WestEd

policy perspectives

Loosening The Reins

Evidence and Considerations for Lifting Restrictions on Resources for Schools

by Jason Willis (WestEd), Sean Tanner (WestEd), and Justin Silverstein (APA)

As the nation enters its sixth month of an economic recession due to the coronavirus pandemic,[1] states are struggling to align spending for public education and other services with severely contracted revenues resulting from widespread sector shutdown. State legislatures and governors face difficult choices in determining how best to curtail spending and protect public services. It's likely that many states will consider mitigating the impact of reduced education resources by lifting restrictions on how school districts can use allocated funding. That is, they may consider loosening the reins on the widely used funding stream commonly referred to as restricted or categorical funding.

Categorical funding specifies that funds must be used for particular programs (such as education technology), populations (such as English learners), or services (such as mental health services). Over the past several decades, a number of states have transitioned away from categorical funding for programs or services in favor of funding for specific populations. During the Great Recession, many states went further and revised categorical programs to give local decisionmakers more choices as they navigated a shrinking funding base for public school services. California, for example, collapsed 40 of its categorical programs into a "tiered

1 The National Bureau of Economic Research (NBER). *U.S. business cycle expansions and contractions*. https://www.nber.org/cycles.html. Accessed June 21, 2020.

KEY TAKEAWAYS

1. **Lifting restrictions on restricted programs helps districts navigate declining revenue.**
2. **Focus any categorical funding on student groups (e.g., English learner students) rather than specific programs or services.**
3. **When creating more funding flexibility for school districts, consider reporting requirements that support effective resource use and accountability.**

About This Series

The National Conference of State Legislatures (NCSL) has partnered with WestEd to publish a series of briefs summarizing the evidence and research on common school finance issues that arise during an economic downturn. Specifically, with the onset of an economic downturn, states face the prospect of reduced tax revenue available to fund public services, including public education. This series of briefs leverages what we know from evidence and research to present approaches that state policymakers may take to address these funding realities while supporting public education.

program" in 2008.[2] Earlier, Maryland reduced its categorical program from 30 to four elements, following the equity recommendations of the Thornton Commission in 2002.[3]

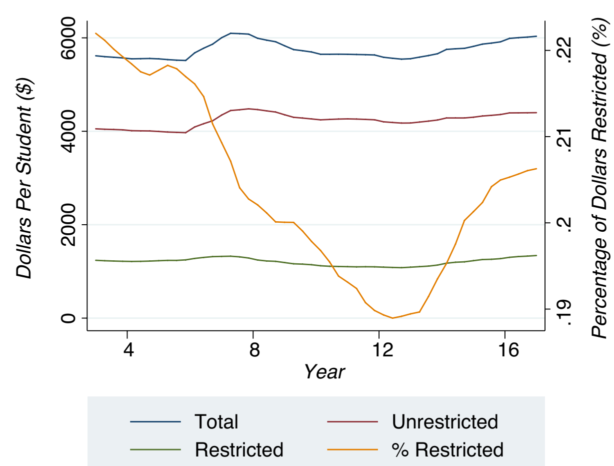
Yet there remains a dearth of research about whether greater local control and flexibility support more effective education decision making or improve outcomes for students. That leaves state policymakers, who are accountable for public taxpayer dollars, continuing to grapple to find a balance between state control of spending and decision making — a one-size-fits-all approach — versus more control at the local level, where resource allocation can be tailored to meet diverse student needs. To support decision making on this school finance lever, this brief explores trends in state categorical funding as well as recent state experiences.It addresses the effectiveness and efficiency of categorical funding, including what is known from research evidence, and looks at unintended expenditures caused by categorical aid. Finally, it offers critical moves for state policymakers on lifting restrictions on local use of funding.

Trends in state categorical funding for schools

Starting in 2003, there was a precipitous decline in the proportion of state revenue across the U.S. dedicated to categorical funding. This trend hit a trough at the end of the Great Recession in 2013 then steadily climbed until fiscal year 2017.

This is illustrated in figure 1, which shows the patterns of state revenue per pupil (in 2017 dollars) for school districts between fiscal year 2003 and 2017. The blue line represents total revenue from the state to school districts. The red line shows unrestricted revenue and the green line shows revenue distributed through categorical funding. The orange line is the proportion of funding from the state that is subject to categorical restrictions (the second, righthand Y-axis) represented as a percent of total revenue. The decline in funding restrictions between fiscal years 2003 and 2013 represents a $180 per student shift in resources or approximately $315,000 for the average school district in the United States.[4]

Figure 1: State Revenue Per Pupil (all states, in 2017 dollars)



2 Stecher, B., Fuller, B., Timar, T., & Marsh, J. (2012). *Deregulating school aid in California: How districts responded to flexibility in tier 3 categorical funds in 2010-2011.* RAND Education and Policy Analysis for California Education. https://www.rand.org/pubs/technical_reports/TR1229.html

3 Silverstein, J. S., Anderson, S., & Chance, B. (2008). Breaking the nexus: Four states' experiences with reforming school finance to increase student achievement for students from all backgrounds. In K. G. Welner & W. C. Chi (Eds.), *Current Issues in Educational Policy and the Law*. University of Colorado.

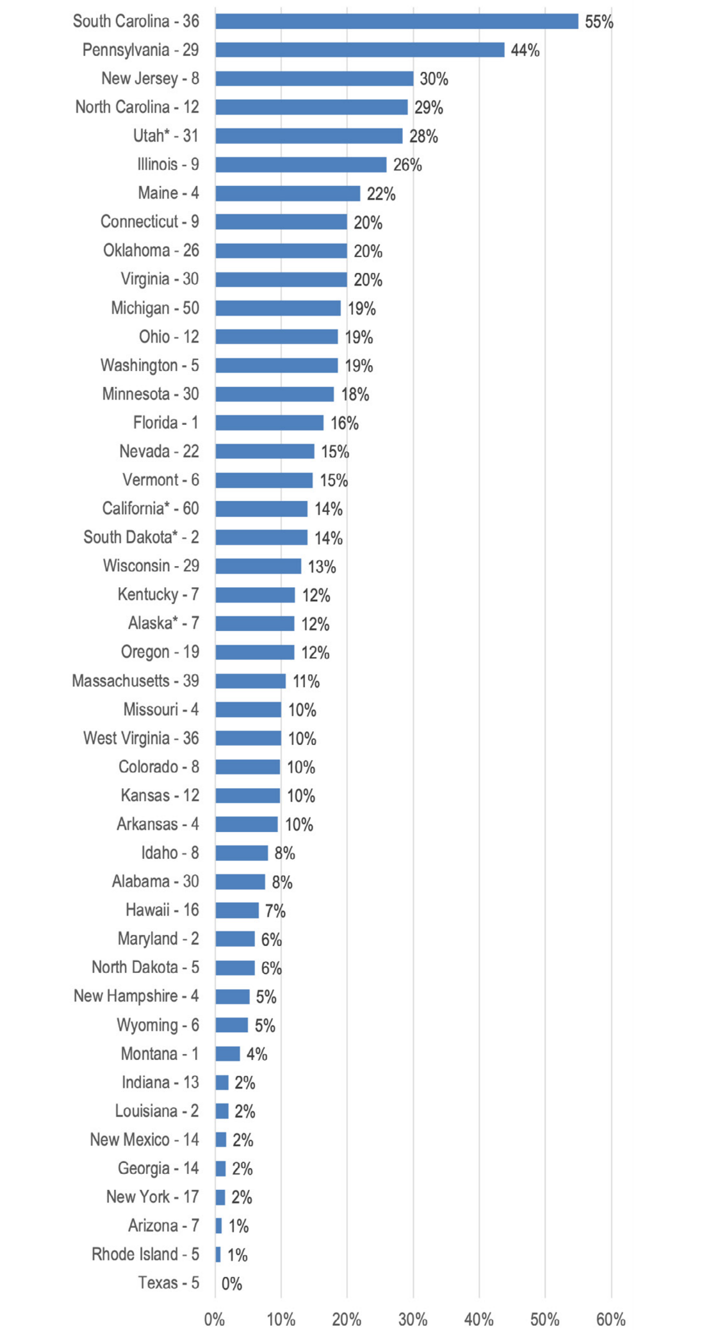
4 The average school district in the United States as of 2018 was 1,710 students according to the latest data from the National Center for Education Statistics at the U.S. Department of Education.

Within these patterns, states differ in terms of proportion and numbers of categorical programs. Based on a fairly recent scan of categorical programs in each state as of 2013,[5] figure 2 shows that categorical funding as a percentage of states' revenue contribution to school districts ranged substantially, from nearly 0 percent in Arizona to over 50 percent in South Carolina. The numbers below each state show further variation in how many categorical programs states operate. We can observe, generally, that as the overall proportion of categorical funding increases so does the overall number of categories.

Recent state experiences

Under the current circumstances, providing more flexibility, with guidance and support, may be advantageous for states, school districts, and students. Flexibility allows schools to invest funds in strategies and programs that they perceive to be efficient in serving their specific student populations and allows them to experiment and uncover new, promising options, potentially enabling continuous improvement.[6] Beyond efficiency, concerns over fairness suggest that categorical restrictions on what goods and services can be purchased should be replaced with restrictions on which types of students should primarily benefit from expenditures.

Figure 2: Percentage of State Education Budget Allocated to Categorical Funding, 2012-13 School Year



* These data are self-reported by the state.

Notes:

- Chart was recreated from Smith, Gasparian, Perry, & Capinpin. 2013. See footnote 5.
- The numbers immediately to the right of state name indicate the number of categorical funds in that school year.
- Tennessee, Nebraska, Mississippi, Iowa, Delaware, and the District of Columbia are not included due to unavailable data.

5 Smith, J., Gasparian, H., Perry, N., & Capinpin, F. (2013). *Categorical funds: The intersection of school finance and governance.* Center for American Progress. Retrieved from www.americanprogress.org/wp-content/uploads/2013/11/CategoricalSpending1-brief-4.pdf

6 Hill, P., Roza, M., Harvey, J. (December 2008). *Facing the future: Financing productive schools.* School Finance Redesign Project. Center for Reinventing Public Education. University of Washington Bothell. https://www.crpe.org/sites/default/files/pub_sfrp_finalrep_nov08_0.pdf

The field lacks strong, causal evidence on the impact such a shift would have on student success. Some limited inferences are possible by contrasting the above mentioned reform in California, in which new state revenue was to be directed to higher-need students, with the wave of adequacy reforms that began in the 1990s, in which new state revenue was directed to lower-wealth districts, but not particular students within those districts. Where the adequacy reforms did indeed reduce achievement gaps across students in high- versus low-wealth districts, they did not reduce achievement gaps across affluent and poor students.[7] Conversely, the reform in California that specifically targeted higher-need students caused those students' achievement to increase more than that of their lower-need peers.[8]

The state's requirement that the new expenditures primarily benefit higher-need students is one plausible explanation for this reduction in achievement gaps. This dovetails with prior research suggesting that flexibility should be accompanied by accountability and guidance to ensure that funds are used effectively and efficiently — though the empirical impact of the combination of flexibility and accountability on student achievement has yet to be identified in a wide array of settings.[9]

While we lack rigorous research on the impact of flexibility on student achievement, many practitioners are clear that they find categorical restrictions to be burdensome and inefficient. For example, in North Carolina, which has progressively increased the number of categorical programs and the restrictions on that funding over the last decade, panels of local practitioners who acknowledge the need for financial accountability nonetheless view current limitations on many allotments as resulting in inefficient resource use.[10] By contrast, chief business officials in California school districts not only value the state's school finance reform (known as the Local Control Funding Formula) for providing flexibility and local control of funding decisions but also feel that the formula addresses their concerns about meeting future financial obligations.[11]

7 Lafortune, J., Rothstein, J., & Schanzenbach, D. W. (2016). *School finance reform and the distribution of student achievement* (NBER Working Paper No. 22011). National Bureau of Economic Research.

8 Johnson, R. C., & Tanner, S. (2018). *Money and freedom: The impact of California's school finance reform on academic achievement and the composition of district spending* (Getting Down to Facts II). PACE. Retrieved from http://gsppi.berkeley.edu/~ruckerj/Johnson_Tanner_LCFFpaper.pdf

9 Odden, A., Archibald, S. & Fermanich, M. (2003). Rethinking the finance system for improved student achievement. In W.L. Boyd & D. Miretzky (Eds.), *American educational governance on trial: Change and challenges* (pp. 82-113). *102nd yearbook of the National Society for the Study of Education*. University of Chicago Press; Hill, P.T., Roza, M., Harvey, J. December 2008. *Facing the future: Financing productive schools*. Final Report from the Center on Reinventing Public Education on the School Finance Redesign Project. University of Washington; Hanushek, E., Lindseth, A., & Rebell, M. Fall 2009. Many schools are still inadequate: Now what? *Education Next. 9*(4) pp. 49-56.

10 Willis, J., Krausen, K., Berg-Jacobson, A., Taylor, L., Caparas, R., Lewis, R., & Jaquet, K. (2019). *A study of cost adequacy, distribution, and alignment of funding for North Carolina's K–12 public education system*. WestEd.

11 Willis, J., Krausen, K., Byun, E. N., & Caparas, R. (2018, September). *Leading the Local Control Funding Formula era: The shifting role of California's chief business officers* (Getting Down to Facts II). PACE. Retrieved from https://gettingdowntofacts.com/publications/era-local-control-funding-formula-shifting-role-californias-chief-business-officers

Emerging insights about the effectiveness and efficiency of categorical funding

Categorical restrictions on spending do not appear to benefit students. Though the research literature on student achievement impact is thin, there is little evidence that categorical revenues increase student achievement. The California case, by contrast, provides evidence that a shift from a categorical approach to one of local flexibility can affect student outcomes.

In the decades leading up to the Great Recession, categorical aid was an increasing share of California's education expenditures, including during prior recessions when general revenues contracted.[12] In 2007, roughly 20 percent of district revenue from the state was delivered via more than 70 categorical programs. During the Great Recession, the state suspended the restrictions on many categories of aid. With finance reform in 2013, the state eliminated most categorical funding in favor of increased, unrestricted general fund revenue. Concurrently, it increased per-pupil revenue. The new flexibility caused graduation rates to increase about 1.4 percentage points over and above what can be explained by the increase in per-pupil revenue.[13]

This suggests that, at least in an environment of rising school revenue, categorical restrictions are inefficient. It is certainly probable that particular districts benefit from particular forms of categorical aid. For example, though revenue earmarked for capital improvements does not improve student performance in California generally, student achievement increased after an initiative in Los Angeles to relieve overcrowding by building more schools.[14] Beyond such specific examples, the field lacks extensive evidence on how an overall reliance on categorical revenue impacts student achievement.

Identifying state policies that increase the efficiency of resources is highly challenging. As evidence continues to mount that increases in school revenue will enhance student achievement,[15] it also appears that student achievement could be improved without additional expenditures, since school spending is not perfectly efficient.[16] We know that some schools are more effective at transforming their resources into student success. We are much less clear about the kinds of state policies that would help other schools achieve that same efficiency.

12 Sonstelie et al. (2001). *School finance and California's master plan for education*. Public Policy Institute of California. pp. 59–62. Retrieved from http://econ.ucsb.edu/~jon/publications/masterplan.pdf

13 Johnson, R. C., & Tanner, S. (2018). *Money and freedom: The impact of California's school finance reform on academic achievement and the composition of district spending* (Getting Down to Facts II). PACE. Retrieved from http://gsppi.berkeley.edu/~ruckerj/Johnson_Tanner_LCFFpaper.pdf

14 Cellini, S. R., Ferreira, F., & Rothstein, J. (2010). The value of school facility investments: Evidence from a dynamic regression discontinuity design. *Quarterly Journal of Economics, 125*(1), 215–261; Welsh, W., Coghlan, E., Fuller, B., & Dauter, L. (2012). *New schools, overcrowding relief, and achievement gains in Los Angeles - Strong returns from a 19.5 billion investment*. PACE.

15 Lafortune, J., Rothstein, J., & Schanzenbach, D. W. (2016). *School finance reform and the distribution of student achievement* (NBER Working Paper No. 22011). National Bureau of Economic Research; Jackson, C. K., Johnson, R. C., & Persico, C. (2016). The effects of school spending on educational and economic outcomes: Evidence from school finance reforms. *Quarterly Journal of Economics*, *131*(1).

16 Jackson, K. C., Wigger, C., & Xiong, H. (2018). *Do school spending cuts matter? Evidence from the great recession* (NBER Working Paper No. W24203). National Bureau of Economic Research. Retrieved from http://www.nber.org/papers/w24203

Unintended expenditures caused by categorical funding

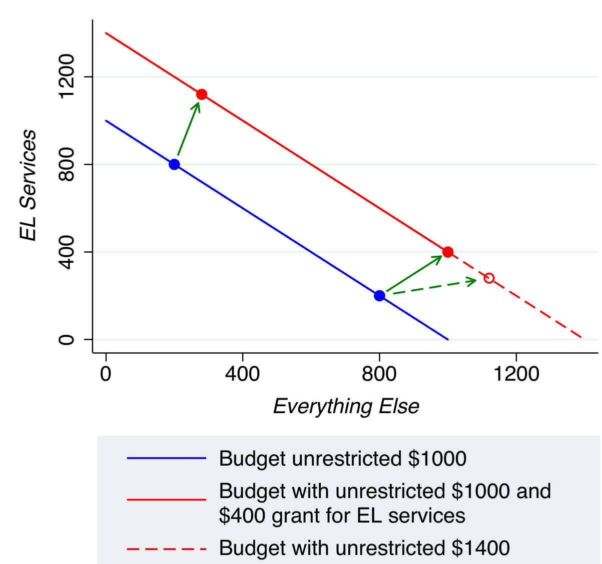
Beyond issues of efficacy, categorical aid tends to increase expenditures in categories not targeted by the aid — even if this effect isn't apparent in an accounting of expenditures. This "displacement" of categorical revenue to unrestricted expenditures happens because districts have spending preferences beyond what is provided via aid programs.

This phenomenon is illustrated by considering expenditures in two hypothetical districts before and after their state provides $400 per pupil in categorical aid for services to English learners. Before the aid program, each district has $1000 per pupil in discretionary spending after making all expenditures necessary for the bare minimum of school functioning.[17] The budget constraint the districts face is represented by the blue line in figure 3 — each dollar spent on EL services is a dollar not spent on everything else. District 1 has a strong preference for EL services, spending 80 percent ($800) of its $1000 per pupil on EL services and 20 percent ($200) on everything else. District 2 has a strong preference for everything else, spending only 20 percent ($200) on EL services and 80 percent ($800) on everything else. These preferences are shown by the districts' placement on the blue line and the second and third columns of table 1 on page 7.

After the state provides $400 per pupil in categorical aid for EL services, the new budget constraint is represented by the solid red line, the dashed extension of which represents the choices the districts would be free to make if the $400 per pupil were given unconditionally instead of restricted for EL services. With the categorical aid, districts must spend at least $400 on EL services and no more than $1000 (their unrestricted revenue) on everything else, so choices along the dashed red line are not permissible.

The districts' new choices are labeled on the red line and also in the fourth and fifth columns of table 1. In keeping with its prior preferences, District 1 spends 80 percent ($320) of the categorical grant on EL services and 20 percent ($80) on everything else. It can claim that it spends the entire categorical grant on EL services, however, because its spending on those services exceeds $400. For such a district, the categorical grant slightly increased spending on non-EL services and was functionally equivalent to additional unrestricted revenue — spending on EL services is 80 percent ($1120) of the new total ($1400), just as it was 80 percent ($800) of the prior total ($1000).

Figure 3: Budget Effects of Categorical Grants



District 2, on the other hand, is somewhat constrained by the categorical restrictions. Given its preferences, it would divide $1400 up by spending $280 on EL services and $1120 on everything else, represented by the

17 This is an oversimplification of the issue, with dollar figures chosen for ease of interpretation.

point on the dashed red line and the sixth and seventh columns in table 1. The conditions of the categorical grant mean that it must spend at least $400 on EL services; it

In other words, policymakers should bear in mind that districts will seek to use funds in ways they prefer, and that categorical restrictions are unlikely to prevent such behavior.

Table 1: Categorical Aid Promotes Spending Increases Beyond the Targeted Program

	$1000 Unrestricted		$1000 Unrestricted + $400 for EL Services		$1400 Unrestricted	
	EL Services	*Everything Else*	*EL Services*	*Everything Else*	*EL Services*	*Everything Else*
District 1	$800	$200	$1120	$280	$1120	$280
District 2	$200	$800	$400	$1000	$280	$1120

does so and, having purchased far more EL services than it would prefer, spends all of its unrestricted revenue ($1000) on everything else. For such a district, the categorical grant did force greater expenditures on EL services than would an unrestricted revenue increase, yet it still increased spending on non-EL services by $200. Half of the categorical was lost to other things, but the district can claim that the $400 spent on EL services was the entirety of the categorical aid and none was lost to other things.

This hypothetical example illustrates that categorical aid will likely increase spending both on the targeted program and on non-targeted programs. Laws regarding maintenance of effort have not been effective in the case of Title I, largely because determining the counterfactual effort in the absence of the Title I grants proves impossible.[18] Such maintenance of effort requirements are unlikely to eliminate displacement in the case of categorical aid for the same reason.

Considerations for State Policymakers

Based on the benefits and tradeoffs suggested by states' categorical funding choices and by research evidence, we offer critical moves state policymakers can take on categorical programs:

Lifting restrictions on existing categorical programs can help local school districts navigate declining revenue environments by enabling more local choice.

School districts serving differing student populations need to base spending choices on their particular students' needs. Categorical programs can limit this flexibility and lead to misalignment between resource allocations and school district priorities. The problem is compounded when districts face declining revenue, forcing limited dollars to be used inefficiently or go unused. When overall revenue is contracting, lifting restrictions on categorical funding allows districts to use funding in ways they deem most likely to effectively support student learning.

18 Gordon, N. (2004). Do federal grants boost school spending? Evidence from Title I. *Journal of Public Economics*, *88*(9–10), 1771–1792; Weinstein, M., Stiefel, L., Schwartz, A. E., & Chalico, L. (2009). *Does Title I increase spending and improve performance? Evidence from New York City* (Working Paper #09–09). IESP.

If using categorical funding, states should focus it on groups of students — for example, low-income or English learner students — rather than on operations such as transportation.

If states continue to implement categorical programs during an economic downturn, it is best to focus these dollars on specific student groups. Targeted student funding creates incentives for districts to provide services for students known to need additional resources to succeed. Operational or program-specific funding can tie the hands of districts — for example, by hobbling districts' ability to reprioritize dollars from transportation to instructional services during a time when providing transportation may be untenable due to public health orders and safety concerns.

When creating more funding flexibility for local school districts, consider enacting reporting requirements that support effective resource use and accountability.

States often use categorical program funding to help ensure that districts give priority to specific student programs or services. As states provide increased flexibility to school districts, this prioritization and direction can be continued through other methods, including accountability and reporting systems. States, of course, still must still hold schools and districts accountable. They can shift funding decisions and greater responsibility to the local level while also maintaining rigorous measurement of student performance and ensuring that districts meet students' full curricular needs.

About the Authors

Jason Willis is the Area Director for Strategic Resource Planning & Implementation for WestEd. The strategic resource planning and implementation team he guides at WestEd supports states and school districts to analyze, improve, and implement school finance and resource allocation systems to improve student outcomes. His past work includes serving as an assistant superintendent and a chief financial officer in several large urban school districts in California. Willis received his MA in education policy and finance from Teachers College, Columbia University.

Sean Tanner is a senior research associate at WestEd. His research focuses on the impact of PreK–12 policies, such as accountability and school finance reform, as well as on educational and socioeconomic inequality. Tanner received an MPP and a PhD in public policy from the University of California, Berkeley.

Justin Silverstein is the co-Chief Executive Officer for Augenblick, Palaich, and Associates (APA) based in Denver, Colorado. He leads the company's school finance team overseeing projects which include large scale statewide school finance studies, interactive cost model development, and work with local school districts. His projects focus on producing information that is actionable for policymakers while being digestible and transparent for stakeholders. Mr. Silverstein studied accounting at the University of Colorado, Boulder.

Suggested citation: Willis, J., Tanner, S., & Silverstein, J. (2020). *Loosening the reins: Evidence and considerations for lifting restrictions on resources for schools*. WestEd.

WestEd is a nonpartisan, nonprofit research, development, and service agency that partners with education and other communities throughout the United States and abroad to promote excellence, achieve equity, and improve learning for children, youth, and adults. WestEd has more than a dozen offices nationwide, from Massachusetts, Vermont, Georgia, and Washington, DC, to Arizona and California, with headquarters in San Francisco. For more information, visit WestEd.org or call 415.565.3000.

NATIONAL CONFERENCE OF STATE LEGISLATURES

NCSL, founded in 1975, represents the legislatures in the states, territories, and commonwealths of the U.S. Its mission is to advance the effectiveness, independence, and integrity of legislatures and to foster interstate cooperation and facilitate the exchange of information among legislatures.

AUGENBLICK, PALAICH AND ASSOCIATES

APA is a Denver-based education consulting firm whose mission is to help clients solve problems so they can meet student performance goals and improve the quality, effectiveness, and efficiency of our nation's public schools. The firm works with public education stakeholders at every level: state legislatures, governors' offices, state education agencies and boards of education, business leaders, foundations, school district superintendents and business officers, county-level leaders, teacher associations, and numerous other groups interested in improving our country's education system. To contact APA, visit apaconsulting.net or call 303-293-2175.