

Public Education Funding: Taxes, Lotteries and Mandates – Oh My!

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Is education important in our society and to our country's future? Does support for the public role in education cross party lines?

The following are quotes from historic and contemporary Presidents of the United States:

- President Dwight Eisenhower: "Teachers need our active support and encouragement. They are doing one of the most necessary and exacting jobs in the land. They are developing our most precious national resource: our children, our future citizens."
- President John F. Kennedy: "Our progress as a nation can be no swifter than our progress in education. The human mind is our fundamental resource."
- President George H. W. Bush: "Think about every problem, every challenge, we face. The solution to each starts with education."
- President Barack Obama: "In a global economy where the most valuable skill you can sell is your knowledge, a good education is no longer just a pathway to opportunity - it is a prerequisite."

There is plenty of common ground among our elected leaders on the importance of education and that our government has a vital role in policy and investing our tax dollars in education. Unfortunately, we see too much dogmatic posturing and too little effort to even find common ground on the facts on which we may base efforts to improve and modernize our education system. Thanks to our scientific progress:

- we have a much greater understanding of how the brain works and how we learn
- we have a much greater understanding of the opportunity that an educated society provides in our modern global economy
- we have an ongoing appreciation of the importance of education in a free and democratic country

We should feel that education spending is one of the best uses of our tax dollars but policy makers cannot even agree if we are spending more or less on education than in the past. It seems we should have a common understanding on how education budgets have changed over time and a better understanding of how expenses have changed in our education system over time. The endeavor today is not to be bogged down on how we should spend our tax dollars in the education system and related policy matters, but to better understand how, particularly in Michigan, our education budget and spending has changed over time. If we can better understand our past and how education spending has evolved, perhaps this common ground will provide a basis for effective progress for education budgeting and policy for the future.

I found a good overview of the merits of having a successful education system within a state in a study by the [Economic Policy Institute](#): “A Well-Educated Workforce Is Key to State Prosperity” (Berger and Fisher, August 22, 2013):

“Major findings of this report include the following:

- Overwhelmingly, high-wage states are states with a well-educated workforce. There is a clear and strong correlation between the educational attainment of a state’s workforce and median wages in the state.
- States can build a strong foundation for economic success and shared prosperity by investing in education. Providing expanded access to high quality education will not only expand economic opportunity for residents, but also likely do more to strengthen the overall state economy than anything else a state government can do.
- Cutting taxes to capture private investment from other states is a race-to-the-bottom state economic development strategy that undermines the ability to invest in education.
- States can increase the strength of their economies and their ability to grow and attract high-wage employers by investing in education and increasing the number of well-educated workers.
- Investing in education is also good for state budgets in the long run, since workers with higher incomes contribute more through taxes over the course of their lifetimes.”

This is a good summary but the question about the amount of public education funding and the policies to achieve these outcomes remains the challenge.

The focus of this presentation will be on Michigan and the state's portion of public school funding for kindergarten through 12th grade (K-12), though other levels of education and other funding sources will be recognized as well. The substantial importance of state funding for school districts across Michigan began with the passage of Proposal A in 1994. The primary purpose of this change was laudable, providing a methodology for better equalizing education funding available among poorer and richer communities, by systematically raising state funding at a higher rate for the poorer communities versus richer communities over a number of years. The approach was to reduce the reliance on local property taxes that also contributed to the variance in funding among Michigan school districts – some district had higher property values and/or approve higher property taxes in support of the local school districts leading to higher and lower education funding among districts across the state. The outcome of the changes in Proposal A also led to greater impact from the state level political process and a more volatile tax base supporting schools – sales tax revenue is more sensitive to economic cycles than property taxes. Prior to the implementation of these changes, the state of Michigan's portion of education funding accounted for approximately 31% and after proposal A the state funding increased to approximately two-thirds of the non-federal funding.

Since the reforms Proposal A brought to Michigan have established the structure of our current public education funding system, it is worth reviewing some key components of Proposal A:

- Homeowners had a reduction in their locally assessed property taxes as funding responsibility shifted to statewide sources
- The change provided a higher level of education funding for the lowest-funded districts and these districts have a higher rate of increases in funding than school districts with more substantial historic levels of education funding.
- The sales tax was increased from 4 percent to 6 percent to help offset the reduction in local property taxes in public school funding.

- A 6-mill statewide tax on homesteads was initiated as another offset to the decline in local property taxes. Proposal A capped the rate of growth in taxable value to 5% per year.
- Local districts must levy property taxes of 18-mills for school operations on non-homestead properties (businesses, rental properties, vacation homes) to support the school district. Additional mills may only be levied for purposes such as buildings and technology (traditional public schools).
- Proposal A established a special Foundation Allowance category for school districts that, in 1994, had a higher than 18-mill local property tax dedicated to school operations. These school districts (over 50 of the 550 public school districts) are permitted to continue local property taxes above the 18-mill threshold and still receive a share of the Foundation Allowance state funding – the category is known as “hold-harmless”.
- School districts may choose to be “out of formula”. In this case they may choose to keep the non-homestead tax revenue collected in their district versus collect their calculated Foundation Allowance.
- The proposal included the implementation of an increase in the state cigarette tax as well as several other lower revenue producing taxes as further offsets to the local property tax cuts.
- The increases in the various state taxes were earmarked to the Student Aid Fund from which a per-pupil funding amount is allocated to each school district. These “Foundation Allowances” were designed to significantly replace local property tax revenue for public schools – and also to be used with a formula to progressively close the funding gap among higher and lower funded public school districts.

It is worth mentioning one other revenue source that is part of the Student Aid Fund that is regularly promoted, the lottery. J. Bob Traxler, a key legislator who was instrumental in the introduction of the Lottery in Michigan, was interviewed by mybaycity.com on August 17, 2017 and recounted his 1972 effort:

“First Gov. Bill Milliken opposed it but his office did very little to hamper Mr. Traxler's ground breaking effort. Turns out he had the most challenges from a fellow Democrat, Rep. Dominic ‘The God Father’ Jacobetti from the Upper Peninsula.

Mr. Traxler wanted to earmark the lottery profits for education . . . Jake, who chaired the house appropriations committee, wanted to pump the money into the state's General Fund where he could determine where the money went. . . . Mr. Traxler prevailed against the powerful chairman in a text book example of how to neutralize an opponent long before he knew what hit him. . . . 'Jake was unhappy,' he [Mr. Traxler] chuckled."

The Lottery sourced K-12 education funding was especially valuable in the difficult economy of the early 1970's when Michigan was losing jobs and it's workers leaving the state. The earmarked funding was intended to provide *additional* funds for education to help not only Michigan's citizens but also make Michigan attractive to people and business that value a first-class education system. It is difficult to determine when this "extra" funding was absorbed into the state's normal budget but I could not find any interested group that disputed the fact that the lottery revenues are no longer a bonus amount.

One of the challenges when looking at funds budgeted for education through federal, state and local sources is that the revenue formula for supporting schools has changed over time. Additionally, the new education programs and mandates, and the related costs for the education system, has grown over the years. The challenge of sorting out the facts and influences on an education budget seems to have left enough room for interest groups to craft reports that support their point of view on education budgets and related spending, but not necessarily providing an accurate picture of public schooling funding. After being frustrated by conflicting depictions of funding for the Michigan education system, the best course of action was to begin by directly reviewing Michigan's historical expenditures for education as reported in the state's annual budgets.

The key questions I had were, 1) has education spending at least kept up with the inflation rate since the full implementation of Proposal A in 1996? 2) What has been the education spending rate of change relative to the rate of growth of Michigan's budget since 1996? The answer to each question is disturbing; by 2017, education spending was over \$1.1 million (7.2%) below the inflation rate as measured by the consumer price index (CPI) and over \$3.7 million (22.8%) below the rate of growth of Michigan's budget. Unfortunately, we will see that the drop in state K-12 education spending significantly understates the decline due to the

unfunded and underfunded additions of education programs and the transfer of expenses to the Student Aid Fund from the general fund within Michigan's budget.

We can surmise, even when considering all sources of public education funding, in inflation-adjusted terms and in relative terms to the growth of Michigan's budget, funding has declined since 1996. Let us now shift our focus to the Student Aid Fund, intended as a protected source of funding for K-12 education purposes. The per-pupil foundation allowance for the school districts is still the dominant part of the expenditures from the fund, but to understand how K-12 support has been impacted over time we need to consider the changes in the use of the Student Aid Fund. Unfortunately, Michigan and many other states decline in education funding is particularly notable since the "great recession" that started in 2008 – according to the Center on Budget and Policy Priorities, Michigan's spending has declined, inflation adjusted, from 2008 through 2015 by 7.4% (20th worst in the country).

Since the establishment of the Student Aid Fund in 1955, the fund has supported K-12 Education. As part of the 1994 Proposal A, the Student Aid Fund was transformed to receive additional earmarked tax revenue which in turn was to be distributed in support of K-12 education. Unfortunately, as part of the 1994 reform, the Student Aid Fund's purpose of being dedicated to K-12 funding was inferred, not specifically stated. The door was opened to expand the Fund's use beyond K-12 during the difficult recessionary period in 2010 when Governor Granholm borrowed \$208 million for community college funding in order to balance the Michigan state budget. In 2012 Governor Snyder signed a budget that included community college and university funding being drawn from the Student Aid Fund and removing any provision for repaying the original "borrowed" \$208 million, thus broadening the budgetary education related use of the Student Aid Fund.

The recharacterization of the use of the Student Aid Fund effectively reduces K-12 protected funding and contributes to the reduction of K-12 funding overall (and there was no overall increase in community college and university funding due to a reduction in funds allocated to postsecondary schools from the general fund).

Just in 2012 this change resulted in a \$400 million reduction in K-12 funding and a related statutory reduction of \$470 per pupil in foundation allowance to K-12 schools. A cumulative total of \$4.5 billion has been redirected to community colleges and universities from the K-12 related School Aid Fund budget from 2010 through the 2019 budget.

In addition to the reduction of funds dedicated to K-12 education due to the inclusion of postsecondary expenditures from the Student Aid Fund, there have been new programs allocated to the Student Aid Fund – such as early childhood programs (totaling over \$257 million in 2017). Since 2002 additional expenses have been transferred from various general fund budget areas to the Student Aid Fund as well, totaling almost \$200 million in 2017 -- examples are school bond debt service, juvenile detention facilities, child and adolescent health centers, state aid to libraries and the state's share of MEAP standardized testing. I found this information from Michigan's Senate Fiscal Agency and I would not be surprised if there have been more expenses shifted to the Student Aid Fund that were intended for K-12 education – the purpose of the fund seems to have been quite liberally expanded.

Another liberty taken by the State of Michigan relates to their effort to address the underfunded pension plan, Michigan Public School Employee System (MPSERS), that benefits educators in Michigan – by adding pension expenses, both current and some catch-up costs, to the Student Aid Fund. As of 2017 the MPSERS plan was only 60% funded and pension reforms in 2010, 2012 and 2017 have been meant to address the underfunded situation – part of the solution was justifying the allocation of some of pension expenses to the Student Aid Fund. This decision further impacted funds that are available for K-12 education.

As an aside, the key reasons for the underfunded situation are related to factors like cutting MPSERS contributions, overestimating investment returns and overestimating employee growth as well as employee compensation (resulting in less money paid into the pension system). Significant aspects of these changes began in 1993, during Governor Engler's administration, and the changes led to cuts in contributions to MPSERS and eliminated the budget commitment to “pre-fund” the health care portion of employee benefits. The changes significantly contributed to the underfunding of the pension system since 1993 along with

factors such as assuming too high of a rate of return on the pension system assets -- basically insufficient money was set aside for these known future benefit expenses. In the end, the state of Michigan deemed the Student Aid Fund as a legitimate resource to address the past underfunding of the educators' employee benefits.

A less appreciated drain on education funding is market inefficiencies made possible by charter school policies. Unfortunately, education reform legislation created education "market" inefficiencies as some charter school proponents lauded the "free market" approach and the benefits of "competition" to raise the cost-efficient educational outcomes in Michigan. Flaws in policies around charter schools opened the door to not only groups that wanted to address ways to improve public education in communities but also to groups that saw opportunities to profit by taking advantage of the public education funding system. The limited and varied reporting standards for Charter and traditional Public Schools has created challenges to fully evaluate this issue, but there are some factors that remain problematic and are unaddressed in current education funding policies:

- Moody's Investor Service (15 Oct 2013) identified the development of charter schools as an issue that has negative credit rating implications for traditional public schools:
 - "Charter schools can pull students and revenues away from districts faster than the districts can reduce their costs . . . cuts in programs and services will further drive students to seek alternative institutions including charter schools."
 - "In Michigan, the statutory framework emphasizes educational choice, and there are multiple charter authorizers to help promote charter school growth. In Michigan, Detroit Public Schools (B2 negative), Clintondale Community Schools (Ba3 negative), Mount Clemens Community School District (Ba3 negative) and Ypsilanti School District (Ba3) have all experienced significant fiscal strain related to charter enrollment growth, which has also been a contributing factor to their speculative [credit] grade status."
- "In Michigan, charter schools may have particularly adverse effects on traditional public school finances because per-pupil funding follows students

as soon as they enter a new school and because, under Michigan state law, school districts have only limited abilities to raise additional funds.”

(Educational Administrator Quarterly, The Effects of Charter School Competition on School District Resource Allocation, David Arsen, Yongmei Ni, September 19, 2011)

- Michigan’s per-pupil state funding (Foundation Allowance) is not adjusted for the school grade or cost of a particular academic program. Some charter schools work to avoid providing more expensive programs and/or avoid more expensive grades (9th -12th). This approach results in traditional schools having to service more expensive portions of the student population and losing funding from less expensive, more cost efficient, portions of the student population.
- Some costs that are not part of a charter school’s expenses must be covered within a traditional school’s budget. For example, transportation and retirement costs associated with the Michigan Public School Employees Retirement System (MPSERS). Most charter schools are not members of the MPSERS system and avoid expenses related to past underfunding of MPSERS as well as current contribution costs – and these costs become proportionately more burdensome on traditional schools as their student population may decline with the movement of per-pupil funding to charter schools.
- There have been reports of some charter schools using strategies of discouraging higher need (higher cost) students from attending particular charter schools -- leading to a disproportionately higher cost students attending traditional public schools.
- There have been reports of some charter schools working to recruit and retain students through each semester’s “count day” (early October and early February) that tallies the number of attending students for allocation of the per-pupil foundation allowance – and then disengaging efforts with the students in hopes the charter school simply collects the money and does not need to provide services through the semester. After the “count day” another school would not be receiving any money for providing education services to these children. Even if such efforts are not very significant, this is a problematic aspect of the funding formula.

Another variation of charter schools that creates similar challenges are “cyber” programs where students may choose to attend “on-line” school. These schools may receive the same state funds as brick-and-mortar charter schools even with a very different and lower cost structure – again, this creates distortion in the “free market” system some advocates have proclaimed as a benefit. Governor Snyder is proposing a 25% lower funding allocation for the cyber schools going forward, though I could not find a sound basis for that adjustment relative to funding that may be appropriate relative for brick-and-mortar charter schools or traditional public schools. Cyber schools would seem to have a role in the future of education but for now, they seem to further muddy the water for an underfunded and flawed education funding system. I thought one observation from Port Huron’s Times Herald (“Cyber school defenders too transparent”, August 29, 2018) summed up a key issue with cyber schools: “Average student-teacher ratios for for-profit virtual schools in Michigan are an unfathomable 146-to-1. Nonprofit cyber schools, such as those run by some Blue Water Area school districts, have ratios closer to 40-to-1. Traditional schools average 23-to-1, and many suggest that is too high, especially in the lower grades.”.

It is rather shocking to recognize that in 2017, the total of the additional expenses that have been added to the spending from Michigan’s Student Aid Fund, is over \$2.1 billion. The expanded definition that includes expenditures beyond the original K-12 focus represents nearly 15% of the expenditures from the Student Aid Fund. The education budget overall has declined in real terms since Proposal A was passed:

- Adjusted for inflation since 1996, the 2017 education budget is approximate \$1.5 billion below this benchmark.
- Adjusted for the rate of the growth of the Michigan budget since 1996, the 2017 education budget is nearly \$4.0 billion dollars less than if education funding had grown proportionately to the Michigan budget.

In summary, there are some key issues that should be addressed from a public education funding standpoint:

- Public education funding has continued to decline in terms of inflation-adjusted dollars and relative to the growth in the Michigan budget.
- Those that support the concept of “free market” and “competition” provided by charter and cyber schools should also be on-board with implementing changes to address the funding distortions and the wasteful spending caused by the inefficiencies.
- If a per-pupil foundation allowance format continues, there should also be a recognition of the different imbedded costs each school district may experience – issues like the make-up of the student population and costs associated with different regions of the state. There is some specialty funding from the state that partially addresses district specific costs.
- Adapting the state funding so as not to penalize schools and school districts for the services and programs that are needed with a student population – avoiding some alternative school efforts to focus upon lower cost student population and burdening traditional public schools and charter schools that serve all populations of students.
- There is still a significant funding gap among school districts which contributes to challenges in providing competitive, quality education within poorer school districts.
- The Student Aid Fund should not be used as a piggy bank for the general fund – the additional expenses added to the Student Aid Fund have contributed to the decline in public education funding and reduced K-12 protected funding.

Perhaps there is some hope for addressing not only public education funding issues but also the topic not meaningfully covered in this paper, spending Michigan funds wisely to achieve quality education that is a standard for the nation. There is a new and broad coalition of business, labor, philanthropic and education groups called “Launch Michigan” that began in the summer of 2018. The focus is to improve K-12 education outcomes and has the goal of Michigan becoming a top 10 education state. In fact, the goal is to return to a top 10 education state after slipping for years – including the time since the implementation of Proposal A in 1995-96.

Initial areas of agreement and focus of Launch Michigan include:

1. “Supporting educators by leveraging existing research and using a statewide educator survey, among other activities, to guide our work.
2. Supporting shared, statewide, research-driven strategies for delivering effective education to all students and sticking to those strategies beyond politics and election cycles, to determine what really works.
3. Supporting a fair and comprehensive accountability system that includes everyone who influences education—not just teachers.
4. Working together to ensure that resources are available to provide for an equitable, student-centered education system and funding model.
5. Elevating public awareness and inspiring action about the current state of education in Michigan.”

These goals and breadth of the Launch Michigan effort give me some hope after learning of the current public education funding challenges.

Primary resources for this paper:

“Michigan Adopts Most Innovative Teacher Pension Reform in the Nation”, Gilroy, Randozzo, Takash of the Reason Foundation, June 16, 2017.

Michigan Senate’s Senate Fiscal Agency

Michigan House of Representatives’ House Fiscal Agency

Michigan’s Executive Budget, State Budget Office

“Historic alliance of diverse organizations comes together to improve Michigan’s K-12 education outcomes; focus on student needs, future”, Business Leaders for Michigan, June 20, 2018.

“Moody's: Charter schools pose greatest credit challenge to school districts in economically weak urban areas”, October 15, 2013

“A hard habit to break: The raiding of K-12 funds for postsecondary education”, Peter Raurk, Michigan League for Public Policy, August 23, 2018.

“A Punishing Decade for School Funding”, Leachman, Masterson & Figueroa, Center on Policy and Budget Priorities, November 29, 2017.

“Consumer Price Index, 1913-“, Federal Reserve Bank of Minneapolis