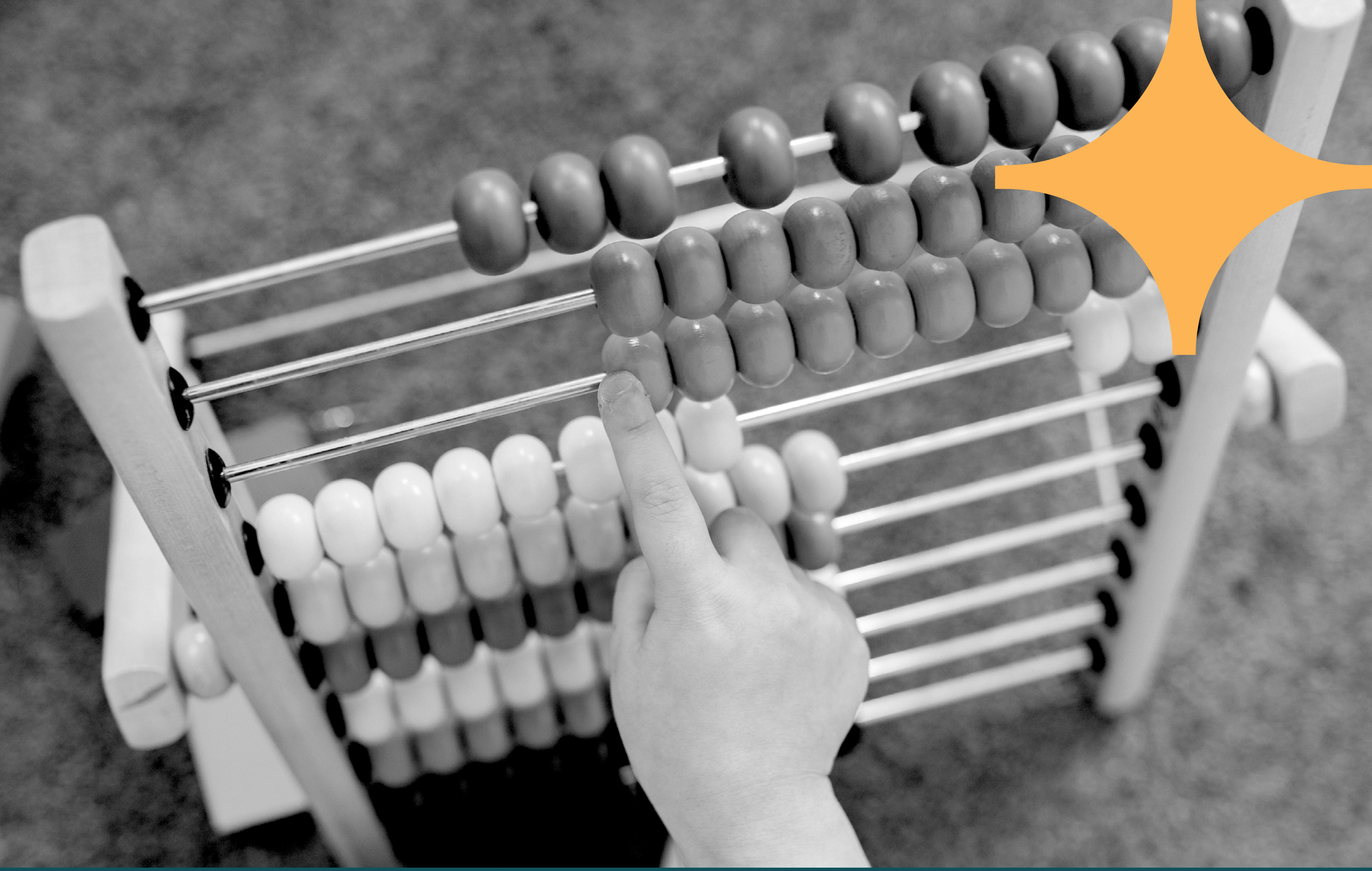

# Fortifying Funding

*How States Can Strengthen Education Finance Systems for the Future*

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Bellwether

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# Executive Summary

States are at a critical juncture as they plan for the future of their education finance systems. Public school enrollment is down in most states and is projected to continue to decline in 38 states.[1] Every region of the country is projected to experience a public school enrollment decline through 2030 due to declining birth rates, especially in the Northeast and West.[2] The possibility of an economic recession looms, and high inflation puts additional cost pressures on schools.[3] Temporary COVID-19 relief is helping to mitigate the impact of underlying fiscal problems in schools, but the federal aid expires in fall 2024.

Amid grim predictions and uncertainty, state policymakers must act. Rather than waiting for a new crisis to emerge, states can adopt policies now that would help their education finance systems weather any coming storms while keeping educational excellence and equity at the forefront.

To prepare for the future, state policymakers can learn from the past — specifically, the Great Recession and the COVID-19 Recession. Drawing on lessons learned from both time periods, we set out to answer the following questions:

- ***What lessons from past economic crises might help state policymakers and advocates prepare for the future?***
- ***How can states take this moment of heightened uncertainty to strengthen their education finance systems against future financial shocks?***
- ***How can states maintain or improve the equity of their funding systems for students and communities most in need of resources?***

This brief identifies **four key insights** from recent economic crises and recommends **state policy actions** aligned with each. These recommendations build upon one another, so states can begin by shoring up state revenue sources and build up to planning for further federal aid in the future.

A recession, a pandemic, or another unpredictable crisis is rarely something state lawmakers can control. However, how they respond to these pressures presents many policy choices and demands prioritization. Learning from the lessons of the recent past, state leaders have a responsibility and an opportunity to put policies in place to protect and equitably allocate resources for student learning, even in times of crisis. Proactive policy planning can help avoid hasty action and minimize negative effects on students and schools.

**INTERACTIVE TOOL**

To examine local, state, and federal education revenue and student enrollment trends over time in your state and nationally, visit Bellwether's interactive tool.

# Key Insights

| Insights | Takeaways | Areas for State Policy Action |
|---|---|---|
| 1. Education finance is contingent on the larger economy. | State education funding and the health of the larger economy are deeply interconnected. The revenue sources states most often rely on to fund schools (personal income and general sales taxes) are especially vulnerable in a recession. Recessions vary in length and on whom they affect most, which can shape the economic outlook for state budgets. | • Diversify and expand state education revenue sources.<br>• Build up state rainy day funds, and consider policies that enable local districts to maintain reserves. |
| 2. State education funding cuts hit districts serving high-need students the hardest. | States must balance their budgets. When states have a budget shortfall of any kind, cuts to education may be a painful necessity, given the sheer magnitude of pre-K through grade 12 spending within state budgets. Less-wealthy districts and those serving high-need students suffer greater harm when states make cuts, because they rely more on state funding. Once cuts happen, it can take years for state revenues to rebound. | • Prioritize students with greater need when cuts are made, using more equitable student-based school funding formulas.<br>• Explore a statutory minimum percentage allocation of state revenues for education.<br>• Equalize local revenues for less-wealthy districts. |
| 3. Enrollment losses affect states and districts differently. | When states lose enrollment, per-pupil revenue might increase in the short term, because there is more money to spread around. At the district level, enrollment loss usually results in state funding loss. As districts lose more students, they will look to the state to help stabilize their budgets. | • Build predictable, temporary supports for districts experiencing enrollment declines.<br>• Define enrollment for funding purposes based on student membership, not attendance, and across multiple days. |
| 4. Federal government intervention can lessen the impact of economic shocks. | Federal relief can lessen the immediate impact of economic shocks on school funding. This is especially true for districts serving high-need students. But the methods for distributing money make a big difference. If underlying state issues remain unaddressed, the effect will be to delay, but not avoid, fiscal pain. | • Do not rely on the presumption of forthcoming federal aid.<br>• Support districts to spend federal aid effectively.<br>• Invest state portions of federal aid to build stronger state systems of support. |

# Introduction

School budgets and education finance are both in a precarious moment. During the COVID-19 pandemic, public school enrollment declined nationally by nearly 3% and in some states by as much as 5%.[4] Because school funding is highly dependent on enrollment, these enrollment declines often lead to reductions in state funding for local school systems. Concerns about enrollment aren't limited to the pandemic: Birth rates in the United States are declining, and federal projections estimate that by 2030 pre-K through grade 12 enrollment across the country will decline by another 5%, with great variation across states.[5]

Districts and states are dealing with inflation and the rising costs of items like food and fuel, which also impacts the bottom line. This comes at a time when schools are using additional resources to address increased student academic and mental health needs from the pandemic.[6] And a potential economic recession in the near future could hit state budgets hard (Sidebar).[7]

Currently, $190 billion in temporary federal COVID-19 relief funding is bolstering district budgets and mitigating the impact of some of these broader fiscal issues, including declining enrollment and district budget deficits.[8] However, federal aid expires in fall 2024.

State education finance systems face significant pressure from inflation, enrollment declines, and economic trends — including a potential recession. Any of these factors could result in significant instability for schools and the students they serve. Even worse, systemically marginalized students and communities stand to lose the most if states make cuts to education funding, since districts with lower local property wealth and greater student needs are usually more reliant on state funds.[9] Reductions in education funding can have negative impacts on student outcomes, including lower graduation rates, college-going rates, and reading and math achievement, especially for economically disadvantaged students and students of color.[10]

**SIDEBAR**

**What Is a Recession?**

The National Bureau of Economic Research (NBER) defines a recession as a "significant decline in economic activity that is spread across the economy and lasts more than a few months."[11]

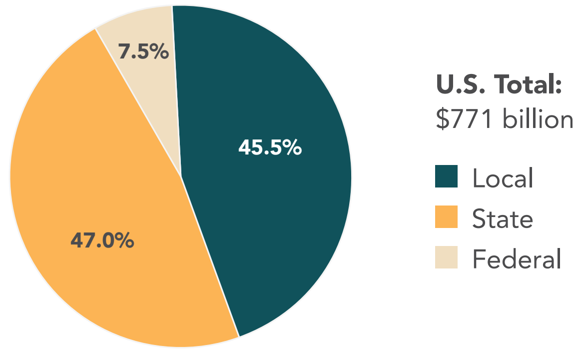
To determine whether the United States is in a recession, an NBER committee of experts uses three metrics: depth, diffusion, and duration.[12]

While each of the three criteria must be met to some degree to officially declare a recession, extreme circumstances for one measure can offset weaker indications from another.

State policy is our primary area of interest because it plays a central role in education finance equity. States are responsible for 47% of all nationwide elementary and secondary revenue ($362.4 billion) (Figure 1).[13] State policies often also govern local revenue generation, which makes up another 46% ($351 billion).[14] Federal funding normally makes up a slim share of less than 10%.[15] In 25 states, state education funding makes up 50% or more of the total (local, state, and federal) education funding (Figure 2).[16] The distribution of local, state, and federal education funding has been about the same since the 1980s.[17]

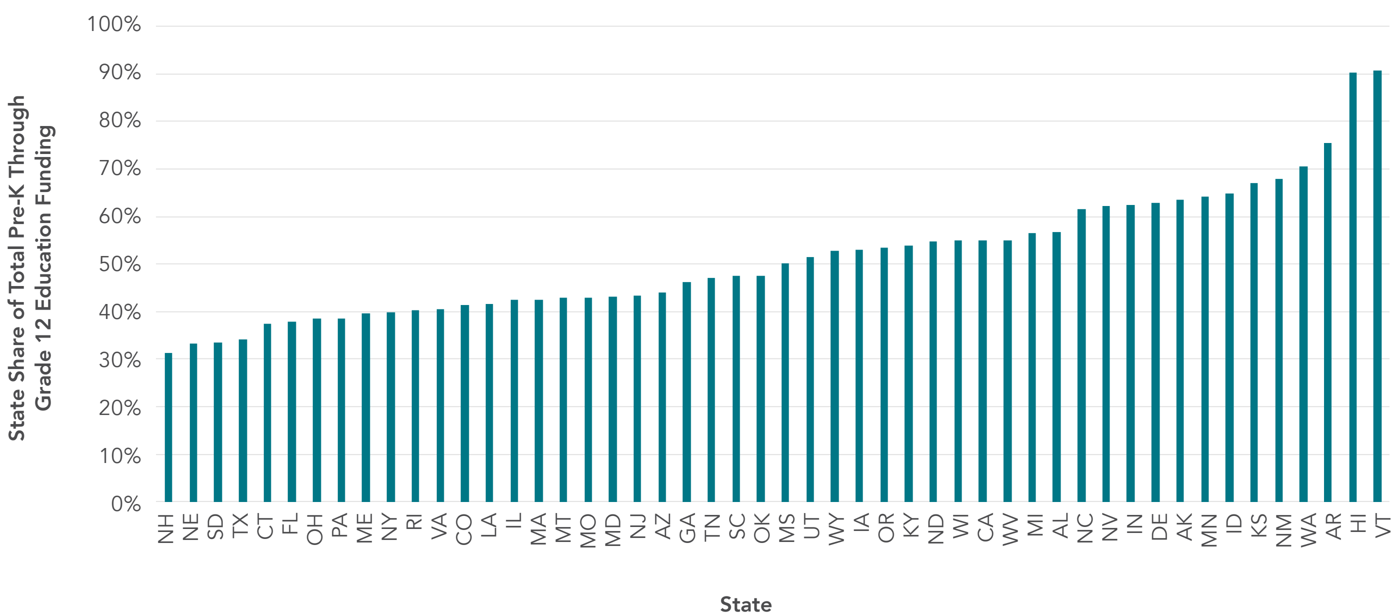
Funding for schools is typically among the top line items in any state's budget.[18] And, unlike the federal government, states have balanced budget requirements, which prohibit them from spending more than they collect in revenue.[19] When they face a revenue shortfall, reductions must be made and, usually, one of the first areas to receive cuts is education.

### FIGURE 1: REVENUE SOURCES FOR PRE-K THROUGH GRADE 12 PUBLIC SCHOOLS, 2019-20




*Source*: *"2020 Public Elementary-Secondary Education Finance Data," U.S. Census Bureau*.

### FIGURE 2: STATE SHARE OF TOTAL (LOCAL, STATE, AND FEDERAL) PRE-K THROUGH GRADE 12 EDUCATION FUNDING BY STATE, FISCAL YEAR 2020




*Source*: *"2020 Public Elementary-Secondary Education Finance Data," U.S. Census Bureau*.

State policymakers cannot control what economic shifts or shocks might come next, but they can learn and prepare based on past experiences with recessions, state budget cuts, and enrollment fluctuations. With some forewarning, now is a critical moment to strengthen state education finance policies and systems for the future.

A strong education finance system must withstand many simultaneous pressures, and state leaders must be clear on their goals when making any changes to such an important area of their state's budget. The criteria we believe are most important for policymakers to consider when building stronger and more resilient state education finance systems include:

**BALANCING BUDGETS**
*Does the policy enable state lawmakers to fulfill their mandate to balance the state budget?*

**ADEQUACY**
*Does the policy fulfill and protect the state's constitutional responsibilities to oversee an education system that can serve every child?*

**EQUITY**
*Does the policy allocate greater resources toward groups of students with greater educational needs? Does it differentiate between wealthy and less-wealthy communities to ensure that limited state dollars are used where they are needed most?*

**SUSTAINABILITY**
*Does the policy enable the state to maintain a functional education finance system in the long term, including recovery after economic downturns?*

With these criteria in mind, the two most recent past recessions provide valuable evidence and insight into what might happen in various crises. During the Great Recession, states made deep cuts to education funding to account for losses in state revenue (Table 1). In the early days of the COVID-19 pandemic, an economic recession, shifts to remote learning, and sudden drops in enrollment and attendance made central assumptions of state education finance systems suddenly inoperable and unpredictable.[20]

### TABLE 1: DEFINING RECENT RECESSIONS

| Recession | Period Range | Duration | Peak Unemployment Rate |
|---|---|---|---|
| The Great Recession[21] | December 2007 to June 2009 | 18 months | 10% |
| COVID-19 Recession[22] | February 2020 to April 2020 | 2 months | 14.7% |

In this brief, we identify four key education finance equity insights from the Great Recession and the COVID-19 Recession for state policymakers and recommend potential policy actions in response to each, explained in greater detail below (Table 2).

Each of these insights and actions builds cumulatively upon the last. First, states should prioritize strong streams of revenue and foundational fiscal stability. Then, states should build policies to prioritize students with the greatest needs when cuts are unavoidable. In response to enrollment loss, states can create policies to stabilize districts by adjusting their programs and budgets to changing enrollment patterns. And finally, if federal aid becomes available in future economic crises, states can do more to leverage that aid effectively toward educational and fiscal recovery.

### TABLE 2: SUMMARY OF INSIGHTS AND STATE POLICY ACTIONS

| Insights | Areas for State Policy Action |
|---|---|
| 1. Education finance is contingent on the larger economy. | • Diversify and expand state education revenue sources.<br>• Build up state rainy day funds, and consider policies that enable local districts to maintain reserves. |
| 2. State education funding cuts hit districts serving high-need students the hardest. | • Prioritize students with greater need when cuts are made, using more equitable student-based school funding formulas.<br>• Explore a statutory minimum percentage allocation of state revenues for education.<br>• Equalize local revenues for less-wealthy districts. |
| 3. Enrollment losses affect states and districts differently. | • Build predictable, temporary supports for districts experiencing enrollment declines.<br>• Define enrollment for funding purposes based on student membership, not attendance, and across multiple days. |
| 4. Federal government intervention can lessen the impact of economic shocks. | • Do not rely on the presumption of forthcoming federal aid.<br>• Support districts to spend federal aid effectively.<br>• Invest state portions of federal aid to build stronger state systems of support. |

# Insights From Recent Recessions and Recommendations for State Action

To prepare for the future, state policymakers can learn from the past — specifically, the Great Recession and the COVID-19 Recession. Drawing on lessons learned from both time periods, this section provides an overview of the **four key insights** we identified, as well as **state policy actions** aligned with each insight.

**INSIGHT 1**

## *Education finance is contingent on the larger economy*

**TAKEAWAYS**

State education funding and the health of the larger economy are deeply interconnected. The revenue sources states most often rely on to fund schools (personal income and general sales taxes) are especially vulnerable in a recession. Recessions vary in length and on whom they affect most, which in turn can shape the economic outlook for state budgets.

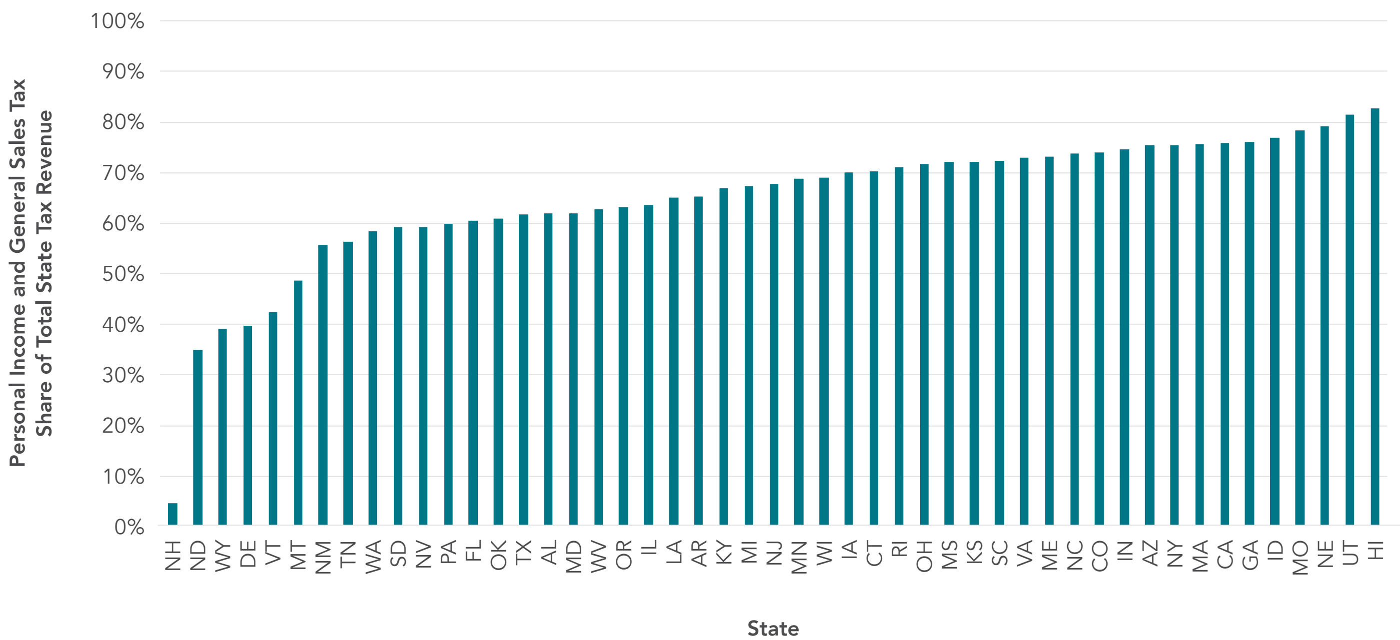
To better understand why and how recent recessions have affected state education revenues, it's important to understand the larger economic ecosystem in which education finance operates. States fund state programs and priorities, including pre-K through grade 12 education, primarily with state-collected tax revenues. The two largest sources of state tax revenue, and by extension, state funding for education, are individual income tax and general sales tax.[23] In fiscal year (FY) 2021[24], tax collections made up about half of state government revenue, and more than two-thirds of that came from individual income tax (40%) and general sales taxes (29%).[25] At the state level, 44 states receive more than half of their total tax revenue from income and general sales taxes (Figure 3).[26]

These two revenue streams fluctuate depending on the health of the economy in a specific state and nationwide. For example, when unemployment rates increase, households have less spending power and companies sell fewer products. These circumstances translate to lower personal income tax and general sales tax revenue collection, which usually leads to budget deficits and cuts to state programs.

But not all recessions have the same effects on state revenues, and by extension, education. During the Great Recession, in the two-year period between the fourth quarter in 2007 and 2009, individual income tax revenue collections declined by 6.2% ($59.5 billion to $55.9 billion), and general sales tax revenue collections went down by 8% ($61.2 billion to $56.3 billion).[27] Even though the Great Recession technically ended in June 2009, state budgets felt the adverse impacts for a few years after. In total, it's estimated that states missed out on at least $283 billion in tax revenue from FY09 to FY12.[28]

On the other hand, the COVID-19 Recession and its negative impact on state economies was brief. In fact, between the second quarters of 2020 and 2021, state individual income tax collection increased by 76% ($94.3 billion to $166.2 billion), and general sales tax revenue went up by 40% ($81.1 billion to $113.5 billion).[29] During FY21 alone, state surpluses were so great that they collectively grew their state reserves by $37.7 billion, an increase of 50% from the year prior.[30]

## FIGURE 3: PERSONAL INCOME TAX AND GENERAL SALES TAX SHARE OF TOTAL STATE TAX REVENUE BY STATE, FISCAL YEAR 2021




***Source***: *"2021 Annual Survey of State Government Tax Collections," U.S. Census Bureau*.

***Why did these two recessions have different impacts on state tax revenue?***

The two recessions were caused by very different factors. While the Great Recession was caused by a banking crisis and the collapse of the U.S. housing market, the COVID-19 Recession was caused by large-scale restrictions in response to public health concerns.[31] The disparate nature of the two recessions provoked different government interventions and impacted different sectors of the workforce, affecting state budgets differently.

During the Great Recession, the American Recovery and Reinvestment Act (ARRA), a $787 billion fiscal stimulus package, came 13 months after the start of the recession and one month after President Obama took office.[32] It provided direct aid to state and local governments with few strings attached.[33] Funds helped address state budget shortfalls. However, most of the aid expired in 2010, when state budget deficits peaked.[34] As a result, state and local employment declined, and state and local governments' gross domestic product contributions — a key measure of economic health — saw slow growth for years after the Great Recession was technically over.[35]

The response to the COVID-19 Recession from Congress was much quicker and larger, not only to address the economic impacts of the recession, but also to enable a more robust response to the public health and educational effects of the pandemic. On March 27, 2020 — only a few weeks after governors around the country declared states of emergency — the federal government passed a $2.2 trillion relief package, the Coronavirus Aid, Relief, and Economic Security (CARES) Act.[36] Two more federal relief packages followed in December 2020 and March 2021 for a total of $5 trillion of relief funding that could be used through September 2024.[37] This immediate federal relief bolstered state and local budgets and helped to stave off deep funding cuts.

The two recessions' differing impacts on the workforce also shaped state revenues. During the Great Recession, the unemployment rate rose from 5% to 10%.[38] Most of these losses were concentrated among middle-wage jobs, which were slow to recover.[39] Many middle-class workers who lost their jobs in the recession took lower-paying jobs, impacting income and economic buying power for years after the Great Recession ended. Total employment did not rebound to pre-Great Recession levels until April 2014,[40] and unemployment did not return to pre-Recession rates until December 2017.[41]

The COVID-19 Recession, on the other hand, did not affect middle-class jobs in the same way. The unemployment rate peaked at 14.7% in April 2020, with the highest rates of unemployment among low-wage earners in the leisure and hospitality industries.[42] Expanded unemployment benefits initially provided substantial support to these unemployed lower-wage workers and raised their purchasing power above what they experienced while working. Consumer spending, in turn, went up and bolstered states' sales tax revenues.[43] The unemployment rate returned to pre-COVID-19 Recession rates in April 2022.[44]

## *Education finance is contingent on the larger economy*

### AREAS FOR STATE POLICY ACTION

State and local revenues make up the vast majority of school funding. Two of the most common and largest revenue streams state governments rely on to fund education are personal income tax and general sales tax, which are especially volatile during a recession, as people are more likely to lose their jobs and dial down purchasing. Recent examples show various ways recessions impact state budgets and different subsets of the economy, which is a reason to shore up state education finance at a larger scale.

State policymakers should take action to strengthen their education finance systems and build greater resiliency before economic pressures force hasty and harmful cuts.

**1. On the broadest scale, states should seek to diversify and expand their education revenue sources to better weather economic pressures:**

**1a. Explore a state-level property tax.**

The most ambitious state plan for statewide education revenue stability would be to institute a state-level property tax, replacing local property taxes' traditional role in funding local schools, and redistribute this funding in combination with other state sources of revenue via the state education funding formula. Property taxes tend to be more stable than income or sales tax. Not only would this improve equity for lower-wealth districts, but it would make state revenues for education less vulnerable to economic downturns.[45]

Vermont is one of a handful of states that have this model, which often faces steep political challenges.[46] One big potential barrier is that a state property tax might depress overall education revenue, because local voters are not incentivized to approve property tax increases that won't necessarily directly benefit local schools. However, a pooled, uniform state-level property tax, combined with other sources of state revenue, would provide a more stable foundation for equitable, adequate distribution of funds to schools during economic downturns or other sudden shocks.[47]

**1b. Create or expand new revenue streams.**

Many states have also sought to create new, dedicated revenue streams for education. One way is through targeted personal income tax increases (also known as the "millionaires tax") on the highest earners in the state, with revenue earmarked for education or other public services. Currently, nine states have a millionaires tax.[48] Most recently, in the 2022 midterm election, Massachusetts voters approved amending the state constitution to create a millionaires tax on income above $1 million, which is projected to raise roughly $2 billion in funds for pre-K through grade 12 education, higher education, and transportation.[49]

As explained above, different recessions have had varying effects on different subsets of the economy. A future recession might hit high earners hardest and impact revenue from a millionaires tax. But, in the meantime, expanding state revenue with education in mind could help states achieve greater equity and adequacy throughout their school finance systems, as well as build up rainy day funds.

**2. Build up state rainy day funds, and consider policies that enable local districts to maintain reserves.**

States should build up their rainy day funds.[50] States with a surplus this year could also use a portion of their surplus funding to reserve funding for future education expenses. For example, in his 2022-23 budget, Colorado Gov. Polis proposed allocating $300 million in one-time surplus funding into the state's education general fund, to protect the state's education funding against cuts if there is a recession.[51]

States should also consider guidance or policies addressing local school systems' ability to build up reserve funds and ensure those policies enable districts to plan effectively to manage short-term financial shocks.

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On the broadest scale, states should seek to diversify and expand their education revenue sources to better weather economic pressures.

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# *State education funding cuts hit districts serving high-need students the hardest*

**TAKEAWAYS**

States must balance their budgets. When states have a budget shortfall, cuts to education may be a painful necessity, given the size of pre-K through grade 12 spending as a proportion of most state budgets. Once cuts happen, it can take years for state revenues for education to return to previous levels. Less-wealthy districts and those serving high-need students suffer greater harm when states make cuts, because they rely more on state funding.

Because pre-K through grade 12 education makes up a large share of overall state spending, when states face a budgetary shortfall, school budgets are vulnerable to cuts. In a recession, state revenues take a harder hit and may take many years to recover. State-level cuts to education funding tend to have a disparate impact on districts with less property wealth and/or large populations of high-need students, because these districts rely more on funding support from the state.

This is partly by design. Many states provide additional funding to districts that serve students with a greater need for educational resources — English learners, students with disabilities, and economically disadvantaged students — and differentiate funding based on local ability to generate revenue from property taxes.[52] This type of design can promote equity and help ensure that state funding aligns with students' educational needs by sending more state resources strategically to schools and districts that need it most. But that also means that across-the-board cuts to state funding hit these districts the hardest. For example, a 5% across-the-board reduction in state education funding may sound equitable on its face, but that percentage reduction has a more severe impact on a district that relies on the state for the majority of its total education funding, compared with a district where local property taxes fund a larger proportion of the overall education budget.

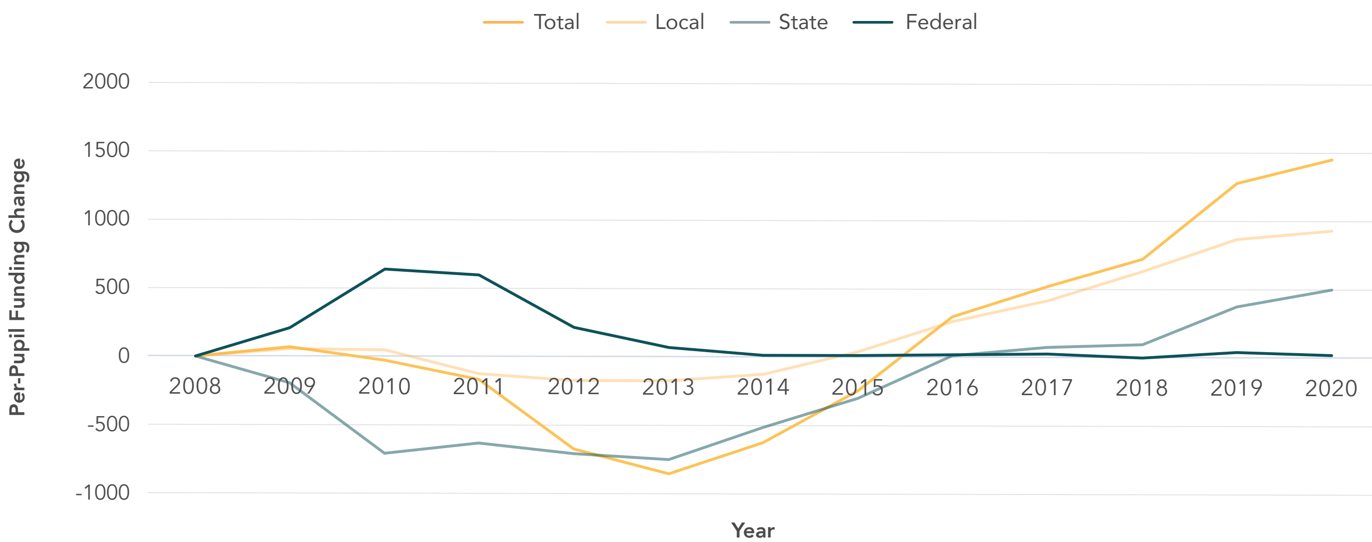
In the Great Recession, state cuts to education were particularly large. State education revenues fell from $341.3 billion in FY08 to $305.9 billion in FY10, a decrease of 10%.[53] Declines in funding corresponded with reductions in school staff. From FY08 to FY13, employment in public schools across the country declined by nearly 300,000, representing a 4% decrease in employment.[54]

Total education revenue was initially stable at a national level because federal aid temporarily made up for state cuts (Figure 4). However, once federal funds expired in FY11, total per-pupil funding dipped below FY08 levels and didn't recover until FY16. As late as the 2019-20 school year, 16 states were still below their state's pre-Great Recession overall education revenue levels.[55]

Cuts varied by state. From FY08 to FY10, 14 states saw a decline in their total education revenues (local, state, and federal), while 39 states cut state education revenues (Figure 5).[56] Twenty-one states cut their education funding by 10% or more.[57]

State cuts did not hit every district equally or equitably. During the Great Recession more affluent districts saw a total per-pupil revenue decline of $700, while high-poverty districts saw a total per-pupil revenue decline of $900 in education funding.[58] Isolating the effects on state-level revenue, it's estimated that high-poverty districts lost between $1,000 and $1,500 per pupil in state education funding, compared to only a $500 drop in per-pupil state education funding for more affluent districts.[59] This was partly because many state legislatures made flat percentage cuts to their state education funding.

### FIGURE 4: NATIONAL PER-PUPIL FUNDING CHANGES BY REVENUE SOURCE COMPARED WITH FISCAL YEAR 2008




*Source*: *"Public Elementary-Secondary Education Finance Data," U.S. Census Bureau, 2008-2020*.

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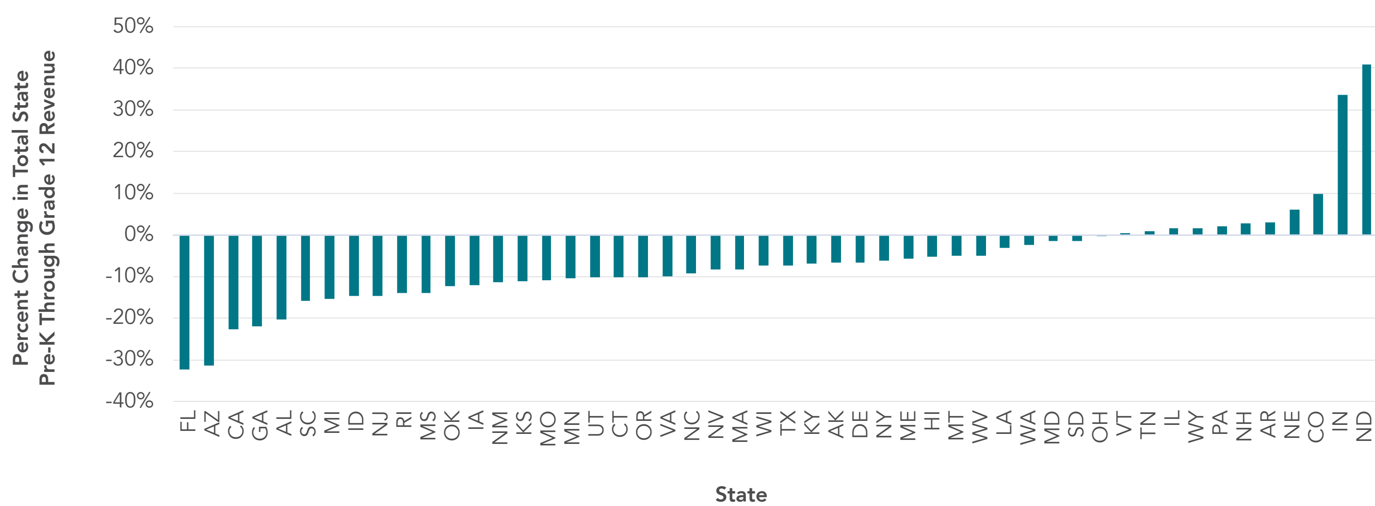
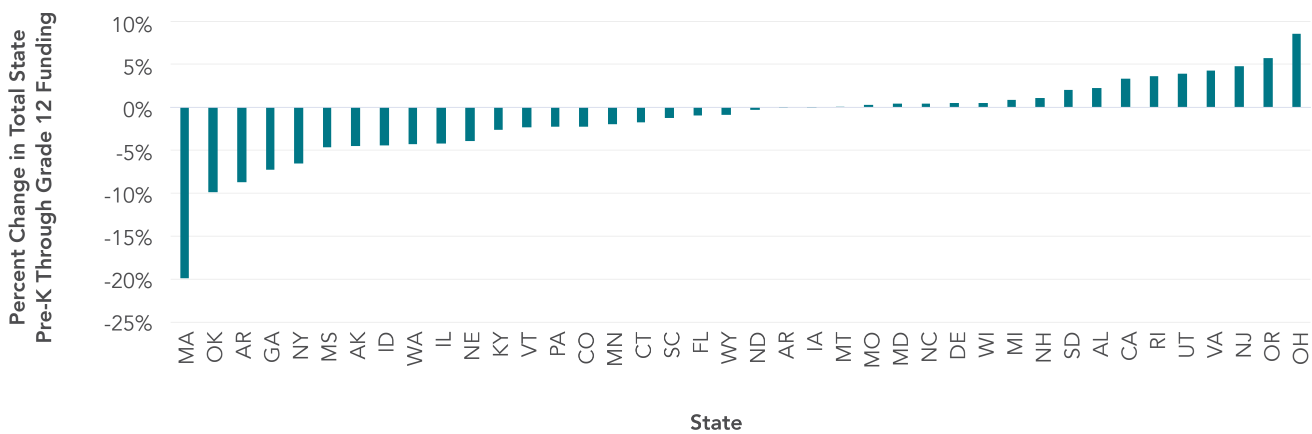
### FIGURE 5: PERCENT CHANGE IN TOTAL STATE PRE-K THROUGH GRADE 12 REVENUE BY STATE, FISCAL YEAR 2008 TO 2010




*Source*: *"Public Elementary-Secondary Education Finance Data," U.S. Census Bureau, 2008 and 2010*.

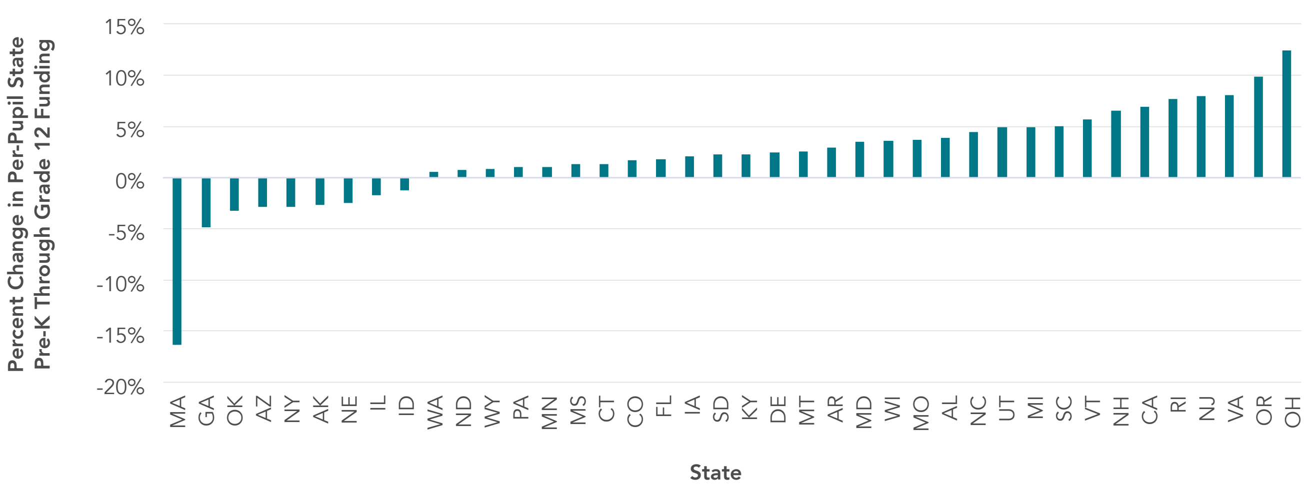
Across-the-board state education cuts disproportionately affect less-wealthy districts that rely on state funding for a greater share of their budgets and cannot generate local funds as easily. These districts also tend to serve more students in poverty.[60] State cuts to education during the Great Recession were associated with an increase in achievement gaps at a district level based on race and wealth.[61] A similar pattern was feared during the COVID-19 Recession. However, revenues in many states bounced back more quickly than forecasted, helped along by federal stimulus. Many states bracing for cuts shifted to plans for spending surpluses.[62] Preliminary data from 40 states found that from FY20 to FY21, overall pre-K through grade 12 education revenues (local, state, and federal) increased from \$654.5 billion to \$662.4 billion.[63] During that same period, state revenues declined slightly, by 1.1%, from \$311 billion to \$307.5 billion. While 18 states had an increase in their total state education revenues, 31 states saw an increase on a per-pupil basis (Figure 6; Figure 7).[64]

**FIGURE 6: PERCENT CHANGE IN TOTAL STATE PRE-K THROUGH GRADE 12 FUNDING BY STATE, FISCAL YEAR 2020 TO 2021**




*Source*: *"Public Elementary-Secondary Education Finance Data," U.S. Census Bureau, 2020 and 2021*.

**FIGURE 7: PERCENT CHANGE IN PER-PUPIL STATE PRE-K THROUGH GRADE 12 FUNDING BY STATE, FISCAL YEAR 2020 TO 2021**




*Source*: *"Public Elementary-Secondary Education Finance Data," U.S. Census Bureau, 2020 and 2021*.

# *State education funding cuts hit districts serving high-need students the hardest*

## AREAS FOR STATE POLICY ACTION

The actions above to expand state revenues might help states avoid or lessen budget shortfalls. And shifting to a statewide property tax could eliminate disparities in local revenue that make lower-wealth, high-need districts budgetarily vulnerable. But cuts to education might still be an unavoidable, painful step to balance state budgets. In past recessions, too many states were slow to rebuild their investments in education even after the recession ended. When cuts are unavoidable, states should prioritize equity for students and structure their education finance systems for less impact on vulnerable students and a faster recovery.

**1. Prioritize students with greater need when cuts are made, using more equitable student-based school funding formulas.**

When states made cuts in the recent past, they often did so with percentage-based cuts that were consistent across districts. This equal approach may seem fair on its face, but it disproportionately affects students with greater educational needs, including low-income students, students with disabilities, and English learners, who are more likely to live in districts that rely on state funding for a greater share of their overall budget.[65] States should instead structure their education funding formulas to formalize a commitment to equity based on student needs. This can provide a roadmap for making cuts, when necessary, in a more equitable way.

The most transparent and equitable state education funding formula in this situation is a weighted, student-based formula, which most states already use.[66] This model starts with a constant base amount for every student and then provides additional funding through weights applied for students with additional educational needs, such as English learners, economically disadvantaged students, and students with disabilities.[67]

Compared to other formula types, a weighted, student-based formula provides a straightforward roadmap for equity when state funding reductions are necessary. For example, if a state cuts the base amount per-pupil in a weighted, student-based funding formula, the weights maintain the system's relative emphasis on low-income students, English learners, and students with disabilities, whereas percentage-based cuts do not.

**2. Explore a statutory minimum percentage allocation of state revenues for education.**

States might also explore a statutory minimum percentage commitment of their total revenue to education. That way, whether state revenues grow or shrink, the states will set a minimum bar for education spending as a percentage of their total budget. They are free to exceed this bar at any time, but this may help protect some education revenues in times of shortfall and ensure that education gets a fair share of revenue in a surplus. This is a relatively new idea that some states are exploring. Policies like this might aid in educational recovery after an economic shock and avoid the long lag in state education spending that many states saw after the Great Recession.

**3. Equalize local revenues for less-wealthy districts.**

If a statewide property tax is infeasible, the second-best option to aid less-wealthy districts through an economic downturn would be a highly equalized local tax. These policy measures aim to keep local property taxes in the system but provide extra revenue generation power to less-wealthy districts. Some states, like Georgia and Texas, have policies that provide extra revenue to districts in communities with lower wealth, which guarantees a minimum level of revenue-generating power for every district.[68] However, these kinds of state supplements might be vulnerable to budget cuts in a recession. Other states mandate that a portion of any local revenue raised above formula expectations by wealthier districts be put into the state system and reallocated.[69]

# *Enrollment losses affect states and districts differently*

**TAKEAWAYS**

When states lose enrollment without a commensurate loss in tax revenue, per-pupil revenue might increase in the short term, because there is more money to spread around. At the district level, enrollment and state funding are more closely linked, unless states implement a hold harmless policy. If districts lose students and funding, they will look to states to stabilize their budgets.

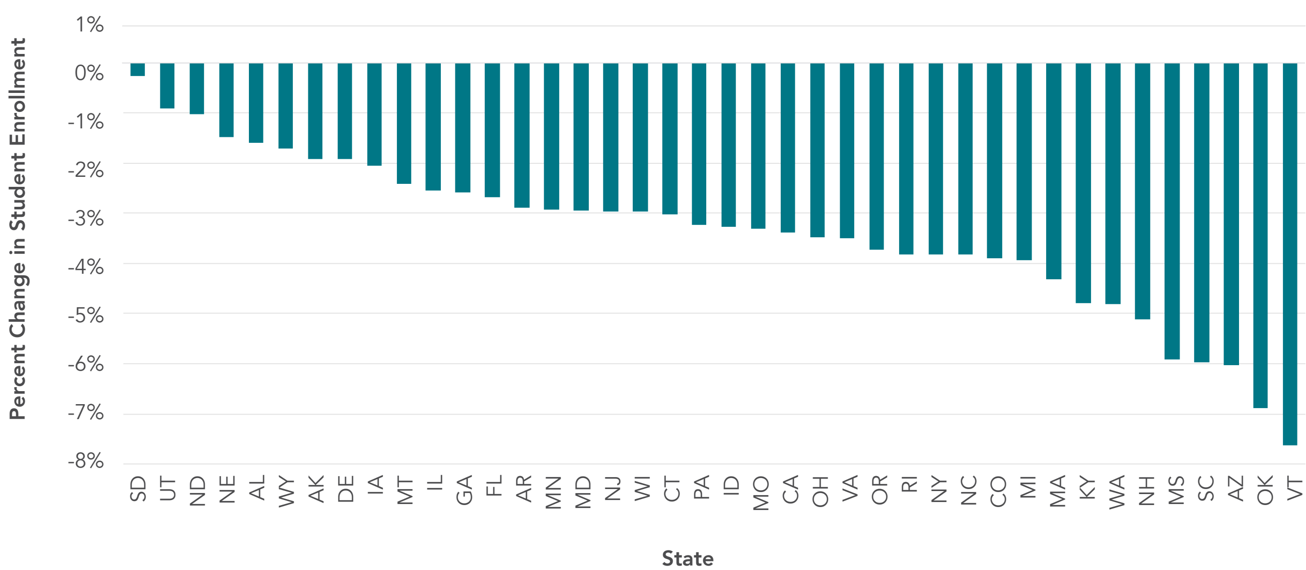
Enrollment shifts affect education budgets very differently at the state and local levels. If student enrollment falls at a state level, that doesn't necessarily mean there will be cuts to education funding. Rather, the state could opt to allocate funding more generously or equitably among fewer students. However, a district with shrinking enrollment would typically receive less state education funding through state funding formulas, which are fundamentally driven by student enrollment, unless the state makes some kind of exception.

Per-pupil funding data from the Great Recession and the initial years of the COVID-19 pandemic show how state-level enrollment and state education funding aren't necessarily linked.

**During the Great Recession**, fewer than half of states experienced declines in enrollment, while the rest either stayed flat or saw increases. Even though enrollment was relatively stable, 40 states saw a reduction in their state pre-K through grade 12 per-pupil education funding.[70]

**During the COVID-19 Recession and pandemic (2019-20 and 2020-21 school years)**, pre-K through grade 12 enrollment dropped by 2.5%.[71] Every state saw a decline in student enrollment (Figure 8).[72] And yet, 31 states saw an increase in their per-pupil state funding, and 18 states had an overall increase in state education revenues.[73]

**FIGURE 8: PERCENT CHANGE IN STUDENT ENROLLMENT BY STATE, FISCAL YEAR 2020 TO 2021**




***Source***: *"Public Elementary-Secondary Education Finance Data," U.S. Census Bureau, 2020 and 2021*.

There are various reasons for the steep enrollment decline during COVID-19, including pandemic-related closures of in-person schools,[74] and parents choosing to home-school, enroll in private school, and/or delay enrollment of kindergarten students.[75] These declines erased a decade of public school enrollment gains and placed overall enrollment slightly below pre-K through grade 12 from 2010.[76]

Enrollment declines did not translate into funding declines at the state level, or in some cases at the district level. In anticipation that COVID-related shocks to attendance and enrollment would be short-term, 22 states instituted hold harmless policies to temporarily freeze changes to a district's state education revenue based on enrollment.[77] With fewer students, strong state revenue forecasts, and additional federal support, states had sufficient funding to support a hold harmless provision and make additional investments. Most of the hold harmless policies expired after the 2021-22 school year.[78]

Even short-term hold harmless provisions come at a cost. For example, in September 2020 the North Carolina state legislature passed a hold harmless provision that cost the state $314 million.[79] Hold harmless policies may also prompt districts experiencing longer-term enrollment declines or budgetary problems to delay tough but necessary budgetary decisions to keep their districts solvent in the future.[80]

## *Enrollment losses affect states and districts differently*

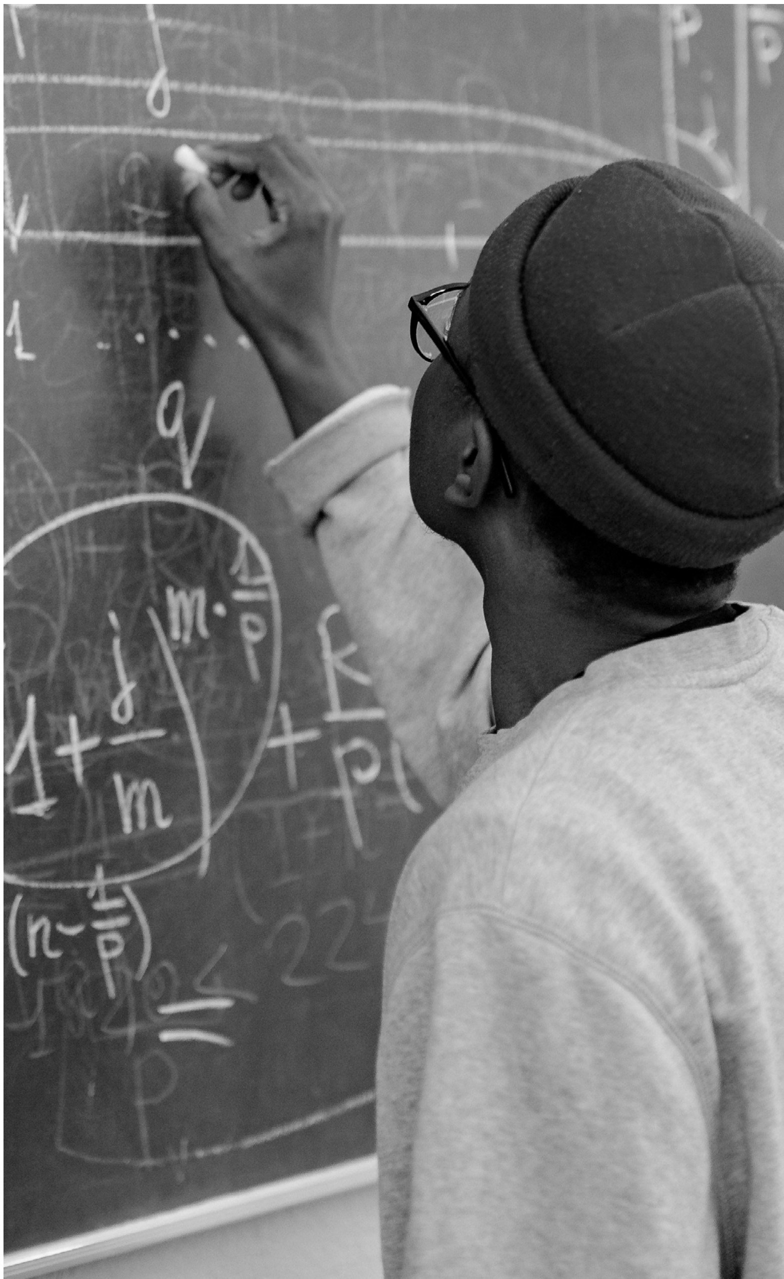
### AREAS FOR STATE POLICY ACTION

**1. Build predictable, temporary supports for districts experiencing enrollment declines.**

As hold harmless policies expire, economic forecasts change, and student enrollment continues to decline, districts will lean on states to avoid or mitigate drastic and unpopular actions like mass school consolidation or staff layoffs.

States can build greater stability in district budgets to withstand periods of temporary stress or adjust for longer-term enrollment declines through various measures. For example, some states account for fluctuations in enrollment by averaging over multiple years or using the highest enrollment number within a certain number of years when determining state funding.[81] States can also temporarily limit how much state funding a district can lose annually due to enrollment declines.

These safeguards give time and a measure of predictability to districts as they adjust to long-term enrollment declines or weather a temporary fluctuation in enrollment. Ideally, districts take this time to right-size their budgets and consolidate programming if needed.



It is imperative, though, that states do not permanently subsidize districts for students they no longer serve. When temporary hold harmless policies become permanent, they undermine the purpose of state school funding formulas and ultimately drain resources from students in districts that may be growing or have greater needs. And districts that delay facing budgetary realities may eventually be forced to make more drastic decisions that can adversely impact students.[82]

**2. Define enrollment for funding purposes based on student membership, not attendance, and across multiple days.**

Another way states can build equity into their finance systems for times of stress is to define enrollment for funding purposes based on student membership, not attendance. Most states fund their schools based on student enrollment, but six states still use an attendance-based metric to determine funding (Table 3).

Attendance measures are more unstable than enrollment, which became clear during COVID-19 virtual learning. Attendance metrics also disadvantage districts serving a high number of economically disadvantaged students, who are more likely to be chronically absent.[83] States should also base their enrollment count across several days rather than just a single "count day," which could unduly influence how schools treat transfer students. Currently, 12 states use a single day to count students for education funding purposes (Table 3).

The most equitable and financially stable student count policy is a membership average, which can also be called an average daily membership (ADM) or an average daily enrollment policy. Twenty-three states currently use an ADM policy (Table 3).[84] Funding based on ADM is also less biased against districts serving high proportions of economically disadvantaged students and acknowledges that districts must be ready and resourced to serve every enrolled student at any given time.

**TABLE 3: TYPICAL STUDENT COUNT POLICIES**

| Student Count Policy | Overview |
|---|---|
| Membership Average (23 states) | Also known as the average daily membership or average daily enrollment, it's calculated by the average number of children enrolled in each district for most or all of the year. The average can be based on the previous or current school year. States can also periodically update the membership average throughout the year or reconcile budgeted estimates with actuals at the end of the year.[85] |
| Attendance Average (Six states) | Calculated by the average number of children in attendance each day for all or most of the school year. States may account for excused absences.[86] |
| Multiple Counts (Nine states) | States collect enrollment or attendance counts on two or more days annually, typically in the fall and the spring. The average of the count days is taken and then the funding allocations are adjusted as needed.[87] |
| Single Count (12 states) | States collect student enrollment or attendance from a single day, usually in the fall, as the student count for the entire year. This point-in-time policy does not make midyear adjustments, so if a district gains or loses students, its funding won't change.[88] |

# *Federal government intervention can lessen the impact of economic shocks*

**TAKEAWAYS**

Federal relief can lessen the immediate impact of economic shocks, like a recession, on school funding. This is especially true for districts serving high-need students. But the methods for distributing money and the timeline for spending it make a big difference. And if underlying budget deficits and inadequate, inequitable state formulas remain unaddressed, the effect will be to delay, but not fully avoid, fiscal pain.

Normally, the federal government provides a relatively small proportion of pre-K through grade 12 education funding (7.5% in FY20).[89] During the last two recessions, the federal government provided relief packages for education that ran through states to school districts (Table 4). In both cases, federal aid was meant to prioritize districts that serve more economically disadvantaged students and counteract potential state cuts. However, this intention was not fully achieved. During the Great Recession, the ARRA allocated $48.6 billion for state education systems to sustain education funding during the economic downturn (Table 4).[90] Federal guidelines mandated that states distribute funds through their respective education funding formulas. There was an assumption that this distribution would be relatively equitable, since state funding formulas tend to distribute more aid to districts with lower property wealth and more low-income students.[91] However, the federal funding was not enough to fully address deep cuts to state funding which, as already discussed, had adverse impacts on districts serving more low-income students.

**TABLE 4: OVERVIEW OF U.S. EDUCATION PROVISIONS IN FEDERAL RELIEF LEGISLATION DURING THE GREAT RECESSION AND THE COVID-19 RECESSION**

| Legislation | Date Signed by President | Date Must Be Spent By | Education Funding |
|---|---|---|---|
| American Recovery and Reinvestment Act (ARRA)[92] | Feb. 17, 2009 | Sept. 30, 2010 | $48.6 billion |
| Coronavirus Aid, Relief, and Economic Security (CARES) Act[93] | March 27, 2020 | Sept. 30, 2022 | $13.5 billion |
| Coronavirus Response and Relief Supplemental Appropriations (CRRSA) Act[94] | Dec. 27, 2020 | Sept. 30, 2023 | $54.3 billion |
| American Rescue Plan (ARP) Act of 2021[95] | March 11, 2020 | Sept. 30, 2024 | $122.7 billion |

More than a decade later, during the COVID-19 Recession and pandemic, federal aid was very different. In total, about $190 billion was allocated to K-12 schools through the Elementary and Secondary School Emergency Relief (ESSER) Fund across multiple pieces of legislation (Table 4). ESSER more than tripled ARRA allocation for K-12 education and more than doubled the baseline level of federal K-12 funding.[96]

The context of federal aid under ESSER is very different from the context of the Great Recession, in that ESSER sought to address not only an economic crisis but also a public health crisis that had a severe impact on schools and student learning environments. The effects of the pandemic on students, schools, and educators will be felt for years to come.

Federal ESSER funding was meant to address economic impacts of the COVID-19 Recession, but it was also meant to help districts create safer in-person learning environments, retain educators, increase access to virtual learning when schools were closed, and address the negative academic and social-emotional impact of the pandemic on students. Under ARP, districts must use at least 20% and states must use at least 5% of their ESSER III funding to address learning loss.[97]

States must distribute the majority of ESSER funds based on districts' Title I allocations, the formula by which the federal government distributes aid for districts serving low-income students. This formula favors districts serving high numbers or high percentages of students from low-income families.[98] Although the Title I formula is flawed,[99] it's a more reliable and consistent way of distributing funds with an emphasis on economically disadvantaged students than individual state formulas.

Data from the 2021-22 school year is not fully available, and the 2022-23 school year is still unfolding, but data so far shows disconnects between enrollment and district budgets. While ESSER and temporary state hold harmless provisions have bolstered district budgets, enrollment has fallen precipitously in many districts and states, with the pandemic deepening the longer-term trend of birth rate decline. An analysis of 118 of the country's largest districts found that district budgets have grown by more than 16% over the past two years.[100] Simultaneously, among the 10 largest school districts in the nation, enrollment has dropped by nearly 6%.[101] Federal ESSER funding provides temporary relief to many districts, but when it expires in September 2024, districts may face fiscal cliffs even steeper than those that occurred after the Great Recession.

## *Federal government intervention can lessen the impact of economic shocks*

### AREAS FOR STATE POLICY ACTION

**1. Do not rely on the presumption of forthcoming federal aid.**

In the past two decades, federal aid was a critical lifeline to schools during economic and public health crises. Federal funds helped balance declines in state revenue, cushioned districts experiencing declining enrollment, and enabled districts to invest in academic support even amid fluctuating state budgets. Federal resources have been particularly important for districts serving low-income students, which are hit hardest by state budget cuts.

Nevertheless, political gridlock in Congress and recurring federal budgetary shutdowns should clearly demonstrate that emergency federal aid is never guaranteed, no matter how severe the need. There are no guarantees of sufficiency or timing in federal aid once it arrives. If temporary aid is used to fund essential school services and staff positions, districts will face a potentially disastrous fiscal cliff once aid expires — and turn to state governments for help.

State leaders should never bank on the possibility of federal aid and should instead focus on the policies under their control. If states build greater equity, adequacy, and sustainability in their own education finance systems, federal aid can be used more effectively to support and invest in students, instead of acting as a Band-Aid over deeper fiscal woes.

**2. Support districts to spend federal aid effectively.**

When considering the short window of remaining time to spend pandemic-relief funds, or planning for a future recession, states should provide clear guidance to districts on how to use one-time funds equitably and effectively. The guidance should include examples of allowable uses of funding that address district needs while avoiding recurring spending commitments.[102] States might also help districts achieve economies of scale and choose high-quality vendors by opting into resources and models that have been pre-vetted by the state.

Districts should avoid using one-time funding to backfill preexisting budget deficits or leave enrollment losses unaddressed. In cases of longer-term enrollment decline, states should enable districts to make tough programming and budget decisions to adjust to their fiscal reality while prioritizing the educational needs of students.

States should also provide models and tools for districts to distribute funding equitably among schools. For example, rather than providing the same tutoring program across all schools, a district might give targeted support to schools based on patterns of performance or enrollment. Or, rather than distributing aid funding on an equal per-pupil basis, districts could tier allocations to schools based on student and community needs.[103]

**3. Invest state portions of federal aid to build stronger state systems of support.**

If states are given the flexibility to spend a portion of future federal aid, they should think carefully about how to invest these funds after critical budget shortfalls are addressed. Federal aid might be able to address long-term state problems in need of investment and infrastructure. Although options will be constrained by the allowable expenditures in any federal relief legislation, examples of the types of investments to consider include updating data systems, improving reporting, and addressing long-standing pension debts. Funds toward these issues might not grab headlines, but they could enable greater government transparency, fiscal stability, and agency efficiency.

# Conclusion

States and districts are grappling with declining student enrollment and its impact on school budgets and state funding systems. Evidence is stacking up that another recession could be on its way, while schools are still working to recover from the profound effects of the COVID-19 pandemic on students and communities. Recent recessions showed how systemically marginalized students and communities were hurt most when states made hasty cuts or enacted policies in moments of crisis. Based on knowledge gained in the past, states can work to stabilize and strengthen their education finance systems against various future possibilities.

State policymakers must do the difficult work to balance budgets, protect educational adequacy and equity, and ensure functional stability for school districts. By proactively enacting structural and process improvements, states can protect students' educational futures.

Many states already have individual policy pieces in place, such as weighted, student-based funding formulas, thoughtful policies in cases of long-term enrollment decline, or strategies to expand and fortify state revenue with educational equity in mind. Any of the individual policy actions recommended above would be an investment in a more resilient education finance system. Cumulatively, these state actions can help students, schools, and communities to weather whatever the future might bring.

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# About Bellwether

Bellwether is a national nonprofit that exists to transform education to ensure systemically marginalized young people achieve outcomes that lead to fulfilling lives and flourishing communities. Founded in 2010, we work hand in hand with education leaders and organizations to accelerate their impact, inform and influence policy and program design, and share what we learn along the way. For more, visit **bellwether.org**.

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