

VERITAS

A JOURNAL OF PUBLIC POLICY IN TEXAS

May 2004

Facts, Figures & Findings

A Guide To TPPF's Public School Finance Research

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An Introduction

As the Texas Legislature grapples with the issue of public school finance, this *Veritas* presents a brief summation of the most salient research to date conducted by the Foundation.

In these pages, you will find not only the summaries of research findings, but a section devoted to a quick recitation of the facts surrounding taxes and public education in Texas.

This format does have obvious limitations; by definition, the complete body of research is not presented here. The topics are explored in greater lengths in the full research papers published by the Foundation since the Fall of 2003.

The web address for each research paper is listed at the beginning of the related summary.

While intended primarily to aid lawmakers in their deliberations during the special session, we also believe the information found here will aid reporters and the general public in better understanding the issue of school finance.

If you have questions or comments about the research or findings presented in this issue of *Veritas*, please contact us.

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Fingertip Facts On Spending

- Increasing funding generally does not improve student performance. (*Assessing Performance*)
- Per pupil spending has tripled in Texas since 1970, even after accounting for inflation and enrollment growth. (*Effective, Efficient, Fair*)
- Texas is 15th in the nation for per pupil spending in cost-adjusted dollars. (*Follow The Money*)
- School district spending offers no basis for claims that additional funding is required. (*The High Costs of Texas Public Education*)
- Districts should spend less on administration and more on instruction. (*Effective, Efficient, Fair*)
- Decreasing class size generally does not improve student performance. (*Assessing Performance*)
- Across-the-board pay increases for teachers do not improve student performance. (*Effective, Efficient, Fair*)
- Teachers with advanced degrees do not improve student performance more than teachers with four-year degrees. (*Assessing Performance*)
- School district consolidation will not reduce state costs. (*Effective, Efficient, Fair*)
- Growth of large districts should be discouraged because they incur substantially higher administrative costs than smaller districts. (*Effective, Efficient, Fair*)
- Student performance improves as the percentage of total funding from the local level increases. (*Effective, Efficient, Fair*)
- School districts owe nearly \$48 billion in principal and interest on bond issues. (*Building For The Future*)

Fingertip Facts On Taxes

- Increasing the overall tax burden will likely decrease the state's output, personal income, employment, job creation, and capital investment. *(Effective, Efficient, Fair)*
- No additional business taxes should be established. *(Effective, Efficient, Fair)*
- A sales tax has less adverse impact than a gross receipts tax, a business activity tax, or taxes on property and personal income. *(Effective, Efficient, Fair)*
- A tax on professional services purchased by business is likely to cause tax pyramiding and create an uneven playing field for businesses. *(Effective, Efficient, Fair)*
- While the business activity tax is attractive due to its universal applicability, its lack of transparency and potential for increased state spending must be considered. *(The Business Activity Tax)*
- A modest shift from property to sales tax on consumer items would positively impact employment, personal income and state gross regional product. *(An Economic Analysis Of Property Tax Relief)*
- Splitting the property tax roll may increase economic efficiency; however, unless stringent precautions are taken, splitting taxpayers into rival factions is not sound economic policy. *(Splitting The Difference)*
- A tax on payroll has the effect of depressing after-tax wages even while increasing labor costs; anyone who works or consumes will pay the tax. *(The Business Activity Tax)*

Follow The Money

A 50-State Survey Of Public Education Dollars

By Chris Patterson, with Chad Blevins and Andrew Brown

Published Oct. 22, 2003.

There is a great sense of urgency building in Texas to reform the state system of school finance, evident in halls of the Capitol, daily news media and conversations in bleachers of football games. There is broad agreement that the current system of funding public schools must be changed, perhaps even scrapped for an entirely new system.

Discussions of school finance focus on education dollars. These discussions are very important because changes to the state's system of funding public education could significantly impact the state budget, reconfigure state spending, shift fiscal priorities of state functions, alter the state tax structure, and impact the state economy.

To increase awareness of how education dollars fit into total state revenues and spending, the Foundation examined all 50 states. Using the most recent information published by the U.S. Census Bureau, the National Association of State Budget Officers, and the National Center for Education Statistics, we assembled a fact sheet for each state that distinguishes sources of education dollars, determines the amount spent on education, identifies the role education plays in total state spending, and examines each state's fiscal capacity to sustain education, framing all of this information within the bigger picture of state revenues and expenditures.

Key Findings of the Survey

Education Revenue: There really is no such thing as “education dollars,” despite popular perception. Most states fund their portion of public education from

general revenue, non-dedicated funds, primarily generated from state taxes (income and sales), fees and licenses. Local property taxes underwrite a proportion of public education costs in nearly every state, as do state property taxes in 37 states (taken from *Facts and Figures of Government Finance 2002*, edited by David Hoffman of the Tax Foundation, Washington, DC). *The primary sources of revenue for Texas public education are local property taxes and state sales tax.*

Sharing the Cost of Education: Public schools are funded through a mix of local, state and federal funds in every state, with some small funding from other sources (such as corporations and foundations). The proportions of this mix vary widely from state to state. In 2001, the highest state share was shouldered by Hawaii (89.8%) and lowest by Nevada (28.6%). *Texas' government shoulders a smaller share of the total cost of public education than most other states. In fact, only ten state governments underwrite a lower portion of the total cost of public education than Texas.*

Per Pupil Spending: There is a large difference in per pupil spending between the states. In 2001, Wisconsin spent the most per pupil (\$10,249.00 cost-adjusted dollars) and Hawaii spent the least (\$5,333.00 cost-adjusted dollars). *Texas spent \$8,568.00 cost-adjusted dollars per pupil in 2001 (a combination of federal, state, local and private funding), placing Texas above the national average, 15th in the nation – according to a state ranking published by the Manhattan Institute.*

Change in State Government Spending on Public Education: From 1996 through 2001, state government spending on public education rose in 49 states (in Alaska, spending decreased by \$211,000). Despite the increase of state education dollars in those 49 states, the percent of state government spending on public education fell as a percent of total state government spending in 26 states. In 2001, the largest increase in public education as a part of total state government spending was in New Hampshire where public

education rose from 2.62% to 20.06% of total state government spending. Alternately, the largest drop in public education as a part of total state government spending was in Alaska where public education fell from 13.9% to 8.65% of total state spending. *Although state government spending on public education in Texas increased by \$3.543 billion from 1996 to 2001, education spending fell slightly from 20.21% to 19.87% as a percentage of total state government spending.*

Change in State Government Spending: Forty-four states spent more than their general revenues received in fiscal year 2002; the most fiscally responsible states were Arkansas, Florida, Iowa, Virginia and West Virginia. Florida actually spent 2.52% less money than was available in general revenue. Alaska's spending exceeded revenue for the fiscal year by 44.10% and Oregon by 34.49%. *Texas spent 5.73% in excess of state general revenues received during state fiscal year 2002 (spending did not exceed funds available, because the state used prior year closing balances of \$4 billion, reducing funds available for unanticipated or future years' fiscal needs).*

Tax and Income Growth 1991-2001: Annual taxes (including fees) increased throughout the nation, with only one exception – Alaska. Growth was as low as 1.08% in Hawaii and as high as 9.07% in New Hampshire. Annual income also grew in all states; income grew slowest in Hawaii (1.12%) and fastest in Nevada (6.74%). Taxes and income grew at approximately the same pace in 15 states and in five states, income grew faster than taxes – a sign of economic health. In 30 states, however, the growth of taxes and fees surpassed growth of income. *In Texas, the growth of taxes (including fees) and income were closely linked – taxes growing 4.41% with income growing 4.80% between 1991 and 2001.*

The information furnished by this survey provokes important questions about state revenues and spending for school finance reform that will be examined in

subsequent reports published by the Texas Public Policy Foundation over the coming months.

- What revenue sources are available to bolster state education funding that will promote economic vitality?
- How much state revenues are available for public education?
- How much should the state pay for public education?
- Is state spending on education and other core functions sufficiently contained to weather economic downturns?
- Will rising costs of other state services undermine funds for public education?
- Is state tax growth sufficiently aligned with current growth of personal income?
- Should state taxes be reduced to remedy past tax growth that exceeded income?
- How can the entire system of state taxes be reformed to improve economic efficiency, economic competitiveness, administrative simplicity, fiscal adequacy and fairness?

This publication is available online at:

<http://www.texaspolicy.com/pdf/2003-10-22-sf-followmoney.pdf>.

Mark Your Calendar!

**3rd Annual Policy Orientation
for the Texas Legislature**

**The Driskill Hotel
Austin, Texas**

January 26 and 27, 2005

Splitting The Difference

Residential And Business Property Taxes In Texas

By Byron Schlomach, Ph.D.

Published January 2004.

For the last decade an issue regarding school finance receiving a lot of attention is the share of total public education spending that has been borne by the state, which is less than half. This, despite ever increasing state expenditures in education.

Partly in response to this fact the 75th Legislature (1997) devoted a considerable part of the state's then-burgeoning budget surplus to public education and sought to reduce the local property tax burden by lowering property tax rates and tripling the homestead property tax exemption. Still, even during the biennium after the 1997 regular session, the state's share of public education spending never exceeded 47.2%. Though the state was supposed to take on better than a 50% share of public education funding, rising property values and the willingness of school trustees to increase tax rates prevented it.

Today, the lion's share of public education spending on the Foundation School Program is borne at the local level and that share has been growing. According to the Legislative Budget Board, in fiscal 1998 the state bore its largest share over the last decade at 47.2%. In fiscal 2000, the state's share stood at 47%. Since then, the state's share of public education funding has markedly declined so that in fiscal 2003 it stood at 39.7%. The state's share of public education spending is projected to decline again to just over 36% in fiscal years 2004 and 2005.

The goal of increasing the state's share of funding for public education spending may or may not be worth pursuing. However, another goal of public education finance reformers is to eliminate the so-called Robin

Hood school finance scheme whereby property wealthy (when wealth is measured on a per-student basis) school districts have significant sums of property tax revenues diverted to school districts that are relatively property poor. The only way to accomplish this goal is to significantly increase the state's share of public education spending.

The goal of eliminating Robin Hood cannot be accomplished with budget surpluses. Past surpluses disappeared and suddenly became a \$10 billion projected deficit in 2003. More importantly, the Robin Hood system exists due to spending inequity across school districts that naturally results from a system heavily dependent on local property taxes. Ending Robin Hood requires less dependence on locally-raised property taxes. For the state to shoulder a significantly larger burden with respect to public education, it must increase state-collected taxes in some way while simultaneously reducing the local property tax burden.

Several potential state taxes have been proposed. Among these are an income tax, a gross receipts tax, a business activities tax, a broadened and/or increased sales tax, and some kind of state-imposed property tax. An income tax and a statewide property tax would each require a constitutional election since both are prohibited under the state's constitution. Texas is currently among 12 states that have no property tax of any kind at the state level.

One of the more talked about tax proposals is a split roll property tax. The most commonly understood structure of a split roll property tax is one whereby real and personal business property is "split" from real residential property.

Typically, business property is taxed by the state using a legislatively-established property tax rate, while residential property is taxed locally. This structure would only apply to school taxes. City, county, and special district taxes would continue to apply uniformly

at the local level to business and residential property, but since the bulk of property taxes are school taxes, a split roll system would represent a major change in property tax policy.

The reason such a change is desirable to some is clear when one considers that almost half (\$559 billion) of Texas's \$1.16 trillion in total property value is business property even when multi-family dwellings (apartments) are included in the residential category. In fiscal 2002, \$14.4 billion in local property taxes funded public schools. Half that could be funded by a state business property tax (with no exemptions or deductions) at a rate of \$1.32 per \$100 valuation, using the Comptroller's 2002 valuation for all property in the state.

The creation of a split roll property tax can be likened to a shell game. A split roll tax system does not, in itself, necessarily result in lower property taxes. It simply converts what was once local tax revenue into state tax revenue by moving business property from the local tax rolls to a new state property tax roll. For an overall property tax decrease to occur for both business and residential property owners, some other tax will have to be increased or created.

Since the exact details about whether or not the overall property tax burden would change are not known, only the concept of a split roll tax in isolation is considered here. Such a policy change can be analyzed in several different ways and there are three perspectives that are considered here. First is from a purely economic efficiency perspective. The question to be answered from an efficiency perspective: to what degree is a split roll system likely to result in a misallocation of resources through tax-instigated changes in the relative costs of goods and services when compared to the current system's effects on allocation?

A second perspective from which a split roll system can be analyzed is also economic – the public choice

perspective. Public choice analysis uses economic tools and assumptions to analyze government behavior. This makes it possible to get some idea of how a split roll system might change over time by considering the incentives it inherently produces for decision makers tasked with funding government. It helps us understand the potential effects of a split roll system for the state as a whole in the long run.

Finally, there are the practical aspects of such a system. Texas has a strictly local property tax system with an institutional structure already fully in place. There are practical considerations involved in transitioning to a system of statewide property taxation which also must be considered.

This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-01-26-sf-splitroll.pdf>.

Effective, Efficient, Fair

Paying For Public Education In Texas

By Richard Vedder, Ph.D., and Joshua Hall

Published February 2005.

Should Texas change the way it finances public schools and delivers educational services to students? That question is being debated by leading policymakers and average citizens, not only in the halls of the Capitol in Austin, but by concerned citizens throughout the state.

This report provides some of the information that Texans need to make informed decisions about public school finance. In the first part, the report evaluates student performance and spending in school districts throughout Texas to identify efficient, effective use of taxpayer dollars and determine if additional funds will improve student achievement. The second part evaluates proposals forwarded in Texas to increase state revenues for public schools and proposes a new

role for the state to play in the funding and delivering of public education.

Texas schools do not perform exceptionally well in carrying out their mission, and an argument can be made for changing the methods of financing student learning. At the same time, Texas has a reasonably growth-friendly system of taxation that would argue against radical change in order to provide incremental resources to the education system. Given research that questions the wisdom of increasing funds to public schools for the purpose of raising student achievement, this argument holds particular weight.

While changes in the way Texas finances public schools could benefit students, policymakers should be cautious about over-centralizing or over-regulating the funding or operations of the schools.

Given the rapid rise in Texas school costs over time, combined with what are at best modest improvements in learning, attention should be shifted from putting more resources into the existing system and shifted toward thinking of new, potentially more efficient, ways of providing educational services.

Part I of the study evaluates student performance and spending in Texas school districts:

- Despite decades of costly reform, the educational success of students in Texas public schools is still primarily determined by economic status.
- Student achievement in Texas public schools is generally unaffected by:
 - ⇒ teacher education,
 - ⇒ teacher pay, or
 - ⇒ the number of students per teacher.
- Higher per-student spending has almost no effect on student achievement.
- Student achievement in Texas public schools is highest in districts:
 - ⇒ where the adult population has a high degree of college education,

- ⇒ funded primarily by local funds,
- ⇒ where student attendance is high, or
- ⇒ there are more students per teacher.

Based on this analysis and extant research, student achievement in Texas could be improved by:

- focusing on how funds are allocated rather than on the level of funding,
- recognizing there is no scientific way to identify “adequate” funding and no significant relationship between funding and student achievement,
- strengthening the state’s educational accountability system,
- allowing local communities to underwrite a greater share of education, and
- introducing competition – greater inter-school, inter-district choice and vouchers.

Part II of the study evaluates various tax proposals to increase state revenues for public schools:

- the adverse effects of most current tax proposals are very unlikely to be outweighed by increased funding to education,
- a sales tax has less adverse impact than a gross receipts tax, a business activity tax, or taxes on property and personal income,
- a tax on the professional services purchased by business is likely to cause tax pyramiding and create an uneven playing field for businesses,
- increasing the overall tax burden will likely decrease the state’s output, personal income, employment, job creation, capital investment, business start-ups and population growth,
- increasing the state’s share of education funding is likely to reduce achievement,
- if state revenues must be enhanced, expanding the sales tax base would be least economically detrimental as long as business inputs are excluded,
- a revenue neutral sales tax base expansion with a simultaneous reduction in the sales tax rate is likely to enhance the state’s economic growth,
- reducing property taxes and replacing revenues

with sales tax to finance public schools would likely have a modestly positive impact on the economy, and

- the current tax system is sufficiently flexible and provides adequate revenue growth for public schools. Education spending and education productivity are the real problems facing Texas.

This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-02-25-vedderhall-all.pdf>.

Texas-STAMP

A Sophisticated Tax Model For Texas

By the Beacon Hill Institute at Suffolk University

Published March 2004.

Changes in tax rates have measurable effects on taxable activities. The weight of evidence shows that state-level tax increases have significant negative effects on state economic activity. Yet it is not easy to quantify these effects, and the job can only be done satisfactorily with the help of a complete tax model.

In order to be able to analyze sweeping changes in the tax system, the solution is to build a *Computable General Equilibrium* (CGE) model of Texas. We have constructed a CGE model of Texas (Texas-STAMP), and in this report we explain the concept behind the CGE model, set out the individual components, and then use it to ask what would happen to the Texas economy under three competing tax packages being debated in the Texas Legislature.

CGE models are typically large, complex, and difficult to build; for instance Texas-STAMP has over 15,000 equations, 3,800 variables and almost a thousand lines of computer code, and every run of the model produces 920 pages of output. This provides one reason why CGE models are not used more widely at the state

level. An important exception is the complete and well-documented CGE tax model for California. The California CGE model was developed with state funding, after that state passed a law (SB 1837, 1994) requiring the Department of Finance to perform “dynamic revenue analysis” of any proposed legislation with a revenue impact of \$10 million or more. In this context, a dynamic revenue analysis differs from a static revenue analysis in that it takes account of the secondary effects of tax changes; for instance, a lower property tax might leave more money in people’s pockets and so, as they spend more, revenue from the sales tax might rise, offsetting in part the initial cut in the property tax.

Answers to seven common questions about the Texas-STAMP, its operation, capabilities, limitations and uses.

1. *What is Texas-STAMP and what does it do?*

Texas-STAMP is a computer program developed to estimate the effects of specific changes in the state tax system. It is a dynamic general equilibrium model. As a dynamic model, Texas-STAMP estimates both primary and secondary effects of tax changes – for example, lowering a property tax might cause sale tax revenues to rise, offsetting some of the loss of government revenues from property tax reduction. As a general model, Texas-STAMP takes all the important markets and interactions into account, such as banking, retail, and utilities. As an equilibrium model, Texas-STAMP assumes demand will equal supply in every market. Texas-STAMP also estimates how changes in taxation affect various facets of the economy over five years, such as labor supply, consumer prices, immigration and growth of capital.

2. *How is Texas-STAMP constructed?*

Texas-STAMP was built to provide a mathematical description of the economic relationships among

producers, households, government, and the rest of the world. Texas-STAMP has over 15,000 equations, 3,800 variables, and almost 1,000 lines of computer code. Every run of the model produces 920 pages of information, although the user does not have to wade through all of these pages to effectively use the model.

3. What specific information will Texas-STAMP provide?

Texas-STAMP will estimate how a specific change in the state tax system impacts:

- Gross wage rates,
- Number of private jobs,
- Number of government jobs,
- Disposable real income,
- Disposable real income per capita,
- Revenues generated by other state taxes, and
- Revenues generated by local taxes.

4. How does Texas-STAMP work?

The model will instantly produce the estimated impact of a tax reform after a specific tax and rate is keyed into the program, identifying change in state revenues for:

- Sales tax,
- State gross receipts tax,
- Franchise tax,
- Business activity tax,
- Motor fuels tax,
- Motor vehicle tax,
- State personal income tax,
- State cigarette tax,
- State professional services tax -- personal,
- State professional services tax -- business, and
- Local property tax.

5. What are the limitations of Texas-STAMP?

While this model is extremely useful, there are two important limitations to a computerized model of this

type. First, the model cannot account for everything – tax or effect. Secondly, estimations are based on the assumption that economic behavior remains stable. This assumption is problematic because neither human nor computer estimations can predict the unforeseen in an economy. An unpredicted event, such as 9/11, could completely change trends.

6. *Who can use Texas-STAMP?*

The Foundation is making the model available to all members of the Texas Legislature and providing the training required to use the model.

7. *How can Texas-STAMP be accessed?*

The model can be accessed on the Foundation’s web site. Using a laptop computer, policymakers can estimate the effect of tax proposals from the floor of the Capitol, or anywhere an internet connection is available.



This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-03-10-stamp.pdf>.

Assessing Performance

Spending And Learning In Texas Public Schools

By Sanjiv Jaggia and Vidisha Vachharajani

Published March 2004.

Over the last 25 years, Texas public schools have undergone comprehensive reform, and state funding has increased significantly.

Scores on the National Assessment of Educational Progress indicate strong gains for Texas elementary students and modest gains for middle school students. To determine what role funding has played in improving student performance and whether resources

really matter, the Texas Public Policy Foundation commissioned the Beacon Hill Institute at Suffolk University (BHI) to provide a model for evaluating spending and achievement, and to use this model for evaluating school districts throughout Texas. The model and results of this study can help guide development of effective education policy and efficient funding decisions.

The BHI Educational Assessment Model was designed to answer the following three questions:

- How is student performance affected by – prior performance demonstrated by the district, teachers’ education, teachers’ experience, teachers’ pay, student-teacher ratio, percentage of student population that is economically-disadvantaged, and percentage of students enrolled in special education?
- How is student performance affected by funding and allocation of funds?
- What school districts are most successful in overcoming the likelihood that student performance will be determined by the economic status of the student population and academic variables including past school performance and the percentage of students requiring special education?

The third question is very important because Texas holds public schools accountable for equipping all student groups with the skills necessary for educational success, and closing the achievement gap between students that is associated with low-income, race and ethnicity. This is also a central requirement of the federal No Child Left Behind Act. The BHI model identifies school districts that are closing the achievement gap, adding educational value to compensate for the academic and economic disadvantages and producing higher levels of student performance beyond what the district has accomplished in the past.

BHI’s assessment of the performance of Texas public

school districts revealed the following:

- Prior performance of school districts was the strongest determinant of passing rates for state assessments, SAT/ACT scores, graduation rates and dropout rates.
- The economic status of the student population was the second strongest determinant of district performance on all outcomes measured.
- Increasing total district expenditure had no effect on passing rates for state assessments or, in some cases, worsened performance.
- Increasing total district expenditure worsened both SAT and ACT scores.
- Increasing district expenditure on instruction as a share of total expenditure generally improved student performance (except for grade 5 mathematics).
- Increasing district expenditure on leadership, teacher salaries and class size reduction generally did not improve student performance (the one exception was for grade 5 mathematics).
- Increasing teacher experience never improved student performance.

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This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-03-19-BH-Educ.pdf>

The Business Activity Tax

Is The BAT A Homerun Or A Strike-Out?

By Richard Vedder, Ph.D., and Byron Schломach, Ph.D.

Published March 2004.

Some in the Texas Legislature are presently considering several proposals to replace at least a portion of the school property tax with a business activity tax (better known as a value-added tax). It is believed this proposal would enable the state to eliminate “Robin Hood” and provide funds to alleviate

educational disadvantages caused by existing property tax limitations.

Without taking a position on the business activity tax, the Texas Public Policy Foundation's free market philosophy dictates that any tax policy alternative be fully considered in the marketplace of ideas. To this end, the strengths and weaknesses of any proposed policy must be considered and that is the purpose of this paper.

All too often, policy changes that have profound economic effects are made with little regard to the economics of the issue. For example, some years ago, popular sentiment in favor of "taxing the rich" encouraged the U.S. Congress to impose taxes on various "luxury" goods such as furs, small private aircraft, and yachts. Tax revenues plummeted as the rich went elsewhere for their luxuries. At the same time, the middle class workers who made the luxury goods were rendered unemployed.

Policymakers ignore economic analysis at the peril of themselves and their constituents. The politics of making policy are not avoidable. The economic effects of politically determined policy are even less avoidable. Just as potential policy changes have their political positives and negatives, so too do they have their economic positives and negatives. The business activity tax is no different.



This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-03-19-BAT.pdf>

The High Costs Of Texas Public Education

A Study Of Three Texas School Districts

By Milton Holloway, Ph.D.

Published March 2003.

This study examines the economic performance of three Texas school districts, investigates the regulatory and financial incentives that are driving up expenditures, and examines the financial accountability of school districts to taxpayers. Sources of information used for the examination included the annual school district actual expenditure and student performance reports by the districts to the Texas Education Agency for 1996-97 through 2002-03. The three school districts studied represent small, medium and large districts from north, central and south Texas: Laredo ISD (24,000 students), Austin ISD (78,000 students) and Dallas ISD (163,000 students).

Economic Performance

The three school districts examined did not attempt, and state policy does not require, measurement of the economic efficiency by systematically comparing performance with expenditures, or to allocate limited resources based on economic efficiency. Nor is there any evidence from expenditure data that districts give the highest priority to instructional expenditures when budgets are tight. Trends in the allocation of available revenue among school functions are away from instruction and toward discretionary activities. District expenditures are highly correlated with available taxing ability and unrelated to productivity. The major component of all the functions in annual operating expenditures is payroll where increases are related to long-term, economy-wide wage increases, and not to productivity.

Financial Accountability of School Districts to Taxpayers

Recordkeeping for the three districts was tailored to meet regulator requirements instead of identifying what money was spent on state mandated services and the required program of instruction, or differentiating between mandatory and discretionary expenditures. Despite the wealth of information available, much of which is easily accessible online, financial accounting and performance reporting greatly lacks the transparency that is required for taxpayers to understand whether their tax dollars are well-spent and for state legislators to make informed decisions about education funding. The focus is on accounting for what was done without attention to available alternatives.

Regulatory and Financial Incentives

Austin, Dallas and Laredo, like all other school districts in Texas are encouraged by the current system of public education in Texas to spend whatever funding is available and to increase spending, undisciplined by tests of economic efficiency, either through rule to relate revenue allocation to economic efficiency or through creation of a level playing field to encourage competition. The system impedes access to available information, relying on the Freedom of Information Act to prevent information flow rather than encourage it.

Recommendations

- State funding should prioritize instructional spending through incentive programs such as matching teacher pay with measurable student achievements.
- State funding should be partially based on an economic efficiency measure.
- State policy should discourage growth of large school districts with high administrative costs that do not produce high student outcomes efficiently.
- Market-based spending should be created through public school competition and voucher systems that make public education responsive to consumers

(students and parents) rather than the bureaucracy.

- Accounting procedures should be developed to distinguish discretionary spending from expenditures on state required activities and to require provision of an economic rationale for professional/contractor spending decisions.

This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-03-25-holloway-costs.pdf>

Building For The Future

A Look At School Facilities Funding In Texas

By Byron Schlomach, Ph.D., and Wendell Cox

Published April 2004.

School facilities debt is a growing problem that is central to the challenge of funding public schools in ways that enhance the efficiency and effectiveness of state education dollars. As a part of the Texas Public Policy Foundation's school finance research initiative, district spending was examined to determine the extent of school facilities debt and identify how state policies influence district decision-making regarding debt. This research examines school facilities funding in Texas from a high-level, institutional perspective. It offers practical strategies for maximizing investments in facilities spending, decreasing school debt, and increasing local responsibility so that more educational dollars can be spent on instruction and improving student performance.

Findings

- Almost 70% of Texas school districts are burdened with facilities debt.
- Texas school districts owe close to \$50 billion for construction or renovation.
- Taxpayers pay twice for school facilities – local property taxes and state tax dollars.

- Districts receive over \$700 million state funds annually to offset facilities debt.
- State subsidies encourage districts to spend more – a district receiving the Instructional Facilities Allotment is automatically in \$7.4 million more debt.
- Robin Hood encourages districts to spend money on facilities instead of instruction because districts can keep dollars spent on facilities away from Robin Hood redistribution.
- Wealthy school districts are encouraged to finance expenditures with debt even when they could be financed with normal operating funds – a wealthy district under the Robin Hood system incurs \$6.4 million more debt.
- State subsidies encourage districts to spend extra on facilities design and size.
- The wealthier a district, the greater the debt it assumes – with each \$100,000 in total taxable wealth, on average a school district takes on an additional \$650 of debt.
- State subsidies for instructional facilities encourage districts to spend more money on non-instructional facilities.
- Nationally, low growth school districts generally spend as much as high growth districts.
- School districts add \$26,946.47 in facilities debt for each new student.

Recommendations

- Hold bond elections on standard election dates to encourage higher voter participation.
- Abolish the prevailing wage law to reduce renovating/construction costs.
- Eliminate the interest and sinking tax rate so districts pay off facilities bond from the same pool of tax dollars that underwrite operations.
- Disallow the Permanent School Fund bond guarantee program to be used for non-instructional facilities.

- Establish a maximum facilities subsidy for each student.
- Encourage districts to use money-saving facilities designs.
- Require schools to use best practices for school facilities finance.

This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-04-facilities.pdf>

Paying For Education

What Is The True Cost?

By Chris Patterson

Published April 2004.

This report evaluates how Texas public schools are meeting the challenge of educating children today and calculates the cost of public education outcomes on the lives of individual Texans, their communities, and the state economy. Evidence that many Texas public schools are failing public trust is convincing, despite decades of reform, tripling of funds, aggressive efforts of policymakers and intense commitment of educators:

- Academic performance is far below grade-level proficiency, although Texas elementary and middle school students generally keep pace with average national performance.
- For Texas high schools, performance and graduation rates remain at the bottom of the nation.
- Average proficiency of public school students is one to two years below grade level on national norm-referenced tests and similarly behind privately educated peers in Texas.
- Graduates of Texas public schools are unprepared to succeed in skilled vocational training or college.
- Overall performance of students in Texas has not significantly improved over the past several decades.

Race, ethnicity and income still determine student outcomes in Texas public schools; the lives of many African-American and Hispanic youth are blighted by the failure of Texas public schools to erase the achievement gap.

Today, the failure of schools to do their part in building a highly educated workforce has mounting consequences. Within the next two decades, Texans will experience lower standards of living, poorer health, higher crime, less community engagement and deteriorating social conditions unless changes are made.

The price of educational failure will continue to grow until Texans exchange the endless, fruitless reform of public schools – reform that has failed to provide any improvement in the overall quality of public education – for fundamental changes in how public education is delivered.

School finance reform offers an opportunity to fundamentally change the delivery of public education. Texans can offer all children educational quality and equity by focusing funding on students instead of schools, allowing parents to choose where children are educated, and holding schools accountable for final educational outcomes instead of incremental, compartmentalized improvements. Introducing school choice as a new form of delivering education offers Texans a proven means to improve government-operated schools and educational outcomes of individuals.

Student-centered funding that allows students to enroll in government- or privately- operated schools is the next step in the evolution of public education. Unlike other reforms cycled through Texas public schools, vouchers have proven effective in raising educational excellence in equity for students who use school choice and for students who choose to remain in government-operated schools at lower costs. Vouchers offer Texans

a new form of public education, a hybrid of government schools and private schools that is very similar to the public free school system established by the 1876 Texas Constitution.

Texans can no longer afford to pay the price exacted by the current status quo of our education system. The cost is paid in opportunity: personal dreams, economic growth, and quality of life. To create a system of public education that offers opportunity to all children, Texans must choose choice.

This publication is available online at:

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General Principles For Conservatives

School Finance: Education Spending And Taxation
By the Texas Public Policy Foundation and the
Texas Conservative Coalition

Published April 2004.

Fundamentals

Constitutional obligations for public education must be defined.

- Until the Legislature defines “general diffusion,” “suitable provision,” and “efficient,” the debate over school finance will be intractable.
- *West Orange Cove* reaffirms it is the duty of the Legislature to define the terms.

Conservatives must decide what they mean by local control. Conservatives should not simultaneously oppose state mandates for education policy and financing but advocate that the state be the majority source of public education funds. Local control must mean more than local administration, or state administration by proxy. Local control should mean funding for the foundation curriculum, competition among all forms of education (including public), and allow local decision-making, especially parental decision-making, to take precedence over state-based decisions.

Conservatives must challenge the basis of the equity argument. Educational equity is not the same as school funding equity. The equity issue should focus on whether or not children are being educated, not just on how much money is being spent. Parents certainly do not have equal control over their children’s education compared to the school establishment.

- It may cost a certain sum to deliver a particular type of education, but it does not take the same sum to deliver all types of education, as proven by the experience of all forms of public and private

education, including parochial schools, charter schools and home schools.

Educational achievement is not tied directly to high levels of funding. The assumption that more money means better education is unfounded; only by ignoring experience can one believe quality of education is improved solely with additional dollars.

- Home schooling and parochial education prove this. A government-funded, monopoly system is, by nature, inefficient and ineffective.
- Until the state system for funding public education is tied to individual student outcomes instead of the operation of government schools, educational equity will remain unattainable.
- The success of all populations regardless of race, geography or family income to win National Merit Scholarships, pass the ACT & SAT, and get accepted to college indicate that per pupil spending alone is not determinant.

Taxation

The tax debate should be about property tax relief – not just about new taxes or shifting tax burdens. Property tax relief is not simply changing the way in which taxpayers remit property taxes to government (a statewide property tax). *For relief to be relief, the overall tax burden must be lower after the debate than before.*

Residents already have control over the local property tax – if they choose to exercise it.

- Texans choose where to live. Individuals make market-based decisions and move into neighborhoods for a variety of reasons including the property tax rates and system of appraisal.
- Texans can elect school board trustees who oppose property tax rate increases or support rate rollbacks.
- Texans can also demand accountability from city and county officials to reform the appraisal

process, and express their opinions to appraisal boards.

There are simple state approaches to property tax relief:

- A general capping of rates and revenues could alleviate the upward pressure on taxes and put more accountability into the system.
- Establish requirements for school districts to secure supra-majority voter approval for property rate increases or to establish minimum voter turnout levels at elections.
- There should also be a supra-majority requirement for raising state taxes.

Ensure that any tax system is transparent.

- Two virtues of the current school property tax are that the tax is transparent and tied directly to a governmental function. Taxes that are sent directly to general revenue are more likely to be spent irresponsibly or wastefully.
- Taxes to fund public education must remain transparent and dedicated to ensure accountability.

Expanding the base and lowering the rate for almost any tax is preferable to creating a new tax for three reasons.

- First, low rates cause less distortion than high rates. Low rates can be achieved by ending exemptions.
- Second, exempting certain classes of people or businesses from taxation is a distortion in and of itself. Distortions negatively affect the economy and adversely affect those individuals not exempted. They could also lead to manipulation of the tax system.
- Third, a broader base allows support for the system of public education to be shared more fairly and equitably. All Texans derive some benefit from the state's educational system.

Creating new taxes adds administrative costs for the state, businesses and individuals. The state sales tax has

one of the lowest administrative costs compared to other forms of taxation.

- The state sales tax should be a model for other forms of taxation.
- Any form of income tax typically has high administrative costs and subject to myriad interpretations and disputes.

Creating new taxes should be tied to eliminating other taxes. For example, oil and gas severance taxes (\$1.115 billion combined in FY '00) and the utilities tax (\$264 million in FY '00) should be abolished as part of any debate involving creation of new taxes.

Spending

Requests for new money should be carefully scrutinized, not just in light of the cost, but against the background of the appropriate role of government.

- Real, per-student spending has *tripled* over the last 30 years. *Spending on public education has increased every year for the last 25 years, without exception.*
- While public education spending must grow due to increased student populations, *increases for other reasons cannot be justified given growth in spending in recent history.*
- Legislators should ensure that existing funds are spent wisely before adding new funds by utilizing new tools that may deliver education at a lower cost.

There is no magic funding formula that balances state and local revenues dedicated to public education. It is public policy fiction that the state should pay at least 60 percent of all costs to fund public education, though no clear rationale is offered for that standard.

- The Constitution requires the Legislature “make suitable provision for the support and maintenance” of a “free” system of schools. The Constitution does not require full or substantial funding on the part of the state – it does not even suggest a

funding balance at all.

- Integral to this notion is the fallacy that there are distinct classes of local and state taxpayers. All taxpayers are local.

Funding incentives for rewarding excellence will improve public education, increasing the efficiency and effectiveness of public dollars.

Public schools must be held *more* accountable for spending both local and state tax dollars.

- An accounting system that differentiates types of spending must be used to identify required from optional, elective spending.
- Activity-based budgeting should be instituted to ensure first dollars are spent on students and state-mandated programs for students.
- Academics should be fully funded before money is invested in extracurricular activities.
- Schools and school districts must enact financial efficiencies, such as consolidating purchasing and services.
- Responsibility for financial decisions by local schools must be borne by local communities – state aid and bond guarantee for facilities debt must be eliminated.

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This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-04-TCC-TPPF-First-Principles-SF.pdf>

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