Reforming Education Finance in New York State

Testimony Before the New NY Education Reform Commission

Professor John Yinger
The Maxwell School, Syracuse University

November 22, 2013

Introduction: Education Finance in New York State

Good morning and thank you for giving me the opportunity to testify today. As I emphasized in my testimony to this commission last year, I believe that disparities in school quality are the principal problem facing elementary and secondary education in New York State. Just to give one example, only 5 percent of the students in Rochester met or exceeded the 2013 ELA and math proficiency standards, compared to 31 percent of students statewide.[1] These disparities are not only profoundly unfair, but also place severe constraints on New York's potential for economic growth.

These student performance disparities are closely linked to funding disparities. This link is not just hypothetical. Numerous studies of education cost functions by me and by other scholars show conclusively that in New York and many other states, districts with higher student performance spend more, all else equal.[2] Disparities in funding therefore contribute directly to disparities in student performance.

Like most other states, New York has taken some important steps to minimize disparities in school funding. This commission needs to recognize, however, that with one important but apparently temporary exception, the policy choices made by New York State over the last fifteen years have made these disparities worse. Unless drastic changes in education finance policy are made, these disparities are on track to widen substantially in the decades ahead, not to diminish.

In this testimony I will provide some background on the education finance system in New York, explain the misunderstandings that have led policy astray, and suggest some reforms to get the state back on track.

As you all know, elementary and secondary education in New York State is funded by state aid, state compensation for STAR property tax exemptions, federal aid, and local revenue,

---

[1] Complete results are available at http://www.oms.nysed.gov/press/grades-3-8-assessment-results-2013.html .

[2] Cost function studies for New York State include Duncombe, Lukemeyer and Yinger (2003), Duncombe and Yinger (1997, 1998b, 1999, 2000, 2001, 2005, 2007a), and Wang, Duncombe, and Yinger (2011). Duncombe and Yinger (2007b, 2011) review cost-function studies.

which consists almost entirely of property tax payments. Perhaps the most important feature of this system is that the relative contributions of these different revenue sources vary widely across types of districts. As shown in Figure 1, which applies to 2011-12, the relatively wealthy downstate suburbs receive only 16 percent of their revenue from state aid, whereas Syracuse, Rochester, and Buffalo, the Upstate Big Three, receive, on average, 69 percent of their revenue from state aid.[3] Conversely, local revenue makes up 74 percent of the total in the downstate suburbs compared to only 19 percent in the Upstate Big Three. Other types of districts fall somewhere in between these extremes. (Because New York City is so unique, this testimony focuses on the rest of the state.)

The main reason for these differences in revenue sources is, of course, the large differences in property wealth across districts. As shown in Figure 2, the state's measure of property wealth per pupil, ranges from only $142,000 in the Upstate Big Three to $2,177,000 in the downstate suburbs. New York State recognizes that these large differences give some districts a huge advantage in raising school revenue, and like most other states, New York uses a foundation aid formula to help level the playing field.

A foundation aid formula has three principal components: a target spending level, an expected local contribution, and a state aid amount.[4] The target spending level is the amount state officials believe is required to provide their definition of an adequate education. Districts with higher wealth are expected to make a larger contribution. The simplest foundation formula sets the local contribution equal to a constant percentage of the local property wealth per pupil. In this way, wealthier districts are expected to contribute more. State aid is then just the difference between the spending target and the expected local contribution.

Figure 1 reflects the impact of the New York formula, which is somewhat more complicated that the simplest form but follows the same principles. Districts with lower property wealth per pupil receive more state aid.

Another central issue in understanding education finance in New York (or any other state) is that some types of students are more expensive to educate than others. As established by dozens of scholarly studies, the cost of bringing at-risk students, defined as those who come from poor families, who have limited English proficiency, or who have special needs, up to any given performance standard is higher than the cost for other students.[5] As shown in Figure 3, the distribution of at-risk students also varies widely across types of districts in New York, with the highest concentrations in the large cities.

Virtually every state makes some type of adjustment to its aid formula to account for at-risk students.[6] One approach is to define weighted pupils, with higher weights on students who are at risk. An article by William Duncombe and me (2005) finds extra weights of 100 percent

---

[3] These revenue figures and most of the other measures cited in this testimony are available at: http://www.oms.nysed.gov/faru/Profiles/profiles_cover.html

[4] A detailed discussion of foundation aid formulas can be found in Yinger (2004).

[5] See the studies in footnote 2.

[6] Hoang (2004) describes the weights for at-risk students in the aid formulas of different states.

for children from poor families in New York, but some other studies for other states find lower weights. Most state aid programs use weights in the 10 to 25 percent range, although Maryland and New Hampshire recently implemented aid formulas with 100 percent poverty weights under some circumstances.

In the CFE case, the New York Court of Appeals endorsed the principle of providing an adequate education for all students. Moreover, it endorsed the principle that the education finance system must account for the higher costs of educating at-risk students. Even though the CFE decision directly applied only to New York City, elected officials in the state incorporated these principles into the aid reforms implemented in 2007. These reforms eliminated many categorical aid programs and shifted their funds into the foundation aid formula, and they introduced more realistic weights for poor children, up to 100 percent in some cases, into the calculation of target spending. This new aid formula was intended to be phased in over four years, but the phase-in period was later extended to seven years. As shown in Figure 4, the first two years of this phase-in brought significantly higher aid for the Upstate Big Three, which are the neediest districts in the state. Except in the case of Yonkers, other needy types of districts, also received relatively large aid increases.

Evaluation of Recent Changes in New York's Education Finance System

With this background, it is now possible to have some perspective on recent policy developments: aid cut-backs, the tax cap, and STAR.

In 2009, state policy makers decided that the recession made it impossible to continue to phase in the 2007 education finance reforms. As a result, New York's schools experienced large cuts in state aid in the 2009-10 and 20010-11 school years, and little change in 2011-12. These changes are shown in Figure 5. This figure indicates aid cuts as a percentage of spending, not as a percentage of initial aid. After all, a given percentage cut in aid imposes a much larger burden on poorer districts, which rely much more heavily on aid than do richer districts.[7] As shown in Figure 5, the percentage cut in overall funding from 2010-2012 was over twice as high for the Upstate Big Three (7.4 percent) as for the downstate suburbs (3.2 percent). In other words, the cuts not only lowered the level of aid, they also went a long way toward undoing the aid reforms of 2007-2009.[8]

Figure 5 make use of the most recent data sources in which payments to individual districts can be identified. The aggregate budget data indicate that the aid increases for 2012-13 ($805 million) and 2013-14 ($944 million) are slightly higher than those in 2011-12 ($675 million). These increases have not been designed, however, for a return to the distribution of aid state promised by the 2007 reforms.

---

[7] The cuts as a percentage of initial aid were somewhat higher downstate than upstate. Measured in this way, the cumulative cuts were 17 percent for downstate suburbs and 10 percent for the Upstate Big Three. But these numbers ignore the heavy reliance of the Upstate Big Three and other needy districts on state aid.

[8] For a discussion of equity principles applied to cuts in state aid, see Zhao and Coyne (2013).

In 2011, New York State passed a property tax cap. To be more precise, this "cap" is a limit on the percentage increase in the property tax levy. Although the actual cap is quite complicated, because it adjusts for many features of a school district's budget, the basic idea of the cap is to limit increases in a district's property tax revenue to 2 percent per year.[9]

This design is also out of step with New York's education finance system. Because wealthy districts rely much more heavily on property taxes than do poor districts, their property tax levies—and hence their allowable levy increase—are much larger in absolute terms. A few wealthy downstate suburbs collected over $30,000 per pupil in local revenue in 2011-12, whereas the Upstate Big Three collected about $3,700. The tax cap therefore allows these rich districts to collect $30,000 × 0.02 = $600 more per pupil the next year; the Big Three can only raise their revenue by $3,700 × 0.02 = $74. These disparity grow over time. As shown in Figure 6, over the next 25 years the average downstate suburb will be allowed to raise its revenue by almost $14,000 per pupil, but the Upstate Big Three will only be able to raise their revenue by a little over $2,000 per pupil. Without a dramatic (and unlikely) shift in state aid toward poorer districts, therefore, the fiscal disparities across school districts in New York State are going to keep growing and growing.

Finally, the STAR program, which was fully implemented in 2001-02, provides all homeowners with exemptions from school property taxes. STAR has become an important part of New York's education finance system, with a total cost of $3.3 billion in 2012.[10]

Two features of STAR contribute directly to the disparities in New York's education finance system. First, the so-called Sales Price Differential Factor (SPDF) provides an unjustified boost in the exemption in counties with average house sales prices above the state average. For example, in 2013 the exemption in Westchester County is 2.4 times as large as the exemption in Saratoga County and more than three times as large as the exemption in all the other counties upstate. The net cost of this provision for the state's taxpayers is over $1.5 billion per year. I know of no other policy in New York or any other state that rewards people for deciding to live in wealthy places, and I know of no legitimate justification for the SPDF.

Second, STAR does not provide assistance to renters.[11] As a result, state compensation is much higher in districts with a high share of homeowners, which tend to be wealthy districts,

---

[9] The details of the tax cap can be found at http://www.tax.ny.gov/research/property/cap.htm .

[10] By lowering the local share of any tax increase, STAR also gives voters an incentive to spend more and raise the property tax rate. This was predicted by William Duncombe and me (1998a) and confirmed by Rockoff (2010) and Eom et al. (2013). The latter paper estimates that STAR induced a 3.82 percent spending increase and a 12.5 percent property tax rate increase in the average district in the state. This tax increase offset 30 percent of the initial savings from the STAR exemptions and significantly raises taxes on business property. The new tax cap and a new 2 percent limit on increases in a homeowner's STAR savings may mitigate these effects in the future. For the details of STAR, see http://www.tax.ny.gov/pit/property/star/index.htm.

[11] The STAR legislation provides an income tax credit for all taxpayers, including renters in New York City, but nowhere else.

than in districts with a high share of renters. In combination with the SPDF, this feature leads to enormous disparities in state compensation across types of districts. As shown in Figure 6, STAR payments per pupil are over 5 times as high in downstate small cities and suburbs as in the Upstate Big Three. The overall cost of the STAR program is now about $3.3 billion per year. Given the huge educational disparities in the state, it makes no sense to be devoting such a large share of the state's education aid budget to such an unequal program.

Finally, one common feature of these recent major changes in New York's education finance system is that they were passed without independent analysis and with little public debate. In my judgment New York State's education finance policy, and its education policy generally, would be greatly aided by better data provision and by an independent budget office or something like it.

The New York State Education Department does provide some data on its website in readily accessible form, but these data are incomplete; that is, the posted data are a subset of the data needed to study education finance. Moreover, many other departments of the New York State Government, which also provide data, such as property values, that are needed to study education finance, make data collection even more difficult. A serious effort to identify and post a comprehensive data set for school districts in New York would allow a wide range of scholars and advocacy groups to contribute to the debate on the state's education finance system. This point also applies to education policy in general; for example, a student-level data set that was made available to scholars, with appropriate controls for confidentiality, could shed light on a wide range of education programs, from pre-K to charter schools, to high-school drop-out prevention.

An independent budget office or a larger analytical group in the New York State Education Department also could make an important contribution to better policy. Changes in the education finance system such as those discussed in my testimony are too important to be passed without careful evaluation. If they have access to data, scholars can certainly participate in this debate, but an independent analytical group would ensure that all major education finance (and other) initiatives receive the analytical attention they deserve.

An improvement in data collection and analytical capacity at the state level would also contribute to accountability. Additional state aid for poor school districts should be combined with an accountability program. In my view, however, accountability is a two-way street. Not only must school districts that receive state funds be accountable for how they use it, but state education officials must take responsibility for helping to design and evaluate the types of programs that facilitate improvements in student performance. Just as it makes no sense for the state to give a lot of money to a poor school district and then walk away, it makes no sense for the state to expect a poor district to conduct program evaluations and experiments.[12]

[12] It also makes no sense to expect poor district to be able compete with rich districts for state grant. This type of competition does not take place on a level playing field.

Recommendations

This analysis leads me to the following recommendations.

1. Embrace the education aid reforms introduced in 2007.

The education finance principles endorsed by the Court of Appeals call for a fully funded foundation aid formula with appropriate weights for at-risk students. The aid formula that started to be phased in in 2007 applied these principles to the entire state and gave the state's neediest districts a fighting chance to give their students an adequate education. Without a formula of this type, backed up by a strong accountability program, New York State will continue to leave many of its children unprepared for the demands of today's labor markets and unable to meet their responsibilities as citizens. All of New York's citizens pay the cost for this waste of our children's talents.

Thus, I strongly recommend a return to the phasing in of the 2007 formula. As of 2012, the percentage growth in state aid in New York is limited to the percentage growth in personal income. With this constraint in place, it is critical that deviations from the 2007 formula be considered. My recommendation is to calculate each district's gap between its fully phased in aid specified in the 2007 reforms and the current aid level and then to use the allowable overall aid increase to close this gap for every district by the same percentage. This procedure should continue until the 2007 reforms are fully implemented.

2. Modify the tax cap to recognize the higher role for state aid in some districts.

The current design of the tax cap punishes districts that rely heavily on state aid, which include the state's neediest districts. If left in place, this feature will result in a huge growth in fiscal disparities across districts. The simplest way to address this inequity is to change the tax cap so that it is expressed as a percentage of the school budget, not as a percentage of the tax levy. A cap that limits the growth in the property tax levy to 1.5 percent of the school budget would be preferable, for example, to the current one expressed as 2 percent of the tax levy itself. This approach would still leave some inequity, however, because rich districts spend more than poor districts, on average. Consider this example from Porter (2013): "the wealthiest 10 percent of school districts, in rich enclaves like Bridgehampton and Amagansett on Long Island, spent $25,505 on average per pupil. In the poorest 10 percent of New York's school districts — in cities like Elmira, which has double the nation's poverty rate and half its median family income — the average spending per student was only $12,861."

An even fairer approach, therefore, would be to base the limit as a percentage of each district's target spending amount in the state's foundation aid formula. With this approach, the revenue growth for each district would be a percentage of the amount that the state thinks that district needs to spend to provide an adequate education. Although no state currently uses a tax cap of this type, several states, including Kansas and Michigan, use the foundation level of

spending as the maximum amount a school district is allowed to spend. This is, of course, a much more stringent limit than the one in New York.

3. Reform STAR.

Property tax exemptions are a reasonable way to lessen the burden of the property tax on low-income homeowners, but the consequences of these exemptions for the overall education finance system need to be recognized. The most important problem with STAR is that it consumes over $3 billion of New York's funding for elementary and secondary education to fund a program that rewards wealthy homeowners and ignores renters; as a result it is fundamentally unfair to school districts in which renters are concentrated, including large cities. The other components of the education aid budget do not even attempt to offset this inequity.

The unfair treatment of renters is not an easy problem to solve because tax savings for renters are likely to be shifted to landlords in the form of higher rents. My recommendation is to eliminate the unfair Sales Price Differential Factor (SPDF) and use the funds for a new STAR payment based on the number of renters in a school district. This would solve the education finance portion of the inequity, even though it would not directly help renters. The total cost of STAR is about $3.3 billion and the total cost of the SPDF is about $1.5 billion. New York has about 4,440,000 homeowner households and 3,660,000 renter households. So the budget for the SPDF would fund a payment of ($1.5 billion) ÷ (3.66 million) = $410 per renter household, which is virtually the same as the payment per owner household from the current STAR without the SPDF, which equals ($3.3 billion - $1.5 billion) ÷ (4.44 million) = $405.

4. Improve the analytical capacity and data systems for education in New York State.

Some of the problems with the state aid formula, with the new property tax cap, and with STAR might have been avoided if they had been subject to an open debate based on accurate, current data. New York is far behind many other states in the provision of data on education finance and education generally. New York is also far behind many other states in the creation of institutions, such as an independent budget office, that can contribute to an independent assessment of important policy innovations in education. Pennsylvania recently set up an Independent Fiscal Office, for example, and both North Carolina and Texas have been pioneers in providing extensive education data to scholars.

I understand that legislation to create such an office was introduced in the New York State legislature this year. Although I do not know the details of this legislation, it certainly sounds like a step in the right direction. I strongly urge this commission to support this legislation or an equivalent expansion of the analytical capacity in the State Education Department.

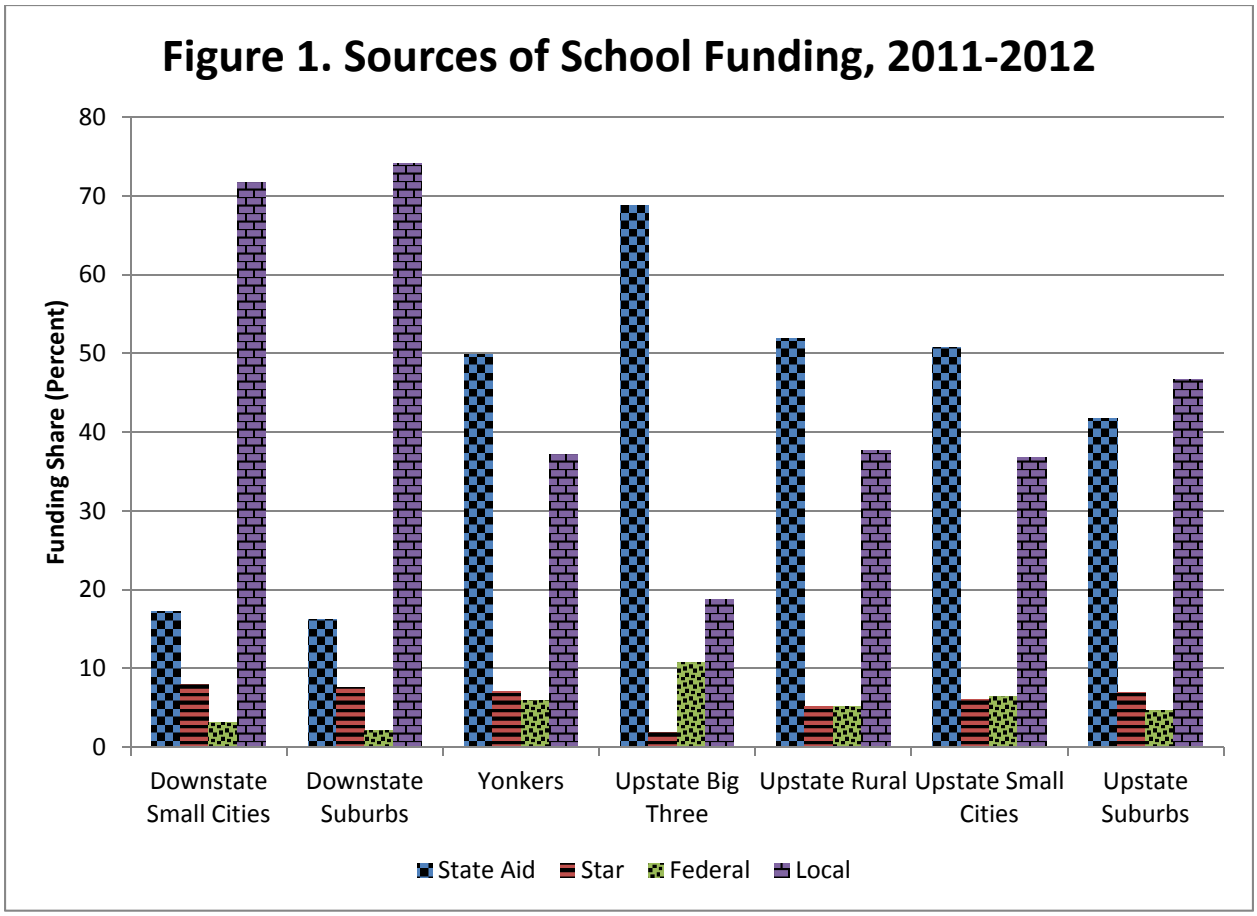


Figure 1. Sources of School Funding, 2011-2012
Funding Share (Percent)
80
70
60
50
40
30
20
10
0
Downstate Small Cities
Downstate Suburbs
Yonkers
Upstate Big Three
Upstate Rural
Upstate Small Cities
Upstate Suburbs
State Aid
Star
Federal
Local

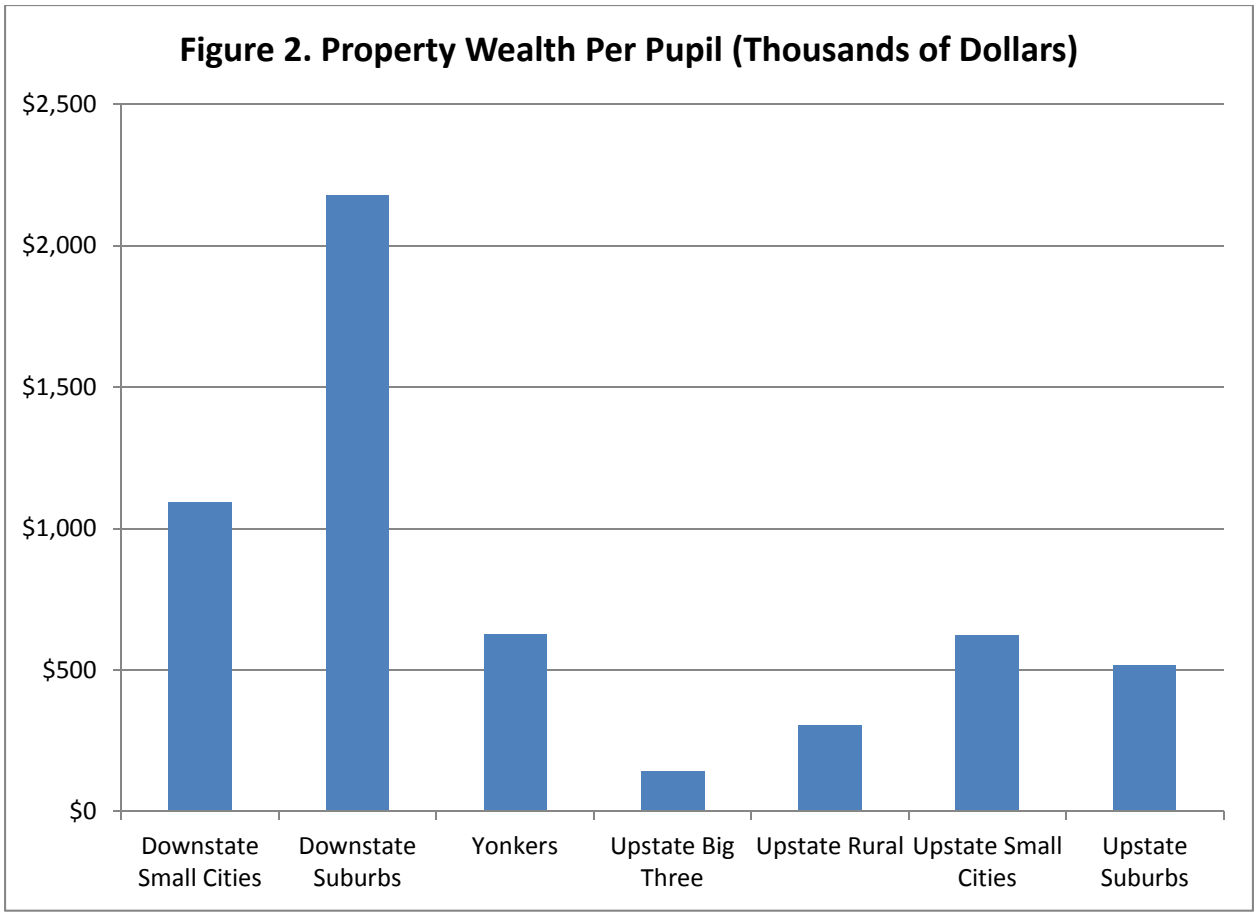


Figure 2. Property Wealth Per Pupil (Thousands of Dollars)
$2,500
$2,000
$1,500
$1,000
$500
$0
Downstate Small Cities
Downstate Suburbs
Yonkers
Upstate Big Three
Upstate Rural
Upstate Small Cities
Upstate Suburbs

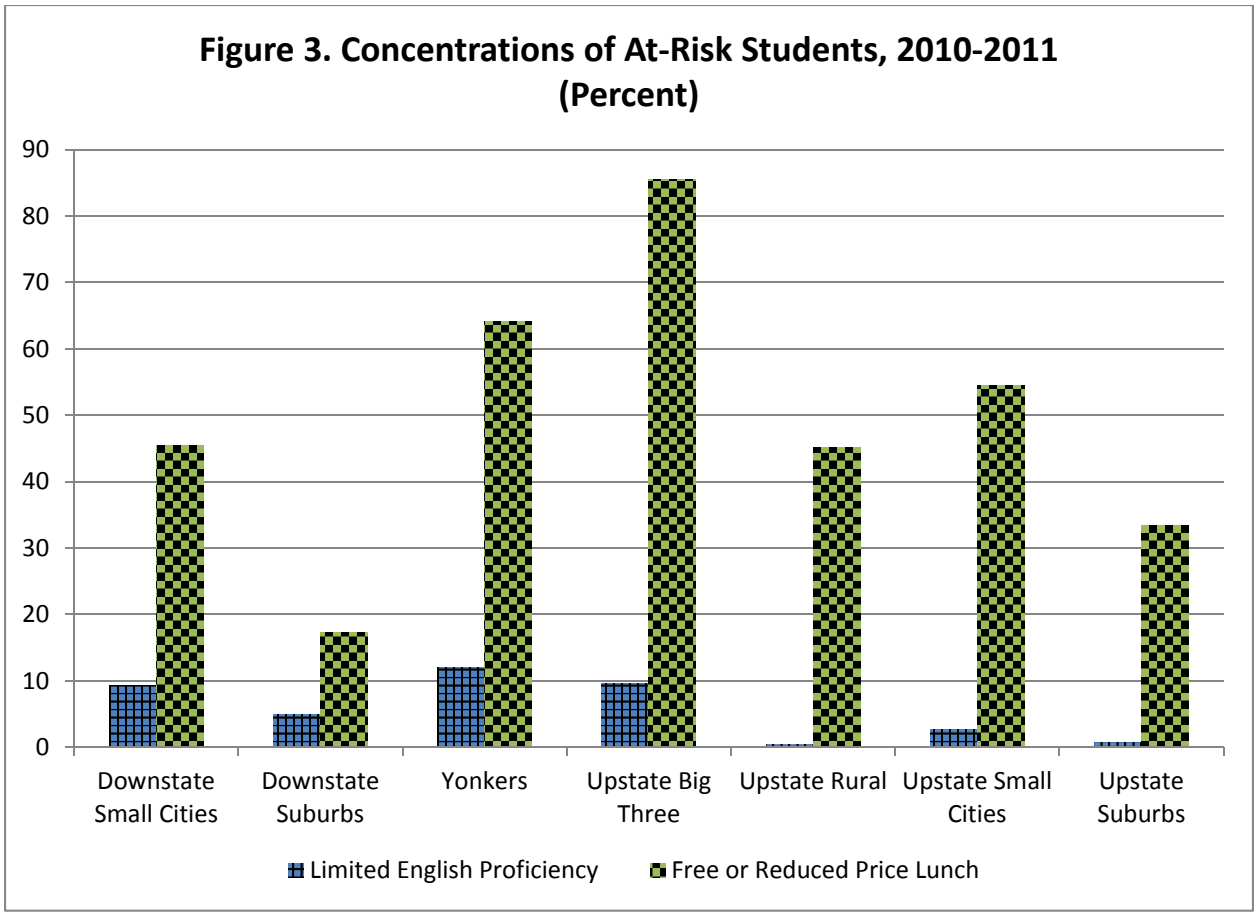


Figure 3. Concentrations of At-Risk Students, 2010-2011
(Percent)
90
80
70
60
50
40
30
20
10
0
Downstate Small Cities
Downstate Suburbs
Yonkers
Upstate Big Three
Upstate Rural
Upstate Small Cities
Upstate Suburbs
Limited English Proficiency
Free or Reduced Price Lunch

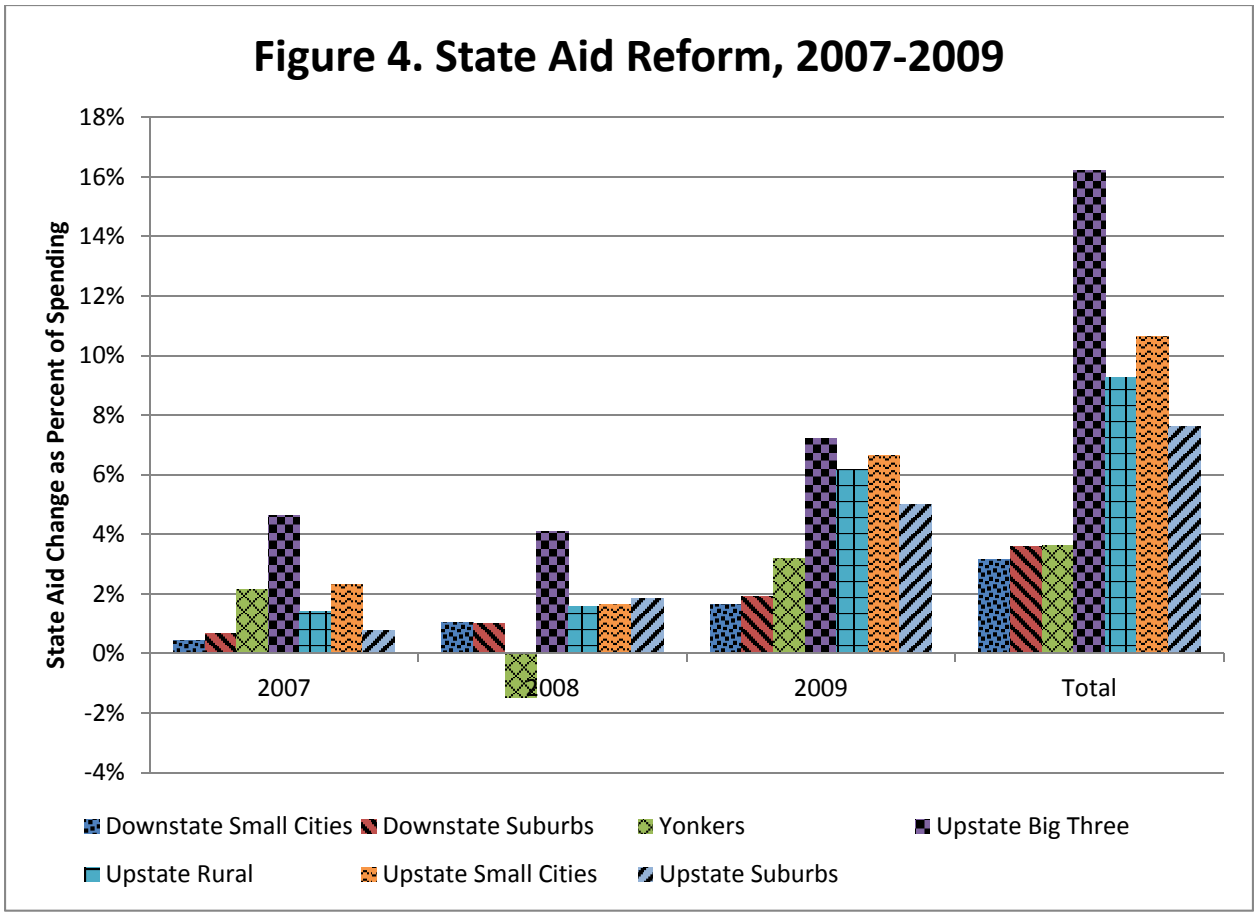


Figure 4. State Aid Reform, 2007-2009
State Aid Change as Percent of Spending
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
2007
2008
2009
Total
Downstate Small Cities
Downstate Suburbs
Yonkers
Upstate Big Three
Upstate Rural
Upstate Small Cities
Upstate Suburbs

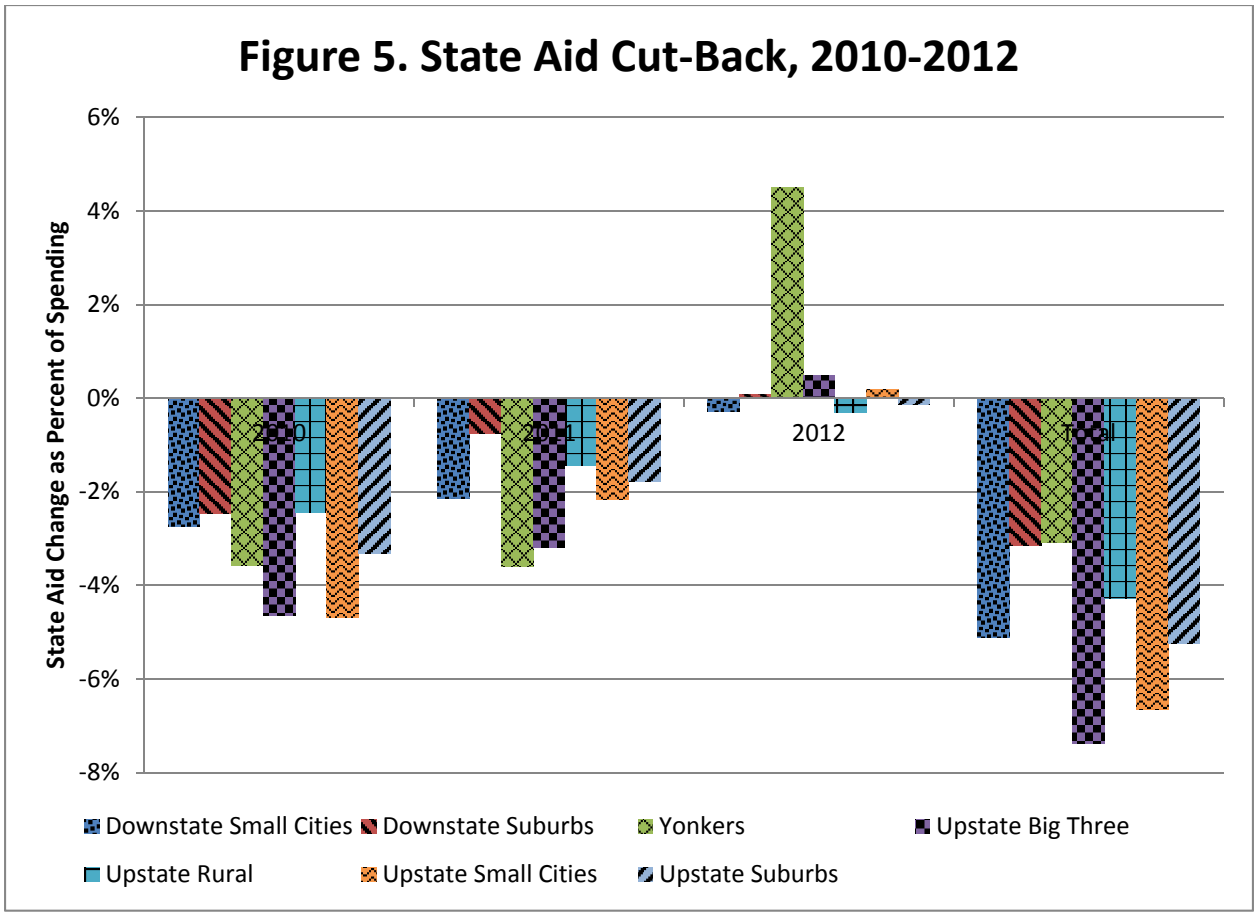
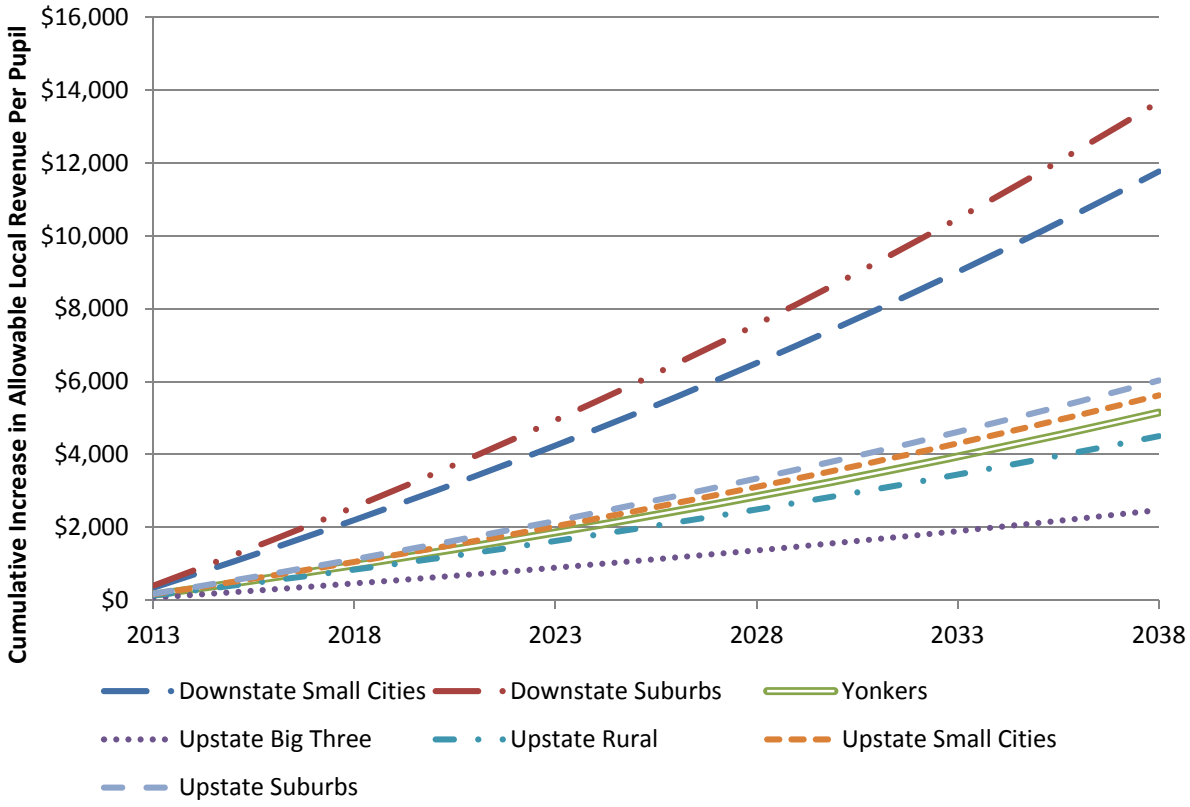


Figure 5. State Aid Cut-Back, 2010-2012
State Aid Change as Percent of Spending
6%
4%
2%
0%
-2%
-4%
-6%
-8%
2010
2011
2012
Total
Downstate Small Cities
Downstate Suburbs
Yonkers
Upstate Big Three
Upstate Rural
Upstate Small Cities
Upstate Suburbs

Figure 6. Allowable Local Revenue Increases Under the Tax Cap



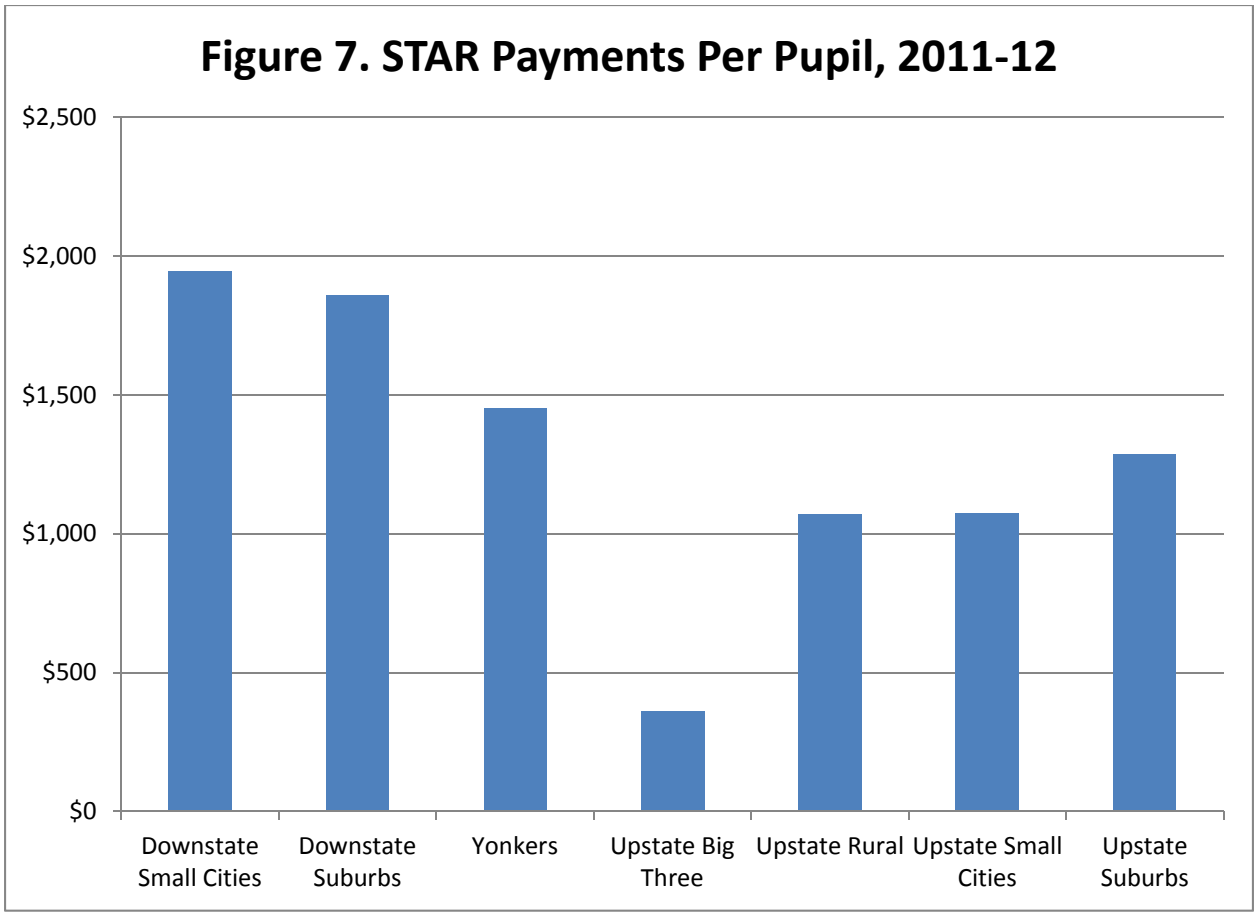


Figure 7. STAR Payments Per Pupil, 2011-12
$2,500
$2,000
$1,500
$1,000
$500
$0
Downstate Small Cities
Downstate Suburbs
Yonkers
Upstate Big Three
Upstate Rural
Upstate Small Cities
Upstate Suburbs

References

Duncombe, W., A. Lukemeyer, and J. Yinger. 2003. "Financing an Adequate Education: The Case of New York." In *Developments in School Finance: 2001-02*, edited by W. J. Fowler, Jr. (National Center for Education Statistics): 127-154.

Duncombe, W., and J, Yinger. 2011. "Are Education Cost Functions Ready for Prime Time? An Examination of their Validity and Reliability." *Peabody Journal of Education* 86 (1): 28-57.

Duncombe, W., and J, Yinger. 2007a. "Does School District Consolidation Cut Costs?" *Education Finance and Policy* 2 (4) (Fall): 341-375.

Duncombe, W., and J, Yinger. 2007b. "Measurement of Cost Differentials" (with W. Duncombe). 2007. In *Handbook of Education Finance and Policy*, edited by E. Fiske and H.F. Ladd (Laurence Erlbaum Publishers), pp. 238-256.

Duncombe, W., and J, Yinger. 2005. "How Much More Does a Disadvantaged Student Cost?" *Economics of Education Review* 24 (5) (October): 513-532.

Duncombe, W., and J, Yinger. 2001. "Alternative Paths to Property Tax Relief." In *Property Taxation and Local Government Finance*, edited by W.E. Oates (Lincoln Institute of Land Policy): 243-294.

Duncombe, W., and J, Yinger. 2000. "Financing Higher Student Performance Standards: The Case of New York State." *Economics of Education Review* 19 (4) (October): 363-386.

Duncombe, W., and J, Yinger. 1999. "Performance Standards and Educational Cost Indexes: You Can't Have One Without the Other." In *Equity and Adequacy in Education Finance*, edited by H. F. Ladd, R. Chalk, and J. S. Hansen (National Academy Press): 260-297.

Duncombe, W., and J, Yinger. 1998a. "An Analysis of Two Educational Policies in New York State: Performance Standards and Property Tax Relief." In *Educational Finance to Support Higher Learning Standards*, edited by J. H. Wyckoff (New York State Board of Regents): 98-137.

Duncombe, W., and J, Yinger. 1998b. "School Finance Reform: Aid Formulas and Equity Objectives." *National Tax Journal* 51 (2) (June): 239-262.

Duncombe, W., and J, Yinger. 1997. "Why Is It So Hard to Help Central City Schools?" *Journal of Policy Analysis and Management* 16 (1) (Winter): 85-113.

Eom, T,H., W.D. Duncombe, P. Nguyen-Hoang, and J. Yinger. 2013. "The Unintended Consequences of Property Tax Relief: New York's STAR Program," Working Paper, Center for Policy Research, Syracuse University, November.

Hoang, Yao. 2004. "A Guide to State Operating Aid Programs for Elementary and Secondary Education." In *Helping Children Left Behind: State Aid and the Pursuit of Educational Equity*, J. Yinger Editor (MIT Press), pp. 331-352.

Porter, E., 2013. "In Public Education, Edge Still Goes to Rich," *The New York Times*, November 5.

Rockoff, J.E. 2010. Local Response to Fiscal Incentives in Heterogeneous Communities. *Journal of Urban Economics* 68 (2) (September): 138-147.

Wang, W., W. Duncombe, and J. Yinger. 2011 "School District Responses To Matching Aid Programs For Capital Facilities: A Case Study of New York's Building Aid Program." *National Tax Journal* 64 (3) (September): 759-794.

Yinger, J., 2004. "State Aid and the Pursuit of Educational Equity: An Overview." In *Helping Children Left Behind: State Aid and the Pursuit of Educational Equity*, edited by J. Yinger (MIT Press): 3-57. (Available as the sample chapter on the internet at: http://mitpress.mit.edu/books/helping-children-left-behind .)

Zhao, B., and D. Coyne. 2013. "A More Equitable Approach to Cutting Intergovernmental Aid." *Public Finance Review.*

Brief Biography of the Author

Dr. John Yinger is a Trustee Professor of Economics and Public Administration at the Maxwell School, Syracuse University, and director of Maxwell's Education Finance and Accountability Program. He joined the Maxwell faculty in 1986 and has taught state and local public finance to the master's students in public administration every year since then. In addition to his widely cited research on local public finance generally, Professor Yinger has closely studied the New York education finance system and has published many articles on this system in professional journals. Along with Professor William Duncombe, he submitted a friend-of-the-court brief in the CFE case (available at: http://cpr.maxwell.syr.edu/efap/about_efap/cfe.html). Professor Yinger's co-authored 2011 article on building aid in New York State won the *National Tax Journal*'s Richard Musgrave Prize for the most outstanding article of the year. His edited book, *Helping Children Left Behind: State Aid and the Pursuit of Educational Equity*, was published by MIT Press in 2004. Professor Yinger's personal web site is http://faculty.maxwell.syr.edu/jyinger/. The website for the Education Finance and Accountability Program is http://cpr.maxwell.syr.edu/efap/index.html.