

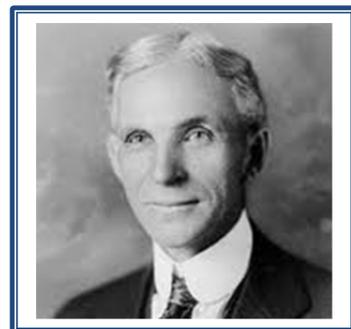
EDUCATION FUNDING IN ALASKA: *A Broken System*

Review

Prepared by Dan Bockhorst, Borough Manager, Ketchikan Gateway Borough – November 2012

INTRODUCTION

Henry Ford said, “It is well enough that people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning.”



Similar views might be expressed about education funding in Alaska. If Alaskans fully understood our education funding formula, perhaps there would not be a revolution, but certainly there would be widespread outrage and demand for reform.

Alaska’s system of public schools touches the lives of virtually every citizen in our state. The Alaska Department of Education and Early Development projects that the system will educate 129,021 students at a cost of \$1,850,577,827 this year.

Funding for schools in Alaska is a vital public interest; the manner in which it is carried out is also arcane and deeply flawed. There are 53 school districts in Alaska that may be classified as follows in terms of education funding:

- 3 are super-rich. They pay a small fraction of the local burden that the State imposes on middle-class districts. They also escape the limits of a federal disparity test designed to ensure relatively equal spending for students throughout Alaska.
- 20 are middle-class. These districts bear the brunt of the heavy local burden to fund schools – the required contribution for basic need imposed by the State of Alaska on city and borough governments that operate school districts.
- 11 districts are difficult to categorize because of the tenuous basis upon which their local burden is determined.
- 19 escape any local contribution whatsoever. This is the most egregious aspect of the flawed system. It is the product of a failure over the past half century to implement key provisions of Alaska’s Constitution. Were they to organize, some of these 19 districts have resources that would rank them among the “super-rich” districts.

The arcane nature of Alaska’s funding formula probably serves to keep public outrage in check.

This Review addresses the system of education funding in Alaska in three parts.

Part One: Background

The first part of this paper, comprising 6 pages, provides background about Alaska’s system for public schools, starting with the constitutional obligations of the State of Alaska, the type and number of school districts encompassing Alaska’s 663,267 square miles, and observations about the incredible diversity of the 53 school districts that serve Alaskans.

Part One also includes an explanation about how the State’s byzantine education funding formula works. It shows that Alaska’s funding formula accommodates the great diversities among Alaska’s 53 school districts to reasonably ensure that each will receive “basic need” – the funding necessary to provide for a basic education.

Part One also explains how basic need is financed with State, local, and federal funds, and addresses opportunities to supplement funding for districts beyond the level of “basic need.”

Part Two: Public Policy Concerns

Part Two is a nine-page critical review of education funding issues in Alaska.

The second part of this paper presents arguments that while basic need fairly measures the funds necessary to provide for basic education in each of Alaska’s school districts, the manner in which basic need is funded is severely flawed. Critical misperceptions that have persisted in the formulation of education funding policy in Alaska are addressed.

Part Two also describes how the local burden for funding of basic need is borne by “middle-class” municipalities, while loopholes in the education funding formula allow “super-rich” municipalities to escape commensurate responsibility for funding. Even worse is the fact that super-rich unorganized areas are allowed to evade responsibility altogether – simply because they choose to do so.

Also reviewed is the “federal disparity test,” which applies to education funding in Alaska. Additionally, shortcomings are observed in the State’s effort to accurately determine mandatory contributions for 11 of the 34 the districts that are subject to the State’s mandate for local contributions to basic need.

Part Two also examines the change in the State’s priorities for education funding. In the late 1980s, the State fully funded basic need. Despite the fact that the State recently declared itself to be, “in the strongest financial position in its history,” districts operated by municipal governments today receive, on average, only about 80 percent of basic need from the State; some receive little more than half.

The second part of this Review also stresses that Alaskans are not treated equally and do not have equal obligations when it comes to funding of education, despite the fact that our Constitution guarantees both.

Part Two concludes with a discussion of the critical promise made in law by the Alaska Legislature and Governor to Alaskans in 1963 that borough governments would not be penalized because of incorporation. Regrettably, that promise has not been honored.

Part Three: Options to Address Public Policy Concerns

The final portion of this paper is a two-page review of options to address the policy concerns raised.

PART I - BACKGROUND

I. THE STATE HAS A CONSTITUTIONAL DUTY TO ADEQUATELY FUND BASIC EDUCATION

A. Alaska's Constitution Requires the State to "Maintain a System of Public Schools"

Article VII, Section 1 of the Constitution of the State of Alaska provides:

The legislature shall by general law establish and maintain a system of public schools open to all children of the State . . .

B. No Other Government Shares Responsibility to "Maintain" Alaska's Public School System

In *Macauley v. Hildebrand*, 491 P.2d 120, 122 (Alaska 1971), the Alaska Supreme Court stated as follows regarding Article VII, Section 1:

This constitutional mandate for pervasive state authority in the field of education could not be more clear. First, the language is mandatory, not permissive. Second, the section not only requires that the legislature "establish" a school system, but also gives to that body the continuing obligation to "maintain" the system.^[FN6] Finally, the provision is unqualified; no other unit of government shares responsibility or authority. That the legislature has seen fit to delegate certain educational functions to local school boards in order that Alaska schools might be adapted to meet the varying conditions of different localities does not diminish this constitutionally mandated state control over education.

^{FN6.} The state supplies a minimum of 90% of school operating funds. AS 14.17.021(c)(5).

C. The Duty to "Maintain" the School System Includes an Obligation to Adequately Fund It

In *Moore, et al. v. State of Alaska*, 3AN-04-9756 CI, (June 2007) Superior Court Judge Sharon Gleason determined that "the State's constitutional obligation to maintain schools has four components" (p. 174). The obligation to adequately fund schools is one of those four components.¹

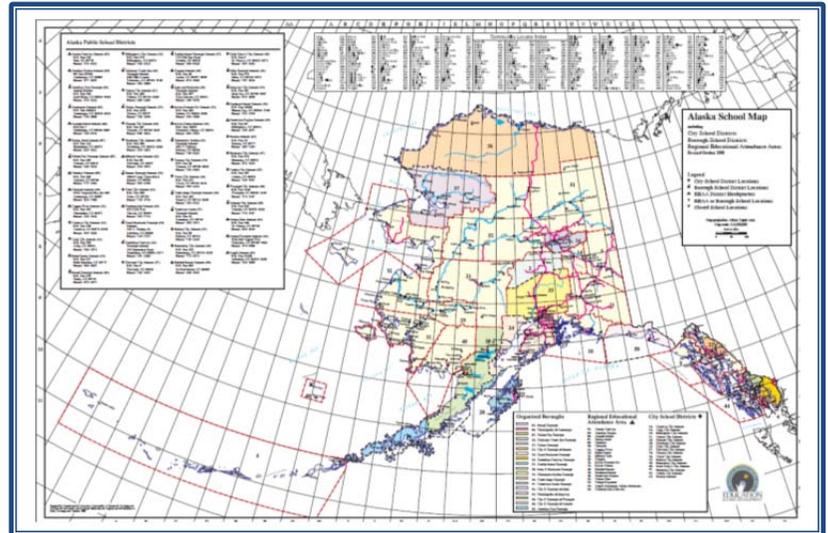
¹ Judge Gleason stated:

First, there must be rational educational standards that set out what it is that children should be expected to learn. These standards should meet or exceed a constitutional floor of an adequate knowledge base for children. Second, there must be an adequate method of assessing whether children are actually learning what is set out in the standards. Third, there must be adequate funding so as to accord to schools the ability to provide instruction in the standards. And fourth, where, as here, the State has delegated the responsibility to educate children to local school districts, there must be adequate accountability and oversight by the State over those school districts so as to insure that the districts are fulfilling the State's constitutional responsibility to "establish and maintain a system of public schools" as set forth in Article VII, § 1 of Alaska's Constitution.

II. THE STATE FUNDING FORMULA ENSURES THAT EACH OF ALASKA'S 53 DIVERSE DISTRICTS RECEIVES THE RESOURCES NEEDED TO PROVIDE STUDENTS WITH A BASIC EDUCATION

A. Alaska's 53 School Districts are an Incredibly Diverse Lot

Alaska has 53 school districts. Those districts encompass 663,267 square miles. There are vast differences among the districts. For example, the school district with the smallest enrollment is expected to serve only 11 students in the current fiscal year; while the district with the largest enrollment is expected to serve 48,545 students.² The jurisdictional areas of each district vary greatly. Alaska's smallest district encompasses 0.51 square miles, while the largest district, at 84,983 square miles, is bigger than 38 states in our nation.³ There are also significant differences in terms of operating costs. For example, the outlay for salaries of school administrators, teachers, and classified employees; the cost of certain goods; and the expense for energy in the least expensive district are less than half those in the most expensive district.⁴ The distinctions noted above impact the cost of providing basic educational services.



Map of Alaska's School Districts:
<http://education.alaska.gov/Facilities/pdf/doe2008map.pdf>

B. Alaska's Education Funding Formula Accommodates the Great Diversity Among School Districts

The State's statutory formula for determining education funding in each of Alaska's 53 districts – "basic need" – accounts fairly for the great diversity that exists among Alaska's 53 school districts. The formula is made up of eight components described below:

Average Daily Membership

"Average Daily Membership" or "ADM" measures the student population (the average number of enrolled students during the 20-school day count period ending the fourth Friday of October). Correspondence students are reflected as a separate component.

² *Public School Funding Program Overview*, Alaska Department of Education and Early Development, page 8 (September 2012).

³ The corporate boundaries of the City of Pelican, Alaska's school district with the smallest jurisdictional area, encompass 329 acres, or 0.51 square miles. The corporate boundaries of the North Slope Borough, Alaska's district with the largest jurisdictional area, encompass 84,983 square miles. Source: Alaska Department of Commerce, Community, and Economic Development (<http://www.commerce.state.ak.us/dca/lbc/Municipal%20Certificates/>).

⁴ *Alaska School District Cost Study Update*, Institute of Social and Economic Research, University of Alaska, (January 31, 2005) <http://lba.legis.state.ak.us/pubs/school2005.pdf>.

School Size Adjustment	Adjustment is made to account for instructional operating costs that are influenced by the size of each school in the district. ⁵
Temporary Adjustment for Significant Decline in Enrollment	If a district suffers a decrease of 5 percent or more in its Average Daily Membership, it is eligible for up to three years of declining funding to soften the impact of the reduced enrollment.
District Cost Factor	To adjust for the widely varying costs of operating schools throughout Alaska, funding for each district (except Anchorage, which is used as the base) is adjusted for cost differentials. Cost factors are specific to each school district and range from 1.000 to 2.116.
Special Needs Funding	Vocational education, special education (except intensive special education), gifted/talented education, and bilingual/bicultural education are funded at 20 percent of Average Daily Membership adjusted for the steps above.
Career & Technical Education	This component funds career and technical instruction for students enrolled in grades seven through 12.
Intensive Services Funding	This element provides funding for intensive special education students.
Correspondence Students	Correspondence students are funded at a rate of 80 percent of the Base Student Allocation, with none of the adjustments above (e.g., District Cost Factor).

The end result is termed the “adjusted ADM.” The adjusted ADM is multiplied by the “base student allocation” set in statute (presently \$5,680) to determine basic need. The adjustments from the components noted above are significant. Statewide, adjusted ADM for all districts is nearly double the raw ADM figure. Again, reflecting the incredible diversity of districts in Alaska, “adjusted ADM” figures for the 53 districts range from as little as 0.92 of the raw ADM figure to more than 8 times the raw ADM figure.⁶

Further information about the elements of basic need is provided in “Public School Funding Program Overview,” Alaska Department of Education and Early Development (September 2012), which is available online at http://education.alaska.gov/news/Funding_Program_Overview_2012.pdf.

⁵ The specific school size adjustment factors were determined by a team of education experts and through the use of statistical modeling. See, *Alaska’s Public School Funding Formula: A Report to the Alaska State Legislature*; Alaska Department of Education and Early Development (January 15, 2001) <http://education.alaska.gov/publications/FundingFormulaSB36Report.pdf>.

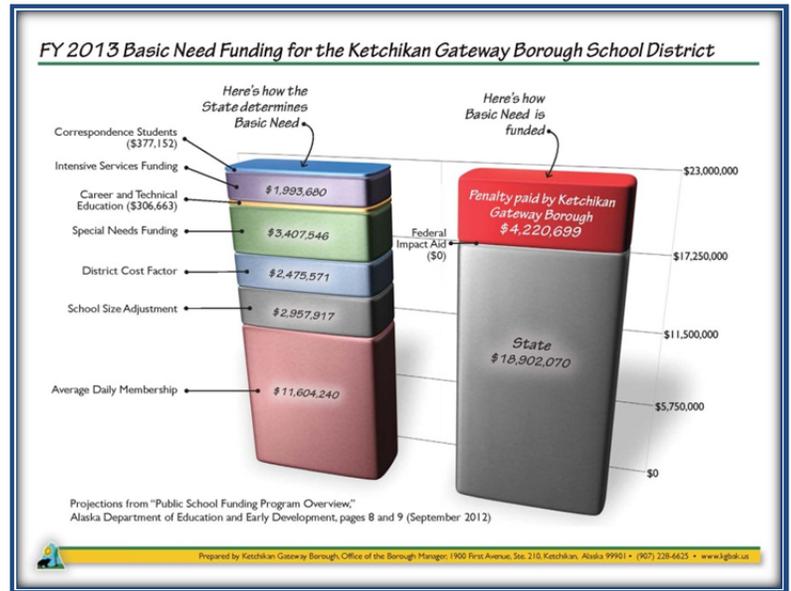
⁶ In September 2012, the Alaska Department of Education and Early Development projected a raw ADM figure for all districts, including correspondence students, plus the State boarding school at Mount Edgecumbe, of 129,021.48. The “adjusted ADM” number is 1.9 times that figure at 245,943.8. In terms of individual districts, at the low end, the City of Galena’s projected raw ADM figure is 3,704, whereas its adjusted ADM is 0.92 of that figure (3,425.85). The unusual negative adjustment – the only district that experiences a reduction in the raw ADM figure – stems from its relatively substantial correspondence student population (3,400 of the 3,704 students). As noted above, correspondence students are funded at 80 percent of ADM, without other adjustments such as those for district cost differentials. On the high end of adjustments, the Aleutian Region REAA’s ADM of 30 is adjusted to 249.42, an increase of 8.3 times the raw figure.

III. FUNDING OF BASIC NEED

A. The Type of District Affects the Manner in Which Basic Need is Funded for that District

Beyond the distinctions among districts noted in Part One-II-A above, there is one other significant difference worth noting in the context of education funding in Alaska. It concerns differences in organizational structure. Unlike the previously noted distinctions, differences in organizational structure do not materially impact the cost of providing educational services. However, those distinctions are significant in terms of how the State chooses to fund “basic need.”

There are three types of school districts in Alaska: (1) city school districts operated by home-rule and first-class cities in the unorganized borough; (2) borough school districts operated by organized boroughs; and (3) regional educational attendance areas (REAs), which are educational service areas established in the unorganized borough under AS 14.08.031.



Of the 53 school districts in Alaska, 16 are city school districts, 18 are borough school districts, and 19 are REAs.

B. Municipal Governments that Operate School Districts Must Pay a Portion of Basic Need

Payment of basic need by the State of Alaska to city governments that operate school districts (home-rule and first class cities in the unorganized borough) and organized boroughs is reduced by the equivalent of a 2.65 mill tax levy on the full and true value of the taxable real and personal property within the district in the second preceding year, up to a maximum of 45 percent of the district’s basic need for the preceding fiscal year. Public policy concerns regarding the 45-percent-of-basic-need cap are addressed in Part Two: Public Policy Concerns.

This reduction in the payment of basic need is commonly referred to as a “required local contribution.” Only 34 of Alaska’s 53 school districts (16 city districts and 18 borough districts) are required to make a local contribution.

AS 14.17.410(d) provides, “State aid may not be provided to a city or borough school district if the local contributions required under (b)(2) of this section have not been made.”

C. Federal Impact Aid is also Considered for All Districts

The Federal Impact Aid law (Title VIII of the Elementary and Secondary Education Act of 1965) provides funding on the basis of the number of students who reside on Indian lands, military bases, low-rent housing properties, and other federal properties, or who have parents in the uniformed services or employed on eligible federal properties.

Projections by the Alaska Department of Education and Early Development in September 2012 indicate that 43 of Alaska's districts will qualify and apply for \$106,015,662 in eligible Federal Impact Aid in the current fiscal year. District-wide average funding under the Federal Impact Aid program varies widely among the districts that receive Federal Impact Aid from as much as \$7,733 per student in one district to as little as \$3 per student in another district. Again, 10 districts either do not qualify for Federal Impact Aid or find the associated administrative burden relative to the revenues to be too great to apply.

Of the estimated \$106,015,662 in projected funding, \$69,889,579 is expected to be used to reduce the State's share of basic need payments. Public policy issues regarding Federal Impact Aid are addressed in Part Two of this Review.

D. Summary of Funding for Basic Need

To summarize A, B, and C above, "basic need" is funded by: (1) 90 percent of eligible Federal Impact Aid received by city school districts, boroughs school districts, and REAAs; (2) local contributions from city and borough governments that operate school districts; and (3) State aid. Specific projections statewide for each component for FY 2013 follow:

\$69,889,579	90 percent of eligible Federal Impact Aid
\$216,206,095	mandatory local contributions from city and borough governments
<u>\$1,110,865,108</u>	State aid
\$1,396,960,782	basic need

IV. STATE LAW ALLOWS SUPPLEMENTAL LOCAL FUNDING ABOVE THE LEVEL OF BASIC NEED:

A. Supplemental Funding is Permitted within Limits

A district may receive local funding beyond the prescribed level of "basic need." The Alaska Department of Education and Early Development projects that municipally operated districts will contribute \$453,617,045 in supplemental local funding to their districts in the current fiscal year. To nominally assure equal educational opportunities and to comply with federal disparity limits, State law limits such supplemental funding to a maximum of 23 percent of basic need or a 2-mill equivalent of the full and true value of the taxable and real property within the district, whichever is greater.

In order for the State to apply Federal Impact Aid to reduce the State's share of basic need as discussed in Part One-III-C above, Alaska must meet a federal equalization test (commonly referred to as a "disparity test") with respect to supplemental funding.

The disparity test measures the amount of revenue per student at the 95th and 5th percentiles of the total number of pupils in attendance in schools throughout the state.⁷ The federal law limits to 25 percent the

⁷ 34 CFR Part 222, subpart k, Appendix to Subpart K of Part 222, 1(a) prescribes the manner in which the disparity is determined. For Alaska, the disparity test is applied as follows: (1) The 53 school districts and the Mt. Edgecumbe State boarding school are ranked in descending order of revenues per "adjusted ADM" per district. (2) The statewide total adjusted ADM is then multiplied by 5% to obtain the target number needed to find the 95th and 5th percentiles of the adjusted ADM. (The 95th percentile is simply the figure below which 95 percent of the adjusted ADM falls; the 5th percentile is the lowest 5 percent of the adjusted ADM.). (3) The adjusted ADMs are added from the top down until the target number is reached but not exceeded, the next district down is the 95th percentile. (4) The adjusted ADM are added from the bottom up until the target number is reached but not exceeded, the next

variance in per student revenues at the 95th percentile and the 5th percentile. That is, the per-pupil revenue at the 95th percentile is not allowed to exceed more than 25 percent of the per-pupil revenue at the 5th percentile.

The State of Alaska maintains this standard by placing a cap on supplemental local contributions that exceed the level of basic need for each district. The State-imposed cap on excess local contributions is equal to 23 percent of the districts' basic need or the equivalent of a 2-mill tax levy on the full and true value of the taxable real and personal property within the district in the second preceding year. The 2-mill levy portion of the cap is addressed in Part Two.

The State of Alaska considers all districts equal at basic need,⁸ so by placing a cap on excess local revenues, the State hopes to continue to meet the federal equalization standard of 25 percent. The State of Alaska measures disparity not strictly on a per-pupil basis, but on the basis of adjusted average daily membership.⁹

In her previously noted 2007 decision in the *Moore* case, Judge Gleason accepted testimony that the federal disparity test is a conservative test that only six or seven states could pass, and that Alaska's score on the test was "quite good."

Based on that testimony, Judge Gleason concluded, "The fact that the State passes the federal disparity test provides support for a finding that the State's system of funding education is equalized." *Id.* at p. 126.

B. Supplemental Funding Can be Provided for All Districts, Not Just those Operated by Boroughs and Cities

State agencies invariably recognize that supplemental local funding can be provided to city and borough school districts by their respective city and borough governments. However, they almost always fail to recognize that supplemental local funding can also be provided to regional educational attendance areas by the State – this issue is addressed in Part Two.

district up is the 5th percentile. (5) The amount of revenue per adjusted ADM for the district at the 5th percentile is subtracted from the amount of revenue per adjusted ADM for the district at the 95th percentile, and the result is divided by the amount for the district at the 5th percentile, yielding the percentage of disparity.

⁸ *Alaska's Public School Funding Formula: A Report to the Alaska State Legislature* (January 2001).

⁹ See, *Memorandum Number 2012—008*, DEED Commissioner Mike Hanley (February 23, 2012) available online at http://education.alaska.gov/schoolfinance/pdf/FY11_DisparityTest.pdf.

PART TWO: PUBLIC POLICY CONCERNS

I. WHILE THE DETERMINATION OF “BASIC NEED” FOR EACH DISTRICT REASONABLY REFLECTS THE COST OF PROVIDING A BASIC EDUCATION, THE MECHANISM FOR FUNDING BASIC NEED LACKS A RATIONAL BASIS

A. It is Argued that REAAs are Exempt from Local Contribution Requirements Because they Lack Authority to Levy Taxes

As noted above in Part One-III-B, city and borough governments that operate school districts are required by State law to make a local contribution in support of schools. The “contribution” is in the form of funding to close the gap in payment of basic need by the State of Alaska. REAAs are exempt from that requirement. In debate over the topic, it is often noted that REAAs lack taxing authority.¹⁰ The argument follows that, therefore, REAAs should be exempt from the requirements for a local contribution.

It is certainly true that REAAs lack the power to tax. However, it is equally true that city school districts and borough school districts also lack the power to tax.

While no school district in Alaska has the power to tax, in every case, the government under which a school district operates has the power to tax. Home-rule or first-class city governments in the unorganized borough operate city school districts and have taxing power; borough governments operate borough school districts and have taxing power, and REAAs (educational service areas) operate under state law and may be taxed by the State.

It is remarkable that the State has so readily imposed significant burdens on residents of municipal governments that operate school districts (e.g., assessment for tax purposes, and partial funding of basic need), but has not seen fit to apply those burdens to others.

As noted in Part One-III-A, REAAs are created under AS 14.08.031 as formal “service areas.” Alaska’s Constitution provides that “taxes, charges, or assessments” may be levied in a service area by a borough assembly¹¹ and that the Alaska Legislature “may exercise any power or function in an unorganized borough which the assembly may exercise in an organized borough.”¹²

¹⁰ For example, the State Attorney General’s office posits that, “Alaska has an equalized system of school finance that assures that school districts with limited resources, *including those without local tax authority*, receive equitable state funding.” (emphasis added) Brief Of *Amicus Curiae* State of Alaska in Support of the Respondents in the Supreme Court of the United States, *Zuni Public School District No. 89, et al. v. Department of Education, et al.*, page 2 (December 14th, 2006).

¹¹ Article X, Section 5 states in relevant part, “. . . The assembly may authorize the levying of taxes, charges, or assessments within a service area to finance the special services.”

¹² Article X Section 6 of Alaska’s Constitution provides:

The legislature shall provide for the performance of services it deems necessary or advisable in unorganized boroughs, allowing for maximum local participation and responsibility. It may exercise any power or function in an unorganized borough which the assembly may exercise in an organized borough.

B. It is Wrongly Believed by Many that REAs Lack Tax Bases

It is also a common misperception that areas encompassed by REAs lack the fiscal resources to contribute in support of services. For example, the court found in the *Moore* case referenced above that, “REAs are not required to make a local financial contribution to their school districts because of the status of the land in these communities.” *Id.* at p. 24.

If that were the case, the Ketchikan Gateway Borough could make a strong argument for exemption since 99.7 percent of the land within the Ketchikan Gateway Borough is exempt from taxation. Notwithstanding its limited tax base, the Ketchikan Gateway Borough has existed as a borough for nearly a half-century – the result of a mandate by the State of Alaska in 1963.

It is clearly a myth that all REAs lack fiscal resources to fund services. For example, in litigation over borough incorporation in 2007, the State Attorney General’s office noted that the per capita value of taxable property in the Delta-Greely REAA was \$170,342 – more than twice the figure for the Fairbanks North Star Borough which was incorporated by legislative fiat more than four decades earlier. Specifically, the Attorney General’s Office noted:

If incorporated, the proposed Deltana Borough [Delta-Greely REAA] would rank second among the seventeen boroughs [in full and true value of taxable property], behind only the North Slope Borough. The per capita assessed value of the proposed Deltana Borough is more than twice the figure for the Fairbanks North Star Borough. The average for all boroughs was \$105,505 per resident. The median figure is \$88,601. The figure for the proposed Deltana Borough is [\$170,342 which is] \$64,837 (61.5 percent) greater than the average figure and \$81,741 (92.3 percent) greater than the median figure.

In studies, the State of Alaska has found that several other regions of the unorganized borough possess significant resources. One study found that at least six other regions of the unorganized borough that are comprised of relatively affluent local citizens who enjoy diverse industries, many cash employment opportunities, and much unencumbered private property ownership.¹³

Moreover, a number of home-rule and first-class city governments in the unorganized borough – all of which are required by State law to operate city school districts – have limited fiscal resources. These include the City of Hoonah, City of Kake, and City of Pelican – all of which were classified as economically distressed communities. Yet all home-rule and first-class cities in the unorganized boroughs are subject to the same local contribution requirements that apply to boroughs.

C. “After all, why should they tax themselves for services received from the state, gratis?”

As noted above, the Delta-Greely REAA would be one of the richest borough governments if it incorporated. In 2007, voters in the Delta-Greely REAA voted on a borough incorporation proposition. Voter participation was heavy – 1,378 of the 2,915 registered voters went to the polls – a 47.27 percent turnout. Disappointingly, more than 90 percent of voters rejected incorporation – 1,242 (90.6%) to 129 (9.4%).

¹³ *Unorganized Areas of Alaska that Meet Borough Incorporation Standards, A Report by the Alaska Local Boundary Commission to the Alaska Legislature Pursuant to Chapter 53, Session Laws of Alaska 2002* (February 2003).

The State Attorney General's Office noted in 2007 that the value of taxable property in the Delta-Greely REAA was \$170,342 per resident – more than twice the figure for the Fairbanks North Star Borough.

The facts relating to the Delta-Greely REAA reflect the wisdom of the late Jay Hammond when he observed years ago:

Attractive enough on paper, in practice, the organized borough concept had little appeal to most communities. After all, why should they tax themselves for services received from the state, gratis? Understandably, during the early years of statehood, there were no organized boroughs in Alaska.

Tales of Alaska's Bush Rat Governor, Jay Hammond (p. 149).

The legislative and executive branches of our state government have yet to come to terms with the human characteristics recognized by former Governor Hammond.

D. While the Value of Taxable Property is a Reasonable Measure of Wealth and Capacity to Pay, the 45-Percent-of-Basic-Need Cap Greatly Diminishes the Public Policy Purpose of Required Local Contributions

The value of taxable property is used to determine the required local contribution for each city and borough government that operates a school district. Taxable value is certainly a reasonable (and common) measure of both wealth and the capacity to pay for services. After all, ad valorem property taxes are ubiquitous in our nation – except in Alaska's REAAs.

However, "basic need" as defined above has no correlation whatsoever to wealth. Some of the districts with the greatest basic need per student are among the poorest districts. Thus, the 45%-of-"basic need"-cap has no place in a formula designed to address equalization of the burden for services.

If the obligation for a required partial payment of basic need does not apply uniformly to all Alaskans, it becomes merely an exercise by the State to harvest low-hanging fiscal fruit.

The cap on local contributions at 45 percent of basic need simply serves the "super rich" municipalities. It limits their required contributions to levels far below those required of the "middle class" municipalities. Specifically, 31 of the 34 municipal governments that operate school districts in Alaska pay a required local contribution equal to 2.65 mills. However, the remaining three super rich districts are capped at 45 percent of basic need. Based on current projections, one of the three will pay a local contribution equal to only 1.48994 mills, while another will pay 1.26935 mills, and the richest of all will pay only 0.713906 mills.

In other words, the middle class municipalities pay a tax rate that is 3.7 times greater than the richest of the rich districts. This renders the public policy purpose of local contributions a farce. If the obligation for a required partial payment of basic need does not apply uniformly to all Alaskans, it becomes merely an exercise by the State to harvest low-hanging fiscal fruit.

E. Even Worse, Some Super-Rich Districts Simply Choose not to Pay

As egregious as the circumstances in Part Two-I-D are, some REAAs (e.g., Delta-Greely REAA) have substantive fiscal resources, but merely choose not to form boroughs. This reflects a far greater failure of the public policy purpose of required local contributions.

When faced with policy concerns that REAAs do not make a local contribution for the payment of basic need, it is sometimes argued that the deduction of 90 percent of Federal Impact Aid generated in REAAs as outlined in Part One-III-C above, is the functional equivalent of a local contribution. This argument fails to recognize that 90 percent of Federal Impact Aid generated in municipally operated school districts is also deducted from the basic need of municipal districts. In fact, more Federal Impact Aid is deducted from the basic need of Anchorage and Fairbanks than is the case in 84 percent of all REAAs. Anchorage and Fairbanks, of course, also pay a very substantial local contribution *in addition* to the deduction of Federal Impact Aid.

F. While Alaska Passes the Federal Disparity Test, Education Funding is not Truly Equalized

As observed earlier, Alaska's education funding system has been proclaimed to be "quite good" when measured under the federal disparity test. However, while Alaska indeed passes the test, the test is constructed in such a manner that it fails to measure true disparity – particularly in Alaska.

The disparity test measures the amount of revenue per student at the 95th and 5th percentiles as described in Part One-IV-A. The provision in federal law dictating that disparity is measured at the 95th and 5th percentiles is explained by the U.S. Department of Education as follows: "These cutpoints have been chosen to reduce the influence of extreme values that may occur."¹⁴

Excluding outliers often has a reasonable purpose in making statistical comparisons. For example, if one wished to compare the average price of gasoline in Anchorage to that of Fairbanks, it would be logical to exclude the outliers in each community. However, a true measure of the disparity of revenues among school districts cannot be measured by excluding outliers. This is particularly the case given the characteristics of Alaska's school districts. Indeed, 38 school districts in Alaska (71.7%) collectively serve fewer than 10 percent of the students in Alaska. Thus, using the 95th and 5th percentiles to measure disparity could theoretically exclude all of those 38 school districts – 71.7% percent of the school districts in Alaska.

In fact, a large percentage of Alaska's school districts are excluded from the disparity test. The cutpoints used in the federal disparity test currently eliminate nearly 20 percent of districts in Alaska – the 6 richest districts and the 4 poorest districts.

Applying the disparity test to all 53 districts yields a far different result. The disparity in revenues between Alaska's wealthiest district and the poorest district per student (unadjusted ADM) in FY 2011 was 127.9 percent – more than five times the disparity allowed by federal law at the 95th and 5th percentiles.

¹⁴ *Revenues and Expenditures for Public Elementary and Secondary School Districts: School Year 2008–09 (Fiscal Year 2009) First Look*, Institute of Education Sciences, U.S. Department of Education, p. 16 (November 2011).

Similarly, without excluding the outliers, the disparity between the wealthiest district and the poorest district per *adjusted ADM* in FY 2011 was 102.7 percent – more than four times the disparity allowed at the 95th and 5th percentiles.¹⁵

As noted previously, the Attorney General’s office has asserted that, “Alaska has an equalized system of school finance.” The State Attorney General’s office defined an “equalized system of school finance” as one “that equalizes the difference between rich and poor districts.”¹⁶

It is difficult to accept the claim that Alaska’s educational funding system is “equalized” unless one adopts the Orwellian Commandment that “All animals are equal – but some animals are more equal than others.” George Orwell, *Animal Farm*, p. 112 (1946).

The two-mill alternative to the 23%-of-basic-need cap governing supplemental funding, in fact, appears to be designed to allow the wealthiest districts to flaunt the disparity limits by accommodating excessive expenditures by the rich few. Given the characteristics of Alaska school districts, it is predetermined that the wealthiest district will rank above the 95th percentile. Thus, it is a “sure bet” that the wealthiest districts in Alaska will not be impeded by the federal disparity test. The super-rich districts can and do utilize the two-mill option without consequences because they will rank above the 95th percentile cutpoint.

The 2-mill limit for supplemental funding is just as much out of place in terms of disparity limits as is the 45-percent-of-basic-need limit in capping required local contributions toward basic need. In terms of the latter, while penalties suffered by super-rich districts in terms of required local contributions are greatly limited by the 45-percent-of-basic-need cap, the benefits enjoyed by the super-rich districts are correspondingly greatly enhanced by the two-mill option for supplemental funding. Under the 23-percent-of-basic-need limit, the richest district in Alaska would be limited to supplemental support of \$6,426,221. However, under the two-mill option, that district may contribute \$34,079,706 – more than five times what it could contribute under the 23-percent-of-basic-need limit.

G. The State Fails to Allocate Resources Needed to Accurately Determine “Full and True Value” the Foundation to Calculate Local Contributions

As noted above, the State requires city and borough governments that operate school districts to contribute a portion of basic need equal to a 2.65 mill levy on the full and true value of taxable property (not to exceed 45% of basic need).

¹⁵ The most recent disparity test conducted by the State of Alaska was reported on February 23, 2012, for FY 2011 spending. (See previously cited *Memorandum Number 2012—008*, DEED Commissioner Mike Hanley (February 23, 2012)). The revenues for the richest of the rich districts in FY 2011 amounted to \$55,028,469. There were 1,614.40 students enrolled in that district in FY 2011. The adjusted ADM for that district was 4,713.47. Thus, the revenue per student in that district was \$34,086; while the revenue per adjusted ADM was \$11,675. In contrast, the revenues for the poorest district in FY 2011 totaled \$7,054,983. There were 471.78 full-time equivalent students enrolled in that district at that time. The adjusted ADM for that district was 1,225.14. Thus, the revenue per student in the poorest district was \$14,954; while the revenue per adjusted ADM was \$5,759.

¹⁶ Brief of *Amicus Curiae* State of Alaska in Support of the Respondents in the Supreme Court of the United States, *Zuni Public School District No. 89, et al. v. Department of Education, et al.*, page 2 (December 14th, 2006).

Full value determinations are made by the State Assessor, an employee of the Alaska Department of Commerce, Community, and Economic Development. Where available, the State Assessor relies extensively on the assessment records of municipalities in making full-value determinations.

However, only 14 of the 18 organized boroughs and only 9 of the 16 home-rule and first-class cities in the unorganized borough levy property taxes. In doing so, those 23 local governments spent an estimated \$17,151,365 for assessment work in 2011. *Alaska Taxable – 2011*, p. 61-62. That expenditure reflects only the cost of a one-year update to a data base developed, in most cases, over decades. The State Assessor has many millions of dollars' worth of data at his disposal to make full value determinations for those 23 municipalities.

In contrast, the State Assessor has no municipal assessment data upon which to make full value determinations in 11 of the 34 (32.4%) municipal governments that operate school districts. Those 11 districts encompass more than 94,000 square miles – an area larger than 39 states.

The Office of the State Assessor has a tiny staff – the State Assessor and Assistant State Assessor – with a personnel budget (including benefits) of just \$289,683.¹⁷

The office of the State Assessor has many duties beyond full-value determinations. Thus, it stands to reason that the foundation for full-value determinations for the 11 municipal governments that do not levy property taxes and therefore have no assessment data is not remotely comparable to the 23 that do levy property taxes.

In one case, concern had been expressed for years that the formal full value determination for one borough that does not levy property taxes was less than the capital investment in a single fish processing plant in that borough. In an apparent effort to at least partially rectify that glaring circumstance, the full value for that borough recently increased in a single year by 52.6 percent.¹⁸ These circumstances raise significant concerns whether mandatory local contributions for schools, which are based on full value determinations, are fair for all.

H. The “Required Local Contribution” is Merely a Thinly-Disguised and Poorly Conceived State Tax

The State of Alaska does not levy a personal income tax, ad valorem property tax, or sales tax. However, the local contribution toward “basic need” mandated by AS 14.17.410(b)(2) is a thinly disguised State tax. The State requires the “contribution” and the State – *exclusively* – benefits from that “contribution” in the form of a reduction in its own obligation to fund “basic need.”

The State tax is poorly conceived in more than one respect. First, Alaskans who reside within 19 of the State’s 53 school districts (36%) are exempt from this tax. If applied nationally, Alaska’s approach would be analogous to excluding residents of 18 states (36%) from federal income taxes.

Additionally, as noted in Part Two-I-G above, 11 of the 53 districts (21%) have no local assessment records. Those 11 districts encompass an area larger than 39 states. With a personnel budget of \$289,683, the two-person office of the State Assessor cannot possibly accurately determine the full and true value for such a vast area with no assessment data.

¹⁷ State of Alaska FY2013 Governor’s Operating Budget; Department of Commerce, Community, and Economic Development; Community and Regional Affairs, RDU/Component Budget Summary, p. 14 (December 15, 2011).

¹⁸ The full value for the Aleutians East Borough was \$156,158,100 for 2009 and \$238,347,700 for 2010. *Alaska Taxable-2011*, p. 55.

Using the analogy of federal income tax, the lack of records for those 11 of 53 districts in Alaska (21%) is similar to a circumstance where income for residents of 11 states is not reported to the IRS, but where two IRS auditors are left to guess at income for those 11 states.

In addition to the concerns above, three super-rich municipalities pay rates that are far below those paid by the remaining percent of Alaskans because of the 45%-of-basic-need cap. In one case, the rate is about one-quarter of the rate paid by the “middle-class” municipalities.¹⁹ To apply the federal income tax analogy, this is equivalent to applying a much lower tax rate to residents of three states in the nation.

Thus, 20 of the 53 school districts in Alaska are subject to a system that is more rigorous, and which holds residents fully responsible for payment of the subsidy to the State.

II. The State’s Priorities have Shifted

It is undeniable that the State of Alaska spends a great deal of money on education – an estimated \$1.1 billion on funding for grades K-12 in FY 2013 alone. As significant as that figure is, it is appropriate to reflect on the 1987 report on education funding by the House Research Agency of the Alaska State Legislature. Chapter One of *Public School Financing in Alaska*, which provides an historical review of education in Alaska, concludes with the following statement:

In reviewing the history of education organization and funding in Alaska several trends become apparent. The most striking is the steadily increasing level of State support for education. After statehood, the reimbursement system was replaced by a foundation formula which required local districts to pay a portion of local education costs, but also made the State a more active participant in funding education. The second foundation formula, fueled by revenue from Prudhoe Bay, eventually eliminated required local effort and increased State aid to 100 percent of basic need. . . .

Twenty-three years after that report was written, the Commissioner of the Alaska Department of Revenue announced, “The state is in the strongest financial position in its history, and has a stable outlook with tremendous opportunities.” *Press Release No. 10-006*, November 23, 2010.

In light of the above, it is remarkable that today, the State requires municipal governments to pay more than \$200 million annually of the cost of basic need. The State is obligated to only pay as little as 55 cents of every dollar of the prior year’s “basic need”, minus 90 percent of the eligible Federal Impact Aid. In one case, that amounts to only 51 percent of basic need in FY 2013.²⁰

¹⁹ The ADM in the three municipal governments that benefit from the 45%-of-basic-need cap (i.e., North Slope Borough, City of Valdez, and Municipality of Skagway) is projected to be 2,305, which is 1.8% of the total statewide ADM of 129,021.48. The required local contribution of the North Slope Borough is 0.713906 mills, or 26.9% of the 2.65-mill rate that applies to 31 municipalities that operate school districts.

²⁰ FY 2013 projections prepared by the Alaska Department of Education and Early Development in September 2012 estimated that the North Slope Borough’s basic need will be \$27,940,090, which will be funded with \$12,164,847 in local revenues, \$1,473,687 in Federal Impact Aid, and \$14,301,556 in State aid. The projected State aid equals 51.2% of projected basic need.

III. ALASKA'S CONSTITUTION PROVIDES THAT ALL ALASKANS HAVE BOTH EQUAL RIGHTS AND EQUAL OBLIGATIONS



Article I, Section 1 of Alaska's Constitution provides that all Alaskans are "equal and entitled to equal rights." Along with the guarantee of equal rights, that same section of our constitution provides that "all persons have corresponding obligations to the people and to the State."

In fact, as is shown throughout this paper, all Alaskans are not treated equally and do not have corresponding obligations when it comes to education funding. The State funds 100 percent of "basic need" in many districts, but funds as little as 51 percent of basic need in other districts. There is no rational basis for this disparate treatment.

IV. A PROMISE MADE IS A DEBT UNPAID

Article X, Section 1 of Alaska's Constitution encourages the creation of organized boroughs (see *Mobil Oil Corp. v. Local Boundary Commission*, 518 P.2d 92 (Alaska 1974)).

The framers of Alaska's Constitution intended that the Alaska legislature and governor would create inducements for the formation of organized boroughs (see *Alaska's Constitutional Convention*, Vic Fischer, p. 120). The State has, regrettably, failed to accomplish that goal.

In the fifth year of statehood, fearing that borough government would never be implemented, the 1963 legislature adopted a bill (*CSHB 90*) mandating that eight areas of Alaska form organized boroughs. Those eight areas – Anchorage, Fairbanks, Kenai Peninsula, Matanuska-Susitna Valleys, Kodiak Island, Juneau, Sitka, and Ketchikan – today encompass 610,709 of 722,190 (84.6%) of all Alaskans. Then-Governor William A. Egan, President of Alaska's Constitutional Convention, signed the bill into law as Chapter 52 SLA 1963.



The 1963 Alaska State House (shown above) along with the Senate and Governor Egan promised, in law, that boroughs would be treated equally.

Section 1 of Chapter 52 SLA 1963 promised that boroughs would suffer no penalties or loss of revenues because of incorporation. Specifically, the law states:

No area incorporated as an organized borough shall be deprived of state services, revenues, or assistance or be otherwise penalized because of incorporation.

Once those eight areas were incorporated, however, the State abruptly abandoned its policy of mandatory borough formation, adopting instead, a "laissez-faire" approach. The 1963 law, however, was never repealed. After nearly 54 years of statehood, more than 60 percent of the geographic area of Alaska remains outside organized boroughs.

Has the State of Alaska honored its critical 1963 promise? No. State agencies have openly admitted that organized boroughs are "severely" penalized. For example, the Alaska Department of Education and Early Development, Alaska

Local Boundary Commission, and Alaska Department of Commerce, Community, and Economic Development stated nearly a decade ago:

Contrary to the express intent of the 1963 Mandatory Borough Act, organized boroughs are being severely deprived of State services, revenues, or assistance and are being penalized because of incorporation.

School Consolidation – Public Policy Considerations and a Review of Opportunities for Consolidation, p. 54, February 2004.

Many today who learn for the first time or who are reminded of the promise made to the people of Alaska by the 1963 Legislature and Governor Egan a half century ago, are all too willing to dismiss the promise. They say it is naïve to believe that the State would honor it. They say that future legislatures were not bound by the promise.

Keeping a promise is a matter of integrity. As Robert Service wrote more than a century ago, “a promise made is a debt unpaid.”

PART THREE: OPTIONS TO ADDRESS PUBLIC POLICY CONCERNS

Based on the public policy concerns outlined in Part Two, the Ketchikan Gateway Borough seeks full funding of “basic need” by the State of Alaska for all school districts.²¹ Doing so would resolve every one of the policy concerns raised in this paper with the exception of the two-mill equalization issue regarding supplemental funding addressed in Part Two-I-F of this Review.

The issue of the importance of full state funding for basic education is summarized well in *Education Week* (“*School Finance*,” June 20, 2011, <http://www.edweek.org/ew/issues/school-finance/>):

The higher the share of funding that states provide for education, and the more states target that money, the better the chances for increasing equity in the system.

Court battles have repeatedly determined that states are responsible for all education spending and that even when their funding is simply a minor supplement to local budgets, states should not allow one district to spend vastly more than another.

Of particular significance, full funding of basic need would honor the 1963 promise with regard to funding of schools, and bring equity to all Alaskans. It would also eliminate one of the most onerous financial burdens placed on taxpayers of existing organized boroughs, and remove the biggest disincentive to incorporation of new boroughs.

As pointed out in a recent conversation with Vic Fischer,²² resolution of the Ketchikan Gateway Borough’s policy concerns outlined here may bring about the true vision and goal of the framers of the Alaska Constitution with respect to borough government. In that regard, Mr. Fischer stated:

It may take years of litigation . . . but this may finally beget results. The constitutional intent with respect to boroughs may yet be achieved.

The Ketchikan Gateway Borough has commissioned Bob Hicks²³ to review the policy concerns addressed here. The results of that review are presently protected by attorney-client privilege pending a determination by the Ketchikan

²¹ Barring full funding of basic need by the State as a means of providing equal treatment, the State must impose the same burdens on all Alaskans – that is, to truly provide that “all persons have corresponding obligations to the people and to the State.”

²² Victor Fischer was one of fifty-five delegates to the Alaska Constitutional Convention in 1955-1956 (where he served as Chairman of the Committee on Executive Branch, Member of the Committee on Style and Drafting, and Member of the Committee on Local Government). Mr. Fischer served in the Territorial House of Representatives from 1957-1959 and in 1961, he became the first director of Alaska’s Institute of Social and Economic Research [at the time it was called the Institute of Social, Economic, and Governmental Research]. He has degrees from the University of Wisconsin, MIT, and Harvard. Mr. Fischer served in the Alaska State Senate from 1980 to 1986. He authored and co-authored numerous books, including the particularly authoritative works *Alaska’s Constitutional Convention* and *Borough Government in Alaska*. He has also been recognized many times by the Alaska Supreme Court as an expert in Alaska local government.

²³ Mr. Hicks is eminently qualified for the task. A graduate of Harvard Law School, Mr. Hicks served as an Alaska Supreme Court law clerk, first to Justice John Dimond and then to Justice Robert Boochever. He was later appointed the first Executive Director of the Alaska Judicial Council in 1973, conducting many studies of Bush justice in Alaska until 1975 when he entered the private practice of law in Anchorage. During his four decades in private practice of law in Alaska, Mr. Hicks specialized in municipal law, education law,

Gateway Borough Assembly whether to pursue litigation. The analysis by Mr. Hicks has disclosed many limitations and weaknesses in prior case law regarding education funding in Alaska.

There are a number of options for pursuit of reform. Municipalities might refuse to pay the required local contribution, forcing the State to fully fund basic need or invoke the previously noted terms of AS 14.17.410(d), which provides, "State aid may not be provided to a city or borough school district if the local contributions required under (b)(2) of this section have not been made." Another possible option is a statewide initiative to repeal AS 14.17.410(b)(2), the requirement for a local contribution. Municipalities may also form a coalition to seek legislative repeal of AS 14.17.410(b)(2).

Of course, there is always the option of litigation – probably the second least appealing option for the Ketchikan Gateway Borough. The least appealing option is to *do nothing*.

The Ketchikan Gateway Borough is seeking support from other municipal governments who suffer the same injustices outlined here and who wish to remedy those wrongs. Contact the Ketchikan Gateway Borough Manager for further information:

Dan Bockhorst
Borough Manager
Ketchikan Gateway Borough
1900 First Avenue, Suite 210
Ketchikan, Alaska 99901

Telephone: 228-6625
E-mail: DanB@KGBAK.US

and local boundary law. At various times, he served as the city attorney for Nome, Bethel, Dillingham, Unalaska, Seldovia, Emmonak and Kotlik, as special counsel to the North Slope Borough Assembly, and as legal counsel to the Nome City School District, the Delta-Greely REAA, the Alaska Gateway REAA and the Craig City School District. Mr. Hicks was retained by the Alaska Local Boundary Commission in 1987-88 to perform a comprehensive rewrite of its regulations. On numerous occasions, the Local Boundary Commission has invited him to conduct seminars for newly appointed commissioners. He also served as a commissioner and as vice-chair of the Local Boundary Commission.