Building State Capacity and Productivity Center
at Edvance Research, Inc.

# Funding for Students' Sake: How to Stop Financing Tomorrow's Schools Based on Yesterday's Priorities

Larry Miller, Center on Reinventing Public Education
Marguerite Roza, Edunomics Lab
Suzanne Simburg, Edunomics Lab

May 2014

One of a state's primary responsibilities is to divvy up the public funds for K-12 schooling. In each state, a set of finance policies determines how the state and local funds are apportioned so that districts and other providers can then apply them to schools and classrooms. Different states use a host of variables and formulas to determine how much each district and school receives. Depending on the state, the allocations may factor in a district's distinctive assortment of student needs, or the district's size, cost of living, degree of urbanicity, and so on. And in some cases, the allocations are dependent on whether students are taught in district schools, charter schools, or online schools.

As important as state allocation formulas are, they don't change much over time, even as what we know about education evolves. While states might tweak their models from year to year—layering new program funds on the old model, or adding ways for districts to retain funds as they lose students—states tend to make major changes only about once every two decades.

> "Student performance depends not only on the amount of money we have for education but also on how those funds are used."

In many states, that once in two decades seems to have arrived. Some leaders have come to realize that allocation formulas have big implications for whether a state's education system promotes or inhibits increased productivity in schools. So, now that a few states are seeing some black in their balance sheets after several years of highly constrained state funding, and districts are asking for a share of the new money, forward-thinking state leaders are calling for something in return—namely, that districts and schools make sure the money does more to improve student outcomes.[1] As Colorado State Senator Michael Johnston stated recently, "Student performance depends not only on the amount of money we have for education, but also on how those funds are used."[2]

This focus on getting a greater return on funds has implications not just for districts but also for states. To get better outcomes for the money—an imperative given today's budget strictures and urgency

1. For example, California just approved new finance legislation, and recent or active proposals have emerged in Colorado (defeated at the ballot in 2013), Pennsylvania (the Governor's Expanding Excellence Program), and Ohio (where there were proposals by the governor and the House).
2. Michael Johnston, opening remarks to the School Finance Partnership Dinner hosted by the State Board of Education, March 19, 2012.

for better student results—districts will have to use funds differently going forward.[3] Student-based allocation, also known as weighted student funding,[4] where funds are attached to each student and move with students wherever they go to school, provides the most equitable, efficient, and flexible path toward increased productivity. This essay explains why it is a good idea to allocate resources on the basis of students, and measures several states' progress toward doing so.

## HOW DO STATE FORMULAS AFFECT DISTRICT SPENDING?

> **Student-based allocation provides the most equitable, efficient, and flexible path toward increased productivity.**

Education finance formulas not only determine the level of funding a district gets from state and local sources, but also affect the choices districts make regarding how to spend their funds. Funds are often deployed on the basis of purchased inputs (for example, money to fund one teaching position for every 20 students) or historic funding levels (where each district receives some percentage more than it received the previous year). Some allocation formulas link funds to a specific delivery model or program (for example, funds are directed to tutoring, or to keeping Advanced Placement courses small, or to providing anti-bullying initiatives, or to subsidizing smaller schools).

The specifics of state funding formulas vary widely. But what many states have in common is layer upon layer of rules and provisions that limit districts' flexibility, create inequities among districts, and hinder productivity. As states urge districts to try to get more bang for their buck, they will want to take stock of the following ways their allocation policies matter for districts:

### Equity and Accountability

If some districts are given more funds than their peer districts with similar student needs, or if the formulas do not recognize districts with greater student needs, then district and school leaders might rightly see the finance system as inequitable. They might then question how

3. Marguerite Roza. "Leveraging Productivity for Progress: An Imperative for States," in *Prioritizing Productivity: The SEA of the Future*, Vol. 2, ed. Betheny Gross and Ashley Jochim (San Antonio: Building State Capacity & Productivity Center at Edvance Research, Inc., 2013).
4. The terms *student-based allocations* (SBA) and *weighted-student funding* (WSF) are sometimes used interchangeably. SBA is used in this paper to emphasize funding of students as compared to funding of objects or programs and services.

they can be held to the same accountability standards as better-funded places. For accountability systems to work, district and school leaders need to believe they operate on a level playing field.

## Flexibility for New Delivery Models

Sometimes, state leaders want districts to use funds differently, but state formulas do not let them. In some states, allocations come in the form of schooling inputs, and the formula fixes how money is to be spent—how many teachers are funded for a certain number of students, how many computers or textbooks are purchased, how many periods are funded in a school day, and so on. This limits the flexibility of district leaders to decide how their funds are spent, and causes them to worry more about complying with rules than about leveraging their funds for greater productivity.[5]

When schools shift to digital content, it doesn't make sense to lock in spending on textbooks. Funding based on fixed class sizes or rigid compensation structures seems dated in a world where districts are rethinking these parameters.

## Adaptability and Efficiency

When district enrollment drops due to shifting demographics or the growth of charter schools, districts are slow to rightsize their operations or shift to contractors in areas where that makes financial sense. Some of the sluggish response is likely the result of state allocation formulas that work precisely to keep districts from adapting. For example, "hold harmless" formulas (which provide extra funds to districts where declines in enrollment would otherwise create a dip in funds) and subsidies that allow small school systems to provide services in the same way that larger systems do both allow districts to maintain levels of service that may not be appropriate for their mix of students. Such allocations remove the incentive to innovate for greater productivity.

In states that are moving toward student-based allocations, part of the thinking is that as delivery models evolve, so should school financing. When schools shift to digital content, it doesn't make sense to lock in spending on textbooks. Funding based on fixed class sizes or rigid compensation structures seems dated in a world where districts are rethinking these parameters.

5. Hold harmless formulas also create funding inequities that threaten the perceived fairness of accountability systems.

Given how rarely state allocation formulas are changed, it's likely that any major formulas adopted in the near term will still be around into the 2030s. Consequently, tying funds to schooling inputs or certain delivery models, rather than to students, will hold districts back from making the changes they will need to in the coming years.

## How Much Is *Really* Allocated Based on Students?

To meet these challenges, some states are adopting student-based allocations, where a fixed amount of funds is allocated per pupil or per pupil type, and follows the student to whatever school the student attends. The fixed amount includes adjustments for student needs—for instance, a student with limited English proficiency may be funded at a higher level than a native English speaker would be, and similarly, more funds are attached to students with disabilities or those living in poverty.

Tying funds to schooling inputs or certain delivery models, rather than to students, will hold districts back from making the changes they will need to in the coming years.

A student-based allocation model addresses several of the concerns mentioned above. By delivering a fixed amount per student type, the allocations meet the test of equity. In a student-based allocation structure, funds remain flexible and can be redeployed in new ways as more promising delivery models emerge. A strict student-based allocation structure means funding is automatically adjusted when enrollment shifts, so districts learn to adapt regularly to changing conditions. As an added bonus, allowing districts to keep the savings associated with more efficient delivery models provides the incentive to innovate for greater productivity.

Some states do have student-based allocations as part of their allocation formulas—but then they are smothered by myriad other allocations and provisions. Some states are in fact considering implementing or expanding student-based allocations. Others don't use them at all.

The Edunomics Lab has been conducting an ongoing study in five states to determine the portion of state and local monies delivered via student-based allocation.[6] Measuring progress toward full student-based allocation can inform state policymakers as they take stock of the current finance policies and set goals for future policies.

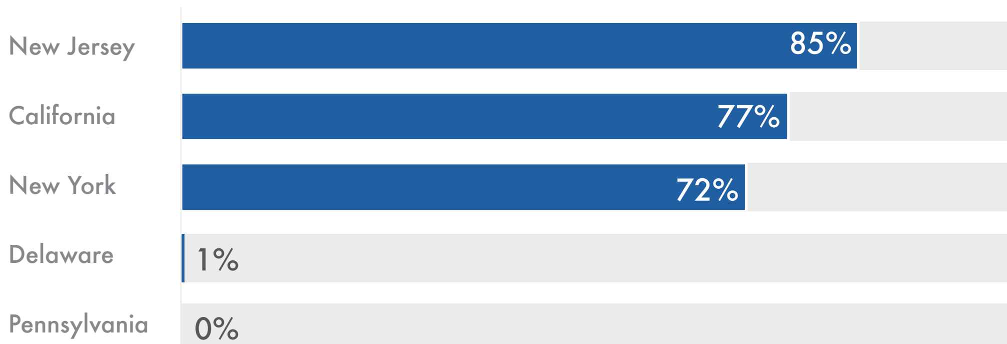
6. Marguerite Roza, Larry Miller, and Suzanne Simburg, "To What Extent Are School Districts Funded by Student-Based Allocations? An Analysis of State Aid and Local Revenue Funding Mechanisms Across Five States" (Washington, DC: Edunomics Lab at Georgetown University). See the study for the list of the five states, plus additional states included in the analysis.

The study analyzed all state and local funds in each state—California, Delaware, New Jersey, New York, and Pennsylvania—and determined the dollar amount of any funds deployed with a student-based formula. To be considered student-based, the allocation had to deploy a fixed amount of money on the basis of students or student types. The study considered all state and local public funds for K-12 education, excluding any long-term obligations like debt for facilities.[7] Figure 1 captures the findings for each of the five states for the 2013–14 fiscal year.

In California, New Jersey, and New York, nearly three-quarters or more of state and local funds follow a student-based formula. In contrast, almost none of Delaware's and Pennsylvania's funds are deployed on a student basis.

In California, which used to employ a variety of types of allocations, a recent state education finance overhaul, called the Local Control Funding Formula (LCFF), implemented a student-based formula.[8] For each district, the state determines the target spending, based on the mix of students, and then applies some or all of the local revenues toward that target. State funds then make up the difference. (Figure 2 shows how much is allocated for each student by grade level and need.) A similar model was proposed in Colorado, but the Colorado formula was tied to a measure asking voters for additional funding and that measure was defeated at the ballot box in November 2013. Also in 2013, governors in Ohio and Pennsylvania made proposals to advance student-based

Figure 1. States Vary in the Portion of Their Monies Deployed via Student-Based Allocations




Percent of state and local monies allocated on the basis of students.

7. Federal funds, which represent some 9–12% of total K-12 revenues, were excluded from this analysis, as were funds for long-term debt and capital costs.

8. While California's LCFF dictates the allocation of funds, it does not mean that the state has removed all process constraints that can inhibit flexibility. In fact, California retained its class size limits, but does allow a district to exceed the state's 24-student class size maximum if such a provision is included in a local bargaining provision.

allocation; both proposals are currently pending.

New Jersey passed finance legislation in 2008 that uses a student-based allocation formula as the target for the sum of state and local funding. While New Jersey still maintains several separate allocations, such as one for transportation, some of those are also allocated in fixed per-student increments and thus also qualify as student-based allocations, even if not flexible. In New York, a long-running complex finance formula has undergone changes over the years, but many portions are still based on students. New York's state funds are determined in part by local revenue capacity, but with many formula details and exceptions. In each of these three states, while a substantial portion of the funds follow students, between 15 percent and 28 percent of the funds do not—because of hold harmless provisions, separate allocations that fund programs or services, allocations that take the form of reimbursements, and other factors.

Figure 2. Per Student Allocations in California

| Student types | Allocation |
|---|---|
| Grades K-3 | $7,557 |
| Grades 4-6 | $6,947 |
| Grades 7-8 | $7,154 |
| Grades 9-12 | $8,505 |
| Limited English | +20% |
| Poverty* | +20% |
| Foster youth | +20% |

Source: Data from California Department of Education, "Local Control Funding Formula Overview," last reviewed January 15, 2014, accessed February 11, 2014.

*High-poverty districts receive an additional 50% weight for each disadvantaged student above the 55% threshold.

In contrast, Delaware and Pennsylvania each allocate funds in a way that is not based on students at all. Delaware's formula awards "units" instead of dollars, where each unit is the equivalent of a full-time staff position. Some of the units are assigned on the basis of student counts, while others are assigned on a per-school or other basis. This locks in staff positions in ways that can feel inequitable and limit flexibility—one middle school might have just one more student than another middle school, which, under the formula, may net the school the funding for one more administrator. Since what gets delivered are units, not funds, the increments are larger and less flexible. Under this system, it is not the case that the state spends the same dollar amount on each student regardless of which school the student attends. Pennsylvania does have a student-based formula on the books, but it hasn't been used in years. Instead, funding is allocated by just adding a percentage each year to whatever districts received the year before.

## REMOVING BARRIERS TO STUDENT-BASED ALLOCATIONS

Even in states where the basic allocation formula is student-based, a substantial portion of the monies may be allocated via mechanisms other than student-based funding. These extra allocations make the state and local revenue structure less transparent, less equitable, and less flexible. Ending or shrinking the following types of allocations can free funds to expand allocations via a student-based formula, and thus make it easier for district and school leaders to apply funds in ways that are efficient and best meet the needs of their students and communities:

> Legislatures are often tempted to put limits on how districts can use state monies, but succumbing to this temptation means that districts cannot make smart trade-offs about how to apply their funds.

### Categorical Funding for Programs or Delivery Models

State legislatures sometimes earmark funds to be used only for a specific program, school type, or delivery model. The initiatives—Advanced Placement classes, computer science classes, charter schools, or online learning programs—may have been justifiable when they were conceived. But by earmarking funds for only certain programs, states tie the hands of district and school leaders. Some states dedicate money specifically for charter schools, some states earmark vocational schools, and some target digital learning. By funding each model separately, the funds tip the scales in favor of some schools or delivery models over others, and prohibit a fair comparison on the merits of one program to another since some delivery models receive more resources than others. For instance, when digital learning is funded by a separate line item, those offerings are not managed under the same performance and cost expectations as other delivery models. A school that might benefit from more digital learning may refrain from adopting it, because leaders have been conditioned to develop these programs only when funds are dedicated to do so.

## Dedicated Funds for Schooling Inputs

Funding for specific schooling inputs can also constrain district spending choices and perpetuate inefficiencies. In Delaware, the decades-old finance system funds salaries for employees instead of delivering funds that are made fully flexible to districts. According to the Education Commission of the States, six other states—Alabama, Idaho, Washington, North Carolina, Tennessee, and West Virginia—use as their primary formula one that allocates resources in the form of teachers, like Delaware.[9] In many states, smaller amounts of monies are allocated for specific schooling inputs like reading coaches or bonuses for teachers with National Board Certification. Legislatures are often tempted to put limits on how districts can use state monies, but succumbing to this temptation means that districts cannot make smart trade-offs about how to apply their funds. And, it provides perverse incentives. If funds are earmarked for reading coaches, and a school finds that it does better using an approach that does not require reading coaches, it loses those funds—so the principal might be inclined to revert to the (less effective) coaches.

## Reimbursements

Some states allocate a portion of their funds on a cost reimbursement basis, where districts can submit expenditures for reimbursement for services such as transportation and food services, often up to a certain funding limit. This encourages districts to spend more on reimbursable activities, and discourages them from seeking efficiency improvements from reimbursed activities. Some districts with high transportation bills have been able to rethink the number of school days, increase public or family transportation, and take other measures to reduce their busing bill. In a strict reimbursement model, districts do not save money by making such changes, so they don't bother to try. For example, years ago in Seattle, a new, lower-cost transportation plan was proposed, but after finding that the savings would just result in fewer dollars from the state and no extra monies for the district, the school board determined that the effort involved was not worth it and scrapped the plan.

## Hold Harmless Provisions

Hold harmless provisions, also known as phantom student funds, are funds delivered to districts specifically to hold them financially harmless from any changes created by enrollment shifts or other formula modifications. The effect is that districts receive monies for students

9. Michael Griffith and Daniel Thatcher, "School Funding Overview" (presented at Texas State Senate, Austin, TX, July 30, 2012), accessed May 12, 2014.

not enrolled (sometimes called phantom students). This policy ensures that districts do not have to adapt to changing conditions, and dedicates funds to them that could otherwise be made available to all districts to raise the base student allocation. Four of the five states studied here had some funds being deployed on a hold harmless basis (Delaware being the exception).

## Small-Scale Subsidies

Some states assume that districts or schools with fewer students have some minimum level of fixed costs that are unavoidable, and thus provide a dedicated allocation to smaller districts or smaller schools, which then receive more per-pupil funds than their larger counterparts do. But new research on small districts and schools suggests that the higher costs in fact aren't fixed and that some smaller schools and districts do not cost more than larger ones.[10] For example, Georgia gives smaller districts 15 percent more than the average per-pupil spending levels, while in Minnesota and Wisconsin, small districts operate at funding levels on par with their larger peers. According to a 2010 *Education Week* report, 29 states have dedicated funds in their state allocation formula to account for district scale. Others fund some personnel or programs in "one per district" amounts, such that when the costs of those items are divided by the lower enrollment of smaller districts, per-pupil price tags are quite high. Even if large districts do enjoy important economies of scale, small-district subsidies discourage merging or sharing services across districts—both potential means of improving productivity. Charter schools (essentially single-school districts) have learned this lesson and often share purchasing, specialized services, or back-office functions.

## Untamed Local Funds

Local funds have long been identified as a source of significant inequity between districts in many states. Where states permit locales to determine the extent to which they levy funds, those funds may reflect local property wealth, population demographics, or other nonstudent factors.

Many states' formulas now take into account local revenue in their state formulas in some manner. Some deliberately build state monies on top of all or some of the local revenue, such that the local revenue counts toward the student-based allocation. Another strategy is to use

10. Marguerite Roza and Jon Fullerton, "Funding Phantom Students," *Education Next* 13, no. 3 (Summer 2013), accessed February 13, 2014.

equalization funds to ensure that all districts can raise the same level of per-pupil funding at a particular levy rate.

Where local monies are not factored into state per-pupil allocations, or are permitted to rise above student-based equalization efforts, these funds contribute to uneven funding across districts. Because local funding is such a large portion of the revenue picture (sometimes more than half the pie), these funds must be factored into the state allocation structure to create a true student-based financing system.

## Direct State Payments for Benefits and Pensions

Some states disburse education monies that never actually pass through the districts or schools—by paying directly into a pension fund or benefits provider. Where allocations like these are paid out separately, they distort for districts the true cost of labor and inhibit thoughtful trade-offs at the district level on the costs of services. Say, for instance, that a district is comparing the costs of a nursing service to the costs of hiring nurses for some special education care. If the state is directly paying the benefits tab for the nurse, then the district doesn't factor in total public costs for the hired nursing staff option. Where these separate allocations distort spending decisions, they can create inefficient choices with public funds.

## Performance Funding

Performance funding[11] would award more dollars to districts or providers (sometimes digital providers) if student outcomes meet a specified performance level. These proposals are gaining some popularity in legislative dialogue, and sound like they might enhance productivity, but they do create problems for a system aiming to create equity, flexibility, and accountability.

First, where districts or providers do receive performance funds, those funds create uneven spending on a per-student basis, and thereby confound attempts to create a level playing field for accountability in subsequent years. Second, given the retroactive nature of the allocations, most districts would not be able to apply the funds in ways that benefit the students who generated those funds. Performance funds are not common practice yet, but insofar as they are being considered, it is worth understanding how they pose a threat to student-based allocations.

11. The comments here address state allocations to districts based on student performance, and should not be confused with district efforts to compensate teachers based on teacher performance or productivity.

Figure 3 shows which of the financing models discussed above exist in the five states profiled here. As is clear, even in states that use a student-based allocation as the primary vehicle for allocating state and local monies, these other allocations layer on and divert funds in ways that confound the equity and incentives created by student based allocation.

As states begin to prioritize productivity, the window may be opening for making changes to the resource allocation formulas. For some legislators, the temptation will be to flex their muscles and modify their finance formulas in ways that impose restrictions on districts for how to apply new funds. But where states want improved student outcomes from districts and schools in return for new monies, they'll need to remember that district and school leaders can accept that responsibility only if given some flexibility with the resources they are allocated. Moving more funds to a student-based allocation model would set states, and educators, on a path toward greater equity, flexibility, and productivity.

Where states want improved student outcomes in return for new monies, they'll need to remember that district and school leaders need some flexibility with the resources they are allocated.

For states wanting to expand the portion of the funds delivered via a student-based model, one option is to consolidate some of the funding

Figure 3. States Apply Funds in Ways That Defy Student-Based Allocation

| Source of funding | CA | DE | NJ | NY | PA |
|---|---|---|---|---|---|
| 1. Funds for programs or delivery models | X | X | | X | X |
| 2. Dedicated funds for schooling inputs | | X | | | |
| 3. Reimbursements | X | X | | X | X |
| 4. Hold harmless (phantom student funds) | X | | X | X | X |
| 5. Small district subsidies | X | | | | X |
| 6. Untamed local funding | | X | | X | X |
| 7. Direct state payments for pensions, benefits | X | X | X | | X |
| 8. Performance funding | | | | X | |

mechanisms discussed here and redirect those funds into their student-based formula. To gauge progress, these states can measure the percentage of state and local monies that is allocated on the basis of students.

No one can know for certain all the different kinds of schooling models that will emerge in the next two decades, let alone which will yield the greatest return for students. For state leaders, designing an allocation system amid such uncertainty is tricky, particularly when modifying such allocation systems can take years. But the one thing we know will still be here in twenty years are the students. Aligning money with the students offers some promise that a finance formula will be able to stand the test of time.

> One thing we know will still be here in twenty years are the students. Aligning money with the students offers some promise that a finance formula will be able to stand the test of time.