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Categorical School Finance: Who Gains, Who Loses?

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Categorical School Finance: Who Gains, Who Loses?

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EXECUTIVE SUMMARY

Over the past 30 years, a combination of court rulings, legislative enactments, and voter initiatives has made dramatic changes in the landscape of education governance in California. The presumption of local control, a system based on local electoral accountability, has been superseded by a system of centralized, administrative accountability. Among the most sweeping changes are those that affect the way in which the state's public schools are financed. Until 1980, paying for elementary and secondary education was largely a local matter. Local property taxes paid most of the bills. The state provided some funds for special purposes and guaranteed a funding floor. However, the state had very little to say about how those monies could be spent. The present system is much different. How much money a district gets and how that money is spent is decided primarily in the legislature, not in local communities by school boards.

This paper examines changes in California's school finance system over the past 35 years. It focuses specifically on the growth of categorical program funding. The study assesses the nature and magnitude of changes, the causes of those changes, the significance of those changes for the capacity of schools to provide high quality educational services, and proposes alternative models to the existing system of categorical funding. The specific context for assessing the changes in the structure of school finance is its impact on equity, adequacy, flexibility and choice, efficiency, predictability and stability, rationality, and accountability.

Findings

- Since 1980, there has been a dramatic change in the share of funding between restricted (categorical) and unrestricted (general purpose, revenue limit) funding. Measured in constant dollars, unrestricted funding declined, on average, by 8 percent, while categorical funding increased by 165 percent. Schools receive, on average, about $355 less per pupil in unrestricted funds today than 20 years ago. If the share of funding had remained the same, it would amount to nearly $32,000 per classroom of 30 students.
- In 2001-02, there were 124 categorical programs in education totaling just under $13 billion. However, 24 of them comprise 88 percent ($11.4 billion) of total funding.
- There is considerable programmatic overlap, even among the 24 largest categorical programs. In general, all 124 categorical programs fall into ten categories.
- The allocations of some the largest categorical programs are regressive and most likely out of compliance with the California Supreme Court's *Serrrano* decision. The Court exempted categorical programs from equalization on grounds that they served a *rational, compelling* state interest.
  - While Economic Impact Aid (EIA) is generally related to measures of student need, it is at best a weak relationship.
  - Supplemental Grants, Targeted Instructional Improvement Program funds, and School Improvement funds are regressive and unrelated to any measures of need, either student disadvantage or academic performance. In some instances, the lowest need students receive the highest levels of funding.
- School finance in California has shifted from a demand-driven to a supply-side system of funding. Education funding is based on the availability of state revenue, *not on the real cost of providing education services* in any given district.
- Absent major restructuring of the system of school finance in California, the growth of categorically funded programs is likely to continue.
- Categorical funding reform needs to be based on a complete restructuring of the logic and principles of non-revenue-limit funding.
- Categorical funding should be tied to a system of planning and accountability. Categorical budgeting at the school and district should be based on needs assessments, planning, and evaluation.

The Context of California School Finance

As a consequence of a combination of court rulings, legislative enactments, and voter initiatives, traditional patterns of school governance in California have changed dramatically over the past 35 years. The presumption of local control, a system of governance based on local electoral accountability—the system in place for the previous 150 years—has been superseded by a system of centralized administrative accountability. Decisions regarding resource allocation; curriculum; student, parent, and teacher rights; student assessment; and student promotion and graduation standards used to be matters of local discretion, but are now made at the state level. Since enactment of the Public School Accountability Act (PSAA) in 1999, the state can take over "failing" schools and fire teachers and principals. Districts are subject to voluminous state and federal regulations and reporting requirements. The state tells teachers how to teach reading and tells teachers and administrators how to behave with parents. There are few areas of teaching and learning that are not subject to legislative mandate.

The most sweeping changes, however, have been in school finance. Until about 1980, paying for schools was pretty much a local matter: local property taxes paid most of the bills. The state provided some money, mostly a guaranteed floor, but had very little to say about how those dollars could be spent. The state picked up the tab also on unusual costs like transportation or special education. It is a very different system now. How much money a district gets and how that money is spent is decided primarily in the legislature, not in local communities by local school boards.

This paper examines changes in California's school finance system over the past 35 years. It focuses specifically on the growth of categorical program funding. The study assesses the nature and magnitude of changes, the causes of those changes, the significance of those changes for the capacity of schools to provide high quality educational services, and proposes alternative models to the existing system of categorical funding. The specific context for assessing the changes in the structure of school finance is its impact on equity, adequacy, flexibility and choice, efficiency, predictability and stability, rationality, and accountability.

School Funding Prior to Proposition 13

The state's school finance system prior to *Serrano* and Proposition 13 was a local affair. When the *Serrano*[1] suit was filed in 1968, roughly 60 percent of funding for schools came from local property taxes, about 35 percent came from state revenues, and the remainder from federal sources. The state's share was allocated through a foundation system designed to assure a minimum level of expenditure in each district. State aid comprised two components: basic aid, a constitutionally guaranteed $125 dollar per pupil grant to all districts, regardless of local property tax wealth; and equalization aid, which was based on a combination of property values (assessed valuation) and the local tax rate (the computational tax rate). Supplemental aid was available to very poor (very low assessed valuation per pupil) districts that were willing to tax themselves at high rates.[2]

Each year, school districts developed their operating budgets and calculated the local property tax and state revenues available to them. If proposed expenditures exceeded anticipated revenues, local school officials could ask voters to approve an increase in local tax rates. Between 1960 and 1970, per pupil expenditures in constant dollars increased by 56 percent, and between 1960 and 1980 by 110 percent.[3] Funds to districts were unrestricted, in the form of block grants. How those funds were allocated at the district level, was largely a consequence of local decisions regarding teacher salaries, the nature and number of program offerings, and infrastructure needs. The school finance system in 1969 – 70 provides the context for evaluating the current system and the ways in which it has changed. While adequacy and equity have become the salient school finance issues, other features of school finance systems are equally important.

Adequacy. As noted above, school funding increased dramatically, 110 percent in inflation-adjusted dollars between 1960 and 1978, just before Proposition 13. During that period, per pupil revenues in real (adjusted for values in 2000) dollars grew by $2,836 from $2,586 to $5,422. In operational terms, this meant an increase of $85,000 per classroom of 30 students. While the state set a minimum tax rate for districts, nearly every

district in the state exceeded the minimum. Tax overrides and bond approvals for facilities construction and renovation required a simple majority vote.

Stability and predictability. Property taxes, which comprised 60 percent of California school revenues in 1960, have been and remain today an important element of local government financing.[4] A virtue of the property tax is its stability. The tax does not fluctuate with economic cycles, producing a fairly steady revenue stream even during economic downturns. On the other hand, tax revenues increase with increased economic activity and growth. As communities grow, so do property tax revenues.

Flexibility and choice. In his classic article on local government finance, Charles Tiebout proposed that communities served as public markets by offering residents different baskets of public goods. Individuals and families vote with their feet and locate in the community that offers the bundle of public services and taxes that are consonant with their preferences for public goods and are provided at a price that suits their pocketbooks.[5] The school finance system allowed communities to match educational services with community preferences and the ability and willingness to pay for them.

Efficiency. On average, local budgets were fairly closely aligned with the actual cost of educational services. The discretionary use of education revenues embodied the principle of subsidiarity, the principle that decisions should be made by those units of government that are closest to the people who will be affected by them. Inasmuch as local school revenues comprised a combination of local and state discretionary funds, districts could target funding according to specific needs and priorities. Some districts chose to pay teachers high salaries in order to attract the best teachers. Other districts might have chosen to spend more on students with special needs and yet others on facilities.

Rationality. The funding system was simple to understand and easy to administer. Almost all funding was unrestricted. In addition to equalization and basic aid, the state provided for excess costs, such as transportation in rural districts. Basic aid was a flat $125 per pupil grant to all districts. Equalization aid was computed by multiplying a computational tax rate times the local assessed valuation per pupil, adding the $125 basic aid grant, and subtracting the result from the state-guaranteed foundation—$355 per elementary and $488 per high school student in 1969. If the result was positive, the state paid the amount as equalization aid. If the result was negative or zero, the district received only the $125 basic aid grant.

Accountability. School finance was based on a system of local, electoral accountability. Accountability was exercised through local boards of trustees, who stood for election every four years, and, in turn, appointed the superintendent. If communities believed that their tax dollars for education were not well spent, they could replace both the board and the superintendent.

Equity. A feature of the state's school finance system that attracted reformers in the 1960s was the dramatic difference in expenditures, property wealth, and tax rates from one community to another. In spite of state equalization efforts, significant disparities in per-pupil funding among districts persisted.[6] Per pupil expenditures in 1969-70 in unified districts varied from a low of $612 to a high of $2,414, with a median of $766.[7] Reformers pointed particularly to the disparities in tax rates among communities and the differences in per-pupil funding associated with them. Low-wealth districts had to tax themselves at higher rates than high-wealth districts in order to generate equal revenues per-pupil. The often-used example was the difference between Beverly Hills and Baldwin Park. Beverly Hills had a per pupil expenditure of $1,232 in 1968-69. Baldwin Park, just a few miles away, spent $577 per pupil. Assessed valuation per pupil in Beverly Hills was $51,000, while in Baldwin Park it was $3,700. This meant that Beverly Hills could generate over twice as much in revenues as Baldwin Park, but with a fraction of the tax effort.

The state's response to inequalities in funding was twofold: it provided foundation and supplemental grants to districts, as noted earlier, and it provided categorical funding for special needs. As the *Serrano* plaintiffs succeeded in showing, neither was sufficient to equalize disparities in tax wealth or student need.

The Political Economy of Categorical Funding for Education in California

While all states and the federal government rely on categorical funding in order to influence local spending decisions, the growth of categorically funded programs in California is unusual among states. Over a 20-year period the legislature has multiplied the number of categorical programs more than six-fold. This section examines the historical development and political causes of this growth.

By the mid-1960s, the educational system came under increasing pressure to serve *all* children, including "ethnic, cultural, and linguistic minorities, the poor, the handicapped, children of migrant families, and poorly motivated students. As attention began to focus increasingly on categories of student need, separate programs were created to deal with those specific needs. Each program soon had its own bureaucracy as well as its own funding and monitoring system."[8]

While federal funding for vocational education and so-called "Impact Aid"[9] had been in existence for some time, the program that expanded the scope of categorical program funding for education was the Elementary and Secondary Education Act of 1965. Initially funded at about $2 billion, by 1976 Office of Education (USOE) programs assisting elementary and secondary education had grown to over $4 billion. Of this, Title I comprised the largest share at just over $2 billion. With the money came an entirely new regulatory bureaucracy and system of compliance monitoring. To assure that federal dollars reached those students for whom they were intended, the federal government imposed reams of rules and stringent reporting requirements on states and schools.[10] The resulting regulatory framework was largely in response to flagrant violations by some schools of both the spirit and intent of Title I to serve disadvantaged students.

The trajectory of categorical program funding in California since 1970 shows that until the 1980s categorical funding comprised a modest portion of overall per-pupil funding. Initially, categorical funding was targeted to cover district excess costs such as transportation. Only later, after congressional enactment of PL 94-142, did categorical funding begin to increase.

In California, one of the earliest categorical programs targeted to the special needs of urban students was "Meade Aid," named after Assemblyman Ken Meade.[11] By 1980, there were 17 state-funded categorical programs comprising, on average, 13 percent of total K-12 funding. In addition to Special Education and EIA, they included programs such as Bilingual Education, Drivers' Training, Mentally Gifted Minors, Educational Technology, and Environmental Education. Most programs were funded from the state's general funds. Others, such as Environmental Education, were funded through the Environmental License Plate Fund.

By 2001-02, there were 124[12] categorically funded state programs in education. Some programs duplicate one another; others make minor modifications in existing programs. There are, for instance, four or five funding streams targeted to school safety. There are also a dozen programs scattered among various providers—districts, county offices, higher education—for staff development. Efforts to catalyze or improve educational technology in schools are scattered among half a dozen programs. Various other programs target language learners, disadvantaged students, and school improvement.

This dramatic expansion of categorical funding is attributable to a number of causes. They include the changing policy context of education policy and specifically education finance, as well as changes in the political dynamics of school finance. The factors that have led to the expanded use of categorical funding are discussed below.

Benign neglect. In the aftermath of the United States Supreme Court *Brown v. Board of Education* decision, attention focused on children with special needs and on the fact that in many local school districts the needs of many students—handicapped and non-English speaking, for instance—were largely ignored. While some schools did attend to students with special needs, there was no institutionally anchored policy to define the scope and nature of those services. The United States Supreme Court's decisions in the *PARC* and *Lau v. Nichols* cases gave rise to new programs and policies to target resources specifically to disabled and non-English speaking students. Targeted funding became

the policy instrument of choice for assuring that funds reached intended student populations and that the special services that students required would be provided.

Reapportionment. Senate reapportionment in California after the United States Supreme Court's decision in *Baker v. Carr* altered the balance of power in California's state legislature. The Senate changed from county to population representation. The Assembly was similarly reapportioned according to population. The consequence of reapportionment was to shift power from rural areas to urban, more densely populated areas. The shift in representation gave rise to an interest in urban policy issues—education among them.

Federal compensatory programs. Congress enacted the Elementary and Secondary Education Act (ESEA) in 1965. Its passage was a milestone in education because it represented a major expansion of the federal role in education. It also represented a delicate compromise among contending forces: those who wanted general aid to public schools and parochial schools, which claimed equal entitlement to education. The compromise was to target money not to schools, but to needy children. The regulatory stringency that came to be associated with categorical finance developed to guarantee that federal funds reached their intended beneficiaries.

Serrano. The California Supreme Court's *Serrano* decision required the state to equalize funding among districts. The Court differentiated, however, between general aid—"general revenue limit funding"—and special purpose, categorical, funding. The Court held that categorical funds were not subject to the equalization provisions of *Serrano* since they addressed special needs. Thus, the Court allowed that schools could be funded by two streams, general purpose funds and special purpose funds.

Proposition 13. In addition to the limitations it places on local finance capacity, its main feature is to shift school finance decision making from districts to the state. With the exception of a handful of so-called "basic aid" districts, how much money a district receives is determined by the legislature. Unless a district exceeds its state-determined revenue limit (only 60-odd districts in the state do) increases in local property taxes do not result in higher per pupil revenues for districts. Proposition 13 did allow districts to seek additional local revenues; however, they require a two-thirds majority vote for passage. Only a handful of districts, mostly affluent ones, have been successful in obtaining voter approval for new, local tax revenues. After passage of Proposition 13, the state legislature determined how much money schools would get and what strings would be attached to those monies.

Proposition 98. Passed by voters in 1988, Proposition 98 assigned to K-12 and community colleges a constitutionally protected portion of the state budget by guaranteeing a minimum level of funding. The measure's intent was to provide stability and predictability in K-12 and community college funding from year to year. While it has provided a guaranteed funding base, its major impact has been to use the state budget as a policy tool. Because policy makers often do not know how much money will be available for the following year's budget and because 40 percent of general revenues must go to K-12 and community colleges, there is a last-minute scramble to spend money, as illustrated in the class-size-reduction measure. Rather than putting money into general revenues for schools, legislators increasingly target funds for special purposes. There are a number of reasons for this: some policy makers do not want to fund general revenues because they believe it will go to teachers' salaries—already the highest in the nation; others simply want funds to go to programs that will bear their names. While the number of categorical programs grew at a steady rate throughout the 1980s, their growth accelerated exponentially after 1988.

Growth of categorical lobbies. Categorical programs have created an army of constituencies whose continued existence depends upon continued categorical funding. "Demonstration" programs in reading and mathematics, for instance, continue for decades. Moneys continue to flow to programs long after the purpose for those programs has disappeared. Voluntary and Court-Ordered Desegregation, for instance, is a categorical program that provided funds to school districts that were under court desegregation orders. Additional funds were meant to assist district to desegregate schools. However, little is know about the use of

such funds, the rationale for their expenditure or the rationale for their allocation. Once the money spigot is turned on, it is virtually impossible to shut off. Programs create constituencies that depend on those programs. Constituencies supporting the gifted and talented and vocational education programs, for instance, are well organized and politically mobilized. Categorical lobbies are successful because they form networks with legislators and legislative staff. Economic Impact Aid, for instance, is supported by a network of classroom aides. Programs to combat school violence have reified and, thereby, marshaled school counselors, who, with a host of public safety experts, argue the importance of continued funding of programs to improve school safety. Because of the lobbies that organize in response to programs, once a categorical program is in place, it is virtually impossible to eliminate.

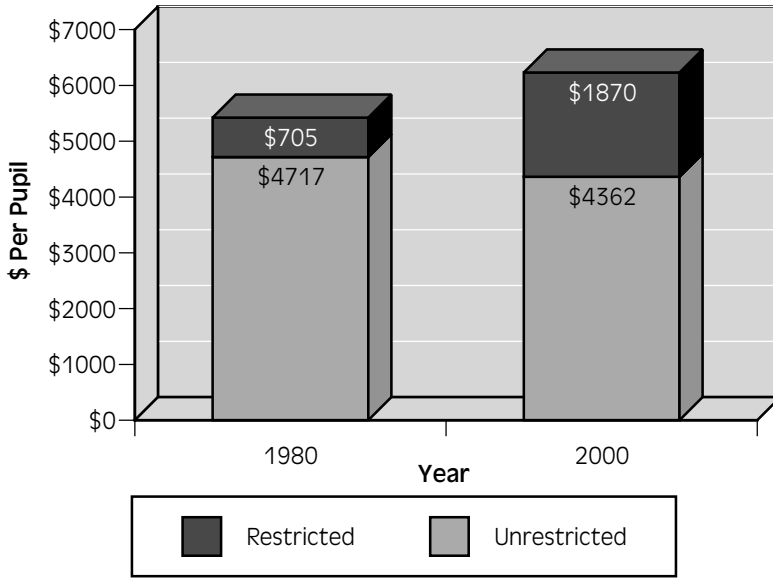
Legislative micro-management. The drift toward state centralization of education governance over the past 30 years has culminated in legislative micro-management of schools. Increasingly, policy makers in Sacramento have come to believe that they can better target resources to educational needs than district officials. The desire to keep additional dollars, especially those that are guaranteed through Proposition 98 from going to teachers' salaries was largely responsible for legislative targeting of school funding into "protected" categorical programs.

The legislature responded to legal and political demands by shifting more funds to categorical programs. Since 1980, there has been a dramatic shift in the share of funding between restricted and unrestricted funds. As Figure 1 illustrates, between 1980 and 2000, average per-pupil funding increased by 15 percent in constant dollars (based on values in 2000) from $5,422 to $6,232. Over that period, the restricted share of those dollars increased from $705 to $1,870, an increase of 165 percent, while unrestricted share declined by nearly 8 percent, from $4,717 to $4,362. For a class of 30 students, that represents a decline in discretionary spending of $10,650. If the share of restricted to unrestricted funding had remained the same in 2000 as it was in 1980, it would amount to nearly $32,000 per class of 30 students.

The Politicization of Categorical Funding

From its inception, categorical funding for schools in California has generated political controversy. Controversy focused on several issues. Chief among them was a deep ideological division between proponents and opponents of compensatory aid for low-income, disadvantaged students. Democrats in the legislature have tended to regard such programs as entitlements and part of a larger social policy agenda to promote greater educational and, ultimately, social equality. Republicans, on the other hand, historically opposed giving more money to students without some accountability for how additional funding would be spent and the results it would be expected to produce. Furthermore, wealthier, generally suburban districts, have regarded categorical programs as redistribution of state tax revenues from suburban to urban districts. Finally, as state revenues—and with it funding for schools—decreased in a frenzy of fiscal retrenchment in the wake of Proposition 13 and again in the current economic recession, districts sought greater flexibility to allocate funds.

FIGURE 1 Changes in the Share of Restricted to Unrestricted Funding: 1980 – 2000



Political pressure to "deregulate" categorical funding led to a state budget stalemate in 1979. Republicans in the legislature, who as a group represented predominantly suburban and rural areas, would not support Assembly Bill 8—a school finance measure that restructured the state's school finance system after Proposition 13 and *Serrano*—unless regulations governing categorical programs were eliminated. A last-ditch, late-night compromise created the "Sunset Review" of all (19 at the time) categorical programs in education.[13]

In response to the seemingly explosive growth of categorical programs and funding, the Legislative Analyst, in 1993, conducted a study of categorical program funding in education. The study, "Reform of Categorical Education Programs: Principles and Recommendations," identified 57 categorical programs that received state support during 1992-93. The study acknowledges the difficulty in determining the exact number of categorical programs and of classifying them according to their purpose. The study notes, for instance, that Child Development represents eight distinct child development programs operated by local agencies, while Special Education consists of five separate programs for students with disabilities.[14] The Analyst's study identified four categories of funding: (1) Programs for Students with Special Education Needs, comprising 12 programs; (2) Programs to Improve Instruction and Curriculum, comprising 25 programs; (3) Programs Addressing Student Social and Health Needs, comprising 9 programs; and (4) Administration and Other Programs, comprising 11 programs.

In 2001-02, the state budget identified 124 categorical programs in education, totaling just under $13 billion.[15] Just as in 1993, they cover a wide range of programs, targeting a variety of policy objectives. Among them are funds for charter schools, various provisions of the school accountability law, professional development, special education, student services, school safety, vocational and occupational programs, technology, curriculum and instructional improvement, class-size reduction, and year-round schooling. In spite of the large number of categorical programs, 24 —roughly 10 percent—comprise nearly 88 percent ($11.4 billion) of total categorical funding.

Table 1 shows five-year funding levels for the 26 largest categorical programs.

Just as categorical programs represent a wide range of state policy objectives, there is considerable variation among them in state funding levels. Largest among categorical programs are Special Education Program Grants, at $2.7 billion and comprising 21 percent of total categorical funding. At the other extreme is Mathematics Staff Development at $5 million, comprising 0.2 percent of categorical funding. Even among those largest programs that comprise 88 percent of total state categorical funding, there is again considerable variation in funding levels. Following Special Education are Class Size Reduction funded at $1.6 billion in 2001-02 and Targeted Instructional Improvement Grants (formerly Court-Ordered and Voluntary Desegregation Funding) at over $700 million. At the lower end were Instructional Materials K-8 at $137 million and After School and Safe Neighborhood Partnership Programs at $117.5 million.

The data show that between 1998-99 and 2001-02, funding among these programs increased by 37 percent, from $8.55 billion to $11.7 billion. New programs account for a large share of that increase. The Public School Accountability Act with its associated programs accounts for $1.85 billion of the $3.16 billion, a nearly 60 percent increase between 1998-99 and 2001-02. Staff Development accounted for another $180 million of new funding.

Among the 26 largest categorical programs, there is considerable programmatic overlap. As noted already, school accountability is represented by five programs[16] with a combined funding of just under $2 billion. Two staff development programs account for $404.6 million. There are several programs targeted to instructional improvement. Class-size reduction programs at the elementary and secondary level amounted to over $1.7 billion in 2001-02. Adult Education and Regional Occupation Programs accounted for $970 million. Economic Impact Aid (EIA) targets additional resources to disadvantaged students. The School Improvement Program (SIP) provides money to schools to engage in school-level instructional improvements. Other programs among the major

TABLE 1 Major Categorical Education Programs (Figures in thousands)

Program	1998-99	1999-2000	2000-2001	2001-2002	2002-2003
Adult Education Program	530	542	573.6	599.7	506
After-School and Safe Neighborhoods Partnership Programs	50	85	87.8	117.5	121.6
Child Care and Development Programs	794	852	1,140	1,266	1,199
Class-Size Reduction Program, Grade 9	44.5	161	166.9	110.1	98.2
Class-Size Reduction—Operations, K-3	1,580	1,534	1,566	1,610	1,479
Deferred Maintenance	115	143.7	176.3	176.3	205.7
Desegregation Program /Court Ordered[1]	490.6	504.9	528	/	/
Desegregation Program/ Voluntary[1]	122.6	138	148.7	/	/
Economic Impact Aid	382	394	426.9	465.6	444.6
High Achieving/Improving School Program	/	/	131.2	157	144.3
Home to School Transportation Program	489	503	481	498.7	471.6
Immediate Interventions/Underperforming School Program	/	63.7	71.7	161	184.6
Instructional Materials, K-8	133	125.9	131	137	/
Instructional Time and Staff Development Reform Program (Staff Development Buyout)	195	225	246.8	224.2	204.7
Other State Mandated Programs	109.5	98.5	159.9	1,44.3	111.8
Public School Accountability Act (PSAA)	/	/	156.6	301	169.9
Regional Occupational Centers (ROC/Ps)	309	320	337.3	370	359.3
School Accountability/Interventions and Rewards	/	/	46.6	517.9	484.5
School Improvement Program	375	386	400	414.8	389.5
School Library Materials	158.5	158.5	158.5	158.5	20.7
Special Education Program Grants	2,125	2,256	2,400	2,732	2,667
Staff Development	/	/	/	180.4	102.6
Student Assessment	55.9	62.2	112.3	117.3	99.6
Summer School Program	285.5	309.77	418.7	449	433.2
Supplemental Grants	206.1	212	221.8	233.8	229.9
Targeted Instructional Improvement Grants	/	/	/	713.4	668.6
TOTAL	**8,550.2**	**9,075.17**	**10,287.6**	**11,711.2**	**10,795.9**

[1] Court-ordered and voluntary desegregation programs became the Targeted Instructional Improvement Grants program in 2001-02.

categorical programs, provide instructional and library materials. Finally, Supplemental Grants attempt to "equalize" funds by providing categorical monies to districts that are not eligible for categorical funds, largely because of their demographics. (Supplemental Funds are discussed in greater detail below.)

Programmatic overlap is even more pronounced when one looks at the five-year funding of all 124 categorical programs. There are a half dozen programs for staff development (in addition to the ones already noted); there are programs for training principals and high school athletic coaches. There are a variety of school safety programs, funds for instructional materials, before and after school programs, county fiscal oversight of districts, technology, and school-to-work programs. There are, for instance, four programs aimed at making advanced placement courses more accessible to students. In addition to the categorical programs listed here, there are yet others that flow to community colleges, campuses of the state university and the University of California. These include various outreach and student services programs. While funding for

TABLE 2 Categorical Program Types

Types of Categorical Programs	Examples
Supplemental Services	Language and Literacy, Economic Impact Aid, Summer School Programs, English Language Acquisition Program, English Language and Intensive Literacy Program, Gifted and Talented, Early Childhood
Special Needs	Funding streams related to disabled student services
Variable Cost	Transportation, Small School District Bus Replacement Program
Transition from School to Work	Regional Occupation Centers, Agricultural Vocational Education, Adult Education
Instructional Development	Instructional Materials, Library, Digital High School, Standards Based Instructional Materials
Instructional Improvement	Class-size reduction programs, School Improvement Program
Mandated Costs	Collective bargaining, transportation
Staff Development	BTSA, subject-matter projects, staff development buy-out, bilingual teacher training
Facilities and Infrastructure	CSR Facilities, deferred maintenance, bus replacement
Student Services	AVID, outreach, Advanced Placement, school safety, child nutrition, gang-risk intervention programs, at-risk youth
Accountability	PSAA, High School Exit Exam, II/USP, TIIG, High Priority Schools Grant for Low Performing Schools

these programs flows to higher education, they target K-12 students or schools. This is true also for staff development and various subject matter programs. The California writing, science, and math projects are funded through the University of California, Office of the President. The categorical programs represent a bewildering array of funding streams and program requirements that are initiated, take on a life of their own, and are rarely reviewed or evaluated.

While the Legislative Analyst identified four program types, the current array of programs might be more appropriately placed into the ten categories shown in Table 2.

Inequitable Allocation of Categorical Dollars

The California Supreme Court's *Serrano* ruling excluded categorical programs from its equalization requirement. In so doing, the Court reasoned that categorical programs served special needs not met by revenue limit funding. According to the *Serrano* principle, however, funding outside of the Serrano band is only justified if there is some *rational, compelling state interest* in the allocation of those funds. The question this raises for policy makers is whether the present allocation of categorical funds is justified on those grounds. The rationality of this type of funding is all the more important given the large share of per-pupil funding represented by categorical programs.

This section of the paper assesses the distribution of selected categorical funding sources in terms of their relationship either to educational needs based on district characteristics or to student needs based on student characteristics. In the absence of other measures, the Academic Performance Index (API) is the basis for determining academic need.[17] API data are aggregated at the district level, to make it compatible with available finance data[18]. Student need is based on a "Need Index," a scaled composite of the percent of a district's Hispanic and African-American students, percent receiving free and reduced meals, percent of students' families eligible for Calworks, percent of English learners, and average level of parents' education. The index is weighted to measure the effects of higher concentrations of the presence of these variables.

TABLE 3 Per Pupil Funding for Selected Categorical Programs

(2001-2002)

Funding	State Mean	25th Percentile	50th Percentile	75th Percentile
Total Revenues	$7,824	$6623	$7,081	$7,955
State Categorical Funding	$1,556	$1,201	$1,429	$1,721
Federal Funds	$557	$244	$399	$648
School Improvement	$96	$69	$90	$111
Economic Impact Aid	$68	$24	$49	$89
Supplemental Grants	$65	$34	$64	$86
Targeted Instructional Improvement Grants	$185	$19	$58	$156

Data source: California Department of Education

Table 3 shows the distribution of funds among districts. As noted earlier, state and federal categorical funds comprise, on average, 30 percent of total per- pupil funding. The average for state categorical funding is $1,556, while the 25th percentile is $1201 and the 75th percentile is $1,721. Table 3 also shows that for the different categorical programs there is a significant difference among districts in per-pupil funding. The table also shows differences in socioeconomic status (SES) and educational need. The Need Index is 100 for the state average. Districts in the first quartile of need are 31 percent of the state average for need, while those in the top quartile of need are 26 percent above the state average. This would logically be expected since the distribution of funds should reflect varying district needs. Districts with higher concentrations of poverty or disadvantage should receive more EIA funding, for instance, than districts with few disadvantaged students. The question is whether allocation differences are systematically related to differences in district characteristics that trigger different levels of need and additional funding.

Differences among districts in relation to indicators of need and levels of categorical funding are more apparent when districts are divided into two groups: the one a high-need, low-performing group, the other a low-need, high-performing group.[19] Table 4 shows differences in funding and levels of need. Ironically, the low-need, high performing schools receive nearly twice the amount per pupil in SIP funds than high-need districts. They also receive about one-third of the Supplemental Grant funding per pupil. However, they receive nearly four times as much in EIA funds. Differences in need measures are also notable. High-need districts have average API scores of 615, compared to 825 for the low-need districts. Their average Need index is 296 percent above the state average, compared to 21 percent of the state average; and the percent of teachers with emergency credentials is 20 percent, compared to 2 percent. The apparent incongruities in funding—the lack of clear correspondence between levels of funding for the selected categorical programs and some indicator of need—is sufficient reason to explore further the allocation of categorical funds and need.

One measure of association between levels of program funding and need is simple correlation. Table 5 shows the relationship between levels of funding for SIP, EIA, and Supplemental Grants and Need and API. The API and the Need Index are used as a measure of need to test whether higher levels of funding flow to schools with greater need as a consequence of low performance or socioeconomic status of students.

The correlations show that EIA is indeed correlated with Need, and that the correlation is statistically significant. Although significant, only 26 percent ($r^2 = 0.26$) of the difference in per-pupil EIA funding is explained by different levels of Need. The correlation between EIA and API does indicate that low achieving districts receive more funding for EIA. Both SIP and Supplemental Grant funds, on the other hand, are inversely correlated with Need. This means that students with greater need, on average, generate lower levels of funding. The correlation of SIP and Supplemental funding with API indicates that districts with higher than average API scores receive higher levels of funding. While in all instances the explained variation is under 5 percent, the direction of the association rather than the magnitude of the effect is significant for policy purposes. Based on these correlations, it is difficult, if not impossible, to defend the distribution of SIP and Supplemental funding in light of any measure of need that would justify a compelling or rational state interest. While EIA funding is more rationally related to need, the distribution is only marginally defensible. Finally, TIIG funds are uncorrelated with either measure of need.

No Rational Relationship between Need Measures and Funding

The relationship between some measure of need and categorical funding is further examined by means of crosstabs. Tables 6, 7, and 8 examine the distribution of EIA, Supplemental, and SIP funds in relation to measures of academic performance and Need. Table 4 compares levels of EIA funding by quartiles of per-pupil funding with quartiles of Need. The cells show the percentage of students who are in a given quartile of Need and also in the same quartile of per-pupil funding. The table shows, for instance, that 53.8 percent of students in the bottom quartile of Need are also in the bottom quartile of funding. At the other extreme, the data show that

TABLE 4 High and Low Need Districts: Selected Data

		High Need/ Low Performing	Low Need/ High Performing
Number of Districts		46	61
Number of Students		1,142,493	221,621
School Improvement Program[1]			
	Mean	48	86
	Maximum	8	54
	Minimum	356	207
Economic Impact Aid[1]			
	Mean	98	23
	Minimum	6	0
	Maximum	937	113
Supplemental Grant[1]			
	Mean	15	77
	Minimum	2	7
	Maximum	134	143
Targeted Instructional Improvement Program[1]			
	Mean	142	109
	Minimum	2	1
	Maximum	251	221
Academic Performance Index			
	Mean	615	825
	Minimum	474	764
	Maximum	636	922
Need			
	Mean	296	21
	Minimum	139	5
	Maximum	503	31
Teachers w/emergency credentials (percentages)	**Mean**	20	2
	Minimum	13	1
	Maximum	56	4

[1] $ per pupil
Data Source: California Department of Education

81.6 percent of students in the highest quartile of Need are in the highest quartile of funding. A more equitable distribution would have the cells on the diagonal all have percentages of, say, 80 percent. It is in the second and third quartiles that the distribution veers from its policy intent. This can be attributed to various causes, most likely among them is the changing demographics of school districts and the failure of the state to adjust allocation to formulas to correspond to those changes.

While the allocation of EIA has a defensible, if imperfectly systematic, relationship to need, the same does not hold for Supplemental and SIP funding. Based on the distribution statistics in Table 7, it is difficult to

TABLE 5 Correlations of Need and Selected Program Funding

	Per Pupil EIA (N=887)	Per Pupil SIP (N=820)	Per Pupil Supplemental Grant (N=491)	Per Pupil Targeted Instructional Improvement Grant (N=61)
API	-.382**	.103**	.121**	-.194
Need	.511**	-.104**	-.199**	.247

Data Source: California Department of Education
** Correlation is significant at the 0.01 level (2-tailed)
* Correlation is significant at the 0.05 level (2-tailed)

TABLE 6 Crosstabulation of Quartiles of Per-Pupil Economic Impact Aid Funding by Quartiles of Student Need (pupil weighted: N = 5,800,605)

		Quartiles of Economic Impact Aid Funding Per Pupil			
		First Quartile	Second Quartile	Third Quartile	Fourth Quartile
Quartiles of Need	First Quartile	53.8 %	19.4 %	3.5 %	0.5 %
	Second Quartile	29.3 %	38.1 %	3.4 %	3.4 %
	Third Quartile	8.5 %	35.4 %	14.5%	14.5 %
	Fourth Quartile	8.3 %	7.1 %	37.3 %	81.6 %

Data Source: California Department of Education

discern what state policy objective supports the existence of Supplemental Grants as a categorical funding stream. Not only does the distribution evidence a certain randomness, but an element of irrationality. In terms of the *Serrano* mandate related to categorical funding, it is difficult to understand, much less justify, why 78.6 percent of students in the highest quartile of Need are in the bottom quartile of funding. At the other end of the scale, just under 27 percent of students who are in the highest quartile of Need are in the highest quartile of funding. While the allocation is not as skewed with respect to SIP funds, (Table 8), there is no discernible, systematic relationship between Need and per pupil funding. As with Supplemental funds, the distribution is somewhat skewed by the fact that just under half (46.8 percent) of students in the top quartile of Need are in the bottom quartile of per pupil funding.

While the allocation of Supplemental and SIP funds appears to lack any rational basis, the allocation of the

TABLE 7 Crosstabulation of Quartiles of Per Pupil Supplemental Grant Funding by Quartiles of Student Need (pupil weighted: N = 5,800,605)

		Quartiles of Supplemental Grant Funding Per Pupil			
		First Quartile	**Second Quartile**	**Third Quartile**	**Fourth Quartile**
Quartiles of Need	**First Quartile**	4.6 %	13.5 %	16.1 %	23.8 %
	Second Quartile	5.9 %	22.6 %	23.9 %	28.6 %
	Third Quartile	10.9 %	28.6 %	31.2 %	20.8 %
	Fourth Quartile	78.6 %	35.3 %	28.2 %	26.9 %

Data Source: California Department of Education

Targeted Instructional Improvement Grant (TIIG) is even more difficult to understand. TIIG was created by Senate Bill 735 (Chapter 891, *Statutes of 2001)* and funded at $713.4 million in 2001-02. It replaces two existing programs: the court-ordered desegregation program and the voluntary desegregation program. The legislation gives priority for expenditure of funds to court-ordered desegregation programs that have court orders currently in force. Funds not needed for this purpose may be used to improve instruction for the lowest-achieving students. It should be noted that there are no districts under court-ordered desegregation. The obvious question the legislation raises is why schools that are not longer under desegregation order should receive the additional state revenue. The second question regards the rationality of the distribution. In 2001-02, 59 districts received TIIG funds: average per-pupil funding was $136, while the median was $58. The range in per-pupil funding is from a high of $1,893 for Sausalito/Marin City Unified School district to a low of $2 per pupil for the La Habra Unified School District. The huge variance in per-pupil funding is the consequence of the absence of any state funding formula. What districts could negotiate in the budget was basically what they received. In 2001-02, Bakersfield City Elementary District, with an 80 percent minority population, received $225 per pupil; Berryessa Union Elementary is 87 percent minority and received $34 per pupil. El Centro Elementary is 92 percent minority and received $72 per student. The big winners in the TIIG sweepstakes were San Jose Unified (formerly under court-ordered desegregation), at $968 per pupil and a 73 percent minority population, and Sausalito/Marin City Elementary, at $1,893 and 82 percent minority.

These disparities raise serious equity issues, to say nothing of their legality in light of the *Serrano* mandate. As noted earlier, Sausalito/Marin City receives $1,893 in TIIG funding. The question is why, when the district's total per pupil revenues are $18,245—more than $11,000 over the per-pupil average for elementary districts. It is also about $11,000 more per pupil than revenues for schools of comparable size and demographics. Sausalito/Marin City is 76 percent minority, 53 percent free lunch, and 6.4 percent English learners. Semitropic Elementary District has total revenues of $5,253 per pupil. Of its pupils, 87 percent receive free meals, 95 percent are minority, 6.4 percent are English learners, and 30 percent of teachers have emergency credentials. A significant difference between Sausalito/

TABLE 8 Crosstabulation of Quartiles of Per Pupil School Improvement Program Funding by Quartiles of Student Need (pupil weighted: N = 5,800,605)

		Quartiles of School Improvement Program Funding Per Pupil			
		First Quartile	**Second Quartile**	**Third Quartile**	**Fourth Quartile**
Quartiles of API	**First Quartile**	39.2 %	30.9 %	26.8 %	17.7 %
	Second Quartile	29.5 %	22 %	18.1 %	28.5 %
	Third Quartile	17 %	28.7 %	25.3 %	24.9 %
	Fourth Quartile	14.3 %	18.4 %	29.7 %	28.9 %

Data Source: California Department of Education

Marin City School Districts and its comparison districts is that half of the comparable districts with half of the revenues have all their schools score in the 6 to 10 rankings in the API, while with its much greater funding, none of Sausalito/Marin City's schools are in the 6 to 10 rankings for the API.

The Shift from Demand-Driven to Supply-Side Funding

Another consideration regarding the effect of categorical funding on the state school finance system is how it has changed the context of school finance with regard to funding adequacy, stability and predictability, flexibility and choice, efficiency, rationality, accountability, and equity. As noted at the beginning of this paper, these are important policy goals that should form the foundations of a system of school finance. As the following discussion will show, the current system of categorical funding undermines these policy objectives.

Adequacy. The issue of adequacy is not entirely relevant in this context. It is generally assumed that categorical funding addresses equity rather than adequacy issues. However, there is a significant indirect effect: the growth in the relative share of restricted to unrestricted funding means that schools have fewer discretionary dollars. As noted earlier, categorical funds represent about 40 percent of the *state* share of funding and over 30 percent of overall per-pupil funding. In addition, roughly 80 percent of per-pupil funding goes to salaries and benefits. Consequently, fewer dollars are left for instructional materials, facilities maintenance, and professional development and instructional improvement. Regarding specific programs, the adequacy of special education funding has long been a subject of controversy. In the mid-1990s, a law suit against the state alleged that state funding for special education did not cover the full cost of special education services, and, as a result, districts were having to fund special education services out of the regular education revenues.

Stability and predictability. The shift from property tax to state general fund revenues as the major share of school funding has created a more unstable system of funding. In spite of voter approval of Proposition 98, whose intended purpose was to provide greater stability and predictability in school finance, schools still face considerable uncertainty from year to year

regarding funding. It is generally not until the "May revise" that legislators know how much money will be available for education in the coming fiscal year. How those monies are allocated then depends on the political dynamics of the budget process. In 1997, for instance, schools received nearly $1.6 billion in new funding to reduce class sizes to a maximum of 20 in grades K through 3. The decision to fund class-size reduction was made by the governor who did not want to see additional funds go to general revenues for fear that they would be used to increase teacher salaries. The last-minute class-size reduction measure required schools to scramble for both teachers and facilities as they had little more than a month to implement the program. Basic Aid districts, whose local revenues exceed their revenue limit caps are the ones who enjoy the greatest funding stability. In the recent spate of funding reductions, they have essentially been unharmed.

Flexibility and choice. The loss of flexibility and choice in finance has generated perhaps the most criticism among districts. The increased reliance on categorical funding has diminished local capacity to allocate resources according to local needs. Instead, funding priorities and allocation of funds is increasingly determined by the legislature who, among all the players in public education, is probably the least aware of what a particular school's or district's funding needs or priorities may be. For instance, districts may have chosen to use funds earmarked for class-size reduction in other ways, ways that perhaps they believe would have had greater impact on teaching and learning. Categorical funding is based on the idea that "one size fits all" and gives short shrift to local preferences.

Efficiency. The idea of efficiency in school finance suggests that the cost of providing education services is closely related to expenditures for education. California now has a supply-side rather than demand-driven system of school finance. School budgets are not based on the cost of providing education services but on how much schools receive from the state and how they are told to spend it. That, in turn, is determined by how much money is available in the state budget and the politics of the budgetary process. In the spring of 2003, as districts had to face reductions in funding, some districts had categorical funds they were unable to spend. Often districts spend money just because it needs to be spent, not because it serves educational needs or priorities. A second issue related to efficiency is program duplication and overlap. As already noted, a number of categorical programs all aim at the same general problem. There are a half dozen programs dealing with school safety or professional development or student outreach. There are several programs, in addition to outreach, to assist under-represented minority students to gain college admission. Or programs aiming at similar objectives and perhaps even targeting the same students are funded through various providers. Adult Education, Regional Occupation Programs, and community colleges often compete for the same students.

Rationality. Allocating funds for special purposes presumes a compelling or rational state policy interest or policy objective. As the allocation data regarding TIIG, SIP, and Supplemental Grant funds show, there is no apparent relationship between any rational state interest and allocation of funding for those programs. Categorical programs tend to respond to perceived or real education problems in an ad hoc, piecemeal fashion. As problems multiply, so do categorical programs. While allocation of categorical funds may in some instance be related to need and actual costs—transportation, for instance—often it does not. As discussed above, TIIG not only varies significantly from one district to another, it seems to bear no logical relationship to any indicator of need. Not only is the rationale for TIIG funding questionable (particularly in the absence of court-ordered desegregation), but also per pupil funding to districts. The rationality (to say nothing of the legality) of Supplemental Grants is equally questionable. It is difficult to imagine how, under the *Serrano* guideline, the program serves a compelling or rational state interest as it funds districts which have no special need other than the general need for more money.

Categorical program funding also undermines the rationality of the state's education accountability system. In 1998, the legislature enacted the Public Schools Accountability Act (PSAA). In principle, the measure shifted responsibility to schools for the student achievement outcomes that they produced. In the PSAA, the state created a high-stakes system of

accountability that invokes a series of sanctions against schools for failing to improve the academic performance of all students. Schools can be "dissolved" or "reconstructed," and principals can be dismissed. While holding schools accountable for results, the legislature did nothing to provide schools with the autonomy and flexibility to achieve them. The current governance structure of education hobbles schools with myriad regulations and limitations: schools have little control over the allocation of resources but are expected to produce outcomes as though they did. The result is a highly dysfunctional system of governance. Schools are micro-managed from Sacramento but are held accountable for the outcomes.

Accountability. Accountability for categorical program expenditures is generally based on districts' and schools' compliance with program regulations rather than on program effectiveness. The Legislative Analyst in its 1993 report on categorical funding noted that "state administration of categorical programs impedes local flexibility in program design and administration by reinforcing the focus on program rules and regulations."[20] The incentive system that guides categorical program implementation focuses exclusively on input variables and processes. The state, on the other hand, enacted the PSAA in 1998 to hold schools, through high stakes sanctions, accountable for educational outcomes—student achievement as measured by the Academic Performance Index. Accountability and categorical funding, along with the regulatory structure that it creates, are essentially incompatible. Ideally, if schools are to be held accountable for producing results, they should be given the flexibility and autonomy to achieve those results. At a minimum, they should have control over resource allocation.

Equity. As shown in the discussion regarding allocation of categorical dollars, it is difficult to discern from the data how a number of categorical programs advance equity interests. Of the programs discussed in this paper, EIA comes closest. Other programs such as special education, English learner, and outreach clearly do advance equity interests by targeting money to students who need additional education services. Supplemental Grants, on the other hand, work against equity by targeting money to students who show no demonstrated need.

Overall, there is little evidence by which to conclude that the present system of categorical funding is equitable, efficient, or rational. In the absence of systematic state evaluation of these programs, it is impossible to know what benefit they provide as categorical programs. Some programs, Adult Education, for instance, vary greatly in program design and delivery. [21] Given the *Serrano* standard regarding categorical funding, the presumption should be that all funding is equalized block funding and the burden of proof should be on the state when it creates a categorical program.

Prior to Proposition 13, if districts wanted new programs they budgeted for them. Under the current system, schools look to the state to fund any new initiatives. Who gets money for what depends on the politics of the budgetary process in the Capitol. Since Proposition 13, textbook publishers, test developers, teachers unions, reading specialists, counselors, school districts, and a host of other interests flock to Sacramento seeking to get their tin cups filled with categorical dollars.

Rethinking Categorical Funding

For the budget year 2003-04, former governor Gray Davis proposed consolidating 64 categorical programs into a single block grant and, with few exceptions, repealing all statutes and regulations governing those programs. The proposal elicited only tentative support from districts, welcoming the prospect of long sought-after flexibility, but also showing concerns about implementation.

Currently, the Legislative Analyst (LAO) proposes consolidating 45 programs and 31 mandates into 5 block grants:

- Academic Improvement
- Compensatory Education
- Teachers Support and Development
- Alternative Education
- School Safety

With consolidation, the LAO also proposes to create a new role for the California Department of Education, including a new school accountability system, technical assistance and program oversight, monitoring program quality rather than compliance, program evaluation and research.

While organizing existing programs into functional block grants is one way to restructure categorical program funding, there is no particular rationale for these categories as opposed to others. Moreover, it seems to take for granted that existing programs should continue to exist as categorical programs, albeit in consolidated form. While the LAO proposal would give schools the flexibility they seek, the proposal is silent on equity issues. The proposal does not address whether some categorical programs ought to be eliminated entirely and their funds equalized in base revenue limits. Presumably, ROP and Adult Education funding would be consolidated into the Alternative Education Category. Would they continue to operate as in the past, as independent programs?

Rather than shifting programs among boxes, it might be more desirable to rethink the concept of categorical programs and their role in a system of school finance. To that end, it is useful to develop, first, the guiding principles for categorical school reform and, second, a conceptual framework for categorical funding.

The following are principles for anchoring categorical reform. The principles are based on research on effective schools and the conditions necessary to create them; they are consistent also with those proposed by the LAO in its 1993 study.

- The quality of education services delivered by schools is dependent on various factors, among them, adequate financial resources to purchase services, instructional materials and equipment; to maintain and, as needed, to acquire new facilities.
- Schools must have the authority, flexibility, continuity, stability, and expertise to channel resource streams into effective instructional programs. This requires the following conditions:
  - Subsidiarity. Decisions regarding resource allocation in schools should be made by those who have to implement them. Put another way, decisions ought to be closest to individuals who will be affected by them.
  - Accountability: Schools should be accountable for the results they produce. However, those results should be meaningful and should be based upon multiple indicators. Various external interventions should be triggered based upon such indicators.
  - Equity based on equal opportunity. Schools must have the resources to provide each child with access to high quality education.
  - Choice. Within a framework of state-defined standards and curriculum, schools should offer students, parents, and communities flexibility in the provision of educational services.[22]
- Finally, the state should have the responsibility for technical support, oversight, and program evaluation.

In addition to a set of principles for school finance, it is also necessary to rethink the logic of categorical funding. As noted throughout this paper, the present system of categorical finance lacks a coherent policy focus and systematic structure. The various categorical funding streams represent a collection of programs targeted to disparate problems; often several aim at the same problem. Generally, categorical programs substitute for coherent, comprehensive policies. Monies are targeted to various areas of professional development—reading, technology, mathematics and science, for example.

An alternative model for funding special needs and state priorities is to begin with the proposition that schools are responsible for the delivery of education services. The quality of teaching and learning depends on the resources schools have available to them and their ability to organize those resources—human, material, and financial—into effective education programs and practices. It also depends on the resources that children bring to school with them—their readiness to learn and their educational aspirations. Finally, the quality of learning outcomes is shaped by communities—the resources available in communities to children and families (and the ability of children and families to avail themselves of them) and the social and economic environments that define the context of schooling. However, as it is well known, there are huge disparities among schools in their capacities to deliver high quality education services; huge disparities among children in their abilities to benefit from education; and huge disparities among communities and

the impact they have on schools generally and teaching and learning specifically. Some children, schools, districts, and communities need additional resources—funding beyond that provided by revenue limits—in order to equalize such disparities.

Based on the above, special purpose funds can be allocated to schools based on and triggered by a set of student, school, district and community indicators. According to this model, schools would receive additional funding based on the following three categories of need.

Student Need. Student indicators comprise a range of education needs that are student specific. Need may be based on English language fluency, socioeconomic status, under-representation in higher education, and handicap or learning disability. The logic of this category of funding is that it is driven by various student characteristics. How much money a particular student would generate beyond the revenue limit would depend on the combination of characteristics and the funding weights attached to each of those characteristics.

School. School-centered funds are driven by school characteristics and are targeted to improving the organizational capacity of schools. Such monies could be used to improve teaching and learning. Under this scheme, each school receives a block grant. Schools defined as "high need" schools would receive an additional, pupil-weighted allocation. "High need" funds might be triggered by a composite indicator such as the Need Index used in this study. Funds might be used for advanced placement or academic enrichment programs, outreach, the like. Existing programs such as the Supplemental Grants, Targeted Instructional Improvement Program, and school-higher education partnerships and outreach would be folded into this category of funding. Finally, funding to support the Public School Accountability Act (PSAA) should be funded in this category.

District and community. This category of funding would be targeted to meet a wide variety of community needs. They include life-long learning (skills development and employment training and retraining, for instance), early childhood education and childcare, school and community safety programs, extended day programs, and school-family participation programs.

There are various policy strategies for allocating the proposed funding streams. Some funds may be passed though districts directly to schools (e.g., those driven by student characteristics), while others, such as funds allocated to schools and districts would be allocated by districts. Policy makers could, for instance, specify that certain percentages of block-grant funds to schools or districts must be used for professional development. Regardless of specific implementation strategies, the underlying principles for this funding are critical: schools and districts need to have monies protected for instructional materials, professional development, facilities, and the like. Finally, the school finance system needs to be aligned with the existing accountability system.

Policy makers may wish to simplify the contents of the three categories. For instance, they may wish to pull life-long learning and employment training (currently funded under Adult Education and ROPs) and shift those to other providers—community colleges or counties, for instance. The goal of categorical reform should be to create a system that targets funds where they are needed, and does so equitably and efficiently.

Categorical Restructuring and Accountability

A major concern of policy makers regarding changes in categorical program funding is that funds may not flow to those students for whom they were intended or, more generally, that funds are not used for their intended purposes. As the data show, however, within the current funding system, there is little correspondence between any measure of compelling state interest and the flow of categorical dollars. While there may be a clear line between program funding and service delivery in a program like Special Education, the connection between program funding, service delivery, and student outcome for most categorical programs is generally unknown.

At the same time, policy makers clearly should know how various categorical funds are spent and what educational benefit they may have. How, for instance, are Targeted Instructional Improvement, Supplemental, EIA, and SIP moneys spent? What is the interaction of these funds with other funds such as Instructional Development Buyout, Staff Development, and various

provisions of PSAA? Consolidation and deregulation of categorical funding should be accompanied by some accountability measures that require schools and districts to justify how these funds are allocated in terms of educational need. One strategy to that end would be to require schools and districts to submit plans for the use of funds. Such plans may be two- or three-year plans that define a school educational strategy related to the special student needs supported by categorical funding.

Reform of categorical funding should not be viewed as an exercise of aggregating programs and funding streams into various boxes. Rather, categorical funding reform should encompass a broader, comprehensive reform effort to tie special purpose monies to specific educational outcomes. Schools should be required to develop plans for the expenditure of categorical monies. Plans should be based on needs assessment, goal specification, how monies will be used to achieve organizational objectives, and evaluation of goal attainment. Districts, in turn, should develop plans to show how they will provide the necessary support services to schools to help them achieve their objectives. A fundamental component of categorical reform should be to make the use of discretionary funds to achieve specific objectives more self-conscious and purposive.[23]

The matter of accountability raises issues about school governance and oversight arrangements that are well beyond the scope of this study. Albeit in different ways, both the Master Plan Commission and the *Williams* case argue for the need to restructure existing governance and finance arrangements and argue, moreover, that the two should proceed in tandem. Within the scope of this study of categorical funding reform, it is unlikely that significant changes in the current system of categorical funding can occur in the absence of some assurances regarding the effective use of funds. In that light, categorical finance reform should not be viewed as "technical tinkering" or "adjustment" to the current system of school finance. Instead, categorical reform should be regarded as linking school resource allocation to planning, assessment, and evaluation: in short, using discretionary resources in order to provide high quality education to all children.

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Endnotes

[1] *Serrano v. Priest,* 557 P. 2d. 929 (Cal. 1974); *Serrano II,* 18 Cal. 3d 748 (1977)

[2] For a further discussion on this topic see J. Sonstelie. *For Better or Worse: School Finance Reform in California.* San Francisco, CA: Public Policy Institute of California. (2000); Elmore & McLaughlin, op, cit.: *Serrano v. Priest,* 487 P.2d 1241 (1971) and 557 P.2d 929 (1976).

[3] It should be noted that statewide, beginning in 1971-72, local revenues began to decline as a percentage of total funding as the share of state revenues increased. Between 1971-72 and 1977-78, local property tax revenues in constant dollars increased by 3.4 percent while during the same period state aid increased by 41 percent.

[4] A. Odden & L. Picus. *School Finance: A Policy Perspective, 3rd Ed.* Boston, MA: McGraw-Hill. (2003)

[5] C. Tiebout. A Pure Theory of Local Expenditures. *Journal of Political Economy,* (64)5. (1956)

[6] J. Sonstelie, E. Brunner & K. Ardon, op cit.

[7] R. Elmore & M. McLaughlin, op. cit.

[8] M, Timpane. *The Federal Interest in Financing Schooling.* Cambridge, MA: Ballinger Press (1978)

[9] Funding to compensate school districts for federal land not subject to local property taxes and children of families living on federal property, e.g. military bases.

[10] See generally, D Kirp & D. Jensen. *School Days, Rule Days.* Philadelphia. PA: Falmer Press (1986)

[11] The program was later transformed into the Economic Impact Aid (EIA) program, which continues to be one of the largest of the state's categorical programs at $465.6 million in 2001-2002.

[12] The exact number of categorical programs is debatable due to differences in the definition of categorical programs. The Legislative Counsel identifies 69 categorical programs (Amendments to Senate Bill 177, As Amended in Senate May 8, 2003).

[13] The compromise required the legislature to conduct a review of the state's categorically funded programs and establish a five-year timetable for its completion. If no legislative action was taken on a designated program by a specified date, all regulations pertaining to the program would be voided. However, districts would still be required to comply with the program's legislative intent and funds for the program would have to be used for the program's general purposes. The legislature established a joint Senate-Assembly committee to oversee the sunset review. The author of this study was the committee's consultant.

[14] Legislative Analyst. *Reform of Categorical Education Programs: Principles and Recommendations. Sacramento, CA: Office of the Legislative Analyst (1993), p.10*

[15] California Department of Education (2002)

[16] High Achieving Improving Schools ($ 157 m), Immediate Intervention/Underperforming Schools ($ 161 m), Public Schools Accountability Act ($ 301 m), School Accountability/Intervention and Rewards ($ 517.9 m), Targeted Intructional Improvement Grants ($ 713.4 m), Student Assessment ($ 117.3 m) for a total of $1.98 billion.

[17] It can be argued that perennially low-achieving schools might receive additional resources in order to improve their performance; but, in any event, low performance could provide the rationale for a compelling state interest in providing schools with additional funds.

[18] District finance data is taken from the J-200 and J-300 data sets available online. These data were merged with another data set provided by the California Department of Education that break out the "Other State Revenues" category in the J-200 data. These finance data files were then merged with district demographic data files (downloaded from CDE), List of California School Districts and Schools (for US Census Bureau population statistics), Language Survey data base, and API 2002 Base Data.

[19] High-need, low-performing schools are those that are in the bottom quartile API, the top quartile of percent of teachers with emergency credential, and the top quartile of Need. Conversely, low-need, high-performing districts are those in the top quartile API, bottom quartile of percent of teachers with emergency credentials, and bottom quartile of Need.

[20] Legislative Analyst. *Reform of Categorical Education Programs: Principles and Recommendations. Sacramento, CA: Office of the Legislative Analyst (1993), p. 44*

[21] See T. Timar. "Adult Education Program Delivery in California." Sacramento, CA: Master Plan Review Commission (1987)

[22] Choice, as used here, is not meant to suggest charter schools or vouchers. Instead, it refers to the capacity of communities to determine what mix of education services their schools should offer. Some might want to have close collaborative relationships with local community colleges, others with businesses, yet others may wish to have strong arts or language programs.

[23] For a thorough discussion on this topic, see Norton W. Grubb, "Spinning Straw into Gold: The New School Finance." Grubb, W.N. & Goe, L. *The Unending Search for Equity: California Policy, The "New" School Finance and the Williams Case.* www.idea.gseis.ucla.edu/publications/williams/index.htlm>www.idea.gseis.ucla.edu/publications/williams/index.htlm

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