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AT ISSUE

PUBLIC POLICY INSTITUTE OF CALIFORNIA

SCHOOL FINANCE REFORM

MARGARET WESTON

Californians are very concerned about funding for their K–12 public schools. They consistently say that K–12 education should be protected from spending cuts over and above any other area of the state budget.[1] But California's system of school finance is in trouble. Many studies have found it to be inequitable, with wide variation in per-pupil funding. Prominent critics charge that schools do not receive enough resources from the state to enable all students to meet California's academic standards. And the system is governed by such a complex array of laws and formulas that only a few experts truly understand how it works. This At Issue will describe California's school finance system, review its key challenges, offer principles for reform, and outline pathways toward a more equitable, adequately funded, and transparent system.

INTRODUCTION

In May 2010, a coalition of students, parents, school districts, and three major education organizations filed a lawsuit against the state and Governor Schwarzenegger, charging that California's school finance system is unconstitutional because it fails to provide all students with an equal opportunity to meet the state's academic goals.[2]

The suit is part of a growing consensus that California's school finance system is in dire need of reform. Prominent academic and governmental studies have pointed to the system's flaws and offered guidelines for restructuring it.[3] These studies identify three central concerns with the current system: it is inequitable, inadequately funded, and overly complex.

The studies also suggest that giving every student an equal opportunity to meet academic standards could be very expensive.[4] Given the state's financial woes, it is unlikely that additional funds will be available soon. But it would not cost a lot of money to reform the school finance system so that it is more equitable and transparent.

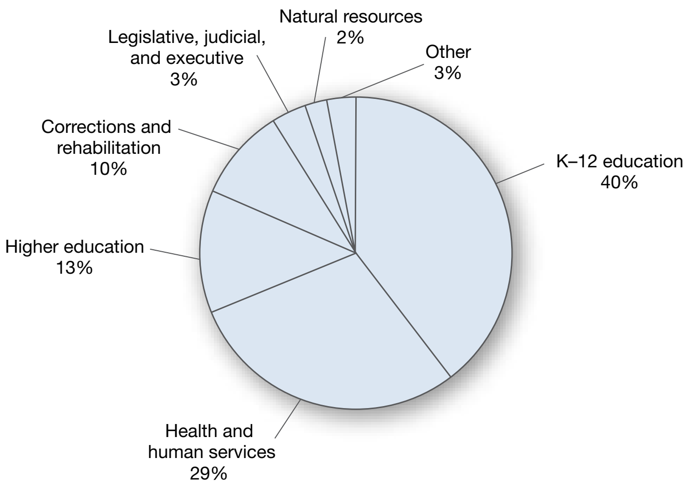
Pursuing structural reforms today will not only meet a critical need but will also help California be better prepared tomorrow, when it can afford to invest more in its K–12 system than it does now. In time, the state will probably be able to spend more per pupil, in part because demographic projections suggest that public school enrollment will not increase substantially during the next decade.[5] Also, economic recovery, when it comes, will increase state tax revenues, which might mean more money for the schools. To make the most of any additional funds, California needs to change its complex and inequitable distribution policies.

CALIFORNIA'S SCHOOL FINANCE SYSTEM: HISTORY, STRUCTURE, AND CRITIQUES

California's current school finance system is largely a product of two 1970s-era events that shifted the bulk of school funding from the local to the state level. First, the 1971 California Supreme Court decision known as *Serrano v. Priest* found the state's school finance system to be unconstitutional. Then, in 1978, the passage of Proposition 13 lowered the amount of local property tax revenue available to cities, counties, and schools.[6] Before these events, school districts set their own property tax rates, and this local revenue constituted the majority of school district funds. Afterward, the burden of financing California's schools shifted largely to the state. In 1977, 33 percent of school revenues came from state sources; now the state provides approximately 60 percent.[7]

Today, California spends more on K–12 education than on any other area of the state budget (Figure 1). The state determines its K–12 contribution through a series of complex formulas governed by Proposition 98, a voter-approved initiative that dictates the minimum amount that the state must spend.[8] Proposition 98 revenues include local property taxes and money from the state's general fund. These sources account for just over 70 percent of all annual K–12 revenues (Figure 2).

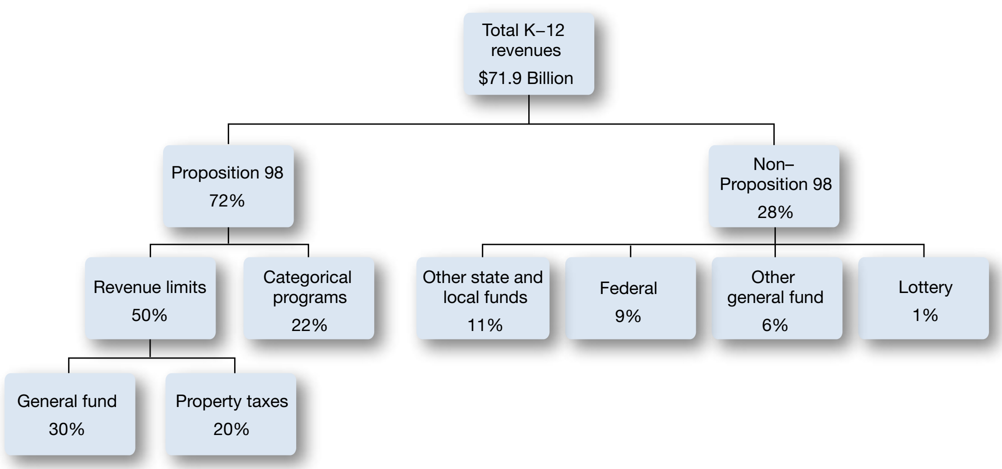
FIGURE 1. K–12 EDUCATION IS THE LARGEST SPENDING CATEGORY IN THE GENERAL FUND



SOURCE: California State Budget 2010–11 Summary Charts, Figure SUM-03.

NOTES: The figure shows general fund expenditures only. "Other" includes General Government ($1,120 million); Business, Transportation, and Housing ($905 million); State Consumer Services ($598 million); Environmental Protection ($77 million); and Labor and Workforce Development ($58 million). Negative statewide expenditures of $4,309 million not shown.

FIGURE 2. CALIFORNIA'S K–12 REVENUES ARE ALLOCATED THROUGH A COMPLEX SYSTEM



SOURCE: California Department of Education, *Report on the Budget Act of 2008*.

NOTES: This chart represents funding levels in the 2008 Budget Act (Chapter 268, Statutes of 2008) enacted on September 23, 2008, for all entities that receive K–12 funding. It does not reflect revisions to the Budget Act that lowered total spending and certified the Proposition 98 guarantee at $49.1 billion. Therefore, the percentages are estimates. The figures given are percentages of total funding: for example, property taxes make up 20 percent of all K–12 revenues and 40 percent of revenue limit funding.

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California's school finance system
is in dire need of reform.

The majority of Proposition 98 funds support the largest K–12 funding category, known as "revenue limits," which pays for basic school operations.[9] Every school district has a base revenue limit—a dollar amount per pupil, funded through the district's share of local property taxes. If a district's property taxes cannot fund the base amount, the state covers the gap.

Proposition 98 funds also support state categorical programs.[10] Unlike revenues for basic operations, these program funds must be spent on specific activities such as special education, textbooks, and professional development for teachers.[11]

Revenues not governed by Proposition 98 comprise less than 30 percent of all K–12 funds. The majority of these revenues come from federal categorical programs, such as Title I, and local sources, such as parcel taxes or donations.

Critiques of the System

As noted above, critiques of California's current school finance system focus on three overarching problems: inequitable funding, inadequate resources, and too much complexity. The per-pupil funding for similar districts serving similar students varies greatly. And districts with higher per-pupil costs—for example, those with more English learners or economically disadvantaged students—do not necessarily receive enough additional resources to address their students' needs.[12]

Critics also note that the state does not provide enough resources for all students to meet the state's academic performance standards. For example, in one measure of resources, pupil-staff ratios, California ranks last or almost last among all states, trailing similarly large, diverse states such as Florida, New York, and Texas (Table 1).[13]

Finally, critics agree that the system is all but impossible to comprehend—from the complicated formulas determining the Proposition 98 funding guarantee to the many categorical programs, each with its own formula and rules. The system is so complex that the state cannot determine how revenues are distributed among its school districts and no more than a handful of experts fully understand it.[14]

PRINCIPLES FOR REFORM

California's school finance system is the product of four decades of state policy proposals and preferences; these piecemeal changes have left it without a unifying structure.[15] This section offers five guiding principles for a new approach to school finance. These principles provide a framework for allocating new revenues and creating a more efficient school finance system.

Meet Resource Needs

Some students are more expensive to educate than others. English learners and special education students usually need additional resources to achieve state standards. Some high school students take specialized classes with expensive lab equipment. Students living in rural areas often have extensive transportation needs.[16] An equitable school

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TABLE 1. CALIFORNIA'S PUPIL-STAFF RATIOS ARE AMONG THE HIGHEST IN THE NATION

	Students per teacher	Rank	Students per counselor	Rank	Students per librarian	Rank	Students per school administrator	Rank
California	20.8	49	809.2	49	5,038.5	50	433.1	47
Florida	15.8	37	433.3	30	912.0	36	333.3	37
New York	13.1	9	463.1	37	876.8	32	294.6	28
Texas	14.5	26	249.7	29	922.8	37	231.7	9
All other states	15.1		440.0		782.8		312.3	

SOURCE: National Center for Education Statistics, Common Core Data, 2007–2008.

NOTE: Rankings based on all 50 states. The "all other states" category includes all states except California, Florida, New York, and Texas. The District of Columbia is excluded.

finance system would provide additional revenue to districts facing these different resource needs.[17] At the same time, to maintain simplicity and transparency, it would be important to address only major needs.[18]

Structure Incentives Properly

In meeting resource needs, a school finance system should structure incentives properly. In particular, the system must not inadvertently reward districts for actions contrary to the best interests of students and taxpayers. For example, struggling students require additional instruction. But if the state awarded additional funds to districts based on the number of students failing state tests, districts would have no financial incentive to help their struggling students. On the contrary, improved student performance would ultimately reduce revenue. Instead, funds should be allocated by a measure that cannot be manipulated by school districts but is highly correlated with student achievement—family income, for example.[19]

Allocate Funds Transparently

School district revenues should not be shrouded in mystery. Yet according to the Governor's Committee on Education Excellence (2007), the current school finance system is "virtually impenetrable." It is quite difficult to determine a district's total revenues and revenues in each categorical program.[20] It is similarly difficult to explain why per-pupil funding varies from one district to another. The complexity of California's system impedes any transparency. Rather than the domain of a few experts, a school finance system should be accessible to all citizens.

Transparency offers an additional benefit: when funding is transparent, it can also be flexible. As costs become clearer, the system can allow for changes in funding rates in light of improved estimates of costs or student needs.

Treat Similar Districts Equitably

An equitable school finance system would allocate funds using an equal per-pupil rate. Programs that compensate districts for extra costs would allocate funds according to a statewide per-pupil rate.[21] Equal per-pupil rates would improve transparency and explain differences in funding levels across districts.

California's current system bases many programs' funding rates on historical expenditures instead of linking them to actual cost differences. Consider California's system of revenue limit funding: despite state equalization efforts, there are large variations in base rates.[22] For example, in four Southern California districts within the same zip code, base revenue limit rates ranged between $6,100 and $7,400 per pupil in 2009–2010 (Table 2). If District 1 had received the statewide average base revenue limit of $6,454 per pupil, its budget would have been $1.2 million higher—not a trivial increase. There is no rational basis for differences in base revenue limit rates—or any other program rates.[23]

TABLE 2. **BASE REVENUE LIMITS VARY, EVEN AMONG DISTRICTS IN THE SAME ZIP CODE**

	District type	Base revenue limit (2009–2010)	Difference from statewide average (2009–2010)
District 1	Elementary	6,110	-344
District 2	Elementary	6,610	+156
District 3	Elementary	7,137	+683
District 4	High school	7,376	+922
All districts		**6,454**	

There is no rational basis for differences in base revenue limit rates—or any other program rates.

Balance State and Local Authority

California has almost 1,000 school districts and more than 8,000 public schools, each with a set of unique needs. A one-size-fits-all approach may not work for every school or school district. The state should take advantage of local knowledge by granting districts more decision-making authority and more control over revenues in exchange for a higher level of accountability.[24]

PATHWAYS FOR REFORM

Given California's current budget problems, school finance reform is not likely to happen overnight. But incremental changes over time could result in a much-improved system. As the economy recovers, K–12 education will receive more revenue than it does today, thanks to Proposition 98. At the same time, student enrollment will remain relatively flat, creating an opportunity to spend more per pupil.[25]

In the past, the legislature has typically used Proposition 98 funding increases to create new categorical programs.[26] But this strategy has led to a fragmented system. PPIC has investigated an alternative strategy, explained in depth in "Pathways for School Finance Reform in California." Briefly, this strategy would use the expected per-pupil funding increase to strengthen three core elements of California's school finance system: the base program (for all students); special education; and Economic Impact Aid, a program that targets both English learners and socioeconomically disadvantaged students.[27]

This strategy would equalize per-pupil funding rates in each area and increase the average rates of each program. Based exclusively on expected increases in per-pupil and using current K–12 revenue formulas, this approach would raise the per-pupil funding rate to the new targets gradually, on a 20-year timeline. Any new funding targeted at reform would result in faster progress.[28] The funding rates in 2030 would be much higher than the current rates, particularly for Economic Impact Aid, and much closer to the rates envisioned by practitioners and researchers (Table 3).[29]

The PPIC strategy shows that small investments over time can result in significant changes to the school finance system. This type of school finance reform is attractive because it does not require a large single-year funding increase and ensures that no district would experience a decrease in funding per pupil.

CONCLUSION

The *Serrano v. Priest* decision and Proposition 13 shifted the funding responsibility for California's K–12 schools from localities to the state. Since Proposition 98, which calculates the annual minimum state contribution to K–12, the state has not had to reckon seriously with its level of support. The current *Robles-Wong v. California* lawsuit, and the

TABLE 3. PPIC'S PROPOSAL WOULD RAISE FUNDING RATES GRADUALLY

Program	Median rate ($/ADA, 2009–2010)	Median rate range in 2030 ($/ADA, 2009–2010)
Revenue limits	5,209	6,368–7,486
Special education	637	637–693
Economic Impact Aid	313	314–1,081

NOTES: Program rates in 2030 reflect final median rates from four scenarios, expressed in 2009–2010 dollars. Each scenario allocates expected increases in funding differently, which explains the range in rates reported in the table. See Rose, Sonstelie, and Weston 2010. The flex item rate in 2030 ranges roughly between $776 and $1,541 per pupil.

The PPIC strategy shows that small investments over time can result in significant changes to the school finance system.

research leading up to it, gives California the opportunity to take stock of its goals for its students and determine how much those goals will cost.

Economic recovery and favorable demographic trends will provide an opportunity to invest more in K–12 education. The state can use this opportunity to address underlying weaknesses in its school finance system and create a formula that, in time, will ensure higher and more equitable levels of funding.

Of course, priorities for funding may differ. This report outlines a system that increases base funding for all students and prioritizes students who need additional resources to achieve state standards—English learners and socioeconomically disadvantaged students. State policymakers may have other priorities, such as teacher professional development or career-technical education.

Whatever path it chooses, the state needs to act now to determine its priorities, indicate those priorities in a transparent way through per-pupil funding targets, and create a long-term plan to reach the targets. With a dedicated plan, California can carry out much-needed school finance reform.

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NOTES

1 In the past several PPIC surveys focused on Californians and education, 54 percent (2005) to 63 percent (2010) of state residents have chosen K–12 education as the budget area they most want to protect from spending cuts. See Baldassare et al. 2005–2010.

2 See www.fixschoolfinance.org for more information about the coalition and lawsuit. A second lawsuit was filed on July 12, 2010, by a coalition composed of the Campaign for Quality Education, Alliance of Californians for Community Empowerment, Californians for Justice, the San Francisco Organizing project, and more than 20 individual students and parents. For more information, see www.publicadvocates.org.

3 Bersin, Kirst, and Liu 2008; Chambers, DeLancey, and Levin 2007; Duncombe and Yinger 2007; Gandara and Rumberger 2007; Governor's Committee on Education Excellence 2007; Harr et al. 2007; Imazeki 2007; Kirst, Goertz, and Odden 2007; Loeb, Bryk, and Hanushek 2007; Reich 2007; Rose et al. 2003; Sonstelie 2007; Weston 2010.

4 Rose et al. (2003). Rose et al. (2008) and Reinhard et al. (2008) model the proposals formulated by Bersin, Kirst, and Liu (2008) and the Governor's Committee on Education Excellence (2007). They estimate that additional costs would be between $2 billion and $12 billion (in 2004–2005 dollars).

5 The California Department of Finance expects student enrollment to increase 6 percent by 2020, while the number of taxpayers is expected to increase 16 percent. If there are more taxpayers per student, a given tax burden for the average taxpayer will produce more per-pupil revenue for schools. See Rose, Sonstelie, and Weston 2010.

6 For more information about the history of California's school finance system,see Kemerer and Sansom 2009 and Sonstelie, Brunner, and Ardon 2000.

7 Sonstelie, Brunner, and Ardon 2000. See Figure 1 for sources of funding.

8 Passed in 1988, Proposition 98 is complex. It requires the state to spend at least 40 percent of its general fund on K–14 education. For a thorough summary of its history, formulas, funding sources, and expenditures, see the Legislative Analyst's Office Proposition 98 tutorial at www.lao.ca.gov.

9 Each district's revenue limit was based on its 1972–1973 expenditures per pupil. The limits have been increased over time due to inflation and equalization. See Weston 2010 for more information on revenue limits.

10 See Weston, Sonstelie, and Rose 2009 for a comprehensive list, description, and analysis of California's categorical revenues.

11 Recently the state eased restrictions on approximately 40 categorical programs so that the funds may be spent on any educational purpose through 2012–2013. See Legislative Analyst's Office 2010 and Weston, forthcoming, for more information about the new categorical flexibility.

12 Governor's Committee on Education Excellence 2007; Rose el al. 2008, pp. 13–18.

13 Of course, it is very difficult to determine the resources needed for the state to meet its goals for student outcomes and their cost. Several studies have estimated a substantial increase (PPIC's estimate is 40 percent) in K–12 funding necessary for all students to achieve the state's standards. See Chambers, DeLancey, and Levin 2007; Imazeki 2007; and Sonstelie 2007.

14 Governor's Committee on Education Excellence 2007.

15 Kirst, Goertz, and Odden 2007.

16 There is some debate regarding the effect of additional revenues on student achievement. For example, Loeb, Bryk, and Hanushek (2007), in summarizing findings from the 23 Getting Down to Facts studies, concluded that more revenue in itself would not improve student outcomes. Similarly there is some uncertainty over costs for certain types of students. See Rose et al. 2008 for an analysis of cost differences across California's school districts. For more information and cost estimates for groups of California students, see Chambers, DeLancey, and Levin 2007; Gandara and Rumberger 2007; Harr et al. 2007; Imazeki 2007; Rose and Sengupta 2007; and Sonstelie 2007.

17 California's current system does recognize some of these costs through dedicated funding for special education, English learners, transportation, and small isolated schools, for example. However, the funds currently allocated for these costs are either insufficient or violate one or more of the four other principles of school finance reform. See Gandara and Rumberger 2007; Rose, Sonstelie, and Weston 2010; Lipscomb 2009; Sonstelie 2007; and Weston 2010.

18 See Rose et al. 2008 for an assessment of which costs are large enough to warrant additional funding.

19 There is a negative relationship between the proportion of students eligible for the free or reduced-price lunch program and a school's academic achievement as measured by the state Academic Performance Index (see Rose et al. 2008, pp. 6–11). There is some debate about the underlying causes and strategies for addressing this problematic relationship. For an example of the debate, see Williams and Noguera 2010.

20 Weston, Sonstelie, and Rose 2009.

21 In California's current system, districts receive funds to support additional services and materials for English learners and disadvantaged students, but the per-pupil rates vary greatly. In 2009–2010, the rates ranged from $102 to $3,277 per targeted student—a clearly unequal and inequitable distribution.

22 See Weston 2010.

23 High school districts have the highest base revenue limits. In 2009–2010, high school districts received approximately $1,000 more per pupil, on average, than unified districts and over $1,200 more per pupil than elementary districts. These higher rates for high school districts are often justified by the idea that high school students are more expensive to educate because of lab equipment and specialized teachers. Although this may be true, these higher rates are not an explicit state policy. If California pursues a policy that differentially funds students based on their grade level, it could look to its charter school funding formula where all students in the same grade band are funded at the same rate. See Weston, Sonstelie, and Rose 2009 and Weston 2010.

24 California recently took a step toward allowing more local control. For early results of California's flexibility provisions, see Legislative Analyst's Office 2010 and Weston, forthcoming. Senate Bill 1396 (Lowenthal 2010) would pilot maximum categorical flexibility to three districts in exchange for more stringent student outcome requirements. The full text of the bill, analysis, and updates on the bill's progress are available at www.leginfo.ca.gov.

25 In general, the Proposition 98 guarantee increases school funding at the rate of growth in per capita personal income, which is typically faster than inflation. This results in an annual increase in real per-pupil funding, which is factored into our simulations. See Rose, Sonstelie, and Weston 2010 for more information on the simulations and assumptions behind those simulations, including enrollment projections.

26 See Legislative Analyst Office 2006, for example.

27 See Rose, Sonstelie, and Weston 2010. The report also explores other scenarios, including equalizing the "flex item," the funds in the 40 categorical programs granted flexibility in the 2009 Budget Act.

28 The simulations in Rose, Sonstelie, and Weston (2010) offer one set of alternatives. We are able to model others; send inquiries to schoolfinance@ppic.org.

29 Bersin, Kirst, and Liu 2008; Chambers, DeLancey, and Levin 2007; Governor's Committee on Education Excellence 2007; Harr et al. 2007; Lipscomb 2009; Sonstelie 2007.

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