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School finance will continue to be an important policy issue in the future.

State School Finance Issues for the 1980s

by John Augenblick

The purpose of this article is to discuss some of the issues that states will face as they deal with school finance in the middle of this decade. School finance will remain an important issue for at least three reasons. First, state courts continue to scrutinize school finance systems. Second, school finance systems have become extremely complicated. Third, education is receiving much attention through the national reform reports. These and other issues indicate that school finance is changing. As a result, education policymakers and leaders will need to modify the way they look at state school aid formulas. The remainder of this article provides further background information about the three issues delineated above. Hopefully, by knowing more about where school finance is and has been, it will be easier to deal with where it is going in the future.

Recent Court Involvement in School Finance

Despite all the concern policymakers express about the influence of the courts in school finance, only seven states have actually been required to modify their school finance systems in response to court decisions between 1971 and 1983. Those states include California, New Jersey, Connecticut, Washington, Wyoming, West Virginia, and Arkansas. While school finance systems in three states have been declared unconstitutional in the 1980s, systems in four states have been upheld including Georgia, Colorado, New York, and Maryland.

This is not to say that the courts have not been, and will not be, a potent catalyst of change in the structure of school finance systems. Numerous states initiated their examinations of school finance because of a perception that the courts might otherwise require that changes be made. However, legal strategy confused the improvement of state aid systems for many years. Before 1970, cases claimed that the allocation of state support was not related to the needs of school districts. Courts found this approach impossible to resolve and ultimately condemned such cases to failure. A new approach, based on equal protection guarantees, was used successfully in the early 1970s to declare school aid systems unconstitutional in many states. The problem with that approach was that it did not give policymakers much guidance about how to improve school finance. Rather, it created a negative standard, fiscal neutrality, that required that there be no relationship between spending and the wealth of school districts. This approach did not consider the needs of districts; it also did not consider the issue of local control, particularly in regard to school district tax rates. In 1973, with the *Rodriguez* case, this approach was abandoned.

In its place new approaches were developed based on the education clauses of state constitutions. Since the language of the education clauses differs among the states, each state school finance system was reviewed on a somewhat different basis. Systems were declared unconstitutional because they did not provide "thorough," "efficient," "basic" or "ample" education opportunities. However, no universal definition of these terms has emerged. The courts have debated the language, as have state legislatures, without achieving concensus. Essentially, what the courts have required is that the legislatures demonstrate a rational relationship between the allocation of support and the needs of school districts. Where legitimate differences exist among districts, variations in support are justifiable. The difficult policy issue focuses on the distillation of legitimate differences from among all differences. Are differences due to characteristics of pupils legitimate? What about those related to school district characteristics? Are voter preferences legitimate or not? Ten years after *Robinson*, the 1973 case in New Jersey that revived school finance litigation after *Rodriguez*, answers to these questions vary among the states. Lower courts in many states have tended to be more sympathetic than appeals courts to plantiffs' suggestions that state aid systems are not rational. When state supreme courts have found state aid systems to be sufficiently rational not to overthrow them, the decisions tend not to be unamimous ones; even the majority opinions tend to point out deficiencies in those school finance systems that are legally acceptable.

Two recent cases raised a new issue for the states. In California and Washington, litigation sought to clarify the role of the state in light of earlier decisions that school finance systems were unconstitutional. Both states faced difficult fiscal situations that made it increasingly difficult to provide adequate levels of state aid. In California, the court found that progress in reducing per pupil expenditure variations had been sufficient and that further state support, which increased dramatically with the passage of Proposition 13 in 1978, was not needed. In Washington the court found that the state had not provided sufficient funds to meet the new requirements it had established in response to the *Seattle* case. In a sense, this was similar to the situation in New Jersey where, in 1976, the court closed the schools until the state provided the support necessary to fully fund its new school formula.

What does all this mean for state policymakers? First, policymakers should periodically review the structure of their school finance systems and determine whether such structures are rational. This requires that policymakers specify the goals and objectives of their state aid systems, choose an appropriate definition of equity among the variety that exists, assure that state and local re-

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sources are adequate, and explicitly balance local control against equity and adequacy concerns. The major deficiency of most school finance systems is that they do not achieve the purpose for which they were designed. In many cases the systems are several decades old; they were designed in a different time for different circumstances. Alternatively, annual incremental changes made to a perfectly rational system reduced, over time, its rationality.

Second, policymakers should strive to stay out of court. Among the school districts of every state there are usually several that cannot spend at levels they deem appropriate, that are relatively poor or that perceive themselves to be "losers" in the annual distribution of state aid. These districts have in the past and will in the future bring legal action against a state. The worst situation under which policymakers can evaluate and modify state aid systems is when a court has mandated change and, while retaining legal jurisdiction, is monitoring the progress of the policymakers.

Third, policymakers should learn to live with complex state aid formulas when complexity is justified by increased rationality. Simplicity is a virtue to strive for in the design of a school finance system; but simplicity should not be sought at the expense of sensitivity to the widely varying circumstances facing school districts.

The Increasing Complexity of State Aid Formulas

Between 1965 and 1980 many states modified their school aid formulas to increase their sensitivity to the wide variation that exists in the property wealth of school districts. Using approaches that had been used before, such as the foundation program, and using newer approaches, including guaranteed tax base, guaranteed yield, two-tiered systems and recapture, the states have been fairly successful at alleviating the impact of property wealth on school district spending decisions. While some of these new approaches have exotic names, they are essentially equivalent to the older approaches in terms of their computation. They differ in regard to those factors that the state controls: tax rate, expenditure level, or level of state match for local funds.

These wealth-related formulas have become complicated by mandated minimums and maximums, "kinked" matching relationships under which state aid changes as local effort changes, variable partial recapture under which the state recaptures only a portion of excess local revenues and the portion depends upon the level of local revenues, and proportional reductions of state support when districts do not make specified tax effort or when state appropriations are less than the level required to fully fund a formula. Over the past few years a number of states also have implemented new approaches to measure the wealth of school districts. Most states continue to rely on property wealth per pupil as the indicator of relative fiscal strength. Many states have either improved their property assessment systems or used property assessment equalization procedures to assure that the distribution of state aid is based on comparable measures of the property wealth of districts. Some states have moved beyond property wealth and included income in their determination of fiscal capacity. Recently, Vermont included an income factor in its formula, joining Rhode Island, Virginia, Kansas, Connecticut, Maryland, Missouri, Pennsylvania and New York, which use such a factor in distributing at least a portion of state support.

In the late 1970s the states focused much of their attention on improving the sensitivity of school finance systems to the varying needs of school districts. These needs were primarily associated with characteristics of the pupils being served or characteristics of the districts that affect the cost of providing services to all pupils. The states began this process by creating separate, categorical programs designed to allocate supplementary state support for such activities as special education, bilingual education or compensatory education. These programs were stimulated by the expansion of federal aid for similar activities and many of them were designed in the same manner as federal programs. Some states started to move away from the strict financial accounting approach inherent in federal programs by using the pupil-weighted approach, under which pupils participating in relatively costly educational programs were weighted to reflect the relative cost of providing services to them. Because most state aid systems are enrollment driven, these districts would receive more state support. In some states this system operates as a rational method of allocating state support with no requirement that districts spend funds for the same purposes for which they are received, similar to a block grant approach. Over time, the states have increased the number of weighting categories consistent with the precision of their accounting systems to specify program cost differences. It is becoming somewhat more popular now to link funding to the type of service provided by the district rather than the classification of pupils, since it is the way the services are provided, and not the disability of the pupil, that directly determines cost. For example, while there may be a dozen or more categories of pupils receiving special education services, such services are only provided in four or five different ways.

While the states have made a great deal of progress in linking the allocation of state support to the needs of pupils, they have also started to recognize the cost implications of district characteristics. A number of states have studied price-of-education factors that adjust state support based on the varying purchasing power of similar amounts of money around a state. Florida uses a cost-of-living index; Alaska uses an adjustment based primarily on accessibility. Ohio has incorporated a regional cost-of-living adjustment into its state aid formula and Missouri implemented a district cost index based on factors beyond the control of districts that affect their ability to attract similarly qualified personnel. States also are incorporating factors related to school or school district enrollment levels in their formulas in recognition of the relatively higher per pupil cost of providing educational services in small school districts. Oklahoma's new system contains a formula to increase the weighting given to pupils in districts with less than 500 pupils. Using a geometric equation, the formula gives more weight to pupils in very small districts. Wyoming's formula, based on classroom units, provides more aid to schools that are small.

Some states also have included simple approaches to recognizing the fiscal impacts of declining enrollments by allowing districts to use prior year enrollments or to average enrollments over a number of years. These approaches do not directly confront the issue of marginal costs, the recognition that the actual cost of adding or subtracting a pupil is less than the average cost, but they do cushion what could otherwise be a precipitous loss of funds for districts rapidly losing enrollment. In a few states, extra support is given to urban school districts. A

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few years ago there was a great deal of interest in municipal overburden, a fiscal condition thought to be faced by large, urban areas. Court cases in New York, Maryland and Wisconsin included this issue although research is mixed about its existence. Nonetheless, some states have sparsity and density factors that attempt to provide increased state support to very small or very large districts.

One problem that affects school districts, particularly as enrollments stabilize or decline, is the increasing cost of personnel. In some districts there is little turnover of teachers, which results in increasing per pupil costs as teachers' salaries increase. Some states recognize this problem by including teacher training and experience factors in their formulas. Using these factors, districts with relatively better trained or more experienced teachers receive relatively higher levels of state aid. Oklahoma explicitly included such a factor in its new formula and other states, such as Texas and Delaware, implicitly recognize this problem in their foundation programs.

The increasing complexity of state aid formulas not only leads to increased confusion for policymakers, taxpayers and administrators, but also increases the likelihood that the formula provides inappropriate incentives and disincentives for school districts. Every state aid system provides incentives and disincentives to school districts. These are complicated because districts with different characteristics respond to them differently. Also, given the multiple goals of the education system, it is possible that a policy designed to promote one goal serves as a disincentive to achieving another goal. School finance systems can be designed to accomplish a variety of objectives, which might include:

- Assuring that adequate revenues are provided by school districts
- Encouraging the provision of appropriate education programs
- Promoting the efficient use of resources
- Increasing the productivity of teachers
- Promoting appropriate levels of local control
- Increasing parental involvement in school decision-making
- Improving pupil achievement

It is now recognized that a particular structure of a state aid system can stimulate or discourage districts from providing local support for schools. Some approaches to providing support for pupils in special programs may discourage their placement in appropriate programs. States can encourage districts to improve the quantity and quality of services they provide by providing more support for high-quality teachers or lower pupil-teacher ratios or by increasing support to districts that comply with procedures perceived to be related to improving schools.

It is not easy to understand all the incentives and disincentives provided by a state aid system, but increasing knowledge in this area is crucial to improving school finance systems, particularly as they become more complex. Policymakers who do not understand how their state aid systems work; how their structures are related to the educational goals and objectives of the state; the impacts of state aid allocation procedures on district administrators and taxpayers; and the relationship between equity, adequacy and efficiency, will be overwhelmed by the complexity of their school finance systems. In the future, it will be important to assure that the complexity of state aid systems can be justified by recognizing the widely ranging needs of school districts and assuring that state support is distributed with incentives to improve the quality of the system.

Short-term and Long-term School Finance Issues

During 1983 several national commissions and study groups have issued reports calling attention to problems with the education system in this country and proposing solutions that would affect states, localities, teachers, and, hopefully, pupils. In addition, several states are examining the structure, financing and governance of education through broad-based commissions supported by governors, legislatures, state and local education policymakers, and the private sector. Education is emerging as a major topic of debate and it is likely to be among the central issues of the 1984 presidential election. Over the next year, and possibly longer, education will be highly visible, presenting policymakers with what could be either the best or the worst time to debate the controversial issues surrounding education and to implement changes, depending on the extent to which the long-awaited economic recovery improves the fiscal situation in state and local school districts.

The recommendations of those study groups that have released reports range from exhortative rhetoric to incremental changes, from those that cost almost nothing to implement to those that would require billions of dollars of new spending, and from those that might best be implemented at the federal level to those that can only be dealt with by local school districts. Strengthening the curriculum, improving teacher preparation and inservice training, raising teachers' salaries through a general pay boost or merit pay, lengthening the school day or the school year, increasing the availability of technological innovations, increasing admission standards of colleges, solving the remediation problem, and a myriad of other proposed actions to improve the quality of the education system all have implications for school finance. They all have an impact on the provision of adequate resources for education, the equitable distribution of resources, and the efficient use of resources.

State policy makers face two types of school finance policy issues as they consider these recommendations in light of the historical development of school finance: short-term problems that should be resolved as quickly as possible and long-term issues that should be confronted over the next few years. Short-term problems include:

- Providing adequate revenues to schools
- Assuring appropriate teacher salary levels
- Promoting local control
- Paying for deferred maintenance
- Creating incentives for school improvement
- Improving the equity of school finance systems

The most important issue facing the schools today is the provision of adequate revenues. While inflation has decreased, the federal role has deteriorated and both states and school districts have undergone fiscal stress caused by increasing responsibilities and poorly performing revenue systems. In the future, in most states, assuring that adequate resources are provided will be a state responsibility. This is not to say that local sources of revenue should not be tapped; in fact, to assure the viability of the system, revenues should be diversified by the use of such mechanisms as local option sales or income taxes, foundations and, perhaps, increased reliance on property taxes, provided that property tax administration can be improved. State support will, however, become more important and alternatives to enrollment-driven formulas may be needed.

Over time, the share of all resources consumed by personnel has remained fairly constant. In the future, demands for teacher salary increases will change this pattern; either total expenditures will increase or less funds will be available for nonpersonnel costs. While states do not, in most cases, play a direct role in setting teacher salaries, they must recognize that in order to attract and retain highly qualified staffs, adequate funds, targeted to salaries, will need to be provided.

Local control has always been an important component of education governance in this country and reliance on local control appears to be increasing. School finance systems must respond by finding ways to increase local control over how much money is spent and how available funds are spent by schools. Block grants, school site budgeting, and other mechanisms can be used to do this.

Many states provide no support for capital outlay or debt service. During the past few years many districts have neglected building maintenance as budgets have been squeezed. While it is relatively easy to defer building maintenance in the short term, such a policy can be costly in the long term. States will have to become more involved in supporting building maintenance in order to avoid serious problems in the future.

Policymakers need to examine the incentives in their state aid systems and assure that they are designed to improve schools. School districts that demonstrate improvement can be rewarded. School districts can be encouraged to adopt policies that appear to be related to school improvement. Demonstrating improvement in pupil performance and operational efficiency will be increasingly important in maintaining public support of schools.

Equity remains an important goal of school finance systems. States must continue to improve the rationality of aid allocation procedures by increasing their sensitivity to the needs of pupils and districts and by improving their procedures for measuring school district wealth. The increasing complexity of state aid formulas should be justified by improvements in the recognition of factors that affect the cost of providing education services.

In the long run a set of broader issues faces state policymakers concerned with school finance. This set includes:

- Compensating teachers
- Supporting private schools
- Improving the efficiency of schools
- Expanding the services provided by schools
- Assuring the availability of local support
- Paying for remediation

While teachers' salary levels will be of concern to policymakers in the short run, compensation for teachers, including salaries, benefits, tenure, career ladders, and length of work year will be issues over the next several years. States will be in a position, through their school finance systems, to influence school district behavior by creating statewide minimum salary schedules, allocating sufficient funds to increase total compensation and providing incentives to districts to modify their current compensation systems.

The recent decision of the U.S. Supreme Court in the *Mueller* case raises the issue of state support for private schools to a new level. It is anticipated that several states will examine the use of income tax deductions, if not tax credit or other mechanisms, to provide tax relief to parents paying tuition or other specified costs associated with private schools. Public schools will be seeking ways to charge students for some education costs, which would be eligible for tax deductions, in light of the importance attributed to the structure of Minnesota's plan, which provides benefits to families of pupils attending public and private schools. This issue is likely to receive more attention in a few states than at the federal level, where opposition to tuition tax credits is better organized and large budget deficits are likely to continue.

As the business community becomes involved in improving the education system, it is almost inevitable that the efficiency of the system will receive more attention. Declining enrollments continue to have serious fiscal impacts which are not understood by the public. Several states are considering studies of school district reorganization, a very successful policy pursued by the states up until about 15 years ago. As more states become interested in the competency of pupils and teachers and statewide testing increases, renewed interest in the relationship between resources and attainments is likely to develop. All of these factors suggest that school finance systems may be used to provide incentives to reduce costs, to consolidate school districts, and to reward districts with appropriate relationships between inputs and outputs.

School districts around the country are experimenting with the provision of child care services that supplements the normal education program. Such services represent a new source of income at only marginal expense to school districts. Not only does care provided before and after school provide a benefit to parents, it offers opportunities to provide more educational services to pupils in terms of hours per day and days per year; it even legitimizes the provision of very early childhood education. Because the provision of such services also might affect teacher salaries and could offset some of the negative impacts of declining enrollment, it will be an important issue, and one with broad fiscal implications in the future.

The availability, and perhaps the expansion, of local support for schools is crucial to their fiscal future. One threat to local support is the changing demography. A smaller proportion of the population has children in the schools, making it increasingly difficult to obtain voter approval of increasing local taxes. It may be important in the future to change both the types of revenues that can be used locally, permitting the use of local sales or income taxes, and the mechanisms by which approval for such revenues is achieved, by giving greater power to school boards to impose taxes.

A number of issues affecting the future of school finance are related to the interaction between the elementary/secondary and higher education systems. Increased competition between the education sectors for scarce resources will make it even more important to resolve these territorial issues. One of these issues is remedial education, services provided to pupils who do not meet whatever standards are specified to continue their education. It may be costly to retain pupils in elementary schools rather than simply allowing them to continue into high schools. Which sector should provide remedial education beyond high school, and who should pay for such services (the pupil, the state, the school district, or some

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combination) must be addressed.

In conclusion, school finance will continue to be an important policy issue in the future. States will play a central role in funding schools. In designing state aid systems, policymakers will need to balance the amount of revenue they provide against the equity they achieve and the level of local control they promote. States will increasingly use school aid formulas as policy tools that provide incentives for school improvement and efficiency. State policymakers will not be able to confine their concerns about school finance to formula structures; they will need to pay special attention to compensating teachers, the provision of local support, aiding private schools, and the relationship between elementary/secondary and postsecondary education. As the states recover their economic vitality, they will be besieged by increased demands for support; school finance, an old concern surrounded by new issues, will be at the top of the list.

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