

WHAT WOULD PROPOSITION 76 MEAN FOR EDUCATION?

Governor Schwarzenegger's California Recovery Team, a business-backed coalition, has placed an initiative on the November special election ballot that would dramatically change the rules governing the state's budget process and make significant changes to the Proposition 98 school funding guarantee. This *Brief* examines the provisions that would affect the state's school funding guarantee and concludes that Proposition 76:

- Could lead to cuts in school funding due to the operation of the new state spending cap.
- Would reduce the long-term school funding guarantee by \$3.8 billion. In K-12 education, this translates into an annual reduction of slightly less than \$600 per pupil.
- Would allow reductions to, but not increases in, Proposition 98's minimum school funding guarantee by allowing the governor to unilaterally reduce school spending, while eliminating the maintenance factor provisions contained in current law.
- Eliminate "test 3" and the maintenance factor provisions of the Proposition 98 school funding guarantee, as well as the state's obligation to restore the guaranteed funding level to reflect repayment of current maintenance factor obligations. Instead, Proposition 76 would require the state to make one-time payments totaling the state's outstanding maintenance factor obligations within 15 years.
- Exclude any "overappropriations" of the school funding guarantee from the base used to calculate future years' funding guarantees.
- Establish a schedule for repaying schools for so-called "settle-up" obligations.
- Give state-mandated programs "first call" on state dollars appropriated to schools.

The Legislative Analyst concludes that, "Overall, the measure's Proposition 98-related changes would result in the annual budgets for K-14 education being more subject to annual funding decisions by state policymakers and less affected by the minimum guarantee."

Proposition 76's Changes to School Funding: An Overview

Proposition 76 would:

- Impose a new limit on state spending based on the average growth in General Fund and special fund revenues for the three prior years.
- Allow the governor to unilaterally reduce school funding below the level required by the Proposition 98 guarantee under certain circumstances. The lower level of funding would become the "base" used to calculate the funding guarantee for the next fiscal year.

The New Spending Limit Could Pit School Spending Against Other Priorities

Proposition 76 would create a new limit on state spending that would be in addition to, not a substitute for, the existing State Appropriations Limit (SAL). The new limit would apply to "total expenditures" and spending could increase by no more than the average revenue growth in specified funds for the three prior years. Analyses of historical spending and revenue data by the California Budget Project (CBP) suggest that Proposition 76 would substantially reduce spending over time.¹ This finding is supported by the Legislative Analyst's analysis of Proposition 76, which concludes that, "Over time, we believe that the

operation of this limit would likely reduce state expenditures relative to current law.”²

The CBP analysis found that the 2005-06 Budget spends substantially more than would be allowed by Proposition 76 under any of three base year scenarios examined. This analysis found that reductions equal to 11.1 percent of 2005-06 spending would be required to reach the cap under 1987 and 1990 base year scenarios, while reductions equal to 5.2 percent of 2005-06 spending would be needed to reach the cap under a 1995 base year scenario. Assuming that reductions were made on an across-the-board basis, K-12 education spending would be cut by \$4.1 billion under the 1987 and 1990 base year scenarios and \$1.9 billion under the 1995 base year scenario, equivalent to \$675 and \$316 per pupil, respectively.

To the extent Proposition 76 limited allowable spending, regardless of available resources, the Legislature would be forced to choose which programs to cut to bring spending into alignment with the cap. While school funding would remain subject to the Proposition 98 guarantee, competition for room under the spending cap could increase pressure on the Legislature to suspend the Proposition 98 guarantee in order to avert deep reductions in other areas of the budget. While the Legislature could choose not to cut school spending, doing so would necessitate deeper reductions to higher education, health care, public safety, or other program areas.

The Governor Could Cut School Spending Below the Proposition 98 Guarantee

Proposition 76 would give the governor unilateral authority to declare a fiscal emergency and cut spending under specified circumstances. Proposition 76 states that, “Notwithstanding any other provisions of this Constitution...the Governor shall reduce items of appropriations as necessary to remedy the fiscal emergency.” This authority would allow the governor to reduce K-14 education spending below the level required by the Proposition 98 school funding guarantee, as well as to reduce other constitutionally dedicated spending. The impact of any reductions made by a governor would permanently reduce the minimum funding guarantee for schools, since Proposition 76 also eliminates the obligation to restore funding in years when schools receive less than the minimum required by Proposition 98 (see below).

Proposition 76 Eliminates “Test 3” and Maintenance Factor Obligations

Current law provides two mechanisms for reducing school funding below the minimum required under “normal” or “test 2” years.¹⁰ The first allows the Legislature to suspend the Proposition 98 guarantee by a two-thirds vote. The second

How Does California’s Funding for K-12 Education Compare to That of the Nation?

California lags the rest of the US in K-12 education spending per pupil, education spending as a percentage of personal income, and the number of students per teacher:

- In 2004-05, California ranked 35th among the 50 states and the District of Columbia in per pupil school expenditures, spending \$1,051 less per pupil than the nation as a whole.³ If California had spent the same amount per pupil as the US in 2004-05, the state’s schools would have received an additional \$6.4 billion.
- Californians also spent a smaller share of their personal income on K-12 education than residents of most other states. In 2004-05, California ranked 39th among the 50 states and the District of Columbia on this measure, which is one indicator of a state’s ability to pay.⁴ If California had spent the same share of the state’s personal income on K-12 education as the nation as a whole in 2004-05, schools would have received an additional \$4.5 billion.
- California had the fourth-highest number of K-12 students per teacher in the country in 2004-05. California’s schools had 19.3 students for each teacher, compared to 14.7 students per teacher for the US as a whole.⁵

California was not always a national laggard in its financial commitment to K-12 education. Throughout the 1970s, the state’s per pupil spending exceeded the nation’s by an average of almost 8 percent. However, school spending began to fall following the passage of Proposition 13 in 1978 and since 1980 has been, on average, about 9 percent less than that of the rest of the US. In 2004-05, California’s spending per pupil lagged that of the US by 11.5 percent.⁶

K-12 education spending as a share of personal income has been consistently lower in California than in the US overall; however, the state now trails the nation by greater margins than it did in the 1970s. For example, in 1977-78, just prior to the implementation of Proposition 13, Californians spent 95.1 percent as much as the rest of the nation on education as a share of personal income, while in 2004-05 they spent only 91.6 percent.⁷

California has consistently exceeded the US with respect to the number of pupils per teacher. However, the number of pupils per teacher in California now exceeds that of the nation by a much greater margin than in the 1970s, despite the effort beginning in 1996 to reduce classroom size in grades K-3.⁸ In 2004-05, the number of pupils per teacher was 31.5 percent higher in California than in the US, compared to 17.8 percent higher in 1977-78.⁹

provides an alternative formula ("test 3") that requires a smaller increase in school funding.¹¹ These provisions are designed to prevent the non-education share of the budget from experiencing disproportionate cuts during bad budget years.

Under current law, a maintenance factor obligation is created whenever funding is below the test 2 level. As the state's revenues improve, funding is restored to the test 2 level. The restoration of funds increases the base used to calculate the guarantee in future years. The current requirement does not treat amounts below the test 2 year as a loan and schools are not repaid for the funds they did not receive in a test 3 level or during a suspension. Instead, as the state's revenues improve, the minimum funding guarantee increases to the level where it would have been if funding had stayed at test 2.¹²

Proposition 76 repeals the maintenance factor requirements of the Proposition 98 guarantee. This eliminates the obligation to restore the school funding to the long-term test 2 funding level if the Proposition 98 guarantee is suspended or if a governor reduces school funding below the minimum guaranteed level during a fiscal emergency. The Legislative Analyst notes that elimination of the maintenance factor obligation would "permanently 'ratchet down' the Proposition 98 minimum guarantee" if school funding is reduced below the test 2 level in any given year.¹³

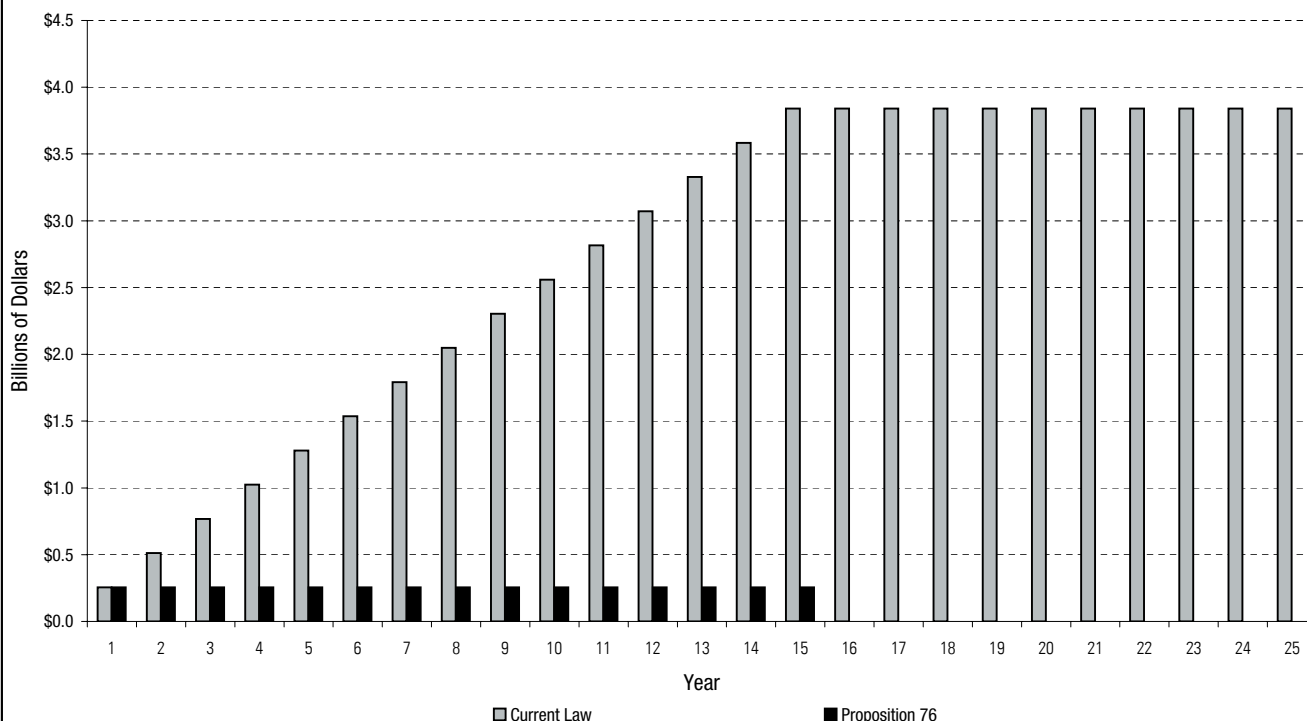
Proposition 76 also repeals test 3 of the Proposition 98 guarantee, while retaining the Legislature's ability to suspend the guarantee by a two-thirds vote. The elimination of test 3 could also result in deeper reductions to non-education portions of the budget in bad budget years. Opposition to suspending the Proposition 98 guarantee would likely increase since what are now one-time reductions in school funding would become permanent cuts.

The Current Maintenance Factor Obligation Would Be Turned Into a One-Time Payment

The state currently has a \$3.84 billion maintenance factor obligation. This obligation reflects \$1.8 billion attributable to funding K-14 education at the test 3 level during the recent budget crisis and \$2 billion from the suspension of the Proposition 98 guarantee in 2004-05.¹⁴ Under current law, school funding would be increased as the state's revenues improve and the long-term base used to calculate the Proposition 98 guarantee would be increased by this amount. As funding is restored to the base, the base increases to reflect changes in per capita personal income and enrollment.

As noted above, Proposition 76 repeals the state's obligation to restore school funding to the long-term test 2 level. Instead, the state would be required to make one or more one-time payments

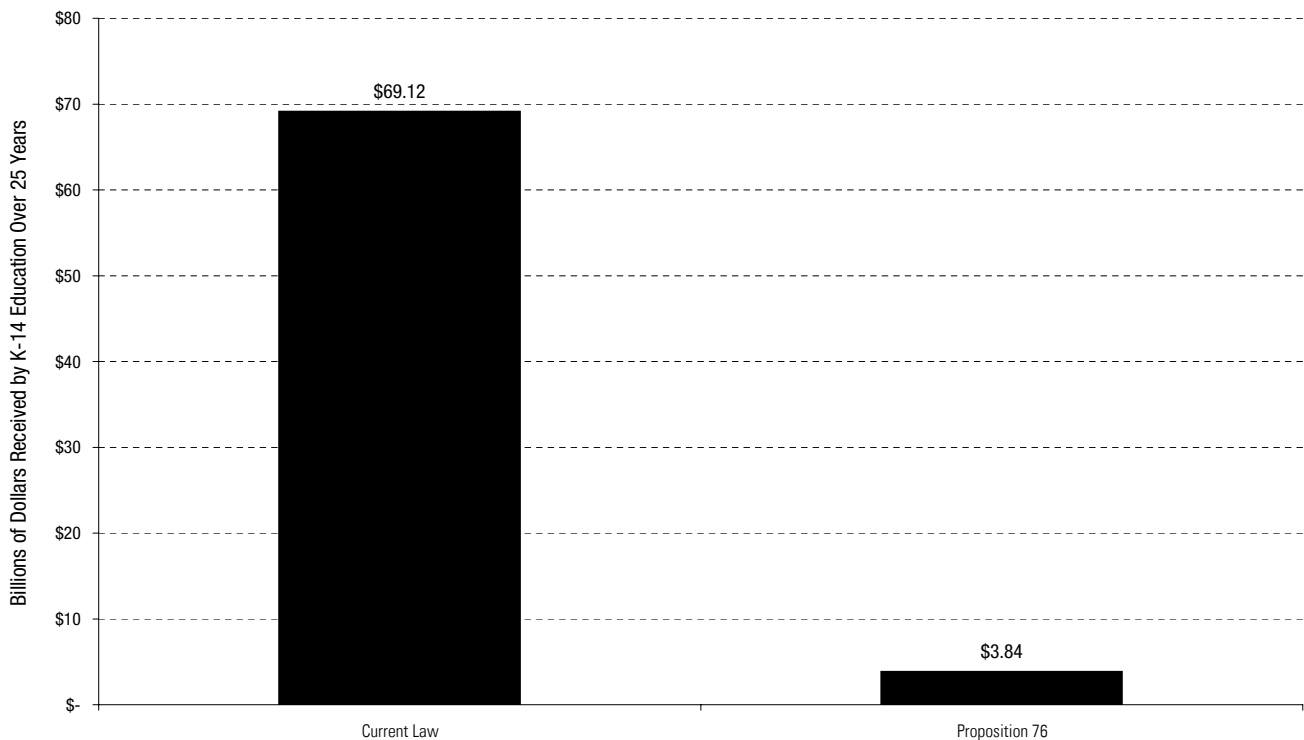
Figure 1: How Does Proposition 76's Maintenance Factor Provision Differ from Current Law?
Assumes Restoration Over 15 Years Under Current Law and 15 Equal Payments Under Proposition 76



Note: Assumes restoration over 15 years under current law and 15 equal payments under Proposition 76.
Source: CBP calculations

Figure 2: How Is Proposition 76 Different from Current Law?: A 25 Year Hypothetical Comparison

Assumes Restoration Over 15 Years Under Current Law and 15 Equal Payments Under Proposition 76



Note: Assumes restoration over 15 years under current law and 15 equal payments under Proposition 76.
Source: CBP calculations

totaling the current outstanding balance no later than July 1, 2021. The difference between current law and the proposed change is significant.¹⁵ Assume, for example, that under current law, the base funding level was increased to reflect the outstanding maintenance factor obligation in 15 equal increments (Figure 1). At the end of this period, the minimum guarantee would increase by \$3.84 billion.¹⁶ Over 25 years, schools would receive a total of \$69.1 billion plus inflation and enrollment adjustments attributable to the \$3.84 billion as the maintenance factor obligation is restored pursuant to current law. Under Proposition 76, after 25 years, schools would receive a total of \$3.84 billion (Figure 2). The difference translates into slightly less than \$600 per pupil per year in K-12 education, enough to pay the salaries of approximately 60,000 teachers.

Future “Overappropriations” of the Proposition 98 Guarantee Would Not Increase the Base

Under current law, any amounts allocated to school funding in excess of the minimum Proposition 98 guarantee become part of the base used to calculate the minimum funding level for subsequent years. As a result, any “overappropriation” of the guarantee increases the minimum funding level in the future. Some argue that this requirement discourages lawmakers from spending more than the minimum required, since the added

spending increases the state’s long-term fiscal obligations. Others argue that without an ongoing guarantee of continued funding, school districts are reluctant to commit any additional funds to ongoing expenses, such as more teachers or higher staff salaries.

Proposition 76 would exclude any amounts appropriated in excess of the minimum funding level from the calculation of future years’ funding obligations. Thus, overappropriations would become one-time payments, rather than an ongoing obligation.

The 2005-06 Budget provides \$740 million more to K-14 education than is minimally required by the Proposition 98 guarantee.¹⁷ Under current law, this amount would raise the minimum guarantee by an equivalent amount in 2006-07 and beyond. Under Proposition 76, the \$740 million would become a one-time payment and would not increase the minimum guarantee.

Other Changes to the Proposition 98 Guarantee

In addition to the changes described above, Proposition 98 would:

- Require so-called “settle-up” payments owed to schools for 2003-04 and prior fiscal years to be allocated within 15 years of the effective date of Proposition 76. The state currently

owes schools over \$1 billion in settle-up payments. Under current law, these amounts would be repaid at approximately \$150 million per year beginning in 2006-07.¹⁸ Under Proposition 76, outstanding amounts could be repaid at any time within 15 years of the measure's effective date.

- Divide settle-up payments and the one-time payment in lieu of the existing maintenance factor restoration between K-12 education and community colleges based on the share of Proposition 98 funding each received in 2005-06.
- Require settle-up payments for 2004-05 and future fiscal years to be appropriated within 24 months of the end of the fiscal year.
- Require the state to appropriate amounts owed to schools for state-mandated programs no later than the 2020-21 fiscal year.¹⁹
- Require that amounts allocated to schools under the minimum funding guarantee must first be used for state-mandated programs.
- Specify that, in years when revenues exceed allowable spending, half of the General Fund's share of any excess would be used to make one-time payments equal to the state's outstanding maintenance factor obligation, repay amounts owed to various transportation funds, or repay outstanding deficit financing bonds. The Legislature would

determine how much of the excess to allocate between these three purposes. An additional 25 percent would be dedicated to roads, highways, and school construction. The allocation of funds between these three purposes would be left to the Legislature and there is no set allocation of funds to any of the three purposes.

What Would Proposition 76 Mean for Long-Term School Funding?

Proposition 76 would reduce the long-term school funding guarantee and could limit future growth in the minimum funding level. The most significant change is the exclusion of outstanding maintenance factor obligations from the long-term minimum funding level. Instead, schools would receive one or more one-time payments totaling the outstanding obligation. This change would reduce the long-term funding guarantee by \$3.84 billion.

Taken together, changes made to the Proposition 98 guarantee would allow funding to be reduced below the level required under current law. In contrast, Proposition 76 would not prevent the Legislature from spending more than the minimum required level, but these amounts would not increase the minimum guarantee. The Legislative Analyst concludes that Proposition 76 would "result in the annual budgets for K-14 education being more subject to annual funding decisions by state policymakers and less affected by the minimum guarantee."²⁰

Jean Ross prepared this Budget Brief. The California Budget Project (CBP) neither supports nor opposes Proposition 76. This Budget Brief is designed to help voters reach an informed decision based on the merits of the issues. The CBP was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

¹ This analysis is presented in California Budget Project, *Proposition 76's New Spending Cap Could Require Substantial Spending Cuts* (September 2005).

² Legislative Analyst's Office, *Proposition 76. State Spending and School Funding Limits. Initiative Constitutional Amendment*, downloaded from http://www.ss.ca.gov/elections/vig_2005.htm on September 16, 2005.

³ CBP analysis of National Education Association data.

⁴ CBP analysis of National Education Association and US Bureau of Economic Analysis data.

⁵ CBP analysis of National Education Association data.

⁶ CBP analysis of National Education Association and National Center for Education Statistics data.

⁷ CBP analysis of National Education Association and National Center for Education Statistics data.

⁸ George W. Bohrnstedt and Brian M. Stecher, eds., *What We Have Learned About K-3 Class Size Reduction in California* (California Department of Education: September 2002), p. 4.

⁹ CBP analysis of National Education Association and National Center for Education Statistics data.

¹⁰ Under most circumstances, the minimum funding level is calculated using test 2. Under current law, whenever funding is below the test 2 level, a maintenance factor obligation is created. As the state's revenues improve, funding is restored to the test 2 level, and this restoration of funding increases the base used to calculate the spending guarantee for future years. A suspension of the Proposition 98 guarantee also creates a maintenance factor obligation.

¹¹ This provision, known as "test 3," applies in years when per capita General Fund revenues decline or increase more slowly than per capita personal income. A third test, "test 1" requires a set percentage of General Fund revenues to go to schools, but that test has not been used since 1988-89.

- ¹² Under current law, the adjustment factor for test 3 is based on per capita General Fund revenue growth.
- ¹³ Legislative Analyst's Office, *Proposition 76. State Spending and School Funding Limits. Initiative Constitutional Amendment*, downloaded from http://www.ss.ca.gov/elections/vig_2005.htm on September 16, 2005.
- ¹⁴ EdSource, *Proposition 76: State Spending and School Funding Limits* (September 2005) downloaded from <http://www.edsource.org/pdf/prop76.pdf> on September 23, 2005.
- ¹⁵ Consider this analogy. An individual earns \$40,000 per year. Her employer falls on hard times and asks the worker to take a \$10,000 per year pay cut. If Proposition 98 applied to this situation, the worker's salary would be returned to \$40,000 per year when the employer's financial condition improved. The worker would be guaranteed a \$40,000 salary in the future, but would not be repaid for any amounts lost even if it took several years for the employer's financial condition to improve. Proposition 76 would not require the employer to restore the worker's salary to its former level. The worker would receive amounts owed prior to the effective date of the Act over 15 years, but these payments would be bonuses and would not increase her salary above \$30,000 per year.
- ¹⁶ In fact, the base would increase by more than \$3.84 billion since as funding is restored to the base, the annual inflation and enrollment adjustment would be applied to the entire base.
- ¹⁷ Legislative Analyst's Office, *Proposition 76: Key Issues and Fiscal Effects* (September 30, 2005), p. 11.
- ¹⁸ Legislative Analyst's Office, *Proposition 76. State Spending and School Funding Limits. Initiative Constitutional Amendment*, downloaded from http://www.ss.ca.gov/elections/vig_2005.htm on September 16, 2005.
- ¹⁹ Amounts owed for programs under the Proposition 98 guarantee would count toward the minimum funding guarantee.
- ²⁰ Legislative Analyst's Office, *Proposition 76. State Spending and School Funding Limits. Initiative Constitutional Amendment*, downloaded from http://www.ss.ca.gov/elections/vig_2005.htm on September 16, 2005.