Chapter 6

Education Financing: How Many Types of Equity?

The whole problem is that people pay taxes, not towns.

—Vermont representative

This lament by a frustrated Vermont representative offers an entry point into yet another avenue of politics created in a federal system. In financing education, tensions arise among state governments, localities, and citizens. On the one hand, localities want states to shoulder greater shares of financial responsibility and alleviate discrepancies in revenue capacities among localities. On the other hand, these local officials desire administrative control over their schools. Complicating these competing demands, citizens demand quality schools and property tax reform and generally resist tax increases. Court orders to equalize funding across school districts only add further complexity and add another component to intergovernmental relations.

The previous chapter examined how legislators connected education and training programs with economic development strategies. In this chapter, I consider broader issues regarding public education financing and how the provision of a public good supported by legislators links with the taxes imposed to finance it. Primary and secondary education provide the best example of a government-provided public good, and this chapter examines the variance in how states connect taxes to a public good. In the case of education, states provide thirteen years of public-school education to their citizens, so the issue is not variance in program design, as it is with tax policy, economic development, or Medicaid reform. With education, representatives struggled with three issues:

1. finding politically palatable connections between taxes and services
2. reducing the lack of responsiveness to the ability-to-pay principle created over time with the property tax, and
3. retaining the policy accountability of education.

Representatives in several states have devoted considerable attention to financing public education and to defining the appropriate role for state governments in providing public education. State responsibility for financing public primary and secondary education has grown substantially in the past two decades (Gold 1992). With respect to intergovernmental relations, education presented a situation in which the state would assume a responsibility previously held by local governments. But rather than shift resources so that localities would enjoy a windfall of revenues, most states also exercised the prerogative to constrain local tax powers. Consequently, with state assumption of education responsibility came a decrease in the revenue possibilities for localities. The state budget lines shifted out with new revenues, but so did their spending obligations. For localities, both spending and revenue contracted.

Local school districts have grown increasingly dependent on state governments for education funding and for a mechanism by which to alleviate and redress the inequities created by property taxes. The relationship between localities and state creates yet another dimension of tax politics. In this dimension, locally elected officials must reconcile three things—local control, tax equity, and the fair provision of a public good, education. How legislators navigate these politics has consequences for both state and local officials.

Education financing demonstrates that state representatives are not necessarily tax averse and will impose large new tax increases under particular conditions. The main issue vis-à-vis education revolves around vertical transferability. State legislators have been willing to increase state tax burdens to reduce inequities in local tax burdens and equitably provide a public good—primary and secondary education. In terms of distributional consequences, representatives worried that land-rich and income-rich local school districts could provide much better educations for children than could other districts and that land-rich but income-poor districts would have to impose proportionately high tax rates to maintain minimal educational standards or meet state and federal funding requirements.[1]

With property tax reform and state assumption of education financing, citizens' benefit/tax ratio changes depend on the districts in which they live and the incidence of the tax imposed as an alternative to property taxes. For some citizens, shifting from property to sales taxes will increase their benefit/tax ratios as property taxes decline more than sales tax burdens increase. For other citizens, declines in local property taxes may not offset increases in sales taxes, and benefit/tax ratios decrease. For persons renting housing, changes in benefit/tax ratios depend on whether landlords pass along property tax savings in the form of reduced rent. Another factor affecting benefit/tax ratio changes relates to interactions among state and federal tax policies. For homeowners, federal income taxes may increase as citizens lose a portion of their deduction for property taxes, which will not be offset if the state shifts to sales taxes. Several states offer "circuit breaker" programs designed to offset property tax burdens through various income tax credits and rebates. In these states, the value of property tax credits on state income tax typically decline with reductions in property tax rates or property assessments.

As with changes in income taxes, shifting from property taxes to state sales taxes creates perceptual and objective changes in benefit/tax ratios and in representatives' political-benefits calculations. In Michigan, Republicans and Democrats agreed that many residents would pay the same amount in taxes after the state mandated large property tax reductions and increased the sales tax rate from 4 to 6 percent. Despite little objective change in their tax burdens, legislators believed that constituents supported the change because of the obscurability of sales taxes relative to property taxes.

Legislators grapple with competing and contradictory demands from their constituents. Competing demands imply that different citizens want different things. Elderly homeowners want property tax relief, and parents want good schools for their children. An individual citizen's preferences may not reconcile with each other. For example, Oregon residents have demanded and voted themselves property tax relief and quality schools but have consistently refused to accept new taxes to pay for those schools.

Although conflicting and even contradictory, legislators reported similar demands for education financing across states. Citizens wanted relief from current property tax burdens and containment on future tax increases. The latitude legislators enjoyed to increase other taxes shaped the extent and content of their response to these changes. Even in New Jersey, where the politics of income tax cuts dominated property tax and education financing issues in 1993 and 1994, Republicans and Democrats recognized the potential for property tax resistance to escalate and eclipse support for state income tax cuts.

Legislators indicated a great deal of concern about equity in education, and these concerns went beyond the suburban-urban lines identified by Peterson (1981). Citizen-initiated referenda and judicially imposed education policies shape legislators' attempts to change financing for and the provision of public education. Legislators must fashion solutions for tax equity that accommodate preferences or court and constitutional mandates for service equality. In most states, courts and legislatures have interpreted service equality to mean equal spending per student. Many representatives expressed concerns that the movement away from property taxes as dedicated school revenues may lead to a decrease in policy accountability for education and a subsequent decrease in the overall political accountability of local and state governments. The accountability dynamic between state and local government changes when state governments transfer large portions of funding responsibility from localities to themselves.

Table 10 presents data from several states regarding property tax rates. The case-study states—New Jersey, Vermont, Oregon, and Michi-

TABLE 10. Education Spending and Taxes

	Spending per Pupil	Spending per Capita	Property Taxes per Capita
New Jersey	7,315	1,030	1,268
	(2)	(5)	(3)
Vermont	5,711	965	954
	(6)	(7)	(8)
Massachusetts	5,706	805	877
	(7)	(13)	(11)
Michigan	5,073	865	950
	(13)	(8)	(9)
Oregon	4,782	822	884
	(16)	(10)	(12)
Mississippi	2,933	562	357
	(49)	(49)	(42)

Source: U.S. Department of Education 1992 for columns 1 and 2; U.S. Bureau of the Census, 1993 for column 3.

Note: Numbers in parentheses are state rankings among all fifty states and the District of Columbia.

gan—all had relatively high property taxes. They have also taken different routes in addressing these problems in recent years.

Table 10 indicates that the case-study states in which legislators debated reform measures tended to be those where education spending and property taxes were relatively high. Another way of measuring the property tax burden is as a percentage of personal income. Using this measure, Vermont imposed the heaviest burden on its citizens, with property taxes at 5.4 percent of income, followed by New Jersey at 5.15 percent, Michigan at 5.11 percent, and Oregon at 4.95 percent. This measure illustrates relative tax burdens. For the entire nation, New Hampshire imposed the heaviest property taxes, with property taxes at 6.46 percent of income, although that state has no personal-income or general sales taxes. Alabama's property tax constituted only 1.13 percent of personal income (U.S. Bureau of the Census 1993).

Legislators attempt to find a balance for education financing that preserves policy accountability for education and stabilizes or enhances the government's general political accountability. Representatives promote tax changes that their colleagues and constituents find palatable. Doing so may mean accepting an obscure funding source at the expense of tax equity or revenue dependability or compromising among these principles.

Representatives seek to apply the principle of ability to pay but differ on just what it means. For some, the income tax provides the only means by which to apply the ability-to-pay principle. For others, the sales tax suffices, with the rationale that citizens with large disposable incomes will pay more in sales taxes than will lower-income individuals. Generally, the shift from property to income taxes would better reflect citizens' ability to pay taxes vis-à-vis their gross incomes than would a shift from property to sales taxes. Given that property taxes will be traded for other taxes, higher-income citizens are thus better off when voters enact sales taxes rather than income taxes.

Legislators pursue adequate funding for all school districts. In some cases, a philosophical or ideological desire to equalize educational opportunities motivates these desires. In other cases, state constitutions, statutes, and court orders influence legislators to promote equality in education. Overlapping both these situations, some legislators supported changes because they came from districts one might describe as land rich and cash poor. In other words, as a result of holding land with high assessed values but having modest wage incomes, citizens might face onerous property taxes.

Peterson (1981) recognizes both the developmental and distributional aspects of education policy. I offer an analysis that considers these two aspects but adds new insights that were not salient a decade and a half ago.[2] The main difference is the growing perception among state representatives that property taxes are inelastic and neither responsive to nor reflective of a citizen's ability to pay. While the distributional and developmental aspects of providing education remain much as Peterson described them, I connect the politics of property taxes with providing education.

I explore efforts to grapple with education financing in Michigan, Oregon, Vermont, and New Jersey and offer corroborative information from Massachusetts and Mississippi. In the first four states, property taxes gained prominence on state agendas, but they did so with different results. Michigan legislators designed and voters enacted a $6 billion tax shift from property to sales taxes. Oregon voters enacted severe property tax limitations but failed to increase or enact alternative taxes, as Michigan did. In New Jersey, Governor James Florio's efforts to address both court-mandated funding equalization and local property tax burdens via income and sales tax increases have been rebuffed in Governor Christine Todd Whitman's efforts to reduce state income taxes. Finally, in Vermont, legislators have grappled with property tax inequities since the early 1970s and have created four programs designed to address specific distributional and funding problems created by local property taxes. By 1994 divisions existed on whether to create a fifth mechanism by which to address problems, have the state assume or redistribute all local property taxes, or raise broad-based income and sales taxes in return for reductions in property taxes. No clear consensus existed by the early spring of 1995, despite considerable efforts in the legislature and by Governor Howard Dean. Before moving to the case studies, however, I first present the problem that property taxes present legislators. I then describe legislators' preferences and their emphasis on the principles of accountability, equity, obscurability, and dependability.

Background

Since the late 1970s, states have assumed greater responsibility for financing public education, and state taxes have supplanted local taxes in many states as the primary source for school funding (Gold 1990, 1992). The basic political problems with property taxes are their lack of obscurability and their disconnection from the ability-to-pay principle. The visibility of property taxes is exacerbated by their local politics. Unlike sales and income taxes, voters in many states regularly vote to approve or disapprove various property tax ballot measures for local governments. In state after state, legislators bemoaned local property taxes and depicted them as driven by the cost of education. These representatives preferred funding education as a function of the costs in combination with tax mechanisms that reflected citizens' abilities and willingness to pay for public education. Representatives in all eleven states argued that the service being provided—education—did not solely determine the public's collective willingness or ability to pay. In addition to support for education, legislators believed that the tax mechanisms for education financing also influenced willingness to pay.

Faced with a situation in which wealthier localities can provide better education with lower property tax rates than can their less affluent neighbors, state policymakers have several options (Gramlich 1990). They may consolidate school districts and pool tax bases. Doing so evens income disparities among communities by essentially changing the parameters of the community. Consequently, all citizens in the newly formed district face the same property tax rates. A second solution is for state governments to equalize funding and tax burdens as a proportion of income across districts. Legislators may seek to equalize funding by developing matching rates for property tax revenues that favor poorer localities (Gramlich 1990). Alternatively, legislators may leave school districts to tax at whatever rates are necessary but alleviate property tax burdens by offering various state income tax rebates to ensure that citizens do not pay more than a certain proportion of their incomes in property taxes.

Legislators' Preferences and Perceptions

In approaching education financing, representatives emphasized both their individual principles and the intergovernmental and state policy parameters in which they operated. Most legislators sought to continue providing roughly equal educational benefits for the children in their states, although several Republicans suggested that benefits could be expanded and more individually tailored by moving to a system of school vouchers. On the tax side, representatives sought to reintroduce the ability-to-pay principle, which they felt was no longer applicable with property taxes. Equally important, in moving toward collective decisions, representatives in Oregon, Vermont, New Jersey, and Michigan all had to fulfill various state statutes or constitutional provisions to provide “equal” education to schoolchildren. And the states varied in their allowance for local tax prerogatives.

Education financing presents a set of contradictory pressures for state representatives. They find themselves drawn into alleviating local property tax burdens, yet doing so necessitates raising state taxes. Concomitant with changes in finance mechanisms are changes in revenue dependability and the latitude of state legislatures to raise specific taxes in the future. For example, several legislators in Michigan suggested that the increase in the sales tax was likely to be the last. Michigan’s 4 percent sales tax had been low relative to neighboring states prior to 1994 and now approached the national average rate. The representatives suggested that they did not support further raising the tax or could not envision doing so.

Shifting funding responsibility from state to local governments creates potential changes in the political accountability of state and local governments and in the policy accountability associated with education. Table 11 illustrates the principles relevant to education financing and depicts the relative frequencies with which legislators mentioned the various principles.

Legislators’ concerns regarding equality revolved around two issues. Many believed that the state had a responsibility to ensure, if not finance, equal educational opportunities for every child. Educational equality typically translated into providing dollars to districts based on the size of their student populations. Representatives recognized that relying on local property taxes as the primary source for education funds either limited the likelihood of equal education or proscribed it. Equal funding demands in turn implied a state solution to a local revenue problem.

The second issue with which legislators must contend when equalizing

TABLE 11. Principles in Education Financing (in percentages)

	Democrats	Republicans	Total
Equality in educational opportunity	87	48	68
Tax equity	95	48	71
Horizontal equity	67	56	62
Obscurability	38	43	40
Dependability	21	8	15
Accountability	46	22	34

Note: Total number of legislators = 51 (26 Democrats, 25 Republicans).

educational services deals less with finance policy and more with the politics of taxation and federalism. Court interventions or the threat of court decisions motivated state representatives to support alternative funding mechanisms. More political motivations came from constituents, who could vent their anger about taxes by refusing to reelect officeholders or by passing referenda limiting state and local governments' tax powers.

Tax equity concerns reigned paramount in legislators' support for adopting new state taxes to supplant local property taxes. Fifty percent of the legislators contended that the property tax was regressive and did not reflect citizens' ability to pay taxes. Such a contention runs counter to much of the literature, which assumes that property tax burdens correspond directly with income (Peterson 1981). Although the correlations between home values and property tax liabilities have been direct, they have not necessarily been proportional to citizens' ability to pay. This lack of proportionality is why legislators found property taxes regressive. Members from every case state except Tennessee suggested that the problem with property taxes is that they are taxes on commodities (houses) for which citizens can do little to change their consumption once purchases are made. Whereas with sales, excise, and even income taxes, citizens can modify their behavior in response to tax policies, their limited ability to move or challenge a property assessment leaves little recourse with respect to property taxes.

Legislators who depicted education as a "tax taker" government function provided a second way of looking at the inelasticity of the property tax. Representatives said that because citizens could not respond to property tax increases the way they could sales and income tax increases (i.e., their housing consumption was fixed, whereas their labor market behavior and "retail" consumption was not), local officials simply developed school district budgets and taxed citizens at whatever rates were required to finance the school district. Legislators contended that other government programs had to compete for whatever tax dollars were available from more volatile sales and income tax revenues and that education ought to compete among these programs.

Although many representatives indicated support for greater state responsibility for education funding, they also perceived potential pitfalls in the shift from local to state financing. Legislators voiced concerns that shifting from local funding to more general and obscure state revenues could decrease popular support for education because policy accountability would decrease. Most legislators believed that education did not suffer the political and policy accountability problems associated with Medicaid. On the contrary, representatives worried that abandoning dedicated property taxes put schools at risk of losing long-enjoyed community support. By moving from property taxes, which citizens connected to education, to a tax that flowed to general government, legislators worried that education would lose what they perceived was a safe status from citizens' antipathy toward many government programs.

A second accountability concern focused on the linkages among state and local governments. Legislators worried that the tax shift would decrease the accountability of local officials and make them less likely to try to efficiently deliver educational services. As one representative said, "How will the local residents hold [the school board members'] feet to the fire if all they have to do is send the bill to the state?" Several representatives suggested that school boards had incentives to agree to generous salary settlements with school employees who would in turn support the board members politically. The same school board members could then request the salary funds from the state government.

Transforming Preferences into Policy

Efforts to change primary and secondary education financing have met with mixed results. In Michigan, legislators offered constituents two sweeping alternatives, and voters chose a sales tax increase over an income tax increase. In other states, tax and education reforms have proceeded incrementally, with legislators tapping various revenues and altering spending formulas each legislative session. Legislators in Oregon and Massachusetts have struggled for a decade to reconcile property tax limitations, demands for equal education, and low state taxes. In Vermont, legislators find themselves at a crossroads where they must decide either to offer a sweeping transformation similar to Michigan or to continue to rework education and tax relief programs that many representatives viewed as increasingly ineffective. Finally, New Jersey assembly members found that the politics of the income tax have largely closed the door on property tax reform.

Michigan

Among the case-study states, the largest tax change occurred in Michigan, where voters enacted a $6 billion shift from property to sales taxes.

Demands for property tax reform persisted through the 1980s and early 1990s. Several political analysts credited Governor John Engler's narrow 1990 election to his pledge to reduce property taxes by 20 percent. Despite the pledge and subsequent efforts, Michigan voters defeated his first proposal for property tax reform by a substantial margin. A state senator set the stage for the changes in Proposal A in July 1993, when she added an amendment that abolished local property taxes. Governor Engler flew back to Lansing to sign the bill into law, forcing the legislature to offer a legislative alternative to the new ballot initiative. The state constitution requires that any sales tax increase be subject to voter approval but allows the legislature to change income tax rates. Consequently, the legislature devised Proposal A, under which voters could enact a sales tax increase; if they failed to do so, a statutory alternative, an income tax increase, would take effect. On March 15, 1994, Michigan voters enacted the largest single tax shift in the state's history, cutting property tax rates from an average of thirty-five mills to eight mills on primary residences and increasing the sales tax from 4 to 6 percent.

The Michigan experience indicates elected officials' willingness to increase taxes to address local tax equity problems. All of the legislators interviewed in Michigan supported abandoning the property tax as the primary funding mechanism for school finance. They differed only on which alternative should replace it. Liberal Democrats favored an income tax increase, and moderate Democrats and Republicans favored Proposal A's sales tax increase. The issue in Michigan was not whether to enact property tax relief but how to do so. The combination of the legislature's prerogative to change income taxes and the referendum process for sales tax increases afforded representatives a means by which to ensure tax reform and share responsibility for major policy changes with their constituents. Although such an arrangement might dilute some of the credit-claiming political benefits from tax reform, it also insulated representatives from the costs of possibly choosing the wrong tax alternative to local property taxes.

Table 12 outlines the elements of Proposal A as it related to individual taxpayers.

Proposal A shifted $6 billion from property taxes to sales taxes. By moving from locally retained property taxes, legislators created a mechanism by which they could increase funding for districts with relatively high property tax rates but low per-pupil spending. Implementing legislation established a spending floor of $4,200 per student. Previously, some districts in the state spent as little as $3,100.[3] At the other end of the spectrum, several districts spent more than $6,500 per pupil. In these districts, the legislature allowed the district to exceed the eight mill cap on homestead property and, with voter approval, add an additional three mills to prevent dramatic spending reductions and cuts in popular extracurricular programs.

The primary opposition to Proposal A emanated from Detroit legislators, led by the Speaker of the Michigan House of Representatives, who argued that the income tax increase was more equitable for the city's residents. They noted that the increase in the personal exemption would have benefited the city's poorest residents. Even in Detroit, various business and political leaders including Mayor Dennis Archer, executives at General Motors, and several school board members countered Detroit area representatives' opposition and publicly endorsed Proposal A. Mayor Archer cited the proposal's decrease in the state's single-business tax as a factor outweighing the regressive effects of the sales tax increase. Proposal A won narrowly in the Motor City and by a three-to-two margin in Wayne County, which includes Detroit.

Legislators cited three factors that led to the overwhelming passage of Proposal A and the concomitant rejection of the alternative income tax

TABLE 12. Elements of Michigan's Proposal A

Proposal A	Statutory Alternative
Reduced maximum millage to 8 mills on homestead property	Maximum millage at 12 mills
Raised sales tax to 6 percent	Retained 4 percent sales tax
Lowered income tax from 4.6 percent to 4.4 percent	Raised income tax from 4.6 percent to 6.0 percent
No change in the personal exemption	Raised personal exemption from $2,100 to $3,000
Raised tobacco tax from 25 to 75 cents per pack	No change in tobacco tax
Lowered single business tax from 2.75 percent of payroll to 2.35 percent	No change in single business tax

increase. First, voters resisted an income tax increase and perceived that they would be better off with a sales tax increase and larger property tax reductions. Second, a light turnout in Detroit relative to that for previous ballot initiatives may have helped swell the margin of victory. Third, the advertising campaign against Proposal A backfired when supporters revealed that tobacco companies ran misleading advertisements in an effort to derail the fifty-cent-per-pack tobacco tax included in the package.

Polls prior to Proposal A's passage indicated strong and growing support for the measure. Table 13 illustrates that support for the ballot initiative grew during the campaign and apparently climaxed with the actual vote, when 71 percent of those voting supported the sales tax changes over the income tax increase.

The obscurability of the sales tax made it marginally appealing. Supporters and opponents suggested that citizens simply resisted the sales tax less, and several Democrats noted that they supported the measure because the sales tax encountered less opposition among their constituents than did the income tax. Senior and junior members recalled how the previous income tax increase, enacted in the depths of the 1983 recession, had led to the recall of two legislators and a movement to recall Governor James Blanchard.

The tobacco industry provided a second component in the victory for Proposal A. In the closing weeks of the campaign, newspapers reported that out-of-state tobacco companies financed advertisements against Proposal A that depicted continuing property taxes and increased sales and income taxes. Governor Engler seized on these ads in his campaign speeches and wrote in an editorial,

> There will be an aggressive ad campaign, bankrolled by the tobacco industry, to confuse voters. The tobacco lobby and its allies are only

TABLE 13. Support for Proposal A

Date	Favor	Oppose	Undecided
January 9, 1994 (poll)	50	26	24
February 13, 1994 (poll)	60	20	20
March 15, 1994 (vote)	71	29	

Source: Poll conducted by EPIC/MRA, Lansing, Michigan, on interviews with 600 likely voters. Polls have error margins of 4 percent.

> concerned about their profits, not about Michigan schools and the way they are funded.
>
> They don't like the fact that Proposal A raises the tax on a pack of cigarettes by 50 cents. They apparently don't want you to know what the state Department of Public Health knows: Michigan would be a healthier state if Proposal A passes. It is estimated that with Proposal A there could be 100,000 fewer smokers and 48,000 lives saved. (Engler 1994)

Campaign analysts, pollsters, and community activists agreed that the $3 million media opposition campaign funded predominantly by tobacco companies backfired in the final days before the vote and increased support for the proposal among moderate voters (Hornbeck and Cain 1994; Holyfield 1994). Calls for tax reform spanned the state's ideological spectrum. Legislators cited the Kalkaska crisis as the motivation from which Republicans and Democrats came to see property tax reform as inevitable. At that point, the state income tax circuit breakers no longer mattered if schools could not operate. After the election, Governor Engler stated, "We were approaching an educational meltdown, and it was the root of inequities in per pupil spending among districts" (Celis 1994).

With Proposal A's enactment, the Michigan state government's share of education funding swelled from 33 percent in 1993 to 79 percent in 1995. In Oregon, a similar shift has transpired, but legislators there have had to contend with consistent citizen rejections of sales tax proposals.

Oregon

Although Michigan's experience with property tax reform is fairly recent, Oregon's odyssey, which began in 1990, offers insights into the consequences of requiring lower property taxes. In 1990 Oregon voters enacted Measure 5, which mandated substantial property tax reductions. At approximately the same time, a court interpretation of the state constitution's provision that the state "provide a uniform system of public schools" for its citizens led to a situation in which the state legislature had to reconcile competing demands to provide more funding and to equalize funding on a per-pupil basis among school districts. The need for greater aggregate funding arose because localities would simply have fewer property tax revenues with which to finance education. Five years after the enactment of Measure 5, and despite budgets designed to equalize funding, Oregon legislators suggested that the system still needed change.

Like Michigan, Oregon's share of primary and secondary education funding rose from 28 percent in 1989 to 69 percent in 1995. Unlike Michigan, where the legislature offered a popular referendum that guaranteed alternative funding to school property taxes, Oregon voters mandated property tax relief with no alternative tax. Because of constitutional provisions, the legislature can change only income tax rates; it cannot institute a new tax. Establishing a sales tax requires voter approval, which presents a situation identical to that of Michigan. Thus, voters in Michigan agreed to raise an existing tax to provide property tax relief. Voters in Oregon have consistently rejected the creation of a new tax but have nonetheless demanded property tax relief.

Oregon representatives find themselves searching for resources in ongoing efforts to meet the conflicting demands of their state constitution, citizen support for quality education, and the voter-enacted Measure 5.[4] Republicans and Democrats alike described the budget process in Oregon as one of "backfilling" budgets with money transferred from state lottery funds to meet commitments to education and fund other general programs.[5] Measure 5 required property tax reductions for school revenues over five years: the maximum rate of fifteen dollars per thousand dollars of assessed value dropped to five dollars per thousand dollars of assessed value by July 1995. Table 14 presents the scheduled rate reductions.

With a constitutional mandate to provide equal funding for students and a voter-imposed referendum mandating property tax reductions, Oregon representatives have responded with a three-pronged strategy. First, they have repeatedly delayed the target date for reaching equalized fund-

TABLE 14. Measure 5—Oregon Property Tax Reductions

Fiscal Year	School Taxes	Nonschool Taxes	Total Property Tax
1991–92	$15.00	$10.00	$25.00
1992–93	$12.50	$10.00	$22.50
1993–94	$10.00	$10.00	$20.00
1994–95	$7.50	$10.00	$17.50
1995–96	$5.00	$10.00	$15.00

Source: Oregon Legislative Revenue Office, 1995b.
Note: Rates are per $1,000 of assessed property value.

ing and argued to state courts that as long as they progress toward equalization, court intervention is not necessary. Second, legislators have twice canceled state income tax rebates and transferred them to education funding. Legislators argued that they did not violate Oregon's state spending limits, which trigger tax rebates, by defining the suspension of income tax rebates as property tax relief rather than as education spending. Finally, the legislature has shifted resources from other departments, particularly human services, to continue to progress toward equalizing education funding across school districts.

In the 1995 House session, increased Republican strength appeared to close the option of retaining the income tax rebates, or "kickers." A group of House Republicans informed their leadership that they would oppose any effort to withhold the kickers. By the middle of the session, it appeared that the kickers would be distributed as part of a compromise on both education spending and tax policy.

Faced with a mounting challenge to replace school funding lost via property tax reductions, the legislature voted to offer a ballot initiative to enact a state sales tax.[6] In 1993 Measure 1 created a 5 percent sales tax, provided an earned-income tax credit and sales tax credit for Oregon's income tax, raised the state's corporate-profits tax, and accelerated the elimination of all school property taxes. In November 1993 voters rejected Measure 1 by a three-to-one margin, leaving legislators with the conundrum of replacing lost local school property taxes with increasingly limited state resources.

Legislators proposed several reasons why Measure 1 failed. Many suggested that opposition to sales taxes was in some sense unique to Oregon: "It's part of being an Oregonian to oppose the sales tax" was a typical comment from both Democrats and Republicans. A second reason for the measure's failure was that it contained numerous and complicated exemptions that voters perceived as creating special tax breaks for selected interest groups, and opponents publicized these exemptions during the campaign. Finally, legislators noted that unlike Michigan, where the trade between sales and property taxes was tangential to property tax reductions immediately following the sales tax increase, Oregon's Measure 1 merely accelerated property tax reductions mandated by Measure 5. As one legislator analyzed the situation, "All Measure 1 did this last time was speed up what citizens had already voted themselves, and in the end they're left with another damned tax. They'd rather stick with the devil they've come to know in Measure 5."

Several representatives suggested that the best chance they had to convince voters to enact a sales tax had been in the late 1980s, when voters considered Measure 5. At that time, the legislature proffered a sales tax referendum that nearly passed, receiving 47 percent of the vote. One legislator suggested that the undoing of that proposal came when opponents publicized a line at the bottom of the initiative that read, "The legislature reserves the right to change the sales tax rate at any time." Legislative supporters agreed that by disconnecting the sales tax from education funding and property tax replacement, they had reduced the probability of ever mounting a successful campaign to enact a sales tax. Several legislators suggested that this realization had led to a lackluster effort on behalf of Measure 1. For example, the measure won approval to be placed on the ballot by a razor-thin vote of thirty-one to twenty-nine in the House of Representatives.

Without the sales tax and with continuing reductions in property taxes, Republicans and Democrats predicted that other programs would suffer as Measure 5 became fully effective. The Legislative Revenue Office estimated that to comply with Measure 5 the legislature would have to cut slightly more than \$1 billion from an annual \$6.5 billion budget (Oregon Legislative Revenue Office 1995a). Even with the sales tax, noneducation spending would have been \$400 million less than the amount needed to fund programs at their level when the property tax reductions began in 1991. This figure represents about a 6 percent decrease in services.

In the aftermath of Measure 5, Republicans, Democrats, and education lobbyists agreed that one of the ironies of the measure was that the benefits did not flow to middle-income home owners. Measure 5 called for all property to be assessed at full market value. These new assessments reduced the benefits from rate reductions as individuals found that their assessment increases offset any rate decreases. Five years following Measure 5's enactment, the organization representing school administrators issued reports documenting that a majority of benefits from Measure 5 flowed to commercial real estate owners in Portland, where assessments had been close to market value in 1990. Consequently, those with large assessments in Portland suffered little from reassessment in 1990 and benefited greatly from annual rate reductions. Overall property tax rates fell from 2.7 percent of assessed value in 1989 to 1.8 percent by 1994, but these reductions fell unevenly. In some rural counties, the tax limits forced a reduction amounting to more than 10 percent of the previous year's revenues. In other counties, updating assessments to full market value actually led to effective tax increases, as rate decreases were more than offset by assessment increases (Oregon Legislative Revenue Office 1995a, C-3).

In Oregon, contradictory measures severely constrain legislators' tax options. Measures propounding sales taxes have failed consistently, and representatives saw little likelihood that such an initiative would pass or even that an increasingly conservative legislature would again place it on the ballot. Thus, legislators hope that a combination of population and income growth will allow the state to eventually reach its equalized funding goals without having to raise the income tax or dramatically cut other programs. One legislator described the situation as follows: "It's ironic that we rely on the lottery to backfill our education budget, because we're gambling that we can fund things in Oregon. . . . As long as the economy grows, we're okay, but if it slips, we have to hope people play a lot of video poker to fund our schools." Massachusetts's experience indicates that when economic growth falters, the ramifications of property tax limitations become magnified and complicate the policy process at a time when states can ill afford new initiatives.

Massachusetts

Massachusetts's experience with property tax limitations has been similar to Oregon's with the notable difference that Massachusetts voters enacted Proposition 2½ fifteen years prior to Oregon's Measure 5. With the passage of time, Massachusetts legislators have coped with the unenviable task of contending with a tax limitation during the recession that gripped the Bay State from the late 1980s through the early 1990s.

Proposition 2½ has resulted in demands from local officials for increased school funding to alleviate the discrepancies between wealthy and low-income districts. As in Oregon, legislators contended with the threat of court intervention as the gaps among localities grew over time. In response to both demands from local school officials and the threat of court-mandated equalized funding, the legislature passed and Governor William Weld approved an education-reform package in 1993.

One question that arose was why education reform had become prominent nearly a decade and a half after the enactment of Proposition 2½. Most legislators agreed that growing revenues in the 1980s and an expanding housing stock delayed the negative fiscal effects from Proposition 2½ until the state slid into recession in the late 1980s. Four Democrats noted that they had no money to redistribute in the early 1990s and were glad the litigation regarding school financing moved slowly through the courts. As the state's economy began to recover in 1993, the legislature and governor agreed to begin funneling additional revenues into education in an effort to hold any litigation in abeyance. Again an exogenous force, the power of the courts, creates a different politics for state representatives than would otherwise be the case.

Despite education-financing reforms, every legislator I interviewed expressed concerns that once the state had used various one-time revenues to pay for education reform it would no longer be able to fund the program. This situation led to a movement to enact a graduated income tax in Massachusetts. Several Democrats and some Republicans had endorsed a "grad tax" proposal to fund the education-reform act. None of the individuals I interviewed believed it would pass in the current legislature or even be seriously debated. One Republican supporter stated flatly that Governor Weld had indicated he would veto the measure and that there was no sense in expending considerable energy passing legislation that would fail at the governor's desk. Even without the governor's opposition, few legislators appeared optimistic that the bill would pass. They cited citizen distrust of government and disdain for the income tax as the principal obstacles.

Three of the eight legislators interviewed suggested that the state would be better off increasing the sales tax from 5 to 6 percent. All three suggested that the relative obscurability of the sales tax coupled with its simplicity relative to changing income and property taxes would generate greater citizen support for a sales tax solution to property tax problems.

Vermont

Vermont representatives debated tax reforms in both the 1993 and 1995 sessions but did so with little hope of enacting broad reforms. Whereas Michigan legislators agreed that the time had come to abandon property taxes for a higher income or sales tax, no such consensus had yet emerged in the Green Mountain State, resulting in considerable political confusion and posturing. Liberal Democrats divided between those who favored state control of the property tax and those who favored increasing income or sales taxes to alleviate local property taxes.

Among moderates a variety of schemes gained support, including various "tax sharing" proposals, in which property tax rates would be equalized across localities and wealthy localities would remit a portion of their revenues to the state. Vermont would in turn transfer these revenues to less prosperous localities. A second group of moderates favored increasing funding for the state's four tax equity programs, all of which had only part of the funding required for them to be fully effective.

Conservatives favored a combination of increased funding for tax equity programs and requirements for schools to lower their costs.[7] No Republican favored state assumption of the property tax, although some said they would support a statewide teachers' contract as a means of controlling salary costs. Most Republicans fell into one of three groups. The first group favored initiating a system in which the state government received a portion of property tax revenues from wealthier localities and remitted this money to poorer localities. The second group favored greater funding of the four state property tax equity programs. The third and most conservative group favored reducing the state's financial role in an effort to encourage localities to control their costs. Supporters of this strategy hoped to signal local officials that the state would no longer fund locally negotiated teacher salary settlements.

In early 1995 the House sent a measure, H. 351, to the Senate. The bill would have created a system of property tax sharing whereby wealthier communities would have remitted a portion of their property taxes to the state, which in turn would disperse the money to localities with smaller tax bases. The measure enjoyed bipartisan support among House moderates, with seventeen members cosponsoring the bill. One Republican proponent ventured that the hostile opposition from both sides assumed that a solution could be enacted in a single piece of legislation. This representative argued that once the principle of tax sharing became law, it would be easier to incrementally reconfigure tax and allocation formulas, which had been the subject of heated debate. He further elaborated how some of his more conservative colleagues had said they opposed the bill because it called for fifty wealthier towns to remit taxes to the state. These Republicans said they thought only seventeen towns should contribute. Nonetheless, the bipartisan group offered H. 351 to begin the process of property tax reform using a continuation of the sales tax and a reconfiguration of property taxes and avoiding the income tax. One legislator in this group reflected the position of his Democratic colleagues:

> Personally, I think we need to finance schools according to a citizen's ability to pay, and that means income taxes. The problem is that we already are in the income tax trough pretty deep.
>
> Now we're back to trying to fund rebates. Well, that's been going

> on for fifteen years, and it's not working because people are dissatisfied with their taxes, and the discrepancies in school funds are growing. But we also have no cohesiveness on [tax] policy. We're going to lower the sales tax, which is a $30 million loss. It's an astonishing paradox that we're cutting state taxes when we need to pool our resources to help people on the property tax they deplore. And tourists would help with a higher sales tax.

Moderate Democrats and Republicans promoted incremental property tax reform lest they find themselves repeating the health-care debacle that occurred during the previous session. H. 351 introduced the concept of "equalized yields" and sharing property taxes among localities. One Republican in this group explained the strategy:

> What people in the chamber have to realize is that 351 is not a solution. It's the first step that creates the principle that towns need to share their resources, and it stops us from pitting town against town. For my colleagues in the Republican caucus to oppose this simply as a local-control issue is ludicrous because we have to realize that a lot of liberals live in the gold towns and hate us, and a lot of farmers making twenty grand a year and paying six of it in property taxes still form our constituency, but they're not going to vote for anybody if they lose their farm.

Despite the passage of H. 351 in the House, the Senate refused to vote it out of committee. Some House Democrats who supported the measure suggested that they would oppose any further compromise that did not include the income tax. No Republican I interviewed supported this plan, and several indicated that they would oppose income tax increases. One of the Democrats opposed to H. 351 explained its limitations:

> I'm against the so-called bipartisan compromise in 351 because it only puts horizontal equity on the table. In other words, we can't just make towns equal because you have rich people in poor towns and poor people in rich towns, and we need to get them to pay according to their ability to pay.

Unlike Michigan, where legislators saw political advantages to offering tax options to their constituents, or Oregon, where legislators had tax changes imposed on them by voters, Vermont does not have a referendum process. Most representatives recognized that this situation placed the burden for property tax reform squarely on the legislature and governor. Some found this advantageous, although most noted they could suffer the political fallout from the continuing tensions created by local property taxes and divided state government. Nonetheless, every legislator except one insisted that the legislature and governor would continue to seek compromises and solutions to the property tax problem into the foreseeable future.

Mississippi

Vermont's experience with taxes and education is in many ways similar to Mississippi officeholders' efforts to increase education funding via a 1992 sales tax increase. Legislators recognize that not all localities are capable of providing equal services when they rely on property taxes. Coincidentally, politics dictated that legislators could not increase income taxes even when they believed the services provided should be financed according to citizens' abilities to pay. The resulting compromises in Mississippi and Vermont have been bipartisan agreements to have the state shoulder more responsibility for education financing but to do so with sales taxes. In Mississippi, the legislature raised the sales tax from 6 to 7 percent, and Vermont delayed a one cent decrease in the sales tax rate and thus retained its 5 percent rate. In both states, principal proponents of the spending proposals indicated their preferences for income taxes as applications of the ability-to-pay principle. However, building the necessary support for these proposals necessitated compromising on the tax mechanism. Although Mississippi legislators increased sales taxes and Vermont legislators eliminated a sales tax cut, they did so in efforts to alleviate other tax inequities. State representatives contend with pressures not to compound federal income taxes, to treat localities fairly in providing services, and to raise revenue in the least politically objectionable manner.

Although both Mississippi and Vermont shifted to a greater reliance on sales taxes for education financing, there were substantial distributional differences for the citizens in each state. In Vermont, the delay of the sales tax cut implied only that citizens would not benefit from lower taxes and that no one would face a higher tax burden than already existed. In Mississippi, the rate increase would affect any citizen who made purchases. Moreover, Mississippi does not exempt food from its sales tax, and, consequently, its tax shift was more regressive than Vermont's. Furthermore, Vermont's delay of the sales tax decrease enabled it to fund programs designed to address and alleviate the regressivity of its local property tax burdens.[8]

New Jersey

In Vermont, Michigan, and Oregon, education-finance reform proceeded in those states' larger political and tax contexts. In New Jersey, the opposite has transpired. The politics of the income tax have stalled efforts to alleviate political and local problems created by property taxes. Politicians in both parties agreed that pursuing income tax reductions would encourage demands for property tax reforms but differed on the shape those reforms would take given the rejection of Governor Florio's addition of a progressive income tax in 1990 and Governor Whitman's commitment to reducing income taxes.

In the previous case studies, I have offered examples of states assuming greater responsibility for local schooling or debating how to do so. In New Jersey, the movement to cut state taxes offers further evidence regarding legislators' concerns for both overall (i.e., state and local) tax equity and service provision. Republicans and Democrats expressed concerns that Governor Whitman's tax proposals would lead to greater inequities in the state's already relatively high tax burdens. Nonetheless, Democrats saw little possibility of changing the course of taxes, and Republicans believed that for political reasons, they had no choice but to cut the income tax. Several Republicans noted the need for property tax reform but felt they could neither relent on their pledge to cut income taxes by 30 percent nor raise the sales tax. One senior Republican suggested legislation that would have introduced state-provided financial incentives to localities in return for keeping their property tax rates low. He explained,

> I've sponsored legislation that would check local and county school districts. It would indicate the property tax could not be raised more than the CPI [consumer price index] plus 1 percent. It's time school districts stopped buying their labor peace by these huge 6, 7, and 8 percent salary settlements. . . . The property tax incentive act would mean that if a community could maintain or reduce its property tax load, we would offer them additional state aid. And even in this year's budget I can find $14 million as an incentive to do that.

Facing simultaneous demands for lower property and income taxes, this legislator offered a compromise that would set New Jersey on a path similar to those in Vermont, Oregon, and Michigan—correcting inequities in the property tax with credits and reductions in the income tax. If other states' experiences are any indication, these remedies eventually become inadequate or ineffective, and they often generate unintended consequences. At best, these remedies postpone dealing with discrepancies among localities created by property taxes. In the case of this legislation, several opponents argued that only wealthy school districts with low tax rates and slack in their budgets would be able to meet the spending targets and draw down additional state aid, which could be used to lower property tax rates even further.

Several Democrats and two Republicans suggested that if calls for property tax relief became so loud that the assembly could neither ignore them nor blame localities for profligate local spending, raising the sales tax would be the best means of redress. Although no Republican seriously suggested doing so, several observed that raising the sales tax would provide more state money and allow Governor Whitman to keep her commitment to reduce income taxes. Nonetheless, several Republican leaders suggested two reasons for not doing so.

New Jersey's education finance has been under continual court review. Assembly members suggested that they would resist any tax changes as long as the courts found their progress toward education equality adequate. In the event that this progress slowed, however, the court could impose a funding solution necessitating a tax increase, and assembly members indicated that they wanted to retain the current 1 percent "slack" in the sales tax for just such a court order. As one assembly member said, "Most people just don't mind the sales tax. I've had constituents come up to me and say, 'Hey why don't you go ahead and put the penny back on the sales tax?' "[9]

The second reason had partisan political overtones. The Republicans wanted to resist any and all state tax increases to avoid giving Democrats the ability to claim that Republicans cut the progressive income tax for wealthy citizens and raised the regressive sales tax for poor citizens. One Republican explained the situation:

Assembly Member: I have to tell you I see no better alternative to the property tax. It's a very punitive and regressive tax, so certainly the state doesn't want to assume responsibility for it in some redistribution plan. But we've had to commit to reducing the income tax—the Republican majority has made that a priority. And if we went to raise the sales tax, the Democrats would scream that that's regressive, so we won't be doing that out of deference—or pragmatism, I guess, is more like it.

GB: Do you mean deference to the Democrats?

Assembly Member: Yes, well, I mean, we're not going to give them that weapon—it's not really deference—more like defense.

Other Republicans noted that the party's strategy had been calculated beginning with the 1991 midterm election, when the Republicans gained a two-thirds majority in both chambers of the legislature in the wake of Governor Florio's 1990 tax increase on both income and sales taxes.[10] Facing a veto-proof legislature, Governor Florio agreed to rescind the 1 percent increase in the sales tax rate in 1992 but left his income tax intact. Subsequently, Whitman campaigned against the governor's income tax increase during the 1993 campaign, and she won narrowly. Having captured the governorship and retaining majority control of both houses, the Republicans perceived their tax strategy to have worked and were reluctant to give Democrats the same campaign opportunity.

New Jersey illustrates how politics overlap in federal systems. Governor Whitman has campaigned for income tax reductions as a progrowth measure, yet local officials worry that any developmental benefits will be offset if they must increase local property taxes to meet the state's basic education standards. For some localities, the state tax changes and losses of state aid to education imply that they will be at a disadvantage in the limited politics of local government. For other localities, the loss of state assistance and pressure to raise property taxes may be offset by the benefits accruing to high-income individuals who will gain from a 30 percent reduction in their state income tax liabilities.

Discussion

The education studies produce four points. First, current taxes and tax rates influence the extent and content of legislative proposals for local property tax reform. Second, the mechanisms for changing taxes—legislative, judicial, and popular referenda—influence both proposals and collective decisions. Third, the current politics surrounding education may influence both the willingness of legislators to respond at all to calls for property tax relief and the extent of those responses. Fourth, many Republicans and a few Democrats who saw a need to address property tax inequities also believed a state solution implied that they introduce some mechanism by which to control local education costs, particularly salaries.

One Oregon legislator elaborated on the need for greater state control of locally administered education, given the increased role of state funding:

> On K–12 I think what's going to happen is that we have to move to a statewide salary schedule. . . . There is a perception right now that the unions have a stranglehold on communities, and that's unacceptable. . . . What's happened with teachers is that their settlements are compared across districts, but they're out of line with what's happening in the economy generally. If you look at personal income, Oregon is 10 percent behind the nation, but we're fourth in terms of what we pay teachers.

Legislators find themselves dealing with contradictory demands. Several Oregon legislators noted that they supported property tax relief and opposed a sales tax because not doing so would jeopardize their careers. At the same time, they admitted the difficulty of trying to govern when citizens demanded relief and the courts demanded equal schooling. These political pressures complicate the tasks elected officials face as they attempt to provide goods and services for their constituents.

The mechanisms for policy change—both within and outside legislative institutions—affected policy proposals and collective decisions. In Michigan, the legislature devised a scheme that ensured reform—indeed, necessitated it—and voters expressed their preferences for sales taxes over income taxes in overwhelming numbers. Oregon legislators continue to rely on economic growth and lottery revenues to satisfy demands for funding equalization without being able to impose new taxes, and they continued to respond to the confluence of popularly passed referenda that interacted to constrain both resources and policy choices. Underlying the referenda effects were court interventions monitoring Oregon's progress in achieving equal funding. In Vermont, divided control of the legislature has led to a situation in which legislators and the governor first compromised and agreed to a sales tax cut instead of an income tax cut and then postponed the sales tax rate reduction to meet demands for property tax relief.

Current political and economic conditions shaped representatives' willingness to address equity issues across localities created by school taxes. In New Jersey, the 30 percent income tax reduction necessitated that localities grapple with their own property tax situations. In the short term, it implied that some localities—those with relatively ample resources and low tax rates—would gain an advantage over other localities in pursuing development objectives.

In Michigan, Detroit politicians supported Proposal A in part because it lowered business and property taxes, although it raised the sales tax. In Vermont, legislators debated whether to raise taxes on towns that had benefited from growing tourism to help towns with more modest resources. Some legislators argued that doing so would cripple the state's economy, while others contended that it was the only way to provide education. Vermont representatives ultimately decided to use marginal sales tax revenues from a growing economy to address inequities in tax burdens and local school spending created by local school property taxes. In both Michigan and Vermont, the issues for local officials began with the willingness of the state to address education financing—an issue related to both development and distribution.

The question left open by school-finance reform was how it would change the long-term policy accountability of public education and the overall political accountability of state and local governments. Representatives in every state voiced concerns about a "disconnect" created by shifting financial responsibility from localities to states while retaining local administrative responsibility. In another vein, representatives worried that no longer dedicating property taxes to schools would decrease public support for schools as their funding became another line in state general funds subject to political and economic fluctuations for support.

In this chapter I have focused on the politics between states and localities. The political challenges for legislators were to find a less objectionable but still revenue-sufficient tax, to create greater equity in financing across school districts, and to retain or enhance the policy accountability of public education. Overall, representatives sought to defuse impending political and financial crises by finding a palatable tax for a relatively popular public good—primary and secondary education. In the next chapter, I examine federal-state relations by investigating how Medicaid spending has affected state legislators' views on a government redistribution program designed to benefit low-income citizens and how the avenue of federalism relevant to the program, federal matching grants, has shaped both the development of the political problems surrounding Medicaid and the reforms legislators debate.

Whereas problems with education financing revolved around taxes and local control shifting to state responsibility, state Medicaid crises have been driven by spending and by federal mandates to increase coverage and services. Whereas the political challenge with education was to find a tax that sustained public support for education, the challenge with Medicaid was to control costs and generate obscure revenues to abate public resentment for an unpopular benefits program.