

THE CRUEL DIVIDE:

HOW CALIFORNIA'S EDUCATION FINANCE SYSTEM
SHORTCHANGES ITS POOREST SCHOOL DISTRICTS

K-12 POLICY



FEBRUARY 2012



The Education Trust-West

The Cruel Divide:

How California's Education Finance System Shortchanges its Poorest School Districts

BY HEATHER BARONDESS, LAURA SCHROEDER, AND CARRIE HAHNEL

California has become a landscape of educational contrasts. Stepping through the doors of a school in an impoverished community, you find dozens of students packed together into classrooms without the support services or additional instructional time they need to succeed. A zip code away, in a neighboring district, you can find students with access to a multitude of educational supports and enrichment programs.

This cruel divide is the result of an education funding system that is fundamentally unfair. Not only has California failed to adequately fund its schools, our state has also failed to equitably allocate existing education funding.

At a national level, California's K-12 spending has resulted in fewer teachers, guidance counselors, and librarians per student than any state. In per-pupil spending, California ranks near the bottom, with 42 states spending more per student than the Golden State.¹ While educators, community groups, and our political leaders have called for increased education spending, it will take more than just extra dollars to fix California's education finance system or improve outcomes for the state's more than six million students.

A better system would more equitably distribute dollars to districts and schools—thereby offering districts with large concentrations of high-need students the extra dollars they need to accelerate student performance and close achievement gaps. Yet despite years of efforts to reform California's system of education finance, large divides remain between school districts with the highest and lowest poverty levels.

In fact, we reveal in this report that the highest poverty school districts—those with the largest concentrations of low-income students—receive \$620 less per student, on average, from local and state sources than the most affluent districts. For a mid-sized school district of 6,000 students, that amounts to more than \$3.7 million per year.

The irrational nature of the education finance system is partly to blame. The system is a haphazard collection of arcane and hard-to-navigate policies that manage to hide funding disparities from district leaders and policymakers, not to mention parents and the public. The maze of programs and formulas makes it nearly impossible to understand whether dollars ever reach the schools and students for whom they are intended.

If we truly want to ensure that all California students have access to a high-quality education, our elected leaders must reform our system of education finance to make it rational, transparent, and equitable. In particular, we call on state leaders to distribute dollars based on the diverse needs of students and ensure that those dollars are benefiting students and communities. By reforming our education finance system, California's leaders could better support schools in their efforts to close achievement gaps and prepare all students for college and career.

A RETROSPECTIVE: SCHOOL FINANCE IN CALIFORNIA

Three major events have shaped California's system of education funding: the *Serrano v. Priest* court decision and ensuing state funding reforms, the passage of Proposition 13, and the passage of Proposition 98.

- ***Serrano v. Priest***: For decades, property taxes, supplemented by state aid, paid for California schools. This approach to funding schools resulted in tremendous inequality in the funding amount per pupil, as school districts with high property wealth generated more property tax revenue than those with lower property wealth. The landmark California Supreme Court case, *Serrano v. Priest*, found this model of education funding unconstitutional because it violated the principle of equal protection. In 1976, the court ordered California to fix its school financing system to be more equal.

In response to *Serrano*, the state pursued several reforms to break the link between the property wealth of a school district and its spending on schools. First, the legislature created a new system that called for each district to receive a base level of funding, known as the "revenue limit." Lawmakers intended, over time, to equalize per-pupil spending for general purposes across districts.

- ***Proposition 13***: Voters passed Proposition 13 in 1978, limiting property taxes to 1 percent and property tax increases to no more than 2 percent per year. Proposition 13 has had a major impact over time on the state's education funding system, reducing both the

revenue available for schools and the ability of local communities to raise more revenue by boosting property taxes. The legislature tried to protect school districts from these budget cuts by replacing these local revenues with dollars from the state general fund. This, in turn, shifted much of the decision-making power for education funding from the local level to Sacramento lawmakers.

- ***Proposition 98***: In 1988, voters passed Proposition 98 to ensure that spending on education kept pace with state spending in other areas. Proposition 98 guarantees that a minimum amount of the state's general fund will be spent on K-12 education and the community college system. However, Proposition 98 also includes a series of exceptions, allowing lawmakers to "suspend" the minimum funding guarantee in times of fiscal crisis, or to reduce funding levels when the state's revenue growth is low.

Since the days before *Serrano*, state policymakers have tried to distribute education funding more equally, so that the same amount of money is spent on each student. However, equalizing funding does not address the greater needs of specific student populations, such as English-language learners. Recognizing this, state policymakers have, over time, allocated additional "categorical" funding streams to specific programs or student populations. Nevertheless, as revealed in this report, even when revenue-limit and categorical funding streams are put together, education funding remains inequitable.

UNFAIR FUNDING PATTERNS PLAGUE CALIFORNIA SCHOOL DISTRICTS

Despite nearly four decades of reforms aimed at making California's school finance system more equitable, the sad truth remains: A poor school district is likely to get less funding than one serving fewer low-income students. Important variations within funding streams and between districts lead to considerable differences in funding between the state's highest and lowest poverty districts. In particular, inequities in the three primary state education funding streams skew California's education finance system. These are:

1. *Inequities in revenue-limit funding*
2. *Inequities in the distribution of categorical funds for high-need students*
3. *Inequities in the ability to generate local revenues*

REVENUE LIMITS FAIL TO EQUALIZE FUNDING AS INTENDED

State policymakers designed the revenue limit as a way of equally distributing a baseline level of per-pupil, general-purpose funding among districts. Each of the nearly 1,000 school districts in California has its own revenue limit based on a formula that factors in district type (elementary, high, or unified), size (small or large), historical spending patterns, and other variables like the number of charter schools in the district.²

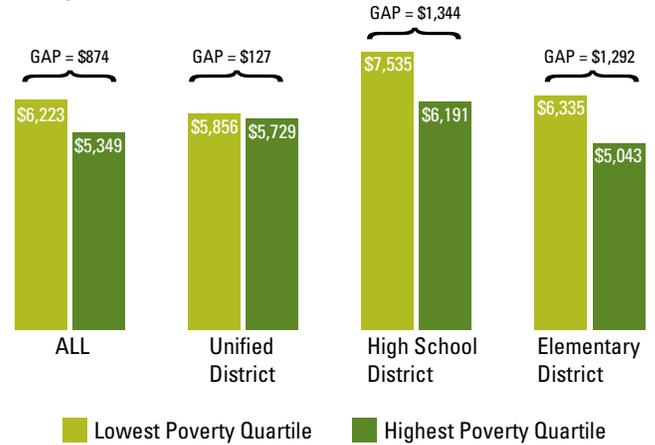
However, despite policymakers' intentions, large variations in revenue-limit funding remain between districts.³ For example, high school districts have a considerably higher base revenue limit than unified or elementary districts because the original revenue-limit amounts were set based on expenditures at the time—and high school districts spent more. Most concerning, the state's highest poverty districts receive less funding than the lowest poverty districts. While factors like district type and size contribute to this disparity, the starkest contrasts are caused by "basic aid" districts. In these districts, property tax revenues exceed the base revenue limit and the districts are allowed to keep the excess.

Figure 1 shows that school districts in the highest poverty quartile receive less revenue-limit funding per pupil than school districts in the lowest poverty quartile. The overall revenue-limit gap between the highest and lowest poverty districts is \$874. The gap is greatest among high school districts, where it amounts to \$1,344.

Despite attempts to equalize per-pupil funding through the revenue-limit formula, some higher poverty districts receive far fewer funds than more affluent neighboring districts. Although this variation occurs between many districts, the variation is greatest when one district is a basic-aid district and the other is not.

Take, for example, Solana Beach Elementary School District and National Elementary School District, both in San Diego County. Solana Beach serves 2,700 students and just 9 percent of its students qualify for free or reduced-price meals. National Elementary has 5,800 students, 84 percent of whom are low income. In 2008-2009, these districts had similar base revenue limits per student, with the higher poverty National Elementary entitled to \$21 more per pupil.⁴ But when this

FIGURE 1: Per-pupil revenue-limit funding in highest poverty and lowest poverty districts



Notes: Only districts with Average Daily Attendance (ADA) greater than 100 students are included in this analysis, and all districts are weighted equally. Weighting by student would yield similar patterns, with gaps evident but less pronounced in some cases. Poverty quartiles are created separately for each district type using eligibility for free and reduced-price meals as a proxy for poverty. Data sources include: revenue-limit data from Ed-Data.org, fiscal year 2009-10 data, accessed in January 2012; poverty data from the California Department of Education, Free/Reduced Price Meals Program and CalWORKS Data Files, October 2010 data submission, accessed in January 2012.

SOURCES AND TYPES OF K-12 EDUCATION FUNDING

California school districts receive funding from several sources, each with their own formulas, guidelines, and strings attached.

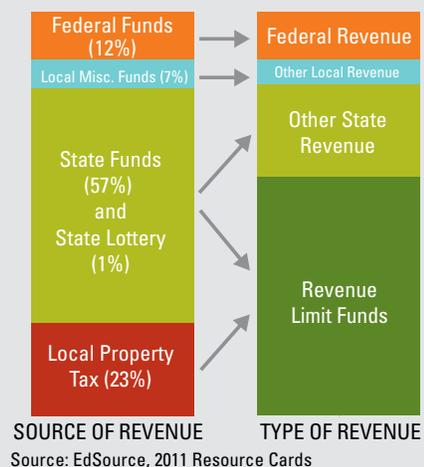
- **Local property taxes** (23 percent) are generated by communities and then sent to the state, where a formula determines how to redistribute these funds to school districts and local governments.
- **State funds** (57 percent) derive from business and personal income taxes, sales taxes, and other special taxes.
- **State Lottery** (1 percent) raises a small amount of funds to be spent on K-12 education.
- **Local "miscellaneous" funds** (7 percent) are collected, managed, and spent by local school districts. These funds include revenues from local parcel taxes, community/parent contributions, interest income, and developer fees.
- **Federal funds** (12 percent) are intended to provide supplemental funding to support the educational needs of low-income students, English-language learners, and students with disabilities.

These funds are then distributed to districts in different ways — some straightforward, some less so.

- **The revenue limit**, the bulk of a district's funding, is comprised of a share of the state funds and local property taxes. Revenue-limit funds, along with a portion of the state lottery monies, may be used for general purposes — anything from paying salaries to buying books to fixing computers.
- **Other state revenues**, comprised of the remaining state funds and state lottery dollars, are categorical, intended for spending on specific programs. Class Size Reduction (CSR) is an example of a state categor-

ical fund that pays for reducing class sizes to 20 students or fewer in kindergarten through third grade, while Economic Impact Aid (EIA) provides resources for low-income students and English-language learners. The governor's first proposal for the 2012-2013 budget includes a plan for collapsing many of these state categorical funds into a single pot of money which would then be distributed to districts based on district enrollment and the percentage of low-income students and English-language learners served.

- **Other local revenues** raised by a community may either be spent on general purposes or earmarked by that district for specific uses.
- **Federal revenues** are funneled to school districts through federal and state formulas, and there are usually specific programs or students for which these dollars may be used.



Source: EdSource, 2011 Resource Cards

base was adjusted for add-ons and excess local taxes, Solana Beach, a basic-aid district, had *total* revenue-limit funding of \$10,613 per student, compared with National, which had revenue-limit funding of \$5,607 per student.⁵ Clearly, the state’s efforts to equally distribute funds through the revenue-limit system have failed when a high-poverty district receives only half the level of funding as a neighboring low-poverty district.

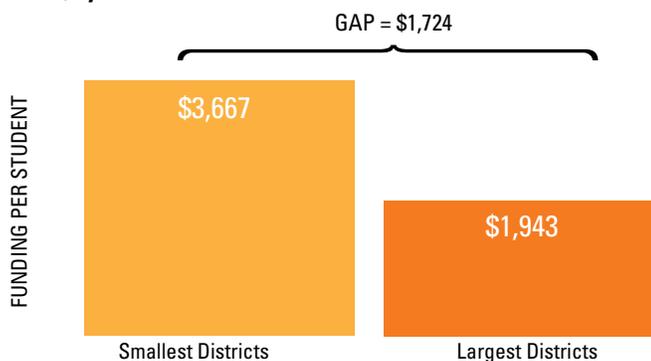
While basic-aid districts provide a stark contrast, we also see irrational distribution of revenue-limit funding among districts with similar size, student demographics, and geographic location. Consider the case of two small, rural, high-poverty districts in Stanislaus County, neither of which is a basic-aid district: Riverbank Unified and Newman-Crows Landing Unified. Riverbank Unified has \$6,233 in revenue-limit funds per student, while Newman-Crows Landing has \$5,115 per student, a gap of more than \$1,100 per pupil.⁶

If Newman-Crows Landing were to receive that difference in funding for each of its 2,600 students, it would mean a budget increase of nearly \$3 million per year.

CATEGORICAL FUNDS TARGETED FOR HIGH-NEED STUDENTS CAN BE INEQUITABLY DISTRIBUTED

Categorical funds are restricted to specific programs or groups of students. Whereas revenue-limit funding can be spent on whatever the district chooses and is intended to equalize base-line levels of funding for all districts, specific categorical funds such as Economic Impact Aid (EIA) are intended to ensure equity by allocating additional funds to support high-need students. For this reason, school districts serving more high-need students receive more of these categorical funds. But while these categorical funds are designed to resolve inequities, the way categorical funds are allocated can actually create further inequities.

FIGURE 2: Per-pupil state categorical funding in highest poverty districts, by district size



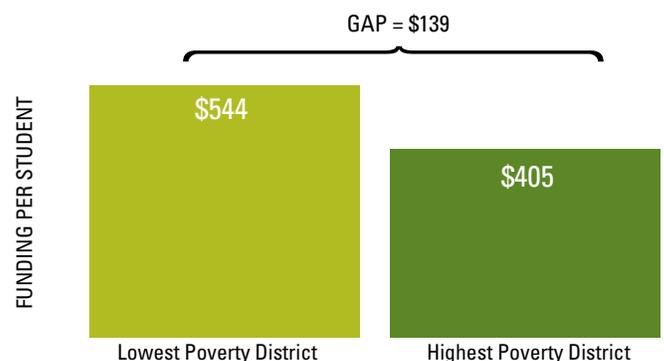
Notes: Largest districts represent the top quartile of Average Daily Attendance (ADA), while smallest districts represent the bottom quartile. Sources: Revenue limit data from Ed-Data.org, fiscal year 2009-10 data, accessed in January 2012; poverty data from California Department of Education, Free/Reduced Price Meals Program and CalWORKS Data Files, October 2010 data submission, accessed in January 2012.

California’s more than 60 categorical programs each come with their own strings and allocation formulas, most of which are based on historical precedent. Often, once a district receives funding for a categorical program, it will continue to receive it, regardless of how many high-need students the district is currently serving.⁷ This can sometimes lead one district to receive twice as much money per high-need student from a given categorical fund than another district. Indeed, when we looked at just the highest poverty school districts, we found that the largest districts received fewer dollars per pupil from categorical programs than the smallest districts (*see Figure 2*).

Of course, averages can mask exceptions. In this case, it is worth noting that the 600,000-student, high-poverty Los Angeles Unified School District had state categorical funding of \$3,774 per pupil in 2010, exceeding the average of the smallest high-poverty districts. This exception shows that policy can be crafted to help or hinder specific districts or groups of districts—and the students they serve.

Researcher Jennifer Imazeki has identified several specific categorical programs where the level of funding provided for eligible high-need students varies tremendously from district to district.⁸ For example, EIA dollars, which serve as California’s primary means of funding the increased costs of educating low-income students and English learners, are unevenly distributed. Low-income and English-learner students in the state’s highest poverty districts receive just three fourths of the level of EIA funding as those students enrolled in the lowest poverty districts, \$405 and \$544 per EIA-eligible student, respectively (*see Figure 3*), due in part to minimum and maximum per-district grant sizes. In 2006-2007, legislators modified the EIA allocation formula to make it more rational. They increased funding levels and began distributing money by the number of English-learner and low-income students

FIGURE 3: Distribution of Economic Impact Aid funding per EIA-eligible student



Notes: This analysis divides districts into poverty quintiles using financial data from 2007-08. Source: Jennifer Imazeki, “Equity, Adequacy and Rationality: Issues in California School Finance,” 2010.

in the district. They set a goal to equalize funding at \$600 per targeted, high-need student, but that objective has not yet been reached. On average, districts receive about \$350 per EIA-eligible student.

Imazeki finds similar irrational, unfair patterns in the distribution of Pupil Retention Block Grant (PRBG) and Targeted Instructional Improvement Block Grant (TIIG) grants. She finds that the lowest poverty districts receive more funding per pupil for these programs than the highest poverty ones. PRBG funds target students who need additional assistance to succeed in school, combining a number of existing programs such as Elementary School Intensive Reading, Continuation High School Foundation, High Risk Youth Education and Public Safety, and Dropout Prevention and Recovery. TIIG funds were originally provided to support court-ordered desegregation and voluntary integration programs.

In 2009, policymakers made a major change to categorical funds when they removed the restrictions attached to roughly 40 of these programs. When making this change, the state did not change the amount allocated to districts, just the requirements related to expenditures. This flexibility gave district leaders the opportunity to spend some of their categorical funds on any general purpose. Many student advocates and district administrators have raised concerns that this new flexibility could hurt the programs for disadvantaged students supported by these funding streams.⁹

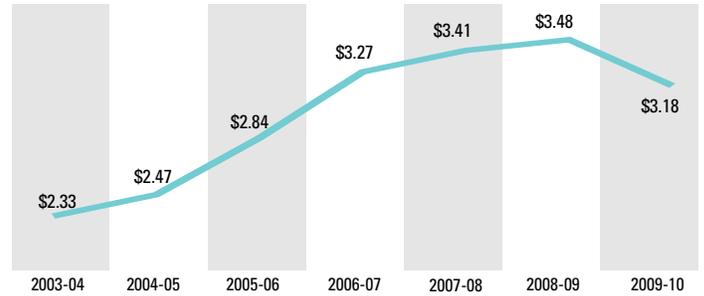
LOCAL REVENUES WORSEN INEQUITIES

Serrano v. Priest and subsequent school finance reforms shifted the funding model for local districts away from local property tax revenue as the main source of funds, because of the inequities that model produced. Yet school districts have increasingly turned to other local funds such as parent contributions, private donations, and parcel taxes to raise additional funds and offset state budget cuts (see Figure 4).

While these local revenue sources can produce more money for schools, they are inherently inequitable: Low-wealth communities simply do not have the same capacity to raise funds as more affluent areas. Overall, the state's wealthiest districts are able to raise \$570 more in local funds per student than the poorest districts. In elementary districts, that gap climbs to almost \$800 per student (see Figure 5).

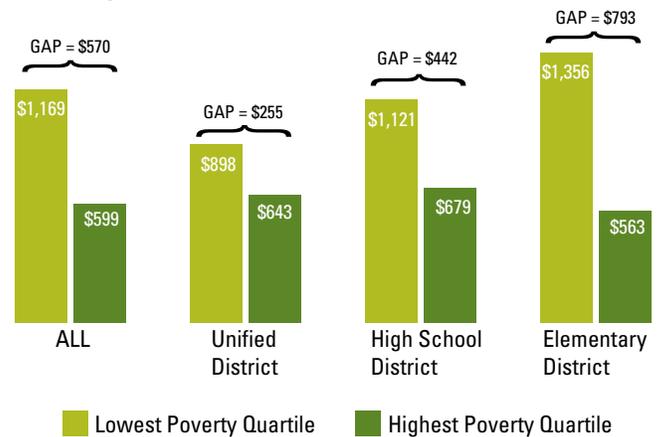
In many cases, parcel tax dollars represent a significant share of a district's local revenues. Parcel taxes require approval by two-thirds of voters in a school district. Voters can approve an additional tax on their property to fund either specific projects in their school district, or to provide additional general purpose dollars. Parcel taxes can be a regressive form of taxation, with the tax affecting lower income home-owners

FIGURE 4: Total amount of revenue generated from local sources, statewide (in billions)



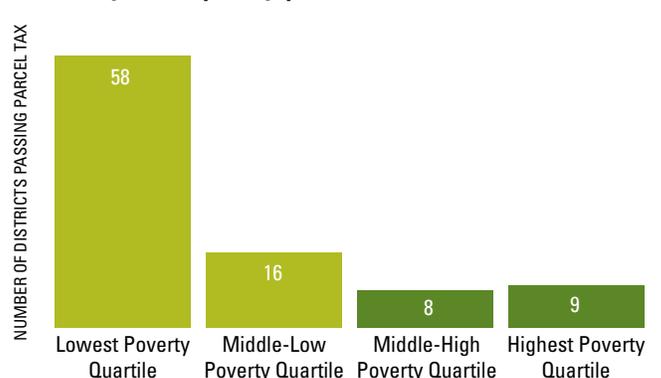
Notes: The statewide totals are calculated by rolling up dollar amounts by revenue type. These figures generally do not include dollars raised by PTAs or local school and district foundations. Source: Ed-Data.org.

FIGURE 5: Per-pupil local miscellaneous revenues in highest poverty and lowest poverty districts



Notes: Only districts with Average Daily Attendance (ADA) greater than 100 students are included in this analysis, and all districts are weighted equally. Local revenue data from Ed-Data.org, Fiscal Year 2009-10. Poverty data from California Department of Education, Free/Reduced Price Meals Program and CalWORKS Data Files, October 2010 data submission, accessed in January 2012.

FIGURE 6: School districts that approved at least one parcel tax from 2001-2010, by district-poverty quartile



Notes: Parcel tax data from EdSource. Poverty data from California Department of Education, Free/Reduced Price Meals Program and CalWORKS Data Files, October 2010 data submission, accessed in January 2012.

more than wealthier homeowners. Generally, each parcel of land is assessed a flat tax (as opposed to property taxes which are based on the value of the property).¹⁰

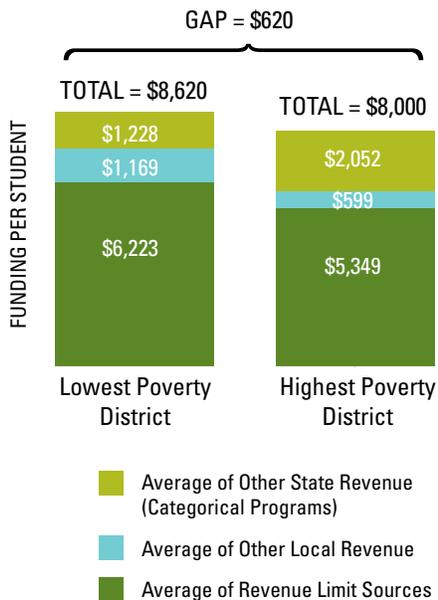
Most parcel taxes have been passed in higher income communities. Of the 91 school districts that passed at least one parcel tax between 2001 and 2010, nearly two-thirds were among the wealthiest districts in the state (see Figure 6). One high-wealth district, Piedmont Unified, approved six different parcel taxes in this period.

THE DISTRICT FUNDING GAP

As we have shown, districts with the highest poverty levels receive fewer base revenue funds than those with the lowest poverty levels. With more affluent districts better equipped to raise local revenues, a wide gulf in funding has emerged between the poorest and wealthiest districts. State categorical funds, which are often designed to even the playing field by directing more dollars to districts serving needier students, are not enough to close the gaps created by base revenues and local funding. To complicate matters, these categorical dollars are not always rationally or evenly distributed, even among similar districts.

When these three revenue streams are considered together, the result is a clear gap in funding between the highest and lowest poverty districts (see Figure 7).

FIGURE 7: State per-pupil funding by revenue source in highest poverty and lowest poverty districts



Notes: Only districts with Average Daily Attendance (ADA) greater than 100 students are included in this analysis, and all districts are weighted equally. Poverty quartiles are created separately for each district type using free/reduced price meals eligibility as a proxy for poverty. Sources include: Revenue data from Ed-Data.org, fiscal year 2009-10 data, accessed in January 2012; poverty data from California Department of Education, Free/Reduced Price Meals Program and CalWORKS Data Files, October 2010 data submission, accessed in January 2012.

MOVING TOWARD A SOLUTION

California's school finance system is unquestionably unfair at many levels. Certainly, our school districts need more funds to adequately serve all students and prepare them for college and career. But more money alone will not solve issues of equity we have identified in this report. California must also distribute education funds more rationally, transparently, and fairly among districts.

Five years ago, the landmark *Getting Down to Facts* study reached the same conclusion.¹¹ It documented a system of school finance marked by irrational decisions, opaque processes, and inequitable results. In response to these findings, the 2007 Committee on Education Excellence, on which The Education Trust—West served, issued a set of recommendations for reforming the state's school finance system. The committee recommended that the state take three steps: 1) transition to a student-centered funding model, 2) reward successful schools with financial incentives, and 3) provide the education system with greater fiscal stability and predictability.

These recommendations remain as urgent and relevant today as when they were issued. Indeed, in his January 2012 budget proposal, Governor Jerry Brown called for a shift to a weighted student funding model. While the details have yet to be worked out, this proposal offers California a chance to seriously tackle the challenge of equitably funding its districts and schools. Given this opportunity, stakeholders should urge state policymakers to act now on the following recommendations:

- **Simplify the school finance system so that policymakers, educators, parents, and local taxpayers can understand where money comes from and how it is spent.** The state should be able to track and clearly show how and why districts receive funds. It should modify the formulas that determine how much money districts receive from different funding streams so they are less complex and more transparent. In addition, it should build better reporting systems down to the school level and require the use of real versus average teacher salaries, as we recommended in our 2005 *California Hidden Teacher Spending Gap* report.¹²
- **Revise the revenue-limit formula so as to distribute base revenues more equally among school districts.** The stark differences in revenue-limit funds that districts receive matter, as other revenue sources such as categorical funds may not fully offset these baseline funding gaps.

- **Move toward providing additional dollars to high-need students through a student-based funding model.** Such a system, which supplements a base level of funding, could provide significantly more resources to districts serving more high-need students.

The state should pursue promising models such as a weighted student formula, where funds are allocated based on the needs of individual students, so that students with greater learning needs receive higher levels of funding. The bulk of money should follow the student to the school level in a rational and equitable way, and parents should be involved in spending decisions. The additional funding should not get diverted to other schools, district-level needs, or programs. In addition, the state must build the robust accountability systems necessary to ensure that increased flexibility is tied to improved student outcomes.

- **Monitor and mitigate gaps in local revenue between high and low-poverty communities.** If proposed reforms to lower the threshold for passing a parcel tax from two-thirds to 55 percent are pursued, the state must take an active role in ensuring that low-income communities with less ability to raise revenue do not fall further behind. Otherwise, tremendous gaps in school district funds caused by local revenues could return the state to levels of inequality not seen since before *Serrano*.

Even if California resolved its budget woes, this would not guarantee our most disadvantaged students would get the extra funding they need or close our state's stubborn achievement gaps. In addition to seeking more funds, we must distribute our education dollars more equitably. Only by both increasing revenues and allocating them more fairly can the state ensure that every school, regardless of location, has the resources to help its students achieve their dreams of college and career.

NOTES

1. Brian Edwards, "How California Ranks" (Mountain View, CA: EdSource, 2010). This reflects 2007-2008 per-pupil spending, adjusted for labor costs and other cost-of-living differences between states.
2. EdSource, "Revenue Limits." http://www.edsource.org/iss_fin_sys_revlimits.html.
3. Margaret Weston, "Funding California Schools: The Revenue Limit System" (San Francisco, Calif.: Public Policy Institute of California, March 2010).
4. Solana Beach Elementary School District had a base-revenue limit of \$5,831, similar to the base-revenue limit of \$5,852 for National Elementary School District. San Diego County K-12 School Districts 2008-2009 Annual Report of Financial Transactions. http://www.sdcoe.net/business2/dfs/mr/ARFT0809_Complete.pdf.
5. Ed-Data.org, District Comparison Results, Fiscal Year 2008-09.
6. Ed-Data.org, District Comparison Results, Fiscal Year 2009-10.
7. Thomas Timar, "How California Funds K-12 Education" (Stanford, Calif.: Institute for Research on Education Policy and Practice, September 2006).
8. Jennifer Imazeki, "Equity, Adequacy and Rationality: Issues in California School Finance." Presented at EdVoice Institute Symposium, July 2010.
9. Bruce Fuller, Julie Marsh, Brian Stecher, and Tom Timar, "Deregulating School Aid in California: How 10 Districts Responded to Fiscal Flexibility, 2009-1010" (Santa Monica, Calif.: RAND Corporation and Policy Analysis for California Education, May 2011). In 2009, both TIIG and PRBG were among the forty categorical programs granted flexibility.
10. Several efforts in California cities aim to levy parcel taxes differently to make them fairer, such as taxing per square foot so that owners of bigger homes pay more than owners of smaller homes. However, many of these efforts are being contested in court.
11. Susanna Loeb, Anthony Bryk, and Eric Hanushek, "Getting Down to Facts: School Finance and Governance in California" (Stanford, Calif.: Stanford University, March 2007).
12. The Education Trust—West, "California's Hidden Teacher Spending Gap: How State and District Budgeting Practices Shortchange Poor and Minority Students and Their Schools" (Oakland, Calif., The Education Trust—West, 2005).

The Education Trust—West works for the high academic achievement of all students at all levels, pre-k through college. We expose opportunity and achievement gaps that separate students of color and low-income students from other youth, and we identify and advocate for the strategies that will forever close those gaps.

ACKNOWLEDGEMENT

Funding for this research was generously provided by the Bill & Melinda Gates Foundation.



The Education Trust—West

1814 Franklin St., Suite 220, Oakland, Calif. 94612
 T 510/465-6444 • F 510/465-0589
www.edtrustwest.org