
SCHOOL FINANCE IN CALIFORNIA AND THE PROPOSITION 98 GUARANTEE

INTRODUCTION

Proposition 98, passed by California voters in November 1988, constitutionally guarantees a minimum level of funding for K-12 education, community colleges, child care and development, mental health, and developmental services. That guaranteed amount is calculated each year using one of three “tests” based on growth in General Fund revenues, per capita personal income, and enrollment. The Governor has proposed constitutional changes to Proposition 98 that would reduce the state’s obligation under the guarantee over time and subject K-14 education to automatic spending reductions in difficult budget years.

The debate over the Governor’s proposed changes raises the question of whether the Proposition 98 minimum funding level meets the needs of California’s public schools. Indeed, California lags the nation as a whole in per pupil spending, teacher-pupil ratios, and education spending as a percentage of personal income.

This paper examines the history of school finance prior to Proposition 98, the provisions of Proposition 98, the law’s implementation and effects, the Governor’s proposed changes to the law, and the current status of California’s school funding.

EDUCATION FINANCE BEFORE PROPOSITION 98

Prior to 1973, K-12 schools were financed largely with property tax revenues imposed by local school districts. Variations in the value of taxable property between districts resulted in significant disparities in per pupil property tax revenues. A school district with high property values could raise substantial revenue per pupil with a low property tax rate, while a district with low property values could raise less even with a much higher property tax rate. The state attempted to reduce these disparities in funding by providing more state aid to low-property-wealth districts. Despite this effort, the combination of state and local revenues per pupil varied considerably.¹ In fiscal year 1968-69, for example, per pupil expenditures ranged from \$1,232 in Beverly Hills to \$577 in Baldwin Park.²

The inequalities in district funding led John Serrano, a parent in East Los Angeles, to file a lawsuit against California State Treasurer Ivy Baker Priest in 1968. Eight years later, the California Supreme Court ruled in favor of Serrano on the grounds that pupils in low-property-wealth districts were denied access to educational opportunities equal to those in high-property-wealth districts. The Court found that:

Substantial disparities in expenditures per pupil among school districts cause and perpetuate substantial disparities in the quality and extent of availability of educational opportunities. For this reason the school financing system before the court fails to provide equality of treatment to all the pupils in the state. Although an equal expenditure level per pupil in every district is not educationally sound or desirable because of differing educational needs, equality of educational opportunity requires that all school districts possess an equal ability in terms of revenue to provide students with substantially equal opportunities for learning. The system before the court fails in this respect, for it gives high-wealth districts a substantial advantage in obtaining higher quality staff, program expansion and variety, beneficial teacher-pupil ratios and class sizes, modern equipment and materials, and high-quality buildings.

There is a distinct relationship between cost and the quality of educational opportunities afforded. Quality cannot be defined wholly in terms of performance on statewide achievement tests because such tests do not measure all the benefits and detriments that a child may receive from his educational experience. However, even using pupil output as a measure of the quality of a district's educational program, differences in dollars do produce differences in pupil achievement.³

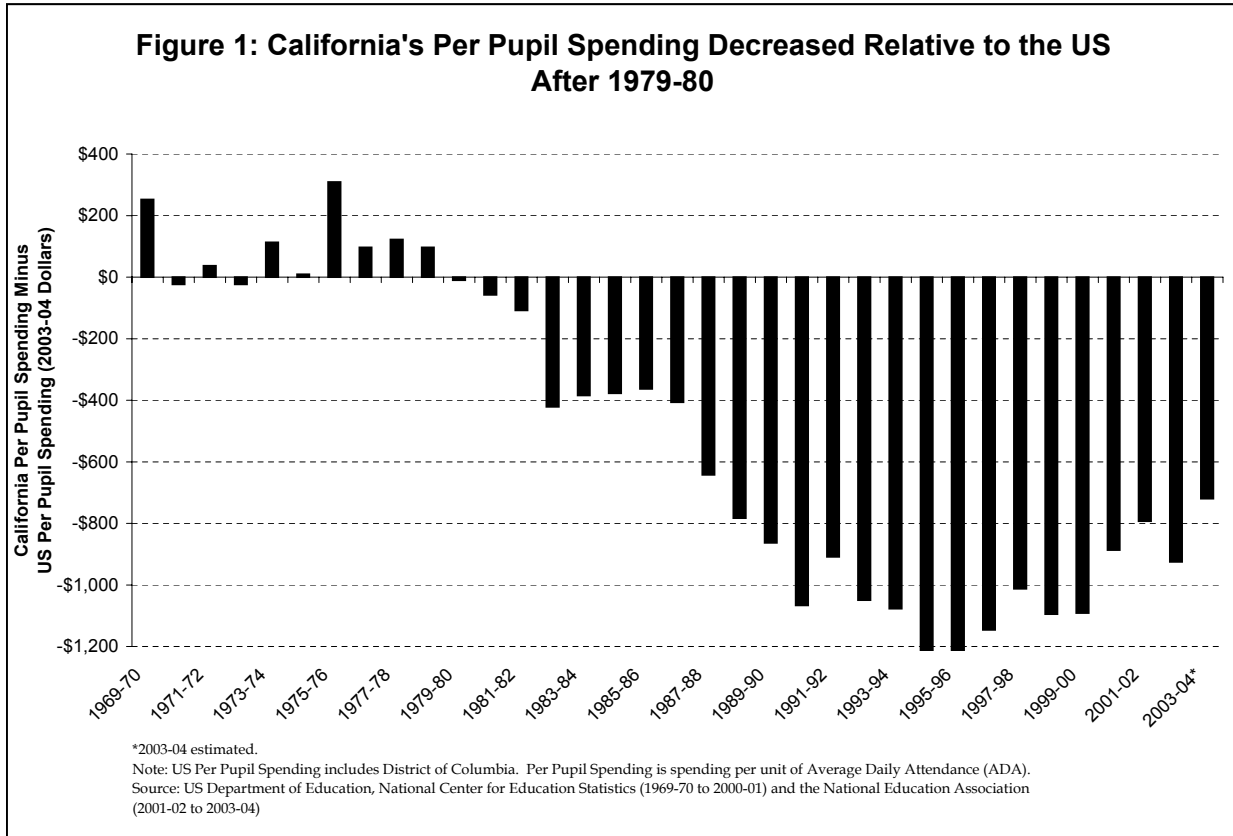
In response to the Serrano v. Priest decision, the Legislature enacted AB 65 (Greene, Chapter 894 of 1977). AB 65 attempted to equalize district revenues over time by creating an annual inflation-adjustment scale based on a district's level of revenues. Districts with low revenues would receive larger inflation increases in order to "level up" funding, while districts with high revenues received smaller or no adjustments in order to "level down" funding.⁴

Before AB 65 went into effect, however, voters approved Proposition 13 in June 1978. The new law limited property tax rates to 1 percent of a property's assessed value at the time of acquisition. Proposition 13 reduced property tax revenues available to local governments and school districts. In an attempt to cushion the impact of Proposition 13 on local governments, the Legislature adopted AB 8 (Greene, Chapter 282 of 1979). AB 8 reallocated approximately \$2.7 billion in property tax revenues from schools to cities, counties, and special districts. This transaction reduced schools' reliance on property tax revenues and increased the state's share of responsibility for school finance.⁵

PROPOSITION 98 OF 1988

During the decade prior to the passage of Proposition 13, California's per pupil spending was at or modestly higher than the national level. After 1979-80, however, California's per pupil spending fell below the national level and has remained below the national level since then. In 1986-87, California's per pupil spending was \$406 below the national level (Figure 1). Prompted by concerns over stagnating funding for schools, the California Teachers Association, the California State PTA, and the Association of California School Administrators sponsored Proposition 98 of 1988, which 50.7 percent of the voters ultimately approved.⁶

Proposition 98 establishes a minimum funding level for K-14 education each fiscal year. The Proposition 98 guarantee consists of three "tests" that apply under varying economic and fiscal



conditions. Proposition 98 states that K-12 education and community colleges shall receive the greater of a fixed percentage of state General Fund revenues (Test 1) or the amount they received in the prior year, adjusted for enrollment and inflation (Tests 2 and 3).

Test 1 guarantees schools a percentage of General Fund revenues equal to the percentage of General Fund revenues appropriated for K-14 education in 1986-87, approximately 40 percent.⁷

Test 2 requires that schools receive at least as much as they received from state and local sources in the prior year, adjusted for enrollment growth and inflation as measured by the percentage change in state per capita personal income for the preceding year.⁸ Test 2 is used in years in which the percentage growth in state per capita personal income **is less than or equal to** the percentage growth in per capita General Fund revenues plus 0.5 percent.⁹ Test 2 is the most frequently applied test under Proposition 98.¹⁰

Test 3 is similar to Test 2 except the inflation factor is equal to the annual change in per capita state General Fund revenues plus 0.5 percent. Test 3 is used in fiscal years in which state per capita personal income growth **exceeds** growth in per capita General Fund revenues plus 0.5 percent.¹¹ Proposition 111 of 1990 added Test 3 to Proposition 98. Test 3 has been used in four fiscal years. Test 3 reduces pressure on the non-Proposition 98 side of the budget when the state faces difficult budgets.¹²

The final guarantee is determined after the end of the fiscal year, as some of the information needed to calculate the guarantee (i.e., actual average daily attendance and per capita personal

income) is not available until the close of the year or later. The process of reconciling the actual and estimated guarantee is known as “settle up.”

The Legislature can suspend Proposition 98 for a single year by a two-thirds vote. Following a suspension or a Test 3 year, the Legislature must increase funding over time until funding returns to where it would have been under Test 2 absent a suspension or the use of Test 3.¹³ The overall dollar amount needed to return funding to this level is called the “maintenance factor.”¹⁴ Restoration occurs in years when the percentage growth in per capita General Fund revenues exceeds the percentage growth in state per capita personal income. Maintenance factor payments become part of the base used to calculate subsequent years’ funding guarantee.¹⁵

PROPOSITION 98 IN PRACTICE

Proposition 98 establishes a funding level, not an entitlement for individual programs.

Proposition 98 establishes a required funding level for programs falling under the guarantee as a whole. It does not create an “entitlement” to funds for any particular program. The Legislature has the authority to allocate funding to individual programs through the budget.¹⁶ In other words, if the Legislature allocates \$100 million for instructional materials in one year, the same amount is not guaranteed in the following year. More specifically, Proposition 98 does not protect individual programs from reduction or elimination.

Proposition 98 covers more than just K-12 education. The Proposition 98 guarantee applies to spending for K-12 education, community colleges, county offices of education, and state agencies providing direct K-12 educational services, such as the State Special Schools, the Department of Youth Authority, and the Department of Mental Health. In 2004-05, K-12 education (including child care and development) accounted for 89.6 percent of Proposition 98 spending, community colleges accounted for 10.2 percent, and all other agencies accounted for less than 1 percent.

Proposition 98 does not specify percentage shares for K-12 schools and community colleges. The result has been continued disagreement over how much should be allocated to each segment. In 1989, the Legislature established a target of providing a minimum of 11 percent of Proposition 98 funds to community colleges. In recent years, community colleges have received as much as 10.6 percent in 2002-03 and as little as 9.4 percent in 2003-04. The Governor’s 2005-06 Proposed Budget allocates 10.3 percent of Proposition 98 funds to community colleges.

Spending above the Proposition 98 minimum leads to a higher required minimum for future years. Proposition 98 requires that schools receive at least as much as they received from the prior year with adjustments for enrollment growth and inflation. Hence, if the Legislature allocates more than the minimum level of funding in a particular year, the increase becomes part of the base used to calculate future years’ guarantees.

PROPOSED CHANGES TO PROPOSITION 98

The Governor has recently proposed sweeping changes to state budget rules, including changes to Proposition 98. The Governor’s proposal, as presented in ACAX1 4 (Keene), would eliminate Test 3 and prohibit suspension of the guarantee. In addition, all General Fund appropriations, including Proposition 98, would be subject to across-the-board reductions when the Governor

determines that the budget is out of balance by \$250 million or more and the Legislature does not enact a plan to address the shortfall within a specified period. Any across-the-board reductions would reduce the funding level used to calculate subsequent years' Proposition 98 guarantee.

The Governor's proposal would also require the state to pay off the existing maintenance factor of \$3.9 billion over a 15-year period. However, maintenance factor payments would no longer be included when calculating the minimum funding guarantee. The state would also be required to pay off an additional \$1.3 billion to meet settle-up obligations over the same period.

Any appropriations exceeding the minimum level would no longer be included in the subsequent year when calculating the minimum funding guarantee under Test 2. Therefore, any funding above the minimum level would no longer increase the base used to determine future years' funding guarantee.

The Legislative Analyst's Office (LAO) has estimated the impact of the Governor's proposal under a range of economic conditions. Under a boom-bust scenario, which has been typical in California during recent decades, Proposition 98 spending would be roughly \$3 billion less than under current law during the initial boom. However, if the state implements across-the-board reductions, then education funding would be permanently reduced during the bust years. Under the scenario evaluated, education spending would be approximately \$10 billion lower in 2014-15 than under the current guarantee.¹⁷

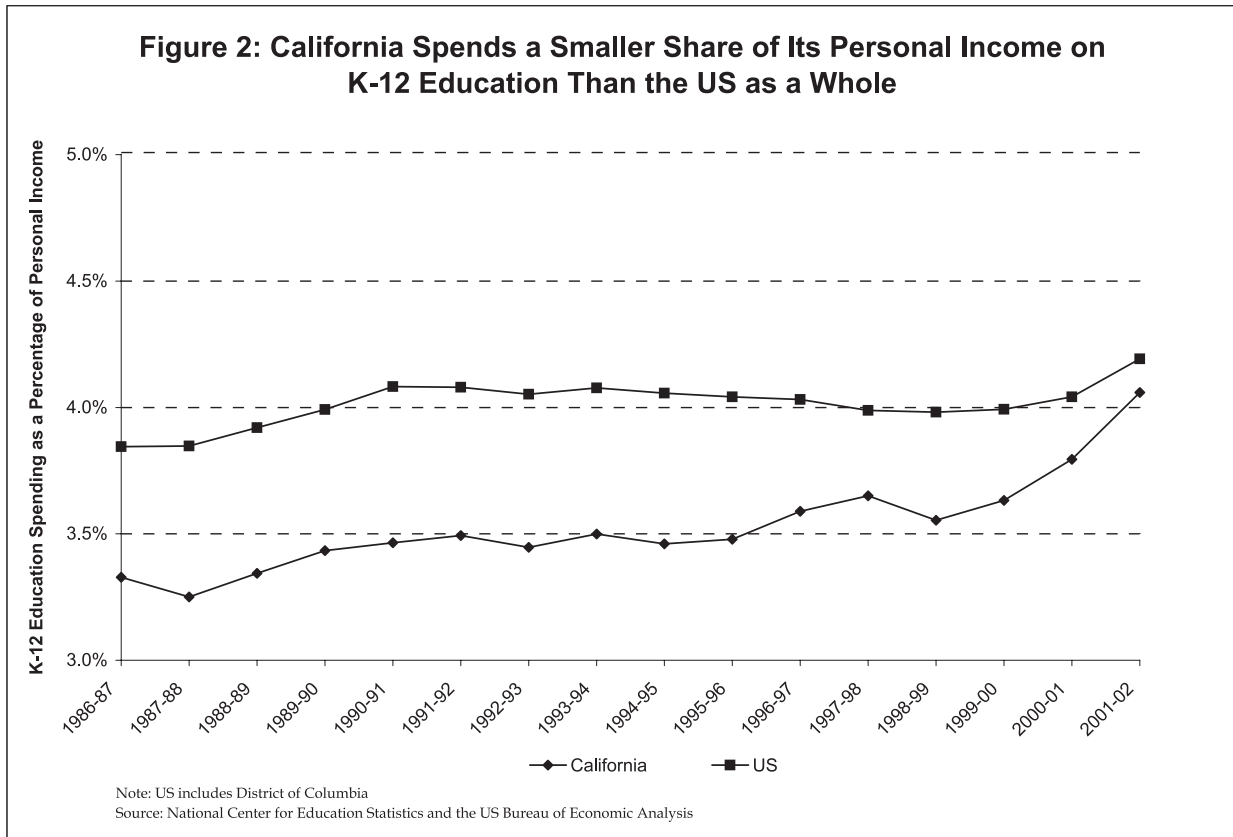
EDUCATION SPENDING IN CALIFORNIA

The proposed changes to Proposition 98 also raise the more basic question of whether the current approach to education funding provides sufficient resources for California's schools to meet the state's academic standards and provide a quality education to California's students.

Spending per pupil in California lags that of the US as a whole (Figure 1). California's teacher salaries are the lowest among the five most populous states and California ranks 32nd nationwide when teacher salaries are adjusted for regional cost of living.¹⁸ The state also has the fourth highest pupil-teacher ratio in the nation, with 20.2 students per teacher, as compared to 15.7 for the US as a whole.¹⁹ As a percentage of personal income – a measure of the size of the state's economy – California has consistently spent less on education than the US as a whole over the past decade (Figure 2).

In contrast, experts have lauded the state for its high academic standards. A recent study, for example, ranked California's reading standards as second in the country, while the state's math standards ranked first. The report also noted a disparity between California's high standards and its low performance on the National Assessment of Educational Progress (NAEP).²⁰

To align standards with instructional implementation, some states have conducted studies to gauge the amount of funds needed for students to meet the state's academic standards. In California, the Legislature established the Quality Education Commission in 2002 to conduct such a study.²¹ However, Governor Schwarzenegger has yet to appoint members to the Commission. The Governor has, instead, appointed 16 members to an alternative Advisory Committee on Education Excellence, a substitute for the Quality Education Commission that may not be required to assess the adequacy of school funding levels.



The current budget debate and proposed changes to Proposition 98 provide an opportunity for the state to look beyond what is minimally guaranteed and assess what resources are necessary to provide a quality education. By doing so, the state can move toward a system of providing an adequate level of funding to ensure a quality education for all California children.

Nirupama Jayaraman prepared this Budget Backgrounder. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

- ¹ Paul M. Goldfinger and Bob Blattner, *Revenues and Limits* (Sacramento: School Services of California, Inc., 2002), p. 3.
- ² CA Supreme Court, *Serrano v. Priest*, 18 Cal.3d 728 (1976), downloaded from <http://login.findlaw.com/scripts/callaw?dest=ca/cal3d/18/728.html> on April 8, 2005.
- ³ CA Supreme Court, *Serrano v. Priest*, 18 Cal.3d 728 (1976), downloaded from <http://login.findlaw.com/scripts/callaw?dest=ca/cal3d/18/728.html> on April 8, 2005.
- ⁴ EdSource, *Selected School Finance Laws and Policies*, downloaded from http://www.edsource.org/edu_fin_law.cfm on November 24, 2004.
- ⁵ California Budget Project, *Proposition 13: Its Impact on California and Implications for State and Local Finances* (April 1997), p. 2.
- ⁶ California Ballot Propositions Database, downloaded from <http://holmes.uchastings.edu/cgi-bin/starfinder/2139/calprop.txt> on October 5, 2004.
- ⁷ This percentage has been adjusted in statute in recognition of shifts in property tax revenues from local governments to schools.

⁸ Proposition 98 originally required the use of the Consumer Price Index to adjust for inflation. However, Proposition 111 of 1990 changed the inflation factor to state per capita personal income growth.

⁹ California Constitution, Article XVI, Section 8.

¹⁰ Legislative Analyst's Office, *Proposition 98 Primer* (February 2005), p. 5.

¹¹ California Constitution, Article XVI, Section 8.

¹² Legislative Analyst's Office, *Proposition 98 Primer* (February 2005), p. 5.

¹³ In the year following a suspension, the guarantee calculations are based on the funding actually received in the suspended year, and not on spending prior to the suspension.

¹⁴ The maintenance factor is annually adjusted for changes in enrollment and the Test 2 inflation factor.

¹⁵ Legislative Analyst's Office, *Proposition 98 Primer* (February 2005), p. 13.

¹⁶ Paul M. Goldfinger and Bob Blattner, *Revenues and Limits* (Sacramento: School Services of California, Inc., 2002), pp. 31-32.

¹⁷ Legislative Analyst's Office, *Governor's Budget-Related Reforms – Proposition 98* (March 2, 2005), p. 6.

¹⁸ Stephen J. Carroll, et al., *California's K-12 Public Schools: How Are They Doing?* (RAND: 2005), p. 79.

¹⁹ National Education Association, *Rankings of the States 2003 and Estimates of School Statistics 2004* (May 2004), p. 17.

²⁰ Sandra Stotsky, *The State of State English Standards* (Fordham Foundation: 2005) p. 7.

²¹ AB 2217 (Strom-Martin, Chapter 1026 of 2002).