

REPORT

Principles of a Sound State Education Finance System



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NCSL provides research, technical assistance and opportunities for policymakers to exchange ideas on the most pressing state issues, and is an effective and respected advocate for the interests of the states in the American federal system. Its objectives are:

- Improve the quality and effectiveness of state legislatures.
- Promote policy innovation and communication among state legislatures.
- Ensure state legislatures a strong, cohesive voice in the federal system.

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Introduction

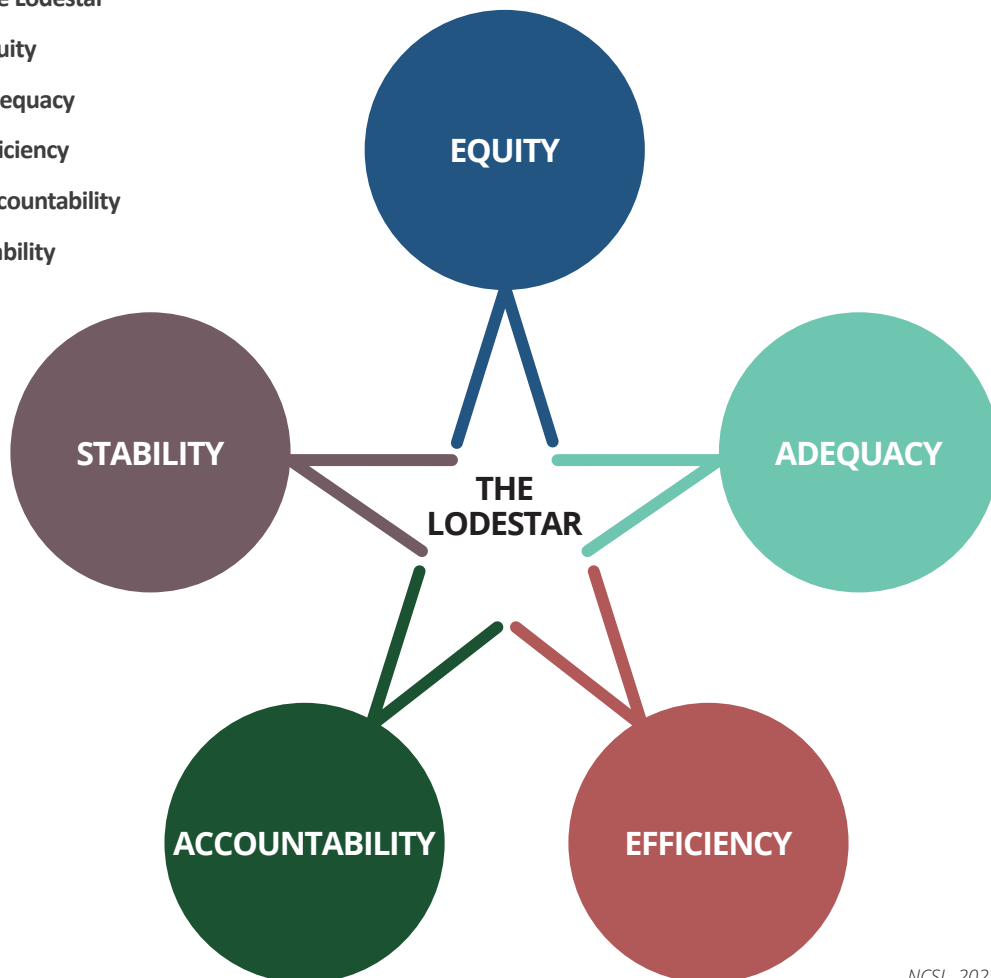
The National Conference of State Legislatures first articulated the five foundational principles of a sound state school finance in its 1996 publication [Principles of a Sound State School Finance System](#): (1) equity, (2) efficiency, (3) adequacy, (4) accountability and (5) stability. The Sound Principles established a framework that has guided state policymakers for nearly three decades. This updated report builds upon that original work, recognizing that while the core five principles remain sound, the education finance landscape has evolved since the mid-1990s and warrants the inclusion of a sixth principle: the Lodestar.

The principles outlined in this report represent more than theoretical constructs—they serve as practical guideposts for state legislators who must navigate the complex intersection of educational goals, fiscal constraints and political realities. These six principles are fundamentally interrelated and interdependent, working together to create finance systems that are effective and sound. No single principle can stand alone; rather, they depend on the presence of each other for a finance system to function well.

The update from the original five principles to six reflects the field’s growing understanding that education finance systems must begin with a clear articulation of purpose—what we now call “The Lodestar.” This addition acknowledges that without a guiding vision, even the most technically sound finance system may fail to serve its intended educational mission.

State legislators serve as the architects of these complex systems, creating the legal and financial frameworks that determine how [billions](#) of dollars in public resources are raised, allocated and spent on education. These principles offer a foundation for crafting finance systems that can remain viable long after current legislative tenures have concluded. They are:

- **The Lodestar**
- **Equity**
- **Adequacy**
- **Efficiency**
- **Accountability**
- **Stability**



NCSL, 2025

What is a State Education Finance System?

A state education finance system encompasses far more than a mechanism for distributing revenues to school districts through funding formulas. It represents a comprehensive framework that governs how educational resources are raised, allocated and managed across multiple levels of government. This system reflects the unique federal structure of American education, where constitutional responsibility for K-12 education falls primarily to state governments while implementation largely occurs at the local level.

The federal education governance system in the U.S. distributes responsibility and oversight over elementary and secondary education to [state governments](#), the [constitutional function](#) of which falling squarely on [state legislative bodies](#) in most states.

State legislatures serve multiple critical roles within this system: they propose and enact tax policies that generate revenue needed to underwrite the education system, direct and authorize local subdivisions of government to levy taxes in support of local education systems, and provide the legal regime under which the entire system operates.

The federal government, for its part, plays a mostly supplementary role in funding K-12 education, with some notable exceptions ([funding for students experiencing homelessness](#) being one). [Federal sources](#) provide on average nearly 9% of funding for public K-12 education, with most of that funding targeted toward low-income ([Title I](#)) and special educations ([IDEA](#)) students.

State legislatures provide the overarching legal framework that governs education finance systems, including the determination of the balance of state versus local funding. This responsibility extends beyond mere fund distribution to encompass regulatory oversight, accountability mechanisms and constitutional compliance. State legislatures are often the entities held constitutionally liable when judicial branches rule that systems fail to serve their constitutional purpose.

The complexity of modern state education finance systems reflects decades of evolution and reform efforts. Historically, local governments raised nearly all revenue needed to build schools and hire teachers. States distributed some funds to school districts or counties on a per capita basis but did so regardless of local fiscal capacity or student needs. The disadvantages of this approach became apparent as conceptions of educational equity and adequacy developed, leading to an augmented role for state governments to aid localities with fewer financial resources. Later, states developed more sophisticated formulas to account for student demographics, district characteristics and local fiscal capacity.

Today's systems operate through geographically based local units of government—school districts—that serve as both the democratic delivery mechanism for education services and the basic units of allocation in education funding formulas. The boundaries and characteristics of these districts, formed through historical processes of community development and consolidation, continue to influence how equitably states allocate education resources statewide. In recent decades, [charter schools](#), which typically enroll students across school and district boundaries, have complicated state equity considerations.

Intergovernmental Aid Formulas

Intergovernmental aid formulas, or education funding formulas, represent the operational heart of state education finance systems. These formulas determine how state and local resources are distributed among school districts to support educational programs and services. The design and implementation of these formulas directly impact the equity, adequacy and efficiency of educational resource allocation across states.

The evolution of education funding formulas reflects evolving conceptions of both [equity](#) and [adequacy](#). By the early 1900s, most states sent a flat dollar amount per student to school districts regardless of their

Why K-12 Education

This report focuses on the financing of elementary and secondary school systems (grades kindergarten to 12). Policy developments since the mid-1990s on both ends of these systems—early-childhood education and services on one end and dual- or concurrent-enrollment programs on the other—though important, are outside the scope of this report. Please refer to [NCSL's resources](#) on those topics.



wealth or need. While simple to administer it resulted in significant funding inequities across districts. **By the 1920s**, more sophisticated foundation plans emerged, whereby the legislature would determine a “foundation” dollar amount per student then adjust the state’s allocation to school districts based on their relative wealth. **By one count**, 38 states employed a flat grant system in the 1930s. The mid-twentieth century saw further refinements to address the extra costs associated with students living in poverty, students with disabilities and English learners.

In the late 1970s and early 1980s, researchers and economists strengthened their conceptual framework for equity and adequacy by introducing methods to adjust for **cost differentials**, a recognition that education costs can shift based on district enrollment (large versus small enrollment sizes) or costs associated with different regions within a state, e.g., urban versus rural areas. Cost differentials can be applied in all funding formula types.

Most state education finance systems today employ one of several primary formula types, each with distinct characteristics and policy implications. **Foundation formulas** provide school districts with a base amount of funding per student, with additional money or weights added to provide extra support for **students with higher needs**. School districts that are geographically isolated or enroll a small number of students or may also receive additional weights to account for diseconomies of scale. **Approximately 36 states** employ foundation formulas today.

Resource-based allocation formulas ensure all school districts receive a minimum level of resources —i.e., staffing, services or programs—based on ratios of students to staff. **Guaranteed tax base formulas, categorical aid, block grants** and **direct reimbursements** represent other approaches taken by states to determine and distribute resources across school districts. In practice, most states employ **hybrid models** that combine aspects of these different approaches.

Modern **formulas often incorporate multiple components** beyond basic foundation or resource-based aid distributions. **Weighting factors**, for instance, act as multipliers in conjunction with foundation aid to provide additional resources for students or school districts with greater needs. Categorical aid targets funding for specific purposes such as transportation or special education. Some states have also developed **competitive funding components** and **incentive aid** programs that reward schools or districts for student performance.

The effectiveness of these funding formulas depends heavily on their alignment with state educational goals and their responsiveness to the diverse needs of students and communities they serve. Well-designed formulas can promote both equity and adequacy while maintaining efficiency, local flexibility and accountability. Long-term student growth is further supported when school districts can plan on predictable, stable funding.

The Six Principles of a Sound State Education Finance System

■ The Lodestar

A sound education finance system begins with and supports the overarching vision and mission of the entire education system.

■ Equity

A sound education finance system adjusts for student needs, school district characteristics and local economic capacity to ensure resources are proportional to need.

■ Adequacy

A sound education finance system provides sufficient resources across the system to achieve reasonable and manageable goals of the statewide education system.

■ Efficiency

A sound education finance system aligns resource allocations—at every level—to the goals of the statewide education system, while enabling flexible decisions closest to students where the impact is greatest.

■ Accountability

A sound education finance system promotes accountability through transparency and includes the ability to link financial decisions to the goals of the statewide education system.

■ Stability

A sound education finance system delivers stable funding for schools and school systems by relying on a mix of revenue sources that behave predictably over time.

The Lodestar: Vision and Mission Alignment

A sound education finance system begins with and supports the overarching vision and mission of the entire education system.

The Lodestar principle represents the most significant addition to the original 1996 framework, acknowledging that sound education finance systems must begin with and support the overarching vision and mission of the entire education system. This principle derives its name from the Middle English “lode-sterre,” meaning a guiding star that serves as inspiration, a model or a guide for travelers.

The Lodestar principle recognizes that the other principles do not exist independently—efficiency is not pursued for its own sake, nor equity merely for equity’s sake—rather, they work in tandem to achieve the goals articulated in the system’s guiding vision. Without this guiding star, education finance systems can become misaligned when competing educational objectives are present.

The principle developed out of education reforms following landmark litigation, prominently the Kentucky case [Rose v. Council for Better Educ., Inc.](#) In 1989, the Kentucky Supreme Court ruled that the state’s education finance system violated the state constitution. It ordered the General Assembly to rewrite the system guided by a set of standards, or a Lodestar. The [standards](#) stipulated that the finance system would provide each child with specific capacities including sufficient communication skills, economic and social knowledge, understanding of governmental processes, self-knowledge, grounding in arts and preparation for advanced training.

Massachusetts provides another compelling example of Lodestar implementation through its response to a similar court directive in [McDuffy v. Secretary of Executive Office of Educ.](#) Rather than simply reforming the finance system, state leaders articulated standardized learning objectives for K-12 students, mapped a finance system that tracked their vision for learning, estimated costs for students to meet standards, calculated local district capacity to fund these costs, and then substantially increased its share of funding to meet these costs. This [comprehensive approach](#), combined with end-of-year assessments, helped lead to Massachusetts students outperforming peers nationally and internationally.

A Lodestar serves as a crucial decision-making guide when policymakers face difficult resource allocation choices. It provides clarity of purpose that transcends shifts in politics or personalities, serving as a consistent guide for long-term policymaking. The vision becomes a touchstone that continually guides the work through what is often a lengthy reform process.

Equity

A sound education finance system adjusts for student needs, school district characteristics and local economic capacity to ensure resources are proportional to need.

The Equity principle ensures that sound education finance systems adjust for student needs, school district characteristics and local economic capacity to ensure resources are proportional to need. This principle recognizes that achieving true educational equity requires more than equal treatment—it demands a differentiated resource allocation that accounts for varying student needs and local circumstances.

Equity in education finance encompasses both horizontal and vertical dimensions. **Horizontal equity** refers to the equal treatment of students who are similar in their characteristics, ensuring that students with comparable needs receive roughly equivalent resources regardless of their school district. **Vertical equity** addresses the degree to which students who differ due to educational disadvantages receive appropriately differentiated treatment and resources.

The principle also encompasses equity for school districts through the concept of **fiscal neutrality**. This concept holds that there should be little to no relationship between local fiscal capacity to raise revenue and the total amount of funding available to local school districts to finance their education operations. Systems with high fiscal neutrality minimize the relationship between local capacity and district spending.

The principle requires states to account for multiple factors that affect educational costs and outcomes. Students with limited English language proficiency or special education needs, or students from low-income backgrounds require additional resources to achieve comparable outcomes. School district characteristics including size, geographic isolation and regional cost variations also influence resource requirements.

Adequacy

A sound education finance system provides sufficient resources across the system to achieve reasonable and manageable goals of the statewide education system.

The Adequacy principle ensures that education finance systems provide sufficient resources across the system to support reasonable and manageable goals of the statewide education system. This principle addresses the fundamental question of whether available resources are enough to enable students, teachers, schools and districts to meet established educational standards and expectations, set forth in state standards, constitutional provisions, and, in some states, court decisions.

Adequacy represents a critical shift from historical approaches that focused primarily on equalizing inputs. The principle recognizes that equal funding may be insufficient if the baseline level fails to support the state's educational goals. It also recognizes that the baseline level will vary across school districts based on student needs and local cost factors.

Defining adequacy requires careful attention to the relationship between resources and educational outcomes. Adequacy should be understood as the cost of achieving student outcome goals, with costs estimated across all school districts using consistent outcome benchmarks. This differentiated approach ensures that measurements of adequacy are comparable across different contexts while accounting for legitimate **cost variations**.

The principle encompasses both statewide adequacy—providing all students with sufficient funding to achieve common outcome goals—and contemplates how adequacy interacts with equity considerations. A state, for instance, may conceivably fund all its school districts at an adequate level (or above) while tolerating wide variations in spending across these same districts. Conversely, school districts in another state may not have access to adequate funding but have access to equitable funding relative to each other.



States balance adequacy and equity considerations with a significant degree of variability. Utah, for instance, strongly emphasizes horizontal equity, with one of the nation’s smallest gaps between lowest and highest spending districts, while also elevating vertical equity, ensuring greater resources for districts with higher concentrations of students in poverty. In 2022, Utah’s low-wealth districts received 62% more resources than high-wealth districts, making it arguably [the most equitable system in the country](#) by this measure.

Equity, however, must be understood in the broader context of adequacy. While Utah achieves remarkable equity, its per pupil spending remains among the nation’s lowest at [\\$10,458](#) in the 2021–22 school year. Per pupil spending in the U.S. averaged [\\$15,630](#) during the same school year. By contrast, New York’s lowest-spending district spent [\\$16,446](#) per pupil—well above Utah’s average—with the state average reaching [\\$28,233](#). (All figures are [adjusted for regional cost differences](#).) This comparison illustrates the complex relationship between equity and adequacy principles.

The availability of resources (or funding) for K-12 education ultimately is borne out of the legislative process. Even where [state courts have ruled](#) that funding for K-12 education is inadequate, the U.S. Supreme Court observed that “[the ultimate solutions must come from the lawmakers and from the democratic pressures of those who elect them](#).” Even with those democratic pressures in the background, state lawmakers can incorporate [evidence-based approaches](#) in their funding decisions to ensure that funding levels are based on legitimate educational costs, rather than political considerations or historical precedents.

Efficiency

A sound education finance system aligns resource allocations—at every level—to the goals of the statewide education system, while enabling flexible decisions closest to students where the impact is greatest.

The Efficiency principle ensures that education finance systems align resource allocations at every level with the costs required to achieve statewide education system goals. This principle recognizes that productive uses of resources tend to occur at points closest to students, where decisions have the greatest impact on educational outcomes.

The principle requires clear definitions of key concepts. **Productivity** represents the ratio of educational inputs (resources) to outputs (student learning). Spending encompasses expenses associated with educational programs and services regardless of outcomes. Cost represents the minimum amount needed to

achieve specific student outcome levels given student backgrounds and contextual constraints. **Efficiency** emerges from the relationship between spending and cost, with inefficiency representing the margin of spending above minimum cost requirements. Spending not proximately associated with the classroom, however, is not necessarily inefficient. Much of the spending on low-income students, for instance, provides meals, transportation or counseling for these students. Students who are not hungry or who are ensured a safe ride home learn better.

The principle emphasizes that **productive resource use occurs closest to students** where decisions most directly impact learning. This suggests that finance systems should provide flexibility for local decision-makers to adapt resource allocation to specific student and community needs while maintaining accountability for results.

Flexibility serves multiple important purposes within education finance systems. It allows local education agencies to adapt resource allocation to their specific student populations and community contexts. It enables systems to accommodate economic, demographic, technological and pedagogical changes over time without requiring frequent wholesale formula revisions. It empowers recipients of funding to make decisions that best serve their students rather than constraining them with detailed mandates from higher levels of government.

To ensure that flexibility does not retreat into inefficiency, and inefficiency into underperforming school systems, sound education finance systems balance flexibility with accountability, like opposite ends of a teeter-totter. Where school districts' flexible spending patterns fail to serve students, states can provide technical assistance and oversight to these districts to get them back on track.

Efficiency also encompasses administrative considerations. Efficient systems minimize the cost of state oversight through ease of administration and local compliance. Complex systems that require extensive bureaucratic overhead may undermine efficiency even if the systems achieve other policy objectives.

Accountability

A sound education finance system promotes accountability through transparency and includes the ability to link financial decisions to the goals of the statewide education system.

Accountability is promoted through transparency and the ability to link financial decisions to statewide education system goals. This principle recognizes the need to balance state oversight responsibilities with local autonomy and innovation.

Traditional accountability approaches often emphasized compliance with input requirements and procedural mandates. The updated principle shifts focus toward outcome-based accountability **that links financial decisions to educational results** while providing flexibility in how those results are achieved. This approach recognizes that rigidity may hinder innovation and local responsiveness to student needs.

The principle requires robust data collection and analytical systems to support informed decision-making. States must collect comprehensive finance data and make it readily available to stakeholders through accessible, transparent monitoring systems.

Effective accountability systems provide mechanisms for identifying and addressing resource misallocations. When school districts allocate resources contrary to state policy, systems need levers to identify problems and processes to address them. Similarly, when resource-need mismatches occur, systems should provide mechanisms to mitigate these disparities.

The principle acknowledges that funding formulas undergo substantial revisions approximately every 25 years on average. Systems must therefore incorporate flexibility to accommodate changes without requiring complete overhauls. This includes feedback loops between practitioners and policymakers to inform when and where resources are insufficient to meet stated educational objectives.

Contemporary accountability approaches increasingly emphasize performance-based elements that link funding to student outcomes. However, these systems must be carefully designed to avoid unintended consequences such as narrowing curriculum focus or penalizing schools serving high-need populations.

Stability

A sound education finance system delivers stable funding for schools and school systems by relying on a mix of revenue sources that behave predictably over time.

The Stability principle ensures that education finance systems foster durable funding for school and school systems by relying on a mix of revenue sources that behave predictably over time. This principle recognizes that educational improvement requires sustained investment, and that unpredictable funding undermines state and local decisionmakers' capacity to effectively plan for and make progress on goals over time.

Revenue stability has become increasingly important as states have assumed larger roles in education financing. The shift from predominantly local funding to greater [state involvement has made education systems more vulnerable](#) to economic downturns that affect state revenues. During the Great Recession, for instance, [nearly 300,000 school employees](#) lost their jobs, and [inequality in school spending rose](#), especially in states with more centralized funding systems.

The principle advocates for [diversified revenue portfolios](#) that combine different tax sources with varying economic sensitivities. This “three-legged stool” approach typically includes property taxes, income taxes and sales taxes, each responding differently to economic cycles. Property taxes tend to provide more stable revenue streams, while income and sales taxes may be [more volatile](#) but can grow more rapidly during economic expansions. Budget stabilizations funds, or [rainy day funds](#), can also provide a welcomed cushion during economic contractions. To emphasize the point, the absence of such a cushion during the Great Recession drove Californians to vote overwhelmingly to establish [a rainy day fund in 2014](#).

The Great Recession also demonstrated the importance of revenue diversification. Schools [heavily dependent on state funding](#) proved particularly vulnerable to the economic downturn, as state income and sales tax revenues fell sharply. Conversely, [property tax revenues actually increased](#) during the Great Recession as many school districts raised tax rates to offset declining property values.

The stability principle extends beyond revenue sources to encompass predictable funding formulas and allocation mechanisms. School districts require sufficient notice of funding levels to plan effectively for staffing, programs and services. Frequent formula changes or unpredictable state budget cycles can undermine local planning efforts and reduce system efficiency.

Conclusion

The six principles outlined in this report provide a comprehensive framework for evaluating and improving state education finance systems across all states. These principles—the Lodestar, Equity, Adequacy, Efficiency, Accountability and Stability—work together as an integrated system rather than as isolated components.

Successful implementation requires recognizing the interdependent nature of these principles and the need to balance competing priorities within political and fiscal constraints. While no state finance system will achieve perfect implementation of all principles, states can use this framework to identify areas for improvement and guide reform efforts.

The evolution from the original 1996 principles to this updated framework reflects the maturation of education finance as a field of study and practice. The addition of the Lodestar principle acknowledges the fundamental importance of vision and mission alignment, while refinements to other principles incorporate decades of research and practical experience.

State legislators, as the architects of these complex systems, can continue to inject these principles into the foundational design of their education finance systems. The principles provide guidance for creating systems that can remain viable and effective long after current legislative tenures conclude.

■ *NCSL wishes to thank the Learning Policy Institute for its partnership and support of the Education Finance Fellowship and this publication.*

Glossary

Adequacy – ensures education finance systems provide sufficient resources for all students to achieve a common set of goals or outcomes, accounting for differences in costs across districts and populations.

Block grants – allocates funding to districts for broad educational purposes, without strict restrictions on specific expenditures.

Categorical aid – directs funding exclusively to categories of programming or populations for specific educational needs, limiting general use.

Competitive funding – distributes education resources based on the quality of district or school proposals in a competitive process meant to encourage innovation or improvement.

Cost – represents the minimum efficient spending needed for a given level of student achievement.

Cost differentials – refer to unavoidable variations in educational service costs across districts due to geographic, demographic and other regional factors.

Direct reimbursements – states pay districts for actual documented expenses in specific programs or services after costs have been incurred.

Efficiency – ensures resources are used to maximize educational outcomes with minimal waste.

Equity – provides funding adjusted for student needs, district characteristics and local capacity so all students get proportional resources for comparable opportunities.

Equity, horizontal – students with similar educational needs receive equivalent resources across districts, ensuring their equal treatment.

Equity, vertical – students or districts with greater needs or different circumstances get appropriately more resources to achieve comparable outcomes.

Fiscal neutrality – aims to eliminate the influence of local property wealth on total available funding, equalizing resources regardless of district tax base.

Flat grants – provide a fixed dollar amount per student to every district, regardless of local differences or actual needs.

Foundation formulas – guarantee every district a minimum revenue per pupil, with state aid filling gaps caused by insufficient local tax capacity.

Guaranteed tax base formulas – ensure districts can access comparable property wealth per pupil for similar tax effort, equalizing revenue regardless of actual district wealth.

Hybrid models – combine features of different funding formulas to address various policy goals within a single state system.

Individuals with Disabilities Education Act (IDEA) – federal law requiring states to provide appropriate education for students with disabilities, partially funding special education services.

Incentive aid – rewards districts or schools financially for meeting performance goals, showing improvement or adopting desired practices.

Productivity – measures student learning and achievement gained per unit of resources spent, focusing on maximizing outputs for given inputs.

Resource-based allocation formulas – distribute staffing and resources based on set student-to-staff ratios, aligning allocations with enrollment rather than discretionary decisions.

Title I (of the Elementary and Secondary Education Act (ESEA)) – provides supplemental federal funds to schools serving high concentrations of low-income students.

Weighting factors – apply multipliers in formulas to increase funding for students or districts with higher needs or costs above the base allocation.

NCSL's Education Finance Fellowship

This report was developed by NCSL's Education Finance Fellowship. The fellowship began in 2017 in a collaboration between NCSL and the Learning Policy Institute as a venue for legislators and legislative staff to learn more about the complex topic of education finance. To date, 94 legislators and staff from 36 states have served as education finance fellows. They gather to engage with top national researchers, thinkers and experts on an array of K-12 education finance topics. From in-person and virtual meetings to one-on-one technical assistance, the following objectives have guided the fellowship:

- *Build knowledge among legislators and staff about new research and policy in education finance.*
 - *Promote exchange of ideas and solutions related to school funding inequities, opportunity gaps and other issues.*
 - *Introduce and connect legislators and staff to other legislative education finance leaders.*
 - *Facilitate access to leading national researchers and policy experts in education finance.*
- The findings of the report were developed on a bipartisan basis among the members of the fellowship in consultation with Learning Policy Institute staff and other education finance researchers and experts.*

Disclaimer

This report is the product of NCSL's Education Finance Fellows. The views and findings expressed in the report are solely those of the fellowship. The report does not represent the views or opinions of any one member, NCSL, or the supporting organizations of the fellowship.

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