

Demystifying School Funding in Indiana

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EDITOR'S NOTE

Terry Spradlin, Associate Director for Education Policy

By most accounts, the method used to determine the allocation of tuition support to public schools in Indiana is a complex endeavor understood by few. Governor Mitch Daniels and policymakers are publicly calling for a simplified funding process that provides transparent goals that Hoosier citizens can fully comprehend. As state leaders embark on this challenging policy discussion, a common level of understanding is necessary and many key questions must be addressed in the process, including:

- *How does the school funding formula presently work to fund schools?*
- *What are the revenue sources for schools and how are these revenues expended?*
- *What are the objectives of the formula and are those goals being met?*
- *What are the issues that must be addressed during the 2005 session of the Indiana General Assembly concerning the formula to maximize funding efficiencies?*

To help demystify the complexities of the school funding formula in Indiana, this Policy Brief will address these questions and issues head-on. Since 1999, CEEP

staff has been commissioned by the state to study, research, and evaluate the state's school funding system. In hopes of broadening the understanding of how school funding in Indiana works, we have devoted the expertise of the Center to tackling this informational need. Furthermore, CEEP invited state Senator Luke Kenley and Superintendent Pat Pritchett, Indianapolis Public Schools, to share their perspectives on the financial needs of public schools that must be addressed during the 2005 legislative session. Their perspectives are shared on pages 6-8 and illustrate significant differences in school funding philosophies. We hope you find this Policy Brief informative.

THE SHAPING OF PUBLIC SCHOOL FINANCE IN INDIANA

Individual states have a long tradition of providing financial support for their K-12 public schools. The rationale for this support is based on each state's constitutional requirement to provide educational opportunity for its citizens. Although "[a]ll fifty state constitutions contain an education clause designed to establish some form of education system" (Jensen, 1997, p.1), the states vary widely in both the amount of funding provided to public schools and the distribution of funding among schools (Park, 2004).

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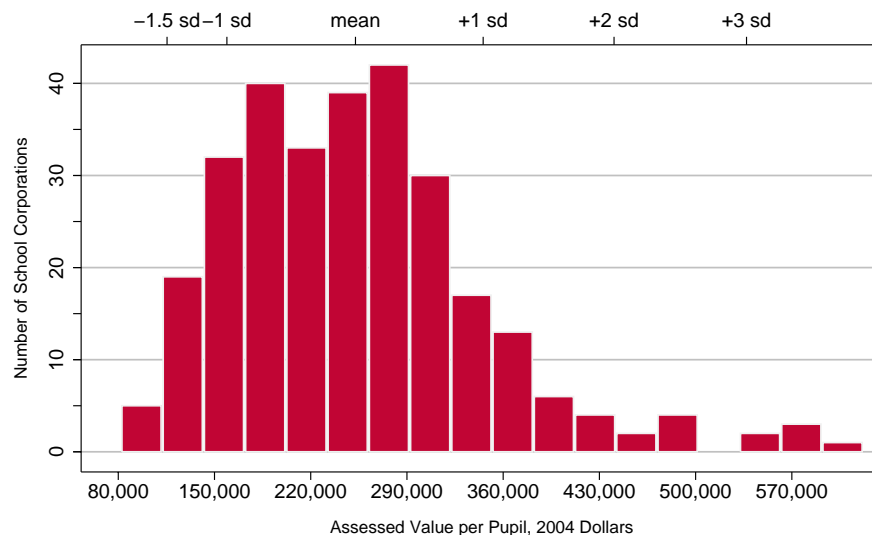
The fundamental phenomenon underlying discussions of school finance is that communities vary in the amount of wealth they possess, and that community wealth affects the financial resources available for supporting K-12 education. The most frequently used indicator of community wealth in discussions of education funding is the assessed valuation of individual and business property within the community. Because communities vary greatly in the amount of taxable property per pupil, significant variations exist across communities in the amount of dollars that could be raised for supporting school corporations.¹

The variations in taxable property per pupil are displayed graphically in Figure 1. While two out of three school corporations have taxable property per pupil that falls between \$159,026 and \$345,449, the distribution is skewed with a few corporations having very high assessed property values per pupil. The concern among policymakers is that communities with low assessed value per pupil have difficulty raising sufficient dollars to provide an adequate education for their citizens.

Dating back to 1949, Indiana has used a *Foundation Program* to provide funding for public school corporations, although the details of the Foundation Program have changed dramatically over time. Generally speaking, in a Foundation Program the state guarantees school corporations a specific amount of per-pupil funding for education, which is known as the *foundation level*, provided that the school corporation raises a designated share of dollars through local property taxes (Augenblick, Fulton, & Pipho, 1991).

Over the past 55 years, Indiana has made several changes in its Foundation Program that have produced a significant reduction in the portion of dollars from local sources and increased the portion of dollars from state-level sources. These changes were designed to: a) eliminate the traditional dependence of per-pupil funding on property wealth per pupil, b) reduce variability in per-pupil funding

Figure 1. Distribution of Assessed Valuation per Pupil, 292 Indiana School Corporations, 2004



across school corporations, c) increase per-pupil funding, and d) reduce variability in property tax rates across school corporations.²

Perhaps the most important recent changes in Indiana’s Foundation Program occurred in 1993. In this year the General Assembly made several modifications to the state’s Foundation Program. As a result, the modified program:

- Continued the bottom up equalization of setting a minimum expenditure per-pupil target for each corporation;³
- Specified that local property tax rates should be the same for school corporations with similar levels of expenditures;
- Mandated that property tax rates could not exceed specified ceilings; and
- Allowed the foundation level per pupil to be adjusted upward for school corporations with lower socioeconomic status.

More recently, the focus of school finance discussions has shifted to the question, “Do school corporations receive an adequate level of regular education per-pupil dollars to enable them to provide students the opportunity for an adequate education?” (Augenblick et al., 2004).

This debate has acquired greater significance due to the recently enacted *No Child Left Behind* act and the state’s accountability law, P.L. 221.

Sources of Dollars. Public school corporations generate almost no money by themselves and depend on local, state, and federal tax dollars to fund virtually all of their operations. To support schools, individuals are required to pay multiple types of taxes, including, but not limited to, local property tax, state income tax, and state sales tax.

The historical reliance on local property taxes as the primary source of revenue for funding local schools placed a large tax burden on property owners, while individuals whose income came from less tangible assets did not shoulder as heavy a burden for school funding. In recent decades, state governments have turned to income taxes and sales taxes to generate additional tax dollars for school funding, and, in particular, to augment dollars for schools in low-wealth communities.

Local vs. State Sources. An important distinction in school finance discussions is the difference between *local sources* of dollars for schools, and *state sources*.⁴ Most of the local dollars are raised by property taxes, along with vehicle taxes and financial institution taxes. Most of

the state dollars for education in Indiana come from the state income tax and the state sales tax. We amplify on this distinction, and its complications, in subsequent paragraphs.

Variations in Community Wealth. If most of the dollars for a school corporation originate from the local community — generated by local property taxes — then the wealth of the community plays a large role in the amount of dollars available for its schools.

High-wealth communities can generate relatively high per-pupil dollars with low-to-moderate tax rates (i.e., low tax effort), while low-wealth communities may be able to generate only low-to-moderate per-pupil dollars despite relatively high tax rates (i.e., high tax effort). Taxpayers in the low-wealth communities are, of course, more likely to notice the burden.

The amount of money a community spends on its local schools is often influenced by two factors: a) the wealth of the community, and b) the value the community places on education. If the community values education highly, it may be more inclined to shoulder a higher tax burden for education. Even though a community may express such willingness, it may lack the means. Taxes for education are not the only ones confronting the taxpayer (e.g., public safety, libraries, etc.) and an awareness of the accumulated burden from all government agencies with taxing authority has been an ongoing concern, as have variations in community wealth and tax rates.

These are not new concerns. Stoneburner (1940) reported, “The lack of equality in the assessed value of property in the state caused the legislature in 1852 to establish boards of equalization throughout the state. These boards were given the power to increase or decrease property assessments for the purpose of equalizing the tax burden” (p. 145).

Today, the Foundation Program places limitations on the degree to which tax rates can be raised or lowered by local authorities and also limits the financial

resources that communities have at their disposal to provide education services.

School Finance Litigation. More than 30 years ago, two landmark cases, *Serrano v. Priest* in California (1971) and *Rodriguez v. San Antonio* in Texas (1973), challenged the school finance systems in those two states. In the intervening three decades, similar challenges of education finance systems have been filed in 45 of the 50 states (Whitney, 1999). In 1987, the Lake Central School Corporation in Indiana initiated a lawsuit raising concerns that the state’s school finance system was still unconstitutional due to persisting inequities in funding (*Lake Central v. State of Indiana*, 1987). The governor and state legislature agreed with the plaintiffs to settle the pending litigation by making many of the changes to the state’s Foundation Program in 1993.

The plaintiffs in school finance cases usually argue that the state’s constitution specifies equal opportunity to education for all students. Lawyers often make two kinds of claims to support their contention that the existing system of school finance does not meet the constitutional standard of equal opportunity (Fulton & Long, 1993).

The first claim is that a relationship exists between community wealth and the local school corporation’s per-pupil dollars for general education operations. That is, wealthy communities in the state have the means and tend, overall, to spend more dollars for their children’s education than do less wealthy communities.

The second claim is that students in wealthier communities tend to exhibit higher academic performance than do students in poorer communities. Table 1 summarizes these inferential claims.

TABLE 1. Claims of Inequity

<i>Community Wealth</i>	<i>Dollars per-Pupil</i>	<i>Student Performance</i>
High →	Higher →	Higher
Low →	Lower →	Lower

Specifically, plaintiffs in these various state court cases claimed that high community wealth is related to higher per-pupil spending for general education operations, resulting in higher student performance, while the inverse relationship exists for communities with relatively low wealth. The assumptions underlying these claims are that higher community wealth leads to higher per-pupil spending, and that a causal relationship exists between regular education per-pupil dollars (see Endnote 2) and student achievement.⁵

Rise of the State’s Role. As a result of such litigation, school finance systems in many states were modified to reduce the strength of the relationship between a local community’s property wealth and its level of education spending, and thereby reduce the dependence of education spending on local property tax dollars.

Reducing the dependence on local property tax dollars was often achieved by increasing the proportion of education dollars coming from state sources, particularly to low-wealth school corporations, and thereby increasing equity in per-pupil dollars across all school corporations, regardless of the property wealth of the corporation’s community. As these goals were articulated and pursued, school finance systems also attempted to improve equity in the tax rates that generated the dollars most directly supporting instruction. More recently, the goal of funding adequacy has received increased attention.

In the subsequent section, a description is provided about the design of Indiana’s Foundation Program and how it reduces the inequities highlighted in the lawsuits filed in other states.

INDIANA'S FOUNDATION PROGRAM: HOW IT WORKS TODAY

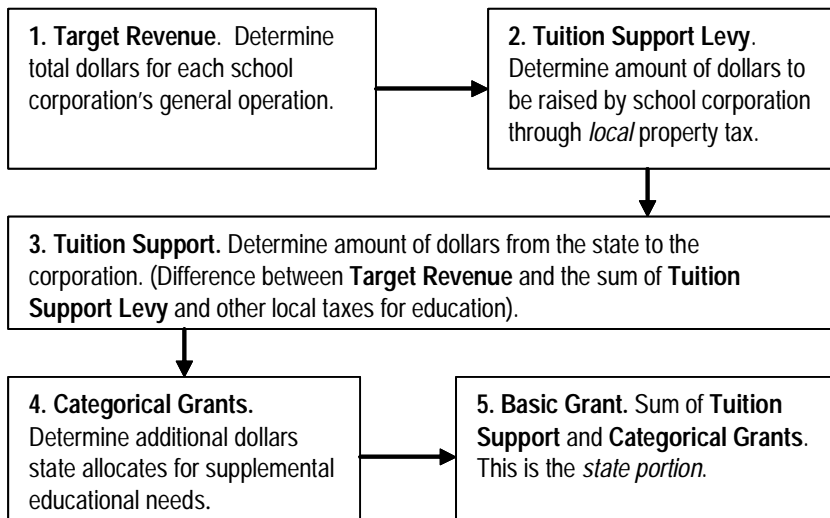
The most frequently used method for distributing dollars to school corporations — and the method currently used in Indiana — is known as a Foundation Program. According to Carey (2002), forty states use some variation of a Foundation Program to determine how much financial support to provide to school corporations.

Under a Foundation Program, the state first determines the total amount of dollars that enable school corporations to fund their regular education operations. Second, the portion of these dollars that can be raised locally to support education (primarily through local property taxes) is established. Finally, the portion of dollars that cannot be covered by local sources is designated as the amount of state support for each corporation. The manner in which a Foundation Program calculates local and state portions of funding depends on a number of formulas. For example, the share of dollars to be raised locally might be determined by multiplying a specific tax rate by the assessed value of taxable property in the school corporation's district. The dollars generated through the Foundation Program are allocated to the General Fund for each of Indiana's 292 school corporations.⁶

Figure 2 shows the major steps for calculating the amount of dollars each school corporation receives through the Foundation Program. Complete details can be found in Reed (2003). The definitions for these terms are:

- **Target Revenue** — The amount of money the Foundation Program allocates to a school corporation for funding its regular education programs.
- **Tuition Support Levy** — The portion of a school corporation's Target Revenue that the Foundation Program indicates should be raised by local property taxes (*local support*).

Figure 2. Steps in Calculating School Corporation Funding.



- **Tuition Support** — The difference between Target Revenue and the sum of Tuition Support Levy and other local taxes for education. This difference is funded by the state (*state support*).
- **Categorical Grants** — These are additional dollars the Foundation Program allocates to meet needs that are supplemental to a school corporation's regular education program (*state support*). Special education and Prime Time⁷ are examples.
- **Basic Grant** — The sum of Tuition Support plus the Categorical Grants (*state support*).

The three calculations, or grants, are known as the Foundation Grant, the Variable Grant, and the Minimum Guarantee Grant.

The Foundation Grant is calculated, as depicted in Figure 4 (page 5), by multiplying the *adjusted* number (see following paragraph) of students in a school corporation times the per-pupil foundation level, times an index that reflects the community's socioeconomic status. Thus, the formula for the Foundation Grant is sensitive to changes in a corporation's student enrollment as reflected in its average daily membership (ADM⁸) and the community's socioeconomic status. The per-pupil foundation level for 2005 is \$4,368. This amount is established by the General Assembly and usually increases each year.

Enrollment Changes. If the current ADM is less than the ADM's for the previous four years (i.e., declining enrollments), then the enrollment count for the corporation is adjusted *upward* based on a weighted average of the amounts by

Calculating Target Revenue

For each school corporation, *three separate calculations* are performed and the calculation that yields the *largest* dollar amount becomes the Target Revenue for the corporation, as depicted in Figure 3.

Figure 3. Target Revenue = Largest of Three Grants

$$\text{Target Revenue} = \text{Maximum of } \left\{ \begin{array}{l} \text{Foundation Grant} \\ \text{Variable Grant} \\ \text{Minimum Guarantee Grant} \end{array} \right\}$$

which enrollments have declined over the previous five years. On the other hand, if the current ADM is larger than the previous years' (i.e., increasing enrollments), the ADM is adjusted downward so that the adjusted ADM is somewhat less than the actual ADM.

The adjustments for increasing and declining enrollments are intended to reduce the effects of large enrollment fluctuations on the dollars for school corporations. Corporations with declining enrollments benefit from this *re-ghosting*⁹ process because the adjusted ADM used to calculate the dollars for general education operations is higher than is the actual, unadjusted ADM. Corporations with enrollment increases do not share in this financial benefit. For these corporations, the adjusted ADM is lower than the actual, unadjusted ADM. Overall, the average difference between the adjusted and unadjusted ADM counts is small — roughly 17 students or 0.5 percent of the mean, although some large differences may exist (see Toutkoushian & Michael, 2004a for details).

Complexity Index. In addition to the foundation level and student enrollment, the Foundation Grant includes the Complexity Index, which generates more dollars for school corporations located in lower socioeconomic communities. This index is the weighted average of the following indicators plus one:

- Percent of families with a single parent in 2000.
- Percent of population aged 25+ years with less than a 12th-grade education in 2000.
- Percent of families below the poverty income level and with dependent children under 18 in 2000.
- Percent of students eligible for free school lunches in 2003.
- Percent of students with limited English proficiency in 2003.

The values for the first three variables are obtained from the U.S. Census and are

Figure 4. Calculation of Foundation Grant

$$\text{Foundation Grant} = \text{Adjusted ADM} \times \text{Foundation Level} \times \text{Complexity Index}$$

updated once every decade. Values for the last two variables are obtained annually from each school corporation. These five variables are intended to represent the wealth, educational attainment, family status, and English language proficiency of students within each school corporation. The weight assigned for each of these variables is based on the relationship between the variable and student performance on the state's ISTEP+ test. The premise is that school corporations with more complex student populations require more dollars to obtain the same level of student performance as do school corporations with less complex student populations. For additional information concerning the Foundation Grant, see the letter from state Senator Luke Kenley which begins on page 7.

The Variable Grant is calculated by multiplying last year's Target Revenue per pupil by the current year's adjusted ADM. Corporations that receive their Target Revenue due to the Variable Grant tend to have high socioeconomic status and/or rising enrollments.

The Minimum Guarantee Grant simply increases last year's Target Revenue by a specific amount that is established by the General Assembly. In 2004-05, the increase was set at one percent. Because this grant guarantees that a cor-

poration will not experience a decline in Target Revenue, corporations with declining enrollments are more likely than others to have their Target Revenue set equal to the Minimum Guarantee.

After these three grant calculations are computed for each corporation, the Target Revenue is set equal to the *maximum* of the three, as shown in Figure 3. This ensures that corporations are not adversely affected by any one of these three options, and it provides stability for funding education. However, this design simultaneously reduces the degree to which education dollars change when enrollments change, and reduces the state's ability to redistribute dollars toward growing school corporations and school corporations with decreasing socioeconomic status.

In 2004, about eight out of ten corporations received their Target Revenue according to the Minimum Guarantee Grant (Table 2). This is a substantial change from previous years, when the percent of corporations funded by the Minimum Guarantee Grant was usually below 50 percent.

For more information about the Minimum Guarantee Grant, see the letter on page 6 from Pat Pritchett, Superintendent, Indianapolis Public Schools.

TABLE 2. Source of Target Revenue for 292 Indiana School Corporations, 2000-2004

Year	Foundation Grant ^a	Variable Grant	Minimum Guarantee
2000	45.5%	23.6%	30.8%
2001	55.5%	7.2%	37.3%
2002	19.5%	19.9%	60.6%
2003	37.7%	13.7%	48.6%
2004	14.5%	4.5%	81.0%

a. Prior to 2003, the Foundation Grant was referred to as the "Bottom Up Grant." Calculations from Legislative Services Agency and CEEP School Funding Formula Simulation Program.

Policy Perspectives

Periodically, the Center for Evaluation and Education Policy will include *Policy Perspectives*, in which we invite respected leaders in Indiana to share their perspectives on the issue being addressed in our Policy Brief.



LETTER FROM PAT PRITCHETT Superintendent, Indianapolis Public Schools

As superintendent of an urban school district where 70 percent of the children live in poverty, more than half are from single parent homes, and a rapidly growing number do not speak English, I wholeheartedly support the concept of a school funding formula based on student needs.

The problem is, unless such a formula is adequately funded, it will actually reduce the amount of per-pupil dollars going to school districts serving the greatest number of at-risk students.

This is best illustrated by the school funding formula adopted by the Senate in 2003, which distributed funding based on a complexity index and did not provide for a minimum guarantee. As will be discussed elsewhere in this newsletter, a "complexity index" weights school funding based on demographic factors that are linked to student achievement. Under the Senate's proposal, East Chicago had the state's highest complexity index, and IPS was tied with Gary for the number two slot. Because the complexity index is designed to drive funding to students with the greatest needs, it would seem to follow that these districts would also receive additional per-pupil funding.

However, because overall dollars were stretched too thin, IPS would have received \$53 less per pupil in 2004 than it received in 2003. East Chicago would have received \$255 less per pupil, and Gary funding would have dropped by \$261 per pupil. Out of the ten school corporations with the highest complexity indices in the state, nine would have had their pupil funding cut, and as a result, would have been forced to reduce services to the very students that the complexity index was designed to help.

There is a common misperception that the minimum guarantee was designed by Democrat lawmakers to help a handful of declining enrollment school corporations at the expense of rapidly growing districts. What most people don't know, however, is that 81% of Indiana's 293 school corporations received minimum guarantee funding in 2004 - up from 30% four years ago. During that same five-year period, overall enrollment decreased in more than half of all school corporations. The minimum guarantee has helped provide stable funding to the vast majority of Indiana school districts during a time of fiscal crisis.

The minimum guarantee is especially critical to districts that serve a disproportionately large number of at-risk students. For example, IPS currently serves 2,500 non-English speaking students at a cost of more than \$5 million per year. Less than \$1 million of that amount is funded through the complexity index and the state ESL grant. Nearly 32,000 low-income students in IPS are eligible for free textbooks. Because the state does not fully reimburse schools for textbooks, IPS loses an additional \$2 million each year. The minimum guarantee helps cover the costs of these under-funded mandates.

The minimum guarantee also recognizes that the fixed costs associated with serving a child remain in the classroom long after the child has gone on to another school district. Currently, IPS schools lose on average one child per grade each year. In each of these schools, the teachers must still be paid, the lights kept on and the school buses running to serve the remaining children. The "dollar must follow the child" approach seems to ignore this reality by assuming that all of the expenses associated with serving a child leave with the child. Further, although IPS has closed nearly 60 school buildings, school closures only make sense after a period of sustained enrollment loss in a given geographic area, and even then, must be weighed carefully against the adverse impact on our neighborhoods.

IPS serves nearly one out of every ten non-English speaking students in the entire state. The district is one of only three Indiana school corporations where more than half of the children come from single parent homes and one of only seven where more than half live in poverty. Yet despite these challenges, IPS has made steady gains in student achievement by increasing remediation and full-day kindergarten and implementing innovative educational programs. This progress will be jeopardized unless the legislature either adequately funds the complexity index or continues the minimum guarantee.

In theory, a school funding formula based on the complexity index is aimed to meet the promise of the federal No Child Left Behind Act. Unless adequately funded, it is an empty promise. ■

Policy Perspectives



INDIANA'S SCHOOL FUNDING FORMULA - A NEED TO GET FUNDING TO THE CHILD Luke Kenley, Indiana State Senator

Two major factors have changed the funding of education (K-12) over the last 10 years.

The first, the assumption of 60% of the school operating funds by state government beginning in 2003, now provides that the state is funding about 85% of operating funds for all schools. The local share of funding through the property tax has been greatly reduced by this change in the funding mechanism. When the property tax contribution of local school districts is measured in terms of ability to pay, the state funding share runs from a low of about 80% to a high of about 90%. This change reduces reliance on property taxes, and allows for a more direct measure of equity funding for all children. This is a positive factor.

The second factor, the use of a minimum guarantee for school corporations over the last 10 years, has now reached the point where 263 school corporations (out of 295) are now operating on a minimum guarantee, without regard to funding concepts that are intended to drive dollars to children in terms of equity and need.

This usage, somewhat unique among the states, has led to some bizarre results. Some corporations, who have lost 30% of their enrollment in the last 6 years, have seen their funding per child increase by as much as 75%. Other schools, with growing enrollments, are now reduced to receiving less than full funding for each additional child, even though their funding per child is among the lowest in the state. This has been a negative factor, especially in a climate where dollars are scarce, and the most efficient use of each dollar is paramount.

Our goals in the 2005 session of the Indiana General Assembly, with respect to the school funding formula, will be grounded in the following ideas:

1. Focus on funding following the child.
2. Simplify the funding formula.
3. Make the formula more equitable to every child.
4. Make K-12 funding a priority within the budget.
5. Transition to these ideas.

FOCUS ON FUNDING FOLLOWING THE CHILD. With almost 90% of our school corporations receiving a minimum guarantee, all the principles developed to direct funding toward "at risk" and special needs children (as well as to those students participating in vocational education programs) have been rendered irrelevant. With the dominance of the minimum guarantee, we are losing the focus of what funding is really about. The focus has shifted from "children" to "corporations."

To remedy this, we should have funding follow the child. There should be a foundation amount of funding for every child. If a school corporation grows and adds children, that basic level of funding should be provided for each additional child. If a child is identified to have multiple needs, the amount available for each need should be funded for that child. If federal dollars are focused on certain children in need, we should insure that those dollars get to those children.

Everything should revolve around the approximately one million children we are funding. The focus should be on the child. The focus should not be, as in a minimum guarantee, on "corporations," "buildings," "current numbers of teachers," or on any other "institution." A failure of the focus encourages two mistakes. It allows us to lose track of our real goal, educating children. It also fails to maximize the use of dollars where they are most needed, with a formula that overrides targeted goals.

SIMPLIFY THE FORMULA. Despite the override of the minimum guarantee, the funding formula remains unnecessarily complex. It needs to be simplified. Once it is determined that funding should follow the child, the basic building blocks of a simpler formula can be constructed. Each child gets a basic foundation amount. Any additional need for children at risk can be funded on a per child basis. We hope to get all schools to be "foundation" schools, with funding occurring where the proven need exists.

(Senator Luke Kenley, Continued)

MAKE THE FORMULA MORE EQUITABLE TO EVERY CHILD. Each child has different needs. In a funding approach, we can try to ascertain what amount is needed for the “basic” education of the child. Beyond this point, it is necessary to have funding flowing to children who have greater needs.

In the last school funding formula, I inserted a more scientifically proven concept, one supported by research at the Indiana Education Policy Center (now named the Center for Evaluation and Education Policy). Although this approach only applied to a few schools, because of the override in most school corporations by the minimum guarantee, the concepts have been shown to be statistically accurate in identifying children who need additional dollars, whether the child is in an urban, a suburban, or a rural school. The past “at risk” index sent dollars based on a total corporate profile and cut off “at risk” dollars in corporations with low indexes. The “complexity” index, as supported by the Policy Center research, is a more scientific measure of need, and as applied within the formula, with the “stacking” effect, will do a better job of getting the funds to every child who meets the criteria.

The “complexity” index consists of five factors:

- 1.Children who qualify for “free lunch.”
- 2.Children in a home with a single parent.
- 3.Children in a home of poverty as determined by federal standards.
- 4.Children who are limited English proficient (LEP).
- 5.Children from a home where one parent has less than a high school education.

Three of these factors are determined by census information. The other two, “free lunch” and LEP, are determined by the schools.

If a child qualifies in more than one category, that child gets the funding for all categories qualified in. This keeps the focus of where the dollars are needed on the child who qualified for the funding. This makes the funding more equitable, as funding itself is driven by the need, the identified need of a child.

MAKE K-12 FUNDING A PRIORITY IN THE BUDGET. The construction of the budget for the next biennium is difficult at best. Indiana faces approximately an \$800 million per year structural deficit. It faces the reinstatement of delayed payments of \$750 million. Revenue projections at best show growth of 4.5% per year, and much of that increase is being eaten up by growth of mandated programs, such as Medicaid. Hoosier taxpayers are in no better shape to pay additional taxes than state government is able to increase funding.

This is going to force a prioritization of spending. It may well be that education receives a “priority” because it is not cut in the next two years. My goal, and a goal shared by most Republicans, is that education is a “priority.” This was reflected in Indiana’s school funding formula passed in 2003, which was the highest increase of K-12 funding in the 50 states in a period of recession. Hopefully, education will be considered a “priority” again.

Indiana has shown its commitment to public school funding. We rank about 15th in funding per pupil in national studies, and even higher in terms of average teacher salaries. We are approaching \$10,000 per child in funding.

TRANSITION TO THESE IDEAS. As we articulate ways to better fund the nearly one million children in public schools, we must do this in a way that does not unfairly disrupt the practices built up by corporations operating under the minimum guarantee. Even though the minimum guarantee has distorted the equitable and efficient use of our dollars, we cannot change without an effort to transition to these changes. Some form of phasing will be required.

CONCLUSION. In my visits with school funding experts across the nation, I find that Indiana has avoided some of the pitfalls that have precipitated lawsuits across the nation. I find that Indiana is already more sensitive to the needs of underprivileged children, and more sensitive to equitably providing dollars where those dollars are needed. However, the minimum guarantee and its dominance in our formula, is beginning to distort our efforts. Every child needs a certain basic foundation funding amount. Many children need additional amounts, which we should insure is used for the benefit of those children. We must make steady progress to make Indiana’s funding fair and enlightened. ■

Calculating Tuition Support Levy

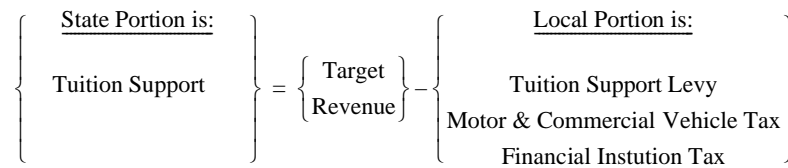
After the Target Revenue is established, the next step is to determine the portion that is to be funded through local property taxes. The Foundation Program does this by multiplying the maximum General Fund tax rate by the current assessed value of taxable property within the school corporation's boundary. In 2004, the maximum General Fund tax rate was 63.7 cents per \$100 plus an adjustment based on the difference between a corporation's Foundation Grant and Target Revenue, and any dollar losses due to P.L. 874 and the construction of new facilities.¹⁰

Property Tax Replacement Credit.

Are the variations in the local portion of education dollars due primarily to differences in community wealth or due to differences in tax rates? One goal of the Foundation Program is that such variations be the result of variation in property wealth and not due to variations in property tax rates. (In Step 3 [cf. Figure 2, page 4], dollars from state sources will be used to equalize differences in per-pupil dollars).

To ensure that variations in General Fund local tax rates are minimized, the Property Tax Replacement Credit (PTRC) was developed. Dollars from the PTRC come from the state sales tax. The purpose of the PTRC is to reduce the General Fund local property tax burden by replacing some of the dollars that would have been required from local sources with state funds. In 2003, the average, adjusted General Fund tax rate was about 72 cents per \$100 of assessed valuation, and the PTRC reduced that rate by about 47 cents down to about 25 cents, a reduction of about 66 percent. This represents the effective maximum rate, in 2003 adjusted terms, at which local property is taxed for the General Fund. Similarly, the state Homestead Credit Deduction (HCD) is used to relieve a portion of the local property tax burden.

Figure 5. State Portion = Tuition Support = Target Revenue — Local Portion



The maximum General Fund tax rate is established for each corporation by a series of complicated formulas described in detail in the *Digest of Public School Finance, 2003-2005 Biennium*. The 63.7cent base tax rate in 2004 is intended to compensate school corporations for dollars they have lost due to one or more of the following: a large differential between their Foundation Grant amounts and their Target Revenues, expenses associated with construction of new facilities, or repercussions of P.L. 874.

Calculating Tuition Support

After the amount of tax dollars to be generated by the property tax and other local taxes is established, the next step is to calculate the state portion of Target Revenue. The difference between the Target Revenue and the local portion (Tuition Support Levy plus other local taxes) is known as Tuition Support. Tuition Support is depicted in Figure 5.

Categorical Grants

Indiana's Foundation Program includes several categorical grants, which are dollars from the state for specific supplemental purposes beyond basic education services. These include:

- **Enrollment Growth Grant** — Partly due to the rehosting process discussed previously, rapidly growing school corporations may have difficulty obtaining sufficient dollars for providing general education services associated with such growth in num-

ber of students. This grant provides these corporations with some additional dollars. To qualify, enrollment in a school corporation must exceed either five percent or 250 students. The formula for this grant provides supplemental funding in the amount of one-third of the per-pupil Target Revenue for each of the additional students enrolled above the threshold. In 2004, about 20 school corporations received Enrollment Growth Grants.

- **Academic Honors Diploma Grant**

— This supplemental grant provides school corporations with an additional \$963 dollars for each Academic Honors Diploma awarded during the previous year. This grant provides an incentive to school corporations and compensates them for the additional expenses incurred in operating this program.

- **Supplemental Remediation Grant**

— This grant is designed to provide additional dollars to help school corporations increase the proportion of students who pass ISTEP+. In 2004, the grant provided \$97.50 for each student who did not pass ISTEP+ in the previous year.

- **Special Education Grant** — Indi-

ana's Foundation Program provides additional dollars to school corporations to offset the cost of providing education to students with special needs. The current amounts provided are \$8,246 per pupil with severe disabilities, \$2,238 per pupil with moderate disabilities, and \$531 per pupil with communications disorders.

- **Vocational Education Grant** —

This grant is intended to offset the

cost of providing vocational education services. The Foundation Program provides dollars for credit hours taught, with the amount of dollars varying based on the demand and wages for field in which training is provided (see Toutkoushian & Michael, 2004a for details).

- **Prime Time Grant** — The dollars in this grant are designated to assist school corporations in keeping the student-adult ratio (teachers and/or teacher-aids) at specified levels in kindergarten and grades 1-3.

Calculating the Basic Grant

The Basic Grant is the amount of state dollars each school corporation receives for their General Fund in order to deliver both general and supplemental education services. Thus, as depicted in Figure 6, the Basic Grant is the sum of the Tuition Support plus all of the supplemental Categorical Grants. Table 3 shows the values and percentages for 2004. Almost five of every six dollars provided to school corporations for education are in the form of Tuition Support, with Special Education funding the largest of all Categorical Grants.

Other Funds

So far we have focused on the General Fund and explained how, as a result of the calculations that occur within the Foundation Program, dollars flow into it. However, public school corporations may levy and collect property taxes not only for the General Fund, but also for Debt Service, Capital Projects, School Transportation, School Bus Replacement, Special Education Preschool, and the Referendum funds, as shown in Figure 7.

School corporations generally may not move dollars between funds, but rather, must use the dollars within a particular fund for that fund's purpose. For example, a school corporation may not take dollars from the School Bus Replacement Fund and spend them for a new building, for buildings must be financed with dollars from the Capital Projects Fund. That is, these seven funds are fiscally independent.

Figure 6. Basic Grant = Sum of Tuition Support and Categorical Grants

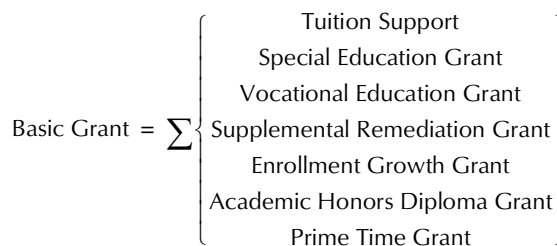
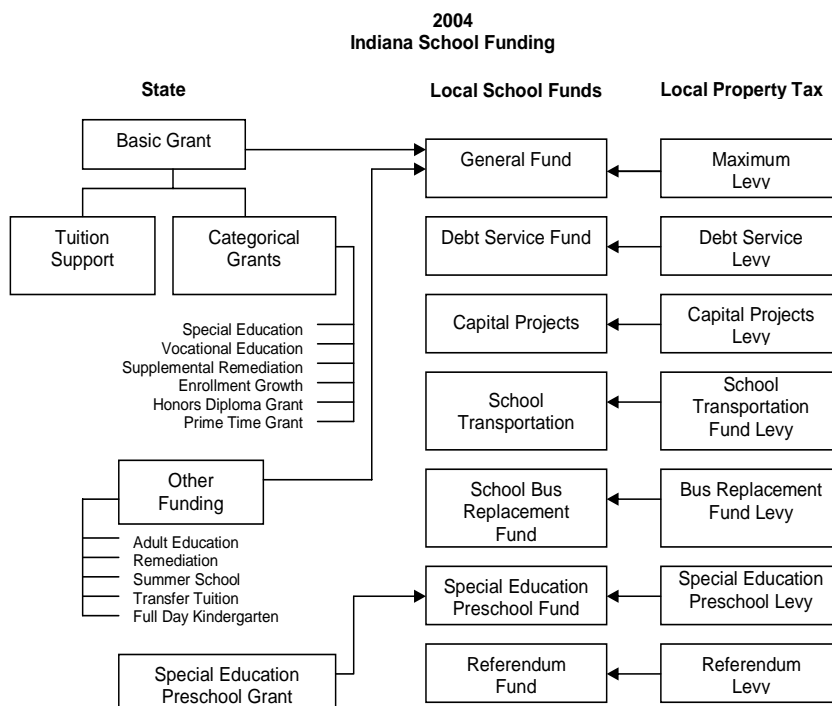


TABLE 3. Basic Grant, 292 Indiana School Corporations, 2004

Source	Amount ^a	Percent
Tuition Support	\$3,020,780,959	82.36%
Enrollment Growth	\$9,662,821	0.26%
Academic Honors Diploma	\$15,095,988	0.41%
Supplemental Remediation	\$14,096,355	0.39%
Special Education	\$412,751,487	11.30%
Vocational Education Grant	\$69,408,325	1.90%
Prime Time	\$126,077,758	3.05%
Basic Grant	\$3,667,873,693	100.00%

a. Calculations from CEEP School Funding Simulation Program. [Data Retrieved November 01, 2004 from <http://dew4.doe.state.in.us/htbin/sas1.sh>]

Figure 7. School Corporation Funds and Sources of Dollars



All of these funds are depicted in Figure 7. The source of dollars, whether state or local, is also shown. The Foundation Program sets a property tax limit for the General Fund, and a tax rate limit exists for the Capital Projects and Special Education Preschool Funds. The Debt Service Fund tax rate is set so that sufficient dollars are available to meet the annual debt payments of the school corporation. The Transportation Fund, limited to a maximum 6 percent yearly levy increase, provides for the day-to-day operating expenses associated with transporting students, while the Bus Replacement Fund generates dollars for purchasing new school buses.

In 2003, approximately 82 percent of all dollars for these funds were located in the General Fund, with the other 18 percent distributed among the remaining funds.

Although this description of Indiana's Foundation Program is a simplified summary that omits many details of the calculations, nonetheless, many readers might agree it is still difficult to keep all the concepts and the relationships between them clearly in mind. Perhaps the most important points to remember are: a) the Foundation Grant tends to equalize per-pupil regular revenue across school corporations, and b) dollars from state sources are used to supplement the local dollars to meet the Target Revenue.

INDIANA'S FOUNDATION PROGRAM: HAS IT ACHIEVED ITS GOALS?

In 1993, eight goals were established for the Indiana Foundation Program. These goals are shown in Table 4. They pertain to various aspects of the inequities in funding and tax rates across corporations, and were established through discussions among the members of the Indiana School Finance Group — which includes individuals from the four legislative caucuses, the State Budget Agency, the Legislative Services Agency, the Department of Local Government

Finance, the Indiana Department of Education, and the Center for Evaluation and Education Policy, or CEEP (formerly the Indiana Education Policy Center).

For the past ten years, CEEP has helped the state monitor the performance of the Foundation Program in meeting these goals, and the results show that overall these inequities have been reduced. Progress toward these goals is evaluated in Toutkoushian and Michael (2004b). Here we examine the results for only those general objectives of school finance mentioned previously in this newsletter.

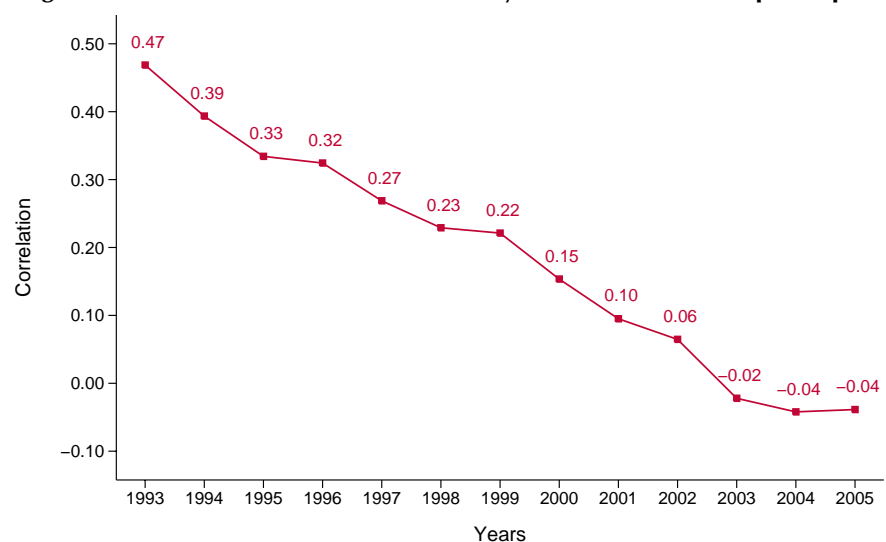
These goals include: a) eliminate the traditional dependence of per-pupil funding on property wealth per-pupil, b) increase per-pupil funding, and c) reduce variability in property tax rates across school corporations.

The Foundation Program was not designed to address the question of funding adequacy, for discussions of adequacy were not prominent before these goals were established.

TABLE 4. Original Goals for Indiana's 1993 Foundation Program **Progress**

• Increase per-pupil funding.	Steady
• Increase the state's share of school corporation revenue.	Steady
• Make per-pupil funding more dependent on school corporation complexity (i.e., provide higher funding to school corporations with more disadvantaged students).	Mixed
• Break the traditional dependence of per-pupil funding on property wealth per pupil.	Achieved
• Make General Fund property tax rates more dependent on regular revenue per pupil.	Steady
• Reduce variability in per-pupil funding across school corporations.	Mixed
• Limit increases in property taxes.	Steady
• Reduce variability in property tax rates across school corporations.	Steady

Figure 8. Correlation between Community Wealth and Dollars per Pupil.



Break Dependence of per-Pupil Spending on Community Wealth. An indicator of community wealth is the assessed valuation of taxable property per pupil. The one indicator of per-pupil dollars most directly related to general education instruction is known as regular revenue per pupil.

One way to investigate whether a relationship exists between two indicators is to examine the extent to which they covary, as shown in Figure 8. That is, as the values of one indicator (i.e., community wealth) increase for particular school corporations, do the values of the second indicator (i.e., education spending) also tend to increase for those same corporations? The same question can be asked for decreasing values.

The correlation coefficient is a numerical value that summarizes the extent to which two indicators do, or do not, covary. A correlation coefficient of zero indicates no relationship exists between the two indicators. The coefficient can range between +1 and -1. The closer the coefficient is to either +1 or -1, the stronger the relationship. A negative sign indicates an inverse relationship exists — that is, as the values of one indicator decrease (e.g., community wealth) for particular school corporations, the values of the second indicator (e.g., education spending) increase for those same corporations.

Figure 8 reports the correlation coefficient for these two indicators for each year from 1993 to 2005.

The relationship between community wealth and education spending was positive and moderately strong in 1993 as indicated by the correlation coefficient of 0.47 for that year. In subsequent years the correlation coefficient is smaller, indicating that the relationship between community wealth and education spending is diminishing. By 2002, the correlation coefficient is so close to zero (i.e., 0.06) that we can safely say the relationship no longer exists. The Indiana Foundation Program has broken the relationship between community wealth and the dollars spent per pupil on regu-

Figure 9. Dollars per Pupil 1993-2005, Current and Adjusted for Inflation.

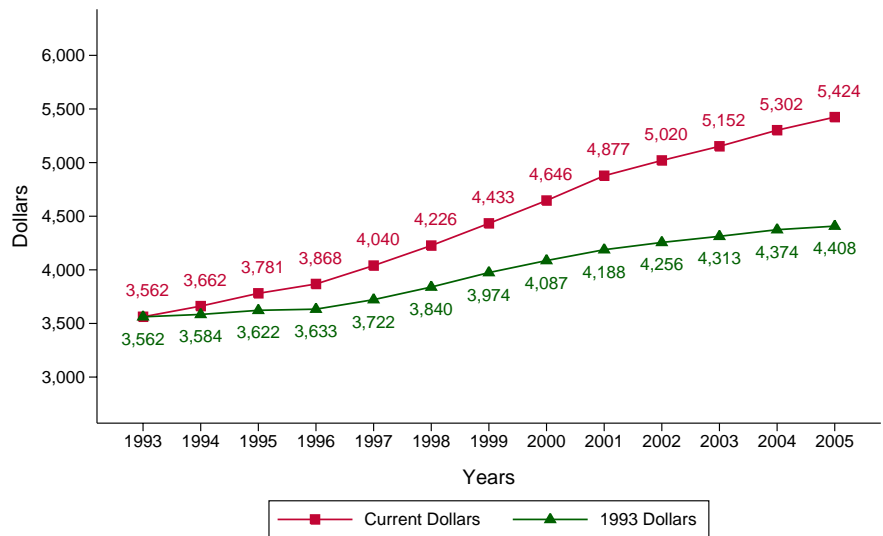
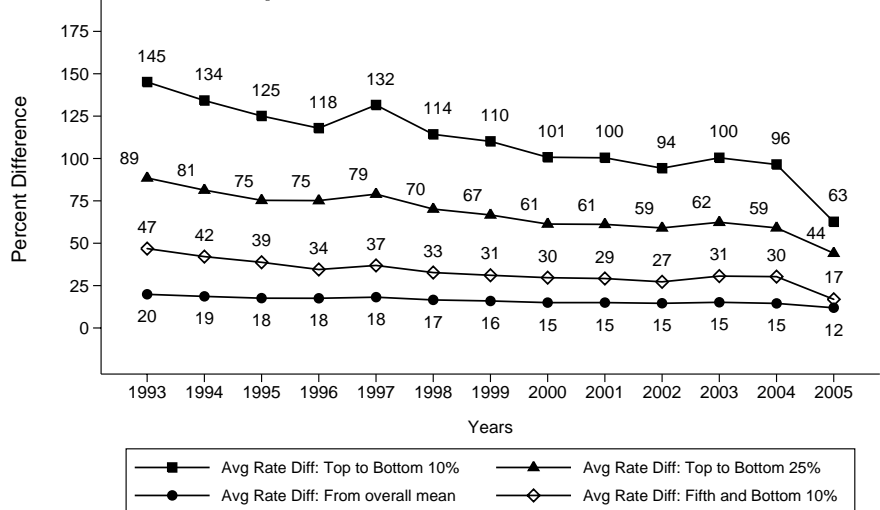


Figure 10. General Fund Tax Rate Differences 1993-2005 for 292 Indiana School Corporations



lar education for Indiana’s 292 school corporations. This is one of the major “success stories” of the state’s Foundation Program.

Increase per-Pupil Funding. The state has successfully increased the regular revenue dollars allocated for K-12 education, as shown in Figure 9. Even after controlling for inflation, the revenues per pupil for education operations have increased by almost 2 percent per year since 1993.

Reduce Variations in Tax Rates

Across Corporations. The Foundation Program, together with the PTRC, has also successfully reduced the large variations that existed in 1993 in local property taxes used for general education operations, as shown in Figure 10.

In summary, Table 4 shows the Foundation Program has been successful in achieving some goals and is exhibiting steady progress toward other goals.

THE IMPACTS OF CHANGING INDIANA'S FOUNDATION PROGRAM

It is common for policymakers in states with Foundation Programs to consider changes in their funding systems with the hope of addressing specific school finance issues. Indiana is no exception to this rule and, as can be seen in this Policy Brief, the state's Foundation Program is likely to be altered during the current legislative session. Prior to making changes, however, it is crucial that policymakers understand the likely impacts that these changes will have on individual school corporations and on the state as a whole.

In an environment where the total dollars to be allocated to education may be held constant, changes in the Foundation Program that direct more money towards a particular use or activity (such as Prime Time education) by definition will take money away from other activities. These trade-offs need to be identified and understood by policymakers. In this same constant-dollar environment, changes in the Foundation Program will provide benefits to some corporations and negatively affect other corporations.

Such costs and benefits will probably be concentrated among certain types of school corporations, such as those located in rural areas, and therefore may lead to unintended consequences. For example, an increased reliance on the Foundation Grant to provide Target Revenues to school corporations will most likely direct more revenues to growing school corporations, many of which are located in suburban areas, and take money away from corporations with falling enrollments, which tend to be urban.

Changes in the Foundation Program could also have dramatic impacts on the state overall. Even a small change in specific parameters in the numerous formulas that comprise the Foundation Program could affect the total dollars that need to be raised at either the state or local level for public education. As an example, Table 5 shows how the Target Revenue total for the state would be affected if only one of the three options were used to determine Target Revenue.

From this table, note that if only the unrestricted Foundation Grant option were used, the statewide Target Revenue would decline by a total of \$254,029,372. Such a decline in revenue would have a significant impact on the

state's public school corporations. Other changes could also be made in the Foundation Program to correct this deficiency, but these changes would also impact the level and distribution of revenues across public school corporations.

Finally, any change in the Foundation Program could also affect the state's progress towards meeting the specific goals outlined earlier in this Policy Brief. If these goals are to be used for evaluating the success of the state's school funding program, then policymakers must take into account how proposed changes in the Foundation Program would affect these goals. For example, an increased reliance on the Foundation Grant may help improve the state's progress towards goals such as allocating more money towards corporations with more at-risk students, but may also introduce more variations across communities in education funding. The simulation model developed by CEEP should prove to be very useful in evaluating the positive and negative aspects of proposed changes in the Foundation Program before they are acted upon by policymakers. In this way, the state can hopefully make improvements to the Foundation Program that align best with the state's priorities, resources, and goals for school funding.

TABLE 5. Total Target Revenue for 292 Indiana School Corporations if Funded by Each Grant Type, 2004

	Grant	Sum ^a	Difference (Maximum - Option)
	Maximum of Three Options	\$5,088,270,640	
Option 1:	Foundation Grant (Restricted)	\$4,982,392,345	\$105,878,295
	Foundation Grant (Unrestricted)	\$4,834,241,268	\$254,029,372
Option 2:	Variable Grant	\$5,018,572,355	\$69,698,285
Option 3:	Minimum Guarantee Grant	\$5,065,724,230	\$22,546,410

a. Calculations from CEEP School Funding Formula Simulation Program. [Data Retrieved November 1, 2004 from <http://dew4.doe.state.in.us/htbin/sas1.sh>].

EXPANDING THE KNOWLEDGE BASE

The articles in this Policy Brief provide both an overview of the state's Foundation Program and also report briefly on how well the Program has worked in achieving specific goals established in 1993. CEEP continues its involvement in monitoring the Foundation Program and analyzing the effectiveness of school funding, as well as developing alternatives that may improve the Foundation Program.

CEEP is developing new approaches for measuring how equitably the Foundation Program distributes revenues to school corporations. This work promises to be helpful not only in Indiana but in other states that are also concerned with the equity of school funding. As the new legislative session begins, CEEP has also developed a model that allows for simulations of the impacts of specific changes in the Foundation Program on school funding in Indiana. Information derived from these simulations should be particularly useful to policymakers as the current legislative session progresses.

Drawing upon developments in other disciplines, CEEP is forging a new approach to the study of school funding adequacy, which is part of the current focus of concern in school finance. While there are several approaches used in the field to examine adequacy, each of these has its limitations. CEEP is in the process of investigating several of these approaches and determining which is most suitable for Indiana. Taken together, these individual projects will provide an information base that would enable the development of the best possible school funding formula for Indiana given current fiscal constraints.

ENDNOTES

1. In the State of Indiana, school districts are called "school corporations." Discussions of school finance systems focus on the dollars received by school corporations, not individual schools, because fiscal planning occurs at the school corporation level. Likewise, payments from the Indiana Department of Education are distributed to school corporations. Within a corporation, schools may differ in demographic characteristics and the amount of dollars received but these intra-corporation differences usually are not included in discussions of school finance systems.
2. The dollars that support instruction most directly are referred to as "regular education" dollars and/or "regular revenue" for education operations. This does not include all of the dollars received by school corporations.
3. Bottom up equalization is an effort to bring those school corporations that are closest to the bottom of the per-pupil funding range closer to the middle.
4. In this discussion we exclude the federal dollars which are less than 10 percent of the total schools receive.
5. Moderately strong evidence exists to support the impact of accountability measures on achievement (cf. Hanushek & Raymond, 2003), while the nature of the relationship between school spending and student achievement remains an area of active investigation, with conflicting results (cf. Card & Payne, 2000; Hanushek, 1989; Harknett et al., 2003; Hedges, Laine, & Greenwald, 1994; Taylor, 1998; Verstegen & King, 1998).
6. Prairie Township School Corporation is excluded from this analysis.
7. The Prime Time grant supplies additional dollars to ensure that all K-3 grades do not exceed a specified adult/student ratio.
8. The ADM (average daily membership) is a count of students who are enrolled in and attending a school within the school corporation. The count is conducted the second Friday after Labor Day. Kindergarten students are counted as one-half ADM.
9. *Reghosting* refers to the adjustment of ADM upward when enrollments are declining, and adjustment of ADM downward when enrollments are increasing.
10. Parents employed on Federal property may have children who attend a local school. Public Law 874 determines the amount of Federal aid to which the school corporation is entitled, based on the number of such children enrolled.

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