Memorandum

To: Governor Perry, State of Texas  
From: Jessie LaVine and John Crary  
Re: Recommendations to Texas’ “Robin Hood” Education Funding Scheme  
Date: May 5, 2007

**Introduction**

Over the past twenty years, the state of Texas has struggled through litigation and legislation in attempts to create educational equity among its residents. Recent efforts to further reform the system included an overhaul of the state’s “Robin Hood” education funding scheme through House Bills 1-5. This legislation does not fix the fundamental funding flaws of the original Foundation School Program and it actually creates a tremendous budget shortfall, thus jeopardizing the stability of the state’s education finance system. This net deficit, in conjunction with improper accounting for educational costs, creates tremendous political and social implications for the state of Texas, and therefore both must be addressed immediately. To ensure the level of equity mandated by the courts, the state must update the student weights and regional cost adjustments in its financing formula. Furthermore, though politically and legally difficult, the Legislature must amend Texas’ State constitution and impose a flat income tax on the residents of Texas. It is only through these reforms that Texas can avoid continual economic distress and create a sustainable and equitable education finance system.

**Legal Background**

Starting in the 1970’s, Texas citizens living in poor districts challenged the legality of the State’s education finance system. They argued that a property-tax based system of education finance discriminated on the basis of wealth. The reliance on local property taxes to fund public education created inequities because property values varied greatly between districts, resulting in funding disparities for educating students. Therefore, they claimed, the system did not provide equal protection and was in direct violation of the U.S. Constitution. The federal district court found in favor of the plaintiffs, giving the state two years to change its system, but after several appeals, the United States Supreme Court reversed this decision, eliminating the mandated education finance reform.\(^1\) Though this decision kept the debated funding system in place, the case alerted citizens to the repairs needed in the State’s educational funding system and ultimately catalyzed long run reform efforts.

In 1984, the Mexican American Legal Defense and Educational Fund renewed the debate, focusing more on the efficiency of the current system. They argued that “such an inequitable finance system was ‘inefficient’ in violation of article VII, section 1, of the Texas Constitution.”\(^2\) This argument proved more effective, and after a long appeals process, the Supreme Court of Texas endorsed the district’s ruling, ordering the state

\(^{1}\) Farr and Trachtenberg, 1999. (pg. 174)  
\(^{2}\) ibid, pg. 134
The legislature to implement an equitable system by the 1990-91 school year. The Supreme Court echoed the finding of inefficiency, stating:

The lower expenditures in the property-poor districts are not the result of lack of tax effort. Generally, the property-rich districts can tax low and spend high while the property-poor districts must tax high merely to spend low. In 1985-86, local tax rates ranged from $0.09 to $1.55 per $100 valuation. The 100 poorest districts had an average tax rate of 74.5 cents and spent an average of $2,978 per student. The 100 wealthiest districts had an average tax rate of 47 cents and spent an average of $7,233 per student. In Dallas County, Highland Park I.S.D. taxed at 35.16 cents and spent $4,836 per student while Wilmer-Hutchins I.S.D. taxed at $1.05 and spent $3,513 per student. In Harris County, Deer Park I.S.D. taxed at 64.37 cents and spent $4,846 per student while its neighbor North Forest I.S.D. taxed at $1.05 and yet spent only $3,182 per student. Many districts have become tax havens. The existing funding system permits "budget balanced districts" which, at minimal tax rates, can still spend above the statewide average; if forced to tax at just average tax rates, these districts would generate additional revenues of more than $200,000,000 annually for public education.3

The Supreme Court offered constitutional guidance for an “efficient” system explaining that it requires a “direct and close correlation between a district’s tax effort and the educational resources available to it; in other words, districts must have substantially equal access to similar revenues per pupil at similar levels of tax effort.”4

This decision led to high pressure negotiations within the Legislature to create a new education finance system. After months of political infighting, the Legislature was still unable to craft a resolution that satisfied all parties. Continuing legal battles complicated the issue further, as the Supreme Court established constitutional barriers that restricted available options. Ultimately though, the Supreme Court mandated that the Legislature approve a new financing plan at the risk of shutting down the state’s public schools. Facing this pressure, the Legislature created Senate Bill 7, a multi-option statute that included the “Robin Hood” financing scheme along with four other options. Though Legislators intended to give districts flexibility through the multiple options, the choices offered included undesirable alternatives such as district consolidation, annexing commercial property, and the education of non-resident students5. Therefore, virtually all districts participated in the Robin Hood plan by default.

The Initial System: FSP

This plan, formally titled “The Foundation School Program” (FSP), is an arrangement between the state and local school districts that consists of two tiers. Tier 1 is the foundation funding level in the FSP. The calculation of Tier 1 funding multiplies the Average Daily Attendance by the basic allotment of $2,537 and is then adjusted for both the Cost of Education Index (adjusts for geographic variations beyond the districts control) and instructional program weights. The adjusted Tier 1 allotment in 2001 was approximately $2,865 per student.6 Districts can participate in this school funding system through levying a tax rate of $0.86 for each $100 of property value. Thus, the responsibility for funding

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4 ibid
5 Hoxby and Kuziemko, 2004. (pg. 12)
Tier 1 becomes a function of the district’s property wealth. Districts able to generate the entire allotment through local revenues do not receive state aid toward Tier 1 funds, while districts unable to generate the allotment receive state funds to cover the difference.\(^7\)

Tier 2 provides additional funding beyond this base level of funding through a discretionary tax rate. Districts may levy a tax rate on top of the Tier 1 of up to $0.64 in order to generate additional revenue. This tax rate promises all districts a guaranteed yield of $27.14 for every penny tax rate increase. Districts under the wealth threshold generate local revenue and the state provides funding to ensure the guaranteed yield is met. Districts with a wealth per student of greater than $280,000 will meet if not exceed the guaranteed yield, and thus Tier 2 equalization is not applicable. Tiers 1 and 2 are funded through a form of wealth equalization called “recapture”. Through FSP’s recapture system, districts with property wealth above a threshold of $280,000 per student pay the above-threshold taxes to the state in order to fund aid to other districts.\(^8\) It is this method of wealth equalization that is the heart of the debate in Texas educational finance reform.

**Recent Legislative Reform: HB 1**

By November 1995, two-thirds of school districts raised their tax levy close enough to the maximum $1.50 per $100 to prompt the Texas Supreme Court to rule that the property tax ceiling amounted to an unconstitutional state property tax.\(^9\) The Court ordered the legislature to grant school districts meaningful discretion to set property tax rates by the end of the 2005-06 school year.\(^10\) In response, the legislature passed HB1 in the spring of 2006.

HB1 mandates a one-third reduction in school district property tax by 2007 (11.3% for 2006, the remainder for 2007). The state intends to compensate districts for this revenue loss by increasing the basic Tier 1 allotment to $2,748 and the Tier 2 guaranteed yield to $31.95 per penny of tax wealth. Additionally, districts can levy up to 17 cents in enrichment, or Tier 3, funds. Districts can levy the first 4 cents without voter approval, the remainder must be approved in a referendum. The first 4 cents are not subject to recapture and the state will guarantee that each district raises at least the same amount as the Austin Independent School District. Any additional funds that are approved will be subject to recapture and the state will guarantee that districts raise at least the same as the 88th percentile of school property tax wealth. The state legislature also raised the recapture ceiling to $319,500 property wealth per student. The state legislature expects these provisions to cost $2,578 million in fiscal years 2006 and 2007. They predict that HB1 in total will cost $3,922 million in fiscal years 2006 and 2007.\(^11\)

HB1 is partially funded through 3 new tax initiatives: a revised business franchise tax (HB2), a new method for calculating the car sales tax (HB3), and an increase in cigarette and tobacco taxes (HB4). The state legislature expects these 3 new initiatives to raise $463 million in fiscal year 2006-2007.

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\(^7\) Hoxby and Kuziemko, 2004. (pg. 13)
\(^8\) ibid, pg. 7
\(^9\) Haynes and Boone, LLP, 2005.
\(^10\) House Research Organization, 2006. (pg. 1)
\(^11\) Other provisions in HB1 include a $2,000 grant per classroom teacher, nurse, and counselor, $275 per high school student, and changes in health insurance and incentive programs for teachers. (House Research Organization, 2006.)
Issues Concerning Capitalization

The initial Foundation School Program received sharp criticism from Harvard University professor Caroline Hoxby. In her article, “Robin Hood and His Not-So-Merry Plan”, Hoxby contended that in the long run, the “Robin Hood” scheme causes substantial negative capitalization, and thus shrinking its tax base and causing districts to raise property tax rates. She claimed recapturing funds from property-rich areas results in higher marginal tax rates, lower benefits, and a decreased desire to reside in recapture districts, creating a downward spiral of property values and tax receipts. (See appendix 1) This, she contends, adversely affects what the state is able to collect in tax payments, undermining the stability of the program. However, given that as of 2000, only 88 districts out of 965 were subject to recapture provisions, it appears that Hoxby overstates the importance of recapture as a revenue source and in doing so weakens her argument for a downward spiral in tax receipts.

Further, by not adjusting the capture threshold for inflation, Hoxby contends that the state effectively lowered the threshold over time, creating a situation that further depressed home values. Ultimately, she believes that the state will have to lower the threshold to maintain its recapture revenue. Though this criticism concerning the static threshold is valid, Hoxby’s predictions concerning home value depression simply did not come to fruition. In fact the state Legislators realized the effect of inflation on the threshold and chose to increase it to $305,000 in 2001. Despite this increase, by 2003, 118 districts were subject to recapture, a 38% increase from 2000. Therefore, this increase in the number of district subject to recapture illustrates that property values continued to rise.

Political Implications

In 2001, the Texas Center for Education Research reported that 98% of school district revenue was distributed equally among districts as a result of the reforms following Edgewood. This revenue equalization is jeopardized by the new Tier 3 funding in HB1. While the first 4 cents of the Tier 3 enrichment funding is equalized at the rate of the Austin Independent City School District, it is not subject to recapture. This will lead to increasing disparity in funding between districts because of the wide variation in property wealth. A school district such as Dew Independent School District, with over $5 million of property wealth per student (ADA) will raise significantly more per student per penny of tax effort than the guaranteed state reimbursement rate. As this extra revenue raised is not subject to recapture, the wealthier school districts will have more resources per student than will average or poorer districts, undercutting the intention of the recapture provision.

The racial implications of this increased disparity are clear. The 15 districts that have the lowest property value (average of $35,000 per student) are 85% percent black and Hispanic, while the 15 wealthiest districts (average of $2.7 million per student) are 75%

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12 Hoxby and Kuziemko, 2004. (pg. 18)
13 Imazeki and Reschovsky, 2004. (pg. 11)
14 Ibid, pg. 18.
15 Ibid, pg 12.
16 Imazeki and Reschovsky, 2004. (pg. 28)
white.\textsuperscript{18} The underlying tension between the two ends of the spectrum is exacerbated by the reliance on property taxes to fund schools. However, Texans also have a strong independent streak that, some would argue, sets them apart from much of the rest of the country. The popular phrase, “Don’t Mess With Texas” extends down to the local government level. Preference for local control of local resources plays a powerful role in the political landscape of Texas.\textsuperscript{19} As discussed previously, striking a balance between eradicating the institutional racism of property tax financed schools and maintaining local control over local resources has proved a substantial challenge.

An additional political consideration is the over-classification of students with disabilities. Hoxby contends that school districts have increased the number of students classified with disabilities since the implementation of the Robin Hood provision. (see appendix 2) Increasing the number of students with disabilities will increase the amount of weighted funding per student that the district receives from the state or is allowed to keep and thus both poor and rich districts have an indirect incentive to over assign students to special needs categories.\textsuperscript{20}

\textbf{Recommendations}

The reforms to FSP contained in HB1 raise two main concerns: how to properly fund education and how to raise enough revenue to ensure the state has the necessary resources to fund education. It is important to examine these two issues separately.

\textbf{Funding}

Providing equal dollars across districts does not guarantee equal outcomes for students. The state must ensure that it is properly adjusting the amount of aid to account for the costs of educating different types of students. Imazecki and Reschovsky show that there are achievement disparities between poor and rich districts and between districts with high and low levels of English language learners.\textsuperscript{21} Researchers from Texas A&M University showed that cost differentials for teacher salaries are not properly reflected in the adjusted cost index, either.\textsuperscript{22} This suggests that the weights used to account for these differences are not sufficient.

Failing to keep up with increasing costs of educating high needs children will place additional pressure to raise taxes on districts with high concentration of high needs children, namely, the low property value districts. Additionally, the state does not adjust these formulas for inflation, essentially reducing funding for education every year. Districts have responded to these pressures as expected by raising property tax rates each year. (see appendix 3) Therefore, the state must update its funding formula to reflect the true costs of educating its students.

Rising accountability standards associated with the No Child Left Behind Act or the possibility of a court case requiring adequacy would place additional strain on the system.

\textsuperscript{18} Aleman, 2006. (Note: 2002 to 2003 school year compiled from the Texas Education Agency School Finance and Fiscal Analysis Division.)
\textsuperscript{19} Farr and Trachtenberg, 1999. (pg. 618)
\textsuperscript{20} Hoxby and Kuziemko, 2004. (pg. 17)
\textsuperscript{21} Imazecki and Reschovsky, 2003.
\textsuperscript{22} Taylor, 2005
The previous court decisions focused on equity rather than adequacy, but these concepts are inextricably linked. The basis of requiring an equitable distribution of resources is ensuring an adequate education for all.\textsuperscript{23} That could imply more money for more at-risk students and would require significant increase in resources to property poor school districts.\textsuperscript{24} Adequacy is a difficult argument to make as it places the burden on the plaintiff to determine what an adequate education entails, however, the recent success of adequacy based arguments in New York State forges the path for other attempts. While the Texas courts found that the state funding formula was adequate in the 1995 ruling, it left the door open to revisit that decision if student achievement is lopsided across the state despite the changes in funding in HB1.\textsuperscript{25}

Additionally, recapture is a necessary, if politically unpopular, provision. Given the Texas court ruling mandating equal revenue for equal effort, the state might have to match the revenue of the highest property value district if there is no recapture. As the number of districts subject to recapture has increased despite the rising ceiling, there is little evidence to support that the recapture provision depresses property values. Therefore, the negatives of unequal funding or the extreme of finding enough state revenue to match the revenue the wealthiest districts are able to raise take precedence.

\textit{Revenue}

As mentioned previously, the first year of HB1’s implementation is predicted to cost $3.922 billion in total in fiscal year 2006-2007 while revenue from the three tax initiatives is only $0.46 billion during this same period. This results in a deficit of $3.46 billion in its first year alone. The further cuts in the mandatory property tax rate the following year will exacerbate this deficit, putting increased pressure on every following state budget.\textsuperscript{26} In fact the following table illustrates the projected costs and revenues for HB1 over a 5 year period.

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<th>Revenue</th>
<th>Net Deficit</th>
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<td>HB 3</td>
<td>HB 4</td>
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All numbers in billions of dollars. Source: LBB Fiscal Notes – HB 1 (May 11); HB 3 (April 27); HB 4 (April 29); HB 5 (May 5).

\textsuperscript{23} Farr and Trachtenberg, 1999. (pg 645)
\textsuperscript{24} Fisher, 2007. (pg. 517)
\textsuperscript{25} Haynes and Boone, 2005.
\textsuperscript{26} Center for Public Policy Priorities, 2006.
Assuming these projections are accurate, HB1’s future success and survival greatly depend on the state’s ability to alleviate this net deficit. A state budget deficit of this magnitude will place pressure on the state to not properly adjust funding formulas for inflation or changes in the cost of educating high-needs populations. One potential solution, though currently unconstitutional, is to instate a flat income tax on Texas residents. Though it may be politically unpopular and requires a constitutional amendment, this pragmatic approach could eliminate Texas’ multi-decade struggle with education finance once and for all and potentially increase the per pupil expenditure in the state which is currently below the national median. (See appendix 4) In order to cover the $6 billion deficit each year, the state would need a 1.35% flat income tax on employees. This is a low rate that the state could raise if additional resources are needed to pay for an increase in standards due to No Child Left Behind or a court ruling mandating adequacy. A flat tax is proposed instead of a progressive tax because low property value districts already receive state assistance through the funding formula.

The income tax is preferable to either increased property or sales taxes because it is less regressive, more stable, and creates fewer economic distortions. Increasing the property tax to create more revenue will subject more districts to the recapture provision. While the recapture provision has positive benefits for the equalization of wealth at the extremes, instituting an income tax avoids the possible negative effects of a drastic increase in the number of districts subject to recapture. Fully funding HB1 by using a state income tax would also decrease pressure on the recapture provision to raise revenue for the state. The state legislature could then consider increasing the recapture ceiling annually according to inflation to prevent additional districts from reaching the ceiling. A flat income tax that finances education could also reduce the perception of the previously mentioned institutional racism of the current property-based system. When compared to an increase in the sales tax, a flat income tax is not regressive and provides a more stable source of revenue. Additionally, a flat income tax would not distort among income brackets or across borders.

Conclusion

School financing in Texas has evolved over several decades through rounds of legislation and litigation. The inefficiencies and debate associated with the current system arise because both the Texas State Legislature and the Texas Supreme Court have continuously avoided the main problem, namely the state’s Constitution. Currently, Texas’ Constitution greatly limits the taxing ability of the state, ultimately at the cost of equal protection of its citizens. With these limits in place, Texas Legislators are forced to work closely with lawyers to create innovative systems of school funding that hopefully provide an equal distribution of resources. However, as proven above, these systems often have far-reaching, unintended economic consequences. Without a constitutional amendment to broaden taxing ability, Texas’ education finance system will continuously face both political and public opposition, even though neither stakeholder possesses the ability to correct the system. Furthermore, the current educational finance issue facing the state of Texas will compound as the state is required to raise additional revenue to fund education,
especially with the increasing educational standards set by No Child Left Behind requirements.

Instituting a state income tax would infuse necessary and constant resources into this fiscally unstable system. A broad based income tax can generate significant new revenue with small effort, reducing significant political opposition to future incremental rate increases as more resources become necessary. The provision of additional resources also opens the door to future changes in school funding moving away from equity and toward adequacy. With the finance system under strain to provide resources and the education of our children hanging in the balance, the time has come to make the difficult decision to fully fund their future.
Appendix 1

Effect of Robin Hood on Property Tax Bases
Property Wealth Per Pupil, Quantile 20

Note: quantile 1 is property poorest, quantile 20 is property richest

Taken directly from Carolyn Hoxby and Ilyana Kuziemko, “Robin Hood and His Not-So-Merry Plan: Capitalization and the Self-Destruction of Texas’ School Finance Equalization Plan”.
Appendix 2

Effect of Robin Hood on WADA/pupil Ratios

Taken directly from Carolyn Hoxby and Ilyana Kuziemko, “Robin Hood and His Not-So-Merry Plan: Capitalization and the Self-Destruction of Texas’ School Finance Equalization Plan”.
Appendix 3

School Tax Rate History from 1985 to 2003

Source: Carole Keeton Strayhorn, Texas Comptroller of Public Accounts, Property Tax Division

Appendix 4

Current per-pupil expenditures in membership for public elementary and secondary schools:
School year 2002-2003

National Average: $8,041
Median: $7,574

NOTE: Current expenditures include salaries, employee benefits, purchased services, and supplies, but exclude capital outlay, debt service, facilities acquisition and construction, and equipment.

School year 2002-2003
References


