DOCUMENT RESUME

ED 320 25[illegible] EA 021 904

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TITLE Incentive Funding Programs and School District Response.
PUB DATE Apr 90
NOTE 42p.; Paper presented at the Annual Meeting of the American Educational Research Association (Boston, MA, April 16-20, 1990).
PUB TYPE Reports - Evaluative/Feasibility (142) -- Reports - Descriptive (141) -- Speeches/Conference Papers (150)

EDRS PRICE MF01/PC02 Plus Postage.
DESCRIPTORS *Educational Finance; Elementary Secondary Education; *Incentives; *School District Spending; *State Legislation; *State School District Relationship
IDENTIFIERS *California

ABSTRACT

In 1983 the California Legislature passed Senate Bill 813, which appropriated an additional one billion dollars yearly for each of 4 years to the schools. Most of the additional money was distributed through the state's general aid formula. However, a portion of the money was offered through eight other new programs designed to encourage specific behavior on the part of school districts, such as lengthening the school year to at least 180 days and increasing instructional time at all levels. A substantial amount of the additional money was distributed in the form of incentives. This report shows that SB 813's incentive funds had a stimulative effect on district instructional funding; districts spent $2.00 on instruction for every incentive dollar received from the state. The report attempts to help policy makers identify the range of fiscal instruments or funding formulas most likely to stimulate desired changes in school district spending patterns. By analyzing the revenue and expenditures of California unified school districts between 1980-81 and 1985-86, this paper shows that the distribution mechanism influences how local school districts spend additional funds. The study found that: (1) incentive grants appear to be more effective than other types of intergovernmental grant mechanisms in increasing school district spending for instruction; and (2) incentives are useful only under limited conditions and for limited time periods. (33 references) (MLH)

Incentive Funding Programs and School District Response

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Prepared for the
1990 Annual Meeting of the
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April 18, 1990

SUMMARY

During the 1980s, two events substantially increased educational funding in California. In 1983 the Legislature passed Senate Bill 813 (SB 813) which, among other things, appropriated an additional one billion dollars a year for each of four years to the schools. In 1988 California voters approved Proposition 98 guaranteeing at least 41% of the State's general fund budget for K-12 public schools and community colleges. The apparent intent of both measures was to increase school district expenditures on direct instructional programs.

This paper shows that the way the state distributes money to local school districts affects the way districts use those funds. SB 813 was passed by the Legislature in 1983, and became effective in the 1983-84 school year. Most of the additional money appropriated by this legislation was distributed through the state's general aid formula. However, a portion of the money was offered through eight other new programs. Some were categorical programs designed to encourage specific behavior on the part of school districts. A substantial amount of the additional money was distributed in the form of incentives. Districts electing to receive incentive funds had to agree, for example, to lengthen the school year to at least 180 days, and to increase instructional time at all grade levels.

This report shows that SB 813's incentive funds had a stimulative effect on district spending for instruction: districts spent two dollars on instruction for each incentive dollar received from the state. As a result, the proportion of total district expenditures devoted to instruction increased following passage of SB 813. Over time though, as the incentive funds were rolled into district revenue limits, the proportion of district expenditures devoted to instruction began to wane.

The purpose of this report is to help state policymakers identify the range of fiscal instruments, i.e., the types of funding formulas, most likely to stimulate desired changes in

school district spending patterns. Information on how local school districts are likely to respond to changes in financial support is important as state policymakers consider their options for apportioning new funds to school districts. By analyzing the revenue and expenditures of California unified school districts between 1980-81 and 1985-86, this paper shows that the distribution mechanism influences how local school districts spend additional funds. Among the study's findings are the following:

- Incentive grants appear to be more effective than other types of intergovernmental grant mechanisms in increasing school district spending for instruction. With the exception of incentive funds, districts tended to devote a smaller portion of additional funds generated through other grant mechanisms to instruction, than they were already spending on instruction.

- The success of incentive programs in garnering school district compliance with Legislative goals may be tied to their limited use, i.e., the "strings" concerning the length of the day and year.

- SB 813's success in getting virtually 100% compliance with the longer day and year requirements may be due to previous funding shortfalls making it difficult for districts to refuse additional money even if certain "strings" were attached.

- Once incentive revenues become part of a district's annual revenue, they tend to be treated more as general aid, and resource allocations begin to revert to previous patterns.

- Incentives are successful, but only under limited conditions and for limited time periods. The harder it is for a district to retreat from the grant requirements, the greater the long term success of the incentive program.

Incentive Funding Programs And School District Response

INTRODUCTION

During the 1980s, states devoted large sums of new funds to education. M ch of this increase occurred after the publication of *A Nation At Risk* in 1983. Nation-wide, total school funding has risen 83% in nominal terms since 1980, and 43% since 1983. When inflation is taken into account, real spending for K-12 education has increased 26% since 1980, and 20% since 1983 (Odden, in press). In California two events have resulted in substantial increases in educational funding during this decade. First, the 1983 enactment of Senate Bill 813 (SB 813) resulted in the appropriation of an additional one billion dollars a year for each of four years to the schools. Second, in 1988 California voters passed Proposition 98, guaranteeing at least 40% of the State's general fund budget would be devoted to K-12 public schools and community colleges. Because of an unanticipated $2.5 billion state revenue surplus, California school districts received nearly $1.5 billion in additional funds between 1988 and 1990 (Commission on State Finance, 1989: 12). While there is substantial evidence that most of that $1.5 billion will be eaten away by inflation and increases in student enrollment, there is still a perception among both the Legislature and the public that the fiscal condition of California schools has improved dramatically in recent years.

Proposition 98's title, *The Classroom Instructional Improvement and Accountability Act*, indicates that the seeming intent of its authors was to increase direct spending on students and instruction. In a campaign circular supporting Proposition 98, State Superintendent of Public Instruction Bill Honig stated, "Proposition 98 requires that additional school funding go into the classroom for instructional improvements" (Honig, 1988). The question is: Will school districts use these funds for instructional programs as intended? or will they spend these new resources for other purposes? More importantly,

are local spending decisions influenced by the mechanism used to distribute funds to the schools?

Evidence from earlier research on the implementation of SB 813, indicates that the way funds are distributed to local school districts affects their spending decisions. Picus (1988) found that SB 813's incentive funds whose purpose was to increase the length of the school day and school year were very effective in increasing spending for instruction. Since most of the additional money distributed to schools as a consequence of Proposition 98 was through one time supplemental flat grants or cost of living (COLA) increases, it will be interesting to see if these funds have the same effect on spending for instruction.

State Legislators attempting to influence school district spending decisions have two options: they can mandate changes in the operation of school districts, or they can attempt to change local behavior through the use of grants designed to elicit the desired behavior. In the past, the Legislature has been reluctant to establish new mandates because California law requires the state to reimburse school districts for the costs of those new mandates.[1] Because incentive programs were not a part of the Proposition 98 funding package passed by the Legislature during its 1989 session, it will be possible in the future to determine whether or not the Proposition 98 funding mechanisms lead to different spending decisions than those made by local districts in response to the funding instruments included in SB 813.

PURPOSE OF THIS REPORT

The purpose of this report is to help state policymakers identify the range of fiscal instruments, i.e., the types of funding formulas, most likely to stimulate desired changes in school district spending patterns. Information on how local school districts are likely to

[1] Section 2231 of the California Revenue and Taxation Code requires that "The State shall pay to each local agency and each school district an amount to reimburse the local agency or the school district for the full costs, which are mandated by acts enacted after January 1, 1973 of a new state-mandated program or any increased service of an existing mandated program."

respond to changes in funding support is important as state policymakers consider their options for apportioning new funds to school districts. This report analyzes spending by California's unified school districts between 1980-81 and 1985-86 to determine how those districts responded to SB 813's financial incentives for improving the quality of education. It compares the response to those incentives with the impact of other aid distribution instruments on spending decisions. This analysis will help policymakers match their policy goals with the fiscal instruments that are most effective in achieving their objectives within different local contexts.

Past empirical research on the effects of grants-in-aid to local education agencies has focused on two themes:

1. The impact of intergovernmental grants on local spending and taxation decisions.
2. The way school districts spend additional budgetary resources.

To date, there has been no research on whether different types of grants stimulate different program spending decisions by local governments. To bridge that gap, this paper summarizes research analyzing the effect of different grant mechanisms on the allocation of resources to program areas by California school districts.

SB 813 marked the second time the California Legislature has used financial incentives to modify local school district behavior.[2] School Districts were offered additional funds for increasing instructional time through longer school days and longer school years, and were offered incentives for increasing the salaries of beginning teachers. By focusing on specific reform measures that were closely tied to instructional programs, the Legislature encouraged school districts to spend a higher proportion of these new revenues on instruction than they had spent from funds received through other mechanisms, such as the revenue limit program (Picus, 1988).

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[2] The first, the Unruh Act of 1964, offered of $20 per ADA to districts that unified, or voted in favor of unification. It succeeded in reducing the number of school districts in the state by nearly 25% over four years (California Commission on State Finance, 1986).

DATA SOURCES

The data for this study were derived from several sources. Data on school district revenues and expenditures were available from the California State Department of Education's *School District Financial Transactions* report (Forms J-41 and J-41a)[3], prepared annually. The California Basic Education Data System (CBEDS) Professional Assignment Information File (PAIF) contain data on staffing patterns and salaries. Data on minority enrollments are also available from CBEDS, and the California Teachers Association provided data on school district teacher salary schedules.

ORGANIZATION OF THIS REPORT

The next section of this paper establishes the conceptual framework for the analysis of the state's impact on local spending decisions. It begins with a brief description of the role of the state in California school finance, and the factors that led to the current finance structure. It then describes the different types of grant mechanisms available to the state, and the ways in which local school districts would be expected to react to each of them.

An analysis of local school district response to different aid instruments follows this discussion. In addition, the third section of the paper describes the implications of these findings for the distribution of state funds in the future. The paper concludes with some observations, conclusions and suggestions for the design of future fund distribution mechanisms in relation to alternative policy goals.

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[3] These forms have been replaced by the J-200 series (Revenues and Expenditures of object code), and the J-380 (Expenditures by Program forms. These forms were created by the Financial Management Advisory Committee (FMAC) and became mandatory for all school districts beginning with the 1987-88 school year.

CAN THE STATE INFLUENCE LOCAL DISTRICT SPENDING DECISIONS?

If a State Legislature wants to influence local government decisions, it can either mandate changes in the way local services are provided, or it can use intergovernmental grants to influence local behavior. While mandates are the most direct way to achieve legislative goals, California law requires the state to reimburse local governments for the costs of implementing mandates enacted after January 1, 1973.[4] Consequently, California's Legislature relies on the distribution of state funds to stimulate desired local action instead of potentially expensive mandates.

THE FISCAL CONTEXT IN CALIFORNIA

Two crucial events in the history of California school finance -- the *Serrano*[5] case and the passage of Proposition 13 -- have given the California Legislature considerable influence over the finances of local school districts. In response to the *Serrano* rulings of the 1970s, the California Legislature moved to equalize revenues and reduce spending disparities among local school districts.[6] To accomplish this goal, the state created a revenue limit for each school district. Revenue limits still used today, determine the amount of general revenue a school district may receive. Created by SB 90 in 1972, school district revenue limits were first used in 1973-74. A district's initial revenue limit was based on the revenues it received in 1972-73. To reduce expenditure disparities over time, the Legislature relied on a "squeeze factor."[7]

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[4] Section 2231 of the California Revenue and Taxation Code.

[5] *John Serrano Jr., et al. v. Ivy Baker Priest, et al.*, 487 P.2d 1241, 5 Cal. 3d 584.

[6] The *Serrano* rulings required that wealth related spending disparities among school districts be reduced to no more than $100 per pupil, adjusted for inflation. In 1988-89 the California Department of Education estimated that 95.9% of the students in public schools were enrolled in districts whose spending was within the inflation adjusted band of $260.

[7] The "squeeze factor" was designed to reduce spending disparities by giving low spending districts larger revenue limit increases than high spending districts. For example, districts spending considerably less than the average district received a 15% revenue increase, while the highest spending districts only received a 6% increase. Over time, this "squeeze factor" was expected to bring the state into compliance with *Serrano's*

Through these programs the State achieved moderate success in meeting the *Serrano* equity requirements. However, it was not until the voters approved Proposition 13 in 1978 that the state was fully able to meet the requirements mandated by the courts. By limiting *ad valorem* taxes to one percent of assessed value, and by limiting the growth of that assessed value, Proposition 13 took local property tax decisions out of the hands of local governments. With property tax rates restricted, the Legislature took responsibility for determining how the property taxes that were collected would be distributed among taxing jurisdictions. Today, a district's general aid, called its revenue limit aid, from the state amounts to the difference between the property tax collections it receives as its share of the 1% levy, and its revenue limit.[8] Consequently, the state effectively determines how much money a school district has available each year. In addition to its revenue limit income, a school district may be entitled to funds through one or more of over thirty state categorical programs including, Special Education assistance, Economic Impact Aid, and Desegregation Assistance.

Since the state has considerable influence over how much and what kind of revenue a school district receives, an important issue is whether the way in which the state distributes those revenues influences school district spending decisions. Below, the intergovernmental grant mechanisms available to a state legislature, and the potential impact of each on school district spending patterns are described.

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requirement that wealth related spending differences be no more than $100 per pupil. See Elmore and McLaughlin, 1981.

[8] The calculation of state aid is somewhat more complicated than this. A 1952 amendment to the State Constitution guarantees each district state aid of $120 per ADA. Because it is required by the constitution, all districts receive this so called "basic aid." If a district's property tax collections are sufficiently high the basic aid allotment of $120 per ADA could exceed the revenue limit. In this case, the district is allowed to keep the entire amount. If property taxes alone exceed the revenue limit, the district is allowed to keep its property taxes, and it still receives the $120 per ADA of basic aid. There are a growing number of so called "basic aid" districts across the state. This unintended consequence of the current finance system resulted from the dramatic increases in housing prices in some areas of the state. When those properties are sold, they are reassessed at their market value. As a result, growth in assessed values in these areas has increased more rapidly than have district revenue limits which are tied to Legislatively approved cost of living adjustments.

TYPES OF GRANT INSTRUMENTS

There are four categories of grant instruments that states can use to influence school district spending decisions. They are:

1. General Aid
2. Categorical Aid
3. Matching Aid
4. Incentive Aid

The California Legislature relies on all of these to distribute state funds to school districts and to influence their spending behavior. Below, the state policy objective and likely district response to each of these policy instruments is described.[9]

General Aid

General aid distributed to local school districts can be used as the district chooses. General aid programs represent the largest portion of state aid to school districts in California, and are composed mostly of revenue limit dollars. General aid increases a school district's revenue, but does not place restrictions on the use of those funds. Past research on the effects of intergovernmental grants for education has shown that school district spending increases by only a portion of the increase in general aid, with the balance devoted to local property tax relief (Tsang and Levin, 1983). However, California's school finance formula makes it impossible for districts to use a portion of their state general aid for property tax relief.

Proposition 13 limited *ad valorem* property taxes to 1 percent of taxable value. Property taxes are levied at the county level and distributed to local jurisdictions according to a formula developed by the Legislature in 1978 (EdSource, 1989:2). The largest component of a school district's general aid receipts from the state is the difference between

[9] The material that follows is derived from the theoretical literature on intergovernmental grants. This literature is substantial, and contains general agreement about the effects of different grant types on local expenditure decisions. See for example, Break, 1980; Musgrave and Musgrave, 1989; Oates, 1972; and Wilde, 1968 and 1971.

its revenue limit and the property tax collections it receives through the county. There is no mechanism for returning property tax receipts to the taxpayers. It is unlikely school districts would want to do so anyway because district revenue limits are higher than property tax receipts in almost all districts in the state. Thus, increases in state general aid will be spent entirely by the recipient school districts, and will not be partially used to provide property tax relief.

Categorical Aid

When the state wants to influence how school districts spend the money they receive more directly, it often relies on categorical aid. There are three kinds of categorical mechanisms a state can use. They include:

1. Programs providing funds on the basis of specific district characteristics. Often, these funds have few restrictions on their use. Examples of these programs include Urban Impact Aid and Small District Transportation Assistance.
2. Programs providing funds to school districts to serve specific populations such as assistance for special education for handicapped children.
3. Programs designed to provide assistance for specific school district non-educational programs such as transportation aid.

The spending effects of categorical grants to California school districts depend on the purpose of the grant and the spending and reporting requirements associated with the grant. If the grant requirements are relatively general, the effect of a categorical grant may be no different than that of an increase in general assistance. Programs like Urban Impact Aid provide assistance to school districts based on certain characteristics -- in this case urbaness -- but are treated as general assistance. On the other hand, if a categorical program has strict spending and reporting requirements, than a district would be expected to spend more money on the supported function, than it would spend on that function if it received a general grant of the same amount. In the analysis that follows, these categorical programs are divided into three categories; 1) general categorical programs that come without specific spending requirements, 2) categorical programs with specific spending

requirements for instructional support programs, and 3) categorical programs dealing with non-educational programs such as transportation.

Matching Grants

Rather than increase a school district's income through general or categorical grants, the state could choose to change the relative prices facing school districts by offering matching grants. For example, the state may offer to pay for half the cost of a certain program. In this case, the cost of the program to the district is reduced. This could alter district preferences such that more of that service is provided than would have been offered in the absence of the matching grant.

The problem with matching grants is that without an appropriation limitation at the state level they have the potential to exceed the state's funding capabilities. If the state offers to match every dollar spent on instruction, local districts might decide to increase instruction in such large amounts that state appropriation would be inadequate to meet the demands of the grant program. At the present time, the only general fund use of matching grants in California is the deferred maintenance program. A district may qualify for matching funds of up to 1/2 of 1% of its general fund budget for expenditures on deferred maintenance. It is estimated that the state will only have enough money to fund 50% of its obligation through this program in 1989-90 (School Services of California, 1989:A-22).[10] It was not possible to separate these funds from other revenue sources with the data available for this study. Consequently, these funds are included in the other categorical category described below.

Incentives

An alternative to the grant instruments described above is the use of incentive funding programs to get local governments to provide desired service levels. For example,

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[10] When the State's appropriation for the deferred maintenance program is not adequate to fully fund all approved expenditures, all allocations to local districts are reduced in proportion to available funds. Thus a district qualifying for $10,000 in matching funds would only receive $5,000.

an incentive grant could be offered to a local school district with the condition that certain service levels be achieved. In exchange, the local district receives additional funding, usually in the form of a general grant. Decisions on how the incentive funds should be spent are up to the recipient government, as long as the requirements of the grant are met.

The advantage of an incentive grant is that it allows the recipient government considerable latitude in determining how to provide the new level of service. On the other hand, local governments are not required to accept the incentive funds, making 100% compliance with legislative goals unlikely. Assuming incentive grants are available to all districts that elect to comply with the incentive, or who are already in compliance, the following effects of an incentive grant can be identified:

I. The district currently operates the program.

   A. The district is in compliance with the requirements of the incentive. It takes the money and uses it as a general grant. The state has spent money and not accomplished anything.

   B. The district is not in compliance with the requirements.

      1. The cost of compliance is less than the amount of the grant. The district complies, takes the grant, and uses the excess as a general grant. The state has accomplished compliance, but the cost has been greater than mandating it and paying the full costs of the mandate.

      2. The cost to the district is greater than the amount of the grant.

         a. The district complies and accepts the grant. Extra district money is used to comply. The grant has had a multiplier effect.

         b. The district does not comply and does not take the grant. The state has failed in getting the district to accept the requirements, but there has been no cost to the state.

II. The district does not currently operate the program.

   A. The cost of compliance is less than the amount of the grant. The district complies, takes the grant, and uses the excess as a general grant. The state has accomplished compliance, but the cost has been greater than mandating it and paying the full costs of the mandate.

   B. The cost to the district is greater than the amount of the grant.

1. The district complies and accepts the grant. Extra district money is used to comply. The grant has had a multiplier effect.

2. The district does not compiy and does not take the grant. The state has failed in getting the district to accept the requirements, but there has been no cost to the state.

With the passage of SB 813 in 1983, the California Legislature enacted incentive programs to increase the length of the school day and the school year, and to increase beginning teacher salaries. These incentives helped significantly increase school district spending for instruction. A brief description of them follows.

Longer School Day and Year: SB 813 provided incentives for school districts to increase the length of the school year to 180 days. Districts that increased the number of school days to 180 (or who already had 180-day school years) received payments of $35 per ADA in 1984-85. Districts were also encouraged to increase daily instruction time over a three year period. Districts meeting the new instructional time goals received incentive payments of $20 per ADA in grades K-8, and $40 per ADA in grades 9-12 in each of three years (1984-85, 1985-86 and 1986-87) if they increased instructional time by least one-third of the amount between their 1982-83 levels, and the goals stated in SB 813. The funds generated by these incentives were added to district revenue limits, becoming permanent additions to their income.

A California Tax Foundation Study of the implementation of SB 813 found that almost every district in the state maintained or increased instructional time to meet the SB 813 goals. In addition, all 24 of the districts surveyed by CalTax increased the length of their instructional year to a least 180 days. The study found that most districts increased instructional time all at once, rather than phasing it in over three years. The surveyed districts indicated that virtually all of the instructional time incentive funding was used to increase salaries for existing teachers, although districts that added an extra class period in the high schools used some of the funds to hire additional teachers. CalTax stated that

most districts were satisfied the funds they received for a longer school day and year were sufficient to cover the increased costs (Kaye, 1985:15-16).

Increased Minimum Teacher Salary: Districts were offered incentives to increase beginning teacher salaries. To participate in the program, a district had to increase the lowest salary on its salary schedule by up to 10% to a maximum of $18,000 in 1983-84, $19,084 in 1984-85, and $20,200 in 1985-86. Other steps in the salary schedule that did not meet the new minimum also had to be increased to at least the new minimum. The state provided funds to pay for the increases above the existing teacher salary schedules. Once done, districts had to permanently incorporate the new figures into their salary schedules. Only 50% of the districts took advantage of this incentive program.

The California Tax Foundation Study found the program has successfully raised beginning teacher salaries between 5% and 15% in participating districts. CalTax also found that most of the districts raised beginning teacher salaries "off the salary schedule" so that when the program expired, they could revert back to their pre-existing salary schedule for future teachers. CalTax added that there was considerable opposition to the program from senior teachers who were concerned about the flattening of the salary schedule (Kaye, 1985:4).

The incentive programs adopted in SB 813 represented only the second time California has used the incentive approach to influence school district behavior, and the first time they have been used to direct local spending to a specific program category, in this case, instruction.[11]

SUMMARY

As this discussion shows, there are alternative funding formulas the legislature can use to distribute new dollars to school districts. The type of formula can have a significant

[11] The first use of incentives was in 1964 when the Unruh Act offered incentives of $20 per ADA to districts that voted in favor of unification.

impact on the way a local district elects to spend its receipts. Consequently, if there are program areas where the legislature believes the money would be better spent, it may want to look for a distribution mechanism that will encourage district spending on those program areas. The following sections describe the past effects of these different grant mechanisms on school district spending patterns. Local district response to the fiscal measures included in SB 813 are used to describe the impact of various grant mechanisms.

CALIFORNIA SCHOOL DISTRICT RESPONSE TO GRANTS-IN-AID

Policymakers are concerned with how the funds they distribute to school districts are allocated among program categories. Specifically, they want to know what portion of total revenue is devoted to each category, and whether or not those proportions are in line with their expectations. For example, if school districts are spending half of their revenue on instruction, what impact will an incentive grant of $35 per pupil have on the proportion of revenue spent on instruction? Will the spending patterns that result from the incentive grant be different than the spending patterns that would have resulted from new categorical programs? And will that differ from the spending patterns that would result from increasing general revenues to school districts? This section begins with a brief description of the expenditure and revenue patterns of California school districts between 1980-81 and 1985-86. It then summarizes findings regarding the impact of different grant instruments on school district spending decisions.

SCHOOL DISTRICT EXPENDITURE PATTERNS: 1980-81 TO 1985-86

The *California School Accounting Manual* (California State Department of Education, 1986) identifies seven program classifications for school district expenditures:

1. Instruction
2. Administration[12]
3. Auxiliary and Other Expenditures
4. Instructional Support
5. Maintenance and Operations
6. Pupil Transportation
7. Pupil Services

Figure 1 shows that in 1985-86, California's unified school districts spent an average of $3,643 per pupil in these seven classifications. Over half of this amount, $1,886 was devoted to direct instructional programs, with the balance spent in the other six program areas. Figure 1 also displays similar data, adjusted to 1985-86 dollars, for each of the other years of the study (1980-81 to 1984-85). Columns one and two show that in real terms, total educational expenditures dropped by over $200 per pupil between 1980-81 and 1981-82, from $3,219 to $3,015. Although inflation adjusted expenditures grew each year after that, they did not return to 1980-81 levels until 1983-84, the first year districts received funds from SB 813.

The percent of total expenditures devoted to each of these seven classifications is summarized in Figure 2. The figure shows the percent of total expenditures devoted to instruction increased from 50.2% in 1980-81 to a high of almost 52% in 1983-84, dropping slightly to 51.77% by 1985-86. While this change does not appear to be a dramatic shift of spending priorities, Figure 3 shows that by 1985-86, districts were spending over $155 million more per year on instruction than they would have spent if the proportion devoted to instruction had remained constant during the six year period. Over

[12]In this analysis, the costs of school site administration (principals and assistant principals) are considered administration. This is because school principals are thought of as administrators by many policymakers, and because the provisions of the Education Code regarding the administrator-teacher ratio treat principals as administrators. Others have assigned the cost of school site administrators to the instructional support category, because principals are often thought of as the instructional leader of a school, providing leadership, guidance and assistance to the teaching staff. How one chooses to account for principals has a substantial effect on the relative percentages of a district's budget devoted to instructional support and administration.

the six years of the study, the cumulative increase in spending on instruction amounted to over $612 million.

Spending for administration also increased as a percent of total expenditures, growing from 12.21% in 1980-81 to 13.37% in 1985-86. To compensate for these increases, spending on auxiliary programs, and instructional support declined as a percent of total expenditures during the six years. Pupil services and transportation remained relatively constant, while maintenance and operations increased as a percent of total expenditures between 1980-81 and 1983-84, and then declined to a level slightly higher than the 1980-81 share.

Figure 1
Total Expenditures Per Pupil
California Unified School Districts: 1980-81 to 1985-86
Adjusted for Inflation to 1985-86 Dollars

	Expenditures Per ADA (1985-86 Dollars)					
	Year					
Expenditure Classification	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
Instruction	1,616	1,542	1,609	1,694	1,806	1,886
Administration	393	381	401	416	445	487
Auxiliary	271	201	197	202	236	249
Instructional Support	324	294	286	297	320	320
Pupil Services	93	90	92	91	96	102
Maintenance and Operations	386	375	387	419	443	443
Transportation	136	132	134	142	148	156
TOTAL	3,219	3,015	3,106	3,261	3,494	3,643

Note: Adjustments for inflation based on the California CPI
Source: Picus, 1988

Figure 2
Program Expenditures as a Percent of Total Expenditures, California Unified School Districts: 1980-81 to 1985-86

	Percent of Expenditures					
	Year					
Expenditure Classification	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
Instruction	50.20	51.14	51.80	51.95	51.69	51.77
Administration	12.21	12.64	12.91	12.76	12.74	13.37
Auxiliary	8.42	6.67	6.34	6.19	6.75	6.84
Instructional Support	10.07	9.75	9.21	9.11	9.16	8.78
Pupil Services	2.89	2.99	2.96	2.79	2.75	2.80
Maintenance and Operations	11.99	12.44	12.46	12.85	12.68	12.16
Transportation	4.22	4.38	4.31	4.35	4.24	4.28

Source: Picus, 1988

Figure 3
Unified School District Expenditures for Instruction: Actual Compared to Expected at 50.2% of Total Expenditures 1981-82 to 1985-86

	Expenditures (dollars)			
Year	Total	Actual for Instruction	Expected Instructional at 50.2% of Total	Increase in spending for Instruction
1981-82	7,213,510,000	3,688,989,014	3,621,182,020	67,806,994
1982-83	7,352,000,000	3,808,336,000	3,690,704,000	117,632,000
1983-84	7,933,020,000	4,121,203,890	3,982,376,040	138,827,850
1984-85	8,903,920,000	4,602,436,248	4,469,767,840	132,668,408
1985-86	9,890,310,000	5,120,213,487	4,964,935,620	155,277,867
Cumulative increase in spending on Instruction				612,213,119

SCHOOL DISTRICT REVENUE PATTERNS: 1980-81 TO 1985-86

The California Legislature has used general aid, categorical grants and incentive programs to finance school district operations.[13] In addition, most California school districts receive funds from the Federal government, and many receive a small amount of money from the state to compensate them for the costs of state mandates. A total of seven distinct revenue categories were identified for the analysis described below. They include:[14]

1. General Revenues
2. Federal Funds

[13] California does offer matching grants for deferred maintenance. As discussed above, they were not considered because the data could not be broken out for analysis. In addition, California has a matching program to provide state support for school construction. However, school construction is financed through capital accounts, and not school district general operating funds. In addition, the problem of an unlimited drain on the state budget is resolved through the use of a special construction account at the state level. School construction is then funded based on a prioritized list of approved projects, until the fund is exhausted.

[14] For more information on how these categories were derived, see Picus, 1988.

3. General State Categorical Funds[15]

4. Instructional Support Categorical Funds[16]

5. Other State Categorical Funds[17]

6. State Incentive Funds

7. State Mandate Reimbursement Funds

Figure 4 displays yearly revenues per ADA for unified school districts in 1986 dollars for each of the seven revenue categories listed above, while Figure 5 shows revenue in each of the seven categories as a percentage of total revenue each year.

One of the most important aspects of SB 813 was the use of incentive funds to encourage school districts to undertake desired activities, most notably to encourage them to increase instructional time, and to raise beginning teacher salaries. The incentive funds that a district received in one year were added to their revenue limits in subsequent years. Consequently, in this analysis, funds were only treated as incentive funds the first year they were received. Once the money was included in the district's revenue limit, it was treated as a general revenue source from that point forward. Funds for increasing minimum salaries were first available in 1983-84. Unified districts only reported receiving $2.259 million that year for this program. Among the districts receiving those funds, they represented approximately one dollar per ADA.

The first year districts could receive funds for both increasing minimum teacher salaries, and for lengthening the school day and year was 1984-85. Figures 4 and 5 show

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[15] General Categorical grants are those made to a school district for a specific reason, but which can be spent on any district function. Two examples are Urban Impact Aid and Meade grants. Both programs distribute funds to local school districts in urban areas. The objective of both programs is to help compensate districts in urban areas for the additional costs of providing education in large cities. In both programs, districts must meet certain criteria to qualify for funds. However, there are no constraints on how the districts spend those funds once received.

[16] Instructional support categorical funds are funds sent to school districts to supplement and improve the instructional program. These include gifted and talented education, instructional television, demonstration programs in reading and math, and funds for the purchase of instructional materials. Although this category includes a number of programs, none represents very much money.

[17] Other Categorical Grants include funding for programs outside of direct instruction, but which can be identified with a specific spending category. Transportation is the largest component of this revenue source.

that incentive funds amounted to $66 per ADA, or 2% of total revenue that year. Although the incentives for beginning teacher salaries and the longer school day continued, incentive funds for a longer school year were only available in 1984-85. Consequently, the additional incentive funds for the longer day only amounted to $29 per ADA in 1985-86, or just over 0.75% of total revenue.

Figure 4
Total Revenue Per ADA By Revenue Source, California Unified School Districts: 1980-81 to 1985-86 Adjusted for Inflation to 1986 Dollars

	Revenue Receipts per ADA (1985-86 dollars)					
	Year					
Revenue Category	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
General	2653	2488	2556	2763	2838	3086
Federal	277	223	198	217	216	209
State Categorical						
General	146	156	163	170	115	157
Instructionally related	16	17	15	31	43	51
Other	122	143	145	156	155	164
State Incentive Funds				1	66	29
State Mandate Reimbursement	11	20	10	12	18	9
TOTAL	3225	3052	3087	3350	3451	3705

Note: Adjustments for inflation based on the California CPI
Source: Picus, 1988

Figure 5
Revenues as a Percent of Total District Revenue, Unified School Districts: 1980-81 to 1985-86

	Percent of Total Revenue					
	Year					
Revenue Category	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
General	82.26	81.52	82.80	82.48	82.24	83.29
Federal	8.59	7.31	6.41	6.48	6.26	5.64
State Categorical						
General	4.53	5.11	5.28	5.07	3.33	4.24
Instructionally related	0.50	0.56	0.49	0.93	1.25	1.38
Other	3.78	4.85	4.70	4.66	4.49	4.43
State Incentive Funds				0.03	1.91	0.78
State Mandate Reimbursement	0.34	0.66	0.32	0.36	0.52	0.24

Source: Picus, 1988

THE EFFECTS OF INTERGOVERNMENTAL GRANTS ON DISTRICT SPENDING

Which intergovernmental grant instrument is most effective in getting school districts to increase the share of their budget devoted to instruction? To answer this question a model using six years of pooled data from California unified school districts was developed. Using multiple regression techniques, data on school district revenues and expenditures, teacher salaries, and other district characteristics from 1980-81 to 1985-86 were analyzed to estimate the effect of different grant instruments on program expenditures by local school districts (See Picus, 1988).

The regression results showed that state incentive funds were the only revenue category that was successful in increasing the share of revenue devoted to instruction. Moreover, even though just over 50% of district funds were spent on instruction, for each of the grant mechanisms other than incentive funds, it was estimated that less than fifty cents of an additional revenue dollar would be devoted to instruction.

The discussion that follows shows how unified school districts would be expected to react to the receipt of an additional dollar of revenue from each of the seven revenue categories. Figure 6 shows the estimated increase (or decrease) in spending by expenditure classification that would result in the average unified school district if the district received a one dollar per pupil increase in that revenue category.

Incentive Grants

Although incentive grants represented a very small portion of district revenue, the incentive grants provided through SB 813 to increase instructional time and to raise beginning teacher salaries were very effective in increasing school district spending for instruction. Figure 6 shows the estimated impact of a one dollar per pupil increase in incentive funds on spending in each of the seven expenditure classifications. It was estimated that the extra dollar resulted in a $2.05 increase in per pupil instructional spending -- a powerful impact. If districts increased spending on instruction an average of

$2.05 per pupil for each dollar of incentive funding, shifts in other expenditure classifications had to be made to compensate for the increased instructional spending.[18]

After SB 813 passed, there was little time for districts to implement the bill's provisions and qualify for the first year incentive funds. Increased instructional time (as required to receive SB 813's incentive funding) requires teachers to spend more time in the classroom, and may require additional teachers. The difficulties of finding qualified teachers on short notice, combined with concern over whether funding for the bill would be available the next year, may have made districts reluctant to commit funds for additional teaching personnel.[19] One way around this problem is to use existing instructional support personnel to meet the increased teaching demand. If funds continued to be available, the district could hire additional teachers and let the instructional support staff return to support functions in the future. This may explain the estimated decrease of $1.18 per pupil in spending on instructional support resulting from increased incentive funding shown in Figure 6. Other shifts in spending expected to result from an increase in incentive revenues include increases in spending for administration and maintenance and operations, and reductions in spending for auxiliary services, transportation and pupil services.

The analysis shows the Legislature's incentive program was successful in influencing districts to increase spending on instruction. The incentive grants offered through SB 813 were almost universally accepted, and, among unified districts, the

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18 When the effects estimated in the incentive funds column of Figure 6 are summed, the total increase in spending only amounts to 40 cents leaving the remaining 60 cents unexplained. One possible reason this occurred is incentive funds represent a very small portion of total revenue -- less than 2% in 1984-85, and less than 1% the other two years incentive funds were available -- and the model could not capture the other effects of an increase. Another, related, possible explanation is that districts used some of their incentive revenue to increase ending fund balances, and thus did not allocate the funds to any of the seven expenditure classifications. Finally, the unexplained portion of the revenue increase may be the result of factors that could not be accommodated in the model's equations.

19 When SB 813 passed, it appropriated funds for two years. Governor Deukmejian vetoed the funding for the second year, claiming that it was unwise to make appropriations over two fiscal years. While funding for the second year was appropriated in the 1984-85 budget, prudent district fiscal managers were understandably reluctant to make hiring decisions on the basis of funds being available the next year. This was particularly important since in California, school districts must notify teachers in March for terminations effective in September. Moreover, the California Legislature does not develop a final budget until the end of June, and sometimes not until the next fiscal year starts in July, further complicating district fiscal planning.

incentives had a multiplier effect, stimulating expenditures on instruction beyond the level of the grant.

General Grants

Figure 5 shows that general grants, primarily revenue limit funds, accounted for over 80% of available funding for school districts. Figure 6 summarizes the estimated effect of a one dollar increase in general assistance on the spending patterns of school districts. Districts spent about 29 cents of each additional general aid dollar on instruction, 12 cents on administration, 29 cents more on auxiliary services, and 7 cents on instructional support. Since districts spend just over 50% of their funds on instruction, the finding that only 29 cents of an additional dollar of general aid is spent on instruction implies general aid increases were used for expenditures other than direct instruction.

The largest other area was auxiliary services. In 1985-86 only 6.84% of each revenue dollar was spent on auxiliary services spent on auxiliary services. But the model estimated that during the period studied, districts spent 29 percent of each additional general revenue dollar on auxiliary services, increasing the share of total expenditures devoted to this area. Large portions of new general grant money appear to have been spent on auxiliary services to replace earlier cuts necessitated by reductions in real per pupil revenues following passage of Proposition 13. Figure 1 shows real expenditures for auxiliary services declined dramatically in 1981-82, and increased after 1982-83, but had not reached their 1980-81 levels by 1985-86.

Spending for other program classifications resulting from increases in general aid was not as responsive as the instruction and auxiliary classifications. The estimated increase in spending for administration of 12 cents is equal to the prior proportion of expenditures devoted to that category. School districts apparently increase administrative expenditures proportionally with revenue, regardless of the source. This is supported by the data in Figure 2 which shows administrative expenditures as a percent of total expenditures were very stable over the six year period, growing by about one percent from

a low of 12.21% to a high of 13.37%. These findings indicate that school district administration is sensitive to changes in revenue, and represents a roughly constant proportion of total expenditures over time.

Federal Funds

Figure 6 shows for each additional dollar of Federal revenue, districts spent 39 cents on instruction, 13 cents on administration, 19 cents on auxiliary services, 7 cents on instructional support and 16 cents on maintenance and operations. These results suggest that while districts spent between 50 and 52 percent of total funds on direct instruction, they spent a smaller proportion -- only 39 percent -- of federal dollar increases on direct instruction. Recent evidence (Birman, et. al., 1987) shows that categorical aid increasingly is spent on instructional aides and other instructional support functions. Since the bulk of Federal revenue to school districts is in the form of categorical aid, if these findings are an accurate representation of school district spending in California, it seems increases in federal funds produce a shift of expenditures away from direct instruction.

As with general aid, auxiliary service expenditures increased with additional federal funds, accounting for an estimated 19 cents of each additional federal dollar. Since most federal programs are designed to meet the needs of special student populations, increased spending on traditional auxiliary programs such as child development services, community programs and food services is not particularly surprising.

The amount of Federal funds devoted to maintenance and operations is surprising. A one dollar increase in Federal Revenue was estimated to increase spending for maintenance and operations by sixteen cents, a higher proportion of the additional revenue than is devoted to this program from prior revenues. Since most Federal programs are categorical, districts are either finding ways to use federal categorical money for maintenance and operations, or are spending large portions of less restrictive Federal assistance, such as impact aid and forest funds, in this category.

Figure 6

Estimated Impact of a Dollar Increase In Revenue on School District Spending By Expenditure Category

	Revenue Category						
				State Categorical Grants			
Expenditure Classification	Incentive Revenue	General Revenue	Federal Revenue	General	Instructional	Other	State Mandate Reimbursement
Instruction	2.05	0.29	0.39	0.41	-0.04	0.15	0.52
Administration	0.78	0.12	0.13	0.11	0.11	0.03	0.03
Auxiliary	-0.36	0.29	0.19	-0.16	-0.24	0.06	0.04
Instructional Support	-1.18	0.07	0.07	0.27	0.71	0.24	0.14
Maintenance and Operations	0.24	0.10	0.16	0.09	0.20	0.01	-0.07
Transportation	-1.09	0.02	0.03	0.05	-0.06	0.86	0.18
Pupil Services	-0.04	0.02	0.02	0.05	-0.03	-0.07	0.03

Source: Picus, 1988

Categorical Grants

California operates over 30 different categorical programs to provide assistance to school districts. As described above, these programs were divided into three revenue categories for analysis; general categorical grants, instructional support categorical grants and other categorical grants. General categorical grants are programs that distribute funds on the basis of specific district characteristics such as urbaness, but do not place specific spending requirements on the recipient districts. They are treated as categorical grants rather than general grants because only certain districts are eligible to receive the funds. Figure 6 shows that an estimated 41 cents of an additional general categorical revenue dollar is spent on instruction and an estimated 27 cents on instructional support, so 68 percent of these revenues are spent on instructional support activities.

Figure 6 shows the impact of an increase of one dollar in instructional support categorical funds on school district spending. Although the general categorical grant column of the figure only explains where 65 cents of a one dollar increase in revenue is spent, it does show the bulk of it is used for instructional support. This finding is not surprising since the programs included in this category are typically used for activities to enhance the instructional program. Recent research into categorical programs which found that categorical funds are frequently used to provide classroom aides also supports this finding (Birman et. al., 1987). The programs that make up this revenue category include GATE, Instructional Television, Staff Development funds, and other programs designed to provide either aides in classrooms, or staff development assistance.

One surprising finding is the slight, 4 cent, decline in spending on instruction resulting from an increase in instructional support categorical grants. Many researchers have found categorical grants have stimulative effects on the programs they support (Grubb and Michelson, 1974; Ladd, 1975; and Vincent and Adams, 1980). This appears to have happened in California as well. Districts apparently shifted funds away from direct

instruction, auxiliary services, pupil services and transportation in order to implement the instructional support programs funded with these categorical resources.

Figure 6 shows that most of the other (non-instructional) categorical grants are spent on pupil transportation, which receives an estimated 86 cents of each additional dollar of other categorical aid. There was also an increase in spending on instruction and instructional support as a result of additional non-instructional categorical grants. If the changes shown in the non-instructional state categorical grant column of Figure 6 are summed, one can see that the aggregate change in spending exceeds one dollar. This may result from the encroachment of pupil transportation spending on general instructional programs.

State Mandate Reimbursement

State mandate reimbursement amounted to $20 per pupil or less each year. Mandate reimbursements resulted in a smaller portion of total revenue expected to go to maintenance and operations, and a larger portion for transportation. This implies that few if any of the mandates funded by the state have to do with plant maintenance. On the other hand, court ordered desegregation programs receive a large portion of these funds. Spending on instruction from each additional dollar of mandate reimbursement aid amounted to 52 cents, approximately the same proportion as already spent on that category.

SUMMARY

This analysis shows that incentive grants are more effective than other intergovernmental grant instrument in increasing school district spending on instruction. SB 813's incentives succeeded in getting local districts to lengthen the school day and year, and to raise beginning teacher salaries, increasing instructional time and expenditures for

direct instruction.[20] In fact, the average district increased spending on instruction by over twice the amount of the grant received for meeting the state requirements.

The success of incentive programs in garnering school district compliance with Legislative goals, may be tied to their limited use. A state incentive program representing a much larger share of total district revenue would create a risk that the state might fall out of compliance with the $100 spending band mandated by *Serrano* , if a substantial number of districts elected not to participate. Even the $66 per pupil average incentive grant received through SB 813 in 1984-85 could have hampered *Serrano* compliance if a large number of districts had chosen not to participate in the program.

The success of SB 813 in getting virtually 100% compliance with the longer day and year requirements may be due to funding shortfalls in the years preceding its passage. School districts experienced real revenue declines in 1981-82, and did not make up much ground in 1982-83. The resulting funding shortfalls may be why they were so willing to accept the incentive requirements to get additional resources. Incentive programs may not be as effective under a less restrictive funding environment, particularly if the program goals are not as universally accepted as the goal of increasing instructional time. Less commonly accepted goals might result in more districts electing not to accept incentive funds.

Incentive programs may only be effective in the short run. Figure 2 shows the percentage of expenditures devoted to instruction was highest in 1983-84, the first year districts received SB 813 incentive funds. The percent devoted to instruction declined in 1984-85 and again in 1985-86 when previously received incentives were rolled into the districts' revenue limits and treated as general revenue. This indicates that after an initial

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20 The California State Department of Education estimated that only 14 districts did not participate in either the longer school day or longer school year incentives. Another eight school districts participated in the year but not the day incentives, and ten districts participated in the day and not the year incentives. Non-participating districts were all elementary or high school districts (Kaye, 1985:13). Consequently, all of the districts included in the study took part in both the longer day and longer year incentives. Although participation in the minimum beginning teacher salary program was lower, most unified districts chose to participate (Kaye, 1985:50).

adjustment, districts began to return to previous spending habits. The 1985-86 expenditures for instruction still represent an increase from the 50.20% in 1980-81. There appears to be a short term gain, followed by a partial retreat in spending on instruction.

Incentives are successful, but under limited conditions, and for limited time periods. Incentives can be a powerful tool for changing local school district spending behavior, but the harder it is for local districts to retreat from the grant requirements, the greater the long term success of the incentive program. For example, in 1964, once a group of districts formed a unified district, undoing that process was very difficult and costly, making de-unification an unlikely prospect. On the other hand, once a district incorporated SB 813's incentive funds for lengthening the school day into its budget, reverting back to old spending habits might be possible by minimizing future teacher salary increases and increasing spending in other areas. This would be a slow process since the district must continue to meet the instructional time requirements. However districts that had to reduce funding in one program category to pay for the increased instructional spending necessitated by the greater instructional time requirement, may, over time, try to make up for the losses by directing funds back to other program categories. An analysis of spending patterns after 1985-86 is needed to ascertain whether or not SB 813's incentives had a long term impact on spending for instruction.

CONCLUSIONS AND POLICY IMPLICATIONS

Experience in California following passage of Senate Bill 813 showed incentive programs were effective in getting school districts to implement legislatively established goals. By offering funding incentives to increase the length of the school day and school year, and to increase beginning teacher salaries, the Legislature got local districts to increase the share of total expenditures devoted to instructional programs. Although it does not guarantee student performance will improve, or dropout rates will decline, interviews with state legislators and other participants in the education policy arena indicate the level of

spending on instruction was viewed as one measure of the success of the reform components of SB 813.

SB 813's incentive grants were more successful in directing expenditures toward instruction than other grant instruments have typically been. School districts responded to the incentive grants by increasing the percent of total expenditure devoted to instruction, whereas the response to general, categorical and federal grants resulted in increases in other expenditure classifications. It is possible that state categorical programs designed to increase instructional spending might have been equally successful, but data on that type of revenue instrument is not available since the Legislature elected to use incentives rather than categorical grants to motivate increased instructional spending. These findings have implications for both California school finance policy, and for state-local intergovernmental fiscal relations in general.

POLICY IMPLICATIONS FOR INTERGOVERNMENTAL RELATIONS

The finding that incentive programs are more effective than other grant mechanisms in getting school districts to implement legislative goals has important implications for the use of intergovernmental grants generally. Incentives are a powerful tool for gaining local acceptance of state established goals. Incentives do not carry the negative connotations associated with mandates, and their voluntary nature makes it possible for local governments to opt out of programs they dislike. On the other hand, carefully designed incentives make substantial compliance with legislative goals a real possibility.

There are a number of factors which must be considered if incentives are to be successful. Incentive programs are most effective when the funding represents a small portion of the local government's budget. If incentives represent a substantial share of local government budgets, they are effectively mandates since local governments will have to meet the incentive requirements to balance their budgets.

Incentives can be expected to achieve higher participation rates in times of fiscal constraint. Local governments facing revenue shortfalls will be more willing to accept funds, even if they come with strings attached, than will local governments with adequate fiscal resources.

Incentive programs may only be successful in the short run, particularly if the funds are rolled into general assistance programs in future years. Local governments will modify their spending patterns to qualify for the grant, but over time can be expected to return to previous patterns. Even when incentive programs require maintaining service levels, once implemented, it may be possible for local governments to use some of the funds in other program areas.

Finally, incentives may only be successful under limited conditions and for limited time periods. The harder it is for local governments to retreat from the grant requirements, the greater the long term success of the incentive program. The ability of a local government to retreat from the grant requirements depends on how difficult and costly it is to do so. Incentives that require major reorganizations, although they may be less successful in gaining compliance, are more likely to have a lasting impact on the local governments. On the other hand, incentives that are easily implemented, and at relatively low cost, may gain greater compliance, but maintaining that compliance may be more difficult.

This study indicates that Legislatures can influence local government spending decisions. However, there is some slippage between legislative goals and local response. State policymakers should remember there will be many individual interpretations of the state's policy goals. Allowing local governments the flexibility to implement state policies in a manner consistent with their view of local needs will make them more responsive to the varying needs of their constituents. It also means that Legislators will not find implementation of their policies to be as neat as they would like. In some instances, legislative goals will not be attained, while in others, they will be exceeded. Meeting the

challenge of providing quality public services requires the continued interest and support of the state's policymakers, and patience as locals strive to implement legislatively established goals.

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