



School-Budget Voters Are Minding Their Own Purse Strings

Acts 60 and 68 Encourage Moderation

by Deb Brighton and Jack Hoffman

Vermont's education funding system was created just over a decade ago to correct what the state Supreme Court called "the gross inequities in education opportunities." Those inequities enabled communities with lots of property wealth to keep tax rates low and per-pupil spending high. Meanwhile, some towns with much less property wealth had the highest tax rates in the state but also the least amount to spend on their students.

That all changed with the passage of Act 60 and Act 68. The funding system is now a statewide system, and Vermont has largely succeeded in eliminating the disparities caused by differences in property wealth, as the Supreme Court ordered. Vermont now has, in the words of Vermont Education Commissioner Richard Cate, "the most equitable [funding] formula in the country."¹

But has Vermont moved toward equity by promoting irresponsible spending? Does the system encourage some communities to vote higher budgets because they know the bulk of the money will come from taxpayers in other towns? Do the towns that benefit the most from Act 60 — that is, get the best return on their homestead tax dollar — also spend the most? Are lower-income taxpayers driving up spending and shifting the burden onto those who are better off?

These are some of the questions that have hung over Act 60 since its passage in 1997. The Public Assets Institute researched these questions to examine some of the changes that have occurred since the new funding system was adopted and to see if Vermonters were taking advantage of their better-off neighbors.

Despite the seeming advantages to gaming the system, we found no evidence that it is happening. In fact, there are strong disincentives against it.

Here are the major findings of our research and analysis:

- ***Towns that get more do not spend more.*** In fiscal 2008, there was a negative correlation between a district's return from the Education Fund and its per-pupil spending. On average, the more a town received compared with what it paid in, the lower its per-pupil spending.
- ***The consequences of higher spending fall on the people who approved that spending.*** When a town chooses to increase per-pupil spending, the tax consequences are, on average, more than 200 times greater on the homestead taxpayers in that town than on property taxpayers in other towns.
- ***High per-pupil spending was linked to high resident income.***² Towns with more high-income residents voted higher school budgets than those with lower-income residents.

Individually, these findings dispel some of the myths that have sprung up around Act 60. Taken together, they paint a consistent picture of what motivates Vermonters when they vote on their local school budgets. How much money comes out of each voter's pocket appears to be the principal factor in their decision-making, not how much money comes from the other communities through the Education Fund. And individuals' ability to pay is still a hurdle to equal educational opportunity, as it was in the past.

Even before Act 60, it was evident that taxpayers responded to tax rates. Districts with low rates tended to have high per-pupil spending, and the low-spending districts were the ones with the high rates. Our research suggests that tax rates still matter most, and that taxpayers vote for the rates they feel they can afford. With Act 60 and Act 68, the more a district spends per pupil, the higher the tax rate. That appears to be a deterrent to high spending in towns with less relative income. In communities where incomes are higher — that is, where people can afford to pay more — tax rates tend to be higher.

How the system works

Money in the Education Fund comes from three primary sources: residential or “homestead” taxes, which can be based on personal income or property values; non-residential property taxes; and support from the state’s General Fund. Additional funds come from one-third of the sales tax, the state lottery, and miscellaneous other revenue. In fiscal 2008, 38 percent of the money came from taxes on non-residential property, 24 percent from homestead taxes (income-based and property-based), 23 percent from the General Fund, and the remaining 15 percent from the other revenue sources (**Figure 1**). Total revenue to the Education Fund was \$1.24 billion in fiscal 2008.

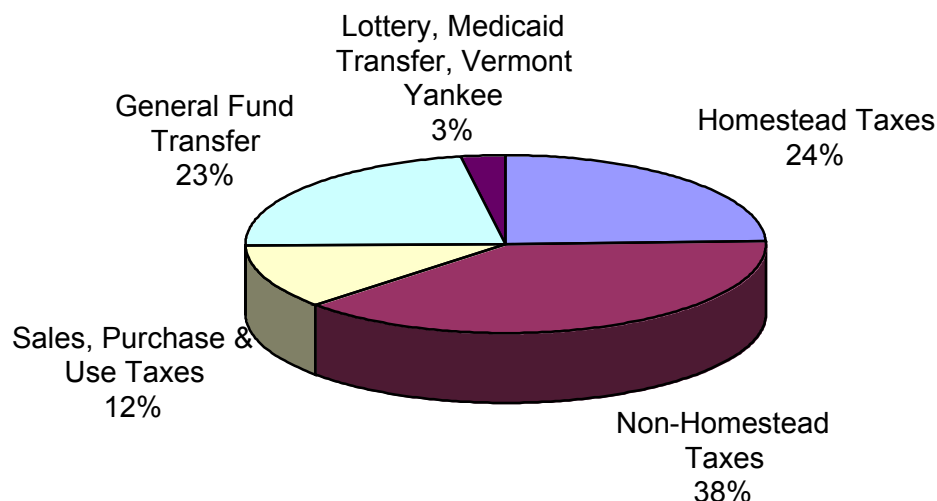
The tax rate for non-residential property is fixed in statute, and there is one uniform rate throughout the state. The money going from the General Fund, the sales tax, lottery, and miscellaneous revenues into the Education Fund is determined by formulas set in statute.³

Homestead taxes — that is, the school taxes local residents pay on their primary homes and some or all of the surrounding property — are different. Unlike all of the other Education Fund revenue sources, local voters have control over the homestead tax rates, which can vary from town to town. Homestead tax rates are determined by per-pupil spending, which is based on the budget approved by voters each spring. The more a community spends per pupil, the higher its homestead tax rates.

However, all communities with the same level of spending per pupil have the same homestead tax rates. This is one of the key features of Act 60 and Act 68. It is the mechanism that has helped to reduce the disparities between property-rich and property-poor towns. It also is the mechanism in the system that encourages voters to moderate their spending.

Homestead taxes can be based on income or property value. The homeowner can choose the method that results in a lower tax bill. In 2007, about 65 percent of homestead owners received an income-based adjustment

Figure 1. Education Fund Revenue Sources, FY 2008



Source: Vermont Department of Education, Public Assets Institute

to their school taxes.⁴ Through this mechanism, commonly known as “income sensitivity,” Act 60 and Act 68 have eased the burden of property taxes for Vermonters.

Whichever method is chosen, the rates are the same for residential homeowners in towns with the same level of per-pupil spending. Similarly situated taxpayers will have the same tax rates and tax bills regardless of whether their school district gets back \$2 or \$10 for every \$1 their homestead taxpayers pay into the Education Fund.

In fiscal 2008, for example, any family paying homestead taxes based on \$50,000 of household income, living in any town with \$10,000 in per-pupil spending, paid \$1,163 in school taxes on its home and up to two acres of land.⁵ And any family paying property taxes on a \$200,000 homestead, and living in any town with \$10,000 in per-pupil education spending, paid \$2,249 in school taxes.⁶ Tax rates vary with per-pupil spending, not with the return the community gets from the Education Fund.

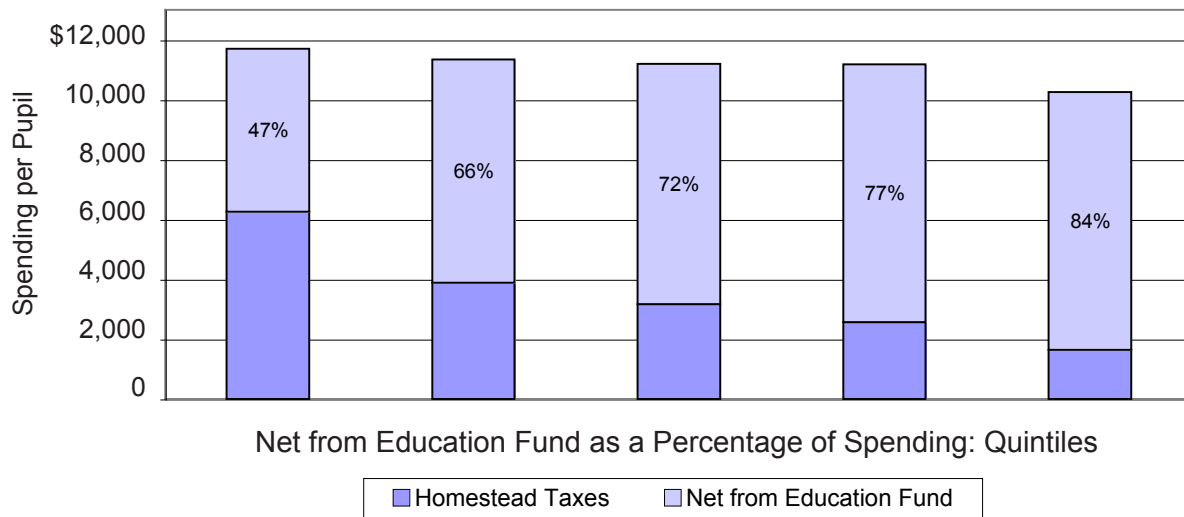
The state sets a base rate for both the homestead property tax and the income-based tax. Local voters then can choose to increase per-pupil spending above a base amount that also is determined by the state. Increasing per-pupil spending in a town increases that town’s tax rates.

Towns that get more don’t spend more

We investigated whether the towns that had the highest return on their tax dollar spent the most per pupil — to see if towns were “gaming” the system. You might think — and some people have speculated — that the greater a district’s return, the greater the incentive to spend. This theory follows the rationale that some shoppers adopt at sale time, which is that the more they spend, the more they save. According to our analysis, this isn’t happening with taxpayers (**Figure 2**).

We looked at the homestead taxes paid by people in each district. This included the taxes paid by people

Figure 2. Education Spending and Return from Education Fund, FY 2008



Sources: Vermont Department of Education, Vermont Department of Taxes, Public Assets Institute

Figure 2 shows the relationship between towns’ per-pupil spending and their net return from the Education Fund. The towns were ranked according to their percentage return from the Education Fund and divided into quintiles (five equal groups of about 50 per group). The height of each bar represents average per-pupil spending for each quintile. The bottom part of each bar represents the portion of spending generated from homestead taxes, and the top part of each bar shows the net amount from the Education Fund. The towns with the lowest percentage return from the Education Fund (shown in the first bar) spent the most per pupil in fiscal 2008. Those with the greatest percentage return from the Education Fund spent the least.

who qualified for an adjustment based on their income, as well as all homestead property taxes. We focused our analysis on the homestead tax because local voters have control over the rate.

As a measure of a community's return on its tax dollar we compared these homestead taxes paid into the Education Fund to the district's total education spending to determine the net benefit from the Education Fund.

All but one school district in fiscal 2008 got back more from the Education Fund than the homestead taxes residents paid in. The returns varied from district to district. On average, towns got back \$1 for every 31 cents in homestead taxes paid in, for a net gain of 69 cents. The highest return was \$1 for every 11 cents paid in. Even the towns of Dorset, Stowe, and Charlotte, where voters' incomes and property values are high, got back at least 20 percent more than they paid in.

Why taxpayers don't 'game' the system

In order to increase their "take" from the Education Fund, local voters would have to increase the per-pupil spending in their town. But by increasing per-pupil spending, they also increase their own tax bills. Every resident's homestead tax rate is determined by the district's per-pupil spending. From town to town, homestead taxpayers with the same level of per-pupil spending have the same equalized tax rates, regardless of whether the town gets a big return or a small return from the Education Fund.

Communities that get back the most from the Education Fund, compared with what their homestead taxpayers pay in, tend to be poorer.⁷ The data show that in fiscal 2008 these communities tended to spend less than towns with higher-income residents even though they were getting a better "return" on their tax dollars. That is consistent with our other finding about the link between spending and family income. If it were true that Act 60 and Act 68 created an incentive to spend more in districts that get more, we would expect to see the highest per-pupil spending in districts that get the biggest return on their tax dollar and the least spending where the return is smallest. The opposite was true.

Tax increases hit hardest at home

Act 60 and the Education Fund created a relationship among school districts that hadn't existed before. Prior to Act 60, local spending decisions had only local tax consequences. Now Vermont has a dynamic funding system. Everyone pays into same pot, the Education Fund, and everyone draws from it. The actions of one district have an effect on all the others.

How much districts affect one another has been a source of speculation since the passage of Act 60 — and later Act 68. Some people have worried that there is a big ripple effect when spending goes up in districts that get a high return on their homestead tax dollars. The Public Assets Institute decided to examine this effect.

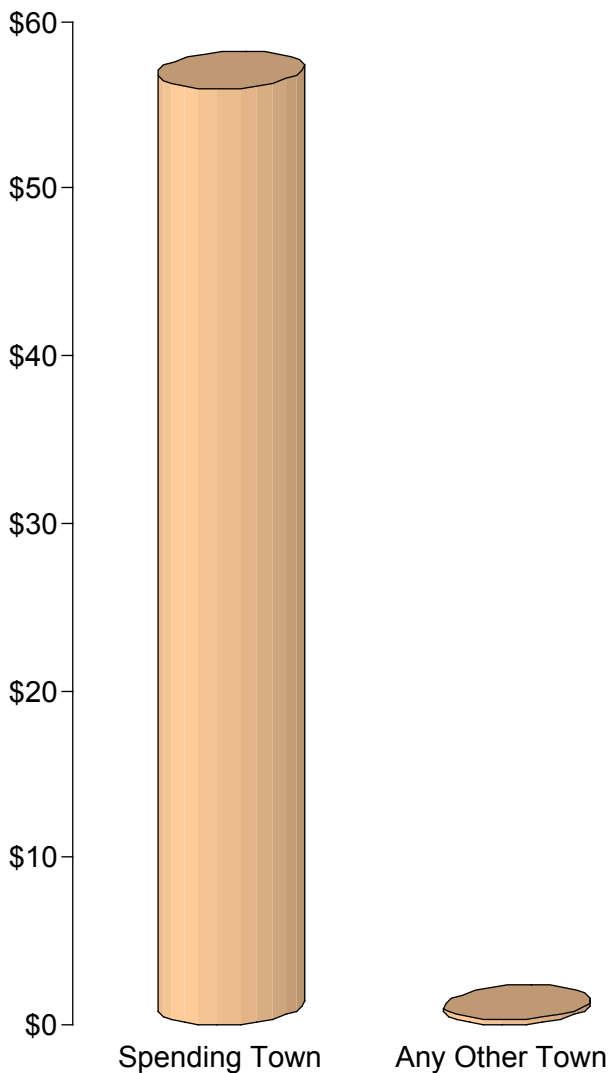
For the analysis, we started with budgets approved for fiscal 2008. Then, one by one, we looked at what would have happened if each district had increased spending by \$500 per student. We calculated the tax effect in all other towns on property valued at \$100,000. Our analysis produced two important findings:

- *A \$500 per-pupil spending increase in one community barely registered in the others.*
- *The tax effect of the \$500 increase on a local homestead taxpayer was more than 200 times that on a taxpayer in another town.*

Once again, despite the conventional wisdom suggesting that Act 60 and Act 68 encourage voters in poor towns to take advantage of their richer neighbors, our analysis shows there are strong disincentives built into the funding system that moderate against runaway spending.

Our research shows that if a town increased spending by \$500 per pupil, in most cases, the tax increase in other communities would be measured in pennies. When we calculated the average effect, a \$500 increase in per-pupil spending in one town would increase taxes by 25 cents in other communities on each \$100,000 of property value (**Figure 3**). That's a 25-cent increase in the tax *bill*, not the tax *rate*.

Figure 3. Tax Effect of \$500 Increase in Per-Pupil Spending on \$100,000 Homestead, FY 2008



Sources: Vermont Department of Education, Vermont Department of Taxes

Figure 3 shows the effect of a school spending increase on a taxpayer in the town that increased its spending and the effect on a taxpayer in another town. The tall column represents the tax increase on a \$100,000 homestead for a resident in an average town that increased its spending by \$500 per pupil. The other column represents the effect of this average town's spending increase on a \$100,000 property in another town.

Meanwhile, homestead taxes in the town that decided to increase spending would go up substantially more. For each \$100,000 of homestead value, taxes would increase \$56 for local homestead property taxpayers. For those who qualified for an adjustment based on income, their taxes would go up \$58 for each \$50,000 of household income. For one town to cause a significant tax increase in other communities, voters would have to impose a crushing burden on local homestead taxpayers in their own town.

To the extent that the actions of one town do affect others, the number of students in the district hiking taxes is a bigger factor than whether the town is getting a good return on its homestead tax dollars. A district with 1,000 students, even a wealthy one, has a greater effect than a small school district that is getting a high return from the Education Fund.

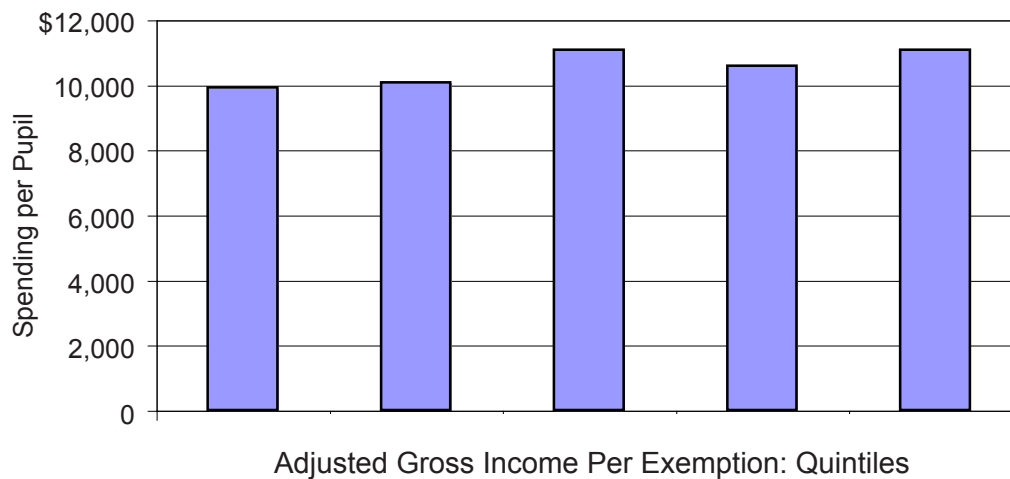
There is another mechanism designed to discourage communities from letting the spending get too far out of line. While there is no limit on how much a town can spend, exceeding the state average per-pupil spending accelerates the rise in homestead taxes for local residents. In effect, every \$1 of spending above the threshold is counted as \$2.

Higher income linked to higher budgets

Act 60 and the refinements that came a few years later with Act 68 have largely succeeded in correcting the inequities in school spending that are caused by disparities in property wealth from town to town. Nevertheless, our analysis found that towns where residents have higher incomes are spending more than towns with lower-income residents.

We ranked school districts according to income⁸ and compared their per-pupil spending. The data showed, on average, that the greater the district's income, the higher its per-pupil spending.

These findings reinforce the findings depicted in Figure 2. Figure 4 shows the positive correlation between spending and income. Figure 2 shows a negative correlation between spending and the return on homestead tax dollars from the Education Fund. Together they suggest that affordability is an important factor for voters and that people approve tax rates they feel they can afford.

Figure 4. Spending Per Pupil by Income, FY 2007

Sources: Vermont Department of Education, Vermont Department of Taxes, Public Assets Institute

Figure 4 shows the relationship between spending and income. Income data are for tax year 2006, (the year in which fiscal 2007 school taxes are paid), and per-pupil spending is for fiscal 2007. The towns in the 1st quintile had the lowest adjusted gross income per exemption; those in the 5th quintile had the highest income per exemption. Although towns in the 3rd quintile spent nearly as much, on average, as the towns in the top quintile, the data reveal a statistically significant correlation between increased spending and higher incomes.

Conclusion

Act 60 has been suspected of driving up education costs by creating incentives for some voters to spend more money. The theory has been that if a community gets back more money from the Education Fund than it pays in homestead taxes, residents will try to increase their return. Our analysis of spending patterns does not support that theory. There was no correlation between high per-pupil spending and getting a higher return from the Education Fund.

Under Act 60, there are tax consequences when voters increase per-pupil spending. Those consequences appear to outweigh any theoretical community benefit to spending more money. There is no incentive for a community to increase its spending in order to shift costs onto those outside the community. In fact, there is a strong reward built into the system to restrain spending — lower taxes.

Finally, Acts 60 and 68 have reduced disparities related to differences in property wealth among towns. This does not mean that all towns or taxpayers — and, consequently, the educational opportunities of all Vermont schoolchildren — are now equal, however. In spite of systemic tax-rate equity, higher-income citizens are still voting higher school budgets, spending more per pupil. Challenges remain in crafting policy that most effectively reduces the inequities facing Vermont's taxpayers and their children.

Methodology

To calculate the net return from the Education Fund and its relationship to spending, fiscal 2008 data on the net homestead school tax collected from each town were compared with the total amount the town received from the Education Fund. A ratio of the net homestead school tax to the total amount received from the Education Fund was created for each town.

To understand the effect that increasing school spending in one town would have on tax bills in all towns, the net homestead school tax and the amount received from the Education Fund were recalculated for each town with the assumption that the town increased its spending by \$500 per pupil. It was assumed that the resulting net cost to the Education Fund would result in an increase in the base tax rates, and this increase was calculated.

To examine whether towns getting higher returns from the Education Fund were spending more per pupil, per-pupil spending was correlated with the return ratio. We found that the towns with a lower return on their tax dollar actually spent more per pupil in fiscal 2008. The Pearson Correlation coefficient was -0.309, and the probability was 0.00% that the relationship could have occurred by chance.

To examine the relationship between income of residents and school spending, we correlated fiscal 2007 spending per pupil with 2006 adjusted gross income per exemption in the town. There is a statistically significant relationship between these measures: the higher the income, the higher the spending. The Pearson Correlation coefficient was 0.341, and the probability was 0.00% that this relationship could have occurred by chance.

END NOTES

¹ “School Funding Gap Grows, Report Says,” Burlington Free Press, Jan. 18, 2008.

² The income measure used is average adjusted gross income per exemption, as reported by the Vermont Department of Taxes in its annual report on personal income tax returns by town for tax year 2006. This measure approximates income per family member. It is one consistent measure of income compiled each year by the Tax Department that provides a means of comparing towns with one another.

³ 16 VSA § 4025. Education Fund

⁴ Vermont Division of Property Valuation and Review, Annual Report 2008, “Property Tax Reduction Payment Summary,” p. 103.

⁵ Household income, as defined for Act 60 and Act 68, falls between gross income and adjusted gross income. It excludes Social Security and Medicare taxes, but includes certain income that may be deducted on state and federal income tax returns. The income of all occupants of the household must be included.

⁶ The property values used here are “equalized property values” calculated by the Vermont Division of Property Valuation and Review. Equalized values are adjusted from values listed by the towns and reflect the state’s current estimate of fair-market values.

⁷ Measured by average adjusted gross income per exemption.

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