April 1995
Insight No. 111

Policy Insight

Dedicated Funds Won't Improve Education

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Originally published by Cascade as Finscal Insight No.10

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Executive Summary

There can be no question that educational attainment is at the heart of increased economic well-being. But policy makers frequently fall into the trap of believing more tax revenues channeled directly to the public school system guarantees improvements in achievement. This paper argues that this approach is flawed for two important reasons:

1. Earmarking alone does not guarantee education spending will increase. Historically, new revenues earmarked for education are used to reduce other funding sources, frequently with regressive effect;

2. Even if greater spending does occur, it is not clear that educational achievement will improve. General subsidies to producers do not change allocation incentives. Educational attainment has very little to do with spending levels, *per se*, but rather with the motivation and quality of teachers. There is too little competition among public schools, and too little discipline in the teacher labor market to stimulate effective teaching. Under the current system, spending can be dissipated too easily on school system bureaucracies and high salaries and benefits for poor teachers, without fear of market discipline.

To avoid these pitfalls, consumers of education (students and parents) must have a meaningful role in the market for education. The great tragedy of American education policy is that in recognizing *some* benefits of schooling as societal in nature, policy makers have eliminated nearly all private influence over the school system. The loss of this consumer autonomy, of course, insulates the school system from forces that would make it responsive and efficient. Parents and students must consume whatever the public monopoly supplies, unless they are willing to wage costly battles against school boards and legislatures.

Giving consumers some of the spending authority induces the education system to be responsive and cost-conscious. If more funds are dedicated for education therefore, they should be earmarked for spending by the consumer, not simply handed over as greater subsidies to the education providers.

Revenue Substitution: The Failure of Earmarking

Proponents of earmarked funds for education believe that this practice stimulates educational output. Ironically, however, earmarking revenues for education often does not even succeed in stimulating education *spending*, let alone educational output. This phenomenon, known as *revenue substitution*, occurs because public officials often use increased revenues from one source to divert revenues from the old source to different uses.

In a series of studies of this phenomenon, economists found that on average, each dollar of new earmarked state revenues generated only about 20 cents of new education spending.[1] In one study (from Michigan), each dollar yielded as little as 6 cents of new spending.[2] The rest of the earmarked funds were used, over time, to divert other revenues to non-education activities or tax relief. Interestingly, the revenue substitution effect was the strongest where resistance to new local taxes was the greatest. The implication is that earmarking of state revenues works least well when (arguably) it is needed the most!

There is little that policy makers can do to affect revenue substitution, either. The result seems to hold whether the earmarking is done through categorical or block grants, or other mechanisms.

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Spending does not Equal Achievement

More importantly, however, even if earmarking caused spending on education to increase, it is not at all obvious that educational outcomes would improve. Block grants to school systems simply increase the total resources of the school system, without necessarily affecting the way it uses those resources.

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Between 1967 and 1980, for example, student achievement test scores in the United States declined by the unprecedented equivalent of one and a quarter grade levels even though per capita spending on public education in the same period had increased in real terms each year.[3] The decline of achievement continues today, although at a slower pace. Clearly, increasing the level of education spending in and of itself does not improve educational achievement.

Lotteries are sometimes a source of earmarked revenues for education. The hope, perhaps, is that the highly regressive burden of this peculiar form of taxation will be offset if the funds are spent on education. Yet, as Mary Borg's study of the Florida lottery reveals, the primary effect of the earmarking has been to provide property tax relief.[4] So, in effect, the end result is simply adding a regressive tax (the lottery), with little or no effect on education spending, let alone educational achievement.

The notion that "spending equals education" had its most robust test in the efforts of the 1960s, 70s, and 80s to equalize per pupil spending across school districts within states. These policies tried to provide equal educational opportunity to all students, regardless of the wealth of their communities. The result, in the words of two economists who have studied the equalization efforts, was "much ado about nothing."[5] The equalization efforts have not extinguished the high variability of educational outcomes observed across school districts. This, too, suggests that factors other than the spending level mostly determine education outcomes.

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The education establishment is quick to blame forces outside the school - particularly changes in the structure of families - for the decline in student achievement scores during the last 25 years. But the decline in achievement scores has been nearly universal, even though social conditions vary significantly across communities. Hanushek's study, for example, finds little association between the marital or work status of a child's mother and his or her performance in school.[6] Educators also blame changes in pupil-teacher ratios and the inadequate teacher salaries for the decline. But as a 1992 university and World Bank study confirmed, pupil-teacher ratios and current salaries are not directly related to student learning.[7]

Bringing Schools into the Marketplace

The main features of a school system that affect educational outcomes are the ability and effort of the teaching staff.[8] These features are not directly stimulated by additional spending, as Mansky's 1985 study confirmed.[9] Raising teacher earnings, for example, results in more teachers, but does not necessarily attract teachers of greater ability, since pay is not merit-based. To improve student achievement, therefore, individual teachers and schools must have an incentive to excel. Simply increasing school budgets does not do that.

There is a way, however, to stimulate teacher and school performance. It is the same way that performance is stimulated elsewhere in the economy. In every other sector of the economy, companies are motivated to improve staff performance because the company will not survive in the marketplace otherwise. The major weakness of the current public education system is that it does not allow such marketplace forces to operate to any significant degree. School systems are operated as public monopolies, largely protected from competition and completely protected from failure. Their output is regulated by political bodies, and the ability to terminate incompetent staff or compensate differentially on the basis of performance is severely restricted by tenure policy and the resistance of teacher organizations.

In contrast to the rest of the economy, which is increasingly exposed to competitive forces, public education has become less exposed to market forces over time. Since 1975, states have dominated school finance, with the result that curriculum policy has become increasingly regulated and uniform. Innovation generally only takes the form of changing the structure and leadership of the bureaucracy, which studies have revealed to be ineffective in improving achievement.[10] Local school districts have consolidated, limiting the ability of families to move into different districts to get a better education for their children. Consolidation has thus reduced the only real way families had to exert any market power over the school system.

Private schools do not provide a very effective competitive threat under current policy either. In most states, spending of public education funds on private schools is not permitted. As a result, taxpaying consumers must pay full private tuition on top of their public school tax obligation. To see the distortion this introduces, assume that taxpaying parents believe they will enjoy a 25% improvement in school quality by moving their children to a private school. However, they must pay 100% more tuition to get this 25% improvement. In effect, the price per unit of additional education is distorted by a factor of four. This price distortion limits severely the ability of private schools to be cost-effective competition to public schools.

The lack of competition is demonstrably linked to inferior academic performance. Borland and Howsen's recent studies of this phenomenon confirmed that educational achievement was reduced significantly by the increased concentration (loss of choice) in the provision of schooling services.[11] Even a relatively modest loss in choice reduced achievement scores by three percent. Although the education establishment hates to be measured by achievement scores alone, there is plenty of evidence that it is meaningful to the economy. Studies show that such declines do correlate with reduced incomes.[12]

Empower Consumers, not School Systems

The obvious way to increase competition, and stimulate performance, is to allow students and parents to patronize and pay for the schools that provide superior educational outcomes. If education funds were provided to families to spend on the schools or schooling services of their choice, the education system might begin to respond.

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This requires giving students and parents a way to choose the schools they patronize, either by encouraging competition among public schools, or permitting public monies to be spent on private education. It is certainly not a new idea, having been first suggested in 1791 by Thomas Paine in his *Rights of Man*. This approach has already been tried, and proved successful, on a very large scale in the form of the GI Bill, through which many veterans were educated this century.

Conclusion

There can be no question that educational attainment is at the heart of increased economic well-being. Society should be eager to maintain or improve the quality of education. The question is how to achieve such improvements. Simply channeling more tax revenues directly to the public school system won't achieve the results we desire.

Competition and choice in education are controversial, mainly because they threaten to change the status quo. But it is precisely the status quo that needs to be changed. Since across-the-board dedicated financial assistance to schools is ineffective, policy makers with lottery or other funds to spend should take a hard look at ways to put education purchasing power back in the hands of consumers.

About the Author

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Endnotes

1 See, for example, Black, Lewis and Link, "Wealth Neutrality and the Demand for Education," *National Tax Journal*, June, 1979, pp. 157-64; Grubb and Osman, "The Causes of School Finance Inequities: Serrano and the Case of California," *Public Finance Quarterly*, 1977, pp. 393-92; and E. Cohn, *Economics of State Aid to Education* (Lexington Books, 1974).

2 Park and Carroll, *The Search for Equity in School Finance* (Rand Corporation, 1979).

3 J. Bishop, "Is the Test Score Decline Responsible for the Productivity Growth Decline?", *American Economic Review*, March, 1989, pp.178-97.

4 M. Borg et al, *The Economic Consequences of State Lotteries* (Greenwood Press, 1994).

5 Carroll and Park, *The Search for Equity in School Finance* (Ballinger, 1983) pp. 167-68.

6 Family size, however, does matter. See, E. Hanushek, "The Trade-off between Child Quantity and Quality: Some Empirical Evidence," University of Rochester Working Paper 97, August 1987.

7 E. Hanushek et al, *Improving Outcomes while Controlling Costs* (Carnegie-Rochester, 1992).

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9 C. Mansky, "Academic Ability, Earnings, and the Decision to Become a Teacher: Evidence from the National Longitudinal Study of the High School Class of 1972," NBER Working Paper 1539, January 1985.

10 R. Ehrenberg, "Determinants of the Compensation and Mobility of School Superintendents," *Industrial-and-Labor-Relations-Review*; April 1988, pp. 386-401.

11 Borland and Howsen, "Student Academic Achievement and the Degree of Market Concentration in Education," *Economics of Education Review*, March 1992, pp. 31-39, "On the Determination of the Critical Level of Market Concentration in Education," *Economics of Education Review*, June 1993, pp. 165-69.

12 Bishop, cited above.

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