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ABSTRACT

This paper examines the relationship between special education fiscal policies and the least restrictive environment (LRE) requirements of the Individuals with Disabilities Education Act (IDEA). It focuses on the need to develop federal and state fiscal policies that achieve a balance between the sometimes competing needs of the LRE and the continuum of services requirements under IDEA. Fiscal incentives for restrictive placements should be removed since they clearly conflict with the IDEA's LRE requirements. Whether the resulting fiscal policies should be as free of any placement incentives as possible, or should actually favor less restrictive placements is a matter for local, state, and federal policymakers to determine. In considering alternative fiscal policies, a conscious effort must be made to consider the placement incentives associated with each alternative and to develop future fiscal provisions with their relationship to program goals clearly in mind. Methods for reducing the number of restrictive placements are offered. The paper focuses on questions such as how to remove fiscal incentives to serve students in more restrictive settings and how to use limited education resources more efficiently to provide better coordination and articulation across educational programs. The paper includes separate discussions of state and federal special education finance reform issues. (Contains 14 references.) (JDD)

Fiscal Issues in Special Education:

Removing Incentives for Restrictive Placements

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CSE

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Center for Special Education Finance

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The Center for Special Education Finance (CSEF) was established in October 1992 to address a comprehensive set of fiscal issues related to the delivery and support of special education services to children throughout the U.S. The Center's mission is to provide information needed by policymakers to make informed decisions regarding the provision of services to children with disabilities, and to provide opportunities for information sharing regarding critical fiscal policy issues.

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Contents

I. Overview

Ever since the passage of the Education for All Handicapped Children Act of 1978 (currently known as the Individuals with Disabilities Education Act, IDEA), tension has existed between the "least restrictive environment" (LRE) and the "continuum of services" requirements of this law. The former, as specified in Section 300.550 of Title 34, *Code of Federal Regulations*, states:

> ... special classes, separate schooling or other removal of handicapped children from the regular educational environment occur only when the nature or severity of the handicap is such that education in regular classes with the use of supplementary aids and services cannot be achieved satisfactorily.

At the same time, IDEA regulations require that a continuum of alternative placements be made available for students with special needs. These must include special classes, special schools, home instruction, and hospital and institutional settings, as well as placements in general education classes.

While the LRE requirements clearly call for less restrictive placements, the "continuum of services" requirement seems to emphasize the need to examine a full range of alternative placement options. As a result, some interpretations of the continuum requirement place relatively less emphasis on the degree of restrictiveness in the resulting placements. For example, Danielson and Bellamy (1989) demonstrated that a differing balance in the interpretation of these two federal provisions at the local and state levels have led to differing placement patterns for students with disabilities.

With increased emphasis on the LRE requirements of IDEA, researchers and policymakers have begun to examine the relationship between special education funding provisions and the degree of restrictiveness in local placement patterns. Dempsey and Fuchs (1993), for example, found that traditional funding approaches, which attempt to differentiate among the cost of basic student placements, may lead to more costly and restrictive placements. In a study of the LRE provisions of IDEA at selected sample sites, Hasazi, Liggett, and Schattman (1994) found that "finance emerged as the cornerstone of influence at all of the sites."

At the federal level, the Office of Special Education Programs (OSEP), within the U.S. Department of Education, has begun to rule states out of compliance with the provisions of IDEA when it finds evidence that their special education funding provisions contain fiscal incentives for restrictive placement options.[1] In addition, at a recent policy conference on formulating a National Agenda for Special Education (Washington DC, July 10-12, 1994), Thomas Hehir, Director of OSEP, identified special education fiscal policy as a primary determinant of local program practices. He then asked whether preferred fiscal policies should attempt to create incentives that actively foster less restrictive placements, or whether they should simply remove existing funding incentives that favor greater restrictiveness.

Purpose of this Paper

This paper examines the relationship between special education fiscal policies and the LRE requirements of IDEA. It focuses on the need to develop federal and state fiscal policies that fully consider the desired balance between the sometimes competing needs of the LRE and the continuum of services requirements under IDEA. As neither of these two requirements entails fiscal incentives for restrictive placements, it is argued that such incentives should be removed since they clearly conflict with the IDEA's LRE requirements. Whether the resulting fiscal policies should be as free of any placement incentives as possible, or should actually *favor* less restrictive placements is a matter for local, state, and federal policymakers to determine. However, it will be argued that in considering alternative fiscal policies, a conscious effort *must* be made to consider the placement incentives associated with each alternative

[1]Additional issues regarding some of the program implications of alternative federal funding policies are discussed in Parrish and Verstegen (1994).

and to develop future fiscal provisions with their relationship to program goals clearly in mind.

Reducing the number of restrictive special education placements in school districts across the nation has become a clearly articulated federal policy objective. According to interviews with state officials, this objective also appears to be a primary rationale for change in many of the 29 states that are actively considering special education finance reform (see Table 1 in Chapter II). With these trends in mind, the relationship between a range of program reforms related to the reduction of restrictive placement patterns and alternative provisions for financing these reforms are presented.

The major reforms discussed in this paper pertain to the provision of services for special education students in the least restrictive environment and to greater integration between special education and other educational programs. Specifically, the paper focuses on questions such as (a) how can fiscal incentives to serve students with special education needs in more restrictive settings be removed, and (b) how can limited educational resources be used more efficiently to provide better coordination and articulation across educational programs? It will be argued that maintaining fiscal and program barriers between general and categorical educational programs is a form of program segregation that leads to restrictiveness in the provision of educational services.

The paper includes separate discussions of state and federal special education finance reform issues. State issues are discussed first (Chapter II), because states have the primary responsibility for providing special education services and provide, by far, the most financial support for these programs.[2] Federal issues follow in Chapter III. Although it was federal legislation (IDEA) that originally ensured a free and appropriate education for all students with disabilities, only about 8 percent of special education funding now comes from federal sources. This is despite the authorization, and what many consider to have been the promise, of federal support of up to 40 percent of the excess costs of special education services at the time of the passage of IDEA.

[2] For the last year in which these data were available (FY 1987-88), the state share was 56 percent, the local share 36 percent, and the federal share 8 percent. (Table AH1, P. A208-210 of the *Fourteenth Annual Report to Congress to Assure the Free and Appropriate Public Education of All Children With Disabilities, 1992.*)

Since the passage of IDEA, special education costs and enrollments have grown considerably. The number of students receiving special education services nationally has grown from 8.2 percent of public school enrollments in FY 1977 to approximately 11 percent in FY 1994. More than 19 billion dollars in local, state, and federal funds were spent for special education and related services in 1987-88 (the latest year for which such data are available.) Of this amount, states and localities provided about 92 percent, with a federal share of approximately 8 percent. Although special education costs have represented a growing share of overall elementary and secondary school spending over the past 2 decades, in inflation-adjusted terms federal aid per eligible student has shown little growth over this period and has slightly declined since peaking in 1991 (Parrish & Verstegen, 1994).

The continuing growth in the number of students identified for special education services, and the corresponding increases in cost, have contributed to an unprecedented degree of public scrutiny regarding special education over the past few years.[3] In addition, there are growing concerns about the fiscal incentives for more restrictive, high cost placements that are contained in some state special education funding formulas, as well as the lack of flexibility in the use of special education funds. Policymakers are increasingly realizing that state and federal fiscal provisions may provide major stumbling blocks to program reform at the local level.

Each of the states and the federal government has a different set of policies and procedures for determining allocations of special education aid to local school districts. A great deal has been written and numerous typologies have been developed to categorize these alternative funding mechanisms (Hartman, 1992; Moore, Walker, & Holland, 1982; O'Reilly, 1993). Although this paper will discuss these alternatives and make some policy recommendations, it will not endorse a single funding approach. Each alternative discussed has been designed to achieve different policy and program objectives, and only after the federal government and individual states better define these objectives can choices among competing financing provisions be made.

Nevertheless, a set of general principles will underlie this paper. These are (a) *that financing policy will influence local program provision;* (b) *that there are no*

[3] Recent examples of this interest include major articles regarding special education programs and costs in the *U.S. News and World Report* (December 13, 1993) and the *New York Times* (April 6, 7, and 8, 1994).

incentive-free financing systems; and consequently (c) *that in developing fiscal policy, it is essential to develop provisions that will support, or at least not obstruct, program goals.* The purpose of this paper is to discuss the policy implications of alternative methods for removing fiscal incentives for restrictive placement options, and to present methods for actually reducing the number of restrictive placements when this is a stated program objective.

Defining Program Reform

Prior to considering the relationship between special education finance policies and the removal of incentives for restrictive placements, it is necessary to develop some agreed upon definition of the specific reforms being pursued. Such reforms generally include the removal of fiscal incentives for placing students in private over public schools, in specialized over neighborhood schools, and in segregated classrooms and settings throughout the school day. Also relevant to finance policies are issues related to greater flexibility in the use of local resources, the creation of intervention systems for all students, and the preparation of special and general educators.

These issues are pertinent for several reasons. First, one way to avoid restrictiveness in the placement of students is to avoid fiscal incentives for identifying students as special education in the first place *when alternative types of interventions are sufficient to meet their needs.* For example, the removal of fiscal incentives to identify more special education students is a stated policy objective of recently enacted special education finance reforms in the states of Vermont, Pennsylvania, Massachusetts and Montana.

Another related objective for program reform is to provide a seamless set of services to meet the needs of *all* students—whether they have general, special, bilingual, or compensatory education requirements. This strategy attempts to reduce the barriers built around these categorical programs, which result in the separation of associated programs and services. These barriers lead to the inefficient use of resources through the required maintenance of multiple administrative units, accounting structures, and facilities; and to the inefficient provision of services for students with multiple special needs. The separation of these services may also be seen as leading to more restrictive service models, and therefore may be relevant to this discussion.

Relating Finance to Program Reform

The concept that appropriate instructional programs and related services cannot be provided without adequate financial support has long been recognized. A newer concept, but one that is becoming widely recognized, is that *the policies that underlie educational financing mechanisms may be as important in affecting program provision as the amounts allocated.* Even the simplest funding systems contain incentives and disincentives that directly influence the orientation, quantities, and types of services to be provided at the local level.

An unprecedented level of special education finance reform is occurring in the states at the present time. Interviews with representatives of all 50 states revealed that this high level of reform activity is at least partly the result of the *fiscal disincentives* in many state funding formulas for the kinds of *programmatic* reform that states are now attempting to foster (see Table 1). States increasingly realize that program policies and guidelines, training, and support will have little impact on program provision while appreciable *fiscal disincentives* remain in place. This is especially true in the current era of increasing fiscal constraint, in which local decisionmakers are hard pressed to pursue reform initiatives that will reduce the financial support they receive from state and federal sources. Furthermore, the policy messages from state and federal governments are clearly mixed. Local districts are sometimes asked to do one thing, while they receive financial encouragement to do just the opposite.

However, it is also clear that changes in fiscal policy alone will be insufficient to result in program change. States reporting the most success in coordinating program and fiscal reform emphasize the need for financial incentives, or at least the removal of disincentives, as well as the provision of a comprehensive system of professional development and ongoing support to effect the desired changes.

II. Special Education Finance Reform in the States

As mentioned in the preceding section, over half of the states in the U.S. are now actively pursuing special education finance reform, as shown in the last column of Table 1. (Some of these efforts are coupled with a more comprehensive set of finance reforms, and in other cases are limited to special education.) To fully appreciate this level of change requires an understanding of how difficult this type of reform can be for state policymakers. Education is the largest single budget item in most states, and changes in the amount of state aid received by local districts inevitably create dissension. Given the very strong advocacy groups associated with special education, funding issues can be among the most contentious state issues that policymakers have to confront. The fact that over half of the states now are engaged actively in changing their special education funding formulas provides strong evidence that a very powerful set of social conditions and reform issues is influencing these changes.

Conditions Affecting Reform

Telephone interviews with state directors of special education or their representatives in all 50 states indicated that the desire to remove fiscal incentives favoring more restrictive placements was among the major factors providing impetus for reform. This was not an issue in all states, however, since some states have formulas, like the federal formula under IDEA, that do not provide fiscal incentives for higher cost placements. Other issues driving reform were rising costs and enrollments, and lack of flexibility in the local use of special education funds.

In states where fiscal incentives for utilizing segregated programs were a major issue, two principal, and often separate, elements of the funding provisions were motivating reform. These elements were (a) aid differentials within the public system that relate to type of placement, and (b) differentials between the amounts of state aid received for private versus public special education placements.

Restrictiveness resulting from public aid differentials

Table 1 classifies states according to four basic types of funding systems. States with public funding differentials favoring placements in separate classrooms, schools, or facilities tend to be those with resource-based systems or pupil-weighting systems that vary based on the primary setting in which students receive services. Both of these types of funding systems generally feature an array of primary service configurations, with state aid varying by type of placement. Because the funding differentials under these systems are directly related to the costs of alternative placements, both can be considered to be *cost-based* systems.

Historically, cost-based funding systems have been seen as strong bases for driving funding differentials. The concept underlying this type of system is that the amount of aid a district receives for a student with special needs should be directly related to the cost of providing services for the student. Since all categorical funding formulas have an underlying cost rationale, many school finance experts and policymakers have preferred systems that differentiate funding amounts on actual differences in the cost of services.

Somewhat ironically, cost-based systems are now sometimes seen as problematic because they create fiscal incentives for higher cost placements that are often provided in separate classrooms or facilities. An example of how this type of problem is described in the popular press comes from a major feature article from *U.S. News and World Report*:

> Texas pays local school districts ten times more for teaching special education students in separate classrooms. The result? Only five percent of special education students in Texas are taught in regular classrooms. (December 13, 1993, page 47)

Table 1
Special Education Finance Reform in the States

State	Current Funding Formula	Basis of Allocation	State Special Ed. $ for Target Population Only	Implemented Reform Within Last 5 Years	Considering Major Reform
Alabama	Pupil Weights	Placmnt. & Condition		✔	✔
Alaska	Pupil Weights	Type of Placement			✔
Arizona	Pupil Weights	Disabling Condition			
Arkansas	Pupil Weights	Type of Placement		✔	✔
California	Resource-based	Classroom Unit			✔
Colorado	% Reimbursement	Allowable Costs	✔		✔
Connecticut	% Reimbursement	Actual Expenditures		✔	✔
Delaware	Resource-based	Classroom Unit			✔
Florida	Pupil Weights	Disabling Condition			✔
Georgia	Pupil Weights	Disabling Condition	For 90% of funds		
Hawaii	Pupil Weights	Placmnt. & Condition	✔	✔	
Idaho	% Reimbursement	Actual Expenditures		✔	
Illinois	Resource-based	Allowable Costs	✔		✔
Indiana	Pupil Weights	Disabling Condition			
Iowa	Pupil Weights	Type of Placement			✔
Kansas	Resource-based	No. of Sp. Ed. Staff	✔		✔
Kentucky	Pupil Weights	Disabling Condition		✔	✔
Louisiana	% Reimbursement	Actual Expenditures	✔		✔
Maine	% Reimbursement	Allowable Costs			
Maryland	Flat Grant	Special Ed. Enroll.	✔		
Massachusetts	Flat Grant	Total District Enroll.		✔	
Michigan	% Reimbursement	Allowable Costs			✔
Minnesota	% Reimbursement	Actual Expenditures	✔	✔	
Mississippi	Resource-based	No. of Sp. Ed. Staff			✔
Missouri	Resource-based	No. of Sp. Ed. Staff			✔
Montana*	% Reimbursement	Allowable Costs	✔	✔	
Nebraska	% Reimbursement	Allowable Costs	✔		✔
Nevada	Resource-based	Classroom Unit	✔		
New Hampshire	Pupil Weights	Type of Placement			✔
New Jersey	Pupil Weights	Placmnt. & Condition			✔
New Mexico	Pupil Weights	Type of Placement			✔
New York	Pupil Weights	Type of Placement			✔
North Carolina	Flat Grant	Special Ed. Enroll.	✔		✔
North Dakota	% Reimbursement	Actual Expenditures		✔	✔
Ohio	Resource-based	Classroom Unit	✔		✔
Oklahoma	Pupil Weights	Disabling Condition			✔
Oregon	Pupil Weights	Special Ed. Enroll.		✔	
Pennsylvania	Flat Grant	Total District Enroll.	✔	✔	
Rhode Island	% Reimbursement	Actual Expenditures			✔
South Carolina	Pupil Weights	Disabling Condition	✔		✔
South Dakota	% Reimbursement	Allowable Costs	✔	✔	
Tennessee	Resource-based	Classroom Unit		✔	✔
Texas	Pupil Weights	Type of Placement		✔	✔
Utah	Pupil Weights	Type of Placement		✔	
Vermont**	Flat Grant	Total District Enroll.		✔	
Virginia	Resource-based	Classroom Unit		✔	
Washington	Resource-based	Classroom Unit	✔		
West Virginia	Flat Grant	Special Ed. Enroll.			
Wisconsin	% Reimbursement	Allowable Costs	✔		
Wyoming	% Reimbursement	Actual Expenditures	✔		

* Montana has passed reforms that are scheduled for implementation in the 1994/1995 school year
** Vermont's special education funding formula also contains a substantial percent reimbursement component

Table Key

Pupil Weights:
Two or more categories of student-based funding for special programs, expressed as a multiple of regular education aid.

Resource-based:
Funding based on allocation of specific education resources (e.g., teachers or classroom units). Classroom units are derived from prescribed staff/student ratios by disabling condition or type of placement.

% Reimbursement:
Funding based on a percentage of allowable or actual expenditures.

Flat Grant:
A fixed funding amount per student or per unit.

However, this type of perverse incentive need not necessarily be linked with cost-based funding systems. An alternative set of funding allocations, or weights, for higher cost students who have been mainstreamed into general education classrooms yet may be developed. However, it is difficult to know how to categorize a "fully included" child under such a system. For example, although a relatively large weight could be created for the special education placement category "general education classroom," it would be difficult to determine a single, appropriate weight. The exact set of supplemental services that is needed when a child is served in a general education classroom will vary considerably for each special education student. Therefore, the accompanying costs will vary substantially by student, which would seem to render inappropriate a single funding weight for a "general classroom" service model.

An important breakthrough in special education funding could be the development of a set of pupil funding weights that reflects alternative integrated modes of service with varying levels of support services for individual students. Developing such a system represents a major challenge for special education policy development and research. Such a system could allow a linkage between funding and service costs, while avoiding the fiscal incentives for more separate placements that have come to be associated with cost-based systems.

It is important to keep in mind that cost-based funding options were never designed to promote segregated or restrictive placements. Rather, they were designed to promote equity and efficiency in funding by linking state aid allocations to program costs. The fact that these systems have sometimes encouraged high cost, segregated placements in a number of states is an unintended consequence of a changing direction in program policy, rather than a fatal flaw in the nature of cost-based funding systems.

■ Incentives for private placements

A second issue related to funding incentives for restrictive placements is the use of separate special education funding mechanisms for public and private special education schools. A quote describing this private schooling phenomenon also comes from the *U.S. News and World Report*:

> Cities like New Haven [Connecticut] actually save money when they send students to out-of-district schools, even though these schools can cost the state more than $100,000 per student, because the state picks up the bulk of the cost. (December 13, 1993, page 50)

Issues relating to fiscal incentives for private placements seem especially difficult for states to resolve. For example, although Massachusetts recently made major changes in its public special education funding system, incentives for public schools to use private placements were retained. Similar concerns have been raised in New York, where a proposal to remove incentives to use private placements has met considerable resistance. Use of private placements varies considerably across the states. While states like New York and New Jersey have 7 and 5.75 percent of their special education students in private placements, respectively, Wisconsin has less than .05 percent and Utah, 0 percent (U.S. Department of Education, 1993, p. A-53).

This large variation in the use of private placements for students with disabilities seems to lie in the tradition and political context of the state. Historically, some states have relied on private schools to provide an important link in the continuum of services for students with disabilities. An important resource to some states, these private schools tend to have strong defenders and a very vocal set of constituents. The question, then, does not seem to be whether these private school resources should continue to be a part of the array of acceptable placement options within a state. Rather, concerns focus on fiscal incentives that actually *favor* the use of private facilities for high cost, low incidence students, and sometimes virtually *preclude* districts from creating program alternatives within the public sector.

What seems important from a fiscal policy perspective is that state funding systems not *favor* private placements. Funding for high cost students should follow students to local school districts, where decisions are best made concerning private versus public school program investments. This type of funding approach would remove any fiscal incentive for the use of private schools. Instead, their use would be based on the merits and unique strengths of the programs and services they offer. This approach also would seem likely to encourage greater collaboration and integration between public and private schools. Private providers may be more likely to move to more integrated service models by working more closely with public school districts. For example, some private school services might be brought directly into public school settings. A neutral funding approach like this could promote a more efficient use of private schooling resources and result in less segregation for students with disabilities.

Lack of Flexibility at the Local Level

A lack of flexibility at the local level is also influencing state fiscal reform. An important concern in a number of states, as described above, is the lack of fiscal mechanisms to support more integrated services, thereby greatly restricting local flexibility in the design of appropriate services. A second concern relates to the inability to use special education funds, or the unavailability of other funds, to support certain types of instructional interventions outside of special education. Consequently, when special education is the only available source of funding for intervention services, there will be constant pressure on special education enrollments and costs.

Interestingly, the majority of states do not require that special education funds be spent on special education services (see fourth column in Table 1). This type of flexibility can, of course, have different implications. It may mean that special education funding is completely rolled into the general state aid allocation and can be used for any purpose. In other states, these alternative uses may be limited to prereferral or other types of remedial or intervention services. In some states, it seems that this type of flexibility has always been available, but has not been widely promoted or publicized. In other states, it has been granted more recently with the express purpose of promoting the development of some type of prereferral assessment and intervention system. Some examples are provided below.

■ An intervention system for all students

In states such as Vermont and Pennsylvania, specific systems of prereferral interventions have been established and implemented in schools throughout the state. Pennsylvania has developed the concept of Instructional Support Teams (ISTs), which has been described as the linchpin of its financial reform package. Although Pennsylvania requires that special education funds be spent on special education services, IST services are included in these costs for auditing purposes. The state provided for a phase-in of IST teams in all of the schools in the state over a 5-year period. During the phase-in, participating schools were to receive grants of $30,000 per year to hire an IST teacher. This teacher is responsible for leading the IST process at the school and for providing any interim interventions that the team may recommend.

The IST team is comprised of the referring teacher, the IST teacher, and the school principal. This program also calls for the state to provide an intensive year of training for all school staff during the first year of implementation, followed by a year of follow-up training. Furthermore, the program is coupled with a state aid system that contains no fiscal incentives for high cost placements or for identifying a greater number of special education students. Thus, the entire system is designed to provide local districts with the resources, training, and discretion they need to provide a broad array of educational services to students with varying educational needs. It was anticipated that the availability of IST services and the fact that state special education aid is not tied to the number of students identified would cause the state's special education counts to drop. Consequently, after 2 years it was expected that local districts would be able to support the cost of IST teachers through savings from this reduction of direct special education services.

Attempts to incorporate alternative intervention systems in states where special education aid is directly tied to the number of students identified may face even more formidable implementation hurdles. As special education counts drop in these types of systems, local districts may stand to lose considerable state special education aid. In Oregon, for example, the funding system is based on a single weight, which is applied to all special education students up to a cap of 11 percent. Because there is no requirement that these funds be spent on special education services, districts have discretion to set up alternative intervention systems such as ISTs. However, as special education counts drop in these districts, state aid is lost. As a result, phone interviews with local special education directors in Oregon revealed that some of those who had previously incorporated IST-type systems in an attempt to drop their overall special education counts were now under pressure to get their special education counts back up to the funding ceiling of 11 percent. Such pressures, however, do not exist in population-based funding systems like those found in Pennsylvania, Vermont, Massachusetts, and Montana, because state aid is not dependent on the number of special education students identified.

■ Flexibility in reallocating transportation costs

Another important issue relating to local flexibility in the use of funds as districts incorporate less restrictive placement patterns relates to separate, categorical funding for transportation services. As districts attempt to move students with disabilities back to their neighborhood schools, they face start-up costs needed to make these schools fully accessible and to purchase multiple sets of specialized equipment, rather than just the one set that may be needed in a single specialized school. These costs may be largely offset through savings in transportation costs. Yet, in state funding systems where transportation is categorically funded, dollars saved through reduced transportation services cannot be recouped for use in other ways (i.e., to support the start-up costs of more integrated programs in neighborhood schools).

Because transportation costs are ongoing, as opposed to the many one-time start-up costs associated with making schools more accessible, reallocating transportation costs not only could lead to better services for students, but also to significant long-term savings to states and school districts. At the least, it would seem that funds currently being allocated to transportation would be more advantageously used to enhance direct instructional services for students, where feasible. At both the state and district levels, important issues should be addressed relating to the need to have special education funds follow students as they move to less restrictive placements.[4]

In addition to transportation savings, the movement of students to neighborhood schools could also lead to other types of long-term savings. Separate special education schools also generate additional costs in such areas as school administration and instructional support.

Better program coordination

A final issue relating to the need for increased flexibility in the use of funds at the local level is the perceived barriers to providing better articulated and coordinated sets of services across categorical program areas. General, special, compensatory, and limited English proficient (LEP) programs far too often exist in virtual isolation from one another in schools with high levels of special needs. Major concerns focus on inefficiencies that result from the need for multiple administrative and accountability structures, alternative forms of determining eligibility that tend to be cumbersome and costly, and the inevitable segregation that results from separated services.

The lack of integrated, well articulated services can be especially disastrous for students with multiple needs. At the extreme, imagine the school day for a student who is LEP, receives compensatory instruction, and is receiving a special education-related service in a school in which all of these special

[4] This issue is discussed further in *Resource Implications of Inclusion: Impressions of Special Education Administrators at Selected Sites* (McLaughlin & Warren, 1994).

programs are run separately from one another. Whether the separation of these services is simply embedded in local tradition or actually has a basis in state and federal law requires further investigation.

In considering alternative state and federal mechanisms for promoting the provision of more integrated services in schools, it is important to recognize that many local providers claim that some of the important barriers to these types of change result from the limitations imposed on the use of state and federal funds. They attribute the types of segregated program options being provided in their schools to rules and regulations they believe preclude them from providing more integrated, well articulated programs. Nevertheless, in their work describing more unified schooling systems, McLaughlin and Warren (1994) found that schools that were successfully implementing these reforms generally did not find that state and federal provisions posed a barrier to successful implementation. Similarly, federal officials in leadership positions report that nothing in the federal law precludes districts from exercising the kinds of flexibility needed to produce well articulated and integrated schoolwide instructional programming.

Although current interpretations of federal law, and its accompanying rules and provisions, may not actually create significant barriers to systemic change in schools, this message has not been consistently reaching many local school officials. This may be due to experiences local staff have had with state and/or federal auditors, who are still focusing on the more rigid auditing interpretations of the past. Or it may be due to more restrictive state rules and regulations, which may have been implemented for a separate purpose or which are a reflection of state-level interpretations of federal policy.

Regardless, states and the federal government could adopt a relatively low cost and low risk intervention to remove what many claim to be an important barrier to school reform. That is, they could clarify their position regarding the use of federal funds by specifying exactly what degree of latitude local districts have in their use of categorical funds. To present this in a positive way, a series of case studies highlighting districts that the state believes have used categorical funds in a particularly innovative or effective manner might be produced. These examples of allowable flexibility could illustrate the range of possibilities that the state or federal government wishes to encourage and promote. They could be disseminated to state and local officials and also be used as a training vehicle for program monitors.

Criteria for the Design of a State Special Education Funding Formula

Given these concerns about state funding formulas and the fact that some contain incentives for more restrictive services, what criteria should be used to evaluate state special education funding systems? Table 2 presents a set of criteria, or standards, that have traditionally been used in considering alternative ways of allocating special education aid to local jurisdictions.

State policymakers may find value in each of the criteria listed in Table 2. However, in adopting state funding reform, it is essential to realize that while these criteria are not mutually exclusive, *a major focus on one criterion may come at the expense of one or more of the others*. For example, depending on how equity is defined, a highly equitable system might be one that is tightly linked to variations in local costs of providing special education services. Districts that spend more on special education services because their resource costs are higher, because they serve more students, or because they serve students with more severe needs, would receive more state aid in recognition of these cost differentials. On the other hand, such a system may also have a fairly substantial reporting burden, may lack flexibility, and may not be placement neutral. Conversely, a system in which special education funds are allocated only on the basis of total district enrollment (e.g., as in Pennsylvania, Massachusetts, Vermont, and Montana) will be identification and placement neutral. Yet, such a system may also be perceived as quite inequitable because it fails to link aid allocations to local variations in pupil need. A system that is fully adequate and predictable may have problems related to cost control, and so on. Thus, in attempting to develop an ideal set of special education funding provisions for a given state, it is essential that policymakers choose the criteria they wish to foster from among these alternatives, and recognize that no system, no matter how simple, will be incentive free.

For example, the federal funding system may be considered placement neutral because the amount of funding allocated is the same regardless of how students are served. While many may believe this to be a desirable attribute, this type of system *does* contain a fiscal incentive. Because the funding level will be the same regardless of the level of service provided, the fiscal incentive is to provide *less* service at a *lower* cost. Similarly, so-called "identification neutral" systems, like those in Massachusetts and Pennsylvania, actually contain fiscal incentives *not* to label students for special education, as districts will receive the same level of funding regardless of the number of students identified. While this may be the policy objective in some of these states, it is essential to realize the incentive and disincentive structures embodied in alternative funding systems. *As funding provisions will have a direct influen~e on program policies, decisionmakers must identify the policies they wish to promote and adopt a funding system that will foster, or at least not inhibit, them.*

Table 2
Criteria for Evaluating State Special Education Funding Formulas[5]

UNDERSTANDABLE

- The funding system and its underlying policy objectives are understandable by all concerned parties (legislators, legislative staff, state department personnel, local administrators, and advocates).
- The concepts underlying the formula and the procedures to implement it are straightforward and "avoid unnecessary complexity."

EQUITABLE

- Student equity: Dollars are distributed to ensure comparable program quality regardless of district assignment.
- Wealth equity: Availability of overall funding is not correlated with local wealth.
- District-to-district fairness: All districts receive comparable resources for comparable students.

ADEQUATE

- Funding is sufficient f.r all districts to provide appropriate programs for special education students.

PREDICTABLE

- LEAs know allocations in time to plan for local services.
- The system produces predictable demands for state funding.
- SEA and LEAs can count on stable funding across years.

(continued)

[5] Adapted from *State Funding Models for Special Education* (Hartman, 1992) and *Policy Objectives for Special Education and Funding Formulas* (Parrish, forthcoming).

Table 2 (continued)
Criteria for Evaluating State Special Education Funding Formulas

FLEXIBLE

- Local agencies are given latitude to deal with unique local conditions in an appropriate and cost-effective manner.
- Changes that affect programs and costs can be incorporated into the funding system with minimum disruption.
- Local agencies are given maximum latitude in use of resources in exchange for outcome accountability.

IDENTIFICATION NEUTRAL

- The number of students identified as eligible for special education is not the only, or primary, basis for determining the amount of special education funding to be received.
- Students do not have to be labeled "disabled" (or any other label) in order to receive services.

REASONABLE REPORTING BURDEN

- Costs to maintain the funding system are minimized at both local and state levels.
- Data requirements, recordkeeping, and reporting are kept at a reasonable level.

FISCAL ACCOUNTABILITY

- Conventional accounting procedures are followed to assure that special education funds are spent in an authorized manner.
- Procedures are included to contain excessive or inappropriate special education costs.

COST-BASED

- Funding received by districts for the provision of special education programs is linked to the costs they face in providing these programs.

PLACEMENT NEUTRAL

- District funding for special education is not based on type of educational placement.
- District funding for special education is not based on disability label.

(continued)

Table 2 (continued)
Criteria for Evaluating State Special Education Funding Formulas

COST CONTROL

- Patterns of growth in special education costs statewide are stabilized over time.
- Patterns of growth in special education identification rates statewide are stabilized over time.

OUTCOME ACCOUNTABILITY

- State monitoring of local agencies is based on various measures of student outcomes.
- A statewide system for demonstrating satisfactory progress for all students in all schools is developed.
- Schools showing positive results for students are given maximum program and fiscal latitude to continue producing them.

CONNECTION TO GENERAL EDUCATION FUNDING

- The special education funding formula should have a clear conceptual link to the general education finance system.
- Integration of funding will be likely to lead to integration of services

POLITICAL ACCEPTABILITY

- Implementation avoids any major short-term loss of funds.
- Implementation involves no major disruption of existing services.

State Fiscal Policies That Foster Integrated Services

As discussed in the introductory section of this paper, federal special education law under IDEA states that special education students should be served in the least restrictive environment. Although interpretations differ regarding the exact types of placement procedures that are required under IDEA, a general preference for less restrictive placements is clear. *Given this policy objective, what types of fiscal policies can states adopt to foster more integrated special education services?*

First, fiscal incentives favoring segregated and separate placements must be removed. Theoretically this could be achieved under any type of special education funding system. Even systems that are driven by type of student placement could conceivably develop a weighting structure that would foster greater integration through the creation of larger weights for an array of higher and lower cost general education placements. Thus far, however, the states attempting to reduce the number of restrictive placements have shown a greater inclination to move toward funding systems that do not differentiate funding based on student placement.

Second, states must make decisions about the extent to which they wish to encourage private special education placements. Some states may decide that private, as opposed to public, placements are more restrictive under any circumstance and may wish to create fiscal disincentives for their use. Other states may decide that private placements are an integral component of the continuum of available placements for their special education students and that these types of placements should not be discouraged. Regardless, it is difficult for states to rationalize fiscal incentives *favoring* private placements (i.e., state funding systems with incentives for the use of private over comparable public placements). In some states, however, this is clearly in place. Although comparable public services currently may not be available in these states, in some cases this is simply because districts have never been allowed the option of taking the state aid they are allotted in support of private tuition to develop comparable public services.

Third, the private schooling issue provides an example of the importance of developing funding systems in which dollars follow students as they move to less restrictive placements. Another example, as cited earlier, is the need for savings in transportation costs to follow special education students to their neighborhood schools to offset other types of costs associated with this type of move. This is an issue for states as they try to foster integrated program practices and for districts as they try to implement them. Districts may have internal mechanisms for resource allocation in place that support places rather than students. As students move from specialized to neighborhood schools, districts will also need to rethink their internal systems for allocating resources.

Fourth, states reporting the most success in fostering more integrated service systems point to the need to support direct training for these types of program interventions. As fiscal disincentives favoring segregated services are removed, districts must be provided with training and assistance in overcoming the many practical difficulties associated with making changes of this type.

Fifth, states should fund and encourage intervention systems for all students. Students who are identified as eligible for special education because identification is the only way to provide them with remedial services have had their service options restricted. As the spirit of greater program integration would seem to include retaining students in general education who do not require the additional protections and legal guarantees associated with special education, state funding systems that actively support alternative interventions for all students will be less likely to lead to program placements that are unnecessarily restrictive.

III. Federal Special Education Finance Reform

It is not possible for a jurisdiction to consider the merits of alternative types of fiscal policy without identifying the specific types of program change it wishes to foster. Therefore, in considering alternative federal funding options, it is important to ask, *what is the federal position on program reform in special education?*

Federal Incentives under IDEA

What, then, are the program objectives that federal funding policies are trying to foster? For example, federal law clearly calls for the provision of special education services in the least restrictive environment (LRE). Accordingly, federal special education funding policy does not contain fiscal incentives for more restrictive placements. On the other hand, the IDEA funding formula has been criticized on the basis of several of the funding criteria listed in Table 2. Most notably, the IDEA funding mechanism does contain an incentive for identifying students with disabilities up to a cap of 12 percent. It does not foster flexibility in the use of funds, since IDEA funds cannot be spent on alternative intervention services. In addition, although nothing in federal law actually prevents the provision of unified services across categorical programs, federal funding provisions do not appear to foster coordination of these types of programs. Indeed, the actual federal position on providing unified categorical programs remains somewhat unclear. Consequently, some state policymakers believe that the funding mechanisms under IDEA present serious barriers to reform at the state and local levels.

Perhaps the predominant set of arguments in this regard relates to federal incentives to identify special education students up to the federal funding cap of 12 percent. States such as Vermont and Pennsylvania have adopted funding systems specifically designed not to reward further identification of special education students. Because state funding is not tied to the type of placement and is not even based on the number of students identified for special education, this type of funding scheme allows a great deal of flexibility. Proponents believe it creates a very positive environment for providing highly integrated services. The number of special education students in these states has generally been reduced through such activities as providing intervention services in general education classrooms, allocating resources for prereferral services, and severing the tie between state special education funding and the number of students identified for special education services.

Representatives from these states feel that reducing the count of special education students is a change for the better. They argue that they can serve a broader range of students with special learning needs in a less restrictive and more appropriate manner. However, they also find that they are losing federal special education support as the numbers of identified special education students drop. Policymakers from these states often express great concern that current federal fiscal policies run counter to their efforts at program reform.

Proponents of reform argue that IDEA funding should be based on total student enrollment. Such a population-based funding system would contain no incentives to identify more special education students or to serve special education students in certain types of settings; it consequently would be likely to lead to less restrictive placements.

A simple description of a population-based system is that two districts with total enrollments of 10,000 students would receive the same amount of state special education funding regardless of the number or percentage of special education students identified or served. This funding approach represents a major departure from prior state special education fiscal policies. Proponents see it as the most effective way to provide districts with discretion and flexibility, to remove incentives for restrictive placements, and to remove incentives to identify more special education students. Opponents to this approach see it as a retreat from the traditional governmental role of promoting special education, and possibly as a dangerous step along a path of eroding protection under IDEA.

In addition, a new set of challenges for population-based systems may be on the horizon. A recent Alabama Circuit Court found that the "total enrollment" method that had been used to calculate state special education aid was in violation of the Alabama constitution (Harper v Hunt, 1993). This approach was found to be "irrational and arbitrary" because school systems with higher percentages of special education students receive less special education aid per pupil than like districts with fewer special education students. Opponents to population-based funding systems may pursue similar legal arguments in other states, which would seem to add caution to considering this type of approach at the federal level.

The federal government appears to face a dilemma. If the funding formula remains unchanged, federal policymakers may be seen as discouraging such reforms as increased flexibility and the removal of incentives for restrictive placements. At the same time, relatively little evidence shows that these types of funding systems are effective in achieving the objectives set by proponents, or that they do not result in some of the unintended consequences feared by opponents. Thus, a full-scale change to this type of system appears premature and would be likely to face considerable political opposition.

It may be more advantageous for the federal government to consider an intermediate approach that would couple "hold harmless" funding provisions with a requirement for the implementation of ongoing statewide evaluation in a limited number of approved reform states. "Hold harmless" provisions could remain in place while careful assessment and monitoring of the effects of these more flexible systems on the services received by students are observed; their continuance would be contingent on the observed results of such ongoing evaluations.

Other Federal Fiscal Policies in Support of Least Restrictive Environment

Beyond the types of "hold harmless" provisions described above, federal funding policy could foster more integrated placements by granting supplements to states with the best records in this regard and perhaps by applying fiscal sanctions against states demonstrating highly restrictive placement patterns. There has also been some discussion at the federal level as to whether federal aid under IDEA should be withheld from states with funding systems containing incentives for more restrictive placements.

Through its monitoring system, OSEP has already begun to challenge states with funding systems containing fiscal incentives for restrictive placements. This may be warranted, and even welcomed, by some state officials in extreme situations. It is also likely to provide a "wake up call" to other states. However, because these funding systems can be very complex, it is sometimes difficult to determine if this type of disincentive actually exists. In addition to assessing the incentives and disincentives inherent in individual state funding systems, the federal government could simply judge states on the basis of results (i.e., the degree to which less restrictive placements are actually occurring across the state). Measures of such results could include the percentage of special education students in private placements as compared to the national average, or other counts of segregated placements such as being served in separate classrooms.

The development of an alternative funding mechanism that will have no additional negative effects poses a unique challenge to states. Developing new policy is likely to take some time and is generally not best accomplished under duress. Many states are well aware that their funding systems are problematic and are actively working on the development of alternatives.

Interviews with state officials in all 50 states revealed that many states are trying to move to funding systems that will remove incentives for segregated services. They also report difficulty in developing a clear set of preferred alternatives. Thus, in addition to disincentives through monitoring, any positive steps the federal government can take to assist the states would likely be even more effective in realizing long-term state fiscal reform.

The fact that at present over half the states are working to change the way they fund special education affords the federal government a unique window of opportunity to positively impact special education fiscal policy across the nation. Financial support and technical assistance for states attempting to make these types of changes could provide considerable leverage in moving states closer to federal policy objectives that foster less restrictive placements.

In addition, because the removal of fiscal incentives favoring segregated services may not be sufficient to produce meaningful and lasting change, federal support for training for more integrated programming and for model demonstration sites featuring these types of programs would also foster this policy objective.

IV. Conclusion

Program reforms promoting practices such as the greater integration of students with disabilities and a reduction in the number of restrictive placements can clearly be enhanced by the creation of fiscal incentives and the removal of disincentives for these reforms. However, changes in fiscal policy alone will not suffice. These types of reform also must be accompanied by a set of specific goals, as well as technical assistance and training.

Integrated service models conceivably can be fostered within the context of any basic funding model. Whether this actually occurs, however, will depend on the specific implementation details associated with the model, and will require a careful definition of the exact practices to be fostered under the proposed set of program reforms. For example, is the policy goal limited to reducing the number of restrictive placements for special education students, or is there also a desire to increase the number and types of services to be provided to students outside the context of special education? Beyond this, is there a related policy goal to provide more integrated services across all categorical programs at the school level? These policy objectives differ and will require somewhat differing fiscal remedies. In shaping appropriate fiscal policy, it is important to identify the related program reform objectives as precisely as possible. Given the strong link between fiscal and program policy, program objectives must be well considered and carefully defined prior to any serious consideration of fiscal reform.

Despite the potential for tension between the "least restrictive environment" and "continuum of services" requirements under IDEA, it is clear that fiscal incentives that clearly *favor* more restrictive placements conflict with the intent of IDEA. Thus, the removal of incentives of this type should be an important priority for state policymakers. This may include the removal of fiscal policies that *favor* special over general class placements, special schools over neighborhood schools, and private over public settings. In addition, states may wish to develop policies that go beyond "placement neutrality" by creating fiscal incentives that actually favor student placements in less restrictive settings.

Similarly at the federal level, although funding provisions under IDEA Part B are already placement neutral, policymakers may wish to go beyond neutrality in developing fiscal provisions that more clearly support less restrictive placements. Representatives from some of the key reform states believe that a federal move to population-based funding would be an important step in this direction.

Irrespective of any decisions about Part B funding policy, the federal government has a unique opportunity to impact the degree of restrictiveness found in state funding formulas across the nation. Over one-half of the states are currently engaged in changing the way they fund special education. Federal input and technical assistance regarding the benefits and liabilities associated with alternative reforms could provide considerable leverage in moving the states closer to federal objectives regarding the placement of special education students in less restrictive settings. Because the vast majority of support for special education comes from state and local sources, federal actions to influence state-level reform will likely have the greatest and longest lasting impact on decreasing restrictive placement patterns across the nation.

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