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It's Elementary

A Monthly Column by EFAP Director John Yinger

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School District Responses to State Aid Programs

Most of the time, state governments appear to pass educational aid programs with little thought about the impact of those programs on the behavior of recipient school districts. States simply assume that the money districts receive will be spent to reach the educational performance targets the state selects. In fact, however, state aid loosens a school district's budget constraint and allows a school district to cut local property taxes or to shift resources into educational programs it prefers. A better understanding of these behavioral responses would allow state policy makers to better meet their educational objectives.

The key to understanding these responses is to recognize that the level of school spending is determined largely by voters' demand for school performance. Like the demand for other things, the demand for school performance goes up with income and down with price. The key to analyzing the impact of aid programs on demand, therefore, is to determine how they affect the income for and price of public education from the point of view of a local voter.

Most states, 41 by my count, rely heavily on a foundation aid formula to assist school districts. With this type of aid program, the state sets a spending target and a minimum expected local property tax rate and then provides each district with the difference between this target and the amount of money the district can raise at this expected tax rate. The idea is to ensure that each district has enough money to reach the spending target. In some states, this spending target varies across districts to account for differences in the number of disadvantaged students, who are more expensive to educate, or other factors. (See my January column.) A foundation aid program is a type of lump-sum aid. It boosts the resources available to voters for providing education and therefore is, from voters' point of view, a type of income.

Another type of aid program, called matching aid, alters the price voters must pay for education, but only a few states use matching aid for education and it is not discussed here. (The effects of matching aid are similar to those of property tax exemptions, which were discussed in my last column.)

Dozens of studies have found that a higher level of foundation aid (or any other type of lump-sum aid) induces voters to select a higher level of educational services. Several studies measure educational services using student test scores, for example, and find that an increase in a district's foundation aid leads to an increase in both educational spending and in test scores in that district. The increase in spending is not as large, however, as the increase in aid. This implies that the aid increase also leads to a reduction in local property taxes. In other words, the aid increase gives voters the opportunity to both obtain better educational services and pay less in property taxes. The ability of voters to translate lump-sum aid into tax relief implies that a foundation aid program may not raise spending to the target level in all districts. According to a foundation aid formula, every district would have enough money to reach its target spending level if it levied the minimum expected tax rate, but voters in some districts may respond to the aid program by cutting their tax rate below this minimum. State officials who pass a foundation aid program with the expectation that it will lead to the target level of spending in every district are likely to be disappointed.

One simple way to avoid this problem, which is used by many states, is to turn the minimum expected tax rate into a requirement. This requirement ensures that the sum of local property tax revenue and state aid is at least as great as the target spending level. An alternative approach is to use a so-called "maintenance of effort" provision. This approach

can be made to work in the short run, but it eventually loses its effectiveness unless it includes a careful adjustment for inflation.

An increase in foundation aid, like an increase in income, also leads voters to demand a broader set of educational services. Thanks to trends in state education policy and to the federal No Child Left Behind Act, states now focus on student test scores in English and math at various grade levels as their principal measures of school performance. An increase in foundation aid will lead to an increase in student scores on these tests, but it will also lead to more demand for and spending on educational programs with little direct impact on these tests, such as art or music programs.

This behavioral response leads to an important, unresolved dilemma for state policy makers. No district should be held accountable for reaching a test-score target unless it has the amount of money it needs, which is the amount indicated by its target spending level. But if a district is given enough foundation aid to bring it up to this target spending level at the minimum expected tax rate, this boost in effective income will, to some degree, induce voters to demand not only better test scores but also improvements in other educational services. No combination of state aid and accountability policies has yet been identified that will simultaneously boost the resources available to needy districts and induce the voters and school officials in those districts to focus these extra resources exclusively on reaching test-score targets selected by the state.

This dilemma cannot be resolved by refusing to give needy districts the extra state aid they need to meet state standards, by setting up an accountability system that blames needy districts for poor performance even when they are under funded, or by ignoring the role of local voters. Indeed, it may be impossible to resolve this dilemma until state policy makers do something they have so far been unwilling to do, namely, try to understand the way local voters respond to state aid programs.
