Legislative Fiscal Bureau

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Secondary Cost Ceiling (DPI -- General School Aids)

[LFB 2001-03 Budget Summary: Page 532, #3]

CURRENT LAW

There are three guaranteed valuations used in the equalization formula that are applied to three different shared cost levels. Each district receives a distinct aid amount and percentage of state support for each tier of the formula, based on its shared costs eligible for aid on that tier.

Primary tier. The first tier is for shared costs up to the primary cost ceiling of $1,000 per member. State aid on these primary shared costs is calculated using a statutory guaranteed valuation of $2,000,000 per member, and is based on a comparison of the school district's equalized valuation per member to the $2,000,000. State aid equals the amount of costs that would be funded by the missing portion of the guaranteed tax base. Every district receives at least the primary aid amount; primary aid cannot be reduced by negative aids generated at the secondary or tertiary aid levels.

Secondary tier. The second tier is for shared costs that exceed $1,000 per member but are less than the secondary cost ceiling, which is equal to $6,533 per member in 2000-01. The secondary cost ceiling is adjusted for inflation annually. The state's sharing of secondary costs is calculated using the secondary guaranteed valuation. The secondary guarantee is not set statutorily, but is allowed to float to a level that fully distributes the available amount of funding for general school aids. In 2000-01, the secondary guaranteed valuation is $874,011.

Tertiary tier. The third tier is for shared costs that exceed the secondary cost ceiling of $6,533 per member. State aid on these tertiary shared costs is calculated using the statewide average equalized valuation per member, which is $303,298 in 2000-01. If a school district's tertiary aid is a negative number, this amount is deducted from its secondary aid. As noted above, if the sum of a district's secondary and tertiary aid is a negative number, this amount is not deducted from its primary aid amount.

GOVERNOR

Set the secondary cost ceiling per member under the equalization aid formula equal to $6,900 in 2001-02 and $7,300 in 2002-03. Beginning in 2003-04 and in each year thereafter, the secondary cost ceiling would continue to be adjusted annually for inflation.

DISCUSSION POINTS

1. The equalization aid formula operates under the principle of equal tax rate for equal per pupil costs, or tax base equalization. In pure form, this means that a school district's property tax rate does not depend on the property tax base of the district, but rather depends on the level of costs. Simply stated, there is an inverse relationship between equalization aid and property valuations; those districts with low per pupil property valuations receive a larger share of their costs through the equalization formula than districts with high per pupil property valuations. The purpose of this policy is to minimize the differences among school districts' abilities to raise revenue for educational programs.

2. To this end, the tertiary level of the equalization formula is intended to serve two purposes. First, it serves as a disincentive for higher spending levels by causing districts to receive aid at much lower levels for costs incurred above the secondary cost ceiling, or lose aid attributable to those costs if a district's per member equalized value is greater than the tertiary guarantee. Second, it attempts to narrow the per pupil spending disparities among school districts by redistributing aid to districts that spend at lower levels.

3. The current three-tiered cost sharing formula was enacted in 1995 Act 27 and first applied to equalization aid paid in 1996-97. The same disincentive effect and redistribution of aid was incorporated in the previous two-tired formula. The following table shows the secondary cost ceiling and total statewide shared costs per member for each year since 1996-97. As shown in the table, the secondary cost ceiling was equal to 97.2% of the statewide shared cost per member in 1996-97. In 2000-01, this percentage declined to 88.8%.

Secondary Cost Ceiling and Statewide Shared Cost Per Member

	Secondary Cost Ceiling		Statewide Shared Cost Per Member		Secondary Cost Ceiling as Percent of Statewide Shared Cost Per Member
Fiscal Year	Amount	% Change	Amount	% Change	
1996-97	$5,936		$6,105		97.2%
1997-98	6,102	2.8%	6,438	5.4%	94.8
1998-99	6,285	3.0	6,763	5.0	92.9
1999-00	6,430	2.3	7,061	4.4	91.1
2000-01	6,533	1.6	7,355	4.2	88.8

4. As a result of the decline in the secondary cost ceiling relative to statewide shared

cost per member, a relatively larger share of school district costs are aided at the tertiary, rather than the secondary, tier of the equalization aid formula. In 1996-97, 173 districts had shared costs per member lower than the secondary cost ceiling. By comparison, in 2000-01, only 21 had shared costs per member lower than the secondary cost ceiling.

5. Administration officials indicate that the Governor's recommendation is designed to restore some of the value of the secondary cost ceiling relative to statewide shared cost per member. By setting the secondary cost ceiling statutorily in the 2001-03 biennium, it can be adjusted to a level that more closely reflects its historical relationship to statewide shared costs per member. Returning to the inflationary adjustment in future biennia would allow for an ongoing increase in the secondary cost ceiling consistent with current law.

6. This provision would increase the amount of shared costs that would be aided at the secondary level and reduce the amount of shared costs that would be aided at the tertiary level of the equalization aid formula. Because districts receive a greater share of their costs from the state at the secondary than at the tertiary aid level, many districts could be assisted by an increase in the secondary cost ceiling. Those districts that would receive additional aid would generally be those with shared costs per member above the resulting secondary cost ceiling, while those with shared costs below the resulting secondary cost ceiling would generally tend to lose aid. Aid eligibility for primary aid only districts would remain unchanged.

7. Increasing the secondary cost ceiling could reduce the disincentive for higher spending by districts with shared costs per member between the current secondary cost ceiling and the proposed higher ceiling. This could divert state aid from school districts with per pupil costs below the current secondary cost ceiling to districts with higher costs. Arguably, districts subject to negative tertiary aid should be encouraged to decrease their costs to a level closer to the current secondary cost ceiling, rather than adjusting the formula in such a way that would benefit higher-cost school districts.

8. There are five factors used in the computation of equalization aid: membership, shared cost, equalized property valuation, the state's guaranteed valuation and the total amount of funding available for distribution. It is not possible to make accurate projections of the these variables for a future school year, or to make accurate projections of the distributional effect of the proposed change in the secondary cost ceiling. However, the distributional effect of various alternatives can be illustrated with the data used to calculate equalization aid in 2000-01, with the secondary cost ceiling of $6,533 adjusted proportionately with any proposed changes.

9. Each school year, the secondary cost ceiling is adjusted by the average percentage change in the consumer price index for all urban consumers (CPI-U) for the calendar year ending on the second preceding December. For the 2001-02 school year, the secondary cost ceiling will be adjusted based on the average CPI change in 1999. For the 2002-03 school year, it will be adjusted based on the average CPI change in 2000. Based on Department of Labor statistics, the average change in the CPI-U was 2.2% in 1999 and 3.4% in 2000. Thus, under current law, the secondary cost ceiling will be $6,677 in 2001-02 and $6,904 in 2002-03. The Governor's recommendation

would then set the secondary cost ceiling 3.3% higher than current law in 2001-02 and 5.7% higher than current law in 2002-03.

10. Had the secondary cost ceiling been 3.3% higher in 2000-01, which is equivalent to the increase recommended by the Governor in 2001-02, it would have been $6,749. Over $5.9 million would have been redistributed among school districts, with nearly 350 districts receiving additional aid and nearly 50 receiving less aid. Aid eligibility for over 30 districts would have remained unchanged. Districts with shared costs per member at or below the new secondary cost ceiling would have tended to lose aid. Had the secondary cost ceiling been 5.7% higher in 2000-01, which is equivalent to the increase recommended by the Governor in 2002-03, it would have been $6,905. Over $15.9 million would have been redistributed among school districts, with nearly 330 districts receiving additional aid and nearly 70 receiving less aid. Aid eligibility for over 30 districts would have remained unchanged. Districts with shared costs per member below approximately $6,870 would have tended to lose aid.

11. It could be argued that all costs at or below the statewide shared cost per member should be aided at the more generous secondary level, and only if costs exceed the statewide per pupil amount should districts be penalized with a lower aid rate or negative tertiary aid. While under current law the secondary cost ceiling is adjusted annually for inflation, it may be more consistent to tie the secondary cost ceiling to the actual statewide costs per member in the prior year, rather than to an inflationary increase from a base amount that is below the statewide per pupil amount.

12. Setting the secondary cost ceiling equal to statewide shared cost per member, however, would reduce the disincentive effects of the tertiary aid level to an even greater extent than the Governor's recommendation, providing even less incentive for districts to maintain costs at a relatively lower level.

13. Had the secondary cost ceiling been set at the prior year statewide shared cost per member in 2000-01, it would have been $7,355. Over $55.7 million would have been redistributed among school districts, with nearly 260 districts receiving additional aid and nearly 140 receiving less aid. Aid eligibility for over 30 districts would have remained unchanged. Districts with shared costs per member below approximately $7,130 would have tended to lose aid.

14. To ensure that the secondary cost ceiling continues to increase at a level more consistent with statewide shared cost per member while still providing for disincentives for spending on the part of school districts, the Committee could chose to set the secondary cost ceiling equal to a percentage of statewide shared cost per member. For example, the secondary cost ceiling could be set at 90% of statewide shared cost per member in the prior year, given that the secondary cost ceiling has been at approximately that level of shared costs in 1999-00 and 2000-01 and would be expected to be at approximately that level in 2001-02 and 2002-03 under the Governor's budget bill.

15. Had the secondary cost ceiling been set at 90% of the prior year statewide shared

cost per member in 2000-01, it would have been $6,620. Nearly $1.6 million would have been redistributed among school districts, with nearly 370 districts receiving additional aid and nearly 30 receiving less aid. Aid eligibility for over 30 districts would have remained unchanged. Districts with shared costs per member at or below the new secondary cost ceiling would tend to lose aid.

16. It could be argued, however, that the negative tertiary aid feature of the equalization aid formula is functioning as intended with the inflationary increase allowed under current law. By reducing aid for higher-cost, higher-value districts, the aid formula acts as a disincentive to further cost increases that could widen the spending disparity between school districts. In addition, the aid lost by these higher-cost, higher-value districts is redistributed under the formula to lower-cost, lower-value districts, which could assist those districts in increasing their spending or reducing their property tax.

ALTERNATIVES TO BASE

1. Adopt the Governor's recommendation to set the secondary cost ceiling per member under the equalization aid formula equal to $6,900 in 2001-02 and $7,300 in 2002-03. Beginning in 2003-04 and in each year thereafter, the secondary cost ceiling would continue to be adjusted annually for inflation.

2. Beginning with equalization aid paid in 2001-02, define the secondary cost ceiling of the equalization aid formula to equal 90% of prior year statewide shared costs per member. Delete the requirement that the secondary cost ceiling be adjusted annually for inflation.

3. Beginning with equalization aid paid in 2001-02, define the secondary cost ceiling of the equalization aid formula to equal 100% of prior year statewide shared costs per member. Delete the requirement that the secondary cost ceiling be adjusted annually for inflation.

4. Take no action.

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