CALIFORNIA BUDGET PROJECT

budget brief

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WHAT WOULD PROPOSITION 38 MEAN FOR CALIFORNIA?

Proposition 38, which will appear on the November 6, 2012 statewide ballot, would temporarily increase personal income tax rates for nearly all California taxpayers and allocate the new revenues to K-12 education, early childhood education, and repayment of state general obligation (GO) bond debt. Proposition 38 would raise an estimated $10 billion in 2013-14 – the first full fiscal year of implementation – and could potentially raise larger amounts in subsequent years.[1] The sponsor of Proposition 38 is Advancement Project Co-Director Molly Munger, and supporters include the California State PTA. This *Budget Brief* provides an overview of this measure and the policy issues it raises. The California Budget Project neither supports nor opposes Proposition 38.

What Would Proposition 38 Do?

Proposition 38, the "Our Children, Our Future: Local Schools and Early Education Investment and Bond Debt Reduction Act," would increase personal income tax rates for nearly all California taxpayers effective January 1, 2013 through December 31, 2024.[2] The new tax rates would be progressive; that is, a higher rate would apply to the incomes of higher-income individuals. These rates would range from a low of 0.4 percent on joint filers' taxable income between $14,633 and $34,692 to a high of $100,298 plus 2.2 percent of joint filers' taxable income above $5 million (Table 1).[3] Proposition 38 would allocate the revenues raised from the new tax rates to K-12 education and to child care and preschool programs, as well as to payment of debt service owed on state GO bonds.[4] The allocation of Proposition 38 revenues would be automatic and would not require the Legislature's approval. A five-member Fiscal Oversight Board would oversee the expenditure of Proposition 38 funds and ensure that annual auditing and reporting requirements are met.[5] Proposition 38 could not be amended by the Legislature; any changes would require voter approval.

Proposition 38 specifies that the revenues raised by the measure would not be considered General Fund revenues and, as such, would not be used to calculate the minimum level of funding for K-12 education and community colleges that is constitutionally guaranteed by Proposition 98, a measure passed by California voters in 1988.[6] Proposition 38 also specifies that the dollars it would provide to schools would be in addition to the state's minimum annual Proposition 98 funding obligation and could not be used to "supplant or replace" local, state, or federal support for K-12 education or child care and preschool programs.[7]

How Would Proposition 38 Revenues Be Used?

Revenues raised by Proposition 38 would be deposited into a newly created California Education Trust Fund (CETF). Until the end of 2016-17, 30 percent of CETF dollars would be used to pay debt service on school facilities bonds, including K-12 and higher education bonds, as well as to make payments on children's hospital and other GO bonds issued by the state. Priority would be given to paying school facilities debt service.[8] In addition, beginning in 2015-16, any "excess" revenues raised by Proposition 38 also would be used to pay bond debt service.[9] Eighty-five percent of Proposition 38 revenues remaining after debt service payments would support K-12 education, and 15 percent would support child care and preschool programs.[10]

Table 1: Proposition 38 Tax Rates			
Taxable Income*		Additional Marginal Tax Rate Proposed by Proposition 38	Total Marginal Tax Rate Including Additional Rate Proposed by Proposition 38
Single Tax Filers	Joint Tax Filers		
Less Than $7,317	Less Than $14,633	0.0%	1.0%
$7,317 to $17,346	$14,633 to $34,692	0.4%	2.4%
$17,347 to $27,377	$34,693 to $54,754	0.7%	4.7%
$27,378 to $38,004	$54,755 to $76,008	1.1%	7.1%
$38,005 to $48,029	$76,009 to $96,058	1.4%	9.4%
$48,030 to $100,000	$96,059 to $200,000	1.6%	10.9%
$100,001 to $250,000	$200,001 to $500,000	1.8%	11.1%
$250,001 to $500,000	$500,001 to $1,000,000	1.9%	11.2%
$500,001 to $1,000,000	$1,000,001 to $2,000,000	2.0%	11.3%
$1,000,001 to $2,500,000	$2,000,001 to $5,000,000	2.1%	11.4%
More Than $2,500,000	More Than $5,000,000	2.2%	11.5%

* Reflects income brackets in 2011. These brackets would be adjusted annually for inflation.
Note: Total marginal tax rates exclude the 1 percent rate on incomes above $1 million that was approved by voters through Proposition 63 of 2004.
Source: Legislative Analyst's Office

How Would Proposition 38 Revenues Provided to K-12 Education Be Distributed?

Proposition 38 revenues allocated to K-12 education could be used "to improve students' academic performance, graduation rates, and vocational, career, college and life readiness," and would be distributed on a per student basis through three types of grants:

- **Educational program grants.** Seventy percent of the revenues allocated to K-12 education would be distributed as educational program grants. Proposition 38 specifies that schools would receive these grants based on their share of statewide enrollment in each of three grade spans. However, students in higher grades would receive larger grants.[11]

- **Low-income student grants.** Eighteen percent of the revenues allocated to K-12 education would be distributed as low-income student grants. Proposition 38 specifies that schools would receive a grant for every enrolled student who is eligible for free and reduced price meals.[12]

- **Training, technology, and teaching materials grants (3T grants).** Twelve percent of the revenues allocated to K-12 education would be distributed as 3T grants. Proposition 38 specifies that schools would receive 3T grants based on each school's share of statewide student enrollment. 3T grants could be used only for "up-to-date teaching materials and technology" and to improve school staff skills.[13]

Proposition 38 Would Restrict How K-12 Education Grants Could Be Spent

Proposition 38 requires that most of the revenues allocated to K-12 education be spent within one school year, and the measure limits how those revenues may be used.[14] Specifically:

- Each per student grant must be provided to the *school* where the student is enrolled.
- Schools could not spend Proposition 38 dollars on district administrative costs.
- Proposition 38 aims to prevent the use of the measure's revenues to increase staff salaries or benefits.[15]

Proposition 38 Would Create Reporting Requirements for Schools

Proposition 38 would create a new reporting requirement that applies to *all* school dollars, not just dollars raised by the measure. Proposition 38 would require school districts to publish a detailed budget for each school site that compares year-to-year revenues and expenditures, the source of each school's dollars, the amount each school spends overall per student and in several expenditure categories, and a detailed accounting of each school's personnel costs. Moreover, Proposition 38 includes requirements for reporting as well as for public input that apply only to revenues raised by the measure. Proposition 38 would require the board of each school district to seek input from the school community about how to spend Proposition 38 revenues.

When a school board decides how it would use Proposition 38 dollars, it would be required to explain how those dollars would improve educational outcomes and how the board would determine whether those outcomes have been achieved. Within 60 days after the close of the school year, each school district would be required to report how Proposition 38 dollars were spent at each school and the extent to which the school improved educational outcomes.

Proposition 38 Would Set a Minimum Annual Spending Target for Every School

Proposition 38 specifies that, beginning in 2013-14, school districts must "make every reasonable effort to maintain" per student spending levels at each of their schools – from funds other than those provided by the measure – that are at least equal to each school's 2012-13 spending level.[16] This "maintenance of effort" (MOE) target would be adjusted annually for changes in the cost of living.

How Would Proposition 38 Revenues Provided to Child Care and Preschool Programs Be Used?

Proposition 38 revenues allocated to early care and education would be used to:

- **"Strengthen and expand" child care and preschool programs.** At least 77 percent of the revenues allocated to child care and preschool programs would be used to increase the number of children served by those programs, increase payments to child care and preschool providers, and develop and implement a California Early Head Start Program. Three-quarters of these dollars would be provided to preschool programs for children between ages 3 and 5. One-quarter of these dollars would go to programs that serve children from birth to age 3, primarily to implement a California Early Head Start Program with content, quality, and eligibility standards similar to those used by the federal Early Head Start Program, which provides child development services for low-income families with infants and toddlers.[17]

- **Restore cuts, increase inspections, and develop databases.** Up to 23 percent of the revenues allocated to child care and preschool programs would be used to restore recent funding cuts, increase the frequency of licensing inspections of child care and preschool providers, and develop databases for evaluating the quality of child care and preschool programs and tracking the educational progress of participating children. Proposition 38 specifies that a large majority of these dollars would be used to restore funding for child care and preschool programs to 2008-09 levels.[18] Proposition 38 specifies that these revenues would also be used to develop, implement, and maintain a new Early Learning Quality Rating and Improvement System to improve the quality of child care and preschool programs.

Proposition 38 Would Impose Requirements on Funding Provided for Child Care and Preschool

Proposition 38 limits how the dollars it would provide to child care and preschool programs could be spent. Specifically, Proposition 38 would:

- **Limit the share of revenues that could be used to increase payments to child care and preschool providers.** No more than 11.5 percent of the "strengthen and expand" funds could be used to increase payments to child care and preschool providers.[19] Proposition 38 also states that these increases would generally go only to providers who meet or exceed quality standards. Moreover, Proposition 38 revenues that are used to restore cuts made to provider payments in recent years would go to *license-exempt* child care providers, rather than to *licensed* child care or preschool providers. This is because the Legislature in recent years has significantly reduced payments for license-exempt providers, but has frozen – rather than cut – payments for licensed providers. License-exempt providers are typically friends or relatives who provide child care.

- **Require that dollars be used to increase the number of preschool spaces.** At least two-thirds of the "strengthen and expand" funds would have to be spent to increase the number of preschool spaces ("slots") available for children from low-income families. Proposition 38 specifies that these dollars would be allocated to the lowest-income neighborhoods first. Moreover, the highest priority for preschool slots would go to "highly at-risk children," which Proposition 38 defines as children from low-income families who are in foster care or who are abused, neglected, or exploited.

- **Require that the majority of newly created child care and preschool spaces statewide be for full-day, full-year care.** At least 65 percent of the newly created preschool slots, and at least three-quarters of the newly created slots in the California Early Head Start Program, must provide full-day, full-year care.

Proposition 38 Aims To Impose a Minimum State Spending Requirement for Child Care and Preschool

Proposition 38 specifies that it would create an MOE requirement for state child care and preschool funding. Proposition 38 sets a base spending level for child care and preschool equal to the share of state General Fund revenues allocated to these programs in 2012-13. Beginning in 2013-14, the share of General Fund revenues dedicated to child care and preschool programs could not be reduced below the 2012-13 baseline level "as a result of funds allocated pursuant to" Proposition 38.[20]

Proposition 38 Would Create a New Quality Rating and Database System for Child Care and Preschool Programs

Proposition 38 would require the development and implementation of a new Early Learning Quality Rating and Improvement System (QRIS) by January 1, 2014. The new system would be intended to improve the quality of child care and preschool programs. Specifically, the QRIS would include:

- A voluntary quality rating scale for child care and preschool programs;
- A skills-development program to help providers increase their quality ratings;
- A method of increasing payments to child care and preschool providers above 2011-12 levels for providers that improve their QRIS ratings; and
- Prompt publication of QRIS ratings so parents and caregivers receive accurate information about the quality and type of program in which their children are enrolled.

Proposition 38 also would require that every California child who participates in a child care or preschool program receive a "unique identifier" that would be recorded as part of a statewide database. The statewide database must be a part of the California Longitudinal Pupil Achievement Data System (CALPADS) and record several pieces of information, including:

- An assessment of the child's primary home language and level of fluency;
- The child care and/or preschool services the child received each year and the setting in which those services were delivered;
- The agency that delivered the child care and/or preschool services; and
- Any quality ratings received by the child care and/or preschool provider.

Who Would Proposition 38's Tax Increases Affect?

Proposition 38 would temporarily increase personal income tax rates on nearly all California taxpayers. However, higher-income Californians would pay a larger share of their incomes in tax increases than those at the low end and middle of the income distribution. The wealthiest 1 percent of Californians – those with incomes of $533,000 or more – would see a tax increase equal to 1.2 percent of their incomes, on average (Figure 1). This increase amounts to an additional $23,224 in annual taxes (Figure 2).[21] Californians in the second highest fifth of the distribution – those with incomes between $58,000 and $96,000 – would see a tax increase equal to 0.3 percent of their incomes, on average, amounting to an additional $250 in annual taxes. Californians with incomes in the bottom three-fifths of the distribution would see even smaller average tax increases.

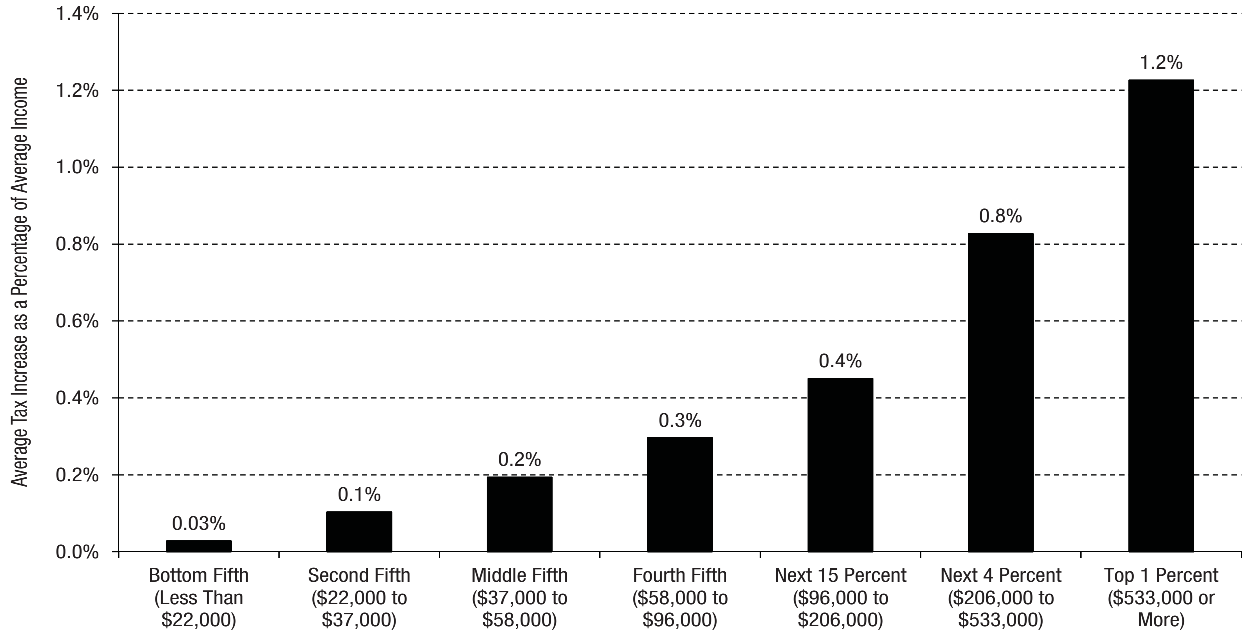
Not all California taxpayers would owe additional taxes under Proposition 38, due to the various tax credits that families can use to reduce their tax bills. The vast majority of higher-income Californians would pay more of their incomes in taxes under Proposition 38, whereas smaller shares of low- and middle-income taxpayers would pay more. For example, nearly all (98.0 percent) Californians in the wealthiest 1 percent would pay more in taxes as would more than three-quarters (76.1 percent) of taxpayers in the second highest fifth of the income distribution. In contrast, just over half (54.3 percent) of Californians in the middle fifth would pay higher taxes under Proposition 38, as would roughly one out seven (14.7 percent) of the lowest-income Californians – those with incomes under $22,000 per year.

High-income Californians would provide the vast majority of revenues raised by Proposition 38. The wealthiest 1 percent of Californians would contribute 44.1 percent of the measure's revenues, while the top fifth would be the source of 85.6 percent of the new revenues.[22]

What Would Proposition 38 Mean for the State Budget?

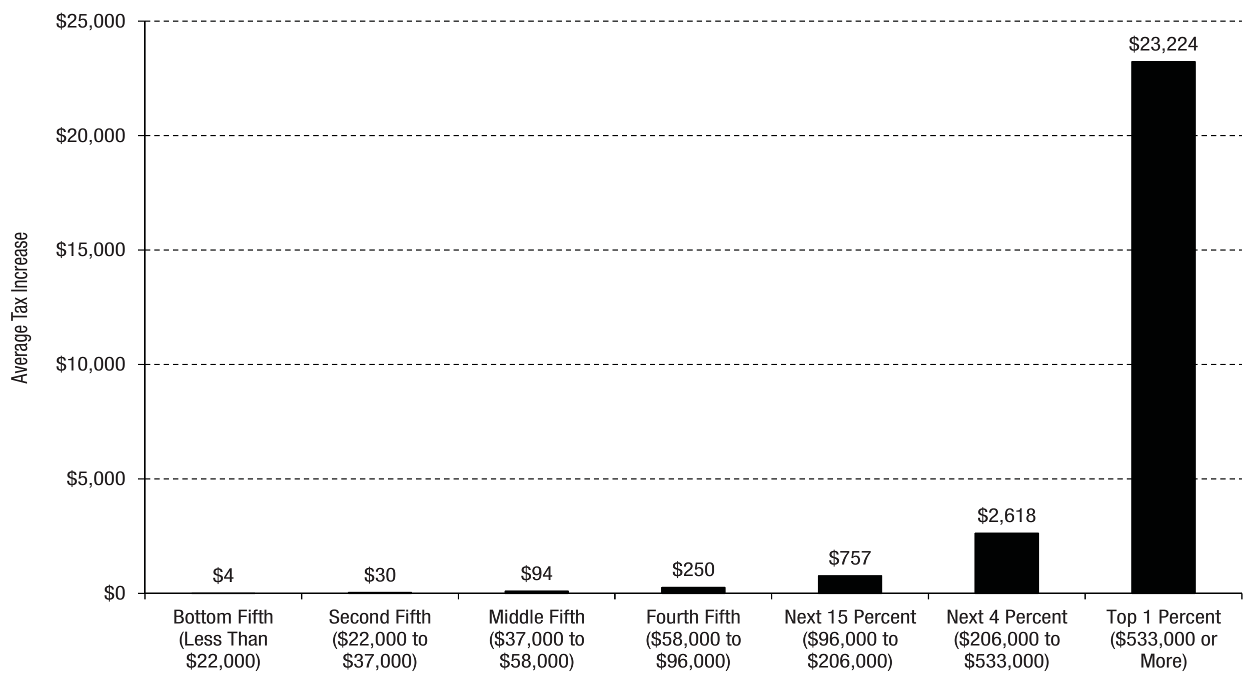
California has faced a structural deficit for more than a decade. Lawmakers bridged recent years' budget gaps largely through "solutions" that were temporary or did not materialize, as well as through deep spending cuts to virtually all areas of the budget. These cuts left California's public systems ill-equipped to respond to exceptionally high unemployment and stagnating incomes

Figure 1: Higher-Income Californians Would Pay a Larger Share of Their Incomes in Proposition 38's Tax Increases Than Low- and Middle-Income Taxpayers



Note: Includes offset for federal deductibility of state taxes. Income is for 2011.
Source: Institute on Taxation and Economic Policy

Figure 2: Proposition 38 Would Primarily Affect Higher-Income Californians



Note: Income is for 2011.
Source: Institute on Taxation and Economic Policy

resulting from the Great Recession and its aftermath, and also threaten to limit the state's future prosperity.

According to the Legislative Analyst's Office (LAO), Proposition 38 would provide around $3 billion per year to pay debt service owed on state GO bonds through 2016-17, which would produce an equivalent amount of savings for the state's General Fund.[23] Beginning in 2017-18, the share of Proposition 38 revenues that could be used to pay debt service would drop sharply, and the measure would potentially provide only a few hundred million dollars per year in state General Fund savings.[24] However, overall General Fund savings from Proposition 38 could be lower than estimated because the measure does not address a provision in the 2011-12 budget agreement that could result in increased Proposition 98 payments.[25]

Higher Education and Other Key Priorities Would Not Receive Proposition 38 Dollars

State budget shortfalls are projected to continue for several years absent additional General Fund revenues. Ongoing shortfalls would likely create pressure to reduce spending, and key public priorities, including the state's colleges and universities, could be targeted for additional cuts. State spending for California's colleges and universities has already been reduced substantially in response to recent state budget shortfalls. Policymakers cut state General Fund spending for both the University of California (UC) and California State University (CSU) by 30 percent or more between 2007-08 and 2011-12. During the same period, spending for the California Community Colleges dropped by more than 20 percent. As state support declined, public colleges and universities increased student fees dramatically, shifting a greater share of the costs of higher education to students and their families. To the extent that these fee increases reduce the number of Californians who get a college education, cuts to higher education could compromise the state's future competitiveness.

Since Proposition 38 would provide support only for specific purposes – primarily K-12 education, child care, and preschool – lawmakers could not use the measure's revenues to restore cuts to other key priorities. Moreover, without significant new General Fund revenues, policymakers may have to make even deeper cuts to bring the state's budget into balance in future years, and the state's colleges and universities, among other key priorities, could be targeted for further reductions.

How Would Proposition 38 Affect Schools?

Proposition 38 would raise significant new revenues and boost spending for schools. The measure also would make school budgets more transparent and could make school funding more predictable. Proposition 38 revenues could help schools hire more teachers and additional support staff such as counselors, librarians, and school nurses. These additional dollars would provide much needed relief for school districts that were hard hit by recent cuts to state education spending. However, while Proposition 38 would raise new revenue for K-12 education, total school spending may not increase as much as estimates suggest because the Legislature could reduce state General Fund support for schools.

Proposition 38 May Not Prevent Reductions in State Support for Education

While Proposition 38 in its initial years would raise an estimated $6 billion annually for K-12 education, according to the LAO, total school funding may not actually increase by that much.[26] Proposition 38 includes provisions designed to prohibit the use of the measure's revenues to "supplant or replace" state support for K-12 education. However, the measure may not necessarily prevent the Legislature from reducing other state spending for schools, particularly at a time when ongoing budget shortfalls increase the pressure to make cuts.[27] In tough budget years, the Legislature could reduce General Fund spending for K-12 education to preserve funding for other core priorities. For example, the Legislature could suspend Proposition 98 or could shift spending for certain programs historically funded outside of the Proposition 98 guarantee within the guarantee, a strategy used in recent years to create General Fund savings that resulted in lower spending for schools.[28] Under this scenario, Proposition 38 revenues could, in effect, partially replace state funding for schools. This type of action could be challenged in court as a violation of Proposition 38's provision specifying that CETF dollars cannot be used to replace other sources of funding for schools.[29] However, it is unclear how a court would rule in such a case.[30]

Proposition 38's Reporting Requirements Would Make School Site Budgets More Transparent

Proposition 38 would change budget reporting requirements for *all* school district dollars, not just those provided by the measure. Currently, spending and revenue information is publicly available only at the school district level, not at the individual school level. Proposition 38's requirement that school districts report budget information by school site would make school spending and revenue information more transparent, which could help state policymakers, advocates, researchers, parents, and other education stakeholders make more informed decisions about allocating education resources.

Proposition 38 Would Provide Funds to Schools Based on Student Enrollment

Since Proposition 38's K-12 education grants would be distributed based on student *enrollment* from prior years – not on an estimate of *average daily attendance* (ADA) – the measure could make school funding more predictable.[31] Currently, the majority of state funding provided to school districts is based on ADA – the average number of days students attend school per year – rather than on enrollment, which equals the number of students that attend school on a specific day in October. ADA usually is lower than enrollment because some students move, fail to attend school regularly, or drop out of school altogether. Basing a large share of school funding on ADA rather than on enrollment presents challenges for school districts, which make staffing decisions early in the school year based, in part, on estimates of what their student attendance will be. If their actual ADA falls short of what was estimated, then school districts may not receive enough funding to support the number of staff hired at the beginning of the year. Since Proposition 38 would provide funding based on prior years' enrollment, not on ADA estimates, districts would know how much funding they could expect from the measure at the beginning of the school year, which could make their staffing decisions easier.

How Would Proposition 38 Affect Child Care and Preschool Funding?

Proposition 38 would raise approximately $1 billion annually for child care and preschool programs in its initial years, according to the LAO.[32] These funds would be used to increase the capacity and quality of child care and preschool programs, in part by allocating a share of the measure's revenues to improve evaluation of these programs.

Proposition 38 Would Not Raise Enough Revenue To Restore Recent Cuts to Child Care and Preschool Funding

Proposition 38 claims that it would allocate up to $300 million of the revenues it raises per year, adjusted for inflation, to restore cuts in state funding for child care and preschool programs made between 2009-10 and 2012-13. However, the measure would likely provide less than that amount. For example, if Proposition 38 raises $10.7 billion in 2014-15, as the LAO projects, only about $200 million of these revenues would be available to restore cuts to child care and preschool programs in that year.[33] This amount would be insufficient since the state has reduced spending for child care and preschool programs by more than three times that amount since 2008-09.[34]

Proposition 38 May Create a New State Spending Obligation for Child Care and Preschool Programs

Proposition 38 aims to impose a minimum spending level for child care and preschool. Beginning in 2013-14, state spending to support child care and preschool – from funds other than those provided by Proposition 38 – could not fall below the share of state General Fund revenues allocated to these programs in 2012-13. This MOE requirement could create a new state spending obligation for child care and preschool programs depending on how the Legislature interprets Proposition 38's provisions.

If the Legislature views Proposition 38 as imposing a binding minimum state spending level for child care and preschool programs, then the measure would likely increase pressure to make cuts to programs and services that lack similar protections. This would be particularly true in years when the cost of certain services supported by the state's General Fund increases at a rate greater than the rate of growth in General Fund revenues. For example, health care spending for seniors and people with disabilities in the Medi-Cal Program could rise somewhat faster than General Fund revenues in the coming years as a result of the aging of the state's population as well as continued medical advances that lengthen life, but also add to costs. Proposition 38 would reduce the Legislature's options to accommodate such an increase because it would eliminate lawmakers' ability to annually adjust General Fund spending for early care and education to reflect current needs. As a result, to maintain General Fund spending within available resources, the Legislature could face a choice between reducing state health care spending for low-income Californians and cutting the budget elsewhere in order to meet Proposition 38's MOE requirement for child care and preschool funding.

However, an alternative interpretation of Proposition 38 could allow the Legislature to reduce child care and preschool funding below the presumed minimum spending level if the reductions are unrelated to the new Proposition 38 revenues.[35] If the Legislature takes this alternative view, it could reduce state support for child care and preschool programs for numerous reasons, such as closing a budget gap or funding other state priorities. Reductions to state support for child care and preschool for reasons such as these could be subject to legal challenges, in which case the courts would likely determine how the measure's MOE requirement should be interpreted.

Should Voters Set Budget Priorities at the Ballot Box?

Proposition 38 would increase personal income tax rates and dedicate the revenues raised to specified uses. Critics of so-called “ballot box budgeting” argue that the initiative process limits voters to an up-or-down choice in isolation from other potential uses of funds. They further argue that earmarking the proceeds from a certain revenue source limits the ability of legislators to modify spending in response to economic, budget, and demographic changes. Finally, to the extent that voters approve new revenues for specific purposes through a ballot measure, such as Proposition 38, lawmakers or voters may feel less inclined to subsequently approve additional revenues regardless of the purpose. However, proponents of initiative-based spending argue that the two-thirds vote requirement for legislative approval of tax increases makes it difficult, if not impossible, to raise revenues to support important program expansions. Given this difficulty, they maintain, it is appropriate to offer voters the ability to raise taxes to fund programs supported by a majority of the voters.

What Would Happen if Voters Approve Proposition 38 and Proposition 30?

Another measure on the November 2012 ballot, Proposition 30, includes temporary tax increases and thus could be viewed as conflicting with the provisions of Proposition 38. The state Constitution specifies that if provisions of two measures on the ballot conflict and both are approved by voters, then the measure that receives more “yes” votes prevails. If voters approve both Proposition 38 and Proposition 30, and Proposition 38 receives more “yes” votes, then only Proposition 38’s personal income tax rate increases would go into effect. In this instance there likely would be legal challenges regarding the extent to which other provisions of the two measures conflict, and the courts would decide whether these provisions actually take effect. For more information about Proposition 30, see the California Budget Project’s publication, *What Would Proposition 30 Mean for California?*[36]

What Do Proponents Argue?

Proponents of Proposition 38, which is supported by the California State PTA, argue that the measure “provides guaranteed funding to restore a well-rounded education and improve educational outcomes.”[37] Proponents claim that policymakers have cut education spending by $20 billion since 2008 and that Proposition 38 would provide billions of dollars to local schools “to reduce class sizes or restore classes in art, music, math, science, vocational and technical education and college preparation.”[38] Proponents state that Proposition 38 provides funding “to restore budget cuts to early childhood education, improve quality, and expand access to preschool.”[39] Proponents also claim that the measure’s revenues cannot be diverted or borrowed by the Legislature or spent to increase staff salaries, that spending decisions will be made locally after public input, and that school districts must publicly report how the measure’s revenues are spent.

What Do Opponents Argue?

Opponents of Proposition 38, including the California Chamber of Commerce, argue that the measure is flawed, costly, and misleading. Opponents argue that Proposition 38 does not require “any of the funds to be used specifically for deficit reduction” and that the measure “is a massive income tax hike for middle class taxpayers[,] … creates a costly new bureaucracy by forcing schools to go through complex red tape just to receive basic funding[, and] … does virtually nothing to improve student performance.”[40]

Conclusion

Proposition 38 would temporarily increase personal income tax rates on nearly all California taxpayers and allocate the new revenues to K-12 education and child care and preschool programs, as well as payment of debt service owed on state GO bonds in certain years. Proposition 38 revenues would be used to increase the capacity and quality of child care and preschool programs and provide per pupil grants to be distributed to local schools. While Proposition 38 would raise significant new revenue for K-12 education, the measure may not increase total school spending by as much as some estimate because the Legislature could reduce other state education spending. Moreover, a key policy issue raised by Proposition 38 is whether it is desirable to ask voters to dedicate hard-to-raise new revenues to a specific set of programs in isolation from other potential uses of funds, especially when state budget shortfalls would likely create pressure to reduce spending on other priorities.

Jonathan Kaplan prepared this Budget Brief *with assistance from Scott Graves and Alissa Anderson. The California Budget Project (CBP) neither supports nor opposes Proposition 38. 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, subscriptions, and individual contributions. Please visit the CBP's website at www.cbp.org.*

ENDNOTES

1 Legislative Analyst's Office, "Proposition 38. Tax to Fund Education and Early Childhood Programs. Initiative Statute. Analysis by the Legislative Analyst," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* p. 60, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.

2 Proposition 38 would not increase personal income tax rates for single tax filers with taxable income of $7,316 or less or for joint tax filers with taxable income of $14,632 or less. "Single tax filers" include married individuals and registered domestic partners (RDPs) who file taxes separately. "Joint tax filers" include married and RDP couples who file jointly, and qualified widows or widowers with a dependent child.

3 Reflects income brackets in 2011. These brackets would be adjusted annually for inflation.

4 Unless otherwise noted, this analysis uses the term "K-12 education" to refer to school districts, county offices of education, independent charter schools, the California Schools for the Deaf, and the California School for the Blind. In addition, this analysis uses the term "child care and preschool programs" to refer to any state-funded preschool, child care, or other early care and education program. Proposition 38 would transfer specified amounts of revenue raised by the measure to offset the cost of debt service payments made from the state's General Fund. Debt service includes principal and interest payments owed on state GO bonds.

5 The board would consist of the state Controller, the state Auditor, the state Treasurer, the state Attorney General, and the director of the Department of Finance.

6 Proposition 38 would require that its revenues be deposited into a special fund rather than the state's General Fund. For an explanation of the Proposition 98 guarantee, see California Budget Project, *School Finance in California and the Proposition 98 Guarantee* (April 2006).

7 Specifically, Proposition 38 states that the revenues it would raise could not be used "to supplant or replace the per capita state, local or federal funding levels that were in place" as of November 1, 2012, adjusted for "changes in the cost of living and, with respect to federal funds, for any overall decline in federal funding availability." In addition, Proposition 38 states that the "amounts appropriated from funds other than the California Education Trust Fund (CETF) for support of the K-12 education system and early care and education programs, whether constitutionally mandated or otherwise, shall not be reduced as a result of funds allocated pursuant to this act."

8 Proposition 38 would require that the revenues allocated to debt service payments fully reimburse the General Fund for the cost of current-year debt service payments on all outstanding school and higher education bonds before any of these revenues could be used for current-year debt service payments on children's hospital or other GO bonds.

9 In a given year, if Proposition 38 revenues increase at a rate exceeding the average growth rate of California per capita personal income during the previous five years, then those "excess" revenues would be dedicated to bond debt service payments. For example, if Proposition 38 revenues increased by 6 percent over the prior year, and California per capita personal income had increased by an average of 5 percent during the previous five years, then the revenues resulting from the difference in these growth rates would be deemed "excess." "Excess" revenues would be calculated using a different formula in 2017-18 – the first year in which 30 percent of Proposition 38 revenues would no longer be required to be allocated to debt service payments.

10 Proposition 38 specifies that no more than three-tenths of 1 percent of CETF dollars collected during any three-year period could be used to pay for administrative costs incurred by the Fiscal Oversight Board, the state Controller, or the state Superintendent of Public Instruction.

11 The amount of the grant for each student in grades 9 through 12 would be 40 percent greater than the amount of the grant for each student in kindergarten through third grade (K-3), and the amount of the grant for each student in grades 4 through 8 would be 20 percent greater than the amount of the K-3 grant.

12 The amount of the low-income student grant would equal the total revenues available for the low-income student grants divided by the number of students eligible for free and reduced price meals statewide.

13 The amount of the 3T grant would equal the total revenues available for the 3T grants divided by the number of enrolled students statewide. A portion of educational program grants and low-income student grants could also be used for the same purposes as the 3T grants.

14 Proposition 38 specifies that up to 10 percent of the dollars provided to K-12 education could be used in the following school year.

15 Proposition 38 generally would prohibit the use of CETF dollars for salary and benefit increases beyond levels that were in effect on November 1, 2012, with the exception of increases for positions partially or totally funded by CETF dollars if those increases are equivalent to those "being received by other like employees in the school on a proportional basis to their partial or full-time status."

16 If a school district does not maintain per student spending at a particular school as required by the measure, it must explain why it was unable to do so in the school site budget for that school as well as at a public meeting.

17 Proposition 38 defines children between ages 3 and 5 as those who are age 3 or 4 as of September 1 of the school year in which they are enrolled in a preschool program and are not eligible to attend kindergarten. Proposition 38 appears to allow revenues raised by the measure to be used for 3-year-olds in both child care and preschool settings.

18 Proposition 38 specifies that $300 million of up to $355 million from the measure's revenues, adjusted annually for inflation, would be used to "restore funding to fiscal year 2008-2009 levels." However, the amount available for restoration would depend on the amount of revenues raised by the measure's tax increase. The measure specifies that these dollars would be used to restore funding equally for all types of reductions made to child care and preschool programs, including restoration of the number of provider contracts and reimbursement rates.

19 No more than 8 percent of the "strengthen and expand" funds could be used to increase payments to preschool providers, and no more than 3.5 percent of the "strengthen and expand" funds could be used to increase payments to child care providers.

20 To meet Proposition 38's MOE, the state would be obligated to increase spending on child care and preschool programs, using funds other than those provided by the measure, at least in proportion to the amount by which state General Fund revenues exceed the 2012-13 level.

21 The average tax increase is based on incomes reported in 2011.

[22] Institute on Taxation and Economic Policy.

[23] Legislative Analyst's Office, "Proposition 38. Tax to Fund Education and Early Childhood Programs. Initiative Statute. Analysis by the Legislative Analyst," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* p. 65, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.

[24] Beginning in 2017-18, only "excess" revenues raised by Proposition 38's new tax rates would be used to pay debt service owed on state GO bonds. The LAO estimates that state General Fund savings due to debt service payments from these "excess" revenues would vary from year to year, "but could be several hundred million dollars annually." Legislative Analyst's Office, "Proposition 38. Tax to Fund Education and Early Childhood Programs. Initiative Statute. Analysis by the Legislative Analyst," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* p. 65, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.

[25] The 2011-12 budget agreement transferred revenues from an existing 1.0625 state sales tax rate to counties to pay for the "realignment" of certain state program responsibilities to local governments. The budget agreement excluded these sales tax dollars from calculations used to determine the minimum funding level for K-12 education and community colleges required by the Proposition 98 guarantee. However, the budget agreement only allowed this exclusion contingent upon voter approval of a ballot measure, by November 17, 2012, that authorizes the exclusion and provides funding for schools and community colleges in an amount equivalent to that which would have been provided absent the exclusion. Proposition 38 would not satisfy these requirements. Therefore, if no other ballot measure satisfies these requirements, the 2011-12 Proposition 98 funding level would be increased retroactively. The Legislature would be required to make "settle up" payments to schools and community colleges in each of five years from 2012-13 through 2016-17 to provide the Proposition 98 funding that schools and community colleges did not receive in 2011-12, which would increase state General Fund costs. An increase in the 2011-12 Proposition 98 guarantee would also raise state General Fund obligations for schools and community colleges by an additional amount in 2012-13 and future years. Proposition 38 specifies that none of the revenues raised by the measure could be used to meet these increased obligations.

[26] Legislative Analyst's Office, "Proposition 38. Tax to Fund Education and Early Childhood Programs. Initiative Statute. Analysis by the Legislative Analyst," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* p. 62, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.

[27] Proposition 38 specifies that non-CETF funding for K-12 education "shall not be reduced as a result of funds allocated pursuant to this Act." This language could be interpreted to mean that non-CETF funds could be reduced for other reasons, such as to close a budget shortfall.

[28] If the Legislature suspends Proposition 98, it must increase funding over time until funding returns to where it would have been absent suspension. The overall dollar amount needed to return funding to this level is called the "maintenance factor." For an explanation of the Proposition 98 guarantee, see California Budget Project, *School Finance in California and the Proposition 98 Guarantee* (April 2006).

[29] As noted above, Proposition 38 states that the revenues it would raise could not be used to "supplant or replace" per capita funding levels that were in place as of November 1, 2012.

[30] Proposition 38 is a statutory measure that does not change either the Legislature's constitutional power over state spending or the Proposition 98 constitutional school funding guarantee. As a result, whether the measure is sufficient to override the Legislature's constitutional authority or the state's constitutional school funding guarantee are questions that likely would have to be resolved by the courts.

[31] Proposition 38 specifies that for the purposes of determining the amount of K-12 education grants a school would receive, a school's enrollment for the 2013-14 school year would equal its 2012-13 October enrollment adjusted for the average percentage change in October enrollment over the past three school years. After 2013-14, enrollment would equal the average monthly enrollment for the prior school year or, if those data are not available, the October enrollment for the prior school year adjusted for the average percentage change in October enrollment over the past three school years.

[32] Legislative Analyst's Office, "Proposition 38. Tax to Fund Education and Early Childhood Programs. Initiative Statute. Analysis by the Legislative Analyst," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* p. 64, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.

[33] Proposition 38 would allocate 10 percent of the revenues raised by the measure to child care and preschool programs in 2014-15 and specifies that up to 23 percent of that amount would be used for "restoration and system improvement." The measure also specifies that up to $355 million, adjusted annually for inflation, would be allocated each year to "restoration and system improvement." Of the dollars allocated to "restoration and system improvement," Proposition 38 specifies that $300 million would be allocated to restore cuts to child care and preschool programs, adjusted annually for inflation. However, based on LAO estimates that Proposition 38 would raise $10.663 billion in revenues in 2014-15, only $245.3 million would be available for "restoration and system improvement" that year, which would fall short of the amount the measure implies it would allocate for these purposes. Proposition 38 specifies that if revenues are not sufficient to cover the measure's requirements, then the amount dedicated to restore cuts would be reduced by the same proportion that revenues fall short of the $355 million specified for "restoration and system improvement." As a result, if the measure raises $245.3 million for "restoration and system improvement" in 2014-15, then roughly $207.3 million would be available to restore cuts to child care and preschool programs.

[34] Estimated state cuts to child care and preschool funding are based on CBP analysis of Department of Finance, California Department of Education, and Department of Social Services data and include reductions to state preschool as well as to CalWORKs and non-CalWORKs child care.

[35] Proposition 38 specifies that funding for child care and preschool programs could not be reduced below the presumed minimum spending level "as a result of funds allocated pursuant to" the measure.

[36] California Budget Project, *What Would Proposition 30 Mean for California?* (September 2012).

[37] "Argument in Favor of Proposition 38," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* p. 66, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.

[38] "Argument in Favor of Proposition 38," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* p. 66, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.

[39] "Argument in Favor of Proposition 38," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* p. 66, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.

[40] "Argument Against Proposition 38," and "Rebuttal to Argument in Favor of Proposition 38," in Secretary of State's Office, *California General Election Tuesday, November 6, 2012: Official Voter Information Guide,* pp. 66-67, downloaded from http://www.voterguide.sos.ca.gov/ on August 20, 2012.