

Ensure Fair Funding that Rewards Results

Make sure that funding: is differentiated and based on students' different learning needs; provides teachers and administrators the resources they need to help all students succeed; and is driven by incentives that promote student learning.

Our Vision:

A students-first philosophy will ensure that differential resources are allocated to address individual students' learning needs. Common sense dictates that students who start behind or who are struggling will need additional resources.

California's Current Reality

The Getting Down to Facts project found that just spending more is not likely to improve achievement. The researchers presented unmistakable evidence that the current K–12 system is “not making the most efficient use of its current resources,” that “only directing money into the current system will not dramatically improve student achievement to meet expectations,” and “what matters most is the way in which the available resources are used.”¹ From various sources, research has found that the current system: (1) is the most complex in the country, lacking an underlying rationale and transparency; (2) is inequitable, treating similar districts differently and not recognizing the different needs of students; (3) is inefficient in its use of resources; (4) creates bad incentives; (5) is not predictable or stable; and (6) is inadequate, especially for disadvantaged students.

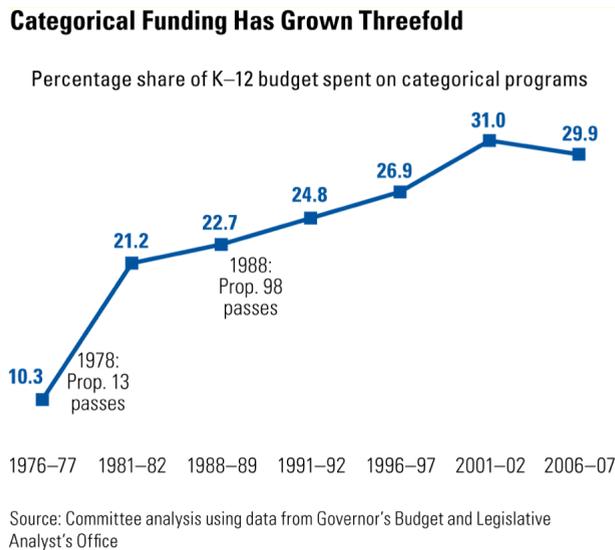
Current system is unnecessarily complex

California's current K–12 education finance system is the most complex in the nation but yields little benefits from that complexity.² Long-time Stanford researcher and former State Board of Education member Michael Kirst describes it this way: “The result of California's history is a finance system that has no coherent conceptual basis, is incredibly complex, fails to deliver an equal or effective education to all children, and is an historical accretion.”³ In fact, the finance system is so complex that the Legislature needed to engage the State Auditor to simply determine the level of funding that went to each school district for each program.⁴ Following that Auditor's report, a new statute required the California Department of Education (CDE) to report the information in the Auditor's report annually; however, to date CDE has indicated it is unable to do so. As a result, the state is once again employing an external entity (this time, a researcher from the Public Policy Institute of California) to attempt to answer the question of how the funds are distributed across districts. When the state cannot answer the simple question of how state funds are distributed without the help of the State Auditor or a seasoned researcher, it is impossible to answer more important questions, such as how the funds are being used locally and whether the funding is being used efficiently. This leaves the public and policymakers with little assurance that the current system is working, and good reason to suspect that it is not.

The current system is composed of a base level of funding plus a set of well over 100 categorical programs. The base funding suffers from historical anomaly. Districts' revenue limits are calculated using 36 pages of line items that each district must fill out to determine its funding. This calculation includes base revenue limits that have evolved out of the pre-Proposition 13 local finance system plus numerous efforts to equalize funding. In addition, there are "revenue limit add-ons" that differentially distribute funds to districts based on historical factors, many of which are no longer relevant.

Categorical programs range from \$1.8 billion for K–3 class size reduction to \$250,000 for civics education. The graphic "Categorical Funding Has Grown Threefold" shows the growth in categorical funding over the last three decades. During that time, categorical programs' share of K–12 Proposition 98 has tripled. Each categorical program has its own history and identified condition that the program is proposing to address. The state has made little effort to understand how these programs operate together or how one set of categorical programs supports another. Because of this, only the more sophisticated school districts are able to transform the myriad categorical programs into a rational education program.

Often, schools and districts must engage costly external consultants to assist schools in using all of the different pots of categorical funds in a way that allows the school to have an integrated program focus. And while it is inefficient that school districts must expend precious resources to navigate the categorical program maze, the alternative is worse — having the district implement a set of disjointed programs focusing on cross purposes, even for the same targeted students. The complexity of the system also is difficult for the state's smaller school districts. Forty-four percent of the state's school districts have fewer than 1,000 students.⁵ For many of these districts, the principal is also the superintendent and the chief business officer, and must navigate the complex state application and compliance processes to receive the district's funding. Many of these districts opt to apply only for the large categorical programs because the smaller ones just aren't worth the workload involved in obtaining the funds — which further skews resource distribution.

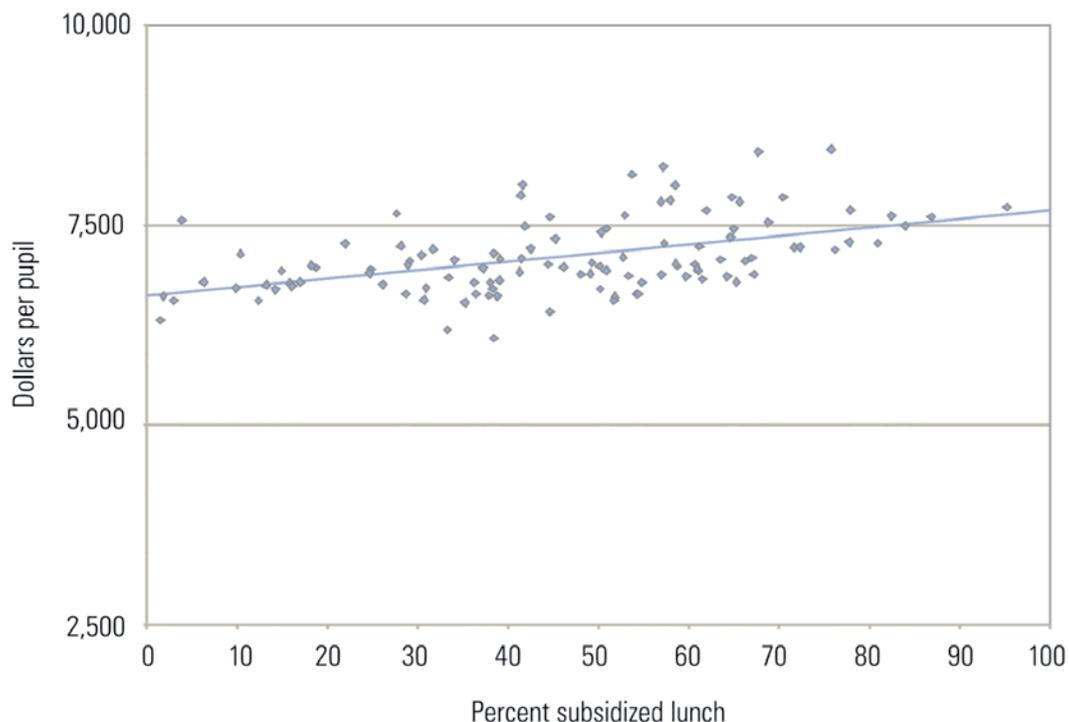


From the perspective of parents and local taxpayers, the finance system is virtually impenetrable. Little information is available on why and how districts receive their funds, what the restrictions are upon the various fund sources, how districts allocate those funds to their schools, and how that allocation impacts the resources that are available in classrooms. So, while parents and taxpayers would like to engage in the decision-making process, the current system virtually excludes them through its complexity.

Current system lacks equity

The complexity of the finance system hides education inequities because only a small handful of finance experts can understand the distributional impact of the various formulas and programs. The total set of categorical programs creates a finance system that is inequitable.⁶ Looking at total funding, Susanna Loeb *et al.* found that a district at the 25th percentile of spending per pupil spends \$3,000 per pupil less than a district at the 75th percentile. On its face, such differences in funding per pupil may not be a problem if the reason for the funding differential is that the district with the higher funding level receives extra funding because its students have additional needs. This is not the case, however. Robert Reich divides school funding equity issues into two categories: horizontal equity and vertical equity.⁷ Generally, a system is considered horizontally equitable if it treats districts serving similar students similarly. Vertical equity occurs when the funding that a district receives reflects the types of students the district serves, recognizing that some students are more expensive to educate than others. Getting Down to Facts concluded that “California funding doesn’t meet either of these criteria.”⁸

Expenditure Per Pupil Varies Little with Percent of Subsidized Lunch Students for Large Unified Districts



Source: Sonstelie, Jon (2007) *Aligning School Finance with Academic Standards: A Weighted-Student Formula Based in a Survey of Practitioners*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University.

- **Fails horizontal equity.** Looking at key characteristics of districts, including urbanicity, grade range, and student demographics, districts in California serving similar types of students in similar types of districts have large variances in funding levels. This suggests that the California system is not horizontally equitable.
- **Fails vertical equity.** The Getting Down to Facts research indicated that “observable district demographics and organizational characteristics correlate with spending disparities across districts, but are not large explanatory factors. Poverty level, racial and ethnic makeup, urban status, and district grade span explain only a small portion of the variation in spending.”⁹ The graphic “Expenditure Per Pupil Varies Little with Percent of Subsidized Lunch Students for Large Unified Districts” shows the relationship between expenditures per pupil and the percentage of students eligible for the federal free

and reduced-price lunch program.¹⁰ While there is a slightly higher per-pupil funding level in districts with higher concentrations of eligible students, 85 percent of these large districts are within \$500 per pupil of the state average. Closer examination of the data reveals that districts with high and low concentrations of students with a specific demographic trait often had higher funding than districts in the middle.

Current system is inefficient

The state's system of categorical programs has long been criticized for its inefficiency.¹¹ Accompanying each of these programs is a state and local bureaucracy that requires significant investments of personnel resources to generate and process the flow of generally meaningless paperwork, redirecting resources away from efforts to improve instruction. Principals who have no choice but to dedicate much of their time to completing the documentation required for compliance with *each* categorical program (to receive the funding) have little time to spend in classrooms, assisting teachers in their role as the instructional leaders of their schools. For large districts, central offices have a large number of staff dedicated to processing the paperwork that accompanies all of these programs. Even then, however, it can be difficult to get staff administering federal Title I grant funds to communicate effectively with other staff administering state Economic Impact Aid (EIA) funds and Targeted Instructional Improvement funds — even though all of these programs target a similar student population. The Getting Down to Facts research concluded that “the regulatory environment imposes a heavy compliance burden on school administrators; and not surprisingly, principals in California report that they spend substantially less time overseeing instruction at their school than do principals in other states.”¹² A recent survey by the Association of California School Administrators showed how this plays out at the local level, reporting that principals spend 36 percent of their time on paperwork.¹³ Given that California has fewer administrators per pupil than other states, having them spend much of their time on paperwork leaves little opportunity for everything else. This system of categorical programs also makes it difficult for schools to implement an integrated program that focuses on their overall goals of, and plans for, improving student achievement. As discussed in the Governance and Accountability chapter of this report, streamlining the categorical structure within the finance system is a critical component of a broad deregulation of California's education system that is essential to ending the current culture of compliance and delegating ever more decision-making authority to local districts in exchange for a higher level of accountability.

Current system creates bad incentives

In allocating monies based on set formulas and compliance with rules — rather than program outcomes — California's finance system does not contain incentives to promote student achievement.¹⁴ Thus, districts, schools, and employees receive the same funding for taking various actions, regardless of whether they produce results. In fact, the state categorical funding structure often creates disincentives to improve student achievement. The state has created numerous categoricals — including the *Williams* settlement, school intervention programs such as the High Priority Schools and Immediate Intervention for Underperforming Schools, teacher recruitment, and targeted additional state preschool funding — that provide funding to schools based on their having low academic performance. While the Committee believes it is appropriate to provide funding to compensate for the conditions that may contribute to low performance, or to accommodate particular student needs, providing money based on insufficient outcomes creates perverse incentives. Instead, districts, schools, and individuals should be rewarded for improving student achievement, supported in efforts to do better, and held accountable if they consistently fail to meet the needs of students.

Current system is unpredictable and unstable

Another shortcoming of California's current system is that the funding that school districts receive is unstable and unpredictable. School districts have become accustomed to the feast-or-famine cycles of K–12 spending in this state, but the lack of predictability reduces districts' ability to plan for the effective use of resources. The instability results from a combination of three factors, including schools' almost exclusive dependence on the state for its resources, the notorious volatility of the state's revenues and budgets, and the timing of the factors used in the Proposition 98 calculations.

- Schools are dependent on the state for the marginal education dollar.** Following passage of Proposition 13 in 1978, the state has taken on a greater role in financing K–12 education.¹⁵ That larger state role means that schools are more dependent on the state’s General Fund. While approximately one-fourth of Proposition 98 funding comes from local property taxes, generally any additional increase in local property tax revenues benefits the overall state budget, and results in a dollar-for-dollar decrease in state General Fund resources going to schools. As a result, with the exception of minor funding sources such as the state lottery and parcel taxes, schools are dependent upon the annual state budget for most of their funding. If the state’s overall finances were stable, this dependence would not necessarily be a problem. However, as the next bullet illustrates, California’s state finances are far from stable.
- The state General Fund is volatile.** The Legislative Analyst’s Office (LAO) has shown that because California has a highly progressive income tax structure, the state General Fund is dependent on taxes paid by the highest-income earners in the state.¹⁶ While the long-term growth of state revenues generated from these high-income earners is relatively high, the annual state revenues that result from this tax structure are highly volatile, because these high-income earners tend to have volatile incomes. Since Proposition 98 funding directly links K–14 education funding to the growth in General Fund revenues, K–12 funding tends to follow the volatility of the General Fund revenues.¹⁷
- Timing of the state budget is difficult for schools.** The timing of the annual adoption of the state budget leaves schools little time to develop their budgets, making it difficult for districts to make long-term plans. Proposition 98 budgets often change significantly from the January 10 version to that proposed in the May Revision. These changes may produce billions of additional revenues to schools...or billions less. Then, state budgets are often so late that districts, especially those with year-round schools, have already started their school year before the state adopts its budget for that school year.

LAO Summary of Proposition 98 Basics

✓	Over time, K–14 funding increases to account for growth in K–12 attendance and growth in the economy.
✓	There are three formulas (“tests”) that determine K–14 funding. Which test depends on how the economy and General Fund revenues grow from year to year.
	<ul style="list-style-type: none"> <p>Test 1 — Share of General Fund. Provides 39 percent of General Fund revenues. This test has not been used since 1988–89.</p>
	<ul style="list-style-type: none"> <p>Test 2 — Growth in Per Capita Personal Income. Increases prior-year funding by growth in attendance and per capita personal income. Generally, this test is operative in years with normal to strong General Fund revenue growth.</p>
	<ul style="list-style-type: none"> <p>Test 3 — Growth in General Fund Revenues. Increases prior-year funding by growth in attendance and per capita General Fund revenues. Generally, this test is operative when General Fund revenues fall or grow slowly.</p>
✓	Legislature can suspend Proposition 98. With a two-thirds vote, the Legislature can suspend the guarantee for one year and provide any level of K–14 funding.

Source: Legislative Analyst’s Office (2005) *Proposition 98 Primer*

- Proposition 98 factors often result in significant midyear adjustments.** The chart “LAO Summary of Proposition 98 Basics” explains the rudimentary elements of the Proposition 98 minimum guarantee calculation.¹⁸ Generally, the Proposition 98 formulas depend on the growth in the state’s economy, as measured by the growth in per capita General Fund revenues and the growth in per capita personal income. In the current Proposition 98 calculation process, the state uses data from two different fiscal years to measure these two factors that reflect the growth in the economy. Specifically, in calculating the Proposition 98 formula annually, the state uses *current year* personal income data, but *budget year* General Fund revenues. At the time when a budget is adopted, the personal income numbers are

clearly determined for the year, whereas the revenue estimates are little more than an educated guess that always proves to be wrong once April tax returns are known — often by \$1 billion or more. Actual revenues are not known until the fiscal year is almost over. In good years, this leads to a “May surprise,” requiring large one-time spending to “settle up” the current year and large increases for the budget year. In bad years, the state is often forced to make midyear cuts to lower the Proposition 98 funding level prior to the end of the fiscal year; then, the state often must dramatically cut ongoing funding in the subsequent budget because the Proposition 98 minimum grows little off of the already-reduced base. Thus, the timing of the Proposition 98 factors add unnecessary volatility to the Proposition 98 calculation that could be improved without changing the long-term funding level for schools. An alternative approach is proposed below.

Current System Under-Invests in the Most Disadvantaged Students

Total resource level lower than other states

There has long been a debate about the relationship between school resources (either in terms of funding levels or staffing levels) and student outcomes.¹⁹ And, while intuitively more staff and higher funding levels at a school should result in better outcomes for students, economists have had difficulty proving this relationship. As the Committee discusses later in this section, how funding is spent and the incentives, accountability, and governance of how funding is allocated can be just as important as, or even more important than, the level of funding.

It is empirically clear, however, that California has lower resource levels than other comparable states. The chart “Student-Adult Ratios for Selected States” shows the staffing ratios for California schools compared to other states.²⁰ California has significantly more students per teacher or administrator. This difference in staffing results from a combination of two factors: lower per-pupil funding levels and higher teacher and administrator salaries.

- **California spends less than other states.** The Getting Down to Facts studies demonstrate that California spends less per pupil than other states. California generates approximately the same level of revenues per pupil as Texas and Florida, approximately \$5,500 per pupil less than New York, and approximately \$630 per pupil less than the remaining states. When adjusting for costs, the large states all spend more than California, including Texas (12 percent more), Florida (18 percent), New York (75 percent), and the rest of the country (30 percent).²¹

Student-Adult Ratios for Selected States

State	Students to teachers	Students to school administrators
California	21.4	476.2
New York	13.8	370.4
Texas	14.9	147.1
Florida	18.0	370.4
All other states	15.6	303.0

Source: Loeb, Susanna, Jason Grissom and Katherine Strunk (2007) *District Dollars: Painting a Picture of Revenues and Expenditures in California’s School Districts*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University

- **Cost of college graduates is higher in California.** According to the Public Policy Institute of California (PPIC), California’s average teacher salaries are the highest in the nation, based on data from the National Center for Education Statistics.²² And, administrator salaries are among of the highest. One of the key factors explaining the higher teacher salaries in California is the relatively high cost of salaries for all professions requiring college degrees in the state. PPIC

suggests that half of the difference between teacher salaries in California and other states is explained by the relative wages of college graduates here compared to other states.

- **Educator salaries in California are higher than labor markets can explain.** PPIC concluded that California teacher salaries are higher than can be explained by the relatively higher salaries in the state. After adjusting for the relative salaries for other college graduates, "... about half of the compensation difference between California and other states is not explained by labor market conditions."

Adequacy studies suggest higher funding needs

The chart "Increased Costs, Above the 2004 Base, Suggested by the Getting Down to Facts Adequacy Studies" shows what each of the adequacy studies that research project estimated as the funding required above the 2004–05 funding level to meet the stated education outcome targets (the desired academic outcomes vary by study).²³ These studies show that the additional cost to meet the state's outcome goals is somewhere between \$1 billion and \$1.5 trillion. The Committee recognizes that the results of this research need to be taken with a grain of salt. Eric Hanushek, senior fellow at the Hoover Institution, articulates the numerous problems with the various approaches used in adequacy studies (see sidebar, "Problems with Adequacy Studies").²⁴ In addition, the state has made significant investments in K–12 education since the 2004–05 data that was used for the Getting Down to Facts studies: The chart "Cumulative Investment in K–12 Education, Beyond Growth and COLA," below, shows that the state has provided almost \$5 billion, beyond adjusting the base for growth in the number of students and cost of living adjustments (COLA), since that time. So, by the measures of some Getting Down to Facts studies, the current funding level could be considered adequate, while other studies would suggest the need for substantial additional investments. What is clear from these studies and other data is that any additional investment made by the state should be targeted at students with the greatest need, as discussed in detail below.

Increased Costs, Above the 2004 Base, Suggested by the Getting Down to Facts Adequacy Studies

Study	Methodology	Cited cost (2004–05 Cost)	Remaining cost after recent investments (2007–08 Cost)
Duncombe and Yinger	Cost Study Analysis	\$1 billion to \$4 billion	\$0
Imazeki	Cost Study Analysis	\$1.7 billion to \$5 billion	\$0
Sonstelie	Modified Professional Judgment	\$17.2 billion	\$12.2 billion
Chambers <i>et al.</i>	Standard Professional Judgment	\$25 billion to \$32 billion	\$20–\$27 billion
Imazeki	Production Study Analysis	\$1.5 trillion	\$1.5 trillion

Source: See the following Getting Down to Facts Reports — Jon Sonstelie (2007) *Aligning School Finance with Academic Standards: A Weighted-Student Formula Based in a Survey of Practitioners*; Chambers, Jay, Jesse Levin, and Danielle DeLancey (2007) *Efficiency and Adequacy in California School Finance: A Professional Judgment Approach*; Duncombe, William and John Yinger (2007) *Understanding the Incentives in California's Education Finance System*; and Jennifer Imazeki (2007) *Assessing the Costs of K–12 Education in California Public Schools*, Institute for Research on Education Policy and Practice, Stanford University

In addition to these five adequacy studies, Getting Down to Facts included a study by the American Institutes for Research on schools that "beat the odds" by producing high student achievement in schools serving largely economically disadvantaged students.²⁵ This study was initially conceived as an adequacy study using the "successful schools" methodology. While the findings from these schools cannot be generalized to determine the cost of moving all schools to an adequate level of education achievement,

the study does make clear that money is not the essential part of the formula for success. The study concludes that "... data reveal no relationship between school resources and academic success" for the schools that were examined against their peers.

Problems With Adequacy Studies

Getting Down to Facts included several adequacy studies that employed diverse methodologies to provide some insight into the difficult question of the role that funding plays in helping schools meet the student achievement goals the state has set. Although several creative techniques have been developed to provide education cost estimates, none of the adequacy studies can overcome one of the main problems in the application of economics and statistics to education funding: There is little to no consistent, direct, statistical relationship between the level of funding and student outcomes. Therefore, the exercise of estimating the amount of additional spending that would be needed to achieve a specified goal immediately encounters problems.

Based in great part on this lack of a statistical relationship, Hoover Institution Senior Fellow Eric Hanushek, a critic of adequacy studies, asserts that costing-out studies should be interpreted as political documents targeted at the agenda of justifying higher funding for schools, rather than as scientific studies. Hanushek points out that even proponents of adequacy studies acknowledge that these methods have weaknesses. Michael Rebell, of the New York-based Campaign for Fiscal Equity (plaintiffs in the New York state adequacy lawsuit), states, "Although these studies use a variety of complex statistical and analytic techniques, all of them are premised on a number of critical judgments which strongly influence their ultimate outcomes." John Augenblick, another nationally recognized adequacy consultant, states, "The advantages of the [professional judgment] approach are that it reflects the views of actual service providers and its results are easy to understand; the disadvantages are that resource allocation tends to reflect current practice and there is only an assumption, with little evidence, that the provisions of money at the designated level will produce the anticipated outcomes."²⁶

During its review of the Getting Down to Facts reports, the Committee performed a detailed examination of the methodologies of the various adequacy studies and identified concerns similar to those noted by Rebell and Augenblick. In particular, the Committee noted the following:

Cost and Production Studies. Getting Down to Facts included two cost study analyses and one production study analysis. Cost and production studies rely on the statistical relationship between the level of funding provided and student outcomes. It appears that this relationship is particularly problematic in California. Generally, the estimates of the cost and the production function approach should generate similar estimates. In the Imazeki study, which used both methodologies, the author herself concluded that the statistic relationship between funding and student outcomes was so unstable that the results should not be considered reliable for answering the question of the additional funding needs for California. The study concluded "the relationship between dollars and student achievement in California is so uncertain that it cannot be used to gauge the potential effect of resources on student outcomes."²⁷ (The much-discussed \$1.5 trillion estimate by Imazeki results from the fact that the almost non-existent relationship led to cost equations with a denominator of nearly zero.)

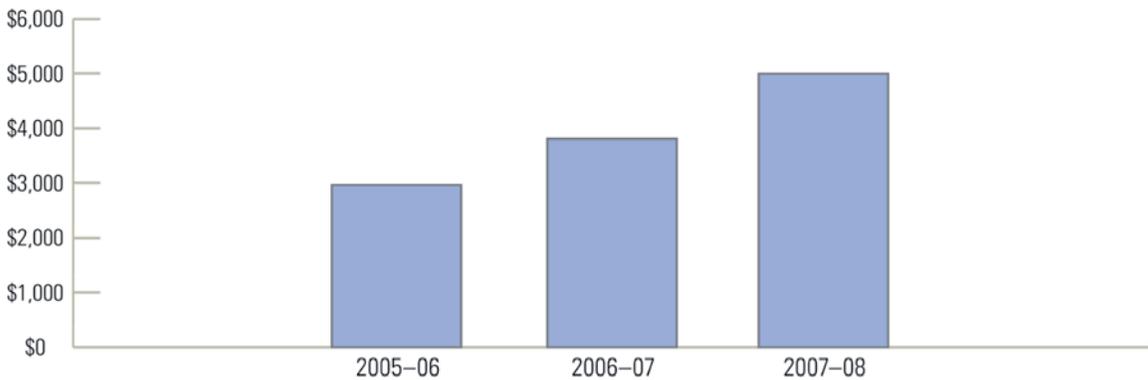
Duncombe and Yinger were more convinced by the statistical relationship that they found in their cost function analysis. However, their cost study also had shortcomings because it had to rely on the choices that voters faced in their decisions of whether to provide additional funding to schools. Given that in California the only way for local voters to increase funding for their schools is through a local parcel tax passed by a supermajority (two-third) vote, most finance experts in California believe that the parcel tax plays almost no role in California's finance system — thus calling into question the methodology that they used.

Professional Judgment Studies. The main criticism specific to professional judgment studies is that an “anchoring bias” inherently exists that (1) ties the funding needed to the current inefficiencies in the system, and (2) does not allow participants to make more meaningful reforms to improve the efficiencies of schools as part of the reform. Although several of the Getting Down to Facts studies make clear that the current system is inefficient, the professional judgment studies at least implicitly ask educators to determine how much more money is needed to improve student achievement using current inefficient mechanisms. The approach focuses basically on asking what additional inputs the system needs. It does not allow the panelist to make any changes to the culture of low expectations that may exist. It does not allow for the development of a continuous improvement model within schools or districts. It does not allow for any flexibility in how teachers are compensated, nor for the deregulation of the bureaucratic structure of the state, nor changes in the governance structures of the state. Thus, as one example, if an educator is asked how much more staff development would provide x points in improved achievement, and he believes staff development as currently offered has limited impact, then the additional investment in the perceived poor quality professional development will be inflated above the estimate that would reflect an improved professional development delivery system.

Critics also cite a related bias that may exist in the professional judgment studies. By including mostly, or exclusively, educators on the panels may inherently “defend” the performance of other educators by suggesting through their decisions that the fault of the current system is the lack of sufficient resources, and not the effectiveness of any of the people involved in using those resources. Again, this is a more likely reaction, since panelists cannot make other reforms to the system.

Finally, all of these models are unrealistic in that they assume that the price of the inputs would not change if the state made additional investments. For example, if the state were to invest an additional \$2 billion, panelists considering whether to hire additional teachers in the exercise assume that compensation for all existing and any new teachers would remain the same; however, past experience demonstrates that when California has increased funding for schools substantially, a large portion of the additional investment was used to increase teacher salaries.

Cumulative Investment in K–12 Education, Beyond Growth and COLA



Source: Staff analysis using data from LAO and the Department of Finance

Targeting students and schools with the greatest needs

Multiple sources suggest that any additional investments should be targeted to educate students with greater needs (students who are economically disadvantaged or are English learners). These sources include the adequacy studies, data from LAO, various national policy think tanks, and data on what other key states provide schools to educate students with economic or language disadvantages. The Committee reviewed these various sources before determining its recommendation for funding goals for disadvantaged students.

Adequacy studies suggest higher funding for disadvantaged students

The aggregate cost implications of the various Getting Down to Facts adequacy studies have been provided above. While there is wide variance in the additional costs estimated among these various studies, the one thing that is consistent across these studies is their findings that the additional funding needed to help schools meet state standards would largely need to be focused at students with the greatest needs. Relevant findings from each of these studies are examined below.

- **Sonstelie.**²⁸ Educators who participated in Sonstelie’s professional judgment review found that increased student poverty strongly hinders school performance, and they predict that resource increases would have only modest positive effects on student achievement. Specifically, the study found that an increase in a school’s budget of \$1,000 per pupil would result in a predicted 13-point increase in that school’s API score. Because districts with high proportions of economically disadvantaged students often have lower API scores to begin with, their resource needs are likely to be higher. At the Committee’s request, the author calculated the additional funding needed to educate economically disadvantaged students using two different measures of economic disadvantage. If a narrow definition were used — that is, students living in poverty (approximately 18 percent of students) — an economically disadvantaged student would require approximately 80 percent higher funding per pupil. If a broader definition of economically disadvantaged were used — eligibility for a free or reduced-price lunch (approximately half of students) — an economically disadvantaged student would require about 35 percent higher funding per pupil. In the aggregate, this study suggested that a cost increase of 40 percent would be needed for roughly half of all schools to meet the state’s goal of an API of 800. For schools serving a high proportion of disadvantaged students, the maximum budget available in the simulation would result in the school still being forecasted to achieve below the state’s target. Thus, this study suggested that even with a 40 percent increase in funding, many schools would not reach the state’s achievement target. “The bulk of these additional costs are due to resources needed to boost achievement in schools primarily serving students from low-income families.”
- **Chambers *et al.***²⁹ This study created a complex index of need and scale (size of district). The need/scale index was a composite measure incorporating the percentage of students eligible for a free or reduced-price lunch, percentage of English learner students, and percentage of special education students. For very small districts (fewer than 1,000 students), districts with the highest need were estimated to require 84 percent higher funding than the lower-need districts to meet the same student outcome targets. For larger districts (more than 10,000 students), the highest-need districts would require 45 percent more funding than lower-need districts. The expert panels suggested that schools serving a higher percentage of low-income students would need smaller classes and more support staff to meet achievement targets.
- **Imazeki.**³⁰ While the Getting Down to Facts project management raised concerns with the stability of the overall cost findings in this particular study, the study reached similar conclusions on the need to make additional investments to assist students with the greatest needs. This study found that the current variation in per-pupil spending among California school districts is not strongly connected to variations in the cost of achieving a quality education. The lack of a relationship between costs and outcomes made it difficult to predict the additional funding needed to produce a quality education in every school. Despite these problems, the study found that students in poverty needed 30 percent more than an “average” student, Spanish-speaking English learners needed 8 percent more funding, and English learners whose primary language was something other than Spanish needed 24 percent more funding to meet the same outcome targets.

- **Duncombe and Yinger.**³¹ This study focused primarily on the inefficiency in California’s current finance system and was highly critical of the current categorical finance system. This study did not specifically address the additional needs of economically disadvantaged students or English learners, and instead focused on the additional needs of districts that are currently achieving below the state’s academic target. It concluded that relatively small efficiency improvements could help most districts meet the state’s API target. Since this study focused on the additional costs to the state to help all districts meet California’s API target of 800 points, it found that the state would not need to make any additional investment (and could actually reduce funding) in districts with API scores above 800. By contrast, districts with API scores significantly below the statewide target would need significant additional investments to meet the state’s API targets. Since districts with higher proportions of economically disadvantaged students and English learners often correlate with those that have lower API scores, these districts would have higher funding needs than districts with more affluent students and few English learners. The study does provide a cautionary note that, based on research on efficiency in New York, increases in funding may actually lead to decreases in school district efficiency and not increases.

LAO suggests higher funding needs for disadvantaged students

In 2006, the LAO analyzed California’s current investment in economically disadvantaged students and English learners as part of the Legislature’s and administration’s discussions about overhauling the Economic Impact Aid (EIA) formula.³² The LAO found that California invested significantly less funding in its economically disadvantaged students and English learners than other states invest. It calculated an implicit weight for California’s current investment in programs that either directly target these populations — as do the EIA formulas — or indirectly target these types of schools — as do remedial summer school and High Priority Grants. The LAO determined that an implicit weight for “core” programs targeting this population would be approximately 1.09, that is, nine percent more funding than received by a typical student. Using a broader measure that included related programs, the implicit weight was estimated at 1.14, or 14 percent more than a typical student. The LAO found that other states that have adopted weighted pupil funding formulas have weights ranging from 1.2 to 1.8 (20 to 80 percent more than a base student) for these targeted populations.

Center on Budget and Policy Priorities notes California’s investments for economically disadvantaged students trail other states

Funding that other states provide for disadvantaged students varies significantly, and given the nuances of each state’s finance system, it is difficult to make accurate comparisons across states on their relative investment in economically disadvantaged students. Using 2001–02 data, the Center on Budget and Policy Priorities estimated the implicit weight of funding provided in each state for programs that specifically target funding to economically disadvantaged students; the Center used a very narrow definition of “targeted funding” in its calculations.³³ The chart “Implicit Weights of States’ Investments in Low-Income Students” shows the implicit weights for the larger urban states for students living in poverty. Using this measure of funding for poor students, California is significantly behind other large states and the nation. These data can only be considered loosely illustrative because the associated nuances are significant. For example, the only program identified in this study for California was EIA — yet, despite its title, 75 to 80 percent of the funding is used exclusively for English learners, rather than economically disadvantaged students. At the same time, funding for the Targeted Instructional Improvement Grant was not included in this analysis, although that funding source is used largely to address the needs of economically disadvantaged students. Other states may have similar anomalies that make these data less accurate; moreover, significant additional investments in economically disadvantaged students have been made in recent years that likely would not be reflected in this study. Criticism aside, this study provides one more reference point regarding California’s under-investment. This study shows that, with the exception of Florida, all states make a significant additional investment in their poor students — and Florida’s approach may be related to the high level of additional funding provided for its English learners.

Implicit Weights of States' Investments in Low-Income Students (2001–02)

State	Percent higher funding for students in poverty
Texas	27.7
New York	19.6
Florida	0.0
Illinois	22.3
Michigan	20.3
California	5.5
U.S. Average	17.2

Source: Center on Budget and Policy Priorities

The Education Trust and National Center for Education Statistics — Cost of Education Index

The Education Trust has developed a series of publications on the gap between the school resources available to low-income and minority students and more affluent students.³⁴ In these studies, the researchers made adjustments to reflect that in serving low-income students (students with income below the federal poverty line), “districts need to provide additional educational services to help those students overcome the range of problems often experienced by children in poverty.” From its review, the Education Trust determined a 40 percent cost adjustment to be appropriate for students in poverty; it referenced the development of such cost adjustments to recent NCES reports, U.S. Department of Education, and U.S. General Accounting Office reports.

Standard & Poor’s

Standard & Poor’s has developed a system to measure the relative efficiency of school districts across the country.³⁵ To calculate a district’s efficiency, Standard & Poor’s investigated the relationship between a district’s spending and its student outcomes to determine the level of achievement that a district is able to attain for a given level of investment. Standard & Poor’s realized that an adjustment was needed to reflect the type of students the district was educating. Since a district’s demographics strongly influence its student outcomes, looking at unadjusted data would have resulted in “findings” that districts serving financially well-off English-speaking students were efficient (i.e., attained high outcomes for funds invested) and that those districts serving economically disadvantaged and English learners were inefficient (i.e., attained low outcomes for funds invested). But clearly, this is not the case. Instead, Standard & Poor’s recognized the need to adjust the spending level of a district to reflect the costs it faced. First, spending levels were adjusted for regional cost differences. Then, adjustments were made for the type of students districts served, to allow for the efficiency of a district to be measured. After making those adjustments, these studies were able to determine which districts are more efficient in serving their students. To support this efficiency measurement, Standard & Poor’s developed cost adjustments for economically disadvantaged and English learner students, using eligibility for the free and reduced-price lunch program as their measure of economically disadvantaged. The firm suggested that educating a student eligible for a free or reduced-price lunch requires 35 percent more funding, or a weight of 1.35. This would imply a weight of 1.7, or 70 percent higher funding, if they had used students in poverty as their measure of economically disadvantaged. (See section entitled “What Measure of Economic Disadvantage?” below, for discussion of the differences between poverty, free and reduced-price lunch eligibility, and other measures of economic disadvantage.) Standard & Poor’s used a weight of 1.2, or 20 percent higher funding, for English learners.

Analysis of investment levels of key states

The Committee conducted its own detailed examination of a few key states' finance systems to better understand the range of investments in economically disadvantaged students that are made across the nation.

New York state overhauls finance system in reaction to the courts

New York has just initiated a new foundation aid plan that collapses 30 categorical programs into a simple unrestricted grant.³⁶ This new formula was in part the state's response to recent adequacy litigation. For 2007–08, the formula is as follows:

$$\begin{aligned} \text{District Foundation Aid Per Pupil} = & \\ & \text{Foundation (or Base) Cost} * \text{Pupil Need Index} * \text{Regional Cost Index} \\ & - \text{Expected Local Contribution.} \end{aligned}$$

The foundation level establishes the cost of educating a student without additional need in the average cost area of the state. For 2007–08, this amount is \$5,661 per pupil. This amount is then multiplied by a need index and a regional cost index. Although the pupil need index is complicated, it translates into significant additional resources for economically disadvantaged students. New York's formula uses a weighted combination of data on students in poverty and the percentage of students eligible for a free or reduced-price lunch, thereby reducing the reliance on one data set. Holding all other factors constant to make it comparable to other implicit weights discussed in this section, New York's weight would be roughly 100 percent more for a student eligible for a free or reduced-price lunch or 200 percent more for a student living in poverty. This additional funding would be even higher in the high-cost areas of the state, because they would be multiplied by the regional cost index. For example, in New York City, these additional funds would be multiplied by an additional factor of 1.425. In addition, at the local level, districts may choose to assess higher local taxes and augment the funding they derive through the state's funding system.

Massachusetts makes significant investment in disadvantaged students

Massachusetts does not have a formula-based system but instead, in each district, provides a specific additional dollar amount for each pupil eligible for a free or reduced-price lunch.³⁷ For fiscal year 2008, the additional funding per pupil is \$2,988 per pupil for grades 1–8 and \$2,416 for grades 9–12. The average school budget in Massachusetts (inclusive of these funds) is \$8,425 per pupil. Converting Massachusetts' additional investment in economically disadvantaged students into a weighted formula adjustment, that state provides roughly an additional 37 percent funding for each student eligible for a free or reduced-price lunch. Conversion of this level of additional investment to target only students in poverty, for analytical and comparative purposes, would translate into an additional 70 percent for each student living in poverty. As with New York, local districts in Massachusetts have the option of assessing higher local taxes to augment the state-formula funding.

Florida targets only English learners and special education students

Florida has developed a relatively straightforward funding system that provides differential funding levels depending on grade level, special education status, and language status.³⁸ Almost all of the state's funding is distributed through this funding formula, although a small number of additional "add-on" programs also receive targeted funding. A student in grades 4–8 establishes the base for Florida's formulas, with the early grades and high schools receiving higher funding levels than that base. Florida's funding formulas do not provide additional funding to districts serving economically disadvantaged students, per se. However, the formula does provide an additional 27.5 percent for English learner students.

Oregon uses a weighted pupil system

Most of the K–12 funding in Oregon is distributed using a weighted student formula.³⁹ In the 1990s, Oregon's Legislature changed its school finance policy by creating a new measure of financial "equity" for school districts. In the process, most of the finance system was transformed into a weighted pupil funding system that distributed funding to school districts based on the

characteristics of the students in those districts. Those characteristics included grade level, special education participation, English learner, poverty, neglected and delinquent, pregnant and parenting, and participation in the foster home system. Some additional funding beyond this weighted pupil funding continues to be provided, primarily for transportation, facilities, and high-cost special education students. The state provides districts an additional 25 percent for students living in poverty and an additional 50 percent for English learners. Conversations with the architects of the Oregon system suggested that the decisions on the weights was largely political and that several years into the new system, they thought that they would like to increase the weight for economically disadvantaged students and decrease the weight on English learners, but that such an adjustment has been politically difficult to pursue.

Higher funding for disadvantaged students compared to what base?

Throughout this section, research and descriptions of other states' finance systems reference various levels of additional spending for economically disadvantaged students and/or English learners. It is difficult to compare the relative levels of additional funding because they often are applied to very different bases and include or exclude funding provided by the federal government in the resources for these disadvantaged populations. For example, the adequacy studies and the research by Standard & Poor's and Ed Trust concentrated on total operational funding and, as such, should include federal funding, such as federal Title I resources, in their calculations. These studies also used a broad definition of funding to determine the base funding (basically all of the funding — state, federal, and local — that is not targeted). By contrast, information from the Center on Budget and Policy Priorities, the LAO, and specific states focused on the state-specific finance systems and did not include federal funds in the calculation, so they may apply the percentage augmentation for disadvantaged students to a base that is more narrowly defined. An additional complicating factor is the role that local revenue has in a state's finance system. Some states allow districts to collect additional local revenue beyond the funding generated by the state's funding formulas; in these states, those districts that receive less state-formula funding because they have few economically disadvantaged students would still be able to generate additional funding by increasing local revenues, skewing the relationship of aggregate funding for "average" students versus disadvantaged students. The combination of these factors makes it very difficult to directly compare any of these numbers among different states; rather, these data can provide some range over which to consider funding for disadvantaged students.

Creating a Rational Finance System

The Committee took a broad approach to addressing the complexities of California's current education finance system, including investigating the state's current expenditure and revenue systems. The Committee initially examined the efficiency of the state's current categorical structure for distributing and managing expenditures, in accordance with priorities set by the state, and found it lacking based on multiple criteria, as discussed in detail above, including that the current system is unnecessarily complex, inequitable, inefficient, unstable and unpredictable, and inadequate especially for disadvantaged students, and that it creates poor incentives. The Committee also determined that the failings of the current finance system have significant ramifications extending beyond the arena of finance, especially on the governance system. The Committee concluded that the current finance system must be dramatically overhauled to address as many of these shortcomings as possible over time.

After proposing a comprehensive overhaul of the existing finance system, the Committee makes several other recommendations to improve the incentives of the funding system, improve the stability of Proposition 98, address some of the finance issues of special education, and accommodate post-retirement health benefits, among other issues. Although the Committee's recommendations would require substantial new investments, based on the most recently available economic projections the Committee anticipates that a significant portion of the proposed additional investments needed to support the recommendations can be achieved within the money that Proposition 98 will dedicate to K–12 education as it moves into Test 1 in the near future.

A New Finance System: The Committee’s Vision

The proposed new funding system will provide a base funding level per pupil that depends on the grade level of the student. Funding for economically disadvantaged students and English learners will be consolidated into a targeted grant for each student, while special education funding will be addressed separately. In the short term, districts will be held harmless, ensuring that they receive at least as much as they do under the current system. Over time, the state will make additional investments to equalize the funding levels across districts and to make the necessary additional investment in the targeted-student grants.

The new funding base would consolidate the existing general purpose funding — some 10 different funding streams that make up the current revenue limit system — into a per-pupil base grant that is differentiated primarily by the grade level of students. Transitioning to funding schools by grade span will go a long way to addressing another problem of the current system — the inequities that have developed over time between districts of different sizes and types. Also consolidated into this new base will be funding from categorical programs that are currently provided to districts in a non-targeted way — categoricals that do not address the needs of special education students, economically disadvantaged students, or English learners, either directly or indirectly.

The state would determine the additional funding needs of economically disadvantaged students and English learners and provide additional funding to support those needs (the Committee recommends initial augmentation targets that are appropriate for initial implementation). The state also would develop an ongoing process to regularly update the funding formulas for these targeted pupils, to ensure that they are current and appropriate.

To improve the political viability of this plan, the Committee recommends holding districts harmless during the transition to the new funding structure, to ensure that districts are at least as well-off under the new system as they are under the current funding system. Since the state would make significant additional investments in students with additional needs, these initial hold-harmless protections are unlikely to have much of a fiscal impact in the long term.

Recommendation 2.1: Transition to a Student-Centered Funding System

The Committee recommends reforming the finance system to (1) ensure that resources reflect the education needs of each individual student and more effectively follow the student who generates them; (2) promote an equitable distribution of base resources in a clear and transparent system; (3) make strategic investments over time to target additional resources to students with the greatest needs; and (4) support local control, thereby allowing districts to develop integrated approaches to helping all children. The Committee recommends accomplishing these objectives by consolidating general purpose funding, transitioning categorical funding to a student-centered funding model, and addressing inequities through targeted investments in the students with the greatest needs over time.

2.1.1: Establish a new base funding level for every student

The Committee recommends that the state establish a new base funding level for the “average student” to serve as the underpinning of the new K–12 finance system. This base funding level should correlate to a determination by state policymakers of the level of resources needed to support the attainment of state education goals by a student who does not experience exceptional learning challenges (i.e., a student who is *not* economically disadvantaged or in need of special education, or for whom English is his native language). At initial implementation, the new base funding level for students would derive from the current level of general purpose funding, combined with funding consolidated from selected other existing sources (discussed below).

2.1.2: Consolidate revenue limits and revenue limit add-ons into new funding base

General purpose funds for school districts usually consist of a combination of local property tax revenues and state funds, which together meet the funding requirements of each district’s base revenue limits. Each district has its own base revenue limit that reflects historical factors related to the respective local finance system in place prior to the passage of Proposition 13 in 1978, combined with equalization efforts that have occurred since that time. While substantial progress has been made to equalize this funding source, there is still some level of inequity at the margins, especially for some high-revenue districts. The Committee recommends streamlining this primary revenue source for school districts to improve the efficiency, transparency, and equity of the base funding level across districts. The first step to develop the new base is to consolidate a set of revenue limit add-ons with the base revenue limits. Revenue limit add-ons often are based on funds provided to districts for actions the district took in the past but for which the relevance has since been lost. For example, some districts receive add-on funding today if it cost them more to raise their minimum teacher salaries in 1983, or if they opened a continuation high school *after* the passage of Proposition 13. Another add-on, Meals for Needy Pupils, provides higher general purpose funding to districts that had a local property tax prior to Proposition 13 for its school meal program (irrespective of whether any of the funding is used for its current meal program). The chart “Major Elements of the District Revenue Limit Formula” provides a brief description of each component of the revenue limit. LAO provides details on each of these elements.⁴⁰ The chart “General Purpose Funds, Large Unified School Districts” displays the inequities in these programs across districts. Each of these programs provides additional general purpose funds to school districts for some historical reason.

Major Elements of the District Revenue Limit Formula

2004–05 (In millions)

Program	Description	Total cost
Base revenue limit	Pays for the basic costs of educating a student.	\$27,753.4 ^a
Necessary small schools	Subsidizes very small schools, usually in small districts.	109.7
Excess taxes (Non-Proposition 98)	Property tax revenues in excess of the amount needed to fund a district’s revenue limit entitlement. These districts receive only basic aid and categorical funds from the state.	201.4
Meals for Needy Pupils	Funding in lieu of property tax revenues that were approved by voters prior to Proposition 13.	126.8
SB 813 incentive programs	Funding to increase the length of the school day and year and to increase minimum teacher salaries. Enacted in 1983.	1,231.7
Minimum teacher salary incentive	Funding to increase minimum teacher salaries. Enacted in 1999 and 2000.	87.1
Interdistrict attendance	Funding for an interdistrict attendance program affecting two districts.	0.5
Continuation schools	Funding for continuation high schools if the school was opened after the passage of Proposition 13.	34.4
Unemployment insurance (UI)	Reimbursement for district UI costs in excess of the district’s 1975–76 UI costs.	212.2
Public Employees’ Retirement System (PERS) reduction	Reduces district funding based on the difference between the current district contribution for PERS employees and a specified base amount.	-10.3
Total		\$29,715.7

a. Amount includes deferrals in payments to districts, and proposed equalization funding. Excludes revenue limit funds resulting from the budget’s proposal to merge 22 categorical programs and the charter school block grant into revenue limits.

Source: LAO — Analysis of the 2004–05 Budget Bill

General Purpose Funds, Large Unified School Districts
2002–03 dollars per average daily attendance

	Average	High	Low
Revenue limit	\$4,571.20	\$6,592.16	\$4,406.37
Necessary small school	14.23	1,312.72	—
Excess taxes	51.65	5,843.40	—
Meals for needy pupils	22.25	616.17	—
SB 813 incentive programs	216.69	385.75	168.99
Unemployment insurance	4.61	13.04	—
Continuation school	12.84	122.82	—
PERS ^a reduction	-87.88	—	-232.33
Totals	\$4,809.40	\$10,684.40	\$4,549.53

a. Public Employees' Retirement System.
 Source: LAO — Analysis of the 2004–05 Budget Bill

The Committee finds that there is no longer a need to maintain these independent streams of general purpose funds, and therefore recommends consolidating these funds into the new base. The Committee recommends making two exceptions to this consolidation: for excess taxes and for necessary small schools. Excess taxes would be the local property taxes generated within districts that meet their entire new base grant funding requirements with local property tax revenues and continue to keep any local property taxes in excess of the base grants. Consistent with current practice, the Committee proposes that these funds remain non-Proposition 98 funds. The Committee also believes that the state should continue funding for necessary small schools, to recognize that some schools that are geographically isolated have higher than average costs that simply cannot be mitigated. Generally, these schools are funded using an alternative formula that provides resources based on the number of students and the number of certificated employees they have. While a better mechanism for funding small schools may exist, the Committee recommends leaving this program in place until a suitable alternative approach is developed.

2.1.3: Differentiate base funding by grade span

Several problems with the current finance system could be improved by moving toward a system that provides differential funding allocations based on the grade level of each student. Currently general purpose (or revenue limit) funding for a school district is differentiated by the size (large and small) and the type (unified, high school, and elementary) of the district. The funding level for high school districts is higher, recognizing the higher per pupil costs associated with operating high schools (e.g. providing a broader curriculum that might include science laboratories and other high-cost educational services or supports). Funding for elementary school districts is lower, and the rate for unified districts is in the middle. Within each size and type of district, the funding level has been generally equalized, and while a small number of districts exceed the state's 90th percentile funding target, most districts are funded at or very close to the targeted funding level for their district size and type. The chart "Base Revenue Limits by Size and Type of District" shows the various revenue limits currently applied for districts.

Base Revenue Limits by Size and Type of District (2006–07 estimated)

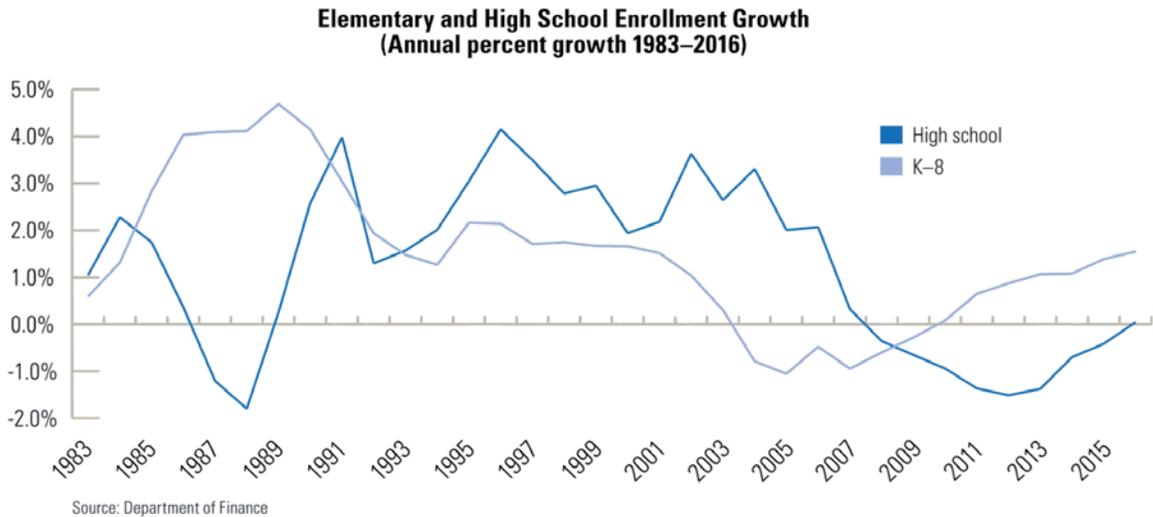
Size and type	Number of districts	Revenue limit target per student
Unified		
Large	262	\$5,021
Small (1,500 or fewer students)	69	\$5,438
High school		
Large	84	\$5,761
Small (300 or fewer students)	3	\$6,338
Elementary		
Large	467	\$4,823
Small (100 or fewer students)	93	\$5,879
County offices of education	58	N/A ^a

a. County offices have multiple revenue limits depending on the type of student that is served.
Source: LAO

This current approach to general purpose funding presents three key problems:

- 7th- and 8th-grade students are funded at different rates.** Both high school and elementary school districts can serve 7th- and 8th-grade students. However, the funding level a district receives for these students varies dramatically. A typical large elementary school district received \$4,823 per pupil in 2006–07 for serving a 7th- and 8th-grader. In contrast, a large high school districts received \$5,761 for serving a 7th- and 8th-grader — a difference of \$938 per pupil (almost 20 percent more), despite the presumed equivalent educational needs.
- Unified districts receive less than the blended average of high school and elementary districts.** One might reasonably expect that the unified funding levels would be roughly the blended average of the high school and elementary school funding levels. However, because of the equalization method the state has used in the past, the funding level for elementary and high school districts are higher than the unified rate. Specifically, Committee staff estimates that the blended average of the large elementary rate and the large high school rate is \$5,151, roughly \$130 per pupil higher than the large unified rate. This \$130 per-pupil difference would translate into some \$85 million for the Los Angeles Unified School District (LAUSD). This result occurred because for each size and type of district, the state equalized toward the level of the 90th percentile district. Historically, there has been greater variance in the revenue limits of elementary and high school districts. This means that the 90th percentile district was more of an outlier for these types of districts than for the unified districts. In addition to creating some inequity in the system broadly, this situation also creates a disincentive for districts to consider unification.⁴¹
- Unified district funding fluctuates as large cohorts move through the system.** As mentioned above, unified districts receive the same revenue limit regardless of the grade levels of its students. The cost of educating high school students is recognized to be higher than for other grades. Therefore, when large cohorts of students are in the high school grades compared to large groups of students being in the elementary grades, unified districts are forced to absorb higher costs within a static budget, creating significant financial hardships. The graphic “Elementary and High School Enrollment Growth” shows statewide enrollment growth since the early 1980s for elementary and high school age ranges. In the late 1980s, most unified districts in the state benefited from having high growth in the number of “cheaper-to-educate” elementary students and slow-growing or declining high school populations, which were more expensive to educate. This

phenomenon benefited unified districts at that time. Recently, unified districts have been suffering from the opposite effect. Statewide elementary enrollments have been falling, while high school enrollments have continued to grow. To demonstrate the impact this can have on a district, LAUSD has seen the proportion of its high school enrollment grow from 25.4 percent in 2001–02 to 29.3 percent. If the large elementary district revenue limit target reflects the cost of elementary school (\$4,823 per pupil) and the large high school district revenue limit target reflects the cost of high school (\$5,761 per pupil), then the change in LAUSD’s percentage of students in high school would translate into increased costs for the district in excess of \$25 million annually. It is likely that other large unified school districts have experienced similar shifts in demographics and related proportional costs.



To address these three problems, the Committee recommends changing the revenue limit system to a grade-level-driven system of base funding for each of four grade spans, structured in a manner similar to the revenue limit funding structure already employed in California for charter schools. Charter schools are provided general purpose funding that is equivalent to the average revenue limit for each grade span. The chart “Estimated General Purpose Charter School Funding” shows the charter school funding rates for 2005–06. Below, the Committee recommends consolidating most categorical programs into this new funding model. As part of that recommendation, the Committee recommends folding grade-specific categorical programs such as K–3 class size reduction into the base funding level for those grades. This will ensure that districts could continue operating similar programs if they determined locally that was the best way to meet academic expectations.

**Estimated General Purpose
Charter School Funding (2005–06)**

Grade span	Per-pupil funding
K–grade 3	\$4,971
Grade 4–6	\$5,041
Grade 7–8	\$5,183
Grade 9–12	\$6,019

Source: California Department of Education

Meeting the funding needs of disadvantaged students

The student-centered funding model is intended to support the learning needs of each individual student. To do so, it attempts to mitigate existing inequities through targeted investments in the students with the greatest needs. Throughout the nation, states that have adopted somewhat similar models — and scholars exploring these models in the abstract — have considered a wide array of student and school characteristics for targeted augmentations, and the Committee similarly examined how complex to make the new system. Economically disadvantaged students, English learners, and special education students are almost universally included, in some form, in these models. Arguments can be made to include multiple measures of economically disadvantaged, the concentration of disadvantaged students, regional cost adjustments, and other cost factors, such as density of the student population and weather. (See Appendix F for discussion of adjustment factors that the Committee considered.) While credible arguments support the inclusion of many of these additional factors, ultimately the Committee determined that an effective education finance structure should focus on the three most compelling student characteristics, and that simplicity, transparency, and local control were more important factors in the distribution of funding than trying to address each additional need.

The Committee believes that there are great benefits to the recently modified structure for the funding of special education and determined that it should be fundamentally maintained, with significant adjustments. For this reason, and others this report will describe in detail, the Committee addresses funding for special education separately, in Recommendation 2.4, rather than including special education as a distinct targeted adjustment within the student-centered funding model.

As discussed in detail at the beginning of this chapter, the state currently particularly under-invests in economically disadvantaged students and English learners. The Committee believes the state should establish a funding goal for the targeted grants in amounts that appropriately compensate for the disadvantages these students face. But prior to determining that funding goal, it is important to determine the data that will be used to target the resources — especially for economically disadvantaged students.

What measure of economic disadvantage?

The amount of additional funding per pupil that a state provides to districts to educate economically disadvantaged students is dependent, in part, on the measure of “economically disadvantaged” that a state decides to use. Broader measures of “economically disadvantaged” tend to generate lower funding goals for each disadvantaged student, while narrower measures tend to produce higher funding targets. In determining which measure to use, the Committee decided to focus only on using data that are already collected, to avoid the costs of collecting an independent set of new data on student family income. Three existing data sets could be considered: (1) federal Title I data, which uses the number of students whose family income is below the federal poverty level; (2) federal free and reduced-price meal eligibility data; or (3) data on families participating in the state’s welfare program, CalWORKs. There are advantages and disadvantages to each measure. The chart “Participation Rates in Programs Serving Economically Disadvantaged Students” shows the different percentages of students in specified districts who are deemed to be “economically disadvantaged” based on the use of different measures of income. In contrast to the federal poverty calculation driving Title I data, federal free and reduced-price meal program eligibility measures the percentage of students whose family’s income falls below 185 percent of the federal poverty threshold for a reduced-price meal (or 130 percent of the poverty threshold for a free meal). There are two main factors to consider in choosing among the measures: (1) the quality of the data, and (2) whether the income threshold generally targets resources at the students with the additional need.

Participation Rates in Programs Serving Economically Disadvantaged Students
(As percent of total enrollment, 2004–05)

District	CalWORKs ^a	FRPM ^a	Title I, Part A
Coachella Valley Joint Unified	9%	86%	39%
Capistrano Unified	1%	15%	7%
Oakland Unified	25%	68%	34%
Los Angeles Unified	14%	77%	32%
Totals statewide	9%	49%	19%

a. CalWORKs = California Work Opportunity and Responsibility to Kids; FRPM = Free and Reduced Price Meal program
 Source: LAO *Analysis of the 2006–07 Budget*

As part of an overhaul of the EIA formula in the 2006–07 budget, the administration and Legislature reviewed the different measures of “economically disadvantaged” that the state could use to drive a revised EIA formula. Policymakers decided to change the eligibility basis from CalWORKs data to Title I data. The Committee concurs with this recent change. While there is a strong correlation among these different measures, there are differences as well. The meaning of the CalWORKs measurement has changed significantly over the last decade, as welfare reform has significantly reduced the number of families in need of CalWORKs assistance. This reduction in the number of CalWORKs families does not mean that these families no longer have additional education needs. Also, the Committee is aware that administrative agencies have experienced difficulty obtaining accurate CalWORKs data, primarily due to privacy concerns, and there is insufficient reason to anticipate that data accessibility would improve to support its use as the basis for calculating student need.

How best to accommodate the needs of English learners?

In determining the funding needs for English learners, the Committee identified similar issues to those related to determining the appropriate funding level for economically disadvantaged students. Funding models in other states provide higher funding levels for English learners than California currently does. For example, as discussed above, Oregon provides 50 percent more funding for its English learners, while Florida provides 27.5 percent higher funding for them. Gándara and Rumberger suggested that the needs of English learners are similar to those of economically disadvantaged students and that if an English learner is economically disadvantaged, that student may not need additional funding specifically targeted to language-based needs.⁴² However, they also noted that further research on this topic is needed. LAO reports that 85 percent of English learners in California are eligible for a free or reduced-price lunch, so there is a strong correlation between these students’ language needs and their status as economically disadvantaged students for purposes of targeting resources. Sonstelie developed a weighted pupil funding model for California in which funding was driven largely by the percentage of economically disadvantaged students, and the number of English learners played no role in elementary schools and only a small role in middle and high schools.⁴³ He suggested that this approach is consistent with the Gándara and Rumberger findings because he also found a significant overlap between English learners and economically disadvantaged students, especially when economic status is measured by eligibility for the free and reduced-price lunch program.

If the Committee were to use free and reduced-price lunch eligibility as the measurement of “economically disadvantaged,” then having English learner status play a less significant role in a funding model might make sense. In fact, that is the approach that other California researchers have proposed recently.⁴⁴ However, the Committee recommends concentrating the state’s additional investments on students with the most significant economic struggles — students living in poverty. The use of that narrower measure of “economically disadvantaged” means that higher numbers of English learners are not simultaneously defined as being economically disadvantaged — yet those English learners who are not living in poverty still have additional

educational needs that must be mitigated. Thus, to ensure that the additional needs of English learners are met, the Committee believes a distinct funding augmentation for English learner students is warranted.

What level of additional investment?

There is no definitive answer to the difficult question of the relative funding need of disadvantaged students. What is clear is that funding levels for disadvantaged students should be significantly higher than for the average student. It also is clear that California's current investment is significantly less than the level in other states, and even smaller when compared to the estimations that adequacy research suggests states would need to make to meet the student outcomes desired by states' accountability systems. Because the Committee recommends using a narrow definition of "economically disadvantaged," the Committee recommends providing a somewhat higher level of per-pupil funding to districts serving these students and distinct funding for English learners. The Committee believes it is important that the targeted funding grants be tied by formula to the base grant funding level; through this linkage, the state can create a dynamic that will adjust the funding levels for the entire model over time.

2.1.4: Provide additional resources for disadvantaged students

The Committee recommends that additional resources be provided to districts in the form of targeted student grants for each student who is "economically disadvantaged" or who is an English learner. To implement these targeted grants in a manner that effectively and appropriately mitigates the education inequities of these students, the Committee specifically recommends the following:

- The state should set the funding formulas for pupils who are "economically disadvantaged" or who are English learners, defined as augmentations of the base per pupil grant in percentage levels appropriate to mitigate these disadvantages.
- Based on its research and deliberations, the Committee recommends that the initial levels of targeted funding be set at a 40 percent augmentation for economically disadvantaged pupils and 20 percent augmentation for English learners.
- As a starting point from which to pursue these funding targets, on a district-by-district basis, the state will transition funding from the current categorical programs that broadly target "economically disadvantaged" students or English learners into the two targeted pupil grants. As the state progressively makes additional investments toward the per-pupil targets, the targeted grants will be equalized across districts to ensure that ultimately all districts receive generally the same level of funding per target student.
- The state should develop an ongoing process to regularly update the funding formulas for these targeted pupils, to ensure that they are current and appropriate. As the state begins to approach the initial funding targets through progressive funding augmentations, the Committee further recommends that the state conduct additional research to determine the effectiveness of the use of these funds and whether additional investments are merited.

The Committee finds that the 40 percent and 20 percent augmentation levels for "economically disadvantaged" students and English learners, respectively, are appropriate midterm goals for initial implementation and can simultaneously serve as a starting place for the more detailed investigation that is warranted by the state. Because California's current investment in these targeted populations is so low, the Committee's recommended initial funding target levels would result in significant additional revenues for most districts compared to their current funding levels.

Once districts have received this funding within the new funding model, they will have flexibility in how they allocate and use this funding — unlike the current conditions that restrict funding use through categorical requirements. One of the current investment problems the state makes is that the funding for "economically disadvantaged" students and English learners can be used only to augment the base program. This means that the programs serving the targeted populations are often outside of, and therefore not well-integrated with, the base education program. The Committee recommends providing districts the flexibility to design their own programs to meet the needs of disadvantaged students in a well-integrated manner.

2.1.5: Consolidate existing categorical programs into the new base augmentation and targeted student grant

As discussed above, research makes abundantly clear that California’s current categorical funding structure is at the heart of the problems with the state’s current school finance system. Because of the many problems identified above, the Committee recommends transitioning the vast majority of current categorical programs into the new funding model. Some have argued that the state should only transition those categorical programs not currently working into the new funding model. However, because of the overlapping nature of the missions of some categorical programs, researchers are unable to untangle which programs are working and which are not, so that evaluations of any specific categorical program often are inconclusive with respect to education effectiveness. Furthermore, there often is no categorical program that is successful in all districts. Instead, a categorical program’s success depends on how a district weaves that categorical program into its comprehensive education plan. For this reason, and to correct the many failings of the research discussed above, the Committee believes that funding from almost all of the categorical programs can be more effectively used if incorporated into the proposed student-centered funding model. During this transition, districts will be able to determine which programs are effective for that district and maintain those programs, while redirecting funding from those programs not working to more efficient uses. Specifically, this recommendation will transition the current categorical funding on a district-by-district basis into either the district’s base grant or the district’s targeted student grant (as described in Recommendation 2.1.4), depending on the original purpose of the categorical program. Appendix D delineates the categorical programs that the Committee recommends be included in this transition to the new funding model, as well as those programs that would be maintained separately.

2.1.6: Ensure that targeted funding gets to schools whose students generate it

Within this funding model, districts serving disadvantaged student populations would be provided substantially increased targeted funds to promote strengthened programs that will lift those students’ achievement. To achieve results, it is important that the services those students need actually reach them at their respective school sites. At the same time, the Committee recognizes that certain district-level services purchased with targeted resources can provide great benefit to targeted students while serving all personnel or all students. The Committee believes that its proposed reforms of finance and governance inherently demand that the primary assurance that targeted students are served by the targeted funds should emanate from an improved accountability system and a school-level accounting system (see Recommendations 2.1.8 and 4.2.2) to ensure that generally the funding gets to the targeted students it is intended to serve. In light of the particularly high stakes attending the substantial augmentations the Committee proposes for these students, however, the Committee recommends the state implement two safeguards until the proposed student-centered funding model and the school and district accountability models (see Recommendations 3.4 and 3.5) are fully implemented:

- For schools meeting both performance and growth targets, require each district superintendent to report annually to his or her board on the district’s budget, specifically identifying the ways targeted funds are to be used to support the students who generate them.
- For schools determined to be chronically low-performing under the new accountability system, require the local school board to ensure that targeted funding is directed to the schools serving those students, allowing minimal exceptions to be approved by the local board where those exceptions can be demonstrated to positively impact the targeted students.

2.1.7: Mitigate skewed incentives to overclassify English learners

Currently, many students are classified as English learners throughout their entire education careers. Recent data from the 10th-grade high school exit exam suggest that more than half of the 10th-grade English learner students have been in schools within the United States for the entirety of their schooling. The system has failed these students. That may not be surprising, because the state has created both fiscal and accountability rewards for overclassifying students as English learners and concomitant disincentives to recognize their successful transition to the general student population.

The Committee recommends that the state limit the number of years any student can be identified as an English learner, thereby reducing the incentive effect created by rewarding districts that do not help their students achieve their reclassification. Districts would receive full additional funding for English learner students for their first three years in the education system. In Year 4, Year 5, and Year 6 of the student’s participation in the system, the district would receive 75 percent, 50 percent, and 25 percent, respectively, of the full English learner funding augmentation for the student. While districts would not receive English learner funding for students after the sixth year and the accountability system would have negative consequences for keeping students classified as English learners for longer than six years, a district would still be permitted to classify a student as an English learner for internal purposes of targeting additional resources from its flexible general funding to meet that student’s language-based needs.

2.1.8: Make school budgets more understandable

The Committee recommends that the state require districts to report the distribution of funding across all district schools, clearly delineating the total resources (i.e., the financial value of the personnel, supplies, and services) that reach each school, as well as the resource level that should be expected to reach each school as a function of its student-centered funding generation. This requirement will allow the public, policymakers, and the accountability system to ensure that targeted funding is generally reaching targeted students.

2.1.9: Ensure equitable funding for charter schools

The Committee recommends that the state ensure that charter schools have equal access to student-centered funding. This would include charter schools receiving equal funding through the student-centered funding model and receiving a block grant in lieu of the few remaining categorical programs that are not consolidated into the student-based funding model. The Committee specifically recommends that the state ensure that charter schools are provided greater access to school facilities and local school facilities bond funds, pursuant to the requirements established in Proposition 39.

Recommendation 2.2: Provide Financial Incentives to Reward Districts and Schools That Succeed

An effective education finance system should include incentives to promote and reward performance. Those incentives should be aligned with education objectives at every level: Districts, schools, and individuals should be rewarded for improving student achievement. Simultaneously, the structural disincentives that stand in the way of high performance must be removed. The Committee recommends that specific funding incentives be created to foster greater student achievement and that all perverse incentives working against achievement be removed, as follows:

2.2.1: Create positive incentives to reward success

The Committee believes that the state should financially reward those schools that succeed, thereby creating a continued focus of the entire system on improving student achievement. The state has previously implemented state-sanctioned reward structures but has done so ineffectively. The Committee identified two pitfalls of prior school reward programs and would urge the state to avoid repeating them: (1) The measure used to determine whether a school received a reward was too volatile; and (2) the combination of a volatile reward and the fact that the funds were only available for one year at a time meant that schools often used the funding on investments that had a low return on supporting future increases in achievement. The Committee has identified a more sophisticated approach that remedies these shortcomings. The Committee recommends that the state provide financial incentives to reward all schools — including charter schools — that succeed, as follows:

- The state would provide financial rewards to school districts on behalf of the schools that were determined to be meeting achievement benchmarks.

- The state would use a measure of the *growth* in student achievement over a multiyear period to determine whether a school would be eligible for a reward, inherently reducing the volatility of the reward program.
- Rewards would be disbursed over several years to ensure that a school could use the funds for ongoing purposes likely to continue the school's success and that they would be able to plan for the loss of that funding if their school's performance changed.

2.2.2: Eliminate disincentives that undermine success

Since the Public Schools Accountability Act began measuring school performance, the state has created multiple categorical programs that effectively “reward” schools or districts that are failing by providing them additional funding *on the basis of their failure*. In part, these investments reflect that the state's overall investment in disadvantaged students has been too low. However, the unintended consequence of these new programs has been to unduly punish schools and districts that have been successful at serving disadvantaged students by discontinuing their targeted funding as they improve, while rewarding the schools and districts that have failed by continuing their funding augmentations. Unfortunately, providing additional funding to failing schools and districts may lead to an inefficient use of those funds, especially if they continue to experience the same capacity limitations or use the same practices that helped produce the initial low performance. The new student-centered funding model will provide a richer funding level for disadvantaged students, intended to support districts' and schools' efforts to address the learning challenges that often attend these disadvantages. These student-centered funds will not differ by a school's or a district's overall academic performance level. The Committee recommends that the state discontinue funding specifically targeted schools with low performance. This reform will eliminate the conflicts between funding incentives and school success.

2.2.3: Promote school site budget authority to reward success

In addition to providing financial awards, the Committee believes that the delegation to schools of budget authority forms an appropriate reward and enhances the benefits of local control. The Committee recommends that the state encourage — but not require — districts to delegate some of their budgeting authority to high-achieving school sites so that school site leadership teams, including administrators and teachers, may make resource decisions they believe will best improve the education attainment of local students. The school inspection system described in the Governance and Accountability chapter of this report will provide districts with data on the capacity of a school site to effectively manage this additional responsibility. For schools that demonstrate continual academic achievement and are identified by the inspector as having sufficient management capacity to effectively execute budget authority, this delegation of authority would be encouraged as an incentive to performance.

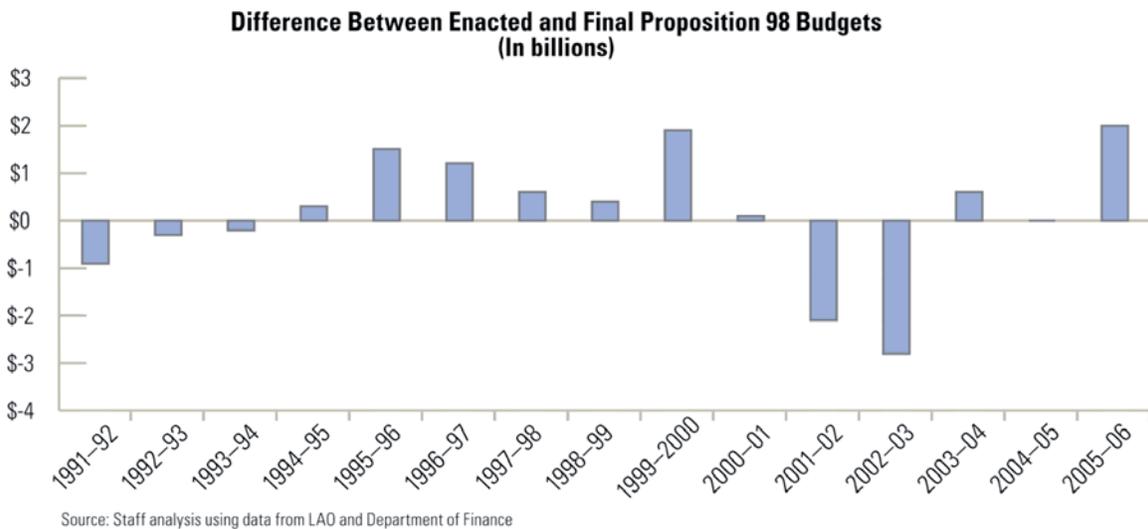
Recommendation 2.3: Create Greater Funding Stability

As discussed at the beginning of this chapter, funding that school districts receive is unstable and unpredictable, with the result that districts' operations are consistently disrupted and their ability to plan for effective use of funding is greatly reduced. The instability and unpredictability of funding is caused by several factors, including the Proposition 98 funding formulas. While Proposition 98 may be an imperfect way of determining funding for schools, at this time the Committee recommends only that technical changes to Proposition 98 be made to improve the predictability of the annual Proposition 98 calculation and the stability of funding over time that results from this funding mechanism. Specifically:

2.3.1: Improve the accuracy of the Proposition 98 calculation

The timing of the current Proposition 98 calculation and apportionment leads to unnecessary volatility of funding for schools, which in turn leads to poor planning by the state and school districts on how to use the funds. In calculating the Proposition 98 formula annually, the state uses *current year* personal income data, but *budget year* General Fund revenues. At the time when a budget is adopted, the actual personal income calculations are known and are locked for the upcoming year; however, the revenue

estimates are an educated guess that always proves to be wrong once April tax returns are known, nearly at the end of the fiscal year. In good economic years, this leads to a “May surprise,” requiring large one-time spending to settle up the current year, and even larger increases for the budget year. In bad years, these miscalculations can require large midyear cuts to schools’ operating budgets, often followed by significant ongoing cuts in the following year’s budget. Looking at historic data for the last decade, these differences in timing for the two formula components have led to final spending in a fiscal year being on average \$1 billion different from spending allocated in the adopted budget act (See chart “Difference Between Enacted and Final Proposition 98 Budgets,” for details).



The Committee recommends altering the timing of the Proposition 98 General Fund revenue numbers to use actual, prior-year revenues. For example, for the Proposition 98 calculation for the 2007–08 budget, the growth in revenues from the 2005–06 year to the 2006–07 year would be used. This small change would yield two benefits. First, it would allow the state to better plan for what Proposition 98 spending will be; this, in turn, would allow districts more time for their planning. Second, it would reduce the volatility caused by the creation and payments of Proposition 98 maintenance factors.⁴⁵

2.3.2: Create a Proposition 98 reserve using Proposition 98 Reversion Account funds

Since Proposition 98 generally follows the state’s economy, education funding goes through boom and bust cycles regularly. During an economic expansion, education funding is required to increase significantly, while in recessions, the state has had to make painful cuts — often eliminating many of the programs created in the expansion. To help reduce the impact of the boom-bust resulting from the current Proposition 98 formula, the Committee recommends that the state create a reserve fund for education within Proposition 98. The state would set aside a portion of any savings from prior-year K–14 education funding into a Proposition 98 reserve. Because Proposition 98 establishes a specific funding level for each year, when the state or districts do not fully spend funding from a categorical program, the funding reverts to the state and is placed in the Proposition 98 Reversion Account, to be reprogrammed for a new Proposition 98 purpose. Currently, half of the Reversion Account funds are set aside to meet the requirements of the *Williams* lawsuit to fund facility maintenance. Within a few years, the state will have fully funded its facility maintenance obligations pursuant to *Williams*. At that point, the Committee recommends annually placing half of the funds from the Reversion Account into a Proposition 98 reserve. In the future, the state would be able to access the reserve in any year that the Proposition 98 minimum guarantee did not provide enough funding to meet the costs of the base program adjusted for growth and COLA. By using savings that occur naturally, the state would be able to protect schools from the bust years, rather than cutting programs or laying off education personnel.

Recommendation 2.4: Improve Special Education Funding

Special education presents a particular challenge to the K–12 funding system. Different from the rest of the finance system, special education funding is administered at the regional level by more than 100 Special Education Local Plan Areas (SELPAs), each with its own governance structure, voting rules, cost-sharing arrangements, and separation of service responsibilities. Special education costs are shared by the federal government, state government, and school districts. The 2006–07 budget provides approximately \$4.5 billion for special education; about \$1 billion of that is from the federal government. Depending on politics and budget conditions, the share paid by the federal/state/local government changes annually. Long ago, the federal government set a target for the share of special education costs it would pay (40 percent of the average cost per pupil) but has never come close to meeting this goal. In fact in recent years, the annual growth in federal funds for special education has not been sufficient to even cover COLA. This often results in the redirection of resources from other education programs to cover the unfunded costs of providing required special education services to students. For decades, the fiscal mechanisms for special education were based on the number of students participating and the type of services provided; as a result, financial benefits would accrue from the over-identification or the over-serving of students. In 1997, AB 602 (Davis) was enacted to address many of these problems.

In general, the Committee believes that by basing special education funding on a proportion of the general student population, the current, census-based special education funding model established by AB 602 (Davis, Statutes of 1997) gets the fiscal incentives right. However, several problems remain within the AB 602 funding structure, and the Committee recommends modifications to it. In addition, the Committee believes several other issues require attention, but they are beyond the Committee’s scope and expertise; the Committee urges consideration of appropriate remedies to those issues, as described below.

2.4.1: Equalize funding across SELPAs

When the AB 602 funding model for special education was developed, the state recognized that the funding per pupil for special education costs was not equal across the SELPAs. As part of the implementation of AB 602, for the next several years the state allocated the growth in federal funding for special education (beyond growth and COLA) to equalize funding levels across the SELPAs. This equalization effort increased the funding per pupil for all districts that were below the statewide average, up to the statewide average. Thus, the bottom half of the funding distribution has been equalized. However, the SELPAs in the top half of the distribution still receive much higher funding annually than those in the lower half. The Committee recommends that the state address the inequities in special education funding across districts, specifically by using a similar approach that has been used to equalize funding for revenue limits in recent years. For revenue limits, the state established an equalization target that was the funding per pupil of the 90th percentile of the distribution. Then, over time, all districts below the 90th percentile target were moved to the 90th percentile funding level. Application of this same methodology to equalize funding across SELPAs would require an increase of some \$300 million in special education funding.

2.4.2: Expand the pool of funding for extreme high-cost students

Recently, districts have faced a significant increase in the number of students they serve who have high-cost learning disabilities. This phenomenon may be related to the rise in autism that has been documented statewide. These high-cost special education students place a significant burden on the districts that serve them and appear to require districts to direct funding away from the base education program to meet these costs. The state currently has a small pool of funds for students who generate extremely high costs. For these students, the state pays a portion of the cost above a specific cost threshold — currently at approximately \$60,000 per pupil and increasing annually by the COLA. The Committee recommends that the state freeze this high-cost threshold for the next five years at its current level instead of letting it grow annually by COLA. As a result, in five years the threshold would remain at approximately \$60,000, rather than growing to approximately \$70,000. This will result in an expansion of the number of students for which the state subsidizes costs and will increase the amount of the subsidy for those students already generating this support. The state will need to increase state funding for special education to implement this policy.

2.4.3: Address shortfalls in federal funding that create inequities

Because of changes in federal law, the state bifurcated special education funding between state and federal funds as part of the 2005–06 budget. While this reform solved several problems, it led to funding inequities in those years when the federal government does not provide enough funding for growth and COLA. Specifically, when federal growth and COLA are underfunded, the shortfall of federal funding falls disproportionately on SELPAs serving growing populations of students. The Committee recommends reforms that solve this inequity and begin to create a track record that documents the underfunding by the federal government. Specifically, the Committee recommends that in years when the federal government does not provide enough funding to cover growth and COLA, the state would first determine the allocation of funding as if the federal government had fully funded special education; then, after determining such a theoretical distribution, the state should apply a “deficit factor,” or proportional reduction to *all* SELPAs, so that the distribution of funding would be commensurate with the actual funds available.

2.4.4: Collaboratively address additional key issues

The Committee believes that several significant special education issues deserve additional attention; however, those issues were either so extremely technical or so complex that to take on these matters would have overwhelmed the Committee’s capacity and resources, impeding its ability to carry out its broader charge. The Committee recommends that the administration engage in a collaborative dialogue with the special education community to develop solutions to address all of the following topics:

- **Special education accountability.** The state has never clearly articulated the outcomes it expects from special education; because of this, there is a general lack of accountability for special education. The absence of an accountability structure makes it difficult to determine whether schools are serving special education students well. The special education community appears ready to seriously engage in an accountability discussion. The Committee recommends that the administration work with the education community to develop a more rigorous accountability system for special education. Through such a process, the state could begin to move away from the compliance-driven approach that still serves as a foundation of special education and begin implementing an increasingly outcome-driven one.
- **Update the special disabilities adjustment (SDA).** The state provides supplemental funding to SELPAs that generally have high numbers of special education students and/or high proportions of high-cost students. Data from 1996–97 are still used for this adjustment. These data must be updated, especially considering the impact of the growth of autism. The state likely will need to collect additional information to update this formula. The Committee recommends that the administration work with the education community to determine the data needed to accurately update the SDA formula and the changes required in the special education data collection process to collect these data and update the formula. Such a process could require three to four years to fully update and fund the formula, but the adjustment is an important one to maintain the integrity of the AB 602 funding model and the confidence of the education community in it.
- **Engage in autism discussion.** Two recent significant activities have started to address the crisis of serving the growing number of autistic students. The Legislature has created a blue-ribbon committee, and legislation has been enacted that authorized the Superintendent of Public Instruction to convene a group to study autism. The Committee recommends that over the next two years the administration actively engage with these bodies to address this difficult education and social service issue.

Recommendation 2.5: Additional School Finance Reforms

Not all financial issues can fit neatly into the student-centered funding model proposed as the principal mechanism for funding K–12 public education in California. The Committee identified three particularly important issues about which it believes the state should take action and makes the following specific recommendations to support them.

2.5.1: Create an ongoing innovation and research fund

As the Committee noted at the beginning of this report, the needs of California’s students and the challenges they face to be competitive in the global economy are constantly evolving. One should similarly assume that the education solutions to those challenges will continually evolve. The Committee therefore recommends that the state provide ongoing funding to test promising new education practices, using a combination of specific pilot projects linked with rigorous data collection and evaluation. The Committee further recommends initially focusing this funding on the evaluation of initial rollout of the new teacher and administrator professional practice models (see Recommendations 1.1 and 1.2), to better inform program elements for subsequent cohorts of participating districts.

Over time, as research describes promising practices in education, additional innovative projects would be funded to determine their appropriateness for implementation in California. Each of these pilots would be evaluated over a multiyear period. At the end of the period, the program would sunset. At that point, the funding for the specific pilot project would be consolidated into the student-centered funding structure of the participating districts, and these funds would count against those districts’ target levels for overall student-centered funding. Each district could then decide whether operating that program constituted a more beneficial investment than other options, using the information provided by the state evaluation. By having these funds count against each district’s target allocation after the pilot period, these pilot districts would not be permanently advantaged for participating in the pilot. This consolidation process is an important one because the state has a poor track record of eliminating programs — even those with poor evaluation results.

2.5.2: Address cost obligations of retiree health benefits

The Committee believes that past and future obligations to fund retiree health benefits present a potential risk to the financial well-being of districts throughout the state, because many districts provide these benefits but have not funded them adequately. The Committee recommends specific actions be taken to ensure that these risks are mitigated.

Districts choose whether to provide health benefits to their retired employees. These benefits are part of a broader group of benefits referred to as “other post-employment benefits” (OPEBs). Some districts provide no OPEBs to retirees; some provide them to retirees only up to age 65; some serve retirees after age 65, but not for life; some offer lifetime benefits; and some offer a combination of these options. Based upon J-90 reporting, in 2005–06 more than half of districts provided some type of OPEBs. The chart “Number of Districts Offering Retiree Health Benefits and the Type of Benefit” shows the breakdown of districts offering various OPEBs.

Number of Districts Offering Retiree Health Benefits and the Type of Benefit

Type of benefit	Number of districts
Up to Age 65	571
Over Age 65, Not Lifetime	68
Lifetime	79
Total	728

Source: School Services of California, Form J-90

The General Accounting Standards Board (GASB) sets national accounting standards for state and local governments, including school districts. Through a statement referred to as GASB 45, the standards board requires school districts providing OPEBs to have actuarial studies completed that estimate the liabilities associated with those benefits using accrual accounting methods

— accounting for benefits that are to be paid in the future at the time that they were accrued. This requirement is being implemented over the next three years. Some districts have had actuarial studies completed recently, to estimate their liabilities, and the findings have been troubling. For example, LAUSD estimates that its unfunded liabilities comprise approximately \$10 billion. While LAUSD has the largest liability in total, at least one district, Fresno Unified School District, has a larger liability on a per-pupil basis. The estimated aggregate cost of these liabilities has been growing significantly as districts have been including in their calculations more accurate assumptions about the factors that determine these costs. Over the next 2.5 years, the statewide magnitude of the problem will be revealed. Although GASB 45 requires school districts to report their unfunded liabilities, it does not require the districts to take any actions to address the costs of meeting these obligations. Because, the size of these liabilities is so large that it threatens the long-term fiscal viability of school districts. And because the state ultimately is responsible for ensuring that students are served, the Committee believes that the state has an obligation to provide fiscal oversight to ensure that the districts offering these benefits can afford to meet the costs of the liabilities over time. To that end, the Committee recommends the state take the following actions:

- **Require districts to develop a plan to address retiree health benefit liability.** Even after reporting a large unfunded liability, districts are under no obligation to take any action to address that liability. For example, despite having identified a \$10 billion liability, LAUSD has not yet taken action to suggest how it will address the obligations either in the short term or the long term. The Committee recommends that every local board be required to adopt a plan to address its unfunded OPEB liabilities, including retiree health benefits. This approach would require a local board to take public action to recognize the cost of these liabilities, and develop a plan to address the liabilities. The plan will provide each local community with an understanding of how its district will maintain its financial solvency in the context of these benefit obligations. Even if the plan were to maintain the pay-as-you-go approach most districts are currently using, the district would become subject to the pressures that accompany public scrutiny.
- **Incorporate OPEB analysis into the AB 1200 process by changing the budget standards and criteria.** The AB 1200 process assesses the fiscal solvency of school districts through the review of their budgets for the current year and two subsequent years. Though long-term liabilities such as those related to retiree health benefits as identified in an actuarial study are reviewed through the evaluation process, so long as these liabilities do not present a threat to the solvency of the district in the current or two subsequent years, a district’s certification is not affected by these liabilities. The State Board of Education administratively establishes the criteria that guide this review process (Budget Standards and Criteria) pursuant to existing statute. Therefore, the Committee recommends that the board update the standards and criteria associated with the AB 1200 review process so that a district with unfunded liabilities that does not have a plan to address these liabilities would receive a “qualified” certification.
- **Require funding of normal cost.** The “normal cost” of providing OPEBs is based on accrual accounting standards. That is, the cost of future benefits accrued in the current year is paid for in the current year. This contrasts with the current pay-as-you-go system, which pays for the cost of future benefits at the time that they are delivered to retirees. The large unfunded liabilities districts face today result from their not setting aside funding for (or paying for) future benefits as they were being accrued by the employees. Therefore, to avoid continued accumulation of unfunded liabilities associated with providing future benefits, the state would require districts offering OPEBs to develop financing plans in their budgets that identify and fund the ongoing normal costs of those OPEBs. This requirement would be incorporated into the AB 1200 fiscal review process. To give districts enough time to adjust to this financial obligation, the Committee recommends implementing this requirement in the near term but giving districts up to five years to adjust their budgets to cover the normal costs. The combination of funding the normal costs and approving a plan to address the current unfunded liabilities will ensure that districts’ fiscal health can be maintained over time.
- **Clarify the use of categorical funding to address these liabilities.** Because it is unclear whether school districts can use state categorical funding to pay for past liabilities, many districts have been paying for these growing OPEB costs from their local General Fund monies. As a result, over time the amount of discretion that a district has is decreased as these obligations grow. Since many teachers are supported by categorical funds, the Committee recommends that the

state allow funding for categorical programs, while they continue to exist as such, to be used to pay the OPEB costs of the retirees that were supported by those funds.

2.5.3: Allow school districts greater autonomy to contract for services

Under current law created by Chapter 894, Statutes of 2002 (SB 1419 Alarcon), a district must prove that it would have a guaranteed cost savings before it is able to contract out an activity. Because it is often difficult to verify efficiencies and prove them in court, districts have been forced to be very conservative about trying to contract out services. Prior to these restrictions, districts were changing practices annually, to have portions of their non-teacher services provided by external providers. Contracting for non-teacher services generally results in lower costs, which can free up funds for other education purposes. Because of the importance of providing school districts with the flexibility to be as efficient as possible, the Committee recommends repealing this statute, and thereby providing school districts with greater contracting authority.

2.5.4: Fully fund state mandates

California's constitution requires the state to pay for the fiscal impact new laws have on schools and districts. There are significant flaws with the process through which the state determines, reviews, and funds state mandates. The Committee believes that the administration should continue to work with the education community and local governments to reform the state mandates process. The administration took an important first step in 2007 when the Governor signed AB 1222 (Laird, Chapter 329, statutes of 2007), which develops an alternative process — which involves negotiation between local government and the Department of Finance — for determining the cost of a mandate. The Committee believes that the administration can make more progress with existing state mandates and improve the way districts are reimbursed for their expenses. (See discussion in Appendix F). However, irrespective of whether progress can be made on the financing mechanism for mandates, the state is required to meet its constitutional obligation by funding the reimbursable mandates annually. The Committee therefore recommends the state fund its existing K–12 mandate obligations, at a cost of approximately \$200 million annually.

Endnotes

¹ Loeb, Susanna, Anthony Bryk, and Eric Hanushek (2007) *Getting Down to Facts: School Finance and Governance in California*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University.

² Multiple reports from the Getting Down to Facts project and other research highlight the complexity of the California school finance system. Getting Down to Facts studies identifying the complexity of California's system include: Susanna Loeb, Jason Grissom, and Katharine Strunk (2007) *District Dollars: Painting a Picture of Revenues and Expenditures in California's School Districts*; Dominic Brewer and Joanna Smith (2007) *Evaluating the "Crazy Quilt": Educational Governance in California*; Thomas Timar (2007) *Financing K–12 Education in California: A System Overview*; Michael Kirst, Margaret Goertz, and Allan Odden (2007) *Evolution of California State Finance with Implications from Other States*; and Thomas Duncombe and John Yinger (2007) *Understanding the Incentives in California's Education Finance System*, Institute for Research on Education Policy and Practice, Stanford University.

³ Kirst, Michael, Margaret Goertz, and Allan Odden (2007) *Evolution of California State School Finance with Implications from Other States*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University.

⁴ The specifics can be found in the California State Auditor report *California Department of Education: The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them*, Summary of Report 2003-107 — November 2003.

⁵ Kirst, Michael, Margaret Goertz, and Allan Odden (2007).

⁶ Loeb, Susanna, Jason Grissom, and Katharine Strunk (2007).

⁷ Reich, Robert (2007) *Equality and Adequacy in the State's Provision of Education: Mapping the Conceptual Landscape*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University.

⁸ Loeb, Susanna, Anthony Bryk, and Eric Hanushek (2007).

⁹ *Ibid.*

¹⁰ Sonstelie, Jon (2007) *Aligning School Finance with Academic Standards: A Weighted-Student Formula Based on a Survey of Practitioners*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University.

¹¹ Examples of papers identifying inefficiency as a problem with the current categorical funding system can be found in Thomas Timar (2004) *Categorical School Finance: Who Gains, Who Loses?* Policy Analysis for California Education. School of Education, UC Berkeley; Thomas Timar (1994) *Policy, Politics, and Categorical Aid: New Inequities in California School Finance*. Educational Evaluation and Policy Analysis; Legislative Analyst's Office (1993) *Reform of Categorical Education Programs: Principles and Recommendations*; Legislative Analyst's Office (2003 and 2004) *Analysis of the Budget Bill for 2003–04 and 2004–05*; and William Dumcombe and John Yinger (2007) *Understanding the Incentives in California's Education Finance System*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University.

¹² Loeb, Susanna, Anthony Bryk, and Eric Hanushek (2007).

¹³ Data from an informal ACSA survey of how site administrators spend their work day (2007).

¹⁴ See Eric Hanushek (2007) *Incentive-Based Financing of Schools*, School Finance Redesign Project, Center on Reinventing Public Education, University of Washington, for a discussion of the role that incentive should play in a school finance system.

¹⁵ Researchers have shown that as states take on a greater share of the financing of K–12 education, the overall level of funding decreases. For examples, see Robert Manwaring and Steven Sheffrin (1997) "Litigation, School Finance Reform, and Aggregate

Educational Spending," *International Tax and Public Finance* and Sheila Murray; and William Evans and Robert Schwab (1998) "Education Finance Reform and the Distribution of Resources," *American Economic Review* (September).

¹⁶ Legislative Analyst's Office (2005) *Revenue Volatility in California*.

¹⁷ Legislative Analyst's Office (2005) *Proposition 98 Primer*.

¹⁸ *Ibid.*

¹⁹ For examples of this debate see Eric Hanushek (1997) "Assessing the Effects of School Resources on Student Performance," *Education Evaluation and Policy Analysis*, Volume 19, and Alan Kruger (2003) "Economic Consideration and Class Size," *Economic Journal*, Volume 113.

²⁰ Loeb, Susanna, Jason Grissom, and Katherine Strunk (2007).

²¹ Loeb, Susanna, Anthony Bryk, and Eric Hanushek (2007).

²² Gordon, Tracey, Jaime Calleja Alderete, Patrick Murphy, Jon Sonstelie, Ping Zhang (2007) *Fiscal Realities: Budget Tradeoffs in California Government*, Public Policy Institute of California, San Francisco.

²³ See the following Getting Down to Facts Reports — Jon Sonstelie (2007) *Aligning School Finance with Academic Standards: A Weighted-Student Formula Based on a Survey of Practitioners*; Jay Chambers, Jesse Levin, and Danielle DeLancey (2007) *Efficiency and Adequacy in California School Finance: A Professional Judgment Approach*; William Duncombe and John Yinger (2007) *Understanding the Incentives in California's Education Finance System*; and Jennifer Imazeki (2007) *Assessing the Costs of K–12 Education in California Public Schools*, Institute for Research on Education Policy and Practice, Stanford University.

²⁴ See Eric Hanushek (2006) "Science Violated: Spending Projections and the 'Costing Out' of an Adequate Education," in *Courting Failure: How School Finance Lawsuits Exploit Judges' Good Intentions and Harm our Children*, Stanford, Education Next Books; and Eric Hanushek (2005) "The Alchemy of 'Costing Out an Adequate Education'" conference paper prepared for the Adequacy Lawsuits: Their Growing Impact on American Education, Kennedy School of Government, Harvard University (paper can be accessed at <http://edpro.stanford.edu/hanushek>).

²⁵ Pérez, María, Priyanka Anand, Cecilia Speroni, Thomas Parrish, Phil Esra, Miguel Socias, and Paul Gubbins (2007) *Successful California Schools in the Context of Educational Adequacy*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University.

²⁶ Hanushek, Eric (2005).

²⁷ Loeb, Susanna, Anthony Bryk, and Eric Hanushek (2007).

²⁸ Sonstelie, Jon (2007).

²⁹ Chambers, Jay, Jesse Levin, and Danielle DeLancey (2007).

³⁰ Imazeki, Jennifer (2007).

³¹ Duncombe, William, and John Yinger (2007).

³² See LAO handout on Economic Impact Aid presented to the Assembly Budget Subcommittee No. 2 on Education Finance, May 2, 2006.

³³ Carey, Kevin (2002) *State Poverty-Based Education Funding: A Survey of Current Programs and Options for Improvement*, Center on Budget and Policy Priorities, Washington D.C. (www.cbpp.org).

³⁴ The Education Trust has a series of reports on “the funding gap”. See the Technical Appendices for these reports for details on how they derived the 40 percent higher funding for economically disadvantaged students. For example, see The Education Trust (2005) “The Funding Gap: Technical Appendix,” (www2.edtrust.org).

³⁵ A series of papers by Standard & Poor’s investigates the efficiency of school districts and requires a cost adjustment for economically disadvantaged students. All of these studies can be found at www.schoolmatters.com. See Martin Hempel (2005a) *Introducing the SES Risk-Adjusted Performance Index*, School Evaluation Services, Standard & Poor’s March 2005; Martin Hempel (2005b) *Measuring Education Productivity in Standards-Based Accountability Systems*, School Evaluation Services, Standard & Poor’s April 2005; Paul Gazerro and Martin Hempel (2004) *Identifying Outperforming and Underperforming Schools*, School Evaluation Services, Standard & Poor’s May 2004.

³⁶ See New York State Department of Education *2007–08 State Aid Projections: Preliminary Estimate of 2006–07 and 2007–08 State Aids Payable Under Section 3609 Plus Other Aids* (download at http://stateaid.nysed.gov/CombAidSA_0708.htm).

³⁷ Massachusetts Department of Education (2007) *The Massachusetts Foundation Budget* can be downloaded at http://finance1.doe.mass.edu/chapter70/chapter_cal.pdf.

³⁸ Florida Department of Education (2006) *2006–07 Funding for Florida School Districts Statistical Report* (www.firn.edu).

³⁹ For a discussion of Oregon’s weights, see Oregon Legislative Revenue Office (2006) *Student Weights: Individualized Education Program*, Research Report No. 7-06 and Oregon Legislative Revenue Office (2006) *Student Weights: English as a Second Language*, Research Report No. 2-06.

⁴⁰ Legislative Analyst’s Office (2003) *The Distribution of K–12 Education General Purpose Funds*.

⁴¹ There are several benefits to unification especially for smaller districts, including improving the efficiency of the district by reducing redundancy in district staffing and improving the alignment of curriculum and programs across grades.

⁴² Gándara, Patricia and Russell Rumberger (2007). *Resource Needs for California’s English Learners*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University.

⁴³ Sonstelie (2007).

⁴⁴ Bersin, Alan, Michael Kirst, and Goodwin Liu (2007) *Getting Beyond the Facts: Reforming California School Finance*, Chief Justice Earl Warren Institute on Race, University of California, Berkeley.

⁴⁵ Proposition 98 allows the state to provide less funding for K–14 education in years when the state General Fund revenues fall or grow slowly (Test 3 year) or when the Governor and Legislature suspend the minimum guarantee. However, in these years, the state creates a maintenance factor equal to the amount that the state funds below the Test 2 funding level. In future years, the state must generally restore the maintenance factor funding when the state has a Test 2 year. Because the difference in time of the Proposition 98 factors leads to the creation and paying off of maintenance factor, it adds to the volatility of school revenues. See the Legislative Analyst’s Office (2005b) *Proposition 98 Primer* for more discussion of the maintenance factor.