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How Education Choice Affects State and District Budgets

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Key Points

- Various forms of educational choice programs, grants, tax credits, vouchers, or savings accounts similarly affect school district and state budgets.
- The budgetary effect on the public school district of each educational choice decision is exactly the same as if a student moved out of the district.
- School finance is one of the most complex issues in state government; much confusion exists regarding the impact on both state and local school district budgets from various forms of educational choice.
- Although most Texans think in terms of local and state funding for schools separately, such is only true for facilities funding.

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Introduction

School finance is one of the most complex issues in state government. Because of that complexity, much confusion exists regarding the effect on both state and local school district budgets from various forms of educational choice. This paper is intended to help illuminate this issue and explain the 'how and why' of fiscal effects on the state and local public schools.

From a theoretical perspective, consumers might elect to receive educational services from several alternatives to the public school district in which they reside and pay taxes. For example:

1. A dissatisfied consumer could move to another school district in search of preferred services;
2. If available, a parent might select a public charter school, though state law significantly restricts charter start-ups and over 100,000 students are currently on waiting lists (Texas Charter School Association);
3. Parents might choose to home-school their child; or
4. Parents might choose a private school or other private service providers.

Number 4 is greatly restricted due to the way education is currently funded; however, if Texas laws were amended, parents could have much greater discretion regarding maximization of educational opportunities for their children. As has occurred in about half the states, parents could be empowered to use tax funds, now held in trust for the education of their child, to educate that child through one or more educational delivery programs (Friedman Foundation, 125-128). Such private choice options might include Education Savings Accounts, Tax Credit Scholarships, Tuition Grants, or School Vouchers.

Although the details for these various options vary, the fiscal effect of each of these four choice options—district transfer, charter, home school, and private choice—are very similar. In fact, the effect on the public school district of residence is exactly the same for every one of these options. In each instance the public school district would retain facilities funding (I&S), but would lose both the state share and the local share of maintenance and operations (M&O) funding for that child. This is true because the state funds the marginal cost of every child through the Foundation School Program (FSP) funding formulas (Legislative Budget Board, 233).

> The effect on the public school district of residence is exactly the same for every one of these school choice options. In each instance, the public school district would retain facilities funding (I&S) but would lose both the state and the local share of maintenance and operations (M&O) funding for that child.

For example, let's assume a district has 50 kids in average daily attendance (ADA) and the FSP formulas indicate that district is entitled to \$8,000 per ADA. As Figure 1 summarizes, that produces a budget of \$400,000 for maintenance and operations (M&O) for that school district. If local M&O property taxes yield \$200,000 then the state would make up the difference and send \$200,000 to the district. If one student were to move out of the state, the new FSP funding level for the district would decrease by one student and the new budget would be \$392,000. Local taxes would still yield \$200,000 so the state would only send \$192,000 to the district, therefore, saving the state \$8,000.

continued

Figure 1: Financial Effect of Student Transferring Out of a School District*

Chapter 42 ISD (Non-Recapture)	50 ADA	49 ADA
District's FSP Entitlement	$ 400,000	$ 392,000
Local Tax Revenue	$ 200,000	$ 200,000
State Expenditure	$ 200,000	$ 192,000
Savings to the State		$ 8,000
Chapter 41 ISD (Recapture)	**50 ADA**	**49 ADA**
District's FSP Entitlement	$ 400,000	$ 392,000
Local Tax Revenue	$ 500,000	$ 500,000
Recapture	$ 100,000	$ 108,000
Savings to the State		$ 8,000

**Assuming FSP M&O funding of $8,000 per ADA.*

Although we think in terms of local and state funding, in essence both are controlled by state law and formulas (Texas Edu. Code, Ch. 41 and Ch. 42). Foundation School Program (FSP) formulas take into consideration many factors but use both state and local funding sources to satisfy state FSP funding requirements (Ibid.). The FSP formulas allocate both state and local funds based on state criteria; therefore, the cost of each additional student who enrolls in a local school district is borne by the state (Legislative Budget Board, 233). Likewise, the state saves money for every child who leaves a public school. This is because state FSP formulas will reduce funding (not just state funding—all funding) to the district by one student (Transparency in Education Funding Sorely Missing). Figure 2 below illustrates this situation.

How various choice options affect local school district and state budgets

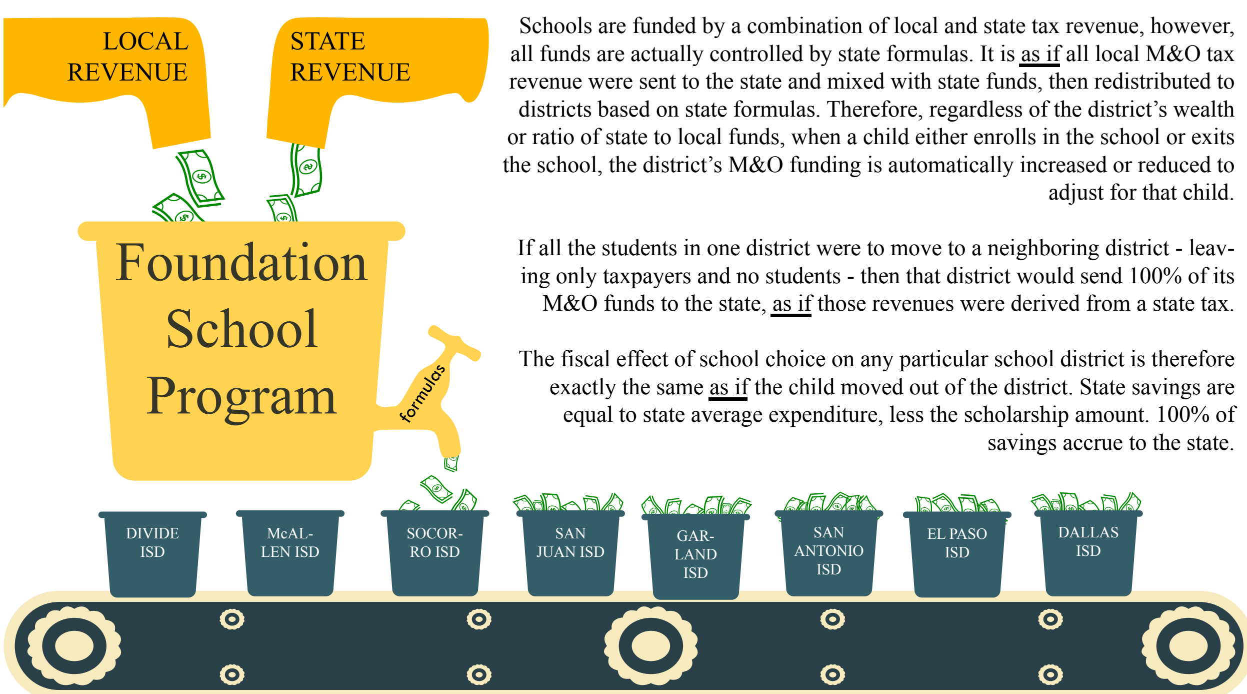
Move of residence out of state

If a student moves out of state, the Foundation School Program (FSP) funding allotment to the school district of residence will decline by one student, so the local school district would lose the maintenance and operations (M&O) funding, both state and local, for that child. Therefore the state, rather than the school district, retains the money held in trust to educate that child. The net effect is a reduction in state General Revenue (GR) needed to fund the FSP formulas.

Move of residence in-state

If the student merely transfers from one district to another within the state, then the FSP allotment (including both state and local funding) effectively follows that child to the receiving district. Hence the receiving district is entitled to additional funding consistent with the FSP funding formulas, and the district of prior residence loses funding for that child equivalent to FSP funding formulas. Such in-state transfer has no net fiscal impact on the state budget.

Figure 2: Public Education Funding – All One Pot



Charter

The effect on a local school district budget is exactly the same as if the child moved out of the district—the school district's ADA is reduced and therefore the M&O funding for that child is lost. If a student transfers from a school district to a public charter school, that transfer has no net effect on the state budget. Dollars simply follow the student from the school district to the charter school. The effect on the state budget is the same as if the child moved from one public school district to another.

Home School

The effect on the local school district budget is exactly the same as if the child moved out of the district. The school district will no longer have M&O funding (neither state nor local) available for that child. If a student leaves a public school in order to be home-schooled, the student has thereby exited the FSP system and the savings accrue to the state. Switching to home school has the same effect on the state budget as if the child had moved out of state. The FSP funds, state and local, which would have been used to educate that child, are saved and remain in the state fund thereby reducing state General Revenue needs by an amount equivalent to local and state FSP M&O.

Grants/Vouchers

The effect on the local school district budget is exactly the same as if the child had moved out of the school district. A grant, or voucher, would normally be paid from the FSP funds. Since the student is no longer in attendance, the school district of residence would no longer be entitled to funding for that child. The impact on the state budget would vary, dependent on the value of the grant or voucher and specific language in the legislation. If the voucher/grant is less than the FSP allotment, then the state would save the difference (SB 276 Fiscal Note, 1-2). Most such programs result in a net savings to the state.

Tax Credit

The effect on the local school district budget is exactly the same as if the child moved out of the district–the school district's ADA is reduced and therefore the M&O funding for that child is lost. Although slightly more complex, the end result of a tax credit program on the state budget is the same as other choice alternatives. The way most tax credit programs are structured, the state saves the difference between the FSP allotment (state and local) and the scholarship value, less outside administrative costs. State revenue is decreased by an amount equal to the value of the scholarship (plus administrative costs), thereby reducing available state General Revenue by an equivalent amount. If the scholarship cost is less than the FSP allotment, the FSP saves the entire FSP allotment for that child; therefore, the net savings to the state is the difference between the scholarship cost and the FSP allotment. (SB 4 Fiscal Note, 1-2)

Education Saving Accounts (ESA)

The effect on the school district is exactly the same as if the child moved out of the school district. Since the student is no longer in attendance, the school district of residence would no longer be entitled to funding for that child. The ESA accrues from FSP funds held in trust for the education of that child. If the ESA value is less than the FSP allotment, the state saves the difference and General Revenue needs would decrease accordingly.

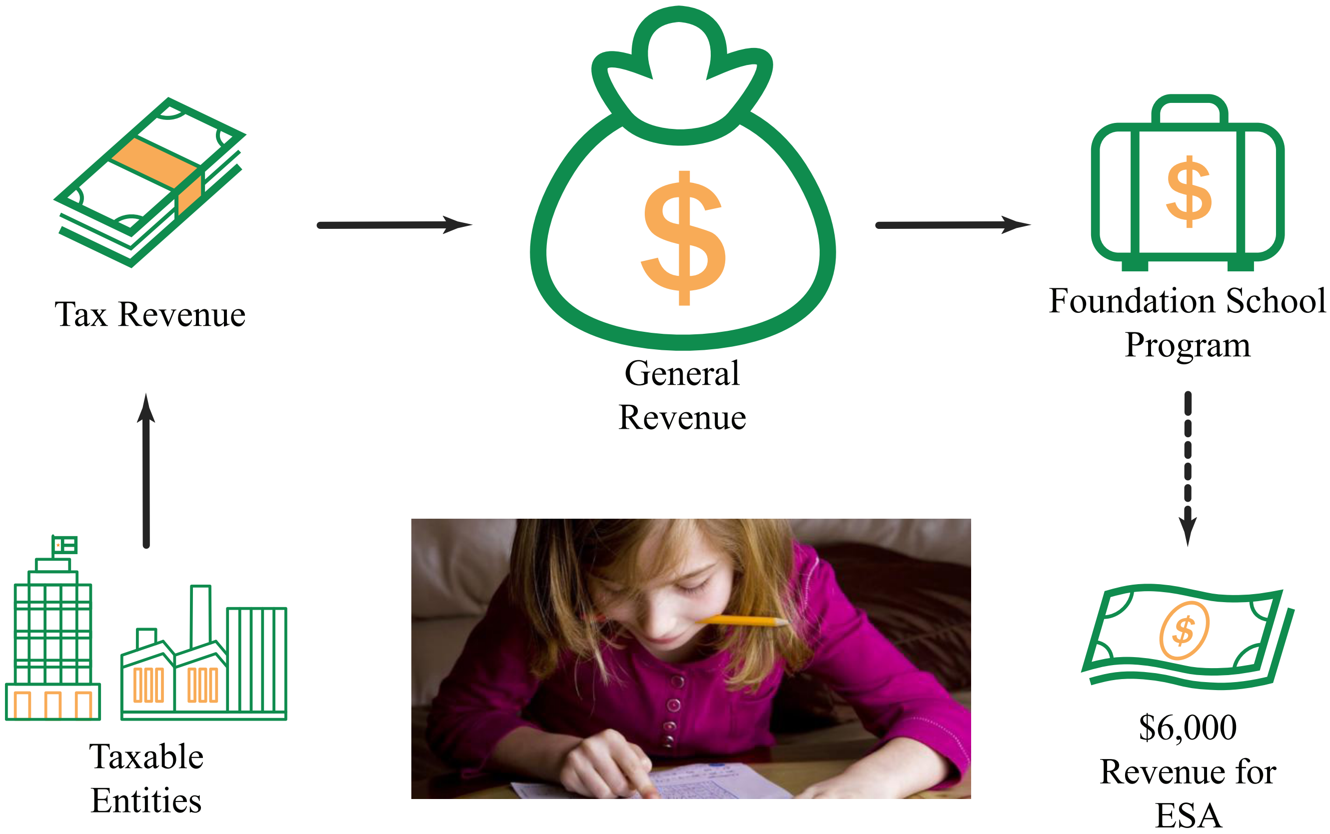
Figure 3 summarizes the effect of each choice option upon school district and state budgets. Figure 4 illustrates the effect that two of the foremost plans—tax credit scholarships and Education Savings Accounts—have upon the public education cash flow.

Figure 3: The Effect of Education Choice on State and District Budgets

Choice Action	Impact on State Budget	Impact on ISD Budget
Move from one ISD to another ISD	Wash – money goes to other ISD [Savings = FSPA - FSPA = 0]	Loss of one FSP Allotment [- FSP Allotment per ADA]
Move to Charter School	Wash --money goes to charter [Savings = FSPA - FSPA = 0]	Loss of one FSP Allotment [- FSP Allotment per ADA]
Move out of state	State saves FSP Allotment [Savings = FSPA - 0 = FSPA]	Loss of one FSP Allotment [- FSP Allotment per ADA]
Home School	State saves FSP Allotment [Savings = FSPA - 0 = FSPA]	Loss of one FSP Allotment [- FSP Allotment per ADA]
Tax Credit	State saves difference between the scholarship and FSP Allotment [Savings = FSPA - Scholarship Cost]	Loss of one FSP Allotment [- FSP Allotment per ADA]
Grant/Voucher	State saves difference between Voucher and FSP Allotment [Savings = FSPA - Voucher value]	Loss of one FSP Allotment [- FSP Allotment per ADA]
Education Savings Account	State saves difference between ESA and FSP Allotment [Savings = FSPA - ESA value]	Loss of one FSP Allotment [- FSP Allotment per ADA]

Note: *FSPA = Foundation School Program Allotment per student*

Figure 4: Effect of Tax Credit or ESA on the State Budget



The existing cash flow relevant to the present discussion is shown above using solid arrows. Tax credits redirect dollars that would go to GR; ESAs redirect state FSP dollars which flow from GR. The only difference is that tax credits draw upon the first stage of the cash flow while ESAs draw upon the last.

Assuming value for each program is $6,000 and that per student FSP funding is $8,000, then:

Under Tax Credit

($6,000)	Less GR revenue
$8,000	Less GR needed
$2,000	Savings to Texas

Under ESA

($6,000)	Less FSP revenue
$8,000	Less GR needed
$2,000	Savings to Texas

Summary and History

Although most Texans think in terms of local and state funding for schools separately, such is only true for facilities funding. Local school district property taxes collected for M&O purposes actually perform like a state property tax.

In the early 1990s, after several attempts to satisfy the Texas Supreme Court equity mandate, Governor Ann Richards and the Texas Legislature attempted to pass a constitutional amendment establishing a state property tax for education (SJR 7). However, Texas voters rejected that proposed amendment to the Texas Constitution by a two-to-one margin (Proposition 1 Backers Turn Tables).

The proposed amendment was intended to allow the state to directly collect and redistribute property taxes collected by local school districts, thus allowing the state to achieve greater equity between school districts statewide. Once defeated, the Legislature was once again searching for ways to solve the lingering school finance equity problem (Defeat of Robin Hood).

Some school districts had great property wealth from which to tax while other districts were very poor (*Edgewood I*, 392-393). Therefore many politicians wished to simply redistribute wealth from one district to another; however, the state was constrained by prior precedent, *Love v Dallas,* which prohibited the spending of tax revenue collected in one district being spent in another school district. With the voters overwhelmingly rejecting their proposed solution, and faced with a court-imposed deadline less than a month away, political leaders were in a quandary (Proposition 1 Backers Turn Tables).

Someone finally came up with a very complex scheme which could potentially allow for such redistribution without the necessity of amending the Texas Constitution. Perhaps by requiring a public vote in the rich districts, which would authorize each district to either send cash to a poor school district or to the state in order to rid themselves of excess wealth, the state could accomplish its redistributionist goal. Under this scheme, and through the election process, taxpayers in each district would be granting permission to spend their money outside the district, thereby hopefully avoiding violation of the *Love v. Dallas* precedent (SB 7). In order to assure that taxpayers in rich districts comply with this new state requirement, they were faced with forced consolidation of their school districts if they failed to approve the scheme at the ballot box (Texas Edu. Code Ch. 41, § 004(b); Ch. 41, § 251).

When this was being debated, in 1993, the Legislature had intermittently been under court order for six years due to the unconstitutionality of the school finance system (Edgewood Case Chronology). Therefore, a majority of legislators believed this scheme was worth trying and passed SB7. This creative recapture process, dubbed Robin Hood, was upheld by the Texas Supreme Court in its *Edgewood IV* decision.

Although we think in terms of only rich districts participating in recapture, effectively all school districts are recapture districts because all M&O funds raised locally are allocated in accordance with state formulas (Texas Edu. Code, Ch. 42).

By controlling all school district funds through the FSP, and through recapture of excess wealth, the same objective was achieved as if the state property tax constitutional amendment had passed at the ballot box in 1993. If a district's revenue exceeded what the state tax would have delivered then the district must send that excess revenue to the state, or otherwise rid itself of that extra wealth. If a district's revenue yield was less than what the state property tax would have yielded then the state makes up the difference (Ibid.). Bottom line, state law and state funding formulas control how local M&O funds are allocated.

After many failed attempts, the state accomplished equity for school districts by redistributing available wealth among school districts while retaining the illusion of local property taxes. Therefore, revenue from local M&O taxes are like an off-budget expenditure by the state. They are controlled by the state and affect state finances without equivalent transparency. ★

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Texas Edu. Code Ch. 41, § 004(b); Ch. 41, § 251.

About the Author

The Honorable Kent Grusendorf The Honorable Kent Grusendorf is a senior fellow in and director of the Center for Education Freedom at the Foundation's Center for Education Freedom.

Grusendorf spent most of his professional life in Arlington as a businessman and successful entrepreneur. Three months after graduating from college he started his own business, in the aerospace industry, and has been an independent businessman ever since. In 1986 he and friends started a bank, now known as Southwest Securities FS Bank, where he served as chairman of the board through much of the banking crisis of the 1990s.

He represented Arlington for 20 years, 1987-2007, in the Texas Legislature where his primary interest and focus was education. In his freshman term, due to his prior service on the State Board of Education, he was viewed as a leader on education issues. Through his appointments, by three governors and three House Speakers, to the House Public Education Committee and various Select Committees, he played a significant role in crafting legislative responses to the Edgewood I, Edgewood II, Edgewood III, Edgewood IV, and West Orange Cove school finance court decisions.

On the national level he was first appointed to the Southern Regional Education Board (SREB) by Governor Clements. He was reappointed to the SREB by Governors Bush and Perry and also served on the SREB's Executive Committee. Grusendorf also served a term as chairman of the American Legislative Exchange Council (ALEC) Education Task Force. During his last two terms in the Texas Legislature he served as chairman of the House Public Education Committee. During his tenure in the Texas Legislature he carried education accountability/improvement initiatives for four governors: Clements, Richards, Bush, and Perry.

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