

Deregulation of School Aid in California: Revenues and Expenditures in the First Year of Categorical Flexibility

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California's school finance system is notoriously complex. Its critics have long advocated for simplifying funding streams and returning authority to local school boards. In 2009 the state partially acquiesced, giving districts significant flexibility over the funds from 40 categorical programs. This flexibility provides an opportunity to see how districts respond when released from categorical funds. This report highlights preliminary results from an ongoing study of district response to the increased categorical flexibility, generally referred to as Tier 3.

We examine the distribution of Tier 3 revenues and federal stimulus funds from the State Fiscal Stabilization Fund and Title I, Part A (representing two-thirds of total stimulus funds) and provide a first look at how districts spent Tier 3 monies. Because of changes in the accounting and reporting of Tier 3 funds beginning in 2009-10, it will not be possible to track specific changes in future expenditures of these funds, but the analysis here provides a baseline to examine future patterns in total expenditure.

Tier 3 now constitutes six percent of the total revenue for K-12 schools, with considerable variation in the level of funding across districts. This means that the extent to which individual districts benefit from flexibility also varies.

Another source of variation is in how much stimulus funding districts have received. Districts with more Tier 3 funding experienced similar changes in *total* revenue as other districts in 2008-09, in part because they received more stimulus funding. Thus, it is possible that once stimulus dollars run out, those districts will be relatively worse off. Future analyses will continue to track these distributional issues.

Important differences also exist in how districts are using Tier 3 funds and their total funds. Districts with more Tier 3 funds devote relatively smaller budget shares overall to instructional personnel, although they spend relatively more of their Tier 3 funds on this category. So far, we have not seen large changes in how districts are spending their budgets but the current analysis only examines the first year under the new policy. It is possible that as the economy recovers and as districts have more time to address local priorities, we will begin to see bigger changes in spending patterns.

The current analysis is limited in two important ways. First, categorical flexibility was adopted during a severe budget crisis, when most districts were trying to maintain core services; these districts also benefited from an influx of economic stimulus money from the federal government. Thus, it may

be difficult to assess the real impact of any one policy change. Second, the accounting data used for this analysis is quite limited in identifying programmatic changes that districts might be making. The case studies reported later this year in our second report (Fuller et al., 2011) and the survey data being collected this spring will provide a more detailed look inside districts.

Background: Categorical reform in tough times.

Although the Legislature has consolidated or streamlined categorical programs over the decades, about 60 such programs continued to operate in 2007-08, comprising approximately two-fifths of state spending on K-12 education. As part of the February 2009 budget deal, the Governor and Legislature gave districts significant flexibility over the funds from 40 of these programs. SBX3-4 set up three ‘tiers’ of categorical funds.

Tier 1 programs were largely untouched. This tier includes some of the largest programs such as Economic Impact Aid, Special Education and K-3 class-size reduction.¹ Tier 2 programs were subject to funding reductions but program restrictions were maintained. Programs in this tier include the English Language Acquisition Program, Agriculture Vocational Education, Charter Schools Facilities grant, foster youth and state testing. Tier 3 programs were subject

to the largest funding reductions, but districts were allowed to use those funds for any purpose. Table 1 shows a sample of the programs in Tier 3, with their most recent appropriations.²

Tier 3 flexibility began in 2008-09 and will continue until 2012-13. Each district’s annual allocation for Tier 3 programs is based on its 2008-09 allocation.³ Therefore, a district’s Tier 3 allocation will not be connected to any changes in program participation or student needs.⁴ Districts also began receiving stimulus funds from the American Recovery and Reinvestment Act (ARRA) in 2008-09. The stimulus funds were allocated in two fiscal years but can be carried over to 2010-11 as well (most funds are required to be spent by September 2011). These one-time funds flowed through multiple federal programs, including the State Fiscal Stabilization Fund (SFSF); Title I, Parts A and D; Individuals with Disabilities Education Act (IDEA), Part B; child nutrition (the National School Lunch Program); and education for homeless children and youth. The stimulus funds offset at least some of the reductions in state revenues. In particular, appropriations from the State Fiscal Stabilization Fund were directly tied to reductions in revenue limits and in certain categorical programs. Aside from SFSF, the bulk of the stimulus funding was allocated through

Title I and IDEA.

Stimulus revenues filled in holes, but varied across districts.

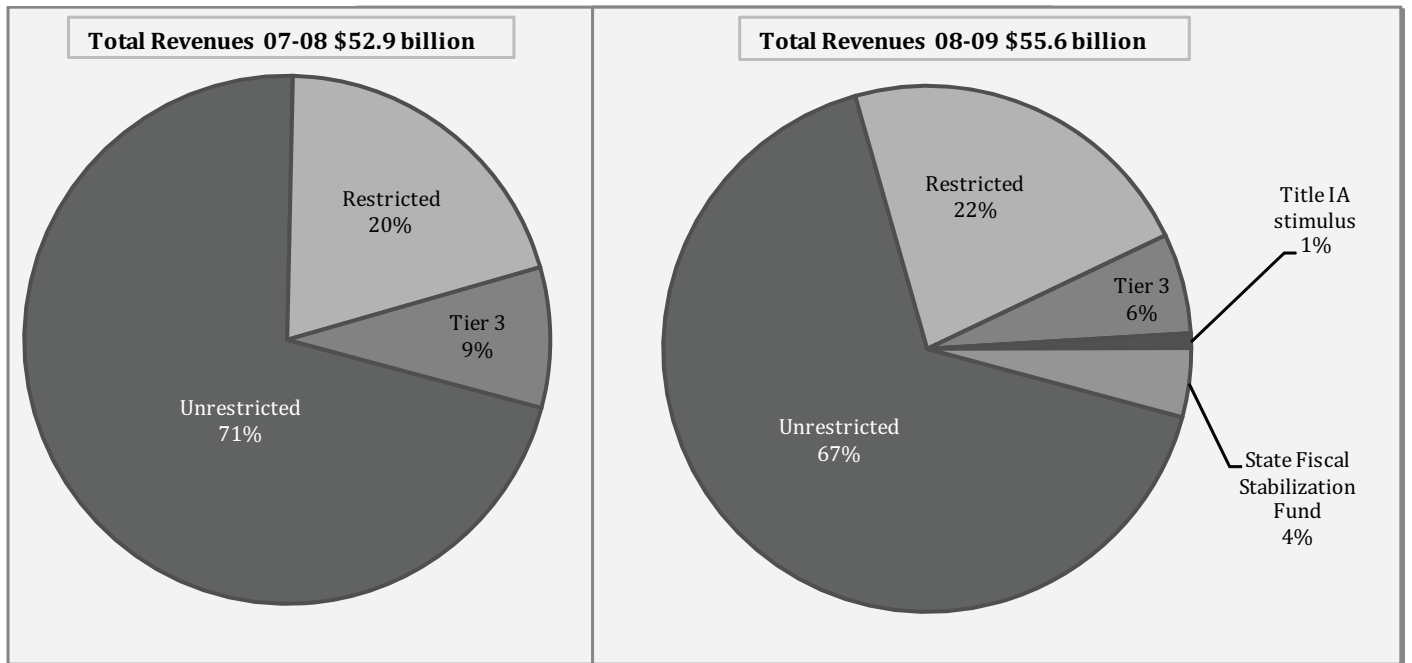
State revenues. The 2008-09 budget agreement that gave districts flexibility over how they could use Tier 3 funds also reduced the total allocation for these programs (along with a reduction in the overall state allocation for K-12 schools). In 2007-08, the average district received \$752 per ADA for Tier 3 programs. In 2008-09 it dropped to \$560. However, because of stimulus funding and other federal funds, *total* district revenues were slightly higher in 2008-09. Thus, average per-ADA district revenue was \$11,382 in 2007-08 and \$11,744 in 2008-09.⁵ As shown in Figure 1, all restricted revenue (including Tier 1, Tier 2, Tier 3, and restricted federal programs) made up 29 percent of total revenues in 2007-08. In 2008-09, Tier 3 became essentially unrestricted revenue and restricted funds (including Title I, Part A stimulus) fell to 23 percent of the total revenues.⁶

District revenues. At the district level, there is considerable variation in the *level* of Tier 3 and stimulus funds, as well as in the *share* of a district’s budget coming from these sources. Tier 3 and SFSF dollars per pupil are greater in remote rural districts and those with higher percentages of students in poverty,

Table 1. Examples of categorical programs folded into the flexible Tier 3 bundle (SBX3-4, February 2009).

Previous categorical program	Statewide funding level (in millions) for FY10
Targeted instructional improvement grant	\$966
Adult education	\$746
School and library improvement grant	\$461
Regional occupational training	\$440
Instructional materials block grant	\$416
Remedial instruction program	\$329
Professional development fund	\$272
Charter school categorical aid	\$226
Class size reduction for grade 9	\$98
Gifted and Talented Education (GATE) programs	\$50

Figure 1. Total district revenue shares, 2007-08 and 2008-09.



Source: Author's calculations using data from SACS. Restricted slice represents Tier 1, Tier 2, and restricted federal programs other than stimulus funding.

which also tend to be districts with the lowest academic performance (Figures 2 and 3).

Tier 3 revenues are noticeably higher in higher-poverty districts, particularly considering that Economic Impact Aid (the largest categorical program targeted on low-income students) is not included in Tier 3. Tier 3 revenue is also higher in high school districts

(see Figure 4) reflecting the fact that many of the Tier 3 programs are geared towards older students (for example, ninth grade class-size reduction, ROP, preparing students for the high school exit exam). Not surprisingly, Title I, Part A stimulus per pupil is highest in large urban districts and in those with the highest proportions of students in poverty.

Are districts with more funds from Tier 3 worse off?

Because funding for Tier 3 programs was cut substantially more than other revenue streams, there may be concern that districts with a relatively large share of these funds were disproportionately hurt by these cuts. These districts may also have higher percentages of poor

Figure 2. 2008-09 Tier 3 and stimulus revenues per ADA by urban status.

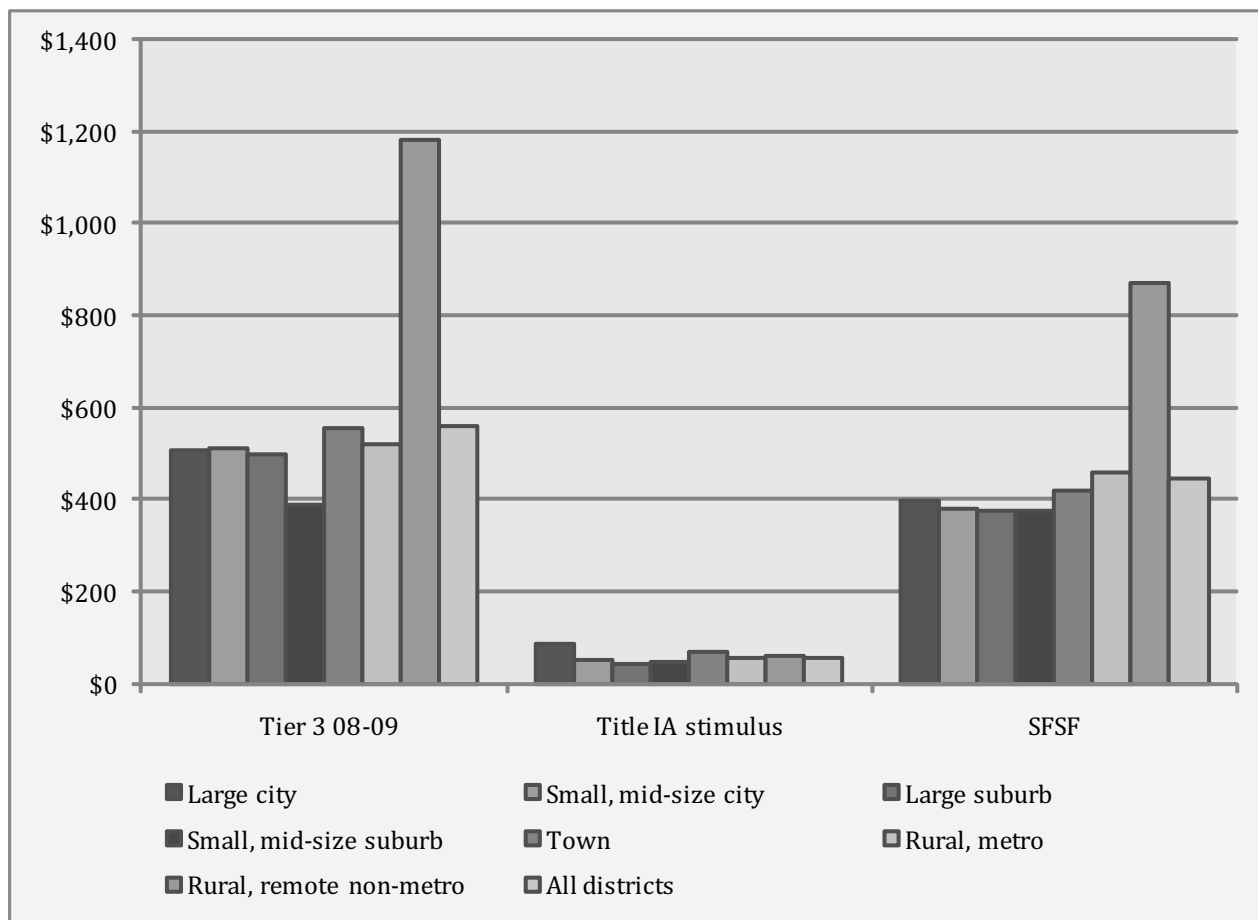


Figure 3. 2008-09 Tier 3 and stimulus revenues per ADA by percent of students in poverty.

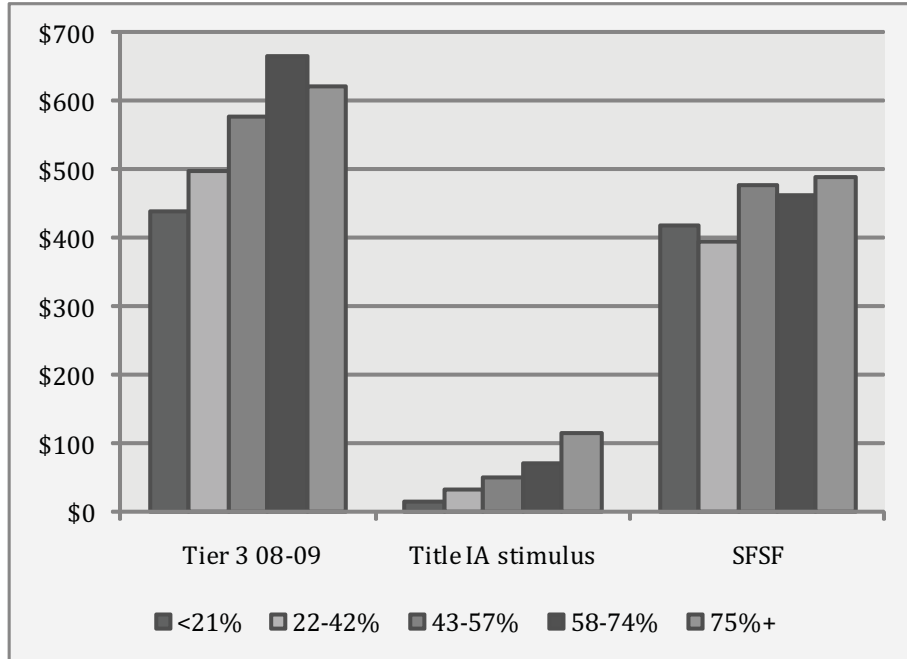
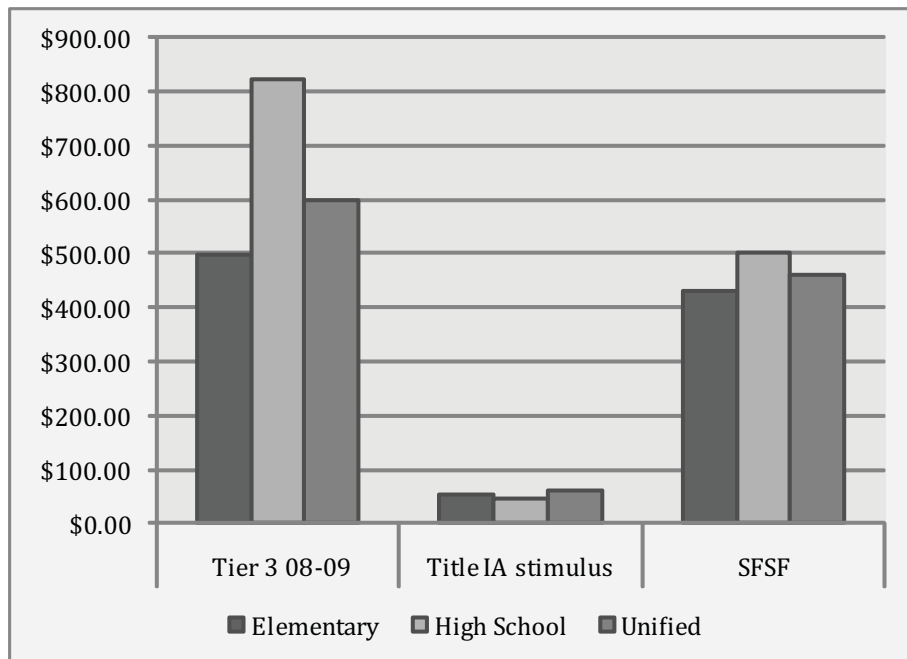


Figure 4. 2008-09 Tier 3 and stimulus revenues per ADA by district type.



and low-performing students. Yet such concerns appear to be unwarranted, at least in the first year under the new policy. Although districts with more Tier 3 revenue did experience a larger drop in the *level* of Tier 3 dollars between 2007-08 and 2008-09, this was a similar percentage drop as that experienced in other districts. This pattern is shown in Table 2. The top panel shows the distribution of Tier 3 revenues and total revenue per pupil for districts with varying levels of Tier 3 revenue. The bottom panel shows the distribution for districts with varying Tier 3 budget shares (that is, the percentage of the total budget coming from Tier 3). For the twenty percent of districts with the highest levels of Tier 3 revenue, the average drop in Tier 3 revenue per pupil between 2007-08 and 2008-09 was \$378, or a drop of 23 percent. By contrast, the drop in revenue was only \$93 for the twenty percent of districts with the lowest levels of Tier 3 revenue, but because these districts have less revenue to begin with, this amounted to a 28 percent drop.

Just as important, districts with the most Tier 3 revenue experienced a similar percentage change in *total* revenue per pupil as did other districts. This is largely because these districts also received more stimulus funding, and because they tend to have higher revenue overall. For example,

districts in the top quintile of Tier 3 funding saw an increase in total revenue per pupil of \$336, or 3 percent, between the two years, while most other districts saw increases of smaller dollar amounts, corresponding to roughly 2 percent of their totals. These patterns are similar if we focus on Tier 3 budget shares instead of revenue levels. However, note that districts with the *lowest* levels of Tier 3 funding, and with the smallest share of their budgets coming from Tier 3 programs, did see substantially *larger* increases in overall revenue than other districts between 2007-08 and 2008-09.

Future allocations of Tier 3 funding will be based on the share of funding received in 2008-09 so the distribution of Tier 3 funding should not change for the next few years. However, stimulus funding was one-time money, appropriated in 2008-09 and 2009-10. Once this stimulus funding is gone, it is likely that we will see a worsening relative disadvantage in total revenue for districts with relatively higher shares of Tier 3 funding.

Too soon to see many changes in district spending.

Prior to flexibility, each of the categorical programs in Tier 3 had

specific rules about how money should be spent. In some cases, districts were required to use the funds to purchase specific *things* (for example, money from Class-Size Reduction was to be spent on personnel). In other cases, the funds could be used to buy whatever things were necessary to fulfill the program's stated *purpose* (for example, money from the Art and Music Block Grant could be used to pay for personnel, materials, or professional development, as long as it supported arts and music instruction). Overall, Tier 3 dollars were largely spent on instructional personnel and 'other instruction,' including books and materials and instructional services (such as travel, conferences and communications services) (Figure 5).⁷ Total expenditures also are concentrated on instructional personnel, but relatively less of the total budget is devoted to other instruction and more of it is devoted to administration and other expenses (such as capital and maintenance).

After flexibility, districts could use Tier 3 funds on whatever things or purposes they desired but we do not see much change in how Tier 3 funds (or all funds) were spent between 2007-08 and 2008-09. There is a slight shift from district administration to instructional person-

Table 2. Tier 3 and total revenues per ADA 2007-08 and 2008-09.

Quintiles	Tier 3 Revenue per ADA 07-08	Tier 3 Revenue per ADA 08-09	Change in Tier 3 revenue	Percent change in Tier 3 revenue	All Revenue per ADA 07-08	All Revenue per ADA 08-09	Change in all revenue	Percent change in all revenue
Tier 3 revenue per ADA								
1	\$333	\$241	-93	-28%	\$9,019	\$9,863	\$841	9%
2	\$444	\$322	-122	-27%	\$9,755	\$9,907	\$160	2%
3	\$565	\$401	-164	-29%	\$10,446	\$10,621	\$180	2%
4	\$766	\$569	-197	-25%	\$11,523	\$11,825	\$298	2%
5 (highest)	\$1,653	\$1,268	-378	-23%	\$16,177	\$16,555	\$336	3%
Tier 3 share of All Revenues								
1	\$404	\$309	-96	-24%	\$12,724	\$13,578	\$827	9%
2	\$470	\$332	-137	-30%	\$10,171	\$10,427	\$250	2%
3	\$581	\$425	-156	-26%	\$10,270	\$10,365	\$102	2%
4	\$753	\$531	-222	-29%	\$10,440	\$10,520	\$82	1%
5 (highest)	\$1,554	\$1,203	-343	-24%	\$13,296	\$13,851	\$559	3%
State Total	\$752	\$559	-190	-27%	\$11,382	\$11,744	\$364	3%

Source: Author's calculations using data from SACS. Each row represents 20 percent of districts, ordered by Tier 3 revenue per ADA (panel A) or percent of all revenues coming from Tier 3 (panel B). For example, for the 20 percent of districts with the highest levels of Tier 3 revenue, the average drop in Tier 3 revenue per pupil between 2007-08 and 2008-09 was \$378, or a drop of 23 percent; it was only \$93 for the 20 percent of districts with the lowest levels of Tier 3 revenue but, because they have less revenue to begin with, that amounts to a drop of 28 percent for those districts.

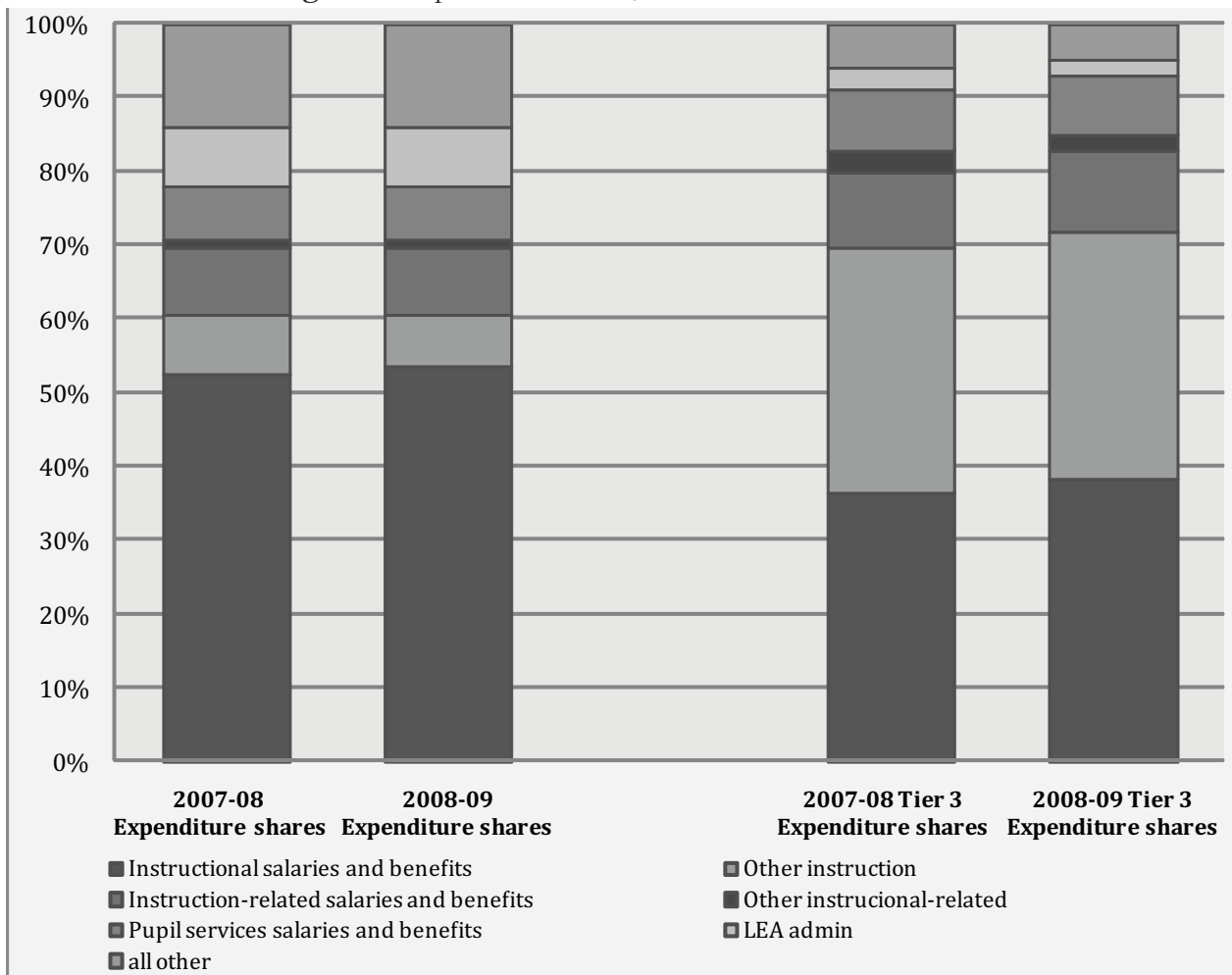
nel, but for the most part, districts did not make dramatic changes in their spending patterns. However, there are two caveats. First, flexibility provisions went into effect more than halfway through the 2008-09 academic year so it is not particularly surprising that we do not see very large changes in how districts used the Tier 3 funds, or in overall spending patterns. They simply did not

have much time to implement many changes.

The second caveat is that the state-wide SACS accounting data is quite limited for identifying the *purpose* for which items were bought. Survey data (LAO, 2010) and case study evidence (Fuller et al., 2011) suggest that districts *have* used their new flexibility to shift funds around, but it may

be that the shifts have been more in the *purpose* for which something was purchased rather than in the *item* bought. For example, if a district had been using funds from the CAHSEE Intensive Instruction and Services program to pay for tutors, it would be considered an instructional salary expense. If those funds were moved into the general funds to pay for a teacher's aide that would otherwise

Figure 5. Expenditure shares, 2007-08 and 2008-09.



Source: Author's calculations using data from SACS. The 'other instruction' category includes books and materials, and services. The 'instruction-related' category includes supervision and administration; library, media and technology; and school administration. The 'pupil services' category includes counseling and health services, food services and transportation.

have been laid off in 2008-09, that would still be considered an instructional salary expense in the SACS.

Critics of categorical funding generally argue that state-level ‘one-size-fits-all’ policies prevent districts from using resources in the ways that best serve the needs of their particular students. The implication is that loosening these restrictions will lead to innovation and more efficient spending. Thus, in normal times, one might expect to see districts using fiscal flexibility to make more dramatic changes. However, a) even if districts did shift funds to serve local priorities, we may or may not be able to identify those changes in the accounting data and b) because Tier 3 flexibility was implemented during a time of fiscal stress, many districts may have used their Tier 3 funds simply to plug holes left by cuts in their budgets. Thus, the overall pattern of spending may not appear very different.

Variability in how districts currently spend categorical funds.

Although there was little change in overall expenditure patterns between the two years, interesting differences in expenditure patterns between districts do appear. Table 3 shows expenditure shares for Tier 3 and total spending in 2007-08 and 2008-09, broken down by the amount of Tier 3 revenue received. Districts in the top quintile of Tier 3 revenue

spend relatively more of their Tier 3 monies on instructional personnel (an average of 45 percent in 2008-09, compared with 33 percent for the bottom quintile) but they spend relatively less on this category overall (48 percent, compared with 56 percent for the bottom quintile).

High Tier 3 districts also spend slightly more on district administration and pupil services (the latter is perhaps not surprising, given that these are districts with more students in poverty). Districts with less revenue from Tier 3 programs are more likely to spend Tier 3 revenue on ‘other instruction’, including instructional materials and services (45 percent, compared to 23 percent for the top quintile) although their relative spending in that category overall is similar to other districts (7 percent for all districts).

Conclusion.

For many years, critics of California’s finance system have bemoaned the fact that local districts have little control over either their level or use of revenues, particularly since research has shown that more local control over resources is related to better student outcomes (Loeb and Strunk, 2007). The heaviest criticism has been leveled at the state’s myriad categorical programs, which tie funds to specific students or purposes and come with extensive regulations. On the one hand, Tier 3 flexibility is an

opportunity to see how districts respond when released from these categorical strings. On the other hand, Tier 3 flexibility was adopted during a severe budget crisis, and most districts have been trying simply to maintain core services. So it is difficult to isolate the discrete impact of this policy change. This report highlights preliminary results from an ongoing study of district response to the Tier 3 flexibility, focusing on the level and distribution of Tier 3 and stimulus funds.

The data reveal considerable variation in how Tier 3 and stimulus funds are distributed across districts. Although districts with relatively more Tier 3 funding experienced similar changes in total revenue as other districts in 2008-09, that was partly because they received more stimulus funding. Once the stimulus funds run out, those districts may be relatively worse off.

We also see that districts with more Tier 3 funds devote relatively smaller overall budget shares to instructional personnel, although they spend relatively more of their Tier 3 funds on this category. So far we have not seen large changes in how districts are spending their budgets, but the current analysis only examines the first year under the new policy. The SACS data is limited in the detail with which we can document changes. It is possible that as the economy recovers and as districts have more

Table 3. Expenditure shares by Tier 3 revenue levels.

Quintiles of Tier 3 Revenue per ADA	Expenditures per ADA	Instructional salaries and benefits	Other instruction	Instruction-related salaries and	Other instructional-related	Pupil services salaries and	LEA admin	All other
Tier 3 expenditures 2007-08								
1	\$312	33%	43%	9%	3%	7%	2%	3%
2	\$407	34%	38%	11%	3%	7%	3%	4%
3	\$509	35%	33%	12%	4%	9%	3%	4%
4	\$708	38%	29%	11%	3%	9%	3%	8%
5 (highest)	\$1,407	42%	23%	9%	4%	9%	3%	11%
Tier 3 expenditures 2008-09								
1	\$236	32%	45%	9%	2%	7%	2%	3%
2	\$311	35%	37%	12%	3%	7%	2%	4%
3	\$384	37%	33%	11%	3%	10%	2%	4%
4	\$564	41%	27%	13%	2%	8%	2%	7%
5 (highest)	\$1,209	45%	23%	10%	2%	9%	2%	9%
All expenditures 2007-08								
1	\$9,061	55%	8%	9%	1%	6%	8%	12%
2	\$9,751	55%	8%	9%	1%	7%	8%	12%
3	\$10,690	52%	8%	10%	1%	7%	8%	14%
4	\$11,271	51%	8%	9%	1%	7%	8%	14%
5 (highest)	\$15,933	46%	8%	9%	2%	9%	10%	15%
All expenditures 2008-09								
1	\$9,415	56%	7%	9%	1%	6%	8%	13%
2	\$9,700	56%	7%	9%	1%	6%	8%	12%
3	\$10,054	54%	7%	10%	1%	7%	8%	13%
4	\$11,573	52%	7%	9%	1%	7%	8%	15%
5 (highest)	\$15,691	48%	7%	10%	2%	9%	10%	15%

Source: Author's calculations using SACS data. Each row represents one-fifth of districts, ordered by Tier 3 revenue per ADA.

time to assess local priorities, we will begin to see bigger changes in spending patterns; this may be particularly true among districts that have relatively more funding from Tier 3 and thus more flexibility. Unfortunately, the 2009-10 accounting data, and that of future years, will no longer identify

Tier 3 funds separately, so future analysis must focus on the pattern of overall expenditures. Successive years of budget cuts have intensified uncertainty for districts. Substantial categorical aid flexibility is one of the few changes that could potentially make life easier for districts. In addition, federal

stimulus dollars have blunted the state cuts, at least in the short run. As the state and federal economic landscapes evolve, it remains to be seen whether districts will use their increased local control to make changes that will have a measurable impact on student outcomes and other local priorities.

Endnotes

¹ Some class-size regulations were loosened, but the appropriation for K-3 class-size reduction was not cut.

² Districts were also allowed to spend ending balances in most categoricals for any purpose. They received increased flexibility through provisions that relaxed requirements related to maintenance, class-size reduction and instructional materials.

³ For a small number of programs, 2007-08 is used as the base year to account for issues related to participation rates.

⁴ Specifically, a district's allocation will be based on its relative share of program funding the base year. If a district received 1 percent of the program funding in 2008-09, it will receive 1 percent of the program funding in each of the succeeding years. The dollar amount will only change if the total state appropriation for that program is changed.

⁵ All revenue numbers are based on district data from the Standardized Accounting Code Structure (SACS) with the exception of revenue for stimulus funding which is taken from the appropriations files available from the California Department of Education. This does not include revenues allocated to county offices or other local entities, and a small number of districts were not included because of missing data; the data here represent 961 districts in 2007-08 and 955 districts in 2008-09.

⁶ In both years, the 'Restricted' slice represents Tier 1, Tier 2, and restricted federal programs other than stimulus funding. This is a higher share of the total budget in 2008-09 largely because unrestricted state funds fell.

⁷ The instruction-related category includes supervision and administration; library, media and technology; and school administration. The pupil services category includes counseling and health services, food services and transportation.

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