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R E P O R T

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# Deregulating School Aid in California

Revenues and Expenditures in the  
Second Year of Categorical Flexibility

Jennifer Imazeki

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## Summary

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For decades, policymakers and researchers have been debating the effectiveness of California’s highly regulated and prescriptive system of school finance. For much of that time, a chief target of critics has been the large share of funding that is allocated through categorical programs, that is, programs where funding is contingent upon districts using the money in a particular way or for a particular purpose. In 2007–08, roughly two-fifths of state<sup>1</sup> school spending on K–12 education was allocated via more than 60 separate programs, each with its own set of restrictions on how the funds from that program could be spent. In 2008–09, the strings were taken off 40 of those programs, collectively known as the “Tier 3” programs, as part of a budget deal that also reduced the funding for those programs.<sup>2</sup>

In 2010, researchers at the RAND Corporation, the University of California at Berkeley and Davis, and San Diego State University joined together to study the impact of the new policy. The objective of the research is to gather evidence about how districts have responded to the fiscal freedom, particularly how resource allocations are made at the district level and what specific changes districts have made in their allocations. Understanding how districts have responded to the Tier 3 flexibility is particularly important in light of Governor Jerry Brown’s recent proposal to largely dismantle the remaining categorical programs and move to a weighted school finance formula that would dramatically increase the control that districts have to spend their budgets as they wish.

The project’s overall research questions were the following:

1. What did district leaders do with the newly flexible Tier 3 funds?
2. How did district leaders make these allocation decisions, and who was involved?
3. What were the reported local consequences of these allocation decisions?
4. What prior conditions and concurrent factors shaped budget decision of district leaders?
5. How did federal Title I stimulus funds interact with decisions about Tier 3 flexibility?
6. What are statewide revenue and spending patterns for Tier 3 and stimulus funds?
  - a. Which kinds of districts, schools, and students benefit most from the flow of deregulated Tier 3 categorical aid and federal stimulus dollars?

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<sup>1</sup> This refers to revenue only from the state general fund and other state sources and does not include federal or local funds. That is, of the money allocated to districts from the state, about 40 percent was disbursed through categorical programs.

<sup>2</sup> See Fuller et al. (2011) for a full discussion of the history of California’s categoricals and the passage of the Tier 3 flexibility legislation.

- b. Do districts (and schools) with larger shares of Tier 3 and federal stimulus funding (as fractions of their overall budgets) spend relatively more or less on instruction and teaching staff, compared with districts that receive less from these sources?

The first five questions are addressed through in-depth case studies of ten districts, detailed in Fuller et al. (2011), and a statewide survey of district administrators, discussed in Stecher et al. (2012). Imazeki (2011) provided preliminary answers to the sixth question using comprehensive accounting and administrative data for all districts.

This report supports and extends the analysis in Imazeki (2011) in three ways. First, the previous report discussed revenues and spending patterns in the 2007–08 and 2008–09 school years; the analysis here adds data from 2009–10, the first full year of Tier 3 flexibility. Second, this report provides technical details about the data and variables that were not included in the earlier policy-oriented brief. Finally, this report presents as much of the data as possible, summarizing multiple measures of revenues and expenditures by district characteristics and exploring the patterns across districts.

## Data

All the financial data for this analysis come from the California Department of Education’s Standardized Account Code Structure (SACS) files. Data on district revenues and expenditures are combined with district characteristics, including district type (elementary, high school, or unified), fiscal health, Basic Aid status,<sup>3</sup> urban category, size, student performance (measured with the Academic Performance Index), percentage of students in poverty, and percentage of English learners. Revenue per pupil from the flexed Tier 3 programs, as well as federal stimulus funds and all restricted revenue, is compared to total revenue per pupil. In the analysis of expenditures, spending is broken into seven categories based on what items are purchased (instructional personnel, instruction materials, instruction-related personnel, other instruction-related materials, pupil services, local education agency [LEA] administration, and all other) and into eight categories based on educational goals (pre-K, general K–12, alternative education, adult education, supplemental education, special education, other instructional or service goals, and goals unrelated to instruction services).

Although the SACS system provides detailed information on the source and use of district monies, there are several limitations as well. Aside from the lag in availability that restricts this analysis to the years through 2009–10, a particular problem is that Tier 3 funds (and associated spending) cannot be identified after the 2008–09 school year. Therefore, only broad conclusions can be drawn about changes in district spending, based on changes in total expenditures.

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<sup>3</sup> Districts with Basic Aid status are those districts with local property tax revenue above their state-determined revenue limit. Because districts can keep the excess tax revenue, Basic Aid districts typically have more unrestricted funds and higher revenue overall.

## Findings

Districts receiving the highest levels of Tier 3 revenue per pupil, and with the largest budget shares coming from Tier 3 programs, tend to be high school districts and large districts in urban areas, serving larger proportions of high-need students (i.e., low-performing, in poverty, English learners). Given that funding for Tier 3 programs was reduced at the same time that more flexibility was granted, concerns have been raised that these districts with relatively more Tier 3 funding have been disproportionately affected by the state's budget crisis. However, the data show that districts with more Tier 3 funding lost a similar share of their budget as did other districts (although that represents larger per-pupil dollar amounts). Furthermore, so far and on average, districts do not appear to be making large-scale changes in how they are spending their money. As budgets have shrunk, districts are clearly trying to protect core programs, particularly instructional personnel and special education programs. There is a great deal of variation in how districts have responded to the budget cuts and to Tier 3 flexibility, but that variation does not seem to be strongly correlated with any observable district characteristics. These observations might be some comfort to those who have feared that higher-need districts would be disproportionately affected or that districts would simply abandon programs for higher-need students without the requirements of the categorical program regulations. On the other hand, districts with comparatively more Tier 3 revenue per pupil do seem to have made relatively larger cuts in programs for alternative and adult education, so the impact on students in these programs is unclear.

Several important caveats need to be considered. The analysis here is fairly broad in scope and only considers data through the first year after the policy went into effect, so districts had relatively little opportunity to make any major changes. In addition, it was (and still is) unclear whether the flexibility will last beyond the legislated sunset date in 2014; thus, some districts may have been reluctant to make major changes anyway. Perhaps most important, it is nearly impossible to separate the effect of increased flexibility from the overall reduction in resources experienced by almost all districts in the past few years. The two undoubtedly interacted as many districts used the additional freedom over Tier 3 funds to compensate for reductions in general funding levels. To the extent that districts made changes in their spending patterns, there is no way to determine whether similar changes would have been made without the accompanying budget cuts.