

Reforming School Finance in Illinois: Some Observations on Principles, Practicalities, and Politics

by Robert P. Strauss

Robert P. Strauss is a visiting professor of economics and public policy at the University of Rochester, N.Y., on leave from the Heinz School, Carnegie-Mellon University. He is a member of State Tax Notes' Advisory Board.

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Some quotable observations on taxation:

"Taxation is the price of a civilized society."

"How we tax ourselves to pay for our public services is a measure of how civilized we are."

"Don't tax you, don't tax me, tax the fella hiding behind the tree!"

"Senator, I appreciate that you and I don't agree on this tax provision; however, I have no intention of trading heart attacks with you on the matter."

1. Introduction

Since the middle of the Great Depression, school districts throughout the U.S. have relied primarily on the real property tax for local tax support of the costs of K-12 education. Of the \$60.5 billion of local taxes raised by politically independent school districts in the U.S. in 1988-89, fully 97.5 percent of these revenues were due to the local property tax.¹ Over the past several years, the adequacy, propriety, and essential fairness of the local school property tax has been challenged in many state courts, and, currently, more than 20 states, including Illinois and Pennsylvania, face constitutional challenges to how they finance their schools. At issue universally is whether students across a state have access to the same base education, given the combined effect of relying so heavily on the local property tax and the various distributional formulas used to share state equalization aid.

For the past decade, I have been involved in Pennsylvania with various study commissions and legislative efforts designed to address the commonwealth's century-old problems with the financial structure of its local governments (counties,

municipalities, and school districts). The range of issues that have been examined include the quality of administration of the local property tax, and how local school districts finance themselves. Many of the same issues Pennsylvania faces continue to face other states. Most recently, the Michigan Legislature eliminated its local school property tax and is searching for replacement revenues.

In late 1988,² the Pennsylvania General Assembly passed and Gov. Robert Casey (D) signed landmark legislation that would have reformed assessment procedures and, over time, improved the quality of the local property tax, as measured by the coefficient of variation in assessment ratios. By paying assessors for better-quality assessment, a direct incentive, the legislation sought to move Pennsylvania out of the basement of the state-by-state assessment quality standings.

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Importantly for our discussions today, the legislation would have moved Pennsylvania's local school districts much further away from the local property tax and to a much greater reliance on a local school income tax to finance the local portion of educational costs. Currently, most of Pennsylvania's local school districts can levy up to a 0.5-percent local wage tax, while Pittsburgh and Philadelphia are able, directly or indirectly, to impose much higher tax rates (2 percent in Pittsburgh, and through Philadelphia's combined city-school budget process, Philadelphia has access to a wage tax rate of 4⁵/₁₆ percent).

Also, it provided various safeguards to taxpayers to ensure that such structural change would not generate "windfalls" to local school boards. The electorate rejected the constitutional amendment in May 1989 to the Pennsylvania uniformity clause that would have triggered implementation of the new statutes.

¹U.S. Department of Commerce, Bureau of the Census, GF-89-5. (February, 1991) *Government Finances: 1988-9, Table 2.*

²See Act 145 of 1988, The Local Tax Reform Act, and the description by the Local Government Commission, *Understanding Local Tax Reform: An Explanation of Act 145 of 1988, The Local Tax Reform Act*, January 1989.

As a result, there is an untriggered set of local tax reform statutes on the books, and some continuing reluctance on the part of the Pennsylvania General Assembly to take up this issue again.

My purpose is to discuss the kinds of issues that surround the idea of moving school districts from the local property tax to the local income tax to provide a better idea of what will ultimately be involved at the conceptual, practical, and political levels. As I have come to learn over the years, legislative action in the fiscal arena that is predicated simply on responding to pending or successful litigation runs the risk of getting things wrong as often as getting things right unless one takes some precautions. In the final analysis, there has to be a set of ideas that can be stitched together to provide a rationale for changing current local tax law, and to which a majority of the electorate can subscribe as a just way to finance the costs of needed public services. Failure to create a compelling, let alone convincing, intellectual argument for a widespread fiscal change, and/or failure to provide a set of convincing printouts of the implications of such change, can mean for state legislators the prospect of having every school superintendent, mayor, county commissioner, teacher union, public employee union, etc. in the state petitioning for relief or redress.

It is easy to see the 1990s as fundamentally different from the 1980s, and as a decade likely to generate continuing fiscal heartburn in state capitals through the industrial East and Midwest.

In order to motivate these remarks about using a local income tax for financing education, I would like to:

- Discuss the strategic setting for state and local governments in the major industrial states in the decade;
- Sketch out four principles of finance that are relevant to structuring state and local taxes and spending;
- Develop an analysis of local school finance that identifies (i) the appropriate financial structure of local schools; and (ii) the appropriate sources and methods of distribution of state funds;
- Discuss the practicalities of moving from the local property tax to the local income tax, and the related matter of local business property taxes.

Below, I will assess the merit, risks, and pitfalls in moving a state's schools from the local property tax to the local income tax, the value in asserting a greater state role in the financing of K-12 education, and the inherent relationship between such changes in local arrangements and the way that state equalizing aid is distributed to schools.

2. The Strategic Setting for Addressing State-Local Fiscal Relations in the 1990s

It is easy to see the 1990s as fundamentally different from the 1980s, and as a decade likely to generate continuing fiscal heartburn in state capitals through the industrial East and Midwest.

1. Most forecasters believe that economic growth in the 1990s will be well below that of the 1980s. We may sputter upward, and then sputter downward. There is good reason to expect that professional, for-profit economic forecasters will continue to engage in overly optimistic projections of the national economy. Since turning points in an economy are notoriously difficult to predict — and I am expecting many more peaks and troughs in the 1990s than in the 1980s, in part because of an increase in worldwide uncertainty due to massive political and economic changes — it is likely that state revenue forecasters may become an increasingly endangered species by the turn of the century.

2. The federally tax-induced speculation in commercial property in the 1980s, coupled with the flooding of that market as the financial system tries to deal with bad portfolios, will continue to mean in most urban areas that urban and suburban property tax bases will move sluggishly. As the economy grows more slowly, and inflation runs at a lower rate, there is every reason to believe that the demand for commercial, industrial, and residential property will continue to be modest, and the supply of at least commercial property will be in significant excess. Obviously, this has implications for school districts' tax bases.

3. A corollary to having to make constant tax rate decisions due to sluggish growth in the tax base is that there will be more than enough political blame to pass among the parties and branches of government. To the brave, this suggests that the surplus of fiscal problems in the 1990s may also constitute a surplus of political opportunities or problems to solve.

4. Revenue-driven state tax policy will become even more prevalent than in the last few years as the recession persists and expenditure elasticities continue to exceed revenue elasticities. I hope state lawmakers will resist the temptation to try to move toward double-digit top personal marginal tax rates in their search for revenues. Remember that high revenue elasticities that result from such high marginal tax rates have a downside risk during periods of recession and economic downturn.

5. Sooner or later the federal government will have to face up to the oceans of red ink its budget creates and either invent new revenue sources or materially change the rate structure of our existing income taxes. The day of states acting ahead of the federal government are long gone, and the forced conformity that attended the Tax Reform Act of 1986 is a harbinger of things to come. Like it or not, large-scale innovation in fiscal institutions will come from the federal government out of fiscal necessity, and there is a need for the states to recognize and go along with this.

The prospect of a peace dividend is illusory at best, for the world will in my judgment continue to be a very dangerous place, and one that will continually beckon for our military presence and attending financial commitments. Also, our friends in California and in our aerospace states undoubtedly will press the notion that we should substitute spending for space exploration in lieu of defense spending.

6. The increased economic integration of vast parts of the world, as evidenced by "1992" and the European Community, is an important indicator that our fiscal federalism, which has served us well for 200 years, is about to become obsolete. Fiscal homogeneity is about to replace fiscal heterogeneity in Europe. The economic benefits of the Commerce and Equal Protection clauses of the U.S. Constitution are about to become swamped by the cooperative response overseas. My hope is that the states will adjust their fiscal instruments, especially in terms of the definition of filing unit and tax base, over time, so that they are increasingly homogeneous.

7. The immediate budget problems facing the states may lead the more hopeful to count on the federal government to create a national health system and free the states of their burgeoning Medicaid costs.

I do not think this grim appraisal of the economic and fiscal environment differs from what many suspect/expect; however, what may be troubling are the sorts of decisions they imply for financing the costs of needed public services at the state and local level.

With this gray backdrop in mind, let me turn to a brief discussion of four normative principles from which one can then derive some concrete implications for the nature of school and municipal finance at the state and local level.

3. Four Principles for Financing Schools and Municipalities

3.1 Principle 1: Financing Methods Should Be Matched With the Nature of Services Provided at the State and Local Levels

Services that benefit narrow groups of users should be priced through user fees. The local property tax is a good barometer of local uses of *municipal* services (fire, police, sanitation) and should be used to finance these services.

Services that are redistributive in nature or very general in impact cannot and should not be priced because the very pricing will defeat their redistributive purpose. As a consequence, we look to the ability-to-pay principle of taxation as an appropriate basis for financing such services, and look in turn to ability-to-pay taxes such as the income tax or the sales tax as appropriate tax sources for these services.

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Let us examine some implications of Principle 1.

Education, welfare, and health services are redistributive services, and it follows that they should be financed at the state level by the income and sales taxes, which are usually taken to be indicators of individuals' and households' ability to pay. Moreover, because education, welfare, and health are redistributive in nature, local support should be of minor fiscal importance overall. That is, poor parts of the state should not be asked to pay for transfers or services to the poor. In this way,

the state redistributes resources from better-off regions to poorer regions in the support of the costs of services to the poor. Of course, local governments can act as the fiduciary or agent of the state in providing such services; however, this line of argument leads to the conclusion that the state should make the primary determination of these redistributive services and fund the vast majority of their costs.

If there is to be local support of the costs of education, it should be out of a local, flat-rate income tax, at a required flat rate.

It goes without saying that the states do not generally operate in this fashion. For example, in New York State, local governments, e.g., New York City, must pay half the state-local costs of AFDC and Medicaid, and few states pay more than 50 percent of the overall costs of education. Moreover, local education costs, as noted earlier, are financed primarily through the local property tax. I would argue that property is neither a measure of ability to pay (in part because it is inherently illiquid) nor a barometer of how much in the way of educational services an owner consumes or benefits from.

Again, education should be primarily financed out of the income and sales taxes at the state level. Since local school districts are not composed of households with the same size incomes, it follows that there is an important role for the state to equalize through state aid to the districts for the basic or foundation portion of education.

If there is to be local support of the costs of education, it should be out of a local, flat-rate income tax, at a required flat rate. (I should note parenthetically my distinct lack of enthusiasm for a local sales tax to finance the local costs of education because of its demonstrated adverse effects on shopping patterns.) The rate should be mandated to create a local stake in the outcome of the spending and should be uniform across districts so that movement by high-income families to high-income school districts will be minimized.

Let me take Illinois as an example. Let me go through a bit of back-of-the-envelope arithmetic to show you the implications of this line of reasoning. In fiscal 1988-89, total outlays from all sources for K-12 education in Illinois were about \$7.9 billion, and personal income in Illinois was about \$215 billion.³ This implies that, were the costs of education financed entirely from the income tax, the total tax rate would be $\$7.9/\215 or 3.7 percent. Obviously, part of the state contribution to local districts comes from business income taxes and the sales and use tax; however, the arithmetic that follows remains instructive.

Let us round the 3.7 percent to 4.0 percent to keep the arithmetic simple, and let us suppose that a study of the foundation costs or base costs of what the state wants every child to obtain in terms of essential educational services comes to 3.0 percent of personal income.⁴ That is, imagine that you examine

³The \$215 billion is a rough estimate of personal income as defined on a national income and accounts basis, and *not* on a taxable individual income tax basis.

⁴This means that the difference between 4.0 percent and 3.0 percent, or an overall tax rate of 1 percent, comes from "extras."

the costs of educating 1.7 million children, the approximate number of children in Illinois' public schools, in the essentials of education, given a desired class size, with a salary structure designed to attract a desired caliber of teacher with a desired range of skills, and so forth, and arrive at the result that the foundation cost will be 3 percent of personal income statewide.

Undoubtedly, one can argue that the state should pay the entire 3 percent and distribute the funds back to the local schools; however, there is probably merit in mandating a local contribution so that local school boards feel some "presence" from the parents who see that they are visibly paying part of the total costs of local education. Suppose we find it attractive to argue that, overall, local support for the foundation costs of education should be one-third, and state support for the foundation costs of education should be two-thirds, then it follows that, in the aggregate, a local income tax of 1 percent should be imposed locally and a 2-percent state income tax should be imposed to make up the state's share.

Again, I would argue that the local income tax rate should not be optional, but that it be imposed by state law. Undoubtedly, districts with households without much income or below average income will collect less than high-income districts on a per-student basis. What should be done to make up the difference? The state should use the proceeds of its aggregate 2-percent income tax to pick up the difference between what is needed per student in each district as contrasted to what the local 1-percent income tax collects. The formula for this is:

$$\text{State Aid to District} = \text{Foundation Amount per Pupil} \times \text{Number of Pupils in District} - 1\text{-Percent Income Tax on Residents in District}$$

We know ahead of time, because we calculated the total foundation costs of education to be 3 percent of personal income, that the formula will add up and distribute statewide enough funds and make it work for each district as well.

Note that the 1-percent tax rate is purely illustrative; it is likely that the overall tax rate could be above 4 percent, and the desired share of local funding could readily be higher or lower than one-third. I think the illustration gives an initial frame of reference of how one might think about calculating what a local income tax rate should be that would be imposed to pay for the local cost of education. Also, it indicates how the shortfall or the remainder should be made up by the state to ensure that a foundation level of education be provided uniformly to each child in the state.

In Pennsylvania under pre-tax-reform law, most school districts other than Philadelphia and Pittsburgh could levy up to a 0.5-percent wage tax and rely on local property taxes for the remainder. The reform legislation allowed the local income tax rate to rise to 1.5 percent, and was optional rather than mandatory. That is, local districts could elect any tax rate up to a *maximum* of 1.5 percent. I think allowing such variability in local tax rates is undesirable because it will encourage higher-income families to segregate themselves at the margin.

Let me turn to some questions that will arise from such an approach to educational finance. For districts with high-income families, it is possible that the 1-percent rate will be sufficient by itself to pay for the foundation costs. Should they be required to pay in the arithmetic "surplus" back to the state? Several sorts of answers are possible:

- Pay the excess into a statewide fund for sharing to poor districts, and thereby create a form of

redistribution/progressivity among districts even though the tax rate is proportional;

- Zero out the excess in the sense of allowing the excess to be used for services beyond the foundation amount in each district.

My guess is that the first approach will be politically unacceptable, and the second will be acceptable politically.

It should be noted that many states promise to cover the gap between the foundation amount and that provided by a local property tax at a state-determined property tax rate. However, such approaches usually wind up covering only a limited percentage of the gap, with the result that students in poor districts fail in fact to get the foundation amount spent on them. Litigation typically then results on the grounds that the state has failed to provide a "thorough and efficient" education, and/or has failed to meet other constitutional guarantees with regard to equal protection.

I think allowing such variability in local tax rates is undesirable because it will encourage higher-income families to segregate themselves at the margin.

It should also be pointed out that even if one favors some form of choice or voucher plan, as contrasted with school assignment based on place of residence and desegregation guidelines, the above sort of reasoning applies to the financing of schools. The money has to come from somewhere.

Another question/issue that can arise is how districts should be encouraged to finance beyond the foundation amount if they wish to provide a superior education. Again, there are a variety of plausible answers to this question that will depend on political tastes. My own view is that one should hold off moving to the property tax for "extras" because it will reward those districts with the good fortune of having highly assessed commercial and industrial property in their boundaries to reap "windfall" revenues, and thereby allow them to continue to outdistance poorer districts. Shopping malls tend to be located in suburbs, for example.

Certainly, poor districts should be encouraged through state matching to go beyond the foundation amount, and one can envision the matching rate to be based on inverse family income to determine how much of a match to provide.

Whether high-income districts need or deserve state aid is an open question. One can create a matching percentage that vanishes to zero in relation to median family income in the state at some stated level, say the 75th percentile of the school district's median family income, and structure the formula so that the matching rate is quite high for the poorest districts.

With respect to calculating the foundation amount, one can find such data buried in a state department of education. Virtually every state goes through such calculations each year, costing out the average state cost of primary and secondary education; of course, the average state cost may simply reflect cost-of-living differences, differences in the seniority structure among districts, and the pay differentials to teachers with master's degrees.

Current school aid formulas equalize around some presumed figure of the foundation amount; the point here is that the mandated local contribution should come increasingly from a flat-rate income tax, rather than the local property tax, and the state should make up 100 percent of the difference between what is necessary and what is available from a local income tax.

Some may argue that creating a more elastic revenue source at the local level (an income tax is usually thought to be more elastic than a property tax) may result in throwing good money after bad; however, it should be remembered that even vouchers have to be financed, and the monies must come from somewhere. The essential argument here is that there should be a fixed *rate* of local contribution to the revenue side of the local school budget so that residents have a stake, even if they do not have school-age children, or children in the public schools, in order to encourage accountability. The local property tax defuses this by virtue of being the wrong sort of tax for education.

The local income tax approach would lower property taxes on businesses because there are no local business income taxes (nor should there be in my judgment because of the adverse location incentives they would provide).

The local income tax approach would lower property taxes on businesses because there are no local business income taxes (nor should there be in my judgment because of the adverse location incentives they would provide). This relative shift in the burden from business to households will create a political problem for local school boards because it will create household taxpayer resentment. There are ways to forestall this problem by forestalling this shift — by assuring, at least statewide, that the household and business shares of the cost of school finance are the same. This can be accomplished by some combination of raising business taxes at the state level, or classifying property as between business and nonbusiness property. The appendix to this paper discusses this issue, which turned out to be very important in the Pennsylvania context, and shows the ramifications of a homestead exemption as an approach to the problem.

Lowering property taxes for education will be popular among the elderly; however, there is also merit in having an income tax base definition that is as broad as the federal, and thereby includes private retirement income (often exempt in many states), and all or some portion of Social Security (often exempt in many states).

If I am correct that there will be sluggish growth and inflation in the 1990s, the local income tax will be more bountiful than the local property tax and more elastic.

Changing revenue sources at the local level should increase local interest in education, since both homeowners and renters will see more clearly their local support for it.

There are some rather simple ways to administer a local personal income tax, given that a state personal income tax is

already in place. If the local income tax rate is fixed at a flat rate for all districts, thereby proportional, and the income tax base is the same as that of the state income tax, then the local income tax can be administered or “piggybacked” by the state revenue department once the personal income tax return has the school district of residence filled out, and the mailing labels subsequently and routinely contain such information. With a little advance notice, the withholding systems can be adjusted. The outstanding issue that will need to be addressed is how to divide up the interest rate “float,” and how to ensure that the local school districts will receive the withholding on a prompt and timely basis. (These days, everyone is nervous about someone else’s sticky fingers!)

If local income tax rates are allowed to vary at the local level, then state administration or state “piggybacking” becomes more difficult, if not impossible.

One can begin to get some information about how such a formula might work by paying the Census Bureau to use their knowledge about the geography of school districts in conjunction with the mailing addresses a state revenue department currently employs to administer the state income tax. The addition of the school district of residence to the state personal income tax form can be accomplished with little administrative expense.

Collecting such data, if not now collected, allows broader scope for experimentation in the state school aid formulas than those currently in vogue.

Let me now turn to some financing issues that arise with respect to municipal government. While school districts, counties, and municipalities provide different services, they extract revenues from the same households, and questions arise over what the appropriate state role should be in refereeing this melee.

3.2 Principle 2: States Should Adjudicate Interjurisdictional Spillovers of Service Use Through State Grants and Local Taxing Authority

Several sorts of spillovers cause local municipal overburden. Older, central cities are typically populated with many state and federal buildings that are tax-exempt, and also have a disproportionate share of religious, health care, and educational institutions vis à vis suburban rings. In each instance, the tax exemptions accorded these organizations imply higher property taxes on residences and businesses with the effect of encouraging migration to the suburbs.

Another source of municipal overburden is the use of municipal services by nonresidents. The commuter use of services is the most common example of such pressures. Again, taxes on residents to provide services to nonresidents encourages mobile households and businesses to migrate out of central cities.

Given the undesirability of such migrations for purely tax reasons, there is an adjudicatory role for state government. Appropriate policy responses include: state financial aid in recognition of tax-exempt property and state aid in recognition of the municipal burdens imposed by commuters. With regard to the problem of nonresident use of municipal services, the states should either enact revenue sharing to address commuter problems or enable local municipal governments to impose commuter taxes with a credit against, say, state personal income taxes in recognition of the state interest in such geo-attribution of service use.

3.3 Principle 3: Financing Responsibility and Benefit Levels Should Generally Correspond to Each Other Geographically

The government that sets the benefit levels should have the primary responsibility for financing a service. This implies that state education, welfare, and health service levels should be defined at the state level in terms of eligibility and services, and that state taxes (income and sales) should be used to finance these as well.

Similarly, to the extent that the state determines the foundation amount of aid, and does not simply rely on a statistical average, then it follows that the state should finance a large portion of the expense. The primary reason for arguing that there should be visible, local proportional income taxes to support part of the cost is to encourage local participation and accountability for school boards, and in effect create a local stake in the efficacy of education.

3.4 Principle 4: Greater State Aid Should Be Coupled With Greater Local Accountability

While it is true that the closer government is to the people, the greater the local interest becomes in the services, it is also true that information about outcomes of public spending is generally not available to the public.

Moreover, state legislators deserve to get greater political recognition for the risks they take in transferring more resources to schools and municipal government.

Accountability is both good management and good politics, and for local governments, schools, and municipalities to receive more state-raised funds with greater equalization, there has to be greater local political recognition of what state-level politicians have done. Also, there must be more forthright statements at the local level about what has and what has not been accomplished.

Some ideas:

1. Require public-record votes of thanks by local schools for state aid
2. Annual reenactment of the local school income tax mandated rate
3. Provide statutorily that the student elected to the presidency of his graduating class be a voting party to all collective bargaining negotiations
4. Submit collective bargaining outcomes to the electorate for ratification
5. Publish key vital statistics about schools:
 - number of kids who start the year and finish the year by grade
 - competency test scores by district and the provision to each parent of their children's results
 - mean and median achievement scores by district and the provision to each parent of their children's results
 - publication of percentages of kids who go on to college, technical schools
6. Publish detailed curricula by district: course syllabi, books used, topics covered, expectations for completion
7. Construct comparable data for municipal and county governments

Not too long ago, I had the privilege of providing these accountability ideas to Taxpayers for a Better Indiana, which

is composed in part of members of various Indiana labor unions. The ideas were initially greeted with considerable skepticism if not hostility. On the other hand, when I reminded everyone that chronically slower economic growth and some inflation in the 1990s would be a permanent part of the economic environment, there was a grudging admission that both management and labor would have to do a better job at convincing electorates that raising tax rates was defensible. Fundamentally at issue is convincing beleaguered taxpayers that something beyond simply higher salaries will result from the sacrifice of more private income.

The government that sets the benefit levels should have the primary responsibility for financing a service.

I should note that I have not dealt in any systematic way with how local schools should spend their monies that will be more rationally generated. As an economist, I believe strongly in examining outcomes and not inputs into the educational process.⁵

It would be an understatement to simply observe that the provision of educational services is in ferment in the United States today; it is probably more accurate to say we are in a national panic about our capacity to educate our children so they can compete in a global economy. However, I do have a few observations.

Irrespective of whether one favors "choice" or not, there is an enormous need to provide objective information to parents about what their children are being subjected to, e.g., the curriculum, and objective information about how well their children are doing. More information is part of my accountability suggestions; however, one needs to do more than simply arm parents with a better idea of what they want for their children. There must be some things done on the supply side of the educational service business that will meet the demands various reform movements are in the process of creating.

Specifically, there needs to be much more attention paid to the *structure* of teachers' salaries. There are several aspects to this:

- Ensuring that more and more able young people are persuaded to go into the teaching profession as contrasted with other college majors;
- Giving simple recognition to the obvious economic fact of life that different specialties in college command different starting salaries in the labor market.

Offering an undergraduate computer science major the same starting salary as an English major is a guarantee that there will not be any certified computer science teachers in local school districts, or Japanese or Russian teachers either. If we think these are important subjects that our children must learn, then we must ensure that local school districts can compete in the general labor market for these skills.

⁵I am pleased when my professional masters students get jobs at good starting salaries, and even more pleased when they remember some of my lectures about how to make the taxation process a bit more rational.

Admittedly, allowing pay differentials at the outset is an anathema to industrial unionism; however, there comes a time when one has to decide what is more important — our children or the teachers unions' nostalgia for behaving in the collective bargaining process like their industrial counterparts. For one thing, labor relations in industry have changed dramatically, while those in the education area remain heavily committed to higher salaries for fewer contact hours without testing for accomplishments.⁶

I do not find it implausible to require that the *percentage* raise each year for comparable performance in the classroom be the same between the computer science teacher and the English teacher, but that their starting salaries reflect market realities. Moreover, I do not believe that the two starting teachers would be offended by initial salary differentials that reflect market realities, and would hope the American labor movement could see its way to accepting this simple idea.

Related to attracting better young people to teaching and paying market salaries for scarce skills so that our youngsters can learn them as well must be the realization that we have a very large inventory of school teachers who are going to be a part of public education in all but the most radical reform scenarios. It strikes me that they, along with most of us in other walks of life, need to go back to the classroom themselves (in the summer) and bone up on their original substantive subject matters as well as acquiring new skills.

Investing in our stock of teachers is important to ensuring that we do not simply try to chase a will-o'-the-wisp called educational reform. Our public universities have the capacity to handle greater summer enrollments, and the educational system, overall, will benefit by greater self-investment.

4. Appendix: Maintaining the Statewide Balance Between Business and Household in Support of the Costs of Education in Pennsylvania⁷

To some, the overreliance on the local property tax in support of education, compared to its being more properly supported by a local income tax, might mean that business was paying too high a share of school taxes and households too low a share under current law. On the other hand, realistic state politicians have observed that the desired shift to personal income taxes from property taxes would never voluntarily occur at school board meetings once elected board members discovered that absentee plant owners would reap what are often described as "windfalls."

In this appendix, I review a number of approaches that were discussed in Pennsylvania to allow school districts to *voluntarily* move from the local property tax to the local income tax, and ways that the overall business share of local school budgets was retained.

Over the years, a variety of ingenious tax policies were constructed in Pennsylvania to ensure that, at least in the aggregate, the calculated business share of state and local taxes would remain the same after enactment of some sort of local

tax reform package that would replace school property taxes with income taxes. For example, under a mid-1980s proposal, the mandatory movement to a local income tax would be accompanied by an increase in the state sales tax that would be shared with school districts in proportion to the loss in business property taxes. Because it was estimated that 30 percent of the sales tax is paid by business, and the 30-percent figure corresponds to what was known about the business property tax burden statewide, one could create and distribute a statewide pot that would address the first problem without violating the uniformity clause of the Pennsylvania Constitution.

We may focus the issue of maintaining the balance between business and nonbusiness share of the property tax with a bit of notation and two simple equations. The first equation says that the old tax system and the new tax system must bring in the same amount of revenue, R , and the second equation says that *share* of total local taxes paid by business must be the same under the old and new system:

$$t_1 \times T_1 + Wage + Occupation = R = t_2 \times T_2 + t_p \times Y$$

where:

t is the property tax rate,

T is the total assessed base,

1 and 2 denote old and new law,

Wage and Occupation are the earned income and occupation taxes locally available under prereform law,

R is total revenue,

Y is the personal income tax base, and

t_p is the personal income tax rate that would be solved for the new tax system to be revenue-neutral.

The assessed base, T , could differ under old and new law if, for example, a homestead exemption were enacted to reduce reliance on the property tax.

The balance requirement, *per se*, is found in the equation below:

$$(t_1 \times B_1) / R = (t_2 \times B_2) / R$$

where B is the business property tax base in the old and new systems.

If local tax reform were to mean just trading the earned income and occupation taxes (the old law local tax sources for schools in Pennsylvania) for a personal income tax, then $t_1 = t_2$, and $t_p = (Wage + Occupation) / Y$. It follows, if $t_1 = t_2$, that (2) is satisfied automatically since the millage rate and B are unaffected by this definition of reform.⁸

If, however, one seeks to reduce property taxes as a percentage of R , then the matter becomes more complex, and one in effect needs to calculate a third equation that compares $t_2 T_2 / R$ to some criterion percentage. For many school districts, the current reliance on the property tax is 90 percent or more.

Two approaches to reducing the reliance on the property tax for school finance suggest themselves: some form of a homestead exemption or general per property exemption that would differentially affect residential property, or a "split rate" or classified approach that would allow the residential property

⁶For those of you who have not been following the education labor scene lately, I suggest you keep track of the merger discussions periodically under way between the NEA and AFT.

⁷This Appendix is drawn from my remarks before the March 1990 American Educational Finance Association Annual Research Conference, "School Finance Reform in Pennsylvania: A View from the Trenches."

⁸In Pennsylvania, the state income tax base is, on average, about 15 percent larger than the earned income tax base. The difference is due to interest, dividends, rents, royalties, and capital gains, e.g., capital income.

tax rate to be reduced while the business property tax rate remained constant. Under the second approach, it is easy to see that (2) would be maintained because the millages would be specific to business and could be chosen to guarantee (2) would be honored.

Under the first, homestead-exemption approach, it is less obvious how (2) would be maintained. By providing a \$10,000 or \$20,000 per-property exemption, subject to a 20-percent maximum reduction per property, one can easily reduce residential property taxes and reduce the overall reliance on the property tax to finance schools. Recall that for business properties, which are typically quite valuable, a \$15,000 exemption will lead to a small percentage reduction in tax at the old millage. In order to ensure that (2) is honored, the new millage needs to increase slightly to offset the impact of the exemption for business. In effect, one is merely solving (1) and (2) for two unknowns: the new millage rate and the new personal income tax rate given a decline in assessed base as a result of the homestead exemption. Whether or not the movement to the personal income tax is large enough to get the overall reliance on the property tax to an acceptable level is an empirical question that can only be answered through trial and error with actual data.

An analysis of data for Allegheny County performed by some students at CMU under my direction several years ago sheds some light on this issue. Table 1 below displays for the school districts in Allegheny County the major components of their own-source taxes in 1985-86. It indicates that property taxes were 80 to 90 percent of local taxes with the notable exception of the Pittsburgh School District, which raised only 60 percent of its local taxes in the form of property taxes. In effect, Pittsburgh was able to move earlier to a local income tax than other districts in the county because it was a "home rule" school district. Note also that nonresidential/business property taxes varied considerably in importance: from a low of 9.3 percent to a high of 49.7 percent.⁹

Were a \$10,000 improvements exemption enacted, the per capita taxes eliminated, and the local wage tax replaced by a local income tax, residential property taxes would fall considerably, and the level of reliance would be no more than 81 percent (see Column G in Table 2) and as low as 52 percent in the case of Pittsburgh. Local income tax rates would typically be from 0.9 to 1.25 percent. Note that in order to satisfy the various constraints, millages would have to go up, typically by 2 to 4 percent. We see from this analysis that it is feasible to shift reliance from the local property tax to a local income tax; residential property taxes are reduced by 15 to 40 percent in the process. ☆

(Report continued on next page.)

If, however, one seeks to reduce property taxes as a percentage of R, then the matter becomes more complex, and one in effect needs to calculate a third equation that compares $(C) \sqrt{R}$ to some criterion percentage. For many school districts, the current reliance on the property tax is 20 percent or more.

Two approaches to reducing the reliance on the property tax for school finance suggest themselves: some form of a homestead exemption or general per-property exemption that would differentially affect residential property or a "split rate" classified approach that would allow the residential property

In this appendix, I review a number of approaches that were discussed in Pennsylvania to allow school districts to voluntarily move from the local property tax to the local income tax, and ways that the overall business share of local school budgets was reduced. Over the years, a variety of legislative tax policies were constructed in Pennsylvania to ensure that, at least in the long run, the combined business share of state and local taxes would remain the same after enactment of some sort of local income tax. This goal was achieved by a variety of means, including the use of a "split rate" approach that would allow the residential property

⁹Several of the districts with substantial industrial property have had very difficult times as the properties have been plowed under or been vacant for many years.

Table 1: 1985-86 School District Taxes in Allegheny County

| ID | School District | Act 511 Per Cap. Wage Tax | Current Law | Taxes | Property Tax as % of Total | Non-Res. Prop. % Share |
|----|---------------------|---------------------------|--------------|-------------------|----------------------------|------------------------|
| | | | Property Tax | 1985-86 Total Tax | | |
| A | B | C | D | E | F | G |
| 1 | Allegheny | \$386,466 | \$3,688,508 | \$4,074,974 | 90.5% | 38.6% |
| 2 | Avonworth | 509,020 | 3,117,336 | 3,626,356 | 86.0% | 9.4% |
| 4 | Baldwin Whitehall | 1,889,513 | 12,793,413 | 14,682,926 | 87.1% | 11.4% |
| 5 | Bethel Park | 2,263,218 | 14,108,292 | 16,371,510 | 86.2% | 21.3% |
| 6 | Brentwood | 485,327 | 3,211,272 | 3,696,599 | 86.9% | 16.4% |
| 7 | Carlyton | 654,950 | 5,090,475 | 5,745,425 | 88.6% | 22.4% |
| 8 | Chartiers Valley | 1,632,545 | 10,393,622 | 12,026,167 | 86.4% | 24.2% |
| 10 | Clairton | 251,388 | 2,312,616 | 2,564,004 | 90.2% | 24.3% |
| 11 | Cornell | 310,119 | 3,925,121 | 4,235,240 | 92.7% | 49.7% |
| 12 | Deer Lakes | 519,245 | 3,694,660 | 4,213,905 | 87.7% | 13.8% |
| 13 | Duquesne | 142,214 | 2,130,034 | 2,272,248 | 93.7% | 40.5% |
| 14 | East Allegheny | 640,930 | 5,513,597 | 6,154,527 | 89.6% | 27.0% |
| 16 | Elizabeth Forward | 773,140 | 4,914,626 | 5,687,766 | 86.4% | 17.7% |
| 17 | Fox Chapel | 2,164,466 | 12,763,092 | 14,927,558 | 85.5% | 20.5% |
| 20 | Hampton | 945,906 | 6,426,843 | 7,372,749 | 87.2% | 14.1% |
| 21 | Highlands | 889,447 | 6,634,472 | 7,523,919 | 88.2% | 21.2% |
| 22 | Keystone Oaks | 1,161,949 | 8,473,603 | 9,635,552 | 87.9% | 36.7% |
| 23 | McKeesport | 1,375,560 | 9,045,331 | 10,420,891 | 86.8% | 17.8% |
| 18 | Monroeville-Gateway | 2,600,073 | 14,685,639 | 17,285,712 | 85.0% | 41.6% |
| 24 | Montour | 1,054,124 | 9,131,997 | 10,186,121 | 89.7% | 35.0% |
| 25 | Moon | 1,725,849 | 8,827,847 | 10,553,696 | 83.6% | 27.9% |
| 26 | Mt Lebanon | 2,730,096 | 18,428,944 | 21,159,040 | 87.1% | 10.4% |
| 27 | North Allegheny | 3,065,594 | 17,153,806 | 20,219,400 | 84.8% | 15.8% |
| 28 | North Hills | 2,596,220 | 13,811,119 | 16,407,339 | 84.2% | 25.1% |
| 29 | Northgate | 623,507 | 3,780,262 | 4,403,769 | 85.8% | 17.5% |
| 30 | Penn Hills | 2,015,823 | 16,965,445 | 18,981,268 | 89.4% | 14.1% |
| 47 | Pittsburgh | 45,783,643 | 68,791,855 | 114,575,498 | 60.0% | 31.2% |
| 31 | Plum | 1,390,547 | 6,609,829 | 8,000,376 | 82.6% | 15.5% |
| 32 | Quaker Valley | 1,037,906 | 6,353,953 | 7,391,859 | 86.0% | 13.4% |
| 33 | Riverview | 383,419 | 3,469,205 | 3,852,624 | 90.0% | 24.2% |
| 34 | Shaler | 2,056,111 | 12,952,946 | 15,009,057 | 86.3% | 11.8% |
| 35 | South Allegheny | 384,806 | 2,653,605 | 3,038,411 | 87.3% | 9.5% |
| 36 | South Fayette | 427,410 | 2,772,691 | 3,200,101 | 86.6% | 23.5% |
| 37 | South Park | 704,864 | 3,960,217 | 4,665,081 | 84.9% | 9.3% |
| 38 | Steel Valley | 522,400 | 6,067,688 | 6,590,088 | 92.1% | 24.3% |
| 39 | Sto-Rox | 511,283 | 3,627,395 | 4,138,678 | 87.6% | 28.7% |
| 42 | Upper St Clair | 1,971,813 | 12,858,580 | 14,830,393 | 86.7% | 12.3% |
| 43 | West Allegheny | 568,589 | 4,756,883 | 5,325,472 | 89.3% | 43.8% |
| 44 | West Jefferson | 1,598,555 | 6,083,832 | 7,682,387 | 79.2% | 21.4% |
| 45 | West Mifflin | 1,571,074 | 9,808,665 | 11,379,739 | 86.2% | 39.3% |
| 46 | Wilkinsburgh | 716,876 | 4,738,083 | 5,454,959 | 86.9% | 24.3% |
| 47 | Woodland Hills | 2,566,611 | 19,004,418 | 21,571,029 | 88.1% | 23.3% |

Table 2: Impact of \$10,000 Improvements Exemption on Allegheny County School Districts

| ID | School District | Reform Prop. Tax | Reform Income Tax | Reform Tot. Tax | % Cut in Resident Prop. Tax | Income Tax Rate | Non-Res. Prop. % Share | Prop. Tax % Reliance | % Change Millage |
|----|---------------------|------------------|-------------------|-----------------|-----------------------------|-----------------|------------------------|----------------------|------------------|
| | | A | B | C | D | E | F | G | H |
| 1 | Allegheny | \$3,169,250 | \$905,697 | \$4,074,947 | -24.5% | 0.89% | 38.6% | 77.8% | 2.3% |
| 2 | Avonworth | 2,725,339 | 901,014 | 3,626,353 | -14.1% | 1.02% | 9.4% | 75.2% | 6.0% |
| 4 | Baldwin Whitehall | 10,915,136 | 3,767,671 | 14,682,807 | -16.9% | 0.96% | 11.4% | 74.3% | 3.0% |
| 5 | Bethel Park | 12,521,539 | 3,849,963 | 16,371,503 | -14.9% | 0.95% | 21.3% | 76.5% | 1.9% |
| 6 | Brentwood | 2,690,490 | 1,006,098 | 3,696,589 | -20.0% | 1.04% | 16.4% | 72.8% | 4.3% |
| 7 | Carlyton | 4,407,982 | 1,337,442 | 5,745,424 | -17.9% | 0.86% | 22.4% | 76.7% | 5.0% |
| 8 | Chartiers Valley | 8,981,106 | 3,045,059 | 12,026,165 | -18.9% | 1.03% | 24.2% | 74.7% | 2.5% |
| 10 | Clairton | 1,646,205 | 917,782 | 2,563,987 | -39.5% | 1.55% | 24.3% | 64.2% | 7.1% |
| 11 | Cornell | 3,452,773 | 782,454 | 4,235,227 | -25.9% | 1.34% | 49.7% | 81.5% | 2.7% |
| 12 | Deer Lakes | 2,997,272 | 1,216,630 | 4,213,902 | -22.4% | 1.05% | 13.8% | 71.1% | 6.7% |
| 13 | Duquesne | 1,632,984 | 639,263 | 2,272,248 | -41.1% | 1.72% | 40.5% | 71.9% | 2.5% |
| 14 | East Allegheny | 4,441,591 | 1,712,936 | 6,154,527 | -27.8% | 1.34% | 27.0% | 72.2% | 3.1% |
| 16 | Elizabeth Forward | 4,337,008 | 1,350,757 | 5,687,765 | -14.8% | 0.77% | 17.7% | 76.3% | 15.2% |
| 17 | Fox Chapel | 11,830,255 | 3,097,301 | 14,927,556 | -9.6% | 0.58% | 20.5% | 79.3% | 2.6% |
| 20 | Hampton | 5,809,392 | 1,563,353 | 7,372,745 | -11.5% | 0.85% | 14.1% | 78.8% | 3.5% |
| 21 | Highlands | 5,293,720 | 2,230,199 | 7,523,919 | -26.6% | 1.23% | 21.2% | 70.4% | 5.5% |
| 22 | Keystone Oaks | 7,502,006 | 2,133,533 | 9,635,539 | -19.7% | 0.97% | 36.7% | 77.9% | 1.6% |
| 23 | McKeesport | 6,941,580 | 3,479,311 | 10,420,891 | -29.3% | 1.39% | 17.8% | 66.6% | 4.1% |
| 18 | Monroeville-Gateway | 13,304,413 | 3,981,300 | 17,285,712 | -18.4% | 1.15% | 41.6% | 77.0% | 1.0% |
| 24 | Montour | 8,159,891 | 2,026,208 | 10,186,099 | -17.5% | 0.88% | 35.0% | 80.1% | 1.8% |
| 25 | Moon | 7,928,330 | 2,625,365 | 10,553,695 | -15.3% | 1.07% | 27.9% | 75.1% | 2.7% |
| 26 | Mt Lebanon | 16,731,258 | 4,427,782 | 21,159,040 | -10.5% | 0.74% | 10.4% | 79.1% | 2.4% |
| 27 | North Allegheny | 15,806,850 | 4,412,550 | 20,219,400 | -9.7% | 0.80% | 15.8% | 78.2% | 2.4% |
| 28 | North Hills | 12,211,982 | 4,195,357 | 16,407,339 | -16.5% | 0.91% | 25.1% | 74.4% | 1.9% |
| 29 | Northgate | 3,190,920 | 1,212,849 | 4,403,769 | -19.6% | 0.99% | 17.5% | 72.5% | 4.1% |
| 30 | Penn Hills | 13,949,538 | 5,031,730 | 18,981,268 | -21.1% | 1.05% | 14.1% | 73.5% | 3.1% |
| 47 | Pittsburgh | 60,140,580 | 54,434,917 | 114,575,497 | -26.2% | 1.89% | 31.2% | 52.5% | 1.4% |
| 31 | Plum | 5,616,432 | 2,383,562 | 7,999,994 | -18.5% | 0.95% | 15.5% | 70.2% | 3.0% |
| 32 | Quaker Valley | 5,888,491 | 1,503,368 | 7,391,859 | -8.7% | 0.59% | 13.4% | 79.7% | 4.0% |
| 33 | Riverview | 3,095,120 | 757,504 | 3,852,624 | -14.7% | 0.78% | 24.2% | 80.3% | 4.8% |
| 34 | Shaler | 11,108,001 | 3,901,040 | 15,009,041 | -16.5% | 0.94% | 11.8% | 74.0% | 5.3% |
| 35 | South Allegheny | 1,922,522 | 1,115,889 | 3,038,411 | -30.9% | 1.24% | 9.5% | 63.3% | 5.9% |
| 36 | South Fayette | 2,397,645 | 802,638 | 3,200,284 | -18.6% | 0.91% | 23.5% | 74.9% | 4.1% |
| 37 | South Park | 3,465,776 | 1,199,305 | 4,665,081 | -14.0% | 0.89% | 9.3% | 74.3% | 5.9% |
| 38 | Steel Valley | 4,808,026 | 1,782,061 | 6,590,087 | -28.2% | 1.39% | 24.3% | 73.0% | 3.7% |
| 39 | Sto-Rox | 2,852,225 | 1,286,453 | 4,138,678 | -31.8% | 1.38% | 28.7% | 68.9% | 7.0% |
| 42 | Upper St Clair | 11,913,322 | 2,917,071 | 14,830,393 | -8.6% | 0.72% | 12.3% | 80.3% | 0.7% |
| 43 | West Allegheny | 4,191,750 | 1,133,722 | 5,325,472 | -23.3% | 0.85% | 43.8% | 78.7% | 2.4% |
| 44 | West Jefferson | 5,355,939 | 2,326,448 | 7,682,387 | -16.4% | 1.21% | 21.4% | 69.7% | 2.6% |
| 45 | West Mifflin | 8,448,117 | 2,931,621 | 11,379,739 | -25.5% | 1.52% | 39.3% | 74.2% | 0.9% |
| 46 | Wilkinsburgh | 3,880,986 | 1,573,973 | 5,454,959 | -25.1% | 0.99% | 24.3% | 71.1% | 5.8% |
| 47 | Woodland Hills | 15,994,406 | 5,576,623 | 21,571,029 | -21.5% | 1.00% | 23.3% | 74.1% | 3.4% |