DOCUMENT RESUME

ED 355 665 EA 024 792

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TITLE	The Financial Equity Debate. Pennsylvania Educational Policy Studies, Number 15.
INSTITUTION	Pittsburgh Univ., Pa. Learning Research and Development Center.; Pittsburgh Univ., Pa. School of Education.
PUB DATE	25 Mar 93
NOTE	15p.
PUB TYPE	Reports - Research/Technical (143) -- Viewpoints (Opinion/Position Papers, Essays, etc.) (120)
EDRS PRICE	MF01/PC01 Plus Postage.
DESCRIPTORS	Elementary Secondary Education; *Finance Reform; Financial Policy; *Financial Support; Property Taxes; School Districts; *School Taxes; *State Aid; *State School District Relationship; State Surveys; *Tax Allocation
IDENTIFIERS	*Pennsylvania

ABSTRACT

Discussion of inequity in funding of Pennsylvania schools has tended to focus on differences between wealthy and poor school districts. In Pennsylvania, 180 school districts have filed a lawsuit challenging the constitutionality of the existing public school funding scheme. A study of the state's 500 school districts, grouped by market value of taxable property and personal income, examined another problem. From 1986 to 1991, poorer districts were forced to increase taxes to support schools while wealthier ones were able to reduce taxes. Since wealthier districts have faster-growing economies, their tax revenues for schools have grown faster than those in poorer districts. Consequently, poorer districts suffered a greater tax strain than wealthier ones. The state attempts to offset differences in district wealth through the Equalized Subsidy for Basic Education (ESBE). A National Conference of State Legislatures (NCSL) report recommends a three-tier approach to Pennsylvania school financing: (1) all districts would receive state funds for basic educational costs; (2) funds would be apportioned in relation to district-aid ratios; (3) and some funds would be raised solely by districts. Disparities in tax burden between districts is expected to worsen unless the state becomes involved in finding a solution. (JPT)

Pennsylvania Educational Policy Studies

PEPS is a joint effort of the University of Pittsburgh's School of Education and the Learning Research & Development Center
This is policy paper number 15 in this series

The Financial Equity Debate

by

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March 25, 1993

The purpose of this series of papers is to contribute to a more informed debate about critical policy issues facing Pennsylvania's public schools. This PEPS series draws upon a data base that has been established here at the University of Pittsburgh under the direction of William Cooley in cooperation with the Pennsylvania Department of Education.

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March 25, 1993

The Financial Equity Debate

William W. Cooley and Debra Pomponio

Executive Summary

Current discussions regarding the need to make the funding of Pennsylvania schools more equitable have tended to focus upon the large differences in expenditures between the wealthiest and poorest school districts. For example, Governor Casey, in his 1993 State of the Commonwealth address, pointed out that expenditures per pupil ranges from $3,400 in the poorest school district to $10,900 in the richest.

In this paper, we examine another aspect of the equity problem. During the past six years, the poorer districts were being forced to increase their local tax effort while the wealthier districts were decreasing theirs. But because the economies in the wealthier districts were expanding at a much faster rate, their local tax yield was increasing at a faster rate than in the poorer districts, in spite of the lower tax effort in the wealthier districts. The varying rates of change in revenues and expenditures that have occurred since 1986 have placed a much greater fiscal strain upon the poorer districts than on the wealthier districts.

Because of the very large differences in taxable wealth among the school districts, the state must participate more strongly in the support of its schools, or the current inequity in funding will only get worse.

Background

The debate regarding the need to reform the way in which schools are financed seems to be heating up, both nationally and in Pennsylvania. Last month, for example, two more states (North Dakota and Missouri) had their methods of funding schools declared unconstitutional. At the federal level, the new Clinton administration has indicated that they intend to define standards for equity in school finance, and use federal impact aid funding as the incentive for states to meet those equity standards.

Meanwhile in Pennsylvania, 180 school districts have now joined the equity law suit filed in Commonwealth Court that challenges the constitutionality of the present system for supporting the public schools. That suit, originally filed by the Pennsylvania Association of Rural and Small Schools on behalf of 127 school districts in January, 1991, is expected to go to trial this spring.

Last May (1992), the chairmen of the House Education Committee (Ronald Cowell) and the House Appropriation Committee (Dwight Evans) announced that their two committees were launching a major initiative to "ensure that students have comparable access to educational programs and resources." They are seeking, through new legislation, ways to increase equity in funding as well as assurances that school districts are financially well-managed.

One result of their initiative was the commissioning of a study that has been conducted by the National Conference of State Legislatures (NCSL). In their report, the NCSL group recommended a three tier approach: (1) all districts would receive from the state those funds needed for the support of a foundation program, reflecting the basic costs of providing an adequate education for all students; (2) a second tier, contributed to by the state in proportion to the district aid ratio, that would deal with cost factors not covered in the first tier; and (3) a third tier, raised solely by the districts.

In his State of the Commonwealth address and subsequent budget message last month, Governor Casey made his own equity proposal, calling for changes that would move the state toward greater equity in school finance. His proposal included the freezing of state support at last year's level of funding, but distributing an additional $100 million to school districts that met certain poverty and tax effort criteria. These various proposals will be the focus of much activity in the General Assembly in the coming months.

Purpose of this Report

In this PEPS report we provide some additional background information that is related to the need for reform in funding schools. We show that the districts with the smaller local tax bases, the ones that have brought suit against the state, are experiencing great fiscal strain.

We do this by examining what has been happening to district revenues and expenditures in the six year period beginning with FY 1986 (school year 1985-1986), and how those changes are related to the relative taxable wealth of the districts.

For the purposes of this paper, the 500 operating school districts have been divided into five groups of 100 each, based upon their relative taxable wealth, as determined by their 1991 aid ratio. A district's aid ratio is a function of the market value (MV) of the taxable property in that district, as well as the reported personal income (PI) of the residents in that district, where both MV and PI are adjusted for size of enrollment. The highest ranked group consists of the 100 districts with the most taxable wealth (i.e. the lowest aid ratio). Table 1 shows the five groups of districts, their aid ratio ranges, and the total number of students

TABLE 1

Aid Ratio Groups for Fiscal Year 1991

Relative Taxable Wealth Ranking	Aid Ratio Ranges	Number of Districts	Number of Students
Highest	.1500 to .3930	100	386,636
2	.3931 to .5562	100	345,757
3	.5563 to .6608	100	492,513
4	.6609 to .7307	100	246,350
Lowest	.7308 to .8482	100	181,524
Totals		**500**	**1,652,780**

enrolled in each of the five district groupings. The 100 districts with the lowest relative taxable wealth tend to include the small, rural districts that are the basis for the equity law suit, but together those 100 districts serve over 10% of the state's public school students (181,524).

Decline In ESBE Support

The way in which the state tries to offset the fact that districts vary greatly in their local taxable wealth is through the Equalized Subsidy for Basic Education (ESBE). This ESBE support is awarded to districts on the basis of their aid ratio and student enrollment, with the wealthy districts (in terms of taxable wealth) having a low aid ratio, and the poor districts having high aid ratios. The poorer the district, the more it relies on state ESBE money to support its schools.

Table 2 displays the average percent of the total local and state

TABLE 2

ESBE as a Percent of State and Local Revenues (For Fiscal Year 1991)

Relative Taxable Wealth Ranking	Average Percent ESBE
Highest	14%
2	27%
3	37%
4	44%
Lowest	51%

revenues that derives from the state ESBE support for each of the five wealth groups. As can be seen in Table 2, in even the 100 poorest districts (those with aid ratios above .7307) the ESBE funding is only about half of all district revenues. Since ESBE is designed to provide more state aid to the districts with the smallest tax bases, that percentage drops off to an average of 14% for the 100 richest districts.

One problem is that since FY 86, the rate of increase in ESBE support has been declining as the state began to have difficulty balancing the total state budget. Table 3 shows the average percent change in ESBE support for this six year period. Thus, for example, the amount of ESBE support between FY 86 and FY 87 increased 7.95 percent for the state as a whole. This percentage increase declined to 2.67 percent for the last year of that six year period. In this paper we examine what happened to district budgets during the same six year period.

TABLE 3

Percent Change in ESBE

For Fiscal Years	Year to Year Percent Increase
1986 to 1987	7.95
1987 to 1988	6.31
1988 to 1989	6.36
1989 to 1990	5.66
1990 to 1991	2.67

It is important to point out that these analyses examine the problem from the perspective of the 500 operating school districts in Pennsylvania. That is, the 500 district budgets are what we are examining, not the one big state budget. The question is, how did districts with differing taxable wealth respond if their ESBE support did not keep up with their increasing costs?

The Revenue Picture

Table 4 shows what happened to revenues for these five groups during this six year period. For example, total revenues increased 54% for the 100 wealthiest districts, but increased only 34% for the poorest districts. The trend in local revenue changes is very consistent with the percent changes in total revenues. This was not so for the changes in ESBE and total state funding. To understand the peculiar changes that

TABLE 4

Percent Change In Revenue
(FY 1986 to 1991)

Relative Taxable Wealth Ranking	Percent Change			
	Total Revenues	Total Local	ESBE	Total State
Highest	54	58	25	44
2	50	53	40	47
3	45	46	40	46
4	39	37	40	42
Lowest	34	34	35	36

occurred in ESBE and total state revenues, we have to turn to what happened to enrollments, since state support is also a function of the number of students that each district serves.

Enrollment Change

Table 5 shows how enrollment has changed for the five tax base groups. For example, the 100 wealthiest districts had a 3.1 percent increase in enrollment whereas the 100 poorest districts experienced a 5.9% decline in enrollment. Thus the overall trend was for the wealthier districts to be experiencing enrollment increases while the poorer districts tended to have enrollment decreases. These differential enrollment changes are off-setting the states efforts to provide more support to the poor districts, since state support is keyed to enrollment as well as aid ratio.

TABLE 5

Average Percent Change in Enrollment (FY 1986 to 1991)

Relative Taxable Wealth Ranking	Percent Enrollment Change
Highest	3.1%
2	1.5%
3	-1.9%
4	-3.7%
Lowest	-5.9%

In the field of educational finance there is the important concept of fiscal strain, which in part has to do with the fact that enrollment decline has a rapid effect upon district revenues, but has a slow effect upon district costs. For example, if a district with 3000 students (about average for the state) experiences a 6% drop in enrollment, those 180 students tend to have been spread out over the 150 classrooms in that district. So a district cannot eliminate 10 classroom teachers simply because it has 180 fewer students to serve. Understanding this phenomena of fiscal strain is important in coming to an appreciation of the plight of the tax-poor school districts.

The Change in Tax Effort

Another aspect of fiscal strain is the fact that the tax base for the poor districts tended to increase at a much slower rate than in the rich districts, so that the tax effort of the poor districts has been increasing, while it has been decreasing in the rich districts. Table 6 shows what has been happening to tax effort in these five district groups. One measure of tax effort is the ratio of a district's total local tax revenues to the total market value (MV) of its taxable property. That ratio of revenues to property wealth is then multiplied by 1000 so that tax effort is a comparable (equalized) millage rate. Comparing tax effort for 1986 with 1991, the wealthy districts actually decreased their effort by 12% while the poor districts increased their tax effort 7%.

TABLE 6

Average Percent Change in Tax Effort and Tax Base (FY 1986 to 1991)

Relative Taxable Wealth Ranking	Percent Change			
	Tax Effort (MV)	Tax Effort (MV & PI)	Market Value (MV)	Personal Income (PI)
Highest	-12	-4.1	82	39
2	-6	- .4	64	38
3	-2	1.5	51	36
4	3	4.2	33	29
Lowest	7	8.0	26	22

There is a problem in focusing exclusively on market values when considering a district's tax effort. People pay their taxes with income, not with the family farm. Table 6 also reports another measure of tax effort that we are studying, one based upon a combination of market value and personal income (PI). This tax effort measure is the ratio of total local tax revenues to the total of market value and personal income. That effort shows a trend similar to the tax effort based upon MV, but here the wealthier districts decreased only 4.1% while the poorer districts increased 8%. MV tends to be about double the amount of PI for the average district. Because tax effort is an important aspect of this equity debate, we plan to conduct additional studies of alternative measures of tax effort.

These differences in tax effort do not mean that the wealthy districts decreased their local revenues. As we saw in Table 4, their local revenues increased 58% while the poor districts generated only a 34% increase in local revenues. The difference in tax effort is primarily due to the differences in the rate of increase in the tax base. For market values, this increase was 82% for the rich and 26% for the poor districts, as is also shown in Table 6. Meanwhile, personal incomes increased an average 39% for the highest wealth districts, and only 22% for the poorest districts.

An increasing tax base results in a smaller local tax effort for a given tax rate. Tax effort is a very important aspect of the school funding controversy since it is a measure of taxpayer equity. Variations in expenditures per pupil is an indicator of inequity from the student's perspective, and variations in tax effort indicate inequity from the tax payer's perspective.

The Expenditure Side of the Ledger

Table 7 shows how districts vary in their changes in expenditures. As would be expected, the percent changes in total expenditures for these five groups are roughly equivalent to their percent changes in total revenues. But there are some important differences within expenditure categories. The big difference is the percent change in benefits. As can be seen in Table 7, the rate of change for benefits is about double what

TABLE 7

Percent Change In Expenditures
(FY 1986 to 1991)

Relative Taxable Wealth Ranking	Percent Change				
	Total Expend.	Regular Program Salaries	Regular Program Benefits	Operat. & Maint.	Transp.
Highest	56	53	99	35	50
2	51	49	91	26	42
3	47	44	83	29	36
4	41	38	79	19	31
Lowest	36	35	73	18	24

it is for salaries. This is partially due to a change in accounting procedures, but the large percent increase for benefits is also due to the explosive growth in health care benefits that has been so much in the news these days. So while the poor districts were able to keep their salaries in line with their smaller revenue growth, they were unable to do so regarding benefits. Other expenditure categories such as operations, maintenance, and transportation seem to have increased at a slower rate to offset these large increases in benefits.

Future PEPS Reports

As the debates regarding educational reform in Pennsylvania continue, we plan to produce additional papers or newsletters that we hope will be useful as Pennsylvanians try to deal with these complex reform issues. Please let us know what types of information you feel would be helpful in these debates. Send your comments and suggestions to:

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