BERKELEY INSTITUTE FOR
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New working paper finds inequalities in types of California school districts that became at-risk of financial insolvency during the Great Recession

Berkeley, CA - A new working paper from the Berkeley Institute for Young Americans analyzed California's historical school district financial data to gain insights into why many of the state's unified school districts became at-risk of financial insolvency during the Great Recession and its immediate aftermath. The new paper is being released during a climate of economic uncertainty when California's state budget is expected to experience multi-year budget deficits in the upcoming years. The paper highlights how district finances were affected by the decisions made by state lawmakers during the last large-scale, multi-year budget crisis, and how districts attempted to stay afloat.

"During times of financial crisis, lawmakers in California have a habit of pushing the state's cash flow problem down to school districts by deferring funding, decreasing per pupil spending, or relaxing benchmarks of school quality such as the length of the school year as cost-cutting measures," said Erin Heys, the lead author of the project. "Our findings show that such decisions had uneven effects across school districts, depending on the budget composition and enrollment trends of local districts. This paper adds to a growing literature providing evidence that districts in California serving low-income students and students of color are more likely to be negatively affected financially during economic crises, with consequences for school quality."

Among the main findings, the paper shows:

- **At-risk districts were more likely to be large, serve disadvantaged students and students of color, and experience sharper declining enrollment.** Some districts that became at-risk during the recession remained in at-risk status for several years following the recession and state budget crisis, and some of the districts in our sample have continued to experience at-risk status in more recent years.

- **Districts that were at-risk during the Great Recession received more revenue from state and federal sources and less from local revenue or other resources**. Over time, the at-risk cohort received more per pupil funding from state and federal sources than the comparison group, and less revenue from local and other sources. During the Great Recession, the at-risk cohort received less revenue from local sources such as property taxes, parcel taxes, or from local fundraising. The at-risk cohort also had less per pupil revenue from other resources, such as the sale of bonds.

- **Districts at-risk of insolvency had slightly higher operating expenditures, lower capital expenditures**. Over time, at-risk districts spent slightly more on employee benefits and classified support salaries, and had higher costs associated with special education—cost pressures that increased during the recession period. The at-risk district cohort spent less on capital investments such as the improvement of buildings, and spent less per ADA to finance capital investments than the comparison group during the Great Recession.

- **Both at-risk districts and the comparison group made operational decisions during the Great Recession that affected school quality.** Both at-risk districts and those in good financial standing cut instructional days during the Great Recession, but at-risk districts cut about a day more and took longer to recover instructional time than districts that remained in good financial standing. The at-risk cohort made spending cuts to teacher salaries that were on par with the comparison group.

- **The at-risk district cohort had a weakened balance sheet**. The at-risk cohort entered the recession with less cash on hand than districts that remained in good financial standing, and this worsened during the recession period when the difference in available cash on hand was reduced by double. Districts at-risk of insolvency also had fewer reserves in the recession period, were more likely to transfer resources between internal funds, and were more likely to engage in external borrowing practices. Notably, the weaker reserves picture persists for the at-risk cohort into the post-period, indicating that the recession had a prolonged effect on the budgets of districts that experienced insolvency status during the Great Recession.

“The Legislative Analyst’s Office recently forecast a $24 billion revenue shortfall in the upcoming fiscal year, and the budget picture could worsen with uncertainties in the broader economy due to the fragile banking system, inflation, and layoffs in the technology sector,” said Sarah Swanbeck, Executive Director of the Institute. “The findings from this paper underscore just how dire the state budget problem could become for school districts, and we caution lawmakers to rethink using the same budgeting maneuvers that have been used in the past to balance the broader state budget.”

School districts today are still reeling from the COVID-19 pandemic and are experiencing growing cost pressures such as rising pension and employee benefit costs, increasing enrollment in special education, facilities costs, and declining student enrollment. There is also a coming ‘fiscal cliff’ as federal pandemic aid ends in 2024. The report makes recommendations to lawmakers and education leaders about the characteristics of districts that became at-risk of financial insolvency during the last multi-year budget crisis, and offers recommendations to address insolvency risk if another recession were to occur.

The Berkeley Institute for Young Americans is a research center affiliated with the Goldman School of Public Policy at the University of California, Berkeley. Our mission is to better understand the unique challenges that young adults are facing, and to develop research-driven policy solutions to create a fair and sustainable society for future generations. For more information about the Institute, please visit our website: youngamericans.berkeley.edu.

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