GRAND CANYON INSTITUTE

Policy Brief

May 21, 2021

AZ Budget Priorities: Massive Tax Cut for the Wealthiest 1% **OR** Invest in the Education of At-Risk K-12 Students

Budgets are about values and priorities.

One key question for Arizona policymakers is whether to cut taxes for 30,000 of Arizona's wealthiest at a cost of $826 million or invest that money in providing targeted educational support for 600,000 at-risk K-12 students to improve their opportunities for success.

On May 18, Governor Ducey and Republican legislative leaders agreed in principle to massive tax cuts for wealthy Arizonans.

One component of the proposed tax cuts protects the wealthiest 1% of Arizona tax filers from Prop. 208, which voters approved in November 2020 to provide additional resources to education. The in-principle agreement announced earlier this week reduces the state income tax rate from 4.5% to 1% on taxable incomes above $250,00 for single filers and $500,000 for married filers, bringing their overall income tax rate to 4.5%. A married tax filer with $1.5 million in taxable income would see their tax obligation reduced by $35,000 under this proposal. This tax proposal has a budgetary cost of $826 million that would benefit about 30,000 tax filers in Arizona.

Budgets reflect values and priorities.

EDUCATION FUNDING OPPORTUNITY INDEX

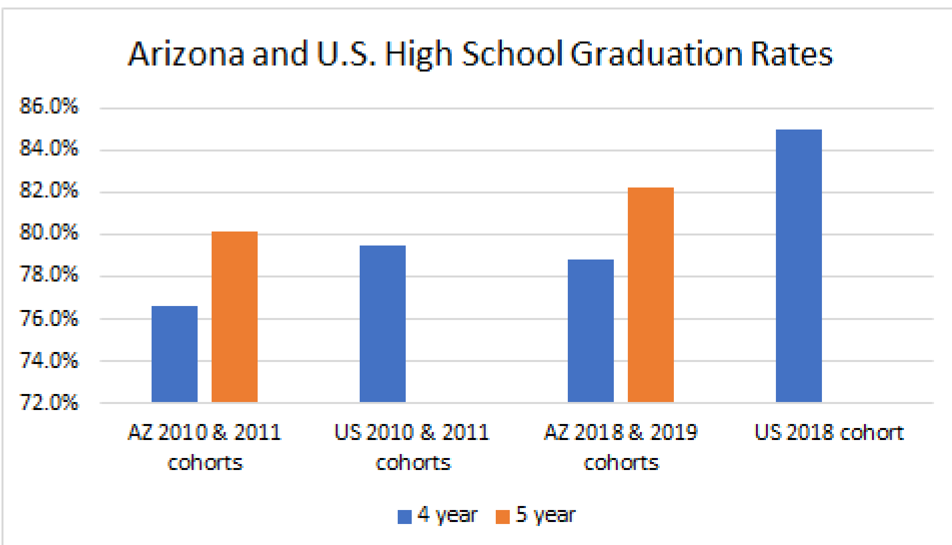
Investment: $813 million

On May 13, the Grand Canyon Institute (GCI) proposed adding an opportunity (poverty) index to Arizona's school funding formula to help close achievement gaps where they are pronounced — among students from low-income families. The state has struggled to improve its high school graduation rate and currently Arizona provides no added state funds to assist students from lower socioeconomic families. This proposal would improve the academic and lifetime achievements of children most at-risk of not graduating from high school and who have less opportunities for prosperity. At an estimated cost of $813 million annually, this proposal would benefit 600,000 students.

Educational attainment in Arizona

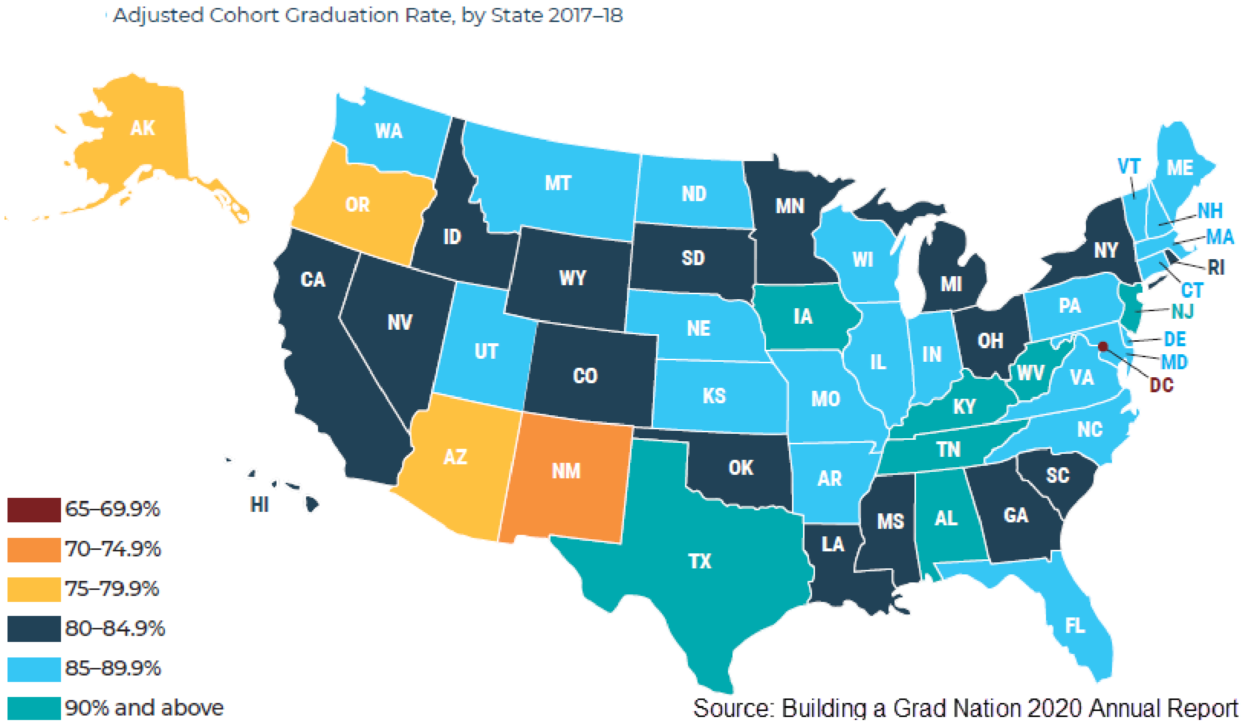
Educational attainment, starting with a high school degree, is critical for individual economic success and stronger economic growth. Governor Doug Ducey has embraced the goal to have 90% of students graduate from high school by 2030. Arizona is not on pace to achieve that goal as noted in the Figure 1 below.

Figure 1 Arizona and U.S. High School Graduation Rates



Source: Arizona Dept. of Education, National Center for Educational Statistics.

Figure 2 Arizona Among the States with Lowest High School Graduation Rate



Educational Attainment Will Drive GDP Growth

Lower high school graduation rates along with lower college-going rates impact Arizona's opportunity for economic advancement. Attracting and developing businesses and industries requires an educated pool of workers that they can rely upon. Arizona was identified as one of the states that would most benefit in GDP growth from improvements in the base education level of its workforce in a 2015 National Bureau of Economic Research paper by Eric Hanushek with the Hoover Institution at Stanford University.[1]

From a K-12 perspective, the most critical area to invest resources is in the children least likely to graduate from high school or matriculate to college. Consequently,

[1] Hanushek, Eric A., Jens Ruhose, and Ludger Woessmann (2015), "Economic Gains for U.S. States from Educational Reform," National Bureau of Economic Research, working Paper No. 21770, December, https://www.nber.org/papers/w21770.

investing additional financial resources in low-performing schools with a high number of students living in poverty is imperative if Arizona is going to improve educational outcomes.

Limitations of Current Efforts

- Arizona's education funding formula does not include a poverty/opportunity weight. Students in a regular education classroom receive the same base level funding regardless of parental education, household stability, income or other factors — even though these characteristics strongly influence student success.
- Arizona ranks among the worst states for its effort, adequacy and progressivity of its education funding.[2]
    - Effort reflects how much funding is provided relative to Gross State Product.
    - Adequacy reflects how much funding is provided relative to what is needed.
    - Progressivity reflects how much funding high poverty districts receive compared to wealthier districts.
- When measuring overall funding received by Arizona's district schools, high poverty districts receive 88 cents for every dollar received by low poverty districts.[3] Arizona is the second-worst state in the country when taken into consideration along with the state's low level of education funding.
- The Classroom Site Fund does not prioritize based on student risk factors.
- Prop. 208 Invest in Ed aims to increase school funding by about $900 million annually. It provides funding for the teacher pipeline and mentorship to improve the workforce. While it will increase the availability of well-trained teachers in Arizona, it does not provide additional funding targeted at issues related to students at risk due to their socioeconomic status.

---

[2] Baker, Bruce D., Danielle Farrie, and David Sciarra (2018), "Is School Funding Fair: A National Report Card," 7th edition, Education Law Center, Rutgers University, February, Is School Funding Fair 7th Edition.pdf - Google Drive.
[3] Baker et al.

- The Governor's 20x2020 provided additional funds but did not target schools serving high-poverty communities. Once complete, the plan will have increased teacher pay by around 20% but was distributed uniformly and did not improve the ability of districts with high numbers of children from low-income families to compete with other districts in hiring the best teachers.
- The restoration of District Additional Assistance has no differential impact based on the needs of the child.

Last year Governor Ducey pushed to expand Project Rocket, but the pandemic and skinny budget preempted that from happening. While it hails as a solution for what ails high poverty schools, it only provides an additional $150 per student.

How a Meaningful Opportunity Weight Would Work

The Grand Canyon Institute proposes an opportunity weight to be added to the school funding formula for students who come from economically disadvantaged circumstances. Free and Reduced Lunch eligibility for the National School Lunch Program, which is 185% or less of the federal poverty guideline, while often used, hides a wide diversity of relative student challenges. The approach recommended by the Grand Canyon Institute places greatest emphasis on students at greatest risk in order to improve the academic support they will need to succeed. The weight would have three levels defined by the following.

1. **Students attending schools that participate in the Community Eligibility Provision (CEP)** program of the National School Lunch Program. These are the highest poverty schools where at least 40% of attending students have been identified as enrolled in programs such as Supplemental Nutrition Assistance Program (SNAP), Medicaid or Temporary Aid to Needy Families (TANF).[4] GCI estimates 165,000 students in Arizona attend these schools. All students attending CEP schools are eligible for free breakfast and lunch.

[4] U.S. Dept. of Education, "GUIDANCE: The Community Eligibility Provision and Selected Requirements Under Title I, Part A of the Elementary and Secondary Education Act of 1965, as Amended." The guidelines note the "identified" population can include students experiencing homelessness or in foster care.

2. **"Identified" student populations.** Schools receiving Title 1 funds also track SNAP recipiency at a minimum, therefore they have data on "identified" student populations. SNAP like Medicaid and free (not reduced) lunch requires incomes to be less than 130 percent of the federal poverty guideline whereas free and reduced lunch programs provide eligibility up to 185 percent. These are also students at higher risk of less academic success. GCI estimates that about 20% of all students not in CEP schools would fall into this category.

3. **Free and Reduced Lunch recipients beyond students in the above categories.** These students are identified through an income reporting process through schools and includes students in families up to 185 percent of the federal poverty guideline. Eligibility is based on collecting forms from parents which is subject to challenges in getting forms returned as well as error.

Table 1 below summarizes the three student groups and how the $800 million investment would break out. The $800 million is not enough to close the achievement gap, but would represent Arizona's first concerted effort to do so.[5]

[5] Baker, Bruce D., Mark Weber, Ajay Srikanth, Robert Kim and Michael Atzbi (2018), "The Real Shame of the Nation: The Causes and Consequences of Interstate Inequity in Public School Investments," Rutgers University Graduate School of Education and Education Law Center, [The Real Shame of the Nation.pdf - Google Drive].

Table 1 Breakdown of Proposed State Investment by Student Groups

	Students	Base Level	Weight	Investment per Student	Total Investment
CEP School Enrollment[6]	165,000	$4,358.33	0.4	$1,743.33	$288,000,000
Other "Identified" Students[7]	167,000	$4,358.33	0.4	$1,743.33	$291,000,000
Other Free & Reduced Lunch Eligible	268,000	$4,358.33	0.2	$871.67	$234,000,000
Total					$813,000,000

REDUCING MARGINAL STATE INCOME TAX RATE TO 1% FOR TOP 1%

Cost: $826 million

The Joint Legislative Budget Committee (JLBC) conducted an analysis of Prop. 208 whose revenue impact is reversed in the Republican leadership proposal.[8]

[6] Based on CEP school enrollment for 2020-2021.
[7] Outside CEP school enrollment, it is assumed about 20% of all other students would be considered "identified" and eligible for the 0.4 weight.
[8] Joint Legislative Budget Committee (2020), "Ballot Proposition 208 Invest in Education Act: Fiscal Analysis, July 30, 20novl-31-2020fn730.pdf (azleg.gov).

Based on the JLBC analysis and review of the 2015 Income Tax Returns from the Arizona Department of Revenue, 88% of filers in the $200,000 to $499,999 income are married or head of household.[9] All filers with taxable incomes above that are impacted. Overall, an estimated 30,000 filers are impacted. The current estimated tax reduction $826 million matches the then presumed revenue increase of $827 million.

Table 2 Illustration of reducing marginal rate to 1% on High-Income Taxpayers

Taxable Income (Married/ head of Household)	Current Income Tax	Governor and Republican leadership Proposed Income Tax Amount	Reduction	% Less
$250,000	$7,551	$7,551	$0	0%
$500,000	$18,801	$18,801	$0	0%
$750,000	$38,801	$30,051	$8,750	23%
$1,000,000	$58,801	$41,301	$17,500	30%
$1,500,000	$98,801	$63,801	$35,000	35%
$2,000,000	$138,801	$86,301	$52,500	38%

[9] Arizona Department of Revenue, "Individual Income Tax Statistics" Tax Year 2015 Preliminary Report (most recent available), https://azdor.gov/sites/default/files/media/REPORTS_STATS_2015_Arizona_Individual_Income_Tax_Statistics.pdf.

Table 3 Arizona Income Tax Filers Impacted by Prop. 208

Adjusted Gross Income Range	Number of Filers	Estimated Percent Receiving 4.5% Cap Benefit	Number of Filers Impacted
$200,000 to $499,999	111,963	5%	5,462
$500,000 to $999,999	17,425	82%	14,321
$1,000,000 to $4,999,999	8,127	100%	8,127
$5 million or more	956	100%	956
		Total	28,866

Contact: Dave Wells

Dave Wells holds a doctorate in political economy and public policy and is the Research Director for the Grand Canyon Institute. He can be reached at DWells@azgci.org or by contacting the Grand Canyon Institute at (602) 595-1025 ex. 2.

The Grand Canyon Institute, a 501(c) 3 nonprofit organization, is a centrist think tank led by a bipartisan group of former state lawmakers, economists, community leaders, and academicians. The Grand Canyon Institute serves as an independent voice reflecting a pragmatic approach to addressing economic, fiscal, budgetary and taxation issues confronting Arizona.

Grand Canyon Institute

P.O. Box 1008

Phoenix, Arizona 85001-1008

GrandCanyonInsitute.org