Striking a Balance:
FINANCING
EDUCATION REFORM IN
THE MOST HEAVILY-TAXED STATE

What are the prospects for generating revenues to finance education reform in the current fiscal climate?

KEY POINTS EMERGING FROM THE DISCUSSION

▲ New revenues for education finance reform should be generated in a way that does not compromise the competitiveness of New York State.

▲ Taxpayers deserve to have their taxes used efficiently and effectively; making current spending more efficient is as important as getting new monies into the school system.

▲ Education reform will not be accomplished until it becomes a priority for legislators.

▲ The business community has a direct stake in the improvement of the public school system: cultivating the human capital necessary to ensure future business growth and prosperity.

▲ A good reform strategy will engage many groups, but the business community has been especially successful in bringing pressure to bear on legislators to accomplish education reform.
In March, the Campaign for Fiscal Equity (CFE) case cleared another hurdle in reaching a conclusion: the New York State Appellate Division of the State Supreme Court upheld the trial court’s mandated infusion of billions of dollars in school aid. Since New York’s combined state and local tax burden make it the most heavily taxed state in the nation, financing this enormous mandate will require carefully constructed tax policy approaches.

Shortly after the decision, on April 27, 2006, the Citizens Budget Commission (CBC) hosted an expert panel discussion to examine the prospects for accomplishing meaningful education finance reform. The event was held at the offices of Greenberg Traurig, LLP and was moderated by CBC Trustee Eugene Keilin. The discussion focused on responsibly generating revenues to fund the Court’s mandate, thinking about other changes needed to accomplish reform, and developing the role of the business community in seeing reform across the finish line.

How Can the State Responsibly Generate Revenues for Reform?

Following an update by Joseph Wayland, a partner at Simpson, Thatcher and Bartlett LLP who is also the lead litigator in the CFE case, on the status of the litigation, Diana Fortuna, President of the CBC, presented CBC’s recommendations for raising the revenues necessary to provide a sound basic education for all students.

CBC’s research rested on the position that the State, rather than local school districts, should be the source of new funding, raising additional funds as part of a longer-term goal to increase its contribution for school funding. Decreasing the mandated share raised by local school districts would alleviate inequities in spending caused by the existing system of funding.

Currently, the State’s education finance system is one in which less wealthy districts, i.e. those with a smaller local property tax base, have a much higher than average tax burden, while districts with a wealthier base can raise more revenues with a smaller taxation effort. While New York has high local taxes, it has lower-than-average state taxes, and lags behind most other states in its share of state funding of education. Nationally, states have moved toward a greater share of funding as a method of ironing out inequities in local district spending.

In seeking ways to raise revenues for education finance reform, CBC was guided by one principle in particular, which Ms. Fortuna explained: “We felt we needed to look for ways to generate funding that would not put the state at a competitive disadvantage.” Its combined state and local tax burden make New York State the most heavily-taxed state in the nation; increasing taxation much beyond the current level would place the State at a disadvantage relative to other states.

In March, the Campaign for Fiscal Equity (CFE) case cleared another hurdle in reaching a conclusion: the New York State Appellate Division of the State Supreme Court ordered New York State to spend at least $4.7 billion in operating aid and $9.2 billion in capital improvements for New York City public schools over the next four to five years. Building on this momentum, local leaders lobbied the State, resulting in a capital funding deal that may supply the State capital funds that the City was seeking. The full details of the funding arrangement are forthcoming.

On April 18, 2006, CFE filed an appeal with the court to issue a clear and enforceable order to the State to comply fully with the CFE order – i.e., to deliver on operating aid. The case is being heard on an expedited basis and the deadline for filing all briefs in the case was August 25, 2006. Oral arguments are set for October 10, 2006.

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— Delegate Jean Cryor—

With this in mind, CBC made three recommendations rooted in the reality that accomplishing meaningful education reform would require striking a delicate balance between raising the required revenues and maintaining the State’s competitiveness.

First, eliminating inefficiencies in the system could generate at least $1.2 billion annually. A sample of changes that could be made include using teacher time more efficiently, consolidating smaller school districts outside of New York City, and reallocating State aid now given unjustifiably to wealthy school districts.
Second, expanding gambling activities could generate an additional $2 billion. This option is preferable to that of a tax increase because it would not increase the overall tax burden, is not regarded as a tax by those paying it, and it would recapture some spending by State residents currently benefiting other states.

Third, broadening the tax base through increased enforcement of sales tax on remote purchases, extending the sales tax to professional services and to certain cover exemptions, and revising the corporate income tax could raise up to $2.6 billion a year. A statewide solution would also require a small increase in the personal income tax.

Do Schools Really Need More Money, Or Are There Other Changes That Must Be Made?

Alair Townsend, Vice-President and Publisher of Crain’s New York Business and a former New York City budget director, generally agreed with CBC’s recommendations; however, she warned that raising broad-based taxes could worsen New York’s competitiveness. Instead, she proposed a reworking of school aid formulas and full use of school capacity as first steps in reform.

Ms. Townsend also posed the following dilemma: How can New York lead the pack in school spending, yet still be inadequately funding education? Ms. Townsend questioned whether infusing the system with new resources before examining current spending was a good approach. She stated, “In my view, [the problems with the school system do] not mean that everything we spend now is necessary and wise, and that we should just build a new set of schools.” For example, she cited much higher instructional costs – rooted in generous pension and fringe benefits for teachers – as something that could be altered to provide substantial cost savings to the school system. Ms. Townsend feared that new monies would flow to schools before a careful assessment of current spending could be completed and before a binding commitment to accomplish reform could be made and agreed upon by the Governor, Legislature, local state administrators, teachers and unions. A prerequisite to increased spending, Ms. Townsend argued, must be basic reform and greater accountability.

Carla Hendra, Co-Chief Executive Officer of Ogilvy North America and the President of OgilvyOne North America, and the parent of children in the New York City school system, agreed that taxpayers deserve more. Based on her experiences volunteering in New York City public schools with underprivileged children, however, Ms. Hendra testified to the startling need that some schools have for basic resources, such as copiers. She argued that the State needs to devote more resources to low-performing schools to ensure children at these schools are receiving an adequate education.

She also emphasized the role of the public school system in cultivating the human capital necessary to ensure future business growth and prosperity. Ms. Hendra described recent recruiting efforts in New York, lamenting, “We cannot find enough young people who have critical thinking and learning and quantitative and analytical skills. And that’s what our business is; our only advantage and asset is people with brains. That’s it. The only thing that matters. When we go out and look at the recruits, and we recruit heavily from the universities, both public and private in New York, it’s getting harder and harder to find enough of the kind of people we need if we’re going to hit our growth targets.” Ms. Hendra called ensuring schools have enough resources to properly educate and train the future workforce “the proverbial no-brainer.”

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— John Stevens—

Like Ms. Hendra, Delegate Jean Cryor has also spent years working on education issues, but in a different role: as a legislator in Maryland. With over a decade of experience in education reform, she offered a pragmatic observation: the question of how much revenue should be raised is second to whether legislators would be willing to take steps to pursue reforms. Any good strategy for education reform will focus on making reform a priority for legislators, who will need to be pressured to muster the political will to tackle such a tough issue.

According to Delegate Cryor, Maryland examined a variety of options to generate new funds for education, including broadening the sales tax and using gambling revenues, and ultimately settled on using funding from the tobacco settlement.
More important than the source of funding, Delegate Cryor stated, was that the funds were baselined into the state budget, creating a situation in which it would be too politically risky for anyone to diminish or remove them. Even after massive turnover in elected offices and new political priorities, the phase-in for funding reforms continued unhindered, because “the political system had been called into play and it worked, and it held, and it wasn’t dependent on an individual’s vision.” Delegate Cryor continued, “The point I’m trying to make here is that if you don’t have a vision that involves politicians and involves their votes and their interests, you are never going to get there.”

How Has the Business Community Participated in Accomplishing Responsible Reform?

John Stevens, Executive Director of the Texas Business and Education Coalition (TBEC), echoed Delegate Cryor’s point on the importance of influencing legislators to take action, and asserted that the business community was uniquely suited to apply calculated pressure on the legislature: “Legislators understand that we can help give them political cover or create a political environment in which it’s safe for them to do the right things. And the business community needs to be a force in this. If they don’t do it, no one else will and no one else can.”

TBEC was established in 1989 by business leaders to have a mechanism through which they could work with educators to improve the performance of the State’s public schools. The idea for TBEC grew out of the frustration of business leaders who, aware of the failures of the public school system, realized the importance of improving education for future economic development in Texas. “The stakes were high,” explained Mr. Stevens, “and the stakes had to do with the future of our economic well-being as a state. It also had to do with the social well-being of the state, as well.”

Funded through major foundation grants but also corporate contributions, TBEC advocates education policies that will improve the performance of public schools through integrated P-16 (pre-k through college) systemic education improvement initiatives and effective public-private partnerships. For example, TBEC’s efforts were instrumental in pushing for fundamental changes in student performance standards and assessment and accountability systems, changes which business leaders demanded as conditions of restructuring Texas’ tax system in order to finance education reform. As Texas revisits its standards this year, Mr. Stevens explained that TBEC continues to have a role in the process of reform, giving voice to the business community’s concerns.

Can the Realignment of State and Local Fiscal Responsibilities Help With Education Reform?

One of the questions asked of our panelists was whether a full assumption of Medicaid costs by the State would create a better state and local finance system that would, in turn, free local revenues for education. New York has the highest cost per Medicaid beneficiary in the nation, and requires local governments to pay an unusually high share of the total cost of the program. This imposes a steep financial burden on local governments, even with a 3.5 percent growth cap on the local share of the program enacted in January of this year. For New York City, this cost is particularly severe; the City is expected to pay about 65 percent of the statewide local share in fiscal year 2006, approximately $4.5 billion. Ms. Fortuna agreed that realignment of state and local fiscal responsibilities in such a way would probably be a good fix for New York; Ms. Townsend also agreed, and said the State should consider assuming other local costs, such as that of pensions, as well.
How Can New York Lead the Pack in Spending, Yet Still be Inadequately Funding Education?

According to *Education Week’s Quality Counts*, an annual publication that assesses education policies in the states, New York State spends $10,665 per pupil on average after adjusting for regional cost differences – over 30% above the U.S. average of $8,041.* This makes New York the third highest spending state in the nation, prompting the question articulated by Alair Townsend: How can such high spending be inadequate?

One answer lies in local preference. Certain school districts have a tax base large enough to generate very significant resources with a relatively low level of taxation. These wealthy school districts spend more on education and drive up the statewide average, which masks the large inequities in spending between wealthier and poorer districts.

Exacerbating these inequities is the allocation of school aid by the State. CBC identified about $750 million that could be saved if the State would eliminate or reduce aid to wealthy districts with a tax base large enough to generate the full cost of a sound basic education on their own. This is a misallocation of funds that contributes to high spending, without addressing inadequacies in the education system.

Third, funds are spent inefficiently throughout the system. Rigid administrative arrangements, exemplified by teacher contracts that divert teacher time away from the classroom or small school districts that could more efficiently be consolidated, impose significant additional costs on the system. CBC’s analysis found that correcting just these two problems would yield savings of almost $500 million.

Other aspects have also been critiqued as leading to inefficiencies and unreasonable costs in the system. Two issues raised by Ms. Townsend are the extent to which generous pension and fringe benefits are driving up instructional costs and how new school construction costs can be reduced by pursuing year-round education and rezoning.

Year-round schooling alters the conventional school calendar, during which no regular classes are scheduled for July and August, by spreading the school year out over the entire calendar year. Combining this spread out school calendar with staggered scheduling for classroom instruction throughout the year better utilizes existing capacity and can easily increase the number of children that any school building can accommodate.

Rezoning could also increase capacity in the current system by easing overcrowding in certain areas. While many schools face overcrowding issues, enrollment is below capacity in most schools. The reason for this imbalance is that many schools are “zoned,” or designated to draw students from particular areas. Schools should be rezoned to reflect shifts in population; however, in practice, rezoning happens rarely. Rezoning could alleviate overcrowding and reduce the costs of new school construction.

*Source: Education Week. *Quality Counts At 10: A Decade of Standards-Based Education.* v. 25, no. 17, January 5, 2006.
Increased the State’s share of school funding would help iron out inequities in spending between districts. Spending in New York State lags other states in its share of school funding and should follow the national trend to increase the State’s share as a way to alleviate inequities.

The CBC Framework:
Where Should the Money Come From?

- Eliminating Educational Inefficiencies: $1.2 billion
- Expanding Gambling Activities: $2.0 billion
- Broadening the Tax Base: $1.5 billion - $2.6 billion
- Total: $4.7 billion - $5.8 billion

CBC’s Recommendations: Getting to $5.6 Billion

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The State – not local school districts – should raise the funds needed to fund a sound basic education because:

- New revenues must be generated in a way that does not compromise the State’s competitiveness. New York has high local taxes, but lower-than-average state taxes; increasing the local tax burden would put New York at a competitive disadvantage. The State also has revenue-producing options, such as gambling, which are preferable to new or increased taxes.