

It's Elementary

A Monthly Column by EFAP Director John Yinger
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More Trouble for the New York State Education Finance System

On December 10, 2013, the New York State Tax Relief Commission issued its final report and recommendations. These recommendations were immediately embraced by Governor Cuomo. Sadly, however, these recommendations continue the assault on New York's education finance system that was initiated by George Pataki, a co-chair of the commission, when he was governor and continued by Governor Cuomo's own policies.

The commission's main proposal, which has a price tag of \$1 billion, is to grant homeowners a property tax rebate for any increase in property taxes, so long as their jurisdiction does not override the 2 percent limit on property tax levy increases championed by Governor Cuomo and implemented in 2011.

It is difficult for me to figure out how anyone could come up with such a misguided and unfair proposal.

It is anti-democratic. Homeowners in jurisdictions where 60 percent of the voters believe that they need an increase in property taxes beyond 2 percent will receive a large financial punishment from the state.

It is profoundly unfair to children and homeowners in poor school districts.¹ A key feature of the New York education finance system is that poor districts receive a much smaller share of their revenue from the property tax than do rich districts. A few wealthy downstate suburbs collected over \$30,000 per pupil in local revenue in 2011-12, for example, whereas the Upstate Big Three (Buffalo, Rochester, and Syracuse) collected about \$3,700. Thus, a rebate equal to the maximum allowable tax increase of 2 percent would equal \$600 per pupil in these wealthy suburbs but only \$74 in the upstate big three. New York's education finance system already cheats the state's poor districts.² Why would any reasonable politician support a proposal to cheat them even more?

It is profoundly unfair to renters and to high-renter school districts. The STAR property tax exemption program provides property tax relief to homeowners. Because STAR exemptions do not apply to renters (and because of the equally unfair Sales Price Differential Factor, SPDF, which is discussed below), STAR payments per pupil are already over 5 times as high in low-

¹ The tax cap and the new proposals apply to all jurisdictions, not just school districts. This column focuses mainly on the school-district component.

² See my column for November 2013 at: http://cpr.maxwell.syr.edu/efap/about_efap/ie/Nov13.pdf.

renter downstate small suburbs as in the high-renter Upstate Big Three. Again, why would any reasonable politician want to make this anti-renter bias even worse?

Although it discourages a few jurisdictions from increasing property taxes by more than 2 percent, it promotes inefficiency by giving voters in every other jurisdiction an incentive to support the 2 percent maximum property tax increase for two years. What voter, if fully informed, would turn down a 2 percent increase in spending paid for by the state? This inefficiency might even last for years if elected officials find it difficult to let these rebates disappear.

It tries to force unproven types of governmental reorganization. Under the commissions' proposal, homeowners would receive the property tax rebates in the second year "only if they reside in jurisdictions that take meaningful concrete steps toward finding structural savings by sharing services with other jurisdictions or consolidating governments in their entirety." These types of reorganization may sometimes be cost-effective, but little is known about the possible savings and they are clearly not appropriate in many circumstances.³ Moreover, this provision penalizes large districts, where opportunities for this type of reorganization are much more limited.

It does not address the property tax burden in the long run. It is a \$1 billion gift focused on homeowners in wealthy districts that disappears in two years. In fact, by encouraging spending up to the tax cap, this proposal might result in property tax increases when the rebates disappear.

Perhaps I should not be surprised by this proposal. When he was governor, after all, George Pataki pushed through the STAR program, which gives no relief to renters and which, thanks to the SPDF, gives much higher exemptions to homeowners in rich districts than in poor districts. As I have documented elsewhere, the SPDF is one of the most unfair tax provisions ever designed by a state government.⁴ This new rebate proposal is just more of the same.⁵

³ My research with Bill Duncombe indicates some budgetary savings from school consolidation for very small districts, but I know of no study that documents such savings for service sharing or consolidation in other cases. See W. Duncombe and J. Yinger, "The Benefits and Costs of School District Consolidation: What Recent Research Reveals about Potential Cost Savings," *The School Administrator*, 5 (67) (May 2010): 10-17. Available at: <http://www.aasa.org/SchoolAdministratorArticle.aspx?id=13218>

⁴ Again, see my November column: http://cpr.maxwell.syr.edu/efap/about_efap/ie/Nov13.pdf.

⁵ Perhaps I also should not be surprised that H. Carl McCall, the other co-chair of this commission, supported these recommendations. When he was the New York State Comptroller, Mr. McCall made the bizarre argument that "STAR should not be counted as school aid" because of the "diametrically opposed distributional patterns between STAR and school aid." STAR is not school aid because it is unfair? He also argued, as did Governor Pataki, that STAR was not part of the education finance system because its "purpose" was tax relief. Whatever its purpose in the eyes of politicians, its effect is to distribute a large share of the state's support for education in a wildly unfair manner. See page 9 of H. Carl McCall, "School Finance Issues in the 1998-99 Enacted Budget," June 1998, available at <http://www.osc.state.ny.us/reports/schools/1998/enbred.pdf>. Mr. McCall also cites a report by Bill Duncombe and me without explaining that our conclusions on these points are the opposite of his.

Perhaps I also should not be surprised that Governor Cuomo supports these provisions. After all, he appointed former-Governor Pataki as a co-chair of this commission, despite Pataki's record, and he championed the tax cap that is so unfair to poor school districts.⁶

But I keep hoping that New York's politicians will recognize that they are cheating students in poor school districts and that the resulting lost skills penalize all citizens of New York State.

One other key proposal in the commission report is to provide an income tax credit to manufacturing firms equal to 20 percent of their property tax payment. What an ironic proposal. As several scholars have shown, Pataki's STAR program created incentives that led to a substantial increase in property taxes on business property.⁷ The latest estimate by my colleagues and me is that STAR resulted in a 12.5 percent increase in the business property tax rate. By making this proposal, Pataki appears to be trying to undo some of the damage that his STAR program caused.⁸

However, the proposed manufacturing tax credit is unlikely to have the intended effect. A 20 percent cut in property taxes for manufacturing represents a gift to current manufacturing firms and will have little or no impact on decisions by manufacturing firms to move into or out of New York State. A property tax cut (or its income-tax-credit equivalent) leads to an immediate increase in the value of manufacturing property and of land suitable for manufacturing establishments. As a result, manufacturing businesses thinking of moving into New York would face an increase in the cost of property that offset the decrease in their property taxes. Manufacturing businesses thinking of moving out of New York also might not be discouraged from leaving because the price of their property, which is what they receive if they leave, would go up. New York does not need any more programs that give bonuses to current businesses without altering the conditions that promote economic development—such as a fairer education finance system.

To develop more reasonable responses to the high property taxes in New York State, policy makers need to recognize that property tax rates are heavily influenced by other components of a state's education finance system. Most importantly, many scholars have shown that increases in state education aid lead to some combination of spending increases and property

⁶ My November column also discussed the unfairness in New York State's tax cap.

⁷ See J. Rockoff, "Local Response to Fiscal Incentives in Heterogeneous Communities," *Journal of Urban Economics* 68 (2) (September 2010), pp. 138-147 and T. H. Eom, W. Duncombe, P. Nguyen-Hoang, and J. Yinger, "The Unintended Consequences of Property Tax Relief: New York's STAR Program," Working Paper, Syracuse University, November 2013.

⁸ To add to the irony, recall that the design of the rebates gives voters an entirely new incentive to increase public spending by no less than 2 percent. Will some future governor appoint Pataki to another commission so he can magnify the damage from this proposal, too?

tax cuts. One survey concludes that foundation aid payments do stimulate spending, but “the bulk of the grant is still used for local tax reduction.”⁹

Thus, the most effective way to cut property tax rates in poor school districts is to give them the education aid that was promised to them by the reforms that were passed in 2007. Rich districts do not need more aid, of course; indeed, they currently receive more than their fair share. The best approach for these districts, is to ensure that voters have full information about the implications for property taxes when they vote on a school budget. With full information and the current levy limit, further tax relief to rich districts is simply inappropriate.

Anyone who believes in a fair and effective education finance system for New York State should strenuously oppose the recommendations of this commission and support a return to the 2007 state education aid reforms.

⁹ This quotation is from page 157 in R. C. Fisher and L. E. Papke, “Local Government Responses to Education Grants.” *National Tax Journal* 53 (1) (1999), pp. 153-168. Using data from New York, Bill Duncombe and I found that \$1 of aid resulted in \$0.67 in property tax reductions. See W. Duncombe and J. Yinger, “School Finance Reform: Aid Formulas and Equity Objectives.” *National Tax Journal* 51 (2) (June 1998), pp. 239-262.