

## **GETTING BEYOND THE FACTS: REFORMING CALIFORNIA SCHOOL FINANCE**

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### **SUMMARY**

California's school finance system is long overdue for reform. We propose a new system that is more rational, more equitable, and, we believe, politically feasible. At its core, our proposal aims to link district revenue to student needs and regional costs, while ensuring that all districts are held harmless at current funding levels. To be sure, a reformed finance system is not a complete solution to the challenges of improving student achievement; changes in governance, incentives, and accountability are also required. But we believe a rational funding mechanism provides an essential backdrop for discussion of broader reform issues. In this brief, we discuss the background of the problems, the principles and concepts that guide our reform, and a simulation of how our reform might be put into practice.

### **BACKGROUND**

For our purposes, a good place to begin in reviewing the history of California school finance is 1970, when schools got their money primarily from local property taxes. California was then among the top ten states in per-pupil spending, but at the district level, spending varied considerably based on local property wealth. In 1971, the California Supreme Court held that the school finance system may not condition district revenue on local property wealth.<sup>1</sup>

The Legislature subsequently enacted a plan to limit the amount per pupil each school district could raise for general spending based on the amount it raised in 1972-73.<sup>2</sup> For each district, this is known as its "revenue limit." Revenue limits, today the largest component of the finance system, have been adjusted in complex ways over the past 35 years, most notably through equalization efforts. In response to a 1976 court ruling,<sup>3</sup> the Legislature in 1977 created a variable annual inflation adjustment that increased revenue limits for low-spending districts more rapidly than for high-spending districts.<sup>4</sup> This "squeeze formula" was

designed to equalize spending across districts over time. The equalization was only partial, however, because it applied only to general purpose spending from revenue limits, not to categorical aid or school construction.

In 1978, vigorous demand for property tax relief culminated in the passage of Proposition 13, which limits property taxes to 1% of assessed value and caps annual increases in assessed value to 2% or the rate of growth in the Consumer Price Index, whichever is less. In addition, under Proposition 13, non-ad valorem special purpose taxes such as parcel taxes require the approval of two-thirds of local voters.

The limits on local taxation in Proposition 13 eliminated over 50% of local school revenue, prompting the Legislature in 1979 to devise a permanent plan to compensate school districts with funds from the state budget.<sup>5</sup> This marked a major turning point, shifting primary responsibility for school finance from local districts to the state. The 1979 legislation retained the concept of revenue limits and continued the path toward equalization, and the California Supreme Court in 1983 held that the state had gone far enough in meeting its constitutional duty to equalize district general purpose spending.<sup>6</sup>

By this time, the state share accounted for nearly two-thirds of school funding, and education revenues became vulnerable to the state's volatile sales and income tax receipts. Meanwhile, California's per-pupil expenditure had fallen relative to other states in light of the stringent limits on local revenue-raising and other political factors. In 1988, California voters passed Proposition 98 to provide K-12 schools and community colleges with a guaranteed share of the state budget as the economy and enrollment grow each year.<sup>7</sup> Nevertheless, California education spending still ranks in the bottom half of states on a cost-adjusted basis.<sup>8</sup>

Layered on top of general purpose dollars from revenue limits are more than 100 state and federal categorical aid programs, each requiring the districts that receive the aid to spend it on a

designated purpose. The proliferation of state categorical programs began in the 1960s as state legislators signaled their lack of confidence in local educators to meet the needs of disadvantaged children. Over time, categorical programs have also become a vehicle to keep state aid increases from being largely absorbed into higher teacher salaries. State policy intervention through categorical programs has been a habit of Democratic and Republican governors alike, and each new program creates a constituency intent on preserving it. Currently, categorical aid accounts for one-third of total education revenue.

Although many categorical programs are motivated by salutary purposes, as a whole they create enormous complexity in the finance system. School districts bound by program restrictions are unable to shift available dollars to meet local needs; the channeling of state funds through dozens of separate programs exacerbates paperwork burdens; and the detailed specification of how funds are to be used—consuming hundreds of pages in the Education Code—produces a compliance mentality focused on accounting for inputs rather than delivery of outcomes. Indeed, categorical programs are rarely reviewed for their educational efficacy. Moreover, many categorical programs that purport to benefit disadvantaged children neither target their intended recipients nor distribute funds equitably based on actual needs.<sup>9</sup>

## PRINCIPLES FOR REFORM

In recent years, California has made important strides toward aligning instruction, assessment, and accountability to academic standards for student performance. But few if any aspects of the finance system are aligned to improving student achievement. As the history above suggests, and as the Getting Down to Facts (GDTF) studies examine in detail, there is no underlying set of principles guiding the school finance system. It is an historical accretion of policies that together lack simplicity, coherence, and fairness. It is overdue for a fundamental overhaul.

Because the problems with the system are complex and multifaceted, they are unlikely to be solved in one fell swoop. For this reason, we have chosen as our angle of incision a reform approach that is anchored in the following four principles.

**1. Revenue allocations should be guided by student needs.** School finance should be aligned with the overarching goal of enabling all students to meet state standards for academic achievement.

Because not all students come to school with the same individual, family, or neighborhood advantages, some need more resources than others to meet a given achievement standard. In allocating education dollars, the finance system should systematically account for differing student needs.

**2. Revenue allocations should be adjusted for regional cost differences.** California is a large state with tremendous diversity from region to region in the cost of living and labor market conditions. This variation directly affects the quality of education that schools can provide with each dollar; indeed, high-wage regions of the state tend to have higher student-teacher ratios. A rational school finance system should strive to ensure that education dollars have the same purchasing power from region to region, especially when it comes to hiring and retaining high-quality teachers.

**3. The system as a whole should be simple, transparent, and easily understood by legislators, school officials, and the public.** The complexity of the current system carries many costs: school officials must spend time on paperwork and bureaucracy that otherwise could be spent on improving instruction; legislators cannot explain to their constituents (much less defend) how education dollars are allocated; and the public cannot understand how additional revenue for education will affect their local schools. In order to foster public confidence and accountability, a rational system should be simple enough that all stakeholders can readily understand its essential elements and underlying principles, and can easily see how and why each district gets what it gets.

**4. Reforms should apply to new money going forward, without reducing any district's current allocation.** In reforming the existing system, we recognize the importance of ensuring a measure of stability and maximizing political feasibility. Thus we envision that a reformed allocation system would apply only to new money available after the year of enactment, thereby holding all districts harmless. Over time, the resulting allocations will increasingly approximate the ideal allocations in a fully reformed system.

To be sure, the problems with the finance system go beyond those addressed by the principles above. There are serious concerns, for example, about the volatility of education revenue from year to year, the lateness of the budgeting process, and the overall adequacy of education spending in California. We do not address those issues here—not because they are unimportant, but because we

believe the best starting point for considering those issues is a rational, fair, and transparent system of allocation. Indeed, one reason we believe the GDTF studies concluded that putting more money into the current education system is unlikely to improve student achievement is that the existing finance system does not allocate dollars in response to student needs and regional costs. Achieving a rational system of allocation will facilitate meaningful discussion on how and how much money should be spent.

The reforms we propose here address the allocation of dollars from the state to school districts. Yet we recognize the importance of how dollars are allocated *within* districts too. In particular, it is vital that school districts also allocate resources to schools based on student needs and that schools and districts spend money in ways that improve achievement, especially among students with the greatest needs. Implicit in our emphasis on simplifying the finance system is a decrease in regulation and an increase in local flexibility. The system we envision places less reliance on input controls and more reliance on outcome-based accountability. We have not examined the full range of incentives, supports, and accountability mechanisms needed to ensure that dollars allocated rationally from the state to local districts are in turn spent wisely by local districts especially on their neediest students and schools. At the moment, this is an issue we continue to grapple with.

## THE BASIC PROPOSAL

We propose a reformed finance system with four components: (1) base funding, (2) special education, (3) targeted funding for low-income students and English learners, and (4) regional cost adjustments. In this section, we sketch the conceptual basis for these components, and in the next section, we provide a simulation of how the system might work in practice.

**1. Base funding.** Conceptually, base funding is an amount per pupil to cover the basic costs of education. It provides general support to buy textbooks and materials, to maintain safe and clean facilities, and to employ qualified teachers and other school personnel. Because basic costs tend to be higher in secondary schools compared to elementary schools, the base amount for each district could be designed to vary according to the number of students in each of three grade spans (*e.g.*, K-5, 6-8, 9-12). Further, base funding would be adjusted for regional cost differences.

**2. Special education.** California allocates special education money to Special Education Local Planning Areas (SELPA) based on the ADA enrollment of regular students. The amount per regular student continues to vary across the state's 116 SELPAs. Accordingly, we propose a continuation of the special education funding equalization process begun in 1997<sup>10</sup> with the goal of allocating equal funding per regular student in each SELPA within five years. In addition, special education money, like base funding, would be adjusted for regional cost differences.

**3. Targeted funding.** Outside of special education, many students face disadvantages that call for additional educational resources if they are to meet the same academic standards as their more advantaged peers. We propose a single program of targeted funding based on an unduplicated count of low-income students and English learners, and on the concentration of such students in a given district. Targeted funding would also be adjusted for regional cost differences.

a. *Low-income students.* The negative relationship between poverty and achievement is one of the most well-documented findings in educational research. In California, the highest API scores of high-poverty schools tend to be lower than the lowest API scores of low-poverty schools. In other words, there is virtually no overlap between the performance distributions of high- versus low-poverty schools.<sup>11</sup>

Importantly, students in high-poverty schools face a double disadvantage arising not only from their own poverty but also from the poverty of their peers. Numerous studies suggest that, in high-poverty schools, a student's peers have less knowledge, vocabulary, and cultural capital, as well as lower aspirations, more negative attitudes toward achievement, and higher levels of disruption and mobility.<sup>12</sup> In addition, parents are less likely to be involved in the school, to hold teachers accountable, and to provide financial or other support. Thus poverty concentration is an important factor in allocating resources, as poor students in high-poverty schools face greater educational challenges than poor students in low-poverty schools.

b. *English learners.* In 2005-06, 25% of California's K-12 students were English learners, and nearly 30% of the nation's English learners went to school in California.<sup>13</sup> Large achievement gaps between EL and non-EL students are well-documented, and many studies show that EL students face special challenges in school, especially

a lack of teachers appropriately trained to teach EL students.<sup>14</sup> The special needs of EL students also include bilingual support personnel, appropriate materials for language development, and additional instructional time to learn English and subject-matter content. In light of these needs, the Legislative Analyst's Office has recommended that "the state adopt a clear strategy for funding EL students," including "an *explicit* weight at which EL students should be funded."<sup>15</sup>

Appropriate funding for EL students must take into account the fact that 85% of California's EL students are low-income. In their GDTF study, Gándara and Rumberger sought to identify the resources needs of English learners independent of their economic disadvantage. After reviewing various cost studies, they concluded:

[T]he evidence suggests that some needs of English Learners are indeed *different* from other students with similar socio-economic backgrounds and their needs cannot all be met with the same set of resources, however it is not clear to what extent—if at all—they require *more* resources than those of poor and low-income children.<sup>16</sup>

At the same time, the authors observed that English learners who are not low-income also have special needs associated with language development. Indeed, English learners who are not poor start school with lower math and language skills than poor students who are not English learners.<sup>17</sup>

The available evidence indicates that English learners have different instructional needs than non-EL students who are low-income. But it is unclear whether meeting those needs requires a greater level of resources than what is needed to meet the needs of low-income students who are not English learners. For purposes of school finance, we believe a fair count of disadvantaged students requiring additional targeted resources is the unduplicated sum of low-income students and English learners. We note, however, that the differing needs of English learners and non-EL low-income students may call for different uses of targeted funds.

Finally, over half of California's elementary English learners attend schools where ELs comprise more than 50% of the student body. This linguistic isolation limits the exposure of English learners to native English speakers who can serve as language "role models."<sup>18</sup> As with poverty, EL status is an educational disadvantage whose sever-

ity varies by concentration, and the finance system should be responsive to this fact.

**4. Regional cost adjustment.** Education dollars do not have the same purchasing power throughout a state as large and diverse as California. The primary reason is that wages vary by region. As a result, the cost of hiring and recruiting the same teacher or other school personnel is different from place to place. These differences have important educational consequences. In particular, higher-wage regions tend to have fewer teachers per student.<sup>19</sup>

We propose adjusting 80% of the dollars (roughly the share of district budgets devoted to personnel) in each component of our proposal using a comparable wage index developed by Heather Rose and Ria Sengupta as part of the GDTF studies. The index divides California into 30 labor market regions based on U.S. Census Metropolitan Statistical Areas. Controlling for demographic and other labor market variables, the index captures for each region the relative wages of occupations requiring an education level similar to what teachers have. When applied to school funding, the index works to equalize labor purchasing power across districts. Index values vary from 0.79 to 1.22, with the highest wages in the Bay Area and Los Angeles and the lowest wages in the northern counties.

#### SIMULATING A REFORMED SYSTEM

Let us now turn to how these ideas might work in practice. We intend our reformed system to affect all revenues apart from federal money and local money besides property taxes. In other words, our proposal replaces the existing mechanisms for distributing the funds that comprise revenue limits, lottery funds, and state categorical programs. The sum of these funds was \$42.2 billion in 2004-05.

From this sum, we set aside money in categorical programs that currently target disadvantaged students. As a preliminary list, we include Economic Impact Aid, Targeted Instructional Improvement Grants, High Priority Schools Program, After School Education and Safety Program, and Immediate Intervention/Underperforming Schools Program. We fold these programs, totaling \$1.7 billion in 2004-05, into a new single stream of targeted funding, which we describe below.

That leaves \$40.5 billion for our proposed system of base funding and special education. In 2004-05, this figure provided roughly \$6,500 per

pupil, which we now conceptualize as a base grant of \$6,000 per pupil<sup>20</sup> plus an average special education grant of \$500 per pupil. Our proposal to complete the equalization of special education funding will require an additional \$300 million annually.

As explained above, the targeted funding in our proposal is based on an unduplicated count of low-income students and English learners. We define “low-income” as eligibility for free or reduced-price lunch (FRPL), which includes all students from households below 185% of the federal poverty line. Although FRPL eligibility covers a wider range of household income than the federal poverty line, we note that the threshold for FRPL eligibility in 2004-05 was \$34,873 for a family of four, which seems a reasonable marker of low-income or near-poor status. In any event, the choice of poverty measure is unlikely to alter the distribution of targeted funds very much because the percentage of students below poverty and the percentage of students eligible for FRPL are strongly correlated. At the district level as well as statewide, the FRPL percentage is roughly three times the percentage of students below poverty.<sup>21</sup>

What funding weight should be assigned to low-income or EL status? The empirical literature offers a variety of estimates, and we do not pretend that the issue can be definitively resolved free of political judgment. Nevertheless, in specifying a weight, we have the benefit of a recent California professional judgment study conducted as part of Getting Down to Facts.<sup>22</sup> The study surveyed over 500 randomly selected teachers, principals, and superintendents in California public schools, using budget simulations to elicit their judgments about the resources schools need to achieve the state’s academic achievement goals.

The study estimated that the cost of bringing a school up to a given API score increased by \$6,632 for every student in the school counted for the purpose of federal Title I funding. (Title I funding is based on the percentage of students in a district below the federal poverty line.) Given the three-to-one ratio between students who are FRPL-eligible and those below poverty, the \$6,632 figure is functionally equivalent to an allocation of \$2,211 for every student eligible for FRPL. Assuming a base funding level of \$6,000 per pupil, the study effectively assigns a weight of 0.37 to each low-income student.

We adopt this weight for FRPL-eligible students and apply it as well to English learners who

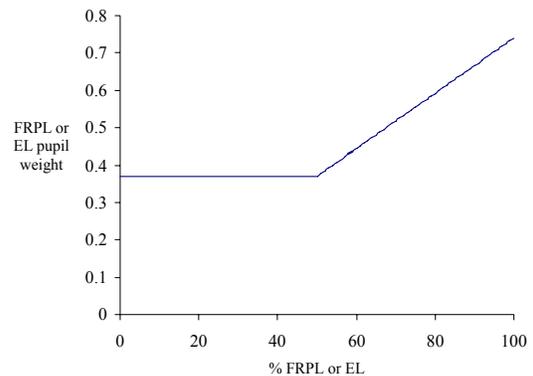
are not low-income. As with poverty weights, we acknowledge there is a lack of consensus on the appropriate weight for EL status independent of poverty. But a weight of 0.37 is nearly identical to the finding of one professional judgment panel in California<sup>23</sup> and reasonably approximates the findings of another professional judgment study in Arizona.<sup>24</sup>

Finally, we adjust this weight so that it increases with the concentration of students who are low-income or EL. There is some evidence that the peer effects of poverty begin to have substantial impact when FRPL-eligible students comprise more than 50% of school enrollment.<sup>25</sup> Similarly, until 2002, federal law allowed Title I funds to be spent on “schoolwide” programs in schools where 50% or more of the students were low-income, out of recognition that high poverty concentration has peer effects throughout a school.<sup>26</sup>

We propose a funding weight that (a) remains constant up to 50% concentration of low-income or EL students and (b) increases as the concentration of disadvantage increases above 50%. We define the weight as follows:

% FRPL or EL	FRPL or EL pupil weight
≤ 50%	0.37
> 50%	0.37 * [2 * (% FRPL or EL)]

The graph below shows how the weight varies according to the percentage of FRPL or EL students.



When this variable weight is applied to a base funding level of \$6,000 per pupil, we estimate the total amount flowing through the targeted program to be between \$8.9 billion and \$10.2 billion. With \$1.7 billion available from the five existing categorical programs folded into the targeted program,

the amount of new money required to fund our targeted program is \$7.2 billion and \$8.5 billion. Adding \$300 million more for our proposed equalization of special education, the total cost of our proposed reform is between \$7.5 billion and \$8.8 billion.

The table below shows the resulting pattern of allocations to districts based on their demographics. Note that these figures do not either reflect regional cost adjustments or the hold-harmless requirement. The figures are only intended to provide a rough approximation of the bottom-line results of our proposed reform. Our preliminary estimates suggest that regional cost adjustments and the hold-harmless requirement will increase the total cost of our reform slightly and will generally result in higher allocations for smaller districts than the figures below indicate.

% FRPL or EL	Base per pupil	Special ed per pupil	Targeted funds		Total revenue per pupil
			per FRPL or EL pupil	per pupil	
0	6,000	500	2,220	0	6,500
10	6,000	500	2,220	222	6,722
20	6,000	500	2,220	444	6,944
30	6,000	500	2,220	666	7,166
40	6,000	500	2,220	888	7,388
50	6,000	500	2,220	1,110	7,610
60	6,000	500	2,664	1,598	8,098
70	6,000	500	3,108	2,176	8,676
80	6,000	500	3,552	2,842	9,342
90	6,000	500	3,996	3,596	10,096
100	6,000	500	4,440	4,440	10,940

**NOTES**

† Alan Bersin is former California Secretary of Education and former Superintendent of San Diego City Schools. Michael Kirst is Emeritus Professor Education and Business Administration at Stanford University. Goodwin Liu is Assistant Professor of Law at UC Berkeley.

<sup>1</sup> Serrano v. Priest (1971).  
<sup>2</sup> SB 90 (1972).  
<sup>3</sup> Serrano v. Priest (1976).  
<sup>4</sup> AB 65 (1977).  
<sup>5</sup> AB 8 (1979).  
<sup>6</sup> Serrano v. Priest (1983).  
<sup>7</sup> Also Proposition 111 (1990).  
<sup>8</sup> GDTF; RAND study.

<sup>9</sup> Timar (1994, 2004, 2006); see also LAO (1993 and more recent reports).

<sup>10</sup> AB 602, Special Education Reform Act (1997).

<sup>11</sup> Sonstelie (2006).

<sup>12</sup> The research, though not uniform, is reviewed in Kahlenberg (2001), pp. 47-76. A recent study of the Moving to Opportunity program, which had a randomized experimental design, found minimal evidence of class-based peer effects, but the treatment was somewhat weak insofar as the treatment group, while attending lower-poverty schools than the control group, still attended schools with above-average levels of poverty. See Sanbonmatsu et al. (2006).

<sup>13</sup> LAO (2007).

<sup>14</sup> Gándara & Rumberger (2006); [additional cites].

<sup>15</sup> LAO (2007), p. E-133. The LAO’s recommendation preceded the release of Gándara and Rumberger’s GDTF study on the resource needs of EL students.

<sup>16</sup> Gándara & Rumberger (2006), p. 83.

<sup>17</sup> Gándara & Rumberger (2006), p. 85 (California kindergarten class of 1998). In addition, there is emerging evidence that English learners continue to have special needs in academic English language development after they exit EL status. See Kornhaber (2007); Gándara; Hakuta. Note that the category of students in need of academic language development potentially encompasses not only students formerly classified as EL but also some native English speakers. See Gándara & Rumberger (2006), p. 84.

<sup>18</sup> Rumberger, Gándara, & Merino (2006).

<sup>19</sup> Rose & Sengupta (2006) (“[A]s external wage pressures grow, districts cut back on the number of teachers they hire and reduce the number of other certificated staff per student (e.g., counselors and nurses).”).

<sup>20</sup> We have not yet examined how the base grant might be weighted according to grade span, although such weights have been proposed in recent legislation. See AB 2531 (2006).

<sup>21</sup> In 2004-05, nearly 50% of California schoolchildren qualified for FRPL while 17%, or roughly one-third, lived in families below the federal poverty line.

<sup>22</sup> Sonstelie (2007).

<sup>23</sup> Chambers, Levin, & Delancy (2006),

<sup>24</sup> National Conference of State Legislatures (2005).

<sup>25</sup> Kahlenberg (2000).

<sup>26</sup> Improving America’s Schools Act of 1994, § 1114. In 2002, the No Child Left Behind Act lowered the schoolwide threshold to 40% low-income. 20 U.S.C. § 6314.