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# School finance reform and voluntary fiscal federalism

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**Abstract**

California has transferred the financing of its public schools from localities to the state. In response, many families have supplemented the tax revenue of their local public schools with voluntary contributions. This paper analyzes that phenomenon. We propose a model of partial cooperation among parents in making voluntary contributions to their public schools. Under reasonable conditions, the model predicts that contributions per pupil should decline with school size. We estimate this relationship using data on contributions to California schools. Our estimates reveal that contributions per pupil do decline with size; however, the rate of decline is surprisingly slow.


*Keywords:* Voluntary contributions; Public school finance

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## 1. Introduction

Over the last 25 years, California has enacted a bold reform of its system for financing public schools. In essence, it has transferred the responsibility for funding its schools from localities to the state. Under local finance, each school district levied its own property tax rate. In its 1971 ruling in *Serrano v. Priest*, the California Supreme Court found this system unconstitutional because differences in the value of taxable property across districts caused inequities in tax revenue.

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The voters of California completed the transfer to state finance by passing Proposition 13, fixing the property tax rate at 1% throughout the state and giving the state legislature authority to allocate property tax revenue among local jurisdictions, including school districts. Armed with this authority, the legislature has achieved a more equitable distribution of revenue across districts, thereby satisfying the Court. However, California has not increased revenue per pupil as rapidly as other states. From 1970 to 1995, spending per pupil fell 15% in California relative to other states.

The combination of equalization across districts and the slower increase in average revenue has led to a relative decline in the funding of districts that fared well under local finance. Understandably, not all parents in those districts regard reform to be an improvement. It has taken away their authority to tax themselves for their mutual benefit. From the perspective of these parents, government is now failing to provide a level of service for which they are willing to pay.

In response to this government failure, many parents have turned to collective action. In 1994, local educational foundations, PTAs, and booster clubs raised nearly $200 million for public schools. The level of contributions varied widely across school districts, creating a type of voluntary fiscal federalism. Can this voluntary fiscal federalism undo the equalization achieved by school finance reform? Olson (1965) has written eloquently about the difficulties of collective action. A group of individuals may have reason to pursue a common goal yet be unable to achieve it because cooperation is not in the self-interest of any one of them. Sandler (1992) has expanded Olson's analysis, delineating situations in which collective action may or may not be successful. Both Olson and Sandler emphasize the fundamental difference between individuals and groups. When an outcome would be beneficial, we may expect an individual to pursue it. The same cannot be expected from a group.

In the case of California's school finance reform, the importance of this distinction is best illustrated with a simple conceptual experiment. Firstly, suppose every school district is composed of just one family. Under local finance, each family is allowed to tax itself to provide the resources it demands for its children's education. Resources vary widely across districts because families differ in preferences and incomes. Now suppose that local finance is replaced by state finance, and the state taxes all families to provide equal revenue to each district. Although the reform equalizes government revenue across districts, families with high demand for school quality will supplement state revenue with their own contributions, yielding the same resources for their children's education as under local finance. In the end, families undo school finance reform through voluntary contributions.

Would they also undo reform if school districts are composed of 100 identical families instead of just one? Under local finance, each family is in exactly the same position as before. Using the authority of their local government, the families in each district will tax themselves to provide the same level of revenue per pupil