

Texas K-12 Education Spending Set to Rise, but Who Will Pay?

By Jason Saving

ABSTRACT: The Texas Legislature approved increased public school spending while at the same time limiting property tax increases. Because new revenue to fund this increase over the longer term was not identified, the latest fix may not fully provide a long-term solution to meeting local districts' needs.

Education funding in Texas has substantially trailed the national average for K-12 students over the past 10 years. In a world characterized by ever-greater globalization and ever-faster technology-enabled disruption, projections suggest the jobs of tomorrow will require substantially higher education levels than the jobs of today. This has raised concerns about the adequacy of Texas' education expenditures.

Since 2012, another trend has entered the picture: rapidly rising property values. This has boosted home appraisals (and property tax bills) to unprecedented levels— and prompted mounting calls to lawmakers to stem rising property taxes.¹

The Legislature, partly in response to those calls, passed an education-reform package in May 2019 consisting of two parts. The first raised K-12 education spending, while the second scaled back future property taxes that in recent years have become the primary funding source for K-12 education.

The juxtaposition of more education spending and less reliance on property taxes may seem odd at first glance. However, these issues are inextricably linked because of the way Texas finances education. The current school funding formula dictates that state contributions fall when local property values soar, which in recent years has led to local school districts bearing an unusually large share of the K-12 funding burden.

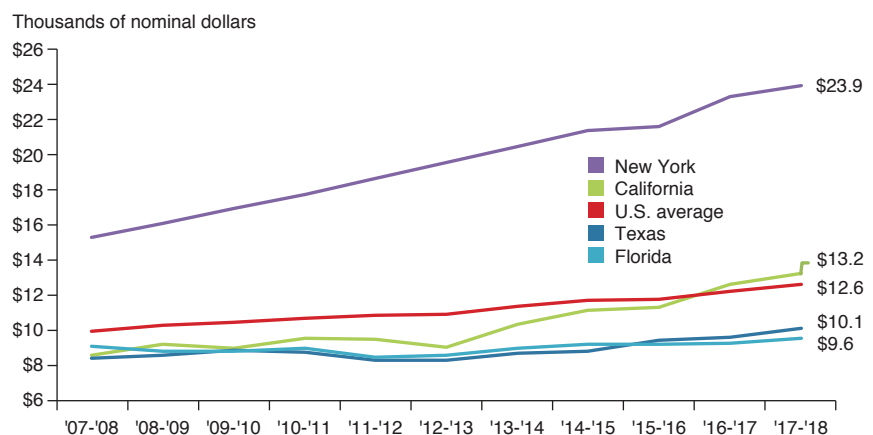
Tamping down future property tax growth changes this calculus, setting the stage for larger state contributions going forward.

Lagging Education Expenditures

For a variety of reasons, the jobs of today require more education and training than the jobs of yesterday. This trend is very likely to continue, leading many to wonder whether state education systems are well-positioned—and sufficiently funded—to meet worker demand.

CHART
1

Texas Per-Student K-12 Spending Increasing, Still Lags U.S. Average



NOTE: Data refer to spending per student enrolled in fall of each school year.
SOURCE: National Education Association.

Nationally, average K-12 education spending per student grew by 3.0 percent, to \$12,602 per year, during the 2017-18 school year (*Chart 1*). This figure has varied to some degree over the course of the business cycle, rising at a relatively slow pace during the Great Recession and its aftermath and then at a faster pace during the economic expansion.

The comparable figure for Texas rose 5.6 percent to \$10,124. While increasing at nearly twice the national average during the 2017-18 academic year, Texas' per-student K-12 spending remained 20 percent below the national average, with only 12 states spending less.

However, overall spending does not necessarily determine how effectively school districts educate children.² Performance also reflects on what schools spend their money. In Texas, despite relatively low per-student K-12 spending, students performed at or slightly below the level of their national counterparts on the National Assessment of Education Progress test, which is the best available metric for comparing student performance across states.

On the 8th grade mathematics test, for example, Texas tied the national average of 282 points, exactly halfway between top-scoring Massachusetts and bottom-scoring Louisiana (*Chart 2A*). Other tests at different grade levels produced mixed results, with Texas significantly below the national average on 4th- and 8th-grade reading but slightly above the national average on 4th-grade mathematics and 8th-grade science (*Chart 2B*).

Encouragingly for an increasingly diverse state, minority students fared better on the tests than their U.S. counterparts. On the 8th-grade mathematics test, for example, African-American students in Texas ranked seventh among the 47 states that break down scores by race, while Hispanic students ranked eighth. However, the Hispanic scores still trailed those of non-Hispanic whites in the state.

Taken together, the evidence suggests Texas teachers produce better results than would be expected given the state's relatively low K-12 education

spending. While economic research suggests that more money does not automatically lead to better outcomes, if Texas teachers are skilled at doing more with less, it seems reasonable to suppose they could parlay additional resources into stronger performance.

Rising Property Taxes

If more education funding is needed, the central role of property taxation in Texas school funding suggests a tax increase might be a possibility. However, recent housing price trends combined with the intricacies of the state's education formula argue against this approach. To understand why, it's necessary to first examine trends in housing prices and then how they affect school funding.

Historically, Texas housing markets do not participate in national boom-bust cycles.³ During the great national home-price appreciation cycle of 2001-06, U.S. home prices rose by one-third while Texas home prices increased only 10 percent (*Chart 3*). Abundant land availability, relatively few zoning restrictions and unusual restrictions on home equity lines of credit are among factors that have tamped down Texas home price growth.

The historical pattern has broken down in recent years. Texas home values rose in line with the nation in 2012-18, resulting in historically rapid home price appreciation and greater housing wealth for millions of Texans. However, it does hurt new homebuyers by making home ownership less affordable. Rapid home price appreciation also carries with it the unwelcome obligation of a rising property tax burden, leading to calls for tax limits.

Linking Schools, Taxes

Many people think that property taxes are the main or even the only funding source for K-12 education. However, a combination of state and local resources along with a small, but significant federal contribution pays the bills in Texas. While a full accounting of school funding involves a number of complexities, a few key elements are especially pertinent.⁴

Texas' Foundation Schools Program provides the bulk of per-student funding for K-12 education. Under the program, the state essentially sets a minimum per-student spending level and then "tops up" each school district's property tax receipts in order to reach that minimum sum.⁵

One implication of this formula is that the state bears much of the fiscal risk posed by unexpected fluctuations in economic activity. If the housing market were to cool and housing prices began to fall, then property tax revenue would fill a lower percentage of the foundation schools' amount, and Texas lawmakers would need to make up the difference with state funds.

But if the state economy were to cool, bringing with it slower consumer purchases, and thus, reduced sales tax receipts, Texas lawmakers would need to find a way to maintain the contribution to school districts. Alternatively, the Legislature could decide to reduce state payments for education, as it did in 2012-13.

A second implication is that a prolonged period of home price appreciation in the state will necessarily reduce the share of education funding provided by the state vis-à-vis local school districts. Indeed, this is exactly what occurred during the 2012-18 period of rapid home price appreciation.

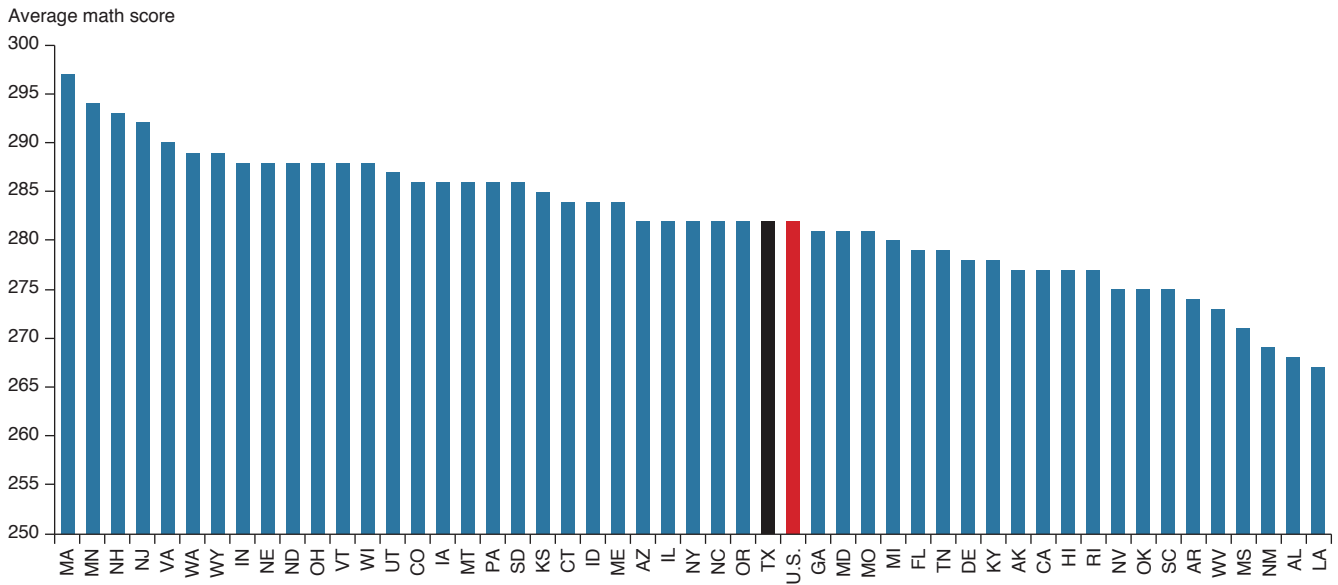
After accounting for identical 45 percent local/state shares of per-student education funding in the 2007-08 academic year, rapid home price appreciation following the Great Recession pushed the local share to 51.4 percent in 2017-18 and to a projected 53.5 percent in 2018-19. At the same time, the state share fell to 39.7 percent and was projected to fall further to 37.6 percent in 2018-19 (*Chart 4*).

From the vantage point of 2018 or even early 2019, it appeared that rapid home price appreciation might continue for some time, further increasing an already-large property tax burden on homeowners while simultaneously propelling the local share of education funding to unprecedented highs. This is where the recent education package enters the picture.

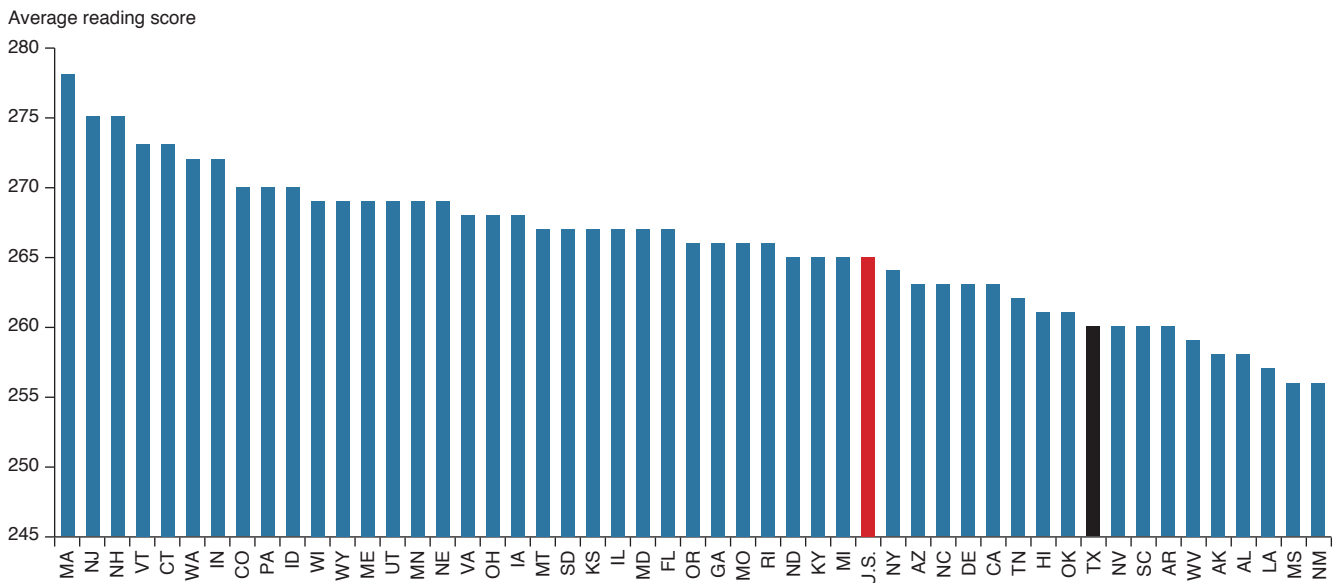
CHART
2

Texas Earns Mixed Grades on Student Achievement

A. Texas Matches U.S. Average on 8th-Grade Math Test



B. Texas Trails U.S. Average on 8th-Grade Reading Test



NOTE: Data refer to 2017 math and reading assessment scores for 8th-grade students.
SOURCE: The Nation's Report Card.

Texas House Bill 2, signed into law in June 2019, increased the state’s baseline per-student funding by \$890. It includes other provisions, such as a more funded full-day pre-K for eligible 4-year-olds. The law also reduces property taxes by 13 cents per \$100 valuation—about \$325 per year for a \$250,000 house.

In the short run, property tax reductions coupled with a one-time boost to per-student funding would cumulatively rebalance the scales by increasing the state share of education funding while reducing the local share. Yet if another period of rapid home price appreciation were to emerge, then over

the medium term, local school districts would once again find themselves shouldering an increasingly larger share of the education-funding burden.

The Texas property tax reform portion of the package (House Bill 3) addressed this issue in a creative fashion. Rather than lower the current 10 percent

yearly cap on *individual* assessment growth, the state imposed a new 2.5 percent yearly cap on *school district* revenue growth from property taxes, with exceptions for new property development. Such a cap carries other policy and economic implications.

Shifting Payment Burdens

One implication is that homeowners have greater protection during housing-market booms. If a house appreciates 10 percent per year, but its taxable value only rises 2.5 percent annually, for example, the homeowner would be shielded from 75 percent of the property-tax increases that would otherwise be paid.

Were this to continue for an extended period of time, a growing portion of the state's residential property tax base would eventually go untaxed (as has happened in California where a 1979 proposition sharply limited property tax increases for many homeowners).

Another implication is that school districts over time will contribute a smaller share of education funding, with the state required to make up the difference. This is a mathematically inevitable feature of capping school district revenue growth.⁶

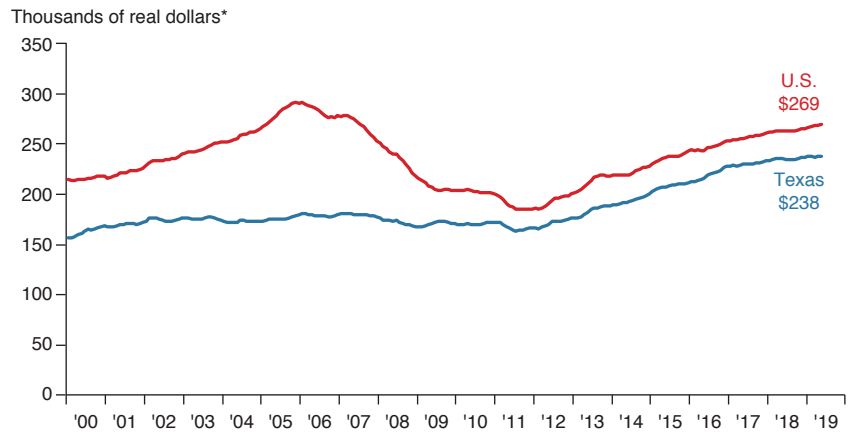
Official cost analyses also suggest the price tag on these reforms will rise over time, from \$11.6 billion in 2020–21 to \$13.5 billion in 2022–23 and more thereafter.⁷ However, the recently approved law does not provide a clear answer as to where the funding will be found.

Higher-than-previously-estimated tax revenue for 2020–21 should lead to a temporary surplus. Over the longer term, barring dramatic changes in economic growth or demands for state services, additional state education funding would have to either be redirected from other areas such as health services (which together with education comprise three-quarters of the state budget) or else generated through higher state taxes (*Chart 5A*).⁸

However, rising fiscal contributions to the Medicaid program for indigent health care along with the state's high uninsured rate make health spending extraordinarily difficult to reduce, and

CHART 3

Texas Home Values Follow National Trend Since 2012



*Four-month moving average, seasonally adjusted.
 NOTES: U.S. data refer to median sales price of single-family homes; Texas data refer to median sales price of single-family homes, condominiums and townhomes. Data are through May 2019.
 SOURCE: The Real Estate Center at Texas A&M University.

the state's sales tax rate is already well above the national average.

This is not to say adjustments in those areas would be impossible. However, it's important to keep in mind that Texas' tax system is already relatively regressive—levying a relatively larger burden on individuals regardless of earnings—because of its heavy emphasis on sales taxation and would become even more so if the state puts more

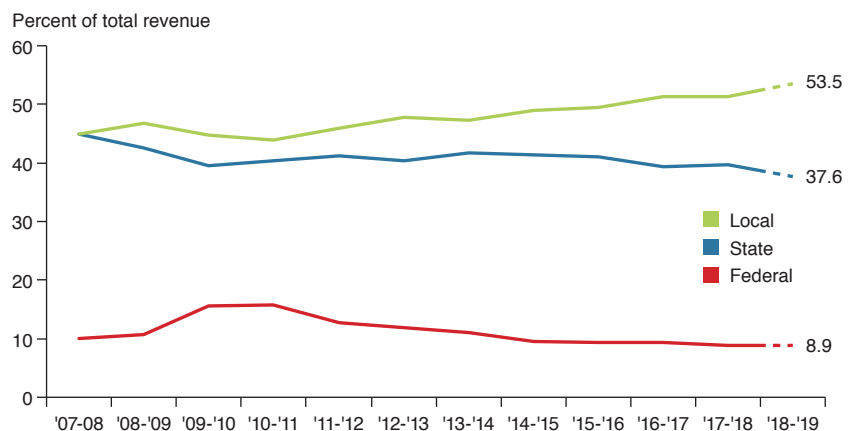
emphasis on the sales tax vis-à-vis the property tax (*Chart 5B*).⁹

A shift in state spending from health services to education would likely also represent a net transfer away from lower-income Texans, who disproportionately consume Medicaid and other state health services.

This leaves the state in a potentially difficult situation, attempting to provide more money for education while

CHART 4

State Share of K-12 Education Funding Declines



NOTES: Data are for Texas. Dates refer to school years. 2018–19 data are a projection without the recent education spending increase.
 SOURCE: National Education Association.

also meeting pressing needs in health and infrastructure and adapting to the realities of demographic change.

Complicating decision-making is a desire to maintain the low-tax, business-friendly climate that traditionally enables Texas to grow about a percentage point faster annually than the rest of the nation. Whether it can achieve a workable solution will determine whether Texas workers are well-positioned for the future and may determine whether the state can keep its growth advantage in years to come.

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Notes

¹ See "Texas Property Taxes Soar as Homeowners Confront Rising Values," by Jason Saving, Federal Reserve Bank of Dallas *Southwest Economy*, Third Quarter 2018, www.dallasfed.org/research/swe/2018/swe1803c.

² See "Education Spending and State Economic Growth: Are All Dollars Created Equal?" by John Deskins, Brian C. Hill and Laura Ullrich, *Economic Development Quarterly*, vol. 24, no. 1, February 2010, pp. 45–59.

³ See "Texas Housing Market Soars to New Highs, Pricing Out Many," by Laila Assanie, Federal Reserve Bank of Dallas *Southwest Economy*, First Quarter 2017, www.dallasfed.org/research/swe/2017/swe1701f.

⁴ For a more detailed summary of Texas school finance, see "Texas School Finance: Doing the Math on the State's Biggest Expenditure," Texas Comptroller of Public Accounts, *Economy, FiscalNotes*, January 2019, <https://comptroller.texas.gov/economy/fiscal-notes/2019/jan/foundation.php>.

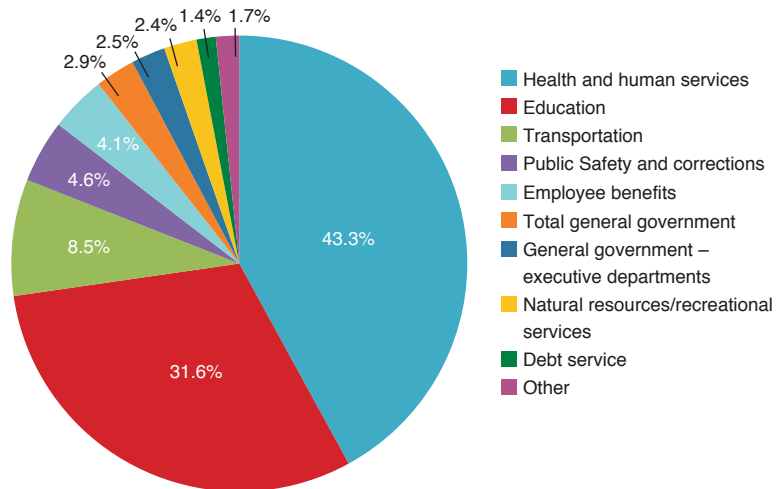
⁵ Other components of the Texas education funding system are less equal, leading to sometimes-substantial per-student revenue differences across school districts. Additionally, questions have been raised about the constitutional adequacy of state funding for public schools. These issues are outside the scope of this article. For more on this, see "Texas School Finance System Survives Recent Supreme Court Review," House Research Organization Focus Report 84-10, Sept. 27, 2016, <https://hro.house.texas.gov/pdf/focus/Schoolfinance.pdf>.

⁶ The governor's "Property Tax Policy" document anticipated this to some degree, stating: "A major effect of capping the growth of local property tax collections will be to reduce the extent to which local revenue for public schools is able to grow. The state must therefore

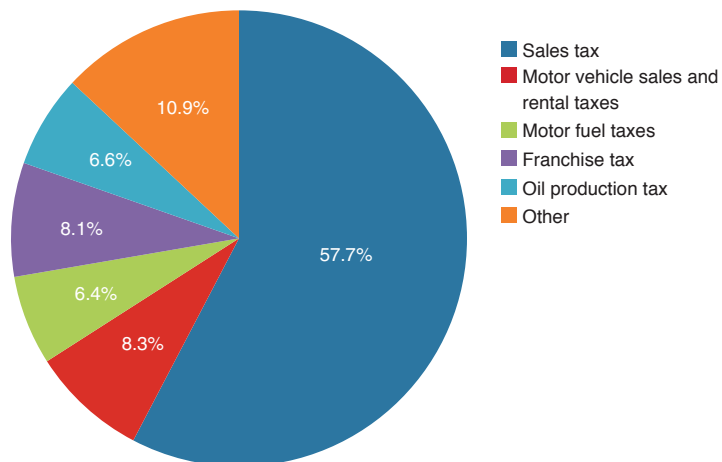
CHART 5

Texas Expenditures, Funding Sources Heavily Concentrated

A. Health, Education Account for 75 Percent of State Spending



B. Sales Tax Accounts for 58 Percent of State Tax Revenue



NOTES: Chart A data refer to fiscal 2018 (September 2017 through August 2018). Chart B data refer to fiscal 2019 year to date (September 2018 through June 2019).

SOURCE: Texas Comptroller of Public Accounts.

be prepared to increase its share," www.gregabbott.com/wp-content/uploads/2018/01/PropertyTaxReform.pdf.

⁷ See fiscal note for House Bill 3 from the Legislative Budget Board.

⁸ The reform package also directs the Texas Comptroller of Public Accounts to create a new fund into which funds from the Available School Fund and online sales tax collections would be deposited.

⁹ For more on the distributional impact, see, "Texas

Taxes: Who Bears the Burden?" by Jason Saving, Federal Reserve Bank of Dallas, *Southwest Economy*, Third Quarter 2017, www.dallasfed.org/research/swe/2017/swe1703b.