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# PLANNING FOR POTENTIAL BUDGET CUTBACKS IN MICHIGAN: SUSTAINABLE SCHOOL FINANCE SOLUTIONS

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# PART 1

## INTRODUCTION

Despite strong initial concerns about budget cuts when the pandemic was first beginning, Michigan has been able to maintain last year's education revenue levels with the help of some federal stimulus dollars.<sup>1</sup> However, there are still major concerns about the fiscal constraints the state could face for the 2021-2022 school year. When considering how they're using current stimulus dollars and the possibility of facing budget cuts in future years, Michigan policymakers must ensure fair distribution of the effects, as well as empower districts with financial flexibility for best use of every education dollar. This involves taking into account structural problems with the state's school finance system. This policy brief provides an overview of Michigan's school finance system, details its primary shortcomings, and makes four recommendations for reducing funding responsibly.

### 1.1

## OVERVIEW OF MICHIGAN'S SCHOOL FINANCE SYSTEM

In 2019–2020, Michigan's School Aid budget delivered about \$15.2 billion to support general operations for K-12 schools. The bulk of these dollars (88%) is derived from the School Aid Fund, which primarily relies on sales, income, and statewide property tax

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<sup>1</sup> Meloni, Rod. "New deal maintains Michigan budget for now; big concerns for next year." Click On Detroit. Clickondetroit.com. <https://www.clickondetroit.com/news/michigan/2020/09/15/new-deal-maintains-michigan-budget-for-now-big-concerns-for-next-year/>

revenue.<sup>2</sup> To allocate funding, Michigan employs a foundation formula in which the state share of funding is inversely related to districts’ ability to raise local dollars. There are three primary components of calculating districts’ funding levels and determining what proportion the state bears responsibility for.<sup>3</sup>

**District Levy:** With few exceptions, districts are required to levy 18 mills on non-homestead property, which is all property other than a taxpayer’s principal residence or other types of exempt property, including commercial property, rental homes, and vacation homes.

**State Share Determined:** After districts’ local per-pupil revenue is calculated, this amount is deducted from the lesser of their per-pupil foundation allowance or the state guaranteed maximum per-pupil amount. The resulting figure is the state share of districts’ foundation allowance.

**Categorical Grants and Other Funding:** Michigan has numerous funding allotments that are outside of the state’s primary foundation funding formula. Because these allotments largely don’t account for districts’ ability to generate local dollars, they’re also referred to as non-equalized funding.

Table 1 summarizes State Aid budget appropriations for FY 2019–2020.<sup>4</sup>

**TABLE 1: 2019–2020 SCHOOL AID BUDGET GROSS APPROPRIATIONS**

Program or Category	State Appropriations (Billions)
Foundation Allowances	\$9.499 (63%)
Special Education	\$1.536 (10%)
MPSERS	\$1.345 (9%)
Federal Programs (non-Sped)	\$1.318 (9%)
Other Programs	\$0.692 (4%)
At-Risk Programs	\$0.522 (3%)
Early Childhood Programs	\$0.263 (2%)

<sup>2</sup> School Aid Budget Briefing FY19-FY20. *Michigan House Fiscal Agency*. House.mi.gov. [https://www.house.mi.gov/hfa/PDF/Briefings/SchAid\\_BudgetBriefing\\_fy19-20.pdf](https://www.house.mi.gov/hfa/PDF/Briefings/SchAid_BudgetBriefing_fy19-20.pdf)

<sup>3</sup> State School Aid Act of 1979, Act 94. *Michigan Legislature*. Legislature.mi.gov. <http://www.legislature.mi.gov/documents/mcl/pdf/mcl-act-94-of-1979.pdf>

<sup>4</sup> School Aid Budget Briefing FY19-FY20.

## PART 2

# ANALYSIS

As they weigh budgetary decisions for this year and future years, it's critical for policymakers to understand the shortcomings of Michigan's school finance system. While Proposition A helped create a more level playing field, substantive flaws remain with how dollars are allocated, which must be considered when devising a fiscal path forward for the current financial downturn. There are numerous problems to address but, in the context of short-term budgeting, three are especially relevant.

### **#1: MULTIPLE FOUNDATION ALLOWANCES ARE BASED ON HISTORICAL FUNDING LEVELS.**

The purpose of a foundation formula is to provide a uniform per-pupil allotment that is equitably supported by state and local revenue, but when Michigan transitioned to this structure in FY 1994–1995 it created three separate allowances that were based on what school districts generated in the prior year. As a result, funding disparities that largely reflected differences in local property wealth and tax rates were baked into a new three-tiered system. While the gap between the two remaining foundation allowances has closed over time, it's still substantial. In FY 2019–2020, the minimum allowance was \$8,111 per pupil and the state-guaranteed maximum allowance was \$8,529 per pupil—a difference of

\$418 per pupil, with some districts funded at levels in between these amounts.<sup>5</sup> This means that many of Michigan's students are shortchanged based on nothing more than funding levels from nearly 30 years ago, which defeats the purpose of having a fair and uniform foundation allotment.

It's also important to note that a special category of districts that were higher-spending in in FY 1993–1994—hold harmless districts—are funded at the state-guaranteed maximum level but are also permitted to levy additional local millage to raise dollars in excess of what state formulas provide, putting them at an unfair advantage compared to most of the state's school districts. As of FY 2018–2019, 24 hold harmless districts had levied additional millage, and 14 had exceeded their statutory foundation without additional millage since they were also out-of-formula districts (i.e. generated sufficient local revenue to cover or exceed their foundation allowance).

It's important to recognize that Michigan has made real strides in increasing funding fairness over the last decade. Between the 2008-2009 school year (SY) and SY 2019-2020, the gap between the minimum and target foundation allowances narrowed from \$1,173 per pupil to \$418 per pupil.<sup>6</sup> Over that same period, the share of students receiving the equalized minimum amount grew from 40% to 63%.

However, the share of students being funded above the foundation target (i.e. students in hold harmless districts) has remained virtually flat over the last decade at about 11%.<sup>7</sup> This is because state legislators have—understandably—focused more on bringing up the minimum and less on phasing out some of the historically rooted formula features that favor a select number of districts.

Some of these formula-favored districts have lower student needs than their minimum allowance counterparts. Given current revenue projections, it's worth looking closely at overall funding fairness. Figure 1 offers a snapshot:

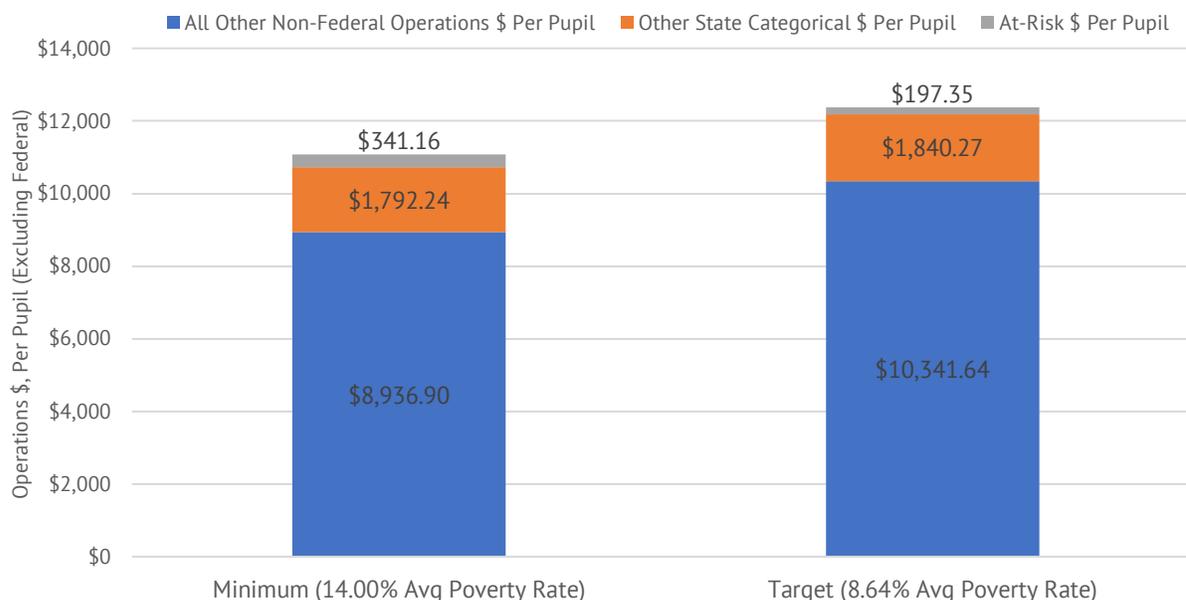
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<sup>5</sup> State Aid Foundation Allowance Parameters. *Michigan Legislature*. Michigan.gov. [https://www.michigan.gov/documents/sw\\_fndamts\\_11719\\_7.pdf](https://www.michigan.gov/documents/sw_fndamts_11719_7.pdf)

<sup>6</sup> Per-Pupil Foundation Allowance Ten-Year History for Schools. *Michigan Senate Fiscal Agency*. Senate.michigan.gov. [https://www.senate.michigan.gov/sfa/Departments/DataCharts/DCk12\\_FoundationHistory.pdf](https://www.senate.michigan.gov/sfa/Departments/DataCharts/DCk12_FoundationHistory.pdf)

<sup>7</sup> Ibid; MI School Data Financial Information Database District Profiles. 2018-2019. <https://www.mischooldata.org/DistrictSchoolProfiles2/FinancialInformation/BalanceSheet/FidFoundationAllowance.aspx> - Provided by Ben Degrow of the Mackinac Center

**FIGURE 1: ALL STATE AND LOCAL OPERATIONAL FUNDING FOR MINIMUM AND TARGET DISTRICTS (WEIGHTED FOR DISTRICT SIZE)**



**Source: MI School Data Financial Information Database, Michigan Legislature 2018-2019 District Foundation Allowance Amounts**

Figure 1 reveals some key insights. First, notice that—despite having higher poverty rates—minimum districts are receiving an average of \$1,309 less per pupil in operations revenues from state, local, and intermediate sources than target districts are. However, also note that foundation allowance amounts in Michigan aren’t always lower for less-wealthy districts. The more fundamental problem is that—rather than adjusting for existing funding disparities—state categorical dollars flatly layer on top of the existing disparities.<sup>8</sup>

As mentioned earlier, a majority of Michigan students are now funded at the minimum foundation level, which was \$8,111 this school year (2019–2020). However, a substantial number of pupils are still receiving additional state foundation dollars due to historical funding patterns. Using district enrollment data and current foundation allowance figures, we estimated that the state could save roughly \$146 million if it funded all districts currently above the minimum allowance at the minimum level instead.<sup>9</sup> Note that this

<sup>8</sup> All funding data for Figures 1–3 and Table 2 come from the MI School Data Financial Information Database (FID) revenue reports. Note that the dollar figures recorded in these reports sometimes differ slightly from State School Aid Status Report figures. This is likely because FID data include some dollars rolling over from previous years. These discrepancies don’t impact the validity of our broader analysis.

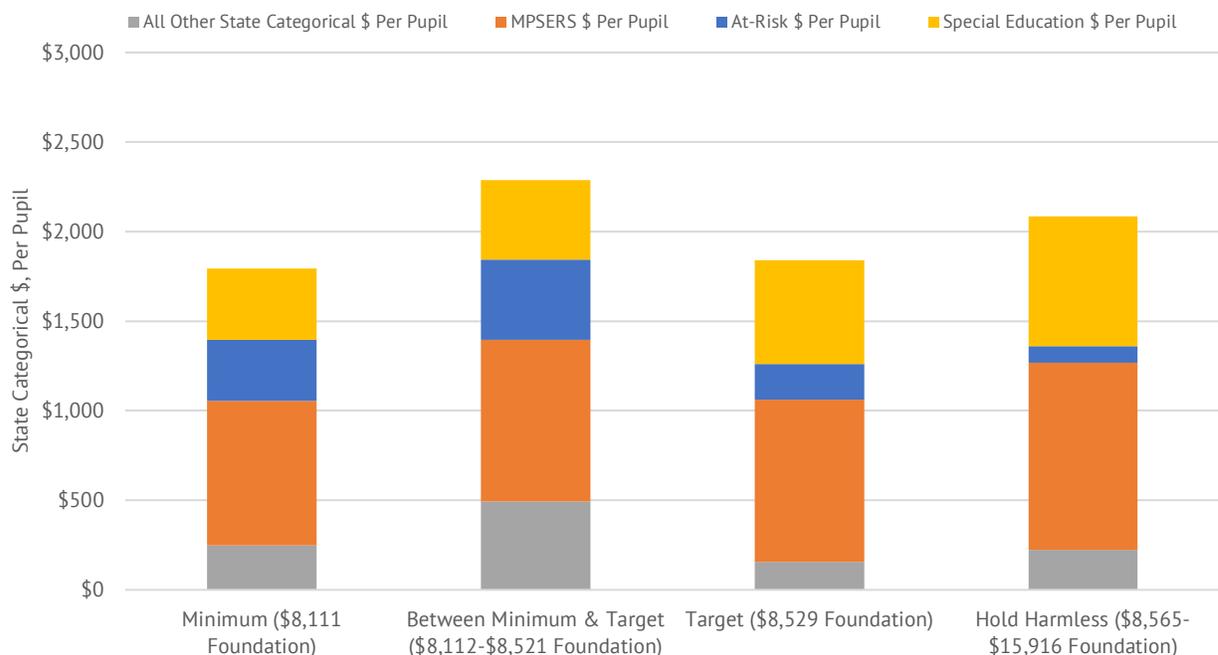
<sup>9</sup> Authors’ calculations based on district enrollment and foundation allowance amounts, obtained from MI School Data Financial Information Database (FID)

estimate treats hold-harmless districts as if they were at the target level, since any foundation dollars above the target come exclusively from local sources for those districts.

## #2: CATEGORICAL FUNDING ALLOCATIONS ARE LARGELY NON-EQUALIZED AND RESTRICT LOCAL FLEXIBILITY.

Numerous categorical grants, both large and small, exist “outside” of Michigan’s primary equalization formula, including funding streams for At-Risk, Early Childhood Education, Special Education, and Career and Technical Education. Two problems with these funding streams aren’t necessarily related to their purpose. First—as depicted in Figure 1—they’re layered on top of inequitable allocations of foundation dollars such that funds are diverted to districts (e.g. hold harmless districts) that already receive more than their fair share of revenue. While there is some attempt to mitigate this problem (e.g. some districts only receive a portion of their At-Risk funding), it falls well short of having a streamlined equalization formula in which all or most operating dollars are pooled together. Figure 2 allows for a closer look at just state categorical grants.

**FIGURE 2: STATE CATEGORICAL FUNDING FOR MINIMUM, TARGET, AND HOLD HARMLESS DISTRICTS (WEIGHTED FOR DISTRICT SIZE)**



By isolating just categorical grants, Figure 2 illustrates how districts receiving above the minimum—despite already receiving higher foundation allowances and very often seeing higher overall funding levels—are actually receiving more resources per pupil from these state programs than their minimum counterparts are. While some of these disparities are attributable to the fact that these district groups have different populations of higher-need students, the funding disparities reflected in Figure 2 often aren't closely related to differences in individual student needs. Moreover, these data don't capture all of the inequities because they don't include variations in Intermediate School District (ISD) revenues. ISDs provide a large share of the special education services to school districts in their geographic area, as well as other services like career and technical education. But they are not funded equally due to additional hold harmless allowances and their heavy reliance on property tax revenues. Some ISDs such as property-rich West Shore raise nearly \$1,500 per student they serve, while others like Saginaw only raise about \$370 per student enrolled in their programs.<sup>10</sup>

Additionally, these funding streams are tied to specific purposes and come with strings attached that limit local flexibility. While top-down spending mandates are intended to ensure that dollars are spent effectively, research shows that there isn't one correct way to structure spending and that a one-size-fits-all approach doesn't produce better outcomes. Instead, such mandates only ensure that resources are allocated inefficiently since they prohibit district and school leaders from aligning spending with their actual needs. The reality is that even in good fiscal times spending tradeoffs must be made, and it's best to empower those who are closest to students to make decisions over scarce resources.

### **#3: AT-RISK FUNDING ISN'T EFFECTIVELY TARGETED TO STUDENTS MOST IN NEED.**

Funding for At-Risk students grew by 69% between FY 2014-2015 and FY 2019-2020, and eligibility rules have expanded in recent years to include substantially more students such that more than half of all students statewide now qualify for funding.<sup>11</sup> Eligibility criteria include the following categories of students:

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<sup>10</sup> Michigan Department of Education, 2017-2018 State Aid Status Reports. Provided by Ben Degrow of the Mackinac Center.

<sup>11</sup> School Aid Budget Briefing FY19-FY20.

- Economically disadvantaged
- English language learner
- Chronically absent
- Victim of child abuse or neglect
- Pregnant teenager or teenage parent
- Family history of school failure, incarceration, or substance abuse
- Immigrated within the immediately preceding three years
- Did not complete high school in four years and is continuing in school as identified in the Michigan cohort graduation and dropout report
- Did not achieve proficiency on the English language arts, mathematics, science, or social studies content area assessment
- At risk of not meeting the district's or public school academy's core academic curricular objectives in English language arts or mathematics, as demonstrated on local assessments

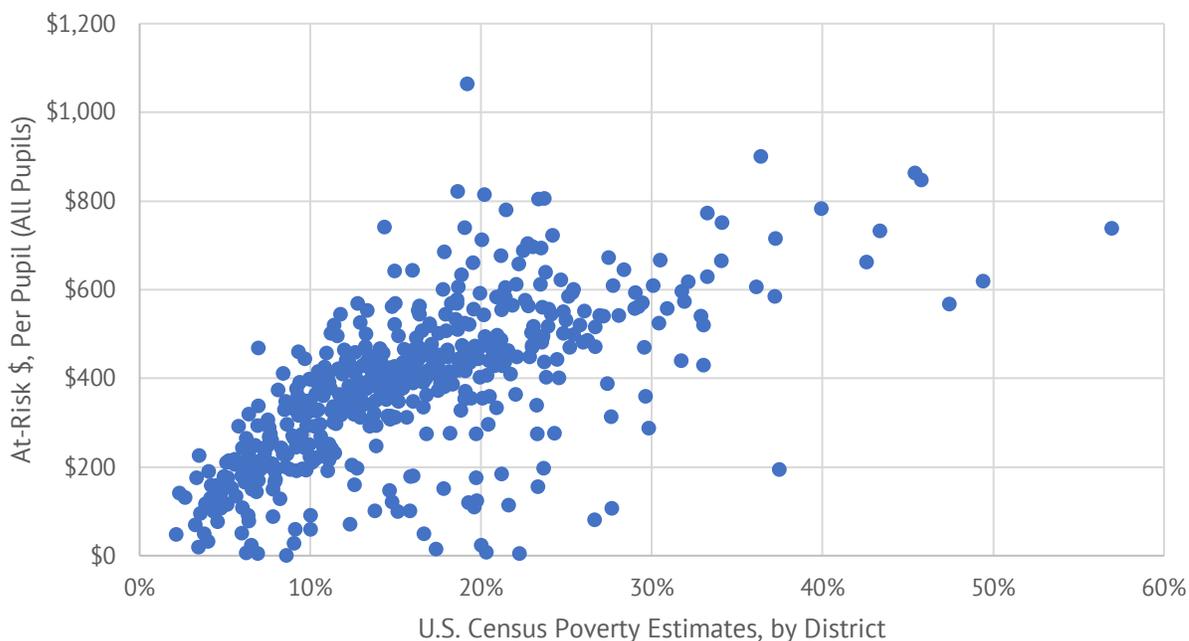
In addition to direct certification through programs such as SNAP and TANF, students are also categorized as economically disadvantaged if they're eligible for free or reduced-price meals through the federal National School Lunch program. Not only is this a lower bar for eligibility, but many schools now qualify for the Community Eligibility Program (CEP) that relieves them of the burden of collecting NSL eligibility forms. However, in order to maximize their At-Risk funding, Michigan's CEP schools must still collect this information even though it's no longer required for federal purposes. When Massachusetts moved away from relying on FRL counts to deliver At-Risk dollars, it saw a 31% decrease in the share of eligible students and employed a higher weight for each identified student to target dollars more effectively.

Figure 3 provides a picture of how At-Risk funding is distributed to Michigan districts based on U.S. Census Bureau child poverty estimates. Note that At-Risk dollars are calculated in per-pupil terms based on each district's *total* enrollment, not based on each district's At-Risk counts.<sup>12</sup>

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<sup>12</sup> We were unable to obtain up-to-date At-Risk student counts for every Michigan district. If Figure 3 had displayed At-Risk dollars per program-eligible child only, most districts would be plotted at or near \$920.

**FIGURE 3: DISTRIBUTION OF AT-RISK DOLLARS TO MICHIGAN DISTRICTS, BY CENSUS POVERTY RATES**



Source: MI School Data Financial Information Database, U.S. Census SAIPE Reports 2018-2019

Notice in Figure 3 that—while higher poverty rates are generally associated with greater At-Risk funding per pupil—districts vary substantially. This graph shows that Michigan’s current At-Risk funding eligibility metrics often don’t closely align with census poverty measures. Table 2 provides a few case study districts that more directly illustrate how Michigan’s current mix of eligibility criteria works out in practice.

**TABLE 2: HOW CURRENT AT-RISK ELIGIBILITY CRITERIA DRIVES INEQUITABLE FUNDING: CASE STUDY DISTRICTS**

District	U.S. Census Child Poverty %	Foundation Allowance	At-Risk Funding Per Pupil
Muskegon City School District	34.1%	\$8,182	\$751.90
Caseville Public Schools	14.4%	\$8,249	\$741.05
Carney-Nadeau Public Schools	13.3%	\$8,111	\$553.72
Alma Public Schools	21.7%	\$8,111	\$410.47

Source: MI School Data Financial Information Database. U.S. Census SAIPE Reports 2018-2019. Per-Pupil Foundation Allowance Ten-Year History for Schools, Michigan Senate Fiscal Agency

Notice first from Table 2 how Muskegon and Caseville receive similar At-Risk funding per pupil—even though Caseville has a foundation allowance above the minimum and less than half of the poverty rate of Muskegon. A similar comparison could be made for Carney-Nadeau and Alma, but this time the former receives significantly higher At-Risk funding despite having a lower poverty rate. Even further, notice how Carney-Nadeau and Caseville have quite similar poverty rates, and yet Caseville receives substantially more At-Risk funding per pupil.

## PART 3

# RECOMMENDATIONS

Ideally, policymakers would pursue structural reforms that provide sustainable solutions to these and other problems with Michigan's school finance system. This would include streamlining operating dollars into a true weighted student funding formula, overhauling how special education dollars are allocated, and rethinking the role of independent school districts. If more-fundamental reforms aren't feasible in the short-term, policymakers can effectively address the budget shortfall in four practical ways that account for existing problems and help make the most out of every education dollar.

## #1 IMPLEMENT 2X FORMULA IN REVERSE

Critically, whenever policymakers do encounter a scenario where budget reductions are necessary, they should avoid proration and forgo across-the-board cuts that fail to account for existing funding disparities, such as those that were made during the last budget crisis in 2009–2010. To do this they should take a page from the 2x formula methodology that has been employed to increase funding and start by reducing all districts to the minimum foundation allowance so that any additional cuts are made on a more level playing field. For example, a district that is currently funded at the state-guaranteed maximum (\$8,529 per pupil) would be brought down to \$8,111 per pupil, as would any district whose statutory foundation amount is between these levels. Of course, these reductions don't necessarily need to be permanently enshrined in statute. It's also important to note that the majority of districts and all public school academies are currently funded at the minimum,

representing about 63% of Michigan's students. We estimate that this could save roughly \$146 million.

## **#2 ELIMINATE OR REDUCE SELECTED CATEGORICAL GRANTS**

Policymakers should aim to close as much of the budget shortfall as possible by eliminating or reducing funding for selected categorical grants that aren't constitutionally required. This involves targeting the funding streams that are the most restrictive and aren't delivered based on student characteristics. For example, there are currently grants for professional development, educator evaluation, and even funding for a pilot project for purchasing locally grown fruits and vegetables. While many of these allotments are small, it only makes sense to clean up the inefficiencies in Michigan's funding formula before making cuts elsewhere, which also provides longer-term benefits.

## **#3 MAXIMIZE SPENDING FLEXIBILITY TO LEVERAGE EXISTING DOLLARS**

After implementing some form of reverse 2x formula reductions and cutting from selected categorical grants, any form of across-the-board budget reductions should be made in a way that maximizes financial flexibility for school districts by empowering local leaders to make important tradeoffs in spending decisions. This could also involve statutory changes to highly restrictive programs such as At-Risk that reduce potentially innovative solutions to district budget shortfalls. Instead of regulations, policymakers should look to the new school-level spending data required by the federal Every Student Succeeds Act to ensure that districts are effectively targeting dollars to the students who are most in need.

## **#4 TARGET AT-RISK DOLLARS MORE EFFECTIVELY**

Policymakers should consider moving away from using FRL counts for identifying economically disadvantaged students in order to more effectively target At-Risk dollars to the students who are most in need.

## PART 4

# CONCLUSION

Even in a constrained fiscal environment, Michigan can improve funding equity and better empower local leaders. These recommendations are intended to help ensure that budget cuts—whenever they become necessary—aren’t disproportionately shouldered by Michigan’s most disadvantaged students, and to ensure that district leaders are able to trim their budgets with a scalpel rather than an axe.

# ABOUT THE AUTHORS

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