School Funding in Maine: Priorities for Improving Equity

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by

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Introduction

The past decade has been a tumultuous period for our nation's public schools. Continued increases in the frequency and tenacity of difficult social problems and substance abuse has placed far more school children "at risk," a major recession has eroded states' financial support for education, and disenchanted taxpayers are increasingly approving fewer property tax dollars at the same time they demand improved school performance and accountability. Not surprisingly, the number of lawsuits being waged against state systems of school finance have multiplied dramatically. With the recent overturn of Ohio's finance system (Harp, 1994), a total of nine state funding systems have been declared unconstitutional since 1989; nineteen other lawsuits are still in progress.

During the past several years, a quiet revolution by justices hearing arguments in lawsuits charging unequal educational opportunity has been underway. Not that long ago, making roughly equivalent per pupil expenditures, particularly if they were at a reasonably high level, provided a near guarantee that the courts would find a state's funding mechanism constitutional with regard to equal educational opportunity. Today, when a funding system is challenged on the basis of denial of equal opportunity, judges routinely discount the usefulness of per pupil expenditure evidence and instead require comparative information about resource availability including the range of courses offered, the number and condition of computers and other technology, and teachers' salaries, experience and education (Dayton, 1993). Several recent cases additionally have cited disparities in the extent and condition of school facilities as an important basis for the overturn of state funding systems (Harp, 1992).

Hansen, Rath and Hagans (1991) have pointed out that "the results expected [by the courts] are such that the historically accepted and still often commonly employed state school finance programs are not acceptable" for achieving constitutional objectives. Despite those stricter standards for establishing equal educational opportunity, Maine recently saw its funding mechanism upheld. Does this mean that school funding reform is now unnecessary in Maine?

It is important to understand that court considered Maine's finance system only from the perspective of the charges in the lawsuit, which were confined to a specific set of actions taken during a narrow time frame. A finding for the state simply means that the plaintiffs had failed to prove that the state's recent compromises on the school funding distribution over the past few years had seriously disadvantaged their students. As such, the lawsuit against the state implicitly accepted the "formula" devised to implement the 1985 school funding law as equitable by arguing that a return to that formula would restore equity. Thus, unlike many states who have faced constitutional challenges, Maine's funding approach did not receive a close and thorough scrutiny.

Would Maine's system have been able to withstand a more comprehensive challenge? It is of course impossible to predict the outcome of a hypothetical lawsuit. Nonetheless, as the result of a probing investigation of pupil equity initiated by Governor McKernan's "Task Force to Provide Recommendations Regarding School Funding" (1993) and continued by the Legislature's Joint Education Committee we now know that substantial disparities in learning opportunities exist in Maine, not only *among districts* but also *among schools within the same district.* In addition, the condition of school buildings and labs, the availability and age of computers, and teachers' salaries were similarly found to vary widely both across and within

districts (see LaPlante, 1994).

The research results also raised concerns about the way that we organize to deliver education in Maine, because the more loosely structured "unions" (in which member towns have separate school boards and individual budget authority) were more likely to have disparities in resources among their schools. In addition, it was suggested that a recent budgetary pattern of very low annual expenditures on equipment and other capital outlay as well as disparities in computer and physical resources may be attributable to incentives and disincentives deriving from the state's higher rate of assistance for school construction.

These are pressing issues for Maine; when combined with continuing citizen dissatisfaction with the property tax, they signal the need to place school finance reform among the state's highest policy priorities for the near future. This paper highlights and explores the two broad issue areas that are central to the deliberations of the newly formed education funding study commission (1993 P.L. Ch. 684, Section 4): pupil equity and taxpayer equity. In some instances, options for abating some the most pressing problems will be indicated and discussed briefly. First, however, a quick review of the process Maine uses to fund schools may be helpful.

Maine's School Funding Formula and Pupil Equity

The "formula" for allocating state aid for education in Maine is essentially a two stage process. The first stage is the determination by the state of how much of each district's projected budget will be subject to subsidy. The state uses statewide data on education spending for the previous year to determine spending "norms" for secondary and elementary education, i.e. the average or per pupil expenditure amount for each level. This amount becomes the "foundation"

per pupil amount.

Once the foundation amount has been determined, the number of elementary pupils in each district is multiplied by the state's average expenditure amount to arrive at a projected budgetary need for running an elementary education program based upon "normal" (or average) statewide spending responses. This process is then repeated for districts that run a secondary education program and the results combined with the elementary budget estimate to obtain a district total. The total amount is updated to reflect inflation; this final figure becomes the portion of total spending for regular programs that the state will subsidize.

In addition to the regular subsidy from the state (which is the major part of state aid for education), there are a variety of special "programs" such as special education that are approved for subsidy using other methods. Debt service on school construction and expenditures for capital leases are also funded separately; there is a debt service "circuit breaker" that caps the number mils any district must raise for these purposes. Thus, recipient districts often find that the state share of debt service exceeds the percentage of regular spending the state subsidizes.

The second part of the state's funding process is the determination of state and local shares of financing responsibility, which requires the state to decide how each town's ability to pay for education compares to that of other Maine communities, or what may be called "relative fiscal capacity." Once the state has rank ordered the towns by property wealth, the share of approved spending the state will pay is decided.

Through what is known nationally as a foundation funding approach, Maine attempts to ensure that a roughly equivalent number of dollars or "foundation" allocation will be available to finance the education of each child in the state. Although some states who use the

"foundation" approach continue to see vast interdistrict funding differences, Maine has made significant progress towards equalizing per pupil spending. This has been accomplished by targeting the overwhelming bulk of total state education aid dollars to supplement local ability to pay in the poorest districts. In addition, during the 1980's, the state made a concerted effort to increase the state's share of local education spending to more than half of the total.

The combination of a high state share and aggressive equalization of local ability to pay earned Maine accolades: funding system has often been cited nationally as being among the most equitable in the country. Thus, when the extent of disparities in learning opportunities among and within Maine's school districts was revealed by the Joint Education Committee's study of resource availability, many people were understandably startled.

It is important to recognize at the outset that there is much positive that may be said about Maine's formula, because it achieves a far higher level of fiscal equalization than most states. Nonetheless, we now know that relatively equal per pupil expenditures do not equate with equality of learning opportunities in Maine's schools. At first glance, the concept of ensuring an equal number of dollars per pupil sounds like a reasonable way to guarantee learning opportunities and to use as a guide for approving local spending for subsidy. However, there are several problems associated with this approach. Understanding why *equivalent* per pupil spending can not ensure *equity* is the single most important step to shaping an improved state education aid allocation mechanism.

Education is a service that is particularly burdened by what is known as the "high fixed cost problem" of the public sector, which arises because whole increments of inputs must be provided, whether the service is offered to one student or twenty. An entire building, rooms with

chairs and blackboards, and teachers must be in place if any students are to be educated. Accountants called expenditures that must be made before even beginning production *fixed costs.*

Maine's funding approach treats all expenditure needs as variable costs, which means it is assumed that spending must increase by the state average per pupil amount each time a new student enters the school, and conversely, that there is a commensurate reduction in spending need when a pupil leaves the district. In actuality, the fixed costs of delivering education do not necessarily change when one child is added to a class or one child leaves. On the other hand, spending will need to increase sharply after the addition of a large number of students, because expansion of facilities is required and addition of teachers.

The fixed costs associated with educational delivery translate into a minimum or "threshold" expenditure that is independent of the number of students. The current funding approach does not recognize the need for a minimum outlay of funds to mount a school program.

The major problem with ignoring fixed costs arises because failure to build in an expenditure threshold for districts with low numbers of pupils results in a serious underestimate of spending need. In some cases, such as Vanceboro, the district makes up the gap, at the expense of very high tax rates. Other districts do not, with the result that students receive a reduced "basket" of educational resources.

Treating expenditure requirements as fully variable causes state funding to be far more sensitive to changes in the number of pupils, than it needs to be. As a result, budgets fluctuate, with aid windfalls for districts who can accommodate new students within existing facilities and funding shortages in districts with declining enrollment.

Another problem emerges from the use of average per pupil amounts to estimate budget needs: with the exception of special education, differing pupil needs like language barriers, behavior problems, and characteristics that place students "at risk" are not considered. Student specific attributes that require additional teacher attention, special classes, or remedial services make it more expensive to "produce" education. Factors such as these, as well as exceptionally cold weather, geographic isolation, and others are called *cost differences* because they influence the cost of achieving an acceptable "output" from the "production" system.

If all districts had an equivalent percentage of students with exceptional needs, the school aid budget approval process might not need to specifically incorporate indicators of the extent of cost differences. However, these cost factors vary widely from one district to another. LaPlante's (1994) analysis of the correlates of resource availability and determined that high percentages of students eligible for the free and reduced lunch program explained why some districts had lower levels of programming than school size, median household income and tax effort would predict.[1]

Reform Priorities and Options

First, an improved school funding approach would include a threshold estimate of spending to be used for isolated districts, recognize cost differences that occur from district size and school size, and provide additional funds for schools with a high proportion of students with exceptional needs. Second, a new funding method should include recognition that except in limited cases where facilities are nearing capacity (or ready to be closed) small enrollment increases (or decreases) do not result in immediate cost increases (or savings).

Although an allocation by classroom rather by pupil has been used in some states to

prevent increases in education aid, allocating funds by "chunks" of students in a rural state makes a great deal of sense. Development of a state level, local education budget estimation and approval system to define the subsidizable portion of each district's operating spending could be structured to ensure adequate spending in all districts and to more closely estimate expenditure needs for priority purposes (as defined by the state) in districts of various sizes.

The determination of "adequacy" will need to recognize that differences among pupils affect the costs of "producing" comparable outcomes. A third means of improving the school funding approach would be the identification of pupil characteristics that legitimately affect the costs of educational delivery, an evaluation of the magnitude of that impact on spending, and incorporation of the resultant weighted counts of pupil "needs" into the determination of optimal class sizes and funding. Fortunately, a number of states have already made significant progress in this area and can provide insights and guidance to Maine.

A funding mechanism that could incorporate cost function information might be a "formula," but ideally should be closer to a budgeting system where actual expenditure needs would be the basis for subsidy, not statewide, aggregate behavior. Although a more "subjective" system runs the risk of being viewed as "political," it would offer a heretofore unseen potential for "cost efficiency": a close matching of resources to expenditure needs.

A new, resource based system could initially focus upon paying salaries of all teaching staff and administrators, with state maximum salary levels specified for each combination of education and experience. Districts whose salary levels exceeded the state maximum would be "on their own" for the excess portion of each salary. Eventually, the maximum numbers of teachers and administrators that are necessary, given various school conditions (number of

pupils, percentage of "at risk" pupils, number of special education) could be determined through research and built into this budget approach to control costs and promote equity.

The remaining operating costs might be allocated initially on a classroom basis, to avoid both over budgeting where additional pupils do not add to costs and under budgeting, when there are not enough pupils for the per pupil allocation to add up to the needed minimal outlay.

Over time, the subsidy approach could be refined to permit targeting funds to specific sets of resources (such as science equipment, textbooks) that are linked to state curricular objectives and establishing goals for class sizes, administrator to teacher ratios, and the size of both individual schools and school districts. This objective could not be accomplished fully until research teaches us more about the links between learning outcomes and required sets of resources.

IMPROVING CAPITAL FINANCING METHODS

The state legislature establishes in statute a percentage of total debt service for school construction to be retired by the state and a maximum number of local mils for debt and capital leases. The percentage of approved school debt service paid by the state has increased substantially over the past decade, from approximately fifty percent of school's principal and interest payments, to the current level of approximately 68 percent. "Need" for assistance is established by the priority of the capital project.

State aid is provided for approved projects under a cost sharing arrangement that establishes a maximum mil rate for debt service. Once a district reaches the statutorily defined level, "circuit breaker" state aid assumes the remaining costs. The circuit breaker for debt is applied to the debt portion of school costs only, so that a district with a low overall mil rate but

high debt service expense qualifies for assistance, *regardless of their own ability to pay and the number of mils raised for schools.*

There are several problems that may be identified. First, some districts that make very low tax effort for schools receive "circuit breaker" funding for debt because the two expenditure areas are treated separately. Second, LaPlante's (1994) analysis for the legislature found several different types of evidence that suggest schools are deferring capital investment in plant and equipment until they can build a new school with state assistance. A third and closely related problems emerges because newly constructed schools have wonderful equipment and facilities while other schools *even within the same district* go without.

While some districts have growing school age populations who will not be accommodated within existing facilities and other may legitimately need to fully replace old buildings, many districts do already or eventually will face major physical plant updating. A singular emphasis on providing capital assistance in the form of substantial debt service subsidies and hence construction, which made sense during the days of rapid increases in children to be educated, today is an incentive for districts to ignore alternatives that may be far more cost-effective and more quickly accomplished.

The examination of resources available in Maine schools revealed wide variations in the availability of computers and other technology and the use of what schools do have. The ability of Maine's graduates to step into jobs in a technologically sophisticated work world is compromised when we underinvest in essential educational tools.

First and foremost, there is a critical need for an inventory of facilities and technology and assessment of condition, to be followed by a statewide action plan for meeting the needs

identified.

Secondly, the state should adopt a broader view of "school facilities" to include not only new construction but also reinvestment in existing buildings and the acquisition and upkeep of other fixed assets like science labs, machinery and technology used in the vocational education programs, and computer labs. This broader range of capital investments and assets should be eligible for higher subsidy, as we now do with debt, which average close to 70% of the total, compared to only 50% of other school expenditures. Providing matching "capital assistance" to districts rather than strictly "debt service" would permit districts to make a more comprehensive assessment of capital investment needs and encourage them to utilize the most cost-effective means of meeting their highest priorities.

The annual orientation of school budgets and funding mechanisms is a significant barrier to acquisition of major pieces of equipment or reinvestment in facilities, for two reasons. First, sound budgeting strives to keep spending, and hence revenue requirements, relatively "smooth," i.e., to avoid the peaks and troughs spending pattern associated with the occasional high outlay of dollars. This biases spending for equipment towards yearly purchases of inexpensive items that may be less valuable to learning than a single major expenditure, for example to acquire a high quality microscope or computer for classroom instruction. Second, the fact that unspent funds "lapse" at the end of the year encourages last minute expenditures for nonessentials, so the money won't be "lost" and so policy makers won't reduce the next year's budget to reflect actual expenditures at a lower level than planned.

Districts *could* "save up" for capital asset acquisition or other capital investments by establishing a reserve fund or a sinking fund, which are fund types that permit money to be

carried over into another fiscal years. Many municipalities use this approach to finance fire engines, for example. However, districts would need assurances from their school boards that money placed into a reserve would not be "raided" come budget time. In addition, the state's budget approval and cost reimbursement procedures would need to be able to accommodate the "lumpy" expenditure pattern that accompanies periodic large outlays for capital assets. Ideally, the higher state share currently available for financing approved capital leases and debt service would be extended to match the district's capital investment dollars.

A redesigned aid program should yield significant cost savings in the short term but particularly in the long term, because districts could time investments in plant and equipment to take advantage of the best alternative and avoid the opportunity costs that accompany deferred maintenance and "doing without" computers or other technology and capital asset requirements.

Taxpayer Equity and the Property Tax

Maine's school finance system has been quite successful at equalizing mil rates for education across the majority of communities. Nonetheless, Maine's citizens have become increasingly dissatisfied with the property tax and also have come to question the efficacy of using property valuation as the single measure of relative local fiscal capacity. Even in communities where tax effort is well below the norm for the state, it is becoming more difficult to obtain approval of school budget increases.

Although the majority of towns raise between seven and ten mils for schools, there are significant disparities in the extent to which the "highest tax effort" and "lowest tax effort" communities tap into their property value. In 1993-94, there was a difference of nearly 20 mils between the most heavily and most lightly taxed towns. The problem of the high tax outliers is

largely explained by the budget approval process which ignores the necessity of a threshold expenditure and leaves isolated, low population communities on their own for large portions of their school spending.

The low effort in some towns is tied to other factors. Unlike many states that utilize a "foundation" funding approach with a minimum tax effort requirement, Maine does not require a minimum tax effort. In a comparatively small number of districts, the mil rate required to raise the foundation amount is very low for two reasons. First, districts with high property tax wealth may raise sufficient revenues to finance school with a low mil rate. Second, high wealth districts that "tuition" their students to other districts often pay the required tuition with a comparatively low tax effort. Districts "get away" with such low mil rates because Maine's school finance approach also makes each town responsible for *only* the own residents' children.

The minimum aid component of school funding is another area of concern. Minimum aid has been criticized as being "disequalizing," because it provides money to districts that have high wealth. Similar provisions have contributed to the overturn of state finance systems in other states, such as New Jersey (Abbott v. Burke, 1988). In addition, the federal governments monitors the percentage of education aid that is non-equalizing; states become ineligible for federal education "impact" aid if the equalization portion drops beneath 75% of the total.

Although the arguments for abolishing this part of the aid program have merit, there are also sound reasons for keeping it in place. First, the annual total for this financial assistance is quite a small percentage of the total allocation for school aid (less than 1%). From a legal perspective and in terms of the federal funders, this is such a small amount as to be considered negligible. Of course, just because we can "get away with it" should not be the rationale for

keeping the minimum aid program in place. The better argument rests with the necessity for the state to maintain a linkage with each district, to encourage a partnership for education that will work to forward the policy agenda. Districts receiving no state aid have little reason to comply with state initiated endeavors, unless they would have done what the state is advocating anyway.

Reform Needs and Options: Taxpayer Equity

First, the school funding process needs to be somewhat less sensitive to changes in property values, because sudden increases and decreases in aid do not make for good budgeting or content taxpayer. While it is important to differentiate the relative ability to pay of community, real estate markets may sometimes over or underestimate the true, long term value of property.

Second, the significant tax disparities that exist between the high effort and low effort towns reduce an otherwise reasonably equitable distribution of tax shares. The recommendations presented in the previous section for improving the budget approval process should help towns like Vanceboro that face very high taxes because the state views so little of what they spend as subsidizable.

In terms of the low tax effort towns, a minimum effort requirement needs to be built into our funding approach. The minimum effort could be set at five or six mils, which is still well below average. A phase in of the added effort requirement would permit districts to adjust to the added tax burden. A minimum mil rate requirement will result in some districts raising more tax dollars than they need for their own children.

Property tax relief and perhaps the possibility of abolishing the property tax for education altogether are likely issues the new education funding committee will need to grapple with.

Maintaining the property tax for schools, but with a higher state share of the total (see later recommendation on the homestead exemption) has some clear advantages for Maine. First, our state revenues are extremely sensitive to economic change. The "bungee-cord" budget fiasco of the early days of the recession occurred because our personal income and sales tax collections had plummeted faster and further than anyone would have guessed and more than any other state. The property tax on the other hand is a comparatively stable tax that ensures something of a steady state flow of revenues during the bad times but frustrates in its unresponsiveness during the good times.

Ideally, state taxes and the property tax could be used more consciously to complement each other across economic cycles. During the "good times" the state could undertake capital projects and other one shot expenditures for local schools to reduce the demand on the property tax. Then, during an economic downswing, the property tax could pick up some of the gap created by falling state revenues. It would need to be clear to everyone involved that property tax relief by the state during the good times would not continue in the event of a major downturn in state revenues.

Whether done as part of the school funding process, or separately, as direct assistance, property tax relief strategies need to be in place and adequately funded at all times to offset the regressivity of the property tax and mitigate other problems. It is very important when designing tax relief mechanisms to identify the objectives of relief and the intended beneficiaries of the policy. Only then can the strategy best able to meet be developed.

There are three broad types of property tax relief that may help to offset some of the disfavor that tax has fallen into in recent years. First, the most common type of relief, and the

one most people think of is assistance for individuals unusually hard hit be taxes. Relief for individuals is best given directly to them, such as through a circuit breaker or the tax deferral program, because it will have the greatest impact. These are excellent programs and with careful structuring can enhance the overall equity of the tax system.

The second type of relief is also actually aid for individuals, but it is not limited to the extraordinary cases. A good example of this type is a program of relief for resident homeowners. Maine had developed a "homestead exemption" program several years ago but never implemented it due to the budget crisis. The design of that particular program was based upon the exemption of a percentage of property value from the tax. The greatest beneficiaries of that design are the residents with the most property wealth. Thus, the program would reward people in accordance to their wealth.

A superior approach is to a homestead exemption is to permit a dollar amount exemption. First, the resident with the least expensive property would receive the greatest benefit, because the exemption would comprise a higher percentage of home value. This would do a great deal to offset the regressivity of the tax. Second, a dollar amount is far easier to budget for and administer, because you do not need to know home value, only how many homes there are.

A homestead exemption program for Maine residents would need to be a 100% state financial responsibility or part of the objective would be lost, particularly in towns with high percentages of residential property. The reason is simple: in the absence of state aid, the property owners would need to make up the loss of the exemption.

A homestead program could be structured to benefit all resident property owners equally, or to provide extra relief to the elderly. If the elderly were permitted a $30,000 exemption from

the school property tax and all other resident homeowners a $15,000 exemption from school taxes, approximately $60 million in new state funding would be required.

It is important to keep in mind that the homestead exemption would not benefit renters; they could be assisted under a special circuit breaker for renters.

The third type of property tax relief that may be considered is community level relief. The idea behind this relief comes from research based upon the behavior of the "median" voter in a community. This average individual has been hypothesized to be the political pulse of the community; a great deal of research on voting and related issues confirms the need to consider how the typical person, not just the extraordinary cases are thinking.

Governor's McKernan's education bill proposed a method recommended by the Task Force (1993) under which the local property valuation to be used in the state's school aid process may be reduced when a community's "Index of Fiscal Hardship" is higher than average. The extent of the reduction in valuation was linked to the degree to which the qualifying community's fiscal hardship differs from the "normal" (or average) circumstance.

Consideration of circumstances that may diminish the true capacity to finance schools to less than 100% of the town's valuation is supported by a great deal of research on the fiscal condition of towns and cities. There is little debate that cost of living factors and high taxes lead to relocation of residents with the ability to secure housing in other areas. In addition, research has demonstrated that home values grow more slowly or even decline in high tax areas, because the combined cost of mortgage, taxes and other social costs such as poverty are higher than the price of a comparable property elsewhere.

Finally, good assessments are essential to trust in any system of property taxation.

Although Maine is ahead of many states because the state set standards for assessing, supervises local practices and offers training, there are areas where improvements could be made. In particular, we need a method for more realistically assessing property for taxation in certain coastal, island and recreational areas of the state where the occasional nature of sales of property brings high prices that do not reflect the true value of all parcels.

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1. The four variable taken together explained more than half the variance in programming in Maine schools.