



MEMORANDUM

To: Members, Joint Appropriations Committee
Members, Joint Education Committee

From: Lawrence O. Picus

RE: JAC Recommendations for the External Cost Adjustment for 2007-08

Date: November 27, 2006

At its November 1, 2006 meeting, the Joint Appropriations Committee voted to recommend a 3.8 percent External Cost Adjustment (ECA) to the Wyoming Block Grant School Funding Model for the 2007-08 school year. The specific choice of 3.8 percent is based on the use of the Employment Cost Index for Education Workers. In our opinion, this is the appropriate inflation measure to use for adjusting the Wyoming Block Grant School Funding Model for the next school year.

The purpose of the ECA is to adjust the amount of funding provided to school districts through the Wyoming Block Grant School Funding Model for changes in the prices of goods and services purchased by Wyoming school districts. The ECA estimates the changes needed in funding for the Funding Model by using the best possible measure of the change in the prices of those goods and services. The Wyoming Supreme Court has called for recalibration to take place once every five years. Given the cost and complexity of that process, and the availability of cost indexes that can approximate changes over time, this approach is appropriate and offers school districts an assurance that they will have adequate resources to provide the basket of education services to all Wyoming School children. Moreover, if the Legislature establishes the ECA early in its budget process, there is sufficient time for school districts to prepare budgets for the upcoming fiscal year.

The ECA thus inflates (deflates) the proper determination of costs by an amount which recognizes the rate of inflation (deflation) in those costs in the period between recalibrations. The use of such an index to adjust funding between five year recalibrations assures adequate funding for all K-12 schools and provides timely information for both the state and local school districts to plan education programs each year. Recalibration of the entire funding model every five years assures the system will remain "cost based" using current methods and technologies.



In its deliberations, based on our report the JAC elected to recommend an ECA of 3.8 percent based on the Employment Cost Index for education workers. The Employment Cost Index (ECI) is a quarterly measure of changes in labor costs. It was established to show changes in wages and salaries and benefit costs, as well as changes in total compensation of employees using a representative sample of employers across the United States. It presents data as a total for all workers and separately for private industry and for State and local government workers, including education workers.

The ECI was developed in the mid-1970s in response to the rapid acceleration of both wages and prices at that time. It currently offers time series data on the average cost of employee wages and offers an alternative to price indexes that consider the costs of goods purchased by consumers. In that regard it is a more accurate reflection of the change in the cost of resources purchased by school districts which are mostly composed of personnel including teachers, administrators and classified employees.

The ECA is applied to that portion of the funding model that is not based on 100 percent reimbursements (e.g. special education and transportation). We estimate that just under 80 percent of the remaining portion of the funding model consists of expenditures for personnel, making the use of an index that estimates the change in the price of education workers the appropriate choice for the ECA.

It could be argued that an alternative index that includes the price of goods purchased by school districts should be used either for the non-personnel portion of the funding model, or for the entire model. We argue against this for two reasons:

1. The price indexes that are typically used are no more accurate predictors of the costs of goods purchased for schools than the Employment Cost Index, and
2. The added complexity of the computation does not justify its use given the relative uncertainty that it provides more accuracy.

First, as detailed in our October 11, 2006 memo, the other indexes that are typically used for this purpose ranged from 2.3 percent (the Employment Cost Index for All management, business and financial private industry workers) to 5.6 percent (the Wyoming Cost of Living Index). The problem with using price indexes of this type is that the basket of goods and services they rely on to estimate changes in prices are different from the goods and services typically purchased by school districts. The ECI for education workers comes closest to measuring changes in the prices of the things school districts typically purchase – teachers, administrators and other education workers.

Second, it has been suggested that the ECA should be split into a personnel and non-personnel index. The difficulty with this approach is that to use one of the non-personnel indexes such as the CPI or WCLI for the 20 percent of the non-reimbursable portion of the funding model makes computation of the ECA more complex with no real guarantee that it is more “cost based.” In fact given the wide fluctuations in the price of such things as gas and oil, having one consistent



measure of the estimated change in costs will provide more stability over time for school districts.

As a result of this analysis, we recommend that the Wyoming Legislature adopt a single ECA figure for the non-reimbursable portion of the funding model, and that for the 2007-08 school year, they rely on the Employment Cost Index for education workers of 3.8 percent.