Tax Reform and State Education Spending: Lessons Learned in Michigan

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Introduction

Policymakers across the nation have always acknowledged that high-quality public education is essential for developing an intelligent and productive work force that can contribute to the economic well-being of communities, states, and the nation as a whole. However, since the 1980s, state and local governments have been required to do more than just recognize the importance of education. The federal government has asked that state and local governments assume greater fiscal responsibility and play a larger role in the administration and management of education programs. A major concern for governors and state legislators is how to provide a higher level of quality, quantity, and fairness in distribution of education services in this era of federal devolution and with smaller budgets and slow, if not stagnant, economic growth. In the context of changing fiscal conditions for states, the issue of education reform is defined by two questions: (1) in the early stages of reform, what measure can be used to determine the quality and equity of public education? and (2) how can state and local governments find ways to replace the funds which are no longer available due to federal budget cuts?

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In the attempt to answer the question of quality and equity of education, policymakers have generally focused attention on the amount of money spent by different schools. In the late 1980s, parents, teachers, and school administrators across the country pointed to gaps between money spent by the richest and poorest school districts as symbols of unfair education practices that limited students' equal access to high-quality education. Many citizens levied charges of inequality in education through the legislature and the judicial system. Courts across the country heard cases that questioned the constitutionality of the states' school financing systems.[1] In order to avoid possible lawsuits and court injunctions to correct alleged inequalities, legislators in other states tried to find ways to provide more revenue for schools so as to allocate funds on a more equal basis and decrease spending gaps between richer and poorer districts.

As the search for new school funds began in the 1980s, policymakers realized that some potential sources were now off-limits. Traditionally, state and local governments have turned to property taxes as a major source of revenue for schools. However, political leaders across the country faced growing discontent among citizens over the heavy burden of property taxes. Beginning as early as the 1970s, citizens expressed an unwillingness to continue financing education and other programs with unlimited, unchecked growth in property taxes. In 1978, the passage of Proposition 13 in California represented one of the first popular demands that state and local governments find other sources of revenue for public programs. Through Proposition 13, California voters placed a limit on revenue that could be raised through property taxes. Other states implemented similar policies that forced legislators to seek alternatives to property taxes as a means of financing increasing education demands and responsibilities. If legislators needed to raise taxes to finance education, public outcry about raising property taxes proved that the tradition of turning to this particular source was no longer a viable option.

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Recognizing the various obstacles that stood in the way of education finance and tax reform, lawmakers have recently developed unique programs to help states effectively, efficiently, and fairly meet growing fiscal, managerial, and administrative demands associated with providing high-quality public education to all students. John Engler (R), governor of Michigan, and state legislators hoped the state would be among the many that successfully addressed the sensitive financial and administrative issues facing public schools. Since initiating reforms in the tax and public school systems in 1993 and 1994, Michigan has gained the attention of other states that are looking for fiscal reform models that can be adapted to states' individual education finance and management needs.

The following case study will examine the effects of Michigan's tax and education reforms on the state's public schools and will discuss lessons learned by Michigan policymakers that could be useful to other states in the midst of education reform efforts.

Background

In 1993, Governor Engler and state legislators highlighted two major issues in the state's policy agenda: public education and state tax reform. The focus on tax reform was inspired by growing discontent among citizens over high local property tax rates relative to the national average. Additionally, tax reform became more important as periods of slow economic growth characterized by recessions continued after the downturn of the auto industry. While the state's economy was a concern of the Engler administration, policymakers were also aware of the intensifying debate among parents, teachers, and administrators over the condition of Michigan's public school system.

To address these concerns, Governor Engler and Michigan lawmakers proposed changes in the tax structure and the public school financing system. The governor's initiatives and those of the Michigan legislature were designed to accomplish three goals: (1) better equalize spending across school districts; (2) lessen the heavy burden of property taxes used to finance education by widening the pool of revenue available to schools; and (3) make better use of some of Michigan's underutilized sources of tax revenue.

Beyond the nationwide dialogue on financing public education, specific financial circumstances in one Michigan school district caught the attention of state policymakers and community leaders. The early closure of one district's schools due to insufficient funds to complete the academic year sparked a statewide debate that led to substantial changes in the way Michigan raises and allocates school resources.

The closing of schools in rural Kalkaska, Michigan was a signal that school finance reform would become a central issue in state education policy discussions. On March 24, 1993, nearly 75 days early, schools in Kalkaska were closed. Just before, on March 15, 1993, voters in Kalkaska had rejected a proposal to raise the revenue necessary to keep the schools open for the full school year. The proposal would have raised $1.5 million by increasing the property tax through an additional 7.36 mills.[2] But citizens in Kalkaska would not accept an average increase of $160 in property taxes to fund local schools and, over a period of six months, local residents had rejected a total of three similar proposals.

Kalkaska, Michigan's unprecedented closure of schools drew the attention of Keith Geiger, then-president of the National Education Association (NEA). Geiger, a native of Michigan, attended the formal closing of Kalkaska schools. There, he suggested that the schools' closing was not the fault of local administrators or the school board, but instead was caused by "Michigan's archaic and inadequate system of school finance."[3] The closing of Kalkaska schools gained state and nationwide attention as Michigan began looking for solutions to problems in the school systems. The first step state legislators took was to analyze the current revenue base and means by which the state funded education.

Primary Source of School Revenue: The Local Property Tax

Tax reform proponents such as state senator Debbie Stabenow (D), who proposed fiscal reform measures, were concerned about Michigan's relatively heavy dependence on homestead and business property taxes as a source of state revenue.[4] The property taxes in Michigan have traditionally been relatively income inelastic. John E. Anderson of the University of Nebraska-Lincoln reported in 1991 that the income elasticities of the property tax bases in Michigan's urban and rural areas were 0.9394 and 0.6448 respectively.[5] Simply put, changes in personal income resulted in less than proportional changes in the property tax bases, making this revenue base relatively stable and consistent.

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However, the stability of the property tax base is often undermined by two factors. First, since the amount due in property tax is based on the state's assessed value of the given property, many businesses and homeowners have challenged assessments and found ways to lower the value of the property and thus lower the revenue generated by the tax. Second, tax abatements, financing structures, and other incentives designed to lure businesses to different districts have served to lower the tax base available to those districts attempting to increase revenues. In addition, during periods of increased economic growth, property tax revenues seldom keep pace with rates of increase in population or personal income.[6]

Accordingly, supporters of state tax reform suggested that Michigan spread the tax burden more evenly among different sources to provide a more stable, consistent flow of revenue for the state and local entities, and to better facilitate the economic growth Michigan so desperately needed. Authors Paul Ballew, Richard Mattoon, and William Testa concluded that "With greater balance in the state's tax structure and lower property tax rates, the state may improve its business climate and enhance its development prospects."[7] Some economists believe that reliance on different tax bases can help provide an environment in which greater economic growth more directly translates into greater revenue available for public services like education. Ballew, Mattoon, and Testa further emphasized the importance of diversifying the tax base by suggesting that "the principle of balance among revenue sources suggests that over-reliance on any one source tends to retard economic performance by distorting the prices that people and businesses face when making economic choices."[8] Throughout the ongoing debate over the stability and use of property tax as a revenue base for school spending, new policies emerged as attempts to adequately and fairly finance public education in Michigan.

First Attempts at Reform

One of the earliest attempts at addressing the use of local property tax revenue was a proposal by state senator Stabenow (D). Stabenow's proposal, later entitled Public Act 145, represented an amendment to Senate Bill 1 (a tax reform bill introduced in July 1993) that effectively eliminated nearly $6.7 billion in local property tax revenue used to finance local schools. Public Act 145 was approved in July 1993 by the state Senate, which voted 29-5 to approve the tax cut. The Michigan House of Representatives subsequently accepted the proposal by a vote of 69-35 and Governor Engler signed Public Act 145 into law in mid-August 1993.[9] Michigan legislators had broken with tradition and effectively eliminated local property taxes as the primary source of revenue for public schools.

The enactment of Public Act 145 sparked a debate between state policymakers and the Michigan Education Association (MEA), the primary teachers' union in Michigan. The teachers' union held a press conference denouncing Public Act 145 during which MEA president Julius Maddox criticized the actions of state policymakers as irresponsible.[10] Teachers, administrators, and other members of the MEA wanted legislators to enact policies to make sure

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that local taxpayers did not get a large tax break at the expense of many underfunded schools.

Governor Engler acknowledged the growing concern over school spending as policymakers sought to restructure several elements of the state's tax system. Any revisions in Michigan's tax code would have to consider the effect such changes would have on local districts' ability to pay for educational services. After eliminating local property taxes as a source of revenue for schools, local governments should be able to depend on the state for support in funding local schools. Engler hoped to use a more diversified tax base to increase the state's role in financing public education.

The decision to allow the state to take greater responsibility for school funding was based in part on the widely-held perception that education spending in Michigan was inequitable. Many parents, teachers, and policymakers believed that one of the major problems facing Michigan's public school system was the inequity in spending among the state's 557 school districts, and proponents of tax restructuring and education finance reforms argued that in order to improve the state's effective delivery of quality education to all students, the state had to take steps to ensure that schools were more equally funded. The underlying assumption was that equalizing the spending among school districts would lead to greater equity in the quality of education among districts.

Shortly after the enactment of Public Act 145, Governor Engler developed a plan to replace revenues lost to schools due to the elimination of local property taxes previously used to finance schools. As part of his school finance reform plan, Engler proposed several options to replace lost education revenue. His proposal included:

- a two-cent increase in the state sales tax;
- a new four percent real estate transfer tax; and
- a new statewide tax on non-homestead property.[11]

The underlying goal of changing the tax structure was not simply to change the way schools were funded. Policymakers were also concerned about the effect of the current tax structure on Michigan's economic growth. The state's laggard economy could not sustain a tax structure that would not adapt to changing business cycles and industries. Shifts in the auto industry adversely affected Michigan because the economy had become too heavily dependent on manufacturing. Personal income fell as large proportions of the high-paying manufacturing jobs were replaced with lower-paying, more service-oriented jobs. As personal income fell, Michigan had to rely more on taxes assessed on businesses and personal property to sustain the state's shrinking revenue base. According to the Advisory Commission on Intergovernmental Relations, Michigan's property tax rate in 1990 was 31 percent higher than the national average.[12]

Governor Engler's suggestions for tax reform were designed to address concerns about the state's overreliance on property tax, the diversity of Michigan's tax base, the need to spur economic growth, and funding sources for public education. Once presented with the governor's proposal, state legislators used his recommendations as a basis to begin the legislative debate. After lengthy negotiating sessions behind closed doors, the state legislature voted on December 24, 1993, for a ballot proposal (later entitled Proposal A) which consisted of a package of tax reforms. The ballot proposal included the changes in the state sales tax, real estate transfer tax, and the new non-homestead property tax contained in Governor Engler's plan. Proposal A also included a decrease in the state personal income tax from 4.6 percent to 4.4 percent, an increase in the tax on out-of-state calls from four percent to six percent, and an increase in the cigarette tax from twenty-five to seventy-five cents.[13] Proposal A was structured as a complete package. None of the provisions would go into effect if all elements were not passed. Acceptance of Proposal A would also require a referendum to change the state sales

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tax. On March 15, 1993, by a margin of 69-31 percent, citizens voted overwhelmingly to accept Proposal A.[14]

A striking feature of the reformed tax structure was its revised method of levying property taxes. Instead of allowing local districts to establish common property tax rates on all types of property within each district, Michigan set statewide rates on different classes of property defined by the state. For primary homes, the new state property tax rate is six mills; secondary homes and businesses are assessed at 24 mills.[15] The new provisions represent an 82 percent reduction in average statewide property taxes paid by primary homeowners, and a 30 percent reduction in average statewide property taxes paid by secondary home and business owners.[16] According to State Treasurer Roberts, Michigan's new tax structure represents a more even and fair tax burden among state residents and businesses. In a statement made on November 3, 1995, Roberts argued the new system was fairer because:

> Before Proposal A, Michigan property tax payers were paying at a rate 30% above the national average. After Proposal A, they were paying 9% below the national average. Additionally, Proposal A raised the state sales tax by 2 cents to replace the revenues lost in the property tax cut. This effectively broadened the base for funding public education.[17]

Increasing the availability of revenue for schools was only the first step. In order to redress disparities in spending among local districts, the formula used to determine schools' spending levels had to be revised. In theory, Michigan's previous education funding system was supposed to acknowledge spending disparities and adjust state aid to eliminate the imbalances. Based on a formula, districts with smaller property tax bases were to receive more state aid than districts with larger bases. Established in 1973, this "power equalizing" formula gave the most state aid to the property-poor districts. Districts whose property tax revenues exceeded the guaranteed state contribution under the formula received no state aid.

In practice, however, the "power equalizing" formula did not help ensure equity in per-pupil expenditures among Michigan school districts. Differences in district tax rates limited the state system's ability to equalize spending across districts. For example, in the 1993-94 school year, the Bloomfield Hills school district ranked first in per-pupil expenditures, spending $5,017 on basic instructional programs. In contrast, state capital Lansing's school district ranked 218 of the 557 districts in the state, spending only $2,444 per pupil.[18] Differences in property wealth among districts offset any equalizing effect produced by the state-aid formula. Ruth Beier of Michigan State University's Institute for Public Policy and Social Research explains:

> In other words, the distribution of property wealth in Michigan is so skewed, it is impossible (at current state tax rates) for the state to spend enough in the property-poor districts to bring them up to the level of the property-rich districts. The school finance problem will exist as long as Michigan maintains current school district boundaries, and property taxes are the major funding source of schools.[19]

New District Spending Formula

Together, the new tax provisions in Proposal A help generate revenue to be allocated to local districts based on a new education finance formula. Under the new system, each school district is given a lump sum from the state called a foundation guarantee. Simply put, a foundation guarantee is a per-pupil allowance for school districts. To achieve more equalized spending among districts, the new funding formula uses the spending levels of previous years in each district to determine individual spending levels in subsequent years, and districts are allowed to add an annual increase to the foundation. Poorer districts are permitted greater annual increases than wealthier districts.

In order to calculate the allowed annual increase, policymakers categorized districts based on spending levels from previous years. For the first year of the new spending plan, 1994-1995, districts that spent less than the Basic Foundation Allowance of $4,200 in 1993-94 were allowed to increase per-pupil expenditures by $250 or by the amount necessary to reach $4,200, whichever was larger. Districts that spent between $4,200 and $6,500 were allowed 1994-95 increases that ranged from $160 to $250. For districts that spent more than $6,500 in the 1993-94 fiscal year, the allowed annual increase was $160 per-pupil.[20]

School spending for years beyond 1994-95 is also based on a formula that begins with a minimum allowance. Basic Foundation Allowances and annual increases are adjusted over a period of time to lessen the gap in spending between richer and poorer districts. While the maximum allowed increase for wealthier districts in 1994-95 was $160, the maximum allowance for wealthier districts in 1996-97 was $155.[21] Based on reports and estimates from a state revenue estimating conference, the state legislature set the Basic Foundation Allowance for 1996-97 at $5,308 per-pupil. The allowed increase of $155 represents the difference between the 1996-97 and 1995-96 allowances ($5,308 - $5,153). For fiscal year 1996-97, all districts that had foundation allowances above the Basic Foundation Allowance in fiscal year 1995-96 had their allowances increased by the same dollar amount as the increase in the Basic Foundation Allowance. Districts that had less than the 1995-96 foundation allowance received 1996-97 allowances based on the following formula:

> **1996-97 Foundation Allowance Per Pupil = a + 2i – {(i – 50) x [(a – (4200 + p)) / (b– (4200 + p))]}**

In this formula:

> a = the 1995-96 per-pupil foundation allowance;
>
> i = the amount of change in the Basic Foundation Allowance from the previous year ($155 in 1996-97);
>
> p = the dollar amount of change in adjustments made from 1994-95 to the immediately preceding State fiscal year in the lowest foundation allowance ($306 in 1996-96); and
>
> b = the Basic Foundation Allowance for the fiscal year being calculated ($5,308 for 1996-97).[22]

Responsibility for financing the calculated foundation guarantee is shared by the state and each local government. Michigan's Public Act 300, enacted in 1996, outlines public school appropriations for fiscal year 1996-97 and describes how state and local financing responsibilities are determined. The Act says that:

> The State allocation to a district from the foundation allowance appropriation is the difference between the product of the district's foundation allowance per-pupil (or $6,808, whichever is less) and the district's pupil membership, less the local revenue on 18 mills or the number of mills levied in 1993, whichever is less.
>
> The local share of the foundation allowance is raised from limited local school operating mills levied as provided in Section 1211 of the Revised School Code.[23]

As explained in the Michigan School Aid Act, part of a school district's funding may come from an 18-mill property tax, subject to approval by district voters, on all non-homestead property within the district. The use of revenue generated by this property tax is also determined by a formula. Districts with a foundation allowance of less than $6,808 for 1996-97 may finance the local portion of the allowance using the revenue generated by the 18-mill non-homestead property tax. However, if a district chooses not to levy the 18-mill tax, the state will not increase the foundation allowance to replace revenue that would have been generated by the local non-homestead property tax.[24] For this reason, most districts have elected to levy the non-homestead property tax, which has led to relative uniformity in levied property taxes among school districts.

Any further increases in education spending beyond the allowed annual increases and the revenue generated from the extra three mills are to be shared among all districts, property-rich as well as poor, within a county.

The equalizing nature of this tax and education spending plan does not require districts with higher per-pupil expenditures to decrease spending. For the wealthier districts, the state grant is determined by the difference between $6,500 and the revenue generated by the 18-mill non-homestead property tax. If residents in such districts wish to spend more, a hold-harmless property tax on local homesteads may be levied. Districts with high spending levels before the state's enactment of the new funding plan can maintain the higher per-pupil expenditures, but spending in excess of $6,500 per pupil must be financed by levying a local tax on residents in the district.[25]

With voter approval, wealthier districts may also levy an additional three mills on homestead property each year until 1997-98. This additional property tax represents the only option wealthier districts have to increase spending on education in excess of each district's foundation guarantee. After 1997-98, any additional tax, such as the three mills assessed on homestead property, must be approved by voters within the county, not just the district, and the additional revenue must be shared equally with all districts within the county on a per-pupil basis.[26] Thus, any further increases in education spending beyond the allowed annual increases and the revenue generated from the extra three mills are to be shared among all districts, property-rich as well as poor, within a county. The purpose of this provision is to ensure that all districts, rather than a select few, benefit from increased education spending.

Under this new system, schools that were considered underfunded can use the increased state funding to pay for improvements that were not previously affordable due to local revenue constraints. Before 1993, districts with wealthier homeowners could simply raise local property taxes to finance demand for more educational services. Constituents in such areas could afford to pay for high-quality programs, facilities, and technology that enhanced the quality of education for area students. Unfortunately, poorer districts could not depend on wealthy homeowners to finance school improvements for students who were no less deserving of a better education than children in wealthier districts. The new school finance system was an attempt to redress the school funding imbalances among richer and poorer districts by offering poorer districts funding alternatives.

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Michigan's Plan in a National Context

Michigan was not the first state to implement changes in the school finance system and tax structure in an attempt to equalize spending among school districts. In a December 1995 report, the United States General Accounting Office (GAO) studied education reform initiatives in Texas, Minnesota, and Tennessee. The three states were chosen for the study based on several criteria including:

- state guidelines regarding portions of education budgets provided by local revenues;
- limits on a state's ability to increase spending or raise taxes;
- sources of revenue used to finance changes in education spending formulas; and
- availability of data concerning school spending and tax revenues since school reform initiatives had been implemented.[27]

Michigan was not chosen as a subject for the study because GAO believed that the state's reform measures had not been in place long enough to provide sufficient data for a conclusive study of the effects of education finance reform efforts.

After reviewing documents concerning the participating states' laws, financing systems, spending formulas, legal challenges to school finance plans, state budgets, and other demographic data, GAO found that school finance reform plans in the three states had several characteristics in common. The reforms in the three states also have some similarities to Michigan's efforts. For example, like Michigan, Texas limited local districts' ability to raise revenue for education. According to the GAO report, Texas Senate Bill 7, which was passed in May 1993, placed a tax limit of $1.50 per $100 of property value on all districts. A tax of up to $2.00 per $100 of property value could be levied for bonds and debt service if approved by local voters.[28] The Texas provision is similar to that in Michigan, which allows wealthier districts to levy a property tax of three mills each year on homestead property to increase district school spending beyond the foundation guarantee. However, Michigan's effort is unique in that the provision works to ensure that a wider range of students benefit equally from the wealth of individual districts.

Other states seeking to change school finance and tax systems were also concerned about how to improve educational services with limited resources. Tennessee recognized that education reform does not come without a cost and that attempts to equalize spending among school districts and to improve the overall quality of education would require an increase in revenues. One provision in Tennessee's plan that resembles Michigan's reform plan is the increase in the state sales tax. Tennessee lawmakers determined that in order to finance the new education finance system (entitled the Basic Education Program) to equalize school spending, approximately $665 million in additional revenue would have to be raised.[29] To finance the new program, state legislators increased the state sales tax by one-half percent but policymakers chose not to pursue an increase in the state income tax. During interviews with GAO, state legislators reported that "using an income tax to finance the plan proved not to be a viable option because the Tennessee governor tried and failed, in a special session, to pass what would have been the state's first broadly based income tax."[30]

Thus, the personal income tax was no more viable an option for increased revenues for schools in Tennessee than in Michigan. If state and local revenues had to increase, voters in both states clearly did not want decreases in after-tax personal income to be the result. By raising sales and cigarette taxes and creating new ones, such as levies on real estate transfers and out-of-state phone calls, Michigan lawmakers found a way to acknowledge objections to higher income taxes and still raise revenues to finance changes in school spending.

Policymakers and educators should be careful not to depend on fiscal equalization and increases in education spending as the sole means by which to improve the quality of education.

Underlying Assumptions about Spending and the Quality of Education

Under Michigan's education and tax reform plan, equalization of per-pupil expenditures among districts is one step in the state's effort toward improving the quality of educational services. In order to assess Michigan's efforts, evaluators must understand the basic assumptions about education that underlie the state's reform proposals.

One assumption is that per-pupil expenditure is an accurate and adequate measure of schools' performance. By extension, it is assumed that comparing expenditures among schools thus offers an indirect means to compare the quality of education the schools provide. However, such comparisons say nothing about how efficiently each school is using available resources. A wealthy school that spends $4,000 on needless services or programs is no more efficient or effective than a poorer school that does not have the $4,000 to spend on any services. Eric A. Hanushek of the University of Rochester suggests that "if schools are not operating efficiently, the interpretation of expenditure differences becomes totally ambiguous, because expenditure variations need no longer be directly correlated with variations in school quality."[31]

Although educators and policymakers may question the efficiency of both richer and poorer districts, few doubt nonetheless that some correlation exists between the quality and depth of services a school can provide and the resources available to provide such services. Until definitively proven otherwise, most policymakers have tentatively accepted the premise that most schools are operating with some degree of efficiency. Education finance reform efforts have, however, been undertaken with the understanding that schools can and should also take steps to ensure that resources are put to the most efficient and effective uses.

Another related assumption underlying Michigan's education finance reform efforts is that increasing spending in poorer districts will lead to increases in the quality of education and better academic performance by students. Using generally accepted measures of student performance such as standardized test scores, empirical studies have shown no correlation between school expenditures and academic achievement. Hanushek concluded that "there is no systematic relationship between school expenditures and student performance. Given that, legal arguments and policy decisions based on expenditure variations are simply suspect, at least from an educational perspective."[32]

Hanushek compared students' standardized test scores and school spending among various districts to illustrate his contention that student performance is not a direct reflection of school expenditure.[33] Hanushek's analysis shows that from 1967 to 1991, while per-pupil expenditures steadily increased, student performance as measured by average scores on the Scholastic Aptitude Test (SAT) decreased. The only increase in SAT scores during this period occurred between 1980 and 1984 and again (only slightly) in 1991. The general trend in SAT scores has been a decline, while the trend in per-pupil expenditures has been a steady increase. Such empirical evidence suggests that policymakers and educators should be careful not to depend on fiscal equalization and increases in education spending as the sole means by which to improve the quality of education. Although equalizing spending among districts and providing resources not available to poorer districts may help create an environment more conducive to improvements in education, such steps, taken alone, are not enough for schools to provide a high-quality, effective education in the most efficient way possible.

Tax and Education Spending Reforms: Early Effects and Reactions

While acknowledging the tenuous relationship between school spending and student performance, Michigan educators and school administrators have attempted to determine the financial and political impact of the state's new school spending and tax proposals on local districts.

The effort in Michigan to ensure education equity often came into direct conflict with the desire of local districts, especially wealthier ones, to individually decide what programs and levels of spending best served students within district boundaries. After all, school districts were viewed by educators, administrators, and school boards as autonomous entities whose education policy decisions were not to be determined by distant politicians in the state capitol. Until 1993, Michigan school districts had enjoyed a great deal of discretion in determining how much was enough in terms of spending on education. Therefore, educators generally did not welcome the increase in state intervention involved in the new tax and education spending reforms. To many school districts and parents, the increased reliance on state funds to finance education and the imposed limits on local powers to increase spending for schools meant districts would be accountable and beholden to the state. Moreover, future school funding decisions would have to be made within the limits set by the state and could not be based solely on the demands of district residents.

Despite the concerns of local government officials, teachers, and parents, progress has been made toward equalizing school funding. The school districts and state government have been able to collect data and evaluate the effectiveness of the reforms thus far in reaching the goal of more equal spending among districts. Generally, the gaps in spending between the richest and poorest districts have narrowed. In 1994-95, under the new spending guidelines, the difference in spending among districts was slightly lower than in 1993-94. After the first year of the new guidelines, all districts had a minimum spending level of $4,200 per pupil. The 1994-95 minimum spending level is $1,361 higher than Michigan's 1991-92 implicit foundation level of $2,839, calculated in a February 1997 GAO study.[34] The percentage differences in spending among districts in 1994-95 were also smaller than in the previous year. However, the differences in dollar amounts of spending per pupil remained the same due to the provision that districts in which 1993-94 spending was above the foundation allowance were granted annual increases by equal per-student amounts. Districts with pre-1994 spending below the foundation allowance were granted larger per-pupil increases.

A simulation conducted by education policy researchers Ronald Fisher and Robert Wassmer shows projected changes in district spending over the course of four years. Based on certain economic assumptions,[35] Fisher and Wassmer concluded that average per-pupil expenditures among the poorest Michigan districts (those spending less than $4,200 in 1993-94) increased by $300 and the standard deviation in spending among districts was reduced from $169 to $87.[36] Although such changes are modest, they represent progress toward the goal of more equalized spending among school districts. Fisher and Wassmer project that "assuming that the program as adopted is not subsequently altered, additional equalization will occur until districts reach the $5,000 state foundation guarantee [set for fiscal year 1994-95]."[37]

The education community has expressed mixed feelings about the new tax and education finance structures. In principle, the NEA and the MEA shared Governor Engler's desire to lessen public schools' reliance on property taxes for funding. Being one of the more heavily represented state delegations in the NEA, Michigan representatives played a significant role in proposing NEA resolutions concerning state tax reform. As Michigan and other states began implementing innovative tax reforms and education spending measures, the NEA, which has nearly 2.2 million members nationwide, felt the need to clarify the association's position on the developing education reform efforts.

After a meeting in February 1996, the NEA Resolutions Committee issued a preliminary report that included tax reform resolutions to be voted on by the NEA Representative Assembly in July 1996. On July 4 and 5, the Assembly voted to adopt these resolutions. Specifically, the NEA (with the MEA voting to adopt) accepted resolution A-21 that states:

The National Education Association supports tax reform and believes that it should:

a. Increase tax fairness and raise revenue necessary to finance quality public education and other public services
b. Prevent excessive reliance on property tax or any other single tax
c. Reflect the findings of comprehensive studies of the total individual and corporate tax burden
d. Assure a tax burden distribution that reflects the ability to pay and that safeguards family subsistence
e. Assure that statewide uniformity in property tax effort be required
f. Provide for increased local and state funding of public education
g. Not be used to place arbitrary maximum limits on any state or local government's ability to spend or tax, particularly since such limits have a negative impact on the full funding of schools
h. Eliminate tax laws and rulings that are harmful to education employees and educational needs.[38]

Although the MEA and NEA voted to support tax reform, the elements of the adopted resolution A-21 represent something of a departure from Michigan's education spending caps and limits on millage increases placed on school districts. For example, the resolution opposed spending and taxing limitations because of the negative effects such provisions can have on the full and adequate funding of schools. The NEA understands policymakers' desire to equalize spending among rich and poor districts and to ensure the efficient use of scarce school funds. However, the association is also concerned that the greater fiscal constraints placed on districts may be levied arbitrarily and limit local schools' and districts' abilities to effectively meet the educational needs of specific student populations.

Although resolution A-21 contains statements that are incompatible with some of Michigan's efforts at school finance reform, the MEA has not yet collectively and publicly expressed strong opposition to school finance and tax reform measures implemented in the state. The MEA has essentially taken a "wait-and-see" position, choosing to withhold specific judgement as to the effectiveness and impact of state education finance and spending efforts until more data can be collected for more comprehensive evaluation.

The MEA also has expressed concern over the tax reform plan's greater reliance on the state sales tax as a source of revenue for schools. When the original tax reforms were introduced, the MEA questioned the stability of the sales tax base. As education policy researcher Chris Pipho suggests, "The Michigan Education Association opposed the state's move to a sales tax and favored reliance on an increase in the state income tax. The teachers' union felt that the tax base for the sales tax was likely to drop during an economic recession."[39] In other words, a decrease in the tax base would result in less funding for schools if districts were dependent on state sales tax revenues for a large proportion of education funding.

In the event that voters had rejected the referendum calling for the heavier reliance on sales tax revenues to finance education, Michigan legislators developed tax alternatives that were compatible with MEA requests. If the ballot proposal did not pass by referendum, state legislators offered a statutory alternative that would institute a 1.6 percent increase in personal income tax for financing education.[40] This option was more compatible with MEA representatives' hope to finance education using a more stable tax base. However, the statutory alternative was never implemented since Michigan citizens voted to accept a two-cent increase in the state sales tax to be directed toward education finance.

Lessons Learned

The tax and school finance reform initiatives Michigan implemented in 1993 and 1994 were designed to address several issues in state public policy.

First was the increasing dependence on local property taxes to finance public education. Property owners in Michigan felt unduly burdened by property tax rates that were about 30 percent higher than the national average. Citizens supported efforts to improve the structure and quality of education in the state but demanded that such improvements be made without raising already high property tax rates. Through Public Act 145 and Proposal A, Governor Engler and state legislators hoped to lessen the burden of local property taxes among district residents while widening the tax base for education spending and equalizing spending across school districts.

Michigan's reform efforts may serve as a model for other states that wish to better equalize school spending through policies that are more expedient, affordable, and politically viable than a complete overhaul of current systems.

Although the tax and education reforms have only been in effect for a short time, preliminary analyses suggest that Michigan school districts may be moving closer to reaching the policymakers' goals. In 1995, authors Michael Addonizio, C. Philip Kearney, and Henry Prince concluded, "School property taxes have been reduced by more than half and the state share of K-12 revenues has risen from 45 to 79 percent."[41] The increased role of the state government in financing education has lessened the burden on those district residents who may be less willing or able to support increased spending for local schools. At the same time, the state-enacted reforms have left room for other districts to find revenue options for financing greater demand for educational services.

In the attempt to lighten the citizen load of property taxes without substantially decreasing state and local revenues, policymakers were also challenged by the need to widen the pool of resources. Provisions in the reform plans such as the increase in the state sales, cigarette, and real estate transfer taxes were designed to spread the tax burden over a wider base of public fund sources. In this way, Governor Engler and the state legislators acted to more effectively and efficiently use the revenue sources at the state's disposal.

Another question Michigan legislators and Governor Engler faced was how and to what degree to equalize school spending across local districts. Policymakers recognized the growth in court cases in Michigan and across the country that challenged the constitutionality of disparities in district spending. Michigan's new school funding mechanism, centered on the Basic Foundation Allowance, has shortened the range between low and high revenue districts. According to Addonizio, Kearney, and Prince, the ratio of school spending by the wealthiest district to spending by the poorest was 3.2:1 before the tax reforms. The wealthiest district, Bloomfield Hills, spent $7,081 more per pupil than the poorest district, Onaway. After the tax reforms were implemented, however, the spending ratio was reduced to 2.5:1 in 1994-95. The difference in spending between the richest and poorest districts fell to $6,318.[42] While Michigan took a step toward equalizing spending across school districts, hold-harmless clauses and options allowing district citizens to vote for additional millage increases maintained local districts' flexibility in deciding how much to spend on local schools. Thus, despite the tax and education reforms enacted at the state level, a great deal of fiscal and administrative autonomy remains at the local level.

Court cases in Michigan and other states that challenge inequity in school spending across districts have not set a clear precedent that requires state and local governments to fully equalize school spending. In *Jackson Public Schools v. State of Michigan*, the Michigan Court of Appeals found that the state's equal protection clause did not require the state legislature to provide equal financial support for public schools.[43] Equal protection under the law could be provided for students without requiring fully equalized spending among school districts. But Michigan found a way to restructure the state education finance system that so far has not been challenged as a violation of the state's constitution.

Michigan's reform efforts may serve as a model for other states that wish to better equalize school spending through policies that are more expedient, affordable, and politically viable than a complete overhaul of current systems. States may find that education finance proposals need not completely abolish fiscal discretion and autonomy at the local level. Greater equity in spending and state resource allocation can coexist with a degree of local districts' freedom to determine how to raise and spend revenues.

In addition to the explicit goals related to equalizing school district funding, the underlying impetus of Michigan's reforms was to improve the quality of education throughout the state and especially in poorer districts. But spending more on education and more fairly distributing the burden of school finance will ultimately mean little if students' academic performance doesn't improve. Therefore, a key question in evaluating the effectiveness of the changes is where to look for evidence of improved student performance and how to control for other factors which may also affect performance.

A February 1997 news release by the Michigan Department of Education reported that, according to the National Assessment of Education Progress Report, fourth-grade students in the state showed a six-point increase in average standardized mathematics test scores. Eighth-graders showed a ten-point gain. In contrast, the national average gain in mathematics scores for fourth- and eighth-grade students was only four points.[44]

Policymakers and educators are cautious when drawing conclusions about the effectiveness of school spending and tax reforms based on standardized test scores. As noted previously, researchers are questioning the validity of a causal relationship between spending and performance. Additionally, math scores are only one measure of performance. Other areas of student activity, including trends in test scores on other academic subjects, must be analyzed as well. Even more important, the effects of tax reforms should be separated from other factors such as changes in curriculum, the purchase of new technology, and systemic changes (the development of charter schools for example) to determine the net impact of the fiscal reform efforts. Nevertheless, if one element of student performance is improving, Michigan policymakers, teachers, and parents will undoubtedly be encouraged to continue with the reforms. And any gains in student performance in Michigan may encourage other states to adopt similar reforms.

Perhaps one of the most important lessons Michigan policymakers learned in attempting to meet citizens' demands for reforms in education finance and tax structures was that such challenges cannot be effectively addressed with one statute or policy. Different tools and options must be combined in a package of initiatives that approaches the policy problem from different perspectives. Issues of education finance and tax systems are simply too complex to be covered by one plan. Moreover, Michigan's reform initiatives emerged from a constant public debate among stakeholders both inside and outside the legislature. Parents, teachers, unions, legislators, property owners, and tax experts engaged in substantial policy discussions. By including various stakeholders in the reform process, Michigan policymakers succeeded in incorporating the ideas and concerns of all stakeholders in the resulting policy outcome. Indeed, making more room at the policy table may be the key to the success of current and future policy initiatives in Michigan and across the country.

Notes

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[1] In *Tennessee Small School System v McWherter*, 851 s.w.2d 139 (Tenn. 1993), and *Edgewood Independent School District v Bynum*, No. 362515 (Tex. Dist. Ct. Travis County, filed 23 May 1984) the Tennessee and Texas school finance systems were challenged as violations of the states' constitutions. *Edgewood Independent School District v Bynum* (1984) was first in a series of school finance cases filed in Texas.

[2] Each mill translates into $1 per $2,000 of the assessed market value of the property.

[3] David Hacker and Joan Richardson, "No more school: parents think over what to do for the kids," *Detroit Free Press*, 25 March 1993, 1A.

[4] Michael F. Addonizio, C. Philip Kearney, and Henry J. Prince, "Michigan's High Wire Act," *Journal of Education Finance* 20, no. 3 (1995): 239.

[5] John E. Anderson, "Reducing Reliance on the Property Tax in School Finance," *Fiscal Equalization for State and Local Government Finance*, (Westport, Connecticut: Praeger Publishers and National Tax Association, 1994), 129.

[6] *Ibid.*

[7] Paul D. Ballew, Richard H. Mattoon, and William A. Testa, "School Reform and Tax Reform: A Successful Marriage?" *Government Finance Review* 10, no. 4 (August 1994): 34.

[8] *Ibid.*

[9] Addonizio, Kearney, and Prince, "Michigan's High Wire Act," 239.

[10] Hacker and Richardson, "No more school," 1A.

[11] Addonizio, Kearney, and Prince, "Michigan's High Wire Act," 243.

[12] Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, Vol. 2 (Washington, DC.: ACIR, September 1992), 275.

[13] C. Philip Kearney, "Out with the Old / In with the New – Or More of the Same? School Finance Reform in Michigan," *The Clearing House* 68, no. 2. (November 1994): 91.

[14] *Ibid.*, 90.

[15] Ballew, Mattoon, and Testa, "School Reform and Tax Reform," 32.

[16] *Ibid.*

[17] Michigan State Treasurer Douglas B. Roberts, 3 November 1995.

[18] Michigan Department of Education, *Bulletin 1014: MI K-12 Financial Data & Ranking* (Lansing, MI, 1993-94).

[19] Ruth Beier, "School Finance: Finding the Dollars to Make Educational Sense," *Policy Choices: Framing the Debate for Michigan's Future*, ed. Timothy S. Bynum and Phyllis T.H. Grummon (East Lansing, MI: Michigan State University Press, 1993), 168.

[20] Ronald C. Fisher and Robert W. Wassmer, "Centralizing Educational Responsibility in Michigan and Other States: New Constraints on States and Localities," *National Tax Journal* 48, no. 3 (May 1995): 419.

[21] Michigan House and Senate Fiscal Agencies, *The Michigan School Aid Act Compiled and Appendices* (Lansing, MI, 1996), 67.

[22] *Ibid.*, 67-68.

[23] *Ibid.*, 54.

[24] Fisher and Wassmer, "Centralizing Educational Responsibility," 420.

[25] *Ibid.*

[26] *Ibid.*, 420-421.

[27] U.S. General Accounting Office, *School Finance: Three States' Experiences with Equity in School Funding* (Washington, DC: GAO/HEHS 96-39, December 1995), 32.

[28] *Ibid.*

[29] *Ibid.*, 41.

[30] *Ibid.*

[31] Eric A. Hanushek, "Can Equity be Separated from Efficiency in School Finance Debates?" *Essays on the Economics of Education*, ed. Emily P. Hoffman (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1993), 37.

[32] *Ibid.*

[33] *Ibid.*, Figure 1 "Real School Expenditure and Achievement 1967-1991," 39.

[34] U.S. General Accounting Office, *School Finance: State Efforts to Reduce Funding Gaps Between Poor and Wealthy Districts* (Washington, DC: GAO/HEHS 97-31), 184. The implicit foundation level calculated represents "the minimum amount of total funding the state's equalization policies would enable districts to spend for each student, assuming all districts had made the same minimum tax effort." See footnote (c) to Table XXVII.1 on page 184.

[35] Fisher and Wassmer, "Centralizing Educational Responsibility," 422. Fisher and Wassmer assume a 5% annual increase in nominal income, 3% increase in the general price level, 1% annual increase in school enrollment, and an income elasticity of school fund revenue of 0.9 (see Table 3, p. 422).

[36] *Ibid.*

[37] *Ibid.*

[38] National Education Association of the United States of America, *Preliminary Report of the 1995-96 Resolutions Committee, Winter Meeting, February 21-25, 1996* (Washington, DC: NEA, 1996), 6-7.

[39] Chris Pipho, "Property Tax Bans Catch On," *Phi Delta Kappan* 75, no. 10 (June 1994): 742.

[40] Kearney, "Out with the Old / In with the New," 91.

[41] Addonizio, Kearney, Prince, "Michigan's High Wire Act," 268.

[42] *Ibid.*, 257.

[43] *Jackson Public Schools v State of Michigan*, 348 N.W. 2d 303 (Mich. Ct.App., 1984).

[44] News Release, "MI Students Outpace US Averages on Math NAEP Tests," Michigan Department of Education, 27 February 1997; available from http://www.mde.state.mi.us/; INTERNET.

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