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Lawrence O. Picus
University of Southern Cal ifornia

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California's system of school finance has grown into a needlessly complex system.

A Quarter Century of Turmoil: School Finance in California on the 25th Anniversary of *Serrano*

Lawrence O. Picus

This year marks the 25th anniversary of the California supreme court's August 1971 ruling that the Golden State's system of school finance violated the equal protection requirements of the state and federal constitutions. That ruling, commonly referred to as *Serrano I*,[1] set in motion a series of changes to the ways schools are financed in California that continues to have repercussions across the state and the nation. This article, written in January, 1997, offers an historical perspective on how school finance has changed in California over the past 25 years, and suggests that the legacy of *Serrano* may not be equal opportunity for California's public school children, but rather a confusing and needlessly complex funding distribution formula that in reality fails in providing the equity (or equality) mandated by the courts.

The article begins with a brief summary of California's current school funding picture, looking at both student demographics, current revenues and expenditures, and measures of school finance equity. This section takes a close look at the categorical programs currently included in the school finance system, and suggests that these programs do a poor job of providing funding to meet identified student needs, and instead are created and distributed on the basis of political expediency. Because nearly one-fourth of education funds are distributed through these programs, they have had a detrimental impact on school finance equity. The second section provides a very brief history of the major stepping stones in the development of the current funding formulas. The final section of this article offers some suggestions for improving the financing of California's schools.

K–12 Public Education in California Today

In 1996–97, the 1,000 school districts in California are responsible for the education of 5,418,707 children in grades K–12, as well as another 396,344 adults and pre-school age children. To provide this education, the districts will spend an estimated $32.951 billion (EdSource, 1997). Of this total, $25.863 billion, or $4,773 per pupil in average daily attendance (ADA) is allocated to meet the minimum funding requirements of Proposition 98. The balance comes from federal funds, local miscellaneous revenues, adult education programs, and the state lottery. Despite the large total, California ranks in the bottom decile of the 50 states in per pupil expenditure (Education Week, 1997).

These limited funds, are used to educate the most diverse student population in the United States. Children of color represent 59% of school enrollment. Approximately 45% of them receive free or reduced price lunches, and over 24% do not speak English as their primary language. While Spanish speakers dominate, there are some 45 different languages spoken by children in the state. Twenty–four percent of the children live in poverty, and 26% come from single parent households (Education Week, 1997). Moreover, because of limited funding, California public school classes are the largest in the nation, with an overall pupil-teacher ratio of 24.1 to 1, compared to a national average of 17.1 to 1 (EdSource, 1997). In the most recent NAEP tests, only 18% of fourth graders were classified as "proficient readers," and only 16% of eighth graders were considered proficient in math (Education Week, 1997). Approximately 9% of the state's children have been identified disabled. Rural residents make up 18% of the student population, suburban and small city residents 50%, and urban children compose 32% of total district enrollment.

While teachers are somewhat better compensated than the average across the United States, the state's ranking for average teacher salary continues to slip. In 1994–95, the average teacher salary in California was $40,667, ranking 11th among all of the states. For 1996–97, at the initiative of Governor Pete Wilson, a large share of the new revenues available to schools (after a long drought in additional state funding due to the lingering effects of the recession), was focused on reducing average class size in the primary grades to no more than 20 students per teacher. This policy, which provided an incentive of $650 per pupil in classes of 20 or less, focused on the first and second grades, with districts encouraged to expand it to grades K and 3 as well.

As this brief discussion shows, California has the most diverse student population of any of the 50 states, and seems to have fewer resources to provide for their education than do most other states. The source of those funds and how they are used are described next.

Where does the Money Come From?

The single largest contributor of school revenues is the state, which provided an estimated 57.4% of the total. Table 1 shows sources of revenue for the three most recent years. The table shows that the state's share has increased over these three years from 53.1% of the total to over 57% of that total. The reason for this is the robust revenue growth the state has experienced compared to the growth in property values which has been generally stagnant in most parts of the state. All of the other sources of funds have declined somewhat in importance over the last three years, and in the case of lottery receipts, are estimated to actually drop by some $5 million a year.

Where does the Money Go?

Table 2 shows in both per pupil expenditures and percentages of the total how educational dollars were spent in California in 1994–95. Nearly two-thirds of expenditures occurred at the classroom, with teachers representing the single largest expenditure item, and accounting for over 51% of the total. School site costs, including principals and other

Lawrence O. Picus is Associate Professor at The University of Southern California and Past President of the American Education Finance Association.

Table 1
Sources of Revenue for K–12 Education in California: 1994–95 to 1996–97

	1994–95 Amount in millions %		1995–96 (est.) Amount in millions %		1996–97 (est.) Amount in millions %	
	($)	(%)	($)	(%)	($)	(%)
Federal Aid	2,449	8.32	2,548	8.10	2,569	7.80
State Aid	15,658	53.20	17,482	55.61	18,928	57.44
Property Tax	8,573	29.13	8,661	27.55	8,705	26.42
Local Misc.	2,110	7.17	2,110	6.71	2,110	6.40
Lottery	643	2.18	638	2.03	638	1.94
Total	29,433		31,439		32,950	

Source: EdSource (1997), p. 22

Table 2
Distribution of Expenditures by Category,
California School Districts: 1994–95

Category	Amount Per Pupil ($)	Percent ($)
Classroom Costs	**3,165**	**65.03**
Classroom Teachers	2,504	51.45
Instructional Aides	236	4.85
Pupil Support[1]	135	2.77
Books, supplies, Equipment	291	5.98
School Site Costs	**1,398**	**28.72**
Site Leadership[2]	357	7.34
Instructional Support[3]	212	4.36
Buildings[4]	480	9.86
Food	208	4.27
Transportation	141	2.90
District Office Administration	261	**5.36**
State Department and County	42	**0.86**
County Oversight	23	0.47
Calif. Dept. of Education	19	0.39
Total Costs	**4,867**	**100**

1 Counselors, psychologists, nurses
2 Principal, vice principal, secretary
3 Curriculum, library, media, clerical
4 Utilities, maintenance
Source: California Department of Education, 1996

administrative staff, utilities and maintenance, food, transportation and instructional support amounted to another 29% of the total. As the table shows, almost 94% of all expenditures occur at the school site, while central district administration accounts for just over 5% of total expenditures.

Equity

Most analyses of school finance equity in California find that the distribution of funds to school districts is highly equitable. Hertert's (1996) work in this field showed high levels of equity at the district level, but considerably less equity when comparisons are made across schools. In fact, compliance with the *Serrano* requirement that per pupil expenditures be within $100 per ADA (adjusted for inflation, the figure is now approximately $300), has been measured by the percent of pupils in districts within the bands. Overall, in 1995–96, 96.4% of students in the state were enrolled in districts that had per pupil expenditures within the adjusted *Serrano* band.

The problem with these measures is that they only consider general revenue limit expenditures.[2] And in fact, since *Serrano* specifically requires elimination of wealth related spending disparities, many other ways to distinguish districts for funding purposes have been developed. Most important is the analysis of the *Serrano* bands themselves. While compli-

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ance seems high, it is important to realize that there are in reality six different bands for analysis, based on the type (unified, high school or elementary) of district, and the size (large or small) of districts. The mean expenditures per ADA vary considerably across those bands.

Also missing in these equity analyses is state categorical funding which represents nearly one-fourth of total school district revenues. Typically left out of equity analysis, these funds are distributed to school districts through a variety of formulas and procedures that often have little to do with student need and more to do with political expediency.

Today there are over 70 state and federal categorical programs in California, ranging from special education, which accounted for nearly $2 billion in state funds in 1996–97, to very small programs such as restructuring grants for which just over $26 million was appropriated in 1996–97. The funding requirements of each program are different, and often confusing. Examples of some of the larger programs and the problems they create are offered below.

Special Education

The largest single categorical grant program operated by the state, special education suffers from insufficient funding to fully reimburse districts for the costs of providing educational services to children with disabilities. In addition, the system in place, which provides funds to districts on the basis of student placements, is in need of modification.

First, something on the order of one-third of special education costs must be borne by local school districts, creating an encroachment on the general fund (Goldfinger, 1996). While Murphy and Picus (1996) show that this encroachment, along with encroachment for pupil transportation, only averages 6% of general fund budgets, they also show that the impact varies substantially from district to district with some experiencing little or no encroachment and others encroachment levels as high as 12% of the general fund budget. In a state where general spending per pupil is substantially equal, dramatic differences in the proportion of the general fund represented by this encroachment seem to create a serious problem with *Serrano* equalization, and could leave the state open to another legal challenge.

The way funds are distributed is also needlessly complex, requiring districts to fill out a number of intricate forms and make a number of difficult judgments as to how to maximize state reimbursements. Funds are distributed to districts for program units based on the service delivery mode (i.e. self contained or resource room programs, etc.). The value of a program unit depends on the service delivery mode. Each district's program unit values were established in 1981–82 and since that time have been adjusted (sometimes) with a cost of living adjustment (COLA). The result today is that the amount of money a district generates for each program unit may have little relationship to its special education costs.

Districts are also compensated for the "indirect" costs of providing these services through a support services ratio, which is a percentage (also determined in 1981–82) of the direct costs of each program unit. Picus and Miller (1995) show that the current system has allowed many districts to "take back" programs for severely disabled children from county offices of education and keep the higher support services ratio of the county, which is typically higher. Unfortunately, Picus and Miller (1995) also found that when districts do this, they experience higher costs of providing the service to the children they have taken back, and moreover, the county also incurs increased per pupil costs for those students who are left in the county program. This often leads to the county charging a higher price to the disabled students' home districts.

Pupil Transportation

Due to different geographic conditions and population densities, pupil transportation costs can vary dramatically across districts. Today, the state transportation reimbursement program provides districts with 95% of the funding they received in the previous year, regardless of need. Thus, districts able to reduce transportation costs often are at an advantage compared to districts that have increasing transportation costs due to population growth or other factors. Since the allotment to districts is a lump sum rather than a per pupil amount, districts with growing enrollments are at a substantial disadvantage (for details see Goldfinger, 1996).

Supplemental Grants

Perhaps the best example of the problems with categorical grants in California are supplemental grants. Offered to districts for three years starting in 1989–90, districts qualified for funding if they had a low revenue limit, and if they received lower than average receipts from 27 other categorical programs. In effect, districts were treated as disadvantaged, and thus eligible for additional funds, if they were not generally disadvantaged enough to qualify for other programs. This program, which was justified on the basis of improving more equalization of total funding, was eventually rolled into recipient district revenue limits.

The Mega-Item

To give districts more flexibility in the use of categorical programs, beginning in 1991–92 the legislature has combined at least 30 categorical programs into a $3 billion "mega-item" in the state budget act (EdSource, 1997). Districts are allowed to redirect up to 15% of the funding in any program within the mega-item to any of the other designated programs, or, in 1996–97, to or from Healthy Start or Conflict Resolution programs. In addition, for 1996–97, districts are allowed to shift as much as 50% of a program's revenue to cover one-time expenses of class size reduction. Designed to give districts more flexibility in the use of categorical funds, it still places districts with low categorical funding receipts at a disadvantage compared to districts receiving more revenue through these programs.

The state legislative analyst offers an interesting perspective on the importance state policy makers have begun to place on the use of categorical programs to direct money to certain districts and/or to accomplish specific state goals. In her analysis of the Governor's 1997–98 budget bill, the legislative analyst states that the growing emphasis on categorical programs means that none of the new 1997–98 money available to schools under the requirements of Proposition 98 will be available for locally determined priorities. She argues that none of the increased funding projected for 1997–98 will be used to increase revenue limit funding beyond the statutorily required COLA, concluding that "as a result, the budget would provide increases only in those targeted areas and not for needs identified by local school boards" (Legislative Analyst, 1997: 12).

How has California found itself in the position where despite large increases in revenue for public schools, local districts have no flexibility in how they can spend their funds? The next section of this article offers a very brief history of the major events of the last 25 years and how they have shaped the current situation.

School Finance in California: 1971 to the Present

Among the 50 states, California's school finance formula is perhaps the most complex.[3] Rather than reform the system from top to bottom, as is generally done in other states, California's response to school finance reform has been to layer additional formulas and programs on top of the existing

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program. The result is a system so complex and unintelligible that only a few individuals in Sacramento are able to navigate through the thicket. School finance theory suggests that a more straightforward and simple approach to the distribution of funds is more efficient, and more likely to insure that funds are targeted to the students for which they are intended (see for example, Odden & Picus, 1992).

How did California's system become so complex? Three factors have led to the development of the current funding scheme:

1. The *Serrano* court ruling
2. Passage of Proposition 13
3. Passage of Proposition 98

Serrano

Serrano v. Priest, originally filed in 1968, was California's vehicle for school finance litigation for many years. Based on the state constitution's equal protection clause, *Serrano* requires substantial equality in the way general funds for K–12 education are allocated to school districts. Specifically, *Serrano* requires that all property wealth-related spending differences across districts be reduced to no more than $100 per student in Average Daily Attendance (ADA). Court rulings in the case have allowed the $100 figure to be adjusted for inflation, so that today it is approximately $300 per ADA. Moreover, the court has allowed the state to reach "substantial" compliance with this requirement, meaning that we have reached an acceptable level of equality today with some 96% of our students enrolled in districts where expenditures are within that $300 band.

Serrano only applies to wealth related spending differences, allowing differential expenditures for district characteristics such as type and size, and for differing student needs. It is out of this flexibility that our system of categorical grants has grown. However, to fully understand today's system, a brief discussion of Proposition 13 is essential.

Proposition 13

Proposition 13, passed by the voters in June, 1978, placed a constitutional limitation of 1% on property taxes, and further limits the growth of a property's assessed value to no more than 2% a year until it is sold, at which time it is reassessed at market value. It was this dramatic reduction in property taxes that led to the establishment of today's basic school finance system.

Prior to passage of Proposition 13, realizing that the courts would eventually require the state to improve school funding equity, the legislature had made a number of changes in how school district revenues were collected. Primary among those changes was the establishment of revenue limits for each district. Each district in the state was assigned a revenue limit based on its 1970–71 general revenues. It was called a limit because districts had few options for exceeding it on an annual basis. The state then established the rates by which district revenue limits would increase each year, allowing districts with low revenue limits greater increases than those with high revenue limits. Districts still had some flexibility to ask voters to approve additional increases in property taxes for their schools.

Proposition 13 changed all that. Property taxes were constitutionally limited to 1%, and the dramatic reduction in tax collections meant that, absent state assistance, districts would have dramatic revenue shortfalls. Fortunately, the state had a substantial funding surplus and was able to use that money to "bail out" the schools and other local government agencies. The system established to fund schools relied on the revenue limit system. Today, each district's revenue limit is based on the previous year's revenue limit adjusted by a Cost of Living Adjustment (COLA). Property taxes are distributed to local jurisdictions by the county tax collectors as directed by the legislature, and in the case of school districts, the state makes up the difference between property tax receipts, and the district's revenue limit. There is no local ability to raise additional taxes, and school districts are also quite constrained in their ability to implement other kinds of user fees for revenue purposes.

Proposition 98

The final piece of the puzzle is Proposition 98. While Proposition 98 is a complex law, it essentially creates a minimum funding floor for education by dedicating a fixed share of the state's general fund to K–12 education and community colleges. This has created two problems for schools:

1. The legislature has tended to look at Proposition 98's spending floor as a ceiling, and
2. Dependence on the state for funding has left the districts with relatively slow revenue growth over time, particularly during recessions (see Picus, 1991).

The system that has evolved as a result of these events is needlessly complex and has become ineffective in providing an adequate level of funding to school districts and in insuring that funds are targeted to students with identified special needs. The next section offers some possible solutions to these difficult problems.

What Should California Do?

Repairing the current school finance system in California is no small task. There are a number of difficult decisions that need to be made to establish an adequate, student focused funding system for the states 5.5 million school age children. The recommendations that follow are designed to create a system that will provide more money for education, and focus those funds on student needs.

Adequacy

Given the tremendous needs of California's public school children, it seems important to increase spending generally. While a lofty goal, the difficulty of finding more funds for education is underscored by voter passage of a Proposition lowering the top marginal tax rates for the state's personal income tax. Despite the fact that the measure only affected individuals with taxable incomes exceeding $200,000 a year and joint incomes in excess of $400,000 a year, the voters elected to lower tax rates. Similarly, Governor Wilson continues to call for more general cuts in income and business taxes. Since Proposition 98 guarantees schools a share of the state's general fund revenues, these cuts would directly impact education.

What is needed is more money, not less. Unfortunately, options are few. The voters have already indicated how they feel about raising income taxes (even on the wealthy), and it seems unlikely they would be willing to change the terms of Proposition 13 even though simply assessing all property at its market value would probably nearly double state-wide property tax collections. While that may not be feasible, one possibility would be to reassess all property at market value, and then lower the tax rate so that the same amount of property taxes would be collected in each county. With tax rates below the constitutional limit of 1%, voters of local jurisdictions could be allowed to increase their property taxes, up to the 1% limit, with a majority or two-thirds vote.

This option would have differential impact on property tax payers depending on when they purchased their home or business, and where they live. Generally, the longer they have owned the property, the more they would have to pay. To mitigate any major problems of overtaxing individuals on limited or fixed incomes, a state circuit breaker property tax relief program could be established. Moreover, by allowing decisions on the level of property taxation to be made at the district level, the system would infuse much needed local control back into the governance of our schools.

Equity

While general funds for education (revenue limits) are distributed in an equitable fashion, the trend in California in recent years has been to place more and more of the total funding for schools outside of the revenue limit, reducing overall equity. Two solutions stand out here. The first is to work hard to put increases in funding that become available into the revenue limit foundation system rather than into new or existing categorical programs. The second is to reform the categorical grant system so that funds are targeted at identified student needs and follow students, not districts. For programs like special education, a weighted pupil formula seems ideal. In other areas where categorical programs are needed, pupil weighting schemes or state reimbursement programs should be considered. Finally, the state should work to eliminate most small specialized categorical programs, rolling their funding into district revenue limits, and then working to more fully equalize district revenue limit funding. This will allow all districts to benefit equally from increases in state revenues, while maximizing local decision making over how those funds are used.

Conclusion

California's system of school finance has grown into a needlessly complex system that does not provide adequate funding for the state's schools, and distributes what funding it does make available in a manner that often has little to do with identified student needs. Major reforms of the current system are needed to simplify the distribution of funds and to insure that resources are aimed directly at the students most in need of fiscal support. Making these changes will not be easy as there is very little willingness across the state to increase taxes to pay for any public service, including education. Moreover, many of the state's current programs have developed through political processes designed to help specific regions of the state. Undoing this political allocation of educational funds will be an extremely difficult task.

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