

## SCHOOL FINANCE 2003-04

# STATE BUDGET WOES REVERBERATE THROUGH K-12 EDUCATION



When California voters passed Proposition 13 in 1978, they severely reduced local property taxes and effectively placed control over school funding in the hands of state government. When they voted for Proposition 98, they required state lawmakers to give public education first call on the state's General Fund revenues.

Those two decisions loomed large in the budget debate of 2003-04, a debate that had to somehow address an accumulated two-year deficit of about \$38 billion. The deficit represented a shortfall from prior years, plus a difference between expected revenues and the expenditures in the year ahead.

The dust finally settled more than a month after the constitutional deadline for budget passage, just in time for additional turmoil as the state geared up for a history-making gubernatorial recall election. Voters' decision to replace Democrat Gray Davis with Republican Arnold Schwarzenegger certainly means change is in the air for California and perhaps for K-12 education. Of more immediate concern for schools, however, is getting through 2003-04 with less general-purpose money and sharp cuts in some

special programs, including several created to support the state's expectations for improved student performance and greater school accountability. School districts also face management challenges as they cope with the continued volatility of California's economy and its impact on their own revenues.

Along with an overview of how state leaders responded to the budget crisis, this report describes the amount of money available for K-12 public education and how it was allocated for 2003-04. It also provides some perspective on how districts vary in the financial situations they face and in the options they have for coping with falling revenues and rising costs. Finally, the report looks at the issues most likely to shape the school finance debate in the near future, a debate that begins in January 2004 with Gov. Arnold Schwarzenegger's first state budget proposal.

### The juggling act: State uses creative approaches to make ends meet

The story of the 2003-04 California state budget began two years ago when the state's General Fund revenues plummeted along with the California economy. In responding to the situation in 2002-03, state leaders used borrowing and deferrals to close a \$23.6 billion gap rather than permanently cutting expenditures or increasing revenues through new taxes.

In December 2002, just three months after the Legislature and Gov. Gray Davis passed the 2002-03 budget, revised budget figures showed an even bigger problem. It became clear that the state's General Fund revenues would come to only \$69 billion for 2002-03, while lawmakers had already committed to General Fund expenditures of \$78 billion. Davis proposed a package of expenditure cuts and tax increases to address the problem, which legislators rejected. They decided instead to borrow \$10.7 billion to make up the shortfall and give the state some breathing room. Thus California began its 2003-04 budget discussion with an accumulated deficit, debt service to finance, and a continuing imbalance between anticipated revenues and expenditures.

State leaders first had to address the \$10.7 billion problem created in 2002–03. They planned to cover the debt using bond financing. California’s Constitution prohibits the state from incurring “a debt or liability” of greater than \$300,000 without approval by two-thirds of the Legislature and a majority of voters. State leaders instead designated the California Fiscal Recovery Finance Authority as the issuer of the bonds. The direct obligation for repayment was placed onto local governments, requiring them to use a half-cent of their sales tax proceeds to collectively cover annual payments of \$2.3 billion beginning in 2004–05. In turn, the state will use property tax proceeds to repay local governments, proceeds that would otherwise go to

K–14 education (kindergarten through community college). Finally, the state will repay K–14 education through the General Fund. For obvious reasons, many Sacramento insiders have dubbed this the “triple flip.” In late September, the Pacific Legal Foundation filed suit challenging this action because voters did not approve incurring the debt and because its purpose is to pay for ongoing operating expenses instead of funding infrastructure projects. The state says that the repayment will be contingent on annual appropriations from dedicated state sales tax revenues, and thus is legal. A legal settlement may take considerable time.

For 2003–04 General Fund revenues have been projected to total \$72.8 billion, an increase over the prior year but still far short of the \$78 billion in anticipated expenditures. Republican party leaders quickly took the position that the problem would have to be solved without tax increases of any kind. California’s requirement for a two-thirds vote of the Legislature to approve the budget meant that the minority party—which held 40% of the legislative seats—could make its position stick. Both state law and public support for schools pushed lawmakers to find solutions that would keep cuts to education at a minimum. Yet with K–12 education accounting for more than 39% of General Fund expenditures, their ability to do so was limited.

State leaders ultimately found a way to cover the expenditures without raising taxes. They used a combination of tactics that effectively shifted responsibility for certain expenditures away from the state General Fund.

First, the state reduced its General Fund obligation to local governments by raising the state’s vehicle license fee (VLF)—much of which goes to cities and counties—to its prior level. The locals expect to keep about \$3.4 billion in revenues generated through the higher VLF. Davis and State Controller Steve

Westly said the California Revenue and Tax Code required the VLF increase. (See the box on page 3 about the VLF for more clarification.) Immediately after the increase went into effect, the Howard Jarvis Taxpayers Association filed a lawsuit on the grounds that it violated the provisions of Proposition 13, which requires a two-thirds vote of the Legislature to raise taxes. The increase was also the immediate target of the state’s newly elected governor.

Second, California is using an expected increase in funds from the federal government to pay for \$2.2 billion worth of services that would have come out of the General Fund. An additional \$1.9 billion in pension fund obligations will be covered through another loan, this one to be repaid over five years at a rate of \$419 million annually. And finally, by changing Medi-Cal’s finances from accrual to cash accounting, the state was able, on paper, to shift about \$930 million in expenditures out of the 2003–04 budget year.

Taken together, these actions resulted in a balanced budget that includes a \$2 billion reserve going into 2004–05.

### **Proposition 98 puts education center stage in budget discussions**

The provisions of Proposition 98 made education funding a central focus of the budget debate. The California Constitution requires that funds for schools increase in step with any annual growth in the state’s per capita personal income or General Fund revenues. Thus K–14 education gets first claim on state dollars up to the amount of the Proposition 98 guarantee.

### *Funding decision for schools follows a convoluted path of cuts and deferrals*

This year the major challenge was determining the level of that guarantee due to uncertainties surrounding the 2002–03 budget and its allocation for schools. Falling General Fund revenues in

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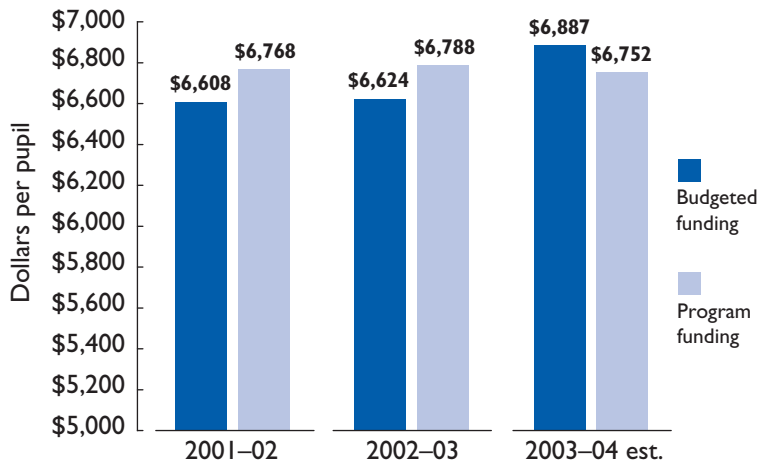
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**figure 1** Adjusted per-pupil amounts show a reduction in Proposition 98 funding



The budgeted amounts per K-12 student do not reflect the deferrals that have been part of state education funding since 2001-02. The “program funds” take those deferrals into account and thus more accurately reflect the amounts allocated to pay for educational programs each year.

DATA: LEGISLATIVE ANALYST’S OFFICE (LAO)

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2002-03 reduced the state’s minimum obligation to education under Proposition 98. (For a more detailed explanation of Proposition 98, see the box on page 4.)

As revenues continued to come in below projections during the first half of 2003, state leaders agreed to reductions for K-14 that eventually totaled about \$2.7 billion, much of it accomplished by deferring payments to schools from one year to the next. Ultimately, the K-14 allocation for 2002-03 was \$43.9 billion as opposed to the \$46.5 billion originally called for in the state budget. This reduced figure for 2002-03 became the base for determining the state’s 2003-04 obligation under Proposition 98, which comes to \$45.7 billion for K-12 and community colleges combined.

This budget also depends heavily on deferring money owed to education into future years. All told, at the end of 2002-03, the state owed education \$3 billion. Actions that were part of the 2003-04 budget package reduced this liability to \$2.7 billion.

To get a perspective on how all of this maneuvering affected the overall financial condition of schools, it is helpful to use a per-pupil amount. Based on calculations by the Legislative Analyst’s Office (LAO), the amount allocated per pupil under the Proposition 98 funding guarantee has changed very little since 2000-01 when it was \$6,608. The budget estimates it at \$6,887 for 2003-04, an amount that could change based on the number of students who eventually attend school this year and on actual state revenues passed on to schools. On the face of it, this looks like an increase over the final 2002-03 allocation of \$6,624. These figures, however, distort the actual level of growth. They do not reflect the series of deferrals that have been part of the budget balancing act over the last three years, most notably the postponement of the final state payment to K-12 schools from June to July. When per-pupil amounts are adjusted to display the impact of the deferrals, as in Figure 1 (above), it is clear that the “program funds”

## Vehicle license fee offset: A brief history

Each year when they register their cars, Californians pay a vehicle license fee (VLF). The fee is set at less than 2% of the vehicle’s current estimated value.

The state Constitution guarantees that most of the VLF revenues go to cities and counties. About three-quarters of the funds may be spent as these local governments wish, and one-quarter is restricted to various health, mental health, and social services programs. VLF revenues make up a significant portion of local governments’ tax revenues—about 10% for cities and 25% for counties.

In 1998 the Legislature began a series of reductions in the VLF, the first one a 25% reduction that became effective on Jan. 1, 1999. Just two years later, the fee was reduced—on a supposedly permanent basis—another 42.5% (for a total reduction of 67.5%). This meant that the typical car owner paid a \$66 vehicle license fee rather than \$204.

The state compensated cities and counties for every dollar lost to the fee reduction. This cost the state’s General Fund almost \$12 billion from fiscal year 1998-1999 through 2002-03.

The law that created the first VLF decrease provided that the tax relief would shrink if there were “insufficient monies” in the state’s General Fund to compensate local governments. Drivers would have to make up the difference by again paying the higher fees. However, the bill did not define “insufficient monies” or specify who would define it. Although the provision could have been implemented in 2002-03, when the state experienced serious fiscal difficulties, it was not until 2003-04 that some state leaders decided that the General Fund could not afford to pay cities and counties and that the VLF would have to rise.

## Proposition 98 guarantees a minimum level of funding for public schools

The state Legislature and governor largely control California's school finance system because they, for the most part, determine how much money school districts receive. Local school boards do not have independent authority to raise taxes. Further, while school district officials decide how to spend funds, they do so within the constraint that about a third of their operating money on average is earmarked by the state or federal government for special purposes. In addition, employee salaries and benefits make up more than 80% of most district budgets and are subject to collective bargaining.

When voters approved Proposition 98 as an amendment to the California Constitution in 1988, they guaranteed K-14 education (kindergarten through community college) a minimum amount of state and property tax revenue each year. The calculation of that guaranteed amount is largely based on the health of the state's economy. The Proposition 98 funding guarantee relies on three basic principles:

- In years of "normal" state revenue growth, K-14 education receives at least the same amount as the previous year, adjusted for changes in enrollment and per capita personal income.
- When revenue growth from one year to the next is particularly bad, K-14 education participates in the state's losses according to specified "fair share" formulas.
- Following a "fair share" reduction that causes the Proposition 98 funding guarantee to lag normal growth, the state is obligated to eventually restore K-14 funding to what it would have been if no reduction had occurred.

In practice, Proposition 98 has meant that education is entitled to the same amount allocated the previous year, plus enrollment growth and an inflation adjustment equal to the change in per capita personal income in the state. This is generally referred to as Test 2. (See the diagram below.) In difficult economic years, the state can provide a lesser amount as specified in Test 3. The shortfall must be restored in a future year when state tax revenues grow faster than personal income.

These formulas and requirements were based on the unrealized assumption that the state's General Fund growth would be relatively stable from one year to the next. Revenues have been particularly volatile and unpredictable since 2000. During both the 2001-02 and 2002-03 budget cycles, the K-14 allocations were cut or deferred midway through the budget year in order to lower the amount of the guarantee for the following year.

The actual amount of the Proposition 98 minimum funding guarantee is calculated using one of three tests.

### Test 1

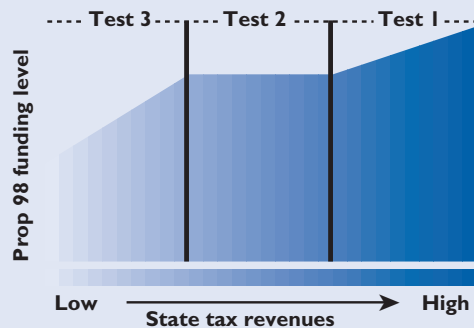
at least 34.6% of state General Fund revenues.

### Test 2

same amount as previous year, plus enrollment growth and inflation adjustment based on growth in per capita personal income. For 2003-04 Test 2 applies.

### Test 3

same as Test 2 except the inflation adjustment is the annual change (increase or decrease) in per capita General Fund revenues plus 0.5%.



available per pupil for 2003-04 are less than in the previous two years.

### *K-12 education receives \$12 billion from sources besides the state*

The funds allocated to K-12 education under the Proposition 98 formula represent the lion's share of money for schools but certainly not the whole amount. The pie chart in Figure 2 on page 5 shows that public education receives about \$12 billion more than the state allots through Proposition 98 alone. The sources include the federal government, the California State Lottery, and "local miscellaneous" money, which accounts for 6.4% of education funding overall but can vary substantially from one district to the next.

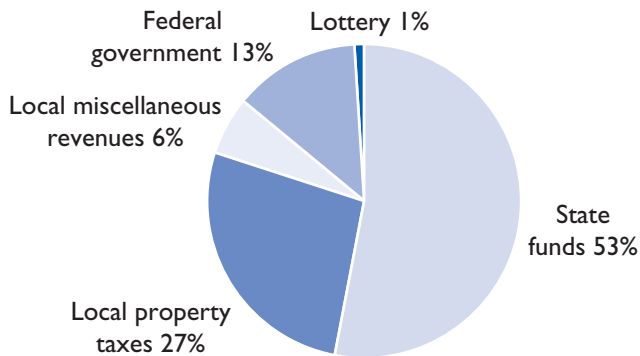
In recent years, federal education support has grown steadily, particularly as a portion of California's total K-12 budget. For many years, federal programs provided about 8% of K-12 funding in California. In 2001-02 the total was \$5.4 billion, about 10% of the budget. That amount grew to \$7.1 billion in 2003-04, representing almost 13% of the total budget and an increase of \$1.7 billion in two years, mostly in ongoing funds.

All federal dollars are earmarked for specific "categorical" programs. Most of the increase over the last two years is the result of the 2002 reauthorization of the Elementary and Secondary Education Act (ESEA). The law, commonly known as No Child Left Behind (NCLB), created a set of sweeping new policies to which California has been gradually responding.

Throughout 2003 California officials negotiated with the federal government regarding various aspects of the state's application for NCLB funds and its proposals for implementation. Because the funds were already coming in to state coffers, the point of the negotiations was to outline the state's commitment to change various programs in compliance with federal regulations. The most notable changes were: 1) adapting and expanding California's accountability system; and 2) developing new ways to determine the



figure 2 | **K–12 funding comes from several sources**



In 2003–04 the sources of funds for California public schools include:

**State funds \$29.3 billion (53%)**

mostly from California sales and income taxes, including about \$1.7 billion not counted toward the Proposition 98 guarantee.

**Local property taxes \$14.8 billion (27%)**

which state lawmakers allocate to schools. (Cities, counties, and other agencies also receive some local property tax revenues. Total includes some local property taxes not counted toward the Proposition 98 guarantee.)

**Local miscellaneous revenues \$3.5 billion (6%)**

includes community contributions, interest income, developer fees, and revenues from local parcel tax elections.

**Federal government \$7.1 billion (13%)**

earmarked for special purposes.

**Lottery \$0.8 billion (1%)**

projected at about \$124 per student (ADA), with \$12 per ADA to be used only for instructional materials. (ADA is average daily attendance.)

**Total estimated revenues for 2003–04 from all sources \$55.7 billion**

**Projected California public school average daily attendance (ADA):**

- For purposes of Proposition 98: 5.99 million students
- Including adult education and regional occupation programs: 6.40 million students

FUNDING DATA: CALIFORNIA DEPARTMENT OF EDUCATION (CDE)  
ADA PROJECTIONS: CALIFORNIA DEPARTMENT OF FINANCE

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qualifications of teachers and instructional aides.

The various components of NCLB provide about \$2.8 billion or almost 40% of the federal money the state receives. For 2003–04 this includes an increase of about \$333 million added to an NCLB-inspired increase of \$737 million in 2002–03. This \$1 billion augmentation for K–12 education clearly came at a time when California schools needed the funds.

Less clear is the extent to which NCLB has also created new requirements and costs for local districts and the state as a whole.

*Facilities funding represents a bright spot for public schools*

While local schools' operating budgets have been affected by the state's economic woes, their ability to address facility needs has improved since 2001. Voters have helped make this possible by passing two

major statewide bond measures to help pay for K–12 schools, the most recent for \$11.4 billion in November 2002. Two years earlier, they also approved Proposition 39, which allows local school bonds to pass with a 55% majority vote. And they have supported local general obligation bond elections that have raised a total of \$12.3 billion since January 2001.

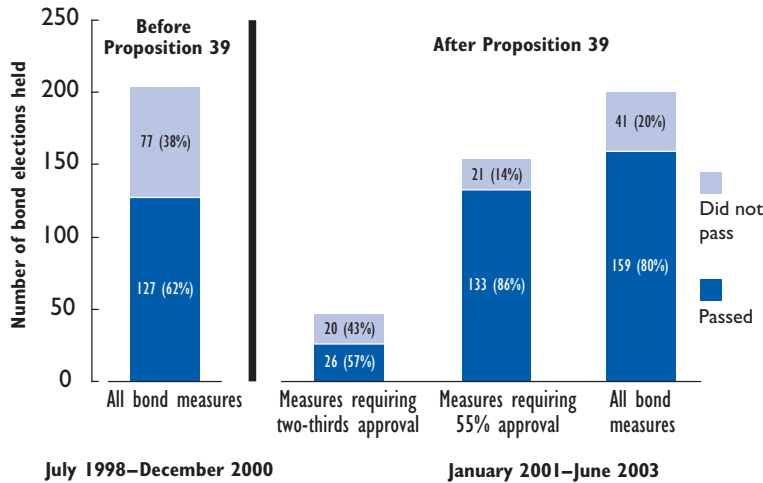
The Office of Public School Construction (OPSC) reports that state facility funds are rapidly being committed to local building projects. Of the \$11.4 billion that voters approved in 2002, about \$9.5 billion had been allocated as of the end of September 2003. This included \$4.4 billion for new construction, \$3.3 billion for modernization, and \$1.7 billion for “critically overcrowded” schools, which get special priority for funding. In addition, almost \$100 million went to finance building projects at six charter schools, which serve a total of 2,651 students.

A measure on the March 2004 ballot will ask voters to authorize another \$12.3 billion in bonds to pay for facilities for both K–12 (\$10 billion) and higher education (\$2.3 billion). This measure will provide funds to largely address the balance of the state's school facility requirements through 2007. The state's share of that requirement was estimated at \$22.8 billion in November 2002 by the California Department of Education (CDE).

The ongoing success of local general obligation bond elections under the state's new rules has helped districts meet their “matching fund obligations” and thus qualify for state bond proceeds. Districts must provide 50% of total project costs as a local match for new construction and 40% of total costs for modernization projects. As Figure 3 on page 6 shows, the number of elections has not increased, but the passage rate has. Even more notable is the amount of funding being authorized in these elections, which has almost doubled.

figure 3 | Proposition 39 changed the facilities funding picture

Since 55% voter approval went into effect, more local GO bond measures have passed



And they have raised more money

July 1998–December 2000

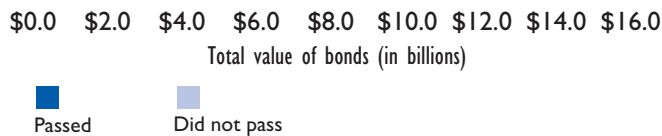


Before Proposition 39

January 2001–June 2003



After Proposition 39



DATA: EDSOURCE, SCHOOL SERVICES OF CALIFORNIA

EDSOURCE 11/03

The passage of a local bond election does more than just pay for building costs. It helps a district's financial health by allowing it to reserve its annual revenues for ongoing operations rather than having to

use them for unexpected building repairs. Such repairs can be a constant concern when buildings are old and run-down. The boost to employee and student morale is less easily quantified but no less important.

How the cuts were made

The full story of California school finance has to take into account not only how much money was available to schools, but also how state leaders chose to distribute it. In general, money goes to school districts and county offices of education in two ways. About two-thirds is "revenue limit" funding that districts can largely spend at their discretion, and the rest is "categorical aid" earmarked for special purposes. Some funds are targeted for particular groups of pupils, such as students with disabilities; and some are for specific programs, such as class size reduction and instructional materials.

In recent years, California used categorical funding to further its standards-based reform agenda. The new federal funds from NCLB support the same goals but have required some program changes. In 2003–04 however, the state struggled to maintain its reform investments. In some cases, state leaders found themselves reducing or even eliminating programs they created and funded just a few years ago for such things as instructional materials and professional development. In other cases, recently created state programs were superceded by federally funded ones with similar goals but different regulations and requirements.

Revenue limits are reduced, but districts have flexibility to backfill

California school districts receive general-purpose money from the state based on a per-pupil revenue limit. They can use this money as they see fit for the day-to-day operation of schools, including everything from teacher salaries to the electric bill. Each district has its own revenue limit amount, set annually using specific formulas required by state law. This system is meant to ensure that districts of a similar type—i.e., large and small elementary, unified, and high school districts—receive more or less equal base revenue amounts for each student they serve,

**figure 4** Average “base revenue limits” (per pupil) due to school districts for 2003–04 and the reduced amounts they will receive

District type	2002–03 base revenue limit	2003–04 base revenue limit due to district	Reduction of base due to no COLA	Reduction of base due to revenue limit cut	Net 2003–04 revenue limit district will receive
Elementary	\$4,563	\$4,648	\$85	\$55	\$4,508
Unified	\$4,753	\$4,841	\$88	\$57	\$4,696
High School	\$5,485	\$5,587	\$102	\$66	\$5,419

DATA: ESTIMATES OF AVERAGES FROM SCHOOL SERVICES OF CALIFORNIA

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without regard to student characteristics or regional differences in the cost of living. Revenue limit income is paid to each district, on a per-pupil basis, according to its average daily attendance (ADA) figures.

For 2003–04 state leaders took the rather unusual step of reducing revenue limits. These reductions took two forms. The first was to not give districts the 1.8% cost-of-living adjustment (COLA) they were due. The second was to actually cut revenue limit amounts by 1.2%. As Figure 4 above illustrates, this resulted in a net reduction of about 3% between the “base revenue limit” amount districts were due and the actual per-pupil amount they will receive. The funding did include an additional \$577 million to pay for an expected 1.34% increase in the number of students and another \$459 million to pay for higher costs related to the Public Employees’ Retirement System (PERS).

#### The impact varies among districts

Figure 4 summarizes the revenue limit reductions—on average—among California school districts, but it obscures the fact that the ultimate fiscal impact varies fairly widely. That is due in part to variations in districts’ revenue limits. The actual reductions range from about 1.2% to 1.35%.

In terms of total revenues, the more telling difference is between districts experiencing enrollment growth and the

increasing number that are experiencing declines. The latter group will likely face more serious budget challenges because school districts are funded based on how many students they serve. Changes in student enrollment can mean losses or increases in revenues in a single year that do not necessarily correspond to changes in operating costs. As described in the box on this page, enrollment changes vary widely in different parts of the state.

### Variations in enrollment growth—or decline—create different challenges in different areas of the state

K–12 enrollment grew 12% in California from 1994 to 1999, but grew just 6% in the next five years. The enrollment trends in different areas of the state, however, varied quite dramatically from these averages.

In 22 of California’s 58 counties, total K–12 enrollments actually decreased between 1999 and 2003, with the rate of decline ranging from 2% to 13%. The most populous counties to see enrollment declines were in the San Francisco Bay Area, including San Francisco and Santa Cruz counties, which both decreased 4% between 1999 and 2003, and Marin, San Mateo, and Santa Clara counties, which decreased 2%. Enrollment growth was flat in Alameda County as well. That left Contra Costa County, with a growth rate of 6%, as the one exception in the region.

In many other areas of the state, enrollments were still growing from 1999 to 2003, though more slowly than in the previous five years. For example, huge Los Angeles County added 12% (173,057 students) in the first half of the last decade and 6% (95,524 students) in the second five-year period. Orange County’s 20% growth rate went down to 9%. In six counties—Modoc, Mono, Placer, Riverside, San Bernardino, and San Joaquin—the growth rates remained at 10% or higher, representing a total increase of 108,380 students.

#### Flexibility in use of other funds can be used to help mitigate revenue limit cuts

To help districts absorb the reductions in general-purpose funding, state policymakers granted them some limited-term financial flexibility, including:

- Reducing by half the required level of reserves for economic uncertainty so they will range from 0.5%–2.5% (depending on district size) for fiscal years 2003–04 and 2004–05. The

## Dispute over “basic aid” school districts ends in compromise

For most school districts, revenue limit income comes from local property taxes to which state funds are added. In a handful of districts, local property taxes equal or exceed the total revenue limit amount. In the past, these districts kept the excess taxes and received an additional \$120 per student in constitutionally guaranteed “basic aid.” They were commonly referred to as “basic aid” districts, a term that often gave the impression that they received less funding than their counterparts.

In January 2003 Davis proposed that the state eliminate the basic aid allocation to these districts and also reduce their categorical funding by the amount of local property taxes they collected in excess of their revenue limits. To help clarify their status, state officials began referring to them as “excess tax” districts.

Following a spirited debate and a very public outcry from residents in some of the 82 districts affected, the governor moderated the second half of the proposal. Ultimately, the \$120 basic aid payment was eliminated with the justification that the state met its constitutional obligation with other state funding from categorical programs. In addition, excess tax districts saw a \$9.9 million cut in their categorical programs—equivalent to approximately a 1.5% reduction in their revenue limit. This about equaled the 1.2% cut in revenue limit funding experienced by other districts.

freed-up funds could be used for any purpose.

- Reducing required reserves for ongoing and major maintenance of facilities from 3% to 2% for 2003–04.
- Allowing districts to use at their discretion all of their unspent 2002–03 categorical fund reserves. Some programs were excluded, including

Economic Impact Aid, Special Education, Targeted Instructional Improvement Grants, Instructional Materials, and programs for helping underperforming schools. Funds from these programs can *only* be used to backfill a district’s share of revenue limit reductions in 2003–04.

On the other hand, policymakers reduced districts’ flexibility to transfer funds among several categorical programs. For many years, districts have been able to shift a portion of their categorical funding as long as no program’s funding was reduced by more than 20% and no program’s funding was increased by more than 25%. This year, the caps were set at 10% and 15% respectively. Districts that had transferred the maximum amounts in 2002–03 were allowed to do so for one more year.

In addition, legislators passed a bill (Senate Bill or SB 556) to give districts some flexibility with respect to class size reduction (CSR) for kindergarten through third grade, but Davis vetoed it. Under the current provisions, districts only receive CSR funding for K–3 pupils enrolled in classes with a maximum of 20 students per teacher. If a classroom has 21 students, the district does not receive any CSR funding for those 21 students. The vetoed legislation would have relaxed the penalties should a district slightly exceed the cap.

### Actions address discretionary monies

As has happened for the last few years, Democrats and Republicans in the Legislature also debated the possibility of equalizing revenue limits. A variety of historical actions have resulted in variations in revenue limit amounts of more than \$300 per student among some districts. In the latter stages of budget negotiations, legislators considered reducing funding for four programs by a total of \$50 million and providing that amount for equalization instead. In the end, the

Legislature rejected this proposal and also repealed a 2002 law (Assembly Bill or AB 2781) that had set aside another \$203 million for this purpose.

Some educational funds that go to districts as categorical money can be used to support the overall educational program. Among these programs, several target districts that serve the neediest students. These include Economic Impact Aid and English Language Learners, both of which received the same funding in 2003–04 as they did in 2002–03. The Targeted Instructional Improvement Grants (a program that replaced desegregation funds in 2001–02) go to similar districts. The funding was held constant, but a portion of their allocation was deferred into 2004–05.

By contrast, Supplemental Grants were cut by \$80 million or about 33%. These grants generally go to a different and typically less challenged group of districts. In some districts these grants supplement revenue limits, while in others they go to specific programs.

### State leaders depend on federal increases to meet Special Education and child-care obligations

About 11% of students in California receive Special Education services based on their having physical, mental, or learning disabilities. School districts are not expected to provide all of these services from their regular revenues. They receive extra funds from both the state and federal governments to help with Special Education. In turn, local districts are required to provide services within both state and federal guidelines. The percentage of students who receive Special Education services has grown steadily from the 9% it was in 1991–92.

Over the almost 30 years since Special Education became a state and federal mandate, there has been regular debate and litigation about the share that local districts, the state, and the federal govern-



**figure 5** Federal increases in Special Education funding makes up for state cuts

Year	State funds (in millions)	Federal funds (in millions)	Total (in millions)
2001-02	\$2,723	\$670	\$3,393
2002-03	\$2,711	\$798	\$3,509
2003-04	\$2,687	\$951	\$3,637

DATA: EdSource AND CALIFORNIA DEPARTMENT OF EDUCATION (CDE)

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ment should each contribute. A lawsuit settled in 2001 required the state to increase its annual funding for Special Education by \$125 million. This was just at the time that the state economy and budget began declining. Concurrently, after being heavily lobbied, the federal government began to strengthen its commitment to Special Education. Over the last three years, California officials have depended on the increases in federal support to help meet the state's obligation to fund Special Education. (See Figure 5 above.) As a result, local districts have not received the extra help with Special Education costs that increased federal funds would have provided.

The net increase for Special Education in 2003–04 pays for growth in the number of students served. Local education agencies will also have to cover additional costs, however, due to another budget decision. For some time, counties have provided mental health services required for Special Education students—an expense that state government reimbursed. State funds for these services were cut from the budget in 2002–03, leaving counties with the costs and not the revenues. Of this year's increase in federal funds for Special Education, \$69 million will go to county offices of education to fund these county services.

A number of subsidized child-care programs are funded under the auspices of K–12 education. In many cases these receive a combination of state and federal funds.

Legislative action this year changed some eligibility rules and reimbursement rates in order to save money. Legislators also used an increase in federal money in place of some state funds for child-care programs that are part of K–12 education. The net result was a reduction of more than \$120 million in state funds allocated for these programs compared to the amount approved in the 2002–03 Budget Act.

#### *The state gives and the state takes away*

In his initial budget proposal for the 2003–04 budget, Davis recommended doing away with 64 assorted state categor-

## **Many of the cuts affected programs that lawmakers created just a few years ago.**

ical programs, reducing the \$5.1 billion in funding previously provided for these programs, and then giving local districts the flexibility to spend the remaining money as they saw fit. Some education advocates and legislators objected to his choice of programs either because of what was not included or because they felt that programs included on the “cut” list were very important. The governor's proposal varied considerably from a categorical consolidation recommendation previously presented by the LAO, which has

also failed to get sufficient support for implementation.

Eventually, the goal of revamping categoricals was once again abandoned. At that point, the LAO and the group of education organizations commonly called the Education Coalition responded with suggestions for reducing specific programs as a way to accomplish the funding cuts needed for a balanced budget. Many of the cuts affected programs that lawmakers created just a few years ago.

#### **Cuts in instructional material funds may be the easiest to manage**

In recent years the state has significantly increased its investment in instructional materials. California added \$1 billion to its textbook allocations from 1998–99 to 2001–02 to make sure that schools had textbooks and other materials aligned to the state's academic standards and curriculum frameworks in the four core subject areas: English language arts, mathematics, history/social science, and science. This was in addition to an existing Instructional Materials Fund allocation and was also

augmented with funding for classroom libraries. At its highest level, in 2001–02, the allocation totaled \$446 million.

In the 2002–03 budget, the Legislature consolidated these instructional materials programs and allocated \$400 million to the Instructional Materials Funding Realignment Program (IMFRP). With an excess of optimism, as it turns out, legislators at the time expressed the intent to provide \$350 million in 2003–04, with substantial increases annually until 2006–07. Those

appropriations were intended to align with the State Board of Education's schedule for adopting instructional materials and the estimated cost of each adoption. The program was reduced by \$103 million midway through 2002–03. The IMFRP

Board had revised that list because its members determined that some of the adopted materials were not fully standards-aligned.

School libraries will see little new stock this year as the School Library

To improve the qualifications and supply of new teachers, California developed a number of recruitment programs. Among them was the creation in 2001 of six regional Teacher Recruitment Centers that were developed and run by county offices of education. Lawmakers this year completely eliminated those centers, for which \$8.3 million had originally been budgeted.

On the advice of the education community, lawmakers also eliminated the \$88 million Teaching as a Priority (TAP) program they created in 2000–01 to help school districts put well-qualified teachers into low-performing schools. This program was generally seen as not having the level of impact lawmakers had hoped it would.

By contrast, funding for the Beginning Teacher Support and Assessment (BTSA) program remains almost the same. This program enables school districts to provide support for newly credentialed teachers and assess their progress. Since 2002 all new teachers in California have been required to participate in this type of induction program for two years in order to earn a professional-level credential.

The other general category of teacher-related programs provides professional development and support for fully credentialed teachers who need to improve their skills or knowledge. Staffs also need time together away from the classroom for improving the instructional program of their school as a whole.

Lawmakers ended up emphasizing those programs that serve entire school staffs and largely eliminating several recently created programs that tended to target individual teachers. Incentives for National Board Certification were reduced by about a third by eliminating the financial aid for going through the process and the \$10,000 bonuses given to teachers who earn certification. The program that provides board-certified teachers with \$20,000 if they teach in a

## ***Lawmakers ended up emphasizing those programs that serve entire school staffs and largely eliminating several recently created programs that tended to target individual teachers.***

allocation for 2003–04 is \$175 million, a reduction of 56% from the 2002–03 Budget Act.

In many districts the generous past funding has put a wealth of new books on the shelves or in students' hands. To the extent that is true, the modest allocation this year—about \$28 per pupil—may be one of the easier cuts for schools districts to cope with. This is in part because textbooks are one-time expenditures. Some districts may have funds from 2002–03 or prior years that they have yet to spend. They will also receive about \$12 per student in lottery funds that they must spend on instructional materials.

In addition, lawmakers relaxed some related regulations put into place in 2002. As part of the IMFRP, the state had required districts to provide students with standards-aligned instructional materials in the second full school year after the State Board of Education adopts the materials. New legislation gives districts an additional year and allows them, through 2004–05, to count materials that they purchased from the State Board's 1998 adopted list of math and reading/language arts materials (AB 2519) as standards-aligned. The State

Program was cut by 82%, to about \$4 million. The state also provided about \$4 million in one-time funds for K–4 classroom libraries. This is in stark contrast to the \$158 million libraries received in 2001–02. School libraries became the target for this sizable state investment when excess funds became available in the late 1990s. In the previous decade or more, libraries had often been neglected in favor of other local priorities.

### ***Some teacher quality programs continue while others are eliminated***

The improvement of classroom teaching has been a central goal of the state's reform efforts since 1997. Critical to that goal are two types of activities: 1) those intended to strengthen the qualifications of teachers entering the profession; and 2) those intended to help current teachers improve their practice. An overarching concern has been that the lowest-performing students are disproportionately likely to be taught by teachers who are less than fully credentialed. California lawmakers, in attempting to address these issues, created a wealth of new programs between 1999 and 2002. In 2003–04 they dismantled several of them but provided full funding to others.

low-performing school for four years remains intact. An \$8 million training program for those teaching Advanced Placement classes was eliminated. The Peer Assistance and Review (PAR) program was cut from \$87 million in the 2002–03 budget to \$25 million this year. PAR, created in 1999, took the place of the state’s long-standing mentor teacher program. Its original purpose was to improve teacher quality through professional assistance from peers, but reports of its effectiveness were mixed. The amount left was enough for districts to meet the local matching requirement of BTSa.

Funding for the state’s largest professional development program was held constant at \$230 million. The Staff Development Buy-Out Program, as it is commonly called, gives school districts funding to hold three days of teacher professional development in addition to state-funded instructional days. The budget also preserved the standards-based Math and Reading Professional Development program, but with a modest funding level of \$32 million.

However, several federal programs supplement the amount available for professional development. The Reading First program, which grew from \$132 million to \$145 million, trains K–3 teachers in reading instruction. Legislators also changed the eligibility requirements for this program (AB 1485) to assure that classrooms using bilingual instruction could receive federal funds if they had adopted state-approved instructional materials. A new federal program, the Math and Science Partnership Program, provides \$14 million to school districts. In addition, the federal government added about \$20 million to an existing pool of \$321 million that California can use to lower class sizes or to train, recruit, and retain teachers. For the most part, school districts have discretion over which way they use these funds.

<b>Budget actions affect teacher quality</b>	
<b>Recruitment/retention programs</b>	
Teaching as a Priority (TAP)	Funding cut completely
Regional Teacher Recruitment Centers	Program repealed
Improving Teacher Quality federal grants (recruitment/retention, reforming certification, teacher testing, class size reduction)	Funding increased
Governor’s Teaching Fellowships	Program repealed in 2002–03
<b>Programs aimed at improving existing instruction/leadership</b>	
Beginning Teacher Support and Assessment (BTSa)	Funding retained
Peer Assistance and Review (PAR)	Funding reduced to amount that districts need for local match for BTSa
National Board Certification - Financial aid for certification process - Incentive for getting certification - Incentive for getting certification and working in a low-performing school	- Funding cut completely - Funding cut completely - Funding retained
Staff Development Buy-Out Program	Funding retained
Reading First federal program (reading assessments, teacher training)	Funding increased
Math and Science Partnership Program (federal program)	New program
Principal Training Program	Funding decreased

Finally, the budget preserved \$5 million in funding to maintain a minimum commitment to the Principal Training Program created in 2001. This was the least the state could spend and still meet the terms of an agreement with the Bill & Melinda Gates Foundation to provide \$18 million over three years to help make the program available to local schools. At the same time it eliminated the \$5 million, 20-year-old Administrator Training and Evaluation Program. This program, run by the California School Leadership Association (CSLA), provided a more general type of leadership training.

### **NCLB changes California’s intervention and improvement programs**

Along with programs that specifically address teacher professional development, the state’s intervention programs for low-performing schools have provided participating schools with resources for school staff training. The Immediate Intervention/Underperforming Schools Program (II/USP) came on the scene in 1999 and provided funds to support improvement plans at about 430 low-performing schools a year for three years, for a total of about 1,300 schools and \$161 million in state funds at its height.

## Program Improvement and AYP are focus of revised accountability system

California's accountability measures changed due to requirements of the federal No Child Left Behind Act (NCLB).

Schools are now expected to make "adequate yearly progress (AYP)" based on student performance on, and participation in, standards-based tests. Schools fail to make AYP when expected percentages of students in any subgroup fail to attain proficiency in English language arts and math or when they do not meet specified Academic Performance Index (API) scores or improve their API score by one point. High schools have the extra requirement of improving their graduation rate by at least 0.1% each year. Schools must also test 95% of students in every subgroup to make AYP.

Schools that fail to make AYP for two consecutive years become Program Improvement schools. For a more thorough explanation, go to: [www.edsource.org/edu\\_acc\\_ayp.cfm](http://www.edsource.org/edu_acc_ayp.cfm)

The High Priority Schools Grant Program (HPSG), which shifted the focus to the bottom 10% of schools, began taking the place of II/USP in 2001–02. While \$123 million in funding goes to schools already in the II/USP program, no new schools have been included for two years. The state allocated \$234 million for HPSG, in part to cover the cost of adding a final group of schools to the program.

Meanwhile, NCLB established a different program-improvement system that must be used at schools receiving Title I funding. (Schools with high percentages of low-income students qualify for Title I.) Schools that enter Program Improvement under NCLB do not get extra funds per se. Rather, districts are

expected to use their regular Title I resources to help their schools meet the Program Improvement requirements. In the first two years, this includes development of an improvement plan and direct services to students, including paying up to 20% of their Title I Part A (basic grant) allocation for transportation should parents choose to send their child to another school and for supplemental instructional services such as tutoring for students who qualify. To support these requirements, the federal government has increased its Basic Grants under Title I from less than \$1.2 billion in 2001–02 to \$1.7 billion in 2003–04.

A total of \$60 million in state and federal funds will be available to administer improvement programs in the most chronically struggling schools. The Statewide System of School Support, or "S4," consists of regional consortia of county offices of education and/or school districts. Each consortium will receive funding to help build local capacity to intervene in struggling schools, particularly those that are in "corrective action" for failing to make AYP for four or five years. Specifically, each consortium with a school in "corrective action" will receive between \$75,000 and \$125,000 to create School Assistance and Intervention Teams (SAIT) to work with such schools. The teams will then receive between \$75,000 and \$125,000 for each school they work with. In turn, each school will get \$150 per pupil to implement the reforms required by the SAIT. Schools that have failed to make AYP for two to three years, and are thus in Program Improvement, will have second priority for assistance from the S4 consortia.

The relationship between NCLB and California's own intervention programs remains somewhat unclear. In the next legislative session, state and education leaders are expected to look at ways to integrate or combine the two programs.

## Supplemental instruction programs for struggling students face cuts

As with various other reform areas, California first expanded and is now contracting somewhat its commitment to provide extra academic support for struggling students. Beginning in 1998–99, the state created multiple programs that operated outside the regular school day or year. The funding for these programs represented a substantial increase from the approximately \$161 million the state spent for summer school and some other small programs in 1997–98.

In 2003–04 two programs have been eliminated: the Elementary School Intensive Reading Program created in 1999 and Math Academies for 7th and 8th graders created in 2000. Funding for these two programs totaled \$43 million in the 2002–03 budget. The state also saved \$29 million by eliminating the long-standing Miller Unruh Reading Program, which paid for reading specialists.

Funding for summer school and the other student support programs has also been cut since 2001–02, when it totaled \$435 million. These programs have been a target for mid-year cuts and deferrals, making the specific annual allocations for these programs complicated to follow. The net result was funding of about \$340 million in 2002–03 and about \$350 million in 2003–04. The per-pupil funds districts receive will remain at \$3.45 per hour, but it is unclear whether schools will have sufficient funds to provide support services to all the students who they identify as needing extra help.

For some schools, pressure to offer these services has escalated along with accountability demands, particularly as a result of NCLB. Schools that have repeatedly failed to meet their AYP goals must offer supplemental academic support to low-income students. A limited amount of additional federal money will be available for this purpose, in addition to Title I basic grants.

figure 6 | State and federal education money earmarked for special purposes

Major state programs (all dollar figures are in millions)	Budget Act 2002-03	Final 2002-03 (reflecting mid-year cuts/deferrals)	2003-04 funding appropriated in advance (most are deferrals from 2002-03)	2003-04 Budget Act
Special Education	\$2,711	\$2,497	\$214	\$2,687
Class Size Reduction (K-3)	1,659	1,659		1,659
Child Care and Development	1,403	1,403		1,281
Targeted Instructional Improvement Grants	1,451 <sup>a</sup>	1,187	264	642
Adult Education (includes \$19 million for adult education in correctional facilities in 2002-03 and \$14 million in 2003-04)	601	557 <sup>b</sup>	41	551
Economic Impact Aid	499	499		499
Pupil Transportation	524	385	140	474
School Improvement Program	0	314 <sup>c</sup>	115 <sup>d</sup>	387
Regional Occupational Centers and Programs	373	373		370
Summer School/Supplemental Instruction	450	342 <sup>e</sup>	83	269
High Priority Schools Grant Program	217	180	37	234 <sup>f</sup>
Instructional Time and Staff Development Reform	306 <sup>g</sup>	257	49	230
Instructional Materials	400	297		175
Supplemental Grants	242	0	242	162
Student Assessment	155 <sup>h</sup>	155		131 <sup>i</sup>
Immediate Intervention/Underperforming Schools Programs (II/USP)	224 <sup>j</sup>	185	39	123 <sup>k</sup>
Class Size Reduction, Grade Nine	110	110		110
Beginning Teacher Support and Assessment (BTSA)	102 <sup>l</sup>	102		86
<b>Major federal programs (all dollar figures are in millions)</b>				
ESEA Title I - Extra Support for Students who Live in Poverty		\$1,772		\$1,999
Basic Grants		1,496		1,711
Reading First		132		145
Migrant Education		134		132
Homeless Children Education		7		7
Advanced Placement Fee Waiver		3		4
Child Nutrition		1,414		1,445
Child Care and Development Programs		891		1,045
Special Education		798		951
ESEA Title II - Improving Teacher and Administrator Quality		400		443
Part A - Improving Teacher Quality		317		341
Education Technology		83		88
Math and Science Partnership Grants				14
School Renovation Grants Program		139		139
Vocational Education		138		138
ESEA Title III - English Learners and Immigrant Students		109		133
ESEA Title IV - 21st Century Schools		93		129
After-school Programs		41		76
Safe and Drug Free Schools and Communities		52		53
Adult Education		92		82
ESEA Title VI - Assessment Funding		29		45
ESEA Title V - Innovative Programs		39		40

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<sup>a</sup> Reflects \$713 million deferred from 2001-02 to 2002-03 and \$738 million appropriated in the Budget Act of 2002-03.

<sup>b</sup> The \$43 million reduction includes a \$41 million deferral of adult education funding to 2003-04 and a \$3 million cut from adult education in correctional facilities (Senate Bill 1X 18, 2003).

<sup>c</sup> Appropriated in Assembly Bill 2781 (2002).

<sup>d</sup> Appropriated in Assembly Bill 2781 (2002).

<sup>e</sup> Senate Bill 1X 18 reduced the 2002-03 appropriation by \$108 million and appropriated \$83 million in 2003-04.

<sup>f</sup> Includes \$15 million in federal funding.

<sup>g</sup> Reflects \$76 million deferred from 2001-02 and \$230 million appropriated in the Budget Act of 2002-03.

<sup>h</sup> Reflects \$61 million deferred from 2001-02 and \$29 million in federal funding.

<sup>i</sup> Includes \$45 million in federal funding.

<sup>j</sup> Includes \$40 million in federal funding.

<sup>k</sup> Includes \$24 million in federal funding.

<sup>l</sup> Reflects a \$14 million deferral from 2001-02.



### State testing system will change some

Total funding for student testing remained relatively stable, in part thanks to new federal funds. Student testing as a whole will receive \$131 million,

(CAHSEE), including almost \$2 million for developing workbooks to help students prepare for it and \$1 million for an independent consultant to report on possible alternatives for disabled students (SB 964).

ments, and the state will not provide any funds for reimbursements.

## Total funding for student testing remained relatively stable, in part thanks to new federal funds.

including \$85.9 million in state funds and \$45.4 million in federal monies. That amount reflects an unspecified cut in state funding of \$10 million. The State Board of Education and Department of Finance are expected to agree on how these cuts will be made.

About half of the testing money goes to support the state's Standardized Testing and Reporting (STAR) Program, which includes:

- The California Standards Tests and CAT/6 for virtually all students in grades 2-11;
- The California Alternative Performance Assessment for severely disabled students; and
- The SABE/2 for Spanish-speaking students who have been enrolled in California public schools for less than a year.

The federal funds came with some new guidelines and expectations, particularly related to the testing of English learners. The state will be spending \$1.4 million, for example, to add reading and writing assessments for kindergarten and first grade students to the California English Language Development Test (CELDT). The total budget for the CELDT is more than \$11 million. The state is also choosing to devote \$3 million to develop native-language assessments in languages besides Spanish.

Another \$21 million will pay for the California High School Exit Exam

Under some political pressure to reduce the student testing program, lawmakers did pass a measure (AB 1485) that will cut back the STAR program in the future. Beginning in 2005, the norm-referenced test (currently the CAT/6) will only be administered to grades 3 and 8.

### Mandated cost reimbursements are virtually eliminated

Proposition 4, approved by California voters in 1979, requires the state to reimburse local government agencies—such as school districts and county offices of education—for the cost of implementing mandatory new programs or services. If the state delays these payments, it must reimburse with interest.

For several years state leaders have deferred these reimbursements in order to help reduce Proposition 98 expenditures and balance the budget. The 2003–04 Budget Act provided only \$36,000, just \$1,000 for each of the 36 mandates. The state now has an accumulation of almost \$1 billion in unpaid mandate claims, but local districts still have to comply with the state's requirements for the most part. Two mandates—one requiring safety features on school buses and the other requiring schools to report crimes in ways not conforming to new federal legislation—were suspended altogether. This means that local agencies will no longer be required to comply with these require-

### What can local school districts do to get by?

Many California school districts face big financial challenges in 2003–04, particularly in comparison to the years of increased funding they enjoyed between 1996 and 2001. Given the problem of higher costs and lower funding, school districts have two options for addressing the issue: they can try to raise revenues or reduce expenditures.

### Districts have few revenue options

The options for increasing local revenues are quite limited. Districts could try to get additional categorical funding if it were available—but outside of the few new programs created by NCLB, such opportunities are virtually non-existent this year. They could also seek private contributions, such as those available from foundations and community groups. Private foundations in California, however, have seen their endowments shrink along with the Dow Jones Industrial Average, and many have pulled back on their grants.

Districts in higher-wealth communities seem to have more options for raising funds in difficult times, or at least to be more apt to do so. More than 400 education foundations exist in California specifically to support the schools in their community. Most are affiliated with districts, though some are connected to specific schools. Some PTAs and other parent organizations also raise substantial amounts along with providing volunteer hours that help schools serve students and offer extra programs.

The one other option school districts have—and probably the most lucrative one—is the passage of a parcel tax. These levies, which require two-thirds approval from local voters, authorize the district to collect a flat tax from each separate parcel of property within its attendance boundaries. About half of these elections

typically pass. Election data indicate that a larger than usual number of districts have recently tried this strategy. During the first six months of 2003, 24 districts held elections and half of the measures passed. This is a notable increase in attempts, which average about 16 per year. However, the total number of elections is still quite small given that the state has 986 school districts.

On average, parcel tax amounts also appear to be increasing. In the last 18 months, the median was \$108 per parcel, but that masks some extremely high amounts. In Kentfield Elementary School District in Marin County, for example, voters approved a levy of \$550 per parcel.

Those districts that pursue parcel tax elections tend not to be the ones serving students from low-income households. Of the 39 parcel tax elections held between January 2002 and June 2003, only three were held in districts where the portion of students participating in the National School Lunch program exceeded the state average. It is interesting to note that in two of those districts—Mojave Unified in Kern County and Emery Unified in Alameda County—the measures passed. A proposed constitutional amendment to lower the passage threshold to a 55% super-majority received legislative attention this year but did not garner the necessary two-thirds approval. Such a measure would almost certainly improve the likelihood of passage and thus increase districts' willingness to approach voters.

#### **Increased costs are built into the system**

While school districts' revenues will remain fairly flat or go down somewhat, the same is not likely to be true for their expenditures. The "demand for services" is based on the students who enter the schoolhouse door, and it takes a certain number of people to provide those services—particularly classroom teachers. With 80% to 85% of district expenditures going to personnel—and more than 50% devoted just to teachers—the

options are limited and the challenges serious. Many districts gave substantial salary increases through 2001, and those represent ongoing obligations.

District salary schedules give pay increases based on years of experience and

face faster escalation of costs due to the steeper and more rapid increases typical at the early end of the salary schedule. Lawmakers this year passed legislation (AB 1207) that enables school district employers to sweeten the pot for teachers

## ***While school districts' revenues will remain fairly flat or go down somewhat, the same is not likely to be true for their expenditures.***

employees' continuing education. As a result, salaries for individuals rise periodically without a district granting a raise per se. The make-up of a given district's staff in terms of experience and education will determine how much personnel costs as a whole rise automatically from year to year.

Given the wide recognition of the budget situation this year, few districts and unions are likely to be discussing substantial raises during collective bargaining. If they do, they may be simultaneously looking for savings. Related to teachers, those might include such measures as increasing class sizes, reducing teachers' preparation or nonteaching time (during which someone else is paid to work with students), or cutting back on paid employee leaves. All of these measures are part of the collective bargaining agreement. Outside the classroom, reductions are more likely to be accomplished through personnel cuts, such as reducing maintenance staff, cutting library or counseling services, and cutting central office administrators.

Another option for reducing payroll costs is to offer retirement incentives to the district's most experienced—and thus most expensive—employees. Replacing them with less experienced, lower-paid staff may save money in the short term. In subsequent years, however, districts will

who retire early. The bill, which was heavily supported by the California Teachers Association (CTA), expands the options districts can offer to encourage early retirements. Another such option program was put in place during the fiscal hardships in the early 1990s, but it expired in 1999. The new law makes this a permanent option that school districts and unions can choose to make part of their collective bargaining agreements. Concurrently, Davis vetoed a bill (AB 457) that provided similar benefits for classified employees, such as clerks and instructional aides.

Along with most other California employers, school districts have also faced rising costs for both employee health insurance and workers' compensation insurance. School Services of California estimates that health and welfare expenses in a typical unified school district have increased by 54% since 1997–98, compared to state-determined cost-of-living adjustments (COLAs) for school districts that have totaled 27.2% in the same time period.

Workers' compensation insurance costs increased by about 8% in 2002–03, according to an estimate from School Services. However, districts may get some relief in 2003–04 or at least not face more increases. Davis signed into law a package of reforms (SB 228 and AB 227) that state officials expect will prevent further

## **Legislators also continued to support the development of a data system that will enable California to track students' progress as they move through the school system.**

increases and may result in rate reductions in the coming year.

### **Other legislation addresses charter schools and a statewide data system**

Consistent with a trend toward increased accountability for charter schools in recent years, a new law (AB 1137) specifies some oversight responsibilities for charter-granting organizations and some student performance expectations for the schools themselves. Beginning in 2004, charter-granting authorities—usually school districts—must identify a contact person for charter schools, visit each charter under their authority at least once a year, ensure that charter schools submit required reports, monitor their charter schools' fiscal condition, and notify the CDE when a charter is denied or revoked, or a charter school closes. Charter-granting authorities already receive supervisorial fees the state expects them to use to cover the cost of these responsibilities.

The legislation also creates modest student performance expectations beginning in 2005 for charter schools in operation four years or more. Charter schools must either perform better than 30% of public schools (based on their API score), meet their state-set API growth targets two years out of three, or demonstrate performance comparable to schools with similar populations.

The bill also adjusts funding for charter schools that receive a categorical block grant in lieu of funding for separate programs. Four additional programs were added to the block grant, a move that was

consistent with a recommendation in a recent charter school evaluation completed by RAND. In addition, charter schools are now prohibited from applying for any of the categorical programs that are included in the block grant.

Legislators also continued to support the development of a data system that will enable California to track students' progress as they move through the school system. Scores from the statewide STAR tests, the high school exit exam, and the California English Language Development Test (a placement test for English learners) would all be included in this system. In 2002–03 policymakers appropriated almost \$7 million for this project and to satisfy related federal requirements. New legislation this year (SB 257) requires the existing Public Schools Accountability Act Advisory Committee to make a formal recommendation regarding the feasibility of using this longitudinal database to create a measure of school improvement. Lawmakers again allocated \$7 million to this effort, making California one of 22 states working on building a longitudinal data system. The goal is to have the system in place by the end of 2006.

### **Important issues loom on the horizon**

The year 2003 will certainly be remembered as a volatile one for California as a whole, but perhaps less so for schools. After years of dramatic reform that included new state programs of every stripe, public education was largely granted a hiatus from new ideas and

instead continued to implement reforms already underway. Those major reform themes will still be the agenda in 2003–04—but with fewer resources and more uncertainty about what is likely to happen in Sacramento.

A new governor—particularly one whose views on public education are just beginning to emerge—could mean new reforms. It is clear, however, that the first challenge for Gov. Arnold Schwarzenegger will be getting his administration and his initial state budget proposal in order. A number of structural and procedural components embedded in California state law will make the latter a daunting task, just as it was for his predecessor.

### **California's budget problems go deeper than money**

In both 2002–03 and 2003–04, state lawmakers used a series of fund transfers, loans, and deferrals to create a budget that was “technically” balanced. In the process, they avoided dealing with the fundamental problem that the state's income does not currently cover its expenditures. As that income begins to increase due to the economic recovery, some of this problem may start to abate. However, the state still must face the mismatch between income and expenses that has created a huge debt since 2001–02. The LAO estimates that the cumulative deficit could still total \$8 billion at the end of 2004–05 if no corrective actions are taken.

The current crisis has left several problems for the state and lingering concerns about the system as a whole. One long-term impact will be higher costs when California borrows money. States and other public entities are assessed interest on bonds they issue—whether they are for school buildings or highways—based on a bond rating that takes into account their overall fiscal health. California's rating, last issued by Standard & Poor's after the 2003–04 budget adoption, has been downgraded from an “A” to a “BBB.”

The latter is one of the lowest ratings ever given to a state government. This will result in the imposition of higher interest payments on new bonds and penalties on current bonds. It also makes the state's bonds less attractive to investors and thus more difficult to sell.

Some past decisions by California voters have contributed to the current situation. Actions taken at the ballot box have both limited California's revenue options and forced automatic increases in expenditures.

In 1978 voters used the initiative process to pass Proposition 13 and dramatically limit state and local governments' ability to increase property taxes, one of the most stable sources of revenue, to support public education and other services. That has left schools highly dependent on the state General Fund for their revenues. The General Fund in turn depends on an income tax system whose yield fluctuates greatly and a sales tax that is not growing at the same pace as the economy because it does not cover services or Internet transactions.

Voters have also tied the hands of lawmakers interested in reducing expenditures. The most notable example of this is Proposition 98. Its guarantee of a minimum funding level for schools has for several years been part of the reason lawmakers have resorted to such convoluted budget mechanisms as deferrals and loans. Yet absent that guarantee, education advocates would argue, California's public school districts could all have been forced to return to their 1999 spending levels, a difficult prospect given higher ongoing costs such as salaries.

Looking to 2004–05 and beyond, Schwarzenegger and legislators will have to begin accommodating another voter-mandated expenditure. The provisions of Proposition 49, a measure Schwarzenegger himself sponsored, set 2004–05 as the base year for committing a set level of state funds to after-school programs. The

## ***After years of dramatic reform that included new state programs of every stripe, public education was largely granted a hiatus from new ideas and instead continued to implement reforms already underway.***

way the measure was written, however, no additional funds will be required this year due to the budget situation.

In this most democratic of states, voters will soon get another chance to affect state leaders' budget decision making. The Budget Accountability Act, slated for the March 2004 ballot, would reduce from two-thirds to 55% the vote required by the state Senate and Assembly to adopt the state budget and related tax legislation. The initiative also includes a mandatory budget reserve and penalties for legislators and the governor should they miss the constitutional deadline for budget passage.

### ***California's complex school finance system presents a major obstacle***

California's school finance system is the 800-pound gorilla that has yet to be tamed. The last few years have made clear just how central the education budget is to the state's overall budget planning process. Further, a substantial portion of the extra expenditure state leaders committed to during the growth years was for education. The money went to support measures aimed at improving school performance and raising the skills of teachers and other educators, goals most Californians see as a high priority. But new expenditures such as class size reduction, pay raises, and a new accountability system were laid on top of a funding mechanism that is complex at best and counterproductive at worst.

Few people defend the current school funding system, with its archaic revenue limit calculations and its plethora of

categorical programs. Nevertheless, developing consensus about how to change it seems nearly impossible at times. The challenge comes in part from the fact that school finance is so closely tied to issues that can be divisive, complex, and highly political. They include questions about local versus state control of schools, how to balance the interests of individual communities against the common good, who should be held accountable for schools' fiscal management, and how much money schools need to deliver the quality of education California expects. Californians have dodged these questions for many years, but that may change in 2004 for several reasons.

A lawsuit filed by a coalition of legal teams including the ACLU and Public Advocates, *Williams v. California*, asks the courts to decide the nature of the state's responsibility for providing at least a baseline of educational services, including a safe school environment. The plaintiffs say the state has the obligation to operate some kind of oversight system to prevent and correct disparities in the way resources are allocated and to assure basic services are provided at every school. The state, as defendant, says that it has provided significant resources to address the needs identified in the lawsuit and that ultimately it is the responsibility of districts to ensure that those services are provided. The case is now scheduled for trial in summer 2004, but it has been postponed several times previously.

A reconsideration of the entire school finance system—including equity, finan-



## What happened to the K-16 Master Plan?

From 2000 until 2002, a large assemblage of researchers, educators, and other experts were divided into Working Groups to create recommendations for the Joint Committee to Develop a Master Plan for Education. After receiving those recommendations, and getting public feedback, the committee presented a Master Plan proposal to the Legislature late in 2002, out of which came a series of separate legislative proposals. Among them was the establishment of a Quality Education Commission, a proposal Assemblywoman Virginia Strom-Martin introduced in 2002. The measure (Assembly Bill or AB 2217) was signed into law and called for the commission to begin its work in July 2003. The job of the QEC is to develop a recommendation for changing California's school finance system based on an "adequacy model."

When no funds for the commission's work were included in the original 2003-04 state budget proposal, private foundations stepped forward to help. (Lawmakers passed Senate Bill or SB 712 to make this private funding possible.) In summer 2003, the William and Flora Hewlett Foundation and the Bill & Melinda Gates Foundation together committed funds to get the work of the commission started. The 13 members of the commission include seven gubernatorial appointments. Davis made his selection prior to leaving office, but his appointees were not confirmed by the Legislature and the new governor could replace them with his own choices.

Meanwhile, members of the Master Plan Committee introduced bills to implement other elements of the Master Plan. These proposals were expected to be "two-year bills" and thus part of the legislative debate during the 2004 session. The ones directly related to K-12 education include:

AB 56 – This **school readiness** bill would create a statewide system of school-readiness centers, lower the minimum age for compulsory education from 6 to 5, and extend the minimum kindergarten day by 50 minutes.

SB 550 – This bill related to **student learning** would define what should be expected in terms of student achievement and the opportunities to learn that should be guaranteed to all students. It would also promote increased alignment of curriculum throughout the system.

SB 6 – This bill focusing on **public education governance** would delineate responsibilities and assign authority among state, regional, and local education entities.

AB 242 – This **education personnel** bill would make health and welfare benefits uniform for teachers statewide and would strengthen teacher credentialing and professional development requirements.

AB 1550 – This bill would establish standards for **school and university facilities** and create a statewide facilities inventory. It would also eliminate the use of "Concept-6" year-round schedules (which have as few as 163 days of instruction) and require a state construction plan for the higher education system.

cial management, and the appropriate level of school funding—are on the agenda of the Quality Education Commission (QEC). (See the box on this page related to the Master Plan.) The QEC could begin meeting as early as November 2003 and is expected to submit a report to the Legislature within 12 months of its first meeting. The model to be developed by the QEC

also takes on the issue of categorical programs. It eliminates almost all of the existing categoricals in favor of a system that provides a base amount to schools with augmentations to cover extra costs involved in educating English learners, low-income students, and Special Education students to the state's standards.

Meanwhile, the issue of flexibility in

categorical programs has become a separate subject of debate. Two years ago, the LAO proposed consolidating the state's 100 separate programs into five large block grants. In January 2003 Davis proposed a different approach to consolidation as part of the 2003-04 budget. This year, state legislators authorized the state auditor's office to evaluate the relative merits of categorical programs. Their report is expected in November 2003. And most recently, Schwarzenegger has called for categorical reform in order to give local school districts greater flexibility. Despite this momentum, the outcome is far from certain. Categorical programs have proliferated based on concerns that school districts should be required—or at least strongly encouraged—to provide certain education services in specified ways that state leaders believe are best. California's creation of about 100 separate programs has taken that idea to the extreme, yet every categorical program has its defenders. In some cases, the programs serve the needs of a particular special interest group. Some have outlived their usefulness while others further goals that remain important to many education stakeholders. It will take cooperation and a collective willingness to compromise to navigate this political landscape successfully.

### *The power to change education policy rests with state leaders*

Despite the presence of 986 separate school districts with locally elected boards—or perhaps because of them—state leaders make education policy in California. The governor and Legislature do not act alone, however. The State Board of Education, the California Commission on Teacher Credentialing, the State Superintendent of Public Instruction, and the California Department of Education all have roles to play. The new governor's ability to affect these various entities differs. His ability to



unify them behind a clear agenda for education remains to be seen.

Schwarzenegger will be able to exert some influence over these state-level players immediately. He could make a total of seven appointments to the 11-member State Board of Education in December, including three that would require withdrawing appointments put forward by his predecessor but not yet confirmed. In early November he appointed former Los Angeles mayor Richard Riordan as his new Secretary for Education. During his tenure as mayor, Riordan worked actively to reform the Los Angeles Unified School District. More recently, he has served as one of Schwarzenegger's key education advisors. However, California's elected Superintendent of Public Instruction, Democrat Jack O'Connell, will remain in office and at the helm of the Department of Education. California has a history of tension and, sometimes, outright conflict between a Democratic state superintendent and a Republican governor. For the sake of California's six million school children, it is important that history not repeat itself. The ability of the state's key education leaders to find common ground and work together will be crucial to the success of the state's schools and its students.

California made history with its recall of a sitting governor. Schwarzenegger was elected in part based on his promise to act collaboratively with other state leaders to create positive changes. He has stated that those changes extend to the school finance system. If he can in fact achieve that aim, he will make history for more than the way he was elected. ■■

## ***The ability of the state's key education leaders to find common ground and work together will be crucial to the success of the state's schools and its students.***

### ● | **To Learn More**

*California Spending Plan for 2003-04*, Legislative Analyst's Office, published in October 2003, gives a comprehensive explanation of the state's budget actions and current situation, including information about state funds for K-12 education. Go to: [www.lao.ca.gov](http://www.lao.ca.gov)

*High Expectations, Modest Means: The Challenge Facing California's Public Schools*, by Public Policy Institute of California, provides an overview of the match—or mismatch—between California's academic expectations and its school funding system. Go to: [www.ppic.org](http://www.ppic.org)

*The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them*, California Department of Education (CDE), published in November 2003, is the state's audit of categorical programs. Go to: [www.bsa.ca.gov/bsa/](http://www.bsa.ca.gov/bsa/)

Go to [www.decentschools.org](http://www.decentschools.org) to read documents submitted as part of *Williams v. California*, get updates on pleadings, and other information. The Legal Alliance—sponsored by the California School Boards Association and Association of California School Administrators—has also been involved in the suit, along with attorneys for the state of California.

Detailed, current information about the state facility program is now available at the Office of Public School Construction (OPSC) website at: [www.opsc.dgs.ca.gov](http://www.opsc.dgs.ca.gov)

*Selected Readings on California School Finance* contains the most popular EdSource publications related to school finance and school district budgeting. Updated annually, this volume includes the most recent information available. Go to [www.edsource.org](http://www.edsource.org) or call 650/857-9604 to order.

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For background information, updates, and links about School Finance, go to [www.edsource.org](http://www.edsource.org) and click on Education Issues, then School Finance. For related data, click on School Data.

For data about every school and district in California—and the ability to compare districts' financial data—visit the Education Data Partnership: [www.ed-data.k12.ca.us](http://www.ed-data.k12.ca.us)

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Given California's state budget deficit and recent political instability, no one thinks K-12 funding is going to increase this year or next. But crisis can create opportunity—and many believe this is the perfect time to re-examine and restructure the way California funds and oversees its public schools.

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Good question, with no simple answers. How much funding is "adequate"? What should determine differences in funding between districts? How should district financial management and governance practices influence funding levels? How should any additional funds be targeted to ensure the greatest improvement in student achievement?

This EdSource Forum will tackle these questions and will describe the efforts underway in California and other states to bring funding for K-12 schools more in line with the higher expectations we now have for them. Join us for this important discussion!

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**Liz Guillen**, policy advocate and attorney, Public Advocates

**Jon Sonstelie**, senior fellow, Public Policy Institute of California

**John Mockler**, former executive director, State Board of Education

**Peter Schrag**, contributing editor, *Sacramento Bee*, and author of *Final Test: The Battle for Adequacy in America's Schools*

**Jeannie Oakes**, director, UCLA's Institute for Democracy, Education, & Access

**Samira Ahmed**, deputy director, Campaign for Fiscal Equity (New York)

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