

Funding What Matters

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INTRODUCTION

The Legislature is in a box, constitutionally speaking, on school finance.

It begins with these words from the Texas Constitution, which assign the Legislature a duty: “A general diffusion of knowledge being essential to the preservation of the liberties and rights of the people, it shall be the duty of the Legislature of the State to establish and make suitable provision for the support and maintenance of an efficient system of public free schools.”¹

Two walls of the box relate to the education provided, and two provide strictures on paying for it. First is the requirement that the education provided must be “adequate” – that is, the public school system must accomplish “the general diffusion of knowledge ... essential to the preservation of the liberties and rights of the people.” Next, the means adopted must be “suitable” to its purpose.² Third, the system itself must be “efficient” (often called “equitable”), which means districts must have substantially equivalent access to similar revenues per pupil at similar levels of tax effort to the point of achieving adequacy.³ And the last wall is the constitutional prohibition of a statewide property tax,⁴ with the concomitant prohibition against forced redistribution of local revenue.⁵ For each of these standards, the Legislature decides how to meet them, and the courts determine whether they have been met.⁶

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At the ceiling sits a statutory tax-rate cap,⁷ which is quickly being met by the rising floor of school districts' tax rates hitting the rate-cap ceiling.

According to the Texas Supreme Court in the recent *West Orange-Cove Consolidated I.S.D. et al. v. Alanis et al.*, a single district can state a claim if it alleges that it is forced by the state to tax at a particular tax rate.⁸ In previous cases, "we foresaw a day when increasing costs of education and evolving circumstances might force local taxation at maximum rates" to provide a general diffusion of knowledge, the Court stated. At that point, the tax-rate "ceiling" could become a "floor," in which event "the conclusion that the Legislature had set a statewide ad valorem tax would appear to be unavoidable because the districts would then have lost all meaningful discretion in setting the tax rate."⁹

With *West Orange-Cove* back before the trial court, several school districts at or near their statutory cap have recently announced that they will be joining as plaintiffs in the case. The districts claim that, at the same time that they are running out of fiscal juice, the state is expecting higher student performance. A more difficult new Texas Assessment of Knowledge and Skills (TAKS) exam will hold districts accountable this year, and passing rates are set to automatically rise over the next three years. Districts also are now being judged by the federal No Child Left Behind (NCLB) Act's accountability component, called Adequate Yearly Progress (AYP). Soon, the more academically rigorous Recommended High School Program (RHSP), with added science, math, and foreign language requirements, will become the state's default graduation plan. Educators face a veritable bevy of new initiatives and initials.

What worries many educators is the tough new exam that this year's 11th graders must pass, starting this Spring, to graduate in 2005. Unlike last year's new "no pass, no promote" requirement that third graders must pass the third-grade reading TAKS to be promoted to fourth grade (which they did well on, thanks to a well-planned Reading Initiative), this year's "no pass, no graduate" requirement could create a disaster if large numbers of kids cannot pass and cannot graduate. The new graduation exam includes physics, chemistry, biology, algebra, geometry, and U.S. history (including early American history the students last took in 8th grade).¹⁰ Predicted failure rates are startling: Nearly half of last year's sophomores (this year's 11th graders) who took the first administration failed one or more parts of the exam, including disproportionate numbers of Hispanic, African-American, poor, and immigrant students.¹¹ While the percentage of failures may change, what is certain is that a new high-stakes test always begets a federal lawsuit by affected students over "opportunity to learn."¹² Clearly, high school has become high stakes – educationally, legally, and politically.

Getting school finance right, very soon, is the Legislature's daunting duty. The Legislature can choose to live within the box (by changing the tax-rate ceiling or buying down the floor or changing statutory requirements for adequacy, suitability, or equity) or reshape its constitutional contours entirely (via constitutional amendment).¹³ This paper will examine the options available if the Legislature takes either, or both, routes.

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This paper will presume that the leadership intends a comprehensive fix for school finance and intends to meet two primary goals in reforming the school finance system. The first is spending reform – a fair school finance distribution system that efficiently and tangibly promotes student success while recognizing real and legitimate cost differences among students and districts. To support this goal, a second goal is tax reform – a fair tax system that provides stable long-term revenue growth (by encouraging economic growth, job growth, and property tax cuts) that is sufficient to keep up with state goals and with enrollment and inflation. Both objectives are designed to ensure the system is constitutional.¹⁴

Further, this paper will argue that, in reforming Texas’ school finance system to efficiently drive student success, the Legislature should follow its own proven process for success. What has made our school system great – with national praise and federal emulation with NCLB – is that it sets standards and provides capacity, assessment, and accountability:

- **Standards** – Sets high and measurable goals (e.g., all students should read on grade level by the end of third grade).
- **Capacity** – Provides the means and the local-control freedom to reach those goals (e.g., a well-planned and executed Reading Initiative with research-based reforms and financial support, equalized funding, and a choice of research-based tools).
- **Assessment** – Assesses whether the goals are met (e.g., TAKS test).
- **Accountability** – Provides accountability and consequences for the results (e.g., holding third grade students back rather than socially promoting them to fourth grade and consequences for districts and schools including publicity, accreditation ratings, and closures).

In building a new school finance structure, the Legislature can apply these same principles to build consensus. In doing so, the Legislature can define what matters and fund what matters.

STANDARDS: HIGH AND MEASURABLE GOALS

The good news about Texas’ education reforms is that they seem to be working. Schools are improving, and students are learning more. Scores on the National Assessment of Educational Progress, recently announced, showed that each major ethnic group in Texas scored seventh or higher among their peers around the country on the NAEP math fourth grade exam, for example.¹⁵ Despite more difficult accountability standards, in 2002 almost 2,000 schools earned TEA’s coveted “exemplary” accountability rating – up from 67 schools in 1994.¹⁶

As schools have improved, every legislative session of the last decade has produced higher goals, new goals, and new reforms. (See “A Short History of Events and Reforms” at the end of this paper.) The old TAAS was replaced with the tougher new TAKS in the 2002-03 school year, to be given in more grade levels and subjects. The ban on social promotion began with the third-grade reading test in 2003, and will begin for fifth- and

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eighth-grade reading and math tests in 2005 and 2008, respectively. The Class of 2005 must pass a much more difficult graduation exam, and next year's freshmen will default to the Recommended High School Program to graduate. On top of this are new federal NCLB requirements, including Adequate Yearly Progress and Highly Qualified Teachers.

As the Texas Supreme Court has noted, there is a direct link between the Legislature's setting of goals and the constitutionality of the system; the Legislature must equalize to the level necessary for a "general diffusion of knowledge." Although that bar is presumed to be the level of an accredited education, the *West Orange-Cove* Court says that the constitutional mandate of a "general diffusion of knowledge" may be broader than the state's system of accountability and accreditation:

We acknowledged in *Edgewood IV* that the Legislature in 1993 equated an accredited education with a general diffusion of knowledge and discharged its duty to provide for the latter by demanding accountability of school districts. But we also insisted that the 'State's provisions for a general diffusion of knowledge must reflect changing times, needs, and public expectations,' and that the Legislature is not the sole arbiter of the constitutional standard. *The public school system the Legislature has established requires that school districts provide both an accredited education and a general diffusion of knowledge. It may well be that the requirements are identical; indeed, as in Edgewood IV, we presume they are, giving deference to the Legislature's choices. But it is possible for them not to be – an accredited education may provide more than a general diffusion of knowledge, or vice versa – and because both are binding, a district may allege that taxation at a maximum rate in order to satisfy either is a state ad valorem tax.*¹⁷ (Emphasis added.)

What has puzzled readers, and what the dissent criticizes, is the Court's lack of direct support for its statement that "the public school system the Legislature has established requires that school districts provide both an accredited education and a general diffusion of knowledge."¹⁸ Perhaps the Court means that the Education Code has changed significantly since the 1993 law that the Court upheld in *Edgewood IV* and has added requirements beyond accreditation. Many of the newer statutes are similar to the accountability system, in that they are legislated requirements that "leave no meaningful discretion for districts" to provide something other than an adequate education¹⁹ (and no meaningful discretion in disbursing revenue).²⁰ For example, the 1995 rewrite of the Education Code added specific academic goals of exemplary performance and revised missions and objectives.²¹ While the dissent says the Legislature could not have meant these aspirational goals to be part of the "general diffusion of knowledge" because they are not enforceable,²² these sections do outline legislative policy choices. Also, subsequent Legislatures have enacted tougher graduation requirements and graduation plans. In addition, the federal government now requires the states to implement NCLB (giving neither the state nor the districts discretion in some areas), and some readers of

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West Orange-Cove believe that federal NCLB requirements are now bootstrapped into the “general diffusion of knowledge.”

While the Court’s statement is not entirely clear, litigants will have a chance to expand or expound upon the issue, as the case is back before the trial court. The Court stated: “[T]he trial court has discretion to further clarify the issues to be litigated by requiring the plaintiffs to allege specifically, for example, whether they are taxing at maximum rates to provide an accredited education, or to provide for a general diffusion of knowledge, or both, and whether the costs are different.”²³ (And, presumably, to flesh out what they believe is meant by a general diffusion of knowledge.)

Involving courts in deciding what is meant by “general diffusion of knowledge” would engage the judiciary “in a debate over policy choices” within the Legislature’s province, the Court stated. “[I]t is outside the scope of judicial authority to review the Legislature’s policy choices in determining what constitutes an adequate education, and we emphasize that the courts cannot undertake to review those choices one by one or attempt to define in detail an adequate education. But once policy choices have been made by the Legislature, it is the judiciary’s responsibility in a proper case to determine whether those choices as a whole meet the standard set by the people in article VII, section 1.”²⁴

To avoid having the judiciary define adequacy when they rule on what the plaintiffs allege are laws that comprise the general diffusion of knowledge (i.e., laws that tie up their meaningful discretion), the Legislature could clearly define the educational goals for the public school system and put them in place through specific legislation. A good start would be putting more definite goals at the beginning of the Code, with references to later provisions regarding enforcement and consequences (that which ties up the districts’ meaningful discretion). Looking at the expectations and enforcement of every statute, from a standpoint of clarity, would help both courts and educators.²⁵ As an added benefit, it would crystallize debate for future legislative efforts to expand the state’s goals and mandates.²⁶ The proposed new priority – and its cost – could be balanced against the existing ones, given that a finite level of time and resources exists in schools.

The Danger of “Mediadequacy”

In determining the educational goals for the public school system, the Legislature should ensure that they are not set too low, to ensure that the goals will drive improvement. Currently, the state’s academic goals expect “exemplary performance.”²⁷ This goal, however, is more lofty than grounded, as it is not actually tied to accreditation. Given that the state will soon be setting performance expectations for districts and schools, as it updates the accountability and accreditation system to reflect the new TAKS, there will be pressure for the state to set high standards in accordance with the state’s existing “exemplary” goals. Because these standards form the basis of an adequate education, retreating from exemplary expectations could foster criticism for pegging adequacy at a “mediadequate” level – mediocre adequacy.

Another basis of an adequate education is current law’s broad mission statement that “all Texas children have access to a quality education that enables them to achieve their

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potential and fully participate now and in the future in the social, economic, and educational opportunities of our state and nation.”²⁸

This mission – which is in addition to the state’s “exemplary” academic goals – seems to include opportunities to prepare for college and for work. The mission is consistent with the myriad statutes that provide for AP classes, the Recommended High School Program, and courses in the required curriculum, such as career and technology education, art, music, and physical education, that round out a quality education. The mission is also consistent with long-held practices, programs, activities, and courses at the local level.

If the state funds only to the level at which each school district is accredited – i.e., students pass reading, math, science, and social studies – but not to the level at which each child in that district has access to a quality education, with job training if needed or AP classes or the “extras” that round out the general diffusion of knowledge – is the state also promoting mediadequacy? If reading, writing, arithmetic, history, and science are the sum-certain of what every child should know, then why does the state have a standard curriculum in art, foreign languages, technology, and health?²⁹ The answer is because the state and its citizens expect a quality education to provide opportunities beyond the basics. Citizens expect art classes, for example, and civil rights cases have started with the lack of music classes. If the Legislature does not broadly define its expectations, it will in effect level down the quality of education – and opportunity – that citizens expect to be provided to every child.

Too low a threshold could also raise constitutional questions. As the Court stated in *West Orange-Cove*: “Certainly, if the Legislature substantially defaulted on its responsibility such that Texas school children were denied access to that education needed to participate fully in the social, economic, and educational opportunities available in Texas, the ‘suitable provision’ clause would be violated.”³⁰

The state’s required curriculum has been in place, more or less, for more than two decades and is a good basis for determining adequacy. It contains a foundation curriculum (English language arts, math, science, and social studies), which gets the most emphasis because it is assessed, and an enrichment curriculum (languages, health, physical education, fine arts, economics, career and technology education, and technology applications).³¹

For each subject, the State Board of Education writes the curriculum, and the Board requires as a condition of accreditation that districts provide instruction in the curriculum at appropriate grade levels. In addition, the curriculum is used to evaluate instructional materials and to create the state assessments. This is the “iron triangle” of curriculum, materials, and assessment. The law not only ensures that students have the “opportunity to learn” for state tests, it also ensures that districts must provide – and are able to provide – the state’s required instruction.³²

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These are high goals, and they are measurable. The foundation curriculum is measured through tough state assessments, and the enrichment curriculum is measured through whether the districts provide instruction in that part of the required curriculum.

CAPACITY: THE COST OF REACHING HIGH GOALS

At the same time the state's academic goals are rising and broadening, with many new tests and initiatives, the schools are hitting a financial wall. Addressing this issue, and efficiently driving student success to meet those high academic goals, is what many educators see as the similarly high goal of comprehensive school finance reform.

Once the state has set high and measurable goals, the Legislature can provide the means to reach those goals by taking a realistic look at the costs and the revenue needed to meet those costs. This section of the paper will examine the cost of reaching high goals, including formula updates; the revenue options available, including issues of equity and the "Robin Hood" share-the-wealth law; and how to provide more freedom to allow districts to efficiently and effectively allocate their resources.

Fund Education First

The Texas Constitution gives the Legislature a major duty when it comes to the state budget: Establish and make suitable provision for the support and maintenance of an efficient system of public free schools.³³ Last session, the Legislature chose to fund education first in the budget.³⁴ In the face of the state's worst fiscal crisis – a \$9.9 billion shortfall – the Legislature also chose to avoid any new tax increases. By making the tough choices to hold down costs and cost drivers in the overall state budget, the Legislature in the future should be able to put a greater share of state revenue into public schools.³⁵ In addition to the Legislature's conscious prioritization of funding education first in the budget, the Legislature deferred any major revenue-raising options until a complete tax overhaul can be achieved, with an intended deadline of September 1, 2004, for reforming the school finance system.³⁶

In the Education Budget, Fund What Matters First

Within the state education budget, the Legislature could concentrate its resources on what most affects the quality of education. Instruction matters. Teachers matter. Campus leadership matters. Those items that have the greatest impact on a child's education could be funded first in the state education budget and funded the most equitably.

Each element of a school can be broken down, as the Legislature did in reforming the state's Education Code when it built a matrix of who should make the decision in each element of education. With good data, it might be possible to build a matrix of each element's relationship to driving student performance and draw a rough correlation to the extent to which funding and equity matters. (Caveat: This exercise is more useful for study and informing policy makers and the public than for holding educators' feet to the fire for their use of resources, because too many high-stakes performance measures are as bad as none at all.)

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The element that bears the greatest relationship to student learning should, arguably, be the element most equitably funded, with equal opportunity for each student to have access to the items that matter most to the quality of their education. Conversely, the elements that bear the least relationship to student learning could be least equitably funded. In fact, the state's finance system historically has followed this pattern. The state has enacted various sorts of minimum salaries for teachers, and 100 percent equity for instructional materials, but the state has had a lesser interest in equitably funding stadiums, for example.³⁷

Updating Student Formulas to Reflect Actual Costs

For the most part, education funding formulas are meant to drive student success, and money follows the student. A large number of formulas adjust for differences among students. Other formulas compensate for differences among districts' costs to educate students because of geography and labor markets. Many formulas have one thing in common: They are ancient. It's been so long since they've been updated that they are accurate in neither predicting nor providing funding for actual costs.

Student allotments – factors accounting for how much extra it takes to educate students who are limited-English proficient (LEP), special education, or economically disadvantaged, for example – are out of date and should be updated to reflect what it takes to educate these specific kinds of students. Consider the amount of time it takes to educate a child who cannot speak English; the child is learning both English language skills and the other academic subjects that his peers are learning.³⁸ If he does not learn both, he is left behind and is at far greater risk of dropping out. The number of non-English-speaking children is increasing in Texas schools, especially in urban areas, and the need for bilingual teachers has driven school districts to recruit overseas and train their own teachers.³⁹ One solution for districts may be to pay these teachers, who are in short supply, a salary year round so they can provide intensive English instruction during the summer as well as during the rest of the year (although this may not work for areas with heavily migrant populations and high mobility rates). Another solution may be for the state to provide intensive professional development and materials, as it did with the Reading Initiative.⁴⁰ If students cannot get up to speed, and as more LEP students are coming into Texas schools, the state's dropout numbers will escalate.

One issue that has been raised in legislative hearings has been “overidentification” of students in these categories. Some say that providing extra money for LEP or special education children could give school districts an incentive to overidentify students in these categories to draw more dollars. (Identifying economically disadvantaged students, who draw compensatory education dollars, is more objective, because it is generally based on enrollment in the national free- and reduced-price lunch program.)⁴¹ Overidentification appears to have been a bit of an overblown plausibility. Testimony at legislative hearings has attested, on the contrary, to a lack of an incentive to overidentify, because districts' costs to educate these two populations exceed the amount the state allots for that purpose.⁴² (The high cost to educate these specific populations, in fact, may be the basis of an adequacy claim by some of the newly announced litigants in *West Orange-Cove*.) A more cogent criticism for LEP might be that kids may spend too many

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years in a bilingual program. If there is evidence that the current formula produces such an outcome, perhaps funding can be restructured to provide more up front, in the costlier years, as an incentive, with less in later years as the student transitions to English.

In special education, there are 12 classifications with different weights for various instructional arrangements.⁴³ These have been studied and revised more recently than some other formulas. As with LEP, districts say they spend more than they get from state allotments. If there is overidentification, perhaps it has to do with how students are identified and whether students are truly special education, are dyslexic, or have developmental issues associated with poverty, for example. By researching the real cost of educating these students, and cost-effective practices for doing so, the Legislature can update these student allotment formulas for poor, bilingual, and special education students. The Legislature may consider a more transparent form of funding for these allotments as well, such as a dollar-figure allotment per student, rather than a “weight” multiplier.

Two other allotments – the gifted and talented allotment and the career and technology allotment – are also based on the number of students enrolled in those programs.⁴⁴ The number of students enrolled is in fact subjective. Some argue for abolishing the career and technology weight and say that giving districts more money for a vocational weight gives districts an incentive to track students into career and technology courses instead of into college-preparatory courses. Others say the Legislature could address the tracking issue by, for example, allocating funds based on a set percentage of overall student enrollment instead of based on enrollment in the program. (A similar method has been suggested for gifted and talented programs; for both, funds would be rolled into the Basic Allotment or sent as a “block grant.”) That way districts could retain the programs, which are part of the required curriculum, which emphasize skills the market demands (e.g., math, technology, and science), and many of which (like auto mechanics) are more expensive to provide because of space and equipment. Perhaps the state could encourage more local business participation, in order to spur direct on-the-job experience and workforce training.

Another area where student allotments are being examined is in secondary school. The state’s TAKS scores drop off precipitously in middle school, and high schools face a grueling exit-level TAKS this year and a phase-in of the Recommended High School Program next year. At the same time, teaching loads are increasing across the state because of the squeeze of the school finance system. Legislators are considering ways to help districts meet high school’s growing costs.⁴⁵ An allotment for students enrolled in the Recommended High School Program or even more advanced programs, such as AP, IB, or college courses, would be an incentive to track more students into taking a more academic curriculum that will prepare them for college.

One more note about student cost adjustments: While some might end up being differently configured, or more limited, or block granted, a dramatic or sudden cut in any of these student allotments would put a strain on local districts. Sudden cuts at the state level often get softened at the local level (for example, many school districts this year

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made up the difference when the Legislature cut educators' \$1,000 stipend to \$500) because of local expectations. But as a practical matter it creates a strain at the local level if it is not phased in. It is unrealistic, for example, to eliminate vocational funding and expect that career and technology teachers and shop classrooms could – poof! – overnight convert into physics and foreign language teachers and labs.

Revising Other Cost Formulas to Reflect Actual Costs

The school finance system is a fossil record of long-forgotten hold-harmless formulas, long-neglected allotments and adjustments, and long-decayed relics that even predate the Robin Hood system. One such relic is the six percent that districts pay the Teacher Retirement System for every salary above the minimum salary.⁴⁶ It was started as a way to help with equity so that high-salary (and back then, that meant “wealthy”) districts would pay more. In reality, almost every district in Texas now pays the six percent. Like a tax on the cost of labor, it has the greatest effect on districts that have higher-cost labor markets. Along the way, it has also been responsible for every district in Texas having to keep and calculate a “relic salary schedule” for administrators and others who were removed from the minimum salary schedule when it was pared down in 1995.⁴⁷ Although this relic salary schedule has been abolished since 1995, the state only pays up to that outdated amount (which is lower than the current minimum teacher salary schedule) – passing six percent extra to all districts. The real kicker is that the Texas Constitution clearly states that the state must pay at least six percent “of the aggregate compensation paid to individuals participating in the system.”⁴⁸ The Constitution does not seem to provide authority for the state to pass all or any part of this responsibility on to local districts. It is a potential litigation landmine in the fossil record of school finance.

Another formula overdue for an overhaul is the Cost of Education Index (CEI), which is supposed to account for uncontrollable market variations in the costs of education between regions.⁴⁹ It mainly adjusts for the fact that it's a lot more expensive to hire a teacher in a market where teachers have more higher-paying opportunities and a more expensive cost-of-living. In 1999, the Legislature recognized that the CEI was outdated. Although the Legislature commissioned the Dana Center to conduct a study to update these costs, the Legislature had no appetite for following through in 2001, when addressing health care costs became a major issue instead. The CEI is now more than a decade old and, more importantly, does not accurately adjust for market costs or other uncontrollable costs.⁵⁰ Interestingly, there is a correlation between regional high-cost labor markets and higher-cost housing and higher-cost property taxes; had the CEI been updated, it could have helped some wealthier, higher-labor-cost districts because a wealthy district pays less recapture due to an adjustment for 50 percent of the amount of its CEI.⁵¹ The CEI is typical of the long-outdated adjustments in the system that are created, intended for periodic updates, and then shunted aside as too costly to address when other, more politically pressing policies take precedence.

Another fossil is the transportation allotment, which was last updated in 1983. This allotment accounts for \$297 million, or 34 percent, of the \$860 million spent on transportation. The \$297 million driven by the allotment is itself a mix of state and local money and is not all state funds.⁵² When educators fear that lawmakers will create

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formulas but never update them, they can point to the classic example of the transportation allotment. It was last set more than 20 years ago, and more students are riding buses now.⁵³ Driver salaries (60 percent of transportation costs) have also risen tremendously,⁵⁴ as have bus prices. Not only is the amount not based on or predictive of actual costs, neither are the policy choices it encourages. Because it pays for the transportation of children who live more than two miles from their “home” (or nearest) school,⁵⁵ districts often provide bus service only for kids more than two miles from school. It’s unrealistic to expect young kids to walk two miles (although doubtless their parents did, uphill in the snow, both ways), especially if crossing dangerous intersections or dangerous drunks. If we have alcohol- and drug-free zones within 1,000 feet perimeter of schools,⁵⁶ why are transportation funding formulas set two miles away? Also, the two-mile rule is a major impediment to public school choice because it has been interpreted to not fund bus service to take students to a magnet school of their choice, particularly if the student lives within two miles of a “home” school.⁵⁷

There are other adjustments for small districts, mid-sized districts, and sparsely populated districts.⁵⁸ The sparse district formula, of particular importance for students who must be transported long distances, has long been part of school finance. The mid-sized district adjustment is a more recent creation, added in 1995 by East Texas legislators. And the small district adjustment, which helps roughly 700 districts with 1,600 or fewer students, has been in school finance law for longer than fire ants have been in Texas. Over the years, even small modifications of the small district formula have created a large sting of opposition because of the fears of its effects on local communities. The Supreme Court has repeatedly criticized the multiplicity of districts and suggested consolidation of Texas’ 1,040 districts as a way to solve school finance.⁵⁹ Consolidation, in fact, is considered to be expressly constitutional. But when consolidation of tax bases and districts was proposed in 1993, strong opposition led to S.B. 7’s “cafeteria plan” in which voters in wealthy districts can choose to shed wealth in a variety of otherwise-unconstitutional alternatives (writing a check to the state or other districts) that do not involve the hated consolidation.⁶⁰ From a political standpoint, the Legislature will be balancing any efficiencies to be gleaned with the strong and personal opposition of primarily rural areas.

Reformulating the Formulas

The Legislature may choose to update any or all of these formulas, or to collapse them all together into a simpler “block grant” formula intended to account for total costs of education, with no restrictions on using the money for certain categories of expenses. As the Legislature undertakes adequacy studies and reconsiders these formulas, the key is to realistically assess the costs of meeting the state’s goals at various levels. Legislators should keep in mind that, over time, those goals and the costs to implement new goals will rise. In addition, other costs – particularly labor and benefits – will rise. Several legislators have proposed indexing the formulas with inflation as a way to keep adequate levels of funding, at stable and predictable growth, sufficient to keep the system constitutional.

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In addition to inflation, legislators have proposed that the system continue to keep up with enrollment growth. This is a critical factor. In just three years, Texas added almost a quarter million students. That's about 83,000 students per year, which is like annually adding a school district larger than the size of Fort Worth ISD.⁶¹ A new school finance system must be based on a revenue structure with the capacity to keep pace not only with inflation, but also with enrollment growth.

CAPACITY: THE MEANS TO MEET HIGH GOALS

What are the various tax structures that could provide capacity while ensuring students in every district are afforded the same opportunity for a quality education?

Generally, there are two methods the Legislature has considered to ensure equity. The first is redistribution of property taxes or property tax bases. This includes consolidation or redrawing school district lines to achieve equity. It also includes turning all or some school district property taxes into state property taxes – either at a certain level (such as a state tax of \$1) or based on certain kinds of property (such as a “split roll” that imposes a state tax on commercial property and a local tax on residential property). By itself, redistribution does not improve adequacy. The second method is revamping the state tax system to increase the state's share of education costs and drive down local property taxes. Both of these options will be discussed after a brief explanation of the current system and how it has affected property taxes.

The Current System

The school finance system has more tiers than a wedding cake. Tier 1 is the “foundation” level, with a district entitled to receive a basic allotment of \$2,537 per student, at a tax rate of \$0.86 per \$100, increased by the district and student adjustments described above. Tier 2 is the “enrichment” level for local tax rates between \$0.86 and \$1.50, and the district is guaranteed to receive \$27.14 per penny per weighted student in state and local funds. The Court has recognized that Tier 1 alone does not cover the cost of an education that meets legislated accreditation standards.⁶² Because both tiers are necessary, the terms “foundation” and “enrichment” are misnomers, and they are certainly not related to the curriculum classifications of the same name.⁶³ Tier 3 is the “facilities” level, with an Instructional Facilities Allotment for new instructional debt and an Existing Debt Allotment for old debt. This state facilities funding, which is a fairly recent creation, is separate from the equalized \$1.50 of maintenance and operations taxes.

Rising Taxes

In the three-tiered system, as a district's property values (and wealth per student) increase, its state aid decreases, and the local share increases. Property values have increased dramatically in recent years, fueling a total increase in education dollars. In fact, of the \$8 billion in higher property taxes in the last decade, \$6 billion is due to higher taxable *values*, and \$2 billion is due to higher tax *rates*.⁶⁴

It's an important distinction. School taxes in many areas of the state have gotten a double whammy – the frustration of rising tax rates multiplied, literally, by the frustration of

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rising property values. If your house was valued at \$125,000 in 1993, and your school tax rate was \$1.25 per \$100 in value, you paid \$1,562.50. Ten years later, your house is worth \$200,000, and your rate is \$1.50, and you paid \$3,000. Your rate went up 20 percent, your value went up 60 percent, and together the total amount has almost doubled.

In the past decade, as Robin Hood morphed into the goose that laid a billion dollars in recapture revenue annually, tax rates in wealthy districts have gone up more than average (because the school finance system was designed to bring up those historically low tax rates); taxable values have spiked; and on top of that, the districts have to write a check for a recapture payment. That is the source of Robin Hood frustration: Your taxes have gone up more than everyone else's, but your programs are being cut while your taxes are going to other schools. Ten years after his creation, Robin Hood is now probably more loathed by those who pay him than loved by those whom he pays.⁶⁵ The public visibility of writing a check to other districts or the state is exacerbated by the fact that the higher the tax burden, the more money is sent away.

It's not just the wealthy recaptured Robin Hood districts that feel the sting of less gain for more tax pain. Unlike cities and counties, higher property values in your school district do not necessarily mean that much more education revenue for your school district, because higher values often mean less money from the state. Increases in local property values primarily benefit the state (all other things being equal) by reducing the school district's entitlement to state funds. State funds offset by rising property values creates a "surplus" to the state (used in 1997 for homestead exemption, in 1999 for \$3,000 teacher salary hike, and in 2001 for health insurance). Diversion of these state funds to other state budget areas, and dedication of these funds (e.g., pay raise), ensured reliance on higher local property taxes. It also ensured that local needs, such as keeping better teachers in shortage areas or paying other rising costs, would drive up local tax rates. The Legislature recognized this taxing dilemma in 2003 and tried to give districts more discretion in the use of state funding.

What if value growth slowed? A decline or slowing of property value growth (for example, if mortgage interest rates rise and home values cool) could create severe problems for the state. Just as it has been the beneficiary of value growth, the state is on the hook if values decline; it is obligated to make up the difference if there is not sufficient local revenue, for example, to meet enrollment growth.

Revenue Options

The two most common options that the Legislature has considered to ensure equity are redistribution of property taxes and replacement of all or some property taxes with other forms of state revenue. Redistribution includes the current Robin Hood system of sending local property taxes between districts; the consolidation of tax bases to achieve equalization; and a full or partial statewide property tax that turns local taxes into state taxes. Replacement includes abolishing or reducing property taxes and replacing them with other state taxes. The latter course is preferred by those who believe that property

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taxes are too high and by those who believe that property taxes have no more room to grow.⁶⁶

Redistribution: Consolidation

In 1991, the Legislature created 188 County Education Districts to levy, collect, and distribute property taxes, to achieve equalization among school districts, but did not provide for local voter authorization of them.⁶⁷ These districts were held unconstitutional for levying a state ad valorem tax and for levying an ad valorem tax without an election.⁶⁸ The Legislature responded in 1993 by offering a constitutional amendment to legalize CEDs and to expressly authorize the Legislature to redistribute local school property taxes. The voters responded by soundly defeating it on May 1, 1993.⁶⁹

Nonetheless, the Court has recognized that the Legislature has the power to redraw school district lines and to effect consolidations of tax bases or school districts. Those are, in fact, the three constitutional fallback options available under current law to the Commissioner of Education should a property-wealthy school district's voters not opt to send a check to the state or to another district.

Redistribution: Statewide Property Taxes

Although it's the "Mother of Robin Hood," a statewide property tax is an upfront way to redistribute property taxes. It would require a constitutional amendment.⁷⁰

Another form of a statewide property tax that would require a constitutional amendment is the "split roll," in which commercial and residential property are treated differently.⁷¹ This can include a statewide maintenance and operations tax on only commercial property, with lower local taxation of residential property.⁷² The term is also used to denote any proposal that involves cutting residential property taxes – by either cutting homeowner-only rates or imposing artificial limitations on residential property values.

The beauty of a split roll, from a lawmaker's perspective, is that it is cheaper to buy down residential taxes (and thus easier to build legislators' consensus). It could also mean that only a handful of districts – those with high residential values – would qualify as wealthy, which would mean a reduction or end to recapture of local taxes. And it could, arguably, undermine *West Orange-Cove* litigants' statewide property tax argument on which the litigants have based their adequacy claim.⁷³

Capital-intensive businesses and school districts with high commercial property values intensely dislike the split roll, however. Business argues that cutting only residential property taxes does not spur job growth and create a more stable revenue environment that can sustain capacity. Businesses that are suddenly taxed at the state level would face the prospect of their already-high property tax burden carrying the state's entire load for public education and the possibility of a higher tax rate or values in the future.⁷⁴ School districts that lost a high-value commercial property tax base would face a fall from rich to poor as their local taxes become state taxes, and they might have to raise (what's left of) local taxes on homeowners or cut homestead exemptions to compensate.

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Merely enacting a split roll to buy down residential rates does nothing for long-term capacity or even short-term, revise-formulas-but-hold-everyone-harmless immediate capacity. A patchwork of taxes to bridge this hold-harmless gap and cut residential rates would probably just set the state up for a continuation of litigation and legislation.

Replacement Taxes

With so many district tax rates being at or near the statutory \$1.50 cap on maintenance and operations taxes, the potential for a value slowdown creates an impetus – on the part of educators, who see dwindling capacity, and the state, which sees a potential state budget hit – to replace part of the property tax with another source of revenue.

The goals of comprehensive tax reform seem to be coalescing around reducing property taxes, improving the economy, and creating long-term capacity. Many legislators say they seek a fair tax system that improves the Texas economy and job growth, while providing significant property tax relief (including the death or dismemberment of Robin Hood) and providing stable long-term revenue growth for schools sufficient to keep up with enrollment and inflation.

A major goal of tax reform should be that, taken as a whole, the changes improve the Texas economy and job growth (which in turn improves revenue streams and capacity). Governor Rick Perry during the 78th Legislature laid out an ambitious plan to spur economic development, and tax reform should meet the same objectives. There is evidence that cutting business property taxes, for example, will spur more capital investment, expansion, and thus job growth. Of course, other taxes would have to be raised to compensate.

Perhaps legislators should study at what level a property tax cut will spur the most economic growth and at what level expanded taxes will not dampen growth. If legislators choose this route, the rate at which the taxes are replaced could be phased in over time to help with the effect on economic growth.⁷⁵

Proposals for comprehensive and broader reform include taxing those, such as service providers, who are not perceived as carrying as heavy a tax load, with taxes based on sales, receipts, income, or payroll:

- **Expanding the sales tax base and/or rate.** The Senate unanimously passed a plan during the 2003 regular session that would have expanded the sales tax base to many currently exempt services (swapping the new money for tax relief),⁷⁶ although the plan died in the House. There have also been proposals in the past to increase the amount of the sales tax rate and to repeal various sales tax exemptions.
- **Creating a value-added tax.** David Hartman, chairman of the Lone Star Foundation, has proposed a “Flat BAT” (Business Activity Tax), which is a single-rate, subtraction-method value-added tax levied, at a maximum 3 percent rate, upon all employers and recipients of commercial revenues, including

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corporations, partnerships, proprietorships, and governments. The tax base would be all revenues received less all purchases of goods and services, including fixed investments. It would replace local school property taxes (with 30 cents of local property taxes for non-redistributed local enrichment funding) and state business taxes.⁷⁷

- **Enacting a gross receipts tax.** A gross receipts tax could be based on a percentage of revenues received or based on a set dollar amount per bracketed range of revenue received. In Washington, a comprehensive Business & Occupation Tax is levied on every dollar, except the first \$1,000 in monthly receipts, that a for-profit business turns; rates range up to 1.5 percent. Because the tax is paid regardless of whether the business is profitable, low-margin businesses are disadvantaged. Like the BAT, its advantage is that it is broad-based enough to have a low rate.
- **Expanding the franchise tax base to partnerships and sole proprietorships.** The criticism of the franchise tax is that it is largely optional. Many businesses, such as law firms, organize as limited liability partnerships and do not have to pay this tax on corporations. Extending this or any other income-based tax to partnerships and sole proprietorships, however, may necessitate a statewide referendum if it imposes any “tax on the net income of natural persons, including a person’s share of partnership and unincorporated association income.”⁷⁸ In other words, an individual law partner or a sole proprietor may not be assessed the net income component of the franchise tax without a referendum vote (or a constitutional amendment that allows partners and other business owners to pay the franchise tax or another income-based tax).⁷⁹
- **Enacting a personal income tax.** Texas’ lack of a personal income tax is as ingrained in our culture as chili and cornbread. Absent overwhelming enthusiasm from back home urging legislators’ support, suggesting this option to most legislators is like asking them to stick their hands in a fire ant mound. As noted previously, taxing personal income requires voter approval in a referendum (or in a constitutional amendment). If approved by referendum, the Constitution requires that not less than two-thirds of the net revenue must be used to reduce the rate of maintenance and operations property taxes levied for public education (with local M&O maximum rates reduced per penny of tax relief); the remaining revenue is dedicated to education, subject to legislative appropriation.⁸⁰
- **Enacting a payroll tax.** An employer-paid tax on labor could skirt the constitutional requirements on an income tax. It would, obviously, disadvantage labor-intensive industries. Nevada in July passed a gross payroll tax of 0.7 percent (to be reduced to 0.65 percent) that allows deductions for employer-paid health insurance.

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Smaller-dollar, more patchwork proposals for revenue increases include:

- **Allowing video lottery terminals** at regulated dog and horse tracks is a non-tax revenue source that could bring in money that is currently lost to other states. It requires a constitutional amendment, according to the Attorney General.⁸¹ Perhaps such an expansion of gambling could be coupled with a reduction in unregulated and untaxed gambling.
- **Modifications to the corporate franchise tax.** These are less comprehensive – and less revenue-raising – reforms than extending the franchise tax to non-corporate structures. The first proposal (\$194 million per year) is changing the partnership nexus and “location of payor” rules (both factors in closing the “Delaware Sub” loophole). Under long-standing policy, a limited partner whose only contact with the state is through the holding of a limited partnership interest has no Texas franchise tax filing responsibility. In addition, Texas sources income from intangibles to the legal domicile (state in which companies legally organize, usually Delaware) of the payor. The result of these policies is that a partnership can flow income to its limited partner without subjecting it to taxation since its partner has no filing responsibility in Texas. Furthermore, the partner can then flow the same partnership income up to its Texas-headquartered parent as a dividend under the “location of payor” rule without triggering Texas receipts. This proposal would eliminate current Delaware sub tax-avoidance strategies.⁸² Another proposal (\$50-95 million per year), voted out of a Senate committee last regular session, would have denied companies the ability to deduct certain management fees, charges for the use of an intangible, and certain interest paid to an affiliated company not subject to Texas franchise tax.⁸³ The proposal was pulled down because of its uncertain impact.
- **Imposing tax increases on specific goods or transactions.** Some are advocating singling out already-taxed goods, such as soft drinks, alcoholic beverages, cigarettes, and gasoline, for even higher taxes. Some are proposing to enact a severance tax and sales tax on coal. Enacting real estate transfer taxes is another possibility. Another idea is to enact a surcharge on amusement service tickets, such as sporting events, concerts, movies, and theme parks.

In terms of stability, the Legislature should ensure that it does not single out particular segments for extra-burdensome taxation to the point that it drives that business or good out of state, thereby lowering the actual amount of new revenue expected. Punitive taxation does not necessarily create plentiful revenue. Mobility of goods and services that are taxed is especially important to consider in an Internet economy, and it is especially important in a state that has about 2,500 miles of borders with four states and a nation, more than any other state.⁸⁴

The Lighthouse and the Outhouse

Short of entirely eliminating the local property tax and replacing it with state taxes, which is unlikely, the Legislature will next have to grapple with Robin Hood, both at the level

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of a general diffusion of knowledge and at the level of local supplementation to meet local needs. This is likely to be one of the thorniest issues the Legislature tackles.

One way is to continue local recapture at all levels and hope that lower property tax rates will mitigate recapture payments and make them less noticeable.

Another option is for the Legislature to draw a line at the general diffusion of knowledge (a better term would be the “quality education level” or the “educational excellence level”) and say that it doesn’t care about equity beyond that level: Local supplementation would be entirely a local issue, with neither recapture nor equalization of funding. In *West Orange-Cove*, the Supreme Court made it even more clear that local supplementation is not unconstitutional as long as efficiency is maintained, even if there’s neither equalization nor recapture, as long as the Legislature isn’t relying on this local supplementation to satisfy the general diffusion of knowledge.⁸⁵ In other words, yes, it is legal for the Legislature to allow wealthy districts unfettered access to revenue above the level necessary for a general diffusion of knowledge. And it doesn’t legally have to help other districts reach that same or any other level above the general diffusion of knowledge.

The political problem with some districts being able to raise and spend more money (at lower tax rates) than others is that it drives the others into thinking that they are second-class districts relegated to pre-*Edgewood* days of higher taxes for lower revenue. Equity advocates say that wealthy-district legislators will no longer have a vested interest in raising the adequacy (and state-revenue) bar for the poor districts. The educational problem, which is more troubling, is that if wealthy Lighthouse ISD, for example, can pay its teachers \$15,000 more per year than its neighboring poorer district in the same region or job market, then Lighthouse will probably deliver a better education than its poorer neighbor.⁸⁶ The problem could then become a legal one: When the expectations bar is raised on the general diffusion of knowledge, all districts must be able to meet it.⁸⁷ Wealthy districts’ unfettered access to revenue above the level necessary for a general diffusion of knowledge could eventually raise the bar for the general diffusion of knowledge.

Juggling this equity/adequacy question is one of the trickiest balancing acts in school finance. Another option is for the Legislature to provide substantially equalized local supplementation, up to a set percentage of the general diffusion of knowledge, but limit recapture to the general diffusion of knowledge level only. That is, require no recapture above the general diffusion of knowledge (for example, a \$1.00 tax rate), but allow all districts a true enrichment tax (for example, up to another \$0.25), while giving poorer districts some measure of equity on enrichment, tied to a dollar or percentage figure of the revenue advantage that wealthy districts have over other districts.⁸⁸

Meaningful Discretion

The Legislature, if sticking with some level of local property taxes, should allow local discretion in setting local tax rates. The state may calculate the local tax rate needed for a general diffusion of knowledge at \$1.00, for example, but if it limits districts to that tax

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rate it provides no meaningful discretion, and that is the test for whether a property tax is a state tax. The Court stated, “An ad valorem tax is a state tax when it is imposed by the State or when the State so completely controls the levy, assessment and disbursement of revenue, either directly or indirectly, that the authority employed is without meaningful discretion.”⁸⁹ In other words, the rate should be high enough that there is a constitutional cushion above the general diffusion of knowledge. Meaningful discretion could also mean the state not imposing controls on the levy that block local discretion in raising rates.

CAPACITY: THE FREEDOM TO MEET HIGH GOALS

The revenue capacity to provide a quality education and meet local needs should be coupled with greater freedom to allocate resources where appropriate.

A major goal of the 1995 Code rewrite was local control. To take that one step further, the Legislature could look at every mandate, prohibition, and restriction in state law (as was done in 1995), but this time see if it bears a relationship to meeting the state’s goals or if it creates its own policy goals instead. The Legislature also could look at waiver requests from school districts to see what laws appear to routinely hamper districts in their delivery of education.⁹⁰

Market Costs and Statutory Costs

Both statutes and the market impose cost drivers in education. Legislative assessments of the costs of meeting certain outcomes will hopefully review both kinds of costs. Where statutory costs exceed market cost, revising statutes makes sense, because it can let districts most effectively concentrate their resources where they will most make a difference. Where a statutory cost driver exceeds market-based costs, and the Legislature chooses not to revise it, it then becomes a policy choice of the Legislature that should be factored into the cost of a general diffusion of knowledge, as it affects local discretion in the disbursement of revenue.⁹¹

An example of statutory costs is making the Recommended High School Program the default graduation plan for every ninth grader who starts in 2004. The Legislative Budget Board estimated that the Program, with its added requirements in science, math, and foreign language, will result in the need for 4,000-5,000 more teachers and \$400-500 million annually in facility construction.

Flexibility for Operations

State law dictates the who, what, when, where, how, how many, and how much of personnel hiring, firing, pay, qualifications, training, and evaluation.

An example of both statutory and market-based costs is the statute requiring a maximum class size in Kindergarten through fourth grade of no more than 22 students per teacher.⁹² This law, enacted as part of H.B. 72, certainly has driven costs since the mid-1980s. Repealing it, however, does not necessarily cut costs, because there is now a market (and facilities) expectation of small classes in early elementary grades and because small

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classes may be a necessary means to achieve the high goals the Legislature has set. At the margin, however, some common-sense revisions could guard against educationally unsound byproducts of the law's strict interpretation. For example, young children should not have to change teachers mid-year when the addition of a new child puts a class over the limit and causes the class to split.

Another potential cost driver is the teacher salary schedule, which is set in statute and which guarantees a minimum salary that increases according to years of experience. Again, market demand, rather than statute, usually plays a larger role in setting actual teacher salaries, and the salary schedule may not be above market rates at this time.⁹³ But it is possible that a school would want to pay certain teachers less than the salary schedule in order to pay a hard-to-find or excellent teacher more, and the statute does theoretically hamper this allocation of resources. A better way around this is an Excellence Fund, comprised of new money, that allows a district to design a plan to expect and pay its great teachers more.

Another area where flexibility is useful is in certification of teachers. NCLB in a year will require all districts to hire "highly qualified teachers." Defining what the state means by this legal catchphrase could help control costs. On one hand, it could mean teachers must be certified in their area and by grade level. Or, it could mean someone takes a test and gets an alternative certification, then agrees to work two years at-will, and at the end the district decides on their continued employment (e.g., new kinds of certifications and contracts for secondary grades' hard-to-fill positions).⁹⁴

Flexibility for Funds

In the 2003 regular session, the Legislature was successful in giving meaningful local control to districts, in terms of not dedicating the money, as had been the practice in previous sessions. At the same time, however, the Legislature faced a budget crunch and cut the \$1,000 stipend to \$500, because the 2001 Legislature had appropriated only one year's stipend, starting in the second year of the biennium.⁹⁵ In addition, there were cuts in other programs, and many districts viewed their use of the flexible money as simply filling holes left by cuts. That is the nature of taking away with one hand and giving with the other; no one tends to be grateful for the "new" money, even though they appreciate the freedom to use it in new ways.

The 2003 Legislature also gave districts more flexibility to use existing money in a way that provided the greatest benefits for their students. For example, untying restrictions on compensatory education funds will help districts better allocate their resources.⁹⁶

The Legislature is considering expanding this concept. To the extent it does not conflict with federal law, untying use of categorical funds for certain allotments could mean districts would essentially get unrestricted "block grants," whose amount would be determined, per student, based on student and district characteristics. This idea has gained some momentum with legislators who are interested in having less paperwork and prescriptive programs and in focusing more on results.

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Whether the Legislature goes to block grant funding or sticks to traditional allocation methods, continuing to improve flexibility for use of program funds will help school districts better allocate their resources. Tying up flexibility, by for example creating a “non-instructional cost ratio,” below which districts are penalized retroactively for something they did not know about, detracts from local control of allocating resources. This proposal did not recognize that in one year a school district could have dealt with significant mold maintenance issues at a campus or significant teacher turnover or a particular special education child who needs special services or some other local issue that does not neatly show up on a computer print-out.

Flexibility for Facilities

Prescribing one kind of statewide standard building, as an efficiency mechanism, may not work for humid Houston and arid El Paso. Materials, ventilation, and air conditioning may necessarily differ for construction based on location. What does make sense, from an efficiency standpoint, is to examine state law for ways to rein in construction costs that are driven by statute, not by market forces. Several groups have testified about the need for flexibility in wage rates paid for construction, for example.⁹⁷ That way, more education dollars can be put inside the classroom instead of into building one.⁹⁸

ASSESSMENT AND ACCOUNTABILITY FOR RESULTS

As a former Commissioner of Education used to say, the state sets “what” students should know and the locals provide “how” to meet it.⁹⁹ In school finance, the courts assess “whether” the Legislature has satisfied its constitutional duty and, sometimes, provide consequences if it has not.

There have been attempts, over the years, to take the courts out of this assessment and accountability process in school finance, but generally such constitutional amendments have never had much support in the Legislature because they are viewed as a full-front attack on equity. Even coupled with property tax relief, such a constitutional amendment would have difficulty getting a supermajority of House and Senate votes if it is viewed as a retreat from equity.

Given that courts will likely retain their role in assessing the constitutionality of a school finance plan and fashioning a remedy, the Legislature will need a method to assess for itself whether it has equitably funded a general diffusion of knowledge. In addition, legislators – as well as parents and educators – would benefit from research on best practices and on what provides the greatest return on resources. Lt. Gov. David Dewhurst has expressed a special interest in this area. In announcing appointments to the Joint Select Committee on Public School Finance, he said he wanted the committee to look at 20 to 30 of the highest-performing school districts to see what best practices they are using to achieve exemplary results. Perhaps this will be a role for the Texas School Performance Reviews, which in January will move to the Legislative Budget Board from the Comptroller’s office.¹⁰⁰

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Beyond best practices at the school district level, one commentator suggests that, because teachers are the main variable affecting student achievement, public school accountability research should be extended to teacher performance. He says that, by measuring classroom achievement, and norming it based on grade level, it is possible to determine the average grade level for reading and math for a given teacher's class at the end of the year – and the gain in the subsequent year. Year after year, if a given teacher is above or below the average, it is theoretically possible to determine teacher quality data that researchers can then link to the incremental value of a Master's teaching certificate or years of experience or class size to determine these variables' impact on learning.¹⁰¹ If the Legislature enacts such a plan, it would also be important to look for patterns with certain students, such as at-risk or LEP. This is an interesting idea (albeit politically sticky to implement), and one that can, of course, cut both ways: What if research showed that elementary teachers with 14 students consistently posted dramatic gains? Would this raise the cost bar on the general diffusion of knowledge?

To link the data, the Legislature might have to change the statute that bars teacher-level data at the Teacher Retirement System from being used for research purposes with data on student performance at the Texas Education Agency.¹⁰² Researchers cannot currently link performance data to teacher colleges to assess higher education's impact on K-12. Changing this law could be another tool for educators and policymakers to use in finding and funding what matters.

Building In Evaluations and Clear Consequences

Just as the Legislature should not create and fund new reforms unless there is hard scientific evidence that they will improve student learning – that is, help meet set goals – the Legislature should build in evaluations of new reforms – whether incentives to create certain-sized schools, performance pay, or any other reform. With Texas' wealth of data, researchers can build in return-on-resources data elements to assess whether the reforms helped the state meet its specific and measurable academic goals. If the reforms had no discernible impact or a negative impact, there should be accountability and consequences. In creating reforms, especially with an "Excellence Fund," legislators should avoid creating a high-cost reform for which there is no exit strategy and instead should make that exit strategy clear from the outset to all participants.

Each new reform or mandate should prove that it helps accomplish a state goal, such as improving student learning or performance. For example, say that the Legislature wants to create a parent awareness program, where parents are allowed to require teachers to notify them of all homework assignments for the child, by the mutual choice of email or a notebook of assignments. If the proponents could show this practice was used consistently throughout high-performing schools, or that a pilot showed high return on resources because of it, the Legislature could then weigh the potential benefits against the costs of the options or the least costly effective option.

If the Legislature chooses to enact an Excellence Fund, it should fund first those items or reforms that are designed to support the state's already existing academic goals and that most readily impact the quality of education in a classroom. Next, it should ensure that

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every reform has measurable goals, enough funding and freedom to meet those goals, and a substantial evaluation component. At its best, an Excellence Fund can be used to increase student performance by providing research-based incentives and tools. But at its worst, it can be a giant playpen for pet projects that are unrelated to performance.

Bottom line: In funding what matters, measure what provides returns on the margin. Fund equitably (and as a budget priority) those elements which directly relate to and impact the quality of each student's education. Fund each element at a reasonable and adequate level. Let the market, not political dictates, regulate education delivery. And measure what provides the best returns on the margin and use that information in the future for funding decisions.

CONCLUSION

Legislators do not construct a school finance box behind a veil of ignorance; they are individually armed with a surfeit of print-outs, runs for their districts, and calls from back home. A school finance bill is unlike an appropriations bill, or a tort-reform bill, or many other kinds of bills, in that impact to a given legislative district is immediately discernible, down to the penny that the district will receive. A school finance bill, even sweetened by a tax-cut bill, is still a school finance bill. Likewise, a tax-swap bill by itself is still a school finance bill, because of the impact on school property taxes.

Because of the uniqueness of a school finance bill, it is unlikely that school finance reform will be a zero-sum game, whether it is a tax-swap bill or a more comprehensive bill. To do so creates huge numbers of losers, whose unhappiness will by far outweigh the happiness of those perceived as winners.¹⁰³ The grand tradition of school finance is the do-no-harm "hold harmless" for every would-be-loser district. Such a hold harmless would likely be set above an adequacy level determined by the Legislature and assessed eventually by the Court, in order to retain constitutional local discretion over taxes.

The Legislature can also build consensus and put the effort on a positive level by recognizing the high goals that schools and students face, costing them out, and creating a system that will help achieve those goals. Standards, capacity, assessment, and accountability have put Texas on the map in educational reform. They can do the same for this historic school finance reform.

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A SHORT HISTORY OF EVENTS AND REFORMS

- 1949 – Gilmer-Aiken Act creates foundation program with local tax effort and state aid
- 1983 – H.B. 72, famous for “no pass, no play,” also updates school finance system
 - 1989 – *Edgewood I*: Texas Supreme Court rules that the school finance system is unconstitutional and orders the Legislature to overhaul the system by May 1, 1990
- 1991 – *Edgewood II*: Texas Supreme Court rules that SB 1 is unconstitutional
- 1992 – *Edgewood III*: Texas Supreme Court rules that SB 351, which mandated County Education Districts without local voter approval, are unconstitutional as violating the prohibition against a statewide property tax
- 1993 – After a May constitutional amendment fails, the Legislature passes S.B. 7, which creates the current school finance system, repeals some mandates, and creates a new accountability system
- 1995 – *Edgewood IV*: Texas Supreme Court affirms the constitutionality of the school finance plan enacted in S.B. 7
- 1995 – Legislature passes S.B. 1, a comprehensive overhaul of the Texas Education Code, which focuses on improving education by reducing state mandates and creating more local control (including charters) and by creating a new curriculum with which tests and textbooks will be aligned
- 1997 – Legislature passes H.B. 4, which creates and funds the Reading Initiative and establishes a new program for funding facilities
- 1997 – State Board of Education adopts the Texas Essential Knowledge and Skills (TEKS), the first major curriculum overhaul since 1981
- 1999 – Legislature passes S.B. 4, which gives teachers, librarians, counselors, and school nurses a \$3,000 across-the-board pay raise and which establishes a “no pass, no promote” process for phasing out social promotion
- 1999 – Legislature passes S.B. 103, which creates a new statewide student assessment program
- 2001 – Legislature passes H.B. 3343, which establishes a group health insurance plan and \$1,000 stipend for most public school employees (funded for one year)
- 2001 – Legislature passes H.B. 1144, which creates the Math Initiative
- 2002 – New TAKS test is introduced during the 2002-03 school year
- 2002 – President Bush signs “No Child Left Behind Act” (NCLB)
- 2003 – “No pass, no promote” law begins, with third-grade students required to pass the new TAKS reading test in Spring to be promoted to fourth grade in Fall 2003
- 2003 – *West Orange-Cove*: Texas Supreme Court holds that the State did not prove, as a matter of law, that the school finance system is constitutional; case sent back to trial court
- 2003 – Facing \$9.9 billion shortfall, Legislature passes budget to give \$1.2 billion in flexible funds but also makes cuts in programs and stipends
- 2003 – District’s rated on NCLB’s Adequate Yearly Progress for the first time
- 2004 – This year’s 11th grade students must pass a more difficult TAKS in Spring 2004 to graduate in Spring 2005; multiple retries are allowed
- 2004 – The Recommended High School Plan becomes the default curriculum for ninth-grade students who enter high school in 2004 and graduate in 2008
- 2005 – Fifth-grade students must pass TAKS reading and math to go to the sixth grade
- 2008 – Eighth-grade students must pass TAKS reading and math to go to the ninth grade

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ENDNOTES

¹ Tex. Const. Art. VII, Sec. 1.

² *West Orange-Cove Consolidated I.S.D. et al. v. Alanis et al.*, 107 S.W.3d 558, 579 (Tex. 2003).

³ *Id.* at 566 (“the constitutional standard of efficiency requires substantially equivalent access to revenue only up to a point, after which a local community can elect higher taxes to ‘supplement’ and ‘enrich’ its own schools”). It is interesting that the Court is now using “equivalent” instead of “equal” access.

⁴ Article VIII, Section 1-e of the Texas Constitution states: “No State ad valorem taxes shall be levied upon any property within this State.” The Texas Supreme Court set out the following test for determining constitutionality in *Carrollton-Farmers Branch Indep. Sch. Dist. v. Edgewood Indep. Sch. Dist.*, 826 S.W.2d 489, 502 (Tex. 1992) [*Edgewood III*]: “an ad valorem tax is a state tax when it is imposed directly by the State or when the State so completely controls the levy, assessment and disbursement of revenue, either directly or indirectly, that the [taxing] authority employed is without meaningful discretion.”

⁵ *Id.* See also Article VII, Section 3 of the Texas Constitution, which states that a district’s taxes are “for the further maintenance of the public free schools, and the erection and equipment of buildings therein.” The Court, relying on this provision in *Love v. City of Dallas*, 40 S.W.2d 20, 27 (Tex. 1931), held that the Legislature cannot compel a school district to use its resources for the education of nonresident students. Because a property-wealthy district’s voters can choose a share-the-wealth option of educating nonresident students (write a check to the state or another district), in lieu of an expressly constitutional fallback (forced consolidation or detachment and annexation), the current law was upheld in 1995. See *Edgewood Indep. Sch. Dist. v. Meno*, 917 S.W.2d 717, 738-739 (Tex. 1995) [*Edgewood IV*].

⁶ *West Orange-Cove*, 107 S.W.3d at 563-564. See also *Edgewood III* for an example of the Court striking down a share-the-wealth scheme.

⁷ Tex. Educ. Code Sec. 45.003(d) (cap of \$1.50 per \$100 in property on maintenance and operations taxes). Some districts can levy higher M&O tax rates because of local laws passed decades ago.

⁸ *West Orange-Cove*, 107 S.W.3d at 579.

⁹ *Id.* at 580.

¹⁰ Try the 11th grade test at www.tea.state.tx.us/student.assessment/resources/release/taks/index.html, particularly the Science test.

¹¹ TEA figures cited in “TAKS renews exit test debate,” *San Antonio Express-News*, August 18, 2003, page 1B.

¹² See, e.g., *G.I. Forum, Image de Tejas v. Texas Education Agency*, 87 F.Supp.2d 667 (W.D. Tex. 2000) (upholding use of TAAS high school exit exam as graduation requirement).

¹³ Another idea would be to tax outside the box (for example, allow property-poor districts access to other forms of revenue such as an equalized regional sales tax), but that is beyond the scope of this paper.

¹⁴ Both objectives are also designed as consensus issues for bills or constitutional amendments. It is far easier to craft legislation that everyone hates than to build consensus for a bill that can get 76 House and 16 Senate votes or a resolution that can get 100 votes and 21 votes and the vote of the people.

¹⁵ See NAEP scores at <http://nces.ed.gov/nationsreportcard/> and at www.tea.state.tx.us/press/naep03.html (November 13, 2003). Average NAEP reading scale scores, flat for the 2003 exams, do not include the first wave of students educated under the Reading Initiative, who take fourth grade exams in 2004.

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¹⁶ See www.tea.state.tx.us/perfreport/account/ratingsxyrs.html.

¹⁷ *West Orange-Cove*, 107 S.W.3d at 581.

¹⁸ *Id.* at 593. See also *Id.* at 584 (in responding to the dissent, the Court cites Tex. Educ. Code Sec. 4.001(a) and says: “The Legislature has expressly defined the mission of the public school system, including school districts, to accomplish a general diffusion of knowledge.”).

¹⁹ *Id.* at 580.

²⁰ See, *infra*, “Capacity: The Freedom to Meet High Goals,” for examples of laws that tie up a district’s meaningful discretion in disbursing revenue.

²¹ Tex. Educ. Code Secs. 4.002 (academic goals) and 4.001 (mission and objectives).

²² Tex. Educ. Code Secs. 4.001 and 4.002. The dissent criticizes the Court’s possible use of the “aspirational mission statement” in that it does not apply directly to school districts and is unenforceable. See *West Orange-Cove*, 107 S.W.3d at 594-95 (Smith, J., dissenting).

²³ *Id.* at 583.

²⁴ *Id.* at 582.

²⁵ This is similar to what the Legislature did in the 1995 Code rewrite in pulling together the various duties of the Commissioner, TEA, and State Board of Education in Chapter 7. To keep future Legislatures from easily amending around such a goals section and creating unfunded mandates elsewhere in the Code, the section could include a requirement that it prevails unless the newer law specifically cites the section.

²⁶ Every session, there are bills to add new goals or mandates for schools. Legislators could ask: Is it a worthwhile goal? Does it detract from other academic goals? How much will it cost in time and money? How are results measured? Who is held accountable and how? Accurate projections of costs and local control, with assessment of results, are essential. Taking this approach ensures that the proper amount of deliberation – of both up-front costs and back-end consequences – occurs before setting a new goal.

²⁷ Tex. Educ. Code Sec. 4.002 (“students shall demonstrate exemplary performance in the reading and writing of the English language” and in the understanding of math, science, and social studies).

²⁸ Tex. Educ. Code Sec. 4.001(a).

²⁹ See Tex. Educ. Code Sec. 28.002 (“Required Curriculum”).

³⁰ *West Orange-Cove*, 107 S.W.3d at 580. This language tracks the mission statement in Tex. Educ. Code Sec. 4.001(a).

³¹ Tex. Educ. Code Sec. 28.002. Ideally, “economics, with emphasis on the free enterprise system and its benefits,” should move up to the foundation curriculum’s social studies area, to ensure it is assessed.

³² Tex. Educ. Code Sec. 28.002(c).

³³ Tex. Const. Art. VII, Sec. 1.

³⁴ See, e.g., House Floor Amendment 9 by Heflin, H.B. 1, 78th Regular Session, April 14, 2003.

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³⁵ Rep. Kent Grusendorf, “Budget work clears way for school finance,” *Fort Worth Star-Telegram*, June 15, 2003.

³⁶ See Sections 1-3, H.B. 3459, 78th Legislature, 2003.

³⁷ The local tax rate for debt service was not equalized until very recently with facilities funding (Existing Debt Allotment and Instructional Facilities Allotment). These programs have been crucial to buying down tax rates (EDA) and bringing poor districts up to par with instructional facilities (IFA). The author is not suggesting a cut to either of these programs – just observing that “great teachers” and other elements directly impacting instruction require, on the whole, more equalization funding than “great facilities.”

³⁸ The author can attest to the frustration of trying to learn long division and other subjects in another language, having attended a bilingual elementary school in Madrid, Spain.

³⁹ See testimony of Dallas I.S.D. administrators at the House Select Committee on Public School Finance’s Subcommittee on Cost Adjustments, October 22, 2003.

⁴⁰ Robert Scott, interim Commissioner of Education, recently announced an initiative to help LEP students, including developing effective training of teachers and using research-based materials with proven results.

⁴¹ Tex. Educ. Code Sec. 42.152.

⁴² See *supra*, endnote 34. Other objective factors are tests that are generally used to identify a student’s proficiency in English and parental approval of a student’s entry into or exit from the program. Tex. Educ. Code Sec. 29.056. Interestingly, Section 29.058 allows 40 percent more non-LEP students to also enroll.

⁴³ Tex. Educ. Code Sec. 42.151.

⁴⁴ See Tex. Educ. Code Secs. 42.156 and 42.154.

⁴⁵ As discussed later, the Legislative Budget Board estimated that the RHSP, with its added requirements in science, math, and foreign language, will result in the need for 4,000-5,000 more teachers and \$400-500 million annually in facility construction. See <http://www.capitol.state.tx.us/cgi-bin/tlo/textframe.cmd?LEG=77&SESS=R&CHAMBER=H&BILLTYPE=B&BILLSUFFIX=00112&VERSIION=1&TYPE=F> .

⁴⁶ Tex. Gov’t Code Sec. 825.405.

⁴⁷ Retention of the pre-1995 relic salary schedule for TRS-calculation purposes came about in the final days of S.B. 1 in 1995, in an outside-the-bounds resolution. It was intended as a temporary fix for a potential last-minute fiscal note and not as a logical or permanent feature of school finance.

⁴⁸ Tex. Const. Art. XVI, Sec. 67(b)(3). Although the section imposes the same requirement on paying at least six percent of “aggregate compensation paid” to individuals in the Employee Retirement System, the “aggregate compensation” of ERS and TRS participants are treated entirely differently.

⁴⁹ Tex. Educ. Code Sec. 42.102. The current formula is based on 1989 data.

⁵⁰ Some districts have uncontrollable costs, also not reflected in the current CEI, because they must pay Social Security for all or some of their employees.

⁵¹ Tex. Educ. Code Sec. 41.001 (equalized wealth level is based on taxable value divided by number of students in “weighted average daily attendance,” which under Sec. 42.302 includes a 50 percent recognition

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of the CEI). The 50 percent recognition was a result of a 1990 political compromise to “split the difference” between the House and Senate in a conference committee, per Lynn Moak.

⁵² Figures for 2001-02. Bob Popinski, “Texas Pupil Transportation,” LBJ School Professional Report (forthcoming 2003). Because this allotment is in Tier 1 only, under Tex. Educ. Code Sec. 42.302, the \$297 million under the transportation allotment is a mix of state and local dollars.

⁵³ In five years, student enrollment increased 5.6 percent, while students using transportation rose 13.4 percent. The state allotment increased 1.5 percent (\$4.3 million), while funds needed to fund transportation increased 26 percent (\$176 million), which meant more non-instructional costs for local districts. “Texas Pupil Transportation Allotment,” Northside I.S.D., September 18, 2003 presentation to the House Select Committee on Public School Finance Cost Adjustments Subcommittee.

⁵⁴ Popinski, *supra* endnote 52.

⁵⁵ Tex. Educ. Code Sec. 42.155. See Subsection (d), however, which provides for 10 percent of the transportation allotment to be used to transport children within two miles in hazardous traffic areas.

⁵⁶ See Alcoholic Beverage Code Sec. 109.33 and Tex. Health & Safety Code Sec. 481.134.

⁵⁷ See Fiscal Note, S.B. 165, 77th Legislature.

⁵⁸ Tex. Educ. Code Sec. 42.103. There is a sparsity adjustment in Sec. 42.105 for districts with very few students, as well as a sparsity adjustment in Sec. 42.103(b)’s adjustment for districts with more than 300 miles and not more than 1,600 students.

⁵⁹ See, e.g., *Edgewood Indep. Sch. Dist. v. Kirby*, 804 S.W.2d 491, 496 (Tex. 1991) [*Edgewood II*] (criticizing a plan that “does not change the boundaries of any of the current 1052 school districts...”); *Edgewood III*, 826 S.W.2d at 495 (“the crazy-quilt pattern of small school districts remains a significant feature of the Texas public education system”) and at 511-512; *Edgewood IV*, 893 S.W.2d at 471 n.21 and at 477 (“There is little indication that this pattern was created on the basis of educational considerations”).

⁶⁰ S.B. 7, 73rd Legislature, 1993.

⁶¹ See State AEIS Reports (2002-03 total students were 4,239,911; 2001-02 were 4,146,653; 2000-01 were 4,059,619; 1999-2000 were 3,991,783). Fort Worth ISD had 80,989 students in 2002-03.

⁶² *West Orange-Cove*, 107 S.W.3d at 569-570.

⁶³ School finance attorney David Thompson, while serving on last interim’s select committee, suggested rolling both of these tiers into one.

⁶⁴ Dan Casey, Texas Taxpayers and Research Association conference, October 16, 2003.

⁶⁵ See Lucy Hood, “Robin Hood is now a villain; two school districts show how this has happened,” San Antonio Express-News, May 18, 2003, page A1 (“Initially it was tolerated by the rich and celebrated by the poor. But now the entire system is at a crossroads. ... The fundamental problem is the burden placed on local property taxes.”).

⁶⁶ Of course, “room to grow” could also be achieved by creating higher values through repealing or reducing property tax exemptions or improving property tax appraisals and collections.

⁶⁷ S.B. 351, 72nd Legislature, 1991.

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⁶⁸ The Court held S.B. 351 unconstitutional for levying a state ad valorem tax in violation of Art. III, Sec. 1-e, and levying an ad valorem tax without an election in violation of Art. VII, Sec. 3 of the Texas Constitution. *Edgewood III*, 826 S.W.2d at 524.

⁶⁹ S.J.R. 7, 73rd Legislature, 1993. It was defeated 1,293,224 to 755,417 and coincided with a U.S. Senate special election.

⁷⁰ Tex. Const. Art. VIII, Sec. 1-e provides: “No State ad valorem taxes shall be levied upon any property within this state.” This provision was added in 1968.

⁷¹ A constitutional amendment would be needed to address, at the least, Tex. Const. Art. VIII, Secs. 1 (equal and uniform taxation) and 1-e (no statewide property tax).

⁷² A district’s entire tax base would need to be retained for debt service purposes.

⁷³ However, if there is still a local tax for residential property, and the state makes districts use that to its full extent to discharge the state’s business, to the extent that districts do rely on that local rate with no meaningful discretion, there is still a claim on adequacy.

⁷⁴ A guaranteed maximum state property tax rate in the Constitution for commercial property could mitigate the uncertainty of the capital-intensive tax burden.

⁷⁵ See Eric A. Hanushek, “Thinking About School Finance in Texas,” presentation to House Select Committee on Public School Finance Subcommittee on Cost Adjustments, October 22, 2003 (“Larger and more abrupt changes tend to hurt specific groups more.”).

⁷⁶ H.B. 5, 78th Legislature, Regular Session, as passed by the Senate, May 6, 2003.

⁷⁷ See David A. Hartman, “Texas State Tax Reform Via the Flat BAT,” Lone Star Foundation, 2003.

⁷⁸ Tex. Const. Art. VIII, Sec. 24. The current franchise tax on corporations is based on the higher of earned surplus (which is largely net income) or taxable capital (net assets).

⁷⁹ Lawyers, arguably, are examples of “natural persons.”

⁸⁰ Tex. Const. Art. VIII, Sec. 24.

⁸¹ Attorney General Opinion GA-0103, September 23, 2003.

⁸² For an excellent overview of the franchise tax, see “Forms of Business and the Texas Franchise Tax,” Texas Taxpayers and Research Association Research Foundation.

⁸³ Senate Committee Substitute to H.B. 2425, 78th Regular Session. See Fiscal Note to C.S.H.B. 2425.

⁸⁴ Texas has 2,475 miles of borders with other states and Mexico, according to Texas Borders information at www.texasalmanac.com.

⁸⁵ *West Orange-Cove*, 107 S.W.3d at 567, 579.

⁸⁶ See *Edgewood Indep. Sch. Dist. v. Kirby*, 777 S.W.2d 391, 393 (Tex. 1989) [*Edgewood I*] (“The amount of money spent on a student’s education has a real and meaningful impact on the educational opportunity offered that student. High-wealth districts are ... better able to attract and retain experienced teachers and administrators...,” also noting differences in quality of education programs offered).

⁸⁷ *West Orange-Cove*, 107 S.W.3d at 581 (“changing times, needs, and public expectations”).

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⁸⁸ See Texas School Alliance, “School Finance Position Statement,” 2003.

⁸⁹ *Edgewood III*, 826 S.W.2d at 502.

⁹⁰ Tex. Educ. Code. Sec. 7.056. See also Ellen Williams, “Education,” 49 SMU Law Rev. 901, 906-907 (1996) (“Waivers inject common sense into the process by letting the state's educational leader decide, on a case-by-case basis, whether a state restriction unduly frustrates a district's or school's educational objectives. ... Waivers, in a sense, led the way in reforming the Education Code, because they made apparent many constraints that bound educational innovations.”).

⁹¹ This includes mandates (“shall”), prohibitions (“may not”), and restriction (“may, provided that”). For example, it’s easier to pass a law that says, “ESL teachers will be paid at least as much as football coaches” than it is to pass a law that says, “Football coaches may not be paid more than ESL teachers,” because the former appears to give a group something while the latter appears to take something away from another group. Both, however, tie up a district’s discretion in disbursing revenue to meet the needs of students.

⁹² Tex. Educ. Code. Sec. 25.112(a).

⁹³ Where market costs exceed statutory costs, there is little gain from revising the statute.

⁹⁴ The State Board of Educator Certification in November 2003 adopted a rule to allow persons with degrees in a subject to take a certification exam and teach, similar to H.B. 318 in the 78th Legislature, Regular Session, 2003.

⁹⁵ In some respects, the 2003 Legislature kept the same amount, \$1,000, but just stretched it over both years of the biennium.

⁹⁶ S.B. 894, 78th Legislature, Regular Session, 2003. Abilene ISD, for example, will be able to use the funds to run their alternative high school for students at risk of dropping out. See House floor exchange between Rep. Bob Hunter and Rep. Grusendorf on S.B. 894, May 19, 2003 (Sec. 42.152(c)(3) explicitly says a school can use compensatory education dollars on a program specifically designed to serve students at risk of dropping out of school).

⁹⁷ See Tex. Gov’t Code Chapter 2258.

⁹⁸ Some districts, for example, bond their technology improvements for classrooms.

⁹⁹ See testimony of Lionel “Skip” Meno to the House Select Committee on Public School Finance, November 3, 2003.

¹⁰⁰ H.B. 7, 78th Legislature, 3rd Called Session, 2003.

¹⁰¹ Royal Masset, “The Next Step in Education Accountability,” Quorum Report, September 29, 2003.

¹⁰² Tex. Gov’t Code Sec. 825.507(b)(5).

¹⁰³ Unfortunately for the Legislature, those whom it perceives as winners often do not perceive themselves as such.