

# Oregon Public School Transportation--Funding: An Evaluation of Alternative Methods

## Summary and Recommendations

Through a budget note, the 2007 Legislature called on the Oregon Department of Education to conduct a study on alternative methods of funding school transportation. The budget note reads:

*“The Oregon Department of Education will conduct a study on alternative methods to funding transportation costs for students. The study should focus on reducing costs and increasing efficiency. The Department will report to the interim Joint Committee on Ways and Means or the Emergency Board on the options available along with recommendations on suggested changes before the 2009 Legislative session.”*

While the budget note is silent about the level of service or standards that an alternative method would need to meet, ODE believes the intent of the legislature in creating the budget note was to determine if changes to Oregon’s school transportation funding method could promote a more efficient use of resources—in other words, to see if Oregon school districts can provide the same level of transportation services as they currently do, but at a lower cost.

The Department of Education contracted with ECONorthwest to evaluate alternative funding methods with the goal of identifying the methods best capable of promoting efficient delivery of school transportation services.<sup>1</sup> As part of its study, ECONorthwest identified four basic funding methods that can be employed to fund school transportation systems:

- Approved Cost (Oregon’s current approach)
- Block Grant
- Per-Unit Allocation
- Efficiency-Based Formula

In evaluating the alternative funding methods, ECONorthwest reviewed Oregon’s current funding method as well as those of eight other states.<sup>2</sup> The states were chosen to provide examples of all four basic funding methods identified. Based on this review and on widely-accepted economic principals of efficiency, ECONorthwest concluded that Approved-Cost funding methods, like Oregon’s current method, provide weak incentives for school districts to operate their transportation systems efficiently. This occurs because districts do not bear the full burden of transportation cost increases, nor do they reap the full benefits of cost savings. As a result, Oregon’s current funding method is unlikely to lead to the most efficient, least-cost practices.

ECONorthwest also concluded that the other three methods provide incentives that have the potential to increase the efficiency of the system relative to Oregon’s existing funding method.

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<sup>1</sup> ECONorthwest, Oregon Public School Transportation Funding: An Evaluation of Alternative Methods, January 2009

<sup>2</sup> Arizona, Florida, Indiana, Idaho, North Carolina, Ohio, Utah, and Washington.

Both the Block Grant approach and the Per-Unit Allocation approach, if designed properly, can provide incentives for efficiency by placing the burden of cost increases, and the benefits of cost savings, fully with the districts. The Efficiency-Based Formula approach also has strong efficiency incentives because it provides each district with the level of funding needed for an efficiently operated transportation system. Districts that can provide services for less than their transportation allocation get to keep the savings for other uses, while districts that spend more than their allocation must pay the difference themselves. Efficiency-based formulas have the added advantage of being more equitable because they more accurately account for the differing cost environments in which districts operate, more closely matching funding with actual costs.

## **Key Findings**

ECONorthwest's primary finding is that there are a number of alternative transportation funding methods that can provide stronger incentives for districts to operate their systems efficiently than Oregon's current method. As part of their report to ODE, ECONorthwest developed a "best practices frontier" formula that identifies districts that operated in the most cost efficient manner and compares costs of the districts deemed most efficient to other districts in Oregon. Based on this economic modeling, ECONorthwest estimates that districts, collectively, could save approximately \$20 million per year if all districts were as efficient as the most efficient districts in the state.

Adopting a transportation funding method with stronger efficiency incentives should help move districts toward more cost-efficient operating practices while at the same time maintaining the level of transportation services that districts currently provide.

Each of the alternative funding methods evaluated by ECONorthwest has advantages and disadvantages relative to Oregon's current Approved Cost method.

### **Block Grant Method**

Advantages: Promotes efficiency, is easy to administer, is stable and predictable, and is easy to explain.

Disadvantages: If built off of districts' historic funding levels, it could perpetuate inequities that exist in the current system.

### **Average Cost per Unit Method**

Advantages: Can be designed to promote efficiency, stability, and predictability.

Disadvantage: Probably the least equitable of all the methods evaluated because it does not account for variations in costs outside of districts' control. Is likely to be less equitable than Oregon's current method.

### **Efficiency-Based Formula Method**

Advantages: Promotes efficiency, is easy to administer, is stable and predictable, and can be designed to be more equitable than the other methods evaluated.

Disadvantages: Relies on statistical methods, so is difficult to explain to district officials.

### **Seek Stakeholder Input Before Considering Changes to the Funding System**

The topic of student transportation funding is not just a simple case of inputs and outputs or economic formulas. There are a wide range of stakeholders (parents, labor, management, school districts, students, etc.) that comprise Oregon's student transportation system. These stakeholders and consumers have a stake in the outcomes and can share additional perspectives and expertise that should be considered before any attempt to change Oregon's current funding system is undertaken.

When considering options for changes to Oregon's school transportation funding method, the Department recommends the legislature first seek input from these divergent stakeholders. While the ECONorthwest study provides a clear analysis of the cost and efficiency characteristics of alternative financing methods, input from other interested parties is likely to raise additional issues that are important for the legislature to consider in its decision-making process.

ODE also believes it is important for the Legislature to understand some of the common misperceptions about Oregon's student transportation system as it weighs any changes. For example, many stakeholders equate the word "efficiency" with the contracting out of public services to private companies or the reduction of wages and elimination of benefits. During the course of this budget note, both ECONorthwest and ODE concluded that contracting out of services is not inherently more efficient than services provided by public employees. Especially in these difficult economic times, many stakeholders are fearful that jobs may be lost or benefits, such as healthcare, reduced or eliminated in the name of "efficiency."

There is also some public perception that our student transportation system would be more efficient if only the "wasteful" spending were eliminated. It should be noted that ECONorthwest concluded that school districts have become more efficient in delivering student transportation over the past 8 years. While the current funding system may not provide the strongest incentives for efficiency, neither ECONorthwest nor ODE found evidence that districts are attempting to be anything less than prudent with the transportation funds they receive. Districts respond to the incentives that the funding method provides, but the incentives for efficiency embodied in Oregon's current funding method are simply not as strong as those in the alternative methods that were evaluated.

ODE also strongly believes that the legislature should consider three things above all else in deciding whether or not to move forward with changes to the funding system.

1. Student safety and the safe transportation of all students from school to home or from school to school-related activities should be the primary goal of any funding system.
2. Equity and fair distribution of funds should also be a top priority.
3. Incentives for operational efficiency should be built into the system so that transportation goals can be achieved for the lowest cost possible.

ODE also agrees with the ECONorthwest recommendation that the legislature explicitly consider other goals it wishes to achieve with the school funding method (e.g., greater fuel efficiency for buses or reductions in traffic congestion around schools) as part of its deliberations.

## **Recommendations**

If, after reviewing the ECONorthwest report and listening to stakeholders, the legislature wants to consider changes to the school transportation funding system that could provide stronger efficiency incentives for school districts, the Department of Education recommends consideration of three specific options:

**Option 1: Direct estimates of the efficient level of funding** based on the frontier efficiency model results from the ECONorthwest study. This approach provides strong efficiency incentives for districts and is the most equitable of all the approaches evaluated. This method could be easily implemented as a simple funding ratio, where each district's per-rider funding is expressed as a ratio of the per-rider funding of the lowest-cost district, as shown below:

$$\text{District transportation grant} = \text{Baseline grant amount} * \text{District weight} * \text{Number of riders}$$

Where the *Baseline grant amount* is the per rider level of funding for the least-cost district as estimated by the frontier efficiency model, the *District weight* for each district (also estimated by the frontier model) expresses each district's cost differences from the least-cost district, and *Number of riders* is the number of students transported by the district.

**Option 2: A weighted funding formula** also based on the frontier efficiency model results from the ECONorthwest study. In this option, the results of the frontier efficiency model would be converted to a weighted formula based on the key transportation cost drivers identified in the ECONorthwest study. This formula would be conceptually similar to the weighted formula that Oregon currently uses for the state school fund—that is, a base level of funding plus added funding for conditions that cause costs to be higher.

$$\text{District transportation grant} = (\text{Base grant} + \text{Weight}_i * \text{Cost factor}_i) * \text{Number of riders}$$

Where the *Base grant* is a base amount of funding per rider, *Weight<sub>i</sub>*, estimated from the frontier efficiency model, is the weight applied to *Cost factor<sub>i</sub>* for each district. The cost factors are the cost drivers, identified in the frontier model, that vary across districts and influence the

costs of operating their transportation systems. They include the geographic size of the district, the average distance that students are transported, the number of high-needs special education students transported, and regional wage cost differences.

This approach is more intuitive and should be more familiar to districts than the approach described in Option 1 because it is similar, in structure, to the State School Fund distribution model. Like Option 1, it has strong efficiency incentives, but is likely to be less equitable because it provides less precise estimates of the efficient funding levels for each district.

**Option 3: A block grant approach** using current district transportation spending as the starting point. As with Options 1 and 2, a block grant can be designed to have strong efficiency incentives, but is likely to be less equitable than either Option 1 or 2 because it would perpetuate current inequities in the system. Based on the estimates from ECONorthwest's frontier efficiency model, these inequities are not inconsequential. The advantage of this option over the other two is that it is easier to explain and may be somewhat easier to administer. The block grant would be calculated using the following formula:

$$\text{District transportation grant} = \text{Base year amount} * \text{Growth rate} * \text{Number of riders}$$

Where the *Base year amount* reflects each district's historic per-rider expenditures under Oregon's current funding method and *Growth rate* is the growth in per-rider costs from the base year calculated as a weighted average of the statewide growth rates for fuel, wages and salaries of transportation workers, and buses.

In addition to estimating relative transportation funding needs across districts, all three options described above will require ongoing statewide estimates of changes in transportation costs attributable to changes in the price of fuel, wages and salaries, and buses. We recommend that the responsibility of making those estimates be given to the existing School Revenue Forecast Committee. That group has a proven track record in estimating education cost increases and has the expertise to make the estimates needed for the three options described above.

## **Conclusions**

Oregon's current method of funding student transportation does not provide strong incentives for school districts to seek out the most efficient, least-cost practices.

ODE recommends that the Legislature first seek input from stakeholders and develop a list of clear goals for the student transportation funding system before deciding whether or not to seek changes to the current system.

If the Legislature chooses to seek another option, ODE recommends that the Legislature evaluate the frontier-efficiency approach developed by ECONorthwest, implemented either as a simple funding ratio or as a more intuitive weighted funding formula. It provides strong efficiency incentives by placing the full burden of cost increases, and the full benefits of cost savings, with the school districts. Statewide, ECONorthwest estimates that school districts could reduce their spending on transportation by an estimated \$20 million per year (about 9% of current

transportation spending) while still maintaining the current level of transportation services to students. Either of these approaches would also be more equitable than Oregon's current funding method.

Alternatively, the legislature could choose a block grant approach using district spending under Oregon's current system as the starting point. Block grants, like the efficiency-based approaches, provide strong efficiency incentives by placing the full impact of both cost increases and cost savings with the school districts. A block grant approach is easier to explain and somewhat easier to administer, but at the cost of being less equitable.

The legislature's safety and equity goals, as well as any other goals they may want set for the student transportation system, will influence which of the three options best achieves their objectives.