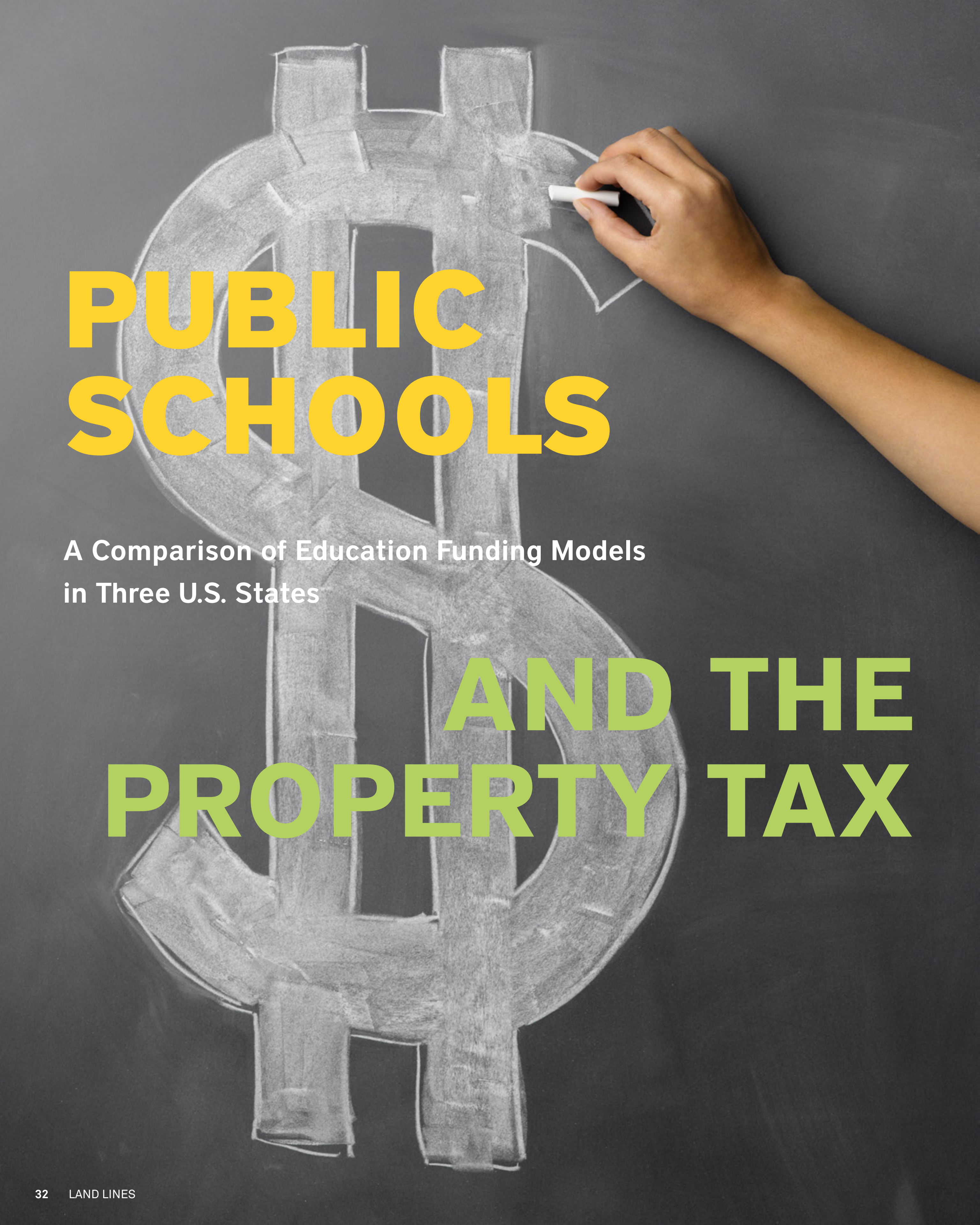


PUBLIC SCHOOLS AND THE PROPERTY TAX

A Comparison of Education Funding Models in Three U.S. States

By Daphne Kenyon, Bethany Paquin, and Semida Munteanu

This article is excerpted from a forthcoming Lincoln Institute Policy Focus Report, *Rethinking the Property Tax–School Funding Dilemma*, and from a Lincoln Institute working paper, "Effects of Reducing the Role of the Local Property Tax in Funding K–12 Education." To learn more about Lincoln Institute publications, visit **www.lincolninst.edu/publications.**

THE MASSIVE SHUTDOWN of K–12 schools sparked by the COVID-19 pandemic has no precedent in U.S. history. By the end of the 2019–2020 school year, at least 50.8 million public school students had been affected by school closures (*Education Week* 2020). Although schools closed during the 1918 influenza pandemic, fewer children attended school then and schools were not as integral to daily life (Sawchuk 2020). This time, almost overnight, the national education system shifted dramatically. Teachers were required to adapt lessons to virtual meeting platforms. The forced rapid transition to online methods led to learning loss or unfinished learning for many students. The pandemic exacerbated existing disparities and created new challenges for students of color, English language learners, and students with disabilities.

The pandemic also sparked a temporary shift in national education funding as the country experienced one of the deepest economic downturns in its history. Vigorous federal fiscal policy helped make it the shortest recession in the country's history as well, and as part of this economic rescue effort, Congress funneled hundreds of billions of dollars to education.

These funds came via the March 2020 CARES Act; a second infusion sent to state and local governments in December 2020; and the American Rescue Plan Act of March 2021, which contained another $350 billion for state and local governments plus about $130 billion specifically for K–12 education. Altogether in the first year of the pandemic, the federal government provided an unprecedented amount of aid for public K–12 education, equivalent to about $4,000 per student (Griffith 2021).

The property tax has been the single largest source of local revenue for schools in the United States, reflecting a strong culture of local control and a preference for local provision.

Although this lessened the fiscal impact of the pandemic in the near term, it did not permanently alter the federal government's traditionally modest role in funding K–12 education. Public schools are typically supported by a combination of state aid and local funding. The property tax has been the single largest source of local revenue for schools in the United States, reflecting a strong culture of local control and a preference for local provision.

Credit: Jeffrey Coolidge via Getty Images.

An Ideal Local Funding Source

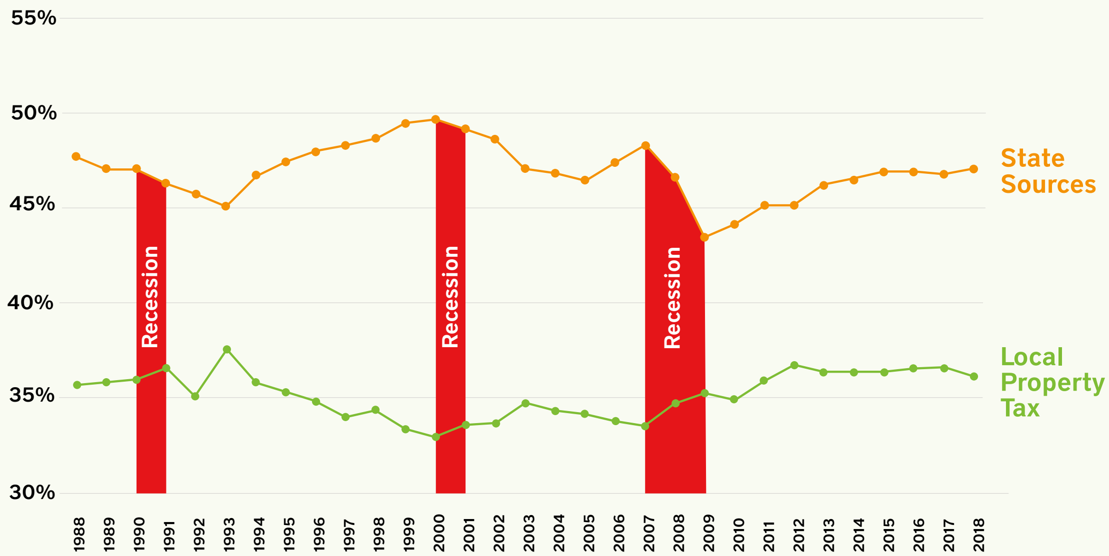
Property taxation and school funding are closely linked in the United States. In 2018–2019, public education revenue totaled $771 billion. Nearly half (47 percent) came from state governments, slightly less than half (45 percent) from local government sources, and a modest share (8 percent) from the federal government. Of the local revenue, about 36 percent came from property taxes. The remaining 8.9 percent was generated from other taxes; fees and charges for things like school lunches and athletic events; and contributions from individuals, organizations, or businesses.

In many ways, the property tax is an ideal local tax for funding public education. In a well-structured property tax system, without complex or confusing property tax limitations, the tax is both visible and transparent. Voters considering a local expenditure, such as for a new elementary school, will have clear information on benefits and costs. The property tax base is immobile; by contrast, shoppers can easily avoid a local sales tax by driving a few miles and businesses can avoid liability for local income taxes by relocating office headquarters.

The property tax is also a stable tax, as evidenced by its performance relative to the sales tax and income tax each time the economy falls into a recession. Since state governments rely predominantly on sales and income taxes, states often cut aid to schools in recessions in order to balance their budgets. This means that in most

Figure 1

State Aid and Local Property Tax as a Share of United States K–12 Education Revenues, FY1989–FY2019



Source: Calculations using data from the National Public Education Financial Survey/National Center for Education Statistics.

recessions public schools increase their reliance on property tax revenues to make up for declining state school aid (see figure 1).

But the property tax as a source of school funding has not been without controversy. In the 1970s, public recognition that disparities in the relative size of local tax bases can lead to differences in the level and quality of public services ignited a national debate about the importance of equal access to educational opportunity. As the single largest source of local revenue, the property tax became the main target in this debate, giving rise to proposals that sought to reduce schools' reliance on local property taxes and increase the state share of education spending to mitigate educational disparities. Between 1976 and 1981, the local property tax share of national education revenues declined from approximately 40 percent to 35 percent (McGuire, Papke, and Reschovsky 2015). But in the three decades since, the role of the local property tax in school funding has remained remarkably stable, never deviating much from that 35 percent.

In recent years, increased public concern about rising inequality has amplified the debate about ensuring equal access to educational opportunities and adequate funding to address the needs of all students, especially those in traditionally disadvantaged groups. Some suggest that an increase in state aid would accomplish this goal, but there are conflicting results in the literature as to whether centralizing school funding by substituting state aid for local property tax increases or decreases per-pupil spending and equity. With the pandemic forcing a reconsideration of school funding formulas, including those based on enrollment (see sidebar), the following excerpted case studies of Michigan, California, and Massachusetts offer examples that may be helpful to places considering the best way to provide an adequate and equitable education for all. Massachusetts relies heavily on the property tax to fund schools, while California and Michigan rely heavily on state aid (see table 1, page 36).

Public school enrollment declined during the COVID-19 pandemic. Credit: miljko via Getty Images.

SCHOOL ENROLLMENT AND FUNDING FORMULAS

When the pandemic thrust students across the country into remote and hybrid learning, many public schools lost enrollment. For the 2020–2021 school year, enrollment was down 3 percent nationwide compared to 2019–2020. Declines were uneven across states and student groups, with the largest drops among pre-K and kindergarten students and among low-income students and students of color (NCES 2021). Since state aid for public schools is linked to the number of students attending or enrolled, a slump in attendance or enrollment can reduce that revenue. In response to these enrollment declines, many states adopted short-term policies to hold school districts harmless. Delaware and Minnesota, for example, provided extra state funding for declining districts. Many states, including New Hampshire and California, used prepandemic enrollment to calculate state aid (Dewitt 2021; Fensterwald 2021). Texas announced hold-harmless funding to districts that lost attendance if they maintained or increased in-person enrollment, in an effort to bolster in-person learning. All of these provisions are temporary, and states are waiting to see if enrollment will recover in 2022–2023. If it doesn't, the data suggest that reduced funding for schools with the highest enrollment declines will disproportionately affect Black and low-income households (Musaddiq et al. 2021). These fiscal and equity concerns are causing educators to rethink the measurement of attendance and enrollment, and its link to funding.

Table 1
School Funding and Spending: Comparing States

	California	Massachusetts	Michigan
Percent of K–12 revenue from the property tax (FY 2019)	27%	52%	27%
Percent of K–12 revenue from state aid (FY 2019)	58%	39%	60%
Per-pupil school spending (state rank) (FY 2020)	$14,053 (16)	$18,269 (8)	$13,072 (19)
Is per-pupil spending adequate in high poverty districts? (Baker et al.)	Severely inadequate	Above adequate	Severely inadequate
Growth in real per-pupil school spending, 1970–2018 (in 2019–2020 dollars)	$7,454 131%	$13,616 253%	$6,387 111%
Strength of state-imposed property tax limits	Very restrictive	Modestly restrictive	Very restrictive

Sources: U.S. Census, National Center for Education Statistics, Wen et al. (2018), Baker et al. (2021).

Michigan: A Tax Swap

Michigan voters passed a proposal in 1994 that reduced reliance on the local property tax, shifting much of the state's school funding to the sales tax and other taxes while restructuring state aid to schools. Research suggests this shift led to increased spending in the short term that improved some educational outcomes, but also resulted in a distribution of funds that did not reach the students who most need support.

Michigan voters had considered and defeated a series of proposals to restructure property taxes and school funding before approving Proposal A in 1994, which reduced reliance on the property tax and raised the sales tax to pay for that property tax relief. This "tax swap" greatly increased state education aid in the year of implementation and for some years after, changed the basic state aid formula, and changed the way state education aid is targeted.

The state raised the sales tax from 4 to 6 percent, depositing the revenue into the School Aid Fund. It obtained additional revenue from the income tax, real estate transfer tax, tobacco taxes, liquor taxes, the lottery, and a new state government property tax known as the State Education Tax. Local property taxes levied for school operating costs, which had averaged a rate of 3.4 percent before Proposal A, were eliminated; the state mandated a 1.8 percent local property tax rate on nonhomestead property, and all property became subject to the 0.6 percent State Education Property Tax.

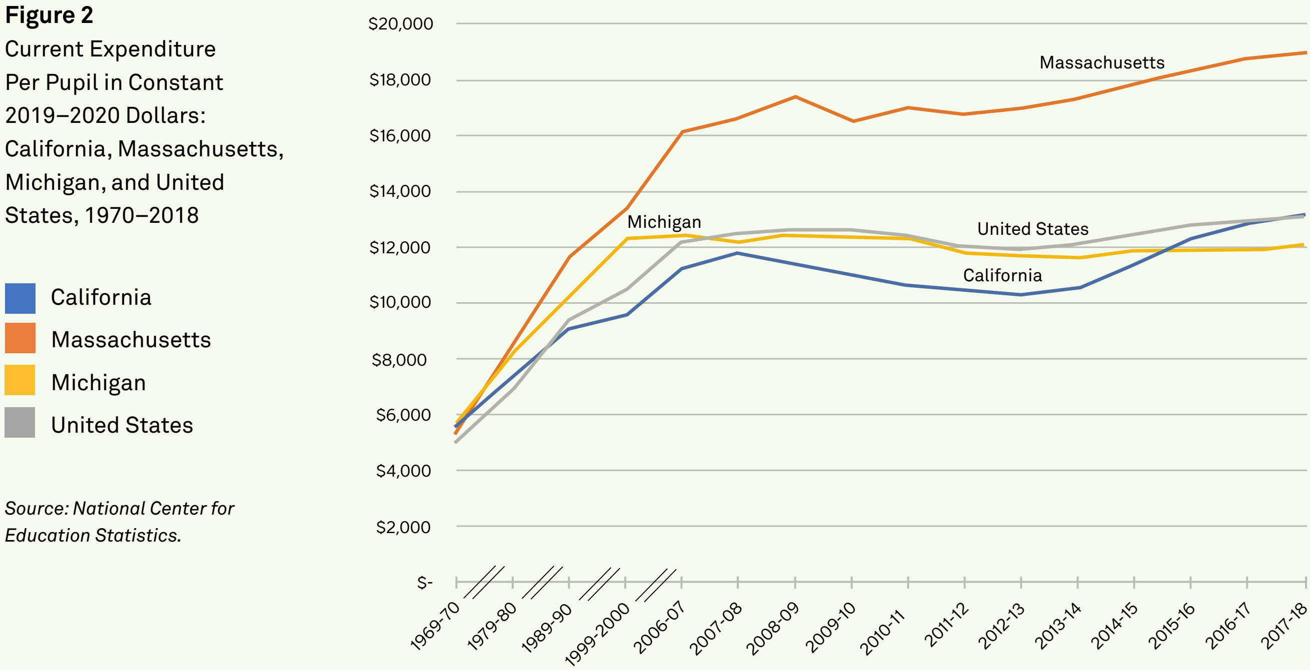
State aid under Proposal A explicitly targeted low-spending districts. Increases in state funding were phased in over time, with substantial increases for low-spending districts, without reducing the funding of initially high-spending districts. In addition, school districts were allowed only limited options for supplementing education spending (Courant and Loeb 1997).

Because Michigan's tax swap was enacted so long ago, we can observe the impacts of three recessions on state aid and local property tax funding. During the 1990–1991 and 2000–2001 recessions, reliance on state aid decreased while reliance on the local property tax increased. In the Great Recession, reliance on state aid decreased and reliance on the local property tax decreased slightly. The fact that the property tax was less effective as a backstop in the Great Recession is likely due to uniquely restrictive property tax limits in the state. Michigan's property tax is subject to all three main types of property tax limits: rate, levy, and assessment. In addition, one provision of the levy limit is particularly restrictive: not only does it require reductions in tax rates when the property tax base grows rapidly ("Headlee rollbacks"), but unlike most state levy limits, it prohibits increased tax rates without an override vote when the property tax base grows slowly or declines. This had a very constraining effect on property tax revenues during the Great Recession, when property values declined (Lincoln Institute 2020).

Although real per-pupil education revenue increased at a faster rate just after passage of Proposal A, beginning with the recession of 2000–2001, real state aid declined for many years, leading to slower growth or declines in total real per-pupil revenue and in educational expenditures per pupil (see figure 2). An empirical study to analyze the impacts of Proposal A on revenue and spending in K–12 education concludes that "the reform increases the level of school revenue and spending at the state level only in the first two years of the reform; the reform eventually decreases it two years after and onwards" (Choi 2017, 4).

Importantly, a tax swap may not create a more equitable school finance system. The school finance restructuring in Proposal A did

Figure 2
Current Expenditure Per Pupil in Constant 2019–2020 Dollars: California, Massachusetts, Michigan, and United States, 1970–2018



Source: National Center for Education Statistics.

Credit: Prostock-Studio via Getty Images.

reduce the disparities in school spending per pupil among school districts (Wassmer and Fisher 1996). This equalization was primarily accomplished by using state aid to raise per-pupil spending of the lowest-spending districts and placing some restrictions on spending on the highest-spending districts. But Michigan's Proposal A was not designed to target aid to the children or the school districts most in need. It targeted additional school aid to previously low-spending school districts, which tended to be middle-income and rural.

An evaluation of the equity and adequacy of school funding systems across the United States concluded that resources in Michigan's highest poverty districts are severely inadequate (Baker et al. 2021). Thirty-seven percent of students attend districts with spending below the amount required to achieve U.S. average test scores.

The recovery from the COVID recession, along with the massive influx of federal funds for education, may yet enable a turnaround in Michigan's K–12 education system. In her 2022 State of the State address, Governor Gretchen Whitmer said her next budget would include the largest state education funding increase in more than 20 years (Egan 2022).

California: Shifting Control

California's school finance narrative illustrates the tension between school funding equity goals and property tax reduction goals, providing a cautionary tale of the danger of diminishing local funding and the unintended consequences of assessment limits. In its pursuit of educational equity, California shifted funding away from local governments at the cost of local control. In taxpayers' quest to control property tax increases, they traded horizontal equity for predictability.

Prior to 1979, California school districts raised over half of their revenue locally and school districts exercised control over their budgets and property tax rates. School finance litigation that began in the early 1970s drove legislation that began to erode this local control, shifting authority for property tax revenue distribution to the state in an attempt to equalize school district revenues. This series of cases, known as *Serrano v. Priest*, was motivated by concerns that the disparities in wealth among school districts created by dependence on local property taxes discriminated against the poor and violated California's equal protection clause.

During the same period, dramatic growth in property tax values without an offsetting decrease in property tax rates incited a tax revolt that culminated in the passage of Proposition 13 in 1978. This citizen-initiated constitutional amendment fundamentally changed the nature of property tax assessments and imposed strict limits on growth in assessed values and property tax rates. Among other things, Proposition 13 limited growth in assessed values to 2 percent per year and capped cumulative property tax rates at 1 percent of assessed value. Combined with the assessment limit, the rate limit provided certainty to taxpayers about how much property taxes could increase in the future—but stripped local governments and school districts of their ability to control spending levels and budgets. Proposition 13 also instituted acquisition value assessment, under which properties are reassessed only when sold. This provides a strong incentive for taxpayers to remain in their homes and contributes to the state's housing affordability crisis.

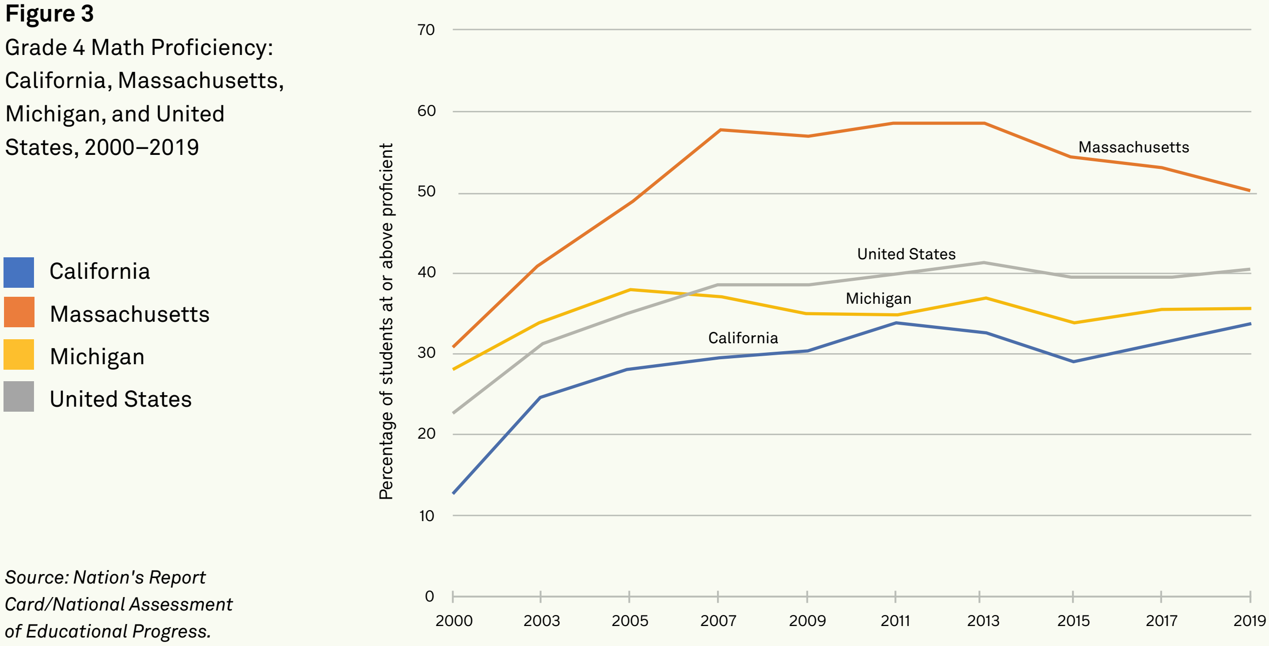
Proposition 13 also prevented local governments and school districts from exceeding the limits in order to raise funds for local priorities, except for voter-approved bond measures. It required a two-thirds majority vote by both houses of the California legislature to increase any state tax and required a two-thirds majority vote of the electorate for local governments to impose special taxes.

In 1978, school district tax collections accounted for 50 percent of school district revenue; in 1979, they made up only a quarter of total revenue. The state aid share of school district revenue, supported mostly by state income taxes, climbed from 36 percent in 1978 to 58 percent in 1979.

In 1986, the California Court of Appeal held that the state's centralized school finance system complied with the state constitution. The court found 93 percent of California students were in districts with wealth-related spending differences of less than $100 per pupil as prescribed by the courts in 1976. While the reforms satisfied the court, making per-pupil spending more consistent among school districts has not definitively improved or equalized educational outcomes.

Together, the court rulings and Proposition 13 altered the school finance landscape in California and inspired a wave of property tax revolts and school finance litigation across the United States. The school finance reforms in California successfully constrained revenues, but at the cost of local control and to the detriment of education quality. School districts lost control over their primary revenue source, per-pupil spending fell below the national average (see figure 2), and academic achievement and public school enrollment declined (Brunner and Sonstelie 2006; Downes and Schoeman 1998).

Figure 3
Grade 4 Math Proficiency: California, Massachusetts, Michigan, and United States, 2000–2019



Source: Nation's Report Card/National Assessment of Educational Progress.

California's test scores continue to suffer. National Assessment of Educational Progress (NAEP) scores for California show that its students continue to perform below the national average, although the gaps have narrowed since 2013, when California enacted the Local Control Funding Formula (LCFF) school finance reforms (see figure 3). Among other reforms, the LCFF targets aid to high-need districts through concentration grants and gives districts more discretion over how they spend state funds.

One analysis suggests that California's reforms played a major role in the rapid decline in public school enrollment in the 1970s and a partial role in the rapid growth in private school enrollment during the same period (Downes and Schoeman 1998).

Persistent efforts to amend the state constitution to eliminate acquisition value assessment for nonresidential property provide evidence of long-term dissatisfaction with Proposition 13 among some Californians. Referred to as a "split roll," such proposals are often debated but rarely make it to the ballot. Voters narrowly defeated one such proposal, Proposition 15, in November 2020. Proposition 15 would have returned certain commercial and industrial real property to market-value assessment while preserving acquisition value assessment for residential properties and most small businesses.

Credit: skynesher via Getty Images.

Massachusetts: Targeted Aid

Massachusetts' case indicates that targeting state aid to the school districts that need it most and linking accountability standards to increased school aid can produce strong academic results. The state was also able to reduce reliance on the property tax while improving its property tax system. However, recent years show that even strong school finance systems can backtrack and should be reevaluated periodically.

In 1980, Massachusetts enacted a property tax limit known as Proposition 2½. The two most important components of Proposition 2½ limit the level and growth of property taxes: they may not exceed 2.5 percent of the value of all assessed value in a municipality, and tax revenues may not increase more than 2.5 percent per year. Because K–12 schools are part of city and town governments in the state and not independent governments, as in some states, Proposition 2½ directly affects schools.

One might expect that reducing reliance on the property tax in a state that does not allow local governments to levy either sales or income taxes might heavily constrain local government revenues. But local governments were lucky in the timing of the enactment of Proposition 2½. The tax limitation came into force at the beginning of a period of significant economic growth in the state popularly termed the "Massachusetts Miracle." This enabled the state to increase aid to localities, which cushioned the tax limitation's impact.

Also important is the fact that Proposition 2½ was not a constitutional amendment, but a piece of legislation that could be modified by the legislature—and was. Altogether, Proposition 2½ had "a smaller impact than either its supporters had hoped or its detractors had feared" (Cutler, Elmendorf, and Zeckhauser 1997). Although not perfect, Proposition 2½ is less restrictive and less distortionary than many property tax limits in other states (Wen et al. 2018).

During the 1980s, the state also reformed its property tax system by moving to assessing properties at full market value. Before this reform, most properties, especially residential ones, were assessed at far less than market value, with high-income properties receiving preferential treatment. Proposition 2½ created an incentive to move to the full value because of the 2.5 percent cap on the property tax levy.

As the state was coming out of a deep recession in the early 1990s, the quality of its public schools had caused broad dissatisfaction. The Massachusetts Business Alliance for Education published *Every Child a Winner* in 1991, calling for "high standards, accountability for performance, and equitable distribution of resources among school districts" (MBAE 1991). The highest court was considering an equity lawsuit that had been filed in 1978, and the state Board of Education published a report highlighting some schools' shortcomings (Chester 2014).

In 1993, a pivotal year, the state legislature passed the Massachusetts Education Reform Act (MERA) and the state's highest court ruled in *McDuffy* that the state was not meeting its constitutional duty to provide an adequate education for all students. MERA had a number of important components, including a large increase in state aid for education (from $1.6 billion in 1993 to $4 billion in 2002), and a new school funding formula targeted to districts that needed it most. Another component of MERA was curriculum standards and accountability. In 1998, the MCAS (Massachusetts Comprehensive Assessment System) was administered for the first time to measure student achievement.

In a second school funding lawsuit, *Hancock v. Driscoll*, settled in 2005, the Supreme Judicial Court concluded that "a system mired in failure has given way to one that, although far from perfect, shows a steady trajectory of progress" (Costrell 2005, 23). One measure of Massachusetts' achievement is the improvement of state scores on NAEP tests (see figure 3, page 39).

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Although the original intention was to reevaluate and, if need be, revise the state's school funding formula periodically, that did not happen. Furthermore, after several years of growth in state school aid, cuts came in 2004, then again in 2009 after the onset of the Great Recession.

In 2015, a Foundation Budget Review Commission was established to review the state's school aid system (Ouellette 2018). The commission concluded that local governments were bearing a disproportionate share of the cost of educating children and that several elements of the foundation aid program, such as the way health insurance costs were taken into account, were outdated.

In 2019, the legislature passed and Governor Charlie Baker signed the Student Opportunity Act (SOA), which provides $1.5 billion in additional school aid better targeted to low-income students. This revised school aid system was designed to be phased in over seven years. In 2020, the state delayed the funding increases because of pandemic-related economic uncertainty. However, in 2021, the legislature fully funded the act for the first time (Martin 2021).

Finding the Right Combination

Neither state aid nor the property tax on its own can provide adequate, stable, and equitable school funding. But the right combination can provide all three. Just as weaving requires lengthwise and crosswise threads (the warp and woof), so a sound school finance system requires a well-designed property tax and well-designed state school aid.

The *system* of state and local funding should provide sufficient funding so that all children, no matter their race, ethnicity, or income, can receive an adequate education. When designed properly, state aid can ensure that all school districts can provide an adequate education and weaken the link between per-pupil property tax wealth and per-pupil education funding—without sacrificing the benefits that come from a stable property tax base and local control of public schools.

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