MINNESOTA CENTER for Fiscal Excellence

How Much is Enough?

The Implications of School District Labor Cost Trends for State Education Aid

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I. Executive Summary

How much state support for K-12 education is "enough"? Answering that question is very difficult for a fundamental reason: although the state exercises substantial control over school districts' revenues, it has little influence over how the over 300 independent school districts across Minnesota manage their largest cost: labor expenses.

School districts' labor expenses have the largest impact on whether state funding for education keeps up with growing costs. Spending on compensation (salaries and benefits) for district employees comprises nearly 80% of total school district general fund spending – which finances most day-to-day school operations. Moreover, the vast majority of these labor costs are the result of the collective bargaining agreements districts negotiate with various employee unions. This gives districts themselves considerable ability to influence and manage price inflation in what is by far their largest purchased input. As a result, the common litmus test of whether increases in state funding for education have been enough – "Do they keep up with inflation?" – turns out to be a more complicated concept and policy issue than is commonly depicted.

In this report, we take a closer look at the recent relationship between school districts' labor costs and state funding for K-12 education and explore the implications past practices and current trends have for the future distribution of state funding to schools. Our primary focus in this report is basic education formula aid, the workhorse of the state's education finance system and the prime focus in debates over the level of state support for K-12 education.

Our analysis is divided into three parts. First, we study the relationship between the provision of basic education formula aid and the results of collective bargaining agreements. Second, we examine the relationship between district-level employment changes (which drive district costs) and district level enrollment changes (which drive district revenue). Finally, we investigate how the purchasing power of the new basic education aid the state provided in 2015 is affected by district-level employment costs and trends.

<u>Key Findings</u>

1. **Even though the same amount of per pupil basic education aid is provided across the state, the cost of contract settlements demonstrate considerable variability from district to district.**
    - Over the ten-year period from FY 2006 through FY 2015 (the years for which data was available), negotiated growth in total compensation costs (salaries plus benefits) generally ranged from 2% to 5% per year, depending in part on economic conditions.
    - While longer periods of analysis somewhat reduce the variability across school districts, considerable diversity remains in how school districts manage their primary cost element.
2. **The relationship over time between district-level employment changes (which drive district costs) and district level enrollment changes (which drive district revenue) also demonstrates significant variability from district to district.**
    - The overall correlation between changes in districts' student counts and changes in districts' staffing over time is positive as would be expected (increasing student counts = increasing district employment and declining student counts = declining district employment). On a percentage basis district staff changes occur on average 70% as fast as pupil changes.
    - However, nearly 20% of the state's traditional public school students belonged to a school district with a counterintuitive relationship – declining employee counts

accompanying rising pupil counts or increasing employee counts accompanying declining pupil counts.

- 62% of Minnesota school districts – representing 58% of the students in traditional public schools – have faced an eight-year trend (from 2006-07 to 2013-14) in which any increases in basic formula aid have been at least somewhat offset by the loss of students.

3. **The labor purchasing power of the new basic education formula aid the state provided in 2015 (2% more in 2015-16 and again in 2016-17) is hugely affected by district-level employment costs and trends.**
   - Annual growth in districts' total compensation costs on a per student basis has varied tremendously across the state in recent years. From 2007 (the first year for which data is available) to 2014, district growth in compensation costs has ranged from a high of 12.2% per pupil to a decline of -3.7% per pupil.
   - The purchasing power of the new per pupil basic education aid provided this year varies significantly from district to district. In nearly three-quarters of the state's school districts, projected growth in compensation costs through FY 2017 (based on continuation of each district's recent trends) will exceed the increase in basic formula aid that the state enacted in 2015. The median "shortfall" in those districts is $225 per pupil. In the remaining quarter of Minnesota school districts new basic formula aid exceeds projected growth in district compensation. The median "surplus" is $95 per pupil.
4. **The relationship between labor cost trends and state aid portend education finance sustainability challenges going forward.**
   - Total school general fund compensation costs totaled $7.2 billion in 2013-14. Assuming 1) there are no changes to the compensation designs that currently exist in collective bargaining; 2) future growth in total compensation costs per employee continues along recent trends, 3) the statewide students-to-total employee ratio remains unchanged; and 4) current projections by the State Demographer's office in the number of students are accurate; then total general fund school compensation is projected to be $1.3 billion higher by 2019 and $4.2 billion higher by 2029.
   - To put the $4.2 billion increase in perspective, if the state were to finance 100% of the cost through new basic formula aid (thereby providing aid to all districts equally while insulating local property taxpayers from these cost increases), this translates into a 4.1% average growth in the basic aid formula allowance per year through 2029.
   - Even though other forms of school aid exist to help pay for higher labor costs and mitigate the demands on the basic aid formula allowance, the 4.1% projected increase does not factor in inflation in non-labor purchases, reserve requirements, teacher labor market characteristics and underfunded pensions – all of which are likely to place additional financial pressure on school districts.

Conclusions and Recommendations

1. **"Education inflation" and aid sufficiency are both district-specific conditions and heavily district-influenced conditions.** Education finance policymakers should recognize this as such when determining how the state will support local school districts. Moreover, the common practice of evaluating education finance sufficiency based on tracking aggregate school district revenues or spending totals and adjusting them by some national inflation measure is crude at best and highly misleading at worst.
2. **The distribution of supplemental state general education aids and other aid programs designed to compensate districts for having more challenging and costly**

educational environments should be based on a strong understanding, and if possible quantification, of the impact these conditions and factors have on district labor requirements and accompanying costs. Two particular areas meriting closer examination are the adequacy of declining enrollment aid and adjusting aid formulas for geographic cost differences.

3. **Alternative compensation designs are needed going forward to complement state per pupil aid and ensure sustainability in education finance.** Moving away from the traditional uniform salary schedule and towards alternative strategies can be challenging to design responsibly without creating other unintended consequences. Our findings, however, suggest moving to an alternative compensation design that offers the opportunity to repurpose existing compensation resources for greater effect is rapidly evolving from a debatable policy discussion to an undebatable fiscal necessity.
4. **There is a need for greater public transparency of collective bargaining agreements.** New resources the state makes available to districts can be appropriated by the existing workforce through the collective bargaining process. Taxpayers therefore must have every opportunity to evaluate how well their elected officials are respecting the balance between the private interests of district employees and the interests of students and the broader public.

Specifically, we recommend that:

- Upon the conclusion of a collective bargaining agreement, school districts make settlement information about how changes in the following items will impact district finances over the course of the contract:
  1. changes that affect all employees equally (sometimes referred to as “cost of living adjustments”)
  2. additional changes affecting compensation based on tenure (“steps”)
  3. additional changes affecting compensation based on educational credentials (“lanes”)
  4. health benefit cost increases
  5. total cost impact
- School district officials should identify, describe, and to the extent possible quantify the cost impacts of state mandates on school operations.