

*TACIR staff renewed the search for an alternative model for equalizing education funding in response to a request from Governor Bredesen's Task Force on Teacher Pay by surveying information about models in other states. Not only would the information be good background, but it was reasonable to think that there were other states with local governments that operated schools and were fiscally similar to those in Tennessee with respect to how they funded education.*

*The methods those states used to equalize education funding could be a model for a new method for Tennessee. This brief is an expanded version of an appendix included in the October 2005 TACIR staff report "A Prototype Model for School-System-Level Fiscal Capacity in Tennessee: Why and How."*

## SEARCHING FOR A FISCAL CAPACITY MODEL

### WHY NO OTHER STATE IS COMPARABLE TO TENNESSEE

*by Harry A. Green and Stan Chervin*

Equalizing funding for public schools continues to be an issue in Tennessee. In the past few years,

- ♦ Tennessee's Supreme Court found the state's education funding scheme unconstitutional for the third time, focusing specifically on teachers' salaries,
- ♦ Governor Bredesen appointed a Task Force on Teacher Pay, which recommended changing to a system-level fiscal capacity model for equalization, and
- ♦ the Tennessee General Assembly asked the Basic Education Program Review Committee, appointed by the State Board of Education, to consider developing and implementing a system-level fiscal capacity model.

During the 2006 legislative session, the General Assembly directed the Review Committee to develop a consensus recommendation on a system-level fiscal capacity model. The General Assembly also established a summit to review Tennessee's entire public school funding scheme. Fiscal capacity has recently been discussed in conjunction with possible changes in the distribution to city and county governments of revenue from state-shared taxes and in the distribution of the local share of E911 funding. But the only major state aid program that is equalized remains funding for public elementary and secondary schools. Education fiscal capacity has long been determined at the county level even though 28 of Tennessee's 95 counties have more than one school system. Currently all school systems within each county are treated as though they have the same fiscal capacity per student.

If state funding for local education or any other local program were to be equalized at something other than the county level, how might it be done? Are there programs in other states that could be used as a guide? This question raises three threshold questions:

1. Are there other states in which public schools are operated by more than one type of local jurisdiction (county, city, or special school district)?
2. If so, do the local jurisdictions in such states differ in their fiscal authority and are any of them fiscally dependent for some of their school funding on other local jurisdictions?
3. Do these states equalize funding in a way that could be used as a model?

While the answer to the first question is “yes,” the answer to the second seems to be “no,” consequently, we never reach the third question. This brief explains why.

## BACKGROUND

Nationally, state funding for public elementary and secondary education has grown about as rapidly as total state spending. During fiscal year 2002, state intergovernmental aid to local school systems in the United States totaled \$217.5 billion, 83% more than in fiscal year 1992. Direct state general expenditures for all states combined grew at about the same rate.<sup>1</sup> The comparable figure for Tennessee is \$2.8 billion, 112% more than in fiscal year 1992. The state’s direct expenditures on public welfare, a category dominated by Tennessee’s medicaid program, grew 148%. The only

other major program that grew more than 100% during this period was higher education (106%). Much of the growth in higher education was financed by increases in tuition rather than increases in state appropriations. Other major state direct expenditure programs grew much more slowly, at rates of 68% or less. Expenditures for interest payments on general debt declined 2%.

The growth in state aid nationwide for public education is the result of a combination of (a) successful litigation by local school systems against some state governments and (b) deliberate, but wholly discretionary, attempts to improve education in other states.<sup>2</sup> The increased aid in most cases was designed to reduce educational inequalities that often resulted from uneven distributions across school districts of local taxable wealth per capita or per student. Uneven distributions in taxable wealth per capita typically result from uneven patterns of economic activity. Most states take these differences into consideration when distributing state aid for schools. Based on the outcome of lawsuits, some states are more successful than others. In all cases, the intent is to equalize funding and reduce variation in local education spending.

**Equalizing education funding is most challenging in states like Tennessee that have multiple types of school systems (county, city and special school districts) with complex local funding arrangements.** The simplest situation\* occurs in states with school districts that all have the same taxing

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\*Other than Hawaii, which funds public schools at the state level.



authority, generally the power to levy school property taxes. This is typical of independent school districts, which have their own taxing authority and are not dependent on other local governments for funding (either cities or counties). When all of the districts in a state are dependent on the same taxing authority, their ability to raise revenue can easily be measured and compared either using their per student tax bases or by applying statewide average tax rates to each district's tax base. Such states are not comparable to Tennessee and, therefore, cannot be used as models.

**Of the 15,014 public school systems in the United States in fiscal year 2002, nearly 90% were independent school districts.** The balance were state-dependent public school systems (178 representing 1.2% of the total), county-dependent public school systems (567 representing 3.8% of the total), and municipal- and town-dependent public school systems (763 representing 5% of the total).<sup>3</sup> In Tennessee, public education is provided by counties (93 systems),<sup>4</sup> cities (27 systems), and special (independent) school districts (15 systems).<sup>5</sup> Three of the 93 county systems are part of metropolitan forms of government (Davidson, Moore, and Trousdale Counties), which are hybrid governmental entities that are fiscally more like counties than like cities in how they fund schools. In each of these cases, there is only one school system in the county.

Local school finance in Tennessee is complicated in counties with more than one school system because of the fiscal interrelationships among those systems. With the exception of those in Gibson County, all cities and special school districts are partially dependent on county governments for funding and have tax bases that overlap the county tax bases. In this respect, even Tennessee's special school districts are not fully independent. **To be considered a model for Tennessee, a state would have to have more than one type of local jurisdiction funding public schools, the jurisdictions would have to have multiple sources of local revenue, and some would have to be fiscally dependent on other local jurisdictions to fund their schools.**

## FISCAL DIFFERENCES AMONG TENNESSEE SCHOOL SYSTEMS

School systems in Tennessee differ not only in their governance, but also in their powers to tax and to access other own-source local revenues, and in their statutory fiscal relationships with one another. **The result is a group of fiscal entities that in many ways are not comparable to one another and a state that is not comparable to any other state.**

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- the jurisdictions would have to have multiple sources of local revenue, and
- some would have to be fiscally dependent on other local jurisdictions to fund their schools.



## COUNTIES

County governments generally levy countywide school property taxes to support public education.<sup>6</sup> In some counties, supplementary specific taxes are imposed for school transportation or school debt or both. All Tennessee county governments also levy a countywide local option sales tax, with rates varying from a low of 1.5% in DeKalb and Johnson Counties to a statutory maximum of 2.75% in 35 counties.<sup>7</sup> State law earmarks half of all local option sales tax revenue for public schools. Counties may choose to use the remainder of the local option sales tax revenue collected in unincorporated areas to fund their schools. They may choose to use revenue from other county taxes to fund their schools as well.

If there are multiple public school systems in a county (city systems or special school districts in addition to the county system), all revenue raised by the county to fund schools must be shared on the basis of weighted<sup>8</sup> student attendance. There is some disagreement, but no case law on the issue of whether the statutory sharing requirement applies to revenue from state-shared taxes. It appears that most counties do so, and the University of Tennessee's County Technical Assistance Service advises them to. Federal revenue, such as TVA payments in lieu of taxes, does not have to be shared even if the distribution is through the state rather than directly from the federal government.

## CITIES

Cities may impose property taxes, but they generally do not specify a tax rate to fund their public schools. **They are not required to share revenue from their**

**tax levies with county governments, whether they spend it on education or for any other purpose.** In addition, cities receive a portion of the half of all local option sales tax revenue that is earmarked for education based on the number of students attending their schools. And they are allowed to spend the other half of the local option sales tax collected within their borders on anything they choose, including their own schools. Moreover, cities located in counties that do not impose the maximum local option rate of 2.75% may impose a higher tax rate that applies only to sales within the city limits, retain all of this additional revenue, and spend all or part of it on schools without sharing it with other systems. As of July 1, 2006, 20 cities impose local option rates that are greater than the rate levied by the county in which they are located.

## SPECIAL SCHOOL DISTRICTS

There are currently 15 special school districts in Tennessee.<sup>9</sup> Many of these systems were initially authorized in the early part of the 20<sup>th</sup> Century. In two counties (Carroll and Gibson), all the regular elementary and secondary education is provided by either special school districts or a city school system.<sup>10</sup> Special school districts are authorized by private acts to levy property taxes that apply only within the boundaries of the special school district. The revenue from these special district taxes are not shared with other school systems. **Like cities that operate schools, they share in all county education tax revenue, regardless of source, based on the number of students attending their schools.**



**METROPOLITAN GOVERNMENTS**

Tennessee now has three metropolitan governments: Nashville and Davidson County, Hartsville and Trousdale County, and Lynchburg and Moore County. To a large extent, these metropolitan governments have the same fiscal flexibility as counties in which there is only a county-run school system plus the additional flexibility that comes from being a city-county hybrid that has the taxing power of both entities and access to the state-shared tax revenues distributed to both.

**COMPARABILITY OF OTHER STATES TO TENNESSEE**

Obviously, to be comparable to Tennessee and provide a useful model for determining local capacity to fund public schools, a state would have to have school systems that are both fiscally diverse and fiscally interrelated. In other words, a state would have to have at a minimum two characteristics:

- ◆ at least two types of jurisdictions—in terms of their taxing authority—that fund public schools, and
- ◆ at least one type of school system that must share its tax revenue with at least one other type of school system.

**A review of public school systems in the United States provides a short list of states with a diverse set of jurisdictions responsible for public education, but no state’s public school funding scheme has the fiscal complexity of Tennessee’s.** Most of the 50 states have only one type of local jurisdiction operating school systems, typically independent school districts that all have the same taxing authority. Most of the remaining states rely solely on property taxes for local revenue. **All of the local jurisdictions in the states that rely on more than one source of local revenue have the same taxing authority. No state has jurisdictions that operate schools and share revenue with other school systems. Tennessee is unique in this respect.** No state is comparable, and no state can serve as a model for Tennessee to follow in developing a new way to equalize its education funding formula.

Here is why: based on information from the most recent federal Census of Governments that is conducted every five

- Most of the 50 states have only one type of local jurisdiction operating school systems, typically independent school districts that all have the same taxing authority.
- In most of the remaining states, schools rely solely on property taxes for local revenue.
- All of the local jurisdictions in states that rely on more than one source of local revenue have the same taxing authority.
- No state has jurisdictions that operate schools and share revenue with other school systems.
- **Tennessee is unique in this respect.**

years, public education in 36 of the 50 states is provided solely through a single type of school system. Those states fail to make it past the first hurdle: having school systems that differ in their fiscal structure. They never reach the second hurdle: having fiscally interrelated school systems like those in Tennessee.

That leaves 13 states (not counting Tennessee) with more than one type of jurisdiction responsible for education, only two of which—Alabama and Virginia—border Tennessee:<sup>11</sup>

- Alabama (128 independent school districts operated by cities and counties)
- Alaska (13 county [borough] systems, 22 municipal systems, and 19 state systems)<sup>12</sup>
- Arizona (231 independent school districts and 14 county systems)
- California (1,047 independent school districts, 59 county systems, and 1 municipal system)
- Connecticut (17 independent school districts, 19 municipal systems, and 129 town or township systems)
- Maine (99 independent school districts, 17 municipal systems, and 178 town or township systems)
- Massachusetts (82 independent school districts, 2 county systems, 44 municipal systems, 201 town or township systems)
- Michigan (580 independent school districts, 9 municipal systems, and 150 state systems)<sup>13</sup>
- New Hampshire (167 independent school districts, 1 county system, 9 municipal systems)

- New Jersey (549 independent school districts, 50 county systems, 18 municipal systems, and 4 town or township systems)
- New York (683 independent school districts, 25 county systems, and 7 municipal systems)
- Rhode Island (4 independent school districts, 7 municipal systems, and 24 town or township systems,<sup>14</sup>)
- Virginia (1 independent school district, 94 county systems, and 38 municipal systems)

But are the school systems in these states really different in terms of their fiscal structure? Do they share local funds? And if so, does the state actually consider these differences when distributing state education funds to them? Unless the answer to each of these questions is “yes,” these states are not comparable to Tennessee and should not be used as a model for a fiscal capacity formula to equalize school funding across the state. The answers for the short list of states with more than one type of local jurisdiction that operates public schools are summarized in the following table.<sup>15</sup>

Column (1) in this table indicates the types of school systems identified in Table 12 of the *2002 Census of Governments*. Column (2) combines the results of two separate determinations:

- is there more than one type of school system in the state, and
- if so, do the different types of school systems identified have different fiscal authority.



## Summary Data for Other States with More Than One Type of School System

State	Types of School Systems (a)	Different Systems and Different Fiscal Authority	Capacity Measure Used	Major Own-Source Revenues Considered (b)	Other Minor Revenue Available (b)
(1)	(2)	(3)	(4)	(5)	
Alabama	C,M	N	Y	P	S
Alaska	M,B,S	N	Y	P	S,NT
Arizona	I,C	N	Y	P	N
California	I,C,M	N	N	NA	NA
Connecticut	I,M,T	N	Y	P	N
Maine	I,M,T	N	Y	P	V
Massachusetts	I,C,M,T	N	Y	P	M,H
Michigan	I,M,S	N	Y	P	N
New Hampshire	I,C,M	N	Y	P	N
New Jersey	I,C,M,T	N	Y	P	NT
New York	I,C,M	N	Y	P	S
Rhode Island	I,M,T	N	N	NA	NA
<b>Tennessee</b>	I,C,M	<b>Y</b>	<b>Y</b>	P,S	State-shared Taxes
Virginia	I,C,M	N	Y	P,S	Other

Source: "2002 Census of Governments" and individual state data.

- Notes (a) Types of school systems: I = independent school district, C = county system, M = municipal system, T = town or township system, S = state school, B = borough system.
- (b) Major own-source revenues: P = property taxes, S = sales taxes, I = income tax, V = annual vehicle excise tax, H = hotel motel taxes, NT = non-tax revenue, Other = state reimbursement payments for phased-out local vehicle property taxes. NA = not applicable because fiscal capacity not a consideration in distribution of funds.

In some cases, the determination is based on detailed information obtained from each state indicating that, in fact, public education is provided by only a single type of school system, and the Census data is misleading. This is true in several states where some independent school systems are actually a combination of several cities or towns that join together to provide education. In others, they are legal entities that do not actually provide education, but merely pay tuition for students (generally in small towns or cities) to attend actual school systems operated by neighboring localities. Based on this column alone, no states are comparable to Tennessee.

Column (3) indicates the presence or absence of some type of local capacity measure in a state's school-aid program. **All but two states in the list use some measure of local fiscal capacity in establishing the distribution of state aid to local school systems.** Column (4) indicates the type of taxes or revenues that are specifically considered in each state's calculation of school system fiscal capacity. **In most states in which fiscal capacity plays a role in state aid calculations, only property wealth is considered.**<sup>14</sup> Column (5) indicates any other minor revenue sources that are available to school systems, regardless



of whether they are considered in a state's formal measure of fiscal capacity.

Based on this information, no other state has the variety of school system types in combination with the complex fiscal powers and interrelationships among school systems that exist in Tennessee.

## NOTES

<sup>1</sup>Direct general expenditures include those made by the state itself for public welfare, higher education, highways, health and hospitals, interest on the state general debt, corrections, and other programs. They do not include state intergovernmental aid to local governments.

<sup>2</sup>Successful school finance cases occurred in nineteen states between 1971 (*Serrano* case in California) and 1998 (*Abbott v. Burke* in New Jersey). Source: Wallace E. Oates (2001), p. 214.

<sup>3</sup>U.S. Census (2002), Table 12.

<sup>4</sup>U.S. Census data (for 2002) categorizes Metropolitan Nashville-Davidson County, Metropolitan Hartsville and Trousdale County, and Metropolitan Lynchburg-Moore Counties as cities, but they are treated as counties in the state's public education funding formula. Carroll County provides transportation and some vocational education services only, while Gibson County provides no public education.

<sup>5</sup>The school system in Memphis is legally a special school district, not a city school system; however, unlike the other fourteen special school districts, it has no independent taxing authority. The city of Memphis provides funding for the school system from property tax revenues.

<sup>6</sup>County governments are not required to levy education property taxes if all students are eligible to be served by either a city or special school district; TCA 49-2-501(b)(2)(C).

<sup>7</sup>As of July 1, 2006.

<sup>8</sup>For example, students in vocational classes are given more weight in the calculations than those in regular instruction because vocational classes are more expensive.

<sup>9</sup>Includes the Memphis school system, which is mistakenly classified as a city school system by many; however, unlike the other fourteen special school districts, it has no independent taxing authority. The city of Memphis provides funding for the school system from city property tax revenues.

<sup>10</sup>The Carroll County school system provides some vocational education and all public school transportation. There is no Gibson County school system, but a special school district bears the same name.

<sup>11</sup>The Census of Government indicates that only Mississippi and Virginia have more than one type. However closer inspection reveals that almost all K-12 public education in Mississippi is provided by independent school districts, all with similar taxing authority. And while the federal data indicates that Alabama has only special school districts, closer review shows that many of those special school districts were created by cities or counties and are fiscally dependent on them. This complexity makes Alabama a more useful comparison.

<sup>12</sup>The state systems in Alaska serve students in politically unorganized, generally rural areas of the state.

<sup>13</sup>Michigan has 150 public state university authorized charter schools.

<sup>14</sup>Texas and Wisconsin are serviced predominantly by independent school districts with the exception of one system in Texas and two systems in Wisconsin. They are excluded from this list. Data source: *U.S. Census (2002)*, Table 12.

<sup>15</sup>Several states have state-dependent schools systems (vocational, special systems, or charter school systems) in addition to the various local systems common in all states.

<sup>14</sup>This follows directly from the fact that in most cases, local school district taxing authority is limited to property taxes only.



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## Tennessee Advisory Commission on Intergovernmental Relations (TACIR)

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- Analyze the functions of local governments and their fiscal powers,
- Analyze the pattern of local governmental structure and its viability,
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- Publish reports, findings and recommendations, and draft legislation needed to address a particular public policy issue, and
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