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The Argument For: Retaining Income as One of Two Factors in Maine's School Aid Funding Formula

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COMMENTARY

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Retaining Income As One of Two Factors in Maine's School Aid Funding Formula

by Michael F. Brennan and
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Background and Areas of Agreement

Over the last one-and-a-half years, *Maine Policy Review* has featured a series of articles that have addressed Maine public education funding issues, particularly the state's school aid funding formula.[1] This is another piece in that continuing dialogue—a piece that, while it finds much to agree with in the writings of those who have already spoken on these issues, will forcefully argue that real tax equity can only be attained if income continues to be a factor in the state school aid funding formula.

But before getting to our main thesis, some digression is necessary. All of the previous authors have recognized that school funding issues, though deserving of independent and apolitical consideration, cannot be entirely separated from the broader range of state- and local-government tax and funding issues that face us. In addition to their recommendations with respect to school funding, they have in varying degree made suggestions with respect to these broader issues. We agree with many of their school funding recommendations, and with a number of their broader tax policy recommendations. Indeed, we could hardly be more articulate or blunt than Senator Peter Mills in his comments with respect to service center communities, local option taxes, and the sharing of state sales and income taxes.[2] It seems appropriate to lay out some of these broad areas of agreement; we do not want *Maine Policy Review* readers to conclude that even experts in these fields are hopelessly divided. We do not believe that to be the case; in our view there is more shared agreement than there is disagreement. For example, most observers would conclude that:

1. The property tax, without state equalization aid, could not fairly fund public K-12 education in Maine; the question then is not whether state school aid is needed—it is—but how far toward complete equality among Maine's 286 school districts can—indeed, should—such aid programs go.

2. State school aid funding formula(s) should strive for both student equity and taxpayer equity—these are not mutually exclusive goals.

3. State school aid funding formula(s) can (and should) be simplified.

4. More state aid for education will ease the effect of, but will not totally eliminate, present inequities in state school aid distribution formula(s).

5. Seemingly equitable across-the-board school aid reduction calculations (begun in the early 1990s in response to revenue shortfalls) were misguided; in fact, this mechanism only exacerbated differences between school districts with high per-student property tax valuations and those with lower valuations.[3]

6. More of the costs for actually operating the schools should be included in the operating cost portion of the state school aid funding formula; too much is left out—thus inequities in property tax resources are not as fully equalized as they could be.[4]

7. Increasing the minimum school-related tax effort in towns with high property tax (and/or income) wealth would improve overall tax equity. On a sliding scale these wealthier towns could be required to bear a portion of their own program, debt service, or pension costs, since a "pay in" mechanism seems politically unacceptable.[5]

8. Battles over property tax relief should not be fought within the context of school aid funding formula debates; circuit breakers, homestead exemptions, and adjustments to state formulas distributing sales and income tax revenues should be discussed separately and stand or fall on their own merits.

9. State funding for any aspect of public education costs (construction, pensions, special education, transportation, English as a Second Language) should never rise to the level of 100%; towns will only moderate expenditures in these areas if they must bear a meaningful portion of these costs.

We believe there is near total agreement on these nine points. Beyond them is a range of other principles and/or modifications to our present school aid funding formula(s) that most informed observers would accept. For example:

1. Cushioning or hold-harmless provisions, which serve to insulate individual school districts from downturns in state school aid occasioned by declining enrollments and/or by property valuation or income rises, may be a political necessity, but they should not operate for more than a two- to three-year period. In addition, such provisions should be scaled down sharply over this time period. The basic equalization aid formula(s) must be allowed to work if statewide school aid equity is to be achieved.

2. To the extent that is politically feasible, state school aid to individual school districts should be given out on the basis of need; so-called flat aid, foundation aid, aid that is distributed without regard to property tax and income wealth should be eliminated or kept to the barest minimum.

3. The level of state contribution to various categories of school expenditures (operating costs, program costs, debt service, pension costs) may vary, which is fine; but the formula(s) for distributing whatever aid is given in each of these categories should be drafted in a consciously parallel manner (if indeed they are not identical), and should in each case rely on the same wealth equalizing factors, such as property tax base and income.

4. We should remove as rapidly as possible the so-called reduction calculation from state school aid distribution formula(s) (see paragraph five above). This calculation, perhaps

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justifiable politically when, in the early 1990s, state school aid first fell below statutory commitments, is today unnecessary. Continuing the reduction calculation unfairly skews the basic equalization aid distribution formula(s).

5. Given the fact that normal accounting practices are adhered to in all 286 school districts and that computer storage and transmission of data is widely available, it would seem possible to avoid having to calculate state aid distributions on

the basis of enrollment and expenditure data that in some settings are as much as two years old (the payment of school district bills cannot be put off for two years). We can—and should—move to shorten all time lag factors in the calculation of state school aid.

In summary, there are clearly more areas and points of agreement among those most knowledgeable about state school aid formula(s), issues, concepts, principles, etc., than there are areas or points of disagreement. We should not let the relatively few points of disagreement nor the tone of our debate get in the way of working together and developing a more unified strategy that will more nearly achieve those goals and objectives with respect to state school aid.

The inclusion of income in school aid equalization formula(s) has been embraced in over a dozen other states. Legislators, scholars, tax experts, and educators in these states have not all been misled.

Keeping Income in the School Aid Funding Formula

We now turn to the major thesis of this piece—that median household income should be retained as one of two wealth factors (property tax wealth being the other) in state school aid distributions to Maine's 286 school districts. This so-called equalization aid is designed to assure, as nearly as possible, statewide uniformity in both per-pupil education expenditure, and taxpayer effort to fund K-12 education. It should be stated that the inclusion of income as a measure of wealth and a factor in school aid equalization formula(s), which began in Maine in 1996, was not the product of any political machination. It did not grow out of any cabal engineered by urban school districts, and it was not part of any big school district-small school district, north-south, coastal-inland strategy to gain some unfair advantage over one's neighbors. In fact, the idea has been around for a long time. The inclusion of income in school aid equalization formula(s) has been embraced in over a dozen other states. Legislators, scholars, tax experts, and educators in these states have not all been misled. They examined and accepted the same lines of reasoning that most recently moved Maine's Rosser Commission[6] to recommend that income, along with property tax wealth, be included as a measure of local ability to pay in state school aid equalization formula(s). The Rosser Commission's motives and conclusions were clearly stated: the inclusion of income would "provide a fairer method of determining ability to pay."[7] They went on to note that "economists generally find that income is a more realistic measure of one's ability to pay for a good or service than property wealth."[8] They concluded by noting that "the use of two factors in determining ability to pay will minimize the impact of abrupt changes in either of the two factors."[9]

The Commission's reasoning, and that of other states that use income in their approach to equalization aid, is grounded in recognition of a fundamental and inherent defect in the property tax—it may measure a form of taxable wealth more or less accurately,[10] but it does not accurately measure the current ability of a property owner to pay the tax imposed. The latter is most readily measured by the property owner's current income. This disjoint between a property tax burden and the ability to pay that burden has been widely recognized by state and local government tax theorists for some time.[11] This recognition, more than any other factor, has prompted Maine and most other states to create income-related circuit breaker and homestead exemption programs.[12] If property wealth invariably gave rise to an ability to pay taxes predicated on that wealth, such programs would be unnecessary. But there is no automatic ability to pay, and such programs are very necessary. It follows then that school equalization aid formula(s) that take income into account, and which recognize that property wealth and ability to pay do not always coincide, are thus not only appropriate but necessary if tax equity principles are to be maintained.

Some hypothetical examples may illustrate the points being made. Two Maine towns have roughly the same equalized taxable property valuation per student—town A has a median household income in excess of $50,000, town B has a median household income below the state median ($31,348). A one-dimensional (property valuation) approach to state school aid funding would treat these two towns equally; a more equitable approach, one that also appeals to our common sense, would include the income factor as well as property valuation in the aid formula. Town A would then get less state school aid than town B, because town A has both greater overall wealth and a greater ability to pay to meet school-related property tax impositions than town B. This is the greater fairness that the Rosser report spoke of—it is also what Maine law presently allows—and we should retain, perhaps even expand, the present law.[13] Finally, it should be noted that any number of Maine towns very closely fit the hypothetical profile.[14]

Two other hypothetical classes of town are worth noting. There are towns that have a relatively high property valuation per student, but relatively low median income. A one-dimensional (property valuation) approach to school aid would characterize such towns as rich and afford only minimum state school aid. But when total wealth is looked at (income and property valuation), it is clear that such towns are not as rich as they seem; with income in the formula, they would receive somewhat more school aid. This is appropriate, and is another example of the larger fairness the Rosser report mentioned. Here again, any number of Maine towns fit the hypothetical.[15] A second class of town are those with relatively low property valuations per student, but relatively high median incomes—here the one-dimensional approach to distributing state school aid would characterize such towns as poor and afford a generous level of state school aid. But with income in the aid distribution formula, such towns would receive somewhat less school aid. This also is fair, and comes from having looked at a larger measure of wealth (income and property), and not just property alone. Again, the hypothetical is readily found in Maine.[16]

Conclusion

Those who have examined Maine's school aid funding mechanisms are agreed on many points—particularly that these mechanisms can be made more equitable to students and taxpayers statewide, and that they can and should be simplified to facilitate intelligent debate on these important issues. On the question of whether income should be retained in the school aid funding formula, the evidence seems overpowering that it should be retained. This is the consensus of other states that have examined the question; it was the conclusion of the Rosser Commission, and it accords with common sense and logic. The examples given bear out the fact that including income in the formula achieves more equitable overall results. Property valuation is certainly a measure of wealth, but it is not as accurate a measure as property and income taken together. It also does not address ability to pay questions as fully as current income levels do.

The material presented here suggests that, if anything, the use of income as a factor in the distribution of state school aids should almost certainly be expanded over the next several years. It should not for any reason be abandoned.[17]

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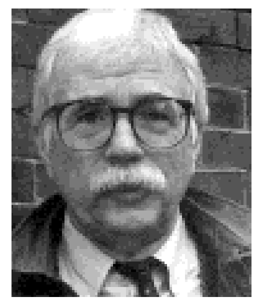

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Please turn the page for article endnotes.

ENDNOTES:

1. See Patrick M. Dow & Ralph Townsend, "Reforming Maine's Education Funding Process," *Maine Policy Review,* Fall 1998; Peter Mills, "Maine's Dubious Odyssey into the Funding of Local Government," *Maine Policy Review,* Fall 1999; Yellow Light Breen, "Opportunity and Equity," Maine Policy Review, Fall 1999.
2. Mills, *Maine Policy Review,* Fall 1999: 45-6.
3. Breen, *Maine Policy Review,* Fall 1999: 51-2.
4. Ibid, 53.
5. Mills, *Maine Policy* Review, Fall 1999, particularly paragraphs 2, 3, and 9 on page 41.
6. The Commission came to be known by the name of its chairman, John Rosser; its full name was, The Committee to Study Organizational and Tax Issues in Public Schools. It was created by the 116th Maine Legislature, and was the fifth study group in ten years (and many hoped it would be the last) to examine and advise policymakers on various aspects of primary and secondary education in Maine. Its final report, *Keeping Promises: Honoring Our Commitment to Education Equity,* was published in February 1995.
7. Ibid, 28.
8. Ibid.
9. Ibid. A reading of the entire report, or at least the section dealing with the inclusion of income as a measure of wealth in state school aid formula(s), is useful.
10. The wealth measured is often little more than an assessed valuation of wealth—there is often no cash or savings in hand, and little or no ability in the short-term to convert a portion of this so-called wealth, a portion of what is said to be a more valuable asset, such as one's house, farm, or woodlot, into real dollars in order to pay rising property taxes predicated on the rising paper-value of the asset. The increased property tax bill is almost always paid out of current income; when that is not possible, the asset (house, farm, woodlot) must be sold. Current income, then, not the paper-value of a non-liquid asset, is the more practical and tangible factor in determining whether property tax obligations (whether for schools or other governmental services) can be met. And though state school aid formula(s) cannot be expected to fully overcome these inherent weaknesses in property taxation, they can be structured in ways that minimize the problem. The inclusion of income in school aid formula(s) as a measure of wealth, and of the ability to pay current property tax obligations, is a useful step in this direction.
11. See H. Groves, *Financing Government,* 1939. In a section dealing with general criticisms of the property tax, he notes: "The property tax correlates badly with income from property." See also D. Netzer, *Economics of the Property Tax,* 1966. Also, 0. Peterson, *Property Tax Reform,* 1973, which is an anthology. An article by J. Shannon, "The Property Tax: Reform or Relief," notes: "No other major tax in our system bears down so harshly on low income households, or is so capriciously related to the flow of cash into the household."
12. See Hellerstein & Hellerstein, *State and Local Taxation,* 4th ed., 1978. In a chapter dealing with property taxes, they note: "Circuit breakers are designed to cut off or reduce a qualified taxpayer's tax load when the property tax reaches too high a proportion of the family's household income." See also D. Gold, *Property Tax Relief,* 1979, particularly Chapter 3, "The Residential Circuit Breaker."
13. The Rosser Commission report recommended that income wealth and property tax wealth each be weighted at 50% in the state's school aid funding formula; they would have phased in the income portion beginning at 20% and adding 10% a year over the three years following the 1996-97 school year. Instead, the Legislature established the income factor at a level of 15%—property valuation, then, was an 85% factor. This weighting of the distribution formula has not been changed since it was enacted. Moreover, the income factor is only applied to the operating cost portion of state school aids.
14. For example, using 1998 data, Cape Elizabeth (with $391,052) and Greenville (with $386,885) have per-student property valuations that are nearly equal. Median income in Cape Elizabeth was $55,478; in Greenville it was $20,887. Without income in the formula these two towns would be treated the same for school aid funding purposes. With income in the formula, Greenville would receive somewhat more state school aid—it has less overall wealth. Indeed, it needs and deserves more school aid support than Cape Elizabeth.
15. For example, using 1998 data, Rangeley has $926,410 property valuation per student (well above the state average, $318,193), but its median income is only $25,046 (well below the $31,348 state median). Without income in the formula, Rangeley would get very little state school aid. With income in the formula, they get somewhat more. This is fair and derives from the fact that Rangeley has less total wealth and ability to pay than looking at property valuation alone would suggest.

16. For example, using 1998 data, Durham has only $212,441 property valuation per student (well below the state average), but its median income is $41,875 (well above the state median). Without income in the school aid formula, Durham would get more school aid than it deserves—it would appear poorer than it really is. With income in the formula, Durham gets somewhat less school aid. This is because we have used a fairer measure of the town's overall wealth.

17. The Legislature's recent abandonment of a cost of living adjustment factor (COLA) in Maine's school aid distribution formula is beyond the scope of this paper, but the authors regard it as an unfortunate step—the loss of another useful tool for achieving greater fairness in the state's distribution of school aid. Other states use COLAs; the Rosser report recommended use of this tool. Finally, most observers agree that there are significant price differentials in providing basic educational needs between different regions of the state. This being the case, we should have more patiently refined our use of COLA rather than abandon it.