

the Southwest ECONOMY

THE FEDERAL RESERVE BANK OF DALLAS

MAY 1990

School Finance Reform in Texas

"We hold that the state's school financing system is neither financially efficient nor efficient in the sense of providing for a 'general diffusion of knowledge' statewide, and therefore that it violates article VII, section 1 of the Texas Constitution."

The Supreme Court of Texas
*Edgewood Independent
School District v. Kirby*
777 S.W. 2d 391 (Texas 1989, p. 397)

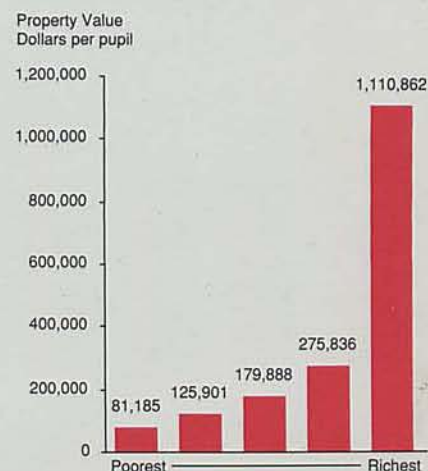
With these words, Texas' highest court ruled the state's school finance system unconstitutional and ordered reform by May 1, 1990. The court found that disparities in local property values led to unacceptable differences in revenues derived from property taxes (*Chart 1*). For example, in 1985 Highland Park Independent School District (ISD) raised 38 percent more revenue per pupil with a property tax rate one-third that of Wilmer-Hutchins ISD. In a system acceptable to the court "districts must have substantially equal access to similar revenues per pupil at similar levels of tax effort" (*Edgewood*, p. 396).

In addition to requiring state monies, reforming educational funding has the potential to change the face of primary and secondary education in Texas. In Texas, like in many other states, control of primary and second-

dary education has been left largely in the hands of local school districts. Increased state funding could reduce local school district control. In choosing the vehicle for reforming educational funding, the state legislature will determine how much control local school districts will retain.

The state legislature, in two special sessions this spring, is examining options for reform. The legislature has several strategies to consider—full state funding, foundation programs or guarantee programs. In the 1970s and early 1980s, the highest courts of six states—Arkansas, California, Connecticut, New Jersey, Washington and Wyoming—required their respective states to make

Chart 1
Disparities of School District Values, 1985
(Property Value Per Pupil by School Districts by Quintile)



school finance more fair. Today, California and Washington rely on full state funding, Arkansas and Wyoming finance their schools with foundation programs, and Connecticut and New Jersey use guarantee programs.¹

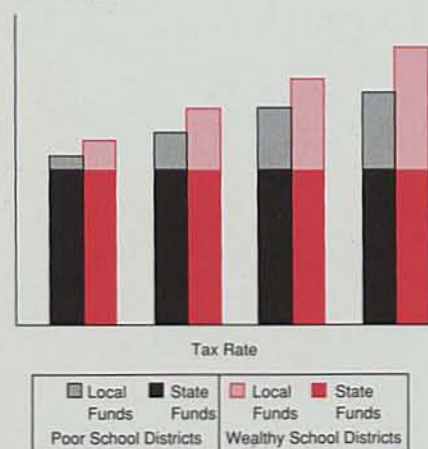
School Finance Strategies

Full State Funding. Under full state funding, the state collects the school taxes and then redistributes them to the school districts. The state may assume complete financing responsibility for the schools, or it may take responsibility for a basic program and leave enrichment activities to local school districts. The state may or may not direct the way in which school districts use state funds. Chart 2 illustrates school district revenues per pupil under a full state funding program that allows for local enrichment.

Foundation Programs. A foundation program sets a minimum standard for per-pupil expenditures in the state. If a school district's revenues are less than the standard, the state makes up the difference—even if the school district is using the lowest possible tax rate. If a school district's revenues exceed the standard, the state takes no

Chart 2
School Financing
under Full State Funding with Enrichment

Dollars per pupil

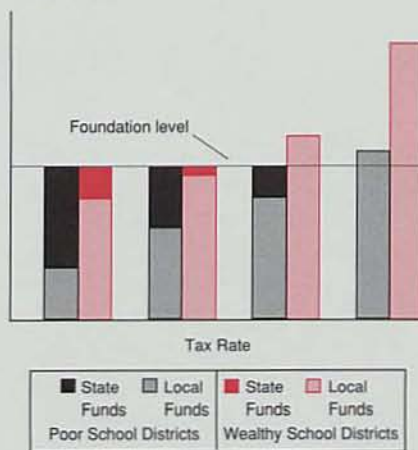


action. When the standard is set high enough, expenditures become roughly equal across the state because only a few wealthy school districts choose to spend more than the foundation level (Chart 3).

Under a foundation program, much of the cost of education can fall on the state government because the program assures school districts a specific level of funding regardless of their tax rates. That gives the school districts incentive to choose the lowest possible tax rate. In some states, the legislature established minimum local tax rates to prevent local school districts from shifting responsibility for funding to the state government.

Chart 3
School Financing
under a Foundation Program

Dollars per pupil



Guarantee Programs. A guarantee program sets a guaranteed level of funding for each tax rate that the local school district chooses. Under a guarantee program (sometimes known as a guaranteed tax base), the state constructs a hypothetical tax base for each school district based on the number of students in the district. Tax rates are decided by local school districts. In the case where a district's actual tax base is lower than the hypothetical base, the state makes up

the difference between actual tax revenues and tax revenue that the district would receive if it had the hypothetical tax base (Chart 4). States often set upper limits on the revenue they will guarantee. In the case where a district's actual tax base is greater than the hypothetical tax base, the state might take no action, or, in a process known as *recapture*, the state might claim the difference between actual tax revenues and tax revenue that the district would receive if it had the hypothetical tax base.

Choosing a School Finance Strategy

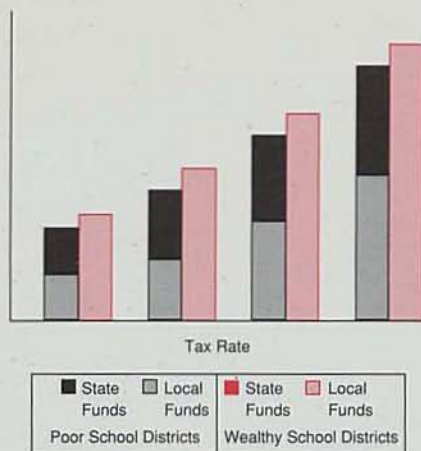
In choosing their strategy, Texas legislators will consider several criteria. They must satisfy the court. They will also consider how their program affects the quality of primary and secondary education in Texas, how much it costs the taxpayers and its effect on local school district control.

Satisfying the Court. The Texas Supreme Court set broad guidelines for satisfactory reform. The public school system must efficiently provide a basic program that leads to a general diffusion of knowledge. The court found that meeting this criterion requires a financing system in which there is "a direct and close correlation between a district's tax effort and the educational resources available to it" (Edgewood, p. 396). Nonetheless, satisfying the court does not require equal expenditure per pupil. The court specifically allows communities to supplement the efficient system with enrichment funds if those funds are derived solely from local tax revenues.²

With sufficient funding, all three of the financing strategies probably would satisfy the court. Full state funding would satisfy the court's requirements if the basic program provided by state funding leads to a general diffusion of knowledge and any enrichment funds

Chart 4
School Financing under Guarantee
Program without Recapture

Dollars per pupil



come from local tax revenues. Similarly, a foundation or guarantee program would satisfy the court if the minimum level of funding or the guarantee was set high enough to provide the basic program acceptable to the court. If the guarantee is set high enough to discourage most school districts from spending more than the maximum guaranteed amount, the legislature also might avoid the problem of defining a general diffusion of knowledge.

Costs. All of the programs are likely to increase both state funding and total spending on education. Full state funding that provides at least \$3,500 per student for basic programs each year could cost Texas taxpayers an estimated \$11 billion annually, all of which would be funded through the state government. A similar foundation program would cost Texas taxpayers \$11 billion annually with at least \$6 billion funded through the state government. A similar guarantee program without recapture would cost Texas taxpayers somewhat less than \$11 billion annually with about \$5.5 billion funded through the state government. Enrichment programs would add to local expenditures.

Including enrichments, total spending on primary and secondary education in Texas is likely to be greater with full state funding of the basic program than with a foundation program because full state funding is likely to lead to greater enrichment spending than a foundation program. With full state funding, local school districts need not fund the basic program locally before they can offer enrichment programs, whereas they must with a foundation program.

Full state funding is also likely to be more costly than a guarantee program. With full state funding, school districts would have no incentives to hold their costs below the state-funded level—even if they could meet their goals with less money. Under the guarantee program, school districts will have an incentive to hold their costs down. The guarantee program preserves a closer relationship between district costs and local taxes.

A foundation program is likely to be more costly than a guarantee program as well. Under the foundation program, some school districts are likely to receive more funding than necessary to support their basic programs. These excess funds could not be used on supplemental enrichment programs because the funds would not be derived from local tax effort as the court requires. Although the guarantee could encourage some property-poor school districts to spend heavily on education, other school districts probably would spend less money than the guarantee.

With recapture, a guarantee program might require little or no state funding, but recapture seems politically infeasible in Texas because it would require a transfer of funds from taxpayers in school districts with high property values. Even without recapture, a guarantee program is likely to require less state funding than a

foundation program. School districts have an incentive to shift the burden of school finance to the state under a foundation program, but a guarantee program does not have such an incentive.

Full state funding requires more state funds than either a foundation or guarantee program. With either of the latter programs, local funds contribute to the basic program.

The most expensive program may not be the best. Research shows that the connection between educational expenditures and student achievement is weak (*See the box titled "More Money May Not Mean Better Education"*).

Local Control, Incentives and Quality. State funding could shift the control of primary and secondary education in Texas from local school districts toward the state government. Greater state control could enhance or lessen educational quality in the state. In Minnesota, state funding has been used to foster competition between school districts with the hope of improving quality. Parents are given a choice of schools in competing districts.³

Without a similar open enrollment program in Texas, maintaining some degree of control at the local school district would be desirable. Economists have found that public spending is best handled at the level of government where the primary benefits are received.⁴ Although the benefits of primary and secondary education spill across school district lines, they are primarily local. Local control allows school districts to meet local needs and gives each community a greater voice in the kind of education it will provide.

Full state funding of basic programs would greatly reduce local school district control over the size of the school budget. Local school districts would be limited to determining the level of their enrichment programs.

Full state funding could also reduce local control over the distribution of resources within a school district. Once the legislature sets the level of funding for basic programs, it is likely to direct how those funds must be spent. In doing so, the legislature may mandate programs that do not meet the needs of individual school districts.

Compared to full state funding, a foundation program could more severely limit a local school district's control over the size of its budget. A foundation program would inhibit enrichment spending in all but the wealthiest school districts. A district that raises enough funds to offer enrichments would lose its state funding. To raise funds for its enrichment programs,

a district also would have to raise sufficient funds from local taxes to cover the basic education.

A guarantee program would preserve control for local school districts. Under guarantee programs, individual school districts would choose the level of funding consistent with the educational objectives that meet their own community standards.

Conclusions

All three finance strategies—full state funding, a foundation program and a guarantee program—could be modified to satisfy the court. All of the programs will increase total spending on primary and secondary education in

Texas. Nonetheless, the programs differ in costs and the degree of local control that they allow.

Full state funding is the most costly and could severely limit local school district control over the size and distribution of educational funds. A foundation program that is likely to satisfy the court would limit local control to enrichment spending and would discourage school districts from offering enrichments. A guarantee program that would satisfy the court would be the least costly and would preserve local school district control over the size and distribution of the school budget.

—Lori L. Taylor

More Money May Not Mean Better Education

Underlying the court's displeasure with school finance in Texas is the notion that a general diffusion of knowledge requires a general diffusion of money. Many economists strongly disagree. Professor Eric Hanushek of the University of Rochester analyzed 65 studies that examined the relationship between expenditures per pupil and student achievement. After adjusting for family characteristics, only 13 of the 65 studies indicated that increasing expenditures significantly increases student achievement. Surprisingly, three of the 65 studies indicated that increasing expenditures significantly decreases student achievement. The remaining studies found no relationship between expenditures and achievement.¹

Increasing expenditures has the potential to increase achievement if funds are allocated effectively, but many popular strategies for improving the schools are generally ineffective. Professor Hanushek's analysis also demonstrates that the programs school districts tend to fund with additional school money—smaller class sizes, higher teacher salaries, more experienced teachers, or more teachers with advanced degrees—have no systematic effect on student achievement. The research does not imply that teachers are unimportant to student achievement. Instead, it indicates that current measures of teacher quality—their experience and education—seldom differentiate good teachers from bad ones. Increasing the number of teachers or the salaries of current teachers would be ineffective in a system that relied on these poor measures of quality when making decisions about hiring, firing and promotions.

¹ Hanushek, Eric A. (1986), "The Economics of Schooling: Production and Efficiency in Public Schools," *Journal of Economic Literature* Vol. 24, No. 3, pp. 1141-77.

¹ See Richard G. Salmon, Christina Dawson, Stephen B. Lawton, and Thomas L. Johns, compilers and editors, *Public School Finance Programs of the United States and Canada, 1986-87*, Blacksburg, Va.: American Education Finance Association and Virginia Polytechnic Institute and State University, 1988, p. 4.

² The court did not define the terms *basic* or *enrichment* programs. A basic program provides education in the fundamental subjects essential for a general diffusion of knowledge. An enrichment program provides funds for athletics and instruction in supplementary subjects.

³ Similar programs are possible without state funding if the parents' choices are limited to schools within their school district.

⁴ See Wallace E. Oates, *Fiscal Federalism*, New York: Harcourt Brace Jovanovich, Inc., 1972.