



# How Approaches to Stuck-in-the-Mud School Funding Hinder Improvement

By Melissa Lazarin | November 18, 2013

When it comes to school finance, far too many states and districts are lacking innovation, flexibility, and new ideas. Instead, many state and education leaders continue to support and employ methods that prevent schools and principals from undertaking the efforts that they think are most needed to improve education in their classrooms. The use of state categorical grants—funds to school districts with strict limits on their use—exemplifies this lack of innovation in school finance.

States generally allocate dollars to school districts based on funding formulas as determined by state law. Formula funding takes two forms: foundation grants or base grants, which cover the basic cost of education, such as salaries and textbooks; and categorical grants—money that must be used specifically for the purpose designated by the legislature or state education agency.

Because of their designated-use requirement, categorical grants can discourage school leaders from using their dollars in ways that might best address their students' needs. School-funding policies should ideally empower local school leaders to target resources toward services, programs, and supports that they believe will be most effective. To do this, schools need to receive as much or all of their funding through a weighted student formula grant.

Weighted student funding—also known as student-based budgeting—is an alternative approach to allocating state education dollars based on student needs all the way down to the school level. Principals and other school leaders who are most knowledgeable of school conditions and student needs decide how to spend the funds.

Categorical grants, however, remain all too common in state education finance systems. New survey data released today in a Center for American Progress issue brief by Joanna Smith and researchers at the Rossier School of Education's Center on Educational Governance at the University of Southern California, provide a national overview of which states have embraced more flexible funding streams and which are still using rigid bureaucratic categorical grants to fund schools. The data also show the extent to which categorical grants comprise state education budgets and reports on state finance and district officials' opinions of categorical grants.

According to the survey, there is great variance across the country in the employment of categorical grants, with many states recognizing the limitations of such grants and moving away from them—providing some hope for innovation in these states. Yet, in many states, categorical grants remain a key component of education funding, and it is these states that need the most reform.

Worse, the state-level survey responses ultimately confirm that in many states, school finance is stuck in traditional, outdated, inefficient, and ineffective approaches. Despite the experience and opinions of top education experts, state-level officials continue to believe that categorical grants are good or at least not bad. Somewhat defying logic, many even think categorical grants do not stand in the way of improving achievement, innovation, or flexibility.

---

## Key findings

### Categorical grants are prominent in state education finance systems

There is a notable range in the number of individual categorical grants and the significance of categorical grants relative to the overall state education budget. States had an average of 16 categorical grants in the 2012-13 school year, amounting to an average of almost \$1 billion dollars per state. But the number of categorical grants ranged from 64 grants in Iowa to just 1 grant in both Florida and Montana. The average percent of a state's education budget funneled through categorical grants is just north of 13 percent.

Below we identify the five states that have the greatest number of categorical grants and the five states in which categorical grants make up the largest percentage of the state education budget. It is worth mentioning here that recently passed legislation in California significantly trims the number of categorical funding streams. (See text box on page 5.)

## Top five worst offenders in number of categorical grants, 2012-13 school year

Rank	State	Number of programs	Percentage of budget	Dollars allocated
1	Iowa	64	N/A	N/A
2	California	60	14%	\$9,715,100,000
3	Michigan	50	19%	\$2,000,000,000
4	Massachusetts	39	10.7%	\$505,000,000
5	South Carolina	36	55%	\$1,215,000,000
5	West Virginia	36	10%	\$1,493,300,000

N/A: Data not available

Source: Joanna Smith and others, "Categorical Funds: The Intersection of School Finance and Governance" (Washington: Center for American Progress, 2013).

## Top five worst offenders in percent of education budget funded by categorical grants, 2012-13 school year

Rank	State	Percentage of budget	Dollars allocated	Number of programs
1	South Carolina	55%	\$1,215,000,000	36
2	Pennsylvania	43.8%	N/A	29
3	New Jersey	30%	\$2,560,600,000	8
4	North Carolina	29.2%	\$2,388,000,000	12
5	Utah	28.4%	\$845,600,000	31

N/A: Data not available

Source: Joanna Smith and others, "Categorical Funds: The Intersection of School Finance and Governance" (Washington: Center for American Progress, 2013).

Interestingly, there is not a clear correlation between the number of grants and the percentage of a state's education budget that is allocated through categorical grants. New York has 17 different categorical grants, but they account for only 1.5 percent of the state's education budget. On the other hand, Maine has only four categorical grants, but they account for 22 percent of the state's education budget.

A variety of policymakers are empowered to create or terminate categorical grants

In every state surveyed, the legislature has the decision-making power to create, end, or consolidate a categorical grant. The governor also has control in almost half of the states surveyed, including Alabama, Ohio, and Virginia. Other decision makers include state boards of education and the state education chief. In Kentucky, voters have the power to create grants but not to terminate them.

## There has been a notable decrease in the use of categorical grants

The data show that states have decreased their use of categorical grants since 2008. The average number of funding programs dropped from 25 to 16 in the 2012-13 school year. Twenty-nine states have reduced their number of categorical grants, with only 14 increasing the number they employ; 6 states remained the same.

There were some notable declines. Ohio, for example, reduced its number of categorical grants from 105 in 2008 to just 12 in the 2012-13 school year. Arkansas, Hawaii, and New York made significant strides to reduce the number of categorical grants as well.

On the flipside, Massachusetts had 18 categorical-funding grants in 2008, but by the 2012-13 school year, its number of grants had more than doubled to 39.

## States most commonly used categorical grants for special education

States use categorical funding for a variety of different kinds of programs, ranging from general instruction funding for charter schools to funding for parental involvement. Special education, however, was the most common categorical program reported by states: 25 out of the 36 surveyed states used categorical grants for special education in the 2012-13 school year. Other common uses included funding for student transportation (21 states), professional development (20 states), interventions for low-performing students (17 states), school nutrition programs (16 states), vocational programs (14 states), and gifted and talented programs (14 states).

## State education officials generally have a positive view of categorical grants

State officials generally have a positive—or at least neutral—perception of categorical grants and of the impact that they have on education. A majority of state officials, for example, felt that categorical grants help schools and districts meet student improvement targets. But at the same time, almost 40 percent were neutral, and 9 percent reported that they did not agree that categorical grants helped meet improvement targets.

State officials' opinions were more mixed when it came to questions regarding the impact of categorical-grant usage on innovation, flexibility, and efficiency. A plurality—37 percent, 34 percent, and 31 percent, respectively—were neutral on each of these topics. But at least 20 percent of respondents felt that categorical grants limit innovation, flexibility, and the efficient use of funds—an uptick over the degree of negative opinions expressed above. Still, more respondents weighed in favorably than either neutrally or negatively with a little more than 40 percent disagreeing with the claims that categorical-funding limits innovation and flexibility and impedes efficiency.

District superintendents and school board members are favorably disposed to categorical spending, though they expressed the desire for greater flexibility

Somewhat surprisingly, district officials had positive things to say about categorical grants. Interviewees—superintendents and school board members—noted that placing restrictions on the funding helps ensure that the money is actually spent on the targeted populations. This opinion was likely helped by the perception that categorical funding is sometimes supplementary to general aid, rather than a restriction on base funding.

On the issues of innovation, flexibility, and efficiency, district-level school officials gave more mixed responses. In general, they believed that decisions about how to spend resources are best made locally, as those closest to the grant are in the best position to understand the specific and unique needs of their students and schools. Thus, district leaders had a sense that greater or even maximum flexibility should be given to districts, even within the vein of categorical grants. As one survey respondent noted, “I think the bulk of that is best left at the local level and I don’t have a problem with being held accountable.”

## California: A bright star

In the wake of the recent economic recession and the need to make significant cuts to state budgets, governors and state legislatures have been forced to rethink how they spend state resources, especially how they spend education dollars. Some states have seen this as an opportunity to significantly change the way school districts are funded in their states. In 2009, the California State Legislature, in addition to proposing massive budget cuts to schools, eased restrictions on approximately 40 categorical-grant funding streams, allowing districts to spend this money for any educational purpose.<sup>1</sup> The added flexibility was intended to help districts absorb the budget shortfall and use what funding they had in ways they thought would be most helpful.

Made possible with voter-approved tax revenue increases in 2012, California Gov. Jerry Brown (D) proposed more permanent and significant school-funding reforms, including distributing a portion of funds to districts based on the extra needs of groups of disadvantaged students, eliminating a host of categorical programs, and giving school districts more control over budgeting decisions. In June, Gov. Brown and the state legislature settled on a new funding formula known as the Local Control Funding Formula, which eliminated approximately three-quarters of the state’s categorical programs in the process.<sup>2</sup>

While the new formula does not drive funds down to the school level, districts will receive a base grant that is determined by their average daily attendance across grade spans, with more dollars targeted to higher grade levels.<sup>3</sup> In general, districts will see funding increases across the board—an average of \$537 more per student in base funding.<sup>4</sup> In addition, districts will receive an additional 20 percent for each English language learner, or ELL, low-

income student, and foster youth student. Districts that have a high concentration of ELLs and low-income students—more than 55 percent of their student enrollment—will receive an additional 50 percent for each student above the 55 percent threshold.<sup>5</sup>

The school-funding law requires districts to increase or improve services for ELLs and low-income students with the supplementary dollars.<sup>6</sup> Furthermore, districts must develop an accountability plan that includes goals for major student subgroups, including ELLs and low-income students, across eight priority areas: student achievement, student engagement, school climate, parental involvement, implementation of the Common Core State Standards, course access, basic services, and other student outcomes.<sup>7</sup>

Exactly how much discretion districts will have over the weighted, supplementary dollars they receive is still up for debate. Draft regulations from the State Board of Education currently provide school districts that receive supplementary dollars for ELLs and low-income students with broad flexibility over how to spend the additional funding.<sup>8</sup> But some advocates worry that the draft regulations do not ensure that the additional dollars effectively target low-income students and ELLs.<sup>9</sup>

The full implementation of California's new funding formula will take place over the next eight years with many key decisions related to accountability and transparency occurring in the next several years.<sup>10</sup> All eyes will be on the Golden State as it courageously disrupts its school finance system and transitions to a fairer, more equitable way of funding its schools.

---

## Key takeaways

The issue brief by Smith and researchers at the Center on Educational Governance, alongside the official state-level surveys, has several key takeaways. First, it provides a stark picture and reaffirms what many advocates know: school finance reform must be an essential element of efforts to improve schools. While a significant part of education finance systems, categorical grants are not always aligned with a district's priorities and needs. Sometimes inaccurately, categorical grants dictate educational priorities at the district and school level.

Second, the information presented here clearly indicates that using categorical grants is not the only option. Many states use very few categorical grants in their funding systems or allocate a small proportion of dollars to the categorical grants they do use. These states show that funding can be done differently, and they should encourage policymakers in states that still rely heavily on categorical grants to move in a similar direction. Indeed, the outlier states should realize that they are significantly out of step with how most states are using categorical funds.

To be clear, the states that have moved away from or do not use categorical grants do not necessarily have equitable funding systems, and so we do not condone simply copying their funding systems. Ultimately, states should adopt weighted student funding as their method for allocating resources. But on the issue at hand of eliminating or reducing categorical grants, these states have made progress.

Third, we need to listen more closely to district and school leaders. They want and need more flexibility in funding, but they are willing to take funding in any form. Categorical funding is better than no funding, and their fear of losing funding affects how they view the grants they receive. These leaders also realize that accountability is important, both as a consequence for receiving flexibility and as a driving force to ensure funding is spent wisely and on the students who need it the most.

Finally, we need to focus more attention on the bright stars: states that are doing things right by innovating and reforming their funding systems in order to provide flexibility and empower local actors. This is a way to change the conversation and provide more examples that change is possible. States such as California show that school-funding reform can happen.

---

## Conclusion and recommendations

Governors, legislatures, and state departments of education need to address important issues about how their schools are funded. They should focus on making sure resources reach students and classrooms based on specific needs, that districts and schools have greater flexibility in decisions about how to spend those resources, and that resources are spent productively. This requires flexible and innovative strategies, which are popping up in other areas of education but are essential in school finance.

With that in mind, we make the following recommendations:

State policymakers, education leaders, and advocates need to recognize the disconnect in accountability systems that hold school and district leaders responsible for student achievement without giving them funds based on their students' needs nor decision-making control over how best to use the funds they do receive.

States and school districts should adopt weighted student funding systems that provide all operational dollars—down to the school level—through a formula that distributes resources based on the specific needs of a school's students. While central district administrations need operational funds, most weighted funding should be driven to the school level so that the flexibility is primarily in schools and not at the school-district level. Then districts should hold their schools accountable for the achievement of all of their students.

We also encourage states to provide increased school-funding transparency so parents and key stakeholders can play an active role in identifying priorities and designing and implementing strategies.

Stuck-in-the-mud approaches to funding and managing schools can hinder school-improvement efforts. While categorical grants provide a relatively stable form of funding for districts and schools to spend toward important services such as special education, they do so at the expense of local flexibility. This is not an either-or scenario; we can achieve both equity and empower local decision making at the district and school level by moving toward weighted student funding systems that drive resources to schools based on students' needs.

---

## About the author

**Melissa Lazarín** is Director of Education Policy at the Center for American Progress.

---

## Acknowledgements

The author thanks Juliana Herman for the invaluable assistance she provided on an earlier draft of this brief while she worked for the Center for American Progress. The author also thanks the Eli and Edythe Broad Foundation for their ongoing support of our education programs and of this brief. The views and opinions expressed in this report are those of the author and do not reflect the position of the foundation. This brief is part of a larger multiyear project on governance, conducted in partnership with the Thomas B. Fordham Institute, which evaluates the governance arrangements of our nation's K-12 education system and how they may be improved.

---

## Endnotes

- 1 Margaret Weston, "California's New School Funding Flexibility" (San Francisco: Public Policy Institute of California, 2011).
- 2 Legislative Analyst's Office of California, "An Overview of the Local Control Funding Formula" (2013).
- 3 Ibid.
- 4 John Fensterwald, "It's a deal: Brown, top lawmakers raise base funding in finance formula," EdSource, June 11, 2013.
- 5 Ibid.
- 6 Ibid.
- 7 Ibid.
- 8 John Fensterwald, "Proposed spending regs give districts leeway to choose how to serve high-needs students," EdSource, October 28, 2013.
- 9 Ibid.
- 10 Legislative Analyst's Office of California, "An Overview of the Local Control Funding Formula."