

School Finance Reform in an Imperfect World

By William P. Hobby and Mark G. Yudof

School finance reform in Texas is beginning to resemble a nineteenth century Russian novel. The story line runs across generations, the plot is complex, the prose is tedious, and everybody dies in the end.

Forty years after the enactment of the historic Gilmer-Aikin reforms, the Texas Supreme Court held in *Edgewood Independent School District v. Kirby* (1989) that current methods of financing public schools, relying extensively on local property taxes, were inefficient and violated the Texas Constitution. The problem is that the dollars spent on the education of each student largely depend on the property wealth of his or her school district. Poor districts tax at higher tax rates than affluent ones, only to raise fewer dollars for education. In order to correct this situation, the court held that there must be substantially equal access to resources; the system must be "fiscally neutral" in the sense that each penny of tax effort in a poor district should raise substantially what a penny raises in a more fortunate district.

In response to *Edgewood I* the Texas Legislature enacted Senate Bill 1 in 1990. The bill essentially provided that, by the year 1995, a penny of tax effort in even the poorest district must yield the same amount per student as it would for the student in the district at the 95th percentile of wealth. If a property tax of \$1.00 per hundred dollars of assessed value produced \$2500 per pupil in District A (a district at the 95th percentile of wealth), then it should yield \$2500 in District B--even if District B has only a fraction of District A's property wealth. This is accomplished by the state "guaranteeing the yield;" it makes up from state revenues the shortfall between what a poorer district can raise on its own and the specified guarantee at the 95th percentile.

In January 1991 the supreme court overturned Senate Bill 1 in the *Edgewood II* case, thereby corroborating Voltaire's maxim that "the best is the enemy of the good." At the 95th percentile reform was expensive but feasible without turning the educational system upside down. By requiring equalization at the tail end of the distribution--the equivalent of using Ross Perot's income as the standard for wealth redistribution, the sums required become gargantuan unless serious structural reforms are undertaken. Nonetheless, the court held that the property wealth of the wealthiest districts may not be excluded from the state-wide tax base, and it suggested that the legislature consider tax base or even school district consolidation. The bigger the taxing entities, the less disparity in wealth among districts and the easier it is to accomplish fiscal neutrality.

Edgewood II arguably went well beyond what any other state supreme court had required in similar circumstances. But the story does not end there. Months later, in considering a motion for rehearing, the court affirmed its view of 60 years that the state may not "recapture" a portion of what is raised in the most affluent districts and redistribute it to the poorer districts. The net effect of this decision was to say that the legislature could achieve compliance with the Texas Constitution in only three ways: (1) the state must assume all or most of the responsibility for funding public education, presumably generating the needed revenue through a new state tax; (2) consolidate school taxing jurisdictions; or (3) consolidate school districts. The Legislature chose option 2 in Senate Bill 351, creating cumbersome county-wide education districts (and a few larger aggregations). These county districts were required to tax at a minimum of \$.72 per hundred dollars of valuation, while the old school districts remained intact for purposes of supplementing that tax and governing local public schools. About two-thirds of the cost of reform was placed on local taxpayers.

The bill had the effect of increasing property taxes geometrically in the most affluent districts, significantly raising taxes in urban areas such as Dallas, Houston, and Austin, placing caps on educational spending in the highest spending districts, and dramatically reducing the expenditure gap between poor and rich districts. The latter equalization occurred because a portion of the funds collected by the counties in affluent school districts will be redistributed to other districts in the same county.

Senate Bill 351 came under attack from districts disadvantaged by the new plan, and many astute observers who attended the recent oral argument in the supreme court believe that the court will overturn the new law. The state constitution forbids a state-wide property tax, and the court may hold that the county districts are a disguised form of state property taxation. If this occurs, the effective choices for the Legislature will be reduced to genuine school district consolidation--a measure only marginally more popular in Texas than Saddam Hussein is in Israel--or a state income tax.

How did we end up in this fix? The core problem is the Edgewood II decision, and the court should overrule it. It is of trivial importance as to whether the property wealth of the richest districts is included within the system for financing public education. The focus should be on how to achieve fiscal neutrality in expenditures, not on whether it is efficient to undertax some property. Eschewing perfection and meaningless symmetry, the court should return to the "substantially equal" standard of Edgewood I and accept the basic conceptual framework of Senate Bill 1.

Senate Bill 1 is not the definitive answer, but it is the right starting point. Perhaps the level of equalization should be higher than the 95th percentile, perhaps we need better or fairer measures of equity, perhaps the phase-in period should be shorter, and perhaps the legislative promises in the out years need to be more concrete and specific. The point, however, is that, as things stand under Edgewood II, the combination of the quest for perfect equity and the gradual elimination of policy options by the court has resulted in a politically unstable situation. A taxpayer revolt is a real threat. Many legislators and state elected leaders are so traumatized by the first three rounds of Edgewood that they may refuse to enact any plan in response to an Edgewood IV, leaving it to the court to bring order to the apparent chaos. Even if political leaders wish to act, legislative stalemate may ensue. And the net result will be years of political and fiscal uncertainty without great promise of substantial gains in equity.

Most importantly, the court needs to speak with clarity. In the current crisis, it is not enough to declare what is unconstitutional; the court should say what is constitutional. Carl Parker, chairman of the Senate Education Committee, says that he wants to surrender to the court on the school finance issue. The problem is that the justices will not tell him where to turn himself in.

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Written in 1991.