

# **Thinking about School Finance in Texas**

Eric A. Hanushek

Stanford University and University of Texas at Dallas

October 22, 2003

School finance in the United States has been in turmoil for thirty years. Three things have contributed if not caused this turmoil. First, the courts have become very active participants in the design of school finance policy, and this is not something they are particularly well-equipped to do. Second, court decisions have reinforced a more general tendency to centralize school decision making at the state level. Third, school finance has been largely divorced from considerations of the performance of schools. The result has been that the outcomes have been disappointing both in terms of the levels of student achievement and in terms of measures of equity across schools. The State of Texas of course knows many of the problems, and I believe it is a very good sign that the Governor and the Legislature are prepared to address the issues.

The topic of how best to finance the schools of Texas is clearly a huge one with many facets. I cannot hope to discuss all of them here today. I will attempt to outline some of the larger issues, and I am prepared to address in more detail any specific aspects that you might wish.

By way of background, I have been involved in school finance and school policy issues for over three decades. I am trained as an economist and have taught general public finance and the economics of education at the U.S. Air Force Academy, Yale University, the University of Rochester, and most recently Stanford University. I am also a member of the Koret Task Force on K-12 Education of the Hoover Institution, a group charged with coming up with new ideas about how to improve our schools. Over this time I have conducted research on both the finance of education and on student performance in a wide variety of settings. Most recently, over the past six years I have

worked at the University of Texas at Dallas analyzing aspects of student performance in Texas.

## **Perspectives on Finance**

A variety of perspectives are relevant for the school finance debate, and the legislature must essentially consider them all. First, the view that I personally believe is most important in finance discussions is that of educational policy, and specifically of incentives to improve performance. Second, school finance can be viewed from the revenue side – the equity, efficiency, and politics of how funds are raised. Third, school finance can be considered in terms of pure spending opportunity and equity.

I will spend most of my time on the first issue, because I believe that there is a strong tendency, particularly when the debate involves the courts, to neglect the implications of finance for the efficiency and learning outcomes of schools. Simply put, the way that schools are financed including the overall levels of funding can influence the choices that schools make and ultimately how much students learn. Let me start, however, with a few comments on the other two issues.

The tax and revenue side is, for the most part, not an issue of educational policy, but it clearly has a strong influence on the political debate and on citizens' views of fairness. Conceptually, there are a wide range of choices available to a state to raise funds for schools, but in most states these choices are clearly influenced by history and political perceptions. One set of important decisions is what tax instrument to use. A second is how much is raised by the state and how much is raised by localities. A final set is essentially who pays for the funding.

Most states use a mixture of state and local taxes. Basic state funding ensures that a minimum amount of funding is available for all schools and generally is designed to equalize the impact of the specific location on funding decisions. States also tend to raise funds to compensate for specific aspects of differences across districts, such as special needs populations. The local part of financing allows citizens to be more closely involved with educational decisions and to express their own specific choices in terms of demand for education.

You are obviously well-versed in issues about the politics of changing property taxes, sales taxes, or the use of income taxes. I would be willing to talk about specific kinds of taxes, but I am not sure that I can be as useful in that as in other aspects of the finance issue.

I will just point out one specific aspect of the tax side of the equation that is important for the perceptions of fairness and the politics of finance. As a starting point, it is obvious that everybody would prefer to pay less tax (as long as the amount of spending on schools is same). People can in fact find some tax bargains, when they can get others to pay for spending on their schools. This happens, for example, if citizens can charge commercial and industrial property to support local schooling or if they can get tax payers elsewhere in the state to pay for their schools. But if one community looks attractive from the tax side (because nonresidents appear to be paying a large portion of the bill), many citizens will want to move into that district, and the price of land and homes in the district will be bid up. In effect, citizens are prepaying part of their tax bill through higher home prices. Then consider what happens when the legislature changes the rules, perhaps because of a court judgment on school funding. The new rules will

advantage some new districts and disadvantage some of the old, tax-attractive districts. This leads to changes in the values of houses and, if large, leads to natural political outcry. The result, as you well know, is people are outraged about “robin hood” and other elements of the change in circumstances. One implication is that any change in taxes will necessarily alter who is paying how much and will have implications for political support. Larger and more abrupt changes tend to hurt specific groups more.

The opportunity and equity side have frequently been made the centerpiece by courts and by the natural discussion in the legislature. Since this relates directly to the main messages of my testimony, I will simply underscore one idea: Do not think that this is that same as discussing educational policy. The distribution of spending across districts is only vaguely related to the amount of learning provided in different communities.

With that, let me turn to my main message about how what you are doing may or may not affect the learning outcomes of the students, whom I believe are the people who should be most important in these debates.

## **What Has NOT Worked**

Let me start with a quick listing of the policies and actions that have not worked. At this point I am judging “working” by results in terms of student learning and performance.

The list begins with a central fact: spending and inputs are not good indicators of school quality and thus cannot be a reliable focus of policy making. While I think many now appreciate this, there are some who are still surprised to be told that resources are not closely related to effectiveness within the current system. This holds nationally, and

it holds in Texas. It also makes the job of the legislature more difficult, because it is not sufficient to decide just on the level and distribution of spending across districts.

A closely related fact is that state regulation of schools has generally been ineffective in improving performance. Attempts, for example, to regulate teacher quality through teacher certification requirements have not in general assured that all students have high quality teachers. Other notions such as mandating lower class sizes across the state have great political value but, according to available evidence, cost much too much for the educational gains that can be expected.

One specific aspect of this, perhaps more obvious in Texas than in most states, is that communities differ widely in their populations, in their educational needs, and in their preferences for how to run their schools. This makes it very difficult to dictate school policy from Austin, because the “average” policy will generally not be the most appropriate for many communities.

This causes an obvious conflict for you as legislators, because you have taken on the job of making decisions that are in the best interests of the citizens of Texas. And, you rightfully want the schools to be as good as possible. It does have direct implications for the kinds of decisions you want to consider and for the need to involve local schools and communities in the decision process.

Finally, there is much discussion about “adequacy” in education. This discussion resonates with courts and legislatures, because it suggests that there are fundamental principles that can be used to determine how much should be spent on education. Let me be very clear about this. Adequacy is not something that can be determined by science. It is not something that I can come here and provide you with. The amount that is spent

on education is at its heart a political decision. It is one that I as a scientist might have my own personal feelings about, but it is not one where scientific investigation can or should be substituted for the political decisions that you are charged to make.

## **Basic Principles and Specific Application**

The most important element in my mind is “*do not lose sight of student outcomes in your debate about school finance.*” The primary reason why you are giving the attention that you do to school funding is that you correctly realize that schools have a huge impact on the future well-being of Texans. As I will discuss momentarily, Texas has one of the best developed accountability systems in the nation. This accountability system should be preserved and strengthened. It should also be, in my opinion, used in the finance system to develop better incentives to improve school outcomes.

Discussion of the educational policy aspects of finance leads naturally to a discussion of the incentives that are set up. Financing creates incentives for districts and individuals to take action, and the hope is that these actions are ones that support improved student achievement. In simplest terms, incentives that reward student achievement encourage people to pursue higher achievement. Those individuals doing exceptional jobs should be recognized and encouraged.

What should be avoided are incentives that simply get people to do things to attract more funding without directing actions toward achievement. A prime example, seen in many places, is that reimbursement for special education can cause more special education identification. This happens when the reimbursement exceeds the costs of providing services and when the handicapping condition is fuzzy. But other similar incentives can distort educational policy without improving student outcomes.

A key element in providing incentives and linking them to financing is having sufficient information. Texas already has a testing and accountability system that leads the nation. This is extraordinarily important and is key to developing a strong financing and incentive system. Related, Texas has the capacity to begin developing the kinds of information that districts and the state department need to improve schools. I return below to the research and accountability linkages that are important in this regard.

Another element of any financing system is obviously a recognition of unavoidable cost differences across districts. Schools located in tougher labor markets, for example, must pay extra to attract good teachers. Similarly, a variety of both urban and rural districts face cost differences related to the scale of district operations. A solid financing system should take such things into account, although, as pointed out below, this takes some care so as not to introduce other incentives.

Finally, in terms of general principles, I think it is important have an escape clause. The system must be able to respond to students that have not been well-served. Where schools fail there must be a mechanism to offer them a chance of learning.

## **Some Specifics of Finance**

There are a variety of ways of developing a system that addresses these principles, and I do not pretend to know the one that will work best for Texas. I can, however, give some examples that illustrate the principles.

One simple idea is linking the funding of students to the student so that basic aid follows the student if he or she moves to a different school. Thus, for example, the basic aid for a typical student might be set at a given amount regardless of the specific school attended. This aid amount could then be adjusted, say, for a small number of cost

differentials: district size, perhaps density, and labor market differences in teacher salaries.

What one wants to avoid, however, is an overly complicated system that sets up incentives for districts to change the “labeling” of students or the basic education that is provided. This problem, for example, plagues special education. Options such as basic block grants to districts for most special education along with “insurance” to districts for readily identifiable, very high cost students make sense because they do not encourage new labeling. Also to be avoided are rewards for failure. If, for example, the financing system provides extra funding for low achieving students, districts face an immediate conflict.

Rewards can be built into the basic system by paying bonuses to teachers who perform at a high level – i.e., those who get large *gains* in achievement. These bonuses can be structured in a variety of ways, such as at the school level or the individual level. But by providing direct add-ons for performance, the incentives are more directly aligned with the objectives.

A related option is providing choice to students and parents. The current system already provides some through the provision of charter schools, although limits on this place a ceiling on what can be achieved. The advantage of more choice is that parents are then enlisted in working along with the basic accountability system to ensure high performance. The accountability system provides the needed information but does not ensure that things improve. Regulatory action and/or bonuses for performance enhance the possibility of improvement. So does the possibility that parents will react.

In reality there is currently choice for a large majority of Texas citizens through their decisions on residential location. This does not work well for disadvantaged students whose families have fewer options, or for rural students who are constrained by density of other students. Expanded school choice options could directly help both of these groups. But it would also help the majority of families who can achieve choice by also incurring the expense of a move.

Finally, I would encourage you to think about a school failure clause. If the accountability system points to schools that are failing, the students in those schools should have options to move. Some of this is built into the requirements of the *No Child Left Behind Act*, but they take a long time to kick in -- longer than the time available to a number of the current students. An individual student gets only one chance through the system, and attention should be directed to providing that student with a make-up chance if the school fails. My personal preference would be to provide a voucher to students in schools judged a failure for two consecutive years, similar to the plan in Florida.

## **Exploiting Accountability to Evaluate the System**

The testing and accountability system in Texas has been a jewel. Only a handful of states had such systems when Texas began, and few states have introduced systems subsequently that are comparable.

But the system is vulnerable. There are a number of people who simply do not want information about student performance to be publicly available. They produce polemical "analysis" with the purpose of crippling, if not eliminating, the accountability system. We saw some of this when Governor Bush was running for President, and we have seen it repeated since.

One clear defense against this is ensuring that competent researchers have access to the data generated by the accountability system. The spurious claims of the detractors can then be put under the spotlight and revealed for what they are.

There is another important aspect of this. An accountability system can point to places where improvement is needed but, by itself, will not indicate how to correct any deficiencies. Indeed, it is difficult for people within troubled schools to know what to do. Sometimes they try a change of personnel. Sometimes they try the introduction of new programs. They have trouble learning from the choices of other schools.

Research and evaluation employing the accountability data can do that – separate effective from ineffective programs and identify important elements of school quality. We have examples in the research produced by the Texas Schools Project at the University of Texas at Dallas. More examples are on the way. The newly established National Center for Educational Accountability, for example, is beginning to move along the directions established by the UTD Texas Schools Project.

This research and evaluation work is not something that can be effectively done by TEA, but it is essential that TEA and other State agencies continue to cooperate in ensuring researcher access to data . A number of important legal and policy issues arise, such as maintaining appropriate safeguards of confidentiality of individual records, but these are scientifically manageable. (Responsibly dealing with these issues has been a central thrust of the UTD Texas Schools Project, and we have developed what we believe are model procedures).

## **Conclusions**

Simply stated, you have an enormous opportunity to build on the already strong accountability system. By linking the finance of schools to results, you can move the nationally recognized schools of Texas even farther ahead. The danger always is that a number of people will counsel you to develop policies that would lead in the opposite direction.