

STATE AID AND THE PURSUIT OF EDUCATIONAL EQUITY: LESSONS FOR NEW YORK

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Introduction

It is a pleasure to be here. I have long believed that scholars trained in public finance, such as myself, and scholars trained in education, such as all of you, would benefit from more conversations with each other. So I am particularly glad to have this conversation with you tonight.

Before I begin, however, I must say that I do have one little complaint. As a big fan of the Syracuse University basketball team, I wish you had invited me to Albany two weeks earlier. Then I could have seen the Syracuse team, the eventual national champion, play in the regional finals of the NCAA basketball tournament, which was hosted by Siena College.

There is a cartoon on the door of my office. It pictures a middle school science fair somewhere in New York. On the left a student poses with his talking robot. On the right a student poses with her decoding of a fly's DNA. But the blue ribbon is going to a student in the middle of the picture, standing in front of a blackboard that is covered with algebra. As he posts the blue ribbon on the black board, one judge turns to another and says "Great Scott, she has figured out the state school aid formula."

Today I am here to build on that student's work, that is, to try to give you some insight into state aid and to explain why there is an urgent need to reform the state aid formula in New York.

Education Finance Reform And The Courts

In 1971, the debate over education finance reform was funda-

mentally altered by the *Serrano* decision of the California Supreme Court, which declared that financing education with a local property tax violated the state's constitution. Although a 1972 U.S. Supreme Court decision, *Rodriquez*, declared that the U.S. Constitution has nothing to say about educational equity, many state supreme courts have followed the California court's lead. Indeed, since 1971, 44 state courts have heard challenges to their state's education finance system, and 18 educational finance systems have been declared unconstitutional by a state supreme court. In addition, court decisions have resulted in major education finance reforms in many states, including California, Kentucky, New Hampshire, New Jersey, Texas, and Vermont. Moreover, several states, including Kansas, Maryland, and Michigan, have implemented major reforms without a mandate from their state supreme court.

These court cases and education finance reforms are driven by longstanding disparities in student performance within each state, particularly the relatively low student performance in big city districts. Indeed, the schools in virtually every large city in the nation fall behind the rest of their state on state-administered exams. On eighth grade reading exams administered in 2001, for example, the share of students reaching a state-determined minimum score was over 40 percent below the state average in St. Louis, Baltimore, Philadelphia, New Orleans, Milwaukee, Buffalo, Detroit, Providence, Rochester, Denver, Oakland, and Newark.¹ All of these cities fall 40 percent or more behind their state on math scores, as well, along with Dayton, Cleveland, Chicago, Indianapolis, Pittsburgh, Richmond, Los Angeles, Minneapolis, Boston, and New York City.

State supreme court rulings on education finance have expressed a variety of equity standards. Since the *Rose* decision by the Kentucky Supreme Court in 1989, most courts have called for their states to ensure educational adequacy.

According to this standard, a state must ensure that every school district provides at least some minimum level of education. In this

context, education is a broader notion than simply spending per pupil, and is often interpreted to mean average student performance. Some courts have referred to other equity standards, such as complete equality. The courts' signals about these other standards are never very clear, however, and I will focus my remarks on the educational adequacy, which is the most basic and widely accepted standard.

Foundation Aid Formulas

Most states distribute aid to school districts through some form of a **foundation aid formula**, which is explicitly designed to achieve educational adequacy. Foundation aid is defined by the following formula

$$A_j = E^* - t^* B_j$$

where A_j is aid per pupil to school district j ; E^* is the foundation spending level per pupil, which is selected by state officials and is the same in every district; t^* is a "fair" property tax rate, which also is selected by state officials and is the same in every district; B_j is the actual property tax base per pupil in district j .

The intuition behind this formula is straightforward. The state decides on the level of spending required to meet the adequacy standard (E^*) and then makes up the difference between the revenue required for this spending level and the amount of money a district can raise at a tax rate the state thinks is fair (t^*). Districts with relatively large tax bases per pupil receive little or no aid under this formula.

How Much Spending is Adequate?

States face four key decisions in the design of a foundation formula. First, each state must decide how much spending is adequate. Not surprisingly, adequacy standards vary widely across states. One of the highest standards was set by the Kentucky Supreme Court in its 1989 *Rose* decision, which called for schools to provide students with seven "capacities," including "sufficient oral and written communication skills to enable students to function in a complex and

rapidly changing civilization,” “sufficient understanding of governmental processes to enable the student to understand the issues that affect his or her community, state, and nation,” and “sufficient levels of academic or vocational skills to enable public school students to compete favorably with their counterparts in surrounding states, in academics or in the job market.”

Should the Foundation Spending Level Be Adjusted for Education Costs?

The second decision is whether to adjust the foundation spending level, E^* , for education costs. The cost of education is the amount a district must spend to obtain a given level of student performance. Educational costs are often measured with an education cost index, which is like a cost-of-living index. Just as real income equals actual income divided by cost-of-living index, student performance (i.e. real educational spending) equals actual spending divided by an education cost index.

The cost of education varies across districts for two reasons. First, education costs depend on conditions in the labor market for teachers. Some districts operate in high-wage labor markets, and therefore must pay higher wages to attract teachers away from private sector jobs. In addition, some districts must pay more than others to attract teachers because of relatively challenging conditions in the classroom.

Second, education costs are higher in school districts with more disadvantaged students. As documented by dozens, if not hundreds of studies, the cost of education increases with concentrated poverty, with the share of students speaking English as a second language, and with the share of students who have special needs.

This analysis implies that school districts with higher education costs must spend more to achieve any given performance level. As a result, a cost adjustment is needed to combine a **performance** definition of education with an **adequacy** standard. To put it another way, high-cost districts will not achieve adequate student performance

even if they are brought up to a spending level that results in adequate performance for districts with average costs.

Fortunately, a performance objective can easily be supported by implementing a cost-adjusted foundation formula, which is

$$A_j = S^* C_j - t^* B_j$$

where A_j is aid per pupil to school district j ; S^* is the foundation spending level per pupil in a district with average costs; C_j is an educational cost index for district j ; and t^* and B_j are the same as in the standard foundation formula. In this context, the education cost index is defined to equal 1.0 in the average district. An equivalent approach is to use a so-called weighted pupil approach, which gives more weight to poor students than to non-poor students and so on. Although many states include a cost adjustment or pupil weights in their aid formula, these provisions are inevitably ad hoc and understate the variation in educational costs across districts. One of the great challenges in education finance is to develop methods that are acceptable to policy makers and that accurately reflect educational cost variation.

Should a Minimum Tax Rate Be Required?

The third decision is whether to make t^* the minimum required property tax rate for all districts. By the logic of a foundation formula, a district will not reach the foundation spending level (E^* or $S^* C_j$) unless it charges a tax rate of at least t^* .

However, many needy districts will not levy this tax rate unless it is required. In fact, many studies show that the state aid received by a school district results in some combination of spending increases and property tax relief — not in spending increases alone. Large increase in aid may therefore result in tax rates below the minimum required for an adequate education, that is, below t^* . Thus, the foundation level of spending will not be achieved unless a minimum rate of t^* is required.

One key underlying lesson here is that state officials need to be

aware of behavioral responses to their policies, including the behavioral responses of voters and school officials. Changes in state aid formulas do change school district behavior!

How Should the Financing Burden Be Distributed?

Fourth, a state must decide how to distribute the burden of paying for a program that brings all districts up to an adequate education, as defined by the foundation spending level (E^* or S^*C_j). A state has three broad tools it can use to raise the required funds. The first tool involves the aid formula itself. The amount of money the state must come up with is inversely related to the amount of money school districts are expected to raise, as determined by the minimum property tax rate, t^* . As a result, a state can help to pay for a higher foundation level by raising the minimum required property tax rate. Because increases in t^* place the burden on the districts that need help the most, only a relatively small portion of the required funds can be raised in this way. Nevertheless, setting a reasonable t^* ensures that even the neediest districts are bearing their fair share of the burden for raising the adequacy standard.

The second tool is a broad-based state tax, such as a sales tax or an income tax. Using a state tax spreads the burden for a higher adequacy standard across all taxpayers in the state. The precise pattern of this burden depends, of course, on the tax that is used. Most state income taxes exempt the poorest taxpayers, for example, whereas a general sales tax tends to hit low-income households particularly hard. Each state must decide which burden pattern is most appropriate.

The third tool is to collect contributions directly from the least needy school districts. This can be done in a variety of ways. The most obvious way is simply to cut their state aid and redistribute it to districts that need it more. Some states use more controversial methods, called recapture, to gather contributions from wealthy districts. In Vermont and Texas, for example, wealthy districts that want to raise additional funds themselves must share some portion of the money

they raise with poorer districts.

Overall, a state's objective in considering these four aspects of a foundation aid formula is to create an aid system that ensures adequate student performance in every district and that spreads the funding burden across the state in a manner that is perceived to be fair.

Reforming Education Finance in New York State

Now I would like to apply these lessons to New York State. In effect, I want to go back to that middle school student in the cartoon I told you about earlier, take a look at what she wrote on the blackboard, evaluate it, and show how it should be reformed

The need for education finance reform in New York State is demonstrated by the large differences in student performance across districts in the state. As indicated earlier, for example, Buffalo, Rochester, and New York City all fall far behind the rest of the state in the share of students reaching the state's target test scores.

What's Wrong with Education Finance in New York State?

The problems in the education finance system in New York State can be illuminated by considering the four decisions in a foundation aid system, which were discussed earlier. First, the spending level accepted as adequate is far too low. Many districts reach a high level of performance, of course, but the city districts clearly do not. Unfortunately, a low adequacy standard was recently certified by a state appeals court in *Campaign for Fiscal Equity v. New York*. This court's opinion, issued in 2002, declared that "The skills required to enable a person to obtain employment, vote, and serve on a jury are imparted between grades 8 and 9" and "Society needs workers at all levels, the majority of which may very well be low level." This decision is now being appealed to New York's highest court. I certainly hope it is overturned, as it sets a pitifully low standard for the Empire State!

Second, the education cost adjustments in the current state aid

formulas are not satisfactory. One of my colleagues, William Duncombe, and I have found large education cost differences with New York state. In one study, for example, we estimated a cost index of 183 in New York City, 178 in Yonkers, 151 in the upstate big three (Buffalo, Rochester, and Syracuse), 114 in the downstate suburbs, and 93 in the upstate suburbs. In other words, the cost of education per pupil is 83 percent above the state average in New York City, but 7 percent below the state average in the upstate suburbs.

Despite these cost differences, the main operating aid formula does not adjust for education costs at all. Several small categorical aid programs, such as Extraordinary Needs Aid and Limited English Proficiency Aid do adjust for these costs, but their adjustments are ad hoc and these programs constitute a small fraction of the state aid budget. Moreover, these programs are eliminated under the Governor Pataki's current budget proposals, which consolidate most aid programs into one block grant, with no cost adjustment. The state also pays for pre-K and class-size-reduction programs that serve as compensation for the high education costs in some districts. Because many studies support the efficacy of these types of programs, they are extremely important for needy school districts. Unfortunately, however, the Governor also proposes the elimination of these programs. From the point of view of the state's highest-cost school districts, therefore, the Governor's proposals are the worst set of aid cuts imaginable.²

Third, New York does not require school districts to levy a minimum property tax rate. As a result, the districts that receive the most aid, including some cities, have very low property tax rates. These low rates are part of the explanation for the relatively poor student performance in these districts. Syracuse provides one good example. According to some calculations by William Duncombe, Syracuse has regularly responded to state aid increases by cutting the school property tax rate and property taxes now provide a very small share of the Syracuse schools operating budget.

Finally, the burden for financing state aid to education in New

York is not distributed in a fair manner. Far too much aid is given to low-need places, thanks to an aid formula with hold-harmless provisions and poor cost adjustments. Far too much money (\$3 billion!) is spent on the STAR program for homeowners. This program short-changes cities, with their high renter concentrations, and gives property tax relief to all districts regardless of need. Moreover, the STAR exemptions are higher in high-wealth counties. This provision, which makes absolutely no sense, requires the rest of the state to send \$400 million each year to the wealthy suburbs around New York City.

How to Fix Education Finance in New York

This analysis points to a clear agenda for state aid reform in New York. First, the state should set a high standard for an adequate education. The poor performance of students in needy districts is the states most pressing education problem and setting a high adequacy standard is urgently needed to address it. Second, the state should get serious about adjusting its aid for education costs. As noted earlier, William Duncombe and I have estimated that the cost of education per pupil is almost twice as high in New York City as in the average district, so the foundation spending level per pupil and the associated state aid, should be almost twice as high for New York City as well. Perhaps no figure provides a more devastating critique of the current system than the fact that New York City receives less aid per pupil than the average district in the state.

Third, the state should require a minimum contribution from all school districts. Syracuse is, of course, a poor city, but it should not be allowed to cut its own contribution to schools as low as it has. No adequacy standard will be reached without a minimum tax rate requirement, and no agreement on burden sharing will ever be reached if the neediest districts do not participate.

Fourth, the state should improve the fairness of the education finance system not only by setting a minimum tax rate, but also by shifting aid away from the wealthy suburbs and other low-need

districts, by raising additional money with broad-based state taxes (especially the income tax), and by reforming (or even eliminating) the STAR program.

These reforms in education finance are not the whole story, of course. The state should also look into supporting educational programs and administrative techniques that are known to be effective. But that is a discussion for another day.

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ENDNOTES

1. These figures are based on Michael Casserly, *Beating the Odds: A City-by-City Analysis of Student Performance and Achievement Gaps on State Assessments*. (Washington, D.C.: Council of the Great City Schools, June 2002). (Accessed through the internet at <http://www.cgcs.org/pdfs/beatodds2.pdf>) The statements in the text are based on 8th grade tests given in 2001, except for cities in Ohio (9th grade scores); Denver, Detroit, and reading in St. Louis (7th grade scores); and math in Detroit (2000).
2. In releasing his budget proposals, Governor Pataki said “In these fiscal times, we need to focus on the fundamental aspects of our school aid formula—those components that are absolutely critical to the mission of K-12 education.” He focused on the most critical programs all right—by throwing them out! In 2002, Governor Pataki called New York’s education aid formula a “dinosaur” that should be “on the ash heap of history.” I agree with this sentiment but obviously do not agree with his proposed alternative.