The Ambiguity of *Serrano*: Two Concepts of Wealth Neutrality

By LEE S. FRIEDMAN*

Introduction

In a four to three decision on December 30, 1976, the California Supreme Court affirmed a trial court finding[1] and held that the system of public school finance in California was invalid because it violated the state constitution's guarantee of equal protection of the laws.[2] In the court's opinion, the fundamental defect was that the finance system "makes the quality of a child's education depend upon the resources of his school district . . . ."[3] In this commentary, any system free from this defect will be termed "wealth neutral."[4] The court has not provided a clear test to distinguish wealth neutral systems from offending systems. Since the meaning of "full" compliance is thus uncertain, the current legislative debate about "full" and "substantial" compliance is vacuous. The nature of this ambiguity will at some point compel further court guidance. The purpose of

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1. Serrano v. Priest (Serrano II), 18 Cal. 3d 728, 557 P.2d 929, 135 Cal. Rptr. 345 (1976), *cert. denied*, 45 U.S.L.W. 3822 (U.S. June 15, 1977).

2. *Id.* at 774-75, 557 P.2d at 957, 135 Cal. Rptr. at 373.

3. *Id.* at 755, 557 P.2d at 944, 135 Cal. Rptr. at 360 (quoting Serrano v. Priest (Serrano I), 5 Cal. 3d 584, 614, 487 P.2d 1241, 1263, 96 Cal. Rptr. 601, 623 (1971)).

4. Economists use the word "fiscal" in reference to tax and expenditure policies, and "neutral" to mean not affecting resource allocation decisions. *Serrano II* held that wealth was not to affect resource allocation in education; hence "wealth neutrality." It is fiscal policy which should be non-neutral; such a policy is intended to affect resource allocation decisions in education to offset the influence of wealth.

this commentary is to delineate the nature of the ambiguity and to examine alternative paths to its resolution.

In Part I, two different concepts of wealth neutrality and the tests that can be used to distinguish offending from neutral systems under each are described. This section continues by describing the inconsistency between these two concepts; that is, why it is generally impossible to satisfy both simultaneously. Part I concludes with a discussion of which concept is preferable. After a review of the *Serrano* rulings,[5] Part II suggests that the courts were unaware that these concepts are in fact inconsistent. Three additional matters involving the meaning of wealth neutrality which *Serrano II* left unresolved are also discussed in this section: taxpayer equity requirements,[6] the $100 rule of the trial court,[7] and the constitutionality of basic aid.[8] Finally, in Part III, the two bills pending in the legislature (A.B. 65 and S.B. 525)[9] are analyzed to determine whether either one is likely to meet one of the two tests for wealth neutrality.

I. Defining Wealth Neutrality

A. The Basic Ambiguity: *Ex Ante* or *Ex Post* Wealth Neutrality?

How can one distinguish a wealth-related disparity[10] from any ordinary disparity? That question is posed "tongue in cheek" because it is of course possible that disparities may be offensive for reasons other than wealth. Nevertheless, the *Serrano* decision only requires the elimination of wealth-

5. Serrano II, 18 Cal. 3d 728, 557 P.2d 929, 135 Cal. Rptr. 345 (1976); Serrano I, 5 Cal. 3d 584, 487 P.2d 1241, 96 Cal. Rptr. 601 (1971); Memorandum Opinion Re Intended Decision, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938,254 (Apr. 10, 1974); Findings of Fact and Conclusions of Law, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938,254 (Aug. 30, 1974).

6. Serrano II, 18 Cal. 3d at 757 n.35, 759 n.38, 557 P.2d at 945 n.35, 946-47 n.38, 135 Cal. Rptr. at 361 n.35, 362 n.38.

7. Findings of Fact and Conclusions of Law at 57, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938,254 (Aug. 30, 1974); Serrano II, 18 Cal. 3d at 749 n.21, 557 P.2d at 940 n.21, 135 Cal. Rptr. at 356 n.21.

8. Basic state aid consists of a flat grant to each district of $125 per pupil per year, regardless of the relative wealth of the district. *See* CAL. CONST., art. IX, § 6, para. 4; CAL. EDUC. CODE §§ 177501, 17801 (West Supp. 1977) (current version at *id.*, §§ 41370, 84360, 41800 (West Spec. Pamph. 1976)). Findings of Fact and Conclusions of Law at 57, 62, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938,254 (Aug. 30, 1974).

9. A.B. 65, Cal. Legis., 1977-78 Reg. Sess. (1977-78 Regular Session) (Dec. 15, 1976) (introduced by Assemblyman Greene); S.B. 525, Cal. Legis., 1977-78 Reg. Sess. (Mar. 10, 1977) (introduced by Senators Rodda and Dills).

10. By disparity, I mean differences among districts in educational expenditures per ADA, unless otherwise noted. ADA (Average Daily Attendance) is computed by adding together the number of students actually present on each school day and dividing that total by the number of days school was taught. Serrano I, 5 Cal. 3d at 592 n.4, 487 P.2d at 1246 n.4, 96 Cal. Rptr. at 606 n.4.

related disparities.[11] The trial court's task in this regard was made easy by the existence of patent disparities between high-wealth and low-wealth school districts, the former spending, in 1973-74, from two to four times more per pupil than the latter.[12] But suppose that under a new system the number of low-wealth districts spending more than high-wealth districts increases, and that in those cases where low-wealth districts spend less, the absolute differences diminish. Could the boundary between a neutral and an offending system then be defined?

One approach to this problem is statistical. The first determination is whether differences in district educational expenditures per child are systematically (statistically) and significantly related to differences in district wealth per child. The mathematical procedures for conducting such a test are relatively straightforward.[13] This may be called *ex post* wealth neutrality because it is a test conducted after expenditure choices are made.[14] The

11. In fact, the trial court holding specifically allows disparities based upon the special educational needs of students and differing costs that districts face in providing identical educational services. Findings of Fact and Conclusions of Law at 56, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938,254 (Aug. 30, 1974). Whether disparities based on the different preferences of voters in different districts are offensive is another issue.

12. Findings of Fact and Conclusions of Law at 18, 19-20, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938,254 (Aug. 30, 1974).

13. Briefly, the procedure is to run a multiple regression analysis where the dependent variables are district expenditure per ADA with all categorical funding and cost adjustments removed, and the independent variables are district wealth per ADA, the square of this term, and the cube of the term. The latter two terms are included so that the regression represents a Taylor series expansion, which can identify both linear and non-linear relationships. The expansion beyond simple linear regression is necessary to identify, for example, a financing system where both low- and high-wealth districts have high educational expenditures but average-wealth districts have low expenditures. Violations of wealth neutrality are indicated by regression coefficients which are different from zero (with high statistical confidence, as judged by a t-test). The larger the absolute value of the slope of this equation, the greater is the degree of violation. While the statistical procedures may be unambiguous, the decision on how different the coefficients may be from zero without constitutional offense remains with the court.

A simpler, but more restrictive, empirical test is for the court to require that a very large percentage of all districts (*e.g.*, 95%) have expenditures (net of categoricals and cost adjustments) within a fixed range (*e.g.*, $1200-$1400). *See* A. Rodda, Basic Elements of School Finance Proposal for Reasonable Compliance with *Serrano* 2-3 (Feb. 17, 1977) (memorandum). The reason this test is more restrictive is that its practical effect is to deny equal-wealth districts the option of a wide choice of expenditure levels. Since the test, as given, only applies to expenditures other than categoricals to meet special needs or district cost differences, it restricts voters from providing substantially different amounts of additional funds for the children attending school in their district. By contrast, the first test only restricts voter preferences to the extent they are wealth-related. Further, the second test may not be sufficient because expenditures may be wealth-related within a fixed range.

It should be mentioned that the difficulties noted by the trial court in statistical procedures designed to separate the effects of factors influencing achievement test scores do not occur with force here. Memorandum Opinion Re Intended Decision at 89, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938, 254 (Apr. 10, 1974). The only question being asked is whether expenditures are related to wealth. What measure of wealth to use is a question deserving of debate but one which arises independently of any statistical testing.

14. Stephen M. Barro briefly notes the distinction between *ex ante* and *ex post* neutrality in a very interesting article. S. Barro, *Alternative Post-Serrano Systems and Their Expenditure*

important characteristic of the *ex post* test is that it judges a financing system by its results. If for any reason high-wealth districts have a statistically verified tendency to spend more than low-wealth districts, or vice versa, the *ex post* test will not be satisfied, *i.e.*, the condition of wealth neutrality is violated.

A second approach, *ex ante* wealth neutrality, requires the financing system to ensure that equal tax efforts result in equal expenditures.[15] In its simplest version, district power equalizing, the tax effort is measured by the property tax rate.[16] Under this system, the state publishes a schedule relating expenditure levels to property tax rates. The only way a district can have a particular expenditure level is for it to tax itself at the rate corresponding to that level on the state schedule. A district chooses its tax rate, and receives the expenditure level associated with that rate. If the locally raised revenues are not sufficient to provide the necessary expenditures, the state subsidizes the difference. If more than enough revenues are raised, the district must turn the excess over to the state. Districts making the same efforts, *i.e.*, choosing the same tax rate, have the same expenditures.

There are good reasons for rejecting the property tax rate as a fair measure of tax effort, however.[17] Consider two districts with equal property wealth but whose residents have different income levels. The same property tax rate choice would seem to imply a greater effort by the district with lower income residents. Even though measures can be constructed to account for this condition,[18] the property tax burden is a difficult and contro-

Implications, in SCHOOL FINANCE IN TRANSITION: THE COURTS AND EDUCATIONAL REFORM, 25, 32 (J. Pincus ed. 1974).

15. An alternative, more general *ex ante* definition requires only that the financing rules omit district wealth in the official formula or formulae determining district expenditures per child. Despite the appeal of its simplicity, this approach has undesirable features as a standard of wealth neutrality. All systems satisfying the definition in the text also satisfy this more general definition; thus the latter includes "inequitable" systems which the former precludes. (The latter would be "inequitable" because it would violate the peculiar tax equity notion of the *ex ante* standard, as defined in the text. As a matter of pure tax equity, it is generally considered more equitable to provide funds to low-wealth districts out of general funds rather than taxes on specific government services provided by wealthier districts). Such an approach would not necessarily be inappropriate as a constitutional standard whose only purpose is to guarantee protection of the child's fundamental interest in education from the influence of wealth. Nevertheless, it will be argued that the *ex ante* standard as proposed in the text does not ensure this protection. A fortiori, neither does the more general definition. Since the general definition is not only plagued with the deficiencies inherent in any *ex ante* standard but also has been considered by the courts, it merits no further discussion.

16. District power equalizing was first proposed in J. COONS, W. CLUNE, & S. SUGARMAN, PRIVATE WEALTH AND PUBLIC EDUCATION 201 (1970).

17. The task force I directed filed a brief of amicus curiae in the recent *Serrano II* proceedings to ensure that this viewpoint was represented. See note 59 *infra*.

18. *See, e.g.*, 1 SENATE SELECT COMMITTEE ON SCHOOL DISTRICT FINANCE FINAL REPORT 65-67 (Calif. 1972).

versial issue.[19] In a district with many renters and absentee landlords, a high property tax rate might be a large burden if it is shifted to tenants through rent increases, though only a small burden if paid by the absentee landlord through a lowering of property value. Thus, it is not easy to determine what constitutes equal effort, because the decision as to whether known burdens among people of unequal wealth are equal entails a value judgment, and because it is difficult to know what all the burdens are for each individual taxpayer.

In sum, the *ex post* wealth neutrality test is essentially concerned with the results of any school financing plan, *e.g.*, that actual expenditures not be systematically related to the wealth of districts. An examination of the rules would only be required if necessary to change the results, not as a test of constitutionality. On the other hand, the *ex ante* wealth neutrality test is inherently concerned with the rules of any school financing plan, *e.g.*, that equal tax efforts lead to equal expenditures. The resulting pattern of expenditures does not matter so long as the rules are fair.

B. The Inconsistent Relationship Between the *Ex Ante* and *Ex Post* Standards

It is generally impossible to satisfy both types of neutrality simultaneously. There are of course exceptions. The legislature can ensure the achievement of both *ex ante* and *ex post* neutrality by redistricting or by full state funding.

Suppose the legislature redesigned the boundaries of school districts so that all districts had the same wealth. No disparities of either type would be caused by differences in wealth since such differences would not exist. Nevertheless, this is not an attractive alternative under a design with numerous districts, because the relative wealth per pupil may change rapidly over time due to changes in school population and total district wealth. Although reducing the number of districts would decrease the frequency with which redistricting would be required, it would also increase the administrative problems of ensuring intra-district equality and might destroy the sense of community many associate with small neighborhood districts.

The second method of ensuring both types of neutrality is full state funding. Under this method, the state sets a uniform expenditure level for all schools. This ensures *ex post* wealth neutrality as there are no expenditure differences. The state then raises the necessary revenues through a particular statewide tax (*e.g.*, income, sales, or property) that burdens all equally. Since all residents make equal tax efforts, by legislative definition, the system is *ex ante* wealth neutral. Nothing in this system precludes the legislature from providing categorical funds to take account of special

19. *See* Aaron, *A New View of Property Tax Incidence*, 64 AM. ECON. REV. 212 (1974).

student needs and the differential costs that districts face in providing the same services (*e.g.*, a classroom at reasonable temperature), or from establishing a fund for innovative demonstration projects as long as all schools or districts have equal opportunity to apply. Furthermore, local community control over the use of funds can be maintained. Of the two methods that satisfy both tests for wealth neutrality, full state funding seems preferable.

Neither system allows local choice of expenditure level among districts of varying wealth. In any system where districts have unequal wealth and such local choice is permitted, however, it is generally impossible to satisfy simultaneously both types of wealth neutrality. To illustrate why this is so, consider the pedagogic example of one person choosing how much of a particular good to buy. This will depend, of course, on the individual's wealth, the price of the good relative to other goods, and the preferences that the person has for the goods in question. For example, compare the purchase of fast food hamburgers with the purchase of yachts. It may be that one or two hamburgers per week is all that a person can tolerate, such that doubling wealth results in no increase in hamburger purchases. It may be that the person actually buys fewer hamburgers. In both cases, the proportion of wealth spent on the good decreases as wealth increases. In a more typical case, there may be a small increase in the quantity purchased, but total spending on the good would still decrease as a proportion of wealth. The proportion of wealth spent on yachts, by contrast, may increase as wealth increases.

Clearly, there is no reason to expect all people to spend the same proportion of their wealth on any particular good, even if they had identical preferences. If district power equalizing is deemed to offer all people the opportunity to buy a given quantity of education for the same fraction of their wealth, there is no reason to assume a priori that low-wealth groups will choose the same proportions and, therefore, quantity, as high-wealth groups. Thus, it would be a fortuitous empirical result if education happened to be precisely that kind of good for which low-wealth groups chose to make their "efforts" equal to high-wealth groups.

For the sake of exposition, the discussion regarding behavioral response to district power equalizing is oversimplified because it covers only income or wealth effects. In the hamburger and yacht examples, the price of each was assumed constant. Yet district power equalizing ensures that low-wealth districts pay a lower price per unit for education than high-wealth districts. The price effect alone would tend to increase purchases in the low-wealth districts.[20] Empirical studies of spending on public education sug-

20. This price difference is, in fact, where the "power" in district power equalizing lies. The only way in which DPE changes district wealth from the status quo is that a low-wealth

gest, however, that as a commodity it is more like hamburgers than yachts.[21] The price effect of district power equalizing thus works to magnify this result: if people had identical preferences, low-wealth districts would choose higher expenditure levels than high-wealth districts. In practice, preferences may differ. If preferences are education-intense in high-wealth districts, this would mitigate the result described. Some economists have tried to estimate how school districts would respond to district power equalizing, but the statistical problem is thorny and the results are mixed. While three of the best studies all agree that such plans will not result in *ex post* wealth neutrality, two estimate that district power equalizing will reverse the spending disparities, *i.e.*, low-wealth districts will spend more than high-wealth districts because the price per unit of education is so much cheaper for them, and another concludes that high-wealth districts will continue to spend more than low-wealth districts because the former's residents have strong preferences for education.[22] In any case, there is only a remote chance that district power equalizing will satisfy the *ex post* neutrality test.

One question remains: could the definition of "equal effort" be manipulated in such a way that *ex post* results are achieved? Imagine designing a system which is considered to follow the "equal effort, equal expenditure" rule. Suppose the results are such that high-wealth districts continue to spend substantially more than low-wealth districts. Then draw the inference that the initial design was faulty: low-wealth districts still carry a greater burden in attempting to reach a given expenditure level. Redesign the "effort" measure to reduce the difficulty of raising revenue in low-wealth districts. Continue this process until the results are *ex post* wealth neutral and simply define the efforts leading to these results as equal. While such an exercise can be conducted, it is farcical because it effectively dispenses with the *ex ante* test. It might be argued that the exercise is not a charade because

community can purchase the same quantity of education as it previously did and have some extra dollars left over, because the price is lower, to spend on anything they wish (hamburgers, yachts, or education).

Horizontal equity requires, certainly, that equally wealthy districts are charged the same price, and district power equalizing meets this test. The adjustments in price necessary to achieve *ex post* wealth neutrality also must be done by treating equally wealthy districts alike. *See* Feldstein, *Wealth Neutrality and Local Choice in Public Education*, 65 AM. ECON. REV. 75 (1975) [hereinafter cited as Feldstein].

21. *See generally* W. GRUBB & S. MICHELSON, STATES AND SCHOOLS: THE POLITICAL ECONOMY OF PUBLIC SCHOOL FINANCE (1974) [hereinafter cited as STATES AND SCHOOLS]; Feldstein, *supra* note 20. The study suggesting undercorrection is D. Stern, The Effects of Alternative State Aid Formulas On the Distribution of Public School Expenditures in Massachusetts (1972) (unpublished Ph.D. dissertation in the M.I.T. library).

22. *See generally* STATES AND SCHOOLS, *supra* note 21; *see also* Feldstein, *supra* note 20, at 13.

"true" tax equity should lead to *ex post* neutral results; that is fallacious because if the identical system were to be applied to the provision of any other good (*e.g.*, police services), the results would undoubtedly not be *ex post* wealth neutral.[23] It seems insensible to insist that the same burden is fair for one good but not another.

In sum, it is possible to marry the two independent concepts of *ex ante* and *ex post* wealth neutrality only by a redistricting plan or by full state funding. Any financing system that allows local choice of expenditures in districts of varying wealth requires a separation of the concepts. Either concept can be achieved in this context, but not both.

C. The Choice Between the Standards

The *ex post* standard seems preferable as the real test of constitutionality, but the *ex ante* standard may be useful as a temporary guide to the drafting of legislation. If local choice without redistricting is desired, an initial plan with "equal effort, equal expenditure" rules would at least provide information on expenditure choices during the phasing-in process. The final tax rates could be adjusted to achieve *ex post* neutral results. The *ex post* standard is preferable because it protects the interest of children in education; the *ex ante* standard purports to protect the interest of taxpayers in sharing fair burdens. While both interests are important, if only one can be mandated as a specific constitutional principle, the educational interest of children seems more important. In other words, the legislature may weigh the alternatives of local control, taxpayer equity, redistricting, and increased state funding, provided the interests of school children are protected in the final solution.

The *ex post* standard requires that the average expenditure per child in low-wealth districts be equal to the average expenditure per child in high-wealth districts, apart from all categoricals, special needs, or cost adjustments.[24] This standard does not restrict variation in spending among districts of the same wealth, but such variation could only arise as a result of varying preferences among voters in different but equally wealthy districts and not due to variation in pupil needs or costs, which must be analyzed separately. Whether a child's education should vary according to the non-wealth-related

23. Recall the first example with hamburgers and yachts. To induce individuals of differing wealth to spend the same proportion of their resources on hamburgers, the wealthier individual would have to be offered a lower price than the poorer individual. In the case of yachts, however, the price for the poorer individual would have to be lowered. The adjustments go in the opposite direction and equity has nothing to do with it. This is an extreme example, but it is generally true that the precise "equal effort" definition necessary to make the consumption of one good wealth neutral will not lead to neutrality if applied to another good.

24. This statement is a slightly simplified version of the formal requirement for *ex post* wealth neutrality described earlier. See notes 13-14 and accompanying text *supra*.

whims of voters is a constitutional question distinct from that raised in *Serrano*, which only concerned wealth-related disparities. The *ex ante* standard, on the other hand, only requires that equal tax efforts lead to equal expenditures. This possibly protects the taxpayer; it guarantees nothing to children. As the examples in this section demonstrate, under such rules it is not voter preferences but wealth itself that causes differences in expenditures. Moreover, substantial *ex post* wealth-related disparities could still occur. While it is possible that *ex ante* standards could lead to *ex post* neutral results, that is no reason to reject the *ex post* standard. *Ex post* wealth neutrality is still the preferable test of constitutionality.

II. The *Serrano* Decision

A. The Failure to Recognize Inconsistency

The *Serrano* opinions leave the impression that the court would like to have both *ex ante* and *ex post* wealth neutrality. In the 1971 *Serrano I* ruling, the court wrote that "wide differentials remain in the revenue available to individual districts and, consequently, in the level of educational expenditures. . . . Thus, the state grants are inadequate to offset the inequalities inherent in a financing system based on widely varying local tax bases."[25] This seems to suggest that the court is concerned with resulting expenditure disparities. The court may correctly believe that it is the unequal tax bases which cause disparity, but the differences in tax bases would presumably not be of concern if *ex post* disparities did not result. Similarly, the court later stated: "The foundation program partially alleviates the great disparities in local sources of revenue, but the system as a whole generates school revenue in proportion to the wealth of the individual district."[26] Again, the concern for results was evidenced by the court's analogy to the poll tax: "In Harper v. Virginia State Bd. of Elections, . . . the high court struck down a $1.50 poll tax, not because its *purpose* was to deter indigents from voting, but because its *result* might be such."[27]

The court raised the *ex ante* question only once in 1971. The court noted: "[T]he parents allege that . . . as a direct result of the financing system they are required to pay taxes at a higher rate than taxpayers in many other districts in order to secure for their children the same or lesser educational opportunities."[28] The court simply noted, however, that because the second cause of action (that of the parents) incorporated the first cause of action (that of the children), and a constitutional defect was found in the first cause of action, plaintiff parents had demonstrated a sufficient

25. Serrano I, 5 Cal. 3d at 594, 487 P.2d at 1247-48, 96 Cal. Rptr. at 607-08.
26. *Id.* at 598, 487 P.2d at 1250-51, 96 Cal. Rptr. at 610-11.
27. *Id.* at 602, 487 P.2d at 1254, 96 Cal. Rptr. at 614 (emphasis in original).
28. *Id.* at 618, 487 P.2d at 1265, 96 Cal. Rptr. at 625.

cause of action.[29] The supreme court then remanded the case to the trial court, so that it could determine the truth or falsity of the facts alleged in the plaintiffs' complaint.[30]

In finding for plaintiffs, the trial court was bolder in its ruling. On the *ex ante* issue, the trial court concluded:

> The California public school financing system fails to meet the equal protection requirements of the California Constitution because property taxpayers who are plaintiffs in this action, as a direct result of the California public school financing system, are required to pay taxes at higher tax rates than taxpayers in many other school districts of the State in order to obtain for their children the same or lesser educational opportunities than are afforded to children in such other school districts.[31]

Still more bluntly, the trial court concluded: "The equal protection provisions of the California Constitution require that school districts receive the same revenue for the same tax rate."[32] In its findings of fact, the court also cited several financing plans that did not produce wealth-related spending disparities, including district power equalizing.[33]

The trial court did not, however, settle on the *ex ante* definition and reject the *ex post* alternative. Actual disparites in spending were also of great concern:

> The wide disparities in expenditure levels between low-wealth school districts and high-wealth school districts, which will be continued for years under S.B. 90 and A.B. 1267, are unconstitutional because they have significant adverse effects on the quality of the educational programs and opportunities afforded the children in the low-wealth school districts as compared with the quality of educational programs and opportunities afforded the children in the high-wealth school districts.
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> . . . .
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> The per pupil expenditure differentials between school districts under the school financing system, including S.B. 90 and A.B. 1267, constitute a denial of equality of treatment to the children of the low-wealth school districts of the state.[34]

The trial court felt comfortable in requiring both that expenditure disparities be eliminated and that equal tax rates lead to equal expenditures, because of an empirical assumption: "To the extent that equal tax rates can produce different expenditure levels, or that equal expenditure levels can be produced by different tax rates, even when convergence has been completed,

29. *Id.* at 618, 487 P.2d at 1266, 96 Cal. Rptr. at 626.

30. *Id.* at 619, 487 P.2d at 1266, 96 Cal. Rptr. at 626. Since the court was ruling on demurrers, it considered all of the allegations of plaintiffs' complaint as true.

31. Findings of Fact and Conclusions of Law at 47-48, 57, 58, 63, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938,254 (Aug. 30, 1974).

32. *Id.* at 59.

33. *Id.* at 31-32.

34. *Id.* at 64-65.

the system will still be generating school revenue in proportion to the wealth of the individual district."[35] In other words, the court assumed that "equal effort, equal expenditure" rules would lead to expenditures which did not correlate with the wealth of the district. Unfortunately, as an empirical proposition, this assertion is almost certain to be false.[36]

The trial court decision was appealed to the California Supreme Court, which affirmed the judgment of the lower court in *Serrano II*. As in *Serrano I*, the court seemed more concerned with actual disparities, but did not reject any trial court findings or conclusions related to the "equal effort" requirement. For example, the supreme court summarized the trial court findings as follows: "Substantial disparities in expenditures per pupil among school districts cause and perpetuate substantial disparities in the quality and extent of availability of educational opportunites. For this reason the school financing system before the court fails to provide equality of treatment to all the pupils in the state."[37] The court thus viewed expenditure disparities as causing disparities in educational opportunity; thus, educational opportunity cannot be construed to mean "a decent tax base." Assuming the court meant school offerings, a later footnote in the *Serrano II* opinion becomes particularly significant: "[T]he fact that disparities in district wealth result in disparities in tax effort required to reach foundation levels is not by itself determinative of the issue before us. It is only insofar as such disparities have the effect of producing disparities in *educational opportunity* that they here concern us."[38] This suggests that the court is primarily concerned with *ex post* wealth neutrality and that the *ex ante* test interests the court only because it believes that test will lead to *ex post* neutrality.

B. Additional Wealth-Related Ambiguities

Three additional ambiguities in *Serrano II* are: taxpayer equity requirements, the $100 rule of the trial court, and the constitutionality of basic aid.[39] The court's taxpayer equity requirements would be dropped entirely if the *ex ante* standard were rejected in favor of the *ex post* standard. Tax rates and expenditures return as fiscal policy tools to achieve wealth neutrality, but do not define it. If the *ex ante* standard is maintained, then it is important to distinguish between tax effort and tax rate because the latter is a very particular concept of tax effort.[40] For example, most people consider a

35. *Id.* at 20. The convergence the court refers to is when all districts under S.B. 90 and A.B. 1267, assuming no voter overrides, spend at the foundation level.

36. See text accompanying notes 20-22 *supra*.

37. Serrano II, 18 Cal. 3d. at 747, 557 P.2d at 939, 135 Cal. Rptr. at 355. The passage goes on to assert that equal expenditure levels are not required, but that the current system gives substantial advantages to high-wealth districts. *Id.*

38. *Id.* at 757 n.35, 557 P.2d at 945 n.35, 135 Cal. Rptr. at 361 n.35.

39. See notes 6, 7 & 8 *supra*.

40. See the discussion in text accompanying notes 34-38 *supra*.

progressive income tax more equitable than a proportional income tax. As a standard of constitutionality, it would indeed be unfortunate to require "equal rates" rather than "equal efforts." Since the court in *Serrano II* seems to view the tax requirements as a guide to neutrality rather than neutrality itself,[41] the distinction becomes less important.

Because of the *ex ante* and *ex post* distinction, the interpretation of the trial court's $100 ruling is ambiguous. The court stated:

> The following are each, in the context in which they are now utilized, objectionable . . . from an equal-protection-of-the-laws standpoint: . . . (3) wealth-related disparities in expenditures per pupil among school districts, apart from the categorical aid, special-needs programs that do not reduce to insignificant differences, which mean amounts considerably less than $100.00 per pupil, within a maximum period of six years . . . .[42]

The *ex post* interpretation of this ruling is that the average expenditure per pupil within any given wealth class be within $100 of the average expenditure for any other wealth class. The *ex ante* interpretation is that if districts make the same tax effort, they must receive support per pupil within $100 of each other. These are very different requirements, but one can only speculate about the court's intention. The argument could be made that because the court gave its approval to district power equalizing as a wealth neutral system,[43] it must have had the *ex ante* definition in mind. But the state schedule for district power equalizing does not have to allow wide choice of expenditure level. The court's intention might have been to restrict local choice within a $100 range in order to ensure that no gross expenditure disparities would result.

One final matter is the constitutionality of basic aid. The court has ruled it unconstitutional in the present system.[44] An unfortunate choice of wording may have led to some confusion, however.[45] It is the inclusion of basic aid in the equalization aid calculation that is anti-equalizing; this is the only defect of basic aid in the current system.[46] Otherwise, basic aid is simply a uniform grant per pupil funded out of state revenues. In fact, full state funding, which the court stamped as wealth-neutral,[47] may be viewed as a simple expansion of the basic aid concept.

41. *See* Serrano II, 18 Cal. 3d at 757 n.35, 557 P.2d at 945 n.35, 135 Cal. Rptr. at 361 n.35.

42. Findings of Fact and Conclusions of Law at 57, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938,254 (Aug. 30, 1974).

43. *Id.* at 32.

44. *Id.* at 57, 62-63.

45. A.B. 65 eliminates basic aid entirely. While this could be quite intentional, to allow the state to target its funds on low-wealth districts, it is not the only way to eliminate the defect. Another way is simply to remove basic aid from the equalization aid calculation.

46. Findings of Fact and Conclusions of Law at 17, Serrano v. Priest, Super. Ct. of the County of Los Angeles, No. 938, 254 (Aug. 30, 1974). See note 50 and accompanying text *infra*.

47. *Id.* at 31.

III. The Proposed Remedies

A. The Similarities Between A.B. 65 and S.B. 525

Two school financing proposals are presently before the legislature. Governor Brown has introduced a plan, A.B. 65, through Assemblyman Leroy Greene. Senator Albert Rodda, chairman of the Senate Finance Committee, has introduced a competing plan, S.B. 525. The two bills are more striking in their similarities than in their differences.[48] Both maintain the current districts and allow local choice; hence, neither can satisfy both concepts of wealth neutrality. Both retain the basic foundation plan with a revenue limit, or district expenditure ceiling, for each district set by the historical expenditure pattern of that district and adjusted annually for inflation. Both retain the provisions allowing voter overrides of the revenue limits. Certainly, to this point, both will surely offend the court. However, both make substantial efforts to narrow the expenditure gap as well as the differences in property tax rates. For example, both bills provide for increases in the foundation level of $400-$600 by fiscal year 1980-81.[49] They also propose to eliminate "slippage," the phenomenon whereby the assessed value of property grows faster than the foundation level,[50] resulting in the decline of state equalization aid as a part of foundation level spending. Both propose to eliminate slippage by holding the state share constant through adjustment of the computational tax rate.[51] Further, both propose

48. The bills introduced to the legislature are subject to amendment at any time, and the information available at the time of this writing may already be out of date. Information on Governor Brown's plan consists of: A.B. 65 Cal. Legis., 1977-78 Reg. Sess. (Dec. 15, 1976) (amended in Assembly Mar. 9, 1977) introduced by Assemblyman Greene; Education Committee, New State School Program as Proposed to be Amended into A.B. 65 (Feb. 24, 1977) (memorandum); Education Systems Unit, Department of Finance, A.B. 65 (Greene), A New State School Program for K-12 Local Assistance—A Five Year Implementation Plan (Feb. 1977) (mimeo) [hereinafter cited as Greene]. Information on Senator Rodda's proposal consists of: S.B. 525, Cal. Legis., 1977-78 Reg. Sess. (Mar. 10, 1977) (introduced by Senators Rodda and Dills); A. Rodda, Basic Elements of School Finance Proposal for Reasonable Compliance With Serrano (Feb. 17, 1977) (memorandum) [hereinafter cited as Rodda]. Both A.B. 65 and S.B. 525 involve major adjustments to existing complex formulas, and without the benefit of computer simulation, only rough calculations and rough approximations are available to make even rougher estimates of the changes each bill makes from the status quo. Given these limitations, it is best to make only broad observations.

49. The foundation level for 1976-77 was $1094 for unified districts. Greene, *supra* note 48, at 27. Under A.B. 65, this will be $1661 in 1980-81. Under S.B. 525, the level will be between $1516 and $1544, depending upon inflation.

50. The state currently grants equalization aid to districts whose own assessed value/ADA times a state computational tax rate is less than the difference between the foundation level and basic aid. The equalization aid is the amount that would bring the district exactly to the foundation level if it taxed itself at the computational rate. Algebraically: Equalization aid = Foundation Level - [Basic Aid + (Computational Tax Rate x AV/ADA)]

51. A.B. 65 maintains the state share at the 1977-78 level; S.B. 525 maintains the state share at the level of the prior year.

that voter overrides be done on a power-equalized basis.[52] In this respect, A.B. 65 is less restrictive in that it applies this requirement to all voter overrides above the foundation level after 1981-82; S.B. 525 only applies power equalization to overrides above 120 percent of the foundation level (after 1980-81). Finally, both propose to put an effective freeze on the tax rates of the wealthiest districts and have the state recapture most of the excess revenue generated above the revenue limit due to a growth in assessed valuation. A.B. 65 allows the district to reduce tax rates by ten percent of the reduction it could make to keep expenditures constant, and the state recaptures the other ninety percent. S.B. 525 completely freezes the tax rate, but the state only recaptures fifty percent of the excess above the revenue limit.

A.B. 65 has three additional features aimed at *Serrano* conformance: the elimination of basic aid, the imposition of minimum tax rates, and a guaranteed yield program.[53] The removal of basic aid only affects districts whose assessed value per ADA times the computational tax rate is higher than the foundation level (i.e., high-wealth districts); all other districts will have equalization aid increased by the decrease in basic aid.[54] The minimum tax rate applies only to a few very high-wealth districts; when levied, the state recaptures the excess revenue above the revenue limits. The guaranteed yield program applies only to equalization aid districts and only to spending above the foundation level but below the revenue limit. All spending above revenue limits requires voter override and is power-equalized by the provision discussed above. Within this limited range, all districts must use the same incremental tax rate to raise expenditure/ADA above foundation levels. This tax rate is designed to be low, so that state aid is provided to supplement the local funds in the vast majority of districts.

There is one provision of A.B. 65 which has an anti-equalizing effect. Current legislation puts a "squeeze" on the revenue limits of all districts with revenue limits above the foundation level. Each year there is a fixed dollar inflation adjustment to all such limits, but only districts spending at the foundation level receive the full adjustment, *i.e.*, have a "squeeze

52. Under both plans, the addition necessary to the tax rate to raise a given amount of additional expenditure is determined by dividing the additional expenditure/ADA by the state average assessed value/ADA.

53. In addition to all the provisions mentioned so far, A.B. 65 provides substantial categorical funding for the special needs of students, the high costs that some districts face, and educational reform. In terms of education in general, these may be the most important components of the proposed bill. Discussion of them is omitted here because the details have no direct bearing on *Serrano* compliance; these proposals are relevant only to the extent that they result in the shifting of the financing burden from the local property tax. Since the total effect of A.B. 65 is to shift the state share from its current 40% to 43% in 1981-82, this will not be decisive. See Greene, *supra* note 48, at 1-2.

54. See formula in note 50 *supra*.

factor'' of 1.0. Districts spending at twice the foundation level or more have a ''squeeze factor'' of .5 and only receive half the inflation adjustment. Between these two spending levels, the squeeze factor is computed proportionally: the closer spending is to the foundation level, the larger the allowed adjustment to the revenue limit. Eventually, this would cause convergence of the revenue limits of all districts. A.B. 65 modifies the squeeze factor to 1.0, the full amount, for all district spending at or below 120 percent of the foundation level. This has the effect of ensuring that districts ''squeezed'' to within 120 percent of the foundation level will not be squeezed further, thus preventing convergence. High-wealth districts will be able permanently to maintain revenue limits twenty percent higher than foundation level districts.

To recapitulate, A.B. 65 and S.B. 525 are remarkably similar. They retain the framework of the current foundation system, but have a number of provisions to reduce the expenditure gap and the variations in tax rates necessary to produce given revenues. But the question remains: Do they go far enough to satisfy either of the two tests for wealth neutrality?

B. Failure Under the Wealth Neutrality Tests

It may reasonably be argued that A.B. 65 and S.B. 525 are each insufficient under both the *ex ante* and the *ex post* tests. It seems clear that equal tax efforts do not lead to equal revenues. High-wealth districts can continue to spend at high levels with low tax rates. While the squeeze factor may control expenditures, there is no mechanism to force tax efforts up to the computational tax rate. The slippage provisions only prevent a worsening of the already defective status quo. The power equalizing provisions may be a bit misleading; they are only incrementally power equalizing. The high-wealth districts start with revenue limits much greater and tax rates much lower than those of low-wealth districts. Even if both can add on with ''equal power,'' that still results in unequal total tax efforts and expenditures. Thus, neither bill satisfies the *ex ante* test for wealth neutrality.

The increase in foundation levels will put a substantial dent in the expenditure gap; Beverly Hills may only be spending 160 percent of what Baldwin Park spends.[55] According to the Rodda memorandum, ninety percent of all of the state's ADA will be within a $200 expenditure range by 1980.[56] If this is true, then the Governor's proposal may do even better.[57] Nevertheless, because of the perpetuation of historical patterns through

55. See Greene, *supra* note 48, at 25 (table 8).

56. See Rodda, *supra* note 48, at 3.

57. Provided that the anti-equalizing squeeze modification is dropped, the governor's proposal seems to do more for *Serrano* compliance than does that of Senator Rodda. Nevertheless, the provisions of each are quite complex and this conclusion is at present tenuous.

revenue limits, probably neither bill will satisfy the *ex post* test. It is difficult for low-spending districts to catch up to high-spending districts because voter overrides are necessary to close the gap. If districts are not squeezed below 120 percent of the foundation level, this will create a permanent hurdle that low-spending districts must overcome (*i.e.*, override) while high-spending districts bypass it.

It is worth trying to understand why the legislature seems unwilling to assume the task of compliance with *Serrano* other than by making incremental adjustments to the status quo. As both A.B. 65 and S.B. 525 attest, the legislature has moved in the right direction but not far enough to require major cutbacks in any school's program. There is an understandable fear that such cutbacks would result in a flight from public to private schools. The legislature is inclined to elevate the bottom half, but only to the extent that it does not require a tax increase. The proposals go as far as they do primarily because school enrollments are declining. That is, because the number of school age children is decreasing, the total burden is easing. A given amount of state aid is spread over fewer children, thereby increasing expenditures per child. Furthermore, taxpayers in wealthier districts are accustomed to paying a certain total; as their enrollments decline, excess revenues are generated if expenditures per child are fixed at a ceiling. Thus, the state can siphon off the excess revenues through the tax freeze provisions mentioned above. Those revenues can then be used to increase foundation levels and hence spending in low-wealth districts, and the taxpayer will feel no more burdened as a result.

Such a strategy may, however, gain little. There are times when principles deserve a stronger voice than they usually get in the political process. It is a rare occasion when the highest court in a state places the legislature so clearly on notice that the method of financing education is wrong. Full compliance with the *Serrano* mandate is therefore inevitable. Of course, the ambiguity of the *ex ante* and *ex post* standards may understandably lead to a certain amount of legislative confusion as to the court's mandate. It is indeed unfortunate that although the legislature has taken steps in the right direction, it does not have the will to achieve more complete reform of California's school financing system.

Conclusion

An important ambiguity, the difference between *ex ante* and *ex post* wealth neutrality, was not noticed by the courts in any of the *Serrano* rulings. The former is a statement about rules, that equal tax efforts should lead to equal expenditures. The latter is a statement about results, that expenditures should not be correlated with the wealth of districts. While there is no doubt as to the direction in which the legislature must move, the

meaning of full compliance is ambiguous because it depends upon which type of wealth neutrality is required.

If the court insists on the achievement of both *ex ante* and *ex post* neutrality, then the only acceptable alternatives are redistricting into equal wealth districts or full state funding. In systems with districts of varying wealth that allow local choice, only one of the two standards can be met. The *ex post* standard is preferable to the *ex ante* because the former is concerned with the interests of children while the latter is not. The *ex ante* concept can perhaps be interpreted as a guide to the achievement of *ex post* neutral results. In its most recent ruling, the court seems to favor this interpretation.[58] If the court chooses the *ex ante* standard as an independent concept, then it is important that the taxpayer equity requirement be stated in terms of tax effort, not tax rate; otherwise the legislature may be forbidding progressive taxation in school finance.

The two bills introduced into the legislature at the time of this writing, A.B. 65 and S.B. 525, are remarkably similar in their gradual approach to *Serrano* compliance and neither one is likely to satisfy either the *ex ante* or the *ex post* standard because they probably cling too closely to historical patterns already known to be defective. However, the legislature can comply with *Serrano* in many ways under either concept of wealth neutrality.[59] For legislators, such change is neither pleasant nor easy; nor will it be desired by high-wealth, high-spending districts with few special pupil needs. But for all of us, *Serrano* provides a unique opportunity to make equal educational opportunity a reality.

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58. Serrano II, 18 Cal. 3d at 757 n.35, 557 P.2d at 945 n.35, 135 Cal. Rptr. at 361 n.35. This may be the second important *Serrano* footnote. See note 6 *supra*.

59. *See* California School Finance Task Force of the Graduate School of Public Policy, University of California, Berkeley, Implementing the Serrano Decision: Constraints, Alternatives, and Avoiding Unintended Consequences (Aug. 1976) (summary report) (L. Friedman, director). *See also* Sugarman, *Principled Serrano Reform*, 4 HASTINGS CONST. L.Q. 511 (1977).