Principles of a Sound State School Finance System

by the
Education Partners Project
Foundation for State Legislatures

National Conference of States Legislatures
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The National Conference of State Legislatures serves the legislators and staffs of the nation's 50 states, its commonwealths, and territories. NCSL is a bipartisan organization with three objectives:

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- To foster interstate communication and cooperation;
- To ensure states a strong cohesive voice in the federal system.

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About the Education Partners Project

In early 1994, the National Conference of State Legislatures and the Foundation for State Legislatures convened a group of state legislators, legislative staff, business organizations and nonprofit organizations to begin a conversation about the principles and components of a sound state school finance system.

The major purpose of the Education Partners Project is to encourage dialogue and build consensus among these groups because educational goals can be realized only when coupled with a sound funding system.

In addition to this report, four working papers on related education finance topics emerged from the partnership:

1. The Relationship Between Educational Expenditure and Student Achievement;
2. The Search for Equity in School Funding;
3. Efficiency and Education Finance;
4. Taxation and Revenues for Education.

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Introduction

Funding for public elementary and secondary education is a significant portion of most state budgets, representing on average approximately one-third of general fund appropriations. As a result, policymakers spend considerable time and thought in allocating money to schools to achieve a range of funding goals. These goals are represented by principles underlying public school finance—equity, efficiency, adequacy, accountability and stability.

In the 1990s, many policymakers are concerned that state school finance systems:

- Relate funding to state educational goals and standards;
- Link funding to improved educational results;
- Address capital investment as well as operating expenditures;[1]
- Encourage schools to make the best use of available resources;
- Are perceived as fair to both students and taxpayers.

This booklet is designed to give policymakers broad principles for the design of state school funding systems. We recognize that no one funding formula or set of formulas is right for all states, given voter diversity, tradition and interpretations of state constitutions with regard to education.

It is important for the reader to note that this report is limited to the principles of a sound state school funding system for public elementary and secondary education, which includes both the revenue and expenditure sides of funding. The report does not define the content of educational programs, curriculum, assessment or standards because they are beyond its scope.

1. Capital investment refers to the construction and maintenance of facilities as well as technology infrastructure.

What Is a State School Finance System?

A state school finance system is sometimes viewed simply as a mechanism for distributing revenues to school districts through various funding formulas. However, a state school finance system is much more complex. It encompasses how revenues are raised and at which levels—local, state, federal. The type and mix of taxes used, such as property tax vs. income or sales taxes, are important issues, as are the use of nontax revenues, such as those from lotteries and gaming. Another concern is how the funds are spent and accounted for by local school districts.

Historically, the structure of school funding systems has been influenced by three major legal considerations:

- State constitutional requirements;
- State statutes;
- Judicial decisions.

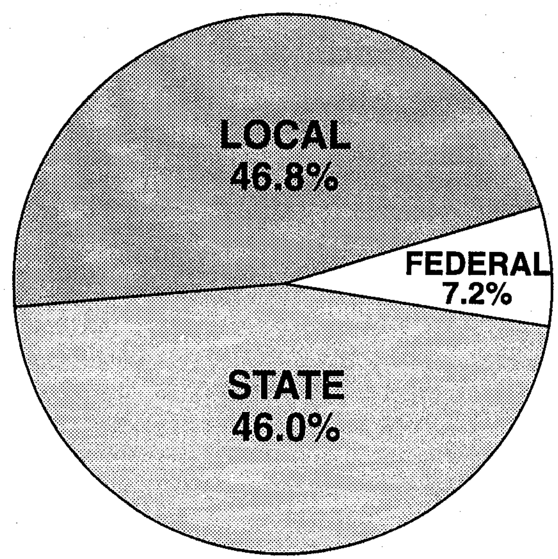
Provision of and funding for public education is a unique requirement of state constitutions. Over the years, legislatures' interpretations of that responsibility have been translated into state statutes that have defined the state and local shares in funding education. In addition, some state courts have shaped school finance systems over the past 25 years. When state courts have ruled school finance systems unconstitutional, legislatures have been directed to change school funding systems, although court decisions have varied in their specificity. In addition, judicial rulings in one state have no legal bearing on funding systems in other states.

Education funding may be visualized as a partnership among local school districts, the state and the federal government. This is a partnership that has evolved over time. The most current data are from 1993-94, where the average shares were 46.0 percent state; 46.8 percent local; and 7.2 percent federal. (See figure 1.) However, there is tremendous variation across states in the relative shares. (See appendix A, for a state-by-state listing.)

Each state uses a combination of school aid formulas. For the most part they fall into a few broad categories. All states have some type of basic aid to school districts. Basic aid may be used for any school district operating expenditure. Forty states use a foundation program for distribution of basic aid. (See appendix B for a description and summary table of types of basic aid formulas.) A second type of aid is categorical aid, where funding is targeted and must be spent by the school district for a particular purpose, such as transportation or special education. Some state funding systems use weighting factors instead of or in addition to categorical aid. A weighting factor acts as a multiplier in conjunction with basic aid. In recent years, a few states have developed competitive funding components, such as aid based on submission of proposals, and incentive aid, awarded to schools or school districts for student performance.

Figure 1

Federal, State and Local Shares in Funding Public Education, 1993-94



Source: National Education Association. *1994-95 Estimates of School Statistics* (Washington, D.C., 1995), 38.

Principles of a Sound State School Finance System

A sound state school finance system is characterized by clarity of purpose, internal consistency and comprehensiveness. Yet the funding system itself remains a means to the end, that of providing a quality education to every child in a state. It is important to note that in crafting a sound state school finance system policymakers face the challenge of trying to balance these principles to achieve an integrated funding system. A sound state school finance system is based on five primary principles:

1. Equity

A sound state school finance system provides equity for both students and taxpayers

2. Efficiency

A sound state school finance system is efficient, making the best possible use of resources. An efficient school finance system also minimizes the cost of state oversight through ease of administration and ease of local school district compliance.

3. Adequacy

A sound state school finance system provides adequate resources to local school districts so that they may achieve state and local educational goals and standards.

4. Accountability

A sound state school finance system incorporates fiscal accountability at the state and local levels through generally accepted budgeting, accounting and auditing procedures. Increasingly, accountability links finance and outcomes as in performance-based budgeting. Accountability also includes collection and maintenance of a state fiscal data base for systematic evaluation of the funding system at regular intervals.

5. Stability

A sound state school finance system promotes predictability and stability of educational revenues and expenditures over time.

1. Equity

A sound state school finance system provides equity for both students and taxpayers and in operating and capital expenditures.

Equity is a complex concept to define and operationalize. Equity for students is often broadly defined as equality of educational opportunity or equality of access to educational opportunities. Student equity may be defined more precisely if divided into horizontal and vertical equity. Horizontal equity means "the equal treatment of equals." It is most often operationalized as equality of per pupil expenditures, with a focus on reducing disparities in per pupil expenditures across school districts.

Vertical equity is more complex; it is defined as "the unequal treatment of unequals." It allows differential spending levels based on needs of students. In particular, it gives consideration to the potential need for additional resources for special populations, such as students with developmental disabilities, limited English proficiency and family poverty, as well as talented and gifted children. Vertical equity also includes addressing conditions outside the classroom that affect a child's ability to learn, such as nutrition, health and family environment. The field of integrated or collaborative services for children is emerging as an important consideration for achieving vertical equity. Blending funding streams from education and social services is one of the challenges of collaborative service delivery.

Pragmatically, a sound state school finance system cannot exist without taxpayer equity because there would not be continued support for educational expenditures. Taxpayer equity includes issues of tax capacity and tax effort. Tax capacity here refers to the ability of an individual or jurisdiction to support education. More simply, tax capacity refers to wealth, which for taxation purposes may be measured in a number of ways, for example, in terms of real and tangible property and personal and corporate income. Tax effort generally refers to a ratio of actual tax collections to a tax base.

Sound taxation principles recognize that those jurisdictions with the most wealth or tax capacity are able to shoulder a larger burden of

local educational expenditure than those in less fortunate school districts. Sound taxation principles also recognize that even less wealthy school districts can make some type of fiscal effort through a local tax rate for education that is consistent across school districts, with the state providing proportionately more aid to the less wealthy.

In recent years, the importance of equity in capital and operating expenditures for school districts has emerged as an important state school finance policy issue, in part due to the release of national studies and school finance litigation. Tremendous variation in state support for capital expenditures exists at present. Because school districts in most states must rely on local bond issues based on property wealth to construct and renovate facilities, considerable inequity exists in school facilities. With greater emphasis on technology in the workplace, significant capital investments in upgrading equipment and facilities in schools are necessary to insure students have equal access.