Background and Elimination of the State Equalization Account

prepared for the School Funding Interim Commission
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The Foundation Program and the SEA, 1949-1993

The state equalization account (SEA) was created as part of the Foundation Program Act of 1949. The Foundation Program, frequently amended, was Montana's school funding formula for over 40 years until House Bill 667 (1993) replaced it with the first incarnation of Montana's current funding formula centered on the school district general fund BASE (Base Amount for School Equity) budget.

The Foundation Program established "foundation schedules" based on student population, not unlike how the current formula establishes BASE budgets. The Foundation Program distributed state equalization aid as part of ensuring that each district could raise the revenue necessary to meet the foundation schedule. This aid came from the SEA, which was funded by 25 percent of the state income and corporation tax revenue and a state general fund appropriation (see figure 1). The Foundation Program was changed numerous times in the decades following its establishment.

Significant changes followed the first major lawsuit related to school funding in Montana, *Helena Elementary School District No. 1 v. State of Montana*, which was decided by District Court Judge James Loble in January 1988 and appealed to and ultimately affirmed by the Montana Supreme Court in February 1989. In this case, which is often referred to as the "equity lawsuit," the courts found that Montana's school funding formula was unconstitutional due to an excessive reliance on local levy funding that led to schools in lower-wealth districts spending far less per pupil than schools in higher-wealth districts.

Lawsuit, Special Session, and a Big Bill—HB 28 (1989)

The Legislature responded to the "equity lawsuit" decision with House Bill 28 in the June 1989 special session, which among many other things increased the foundation schedule amounts and the state share of district general fund budgets significantly and established a guaranteed tax base

(GTB) equalization mechanism for the first time in Montana school finance history to address property tax wealth disparities. The bill also increased the county equalization mills from 45 mills to 55 mills and instituted a new 40-mill statewide equalization levy to provide funding for increased state equalization aid via the SEA—hence, the 95 mills we know today. It was also HB 28 that removed coal, oil, and gas from the property tax base. (See figure 2 for a depiction of the Foundation Program in 1991, including an expanded list of revenue sources for the SEA.)

Another Lawsuit and an Even Bigger Bill—HB 667 (1993)

A second lawsuit was filed in 1992 contending that HB 28 had not fixed the disparities in the system. The 1993 Legislature responded by completely overhauling the funding formula with HB 667. It was HB 667 that created BASE budgets, maximum budgets, per-ANB (average number belonging) and basic entitlements, and so forth to replace the Foundation Program. The SEA remained intact and was to be the main funding source for the newly coined term "BASE aid," which combined "direct state aid" and "GTB aid," not unlike how the SEA had been used previously.

In the early 1990s, the existing funding sources raised approximately $400 million annually, just about enough to cover BASE aid. However, a different bill in 1993—Senate Bill 378—transferred the revenues flowing to the SEA from income, corporation, and coal taxes to the state general fund effective fiscal year 1995. In whack-a-mole fashion, this required a general fund transfer to the SEA of $126 million for fiscal year 1995 to make up for the lost revenue.

Enter SB 83; Exit the School Equalization Account (1995)

Also taking place during the early 1990s were numerous conversations in statehouses around the nation about the amount of earmarked revenue in state budgets. The National Conference of State Legislatures conducted a study that showed a large increase in the percentage of state budgets that were earmarked. During the 1993-1994 interim, the Legislative Finance Committee (LFC) formed a subcommittee to explore this topic, and eventually the subcommittee's recommendations were unanimously approved and a bill draft that would become Senate Bill 83 (1995) was requested by the LFC.

In his opening remarks to the Senate Finance and Claims Committee, SB 83 sponsor Senator Lorents Grosfield of Big Timber explained the motivation behind the 57-page “act generally revising laws concerning dedicated revenue and statutory appropriations” as simplifying state finances and the budget and making it easier for the Legislature to scrutinize, prioritize, and monitor taxpayers’ money. The main controversy surrounding the bill appears to have involved the de-earmarking of bed tax revenue, but by far the largest dedicated revenue and statutorily appropriated account affected was the SEA.

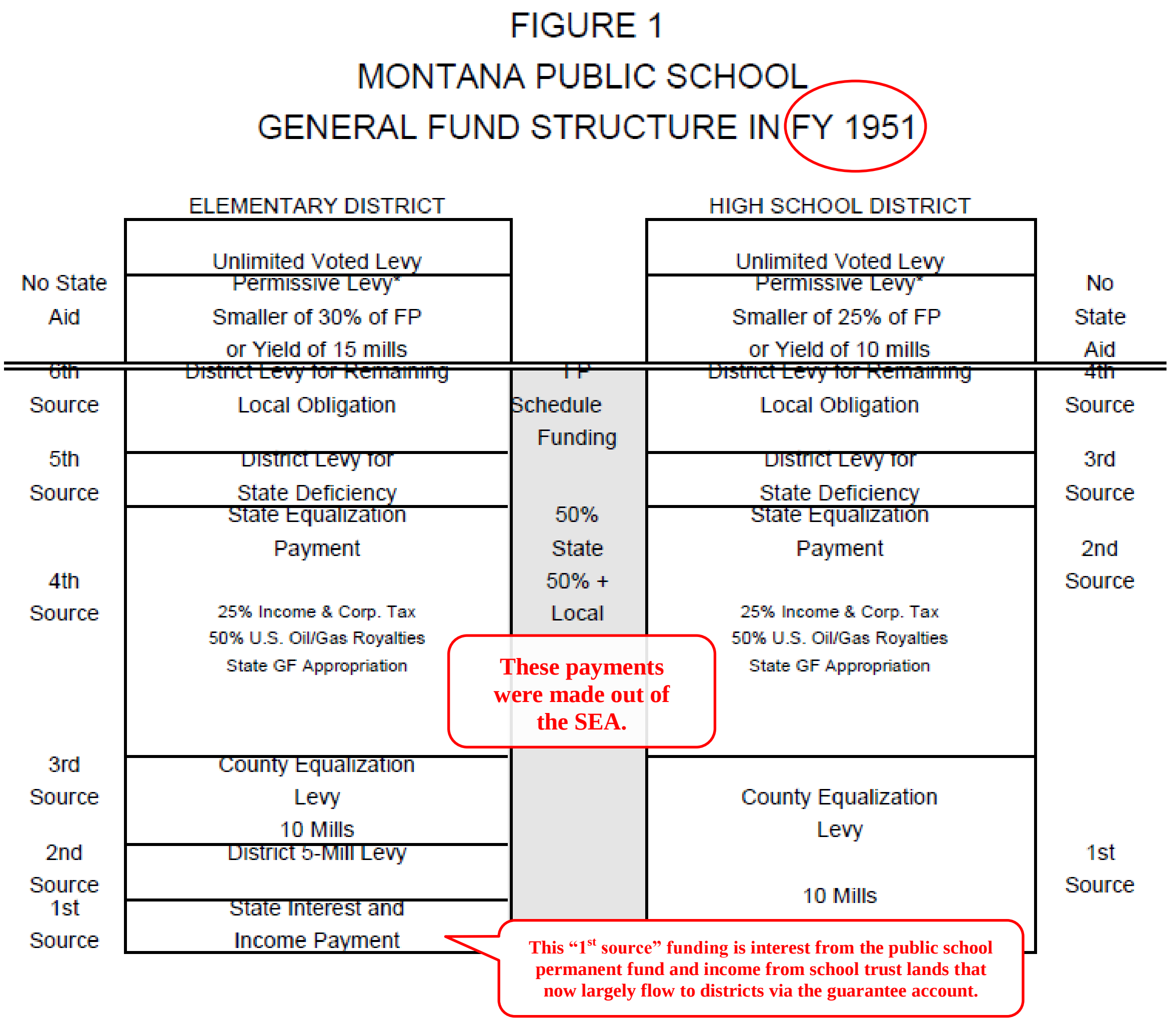
Although the portions of the income, corporate, and coal taxes that previously fed the SEA had already been rerouted to the state general fund by SB 378 in 1993, SB 83 redirected all of the remaining SEA revenue streams to the state general fund and removed all statutory references to the account, thereby eliminating the account (notably, the redirected revenue streams included state lottery net revenue, which marked the final divorce of education and the lottery until 2015, when House Bill 354 rekindled the relationship through STEM scholarships). Language was left intact to make clear that the *purpose* for revenues generated from sources like the 95 mills and the interest and income from the state school trust lands was still state equalization aid but that, instead of being accounted for in a dedicated account, these dollars would flow through the state general fund.

Postscript: The Guarantee Account Is Born (2001)

In an effort to stabilize long-term growth of the public school permanent fund—and perhaps to appease concerns that proceeds from the state school trust lands and interest from the public school permanent fund needed to be clearly and directly connected with funding public schools and not comingle with other dollars in the state general fund—the guarantee account was created through Senate Bill 495 in 2001. The new section of law establishing the guarantee account (20-9-622, MCA) has been amended several times in the past 15 years, but it remains a dedicated revenue account through which flow the interest and income generated by the state school trust lands. Returning full circle to the early days of the Foundation Program, the guarantee account is used as the first source of K-12 funding.

Note: The following diagrams (notes in red have been added) and much of the content of this brief are from the invaluable work of Andrea Merrill, staff researcher for the Montana Legislative Council, in her 1992 report *The Montana School Foundation Program and State Equalization Aid: A Legislative and Financial History, 1949-1991*.

Figure 1



* As noted on the previous page, the only change to the 1949 Act was to increase the elementary district permissive amount from 20 percent to 30 percent or to the amount a 15-mill levy could raise, whichever was smaller. The permissive amount for high schools with 100 ANB or less was increased from 15 percent to 30 percent, while the allowable permissive amount for a high school district with more than 100 ANB was limited to a 25 percent increase or to the amount that a 10-mill levy could raise.

Figure 2

APPENDIX A

MONTANA PUBLIC SCHOOL
GENERAL FUND STRUCTURE IN FY 1991

MAXIMUM GF BUDGET	DISTRICT VOTED LEVY	REVENUE & BUDGETS FY 1991
GREATER OF: * 135% OF CURRENT YEAR'S FP AMOUNT * 104% OF PREVIOUS YEAR'S GF BUDGET	* PROPERTY TAXES * P.L. 81-874	
PERMISSIVE AMOUNT * 35% OF FOUNDATION PROGRAM AMOUNT	**PERMISSIVE LEVY** * NONLEVY REVENUE VEHICLE FEES, INTEREST, TUITION,FLAT TAX, P.L.874 CASH REAPPROPRIATED * DISTRICT MILL LEVY * STATE GTB AID IF ELIGIBLE	
TOTAL FOUNDATION PROGRAM AMOUNT * 100% OF FP SCHEDULES	**STATE EQUALIZATION** * 40 MILL LEVY * NET LOTTERY REVENUE * INCOME TAX (41.3%) * CORPORATION TAX (28.5%) * COAL SEVERANCE TAX * U.S. MINERAL ROYALTIES * 15% COAL TRUST INTEREST * SCHOOL TRUST INCOME * COUNTY SURPLUS * DIRECT APPROPRIATIONS	$4.2m $115.9m $17.8m $5.7m $21.9m $7. m $35.8m
	COUNTY EQUALIZATION * 33 MILLS FOR ELEMENTARY * 22 MILLS FOR HIGH SCHOOL * OTHER REVENUE VEHICLE FEES, FEDERAL FOREST, TAYLOR GRAZING, MISC. REVENUES	

By 1991 the sources and amount of revenue in the dedicated SEA had grown. The changes to the funding formula by HB 667 in 1993 increased the SEA even more and spurred its elimination in 1995 by SB 83.