



DOCUMENT REVIEWED: “They Spend WHAT? The Real Cost of Public Schools”

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### **Summary of Review**

The CATO Institute’s Policy Analysis *They Spend WHAT? The Real Cost of Public Schools* contends that the figures most commonly associated with spending on K-12 public education do not include all relevant expenditures. It also cites survey evidence suggesting that voters underestimate the cost of education and, when presented with a higher per-pupil expenditure figure, will support lower spending. The report notes that education is the largest spending category in combined state and local budgets, and it examines spending in five of the nation’s largest metropolitan areas plus the District of Columbia. The heart of the analysis is a comparison, within each of the selected districts, of three alternative calculations of school spending. An estimated private school cost is also calculated and presented. The report presents large “real” costs per pupil. However, the spending numbers calculated for the report actually double count, adding in both capital construction and debt service. The use of flawed data renders the report to be of limited value in policymaking.

## Review

### I. INTRODUCTION

The Cato Institute recently released a policy paper titled *They Spend What? The Real Cost of Public Schools*.<sup>1</sup> The report makes the case that voters, deprived of reliable information on the magnitude of education costs, are misled into support for programs that are overpriced and wasteful. The argument is based on a comparison of several numbers associated with spending per pupil, including a “real” per-pupil cost of public education calculated by the report’s author, Adam Schaeffer. The report never expressly states that official figures are wrong. However, it leaves readers with the clear inference that official figures are an attempt to mislead the public, given the magnitude of the differences between the figures school districts make most visible to voters, the most commonly used figures produced by the National Center on Education Statistics (NCES),<sup>2</sup> and the author’s own calculations. Because of a key mistake, however, the argument collapses along with the author’s calculated “real” spending figure. Specifically, capital construction is typically paid with the proceeds of borrowing, so a calculation should include either the cost of capital construction or the amount paid to service debt; the calculations in this report, however, include both.<sup>3</sup> The result is a double counting that substantially distorts the total for districts engaged in capital construction projects.

### II. FINDINGS AND CONCLUSIONS OF THE REPORT

The report’s primary finding is that several of the most widely available measures of per-pupil spending understate spending within school districts. In particular, the report focus-

es on (a) expenditures per pupil commonly provided to the public by districts, and (b) total expenditures per pupil produced by the NCES.<sup>4</sup> By definition, total current expenditures are not comprehensive; the numbers exclude non-current expenditures such as capital costs and debt service, as the report notes (p. 5). (As discussed in endnote No. 10, however, and contrary to the report’s assertion, most employee benefits are included in most districts’ current expenditure numbers.) Similarly, no NCES definition of expenditures includes all expenditures school districts make on behalf of pupils, since expenditures such as capital construction and municipal spending carried in school budgets would distort consistent comparisons.<sup>5</sup>

The Cato report details problems faced by anyone attempting to calculate total spending per pupil from data provided by districts. Budget reports sometimes contain overlapping expenditures, and calculating total spending per pupil is a difficult task.

In order to show the gap between publicly reported spending per pupil and “real” total spending per pupil, the report presents the author’s own calculations of a comprehensive figure. In every case he finds his “real” cost of education per pupil to be higher than the district’s most widely distributed figure, generally much higher. Differences range from an atypically low 3% in North Chicago to a high of 151% in Los Angeles (LAUSD). The author’s own figures are also higher than the NCES figure of total expenditures per pupil in all cases.

The report cites survey data from several sources indicating that people are unaware of the cost of education per pupil. When asked to guess, they provide answers that are lower

than NCES figures (p. 3 and p. 26, n. 13). It points out that education spending, accounting for a bit more than 25% of combined state and local total spending, is the single largest item in state/local budgeting. The report also states that education spending has increased more rapidly than inflation.

From these findings, the report concludes that spending is too high. The author contends that voter approval for this overspending is based on ignorance of actual spending levels. Voters armed with the knowledge of “real” total education spending per pupil would accordingly gain control of runaway spending. Moreover, the higher public school spending figures place the spending on private school education in a more favorable light, with clear implications for the policy benefits of school vouchers.

### **III. THE REPORT’S USE OF RESEARCH LITERATURE**

The analytical portion of this report is based on original sources, evidencing the author’s detailed examination of local education figures as reported by school districts. The report’s limited research citations are generally studies from other libertarian or conservative think tanks rather than academic literature.

The report is aimed at the general reader, so the absence of academic references is not surprising, even though the figures presented are clearly intended to be taken seriously. It would have been reassuring to see the report manifest an understanding and appreciation for the complexities associated with the reporting of education finance information.<sup>6</sup> Also, the report’s claim that voters, supplied with accurate information on total education spending per pupil, can evaluate the adequacy or excess of that spending completely ignores the complicated and extensive legal debates over the cost of an adequate education.<sup>7</sup>

### **IV. REVIEW OF THE REPORT’S METHODS**

The analysis centers on comparison of four numbers for three districts in each of five large metropolitan units and the District of Columbia: the center-city district and districts with the highest and lowest per-capita income, yielding a total of 18 districts. The Total Expenditures per Pupil figure is the most inclusive spending figure generally available from NCES. The most recent year for which this figure was available is 2006.<sup>8</sup> The report also includes what it calls a “stated public spending per pupil” figure, which is the per-pupil figure provided by each district. If a per-pupil figure is unavailable, the author calculates one by dividing the most widely distributed total figure by a pupil count. The author’s own “Real Public” figure is calculated for each district based on figures from budget reports and audits for grades K-12 where possible and PreK-12 where necessary. Lastly, the author calculates median private school expenditure estimates for each metropolitan region in the study.<sup>9</sup>

It should be noted that the large metropolitan units studied for this report have higher costs of living than surrounding areas, and center city districts typically have disproportionate numbers of pupils who live in poverty, have special needs, and are not native speakers of English. It is reasonable to assume the costs of educating these pupils are well above a statewide average. Conclusions or claims derived from these analyses might, therefore, not be generalizable to other areas.

One of the more unfortunate aspects of the report is the frequent inference that figures other than the author’s are misleading. It should have been possible to recognize the figures’ limitations for the report’s purpose while appreciating the reasons behind them. With that in mind, the following describes

some strengths and weaknesses of each of the four types of figures:

- **NCES Figures.** The report uses Total Expenditures per Pupil for its comparisons, but it directs most criticism to the deliberately less comprehensive Total Current Expenditures per Pupil figure. Analysts use current expenditures per pupil rather than total expenditures because the figures provided are more consistent across states, across districts, and over time. They are, consequently, more comparable. Elements excluded from current expenditures are either not part of PreK-12 education (e.g., adult education), are duplicative (e.g., tuitions), or are so variable that they distort the year-to-year comparisons (e.g., construction costs).
- **Stated Public Spending per Pupil.** The report correctly notes that no school district would divide all district spending by a pupil count to produce a per-pupil spending figure. Districts often exclude “capital expenses, debt service, and health and retirement benefits” (p. 15).<sup>10</sup> . It is not, however, true that these expenses are ignored. District financial reports are prepared to withstand federal, and usually state or external, audits. Auditors care about the bottom line. Expenditures may not be in per-pupil spending, but they are available, and they are positioned in district reports with reason. Capital expenses, for example, are treated separately from other expenses because they are highly variable from year to year and because they are typically funded through long-term debt.<sup>11</sup> Far from being hidden, these expenditures are often presented in separate bond votes to draw voters’ attention to the multiyear nature of the commitment.

Many expenditures are beyond the ability of local districts and voters to change.

Debt service is the result of a binding prior commitment. Pension contributions are determined by actuaries, and districts are usually required to pay the determined amount. Special education spending is mandated by federal and state legislation. School boards structure information to draw attention to portions of the budget most subject to control by boards and district voters.

**Real Spending per Pupil.** The figure is as comprehensive as the Cato author can make it. It is also flawed by double counting. He makes a point of including both capital construction and debt service (p. 15). By far the largest difference between the stated public per-pupil figure and the report’s “Real” figure turns up in LAUSD. The “stated public” figure was \$10,053, while the “Real” figure is \$25,208. At this reviewer’s request, finance specialists at the California Department of Education were able to reconstruct the Cato figure to within \$6 as follows. They started with the 2008-09 total authorized expenditures figure for all of LAUSD: \$17,685.9 billion. They then removed a number of expenditures that duplicate or fall outside K-12 education, but retained capital construction and debt service as the author did. They divided by average daily attendance to produce a per-pupil spending figure of \$25,202.<sup>12</sup> The author’s justification for the nature of the report’s calculation is “that these are expenses borne by the taxpayer . . . and as such must be included” (p. 15). However, most capital construction expenditures are not paid with taxpayer dollars. They are paid with proceeds from bonds. Taxpayer dollars then service the debt. This is key. The cost of a house bought with a loan is not the purchase price plus the cost of the loan. For a school district, what taxpay-

ers are paying for in any year is debt service in that year. Unquestionably in the case of Los Angeles and more likely that not in some of the other comparisons, the bulk of the difference is caused by this inclusion of capital construction. A significant portion of any remaining variance would likely be explained by a district's choice to exclude debt service from spending per pupil.<sup>13</sup>

- **Estimated Private Spending per Pupil.** The figure is presented but never really discussed in the report. It is silently present in each comparison table. The apparent intent is to encourage readers to assume greater efficiency in private education. In fact, the use of a five-year-old figure, inflated to current dollars, while demanding detailed data from *public* districts underscores the different treatment here of public and private education. Setting aside the complicated issues of the differences in instructional needs between pupils served by each sector, it is interesting that the report ignores Rutgers professor Bruce Baker's recent thorough analysis of private school expenditures.<sup>14</sup>

## V. REVIEW OF THE VALIDITY OF THE FINDINGS AND CONCLUSIONS

The bulk of the report is directed toward proving a massive disparity between "stated public" spending per pupil and "real" spending per pupil. People who work in the field of education finance understand that published per-pupil figures do not include all spending on K-12 education. But the size of the gap in this analysis is incorrectly overstated by the inclusion of both capital expenditures and debt service payments.

A vital but largely unexplored assumption underlying the report is the notion that there is an appropriate cost per pupil, identifiable

at least generally by any informed voter (p. 4). In fact, the appropriate cost for educating some "average" pupil would be an artificial construct. Pupils have individual strengths and weaknesses and unique mental, physical and emotional needs. They are not distributed equally among districts. No discussion of spending per pupil can have policy relevance without some criteria for determining the appropriate cost. While these broad-stroke analyses are worthwhile, we should keep in mind their limitations.

The report starts with a defensible point. In fact, if the report had excluded capital construction from the calculation, it would still have found that many districts exclude debt service and retirement benefits and no doubt other spending in the most prominent set of figures. The analysis would, therefore, have reported a meaningful difference between the author's version of real spending and the figures most districts focus on. Of course, it makes sense if you're on a school board to concentrate on the portions of the budget you can change, so this wouldn't be evidence of anything nefarious. But depending on the policy question being asked, calculations including these additional amounts could provide a useful piece of information. The argument that voters and others should be more aware of the additional spending is not unreasonable.<sup>15</sup> Unfortunately, findings based on a spending figure including both capital construction and debt service have little validity.

## VI. USEFULNESS OF THE REPORT FOR GUIDANCE OF POLICY AND PRACTICE

The claims made about spending per pupil are distorted by the choice to examine spending in some of the most expensive areas of the country and by the double counting of capital construction and debt

service. The usefulness of the report is therefore limited. In the end, we are left with a manufactured controversy arising from a misunderstanding of the relationship be-

tween capital construction and debt service, amplified by the report's unwillingness to consider the reasoning underlying more traditionally disseminated numbers.

## Notes and References

- <sup>1</sup> Schaeffer, Adam B. (2010, March). *They Spend WHAT? The Real Cost of Public Schools*. Washington, DC: The Cato Institute. Retrieved March 29, 2010 from [http://www.cato.org/pub\\_display.php?pub\\_id=11432](http://www.cato.org/pub_display.php?pub_id=11432).
- <sup>2</sup> The National Center for Education Statistics is the primary federal entity for collecting and analyzing data related to education. It is a collaborative effort of the United States Department of Education, the Bureau of the Census, and state education agencies.
- <sup>3</sup> Capital construction produces enduring assets, but construction costs in any year can be enormous compared to other portions of the budget. It would rarely be defensible to include capital construction rather than debt service to track annual expenditures. Not all capital construction is paid with district debt service. States offer construction aid, often funded through state borrowing. There is no single, comprehensive figure that achieves the report's objective. There are many potential figures, each with advantages and disadvantages.
- <sup>4</sup> The Total Expenditures per Pupil figure is the most inclusive per-pupil spending figure generally available from the NCES. The NCES produces many subsets of total expenditures, current expenditures and total current expenditures per pupil to answer different questions. To get a sense of the variety of definitions, go to the NCES glossary at: <http://nces.ed.gov/ccd/bat/glossary.asp?letter=T>.
- <sup>5</sup> This is not the same as saying these expenditures are not reported, though. They are collected by and are available from NCES.
- <sup>6</sup> The definitive source is Alison, G.S., Honegger, S.D., and Johnson, F. (2009). *Financial Accounting for Local and State School Systems: 2009 edition* (NCES2009-325). Washington, DC: National Center for Education Statistics, Institute of Education Sciences, U.S. Department of Education.
- <sup>7</sup> See Mathis, W. J. (2009). "After Five Years, Revisiting the Cost of No Child Left Behind," in Rice, J. K. & Roellke, C., eds., *High Stakes Accountability: Implications for Resources and Capacity*, Charlotte, NC: Information Age Publishing, pp. 197-224.
- <sup>8</sup> It is clear from the notes that the report compares figures from different fiscal years for one district. There is no indication that the author saw this as a problem.
- <sup>9</sup> The figures are produced by inflating the median highest tuition figure for 2004 (the most recent available) to 2009 dollars; increasing the result to 25% to roughly account for private school spending not covered by tuition; and adjusting for per-capita income in the metropolitan area.
- <sup>10</sup> The words "health and retirement benefits" are confusing. Health benefits for employees make up the largest share of the benefits object (federal object code 200), and benefits are the largest object category in current expenditures (after salaries). These costs are reported. It is possible the author, or an editor, has confused "health and retirement benefits" with pension contributions and health benefits for retirees, which are frequently excluded.
- <sup>11</sup> The implications of the funding for capital construction are discussed at greater length in the examination of the report's "Real Public" spending figure, later in this review.
- <sup>12</sup> My thanks to Peggy O'Guin, Administrator, School Fiscal Services Division, and Loren Boone, Staff Services Manager, both of the California Department of Education, for recreating the figure. Ms. O'Guin also called to my attention the report's highly distorting use of authorized expenditures rather than estimated expenditures despite the ready availability of estimated expenditures. The figure immediately to the right on the page, estimated expenditures, is a better approximation of expected expenditure. The estimated capital funds figure is more than \$3 billion, or \$4,858 per pupil, less than authorized. *2008-2009 Superintendent's Final Budget*, Los Angeles Unified School District, Budget Services and Planning Division, p. I-44.
- <sup>13</sup> Adding half the cost of a building that will be paid for over two years to the cost of servicing a bond that will be paid over 20 years for a school that, with proper maintenance, can last indefinitely adds shock value to "real" education spending. Capital construction is not a current expense because it produces an asset that gives value over a long period. One could aggregate the total cost of interest and principal payments over the entire life of the loan. If one wanted the total cost, this could be done by discounting future payments,

perhaps by the interest rate on the debt. In any case, what taxpayers are paying for in any year is debt service in that year.

<sup>14</sup> Baker, B. (2009). *Private schooling in the U.S.: Expenditures, supply, and policy implications*. Boulder and Tempe: Education and the Public Interest Center & Education Policy Research Unit. Retrieved April 11, 2010, from <http://epicpolicy.org/publication/private-schooling-US>

<sup>15</sup> The report's assumption that this additional information will sway voters is, however, doubtful. Vermont voters are required to approve total spending (excluding educator retirement benefits), and Vermont is within the top decile in any calculation of spending per pupil. Clearly, there are other major factors in play regarding voter desires and intentions.

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