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It's Elementary

A Monthly Column by EFAP Director John Yinger
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How to Pay for Education Finance Reform

Education finance reform is an expensive proposition. It differs from most large items in a state's budget, however, because it is often mandated on constitutional grounds by a state's highest court. As a result, elected officials sometimes must find a way to fund an expensive reform that does not fit into their standard budget plans. In 1976, for example, the New Jersey Supreme Court briefly shut down the state's schools until elected officials passed an income tax. Earlier this year, under pressure from their state's highest court, elected officials in Kansas passed a substantial increase in their state aid budget. A trial court in New York has required the state to come up with \$5.7 billion more per year to fund the New York City schools, although that decision is now under appeal.

What is the best way to fund education finance reform? Ruling out revenue gimmicks and short-term fixes, elected officials have five main sources of revenue to draw on.

Reallocate the Existing State Aid Budget

The first potential revenue source is the existing state education aid budget. In most cases, the need for education finance reform arises because wealthy districts are receiving too much aid from the state and poor districts are receiving too little. One obvious solution, therefore, is to reallocate the existing aid budget so that more of it goes to poor districts.

The advantages of this approach are that it goes directly to the heart of the problem and does not require any new revenue. The disadvantage, of course, is that it is politically unpopular because it creates a visible class of "losers," namely, the wealthy districts. There is an ironic circularity here; the wealthy districts would not be in danger of losing aid if the education finance system met constitutional standards in the first place.

Impose a Minimum Local Property Tax Rate

Some share of the funding for education finance reform can also be raised by requiring a minimum local property tax rate. Many poor school districts have relatively low property tax rates, both because they must stretch their limited funds over many other public and private functions and because they often receive above-average amounts of state aid. Thus requiring a minimum tax rate above the level currently set by poor districts will increase the revenue available to schools in these districts and help the people for whom education finance reform is designed, namely, the students. Moreover, this approach is already widely used as part of a foundation aid formula (see my December 2004 column).

Some people may object to a plan that raises taxes in the poorest school districts, but in fact, taxpayers in these districts are likely to benefit from education finance reform in the form of increased property values (see my previous column). Moreover, contributions from taxpayers in the poorest school districts may assuage taxpayers in other jurisdictions, who do not want to bear the entire burden of reform themselves.

Recapture Revenue from Wealthy Districts

Several education finance reform proposals attempt to close student performance gaps in a state not only by providing more aid to poor districts but also by “recapturing” funds from wealthy districts to discourage them from spending beyond a certain amount. In Texas and Vermont, for example, wealthy districts cannot raise their spending without also contributing into a fund that is distributed to other districts in the state. This approach has the advantage that it does not require any new state funds, but the disadvantage that, like the previous approach, it creates a visible class of losers. Indeed, this approach is likely to be even more unpopular than redistributing existing state aid. It appears to be accepted in Vermont because many wealthy districts contain vacation property owned by people who do not live in the state and in Texas because only a few very wealthy districts are affected.

Turn the Property Tax into a State Tax

A third approach that combines elements of the previous two is to transform the property tax, or some portion of it, from a local tax into a state tax. This step automatically sets a uniform tax rate for the state, which serves as a minimum required rate. Moreover, it automatically recaptures some funds from wealthy districts because all revenue from the tax is sent to the state for redistribution through state aid,

and no district gets to keep the extra revenue it generates because it has above-average wealth. This approach therefore has analytical advantages similar to those of the previous two, but it has proven to be less unpopular, perhaps because it is seen as a tax-shift, not a tax increase, and because it does not require school districts themselves to raise their own tax rates or to contribute to a state-wide revenue pool. Versions of this approach have appeared, for example, in recent reforms in Kansas, Michigan, New Hampshire, and Vermont.

Increase a Broad-Based State Tax

The final revenue source, and perhaps the most obvious, is to increase the state sales or income tax. Tax increases are never popular, but increases in broad-based taxes have the advantage that they spread the burden of education finance reform over a large share of a state's population. This approach therefore minimizes the impact on any particular group and is widely perceived as fair because the education system clearly benefits the state as a whole. A comparison of the specific equity and efficiency consequences of various changes in broad-based taxes is beyond the scope of this column and obviously depends on the circumstances in a particular state. Nevertheless, it is safe to say that, in most states, some portion of the revenue for education finance reform should come from broad-based taxes.

Regardless of the constitutional and/or policy objectives it is designed to achieve, any school finance reform places a new financial burden on some groups. Reforms that raise the minimum required local property tax rate raise revenue from the poor districts that the plan is presumably most designed to help. A reform plan can also impose a burden on wealthy districts if it includes cuts in their state aid, recapture provisions, or state takeover of the property tax. And, of course, any reform plan that raises state taxes imposes burdens on taxpayers in all school districts. Every state needs to find a way for these three (overlapping) groups to share the burden that is perceived to be fair and that provides enough revenue to meet the state's constitutional obligations.