

Stealth State Spending

How Property Taxes Grow State Spending

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For Texas state government, fiscal years 2004 and 2005 were supposedly thin years. The \$10 billion shortfall forecasted during the 2003 legislative session forced some belt tightening that is still being felt and protested today. Those who protest the belt-tightening insist that it was particularly unjustified given how frugal the state legislature has been recently.

A careful look at the numbers, though, and an understanding of how school finance and property values interact with the state budget yield a somewhat different picture. When viewing Texas state spending adjusted for inflation and population growth, and taking property value increases into account, fiscal 2004 was only a thin year in that spending did not exceed that of 2003. Confused yet? Well, there is an explanation.

How School Property Taxes Finance State Spending

As anyone who has witnessed a presentation on the subject can attest, school finance is complicated. Formulas build on formulas. They interact in strange ways. There is always a caveat here and a hold-harmless there. Then there are wealth levels, effective rates, weighted students and a plethora of other special vocabulary words that only confuse. Nevertheless, all of it can be boiled down conceptually in a relatively simple way.

Think of a glass. The glass represents the amount of funding a school district will receive. A lot of things go into determining the size of the glass, including the number of students, how often they attend, the types of students, the size of the school district, its population density, and the school district's property tax rate.

The school funding system is devised so that the glass can be filled with both local property tax money and state money. Suppose local property tax money is represented as water. State money, let's say, is oil. Property wealth in a school district determines how much of the glass is filled with water. A very poor district will not be able to fill much of the glass with local taxes—water. A very rich district will fill the glass to overflowing.

Now, suppose a relatively poor district only fills the glass half way with local money—water. Then, the state is obligated to finish filling the glass with oil—state money—which floats on top of the water. If property wealth increases in the poor school district, the water level rises in the glass because there is more property tax money. That means oil is displaced, or crowded out of the glass. As local money increases, the state money “spills out” back into the treasury, where the state then spends it on other things.

Now suppose we are looking at a rich district filling its glass to overflowing. The overflow, through the alchemy of Robin Hood, is magically converted to oil—state money. When the rich district's wealth increases, the glass overflows all the more, turning into additional oil. That oil is distributed to other poor districts, but that means less oil has to come from other state sources. Again, the state saves money and is able to spend it on other things.

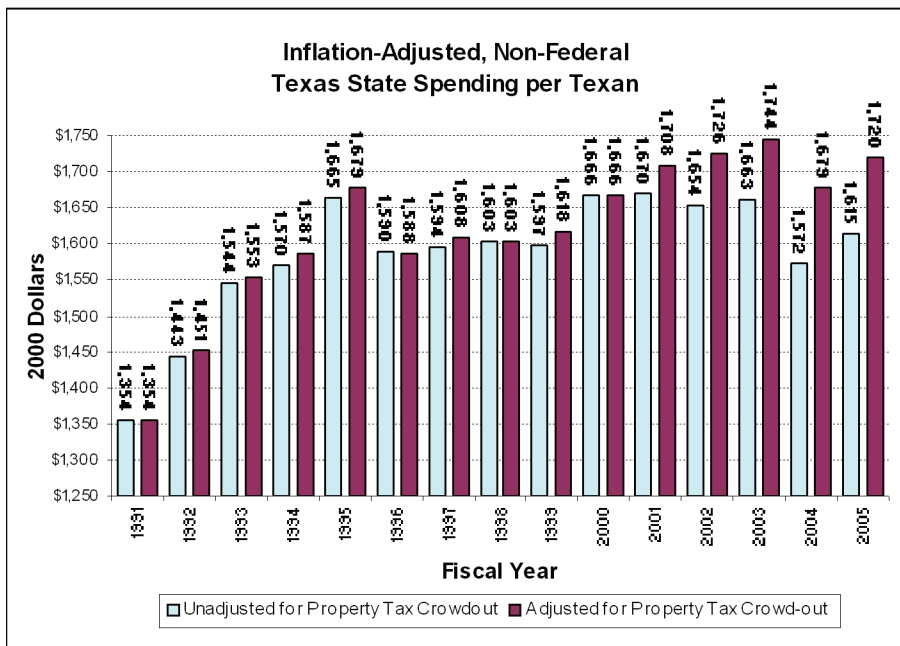
This simple analogy for our school finance system accurately describes how state finances are benefiting from rising property values, even though the property tax is supposed to be a local funding source.¹ When property values rise, as they have in Texas for many years now, state finances benefit. It is because of property value increases that the state's share of school funding has dropped from 47 percent in fiscal 2000 to just over 37 percent in 2005. Prior to 2000 and throughout the 1990s, the state generally covered 45 to 47 percent of total school operations spending.

The Real Story on State Spending

It has been stated, and official state documents appear to support, that taking account of population growth and inflation, and netting out federal funds, state spending has trended slightly downward of late. Using figures from the Comptroller's website, adjusting for inflation using the Consumer Price Index, and dividing by population esti-

¹In addition, it shows the Texas Supreme Court was correct to rule that the state has a statewide property tax as well as why the reasoning employed by the court is completely wrong. It has nothing to do with rate caps.

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This new, more accurate pattern is revealed by the darker bars in the graph at left. The difference between them and the lighter bars is that the darker bars include the money that has been crowded out by rising property values. There is very little difference in the lighter and darker bars for fiscal years 1991 through 2000. But beginning with 2001, there is a growing divergence between the two patterns. Beginning with 2001, the state's share of school spending dropped precipitously. Again, this was due to rapidly rising property values. This then allowed the state to spend more on other programs.

Instead of stability in inflation-adjusted state spending per Texan from 2000 to 2003, we had a rapid rise, partly fueled by rising property values crowding state money out of the schools. Thus, by 2003, state spending per Texan can be said to have risen to a record \$1,744 with \$81 of that spending financed by rising property values.

mates from the Census Bureau, it appears that this assertion is confirmed. This calculation yields the pattern revealed by the lighter bars in the graph above.

In 1991, the state spent \$1,354 per Texan (in 2000 dollars). By 1995, the state had increased spending to a whopping \$1,679 per Texan, followed by four years of stability at a lower spending level. Then, in 2000 there was a sudden ratchet upward with four more years of stability at the higher level. Then, there was the downturn in 2004 with the recession. Looking at the pattern from the lighter bars, 2005 spending still appears thin by historical standards, barely exceeding the spending level of 1998, and nowhere near the spending level of 1995.

The problem with this story is it completely ignores the crowding out of state funding for public schools by local funds rising out of increasing property values. In 1991 and 2000, the state funded 47 percent of school operations spending and somewhere near that level in the intervening eight years. The only way to see how the crowding out of state funding has propped up state spending is to suppose the state kept its share of school operations spending at 47 percent. Using numbers from the Legislative Budget Board's *Fiscal Size-up*, and making the appropriate adjustments, a different pattern emerges.

Instead of spending per Texan falling by more than \$90 from 2003 to 2004 when the effects of the recession were felt, it only fell \$65 on the strength of property values. In fact, the 2004 level of spending only fell to that of 1995, a previous record year in spending. Fiscal 2005 spending has recovered to just under that of 2002, rather than being just over that of 1998. Fiscal 2005 is not the sixth-highest spending year in state history. It is the third highest, and misses being second highest by only \$6.

Conclusion

For those who would claim state spending has been flat or decreasing when population growth and inflation are taken into account, this analysis shows them incorrect. Some might say the run-up in spending from 1999 to 2003 is minor—just a little more than \$10 per month per Texan. For a family of four, though, that is \$40 per month, or almost \$500 per year; the private sector puts its money to much better use than does the public sector.

Texas has a low-spending state government. It is still below average when local government is taken into account. But, Texas' state and local government share of the economy is rising. It does no favor to Texans to deny the state's role in that growth. ★

¹Legislative Budget Board, *Fiscal Size-up: 2006-07 Biennium*, (Austin, Texas) 177, available at http://www.lbb.state.tx.us/Fiscal_Size-up/Fiscal_Size-up_2006-2007_0106.pdf.

²Ibid, 8.

³State spending net of federal funds is calculated by taking total spending available at <http://www.window.state.tx.us/taxbud/expend.html> and subtracting federal funds, available at <http://www.window.state.tx.us/taxbud/revenue.html>.