and after approval by the electors in the intermediate school district, an intermediate school district can levy an additional property tax up to three mills, the proceeds of which are shared, on a per-pupil basis, with each constituent district to augment the revenues received via the foundation grant. Few intermediate districts levy the tax because it requires tax base sharing among the participating districts.

A less common feature associated with local-option taxes is a recapture provision that requires some or all of the supplemental local revenue to be returned to the state for distribution among other districts. In some states, recapture provisions are part of the base foundation program. In these cases, districts that are able to satisfy their foundation targets with a local tax effort below the minimum level are still required to levy, at the full rate, the state-required minimum tax; however, they are not able to retain the resources for use at the local level. Instead, the excess local resources (above the target) are shared with the state and distributed to other districts. Michigan's foundation program does not contain a recapture component. In Michigan, to qualify for the full foundation amount the minimum required tax effort is the lesser of 18 non-homestead mills or the millage levied by the district in 1993 and in some districts.

Power Equalization Programs

In contrast to a foundation program that sets a minimum revenue target, a *power equalization program* guarantees that each district will have the ability to generate the same revenue per pupil from a given tax rate, regardless of the districts property wealth. A primary goal of these programs is wealth neutrality, whereby the goal of the state aid is to level the playing field between low-wealth and high-wealth districts by guaranteeing an equal tax base. The state does not require a specific tax rate, but instead each district sets its own rate. The state guarantees a certain amount of revenue (combined state and local) per mill levied. Districts determine the amount of per-pupil revenue they will have, based on the tax rate their voting constituency chooses and given the adjusted tax base. Local control and taxpayer equity are key goals of power equalization programs.

State aid is provided to subsidize locally generated revenue by way of a formula that takes into account local tax effort. In most cases, the state determines a guaranteed yield for each mill levied locally (up to a maximum tax rate) based on a statewide average of property wealth per pupil. State aid payments are made in an amount equal to the difference between the guaranteed yield and the actual yield in the individual district. As such, power equalization programs use variable matching rates to provide larger matches to districts with lower per-pupil property wealth.

Brief History of Michigan's Equalization Programs

Michigan's long history of providing state aid to local school districts began in the early years of statehood. For a good portion of its history, the state government provided aid to equalize local property wealth across districts. The unevenness in property wealth across the state led to unevenness in per-pupil revenues available to educate K-12 students. Greater amounts of state aid were provided to those districts with lower property wealth to help address these per-pupil revenue disparities.

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Since 1970, Michigan has employed both major forms of equalization systems for distributing state aid to local school districts. Michigan has gone from the foundation model (used until the early 1970s) to the power equalization model (used from the mid-1970s to the mid-1990s) and back to a foundation model (in use since 1995). Changes from one method to the other have been accompanied by statutory and constitutional changes. In some cases, court decisions prompted school finance system changes. At other times, changes resulted from political pressure applied to state policymakers.

Prior to the 1973-1974 school year (state FY1974) state aid was distributed to local districts by means of a conventional deductible millage formula, a type of foundation model.[6] This system provided each district with a specific foundation grant if local voters approved a school operating property tax rate no less than the deductible rate.[7] Under this system, the state and local districts shared in financing education up to a given amount, with local taxpayers paying the entire cost beyond this amount. The

required rate was very low and for districts choosing to exceed the rate, final per-pupil revenue was largely determined by local property wealth, regardless of the tax effort. Under this system, state aid did not do a sufficient job of equalizing per-pupil property wealth disparities, and in 1972 the Michigan Supreme Court found the system in violation of the 1963 Constitution's equal protection clause (Article I, Section 2).[8]

Prompted by the Michigan Supreme Court's initial decision in *Governor v. State Treasurer* (1972), the legislature enacted a new school aid formula, based on the power equalization concept.[9] The new guaranteed tax base (GTB) formula marked a shift away from the foundation model for property wealth equalization purposes. During its lifespan, the GTB formula had varied success in achieving its primary goal of neutralizing property wealth across districts.[10]

Initial progress in addressing property wealth disparities through the GTB formula was aided by a strong state economy and robust state revenue collections from FY1974 to FY1979. This period was followed by a period of rapid decline in the property wealth equalization gains made earlier. Efforts to further equalize per-pupil expenditures under the GTB formula stalled and reversed course during the early 1980s because of the weak economy and slowdown in state revenue growth. The efficacy of the GTB formula and state aid payments were seriously restricted by the severe recession in the early 1980s and escalating property assessments. Coming out of the economic downturn in the mid-1980s and despite a slow recovery, gains in wealth neutrality were achieved with the help of additional state revenues resulting from a temporary state income tax increase and state budget decisions to increase funding for K-12 education.

The Proposal A school finance reforms had a number of objectives, one of which involved switching the method used to distribute general state aid to local districts. At its core, this change shifted the basis upon which the state distributed unrestricted operating dollars to local districts from the property tax rate to the number of pupils in each school district.

Although components of the power equalization formula were tinkered with over the years, the GTB formula was the primary method used by the state to distribute general assistance to local districts for 21 years, from FY1974 through FY1994. Major political pressure to do something about per-pupil resource disparities and the tax burden associated with public education finances in the early 1990s ultimately led to abandonment of the GTB formula. A shift back to a foundation program for distributing state aid and equalizing local property wealth in public education finances was a key component of Proposal A of 1994 and related school finance reforms.

The Proposal A school finance reforms had a number of objectives, one of which involved switching the method used to distribute general state aid to local districts. At its core, this change shifted the basis upon which the state distributed unrestricted operating dollars to local districts from the property tax rate to the number of pupils in each school district. The GTB formula was replaced with a per-pupil foundation formula that more heavily relied on state taxes to finance school operations. Michigan first used the current foundation grant in FY1995. While this has been the primary mechanism used for the past 16 years, the intricacies of the foundation program have changed over time.

Michigan's Foundation Grant

Michigan's 775-plus school districts (traditional public schools and charter schools) receive the majority of their operating revenue through a formula allocation generally referred to as the foundation grant.[11] Revenues school districts receive through the foundation grant can be used for general operating purposes, such as paying salaries and benefits of school employees, utility bills, and purchasing classroom supplies, to name a few items. These resources are fundamentally different from those received via categorical programs, also appropriated through the state School Aid Fund budget, which include restrictions on their uses (e.g., special education, at-risk student funding, district-specific grants). As general operating revenue, the foundation grant is not used to support debt service costs. Instead, traditional public school districts may levy a separate property tax, subject to voter approval, to finance debt costs.

Foundation grants are based on a complex set of formulas and are commonly reported on a per-pupil basis. There is a common misperception, perhaps because of the term "foundation", that all school districts receive the same amount. The reality is that foundation grants vary in size across school districts in the state, which has been the case since the implementation of the foundation program. Through direct efforts of state policymakers over the years, the difference between the highest foundation grant and the lowest foundation grant has been reduced sub-

Proposal A: What Are We Talking About Here?

On December 24, 1993 the legislature adopted a complex plan to restructure the funding of public K-12 education. The plan consisted of a ballot proposal to amend the 1963 Constitution, together with implementing legislation, and an alternative statutory plan which would take effect if the ballot proposal was rejected. Voters cast a single vote to choose between two similar reforms, neither of which involved a continuation of the current education finance system. The ballot proposal (designated as Proposal A by state election officials) was submitted to voters at a special election on March 15, 1994, amending several constitutional provisions:

- Permit school operating taxes to be imposed on a non-uniform basis.
- Limit assessment increases on individual parcels of existing property to the lesser of five percent or inflation beginning in 1995. Property would be reassessed at 50 percent of true cash value upon transfer in ownership.
- Increase the sales tax rate from 4 to 6 percent, beginning May 1, 1994. The additional revenue from the sales tax would be dedicated to the School Aid Fund.
- Require that the state guarantee each local school district in FY1996 and thereafter at least as much combined state and local operating revenue per pupil as in FY1995.
- Require a three-fourths vote of the legislature to increase school operating taxes beyond those in effect February 1, 1994.

The major difference between the two approaches was that Proposal A and its implementing legislation relied primarily on a sales tax increase, while the statutory alternative plan relied primarily on increases in the individual income tax and the Single Business Tax. The proposed sales tax increase required voter approval because the rate is limited in the state Constitution, while the legislature was authorized to increase the income tax and the Single Business Tax rates statutorily.

The term "Proposal A" and references to it can lead to confusion because of the different ways in which the term is employed. In a strictly historical context, Proposal A refers to the March 1994 statewide ballot proposal to amend the 1963 Constitution to implement certain components of the new K-12 education finance system. For the purposes of this report, the term "Proposal A" is used more generically to describe the entire education financing system created as a result of both the constitutional amendment and the related statutory changes. The term also is synonymous with the period 1993 - 1994.

stantially; however, absolute equity (i.e., same per-pupil revenue for all children) has not been achieved.

While the foundation grants create most of the per-pupil revenue disparities among school districts today, they are not the only factor creating variation. Schools also receive varying amounts of state categorical aid according to specific state and federal rules and guidelines. Both state and federal resources support categorical funding that account for the per-pupil revenue differences even among districts with exactly the same foundation grants. In most cases, this targeted aid is based on district-specific criteria (e.g., declining enrollments) and student-specific criteria (e.g., special education, at-risk). In very rare cases, school districts also receive discretionary local enhancement revenue that is derived from a local property tax levied on a regional basis. Thus, a host of factors can explain why two districts with the same foundation grant have different *total* per-pupil revenue amounts. The scope of this report is limited to the primary operating resource for schools – the per-pupil foundation grant.

The most influential factor in determining a district's initial foundation grant was the amount of per-pupil revenues it received just prior to the implementation of the foundation grant, the total (state and local) per-pupil revenue each district received in FY1994.

History of the Foundation Grant

Michigan returned to a foundation grant program to distribute resources to school districts as a result of statutory and constitutional changes approved in late 1993 and early 1994. Proposal A of 1994 amended Article IX, Section 11 of the 1963 Michigan Constitution by establishing the constitutionally-required, per-pupil revenue floor. Specifically, Section 11 provides:

> Beginning in the 1995-96 state fiscal year and each state fiscal year after 1995-96, the state shall guarantee that the total state and local per pupil revenue for school operating purposes for each local school district shall not be less than the 1994-95 total state and local per pupil revenue for school operation purposes for that local school district, as adjusted for consolidations, annexations, or other boundary changes.

In addition to setting this minimum level, the new constitutional language and the related implementing statutory law addressed other policy objectives central to school finance reform.

The Per-Pupil Funding Floor

This new section in the Constitution was not self-implementing. The legislature was required to take steps to effect the initial per-pupil funding floor for each district. Mathematically, the language required the legislature to come up with each district's combined (state and local) operating revenue for FY1995. Related to this, but not required by the constitutional language, the legislature had to articulate a policy of how it was going to approach the revenue inequities that existed at the time of Proposal A's adoption.

The most influential factor in determining a district's initial foundation grant was the amount of per-pupil revenues it received just prior to the implementation of the foundation grant; the total (state and local) per-pupil revenue each district received in FY1994.[12] The per-pupil revenue in FY1994 reflected the property wealth disparities that existed at the time and the distribution of state aid through the GTB formula. This formula directly relied upon a district's property wealth and tax effort to determine the amount of state aid.[13] To address some of these existing disparities within the constructs of the new financing system, a series of adjustments were applied to the FY1994 per-pupil revenue numbers based on explicit policy directives contained in state law.[14]

Initial Policy Considerations and Objectives

A key policy directive of the school finance reforms related to reducing per-pupil revenue disparities most effectively. Funding at the average was seen as an unacceptable proposal for a variety of reasons. Use of an average per-pupil revenue figure to achieve equity would cause a reduction in the amount of

revenue received for a significant number of students in the state. Parents in these high-revenue districts were unwilling to accept reductions for their children and the education community would not tolerate the staff and budget reductions necessary to balance a school budget based on reduced revenues. Thus, leveling down was not considered politically feasible. A more acceptable approach involved raising the revenue provided to districts at the bottom of the per-pupil revenue spectrum by increasing revenues to these districts by the greatest amounts.

Pursuing a policy of "raising the floor" required a series of decisions. The initial decision involved creating a system to bring the lowest revenue districts up to some minimum level. It was decided that all districts would receive at least $4,200 in total per-pupil revenue in FY1995, effectively setting this amount as the new constitutional funding floor. To effect this change, all districts below $4,200 were raised to this amount or received a $250 per-pupil increase, whichever was greater.[15] This policy affected the 105 lowest revenue districts.

Another policy directive involved setting a target of $5,000 per pupil in FY1995, commonly called the "basic grant." This was the amount of revenue that policymakers hoped all districts would eventually receive. In a related policy decision, the legislature chose to move districts toward this amount in phases rather than a single adjustment. The decision to use a phased-in approach was largely related to cost considerations and the limited ability of state resources to get all districts to the basic grant with a single annual adjustment. To move districts toward the basic grant amount, a sliding scale was employed. This mechanism provided larger increases to grants closer to the minimum amount than grants closer to the basic amount.

Another objective involved setting a maximum per-pupil amount which the state would guarantee under the new foundation program. Initially, this was set at $6,500 per pupil, $1,500 above the basic grant. the foundation grant for FY1995.

Despite its name, the maximum grant did not represent the highest per-pupil revenue amount under the foundation program because some districts were able to receive combined state and local revenue in excess of this amount in order to maintain their pre-Proposal A higher revenue amounts. Rather, the maximum grant represented the amount at which

All Foundation Grants Are Not the Same

Under the Proposal A reforms, the amount of each district's initial foundation grant (FY1995) was largely determined based on the amount of per-pupil revenue (combined state and local) a district received in FY1994. Using a calculated FY1994 base revenue amount for each district, state law provided adjustments of varying amounts to arrive at each district's initial foundation grant. Despite the variation among districts, there were three key categories created with the initial foundation grants; the minimum, the basic, and the maximum grants. These categories are commonly used to describe where districts are on the spectrum of foundation grants across the state. Furthermore, these amounts determine the annual adjustments made to each grant in terms of the method used and the amount. This report uses these three descriptions to show growth in the foundation grant since Proposal A's implementation.

The **minimum grant** was set at $4,200 per pupil in FY1995. This is the constitutional minimum grant that each district is guaranteed.

The **basic grant** was set at $5,000 per pupil in FY1995, $800 above the minimum grant. This was the initial "target" amount that the state wanted all districts to receive.

The **maximum grant** was set at $6,500 per pupil in FY1995, $1,500 above the basic grant and $2,300 above the maximum grant initially. This was the maximum amount that the state would participate in the foundation program, not the largest grant. Some districts, with the assistance of additional locally-raised revenue, were able to maintain their higher pre-Proposal A per-pupil revenue amount.

Table 1
School Districts by Per-Pupil Revenue Group: FY1994 and FY1995

Per-Pupil Revenue	Number of Districts FY1994	FY1995	Change
less than $4,200	105	0	-105
at $4,200	0	40	40
$4,200 to $5,000	256	266	10
$5,001 to $6,499	144	194	50
$6,500 and above	46	51	5

* Only districts in operation in both years are included in the comparison.

Source: Michigan Department of Education

the state would participate in funding a district's foundation grant. Districts above $6,500 per pupil were required to raise the difference entirely from a separate millage, called a hold harmless tax that was subject to voter approval.

Finally, a hold harmless provision was included to safeguard districts from having to reduce funding to achieve the stated goal of equalizing per-pupil revenues. Thus, the state participated in the foundation program for those districts up to $6,500 in total state and local revenue for FY1995. Anything above that amount, local districts were required to fund entirely from the hold harmless tax. For example, a district with total per-pupil revenue of $8,000 in FY1995 had to raise the additional $1,500 ($8,000 foundation grant minus $6,500 state maximum grant) from a supplemental local property tax, above the required 18 mill non-homestead tax. The hold harmless millage is levied on homestead property before being levied against the non-homestead tax base.[16]

The initial effects of funding equalization efforts are seen in the lowest-revenue districts being raised to at least the minimum per-pupil amount in FY1995.

Table 1 summarizes the initial effects of the early policy changes affecting per-pupil funding of districts in FY1994 and FY1995. The initial effects of funding equalization efforts are seen in the lowest-revenue districts being raised to at least the minimum per-pupil amount in FY1995. These districts received the largest annual increases, in both dollar and percentage terms. Forty of these districts, previously below the $4,200 per-pupil level, were raised to the minimum grant level in FY1995, while the remainder received increases that caused their per-pupil grant to exceed the new minimum.

Foundation Grant Components

For nearly all school districts, the per-pupil foundation grant consists of two components: a local revenue piece and a state revenue piece.[17] A small number of districts (29 in FY2010), commonly referred to as "out of formula," are able to fully finance their foundation grants from the local property tax component and subsequently do not receive a state aid payment related to their foundation grant. The local revenue component of the foundation grant comes from the local school operating property tax levied on non-homestead property, which is 18 mills for most districts.[18] For hold harmless districts, the revenues from the non-homestead school operating tax are supplemented by the revenues from the hold harmless tax. The proceeds of the non-homestead property tax (and hold harmless tax) are dedicated to local school operating purposes and these dollars are the first resources applied to each district's per-pupil foundation grant. While local tax effort is not technically required to receive state aid, the State of Michigan assumes that the local districts are levying

Illustration 1
Foundation Grant Calculation

Hypothetical district foundation grant:	$7,300
Non-homestead value of property in school district (taxable value)*:	$250,000,000
Non-homestead school operating property tax rate*:	18 mills
Pupil membership used for foundation program:	3,000

Local Component:

(Taxable value (school district) * Rate) / Membership = Local amount

($250,000,000 * 0.018) / 3,000 = $1,500 per pupil

State Component:

Foundation grant – Local component = State component

$7,300 – $1,500 = $5,800 per pupil

* Under state law changes enacted in 2007, industrial personal property is entirely exempt from the 18-mill school operating tax and commercial personal property is exempt from 12 of the 18 mills.

the local tax at the maximum rate allowed and adjusts the amount of state aid accordingly. **Illustration 1** provides a general mathematical description of each component of the foundation grant for a hypothetical school district, based on an assumed foundation grant amount.

The second component of each district's foundation grant is state aid, which is the difference between the district's foundation grant and the local per-pupil revenue generated by the 18-mill non-homestead tax levy. The total amount of general state assistance a district receives each year is calculated by a relatively straightforward mathematical operation. After determining each district's per-pupil state aid payment, this figure is multiplied by the number of students in the district. Since its inception, the foundation program has used a blended count of the number of students that takes into account the actual pupil enrollment figures of the current school year and the previous school year. This count is referred to as "pupil membership."

A district that has had a Headlee rollback will not receive the full amount of the local component of its foundation grant.

State aid payments are made monthly, 11 times throughout the state fiscal year with the first payment in October and no payment in September. The final two payments (July and August) are made after school districts end their fiscal years on June 30. Revenues from the 18-mill non-homestead tax are received by districts when distributed by their local taxing jurisdiction (city or township), usually in February and September.

The local component of the foundation grant can be altered with changes in the tax rate and the tax base of the 18-mill local tax. Because the 18-mill tax is subject to Headlee millage rate rollbacks required by the Michigan Constitution (Article IX, Section 31), a rate reduction will reduce the tax yield, all else being equal.[19] As a result of previous Headlee rollbacks, a number of districts each year do not levy the full 18 mills. A district that has had a Headlee rollback will not receive the full amount of the local component of its foundation grant. A shortfall in the local component is not compensated for by an increase in the state component as state law assumes that all districts levy the entire 18 mills. Thus, if a Headlee rollback is in effect, a school district will receive less than the full amount of its per-pupil foundation grant.

Is the Non-Homestead School Operating Tax Really a Local Tax?

The non-homestead school operating tax is a local tax; however, the revenues from the tax are effectively state revenues for purposes of the per-pupil foundation grant distributed to local districts. The tax is levied by local school districts and retained by districts to be applied toward their foundation grants. Furthermore, the proceeds from the tax are not applied against the constitutional state government revenue limit (Article IX, Section 26 of the 1963 Constitution). While technically a local tax, the revenues from the tax are effectively state revenues when it comes to school operating revenues because of the state limitations on rate and tax base growth (constitutional and statutory) and how it operates as a component of the foundation grant.

State law strictly controls the rate and base of this tax. The maximum rate allowed is capped at the lesser of 18 mills or the district's 1993 operating levy. Furthermore, the tax, like all local property taxes, is subject to the various property tax limitations of the Michigan Constitution. Local school operating tax revenue growth is effectively controlled by both the unit-wide revenue limitation contained in Article IX, Section 31 (part of the Headlee Amendment to the Michigan Constitution approved in 1978) as well as the per-parcel limitation contained in Article IX, Section 3 (approved as part of Proposal A of 1994).

While a school district had a vested interest in the growth of its property tax base prior to Proposal A, in the current foundation grant system, the 18-mill tax and the various state levied taxes dedicated to the School Aid Fund all contribute equally to calculations of the amount of revenue available for distribution for school operations. The performance of the local property tax is immaterial when it comes to determining per-pupil operating revenues for individual school districts because state aid from the other sources (6-mill State Education Tax, Sales and Use Tax, and tobacco taxes) will be used to make up the difference between what the local tax generates and what the Michigan legislature sets as each district's foundation grant. Thus, while the 18-mill tax is a local tax for purposes of constitutional property tax limitations and state revenue limitations, the revenues it generates are practically indistinguishable from the various state tax revenues used to provide state aid to local districts through the foundation program.

Holding all other factors constant in the foundation grant calculation (e.g., membership, millage rate, foundation target), changes in the local tax base will alter the yield of the 18-mill tax. However, unlike the levy reduction that results from a Headlee roll-back, the per-pupil foundation grant is not negatively affected. Under such a scenario, the amount of state aid is adjusted to compensate for changes in the local school operating property tax yield. Thus, on an annual basis and assuming all else equal, the amount of state revenue provided to each district changes with changes in the local property tax base – a base increase reduces state aid while a base reduction increases state aid.

Annual Adjustments to the Foundation Grant: Mechanisms and Growth

Various methods have been employed to increase the foundation grants of school districts each year, including the use of:

- The automatic foundation index to adjust the basic grant;
- The 2X formula sliding scale used for districts below the basic grant;
- Equal per-pupil adjustments for all districts;
- Separate equity payments; and
- Categorical payments for hold harmless districts.

The use of these methods has varied by year and, depending on the method employed, affected districts differently based on the amount of their foundation grant at the time of adjustment.

Foundation Index and the 2X Formula

The school finance reforms that accompanied the adoption of the foundation grant included statutory changes that were designed to adjust the foundation grant for each district annually. Initially, annual increases varied based on whether the district was receiving the minimum grant, the basic grant, or the maximum grant. Despite the different grant amounts established at the outset of the foundation program, future annual adjustments for each district were directly tied to changes made to the basic grant. Thus, the basic grant, and changes made to it, became the primary mechanism for determining the annual changes to each district's per-pupil funding.

The State School Aid Act includes a formula to determine annual changes to the lowest grant based on annual changes to resources in the School Aid Fund and annual statewide enrollment changes. This foundation index, which took effect in FY1996, is a product of two ratios, a revenue adjustment factor and a pupil membership adjustment factor. State law requires that the index will be calculated at each state revenue estimating conference (January and May) in order to "assist the legislature in determining the basic foundation allowance for the subsequent state fiscal year." (Note: State law does not require the index to be used to adjust the basic grant, but it must be calculated twice a year.) **Illustration 2** describes the calculation of these two ratios and their product, the foundation index.

> The revenue ratio is structured such that year-over-year increases in state dedicated revenues translate into a higher index value and therefore an increase in the basic grant.

The revenue ratio is structured such that year-over-year increases in state dedicated revenues translate into a higher index value and therefore an increase in the basic grant. Conversely, a decline in revenues will produce a reduction in the basic grant. The revenue factor, however, is combined with the enrollment factor to calculate an index value which may be used to adjust the foundation grant each year. The enrollment ratio is designed to temper revenue increases when statewide enrollments are rising. In other words, the enrollment factor recognizes that with increasing enrollments (and rising revenues), the per-pupil grant cannot rise as much because there are more pupils participating in the foundation program.

Illustration 2
Calculation of Foundation Index

Revenue Adjustment Ratio:

$$\frac{\text{(Next year School Aid Fund revenue + Current year School Aid Fund revenue)}}{\text{(Current year School Aid Fund revenue + Previous year School Aid Fund revenue)}} = \text{Revenue adjustment factor}$$

Pupil Membership Adjustment Ratio:

$$\frac{\text{Current year statewide pupil membership}}{\text{Next year statewide pupil membership}} = \text{Pupil membership adjustment factor}$$

Revenue adjustment factor * Pupil membership adjustment factor = Foundation index

Increase in Lowest Foundation Grant:

Current year's lowest foundation grant * Foundation index = Next year's lowest grant

Note: Section 20 of The State School Aid Act of 1979, as amended, describes the calculation of the two ratios and the index.

Section 20j of the State School Aid Act: A Budgetary Solution to a Statutory Problem

Hold harmless districts received annual per-pupil revenue increases equal to the basic foundation grant increase each year through FY1999. For FY2000, state policymakers decided to increase the basic grant by $238 per pupil. However, providing this dollar increase to the foundation grants of hold harmless districts triggered the inflationary growth cap contained in the Revised School Code (described above). Therefore, the cap resulted in these districts receiving only an inflationary increase in their foundation grant in FY2000.[a] The dollar increase each district received from this inflationary adjustment was different because it was based on each district's FY1999 foundation grant. The inflationary increase did not apply to the basic foundation grant from the previous year, which would have resulted in each district receiving the same annual increase. As a result, the inflationary increase was less than the $238 per-pupil bump provided to the basic foundation grant (see **Table 2**). In some cases (e.g., the bottom five districts in the group), the inflationary increase was less than one-half of the increase provided to the basic grant.

In keeping with prior policy, the state desired to ensure that all districts received at least the same per-pupil dollar increase that the basic foundation grant received in FY2000. Rather than amend the Revised School Code to address the challenge posed by the inflationary cap, the state chose to provide a supplemental payment to hold harmless districts via the state budget. If the state had decided to amend the section of the Revised School Code to deal with the inflationary cap to allow districts to increase hold harmless millage rates, it would have required an affirmative vote from three-fourths of the members in each house of the legislature pursuant to Article IX, Section 3 of the Michigan Constitution.[b] Instead of a statutory fix, the state chose a budgetary fix to address the inflationary cap, which required a simple majority vote.

The supplemental payment was effectively a new categorical grant contained in the School Aid Fund budget (Section 20j) for FY2000. Under this budgetary solution, each district's supplemental payment was equal to the difference between the $238 basic foundation grant increase and the amount of the inflationary increase allowed under the Revised School Code. Technically, the Section 20j payment is not part of a district's foundation

Table 2
Select Hold Harmless Districts FY2000 Per-Pupil Increases

Districts	FY1999 Foundation Grant	Statutory Per-Pupil Increase*	Sec. 20j Per-Pupil Payment	FY2000 Per-Pupil Increase
Top 5 Hold Harmless Districts				
Bloomfield Hills	$10,916	$174	$64	$238
Birmingham City	$10,839	$173	$65	$238
Jefferson Schools	$10,121	$162	$76	$238
Southfield	$9,920	$159	$79	$238
Oneida Twp.	$9,643	$155	$83	$238
Bottom 5 Hold Harmless Districts				
East Lansing	$7,094	$113	$125	$238
Livonia	$7,066	$113	$125	$238
Clarenceville	$7,036	$113	$125	$238
Northville	$7,011	$113	$125	$238
City of Harper Woods	$6,946	$112	$126	$238

* Statutory increase (inflationary) allowed under The Revised School Code. For FY2000 the inflation adjustment was equal to 1.6 percent.

Source: Michigan Department of Education

Section 20j of the State School Aid Act (continued)

grant; however, these dollars are indistinguishable to schools in terms of general operating revenues.

Because of the mechanics of the inflationary cap, hold harmless districts with foundation grants closer to the maximum received smaller per-pupil increases in dollar terms (i.e., their base was lower). These districts received larger supplemental payments from the state to ensure they received the full $238 per-pupil increase in FY2000. A district's total Section 20j amount under the State School Aid Act was based on its general pupil membership count and the amount of the state supplemental payment.

The basic foundation grant increase in FY2001 ($300) and FY2002 ($300) exceeded the inflationary cap for a number of the hold harmless districts. In each year the state again authorized another budgetary patch, effectively adjusting the previous years' Section 20j payment amount as part of the State School Aid Act. Section 20j appropriations were necessary every year to maintain the per-pupil revenues in these districts even though the per-pupil foundation grant increases in the years since FY2002 did not trigger the inflationary cap.

The state's decision to address the inflationary cap via the annual appropriations process rather than through a permanent amendment to the Revised School Code meant that this supplemental payment would be subject to annual legislative review and open to gubernatorial line item veto. Because of resource constraints, Governor Granholm vetoed the Section 20j payment contained in the FY2010 budget, effectively reducing 39 hold harmless districts' foundation grants.

The gubernatorial veto reduced the foundation grants of six school districts (Avondale, Clarenceville, East Lansing, Harper Woods, Livonia, and Northville) below the basic grant amount ($8,489) for FY2010. These districts received less per-pupil funding, despite the fact that they levy the additional hold harmless tax. To address the taxpayer equity issue with this situation, state law was changed in 2010 to prohibit these districts from levying the hold harmless tax effective with taxes collected in 2011 (FY2012). In effect, these districts will no longer be hold harmless districts. In lieu of the foregone local property tax, the State School Aid Act was amended to provide these districts with enough state aid so that their foundation grants will be equal to the basic grant for FY2012; however, the grants will0 be less than they were before the veto.

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[a] The inflationary increase for the year was 1.6 percent under the provisions of The Revised School Code.

[b] Section 3 was amended as part of Proposal A and required a supermajority vote to increase the statutory tax limits for school operating taxes (e.g. the hold harmless tax) in effect on February 1, 1994.

However, in an environment of falling enrollments (and rising revenue) the index value would rise slightly more than it would have if enrollments were rising.

Despite the calculation of the index coming out of the revenue estimating conference, in many years the legislature set the index to 1.0. This allowed the legislature to determine the amount of any basic foundation grant increase for the subsequent year, independent of the automatic index.

Once determined (either by the formula or by the legislature), state law requires that, at a minimum, the foundation index is applied to the current year's lowest foundation grant to determine next year's lowest grant amount. The automatic index mechanism was used each year through FY2000, with the exception of FY1999 (see box **FY1999 Foundation Grant Adjustments: *Durant* and MPSERS** on page 23).[20] For example, in its first year of use, the index yielded a value of 1.0306 or an increase of 3.06 percent (at least) to the lowest foundation grant in FY1996.

In addition to providing a method for increasing the basic grant, state law also prescribed annual adjustments for those districts below the basic grant amount, commonly referred to as the "2X formula." These districts received per-pupil annual increases greater than the annual increase in the basic grant. The objective was to gradually move these districts to the basic grant level over a period of years by providing larger annual increases to districts with revenues below the basic grant level. Through FY2000, the minimum grant level was increased by

twice the amount of the basic grant and districts between the two levels received varying amounts based on a sliding scale. For example, in FY1996, the basic grant was increased $153 per pupil (using the foundation index) and the minimum grant by twice the amount ($306 per pupil). Through the use of this sliding scale mechanism, the original policy goal of raising all districts to at least the basic foundation grant was achieved in FY2000.

Finally, the Revised School Code also addresses the treatment of annual increases for hold harmless districts by capping the maximum per-pupil increase allowed. These districts are eligible to receive the lesser of: 1) the increase in the basic grant, or 2) the prior year's foundation grant increased by the rate of inflation. If an increase in the basic grant exceeds inflation, a high-revenue district is required to reduce its hold harmless millage to provide only enough revenue to allow for an inflationary increase in its foundation grant from its prior year amount. Capping growth in the foundation grant at the rate of inflation was designed to complement the stated policy of "raising the bottom" in the effort to close the gap between low- and high-revenue districts.

Uniform Increases and Additional Equity Payments

After all districts were raised to at least the basic grant amount in FY2000, the 2X formula was abandoned. Beginning in FY2001, all districts began receiving the same dollar increase in their foundation grant based on the adjustment made to the basic foundation grant. As opposed to using the foundation index formula to determine annual adjustments, state policymakers determined the annual increases to the basic grant, after taking into account projections of state and local education revenues and enrollments. The decision to abandon the sliding scale effectively created a fixed dollar difference between the basic grant and the maximum grant – a $1,500 per-pupil spread. For each year that the same dollar increase was provided to all foundation grants, the original $1,500 per-pupil spread was maintained. These adjustments had a range-preserving effect, although, mathematically, the uniform annual increase resulted in a larger percentage increase for low-revenue districts compared to high-revenue districts. Despite the same absolute $1,500 per-pupil spread between grant amounts, the ratio of the maximum grant to the basic grant shrank and greater per-pupil equity was achieved.

> The equity payments had a range preserving effect on per-pupil funding disparities among the non-hold-harmless districts.

To further reduce per-pupil revenue disparities, the state adopted a policy of providing separate equity payments to lower-revenue districts. Unlike the sliding scale increases of the 2X formula which relied on a range of annual increases to foundation grants, the equity payment approach provided all districts below the maximum grant amount with the same dollar increase in their foundation grant. While this approach did reduce the spread between the lowest grant and maximum grant, it did nothing to reduce the per-pupil funding differences of districts below the maximum amount, but only the spread between the lowest and the maximum grant amounts.[21]

Per-pupil equity payments were made in FY2002, effectively raising the basic grant from $6,300 to $6,500 per pupil. In FY2007, districts below the maximum grant amount received another equity payment ($23 per pupil). The combined effect of these two equity payments was to reduce the spread between the basic and maximum grants by $223 per pupil, from $1,500 in FY2001 to $1,277 per pupil in FY2007.

Changes from FY1995 to FY2007

Changes to the foundation grant since FY1995 and through FY2010 are examined below, breaking the entire period into two sub-periods. The paper discusses changes from FY1995 to FY2007 first, followed by a examination of the changes from FY2008 to FY2010.

For the period FY1995 to FY2007, **Table 3** provides a history of the minimum, basic, and maximum grant amounts and annual changes for each. Annual changes in the amount of the minimum, basic, and maximum grants varied considerably over the entire period. The difference between the maximum and the minimum grants in each year shows that the gap, initially at $2,300 in FY1995, decreased to $1,277 by FY2007. The effects of using the sliding scale can be seen in the annual increments to the minimum grant in FY1996 through FY1998 and again in the changes for FY2000, when compared to the annual changes to the basic grant.

Examining the entire 13-year period, a sub-period of consistent and steady growth is seen from FY1995 through FY1998, followed by a year of no across-the-board increases. Only the minimum grant was increased in FY1999 as part of the state's response to the settlement in the *Durant* court case (see box on page 23). The period from FY2000 through FY2003 is characterized by substantial annual increases, with annual growth in the basic grant topping 8 percent in FY2002. For two years, FY2004 and FY2005, districts received no or very small increases in the foundation grant. In FY2006 and FY2007, moderate growth in the foundation grant occurred, 2.6 percent and 3.4 percent, respectively.

Table 3
Minimum, Basic, and Maximum Foundation Grants: FY1995 through FY2007

	Minimum Grant		Basic Grant		Maximum Grant		
Fiscal Year	Amount	Annual Change	Amount	Annual Change	Amount	Annual Change	Minimum Difference
FY1995	$4,200		$5,000		$6,500		$2,300
FY1996	$4,506	$306	$5,153	$153	$6,653	$153	2,147
FY1997	$4,816	$310	$5,308	$155	$6,808	$155	1,992
FY1998	$5,124	$308	$5,462	$154	$6,962	$154	1,838
FY1999	$5,170	$46	$5,462	$0	$6,962	$0	1,792
FY2000	$5,700	$530	$5,700	$238	$7,200	$238	1,500
FY2001	$6,000	$300	$6,000	$300	$7,500	$300	1,500
FY2002*	$6,500	$500	$6,500	$500	$7,800	$300	1,300
FY2003**	$6,626	$126	$6,626	$126	$8,000	$200	1,374
FY2004**	$6,626	$0	$6,626	$0	$8,000	$0	1,374
FY2005	$6,700	$74	$6,700	$74	$8,000	$0	1,300
FY2006	$6,875	$175	$6,875	$175	$8,175	$175	1,300
FY2007***	$7,108	$233	$7,108	$233	$8,385	$210	1,277

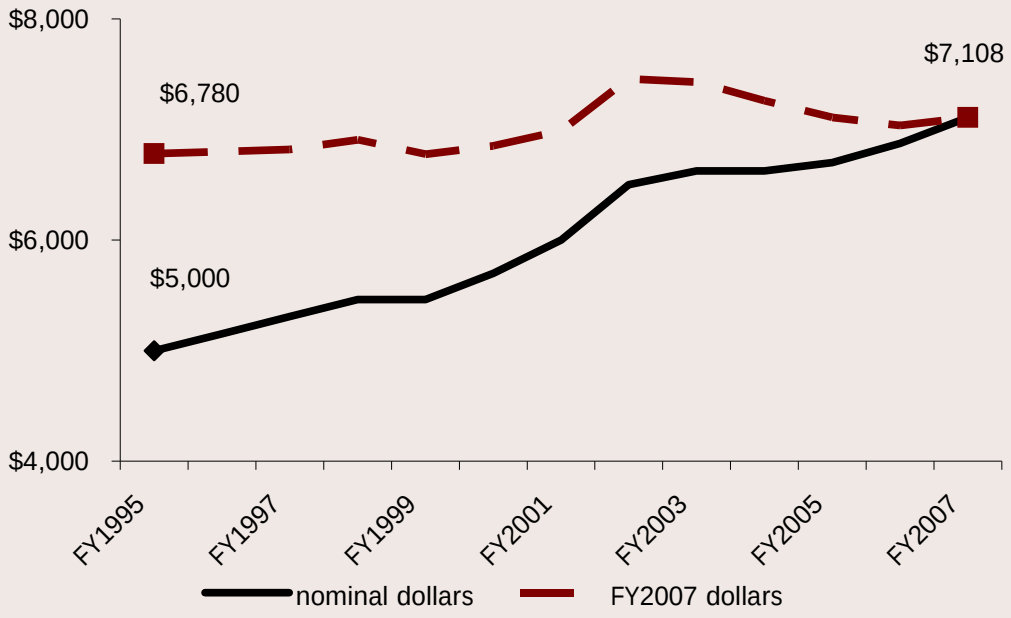
* The minimum/basic grant included a $200 per pupil equity payment subsequently built into the base; basic grant amount was $6,300 in FY2002.

** The foundation grant was effectively reduced for all districts when a $74 per-pupil proration was required.

*** The minimum/basic grant included a $23 per pupil equity payment subsequently built into the base; basic grant amount was $7,085 in FY2007.

Source: Senate Fiscal Agency, School Aid Funding Formula: Further "Closing of the School Aid Equity Gap", December 2007.

Chart 1
Basic Foundation Grant: FY1995 to FY2007



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

Source: Senate Fiscal Agency; US Bureau of Labor Statistics

Growth in the basic grant from FY1995 to FY2000 matched the growth in the U.S. Consumer Price Index over the same period (see **Chart 1**). The sizeable annual grant increases between FY2000 and FY2003 exceeded the growth in inflation during these years, accounting for real growth in the basic grant. However, this period of real improvement was nearly wiped out when the sizeable increases in the grant were halted in FY2004 and FY2005. While the nominal grant was basically held constant during this period, the value of the real grant declined. Over the entire 13-year period, the basic grant increased at an average annual rate of 2.97 percent, slightly higher than the annualized growth rate of the U.S. CPI (2.57 percent). In inflation-adjusted dollars, the grant grew by $328 from FY1995 to FY2007.

The sizeable annual grant increases between FY2000 and FY2003 exceeded the growth in inflation during these years, accounting for real growth in the basic grant.

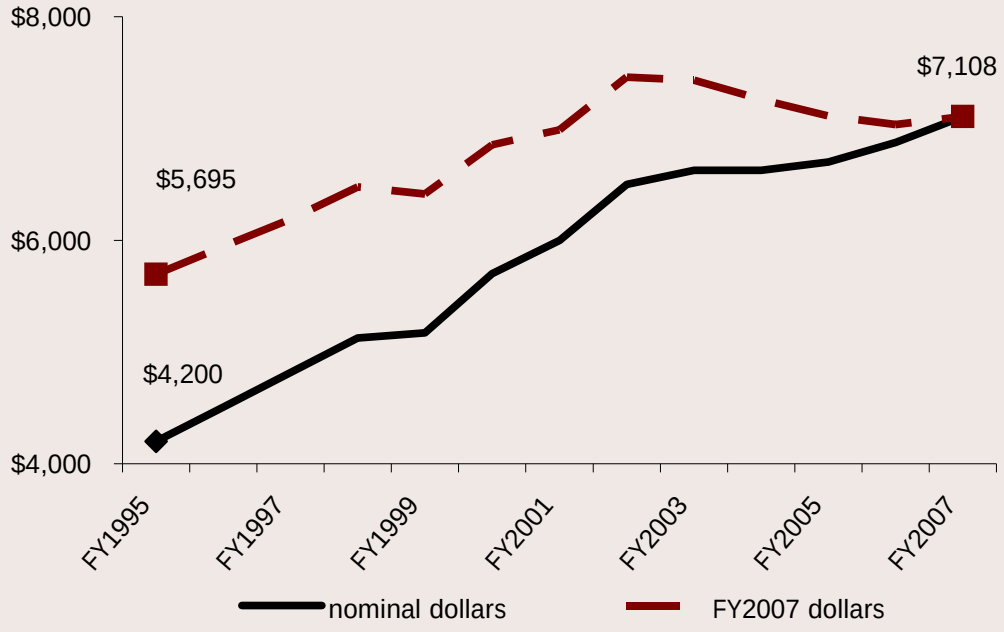
On the other hand, the minimum grant grew faster than changes in inflation because it received substantially larger annual increases, especially measured against the increases provided to the basic grant, early on. Whereas the basic grant generally tracked the changes in prices, the minimum grant grew at a rate more than double the rate of change in inflation between FY1995 and FY2000 (see **Chart 2**). During this period, these low-revenue districts benefited from the 2X formula and received annual increases equal to two times the increase provided to the basic grant.

Over the entire period, FY1995 to FY2007, the average annual growth rate of the minimum/basic grant was 4.48 percent, almost twice as large as the annualized growth rate of inflation.

Over the entire period, FY1995 to FY2007, the average annual growth rate of the minimum/basic grant was 4.48 percent, almost twice as large as the annualized growth rate of inflation (2.57 percent). In real dollar terms, the grant increased a total of $1,413, from $5,695 in FY1995 to $7,108 in FY2007.

In contrast, the 51 hold harmless districts (as reflected in the changes to the maximum grant) did not fare as well as other districts in terms of foundation grant growth. These districts experienced similar periods of growth and stagnation as the basic grant, with a

Chart 2
Minimum Foundation Grant: FY1995 to FY2007

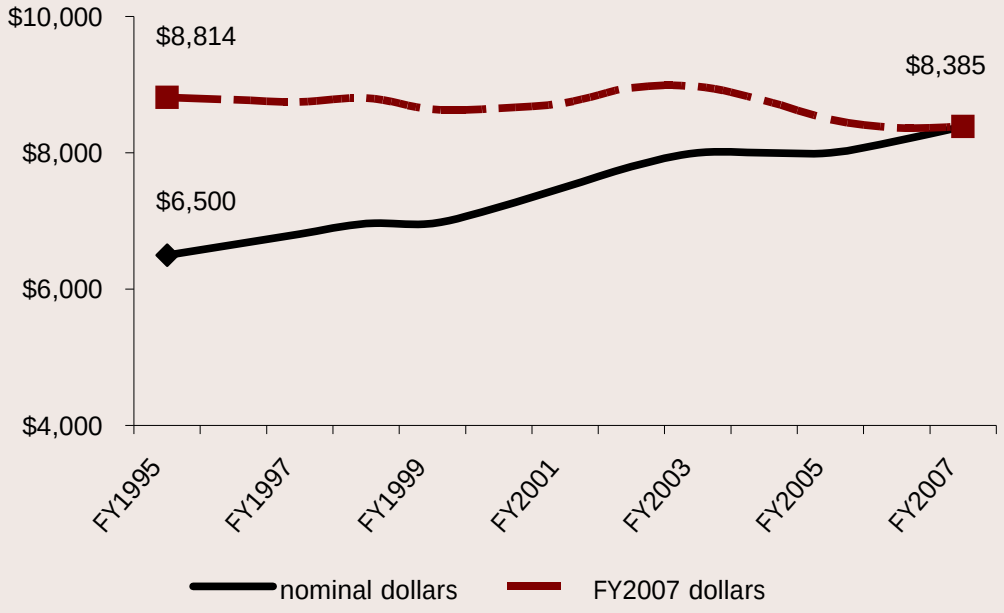


* Minimum grant adjusted using U.S. Consumer Price Index (state fiscal year basis).

Source: Senate Fiscal Agency; US Bureau of Labor Statistics

couple notable differences (see **Chart 3**). The overall growth of this grant from FY1995 to FY2007 did not benefit from the separate equity payments provided to the basic grant in FY2002 ($200 per pupil) and FY2007 ($23 per pupil). These payments effectively increased the overall and annual growth rates of the basic grant and decreased the spread between the basic and maximum grant from $1,500 per pupil in FY2001 to $1,277 per pupil in FY2007. Because the annualized growth rate of the maximum grant (2.14 percent) was less than the annual growth rate of the U.S. CPI (2.57 percent) from FY1995 to FY2007, the grant realized an inflation-adjusted reduction of $429 per pupil.

Chart 3
Maximum Foundation Grant: FY1995 to FY2007



* Grant adjusted using U.S. Consumer Price Index (state fiscal year basis).

Source: Senate Fiscal Agency; US Bureau of Labor Statistics

Changes since FY2007

In FY2008, the state again changed the method used to annually increase the foundation grants of districts and how much state aid each district receives. After abandoning the sliding scale in FY2001 in favor of an approach that treats all districts equally, state policymakers returned to the 2X formula to provide larger annual increases to those districts receiving less than the maximum grant and smaller increases to those districts at or above this level. To effect this policy change, a two-part adjustment was employed for FY2008. The first step provided all

FY1999 Foundation Grant Adjustments: *Durant* and MPSERS

With the exception of the lowest-revenue school districts, FY1999 foundation grants were frozen at their FY1998 levels despite the fact that Michigan's economy was performing very well and state School Aid Fund revenue growth was very strong. Only those districts receiving the minimum grant received an increase, albeit a very small one ($46 per pupil). The decision to hold the line on foundation grant increases in FY1999 was influenced by the State of Michigan's resolution of the *Durant* lawsuit.[a] Furthermore, instead of providing foundation grant increases, the state made adjustments to the required employer contribution to the Michigan Public School Employee's Retirement System (MPSERS) in FY1998. Both the lawsuit settlement and the retirement system changes had the combined effect of providing additional budgetary resources to local school districts outside of the foundation program. The retirement system changes set up the system to be more sensitive to changes in market performance because the full effect of recent investment gains were reflected in the value of the investment portfolio and the five-year smoothing of investment earnings was reset.

The Michigan Supreme Court decided the *Durant* lawsuit in July 1997 in favor of 84 plaintiff school districts and awarded them $212 million in damages. At issue in the case was the proper level of state funding provided to school districts for special education and if Section 29 of Article IX of the 1963 Constitution (prohibition on unfunded mandates) was violated. Recognizing that districts not part of the lawsuit might sue, the State of Michigan agreed to make payments to both plaintiff and non-plaintiff districts. Plaintiff districts shared in a lump sum payment ($212 million), which represented an amount of underfunding for three fiscal years (FY1992 through FY1994). Non-plaintiff districts shared $636 million through a series of annual payments over 15 years. The state's settlement with both plaintiff and non-plaintiff districts also resulted in changes in how special education payments to districts were to be made, prospectively. Based on the court's ruling, the state was responsible for a set percentage of general special education and special education transportation costs, 28.6 percent and 70.4 percent respectively. The *Durant* settlement was part of a broader set of financial decisions by the state and local school districts that generated a larger favorable financial effect on districts' budgets than the *Durant*-related payments.[b]

In addition to the direct financial provisions from *Durant* benefiting districts, districts also benefited from a decision by the state to decrease the required employer contributions to the state-managed MPSERS, effective in FY1998. The retirement savings were achieved by fully reflecting the significant increase in the value of the retirement fund portfolio through FY1997 and changing certain actuarial assumptions (e.g., future wage escalation) that had the effect of holding down the increase in the employer contribution. These changes helped reduce the employer contribution to the system for the pension benefit from 10.97 percent of payroll in FY1997 to 6.7 percent of payroll in FY1998. The resultant savings, estimated at $300 million, were passed along to districts in the form of cost reductions to their annual retirement funding bill.

Thus, because of the financial settlement in *Durant* and the changes involving MPSERS, the foundation grants for all but the lowest-spending districts were held at their FY1998 levels in FY1999. In lieu of directing state resources to the foundation program in FY1999, additional funding was provided to special education and at-risk programs ($100 million).

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[a] *Durant v. State of Michigan*, 238 Mich App 185 (1999).

[b] Citizens Research Council of Michigan, *The Durant Decision,* Memorandum 1048, February 1998.

Foundation Grants for Charter Schools

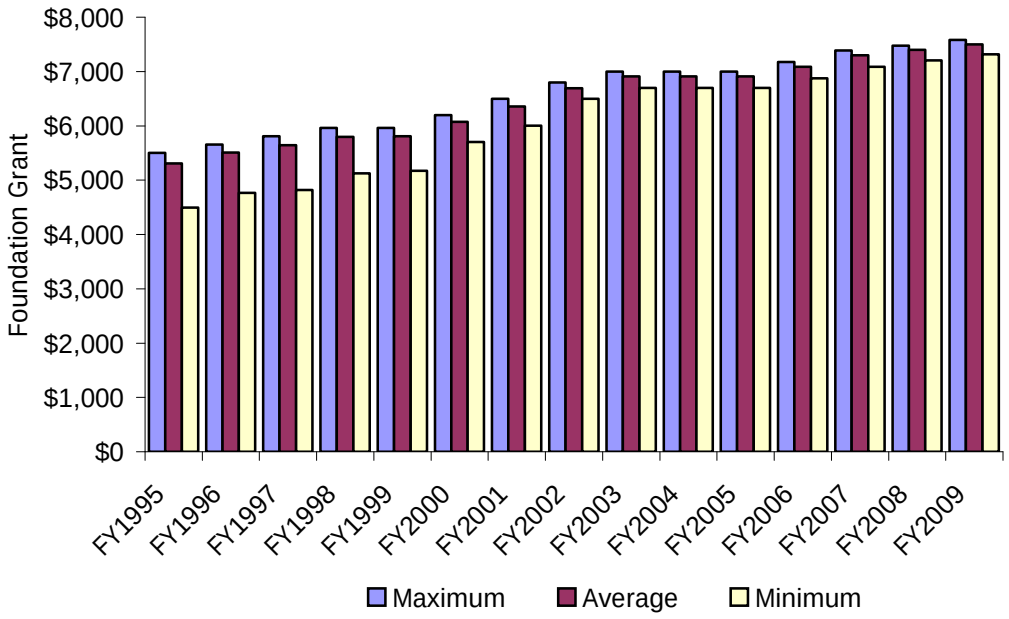
The authorization of charter schools was a key component of the education quality and accountability reforms that accompanied Proposal A and the related school finance reforms of the mid-1990s. Charter schools are public schools under both the Revised School Code and the State School Aid Act of 1979 and the Michigan Supreme Court has confirmed that charter schools are public schools for the purposes of Michigan constitutional provisions dealing with school funding (Article VIII, Section 2 and Article IX, Section 11). As public schools, charter schools are prohibited from charging tuition. Also, because charter schools lack taxing authority, they do not have access to the local property tax revenues that traditional public school districts have to support school operations. Therefore, without access to local property taxes or tuition resources, the foundation grants of all charter schools are entirely financed by state School Aid Fund resources. Like traditional public schools, established charter schools use the blended student enrollment count to determine pupil membership under the foundation grant calculation.

Until FY2008, the foundation grant of a charter school could not exceed the lesser of 1) the amount received by the traditional public school district in which the charter school is located or 2) the minimum foundation grant plus $300. Over the years, the charter schools have received the same annual grant adjustments as their host resident district. Thus, if the host district received a larger increase under the 2X formula then so did the charter school located in the traditional public school district.

In FY2008, state law was changed to allow charter schools to receive a foundation grant equal to the lesser of 1) the amount received by the traditional public school district in which the charter is located or 2) the maximum grant received by any charter school in the state (which was $7,580 in FY2010). This change is designed to allow charter schools residing in higher-revenue traditional public districts to eventually receive a foundation grant equal to their host district, based on the continued use of the 2X formula to provide annual foundation grant increases.

Chart 4 presents the maximum, minimum, and average foundation grant received by charter schools in Michigan from FY1995 to FY2009 and the effects of per-pupil revenue equalization. The difference between the maximum ($5,500 per pupil) and minimum ($4,497 per pupil) grants was a little more than $1,000 in FY1995 when Proposal A took affect and 11 charter schools were in operation. By FY2000, 162 charter schools operated and the spread between the maximum and minimum foundation decreased to $500, when all districts in the state received at least the basic grant amount ($5,700). Since that time, the spread has been reduced further to $264 in FY2009.

Chart 4
Foundation Grant Amounts for Charter Schools



Source: Senate Fiscal Agency

districts with the same per-pupil increase. The second step involved an equity payment to those districts below the maximum revenue level. The districts below the maximum received a supplemental payment based on a sliding scale with the largest increase being twice the amount of the maximum grant.

The return to the 2X formula resulted in districts receiving per-pupil foundation grant increases ranging from $48 to $96 in FY2008. The level at which districts did not receive additional funds above the base $48 per-pupil adjustment was $8,433 per pupil. With the return to the 2X formula, the new target foundation grant was set equal to the maximum amount, in a manner very much similar to the operation of the foundation program immediately following the adoption of Proposal A. In other words, the maximum grant amount became the new basic grant for purposes of further narrowing the per-pupil funding disparities. For FY2008, the minimum grant that was guaranteed to all districts was increased by $96 to $7,204 per pupil, an increase of 1.4 percent compared to a 4.4 increase in the U.S. CPI for the same period. The state used the 2X formula again in FY2009 with increases ranging from $56 per pupil to $112 per pupil (See **Table 4**). These annual increases surpassed the change in U.S. CPI, which declined 0.3 percent in FY2009.

The full effect of the declines were not reflected in the per-pupil funding amounts because of the availability of discretionary federal funding allocated through the American Recovery and Reinvestment Act of 2009.

The national recession of 2008 and 2009 reduced state revenues in FY2009 and FY2010, including taxes dedicated to schools. State School Aid Fund revenues declined by 5.1 percent in FY2009 and 1.0 percent in FY2010; however, the full effect of these declines were not reflected in the per-pupil funding amounts because of the availability of discretionary federal funding allocated through the American Recovery and Reinvestment Act of 2009. These resources were distributed to districts as a partial replacement of state aid resources.

Despite the use of $450 million in temporary federal funding, the FY2010 School Aid Fund budget required a $154 per-pupil cut to finance foundation grants in response to the first-ever two-year decline in dedicated School Aid Fund revenues. While districts had some discretion where to apply the per-pupil cut, the reduction effectively reduced the foundation grant for all districts (see **Table 4**). The $154 per-pupil reduction wiped out 75 percent of the combined increase to the minimum/basic grant from the previous two years (FY2008 and FY2009). It also reduced the maximum grant to below the FY2007 level by completely eliminating the combined $104 total increase provided in FY2008 and FY2009. In inflation-adjusted dollars, the FY2010 per-pupil cut caused the basic grant in FY2010 to be $93 less than it was in FY2000,

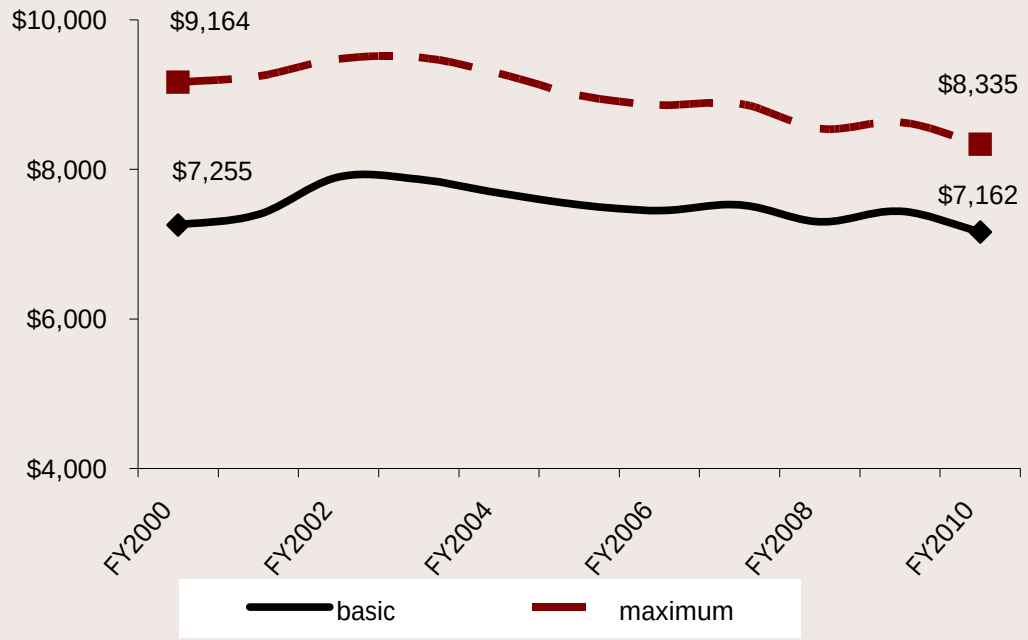
Table 4
Minimum and Basic/Maximum Foundation Grants: FY2008 to FY2010

Fiscal Year	Minimum	Annual Change	Basic/ Maximum	Annual Change
FY2008	$7,204	$96	$8,433	$48
FY2009	$7,316	$112	$8,489	$56
FY2010*	$7,162	($154)	$8,335	($154)

* Although a district's foundation grant was not reduced statutorily, the $154 per-pupil reduction in state aid contained in the State School Aid Act for FY2010 had the same effect and is reflected as such for purposes here.

Source: Senate Fiscal Agency

Chart 5
Changes in Inflation-Adjusted Foundation Grants: FY2000 to FY2010 (FY2010 dollars)



* Grant adjusted using U.S. Consumer Price Index (state fiscal year basis).

Source: Senate Fiscal Agency; US Bureau of Labor Statistics

a decrease of 1.3 percent (see **Chart 5**). The FY2010 per-pupil cut to the maximum grant in FY2010 caused the grant to be $829 below where it was in FY2000 ($9,164 per pupil) in real terms, equating to a total reduction of 9.0 percent over the 10-year period.

Major Factors Influencing Foundation Grant Growth

Until recently, two primary factors simultaneously influenced the annual changes observed in the amount of the basic foundation grant over time. The first factor is the amount of state and local revenue available for distribution. All else being equal, additional resources will allow the grant to increase year-over-year. The amount of resources available to the foundation program in any given year can be affected by various things. Most obvious is the growth in dedicated K-12 revenues at the state and local levels.[22] Similarly, a shift in the amount of state resources away from categorical assistance to the foundation program can result in proportionately more resources being available to distribute through the per-pupil grant. These additional resources will permit the foundation grant to increase year-over-year.

The second factor influencing annual changes in the foundation grant is the number of students participating in the foundation program. When statewide school enrollments increase, the limited resources available each year have to be spread across more individuals, driving the foundation grant down. Alternatively, shrinking enrollments effectively free up resources at the state level, allowing these dollars to be used to increase the foundation grant. Generally speaking, these two main factors -- amount of money available and number of students – combine to determine the amount of the foundation grant each year. Changes in one factor that might allow the grant to increase independently can be offset by changes in

Foundation Growth after Required MPSERS Contribution

Prior to the implementation of Proposal A in 1994, the State of Michigan and public school districts shared in the financing of the employer contributions to the Michigan Public School Employees Retirement System (MPSERS) for public school districts. Those contributions, expressed as a percentage of active employee payrolls, prefunded the actuarial costs of the defined benefit plan provided to public school employees plus the costs of health benefits for retirees on a pay-as-you-go basis. After Proposal A, full responsibility for financing the employer contributions passed to the school districts, which financed the required annual contributions from their foundation grants. Since 1995, the annual contribution rate has fluctuated, but the general long-term trend has been an increase. In some years, the rate grew more rapidly than growth in the foundation grant, requiring larger shares of the foundation grant to be dedicated to financing the retirement contribution.[a] 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.

The required contribution rate was 14.24 percent of payroll in FY1995, when Proposal A took effect. In FY2010, the rate was 16.94 percent of payroll, a change of 2.7 percentage points or nearly 19 percent over the 16-year period. This compares to a decline of 0.2 percent in the inflation-adjusted value of the basic grant over the same period. The effects of the annual changes in the retirement rate on the real value of the grant are reflected in **Chart 6**.

The chart compares growth in the inflation-adjusted basic grant with changes in the inflation-adjusted basic grant after accounting for the increase in the employer contribution rate to MPSERS. In other words, the real value of the basic grant is reduced to reflect the changes in the required retirement contribution rate since FY1995.

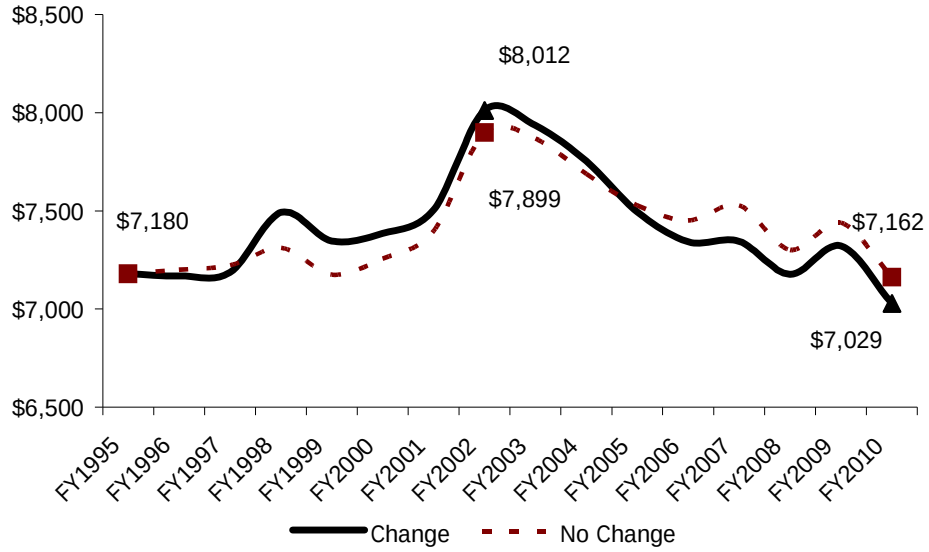
While the employer contribution rate fell in the late 1990s in response to the growth in the value of the investment portfolio, it began rising steadily and consistently in the early 2000s. This growth was a function of poor investment performance relative to actuarial assumptions, the decision to "mark to market" the investment portfolio, and the declining payroll. Increased required contributions for retiree health care benefits also contributed to the retirement system contribution rate rising. These costs, unlike the pension benefits promised under MPSERS, are funded on a pay-as-you-go basis. The retiree health care component rose in reaction to health care costs and the number of retired school employees/beneficiaries receiving benefits.

Over the entire 16-year period, the real value of the grant, adjusted for the employer contribution increase, rose from $7,180 in FY1995 to $8,012 in FY2002, before falling to $7,029 in FY2010. This is $133 less than the value of the per-pupil grant adjusted by inflation alone ($7,162). The employer contribution rate to MPSERS rose again in FY2011 and in FY2012, while the basic grant was held constant in FY2011 and reduced by $470 in FY2012. These changes further reduce the real value of the grant.[b]

[a] Citizens Research Council of Michigan, *Financing Michigan Retired Teacher Pension and Health Care Benefits,* Report 337, September 2004.

[b] The MPSERS employer contribution rate may be adjusted downward if the Michigan courts find that a recent law requiring school employees to contribute three percent of their pay towards retiree health insurance is legal (*McMillan v. MPSERS*).

Chart 6
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
Source: Senate Fiscal Agency; Office of Retirement Services, US Bureau of Labor Statistics

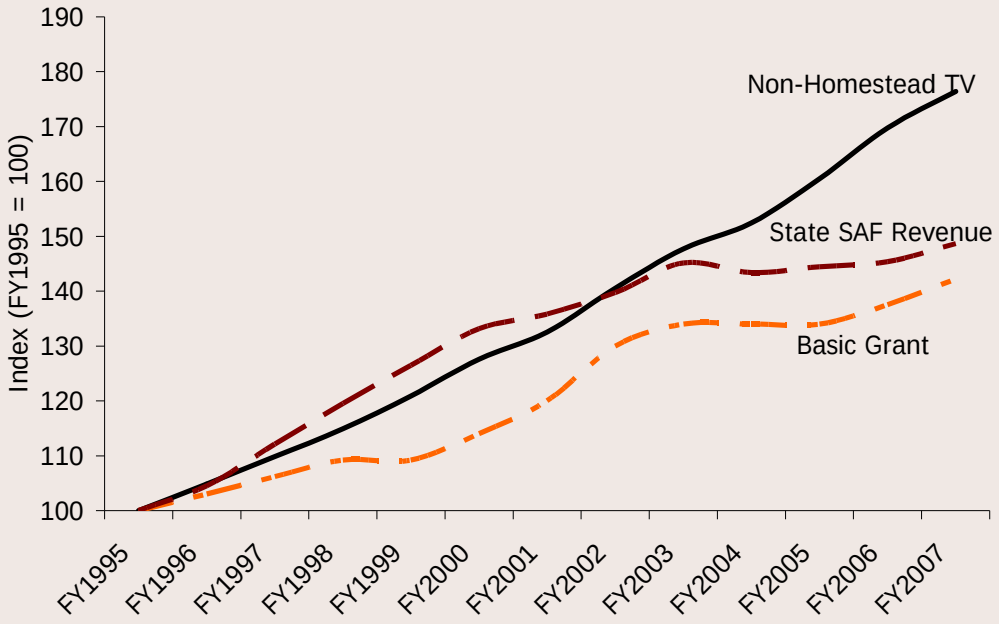
the other factor that might result in a grant to decrease. Thus, it is important to understand what is going on with both factors at the same time.

During the first 13-year period operating under Proposal A and until the Great Recession of 2008, the observed changes in the different foundation grant levels occurred for two different reasons. Through FY2003, annual foundation grant increases were fueled by relatively strong growth in dedicated local and state revenues, as reflected in **Chart 7**. Dedicated School Aid Fund revenue, as well as the local 18-mill non-homestead property tax for school operations, showed strong growth throughout the early 2000s. During this period, student enrollments in Michigan public K-12 schools rose fairly consistently. To some degree, this enrollment growth tempered the annual growth in the foundation grant made possible by the increase in state and local tax revenues.

Beginning in FY2000, growth of the major foundation funding source, dedicated School Aid Fund revenue, slowed. By FY2003, revenue growth stagnated while local property tax revenues continued to exhibit strong annual growth. As a result of the slowdown in the School Aid Fund growth, annual increases to the foundation grant ceased in FY2003. The foundation grant was saved from the full effects of the state resource declines during this time, in part because of changes in statewide enrollments that took hold around the same time. Since FY2003, statewide enrollments have exhibited an unabated decline. This demographic trend allowed the foundation grant to remain basically constant for a period (FY2003 through FY2005), despite the very weak revenue growth during the time. Declining enrollments allowed the grants to increase moderately (FY2006 and FY2007), despite the continued laggard growth in state resources.

Changes to the foundation grant since FY2007 have been influenced in a number of ways. First, growth has been affected by a clear policy shift toward further narrowing the gap between the lowest- and

Chart 7
Growth of SAF Revenues, Local School Operating Taxes, and Foundation Grant



Sources: Michigan Department of Education; State Tax Commission

highest-revenue districts. This policy change is reflected in the return to the 2X formula for providing annual per-pupil revenue increases.

Second, since FY2008, dedicated state school aid taxes have been negatively affected by the recession and its impacts on the Michigan economy. Meager baseline School Aid Fund revenue growth in FY2008 (less than one percent) followed by two consecutive years of revenue declines in FY2009 (5.1 percent) and FY2010 (1.0 percent) has constrained the growth of the foundation grant. Some of the recent revenue declines were partially offset by the availability of temporary federal resources that were used to provide a grant increase in FY2009 and mitigate the size of the effective reduction in FY2010.

Third, and most recently, foundation grant adjustments have been influenced by budget decisions having to do with the state's General Fund. As state policymakers grapple with ongoing General Fund budget deficits, they have required the School Aid Fund to pick up costs previously borne by the General Fund. Initially, most of these funding decisions involved shifting K-12 education programs or services previously financed with General Fund revenue to the School Aid Fund budget. Beginning in FY2010, and again in FY2012, the use of School Aid Fund revenue was expanded to finance post-secondary education (community colleges and higher education) appropriations; a break with past budget policy precedent. The recent policy change has the effect of re-directing resources previously available for K-12 education to other state budget priorities. For example, the FY2012 budget finances almost $400 million in post-secondary education appropriations from the School Aid Fund, amounting to nearly $267 per pupil.

Statewide Enrollment Changes: Trends and Causes

Statewide K-12 enrollments in the 10 years prior to Proposal A were fairly constant, although in the four years prior to adoption of the foundation grant annual enrollments increased each year. After enact-

Chart 8
Annual Statewide Enrollments and Blended Foundation Pupil Memberships

Source: Michigan Department of Education, Bulletin 1014 and Financial Status Reports

ment of the school finance reforms, annual statewide enrollments (traditional public school districts and charter schools) continued to climb through FY2003 and reached 1,750,000 before changing course (see **Chart 8**). Since FY2003, however, statewide annual enrollments and the pupil membership count used in the foundation program have entered an era of decline. Since then, total statewide figures for enrollment and membership have declined each year, equating to a total decline of 7.0 percent and 5.5 percent, respectively.

After peaking in FY2003, enrollments fell, on average, 1.0 percent per year between FY2003 and FY2009. The corresponding annual declines in the pupil membership counts have been slightly more gradual (0.7 percent) due to the fact that these figures use a blended count that incorporates both current- and previous-year enrollment figures (see box below), which has the effect of dampening year-over-year enrollment declines.

Declining statewide enrollments during the past six years are primarily the result of a reduction in Michigan-based births. The peak in Michigan-based births occurred in 1990. To a lesser extent, declining statewide enrollments are caused by out-migration stemming from the economic conditions in the state and families pursing alternative forms of education, such as private schools and homeschooling. The statewide trend of year-over-year student enrollment declines is projected to continue through calendar year 2012.[23] Current projections of school enrollments and foundation grants for FY2011 and FY2012 include pupil declines of 1.6 percent and 1.3 percent, respectively.

Blended Count Used in the Foundation Grant Program

The foundation program does not rely entirely on a district's current-year enrollment for purposes of distributing state aid. Instead, state law requires school districts to conduct two separate student counts. This blended count is used to determine the pupil membership figure for purposes of the foundation program. The first count is the fall head count for the current school year (75 percent of this count). The second count is the spring student count from the prior school year (25 percent of this count). Mathematically, the current blended count is represented by:

(0.75 * current year enrollment) + (0.25 * prior year enrollment) = Pupil Membership

The use of a blended count helps mitigate the negative revenue effects at the local school level during periods of declining enrollments and is intended to provide a financial incentive for schools to retain students from year-to-year. In this environment, fewer students result in fewer dollars under the per-pupil foundation model. The weighting of the two counts has changed since adoption of school finance reforms in FY1995. Initially (FY1995), the counts were equally weighted at 50 percent. Over time, the weights were gradually shifted to an 80 percent/20 percent blend (used in FY2001 to FY2004). However, in response to declining enrollments, statewide and at the individual district level, the prior-year count was given additional weight. Since FY2005, the blended pupil count has been 75 percent of the current year head count and 25 percent of the previous year head count. The change to the weightings has helped smooth the observed decline in pupil membership figures since FY2003, vis-à-vis the actual student enrollment figures for each year.

Beginning with the FY2012 budget the weightings will change course again, but this time to a 90 percent/10 percent blend. This shift will allow growing districts to more fully benefit (in funding terms) from the additional students. Conversely, the enrollment losses in declining districts will not be smoothed as much.

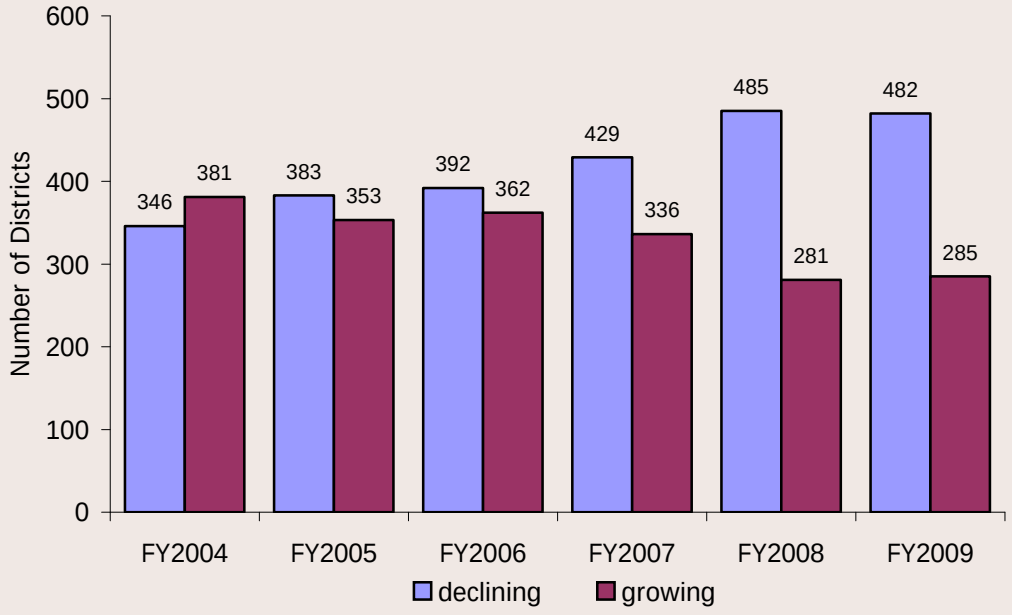
Enrollment Changes at the District Level

Statewide enrollment figures can mask substantially different experiences at the individual school district level. Factors affecting annual enrollments at the district level include those influencing statewide enrollment figures, such as demographic factors (birth rates and out-migration), but districts are also exposed to competition for students. While inter-district competition results in no net gain or loss for the state as a whole, districts do experience gains and losses when students change districts because of competition. A student's corresponding foundation dollars follow them during such migrations.

Depending on the year being examined, the competition for students and demographic changes manifest themselves in enrollment changes to varying degrees across the state. Some districts will see increases in enrollments, while others will see declines. Using FY2009 figures as an example, a little more than one-third (285 districts) of the total traditional public school districts and charter schools gained students from the prior school year while the remaining two-thirds of all districts experienced a decline in enrollment.[24] **Chart 9** presents the number of school districts with declining and growing annual enrollments for the six-year period FY2004 through FY2009. Since statewide enrollments began declining in FY2004, the number of districts with year-over-year enrollment losses has grown from 346 to 482.

Changes in annual enrollment can have significant fiscal effects on local school district budgets because general education operations are financed with the per-pupil foundation grant. In the short-run, the marginal costs of losing a student are far greater than the average costs of educating a student. This can place a strain on local budgets because annual

Chart 9
Annual Enrollment Changes in School Districts: FY2004 to FY2009



* Includes traditional public school districts and charters.

Source: Center for Educational Performance and Information

Enrollment Changes in Traditional Public Schools Compared to Charters

The statewide examination of district-level enrollment changes hides considerable variation, including differences that exist between traditional public school districts and charter schools as well as differences within the traditional public school district community. Statewide enrollment in Michigan's traditional public schools in FY2009 was down nearly 34,900 students compared to where it was at the start of Proposal A (FY1995). This 2.2 percent statewide decline partially accounts for the changes observed at the district level, along with a host of other factors — including competition for students and demographic shifts at the individual community level.

Looking only at traditional public schools for FY2009 reveals that nearly 75 percent of the 551 districts (406 districts) experienced annual membership losses. Of this group, 256 districts realized a loss of 2.5 percent or greater, the rate of decline for all traditional public school districts as a group for the year. In FY2009, a little over one-quarter of all traditional districts (145 districts) did not experience a decline (i.e., no change in enrollment or an increase in enrollment) (see **Table 5**). Approximately 75 percent of traditional public school children in FY2009 were educated in districts that experienced year-over-year enrollment declines.

In contrast, only 76 of the 216 charter schools (almost one-third) experienced enrollment declines from FY2008 to FY2009.[a] Overall, as a group, charter schools saw a net increase in enrollments of approximately 3,500 students in FY2009, an increase of 3.5 percent.

FY2009 provides a snapshot of traditional public school enrollment trends, but is also indicative of a long-term trend in enrollment changes for traditional public districts vis-à-vis charters. The number of traditional public districts experiencing annual enrollment losses has increased steadily since FY2003, rising from 300 districts to 406 districts (see **Chart 10** on page 33).

The long-term trend for charter school enrollments tells a different story. While the number of charter schools experiencing year-over-year enrollment declines has increased slightly in recent years, the overall picture has been one of relative stability compared to that of traditional public school districts (see **Chart 11** on page 33). Furthermore, at the same time that the number of charter schools with declining enrollments each year has been somewhat stable, the number of charters experiencing rising enrollments also has remained fairly stable. This is in direct contrast to traditional public districts, which have seen fewer and fewer districts with year-over-year enrollment gains. The aggregate statewide enrollment in charter schools between FY2003 and FY2009 grew 58 percent, compared to a 9 percent statewide decline in traditional public schools. It is worth noting that the number of charter schools over this period increased from 180 to 224, so the enrollment growth was spread across a greater number of schools.

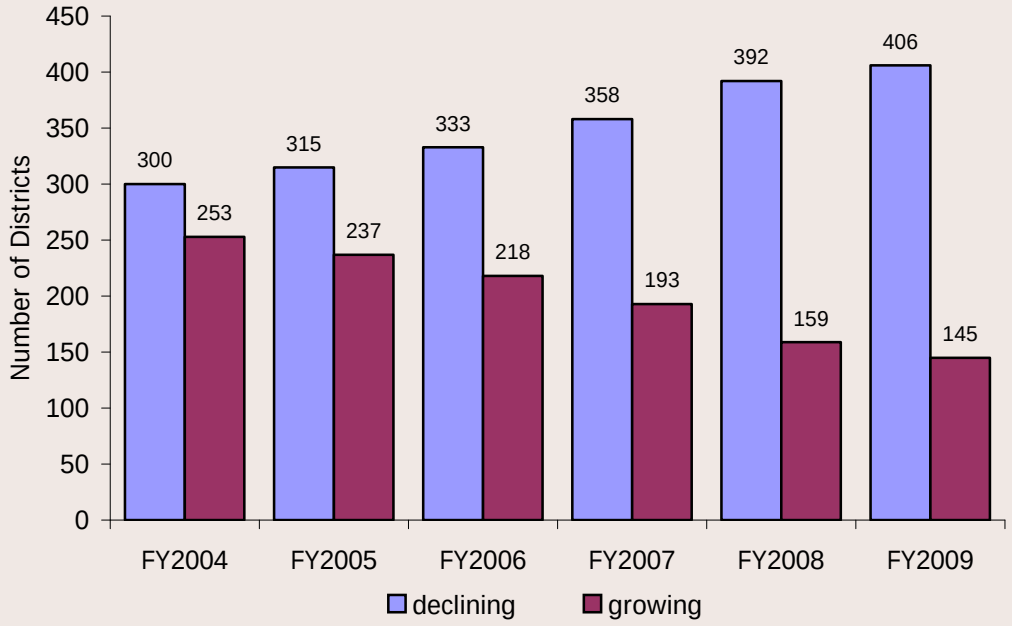
[a] For charter schools, those schools newly created or recently abolished are not included in the year-over-year count because of the lack of two consecutive years of enrollment data. Including these charters would distort the number of districts with either increasing or decreasing enrollments. A total of 224 charter schools registered enrollments in FY2009, but 216 these schools had FY2008 enrollments.

Table 5
Enrollment Changes in Traditional Public School Districts: FY2008 to FY2009

Enrollment Change	Number of Districts	Percent of Districts	Total Enrollment	Percent of Students
Decline >10%	29	5.3	131,889	8.7
Decline 2.5% to 10%	227	41.2	478,697	31.6
Decline 0.1% to 2.5%	150	27.2	528,912	34.9
Non-decline	145	26.3	374,106	24.7
Total	551		1,513,604	

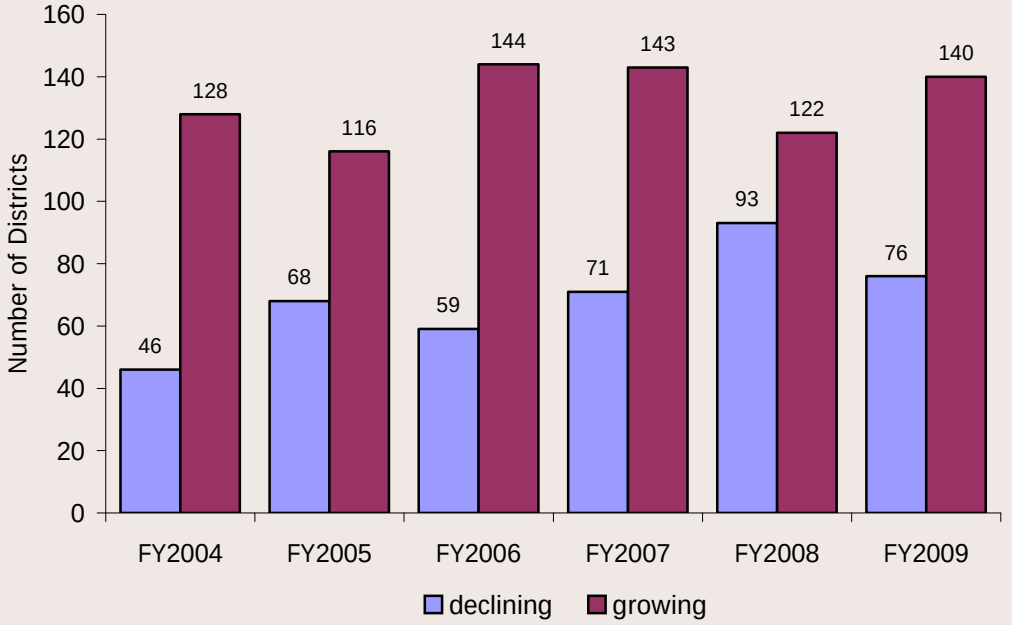
Source: Center for Educational Performance and Information

Chart 10
Annual Enrollment Changes in Traditional Public Districts: FY2004 to FY2009



Source: Center for Educational Performance and Information

Chart 11
Annual Enrollment Changes in Charter Schools: FY2004 to FY2009



Source: Center for Educational Performance and Information.

enrollment losses generally cannot be translated into immediate cost reductions that match the per-pupil funding lost.

Different Effects of Declining Enrollments

Under Michigan's foundation program, funding is designed to follow the student. Rising student enrollments generally mean more funding for an individual district, while declining enrollments result in the opposite. This dynamic has different effects depending on the level of government (state or local school district). For example, from the perspective of the State of Michigan and the annual School Aid Fund budget, and assuming a constant level of aggregate revenues to distribute statewide, declining enrollments generally mean more resources to distribute on a per-pupil basis. Conversely, from the perspective of a local district and given the same assumptions, declining enrollments translate into fewer resources in the aggregate.

In an environment of shrinking enrollment, the revenue impact associated with fewer students, especially in average- and small-sized districts, cannot be converted to immediate and equal expense reductions because of the nature of school spending and districts' desire to maintain class sizes.

Local Budgets. Declining enrollment creates fiscal challenges for school district budgets because the total amount of funding received through the foundation program is based, in part, on the pupil membership count. As annual enrollments fall, districts lose revenue under the per-pupil foundation program, but they may not be able to cut expenses as quickly as the reduction in revenues. School spending is highly concentrated in teacher salaries and other forms of compensation, such as group insurances and retirement benefits. These costs, on a per-employee basis, can be difficult to reduce in the short-run and in response to year-over-year enrollment declines because of the role that contracts and collective bargaining play in setting compensation levels for school employees. In the near-term time horizon, schools can address the fiscal effects of enrollment declines through reducing/cutting programs and/or increasing class sizes, up to a point.

Declining enrollments may result in fewer resources, but may not translate into immediate reduced costs for districts. For example, a traditional public district of average enrollment size (2,500 in FY2009) that experiences the average statewide enrollment decline (1.5 percent) will lose 29 pupil memberships under the foundation program. Assuming the district receives the basic foundation grant, the enrollment decline corresponds to a loss of about $200,000 – equivalent to the total annual compensation costs of approximately three instructional employees. If these losses were realized within a single grade or even a single school, it might be possible to eliminate distinct positions to manage the fiscal impact. However, the losses tend to be spread over the entire district, across multiple grades, and throughout a number of buildings. For the typical district, it can take a number of years of such gradual enrollment declines to effect personnel reductions and realize cost savings.

Under the foundation allowance program, it is much easier to manage up (i.e., accommodate growing enrollments) than it is to manage down. In an environment of shrinking enrollment, the revenue impact associated with fewer students, especially in average- and small-sized districts, cannot be converted to immediate and equal expense reductions because of the nature of school spending and districts' desire to maintain class sizes. Faced with shrinking enrollments and fewer resources, compensation costs might not come down as quickly as revenues because collective bargaining agreements generally stipulate that the least experienced workers

(and lowest paid) must be laid off first. The current foundation program was developed in an era of rising enrollments and little attention was given to the fiscal effects of declining enrollments within the structure of the program.

State School Aid Fund Budget. In any fiscal year, School Aid Fund dollars associated with the foundation grants in those districts experiencing enrollment declines become available to support the foundation grants in those districts with enrollment increases in the same year. In effect, the state aid pie is sliced into differently sized pieces and the resources shifted from some districts to others. This occurs both during times of rising, as well as stagnating growth in the amount of money available to distribute to local districts, whenever there is net statewide enrollment declines.

> In total, over 60 percent of all traditional public school districts experienced some level of enrollment decline with nearly 9 percent experiencing an enrollment reduction of one-third or greater from FY1995 to FY2009.

For example, because there was a net statewide enrollment decline in FY2009, School Aid Fund resources previously allocated to the students who left the system were effectively freed up to help finance the foundation grants in other districts. Even if the aggregate amount of revenue is constant, this can allow per-pupil funding to increase. If the level of dedicated education resources decline from one year to the next (which has been the case recently), declining statewide enrollments can help avoid or mitigate reductions to the per-pupil foundation grant statewide that otherwise would have to occur if enrollments are rising. Thus, declining enrollments can help balance the School Aid Fund budget's obligations during periods of declining state revenues.

Characteristics of Declining Enrollment Districts

Annual enrollment changes among traditional public school districts have varied considerably and in some cases the changes have been profound (see **Table 6**). In total, over 60 percent (334 districts) of all traditional public school districts experienced some level of enrollment decline with nearly 9 per-

Table 6
Enrollment Changes in Traditional Public School Districts: FY1995 to FY2009

Enrollment Change	Number of Districts	Percent of Districts	Total Enrollment	Percent of Students
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%	98	17.8	245,087	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%	47	8.5	210,857	13.9
Subtotal	217	39.3	787,781	52.0

Source: Center for Educational Performance and Information

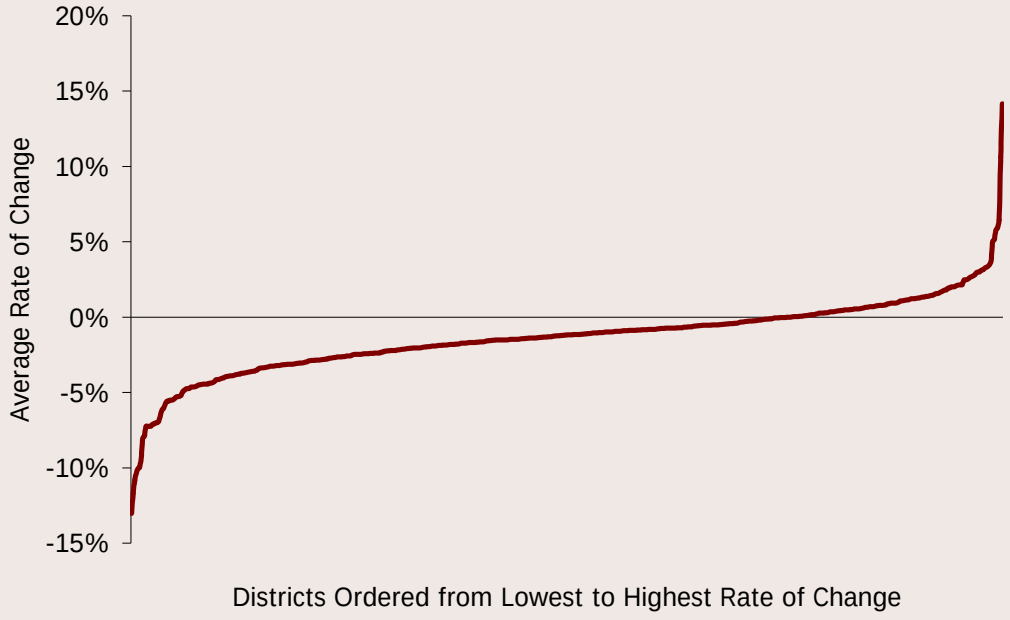
cent (50 districts) experiencing an enrollment reduction of one-third or greater from FY1995 to FY2009. At the other end of the spectrum, approximately the same number of districts (47 districts) experienced enrollment gains of one-third or greater during the period. Nearly 43 percent of all traditional districts (236 districts) experienced an enrollment decline of 10 percent or more, a loss which is almost five times as large as the total statewide figure of 2.2 percent decline.

As noted above, nearly 75 percent of all traditional districts experienced declining enrollment from FY2008 to FY2009 and 61 percent of districts have lost enrollments since the implementation of Proposal A. Since FY2003, when statewide enrollments started to decline, the number of districts with year-over-year declines, regardless of size or geographic location, has grown significantly. However, the annual rate of decline over the six-year period varies greatly from district to district. Similarly, the average rate of growth in those districts with rising enrollments also varies.

Nearly 75 percent of all traditional districts experienced declining enrollment from FY2008 to FY2009 and 61 percent of districts have lost enrollments since the implementation of Proposal A.

Chart 12 shows the average annual rate of change in each school district's enrollment from FY2003 through FY2009; the far left side of the chart represents the district with the greatest average annual rate of decline and the far right side represents the district with the greatest annual rate

Chart 12
Annual Rate of Change in Enrollment by School District: FY2003 to FY2009



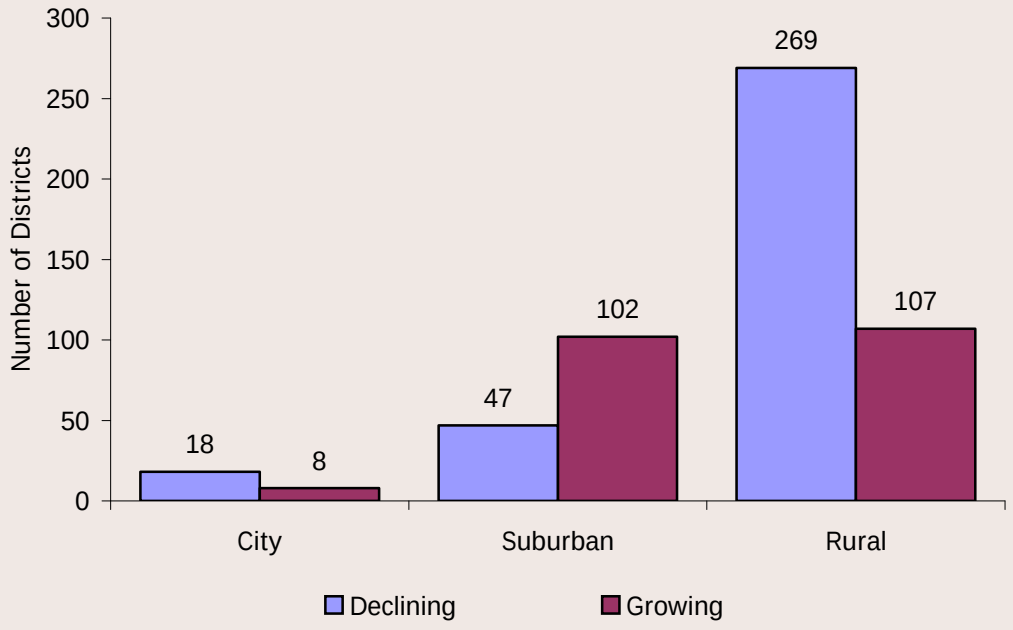
Source: Center for Educational Performance and Information

of increase. Over 70 percent of the districts had an annual rate of growth or decline between 0 and 2.5 percent for the six-year period.[25] The average rate of growth for growing districts during this period was 1.5 percent, while the average rate of decline for shrinking districts was 2.4 percent. The statewide average annual rate of change during the period was a decline of 1.5 percent.

Chart 13 examines schools districts with declining and growing enrollments by district type – central city, suburban, and rural.[26] While all district types have experienced some degree of declining enrollments, the problem has been most pronounced in rural and city settings. Nearly 72 percent (269 districts) of the 376 rural districts have lost enrollments since the adoption of the foundation grant. Similarly, nearly 70 percent of 26 districts serving central cities have lost student enrollments between FY1995 and FY2009. In contrast, 68 percent of the 149 suburban districts have experienced enrollment *gains* between FY1995 and FY2009. No single factor explains the different

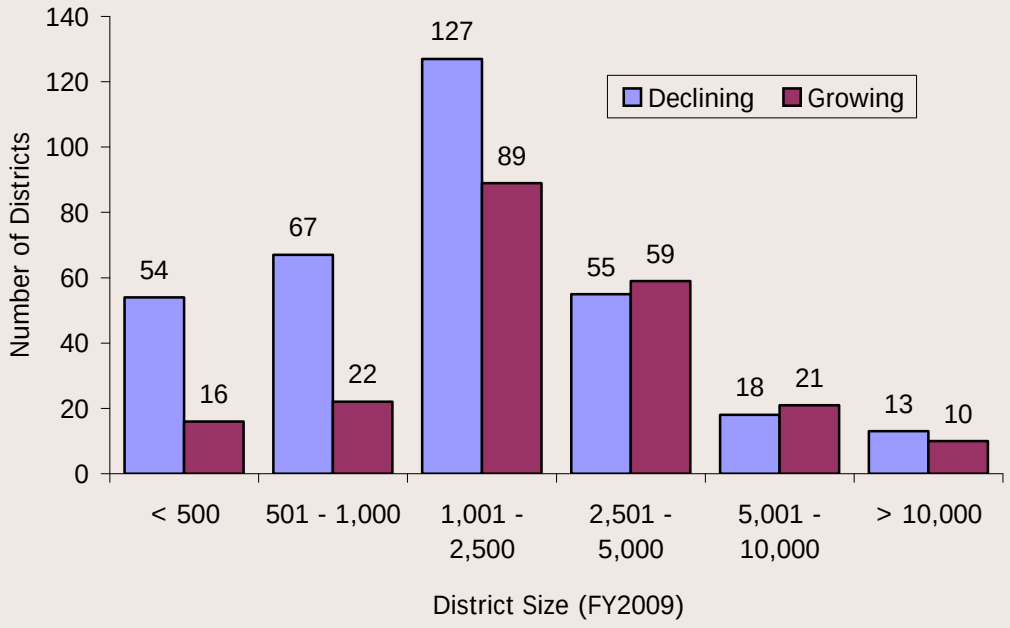
> While all district types have experienced some degree of declining enrollments, the problem has been most pronounced in rural and city settings.

Chart 13
Declining and Growing Districts by Type: FY1995 to FY2009



Source: Center for Educational Performance and Information; US Dept. of Education, National Center for Educational Statistics

Chart 14
Declining and Growing Districts by Size: FY1995 to FY2009



Source: Center for Educational Performance and Information

causes for enrollment declines in either the city setting or the rural setting; however, it is likely that a number or forces are contributing simultaneously. Most of Michigan's charter schools are located in urban areas, which will explain some of the enrollment declines in central cities. In the case of rural schools, migration patterns might explain some of the observed enrollment losses.

Smaller districts have experienced the greatest amount of decline. These districts are primarily located in rural parts of the state. **Chart 14** shows that enrollment losses have been concentrated in districts with less than 2,500 students. Of the total 334 districts that experienced declines between FY1995 and FY2009, 248 districts (74 percent) had fewer than 2,500 students (the approximate statewide average district enrollment in FY2009). In contrast, of all the school districts with enrollments larger than 2,500 students, the number of districts with declining and growing enrollments is almost equal, 86 districts and 90 districts, respectively. Looking at the student populations in declining versus growing districts, nearly 726,000 students in FY2009 were educated in declining enrollment districts. The vast majority of these students (69 percent) were located in districts with enrollments greater than 2,500 in FY2009.

Who is Gaining Enrollment?

As depicted in **Chart 8** (on page 29) only a small fraction of school districts saw enrollment increases over the past six years. There is considerable diversity in this group of districts in terms of enrollment size, geographic location, household income, and type. Despite this variation, some general observations can be made. Most are suburban districts. This is important because many charter schools (a key source of competition for students) are situated in urban settings (though students from any district can enroll in a charter school). Thus, many of the increasing enrollment traditional public districts do not face the same competitive forces for students that central city districts do, although suburban districts compete for students with private and parochial schools situated nearby. Districts of all types face many of the same competitive forces associated with inter-district choice provided by Michigan's schools of choice policy.

Growing districts share similarities in terms of income and total enrollments. Nearly all of the increasing enrollment districts have median household income above the statewide average. In terms of enrollment size, these districts tend to enroll more students than the average district in the state. Many of these factors are outside of the control of school district administrators and board members.

Separate from income, location, and size, there may be factors that districts (including declining enrollment districts) can control. These factors include the quality of programming within districts, the achievement level of schools, parental and community involvement, and many more. One option for dealing with declining enrollment would be to examine districts with increasing enrollments to see what strategies might be transferred to districts experiencing declining enrollments.

The Kalamazoo Promise Driving Enrollment Growth in Kalamazoo

The Kalamazoo Promise, a unique economic development tool, is largely credited with improving enrollments in that central city public school district. In November 2005, The Kalamazoo Promise was created as an education-based economic development tool, funded by a group of anonymous donors. While some of the specifics of the program can be fairly technical, the basic premise of The Promise program is that students graduating from the Kalamazoo Public School (KPS) district will receive full college scholarships. KPS is a large, urban district with an enrollment of over 12,000, of which 39 percent is African American. The program differs from other post-secondary scholarships in that it is not based on need or merit, but instead on location. Specifically, beginning with the graduating class of 2006, every graduate of KPS enrolled and residing within KPS for at least the previous four years is eligible for a scholarship to a Michigan public university or community college.

The Kalamazoo Promise was designed to address a host of issues confronting the area immediately surrounding KPS – educational achievement, economic development, community development, etc. Related to the education goals and specific to KPS finances, The Promise was effective at reversing the district's decades-long enrollment decline and helping stabilize district finances under the per-pupil foundation program. This change was the result of both "front end" and "back end" effects on annual enrollment levels. In terms of the "front end," The Promise has been responsible for drawing families (and students) from surrounding districts, incenting them to move (and enroll) in KPS. On the "back end," evidence suggests that the program has been effective in reducing "exit rates" from KPS. Furthermore, this research suggests that reducing the "exit rates" has had a more significant effect on enrollment gains than boosting the entry rates.[a] With the scholarship in place, students are less likely to transfer from KPS to other districts or charter schools.

From FY2005 to FY2010, KPS enrollment increased a total of 18.9 percent, from 10,343 to 12,301 students. This experience contrasts markedly with that of other urban school districts in Michigan during the same period. It also contrasts with the experience of the eight neighboring Kalamazoo County school districts (Climax-Scotts, Comstock, Galesburg-Augusta, Gull Lake, Parchment, Portage, Schoolcraft, and Vicksburg). Collectively, these districts witnessed a total enrollment decline of 7.3 percent from FY2005 to FY2010.

The Kalamazoo Promise clearly has had an effect on KPS enrollment by allowing the district to reverse its historical trend and begin growing in the face of statewide enrollment declines. To some extent, this growth has been at the expense of other districts. However, some of the growth is attributable to higher "retention rates" and reducing the number of students that exit KPS. Although improving KPS enrollments was not the sole educational objective of The Promise, it has been one result.

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[a] Timothy Bartik, Randall Eberts, and Wei-Jang Huang, "The Kalamazoo Promise: Enrollment and Achievement Trends in Kalamazoo Public Schools," presented at the PromiseNet 2010 Conference, June 16-18, Kalamazoo, Michigan.

Addressing Declining Enrollments

The state has recognized the fiscal management challenges created by declining enrollments at the school district level, opting to address the issue in two ways. The first method involves how students are counted for the foundation program and making changes to the weightings allocated to the components of the pupil membership figured used in the calculation of foundation grant funding (discussed earlier). The second method involves providing additional funding to declining enrollment districts through a categorical grant. In both cases, these responses have been less than fully effective in completely mitigating the negative revenue effects associated with declining enrollment.

In both cases, these responses have been less than fully effective in terms of completely mitigating the negative revenue effects associated with declining enrollment.

Blended Count

Over the years, the state has changed the weightings assigned to the blended count to help mitigate the negative revenue effects of declining enrollments on school districts' budgets. On different occasions, statutory changes to the State School Aid Act have been made to give more weight to the previous year's enrollment count and less to the current year's count. In FY2005, the current year/previous year weightings were changed from 80/20 to 75/25 to favor the previous year enrollment figures. The weightings were changed to 90/10 for FY2012, which will favor the current-year enrollment count more than the 75/25 blend.

The blended count is used by all districts (both traditional public school districts and charters) and affects declining and growing districts differently. The districts with increasing enrollments are prevented from taking full advantage of year-over-year enrollment gains. In effect, only 75 percent of an annual enrollment increase is reflected in the foundation program calculation. On the other hand, the use of the blended count protects declining districts from the full effects of lost pupils – current year pupil counts only represent 75 percent of the actual enrollment shrinkage. Stated another way, these districts are allowed to count 25 percent of the pupils they lost from one year to the next for purposes of the foundation program in the current year.

Policymakers might consider further modifications to the blended count, such as a change to a 60/40 or 50/50 composition in an effort to further shield declining districts from the full effect of lost pupils. The blended count used in the three years following Proposal A's adoption was 50/50 before changing to 60/40.

When the legislature decides to change the weightings to favor the previous year count (i.e., the higher enrollment figure for a declining district), districts with rising enrollments will be negatively impacted while declining enrollment districts will be advantaged. In other words, a growing district will experience a loss of funding compared to what the district would have received if the formula change did not occur.

Another option that might be considered involves the use of two different blended counts, one for declining districts (e.g., 70/30) and one for growing districts (e.g., 100/0). Such an approach would help shrinking districts manage through annual funding reductions when state aid is distributed on a per-pupil basis. Some states, such as Minnesota, allow declining districts to use a different blended count than growing districts in order to dampen the pupil loss year-over-year. A slight deviation of this option would allow declining districts to use a three-year average enrollment figure, providing equal weighting to each of the previous three year enrollment amounts.

Another alternative would allow districts to use the greater of the two most recent fall enrollment counts, a method endorsed by school business officials. This would allow declining districts a full year to plan for the reduction in students and accompanying funding cuts.

Categorical Funding

In recognition of the growing challenges raised by declining enrollment and as another tool to address the phenomenon, the legislature has set aside dedicated state resources to be shared by eligible districts. A new state categorical grant was created in FY2007 for declining districts. Basically, this funding is available to districts with two prior consecutive years of declining pupil memberships. Provisions in the state School Aid Act allow districts to calculate a three-year pupil membership average and use this number for the foundation grant calculation (which would be higher if a district is losing enrollments).[27] Each district's calculated payment is equal to the district's foundation grant multiplied by the difference between the three-year pupil membership average and the current-year membership figure. Districts receive less than the full calculated amount because of the amount of funding statewide and the number of districts eligible. The state law excludes charter schools from receiving declining enrollment grants

Although the declining enrollment categorical grant has been available since FY2007, the state has never fully funded the appropriation. To do so would be extremely expensive; requiring at least $220 million according to the Senate Fiscal Agency.[28] In recent years, the appropriation has been $20 million, down from $30 million in FY2008. Because of the increasing number of eligible districts each year and the relatively small amount of funding available, district declining enrollment grants have been significantly prorated. In FY2011, eligible districts will receive a prorated declining enrollment grant equal to about 8 percent of the full amount allowed under state law. Given the significant proration, the supplemental payments have not been able to make up for the revenue losses declining enrollment districts experience.

> These policies have benefited declining districts at the expense of other districts; however, they have fallen short of fully compensating districts for the revenue losses from fewer students.

Thus far, all state policies designed to address declining enrollment have had the effect of padding the enrollments of declining-enrollment districts. These policies have benefited declining districts at the expense of other districts; however, they have fallen short of fully compensating districts for the revenue losses from fewer students. In the case of the declining enrollment grants, constraints on the amount of state revenue available for this program have been the major limiting factor. Directing more state assistance to this categorical grant would leave fewer resources available to all districts under the foundation grant program, which can hamper efforts to reduce per-pupil funding disparities.

Per-Pupil Revenue Disparities

At its core, the foundation program was designed to provide general assistance to all local school districts in order to deliver at least basic educational services across the state. However, as noted earlier, there was no attempt to define what was included in the concept of "basic." Instead, each district's initial foundation grant was largely determined by the level of funding it received under the previous financing system. Initial adjustments to the FY1994 per-pupil revenue amounts were made with the understanding that those districts spending less than the "basic" grant amount were delivering something less than a basic educational program. At no time during the design or implementation of the foundation grant, and at no time since, has there been an explicit attempt to quantify what constitutes a basic education. Similarly, no attempt has been made to account for cost differences across districts. There is a touch of irony in the state's use of the term "basic" to describe a foundation grant amount when little has been done to establish what is, or is not, included in basic educational services across districts.

In addition to its role as the basic operating revenue source, the foundation program was designed as the state's tool to address the per-pupil funding disparities that existed between high- and low-revenue districts prior to FY1995. To reiterate, a stated goal of the Proposal A school finance reforms was to reduce, not eliminate, these disparities in the years just following the implementation of the new financing system. It was believed that such reductions would provide greater educational opportunity or horizontal equity -- meaning that similarly situated students would be treated similarly for purposes of school spending.[29] Horizontal equity does not involve equalizing per-pupil funding to take into account the different costs of educating children (e.g., student characteristics, teacher salaries, etc.) across districts. Also, either explicitly or implicitly stated at the time of Proposal A's enactment, it was thought that reducing per-pupil revenue differences would improve student performance in initially lower-revenue districts.

Differences at the District Level

By its very design, implementation of Michigan's foundation program did not seek absolute equity – where the same amount of per-pupil funding is distributed to all districts statewide. Absolute equity does not preclude differently situated students from being treated differently through the allocation of categorical or supplemental resources, i.e., special education students receiving additional resources compared to general education students. As previously noted, the design of Michigan's foundation program permitted certain per-pupil funding disparities to continue under specific condition (e.g., hold harmless districts had to raise the additional resources exclusively at the local level to maintain their higher per-pupil revenue amounts.)

Despite the initial per-pupil funding inequities that were folded into the new foundation program and the various foundation grant amounts (minimum, basic, and maximum), significant strides have been made towards greater horizontal equity. These have been accomplished over the years through two primary methods. First, the state employed the 2X formula to annually adjust the foundation grants of lower-revenue districts up to twice the size of higher-revenue districts. Second, the state equalized per-pupil revenue by providing occasional supplemental equity payments to the lowest-revenue districts. A third way that per-pupil revenue has been equalized is by reducing funding of the highest spending districts, but this only occurred once and its effects were minimal in terms of statewide equalization efforts (i.e., gubernatorial veto of Section 20j funding in the School Aid Fund budget in FY2010).

A fairly simple and straightforward method to chart progress towards per-pupil funding equalization and horizontal equity is to examine changes between the highest and lowest per-pupil foundation grants. **Table 7** illustrates how the range or equity gap between these two has been reduced in dollar terms between FY1994 (the per-pupil revenue amounts just before Proposal A) and FY2010.

The range between the highest and lowest foundation grants has been reduced considerably over the past 16 years. The absolute gap has been lowered from approximately $7,500 to $5,000, a reduction of 33 percent. Equity gains, also expressed as a ratio of the highest to the lowest, were made in every year since FY1994 with the exception of the two years when foundation grants were frozen (FY2003 and FY2004). Through FY2009, all equity gains were achieved through the "leveling up" approach, by either providing larger annual increases in foundation grants to those districts closer to the bottom of the range or providing these districts with supplemental equity payments.

Through FY2009, all equity gains were achieved through the "leveling up" approach, by either providing larger annual increases in foundation grants to those districts closer to the bottom of the range or providing these districts with supplemental equity payments.

The horizontal equity gains seen in FY2010 (reflected in the $119 gap reduction from

Table 7
Lowest and Highest Foundation Grants

	Lowest	Highest	Difference (High – Low)	Ratio (High to Low)
FY1994	$2,762	$10,294	$7,532	3.73
FY1995	$4,200	$10,454	$6,254	2.49
FY1996	$4,506	$10,607	$6,101	2.35
FY1997	$4,816	$10,762	$5,946	2.23
FY1998	$5,124	$10,916	$5,792	2.13
FY1999	$5,170	$10,916	$5,746	2.11
FY2000	$5,700	$11,154	$5,454	1.96
FY2001	$6,000	$11,454	$5,454	1.91
FY2002	$6,500	$11,754	$5,254	1.81
FY2003	$6,626	$11,880	$5,254	1.79
FY2004	$6,626	$11,880	$5,254	1.79
FY2005	$6,700	$11,954	$5,254	1.78
FY2006	$6,875	$12,129	$5,254	1.76
FY2007	$7,108	$12,339	$5,231	1.74
FY2008	$7,204	$12,387	$5,183	1.72
FY2009	$7,316	$12,443	$5,127	1.70
FY2010*	$7,162	$12,170	$5,008	1.70

Note: Lowest and highest grants are reflected here to show the effects of per-pupil reductions enacted throughout years that may not have been statutorily reflected in the foundation grant, but had the same effect. Also, equity payments subsequently incorporated into the foundation grant are included.

* FY2010 includes the effects of the $154 per pupil reduction for all districts and the hold harmless/Sec. 20j veto reduction for select districts.

Source: Senate Fiscal Agency

FY2010 Per-Pupil Reduction and the Section 20j Veto

Despite the use of $450 million in one-time federal resources available from the American Recovery and Reinvestment Act of 2009, the FY2010 School Aid Fund budget required further reductions from the spending levels authorized in FY2009 based on the estimated level of available resources. Initially, the budget included a $165 per-pupil reduction in state aid for all districts. Subsequent action reduced the funding cut by $11 per student, thus the final FY2010 budget included a $154 per-pupil cut for all districts. (The legislature did not statutorily reduce the basic foundation grant within the State School Aid Act, but the reduction had the same basic effect. For this reason, the reduction is included in the foundation grants presented here.) Because the reduction applied to all districts, it had no effect on per-pupil revenue disparities.

In addition to the $154 per-pupil reduction, hold harmless districts were affected by a veto of the Section 20j allocation contained within the State School Aid Act (discussed earlier). This veto had the effect of reducing per-pupil revenue amounts in affected districts to varying degrees in FY2010 because of the manner in which the supplemental payments are calculated. In total, the veto affected 40 districts in amounts ranging from a $119 per-pupil cut in Bloomfield Hills School District, with an effective foundation grant of $12,443, to a $324 per-pupil cut in Harper Woods School District, with an effective foundation grant of $8,497.

Unlike the $154 per-pupil cut, the 20j cut did have the effect of reducing the revenue disparities at the per-pupil level, albeit very minimally because of the relatively small size of the cut to districts with the highest per-pupil grants. Also of significance is the fact that the 20j cut produced equity gains by cutting state aid funding for the higher revenue districts as opposed to providing additional funding to districts below the hold harmless amount.

FY2009 to FY2010) were achieved by breaking with the tradition of leveling up those districts nearer the bottom of the range. Instead, equity gains were effectively realized when the highest grant was reduced. This occurred as a result of Governor Granholm's veto of a supplemental state aid payment to certain high-revenue districts (Section 20j) as part of the FY2010 state budget. Justification for the veto was premised on concerns about projected revenue availability in the School Aid Fund for FY2010, not on a policy to increase school funding equity (see **FY2010 Per-Pupil Reduction and the Section 20j Veto** box). However, the veto had the effect of narrowing the gap between the lowest- and highest-revenue districts from $5,127 per pupil in FY2009 to $5,008 per pupil in FY2010.

The chief problem with using the range as a measure of per-pupil revenue disparities is the fact that this measures differences at the extremes, ignoring the distribution of per-pupil amounts that exist between the lowest and highest amounts. Furthermore, these amounts do not provide any information about how many students are at each level, or the number of students at various amounts in between the two extremes. Another way to examine the reduction in per-pupil revenue disparities under the school finance system is to sort school districts by their foundation grant and then group districts into five equal sub-groups or quintiles. To represent the per-pupil revenue amount for each subgroup, the average foundation grant is calculated and examined. Changes in the average for each quintile over time show how per-pupil disparities have been lessened.

Table 8 presents per-pupil revenue disparities at the district level by quintile in inflation-adjusted dollars (FY2009) for FY1994, FY2000 and FY2009. An intermediary point (FY2000) is selected because through this period a sliding scale was used to provide additional funds to lower-revenue districts. This sliding scale was abandoned in the following years, until its reemergence and implementation in FY2008. The change in the average foundation grant for each quintile is compared to the average figure for that group just prior to the finance reforms in FY1994.[30]

The greatest degree of foundation grant growth for all districts occurred between FY1994 and FY2000, but growth was the greatest for the districts with the lowest per-pupil revenues.

The greatest degree of foundation grant growth for all districts occurred between FY1994 and FY2000, but growth was the greatest for the districts with the lowest per-pupil revenues. Between FY1994 and FY2000, the average foundation grant in the first quintile (lowest per-pupil revenue districts) increased by $1,380 per pupil in real terms. At the other end, the growth of the average grant in the fifth quintile (highest per-pupil revenue districts) failed to keep pace with inflation and declined by $232 per pupil. The gap between the two quintiles in constant FY2009 dollars was reduced from $3,876 per pupil in FY1994 to $2,264 per pupil in FY2000, a 42 percent cut.

The lowest per-pupil revenue quintile realized further equity gains between FY2000 and FY2009 as a result of two equity payments ($200 per pupil in FY2002 and $23 per pupil in FY2007) and the use of the 2X formula in FY2008 and FY2009. The spread between the foundation grants of the first and fifth quintiles was further reduced in the years between FY2000 and FY2009, falling from $2,264 per pupil in FY2000 to $1,511 per pupil in FY2009. The highest per-pupil revenue quintile lost further ground relative to inflation over the FY2000 to FY2009 period. Similarly, the growth in the average grant for the fourth quintile did not keep pace with inflation. During this period, the lowest three quintiles continued to see growth in real terms from their pre-Proposal A foundation grant amounts.

Table 8
Inflation-Adjusted Average Foundation Grants by District Group*: FY1994, FY2000, and FY2009

Quintile**	FY1994	FY2000	FY2009	Change FY1994 - FY2000	Change FY2000 - FY2009	FY1994 – FY2009 Dollar Change	FY1994 – FY2009 Percent Change
1	$5,755	$7,135	$7,333	$1,380	$198	$1,578	27.4%
2	$6,348	$7,135	$7,324	$787	$189	$976	15.4%
3	$6,773	$7,145	$7,322	$372	$177	$549	8.1%
4	$7,460	$7,577	$7,496	$118	($82)	$36	0.5%
5	$9,630	$9,399	$8,844	($232)	($555)	($786)	(8.1%)
Diff. = Q5 - Q1	$3,876	$2,264	$1,511				

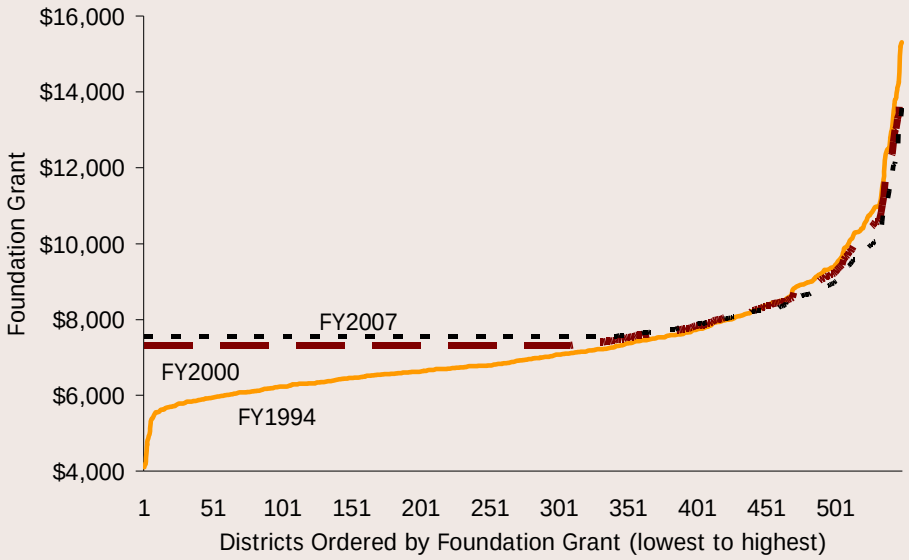
* Foundation grants include the supplemental allocation provided to eligible districts under Section 20j of the School Aid Act.

** Quintiles include 110 districts (5th quintile excludes two districts – Bois Blanc and Grant Twp – with small enrollments and high per-pupil revenues in FY1994).

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

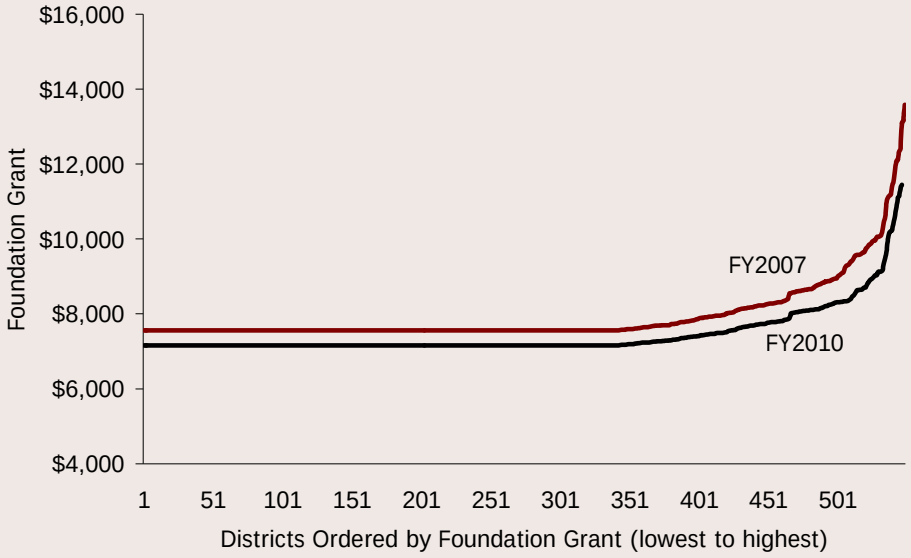
Equalization of per-pupil revenue across school districts under Proposal A is further evidenced in terms of the distribution of districts by their foundation grants in constant FY2010 dollars, when amounts for FY1994, FY2000, and FY2007 are compared (see **Chart 15**). Clearly, the various mechanisms used to level up have been successful, with more districts at the same, higher per-pupil revenue amount. Furthermore, lower-revenue districts (those on left side of chart) have experienced growth relative to inflation at each point (FY2000 and FY2007) since FY1994. However, growth of the foundation grants for higher-revenue districts (right side of the chart) has trailed inflation. As can be seen, the inflation-adjusted FY2007 foundation grant in nearly 20 percent of the districts is below the FY1994 level.

Chart 15
Distribution of Districts by Foundation Grant: FY1994, FY2000, and FY2007
(FY2010 Dollars)



Source: Michigan Department of Education; US Bureau of Labor Statistics

Chart 16
Distribution of Districts by Foundation Grant: FY2007 and FY2010
(FY2010 Dollars)



Source: Michigan Department of Education; US Bureau of Labor Statistics

Further erosion of the grant occurred between FY2007 and FY2010 with the per-pupil reductions that affected all districts and the Section 20j veto that affected only the highest-revenue districts. As a result of these cuts, the real value of the foundation grant in all districts in FY2010 is below where it was in FY2007, but the decline was greater for those districts with higher foundation grants because of the Section 20j veto (see **Chart 16**).

Differences at the Student Level

The previous comparisons focused on disparities among districts where each quintile consisted of an equal number of districts; however, the aggregate number of Michigan school children varied within each quintile because districts have different enrollments. Another way to look at reductions in per-pupil revenue disparities is to examine changes at the student level. To do this, students are ranked by the level of per-pupil revenue in their districts and divided into quintiles, similar to the operation involving districts. An average foundation grant for each subgroup is calculated. Then changes over time in the average grant for each quintile are examined to determine progress towards narrowing the per-pupil revenue gap among K-12 students. We would expect to see similar results to what was discovered at the district level, which is the case. **Table 9** presents this information in constant FY2009 dollars (inflation-adjusted) for three years, FY1994, FY2000, and FY2009.[31]

> Whereas per-pupil revenue growth for the bottom 40 percent of students surpassed inflation from FY1994 through FY2009, the revenue growth for nearly 40 percent of Michigan students failed to keep pace with inflation and the middle 20 percent of students just barely kept pace with inflation during the period.

The general result at the student level is similar to that observed at the district level, notably that considerable progress has been made to narrow the gap between the number of students in high- and low-revenue districts. The spread between the fifth quintile (highest per-pupil revenue) and the first quintile (lowest per-pupil revenue) was decreased from $4,254 per pupil in FY1994 to $1,933 per pupil in FY2009, after adjusting for the effects of inflation.

Whereas per-pupil revenue growth for the bottom 40 percent of students (first and second quintiles) surpassed inflation from FY1994 through FY2009, the revenue growth for nearly 40 percent of Michigan students (fourth and fifth quintile) failed to keep pace with inflation and the middle 20 percent of students just barely kept pace with inflation during the period. Sixty percent of Michigan school children have experienced inflation-adjusted per-pupil revenue growth since the adoption of Proposal A; however, the average real per-pupil rev-

Table 9
Inflation-Adjusted Average Foundation Grants by Student Group*: FY1994, FY2000, and FY2009

Quintile**	FY1994	FY2000	FY2009	Change FY1994 - FY2000	Change FY2000 - FY2009	FY1994 – FY2009 Dollar Change	FY1994 – FY2009 Percent Change
1	$6,065	$7,135	$7,322	$1,070	$187	$1,257	20.7%
2	$6,760	$7,152	$7,325	$391	$173	$564	8.3%
3	$7,452	$7,570	$7,498	$119	($73)	$46	0.6%
4	$7,964	$7,997	$7,816	$33	($181)	($147)	(1.8%)
5	$10,319	$9,981	$9,255	($338)	($726)	($1,064)	(10.3%)
Diff. = Q5 - Q1	$4,254	$2,846	$1,933				

* Foundation grants include the supplemental allocation provided to eligible districts under Section 20j of the State School Aid Act.

** Quintiles based on FY2009 enrollments and each includes 302,600 students (5th quintile excludes two districts – Bois Blanc and Grant Twp – with small enrollments and high per-pupil revenues in FY1994).

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

enue amount for 40 percent of K-12 students (fourth and fifth quintiles) was larger in FY1994 than it was in FY2009.

Foundation Growth and District Wealth

The foundation program and the annual adjustments made to the foundation grant ignore certain economic and demographic characteristics of individual districts and the students attending these schools. In some cases categorical funding provides additional resources to districts to educate students based on various economic and demographic factors with the understanding that these characteristics may make it more difficult to educate children. Examples include at-risk and special education students. However, because the vast majority of state aid is distributed through the foundation program and this funding provides the basis for school operations, it is instructive to examine foundation grant growth by various district characteristics. Also, it may be the case that the additional funding allocated through categorical grants does not fully support the added costs associated with certain students, and the foundation grant subsidizes the education of select groups of students.

The state's policies to raise the bottom have not had the direct affect of increasing funding for districts serving the state's poorest populations.

While poorer districts have seen larger increases in their per-pupil grant from FY1994 to FY2009 compared to wealthier districts, the poorest districts have not fared the best. Some of the poorest districts in the state prior to Proposal A had per-pupil revenues at or above the statewide average and therefore did not receive the largest benefits from state efforts to reduce per-pupil revenue disparities. Prior to Proposal A, district wealth and per-pupil revenue were not perfectly correlated, although there was a positive relationship between the two.

There are a number of reasons why the poorest districts have not benefited the most from the state's funding equalization efforts. Specifically, some large districts located in poor central cities benefited from higher tax rates and more state aid, resulting in higher per-pupil revenues prior to Proposal A. At the same time, many middle-income districts (rural and suburban) with average household income or property wealth had low per-pupil revenues because the residents in those communities chose to tax themselves at relatively low rates and did not receive as much state aid. Thus, the state's policies to raise the bottom have not had the direct affect of increasing funding for districts serving the state's poorest populations.

Table 10
Inflation-Adjusted Average Foundation Grant by District Median Household Income: FY1994 and FY2009

Quintile	Median Income	FY1994	FY2009	Dollar Change	Percent Change
1	$36,723	$6,989	$7,677	$688	9.8%
2	$42,878	$6,526	$7,413	$887	13.6%
3	$47,611	$7,064	$7,590	$526	7.4%
4	$55,683	$7,363	$7,667	$304	4.1%
5	$66,858	$7,964	$7,944	($20)	-0.3%
Diff. = Q5 - Q1		$975	$267		

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

Table 11
Inflation-Adjusted Average Foundation Grant by District Property Wealth: FY1994 and FY2009

Quintile	Median SEV/Pupil	FY1994	FY2009	Dollar Change	Percent Change
1	$133,918	$6,571	$7,386	$815	12.4%
2	$171,289	$6,473	$7,348	$875	13.5%
3	$207,257	$6,666	$7,425	$758	11.4%
4	$267,441	$7,093	$7,541	$448	6.3%
5	$436,183	$9,128	$8,603	($525)	-5.7%
Diff. = Q5 - Q1		$2,557	$1,217		

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

Table 10 examines the growth in foundation grants by districts' median household income.[32] The average foundation for the districts serving the poorest populations (first quintile) experienced inflation-adjusted growth of 9.8 percent between FY1994 and FY2009; however, this was below the growth seen in the second quintile (13.6 percent). The districts serving the poorest populations did not benefit the most from the perspective of reducing per-pupil revenue disparities, but they did do better than the wealthiest 60 percent of school districts.

As would be expected from the discussion about foundation grant growth, the quintile with the highest median household income (fifth quintile) experienced a decline in the real value of the average foundation grant. In the pre-Proposal A era, many of the wealthiest school districts also had the highest per-pupil revenues because of their substantial property wealth. They were able to generate significant local property tax receipts with low tax rates and they did not face the strict per-pupil revenue caps that exist today under Proposal A's centralized school financing system.

The spread between the average foundation grant in the districts serving the poorest populations (first quintile) and the districts serving the wealthiest populations (fifth quintile) was reduced from $975 in FY1994 to $267 in FY2009.

As was the case with the breakout of districts by household income, the districts serving the poorest populations did not fare the best in terms of inflation-adjusted grant growth from FY1994 to FY2009.

Similar results are seen when district wealth is measured in terms of property wealth (taxable value per pupil). Under the previous school financing system property wealth was directly, but not perfectly, correlated with per-pupil revenue. The link between property wealth and per-pupil revenue was stronger than the relationship between household income levels and per-pupil revenue. The correlation between property wealth and district revenue was strongest for the highest-revenue districts (**Table 11)**. In terms of Proposal A's efforts to reduce per-pupil funding disparities, progress can be seen in the difference, over time, of the average foundation grant of the districts with the highest property wealth (fifth quintile) and the average grant for the districts with the lowest property wealth (first quintile). As was the case with the breakout of districts by household income, the districts serving the poorest populations did not fare the best in terms of inflation-adjusted grant growth from FY1994 to FY2009. The average foundation of the second quintile of districts had the greatest total inflation-adjusted growth (13.5 percent) during the period.

Table 12
Inflation-Adjusted Average Foundation Grant by Percent of Free or Reduced-Price Lunch Eligible Students: FY1994 and FY2009

Quintile	FY1994	FY2009	Dollar Change	Percent Change
1	$7,238	$7,718	$480	6.6%
2	$6,787	$7,557	$770	11.3%
3	$6,751	$7,480	$729	10.8%
4	$7,282	$7,634	$352	4.8%
5	$7,874	$7,914	$40	0.5%
Diff. = Q5 - Q1	$636	$196		

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

A related analysis of per-pupil revenue based on another measure of district wealth produced similar results as those based on median household income and property wealth. For this examination, school districts were ranked by the percentage of total students eligible for free or reduced-price lunch under the National School Lunch Program.[33] This measure is not used to determine the amount of the foundation grant received by individual districts; however, the number of students qualifying for free lunch under the National School Lunch Program in each district is used to distribute state resources under the at-risk student categorical program (see **At-Risk Categorical Funding** box on page 51). For purposes of determining district wealth, it is assumed that districts with larger percentages of students eligible for free or reduced-price lunch are relatively poorer than those with smaller percentages of eligible students.

Table 12 shows the growth of the inflation-adjusted average foundation grants for each quintile of school districts ranked by this metric. In this comparison, the districts in the second and third quintiles (districts falling between the 20 and 60 percentiles) had the greatest real foundation grant growth, followed by the first quintile. The group consisting of the districts serving the fewest free or reduced-price lunch students saw growth that slightly exceeded (0.5 percent) the growth in general prices from FY1994 to FY2009.

At-Risk Categorical Funding

Michigan has a long-standing commitment to providing supplemental funding for school children determined to be educationally at-risk. State at-risk funding targets children from low-income households based on federal free lunch eligibility criteria. The basic premise is that these low-income children, for a variety of reasons but primarily economic ones, have educational needs that are more complicated and thus require additional resources. This money is designed to supplement, not supplant, general operating funding provided through the foundation grant. Thus, even before Proposal A, this funding was provided through a separate categorical program. However, since the adoption of Proposal A, the amount of at-risk money that an eligible district receives is directly related to the size of the district's foundation grant.

Eligibility and Use of Funding. Both traditional public school districts and charter schools with a foundation grant below the maximum amount are eligible for at-risk funding. A one-time application is required to begin receiving the supplemental funds and money must be used for pupils who meet at least two of the following characteristics:

- Victim of child abuse or neglect,
- Below grade level in English language and communications skills or mathematics,
- Pregnant teenager or teenage parent,
- Eligible for free or reduced-price lunch,
- Atypical behavior or attendance patterns,
- Family history of school failure, incarceration, or substance abuse.

In addition, other pupils may be eligible for this funding based on academic performance on the most recent Michigan Education Assessment Program or Michigan Merit Exam; pupils in grades K-3 who are at risk of not meeting core curricular objectives; and children birth to age 5 that meet the at-risk criteria used to determine eligibility for the Great Start School Readiness Program.[a]

Unlike the general foundation grant, at-risk funds cannot be used for all operating costs associated with educating at-risk students. The funding must be used for specific instructional programming and direct non-instructional services, as defined in state law. Generally speaking, instructional programs include tutorial services, early childhood education, reduced class size, adult education (e.g., adult high school completion, adult English as a second language), K-3 early intervention, and reading assistance. Direct non-instructional services can include early childhood education, medical and counseling services, school health clinics, security, and hearing and vision screenings.[b]

Equally important, state law prohibits at-risk funds from being used for any administrative costs associated with the instructional or direct non-instructional programming, including personnel time spent managing the program, audit, evaluation, and/or indirect costs.

Allocation to Districts and Funding History. At-risk funds are distributed to traditional public school districts and charter schools via a formula based on the number of students who qualified for free lunch under the National School Lunch Program in the previous fiscal year and the amount of the foundation grant.[c] Statutorily, for each eligible at-risk student, a district receives a maximum supplemental payment equal to 11.5 percent of the district's foundation grant. This percentage is established in the annual School Aid Fund budget and it has remained constant since 1995. For example, a district that received the state minimum foundation grant of $7,316 in FY2009, was eligible to receive a maximum at-risk payment of $841 per eligible student, totaling $8,157 for each at-risk pupil in combined foundation grant and categorical funding. However, this amount was reduced by 30 percent to meet the available funding.

A district's maximum total at-risk supplemental payment is calculated by multiplying the number of eligible pupils by 11.5 percent of the district's foundation grant. However, a district's actual payment is controlled by the amount appropriated each year. When the appropriation is below the full amount needed to satisfy all districts' statutory maximum, a prorated amount is distributed. Proration is calculated to provide the same per-pupil dollar reduction for each district.

Table 13 (on page 52) presents the history of at-risk funding and the number of eligible students each year for the last eight years, FY2003 to FY2010. The total appropriation amount has remained fairly constant, hovering around $310 million per year; however, the number of students eligible for this funding has increased rapidly and steadily, rising from 444,916 students in FY2003 to 558,554 students in FY2010 – a total increase of 26 percent. Similarly, the number of districts participating also has increased over the eight-year period, mirroring the state's economic troubles and the associated decline in jobs and incomes. As a direct result of flat funding and rising eligibility, the required per-pupil re-

Table 13
At-Risk Categorical Funding History and Per-Pupil Proration

	"At-Risk" Appropriation (millions)	Eligible "Free Lunch" Students	Number of Districts	Percent of Statutory Maximum	Per-Pupil Proration
FY2003	$ 314.2	444,916	675	90.6%	$ 73
FY2004	$ 314.2	459,414	684	87.1%	$ 99
FY2005	$ 310.4	479,825	701	83.1%	$130
FY2006	$ 310.5	499,939	707	77.7%	$176
FY2007	$ 310.5	508,577	714	74.9%	$206
FY2008	$ 310.5	528,946	715	70.9%	$242
FY2009	$ 309.0	531,827	719	69.8%	$254
FY2010	$ 309.0	558,554	741	64.9%	$295

Source: Michigan Department of Education; Center for Educational Performance Information.

duction from each district's statutory maximum increased — from $73 in FY2003 to $295 in FY2010.

Table 14 illustrates the effects of the prorated per-pupil funding reductions on a district receiving the minimum foundation grant. By law, the maximum per-pupil at-risk supplement grew with the minimum grant from $771 in FY2003 to $841 in FY2010. However, because of proration, the actual per-pupil at-risk payment declined from $698 in FY2003 to $546 in FY2010 – a total reduction of 22 percent. Inflation increased by 19 percent during this period; therefore, the real value of the at-risk payment declined by 34 percent.

[1] Michigan Department of Education, Office of School Improvement, *Section 31a Program for At-Risk Pupils Allowable Uses of Funds*, December 2009.

[2] Ibid.

[3] For example, the FY2010 distribution is based on the number of free lunch-eligible students on October 31, 2008 (FY2009) and reported to the Michigan Department of Education, subject to adjustment not later than December 31, 2008.

Table 14
Effects of Prorated At-Risk Funding on Districts Receiving Minimum Foundation Grant

	Minimum Foundation Grant	Maximum Per-Pupil At-Risk Payment	Pro-Rated Per-Pupil At-Risk Payment
FY2003	$6,700	$771	$698
FY2004	$6,700	$771	$671
FY2005	$6,700	$771	$640
FY2006	$6,875	$791	$614
FY2007	$7,108	$817	$612
FY2008	$7,204	$828	$587
FY2009	$7,316	$841	$587
FY2010	$7,316	$841	$546

Source: Michigan Department of Education; Center for Educational Performance Information.

The Achievement Gap

The educational achievement gap between poor and non-poor children, and between minority and white children, has been at the center of national and state education policy debates for decades. Major federal judicial rulings (e.g., 1954 *Brown v. Board of Education* desegregation decision) and legislative changes (e.g., the 1965 Elementary and Secondary Education Act) have addressed achievement disparities among school-age children. More recently, the enactment of the federal No Child Left Behind (NCLB) law required universal testing and disaggregating test scores in order to better identify and address disparities. Despite these major initiatives, a number of poor, minority Michigan school children still struggle to achieve on national and state tests, relative to non-poor, non-minority students.

> Although there is evidence that the achievement gap between White and non-White students in Michigan has narrowed, it remains among the largest in the nation based on NAEP scores.

The magnitude of the achievement gap in Michigan was brought into clear focus when Detroit Public Schools' scores on the 2009 National Assessment of Educational Progress (NAEP) were reported. The Detroit Public School district, where only about 3 percent of the students are white, registered the lowest test scores in the history of the NAEP.[34] Compared to students in other large urban school districts across the county, low-income African American students in Detroit scored the worst.[35]

Unfortunately, the educational performance struggles of Michigan's low-income and minority students are not limited to Detroit Public Schools. Based on the state-administered Michigan Educational Assessment Program (MEAP) test, non-white students (African American and Hispanic) did not perform as well as white students statewide in 2010. Scores on fourth and eighth grade reading and math tests were lower for non-white students than their white counterparts (see **Table 15**). Although there is evidence that the achievement gap between white and non-white students in Michigan has narrowed, it remains among the largest in the nation based on NAEP scores.[36]

In FY2009, African American students accounted for 17 percent of the total student population in traditional public schools; however, the distribution of this population across the 551 traditional public school districts was far from homogenous. African American students were heavily concentrated in a handful

Table 15
2010 MEAP Scores

	Reading		Math	
Race	**Grade 4**	**Grade 8**	**Grade 4**	**Grade 8**
All Students	430.3	821.8	428.8	818.1
White	434.8	825.0	432.1	821.5
Hispanic	421.2	814.3	421.7	810.1
Black	415.1	810.3	416.2	803.7
Difference: White-Black	19.7	14.7	15.9	17.8
Difference: White-Hispanic	13.6	10.7	10.4	11.4

Source: Michigan Department of Education

Table 16
Distribution of African American Students

Percent of District African American	Number of Districts	Percent of African American Students Statewide
0% to 1%	225	0.7%
1% to 5%	192	4.5%
5% to 33%	96	23.1%
> 33%	38	71.7%

Source: Center for Educational Performance and Information

of districts, which are mainly urban (see **Table 16**). Thirty-eight districts accounted for almost three-fourths of all African American students in traditional public school districts. Conversely, 412 (75 percent of all districts) had student populations that consisted of less than 5 percent African American children.

Foundation Growth and District Racial Composition

District students' race is a characteristic that was largely ignored in establishing the initial foundation grant amounts and has not played any role in the annual adjustments made to the grant since. Original foundation grants were based on pre-Proposal A per-pupil revenue amounts and those districts with the highest concentrations of non-white students (many of the urban districts such as Detroit, Flint, Lansing) had some of the highest per-pupil revenue amounts because they benefited from greater amounts of state aid (due to high tax rates and low property wealth) under the previous financing system and received more categorical assistance because of their unique student and district characteristics. Since Proposal A's adoption the greatest annual revenue increases have been targeted at the lowest revenue districts. Thus, in light of Proposal A's goal of raising the per-pupil amounts of the lowest revenue districts, districts with the highest concentrations of non-white students did not benefit the most from per-pupil funding equalization.

When growth in foundation grants across districts is examined through a racial composition lens, districts with the highest percentage of African American students have fared the worst (see **Table 17**). The average foundation grant in these districts declined 3.0 percent in inflation-adjusted dollars between FY1994 and FY2009, compared to a 10.1 percent

Table 17
Inflation-Adjusted Average Foundation Grants by Percent of African American Students in FY2009: FY1994 and FY2009

Percent of District African American	FY1994	FY2009	Dollar Change	Percent Change
0% to 1%	$6,902	$7,599	$698	10.1%
1% to 5%	$6,970	$7,536	$566	8.1%
5% to 33%	$8,031	$8,014	($17)	-0.2%
> 33%	$8,334	$8,088	($246)	-3.0%

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.

increase in districts where the African American population makes up less than 1 percent of the student enrollment. Districts with the highest concentration of African American students had the highest average grant in FY1994, which is still the case in FY2009; however, because of disparate growth rates, the per-pupil revenue difference between district groups declined from $1,432 in FY1994 to $409 in FY2009.

These districts consist of students scoring the lowest on Michigan's standardized MEAP tests and have some of the highest dropout rates in the state. Thus, Proposal A provided the smallest annual per-pupil increases (after adjusting for inflation) to some of the state's worst performing students and districts with the poorest populations. As discussed later in this report, many of these districts also experienced the largest enrollment declines since Proposal A, which exacerbated the financial losses associated with minimal per-pupil annual increases.

Total Foundation Revenue Changes by District Type

Under the foundation program, the total amount of general operating assistance that an individual school district receives each year is determined based on the amount of its foundation grant and the district's pupil membership. **Table 18** provides a summary of the interaction of enrollment changes and foundation grant changes (i.e., enrollment multiplied by foundation grant) from FY1995 to FY2009 and their cumulative effect on the growth in total foundation revenue by type of traditional public school district.[37]

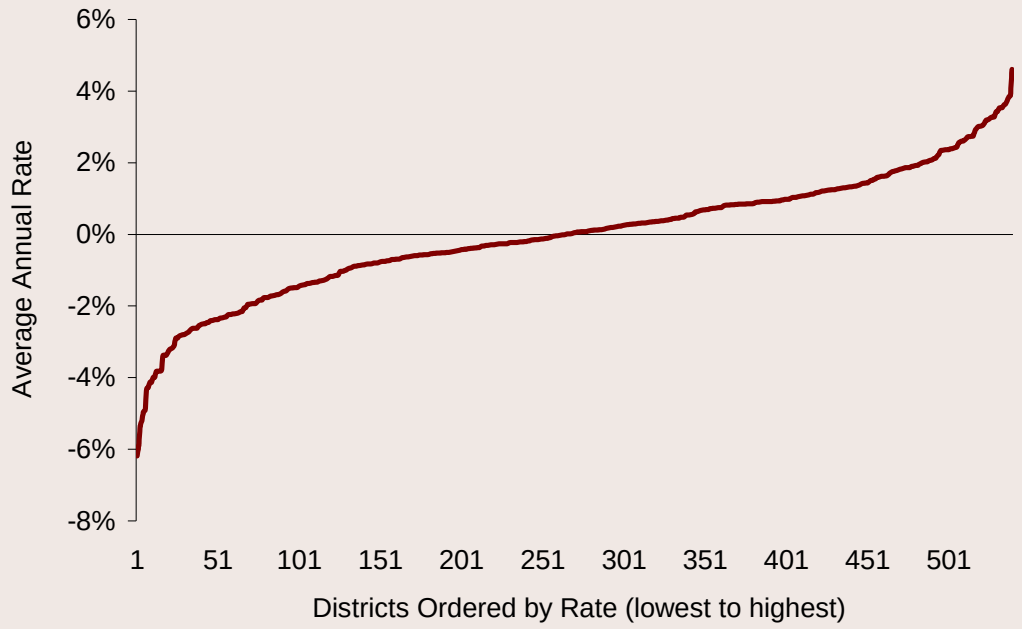
Just over 60 percent of all districts have seen some reduction in their student enrollment from FY1995 to FY2009. Rural districts have been impacted the greatest as nearly 72 percent of all the districts in that grouping have experienced enrollment decline. Almost 70 percent of all central city districts have

Table 18
Changes in Enrollment, Foundation Grant, and Total Foundation Revenue by District Type: FY1995 to FY2009
(FY2009 Dollars)

	Enrollment		Real Foundation Grant		Total Foundation Revenue	
	Decline	Gain	Decline	Gain	Decline	Gain
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.

Chart 17
Annual Rate of Change in Total Foundation Revenue: FY1995 to FY2009



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.

experienced enrollment losses over the last 15-year period. In contrast, the number of suburban districts with enrollment gains has outnumbered the suburban districts with enrollment losses.

Compared to the number of districts experiencing some degree of declining enrollment, many more districts experienced some real growth in the foundation grant between FY1995 and FY2009. Nearly two-thirds of all school districts saw the growth in their foundation grant exceed the growth in inflation over the 15-year period.

When enrollment and foundation grant changes are combined, a total of 273 districts, nearly half of all traditional public school districts, have experienced a decline in their inflation-adjusted total foundation revenue between FY1995 and FY2009.

Of course, the experiences of Michigan's districts have been anything but uniform in terms of the degree of total foundation revenue growth: some districts have experienced substantial real foundation revenue growth while others have seen significant revenue losses. To show this diversity, **Chart 17** presents the average annual rate of change in total foundation revenue for traditional public school districts between FY1995 and FY2009.[38] The average annual rates ranged from a decline of 6.2 percent (far left side of chart) to an increase of 4.6 percent (far right side of chart). The average annual rate of change in the total foundation revenue between FY1995 and FY2009 was a decline of 0.23 percent.

Despite the variation in annual rates of change, some broad conclusions can be drawn about the observed changes in total foundation revenue, especially when

districts are categorized by type (city, suburban, rural). As a group, suburban districts have fared better than central city and rural districts, primarily due to rising enrollments. Rising enrollments helped offset foundation grant declines. Although rural districts experienced the greatest growth in the foundation grant between FY1995 and FY2009, partially because they had the lowest per-pupil revenue before Proposal A, declining enrollments in these districts have been particularly problematic and caused total foundation revenue declines in many cases. The central city districts experienced the worst of both worlds: declining enrollments and reductions in their inflation-adjusted foundation grants.

Traditional public school districts serving students in some of Michigan's largest and most iconic cities have experienced the largest total foundation revenue declines, primarily as a result of enrollment losses. In some cases, such as Detroit, these districts are responsible for educating large portions of the state's children enrolled in traditional public schools (see **Table 19**).

Traditional public school districts serving students in some of Michigan's largest and most iconic cities have experienced the greatest total foundation revenue declines, primarily as a result of enrollment losses.

Detroit and Flint, for example, both experienced enrollment declines of greater than 40 percent between FY1995 and FY2009, contributing to total foundation revenue declines of 42 percent and 46 percent, respectively. Even in some districts that experienced moderate real growth of their foundation grants, such as Benton Harbor, these financial gains were wiped out entirely by the attendant enrollment losses. Even moderate enrollment declines, such as those that occurred in Bay City, can overwhelm the positive fiscal effects that accompanied strong foundation grant revenue growth.

Table 19
Changes in Enrollment, Foundation Grant, and Total Foundation Revenue in Select Districts within Urban Areas: FY1995 to FY2009

	Percentage of Statewide Enrollment	District Enrollment Change	Real Per-Pupil Grant Change	Total Foundation Revenue Change
Flint	0.9%	-44.8%	-1.6%	-45.7%
Benton Harbor	0.2%	-43.8%	12.4%	-36.8%
Pontiac	0.5%	-42.6%	-1.5%	-43.5%
Detroit	6.2%	-40.3%	-2.9%	-42.0%
Grand Rapids	1.2%	-28.0%	1.2%	-27.1%
Lansing	1.0%	-27.3%	-1.0%	-28.0%
Saginaw	0.6%	-27.0%	-2.3%	-28.7%
Muskegon	0.3%	-23.8%	1.3%	-22.8%
Battle Creek	0.4%	-22.6%	-1.7%	-23.9%
Jackson	0.4%	-18.4%	-0.7%	-18.9%
Highland Park	0.2%	-13.9%	-4.3%	-17.6%
Bay City	0.6%	-13.0%	16.8%	1.7%

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.

Where Did All the Students Go?

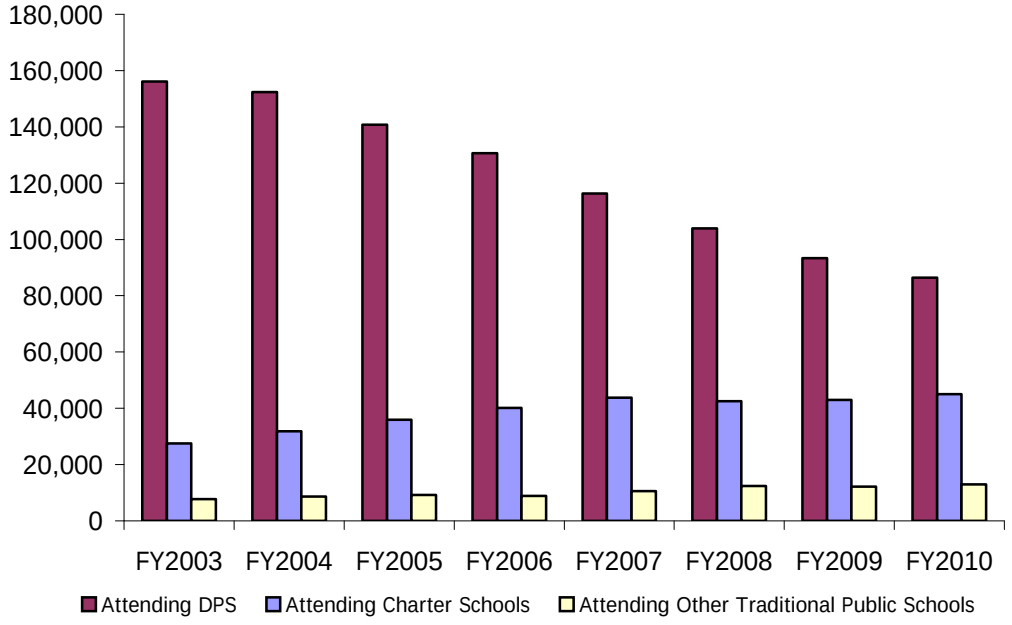
Detroit is Michigan's most iconic city and is home to the state's largest school district, Detroit Public Schools (DPS). In FY2010, 9.0 percent (144,435) of the state's public K-12 student population resided in Detroit and attended DPS, charter schools within Detroit, non-Detroit charter schools, or other traditional public schools. Of this total, DPS was responsible for educating the largest share of Detroit resident students, about 60 percent or 86,470 students (5.8 percent of the state's traditional public school students), larger than the combined student body of the next four largest districts in FY2010.

Similar to other urban cities (Flint, Grand Rapids, Lansing, and Saginaw), the main public school district (DPS) has experienced massive enrollment losses in recent years, particularly since FY2003 when statewide enrollments peaked. In the case of DPS, enrollments in FY1995 (158,379 students) and FY2003 were basically the same (156,182 students). This means that almost the entire enrollment decline since the adoption of the foundation program in FY1995 was concentrated between FY2003 and FY2010. Over this seven-year period, DPS's enrollment declined every year for a total loss of 63,305 students or 43.7 percent. This enrollment loss is nearly equivalent to the combined enrollments in the next three largest districts (Utica Community Schools, Plymouth-Canton Community Schools, and Grand Rapids Public Schools). So, where did all the students go that were previously enrolled in DPS? No single factor accounts for the enrollment decline, rather a host of factors contributed to this massive loss.

One factor which is not unique to Detroit has to do with the reduction in birth rates and the end of the Baby Boom Echo (i.e., children of Baby Boomers or those born between the mid-1970s to early 2000s). This is reflected in the fact that statewide enrollment figures since Proposal A peaked in 2003. Additionally, statewide enrollments also declined in response to the economic situation in the state: employment opportunities in Michigan, or the lack thereof, have caused families, including those with school-age children, to leave the state to seek work elsewhere.

In addition to the broad demographic forces affecting Michigan's population and DPS, part of the explanation lies with the long-term trend in population changes for the City of Detroit. Detroit has been losing population consistently since the 1950s, according to decennial census figures, with the rate of loss varying over time. Prior to 2010 decennial

Chart 18
Detroit Resident Enrollments: FY2003 to FY2010



Source: Center for Educational Performance and Information

census, declines were greatest between 1970 and 1990. Between 1990 and 2000, the rate of decline was less pronounced. In contrast, the State of Michigan consistently gained population since the 1950s and only recently (beginning in 2006) began losing population.

Most recently the U.S. Census reported that Detroit's resident population declined 23 percent from the 2003 estimate (926,903) to the 2010 Census (713,777). This represents a significant drop in population, but it is less than the 44 percent loss in DPS student enrollments over the similar period.

Another explanation for the DPS student decline between FY2003 and FY2010 is the availability of school choice to Detroit residents. Competition for students from charter schools is reflected in the enrollment growth seen in charter schools vis-à-vis the decline in DPS enrollment. Also, competition for Detroit students comes from other non-Detroit traditional public schools, which partially explains the enrollment losses in DPS. In FY2009, Detroit was home to 50 charter schools (approximately 22 percent of the total 224 statewide). In Detroit, reasons for student migration to charter schools or other traditional districts likely mirror those found in other areas of the state; however, greater out-migration may have occurred in DPS because of concerns about the quality of the education provided in the district compared to alternative educational settings.[1]

It is also quite likely that recent financial and academic challenges account for some of the exodus from DPS, although the amount is not quantifiable. The district has been under the supervision of a state-appointed emergency manager since early 2009. Initially, the position was tasked with stabilizing the district's finances and eliminating the accumulated deficit. Recent changes to state law (Public Act 4 of 2011) have provided the position with the authority over academic matters as well financial dealings in struggling districts. Operational, financial, and academic changes initiated under the emergency manager may have contributed to some students leaving DPS for other educational providers, in Detroit and elsewhere.

Detroit residents attending charter schools (in Detroit and elsewhere) increased from 27,506 students in FY2003 to 45,036 students in FY2010, an increase of 17,530 students, or 63.7 percent (see **Chart 18**). Although representing a smaller cohort of Detroit residents, those attending non-Detroit traditional public school districts increased from 7,770 students in FY2003 to 12,929 students in FY2010, a change of 5,159 students or 66.4 percent. The combined increase of Detroit residents attending either charter schools or non-Detroit traditional public schools was 22,689 students over this period. This compares to a decline in DPS enrollment of 63,305 students. The net enrollment increase in charter schools and non-DPS public schools accounts for 35.8 percent of the total enrollment decline in DPS from FY2003 to FY2010.

The changes in Detroit resident enrollments among the various schools have been profound (see **Table 20**). In FY2010, charter schools were responsible for educating nearly one of every three Detroit children, compared with one of every seven children in FY2003. DPS, on the other hand, was responsible for educating four out of every five children in the city in FY2003, but recently DPS's share dropped to three of every five children. Non-Detroit traditional public schools also gained Detroit resident enrollments during the time that DPS lost enrollments. If current trends continue, it is likely that DPS will remain the largest single educator of Detroit children, but soon it will be responsible for educating less than one-half of the children in its geographic district: the remainder will be attending either charter schools or other traditional public schools outside the city limits.

[1] Citizens Research Council of Michigan, *Nontraditional K-12 Schools in Michigan*, Report 364.

Table 20
Detroit Resident Enrollments: FY2003 and FY2010

	FY2003		FY2010	
Attending Detroit Public Schools	156,127	82%	86,470	60%
Attending Other Traditional Public Schools	7,770	4%	12,929	9%
Attending Charter schools	27,506	14%	45,036	31%
Total	191,403		144,435	

Source: Center for Educational Performance and Information

Evaluation of Michigan's Efforts to Address Funding Disparities: National Context

A number of studies have examined state school finance systems from an equity perspective, with a specific focus on how state policies affect low-income children and children of color. Generally, the studies attempt to determine whether school districts with the highest concentrations of low-income students and minorities are getting a fair amount of state and local education resources. Individual state results vary depending on the study; however, general themes are evident when comparing across studies. In Michigan's case, the general observation is that the financing system does not adequately account for educational needs of low-income and minority students and that funding inequities between high- and low-wealth school districts do exist.

Is School Funding Fair? A National Report Card

A recent study by the Education Law Center, a New Jersey-based advocacy organization concerned with school funding equality, examined the fairness of state school finance systems throughout the United States.[39] The study used a definition of fairness that went beyond simple measures of resource levels to include whether sufficient funding was directed to the poorest schools in a state, based on pre-recession data. The Law Center based its analysis on four metrics of fairness and the result for Michigan was a mixed bag depending on the individual measure.

In the national context, Michigan was grouped with 13 other states that exhibit concentrated levels of poverty – states in which at least 10 percent of their student population is in districts with poverty rates over 30 percent. According to the U.S. Census data, 25 Michigan districts containing 202,717 students (13 percent of the statewide total), had a student population where more than 30 percent of students were poor. Such levels of concentrated poverty, according to the study, are the "most critical variable affecting funding levels," and correlate with a number of factors that impact the costs of providing equal educational opportunity, including gaps in achievement, racial composition, and English language proficiency. According to the Education Law Center, fair state finance systems, in addition to providing sufficient overall funding for all schools, should target more dollars to high-poverty versus lower-poverty districts.

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The study used four measures of fairness to evaluate states: funding level, distribution, effort, and coverage. On the first metric, compared to other states and the District of Columbia, Michigan received average marks for its overall funding level, measured as per-pupil revenues adjusted for student poverty rates, regional wage variation, economies of scales, and population density. Michigan was ranked 23rd overall, with an adjusted state and local revenue per-pupil amount of $9,678, below $10,132 per pupil for the U.S. average.

In terms of funding distribution and targeting more resources to higher-poverty districts; however, Michigan received a grade of "D". The state's financing system was labeled regressive, although the relationship between the level of funding and student poverty was determined not to be statistically significant. The study found too much variation among individual Michigan districts on this measure to establish a pattern, a result that one would expect given how the foundation program functions.

With respect to funding effort (state and local revenues as a percent of state economic output), Michigan received an "A." This is consistent with Michigan's long-standing support of high levels of education funding, relative to its available economic resources and compared to other states. Recently, however,

Michigan's standing among other states on this measure has slipped.

The fourth measure was coverage, which attempted to capture the degree to which children attend public schools vis-à-vis private schools and the household income of those children. Michigan ranked above the U.S. average, in the top one-third of states on this measure – 16th overall. This was due to the fact that 88 percent of Michigan school age children are enrolled in public schools (traditional public and charters) and the ratio of household incomes in public schools relative to private schools was below the U.S. average. Strong support of public schools, relative to private schools, is evidence of the potential political will to support fair funding.

The Education Trust's *Funding Gaps* Report

From time to time, The Education Trust, a Washington D.C.-based organization that advocates for equality in educational opportunity, examines state education finance systems to determine if districts with high concentrations of low-income, minority, and/or English-language-learning students are receiving their fair share of funding. Additionally, The Education Trust calculates funding gaps that exist between the highest- and lowest-poverty school districts within states. The most recent report was released in 2006, based on financial data from the 2003-04 school year.[40]

According to the *Funding Gaps* report, most states are unfair in their treatment of high-poverty and high-minority school districts, providing fewer resources to districts with high concentrations of these students. Michigan is one of these states. Without adjusting for cost differentials, Michigan exhibited a funding gap of $573 per pupil in total revenues between the highest- and lowest-poverty districts in 2004.[41] After adjusting for the additional costs associated with educating low-income students, the gap in Michigan expanded to $1,073.[42] The U.S. average funding gaps were $825 per pupil (unadjusted) and $1,307 per pupil (adjusted). While Michigan fared better relative to the U.S. averages, its system was deemed unfair along with 33 other states.

Without adjusting for cost differentials, Michigan exhibited a funding gap of $573 per pupil in total revenues between the highest- and lowest-poverty districts in 2004.[41] After adjusting for the additional costs associated with educating low-income students, the gap in Michigan expanded to $1,073.

The disparity in funding between high- and low-minority districts in Michigan was less stark. In Michigan, a gap did not exist when the figures were unadjusted; however, a small gap ($251 per pupil) did develop when per-pupil revenues were adjusted to account for the additional costs of minority students. Michigan's gap was well below the calculated "funding gap" for the U.S. as a whole ($1,213 per student) in 2004. Nationally, 30 states had funding gaps between their highest and lowest minority districts, 12 of which had gaps that exceeded $1,000 per student.

The Education Trust recommends a series of public policy responses at each level of government to address funding disparities. For state governments, the *Funding Gaps* report suggests a larger role for states vis-à-vis local school districts in funding responsibility for schools – substituting local property taxes which are inherently biased against low-wealth communities with statewide revenue sources. In Michigan's case, revenue-raising responsibility is already highly centralized at the state level. Another policy prescription is to target funding to high-poverty districts. As noted previously, the amount of Michigan's "at-risk" categorical funding has remained constant despite growing demand over the years, which has reduced the effectiveness and efficacy of the targeted funding to ameliorate funding disparities. The final recommendation favors state involvement in sub-district resource allocation to ensure that individual schools are equitably funded. Michigan's current finance system is void of such mechanisms.

At the local level, recommendations to improve educational opportunity for low-income and minority students hinge on greater transparency in budgeting and resource allocation within districts, changing the distribution formula used by districts to target resources to individual schools. The report recom-

mends the use of weighted student formulas, whereby school budgetary decisions are based on student needs rather than program or staff allocation metrics.[43]

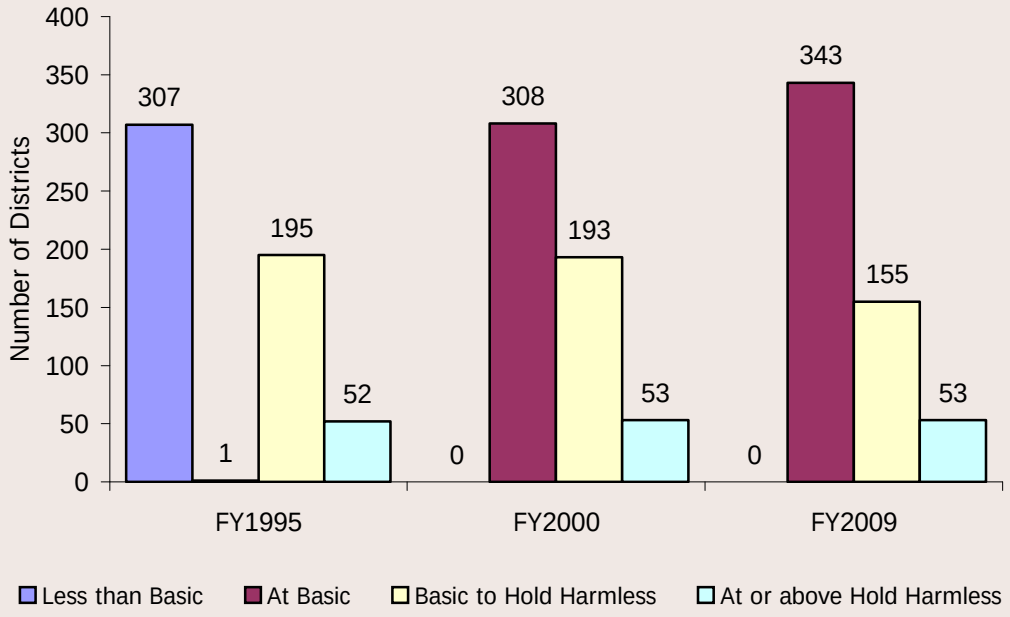
Issues to Consider Regarding Further Per-Pupil Revenue Equalization

As others have noted previously, and what the preceding discussion reiterates, is that the current school financing system has resulted in significant gains in per-pupil revenue equalization across school districts and students, at least in terms of general operating assistance.[44] As **Chart 19** shows, equity gains have been achieved primarily through polices directed at raising the bottom. In FY1995, 55 percent of traditional public school districts (representing 35 percent of students) received a foundation grant less than the target amount of $5,000 per pupil. By using the 2X formula, all districts received at least the the target grant amount by FY2000 ($5,700). Further leveling up occurred in FY2003 and FY2007 as a result of equity payments made to lower spending districts. As a result, by FY2009 62 percent of the districts representing 41 percent of students received the same foundation grant ($7,316). More recently, and in contrast to the policy of leveling up, minor equity gains were realized when cuts to per-pupil funding were targeted at higher-revenue districts (Section 20j veto). While these cuts were significant to the districts affected, they contributed marginally to reducing the overall equity gap.

> A logical question facing policymakers prospectively is whether to pursue further gains in horizontal equity when additional resources become available.

Regardless of the means, equalization has reduced differences in per-pupil revenues. However, large differences still exist between districts. The spread between the highest- and lowest-revenue districts in FY2009 was $5,000 per pupil. Also, there continues to be variation in per-pupil rev-

Chart 19
School Districts by Foundation Grant Grouping: FY1995, FY2000, and FY2009



Source: Center for Educational Performance and Information

enues based on district type, size, and other characteristics. Equity gains have fallen short of absolute equity. A logical question facing policymakers prospectively is whether to pursue further gains in horizontal equity when additional resources become available.

If policymakers endeavor to further reduce the equity gap, a number of issues should be addressed. Perhaps most important is defining what is meant by equity and establishing some type of broad timeframe to achieve the goal. If absolute equity is the ultimate goal, it may be years until such a goal is achieved based on the rate of progress thus far and given the outlook for revenue growth prospectively.[45] The costs of further equalization are great and have to be considered. Furthermore, directing future resources towards greater equalization will mean that other policy goals will continue to take on secondary importance. Finally, policymakers may want to consider the effects, if any, that greater equalization has on academic performance.

Neither Proposal A nor the related reforms define the level of per-pupil funding equalization that should be achieved.

What Level of Equalization?

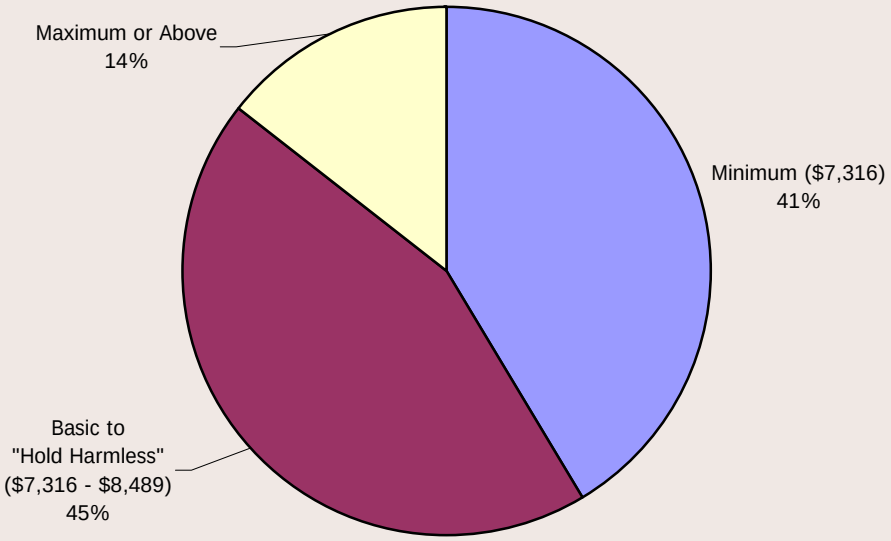
Neither Proposal A nor the related reforms define the level of per-pupil funding equalization that should be achieved. Similarly, policy changes did not set a timeline to reduce per-pupil disparities. For example, while an initial goal was articulated to raise all districts to at least the target (basic) foundation grant a specific time frame for doing so was not established. It took six years for all districts to reach at least the targeted amount. More recently, the state establish and budget decisions in FY2010 required equal per-pupil funding reductions for all districts and halted funding equalization efforts.

As the national and state economies improve, state-dedicated school revenues are expected to grow. Policymakers will have to decide how to use the additional state resources and whether to re-engage efforts to reduce disparities in general operating funding. However, if policymakers decide that per-pupil funding equalization should assume a secondary role, future additional resources might be directed at other policy objectives such as providing more resources to students with special needs and to those who are more difficult to educate. The state may turn its attention to the concept of vertical equity, defined as treating different districts (and students) differently. Furthering this policy goal would involve directing more resources to categorical funding that supports at-risk and special education students, and proportionately fewer resources to the general foundation program. Alternatively, greater vertical equity might be achieved by modifying the foundation program to incorporate funding components that take into account certain student characteristics.

Financial Costs of Further Equalization

If further per-pupil equalization is to occur, it is likely to happen by leveling up as opposed to reducing the foundation grants of higher-revenue districts. This has been the preferred method to date; how-

Chart 20
Traditional Public School Students by FY2009 Foundation



Source: Senate Fiscal Agency; Center for Educational Performance and Information

ever, it is also the most costly. **Chart 20** shows the distribution of traditional public school students in FY2009 by foundation grant. Approximately 86 percent of the 1.5 million students were in districts that received less than the maximum foundation grant of $8,489.

Further equalizing per-pupil funding for students below the hold harmless grant will be extremely expensive (see **Table 21**). Based on FY2009 data, it would cost $509 million to increase the foundation grants of students to at least $7,903 (one-half of the difference between the current maximum grant ($8,489) and the minimum grant ($7,316). This would result in about three-quarters of the total student population being equalized and leave one-quarter of the students in districts receiving more than the new minimum funding. The cost of equalizing

Table 21
Estimated Cost of Equalizing FY2009 Foundation Grants at Two Levels

Level of Equalization	Pupils Equalized (Percent of Total)	Pupils Above Equalized Level	Total Cost (millions)	Cost Per Pupil Equalized
$7,903 (1/2 of difference between minimum and maximum)	1,117,751 (74%)	395,853	$509	$455
$8,489 (maximum grant)	1,296,684 (86%)	216,920	$1,221	$941

Source: Center for Educational Performance and Information; Senate Fiscal Agency

all students to at least the maximum level would be $1.2 billion and would result in 86 percent of the total students being equalized. Even if this level were funded, it would leave 216,920 students in districts spending more than the newly-equalized level.

The actual costs of equalization could be substantially greater than the figures reported in **Table 21** because the data reflects only the cost of leveling up some portion of the students in districts that receive a foundation grant below the maximum grant amount. In practice, efforts to achieve greater equalization will probably have to include the costs of providing other districts with some degree of increase. In other words, it is unlikely that equalization is going to occur in a vacuum, but more likely will occur in an environment where all districts are provided some level of additional resources. Thus, it could be necessary to provide increased revenues for all students, not just those below the proposed equalization level, including students enrolled in charter schools. Furthermore, these increases represent additional annual costs, which would add substantially to the cumulative costs of equating per-pupil revenues.

A series of research papers suggest a positive and large spending effect on pass rates for standardized tests following implementation of Michigan's finance reforms.

Equalization and Student Academic Achievement

Similar to many other states that have reformed their school finance systems, Michigan endeavored to achieve multiple goals when it abandoned its power-equalization/guaranteed tax base formula in favor of the foundation grant program in the mid-1990s. One goal was to achieve greater per-pupil revenue equalization to provide more equal educational opportunities to students. Another objective was to reduce the property tax burden by significantly curtailing the role the tax plays in financing K-12 education. Another important objective, and one that was clearly related to efforts to achieve greater per-pupil funding equalization, was to improve student performance.

There is considerable evidence that progress towards the first two policy goals has been made. Evidence regarding the effects of equalization on student achievement, however, has been less plentiful. Academic research on the link between per-pupil revenue equalization and student performance, especially among lower-revenue districts, provides some insight on the progress made toward the third policy objective.

The Michigan Experiment. An important public policy question that arises following the adoption of school finance reform is whether the new system results in improved student academic performance. Considerable academic research has been conducted to determine the link between education spending and student performance, a relationship that has proven difficult to establish.[46] In many previous studies, the difficulty in establishing such a relationship resulted from the lack of substantial reform (i.e., reform did not generate a large enough variation in inputs) and/or methodological challenges (i.e., inability to develop an econometric model capable of controlling for confounding variables with available data or by methodological means). For example, research found that California's school finance equalization system of the 1970s did not improve student performance for the low-spending school districts primarily because the method of equalization was focused on reducing per-pupil funding in higher-revenue districts, as opposed to raising the revenues in lower-revenue districts.[47]

Michigan's school finance experience has proven to be an ideal experiment or case study for researchers attempting to link financial resource inputs to student performance outputs, especially for districts with lower per-pupil revenues before the reform. A major reason has to do with the sizeable changes in funding provided to school districts, especially lower-revenue districts, initially. Although this equalization slowed in later years, the initial variation in annual per-pupil revenue increases provided the exogenous variable that was lacking when researchers examined other school finance reforms.

Performance Gains in Low-Spending Districts. A series of research papers authored by economics professor Leslie Papke, Ph.D. of Michigan State Uni-

versity suggest a positive and large spending effect on pass rates for standardized tests following implementation of Michigan's finance reforms.[48] This conclusion has been confirmed by others looking at Michigan-based test scores; however, the research did not find the same improvements in nationwide test scores.[49] Prof. Papke's research employed a variety of econometric models to show that Michigan's school finance equalization has improved student performance, at least for Michigan 4th graders on standardized math tests. She found that "a rough rule-of-thumb would be that 10 percent more real spending increases the pass rate by between one and two percentage points, and more for initially underperforming schools." Using alternate methods, she also found that the increase in the percentage of students performing satisfactorily on the test, given the same increase in real spending, was 2.5 percent. Her findings are consistent with the conclusions reached by other researchers that examined Proposal A's per-pupil funding equalization effects on student achievement.[50]

> The increase in pass rates is equivalent to improving the performance of 1 child out of 40.

Prof. Papke notes that while all districts improved student performance since the implementation of Proposal A, the effects were greatest for the initially lowest–revenue districts, which received the largest annual per-pupil increases after Proposal A. In other words, initially low-revenue districts improved more than high-revenue districts. This finding provides support for policies that target resources to low-performing schools.

It is important to note the relatively large funding increase (e.g., 10 percent in real terms) needed to achieve very modest gains in student performance. Specifically, the increase in pass rates (2.5 percent) is equivalent to improving the performance of 1 child out of 40. It is also worth noting that the research examined equalization efforts through 2004. Student funding equalization was strongest during the years immediately following Proposal A's adoption and into the early 2000s when the growth of the foundation grant exceeded inflation for most districts, especially the lowest spending districts. However, since that time, funding equalization has stagnated and growth in the foundation grant has not kept pace with inflation. Thus, the existing research does not tell us whether the minimal funding increases provided to the foundation allowance during the mid- to late-2000s have had any effect on student performance. This is especially relevant given the modest equalization gains achieved during this latter period. Future research is likely to shed light on the effect of more recent school funding changes in Michigan and student performance, especially among districts with relatively lower per-pupil spending.

Conclusion

The school finance reforms of the mid-1990s were borne out of a sense of crisis; a crisis that manifested itself on many levels. Leading the way was concern about property taxation. Specifically, school operating property taxes in many communities were deemed to be too high and growing at a rate that outpaced the growth in taxpayers' incomes and their ability to pay. Coupled with the concerns about property tax growth was the uncertainty about the future funding of local schools. Voter angst and anti-tax sentiment made the renewal of expiring local school millages in some communities anything but a "sure bet," which was exemplified by the case of Kalkaska schools' inability to get a millage passed in early 1993 after numerous attempts. Also, there was a perceived "quality crisis" in many districts, defined in terms of per-pupil funding. The heavy reliance on local property taxes (i.e., property wealth) resulted in wide per-pupil revenue disparities across districts (even at low tax rates), which was deemed unacceptable by many. Finally, for some observers the "quality crisis" also touched upon issues of educational choice, or lack thereof, and the accountability of traditional public school districts.

The statewide question of amending the state constitution, presented as Proposal A of 1994, and the related statutory changes that accompanied it addressed, to varying degrees, all aspects of the educational crises, real or perceived, that existed in the mid-1990s. The most substantial reforms, at least in the near-term, involved the K-12 revenue collection and allocation areas. To a lesser extent, quality and accountability reforms were addressed through other changes enacted at the time. More recently, reforms involving education quality and performance have been at the forefront of the public policy debate.

Various components of the K-12 education landscape have changed since the implementation of Proposal A; however, the primary systems and methods for collecting and distributing K-12 education resources to local school districts have not been modified materially. The major sources of revenue (state and local) and related tax rates are the same, while the per-pupil foundation grant remains the primary mechanism to allocate the majority of operating funding school districts. Despite the significant changes to Michigan's economy and population over the past 16 years, the Proposal A financing system remains in tack today.

Today, as was the case in 1994, the financing of K-12 education is a major public policy issue. For many observers of the policy debate today, the Proposal A school finance system has been in crisis for some time. Problems with the system surfaced in the early 2000s, when the Michigan economy, after a mild national recession, never fully recovered. The growth of state revenues, which shoulder most of the financing responsibility for funding public schools, tracked the slowdown in economic activity. Michigan's continued economic challenges throughout the decade arising from the deterioration of the state's manufacturing base further affected school finances.

For a growing number of districts over the last decade, the effects of the sustained economic slowdown were made worse by declining student enrollments that translated into fewer dollars under Proposal A's per-pupil foundation mechanism. More recently, the national recession reduced the aggregate amount of state funding going to K-12 schools for two years in a row (FY2009 and FY2010), necessitating across-the-board per-pupil funding cuts. Revenue growth (relative to economic growth) in the post-recession period will be constrained by the design of the state's tax structure and is expected to be below the annual growth in school spending pressures.

Because many throughout the state currently perceive a school funding crisis, calls for school finance reforms in recent years have been the loudest since Proposal A was enacted. The calls have largely focused on the amount of funding provided to schools, both at the aggregate and per-pupil levels. Equally important, but sometimes lacking in the policy discussion and the reform rhetoric, has been the method to distribute state and local resources to school districts. Specifically, little attention has been given to how the Proposal A foundation grant has functioned over the last 16 years. Any review of the foundation grant must first consider the origins and stated policy

objectives of the primary mechanism for distributing state and local operating revenues to schools. However, also important to consider are the public policy issues that have been largely unaddressed by the foundation grant, either intentionally or unintentionally. The measurable, and sometimes tumultuous, changes to Michigan's economy, population, and the state budget (all factors that directly impact upon the functioning of the foundation grant) demand that a broader perspective be adopted when evaluating the distribution of operating revenues to schools.

Michigan's experience with Proposal A suggests that 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 choice in public education. Ultimately, and regardless of the origins of reform, 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. The Proposal A financing system raises a host of questions:

- 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?

Endnotes

[1] Citizens Research Council of Michigan, *State and Local Revenues for Public Education in Michigan*, Report 363 September 2010.

[2] National Center for Education Statistics, *Digest of Education Statistics: 2009*, April 2010, Table 172: Revenues for Public Elementary and Secondary Schools by Source of Funds.

[3] U.S. Census Bureau, *Public Education Finances: 2008*, June 2010.

[4] Education Week, *School Finance*, December 6, 2007. www.edweek.org/ew/issues/school-finance

[5] John Augenblick, *The Status of School Finance Today,* ECS Issue Paper — Education Finance in the States: Its Past, Present and Future, Education Commission of the States, July 2001.

[6] Michigan school districts operate on a fiscal year basis that runs from July 1 to June 30, which contrasts with the state fiscal year that begins on October 1 and ends on September 30. For purposes of this report and to avoid the confusion that can accompany the different timing with these two fiscal periods, all fiscal year citations refer to the State of Michigan, unless otherwise noted.

[7] An alternative to the deductible millage program was contemplated by Public Act 100 of 1970. This law contained a state aid program for two years, 1970-71 and 1971-72, however, it was ultimately abandoned. Under PA 100, a conventional deductible millage formula was to be used in the first year. In the second year (1971-72), PA 100 distributed state aid based on a new power equalizing system, which guaranteed a local district an equal return in combined state and local funds for each mill levied. Public Act 100 also included a new provision to provide state reimbursement for a portion of non-public school teacher salaries beginning in 1970-71. This piece of the law was effectively nullified when state voters, in November 1970, adopted a constitutional prohibition against state aid to non-public schools (Article VIII, Section 2). Many observers viewed the aid to non-public schools and the new power equalization system as a package (i.e., non-severable) and the constitutional amendment killed the entire package. Following the statewide vote in 1970, the legislature repealed PA 100 in 1971 and the new power equalizing system, and restored the traditional deductible millage formula.

[8] *Governor v State Treasurer* (389 Mich 1; 1972).

[9] In 1973, after the U.S. Supreme Court ruled in *San Antonio Independent School District v Rodriguez* that per pupil disparities did not violate the equal protection clause of the U.S. Constitution and the Michigan Legislature enacted the GTB school aid formula, the Michigan Supreme Court vacated its earlier decision in *Governor v State Treasurer*.

[10] Michael F. Addonizio, *At the Crossroad in Michigan K-12 School Finance,* Michigan State University and Michigan Senate Fiscal Agency, March 1988.

[11] In FY2009, there were 551 traditional public school districts (technically referred to as local education authorities or LEAs) and 233 charter schools (technically referred to as public school academies or PSAs) for a total of 784 local school districts. In addition to LEAs and PSAs, there were 57 Intermediate School Districts or ISDs in FY2009. In this report, the term "local school district" is used generically to refer to traditional public schools or LEAs, unless specifically noted otherwise. This report also uses the generic terms "charter schools" or "charters" to refer to PSAs when appropriate.

[12] A series of calculations were made to arrive at the total revenue from state and local sources each district received in FY1994. This included both select categorical and general aid received by each district. This revenue total was divided by each districts' pupil membership level to arrive at a per-pupil revenue amount. A major categorical included in the revenue figure was the state's contribution to the Michigan Public School Employees Retirement System. See: Senate and House Fiscal Agency, Printout Explanation of Public Act 336 Estimated Impact by School District, unpublished data, January 1994.

[13] House Fiscal Agency, *Memorandum: The Basics of the Foundation Allowance – FY2008-09*, January 2009.

[14] Public Act 336 of 1993 amended the School Aid Act to implement the foundation allowance program effective FY1995.

[15] C. Philip Kearney and Michael F. Addonizio, *A Primer on Michigan School Finance*, Fourth Edition, 2002.

[16] The additional tax levy is first applied to homestead property, up to 18 mills. If additional local revenue is required, an equal millage rate is applied to all property in the district, such that homestead and non-homestead property is assessed at the same aggregate rate under the foundation program.

[17] For special education students, the foundation grant is entirely funded by the state government (with state and federal resources). The local 18-mill property tax, or its equivalent, is not used to finance the foundation allowance for special education students.

[18] "Non-homestead" property generically refers to all property, real and personal, other than: a principal residence, qualified agricultural property, qualified forest property, supportive housing property, and industrial personal property. Furthermore, as a result of the State of Michigan's business tax restructuring in 2007, commercial personal property was partially exempted (12 of 18 mills) from the "non-homestead" school operating tax. For the purposes here, we generally refer to the 18-mill "non-homestead" tax to include the 6-mill tax applied to commercial personal property.

[19] The 18-mill non-homestead tax is subject to tax rate rollback because it is a local tax, but the 6-mill State Education Tax (a state property tax) is not subject to the rollback provisions.

[20] The index was not used in FY1999 to adjust the lowest foundation grant. Instead the state set the index to 1.0 in statute and provided a $46 increase to the minimum grant. The decision to minimize the foundation grant increases was related to the State of Michigan's settlement in the *Durant* lawsuit (discussed later).

[21] Initially, equity payments were made separate from a district's foundation grant, but they were subsequently built into the base of a district's foundation grant.

[22] For a more comprehensive discussion of the performance of Michigan state and local revenues dedicated to public education, see Citizens Research Council of Michigan, *State and Local Revenues for Public Education in Michigan*, Report 363, September 2010. Because CRC devoted considerable attention to the topic of dedicated education revenues in the earlier report, the majority of the discussion in this report pertains to the enrollment changes.

[23] Senate Fiscal Agency, *Declining Enrollment: A Continuing Issue,* State Notes, June 2008.

[24] The data collected for this analysis is from the State of Michigan, Center for Educational Performance and Information (CEPI) and is based on district-wide headcount information. Only districts in operation in both FY2008 and FY2009 are used in the analysis of increasing and declining enrollments; therefore, some charters may not be included.

[25] For this presentation, a couple of very small districts have been excluded because the enrollment changes in these districts translate into substantial annual rates of increase/decrease.

[26] This categorization of Michigan school districts is based on the *Common Core of Data: School Years 2008-09* compiled by the US Department of Education, National Center of Educational Statistics (NCES), adjusted by the Citizens Research Council of Michigan. Rural districts include all districts outside of an urbanized area (i.e., all sizes of town and rural districts classified by NCES).

[27] This payment is not available to a very small subset of school districts that are already using a three-year average membership figure or eligible for "geographically isolated district" funding under the state School Aid Act.

[28] Senate Fiscal Agency, *Declining Enrollment: A Continuing Issue,* June 2008.

[29] For discussions of per-pupil revenue equity measures and Michigan's efforts relative to these see: 1) C. Phillip Kearney and Michael F. Addonizio, *A Primer on Michigan School Finance, 4th edition*, 2002, and 2) H.J. Prince, "Michigan's School Finance Reform: Initial Pupil-Equity Results", *Journal of Education Finance*, Spring 1997. Both works are cited in Michael F. Addonizio and Douglas Drake, *Revolution and Evolution: Michigan's Proposal A School Finance Reform, A Retrospective Analysis*, 2005.

[30] This analysis is based on traditional (non-charter) school districts in continuous existence in FY1994, FY200, and FY2009; all other districts have been excluded.

[31] Again, this analysis is based on those traditional public school districts in continuous existence in FY1994, FY2000, and FY2009.

[32] This categorization of Michigan school districts is based on the *Common Core of Data: School Years 2008-09* compiled by the US Department of Education, National Center of Educational Statistics (NCES) using Census 2000 median household income data.

[33] The National School Lunch Program is a federally-assisted meal program available to public and private school children. Children from families with incomes at or below 130 percent of the poverty level are eligible for free meals. Those with incomes between 130 percent and 185 percent of the poverty level are eligible for reduced-price meals, for which students can be charged no more than 40 cents. (For the period July 1, 2010, through June 30, 2011, 130 percent of the poverty level is $28,665 for a family of four; 185 percent is $40,793.)

[34] Robin Erb and Chastity Pratt Dawsey, Detroit Free Press, "Detroit students' scores a record low on national test," December 8, 2009.

[35] The Education Trust-Midwest, *Becoming a Leader in Education: An Agenda for Michigan*, January 1, 2011.

[36] Citizens Research Council of Michigan, *Early Childhood Education*, Report 366, February 2011.

[37] For this analysis, the enrollment figures are the reported student headcount data (district level) from the Center for Educational Performance and Information. This enrollment figure is different from the pupil membership count used to allocate foundation funding.

[38] A small number of very small districts have been excluded because relatively minor changes in enrollment have the effect of inflating the average annual rates calculated. A total of 28 districts had student enrollment of less than 100 children in FY1995.

[39] Bruce Baker, David Sciarra, and Danielle Farrie, *Is School Funding Fair? A National Report Card,* Education Law Center, September 2010.

[40] The Education Trust, *Funding Gaps 2006*, January 2006.

[41] To compare across states, The Education Trust report adjusts per-pupil revenues to account for regional cost differences and the additional costs of educating students with disabilities, which has the effect of reducing the effective funding in high-cost districts with large numbers of students with disabilities.

[42] Further adjustments (beyond regional cost differentials and disabilities) are made for high-poverty and high-minority districts, adding 40 percent to the cost of educating students in these districts.

[43] Weighted student formula, also known as student-based budgeting, is a resource allocation process driven by the characteristics of the student population in individual schools, as opposed to the raw number of students attending a school or the programs offered at a school. Generally, the weighted student funding system helps ensure more funding is allocated to students with more expensive educational needs. To date, such systems have been used sparingly throughout the U.S.

[44] C. Philip Kearney and Michael F. Addonizio. *A Primer on Michigan School Finance*. Fourth Edition. 2002. David Arsen and David Plank. *Michigan School Finance Under Proposal A State Control, Local Consequences*. 2003. Leslie E. Papke. *The Effects of Changes in Michigan's School Finance System.* August 2006.

[45] CRC details the major structural issues that will constrain state and local education revenue growth in its September 2010 report, *State and Local Revenues for Public Education in Michigan*.

[46] J. Yinger, "State Aid and the Pursuit of Educational Equity: An Overview," in J. Yinger, ed., *Helping Children Left Behind: State Aid and the Pursuit of Educational Equity,* 2004.

[47] T.A. Downes, *Evaluating the Impact of School Finance Reform on the Provision of Public Education: The California Case,* National Tax Journal, vol. 45, 1992.

[48] Leslie E. Papke, "The Effects of Changes in Michigan's School Finance System", Department of Economics, Michigan State University, 2006.

[49] Joydeep Roy, "Impact of School Finance Reform on Resource Equalization and Academic Performance: Evidence from Michigan", Working Paper #8, Education Research Section, Princeton University, 2004.

[50] J.B. Cullen and S. Loeb, "School Finance Reform in Michigan: Evaluating Proposal A" in J. Yinger, ed., *Helping Children Left Behind: State Aid and the Pursuit of Educational Equity,* 2004.