

CHAPTER TWO

WHY SCHOOL FUNDING REFORM IS NECESSARY

The June 2003 *Campaign for Fiscal Equity* (CFE) decision is the latest volley in a nationwide battle to establish the opportunity for a quality education as a fundamental right under state constitutions. The CFE decision states clearly that New York State is not meeting its constitutional obligation to provide an adequate education for New York’s school children—and places school funding reform squarely on the agenda of state lawmakers. This chapter provides an overview of this important court decision, reviews the current status of the attempts to implement the decision and to improve New York State’s education system in response to this decision, and surveys the experience of other states that have sought school finance reform.

Is Education a Fundamental Right?

In the past quarter century, education advocates have sought to spell out what rights to a basic education—if any—are guaranteed by the various state constitutions. After a 1973 U.S. Supreme Court decision ruled that the Equal Protection Clause of the Fourteenth Amendment does not require equal funding of poor and wealthy school districts, advocates in many states sought to locate these guarantees in their own constitutions.² New York was among these states.

The New York State Constitution has been interpreted to guarantee a “sound basic education” to all New York school children—and a series of court decisions have found that the state has not met this requirement.

The New York Constitution requires the state legislature to provide New York school children with a public education. Article XI, §1 requires that “the legislature shall provide for the maintenance and support of a system of free common schools, wherein all the children of this state may be educated.”

But this provision, known as the “Education Article” of the New York Constitution, tells us nothing about the quality or duration of the education that the

state must provide. (Almost every other state also has an Education Clause that describes the state’s duty to provide education—and most of these constitutions describe education in similarly general terms.)

In 1982, the state Court of Appeals took a first step toward interpreting the New York Education Clause. The Court found in its *Levittown v. Nyquist* decision that Article XI requires the state to “ensure the availability of a sound basic education to all its children”—leaving unanswered the question of what a “sound basic education” means.³ But the Court also ruled that neither the Education Clause nor any other provision of the New York Constitution required reforming school funding to achieve greater equity between poor and wealthy districts, closing the door to an equity-based avenue to school finance litigation in New York.

Since the 1982 decision made it clear that the courts did not require school funding to be *equitable*, education advocates next sought to convince the courts that New York had failed to achieve the constitution’s guarantee of an *adequate* education.

The CFE Decision: A Decade of Litigation

The litigation culminating in the June 2003 decision began in 1993, when a nonprofit coalition called the Campaign for Fiscal Equity (CFE) and more than a dozen community school boards filed a lawsuit arguing that the state had not met its constitutional duty to provide an adequate education to children in New York City. Representatives of the state government sought to dismiss the case, and successfully argued that the community schools—and the City of New York, which had filed a companion case—were not eligible to file such a suit.

But in June of 1995, the state Court of Appeals ruled that Campaign for Fiscal Equity could proceed with its challenge of the State’s school finance system on the grounds that it denies students in New York City the opportunity to a “sound basic education.”⁴ In other words, the court admitted that adequacy was a legitimate basis for a constitutional complaint, and allowed CFE the chance to prove that New York State

³*Board of Education, Levittown Union Free School Dist. v. Nyquist*, 57 NY2d 27 (1982)

⁴*Campaign for Fiscal Equity, Inc. v. State of New York*, 86 NY2d 307 (1995)

²*San Antonio Ind. School Dist. v. Rodriguez*, 411 US 1 (1973)

is not adequately funding schools. The case was remitted to a trial court to evaluate CFE's claims.

In 1999, a trial court heard arguments from CFE and other organizations in a case that sought to answer several fundamental questions:

- What precisely is a “sound basic education?”
- Are students in New York City receiving the opportunity for a sound basic education?
- If not, does the fault lie with a lack of adequate resources?

In January of 2001, the State Supreme Court ruled that students in New York were not receiving the opportunity for a sound basic education, and that the school finance system was largely to blame for these inadequacies. As a result, the Court found the State's system for funding public education unconstitutional. The State of New York immediately appealed the trial court's decision, and in June of 2002 an appellate court overturned much of the January 2001 decision.

In June of 2003, the Court of Appeals (the state's highest court) reversed the intermediate court's decision and reinstated the original ruling—that the state's system of funding New York City schools was unconstitutional. The Court found that “whether measured by the outputs or the inputs, New York City schoolchildren are not receiving the constitutionally-mandated opportunity for a sound basic education.”

The Court of Appeals also used the evidence gathered by the trial court to clarify its ruling that the Education Clause required the state to provide all students the opportunity for a “sound basic education.” The Court ruled that a sound basic education requires providing New York school children a “meaningful high school education, one which prepares them to function productively as civic participants.”

The Court's Remedy: Achieving Adequacy

Faced with a choice between providing no guidelines to the legislature on how to reform education finance and providing a detailed blueprint for reform, the Court chose a middle ground, requiring the State to take three concrete steps toward reform:

- The state must **determine the cost of providing a sound basic education** in New York City.
- The state must **ensure that each school has the resources necessary** to provide the opportunity for a sound basic education.
- The state must **create a system of accountability** to ensure that these new state resources are being used effectively to fund education.

Though the *CFE* decision pertains to New York City school children, the decision will likely have implications for all of New York's school children. For the first time, state policymakers have guidelines against which to judge the adequacy of elementary and secondary education. And the availability of this yardstick will likely prompt them to apply the *CFE* requirements on a statewide basis, which is, in fact, the position that has been agreed upon by the governor and the legislative leaders.

The *CFE* remedy required the State to act quickly—and state policymakers failed to do so. In fact, the July 30, 2004 deadline set by the Court of Appeals passed without any legislative action. The case is now back in the hands of the courts for further action.

Shortly after the state missed this deadline, supreme court Justice Leland Degrasse appointed a panel of three distinguished lawyers to serve as referees to “hear and report with recommendations” by November 30, 2004 and to specifically:

1. Assess what measures the state has taken to follow the Court of Appeals' directives;
2. Identify areas in which compliance is lacking; and
3. Make recommendations on how to bring the state's school funding system into compliance with the ruling.

After a series of hearings, the judicial referees issued a report making six recommendations:

1. That the New York City school district should be provided with an additional \$5.63 billion per year in operating funds, with this increase being phased-in over a 4-year period;
2. That the state should conduct new “costing out” studies every four years to reexamine and re-determine the costs of providing a “sound basic education” to all students in New York City;
3. That City schools should be provided with \$9.179 billion in additional funding for capital improvements over the next five years;
4. That the state should conduct new facilities studies every five years to determine the additional funding, if any, required in the future to ensure that every New York City student has available facilities sufficient to provide the opportunity for a sound basic education;
5. That the funding studies referred to above should continue into the future until successful reforms to the state's education finance formulas have rendered such studies unnecessary;
6. That certain enhancements, that are essentially agreed upon by the parties, to the existing New York accountability structure be implemented.

It has been estimated that applying the referees' recommendation to all school districts in the state would require approximately \$8.5 billion per year (the \$5.6 billion recommended by the referees for New York City plus \$2.9 billion for other needy school districts around the state).

It has been estimated that adequately funding schools statewide would cost about \$8.5 billion per year.

The referees did not make a recommendation as to how the responsibility for providing the additional funds should be divided between the state and New York City, suggesting that the state should make that determination on its own. It is not known at this time how the legislature will allocate responsibility between the state and the city. New York City has asked that the state provide all of the additional funds. The state and CFE, on the other hand, have suggested that a portion of this responsibility be carried by the city itself. Under CFE's proposal, this division of responsibility would be determined for all school districts, including New York City, on the basis of a sharing formula that takes into consideration each district's wealth (as measured by both the adjusted gross income of school district residents and the full value of taxable real property in the district) relative to its pupil count adjusted for student need. While it is uncertain how much these funding responsibilities will be divided, it is clear that New York State must find sufficient revenue to substantially increase its state aid to local school districts.

How Can New York Achieve Adequacy?

One important question left unanswered by the court's decision is how New York policymakers must change the education finance system to comply with the decision—and how much these changes will cost. In the wake of the June 2003 Court of Appeals decision, two groups, the New York State Commission on Education Reform and the Sound Basic Education Task Force, organized by the Campaign For Fiscal Equity and the New York State School Boards Association, presented recommendations and costing-out studies to the governor and legislature, and ultimately, when they failed to act, to the State Supreme Court during its compliance proceedings.

The Governor's Commission Proposal

The New York State Commission on Education Reform was established by an Executive Order issued by Governor George E. Pataki. The Commission asked Standard & Poor's School Evaluation Services (S&P-SES) to analyze the issues involved in determining the actual cost of providing a sound basic education. In its report, S&P-SES developed an analytic framework based on the "successful schools" methodology. Actual cost determinations would depend on the specific choices the policymakers might make concerning the extra weightings that should be used for children with special needs, regional cost indices and other such items. For illustrative purposes, S&P-SES showed that using certain variables, the costs for providing the opportunity for a sound basic education for all of New York State's school children would be between \$2.5 billion and \$5.6 billion annually.⁵ The Commission has used these variables and these figures in its report. The Commission provided a set of recommendations for the distribution of this additional financing as well as recommendations for ensuring the overall accountability of public education in New York.

The Commission also recommended changing the formulas by which New York distributes state aid to be more sensitive to local cost factors such as wealth, poverty rates and the presence of students with disabilities or limited English proficiency. The Commission also recommended ways for the state to improve capital projects funding, and advised that these changes should be phased-in over five years.

In response to the Commission's findings, Governor Pataki suggested a series of changes to the state's revenue structure, and increases in state, local and federal spending over the next five years that would total \$8 billion.

Under the governor's plan, the additional \$8 billion would be raised over five years using a variety of sources, with the biggest contribution coming from an expansion of video lottery terminals (VLTs). The Governor projects that, once implemented, the expansion of VLTs would bring in an additional \$2 billion annually and would be dedicated solely to providing a sound basic education.⁶ The Governor's proposal also includes an additional \$2.5 billion in State aid, an anticipated \$2 billion in additional federal funding and requires New York City to contribute \$1.5 billion.

⁵Resource Adequacy Study for the New York State Commission on Education Reform, March 2004

⁶State Education Reform Plan, August 12, 2004

The Governor's proposal, however, has flaws. First, in July 2004, the New York Appellate Division ruled that the State's current method of distributing VLT revenue is unconstitutional.⁷ The Appellate Division concluded that since VLTs are considered a lottery and the New York constitution requires all net proceeds of lottery revenue to go towards education, the VLT revenue distribution system that includes giving portions of the VLT revenue to horse track interests is unconstitutional. This ruling has been appealed to the Court of Appeals, so any effort to devote additional VLT revenues to education must first cope with this constitutional problem. The use of VLT revenues to fund education is problematic for other reasons, as described in Chapter Eight.

In addition, the Governor's plan includes \$4.5 billion in unsubstantiated aid. The plan projects an additional \$2.5 billion in state aid and an additional \$2 billion being provided by the federal government. However, the Governor does not detail how these revenues will be raised—and the basis for expecting an additional \$2 billion from the federal government is unclear. New York City Mayor Michael R. Bloomberg also claims that he has no source for the proposed \$1.5 billion city share.

Sound Basic Education Task Force Proposal

A second costing-out proposal was undertaken by two national consulting groups, the American Institute for Research and Management Analysis and Planning, Inc. (AIR/MAP) and endorsed by the Campaign for Fiscal Equity, the plaintiff in the 1993 litigation, and its Sound Basic Education Task Force. The Task Force proposals resemble the Governor and Commission's recommendations in regard to adjusting state aid formulas and implementing better accountability mechanisms. The most significant difference between the two proposals is in the amount needed to provide New York school children with a sound basic education. The AIR/MAP report states that the additional amount needed statewide ranges between \$6.2 billion to \$8.4 billion annually.⁸ Taking a figure in the middle of this range, however, and updating it for inflation through 2004-2005, CFE has recommended a total statewide increase of \$8.5 billion. Unlike the Governor's proposal, the Task Force does not suggest a way to raise this additional revenue. Furthermore, the Task

Force proposes \$10 billion in additional funding for capital projects (to be phased in over five years) along with regulative changes whereas the Governor's proposal only suggests regulative changes without any additional funding.

Using video lottery terminal (VLT) revenues to fund education may be unconstitutional.

Neither of these proposals includes a realistic mechanism for raising the necessary funds—and there remains disagreement on whether achieving adequacy will require additional revenues in the \$2.5 to \$5.6 billion range prescribed by the Governor's Commission or the \$8.5 billion recommended by CFE.

How New York Schools Are Funded

Why is it so difficult to achieve educational adequacy? The basic problem is that close to half of the revenue currently used to fund schools comes from local governments themselves—and local governments vary tremendously in their ability to finance adequate public services.

In fiscal year 2001-2002, New York state and local governments spent \$35 billion on elementary and secondary education. Of that total state aid to local governments represented just over \$17 billion, or 48.7 percent of all public school funding, and federal aid added another 5 percent. This left local governments to pick up more than 46 percent of the cost of funding elementary and secondary education.

In New York, as in most other states, the primary source of local funding for education is the property tax. One problem with the use of property taxes as a source of school funding nationwide is that property-poor districts are less able to use these revenues to fund schools. The less property wealth in a given district, the less property tax revenue that district can raise in taxes—and the less revenue is available to adequately fund schools. As a result, property-poor districts are usually not able to fund the costs of education as easily as property-wealthy districts.

For example, the Lafayette school district is one of the poorest in the state. For each pupil in the school system, Lafayette has less than \$100,000 of property value that can be taxed to pay for schools. The much wealthier Rye school district has more than \$1.1 million of property value for each student. In 2002, Lafayette real property taxes were 1.81 percent of

⁷Joseph Dalton et al v. George Pataki, 780 N.Y.S.2d 47 (2004)

⁸The New York Adequacy Study: "Determining the Cost of Providing All Children in New York an Adequate Education", March 2004

property value, while Rye taxed properties at 1.27 percent of value—almost a third less than in Lafayette. But because Rye’s per-pupil tax base is so much larger, the Rye district was able to raise nine times more per pupil than did Lafayette in 2002.

In this example, the vast difference in property wealth between these two districts mean that residents of the low-wealth district are doubly punished, paying property taxes at a much higher rate and receiving much less funding per pupil in return.

In addition to differences in property wealth, differences in the cost of delivering an adequate education can vary among school districts due to “local cost factors”. Local cost factors include the incidence of students in poverty, speaking English as a second language, and/or enrolled in special education programs. The June 2003 *CFE* decision concludes that an increase in these local cost factors will increase the cost of providing a sound basic education.

The Struggle for Adequacy in Other States

Many states have struggled with court-ordered school finance reform in recent years. While the Court of Appeals’ June 2003 decision is an important step towards achieving educational adequacy, the experience of other states shows that recognizing school funding inadequacies is only the first step in achieving progressive reforms of a state’s education funding and tax systems. This section looks at the recent experiences of three states—Alabama, Kentucky, and Michigan—in combining tax reform with school finance reform, with an eye toward drawing lessons for school finance reform in New York.

In the case of *Harper v. Hunt*, which began in 1990, Alabama’s entire primary and secondary public school system was declared unconstitutional by a lower court because it did not fulfill the constitutional guarantee of an adequate and equitable education.⁹

The lower court’s decision prescribed specific policy changes to remedy these constitutional violations, including performance standards for students and educators, school accountability, staff development, teacher pay, and school capital infrastructure. Annual cost increases for these educational changes were estimated at \$1.7 billion.

Recently, the Alabama Supreme Court upheld the lower court’s finding that the system was unconstitutional, but instructed the lower court to leave deci-

sions about how to achieve adequacy to the legislature and the governor.¹⁰ To date, the legislature has not complied with the court’s mandate—and there is no prospect for revenue-raising reforms in the near future.

In 1989, the Kentucky supreme court found the Kentucky school system unconstitutional in *Rose v. Council For Better Education*. The court described in detail the requirements of an “efficient” education system. The list of these requirements drawn up by the court became the “Rose standards” that has been used in Massachusetts, North Carolina, and a number of other states.

Responding almost immediately to the *Rose* mandate, the Kentucky General Assembly enacted a plan which totally overhauled the system for K-12 education and created a new school funding system that included state-aid adjustments for exceptional and at-risk students as well as transportation costs.¹¹ It also included funds for special education, preschool programs, technology, professional development, deficient schools and rewarding school improvement.

The main funding sources for the reform plan were a sales tax increase, an increase in the corporate income tax, and loophole-closing personal income tax reforms. Local districts were required to levy a minimum property-tax rate of 30 mills to participate in the state-aid program. Local supplements were also limited, partially equalized, and subject to local voter approval. The new taxes increased funding for schools by 42 percent from 1990 to 1994, and by 1999 the per-pupil spending gap between wealthier and poorer districts had closed from \$1,199 to \$757. During that time, reading scores doubled for Kentucky’s students, and student test performance also improved.

The Kentucky legislature took steps to ensure that the increased state taxes from this plan would not fall primarily on low-income taxpayers by simultaneously enacting a low-income tax credit. The 1990 reforms also strengthened the personal income tax base in a progressive way by eliminating the state’s deduction for federal personal income taxes paid—a rarely used loophole that primarily benefitted the very wealthiest Kentuckians.

Unlike the other states surveyed here, the impetus for school finance reform in Michigan in the early 1990s was not a court mandate, but public dissatisfaction with the state’s high property taxes and

¹⁰*Ex parte Governor Fob James*, 2002 WL 11508(Ala.,2002).

¹¹*Rose v. Council for Better Education, Inc.*, No. 88-SC-804-TG; Supreme Court of Kentucky, 790 S.W.2d 186 (1989).

⁹*Alabama Coalition for Equity, Inc. v. Hunt* No. CV-90-883-R (Ala. Cir. Ct. Montgomery County), 6224 So.2d 107 (Ala. 1993).

inequality in school funding between poor and wealthy local districts. In 1993, the state legislature voted to eliminate the local property tax as a source for school funding. In a 1994 election, Michigan voters ratified a “tax swap” that funded local property tax repeal by increasing general sales taxes by two percent and cigarette taxes by 50 cents per pack, with the proceeds devoted to funding schools. The voters also agreed to create a new state-administered property tax. These changes shifted most of the school funding burden from local governments to the state.

The state’s assumption of the school funding burden resulted in funding increases of up to 30 percent for poorer districts, and reductions in revenue to wealthy districts of about 4 percent.

The Michigan tax reforms were also designed to restore balance to the state’s tax system. In 1990, Michigan property taxes were more than thirty percent above the national average, while its sales and excise taxes were more than thirty percent *below* the national average. The 1994 reforms reduced this imbalance substantially: by 2000, Michigan property tax revenues were just seven percent above the national average, and consumption tax revenues were only ten percent below the national average.

While this change restored balance to Michigan’s tax system, it did so by increasing slow-growing cigarette taxes and volatile sales taxes, which generated insufficient revenues to replace the lost property tax receipts. The state responded to these problems two years later, in 1996, by dedicating a portion of personal income tax revenues to schools. But the state’s initial choice of slow-growing, unfair consumption taxes as a revenue source forced lawmakers to return to these issues a second time.

Because this “balancing” process involved increases in regressive sales and cigarette taxes, these changes also made the Michigan tax structure more regressive. Since the 1996 release of ITEP’s study, *Who Pays?*, Michigan has been recognized as one of the “terrible ten” most regressive tax systems in the nation—largely due to the school finance reforms implemented in 1994.¹²

Conclusion

The June 2003 CFE decision culminated a ten-year judicial odyssey with an emphatic statement that the state’s education system is unconstitutionally in-

adequate. The recommendations of the recent Governor’s Education Commission and CFE’s Sound Basic Education Task Force provide a valuable starting point for thinking about what education policy changes will be required to revitalize the New York education system. However, the question of how educational adequacy can be paid for remains largely unresolved—the Governor’s recommendations provide unfunded or constitutionally suspect revenue sources, and both the CFE and the Special Referees do not recommend any specific approaches to revenue-raising. Later chapters of this report will take a first step toward answering the important question of how tax reform strategies can be used to achieve educational adequacy.

School funding adequacy has been a battleground in dozens of states in recent years—and recognizing educational inadequacy is by no means a guarantee that adequacy will be achieved. The experiences of other states offer valuable insights for state policy makers. Kentucky’s 1990 reforms show that judicial mandates for education funding reform can result in immediate action, with long-run improvements in educational achievements while simultaneously revitalizing the state tax system. Kentucky’s legislature responded to a court mandate within a year, passing a revenue-raising package that increased state revenues through a combination of loophole-closing and rate increases that “spread the pain” between income, sales and property taxes. Kentucky lawmakers also seized the opportunity to enact true tax reform, shoring up the income tax base by eliminating a costly loophole and providing low-income tax relief to help offset the state’s regressive sales tax increases.

The Michigan legislature also managed to push through tax changes to fund educational adequacy. But the state’s use of cigarette and sales tax revenues bodes ill for the long-term viability of education funding in the state—and has made the tax system more inequitable. The Michigan reforms show that school funding based on slow-growth revenue sources may present a short-term respite without providing a long-term solution.

Finally, the example of Alabama shows that judicial mandates are insufficient to ensure educational adequacy. More than a decade after the state’s education system was first found inadequate, no substantial reforms have been enacted—and Alabama’s schools continue to perform poorly. The Alabama experience shows clearly that if judicial mandates are ignored, litigation designed to achieve school funding reform can make matters worse rather than better.

¹²Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*. (1996)