Must Enrollment Declines Spell Financial Chaos for Districts?

Avoiding Budgetary Shell Games to Create More Nimble Fiscal Systems

By Marguerite Roza

As the school year opens, districts in Los Angeles, Seattle, and Milwaukee are in the unenviable position of suffering enrollment declines. Three years ago, Baltimore and Portland, Ore., topped the list of districts in fiscal chaos created by falling enrollment. Five years ago, we read about San Francisco; Dayton, Ohio; and Buffalo, N.Y.—all in the same boat.

Each time, local press reports have a familiar ring, cataloging efforts to cut programs, close schools, and tighten the belt in ways that "won't affect the classroom." Faced with red ink, district leaders dip into reserves, pare down extracurriculars, and impose hiring freezes to weather the storm. Still, the cycle is incredibly disruptive. New programs get scrapped, students get moved as schools are closed, and district leaders find themselves focusing on little other than budget cuts. In these "tough times," there are big changes in district leadership, where the new top priority is to "get the district back on solid financial ground."

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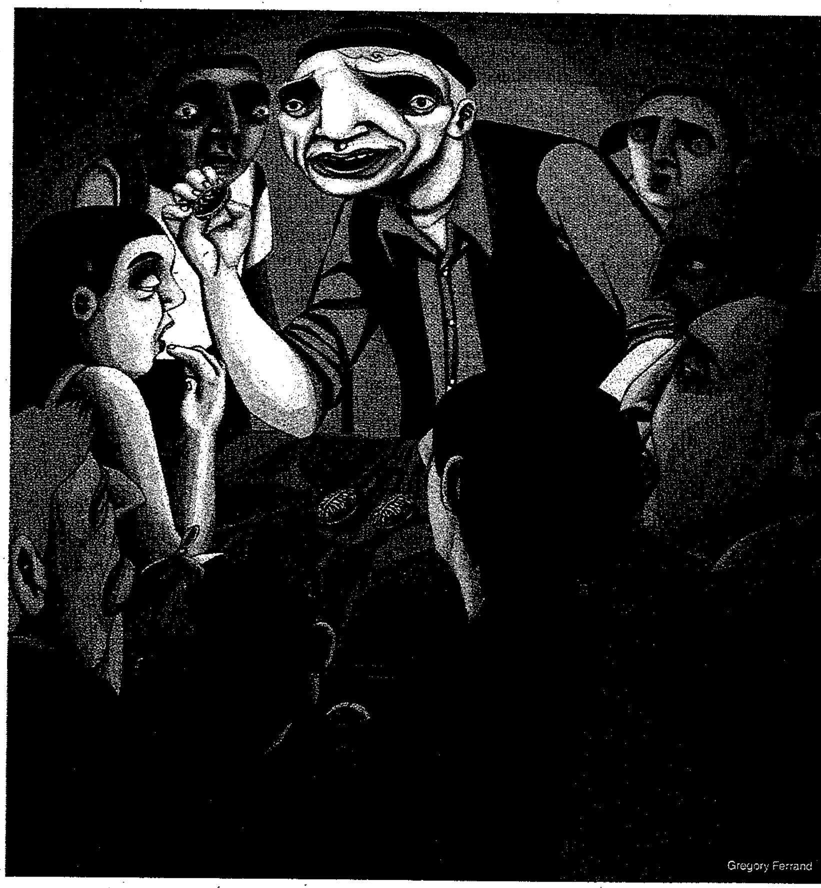

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Yet as destructive as these cycles are, they are also somewhat predictable, because enrollment patterns are inherently bumpy in urban settings. By now, districts should expect fluctuations with economic or demographic shifts, or as students move among charters, private schools, or home schooling options.

The crux of the problem is that while some *revenue* streams are dependent on student counts, *expenditures* are not. For San Francisco, a reduction in one student equates to a loss of $5,000 in state money. When Cleveland lost 12 percent of its students over eight years, its revenues dropped by $50 million (or $6,200 per student). But Cleveland's expenditures couldn't shrink by that amount without some serious budget intervention.

What is it about school districts that makes them unable to shrink when students leave and revenues decline? Obviously, there is not a critical mass of students needed for fiscally viable district operation. A scan of the 14,000 or so districts in this country shows that they can and do operate at all different sizes, most of which are much smaller than the urban districts perpetually in fiscal trouble. It isn't the new enrollment levels that are the problem; it is, rather, the shrinking itself that creates fiscal chaos.

A deep dive into districts' spending patterns points clearly to the dilemma: Big-city districts make bulky, inflexible, and sometimes irreversible expenditure commitments that aren't dependent on revenues and aren't tied in any meaningful way to enrollment. And so, in per-pupil terms, these commitments cost the district more and more each year when the denominator (pupils) drops.

How is it that a service industry like education is so heavily reliant on what feel like fixed costs? Some of it, of course, involves bricks and mortar, but not much. Each of the following common practices contributes to districts' reliance on inflexible costs:

• *Specialized services and programs work like fixed costs.*

When district leaders sit down to craft a budget, they start with last year's allocation showing how much they spent on the athletic department, the Hispanic-heritage program, the energy-conservation division, or the college-awareness team. Inevitably, each unit has its own director and core adminis-

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trative staff. None of these positions is linked in any meaningful way to enrollment, and all of them fight for their life in the budgeting process. Districts rarely if ever merge programs, so for district leaders trying to make cuts in departmental spending, the only options are to eliminate an entire program (very unpopular) or make tiny, indistinguishable adjustments to each unit's budget. For budget administrators, each program looks and feels like a fixed cost.

• *Districts make per-school allocations.*

Any time a district allocates staff positions on a "one per school" basis (or one per set of schools), the per-pupil cost of each position rises as enrollment declines. This includes costs for the principal, vice principal, and librarian, as well as other specialists including nurses, social workers, experts in gifted education, detention officers, parent liaisons, and so on. Shrinking districts are faced with either cutting a service altogether or closing schools. Both strategies are incredibly unpopular, and thus too many district leaders avoid them until deep in the red.

• *Sticky commitments to staff members extend well beyond the limits of current revenues.*

In a staff-heavy industry, it's not surprising that the bulk of the operating budget is spent on people. But districts do themselves a disservice by managing their megabudgets in terms of full-time equivalents, or FTEs, and not dollars, because staff positions don't convert reliably or consistently into present-day dollars.

Let's say, for instance, that enrollment drops in a district in which teachers average 12.2 years of experience, and the district imposes a hiring freeze. With no new teachers coming in at the bottom of the salary scale, costs per teacher start to rise, making the average salary go up as well. Suddenly, the district has to spend a lot more per teacher when it is trying to cut costs. For districts making more dramatic staff cuts, teacher tenure becomes an enormous barrier.

Guaranteed health benefits and defined-benefit pensions create similar consequences for shrinking districts. Districts generally don't pay for these promises from present-day budgets, but assume that a portion of future revenues will be earmarked for current staff members' retirement expenses. As enrollment drops and revenues fall, these commitments eat up a larger share of per-pupil revenues.

Some districts use enrollment declines as a "not our fault" response to unanticipated red ink. Yet if we accept the fact that fluctuations in enrollment are inevitable, the solution is clear: Districts need to create more nimble fiscal systems, in which expenditures (like revenues) are driven more directly by year-to-year enrollment. What this means is that instead of allocating a fixed amount to each budget unit, the allocation is converted to a per-pupil amount that remains constant each year.

One variant of this approach—weighted-student funding—now exists in a handful of larger districts for some expenditures. With weighted-student funding, *school* resources are allocated per pupil (or pupil type) directly to schools as a way to achieve equity and/or enable decentralized control. The idea proposed here is that a much larger share of district resources be allocated on the basis of enrollments, not only to schools, but also to departments, services, operations, administration, or other district functions.

This kind of allocation model makes district-level budgeting

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inherently responsive to changes in enrollment. As enrollments decrease (or increase, for that matter), the *per-pupil* allocations stay the same. Where high school literacy was a priority, it is still a priority. Sure, with declines, some district services miss out on economies of scale—at which point the department may need to reorganize delivery, possibly by jointly providing the service with another district or contracting out for the service on a per-pupil basis.

Hiring employees with broad skill sets is another way to handle fluctuations in district needs and workloads. Instead of separate counselors, social workers, and nurses, a district might hire individuals who can serve several functions. Instead of separate custodial, grounds, and maintenance staffs, the district might seek building-services workers, who could both cut the grass and sweep the halls. The key point is that enrollment changes shouldn't alter fiscal priorities and force

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massive budget overhauls.

Budgeting per pupil might seem harsh when enrollment is declining, since schools can end up with fewer dollars than they had the previous year. But this approach, when coupled with a choice system, also puts decisions about how to handle declining revenues and whether or not to close or merge schools in the hands of the parents and the schools, not district staff members who have little stake in the matter. For schools, declining resources signal an early wake-up call to redesign (possibly as an intentional small school), or, where viable, recruit more students. Schools get closed when parents begin to opt out for other schools with higher enrollments.

All district revenues are not student-driven, however, so districts need not shift all of their expenditures to student-based budgets. Revenues earmarked for construction, for example, tend to come in by the project, and it makes sense that these funds get spent in the same manner. The key is moving to a system where budgets match the reliability of the revenue source. So where districts receive state funds on a per-pupil basis, these funds should leave the district coffers in exactly the same way.

A crucial element in this budgeting reform is a requirement that districts discontinue the practice of making long-term spending commitments unless they can be budgeted for in present-day dollars. Defined-benefit and pension programs could be replaced with defined-contribution programs (a change already taking place in some locales). Tenure systems might be modified to allow for more fiscal flexibility, perhaps by including provisions for declining enrollment, or limiting the portion of the staff that can be tenured.

States, too, should do their part to make revenue streams for districts more predictable and fluid. Policies that specify per-school allocations or dictate how resources are to be used conflict with efforts to link resources to pupils.

The proposed changes won't be easy, as traditional budgeting practices are deeply rooted in district habits, and even in local politics. School board members facing re-election have been known to make promises that wreak fiscal havoc in years to come. But the benefits of budget reform are real, not only in terms of long-term fiscal stability, but also in the sense that priorities can be articulated in district spending patterns. Perhaps most important, a stable financial infrastructure can set the stage for more stability in leadership, priorities, and strategies. ■