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FUNDING GUARANTEES FOR REVENUE SHARING AND K-12

House Joint Resolution BB (Substitute H-5)
Second Analysis (3-26-98)

Sponsor: Joseph Palamara
Committee: Tax Policy

THE APPARENT PROBLEM:

Representatives of local units of government say that the only way to ensure that they receive the amount of revenue sharing promised to them more than 20 years ago, and to protect those promises from being routinely broken, is through a constitutional amendment. Revenue sharing represents a substantial portion of the budgets of local units of government. However, according to a 1993 report from the Citizens Research Council of Michigan:

"Statutory revenue sharing distributions (excluding constitutionally-mandated sales tax revenue sharing) have been subject to the vagaries of state budget cycles, including legislative budget cutting during the past two recessionary periods. In the early 1980s, several executive orders reduced and eliminated payments to local governments from each of the three statutory taxes. In the early 1990s, as well, executive orders and public acts resulted in reductions in payments from each of these taxes for specific years. In addition, due to one-time expenditure adjustments, the timing of payments to local governments [was] shifted from one state fiscal year to another so that payments [could] be eliminated in one of those years." (From the October 1993 CRC publication, "Unrestricted State Revenue Sharing in Michigan.")

According to information from the House Fiscal Agency, about 40 percent of total revenue sharing payments comes from the constitutional dedication of 15 percent of the first 4 cents of the sales tax to cities, townships, and villages. The remainder of revenue sharing comes from statutory provisions (under which counties are included). Public Act 342 of 1996 changed the source of revenue for the statutory portion. Prior to that act, a portion of state income taxes and single business taxes were earmarked for local revenue sharing. Public Act 342 instead dedicates 21.3 percent of revenues from the first 4 cents of the sales tax. The HFA notes that this earmarking "was opposed by some because it made permanent a series of controversial annual reductions in revenue sharing appropriations from the levels established in the standing revenue sharing statutes. This practice began as a one-year lag in revenue sharing growth during a recessionary period in the early 1990s, but was continued by the Legislature through FY 1996-97." (See the HFA publication, "Fiscal Fundamentals 1998.") Information from the HFA indicates that actual payments made to local units during the 1990s fell about half a billion dollars short of the amounts that would have been paid if the old statutory revenue sharing formula had been followed.

In a related matter, representatives of public schools say that the designers of Proposal A intended to earmark sufficient revenues from state and local tax sources to create a self-sustaining fund for the K-12 system that does not depend upon annual appropriations from the general fund. (Proposal A, passed by voters in 1994, reduced local property taxes and created a new school finance system that relies more heavily on state tax funding.) Enough revenues were to be earmarked, they say, so that the growth in designated revenues would be sufficient for schools to keep up. However, the designers did not succeed in this. The proposal, say public school representatives, was underfunded. As a result, the schools continue to remain dependent on annual appropriations decisions. At the same time, they are vulnerable to cuts in the taxes that are designated for the state school aid fund. This, they say, has led to insufficient growth in revenue for many school districts; in particular, for districts with relatively high per pupil spending when Proposal A took effect. Indeed, the per pupil revenue of most districts will not increase from 1997-98 to 1998-99.

An amendment to the constitution has been proposed that would guarantee a certain level of spending for public schools and fulfill the promise of Proposal A, and also to guarantee certain levels of revenue sharing to local units of government.

THE CONTENT OF THE RESOLUTION:

The resolution proposes amending the state constitution (Article IX, Sections 11 and 40) in the following ways.

** It would guarantee that the total amount distributed by law to assist counties, cities, villages, and townships will change from one state fiscal year to the next by at least the same percentage as the change in the combined gross state school aid fund revenue and gross general fund/general purpose revenue (as adjusted for changes in state law or administrative determinations). The requirement would apply beginning with the 1999-2000 state fiscal year. (The distributions referred to are in addition to those provided for in Article IX, Section 10, which requires that 15 percent of the first 4 cents of the sales tax be used for assistance to townships, cities, and villages on a population basis.) For the purpose of determining distributions under the new section and Section 10, the calculation would be made using $1.486 billion as the total distribution amount for the 1998-99 state fiscal year.

** It would guarantee that the total amount appropriated for state aid to local and intermediate school districts will change from one state fiscal year to the next by at least the same percentage as the change in the combined gross state school aid fund revenue and gross general fund/general purpose revenue (as adjusted for changes in state law or administrative determinations). Distributions for the 1999-2000 state fiscal year would be calculated using $9.53 billion as the total distribution amount for the 1998-99 state fiscal year.

** It would guarantee that each local and intermediate district's total state and local per pupil revenue for school operating purposes in each state fiscal year be no less than its per pupil revenue for the 1997-98 state fiscal year (as adjusted for consolidations, annexations, or other boundary changes). This would begin with the 1999-2000 state fiscal year.

The proposed amendment would be submitted to the state's voters at the next general election.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the resolution would not affect the amount of state revenues, only their distribution. (3-20-98)

ARGUMENTS:

For:

Revenue sharing payments to local units of government have been less than promised in statute throughout this decade and recent legislation has incorporated those reductions into future allocations of state revenue. The resolution would put a revenue sharing funding guarantee into the state constitution to prevent this from happening again. The resolution establishes a floor for revenue sharing and then guarantees that growth in revenue sharing will at least equal growth in total state revenues. Only a constitutional amendment can offer this protection for revenue sharing and ensure that old promises to local units of government are kept in the coming years. Revenue sharing constitutes a significant portion of the funding of local units of government, amounting to about one-quarter of city and village budgets and nearly one-half of township budgets on the average. They have unfairly borne the brunt of state budget cutting in the past. Moreover, local units are suffering from the restrictions on property tax revenues resulting from the assessment cap put into the constitution by Proposal A.

For:

The resolution attempts to fulfill what many believe was a basic promise of Proposal A, which created the new state school finance system: a stable source of dedicated revenues for public elementary and secondary education. Although a large portion of the revenue for schools is currently dedicated, the schools still depend on a substantial contribution from the general fund. School officials complain that Proposal A was underfunded and that, as a result, funding for many school districts has been relatively flat in the past few years. The resolution would provide a guaranteed level of funding for the public schools by establishing a baseline and then guaranteeing that revenue for schools will grow at least equally with total state revenues. This will, among other things, protect schools from any cuts in the taxes upon which they depend.

Against:
By earmarking revenue in this way, the resolution would substantially reduce the flexibility needed by the legislature and governor to make fundamental budget decisions based on contemporary assessments of the state's needs. This is not good public policy. It could tie the hands of future legislatures in fiscal emergencies.

Against:
Public Act 342 of 1996 created a bipartisan legislative task force to address revenue sharing issues, including "changes in the formulae or sources of funds it considers advisable." Perhaps the task force should be permitted to complete its work before proposals such as this are considered.

POSITIONS:

The Michigan Townships Association supports the resolution. (3-21-98)

A representative of the Michigan Municipal League testified in support of the resolution. (3-18-98)

A representative of the Michigan Education Association testified in support of the resolution. (3-18-98)

A representative of the Middle Cities Education Association testified in support of the resolution. (3-18-98)

A representative of the Michigan Association of Counties testified in support of the resolution. (3-18-98)

A representative of the Department of Management and Budget testified in opposition to the resolution. (3-18-98)

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.