

Executive Summary

The constraints imposed on localities by the combination of Proposition 13 and the policy responses to the *Serrano* decision contributed to relative decline in spending in California, as did other constraints imposed on the ability of the state government to raise revenue. Researchers have shown that the responses to the constraints on public provision of education that result from school finance reforms and tax limitations are varied in their type and magnitude. One response that has been discussed but has not been quantified is the substitution of increased public spending on parks and recreation and other services benefiting children when education spending is constrained. A related response that has also not been quantified is increased use of privately-provided educational services. The goal of this paper is to determine if, when fiscal constraints are imposed, provision of non-school provided services to children increases.

A two-pronged approach is utilised to accomplish this goal. First, data from the Census of Governments from 1972 to 2002 are used to determine if, in those states in which constraints have been imposed on education spending, growth in non-school spending has been more rapid, when compared to growth in spending in unconstrained states.

Since the finance data provide little information on the extent to which private sector substitution has occurred, the 2001 Before- and After-School Programs and Activities Survey is used to document cross-state differences in the participation in after-school activities.

Existing Evidence on Public Sector and Private Sector Substitution

Much of the existing research on the impact of court-mandated school finance reforms like the reform that occurred in California after the *Serrano* decision indicate that increases in spending on services that might substitute for education spending would not be expected in the aftermath of such reforms. No substitution would be expected both because finance reforms

impose, at most, minimal constraints and because state governments limit the impact of reforms on high-income communities by reducing state-level expenditures in other areas of spending. As a result, the need for and the ability for substitution are both limited.

Similarly, on average, the extent of public sector substitution in the aftermath of a tax or expenditure limit like Proposition 13 is likely to be limited because, after most such limits, state aid increases compensate for lost local tax revenue. The story cannot, however, stop with the average effect. Proposition 13-style limits have increased centralization of revenue raising, increased local use of non-tax revenues, and reduced revenue-raised through local broad-based taxes. All of these results imply that the extent to which limits constrain localities will vary, and localities that are more constrained might substitute non-education spending for education spending, particularly if generating non-tax revenue for non-education spending is easier than generating such revenue for education spending.

A review of the the evolution of the state and local fiscal situation in California indicates, however, that other local governments in the state may have had limited scope to increase their spending in response to declining school district spending. A combination of legislation and voter initiatives has resulted both in a reallocation of property tax revenues from cities and counties to school districts and in earmarking portions of state revenues for school districts. All of this evidence seems to indicate that the evolving fiscal structure of state and local governments in California has constrained the ability of cities and counties to increase spending in areas that might substitute for education spending.

Finally, the central lesson from the research on the impact of constraints private school attendance and on private contributions to public schools seems to be that, while there are private responses to constraints, these responses tend to be small.

Evidence on Substitution

Neither the analysis using the fiscal data from the Census of Governments nor the analysis using data on the utilisation of after-school activities produces evidence of substitution in the dimensions considered. Public spending on services that could substitute for education has not increased relatively in counties in which localities are subject to fiscal constraints. Participation in after-school activities that could substitute for schooling services also is no different in localities facing constraints relative to localities in which no such constraints are present.

The absence of substitution is consistent with two observations that have been made in the literatures on the impact of school finance reforms and of revenue and expenditure limitations. First, elementary and secondary education spending tends to be less affected by constraints than do other spending categories. As a result, the scope for substitution of public non-education spending is limited. Second, while private responses to fiscal constraints exist and, in areas where the constraints are particularly binding, are large, the mean response tends to be small.

One piece of evidence that is consistent with this last observation is the heterogeneity in the extent to which non-education spending changes in the aftermath of fiscal constraints. For example, in states in which there have been legislative finance reforms, per capita parks expenditures appear to have increased in counties with higher per capita current education expenditures in 1982. Similarly, in states in which there have been court-ordered finance reforms, per capita library expenditures appear to have increased in counties with with higher per capita current education expenditures in 1982. Both of these results are consistent with substitution of non-education expenditures for education expenditures in counties in which local school districts were likely to be most affected by fiscal constraints.