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A Brief History of California's Education Finance System

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This issue brief series is part of the California 100 initiative. The purpose of this brief is to foster conversations about the future of education in California. You may read the full report here.

Overview

California is unique in that it has a direct democracy system that allows voters to make important policy decisions that in other states are typically left up to legislators. This means that in California, many of the most important school finance decisions have been made through the ballot initiative system, where voters have played a significant role in deciding how early childhood education, K-12 schools, and community colleges are funded. It also means that school finance policies enacted through the initiative system are much more difficult to amend or alter. In this issue brief, we review the major propositions passed by voters over the last 50 years that influence school finance in the Golden state. We also briefly review important legal challenges and laws passed by the legislature that have molded the shape of school finance (for a more complete list of the propositions, court decisions, and laws that affect school finance in the state, see the Finance Appendix Tables 1-3).

A brief history of California's education finance system

Throughout much of the mid-20th century, revenue for California's school districts predominantly came from local property taxes and voter-approved special taxes, alongside a modest apportionment from the state (Brunner & Sonstelie, 2006; Timar, 2006). Over time, wide disparities in local revenue generation grew at the district level—wealthy districts had higher assessed property values than low-wealth districts and were more likely to raise additional funds by voting to increase tax rates or by passing other special revenue generating measures (Brunner & Sonstelie, 2006). In 1971 the state Supreme Court ruled that such disparities in local revenue generation violated the equal protection clause of the Fourteenth Amendment in the landmark *Serrano v. Priest* court case (Henke, 1986).[1] The decision fundamentally transformed the design of K-12 financing from a decentralized system in which local communities raised the majority of revenue for schools via property taxes to a state centralized system whereby the state legislature would play a large role in determining the equalization of per pupil funding across K-12 districts (for more information, see Timar, 2006). Shortly after the Serrano decision, the legislature passed Senate Bill 90 in 1972, which increased state aid and created a 'revenue limit' system that equalized per pupil revenues across districts (Sonstelie, Brunner, & Ardon, 2000).

[1] There were actually three decisions that were a part of this case. The first was in 1971, the second decision came in 1976, and the final court decision was in 1977. For more information, see Henke (1986).

Following the final *Serrano* decision, in 1978 voters passed Proposition 13 to limit increases to the residential and commercial property tax rate across the state, and to give the legislature authority to allocate property tax revenue between local jurisdictions (Brunner & Sonstelie, 2006).[2] More specifically, Proposition 13 capped property tax rates at one percent of a property's purchase price, with increases in the assessed value thereafter capped at two percent per year or capped at the rate of inflation, whichever is lower; the law also gave the state government authority to allocate locally generated property tax revenue (Chu & Uhler, 2016). While the purpose of Proposition 13 was to limit government spending and tax increases, the new voter-approved constitutional amendment put further pressure on the state to fund K-12 education from the General Fund. The composition of K-12 revenue before and after *Serrano* and Proposition 13 illustrates the profound transformation that took place: Up until the 1970s school districts were 60 percent financed by local revenue, 34 percent was provided by state revenue, and 6 percent from federal revenue (Timar, 2006). Today, local revenue accounts for only 32 percent, the state provides 58 percent, and the federal government contributes roughly 10 percent (Legislative Analyst's Office, 2019).

Shortly after the passage of Proposition 13, in 1979 state lawmakers passed SB 154 and AB 8, which set in place property tax distribution rates between school districts, cities, counties, and special districts based on county-wide allocations in the mid-1970s that still remain in place today (Hill, 2000; McCarty, Sexton, Sheffrin, & Shelby, 2001).[3] These antiquated allocation laws have a significant impact on school district budgets and have been overlooked in current policy debates about school funding. The Legislative Analyst's office has found that property tax allocations to school districts vary widely from county to county, from 20-64 percent, but limited research has examined how property tax allocation laws might benefit some school districts over others (Hill, 2000; McCarty et al., 2001). Some research documents that the uneven distribution of property tax to school districts and other local jurisdictions has caused major friction during economic downturns, resulting in a long history of state-mandated shifts between schools and local governments (Murphy, Paluch, & Mehlotra, 2019). And in some cases, districts have such strong returns from property values and favorable allocation laws that they become 'basic aid' districts that do not need to rely on state funding for K-12 at all, and are therefore little impacted during economic recession (Weston, 2013).

Beyond changes to property tax law, another landmark change for school finance came in 1988 with the passage of Proposition 98.[4] After the tax revolt that ensued during the 1970s and the shift to a centralized state model of school finance after *Serrano*, schools were underfunded as the state and broader economy experienced the 1980s oil shock, high unemployment, and inflation (Murphy, Paluch, & Mehlotra, 2019; Sheffrin & Sexton, 1998). Voters intended to increase funding and reduce political battles in the state legislature over

[2] Other laws were put into place at this time as well such as the Gann Limit and Redevelopment Funds, which also had an impact on school district budgets. For more information, see Timar (2006).

[3] Property tax distribution formulas were altered again in 1992 after the legislature established Educational Revenue Augmentation Funds to distribute more property tax to schools and community colleges during an economic recession (for more information, see Hahnel et al., 2020).

[4] A complex set of laws and other propositions govern Proposition 98; for a review, see Kapphahn & Kuhn (2017) and Wassmer (2008). Proposition 98 was also modified in 1990 by Proposition 111.

school financing by requiring funding for K-12 and community colleges to be a constitutionally protected share of the state budget. Proposition 98 set a 'minimum guarantee' that the state allocates at least 40 percent of the General Fund to the K-14 education budget each year (Kapphahn & Kuhn, 2017), locking funding for community colleges—a discretionary program—together with K-12 funding, a compulsory program.[5]

In more recent years, new revenue generation for schools has fallen directly to the will of voters. In the aftermath of the Great Recession, voters passed Proposition 30 in 2012 to increase income taxes on earnings above $250,000 for seven years, and added 0.25 percent to the state sales tax for four years; the proposition provided this new revenue exclusively to K-12 and community colleges. In 2016, voters approved Proposition 55, which extended the income tax increase on those earning above $250,000 until 2030, with most of the money allocated to K-14 education (Murphy, Paluch, & Mehlotra, 2019). Both Propositions 30 and 55 were essential to getting education finance back on track following the Great Recession.

Consequences

Many of these propositions, court cases, and laws were designed with good intentions to protect students' right to an equal education, or to provide adequate funding to students across districts. However, three of these historical decisions have had unintended consequences for K-12 districts, community colleges, and students; namely, the *Serrano v. Priest* court decision and Propositions 13 and 98. Together, these decisions have exposed school funding to the volatility of the state General fund and the booms and bust of the business cycle, while also tying the hands of lawmakers to raise new revenue. The *Serrano* decision legally centralized school finance at the state level, while Proposition 13 significantly weakened property tax revenue for the state—a stable revenue source that typically withstands wide fluctuations in the business cycle—and instead put the onus on the state to provide more revenue for schools from the state's General Fund, which is highly unstable and unpredictable during recessions (Miller & Chu, 2018). Proposition 98 was passed with intentions to provide a minimum funding guarantee for districts, but lawmakers often see it as a 'ceiling' and rarely allocate more than 40 percent of the General Fund to the K-14 education budget (Kapphahn & Kuhn, 2017). In addition, lawmakers' hands are often tied by a long list of complex rules, laws, and regulations guiding Proposition 98 that make it difficult to adjust revenue for K-14 during budgetary shortfalls or to increase funding even during times of economic stability (for further discussion, see Kapphahn & Kuhn, 2017). Arguably, the school finance system could have benefitted from *Serrano* or Proposition 98 alone, but their interaction with Proposition 13 has meant that the effects of state centralization are exacerbated. Proposition 13 erodes local property taxes which are a stable source of revenue for schools and community colleges, leaving the state to backfill education budgets with more volatile funds, leading to severe funding shortages during economic recessions.

[5] The 40 percent allocation is just a rough rule of thumb. Each year, the legislature uses three 'tests' to determine the precise allocation, and there are a host of nuanced laws and rules governing the exact amount allocated to K-12 every year. For more information, see Kapphahn & Kuhn (2017).

Together, such decisions have resulted in a major transformation of revenue for K-12 school districts; prior to the 1970s per pupil spending was above the national average, and now it lags toward the bottom after accounting for cost of living (Hahnel, Hough, & Willis, 2020). For community colleges, the story is much the same: Proposition 13 and Proposition 98 led to massive underinvestment in community college districts, and put funding for the higher education segment in direct competition with the K-12 system (Spence, 2002).

The bottom line is that such reforms have trapped the majority of education funding in a gridlock of the state's General Fund with few, if any, options to raise new revenue for education when the economy is strong, or to address budgetary shortfalls when the entire state revenue system fluctuates during recessions.[6]

[6] One option is for voters to undo propositions by simply placing new initiatives on the ballot to modify or eliminate existing constitutional amendments. Once placed, the initiative requires just a simple majority vote for approval. An example of this was Proposition 15, which would have changed property tax rates for commercial property owners by undoing a portion of Proposition 13 (originally passed in 1978). For a review of ideas to transform the finance system, see Finance Appendix Table 4.