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ABSTRACT

This paper explores educational financial flexibility with a focus on the specific issues surrounding local flexibility in North Carolina school districts. Strategies that states have used to increase local financial flexibility include waivers, reduction of budget categories, block grants, and school-based budgeting. The North Carolina system of school finance is distinctive because state statutes (School Machinery Act of 1933 and the Basic Education Program Act of 1985) require the state to provide the instructional expenses for current operations of the public school system. Local school districts have argued that the school system that has evolved from these statutes constrains actions. The most common recommendations made to increase flexibility at the local level involve reducing the number of line items and/or using reversions of unspent funds. Using personnel funds to achieve flexibility also presents problems. Points to consider when developing strategies to increase local finance flexibility include: (1) Policies must support the state's constitutional responsibility for school finance; (2) in order to judge the flexibility of policies, the purpose to be served must be specified; (3) any plan for local flexibility must accommodate important state interests; (4) since waivers provide limited flexibility, analyzing and changing restrictive regulations may be a more effective strategy for achieving flexibility; and (5) proposed strategies for increasing local financial flexibility should be analyzed for negative and positive consequences. Contains 28 references. (Author/LMI)

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Financial Flexibility in North Carolina Schools

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Financial Flexibility in North Carolina Schools

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FINANCIAL FLEXIBILITY IN NORTH CAROLINA SCHOOLS

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Executive Summary

This paper explores educational financial flexibility with a focus on the specific issues surrounding local flexibility in North Carolina school districts. Strategies that states have used to increase local financial flexibility include: waivers, reduction of budget categories, block grants, and school-based budgeting. Waivers increase flexibility at the local level by offering varying degrees of freedom from state regulation without relinquishing state authority or accountability. Reduction in the number of budget categories may provide greater flexibility within specific programs while still retaining broad state interests. Block grants are the most flexible method of financing school districts; funds are sent to districts in one lump sum with few specific requirements as to how the monies are to be spent. An increasingly popular type of financial flexibility is school-based budgeting which transfers decision-making authority from the district to the school building level. Examples from states using of each of these strategies are included in the paper.

Experiences in states reveal both advantages and disadvantages associated with each strategy. Waivers offer relaxation from regulation to support school improvement, and may serve as incentives for improvement. However, state examples show that districts do not seem to participate heavily in rule-by-rule waivers even when the opportunity is available. Reduction in the number of budget categories often means that fewer regulations will be specified within categories, thus increasing some measure of local flexibility. However, this strategy jeopardizes state interests previously protected under categorical grants and districts risk losing funds because broader categories are more prone to budget cuts. Block grants provide the greatest flexibility, however, the focus of the funds is obscured and these grants are more prone to budget cuts than are categorical grants. School-based budgeting provides participants with the authority to use funds more efficiently and effectively to address local needs, but poses a serious challenge to authority relationships within schools districts. State mandated school-based budgeting may also be problematic in schools districts whose superintendents are not in favor of the initiative.

The North Carolina system of school finance, while having a number of features in common with other states, is distinctive because state statutes (School Machinery Act of 1933 and the Basic Education Program Act of 1985) require the state to provide the instructional expenses for current operations of the public school system. Local school districts have argued that the finance system that has evolved from these statutes constrains actions. In response to local concern, financial flexibility has been studied by various commissions, task forces, and study groups including the Governor's Commission on Public School Finance (1979), the School Finance Project (1983), Task Force on Accountability/Flexibility (1989), the Forum

Study Group (1988), and Government Performance Audit Report (1992). The most common recommendations from these groups are increasing flexibility at the local level by reducing the number of line-items and/or by using reversions. However, few recommendations have been implemented due to the barriers to flexibility inherent in the state system of funding including line-item budgeting, reversions, and personnel.

Line-items offer three important benefits to the state: (1) specification of particular statewide interests, (2) increased potential for resources through reversions, and (3) a detailed system of financial accounting. Major reductions in the number of line-items may diminish these benefits.

In North Carolina, reversions of unspent funds into the General Fund provide both resources for the upcoming year and a cushion against overspending. Some strategies for flexible funding have the real potential of reducing the amount of funding in the State's General Fund. Until different strategies are developed to secure funds for the General Fund, or the State is willing to risk having fewer funds available, reversions will continue to be a barrier to local flexibility.

Personnel is the largest recurring expenditure for public schools. There are two barriers to the use of personnel funds to achieve greater flexibility: (1) the potential for detrimental impact on educational programs if districts exercised the flexibility to reallocate personnel critical to instruction; and (2) statutes and regulations that limit flexibility (e.g., guaranteed salaries, state salary schedules, class size restrictions, and certification). Strategies to achieve greater flexibility need to address these barriers if local flexibility is to be increased.

Points to be considered when developing strategies for increasing local financial flexibility include:

1. Policies for local flexibility must support the state's constitutional responsibility for school finance, or statutes must be changed to shift more responsibility for school finance to local governments.

2. In order to develop, implement, and judge the adequacy of policies for flexibility the purpose to be served must be specified.

3. To be successful, any plan for local flexibility must accommodate important state interests.

4. Waivers provide limited flexibility. Analyzing and changing restrictive regulations may be a more effective strategy for achieving flexibility.

5. Strategies proposed for increasing local financial flexibility should be analyzed for negative as well as positive consequences.

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TABLE OF CONTENTS

Page

Executive Summary i
Acknowledgments iii
Table of Contents v
Introduction 1
State Finance Strategies that Support Local Flexibility 1
    Waivers 1
    Reducing the Number of Budget Categories 3
    Block Grants 4
    School-Based Budgeting 4
    Summary 6
The North Carolina Experience 8
    The North Carolina System of School Finance 8
    Flexibility in North Carolina 9
        The 1979 Governor's Commission on Public School Finance 9
        The School Finance Pilot Project 9
        Task Force on Accountability/Flexibility. 10
        The Forum Study Group 11
        Waivers in Senate Bill 2. 11
        Flexibility for the University System. 13
        Government Performance Audit of 1992 13
    Barriers to Flexibility 14
        Reversions. 14
        Line-Item Budgeting. 14
        Personnel 15
Discussion 16
References 19

Financial Flexibility in North Carolina Schools

The issue of local flexibility in the use of state resources is a complex and recurring one because it involves two competing policy values — the value of *liberty* which places local educational agencies such as schools in the position of determining their own direction and destiny, and the value of *equality* which supports uniformity across local agencies to achieve similar educational goals for all citizens. Both values are highly regarded; therefore, issues such as financial flexibility which pit the two against each other are difficult to resolve satisfactorily.

Advocates of more flexible use of state resources at the local level cite the ability to: (a) address local needs, (b) shift resources to needs as they arise, (c) increase efficiency in the use of resources, (d) reduce resources directed to administration and monitoring of external rules and regulations, and (e) foster local innovation (Ornstein, 1974; Henderson, 1983; McLaughlin, 1988; Clune & White, 1988; Augenblick, Gold & McGuire, 1990; Monk, 1990; Swanson & King, 1991).

Critics of more flexible use of resources at the local level suggest that: (a) important state priorities may not be addressed, (b) students with more costly needs may not be as readily served, (c) accountability will decrease, (d) high quality local programs may decline if they are not a local funding priority, (e) there may be problems in achieving local consensus on how to use funds, and (f) less specified categories for funding would be easy targets for budget cuts (Henderson, 1983; Guthrie, Garms, & Pierce, 1988; Monk, 1990; Swanson & King, 1991).

The purpose of this paper is to explore the issue of local financial flexibility with a focus on the implications for North Carolina. The paper begins with a description of some of the strategies that have been used at the federal, state, and local levels to achieve greater flexibility; then focuses on the North Carolina school finance system, its experiences with financial flexibility, and barriers to flexibility contained in the State's system, and concludes with a discussion of the some observations regarding the issue of financial flexibility in North Carolina.

State Finance Strategies that Support Local Flexibility

Surprisingly, one of the consistent findings of reviews of educational finance in this day of reform and restructuring is that very little has changed since the publication of *A Nation At Risk* (Augenblick, Gold, & McGuire, 1990). Many states are in the midst of rethinking and redesigning their basic financial structures to achieve equity as a result of court decisions, but few states have made changes in school finance practices consistent with new initiatives to change the way that education is designed and provided. Efforts to alter finance related to reform have been in the form of pilot projects or categorical funding programs to support specific reform initiatives rather than statewide changes in the distribution of funds to school districts. The most common strategies to increase local flexibility that have been used in these circumstances have been: (a) waivers; (b) reduction of the number of budget categories; (c) block grants; and (d) school-based budgeting.

Waivers

Waivers allow for increased flexibility at the local level through deregulation without the loss

Waivers

In 1989, South Carolina passed "Target 2000: School Reform for the Next Decade." Three of the programs included in this reform legislation provided for waivers from state regulations: (a) Dropout Prevention Program; (b) Innovative Grant Program; and (c) Deregulated Schools Program.

Both the Dropout Prevention Program and the Innovative Grant Program offer rule-by-rule waivers to those schools which compete for and receive the special program grant. These schools are then eligible to apply for waivers. However, very few of the participating schools have taken advantage of the waiver process. Of the 71 schools participating in the Innovative Grant Program only 4 schools requested waivers regarding defined minimum program standards; of the 32 grants with the Dropout Prevention Program, only 15 waivers were submitted, with some schools requesting multiple waivers. Generally, waiver requests were for variations of instructional time and for credit hours (Fuhrman & Elmore, 1992).

High performing schools may also apply for the Flexibility Through Deregulation Program which provides automatic exemptions to schools meeting four strict performance criteria. The purpose of the program is to "stimulate innovation and creativity in South Carolina schools by giving exemptions from many state statutory and regulatory requirements governing school operations and programs" (South Carolina State Board of Education, 1992, p. 7). This program offers exemptions from the defined minimum program standards (class scheduling, class structure, and staffing), basic skills assessment program, and state funded compensatory education and state funded remedial education for a period of up to 31 months.

In January 1990, 230 out of 1100 schools in South Carolina qualified for the Deregulation Program. The range and types of activities in these schools have varied during the ensuing months. Some schools have done little to deviate from their defined minimum programs while others have been quite innovative in altering their programs. However, it is interesting to note that many of these innovations could have been accomplished prior to implementation of the Deregulation Program, but had not. (Fuhrman & Elmore, 1992)

In 1989, Washington implemented Schools for the 21st Century to promote local innovation in participating schools or districts. Rule-by-rule waivers are provided. However, waivers have been requested infrequently by the project sites. Of the 21 projects participating in the first year, six requested a total of 15 waivers, of which nine were granted. The most common waivers requested were: (a) regulations governing total program hour offerings for basic skills and work skills, and (b) classroom teacher-student contact hours. Project sites reported barriers other than regulation to be problematic (e.g., lack of funding, skepticism, weak district support); thus, waivers were not as useful as originally anticipated. (Fry, Fuhrman, & Elmore, 1992)

Figure 1. Waivers

of state authority or accountability. Local schools or districts may request to be released from specific state rules and regulations. Districts or schools must apply for a waiver from each regulation they wish to be exempted. Waivers are appealing because they offer individual districts varying degrees of freedom to maximize the use of existing funds while maintaining and protecting the state's interests.

The state descriptions contained in Figure 1 provide examples of waivers used in reform efforts to support school improvement and examples of incentives for improvement. The actual experience with waivers in these two instances, however, suggests that the policy is more conceptually than practically sound. Districts do not seem to participate heavily in waivers when the opportunity is available.

Reducing the Number of Budget Categories

As public education in the United States became more inclusive and comprehensive, the variety and number of areas in which states provide fiscal support increased. This led to the creation of numerous expenditure categories with rules that dictate the spending of state funds and place limits on local flexibility. Collapsing the number of budget categories is one strategy that provides greater local flexibility. The appeal of strategies for reducing the number of line-item or programmatic budget categories is that they provide local flexibility while still retaining broad state interests. The state-level risk is that specific state interests reflected in line and program items will be obscured. Local districts are potentially at risk of losing funds because broader categories are more prone to budget cuts.

Reduction of Categories

South Carolina is currently working on an Education Consolidation plan which collapses 16 special competitive grant program categories into two main categories: (a) Innovation; and (b) Family Literacy & Services Collaborative. The funding for the two initiatives will be based on both average daily membership and equity. Once funding levels are determined, 70% of the funds will be sent directly to the schools with the remaining 30% going to support district-level innovations.

Utah provides 75% of educational financing in the state. Seventy percent of the state funds are unrestricted while the remainder protect interests in areas such as special education, vocational education and a career ladder program. There has been limited variation across districts in how state funds are spent, however, because most of the funds support personnel. Prior to the present system, the state instituted a system called the "Special Purpose Option." If a district had a proposal which would address local problems and required funds from several line items (e.g., bilingual education, class size reduction, and textbooks), the district could, with approval, combine money from all of those accounts to pay for the program. This program was discontinued when the current program was instituted.

Figure 2. Reduction of Categories.

The two states in Figure 2 used line item reductions in different ways. For South Carolina, line-items were collapsed for special programs. In Utah they were collapsed for the regular education program and categorical funding was retained for special interests. The examples also point out a potential problem with any strategy for increasing flexibility. The financial requirements for providing basic educational programs are quite high. For many states, particularly in these times of scarce resources, there may be very little money left after paying for essentials to use funds flexibly.

Block Grants

Block grants are the most flexible method of financing school districts. Funds are sent to the local school district in one lump sum with few specific requirements as to how the monies are to be spent. Districts are allowed a greater degree of "flexibility" with the funds and thus are afforded greater discretion in design and implementation. The responsibility and administration of many funding decisions shifts from the state to local personnel who are in most direct contact with the students (Swanson & King, 1991).

As described previously, some states have experimented with collapsing a number of line items into several large, block-like categories. But few have attempted to collapse all funds going to the district into a single block grant. However, block grants have been used by the federal government for many years, and such experience lends insight to the discussion of block grants from the state to local school districts.

The federal block grant experience described in Figure 3 illustrates both benefits and liabilities of flexibility. States benefited from the ability to address local needs and the reduction in regulations and paperwork associated with the many programs that were consolidated. However, the program also included an across-the-board budget cut that could not be associated with any particular priority and resulted in severe reductions in programs for states that had large numbers of special populations who had previously been targeted for funds.

School-Based Budgeting

Traditionally, states distribute education funds to school districts or other local government units which are then responsible for the distribution of funds and/or resources to individual schools. For this reason, most discussions of flexibility focus on methods of achieving greater flexibility at the district level. However, as governance moves from the district to schools through implementation of site-based management plans, so does the concept of financial flexibility. One of the most common types of school flexibility at the building level is school-based budgeting. School-based budgeting requires the transfer of decision-making authority from the district to the school building level. It may be mandated to all districts by the state or it may be initiated by the school district for some or all of the schools within the district (Wohlstetter & Buffett, 1992).

The benefits of school-based budgeting include: (a) increased efficiency because budget decisions occur closest to those affected by the decisions (Levin, 1987), (b) increased flexibility in the instructional program because the school's spending authority is expanded (Clune & White, 1988), and (c) more accountability close to the actual instructional process (Ornstein, 1977).

However, experience shows that there are potential problems associated with school-based budgeting. First, in order for budget decisions to shift from the central office to the school building level, authority relationships within school districts must change. In practice, budget decisions have been delegated to the school level, but real expenditure authority has remained at the central office (Hentschke, 1988). Second, district site-based management programs have often run afoul of state rules and regulations. Likewise, state-initiated programs have run afoul of district rules and regulations. And finally, in situations where the state has mandated school-based budgeting, problems arose when district superintendents did not support the initiative.

One of the newest initiatives designed to increase financial flexibility at the local level involves channeling state funds directly to local schools (Odden, 1991). A few states have initiated pilot studies in which individual schools are given complete discretion over some parts of their budgets for school innovation or school improvement (Augenblick, Gold, & McGuire, 1990). These schools have complete control over their resources and may apply for further waivers from other state regulations. However, to date there are no reports of states sending all

Federal Block Grants

The most far reaching example of federal block grants occurred in 1981 when the government consolidated 43 categorical grants into one block grant under the Education Consolidation and Improvement Act (ECIA). The consolidation of the categorical grants was to serve two purposes: (a) reduce administration, monitoring, and evaluation; and (b) transfer power back to the states by aligning educational decision making and program implementation with local needs (Comptroller General of the United States, 1984). With reduced administration, monitoring, evaluation, and increased decision making at the local and state level, the federal government reasoned that states would be able to use federal dollars with greater efficiency. The benefits of this type of program were appealing. States would have increased flexibility in deciding how federal dollars were spent. Further, states would be released from the myriad of federal paperwork, administration, monitoring, and evaluation accompanying each of the 43 categorical programs.

However, there are tradeoffs to the benefits of consolidating categorical funds into a block grant; changing the locus of control from the federal to the state level had both economic and programmatic impacts on state education. The economic tradeoffs meant that fewer federal dollars were sent to the state level. The federal government reduced funding to the states by an average of 12 percent explaining that greater efficiency in the use of these dollars meant that fewer dollars would be needed. Further, there were programmatic tradeoffs. The impact of this reduction hurt the quality of programs in states serving large numbers of poor and minority children. (Astuto & Clark, 1988; Verstegen, 1984). Under the previous categorical grant, states with large numbers of poor and minority children received federal funds earmarked for these populations based on funding formulas. However, under ECIA, these categories were consolidated which meant states no longer had these specific federal dollars to reach these populations.

Figure 3. Federal Block Grants

school funding directly to the school site. Research for this study revealed that in most (if not all) states, education funds are still distributed from the state to the district or governmental unit level in a traditional manner, with the superintendent and local school board deciding on the distribution of resources to the school site in accordance with federal, state, and local law.

As states are developing and implementing reforms that place substantial decision-making authority at the school level, they are also beginning to develop strategies to provide school-based participants with the authority to use funds flexibly to address their needs. This is a different kind of flexibility than the strategies previously described, but one that can be expected to become more prominent as states include strategies such as site-based management in their reforms.

Summary

This review showed that financial flexibility is often part of a larger change effort. In the case of federal block grants it was part of a change in ideology from the federally-sponsored Great Society Programs of Lyndon Johnson to the minimization of federal involvement in state and local affairs led by the Reagan administration. Waivers and site-base budgeting are strategies often included in recent broad educational reforms. Reductions in the number of line-items does not appear to be aligned with any particular change effort but have been used in a variety of ways in specific state programs. Perhaps the most important implication of this review is that financial flexibility is not often used as an end in and of itself, but as a strategy that is part of a larger program or ideology.

School-Based Budgeting

Florida *has emphasized school-based budgeting in legislation spanning the past twenty years. The state provides for voluntary participation in school-based management and school-based budgeting. State funds are given to participating districts for professional development activities and technical assistance to: a) develop fiscal decision-making capacity, and b) promote restructuring reform at the local level.*

California *uses a number of different strategies to support school-based budgeting including reducing the number of categories to increase flexibility at the local level, providing additional resources to schools, and combining funds from different categories without the requirement of tracking where funds were spent (Wohlstetter & Buffett, 1991, p. 6). The state also provides 8 days of released time for staff development in schools to design budgets based on local school needs (Wohlstetter & Buffett, 1991).*

Kentucky *has mandated that by 1996 school-based management will be in all school districts. The potential role of school-based budgeting is under consideration; however, the way has been paved by the development of a new accounting manual created to facilitate school-based budgeting (Odden, 1992).*

Figure 4. School Based Budgeting

The review also indicated that flexibility has potentially negative consequences as well as benefits. The advantage of heavily specified systems of finance is that interests are clearly articulated and supported. Efforts such as block grants that eliminate specificity also eliminate the focus of the funds and leave them vulnerable to changes such as across-the-board reductions that are not related to need.

The North Carolina Experience

In order to understand the applicability to North Carolina of the strategies described previously, it is first necessary to understand how North Carolina finances its public schools.

The North Carolina System of School Finance

The North Carolina system of school finance, while having a number of features in common with other states, is distinctive in its reliance upon state revenues to support elementary and secondary education (Governor's Commission on Public School Finance, 1979). While a number of circumstances and events have led to the dominance of state funding of public education, two legislative acts have particular significance: (a) the School Machinery Act of 1933 and (b) the 1985 Basic Education Program.

The Constitution of 1868 mandated that the General Assembly provide a "general and uniform" system of public schools. A number of strategies for funding public education were used until 1933 when, with the passage of the School Machinery Act, the State accepted the responsibility to provide teachers, administrators, and instructional resources for education while local districts retained most of the responsibility for providing the physical facilities for education. This Act distinguishes North Carolina from most other states by providing for the funding of public education through the state rather than from local efforts through property taxes and levies. The Act is also the basis for state, rather than local, control of educational financing in the State.

In 1985, the State went one step further passing the Basic Education Program (BEP) which specified that "uniform" meant that all children in the State would have equal access to a basic, not minimum, education program. The BEP required that a standard course of study be provided, that class size be regulated, and that specified instructional support be available. Funding for the BEP, like the School Machinery Act was to be provided by the State.

The historic effect of state and federal funding for local schools was the creation of a complicated system of formulas to allot resources to local school districts. For 1992, there was the possibility of state and federal resources being allotted to districts in 84 separate categories with approximately 50 categories providing funds to all districts.

There are several key features of the State's finance system. First, the State has developed salary schedules for most school employees and provides resources for salaries and benefits based on these schedules. Second, the salary of a number of school positions, notably classroom teachers, is guaranteed by the State, i.e., the State pays the actual salary and benefits of the employee based on its salary schedule rather than forcing districts to absorb the difference between an average salary and that of a more experienced employee. Third, certain allotments reflect specific state interests beyond the BEP such as the Willie M. program, the program for preschool children with disabilities, and the inclusion of teacher assistants in K-3 classrooms. With these allotments often come conditions under which the funds may be used and, for some, prohibitions against flexibility. Finally, with few exceptions, resources remaining in individual allotment categories revert from the Public School Fund to the State's General Fund on July 1 of each year and become part of the State's total resource base for the new year.

Within this system of finance, heavily prescribed and supported by the state, the issues of local flexibility must be considered.

Financial Flexibility in North Carolina

The issue of increased flexibility in public school funding has been considered many times in North Carolina. This section of the paper describes some of the major efforts and recommendations from 1979 to the present.

The 1979 Governor's Commission on Public School Finance. In 1977 Governor James B. Hunt, Jr. authorized a Governor's Commission to study the North Carolina public school financial system and prepare recommendations which would assure more equitable financial support for equal educational opportunity for every child in the state (Governor's Commission on Public School Finance, 1979). The Commission listed several criteria for an equitable funding formula that included: (a) "a substantial degree of flexibility should be maintained so as not to restrict local response to unique conditions or to limit local aspiration in advancing public education," and (b) "a proper balance must be created between state assurance of reasonable uniform educational opportunity and local discretion" (p. 2).

At the time of the report, the State used 63 line-item allotments to distribute funds to schools. The report described three limitations of the line-item allotments: (a) the many standards and criteria used do not focus directly on educational needs and program costs, (b) the volume of formulas and accountability standards may tend to restrict local prerogative, and (c) the system of many small categorical grants does not present a comprehensive approach to funding. They stated an opinion that local school districts should be freed of some of the financial accountability controls for the many line-items. A major recommendation of the report was that the entire system of base funding for public education be changed to one based on program cost rather than line-item allocations (Governor's Commission on Public School Finance, 1979).

The School Finance Pilot Project. In 1983 the General Assembly called for the development of the BEP and of a pilot project that would explore a system for allocating funds that was responsive to both state and local needs. Specifically, the General Assembly allowed the eight participating districts "...greater flexibility with funds appropriated through any line items not governed by special provisions to the several appropriation acts" (North Carolina State Department of Public Instruction, 1987). Districts were able to flexibly use funds in 21 of the 59 major expenditure categories. About 80% of the total operational funds from the State were included in the project. Districts could also request waivers from the State Board of Education and the Advisory Budget Commission in the remaining 38 categories. A third strategy was modification of the fiscal year that allowed the districts to spend state money through August 1 on summer school rather than having to return all unspent funds on June 30.

The experience of the Pilot Project was that only limited flexibility was actually available. In their external evaluation of the project, King and Ritchie (1987) found that a number of waivers requested from the State Board and the Advisory Budget Commission were considered reasonable and necessary by the local school district, but were not granted. The reasons waivers were not granted appeared to be adherence by the State to specific rules and regulations rather than a propensity to waive rules for the pilot projects. Secondly, there was pressure exerted by interest groups in Raleigh to deny waivers. Uncertainty regarding continuation of the project led districts to use flexible funds on non-recurring items rather than on longer term programs. In addition, districts found that the realities of the BEP, class size restrictions, and continuing personnel obligations left little in the way of financial resources that could be used flexibly.

In spite of these limitations, the participating districts were very satisfied with the added flexibility and recommended that the program be continued. They cited benefits of improved planning, more efficient use of resources, the introduction of instruction in areas where resources were previously inadequate, and the introduction of special programs to meet local needs such as remedial programs, in-school suspension programs, etc. Participating districts found the ability to carry over and spend funds until August 1 particularly helpful in financing summer school programs (King & Ritchie, 1987). Often mentioned by those participating were the particular benefits of added flexibility to small schools and low wealth districts.

The external evaluation also recommended the continuation and expansion of the project. In addition, King and Ritchie (1987) recommended that: (a) flexibility be granted in several broad categories; (b) the reversion date of August 1 be continued; (c) districts be able to carry a certain percentage of unspent funds forward as cash balance, planning funds, or summer school support; (d) pre-service and in-service preparation in decision making and budgeting for board members, administrators, and teachers be provided; and (e) the State should tolerate more discretion in local efforts to meet state goals.

In September of 1988 the State Board of Education informed the General Assembly that the Board would not request the same model tested in the Pilot Project. Instead, the Board asked that the Department of Public Instruction staff work with the Legislature to develop a new model that would more appropriately test flexibility (North Carolina State Board of Education, 1988). No further legislative action was taken and the Pilot Project was discontinued.

Task Force on Accountability/Flexibility. Because the strategies used in the Pilot Project were not deemed suitable for statewide application and legislation still called for reports on the issue, the State Department of Public Instruction, in January of 1989, called together a task force of superintendents, principals, teachers, local school board members (including representatives of the pilot units), and members of the General Assembly to develop alternative approaches for local financial flexibility for the State Board's consideration.

In their report, (Task Force on Accountability/Flexibility, 1989), the Task Force recommended the following:

1. Optional participation in the accountability/flexibility program;

2. Provision of staff development regarding flexibility for many different groups, including local county commissioners and local boards of education;

3. Accountability based on improvement in certain student outcomes and the conditions of learning and teaching;

4. Specific changes providing more flexibility in current legislation regarding class size, certification, teacher assistants, and textbooks;

5. Reduction of 44 current line items into seven allotments for: (a) instructional personnel (certified), (b) instructional support personnel (certified), (c) instructional support - general, (d) administrative support, (e) instructional supplies/materials/equipment/textbooks, (f) exceptional children, and (g) remediation.

The Forum Study Group. In 1988 The Public School Forum brought together 77 business, educational, and political leaders from across the State to form The Forum Study Group. The Group's charge was to frame policy alternatives that would lead to better schools. Like similar groups across the country, The Forum Study Group stated their belief that nothing short of fundamental restructuring of schools was sufficient to improve education in the State. The critical elements in this restructuring were described as: (a) accountability defined in terms of student success, combined with (b) flexibility at the school and district level.

The group stated their opinion that more control and flexibility over educational decisions and resources should be returned to the local level in exchange for demanding accountability standards for student achievement (The Forum Study Group, 1988). Specifically, with regard to flexibility the report called for:

1. Greater flexibility in the use of personnel resources, especially in the area of providing general assistance to teachers.

2. The collapse of 70-plus non-transferable budget line-items and the ability to transfer funds into other areas granted to local school boards and educators. The recommended categories were: (a) instructional personnel, (b) instructional supplies and equipment, (c) instructional support personnel, (d) general administration, (e) auxiliary services, and (f) categorical programs.

The purpose for this flexibility was to allow districts to redirect resources to areas of local need. Without this flexibility the Group questioned the public's ability to seek account ability for results. They indicated that too little flexibility would also undermine the support of school-based staff for accountability (The Forum Study Group, 1988).

Waivers in Senate Bill 2. The primary strategy for enhancing local flexibility that has been enacted statewide is the individual, rule-by-rule waivers contained in Senate Bill 2 which was passed in 1989. Under Senate Bill 2, school districts could apply to the State Board for waivers from state laws in the areas of: class size, teacher certification, textbooks, and assignment of teacher assistants. As of November 1992, 2,494 waiver requests from school districts had been received. Of these waivers, 743 (30%) related directly to school finance.

Approximately 51% of the 743 finance waivers were recommended for approval, 12% were recommended with specific stipulations, and 25% were not recommended. The remaining 12% either did not require waivers, were under consideration statewide, or required more information before a decision could be made (see Table 1).

These results show that some waivers were consistently approved by the Board while others were not illustrating the complexity of competitive state and local interest in the waiver process. Three waivers recommended consistently by the Board were: (a) flexibility in the use of summer school funds for remediation during the regular school year, (b) flexibility in the use of instructional materials/textbooks, and (c) flexibility in the use of BEP position and funds. These waivers were related clearly to the structure and process used to provide instruction.

The information available for this analysis was not as informative regarding waivers that were not approved. However, a 1991 report by the North Carolina Department of Public Instruction of 2000 waiver requests reviewed indicated that slightly less than half of the ones not approved were ones over which the Superintendent and the State Board of Education had real discretion. The remaining requests, such as requests for exemption from state purchasing and contract regulations, were prohibited by state or federal law and beyond the purview of the Department of Education (North Carolina Department of Public Instruction, 1991).

In this short time period, North Carolina's experience with waivers has been mixed. The mechanism of waivers has provided some financial flexibility. However, only half of the financial waivers requested for financial flexibility were granted and these represented only 15% of the total number of waivers requested. Also the analysis revealed that districts requested greater flexibility from both education regulations and those that were imposed by the State outside of education. Since the State Board of Education does not have the authority to grant waivers in areas regulated by other areas of state government, many rules and regulations that restrict flexibility are not included in the present waiver process. Finally, according to the 1992 Government Performance Audit report (KPMG Peat Marwick, 1992) the funds affected by the waivers were minimal ($3.4 million of the over $3 billion state school budget).

House Bill 1340, which revised Senate Bill 2, shifts the opportunity of financial flexibility from the school district to individual schools. Individual school staff must prepare their own school improvement plans based on the district's performance goals. Schools desiring waivers will include waiver requests as part of their plan.

It is uncertain, given the State's financial system and local district practices of providing resources to school sites, how the statute will provide for school-based financial flexibility or how this school-based waiver system will affect school districts' ability to use funds flexibly.

Flexibility for The University System. In 1990 and again in 1991 the General Assembly passed legislation to provide additional management flexibility to the State's University of North Carolina campuses. The 1990 legislation contained nine provisions, some of which included: (a) consolidation of several budget items, (b) use of unspent utility funds, (c) transfer of funds into instruction and libraries from other purposes, (d) phase out of the inclusion of overhead receipts for General Fund operating budget, and (e) refunds to campuses of sales taxes on contracts and grant expenditures.

A 1991 bill provided further flexibility which allows campuses meeting specific requirements so as to be designated as a Special Responsibility Constituent Institution to: (a) receive a single sum budget, (b) revert an amount equal to an adjusted historic reversion rate, and (c) retain up to 2 1/2% of unspent General Fund appropriations above the required reversions amount for one-time expenditures.

Government Performance Audit of 1992. In 1991 the North Carolina Legislature authorized a performance audit of the entire state government operation. The report on funding public education (KPMG Peat Marwick, 1992) noted that "funding formulas are too controlling and prescriptive to allow local school districts to effectively manage their operations. The current waiver process does not provide the necessary flexibility" (p. 5.4). The report cited recent efforts to increase flexibility through the consolidation of some funding categories by the 1992 General Assembly, the flexibility provided in the funds allotted to the small and low wealth schools, and waivers. However, the report noted that even if teaching positions were excluded from considerations of flexibility, over 43% of the state education budget, or approximately $1.4 billion, is significantly restricted as to purpose or use (KPMG Peat Marwick, 1992). The report concluded that these restrictions not only limited the ability of local units to manage their operation, but also had the potential of reducing the overall benefit to the State of the funds it was allocating by reducing their effectiveness and efficiency.

The report recommended that "efficiency in school district and school operations can be improved by simplifying funding formulas and empowering the school districts to manage for results" (p. 5.11). Specific suggestions for increasing flexibility and efficiency included: (a) combining major non-teaching funding categories, (b) contracting out services in communities where private sector resources are available, (c) providing some services through multi-county or multi-district service delivery mechanisms, (d) providing incentive awards for increased efficiency, and (e) allowing districts to carry forward a portion of their savings resulting from flexibility. The concluded by stating that, "the realization of actual benefits will be dependent upon the General Assembly and its willingness to expand the flexibility begun in Senate Bill 2 and the local school districts themselves and their resourcefulness and creativity" (p. 5.12).

Barriers to Flexibility

This portrait of North Carolina reveals a public school finance system that is heavily state funded and controlled. It also reveals a number of efforts to come up with plans for increased financial flexibility at the local level for public schools that have not been adopted. The experience of the State's university system has been quite different. A number of allowances have been made quite recently to both increase the flexible use of funds and to increase the amount of funding through the return of funds previously kept by the State for the General Fund. With calls from The Governor's Study Commission, participants in pilot studies, task forces and study groups, why have strategies to increase financial flexibility at the local level for elementary and secondary education not been developed and implemented? There appear to be three strong barriers that must be addressed before local flexibility for public schools can become a reality.

Line-Item Budgeting. Reductions in the number of line-items are recommended in most studies of public school finance in North Carolina. However, numerous, detailed line-item allocations with matching budgeting provide three major benefits for the State: (a) increased potential for reversions thereby generating funds; (b) a detailed system of financial accounting; and (c) specification of particular statewide interests. Major reductions in the number of line-items have the real potential of reducing all three of these State benefits. It would seem that this is an area where State interests and benefits have been greater than the desire to grant local districts greater flexibility. Reducing the number of budgetary line-items has been recommended a number of times over the past 20 years with no result. Perhaps with the reform suggested by Senate Bill 2 and House Bill 1340 along with the State's enhanced capacity for accounting, granting flexibility by significantly reducing the number of line-items for budgeting could become a more palatable option for the State.

Reversions. North Carolina is a state that requires a balanced budget. Reversion of unspent funds into the General Fund from the many line items that comprise the State's funding system provides both resources for the upcoming year and a cushion against overspending. Public education comprises 43.4% of the state budget. Reversions from public education are often the largest of any state agency, approximately $59 million in 1992. Strategies for flexible funding, such as collapsing line items into broader categories or block grants, that would allow more movement of expenditures among line items, have the real potential of reducing the amount of funding in the State's General Fund. Until different strategies are developed to secure funds for the General Fund or the State is willing to risk having fewer funds available, reversions will continue to be a barrier to local flexibility.

Personnel. Large numbers of adults are needed to teach, support, and provide for the physical well being of our children while they are in school. As a result, personnel is the largest recurring expenditure for public schools. In 1992-93 North Carolina allocated 96.4% of its state funds for public education to personnel. If personnel were to be excluded, less than 4% of the funds provided to local districts by the State could be considered for flexible use and many of these funds support critical school functions that cannot be deleted to provide flexibility in other areas. To achieve marked financial flexibility at the local level, therefore, districts would need to have greater flexibility in the use of funds allocated to personnel. There are two major barriers to the use of personnel funds to achieve flexibility.

The first barrier has to do with the overall adequacy of funding for education in the State. While North Carolina has increased funding for education over the past ten years and state spending for public education represents approximately 44% of the State's total General Fund expenditures, the State still falls below the national average in its funding of public education, ranking 32nd in 1991 (KPMG Peat Marwick, 1992). The BEP is attempting to provide equity in the program of education available to students across the State, primarily through the provision of personnel. The BEP has yet to be fully funded. Consequently, the State does not yet have its Basic Education Program in place for all students. There is a serious question as to whether flexibility which includes the ability to reallocate personnel monies, particularly those for instructional personnel, would be educationally sound. Clearly there could be greater efficiency by using strategies such as shared positions in smaller districts and more flexibility within personnel categories. However, the question that would have to be addressed is, "How does any strategy for financial flexibility that involves school personnel affect the quality of the educational program?"

The second barrier is the number of statutes and regulations regarding personnel such as guaranteed salaries, state salary schedules, class size restrictions, and certification. Many of these statutes and regulations serve not only state interests but local interests and those of the individuals working in schools as well. Strategies to achieve greater flexibility which involved these statutes and regulations would need to be carefully examined to ensure that they did not create undue harm or risk for local school districts and school personnel as well as the State.

Discussion

This review has revealed a number of points that State policy makers should ponder when considering strategies for increasing local financial flexibility.

1. **Policies for local flexibility must support the State's constitutional responsibility for school finance, or statutes must be changed to shift more responsibility for school finance to local governments.**

The School Machinery Act of 1933 established the State rather than local county governments or schools districts as having the responsibility for financing the operation of public schools. Local governments are only responsible for capital expenses, but may supplement state funding in other areas. In no other state save Hawaii is the mandate for state financing so clear. The discussion of increased local flexibility with state funds must take place within this context of state responsibility for funding instructional expenses, or the Constitution and other statutes must be changed to create a public school finance system that has less state and more local control and responsibility.

2. **In order to develop, implement, and judge the adequacy of policies for flexibility, the purpose to be served must be specified.**

There does not appear to be consensus regarding a purpose for increased local financial flexibility. The reports reviewed for this paper described three different purposes North Carolinians have proposed for increased flexibility: (a) enhanced ability to address local needs, (b) promotion of innovation and change, and (c) improved efficiency in the use of resources. In addition, many discussions of flexibility seem to support the value of liberty mentioned at the beginning of this paper, i.e., the general value of increasing local control and decreasing state control. Intents or purposes, however, suggest specific types of policy strategies. Policies to promote innovation and change through flexibility would be quite different from those to promote efficiency. This suggests that before policies for financial flexibility can be developed, and certainly before their adequacy and appropriateness can be judged, the purpose for flexibility must be clarified.

3. **To be successful, any plan for local flexibility must accommodate important state interests.**

Funding for education in North Carolina, as in most states, represents the highest percentage of the State's budget. For this reason and because of the State's responsibility for public school finance, a number of important state interests are embedded in the educational finance system. The failure of strategies to significantly increase local financial flexibility over the past 20 years suggests that flexibility challenges or conflicts with multiple, strong state interests. For example, strategies that would reduce the number of line-items in the budget or would allow the expenditure of funds from allotments after June 30th risk funds that the State uses to comply with the constitutional mandate for a balanced budget. Broad strategies such as collapsing large numbers of line-items or block grants risk state-wide programmatic interests such as differentiated pay and teacher assistants. One major state interest that is not challenged by increased local financial flexibility is accounting. Through its Uniform Chart of Accounts, North Carolina can account for the expenditure of funds better than most states.

Local financial flexibility may conflict with State interests, but this does not mean increased flexibility is a bad concept or that it is not feasible. Rather, as was demonstrated in the policies for increased flexibility in the university system, these challenges and conflicts are ones that can and should be accommodated in policies proposed for increased financial flexibility for public schools.

4. **Waivers provide limited flexibility. Analyzing and changing restrictive regulations may be a more effective strategy for achieving flexibility.**

The use of rule-by-rule waivers in South Carolina and Washington showed that little flexibility was actually realized. According to the North Carolina Department of Public Instruction, close to 78% of the existing state budget for education may be used flexibly through Senate Bill 2 waivers (North Carolina Department of Public Instruction, 1992). Yet according to the Government Performance Audit Report (KPMG Peat Marwick, 1992), less than 1% of the funds were requested to be used in ways other than the purpose for which they were allotted. Perhaps, as demonstrated by the Pilot Project, the $2.6 billion that is available to be used flexibly pays for critical functions such as teaching and support for teaching, and there is little in the State-supported budget that can be used in other ways without damaging the instructional program.

Local school district personnel may not be sufficiently familiar with the ways in which they can use state funds. The waiver process revealed that a number of school districts requested waivers for use of funds that could already be used without a waiver. Several of the reports reviewed for this paper suggested that LEAs be provided with staff development in the utilization of flexible funds. This would seem to be an especially critical need as the waiver requests shift to school sites, where staff have limited training and experience in local and State finance.

The granting of rule-by-rule waivers may not be the best policy strategy to provide increased flexibility. Instead, the State might be better served by studying its regulations with the intent of identifying those that inhibit flexibility and determining the appropriateness and feasibility of changing them.

5. **Strategies proposed for increasing local financial flexibility should be analyzed for negative as well as positive consequences.**

Both the literature and the North Carolina experience in the Pilot Project cite the benefits of increased local flexibility as being the ability to address local needs, improve planning, increase efficiency in the use of resources, shift resources to needs as they arise, and pursue innovation. However, altering the North Carolina system of school finance to include increased local flexibility may also have negative consequences for school districts.

For example, if guaranteed salaries were no longer provided in a plan for flexibility, school districts could be placed in the position of being unable to hire more experienced and more qualified teachers. If guaranteed salaries and salary schedules were eliminated for flexibility, the equity across districts that currently exists could be jeopardized. The ability to contract for services currently provided by school employees on a state salary and benefit schedule could result in reductions in workers' salaries and benefits. Federal block grants were accompanied by across-the-board cuts in funding — a circumstance that could happen in the State as well. Finally, certain plans for flexibility could place local districts in the position of having to share a greater portion of the financial risk currently assumed by the State should budget projections and expenses go awry. These potential negative consequences may not justify limits to local flexibility; however, they need to be considered as changes are proposed.

There does appear to be considerable room for additional flexibility within the system without great risk of these negative consequences. To preserve the benefits that the State, local districts, and educational personnel enjoy from the present system and to provide additional flexibility, we suggest that the State first consider the following questions regarding any plans for financial flexibility:

1. What is the purpose of increasing local flexibility (to meet local needs, increase efficiency, foster innovation)? Does the proposed strategy adequately address the purpose for flexibility?

2. What will be the impact of the strategy on programmatic state interests?

3. What will be the impact of the strategy on personnel and personnel policies?

4. Will the strategy protect school districts from significant reductions in state funds?

5. What will be the impact of the strategy on the General Fund? If the effect is one of reduction, is the amount of the reduction acceptable?

6. What will be the impact of the strategy on the quality of education in the State?

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