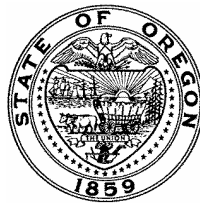


Theodore R. Kulongoski
Governor



Governor's Report **Effects of 2005-07 Recommended Budget on Education in Oregon**

Governor Theodore R. Kulongoski
January 2005

Introduction

Oregon statute ORS 291.228 requires the Governor to submit a report on the adequacy or inadequacy of the recommended budget on K-12 public education.

As I stated in my State of the State address January 10, 2005: "I've been asked many times since I unveiled my 05-07 budget if giving \$5 billion, 45 percent of the state General Fund, to K through 12 education is adequate. The answer is no. But it is all we can afford given our current revenues."

The revenue challenges we face today are not new – they are the product of over a decade of decisions made by both the public and the state's elected officials. The state budget grew in the 1990's at a rate that was unsustainable given Oregon's economic and tax structures. We budgeted as if the overcharged economy of the 1990's would continue forever. We made the problem worse in the five special sessions in 2001 and 2002, because instead of making the tough decisions that were necessary in a recession economy, we attempted to avoid reality by using one-time revenues to sustain an over-inflated state budget.

Further, since the passage of Ballot Measure 5 in 1990, the state's proportion of funding for K-12 public education has increased from 30 percent to 70 percent. Due to the current severe revenue shortfall, funds available under current law do not support the funding of state programs into the 2005-07 biennium at the program levels in place for the 03-05 biennium. Because K-12 education alone takes up 45 percent of the General Fund allocation, it is not possible to hold education harmless from the severe cuts the revenue shortfall requires us to make in order to balance the budget.

For the long-term health of our education system and the Oregon way of life we must commit to three actions:

- First, we must stabilize education funding so schools can budget with greater certainty. We cannot allow the mid-year cuts forced upon our education system in the past several years.
- Second, we must grow the economy. By increasing the number of Oregonians who are working in quality family-wage jobs, we increase the amount of revenue available to support the state's essential programs.
- Third, we must create both a rainy day fund and a K-20 education investment fund. These funds will give state government – and school funding - the stability and sustainability they have lacked for years.

We must also stop looking at education as various separate silos (pre-K, K-12, Community Colleges/Workforce, and the Oregon University System). Education should be viewed as an enterprise, each piece connected to and dependant on the other. My recommended budget and this report both represent initial steps to bring these pieces together. In contrast to previous reports that have focused almost exclusively on the K-12 portion of Oregon's education system, this report examines my recommended budget's impact on K-12 within the broader context of the lifelong education system.

This system-wide view of the education system is essential to our success in equipping Oregonians of all ages with the knowledge and skills they need to compete in a 21st century economy.

If we are to build the strong economic base needed to provide the way of life we want for ourselves, our children and our grandchildren, we must have the best-educated workforce in the world. The measure of our success will be more than graduation rates or degrees earned; it will be the number of employed Oregonians pursuing the careers they want, living the Oregon lifestyle and contributing to the success of our state.

Before getting into the specifics of education funding in my recommended budget, I want to make one other point. One of Oregon's great assets is its education workforce. For nearly 15 years our K-12 teachers, administrators and support personnel have continued to do more with less. Despite the loss of local control of revenue, the disproportionate effects of equalization, and the instability created by mid-year funding cuts through special sessions and ballot measures, our schools have continued to help more students reach higher levels of achievement.

In 1990, 52 percent of third graders met the state benchmark in reading. Today 82 percent of all third grade students (including those previously excluded from testing due to handicapping conditions) meet or exceed these benchmarks. Our high school graduates remain at the top in the nation in both SAT and ACT scores. All of these successes have occurred while our investment in our schools, as a percent of the state's economy, has declined.

Some have used this success and sacrifice to say schools do not need more money; they just need to be more efficient. During the 1990's this may have been accurate in some respects - and districts responded by streamlining their operations, holding costs at or below inflation rates and prioritizing their program offerings. But the changes schools have been forced to make in the past decade go far beyond streamlining. Many of these reductions have also led to the loss of vital classes and offerings that encourage healthy citizenship and maximize a student's future success. In many of our school districts the arts, vocal and instrumental music, and drama have been severely cut or eliminated. Most elementary schools are without certified physical education instructors and programs. Only in our high schools will we consistently find full-time certified librarians. To balance the budget, many districts have been forced to eliminate their professional/technical training programs. These programs not only prepared students for post-secondary training but also provided the real life relevance so many of our students need.

We must separate the business costs of school districts from the educational costs. The gap in state revenue needed to meet educational costs is far greater than can be made up by efficiencies alone. However, we may be able to help alleviate some of the educational need with cost savers on the business side. I have recommended several actions that will not make education less expensive but will allow more dollars and personnel to focus on the needs of students. Unlike the efficiencies already carried out by districts, my proposals look at changing the way the system operates both within K-12 and across education sectors. Some of these proposals are:

- Create a PreK-20 statewide data system to provide better tracking and counseling for students and maximize system accountability.
- Reduce the number of Educational Service Districts (ESDs) from 20 to between 9 and 12.
- Use the ESDs as regional hubs for the new data system as well as assuming many of the central office business functions of districts such as payroll processing, reporting and transportation scheduling.
- Establish a single statewide insurance pool for all education employees (as we have for all state employees) in order to use the larger group buying power to leverage the best rates and plans while also educating employees on usage.

I continue to believe that there could be as much as \$100 - \$200 million available to funnel directly into the classroom if school districts and legislators focus in on the reforms I am proposing, and if they dedicate themselves to finding additional reforms in the system. While the amount of savings generated by these measures is clearly not sufficient to meet the entire universe of schools' needs, they provide a significant amount of money that can be redirected from business costs to fund education for Oregon students. This is an opportunity we cannot afford to overlook. These are commonsense ideas whose times have come, both out of advances in today's technologies and out of necessity.

The Governor's Recommended 2005-07 Budget for Education (Overview)

My budget allocates \$5 billion for the basic support needed for K-12 public schools. Although this number is not as high as many people would like, it is significant because of what it represents for the future: it is the first step in stabilizing school funding since Measure 5 was passed in the early 1990s. This is a funding amount that we know we can sustain, without one-time revenue, bonding or accounting tricks. It is a solid foundation on which we can build and therefore serves as a starting point for what I hope will be a future of increased investment. Accordingly, my budget goes beyond the \$5 billion and includes plans to increase the state's investment in education in the future by building a sustainable preK-20 investment fund.

Post secondary education, both at our community colleges and universities, is an integral part of our education enterprise. For the past several biennia we have disinvested in this sector. This disinvestment has led to double-digit tuition increases and closing the door of higher education on thousands of worthy Oregonians.

The costs of community college programs are high because we expect them to provide a pathway for two year AA degrees, four year BA degrees, professional/ technical certifications and job retraining. The pathway provided by community colleges is a critical piece of our effort to help Oregonians gain the skills they need to succeed through a seamless K-20 system. We must find ways to help maintain these professional/technical programs at their current top quality and to continue the collaborative efforts our community colleges are carrying out with our universities to help students progress more efficiently through the degree track programs.

My budget for community colleges calls for \$388 million in state funding. Even with an increase in local property taxes, this budget amount will not allow many community colleges to continue their current operations without additional tuition increases. Although we cannot solve the problem of rising tuition costs in this biennium alone, this budget is a first step in stopping the disinvestment and making post-secondary education more accessible and affordable for Oregonians.

I have proposed a \$50 million increase in the Oregon Opportunity Grants program, opening the door for thousands of Oregonians who wish to pursue post secondary training at both our Community Colleges and Universities. In the short term, no other single investment of \$50 million dollars will mean so much to rebuilding our economic base.

I have also proposed investing \$94.1 million in Article XI-G bonds for much-needed construction projects at our community colleges. This investment will make sure our facilities are able to meet the growing demands and put thousands of Oregonians to work, thus stimulating the economy. This is the first state investment in community college facilities in over 20 years.

For our universities, my budget allocates \$685.4 million in General Funds. This amount includes the funds necessary to build the Community College and University portions and begin the preK-12 portion of the statewide data system. At this funding level I have directed the universities to keep their tuition increases at an average of 5 percent per year. I also recommend investing in several deferred maintenance projects at the state's universities that are long overdue. This will not only help protect our educational assets, but will also put hundreds of Oregonians to work.

The Governor's Recommended 2005-07 Budget for Education (Detail)

Early Childhood:	\$43.9 million Oregon PreKindergarten/ Headstart (State Appropriation)
	\$119.4 million Early Childhood Special Education (State and Federal Appropriation)
K-12 (State School Fund):	\$ 2,530.9 million (Local Property Taxes) \$ 5,000.0 million (State Appropriation)
Community Colleges:	\$ 388.4 million (State Appropriation) \$ 220.0 million (Local Property Taxes) \$ 91.2 million (Bonding for Capital Construction)

Oregon University System	\$ 685.45 million (State Appropriation)
	\$ 102.3 million (Bonding for deferred maintenance)
	\$ 163.6 million (Bonding for Capital Construction)
Oregon Student Assistance Commission	\$ 91.6 million (State Appropriation) Oregon Opportunity Grants
OHSU (A Public Corporation)	\$ 50.2 million (State Appropriation)
	\$ 2.7 million (State Appropriation for Poison Center)
	\$ 32.0 million (Debt service on bonds)

Evaluation: Is this funding sufficient?

1. K-12

In 1999, as an Oregon Supreme Court Justice, I served on the original Quality Education Commission established by then Governor John Kitzhaber. The Quality Education Model (QEM) was developed to help us identify those best practices, educational opportunities and support systems Oregon students need to meet high standards. We can use the model to calculate the cost of this system. The Commission has continued its work analyzing current research and fine-tuning the cost calculations. For the 2005-07 biennium, the Commission has determined we would need to invest \$7.096 billion, or \$2.096 billion more than is currently available, to support best practices. It, along with the School Revenue Forecast Committee, calculates that it will take \$5.318 billion for our schools to simply maintain today's level of service and program.

The recommended budget for primary and secondary schools (K-12) for 2003-05 is therefore not sufficient to ensure that the state's system of public education meets the quality goals established by law.

The budget appropriates approximately 70.5 percent of the funding level estimated by the Quality Education Commission, established by the Legislature under ORS 327.497 through 327.506, as being sufficient for Oregon's students to meet the academic standards established through the Oregon Educational Act for the 21st Century.

It is also important in this evaluation to consider the federal mandate "No Child Left Behind." This mandate only applies to K-12 and requires that 99 percent of all students must meet the state's high academic standards. Since, as a state we set 90 percent as our target and designed the QEM to calculate the cost of that effort, we can only conclude at this time that it would take significantly more than the \$7.096 billion to meet the federal mandate.

2. Post-secondary

My goals for post-secondary education are quite clear: improve access and affordability. It is these two important, overriding goals for post-secondary education that my proposed budget begins to consider.

Although community colleges and higher education are important parts of the state's system of public education, neither of those systems has the type of measurable statutory goals that exist for K-12. Therefore, until such goals for community colleges and higher education are developed and placed into statute, the provisions of Measure 1 do not apply to them.

However, I have made it clear that I believe we must look at the entire education system (PreK-20) as an enterprise. I therefore have directed both the State Board of Education and the State Board of Higher Education to carry out the work necessary to establish a clear set of goals for this enterprise in the future.

3. Pre-K

Oregon's PreK-Headstart programs are critical to our children and this state. My budget provides funding for approximately 53 percent of the eligible children, down from nearly 60 percent last biennium. As with the entire budget process, making this recommendation was not easy. We must find ways to better fund the entire education enterprise PreK-20 and invest any new revenues for education in strategic ways to help the total system.

Evaluation: What is the reason for the insufficiency?

As I mentioned previously, the current severe shortfall and revenue structure does not allow us to fund K-12 at a level I consider adequate.

My recommended budget aligns current revenues of \$11.9 billion (General Fund and Lottery Funds) to our highest needs for economic growth, the health and welfare of our citizens and the education of our children and adults. Nonetheless, this still leads to reductions throughout the state budget to reconcile with the revenue gap. Given a larger amount of stable state revenue I would have funded many additional programs – education programs primary among them - at higher levels. We simply do not have that luxury at the current time.

I know some would seek to avoid such painful choices by arguing for a borrowing package to provide more money for our schools and our vulnerable citizens. Although that might make things easier during this budget cycle, it would narrow our choices in the future and would jeopardize our chances of long-term economic and financial stability. It would also be an unwise way to use up the state's bonding capacity. We have just one option: adjust our budget and map out a spending plan that will allow us to live within our means, while we work to improve our financial situation and invest in our future.

Evaluation: What is the impact of the budget on the state's ability to meet the quality goals?

The Quality Education Commission developed the Quality Education Model (QEM-2004) as the means for determining the statewide level of resources necessary for K-12 schools and students to meet the quality education goals. The Commission described the average allocation of resources in elementary, middle and high schools using the 2003-05 school years as the baseline years. The Commission then recommended best practices and levels of resources that would be necessary to support 90 percent of Oregon's students meeting the state benchmarks at the third, fifth, eighth and tenth grades by the end of the decade. The Commission outlined those findings and recommendations through the use of "prototype" school models. The Commission also established its expectations for student performance against those academic benchmarks under both the baseline allocation and the recommended allocation. (More details on the Commission's work and recommendations can be found at <http://dbi.ode.state.or.us/qualityed>).

The Quality Education Commission continues to recommend full implementation of the best practices described in the Model but is well aware of the funding problems caused by the current economic downturn. The Commission did, however, set out several recommendations for strategic investment that have been included in my recommended budget. A few are:

- Provide State resources to complete an overview of the existing cost and effectiveness of the State's educational data system for grades PreK-20, and implement an improved system within the next two years.
- Improve the alignment between the K-12 school curriculum and Oregon's post-secondary education and employment needs.
- Continue the line item in the state budget to pay for the highest cost special education students, and look for efficiencies to provide services to these students at lower cost.

Nonetheless, we can expect the \$5 billion in state funding outlined in my recommended budget to have the following potential impacts on the programs and services provide by our school districts.

SCHOOL DISTRICT REDUCTIONS

Using the QEM to estimate budget impacts, following are three examples of the types of reductions that school districts may face at a funding level of \$5 billion (\$318 million below QEM Baseline):

Example 1 – Reductions in support and counseling staff.

- Reduce all support staff by 20 percent (2000 employees statewide).
- Eliminate middle and high school counselors (882 employees statewide)
- Replace textbooks half as often as is currently done.

Example 2 – Reductions in teaching staff and all extracurricular programs.

- Raise all class size in elementary, middle and high schools by 1 student, eliminating 955 teachers.
- Eliminate all extracurricular activities.
- Upgrade computers and software half as often as is currently done.

Example 3 – Reduce the school year, increase class size.

- Reduce the school year by five days.
- Increase class size by 1 at all levels. (955 teachers statewide)
- Eliminate professional development training for teachers.

It should be noted, again, that the model does not mandate that schools make these types of reductions or utilize resources in a certain manner. The QEM is a budget model that describes and estimates the costs of activities that could be expected to result in identified outcomes.

EXPECTATIONS FOR STUDENT PERFORMANCE

The QEM also forecasts student performance on state reading and math assessments under the baseline level and the fully implemented QEM. The proportion of students reaching benchmark levels has generally increased over the past decade, with much greater and more consistent gains at the elementary level and less consistent and considerably smaller gains being identified as students moved through middle and high school levels. If the Model were fully funded, the QEM predicts sustained improvement over the decade with 90 percent of students reaching state benchmarks by 2014.

Under my Recommended Budget for 2005-07, the performance expectations are as follows:

- It is possible that the improvement rate in reading and math at all benchmark levels will continue to flatten out.
- Students will have fewer opportunities to achieve in other academic areas as the curriculum becomes narrower, instructional time is reduced, and schools are less able to meet diverse student needs.

These potential negative effects could be mitigated by freeing up dollars for the classroom within our existing K-12 budget. As identified above, there are significant opportunities for additional efficiencies through economy of scale in the public school system.

Many administrative services such as payroll, data processing and transportation could be centralized, rather than being done individually by each of Oregon's 198 school districts. It is also critical to enact a statewide K-12 health insurance pool. I brought this proposal to the last legislature and I will fight for it again this biennium.

Conclusion: Building a Sustainable Future

As statutorily required, this report has examined the impacts of my recommended budget for education for the 2005-07 biennium. The decisions we make for the next two years not only affect state programs and services today, but as we know from our state's fiscal history, they also have a lasting impact on the direction of our state far into the future.

That is why it is important to not only make decisions based on our immediate needs, but to have a vision for where we want Oregon to be in the coming decades; to be able to identify what we can do today to move us closer to those goals of a strong economy; to ensure fiscal discipline and security, and an accountable government; and to be a state prepared to address future trends and changing needs that could impact the quality of services and life for the citizens of Oregon.

We are currently experiencing the results of a decade of operating on faith that our economy would keep growing as it did in the 1990's, rather than planning for what would happen if it didn't. I believe the state made a critical mistake – and missed a critical opportunity – by failing to set aside a portion of our state budget as a rainy day fund against future difficulty. Like a homeowner without insurance, we had little to fall back on when hard times hit. That's why my 2005-2007 budget includes a long-term plan for a rainy day fund and a K-20 education investment fund.

The state's General Fund dollars are the most frequently discussed piece of the overall budget for two reasons: most of the money comes from the individual and corporate income tax, and it is the primary source of funding for education, health and human services, and public safety – all issues very important to Oregon's citizens and communities.

Because our current revenue structure is volatile, it is an important safety net for the state to establish a rainy day stability fund for the critical programs and services funded with these dollars. If we make hard choices today - and if elected leaders and citizens alike, draw the line on how much we spend - Oregon has the opportunity to create new stability for the future.

Making these hard choices will also allow us to actually invest much-needed dollars in education in the near future.

My recommended budget spends \$11.1 billion of the \$11.2 billion in General Fund revenues over the next two years based on the most recent economic forecasts. The last \$100 million is set aside for emergencies during the interim between legislative sessions. At one percent of revenues, this is an insufficient reservation of funds for emergencies or to protect against fewer revenues coming in than projected.

However, if we make and stick to the hard choices today and live within the ongoing General Fund revenues that we expect to collect under the current tax structure, we can begin to support a true rainy day fund in 2007-09. By 2009-11, we would not only have a rainy day fund; we could have almost \$500 million per biennium available for investment in the preK-20 system in the future. (Attachment A)

If we choose to adopt the practice of many other states - and that Oregon has chosen in the past - and rely on borrowing, putting off payments, or using a windfall for ongoing operations, the difference is astounding. Instead of beginning to amass savings for our future, we will continue to talk about “shortfalls” in 2007-09 and will not be able to begin investing in a rainy day fund until 2011-13 or even 2013-15. We must ask ourselves if one-time money today buys us the Oregon we want tomorrow. I believe the answer is a resounding “no.” At best, if Oregon continues down this path, it would be just one more band-aid instead of a real investment plan for our future.

Attachment A

Rainy Day Fund / PreK-20 Investment Fund Projection (in Millions of Dollars)
No One-Time Money Used

	<u>2005-07</u>	<u>2007-09</u>	<u>2009-11</u>	<u>2011-13</u>	<u>2013-15</u>
Beginning Balance	91	100	125	140	158
Revenues	11,130	12,543	14,048	15,763	17,688
One-Time Revenues	0	0	0	0	0
Expenditures	11,137	12,110	13,306	14,616	16,093
Rainy Day Fund - Goal (4 percent of Revenues)	0	502	562	631	708
Ending Balance/ Emergency Fund (1 percent of Revenues)	100	125	140	158	177
Investment for PreK-20	0	0	496	1,061	1,499
<i>Note 1:</i> The Rainy Day Fund Goal of 4 percent of revenues would not be filled until 2009-11 biennium. The 2007-09 Rainy Day Fund would be \$408 million.					
<i>Note 2:</i> The Rainy Day Fund and PreK-20 Investment Fund numbers are cumulative; the 2013-15 amount is the total amount that would be accumulated if none of the rainy day fund or investment fund were spent in the prior biennia.					

Rainy Day Fund / PreK-20 Investment Fund Projection (in Millions of Dollars)
\$600 Million One-Time Money Used

	<u>2005-07</u>	<u>2007-09</u>	<u>2009-11</u>	<u>2011-13</u>	<u>2013-15</u>
Beginning Balance	91	100	125	140	158
Revenues	11,130	12,543	14,048	15,763	17,688
One-Time Revenues	600	0	0	0	0
Expenditures	11,737	12,764	14,019	15,393	16,940
Rainy Day Fund – Goal (4 percent of Revenues)	0	502	562	631	708
Rainy Day Fund - Actual	0	0	14	367	708
Ending Balance/ Emergency Fund - 1 percent of Revenues	100	125	140	158	177
Investment for PreK-20	0	(246)**	0	0	388
<i>** Represents a shortfall for 2007-09.</i>					

