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Making Things Worse

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It's Elementary

A Monthly Column by EFAP Director John Yinger
June 2006

Making Things Worse

The two main elements of the education finance system in New York State are state aid to school districts and the local property tax. The State of New York faces a court mandate to reform its state aid programs, which have failed to ensure a “sound, basic education” for all students. Moreover, property taxes are very high by national standards, but the main program used to reduce them, the School Tax Relief Program, STAR, has been shown to encourage wasteful spending by school districts and to magnify the inequities in the State’s education finance system.

So what do the elected officials in New York State do? They hold state aid to education constant in real terms without changing the way it is distributed and spend \$1 billion dollars a year to expand the STAR program. These steps only magnify the problems that the elected officials should be trying to solve.

The revisions to the state education aid do nothing to address the problem identified by New York’s highest court, namely that New York City receive far too little state aid to allow it to deal with the high costs associated with its location in a high-wage areas and its high concentration of disadvantaged students. Many other districts in the state, particularly other large cities, also face high-wages and/or concentrated student disadvantages. The new state aid budget does nothing to help these districts either.

The expansion of STAR takes a new form, namely, the provision of an income tax credit equal to 30 percent of a homeowner’s existing STAR tax break. In most districts, this amount is \$9000 multiplied by the school district’s property tax rate (or the property tax rate devoted to schools in city districts). The tax break is higher, however, in districts located in high-wealth counties. The tax credit is also higher for elderly homeowners with moderate incomes.

This approach to property tax relief uses a new mechanism, namely, an income tax credit, but is otherwise equivalent to the original STAR tax breaks. From a homeowner’s perspective,

therefore, it is equivalent to a 30 percent boost in STAR. Moreover, from an analytical perspective, this program is equivalent to a 30 percent increase in the negative unintended consequences and the extreme unfairness associated with the original STAR program.

As explained in more detail in previous columns, STAR (both the original and the income-tax-credit extension) give voters a powerful incentive to increase school spending—in an inefficient manner—and to increase local tax rates. This incentive arises because STAR lowers the share of any property tax increase local voters must pay, which is equivalent to a cut in the price of school spending. My colleagues and I have estimated that the original STAR induced voters in the typical district to raise the local property tax rate by 20 percent on average, an increase that offset about one-third of the original tax savings to homeowners and significantly increased the property tax burden on business throughout the state. Thus, we can expect local property tax rates to increase by another 6 percent, on average, because of this expansion in STAR (which is the 20 percent impact multiplied by the 30 percent increase in the STAR incentive).

The major source of the unfairness in STAR is the higher tax break given to homeowners in wealthier counties. This provision cannot be justified by any established equity principle and it significantly magnifies the financing inequities that led to the court case against the State's education finance system in the first place.

The sad part about all this is that New York's elected officials did not have to make things worse. As explained in my previous two columns, an income tax credit would be a reasonable way to provide property tax relief, if it were tied to the average school property tax rate in the state, not the school tax rate in the homeowner's school district, and if it did not include any upward adjustment in wealthy counties. In addition, lawmakers could easily make such a credit even fairer by extending it to renters. Finally, educational aid programs that address inequities like those found in New York are well known and widely used around the nation.

The citizens of New York State deserve education finance reforms that make things better instead of making them worse. I urge elected officials to reform the STAR program and its income-tax-credit extension and to implement a simple, fair foundation aid program that would allow all districts in the state, including the poor cities, to provide a sound, basic education.