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REPORT

Deregulating School Aid in California

How Districts Responded to Flexibility in Tier 3 Categorical Funds in 2010–2011

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Summary

Background

California policymakers have long debated how state funds should be allocated to schools. Some argue for policies that target funds to particular purposes ("categorical funding") while others advocate giving schools and districts flexibility in determining how to allocate their funds. For the most part, the former approach has held sway since the 1970s, as the percentage of earmarked education funding has grown from about 25 percent of state education funding in 1980 to nearly 40 percent in 2007–08 (Imazeki, 2012). Yet, neither research nor recent experience provides clear evidence about which approach yields more positive student outcomes.

The issue became relevant again in 2009 when the legislature, faced with declining revenues, decided to reduce educational funding in the state. To lessen the impact on districts, the legislature enacted SBX3-4, which grouped the state's categorical programs totaling $19.1 billion in state funding (LAO, 2010) into three tiers with varying levels of flexibility. For Tier 3 programs, which included 40 of the more than 60 categorical programs and accounted for roughly $4.5 billion, districts were given complete flexibility to use the resources as general funds. Although this particular deregulation was likely the result of political expediency rather than a discrete change in philosophy concerning fiscal regulation (Fuller et al., 2011), policymakers expressed a number of competing hypotheses about how districts would use additional flexibility. Their predictions about district responses included the following: districts would "sweep" deregulated dollars into the general fund to maintain financial solvency; districts would make focused investments in new instructional approaches to meet local needs and state accountability demands; districts would further delegate decisionmaking to the school level where educators are most familiar with student needs; and districts would be influenced by vocal, organized constituencies, resulting in greater disparities among schools or student groups. This study examines how districts made allocation decisions about these funds and sheds light on the accuracy of those predictions.

This research project, which began with case studies of ten districts in 2010 and ends with the statewide survey reported here, aims to inform the ongoing debate over categorical funding by examining the effects of Tier 3 flexibility. The survey was designed to help us answer five questions:

1. How informed were district leaders about Tier 3 policies, where did they get their information, and what opinions did they hold regarding regulations and legislative intent?
2. What did districts do with the newly flexible Tier 3 funds?
3. How did district leaders make these allocation decisions and who was involved?

4. What were the reported consequences of these allocation decisions?
5. What do district leaders think is likely to happen with Tier 3 funds in the future?

This report illuminates how district leaders responded to sudden, limited fiscal flexibility and the conditions that shaped their decisions. The situation did not permit us to answer more-general questions about potential responses to flexibility, such as whether district leaders allocate dollars to more cost-effective instructional strategies or whether their decisions lead to better student outcomes.

Methods

To answer these five questions, we conducted a survey of 350 California school district chief financial officers (CFOs) between April and August of 2011. The survey questions grew out of case studies of Tier 3 deregulation we had conducted previously. We selected a stratified sample of districts that varied across the key characteristics identified in our ten-district case studies as relevant to districts' use of fiscal flexibility.

Each CFO was contacted initially by email and was offered a $25 gift certificate for participation. Over the next four weeks, respondents received four follow-up emails. Our final response rate was 64 percent of the original sample (223 individual districts). We used non-response weighting so the final results would reflect the population of districts in California.

Key Findings

How Well Did Districts Understand the Regulations and the Purposes of the Legislation?

Even after a year of implementation, uncertainty persisted over the purposes of Tier 3 flexibility and the rules governing it. For example, about half of CFOs thought that Tier 3 flexibility represented a fundamental shift in the legislature's policy of controlling categorical aid funding; about half did not. Opinions among CFOs also differed as to whether the law enabling flexibility superseded court orders and legal mandates.[1] Similarly, CFOs differed in whether they continued to track revenues and expenditures using the categorical funding "object codes."

Who Did Districts Turn to for Information and Advice?

CFOs relied heavily on School Services of California and their county office of education to make sense of the rules and regulations related to Tier 3 flexibility. The state Department of Education was not commonly seen as a source of information.

What Was Done with Tier 3 Categorical Funds?

According to CFOs, the bulk of Tier 3 program funds were reallocated, that is, "swept" into district general funds. Some programs took heavier hits than others—pupil retention, Targeted Instructional Improvement Block Grants (TIIBGs), and programs linked to teacher quality, such as the Professional Development Block Grant. Some programs were less likely to have their funds reallocated, such as preparation for the California High School Exit Exam (CAHSEE).

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[1] Although, as noted previously, this may be partially explained by confusion about the interpretation of the survey item.

A number of districts also protected the Professional Development Block Grant. Programs not essential to core subjects—for example, the stream for arts and music—were commonly swept into the general fund. Even programs that may have strong local constituencies, such as Gifted and Talented Education (GATE), were also frequently swept. Most districts swept unexpended prior-year balances from Tier 3 categories into their general fund as well. Sweeping into general funds was common across all types of districts, but particular district leaders showed a stronger inclination in this direction: those in rural districts, small districts, and less fiscally healthy districts.

What Priorities Did District Leaders Emphasize?

CFOs reported three top priorities: preserving fiscal solvency, retaining staff, and preserving current instructional programs. Concern over potential conflicts with labor unions was not a sizable worry for most CFOs, although those in urban districts were more concerned about this than CFOs in suburban and rural districts. Still, about one-third of CFOs reported that aligning spending with "school improvement goals" was a high priority, and a few reported allocating newly flexible dollars to instructional reforms. CFOs in urban districts were significantly more likely to fund new initiatives, compared with rural or suburban CFOs.

Who Influenced Decisions About Tier 3 Programs?

According to the CFOs, most major decisions were made by the superintendent and district office staff. Parent groups, local constituencies, and union leaders were much less involved or influential. These latter groups, however, were more involved in the budget process within large and urban districts. Almost three-fifths of CFOs reported that principals were not awarded additional fiscal discretion in the wake of the Tier 3 reform.

What Were the Consequences for Students, Staff, and Other Stakeholders?

We found nearly unanimous agreement that flexibility helped districts avoid layoffs and salary reductions. CFOs also reported that reallocation of Tier 3 funds, and the accompanying reduction of some long-standing categorical programs, did not cause great conflict among parents and various stakeholder groups. Nearly 80 percent of CFOs believed that deregulation did not harm low-achieving students by allowing resources to be shifted away from them. The exception is that CFOs in some large districts, urban districts, and districts serving English learner (EL) and minority populations expressed some concerns about Tier 3 categorical funds flowing away from those students who needed them. Finally, many CFOs reported that districts used categorical program flexibility as an opportunity to align local priorities and needs with their financial resources.

What Do Districts Expect to Happen in 2011–12?

Looking forward, CFOs expect fiscal pressures to lead to further belt tightening. CFOs expect to reduce classified and certificated staff and increase class size in 2012, but they were less likely to anticipate changes that require renegotiating contract provisions. As noted, CFOs indicate that they will continue to sweep Tier 3 funds into the general fund in 2012 to mitigate financial difficulties and that, in many districts, the level of Tier 3 funds they sweep is likely to increase.

Lessons Learned from Tier 3 Flexibility

Does the evidence we collected support any of the common hypotheses about how flexibility would be used? For example, were districts more likely to sweep deregulated dollars into the general fund to maintain financial solvency; make focused investments in new instructional approaches to meet local needs and state accountability demands; further delegate decision-making to the school level; or respond to vocal, organized constituencies resulting in greater disparities among schools or student groups? Before looking at these questions, it is important to remember that the legislature granted districts flexibility over Tier 3 categorical funds during a time of sharp budget cuts and great fiscal uncertainty. As a result, we must be cautious in generalizing these findings to other situations because responses to flexibility might be different in a different fiscal context.

Overall, responses from CFOs were consistent with the general notion that districts were displaying "rationality on the ground" in face of declining revenues and uncertainty over policy. Most CFOs reported that their district engaged in a serious assessment of budget priorities in the face of fiscal uncertainty and newfound flexibility, and they chose a conservative strategy of protecting employees, class sizes, and core instructional programs. A few reported capturing newly flexible dollars to mount instructional reforms, but this was not common. We found little evidence that districts engaged in careful weighing of the relative effectiveness of programs as a basis for linking spending priorities to student achievement. For the most part, decisions were made centrally, not passed down to the school level. Generally, vocal constituencies did not dominate the decisionmaking process, although some CFOs in large districts were concerned that the choices made were reducing resources for low-achieving students.

Going forward, the legislature must decide by 2015 whether to continue Tier 3 flexibility. Governor Jerry Brown has proposed a broad expansion of this approach, hoping to create a $7.1 billion flexible block grant for local districts. As this policy proposal is considered, we encourage California policymakers and education stakeholders to attend to the following issues:

- The legislature and governor should articulate clearly the purposes of fiscal flexibility in order to reduce confusion at the local level. Two issues are intertwined in debates about deregulation and flexibility—which educational programs will be supported and who will make the choices. It would be helpful to send clearer signals about each of these issues.
- Similarly, if the legislature and governor hold particular priorities with regard to improving the performance of low-achieving students or advancing certain reform models, those priorities should be made explicit to local educators.
- Other policies are being considered that interact with flexibility, and educators will need much clearer information and guidance to deal with multiple, interrelated policy changes. In particular, the Governor's plans also include a new approach to allocating educational funds—a weighted student formula. Such a change would add additional uncertainty for districts and schools, and clearer guidelines about purposes and procedures will be essential if such changes are made.
- The Department of Education should require districts to use a common system for reporting on revenues and expenditures, and the system should permit tracking of resources in ways that are relevant to any new program and finance priorities.

- Policymakers should require evaluation of the impact of flexibility to determine which students, schools, and programs benefit from fiscal flexibility, and which do not.