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# THE FATE OF THE DETROIT PUBLIC SCHOOLS: GOVERNANCE, FINANCE AND COMPETITION

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## I. INTRODUCTION

The Detroit Public Schools (DPS) face serious challenges. Student test scores are amongst the lowest in the nation. “Only 3 percent of Detroit’s 4th graders and 4 percent of its 8th graders meet national math standards; experts say that our students could have done about the same if they just guessed on the test.”<sup>2</sup> High school dropout rates are high. “Only 58 percent of DPS students and 78 percent of public charter schools graduate from high school in four years. Fewer than one in four of those students enroll in college.”<sup>3</sup> Enrollment numbers and, therefore, district revenues are in near free fall.<sup>4</sup> In the past decade, more than one hundred thousand students have left the district and DPS has closed over 100 schools. The school system is under the control of a state appointed Emergency Manager. Finally, the state’s lowest performing schools, many of which are in Detroit, are now being placed in a new state-controlled Education Achievement System (EAS).<sup>5</sup> Enabling coherent systems of governance and finance amidst such disparate and chaotic forces is a daunting, if not impossible, challenge.

Into the breach, many advocate greater competition as a part of the solution. In a competitive system, parents would be afforded an increasing portfolio of schools from which to choose. In Michigan, this is done by chartering Public School Academies (PSAs) and encouraging inter-district competition through schools of choice. Schools are forced to compete for students and, therefore, dollars. In theory, increased competition can create incentives to improve the quality of education.<sup>6</sup> Unfortunately, there is nothing magical about competition, in theory or

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2. See EXCELLENT SCH. DET., TAKING OWNERSHIP: OUR PLEDGE TO EDUCATE ALL OF DETROIT’S CHILDREN 3 (2010).

Only 2 percent of Detroit’s high school students are prepared for college-level math and 11 percent for college-level reading.

*Id.* (internal citation omitted).

3. See *id.* at 6.

4. See *id.* at 10.

5. *Id.* at 9, 12.

6. CITIZENS RESEARCH COUNCIL OF MICH., REPORT 364, NONTRADITIONAL K-12 SCHOOLS IN MICHIGAN 5 (Sept. 2010) [hereinafter CRC, NONTRADITIONAL K-12 SCHOOLS] (“Some advocates of charter schools sought to bring the pressures of the competitive marketplace to public education, based on the belief that by increasing competition, charter schools would drive quality up and drive cost down.”).

practice. Depending upon how it is structured, competition can produce either desirable or undesirable results.

The actual consequences of competition depend, in a path-dependent manner, upon the historical context in which competition takes place, the status of the complementary social institutions supporting the market and the incentives that drive the system. Part II of this Article sketches the historic setting of how markets and competition have shaped the contours of Detroit and Southeast Michigan. An unappreciated irony in the debate about school choice is the extent to which the problems of Southeast Michigan can themselves be ascribed to the detrimental side effects of competition, with a century of successive waves of industrialization and de-industrialization. Moreover, competition in public spaces between local governments for mobile citizens in Southeast Michigan did not produce anything like the socially efficient equilibrium of economic models. Rather, competition in public space actually facilitated the long-term racial and economic segregation that now defines the region. For better or worse, school competition will be dramatically affected by these historic forces. Returning to the present, Part III examines the underlying governance and financial structure of K-12 education in Michigan. The effects of competition will be dictated by the school finance formula of Proposal A, which creates winner-take-all incentives. The state per-pupil foundation allowance rewards schools not with the infra-marginal revenue necessary to educate one additional student, but rather with a bonus of the full average costs associated with educating any other student in the district. School districts losing students are penalized by an equivalent amount. This creates powerful and potentially perverse competitive incentives. Part IV outlines the history of governance and finance for the Detroit Public Schools. Finally, Part V explores the fate of the Detroit Public Schools. This Article contends that the Detroit Public Schools cannot survive the financial dynamics created by Proposal A. School choice and competition make these dynamics worse. In five years, it is unlikely that DPS will continue to exist in anything like its traditional form. Competition is not a substitute for a sustainable formula of school finance. Much more needs to be done to address the real need of Detroit's children.

## II. HISTORICAL SETTING: CAUTIONARY TALES OF COMPETITION IN DETROIT

More than any other city, the story of Detroit is the story of the competitive rise and fall of a municipality built around a single industry; a double, if not triple boom town. Detroit is also a story of the peculiar geography of northern racism. Each story involves competition. Each

story also illustrates how choice never takes place in a vacuum and how playing fields are seldom level. In America, differences in wealth, mobility and race always matter.

*A. Competition, Globalization and De-Industrialization in Southeast Michigan*

Today, the dynamics of de-industrialization are apparent to everyone. Financial capital is more mobile than labor, and physical space (real property) is the least mobile thing of all. Dollars follow opportunity. Low labor costs create industrial profit potential and manufacturing plants (and jobs) move overseas. This is nothing new to Detroit residents. De-industrialization started here over sixty years ago, with plants moving first to green spaces and suburbs within the state, then to lower cost labor markets in other states, before finally transplanting themselves abroad. But de-industrialization is only part of the story. In detailing the “Origins of the Urban Crisis: Race and Inequality in Postwar Detroit,” Thomas Sugrue gives equal significance to racial discrimination in employment and housing (each themselves artificial restrictions on market mobility).<sup>7</sup>

Like glaciers in the ice age, these forces have shaped the geographic and cultural landscape of Southeast Michigan.

*Origins* was an attempt to bridge the structural and the cultural – to start with important questions asked by whiteness scholars, but to provide a more rigorous account of the mechanisms that perpetuated racial differences in ideology and experience. Urban inequality, I argued, is the result of the mapping of understandings of racial differences onto the geography of a city – and to the power of categories of racial difference to create racial hierarchies that shaped housing patterns, workplace practices, private investment, and the public policies that reinforced them. Above all, I contended racial inequalities persist because of the mutual reinforcing processes of ideology and political economy, of identity and self-interest.<sup>8</sup>

This analysis presents a number of challenges to economists. In theory, a perfectly competitive market should help end, not perpetuate

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7. THOMAS J. SUGRUE, *THE ORIGINS OF THE URBAN CRISIS: RACE AND INEQUALITY IN POSTWAR DETROIT* xviii (Princeton Classic ed. 2005) (“Any one of [these forces] would have had devastating consequences, but the combined effect of all three reshaped American cities in ways that still affect us today”).

8. *Id.* at xx.

discrimination in housing and employment. Population density maps of Detroit based on the 1950 census show incredibly high rates of density (the highest rates anywhere in the city) in the areas popularly known as Black Bottom and Paradise Valley.<sup>9</sup> These levels of density would be consistent with the existence of high-rise, multi-family dwelling units that are found in other large urban areas; yet another distinguishing feature about Detroit is the near absence of any such housing structures.<sup>10</sup> The truth is that these areas of high density marked the narrow boundaries of the Black ghettos, individuals forced into some of the city's most poorly maintained, multiply divided and unsafe housing stock.

To add economic insult to injury, in this period it “was not unusual for blacks to pay twenty to forty percent more for rent than whites in equivalent apartments.”<sup>11</sup> In a perfectly competitive market, white landlords should have been clamoring to cater to such pent-up demand by offering better housing at lower prices to the residents of Black Bottom and Paradise Valley. We all know that this did not happen. Rather than demonstrating efficiency, economics here provide an implicit measure of the extreme depth of the racial discrimination that existed to create and perpetuate these invisible geographic boundaries. Sadly, these perverse dynamics can create self-reinforcing vicious cycles.

The process of housing segregation set into motion a chain reaction that reinforced patterns of racial inequality. Blacks were poorer than whites, and they had to pay more for housing, thus deepening their relative impoverishment. In addition, they were confined to the city's oldest housing stock, in most need of ongoing maintenance, repair and rehabilitation.<sup>12</sup>

The ability or inability to purchase quality-housing stock, in turn, has been the principle means in this country of building wealth in one generation and transferring that wealth to future generations. The effects of discrimination and inequality structurally move from one generation

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9. KURT METZGER, DATA DRIVEN DET. (D3), METROPOLITAN DETROIT'S DIVERSE POPULATION: A CLOSER LOOK 13 (2011) (Presentation to Legislators in the “D” with DTE), [http://datadrivendetroit.org/web\\_ftp/Presentations/DOI\\_DTE\\_7\\_2011\\_small.pdf](http://datadrivendetroit.org/web_ftp/Presentations/DOI_DTE_7_2011_small.pdf).

10. SUGRUE, *supra* note 7, at 20-21 (“Detroit had virtually no tall buildings. Unlike its east coast counterparts, Detroit lacked both tenements and high-rise apartments. Only 1.3% of the city's residential structures were apartment buildings.”). Detroit was the kingdom of small, single family homes. Indeed, another feature of Detroit was its staunch and often violent opposition to federally subsidized public housing. *Id.* at 86.

11. *Id.* at 54.

12. *Id.* at 36.

to the next. An identical story could be told about the paradoxes of economics and discrimination in labor markets.

Why is any of this relevant in an article about public school governance, finance and competition? First, it serves as an important foil to how the word “competition” often works at an ideological level in public discourse. Repeated use of the word “competition” cognitively primes the policy making brain in this country to be thinking in terms of “efficiency” and “optimality.” In truth, depending upon the circumstances, competition can be good or bad, efficient or inefficient, desirable or undesirable. Even the very word “competition” can have many different meanings in different contexts. Competition can be associated with the social welfare maximizing general equilibrium of neoclassical economics. Competition can also imply the “creative destruction” commonly associated with Joseph Schumpeter,<sup>13</sup> where progress to the next stage of competition unavoidably requires the destruction of the previous stage (perhaps a more apt metaphor for the history of Detroit). In debates about competition in public schools, we need to be more conscious of the many different meanings that competition can have.

Second, the history of Detroit (especially as it relates to race) illustrates how competition in practice may not work like the theoretical models predict. The ultimate effects of competition will depend upon local context and how the market is structured. Moreover, no market can be understood apart from social, political and economic contexts in which it is nested. The teaching of modern institutional economics is that the market itself is a social institution, with no clear dividing line between public and private.<sup>14</sup> The complex forces perpetuating housing segregation in Detroit illustrate this point. Since the adoption of New Deal policies, the market for housing has been driven by the availability of federally insured mortgages. Federal housing programs, however, expressly incorporated discriminatory standards as a matter of public policy.<sup>15</sup> Federal policies, in turn, were supported by the discriminatory work of private real-estate associations and policed on the ground by often violent neighborhood improvement associations. In the end, the market itself became the primary rationalization for discrimination, with claims that blacks moving into white neighborhoods would cause property values to fall. Here, the market became an efficient enforcer of the racial prejudices of landowners. Finally, the social, political and

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13. See JOSEPH SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* (1942).

14. Peter J. Hammer, *The Architecture of Health Care Markets: Economic Sociology and Antitrust Law*, 7 HOUS. J. HEALTH L. & POL'Y 227, 229 (2007).

15. See generally SUGRUE, *supra* note 7, at ch. 2, 7 and 8.

economic forces detailed by Sugrue define the facts on the ground that we now face. No intelligent discussion of social policy in Detroit can happen on a blank slate; all such discussions must understand and appreciate this history. However policies over school governance, finance and competition play out in the Detroit Public Schools, they will play out in the context of the extreme forms of inequality and racial segregation that now define the city landscape and the entire metropolitan area. These factors must be acknowledged as centrally important and not pushed to the margins.

### *B. Competition in Public Spaces and Racial Segregation in Southeast Michigan*

How should we think about competition in public spaces? In 1956, Charles Tiebout projected theories of private competition into the public space of competition between local municipalities.<sup>16</sup> In theory, with the satisfaction of appropriate assumptions – perfect information and perfect (costless) mobility – citizens will sort themselves into communities that match their economic preferences.<sup>17</sup> Furthermore, local municipalities will have positive incentives to compete with each other for residents. How has this competition played out in Southeast Michigan? The past is still with us. The 2000 census revealed that the Detroit Metropolitan Area was the most racially segregated metropolitan area in the country.<sup>18</sup> No one would pretend that this outcome is either efficient or just. Often, the power of a theoretical model is to help reveal why the reality we observe is so different from what the theory would predict. There are important processes of social reproduction at work. A half-century later,

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16. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

17. CITIZENS RESEARCH COUNCIL OF MICH., REPORT 369, REFORM OF K-12 SCHOOL DISTRICT GOVERNANCE AND MANAGEMENT IN MICHIGAN 9 (May 2011) [hereinafter CRC, REFORM OF K-12 SCHOOL DISTRICT GOVERNANCE] (“This relates to the Tiebout hypothesis, which states that competition among local communities leads to efficiency in the provision of public goods. In other words, people will ‘vote with their feet’ and move to the school district that provides their desired level of school services and their desired level of taxation.”) (internal citation omitted). See also RAJASHRI CHAKRABARTI & JOYDEEP ROY, EFFECT OF CONSTRAINTS ON TIEBOUT COMPETITION: EVIDENCE FROM MICHIGAN SCHOOL FINANCE REFORM (2010) (applying the Tiebout model to school finance reform in Michigan and finding that Proposal A reduced competition and effort in the highest spending school districts).

18. Based on the 2000 Census, Detroit was the most racially segregated metropolitan area in the country. By 2010, Detroit had fallen to fourth place. *Metro Detroit No Longer Most Segregated*, DET. NEWS, Mar. 29, 2011, <http://news.yahoo.com/blogs/detroit/metro-detroit-no-longer-most-segregated-143407993.html>.



the same pattern revealed by the 1950 census map illustrating the complete racial segregation between blacks and whites within the city of Detroit has been reproduced at a regional level. The story involves many of the same forces leading to the initial segregation of Detroit, such as discrimination in housing and economic opportunity. The story also reveals the ways in which the lack of perfect mobility permits Tiebout-like sorting along dimensions other than efficiency. Again, public policy played a significant role. Federal highway systems simultaneously decimated African-American neighborhoods in Detroit and facilitated the exit of whites from the city, as did the continuation of federally subsidized housing loans. The lack of any meaningful system of regional public transportation created additional barriers separating the city from the suburbs.

Municipalities did compete with each other, but not in ways that furthered equity and efficiency.

Suburbanization exacerbated the impact of boundary drawing and neighborhood defensiveness that shaped the post-war city. In fact, suburban governments often acted as super-neighborhood associations, using their governmental powers to enforce zoning laws that relentlessly excluded low- and moderate-income "outsiders," disproportionately people of color. They fiercely resisted intergovernmental cooperation, staunchly defended the age-old principle of local control, and relied on local taxes to fund local public works, social services, and de facto private schools.<sup>19</sup>

One of the most important questions facing Southeast Michigan is why competition between public entities has persistently compounded rather than remedied economic and racial inequality. In some respects, Detroit is not substantially different from other rustbelt cities of the north – Chicago, St. Louis, Cleveland, and Pittsburgh. Each city struggled in different ways with the forces of de-industrialization and discrimination in housing and employment. Each still suffers some of the same ills as Detroit in terms of racial and economic segregation. At the same time, the problems of Detroit appear to consistently be a full standard deviation more severe than the problems of these other cities. Why is this so?

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19. SUGRUE, *supra* note 7, at xxi.

The work of David Rusk points in the right direction.<sup>20</sup> The problem returns to questions of law, geography, competition and unintended consequences. The ability of Southeast Michigan to fracture into a myriad of economically and racially segregated fiefdoms has its origins in state laws defining the powers of state, county and local governments. Rusk speaks of distinctions between county-states and township-states, and between “big box” states and “little box” states. Michigan is at the extreme of the Township-state and “little box” state categories. What this means intuitively is that state law has vested tremendous power at the most local of local levels. In essence, every city, municipality and charter-township can do anything they want within their own borders. In this system, territory is inviolable, making annexation nearly impossible. In terms of regional cooperation, every local government has a veto right. When one realizes that Southeast Michigan is not only one of the most racially segregated areas of the country, but is also one of the most fractured regions in terms of the sheer number of local governments, one starts to appreciate the real dimensions of the problem. If an economist were to model the question of regional cooperation in Southeast Michigan as a bargaining problem, the dominant prediction would be continued stalemate.

This is a problem for everyone in the region. Racial segregation and regional segregation are unavoidably connected with economic segregation. Southeast Michigan is not only one of the most racially segregated regions in the country; it is also one of the most economically segregated areas of the country. There is no shortage of competition between separate and isolated public municipalities. Different municipalities compete with each other to attract and retain sports teams, corporate headquarters and new businesses. Sadly, competition can be good or bad, depending upon how it is structured. Competition can create incentives to “race to the top” or to “race to the bottom.” In Michigan, competition in public spaces has not created anything like the efficient equilibria predicted in Tiebout’s models. Rather, competition in public spaces in Southeast Michigan has created continued divisiveness.

Competition can also create islands of wealth and islands of poverty. Detroit is a fiefdom increasingly isolated from the rest of the region. Detroit has a declining tax base and a declining population base; trend lines that can be traced back to the 1950s with the beginning phases of de-industrialization. Detroit has extremely high rates of poverty and unemployment. Finally, and not surprisingly, Detroit has a struggling

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20. DAVID RUSK, *CITIES WITHOUT SUBURBS: A CENSUS 2000 UPDATE* (3rd ed. 2003); see also David Rusk, *Changing the “Rules of the Game”: Tools to Revive Michigan’s Fractured Metropolitan Regions*, 13 J.L. SOC’Y 197 (2012).

school system. To understand the challenges facing the Detroit Public Schools, we must first lay the foundation for understanding the school governance, finance and competition policies in Michigan more generally.

### III. SCHOOL GOVERNANCE, FINANCE AND COMPETITION IN MICHIGAN

The Citizens Research Council of Michigan (CRC) has published a number of recent reports on the state of public K-12 education. "Public Education Governance in Michigan" describes the "complex political environment" in which school governance operates, as well as the overlapping domains of shared authority amongst numerous actors.<sup>21</sup> Education policy is a complicated puzzle where the different pieces of policy, governance, service delivery and finance must all fit together in a coherent fashion. The puzzle analogy, however, is imperfect and incomplete. Better metaphors for complex systems come from the fields of engineering, hydraulics and ecology. Education, like health care, might best be approached as a complex adaptive system.<sup>22</sup> To understand a complex adaptive system, one must appreciate notions of high levels of interconnectedness, indirect and multiple forms of causation, and the role of feedback mechanisms. Moreover, one needs to develop a keen awareness of the possibility of unintended consequences, all in a context that is dynamic and changing, not static.

#### *A. Michigan's School Governance System*

Multiple, overlapping domains of authority from the federal - to the state - to the local level characterize school governance in Michigan and the rest of the United States.<sup>23</sup> Plenary authority for education finance

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21. CITIZENS RESEARCH COUNCIL OF MICH., REPORT 359, PUBLIC EDUCATION GOVERNANCE IN MICHIGAN 44 (Jan. 2010) [hereinafter CRC, PUBLIC EDUCATION GOVERNANCE].

22. See ALLIANCE FOR HEALTH POL'Y & SYSTEMS RESEARCH, SYSTEMS THINKING FOR HEALTH SYSTEMS STRENGTHENING (Don de Savigny & Taghreed Adam eds., 2009) (applying theories of complex adaptive systems to health system development). Similar theories have been applied by the Kirwan Institute to the problem of structural racism. See STEPHEN MENENDIAN & CAITLIN WATT, KIRWAN INST., SYSTEMS PRIMER (2008).

23. This discussion focuses primarily on the role that traditional school districts play in providing services to traditional students, in order to establish a baseline for considering the competitive dynamics introduced by schools of choice and charter schools. Moreover, the discussion focuses almost exclusively on systems for determining resource allocation, rather than issues such as curricular content. As such, many important issues, such as the role of the federal government in education, the

and organization in Michigan rests with the state legislature. While much of this authority has been historically delegated to local school districts (and more recently to Public School Academies), the legislature has “the authority to abolish local school districts if it so chooses.”<sup>24</sup> Indeed, the trend in Michigan has been toward greater centralization of school finance, calendars and curricular decisions. The most extreme example of centralized state control can be found in the laws enabling Emergency Managers and the creation of the new Education Achievement System (EAS), a centralized state district for low performing schools.

The State Board of Education is a quasi-independent body created by the State Constitution.<sup>25</sup> While the Board is designated to “serve as the general planning and coordinating body for all public education and to have leadership and general supervision responsibilities over all public education, except public universities,” in practice, it serves more of a consultative and advisory role, with little active policy making or implementing authority.<sup>26</sup> The Superintendent of Public Education is appointed by the Governor, but serves at the pleasure of the State Board of Education.<sup>27</sup> The Superintendent acts as the non-voting chair of the State Board of Education, as well as the Executive Director of the Michigan Department of Education (MDE).<sup>28</sup> As an executive agency, MDE has responsibility for implementing bills passed by the legislature and the policies established by the State Board of Education. In addition, MDE administers state school aid payments, distributes federal grants, oversees local school districts and provides technical and programmatic support to local schools.

While public education is constitutionally a state responsibility, the actual delivery of educational services is typically delegated to local school districts, “which can be thought of as distinct, special-purpose units of local government.”<sup>29</sup> Local school districts are units of governance separate from municipal governance. Complicating matters further, the boundaries of local school districts are often not coterminous with the boundaries of other units of local government. “As of FY2009, Michigan had 551 traditional local school districts (excluding PSAs,

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complexities of special education, the role of Intermediate School Districts and debates over pedagogy will be neglected. What remains is challenging enough.

24. CRC, PUBLIC EDUCATION GOVERNANCE, *supra* note 21, at 4.

25. *Id.*

26. *Id.* at 5.

27. *Id.* at 6.

28. *Id.* An organizational chart outlining Michigan’s State Educational Governance Model is available. *Id.* at 4 (Chart 1).

29. *Id.* at 9.

which are also considered to be local districts).”<sup>30</sup> Local school districts are responsible for implementing the mechanics for delivering educational services. The annual operating budgets for local school districts, however, are largely set at the state level, determined by the annual foundation allowance for the district multiplied by the number of students enrolled in the district. Subject to this externally imposed budget constraint, local school districts make allocation decisions and set spending priorities. In addition, local school districts hire the local superintendent, approve labor contracts, provide an oversight function and help implement policies handed down from state and federal authorities.<sup>31</sup>

Significantly, operating expenses and capital expenses are governed separately in Michigan. Since 1994, the state has centralized control for determining and financing the operating revenues available to local districts.<sup>32</sup> Local districts, however, retain authority to determine and finance (through local property taxes) their capital requirements.<sup>33</sup>

Michigan has been on the vanguard of the charter school movement. Since 1993, folded over this system of traditional school districts has been a system of Public School Academies (PSAs) or charter schools. PSAs “are public schools organized as nonprofit corporations under the Michigan Nonprofit Corporation Act.”<sup>34</sup> As of FY2009, there were 232 PSAs operating in the state.<sup>35</sup> Subject to various restrictions, PSAs can be chartered by the boards of local school districts, Intermediate School Districts (ISDs), community colleges and state universities. The chartering authority is responsible for providing oversight and accountability. “PSAs are considered to be local school districts and their main functions are similar to traditional districts, including directing and developing policy within the district and implementing local, state and federal policies.”<sup>36</sup> PSAs are not bound by the collective bargaining

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30. CRC, PUBLIC EDUCATION GOVERNANCE, *supra* note 21, at 9.

31. *Id.* at 12.

32. *Id.* at 15-16.

33. *Id.* at 12, 16.

34. *Id.* at 18.

35. *Id.* at 18. In some respects, PSAs operate as school districts without geographic borders. This gives them the strategic advantage of the ability to choose their location. Charter schools have targeted students in urban school districts. Fifty charter schools are located in Detroit. CRC, NONTRADITIONAL K-12 SCHOOLS, *supra* note 6, at 14. Other charters will choose to locate just outside the city-center district, yet draw a majority of their students from the urban district. See David Arsen & Yongmei Ni, *The Effects of Charter School Competition on School District Allocation*, 20 EDUC. ADMIN. Q. 1, 11 (2011) (For example, many charter schools located in suburban districts just outside central cities draw a large share of their students from the central cities.).

36. CRC, PUBLIC EDUCATION GOVERNANCE, *supra* note 21, at 18.

agreements of the local district in which they operate.<sup>37</sup> Moreover, even though they are nonprofit corporations, PSAs can “contract with private education service providers (ESPs) to provide teachers who are considered to be private employees of the ESP rather than public employees of the PSA.”<sup>38</sup> ESPs may be either nonprofit or for-profit entities. Furthermore, PSAs are not required to provide transportation services to their students.<sup>39</sup>

Competition may itself be considered an instrumentality of public governance. Since 1996, Michigan has also liberalized its rules governing inter-district school choice.<sup>40</sup> While not mandatory and subject to certain regulations, local school districts may enroll students from other local districts. Districts are prohibited from trying to self-select students on the basis of particular characteristics. Districts are not required to provide transportation to non-district students. However, local districts cannot restrict students in their own geographic domain from enrolling elsewhere. Under state rules, dollars follow students. When either PSAs or local districts enroll students from another district, they receive the full state foundation allowance for the operating expenses associated with that student.<sup>41</sup> Competition is not a trivial or small scale experiment in Michigan. Statewide, the schools of choice program enrolled nearly 80,000 students in FY2009, representing five percent of students across the state and the transfer of \$594 million in state funds through the foundation allowance.<sup>42</sup> PSAs enrollment is even greater, serving six percent of all students statewide in FY 2009.<sup>43</sup> School competition is a billion dollar industry in Michigan.

### *B. Michigan's School Finance System*

This section examines how schools are financed in Michigan and how the structure of school finance affects decision-making. Equity in school finance has been a central issue in education policy for the past half century, but “equity” is a complicated concept with multiple dimensions. There is a tendency for legislators to seize on just one aspect of equity for policy-making purposes, often to the neglect of others.

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37. *Id.* at 19 (Table 7).

38. *Id.*

39. *Id.* at 21 (Table 7).

40. *Id.* at 16-17.

41. *Id.* at 16, 20 (Table 7). In recent years, the total amount of the state foundation allowance a PSA can receive has been capped at \$7,580. CRC, NONTRADITIONAL K-12 SCHOOLS, *supra* note 6 at 12.

42. CRC, PUBLIC EDUCATION GOVERNANCE, *supra* note 21, at 17.

43. *Id.* at 18.

While most can agree that the quality of educational opportunities a child receives should not be determined by their zip code and place of birth, geography remains destiny in defining educational opportunities in Michigan. Before 1994, education in Michigan was financed largely through local property taxes.<sup>44</sup> The state intervened in this era through a “power equalization” program to provide direct subsidies to districts with the lowest property values.<sup>45</sup> An important aspect of the earlier policies was to channel additional state funds to school districts in impoverished urban centers.<sup>46</sup> This addressed one form of inequality (disparate property values), but neglected others. Disparities in absolute levels of spending (rural districts versus wealthy suburban districts) remained wide in the state and were growing.

In 1994, Michigan voters approved Proposal A and ushered in a new era of school finance. The proposal shifted primary responsibility for funding school operating expenses from local property taxes to state revenue sources, including an increased state sales tax.<sup>47</sup> Proposal A was designed to address the dimension of inequality defined in terms of absolute spending levels.<sup>48</sup> That said, it is a common misperception that state per-pupil funding in the wake of Proposal A was equalized.<sup>49</sup> In

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44. CITIZEN’S RESEARCH COUNCIL OF MICH., REPORT 371, STATE AND LOCAL REVENUES FOR PUBLIC EDUCATION IN MICHIGAN 1 (Sept. 2010) [hereinafter CRC, STATE AND LOCAL REVENUES]. (“Prior to the approval of Proposal A in March 1994, the responsibility for funding schools and the decisions regarding annual resource levels were the province of local officials and residents.”).

45. CITIZENS RESEARCH COUNCIL OF MICH., REPORT 371, DISTRIBUTION OF STATE AID TO MICHIGAN SCHOOLS 7-8 (Aug. 2011) [hereinafter CRC, DISTRIBUTION OF STATE AID].

46. *Id.* at 48 (“some large districts located in poor central cities benefitted from higher taxes and more state aid, resulting in higher per-pupil revenues prior to Proposal A.”). *See also id.* at 54.

47. CRC, STATE AND LOCAL REVENUES, *supra* note 44, at 3. Proposal A constituted a dramatic shift in state/local funding. In FY1994, state spending accounted for thirty-one percent of operating revenue, while local revenue accounted for sixty-two percent. In FY1995, the state percentage of operating revenue was seventy-one, with the local level falling to twenty-three percent. *Id.* at 11 (Chart 2). The centralization of funding is also a centralization of control, “[F]or all intents and purposes,” the education system in Michigan “is best characterized as almost entirely state-run in terms of the level of operating revenues available each year.” *Id.* at 13.

48. *Id.* at 5 (“A primary goal of this effort was to address the per-pupil financial disparities that existed under the pre-1993 funding model.”).

49. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 9 (“There is a common misperception, perhaps because the term ‘foundation,’ that all schools receive the same amount. The reality is that foundation grants vary in size across school districts in the state, which has been the case since the implementation of the foundation program.”). *See also* CRC, STATE AND LOCAL REVENUES, *supra* note 44, at 57 (“The reforms sought relative per-pupil funding equity, not absolute equity, and thus the goal was to narrow, not eliminate, the gap that existed between districts.”).

many respects, Proposal A simply ratified existing forms of absolute inequality into the state finance formula, with a soft commitment to try to narrow the bands of inequality over time.<sup>50</sup>

Systems of school finance establish the parameters for local decision-making and dictate what is and is not possible. There are a number of structural oddities in how schools are financed in Michigan. To begin with, Proposal A only addresses operating expenses. The state determines the level of funding available for operating revenues, but local control is retained over all capital planning and financing.<sup>51</sup> This immediately hamstrings efforts at establishing equity in any broad or universal sense. The inequalities embedded in vastly disparate local property bases are retained for capital planning.<sup>52</sup> There are other important implications. The separation of operating and capital expenses makes rational planning difficult, especially in the intermediate and long term. The hallmark of a well-functioning system is the ability to engage in full cost accounting. Moreover, the ability for some districts to be able

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50. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 10 (“The most influential factor on determining a district’s initial foundation grant was the amount of per-pupil revenues it received just prior to the implementation of the foundation grant; the total (state and local) per-pupil revenue each district received in FY1994. The per-pupil revenue in FY1994 reflected the property wealth disparities that existed at the time.”) (internal citation omitted).

51. *Id.* at 9; *see also* CITIZENS RESEARCH COUNCIL OF MICH. & MICH. STATE UNIV., EDUC. POL’Y CTR., ADEQUACY, EQUITY AND CAPITAL SPENDING IN MICHIGAN SCHOOLS: THE UNFINISHED BUSINESS OF PROPOSAL A 1 (May 2005) [hereinafter CRC & EDUC. POL’Y CTR., THE UNFINISHED BUSINESS OF PROPOSAL A] (“One critical element of Michigan’s public school system remains an exclusively local responsibility, however. The revenues for school construction and other capital spending comes almost entirely from local property taxes, which must be approved by local voters.”).

52. CRC & EDUC. POL’Y CTR., THE UNFINISHED BUSINESS OF PROPOSAL A, *supra* note 51, at 1 (“Leaving responsibility for capital spending at the local level perpetuates wide variation in the quality of educational facilities provided in Michigan’s public school system.”). The disparities are dramatic. “In 29 of Michigan’s wealthiest districts, the per-pupil value of property is more than \$500,000. In 75 districts, in contrast, the per-pupil value of taxable property is less than \$100,000. In six districts, including Detroit, the per-pupil value of taxable property is less than \$50,000.” *Id.* at 4. “The residents of Highland Park can never provide the educational facilities available to students in Bloomfield Hills, even if they tax themselves at extremely high rates.” *Id.* at 4-5. The equity issues are also stark. Residents of poorer school districts tax themselves at dramatically higher rates and yet raise substantially lower levels of revenue than their wealthier counterparts. *Id.* at 18-19. “The residents of Detroit levy nearly fourteen mills, the highest rate in Michigan. With very low values of taxable property per-pupil, however, even these high millage rates produce relatively small amounts of revenue for capital investment.” *Id.* at 18. The report concludes that, “[c]apital spending is that the unfinished business of Proposal A.”



to invest differentially higher levels in their facilities can create perverse dynamics in the competitive process.<sup>53</sup>

There are other problems as well. The Michigan system creates a schism or a mismatch between those that set the budget (the state legislature) and those that make the actual spending decisions (the local school district).<sup>54</sup> Budgeting should be part of an organic, learning process that seeks to match needs with revenue. While the structural separation of these functions is not necessarily fatal, it needs other administrative processes where the information held by local decision makers is transmitted to the state decision makers for planning purposes. Sadly, such mechanisms are not well established. Indeed, one of the central criticisms of the Michigan approach has been the failure to have any substantive notion of the basic needs that define the content of financing decisions. "At no time during the design or implementation of the foundation grant, and at no time since, has there been an explicit attempt to quantify what constitutes a basic education."<sup>55</sup> This is one consequence of focusing on the abstract dimension of absolute spending disparities. A myopic focus on simply equalizing absolute levels of per-pupil spending does not consider issues such as potential disparities in the costs of providing educational services across districts or similar disparities in meeting the educational needs of disparate populations of students.<sup>56</sup> The needs of different student populations are not always the

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53. *Id.* at 6-7 ("Most significantly, some high-wealth communities have built new state-of-the-art schools, at least partly in order to attract non-resident students and the educational revenue that they bring with them from neighboring school districts.").

54. CRC, STATE AND LOCAL REVENUES, *supra* note 44, at 14 ("Although the school finance reforms concentrated revenue-raising decisions at the state capitol in Lansing, spending decisions remain the province of local school districts.").

55. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 42; *see also* Tom Watkins, Structural Issues Surrounding Michigan School Finance in the 21st Century: A Call for Dialogue, Input and Action (Dec. 6, 2004) (unpublished report submitted to the Michigan State Board of Education), [www.michigan.gov/.../michiganschoolfunding\\_110803\\_7.pdf](http://www.michigan.gov/.../michiganschoolfunding_110803_7.pdf) ("The 'foundation allowance' introduced in Proposal A differed from district to district and was based on how much revenue per child each district received before Proposal A. It did not consider whether the level of funding was adequate to provide a sound education.").

56. "Proposal A aimed to reduce inequalities in revenues, but it took virtually no account of differences in the costs of providing educational services. If policy makers seek to encourage efficiency across a system of schools, then state funding must account for differences in the costs that local districts confront." DAVID ARSEN & DAVID N. PLANK, MICH. STATE UNIV. COLLEGE OF EDUC. & EDUC. POL'Y CTR., MICHIGAN SCHOOL FINANCE UNDER PROPOSAL A: STATE CONTROL, LOCAL CONSEQUENCE 25 (Nov. 2003). This can be a serious problem. "However, because the costs of educating children vary considerably based on student characteristics, local labor markets and other relevant factors, absolute equalization may require that some districts receive more state aid than

same. These dimensions of equity, as well as their fundamental budgetary significance, do not play a significant role in the analysis.<sup>57</sup>

The Michigan funding formula is relatively simple. The revenue any local district receives is the product of the state “foundation allowance” (a number that will vary district-by-district) and the number of students enrolled in the district – pupil membership.<sup>58</sup> That product defines almost the entire operating budget that the district will receive for the coming year. Ninety percent of the state School Aid Fund is disbursed through the foundation allowance.<sup>59</sup> The operating budget will change as the level of the foundation allowance changes relative to other cost considerations and as student enrollments change from year-to-year.

The regime established by Proposal A has been in place now for more than 16 years. This is sufficient time to assess some of its long-term trends and consequences. Absolute disparities in operating expenses have been reduced, but not eliminated. The gap has been narrowed by placing a soft cap on the allowance of higher spending school districts, while seeking to raise the floor on lower spending school districts.<sup>60</sup> As a result, the gap in the state foundation allowance has been reduced from \$2,300 in FY1995 to \$1,277 in FY 2007.<sup>61</sup> The actual disparity, however, is greater when one considers that the highest spending districts in 1994 were “held harmless” and are able to spend greater amounts than the state allowance, financed through local property taxes.<sup>62</sup> “The spread

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others to ensure that all students receive the same education.” CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 5 (citing Andrew Reschovsky, *Financial Equalization and State Finance*, NAT’L TAX J., Mar. 1994).

57. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 42 (“[N]o attempt has been made to account for cost differences across districts.”).

58. *Id.* at 13.

59. *Id.* at 4.

60. *Id.* at 11 (“Thus, leveling down was not considered politically feasible. A more acceptable approach involved raising the revenue provided to districts at the bottom of the per-pupil revenue spectrum by increasing revenue to these districts by the greatest amount”).

61. *Id.* at 19 (Table 3). This reflects a narrowing of the gap in direct state support. It does not reflect continued differences in support to the hold harmless districts.

62. CRC, STATE AND LOCAL REVENUES, *supra* note 44, at 6 (“In addition to these primary operating taxes, state law allowed some higher-spending districts to levy additional mills, known as ‘hold harmless’ mills, to maintain their higher spending.”); *see also* CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 12 (“Districts above \$6,500 per pupil were required to raise the difference entirely from a separate millage, called the hold harmless tax that was subject to voter approval.”). This approach permits significant disparities to continue. In FY1999, for example, Bloomfield Hills spent \$10,916 per-pupil, while the City of Harper Woods spent \$6,946 per-pupil. *Id.* at 16 (Table 2).

between the highest and lowest revenue districts in FY2009 was \$5,000 per-pupil.”<sup>63</sup>

By focusing on absolute funding levels as the primary dimension of equity, Proposal A has neglected other aspects of equity, such as poverty. “Thus, the state’s policies to raise the bottom have not had the direct affect of increasing funding for districts serving the state’s poorest populations.”<sup>64</sup> Similarly, whether measured in terms of race<sup>65</sup> or urban status,<sup>66</sup> school districts with greatest relative need have not fared as well as other districts under the current system. Other state spending trends illustrate the challenges that all local school districts face. State spending in recent years has struggled to keep pace with inflation. Moreover, when one considers the high proportion of local operating budgets devoted to personnel costs and the role of ever raising retirement and health care costs, there are fewer and fewer relative dollars to spend on direct educational expenses now than there were sixteen years ago.<sup>67</sup>

The amount of the foundation allowance is just half of the equation determining a local district’s operating revenue. The other half of the equation is enrollment, or the pupil membership. Proposal A was designed in an era of increasing enrollment. No thought was given the potentially detrimental effects the formula could have in an era where many school districts are experiencing falling enrollments.<sup>68</sup> State school enrollment peaked in 2003 and has been declining ever sense.<sup>69</sup> There are a number of causes of falling district enrollment – declining birth rates, out-migration from the state, intra-state migration and increased school competition.<sup>70</sup> Inner-city schools and small rural districts face the greatest challenges from a declining student base.<sup>71</sup> The school districts

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63. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 62.

64. *Id.* at 48.

65. *Id.* at 54 (“When growth in foundation grants across districts is examined through a racial composition lens, districts with the highest percentage of African American students have fared the worst.”).

66. *Id.* at 55 (Table 18). “Detroit and Flint, for example, both experiences enrollment declines of greater than 40 percent between FY1995 and FY2009, contributing to total funding revenues declines of 42 percent and 46 percent, respectively.” *Id.* at 57.

67. *Id.* at 27 (“Over the entire 16-year period, the real value of the grant, adjusted for the employer contribution increase, rose from \$7,180 in FY1995 to \$8,012 in FY2002, before falling to \$7,029 in FY2010.”).

68. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 35 (“The current foundation program was developed in an era of rising enrollments and little attention was given to the fiscal effects of declining enrollments within the structure of the program.”).

69. *Id.* at 28, 29 (Chart 8) (“Since FY2003, statewide enrollments face exhibited an unabated decline.”).

70. *Id.* at 30-31.

71. *Id.* at 37.

with the largest continued increases in enrollment tend to be suburban schools with above average median incomes.<sup>72</sup> The demographic pressures of declining student populations faced by urban school districts have been exacerbated by the growth of charter schools.<sup>73</sup>

Without question, the manner in which the school finance formula has been designed and implemented has amplified, not reduced, the trauma experienced by school districts with declining student populations. The most damaging aspect is the manner in which revenue is calculated in terms of average costs per student. This is not rocket science. The dynamics of the problem are intuitive and readily apparent. "In the short-run, the marginal costs of losing a student are far greater than the average cost of educating the student. This can place a strain on local budgets because annual enrollment losses generally cannot be translated into immediate cost reductions that match the per-pupil funding loss."<sup>74</sup> These negative consequences are only partially offset by the weighted formula for calculating the pupil membership. The blended formula weights the enrollment of the current fall semester with that of the spring of the previous year. While the weights have fluctuated over time, the typical weight was in the range of 75/25.<sup>75</sup> The real problem with this approach, however, is that a two year time frame is far too short a period to manage the transition of falling populations and to offset the harshness inherent in the average per-pupil calculation of operating revenue. Sadly, the weights of the blend have been recently changed in a manner that will only increase the financial stress of declining enrollments.<sup>76</sup>

State policy has attempted to address some of the inequalities of the foundation allowance program through categorical funding. For example,

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72. *Id.* at 39.

73. *Id.* at 38 ("Most of Michigan's charter schools are located in urban areas, which will explain some of the enrollment declines in central cities.").

74. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 31-34. The converse is also true. "Under the foundation allowance program, it is much easier to manage up (i.e., accommodate growing enrollments) than it is to manage down." *Id.* at 34. Labor is just one illustration of sticky costs in the short term. CRC, STATE AND LOCAL REVENUES, *supra* note 44, at 45 ("Because of the high concentration of personnel spending, the options for effecting major spending reductions are limited. Personnel costs tend to be 'sticky' in the short-term and intermediate reductions are difficult to achieve because of multi-year collective bargaining agreements determine overall employee compensation.").

75. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 30.

76. *Id.* at 30 ("Beginning with the FY2012 Budget the weighings will change course again, but this time to a 90 percent/10 percent blend. This shift will allow growing districts to more fully benefit (in funding terms) from the additional students. Conversely, the enrolment losses in declining districts will not be smoothed as much.").

in FY2007, the state adopted a program to provide higher levels of support for school districts with declining enrollments.<sup>77</sup> The problem is that this mandate was never fully funded. “In FY2011, eligible districts will receive a prorated declining enrolment grant equal to about eight percent of the full amount allowed under state law. Given the significant proration, the supplemental payments have not been able to make up for the revenue losses declining enrollment districts experience.”<sup>78</sup> Similar categorical funding is supposed to target “at-risk” students.<sup>79</sup> In fact, while the real needs of these children have increased steadily from FY2003-FY2010, “the real value of at-risk payment declined by [thirty-four] percent.”<sup>80</sup>

State action is the sum of continuous incremental choices that define the character of the whole. The inherently unequal maximum foundation grants have always been fully funded (necessarily sending disproportionately more money to some of the wealthiest school districts). The money for “declining districts” and “at risk” populations has not been similarly appropriated. The state’s values are defined by the state’s choices. State financing continues to be dominated by the foundation allowance.<sup>81</sup> Even more disturbing, the categorical funding previously allocated for declining enrollment school districts was completely eliminated in FY2012.<sup>82</sup>

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77. *Id.* at 41.

78. *Id.*

79. *Id.* at 51 (“State at-risk funding targets children from low-income households based on federal free lunch criteria.”).

80. *Id.* at 52.

81. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 4 (“In state FY2011, nearly 90 percent of the total state-source School Aid Fund revenue is distributed to local districts through the foundation program.”).

82. DETROIT PUBLIC SCHOOL EMERGENCY MANAGER, ADOPTED FY2012 OPERATING BUDGET: CREATING CENTERS OF EXCELLENCE IN EVERY SCHOOL AND EVERY NEIGHBORHOOD 52 (2011) [hereinafter *DPS FY2012 Budget*] (“Due to the fact that districts across the State of Michigan have experienced significant declines in enrollment, the State of Michigan has provided some funding proportionate to the size of the school district in order to combat corresponding declines in state aid revenues. The State of Michigan budget calls for the elimination of these funds for the FY2012 budget. This results in a loss of \$5.9 million in annual funds to DPS.”).

#### IV. GOVERNANCE, FINANCE AND COMPETITION IN THE DETROIT PUBLIC SCHOOLS

##### A. Governance of the Detroit Public Schools

At least since 1927, state law has classified the Detroit Public Schools as a school district of the “first class,” subjecting it to additional rights as well as responsibilities.<sup>83</sup> Detroit is the only district in the state to ever fall into this category. “First class” status is recognition that the educational needs and issues in Detroit are often different from those in the rest of the state. The challenges of Detroit are more akin to the challenges of other large urban school districts, like Chicago, Baltimore and Philadelphia.

In the early years of its existence, even though it was popularly elected, the Detroit School Board was effectively subject to the control of city government.<sup>84</sup> This changed at the directive of state law in 1949. Independence is about the autonomous ability to raise money and make spending decisions. “The board of education was freed of the requirement for city approval of budgets and borrowing: it could adopt a budget, determine what part of the capital plan was to be funded by bond proceeds, and determine the tax levy required.”<sup>85</sup> Adoption of new taxes still required approval of local voters. The Board of Education was further empowered to incur debt.<sup>86</sup>

The governance structure of the Detroit Public Schools has been the subject of constant tinkering, debate and reform. In the 1950s and 1960s, the primary question was decentralization. There were calls to break the large centralized district serving nearly 300,000 into smaller administrative units. A 1970 compromise refashioned the school board to

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83. CITIZEN’S RESEARCH COUNCIL OF MICH., A HISTORY OF THE RELATIONSHIP BETWEEN THE DETROIT BOARD OF EDUCATION AND THE CITY OF DETROIT 3 (July 1990) [hereinafter CRC, HISTORY OF THE DETROIT SCHOOL BOARD]. In 1927, the “first class” designation applied to cities having a population of more than 500,000. *Id.* This classification persisted through the School Code of 1955. *Id.* at 7. In the School Code of 1976, “first class” districts were defined as those consisting of student enrollments of over 120,000 pupils. *Id.* at 10. The threshold status was subsequently reduced to 100,000 students. CRC, PUBLIC EDUCATION GOVERNANCE, *supra* note 21, at 13. After DPS enrollment fell below the threshold, the State Attorney General ruled in 2009 that Detroit no longer qualified as a “first class” district. *Id.*

84. CRC, HISTORY OF THE DETROIT SCHOOL BOARD, *supra* note 83, at 3 (“Although members of the board of education were directly elected, the power of the mayor and city council over the activities of the school district effectively made the public school system a department of the city.”).

85. *Id.* at 6.

86. *Id.*

consist of thirteen members, five of whom would be elected at large, with the remaining eight elected from defined geographic regions.<sup>87</sup> Furthermore, new regional boards were elected in each of the eight geographic areas.<sup>88</sup> The state School Code of 1976 went further, making decentralization a state mandate for districts with pupil memberships of more than 100,000 students and creating eight regional boards within the district subject to greater city control.<sup>89</sup> A 1981 Detroit voter referendum ended the decentralization experiment, eliminating the regional boards and returning administrative control back to a central board of education independent of city control.<sup>90</sup> The new school board consisted of eleven members, seven elected from defined districts and four elected at-large.<sup>91</sup>

The traditional governance structure of an autonomous school board elected by local residents continued until 1999, when the state, once again, amended the rules governing first class school districts. “[T]he State stepped in and revised the 1976 State School Code to suspend the powers of the elected school board in first class school districts and appoint a school reform board to take over the duties of the elected board for a minimum five year period.”<sup>92</sup> The reform board consisted of seven members, six appointed by the Mayor of Detroit, in addition to the state superintendent of public instruction.<sup>93</sup> In November of 2004, Detroit voters were once again asked to select what form of governance they wanted for the Detroit Public Schools – the continuation of a variant of school governance subject to strong mayoral control, or a return to the traditional structure.<sup>94</sup> Again, Detroit chose to have a traditional, locally elected school board run its public schools.<sup>95</sup>

Control was returned to a newly elected Detroit School Board on January 1, 2006, but this is by no means the end of the story. The Local Government Fiscal Responsibility Act of 1990 directs the state

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87. *Id.* at 9.

88. *Id.*

89. *Id.* at 10-12.

90. CRC, HISTORY OF THE DETROIT SCHOOL BOARD, *supra* note 83, at 12.

91. Citizens Research Council of Mich., *Proposal E: Form of Governance for the Detroit Public Schools*, CRC MEMORANDUM, no. 1077, 2004, at 2 [hereinafter CRC, *Proposal E*]. “The School Code retained the board’s right to adopt a budget and determine the tax levy to be collected by the City.” *Id.*

92. *Id.* at 1; *see also* CRC, REFORM OF K-12 SCHOOL DISTRICT GOVERNANCE, *supra* note 17, at 19.

93. CRC, *Proposal E*, *supra* note 91, at 1.

94. MGT OF AM., DIAGNOSTIC FINANCIAL ASSESSMENT OF DETROIT PUBLIC SCHOOLS: FINAL DIAGNOSTIC REPORT 1-2 (2005) (“A feature of Public Act 10 of 1999 was the requirement that, after five years of using the CEO management model, the question of retaining the reform Board and the CEO be placed on the ballot.”).

95. *Id.*

superintendent of public instruction to monitor the financial condition of local school districts. “In December 2008, State Superintendent Flanagan declared DPS to be in a state of financial emergency and Governor Granholm appointed Robert Bob as emergency financial manager of DPS in March 2009.”<sup>96</sup> Any ambiguity about the authority of the Emergency Financial Manager over financial matters versus the residual power of the Board of Education over academic affairs became moot with the adaption of Public Act 4 in March 2011, which created the new position of an Emergency Manager with sweeping authority.<sup>97</sup> Roy Roberts was appointed the new Emergency Manager for DPS in May 2011.

Changes did not stop there. In June 2011, Governor Snyder announced the creation of the Education Achievement System (EAS), a new state-controlled school district for the state’s lowest performing schools.<sup>98</sup> EAS will be implemented first for failing DPS schools, before being extended to the rest of the state. This adds yet another layer of governance over an already fractured and complicated organizational chart. There are reasons to be concerned about the impact that EAS will have on DPS. It is estimated that thirty-nine DSP schools will be transferred into EAS.<sup>99</sup> The financial implications on DPS are the same as if DPS lost a comparable number of students to thirty-nine new charter schools. Again, dollars follow students in Michigan. DPS will lose all of the operating revenue associated with these students, without a comparable ability to reduce its fixed costs, including the costs associated with its debt service.<sup>100</sup> It is estimated that DPS already spends \$900 of its per-pupil foundation allowance to pay for debt service.<sup>101</sup> As more students exit DPS for EAS, the same costs associated with debt service and other fixed costs will be spread over a smaller and smaller number of remaining students. The state bemoans the fact that only fifty-five percent of allocated DPS resources currently reach the school level.

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96. CRC, REFORM OF K-12 SCHOOL DISTRICT GOVERNANCE, *supra* note 17, at 19.

97. Local Government and School District Fiscal Accountability Act, Act No. 4, 2011 Mich. Pub. Acts (codified at MICH. COMP. LAWS §§ 141.1501 *et. seq.*).

98. Press Release, State of Michigan, Governor, Detroit Public Schools Emergency Manager Jointly Unveil Dramatic Education Reform Plan to Restructure Failing Michigan Schools 1 (June 20, 2011) <http://www.emich.edu/ea/pdf/Michigan-release-EAA.pdf>; *see also* State of Michigan, Frequently Asked Questions About the Education Achievement System (undated) [hereinafter State of Michigan, Frequently Asked Questions], [http://www.michigan.gov/documents/snyder/FAQ110620education\\_achievementsystem\\_356028\\_7.pdf](http://www.michigan.gov/documents/snyder/FAQ110620education_achievementsystem_356028_7.pdf).

99. State of Michigan, Frequently Asked Questions, *supra* note 98, at 1.

100. *Id.* at 3 (“The local school district will remain responsible for maintenance, debt service and facility allocation.”).

101. *Id.* at 4.



EAS could well make this situation even worse for the students who remain in Detroit schools.

*B. Managing Financial Crises in the Detroit Public Schools: Past and Present*

The fact that a school district's operating deficit can lead to a state takeover and the appointment of an Emergency Manager is a recent phenomenon in Michigan. School financial crises and deficits, however, are nothing new. How financial problems are addressed depend critically on the political, economic and social realities that prevail at the time. It is useful to recall some of these past episodes, as we assess current financial challenges.

Most of the financial crises of the Detroit Public Schools have been rooted in the city's broader economic problems, punctuated by conflicts over politics, race and labor relations.<sup>102</sup> Today, the entire state of Michigan is undergoing profound economic challenges. These economic challenges are more serious and of longer standing for the city of Detroit. The rates of poverty and unemployment in Detroit are amongst the highest in the nation. Property values have fallen dramatically and tax delinquency rates are on the rise. This describes the state of affairs in 2012. Tellingly, it also describes the state of affairs in Detroit during the Great Depression, which had serious implications for the Detroit Public Schools.<sup>103</sup> The 1930s was a time when the schools were under the authority of city government, making the fiscal fates of the school district and the city intertwined. The era led to a period of what scholar Jeffrey Mirel calls "educational retrenchment."<sup>104</sup> While cuts were made across the board, investments in capital assets and infrastructure suffered the

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102. "This study has identified a strong relationship between the health of the local economy and the general condition of the public schools." JEFFREY MIREL, *THE RISE AND FALL OF AN URBAN SCHOOL SYSTEM: DETROIT, 1907-81* 406 (2d ed. 2007). Economic stresses lead to other forms of stress. Mirel's work also "demonstrate[s] a strong relationship between levels of funding, the intensity of political conflict, and the viability of the school system itself." *Id.* at 401. "One cannot understand the rise and fall of the Detroit schools without factoring in the effects of shifting levels of funding." *Id.*

103. *See id.* at 89 ("Unprecedented levels of unemployment and soaring tax delinquencies in Detroit not only caused widespread misery and despair among tens of thousands of residents, but the downward economic spiral also undercut the widely shared unanimity on school issues. Amid fear and confusion, the powerful interest groups in Detroit challenged one another in the arena of school politics.").

104. *Id.* at 91.

most and were the slowest to rebound.<sup>105</sup> There were calls to balance the budget at almost any cost, with unfortunate, long-term consequences.<sup>106</sup> “The Detroit public schools began to deteriorate politically, financially, and educationally as early as the 1930s, a period in which school leadership, staff, and student populations were overwhelmingly white.”<sup>107</sup> Even today, when reading about the state of DPS’s capital facilities, one is struck by the continued dominance of buildings constructed in the 1920s.<sup>108</sup>

While problems may have begun in the 1930s, each successive generation must take responsibility for their own actions and decisions. Economic problems can trigger political conflict, but Detroit also illustrates how racial conflict can be the source of budgetary crises. The best example is the turmoil associated with busing and desegregation in the early 1970s. “The May [1972] election indicated that the voters would rather deny the schools any funds than provide money that might be used for desegregation.”<sup>109</sup> Voters rejected similar millage proposals in August and November elections, contributing to “the worst financial

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105. *Id.* at 93 (“Eliminating new buildings and drastically cutting maintenance services were the only retrenchment actions the board would take that did not generate controversy.”).

106. While speaking to issues beyond just school spending, the words of then-Mayor Frank Murphy could serve as a cautionary message to today’s Emergency Manager. “To sacrifice everything to balance the budget is fanaticism.” MIREL, *supra* note 102, at 95 (internal citation omitted).

107. *Id.* at 401.

108. “In Detroit, more than half of all schools were built before 1930, and the average school is more than 60 years old.” CRC & EDUC. POL’Y CTR., *THE UNFINISHED BUSINESS OF PROPOSAL A*, *supra* note 51, at 4. This statement was made in 2004. Detroit passed a \$1.5 billion bond for capital improvements in 1994, with some raising questions about how the money for capital projects was managed. Citizens Research Council of Mich., *Detroit Ballot Issues Proposal S: Detroit Public Schools Bond Proposal*, CRC MEMORANDUM, no. 1095, 2009, at 8 [hereinafter CRC, *Proposal S*] (“A \$1.5 billion bond proposal passed in 1994; recent investigations by the District’s inspector general found overspending for land and building purchases and a ‘gross lack of due diligence in looking after taxpayers’ dollars.”) (internal citation omitted). In seeking approval of the 1994 bond, it was wrongly estimated that DPS would see a substantial increase in enrollment in the coming decade. Citizens Research Council of Mich., *Detroit School District \$1.5 Billion Bond Proposition*, COUNCIL COMMENTS, no. 1032, 1994, at 1 (“The school district is projecting an enrollment increase of upwards of 20,000 students by the year 2000 and major shifts within the city.”) In 2009, the citizens of Detroit approved another \$500 million bond for school renovation and construction. CHRISTIN CAVE, *PUBLIC SCHOOL REVITALIZATION IN DETROIT*, ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT 2 (2010) (“‘Proposal S’ is a bond which takes advantage of USD 500 million in stimulus dollars that President Barack Obama made available nationwide to build new schools and modernise existing ones.”).

109. MIREL, *supra* note 102, at 350. .

crisis the school system had faced since the 1930s.”<sup>110</sup> The result was a seventy million dollar deficit.<sup>111</sup> In the end, state legislation authorized DPS to issue seventy million dollar in deficit bonds to be paid for through increased property taxes that could be implemented without voter approval.<sup>112</sup> The controversy over bussing was just a symptom of deeper and long-term controversies over race and geography in Detroit. “In 1966, when the system hit its peak enrollment, it served almost 300,000 students who were about evenly divided between black and whites. Twenty-four years later, approximately [ninety percent] of the district’s 170,000 students were African American.”<sup>113</sup> The extreme racial segregation in housing that existed within the Detroit city limits in the 1940s, 50s and 60s, simply reproduced itself at the metropolitan level in the 1970s, 80s and 90s, rendering the Detroit Metropolitan area the most segregated in the nation at the time of the 2000 census. Sadly, the Supreme Court’s opinion in *Milliken v. Bradley*, a school segregation case involving the Detroit Public Schools, rendered federal courts essentially powerless to address this modern form of segregation, one defined by fractured municipal boundaries.<sup>114</sup>

Driven by the loss of manufacturing jobs, a declining tax base and a school finance system dependent on local property taxes, financial crises became endemic parts of the landscape in the 1980s and 1990s. Before the 1994 adoption of Proposal A, school districts in Michigan were financed predominately through local property taxes, with state efforts to ensure greater equity through power equalization programs targeting districts with low per-pupil property values. When school financing is tied to local financing, the fate of the local schools is largely tied to the state of the local economy.<sup>115</sup> The historic forces driving racial segregation in Southeast Michigan are strongly correlated with forces driving the economic disintegration of the region. The 1980s was a time of local and national recession. “The deteriorating economic situation in the city and state in the early 1980s led to reduced property values, lower local tax revenues, and less state aid.”<sup>116</sup> Unlike the 1970s, the financial stress of the schools was not a sign of lack of voter support for the

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110. *Id.* at 346, 351.

111. CRC, HISTORY OF THE DETROIT SCHOOL BOARD, *supra* note 83, at 9.

112. MIREL, *supra* note 102 at 352-53.

113. *Id.* at 413.

114. *Milliken v. Bradley*, 418 U.S. 717 (1974).

115. MIREL, *supra* note 102, at 415-16 (“The financial problems that had been plaguing the Detroit Schools for decades were directly related to the serious economic and social conditions afflicting the city at large and were certainly one of the contributing factors to the poor performance of the schools.”).

116. *Id.* at 417.

schools. Those that remained in Detroit, particularly its African-American population, supported their local schools.<sup>117</sup> “[B]etween September 1977, and November 1985, Detroit voters approved eight out of nine requests by the board for tax revenues or tax increases.”<sup>118</sup>

Despite voter support, DPS ran persistent operating deficits. “[I]n 1978 the system began running annual budget deficits that ranged from a low of \$10 million in mid-decade to a high of almost \$160 million in 1989.”<sup>119</sup> Once again, DPS had to issue deficit bonds to service the deficit. “In September of 1989, voters approved an increase of five mills and the sale of \$160 million deficit funding bonds to be repaid from an unlimited property tax.”<sup>120</sup> In addition to budget deficits, DPS suffered from falling student enrollments during the same period, declining fifteen percent between 1983 and 1992.<sup>121</sup> On the eve of the adoption of Proposal A, local property taxes were high, local property values were low, enrollments were falling and the district was facing structural deficits, despite receiving a relatively higher level of state aid than higher property value districts in surrounding areas.<sup>122</sup> With the adoption of Proposal A in 1994, financing of school operating expenses became a state responsibility. Unfortunately, the shift in financial responsibility did little to abate the financial challenges of the Detroit schools. Under Proposal A, the state, and not the school district, determines the district’s annual operating revenue. Districts are prohibited from supplementing their budgets from local resources. State-defined revenues of a district are determined by the product of its foundation allowance and student enrollment. Recall that Detroit received relatively greater state aid under the pre-Proposal A regime’s power equalization program because of its

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117. *Id.* at 416-17 (“For example, millage elections that often had pitted whites against blacks in the 1960s and 1970s became calmer and quieter affairs in the 1980s. Not only did the elections become less contentious, they also became more predictable. Black Detroiters had consistently supported higher taxes for the schools since the 1940s, and that support did not waiver as the century wore on.”).

118. MIREL, *supra* note 102 at 417.

119. *Id.*; see also CITIZENS RESEARCH COUNCIL OF MICH., DETROIT SCHOOL OPERATING MILLAGE RENEWAL PROPOSAL 5 (Aug. 1993) [hereinafter CRC, DETROIT SCHOOL OPERATING MILLAGE RENEWAL PROPOSAL] (detailing deficits from 1982-1992).

120. CRC, DETROIT SCHOOL OPERATING MILLAGE RENEWAL PROPOSAL, *supra* note 119, at 4.

121. *Id.* (“In the ten-year period 1983 through 1992, the number of students in the Detroit district declined by 31,548, from 213,558 to 182,010.”).

122. *Id.* at 2-3. Between 1983 and 1992, “the Detroit school district ranked very near the bottom of the 524 K-12 school districts in property tax base (state equalized value or SEV) per pupil.” *Id.* at 3. In light of the state power equalization program, however, Detroit was in the top twenty percent of school districts in terms of per-pupil operating expenditures. *Id.* In 1992, local sources accounted for only twenty-four percent of DPS general fund revenues. *Id.*

low property values. This ironically placed Detroit in a category of school districts that received relatively small real increases in state funding. At the same time, all districts faced rising retirement and healthcare expenses for their personnel. Moreover, Detroit faced relatively higher fixed costs and sharp declines in its enrollment base. This combination of factors almost guaranteed the continued existence of chronic structural deficits.

It is important to appreciate the magnitude of these forces. One way is to examine trends in per-pupil revenues and expenses over the period. "From FY1995 to FY2007, the DPS foundation allowance increased from \$5,584 per pupil to \$7,565 per pupil, a 25.1 percent increase. At the same time, expenditures per pupil increased 80.2 percent from \$7,229 to \$13,382."<sup>123</sup> Averages reveal only a partial picture. The cause of the growing gap between per-pupil revenues and expenditures was not the result of costs raising faster than revenue, but rather, in recent years, the inability to cut costs fast enough in a regime of sharply falling revenues. Operating revenues are now driven by enrollment. DPS enrollment has fallen from 168,213 students in FY2000 to an estimated 65,834 students in FY2012, a decline of over sixty percent.<sup>124</sup> Since every student is associated with an equivalent share of the state foundation allowance, DPS has suffered a roughly comparable reduction in state aid over the same period. Between FY2009 and FY2012 alone, state net aid to DPS has fallen over one-third from \$553 million to \$363 million.<sup>125</sup>

This is an unprecedented structural crisis. Without additional external resources to facilitate what is unavoidably a complicated transition, the only option is radical triage – desperate efforts to cut fixed costs even faster than revenues drop. DPS has closed over 100 schools since 2004, with more closures still likely to come.<sup>126</sup> DPS has also been forced to slash the number of teachers it employs. DPS employed 18,747 teachers in FY2003 but only 8,551 teachers in FY2012, a reduction of fifty-five percent. The district is in a state of free fall with no safety net in place and no guarantee of a soft landing.

Proposal A was not intended to address any of the structural issues facing Detroit. Indeed, Proposal A's very design, with its focus on average per-pupil rates of reimbursement only exacerbates these problems. It is not surprising then that the post-Proposal A years have been an era of continued deficits in Detroit. "Data from DPS financial reports show that in a 13-year period from Fiscal Year (FY) 1995 to

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123. CRC, *Proposal S*, *supra* note 108, at 5.

124. *DPS FY2012 Budget*, *supra* note 82, at 49.

125. *Id.* at 9.

126. CAVE, *supra* note 108, at 1.

FY2007, actual DPS revenues exceeded expenditures in only four fiscal years, the most recent being FY2002.”<sup>127</sup> The important point is that the dynamics of the problem are structural and largely transcend issues of governance. It is ironic that three of the four non-deficit years were from 1997-1999,<sup>128</sup> a period when DPS was run by the traditional school board structure, and a period immediately preceding the state imposed reform board. The state reform board controlled the district for five years from 2000-2004. In four of the five years, the state reform board ran a budget deficit, ending with an imbalance of \$123 million in FY2004 alone.<sup>129</sup> In 2005, the district issued another \$210 million in deficit bonds.<sup>130</sup> Deficits continued with the return of control to a newly elected local school board. The deficit was \$142 million in FY2008 and \$137 million in FY2009.<sup>131</sup> The State appointed an Emergency Financial Manager for the District in 2009, but did nothing to change the formula for financing schools with declining enrollment bases.

DPS is in a new era. The principle source of its deficits are falling revenues and the corresponding difficulty of making sufficiently dramatic cuts in fixed costs, all while simultaneously facing the mounting burden of debt from past operating deficits. DPS will issue another \$200 million in deficit bonds in FY 2012.<sup>132</sup> This dynamic, in turn, is caused almost exclusively, by declining student enrollments.<sup>133</sup> Into this already complicated mix, must be added the dynamics of increased school choice and greater competition triggered by charter schools.

## V. THE FATE OF THE DETROIT PUBLIC SCHOOLS

### A. *Can the Detroit Public School Survive the Continuation of Proposal A?*

An accurate diagnosis of the problem is essential for effective policy reform. DPS’s core problems are structural and financial in nature, not

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127. CRC, *Proposal S*, *supra* note 108, at 5.

128. MGT OF AM., *supra* note 94, at 1-3 (Exhibit 1-1).

129. *Id.* (Exhibit 1-2).

130. CRC, *Proposal S*, *supra* note 108, at 4.

131. *Id.*

132. *DPS FY2012 Budget*, *supra* note 82, at 8.

133. The source of many operating deficits is the inability to accurately predict how fast enrollments, and therefore revenues will fall. “The most significant information impacting the resources available to DPS is the accuracy in estimating student enrolment.” MGT OF AM., *supra* note 94, at 4-7. “In both years [FY 2003 and FY2004], the failure to estimate this source of revenue more accurately was one of the significant factors in the resulting General Fund deficits.” *Id.* at 4-8.

issues of governance. Detroit has undergone seven substantial governance transitions since 1976 – decentralization (1976), recentralization (1981), state reform board (1999), return to a traditional school board (2006), Emergency Financial Manager (2009), Emergency Manager (2011) and the creation of the new Educational Achievement System (2011). The State financial system has not changed since 1994. Continued financial distress has been a characteristic of each DPS governance regime. If anything, the lack of continuity in governance has likely made it more difficult to manage the underlying financial problems.

The real sources of DPS's financial problems are defects in Proposal A itself, exacerbated by changes in demographics and the adoption of state policies encouraging schools of choice and increased competition from charter schools. To begin with, Proposal A never leveled the economic playing field. By failing to include capital costs, it perpetuated past inequalities associated with low property values, declining tax bases and aged physical facilities in urban centers. By bifurcating operating costs from capital costs, no one in the state educational system is engaging in anything approaching full cost accounting. By freezing Detroit in the same quintile as many economically prosperous school districts and failing to let considerations of the differential financial costs associated with higher cost students affect the calculation of the state foundation allowance, it ensured that Detroit and other urban school districts would suffer from what can best be characterized as "benign neglect" for more than a decade-and-a-half.

The central failing of Proposal A, however, lies in its overly simplistic per-pupil calculation of a district's operating revenue. Such a flaw can be papered over in periods of universally raising student enrolments. Such a flaw, however, becomes fatal in an era of declining enrollments. Again, this is not rocket science. The flaw is apparent upon reasonable inspection of the system and has been well documented in the literature since at least 2003, when statewide student enrollments started to decline.<sup>134</sup> The problem can be thought of as a fixed-cost-trap. The reduction in operating revenue (the entire value of the foundation allowance associated with that student) is greater than the district's ability to reduce its fixed costs. In the long run, school districts must adjust to enrollment changes. Proposal A, however, exacerbates the difficulty of budgetary adjustments. Spending in declining-enrollment districts cannot be reduced fast enough to match falling revenues without

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134. ARSEN & PLANK, *supra* note 56.

damaging educational programs.<sup>135</sup> Arsen and Plank provide an intuitive illustration of the problem:

[C]onsider the following example based on the Livonia school district. Suppose the district lost one student from every elementary classroom and one secondary school student from every class during a representative class period of the day. This would reduce enrollments by the equivalent of 743 full-time students, or a loss of over \$5 million to the district at its current foundation allowance of \$8105. Yet under this scenario, district costs would scarcely be affected by the enrollment declines. In order to reduce spending in line with the drop in revenue, services and programs for students remaining in the district would have to be cut back.<sup>136</sup>

This presents a serious financial challenge to local school administrators.

The financial challenge is substantial enough when the declining enrollment is attributed solely to underlying demographic trends. When state policies add inter-district choice and charter competition to this dynamic, the challenges are greatly exacerbated. It is akin to an arsonist adding an accelerant to a fire. To begin with, school choice and competition increase the number of departing students, forcing sharper cuts in existing programs and facilities in the traditional public school. These cuts decrease the actual and perceived quality of traditional schools and negatively impact the education of those students who remain. This, in turn, leads more students to leave and future cuts to be even more severe in a self-reinforcing, downward spiral. Conversely, the charter schools and schools of choice receive a bonus payment greater than the marginal cost associated with educating the new student and are, therefore, able to spend even more revenue in improving educational programs and services.<sup>137</sup>

Newer suburban districts receive large infusions of additional funds to expand their educational offerings, while older urban communities must make staffing and program cuts. These school

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135. *Id.* at 25.

136. *Id.*

137. MGT OF AM., *supra* note 94, at 4-8 (“There are numerous fixed costs in school districts, and the removal of one or a group of students does not eliminate these fixed costs. Conversely, in school districts with increasing enrollment, the cost of educating each additional student is typically less than the per pupil amount received as they are absorbed into a system based upon formulas for staff allocations and into schools where the fixed costs will not change dramatically.”).



budgetary changes, in turn, influence households' perceptions of the condition of local schools. School closures and teacher layoffs can create negative perceptions that enhance the prospect that additional families will leave a community, creating a self-reinforcing cycle. For these reasons, Proposal A may not only respond to suburban sprawl, but encourage it as well.<sup>138</sup>

This analysis, offered in 2003, would prove prophetic. Here, the laws of economics act almost like the laws of physics. The results are preordained by the structure of the incentives built into the system. No one should be surprised by the devastating results that they produced.

In FY2003, 191,403 Detroit students received education in a DPS school, a charter school or a different traditional school district under the schools of choice program.<sup>139</sup> Given background changes in the demography of the city, this number fell to 144,435 by FY 2010, a reduction of nearly twenty-five percent.<sup>140</sup> The financial stress created by this demographic shift alone would be substantial enough under Proposal A's punitive funding formula. Over the same period, however, DPS faced increasing pressure from charter schools and schools of choice. The number of Detroit students attending schools in other traditional districts (schools of choice) increased from 7,770 in FY2003 to 12,929 in FY2010, while the number of Detroit students attending charter schools increased from 27,506 to 45,036.<sup>141</sup> As a combined result, the number of Detroit Students attending DPS fell from 156,127 in FY2003 to only 86,470 in FY2010, nearly forty-five percent, to a point where DPS educated only sixty percent of the students remaining in city.<sup>142</sup>

Under Proposal A, the departure of every student represents a loss of the entire foundation allowance associated with the student. The winners win all and the losers lose all. The exodus of these students represents a substantial loss of resources for the school district.

For example, about 44,000 students who lived in Detroit attended charter schools in 2006. Together with 8,000 students attending suburban schools through interdistrict schools of choice, Detroit Public Schools has lost about one third of its

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138. ARSEN & PLANK, *supra* note 56, at 25.

139. CRC, DISTRIBUTION OF STATE AID, *supra* note 45, at 59.

140. The entire population of Detroit fell from 926,903 to 713,777 from 2000-2010. *Id.*

141. *Id.*

142. *Id.*

students, amounting to about \$400 million in revenue loss annually to the two choice programs.<sup>143</sup>

These numbers have only gotten worse. At its core, this is not a problem of governance. This is a problem of the state school finance formula in the context of unprecedented changes in the economics and demography of the city. DPS is in a state of free fall. It is a vicious downward spiral. It is no wonder that more than 100 schools have closed since 2004 and that there is no end currently in sight.

*B. Is School Competition Part of the Problem or the Solution?*

Does competition make education better or worse for the students who remain in the Detroit Public Schools? It is important to understand the frame of this analysis. The inquiry is separate and apart from whether one thinks that charter schools are good or bad. The analysis focuses on how the underlying educational “market” is structured and upon the dynamics of the competitive process itself. Moreover, the focus is upon those who are left behind in the traditional system. Whether charter schools provide a better or worse education for students is a separate and independent concern.<sup>144</sup>

In theory (and in properly structured markets), school competition can increase efficiency and improve educational quality, potentially measurable by a variety of outcomes-based metrics. What does the theory require? To begin with, assume that all families have uniform

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143. Arsen & Ni, *supra* note 35, at 31.

144. There are some excellent charter schools in Detroit and future reform efforts should build off of these lessons. There are also some less than excellent charter schools in Detroit. This reflects national experience. National evidence suggests that some charter schools are better than the average traditional schools, some charter schools are about the same, and some charter schools are worse than average. “The study reveals that a decent fraction of charter schools, 17 percent, provide superior education opportunities for their students. Nearly half of the charter schools nationwide have results that are no different from the local public school options, and over a third, 37 percent, deliver learning results that are significantly worse than their students would have realized had they remained in traditional public schools.” CRC, NONTRADITIONAL K-12 SCHOOLS, *supra* note 6 at 29 (citing CTR. FOR RESEARCH ON EDUCATIONAL OUTCOMES, MULTIPLE CHOICE: CHARTER PERFORMANCE IN 16 STATES (2009)). In Michigan, the evidence suggests that students in charter schools perform slightly better on test scores than students in the “urban clusters” in which charters disproportionately tend to be located, but that charter school children perform slightly below the state-wide average overall. *Id.* at 32 (“Although PSAs generally outperformed similar districts, they lagged the state-wide average in every category tested.”). Given that PSA are free to choose where they locate, this suggests a complicated selection dynamic against the backdrop of geographic educational disparities that continue under Proposal A.

preferences for educational quality that can be measured along a simple vertical dimension (more quality is always better).<sup>145</sup> Let us also assume that all families have equal abilities to exercise and implement their educational choices. If traditional schools are not performing optimally in response to family demands for educational quality, charter schools will open and compete with them. If charters are perceived to offer better educational quality, families will choose to send their children to charter schools. Additional charter schools will open (and existing charters will grow) so long as there is a perceived gap in the quality between charter and traditional schools (and between charters themselves). In theory, in response to the new competition, traditional districts will alter their previously “inefficient” resource allocations in a manner to improve their own educational quality. In the end, the theory suggests that competition will improve the quality of education provided to the students who remain in the traditional school system.

There are a number of characteristics associated with what are perceived to be the most effective charter schools. These schools often have some combination of charismatic principals, smaller classes (lower student-to-teacher ratios), longer school days and longer school years.<sup>146</sup> For competition to be a legitimate policy option, one must imagine that traditional schools would have the capacity to respond to charter competition in a manner that could change their own resource allocations to duplicate the charter strategies. Once one appreciates the many constraints that prevent traditional districts from effectively duplicating successful innovation – union contracts, state regulations and administrative limitations – one also starts to appreciate the limits of what competition itself can accomplish in this setting.<sup>147</sup> One response might be to institute a series of additional educational reforms that afford traditional schools more flexibility. Ironically, if we were confident in the set of reforms that would improve educational quality, we could simply impose these mandates in a regulatory manner within the traditional system, without the need for competition at all. If, however, one proceeds with vigorous competition in a world where traditional schools are not capable of effectively responding to the new stimuli, one simply builds market distortions in from the beginning.

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145. Cf. Peter J. Hammer, *Questioning Traditional Antitrust Presumptions: Price and Non-Price Competition in Hospital Markets*, 32 MICH. J. L. REF. 727, 732-38 (1999) (modeling competition in hospital markets).

146. CRC, NONTRADITIONAL K-12 SCHOOLS, *supra* note 6, at 61 (“Successful charter schools tend to be small, have extended school days and hours, and offer intensive student support, including tutoring and character education.”).

147. *Id.* at 34 (“There are a number of structural, contractual and political reasons why traditional schools have not embraced successful models.”).

The theoretical story becomes even more complicated if one assumes that families have heterogeneous preferences over educational quality – different families have different beliefs about what a quality education is – or that families have differential abilities to evaluate or implement their choices about what educational quality is and what school they want to attend. Competition in markets with heterogeneous preferences will generate differentiated products in response to differential demands (think about the market for automobiles or soft drinks). Competition will also segment families with differential abilities into different classes and categories. Differences in family wealth, motivation, information, access to transportation and capacity to engage complex bureaucracies will all be reflected in how the market sorts and stratifies consumers (and therefore students).<sup>148</sup>

What does the evidence show about the effects of competition? Few states have had as much experience with charter schools as Michigan. Moreover, the economic incentives in support of competition in Michigan (the zero sum game incentives of Proposal A) are amongst the most intense in the country.<sup>149</sup> This provides an opportunity to

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148. Markets can sort consumers along many different dimensions, depending upon the prevailing incentives and the nature of consumer differences. PSAs are formally prohibited from selecting students on the basis of student ability or characteristics. *Id.* at 23. Implicitly, sorting can take place in a number of informal ways. If a PSA offers traditional programs, but does not offer bilingual education, they are unlikely to attract linguistic minorities. If DPS offers a full range of programs for special education and a PSA has no experience or reputation for providing comparable services, it is less likely that parents with special needs children will send them to charter schools. Indeed, some evidence suggests that charter competition has already resulted in a sorting process where greater numbers of disadvantaged students with higher cost needs are left behind in traditional schools. “Charter schools have a smaller proportion of disabled students than the state as a whole, and a smaller percentage of special education students in cluster districts.” *Id.* at 25. Similarly, districts with declining enrolments are also associated with the highest costs students. “A striking feature of the distribution of high- and low-cost students across Michigan schools is that it is systematically related to district enrollment change. Table 12 shows that there is a strong association between the pace of district enrollment change and the share of students who are high cost. The faster a district loses students, the larger the increase in the share of remaining students who are poor or who have disabilities.” ARSEN & PLANK, *supra* note 56, at 27. Even the finding that test scores in Michigan PSAs are slightly higher than the scores of traditional students in the remaining “urban clusters” raises questions of causation. Are charter schools doing a better job at educating students, or are charters implicitly sorting students by ability and attracting relatively better students. This could take place through a mechanism as innocuous as the possibility that higher motivated parents may select charter schools, or that charters may implicitly discriminate against students who lack access to transportation.

149. Arsen & Ni, *supra* note 35, at 8 (“[T]he school finance system in Michigan creates an ideal competitive market for schooling and makes Michigan an especially

empirically test how traditional school districts have actually responded to increased competition. David Arsen and Yongmei Ni examined data from 1994-2006, considering how competition has affected the resources allocation decision of traditional districts.<sup>150</sup> The authors do not find the “efficient” outcomes predicted by economic theory. Rather than responding competitively by reallocating resources in a manner that improves quality, as measured by such variables as instructional programming, Arsen and Ni found that charter competition was associated with reduced spending in instructional programs (quality) and relatively higher spending on administrative functions.<sup>151</sup>

What is to be made of this counterintuitive result? It strongly suggests that competition has no positive effects and indeed may actually harm the quality of education afforded to students who remain in traditional public schools. This could either mean that competition does not work or that public schools administrators are too incompetent (or highly constrained) to respond rationally. Neither explanation seems persuasive. Arsen and Ni found another important result. Charter competition was also associated with increased financial stress for traditional school districts. “[H]igher levels of charter competition are strongly associated with declining district fund balances . . . Rising levels of competition of charter competition clearly generate financial pressure on Michigan [Traditional Public Schools] TPSs.”<sup>152</sup> These findings are consistent with the claim that Proposal A has created a fixed-cost-trap in declining enrollment districts, a negative dynamic that charter competition simply exacerbates.<sup>153</sup> Schools lose revenue and must cut costs. The cuts come disproportionately in areas of instructional programming, arguably decreasing the quality of education available for the students who remain in traditional public schools. Being hamstrung by falling revenues, traditional school districts are simply unable to respond to greater competition by increasing educational quality as predicted in the economic models. “When TPSs in Michigan lose students to choice schools, they lose the entire per-pupil funding associated with those students. This loss in revenues generated pressures

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important case for studying the effects of charter schools on [traditional public schools].”).

150. *Id.*

151. *Id.* at 19 (“So our tentative evidence that charter competition causes TPSs to allocate a declining share of spending to instructional programs simultaneously implies that they devote an increasing share of spending to support services.”).

152. *Id.*

153. *Id.* at 21 (“These results indicate that the loss of students to charter schools has a significant negative impact on the revenues of Michigan school districts, and that is not accompanied by a corresponding decrease in their expenditures.”).

for expenditures cuts, which make it harder for districts to continue providing the same quality programs, let alone improve educational services.”<sup>154</sup>

Independent of the quality of education that charter schools may or may not provide their own students, the fixed-cost-trap created by Proposal A means that school competition is likely to be harmful to students who remain in underfinanced traditional public schools. This prediction is supported by a further empirical study conducted by Ni on the effects of charter competition on student test scores for students in traditional districts.<sup>155</sup>

My analysis suggests that overall charter school competition has had a negative impact on student achievement in Michigan’s traditional public schools. The effect is small to negligible in the short-run, but becomes more substantial in the medium- and long-run. The negative effect of charter competition is consistent for both math and reading tests in both 4th and 7th grades and robust across a range of econometric models and estimations. In the long-run, for districts where charter schools have drawn away a significant share of students, the estimated charter competition decreases their test scores by 0.2 standard deviations in math and 0.4-0.5 standard deviations in reading.<sup>156</sup>

The effects of competition in any setting depend on the local context and how the market is structured. The conclusion here is less an incitement on charter schools per se than it is a continuing indictment on the perverse incentives created by Proposal A. The reason that competition has adverse and growing negative effects on educational quality in center-city school districts facing the highest degree of competition is the fixed-cost-trap. “Charter competition appears to reinforce a vicious cycle of enrollment loss, revenue decline, program cuts, lower educational quality and further enrollment loss in these districts.”<sup>157</sup>

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154. *Id.* at 23.

155. Yongmei Ni, *The Impact of Charter Competition on the Efficiency of Traditional Public Schools: Evidence from Michigan*, 28 *ECON. OF EDUC. REV.* 571 (2009) (employing state-wide Michigan data from 1994-2004 to assess the impact of charter competition on math and reading test scores for students who remain in traditional school districts).

156. *Id.* at 580.

157. *Id.*

*C. The Road Ahead: Enabling the Survival of Detroit Public Schools*

It is important that this discussion be appropriately calibrated. Consider a counterfactual where an elected school board retained governance rights over the Detroit Public Schools since 1998 (or that the 1999 state reform board had remained in control of the district). Further assume that school financing under Proposal A had been recalibrated in a manner to more equitably address the challenges of a rapidly declining enrollment base. Under this scenario, the Detroit Public Schools would still face a range of serious challenges, from test scores to dropout rates to labor unions to administrative inefficiencies to school safety that are common to large urban school districts. Moreover, whatever the system of governance and finance, Detroit schools would still face the legacies of deindustrialization, discrimination and regional segregation that continue to plague Southeast Michigan. These challenges are real and are not going away anytime soon. That said, the Detroit Public Schools are not just facing serious endemic challenges, they are facing a real emergency and not of the type that the state Emergency Manager law is well positioned to recognize, let alone properly address. There is a financial crisis, but the crisis is structural in nature, brought about by flaws in the state financing formula and exacerbated by state policies encouraging greater competition and schools of choice.<sup>158</sup> The Emergency Manager is asked to adopt the myopic focus of eliminating an operating deficit in an era of falling revenues and mounting legacy debt. To do this, the Emergency Manager must relentlessly cut costs even faster than revenues continue to fall. There is nothing in the Emergency Manager law to address the structural causes of the financial crisis or to bring to bear additional resources that might actually improve the quality of education that DPS students can receive. If the state simply

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158. Sadly, rather than recognizing the structural flaws in Proposal A's impact on districts with declining enrollments, the state legislature continues to adopt policies that make the problem worse. The weights for calculating the pupil membership have been changed to 90/10, increasing the financial impact of each new student who leaves the district. CRC, *DISTRIBUTION OF STATE AID*, *supra* note 45, at 30. The special program set up in 2007 to provide additional resources to districts with declining enrollments (a fund that was never fully appropriated in the first place) has been eliminated. *DPS FY2012 Budget*, *supra* note 82, at 52. Finally, the cap on the number of charter schools has been removed. Laura Weber, *Governor Snyder Signs Law Removing Cap on Michigan Charter Schools*, MICHIGAN RADIO (Dec. 20, 2011), <http://michiganradio.org/post/governor-snyder-signs-law-removing-cap-michigan-charter-schools>. This will potentially subject DPS to unlimited charter competition. At the same time, there have been no significant countermeasures to ease the financial problems of districts with declining enrollment, nor has the legislature adopted policies to facilitate a more rational transition to a new demographic reality.

intended, *sub rosa*, to legislate the elimination of traditional public schools in Detroit, it could hardly think of a more effective vehicle to accomplish that objective.<sup>159</sup>

If the Detroit Public Schools are to have any chance at survival, there must be a restructuring of the school finance formula. Under Proposal A, school finance became a state responsibility. The state has an obligation to finance DPS at a level that reflects the true costs of providing a quality education to Detroit children. In an era of falling enrollment, this requires a finance formula that reflects the district's need to spread unavoidably sticky fixed costs over a smaller number of students, without jeopardizing the quality of education for those remaining students. If the state chooses to exacerbate the effects of demographically driven falling enrollments by encouraging greater charter competition and school choice, it should ensure that the children left in traditional schools are "held harmless" from the state's policy choice. A student who remains in a traditional DPS school should not be made worse off when another student leaves the district and takes the entire foundation allowance with her. Students in wealthy suburbs were "held harmless" with the passage of Proposal A and were permitted, in perpetuity, to spend more per-pupil than could legally be spent on students in the rest of the state. Students in central city districts deserve no less. They should be held harmless under Proposal A for the effects of declining enrollment and the loss of further students through choice and competition.

The Detroit Public Schools and the entire city of Detroit are undergoing serious demographic and economic changes. No one can pretend that the structures that exist today are the best suited to meet existing needs. Moreover, the structure of the City and the school district will likely look dramatically different in five or ten years than it looks today. This is an era of transition. As such, this is a period when issues of school governance and finance must be specifically designed to manage

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159. The preoccupation of constitutional law with intentional forms of discrimination has left courts virtually powerless to address issues of structural racism. What would it mean to prove the intent to discriminate against the Detroit Public Schools? In 1994, despite its flaws, it would be difficult to infer that Proposal A would have such a disparate impact on DPS or that such an impact would have been intentional. The case would have been stronger in 2003, with clear shifts in demographic trends and a growing awareness of the impending problems for a district with declining enrollment. Does a state intend adverse consequences when it makes no changes in a program that was neutral upon adoption but begins to have manifested disparate impacts? By 2010, DPS revenues dictated by Proposal A were in a state of free fall, driven by declining enrollments and compounded by the growth of charter schools and schools of choice. What intent can fairly be inferred from the failure to take action at this point? Does the range of legitimate inferences change a year later when the legislature adopts measures that compound the crisis rather than ameliorate its effects?



the transition and to establish an appropriate enabling environment for the implementation of more sustainable and workable policies for the future, with the ultimate objective of providing a quality education for every child born in the city.<sup>160</sup> These are not easy problems, and there are no easy answers.

The principles of effective governance can be clearly stated, even if their implementation remains problematic.

- 1) A clear division of labor, authority, and responsibilities with scope and limit of responsibilities defined;
- 2) A coherent strategy that can be understood and pursued;
- 3) Financial and accountability transparency;
- 4) Representativeness and encouragement for participation;
- 5) Accountability;
- 6) Engagement of civic leadership and broad constituencies;
- 7) A mechanism for different actors in the governance system to learn their roles; and,
- 8) An agenda focused on student learning.<sup>161</sup>

When formulating policy that will regulate conduct in complex adaptive systems, empowering an effective enabling environment is often more important than the particulars of whatever policy is initially adopted. The art is to “manage” issues in the face of evolving circumstances.<sup>162</sup> In that process, each of these core principles plays a role. What is most lacking now is coherent governance and financing structures that map onto the shifting demographic and economic realities of the Detroit school system.

In addition to the principles for an effective enabling environment, there are key economic principles of effective financial management. Full cost accounting is essential for rational long-term decision-making. If the state is responsible for school finance, it must be responsible for all

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160. Particularly in a period of change, policies must be in place to help manage the transition. ARSEN & PLANK, *supra* note 56, at 37 (“Providing transitional support to school districts where enrollment is declining would make it possible for these districts to respond more thoughtfully and deliberately to revenue reductions over time.”).

161. CRC, REFORM OF K-12 SCHOOL DISTRICT GOVERNANCE, *supra* note 17, at 39.

162. The principles of learning, adaptation and evolution can be applied more generally in the school context to encourage the creation of schools and school systems to learn and improve. See generally PETER SENGE ET AL., SCHOOLS THAT LEARN: A FIFTH DISCIPLINE FIELDBOOK FOR EDUCATORS, PARENTS AND EVERYONE WHO CARES ABOUT EDUCATION (2000).

school finance – operating costs and capital costs.<sup>163</sup> Furthermore, a school finance formula should reflect the basic reality that different students have different needs. The operating budget a district receives should be calibrated to meeting the full educational needs of its student population. In addition, basic educational costs vary by region across the state.<sup>164</sup> This reality should be reflected in the state foundational allowance. Finally, rational decision-making, like competition, always happens at the margins. The difference between average measures and marginal measures is drilled into every student who takes a basic microeconomics class. To base the state's foundation allowance on average measures and then to layer a system of competition and school choice over such a flawed premise is difficult to understand or excuse. As a basis for comparison, one can consider the nuance of reimbursement measures used in health care programs, such as Medicare, where hospital costs and patient case-mixes are all subject to careful adjustments. The chaos, dysfunctionality and injustice that would be associated with compensating all hospitals the same average amount of money for each patient they treat anywhere in the country is easy, although frightening, to imagine. The educational reimbursement strategy in Michigan (and elsewhere) is crude by comparison. The state can clearly do better.

One of the most effective mechanisms for linking the principles of a healthy enabling environment with those of good economics in practice is a holistic approach to budgeting. Budgeting is more than a process of strict accounting to make sure that expenses do not exceed revenue.

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163. This raises additional issues about the current approach to financing charter schools as well. Charters receive no separate funds for capital expenses, but, unlike traditional school districts, charters are able to use operating revenue from the foundation allowance to pay for capital costs. CRC, NONTRADITIONAL K-12 SCHOOLS, *supra* note 6, at 14. Charters can also issue government backed, tax-exempt bonds for capital needs. *Id.* at 15. Unfortunately, there is little good data on what charter school capital needs are, or how they are currently financed. CRC & EDUC. POL'Y CTR., THE UNFINISHED BUSINESS OF PROPOSAL A, *supra* note 51, at 64 (“[T]here is very little public information about the current state of capital facilities or capital financing in Michigan’s charter schools. In the absence of transparent and comparable data from Michigan’s charter schools it is impossible to know whether state intervention to provide additional support for capital spending is needed, or whether it would be welcome.”). Again, the issue is lack of coherence and rational planning. No single actor in the state has incentives (or even adequate information) to consider the real costs or consequences of how educational competition works or should be structured.

164. *See, e.g.*, CRC, *Proposal S*, *supra* note 108, at 5 (“However, DPS faces spending pressures that are distinct from many other Michigan Districts, including having a high percentage of low-income students (in fall 2008, 74 percent of DPS students were eligible for free or reduced price lunch compared to 41 percent of students state-wide) and greater security needs.”).

Budgeting should be a broad, inclusive process of identifying goals, making conscious value choices, engaging stakeholders, learning, and adaptation over time.

The key characteristics of good budgeting make it clear that the budget process is not simply an exercise in balancing revenues and expenditures one year at a time, but is strategic in nature, encompassing a multi-year financial and operating plan that allocates resources on the basis of identified goals. A good budget process moves beyond the traditional concept of line item expenditure control, providing incentives and flexibility to managers that can lead to improved program efficiency and effectiveness.<sup>165</sup>

The DPS budgeting process was faulted in 2004 for failing to live up to these principles.<sup>166</sup> Given the obsessive need to cut costs faster than revenues fall and the myopic focus of the Emergency Manager to eliminate operating deficits, these same principles have been given only limited effect in more recent years. More active community involvement and changing the political environment in which budgeting decisions take place will be part of the solution. Unfortunately, the insular, centralization of decision-making associated with the Emergency Manager model leads in the opposite direction.

## VI. CONCLUSION

Given Michigan's current system of school finance, it is unlikely that the Detroit Public Schools can continue to exist in anything like its traditional form. The combination of high historic fixed costs, demographically driven declines in enrollment and the calculation of operating expenses in a manner dictated almost exclusively in terms of a given year's student enrollment creates a formula that is not sustainable. The addition of competition (charter schools and schools of choice) to this unstable framework makes the forces of this self-reinforcing downward spiral even stronger. The appointment of an Emergency Manager, whose primary mandate is to avoid operating deficits, which can only be done by cutting costs faster than revenues fall, simply closes the loop and seals the fate of the Detroit Public Schools. Ironically, when the system collapses in upon itself, DPS and the traditional model of

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165. MGT OF AM., *supra* note 94, at 4-2 (quoting from National Advisory Council of State and Local Budgeting).

166. *Id.* at 4-3 to 4-4.

education will bear the brunt of the popular blame. In the aftermath of the collapse, there are likely to be even more vigorous calls for increased competition in public education.

Detroit often seems to be the victim of complex, invisible forces – the decline of the auto industry, the abandonment of the city’s inner-core, the segregation of the city by race in the 1920s-50s and the re-segregation of the entire region by race in the 1970s-90s. The pending collapse of the Detroit Public Schools might be added to this list, caused potentially as Justice Stewart in *Milliken v Bradley* might observe “by unknown and perhaps unknowable factors.”<sup>167</sup> In truth, these forces are neither invisible nor unknowable. A careful study of history, sociology, race, law and economics can reveal how these forces work and enable one to predict their trajectories and effects in real time. We can choose to be blind to these forces or we can choose to recognize them for what they are and grapple with their consequences. The children of Detroit deserve better than to have state officials stand by while the walls of the public school system fall around them. Who will take responsibility when the last public school in the city is closed?

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167. *Milliken*, 418 U.S. at 753 n.2 (Stewart, J., concurring).

