CITIZENS'
Budget
2003–05

A 10-Point Plan to Balance the California Budget and Protect Quality-of-Life Priorities

Reason

The Performance Institute

Project Director: Carl DeMaio

Part 7

Protect and Improve Education

"During these times of fiscal crisis and uncertainty, districts need maximum flexibility to review all options for accomplishing support service tasks, particularly when the only major cost cutting alternative is to drastically reduce services in the regular education program."
– James Fleming, Capistrano Unified School District

Summary of Citizen Budget Recommendations in This Section:

1. Make Education a Priority by **Adhering to Proposition 98 Funding Requirements** during the 2003-2005 budget cycles.
2. **Reform Categorical Funding System** to streamline funding provided to school districts.
3. Adopt a **"Funding to Follow the Child" Model** that distributes education funds within districts and among districts using a weighted student funding formula to more appropriately and effectively reflect individual student needs.
4. Implement **Competitive Sourcing for Non-Instructional Services** to ensure cuts proposed by the Governor do not affect classroom funding
5. Move toward **Greater Local and Parental Control of Education Funding** through expanded pilot projects in school choice.

The Citizens' Budget sees education as the most important function state government can play—as well as the most important investment to safeguard in a state budget. Toward that end, our budget firmly commits to making all budget expenditures necessary for keeping the funding commitments outlined under Proposition 98. Indeed, under our plan, Proposition 98 will not have to be suspended. However, the Citizens' Budget does call for fundamental education reform.

The Governor's 2003-2004 Budget includes a total of $52.1 billion in operational funding from state, local, and federal sources for K-12 schools for 2003-04. This is a decrease of $1.4 billion, or 2.7 percent,

California Budget FACTS:



100%
The amount of funding the Citizens' Budget fulfills of Proposition 98 funding

$8750
Amount spent per pupil in state public schools this year

70%
Percent of students in 7th grade that do not meet state proficiency standards in math

67%
Percent of students in 7th grade that do not meet state proficiency standards in language arts

29%
Percent of each dollar spent at school district level that goes to non-instructional activities (transportation, food service, etc.)

from estimated expenditures in the current year. The budget also includes a total of $30.3 billion in state, local, and federal sources for higher education. This is an increase of $447 million, or 1.5 percent, over estimated expenditures in the current year.[101]

While our budget accepts the reductions to education funding called for in the Governor's plan, we do not share the Governor's view that across-the-board cuts are the best way to make reductions. School districts across the state are reacting by giving teachers pink slips. State law requires that teachers be put on notice six months in advance of layoffs.[102] These pink slips may be one method to put pressure on the legislature to raise taxes rather than cutting education spending.

In contrast to the behavior above, we propose to achieve the Governor's proposed 2.3 percent reduction without taking a single dollar from the classroom and without issuing a pink slip to a single teacher. Finally, the state cannot simply make education "whole" by maintaining Proposition 98 funding levels. It must ensure that the money spent under Proposition 98 and other sources is put to good use and achieves the best academic performance possible. In order to ensure California has a world-class education system that leaves no child behind, fundamental reforms must be enacted to improve the entire education system.

Rather than announcing teacher layoffs, local school districts need to enact the 1.2 percent reduction through three key reforms. First, school districts should have the ability to competitively source non-instructional services through performance-based contracting. Additionally, school districts need local flexibility to manage the one-third of education revenue (approximately $12 billion in restricted categorical funding) by collapsing these programs into general block grant funding on a per-pupil funding allotment. Finally, academic performance should be tied to individual per-pupil funding through a general public school choice program that allows students to attend any public school using a weighted student formula and through an opportunity scholarship program that allows students in failing schools to transfer to private or higher-performing public schools.

Table 9: Governor's Proposed K-12 and Higher Education Funding 2001-02 Through 2003-04 (Dollars in Millions)

	Actual 2001-02	Estimated 2002-03	Proposed 2003-04	Amount Change from '02-03	% Change from '02-03
K-12[a]	$51,663	$53,521	$52,078	-$1,443	-2.7%
Higher education[b]	28,890	29,874	30,320	447	1.5%
Totals	**$80,553**	**$83,395**	**$82,398**	**-$997**	**-1.2%**

[a] Includes state, local, and federal funds. Excludes debt service for general obligation bonds.

[b] Includes state, federal, and local funds. Excludes direct capital outlay spending and debt service for general obligation bonds.

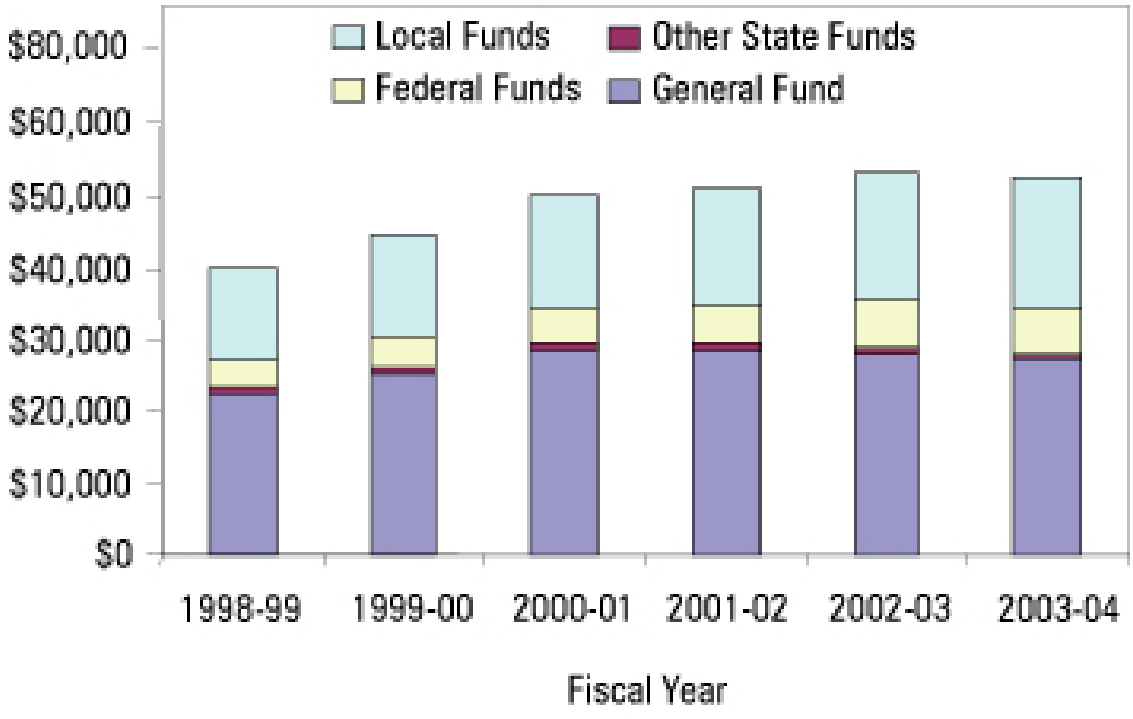
Source: Legislative Analyst's Office,
http://www.lao.ca.gov/analysis_2003/education/ed_1_ov_anl03.htm#_Toc32819890

More Money, Less Performance

California enrolls approximately 6 million students in its public schools, 12.5 percent of the nation's total. In a forthcoming article in *California Policy Options 2003*, UCLA, school management expert William G. Ouchi describes the state of California education:

> *By most measures, these schools are failing in their mission. On the 2000 National Assessment of Educational Progress—Science Examination, California's eighth graders tied for last in the nation with those of Hawaii. California's fourth graders had sole claim to last place in the nation. In the 2001 TIMSS international mathematics test, California again ranked dead last in the U.S., this time tied with Mississippi. A 2000 study by RAND concluded that California ranks last in the nation when reading and math scores are compared for students of the same socio-economic categories. Fewer than 25 percent of California students scored either proficient or advanced in reading.*[103]

Figure 13: Total Revenue for K-12 Education by Funding Source (Dollars in Millions)



Source: Data from Governor's Budget Summary, 2003-04,
http://www.dof.ca.gov/HTML/Budgt03-04/BudgetSum03/10_K-12.pdf

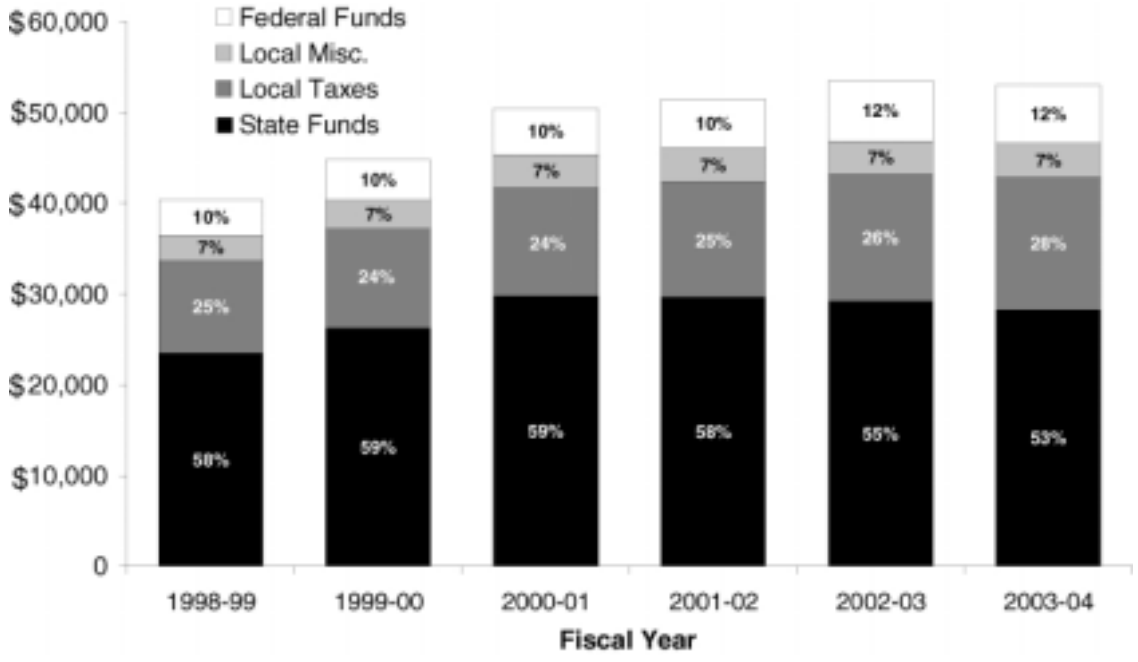
Other indicators also demonstrate how poorly California's schools are performing. The Legislative Analyst's Office estimates that by 2007 100 percent of Title I schools will be failing by federal standards. California ranked 34th in the nation in terms of educational inputs and math scores on the National Assessment of Education Progress for 8th graders and ranked 36th in the nation in terms of educational inputs versus SAT scores. Finally, when examining proficiency exams, between approximately 30 and 38 percent of all California students are proficient in reading and math at grade level (see below).

Table 10: Percent of Students Proficient or Above in English Language Arts and Mathematics (Results From the 2002 California Standards Test)				
	English Language Arts		Mathematics	
	Grade 3	Grade 7	Grade 3	Grade 7
All students	34%	33%	38%	30%
English language learners	12	5	22	9
Economically disadvantaged	18	16	25	16
Special education	17	6	21	6

Despite dismal performance, funding is not the issue. In fact, by a number of accounts, the state is spending more on education but getting less. Despite the much-publicized cries that Sacramento budget cuts are causing financial strain on our schools, analysis of education spending in California shows steady increases in the past five years, especially when all revenue sources to schools are accounted for.

Estimates of per-pupil spending vary depending on which funding sources are included. The Legislative Analyst's Office projects that spending from all sources will total $8,750 per pupil in 2003-2004.[104] This does not include expenses for capital costs. In other comparisons, a study by the *Los Angeles Business Journal* reported that for 25 independent schools in Los Angeles, the average annual tuition was $7,091.[105] A recent study by Ouchi found that the 298 Catholic schools in Los Angeles spend an average of about $2,500 per student in elementary schools and $5,100 per student in high school. By contrast, when school facility construction costs are added into the funding mix, the Los Angeles Unified School District spent a total of $13,267 per student for the 2000-2001 school year.[106]

Figure 14: Revenue for California's K-12 Schools: Source for Revenues ($ Millions, % of Total)



Source: Governor's Budget Summary, 2003-04, http://www.dof.ca.gov/HTML/Budgt03-04/BudgetSum03/10_K-12.pdf

So how can it be that California has dumped billions more into its education system but has seen the same old poor levels of education performance? Research by the American Legislative Exchange council finds that there appears to be *no significant correlation* between four measures of educational inputs: per-pupil expenditures, total funds received from the federal government, average teacher salaries, and student achievement.[107] For example, Washington, Iowa , and Wisconsin rank below the top ten in each of these measures and yet have achieved the highest average test scores in the nation. Several other states including California spend a relatively high amount of resources as measured per pupil and receive significant support from the federal government yet do not demonstrate high levels of student achievement.

Use Competitive Sourcing and Performance-based Contracting for Non-instructional Services

One of the most clear-cut ways school districts can save money or improve services is to outsource non-instructional services. California classrooms and students will sustain less damage in this financial debacle only if local school districts have maximum flexibility to manage their budgets. In May 2002, the city of Philadelphia's school district, which has faced budget deficits the last four years, passed a $1.7 billion budget that projected a $28 million deficit by the end of this fiscal year. Now, the district expects a $2 million surplus. Officials credit administrative cuts, better facilities management, and across-the-board cuts in programs not tied to the classroom. Philadelphia's school district has saved over $29 million in just two years by relying on privatized transportation, food service, custodial, and other support functions. Philadelphia made these financial cutbacks without a teacher hiring freeze or firing any teachers. In fact, Philadelphia is still running a robust teacher recruitment program.[108] Similarly, Chicago's school district saved $20 million over three years by contracting its bus services.[109]

According to the U.S. Department of Education, National Center on Education Statistics, and the California Department of Education, California schools spend between 26 and 28 percent of their budgets on non-instructional services, including operation and maintenance, transportation, and food service.[110] In the 2002-03 and the 2003-04 budgets, this amounts to more than $13 billion each year spent on non-instructional school-site services. According to the American School & University school privatization surveys from 1997-2001, 40 percent of the nation's school districts outsource transportation and more than 20 percent outsource food service.[111] Literature reviews of education privatization cost savings have found between 20 and 40 percent savings from school outsourcing.[112] If 25 percent of the more than $13 billion in California non-instructional services were outsourced at a savings of 20 percent, California school districts would save approximately $651 million in each of the 2002-03 and 2003-04 fiscal years on non-instructional services.

A new California law will cripple the flexibility of local school officials to target spending cuts to non-instructional services and away from teachers and other instructional programs. The privatization law, SB 1419, effective January 1, 2003, requires school officials to analyze potential cost savings from privatization, forbids the private firm from paying workers less than industry standards, and forbids the layoff or demotions of school employees as a result of the contract. The law requires school districts to use the same standards that state agencies must comply with before privatizing jobs done by classified, i.e.non-teaching, school employees. While analyzing potential cost savings is an important step of all school privatization programs, this law provides a serious disincentive to privatizing school support services in California; control of personnel is one of the most crucial aspects of any successful privatization effort. We therefore

recommend that this law be suspended during the state fiscal emergency so that districts may achieve efficiencies through outsourcing.

The Governor's Budget also proposes an $890 million decrease in General Fund expenditures for higher education in 2003-2004. Outsourcing non-instructional services could also lead to cost savings for higher education expenditures. Colleges tend to outsource services at a higher rate than school districts. Conservatively, if California colleges and universities spend 10 percent of their $30.3 billion budget on services that could be potentially outsourced and achieve cost savings of 25 percent, that would result in cost savings of $757 million each year.

When considering the potential of non-instructional competitive outsourcing, the $1.2 billion in proposed cuts to education are not that extreme and demonstrate that additional state monies could be saved if the state took a few specific actions:

- Suspend recently enacted restrictions that have dramatically limited the ability of school districts to outsource support services;
- Tie budget cuts to school districts with incentives that encourage outsourcing; and
- Outsource support services at the UC, CSU, and CC systems.

Reform Categorical Programs

California's state government distributes tax dollars to local school districts and county offices of education in two ways. One method allocates tax dollars to local districts that districts may spend as they deem appropriate. The second method, which accounts for one-third of total K-12 programs from all sources, is through categorical programs. These programs earmark tax dollars for specific purposes and programs. A recent exposé in *The Sacramento Bee* describes California's categorical education funding system as "a monumental mess."[113] The categorical system has grown into a massive and convoluted web, filled with deep disparities, outdated programs, and unaccountable cash streams.

The state has more than 100 categories of money for specific purposes, such as helping poor children or training algebra teachers or educating the academically gifted. Each has a different history, a different funding pattern, and different people in charge. The distribution of categorical money from district to district is uneven, with politics often determining who gets the most cash. A lot of the money is doled out based on outdated programs and formulas with little connection to needs in schools.

In the 1988-89 school year, categoricals together made up about 22 percent of the state budget for education. By 2001-02, that share had grown to about 31 percent—more than $12 billion in a $40 billion budget.[114] The state has at least 20 separate categoricals devoted to the training of teachers and school staff, each with its own bureaucracy. And a dozen or so programs cover some aspect of school safety, but there's no coordinated plan for safe schools.[115]

The Little Hoover Commission explains the administrative costs of a categorical system:

> *Categorical programs have their own paperwork, justifying district eligibility and documenting expenditures. Teams of district personnel to fill out the paperwork are matched by teams of state workers to check it. In addition, most school districts of any size spend money on consultants for advice*

on how to maximize funding or pass audits. The commission also found that districts with high amounts of categorical funding spent a disproportionate amount of money on administration linked to those programs. The Legislative Analyst's Office and a more recent Pacific Research Institute report, and the Sacramento Bee report that there is little evidence that any categorical program is actually meeting its stated purpose.[116]

The Governor's Budget proposes to create a $5.1 billion categorical block grant in lieu of funding 58 individual K-12 programs in order to provide school districts with greater fiscal and program flexibility.[117] The Legislative Analyst's Office proposes an alternate categorical block grant program that would collapse 62 categorical programs into 5 block grants.[118]

The Governor's 2003-04 proposal would continue separate funding for 13 categorical programs because they reflect an administration priority (such as K-3 class size reduction [CSR]), satisfy a federal mandate (such as special education), or would be discontinued in the near future (year-round schools, principal training, and mathematics and reading staff development). The 13 separately funded programs would distribute $5.6 billion in 2003-04. Four programs—special education, K-3 CSR, child development, and summer school—account for $5 billion, or 90 percent of the total.

The Governor's proposal and Legislative Analyst's Office proposal would yield state and district savings by reducing the administrative effort entailed in operating multiple categorical programs. Currently, districts must apply for, separately track, and monitor the appropriate use of categorical funds. The amount of local savings that would result is unknown, however, as established in the chapter on reorganization and streamlining government, estimates confirm an overall savings rate of 15 percent. The budget identifies significant state savings, however, proposing to reduce State Department of Education (SDE) administrative support by $6.7 million and 97 positions to reflect workload savings resulting from the consolidation. In the end, this represents 15 percent of the department's 2002-03 General Fund support.

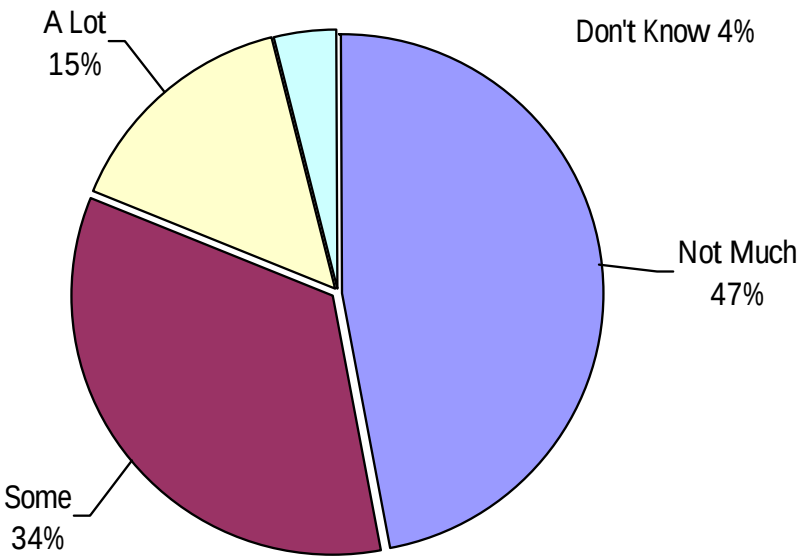
We recommend providing local schools maximum flexibility by creating a block grant for the entire $12 billion and changing the California school finance system to have funding follow the child using a weighted funding formula and devolve fiscal accountability to the school level, which is discussed in the next recommendation. Approximately, 15 percent of the $12 billion covers various administrative costs at the state, district, and local level, for a total cost of $1.8 billion. By collapsing the categorical programs and reducing reporting and compliance activity at the local level, school districts would be able to "stretch" block granted dollars. Therefore, the state could reduce total categorical spending by 5 percent and save $600 million in 2003-2004.

Implement a "Funding to Follow the Child" System

California has one of the most centralized public school systems in the United States. In California, local property taxes are aggregated in Sacramento and then re-allocated to school districts on a per-capita basis. These reallocated funds—both general revenue and categorical funds—flow not directly to schools, but to school district central offices. The central offices then allocate people to schools rather than money based on complex formulas. It is ironic that in California the state accountability systems hold principals accountable for student achievement, but give the principals no authority to make local spending decisions. In Los Angeles, for example, school principals control only 6.7 percent of their school budgets.[119]

In a recent study, UCLA school management expert and management Professor William G. Ouchi found that school districts that use more decentralized management organizations and allow principals to control a larger percentage of the local school budget have better outcomes in terms of student achievement and cost containment. For example, Ouchi's study compared the highly centralized Los Angeles Unified School District and the more decentralized Houston Independent School District. Both districts have 90 percent minority students, and both are heavily low-income, with Los Angeles at 74 percent and Houston at 71 percent. Given these similarities, it is striking that Houston students outperform those of Los Angles by nine or ten points in reading, and by six or seven points in mathematics, on the same Stanford 9 standardized test.[120]

Figure 14: Do you have a lot of confidence, some confidence or not much confidence that your local school district officials are spending money wisely?"



Source: PPIC, March 2002

The study also found that more decentralized districts, such as Edmonton, Seattle, and Houston, had less fraud and corruption and smaller central audit staff per 100,000 students than New York City, Los Angeles, and Chicago.

These decentralized districts use an innovative budgeting system known as Weighted Student Formula. Ouchi explains how the model works in Seattle:

> *All that is needed is to capture the several state-allocated categorical funds, such as those for Special Education, Reading Programs, and GATE (Gifted and Talented Education) and assign the money to the student who qualifies for each special fund. Thus, the money follows the student. In the Seattle system, a "minimum" student—one who qualifies for no categorical funds, receives only his or her per capita basic state allocation. The "maximum" student—one who has multiple learning disabilities, is from a low-income home, and who is a non-English speaker, carries a weighting of up to 9.2 times the basic*

allocation. In addition, each school receives a flat block grant of more than $200,000, so that smaller schools can meet their basic costs.

In addition to the rule that the money follows the student, Weighted Student Formula has a second rule, that each family has a choice of any public school in the system. If a family chooses an out-of-area school, and if the child does not qualify for transportation funding, the family must transport the child to that distant school. Schools must compete for students, and under Weighted Student Formula, they actively seek to enroll Special Education and other students who bring additional Weighted Student Formula funding. The families are empowered by this system, and schools must respond to the needs of families, or suffer declining enrollments. Weighted Student Formula does not create a punitive environment for teachers and does not increase the number of teachers who are subject to discipline or to dismissal. Principals are more publicly accountable under the system.[121]

As Pacific Research Institute's *Grand Theft Education* report recommended, "parental choice in education would overhaul the system and make financial efficiency, student achievement, and parental satisfaction the priority benchmarks."[122] In addition to using a weighted student formula and a public school choice program, California could tie student performance more directly to per-pupil funding by instituting an opportunity scholarship program to allow students in failing schools to transfer to private or better performing public schools.

Rather than using the perverse incentive that offers more funding to failing schools, California could set up an accountability program that allows the lowest performing students to use scholarships to attend private schools. If funding followed children in the bottom 25 percent of school districts, (including more than 25 percent of the student population because of large low-performing districts like LAUSD and Oakland) this would result in at least $2.6 billion in savings. Using the Los Angeles Independent School tuition figure of $7,000 (which is higher than the national per-pupil spending average) and letting the $7,000 follow each of the students in the bottom 25 percent of academic achievement would save more than $2.6 billion.

A complete school choice system where the money follows the child to any public or private school represents the most decentralized system on the school funding continuum and will likely yield the most cost savings. As a thought experiment, if $7,000 followed each of the 5,954,154 California children to a school of his or her parent's choice the cost would equal close to $42 billion and save California close to $10 billion in 2003-2004 in education spending.