ONE PAGE SUMMARY

SUMMARY

In this report, we present an analysis of the relationship between K-12 **revenue composition**—e.g., how much of total revenue is from state versus local sources—and the adequacy, equity, and stability of education spending. Our results suggest that greater reliance on state revenue over local revenue is associated with more adequate and equitable funding, but larger state "shares" may also create more volatile funding year to year. We offer some recommendations for how states might recalibrate their revenue "portfolios," including policy proposals that exploit the strengths and weaknesses of both state and local revenue.

WHY DOES REVENUE COMPOSITION MATTER?

Most debates about K-12 school funding rightfully focus on how much states and districts spend and whether it is distributed fairly. There has been comparatively little attention paid to where that money comes from, even though two states with virtually identical finance systems and student populations that spend the same amount might achieve very different adequacy and equity outcomes depending on the composition of their revenue.

This is because, first, money from different sources tends to be distributed differently. Specifically, state revenue, mostly from sales and income taxes, is typically "pooled" statewide and allocated based on district need (e.g., poverty) and revenue-raising capacity (e.g., wealth). In contrast, local revenue, mostly from property taxes, usually stays where it is collected. Insofar as states that rely more heavily on state revenue will have a proportionally larger pool of funds to target where they are most needed, we predict that larger state "shares" will be associated with more adequate and equitable funding.

At the same time, however, the types of taxes that usually constitute state and local revenue differ in their stability (or volatility) over time. In particular, sales and especially income taxes, which constitute most state revenue, are substantially more volatile year to year than the property taxes that fill local revenue coffers. Accordingly, we anticipate that greater reliance on state over local revenue will be associated with more volatile K-12 funding. This is important because volatility can not only generate massive funding shortfalls in economic downturns, but it can also complicate budgeting and hiring processes even in relatively "normal" economic times. And both of these problems are particularly severe in higher-poverty districts.

ANALYSIS AND RESULTS

We estimate regression models with a panel dataset that spans two decades (1998-2020). Our adequacy and equity outcomes are estimates (2009-2020) from the first national cost model to yield student output-based adequacy estimates in virtually all states. And we use three separate measures that capture different forms and patterns of spending stability/volatility between 1998-2020. Our analysis yields three major findings:

1. Increases in the share of state revenue over time (within states) are associated with increases in statewide adequacy. That is, as reliance on state revenue goes up over time, the percentage of students in districts with adequate funding also tends to go up.
2. Larger state shares are associated with more equitable spending (i.e., more equal educational opportunity). States that rely more heavily on state over local revenue exhibit smaller gaps in adequacy between their highest- and lowest-poverty districts.
3. Larger state shares, however, are also associated with more volatile funding. When states get more of their K-12 revenue from state versus local sources, their spending tends to dip and jump more over time.

RECOMMENDATIONS

State revenue is the great equalizer in school finance and should be a large share of total funding. But proposals to replace local property taxes mostly or entirely with state income and sales taxes as the sources of K-12 revenue may be addressing one problem (inequity) while creating another (volatility) that is also of particular concern to higher-poverty districts. We therefore recommend, most generally, that states avoid overwhelming reliance on either state or local revenue, and that they consider composition when evaluating or reforming their systems.

Second, and more concretely, we offer possible approaches to revenue portfolio recalibration that exploit the strengths of both state and local revenue while avoiding their downsides. These proposals include "redistributing the stability" of local property taxes (e.g., state taxation of commercial and industrial property) and "stabilizing the redistributive impact" of state revenue (e.g., expanding the state sales tax base in a progressive or "progressivity-neutral" manner).

- Read the full report
- Use the accompanying online data visualization tool to view your own state's "revenue portfolio"

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