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It's Elementary

A Monthly Column by EFAP Director John Yinger
March 2007

Education Finance in California Part 2: The Parcel Tax

In California, local voters have very limited control over the property tax. With a 55 percent majority, they can raise property taxes to pay for school capital projects, but they cannot raise property taxes above the state-set limit to fund school operating expenses. However, local voters in California have access, with a two-thirds majority, to a unique tax called a parcel tax. A parcel tax is equal to the same amount for every real estate parcel, regardless of its value.¹

Thanks to the super-majority requirement, not many school districts use the parcel tax. By 2004, 58 school districts in California had a parcel tax, although revenue from the tax was less than \$500 per pupil in about half of these districts. Because the parcel tax is one of the few local revenue sources with clear expansion possibilities, reliance on this tax has been growing. In 1995-96, the parcel tax provided 5.6 percent of local non-property tax revenue; by 2002-03, this share was up to 8.0 percent.

According to the criteria developed by public finance scholars, a parcel tax is a poor substitute for a property tax. The main reason is that a parcel tax does not meet basic standards of fairness, which call for taxes to be related to a taxpayer's ability to pay. Property value is recognized as a reasonable measure of ability to pay, so the property tax, which is based on property value, meets this basic fairness standard.

A parcel tax does not meet this standard, however. The owner of a mansion pays the same amount as the owner of small house, and the owners of a huge factory pay the same amount as a mom-and-pop

¹ This column draws heavily on "Understanding the Incentives in California's Education Finance System," by William Duncombe and John Yinger, The Maxwell School, Syracuse University, December 2006. This study was prepared for the Getting Down to Facts Project out of Stanford University.

store. With a parcel tax, therefore, tax payments are not related to a taxpayer's ability to pay.² Unlike a property tax, in other words, a parcel tax is very regressive, with a much higher burden, measured by taxes as a share of income, for low-income taxpayers than for high-income taxpayers.³

Public finance scholars also consider the extent to which a tax alters consumer behavior. This type of impact is called a distortion or an inefficiency because involves the choice of outcomes with favorable tax outcomes instead of outcomes that yield the highest satisfaction to consumers. A few scholars argue that property taxes and head taxes are not distortionary because they simply serve as the price of access to a community's public services. This argument is based on extreme assumptions, however, and most scholars believe that these taxes do cause some distortion.⁴ A parcel tax is similar to a head tax, but it is likely to be more distortionary because it does not apply to renters but does apply to businesses. Because parcel taxes in California tend to be quite small, they probably do not cause much distortion in the selection of communities. Nevertheless, there is no reason to think that a parcel tax is any less distortionary than a property tax increase that raises the same amount of money—and hence no reason to believe that shifting toward parcel taxes lowers distortion.

One other source of local revenue over which local voters have some control is contributions from educational foundations.⁵ In the average district in California, these contributions bring in about twice as much money as do parcel taxes. With just a few exceptions, however, contributions still constitute only a small part of any district's budget. This source of revenue also raises some severe equity concerns, because districts with richer residents obviously can attract more contributions. Moreover, private contributions may be difficult to regulate; even if contributions directly to schools were

² About 4 percent of the parcel taxes implemented in California are based on square footage, so larger properties have larger tax payments. This arrangement makes a parcel tax more like a property tax, but it still ignores the fact that property can vary in quality as well as in size.

³ Most experts regard the property tax as progressive because the property ownership (and hence tax payment) is concentrated among higher-income households. However, the property tax also imposes a large burden on low-income homeowners, and most states have some type of program, such as a homestead exemption, to ease this burden. A parcel tax also imposes a large burden on low-income homeowners.

⁴ For an informal version of this argument, see J. Yinger, "Bidding and Sorting," http://faculty.maxwell.syr.edu/jyinger/Classes/PPA735/Readings/Bidding_and_Sorting.pdf and <http://faculty.maxwell.syr.edu/jyinger/Classes/PPA735/Readings/B-S-fig.pdf>. For a more formal treatment, see S. Ross and J. Yinger, "Sorting and Voting: A Review of the Literature on Urban Public Finance." In *Handbook of Urban and Regional Economics, Volume 3, Applied Urban Economics*, edited by P. Cheshire and E. S. Mills (North-Holland, 1999), pp. 2001-2060.

⁵ Educational foundations have also appeared in Vermont. See the paper presented for EFAP's 2007 Jerry Miner lecture by Thomas Downes at http://cpr.maxwell.syr.edu/efap/Jerry_Minier/Downes.pdf.

prohibited, parents could make equivalent contributions through tutoring, art, music, sports, or other programs run outside the school system.

Overall, the California education finance system places severe limits on voters' ability to raise money beyond state-defined limits. Moreover, the main sources of revenue that local voters can control, namely, parcel taxes and local contributions, raise serious equity concerns without clear advantages over traditional sources of local revenue, such as local property taxes.