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Financial Evolution

Faced with lawsuits, higher expectations for academic performance, and limited funding, state policymakers are looking for new and better ways to finance public education.

By Lynn Olson

States are at a crossroads over how they raise and distribute money for K-12 education.

Historically, states have focused on how to allocate aid across school districts that have widely different tax bases to achieve some level of fiscal parity. States have paid far less attention to what schools and districts do with that money and the results they produce.

Now that states have set ambitious performance goals for their students—and the federal No Child Left Behind Act of 2001 has demanded that all children achieve those standards in reading and mathematics by 2013-14—the push is on to link education spending to academic results.

"Public school finance systems today uniformly fail to support the nation's education goals regarding greater student performance," says Jacob E. Adams, who directs the School Finance Redesign Project at the University of Washington. "Finance systems determine levels of support based on political bargaining rather than student needs," he says, "and local finance systems are so convoluted that district leaders really don't know where the money is going at the nuts-and-bolts level, where it counts."

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"Chart: Spending Split."

"Chart: School Finance Litigation."

Yet increasingly, legislators want to know what their state education outlays are buying. They're asking what it would actually cost to enable all students to meet state standards—especially those who are poor, speak limited English, or have disabilities—and how to raise the revenues called for by those calculations.

And a new generation of lawsuits is relying on the expectations spelled out in state academic-content standards and tests to argue that states have a constitutional obligation to supply the dollars needed to attain the desired results.

Those nascent efforts to link funding to educational outcomes are the focus of *No Small Change: Targeting Money Toward Student Performance*, this year's edition of *Quality Counts*.

Systems in Flux

Today, 31 states are debating or considering major changes to the ways they pay for education or distribute money to school districts, according to the Education Week Research Center's policy survey of 50 states and the District of Columbia for *Quality Counts 2005*. Sixteen states are embroiled in litigation challenging the school finance systems they now have in place. Lawsuits in 20other states have been decided or settled in the past five years.

The tight state budgets of recent years have also put pressure on education spending, forcing many schools and districts to do more with less. Thirty-seven states and the District identified a lack of resources or unpredictable funding levels as the most pressing school finance issue, particularly given state revenue trends.

The recommendations of an education finance task force in Minnesota capture the tenor of the school finance debate.

Named by Gov. Tim Pawlenty, a Republican, shortly after he took office in 2003, the task force last July advocated a new model for financing schools based on a data-driven analysis of how much it costs to ensure all students have the chance to meet state academic standards.

"We need to make education funding decisions based on data, not on how much money is available year to year," Ric Dressen, the superintendent of the 4,000-student Alexandria, Minn., school district and the chairman of the task force, said in releasing the report.

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Among other recommendations, the group suggested that the formula take into account the added costs of educating students who share certain characteristics, such as family mobility or poverty. It also advocated forming a tighter link between education funding and results, in part by creating a school-based information system that would link student-performance data with detailed information on school spending.

Nearly $500 billion in combined federal, state, and local money is spent on precollegiate education in the United States each year, with nearly half the total coming from state sources.

That large sum of money raises three concerns: Could existing resources be better spent to produce the desired results? How much money is needed to bring all children to state standards? Could state tax systems be improved to better withstand economic downturns and provide greater fairness for students and the public? *Quality Counts 2005* draws on *Education Week*'s annual survey of state education departments to explore those questions.

Recognizing that no two state finance systems are alike, the report provides details on how each state structures its school funding system. It seeks experts' advice on how states, districts, and schools could get a better handle on where their dollars flow and how to get more bang for the buck. It includes an analysis of studies that try to parse out what an "adequate" education costs in three states: Kentucky, Maryland, and New York. And it looks in depth at what happened in one state, New Jersey, when the courts decreed how the state's poorest districts should spend state largess.

The report also examines whether the 3-year-old No Child Left Behind law, the latest reauthorization of the Elementary and Secondary Education Act first adopted in 1965, is an "unfunded mandate," as its critics allege. Finally, this ninth annual *Quality Counts* examines what might be done to fix the revenue side of the school funding picture, which many observers maintain is broken and will be unable to keep pace with future demands, even if the economy improves.

One of the most notable changes in the past decade has been how policymakers talk about school finance. Historically, state legislatures and the courts have sought to make funding more equitable across districts and schools, without much thought to how the money was spent.

Increasingly, though, legislators and judges are asking what's needed to provide children with a sound basic education—in teachers, books, facilities, and programs—and then working to ensure the resources are there to pay for those items regardless of where children live.

To understand that evolution, it's helpful to understand how schools are financed in the United States.

For much of the 20th century, per-pupil spending was hooked strongly to local property taxes. But huge variations in property values within states typically meant that wealthy districts could generate more money per student with less tax effort than their property-poor neighbors. States focused on shrinking such disparities, often by boosting expenditures for low-wealth districts while providing them with some tax relief as long as they maintained a minimum local tax effort.

School finance lawsuits, meanwhile, centered around the equal-protection clauses in state constitutions, arguing that states had a legal responsibility to ensure that equal tax efforts yielded equal resources.

But while the focus on equity helped narrow spending disparities across districts, it did not eliminate them. Indeed, a study released last fall by the Education Trust, a Washington-based research and advocacy group, found that in half the states, the funding gap between districts in high-poverty and low-poverty areas was widening—a striking reversal of progress made during the better economic times of the middle to late 1990s. The focus on equity by states also failed to address any inefficiencies in how districts—rich or poor—used their resources to promote learning.

Since the 1990s, legislatures and the courts have increasingly shifted their gaze to questions of "adequacy," seeking to identify the level of spending needed to produce the objectives spelled out in state constitutions. Although the specific language varies, almost all state constitutions contain requirements for the provision of a "thorough and efficient" or "adequate" education.

"When you put it in adequacy terms, what you're focusing on is children's rights, which judges understand and deal with every day," says Michael A. Rebell, the executive director of the Campaign for Fiscal Equity, a New York City group that successfully challenged its state's system of school finance.

"The judges don't have to concern themselves with all these complex issues about what the [millage] rates are and how the property tax works," he says. "They're saying, we're just going to draw a line about what minimum adequacy is, and you, legislators, figure out how to fund it."

According to Rebell, plaintiffs' lawyers have won almost two-thirds of the major school finance decisions in states' highest courts since 1989, including a string of cases in the past two years.

Like the equity lawsuits that preceded them, such cases often stress the relative inability of poor districts to provide their students with the education available in more affluent settings. The cases also highlight that children with the greatest needs are typically the furthest from meeting state performance standards.

But How Much?

Yet, while adequacy "really sounds like a simple concept," observes Lawrence O. Picus, an economist at the University of Southern California, "the question is, how much is that?"

In the past decade, a handful of consultants have worked with states to put a price tag on adequacy, using four different methods:

• The "successful schools" model identifies schools or districts within a state that have met a specific level of student performance, and then determines how much, on average, those schools or districts spend. The model is sometimes refined to focus on sites that achieve the desired results for the lowest cost. The assumption is that the amount spent is adequate to produce the same outcomes elsewhere.

• The "professional judgment" method relies on panels of educators to identify the resources and programs a school would need—such as teachers, textbooks, and facilities—to produce the desired ends.

• The "evidence based" method is similar, but relies on research to identify individual strategies or comprehensive school designs that have a chance of producing the desired goals, and then calculates how much it would cost to install those strategies in schools.

• The "cost function" method uses statistical models to study the relationship between a desired level of student performance and associated levels of spending for students and districts with different characteristics.

Increasingly, such cost studies are not only required by state legislatures, but also are being ordered by state courts or underwritten by special-interest groups that hope to use the results to spotlight flaws in the existing system.

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Education Week's policy survey for *Quality Counts* found that 30 states have had adequacy studies conducted. Six of those studies were currently under way late last fall.

In addition, the *Education Week* survey showed, 14 states have had studies done to estimate the costs associated with implementing the No Child Left Behind Act. In nine of those states, the studies were still in progress as of late last fall. The debate over NCLB funding is, in large part, about which obligations should be assigned to the federal government and which belong to states, such as bringing students up to state-mandated levels of achievement.

In a perfect world, argues Bruce D. Baker, a finance expert at the University of Kansas, who categorized the **adequacy methods and findings across state studies** for *Quality Counts,* experts would know enough about the ties between resources and student outcomes for the different adequacy methods to yield similar results.

But that's not the case. Baker's analysis for *Quality Counts* found that the cost per pupil, adjusted for regional cost differences and inflation, ranged from $6,820 to $11,107 within Maryland, depending on the method used. Across states, the estimated price tag ranged from a low of $5,009 per pupil in Illinois to a high of $15,639 in New York.

Education Week's analysis of the different methods and the methods' findings in a handful of states—Kentucky, Maryland, and New York—found that each has its strengths and shortcomings. The methods' widely varied results stem, in part, from divergent assumptions about the outcomes to be achieved and the costs of educating students with different needs.

Searching for the Holy Grail?

The idea that students with special needs might cost more to educate is not new. According to *Education Week*'s survey, 43 states and the District of Columbia include weights or adjustments in their school finance formulas that provide extra money for students with certain characteristics, such as poverty, disabilities, or lack of fluency in English.

Twenty-six states and the District adjust their general funding formulas for "at risk" students, broadly defined as students in poverty or those deemed more likely than others to fail academically or drop out of school. But there's little evidence that those dollar amounts are based on empirical data showing what it takes to bring a low-income student, for example, to the proficient level on state tests.

"At the moment, the science of determining adequacy does not permit us even to begin discussions with such precision," argued the economists James W. Guthrie and Richard Rothstein in a 1999 report by the National Research Council, *Equity and Adequacy in Education Finance*.

Nine states adjust their formulas to reflect differences in what a dollar can buy across different regions of a state, such as urban or rural districts.

Eric A. Hanushek, an economist at the Hoover Institution at Stanford University, compares lawmakers' quest for an adequacy figure to "a futile search for the Holy Grail."

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Hanushek says that under the existing system, "there's very little relationship between spending and performance." And nothing suggests that schools would spend any additional cash more productively. "Within the current system," he warns, "the 'required spending' could be infinite if the resources aren't used effectively to promote greater student performance."

Hanushek also worries that once lawmakers and the courts mandate more spending, it's likely to come with more strings attached—a move he considers wrongheaded.

Wyoming avoided that dilemma by determining what it costs to provide an adequate education and then distributing the money to schools in the form of block grants. Policymakers and observers on all sides of the school funding debate are closely watching New Jersey, where the courts in the *Abbott* v. *Burke* finance case ruled that the state's poorest districts be able to spend as much as the wealthiest districts. They also defined the "inputs" that districts must provide to improve outcomes for low-income students, such as preschool and broad social-service programs.

'Information Gap'

Efforts to link spending to results are hampered, in part, by limited evidence about which practices and programs actually produce learning gains. "It's an information gap," explains Baker of the University of Kansas. "It's that we just don't know how to set up a school to achieve an outcome with any precision."

To break through, argues Allan Odden, a professor of educational administration at the University of Wisconsin-Madison, researchers need to focus on what strategies in schools actually raise student performance and then figure out how to apply those strategies cost-effectively. "We need to go inside schools, because the major impacts on student performance are produced by what goes on inside schools," he says.

But getting a clear picture of how schools spend money on instructional programs and services—including staffing—is surprisingly difficult. Most state systems for tracking education expenditures focus on district-level functions. They don't provide useful information on how resources are deployed within schools.

"Our fiscal-accounting categories are too broad and imprecise," says Odden. "Our system doesn't track the dollars in terms of how they're used in the instructional category. And reallocating those dollars is where the action is."

Education Week found that 22 states and the District collect some school-level financial data. Florida, Ohio, and Texas are some of the pioneers in such efforts. The Florida Department of Education provides information on its Web site about student achievement and spending levels at every school and uses the data to calculate a "return on investment" rating.

When researchers Karen Hawley Miles and Marguerite Roza tracked actual expenditures down to the school site within districts—including teacher salaries, central-office services, and what are known as categorical funds—they found large, previously unrecognized inequities in spending between schools within districts. Typically, they learned, the least amount of money flowed to schools serving large concentrations of poor and minority students.

To distribute money more equitably across schools, experts suggest, states and districts must move to "weighted student" funding formulas that are based on individual students and their educational needs. States, they add, should move away from categorical programs that obscure how much money is available at each site.

Education Week found that, on top of their base funding formulas, 48 states and the District now provide categorical funding to schools or districts. Such aid is used for specific purposes, such as early-childhood education, school construction, reading initiatives, and special populations, and often comes with strings attached.

In contrast, says Adams of the University of Washington, state finance systems need to encourage school-level problem-solving by giving schools the authority to spend money as they see fit to meet the particular needs of their students and communities, including the ability to choose and reject staff members.

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Weighted-student funding formulas also would permit money to follow a student to his or her school. That school-based funding approach would also open the way for charter schools and other schools of choice to spend their money quite differently from how it's spent in a more traditional setting, as the profile of the Cesar Chavez Academy in Colorado suggests.

Based on research showing a strong link between teacher quality and student learning, experts also suggest that states and districts move away from single-salary schedules and shift toward compensation plans that reward teachers who have special knowledge or skills, or who succeed in boosting student performance. Teachers willing to work in subject areas with shortages or in hard-to-staff schools also should earn more, those experts say.

Education Week found that in the current school year, only six states have some type of pay-for-performance program based on teacher acquisition of knowledge and skills. Five states have programs that reward teachers based on their students' achievement. Some states also are working with the Milken Family Foundation's Teacher Advancement Program, or TAP. That comprehensive model pays teachers on the basis of their acquired knowledge and skills as well as their students' academic gains.

In addition, 26 states provide recruitment or retention incentives to attract and keep teachers in high-demand subject areas. Fourteen states have such incentives to attract and keep teachers in high-poverty or low-performing schools.

At the same time, 20 states have laws mandating a single-salary schedule. Such statewide pay scales potentially restrict flexibility in how much schools choose to pay teachers.

The Revenue Fix

Even if states could determine how much it costs to bring all, or most, students to a specified level of performance, they'd still need to find the cash. Economists suggest that could be difficult, given the patched-together nature of most state revenue systems.

Education Week found that 31 states have taxes or fees earmarked for education. Twenty-four have lotteries dedicated at least in part to pre-K-12 education. And 35 states require or assume a minimum local tax effort to finance schools. But as the reliance on local property taxes has lessened (33 states limit property taxes), state tax structures have not necessarily stepped into the breach.

Increasingly, states have turned to a variety of "sin taxes"—such as levies on cigarettes, alcohol, and gambling—to help finance public schools, rather than raise sales or income taxes. But those sin taxes are inherently unstable sources of funding. And while 43 states enacted large tax cuts during the boom years of the 1990s, most have neither reversed those cuts nor enacted other tax increases to replace lost revenues, the economist Alice Rivlin points out.

Moreover, experts contend that sales taxes—historically the engine of state budgets—have not kept pace with changes in consumer spending, such as online purchases and the increased consumption of services.

For the foreseeable future, such structural problems mean that state demands for better results from their schools will be accompanied by limited revenue increases, at best. And lawmakers, faced with the large price tags often suggested by adequacy studies, may balk at passing new taxes to pay for such systems.

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