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Gerald R. Bass
University of North Dakota

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North Dakota policymakers are faced with many of the same issues related to school funding as their peers in other states. Opposition . . . greatly reduce(s) the likelihood that any significant changes in school finance systems will be enacted before the turn of the century.

School Funding Issues in North Dakota

Gerald R. Bass

The funding of public schools in North Dakota continues to constitute a series of issues demanding consideration by the governor, members of the state legislature, and other policymakers. While the adequacy of funding continues to be a major focus as these and other interested parties propose and support varied levels of state support that should be provided for public education, a number of other topics have been proposed for consideration. Equity continues as an important issue competing for attention with suggestions to change specific elements of the funding formula, the proper mix of taxes for local and state services, the degree to which school boards and/or local voters are able to increase local operating levies, and the manner by which special education programs are funded.

Funding Formula

Any actions to enhance adequacy and/or equity in school funding must first be examined in relation to the equalized formula used for the distribution of state aid to the North Dakota's school districts. The Foundation Aid Program formula for the 1996-97 school year contains a "per pupil payment" of \$1,862. Under Governor Ed Shafer's budget proposal for the 1997-99 biennium, the appropriation for state aid would be increased by \$15 million with per pupil payments established at \$1,899 for 1997-98 and \$1,935 for 1998-99. Members of the North Dakota Council for Educational Leadership have suggested a \$40 million increase, a level likely to be supported by other education groups.

There are six categories of weighting factors to adjust actual school district enrollment (in average daily membership): preschool special education, kindergarten, rural grades (1-8), elementary (1-6), grades 7-8, and high school (9-12). The elementary and high school categories contain varying weighting factors differentiated by school size. For high schools the weighting factor decreases as size increases, while for elementary schools the factor is higher for both the smallest and the largest schools. Annual adjustments to statutory weighting factors were instituted by 1995 legislation which provided that weighting factors for the 1995-96 school year would be modified by 50% of the difference between the existing weighting factor and that established by a five-year average of costs for

students in each weight classification. For the 1996-97 school year, the adjustment would be at 65% of the difference.

As with virtually all equalized formulas, the Foundation Aid Program formula includes a deduction which varies according to local wealth, in this case property tax revenue. For 1996-97, the "deduct" is calculated at a tax rate of 32 mills, an increase from the previous year's rate of 28 mills. Legislation in 1995 provided that the deduct will continue to rise in proportion to increases in the appropriation for Foundation Aid but cannot exceed 25% of the statewide average general fund levy. While not integral components of the Foundation Aid Program formula, transportation aid and state apportionment (income from school lands) can be reduced for districts which generate more revenue from the 32-mill chargeable levy than is guaranteed by the per pupil payment.

Equity

Equity in North Dakota school funding became a central issue during judicial consideration of the Bismarck case.¹ While three of the five justices ruled on behalf of the plaintiffs/appellants, the January 1994 supreme court ruling did not overturn the existing school funding system, falling one vote short of the supermajority needed to declare a legislative action to be unconstitutional. The case did, however, signal to state policymakers that equity needed to be addressed.

During the 1995 session, the North Dakota legislature passed a bill that created a supplemental payment system by which \$2.25 million were distributed during the 1995-96 and 1996-97 school years to "poorer" school districts, those with below average amounts for both taxable valuation per student and cost of education (expenditures per pupil as measured by average daily membership). Governor Ed Shafer's budget proposal for the 1997-99 biennium included \$20 million for a similar equity fund but did not recommend a specific system for distribution of such money if appropriated by the legislature. Before reviewing proposals for distribution of appropriations for an equity fund, it is important to consider first the causes of inequity in North Dakota's aid distribution system.

The major factor in the equity debate is the degree to which local property tax revenue should be deducted in the equalized formula used in the state. As noted above, the 1996-97 Foundation Aid Program formula includes a deduction of the revenue from a 32-mill levy. Although this is an increase from the previous year's 28-mill deduct, it represents only a small portion of the total levy for most school districts. In fact, the operating levies for districts in North Dakota average over 180 mills. While it might seem obvious that increasing the number of mills used in computing the property tax deduct would result in a more equalized formula, legislators and others have proposed doing just the opposite. One suggestion would reduce the deduct to 16 mills while another would eliminate the deduct altogether. The latter idea would abandon the concept of an equalized formula in favor of a mechanism for distribution of state aid to each school district regardless of local wealth or lack thereof.

With so much of the local property tax revenue accruing to school districts outside the equalized formula, there is considerable potential for inequities in school funding. For example, per-pupil taxable valuation for 219 North Dakota school districts in 1995-96 ranged from \$169 to \$124,694.² Of course, this range was affected greatly by the enrollment, the amount and proportion of land that is not subject to local property taxes, and the type and value of taxable property in each school district. Even eliminating the highest and lowest districts, the range for the remaining 80% was still \$6,628 to \$23,752, nearly four to one. If one were to assume that each of these districts had an operating levy totalling 180 mills, the per-pupil property tax revenue would range from \$1,193 to \$4,275.

Gerald Bass is Professor, University of North Dakota

The 32-mill deduct would reduce the disparity from a 148-mill levy to a range of \$981 to \$3,515. The fact that only a relatively minor proportion of the total property tax revenue for school districts is deducted in the formula accounts for the fact that Foundation Aid provides for only a limited portion of the total revenues received by school districts in North Dakota. The remaining funding is generally not equalized to adjust for local wealth. Obviously, any reduction in the deduct would further limit equalization.

In addition to proposals concerning the amount of property tax revenue that should be deducted in the Foundation Aid Program formula, other revenue sources have also been suggested for deduction. Revenue from oil and gas taxes and from federal impact aid are two substantial sources of operating revenue for some school districts. Neither of these is subtracted in the calculation of a district's Foundation Aid. Since the state's distribution system is somewhat lacking in the wealth neutrality standard that is expected from the federal government and leaders of impact aid districts have established considerable political influence, a deduction for such revenue is not likely to be considered at this time.

The obvious political, and fiscal, problem with changing the state aid distribution system to incorporate either significant increases in the deduction of property tax revenues or oil and gas taxes is the certainty that there will be districts which would lose substantial amounts of revenue by such changes. Without major increases in state appropriations to support the Foundation Aid Program formula, not a possibility at this time, too much money would be directed away from the relatively higher property wealth districts and those which receive oil and gas revenue. While this would promote equity, the cost of such equity would be too high to obtain legislative support for such action.

Since there is little likelihood that any major changes will be enacted in the formula, attention has turned to the governor's equity fund proposal. Four different approaches to distribution of the proposed \$20 million appropriation were made to legislative committees in January of 1997. Department of Public Instruction staff made two proposals. One called for distribution of supplemental funds through a guaranteed tax base system that was proposed but defeated during the 1995 legislative session. The second plan would continue the existing calculations used to distribute the previously appropriated \$2.25 million equity funding according to below average taxable valuation and cost of education. This author proposed a more complex supplemental funding system involving the development of a "more ideally equalized formula" that would include the addition of program-related weighting factors, adjustments to existing grade level weighting factors, and deduction of greater proportions of the property tax levies as well as oil and gas revenue and federal impact aid. The new formula would be used only to distribute any money appropriated separately for equity enhancement but could also serve as a demonstration of elements that might be incorporated eventually, if desired, in a modified comprehensive funding formula that would result in greater equity. However, there is little likelihood of support for that concept due to its complexity and aura of change. The professional associations representing the state's education interests have taken the position that all major increases in funding for education should be put into the existing Foundation Aid Program formula and are likely to oppose the continued use of any supplemental system.

During the 1995-97 interim period, a legislative committee devoted one of its sessions to issues related to the funding of capital outlay. Equity concerns were raised in regard to the unequalized, and thus greatly disparate, levies for the Building Fund and the Sinking Fund in North Dakota school districts. In addition, the overall needs of those districts for repair, renova-

tion, and/or construction of school buildings were cited. Despite those concerns, no committee action was taken. It is likely that issues related to the overall adequacy and equity of school funding will keep capital outlay out of the arena of legislative activity for some time to come.

Tax Bases

During the past year, the North Dakota legislature's Interim Education Finance Committee received a proposal from the North Dakota Stockmen's Association calling for enactment of a \$200 million increase in the state's income tax with \$180 million of that revenue used to reduce existing property taxes. While there was some interest expressed by legislators in reducing property taxes, there was little support for the portion of the proposal that would allocate \$20 million in new funding to public schools. This perspective continued in the legislative session with opposition to any net increase in taxes but continued interest in proposals to reduce property taxes, with or without a replacement through increases in income tax rates.

Consistent with current opposition to tax increases, the legislature in 1995 adopted a measure that, in part, strengthened an existing limitation on the ability of school boards to increase property tax levies. Under this law, school districts are affected quite differently in regard to the ability to raise property tax revenue. Six school districts have locally-adopted unlimited levy authorization that allows those school boards to set the primary general fund levy at any level by majority vote. For the remaining school districts, there is a cap of 184 mills. For districts at or above that cap, the 1995 legislation allowed boards to increase the amount levied by 2% in 1995 and by 1% in 1996. Beginning with fiscal year 1997, districts at or above the cap are not permitted to increase the general fund levy. School boards in districts with levies below the cap are allowed to increase the levy by up to 18% if such increase does not exceed the 184-mill cap.

Special Education

The means by which special education services are funded in North Dakota has been changed in each of the last three legislative sessions. The current system provides funding on both a per-pupil basis and on a supplemental basis for excess costs associated with contracts for services to students with disabilities, low incidence and/or severely disabled students, and certain boarding care. Special education services are provided for administrative units that may consist of a single school district or represent numerous cooperating districts. As the population density varies greatly across the state, so too does the incidence for most disabilities and the ability to access services in a cost-effective manner. It is this variation in demand for and ability to supply special education and related services that has led to so many recent attempts to change the existing funding system. Attempts to fix perceived inequities for some units through legislative action have invariably led to demands in the next session to address new issues of inequity arising from the modified distribution system.

While there is little agreement on how special education funds should be distributed, there is substantial agreement that the costs of special education are rising beyond the ability of local districts and, according to some, the state to provide sufficient financial support. Given the legal environment for special education at this time, there are few who expect any significant reduction in the level of service provided or in the number of eligible students. Therefore, policymakers in North Dakota, and elsewhere, will continue to debate but not put to rest issues regarding the funding of special education.

Outlook

Attention will continue to be focused on the adequacy of the per pupil payment in the North Dakota Foundation Aid Program formula and the total appropriation necessary for such funding at various proposed levels. Of interest also will be the amount of the property tax deduct. However, it is very unlikely that there will be major changes in any of the formula elements before 1999. The Interim Education Finance Committee took no action, and entertained relatively little debate, regarding changes to the existing formula during its hearings in 1995 and 1996.

One likely change to school funding in North Dakota will be a substantial increase in the supplemental equity funding which was set at \$2.25 million during the 1995-97 biennium. Whether or not that appropriation will be increased to the \$20 million figure proposed by the governor, this supplemental funding mechanism is likely to be continued. Support for greater equity within the Foundation Aid Program is limited by the negative fiscal impact that suggested changes would have on some school districts and widespread opposition to any major tax increases. The opposition to tax increases could be tempered by interest, especially by rural legislators, in shifting the relative tax burden from property to income taxes.

Issues related to equity in capital outlay will not be addressed for at least several years. The lack of tax revenue to support major new initiatives noted above will be even more likely to preclude any new state role in funding school con-

struction or supporting the operation and maintenance costs of existing buildings. This could, however, become a more critical issue if proposed legislation is adopted that would strengthen the enforcement role of the state fire marshal's office in inspections of school buildings.

Special education will continue as an issue related to school funding. With major changes having been made during each of the last three legislative sessions, there is likely to be a period of stabilization while policymakers examine the impact of the most recent changes in special education funding and debate whether there is further need for revision.

In summary, North Dakota policymakers are faced with many of the same issues related to school funding as their peers in other states. Opposition to major tax increases, demands for support of services other than education, and lack of agreement among education groups regarding any fundamental changes in funding mechanisms greatly reduce the likelihood that any significant changes in the school finance systems will be enacted before the turn of the century.

Endnotes

- 1 *Bismarck Public School District No. 1, et al. v. State*. 511 N.W.2d 247 (N.D. 1994) (S.Ct. No. 930079).
- 2 North Dakota Department of Public Instruction. (1995). *95-96 district enrollment (K-12), Building Fund levy, tax valutr* (SAS System printout, December 6).