

# FUNDING A SOUND BASIC EDUCATION FOR ALL NEW YORK'S CHILDREN

## Fiscal Policy Institute

In *Campaign for Fiscal Equity vs. State of New York*, decided in 2003, the Court of Appeals, New York's highest court, ruled that the State is failing to ensure sufficient funding to provide New York City school children with the opportunity for a "sound, basic education," as required by the state constitution. New York City school children faced -- and still face -- large classes, crumbling buildings, out-of-date equipment and learning materials, which prevent them from receiving a quality education.

There is now general agreement by citizens and governmental officials alike that a statewide solution is necessary to provide sufficient funding to New York City and the numerous other school districts that are unable to provide a quality education for their children. Funding such a solution through a system of the type described in Part A of this issue brief has been projected to require additional state revenues of about \$8.6 billion annually.<sup>1</sup> Part B of this issue brief examines how those resources can best be raised.

### **A. Establishing a simple and fair formula for distributing adequate state aid to education.**

Currently, state aid for education in New York State is distributed through over 50 separate and unnecessarily complex formulas and grants-in-aid. The approach recommended in this proposal consolidates 39 of these current categories into a single foundation allocation, while increasing the percentage of the state share and providing districts with predictability and transparency in the way their schools are funded. Its main components are as follows:

#### **1. A Comprehensive Foundation Amount**

Virtually all school district educational expenses, except for transportation, facility construction costs, debt service, and high cost public and private special education

<sup>1</sup> See the simulations prepared by the Fiscal Policy Institute for the Campaign for Fiscal Equity at: <http://www.fiscalpolicy.org/ImpactFiscalCFE.pdf>

placements, would be encompassed by a single, comprehensive sound basic education foundation amount ("the SBE foundation amount"). BOCES aid, textbook, library and computer aid to private schools, teacher centers, and special grants that are not part of local districts' basic educational operations would be funded separately through the State Education Department (SED).

This per pupil foundation amount used in this proposal is \$8,037, which approximates the average per pupil state/local funding levels recommended by the *New York Adequacy Study*.<sup>2</sup>

#### **2. Adjustments For Local Cost Factors And Student Need**

Each district's SBE foundation amount would be based on a statewide average foundation amount per pupil adjusted by (a) the cost of education index derived from the results of the *New York Adequacy Study* (b) a sparsity factor to provide additional resources to districts with less than 25 students per square mile.

Each district's SBE revenue requirement would be determined by multiplying the SBE foundation amount by the need-adjusted enrollment count. The pupil count (which is based on pre-Kindergarten through 12<sup>th</sup> grade enrollment) is adjusted to reflect student needs by giving each low-income student a 1.5 weighting, each student with a disability a 2.1 weighting and each English language learner 1.2.

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<sup>2</sup> The Campaign for Fiscal Equity and the New York State School Boards Association partnered with 32 other organizations throughout the state to contract with the American Institutes of Research (AIR) and Management Analysis and Planning Inc. (MAP) to complete a one-year, cutting-edge costing out study that determined the actual amount of funding needed to provide an adequate education to all students throughout the state.

### **3. Division Of Responsibility Between Local School Districts And The State**

The responsibility for financing each district's SBE revenue requirement would be divided between the local district (or local municipality in the case of the Big Five urban districts) and the state government on the basis of the district's relative "ability to pay" as measured by the SBE Combined Wealth Ratio. The SBE-CWR is the average of two ratios: a) the ratio of the district's property wealth per poverty-weighted pupil to the statewide average property wealth per poverty-weighted pupil and b) the ratio of the district's income per poverty weighted pupil to the statewide average income per poverty weighted pupil.

The state aid ratio for a district with a SBE CWR equal to the state average would be 42% with adjustments up for poorer districts (up to a maximum of 95%) and adjustments down for wealthier districts (with a minimum state aid ratio of 5%). The formula for calculating the state aid ratio is  $42\% \times 60\% \times (1.00 - 25)$ . No district would receive less state funding in any year than it received during the prior year.

#### **a. Local Contributions**

Each local school district would be expected to make a defined contribution to the financing of its SBE foundation amount based on an "ability to pay" formula. For districts whose students are not making satisfactory progress toward meeting the Regents Learning Standards, the local contribution would be mandatory. Local districts would be free to make a local contribution greater than this defined minimum to provide educational opportunities above the SBE adequacy level.

#### **b. The State Contribution**

The state would be required to provide the difference between the SBE revenue requirement and the amount generated by the local share. Under this proposal, the overall result would be that the state share of total statewide educational expenditures would rise from the current 47 percent to 52 percent. The state share of total state and local revenues would increase from 49 percent to 55 percent.

#### **4. A Four-Year Phase-In and Four-Year Stable Funding Periods**

Initially, the new Adequate Foundation for All Plan should be phased in over a four-year period, with approximately 25 percent of the incremental allocation for each district added each year. To promote stability and long-term planning by school districts, the state should formally adopt a four-year funding plan setting forth in advance the amount each school district will receive for each of the following four years, subject only to annual inflationary increases or adjustments for extraordinary unforeseen events. The foundation amount and the educational need and cost indices should be reviewed and reconsidered during the third and fourth years of the four-year period, on the basis of a new costing-out study.

#### **5. Adequacy, Predictability, Equity, and Transparency**

A "foundation formula" approach of the type described above would ensure that all school districts have the resources necessary to provide all of their students with a sound basic education. But it would also bring predictability and transparency to school funding in New York while ensuring both student and taxpayer wquit.

#### **A DISTRICT'S SBE STATE FUNDED OPERATING AID =**

- (a) The Statewide Per Pupil SBE Foundation Amount TIMES
- (b) The District's Education Cost Index Factor TIMES
- (c) The District's Sparsity Factor TIMES
- (d) The District's Need-Adjusted Pupil Count TIMES
- (e) The District's State Aid Ratio (Based on the District's Relative Poverty-Adjusted Property Wealth and Income Wealth Per Pupil)

**B. Finding The Resources To Fund A Sound Basic Education for All of New York's Children.**

When the additional funding required to address the state's most critical unmet school facilities needs is included, funding a quality education for students statewide has been projected to cost about \$9 billion annually

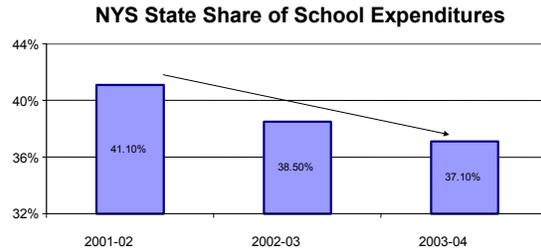
The Governor and the Legislature appear to be deadlocked on how to resolve this matter, and they have not provided the funding needed. One of the major reasons for the deadlock is that current state and local taxes are unable to generate the total additional funding necessary to fund the court decision without devastating other vital state needs, like health care. And, at the same time that we need additional funding for education, many middle and lower income taxpayers are feeling the pinch of higher and higher local property taxes.

**1. State vs. Local Funding**

Compared to other states, New York State depends heavily on local governments to raise the tax revenue necessary to pay for needed services. And, over the last 30 years, New York State has increased its relative dependence on local taxes. New York State is 2nd among the 50 states in terms of the share of taxes collected at the local level (51.3% compared to the national average of 40.9%). New York is now one of only three states in the entire nation that collects more revenues locally than at the state level. And, between 1972 and 2002, New York State went from 10th to 2nd among the 50 states in the percentage of taxes collected at the local level. This dependence on local taxes places significant pressure on the sources of revenue available to local governments in New York State, particularly the property tax - the primary source of local revenue in New York State – and the sales tax.

The State government's share of education funding is declining. New York State depends more heavily on local revenues to finance its public schools than the rest of the nation. The New York State government's share of local school costs has plummeted

over the course of the last four years. In fact, as shown by the chart below, if it were not for "STAR" (School Tax Relief),<sup>3</sup> state revenue would have only covered 37.1% of local school costs statewide in 2003-04 – the lowest level in almost 50 years



**2. Over Reliance on the Local Property Tax Creates Problems**

New York, like three of its neighboring states - - Connecticut, New Jersey and Vermont - - relies more heavily on property taxes (as a percentage of its residents' income) than the nation as a whole. All four of these states rank in the top 10 nationally in this regard.

In New York State in 2002, property taxes accounted for 3.9% of the total personal income of all residents. This was 24% above the national average of 3.2%.

In recent years, property tax collections by New York's local governments have been increasing much more rapidly than the income of state residents. This helps to explain why an increasing number of middle income New Yorkers have been speaking out in favor of alternatives to our state's current heavy reliance on the property tax as a means of funding needed services, including education.

<sup>3</sup> STAR is not included in this chart since STAR, unlike other state payments to school districts is not allocated based on the number of students that a district has or on any other measures of student need. But even when STAR is taken into consideration, the portion of local school budgets covered by state aid revenue has dropped like a rock from 48.2% in 2001-02 to 44.3% in 2003-04.

## How Property Wealth Affects School Funding

School District	Lafayette	Rye	Rye as % of Lafayette
<b>Tax Base Per Pupil</b>	97,443	1,111,792	<b>+1,041%</b>
<b>Tax Rate Applied</b>	1.81%	1.27%	<b>-</b>
<b>Property Tax Per Pupil</b>	1,763	14,117	<b>+701%</b>

Source: Institute for Taxation and Economic Policy

Reliance on local property taxes results in fundamental inequities in school finance because some school districts have a much greater ability to fund their schools with local property taxes than others. That is because some districts have substantially more taxable property per pupil than others.

For example, as shown by the chart above, the Lafayette School District, south of Syracuse, has taxable property of \$97,443 per pupil, while the Rye City School District in Westchester County has taxable property per pupil of more than ten times that amount. The result is that Rye can generate eight times as much money per pupil as Lafayette (\$14,117 vs. \$1,763), with a 30% lower property tax rate (1.81% or \$18.10 per \$1,000 of Full Value v. 1.27% or \$12.70 per \$1000 of Full Value).

### **3. The Sales Tax is Even More Regressive Than the Property Tax**

During the early 1990s, and again during the last several years, many counties responded to budget shortfalls by increasing their sales tax rates, even though the sales tax is the state's most regressive major tax. Since May 2001, 34 of the 57 counties outside of New York City increased their sales tax rates.

New York's state sales tax is relatively low. But when the state rate is combined with state authorized local and regional rates, New York's overall sales tax is relatively high. The New York general sales tax was introduced in 1965 at a rate of 2%. The rate increased to 3% in 1969 and 4% in 1971. Most recently, the state sales tax rate was temporarily increased from 4% to 4.25% for two years beginning on June 1, 2003. The state sales tax rate is now back to 4%. But

New York State also authorizes counties and cities to add a local sales tax to the state sales tax; and the state has established a regional sales tax for the MTA in the NYC metropolitan area.

The result is that the overall (state, local and MTA regional) sales tax rate is now 8% or higher in New York City, 43 of the 57 counties outside of New York City, and in parts of a 44th (Westchester County).

### **4. Gambling Expansions Have Been Authorized by the Governor and the Legislature.**

The expansion of casinos and Video Lottery Terminals (VLTs) that is currently being implemented will produce about \$2 billion a year for education when fully implemented. Gambling is an increasingly popular revenue raising choice for states, and New York was one of the first states to rely heavily on this revenue source with its institution of a State Lottery in 1966. New York State has authorized the establishment of 8 Racinos (Video Lottery Terminals at Race Tracks) and several Indian casinos. Even if the Governor's proposals for additional Video Lottery Terminals at off-track locations and for additional Indian casinos are not adopted by the Legislature, the current gambling program is likely to produce \$2 billion a year when fully implemented. The revenue from the VLTs has already been dedicated to a Sound Basic education Fund. If the Governor and the Legislature did the same with the revenue from the Indian Casinos, it would further reduce the additional revenue needed to fund a legitimate statewide solution to the Court of Appeals' decision in the *Campaign for Fiscal Equity* case.

## **5. As a Matter of Good Public Policy, Corporate Tax Loopholes Should Be Closed.**

New York's Corporate Income Tax now has so many loopholes that it is almost voluntary. Many of the state's major corporations pay little or no income tax: some even pay a "negative" income tax. Plugging some of the loopholes in New York's Corporate Income Taxes by strengthening the minimum tax, implementing combined reporting and adopting a "throwback rule" would raise about \$1 billion per year.

Because most of the corporate tax is exported to stockholders and customers throughout the world, the impact of this option on New Yorkers is minimal. Even the wealthiest 1% of New Yorkers would only see an increase in their tax burden of about 1/10th of 1 percent of their income.

## **6. The Personal Income Tax Provides the Greatest Opportunity for Raising Needed Revenues in an Equitable Manner.**

Of all New York's taxes, the Personal Income Tax is most clearly based on the "ability to pay." And, there is substantial room for raising revenue from the income tax in a fair manner because of the changes that have been implemented over the last 30 years. Those changes have moved New York from a system with 14 brackets with a top rate of 15% to a system with 5 brackets with a top rate of 6.85%. Many options are available for raising additional revenue from by making changes in the Personal income Tax structure. The two possibilities below represent polar cases – one involves raising rates "across the board" by equal percentages; the other involves increasing the rates on upper income taxpayers to restore the progressivity that has been lost over the last 30 years. Both of these options for raising the revenue necessary to increase state aid to education in the way described in the first part of this report (and the many permutations and combinations

that lie between these two options) would make New York's state-local tax system much fairer than it is today by reducing reliance on the property tax and increasing reliance on the income tax.

### **a. An "Across the Board" increase in each of New York State's current income tax rates would raise about \$2.5 billion per year for each 5% by which each of the rates is raised.**

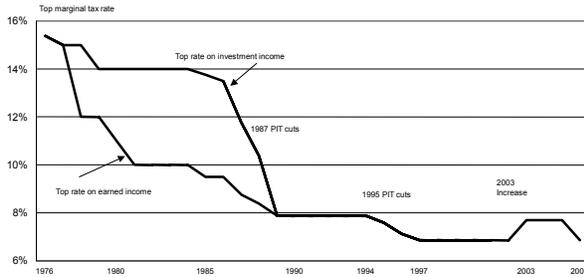
A 5% "across the board" increase in the state's current income tax rates would mean increasing the state's current 4% tax rate to 4.2% and raising the current 6.85% rate to 7.1925%. It does not mean increasing the top rate from 6.85% to 11.85%. This option would increase all of the income tax rates by the same percentage resulting in a tax hike for those currently paying state income taxes.

This option increases the importance of the personal income tax in New York's tax system, but it does not make the tax more progressive. Because the poorest New Yorkers generally pay little or nothing in state income taxes, this option would not impact low-income New Yorkers substantially. About 12% of this tax increase would be offset by lower federal taxes for itemizers.

### **b. Reinstating New York's 1972 tax brackets, tax rates, and exemptions, with the bracket ranges and the exemption amounts indexed for inflation would raise about \$7.8 billion a year while reducing income taxes on the overwhelming majority of New Yorkers.**

New York's state income tax brackets and rates are less progressive than they have been in the past. This proposal undoes the income tax rate changes implemented over the past thirty years, re-imposing the tax rate structure as it existed in 1972 but with the brackets adjusted for the changes in the cost of living that have occurred since then.

New York State has cut its top personal income tax rate by more than 50% over the last 25 years.



The 1972 income tax rates ranged from 2 percent to 15 percent. Under this proposal, the 1972 tax brackets would be indexed for inflation, so the 15% top marginal rate would apply to taxable income over \$236,000 in 2006. This option would raise approximately \$6.7 billion from New York residents of which \$2 billion, or 29%; of that state tax hike would be offset by lower federal income tax payments for New York. This proposal would also raise at least \$1.2 billion from nonresidents, primarily high income residents from New Jersey and Connecticut who commute into New York to work.

**C. Assessing the Economic Impact of Increasing Education Spending and Increasing Taxes to Pay for That Additional Spending.**

Most New Yorkers would like to see New York State's schools receive adequate funding --- yet many wonder if raising taxes to pay for that education funding would hurt the state's economy. In evaluating these tradeoffs, it is important to remember that public spending offers economic benefits that must be measured against the social costs of tax increases --- and the economic benefits of public spending are especially pronounced when spending is focused on education.

To estimate the economic impact that additional education spending and various revenue options would have on the state's economy, the Institute for Taxation and Economic Policy (ITEP) used an economic model that is specifically designed to reflect New York's particular economic and demographic structure. That model is a

general equilibrium model, developed by Regional economic Models, Inc (REMI), that takes into consideration the linkages between the various industries within the state, between industries and the workforce, and between the state and national economies. The model allows fiscal policies with opposing tendencies, such as tax and spending increases, to be analyzed simultaneously, so that the net impact of these opposing policies can be observed.<sup>4</sup>

The ITEP analysis found that increasing education spending by \$6 billion would increase employment in New York State by 1.26% and that an \$8 billion increase would increase employment by 1.67%. ITEP also evaluated the offsetting impact of paying for this increased investment with each of several different revenue sources. The negative impact on employment of raising \$8 billion would range from 1.25% if the revenue were raised through sales tax increases to 1.17% if raised through property tax increases to 1.04% if raised through the income tax.

The income tax has the least negative impact for several reasons including the fact that more of this tax than other taxes is paid by nonresidents, the fact that more of this tax is offset by federal deductibility than other taxes, and the fact that less of the income tax comes out of income that would otherwise be spent in the economy because of the fact that a much greater portion of this tax comes from the portions of personal income that are not necessary to meet the cost of life's necessities.

The result is that the positive economic effect of the additional education spending outweighs the negative economic effect of the commensurate tax increases, and that the net positive economic impact is greatest when the spending increase is funded with an increase in the personal income tax.

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<sup>4</sup> Additional information on this economic impact analysis methodology is available at <http://www.fiscalpolicy.org/EducEcolmpact.pdf>