

The history of education reform reveals that achievements rarely match expectations.

Education Finance Reform in Tennessee

Harry A. Green

Tennessee has been in the mainstream of education reform for the past decade. For a variety of political, economic, and humanitarian reasons, the focus on student needs and effective schooling practices has been a priority for both Republican and Democrat administrations. Tennessee's reform efforts were in concert with a national effort to reform American public education. Prior to the 1990s in Tennessee, public schools were funded using minimum foundation program mechanisms that were based on the weighted average daily attendance, but the level of equalization was small. The result was an inequitable distribution of learning resources to meet the needs of Tennessee's children.

EDUCATION REFORM IN TENNESSEE: THE EDUCATION IMPROVEMENT ACT

After nearly two years of debate and careful deliberation by the Tennessee General Assembly, the Education Improvement Act (EIA) was signed by Governor Ned McWherter on March 11, 1992, and became effective on July 1, 1992. This Act specified new policies, plans, and procedures for the funding and operation of Tennessee's K-12 education system.¹ The Education Improvement Act:

- Created the Basic Education Program (BEP), the Education Trust Fund, and the BEP Account.
- Provided for a phase-in of full funding over a six year period.
- Established that any unexpended balance of the BEP Account would not revert to the General Fund, but rather remain in the Education Trust Fund.
- Required that the state provide 75% of funds generated by the BEP formula in classroom components and 50% in nonclassroom components.
- Authorized the creation of a funding formula that provided unprecedented flexibility to school systems to determine how state funds should be spent to meet local needs.
- Required BEP funds earned in classroom components to be spent solely in the classroom.
- Authorized incentive grants for schools that exceed performance standards.

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- Set out conditions and requirements for Local Education Agencies (LEAs) to receive BEP funds.
- Set the 1990-91 Tennessee Foundation Program (TFP) appropriations as a base and prohibited LEAs from receiving less under the BEP until full funding is realized.
- Provided for maintenance of effort standards by LEAs.
- Mandated class size reductions.
- Provided for education funding on a fair and equitable basis by recognizing the differences in the ability of local jurisdictions to raise local revenues.

The Education Improvement Act (EIA) placed an emphasis on obtaining adequate resources, up-to-date textbooks, better transportation and facilities, reducing class size, accountability, and value-added testing. This initiative resulted in a large increase in the hiring of new teachers and support staff. One important part of this plan was the creation of a management information system that would link teachers and schools to a central database at the State Department of Education.

Funding Allocation Reform. One of the most significant changes has been the introduction of a new funding formula—the Basic Education Program (BEP). This initiative involved a major shift from the Tennessee Foundation Program (TFP) to focus on the application of funds where they count the most—on direct student or classroom needs. The central feature of the BEP is the specification of essential resources needed in schools. Categories for funds include classroom (state share = 75%) and nonclassroom (state share = 50%) components with specific items contained in both. Total costs are calculated by applying cost specifications to Local Education Agency (LEA) student population data.

Equalization and Equity. Another difference in this unique effort (EIA) was the introduction of the local fiscal capacity index, created by the Tennessee Advisory Commission on Intergovernmental Relations (TACIR). This index is used to equalize education funding ability across counties. Factors that influence a local government's ability to raise revenue for education—the property and sales tax bases, the ability to export taxes, resident income, and the school age population in each county—are considered in calculating fiscal capacity.

System Accountability. The focus in Tennessee on system accountability is to provide the public with information about where education funds come from, how the money is spent, and the results in student gains. The BEP has been phased in over six years and is projected to be fully funded by 1998. Annual state reports illustrate the percentages of total state funding and total spending for both classroom and nonclassroom categories. This is consistent with a national trend in which more and better information on where tax dollars are going and how they are being spent is needed. Without such data, a host of new ideas for education reform, such as deregulation, site based decision-making, charter schools, and choice issues, will not have an adequate baseline of data for accountability comparisons.

Report Card. The notion of a system-wide Report Card and individual school report cards is one innovation which allows the public to receive an array of information about schools. For the first time in Tennessee's history, information regarding school and system attendance, promotion, dropout rates, achievement scores, and value-added scores are contained in one report. This report is available each October to the public in each school district in Tennessee. However, for

the computer literate, on-line citizen, the report card is also accessible on the internet. Financial information regarding expenditures are made available including district funding revenue as well as state and federal sources of revenue. Grade level, as well as school and district level, information is also provided. Accountability for spending can now be linked with proficiency test information.

The report card contains system and school results in value-added, achievement areas and attendance, promotion, and dropout rates. The issue of "value added" measures the effect of "in school" variables per year on a child's achievement. The value-added model contains rewards for schools that meet state standards and sanctions for schools that fail to meet such standards. Flexibility was extended to systems through the extinction of 3,700 pre-existing state rules and regulations.

Value-Added Assessment. The value-added assessment system was officially adopted by the Tennessee General Assembly in 1992. Value-added is a concept borrowed from economics which has been applied to schooling and children. The value-added assessment measures academic gains each

year in grades 3 through 8 on a 999-point scale. These gains are then expressed on a system-by-system and school-by-school basis as a percentage of the national average gain by students in that subject that year. Tennessee's Comprehensive Assessment Program (TCAP) utilizes both norm-referencing for national comparisons as well as criterion-referencing for remedial purposes. Additionally, students are pre- and post tested to determine the impact of in-school variables.

This particular innovation is controversial. Schooling is a complex and typically immeasurable process which involves outside, intervening variables that often cannot be controlled by the schooling process. Tests used must measure what the teachers are teaching, and teachers must teach state required curriculum frameworks. The test must match the curriculum in order to be valid and reliable.

Governance Reform. The EIA forced a governance shift from elected superintendents to appointed directors of schools, and from appointed school board members to elected board members. The new law states that school board members and directors of schools may be removed from office by the Commissioner of Education if state projections are not met for

Table 1
Major Funding Components of the Basic Education Program

Classroom Components	Nonclassroom Components
Regular education	Superintendent
1 per 20 ADM K-3	one per county (counties with more than one system receive portion based on share of total ADM)
1 per 25 ADM 4-6	Administrative support positions based on ADM
1 per 30 ADM 7-9	system and school secretaries
1 per 26.5 ADM 10-12	technology coordinators
Special education	Maintenance and operations
based on caseload allocations for students identified and served	based on square feet allocation per K-4, 5-8 and 9-12 ADM at M & O cost per square foot with custodians allocated for specified amount of square feet based on survey data
Vocational education	Noninstructional equipment
1 per 20 vocational ADM K-3	based on total ADM
Other certificated and non-certificated personnel based on ratios:	Capital outlay
regular, vocational and special ed. supervisors	based on square feet allocation per K-4, 5-8 and 9-12 ADM at construction cost per square foot adding 10% for equipment, 5% for architect's fee, and debt service at state bond rate
principals, asst. principals	Pupil transportation
librarians	based on formula which estimates per ADM transportation costs
art, music, physical education	Staff benefits
social workers, psychologists, guidance coun. nurses	insurance and retirement funded by position
substitute teachers	
at-risk assistants	
Materials, equipment, supplies and travel based on ADMs by program area	
Textbooks based on total ADMs	
Staff benefits	
insurance and retirement funded by position	
Other components funded based on ADMs	
alternative schools	
duty-free lunch	
technology	

five components in a system Report Card—which has value-added, proficiency tests scores, attendance rates, dropout rates, and promotion areas.

The Tennessee Small School Systems Lawsuit

Tennessee was thrust into the equity battle by a group of 77 small school systems in *Tennessee Small School Systems v. McWhorter*. In reaction to funding inequities, a coalition of Tennessee Small School Systems (TSSSS) filed a lawsuit in 1988 against the state. They sought declaratory judgment that K-12 education funding was inequitable under the education and equal protection clauses of the state constitution. In July 1991, the chancery court in Davidson County ruled in favor of TSSSS. The General Assembly was assigned responsibility for the reform of school funding before June 30, 1992. An appeal was filed by the state on October 11, 1991. In June of 1992, the appeals court reversed the trial court. The TSSSS requested a Tennessee supreme court review of the case.

The TSSSS lawsuit appeal (April 1992) was heard after the Education Improvement Act of 1992 was signed into law. In an opinion filed in March 1993, all five justices of the Tennessee supreme court unanimously endorsed the conclusions of the trial court. The case was then remanded back to the trial court for the judge to craft an order to correct the school funding crisis in Tennessee. At the chancery court hearing on resolution recommendations (July 1993), the chancellor agreed with the state's argument that since the EIA was just being implemented, more time was needed in which to evaluate its effects.

Basic Education Program

The EIA established an Education Trust Fund in which all funds for K-12 education are placed. Within this trust fund, a special revenue account entitled the Basic Education Program was created. Into this account, all earmarked revenues for K-12 must be deposited. This is to ensure legislative accountability to the public for the tax increase that was necessary to fund education reform.

The Basic Education Program (BEP) is a funding formula that determines the full amount of funding needed by Tennessee's K-12 schools. Embodied in the funding formula are the concepts of adequacy of funding of programs through the annual application of inflation and reevaluation of unit costs based on actual expenditures and equity in funding through fiscal equalization among the LEAs. The BEP, including improvements, accounts for approximately 90.7% of the recommended state allocation for K-12 public education, with the remaining K-12 education funds designated for such initiatives as Career Ladder, curriculum and instruction, driver education, adult and community education, technical assistance and administration, and special schools.²

How the BEP Addresses Adequacy

The BEP formula determines the funding level required for each school system to provide a common, basic level of service for all students. Funds are allocated between classroom and nonclassroom components as shown in Table 1 and explained below:³

Classroom: Classroom components provide the resources for personnel, which include teachers, counselors, assistants, and other professional staff. Classroom components also provide resources for textbooks and other instructional and classroom materials and supplies, as well as staff benefits and insurance. The state government is responsible for funding 75% of the classroom components.

Nonclassroom: Nonclassroom components provide funds for certain administrative and support personnel, maintenance and operations, pupil transportation, and capital outlay. The state government is responsible for funding 50% of the non-classroom components.

The BEP formula is composed of 42 components which are costed primarily on the basis of average daily membership (ADM) in specified classifications. For example, under the "Regular Education" Classroom components, the BEP funds a number of teachers based on the ratios in Table 1 for prior-year ADM.

Thus, a LEA that has 2000 ADM in K-3 would be funded for 100 teachers compared to 50 teachers for a system with only 1000 K-3 students. For non-position components, unit costs are developed each year and multiplied by the number of ADM counts in regular education, vocational education and special education. Once this is completed for each of the 42 components, the costs are summed to produce total estimated BEP funding for each LEA. Costs are re-estimated each year and adjusted for inflation.

Cost Differential Factor. LEAs with above-average costs receive an adjustment known as the "cost differential factor" (CDF). The CDF is measured at a county-area level using average wage data collected by the Tennessee Department of Employment Security. The CDF is designed to adjust funding in counties with above average non-government wage costs. This will affect 18 LEAs during FY 1998. The CDF adjustment is applied to all classroom and non-classroom personnel costs (i.e. salaries) in the BEP formula.⁴

How the BEP Addresses Equity

The final step in the process is to equalize these two components and the statutory ratios.

In Section 49-3-337 of the Education Improvement Act, the General Assembly stated its intent concerning the fiscal equalization of education funding in Tennessee:

It is the intent of the General Assembly to provide funding on a fair and equitable basis by recognizing the differences in the ability of local jurisdictions to raise local revenues.

**Table 2
Equalizing the BEP**

	State	Local
Classroom	75%	25%
Non-Classroom	50%	50%

In pursuit of this goal, the General Assembly established ratios for equalizing spending under the Basic Education Program, as shown in Table 2.

Local education agencies (LEAs) are collectively responsible for 25% of the classroom components and 50% of the non-classroom components.⁵

Measuring Fiscal Capacity. The responsibility for determining how fiscal equalization occurs ultimately rests with the state board of education. Considerable attention was devoted to this subject during two different legislative sessions (1991 and 1992) when the Education Improvement Act was under consideration. There was substantial discussion and interaction among the Department of Education, the Department of Finance and Administration, the State Board of Education and the Tennessee Advisory Commission on Intergovernmental Relations (TACIR) concerning fiscal capacity and fiscal equalization.

After careful deliberation, the state board of education adopted a method of measuring local fiscal capacity that was developed by the TACIR. TACIR spent over three years developing the concepts used in the measurement of local fiscal capacity for education in Tennessee.

The relevant factors that determine local fiscal capacity are: the property and sales tax bases; ability to pay (i.e. resident income); resident tax burden; service responsibility; and local revenue for education. A statistical model is used to measure the relationship among these factors for the 95 county areas. Per pupil fiscal capacity is then generated from the estimated relationships among these fiscal capacity factors. All factors used in the TACIR model are based on official statistics.⁶

Accountability Standards. Accountability standards began in the first year of the BEP. The EIA states that the Commissioner of Education is charged with recommending fiscal and performance accountability standards for local school systems to the state board of education. The board releases notices based on these standards, which are subsequently used in evaluating the operations of the local school systems. Performance standards that have been phased in include:

- setting student performance goals;
- maintaining acceptable attendance and dropout rates;
- establishing value-added assessment;
- comparing the BEP components with the program components existing in each school system during the reporting year;
- establishing school site-based decision making; and
- establishing an Office of Education Accountability within the Office of the Comptroller of the Treasury.

Three specific fiscal accountability measures—maintenance of local effort (MOE), 3% fund balance, and BEP Accountability Budget Summaries—were included to ensure a greater range of accountability. The MOE requirement prohibits a local government from reducing its share of local funding for schools as a direct result of increased state funding. There are two levels of the MOE test applied to local systems. When either of the two requirements is met, MOE has been met.

The 3% fund balance requirement was a fiscal accountability standard in place as a result of the passage of the EIA, but was not implemented until the end of FY 1993, when fund balances first appeared. There are three purposes for which the fund balances may be used: 1) to meet fund shortfalls in budgeted revenues; 2) to meet unforeseen increases in opera-

Table 3
BEP Five-Year Funding

Fiscal Year	New Funds (in millions)	Cumulative Total (in millions)
1992-93	\$113.57	\$113.57
1993-94	\$ 53.74	\$167.31
1994-95	\$117.80	\$285.11
1995-96	\$112.00 ¹	\$397.11
1996-97	\$126.50 ²	\$523.61
1997-98	\$192.50	\$716.11

¹ Does not include \$7 million required for salary equalization.
² Does not include \$5 million required for salary equalization.

Table 4
Progress Toward Full Funding of the BEP from FY 1993 to FY 1996

FY 1996				FY 1993			
Top 10		Bottom 10		Top 10		Bottom 10	
Rank	Percent	Rank	Percent	Rank	Percent	Rank	Percent
1	98.7%	139	79.7%	1	91.6%	139	57.8%
2	96.6%	138	80.2%	2	91.5%	138	62.9%
3	96.1%	137	80.7%	3	90.5%	137	65.4%
4	95.6%	136	81.3%	4	90.5%	136	65.7%
5	95.5%	135	81.7%	5	89.8%	135	66.0%
6	94.7%	134	82.1%	6	89.7%	134	66.1%
7	93.9%	133	82.3%	7	86.7%	133	66.7%
8	93.5%	132	82.7%	8	86.3%	132	67.6%
9	92.8%	131	82.8%	9	86.0%	131	68.0%
10	92.6%	130	82.9%	10	85.5%	130	68.7%
Average	95.3%	Average	81.5%	Average	89.2%	Average	65.1%
Ratio Top to Bottom				Ratio Top to Bottom			
1.17				1.37			

tion expenses; and 3) as a budget item for non recurring purposes.

BEP Accountability Budget Summaries are a significant part of the fiscal accountability process. Each LEA is required to submit a Preliminary Accountability Budget Summary at the beginning of the school year, outlining anticipated classroom and nonclassroom funding needs. Each LEA also submits an end-of-year Final Accountability Budget Summary. The Accountability Budget Summary is intended to hold each LEA accountable for its share of the new BEP improvement funding. It is also a method for tracking the new money that is being invested into the K-12 education system in Tennessee.

Current Funding Versus Full Funding

The law requires full funding of the BEP no later than the fiscal year beginning July 1, 1997.⁷ By the end of FY 1998, a cumulative total of \$716 million in new education funding will have been dedicated into Tennessee's Basic Education Program. The phase-in for BEP funding up to FY 1998 is presented in Table 3. Funding for FY 1998 is based upon a funding increase proposed in the FY 1998 executive budget.⁸

Each year the BEP funding formula is calculated for each LEA to determine what would be allocated if the BEP were fully funded. The allocation at full funding is compared with current funding for each LEA. The current level of funding includes the old Tennessee Foundation Program (TFP) base amount, the categorical programs in place before implementation of the BEP, and cumulative salary improvements. The difference is the amount needed to bring the LEA to full funding. The sum of the amounts of all the differences between current funding and full funding for each LEA is the total amount needed statewide

to fully fund the BEP. Since the BEP is being phased in over a six-year period, state funds are not adequate to fund the total of the differences. Therefore, each year, as more money is appropriated toward full funding of the BEP, the amount each LEA receives in BEP dollars is its current level of funding plus its share of the BEP improvement dollars. The share of the BEP improvement dollars each LEA receives is their proportion of the statewide difference from full funding.

In the first year of the BEP, many systems' percentages of full funding were significantly lower than others. As the state has progressed toward full funding, the extremes in the percentages no longer exist. Since each LEA's percent of full funding each year determines their share of BEP improvement dollars, the systems with lower percentages are getting larger allocations than LEAs with higher percentages of full funding in order to get all systems to 100% by FY 1998. Table 5 shows the progress toward fully funding the BEP the state has made for the ten systems with the highest percentages compared to the systems with the lowest percentages in FY 1996.

As shown in Table 4, the average percent of full funding for the ten systems closest to full funding was 89.2% in FY 1993 compared to an average of 95.3% in FY 1996, an increase of 6.1 percentage points. The increase was much larger for the ten systems farthest away from full funding; in FY 1993 the average was 65.1% compared to an average of 81.5% in FY 1996, an increase of 16.4 percentage points.

Major Sources of Funding

As in all states, Tennessee has three major sources for funding education: federal, state, and local.⁹ Table 5 presents these numbers for the past ten years. During this period, fed-

Table 5
Major Sources for Funding K-12 Education
State of Tennessee

	STATE		LOCAL		FEDERAL		TOTAL
1988-89	\$1,291,053,100	49.3%	\$1,095,936,642	41.9%	\$229,729,800	8.8%	\$2,616,719,542
1989-90	\$1,360,934,700	48.9%	\$1,175,667,534	42.2%	\$248,908,400	8.9%	\$2,785,510,634
1990-91	\$1,400,021,700	47.9%	\$1,243,766,205	42.5%	\$279,436,400	9.6%	\$2,923,224,305
1991-92	\$1,336,518,500	44.7%	\$1,346,506,488	45.1%	\$303,978,100	10.2%	\$2,987,003,088
1992-93	\$1,570,246,300	48.0%	\$1,376,043,443	42.0%	\$327,073,600	10.0%	\$3,273,363,343
1993-94	\$1,724,556,900	48.7%	\$1,476,801,561	41.7%	\$341,750,800	9.6%	\$3,543,109,261
1994-95	\$1,878,614,500	49.6%	\$1,565,981,683	41.3%	\$345,715,700	9.1%	\$3,790,311,883
1995-96	\$1,985,470,100	49.7%	\$1,659,879,967	41.5%	\$351,698,000	8.8%	\$3,997,048,067
1996-97*	\$2,154,105,200	49.9%	\$1,759,542,000*	40.8%	\$402,166,600*	9.3%	\$4,315,813,800
1997-98**	\$2,327,150,300	50.6%	\$1,865,167,000*	40.6%	\$403,956,400*	8.8%	\$4,596,273,700
Percent Growth in Funding							
1989-98	\$1,036,097,200	80.3%	\$769,230,358	70.2%	\$174,226,600	75.8%	\$1,979,554,158
1992-98	\$990,631,800	74.1%	\$518,660,512	38.5%	\$99,978,300	32.9%	\$1,609,270,612

*estimated

**proposed in governor's budget

eral funding has increased nearly 76%, local funding by 70% and state funding by 80%. However, the proportions of funding remained fairly stable. The federal government funded 8.8% of K-12 education in 1989 and also funded 8.8% in 1998. Local governments funded nearly 42% in 1989 falling to below 41% in 1998. State government rose from 49.3% in 1989 to 50.6% in 1998.

When this comparison is made for the six years of BEP funding, the results are dramatically different. Using 1992, the year before BEP funding began, as a base year, the proportion of state funding rose from less than 45% to nearly 51%; local funding fell from 45% to less than 41%; and federal government funding fell from 10.2% to 8.8%.

Moreover, the growth in outlays for these three major sources changed significantly. From 1992-98, the growth in state funding was 74.1%; in local funding 38.5%; and in federal funding, only 32.9%. These numbers illustrate the enormous fiscal impact of education reform and the Basic Education Program.

Commitment of Revenues Earmarked for K-12 Education

A major concern among educators is that fiscal commitments to education may be subsequently revoked or diffused.¹⁰ Many educators in Tennessee are firmly convinced that this is precisely what happened in 1984 when the sales tax was increased by one cent. During subsequent years this was a charge frequently made to legislators and it came up during the debate on the Basic Education Program.

In an effort to allay fears, the Tennessee General Assembly passed House Joint Resolution 191 in 1993. This resolution requires the Tennessee Advisory Commission on Intergovernmental Relations to produce an annual report that traces the flow of all new money from the one-half cent sales tax. TACIR has produced those reports for 1993, 1994, and 1995 and is currently working on 1996. In each of the three years studied, TACIR has found that new appropriations for K-12 education each year exceed the funds earmarked from the one-half cent sales tax increase.

State Funding Sources

Tennessee relies heavily on consumption taxes to fund state services, including education. At the local level, property

taxes continue to be the mainstay, although local sales taxes are extremely important in some areas.

In recent years, Tennessee has raised the state sales tax to fund education reform: in 1984 a one-cent increase was adopted to fund, *inter alia*, the "Better Schools Program" introduced by Governor Lamar Alexander; and in 1992, a one-half cent increase was adopted to fund the "Basic Education Program" promoted by Governor Ned McWherter.

The majority of state funding for Tennessee's public schools is generated from the sales and use tax.¹¹ Other state sources of education revenue are the tobacco and mixed drink taxes. These revenue sources for education are presented in Table 6. In FY 1997, the sales and use tax will generate \$2.63 billion for education, or over 96% of the total. The tobacco tax and the mixed drink tax generated \$86 million and 12.5 million respectively. The litigation privilege tax, which is allocated to the Department of Education and dedicated to the Education Trust Fund, generated nearly \$2 million for FY 1996. Seventy-five percent of the litigation privilege tax is earmarked for the Driver Education Training Program in public schools.¹²

While earmarked education revenues (including those allocated for higher education) fund a large part of education needs, they do not fund all education needs. In FY 1995 (the latest year of reconciliation of earmarked funds), \$2,410,666,000 was raised and deposited into the Education Trust Fund,¹³ while \$2,758,473,300 was actually spent on education.¹⁴ Earmarked revenues funded 87.39% of the total funds spent on education and transfers from the General Fund made up the difference between appropriated amounts and earmarked revenues.

Local Funding for Education in Tennessee

The Property Tax

Historically, the property tax has been the largest source of education funding. Education is predominantly a local function and the property tax is the predominant local tax revenue source. In Tennessee, the property tax provides 52.3% of total local education revenue. If payments in-lieu of property taxes are added, the property tax accounts for nearly 54% of total local revenue (see Table 7).

The use of the property tax among the 139 school sys-

Table 6
Earmarked State Education Funds, FY 1996 and FY 1997*

Tax	1996 ¹ (Actual)	1997 ² (Estimate)
State Sales & Services		
65% of 5.5% of the state tax	\$2,155,033,596	\$2,307,483,750
100% of the half-cent of the sales tax ³	\$302,127,393	\$322,725,000
Tobacco (99.4% of the state tax)	\$83,366,133	\$85,285,200
Mixed Drink (50% of the 15% Gross Receipts Tax)	\$12,258,934	\$13,050,000
Litigation Privilege (75% earmarked for Driver's Ed)	\$691,152	\$739,188
GRAND TOTAL	\$2,553,477,208	\$2,729,283,138

¹ Tennessee Department of Revenue, *Recap of Undistributed Revenue Collections, July 1995 thru June 1996*.

² Calculated by TACIR staff using Tennessee Department of Revenue, *Fiscal Year 1996-1997 (Revised) Estimated Collections by Fund, January, 1997*.

³ This is the tax increase that was earmarked to fund the Basic Education Program. In 1993, it brought in over \$225 million.

* The totals in this table include over \$500 million for higher education.

Table 7
Own-Source 1996 Local Revenue*

Revenue Receipts	Dollars	% of Total
Total Property Tax - Schools	\$777,322,118	52.32%
Payment in Lieu of Property Taxes	\$22,742,033	1.53%
Total Local Option Taxes	\$617,728,465	41.57%
Total Other Statutory Local Taxes	\$10,923,825	0.74%
Appropriations from City General Fund	\$56,324,403	3.79%
Licenses and Permits	\$778,608.00	0.05%
TOTAL COUNTY AND CITY OR SPECIAL DISTRICT REVENUE RECEIPTS	\$1,485,819,452	100.00%

*Excluding Bond Proceeds and intergovernmental transfers.

Table 8
Equity Measurements for Tennessee

	1992	1995	Change	% Change
Range Ratio	1.27	.93	-.34	26.8%
Federal Range Ratio (95th/5th percentile)	.67	.53	-.14	21.1%
Coefficient of Variation	16.5%	14.1%	-2.4	14.5%
McLoone Index	0.81	0.87	0.06	7.4%
Green Index	1.26	1.19	-0.07	5.9%
TACIR Equity Index	0.09	-0.51	-0.60	—
Top 10 Systems/Bottom 10 Systems	0.85	0.67	.18	21.6%
Kingsport/Hancock Co.	.53	.32	-21	39.8%

tems varies significantly. According to data from the Department of Education, the dependence on the property tax ranges from nearly 90% of local education revenue to 15%. Depending on the year examined, around 100 of 139 school system depends upon the property tax for 50% or more of their local education revenue.

The Local Sales Tax

The local sales tax is the second most important source of local revenue. Nearly 42% of total local revenue is derived from the local sales tax.¹⁵ Dependence on the local sales tax to fund education ranges from nearly 71% in Sevier County (a premier tourist area) to 7% in Johnson County. The local sales tax accounts for 50% or more of total local education revenue in 13 school systems.

Appropriations from Cities

Twenty-four city school systems report appropriations from the city general fund as a source of local revenue for education. Humboldt reports that 67% of its local revenues comes from such appropriations. Only three systems report dependence on city appropriations of 50% or more. Overall, city

appropriations constitute only \$56.3 million or less than 4% of total local revenue for Tennessee schools.

Impact of Fiscal Equalization on Equity

The impact of the fiscal equalization policy required by the Education Improvement Act is presented in Table 8. This illustrates that all eight measurements of horizontal equity show considerable improvement.¹⁶

The impact of fiscal equalization is also apparent from the proportion of local funding required for the BEP. The EIA requires that local school system fund 25% of the BEP in aggregate. However, for the classroom share, the proportion ranges from a low of 6% for Hancock County to a high of 40.5% for Metro-Nashville; for nonclassroom funding, the range is a high of 13% for Hancock County and only 89% for Metro-Nashville. Based on the TACIR equity index, this is precisely the empirical result that would be expected.

Although spending per pupil increased in the top spending school system (Oak Ridge City Schools), the "total range ratio" has narrowed significantly from 127.3% to 93.2%. The federal range ratio has narrowed as well, from 67.8% to 53.5%. The coefficient of variation declined from 16.5% to 14.1%. The McLoone Index increased from .81 to .87.

Four non-traditional measures have been added to the analytical mix. The Green Index measures the relationship between spending for the top 50% of students compared to the bottom 50% of students, expressed as a ratio. Although there is no standard for this statistic, a ratio close to one is desirable. This index declined from 1.26 to 1.19.

The TACIR Equity Index is a correlation analysis of state funding and local fiscal capacity. If equalization is working, the relationship should be inverse and moving toward negative one. This analysis shows that this index improved from .09 in 1992 to -0.51 in 1995.

The third non-traditional measurement was one used by the plaintiffs in the *Tennessee Small School Systems v. McWhorter et. al.* A comparison of the top ten systems to the bottom ten systems, expressed as a percentage, indicates a decline in the disparity of per pupil spending from 85% to 67%.

The final non traditional measurement is used to illustrate the impact of the BEP on two systems made famous nationally by a CNN special report. This index is the percent difference, expressed as a decimal, between per pupil spending by the City of Kingsport's school system and that of Hancock County. As this index indicates, the disparity declined from 53% to 32% during this period, a 40% improvement.

Conclusions and findings

Since full funding will not be achieved until FY 1998, it is premature to evaluate the effects of the major education finance reform initiated by the Education Improvement Act in Tennessee. The EIA reforms brought substantial new state funding and provided for fiscal equalization at a level never before achieved in Tennessee.

The effect of these reforms have been to increase the accountability of Local Education Agencies (LEAs) and to reduce significantly the disparity in school spending. This has been achieved without placing spending limits on wealthy LEAs. Without question, a much more equitable system for educating the children of Tennessee has been created.

One downside of increased state spending is the spectre of funding instability that it brings. This is a minor problem compared to the issue of inadequate state funding and spending inequity, but it must be recognized as a danger. The Tennessee state government revenue system is inelastic over time. In FY 1991-92, a funding crisis occurred because of this inelasticity and state funding for education was reduced by \$116 million. Inevitably, this will happen again in time and it is unlikely that the State Revenue Stabilization Fund will be large enough to prevent funding reductions.¹⁷

Although numerous problems remain and some dissatisfaction is found in many areas, objective criteria indicate major improvements in Tennessee's K-12 education system.

- The new system of education finance is working well in terms of the objectives of the Education Improvement Act of 1992.
- The most dissatisfied educators tend to be those in the large urban systems that possess the greatest wealth. Obviously, fiscal equalization impacts them most severely. Moreover, educators in rapid growth counties are dissatisfied because the formula lags one-year behind the most current funding year. Therefore, to some extent these systems are always underfunded.
- Most education leaders, and particularly those from the small schools that prevailed in the lawsuit, have frequently commented on the vast improvements that the new funding has allowed. According to a recent study by the University of Tennessee, for the four-year period 1992-1996, state funding increased at a compound annual rate of 14.6%; local funding by 5.2% and federal

funding by only 2.3%. This is a very large rate increase for state funding and its effect has been obvious in previously underfunded LEAs.

- Horizontal equity has improved significantly during the period 1992-1996 and is expected to continue improving through 1998. After that, equity gains should more or less stabilize. However, since there is no upper limit on local spending, high spending, wealthy LEAs could eventually cause some deterioration in the level of equity achieved.
- The level of accountability and public knowledge about K-12 education has increased significantly. The annual "Report Card" for each LEA is published each Fall and the requirement for appointed superintendents will be fully implemented by the year 2000.
- Standardized test results suggest general improvement by students in LEAs all across the state.

The history of education reform reveals that achievements rarely match expectations. However, it is fair to state that Tennessee has made a major commitment to education reform and that the achievements to date are promising. The National Conference of State Legislatures identifies five principles of a sound state school finance system: equity, efficiency, adequacy, accountability and stability. Tennessee has made considerable progress on all fronts.

Endnotes

1. This article is based in part upon Harry A. Green and Connie J. Smith, *Funding Tennessee Schools: From Reform to Restructuring*. (Tennessee Advisory Commission on Intergovernmental Relations, June 1995), and Harry A. Green, Cliff Lippard, and Lynne Holliday, *Accountability for Funding Education in Tennessee* (Tennessee Advisory Commission on Intergovernmental Relations, April 1996).
2. Interview with Mr. John Sharp, Administrative Services Assistant Manager, Division of Budget, Department of Education
3. Table 1 exhibits the major funding components on which allocations are made to local education agencies.
4. There is some confusion about legislative intent. The Education Improvement Act refers to "cost of operations" but directed a "cost-of-living" study. Also, some educators have interpreted this as a method to address "municipal overburden."
5. T.C.A. Section 49-3-356.
6. See Harry A. Green, et al, *Local Fiscal Capacity for Funding Education in Tennessee*, TACIR, July 1994 and March 1995.
7. T.C.A. § 49-3-354(i).
8. There was considerable controversy about this amount of \$192.5 million. This "balloon" payment is \$60 million more than was anticipated in FY 1997. Also, it should be noted that total new funding for the six year period exceeds \$1.2 billion.
9. See Harry A. Green, "Tax Reform and Education Funding: What are the Options?", *Tennessee's Business* (Middle Tennessee State University, Spring 1991). Also see Steven D. Gold, *Tax Options for States Needing More School Revenues* (NEA, 1994).
10. *Principles of a Sound State School Finance System* (National Conference of State Legislatures, July 1996).
11. Only the State of Washington depends more heavily on the sales tax than Tennessee.

12. *The Budget FY 1994-1995*, State of Tennessee, pages A-53-69, A-81, A-77.
13. Department of Revenue. *Apportionment of Undistributed Revenues*, July 1994-June 1995.
14. *The Budget FY 1995-1996*, State of Tennessee, B-61.
15. The way sales tax is reported by the Department of Education is "Total Local Option Taxes." Small amounts of other local option tax collections are included in the numbers reported. However, these

amounts are extremely small and have little influence on this interpretation.

16. Harry A. Green and Lynne Holliday, *Much Ado About Something: Gains in Education Spending Equity* (TACIR, July 1996).
17. The current governor has taken a "no new taxes" position and the political environment in Tennessee is hostile to both state and local tax increases.