Arkansas Advocates for Children & Families
State Fiscal Analysis Initiative

PAYCHECK$ and POLITICS

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INTRODUCTION

In May, Pulaski County Chancellor Collins Kilgore issued a long-anticipated decision in the Lake View school-funding case *(Lake View School District v. Huckabee*). In his decision, Judge Kilgore ruled that the state's current school-funding formula is unfair to poorer school districts and provides inadequate funding for the education of the state's children. If upheld by the Arkansas Supreme Court, the Lake View case will have major implications for education, the state and local tax systems, and possibly other programs serving low- and middle-income families.

This new brief from the Arkansas State Fiscal Analysis Initiative (SFAI) is the second in a series devoted to the Lake View school-funding case, and provides an overview of the fiscal issues that are likely to be faced as the state considers ways to meet the court's ruling. Among the issues:

- What is an "adequate" education system and how much will it cost?
- How will we pay for an adequate education system?
- What are the implications of the Lake View case for low-income families?
- Where do we go from here?

The Lake View Case: What It Means For Families

by Richard Huddleston and James Metzger

When Judge Kilgore ruled that Arkansas's system for funding public schools is both inequitable and inadequate under the state constitution – and therefore unconstitutional – seven concerns dominated his decision:

1. *Inequities in school curricula.* School districts throughout the state must provide substantially equal educational opportunities for their children. The court acknowledged that some districts, such as Holly Grove or Lake View, might never be able to offer the rich curriculum offered by Fort Smith and other wealthier districts. The state, however, cannot abandon its constitutional obligation to provide similar educational opportunities just because one school district is located in a poorer region of the state.

2. *Inequities in school buildings and facilities.* The state, and not local school districts, has the ultimate burden of ensuring that every school district has "substantially equal facilities to provide a general, suitable, and efficient system of education." Buildings properly equipped and suitable for instruction are critical for education and must be provided. The state must provide some adequate remedy that allows every school district to have equal facilities, equipment, supplies, etc.

3. *Measuring equity.* Expenditures – not revenues – should be the basis for measuring equity. Expenditures should also be used to determine whether education funding is being distributed equitably. Judge Kilgore agreed with arguments that the best measure of whether available funds are being applied efficiently to the education of the state's children is by an accurate accounting of expenditures. The amount of funds distributed by the state that actually reach the classroom, rather than the revenue the state distributes to schools and school districts, is the better measure. The state's constitutional obligation to educate students does not end upon the disbursement of revenues to school districts.

4. *Inadequate teachers' salaries.* Judge Kilgore ruled that teachers' salaries in Arkansas are inadequate to attract and maintain qualified teachers who can provide students with an education. No deficiency in the state's education system is in

more urgent need of attention than teachers' salaries.

5. Deficiencies in early childhood education. Judge Kilgore relied on facts presented at trial concerning the critical role that early childhood education plays in long-term educational success. He ruled that the state must provide pre-school programs that will allow children to compete academically with their peers. He also ruled that the urgency of this need equals that of the deficiency in teachers' salaries.

6. Measuring adequacy. Historically, the state has funded its educational system not on the basis of adequacy, but by first determining how much money was available and then deciding how to divide it. The availability of funds, rather than adequacy or need, has been the standard. Judge Kilgore's ruling requires that the state conduct an adequacy study to determine how much it would cost to provide an "adequate" educational system.

7. The role of desegregation funds. Desegregation funds provided to the Pulaski County school districts should not be included in determining equity between schools. Judge Kilgore ruled that such funds should not be included because they compensate the Pulaski County school districts for expenses that are unique to them.

In *Lake View*, Judge Kilgore relied heavily on Arkansas' low state rankings in educational achievement to determine that the public school funding system is unconstitutional.

The state is appealing Judge Kilgore's ruling to the Arkansas Supreme Court. The Supreme Court is expected to take six to 12 months to decide the appeal (see last page for a description of the appeals process).

What is 'Adequacy' and How Much Will It Cost?

Throughout his *Lake View* decision, Judge Kilgore relied on a Kentucky case, *Rose vs. Council for Better Education* (1989), as the standard for his ruling. In *Rose*, an "efficient" educational system was defined as having "substantial uniformity, substantial equality of financial resources and substantial equal educational opportunity for all students." *Rose* also required that the educational system be adequate, uniform and unitary. Using the *Rose* standards, the Kentucky court further clarified that such a system:

- Be solely the responsibility of the General Assembly.
- Spread the tax effort evenly.
- Provide the necessary resources throughout the state, and it must be uniform.
- Provide an adequate education.
- Be properly managed.

In *Rose*, the court concluded that the goal of an educational system should be to provide every child with seven critical capacities – standards of educational achievement:

- Oral and written communication skills to enable students to function in a complex and rapidly changing civilization;
- Knowledge of economic, social and political systems to enable the student to make informed choices;
- Understanding of governmental processes to enable students to understand the issues that affect one's community, state, and nation;
- Self-knowledge and awareness of one's mental and physical wellness;
- Training or preparation for advanced training in either academic or vocational fields so as to enable each child to choose and pursue life's work intelligently; and
- Academic and vocational skills to enable public school students to compete favorably with their counterparts in surrounding states, in academics. or in the job market.

While some critics have decried *Lake View* as having potentially disastrous fiscal implications for the state, others view the case as a historic opportunity to improve education for all children, regardless of their income status or geographic location.

A major issue, of course, is how the state will pay for the new costs associated with the Lake View ruling. The potential costs are staggering. During the trial, education finance experts testifying on behalf of several school districts suggested that funding for public education would have to be increased by $450 million to $900 million over current levels to provide an adequate public school system for all students. While these estimates provide a very rough indication of the potential costs associated with adequacy, they are not very useful for policy-makers. By their own admission, the experts citing these figures acknowledged the estimates were not based on a careful analysis of the Arkansas system.

The choice of a financing option(s) will depend, in large part, on whose estimates are adopted as the costs of providing an adequate education. It obviously makes a big difference whether the costs are closer to $450 million or $900 million. Some key policy-makers believe that such high estimates are off the mark. In a recent editorial in the *Arkansas Democrat-Gazette*, Ray Simon, head of the Arkansas Department of Education, noted testimony by department staff that, with the exception of teachers' salaries, more money was not the answer to higher student performance. Such comments indicate there is not yet a consensus about what it would cost to provide adequate funding for education. The state needs to conduct an adequacy study immediately to develop more accurate estimates of how much new funding will be needed to meet whatever adequacy standards eventually come out of *Lake View*.

An essential part of any such study is developing a model for providing an adequate education. In his ruling, Judge Kilgore relied on the *Rose* standards. As in other adequacy cases across the country, it will be up to Arkansas to use the *Rose* standards and develop the (1) policy and programmatic details and (2) service-delivery approach of a new educational system.

These details, of course, will determine how much adequacy costs and how much revenue will be needed. Rather than start from scratch, Arkansas should examine the new educational systems that were developed in other states in response to adequacy cases. It should also examine the statistical models that have been used in other states, such as Illinois or Maryland, to estimate the fiscal impacts of implementing new systems (note: a future issue of *Paycheck$ and Politics* will examine the adequacy question in greater detail).

How Will We Pay for an Adequate Educational System?

Once the state has a better understanding of how much it will cost to pay for an "adequate" educational system, it will be in a better position to identify financing options for raising the necessary funds. In essence, three basic strategies are available for raising the money needed to pay for implementing *Lake View*:

1. Spending current educational dollars differently or more efficiently;
2. Re-allocating funds from other state programs to education; or
3. Raising new tax dollars.

1. Spending current education dollars differently or more efficiently. The state and public schools likely will be forced to undertake a critical examination of current priorities in state and local education budgets and consider changing the way funds are allocated. Educational activities that are not considered "core" educational functions — activities that are not essential to providing all students with an adequate education — might be at risk of being eliminated or scaled back considerably.

This option likely will be favored by those who think there is "fat" in current education budgets or that too much money is spent on activities that are not essential to improving student performance.

A critical question that policy-makers will have to consider is what is a "core" or "essential" educational activity? Extracurricular activities such as athletics, band and student clubs might be vulnerable targets for some policy-makers. The state may also consider eliminating or scaling back some core educational activities that don't offer a "big bang for the buck" in terms of payoff for student achievement. While politically appealing to some, the fiscal reality is that Arkansas' low ranking on per-student spending doesn't allow for much "fat" in other parts of the state education budget, or at least not enough to pay for the major new investment required by *Lake View*. Such a strategy is like robbing Peter to pay Paul. It is worth noting that after the 2001 legislative session, the executive branch made deep cuts in several education programs, including early childhood education and public libraries, to help fund the small teacher pay increase adopted during the session (an increase of $3,000 per teacher over two years).

Another option that will be considered by policy-makers is reorganizing school districts to cut administrative costs and make the system more efficient. This could entail merging school districts or re-drawing district boundaries to take advantage of potential economies of scale.

Arkansas currently has 310 school districts in the state. According to one recent study conducted by *Education Week*, Arkansas has the highest percentage of high school students in districts with less than 900 students. Some policy-makers have argued that merging school districts (and their administrative staff and functions) could significantly reduce administrative expenditures, especially in smaller rural school districts. The savings then could be used to increase funding for teacher salaries or classroom-related activities. Some also argue that merging school districts could improve the ability of smaller districts to offer educational opportunities, such as an advanced math or foreign language class, that otherwise would not be offered because it is not economically feasible for them to do so.

Proponents of reorganization cite the high percentage of education expenditures on administration as evidence that reducing the number of school districts could free up funds for teachers' salaries and classroom activities. According to the latest data from the Arkansas Department of Education (for the 1998-99 school year), administrative salaries comprise about 11 percent of salary fund expenditures, or 6 percent of total education expenditures. Administrative-related operating costs (excluding the salaries of administrators) comprise about 52 percent of operating fund expenditures, or 23 percent of total education expenditures.

These figures, however, may be misleading in several respects. First, it is important to note that administrative expenditures may not really be all that high in absolute terms — they just seem so in relative terms because teachers' salaries are

Arkansas' Education Expenditures
1998-99 School Year

Budget Category	Expenditures	% of Fund Expenditures	% of Total Expenditures
Salary Fund			
Teachers	$1,011,916,307	88.4%	48.6%
Administrators	$123,070,409	10.8%	5.9%
Unused Leave and Tuition	$9,215,647	0.8%	0.4%
Total Salary Fund	$1,144,202,363	-	55%
Operating Fund			
Instruction-related	$450,565,225	48.1%	21.7%
Administration-related			
General Support	$48,628,395	5.2%	2.3%
School Administration	$53,498,580	5.7%	2.6%
Business Support			
Capital Outlay	$15,726,043	1.7%	0.8%
Maintenance and Operation	$217,333,467	23.2%	10.4%
Transportation	$94,442,681	10.1%	4.5%
All Other	$21,809,616	2.3%	1%
Central Support	$17,162,709	1.8%	0.8%
Other Support	$1,021,383	0.1%	0%
Non-program Support	$11,912,828	1.3%	0.6%
Community Services	$4,037,055	0.4%	0.2%
Total Administration-related	$485,572,757	51.9%	23.3%
Total Operating Fund	$936,137,982	-	45%
Total Operating Expenditures (salary and operating)	$2,080,340,345	-	-

Note: Includes only operating expenditures. Does not include long-term bonded debt.

Source: Arkansas Department of Education Office of Financial Accountability.

so low. Arkansas teachers' salaries are not only among the lowest in the nation, but also in the southern region. If teachers' salaries were at the regional average, instruction-related expenditures would be a higher share (and administrative costs a lower share) of the state's education expenses.

Secondly, transportation costs represent a significant portion of administrative-related costs. Administrative-related expenditures comprised about $486 million (52%) of operating fund expenditures during the 1998-99 school year. Much of this, however, was due to transportation costs. Transportation costs accounted for $94 million (10%) of all operating fund expenditures. Given Arkansas' low population density, it is unknown what impact, if any, the merging of schools and/or districts might have on Arkansas' high cost of transporting students to and from school.

There would be opposition to any state-level effort to merge schools. Opponents argue

- the potential cost savings associated with school consolidation are much less than commonly believed;
- parents and local officials would have to give up local control over schools to outsiders in surrounding communities; and
- an emerging body of research suggests that smaller school districts improve student achievement.

Parents and local officials also are likely to oppose any consolidation efforts that require greater state control at the expense of local decision-making, especially in decisions about the local financing of schools. This, at least for some observers, is one of the key issues that should be decided by the Arkansas Supreme Court.
There are numerous instances involving the merging of schools and/or school districts in recent years (for a complete listing, see http://www.asis.org/search/annexconsol2001.doc). In Pike County, the Amity and Glenwood school districts merged into the Centerpoint School District. In Southeast Arkansas, Hamburg and several other school districts merged into what is the present Hamburg School District. In Northeast Arkansas, Oak Grove and Paragould merged to form the present Paragould School District.

It is unclear what money, if any, might be saved through the merging of school districts. A 1999 study by the Arkansas Association of Educational Administrators examined expenditures in 218 Arkansas school districts involved in mergers from 1965 through the 1994-95 school year. As a group, the districts spent more after the mergers.

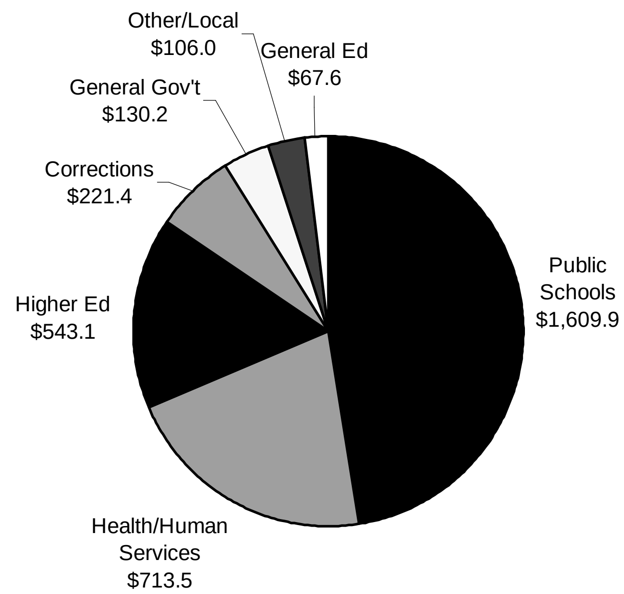
Policy-makers should examine the impact these reorganizations have had on the schools in those areas. One option that may be considered by policy-makers: greater use of one-time or short-term financial incentives to encourage the voluntary merging of smaller districts.

If the state does consider re-organizing or merging school districts, three questions will loom large:

1. What would be the projected cost savings for merging schools and/or school districts?
2. What has been the experience of other states that have merged schools and/or school districts? What has been the impact on parental and community involvement in local schools?
3. What does existing research suggest about the optimal size of rural school districts and the relationship to student achievement?

2. Cutting other services and programs funded by state general revenues. Another option for raising funds is to cut state spending on non-education programs funded by state general revenues. This option, while appealing to some, is very limited. Consider that Arkansas' state general revenue budget for fiscal year 2002 is only about $3.4 billion annually (a small budget compared to other states). Spending for public schools comprises about half of the state general revenue budget (47% or $1.6 billion). This leaves only about $1.8 billion for other programs, such as health and human services, higher education, corrections, general education, local aid, etc. Three critical functions – health and human services, higher education, and corrections – account for nearly 83 percent of the remaining part of the state general revenue budget. Cuts in any of these areas might be very difficult for these agencies to absorb and maintain on a long-term basis.

Distribution of SFY 2002 General Revenues
In Millions



Source: From a presentation by Bill Goodman of the Arkansas Bureau of Legislative Research at the Arkansas Kids Count Coalition Post-legislative Conference, May 14, 2001.

Reducing state spending for health and human services could be especially disastrous. Health and human services include many of the programs that are critical to the well-being of low-income families, such as subsidized health care, child care, etc. The state general revenue devoted to these programs is often the state match for federal dollars. In the Arkansas Medicaid program, for example, state dollars are matched at a 3-to-1 rate by the federal government; the state pays 27 percent of Medicaid-related programmatic costs, and the federal government pays 73 percent.

In state fiscal year 2001, federal government expenditures accounted for approximately 73 percent of the Medicaid program's $1.8 billion operating budget. Thus, every $1 reduction in the state match for Medicaid could result in the loss of nearly $3 from the federal government. This, in turn, could have a major negative impact on the state's ability to provide critical services for low-income families. It also could have negative consequences for the state health-care economy, an industry that contributes significantly to the Arkansas economy. According to one estimate, Medicaid represents 22 percent of the Arkansas medical economy.

3. Raising new revenues through the state tax system. Another option is to revise the state and local tax systems to increase the amount of new revenue that might be devoted to education. There are two major ways of increasing revenue:

1. Reducing corporate tax breaks and incentives; and
2. Raising taxes.

1. Reducing corporate tax breaks and incentives. One possible funding source for *Lake View* is the revenue lost annually through corporate tax incentives and subsidies designed to promote economic development. Businesses receive hundreds of millions of dollars annually in corporate tax incentives and subsidies through state sales tax exemptions, local property tax abatements, and guaranteed loans. (An upcoming issue of *Paycheck$ and Politics* will examine state tax revenue lost annually through corporate tax exemptions and incentives.)

Supporters of such incentives – including many business leaders, economic development practitioners and policy-makers – argue that incentives are necessary to allow Arkansas to compete with other states in efforts to attract and retain companies that provide jobs and income for the state's citizens. They further argue that the state more than recovers its investment in such incentives through new jobs, wages and economic development spin-offs, such as the start up of related businesses, that would not have been created without the incentive. One recent example likely to be used by supporters: Arkansas would not have been able to attract a new, 1,000 job Nestle food-processing plant to Jonesboro if the state had not offered a competitive package of incentives.

Critics oppose corporate incentives on several grounds. First, they argue that companies would have located in the state even without the incentive in many cases. Thus, the incentive represents a revenue loss to the state – revenue that could be used to fund education or other services for families. Secondly, some incentives, especially those designed to recruit new businesses to the state, are unfair to existing businesses that are not eligible to receive the same incentive.

Thirdly, there is often little accountability with these incentives, such as the costs and benefits associated with each project or the length of time companies using the incentives stay in Arkansas. Most project-specific information is protected by exemptions to the Freedom of Information (FOI) law and is unavailable to the public.

A major reduction in corporate tax incentives and subsidies could easily fund a significant new investment in the state educational system. The business community is unlikely to support major reductions in incentives and subsidies as the *sole* means to pay for *Lake View*. However, it might be willing to share the burden by backing more modest reductions as part of a multi-faceted plan that includes other financing strategies. Such a strategy would improve the state's ability to raise the necessary funds, and likely increase public support for passing any new financing strategy through legislative or constitutional action.

From an economic perspective, the reduction or elimination of corporate tax incentives and subsidies is not a decision to be taken lightly. After all, some tax incentives exist for good economic reasons, and in *some* cases, may pay for themselves through the creation of economic benefits such as new jobs and spin-off developments. One question that will have to be addressed is which incentives are worthy of being maintained and which could be eliminated or reduced without causing major long-term damage to the state's economy.

Two major developments during the 2001 legislative session should provide greater information with which to make this decision. Act 757 appropriated $150,000 for an independent study of Arkansas' current economic development incentive programs. The Legislative Council recently issued a contract for this study. Act 1282 requires an annual report to the General Assembly on the programs, goals, and strategies of the Arkansas Department of Economic Development (ADED). As part of the annual report, ADED must provide an accounting of all projects completed during the prior year, including the wages and number of jobs created.

2. Raising taxes. The most controversial way to pay for *Lake View*, of course, is to raise taxes. Each tax differs in its ability to generate funding, the political feasibility of increasing the tax, and the potential impact on tax fairness for low-income families.

<u>Ability to generate revenue.</u> Individual income taxes raise the largest share of state general revenue (an estimated $1.9 billion, or 45%, in SFY 2002 of all general revenue), followed by sales and use taxes ($1.7 billion, or 42%), and corporate income taxes ($258 million, or 6%).

In *Lake View*, testimony for the plaintiffs by education finance experts suggested that anywhere from $450 million to $900 million in new funding would be needed to provide an adequate education system. These estimates, of course, are far too imprecise to make choices about how to finance an adequate system. Nonetheless, they do provide a very rough guide as to the magnitude of the tax increases that might be needed if the state wanted to raise the new revenue from a single tax.

For the sake of discussion, let's assume that an adequacy study determines that $450 million – at the low end of adequacy estimates provided during the Lake View trial – in new revenue will be needed to provide adequate funding for education. If the state tries to raise all of the revenue from a single source, the increase in any one tax will be significant. For example, if the state wants to raise $450 million through individual income taxes, the amount of revenue raised from the tax will have to increase by 24 percent over current collections. Property taxes will have to increase by 58 percent. In contrast, because of their low tax base (relative to other taxes) and the state's historically low utilization of them, severance taxes will have to increase by 5,625 percent to generate $450 million. As large as these increases would be, they would be much higher if the cost of adequacy is deemed to be closer to $900 million.

<u>Current utilization.</u> Another factor that must be considered is the state's current utilization of a given tax. Compared to other states, Arkansas

utilizes some taxes more heavily than other sources. As a percent of personal income, Arkansas' reliance on state income taxes — including personal and corporate income taxes — is average compared to other states. However, Arkansas' use of the general sales tax is much higher compared to other states (8th among all states). Where Arkansas falls behind, and this has a direct impact on education, is the property tax. However you compare it, Arkansas' property tax burden is among the lowest in the country, ranking 46th on a per capita basis and 45th as a percent of personal income.

Increases Needed to Pay for *Lake View* if Only 1 Tax Were Increased

By Tax Source

Tax Source	Est. Revenue for SFY 02 (in millions)	Increase in Revenue Needed from Tax to Raise $450m*
State Taxes		
Individual Income	1,879.6	24%
Corporate Income	258.1	174%
Sales and Use	1,742.5	26%
Alcoholic	32.0	1,406%
Insurance	72.0	625%
Severance	8.0	5,625%
Corporate Franchise	8.0	5,625%
Estate	15.0	3,000%
Other	24.7	1,822%
Local Taxes		
Property (SFY 2000 education only)	770.8	58%

*Assumes that all $450 million in new revenue from a tax would go to education. $450 million is at the low end of estimates provided during the Lake View trial.

Source: Estimated SFY 2002 revenues are DF&A estimates, Official General Revenue Forecast, March 29, 2001. Estimates of

Arkansas' State and Local Taxes

FY 1997-98

	Per Capita		Part of Personal Income	
Tax Source	Amount	National Rank	Amount	National Rank
Personal Income	$548	32	2.6%	24
Corporate Income	$100	22	0.5%	18
General Sales	$749	19	3.6%	8
Selective Sales	$264	33	1.3%	23
Property	$356	46	1.7%	45
Total	$2,143	47	10.4%	34
Total Own-source	$3,150	49	15.2%	31

Note: "Total" includes other miscellaneous taxes not shown here. "Total Own-source," i.e. revenue generated by the state and local governments, includes taxes and other fees/ charges not shown here.

Source: Calculations by Center on Budget and Policy Priorities based on data from the U.S. Census Bureau.

Constitutional and political restrictions on raising taxes. In recent decades, the sales tax has been the tax of choice when Arkansas has needed to raise large amounts of revenue for services such as schools. Constitutional restrictions, opposition by powerful special interest groups, and lack of public support for raising other taxes has fueled the state's reliance on the sales tax.

At the state level, many taxes — including personal and corporate income taxes — constitutionally require a three-fourths vote of both houses of the Arkansas General Assembly to adopt. In contrast, general sales taxes only require a simple majority vote (50% + 1) of the General Assembly. Property taxes, a major source of revenue for education funding, don't require a vote of the Arkansas General Assembly; they must be approved in local elections by the voters in each school district, a process that makes widespread increases in revenue very unlikely.

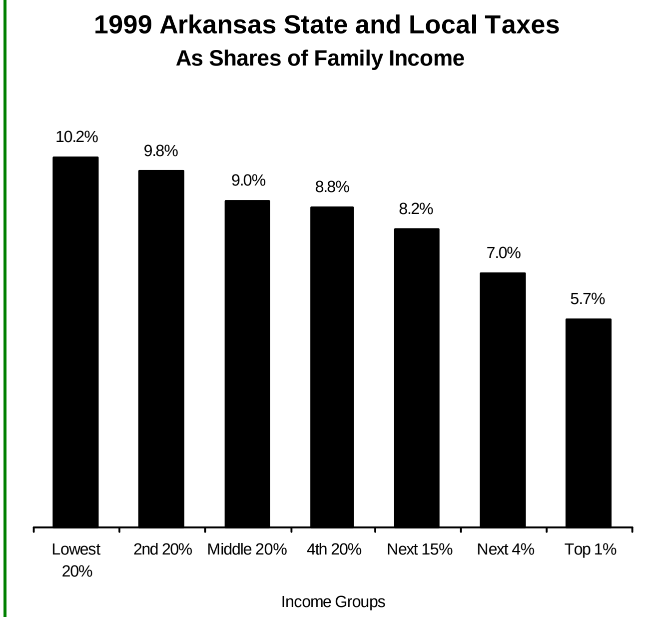
The General Assembly does have some influence over local property taxes. The General Assembly can use the school funding formula to create incentives for raising school property tax rates. Under Amendment 74 to the Arkansas Constitution, school districts must levy a minimum property tax rate for maintenance and operations (also known as the minimum uniform rate of tax, currently 25 mills). The General Assembly may propose an increase in the uniform tax rate, but the change must be approved by the voters in a state-wide election. A state-administered property tax, which some have speculated might be necessary to generate new education funding, would require major amendments to the Arkansas Constitution.

In efforts to raise new funding for education, public opinion may be more important than constitutional restrictions. Historically, property taxes are among the most hated taxes. Public dislike of the property tax was so prevalent that voters overwhelmingly passed a constitutional amendment during the 2000 election that cut property taxes by $300 per homestead (a special session of the General Assembly replaced the lost revenue with a half-cent sales tax increase). Beyond that, it is worth noting that the public is more likely to support increases in specialized "sin" taxes, such as on alcohol or tobacco, than in more broad-based taxes, such as personal income taxes.

A 2001 poll conducted by Arkansas Advocates for Children & Families, the Arkansas Kids Count Coalition, and other groups questioned voters about their preferences for raising various taxes to pay for greater access to quality child care for working families. Voters were much more likely to support increases in sales taxes on discretionary purchases such as alcohol (86%) or tobacco (81%) than in broad-based (and less voluntary) taxes such as the corporate income tax (57%) or personal income tax (27%). Without a serious effort to educate the public about tax issues and the fairness of various taxes, such findings do not bode well for future efforts to raise new funding for education.

What About Tax Equity for Low-income Families?

At this stage in the Lake View case, it is not yet known how much money will be needed to fund the public school system adequately. However, if large tax increases do become necessary, one issue that policy-makers must consider is the impact of any change on tax fairness.



Source: Institute on Taxation and Economic Policy, Microsimulation Tax Model, March 8, 2000.

As documented in previous issues of *Paycheck$ and Politics (*see Issue IV, "How Fair Are Arkansas Taxes?"), Arkansas has a very regressive tax system. That is, low-income taxpayers pay a much higher percentage of their income in state and local taxes than do higher-income taxpayers. According to 1999 estimates by the Institute for Economic and Tax Policy, the poorest 20 percent of Arkansas families pay 10 percent of their income in state and local taxes. In contrast, the wealthiest 1 percent of families pay about 5 percent of their income in state and local taxes.

The major reason why Arkansas' system is regressive is its reliance on the sales tax. Arkansas relies more heavily on the sales tax compared to other states. Sales taxes consume a larger proportion of the income of low-income families. Sales taxes comprise more than 8 percent of the income of Arkansas' poorest 20 percent of families, compared to only 1 percent of the income of the richest 1 percent of families.

Why are sales taxes more regressive? The simple answer is that the lower a family's income, the more of its income that must be spent on items subject to sales taxes. Spending on basic necessities such as food, utilities, clothing, etc., consumes a greater proportion of the incomes of poorer families than higher-income families.

A regressive state and local tax system violates a historically accepted principle of tax fairness. Under a fair tax system, at the very least, low-income families pay no more in state and local taxes (as a percent of their income) than do higher-income families. A system in which everyone pays the same percent of their income in taxes is known as a "proportional" tax system. Many, however, believe that a "progressive" tax system is the fairest. Under a progressive tax system, taxpayers with the greatest ability to pay are asked to contribute a larger share of their income in taxes. During the last century in the United States, most federal and state personal income taxes have been designed as progressive systems.

A major tax increase could dramatically change, for better or worse, the fairness of Arkansas' state and local system. Much will depend, of course, on the strategy used to raise new tax revenue. The state could decide to raise the revenue by increasing only one tax. For example, it could increase sales taxes, a move that could worsen the fairness of the tax system for low-income families. In contrast, it could increase personal income taxes, corporate income taxes, or property taxes. Such a move would likely make the system more progressive and fairer for low-income families.

If an adequacy study determines that a great deal of revenue needs to be raised, the state may have to consider raising several taxes. The impact of such a strategy on low-income families, of course, would depend on which taxes were increased and by how much. To help offset the impact of any tax increase on low-income families, the state could adopt a tax-relief strategy to reduce their burden. Such a strategy might include removing the sales tax on food, adopting a state earned income tax credit for working poor families, or raising the state income tax threshold so that families below the federal poverty line do not have to pay income taxes. The state has several options for raising new revenue to fund education while at the same time protecting the fairness of the state and local systems for low-income families. Tax equity must be at the top of the state's agenda as it debates how to ensure adequate funding for education.

Where Do We Go From Here?
It will be months before the Arkansas Supreme Court rules on the state's appeal to *Lake View*. In the meantime, the Blue Ribbon Commission formed to study the Lake View case, as well as another advisory committee formed to study the structure of public education, will have many issues to consider before they make their recommendations (due in mid-2002). In basic terms, here is what these groups should do in the coming months before issuing any recommendations:

1. Establish a statewide process for engaging the public and collecting citizen input about what should be done to restructure the public education system and how to finance any long-term changes. (Public engagement will be the subject of a forthcoming issue of *Paycheck$ and Politics*.);
2. Examine how other states have restructured their education systems to provide an "adequate" education for all students;
3. Drawing upon analytical models that have been used in other states, conduct a study of how much it will cost to provide an adequate education system; and
4. Examine the potential impacts of education financing proposals on (a) the tax burden of families and the equity/fairness of the state and local tax systems; and (b) funding for other state programs that serve families, including health care, child care, etc.

APPEALING THE LAKE VIEW CASE TO THE ARKANSAS SUPREME COURT

Because of the rules of Arkansas legal procedure, a precise timetable for the appeal of *Lake View* cannot be given, but the rules do provide some parameters.

The most important date — at least for the time being — is September 20, which is the date the "record" is supposed to be filed with the Supreme Court clerk. The "record" is the transcript, pleadings, and exhibits in the case. Because the record is so voluminous, it is likely that a request will be made to delay filing the record approximately 90 days beyond the September date. That request will undoubtedly be granted by the court.

Both sides of the case have filed appeals on Judge Kilgore's decision. Because the Lake View School District, which filed the case and thus was the "plaintiff," filed its notice of appeal first, it is the "appellant" in the case and is required to file its brief within 40 days after filing the record with the Arkansas Supreme Court. The Attorney General's Office, which has the job of defending the state, has 30 days to file its brief from the date the appellant's brief is filed. Reply briefs must be filed within fifteen days. Other parties in the case include the Little Rock and Springdale school districts, which will also submit briefs to the Arkansas Supreme Court.

If an outside party wishes to file an *amicus* (friend of the court) brief, it is bound by the same time limits that govern the appellant's brief. Thus, it must submit a request to the court for permission to write an *amicus* brief. If it obtains permission, it must submit its brief within 40 days of the date the record was filed. Parties may ask for extensions of time to file their briefs — not an uncommon practice. Since the parties will undoubtedly ask for oral arguments, any decision in the case may be months away.

One final note: the attorney general has asked that the relief ordered by the trial court be "stayed," meaning that no relief be granted until the case is heard by the Arkansas Supreme Court. Judge Kilgore denied the motion. The attorney general has now requested the Arkansas Supreme Court to stay Judge Kilgore's decision. No decision has been made by the Arkansas Supreme Court.

For More Information
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