

Reforming Texas Education Finance- A Value Added Tax Approach

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Introduction

The Texas Constitution guarantees free education to all children in the State. In 2018, \$52.3 Billion in State and Local monies went to fund education (Swaby, 2019). The Texas education system is heavily dependent on property taxes to fund the promised right to learning. There has been a long-tailed increment in property values, as a sole source of government budget funding, a trend that property owners hate. The financial burden has become a political problem which has evolved into a heated legislative debate. Advocates for the existing system recommend Texas legislators utilize the projected increase in property taxes to finance education before utilizing additional government revenues; however, such a stand does not address the primary issues of underfunding and inequality in education. One of the roles of legislators is to ensure that government laws benefit the citizens. Texas' old and over-patched educational funding formula fails to protect public schools and fails to provide quality education to our children. This paper will present overwhelming evidence that we have a crisis in funding for public school education in Texas. Efforts since the early 1990s, and before, to correct inequities in the system have only made matters worse. The paper goes on to make the claim that a value-added tax should be included in any serious attempt by the Governor of Texas, the Texas legislature and educational leaders in our state to remediate the system.

Demographics

The student population has increased from approximately 3.7 million to roughly 5.4 million (DeMathews & Knight, 2018). The 5.4 million students spread across 1,019 traditional school districts and 171 charter school districts (Swaby, 2019). Six in ten

Texas students are considered economically disadvantaged, ranking the state ninth nationally. Additionally, one in five of these students is an English-as-a-Second-Language learner, ranking Texas second nationally (DeMathews & Knight, 2018; Samuels, 2018). Modern Texas classrooms have grown radically different compared to the past decades and require a different approach in school financing to improve the students' performance (Freer, 2018).

The State of Texas is ranked educationally between number thirty-six and forty-three when compared to other states in the Union. Texas has many positive attributes in the field of education. The state boasts a nearly perfect graduation rate (89 percent), and the average National Assessment of Educational Progress math scores are on par with the national average (Texas averages 284 while the national average is 281) (U.S. News, 2017). Texas is home to some of the highest ranked colleges in the United States. The average individual might consider these statistics and determine that Texas must be providing the perfect balance of educational funding. Unfortunately, like many other states, Texas is beginning to experience budget constraints which often lend to lawmakers significantly cutting educational funding.

The Four Points

The Texas Education Budget is set to be funded using a model that includes a four-point formula – Basic Allotment, Regular Program Adjustment Factor (RPAF), Tier 2 Yields, and Target Revenue Reduction Factor (Villanueva, 2013). The basic allotment establishes the base level of funding each student receives. The Texas legislature often raises this base pay per student in order to increase the initial funding for school districts. The Regular Program Adjustment Factor allows for the state legislature to

“arbitrarily” cut funding as the entity sees fit (Villanueva, 2013). The Tier 2 Yields is a component of the allocation formula intended to provide enrichment from state and local resources. The Target Revenue Reduction factor is an off-set formula dealing with the 2005 Maintenance and Operation compression legislation.

Texas legislators established a Basic Allotment of \$5,140 for each student (McInerny, 2018). Specific issues can cause a student to receive extra funding: children identified as gifted-and-talented, children whose family income meets a certain threshold, and children who are English-language learners receive an increase from the base amount. The money follows a specific student. If a student enrolls in a school district in El Paso, Texas, the district receives that student’s allotted money; however, if the student’s family moves to Dallas, then the money moves to the new district with the child (McInerny, 2018). The exceptional circumstances create disparities in school budgets where one school could have a bigger budget compared to another within the same district (DeMathews & Knight, 2018).

The Regular Program Adjustment Factor (RPAF) was created in 2011 as a legislative measure to reduce the total regular program allotment. Prior to the 2011 session school districts received an Average Daily Attendance (ADA) allotment for each student enrolled. The 2012-2013 biennium was faced with a budgetary shortfall. Legislators created a staggered reduction schedule for school funding. During the 2011-2012 school year, the RPAF was set at 92.39% to all districts. The 2012-2013 school year saw a 98% allotment. The subsequent two school years saw the allotment return to 100%, with the RPAF expiring on September 1, 2015 (TTARA Research Foundation, 2014).

Tier 2 is commonly referred to as the “fractional funding” formula (TASB, 2016). Tier 2 is divided into two categories, the “golden” pennies, and the “copper” pennies. Under this plan, a school district can levy 4 out of 6 “golden” pennies, which are not subject to recapture and without forcing a ratification election. Additionally, the school district may collect 11 “copper” pennies for Tier 2 enrichment; however, these funds are subject to recapture (Villanueva, 2015).

The Target Revenue Reduction Factor created in 2006 as a method to ensure school districts would not lose funding when Maintenance and Operation tax rates were compressed. In the 2005 Legislative Session, school districts were ordered to reduce their M&O taxes by one-third. This requirement would have significantly reduced funding to schools. The legislature established the Available State Aid for Tax Reduction (ASATR). Districts qualified for ASATR if the formula-based revenue fell short of the target, the State would allocate the difference. This funding ended in 2017, without adequate replacement in the 2008 school funding formula (TASB, 2016).

Background

The Texas Education Agency claims the responsibility of ensuring the state funding formula is followed as set by the Texas state legislature. The TEA website also states that most of their funding is due to the collection of ad valorem taxes, which is how most states garner educational funding. The Texas property tax is made up of two rates – an “M & O” rate, derived from maintenance and operations, and an “I & S” rate, interest and sinking (Texas Education Agency, 2019). According to the Texas Education Agency, “The I&S tax rate provides funds for payments on the debt that finances a district’s facilities” tells us that the onus of school funding – regardless of distribution

among school districts across the state – falls on the backs of taxpayers (Texas Education Agency, 2019; Ramsey, 2018).

Texas has a history of handling education funds in a manner that fails to follow simple logic. Not only is the state legislature failing to revamp the funding formula to consider inflation and population growth, but the lawmakers slowly found a way to shift the burden of paying for education to the local taxpayer. While this is a standard in many states, in Texas, the promised lottery funds are not making a difference in the colossal education budget nor are the rising property taxes able to fund education fully. In order to understand why Texas is cutting their educational funding, we must first look at the educational funding plan of Texas, as well as look at any economic issues that Texas is experiencing (TASBO, 2018).

The Funding Formula

In 2008, legislation set forth the percentages which local, state, and federal government entities were expected to pay toward the Texas education budget. The state of Texas was mandated to put forth 44.9 percent of the educational funds; the local originally supplied 44.8 percent. The federal government was responsible for a mere 10.3 percent of the education budget. Subsequent budgets, including the 2018 budget shows the local, state, and federal contributions were not followed according to the 2008 mandate. The 2018 budget shows the state paid only 35 percent of the state's educational funding while the federal government contributed 9.5 percent. The rest of the funding is the burden of local taxpayers at a rate of 55 percent (Ramsey, 2017). With the 2019 education budget projected to be nearly \$56 billion, the local tax base is looking for ways to restructure the system so that they might find some relief.

Before the 2008 recession, the legislature had cut the maintenance and operations portion of the local property tax by one-third. At the time, the economy promised growth in other areas, so the legislature made the cuts based on these predictions (Smith, 2015). In 2007, the real estate market crash took place, and the resulting recession hit the state's budget hard. Property taxes increased, unfortunately, the funding cuts remained in place. The state legislature has systematically increased property taxes so that state funding has either stayed at previous levels or their obligation has decreased (Transparency Texas, 2017). Another financial factor influencing the number that students receive in the way of educational funds has to do with the state budget's failure to take inflation or population growth into account. Some experts posit this is the reason why educational funding in Texas is not meeting expectations, and the school districts and children suffer.

A non-profit group, Save Texas Schools, began to examine the issues surrounding educational funding. In 2008, the Texas State Legislature made its first significant cuts to education funding. Texas has cut its educational budget by 15 percent, laid off or eliminated specific jobs within the local districts by 135,000, and repeatedly cuts the budget each fiscal year (Chavez, 2017). Additionally, funding for each student has decreased by 1.5%.

In 2009, when President Obama released the American Recovery and Reinforcement Act (ARRA) funds, the Texas state legislature put most of the funds into public education. Texas lawmakers failed to provide relief to local taxpayers via property tax collections. The State looked to lessen the burden on themselves, reducing the

number of funds that they placed in the matrix by as much as six percent, not its citizens (Transparency Texas, 2017).

The 2011 Legislative Session brought additional cuts to education. The Rainy-Day Fund was not sought out as a means of funding education during the recession. Lawmakers failed to find other ways to increase revenue. Instead, the legislature trimmed \$4 billion from the educational funding formula, and approximately 21,000 teachers lost their jobs (Villanueva, 2013). Classrooms became overcrowded as a result, which detrimentally effected students and the remaining teachers (O'Neil, 2018).

The legislature met in 2013 with the news that revenue was increasing. State lawmakers tweaked the funding formula so that local taxpayers and the federal government saw increases to their portion of funding while the state still managed to decrease the number of real dollars that they put toward educational funding. Local taxpayer funding jumped to as much as 50 percent in 2015 (Transparency Texas, 2017). In a sleight-of-hand move, Texas lawmakers appear to have increased educational spending; however, they have raised property values so that taxpayers again bear the brunt of this increase.

When legislators worked to create the state budget for the fiscal year 2014, the budget line amount earmarked for education increased; however, state lawmakers failed to provide adequate funding. The increase from 2011 to 2014 was about \$3.2 billion; again, this is a small amount when one considers the vast percentage education comprises in the Texas state budget. In order to have funded education as it had been before the 2008 cuts, the legislature would have had to allocate over \$5 billion to education. It is important to note, Texas lawmakers, when working to create a budget

for 2014, did not use this policy to cut educational funding. In 2012, the RPAF was utilized to cut a \$2 billion loss (Samuels, 2018). By 2014, the cut was only about \$500 million; however, this was still a cut to the education budget. Further exploration shows that the programs cut within the education budget typically had to do with economically disadvantaged students – a number that comprises many of the children enrolled in Texas public schools (Smith, 2017).

When the state legislature met again in 2015, they created a budget to carry through until 2017. The taxpayer's burden in 2016 was slated to be 48.9 percent, and, in 2017, 51.5 percent. The state laid an additional financial burden on local taxpayers of up to \$6.66 billion for educational spending alone. During the next biennium session, the budgetary obligation was forced even more upon the shoulders of property owners. In 2018 the state contributed just 35 percent and the federal government contributed 9.5 percent. This left a funding deficit of 55.5 percent on the shoulders of local property owners.

The State of Texas has continued to decrease its responsibility where funding education is concerned. The model for fully funding education has morphed into something unrecognizable. When the funding matrix was established, the property tax recapture system was created so that school districts with a lower tax base would not see funding shortfalls. Public education has not been fully funded in over a decade. Transparency Texas reports that the state legislature is funding education in a way that is "unsustainable" (Transparency Texas, 2017). While the state has a right to levy higher property taxes on its citizens in order to fund education, lawmakers are systematically decreasing their obligations, which angers many Texans.

The Texas Lottery

The State of Texas has seen its share of financial issues, and fully funding education has been an issue for decades. The late Governor Ann Richards predicted there would be significant funding shortfalls in many aspects of the state budget, including education, so she proposed instituting a lottery to benefit educational funding. Richards promised that all proceeds from lottery sales would go to benefit education “100 percent” (Webb, 2018). The bill legalizing the lottery was made law in 1991, and Richards even bought the first lottery ticket herself.

The proceeds from the lottery never went entirely to education. In fact, between 1992 and 1997, the funds became a part of the general fund of the state. The Foundation School Fund was created in 1997, some five years after the passage of the lottery bill (Webb, 2018). Even at this time, the proceeds from the lottery still did not go to education as promised. The Foundation School Fund goes to special programs. The Foundation School Fund allocates money to teaching awards, bilingual education, and special education programs. The money does not go directly to the school districts for “education.”

Genevieve Curtis, an investigative reporter at KFOX14 El Paso, reported the Texas Lottery Commission claims to have placed \$22 billion in the educational budget since 1992 (Curtis, 2018). Local school administrators claim that the money earmarked for the education budget via the lottery proceeds rarely makes it to local districts. Curtis

(2018) claims that for every dollar earned through lottery ticket sales, only one quarter goes toward the Foundation School Fund, not education finance.

Over the life of the lottery, some of the proceeds have gone to benefit veterans, pay administrative costs to businesses that sell lottery tickets, and benefit other unnamed state programs. As of 2018, only twenty-seven percent of lottery proceeds go to the Foundation School Fund. In 2017, the state Lottery Commission sent \$1.3 billion of the over \$50 billion educational budget to the Foundation School Fund (Webb, 2018). The lottery, which was proposed to fund the Texas educational budget fully, now provides less than five percent of the Foundation School Fund. Again, the shortfall must be made up elsewhere within the budget, and locals see the brunt of the burden when it comes to funding Texas' children's education.

The Robin Hood Act

In 1993, state lawmakers passed the Chapter 41 law, which eventually became known as "The Robin Hood Act" (Texas School Coalition, 2018). In 1949, the Gilmer Aikin Act provided for educational funding based on local taxpayers. At its inception, this law was meant to supplement the monies provided by the state. Over time, property taxes did not cover the initial supplemental amount, much less help schools to cover operational costs. The basis of this act was to establish a wealth distribution system where rural districts with few businesses or wealthy residents received a comparable allotment to more affluent communities. These rural districts could not keep pace with school districts near Dallas, Houston, San Antonio, and other large cities in Texas. Therefore, a wealth-distribution program that would put all districts on an equal footing was created.

In 1984, Edgewood ISD was a lead plaintiff in a suit against the State of Texas. This lawsuit intended to force the state to examine the current system of educational funds distribution. After seven trips before the state Supreme Court, *Edgewood ISD v. Kirby* produced a ruling that forced the state of Texas to make permanent changes – the judge ruled that “children living in poor districts need equal access to funding, and that more money would have a ‘real and meaningful impact’ on a student’s educational opportunity” (Swaby & Ura, 2018). Texas lawmakers adopted legislation to address this mandate (Texas Education Agency, 2019). The TEA website boasts that the funding formula Texas adheres to is meant to fund school districts in such a manner that the wealth of a particular district does not influence the amount of funding a district receives. In many states, school districts receive funding based on the wealth of the tax base. A rural area might have a few businesses that contribute to the tax base; therefore, the school district within that area might not have a budget with which to operate. Consider a metropolitan area; the tax base in a city such as Dallas would be exponential compared to a rural district with relatively few businesses to support a school district. Texas did not want this discrepancy, so they created the "Robinhood Act," providing each student – no matter where he or she is located – with a base amount of money for education.

Four years after the state Supreme Court ruled with Edgewood ISD, lawmakers put into place the Chapter 41 initiative, which would require “property wealthy” school districts across Texas to “share the wealth” with poorer districts (Texas School Coalition, 2018). In the beginning, only thirty-three districts were deemed Chapter 41 schools and were subject to property tax recapture benefits. In 1993, \$130 million was

recaptured and sent to poorer districts. Each year that property taxes increase, the funding matrix that determines how much wealth is recaptured ends up changing as the base or floor of the system. In order to maintain the equity demanded by the Robin Hood Act, the base amount each district is supposed to garner keeps changing. The state has not kept up with changing the funding matrix appropriately. The initial 33 districts which saw benefits from the Robin Hood Act has ballooned to 448 as of the 2016 – 2017 school year. The number of recipient districts continues to increase. The funding issues created by legislators' inability to keep up with the funding formula has recaptured more than \$1.5 billion from more affluent districts (Texas School Coalition, 2018). This method of recapture leaves 356 wealthy property districts to raise money that ends up outside their district. As much as 50 percent of local taxpayers' monies go to another district as a part of the Robin Hood Act.

The Robin Hood Act infuriates many Texans. Property taxes continue to increase while their local school districts do not benefit. Each year, the number of property-wealthy districts seems to change (Zeeble, 2018). In 2017, the number fell from 448 to 347. In 2018, the number jumped from 347 to 451 (Odessa American, 2018). Those in areas considered property wealthy, especially West Texas, where oil or other mineral deposits make the property much more valuable than in other areas. These Chapter 41 Districts demand that the money they pay into local taxes be more available to students in the district, rather than taking such a large chunk of money and sending it to poorer districts. Lawmakers representing those in West Texas such as Representative Brooks Landgraf state that the money recaptured under the Robin Hood Act is sent to Austin, the state capital, where bureaucrats then decide to where funds are allocated. Along

with his constituents, Landgraf agrees that the funding formula for recapture is “outdated,” and needs to be replaced (Odessa American, 2018).

Matt Kinskey, a Stanford graduate, evaluated the Robin Hood Act and its effect on both wealthy and underprivileged school districts in Texas. Kinskey’s observes there has been zero evidence since the legislative inception to illustrate the funding model has increased test scores or made other measurable improvements to the educational outcomes of those in poorer districts. Kinskey’s study holds with the opinion that more money given to a school district does not ensure higher student success. He points to evidence that most school systems do not spend the money they are allotted wisely. There is evidence that once the money enters a disadvantaged school district, the paper trail ends there.

Under the Robin Hood Act, the Glen Rose Independent School District received \$11,260 per student while the Houston Independent School District only received \$4,250 for each student during the 1992 – 1993 school year (Kinskey, 2009). This unbalance in funding forces wealthier districts make up the lost revenue by increasing property tax amounts. Ironically, though, the Robin Hood Act is written in such a way that elected officials can lower property tax rates in these already poor districts.

The purpose of Robin Hood is to assist those citizens in the poorer districts; however, it is increasingly unfair to those who are paying higher taxes in wealthier districts (Patrick, 2017). Opponents argue this portion of the Robin Hood Act makes it unconstitutional. Lawmakers pacified the state Courts by creating the Robin Hood Act and the property tax recapture program; they failed to make sure that the extra funds are used in such a manner that student success is improved (Kinskey, 2009).

VAT – Value Added Tax

There is a need to address public school funding by adopting a strategy that will generate maximum revenues with reduced economic inefficiency and revenue leakage. The implementation of a valued added tax approach in financing Texas education may be a key component to solving the educational funding crisis. According to Adegbie (2016), using a VAT approach has more significant revenue potential since it is more broad-based and has a trail of invoices that aid in tax compliance and enforcement. The VAT may seem effective in replacing the turnover and single-stage taxes that are troublesome and paralyze the economy and cause revenue leakage or both (Alavuotunki, Haapanen & Pirttila, 2019; Hodzic & Celebi, 2017).

The VAT has empirically been found to be a buoyant tax. The initial idea of adopting VAT among most countries is to reform the existing sales tax system (Kolahi & Noor, 2016). Nevertheless, the approach has proved to be revenue-enhancing because of improved compliance. The VAT can, therefore, provide relief for taxes on personal property and if the VAT approach coincides with a reduction in ad valorem taxes, then the entire tax system in Texas may become more stable and politically acceptable.

The Tax Policy Center tells us that a value-added tax is a “consumption tax, in place in more than 160 countries, including every economically advanced nation except the United States” (The Tax Policy Center, 2018). The Tax Policy Center gives the example of a farmer growing wheat and selling it to a baker: “suppose a farmer grows wheat and sells it to a baker for \$40. The baker turns the wheat into bread and sells it to customers for \$100. The baker’s value added is \$60 – the difference between sales and purchases.” The Tax Policy Center tells us that the VAT (value-added tax) is

successful because of its ease of administration and its ability to significantly raise revenue (The Tax Policy Center). Proponents also claim that a value-added tax does not affect the household budget the way that an income tax does.

A better look at a value-added tax would be a comparison between the VAT and the current system of paying sales tax. Retailers and many manufacturers can obtain a wholesale permit which means that they can buy goods in order to make a new product without paying sales tax on the goods. The consumer pays sales tax, which is collected by the retailer and then sent to the appropriate governmental agency. The VAT would place a tax on wholesale goods, and each person in the supply chain would pay the same amount of tax on the goods. According to most economists, this is a fairer way of taxing goods, and the consumer pays the same amount of tax as he or she would under the current sales tax plan.

The value-added tax is a steady and profitable method of garnering revenue. When calculated correctly, it provides the same cost to citizens as if they are paying the sales tax. Should a business owner feel it necessary, the individual or the company may apply for an exception to certain goods and services that they intend to turn around and sell the goods. Proponents of the VAT believe that the system is much more efficient than the current highly complicated income tax system in place in the United States. Some even label a value-added tax as a “money machine” (DeMatthews & Knight, 2018). Those who would apply the value-added tax in Texas would be able to allocate the money to any area of the budget that is deficient. Furthermore, the state could finally bring forward the amount they originally proposed in 2008 – the 44 percent – that the government of Texas promised to pay for educational funding.

There are many benefits to a value-added tax. A VAT is meant to present new methods of revenue; government entities can use the monies to prevent or reduce budget deficits or put the money into community interests, such as education, which can benefit all citizens (Hodge, 2017). In theory, the value-added tax raises more revenue than a state's sales tax (Adegbie, 2016). Each entity in the chain of supply will know what price to pay to satisfy the value-added tax. Therefore, no one – especially the consumer – pays a doubled tax on any final product.

Conclusion

The formulas used to determine the allocated dollars per student have become outdated and do not reflect the actual cost of offering high-quality education (Allen, 2019). The disadvantaged scale enables some districts to have an increment in recapture payments, while other districts are subject to recapture. The state's Robin Hood Act takes up to fifty percent of property tax revenue from the districts in which the funds originate. Furthermore, the funds recaptured in this manner have been used exclusively to reduce the state's burden for funding education. State lawmakers have essentially put a band-aid on a bleeding gunshot wound. Local taxpayers would have a win-win of more well-resourced schools as well as lower property taxes if the state contributed a significant share towards funding education.

A value-added tax is not a sole means of fully funding education in the state of Texas. It is not a one-step solution to the education funding crisis in Texas. The solution to the state education funding crisis requires a combination of reform and innovation. The state must commit to returning to the elementary level of funding promised in the 2008 formula. Funding from the lottery needs to be reallocated directly toward

education. Gambling should be legalized in the State of Texas with proceeds earmarked directly to education funding. Lawmakers must actively pursue new funding resources, without “recapturing” it from other levels of government. The standardized testing system needs a significant overhaul; it places an undue burden on the otherwise crippled education fund. It is crucial that the legislature must provide tax relief to those who are paying the highest amount of property tax, and they must not rely solely on property owners for funding.

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