

A Guide to Indiana School Finance

1997-1999 Edition



Fiscal Policy Report No. 15

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The Indiana Fiscal Policy Institute (IFPI), formed in 1987, is a private non-profit governmental research organization. It is the only independent statewide source of continuing research into the impact of state taxing and spending policies in Indiana. The IFPI is privately supported by a variety of organizations, corporations, associations, and individuals in Indiana and surrounding states. Contributions to the IFPI are fully deductible under section 501 (c)(3) of the Internal Revenue Code.

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Foreword

As students return to school for the 1997-98 school year, the Indiana Fiscal Policy Institute is issuing its third edition of *A Guide to Indiana School Finance*. The prior two editions provided a “Bird’s Eye” view of the tuition support formula. This edition is no exception; a step-by-step explanation is provided in the Appendix.

New to the third edition, this report addresses several policy issues central to education finance. This report will 1) highlight the State’s role in funding primary and secondary education, 2) discuss recent changes to Indiana’s education finance system, 3) review the basic structure of Indiana’s education finance system, 4) address the challenges of allocating revenues for education, and 5) illustrate some of the anticipated results of the 1997 formula.

In producing this revised edition of the *Guide*, the Indiana Fiscal Policy Institute wishes to extend particular thanks to the State Budget Agency and the Department of Education for their assistance in providing information and answers to many questions. We also benefited from the wise assistance of education policy experts, Dennis Costerison, Indiana School Boards Association, John Grew, House Ways and Means Committee staff, and Gretchen Gutman, Senate Finance Committee staff, who were gracious enough to review earlier drafts of this report. Naturally, the Indiana Fiscal Policy Institute accepts responsibility for any errors of commission or omission.

Executive Summary

The 1973 General Assembly's tax restructuring legislation ushered in a new era of State and local government finance. This era brought about a greater role for the State in financing primary and secondary education. In 1973, 66 percent of education instructional and transportation costs were paid for by local taxes, namely the property tax. The remaining 34 percent were State revenues. Today, the State contributes roughly 60 percent of these costs while local revenues represent approximately 40 percent.

The majority of State and local assistance is provided via the Basic Grant, which funds the general instructional costs of schools. A school corporation's Basic Grant is determined by a legislatively enacted tuition support formula. This formula determines both regular tuition support as well as additional funding for At-Risk programs, special education, vocational education, grants for enrollment growth, and a newly enacted grant awarded based on the number of students receiving an honors diploma. The make-up of a school corporation's Basic Grant will vary depending on differences in property wealth and local factors, such as high or low percentages of students "At-Risk" of completing their education.

The 1997 General Assembly adopted a new tuition support formula for the 1997-98 and 1998-99 school years. This formula includes a foundation grant that establishes a minimum funding level per pupil. A qualifying tax rate is also included to prompt low taxing corporations into increasing their rates and reducing overall variance in school General Fund property tax rates. For those school corporations who tax at a rate above the qualifying rate, there is a guaranteed revenue yield provision. This provision ensures equal access to education revenue regardless of the school corporation's property tax wealth.

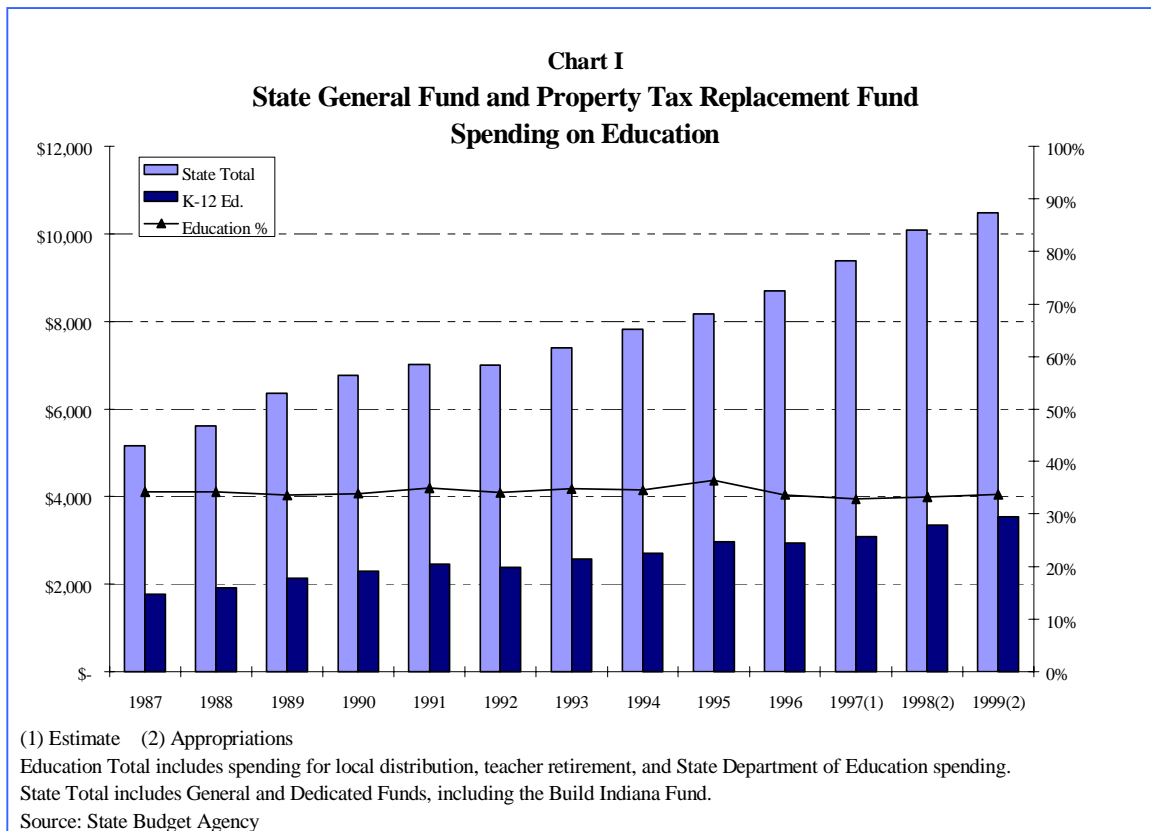
The tuition support formula is the primary tool used by the State to correct for the variation in revenues and tax rates across all 294 school corporations. The State found it necessary to address this variation in order to ensure that all Indiana students have equal education opportunities. This requirement of an equal education opportunity is derived from the State's constitutional responsibility to provide a free education that is openly available to all. Other states, which have similar responsibilities, have faced legal challenges arguing that unequal funding prevents children from having equal education opportunities.

In Indiana, the estimated variation between 1997 Basic Grant spending for the highest and lowest spending school corporations was nearly \$3,000 per pupil. However, in comparing school corporations' spending at the 90th and 10th percentiles, the difference was less than \$840. The tuition support formula adopted in 1997 is anticipated to further improve this measurement of variation. Within the last five years, Indiana has also dramatically reduced the variation in General Fund tax rate variation, which for taxpayers is another measure of equity. Projections of the formula for the next two years suggest that variance between the rate at the 90th percentile and 10th percentile will fall to \$0.61 per \$100 of assessed valuation. As recently as 1987, the difference was \$1.51.

Significant variation continues to exist when the total school tax rate is compared. The total school rate includes not only the General Fund rate, but also the rates for the Debt Service, Capital Projects, Transportation, and the Special Education Preschool Funds. The variation in the Debt Service Fund rates is the most significant. The State has yet to address this issue. It may, however, find it necessary to do so as other states' courts have suggested that there is more to equal education opportunities than instructional costs. Presumably the condition of the school building and other resources also make a difference. This report illustrates that the State's efforts to address the variation in per pupil spending and General Fund tax rates have met with large success. However, the legislature may now need to expand its scope when looking at equity issues in education.

I. The State’s Role in Funding Primary and Secondary Education

Throughout the United States, the provision of primary and secondary education is one of government’s most important responsibilities. This responsibility, derived from state constitutions and interpreted by state court decisions, resides with state legislatures, which can further delegate certain responsibilities to local school corporations.



In Indiana, the State’s constitutional responsibility to provide a free primary and secondary education to all is coupled with a fiscal responsibility. For the 1997-99 biennium, the General Assembly appropriated \$6.9 billion to local school corporations. Total State General Fund appropriations during this same time period are \$20.6 billion. The State’s appropriation to local school corporations represents 34 percent of total State funding and is the State’s largest fiscal commitment. This percentage has been fairly consistent over the last ten years. (Chart I)

Since 1987, State spending for education has increased by approximately \$1.8 billion dollars or approximately six percent each year. The Basic Grant, which provides assistance for tuition support, special education, vocational education, At-Risk programs, and enrollment growth

grants, is the largest source of revenue for local school corporations. Approximately 80 percent of State support for local school corporations is awarded via the Basic Grant. (Table I) Local revenues, such as property tax levies and miscellaneous revenues from the Auto Excise and Financial Institutions taxes, also fund a school corporation’s Basic Grant. Property tax levies, the largest component of local revenues, are strictly controlled by public school corporation property tax levy controls (I.C. 6-1.1-19). The tuition support formula, which calculates a school corporation’s Basic Grant operates in conjunction with these controls when calculating how much revenue can be raised locally for education, what the school General Fund rate will be, and how much assistance the State will provide.

Approximately 20 percent of State assistance is not provided via the Basic Grant. These revenues are primarily used to fund categorical purposes or programs, like student transportation, summer school, and student testing and remediation.

Table I
State Aid for Elementary and Secondary Education
(Dollars in Millions)

Fiscal Year	Basic Grant ¹		Categ. Grants		ADA Flat Grant ³	Transp. Grant ⁴	Special Education Preschool	Teacher Retire ⁵	Total	% Change
	General Fund	Dedicated Fund	Prime Time	Other ²						
1987	\$ 834.6	\$ 494.6	\$49.0	\$ 73.5	\$34.3	\$39.5	\$ -	\$242.6	\$1,768.1	
1988	881.9	541.8	67.7	85.5	34.4	39.3	-	265.6	1,916.1	8.4%
1989	966.8	628.3	76.0	94.0	34.3	41.1	-	297.6	2,138.0	11.6%
1990	1,017.6	679.1	75.0	111.3	34.2	41.1	-	307.9	2,297.6	7.5%
1991	1,075.3	736.9	79.1	121.0	34.0	41.0	-	362.7	2,450.0	6.6%
1992	1,150.3	608.7	73.9	97.3	34.1	38.3	3.6	377.1	2,383.2	-2.7%
1993	1,227.4	742.7	72.1	87.5	34.1	40.8	9.4	363.2	2,577.2	8.1%
1994	1,303.1	829.2	72.4	88.9	34.5	39.8	13.3	318.4	2,699.6	4.8%
1995	1,417.1	1,069.0	72.5	91.9	34.4	42.0	15.3	230.3	2,975.1	10.2%
1996	1,368.6	1,032.4	85.1	111.6	34.4	38.3	17.2	242.8	2,930.4	-1.5%
1997*	1,436.4	1,077.2	86.2	140.3	34.9	38.8	19.3	249.9	3,082.9	5.2%
1998**	1,539.9	1,153.3	95.8	148.9	35.5	39.1	21.7	320.6	3,354.7	8.8%
1999**	1,621.0	1,234.4	95.8	149.1	35.7	39.1	24.0	339.1	3,538.2	5.5%
Avg. Annual Change	5.7%	7.9%	5.7%	6.1%	0.3%	-0.1%	31.1%	2.8%	6.0%	

* Estimate ** Projection

- 1) In 1992, At-Risk funding became part of the Basic Grant. Prior to 1992, it was a separate grant within “Other” Categorical Grants.
- 2) Includes grants for ISTEP/Remediation, Fort Wayne and Indianapolis Desegregation, Summer School, Technology, Adult Education, Free Textbooks, Alternative Schools, Gifted/Talented Programs, National School Lunch, Early Intervention Programs, Performance Based Awards, 4Rs Technology, Library Printed Materials, Transfer Tuition, Distressed Schools, Educational Opportunities At-Risk, Adult Vocational Education, Computer Learning, Innovative School Improvements, Drug Free Schools, Technical Preparation, Professional Development and miscellaneous.
- 3) The State provides a flat grant to school corporations. A school corporation’s flat grant equals the sum of \$40 per pupil (grades 1-12) in average daily attendance (ADA). The grant is distributed to the Debt Service Fund unless a school corporation in the past had no debt and chose to direct the grant instead to the General Fund.
- 4) The Transportation Grant includes regular transportation as well as special and vocational education transportation.
- 5) This category includes Teachers’ Social Security, Pension Cost of Living Adjustment, and Teachers’ Retirement Fund Distribution.

Source: State Budget Agency and Department of Education

II. Recent Changes to Indiana’s Education Finance System

Throughout most of the State’s history, Indiana, like many other states, relied primarily on local property tax revenues to finance primary and secondary education. Reliance on the property tax, however, resulted in large revenue disparities between school corporations because of the variation in property tax wealth, as measured by assessed valuation (AV) per pupil.¹ This variation is illustrated by comparing school corporations with varying levels of AV per pupil. (Table II) In order to raise \$3,715 per pupil (the 1997 minimum funding level and 1998 foundation grant), the difference in property tax rates between the wealthiest and poorest school corporations would be \$29 per \$100 of AV. School corporations with low AV wealth would find it prohibitively expensive to raise enough property tax revenue to finance an education comparable to the median school corporation. Therefore, State assistance is fundamental in reducing the disparate abilities of school corporations to fund educational services.

Table II Potential Revenue Disparities Due to AV Wealth					
	School Corporation Type by AV Per Pupil				
	High	90%	Median	10%	Low
1997 AV per pupil	143,276	70,090	44,838	29,627	11,750
Property Tax Rate (Per \$100 of AV)	2.64	2.64	2.64	2.64	2.64
Property Tax Revenue per pupil	3,782	1,850	1,184	782	310
Minimum per Pupil Funding in 1997	3,715	3,715	3,715	3,715	3,715
Tax Rate Needed to Equalize Revenues @ \$3,715	2.59	5.30	8.29	12.54	31.62

Source: State Budget Agency, IFPI Calculations

The mechanism used by states to distribute revenue generally takes the form of one or more of four approaches.

- 1) Flat Grants. The State provides a specified dollar amount for each pupil in the school corporation.
- 2) Full State Funding. The State provides all education revenue.
- 3) Foundation Plan. The State establishes a guaranteed level of funding for each pupil with the State and local contribution varying according to property wealth.
- 4) Power Equalizing Plans. The State guarantees equal tax capacity, whereby school corporations with identical tax effort will raise equivalent revenue.

¹ Either one of two methods typically determines the number of pupils in a school corporation. The first is an Average Daily Attendance (ADA) count, which is used to determine a school corporation’s ADA flat grant award. The second is an Average Daily Membership (ADM) count, which is used in the tuition support formula and most categorical grants.

Foundation plans and power equalizing plans are by far the most common. Foundation plans emphasize equal funding per pupil, while power-equalizing plans emphasize equal financial capacity per pupil.

A. 1973-1993

In 1973, the General Assembly restructured Indiana’s tax system to reduce reliance on the property tax. The restructuring occurred because of taxpayer frustration with the growth in property taxes. The tax reform measure froze property tax levies, initiated property tax controls, and began a fifteen year shift of the fiscal responsibility for education to State based taxes. Local revenue for education represented 66 percent of the total in 1973. State revenue was 34 percent. Today, these percentages are nearly reversed. (Table III)

<p align="center">Table III K-12 State and Local Operating Revenue (Dollars in Millions)</p>						
Year	Total Local Operating¹	Total State Operating²	% Local	% State	Total	% Change
1973	\$ 599.0	\$ 313.8	65.6	34.4	\$ 912.8	
1974	613.6	370.9	62.3	37.7	984.5	7.9
1975	625.0	414.2	60.1	39.9	1,039.2	5.6
1976	649.7	524.9	55.3	44.7	1,174.6	13.0
1977	652.9	606.2	51.9	48.1	1,259.1	7.2
1978	664.5	683.3	49.3	50.7	1,347.9	7.0
1979	673.0	795.7	45.8	54.2	1,468.7	9.0
1980	709.9	899.9	44.1	55.9	1,609.8	9.6
1981	749.3	1,018.4	42.4	57.6	1,767.7	9.8
1982	830.8	1,043.7	44.3	55.7	1,874.5	6.0
1983	861.2	1,110.1	43.7	56.3	1,971.3	5.2
1984	920.8	1,210.8	43.2	56.8	2,131.6	8.1
1985	976.9	1,309.0	42.7	57.3	2,285.9	7.2
1986	1,063.9	1,427.0	42.7	57.3	2,490.9	9.0
1987	1,146.2	1,516.3	43.1	56.9	2,662.6	6.9
1988	1,225.5	1,694.2	42.0	58.0	2,919.7	9.7
1989	1,297.4	1,846.1	41.3	58.7	3,143.5	7.7
1990	1,392.7	1,949.6	41.7	58.3	3,342.3	6.3
1991	1,503.6	2,084.7	41.9	58.1	3,588.3	7.4
1992	1,609.7	2,321.9	40.9	59.1	3,931.6	9.6
1993	1,692.0	2,378.2	41.6	58.4	4,070.2	3.5
1994	1,760.8	2,482.1	41.5	58.5	4,242.9	4.2
1995	1,844.8	2,553.1	41.9	58.1	4,398.0	3.7
1996	1,873.9	2,694.4	41.0	59.0	4,568.4	3.9

(1) Includes local property tax levies and miscellaneous revenues.
(2) Includes revenues from the General Fund, including funding for Summer School and Evening/Part-Time Education
Source: State Budget Agency and Department of Education (Form 9 Reports)

As a result of the 1973 legislation, the legislature enacted constraints on local revenue and developed a mechanism to gradually replace local revenues with State revenues. Specifically, property tax controls limit how much property tax revenue a school corporation may levy. Also since 1974, the tuition support formula included mechanisms to adjust tax rates. These provisions were necessary to mediate differences in school rates. For instance, school corporations with high property wealth and low property tax rates oppose State efforts that would raise their tax rate and are not particularly sympathetic to high taxing school corporations. Alternatively, a school corporation with low property wealth argues that it is harmful to the economic health of the community, inequitable, and possibly illegal for it to have school property tax rates substantially higher than other school corporations. The General Assembly must mediate these disparities in a way that will maximize local control, minimize differences in per pupil funding and property taxes due to differences in AV property wealth, and provide some assistance to all school corporations.

During the same time period that Indiana restructured its tax system, other states, particularly Texas² and California,³ encountered legal challenges to their education finance systems. These legal challenges were generally based on the variance in property wealth and the presumed variance in educational opportunities that resulted. California’s Supreme Court upheld a decision by a lower court instructing the state legislature to revise the school finance system so that it was fiscally neutral, ruling that a child’s education could not be a function of the property wealth of his or her parents and neighbors. This decision, while it did not apply to the Indiana system, prompted many states, including Indiana, to reassess the extent to which school funding should be tied to local property tax wealth.

Table IV Determination of Foundation Grant		
	School Corporation A	School Corporation B
School Corporation AV	\$50,000,000	\$175,000,000
School Corporation Average Daily Membership (ADM)	1,500	1,500
Foundation Amount	\$ 3,715	\$ 3,715
1998 General Fund Property Tax Rate (per \$100 AV)	\$ 2.64	\$ 2.64
General Fund Levy = (\$2.64/100) * AV	\$ 1,320,000	\$ 4,620,000
General Fund Levy/ADM = General Fund Levy/1,500	\$ 880	\$ 3,080
State Contribution = \$3,715 – G.F. Levy/ADM	\$ 2,835	\$ 635
IFPI Calculations		

² *San Antonio Indep. Schl. Dist. V. Rodriguez*, 411 U.S. 1 (1973).

³ *Serrano v. Priest*, 487 P.2d 1241 (Cal. 1971) and 557 P.2d 929 (Cal. 1976).

Beginning in 1974, the State implemented a foundation grant. Depending on the property tax wealth of a school corporation, the State’s contribution towards the foundation grant level varied. (Table IV) The funding approach was modified substantially from 1973 to 1993, including efforts in the 1985 General Assembly to add a qualifying tax rate and bottom-up equalization component that brought all school corporations to a minimum taxing and spending level. The outcomes of the 1973 through 1993 changes, however, did not eliminate the large disparities between per pupil spending and property tax rates. (Tables V and VI)

Table V					
Variation in Basic Grant Per Pupil Funding					
(1987-1999)					
Year	High PPF	Median PPF	Low PPF	Difference Between High And Low PPF	Ratio Between High And Low PPF
1987	\$4,227	\$2,547	\$2,033	\$2,194	2.08
1989	4,875	2,618	2,451	2,424	1.99
1991	6,116	3,189	2,971	3,145	2.06
1993	6,962	3,433	3,146	3,816	2.21
1995	5,942	3,908	3,563	2,379	1.67
1997*	6,826	4,427	3,919	2,907	1.74
1999**	8,613	4,619	4,168	4,445	2.07

* Estimate ** Projection
Source: State Budget Agency, IFPI Calculations

Table VI			
Variation in State and Local Assistance			
1993	Local Revenue	State Revenue	Total Tuition Support
School Corp @ 90th %	\$2,290	\$1,840	\$4,130
Median School Corp	1,001	2,434	3,435
School Corp @ 10th %	1,306	1,987	3,293

Source: State Budget Agency, IFPI Calculations

The changes since 1973 resulted in significant increases in State assistance to local school corporations. This assistance has also become more categorical. In 1998, the General Assembly appropriated roughly \$683 million in categorical grants or 19 percent of total funding. (Table VII)

Table VII
1998 State Appropriations for Categorical Grants
Total = \$682.7 Million

Special Education	\$278,299,321	Free Textbooks	\$12,567,978
Primetime	95,760,773	Alternative Schools	7,500,000
Vocational Education	52,149,567	Gifted/Talented Schools	6,843,585
Transportation Grant	39,095,000	Honors	5,787,200
ADA Flat Grant	35,500,000	National School Lunch	5,400,000
ISTEP Testing/Remediation	33,860,780	Growing Enrollment	5,532,026
Special Education Preschool Grant	21,660,819	Early Intervention Programs	4,000,000
Desegregation Orders	17,500,000	4Rs Technology	4,000,000
Summer School	15,360,000	Performance Based Awards	3,250,000
Technology Grants	15,000,000	Library Printed Materials	2,000,000
Adult Education	13,500,000	10 Under \$2,030,000 Each	8,115,667

Source: State Budget Agency

Despite the effort of the General Assembly throughout the 1970s and 1980s to address funding disparities, some school corporations became increasingly frustrated with the variation in taxing and spending levels for education. Lake Central School Corporation was not the first entity to challenge the State’s education finance system, but it is perhaps the most notable. In 1987, Lake Central alleged that the tuition support formula produced substantial disparities in pupil funding across school corporations, resulting in unequal educational opportunities. In 1992, Governor Bayh, Lake Central School Corporation, and over 50 other school corporations who had joined the lawsuit reached an agreement that put the lawsuit on hold. The agreement was made possible in part because 1) the Governor agreed to pursue efforts in the 1993 General Assembly with the legislature to rewrite the tuition support formula and 2) the litigants were encouraged by the work of the House Select Committee on Primary and Secondary Education. This Committee reached bipartisan support for two different formula designs; one of which was ultimately enacted.

B. 1993-1997

The 1993 formula represented a major shift in the State’s approach to funding schools. The foundation grant was replaced with a power equalizing grant that attempted to equalize per pupil revenues for those school corporations taxing at the same rate, despite differences in the underlying tax bases. Since per pupil revenues would become exclusively a function of the school corporation’s tax rate, the formula became known as a “reward-for-effort” formula.

This approach broke school corporations into six tiers based on their school General Fund property tax rates. Within each tier, the State would guarantee that State and local tuition support revenue per pupil would be the same for all school corporations levying property taxes at the same rate. The tiers were structured so that, as the tax rate of the local school corporations increased and moved into successively higher tiers, the State guarantee declined until State support would phase out completely.

The 1993 formula required significant tax rate adjustments to move school corporations into the tier structure. Thus, a phase-in approach was adopted to mitigate large changes. Caps guided the allowable increases and decreases in property tax rates. Assuming no legislative changes, all but a few corporations were expected to reach target revenue within the appropriate tier by 1999.

Critics of the 1993 formula contended that it drove property taxes up too far and too fast. Therefore, in 1995, several amendments were made to the 1993 formula approach. One of the most significant amendments was a reduction in the allowable property tax rate change, which would lengthen the time period necessary to fully phase in the reward-for-effort formula.

C. 1997-1999

The 1997 General Assembly enacted a tuition support formula for the 1997-1999 biennium that returns to the used of a foundation grant while maintaining some degree of the reward-for-effort approach. A step-by-step explanation of the 1997 formula is provided in the Appendix.

The 1997 formula includes a “qualifying” school General Fund property tax rate (General Fund rate) of \$2.64 per \$100 of AV in 1998. (This will increase to \$2.65 in 1999.) The qualifying rate increases tax rates for low taxing school corporations and helps in reducing the overall variance of the school General Fund rate. A school corporation’s General Fund rate could increase by as much as \$0.15 or decrease by as much as \$0.25 in a single year.

School corporations with a tax rate above the qualifying level are guaranteed a legislatively determined yield for each penny taxed. In 1998, for each penny taxed above \$2.64, the revenue yield equals \$10 per pupil. The State makes up the difference between what the local school corporation raises with its penny and the \$10 revenue yield. The yield declines to \$9.50 in 1999.

Due to the qualifying rate and guaranteed yield provisions, significant property tax rate adjustments, both increases and decreases, are again expected. A simulation of the tuition support formula projects that over the biennium, **171** school corporations will increase their General Fund rates, **121** will decline, and **2** will remain unchanged. **Nine** school corporations could see their rate decrease by the maximum allowed decline of \$0.50, while **52** could increase by the maximum allowed \$0.30. This simulation also projects the median General Fund rate for 1998 will equal \$2.68, up from \$2.65. (Table VIII)

Table VIII
1998 Median Indiana School Corporation

Based on a simulation of the 1998 tuition support formula for all 294 school corporations, the median school corporation will have a student population of 1,870. Over 19 percent of the students will be at-risk of completing their education.

The median school corporation will have a General Fund rate of \$2.68 and will levy \$2.4 million in General Fund revenue based on property assessed valuation of \$84.5 million. The corporation will raise approximately \$345,000 from miscellaneous tax revenues.

The State contribution will be approximately \$4.8 million for tuition support, \$508,660 for Special Education, \$121,923 for Vocational Education, \$36,890 for At-Risk programs, and \$12,800 in Honors Diploma grants. Total State and local support for the Basic Grant will be approximately \$8.5 million.

The median school corporation would spend \$4,426 per pupil based on AV per pupil of \$45,623.

Local Aid per ADM	\$1,421
State Aid per ADM	<u>\$3,006</u>
Total Basic Grant per ADM	<u>\$4,426</u>

Source: Budget Agency, IFPI Calculations

Neither the 1993 nor the 1997 formulae attempted to standardize per pupil funding. Instead the formulae attempt to standardize the *taxing capacity* of school corporations. Thus, local school corporations would eventually gain more discretion to determine the appropriate education funding level for their community, within the limits of the property tax controls. For this reason, per pupil funding levels and the accompanying school General Fund rates should continue to vary based on community preferences.

Community preference variance is based on different demands for education services. Those with a high demand for education services are often willing to pay higher taxes for those services. There are other school corporations where constituents do not have the same demand and instead place a higher value on lower taxes. Due to the different preferences of constituents, local control has always been a fundamental issue of local communities and school corporations. Thus, differences may never be eliminated, but the variance between a majority of school corporations should grow smaller. Indiana will continue to battle with the appropriate balance of permitting low tax, low spend and high tax, high spend school corporations to continue their practices while trying to reduce over all variance in rates and funding.

III. The Basic Structure of Indiana's Education Finance System

In Indiana, there are approximately 940,000 students in 294 school corporations throughout 1,900 public schools. Regardless of where in Indiana these students live, their education is financed with both State and locally raised revenues. Federal assistance is also distributed to most school corporations via the State, but this source of revenue represents less than five percent of total education revenues in Indiana and is used for specific categorical purposes.

A. State Sources of Revenue

1. **General Fund.** The State General Fund accounts for the expenditure of revenues not dedicated to specific purposes. The General Fund is the largest State fund and the principal source of most major State functions, except transportation. Primary General Fund revenue sources are the taxes on personal and corporate income and retail sales. The 1998 appropriation for tuition support from the General Fund is \$1.5 billion.
2. **Property Tax Replacement Fund (PTRF).** The PTRF was established in 1973 to reimburse local units for revenue lost because of reductions in the property tax instituted in that year. The 1998 appropriation for tuition support from the PTRF is \$1.2 billion. As a result of the 1973 legislation and subsequent amendments, the PTRF also reimburses approximately 20 percent of the maximum normal levy (except for the portion of the levy resulting from referendum or from additional levies to compensate for erroneous rates or assessments), the transportation levy, and the part of the debt service levy attributable to debt issued before 1984.

B. Local Sources of Revenue

1. **Property Tax.** The property tax is the largest single source of State or local revenue in Indiana, and school corporations are the largest users of the tax. This source of revenue remains a significant component of local education funding because it is a stable source of revenue and is less susceptible to changes in the economy.
2. **Financial Institutions Tax.** The financial institutions tax is a franchise tax imposed upon financial institutions transacting business in Indiana. Any business primarily

engaged in extending credit (or leasing that is the economic equivalent of extending credit) or engaged in the business of credit cards is subject to the tax.

While the Financial Institutions Tax is a State enacted tax, revenues from it are distributed to local units based on a formula. The unit receives revenues equal to the amount received by the taxing unit under the now-repealed Bank and Savings and Loan tax in 1989 minus the amount to be received by the taxing unit in the year of distribution from bank personal property taxes.

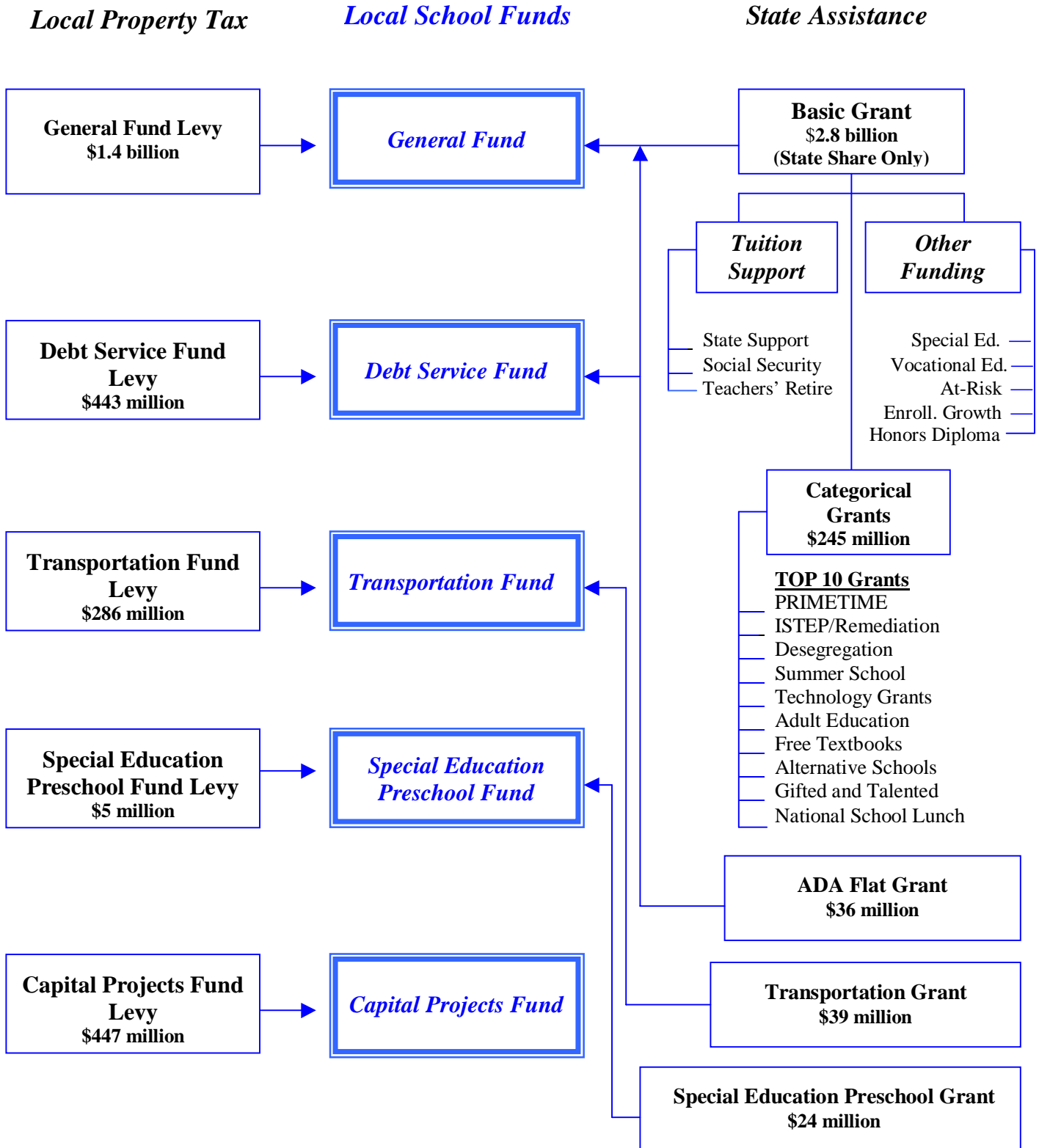
3. ***Motor Vehicle Excise Tax.*** In lieu of a personal property tax on automobiles, Indiana imposes an excise tax on all motor vehicles. The receipts from the tax are distributed to the county in which the owner of the vehicle resides. The revenue is then distributed to each taxing unit, including school corporations, in the same proportion that property taxes are distributed.
4. ***Local Income Taxes.*** Indirectly, an Indiana school corporation may also receive revenue from one of two local option income taxes, the County Adjusted Gross Income Tax (CAGIT) and the County Option Income Tax (COIT). CAGIT and COIT are levied at locally determined rates on the same tax base as the State individual income tax. The taxes are collected by the Indiana Department of Revenue and distributed back to the county in which the tax was levied. The county in turn distributes the revenue to the individual units in proportion to their shares of the property tax levy.
 - a. ***County Adjusted Gross Income Tax (CAGIT).*** CAGIT is distributed to school corporations as replacement revenue for lost property tax revenues, due to property tax relief, lost federal grant revenue sharing, or other local purposes.
 - b. ***County Option Income Tax (COIT).*** Designed as a source of revenue for civil units of government, school corporations may receive COIT revenues as replacement for revenue lost because of locally enacted homestead credits.

In 1996, statewide revenue from the financial institution tax, the motor vehicle excise tax, and the local income taxes is commonly referred to as “miscellaneous revenue” and represented 11 percent of total local revenue for education. The actual percentage received by an individual school corporation will vary widely due to local conditions.

State and local tax revenue for local school corporations is deposited into five separate funds. By far, the largest and most important is the *General Fund*. In addition, there are two special revenue funds, a *Transportation Fund* and a *Special Education Preschool Fund*. The *Debt Service Fund* is unique because the State property tax controls do not apply to this fund. The fifth fund, the *Capital Projects Fund*, is the only one that relies entirely on local funds.

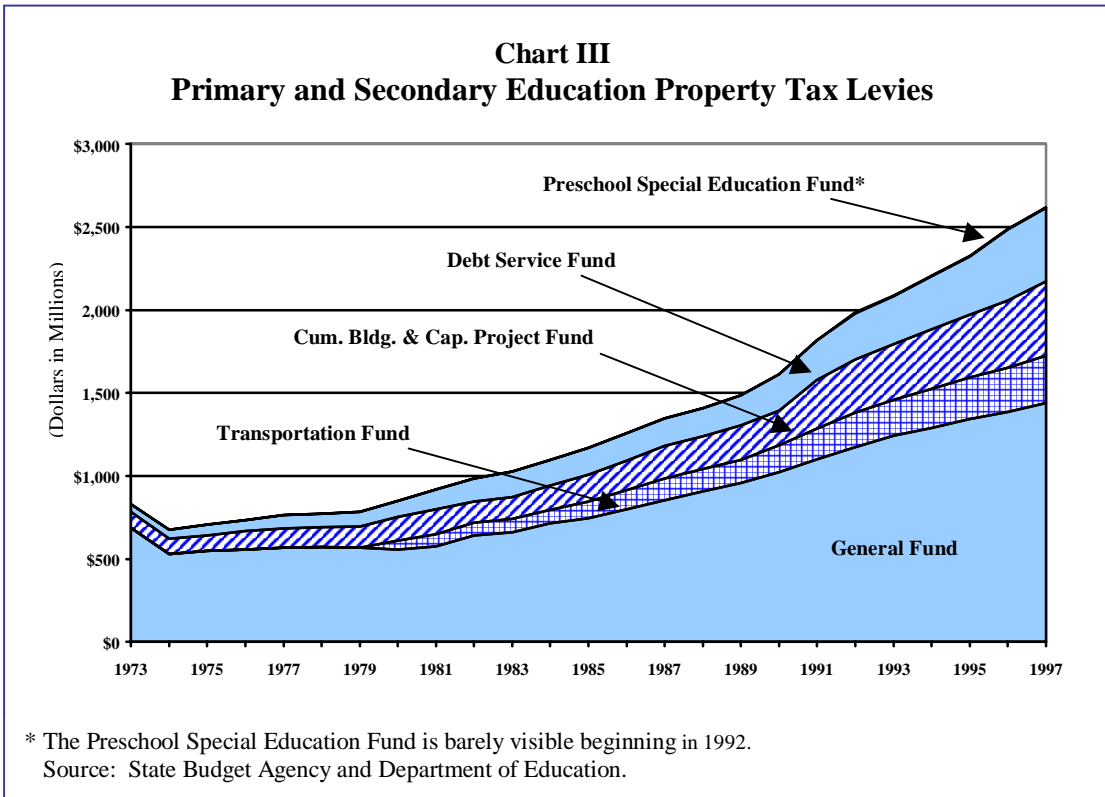
Chart II demonstrates the flow of State and local revenue into the five major funds. On the right side of the Chart, the State channels money to the local school corporations through a Basic Grant, Other Grants, the ADA Flat Grant, a Transportation Grant, and a Special Education Preschool Grant. On the left side, the Chart shows that local school corporations receive property tax levies from five separate levies, each with its own rate and dedicated to one of the five funds.

Chart II Indiana School Finance at a Glance (1998 Revenues)



Total property tax levies for education grew at an average of 6 percent annually from 1973 through 1997. In 1997, total levies equaled over \$2.6 billion with the General Fund representing 55 percent of that total. At an average annual growth of 10.2 percent since inception, the Transportation Fund is the fastest growing. (Chart III and Table IX)

1. **The General Fund** finances the basic operations and programs of a school corporation, including teachers, administrators, and staff salaries, equipment, supplies, utilities, and maintenance.
2. **The Debt Service Fund** finances the retirement of long-term debt and is primarily used for building projects. School corporations, like other local units of government in Indiana may not issue general obligation bonds in excess of two percent of their assessed value. School corporations can issue revenue bonds, which are not limited by the two- percent constraint.



- 3. *The Transportation Fund*** is divided into two accounts. One account finances the purchases of buses. The second finances transportation operations, including salaries. Prior to the fund's creation in 1980, transportation costs were paid from the General Fund.

Limited State funding is available for regular, special education, and vocational education students. School corporations levying a property tax of \$0.42 per \$100 of AV may receive State funding for regular transportation. The amount of State funding is based on the number of eligible regular students⁴ multiplied by an adjusted per pupil amount.⁵ From this amount, the local revenue raised from the property tax is subtracted to determine the State contribution. The State contribution for special and vocational educational students is equivalent to 80 percent of the actual costs of transporting these students.

- 4. *The Special Education Preschool Fund*** finances a federally mandated program for special education preschool children. A corporation may offer its own program, a joint program with other school corporations, or enter into a contractual agreement with public or private agencies that serve special education preschool children. State statute requires each school corporation to levy a property tax of \$0.01 per \$100 of AV to be supplemented with State funding. The State supplementation is determined by subtracting the local share from a guarantee amount equal to \$2,750 per special education preschooler.
- 5. *The Capital Projects Fund*** finances the acquisition, renovation, and construction of capital facilities and the purchase, lease, repair and maintenance of equipment. The fund cannot be used for vehicle purchases (including school buses) or for interscholastic and extracurricular activity facilities or equipment. The purchase of computer related equipment and salaries for computer training and maintenance may also be paid from the fund. In 1987, the General Assembly substituted the Capital Projects Fund for the Cumulative Building Fund. A phase-out process was adopted in order for school corporations to switch from one fund to the other. All school corporations adopted the Capital Projects Fund by 1990.

⁴ An eligible pupil is a K-12 pupil, including disabled 3 and 4-year-olds, who is enrolled in the school corporation. A kindergarten pupil is counted as one-half.

⁵ The adjusted per pupil amount considers the linear density of the school corporation. Linear density is determined by dividing the total number of eligible pupils by the total round trip mileage.

Table IX Primary and Secondary Education Property Tax Levies (Dollars in Millions)							
Year	General Fund	Trans. Fund	Cum. & Cap. Fund	Debt Service Fund	Preschool Special Ed Fund	Total School Levies	% Change
1973	\$ 547.5	\$ -	\$ 94.5	\$ 48.7	-	\$ 690.7	
1974	542.9	-	93.1	50.3	-	686.3	-0.6%
1975	547.1	-	95.2	63.3	-	705.5	2.8%
1976	556.7	-	110.7	66.4	-	733.9	4.0%
1977	567.4	-	117.7	77.9	-	763.0	4.0%
1978	570.5	-	120.6	81.8	-	772.8	1.3%
1979	568.7	-	127.7	87.2	-	783.5	1.4%
1980	556.0	54.7	141.0	98.8	-	850.5	8.6%
1981	574.2	73.0	152.4	118.1	-	917.6	7.9%
1982	639.7	77.8	129.2	137.6	-	984.3	7.3%
1983	661.5	78.2	134.5	151.7	-	1,025.9	4.2%
1984	714.2	82.8	145.1	155.2	-	1,097.3	7.0%
1985	745.1	101.5	160.3	160.6	-	1,167.5	6.4%
1986	798.5	116.1	176.0	167.7	-	1,258.3	7.8%
1987	854.9	130.7	193.4	168.8	-	1,347.7	7.1%
1988	908.5	133.0	195.9	172.4	-	1,409.9	4.6%
1989	955.4	140.9	208.4	182.4	-	1,487.1	5.5%
1990	1,022.8	162.9	208.1	219.5	-	1,613.3	8.5%
1991	1,100.4	186.1	290.8	241.1	-	1,818.4	12.7%
1992	1,173.8	208.2	317.7	281.3	4.0	1,985.0	9.2%
1993	1,242.8	217.4	333.0	291.0	4.1	2,088.4	5.2%
1994	1,288.4	234.4	361.6	317.0	4.2	2,205.6	5.6%
1995	1,343.5	249.7	379.4	348.1	4.3	2,324.9	5.4%
1996	1,385.2	266.9	405.9	425.4	4.9	2,488.3	7.0%
1997	1,439.8	285.6	447.1	442.5	5.0	2,620.0	5.3%
Ann. Avg. Change	4.3%	10.2%	7.1%	9.9%	4.5%	6.0%	

Source: State Budget Agency and Department of Education

IV. The Challenges of Allocating Revenues for Education

In determining how much money to appropriate for primary and secondary education, state legislatures consider at least three types of allocation issues.

- A. Are the appropriations equitable?
- B. Are the appropriations adequate?
- C. Do the appropriations provide the right performance incentives?

A. Are the appropriations equitable? Education is often considered a major determinant of an individual’s future opportunities. Therefore, the quality of an individual’s education has significant ramifications. When quality is not consistent, there are equity concerns. Equity, however, is difficult to define because its meaning varies by individual. As authors Robert Berne and Leanna Stiefel noted, equity “means specifying fair and unfair treatments of individuals and

making choices that distinguish one concept of equity from another, often on the basis of personal values.”⁶ The authors suggest that equity can and should be assessed in four ways.

1. Equity for whom? Who are the different groups that a school finance system must treat equitably?

Students: all students or certain categories of students

→ *Taxpayers:* all taxpayers, only property taxpayers, or property taxpayers with or without children in public schools.

2. Equity for what? What services, resources, or objects should be distributed equitably among these groups?

→ *Inputs,* such as actual dollars spent, price adjusted dollars, or physical resources.

→ *Outputs,* such as test scores, specific skills or capabilities, or percent of students continuing their education after high school.

→ *Outcomes,* such as higher education opportunities, job opportunities, earning potential and income, or satisfaction with education and future life possibilities.

3. What principles are used to evaluate equity? Three common principles used to determine whether an education system is fair include:

→ *Horizontal equity* assumes individuals are similar and should be treated in a similar manner.

→ *Vertical equity* assumes that individuals are different and should be treated differently.

→ *Equal Educational Opportunity* is the equal access to a substantially equivalent education.

4. How should equity be measured? Across the United States, including Indiana, equity is defined as equal inputs, such as per pupil spending and property tax rates. Efforts to evaluate equity-based outcomes are gaining momentum.

Equity in Per Pupil Spending

Previously this report identified differences in per pupil Basic Grant spending from 1987 to 1999. This table showed that the difference between the school corporations with the largest and smallest level of per pupil funding under the Basic Grant has varied and appears to increase further over the 1997-99 biennium. This suggests that Indiana’s education system is becoming less equitable. Another equity measurement concludes differently. This alternative measures the variance between school corporations spending at the 90th percentile and 10th percentile. The 90th to 10th percentile range measurement is considered a better measurement of equity because it eliminates school corporations at either extreme. It instead bases its measurement on the 80 percent of school corporations between the extremes. This measurement shows that per pupil variance in the Basic Grant has and will continue to decline gradually, suggesting that per pupil funding equity is improving. (Chart IV and Table X)

⁶ Berne, R. and Stiefel, L. (1979). Concepts of Equity and Their Relationship to State School Finance Plans, *Journal of Education Finance*, 5, Fall 109.

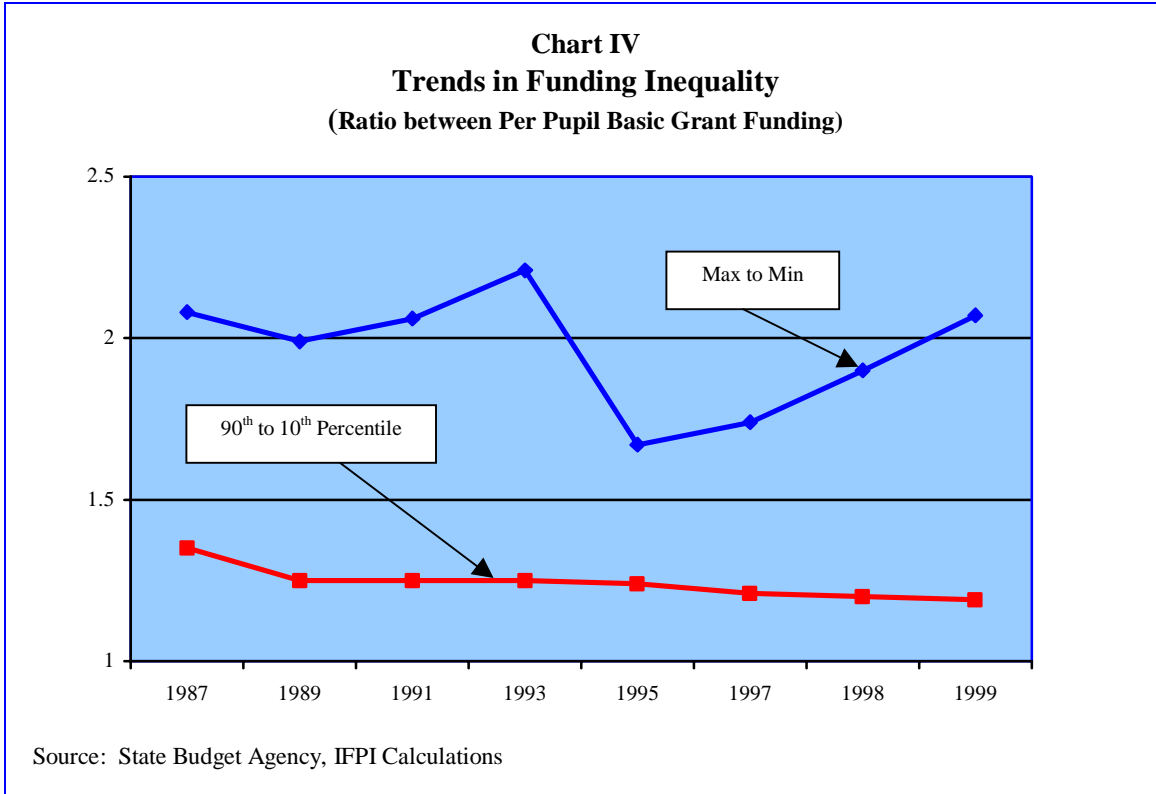


Table X
Variation in Per Pupil Basic Grant Funding

Year	PPF @ the 90 th %	Median Per Pupil Funding	PPF @ the 10 th %	Difference Between the 90 th and 10 th	Ratio Between 90 th % and 10 th %
1987	\$3,143	\$2,547	\$2,334	\$808	1.35
1989	3,177	2,618	2,535	642	1.25
1991	3,819	3,189	3,054	765	1.25
1993	4,129	3,433	3,295	834	1.25
1995	4,568	3,908	3,689	880	1.24
1997*	4,878	4,427	4,041	837	1.21
1999**	5,224	4,619	4,394	830	1.19

* Estimate ** Projection
Source: State Budget Agency, IFPI Calculations

Further evidence of the State’s progress in reducing variance is evident by comparing where the greatest growth occurred. In an analysis of all 294 school corporations, comparing both real and nominal spending growth, the greatest increases have occurred in those school corporations with low spending. The real rate of growth, from 1987 through 1997, ranged from a low of 1.5 percent for school corporations spending at the 90th percentile of all school corporations to a high of 3.7 percent annual increase for the lowest funded school corporation. The median average rate of growth was 2.2 percent annually. (Table XI)

Per Pupil Spending Level	1987 \$/ADM	1997 \$/ADM	1997 Real \$/ADM	1999 \$/ADM	1999 Real \$/ADM	'87-'97 % Change (Real)	'87-'99 % Change (Real)
Maximum	4,227	6,826	5,094	8,613	6,152	1.9	3.2
90th Percentile	3,142	4,878	3,640	5,224	3,731	1.5	1.4
Median	2,548	4,247	3,169	4,619	3,299	2.2	2.2
10th Percentile	2,335	4,041	3,016	4,394	3,139	2.6	2.5
Minimum	2,033	3,919	2,925	4,168	2,977	3.7	3.2

Source: State Budget Agency, IFPI Calculations

The projected real rate of growth from 1987 to 1999 suggests that the 1997 formula will allow the top spending school corporation to increase its spending more rapidly in this biennium. The minimum school corporation's growth will slow over the 1997-99 biennium as more emphasis is placed on replacing some local support with State support. Increases in spending for the bottom 10th percentile will still exceed the rate of growth for the school corporations at the 90th percentile by nearly a 2-to-1 margin.

From 1987 to 1997, this analysis also found that the increases in spending for seven school corporations did not keep up with inflation. Two other school corporations grew at essentially the same rate as inflation. The remaining 285 school corporations increased per pupil funding at a level that exceeded inflation, with the largest rate of growth exceeding five percent. (Table XII)

School Corporation	County	Real Average Annual Rate of Growth
Union Township School Corporation	Fulton	5.1
Maconaquah School Corporation	Miami	4.5
Prairie Township School Corporation	LaPorte	4.5
Medora Community Schools	Jackson	4.3
Greater Clark County Schools	Clark	4.0
Speedway Township Schools	Marion	0.0
MSD Wayne Township	Marion	0.0
MSD Perry Township	Marion	-0.1
Duneland School Corporation	Porter	-0.2
West Lafayette Community School Corporation	Tippecanoe	-0.2
MSD Warren Township Schools	Marion	-0.2
Greencastle Community School Corporation	Putnam	-0.5
North White School Corporation	White	-0.9
Southeast Fountain School Corporation	Fountain	-1.4

Source: State Budget Agency, IFPI Calculations

Taxpayer Equity

The variance ratio in school General Fund rates exceeds the variance ratio in per pupil funding. In recent years, the General Assembly has more vigorously addressed the disparity in General Fund rates. Taxpayer variance is illustrated by comparing school corporations' tax rates at the 10th and 90th percentiles. From 1973 through 1999 there is a steady decline in tax rate variance and a decrease in the dollar value difference between General Fund rates. (Chart V and Table XIII)

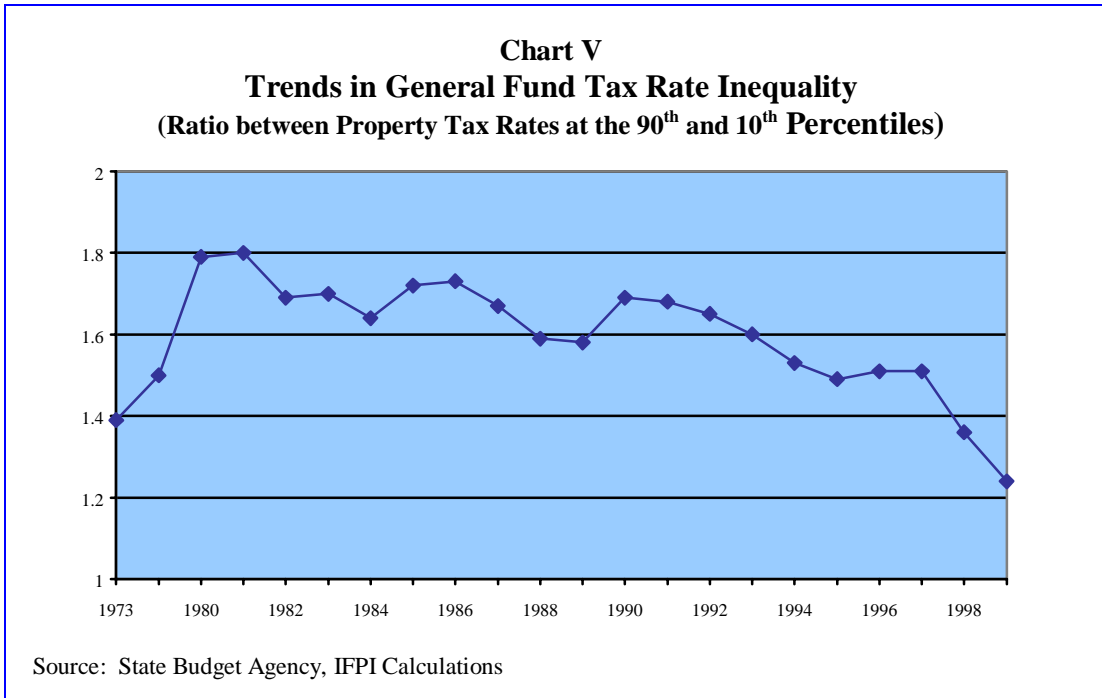


Table XIII
Variation in General Fund Tax Rates

Year	Rate @ 90 th %	Median Rate	Rate @ 10 th %	Difference	Ratio Between 90 th % And 10 th %
1973	\$5.18	\$4.61	\$3.72	\$1.46	1.39
1979	4.30	3.53	2.86	1.44	1.50
1981	2.88	2.21	1.60	1.28	1.80
1983	3.14	2.43	1.84	1.29	1.70
1985	3.38	2.70	1.97	1.41	1.72
1987	3.76	2.89	2.25	1.51	1.67
1989	3.99	3.09	2.52	1.47	1.58
1991	3.50	2.68	2.08	1.42	1.68
1993	3.62	2.85	2.26	1.36	1.60
1995	3.71	2.87	2.48	1.22	1.49
1997*	3.41	2.64	2.26	1.15	1.51
1999**	3.17	2.65	2.56	0.61	1.24

* Estimate **Projection
 Source: State Budget Agency, IFPI Calculations

When *total school property tax rates* are analyzed, the variation is greater. (Table XIV) Total school property tax rates equal the sum of the rates for each of the five major school local funds. Not all school corporations levy property taxes for all five funds in each year. The inequity in total rates is largely, but not solely, a function of unequal fiscal capacity (e.g., variance in AV), which the State has not addressed. In 1997, the difference between the highest and lowest taxing corporations was \$8.48 per \$100 of AV. (Table XIV)

Year	Maximum Rate	Rate @ 90 th Percentile	Median Rate	Rate @ 10 th Percentile	Minimum Rate	Ratio Between 90 th and 10 th Percentiles
1974	\$ 9.04	\$6.69	\$5.38	\$4.13	\$1.38	1.62
1981	7.68	5.04	3.72	2.74	1.72	1.84
1985	8.93	6.16	4.46	3.36	1.83	1.83
1989	11.06	6.55	5.15	3.89	2.28	1.68
1993	11.54	6.26	5.01	3.97	1.43	1.58
1997	10.07	6.39	5.24	4.15	1.59	1.54

Source: State Budget Agency, IFPI Calculations

Seven of the eight highest total school rates are for school corporations in Lake County. Avon Community Schools in Hendricks County is the exception. This school corporation is currently experiencing growth in student enrollment, which is also driving the need for capital expenditures. In 1997, Avon’s debt service rate nearly doubled from an already high rate of \$1.76 in 1996 to \$3.36 in 1997. (Table XV)

High Rank	School Corporation	Total Rate	Low Rank	School Corporation	Total Rate
1	Hobart City Schools, Lake Co.	\$10.07	287	Jennings County Schools	\$3.70
2	River Forest Comm. Schools, Lake Co.	9.62	288	Greensburg Community Schools, Decatur Co.	3.65
3	Hammond City Schools, Lake Co.	9.57	289	Paoli Community Schools, Orange Co.	3.65
4	Whiting City Schools, Lake Co.	7.91	290	Seymour Community Schools, Jackson Co.	3.57
5	Gary Community Schools, Lake Co.	7.83	291	Rising Sun/Ohio Co. Schools	3.52
6	Lake Station Schools, Lake Co.	7.81	292	Speedway Township Schools, Marion Co.	3.46
7	Avon Community Schools, Hendricks Co.	7.59	293	Union Township Schools, Fulton Co.	3.40
8	East Chicago City Schools, Lake Co.	7.52	294	Prairie Township Schools, LaPorte Co.	1.59

Source: State Budget Agency, IFPI Calculations

B. Are the appropriations adequate? Courts have determined that an equitable education is one that is fiscally neutral, irrespective of where a child lives, and presumes a certain minimum education. Adequacy, however, assumes a substantially equal education, including facilities and resources. The Ohio Supreme Court recently addressed the issue when it declared Ohio's education finance system unconstitutional.⁷ In this decision the Court stated:

[M]oney alone is not the panacea that will transform Ohio's school system into a model of excellence. Although a student's success depends upon numerous factors besides money, we must ensure that there is enough money that students have the chance to succeed because of the educational opportunity provided, not in spite of it. Such an opportunity requires, at the very least, that all of Ohio's children attend schools which are safe and conducive to learning. At the present, Ohio does not provide many of its students with even the most basic of educational needs.

The court concluded that Ohio's public school financing scheme must undergo a complete systematic overhaul and:

1. Eliminate the operation of the School Foundation Program (a foundation-based tuition support formula),
2. Reduce reliance on local property tax revenue,
3. Eliminate the requirement that school districts borrow through the spending reserve and emergency school assistance loan programs, and
4. Address the lack of sufficient funding in the General Assembly's budget for the construction and maintenance of public school buildings.

In creating a new system, the General Assembly must ensure that 1) facilities are in good repair and 2) the supplies, materials and funds necessary to maintain these facilities in a safe manner comply with all local, state and federal mandates.

This decision has no bearing on Indiana or any other State's education finance system. In fact, a few months before the Ohio decision, the Illinois Supreme Court upheld its state's education finance system even though it also relies heavily on local property taxes.⁸ There is and has been no trend in state court decisions on the constitutionality of education finance systems over the last 25 years. However, school finance litigation, like taxes, is a certainty, and states will continue to monitor other state court decisions to evaluate the potential for such a decision in their state.

While the objectives of an adequate education system are reasonable (safe schools, quality teachers, sufficient resources), adequacy is not an objective or tested measurement criteria for an educational system. It remains to be seen whether the issue of adequacy represents a new wave of school finance litigation.

⁷ *DeRolph v. State of Ohio*, 681 N.E.2d 424 (Ohio 1997).

⁸ *Committee for Educ. Rights v. Edgar*, 672 N.E.2d 1178 (Ill. 1996).

C. Do the appropriations provide the right performance incentives? School corporations have the incentive to maximize State funding in order to spend more in total or less locally. For this reason, the State must carefully consider what it is trying to achieve, whether the appropriate incentives are there, and what is the possibility of unintended consequences. This cause and effect relationship is illustrated with the recently enacted Honors Diploma Grant. (Table XVI)

**Table XVI
Honors Diploma Grant**

The Honors Diploma is awarded to students who declare their participation in and complete a more rigorous curriculum. Upon graduation, the student will be awarded an Honors Diploma.

State Goal: Better prepare students for post-secondary education endeavors.

State Incentive: Provide an \$800 award to the school corporation for each student receiving an Honors diploma.

Possible Consequences: A positive consequence includes an increasing number of students participating in a more rigorous curriculum and better preparing students for the workforce or higher education opportunities. A potential negative consequence might result in school corporations seeking to dilute the State established curriculum necessary to achieve an Honors Diploma so that more students participate in Honors Diploma curriculum.

Parents may also inadvertently create performance incentives for school corporations. For instance, parents may recognize that school corporations with high per pupil funding also have high-test scores. Therefore, parents may respond by encouraging the school corporation to spend more money. School corporations will strive to respond to the parents' desires. Unfortunately, the outcome, high-test scores, could potentially be achieved without the influx of revenue. Meanwhile, programs without the goal of higher test scores may not receive the same attention or funding priority.

V. Anticipated Results of the 1997 Formula

The 1997 formula furthers the General Assembly's efforts to further improve equity by A) reducing the variance in the General Fund property tax rate and B) equalizing the tax capacity of school corporations.⁹ The first goal directly corresponds with the issue of taxpayer equity. The

⁹ Per pupil revenue equalization is also an objective of the General Assembly. As previously addressed, the 1997 formula provides for greater equalization between the 90th and 10th percentiles. However, the variation actually grows for those school corporations at the highest and lowest levels of spending.

second goal addresses student equity more broadly by creating equal access to revenue. As a result, schools are moving closer to an equal ability to raise funds, but will have different spending levels based on community preferences.

Achieving equity is an incremental process. This section addresses some positive movements towards improved equity from 1997 through 1999. To illustrate how successfully the 1997 formula addresses the General Assembly’s goals, the 294 school corporations were divided into a matrix of nine groups, based on classifications of their General Fund rate and Basic Grant award per pupil.¹⁰ (Table XVII)

		General Fund Property Tax Rate			
		Low	Medium	High	
Basic Grant Spending	Low				
	1997	65	31	2	
	1998	54	38	6	
	1999	72	18	8	
	Medium				
	1997	23	52	22	
	1998	33	46	19	
	1999	17	64	17	
	High				
1997	9	15	74		
1998	11	14	73		
1999	9	16	73		

Source: State Budget Agency, IFPI Calculations

Of the nine possible categories, the optimal categories are:

Low Tax, Low Spend

Medium Tax, Medium Spend

High Tax, High Spend

Placement in one of these three categories suggests that a school corporation’s spending level is equivalent to its tax rate effort. Thus, reward is proportional to effort. In 1997, 65 percent of school corporations fall into one of these three groups. This percentage is anticipated to increase to 71 percent in 1999.

¹⁰ This analysis is based on a simulation of the tuition support formula. Thus, the data is subject to change. Also, these categories are broad, so there may be little difference in spending or tax rate between a school corporation at the lower end of one category and the high end of another. For instance, the difference in tax rates between the lowest “medium tax rate corporation” (\$2.6051) and the highest “low tax rate corporation” (\$2.6036) is \$0.0015 per \$100 of AV.

During the years included in Table XVII, nine to 11 school corporations with high property wealth per pupil are able to tax at low rates but spend at high levels. While this is a positive outcome for that particular community, it would strike a high tax, low spend school corporation as unfair and inequitable. This also violates the equity principle that a school corporation's education spending should be a reflection of tax effort rather than property tax wealth.

There are also a few high tax school corporations who spend in the bottom third of all school corporations. In 1998 and 1999, this occurrence is a transitional phase for several corporations and requires another year of formula driven adjustments before the school corporation's tax rate or funding level changes categories. (Table XVIII)

**Table XVIII
Tri-Creek School Corporation in Lake County**

In 1997, Tri-Creek School Corporation had the 46th highest General Fund rate but ranked 199th in spending. Based on 1997 information, the recently enacted formula projects that, for the corporation's level of spending, Tri-Creek is overtaxing itself. Thus, if the school corporation's actual 1998 and 1999 budgets mirror the formula simulation, Tri-Creek's General Fund rate will decrease by \$0.25 in 1998 and \$0.20 in 1999. These reductions would move the school corporation into the middle property tax rate tier. Its spending level rank would, however, decline to approximately 265 out of 294 and remain a bottom-tier spender because, while the make-up of funding changes, the level remains nearly stagnant.

	General Fund Rate			Basic Grant Spending		
1997	\$3.16	Top Third	46 th	\$4,164	Bottom Third	199 th
1998	\$2.91	Top Third	67 th	\$4,275	Bottom Third	235 th
1999	\$2.71	Medium Third	111 th	\$4,394	Bottom Third	265 th

Source: Budget Agency, IFPI Calculations

A. Reducing the Variance in the General Fund Property Tax Rate

A simulation of the 1997 formula for all 294 school corporations through 1999 indicates that the General Fund tax rate variance will decline. (Table XIX) For instance, in 1997, the range in property tax rates between high tax, high spend corporations is almost \$3.00. In 1999, this range is projected to fall to \$2.55. There is also a total decline from high tax, high spend to low tax, low spend corporations over the biennium, falling from \$3.95 to \$3.16. Thus, not only are more school corporations fitting into one of the three categories, but the size of the categories is also decreasing.

Table XIX				
Comparisons of School Corporations by Tax Rate and Basic Grant Amount				
General Fund Property Tax Rate	Range in Rates	School Corporation Type	Basic Grant/ADM	Range in Grant Amount
1997				
\$1.8484 - \$2.5473	\$0.6989	Low Tax, Low Spend	\$3,919 - \$4,166	\$ 247
\$2.5495 - \$2.8074	\$0.2579	Medium Tax, Medium Spend	\$4,170 - \$4,349	\$ 179
\$2.9103 - \$5.7986	\$2.9883	High Tax, High Spend	\$4,358 - \$6,631	\$2,273
\$3.95		High - Low		\$2,712
1998				
\$1.9984 - \$2.6026	\$0.6042	Low Tax, Low Spend	\$4,033 - \$4,429	\$ 296
\$2.6117 - \$2.7872	\$0.1755	Medium Tax, Medium Spend	\$4,340 - \$4,532	\$ 192
\$2.8174 - \$5.5486	\$2.7312	High Tax, High Spend	\$4,538 - \$6,792	\$2,254
\$3.55		High - Low		\$2,759
1999				
\$2.1484 - \$2.6500	\$0.5016	Low Tax, Low Spend	\$4,168 - \$4,480	\$ 312
\$2.6500 - \$2.7449	\$0.0946	Medium Tax, Medium Spend	\$4,662 - \$4,687	\$ 25
\$2.8174 - \$5.5486	\$2.5460	High Tax, High Spend	\$4,787 - \$7,036	\$2,249
\$3.16		High - Low		\$2,868
Note: This table does not include all 294 school corporations, only those who fit into the optimal three categories. Source: State Budget Agency, IFPI Calculations				

B. Equalizing the Tax Capacity of School Corporations

Equal tax capacity means that for a penny taxed, a school corporation is able to raise the same amount of revenue regardless of the school corporation’s property wealth. Due to differences in AV per pupil among school corporations, that goal is not achieved absent State intervention. In 1997, the General Assembly determined that for every penny a local school corporation taxes above the qualifying tax rate, the State guarantees a \$10.00 return for 1998 and \$9.50 for 1999. The State provides the difference between what the local school corporation can raise with its additional penny and the guaranteed yield. (Table XX)

Table XX		
Equalizing Tax Capacity		
	School Corporation A	School Corporation B
School Corporation AV	\$50,000,000	\$175,000,000
School Corporation ADM	1,500	1,500
AV per ADM	\$ 33,333	\$ 116,667
\$0.0001 * AV per ADM	\$ 3.33	\$ 11.67
Amount Raised Locally	\$ 3.33	\$ 11.67
State Support = (\$10.00 – Amount Raised Locally)	\$ 6.67	\$ 0
Total Return = (Local + State)	\$ 10.00	\$ 11.67
IFPI Calculations		

The guaranteed yield mechanism is only effective when the guaranteed amount is greater than what a school corporation can raise based totally on its own AV. Table XX illustrates the guaranteed yield provision for two school corporations, one that is affected by the provision and one that is not. In 1998, seven school corporations are projected to have a tax capacity that is equal to or more productive than the guaranteed yield. (Table XXI)

Table XXI
1998 School Corporations with Property Tax Capacity
Expected to Exceed the \$10.00 Guaranteed Yield

	AV per ADM	Amount Raised Locally Per Penny
1. MSD Pike Township, Marion Co.	\$141,066	\$14.11
2. Whiting City Schools, Lake Co.	\$136,331	\$13.63
3. Speedway Township Schools, Marion Co.	\$135,097	\$13.51
4. MSD Mt. Vernon, Posey Co.	\$131,257	\$13.13
5. South Spencer Co. School Corp, Spencer Co.	\$123,807	\$12.38
6. MSD Washington Township, Marion Co.	\$109,476	\$10.95
7. Kokomo-Center Township Consolidated School Corp., Howard Co.	\$100,000	\$10.00

Source: State Budget Agency, IFPI Calculations

VI. Concluding Issue

As described, the 1997 formula will reduce variance among school General Fund rates. Since the General Fund rate is the largest component of the total school rate, total variance will also decline. Reducing the variance in the General Fund rate is a commendable goal. However, addressing the variance in the total school rate is increasingly becoming a priority as the sum of the Debt Service, Capital Projects, and Transportation Funds rates now nearly equal or exceed the General Fund rate. (Table XXII)

Table XXII
Variation in Total School Property Tax Rates

	Max	90%	Median	10%	Min	Max – Min	90% to 10% Ratio
General Fund	5.7986	3.4086	2.6516	2.2606	0.7520	5.0466	1.5078
Debt Service Fund	3.3563	1.9559	0.9916	0.1585	0.0000	3.3563	12.3406
Transportation Fund	1.4524	0.9587	0.5950	0.3647	0.0231	1.4293	2.6284
Capital Projects Fund	1.2612	1.1626	0.8714	0.4418	0.0000	1.2612	2.6312
Total Rate	10.0702	6.3876	5.2386	4.1483	1.5900	8.4802	1.5398

Source: State Budget Agency, IFPI Calculations

Currently, critics of the Transportation Fund formula contend that State assistance is inadequate and the threshold for assistance is too high. They note that some school corporations maintain low rates and are able to raise all the Transportation Fund revenues locally. Meanwhile, poorer

school corporations must tax themselves at nearly three times the rate of wealthier school corporations. The demand for transportation services varies substantially across school corporations. For instance, Speedway Township Schools in Marion County have both a low demand for transportation services (pupil distances to schools is small) and large property wealth (\$134,121 AV per ADM in 1997). In 1997, Speedway's transportation rate was the lowest in the State at \$0.02. Meanwhile, rural Franklin County Community School Corporation with less than 3,000 students has the largest rate at \$1.45.

The same tax ratio disparity is true with Debt Service Fund rates (for capital projects). State assistance for this grant is limited to the ADA flat grant, which all school corporations receive, based on the number of pupils, regardless of wealth. Variation between Debt Service Fund rates at the 90th and 10th percentiles equals a magnitude of 12 to 1. This represents the largest disparity of all the funds. The absence of an equalizing mechanism, such as the distribution of State revenues, contributes to the disparity and reflects a view that capital project expenditures, paid for from the Debt Service and Capital Projects Funds, are properly local concerns to be funded with local revenues.

The disparity in the Debt Service Fund presents serious challenges to taxpayer and student equity. The Ohio Supreme Court decision and other decisions suggest that courts are moving beyond the issue of equalizing instructional costs. Today these courts seem to suggest that addressing the disparity in capital facilities and classroom resources is also necessary to insure an equal educational opportunity. Therefore, variation in capital resources of school corporations presents challenges to the goal of equal educational opportunity. Care should be taken by future sessions of the Indiana General Assembly to address the issue of repairing and replacing aging school structures in a manner that will not threaten access to an equal educational opportunity in Indiana.

APPENDIX

Calculating the 1997 School Funding Formula

As previously mentioned, the Basic Grant consists of two components, tuition support and additional funding. Both parts are determined via the tuition support formula. In most school corporations, revenue from the tuition support formula is the largest single revenue source, but, in some, the property tax is so productive that little tuition support is provided. To determine how tuition support is calculated, the formula is broken down into several sections.

Section A – Previous Year Revenue

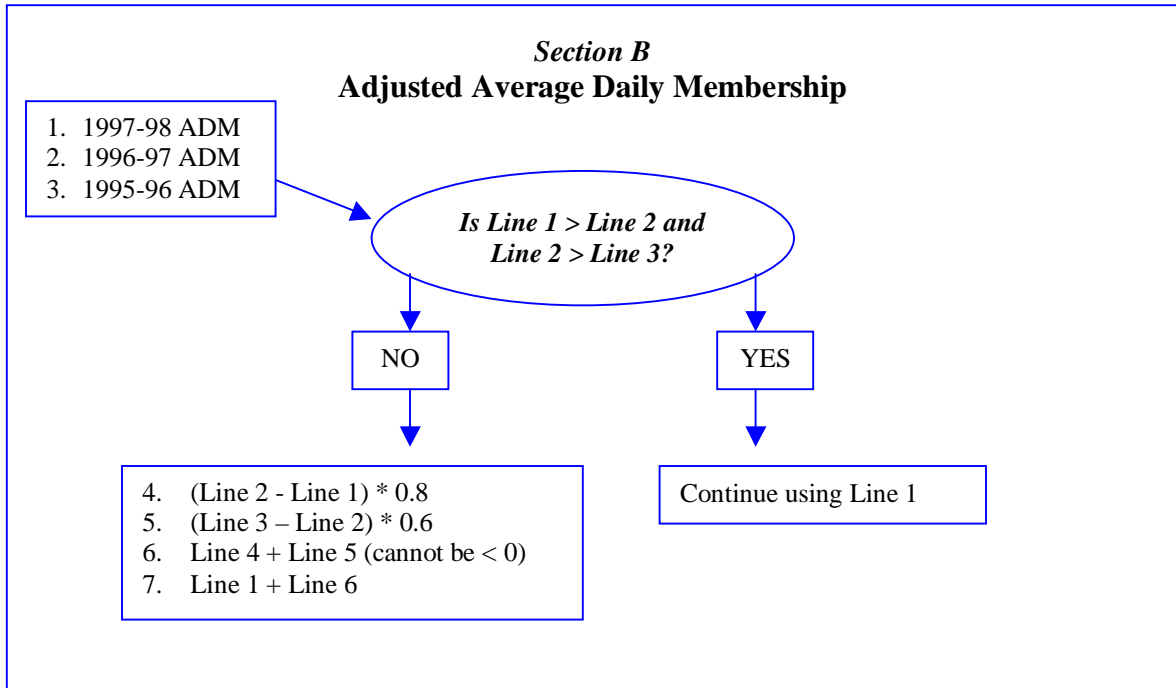
Calculations in Section A subtract the Enrollment Growth, Special Education, Vocational Education, and At-Risk grants from the Basic Grant. Beginning in 1999, the Honors Grant will also need to be subtracted out. These items are removed so that revenue based on specific local circumstances does not influence the next year's tuition support component.

Section A Previous Year Revenues

1. 1997 Basic Grant
2. 1997 Enrollment Growth Grant
3. 1997 Special Education Grant
4. 1997 Vocational Education Grant
5. 1997 At-Risk Grant
6. Sum of Lines 2, 3, 4 & 5
7. Line 1 – Line 6
8. 1997 Tuition Support Levy
9. 1996 Auto Excise & 1996 Financial Institutions Tax
10. 1997 Facilities & 1997 P.L. 874 Revenue
11. Sum of Lines 7, 8, 9 & 10

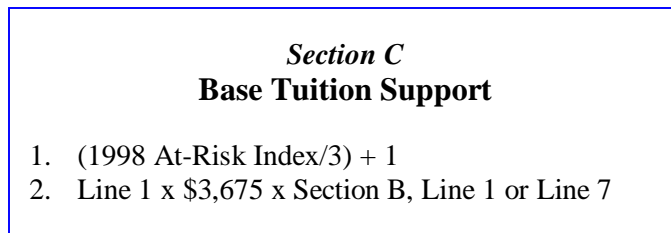
Section B – Average Adjusted Daily Membership

In recognition that it may not be possible to reduce costs as quickly as a school corporation loses students, this section slows down the loss of funds, presumably over a four-year period, by adjusting the average daily membership figure. Lines 4 and 5 include variables that reduce the marginal change in per pupil funding.



Section C – Base Tuition Support

This calculation will in most cases be a comparative value used later in the formula unless a school corporation has a large At-Risk Index and is a low tax, low spend school corporation.



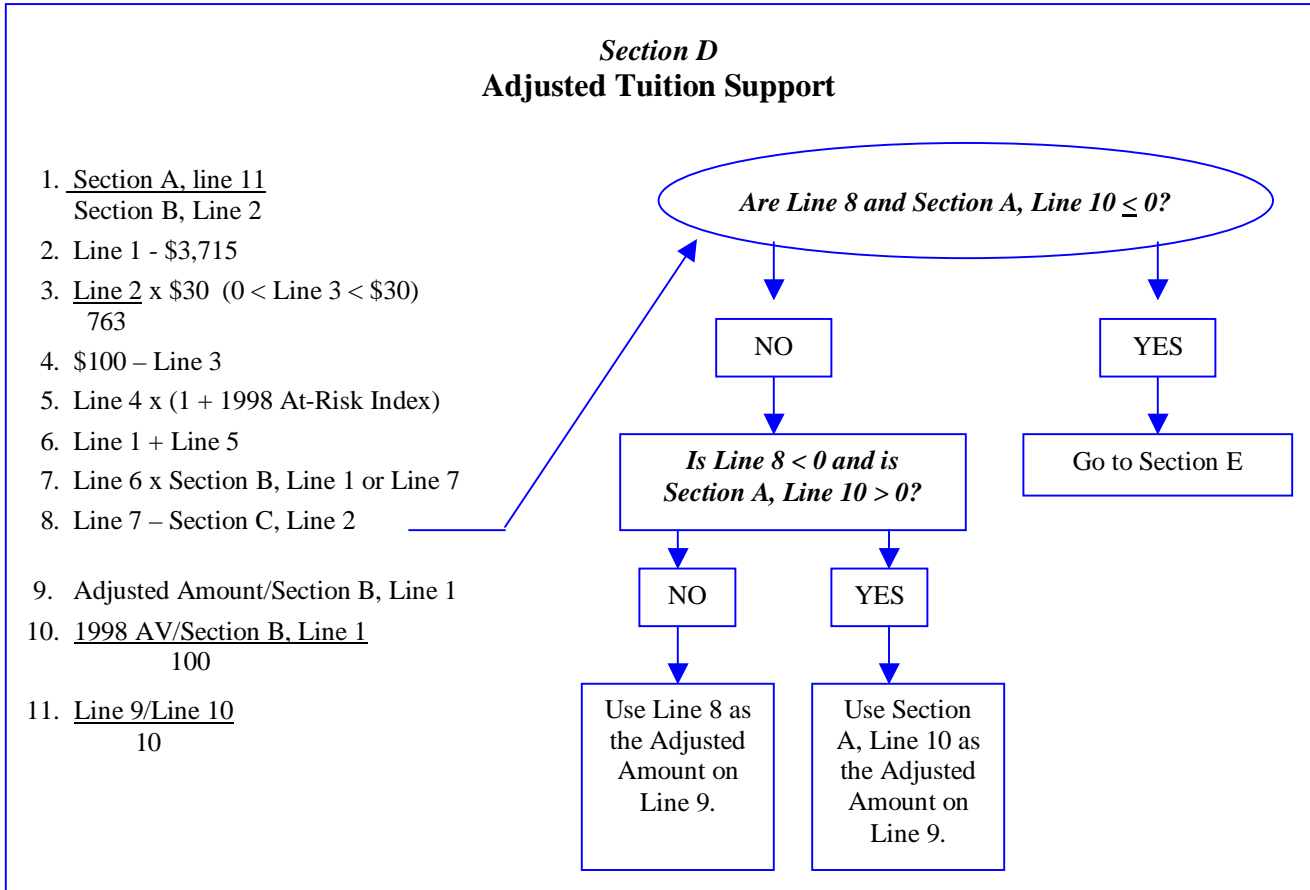
Section D – Adjusted Tuition Support

This section will help determine whether a school corporation is receiving more or less State support than it should based on its prior year assessed valuation and school General Fund property tax rate.

- Line 1:** This calculation equals the 1997 Tuition Support per ADM value.
- Line 2:** \$3,715 represents the 1998 Foundation Grant amount and minimum funding level in 1997. The foundation grant increases to \$3,854 in 1999.
- Line 3 and 4:** This is a flat grant ranging in value from \$70 to \$100 based on prior year tuition support spending per pupil. All school corporations are guaranteed at least \$70 per ADM. The grant award is further adjusted based on the At-Risk index of the school corporation. (The \$763 value will be reduced to \$654 in 1999.)
- Line 5:** The flat grant award is adjusted based on a school corporation’s At-Risk index. As a result of this additional adjustment, the flat grant award could actually exceed \$100 for property poor school corporations with high at-risk populations.

Line 7: The flat grant is then multiplied by the 1998 Adjusted ADM count. This calculation is particularly useful for declining enrollment school corporations since their adjusted ADM is larger than actual ADM.

Line 9: The 1998 per pupil funding level will be based on the higher of Base Tuition Support or Previous Year Revenue plus the flat grant award.



Section E – General Fund Tax Rate and Levy

This section helps determine the school corporation’s 1998 school General Fund tax rate. There are some limits to the amount of change allowed. Unique to 1998, any anticipated increase is subject to a 50 percent reduction. Both in 1998 and 1999, the maximum allowed rate increase is \$0.15 per \$100 of AV. The \$0.15 cap is applied after the 50 percent reduction in 1998 only. The maximum allowed rate decrease is \$0.25 per \$100 of AV.

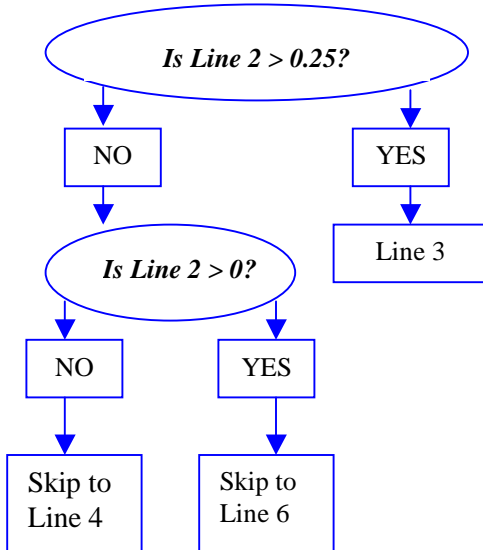
Line 4: Any increase in the property tax rate for 1998 must be divided by 2. This calculation occurs only in 1998.

Line 10: Total Tuition Support

Line 11: State Assistance for Tuition Support

Section E
General Fund Tax Rate & Levy

1. \$2.64 + Section D, Line 11 (if applicable)
2. 1997 G.F. Tax Rate – Line 1



3. 1997 G.F. Tax Rate – 0.25, skip to Line 7
4. Find Absolute Value of Line 2/2 (cannot be > 0.15)
5. 1997 G.F. Tax Rate + Line 4, skip to Line 7
6. 1997 G.F. Tax Rate – Line 2
7. Use Line 3 if Line 2 was > 0.25,
Use Line 5 if Line 2 was < 0
Use Line 6 if Line 2 was > 0 but < 0.25
8. (Line 7/100)* 1998 AV
9. Line 8 + 1997 Motor Vehicle Excise Tax Revenue + Financial Institutions Tax Revenue
10. Select Greater of Section C, Line 2 or Section D, Line 7
11. Line 10 – Line 9

Note: Further adjustment to the tax rate is possible if the State Board of Tax Commissioners determines that the assessment practices of the local assessor results in an inaccurate calculation of a school corporation’s AV.

Once the 1998 school General Fund property tax rate is determined, it is multiplied by the corporation’s 1998 assessed valuation to determine the General Fund levy. The General Fund levy amount plus the miscellaneous revenue are subtracted from the tuition support award to determine the State’s share.

Section F – 1998 Minimum Guaranteed Increase in Regular Tuition Support

The General Assembly included a provision that all school corporations would be guaranteed at least a three percent increase in Tuition Support in both 1998 and 1999. This section will generally only apply to those school corporations with a significant decline in enrollment.

Section F
Minimum Guaranteed Increase in Regular Tuition Support

1. Section A, Line 11 x 1.03
2. Line 1 – Section E, 10 (not < 0)
3. Line 2 + Section E, Line 10 (1998 Tuition Support)
4. Line 2 + Section E, Line 11 (State Grant)

Other Components of the Basic Grant

The State provides additional grants to local school corporations based on local circumstances.

Section G – 1998 Honors Diploma Grant

In 1998, the General Assembly adopted the Honors Diploma Grant. This grant will be awarded on a per pupil basis, based on the number of students receiving an Honors Diploma.

<p>Section G 1998 Honors Diploma Grant</p> <p>1. 1997 Number of Students Graduating with Honors Diploma * \$800</p>
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Section H – At-Risk Grant

In a few sections of the Tuition Support calculation, an At-Risk Index was included as part of the calculation. This index is intended to reflect the added burden placed on school corporations by higher-than-average numbers of children “at-risk” of not completing their education. A three factor formula utilizing statistics related to poverty, single-parent families, and persons under the age of 20 with less than a twelfth grade education determines which school corporations are eligible for at-risk grants. The 1997 formula established a two-tiered calculation. In 1999, the At-Risk grant per pupil will increase from \$2,950 to \$3,135. 236 school corporations are estimated to receive At-Risk grants in 1998. There are seven school corporations estimated to receive over \$1.2 million each, or 42 percent of the total At-Risk Grant.

<p>School Corporations Estimated to Receive More than \$1.2 Million in At-Risk Funding</p>	
1. Indianapolis Public Schools	\$7,013,124
2. Gary Community School Corporation	\$3,867,509
3. Evansville-Vanderburgh School Corporation	\$1,364,936
4. South Bend Community School Corporation	\$1,329,359
5. Hammond City Schools	\$1,304,166
6. Ft. Wayne Community Schools	\$1,253,868
7. East Chicago City Schools	\$1,239,620

<p>Section H At-Risk Grant</p>	
1.	(1998 At-Risk Index – 0.15) * .18
2.	(1998 At-Risk Index – 0.20) * .07
3.	Line 1 Amount + Line 2 Amount
4.	(Line 3 Amount * 1997-98 ADM) * \$2,950

Section I – 1998 Adjustment for ADM Growth

School corporations that experience a single year increase of 250 pupils or five percent total increase in enrollment are eligible for an enrollment growth grant.

Section I
Enrollment Growth Grant

1. 1997-98 ADM – 1996-97 ADM
2. 1997-98 ADM / 1996-97 ADM

Line 1 must be greater than 250 or Line 2 must be greater than 1.05.

3. 1998 Tuition Support / 1997-87 ADM
4. Divide the 1998 per pupil grant by 3.
5. (Line 1 * Line 3) / 3

Section J – 1998 Special and Vocational Education Grants

In 1995, the General Assembly significantly changed the formula used to determine how special education funding was determined. Rather than identifying each disability a child has, a single determination is made whether the child is:

- 1) Seriously Disabled,
- 2) Mild to Moderately Disabled, or
- 3) Communications Impaired or Homebound.

The per pupil dollar value of the special education grant is based on which designation is made.

The 1999 grant awards for Special and Vocational Education will increase to \$7,285 for severely disabled, \$1,977 for mild to moderately disabled, \$469 for communication disorders or homebound studies, and \$1,600 for vocational education grants.

Section J
Special and Vocational Educational Grants

Special Education

1. \$7,205 * 1998 Severe Disabilities Pupil Count
2. \$1,954 * 1998 Mild and Moderate Disabilities Pupil Count
3. \$462 * 1998 Communications Impaired and Homebound Pupil Count
4. Add lines 1, 2, and 3

Vocational Education

5. \$1,570 * 1998 Vocational Education Pupil Count