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ABSTRACT

This report exposes inadequacies in New York's education finance system, summarizing testimony and research collected for a lawsuit filed by the Campaign for Fiscal Equity, Inc., on behalf of New York City students. The lawsuit charges that the state has underfunded the City's public schools, thus denying City students a sound basic education. The lawsuit is also the first case to thoroughly analyze the history of standards-based school reform and its important relationship to constitutional equity and adequacy litigation on behalf of children everywhere. The flawed structure and operation of the state's finance system are responsible for its inability to deliver adequate resources to City students. This report explains why the system does not work, demonstrating that the present funding system does not deliver resources adequate to meet students' needs because it is not set up to do this (there is no mechanism for assessing need). The report discusses how the state funds education; state finance system shortchanges in the City's public schools; education costs not being a factor in the state finance system; the state being legally required to safeguard City schools' access to adequate resources; and recent aid increases not being able to replace systemic reform. Until New York implements a cost-based education finance system, no amount of increased spending can remedy its fundamental failure to ensure that every year enough money is provided to offer a sound basic education to all students. (SM)

CFE
CAMPAIGN FOR FISCAL EQUITY, INC.

In Evidence:
Policy Reports from the CFE Trial

RERORMING NEW YORK STATE'S FLAWED
SCHOOL FINANCE SYSTEM

Volume 2

November 2000

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**In Evidence:
Policy Reports from the CFE Trial**

**REFORMING NEW YORK STATE'S FLAWED
SCHOOL FINANCE SYSTEM**

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INTRODUCTION

In 1993, the Campaign for Fiscal Equity, Inc., a coalition of advocacy groups, school boards, and community organizations, filed suit in the New York State Supreme Court charging that the state's system of financing schools denies students in New York City the opportunity for a sound basic education. Though the State moved to dismiss the case, in 1995 the Court of Appeals upheld CFE's right to pursue a constitutional challenge to the state's education finance system.

The Court of Appeals made clear, in its 1995 decision, the questions that should be resolved at trial. The first task set by the Court was to define a sound basic education—the educational standard to which the state should be held. Next, the Court required proof that the state fails to provide resources adequate to offer all students the opportunity to reach that basic level of education and that the current funding system is to blame.

At the trial in *Campaign for Fiscal Equity, Inc. v. the State of New York*, CFE argued that a sound basic education should provide students the type of skills represented by the New York Regents Learning Standards, the standards to which the state holds all its students. CFE also produced extensive evidence that the state's current finance system does not deliver enough resources to meet the needs of providing all New York's students the opportunity to reach the constitutional standard.

The evidence and expert testimony CFE produced at trial clearly showed that the flawed structure and operation of the state's finance system are responsible for the state's inability to deliver adequate resources to New York City students and

others throughout the state. This report will elaborate how and why the system does not work.

The report will demonstrate that the present funding system does not deliver resources adequate to meet students' needs because it is not set up to do this; the system has no mechanism at all to assess need. Despite being a complex collection of 40 or so disparate formulas and grants purporting to relate to spending, the system no longer distributes education aid on any rational basis. Instead, it serves primarily to support a long-standing political deal that each year allocates to New York City and other parts of the state a set percentage of any increase in state education aid, no matter the actual needs or costs of educating students.

Over the years, the state education aid distribution system has evolved into an overcomplicated hodgepodge of formulas, grants, and adjustments—mostly vestiges of past proposals designed for political gains. Only a very few state education department and legislative insiders understand the system. It certainly is not comprehensible to the average citizen. For this reason, there is no possible accountability for whether and how it works.

To make matters worse, the crucial annual decisions about how much to budget for state education aid and how much aid to allocate for New York City are, as has long been understood, made in a private deal by “three men in a room.” In other words, as this report elaborates, the governor and legislative leaders negotiate the budget based on political rather than educational needs.

As CFE argued at trial, the present finance system needs to be replaced with a simpler, cost-based system that delivers funding where needed to provide all students with access to a sound basic education. CFE's proposed remedy for the

constitutional wrong created by the current system restores the necessary link between need—that is, the costs associated with providing an adequate education to all New York’s students—and the resources devoted to meeting that need. This link has for too long been absent from the way New York State funds public education. Finally, in addition to reestablishing the connection between needs and resources, the new cost-based system must include a broad accountability plan to ensure that all allocated funds are spent effectively to create the opportunity for all students to succeed with the standards set for them by the state.

HOW NEW YORK STATE FUNDS EDUCATION

New York State spent more than \$26 billion last year to educate the nearly three million students in its 680 school districts. Over a million of those students go to school in New York City, the state's largest district by far, whose school system alone has a budget of nearly \$11 billion. Despite those large-sounding numbers, however, many New York City students and others throughout the state are being denied their constitutional right to a sound basic education as a result of inadequate funding. New York State's badly flawed school finance system has long deprived New York City and other high-need districts of the resources they need to provide all students with access to a sound basic education. As a result, only half of the students who enter high school in New York City graduate four years later. Thirty percent will never earn a diploma of any sort. When the new Regents Learning Standards are fully implemented, and all students are required to pass challenging Regents exams to graduate from high school, the graduation rate is expected to fall even lower. As CFE argued at trial in *Campaign for Fiscal Equity, Inc. v. the State of New York*, until the state overhauls its finance system, New York City schools and others statewide will continue to struggle without the resources they need to offer an adequate education to all.

New York State finances education as a joint undertaking between the state and local school districts. State school districts currently receive funding for educational programs from three sources: 54 percent comes from local revenues, 42 percent from the state, and 4 percent from other sources, mainly the federal government. The mix of state, local, and federal revenues has fluctuated over time and varies considerably among districts. In general, the percentage of revenues from local sources increases with district wealth.

New York City, only an average-wealth district, educates nearly 38 percent of the state's students. The city enrolls 70 percent of the state's economically disadvantaged students, 51 percent of its students with severe disabilities, and over 80 percent of its English language learners. A large number of these students are at risk of academic failure and require increased resources. New York City receives only 35.5 percent of the state education aid.

In 1997-98, the average per-pupil expenditure in New York State outside of New York City was \$10,342, but per-pupil spending varies dramatically from district to district. Not all state education aid formulas are adjusted to offset differences in local wealth and local funding varies, so districts with the highest property wealth still receive substantial allocations from a state aid system whose stated purpose is to equalize the financial resources available to all districts throughout the state. The result is that affluent districts can spend two or even three times the amount per pupil spent by poor districts. New York City spent \$8,788 per pupil in 1997-98, a lot less than the average expenditure of the state as a whole, despite the much greater need of its students. Incredibly, the state education finance system also does not account for differing regional costs when distributing aid.

THE STATE FINANCE SYSTEM SHORTCHANGES NEW YORK CITY 'S PUBLIC SCHOOLS

Under the state constitution, New York State has responsibility for providing all its students sufficient resources for education, and it has the means to procure them, but New York City has not received adequate funding for at least the last 13 years. Why not? The structure and operation of the state education finance system prevent it. The system lacks sufficient structural mechanisms to assess and address educational need, and the operation of the system is driven by political rather than educational motivations. The result is a state education finance system in which, as the state education department has consistently told the legislature, and the evidence and testimony in the CFE case confirm, "resources are not aligned with need. Those schools with the greatest need frequently have the fewest fiscal resources. . . ."1

For nearly two decades, the New York State Board of Regents, state-appointed blue-ribbon commissions, the state education department, and knowledgeable observers have repeatedly reported to the legislature, the governor, and other state officials that the state education finance system was not providing adequate funds to all districts. A thick pile of reports warn the state that the structure and operation of its education finance system must "provide the resources each student needs to meet the standards by adjusting for differences in school districts' fiscal capacity, costs and student need."2 It does not. The state finance system remains unchanged even in the face of record state and local budget surpluses. While the New York City public schools remain without adequate

¹ New York State Education Department, Annual Report to the Legislature, 1999, p. 167.

² New York Board of Regents State Aid Proposal: Directions for 2000-2001, August 30, 1999.

resources, the New York State education finance system fails basic tests of adequacy as defined by experts and the Board of Regents, or implemented in other states.³

The System Annually Allots the City a Fixed Percentage of State Aid

The state aid distribution system is both extraordinarily complex and extraordinarily simple. It is extraordinarily complex because it purports to distribute state education aid on the basis of dozens of individual formulas and grant categories. It is extraordinarily simple because the final outcome is pre-determined by a private deal among the state's political leaders to distribute education funds according to a regional shares agreement. Under this agreement, New York City has received a precisely fixed percentage of the annual increase in state aid, usually 38.86 percent, over at least the last 10 years. The complexity of the system provides a mechanism both to camouflage and effectuate this deal.

State Aid Formulas Are Too Complex

For the 1999-2000 school year, the state distributed about \$12.5 billion in education aid through funds appropriated as General Support for Public Schools, using more than 40 different formulas and grant programs. Each formula generally consists of several components. These may include a base amount, a student count, a weighting factor, and additional multipliers that are combined together, through one or more mathematical calculations, to determine the amount of aid generated for each district. As a result, the individual formulas

³ Trial testimony, *CFE v. State*, Levy, pp. 7139:24-7140:20, 7148:19-7152:23; Berne, pp. 12554:4-12560:19; Smith, pp. 18367:10-18368:11, 18408:10-24; Guthrie, pp. 21242:23-21243:13; New York State Education Department State Aid Work Group, *Linking Funding and Successful Strategies for High Student Achievement*, July 1999; H. Carl McCall, State Comptroller, *An Agenda for Equitable and Cost-Effective School Finance Reform*, October 1996, pp. 24-25, 34-41; New York Board of Regents State Aid Proposal: *Directions for 2000-2001*, August 30, 1999.; New York State Temporary State Commission on the Distribution of State Aid to Local School Districts, Frederic Salerno, chair, *Funding for Fairness*, December 1988.

The Largest State Aids Appropriated for 1990 (in millions of dollars):	
Operating Aid	5,934.61
Tax Effort Aid	195.09
Tax Equalization Aid	534.74
Public Excess Cost (Special Education) Aid	1,722.76
Transportation Aid	806.32
Building Aid	934.55
BOCES Aid	427.21
Extraordinary Needs Aid	665.58
Total Major Aids	11,220.86

and the entire distribution system are complicated and difficult to understand. The state education department's description of the Basic Operating Aid formula (the largest single state aid category) requires three and a half pages of single-spaced text and mathematical formulas.

Top State Education Officials Do Not Understand Present System

In fact, the state aid distribution system is unintelligible to all but a handful of state education aid technicians. At the CFE trial, State Education Commissioner Richard Mills called the system a "black box" and said he had no "deep" understanding of its operation. Former Commissioner Thomas Sobol referred to the system as "an ocean of confusion piled on a pillar of disorder" and recalled jokes that only three people in the state fully understood its operation. State Comptroller H. Carl McCall concluded about the system that the state had created a "Frankenstein monster."⁴

⁴ Assembly Hearing on Financing Public Education, Testimony of H. Carl McCall, State Comptroller. Hauppauge, NY, November 29, 1995.

State Aid Is Distributed Through an Agreement by Three Men in a Room

How can such an incomprehensible system persist? It persists because the real operation of the state aid distribution system is driven primarily by a private deal between the governor and the leaders of the state senate and the state assembly. According to the terms of this "share agreement," New York City receives a fixed percentage increase in state aid from one year to the next.

The evidence proving the existence of this share agreement is overwhelming, as revealed at trial through state budget documents, witness testimony, and reports from the state comptroller's office. Here's how the share agreement is effected. Each January, as required by the state constitution, the governor proposes the executive budget. Although it addresses all aspects of the state's financial condition, the executive budget makes general recommendations regarding education and includes specific items designed to ensure a particular distribution of state aid. After its release, the executive budget becomes the basis for negotiations among the governor, the speaker of the assembly, the senate majority leader, and their staffs. The state's former budget director, Robert King, admitted that this process is commonly known as "three men in a room."⁵ These negotiations include discussions about the state education aid budget.

The starting point for these negotiations is "gross amounts of money," as King testified. The negotiations produce a general agreement on the overall amount to be spent on various areas of the state budget, including education. The negotiations also produce an agreement on how education aid is to be distributed among the state's regions. This is the share agreement.

After the share agreement is reached, the formulas and grant programs are modified through a collaborative effort by the state education department, Division

of Budget, and legislative staff, so that the final education budget reflects the agreement. This modification is accomplished through the use of a sophisticated computer modeling system maintained by state education department technicians. As the state comptroller himself specifically found: [T]he formulas are annually "worked backwards" through the state's computers until the politically negotiated "share" for the city schools is hit in the calculations. In this context, the data feeding into the school aid formulas for New York City is really of no practical consequence whatsoever—the City will get the negotiated share of aid regardless of what data they report."⁶

The State Budget Process Does Not Align Resources with Need

In such a process, there is no attempt to determine the actual needs of any particular district, or whether the combined state and local contributions are sufficient to provide adequate resources to meet these needs. The process purports to address various educational needs, for example, by distributing aid on the basis of pupil characteristics or creating funding streams devoted to particular purposes such as class-size reduction, but it has no mechanism for determining the actual costs of meeting these educational needs. As a result, the budget process distributes billions of dollars in state aid through a collection of formulas and categorical grants that fail to ensure that all school districts have adequate resources to provide a sound basic education.

The history of the Extraordinary Needs Aid (ENA) formula provides a telling example of how the state budget process fails to align resources with need. ENA was added to the state education budget in the 1993-94 school year. Its ostensible purpose is to provide additional aid to address the educational needs of at-risk children. It distributes funds, therefore, according to a formula largely based on the

⁵ Trial testimony, *CFE v. State*, King, pp. 21950:2-21952:7.

⁶ H. Carl McCall, State Comptroller, Briefing Paper on School District Data Issues, December 1999, p. 8.

number of at-risk children in a district, as measured by free-lunch status. New York City has a majority of the state's at-risk children, and it has received the majority of ENA funds since it was implemented.

On the face of it, ENA should have increased New York City's total share of state aid. However, after adding extra aid here, the state systematically took it away from other parts of the budget. In five of the seven years before ENA was enacted, New York City received approximately 38.86 percent of the annual increase in state aid. The year ENA was enacted, New York City received 38.59 percent of the annual increase. In each of the six years since ENA, New York City's share of the increase in state aid has been close to or exactly 38.86 percent. Thus, despite the inclusion six years ago of this new aid purported to increase funding to at-risk children, New York City's share of total state aid has hardly risen at all over that time.

The relatively small amount of ENA funds the city receives each year clearly does not provide sufficient resources to meet the educational needs of at-risk children. More strikingly, there is no evidence that the state has ever attempted to calculate the costs of meeting those needs. The purported purpose of ENA is a charade; whether or not ENA existed, New York City would have received the same amount of state aid as the result of the share deal. In reality, the state aid distribution system does not address the educational needs of New York City's at-risk children. One internal state education department document introduced at trial indicated that if state aid were based on need, New York City would receive between \$1 and \$2 billion more in state aid as a result of its high concentration of students' needs, high regional costs, and financial capacity.⁷

⁷ New York State Education Department Equity Subcommittee of the State Aid Work Group, *An Analysis of Equity in Funding in New York State: A "Shares" Approach for Analyzing Needs & Resources*, February 1997.

Individual Formulas Are Arbitrary

Education finance expert Dr. Robert Berne, vice president for academic and health affairs at New York University, testified at trial that the impact of providing New York City with a predetermined increase in state aids is to “negate the general factors that are shown in the formulas . . . that are supposedly driving resources to children in school districts.” A 1998 report on school finance from the state comptroller also concluded that, because the share agreement determines the overall distribution of state aid, the formulas and their individual components have no “real-world meaning,”⁸ and contain “fudge factors” included solely to effectuate the share agreement.⁹ None of the individual formulas attempts to calculate the actual cost of achieving any educational objective, and there is no rational explanation for many of the individual components of the formulas. As the state comptroller concluded:

The current school aid formula[s] . . . [have] been cobbled together piecemeal over the years. . . . Each year new manipulations occur, usually in the middle of the night, to produce the politically desired “shares” of aid on the computer run. One would not expect the product of such a process to be rational or equitable, and it is not.¹⁰

⁸ H. Carl McCall, State Comptroller, School Finance Issues in the 1998-1999 Enacted Budget, June 1998, p. 2.

⁹ H. Carl McCall, State Comptroller, An Agenda for Equitable and Cost-Effective School Finance Reform, October 1996, p. 20.

¹⁰ H. Carl McCall, State Comptroller, Comptroller’s letter: Preface to An Agenda for Equitable and Cost-Effective School Finance Reform, October 1996.

EDUCATION COSTS ARE NOT A FACTOR IN THE STATE FINANCE SYSTEM

The City's Share of State Aid Is Unrelated to Its Attendance Rate, District Wealth, or Local Expenditures for Education

At trial the State defended the present funding system by saying that New York City's share of state aid is derived from pupil count and district wealth. The facts do not support this. Between 1986-87 and 1996-97, New York City public school attendance increased from 85.4 to 86.7 percent. The city made these attendance gains at a time when its enrollment was increasing. Yet New York City received the same percentage share of the annual increase of computerized aids. Then-Regent Harold O. Levy testified at trial that because of the share agreement, "attendance is essentially irrelevant."

While the State maintains that the state aid system is responsive to district wealth, the trial record establishes that the system fails to adjust and vary the level of state aid provided to New York City when its property and income wealth change. From 1988-89 to 1997-98, various measures of New York City's property wealth changed significantly. From 1994-98, for example, New York City's actual value of taxable real property per Total Wealth Pupil Unit in thousands dropped from \$260.3 to \$215.7, a loss in value of 17.1 percent. In contrast, the average value in the rest of the state dropped from \$271.4 to \$266.2, a loss of 1.9 percent. During the same period, New York City's actual valuation of real property decreased from \$297,822 to \$276,893, a 7 percent decrease. In contrast, the rest of the state increased from \$543,808 to \$563,371, an increase of 3.6 percent. Nevertheless, New York City received the same percentage share of the annual increase in state aid.

Other System Features Contribute to City Schools' Shortfalls

Other structural and operational aspects of the state aid distribution system contribute to the ultimate failure of the overall state education finance system to provide sufficient resources to New York City schools.

The State Has Failed to Pay Aid Owed to New York City

As of December 1999, New York State owed the New York City Board of Education \$508 million in prior education aid that had not been scheduled for payment by the legislature. This total represents actual claims filed by the Board of Education from the 1988-89 through 1998-99 school years for funds spent in accordance with prior years' funding formulas and entitlements for reimbursement. Thus far the legislature has agreed to pay off this obligation at the rate of approximately \$30 million per year, even though the schools have already spent the entire amount and city budget rules may require the Board to repay the outstanding amount to the city in the near future.

The State Has Failed to Adjust Aid for Regional Costs

The CFE trial record demonstrates that the state aid distribution system fails adequately to take regional costs into account. This failure has a direct impact on the programs and services provided by school districts in high-cost regions of the state. The impact of regional cost differences has been long recognized. The state education department concluded in 1999 that "[t]he failure to explicitly recognize geographic cost differences within the major operating aid formulas has led to formula allocations which are inequitable. They ignore long-standing recommendations of both the 1988 Salerno Temporary Commission and the 1982 Rubin Task Force concerning this type of cost adjustment."¹¹

¹¹ New York Board of Regents State Aid Proposal: Directions for 2000-2001, August 30, 1999, p. 13.

State Education Department Regional Cost Index		
<u>Labor Force Region</u>	<u>Cost Index</u>	<u>Purchasing Power</u>
Capital District	1.000	\$1,000
Southern Tier	.967	\$1,034
Western New York	.959	\$1,043
Hudson Valley	1.239	\$ 807
Long Island	1.209	\$ 827
New York City	1.343	\$ 745
Finger Lakes	1.038	\$ 963
Central New York	1.002	\$ 996
Mohawk Valley	.930	\$1,075
North Country	.854	\$1,170

As this chart shows, New York City has the highest regional costs of any district in New York State. The professional service costs of doing business in the New York City area are approximately 34 percent higher than equivalent professional service wage costs in the Capital Region.

According to education finance expert Robert Berne, New York State's failure to take regional costs into account when distributing state aid has an adverse impact on New York City and other districts in high-cost areas in two ways. First, most state aid formulas calculate a district's ability to pay using the Combined Wealth Ratio (CWR), which fails to include any adjustment for regional costs. As a result, districts in high-cost areas are disadvantaged; a dollar of income per pupil in a high-cost region is considered by the CWR calculation to be the equivalent of a dollar in a low-cost region.

Second, districts in high-cost regions have less buying power—thus the fundamental unfairness of allocating \$3,000 in state aid per pupil to two districts that are identical in fiscal capacity but located in areas where costs are different. If one district is located in a high-cost area where \$3,000 has a purchasing power of only \$2,250 and 80 percent of the student body lives in households that fall below poverty, and the second district is in a low-cost area where the purchasing power equivalent of this \$3,000 is \$3,500 and only 10 percent of its student body is poor, that \$3,000 will have a very different impact on the education of actual students. This variation and its impact on districts in high-cost regions of the state have led the state education department to conclude that any effort to raise academic standards requires a concurrent modification in the state aid system: “The cost of purchasing a standard, adequate, market basket of educational goods and services will often vary dramatically from one labor market to another . . . a truly fair and adequate financing system must recognize regional cost differentials.”¹² Indeed, the State’s own expert James Guthrie agreed at trial that, when distributing aid, a fair finance system should take regional costs into account, particularly for high-cost metropolitan regions.¹³

The State’s Experts Failed to Determine If the State Aid System Promotes Educational Adequacy

At the trial, the State sought to portray the education aid distribution system as the rational result of a democratic process that furthers legitimate public policy goals by addressing student need and distributing aid on the basis of district wealth. But their own witnesses admitted that they had not analyzed whether the state education finance system as a whole provides sufficient funds to meet actual needs, or whether any individual formula provided funds sufficient to meet the educational need to which it is addressed.

¹² New York Board of Regents State Aid Proposal: Directions for 2000-2001, August 30, 1999, p. 12:

¹³ Trial testimony, *CFE v. State*, Guthrie, pp. 21219:13-21226:8.

The testimony of the State's main funding-formula expert, James Guthrie, was inconsistent in this regard with his own well-documented opinions concerning education finance. Guthrie has long urged states to shift the focus of their finance systems to adequacy, which means guaranteeing the amount of resources needed to meet state standards. He admitted at trial that he believes that when states implement new standards, legislatures need to define what is adequate to get students to those standards and then provide a state finance system that has adequacy as its supporting standard. In other cases where Guthrie has testified about education finance, he actually examined whether the finance system was providing enough money to ensure an adequate education.¹⁴ At trial in *CFE v. State*, however, Guthrie never used the word "adequacy" in his direct examination, offered no opinion as to whether the amount of education funding is adequate in New York City, and admitted that he had not examined whether funding provided through formulas was adequate.

Robert King, the former state budget director, also admitted that he had no knowledge as to costs associated with meeting New York's students' needs. King admitted that the Division of the Budget has not undertaken any analysis to determine whether state aid is sufficient to address student needs. For example, he specifically testified that the Division of the Budget has never analyzed whether formulas such as Extraordinary Needs Aid are sufficient to meet the costs associated with at-risk students. Moreover, King testified that the Division of the Budget has never analyzed district spending, assessed whether it is sufficient to provide an adequate education, or evaluated whether any of the purposes of various state aid programs are accomplished.¹⁵

¹⁴ Trial testimony, *CFE v. State*, Guthrie, p. 21214:2-19.

¹⁵ Trial testimony, *CFE v. State*, King, pp. 22004:24-22005:7.

THE STATE IS LEGALLY REQUIRED TO SAFEGUARD CITY SCHOOLS' ACCESS
TO ADEQUATE RESOURCES

*The State Is Responsible for Ensuring New York City Students a Sound Basic
Education*

At the trial, CFE presented extensive evidence and testimony to show that the state finance system is not equipped to assess student needs and that, indeed, New York City does not receive sufficient financial resources to meet its students' needs and to provide them with the opportunity for a sound basic education. Given that school funding comes from several sources, as described earlier, who then should be held responsible for New York City's funding shortfall?

CFE established at trial that, under the state constitution, New York State bears ultimate responsibility for ensuring that adequate resources are provided in all New York schools. In sustaining the complaint in *CFE v. State*, the Court of Appeals held that "the Education Article imposes a duty on the Legislature to ensure the availability of a sound basic education to all the children of the State."¹⁶ The Court recognized that the state's responsibility not only extends to making "prescriptions" regarding the configuration of the state system but also to ensuring that adequate resources are available in the schools.

So that it can carry out this constitutional responsibility, New York State maintains authority over local governments, including the ability to force them to raise and allocate funds for education. The Court of Appeals made this clear in 1977 when it upheld the legislature's authority to require New York City to maintain education spending at a specified portion of its city budget. "Education," the Court

¹⁶ *CFE v. State of New York*, 86 N.Y.2d 307, 315 (1995).

explained then, "is a State concern, and . . . legislation dealing with matters of State concern even though of localized application and having a direct effect on the most basic of local interests does not violate the constitutional home rule provisions."¹⁷

In other words, whatever authority local governments exercise over education is authority delegated by the state. According to the New York Court of Appeals, every local government is an "instrumentality of the general government of the State, [and] it exercises powers of government which are delegated to it by the Legislature."¹⁸ Therefore New York State is responsible for the adequacy of New York City's education funding; it has the constitutional authority to ensure that sufficient resources are provided to local schools and cannot abdicate its authority or shift its responsibility to local governments. The constitution does not say the state has to assume some predetermined share of the cost of providing adequate resources, but it does dictate that state ensure that the total amount of funds is sufficient to provide a sound basic education.

The State Maintains the Board of Education's Dependence on City Funding

New York State not only has constitutional authority over education funding throughout the state; it also controls, in practice, the ways in which local municipalities and school districts raise revenue for education. In New York, the state has designated most of its 680 school districts "independent" districts. As independent districts, they can raise local revenue for education through taxes levied by their boards of education on residential and commercial properties within the boundaries of each district. In these districts, the local school boards assess property tax levies based either on voter-approved school budgets or legislatively prescribed contingency budgets, if voters fail to approve a board's proposed budget.

¹⁷ *Board of Educ. of the City Sch. Dist. of the City of New York v. City of New York*, 41 N.Y.2d 535, 542 (1977).

¹⁸ *Brown v. Hamptonburg Sch. Dist. No. 4*, 303 N.Y. 484, 488 (1952).

Property taxes provide nearly 90 percent of local education revenues for the independent districts.

In contrast, the school districts in New York State's five largest cities (New York City, Buffalo, Yonkers, Syracuse, and Rochester) have no independent revenue-generating authority. The legislature prevents these "Big 5" school districts from levying taxes to fund school budgets. These districts are thus called "dependent" districts; they must depend on their city governments for funding. By state law, then, the New York City Board of Education must rely on allocations made by the city government from revenues collected by the municipal finance system.

The State's reply to CFE's charge that the state finance system deprives New York City schools of adequate resources is to claim that the city is responsible. According to the State, the city has not provided sufficient funds to the Board of Education, even though it has the fiscal capacity. This contention fails as a matter of law, for the state bears the ultimate responsibility to ensure that New York City students get the opportunity to receive a sound basic education.

The trial record shows that the state has ignored this responsibility. It has fostered and tolerated an education finance system that, at least with respect to New York City, relies too heavily on a fiscally unstable, heavily burdened, heavily taxed, and heavily indebted local government to make up the difference between state funding and what is necessary to provide adequate resources to the city's public schools. In effect, the state has placed too much responsibility on the city's finance system without providing sufficient safeguards to ensure that adequate resources are provided to the city's schools.

The state's share of funding for the New York City public school system, 40-42 percent of total spending in recent years, is not sufficient alone to provide city

schools with adequate resources. The constitution does not require full state funding of education. But the result is that the New York City Board of Education must rely on the municipal government for a large portion of its budget. This state-forced reliance has meant that the Board of Education receives insufficient funds to provide adequate resources to the city schools. The current structure of the municipal finance system includes no mechanism to ensure that the city's education spending, when combined with the state's share, is sufficient to provide adequate resources. In fact, the current structure inhibits sustained, sufficient funding for education.

Three fundamental characteristics of New York City's municipal finance system contribute to fiscal instability for the Board of Education. First, on the revenue side, New York City's tax receipts are particularly sensitive to cyclical changes in the economy that force the city into periodic budget crises. Second, on the expenditure side, New York City must fund a wide array of "essential" municipal services from the same revenue sources that are used to fund education. Third, the city's debt burden is substantial, in part because of its need to fund essential services even during budget crises.

Cyclical Changes in Its Economy Limit New York City's Ability to Support Education

Outside of New York City, local school districts rely principally on property taxes to finance school budgets. Property taxes account for almost 90 percent of local spending in many districts and 79 percent statewide. Property tax revenues tend to be relatively stable over time and provide a predictable revenue stream to school districts. In contrast, local education funding in New York City is allocated from municipal revenues only 37 percent of which are raised from property taxes. Twenty-one percent of municipal revenues come from the personal income tax, 16 percent from sales taxes, and 26 percent from all other taxes, including a variety of

business taxes. Income, sales, and business taxes are particularly susceptible to changes in the economy.

In the CFE trial, the State's own expert Dr. Michael Wolkoff conceded that New York City's reliance on a more diversified tax base, particularly its reliance on income tax revenue, makes it more susceptible to cyclical changes in the national economy. Wolkoff estimated that a 5 percent drop in the national economy would result in a 11 percent unemployment rate in New York City, making it the second most vulnerable city to an economic downturn in the country. He also testified that, during any economic downturn, cities such as New York City face increased expenditures for public assistance, fire, and crime control, and the increased use of public facilities.

Costs of Providing Basic Services to Its Citizens Reduce the City's Capacity to Contribute to Education

In addition to the instability created by a tax base particularly sensitive to economic cycles, New York City's municipal finance system must provide funding for a wide range of municipal services. Some of these, including public assistance and Medicaid, are mandated by state law. The per capita costs of providing these services in New York City are generally higher than in the rest of the state, both because of higher demand for services and because of higher costs for goods and services.

State requirements force the city to assume a greater share of costs for certain services than elsewhere in the state. For example, the state has imposed a matching requirement for Medicaid and public assistance funding that forces city taxpayers to pay nearly \$300 more per capita for Medicaid and nearly \$70 more for public assistance than residents in the rest of the state. New York City currently spends 14 cents of every dollar on Medicaid and public assistance costs.

The City's Heavy Debt Burden Reduces Its Ability to Support Education

Periodic budget crises, arising, at least in part, from the significant cyclical swings in the city's economy, combined with the need to fund extensive and expensive municipal services, have forced the city to take on a heavy debt burden. This burden has had a direct, negative impact on New York City public school facilities. The city's high debt burden limits the Board's ability to fund its capital projects. Like its overall financial structure, the city's debt burden is subject to direct state control.

New York City's direct debt per capita is much higher than other cities in New York State or across the country. Direct debt per capita is debt credited to the property tax, as opposed to debt backed by separate authorities and financed by user fees. In 1997, New York City's debt per capita amounted to \$4,219, significantly higher than the debt per capita incurred in other New York State dependent school districts, including Rochester (\$1,204 per capita), Syracuse (\$1,175 per capita), Yonkers (\$917 per capita), and Buffalo (\$732 per capita).

The City Has Little Unused Financial Capacity to Support Education

At the trial, the State contended that New York City has the fiscal capacity to increase funding for education significantly. To support this contention, the State relied on their experts' testimony that New York City is a relatively wealthy district that undertaxes its residents and the fact that city has had substantial budget surpluses in recent years. Even if the State's assertions about the city's fiscal capacity were true (and evidence contradicts several key State assertions), the State would only have established that it has constructed and perpetuated an education finance system that fails to provide sufficient resources to the New York City school system, even though both state and local governments have the fiscal capacity to provide

those resources. In fact, New York City is heavily taxed, and its education funding shortfalls are not the result of low local tax rates.

New York City's Tax Burden Is Above the State Average

The State argued at the CFE trial that New York City could raise significant additional funds (as much as \$2 billion) for education simply by increasing its education funding effort (as a percentage of its income base and property valuation base) to the statewide average. However, State's expert Michael Wolkoff admitted that this contention has no connection to fiscal or political reality; it is based on the false premise that fiscal capacity and tax effort can be measured by isolating education spending from other components of the municipal budget.

As Wolkoff testified on cross-examination, in order to devote an additional \$2 billion dollars to education, New York City must either increase taxes or shift dollars from existing municipal services. He conceded that he had made no effort to determine whether either option was a feasible financial alternative. Indeed, he testified that he had no opinion as to New York City's actual ability or fiscal capacity to raise taxes by \$2 billion annually.

Wolkoff's analysis failed entirely to consider New York City's overall tax burden. In fact, New York City's overall tax burden on residents, and overall tax rates for businesses, are higher than state or national averages. When measured as a percentage of total tax revenue to personal income, New York City's overall tax burden is 7.7 percent, amounting to a per capita tax of \$2,568. This tax burden is 10 percent higher than the average rate in the rest of the state.

Dr. George Sweeting of the Independent Budget Office has analyzed local tax burdens in order to compare taxes in different jurisdictions. He found that "New York City's homeowner households pay, on average, \$4,675 in combined property

and personal income taxes, the third highest tax rate among [the State's] counties."¹⁹ This rate was higher than taxes paid in the surrounding suburbs, where households pay \$4,534 in combined property tax and local personal income tax. Upstate resident homeowners paid taxes averaging \$2,799.

New York City businesses are also taxed at relatively high rates. An analysis of national tax rates commissioned in 1998 comparing business taxes imposed on a company with 125 employees and revenue of \$15 million and profits of \$1.5 million concluded that New York City had the second highest business taxes among the 27 largest cities in the country. New York City's total local tax effort is the highest of any major city, even when local non-city taxes (county, school district, and other local jurisdiction taxes) are included.

The State Has Failed to Ensure Maintenance of Local Efforts

Because the New York City schools are thus vulnerable during the city's cyclical economic downturns, their local funding needs to be stabilized. Across the country, similar concerns that school districts receive sustained, adequate education funding have propelled changes in many state finance systems. Recognizing that education is a state function, almost four-fifths of the states have adopted mechanisms designed to ensure an adequate local share of resources to support education. These provisions—commonly referred to as maintenance of effort or minimum tax effort provisions—are built on the premise that, as Deputy Education Commissioner James Kadamus testified at the CFE trial, "districts ought to spend equivalent resources from year-to-year in order to maintain fiscal effort and capacity from local sources in order to receive additional dollars from the State."²⁰ According to a state education department study, "New York is one of only 11 states relying on

¹⁹ New York City Independent Budget Office, *Comparing Homeowner Tax Burdens Across New York State*, February 2000, p. 3.

²⁰ Trial testimony, *CFE v. State*, Kadamus, p. 1658:3-21.

substantial local effort for public education funding without specifying what that effort should be in some fashion.”²¹

At trial, the State argued that New York City was not providing enough local funds to support the city’s schools. Even if, despite the arguments in the previous sections, this were true, New York State has not taken enough steps to ensure that localities make sufficient contributions to schools. The legislature clearly has authority to regulate the level of New York City’s expenditures for education. In the late 1970s, it passed a maintenance of effort requirement, known as the Stavisky-Goodman Law, that requires New York City to appropriate an amount of funds to the Board of Education from the total budget equal to the average proportion of the total budget appropriated for the Board in the three preceding fiscal years. The law has, however, proved ineffective and become out of date.

The Regents and the state education department have regularly asked the legislature to strengthen this law. As Thomas Sobol explained at trial, the Regents did not wish to permit localities to reduce revenue for education after the state had increased aid. The Regents have repeatedly expressed the concern that the fiscally dependent school districts have “relatively limited capacity to maintain a fair share of the citywide budget for educational purposes—particularly during periods of local fiscal constraint.”²² These calls for reform have been ignored by the legislature.

²¹ New York State Education Department State Aid Work Group, Analysis of School District Local Tax Effort, September 1999, p. 12

²² New York State Education Department Fiscal Analysis and Services Unit, Memo on Maintenance of Effort: Big 5 Cities, March 25, 1992, p. 1.

RECENT AID INCREASES CANNOT REPLACE REFORMING THE SYSTEM

New York State's total expenditures for education have increased over the last decade and are now among the highest in the nation. According to the most recent figures released by the state education department, total expenditures on education increased from \$19.4 billion in 1989-90 to \$27.4 billion in 1997-98.

Since 1997-98, New York State and its localities have continued to increase expenditures for public education. Robert King, the former state budget director, testified at trial that between 1993-94 and 1999, general support to public schools increased \$3.71 billion, a 40.8 percent increase in funding local education. King testified that aid is projected to increase to almost \$5 billion by fiscal year 2001.

A massive new state education aid program has further added to funding. The School Tax Relief Program (STAR), initiated by the governor in 1998-99, provides state aid to school districts for educational purposes. As a percentage of state general fund spending (including lottery revenues), school aid and state aid have grown from 26.5 percent to 35 percent of the budget between 1991-2000.

Still, the absolute amount of state spending and the relatively large increases over the last several years do not satisfy the state's constitutional obligation to provide the opportunity for a sound basic education. As the Court of Appeals made clear, the issue is whether any particular district has the resources necessary to provide the opportunity for its students to obtain a sound basic education. This issue can only be determined by looking at total district spending (including state and local revenues) and the adequacy of resources purchased with that money.

Even if state spending alone were the proper measure for judging whether the state had met its constitutional obligation, there is presently no way of determining that any particular amount of state spending (or the specific amount provided to New York City) is sufficient to discharge the state's constitutional obligation. Although the State's experts submitted evidence at the CFE trial showing that New York State is one of the highest spending states, it offered no evidence concerning the adequacy of education in any other state. As discussed above, the state education finance system historically has not adequately addressed student need, and the system has no mechanism for determining need. Simply increasing funds during flush times by itself does not correct these deficiencies.

Recent increases in funding are the chance result of unprecedented budget surpluses at the state and local levels rather than structural reform intended to ensure that adequate resources are provided to New York City schools and other high-need areas on a sustained basis. These increases were distributed according to the share agreement, thus squandering the opportunity to correct long-standing inequities and gear funding to need. Since there has been no fundamental change in the structure and operation of the state education finance system, there is no guarantee that recent increases are sufficient or that funding will be sustained at a sufficient level.

Longstanding Variations in State Expenditures Show the System Fails to Address Student Need

One of the more tangible manifestations of the ongoing failure of the state finance system to align resources with need is the per-pupil spending disparity between New York City and other high-need districts, and the rest of the state. In part, this disparity results from the state's heavy reliance on local revenues to support the New York State education system. Because most of these local revenues come from local property taxes, disparities in expenditures are related to district

wealth. As a result, districts with the fewest at-risk students tend to spend substantially more than districts with higher percentages of at-risk students. The poorest districts consistently raise approximately one-eighth of the local levy per pupil that the wealthiest districts do (\$1,351 versus \$10,206). These districts may, in fact, tax themselves at a far greater rate just to raise a very small amount of revenue (\$15.35 versus \$11.00 per \$1,000 of assessed full value).²³

New York City has a higher concentration of extraordinary needs students than the Big 4 or other school districts in the state. Yet, New York City's per capita spending is substantially below the average of the rest of the state. In 1997-98, New York City enrolled 1,076,961 students and spent \$9.5 billion in state, federal, and local funds on education, or approximately \$8,788 per pupil. In contrast, districts in the rest of New York State, enrolling 1,755,156 pupils, spent \$18.2 billion in state, federal, and local funds or \$10,342 per pupil. This disparity of \$1,554 per pupil, when multiplied by New York City's student enrollment, amounts to approximately \$1.7 billion.²⁴

In addition to spending less than the state average, New York City spends nearly \$4,000 per pupil less than the average per-pupil expenditures in the low-need districts in the surrounding suburban counties, even though these districts face similar regional costs and have very few at-risk students.

New York City is unique among major U.S. cities in spending less than its statewide per-pupil average on education. Robert Berne examined the ratio of city to average state expenditures in the 30 largest metropolitan areas in the United States. According to Berne's research, cities generally have higher percentages of high-need students and consequently tend to spend more than other districts in

²³ New York Board of Regents, 1998-99 School Aid Proposal, December 1997.

their state.²⁵ In 1983-84, only Baltimore had a ratio of local to average state spending that was lower than New York City. The vast majority of American cities spent above the statewide average. Twelve years later, there was little change. In 1996-97, New York City continued to have the second lowest ratio of local to state average spending. That New York City, with its high number of at-risk students and higher cost of living, spends substantially less per student than the state average and a third less than neighboring districts with few at-risk students, provides additional proof of the failure of the state finance system to address need adequately.

Since the late 1960s, the state has convened a series of special commissions and task forces to look at the school finance system. Each has recognized that disparities in spending between New York State school districts are emblematic of the diminished educational opportunities for some of the most vulnerable children in our state. The 1982 Rubin Task Force, the 1988 Salerno Commission, and the 1993 Moreland Commission all recognized the deep flaws in the New York State education finance scheme.²⁶ These commissions generally determined that the misalignment between resources and student need, the inability of urban areas to support education on par with their suburban neighbors, and the state's inability to implement fundamental reforms have a devastating and unacceptable impact on thousands of New York State students.

²⁴ New York State Education Department, *Analysis of School Finances in New York State School Districts*, 1997-98, January 2000, pp. 20-21, Tables 12 and 13.

²⁵ Trial testimony, *CFE v. State*, Berne, pp. 11935:18-11939:8.

²⁶ Trial testimony, *CFE v. State*, Berne, pp. 12004:15-12010:13; H. Carl McCall, State Comptroller, *An Agenda for Equitable and Cost-Effective School Finance Reform*, October 1996, pp. 34-41.

CONCLUSION

Recent funding increases may have improved New York City's capacity to provide access to a sound basic education to its public school students, but since the funding system is not based on educational costs or needs, it is not providing a sufficient level of expenditures to the high-needs districts. New York State's historical record provides compelling evidence that, without judicial intervention to clarify and change the state finance system, reform is unlikely, and this clear constitutional wrong will continue.

For this reason, CFE has asked that the Court require the state to adopt an "objective methodology" that will ensure that sufficient funds are available in each school district to provide every school sufficient operating and capital funds to offer all its students the opportunity for a sound basic education. CFE has asked the Court to declare that the legislature bears ultimate responsibility for all aspects of education funding in the state.

CFE has also taken the position that a constitutionally acceptable funding system should

- guarantee that every school has sufficient funds to provide all students with the opportunity for a sound basic education;
- take into account variations in local costs;
- be simple and comprehensible to the public;
- provide sustained and stable funding in order to promote productive long-term planning by schools and school districts; and

- allow school districts to enhance educational opportunities for their students beyond constitutionally required levels.

Until New York State implements a cost-based education finance system, no amount of increased spending can remedy the fundamental failure of the system to ensure that every year enough money is provided from whatever source to provide an opportunity for a sound basic education to all the state's schoolchildren.

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