August 2018

Investing in Our Future:

What you need to know as Texas re-examines the school finance system

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In January, the newly created Texas Commission on Public School Finance began studying and making recommendations to improve the school finance system. This five-part series prepares readers to engage with lawmakers and the Commission by providing background on past school finance commissions, the strengths and challenges of the current finance system, and recommendations for improvements.

- Part 1: How We Got Here – Lawsuits, Studies, and Inaction
- Part 2: Leveling the Playing Field – Ensuring Fair Access to Education Funding
- Part 3: Money in Education Matters – Determining the Cost of a High Quality Education
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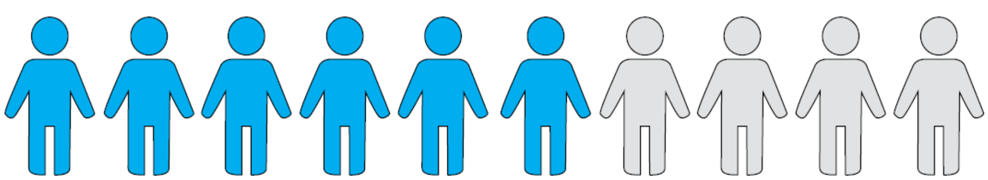
Part 5: Education Costs Money, but Ignorance Costs More

Funding high-quality public education is an investment in the next generation and the future prosperity of our state. Early education, high performing teachers, and engaging classroom experiences are all linked to greater student achievement, and all require sufficient resources to implement correctly. The state's failure to invest in the students of Texas is seen in the low levels of post-secondary degrees and certificates earned by our high school graduates. Only 21 percent of eighth graders earned any type of post-secondary credential within six years of their expected high school graduation. For low-income students, that number drops down to only 12 percent.[1] This is a shocking figure when taking into account that six out of ten Texas students are low-income.



About 5.4 million kids rely on the Texas public education system to prepare them to contribute positively to the state and the economy. That's a lot of kids – in fact, one of every ten students in the country is in a Texas classroom. This means that even the smallest improvements in funding can carry a very large price tag. Fortunately, Texas is not a poor state, just a low taxing state. Texas is the 12th lowest in state/local revenue as a percent of personal income, leaving inadequate funds for schools and other services. Yet, the Legislature continuously chooses tax cuts over kids except when faced with court orders to improve school funding.

Part 5 of this series highlights the legal challenges that led to greater investments in our schools, the choices the Legislature has made to limit the amount of revenue available for schools and other state priorities, and options for improving the state's revenue system.

Lawsuits Led to Funding Improvements

Decades ago, parents in the Edgewood community of San Antonio challenged the school finance system in state court for the first time, arguing that their children did not have access to same quality of education as their affluent peers at other area districts. As they prepared for their challenge, Governor Mark White formed the Select Committee on Public Education (known as the Perot Commission) to study and make recommendations on how to improve the finance system. The Edgewood parents prevailed when the Supreme Court of Texas ruled the system was unconstitutional because school districts across the state did not have access to similar revenue when taxing at similar rates. In response to the lawsuit and the recommendation of the Perot Commission, the legislature passed House Bill 72 in 1984—laying down the foundation of our current school finance system. This new system included improved base level funding, guarantees that the state would bring up funding for districts with little property wealth, and additional funding for special populations called weights.

To support the changes made in HB 72, the Legislature passed tax legislation that generated nearly $4 billion a year in 2018 dollars to support public education. Realizing that the revenue needed to fund education could not come from just one source, the tax law (HB 122) that accompanied HB 72 included 37 different tax changes, including new taxes, expansions to the sales tax, and rate adjustments on existing taxes. In other words, lawmakers understood that money in education matters, and they found that money.

Though the new system guaranteed low property wealth districts a larger base level of funding, no constraints were placed on amount of funding a wealthy district could generate. Further legal challenges focused on the continued inequitable distribution of resources among districts led to several positive improvements to the school finance system, such as recapture. Recapture, often referred to as "Robin Hood," collects local revenue generated in excess of the per student guaranteed funding level and redistributes those funds to other districts and charter schools. Recapture allowed the state to guarantee that school districts would receive a similar amount of total state/local revenue per student for each penny of tax effort, regardless of local property wealth.

In 2005, the Supreme Court of Texas again found the state's school finance system unconstitutional because the cap on school tax rates was working like a statewide property tax, which is prohibited in the state constitution. The court instructed the legislature to give school districts, most of which were taxing at the maximum permissible rate and unable to raise rates further to generate more revenue, "meaningful discretion" to set local tax rates.

The legislature responded in 2006 by requiring school districts to reduce their school property tax rates by one-third, but committed to replacing the foregone property tax revenue so that the school districts would maintain their total state/local revenue. To fund this commitment, the state reformed the franchise tax (now popularly known as the "margins tax") and increased the cigarette tax. However, the new state revenue raised by these changes fell some $10 billion short in each biennium of replacing the property tax revenue given up by the school districts. This $10 billion hole is now built into every state budget, increasing pressure on school property taxes.

This ongoing structural deficit has been compounded by the legislature with further tax cuts and revenue diversions. In 2013 lawmakers temporarily reduced the franchise tax rate and made permanent the small business exemption (HB 500), reducing by $715 million revenue from the franchise tax that is dedicated to public education.

In 2015 the legislature permanently dropped the franchise tax rate by one-fourth (HB 32), further cutting money dedicated to public education by $2.6 billion per biennium. The Legislature also decided to divert $5 billion per biennium in sales taxes, which had been going to the General Revenue Fund to support public education and other state services, to the Highway Fund. In addition, voters approved an increase in the statewide school homestead property tax exemption from $15,000 to $25,000, requiring the state to commit $1.3 billion per biennium to replace lost local tax revenue, without increasing net revenue to schools.

The state Supreme Court's most recent ruling, in 2016, found that the school-finance system is highly flawed, but that it "satisfies minimum constitutional requirements." Without pressure from the courts, legislative attempts to address school finance in the 2017 sessions fell flat, but led to the creation of the current school finance commission. The Texas Commission on Public School Finance, convened to study and make recommendations for the 2019 session, has heard countless hours of expert testimony on how the lack of state support for public education is harming students and the state's future prosperity.

Options for Raising Revenue

Scrub the Tax Code

Texas' tax code contains many outmoded or wasteful exemptions that the Legislature has added over the years, but has never reviewed to determine if these expensive tax breaks are accomplishing their stated goals or achieving these goals in the most efficient manner.

For instance, in 1989 the Legislature gave special treatment to "high-cost" natural gas wells, reducing their tax rate based on relative drilling and completion costs. When this break was granted, the natural gas industry was weak and arguably needed an incentive to undertake higher-cost operations. But now the industry is strong, due to the development of fracking and extensive shale production, indicating that this incentive has outlived its usefulness. Eliminating this provision would have increased state revenue by $368 million in 2017 alone – 25 percent of which is constitutionally dedicated to schools.

Another example is the local option homestead exemption, which allows school districts to grant a percentage homestead exemption of up to 20 percent, in addition to the statewide mandatory flat-dollar exemption of $25,000. The Legislature created this option in 1981, when comprehensive property tax reform for the first time required all homes to be appraised at their full market value. The exemption was intended to cushion the "sticker shocker" resulting from the rapid increase in appraisals in some communities. Thirty-seven years later, the rationale for the exemption is no longer applicable.

This exemption is now offered by fewer than 200 school districts. Since a percentage exemption gives the largest dollar amount of tax break to the highest value homes, more than one-half of the benefit of the exemption goes to the one-fifth of Texas households with an annual income of over $147,000. The state currently replaces half of the property tax revenue foregone by districts granting the exemption, but only for Chapter 41 (property wealthy) districts (this is currently under litigation). The exemption is expected to cost the state $1.4 billion in 2018-19 – roughly equal to the cost of increasing the statewide exemption benefitting ALL homeowners by $10,000.

Modernize the sales tax

Texas adopted the sales tax in 1961, when the 20th Century economy centered on manufacturing. But the current 21st Century economy is based on services, which are generally not subject to the sales tax. The sales tax would better track economic growth and grow along with the rise in needs if it were to encompass fast-growing business and professional services, such as legal, architectural, accounting and brokerage services. Including such services (excluding health care) could have brought in $7.2 billion in 2018-19.

Bring tax rates up to date

The tax rates on many items have not changed in decades, and inflation has dramatically eroded their ability to fund state services, including public education. For instance, the last increase in tax rates on beer, wine, and liquor was in 1984, when they were raised to help fund the education reforms of HB 72. Merely raising those alcoholic beverage's tax rates to track inflation since 1984 could have increased state revenue in 2018-19 by more than $600 million in 2018-19.

Similarly, the tax rate on gasoline and diesel fuel has not be changed since 1991, when the rates were raised to help fund the state's response to the *Edgewood* school finance decisions. Raising motor fuels taxes, one-fourth of which are constitutionally dedicated to schools, could have raised another $6 billion in 2018-19.

Recommendation: Develop a Revenue System Capable of Meeting All the State's Needs

> *"Eight years ago, at the conclusion of the previous school finance case, I said that education costs money but that ignorance costs more money. I also said that it is the people of Texas who must set the standards, make the sacrifice, and give direction to their leaders as to what kind of education system they want. I said that the problems only get worse the longer we wait. I said then and I repeat today, the time to speak is now." Judge John Dietz – February 4, 2013*

Very little has changed since District Court Judge John Dietz first warned that our school finance problems would only get worse the longer we wait. In that time, the Legislature has let the state share of school funding slide from 50 percent after the 2006 lawsuit fixes to only 38 percent by 2019. When revenue estimates showed positive growth, tax cuts were prioritized over the education of our children. This session, to make minor school funding adjustments, the legislature took funding from the Health and Human Service Commission, adding to the deliberate underfunding of the Medicaid program that will need to be made up at the beginning of next session.

Texas will continue to be unable to provide a 21st century education until the Legislature adopts a 21st century revenue system able to keep pace the needs of the state and the changing economy.

[1] Outcomes Workgroup white paper