



## Four Myths Of Public School Finance

### MYTH ONE: Businesses pay taxes.

Every tax is a tax on individuals, regardless of who actually writes the check. There is no fundamental distinction between taxes on individuals and taxes on business. Individuals own businesses (whether as owners or shareholders) so whether or not a business can “pass on” a tax is irrelevant to the reality that individuals pay taxes. A report by the Comptroller’s Office underscores this very important point:

*“It should be recognized that any tax levied directly on a business will ultimately be paid by real, live people – if not consumers via higher prices, then business owners via reduced profits or employees via reduced wages... In any case, or in any combination where the tax burden is borne jointly, the old cliché true: ‘Only people pay taxes.’”<sup>1</sup>*

Voters in Texas understand this. In a statewide poll, the Texas Conservative Coalition Research Institute (TCCRI)<sup>2</sup>, asked the following question: “When lawmakers impose taxes on businesses, do you believe that the businesses actually pay the tax without passing the burden on to you, or do businesses pass the costs on to you in the form of higher prices for goods and services?” Eighty-five percent of voters said they believe that businesses simply pass on the costs.

The Institute also asked the question, “Would you support or oppose making all taxes transparent, meaning all taxes would be directly imposed on you so you know what you are paying, rather than hiding them in the form of a business tax that increases the cost of goods and services?” The response, again, was overwhelming, with 71% of the people polled saying that they want taxes to be transparent.

Transparency is particularly important because it eliminates a key element of fiscal deceit. The most insidious taxes are those hidden from view, where the taxpayer cannot discern the tax liability attached to the purchase of a good or service. The best system of taxation would require direct payments from the taxpayer to the state, or to local school districts, to fund education. A connection between the taxpayer and the government service to be funded creates a level of transparency and understanding that is often lacking in fiscal policy.

Raising taxes is raising taxes, no matter on whom or what the tax is imposed – an idea that voters overwhelmingly reject. According to the January TCCRI poll, seventy-six percent of Texans polled agreed with the statement “Texans already pay enough in taxes. We should not pay more.” [Only sixteen percent of Texans agreed with that statement.] Most strikingly was that opposition was uniform across ideology, party, race and income. There was not one demographic group that supported the proposition that taxes were too low.

Voters, indeed most taxpayers, understand that overall tax burden – federal, state and local – is growing beyond proportion to the benefit derived from government action. They also understand that new or higher business taxes are simply a raid on the voters’ wallets at the end of the day.

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<sup>1</sup> “Tax Incidence and Tax Exemptions,” Texas Comptroller of Public Accounts, January, 2003.

<sup>2</sup> “School Finance and Property Tax Study,” Texas Conservative Coalition Research Institute, Statewide survey of 1000 likely voters, Wilson Research Strategies, January 2004.

*MYTH TWO: Equity should be the foundation of school finances.*

Article VII, Section 1 of the Texas Constitution reads: “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.” Clearly, the Constitutional requirement for an “efficient” system must be predicated on educational results since efficiency means nothing without considering results.

While equity may be noble and compelling, it has proven an unsound basis on which to rest state fiscal policy.

Efforts to establish financial equity have shown little success in producing educational achievement. Despite a decade of redistributing school funding, the achievement gap between student groups is still evident on independent measures like the National Assessment of Educational Progress, and SAT scores. Private schools show this failure is not caused by insufficient effort or funding. Student achievement is generally higher in private schools than public schools even though there is a wide difference in tuition rates between schools and spending is often lower than per pupil spending in public schools, even allowing for subsidies from the federal government or endowments.

Private schools show that quality education can be delivered at different prices and that inequities in per pupil spending have no adverse impact on student achievement. Whether or not “rich” and “poor” districts can tax and spend at equivalent amounts is less important than ensuring that the Legislature creates an efficient system that ensures public schools provide a general diffusion of knowledge efficiently.

The Constitution intends school finance to be founded on efficiency, producing specific educational outcomes, not equity of inputs. Stanford economist Dr. Eric Hanushek defines efficiency as either "maximizing outcomes for a given level of spending" or, equivalently, "minimizing spending to achieve a given level of output." Although efficiency links spending and outcomes, education spending is not directly related to student outcomes because the system is not efficient.

Extensive scientific research produced within the past several decades shows no relationship between funding and student achievement. The home school experience is a profound counter to those that argue there is a definitive and affirmative relationship between high levels of spending and achievement. Funding at any level, equal or unequal, cannot serve as the vehicle for delivering a high quality, equitable education.

Until the myth of equity is dispelled and the Legislature fulfills its Constitutional duty to define what public schools must deliver for students to demonstrate a “general diffusion of knowledge,” as laid out in the *West Orange Cove* decision, educational quality and equity will remain beyond the reach of children in Texas public schools. The Legislature needs to establish what it expects from public education and to propose an amendment to the Constitution that clarifies the state’s role in providing for a system of public schools and pre-empt narrow judicial definitions that will hamper state efforts to improve student achievement in Texas public schools.

*MYTH THREE: The system is in dire need of more money.*

School districts, professional educational associations, and the news media passionately claim that schools cannot educate and students cannot learn without additional funds. However, education spending in Texas over the last twenty-five years has increased each year, without exception. In 1978 state spending on education was just shy of \$4 billion. In 1990, state spending on education was just over \$10 billion. However, in 2002, the Legislature appropriated \$20.2 billion dollars to public education. Public education is the largest single function funded by the state and accounts for 30% of the total budget and 40% of general revenue related spending. In the 2002-2003 biennium, the Legislature appropriated \$29.9 billion for public education, including TEA administration, of which 77% was general revenue. That figure is now over \$30 billion dollars and growing.

Critics universally ignore evidence from experience: increased spending has not substantially improved academic proficiency of students graduating from Texas public schools as evidenced by flat SAT scores and declining ACT scores. They also adamantly reject research evidence; more spending does not inherently improve student outcomes, as demonstrated in a new study the American Legislative Exchange Council.

The Texas Constitution charges the Legislature with “making suitable provision for the support and maintenance of an efficient system of public free schools.” The Legislature discharges this duty by partnering the cost of public schools with local districts. The Texas Education Code clearly specifies the program of instruction that is required for students in kindergarten through grade 12: English language arts, mathematics, science, and social studies (Education Code § 28.002). The State Education Code also requires local districts to provide an enrichment curriculum but assigns the duty of determining what constitutes enrichment to local districts.

The myth of insufficient education funds will not be dispelled until the Legislature requires school districts to fund the foundation program first. Furthermore, Legislators should prioritize the state budget to reflect the foremost importance of public education; additional spending on K-12 should be allocated from other areas of the budget before new revenue is secured.

Central to this myth is the widely promulgated claim that the state has an obligation to provide the lion’s share of education funding, a share that represents at least 60 percent of the cost. A judicial argument in *Edgewood IV* fueled this claim; Justice Hecht asserted the state had never met its constitutional mandate to fund education.

Rising property values and increased state spending on health and human services have pushed down the state’s share of funding. As a consequence, the largest share of education costs is now paid by property taxes. The falling state share is used to justify the claim that the state has failed to adequately fund public education. However this claim ignores the large infusions of state money flowing into the system over the past two decades to meet population growth, supplement instructional programs for under-performing students, increase compensation for public school employees and establish new programs for teachers, such as health insurance coverage.

In fact, there is no requirement for the state to pay for public schools at all, in full or in any proportion. The Constitution requires the Legislature to “make suitable provision for the support and maintenance” of a system of public education. There is strong evidence that local communities benefit from shouldering a large share of public school funding. Local control over financial and operational decisions is protected by majority funding and research demonstrates that student achievement is higher in communities where the larger part of education funding is local.

*MYTH FOUR: The state needs a new system of taxation because the current system cannot adequately fund education.*

Much of the debate over the last year – indeed decade – has focused on the imperfections of the property tax (mainly its burden) in certain areas of the state and many experts have recommended that lawmakers create a new system of funding. The truth is the current system – which relies on local property taxes and the sales and use tax – has been a phenomenal success at generating cash for the state, and public education specifically. While creating a new finance system may be desirable for other reasons, the supposed failure of the property taxes and the sales and use taxes to generate revenue is not one of them.

After adoption of the sales tax in 1961, “the sales tax immediately proved that it could generate considerable amounts of money.”<sup>3</sup> Texas taxpayers paid \$2.3 billion in state taxes in 1972. By 2001, the amount had grown to \$27.2 billion – an 8.8 percent average annual increase. Economic and population growth accounted for 58.1 percent of the increase, and net legislative changes (tax increases less tax relief) accounted for the remainder – 41.9 percent.

According to the Comptroller of Public Accounts, sales and use tax collections, the largest single portion of state taxes, totaled \$824 million in 1972; by 2001 they reached \$14.7 billion, a 10.4 percent average annual growth rate for the 29-year period. The corresponding growth rate for the underlying base – before adjusting for legislative changes – was 8.4 percent. In fact, since 1972 there has only been one dip in state sales and use tax collections over the previous year and that was in 2002 and the decline was one percent.

Statewide school property tax receipts have risen every year since 1985, growing from \$4.6 billion to \$16.4 billion in 2002. The property tax and sales and use tax have generated enormous sums of money making expansion of state and local government programs possible and inevitable given the lack of fiscal discipline over the past two decades.

If there is an identifiable problem with either the property tax or the sales tax in terms of generating revenue it is exemptions. Exemptions are the bane of any tax system, and the Texas system of taxation is riddled with exemptions specific to the property and sales tax, which increase the burden on smaller segments of the population.

In state fiscal year 2003 – extending from September 1, 2002 to August 31, 2003 – exemptions from the sales, franchise, gasoline, and motor vehicle sales taxes will amount to \$24.4 billion. Sales tax exemptions will total \$22.9 billion, while franchise tax exemptions will total \$1.2 billion. Gasoline tax exemptions will amount to \$114.2 million, and motor vehicle sales tax exemptions will total \$143.9 million. Exemptions from local school district property taxes will amount to an additional \$4.2 billion in calendar year 2003. These amounts include exemptions, exclusions, special rates, deductions, and discounts written into the tax law. In fiscal 2002, the combined revenues – accruing to all funds – from the sales tax, franchise tax, gasoline tax, and motor vehicle sales tax were over \$21.5 billion and accounted for nearly 82 percent of the state’s total tax revenue. In addition, according to the Comptroller’s *Annual Property Tax Report for 2002*, there are \$144 billion in school district exemptions and abatements certified by the Texas Education Agency.

Whatever method of finance the state adopts, taxes to fund public education must remain transparent and dedicated, which are the only sure means of accountability.

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<sup>3</sup> “Report of the Staff Work Group on Property Tax Relief,” Part Two, March, 1996, page 35.