School districts generally reduce taxes upon receiving federal and state aid. State-aided districts increase their expenditures to education only about 15 percent of the amount of the state aid, and reduce local tax levies by 85 percent. This substitution effect also accompanies federal aid to states. To meet this problem, Congress defines federal purposes and grants federal monies (categorical grants) only to accomplish these federally-defined purposes, which frequently differ from locally defined or state-defined purposes. The federally defined purposes are training manpower, increasing economic productivity, and increasing efficiency. One possible solution to the substitution effect would be to negotiate the budgets of local school districts at the state level, and to allow the federal government to deal with the states on a general aid basis. However, a powerful new tool to increase the effectiveness of categorical grants is program planning and budgeting systems (PPBS). PPBS is a highly systematized common language which should speed the trend toward the centralization of decision making in education. (HW)
Textbooks on school finance usually have separate chapters for school revenues from federal, state, and local levels and so we usually treat these as separate categories in our thinking about school finance.

Yet the complexities of our fiscal federalism is such that we cannot talk sensibly about allocations of funds to schools at one governmental level without taking into account what happens at each of the other levels.

The reason this is so is that people who have the power of decision in each of the lower governmental levels consider tax funds raised at that level to be "hard" money and view grants from the level above as "easy" or "soft" money.

A local school board and a legislature considering school appropriations deal in common with two sets of pressures. On the one hand parents want school services improved. On the other hand taxpayers generally would like to see the tax rates reduced. Each year the board, and the legislature, strike a balance between these two pressures and set tax rates at a level designed, not to keep everyone happy, because that is impossible, but at least to keep everyone sullen instead of rebellious. Admittedly, the balance at each level is a perilous one.
"Soft" money, from either the state or federal level, tips this balance. The board can allocate funds to increase services, or reduce taxes, or both. Actually some careful analyses have shown that the "soft" money generally goes to reduce taxes, that in fact "soft" money substitutes at a very high level, perhaps as much as 85 percent for funds that otherwise would be raised locally. This means that if we take two districts, equal in ability and comparable in demand for education, both paying the full cost of education from local revenues, and begin to pay state funds to one district but not to the other, we can expect the state-aided district to increase its expenditures to education only about 15 percent of the amount the state adds, and to reduce its local tax levies by 85 percent of the amount of the state funds.

This substitution effect is evident similarly at the state level where the legislature looks upon funds raised by the taxes they impose as "hard" money and funds allocated from the federal level as "easy" or "soft" money. If given free grants by the Congress, the behavior of legislatures can be expected to be about the same as that observed for local boards, that is, the federal money will substitute in very large measure, perhaps at the level of 85 percent, for money that would otherwise be forthcoming from state taxation.

Policy-makers at the federal level early observed how remarkably absorptive of free grants are both state and local governments, and since shortly after the turn of this century have been quite sophisticated in dealing with their sponge-like qualities. The only way to deal with them, the Congress learned by experience, was to define a federal purpose and then appropriate federal monies to be granted upon condition that they be spent only to accomplish the federally-defined purpose.
I hardly need to point out to this audience that federally-defined purposes in education frequently differ from locally-defined or state-defined purposes. Local aims in education are concerned primarily with freedom to transmit the neighborhood values, beliefs, and general culture; such aims may differ sharply by regions, by states, by districts within states, and even by neighborhoods within large districts. Yet everywhere one finds the local insistence on determining who shall teach, what shall be taught, and how much to spend, defended as one of the basic liberties guaranteed by the common law and practice of this society.

State-defined purposes usually include minimum standards for curricular offerings and teacher quality, and attempts to equalize educational opportunities and tax burdens.

The principal federal concerns for more than a century have been with training manpower, with increasing economic productivity, and with efficiency in the accomplishment of these purposes in the sense that federal dollars expended produce the highest return in terms of the federal purpose.

To raise the revenue needed at each level, local districts have depended upon persuasive and often extensive budget reviews to convince the local taxpayers that the taxes requested were justified.

At the state level budget reviews in most states have in the past been impractical because of the large number of school districts, and so complex formulae were provided as a substitute for information not readily available. However, with the sharp reduction in number of school districts, that situation is changing.
At the federal level public school finance people have tried for most of this century to convince the Congress that an equalization formula, not unlike that characteristic of many of our state finance plans, could be made to work, and that general grants could be made to the states to equalize somewhat the great differences in wealth available for support of education and the great differences in quality of education now evident across the 50 states.

The Congress, however, has been less interested in equalization than it has been in federally-defined purposes, and in efficiency. Consequently it has chosen to continue a hundred years of custom in federal appropriations to education, making those appropriations to specific purposes, such as the establishment of the land grant colleges, the offering of specific courses in vocational education, the support of specific programs, such as training in mathematics, science, languages, and for guidance. In short, Congress chooses to avoid the ever-present danger that federal appropriations to education will simply result in lowered taxes at the state and local level by appropriating funds to be expended only for purposes defined by the Congress.

One can argue that the substitution effect to which I have referred is not all bad, that it might in fact be desirable to shift all of the costs of education from the property tax base to the income tax base, and that since the federal government has a general monopoly on the income tax that the federal government should indeed levy sufficient funds and make large enough grants to the states to provide all educational services in the public sector. It would be an awesome reallocation, which I am sure we are not about to make!
There is another course, however, which seems to me to be more practical, and one which perhaps could be more readily achieved in the foreseeable future. This would be to persuade our legislatures to face the fact that our state aid formulae are probably not working very well, that they are indeed a substitute for information, and that the information needed in many of our states to make more rational judgments about how to allocate state funds to education is now accessible, partly because of improvement in our data processing and data reduction systems, and partly because we have fewer school districts to deal with. It is now feasible to suggest that the budgets of local school districts be negotiated at the state level in many of our states. Such a suggestion, which would have been incredible when we had 130,000 school districts, becomes increasingly feasible as the number of districts drops below 20,000. Direct negotiations of budgets certainly would be a possibility worth considering in more than half of the states at the present time, and others are coming into this zone of feasibility each year. The State of Hawaii, and to a lesser extent Delaware and Alaska, have already arrived at this situation and other states are approaching it, speeded by the pressure of increasingly militant teacher negotiations which will drive decisions on salaries to the state level anyway, eventually, and perhaps to the national level.

The preliminary negotiation of budgets could be performed by an agency attached to the legislative council, to the office of the legislative analyst, or to the governor's office; or a governmental agency not unlike a coordinating council for higher education, so common to many states, could be created to handle budget negotiations for school districts in the same way that budgets are handled in many states.
If we could negotiate budgets for schools at the state level, then the federal government might begin to deal realistically on a general aid basis with the states. Short of such a heroic adaptation, however, I see little hope that we can change the federal conviction that categorical aids to local school districts are the only kind of aids that make sense under our present arrangements.

A powerful new tool to increase the effectiveness of categorical grants is program planning and budgeting systems. The Elementary and Secondary Education Act of 1965 made federal aid available on a program basis at the same time that President Johnson issued his executive order to bring all federal agencies under PPBS, and local school officials had to begin, almost without warning, a remarkable reorientation to the task of budget-making. In a very real sense that reorientation will shift their thinking from the traditional task of conservatively projecting into the future an organization hopefully capable of coping with future events to the innovative task of anticipating, inventing, and planning for future events and designing the organization necessary to bring them into being and manage them. Part of the difficulty now being faced by school officials lies in the speed with which they have been propelled into the world of PPBS, which assumes familiarity with cost-benefit studies and the more complex systems analyses. We find ourselves in the plight of a student plunged into algebra before he has learned to do arithmetic.

In closing, let me make it clear that I do not come before you to advocate PPBS as an ideal basis for distributing federal funds to schools. On the other hand I think it most unwise to dismiss it, either as a passing fad or as a
simple tool of management. Actually it is a very powerful and highly systematized common language for describing the structures, functions, and objectives of government services, and the information the system gathers increases the understanding of planners at the state and federal level, thereby increasing their power over educational planning, and will speed the trend toward centralization of important decision-making functions in education. To date educators at the local level have paid little attention, and done little to aid or even to understand PPBS. To continue this know-nothing stance will simply eliminate them from consequential involvement in educational decisions if present trends continue. A disciplined way to understanding is a source of very great power in a democracy, perhaps the only one we should trust in the long run. The economists seem to be building a disciplined way of understanding around PPBS, and if educators want to be involved in the important policy discussions, they will need to learn the language in which much of these discussions are now conducted.

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