

# Horizons

January/February 1993

Vol. 5, No. 1

## Paying for Public Schools in Virginia

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The worth of a state, in the long run,  
is the worth of the individuals composing it.

--John Stuart Mill (1806-1873)

There are about one million children in kindergarten through grade 12 (K-12) of Virginia's public schools. The average expenditure on these one million children is about \$4,400. That makes total, annual, public-school operating expenditures in Virginia about \$4.4 billion (actually, \$4.3 billion in 1988-89). That is a lot of money! (Note: These numbers are for operating expenditures only; they do not include capital--construction--costs.)

This money is spent by 137 separate school divisions, which are located in 95 counties, 40 cities, and two towns and which serve enrollments of less than 400 to more than 120,000 pupils. These local school divisions on average pay 50 percent of the costs of operating the schools, with 40 percent coming from state government. The balance of 10 percent comes from a variety of federal categorical programs.

For many Virginia communities, public school expenditures are the largest item in the local budget. On average, K-12 education accounts for 42 percent of local expenditures. With this large a commitment of money, a very basic question arises: Why, and to what benefit, do Virginia's citizens spend this much money on public education?

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### Why Do We Spend All This Money?

There are historical, constitutional, and economic reasons for spending public money on public education in the United States and in Virginia. The economic rationale will be the focus here, because it underlies both the historical and constitutional rationales.

Among the economic reasons that the public--through its governments--spends money to provide any service are the following:

- A needed service would not be provided at all without government action. Dams, lighthouses, and national defense are examples. In such cases, the benefits are clear, but collecting payments by selling the service in the private sector is not feasible; taxation is the only feasible way to finance the service.
- The level and distribution of a needed service would be inadequate if provided only privately; that is, the public benefits from a higher level of service exceed the additional public cost of providing that service. Immunizations, schools, and roads all fit in this category to some degree. For example, if there were only private schools and only the wealthy had access to them, then a substantial part of the public benefits from schools would be lost.

Thus, the public supports government funds for K-12 education because the public benefits from the expenditures. But the story is a little more complicated, because in the U.S. federal system of government, there is not just a single "public."

In a federal system, public services can be provided exclusively by local governments (e.g.,

garbage collection), exclusively by state governments (e.g., authority to incorporate businesses), exclusively by the federal government (e.g., national defense), or jointly by different levels of government (e.g., roads and schools). Services are often provided by a level of government consistent with the distribution of benefits from those services. In other words, the people (or "public") who get the benefits pay for the services through taxation at the appropriate level of government or upon the appropriate tax sources. This is called the *beneficiaries-pay principle*.

Who benefits from investments in public schools? There are clearly both private and public benefits.

#### Private benefits to individuals and families

- Wages and salaries are generally higher for individuals who have more schooling.
- Better-educated individuals are usually better equipped to deal with the changing circumstances of work and society.
- Schooling improves individuals' personal capacities, such as the ability to stay informed through the news media and to understand complex issues.
- Education reduces the chance that adult offspring will be a financial burden on parents.
- The well-being of subsequent generations is more likely assured in families as members become better educated, essentially breaking the chain of poverty.
- Schools are important to families as child-care facilities.

#### Public benefits to communities

- As the number of better-educated and well-trained workers in the community increases, the economic attractiveness of the community increases.
- Various federal, state, and local financial liabilities associated with large numbers of illiterate or dependent individuals can be reduced or avoided through education.
- The civic and political functions of communities work better when education improves the abilities of citizens to support and participate in those functions.

#### Public benefits to the state and nation

- The central benefits to the national and state societies result from the increasing importance of knowledge and information to the global economy and to the competitive position of the U.S. economy in that global economy. The public benefits to the economy from well-trained workers are increasing,

and the losses and liabilities from the lack of education in citizens are also greater because of the increased competition of a global economy.

#### **Are People Paying for What They Get (and Getting What They Pay for)?**

There is a paradox in school finance in Virginia, and in much of the United States, when examined under the beneficiaries-pay principle. Among the taxes that are available for use by local governments in Virginia, the one that is most geographically restricted or defined is the property tax. This is clear when one compares it to a sales tax or a meals tax where many people from outside the community contribute to local tax revenues. The jurisdictionally restricted property tax is the major source of local revenues for the support of public schools.

On the other hand, the individual, family, community, and state benefits from K-12 education are all finally added up only at the national level. That is, regardless of who receives the benefits of K-12 education, and how those benefits are distributed, one really must go to the national level to account for them all. In fact, a community's benefits from spending on schooling are only captured by that particular community if 1) the students educated in the local schools stay in town, or 2) the quality of the schools attract people to the community.

By the same token, if a community educates citizens and they leave, then the public benefits paid for by the community are lost to it and are captured by some other community and the larger society. Similarly, if a community fails to educate its children and they leave, there is a public liability on the larger society and on the community to which they move.

The beneficiaries-pay principle suggests that those jurisdictions that capture the benefits of public spending should pay taxes in proportion to the benefits they receive. Given the discussion of benefits of K-12 education, it is reasonable then to argue that the largest share of the schooling bill should be paid by the federal government, followed by the state government, and last, if at all, the local government. In Virginia, the ordering is exactly the opposite. As noted above, local governments pay 50 percent, state government 40 percent, and the remaining 10 percent is paid by the federal government.

In fact, the beneficiaries-pay principle is often violated in the United States, because the boundaries

of who pays and who benefits are really quite fuzzy for many public services, including education. That is the basic argument for payments from one level of government to another. But when most of the local contribution for K-12 education comes from property taxes--as it does in Virginia--the violation of the principle is somewhat more acute, and it has some implications for spending on schools.

As stated above, property taxes are the core of revenues available to Virginia local governments and are the major local source that finances local public services. At the local level communities must choose the array and mix of services for which they are prepared to spend their money. Thus schools must compete with fire, police, "meals on wheels," home health care, and other services. Local citizens are particularly interested in those services whose benefits are captured at the local level by enhancing the value of their property. The clearest examples are sewers and road improvements. The problem for schools is that, when compared to other services whose benefits are captured locally by being capitalized into property values, education benefits are not so captured, and this creates an incentive to under-invest in schools.

Elected local government officials must be responsive to the preferences of their constituents (if they are not, the next election will bring more responsive representatives). Local officials have to take into account the needs of the different groups in their jurisdiction. Limiting local revenues to property taxes gives local officials and citizens an incentive to invest in those public services that increase property values. As we have pointed out, education is *not* one of those services.

Property taxes are thus not "good taxes" for paying for K-12 education, because the source of the taxes is not closely linked with the benefits of the service. A "good tax" is one where revenues and expenditures are clearly linked. For example, a tax on retail sales and earmarked for education is linked to the private benefits of education: It assumes that those with higher incomes spend more, and that higher incomes are associated with higher levels of education. This kind of link does not exist or is very slight in the case of taxing real property to fund K-12 education.

### **Are the Obvious Solutions the Best Ones?**

The beneficiaries-pay principle suggests that it might be a very good idea to have the state assume full financing for public education. Moreover, it also suggests that it might be an even better idea to have the federal government providing K-12 education. However, there is another, counterbalancing notion about financing and providing public services: the notion that, as higher levels of government are used to

provide services, the services are controlled by the preferences of those in government agencies, and the organization is operated for the sake of the bureaucrats along with the interest groups that influence those agencies. This argument says that "those who pay the piper call the tune." The option of financing schools at the state level, with taxes based on the well-being of the state economy, may solve the problem of under-investment at the local level, but it will probably also result in a bureaucracy less responsive to the preferences of local constituents.

When considering changes in the Virginia system of school finance, it may be better to improve the current system of local-state funding while retaining the elements of local control that are a strength of the system. For example, it may be possible to deal explicitly with the second part of the school finance paradox--basing local support for K-12 mainly on property taxes--by using some other revenue source that does not have the problems created by the property tax.

Perhaps a better education-funding source would be a local, proportional income tax, say one percent of some appropriate measure of income, earmarked to K-12 education. The state would still have a critical role to play in equalizing the funds available to K-12 education, because income varies widely across school divisions and some localities would still have much more to spend on K-12 education than others. The state, as it does in the present system, would need to provide assistance to localities with fewer resources.

What are the advantages of a one-percent income tax earmarked to education? First, there is a clear link between taxing and spending, alleviating the struggle of local governments when allocating funds to public services. Second, localities could still spend some of their general funds above the one-percent income tax to reflect the preferences of their residents for K-12 education. Third, the state would simplify enormously its task of measuring ability to pay (currently based on the complicated Local Composite Index formula).

### **Summary**

Virginians spend a lot of money on K-12 schooling. The pattern of private and public benefits from education suggests that great disparities in educational quality among school divisions are undesirable in economic terms, not just on constitutional grounds. Further, the undesirable impacts of inadequate spending on schools are not limited to the communities with few resources for schools.

Because K-12 education is a locally provided service that accounts for a large percentage of local budgets, but whose benefits are captured at the national level, it is reasonable to expect local governments to under-invest in that public service. This is particularly true when the basis of local revenues is the property tax.

Greater state and federal involvement in the financing of schools is indicated by the beneficiaries-pay principle. However, the notion that services can be best administered by the lowest level of government possible argues against the loss of local control that would accompany a larger financial role for the state or federal governments. A local, proportional income tax, earmarked for education, is one example of a school-finance alternative that enables localities to use a tax basis more clearly associated with the private or public benefits of education.

(Ed. note: A forthcoming REAP Report, *Educational Performance in Virginia's Rural Schools*, will discuss in more detail the benefits of education, and how they relate to performance in Virginia's rural schools. A notice about the availability of this report will appear in a future *Horizons*. In addition, a REAP Policy Paper that summarizes the education-finance disparity issue in Virginia will be published soon. It will be mailed to all *Horizons* recipients.)

## NOTICES

\*A new REAP Report, *The Economic Impact of Increased Swine Production in a Rural Virginia County*, by Suzanne Thornsby *et al.*, is now available. The report predicts the effects of a simulated 5000-sow increase in swine production in Halifax County. You may request this free publication from Extension Distribution, Landsdowne Street, Blacksburg, VA 24061-0512; phone (703) 231-6192. Please request Publication 448-211/REAP R012.

\*The 1993 Virginia Water Resources Conference will be held April 12-14 in Richmond. More than 60 presentations on a variety of water-related topics will be given. The conference is sponsored by the Virginia Water Resources Research Center and the Virginia Lakes Association. For more information, contact Elizabeth Crumbley, VWRRC, 617 N. Main Street, Blacksburg, VA 24060-3397; phone (703) 231-8038.

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