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ABSTRACT

This paper examines the federal and state constitutional and statutory issues that affect the capacity of governments to raise revenue for education and other children's services, including mandates and key legislation that limit revenues, expenditures, and borrowing. The paper is divided into three major sections: (1) legal issues affecting revenues raised by state and local governments; (2) legal issues affecting expenditures for education and related services; and (3) a summary and suggestions for policymakers. A conclusion is that there are legal limitations affecting the scope of finance reform. However, the limitations can be avoided, or at least mitigated, by careful drafting of state laws and regulations. Policymakers should consider the following building blocks for a reform package: (1) update and amend education clauses in state constitutions to reflect policymakers' educational goals; (2) design comprehensive reform that is not limited to education finance; (3) interrelate education and related social-support services; and (4) take advantage of the opportunities provided by recent federal court decisions and congressional block grants to design reforms. Information on the Finance Project and available resources is included. (LMI)

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LEGAL ISSUES AND CONSTRAINTS AFFECTING FINANCE REFORM FOR EDUCATION AND RELATED SERVICES

November 1995

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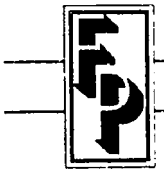

THE FINANCE PROJECT

ABOUT THE AUTHOR

This paper was written by Tom Triplett, Special Counsel to the Minneapolis-based law firm of Faegre and Benson, Professional Limited Liability Partnership. Triplett is a former commissioner of three major Minnesota state departments--Revenue, Finance, and Planning--and a member of The Finance Project's Working Group on Strategies for Generating Revenue for Education and Other Children's Services. Assisting with the preparation of this paper were Natalie Hanlon-Leh of Faegre and Benson's Denver office, and Kent Richey and Rich Erstad of the firm's Minneapolis office.

PREFACE

State and community leaders are under increasing pressure to improve their education, health and welfare systems. If Congress has its way, they will also play a larger role in designing, operating and paying for education and other supports and services for children and their families. The success of any efforts to reform these systems will be determined, in part, by the extent to which they are tied to sound revenue sources.

Most states are in the best financial shape they have been in for years.[1] Revenues and expenditures were higher than originally budgeted in most states during 1993 and 1994, and strong revenue growth has allowed some states to build reserves to their highest levels since 1980. Yet changing demographic and economic conditions, as well as a changing policy landscape, suggest that many states will face significant fiscal and budgetary challenges during the remainder of the decade and beyond. Expected reductions in federal funding will also create considerable pressures for state and local governments to change the way in which they fund education, health and welfare systems.

As policymakers consider whether and how to fill the expected revenue gap, they will need to be aware of the fiscal, legal and political challenges they can expect to face. Governors, legislators and other policymakers will need strategies to prevent the potential erosion of state tax bases due to a variety of economic and demographic changes including shifts in the composition of personal income and movements towards a more service-based economy. They can also be expected to craft legal provisions for dealing with new financing strategies, both those sparked by changes in state revenue bases and those initiated by the changes in the federal-state relationship. And state and local decisionmakers will need to consider not only the legally possible and economically desirable directions for revenue reform but also what is politically feasible in the current environment.

Against this backdrop, The Finance Project's Working Group on Strategies for Generating Revenue for Education and Other Children's Services has prepared a series of studies of systemic revenue generation issues for education and other children's services. It includes:

- *Issues and Challenges in State and Local Finance* -- an outline of the major challenges to raising state and local funds for education and other children's services, suggesting principles that should guide attempts to address these problems.
- *The Effects of Economic and Demographic Changes on State and Local Budgets* -- an analysis of the long-term economic and demographic trends that affect revenue generation, it highlights current and anticipated changes to the economic base and the implications of these changes for the overall mix of state government revenue sources, as well as the most promising sectors and activities for tax revenue growth.

[1] National Conference of State Legislatures and National Association of Legislative Fiscal Officers, State Budget and Tax Actions 1995: Preliminary Report. Denver, CO: National Conference of State Legislatures, July 1995.

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- *Legal Issues and Constraints Affecting Finance Reform for Education and Related Services* -- an examination of the federal and state constitutional and statutory issues that affect the capacity of governments to raise revenue for education and other children's services, including mandates and key legislation which limit revenues, expenditures, and borrowing.
- *Toward State Tax Reform: Lessons from State Tax Studies* -- a review and analysis of recent state tax commission recommendations in selected states which identifies critical factors to the success of state tax reform commissions, focusing on factors linked to the process of forming a commission and generating the necessary consensus to enact tough reforms.

Taken together these studies paint a vivid picture of the current fiscal context as well as the emerging fiscal and budgetary challenges that states and localities will face over the coming several years. They clarify a number of the critical policy and political issues that will confront governors, state legislatures, educators and others who run programs to serve children and their families. And they highlight a variety of options for reform that policymakers may pursue to improve public revenue generation for education and other children's services.

These papers are part of a larger series of working papers on salient issues related to financing for education and other children's services produced by The Finance Project. Some are developed by project staff; others are the products of efforts by outside researchers and analysts. Many are works in progress that will be revised and updated as new information becomes available. They reflect the views and interpretations of their authors. By making them available to a wider audience, the intent is to stimulate new thinking and induce a variety of public jurisdictions, private organizations, and individuals to examine the ideas and findings presented and use them to advance their own efforts to improve public financing strategies.

The Finance Project was established by a consortium of national foundations to improve the effectiveness, efficiency, and equity of public financing for education and an array of other community supports and services for children and their families. Over a three-year period that began in January 1994, the project is conducting an ambitious agenda of policy research and development activities, as well as policy-maker forums and public education. The aim is to increase knowledge and strengthen the capability of governments at all levels to implement strategies for generating and investing public resources that more closely match public priorities and more effectively support improved education and community systems.

Cheryl D. Hayes
Executive Director

INTRODUCTION

> *How do federal and state constitutions, laws, and court decisions affect the ability of states to reform the ways they finance education and other children's services? What are the effects of these constraints on revenues and expenditures? How do they provide incentives for reform as well as impose barriers? What will be their likely impacts on reform models?*

Education *should* not be driven by dollars. In an ideal world, the legitimate needs of educators and their human services partners would be fully funded. Policymakers would understand that well-educated and nurtured children are the nation's most important spending priority.

But this is not an ideal world. Government budgets at all levels are flattening, if not declining. Congress is making significant reductions in spending for education and related services. The world as we have known it in education finance is no more.

Rationale for this Paper

Many factors will influence policy reforms in a given state: the state's political culture and history, the amount of resources available, and the extent of desired education/human services partnering, to name a few. In addition, each state's ability to reform will be limited by legal constraints. Policymakers must understand the nature and impact of these constraints, and that is the rationale for this paper. The goal is to help policymakers achieve their reform goals in ways that are consistent with their states' constitutions and laws.

The target audience for this paper is education, human services, and tax policymakers who know that reforms are needed, but are not yet sure what to do. Reference will be made to some current state laws and programs as examples, but this paper is not intended as a guidebook for reform.[1] Nor is the paper a legal brief. Instead, its authors hope that the legal issues are discussed in such a way that non-lawyers can understand these constraints and are able to develop strategies to achieve their reform goals.[2]

This paper is divided into three major sections: (1) legal issues affecting *revenues* raised by state and local governments; (2) legal issues affecting *expenditures* for education and related services; and (3) a closing section that summarizes the report and suggests some lessons for policymakers. The major sections are further divided to discuss issues arising from federal law (the United States Constitution, acts of Congress, and federal agency regulations) and state law (constitutions and statutes). The first section focuses on revenues.

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[1] A number of recent reports summarize effective programs and financing systems. *See, e.g.*, I. Cutler, A. Tan, and L. Downs, "State Investments in Education and other Children's Services: Case Studies of Financing Innovations," The Finance Project, September, 1995.

[2] Indeed, it is imperative to note that each state's constitution and laws will have a different impact on the issues to be discussed in this paper. The generalized conclusions in this paper need to be applied specifically to each state's legal context.

REVENUES

What federal and state restrictions limit the ability of state and local governments to raise or dedicate revenues for education and related services?

Federal Revenue Limitations

State and local governments are *not* free to use *any* revenues to finance *any* activities in education and related services. Under our nation's system of governance, duly enacted federal law supersedes state and local law when there is a conflict between the two. This part of the paper outlines the limitations on state and local revenue-raising that arise from the federal Constitution and acts of Congress.

Generally, states have broader discretion on the revenue side of the fiscal equation than they do on the expenditure side. There are some, but not many, federal limitations on the ability of states to raise revenues for education and related social services. The following are five areas of federal limitation on state revenue reforms.

Equal Protection

The Fourteenth Amendment to the United States Constitution requires governments to treat all citizens equally in the application of their laws. Over the years, many states have attempted to give their own citizens or businesses preferential tax treatment. Sometimes this strategy is called "exporting" taxes -- i.e., having out-of-state taxpayers pay for in-state services. Income and sales taxes applied equally to earnings and sales within a state -- even if made by non-state residents -- are permitted, but differential taxes which give a preference to in-state residents or businesses are not.[3]

Due Process

The Fourteenth Amendment also requires the exercise of due process in the application of laws which take property or rights away from citizens. In the revenue context, this clause has been interpreted to mean, for example, that when a tax will affect individuals differently, the individuals have a right to present their cases prior to the tax being implemented.[4] If the tax will affect people *en masse*, however, the courts have consistently held that the legislative determination provides all the process that is due.[5]

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[3] *See, e.g.*, Zobel v. Alaska, 457 U.S. 55 (1982); Hooper v. Bernalillo County Assessor, 472 U.S. 612 (1985); Metropolitan Life Inc. Co. v. Ward, 470 U.S. 869 (1985).

[4] Londoner v. Denver, 210 U.S. 373 (1908).

[5] Bi-Metallic Investment Co. v. State Bd. of Equalization of Colorado, 239 U.S. 441 (1915).

Disruption of Interstate or International Commerce

State laws cannot disrupt the traditional federal prerogative of regulation of interstate and international commerce.[6] There are scores of judicial decisions on this point, and the decisions have invariably upheld the federal interest in any attempt at state intrusion.[7]

One of the most hotly debated federal-state issues involving the commerce clause is the taxation of mail-order sales. The landmark 1967 case of *National Bellas Hess v. Illinois*[8] forbade the state of Illinois from forcing a Missouri mail-order house to collect the Illinois sales tax on products delivered to Illinois purchasers via the U.S. mails. The National Bellas Hess company had no employees or facilities in Illinois, and it argued that state-by-state taxation would impose burdens on it which were inconsistent with the intent of the commerce clause. The state of Illinois, supported by its in-state retailers, countered that the company had adequate "nexus" with the state through its catalog mailings to Illinois residents to permit the state to force the company to collect the tax. The Court sided with the company and thereby established the proposition that tangible, direct intrusion into a state is necessary before a state can force a vendor to collect the sales tax. Thus, the Court concluded that the only two recourses for the state are (1) an act of Congress permitting them to collect such taxes, or (2) collecting a "use tax" from each of the buyers of products from companies such as Bellas Hess (which would be very difficult to enforce). Various state tax associations have sought help from Congress on this and related issues, but so far without much success.

Recently, however, the U.S. Supreme Court has shown signs that it is prepared to reduce the impact of the commerce clause. For example, in the summer of 1995, the Supreme Court rejected the argument of Congress that the commerce clause permitted it to restrict the possession of handguns within the vicinity of public schools.[9] While this case does not involve a revenue issue, it nonetheless implies a future more strict interpretation of the clause by the Supreme Court.

Federal Supremacy Clause

In those areas where the federal government is accorded specific power to act by virtue of the federal Constitution, state laws which are inconsistent with federal actions have been overturned. Examples of state revenue laws which were overturned because of the supremacy clause include a state tax on federal bank notes;[10] a city tax on stock issued by the federal government;[11] and a state tax on goods manufactured in Mexico, shipped to the United States and held under bond in a customs warehouse awaiting shipment abroad.[12] While state taxation was not prohibited in this latter instance, it was pre-empted because it would discourage the acts which the federal law was meant to encourage.

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[6] United States Constitution. Article I, Section 9.
[7] *See, e.g.*, Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).
[8] 386 U.S. 753 (1967).
[9] U.S. v. Lopez, 115 S. Ct. 1624 (1995).
[10] McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).
[11] Weston v. Charleston, 27 U.S. (2 Pet.) 448 (1829).
[12] Xerox Corp. v. County of Harris, 459 U.S. 145 (1982).

Again, the U.S. Supreme Court has recently appeared to recede from this position by restoring prominence to the other side of the federal supremacy issue. The Court has begun to revitalize, if only implicitly, the Tenth Amendment to the Constitution, which says that all powers not expressly delegated to the federal government are reserved to the states. There are no recent state *revenue* decisions based upon the Tenth Amendment, but several federal district courts have bestowed new prominence to the Tenth Amendment in other situations.

Debt Financing

Federal law also impacts the use of debt financing by state and local governments. Debt financing for public projects has slowed in this country after the 1986 Tax Reform Act and related legislation. Because of the income tax exemption for interest earned on public debt, Congress has become increasingly concerned about lost tax revenues. That fact, coupled with occasional abuses of public debt financing (usually in non-education contexts), has prompted federal strictures on the availability of tax-exempt financing.

Although such limitations have been applied primarily to private business activities such as economic development financing, this growing congressional concern should be of interest to persons concerned with education finance reform. Thus far, there is no indication of intense congressional interest in limiting tax-exempt financing for education and related services. Such interest could grow, however, as a result of increasingly tight federal finances. Both Congress and state legislatures are giving all elements of public debt financing greater scrutiny in light of the Orange County, California bankruptcy fiasco.[13]

Federal Revenue Limitations: Summary and Lessons for Policymakers

There are relatively few federal limitations on state revenue-raising. Some state revenue laws have been overthrown, not so much on the basis of conflict with federal revenue-raising statutes, but more often because they violate the equal protection, the due process, or the interstate commerce clauses of the United States Constitution.

Carefully worded state revenue laws are generally safe from federal judicial attack, so long as there is no overt and conspicuous violation of a federal constitutional provision or an act of Congress in which the federal government has clear authority to act.

Very recent court decisions imply even more state flexibility in reforms. However, it is still risky for states to venture too far afield from accepted law. Thus, state policymakers should not attempt to impose sales tax collection obligations on a company which does not have state "nexus." On the other hand, state policymakers may want to lobby Congress for clarification on nexus and related questions.

An additional reason to seek clarification from Congress is the growing state interest in new fields of taxation. For example, tax policymakers are eyeing two interstate activities for possible state taxation: transmission of information by telecommunications, and environmental pollution. Depending on how these and similar provisions are drafted, they could easily run afoul of federal constitutional and statutory limitations.

[13] Note also the *state* constitutional limitations on debt finance as described below.

State Revenue Limitations

While there are relatively few federal limitations on the ability of state legislatures and local governments to raise revenues, there are many more *state* constitutional limits. The following are the most common of these.

Availability of Revenues

It is not possible to generalize on the impact of state constitutional limitations, because the 50 state constitutions vary widely in their impacts on revenues. Some states expressly prohibit certain kinds of revenues. For instance, while all state constitutions permit property taxes, seven do not permit income taxes, and six do not allow sales taxes.[14]

Occasionally, revenue sources which are permitted by a state are limited in various ways. For example, 15 states permit the use of property classification systems which allow property being used for different purposes to be taxed at different rates, while the rest of the states require uniform rates.[15] Only four states have no limits on the ability of local government to raise and expend revenues.[16]

Over the past two decades, states have begun to add revenue limitations to their constitutions which limit the amount of revenue that can be raised or expended. Sometimes these limits apply only to certain taxes; other times they apply to all revenues. The limits have tended to appear most often in states which permit their constitutions to be amended by petition of voters ("initiative and referendum" states).

Some states have chosen not to limit revenues directly, but to increase taxpayer information about what their state and local governments are doing. The 1994 Minnesota legislature, for example, enacted "price of government" legislation which requires the legislature to adopt a joint resolution every two years specifying the percent of personal income in the state that will go to state and local governments. The legislature can exceed this revenue limit in later enactments, but it will do so at some political peril.

Another information device is so-called "truth in taxation" legislation which requires local governments to annually advise citizens of their proposed rates of taxation and to hold public hearings on those proposals. Again, those governments subject to such laws can legally choose to ignore citizen complaints, but the political consequences could be severe. Exhibit 1 summarizes the nature and frequency of these limits.

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[14] Fisher, State and Local Public Finance (Scott Foresman, 1988) at pp. 193, 165.

[15] *Id.* at 142.

[16] D. Mullins and K. Cox, "Tax and Expenditure Limits on Local Governments." (Advisory Commission on Intergovernmental Relations and Center for Urban Policy and the Environment at Indiana University, March 1995) at pp. 5-10 (hereinafter "ACIR Report," 1994), p. 5[illegible].

EXHIBIT 1: Types Of Limits

Property Tax Rate Limits (34 states)

- Set a ceiling that cannot be exceeded without a popular vote.
- Apply to the aggregate tax rate of all local governments or only specific types (e.g., school districts or counties)
- Are potentially binding if coupled with a limit on assessment increases; otherwise, can be circumvented by altering assessment practices or through interfund transfers for specific services.

Property Tax Levy Limits (27 states)

- Constrain total revenue that can be raised from the property tax, independent of the rate.
- Are often enacted as an allowable annual percentage increase in the levy.
- Are potentially binding because of the fixed nature of the revenue ceiling, but can be limited through diversification of revenue sources.

General Revenue or General Expenditure Increase Limits (9 states)

- Cap total revenue that can be collected and attempt to constrain spending.
- Are often indexed to the rate of inflation.
- Are potentially binding because of the fixed nature of the revenue or expenditure ceiling.

Assessment Increase Limits (7 states)

- Control ability of local government to raise revenue by reassessment of property or through natural or administrative escalation of property values.
- Are potentially binding if coupled with an overall or specific property tax rate limit; otherwise are easily avoided through an increase in property tax rates.

Full Disclosure/Truth-in-Taxation (22 states)

- Requires public discussion and specific legislative vote before enactment of tax rate or levy increases.
- Is non-binding because a formal vote (generally a simple majority) of the local legislative body can increase the tax rate or levy.[17]

[17] ACIR Report (with modifications), *supra* at p. 2.

Dedication of Revenues

Another form of state limitation is the dedication of revenues -- or "earmarking" -- for specific purposes. For example, many state constitutions specify that revenues from fuel taxes be dedicated to transportation-related activities.

In recent years, state legislatures have begun to dedicate revenues from new taxes or tax-base expansions. With the explosion of lotteries and other state-sanctioned gaming, some legislatures have justified these new taxes by dedicating revenues to politically popular activities such as education. Occasionally, expansions of existing tax bases -- such as the sales tax on services -- have been similarly dedicated.

Limitations Based on Constitutional Rights

Generally, most state constitutions contain protections of individual rights which are very comparable to the federal *Bill of Rights*. State constitutions routinely require the equal application of laws to all citizens and the application of standards of due process. In many state constitutions, in fact, these individual rights are stated at the outset of the constitution, and in language stronger than that of their federal counterparts.

One example may help to show how state constitutional provisions affect financing reforms. A common feature of many reform proposals is the redistribution of property tax revenues from high-wealth to low-wealth areas. On the one hand, such "tax-base sharing" promotes equity as implied in a state's equal protection clause. On the other, it arguably takes "property" from some without due process. How this conflict will be resolved is dependent on each state's constitutional language and judicial history.

Debt Financing

While state constitutions are frequently vague about many topics, they tend to be extremely precise with regard to use of state and local debt financing. This precision grows from widespread abuses of debt financing by states in the latter half of the 19th century.

Generally, the use of long-term debt financing for education and related services is limited to capital expenditures. The construction of school buildings and the acquisition of equipment are common examples of permitted uses for long-term debt financing. Typically, the use of such financing requires local voter approval, but some states have granted authority to local school boards to incur long-term indebtedness without such approval. The theory behind local approval requirements is the recognition that bonded indebtedness will burden future taxpayers, and voter ratification presumably provides a more permanent base of taxpayer support.

In this anti-tax era, it is often difficult to pass voter referenda for new taxes. A popular device to avoid this requirement is the use of "lease-purchase" plans, whereby a governmental unit will technically lease a new building (and thereby avoid having to have voter approval), with the lease providing for a later conveyance of the property to the governmental unit. Conservative legislatures have begun to limit such devices.

As access to debt financing becomes more limited, education may stand to *benefit* in at least one way. The financing tool called "tax increment" financing is being trimmed back by states. Under this technique, a local government unit -- usually a city, but occasionally a county or local economic development authority -- conveys land to a private developer of an economic development project. The conveyance is financed by the sale of municipal bonds which are paid back by the developer in tax payments equal to the tax "increment" generated by the development of the property. While the tax increment is diverted to bond payments, other local government units such as school districts miss out on the opportunity to tax this increment. As federal and state governments tighten down on tax increment financing, schools will tend to benefit as less development revenue is diverted into tax-increment districts.

Many state constitutions permit short-term debt financing for non-capital projects. A tool that is frequently used is "tax anticipation" notes which are sold for temporary cash-flow purposes and are repaid when state aids or property tax revenues accrue. Because such notes are short-term and limited in accessibility, they should not be seen as significant additions to reformers' revenue toolkits.

Other Non-Tax Revenues

State legislatures and school districts are forever looking for non-tax sources of revenues. Such revenues have been growing as a percentage of total education and related expenditures, and they generally derive from student fees or school "surcharges" dedicated to specific activities such as athletics. The courts have upheld the use of fees, especially if accommodation is made for lower-income students. However, legislatures have typically prohibited the charging of tuition in the belief that charging money for basic instructional service is contrary to the spirit if not the precise language of state constitutional provisions.[18]

Somewhat related to the fee issue is the growing use of private donations to help subsidize education and related services. While public schools are not permitted to levy tuition, there usually are no state limitations on the acceptance of donations. There are at least two legal questions involved:

- whether such contributions come with "strings attached" which might be contrary to other law, and
- whether the contribution levels, assuming they will vary from school district to school district, create such inequities in spending that they invoke equal protection issues (as discussed in the section on federal Constitutional limitations on expenditures below).

Conflict with Other Revenues

Another state limitation on revenue raising for education results from the interplay between revenue sources. Because elementary and secondary education comprise such a big part of

[18] For a discussion of issues surrounding the charging of fees, *see* Education Week, October 15, 1995, at p. 5.

total state and local spending in every state,[19] it is impossible to overhaul education financing without forcing major changes in other revenue sources. For example, many states have already reduced or are considering reducing their reliance on property taxes for education funding.[20] Although such moves may make good policy sense,[21] they inevitably force adjustments -- usually increases -- in other broad-based taxes such as the income or sales taxes. This barrier to revenue-raising is more political than legal, but it is probably the most important of the limitations discussed in this section.[22]

State Revenue Limitations: Summary and Lessons for Policymakers

The limitations discussed above constrain the ability of state legislatures to alter their revenue bases for funding education and related services. These limitations derive from constitutional provisions which prohibit reliance on certain taxes, dedicate certain revenues for specific purposes, and constrain access to sources such as debt financing. A significant *statutory* limitation is the impact that revenue reform will have on other revenue laws. The extent of these limitations will vary from state to state, but they exist in some form in every state.

The fundamental lesson for policymakers is that reforming revenue generation for education and related services is extremely complex, and constrained by a number of legal and related factors. State reformers must be sensitive to several important state constitutional limitations, including those that limit or dedicate certain types of taxes or other revenues.

Probably the most difficult hurdle for reformers is the inextricable link between education finance and all other major revenue systems. Because of the huge size of education budgets, any meaningful revenue reforms will have major impact on other politically sensitive taxes.

Education funding reform therefore should -- perhaps *must* -- be done as a part of overall fiscal reform. This broader vision is particularly necessary in respect to the property tax and other local government aids.

There is also a lesson for federal policymakers. As the federal budget situation continues to tighten, Congress may begin to eye revenue sources such as the sales tax that have been traditionally the province of the states. Alternatively, Congress may consider removing the federal deductibility of state income or property taxes (as Congress did in 1986 with respect to state sales taxes). The more the federal government usurps or impairs "state taxes," the more difficult it will be to achieve the funding reforms necessary for the improvement of education and related services.

[19] Almost 28 percent of total state and local expenditures -- which is nearly twice as much as the next highest category (public welfare). Raimondo, Economics of State and Local Government (Praeger, 1992) at p. 68.

[20] A recent well-publicized example of this is Michigan's dramatic shift from property-tax financing of its schools. Michigan voters, in an interesting electoral option, chose to replace the lost education revenues by increasing the sales tax rate from 2.5 percent to 4.5 percent.

[21] What is the conceptual or policy tie between education and services to property in the first place?

[22] Policymakers may broaden political support for their reforms by including other tax reforms in the same package (e.g., making the income tax more progressive or lowering the property tax burden on business).

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EXPENDITURES

What constitutional and statutory provisions restrict the ability of state and local governments including school districts, to spend resources on education and related services?

The previous section of this paper has focused on legal barriers affecting revenue-raising by states and school districts. This section will focus on legal barriers to expenditures.

As a general rule, the federal Constitution, laws, and court decisions impose more limits on expenditures by states than they do on revenue-raising by states. However, as noted in the prior section, the most recent U.S. Supreme Court decisions and new congressional interest in block grants suggest that the federal constraints may be lessening.

Because of the greater complexity of the expenditure side of the finance equation, this section is divided into four major parts: (1) federal constitutional limitations, (2) federal statutory limitations, (3) state constitutional limitations, and (4) state statutory limitations. In working through this discussion, it is important to keep in mind that the same factors may be influential in more than one of these four categories. For example, the federal and all state constitutions contain "equal protection" clauses which can create separate, and not necessarily identical, grounds for judicial intervention.

Federal Constitutional Limitations

Equal Protection

The equal protection clause of the Fourteenth Amendment to the United States Constitution has been the principal basis for federal court intervention in state education funding activities. Even though there is no "fundamental right" to an education under the federal Constitution,[23] there is a long line of federal court decisions imposing limitations on federal and state expenditures based upon the equal protection clause. Generally, these cases control spending whenever a "suspect class" or "fundamental right" is involved.

The most famous of these cases is, of course, the landmark 1954 decision of *Brown v. Board of Education*.[24] In *Brown* and its progeny cases, the U.S. Supreme Court decided that separate schools can never be equal schools. In today's terms, distinctions based on race were held to involve "suspect classes" and are therefore subject to "strict scrutiny" by the courts.

Other distinctions between persons who are not members of "suspect classes" are subject to a less strict review standard. In these cases, a legislative body must demonstrate only that there is a "rational basis" for distinguishing between categories of individuals. For example, wealth is not a "suspect class" for purposes of constitutional analysis.[25] Thus, courts have upheld at least moderate distinctions in education expenditures from community to

[23] San Antonio Indep. School Dist. v. Rodriguez, 411 U.S. 1, 35 (1973).
[24] 347 U.S. 483 (1954).
[25] *See, e.g.* James v. Valtierra, 402 U.S. 137 (1971), and San Antonio Indep. School Dist., *supra*.

community on the basis that local voters in one community should be able, as part of their basic fundamental governmental rights, to choose to spend more money for their education than do persons in an adjoining district.

Where, however, the adjoining districts are substantially different in racial composition, then the court may elect to apply the "strict scrutiny" standard that will force a legislative body to demonstrate a "compelling interest" in order to justify the distinction. Even if this higher standard is invoked, however, the court's ability to fashion a remedy is limited.

Perhaps the most important case in this regard is the 1995 U.S. Supreme Court decision of *Missouri v. Jenkins*.[26] This case involves the Kansas City, Missouri, school district's rapid demographic transformation in the 1970s and 1980s to a district populated by a large majority of poor children of color. By the early 1990s, the district was more than 70 percent African-American, most of their families lived in or near poverty, and the local district was unable to generate the revenues it believed it needed to meet the education and related services needs of the students. Representatives of these students and the local school board eventually sued in federal court seeking court-ordered increases in revenues and other relief.

The presiding federal district court judge concluded that the disparities between the Kansas City district and the adjoining districts were not the result of law -- or *de jure* -- actions by the suburban districts. The court thereby acknowledged that the suburban districts were not predominantly white and wealthy <u>because</u> minorities and the poor were excluded as a matter of purposeful local law or policy. Rather, minorities and the poor did not live in the suburbs because they chose not to or could not afford to.

As a consequence of these findings, the judge could not order a cross-district solution such as forced busing of students to and from the Kansas City district. Instead, he ordered a substantial infusion of state tax dollars into the district. His goal was to create top-flight inner-city schools that would ultimately attract suburban students, create a progressive learning environment, and ultimately increase integration and equalize resources expended.

After several years of diverting more than $1 billion of Missouri taxpayer dollars into the Kansas City district, the state had had enough. It filed suit seeking to overturn the district judge's order. The Court of Appeals generally supported the trial judge, but the U.S. Supreme Court reversed in the summer of 1995. The Supreme Court majority opinion, written by Chief Justice Rehnquist, concluded that the district judge was attempting to fashion a court remedy of inter-district scale, even though the judge had concluded that the suburbs had not perpetrated *de jure* segregation.

Community or Neighborhood Schools

The *Jenkins* case has helped to prompt a re-thinking of the entire issue of busing students to achieve racial integration. There are several policy bases for this re-thinking, including the argument that the further away a child is bused from his or her home, the less likely the parents will be to participate in their child's education. Without such participation, so the

[26] 115 S. Ct. 2083 (1995).

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argument goes, students will not have the necessary home nurturing and support so necessary for education achievement.

Detractors of this view cite *Brown* and its statement "that separate schools can never be equal schools." They argue that it is absolutely imperative to mix the races in order to provide racial minorities with the cultural diversity and support services they need to become successful in adult life. They point to a number of sociological studies which buttress this view.[27]

Proponents counter that even the most racially balanced school is likely to be segregated in the classroom and in social activities.[28] Proponents also argue that it will be much easier to provide concentrated education-related support services in these "neighborhood" or "community" schools.[29]

A variety of recent public opinion polls have shown strong and growing support for the concept of neighborhood schools, even within minority communities and even though it is understood that such community schools will invariably have a higher percentage of racial minorities than do the currently "integrated" schools.

Given the U.S. Supreme Court's decision in *Jenkins*, it is likely that federal court challenges to community schools will not succeed, at least without a showing of significantly reduced spending or resources at such schools. This is especially true when it can be shown that community members of color support this approach and that there is no appreciable difference in student achievement.[30]

Focus on Outcomes

The question of inequitable treatment has become more clouded in recent years by the increasing focus on student achievement–as opposed to expenditures per student–as the method for evaluating education's success. This emphasis on achievement reflects a movement away from education "inputs" as the evaluative model and toward education "outputs." Under the latter approach, the ultimate test is how well students learn and achieve, and not how much money is spent. The bottom line, in other words, is more likely to be reflected in student test scores rather than district financial audit reports.

Although education theorists are moving to this "outcomes" model, the courts are not yet there. This issue was another matter considered in the *Jenkins* case. The district court judge had based his decision in part on the argument that because minorities' achievement scores were so much lower than those of whites, additional state money was justified. The

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[27] For a comprehensive listing of dozens of such studies on this and related issues, see the Brief of Amici Curiae James D. Anderson et al., in Support of Respondents in Missouri v. Jenkins, *supra*, at Appendix A.

[28] This issue has been and will continue to be the subject of much media attention. *See, e.g.*, Education Week (September 27, 1995 at p. 1) and the New York Times (September 26, 1995, at p. 1).

[29] Note the extended discussion on this matter in the section on federal statutory limitations on expenditures below.

[30] But note the possible impacts of strong *state* constitutional equal protection provisions, as discussed below.

Supreme Court majority disagreed. The Court held that disparities in outcomes measures such as test scores were not a permissible basis upon which to order the district court's massive relief. The Supreme Court remanded the case to the district court for a new order, and the matter is still pending.[31]

Although monumental decisions such as *Jenkins* are inevitably vague on some key points, the message of the court's majority is clear: There are limits to federal intervention in state education funding decisions. Unless there is a clear case of *de jure* violations, court-ordered interventions will be limited, if not denied, and grievants should seek legislative relief.

The "outcomes" issue has another legal dimension. Even though the federal courts will not justify judicial intervention on the basis of disparate outcomes, there is no legal limitation on state legislatures or local school boards from deciding to rely on performance measures or outcomes in assessing education performance. Indeed, many states and school districts are now moving to outcome measures rather than "seat time" as the basis for graduation from high school. In these schools, it is no longer enough simply to receive a passing grade in a specified number of courses in order to graduate. It is now necessary in affected schools to demonstrate knowledge and skills, usually through passing a series of standardized tests.

Where such test standards have been implemented, litigation sometimes follows. When a student does not pass the test and is not permitted to graduate, he or she sometimes sues in order to force the granting of a diploma. The arguments in such cases vary, of course, but a typical one is that the school district and its teachers did not try hard enough to help this particular student pass their courses, and that this constitutes a violation of due process. Whether or not such suits prevail, they may have a chilling effect on districts and states. States are occasionally timid about enacting high skill standards, for fear of generating substantial litigation.

Affirmative Action

Just as *Brown v. Board of Education* is being undermined in many ways, so too is a long line of federal law supporting the legality of affirmative action programs. Although affirmative action programs are typically not a justification for school integration, it is arguably possible to make such a case. However, such a possibility is considerably weakened by a recent U.S. Supreme Court decision which held such programs to be unconstitutionally discriminatory, at least in respect to certain federal government programs.[32]

Church and State Issues

Another issue prompting federal court intervention in education funding questions is the appropriate role of sectarian religious influences in American public education. Like the issue of segregation, the issue of *church v. state* has a long history in American jurisprudence.

[31] In the meantime, interestingly, the parties to the suit have been working hard with some success to negotiate a voluntary settlement.

[32] Adarand Constructors, Inc. v. Pena, 115 S. Ct. 2097 (1995).

It is not useful to go through that long history in this paper, but it is important to note that two constitutional questions are presented:

- The first is the impact of the "establishment" clause of the Constitution,[33] which prohibits any government in the United States from attempting to establish a particular religion as a state religion.
- The second provision is the "free exercise" clause,[34] which prohibits the government from interfering with an individual's exercise of her or his religion.

No other issue receives this two-fold attention in the federal Constitution. For our nation's founders, at least, *church v. state* was a critical issue demanding relatively broad treatment in the Constitution. Perhaps in light of this unique and forceful treatment in the Constitution, the federal courts are continually faced with *church v. state* cases. In the field of education and related services, the activities challenged in these cases have ranged from school prayer, to shared facilities, to direct appropriations of public monies for sectarian schools.

Unfortunately, the courts have not been giving clear direction to state legislatures and local school boards. Opinions are frequently vague, and even when they are precise, local jurisdictions have been violating federal law without significant fear of sanctions. New types of education models such as charter schools will offer further opportunity for experimentation -- and litigation. In addition, passage of some sort of school prayer amendment by Congress is likely soon, even though the Clinton Administration has issued school prayer guidelines; this will no doubt confuse the overall issue for years to come.

Vouchers

Many of the *church v. state* issues noted above are not fiscal in nature. One that is is the issue of vouchers. Passage of voucher legislation, in some form, is beginning to sweep the nation, and several proposals have been advanced in Congress for national legislation in this field.

Essentially, vouchers are given by the states to parents and students. They can be valued in any amount of money and can be "spent" by parents and students for K-12 education services at public or private schools. Voucher advocates claim that this system brings free-market competition into education and will inevitably improve education outcomes. Detractors insist that only the well-to-do will take advantage of vouchers, and that the public school systems will become even more concentrated with minorities and the poor, with even fewer resources to spend on them.

If a state's law permits vouchers to be used at private secular schools, the law will likely be challenged on the basis of the establishment clause of the First Amendment. Plaintiffs in such lawsuits will claim that the state expenditures directly support secular education and everything that is taught at these secular schools.

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[33] United States Constitution, Amendment 1.
[34] Id.

It is arguably possible to draft voucher legislation tightly enough so as to pass constitutional muster.[35] However, it is certain that voucher programs will lead to extended litigation.

Regardless of how voucher litigation might be resolved, it is already clear that certain governmental expenditures which benefit sectarian schools are legal. Court decisions have upheld tax deductions for private school tuition,[36] governmental expenditures subsidizing the transportation of private school students,[37] and loaning government-purchased textbooks when the expenditures are not directly tied to a secular purpose or program.[38]

Federal Constitional Limitations on Expenditures: Summary and Lessons for Policymakers

Judicial interpretations of federal constitutional provisions affecting issues such as race and religion are evolving. The U.S. Supreme Court has, in a variety of very recent decisions, begun to unravel established law in this field, and the court's future direction is unclear. With many of these decisions being upheld by 5-4 votes, a modest change in the membership of the Supreme Court could prompt a wholly different line of decisions. Based upon the very general trends of the most recent decisions, it appears that, if anything, state options are increasing.

An obvious suggestion for policymakers is to avoid egregious laws which on their face violate well-established constitutional standards. For example, it is not wise to enact provisions which are explicitly anti-minority or pro-Christianity. Beyond that, however, the evolving judicial law in this field makes it difficult to craft specific lessons for policymakers. Adventuresome state legislatures and school boards appear to be free to try a wide range of approaches toward the improvement of education results.

It will be some time before federal constitutional law in this field becomes clear. However, the general direction of recent court decisions appears to suggest that issues such as busing of children vs. neighborhood schools is a policy or political question for state and local governments and not a legal question driven by the federal Constitution.

Federal Statutory Limitations on Expenditures

As noted above, there is no "fundamental right" to education in the United States Constitution. Perhaps in recognition of this constitutional void, federal involvement in education has been relatively modest. The vast majority of policymaking and funding in the education field has originated with state and local governments. By virtue of the supremacy clause of the United States Constitution,[39] however, congressional activity in a variety of education and related fields will limit state discretion.

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[35] There are models from other fields that might prove helpful. For example, federal funds have flowed to sectarian hospitals and social services providers for years.

[36] Mueller v. Allen, 463 U.S. 388 (1983).

[37] Everson v. Board of Education, 330 U.S. 1 (1947).

[38] Volman V. Walter, 433 U.S. 229 (1977); Board of Education v. Allen, 392 U.S. 236 (1968).

[39] U.S. Constitution, Article IV, Section 2.

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Students with Disabilities

Federal involvement in education has been critical in a few key areas. Students with disabilities have been a regular focus of federal intervention in recent decades. The Individuals with Disabilities in Education Act (IDEA) and the recent Americans with Disabilities Act (ADA), coupled with selected articles such as Title I of the federal education budget authorization acts, have carved out a significant niche for the federal government. Federal legislation for students with disabilities is clearly an area of "federal supremacy," and the ability of state legislatures to modify these provisions is very limited. States are free, of course, to reject federal monies for these programs, but many of the mandated services will still apply.[40]

School-to-Work

A new area of federal intervention is school-to-work transitions programs. Recognizing the need for an increase in the number of technically trained workers, Congress has recently embarked on an ambitious program to encourage youth apprenticeships and other work-based learning programs. The trend in federal legislation in this field recognizes the necessity of substantial inter-mixing of education and training programs and is reflected, in part, by unparalleled cooperative efforts between the federal Departments of Education and Labor.

Although federal activity in this area is growing significantly, this growth does not appear to impair state action.[41] One possible area of conflict, however, relates to registered apprenticeship programs. These activities are under the jurisdiction of the federal Department of Labor, and the ability of states to vary from federal standards has historically been very limited.

Federal Health and Human Services Legislation

With the exception of legislation relating to students with disabilities, federal education provisions have been generally additive to state and local legislation. This is not the case with respect to human and social services legislation. In this field, more than in education *per se*, federal activity has been more exclusive.

Program rules and distribution of funds for the predominant health and human services programs–Aid to Families for Dependent Children (AFDC), Medicaid, and Food Stamps–are governed by federal law. In order to receive federal funds, states must administer their programs according to state plans which are approved by the federal Department of Health and Human Services (HHS). While states may choose some optional programs such as expanded eligibility for Medicaid and have discretion regarding AFDC benefit amounts, eligibility rules and other features such as job training programs must follow federal laws and regulations.

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[40] For example, some states are prohibited by their constitutions from using public funds to aid religious institutions. Where federal statutes are less restrictive (for example, in the Title 1 program) methods to "by-pass" the state and provide the relevant services through a federal contractor have been arranged.

[41] These federal actions are therefore "additive" and not "exclusive."

States which choose to deviate from the federal prescriptions may apply for waivers from the federal regulations pursuant to Section 1115 of the Social Security Act to operate demonstration projects. In order to be approved, a waiver must meet two key criteria: (1) the demonstration project must be cost-neutral, and (2) it must include rigorous evaluation, usually using a randomly assigned control group.[42,43]

Since the beginning of 1992, 40 states have submitted a total of 76 waiver packages to HHS. While the effectiveness of these state-based reform efforts has not yet been determined, the waiver requests themselves document states' widespread dissatisfaction with many federal rules and identify states' interests in reforming their state programs. The seven most commonly requested waivers seek to (1) allow families to keep more of their earned income, (2) allow families to save more money and own reliable automobiles, (3) eliminate rules that make it more difficult for two-parent families to qualify for benefits or to engage in employment once they have qualified, (4) impose stiffer penalties on families who refuse to participate in education and training programs, (5) impose work requirements and time limits, (6) impose penalties on families whose children do not attend school regularly, and (7) eliminate exemptions from mandatory participation in education and training programs.

While waivers were fairly uncommon prior to 1990, the past few years have brought a significant rush toward "welfare reform" at the state level, which frequently has included waiver applications. In the past, the waiver process was extremely complex and lengthy, taking several months to a year for evaluation and approval. Gradually, this process has sped up, and HHS Secretary Donna Shalala released in August 1995 a simplified application process that enables states to submit welfare reform demonstrations and obtain approval within 30 days. Quick approval is granted for state projects which meet one or more of five strategies that require: (1) new work with necessary child care, (2) time limits followed by jobs for those willing to work, (3) minor mothers to live at home and stay in school, (4) parents to pay child support or go to work, and (5) the use of AFDC and food stamps as cash subsidies to private employers to hire welfare recipients.

Links Between Education and Human Services

In the past five years, many waiver applications have focused on welfare-directed proposals such as "workfare" programs, capping benefits to families who have additional children while the mother is on welfare, and benefit time limits. Few proposals have forged links with education programs.

Probably the most notable waiver link with education is the "Learnfare" programs now in use in Wisconsin and a growing number of other states. Under this program, AFDC

[42] At least in Arizona, however, these criteria were not applied.

[43] An excellent source for background information on HHS waivers is the Center for Law and Social Policy (CLASP). Note in particular "The CLASP Guide to Welfare Waivers: 1992-1995," by Steven Savner and Mark Greenberg, which is available for $10 from the CLASP, 1616 P St. NW, Washington, DC 20036; (202) 328-5140. Data on waivers contained in this paper are derived from that source.

recipients whose children are absent from school are "sanctioned" by losing the child's portion of the family's monthly welfare benefit.

Most other waiver proposals in the K-12 area have focused on teen parents through (1) requirements that teens attend school in order to receive benefits, (2) proposals to provide additional supportive services such as child care and transportation for teens, and (3) "rewards" for high school graduation or completion of a G.E.D. Some state legislatures have debated ideas such as diverting Medicaid funds to school-based clinics and requiring welfare caseworkers to monitor the educational progress of school-age children whose families are on welfare.

In addition to these waiver proposals, some state and local human services agencies have experimented with outplacing human services caseworkers in a "community school" format. Typically, these proposals do not involve restructuring or diverting finds or changes in eligibility programs. They therefore do not require waivers of federal law.

Block Grants

Congress has initiated a major move away from "categorical" programs with their associated waiver opportunities and toward "block grants," where the federal government appropriates blocks of dollars to the states to be used as state and local policymakers see fit.

Consolidating federal human services programs into block grants for many states removes many eligibility restrictions and program rules, and leaves those to the states. A likely focus will be improving delivery systems and streamlining bureaucracy, which could mean more links with elementary and secondary education programs.[44] Unfortunately, the conversion to block grants means decreases in overall human services resources and coming battles between human services constituencies over fewer federal available dollars. These battlefields probably will move from the federal government to state legislatures and human services agencies which must set priorities and make difficult allocation decisions.[45]

Federal job training and school-to-work programs are also being folded together into one or two block grants. Again, although the overall amount of funding for such programs will likely be reduced, states will benefit from greater discretion and the ability to fashion their own programs best suited to local needs.

From the state perspective, the fewer the mandates and the greater the discretion, the better. State lawmakers invariably believe they have a better sense of local needs than does Congress. Whether this exchange of more discretion for less money is a good trade is an open question and will no doubt be influenced by the level of future federal expenditures. States will differ considerably in terms of the amount of state funds dedicated to these programs and the projected growth in needs for human services. As a legal issue, however, the fewer

[44] It is anticipated, however, that federal exclusivity and targeting will remain in such critical areas as IDEA and ADA.

[45] For extended discussions on block grants, see "Rethinking Block Grants," C. Hayes and A. Danegger (The Finance Project, April 1995) and "Dollars and Sense: Diverse Perspectives on Block Grants and the Personal Responsibility Act" (The Finance Project, Institute for Education Leadership, and American Youth Policy Forum, September 1995).

the state mandates, the better the opportunity for states to craft their own legislative solutions.

Administrative Impacts

A related issue for policymakers is the administrative changes that must be made in order to accommodate block grants. Although on its face the idea of block grants suggests the removal of bureaucratic hurdles, the opposite may be true for state governments. That is, with the federal government removing its restrictions, the states will be forced to step in and develop policies and procedures for the distribution of the block grants. States must address such questions as these: Will all the money be distributed to local governments on a purely population basis? Will relative need be factored in, and how will that be done? What, if any, review of local administration of the money is appropriate? What outcomes measures are needed to determine program success and future funding?

States failing to develop enforceable guidelines for the distribution of federal block grants may face litigation. A school district or social service provider that believes it did not get its appropriate share of federal funds could sue, claiming abuse of discretion by the relevant state agency for a failure to follow the intent of the federal legislation. Such suits are more likely to fail if the states have allocation rules which are clear, equitable, and consistently applied.

Most current state systems for the distribution of federal funds will be overwhelmed by the coming dramatic increase in the use of block grants. Both the legislative appropriations process and the system for administrative controls may be inadequate, and state policymakers should work with state and local administrators to identify and rectify the problems as quickly as possible.[46]

The Future of Waivers

The idea of federal waivers to states will likely be moot as a result of the transition to block grants. Congress may retain jurisdiction over a limited realm of activity (e.g., special education), and opportunities for waivers in those selected areas may continue. Generally, however, the role for federal waivers will be greatly reduced.

On the other hand, as more regulatory and funding allocation control moves to the states, state governments may find themselves granting waivers to school districts or other local government units within their states. As noted in the prior discussion of block grant allocations generally, states would be subject to litigation if their waiver provisions are not properly drafted and consistently enforced.

[46] For an excellent overview of the systems now in place in the states for the distribution of federal funds, see A. Pérez, "Legislative Oversight of Federal Funds," Legislative Finance Paper (National Conference of State Legislatures, June 1995).

Miscellaneous Impacts

Just as with the state statutory impacts discussed below, there are a variety of federal statutes which will impact these issues indirectly. For example, many education reforms involve technology, and thus federal intellectual property laws (patents, copyrights, etc.) will have an impact. Similarly, federal laws on equal employment opportunity, public health (e.g., immunizations and asbestos removal), and handicapped access will all affect school reform initiatives.

Federal Statutory Limitations on Expenditures: Summary and Lessons for Policymakers

Federal controls on state expenditures for education and related services are more extensive than are federal controls on state revenues. Federal law is particularly limiting in respect to students with disabilities and federal human services programs such as AFDC, Medicaid, and Food Stamps. In respect to the human services programs, at least, the opportunities for state "waivers" from those federal laws are growing. The enactment of block grants for some of these programs further expands state reform options, albeit with fewer federal resources.

It has been many years since the states have been given as much discretion as they have now in structuring education and human services programs. States should take advantage of this opportunity by restructuring human services programs relating to education so that these activities can tie to each other in a more efficient and productive way. Such reforms should recognize, of course, that the overall level of federal resources will decline for some years to come, and that efficiencies in service delivery are crucial.

State policymakers should also recognize the need for transformation of their budgeting and administrative procedures in order to accommodate the dramatic increase in block grants. Ideally, the governor and legislative leaders would work together to develop a system that can fairly accommodate this new federal allocation system. States should ensure that the agencies ultimately charged with allocating the federal dollars have in place the rules and regulations necessary to provide for equitable distribution and to avoid litigation. Similarly, if states elect to have a waiver provision for local government recipients of federal funds passing through the state, state policymakers should carefully draft the waiver guidelines with enough specificity to avoid litigation.

The history of federal legislation has always been moving from greater federal control to lesser control, and back again. Therefore, with the pendulum moving in this new direction, the time to move on innovative state-based reforms is now.

State Constitutional Limitations

As noted in the discussion on revenue limitations, state constitutions typically contain the same sorts of "equal protection" and "due process" provisions as does the federal Constitution. Therefore, issues such as community schools, forced busing, and aid to sectarian schools may also be governed by state constitutional provisions. As the issue of vouchers receives more attention by policymakers, it too will be closely scrutinized for conformity with state, as well as federal, constitutional provisions.[47]

[47] See the discussion of federal *church v. state* constitutional issues in the section on federal Constitutional limitations on expenditures above.

In some cases, the parallel state constitutional provisions are stronger than their federal counterparts. This could mean that a constitutional claim of an equal protection violation–which might have lost under a federal court challenge as in *Jenkins*–might prevail under a state court challenge.

Education Clauses

Of great importance is the fact that virtually all state constitutions contain explicit language requiring the state to provide public education for its citizens. The precise language of these state constitutional provisions varies, but because most were enacted in the late 19th century, there are certain common themes or words that pervade them. The terms "general," "uniform," "system," "public schools," "thorough," and "efficient" are examples.

Some state constitutions state explicitly that public education is a "fundamental right" for its citizens. However, even when a state constitution does not specifically denominate education as a fundamental right, a growing number of state supreme courts are implying such a right.[48]

From the perspective of education advocates, it is clearly desirable to have explicit constitutional recognition of the role and importance of public education. On the other hand, because the words that are typically used in these provisions no longer have contemporary relevance, it is difficult for education policymakers to craft modern-day legislation relying on these 19th-century words. To further complicate the issue, judicial interpretations of these and similar words and phrases have varied radically around the nation.[49]

Expenditure Limitations

For some states, the revenue limitations described above (e.g., the various California limitations such as Propositions 13 and 98) are expressed in terms of expenditure limitations. One recent publication noted such limits in eight states,[50] and more are considering them.

An interesting variation on this theme is the requirement in a handful of states that a *minimum* percentage of the state budget be spent on education.[51] While this appears to be a boon for education, and it may be in some cases, it can also end up being the *ceiling* on education expenditures. Also, it could prove catastrophic to complementary services such as human and social services, which could suffer state cuts (on top of the federal cuts) in order to maintain these percentage requirements for education.

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[48] For an excellent outline of the state constitutional provisions and cases interpreting them, see D. Van Slyke, A. Tan, M. Orland, and A. Danegger, "School Finance Litigation: A Review of Key Cases" (The Finance Project, 1995). *See also* W.E. Turo, "To Render Them Safe: Analysis of State Constitutional Provisions in Public School Finance Reform Litigation," Virginia Law Review 75 (1989) at p. 1639.

[49] *Id.*

[50] The identified states are Arizona, California, Colorado, Iowa, Kansas, Minnesota, Nebraska, and New Jersey; the limits affect schools, other local governments or both. ACIR Report, supra at pp. 5-10.

[51] California provides another example of this. *See* The Finance Project: Case Studies, supra at pp. 13-22.

Privatization

A growing national movement is the use of private, for-profit companies to provide public education services. In some cases, school districts have hired private providers to deliver all portions of public education in a district or particular schools. In other cases, private corporations have been hired to provide only a limited amount of services (e.g., serving as the district's superintendent or as educator of at-risk children).

State contracting laws may impact on such arrangements, but so too may the state constitutions' education clauses. It is conceivable that detractors of privatization (e.g., teacher unions) could claim that using private providers violates the state constitutional requirement for "public education." A claim such as this would be especially forceful if the private provider is allowed to avoid many of the traditional accoutrements of public education, such as the use of public employees as teachers, many of the rigid state procurement policies, the dictates of open meeting laws, or the standards governing the dismissal of teachers.

State Constitutional Limitations on Expenditures: Summary and Lessons for Policymakers

State constitutional language has a much greater effect on most potential state expenditure reforms than do the federal Constitution and laws. This is primarily because of the proliferation of education clauses in state constitutions. Although such clauses give great force to education, most of the clauses use language that has little meaning today and, as a consequence, have spawned many recent state court decisions with widely varying results.

Having explicit constitutional language *of any sort* recognizing the importance of education is desirable, but improvement in the typically used words and phrases is needed. State policymakers should give serious consideration to amendments to their state constitutions which would, at a minimum, (1) clarify whether education is a "fundamental right" for purposes of that state's constitution; (2) update or repeal century-old language which attempts to define the state's appropriate role in education; and (3) incorporate new concepts designed to improve education quality -- e.g., notions of outcomes, accountability, and equity.

State Statutory Limitations

The purpose of this paper has been to identify federal (constitutional and statutory) and state constitutional limitations which inhibit policymakers from reforming the financing of education and related services. Because it is a basic principle of constitutional law that a future legislature can undo any statutes enacted by a prior legislature, there are no purely "legal" state statutory limits to reform proposals.

Indirect Influences

It is also clear, however, that a wide variety of indirectly related laws may impair the workability of education funding reforms. For example, laws affecting working conditions and collective bargaining for public employees, state and local procurement regulations, and the structure of local government units (such as county boards and school districts) may negatively affect the workability of reforms which attempt to integrate education and related

human services legislation. Reforms which stress privatization may run afoul of such local laws as building codes and student transportation requirements.

State budgeting laws may also pose barriers. For example, some states require one level of government to approve another's expenditures, or at least to consult with the other.

Finally, the structure of the state bureaucracy itself may also pose a barrier. Typically, education and human services programs are operated out of separate state agencies. There are frequently informal linkages between these programs, but ultimate accountability for the programs' success is vested in different individuals. As a consequence, there will be inevitable cases of turf protection and other bureaucratic hurdles, as well as missed opportunities for creative partnerships. Also, as noted above, the new block grants will place additional burdens on state bureaucracies.

State Statutory Limitations on Expenditures: Summary and Lessons for Policymakers

None of the examples cited in this part are *absolute* barriers to the reform of education and related services financing. However, they may pose a challenge to the ultimate workability of reform proposals.

The above and other examples point to the necessity of a very broad-reaching reform package. It will not be enough simply to restructure the financing and service delivery. Policymakers should consider the breadth of issues involved in this reform initiative:

- State distribution plans and waiver opportunities should be carefully drafted and consistently enforced in order to ensure equity and help avoid litigation.
- Policymakers should consider restructuring the bureaucracy so that education and related human services are ultimately administered by -- and have clear lines of accountability to -- a single agency head.
- The governor as chief executive must be given substantial authority to ensure effective implementation.
- The reforms should be phased in to give time to help identify indirectly related mandates, and services and programs which will impact on the ultimate workability of the financing reforms.

SUMMARY AND DIRECTIONS FOR REFORM

What lessons can we learn from laws and court decisions that will affect finance reform initiatives? How can policymakers work around these legal constraints as they seek finance reform?

The purpose of this concluding section is to highlight the most important observations from the first two sections of this paper.

The bottom-line summary is this: **There are legal limitations affecting the scope of finance reform. However, the limitations can be avoided--or at least mitigated--by careful drafting of state laws and regulations.**

Federal Limitations

There are relatively few federal limitations on state revenue-raising; there are many more limitations affecting state expenditures. Some state laws have been overthrown, not so much on the basis of conflict with federal statutes, but more often because they violate the equal protection, the due process, the interstate commerce, or the religion establishment clauses of the U.S. Constitution. Federal law is particularly limiting with respect to students with disabilities, and federal human services programs such as AFDC, Medicaid, and Food Stamps.

State Limitations

State constitutions also contain equal protection and due process clauses. In addition, they typically prohibit reliance on certain taxes, dedicate certain revenues for specific purposes, and constrain access to sources such as debt financing.

State constitutional language has a much greater effect on most potential state expenditure reforms than do the federal Constitution and laws. This is primarily because of the proliferation of education clauses in state constitutions. Although such clauses give great force to education, most of the clauses use language that has little meaning today, and their outdatedness has spawned many recent state court decisions with widely varying results.

Needed Breadth for Reform

A fundamental lesson is that reforming financing for education and related services is extremely complex, and constrained by a number of factors. Probably the most difficult hurdle for reformers is the inextricable link between education finance and all other major revenue systems. Because of the huge size of education budgets, any meaningful revenue reforms will have a major impact on other politically sensitive taxes. Therefore, education funding reform should be done as a part of overall fiscal reform.

A Time of Opportunity

Although the legal constraints as defined above will continue to limit the scope of state reforms, two developments suggest that state reforms are now more possible than ever before:

- Very recent federal and state court decisions appear to grant more reform flexibility to the states. Additional clarification is needed on some points, but Congress and the federal courts are signaling expanded reform potential for state and local governments.
- The dramatic federal shift to block grants--as opposed to categorical programs--will give state and local governments substantially more flexibility in developing and implementing reform programs. To some extent, this enhanced flexibility is offset by reduced resources, but, overall, block grants will help provide a more favorable environment for reform.

State policymakers should also recognize the need for transformation of their budgeting and administrative procedures to accommodate the dramatic increase in block grants.

Ideally, the governor and legislative leaders should work together to develop a system that can fairly accommodate this new federal allocation system. States should ensure that the agencies ultimately charged with allocating federal dollars have in place the rules and regulations necessary to provide for equitable distribution and to avoid litigation. Similarly, if states elect to have a waiver provision for local government recipients of federal funds passing through the state, state policymakers should carefully draft and consistently administer the waiver guidelines.

Desirable Components for a Reform Package

It is not the purpose of this paper to recommend specific reform initiatives. However, policymakers interested in reform should consider the following "building blocks" for a reform package:

- Education clauses in state constitutions should be updated and amended to reflect policymakers' education goals.
- State finance reform must be comprehensive. It cannot be limited to education finance alone.
- A state reform package should interrelate education and related social support services. Policymakers should restructure their bureaucracy and the appropriation processes in order to ensure the efficient operation of the reforms.
- Policymakers should take advantage of the opportunities provided by recent federal court decisions and congressional block grants, to design reforms which satisfy far-reaching goals such as adequacy, accountability, and equity.

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There has seldom been a better time for reform of the way states finance education and related services. This window of opportunity may close at any time, however, and states should move quickly in whatever reform directions they choose to take.

THE FINANCE PROJECT

The Finance Project is a national initiative to improve the effectiveness, efficiency, and equity of public financing for education and other children's services. With leadership and support from a consortium of private foundations, The Finance Project was established as an independent nonprofit organization, located in Washington, DC. Over a three-year period that began in January 1994, the project is undertaking an ambitious array of policy research and development activities, as well as policymaker forums and public education activities.

Specific activities are aimed at increasing knowledge and strengthening the nation's capability to implement promising strategies for generating public resources and improving public investments in children and their families, including:

- examining the ways in which governments at all levels finance public education and other supports and services for children (age 0-18) and their families;
- identifying and highlighting structural and regulatory barriers that impede the effectiveness of programs, institutions, and services, as well as other public investments, aimed at creating and sustaining the conditions and opportunities for children's successful growth and development;
- outlining the nature and characteristics of financing strategies and related structural and administrative arrangements that are important to support improvements in education and other children's services;
- identifying promising approaches for implementing these financing strategies at the federal, state and local levels and assessing their costs, benefits, and feasibility;
- highlighting the necessary steps and cost requirements of converting to new financing strategies; and
- strengthening intellectual, technical, and political capability to initiate major long-term reform and restructuring of public financing systems, as well as interim steps to overcome inefficiencies and inequities within current systems.

The Finance Project is expected to extend the work of many other organizations and blue-ribbon groups that have presented bold agendas for improving supports and services for children and families. It is creating the vision for a more rational approach to generating and investing public resources in education and other children's services. It is also developing policy options and tools to actively foster positive change through broad-based systemic reform, as well as more incremental steps to improve current financing systems.

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