

**School Finance Litigation and Property Tax Revolts:
How Undermining Local Control
Turns Voters Away from Public Education**

William A. Fischel
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Abstract

The use of local property taxes to fund public schools in the United States has been under attack since the 1970s as a result of reform-minded lawsuits. Court-ordered reforms typically involve a greater proportion of state funding, more equal expenditures, and less local fiscal control. I explain in nontechnical language why this movement has reduced educational quality. The more extreme cases, such as *Serrano v. Priest* in California, have contributed to tax revolts that have starved education. The advantage of local fiscal control is that home values rise when schools get better, provided that the additional property-tax bite is not excessive. All homeowners, not just those with school-age children, have an interest in efficiently-run schools when education is financed locally. This fiscal feedback is lost when school funds are provided from statewide tax revenues.

About the Author

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1. Introduction

I argue in this essay that a local property tax system provides a political and economic framework that guides voters and school officials to select a more efficient level of public education than a largely state-funded system does. Court decisions that have undermined reliance on the local property tax, such as California's *Serrano v. Priest*¹ decisions, have invariably further centralized the funding and administration of public schools. This trend has undermined political support for education by divorcing voters' property-tax payments from the quality of their local schools. The more extreme court decisions have, when sedulously followed by state legislatures, caused property tax revolts and other political reactions that have further undermined all public schools in the state. The quality of public education in the United States has most probably gotten worse, not better, because of these court decisions.

This essay is written for policy-makers, attorneys and scholars who have a special interest in school-finance reform litigation but do not have much training in economics. The approach I take invokes a standard analysis in the field that is called "local public economics" or "local public finance." I have a point of view about this issue; I am not shy about stating that many courts have done their states a great disservice by jumping into this area. But I am attempting to be evenhanded in my assessment of the economics and related social science literature. I will note areas where knowledge is uncertain and especially contested, and much of the work I describe is relatively recent, so that it has not been fully tested in the scholarly marketplace for ideas. Enough is known, however, to draw some conclusions that, I believe, ought to give pause to those who would rush to the courts to change the system of property-tax financing for public education.

2. The Special Appeal of Educational Equality

Jonathan Kozol's *Savage Inequalities* is required reading in almost every education-reform course in American colleges and universities. It is an account of his visits to selected public schools around the United States in the period 1988-1990.² Kozol's method was not random selection. He singled out especially problematic schools in poor, mostly minority, inner city areas and compared them to especially good public schools in rich, mostly white, suburban areas. His conclusions confirm Mae West's aphorism: rich is better.

Kozol was not simply trying to demonstrate what makes for good schools on his American journey, though. He wanted primarily to prick the conscience of his readers by showing the deplorable conditions in selected inner-city schools. Much of his criticism was directed at the lack of resources for education in poor areas. Like many others before him, he believed that the source of this poverty was the American system of local

financing of schools, which, he argued, allows the rich to spend mainly on their own children and neglect the poor.

His argument strikes a sympathetic chord among many Americans. Even though local funding is now exceeded in aggregate by state and federal funding, which has contributed to equalization of expenditures, there remains considerable variation in spending per pupil within most states and (especially) among the states themselves.³ This Kozol finds intolerable, and he has many sympathizers. Among the numerous values that Americans are said to hold is a belief in equality of opportunity. The differences in income and wealth that characterize a free-market economy are more acceptable if they result from a race in which everyone starts from the same gate. Another sports metaphor, that of “a level playing field,” is often applied to the need for an equally good education by all participants in American society.

This view is the basis for slow-moving but powerful movement within the state courts. The California Supreme Court was the first to insist on statewide funding equality. Spending per pupil from publicly supplied funds, excluding special categories such as special-needs students, has become highly equalized in California. The cause of this equalization is the California Supreme Court’s decisions in *Serrano v. Priest* in 1971 and 1976.⁴ As a result of these decisions, about 95 percent of California public school students attend schools in districts whose per pupil revenues from property taxes and state taxes vary by no more than about 5 percent. All school taxes, including those raised by nominally-local property taxes, are allocated by the state within this constraint. (As I shall describe in section 14 below, Proposition 13, California’s 1978 tax revolt, reduced the amount of property taxes that the state had to work with, but the command to equalize school resources stems from *Serrano*, not Proposition 13.)

Serrano remains a lodestar for lawyers challenging education funding in their state courts, and it is cited by most of the decisions that have favored these challengers. Relying on what even sympathetic observers regard as vague language in their constitutions,⁵ at least 17 state courts have since 1971 held that their school systems rely excessively on local property taxation to fund primary and secondary education.⁶ The courts have found fault with inequalities among local school districts in tax bases, tax rates, and spending per pupil.

Court decisions in the 1970s invoked the constitutional language of equality. However, the precise constitutional basis for *Serrano*, the equal protection clauses of the state and federal constitution, is no longer influential.⁷ This is largely because the U.S. Supreme Court in the 1973 case of *San Antonio v. Rodriguez* decided that the use of local property taxation to finance education did not offend the U.S. Constitution’s equal protection clause. The U.S. Court did not prohibit the states from deploying their own equal protection clauses, but state courts have been leery of doing so. They have instead more often invoked the notion of an “adequate” education for all students under state constitutional provisions that use open-ended terms like “thorough and efficient” education.

Despite the changing constitutional classifications, all of these court decisions have resulted in a substantial shift away from local property taxation and toward funding collected by (and controlled by) the state legislature.⁸ This shift has also reduced the disparities in spending by districts within individual states, although the compression is sometimes only temporary. It has also shifted the balance of power from local school districts to state legislatures, most of which did not actively seek the added authority.

For the most part, these judicial decisions have been praised in law journal articles as paradigms of state-level judicial activism.⁹ The advocates of the litigation believe that persistent pressure by the courts is necessary to have a system that is both high in quality and promotes equality of educational opportunity. Jonathan Kozol has written approvingly of these lawsuits and even submitted a brief for the plaintiffs in the Massachusetts case of *McDuffy v. Secretary* (1993).

The other appeal to fairness that arises in the school finance litigation is the inequality of property taxes among districts. The paradigmatic case here is still the original pair that served as the poster children of the *Serrano* litigation. Beverly Hills could raise more than twice as much revenue per student from its tax base as poor Baldwin Park (another Los Angeles suburb), even though Baldwin Park had twice as high a local tax rate. Is it fair, the plaintiffs asked, that the “accident of geography” of living in one place or another should make such a difference in tax rates as well as in school expenditures?

The idea still resonates with courts more than 25 years after *Serrano*. The Vermont Supreme Court ruled for the plaintiffs in its 1997 *Brigham v. State* decision without benefit of a trial, holding that the mere facts of unequal spending and unequal tax rates rendered the state’s system of school finance unconstitutional. The New Hampshire Supreme Court was similarly impressed by inequalities in tax rates in *Claremont v. Governor* and ruled that a reformed system must fund basic education expenditures from a tax whose rate does not vary across the state’s school districts.

This second issue-tax fairness-is more easily dealt with than the issue of differences in educational opportunity that Kozol raises. It is simply wrong on virtually every account. Unequal tax rates and tax bases are not themselves indicators of unequal economic burdens. This requires, however, an understanding of a complicated-sounding but fundamentally simple idea called tax capitalization. Failure to understand this has needlessly complicated and often frustrated attempts to improve the quality of education for children from disadvantaged families as well as for the nation as a whole.

The subsequent plan of this essay is to develop the theory that underpins what I regard as the good things about decentralized, local control of school spending and property taxation. I will first develop the theory (the Tiebout model and capitalization). The evidence for the operation of this model is then reviewed. Capitalization is among the most widespread economic phenomenon in the local public sector, though its exact parameters are still subject to some debate. Then the implications of the model are explored in the light of empirical evidence. In brief, these are:

- The property tax is not unfair even if there are wide variations in bases and rates.
- Highly centralized school finance systems seem to produce worse educational outcomes on average, with no apparent gains to the poor.
- Court-ordered centralization can undermine political support for the entire fiscal system and has caused both explicit and implicit tax revolts.

3. A Little Theory: Tiebout and Capitalization

Few of us get the level of national defense we really want. It's too much or too little; too aggressive or too dovish; too missile intensive or too land-mine intensive. The reason is that national defense is what economists call a pure public good: The level of the good has to be the same for everyone. The bombs bursting in air do so on behalf of all Americans. As a result, it won't do for New York to have one defense policy and Illinois to have another. Aside from possible conflicts between the states, many might shirk from providing much defense expenditures at all, relying on their neighbors' efforts to repel foreign threats. The founders of our republic understood the adverse consequences of this from hard experience, and they took pains to be sure that the national government would have the authority to raise an army and a navy, with the U.S. President as sole commander in chief.

So we are stuck with national defense and the problems of a monopoly provider—the Defense Department—of military services. But that's not true for the many other public services that can be varied geographically. There is no reason for schools or fire protection or police or snowplowing or parks or beaches to be uniformly provided everywhere. The economics of this insight, which has been apparent as a practical matter to Americans for hundreds of years, were first developed in 1956 by a young economist named Charles Tiebout.¹⁰

Tiebout's enduring insight was that people can register their political preferences for geographically diverse public services by "voting with their feet" as well as by voting in a ballot box. If families can choose among a variety of communities, each with independent powers to tax, spend, and regulate, they will choose the one whose combination of housing and public services is the best match for themselves. In his 1956 article, Tiebout argued that a system of local governments could thus overcome the one-size-fits-none problem of pure public goods. Defense and control of the currency may inevitably be national, but Tiebout offered a compelling reason for allowing many other public goods to be provided locally. Allowing people to sort themselves out allows them to find the best mix of local public services, much as high-school seniors sort themselves out by going to college in different geographic areas.

An important amendment to Tiebout's model was developed by Bruce Hamilton.¹¹ He pointed out that communities would need to use zoning to protect their local services from overcrowding by land uses which would not pay their full tax costs. If zoning can properly discriminate among the sources of municipal costs, Hamilton argued, the much-maligned property tax becomes simply a fee for local services. The tax is still a

compulsory payment within the community, but all those who reside in the community have moved there with a clear understanding that their tax payments are matched up with the public services they expect.

I have argued in several works that most American metropolitan areas (and many rural areas as well) have enough governments, which in turn have enough zoning authority, to make the Tiebout-Hamilton model work tolerably well.¹² Homebuyers in most metropolitan areas can choose among dozens (sometimes hundreds) of local governments, including about as many school districts. When conservative libertarians speak of “the public school monopoly,” they perhaps have in mind some large cities from which people with few economic resources can escape. For the vast majority of other metropolitan-area residents, and for most rural residents, there are usually scores of different school systems from which to choose.

Tiebout’s theory did not immediately take hold of the economics profession. The reason is not difficult to imagine. Clever theory, one can hear his readers saying, but who ever heard of people moving from town to town just to take advantage of the local schools? The answer was, plenty of people. Wallace Oates found this out by proposing a test of the Tiebout model.¹³ If enough people behaved as Tiebout supposed them to, shopping for towns as well as for individual houses, then the price of homes in communities with lower taxes or better services should reflect the net value of such advantages.

Only a few families, of course, actually get up and leave their community because they don’t like their child’s first-grade teacher. (One of the few, ironically enough, was John Serrano, the lead plaintiff in *Serrano v. Priest*, whose family left East Los Angeles for Whittier after the principal of the school John, Jr., was about to enter admitted it was not a good match for their “near gifted” child.¹⁴) Most people shop for a community when some life event causes them to move: they graduate from college, get a new job, get married, have children, or retire. At such times it is nearly costless to think about the qualities of the community as well as those of the house itself. Oates’s idea is a commonplace among real estate sales people. They are so accustomed to potential buyers asking about the taxes, the schools and other community characteristics that most realtors preemptively post such information on the listing sheets of the houses they have for sale.

Oates, however, wanted to get a more systematic estimate of how much various characteristics were valued. He used a theory called hedonic prices (which simply proposes that the value of a complex good like a house is the sum of the values of its characteristics) and a statistical technique called multiple regression analysis to determine the contribution that community characteristics, such as school quality and tax rates, made to the value of housing in each community. Because his statistical test is crucial to the argument in the present work, I will describe it and the methods in some detail using an even simpler (but more current) example.

4. An Econometric Test for Capitalization

Oates tested his theory by examining house values in northern New Jersey municipalities using data taken from the 1960 census. My example of Oates's study is one I undertook for the state of New Hampshire, which had retained me in 1995 as a consultant in its school finance case.¹⁵ I undertook the study to demonstrate for the state that school taxes and school quality (as measured by test scores) were capitalized in the value of owner-occupied homes.

By “capitalized” I mean nothing more than that anticipated benefits and costs that accrue to community residents affect the market value of housing in a systematic way. Good news—like lower tax rates—causes the price of houses to increase, while bad news, such as declining test scores in the local schools, causes the price to decrease. Community tax rates and test scores are thus said to be capitalized in individual housing prices. Capitalization is the same phenomenon by which news of greater expected earnings raises the price of a company's stock and news of unfavorable future conditions lowers the price of the stock. The arithmetic of capitalization is complicated for most people because it involves discounting future benefits and costs to present values.¹⁶ But it is not necessary to do any of this arithmetic to get a reasonable understanding of this important concept. Indeed, I have found that, once I explain the basic idea, most people say, of course, how could anyone think otherwise?

I will describe the study I undertook to show that taxes and school district characteristics *systematically* influence (“are capitalized in”) housing prices. In order to do a statistical study, one needs a random sample of observations that display the characteristics one is interested in. My sample consisted of the 73 New Hampshire towns and cities whose population was at least 2500 in 1990 and which were not part of an elementary-school cooperative school district. (Co-ops mix the finances of towns in ways that are difficult to match with each town's demographic data.) The sample accounts for about three-quarters of the state's population.

The statistical technique for examining this sample is linear regression, which is also called “ordinary least squares” because of its technique of fitting a line such that the squared distance of each observation from the line is minimized.¹⁷ In this method, variations in the *dependent variable* (the 1990 median value of owner-occupied homes in a district) are accounted for by variations in independent variables. The *independent variables* (those upon which the dependent variable depends) in the regression are:

tax rate = the school tax rate per \$1000 of equalized value for the town for the school year 1990-91. (Equalized value is the state's estimate of the market value of property, which it uses for comparative purposes to distribute state aid.)

test score = the sum the two major elements of each town's scores on New Hampshire's uniform statewide achievement test given to fourth-graders in the school year 1990-91.

rooms = median number of rooms in owner-occupied houses in 1990.

miles north = straight-line distance in miles from the town to a single point in the northern suburbs of Boston (approximately at the intersection of I-93 and I-95).

house age = median age in years of houses in the community in 1990.

Regression Results

Dependent variable: Median Value of Owner-Occupied Housing in 1990.

(Mean value of dependent variable: \$131,401.37)

Number of Observations: 73

R-Square: 0.86

<i>Independent Variables</i>	<i>Estimated Coefficient</i>	<i>T -Statistic</i>	<i>Variable Mean</i>
Tax Rate	-2685.23	-6.00	12.8509
Test Score	229.8488	2.11	111.657
Rooms	41331.6	12.37	6.105
Miles North	-373.885	-5.23	54.72
House Age	-535.376	-2.57	27.287
Intercept	-77034.1	-3.69	

The results of the regression show that the independent variables (including the intercept) account for 86 percent of the differences in home values among the communities in the sample. This is the interpretation of the figure labeled “R-Square,” which is a commonly used summary measure of the “goodness of fit” of all of the independent variables. An R-Square of 0.86 indicates a very good fit. The highest possible value is 1.00, which is a perfect fit, and the lowest possible value is 0.00, which would indicate no relation at all between the independent variables and the median value of homes. (The intercept has no economic meaning in this regression; it is included only to determine the best overall statistical fit for the variables.)

The “coefficients” are estimates of how much the independent variables affect home values. The “t-statistics,” which are the ratio of the coefficient estimate divided by the “standard error of estimate” (a measure of how much each estimated coefficient varies from the actual observations), measure the confidence with which one can be sure that each coefficient is greater than zero. A coefficient with a t-statistic of about 1.95 or larger (in absolute value) is regarded as “statistically significant” in empirical studies. “Significance” in this context does not mean “important.” It means only that if the same test were to be applied to a different sample (say another group of towns), we are pretty

confident (odds of 19 to 1 or better) that the coefficient would again be different from zero in the direction that we predict. All of the coefficients in this regression are significant.

The variables most relevant to the present study are *tax rate* and *test score*. Their estimated coefficients, evaluated at the mean of the sample, imply the following: A one point increase in *test score* raises the value of a house by \$229.85 and a one point increase in *tax rate* lowers the value of a house by \$2685.23. Both variables are highly significant and accord with those of many other studies. (The widely disparate numbers given here should not be disturbing. The mean of the variable *test score* is about 112, so a one-point increase is quite small. The mean of the variable *tax rate* is about 13, so a one-point increase is large.)

The estimates show with a high degree of confidence that variations in school tax rates and test scores are capitalized in the value of owner occupied housing. The degree of tax capitalization by this estimate is nearly 100 percent. A one mill (a mill is one-tenth of one percentage point) increase on the value of the sample's mean-value house (\$131,401) would annually yield extra taxes of \$131.40. If an interest rate of 5 percent is applied to \$131.40 over an indefinite time horizon, the present value of the extra taxes is \$2628. This is 98 percent of the estimated coefficient (\$2685.23) on the tax rate variable, which implies that tax capitalization is almost complete. If the estimated coefficient had been only about \$1314, which is about half of what was found here, economists would say that the tax rate was only fifty percent capitalized. (More on the meaning of the degree of capitalization and the choice of interest rate and time horizon in section 6 below.)

The remaining independent variables are included to control for other factors that influence each town's average housing values and which have been used in studies similar to this one. All of these variables are statistically significant and, as I will discuss, important in their effects on explaining average housing value variations among New Hampshire towns and cities.

The *rooms* variable is the median number of heated rooms, excepting bathrooms, of houses in the community. It is a measure of the size of the house. The coefficient indicates that at the mean of the sample, an additional room would add \$41,331.60 in value to a house. This probably overstates the influence of rooms themselves, since larger houses are often on larger lots, which also add value to the property but for which no data are available from census sources.

The variable *miles north* (airline distance of the community from the northern outskirts of the Boston area) was negative and significant. It indicates that, other things equal, homes in the southeastern part of the state are more valuable than in the northern part. This accords with urban economics theory, which holds that people will pay more to live in places where there is a higher density of jobs and closer proximity to work. The southeastern part of New Hampshire is where most of the employment in the state is located, and it offers most convenient access to jobs and services in the Boston area. The

large coefficient of -\$372.89 per mile may also reflect the effects of the Boston area's unusual rise in prices in the late 1980s, which spilled over to southern New Hampshire.

The variable *house age* is a proxy for housing depreciation and obsolescence. Except for those with special antique appeal, older houses generally sell for less because they are worn out and require more maintenance. In this case, the estimate suggests that at the mean of the sample, an additional year of age subtracts \$535.38 from the average house's value.

5. A Concrete Example of Tax Capitalization

The regression study that I described above was intended to show as simply as I can the nature of the econometric evidence in support of the capitalization of school taxes and test scores. But I have found that it helps to have something more graphic to get people to grasp the idea.

In preparing for my testimony in the New Hampshire school finance case, I asked some state officials if they could find some examples of the capitalization phenomena I had told them about. They told me that there was a street (Albin Road) in the outskirts of Concord, NH, that also went through the adjacent town of Bow, NH. A developer had apparently bought land all along this road and had built a set of houses of strikingly similar styles. The lots were the same size, too. But some were in Bow, and some were in Concord. I visited the road and had the state take pictures of the houses to make an exhibit.

Bow is a very small town in population. (Its land area is about the same as Concord's.) It has its own elementary school, but it sent its high school students to Concord High School. Within Bow is an electric-power generating plant, which pays a large fraction of Bow's property taxes. Thus the Bow tax rate is only about half of Concord's tax rate. The state officials I dealt with obtained sale prices for houses in this area. Several homes on both sides of the town line had sold within a few months of one another. We pasted the sale prices on the photographs of each house, and beneath them was the tax payment for each house.

The comparisons provided a stark and graphic confirmation of tax capitalization: Buyers of houses in low-tax Bow paid on average \$16,000 more than buyers of nearly identical houses just a few hundred feet away in Concord. The higher taxes in Concord were compensated by the lower mortgage payment. Bow homebuyers, residents of a town often identified as "property rich," had paid for much of their privileged tax-status in advance.

Consider then what would happen if Concord High School (where children from Bow and Concord both went) built a new wing and apportioned the additional taxes on a per-student basis between Bow and Concord. Homeowners in Concord pay, say, \$200 more in taxes. In Bow, the average homeowner pays only, say, \$90 in additional taxes because

the power plant is paying the rest. But if the additional school services are actually worth \$200 more to the Bow residents, their houses will rise in value by the capitalized value of the \$110 (that is, \$200 in additional school benefits less the \$90 in extra taxes). Hence the price that Bow residents pay for the extra school services is the same as it is in Concord. In Concord, the average taxpayer has to pay \$200 in extra taxes to get \$200 in extra school services. In Bow, the average taxpayer has to pay \$90 in taxes and \$110 in extra annual housing costs to get \$200 in extra school services. To the extent that such a scenario was anticipated by those who sold them their homes, the current Bow residents have paid for it already. To the extent that it was unanticipated, only new buyers (after the new school wing is built) will actually pay for it. But in either case, the additional cost of the better schools is the same for the average taxpayer in both towns: \$200.

There is one variation on this story that needs to be accounted for. I have deliberately held the level of public services (the schools) constant in these examples. What if the two towns had different tax bases and sent their kids to their own rather than a joint high school? To burnish this with realism, I learned that Bow has grown enough that it has decided to build its own high school and stop sending their children to Concord High.

I would expect that the new Bow High School will be a somewhat classier place than Concord High. The Bow power plant will disgorge its tax revenues only insofar as Bow voters are also willing to tax themselves. The power plant does not just hand each Bow resident, say, \$1000 each year. The Bow residents get the \$1000 subsidy only if they tax themselves at the same rate as the power plant and spend the resulting sum on public services. Thus the power plant's taxes amount to a subsidy to particular public services rather than a simple cash grant.

This means that all public services are likely to be a little better in Bow (at least to the extent that the power plant does not offset its tax contributions with greater need for public services). Current Bow voters may in this case face an apparently lower price for public services. However, because all future residents have to buy houses there, they must pay for this privilege in advance. It is not free for them. The economic well being of residents on the low-tax Bow end of Albin Road (the road along which I observed similar houses being sold for different prices) is no greater than that of residents on the high tax Concord end of Albin Road. It is true that the Bow residents will have a fancier school to go to, but Concord residents will have a lower monthly mortgage payment to compensate for that. Capitalization evens out the economic burdens of fiscal differences.¹⁸

6. How Extensive Is Capitalization?

Capitalization studies are now so common that they are an undergraduate exercise. Students in my urban economics class routinely do term papers in which they use real-estate data to show how much taxes and indicators of school quality are capitalized. They are thereby replicating (with more limited samples and usually less sophisticated statistical techniques) the results of many published studies.

The pioneering capitalization study was that of Wallace Oates. After examining a 1960 sample of northern New Jersey communities, Oates concluded that “if a community increases its tax rates and employs the receipts to improve its school system, the [statistical] coefficients indicate that the increased benefits from the expenditure side of the budget will roughly offset (or perhaps even more than offset) the depressive effect of the higher tax rates on local property values.”¹⁹ Before one concludes from this that New Jersey communities were able to spend themselves rich by throwing money at schools, it must be pointed out that Oates assumed that the increased local school expenditures were perceived by parents (and homebuyers) as cost-effective.

Later studies that used samples from various parts of the country confirmed Oates’s results of capitalization of school quality. Using a 1970 sample in San Mateo County, California, Jon Sonstelie and Paul Portney found that “The annual gross rent of our median house is increased by about \$52 for each additional month of average reading improvement achieved by students in the elementary school district. Each additional dollar of per-pupil expenditures on elementary education increases the annual gross rent of the median house by more than 90 cents.”²⁰

Other studies found capitalization of per pupil spending within Toronto and in the Boston area.²¹ Higher test scores were found to raise individual house values (not just for those who have children in the house) in Charlotte, North Carolina, the Boston area, Dallas, the Los Angeles area (before the *Serrano* decision) and in Ohio metropolitan areas.²² A recent study found significantly greater housing values in Massachusetts towns and cities whose school spending and test scores increased more than average in the 1990-1994 period.²³ Almost wherever economists have looked, they have found that better schools raise home values.

The studies that show that anticipated *property taxes* are capitalized in home values are even more numerous. Fortunately for the reader’s patience, many of these studies have been summarized in an important book by economists John Yinger, Axel Borsch-Supan, Howard Bloom, and Helen Ladd.²⁴ They reviewed in detail 30 published studies of tax capitalization by professional economists. These studies used a variety of samples from states and metropolitan areas around the country in which property taxes were the main means of financing local schools. All but three of them show capitalization of property taxes. The studies showing significant capitalization examined samples of local governments in California, Connecticut, Kentucky, Missouri, Montana, New Jersey, New York, and Pennsylvania. Of the three that showed no capitalization, two used samples from Canada, whose tax laws differ in some places from those of the U.S. Tax capitalization has become so common now that it is hard to interest journal editors in additional studies.

The Yinger book is a convenient compendium of studies and a guide to capitalization principles, but it also presents a challenge to the tax capitalization claim. It is almost universally agreed that, other things equal, a higher property tax will lower the value of housing and other property in the community. The remaining question is, how much? If

the degree of capitalization is 100 percent (as my simple New Hampshire study suggested), then 100 percent of the differences in tax rates among communities is offset by other housing costs. The seeming \$800-a-year tax break (relative to the mean of all communities) in a low-tax district is offset by an \$800-a-year higher mortgage payment (or other cost of buying a home, such as giving up interest and dividends on other types of investment²⁵) for the home buyer. If capitalization is only 50 percent, then the seeming \$800-a-year tax break on the house in the low-tax district is offset by an extra \$400-a-year mortgage payment.

The novelty of the Yinger book was that its authors undertook a serious, statistically sophisticated attempt to ascertain the exact degree of property tax capitalization in an active housing market. They had located what appeared to be an ideal sample from which to infer tax capitalization. In the early 1970s, Massachusetts required local assessors to revalue all properties at full market value. Up to that time, many communities had practiced a form of “welcome stranger” assessment. Assessments on preexisting homes were seldom adjusted for inflation in market value, but newly-built or greatly expanded homes were assessed at full market value. (The buyer of the newly built home was the “stranger” who paid more than her fair share of taxes, for which she was “welcomed” by other community residents.) This informal and illegal practice created a situation in which older homes often paid only a fraction of what newer but otherwise comparable homes were paying. Homes in the same community were getting the same services but were paying substantially different amounts in taxes.

When state-ordered reassessment arrived in Massachusetts, however, the old homes had to pull their fiscal weight, and tax bills rose, while newer homes got a tax break.²⁶ As a result, the previously overassessed homes rose in value, while the underassessed homes fell in value, allowing the economists to match changes in tax liabilities with changes in home values. The key factor for the Yinger study was that total taxes and public services did not change within a given community. Only the distribution of tax liabilities changed. From this special sample, it was possible for the Yinger group to see how much home values had changed solely as a result of property tax increases and decreases.

The Yinger study found that there had been capitalization of tax advantages to underassessed homes in every community, but much less than they expected. In their best sample, only about twenty percent of the previous tax differences (which were wiped out by reassessment) had been reflected in the price of housing. A \$300 annual tax break for a favored property should have resulted in a \$10,000 value differential (using their infinite time horizon and a 3 percent discount rate). But in fact it yielded only about a \$2,000 value differential. In this seemingly ideal experiment, very little capitalization took place.

The reason for incomplete capitalization in the Yinger study had nothing to do with the failure of participants in the housing market to notice tax differentials. The failure had to do with the original design of the study. On reflection, the authors of the Yinger study concluded that participants in the housing market had anticipated that the tax differentials

would not be permanent. Homebuyers did not necessarily know that there would be a statewide mandate to reassess at market value. They simply did not think that such blatantly unfair (and illegal) assessment differentials would last for a long time. Thus the Yinger group's use of the infinite time horizon and a low "real" interest rate of three percent, which would be appropriate for a stable and very long-run situation, vastly understated the extent of capitalization, as they admitted in their conclusion.²⁷

A subsequent study from California demonstrated that a tax differential that is expected to last a long time will be 100 percent capitalized. A clever study by A. Quang Do and C.F. Sirmans looked at homes in San Diego County in the 1980s that had been built by developers who had agreed to the terms of a "Mello-Roos" bond.²⁸ This special bond (named for its legislative sponsors, not for laid-back marsupials) was designed to allow California communities strapped by the constraints of Proposition 13, the 1978 property-tax-limitation law, to finance new schools and other public infrastructure. (More on Proposition 13 in section 14 below.) Because Proposition 13 did not allow the older homes (those built before the use of Mello-Roos) to be taxed more, the new homes had to bear the entire burden of building new schools through special taxes to finance the Mello-Roos bonds. But kids from the older homes could attend these new schools just like everyone else. Mello-Roos was the logical extension of the "welcome stranger" aspect of Proposition 13, which severely limited tax reassessments as well as tax rates on existing homes.

The Mello-Roos bonds were paid for by a tax on the new homes, not the old ones, but the public services were the same. Do and Sirmans found that the housing value differences between old and new housing was 100 percent capitalized at a 4 percent rate of interest applied over the 25 year life of the Mello-Roos bond. Because 4 percent is quite close to most other estimates of the "real" (inflation-taken-out) interest rate at the time, I take this study as evidence that a fully-anticipated tax differential will, in an active local housing market, be fully capitalized. The reason for the difference between Do and Sirman's result and that of the Yinger study is that Yinger erroneously supposed (at least at the beginning of their study) that homebuyers in the Boston area thought the tax favoritism would last forever. It did not; the Massachusetts courts ordered reassessments, as was required by state laws that had been flouted in practice.

In California, the ultimate source of the tax differential was Proposition 13, an amendment to the California Constitution that has proved immovable since it was approved in 1978. Thus the homebuyers in Do and Sirmans' California sample could look at a \$700 difference in taxes between two otherwise identical houses—one in the Mello-Roos district, and the other outside of it but in the same school district—and figure the difference in present value terms, which amounted to about \$13,500. I conclude from this that persistent property tax differences among homes within the same housing market (the land area over which home-buyers can search) will be fully capitalized. To find less than full capitalization is for the most part to find that potential homebuyers don't expect the current annual differences in taxes to last very long, or to fail to account for other relevant differences among the communities, such as school quality.

7. Capitalization and Fairness

Economists have known about capitalization of both property taxes and school quality in home values for a long time. What has not been so widely understood is the implications of capitalization for school finance reform. The most obvious implication is that property tax rates do not, repeat, *do not* measure the economic burden of the property tax system. Virtually every court case that has overturned local financing of schools has treated property tax rates as if they were the same as personal income tax rates, in which variations in rates do normally mean variations in economic burdens. Local property taxes are just not the same. The claim that unequal tax bases and unequal tax rates are evidence of economic unfairness is wrong. Nearly all economists who have addressed the issue of capitalization of local fiscal differences concur.²⁹ Let's walk through the argument once again.

Two towns share a school system—a common situation in many small, rural New England communities and, I suspect, many other places. Each town taxes itself based on its own tax base, with the nearly invariable result that tax rates for schools are different. Is this unfair? Not if the houses in the lower-tax town have a higher price-tag than those of comparable quality in the high-tax town. In that case, the mortgage and other housing-related costs will soak up the difference. The person who buys in the low-tax town pays the same for the sum of his municipal services (which are schools in our example) and housing as the person in the high-tax town. It is just a matter of who you pay: In the high-tax town, you pay more of your money to the tax collector; in the low-tax town, you pay more of your money to the mortgage banker. The example I gave above that compared tax burdens in Bow and Concord, New Hampshire, illustrated the principle, which is the concrete manifestation of all of those statistical studies about capitalization.

Here's another analogy. Suppose there are two private boarding schools. Both require all students to live on campus. St. Grottlesex charges \$15,000 tuition and \$10,000 for room and board. The Saltpeter School charges \$10,000 tuition and \$15,000 for room and board. Both give their students the same education; maybe the style is different (Saltpeter uses resident advisors and so imputes that cost to room charges), but their graduates learn the same amount. If one looked only at the tuition—which is what, in a public-school world would determine average tax payments—St. Grottlesex must be more expensive. People might say, isn't it unfair that St. G's charges families more than Saltpeter's to send their kids there? But, since both schools require their students to be residents (as is also the case for public schools in most towns), the total cost of attending either school is the same. Looking at just the tax payment or the tax rate from which it is obtained, without looking at the housing costs, is akin to assuming that daylight savings time makes each summer day 25 hours long.

A group that supported the plaintiffs in the New Hampshire case had a clever public-relations device that they called "the moving house." Priced at \$100,000, the mock-building was moved on a trailer from town to town to show how much the taxes would vary. In low tax Hampton, the taxes on the \$100,000 house were obviously less than they

would have been in high-tax Pittsfield. The exhibitors asked rhetorically, is it fair to allow such variations?

Capitalization shows the subtle fraud of such an exhibit. Capitalization says that when the house moves over the border, the house changes value: If the taxes in the town to which it moves are higher than the regional average, its value falls below \$100,000. If the taxes are lower, it climbs above \$100,000. What changes value, however, is not the structure itself but the land beneath it. This is what makes the moving house so fraudulent. It is the residential building lot that reflects the characteristics of the town. What housing-value capitalization is actually detecting is differences in improved or improvable land values.

8. “Property Rich” Places Are Often Populated by Poor People

The back-up rationale for demanding equalization of property tax rates is that it is a reasonable surrogate for helping the poor. Poor people live in houses that cost less than rich people, goes this story, so that pooling the resources of all communities will provide a benefit for the poor. The comparison in California’s Serrano litigation of poor Baldwin Park and—need it be said?—rich Beverly Hills was calculated to raise that issue. The comparison of “property poor” communities to “property-rich” communities was easily transformed by such examples into a comparison of just plain “poor” and “rich” communities.

There are at least two reasons that this transformation from “property-poor” to just plain “poor” is wrong. The most obvious is that every study shows a very low—often negative—correlation between communities with high property wealth per pupil and communities with high median family income (the best single measure of its residents’ personal wealth).³⁰ The reason for this is that nonresidential property, chiefly commercial and industrial property, often offsets the low personal wealth of the residents.³¹

The most obvious and important example of this offset is large central cities. Many such cities have both large amounts of commercial property and disproportionate numbers of poor people. In California, it was belatedly noticed and reported in the Los Angeles Times (June 30, 1974, § 1, p. 3) that the cities of Los Angeles and San Francisco, which harbor a disproportionate number of low-income people, were among the “property rich” places that were supposed to disgorge their local wealth in the name of school property-tax equity. (This inconvenient fact led some advocates of school finance litigation to argue that such places cannot fund schools adequately because of a “municipal overburden” of commitments for other services. There is no evidence, however, that this condition—which is at least partly self-created—inhibits school spending.³²)

Even among the suburbs and smaller towns, there is a tendency for the low-housing values of the poorer communities to be supplemented by larger-than-average amounts of commercial and industrial property. This is because higher-income people tend to be

fussier about localized disamenities that emanate from higher concentrations of commerce and industry. They avoid places that have disproportionate concentrations of it, and they also use zoning to discourage its entry to their own communities.³³

Paul Carrington, former dean of the Duke University Law School passed this story along to me in a letter of March 11, 1997:

Your footnote [in my “How Serrano Caused Proposition 13”] on the ambiguity of “wealth” brings to mind an experience of a Kansas lawyer that I know. Back in the days of Serrano, he was enlisted by the ACLU to attack the Kansas school finance system, which he agreed to do pro bono. After studying the matter, he observed that the richest district was Kansas City, which had the poorest children, while the poorest district was Pretty Prairie, a suburb of Wichita, which had the richest kids. He went back to his client and suggested the imprudence of their claim. They affirmed, however, that the principle of wealth redistribution was so important that the children of Kansas City would have to be sacrificed. He filed the suit, and the Attorney General of Kansas confessed judgment. He is still wondering why he did what he did.

There is occasionally some recognition of the idea that communities ought to be rewarded for putting up with unpopular land uses. Both Vermont and New Hampshire have a single nuclear power plant located within their borders. Both states have recently been subject to court orders to reduce reliance on local property taxes for school funding. Vermont has proceeded apace with a plan that expropriates some of the tax base of the “property-rich” towns. (One of the projected gainers from this system is Norwich, Vermont, which has the highest median family income in the state, but not much nonresidential property.) But the town with the nuclear plant, Vernon, Vermont, was specifically exempted from this provision. The major inducement for Vernon, a lower-income town, to accept the plant was that it would pay most of the town’s taxes and thus compensate residents for the inconveniences and anxieties caused by the plant. A similar inducement helped the town of Seabrook, New Hampshire, also a low-income town, to accept a nuclear plant.

It has long been my contention that the placement of all less-than-lovely commercial and industrial establishments are subject to the same sorts of considerations.³⁴ Since the advent of comprehensive zoning in the 1910s, commercial and industrial establishments have needed the permission of local political authorities, and these authorities are in most places rather attentive to the home values of their constituents. “Accidents of geography,” as the tax-base of localities are often described by the plaintiffs in school finance cases, are increasingly few and far between.

But one need not accept my theory of local government land-use determinism to reject the idea that residence in “property-rich” towns is an unsatisfactory base from which to redistribute wealth. Suppose the distribution of commercial and industrial property is entirely random, and accidental concentrations of it do confer a windfall advantage on the

people who live there. Such advantages will be capitalized in the value of the homes of people who live there. When they sell their homes, the buyers will have to pay both for the home and for the privilege of the fiscal advantages of the community, whether they be low taxes or good schools or some of both. This will be true for poor people as well as rich people. Local fiscal advantages are as fully capitalized for low-income houses as they are for high-income houses.³⁵

None of the studies that I have reviewed suggest that only the high-income homebuyers respond to fiscal differentials. The poor family that has moved to the low-income communities of Vernon, Vermont, or to Seabrook, New Hampshire, had to pay more for a comparable house there than they would have in the town next door because of the fiscal benefits that the nuclear plant confers on them (less the direct and indirect costs of having a nuclear neighbor). They may live in a property-rich town and pay less in taxes for better schools, but they had to sacrifice something else to make the higher mortgage payments (or rent) on their homes.

9. Fairness of the System Requires Comparisons of Results

There is a subtle counterargument available to those who like the idea of equalized tax rates (or, what is nearly the same, equalized tax bases) for schools but concede that capitalization undermines the simple equity argument. If capitalization results from local voters' expectations about future costs (taxes) and benefits (schools) that accrue to residence in the community, shouldn't we assume that such rational people can expect that things will change? After all, Professor Fischel, you pointed out (along with the Yinger study's authors) that folks in Massachusetts apparently anticipated that their tax advantages from illegal "welcome stranger" assessments would disappear. Why not assume that homebuyers in "property rich" communities in Vermont or New Hampshire or Ohio, the most recent subjects of judicial attention, also anticipated that their courts would find their advantages illegitimate? Can it have been a great surprise for them to discover this after 25 years of state court activism?

The problem with the counterargument is that it tries to settle a normative argument—what ought to be—with a phenomenon that is essentially amoral. Capitalization is itself value neutral. If new scientific knowledge reveals there is an increased chance that your community will be damaged by an earthquake, home values there will decline. Likewise, if political science revealed that there is a similarly increased chance that your community will be taken over by a political coalition of people who want to undermine public schools, home values will decline. Participants in the housing market—all of the potential buyers of homes—do not care about the source of the risk. But clearly we do in designing a political system. We cannot do much about the earthquake other than prepare to endure it. But we can deal with political hazards that are at least part of our own making.

For this reason—the fact that political institutions are of our own making and hence are moral acts—the ultimate rationale for differences in local government services must rely

not on capitalization itself, but whether the political system that produces it is preferable to some other. About earthquakes we have no choice; about our political institutions, we do have a choice.

In the following sections, I will deploy the capitalization phenomenon as the centerpiece for an argument that local control over much of educational spending produces better results than a centralized system. Capitalization itself does not justify this system, any more than the knowledge that you are living in a high-crime neighborhood, and thus paid less for housing, justifies burglary. (Robber to victim: “Stop complaining; you knew this was a high crime area and you saved lots of money on rent by living here. If it weren’t for the likes of me, you’d have had to pay the money to the landlord.”)³⁶

Capitalization does refute the simplistic arguments about tax fairness: Different tax rates are not evidence of different economic sacrifice. But it does not by itself address the Jonathan Kozol argument, which asks, amidst all of his special pleading and biased sampling, the fundamental question: Is there any excuse for a system that allows, for whatever reason, the quality of public education of children to vary by location or, for that matter, by any other factor?

10. How Capitalization Produces Better Schools

The major excuse for the present system is that it performs better than the one towards which the courts have pushed us. There are, of course, plenty of debates about how widely the distribution of benefits of any system ought to be spread.³⁷ I don’t care to explore these philosophical criteria here because I will show that the destruction of local fiscal control that follows from court-ordered centralization probably fails every normative test: It lowers the performance of most students, leaves taxpayers worse off in most instances, and does not seem to help poor children perform better in school or in the labor market. Or, to put it in a positive light, the establishment of a system of local fiscal autonomy (if we had an entirely state-financed system) can raise the average without leaving the poor worse off.

I want it to be clear to the reader that I am not arguing for reliance on the local property tax to be the sole method of public school finance. Both for redistributive and efficiency reasons, there is a role for the states and the federal government to supplement public education both with funds and with some rules as to how the funds must be spent.³⁸ My contention is that higher-government interventions must be careful not to undermine the virtues of the local system. My beef with the court interventions in school finance, aside from questions about their constitutional legitimacy, is that, despite their many disclaimers about maintaining local control, they have undermined a highly effective aspect of our system of public education. The decisions have moved the public school system in a direction that offers poorer incentives for voters and school officials to provide an efficient level of this important public service.

The theory of the efficacy of local control is simple. (I should emphasize that local control means local *fiscal* control: A political scientist who wrote about his service on a school board flatly declared, “The effective place for citizen control is the budget.”³⁹) Consider that all local districts must offer a minimum of schooling, so having no schools is not an option. (This is one of those state rules that probably is necessary to control some deviant behavior.) Now consider a school superintendent who offers to the voters (indirectly through the school board, or directly through a referendum) the following proposition: Build twelve new classrooms and hire twelve more teachers in order to reduce class sizes. This will require a ten-percent increase in the local budget, which must be paid from local property taxes.

Will the voters go along with this proposal? They will find it a lot easier to say yes if the proposal raises the value of their homes. This involves a balance of two opposing forces that I have already identified: higher taxes versus better school quality. The higher taxes are both painful to pay by themselves, and they also reduce the value of the home because potential buyers will notice that taxes are higher. On the other side, however, the voter-homeowners know that better schools (or just keeping them from getting worse by overcrowding) that may result from the smaller class sizes will raise their home’s value. Hence, in addition to whatever other factors will induce voters to favor or oppose the proposal, its effect on their home values will be a powerful discipline to make the right choice.

Let’s suppose that the “cost effective” choice favors the superintendent’s proposal. The supposition is that this will attract homebuyers; they will somehow know that the schools are better. How will they know? It is hard to say. It may be that test scores will rise and the school will make the well-circulated booklet called “The Top 100 Schools in California” or similar publications for other states and metropolitan areas. Or the smaller classes may improve education in more subtle ways, and local word-of-mouth will be passed along by co-workers already in the area or by real estate professionals. (Recall the real estate sales people get a larger commission as home prices rise, so they are eager to pass along good news that raises prices.)

What is much easier to say is that home buyers behave as if they know about the quality of local education. From the capitalization studies described above, we know that homes in communities with good schools attract more buyers and higher bids. The idea has reached even the pages of *USA Today*. “Home Buyers Go Shopping for Schools” (May 15, 1996, p. B1) reported that “childless house hunters are increasingly asking for houses in quality school districts.”

Less obvious is that voters actually behave in a way that rewards the cost-effective proposals and defeats the inefficient ones, whose tax costs outweigh the school benefits. Given the low turnout in most school elections, and given the folk wisdom that all voters care about is lower taxes, how can this elegant theory be reconciled with political reality?

The first thing to point out is that folk wisdom is just wrong in this case; voters obviously are not solely concerned with minimizing taxes. If they were, virtually every school spending issue placed before voters would be defeated. The only ones who would vote for schools would be the direct beneficiaries, those with children in or about to enter the public schools. But in almost every community, these voters are a minority. In the nation as a whole in 1990, only 38 percent of adults lived in households with children under 18. In the absence of capitalization, 62 percent of potential voters have little to lose and much to gain by voting against all school spending. But we do not in fact observe that this happens. The question is, why not?

The answer is that most no-kids-in-school voters are content to stay on the sidelines as long as the higher taxes buy school expenditures whose effects increase (or at least don't decrease) their property values. While the prospect of higher taxes will always bring out some "no" voters, the prospect of preserving or enhancing home values stems the tide as long as the proposed expenditure is realistically designed to make schools more attractive. Of course, some voters will support schools even without any rewards to themselves; they simply want to transfer wealth to future generations. The capitalization principle adds to this incentive, allowing such beneficent voters to do well as well as to do good.

11. Evidence that Capitalization Grabs Voters' Attention

There is some systematic statistical evidence in support of the previous section's view of the nicely-rational voter. Two social psychologists did a survey of voters in a local referendum that proposed to raise property taxes considerably and spend the revenue on local education.⁴⁰ The referendum passed—I'm pretty sure it was in Evanston, Illinois, though the authors did not specifically reveal it—and the researchers wanted to know why people supported it. One of the most frequently voiced reasons, given by people who had no children in the schools as well as those who did, was that a decline in school quality would hurt their home values.

Evanston, the skeptic might point out, is a pretty affluent suburb of Chicago and a university town to boot. Is this behavior typical of other places? Jon Sonstelie and Paul Portney looked at a school referendum in the more middle-class city of South Francisco that was held in 1970. (This was before the *Serrano* decisions and Proposition 13 took away most local control over schools). They concluded that "the larger is the average expected increase in property values in a precinct, the more likely it is that voters in that precinct will support the referendum."⁴¹ They titled their article, "Take the Money and Run" to highlight the fact that even voters with no plans to stay in the community and no children will approve spending measures that will raise the value of their major asset, their homes.

What about the lower-income cities? The anxiety expressed by people to whom I've explained this theory is that it may be okay for upper-class places, but lower-income places with declining tax base may be stuck in a "death spiral." The idea is that as

taxpaying high-income homeowners and industry depart, taxes must be raised, inducing still more people and industry to depart. Self-help is of no use, according to this pessimistic idea; the Tiebout model works fine for the upper crust, but not for the bottom layer, they say.

Capitalization and simple observation show that this pessimistic theory is not plausible. Cities have long had their ups and downs in tax rates without either crashing or bursting at the seams. Industries come and go, and taxes fall and rise without municipal collapse. This is largely because of an underappreciated aspect of capitalization: It induces homeowners (and other property owners) to stay put and put up a fight against decline. This is because the people who own houses can leave, but their asset—the house and, more particularly, the land—is stuck. If they sell their house at a loss, they take less money with them wherever they go.

I often hear claims that people will have to sell their homes to escape the bite of higher local taxes. To whom will they sell? Some fool who does not notice that the taxes are high? What most people mean when they say this is that they have taken a capital loss and are unhappy about it. They take the loss, however, regardless of whether they sell or stay. Capitalization says that you might as well stay as leave. The “death spiral” depends upon a view that there will be more sellers than buyers, which can only be the case if property prices do not change.

Of course, there are people who do not anticipate their higher tax bills. Having high taxes and a high mortgage may induce such people to liquidate their assets if they don't have enough cash-flow to pay both. Thus an unanticipated rise in taxes may indeed induce people to “lose their homes” by selling them, since the bank holding the mortgage usually does not reduce the payments to offset unanticipated tax increases. But even if people do liquidate their assets, there must be buyers who “gain their homes” at a lower price. The higher taxes plus the (now lower) mortgage payments will be just as affordable for the buyer of the home. Housing prices may go down as a result of a loss of tax base or increase in tax rates, but that's no reason for the community to empty out of any particular type of taxpayers.⁴²

I mention this because the “death spiral” argument was presented on behalf of Claremont, a New Hampshire town that was the lead plaintiff in the school finance suit in which I testified. Claremont once had a bustling set of mills, but most have closed, and its residents have had to endure higher taxes. But a visit to the town shows that home construction is proceeding, and new schools have been opened. An advertisement in my local paper compared the price of an eight-room home in Claremont with that of nearby Lebanon, which has lower taxes. The advertisement, sponsored in part by the city of Claremont, pointed out that eight-room homes cost on the order of \$90,000 in Claremont, compared to about \$150,000 in Lebanon. Of course, the tax bill on the Claremont home may be higher than others (a fact the newspaper advertisement did not mention but which potential buyers would certainly discover), but a buyer who saves \$60,000 by buying a

house in Claremont will have cash left over to pay those taxes. As real estate salespeople say, price cures all.

Claremont, moreover, is not a passive observer of the decline of its industrial base. It has an active economic development office, and the issue of revitalizing the town is also raised at school meetings, at which voters are asked to approve or disapprove new school spending. At one such meeting on March 11, 1995, Allen Whipple (a former mayor) spoke in favor of a bond issue that would raise taxes for a new school. He invoked the Sullivan County Citizens for Tax Relief (of which he was not a member), who usually oppose tax increases, in support of the bond issue: “Their goal is property tax relief. The goal is more than just cutting budgets. The goal is to make city hall and the schools more efficient. An environment must be created that will increase the tax base and the average pay of a worker in Claremont. Part of this will be accomplished by having an efficient education system...The school facilities will play a major role in attracting new business to Claremont.”⁴³

The budget passed.

12. State Test Scores May Decline with Centralized Finance

I outlined a theory in section 10 that finds virtue in local fiscal control of education. I presented in section 11 some evidence, both econometric and anecdotal, that homeownership induces voters to pay attention to the quality of schools as well as property taxes. This supports the assumptions of the basic theory, but it does not address whether the Tiebout-style system is better than the alternative towards which the courts have been pushing the states. This and the next section address that question.

The basis for one group of econometric tests of the efficacy of public-school competition and local control is the variation among the states in how schools are administered and financed. There are some dramatic differences. A few states have almost totally centralized funding. Hawaii and California are the two most frequently mentioned—and both have highly problematical public schools.⁴⁴ Other states have more decentralized funding. New Hampshire leads the pack in this respect, with nearly 90 percent of all education funds coming from local sources—and the state’s schools do quite well in sophisticated national comparisons.⁴⁵ The large majority of other states range between 35 to 60 percent of all school funds being raised by statewide taxes. Moreover, some states have moved rapidly toward state funding as a result of court orders. These facts have provided the variation needed to decide whether decentralized funding and competition among numerous independent districts provides better schools.

The question is how to decide which states’ schools are better. The only consistently-graded national test that has been given to a large number of students over the years is the Scholastic Aptitude Test, which students with college ambitions usually take. SAT scores were once considered unreliable indicators of the quality of education in a state because the test-takers are not a random sample. In some states, only a few seniors who

are going out of state to selective colleges take the test (the others take the ACT), while in others (mostly on either coast), more than half of all high-school seniors take the test. States with lower participation rates thus have high SAT scores because the test was taken there only by the better-quality students. But in the last few years economists have used statistical techniques to control for participation rates as well as demographic and economic differences among the states. They find that state SAT score rankings, adjusted for participation rates, are actually reasonable indicators of how much students had learned in the state's schools.⁴⁶

To get a very approximate take on how the SAT rankings related to local funding, I took the 1991 regression-adjusted rankings of 38 states examined by Graham and Husted and matched it with the percentage of school spending financed by the state.⁴⁷ In their top ten, none had more than 50 percent state funding. In the bottom ten, all but three states had more than 50 percent state funding. More sophisticated approaches to SAT rankings attempt to control for other factors affecting each state's education system. Of the econometric studies that have undertaken that, none find that especially high levels of state funding (as opposed to reliance on local property taxation) have improved SAT scores among any group, and some indicate that a large state share makes things worse.

David Card and Abigail Payne are the most optimistic of the group. In their preferred specification, they find a small positive effect on SAT scores of students from states that have increased the state's share of funding, but their result is not statistically significant. In their most elaborate specification, however, they found "no evidence that spending equalization across school districts would raise the [SAT] test scores of the lowest parental education group relative to other groups."⁴⁸ In an earlier study, Mark Berger and Eugenia Toma came to a more pessimistic conclusion. They examined all U.S. states over the period 1972-1990, and found that states that supplied a larger fraction of public school spending from nonlocal sources had lower SAT scores, though this also was not statistically significant.⁴⁹

Of the econometric studies with statistically-significant results, all show a *negative* relationship between statewide SAT scores and the loss of local fiscal control. Thomas Husted and Larry Kenny, who were among the pioneers in using participation-adjusted SAT scores to rank states, examined the trend of school financing over the past 20 years. Their results indicate that states with a larger fraction of education financed by the state had lower SAT scores.⁵⁰ States whose supreme courts had previously ordered centralizing reforms had especially low scores.

Sam Peltzman found a modest but statistically significant relationship between 1972-1981 increases in the state's share of funding for education and declines in statewide SAT scores.⁵¹ A national study by Lawrence Southwick and Indermit Gill which employed data from 1985-1991 found a small but statistically significant negative relationship between SAT scores and percent of funding coming from nonlocal sources.⁵² (They were mainly concerned with teacher salary structures, however, and found that uniform "comparable worth" structures had a negative effect on the SAT scores of states that had

instituted these supposedly egalitarian salary policies, which treated English and math teachers the same as all others.) The sophisticated reports on SAT scores look like a strong vote for local fiscal control.

13. Competition Among Public School Districts Improves Quality

Aside from requiring a large degree of local fiscal autonomy, the system I have described also requires that there be numerous school districts in which potential homebuyers can live and send their children. If not, cost-effective improvements in the school district cannot raise home values. If the kids all have to go to the same school system, homeowners without children get no special benefit from improved schools, since there will be no enhanced demand for their homes compared to those in any other town. But the higher taxes will be a net cost to them, and they will be reluctant to favor any tax increase. (It is possible for some school-quality capitalization to occur even if there are no alternative public schools, because some potential buyers can opt for parochial and independent schools. There is evidence that a reduction in public school quality does increase private school enrollment.⁵³ I will not deal with that option except to note that it is not surprising that school vouchers have found most favor in places such as inner-city areas in which residents have few alternative districts in which to live.)

The idea that competition among towns promotes education goes way back in our history. In his fascinating history of Cooperstown, New York, historian Alan Taylor mentions that the town's first free public school was established specifically in response to a rival town that had set one up and was successfully attracting immigrants at the expense of Cooperstown.⁵⁴ Competition among communities took the form of a "race to the top" even back then.

More recent evidence on competition comes from studies of in-state scores of tests that are administered on a uniform basis and thus do not require the participation-rate adjustment that one must make in comparing states on SAT scores. Blair Zanzig looked at the "Iowa Test" scores of school districts in California in 1970 (before the *Serrano* decision). He found that twelfth-graders in counties in which there were four or more school districts had higher scores. Counties that had fewer districts had lower scores because, Zanzig inferred, there was less competition among the districts.⁵⁵ John Blair and Samuel Staley found that Ohio school districts that were subject to more competition from other public school districts had better reading scores on a standardized, statewide test.⁵⁶

The foregoing studies all invoked modern econometric evidence and employed extensive control variables in attempt to keep other things equal. They largely point to the possibility that a more decentralized, localized system of financing education produces better test scores. The trouble with them is that we do not know what caused the districts in a given area to be numerous or few in number. Perhaps areas with only a few districts were created that way to take advantage of scale economies. If that were the case, we

could not be sure that the worse test results were not offset by some unobservable reasons for consolidation.

In a series of papers beginning with her prize-winning doctoral dissertation, Caroline Hoxby proposed an imaginative test to overcome these problems.⁵⁷ She looked for metropolitan areas around the country that had natural features (chiefly bodies of water) that might separate urban areas into school districts. In areas with many such immutable dividers, the fragmentation of school districts would be “natural” in its most literal sense. Using this control, Hoxby found that a greater number of independent school districts in a metropolitan area increased her measure of educational accomplishment (high-school graduation rates and college-going). Her most important finding was that in the competitive situation (i.e., many school districts in the metropolitan area), all schools, even those serving the relatively disadvantaged, got better. Competition among public schools, like competition among private businesses, raises the quality of all.

Hoxby also found that private and religious school competition was beneficial to public schools. The results of her sophisticated econometrics were illustrated in Albany, New York, last year in an article reported in the *New York Times* (September 30, 1997, p. 19). A philanthropist was distressed by the poor quality of a public school in Albany. She offered free tuition to students from that school to attend the private school of their choice. Many left. But the public school responded by obtaining additional funds from the city and dramatically improving its program. This stanching the outflow of good students and induced several to return.

A less publicized example of the benefits of competition for students is the behavior of rural Vermont and New Hampshire high schools that are dependent in part on the tuition payments from public school students. Many small towns lack a high school, and so, in many cases, their students are given vouchers (usually equal in value to the average cost per high school student in the state) to attend the high school of their choice. The schools to which they can go actively compete for them. Liz Ryan Cole, an instructor at Vermont Law School, has children who attend Thetford Academy, a small public high school near my home in Hanover. She mentioned to me in conversation that her son was taking calculus at Thetford. I wondered how such a small public high school could afford to teach calculus in what she confirmed was a very small class. She replied that the school was making a rational calculation. If it did not offer calculus, its footloose tuition students would go to the larger high school in Hanover, New Hampshire.

Hoxby adds an interesting twist to the incentives provided by capitalization.⁵⁸ My explanation for its superior incentives (compared to a state-funded system) focuses on the benefits that homeowner-voters perceive. But another party is also interested in capitalization. School administrators may realize that efficient school programs, which may be difficult for the public to grasp, will be easier to fund than inefficient programs. The efficient programs improve test scores or other indicia of education quality. This raises the property-tax base, and makes it easier for the school administrator to acquire

more resources. Even holding the tax rate constant, more funds will flow into the school if the value of the tax base increases.

Hoxby's overall line of research has opened up a new window on school finance issues. She has convincingly demonstrated that where the money comes from and who controls it, not just the amount spent, can make an important difference in the quality of public education. She proposes that one reason that it is so difficult to discern that more money improves education is that much of the vast increase in school spending over the last decades—it is much in excess of the rate of inflation—was accompanied by a shift from local to statewide financing.⁵⁹

14. How School Finance Equalization Caused a Taxpayer Revolt

During the 1960s, California had an exemplary public education system. Its university system drew the most favorable notice, but its primary and secondary schools were well regarded, too. They were well-funded, with per pupil expenditures and other indicators of devotion to public education ranking among the top ten in the United States.⁶⁰ The funding was a mix of local property tax revenue and state aid.

In 1971, the California Supreme Court ruled for the plaintiffs in *Serrano v. Priest*. It held that the existing system of reliance on local property taxes to finance public schools was unconstitutional if, the court said, children's educational opportunities were dependent on the taxable property-value of the community in which they were located. The court did not in 1971 specify a particular remedy. It left it to the legislature to find an acceptable system. The California legislature responded by increasing the state's existing school-aid program, and it tried to narrow the spending gap by imposing revenue limits on the high-spending districts. After a time however, it did allow local voters to override these limits in special elections, and enough of the elections succeeded that the trend towards expenditure equalization was undermined.

In December of 1976, just as the 1977 legislative session was beginning, the Supreme Court issued another opinion in *Serrano*. *Serrano II* validated, by a 4-3 vote, the simple remedy proposed by a lower-court judge to whom *Serrano I* had been remanded. The legislature had to assure that state plus local spending on general-purpose school expenditures, which excluded special categories such as aid to handicapped students, should vary by no more than \$100 per pupil across districts. The \$100 range could be exceeded if the reason was not related to property-tax-base differences, but in practice few high-spending districts could make that claim. While the California Supreme Court did not prescribe the \$100 range as the sole constitutional remedy, the \$100 band soon became the litmus for compliance.

The legislature's response to *Serrano II* was a new school finance bill that raised state aid still further and imposed a system by which the additional spending by "property rich" districts had to be shared with other districts. It would have come very close to meeting the *Serrano II* court's \$100 range criterion. It was scheduled to be implemented on July

1, 1978. But as the legislature was considering school-finance reform in the summer of 1977, an enormous property-tax revolt was taking shape. Vigorously promoted by a garrulous former newspaper editor, Howard Jarvis, the voter initiative was placed thirteenth on the ballot for June of 1978.

In many ways, the prospects for Proposition 13 were not good. The great majority of California voters had shown no interest in property tax reduction initiatives prior to 1977, when the Jarvis-Gann (Proposition 13) initiative began. Two well-run initiatives that would have cut local taxes and handed many local responsibilities, including school funding, up to the state, had been handily defeated in 1968 and 1972. But that was before *Serrano* had any bite. As the legislature struggled to comply with *Serrano* from 1971 onward, property tax payments were increasingly separated from the quality of local schools. The 1977 legislation would have completed the divorce. Voters in 1978 had much less reason to oppose an initiative that effectively kicked almost all school funding to Sacramento.

Moreover, and perhaps fatally, the legislature's "level-up" response to *Serrano II* in 1977 required continued reliance on property taxes and thus foreclosed the possibility of heading off the Jarvis-Gann tax revolt by statewide property-tax relief. Although at the time California was running a large budget surplus (driven by inflation and bracket creep), the chief legislative analyst, Alan Post, told legislators that any projected surplus would not be adequate to fund both its school spending bill and meaningful property tax relief (*Los Angeles Times*, August 1, 1977, § 1, p. 3). Legislators knew that taxpayers were upset, but they chose instead to deal with *Serrano* in order to avoid further confrontation with the California Supreme Court. As a result, the Jarvis-Gann initiative became unstoppable.

Proposition 13 was an amendment to the state constitution, and it passed by a 2-1 majority on June 10, 1978. It froze ad-valorem property tax rates on individual properties at one percent, and it rolled back property tax assessments to 1975 levels. Reassessment was permitted only upon sale of the property, except for a maximum two percent annual increase, which was well below property-value inflation. Proposition 13 also banned any statewide property tax, and it required a two-thirds majority of local voters to adopt alternative taxes. The net result was a 57 percent reduction in property tax collections across the state, an amount approximately equal to the property taxes collected for schools. Proposition 13 has continued to keep property taxes in California among the lowest in the nation.⁶¹

My interest in Jonathan Kozol's *Savage Inequalities* was piqued a few years ago. I had published an article in 1989 called "Did *Serrano* Cause Proposition 13?" I showed that, according to the modern theory of local public finance, it was perfectly rational for California voters in 1978 to embrace a draconian property-tax limitation after school finance had been effectively divorced from local tax bases by *Serrano*. Mine was an unusual conclusion among scholars, who had few explanations for the tax revolt other

than that voters wanted, as the subtitle of one book put it, “something for nothing in California.”⁶²

I was at work on a follow-up article, “How *Serrano* Caused Proposition 13,” when I encountered Kozol’s book. To my astonishment, I found that Kozol agreed with my hypothesis. He noted that the California legislature responded to the *Serrano* court’s second and highly-equalitarian order in 1977 with a plan to substantially equalize spending. He went on to explain:

As soon as Californians understood the implications of the plan [AB 65, which was the “level-up” legislation]—namely, that funding for most of their public schools would henceforth be approximately equal—a conservative revolt surged throughout the state.... Proposition 13, as the tax cap would be known, may be interpreted in several ways. One interpretation was described succinctly by a California legislator: “This is the revenge of wealth against the poor. ‘If the schools must actually be equal,’ they are saying, ‘then we’ll undercut them all.’”⁶³

Kozol conceded that there might be more to Proposition 13 than that, but he nonetheless concluded that the *Serrano* plaintiffs “won the equity they sought, but it is to some extent a victory of losers.” His conclusion was seconded by the dean of education finance, Charles Benson, who had been a staunch supporter of the *Serrano* litigation and its reforms. At a Congressional hearing on school finance reform in the early 1990s, Benson warned, “You must be very careful when you wish for things because you may just get what you wish for. We worked hard for equity in California. We got it. Now we don’t like it.”⁶⁴

One difference between Kozol and myself is that he continues to argue in favor *Serrano*-style court rulings, and I argue against them. I don’t think that Proposition 13 represented “the revenge of the wealth against the poor,” as Kozol’s anonymous informant put it. It passed overwhelmingly in almost every California municipality, rich and poor. Even 70 percent of the voters in Baldwin Park—the epitome of the “property poor” district in the *Serrano* litigation—voted for Proposition 13. But we do agree that fiscal support for education in California has declined dramatically. A sophisticated econometric model by Fabio Silva and Jon Sonstelie attributed half of California’s decline in spending relative to other states to the leveling effects of the *Serrano* decisions.⁶⁵ Support for local schools went south after *Serrano*, and statewide support in Sacramento has been unable to replace it. (It should be noted that there was nothing in Proposition 13 that prevented the state from offsetting the property tax cuts with increased income or sale taxes. Indeed, some well-informed observers regarded Proposition 13 as an opportunity to accelerate compliance with *Serrano* II.⁶⁶)

15. Other Taxpayer Revolts in Response to School-Finance Centralization

My account of how *Serrano* caused Proposition 13 has become part of the conventional wisdom among local-public-finance scholars and students of Proposition 13. Even

economists who are partial to centralized funding for schools concede that the *Serrano II* court went too far in this direction and pushed the voters over the Proposition 13 cliff.⁶⁷ Peter Schrag, a liberal-minded journalist who, as the editorial page editor of the *Sacramento Bee* had a ringside seat to the events surrounding Proposition 13, gives my story considerable credit, if not total acceptance, in his book about the consequences of Proposition 13.⁶⁸ At the very least, according to Schrag, the *Serrano II* decision greatly complicated the California legislature's response to the tax revolt.

Was California unique in its fiscal response to *Serrano*? I have not found another case in which a *Serrano*-style decision—one which requires substantial reductions in local fiscal autonomy—directly led to a statewide property tax revolt. However, I believe that other state court decisions have undermined political support for taxes earmarked for schools, and thus indirectly contributed to political reactions that should be considered tax revolts. I will first review some discrete events in several states (I have not examined all of the states) and then, in the following section, the statistical evidence on the connection between court rulings and the level of support for education.

Maine

Events in Maine are among the closest parallels to *Serrano* and Proposition 13. In 1973, the Maine legislature adopted a uniform statewide property tax designed to “recapture” taxable property in property-rich towns and transfer them to other towns and cities to pay for schools. Because only a few towns (mostly resort towns along the coast) had very high taxable property per resident, the net effect of Maine's statewide tax was to take property tax revenue from a small number of towns and give the proceeds to towns and cities with in which a great majority of the state's population resided.⁶⁹

The 1973 Maine legislation was not the product of popular dissatisfaction with schools or local property taxation. It was explicitly motivated by the school finance litigation that began with *Serrano I* in 1971. A *Serrano*-style suit had made its way to the Maine Supreme Court. At the time (1973), the U.S. Supreme Court was hearing the federal court version of *Serrano*, which was *San Antonio v. Rodriguez*. The Maine court specifically delayed its decision to see how the U.S. Supreme Court would rule.

The Maine legislature, however, decided not to wait. It adopted the statewide property tax plan in anticipation of an adverse ruling. The U.S. Supreme Court ultimately ruled in *San Antonio v. Rodriguez* that states were not compelled to reform school finance, and the Maine court, as a result, backed off. But the Maine legislature decided to keep the law on the books. After all, it looked like a politically attractive thing to do, at least if one simply counted noses. The statewide property tax and the related school funding distribution formula allowed the state to transfer property tax wealth from a few towns to other places in which the vast majority of the permanent population lived. It seemed like a no-brainer.

It was. Despite the apparent fiscal benefits of the 1973 program to most Maine residents, the statewide tax and the related school funding reform were unpopular. After four years of tinkering with the distribution formula, legislators agreed to hold a referendum on the tax in 1977. The vote to repeal it passed with an overwhelming majority. Although the small “property-rich” towns that bore the brunt of the statewide tax did vote disproportionately for repeal (in one town of about 400 voters, only a single voter favored retaining the statewide tax), a majority of voters in municipalities that supposedly benefited from the state tax also voted to repeal it. An article that examined the votes by towns and the events leading up to it concluded that “the amorphous issue of loss of local control was successfully raised by those groups seeking rejection of the Uniform [statewide] Property Tax.”⁷⁰

New Jersey

The New Jersey Supreme Court came in second to California’s in its holding that the state’s reliance on local funding was unconstitutional, but it holds the record for the lengthiness of the litigation. Its first ruling was in *Robinson v. Cahill* in 1973, a year after *Serrano*, and its final ruling (at least the court said it was the last) came in the successor case to *Robinson*, *Abbott v. Burke*, in 1998. New Jersey’s holding was based on a provision of its state constitution that called for a “thorough and efficient” system of education, and the court concluded that those words required much more state funding. In 1976, the court actually closed the schools because the state legislature would not pass a bill, sponsored by the governor, that replaced much of the local property tax with a new state income tax.⁷¹ The legislature promptly rolled over, and New Jersey adopted an income tax for the first time in its history.

The new income tax did not, however, work to the court’s satisfaction, and in 1989, it held in *Abbott v. Burke* that the lowest spending districts had to be brought up to the level of the highest. Newly elected Governor Jim Florio induced the legislature, both houses of which had solid majorities of fellow Democrats, to comply with the court’s order. They passed a steep increase in income taxes, offering little reduction in property taxes to the higher spending districts. According to Rutgers political scientists Russell Harrison and Alan Tarr, the 1990 bill “proved extremely unpopular, contributing to the election of veto-proof Republican majorities in both houses of the state legislature in 1991 and to Florio’s defeat when he ran for reelection in 1993. Responding to citizen outrage, the legislature in 1991 amended the Quality Education Act [Florio’s *Abbott* response] to divert \$360 million from school aid to property tax relief.”⁷² This turnaround is to my mind almost as dramatic as the passage of Proposition 13 in California in 1978.

It is important to understand that it was not merely the prospect of higher state taxes that upset New Jersey voters. Governor Florio’s plan also involved a redistribution of school aid among districts (most of which correspond with the boundaries of New Jersey’s 543 municipalities). The new formula would have caused enormous shifts in home values, according to a simulation study by William T. Bogart, David Bradford and Michael

Williams.⁷³ Although on balance this would have shifted wealth from high-income to low income communities, their study found much perverse shifting, including the fact that the poorest community in the state, West Wildwood, would have been a net loser from the system. (I assume West Wildwood lost because its seaside vacation property made it look “property rich” even though its year-round residents were “income poor”—that is, just plain poor.) In the long run, Bogart, Bradford and Williams concluded, the state would have had a net loss in property values as higher-earning households avoided the state for more favorable fiscal climates in Pennsylvania or New York.

Massachusetts

Two well-known property tax revolts, those of Massachusetts and Michigan, are not directly associated with school finance litigation. I nonetheless want to suggest that the penumbra of these cases may have had an effect on political decisions to reduce reliance on property taxation and throw its schools into fiscal disarray. Proposition 2.5 in Massachusetts was passed in 1980, and it remains the best-known offspring of Proposition 13. It was less extreme than California’s initiative but it nonetheless did hold down property taxation and, according to Dutch Leonard, greatly retarded the growth in school spending across the state.⁷⁴ I suspect that Proposition 2.5 can also trace some of its lineage to *Serrano*.

The initial evidence for this idea occurred to me when I read Massachusetts’s 1993 decision, *McDuffy v. Secretary*. *McDuffy* is the Massachusetts version of *Serrano*, but, of course, it was decided more than two decades later. However, the *McDuffy* court noted that the suit was actually begun much earlier (615 N.E.2d 516 at 518):

Initially, suit was commenced in May, 1978, under the caption *Webby v. Dukakis*, by the filing of a complaint and a motion for class certification in the Supreme Judicial Court for the county of Suffolk. Shortly thereafter, the Legislature enacted “School Funds and State Aid for Public Schools,” St. 1978, c. 367 § 70C (codified at G. L. c. 70). Following that legislative enactment, the case was inactive for five years, until 1983, when the parties initiated discovery.

According to a *Boston Globe* editorial (May 16, 1978, p. 16), the 1978 suit had been brought shortly after the state House of Representatives had refused to pass the new school finance bill, Chapter 70. (That is the “G. L. c. 70” referred to in the *McDuffy* quote.) The Representatives soon changed their vote and passed the legislation, and the suit was dropped. As political scientist Edward Morgan reported, Chapter 70 was highly redistributive.⁷⁵ From 1978 to 1980 (the period during which Chapter 70 operated without Proposition 2.5), all measures of inequality in per pupil spending declined. Chapter 70 was also centralizing, increasing state funds from 35 to 50 percent of total expenditures. The changes in school finance in Massachusetts in 1978 all move in the same direction as the *Serrano*-induced legislation moved California’s school finance system.

Unlike my evidence in California, however, I do not have any “smoking gun” statements by Massachusetts legislators that they were responding to a court order or that they were unable to head-off property tax revolts because of their school-spending reforms. However, the further history of the *McDuffy* case (reported in the 1993 opinion) does suggest as much. By 1983, the school finance litigation was active again, and again the state legislature responded in a way that apparently induced the plaintiffs to back off again.⁷⁶ This suggests to me that the legislature had been responding in all phases to the threat of litigation.

An explicit court-order might not have been necessary to goad the legislature in 1978. The *Serrano* precedent greatly increased the chances (we know from the subsequent 1993 decision) that the Massachusetts court would force the legislature to undertake a centralizing school-finance reform. *Serrano* had been a leading precedent in other states whose courts had struck down existing systems of school finance. These included such Massachusetts-like states (eastern and urban) as Connecticut in 1977 (*Horton v. Meskill*) and New Jersey in 1973 (*Robinson v. Cahill*). There were strong reasons for the Massachusetts legislature to preemptively surrender to the *Webby* plaintiffs, and the behavior of the plaintiffs, who dropped the suit as soon as Chapter 70 passed, indicates that they took the legislature’s concession as equivalent to winning in court.

Because Proposition 2.5 was a milder constraint on local government, however, Massachusetts towns were gradually able to escape its constraints during the property-boom of the late 1980s, and locally-driven school spending became more unequal. This inequality is what finally brought the court to make its decision in *McDuffy* in 1993. This scenario did not play out in California because both *Serrano* and Proposition 13 were more stringent than the *Webby*-induced (I suspect) Chapter 70 and Proposition 2.5. After *Serrano* and Proposition 13, California school districts had virtually no discretion to use property taxes to raise spending.

Michigan

The Michigan experience is still more of a stretch for my theory. In 1993, the Michigan legislature practically abolished the use of local property taxes to finance schools.⁷⁷ It offered voters a choice of an income or a sales tax to fund schools, and the voters chose the sales tax in a 1994 referendum. This looks like the quintessential tax revolt, aimed at school finance, but without any explicit goad from the courts. Indeed, when I have asked Michigan-based scholars whether a court ruling played a part in the state’s decisions, the invariable response is “we did it to ourselves.”

Yet there is a penumbra effect that seems detectable in the Michigan history. There was a *Serrano*-style ruling by the Michigan Supreme Court in 1972. In *Milliken v. Green* (also known as *Governor v. State Treasurer*), Michigan’s Governor Milliken sought an advisory opinion about the constitutionality of Michigan’s school finance system, which was then the usual hybrid of local property taxes supplemented by state funds, with much

variation in local tax rates. The court majority ruled that local property taxes were unconstitutional as a basis for school finance.

The court's advisory opinion was not binding on the legislature. That it was intended to signal the legislature about how the court would rule in if a true controversy was brought in future was indicated by Judge T.E. Brennan's tart dissent in the case (at ¶208): "The majority opinion is not good law. It is not even law at all. It is a political position paper, written and timed to encourage action by the state Legislature through the threat of future court intervention." Judge Brennan went on to detail the events that led up to the decision. By the next year, the case was vacated because the U.S. Supreme Court had undermined the state's equal protection argument with its *San Antonio v. Rodriguez* decision, and newly appointed Michigan supreme-court judges were not so eager to have the state court lead the way to school finance reform. And perhaps because the Michigan legislature preemptively surrendered, so no suit was brought to the court.

Other sources indicate that in 1973, the Michigan legislature responded to the court's wishes with a "Robin Hood" style school finance bill, one that took from the property-wealthy and gave to the property-poor.⁷⁸ The system that was finally rejected in 1993 was a "power equalization" formula of the type described in the next section. (As I shall explain in section 18 below, power equalization makes homeowners less concerned whether the taxes come from a local or statewide source, thus undermining one of the primary attributes of a local property-tax system.) While Michigan's system was subject to much legislative tinkering, it remained in place until the legislature voted to abolish school property taxes in 1993. It is surely too strong to say that the dead hand of the 1972 Michigan Supreme Court reached forward to tap the shoulders of Michigan legislators in 1993, but many observers regard the success of school finance litigation in general as having a powerful background influence on state legislative decisions.⁷⁹

Vox Populi: The Michigan 1994 referendum is often described as a popular rejection of the property tax. Yet what was presented to the voters there was a choice between different statewide tax packages, not a locally-controlled property tax. As a whole, severe constraints on the use of the local property tax in the post-World War II period did not arrive until the school finance movement had succeeded in largely divorcing local revenues from local school expenditures.

Before the *Serrano* case had succeeded and school finance reformers flocked to the courts, the issue of whether schools financing should be shifted from the local property tax to a statewide tax was actually put on the ballot in several states. Voters rejected these proposals in Colorado in 1972, Oregon in 1973, and California in 1972.⁸⁰ Constitutional amendments to centralize school financing were also rejected by voters in Michigan in 1971 (Ellwood Hain 1974, p. 351) and in Illinois (Dye and Giertz 1994).

In New Hampshire, the court's 1997 decision against local control was preceded by a 1992 gubernatorial race in which the centerpiece was the issue of local school finance. A well-funded, articulate challenger proposed to replace local property taxes with a state

income tax. As Colin Campbell and I showed, her defeat can best be interpreted as a rejection of her platform.⁸¹ In other states, the court decision favoring *Serrano*-style centralization was followed by a referendum. West Virginia voters were asked to approve a revenue-equalization bill that responded to its court's *Serrano*-style decision (*Pauley v. Kelly*), and the voters said no: "The people wanted local control of taxes."⁸² On May 5, 1998, Ohio voters rejected by a four-to-one margin a proposal to replace local property taxes, whose variations were found unconstitutional by the Ohio Supreme Court in *Derolph v. State* in 1997, with a two percentage point increase in the state sales taxes.

16. Have Court Decisions Raised or Lowered School Spending?

My 1989 paper that connected *Serrano* with Proposition 13 was among the first to argue at length that court-ordered school finance reform might backfire and actually reduce the resources available for public education. Before reviewing other studies, I should note that some advocates of school finance reform are not entirely upset by this finding. Their primary goal is equality. While an equality that raises average spending per pupil statewide is preferable to one that lowers average spending, these equalitarian types would rather see an equality of low-spenders than a high-spending system that, in their eyes, leaves some students behind.

The feeling was best captured in a *New York Times Magazine* article about Vermont, whose response to its court's *Serrano*-style decision effectively lowers spending by some of the "property rich" towns like Stowe (also discussed in section 18 below). Allen Gilbert, a former school board member in the neighboring town of Worcester and the vice president of the Vermont School Boards Association, is quoted as saying, "For years, Stowe kids have had advantages that kids in Worcester haven't had. You have to take some of those advantages away to level the playing field."⁸³

The sentiment that Mr. Gilbert seemed to express is that kids in his hometown of Worcester will gain relative to those of neighboring Stowe as a result of fiscal equalization that pulls Stowe down. This is doubtful. The clearest experience is that of California, which did "level the playing field" in a downward direction. Thomas Downes did a detailed study of the distribution of sixth-grade standardized test scores among school districts before and after both *Serrano* and Proposition 13. He found that the difference between the high-scoring and low-scoring districts remained almost exactly the same in 1985-86, seven years after the *Serrano*/Proposition 13 level-down, as they were in 1976-77, prior to Proposition 13 and the implementation of the *Serrano II* decision of December, 1976.⁸⁴ Courts can level the spending, but that does not necessarily level measurable indicators of education accomplishment.

But Mr. Gilbert's "level-down" sentiment is not typical. Most advocates of school finance reform desired and expected that the litigation they were sponsoring would "level-up" the playing field, so that spending in all but perhaps the richest districts would increase. Meeting shortly after the first *Serrano* decision, the lead attorney for the plaintiffs concluded that "it appears almost inevitable that statewide education

expenditures will rise.”⁸⁵ The balance of this section will concentrate on the evidence about court decisions’ effects on spending levels. I am not concerned here with the decisions’ effects on the lowest spending districts or with the effects of reform on educational quality (most of which is negative, as reviewed in section 12 above). Even if test scores don’t change (or may get worse), don’t the reforms at least raise spending, since the state, with its access to sales and income taxes, has deeper pockets than the local governments? Nearly every advocate of school finance litigation at least implies that state-plus-local spending per pupil should rise with a court victory.

In California, however, the results were quite to the contrary. As many observers have detailed, spending per pupil in California has slipped from its pre-*Serrano* position near the top of the fifty states to a persistent position in the lower quartile. In comparison with resources available, California ranks at the bottom among the states, and even a 1988 initiative that required that 40 percent of the state’s budget be devoted to education has been unable to budge it.⁸⁶ The state’s post-*Serrano* experience is best summarized by the title of a 1991 article by Neil Theobald and Lawrence Picus, “Living with Equal Amounts of Less: Experience of States with Primarily State-Funded School Systems.”⁸⁷ (Washington State, whose court had overturned local financing in *Seattle School District* in 1978, was their other major example, and it currently ranks third, after California and Utah, in average class size.) Even if California were unique in its response, it must be kept in mind that California is by far the largest state and so has the most public school students. One-seventh of the nation’s children attend public schools that would be far better than they are but for the *Serrano* decision.

Although California’s is probably the most extreme response to court-ordered equalization, scholars who have looked at the experience of other states have concluded that it was not the only example. Bradley Joondeph, a law professor, examined in detail the subsequent experience of five of the six states whose supreme courts had ruled for plaintiffs in school finance suits prior to 1984.⁸⁸ (New Jersey was excluded because of lack of comparable data.) Joondeph looked at the growth in per pupil spending in the five states from the year of their decision to the 1991-92 school year and compared it to the U.S. average growth over the same period. California was the slowest, growing at only half the U.S. rate from 1977-78 to 1991-92. Indeed, Joondeph concludes that even the lowest-wealth districts in California fared worse than they would have without the litigation, assuming California’s spending growth would have been similar to the nation as a whole without the decision.

But other states with court-ordered equalization fared poorly, too. Per pupil expenditures in Wyoming and Washington also grew at only about two-thirds the U.S. average after their courts’ decisions, and Arkansas grew at slightly less than the U.S. average. Of the five states Joondeph examined, only Connecticut grew faster, with per pupil expenditures growing at more than two and a half times the national rate. A post mortem on Connecticut’s experience by Wesley Horton, the attorney who both conceived of the case and provided his son as the lead plaintiff, indicated that the major accomplishment of his litigation was that teacher salaries are now among the highest in the nation.⁸⁹ (Anyone

who suspects that these cases are the result of indigenous dissatisfaction with public schools should read Horton's article, in which he makes clear that the Connecticut case was entirely the product of legal scholars and activist lawyers.⁹⁰)

Michael Heise examined the experiences of New Jersey and Wyoming, whose courts had overturned local financing.⁹¹ He found that, when other factors that influence per pupil spending are controlled for by regression analysis, the court decisions had little or no effect on spending trends. His estimated coefficient for the court decision indicated that New Jersey's spending growth actually slowed after the first court decision, though I would note that the New Jersey litigation has gone on so long that it is hard to identify a particular ruling as being controlling.

17. Statistical Evidence on Court Decisions and Spending Levels

Another type of study of the effects of court-ordered reforms on spending levels forgoes the nuances of individual state experiences and instead uses legislative and judicial reform as discrete events to be analyzed by statistical methods. In this approach, the reform either happened or it did not. It allows for a national comparison of states that have adopted school finance reforms with those that have not.

The approach was pioneered by Thomas Downes with an undergraduate coauthor, Mona Shah.⁹² Downes and Shah identified state supreme court decisions that favored plaintiffs and the dates at which they were handed down. Using sophisticated econometric techniques, they attempted to see what effects the court cases had on subsequent spending. (The basic idea was similar to that of Joondeph, described earlier, but with a larger sample of states and an attempt at explaining what other factors may have affected spending.) Downes's findings confirm that there is no reason to expect that a court order favoring the plaintiffs will actually raise state spending relative to the national average. Moreover, he found that states that had centralizing reforms imposed by the state's supreme court were more likely to fall behind in spending relative to the nation than those whose reforms were purely legislative.

The most important contribution of Downes and Shah's study, however, was their inference that court-ordered reform appeared to alter the structure of school-finance decision-making in the states. Thus the alteration that I argued occurred in California (and for which Silva and Sonstlie provided confirming evidence) seemed to have occurred in other states as well. When school funding is dramatically shifted to the statewide level, I argue, the average voter at the local level is no longer the primary determinant of spending. At the state level, the school budget is often a battle of interest groups. Pro-spending interests like teachers' unions have to compete with the highway lobby, environmentalists, medical services, and welfare supporters.⁹³ The parents of children in school and the owners of homes that such parents might buy are almost completely absent at the state level.

While Downes and Shah's evidence does not point to any particular political model to account for the shift they observed, their evidence is consistent with the proposition that where the money comes from does make a difference in how much will be raised. Simulations of particular types of equalizing reforms also show a considerable shift in how budgets are determined. Therese McCarty and Harvey Brazer found, for example, that reforms of the type often required by the courts are as likely to reduce average spending levels as they are to raise them.⁹⁴ Perhaps the most disturbing simulation study is by Selma Grosskopf and others, who used data from Texas school districts and forecast the effects of its court-ordered school finance equalization (*Edgewood v. Kirby*). They found that "budgetary reforms designed to equalize expenditures could actually increase the inequality of student achievement"⁹⁵

Not all of the econometric studies of school finance reform efforts are pessimistic about spending levels. Robert Manwaring and Steven Sheffrin undertook an analysis somewhat similar to that of Downes and Shah. They found that "litigation ultimately had a negative effect [on spending per pupil] in eight states and a positive effect in fourteen others."⁹⁶ Like Downes and Shah, Manwaring and Sheffrin also found evidence that especially stringent reforms ordered by courts had a depressing effect on spending. An especially large increase in the state share of spending appears to undermine the relationship between income and willingness of voters to tax themselves for education. The capitalization hypothesis described in section 10 above explains this seemingly perverse effect: When higher spending does little for home values in a community, education becomes just another claim on tax dollars, and higher income people no longer are willing to tax themselves as readily.

The most optimistic view of the effect of litigation on education spending is offered by William Evans, Sheila Murray, and Robert Schwab.⁹⁷ They find that court-ordered reforms accelerated school spending for the poor districts within a state without having an adverse effect on the rich districts. (They count as "rich" districts that spend a lot, without regard to income or taxable wealth.) This is not necessarily contrary to the Downes and Shah or to Manwaring and Sheffrin, since Evans et al. do not control for the national growth in overall support for education or for other determinants of spending. Even with this caveat, however, Evans et al. base their assessment on dubious classifications of states. For example, they include in "court reform" states Wisconsin, whose 1976 decision in *Buse v. State* actually overturned a legislative plan to tax high-wealth districts for the benefit of others (contrary to what had been mandated by *Serrano II*), and they eliminated Vermont because they claimed, erroneously, that Vermont has no unified school districts. They also erroneously claim that New Hampshire had a major legislative reform of school spending in 1974. My home state has not wavered from local funding for the past thirty years.

The possible misclassification of states is a problem that all studies mentioned in this section share in some degree, so it is not entirely fair to single out Evans, Murray and Schwab. The interaction between the courts and the state legislatures is often subtle, and deciding that one state has had a court order at a particular time while other states have

not is not easily done. As a further example of judicial advance-signaling (beyond those mentioned above in section 15), the Wyoming courts came down with a strong equalization order in its 1980 *Washakie* decision, but the court clearly telegraphed its intentions way back in 1971.⁹⁸ More generally, the acceleration in the success of school finance plaintiffs surely means that few state legislatures can be entirely surprised when they are hit by one. This in turn means that dating “before” and “after” reform is becoming ever trickier. As time goes on, it is harder to know what state legislatures would have done in the absence of litigation.

18. The Power-Equalization Reforms

Caroline Hoxby has come up with a way to evaluate the effects of school finance litigation and the subsequent response of the state legislatures that does not depend on identifying particular decisions.⁹⁹ She instead examined the structure of the school finance system in each state. I have so far pretty much assumed that all centralization of taxation and equalization of school spending has followed the same course: less reliance on local funds means that property tax capitalization is less important. But Hoxby makes the arresting point that school finance centralization should be regarded as a tax on school districts, and not all taxes are structured the same.

This will sound odd to many readers, since most state programs have as their goal to increase spending, at least for those districts that are considered low spenders or are “property poor.” But a state-financed subsidy system to local districts is also in many ways a tax system. Consider the analogy of welfare payments for poor families. Welfare is intended to increase the spendable income of poor people. But because welfare is intended only for the poor, the system is also a tax on the income of the poor from other sources. If the head of a poor family gets a good-paying job and the welfare agency learns about it, the family’s welfare payments will decline. Thus welfare rules of this type amount to a tax on earned (nonwelfare) income. If the welfare payments (including payments in kind such as food stamps, medical care, and housing subsidies) are reduced by a dollar for every dollar earned, then the effective tax rate that the welfare system imposes is 100 percent. We should hardly be surprised if people on welfare find it hard to get off of it at that tax rate.

Centralized school finance systems usually operate very much like the welfare system. Their goal is to supplement the spending of districts designated as poorer than others. Since most states do not have enough funds to supplement all districts by the same amount (unless the state simply runs the schools), they must have some criteria by which state funds are reduced as districts become richer. This reduction is a kind of tax on local spending. Hoxby demonstrated that states which raised this “tax rate” on local districts did indeed fall behind in per pupil spending compared to the national average.¹⁰⁰

I do not propose to review here each of the formulas by which states can fund schools.¹⁰¹ The one I do want to review is the system that has been urged most frequently as a result of successful school finance litigation. It was first mentioned as a solution to school-

spending inequities in the *Serrano* decision in 1971. The most complete description of the plan was given by three law professors, Jack Coons, William Clune, and Stephen Sugarman. Their 1971 book, *Private Wealth and Public Education*, became the Bible of the school finance reform movement.¹⁰² Its solution to the apparent inequalities among school districts was elegant and, at least in the telling, seemingly moderate.

Localism should not be entirely overcome. Its objectionable inequality, according to Coons, Clune and Sugarman, was not one of spending or tax *rates*, which could reflect personal preferences of voters. Its inequality was in tax base per student. Some towns were “property rich” and could tax themselves at a low rate and get gobs of revenue, while other towns were “property poor” and had to tax themselves at a high rate to get even a middling amount of revenue for schools. (The idea that such differences might be capitalized in home values was never considered.) The way to escape this and still retain local control (“subsidiarity,” in their word) was to jettison the usual formulas for state aid and replace it with one they called District Power Equalization.

Power equalization worked like this. The state government would put in place a formula that would ensure that for any given local tax rate, every district in the state could generate the same level of expenditures per pupil. Thus if San Francisco could raise \$1000 per pupil at a tax rate of .01 on the full market value of its taxable property, Los Angeles should also be able to tax itself at .01 and generate \$1000 per pupil in local revenues. The districts did not have to actually tax themselves at the same rate, but if they did, the formerly “property poor” districts would get the same spending per pupil as the formerly “property rich.” Thus, if Richmond, California, a city that has oil refineries and was thus “property rich” could raise more than \$1000 at a tax rate of .01, the excess money generated at that tax rate (or whatever rate it did choose) would be shipped off to the state to assist other districts so that they could raise the same amount of money for the same tax rate. (Richmond is in fact a low-income city with a large African-American community whose formerly well-funded school system went bankrupt in 1991.) The idea was to treat every district as if its tax base were that of the entire state, but not to insist that every district spend the same amount per pupil.

The unpretty side of this business were its consequences for the “property rich” districts. They not only had to support their schools on their own resources, but they had to send money to other districts. This transfer was called “recapture” by the power equalization advocates, who seemed to assume that the “property rich” district had stolen something from the others. And it neglects entirely that people who bought homes in those districts paid much more for them and thus committed themselves to a larger mortgage.

I have recently watched as the state of Vermont, on the other side of the Connecticut River from my home in Hanover, has enacted a version of power equalization in response to its version of *Serrano*.¹⁰³ The largest town that is considered “property rich” is Stowe. It is the home of several ski areas, including the Trapp Family Lodge, still owned by the real-life descendants of the legendary heroes of *The Sound of Music*. The ski areas and attendant commercial and vacation-home development have pulled Stowe from a

formerly remote, mountainous backwater into the ranks of what Vermont's school finance reformers call a "gold town." These towns are expected by Vermont's version of power equalization to continue to decant their golden eggs at an increased rate and share them with the rest of the state.

As the Vermont power-equalization system is proposed to work, voters in Stowe must tax themselves \$1.40 to get \$1.00 in local school spending, and this ratio is expected to rise to more than \$1.90 in a few years. This would amount to a ninety percent surtax on Stowe's school spending, with the proceeds of the surtax earmarked for spending in less property-rich towns. (This is in addition to a statewide property tax, but that tax does not by itself raise local price of education.) Stowe school officials anticipate that this will decimate their highly-regarded school system as local voters rebel at paying the higher taxes. Indeed, three other Stowe-like towns are in open revolt at this writing (July 1998). Two are refusing to send local property tax revenues to the state, and one is mapping a plan to abolish its small public school and open up a substitute private school.¹⁰⁴

My encounters with community leaders in Stowe (I spoke at a Rotary Club meeting in February 1998) suggested that the local reaction to Vermont's power equalization program was more bewilderment than anger. The town had carefully nurtured its development, doing its best to keep it from overrunning its bounds. Enormous amounts of volunteer energy had gone into various town boards over the years. The town's commercial development has generated sales and business-profits tax revenues that were already given to the rest of the state. What crime had Stowe committed that required the state to "recapture" the remaining taxable wealth?

19. Why Power Equalization Discourages Local Support for Education

The appeal of Coons's power equalization plan goes back, I believe, to the ideal expressed by Jonathan Kozol. To true equalitarians, spending on education should not depend on one's parent's wealth or the wealth of the district itself. The idea of a "level playing field" was linked with the idea of a single, statewide tax base. As Jack Coons put it in a defense of power equalization, having every community face the same tax rate for the same expenditure was no more or less controversial than having every person face the same prices in the grocery store. In other words, Coons, like other advocates of power equalization, equated tax rates with prices.¹⁰⁵

Alas, it is not true. Most economists and political scientists regard local decisions as being made by a majority of voters, even if they are nominally made by elected representatives. This majority can be represented by a construct called "the median voter." She is the one who stands in the middle of the electorate on any issue, and, in most cases, her vote will be in line with the winners.¹⁰⁶ Now suppose an election is held in which it is proposed that property taxes be raised to fund a better local education. The median voter asks herself, how much will my taxes rise? If the project raises her taxes by \$100, the price of the project to her is \$100. If she perceives that the benefits of the project to her are more than \$100 (because her kids or the kids of people who might buy

her house get a better education), she will, according to the rational self-interest model of politics, vote for the project. If not, she will vote against it.

The community's property tax *rate* is irrelevant to her thinking. It may be that local officials will explain the project as raising property tax rates by so many mills, but we assume that she translates that into a dollar figure. (In fact, most local officials do the translation when they present the budget: "For an average price house, this proposal will raise taxes by \$100.") But it does not matter whether the additional rate is $.0001 \times \$1,000,000 = \100 , or $.001 \times \$100,000 = \100 . The value of her home (the average-value home in the community) can be a million dollars or only one-tenth of that amount. In order to get the same educational program, the median voter pays the same price for local public services in every community.

Moreover, whatever advantages a large nonresidential tax base confers on residents will be offset by capitalization. Lower taxes and better schools raise housing prices, so those who come after the advantages are put in place will have to pay for their privileges. The full price of public services in such "property rich" communities is the taxes residents pay plus the premium they must pay for their homes. (This was described in the Bow and Concord comparison of section 5 above.) Free lunches are hard to find.

Power equalization undermines the efficiency advantages of the Tiebout model. By pooling all taxable resources into a common statewide base, no individual community has any incentive to improve its own property values by improving the quality of its tax base. In particular, a district that adopts a cost-effective school program should, under a truly decentralized system as described in section 10 above, be able to reap the gains in property values that such a program creates. But under power equalization, the higher property values will either reduce state aid (which comes from general taxes or from property-rich school districts) or, if the district was "property rich" to begin with, increase the amount of property taxes that are to be "recaptured" and shipped to other districts.

Full power equalization is essentially like the incentive effects of a 100 percent wealth tax. If all increments to the wealth of individuals were taxed away, most people would expect the amount of wealth creation and maintenance to drop to nearly zero. Once a power equalization system is in place, it would hardly be surprising if support for local property taxes declined and the efficiency of the public schools was reduced.¹⁰⁷

I have heard *Serrano*-advocates rationalize their tax-base reform with the following argument. Even if the size of the local tax base is a poor basis for redistribution of wealth, court-ordered equalization will inevitably "level up" expenditures. The reason was that the voters in "property rich" places and high-demanders for school expenditures were expected to tax themselves at ever higher rates so as to maintain their own schools. The threat of fouling their own nests was supposed to be the reason that the property rich would continue to lay their golden egg (to mix my avian metaphors).

This was wrong as a matter of both statistical evidence¹⁰⁸ and common experience. Remember when you were caught eating candy in class in grade school? The teacher said, if you are going to eat candy, you have to provide equal amounts to everyone else in the class. The teacher did not expect you to buy a bag of candy for the whole class the next day. His or her intention was to *discourage* you from spending any more on candy for anyone. But spending more on schools seems to have been what state supreme courts expected would happen as a result of their Serrano-inspired, share-with-the-whole-state rulings.

All three of the best-known academic advocates of power equalization have, for various reasons, discarded it and gone on instead to endorse other measures to improve schools. Coons and Sugarman now advocate a system of vouchers targeted at low-income children regardless of where they live.¹⁰⁹ This idea is sound as a means of supplementing locally-controlled property taxes for education, but it cannot replace them. Unlike funding for local schools vouchers do not connect the taxes raised to fund them with the property values of most voters, since vouchers can, under most plans, be used anywhere in the state. Capitalization requires local funding for identifiable local schools.

20. Conclusion

“Local control” is almost as widely derided by academics¹¹⁰ as it is embraced by ordinary citizens. Perhaps academics cannot see the virtues of local control because they tend to view local governments, including school districts, as miniature versions of state governments. Because state governments command more resources, more professional expertise, and a wider geographic domain, it would seem to follow that they are always better equipped to deal with any governmental function. I have contended, however, that local governments are different from and, in many important ways, better than state governments in providing services of interest to their residents because of capitalization.

Capitalization connects two things that Americans clearly care a great deal about: the value of their homes and the quality of their children’s education. This connection guides them and their elected representatives to pay attention to the quality of education as well as other local services whose benefits improve property values. Most of the court decisions that have overturned property tax financing of education have helped divorce the value of one’s home from the quality of schools. (Capitalization occurs much less at the state level because potential residents cannot shop around for states the way they can shop around for communities.) This divorce has most probably contributed to the declining quality of public education and, at least in some states, to a reduction in public support for education as a whole.

As a whole, court-induced centralization of school finance does not meet most important egalitarian goals. Spending and local tax rates have become somewhat more equal within states as a result of the court decisions, but that is a chimerical gain because of capitalization. Lower tax rates result in higher housing prices, so the overall economic burden does not change. The measurable educational outcomes have either declined or

not changed. No social science study persuasively connects the school finance litigation with better outcomes for children from disadvantaged homes.

There is strong evidence from California that the consequence of a highly egalitarian system ordered by the *Serrano* court has made poor children worse off, and there is some circumstantial evidence that court decisions or the threat of such decisions in other states have induced taxpayer revolts that have undermined education for all. At its worst, school finance litigation has engendered dog-in-a-manger equality of low-quality education. At its best, it seems to have done little more than shift tax burdens and property values in ways that offer no systematic benefit to the poor.

It is time for the courts to reconsider the wisdom of these cases.

Notes

¹ Citations for court cases are listed following the references.

² Jonathan Kozol (1991). Kozol had earlier tried out his method of visiting schools and interviewing children and teachers on his visits to Cuba in 1976 and 1977. In his account of this, *Children of the Revolution*, Kozol (1978) had nothing but praise for Cuba's schools and its adult literacy program, although he admits that he was never without a Cuban-government guide and translator on any of his visits.

³ Numerous studies have compared the extent of inequality of expenditures within individual states (e.g., Riddle and White 1993). The recent trend is towards more equality of expenditure within states, though the trend is quite uneven among states (James Wyckoff 1992). Evans, Murray and Schwab (1997a,b) argue that much of the recent equalization has been accomplished by state court decisions, and the largest source of inequality in school spending is now differences among states rather than within states. Caroline Hoxby (1998) shows that most of the inequality in education finance in this century has followed from inequality in income and wealth generally rather than sorting of the wealthy into separate districts.

⁴ An excellent overall account of the California events discussed in this essay is given in Peter Schrag (1998). For a compact history of California school finance, see Lawrence Picus (1991).

⁵ Julie Underwood (1994) shows that constitutional language in most state constitutions does not by itself warrant judicial intervention. Molly McUsic (1991) sees somewhat more in the language of the state constitutions, but her analysis shows that courts do not seem much bound by it. A similar conclusion is reached by Jonathan Banks (1992). A recent dissection of the Vermont Supreme Court's decision by law professor who is sympathetic with its aims concluded that the opinion was completely at odds with the state's constitution and its history (Peter Teachout 1997). I regard the judicialization of public school funding as a political event of some interest, and I have criticized it in other places (Fischel 1998) but my primary task in the present essay is to examine the school-finance movement's economic assumptions and consequences, not to analyze the basis for the courts decisions themselves. For my first pass at the latter issue, see Campbell and Fischel (1996), which demonstrates that the courts are *not* acting on behalf of a supposedly equalitarian majority that is frustrated by legislative gridlock.

⁶ I do not plan to review the court decisions in any detail. For a useful compendium of cases, see Peter Enrich (1995, pp. 185-194). By my accounting of Enrich's cases, there were 14 states in which the plaintiffs obtained a final court ruling that required more uniform state funding for schools. Several of the decisions were reversals of previous

decisions that had upheld the current system. Since 1995, New Hampshire, Ohio, and Vermont, have joined the fold.

⁷ Joseph Henke (1986)

⁸ Bahl, Sjoquist, and Williams (1990) demonstrate the shift away from local financing to statewide financing following *Serrano*-style decisions. See also G. Alan Hickrod et al. (1992). Plaintiffs in recent cases have insisted that “adequacy” and “equality” are the same thing, and courts ruling in their favor have come to a similar conclusion. See, e.g., *Claremont v. Governor* (NH 1997), which applied an “adequacy” standard but insisted on uniform statewide standards and taxes to fund it. See also Peter Enrich (1995, pp. 128-143), who insists on a difference between the adequacy and equality standards but notes that most courts regard them as requiring the same remedies.

⁹ See, e.g., Jonathan Banks (1992); Wesley Horton (1991); [Harvard Law Review] (1991). Increased activism by state courts on this and other issues was pressed by Supreme Court Justice William Brennan (Brennan 1986; Paul Kahn 1996). California Supreme Court Justice Stanley Mosk (1988) proudly mentions *Serrano* as an example of the new state court activism. Cautionary notes by law professors such as Paul Carrington (1973) were few, but the seemingly endless litigation that the cases have promoted has induced at least a few members of the academy to express doubts about either the legitimacy or the efficacy of state court activism in this area (Michael Heise 1994; Paul Kahn 1996; Kevin McMillan 1998).

¹⁰ Charles Tiebout (1956). His paper has become the touchstone of local public finance, and expositions and extensions of it can be found in virtually every textbook on public economics. See, e.g., Musgrave and Musgrave (1989).

¹¹ Bruce Hamilton (1975; 1976). Hamilton regards his second article as the more definitive statement of his theory. He shows there that communities need not have uniform incomes or housing types to get the result that each home pays its own way. The only constraint is that there be some limit on each types of housing so that its foreseeable supply is fixed.

¹² Fischel (1985, chap. 14; 1981; 1992). The last article (Fischel 1992) is my most compact assemblage of evidence in support of the applicability of the Tiebout-Hamilton model.

¹³ Wallace Oates (1969)

¹⁴ Los Angeles Times, December 31, 1976, § I, p. 3. Young John was reported to have prospered in school after the move. The apparently middle-class Serranos—John senior was a social worker—agreed for ideological reasons for their son to be the lead plaintiff

in the suit, which was part of a national campaign by reform-minded lawyers funded by foundations and federal grants (Lee and Weisbrod 1978, p. 335).

¹⁵ The case was *Claremont v. Governor* (1997). The complete report from which the capitalization regression is taken, which includes the sources of data and the data themselves, is available from the author at Bill.Fischel@Dartmouth.Edu or on the web at <<http://www.mainstream.net/nhpolitics/wf/essay.shtml>>.

¹⁶ I undertook to explain to attorneys the mathematics of discounting in a 1991 paper that some lawyers have told me was helpful in understanding the arithmetic (Fischel 1991).

¹⁷ More sophisticated regression methods would try to take into account the fact that some of my independent variables, such as tax rates, are defined using part of the dependent variable, house value, in the numerator. This could cause me to overstate the influence of tax rates on house values. For a general and exhaustive discussion, see John Yinger et al. (1988). At any rate, I offer this regression primarily as an example of the general statistical technique, and for that purpose I want to avoid expository complications.

¹⁸ Moreover, as long as the Bow residents in fact would have been willing to pay for this combination of housing services and schools if they had been offered as independent goods, the supposedly lower tax-price of schools is not economically distorting (Yinger and Ladd 1994). Residents willing to pay for the fancier style of education offered (I am supposing) in Bow will settle there and pay the higher housing prices.

¹⁹ Oates (1969, p. 968)

²⁰ Sonstelie and Portney (1980a, p. 114). See also Raymond Reinhard (1981), who applied an improved econometric method to the data from Oates (1969) and from Sonstelie and Portney (1980a) and found even larger capitalization effects from school expenditures and test scores.

²¹ Bruce Hamilton (1979) [Toronto area in 1961], Heinberg and Oates (1970) [Boston area in 1959], and Larry Orr (1968) [Boston area in 1959].

²² Jud and Watts (1981) [Charlotte, NC]; Li and Brown (1981) [Boston area]; Hayes and Taylor 1996) [Dallas]; Gerald McDougal (1976) [Los Angeles area]; Haurin and Brasington (1996) [Ohio metropolitan areas]. Haurin and Brasington found that school quality was actually the most important determinant of variations in house values. For a survey of articles on schools and housing values, see Crone (1998).

²³ Bradbury, Case and Mayer (1995). William Bogart and Brian Cromwell (1997) found that homebuyers in the suburbs of Cleveland were willing to pay substantial premiums—

on the order of five to ten thousand dollars—to live in higher-quality school districts, even though such districts had higher tax rates.

²⁴ Yinger et al. (1988, pp. 11-47).

²⁵ I generally use the term “mortgage payment” as a shorthand for all of the investment costs of buying and maintaining a home. People sometimes point out that many people have a large amount of equity in their homes and so do not perceive this cost. But this is mistaken; the more equity you have in your home, the more interest and dividends you are foregoing from bonds, stocks or other possible investments. To put it another way, a person who buys a \$200,000 house for “cash” is foregoing all of the interest that the cash could have earned in some alternative investment. The possibility that the home will rise in value does not negate this argument, since one could have borrowed money to buy the home and still gotten the capital gain.

²⁶ The reassessment order actually came from the Massachusetts Supreme Judicial Court, but the requirement for uniform taxation had long been in the state’s constitution. On Massachusetts’ property tax policy of this era generally, see Avault, Ganz, and Holland (1979). In 1978, voters approved a constitutional amendment that allowed differential taxation of commercial property, but this did not negate the rule of uniformity within the residential classification.

²⁷ Yinger et al. (1988, p. 143): “The degree of capitalization reflects household’s expectations about future tax changes. In the Massachusetts case, variation in effective tax rates is caused by assessment errors and, because of much public debate about revaluation, households know that these errors will eventually be corrected. This type of expectation appears to be largely responsible for the incomplete capitalization of current tax differences.”

²⁸ Do and Sirmans (1994)

²⁹ Aaron Gurwitz (1980, pp. 23-24) concluded, “Only if there is no measurable capitalization do fiscal disparities constitute prima facie evidence of horizontal taxpayer inequity.” Ladd and Yinger (1994, pp. 218-19) said, “Full capitalization implies that the benefits to tenants from [equalizing] grant-induced increases in service quality are canceled by rent increases and that the benefits to homeowners are confined to people who currently own property in the community.” For similar statements, see Downes and Pogue (1992); Bruce Hamilton (1976); Inman and Rubinfeld (1979); Paul Wyckoff (1995); Yinger et al. (1988, pp. 135-43).

³⁰ The poor correlation has been known ever since the suits have been instituted, but it has hardly affected the debate within the court system, despite its mention in the U.S. Supreme Court’s *San Antonio v. Rodriguez* decision. See [Yale Law Journal Note]

(1972); Edward Zelinsky (1976). A study done for an earlier New Hampshire school finance case by Karen Negriz (1982), a Dartmouth student working under my direction, found virtually no correlation ($r = .04$) between tax-base per capita and median family income in New Hampshire towns. California data in 1974 had shown that most of the states' poor children actually lived in districts with above-average property values. Jack McCurdy, *School Funding Ruling: a Setback for the Poor?* *Los Angeles Times*, June 30, 1974, § I, at 3. See also Joondeph (1995, nn. 26-28). The only claim to the contrary is by Inman and Rubinfeld (1979, p. 1670), but their data to back this claim apparently were from a sample of suburban Long Island school districts in which Inman (1978, p. 62) noted that there were "trivially small poverty populations."

³¹ Fischel (1976) demonstrates that commercial and industrial tax base is more likely to be in low-income communities in northern New Jersey, and Helen Ladd (1976) showed the same for Massachusetts.

³² Brazer and McCarty (1989, p. 566) conclude that municipal overburden is a canard: "Evidence from several states shows consistently that there is no systematic negative relationship between school and non-school tax rates or expenditures."

³³ It is well established that high-income people are more inclined to support environmental legislation (Kahn and Matsuska 1997) and oppose proposed heavy industry in their towns (Fischel 1979). Vicki Been (1994, p. 1387) has demonstrated that the higher concentrations of poor people near environmentally problematic sites is caused by the poor moving to established sites rather than, as proponents to the "environmental justice" movement claim, the noxious use being deliberately placed near poor places. See also Been and Gupta (1997).

³⁴ This was the subject of my doctoral dissertation, Fischel (1975). That the distribution of industry among localities is affected by zoning as well as tax policies is confirmed in empirical studies by Erickson and Wasylenko (1980), Erickson and Wollover (1987), William Fox (1981), and Warren McHone (1986). I expanded my idea of communities using zoning to manage commercial tax base into a more general theory of zoning to maximize property values in my book (Fischel 1985).

³⁵ Hamilton (1976; 1979).

³⁶ Thus capitalization cannot be used as a reason to tolerate crime, but it *is* a reason not to compensate property owners and renters for living in a high-crime neighborhood. As in the school situation, compensation would make them indifferent to the level of crime. On this "moral hazard" aspect of compensation generally, see Louis Kaplow (1986).

³⁷ A particularly thoughtful application of the egalitarian principles of John Rawls to the school finance issue is Frank Michelman (1969). Michelman concludes that a Rawlsian

standard calls for a “minimum protection” approach, which is generally consistent with the categorical-aid programs aimed at student characteristics rather than the tax base. Most states used such programs before the 1970s (Hoxby 1997). Michelman specifically rejected the most popular remedy urged in school finance litigation, district power equalization, which is described below in section 18.

³⁸ Roland Benabou (1996); Fernandez and Rogerson (1996). These articles consider mainly the efficiency of the goals of equal educational opportunity, not the means of accomplishing them.

³⁹ Gerald Pomper (1984, p. 222). Without such control, he went on, school administrators cannot be prodded to make rational choices between a new math course and an additional secretary for the principal’s office.

⁴⁰ Rasinski and Rosenbaum (1987)

⁴¹ Sonstelie and Portney (1980b, p. 194). See also Benson and O’Halloran (1987), who note in passing the childless voters in Piedmont, California (a suburb of Oakland), support schools because of its benign effect on their property’s value.

⁴² This implication of capitalization was first pointed out by Bruce Hamilton (1976), who argued that the so-called “flight to the suburbs” could not be caused purely by central city tax increases.

⁴³ Mr. Whipple was not squeezing the truth when he pointed out that better schools can help to attract industry. Thomas Luce (1994) found from a study of cities in the Philadelphia area that better schools did attract the labor force that firms need.

⁴⁴ California is discussed extensively in the text in section 14. The official statistics about California’s funding understate the role of state funds because they count its property taxes as local taxes, when in fact they are almost entirely controlled by the state (O’Sullivan, Sexton, and Sheffrin 1995, p. 139; Lawrence Picus 1991). John Thompson (1992) reported that Hawaii’s public school students performed well below the average for most other states in standardized mathematics tests, and he pointed to that failing as a drawback of its centrally financed school system. David Callies, a law professor in Hawaii, told me orally that Hawaii enjoys the dubious distinction of having three of the four largest private schools in the country.

⁴⁵ Comparative data are available from a consulting report for the *Claremont* case by Caroline Hoxby, which is available on the web at <<http://www.heartland.org/hoxby.htm>>. After adjusting solely for participation rates—see the next paragraph in the text to see why—Graham and Husted (1993, p. 199) found New Hampshire SAT scores were the highest of the 38 states that they ranked. After

adjusting for other factors that favor New Hampshire (its higher income, low minority population, etc.), Graham and Husted dropped the state to eighth of the 38 states.

⁴⁶ For an excellent pair of studies showing how SAT scores, when adjusted for participation, are reasonable indicators of school quality differences among states, see Dynarski and Gleason (1993) and Graham and Husted (1993). These studies do not specifically look at methods of financing.

⁴⁷ Graham and Husted (1993, p. 201, table 4, column (2)). This column shows rankings adjusted for participation rates *and* for demographic characteristics. The finance data were from John Augenblick et al. (1993, table 2-B). I excluded federal aid from the base, so that per-pupil spending is state plus local spending.

⁴⁸ Card and Payne (1997, p. 31). They examined data on low-income families, not low-property-wealth towns, so the match between the objects of reform and the objects of their study is less than perfect. It should also be noted that using SAT scores to evaluate improvements in low-income places is problematical because so few poor kids take the SAT. This is less of a problem when comparing state averages, since most students from middle-class families do take the SAT.

⁴⁹ Berger and Toma (1994)

⁵⁰ Husted and Kenny (1995)

⁵¹ Sam Peltzman (1993, pp. 353-355). Peltzman (1996) was similarly pessimistic about the effects of centralization of finance on students who were not headed for college.

⁵² Southwick and Gill (1997). The same result—more state funding, lower state scores—was found in a study of using NAEP (National Assessment of Educational Progress) tests by Victor Fuchs and Diane Reklis (1994).

⁵³ Downes and Schoeman (1998) show that the *Serrano* decision boosted enrollments in California private schools. See also Kenny and Husted (1996). This possibility was actually anticipated by advocates of *Serrano*: Coons, Clune and Sugarman (1969, p. 419), who did not seem to think it likely to occur.

⁵⁴ Alan Taylor (1997, p. 209)

⁵⁵ Blair Zanzig (1997).

⁵⁶ Blair and Staley (1995); Staley and Blair (1995). Borland and Howsen (1993) obtain similar results for a sample of Kentucky school districts.

⁵⁷ Caroline Hoxby (1994). Her thesis is summarized in Hoxby (1995).

⁵⁸ Hoxby (1996, p. 60).

⁵⁹ Hoxby (1997). The proposition the “money doesn’t matter” has been widely and successfully promoted by Eric Hanushek (1986). Hoxby’s other reason that money does not appear to matter is the increase in the power of teachers’ unions since the 1960s. Studies using samples prior to that era showed a reasonable connection between spending and homebuyer’s perception of school quality (e.g., Oates 1969). I would note that court-ordered education finance reform also started in that era. Hoxby finds an independent effect for both district competition and teacher unionization.

⁶⁰ The best narrative that describes the fall from grace of California’s public schools from the 1960s to the late 1990s is Schrag (1998, pp. 38-98). Accounts of the *Serrano* decision and its connection to Proposition 13 are in Fischel (1989; 1996). The best account of the legal relationships between *Serrano* and Proposition 13 is Joseph Henke (1986).

⁶¹ O’Sullivan, Sexton and Sheffrin (1995) provide an excellent analysis of the enduring fiscal effects of Proposition 13.

⁶² Sears and Citrin (1982). The popular notion that property-tax assessment reform was the culprit is not plausible, since uniform assessment had been the rule in most California counties prior to the reform (Diane Paul 1975, p. 101), and the vote for Prop 13 was not especially high in San Francisco, where the scandal that prompted assessment reform arose (Fischel 1996, p. 626, n 120).

⁶³ Kozol (1991, pp. 220-21).

⁶⁴ Benson was quoted in Hickrod et al. (1995). Hickrod nonetheless urged continuing litigation in the *Serrano* tradition.

⁶⁵ Silva and Sonstelie (1995). For additional facts and some pathetic stories of California's public education debacle, see Schrag (1998, pp. 67-73).

⁶⁶ Post (1979, p. 385); Schrag (1998, p. 154). It should be noted that neither *Serrano* nor Proposition 13 prevent private contributions to public schools, which are now routine (though small) in most affluent districts. Another alternative to property taxes is the parcel tax, which must be approved, as per Proposition 13, by a 2/3 local vote. A parcel tax is applied to the parcel itself, not its value, and so it is regressive: mansions pay the same as mobile homes. Parcel taxes are a minor supplement for local schools, usually in affluent areas. On both of these alternatives, see Brunner and Sonstelie (1997).

⁶⁷ Fernandez and Rogerson (1995).

⁶⁸ Schrag (1998, pp. 21-22, 148-149).

⁶⁹ The Maine events are described by Norton Grubb (1974); Leslie Nickerson (1973); and Perrin and Jones (1984).

⁷⁰ Perrin and Jones (1984, p. 496).

⁷¹ Lewis Kaden (1983) reviews the New Jersey Court's battles with the legislature through the 1970s.

⁷² Harrison and Tarr (1996, p. 183). For other studies with similar conclusions, see Bogart and VanDoren (1992), and Michael Mintrom (1993).

⁷³ Bogart, Bradford and Williams (1992).

⁷⁴ Herman Leonard (1992, pp. 21, 86). See also Ladd and Wilson (1985).

⁷⁵ Morgan (1985, Table 1). Further evidence that Chapter 70 reduced local fiscal control is provided by a study by Carroll and Yinger (1994), who found that property taxes were not shifted forward to renters in Massachusetts in 1980, contrary to the implication of the Tiebout hypothesis. Carroll and Yinger take this as evidence against the applicability of the Tiebout model. I take it as evidence that Chapter 70 had undermined the Tiebout model, and, as in California, this inclined more voters to embrace the property-tax revolt.

⁷⁶ As reported by Reschovsky and Schwartz (1992), the 1985 Massachusetts legislation again reduced the fiscal disparities among school districts.

⁷⁷ The events are described and analyzed by Courant, Gramlich, and Loeb (1995), who note that the Michigan reforms seem poised to reduce average spending.

⁷⁸ Marilyn Hirth (1994); Paul Rothstein (1992).

⁷⁹ Norton Grubb (1974, p. 483) confirms that the Michigan legislature acted in response to Milliken. Augenblick, Meyers and Anderson (1997, p. 63) conclude that "even where litigation has not occurred or has not succeeded, the prospect of litigation has prompted revisions of state funding policies." Susan Fuhrman (1979) noted that the *Serrano* decision precipitated legislative actions in Maine (as I have discussed in the text above) and in Oregon, specifically to forestall court actions. See generally Michael Heise (1998).

⁸⁰ Citations to these studies are in Campbell and Fischel (1996, p. 12). Others are mentioned in Paul Carrington (1973). Histories of school finance also point out that state legislatures have debated the issue of local versus state funding almost from the beginning of the republic (Ellwood Cubberly 1919; Morton Keller 1994, chap. 2). Kirk Stark (1992, pp. 809-12) describes a mid-1800s Indiana case that sounded exactly like *Serrano*, except that the legislature largely ignored it, and the court subsequently changed its mind.

⁸¹ Campbell and Fischel (1995). One of the losing candidate's principal advisors was the lead attorney in *Claremont v. Governor*, which in 1997 overturned the state's school finance system, in effect requiring the adoption of the platform that the voters had rejected.

⁸² J.J. Flanigan (1989, p. 234).

⁸³ Elinor Burkett (1998, p. 42). Other statements in the same article by Mr. Gilbert indicate that he was not being quoted out of context.

⁸⁴ Thomas Downes (1992).

⁸⁵ Lawyers Committee (1971, p. 161).

⁸⁶ Schrag (1998, pp. 164-67).

⁸⁷ Theobald and Lawrence Picus (1991). Along with Silva and Sonstelie (1995), Terry Schwandron (1984, pp. 132-36) found that the decline in California's per pupil spending relative to other states began shortly after the first *Serrano* decision rather than just after Proposition 13 was passed.

⁸⁸ Bradley Joondeph (1995). He used a 1984 cut-off for cases to allow enough time for legislation to respond to the court decisions.

⁸⁹ Wesley Horton (1991, p. 718).

⁹⁰ Other evidence that cases are ideologically rather than practically motivated is in Lawyers' Committee (1971) and Lee and Weisbrod (1978).

⁹¹ Michael Heise (1995). Harrison and Tarr (1996) concluded that New Jersey's considerable rise in spending per pupil after litigation began merely continued previous trends and could not be attributed to court decisions.

⁹² Downes and Shah (1995). See also Downes and Figlio (1997) and Downes (1997).

⁹³ Dennis Leyden (1992) shows that interest group competition at the state level could raise or lower spending on schools. See also Picus (1991). From my current perch in Seattle, I have found that the fortunes of Washington's schools are largely dependent on the state's sales tax revenue, and that source has many claimants. The strategy of the Seattle School District plaintiffs envisioned the state adopting new statewide revenue sources to fund it, but the voters have so far declined to go along (Betty Jane Narver 1990, p. 162; Margaret Plecki 1997).

⁹⁴ McCarty and Brazer (1990). For similar findings, see Paul Rothstein (1992).

⁹⁵ Grosskopf, Hayes, Taylor, and Weber (1997, p. 116). On the saga of Texas, whose supreme court's *Edgewood* decisions have vacillated between overturning local financing and then overturning the state's response because it undermined local control of taxes, see Mark Yudof (1991a).

⁹⁶ Manwaring and Sheffrin (1997, p. 117).

⁹⁷ Evans, Murray, and Schwab (1997a). Christopher Bell (1988) also finds a modest increase in spending in states with a larger share of funding coming from state sources, but he also finds that states with more competition among school districts increases spending.

⁹⁸ Michael Heise (1998, n. 24).

⁹⁹ Caroline Hoxby (1997).

¹⁰⁰ Caroline Hoxby (1997; 1998a). She also showed that in those few states in which reforms reduced the state's tax on local spending, overall spending grew rapidly. This accounts for New Jersey's rise in spending for at least part of the time it was wrestling with (and not complying with) its school finance decisions.

¹⁰¹ See Hoxby (1997) for a reasonably accessible description of several types of systems and their effects.

¹⁰² Coons, Clune and Sugarman (1970). District power equalization did not originate with this book however. As Hobby and Walker (1991) point out, Texas had adopted—and later rejected—a version of it in the 1920s. Plus ca chose...

¹⁰³ The case is *Brigham v. State* (1997). For a description, see Teachout (1997).

¹⁰⁴ For current though somewhat partisan sources on the unfolding drama of Vermont's Act 60, see the excellent web site kept by Jeff Pascoe of South Burlington, Vermont: <<http://www.act60.org/>>.

¹⁰⁵ Coons (1978) makes the argument most clearly, but it was also present in Coons, Clune and Sugarman (1970).

¹⁰⁶ The advantage of looking at the median voter rather than just asking about the group characteristics of a majority is that most statistics about the populations of local governments are summarized as averages. Thus it is easy to determine what the median family income, median house value, and median age of household adults is, and from this the demographic and economic characteristics of the median voter can be observed. On the empirical validity of this approach, see Robert Inman (1978) and Randy Holcombe (1989), who generally confirm its usefulness. For a more qualified endorsement, see

Romer, Rosenthal and Munley (1992), who see the median voter applying only in smaller school districts.

¹⁰⁷ Husted and Kenny (1997) found that displacing locally generated taxes with statewide taxes has reduced school efficiency. Using a national sample, David Figlio (1998) demonstrates that property-tax revolts generally reduce the quality of public education. It may be, as Eric Hanushek (1986) argues, that schools are inefficient spenders of money, but it appears that the disease is not cured by arbitrarily reducing the amount of property tax revenue they get. I should note that Figlio did not address the cause of property tax revolts, nor do I contend that all tax revolts are in response to school finance centralization decisions.

¹⁰⁸ Statistical tests of school aid formulas such as district power equalization and its more moderate cousin, “guaranteed tax base” (which forgoes “recapture”) have shown that they tend to equalize tax rates rather than expenditures (Michael Addonizio 1991; Katherine Bradbury 1994; Richard Murnane 1985). Receiving districts cut rates more than they increased spending, and sending districts reduce spending rather than send their taxes to other districts.

¹⁰⁹ Coons and Sugarman (1978; 1992). The third musketeer, William Clune (1992), now specifically disowns power equalization, particularly the “horror of recapture,” though he continues to urge the courts to involve themselves in what he regards (and I do not) as the different issue of educational adequacy. Another early proponent of power equalization, Mark Yudof (1991b), reflected on Texas's attempt to implement it and concluded that the gap between scholarly theory and practical politics is too wide to bridge.

¹¹⁰ Richard Briffault (1992) asserts that local control is unimportant. Christopher Lu (1991) calls local control a “farce.” Jack Coons, the godfather of district power equalization, has elsewhere written of what he regards as the “pathetic American system of local non-government” (1974, p. 305). On the other side, Paul Carrington (1972) worried prophetically about the loss of local control implied by the *Serrano* case.

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