Tax Policy and Public School Finance

Abstract - Over twenty-five years after the Serrano v. Priest (1971) decision by the California Supreme Court sparked intense debate over school finance equity, the topic remains at the forefront of the education reform debate in many states. Over the past two decades, a number of states have faced lawsuits over the equity of their school finance system, and several states have been forced to make changes. In the last several years, a new round of court cases has challenged traditional equity standards and solutions implemented in response to past court orders. Several of the recent challenges, most notable in Kentucky and Michigan, have involved reform of the whole school finance system.

Accompanying the continued debate over school finance equity has been intense interest in reforming the organization and performance of public schools and renewed opposition to local property tax financing of education. After the 1983 publication by the national commission of Excellence in Education of A Nation at Risk, with its scathing critique of American education, "education reform" has become the rallying cry for major structural changes in public schools. Reforms have ranged from the establishment of minimum competency standards and mandatory testing (Fuhrman, Elmore, and Massel, 1993) to the development of new performance incentives for teachers, school, and school districts (Richards, Fishbein, and Melville, 1993; Clotfelter and Ladd, 1996; Elmore, Abelmann, and Fuhrman, 1996), to decentralizing authority to teachers, parents, and local schools (Hess, 1993; Cooper, 1993).

While states have debated how to improve public school performance, the property tax - the heart of local school finance - has come under renewed attack. Recent proposals to reduce the role of the local property tax in financing schools have been passed in five states (Michigan, Oregon, Wisconsin, Nebraska, and Vermont) and have been considered in several more (Gold, 1994a; Reschovsky, 1994).

Despite the fact that state education finance systems have been under challenge on a number of fronts, public finance and education research continues to be segmented into separate
literatures. Past research on school finances has focused primarily on the equity of state aid systems. Various equity standards and measures have been proposed (Berne and Stiefel, 1984) and used in the design of different types of state aid formulas (Monk, 1990). Much less attention has been paid to the design of the whole education finance system using a broader set of criteria. In turn, there is a large body of research on educational productivity (Hanushek, 1986; Monk, 1992) and performance assessment, but very little of it is linked to the design of aid formulas and finance systems. Finally, school taxes have been evaluated using a standard set of criteria as part of tax policy research (Fisher, 1996; Aronson and Hilley, 1986) however, the relationship between taxes, aid distribution, and productivity has seldom been explored.

The artificial separation of taxes, aid, and expenditures is particularly problematic in the case of public education because of the intergovernmental nature to its provision. State and local tax systems are linked through state aid systems. State governments have taken a significant role in financing public schools, but service provision is still principally at the local level. States have been hesitant to turn over service decision entirely to the local school districts, often imposing detailed curriculum, process, and structural restrictions on local school districts (Monk, 1994). The incremental growth of state government involvement in school finance and educational administration has in many states led to a complex web of aid formulas and regulations.

The time is ripe for a comprehensive assessment of state school finance systems. The objective of this chapter is to apply the tools of tax analysis to evaluate possible school finance systems. For example, what are the equity and efficiency trade-offs between state and local funding, different sources of state or local revenue, and different sources of state and local revenue, and different designs of school aid systems? We will draw on the literatures of education productivity, school finance, tax policy and intergovernmental relations to develop a framework for analyzing state education finance systems.

This chapter is organized into two major sections. We begin by developing a conceptual framework for evaluating the different dimensions of state education finance systems, organized around two key criteria - efficiency and equity. While improvement in equity and efficiency lie at the heart of tax and education reform, these concepts are often poorly defined, and the relationship between application
in tax and education policy is seldom explored. We will discuss the different definitions, standards, and measures for each criterion in the context of school finance. We conclude this section by applying these concepts to the design of education tax aid and service delivery systems.

The second major part of the chapter provides a national overview of state school finance systems in 1990. Information from the 1990 *Census of Population*, the 1992 *Census of Governments*, and a 1990 survey of state school aid systems (Gold et al., 1992) will be used to describe the variation among states in the design of their education finance systems. Factors that may be related to equity differences among states will be examined. The chapter will conclude with a discussion of where we are now, what the key areas of school finance reform are for the 1990s and what the important topics for future research are.