

Appendix A

Proposals and Plans

- A-1. *Proposals to the Joint Select Committee on Public School Finance, 77th Legislature*
Craig Foster, public member, Joint Select Committee on Public School Finance
- A-2. *Opening Pandora's Box*
Lynn Moak, Consultant, Moak, Casey, and Associates, LLP
- A-3. *Lieutenant Governor Bill Ratliff's School Finance Proposal*
Lieutenant Governor Bill Ratliff
- A-4. *Proposal to the Joint Interim Committee on School Finance for a Comprehensive Study to Define a Basic Education*
Senator Florence Shapiro, senate member, Joint Select Committee on Public School Finance
- A-5. *Proposal to the Joint Select Committee on Public School Finance*
David Thompson, public member, Joint Select Committee on Public School Finance
- A-6. *Proposal for Alternative Education Tax*
David Thompson, public member, Joint Select Committee on Public School Finance

- A-1. *Proposals to the Joint Select Committee on Public School Finance, 77th Legislature*
Craig Foster, public member, Joint Select Committee on Public School Finance

A. Fix the major broken parts of the current system

1. Provide supplemental state assistance (SSA) to those districts that have reached their maximum M&O tax rates (generally \$1.50) and do not have local option homestead exemptions (LOHEs), (a) granting the first SSA in the second consecutive year a district is at maximum effort, (b) increasing SSA in each subsequent consecutive year, and (c) adjusting SSA so that a district that first qualifies in a later year can achieve the highest level of SSA within a reasonable period of time.

These are the districts that are truly “up against the wall”. They are the ones that have used up all the capacity the state has given them. Assuming a tight budget and no new high cost mandates for the coming biennium, it seems appropriate to take care of these districts before providing additional capacity to districts that have not used the capacity they already have.

SSA should be further adjusted to reflect the relative amount of a district’s funding disparities (See Recommendation D.) and the amount of concurrent increases in the standard funding elements.

2. In the interest of “Truth in Robin Hood”:
 - a. Make detachment and annexation (D&A) of non-residential property the only option to consolidation of districts or tax bases, with one exception: For the few districts that are Chapter 41 by virtue of residential value alone, maintain current options 3 and 4 for that portion of their recapture that cannot be achieved by the D&A of non-residential property.
 - b. Make the D&A reversible and fractional so that a Chapter 41 district’s retained wealth can be adjusted annually to the exact amount of the district’s EWL.
 - c. Prioritize property categories for D&A purposes so that small locally owned properties, like Mom ‘n Pop grocery stores, would be D&A’d last, if at all.

The truth about Robin Hood is that 90% of the need for recapture is attributable to excess concentrations of non-residential property – like minerals, utilities, and major industrial plants. Only 10% is caused by excess concentrations of residential property. Yet, today, 100% of residential taxpayers in every Chapter 41 district pay Robin Hood taxes.

Why not tell the truth about Robin Hood, deal effectively with the real source of the problem, and leave the rest of the taxpayers alone?

If this plan were in effect this year, Robin Hood taxes paid to the state or other school districts would be about \$70 million – instead of the roughly \$700 million dollars that will be paid under current law. At the same time, the annexing districts would have greater local capacity and would therefore be entitled to less state aid. The net result would be basically the same – without the political onus of massive Robin Hood taxes on residential property.

This proposal is somewhat similar to an earlier proposal that called for a “split tax roll”, where the state would tax only non-residential property and school districts would tax only residential property. An advantage of the current proposal is that it impacts only those non-residential properties that are part of the problem. Again, why not leave the rest alone?

B. Complete the task Rep. Wayne Peveto began over 20 years ago.

1. Give County Appraisal Districts and the Comptroller’s Property Tax Division the legal and financial resources needed:
 - a. to ensure that available state funds are spent to enhance the equity and adequacy of our school finance system, rather than to offset local funds lost to undervaluation
 - b. to ensure that all taxpayers contribute their fair share to the state’s public school system, allowing only for differences in local tax rates
 - c. to prevent significant, sudden losses of state aid to school districts due to circumstances for which they are not directly responsible and over which they have limited control

The resources needed include confidential mandatory sales disclosure, penalties for failure to render taxable property, powers to audit business records, and access for on-site inspection of non-residential property.

2. Establish an accountability system for County Appraisal Districts, patterned, to the extent applicable, after the accountability system for school districts, and specifically including the publication of CAD performance measures in local newspapers.

C. Codify the Edgewood equity standards

1. Formally adopt the three Edgewood equity measures as minimum standards.

2. Require the application of the same principles that guided the calculation of the equity measures for the Edgewood IV trial, regardless of changes in funding elements and policies over time.
3. Apply the standards to both the M&O component and the I&S component of the equalized system – except in the case of the total revenue gap.
4. Adjust funding during the settle-up process to ensure all standards are actually met.

D. Adopt a strategy to achieve adequacy and enhance equity

1. Adopt a strategy to exceed the current minimum standards of adequacy and equity, in response to the Supreme Court’s conclusion in Edgewood IV that “the system [under SB7] becomes minimally acceptable only when viewed through the prism of history. Surely Texas can and must do better.”
2. Use the model proposed by the Equity Center in its policy statement entitled, “Offering a Fair and Rational Strategy for Achieving Real Equity and Adequacy”. (See Appendix __.) There is no specific cost associated with the Equity Center’s plan. It simply provides a method for distributing any amount of state funds that become available, over and above the amount required to maintain the current system.

Half of available funds would be used to achieve adequacy by reducing funding deficiencies; the other half, to enhance equity by reducing funding disparities. Every district would receive some of the funds, but those who have the least would get the most.

This proposal replaces earlier versions of Proposal D, which are hereby withdrawn.

E. Find and fix other worn out or broken parts, etc.

1. Commission unbiased studies, similar to the Dana Center’s CEI Study, to determine weights and indexes that accurately reflect cost differences among students and school districts for programs, facilities, and transportation.

It is argued that some costs are more fully recognized in our current allotments than are other costs. We cannot have true funding equity until we have cost equity.

2. Investigate the distribution of funds under recapture options “3+”, “3&4”, and 4, to ensure that current practices are both legal and ethical, and that they conform to legislative intent.

3. Extend the Existing Debt Allotment indefinitely and base state assistance on actual current debt service, not prior I&S tax history [as in Sec. 46.034(b), Education Code].
4. Reject proposals to define “adequate” funding as any amount less than the amount at a very high percentile of students nationally, adjusted for generally recognized cost differences.
5. Establish a School Finance Commission to find and correct unintended and disequalizing consequences before they take effect.
6. Close the loopholes in the state’s current tax system as a first step toward providing increased state funds for public schools.
7. Minimize “surpluses” in the second year of a biennium by developing accurate projections of property value changes, and distribute whatever small surpluses may then occur by increasing the yield per WADA for each penny of M&O tax effort by the same amount for each school district.

These changes were made to the proposal following the presentation to the committee on February 7, 2002.

Equity Center Policy Statement
Offering a Fair and Rational Strategy for Achieving Real
Equity and Adequacy

A proposal for distributing new state funding in a way that will provide adequate and equalized educational funding for all Texas children

Overview

This proposal focuses on the way new state resources, when available, can be distributed so that all Texas children, over time, will have access to similar resources for their education. The method addresses the concern that, for reasons totally unrelated to differences in the costs of providing educational services, there are numerous specific areas in which the current system arbitrarily fails to fund some schools as well as it does others. *Ironically, every school district experiences the negative impact of one or more of the components of this phenomenon*, although some districts are affected to a more significant degree.

First priority – meeting the growing costs of the current system. The first priority for new public education funding would, of course, be to maintain the current system, including enrollment growth and other areas of increased cost to the state. Whatever new money is available after that would be divided into two equal portions for *adequacy* and *equity*.

Adequacy – increasing funding levels across the board. The first half of the remaining money would be distributed to all school districts through increases in the Equalized Wealth Level (EWL), Additional State Assistance (ASA), Basic Allotment (BA), and Guaranteed Yield Level (GL) in such a manner that any two districts with the same tax effort, *irrespective of wealth status*, would receive the same increase in revenue per WADA. (ASA was enacted in 2001 as a means of including Gap districts in across-the-board funding increases.)

This new funding would allow all districts to counter the impact of inflation and to meet new state mandates, higher accountability standards, and growing community expectations.

Equity – eliminating funding disparities. The second half of the remaining new money would be used to move all districts to a common funding level by removing funding disparities in a way that would ensure that *every district would gain revenue*, and *those that have the least would gain the most*.

Proposals for Eliminating Existing Disparities

1. **Establish a uniform yield for all districts.** School districts receive the bulk of their M&O funding based on a variety of levels of “yield” per WADA for each penny of tax effort. There is, in effect, a per-penny per-WADA yield for all of Tier 1 (except transportation and one-half of CEI), Tier 2 is a traditional “guaranteed yield” component, and Chapter 41 districts’ effective yields are reflected in the amount of the Equalized Wealth Level (EWL)—or, in some cases, a “hold-harmless” EWL. Every district should have access to a uniform yield that is at a high enough level to provide for quality education. Until such time as a better measure can be determined, that yield should be set at the average yield available to Chapter 41 districts. *That means that all Chapter 42 districts and more than two-thirds of Chapter 41 districts will benefit from this proposal.*
2. **Fully fund the Transportation Allotment for every Chapter 41 district.** The Transportation Allotment of every Chapter 42 district is fully funded. Chapter 41 districts obviously have transportation costs, but with a few exceptions their Transportation Allotments are not funded at all because of the way recapture is calculated. The Transportation Allotment of every district should be determined the same way and should be fully funded.
3. **Extend the full benefits of the CEI to Chapter 41 districts.** Chapter 42 districts receive the full benefit of the CEI adjustment in Tier 1 while Chapter 41 districts receive only half the benefit, again because of the way recapture is calculated. Chapter 41 districts should benefit from the CEI to the same extent that other districts do.
4. **Extend the Mid-size District Adjustment to Chapter 41 districts.** Chapter 41 districts are not eligible for the mid-size district adjustment, although they experience the same diseconomies of scale that Chapter 42 mid-size schools do. They should receive this funding.
5. **Equalize the impact of ASF Per Capita distributions.** Most Chapter 42 districts never see their Available School Fund per capita money because the state uses it to help pay the *state’s share* of the district’s Tier 1 allotments. Chapter 41 districts, on the other hand, get all of their per capita funds – in addition to the amount of tax revenue they retain after recapture. Chapter 42 districts should be treated the same as Chapter 41 districts. Their per capita funds should be *in addition to* – **not included in** – their Tier 1 allotments.
6. **Eliminate Set-Asides.** Chapter 42 districts lose part of their Tier 1 state aid to set-asides. Chapter 41 districts are not subject to set-asides, yet all Chapter 41 districts receive services financed by set-asides, and some receive grants for programs funded by set-asides. These services and programs should be funded through direct state appropriations, and set-asides should be eliminated so that each district receives its full allotments.

How the Distribution of Equity Funds Would Be Determined

A funding target would be established for each area of disparity, in most cases simply by using the best funding practices of the current state system. By comparing each district's level of funding with the target for that area, a per-WADA deficiency for that area can be determined. The total of these deficiencies for the individual areas would be the difference between where a district currently is funded and where it should be funded. The Equity portion of the new state funding would be dedicated to erasing this deficiency by distributing the money to the districts in proportion to the amount of their deficiency.

For example, a district with a \$1 million deficiency would get twice the benefit as a district with a \$500 thousand deficiency. This practice would send the most new money (per WADA per penny of tax effort) to the districts currently receiving the least. It will also ensure that *every* district has a stake in eradicating the disparities until true and complete equity is achieved.

By removing these funding disadvantages, Texas can move to a system that recognizes real costs and ensures that all districts have a fair and equal access to the state's resources. *And, the state can achieve this while allowing those districts currently funded at more advantageous levels to retain more of their M&O tax collections.*

Summary

Funding for Adequacy: *One-half of all new state funding in a given biennium (after the current system is maintained) should be dedicated to raising the Basic Allotment, Guaranteed Yield, and Equalized Wealth Level so that each district's increased benefit (per WADA and after allowing for disparities in tax effort) is the same.*

Funding for Equity: *The remaining half of new state funding should be dedicated to erasing the funding disparities, listed above, in a manner that would ensure that new money would go to all districts in proportion to the deficiencies in their current funding levels.*

A-2. *Opening Pandora's Box*
 Lynn Moak, Consultant, Moak, Casey, and Associates, LLP

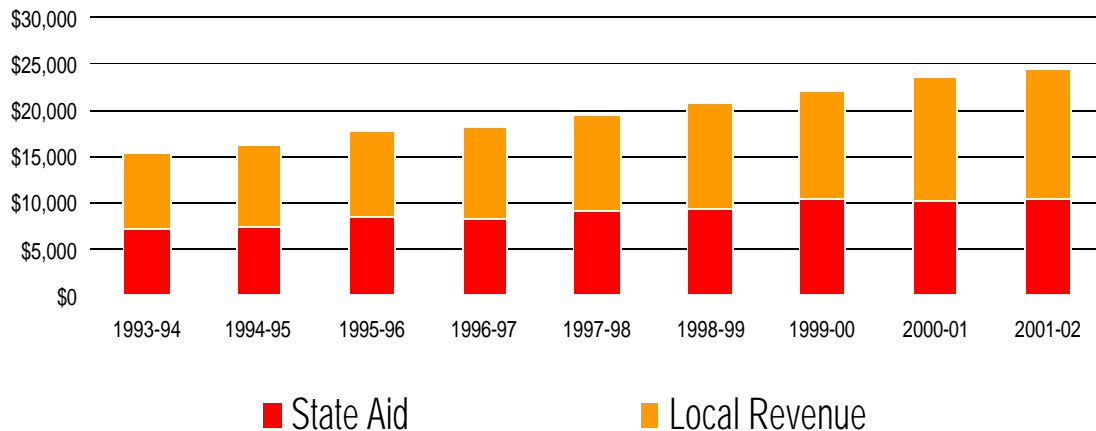
The Goal (42.001 TEC)

- Provision of a thorough and efficient school finance system substantially financed through state revenue resources that
 - Provides equality of access to programs and serves related to student needs
 - Adjusts for local economic factors
 - Provides equal access to similar revenue at similar tax effort for similar students

The Reality of our Current Situation

- System is not substantially financed with state revenue resources unless the property tax is a state tax
- Access to equal programs and services needs improvement
- Revenue equity disparities have not improved since enactment in 1993

Meeting the Demand for Operating Funds (in millions)



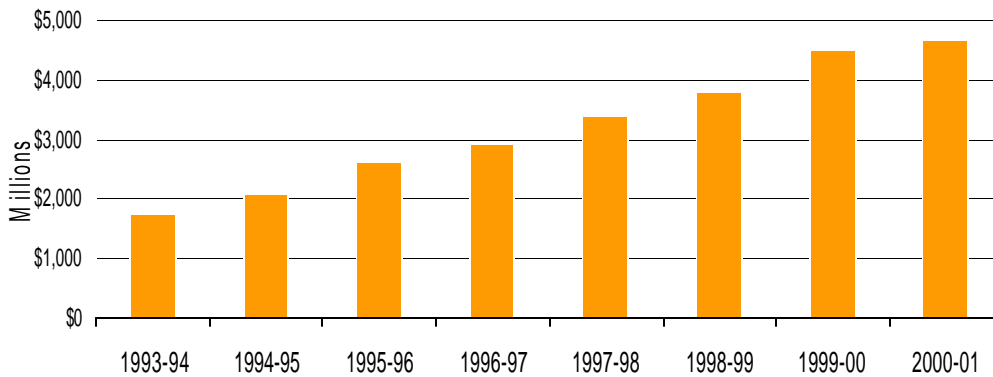
Utilization of State System Revenue Capacity by Type of School District

DISTRICT TYPE	PERCENT OF TOTAL CAPACITY			
	2001-02	2000-01	1999-00	1994-95
A-Major Urban	99.4%	93.7%	93.1%	82.5%
B-Major Suburban	98.7%	96.2%	95.5%	88.4%
C-Other Central City	97.4%	93.5%	93.2%	83.3%
D-Other CC Suburban	96.7%	92.5%	92.2%	83.1%
E-Independent Town	96.1%	91.5%	90.8%	80.8%
F-Non-Metro Fast Growing	96.0%	92.3%	91.2%	82.4%
G-Non-Metro Stable	95.3%	89.4%	88.0%	79.5%
H-Rural	94.0%	88.2%	87.6%	77.5%
STATE TOTALS	97.6%	93.3%	92.6%	83.3%

Utilization of State System Revenue Capacity by Type of School District

District Type	Percent of Total	
	2001-02	1994-95
A-Major Urban	99.4%	82.5%
B-Major Suburban	98.7%	88.4%
C-Other Central City	97.4%	83.3%
D-Other CC Suburban	96.7%	83.1%
E-Independent Town	96.1%	80.8%
F-Non-Metro Fast Growing	96.0%	82.4%
G-Non-Metro Stable	95.3%	79.5%
H-Rural	94.0%	77.5%
<i>State Totals</i>	<i>97.6%</i>	<i>83.3%</i>

Meeting the Demand for Facilities and Equipment



Challenges of the Next Decade

- Growth and inflation
 - 70,000 net growth in student population
 - Average projected inflation and wage rates of 3 percent or more
- Staffing
 - 16 percent turnover rate
 - 24 percent new teachers not fully certified
- Performance mandates
 - New TAKS standards
 - No pass-no promote starts in 2003
- Additional facilities
 - 100,000 newly-enrolled students
 - \$3 billion+ LA trend

A Basic Design for School Finance

- Maximizing the educational dollar
- Determine areas of state financing versus state/local financing
- Establish target revenue for regular student funding from state and local sources
- Adjust for student differentials
- Adjust for community differentials
- Assure equity
- Provide for facilities
- Find the money

Issues in Maximizing the Educational Dollar

- Extra-curricular activities
- Non-instructional costs e.g. transportation
- Distance learning
- Organizational inefficiencies
- Unit cost of facilities
- Lack of incentives for efficiency

Issues in Financing State Priority Areas

- Local contribution to retirement financing
- Technology versus textbooks
- Health insurance employee choice funds
- Special funding arrangements for:
 - Subject area initiatives
 - Technology
 - Program areas: hearing- and sight- handicapped education, Pre-K, 9th grade
 - Current compensatory education setasides

Issues in Financing State Priority Areas

MC&A recommends consideration of:

- Full state financing of retirement benefits with employee share
- Creation of flexible textbook funds for technology
- Incorporate special programs into state-local framework

Issues in Defining the Base Funding Level

MC&A recommends consideration of:

- Basic funding level available for 2002-03
- Add inflation at 3 percent per year
- Add needed program support

- Add equity adjustment to eliminate “gap” by 2006-07
- Equals 5-year target

Student Cost Issues

- Separate weights for gifted education and career and technology education
- Current compensatory education, set asides, 9th-grade funding, bilingual education, and migrant adjustments
- At least ten different weights and instructional arrangements for special education
- Half-day support for disadvantaged Pre-K, with separate grant program

Student Cost Recommendations

- A broad-based, flexible high school weight
 - » Elimination of the career-and-technology education and gifted-and-talented education weights
- Adopt at-risk weight and LEP weight with increased funding
 - » Replace current bilingual and compensatory education weights with an expansion to funding for state performance initiatives
- A simplified weighting system for special education
 - » State assumption of costs for very high-cost students
 - » Provision for hearing- and sight-handicapped children
- Full-day support for disadvantaged 4-year olds

Community Cost Issues

Examine the justification/rationale for:

- Cost-of-Education Index based on ten-year old district data
- Differential applications to Tier I, Tier II, and Chapter 41
- Current patchwork of small, large area, sparse, and mid-sized adjustments
- Transportation formula based on 1984 cost levels

Community Cost Recommendations

MC&A recommends consideration of:

- Restudy of small “by choice,” small by area, and sparsity definitions
- Adoption of modified adjustment for district size up to 5,000 students
- Cost-of-Education Index based on updated data
 - » Examination of regional and urban/rural adjustments
- Updated transportation formula based on current cost levels

Equity Issues

Examine the justification/rationale for:

- Different yields for Tier I and Tier II
- Failure to include transportation impact in Tier II and Chapter 41
- Basis for providing funding advantages based on wealth
- Recapture level and procedures (hold harmless, credits, partnership arrangements, etc.)

Equity Recommendations

MC&A recommends consideration of:

- Establishment of single-tier system based on projected per-student costs translated to revenue yields at specified tax rates
- Eliminate gap in operational funding by 2006-07
- Maintain current equity relative to debt service funding

Facilities Issues

Examine the justification/rationale for:

- Under-funded IFA
- Exclusion of equipment and administrative facilities from IFA definition
- Separate procedures for funding long-term IFA and EDA commitments
- Use of statutory basis for long-term bond commitment
- Highly-limited state role with regard to administration, information, and technical assistance

Facilities Recommendations

MC&A recommends consideration of:

- Establishment of single-tier facilities funding (IFA and EDA) with constitutional authorization
- Inclusion of equipment and administrative facilities in new debt
- Modification of IFA shortfall procedure
- Automatic rollover funding of “old debt” (EDA)
- Constitutional guarantee for state/local partnership
- Modest expansion of TEA role and staffing

Property Value and Tax Rate Issues

Examine the justification/rationale for:

- Use of school finance system to influence appraisal district behavior

- Use of artificially-defined property values to measure taxpaying capacity
- Use of calculated tax rates for the purpose of equalization

Property Value and Tax Rate Recommendations

- Use of actual local property values, exclusive of optional exemptions
- Use of actual tax rates, except in the case of optional exemptions
- Funding strong state monitoring/compliance effort for appraisal district administration (potential constitutional amendment)
- Significant funding adjustment for fast-growing districts if current-year values are used

Long-Term Revenue Principles

- Need for balanced tax structure for education support
 - Return to historic partnership level of approximately equal state and local shares
 - Commit substantial new state revenue sources to property tax reduction
- Trust the people
 - Provide voters with the opportunity to fund quality education, while reducing reliance on property tax revenue

Potential Revenue Sources

- Property tax
 - Reduction
 - Increased enforcement tools should be considered
- Sales tax
 - Consider exemptions
 - Internet taxation
- Business taxes
 - Create “equal and uniform” treatment of business entities
- Income taxes
 - Constitutional amendment for property tax reduction and school improvement

Six-Year Implementation Plan

- Recognize 2003 economic and political barriers
- Keep pace with enrollment and the marketplace
- Scheduled improvements in equity
- Implement rational changes in formula structure
- Develop new revenue initiatives

A-3. *Lieutenant Governor Bill Ratliff's School Finance Proposal*
Lieutenant Governor Bill Ratliff

Opening Statement before the Joint Select Committee
on Public School Finance

- First, let me thank the members of the Joint Select Committee for your service here. This is an impressive group of some of the most knowledgeable people in Texas as regards the funding of our public schools. I sincerely believe, if there is a better solution to this continuing question, you have the horsepower to find it.
- Some members of the Joint Select Committee have, in the past, asked me if I had any particular instructions or proposals for them to pursue. My response was that they should not be constrained in looking for a solution. However, they should be pragmatic in that any proposal should have some reasonable chance of passage through the Legislature, and should either be constitutional or there should be some reasonable chance of passage of a constitutional amendment to make it so.
- Until now, I was reluctant to present any suggestion to this committee, because I did not want to stifle any of the members' creative juices. By doing so today, I earnestly appeal to you to give this suggestion no more weight than any other suggestion. I hope you will dissect it and determine its weaknesses, applying the same scrutiny with which you study other proposals put forward.
- While David Thompson in particular, as well as Craig Foster and others, have come forward with suggested creative modifications, the suggestions to date, which I have been made aware, all appear to be variations of the current plan.
- If we are to address the features of the current system which the Governor and others have criticized as unfair and inequitable, it would seem that the first order of business would be to identify the current system's unpopular features. As the person whose name appears as the author of Senate Bill 7 (affectionately dubbed "Robin Hood"), I believe I am as qualified to itemize such problems as anyone, since I have certainly heard most of them. Any plan presented should be evaluated as to its chances of addressing these objectionable features.
- Before I discuss with you the litany of problems with the current system which I have heard over the years, I must say that I apologize to no person for having authored Senate Bill 7. I am convinced that it was the only plan, short of a personal income tax, brought forward in 1993 which would have kept the public schools open. While I will not go so far as to say that the "Robin Hood" plan saved the state of Texas from a personal income tax (as Senator Bivins has stated), I do know that there were many, many knowledgeable people in Texas who believed that a personal income tax was the only way out of the dilemma we faced in 1993.

- Senate Bill 7 was finally passed by the Senate on May 27, 1993. It was finally passed by the House on May 28, 1993. You may note that this final passage was in the final hours of the 1993 regular session, and its passage was under the very real threat of a court-ordered closure of Texas' public schools as the alternative.
- Because of the atmosphere surrounding its passage, some people have stated that Senate Bill 7 was always intended as a stop-gap measure, only intended as a temporary fix until a final solution could be found. While almost everyone, in 1993, wished for a solution more universally accepted, this plan was only as temporary as most other laws passed by the Legislature. That is, it was intended to be in place until someone came forward with something better.

Difficulties Posed by the Current School Finance System

- 1). Poorer districts continue to believe that the gap in educational opportunity between their students and the students of wealthy districts is too great, is increasing, and is unconstitutional.
- 2). Wealthy districts continue to believe that there is no justification for their districts being required to raise local property taxes to pay for a quality educational program, and then to send a sometimes large share of such proceeds either to the state or to other, less wealthy districts.
- 3). Wealthy districts believe that the statutory cap on local school property tax rates is keeping them from offering a quality education, since they must send a portion of their local tax proceeds to the state or to less wealthy districts.
- 4). Wealthy districts believe that poorer school districts are not exerting the same local taxing effort as wealthier districts, but expect to be able to spend as much as their wealthier counterparts by virtue of receiving additional money from the state or from wealthier districts.
- 5). Many citizens believe the state should pay a greater share of public education costs, but recent increases in local property appraised values, without proportional increases in state funding, have resulted in a declining share of public school educational costs being borne by the state.
- 6). Past Supreme Court decisions have criticized the state's lack of financial assistance to districts for debt service. The current IFA and EDA Allotments, while assisting with debt service, pose difficulties for school districts in that they cannot advise their bond election voters whether they will receive state assistance in their debt payments being authorized.

- 7). Few people, even in the Legislature, understand how the funding formulae work, resulting in poor public perceptions because misinformation is so difficult to refute.
- 8). When the Legislature attempts to adopt financial assistance to school districts (Gov. Bush's reading initiative, state funded teacher pay increases, state subsidized teacher health plan, etc.), the methodology for doing so becomes extremely convoluted because such assistance must be conveyed to the districts in a manner which does not violate (or attempts to circumvent) the "substantially equal access" ruling of the Texas Supreme Court. These convoluted methodologies further complicate the formulae and increase the opportunity for misinformation.
- 9). It is very difficult to allow any type of local property tax abatement, no matter what the cost-benefit ratio of such treatment, when such corporate subsidies amount to grants of state dollars given by local entities, and such subsidies, if allowed, would result in large inequities across school districts.
- 10). While there are good ideas for improving the current system, as long as the local property tax is a major component of the funding, and as long as we are required to meet the "substantially equal access" constitutional test, most of the above difficulties will continue.

A Plan

Submit a constitutional amendment to the voters having three parts:

- 1). Abolish the current local school district authority to levy a property tax for maintenance and operations (leaving the current authority for debt service in place).
- 2). Authorize the Legislature to levy a statewide property tax for the sole purpose of funding the public schools of Texas.
- 3). Grant the Legislature the statutory authority to allow school districts to levy a local property tax for educational enrichment, not to exceed \$0.10 per hundred dollars valuation.

By Statute, Enact a School Funding Methodology with the Following Features:

Statewide Property Tax: Levy a statewide property tax of \$1.40 per hundred, the proceeds from which, when added to the general revenue appropriation, would constitute the foundation school program funding.

Tier One-Basic Allotment: Distribute the equivalent of \$30 per penny (for the 140 pennies levied) per weighted student to school districts to cover their base

maintenance and operations budgets. When transportation and other adjustments are made, this would allow the distribution of about \$4,275 per Weighted ADA (\$6,085 per student) which is, on average, about \$115 per WADA more M&O revenue than is currently available to poorer school districts.

Tier Two–Local Enrichment: Allow school districts, *by local option election*, to levy up to \$0.10 per hundred local enrichment property tax. For those school districts whose tax base is less than \$300,000 per WADA, the state will guarantee such a district a yield of \$30 per WADA per penny of tax rate.

Tier Three–Debt Service Allotment: The state will guarantee a yield of \$35 per penny of tax rate per ADA for all debt service on educational facilities, up to thirty pennies.

Teacher Health Plan: The Legislature should consider levying an additional statewide property tax (above the \$1.40 in Tier One) in order to fully fund a state paid teachers' health insurance plan equivalent to the state employee plan.

A-4. Proposal to the Joint Interim Committee on School Finance for a Comprehensive Study to Define a Basic Education

Senator Florence Shapiro, senate member, Joint Select Committee on Public School Finance

Background:

As a result of the findings in the Edgewood lawsuits, Texas public school finance reforms have almost exclusively dealt with the constitutional principle of equity. We have made great strides in the area of equity, however we have failed to properly address the equally important principle of adequacy. It was assumed that by continually adding resources to the current system to meet equity standards, we had satisfied the adequacy requirements and effectively provided students with a basic education.

Despite Texas's detailed curriculum standards and the implementation of an advanced accountability system, there is still only a tenuous connection between Legislative funding and how those dollars work in the classroom. The level of funding provided by the Legislature must have some relationship to the costs associated with achieving certain levels of student performance.

Proposal:

The time is now for policymakers to decide what components constitute a basic education. Only after this has occurred can the Legislature ever know whether or not we have funded an adequate education for the children of Texas.

The state of Texas should conduct a comprehensive study using national experts and the four currently existing models to help us "cost out" the price of a basic education.

The Successful Schools Model

The Professional Judgment Model

The Econometric Model

The New American Schools Model

This proposal asks the Joint Interim Committee on School Finance to recommend a commissioned study by an outside party to define a "basic education" and report back to the Legislature.

FOUR ADEQUACY MODELS

(1) Successful Schools/Empirical

Created by John Augenblick

This strategy is to identify the cost structures of school districts that are successful. After excluding the outlier districts, both rich and poor, in terms of wealth and per-pupil expenditure, the remaining districts are scoured to see which have been successful in terms of student performance. Then, you look to see how much was spent per pupil in these successful districts. The basic idea is that if a group of districts with a variety of pupil characteristics can succeed with \$X per pupil, then other district should also be able to do so. The underlying assumption is that any district should be able to accomplish what some districts do accomplish.

LBB is currently conducting an abbreviated version of this model as part of their biennial look at school finance, however they are not looking at a district's programming, only finances. While the effort on the part of the LBB is to be commended, a study of this nature can only be effective when programming is considered. Data submitted to this committee at the one of our public hearings shows that the average per pupil expenditure for a Ch. 42 exemplary school district is \$6536. Without knowing more, this figure is somewhat hollow.

(2) Professional Judgment

Created by James Guthrie and Richard Rothstein

This approach simply gathers school professionals together to discuss and reach consensus on what inputs are needed for an adequate education and then they price those inputs. If, for example, the professionals decide (based on research or experience) that elementary class sizes of 15 is needed, they plug that in. If they decide that if there are so many disadvantaged kids an extra classroom aide is needed, they cost for that factor also.

(3) Econometric

Created by William Duncombe and John Yinger - very similar in theory with the Dana Center's CEI study

This approach uses regression analysis (a statistical technique used to find relationships between variables for the purpose of predicting future values) to identify a per-pupil spending level that is sufficient to produce a given level of student performance. This would take data from all districts or schools in a state and explicitly takes into account socioeconomic factors associated with districts and schools. The research also accounts for the varying purchasing power of the education dollar across districts. The findings indicate what an adequate expenditure level would be for a district with the average sociodemographic and student characteristics of the state; the spending level varies by the level of student performance desired. This method also calculates district by district how

much more or less is required - because of such factors as special needs of students, economies of scale, input prices, and even efficiencies.

They have developed a very sophisticated analytical technique to determine empirically how much extra money schools should be provided when they face high-cost problems that are beyond their control - like needy pupils and high wage costs.

(4) New American Schools Model

Created by Allan Odden

Advocates basing school costs on popular, off-the-shelf models for school improvement. Odden has "costed out" the expenses involved in all seven of the designs supported by New American Schools, a private group based in Arlington, Va., that promotes innovation in public schools, and calculated the investment needed to bring every school district in the country up to the same spending levels.

All seven models start out with a basic staffing level of one principal and 20 teachers for a school of 500 students. The design also calls for a full-time technology coordinator, one art and one music teacher, an investment in computer technology and staff development etc. etc. etc. The model then comes up with a price tag, not only for a single state, but to bring all schools across the country to this level.

This plan calls for more federal dollars into education.

Other States Embrace Adequacy

Over the last decade, many states have addressed the adequacy question, either on their own accord or through the direction of their respective state Supreme Court. Here are a few examples of states that have used the national models to frame the adequacy issue.

Illinois (2001) - The Illinois Education Funding Advisory Board, which was charged with producing a school finance report to the state legislature, including recommended changes to the state's school finance system, used the Successful Schools Model. The legislature wanted to re-evaluate school funding in the state in light of the emergence of testing and standards for Illinois schools and students. Prior to the study, Illinois was spending \$4,425 per student and the study recommended a funding level of \$4,600 per student (excluding at-risk students).

Louisiana (2001) - The Louisiana State Board of Education, as part of a statewide re-evaluation of its foundation formula, conducted an adequacy review based on the Successful Schools Model.

Oregon (1997/2000) - The Oregon Legislature wanted answers to the following questions: How much money do schools need, where is the money currently going, what are the

performance results from education spending, are targets being met and is the state properly fulfilling its obligation to provide a quality education for every student in Oregon. The Legislative Council on the Oregon Quality Education Model conducted a study based on the Professional Judgment Model. The commission was composed of 23 educators, lawmakers, business leaders and parents. Prior to the study, Oregon was spending \$5,216 per student, and the study recommended increasing funding to \$5762 per student.

South Carolina (2000) - In South Carolina, the School Boards Association wanted a study of the cost school districts might face in complying with the requirements of the Education Accountability Act of 1998. Using a Professional Judgment Model allowed the School Boards Association to influence state policies on the implementation of state standards and in the future debates on school finance.

- A-5. *Proposal to the Joint Select Committee on Public School Finance*
David Thompson, public member, Joint Select Committee on Public School Finance

INTRODUCTION

The present system of public school finance in Texas is designed to produce precisely the results that it is currently producing. The present system is designed to capture the capacity to raise revenue that is represented by the potential of the local ad valorem property tax and bring that revenue into an equalized system. Stated another way, the system is designed to produce a high level of equity at high local property tax rates.

This present structure has functioned reasonably well for nearly a decade. However, serious structural problems are becoming evident that will result in significant harm to our state's children, educators, and communities unless addressed by the Texas Legislature. The most obvious problem is that, as more and more school districts approach their maximum legal tax rates (in most cases, \$1.50 for maintenance and operations), the system simply doesn't work anymore. Since the present structure was adopted by the Texas Legislature in 1993 and implemented in the 1993-94 school year, the yield, in real dollars adjusted for inflation, of both the basic allotment and the guaranteed yield have decreased. Consequently, school districts have raised rates to pay for growth and inflation. Once districts reach their maximum tax rates, the system will be out of capacity, and districts will have little choice but to reduce some existing programs to pay for increased costs in other areas.

In spite of these significant problems, our current system is not broken. It is not necessary to attempt to replace our local property tax system, which continues to be strongly supported by most Texans and which is closely linked to our concept of local control of public education. What is needed are strategic adjustments that will allow our system to grow over time, that will limit further shifts in overall support of public education from the state to the local property tax, and that will meet current and future legal requirements.

State revenues and local public school revenues are not **B** and cannot be **B** the same thing, since the state cannot levy an ad valorem property tax. However, the state may rely, to some extent, upon local public school revenues to achieve the state's purpose of providing "a general diffusion of knowledge" through an "efficient" system. This shared responsibility for a foundation program is a feature of the Texas system and most states' systems, and should be maintained.

In preparing this proposal, I have tried to take into consideration five values that are important. Others may articulate these same concepts differently, but I believe that we all support a system that is built upon the principles of equity, adequacy, efficiency, capacity and legitimacy. Equity simply means, are we dividing available resources in a fair way? Adequacy means, do we have enough resources to accomplish the purpose that we intend? Remember that Edgewood IV seems to equate adequacy with "a general diffusion of knowledge," which in turn is equated with the cost of an accredited program and must

reflect changing times, needs, and community expectations. Efficiency means, are the resources being used in a non-wasteful and productive way? Capacity means, does the system have room to grow over time to meet inflation, the costs of new programs and increased standards, such as the recommended high school curriculum, and improvements in existing categories of expenditures, such as salaries and benefits? Closely related to the concept of capacity is the idea of some local discretion in raising and spending local property taxes. Remember that Edgewood IV cautioned that, if districts lose the discretion to raise and spend local property tax funds for purposes important to their communities, the system could become unconstitutional once more. Finally, legitimacy means, is the system accepted and supported by those who are subject to it? To date, our system has enjoyed great support from students, parents and taxpayers, as witnessed by the overwhelming passage of large bond issues in all parts of the state. However, as more districts reach their legal tax limits and constituents see programs reduced in their local schools while increases in property taxes only serve to save the state money, legitimacy may become an issue.

Of these five values, the principal current problem is lack of capacity. Any proposal to revise the current system should be evaluated first to determine if it increases the capacity of the system.

ASSUMPTIONS

For purposes of this proposal, I am assuming that, as Mr. Steve Smith testified at that Committee's first meeting, the Texas system, with all of its complexity, accounts for many of the variations between districts and students for which other states' systems do not account. We should attempt to reduce only that complexity in our system that no longer serves a useful purpose, while maintaining the complexity that legitimately recognizes these differences.

Further, in terms of the level of funding that is necessary, I have not attempted to calculate a number to use statewide as the cost per student of a constitutionally required system. Rather, I have relied on a variation of the professional judgment model. I believe that most unnecessary waste and inefficiency has been squeezed out of our system in the past decade and that, for the most part, districts choose to spend those funds that they believe are necessary to accomplish their educational mission and meets the expectations of their communities. However, in addition to making necessary adjustments immediately in the system, it may be useful to conduct a periodic study of the cost of meeting the state's accreditation/accountability requirements, to ensure that the "general diffusion of knowledge" is provided in a system that also retains some meaningful local discretion.

Finally, I have attempted to meet what I understand to be the legal requirements set by the various Texas Supreme Court decisions, particularly Edgewood IV. This decision represents not so much a shift or departure from earlier opinions, but rather an extension or progression of those opinions. In particular, Edgewood IV contains the Court's most explicit and lengthy discussion of issues that are only broadly mentioned in previous decisions, such as the level of funding that is necessary, the role of unequalized

enrichment, and recapture of local property tax revenues. The Texas Legislature has not comprehensively revised the system to reflect any of these issues that are discussed in Edgewood IV.

PROPOSAL

With these assumptions in mind, I propose the following revisions to the existing Texas public school finance system.

First, modify the system to operate as a one-tier system. While there may have been a rational distinction between the two tiers in 1993-94, no such distinction exists today. The two-tier approach only adds unnecessary complexity. Further, I propose using the same definition of WADA in Tier 2 as in Tier 1; apply the CEI to 71% of Tier 2 and count transportation in Tier 2.

Second, revise the recapture mechanism. Edgewood IV suggests that recapture may be both necessary and appropriate up to the level of "a general diffusion of knowledge," but becomes less so at higher levels of tax effort. The present system gives a Chapter 41 district an incremental advantage at every penny of effort. I propose that, up to an effective tax rate of \$1.40, the equalized wealth level (or recapture level), translated into a yield per WADA, and the guaranteed yield level should be the same, so that there is no difference between Chapter 42 and 41 districts up to that level of effort and there are no "gap" districts. At effective tax rates above \$1.40, I propose raising the equalized wealth level as a Chapter 41 district approaches \$1.50. In essence, as a district gets closer to its legal taxing limits, it should be permitted to retain more of the property tax revenues that it generates. Please note that this increase in the equalized wealth level at tax rates above \$1.40 could apply either to a district's total effective tax effort, not just to the incremental effort above \$1.40, or only to the incremental effort.

Third, I propose establishing statutory increases in the guaranteed yield level for a five-year period for Chapter 42 districts. Such statutory increases will give districts stability over time so that they are able to plan effectively. Further, consistent increases in the guaranteed yield level should tend to push districts away from their legal tax rate limits, thus keeping some capacity and discretion in the system over time.

Fourth, if the legislature does not appropriate funds for any school year for the statutory increase in the guaranteed yield level, the maximum equalized wealth level for that school year, regardless of a Chapter 41 district's effective tax effort, would drop to the wealth level per WADA that corresponds to whatever funding level for the guaranteed yield level that has been appropriated. For example, if the guaranteed yield level were statutorily scheduled to increase from \$32 per WADA to \$33 per WADA, but the legislature did not appropriate funds for this statutory increase, the maximum equalized wealth level would drop to \$320,000/WADA, regardless of a Chapter 41 district's effective tax effort. If the legislature subsequently appropriated funds for the statutory increases in the guaranteed yield level, the maximum equalized wealth level would increase as provided above.

Fifth, I propose that the roll-forward each session of EDA be made automatic, so that a true debt tier is created and all debt is covered.

Sixth, I propose that the new cost of education index (the salary and benefits model recommended by the Dana Center) be adopted. Further, as discussed by the Committee, a statutory mechanism should be created to base the CEI on a rolling average of three to five years data, so that the model stays reasonably current, but also changes gradually over time as circumstances change. Also, the CEI should identify regional indices, in addition to or instead of indices for each individual district.

Finally, I propose creating a new hold-harmless for all school districts. If a district is taxing at a nominal tax rate of \$1.50, it would be guaranteed the prior year's state and local revenue per WADA, plus 3 to 5 percent to cover growth and education inflation. This guaranteed increase would include, and would not be on top of, any increases in the guaranteed yield level. Further, if a district received an adjustment in any year because of any local option exemption, the amount of any such adjustment would not be guaranteed under this hold-harmless.

CONCLUSION

As you may expect, the potential cost to the state of this proposal is significant. However, any such increase in state aid is necessary to reverse the erosion of the state's share that has occurred over the past decade and to recognize that the capacity of the local property tax to generate additional revenues is approaching its limits. The basic framework is simple: a one-tier approach to reduce unnecessary complexity; guaranteed funding levels for at least five years, so that districts can plan effectively; increased recapture at lower tax rates, but reduced recapture at higher rates; and, general protection for all districts as they approach their legal tax rate limits, so that the state commits to be a true partner in sharing the cost of public education and takes up the burden that local taxpayers can no longer bear. I believe that this approach will increase the capacity of the system, will provide stability over time, will provide immediate relief to all districts, and will explicitly tie the future of Chapter 41 and Chapter 42 districts together.

Fellow Committee members, I appreciate and respect each of you for your long service and commitment to improving our state's public school system. If you have any questions, or if I may provide additional information, please let me know.

Thank you.

A-6. Proposal for Alternative Education Tax

David Thompson, public member, Joint Select Committee on Public School Finance

I would like to propose for the Committee's consideration the creation of an alternative education tax. This tax would be imposed and collected at the state level, would be dedicated to public education, and would be voluntary for individual taxpayers. Also, I am assuming that it would be approved by the voters of the state in the form of an amendment to the Texas Constitution.

We have heard repeatedly in the Committee that local ad valorem property taxes are too high, that many districts are approaching their legal tax limits, and that the current system, which relies so heavily on such taxes, is rapidly running out of capacity. I generally agree with these sentiments. These problems must be addressed by the state. However, it also has occurred to me that the property tax has one advantage compared to some other existing and potential taxes for individual Texans -- at least it is deductible on federal income taxes for individuals who itemize. I would like to propose the creation of a new state tax that would be deductible, and that taxpayers could elect to pay instead of a current nondeductible tax, namely, the state sales tax.

The Committee has heard testimony that Texas has one of the highest state sales taxes in the United States, both in terms of its rate and in terms of the broadness of its base. For an individual taxpayer, the state sales tax may be the highest, or one of the highest, state taxes that he or she pays. As I understand it, this tax is completely nondeductible on federal income taxes for individuals. Individuals did have such an exemption, but it was eliminated, beginning in 1987. Efforts to restore the exemption have been made from time to time at the federal level, but have not been successful. The state sales tax impacts businesses somewhat differently than it impacts individuals. First, much business activity is excluded from the sales tax. With regard to federal income taxes, if a business pays a sales tax on capital items, it is my understanding that the business would normally capitalize the tax along with the remaining portion of the purchase price, and that cost would be depreciated or amortized over the life of the capital items. If a business paid such a tax on items that are normally expensed, such as supplies or taxable services used in a trade or business, the tax would be deducted along with the cost of the items.

I am proposing the creation of a voluntary state personal income tax, based upon an individual's adjusted gross income as reflected on his or her federal income tax return. The obvious question is, why would anyone choose to pay a state personal income tax? In my proposal, if a person elects to pay the voluntary tax, he or she would receive a rebate of his or her state sales tax. In essence, each taxpayer could choose to pay a deductible tax instead of a nondeductible tax. Even if the alternative tax were for a larger amount than the rebate of the nondeductible state sales tax, it still should be advantageous to any taxpayer who itemizes.

Here is an example. Assume a taxpayer with an adjusted gross income of \$50,000 and four dependents. Assume that thirty-three percent (33%) of the taxpayer's adjusted gross

income is spent on items subject to the state sales tax. Thus, at a rate of 6.25%, the taxpayer has paid \$1031 in state sales taxes, on which the taxpayer already has paid federal income taxes, since the sales tax is not deductible. Create a state personal income tax at a rate of 2.50%, applied to the same adjusted gross income of \$50,000, for an amount of \$1,250. If the individual elected to pay this alternative tax, the Comptroller would rebate the state sales tax of \$1031, for a net increase in funds to the state of \$219, or twenty-one percent (21%). However, the taxpayer would now be able to claim the state personal income tax of \$1,250 as a deduction on his or her federal income taxes.

Basically, every Texas taxpayer would pay either the current state sales tax or a personal income tax, but no taxpayer would pay both. Each taxpayer would pay the tax that worked best for him or her. If it is set up correctly, every taxpayer who itemizes on his or her federal income tax return would benefit from paying the state personal income tax and receiving a rebate on his or her state sales tax. The alternative tax would be tied to the economic prosperity of the state, and should grow over time as the wealth of individuals increases. Further, I understand that, nationally, about twenty-four percent (24%) of all individual taxpayers itemize on their federal tax returns, while the percentage in Texas is close to twenty percent (20%). There are many reasons for this disparity. I believe that one significant reason is that Texas simply does not raise money at the state level in a way that encourages individuals to itemize. I anticipate that this proposal would encourage more Texas taxpayers to itemize on their federal tax returns.

Several assumptions underlying this proposal will need to be researched. For purposes of the example above, I have used what I believe to be realistic estimates of the percentage of adjusted gross income that is spent on items subject to the state sales tax. I recognize that this percentage will vary, depending upon the income of taxpayers and the number of dependents. For example, individuals with lower adjusted gross incomes or more dependents typically spend a greater percentage of that income on items subject to the state sales tax. Thus, it would be necessary to develop a table of imputed sales taxes that takes these various factors into consideration, similar to the tables that existed in federal law for the deduction of such taxes for 1986 and prior years.

Probably the greatest single variable that will affect the amount of net state revenue that this proposal will generate is the percentage of Texas taxpayers who itemize and who will elect to pay the alternate tax in order to obtain the deduction on their federal income taxes. I do not have the resources to make this judgment, but I can identify some of the factors that will influence it. For any optional payment to be attractive to a taxpayer, it must be relatively simple and direct, and the benefit must be relatively substantial and immediate. In other words, if the net benefit to the individual were minimal and a taxpayer had to wait an entire year to order to obtain it, most taxpayers probably would elect not to pursue the alternate tax. One approach would be to make the alternate tax payable anytime during a year, but only due on or before December 31st. Further, since taxpayers would not know their adjusted gross income for the year on or before December 31st, I suggest making the adjusted gross income that is used to compute both the sales tax rebate and the alternate tax payment what is reflected on line 33 of a taxpayer's return for the prior year. The rebate of state sales taxes would need to be fairly immediate, so that

the taxpayer only bears the additional amount for a relatively short period of time, until he or she files his or her federal income tax return on or before the following April 15th.

I believe that this proposal has several attractive features. First, it aligns state tax policy with federal tax policy. Stated another way, it keeps more of our state's taxes paid by individuals who itemize in Texas helping to provide services to our children. Second, it should be relatively straightforward administratively; it does not interfere with the operation of the existing state sales tax system, nor does it affect the collection of local optional sales taxes by the state on behalf of cities and other entities. Third, it is tied to an aspect of our state's economy that should grow over time, particularly as our citizens become better educated and more productive. Fourth, even though this proposal should raise substantial additional state revenues, from the perspective of an individual taxpayer who elects to pay the alternative tax, it not only is at least "revenue neutral" in a broad sense of the term, it actually should provide a benefit. Finally, if a taxpayer has a significant philosophical objection to the very idea of a state personal income tax, without regard to whether or not he or she would benefit, that taxpayer may elect not to pay the alternate tax.

For purposes of this proposal, I am making two further assumptions. First, although it could be argued that a constitutional amendment is not required since this alternate tax would be optional with each taxpayer, as a practical matter I am suggesting that a constitutional amendment be placed before the voters for three reasons: first, to obtain their approval; second, to address any ancillary statutory and/or constitutional issues (such as, does it create an "equal and uniform" problem for some taxpayers to pay one tax and other taxpayers to pay an alternate tax), and; third, to establish any protections necessary to avoid potential abuse of this alternate tax structure in the future. Also, I am assuming that at least a letter ruling from the Internal Revenue Service would be necessary, to assure individuals that the alternate tax really would be deductible from taxpayers' federal income taxes.

I appreciate the Committee's consideration of this proposal. I fully recognize that many members of the Committee know far more about tax issues than I do, and I look forward to suggestions to improve the concept. I also anticipate that the Comptroller's Office and the Legislative Budget Board have substantial expertise that will be helpful. If this is a bad idea, I take full responsibility. If it is an idea that has some merit, I know that many others will have a greater role in its success than I will. As always, thank you for your leadership and personal commitment to the schools of Texas and the children that they serve.