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Analysis, Opinion, and Ruminations on California Education Policy

Decision Guide: Tax Initiatives Headed for California's November Ballot

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Recent public opinion polling[1] shows that eight out of 10 California voters oppose cutting public education funding and a strong majority believes the state's schools need increased funding. In November, voters will decide if they are willing to increase taxes in order to invest more in public schools. They will be presented with two different approaches for doing so, based on two propositions placed on the statewide ballot through California's initiative process:

- *Proposition 38: Our Children. Our Future. Local Schools and Early Education Investment and Bond Reduction Act*, sponsored by philanthropist Molly Munger and the Advancement Project. (The California State PTA has played an active role in supporting this initiative.)
- *Proposition 30: The Schools and Local Public Safety Protection Act of 2012* sponsored by Governor Jerry Brown.

One Problem, Two Different Approaches to Solving It

The two initiatives would both provide additional funding for public K-12 schools in California. They would also provide some revenues for the non-education side of the budget. Both would increase state revenues by raising income taxes but they are structured differently, and the governor's proposal also includes a small sales-tax increase.

The two measures differ in their approach to solving the current K-12 funding problem, the amount of money they would raise, and how the new funds would be allocated.

This brief summarizes and compares the two initiatives with a focus on their impact on K-12 education.

Education Resources in California

California spent $9,503 per pupil in 2008-09, compared to $11,665 in the average state. That is $2,162 less per pupil* and California's funding has decreased since.

On average, educator salaries in California are higher than in most other states, but competitive with salaries in comparable occupations here, reflecting the state's high cost of living.

Compared to the U.S. average, California had almost a third fewer adults working in its schools. In 2009-10, that translated to:

- A ratio of students to teachers of 20 to 1, compared to an average of 15.4 students per teacher** in the U.S. as a whole, with high schools in California having a considerably higher ratio.
- The lowest numbers of librarians and counselors of any state.
- Half as many school district administrators as is typical in the U.S.

* $2,998 less if adjusted for regional cost of living. (EdWeek Education Research Center: www.edcounts.org)

** Student-teacher ratio is different from average class size as it includes all teachers, not just those who teach in a classroom setting. Digest of Education Statistics 2011 (Table 71), National Center for Education Statistics: http://nces.ed.gov

1 Public Policy Institute of California: Californians and Education, April 2012.

PROPOSITION 38: Our Children. Our Future. Local Schools and Early Education Investment and Bond Reduction Act.

Major Sponsors: Molly Munger and the Advancement Project

Official title (as it will appear on the ballot): Tax For Education and Early Childhood Programs.

Link to full text and campaign information: www.ourchildrenourfuture2012.com.

Proposition 38 rests on the assumption that the legislative budget process will not restore or protect education funding. It calls on voters to create a dedicated revenue source and set up a funding process that will allocate additional funds directly to school sites where local educators and communities will make sure they are well spent. It also puts in place extra accountability and public reporting requirements to monitor local decision makers.

How does this initiative increase state revenues and for how long?

The measure calls for an increase in income taxes that would last for 12 years and would then have to be renewed by voters. The extra tax would begin with the 2013 tax year and would be modest for low and middle-income taxpayers, with the rate increasing along with income. Money would start flowing to schools some time in 2013 and proponents say that could be as early as April.

Some estimates of the additional taxes are as follows:

- A married couple with two children and a taxable income of less than $40,000, after all credits, would likely pay no additional taxes:
- A couple earning $75,000 would pay $428 in additional taxes; and
- A couple earning $1.5 million would pay $27,266 more.

The Legislative Analyst's Office (LAO) estimates that Proposition 38 would raise about $10 billion per year initially, and tend to increase over its 12-year duration.

How would the money be allocated and how does that fit into the current K-12 funding system?

When this measure is fully implemented in 2017-18, the tax proceeds are to be split, with about 85% allocated to K-12 education and 15% to early childhood programs.

For the first four years, however, those shares would be 60% and 10% respectively, in order to earmark 30% of the increased revenues to help retire some of the state's substantial bond debt, starting with school facilities. That represents about $3 billion a year, with the specification that it would "free up a like amount to meet other budget needs critical to the overall well-being of children and the families and communities in which they live." The funds would be administered through an Education Debt Service Fund created for that purpose.

The allocation of funds for early childhood programs would be under the control of the state Superintendent of Public Instruction, within parameters described in the initiative.

The bulk of the funds from this measure are targeted for K-12 school sites. The manner by which the funds are allocated rests on a central premise, per the measure's introductory language, that "decisions about how best to use new funds to improve our schools must be made not in Sacramento, but locally." To that end, Proposition 38:

- creates a funding source and allocation process completely outside of the state's General Fund and Proposition 98;
- explicitly prohibits the state from "supplanting" its current education funding obligations with these new funds; and
- specifies that the extra K-12 funds it generates must be spent at school sites, with some restrictions on how local school districts and agencies can use the new revenue.

What amount of funding will the initiative provide to K-12 in both the near term and over a longer time period?

During its first four full fiscal years, the Our Children, Our Future initiative annually adds close to $7 billion in additional K-12 revenues. Added to a projected Proposition 98 minimum guarantee of $54 billion, that would bring total estimated funding for 2015-16 to about $61 billion. (See the box on Proposition 98 for further explanation.)

Beginning in 2017-18, the K-12 share increases to approximately 85%. Based on estimates of increasing revenues from Proposition 38 over time, proponents say that would likely be close to $11 billion in 2018-19. After December 2024, that funding source would only continue with voter approval.

This initiative provides funding outside of the Proposition 98 minimum guarantee. Therefore, it does not directly contribute to an increase in that guarantee or to the size of the state's General Fund. Under this initiative, the base funding level from which the state calculates the Proposition 98 minimum guarantee would thus be lower in comparison to the increase the governor's proposal provides. The state would also need to address the $10 billion in education deferrals, which would lower the Proposition 98 funding commensurately. (See the box on Complicating Factors for more about this.)

What does the initiative do to assure that the additional funds are spent on education and to control how they are used locally?

Proposition 38 creates the California Education Trust Fund (CETF) and explicitly excludes the new revenues from the state's regular budgetary process. A Fiscal Oversight Board made up of key state officials will be responsible for overseeing the distribution and use of the funds, with an independent audit also required.

In the case of the K-12 portion of funding, the initiative requires the funds to go to school sites based on their student populations, and according to a specified formula:

- 70% of the funds would be distributed based on an "active enrollment" calculation the initiative describes. The per-pupil grant amount varies by grade level. (For every $100 provided for grades kindergarten-3, grades 4-8 would get $120 and grades 9-12 would get $140.)
- 18% would be used to provide an additional amount for each low-income student a school serves, providing the same amount per pupil at every school.
- 12% would be given out to support training, technology and materials, with every school getting the same amount per pupil.

Districts would be expected to distribute the funds to schools based on the students they serve and to use all the funds at school sites, except for an allowance for administrative costs, which is not to exceed 1% of the funds.

Further, districts would be required to create procedures for getting public input into how the funds are spent, publish detailed site-level budgets, explain how they expect the expenditures to improve student outcomes, and ultimately disclose whether those outcomes were met. The measure provides detailed requirements for the specifics and frequency of these procedures, including a prohibition against using the money to increase salaries and benefits of current employees.

Outside of K-12, what else does the initiative fund?

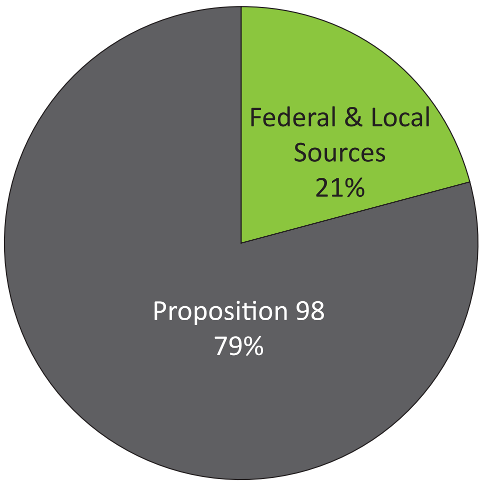
Early Childhood Programs are a secondary but important focus of Proposition 38. Of the funds earmarked for these programs, 23% would go to restore previous funding cuts and improve the state's early childhood care and education systems. One important part of this would be the creation of a student level data system that would be linked to the state's K-12 CALPADs data system.

The bulk of the funds, 77%, would be used to strengthen and expand programs serving two sets of children, those from birth to 3 years of age and those from ages 3 to 5. Among other things, the funds would be used to create a California Early Head Start program consistent with federal guidelines. Existing state and local agencies, including Early Learning Advisory Councils and First 5 Commissions, would be responsible for program quality and oversight.

The 30%—or about $3 billion—allocated for debt payments during the first four years can replace current General Fund obligations for repayment of bonds for schools and similar purposes. This would free up an equivalent amount that state lawmakers could then use for other general fund purposes.

The Role of Proposition 98 in K-12 Funding in California

Total Operating Funds for K-12 Education



- Total operating funds for K-12 education -- $55.5 billion (Based on enacted 2011-12 budget*)
- Proposition 98 provided about 79% of that amount
- The remaining 21% came from a combination of federal and local sources, plus the California State Lottery (less than 2%).

* Excludes local debt service and state general fund contributions outside of Proposition 98.

Data: California Department of Education (www.cde.ca.gov/fg/fr/eb/cefedbudget.asp - accessed 8/2/12)

Rules for Setting the Guarantee Amount

State leaders are obligated to provide a minimum guaranteed Proposition 98 funding level for K-12 education and community colleges. The basic principles are: 1) that funding should grow each year with growth in the economy and the number of students and 2) that education ought to be guaranteed about 40% of the General Fund, the same share as was provided in 1986-87, prior to the passage of Proposition 98. The exact amount of the minimum guarantee is calculated based on a set of complex rules, including the following.

- In years of "normal" growth in the state's General Fund revenues, education gets at least the same as the previous year, adjusted for inflation and for growth in the K-12 student population.
- In years when the state's General Fund revenues do not increase, education suffers along with the state according to a "fair share" formula.
- When the economy improves, as evidenced by an increase in the General Fund, the state must use approximately half of new revenues to begin restoring the Proposition 98 guarantee to what it would have been if the lower revenue years had not occurred.

In any given year, the Legislature can suspend Proposition 98 with a two-thirds vote, but the obligation to restore the minimum guarantee going forward remains in force.

Estimating the Proposition 98 Minimum Guarantee Going Forward

At the time the 2012-13 Budget Act was passed, the state Department of Finance estimated what the Proposition 98 minimum guarantee would be, absent the increase in the state's General Fund provided by the governor's initiative, Proposition 30. The estimated K-12 portion of the guarantee for the next four budget years would be as follows:

- $45 billion in 2012-13,
- $46 billion in 2013-14,
- $52 billion in 2014-15, and
- $54 billion in 2015-16.

Proposition 30: The Schools and Local Public Safety Protection Act of 2012.

Major Sponsor: Governor Jerry Brown

Official title (as it will appear on the ballot): Temporary Taxes to Fund Education. Guaranteed Local Public Safety Funding. Initiative Constitutional Amendment.

Link to full text and campaign information: www.YesonProp30.com.

Proposition 30 assumes that the education funding problem is the result of a long-standing imbalance between the revenues that go into the state's General Fund and how much the state spends; an imbalance that was exacerbated by the recent recession. It calls on voters to solve the problem by increasing the revenues that go into the state's General Fund which should, in the long term, provide strong and consistent funding for education. Constitutional protections that already exist, specifically the Proposition 98 minimum funding guarantee, require that about 40% of General Fund revenues go to K-14 education. The measure does not make any changes in that requirement, hence education is projected to receive roughly 40% of the new revenues provided by the measure. Proposition 30 does not specify a set level of additional funding for schools, but it does include a provision that protects the new tax proceeds from other uses.

How does this initiative increase state revenues and for how long?

The measure calls for:

- A one-quarter-cent sales tax increase effective January 1, 2013 to December 31, 2016.
- An increase in income tax rates on income that exceeds $250,000 per year, effective beginning with the 2012 tax year and continuing through the 2018 tax year.[1]

The LAO estimates that Proposition 30 would raise an average of about $6 billion per year through 2016, with more in 2012-13 since the income tax increase applies to all 2012 earnings.

1 The specific income tax rates: the maximum general rate is 9.3%. Those earning between $250,000 and $300,000 would pay a rate of 10.3% on the amount that exceeds $250,000. Similarly, the rate would be 11.3% on income between $300,000 and $500,000; and it increases to 12.3% on income in excess of $500,000. (These amounts do not include a 1% surcharge on taxable incomes exceeding $1 million, which the state uses to support mental health programs.)

How would the money be allocated and how does that fit into the current K-12 funding system?

The extra funds generated by this initiative would be available to support the state General Fund and would be subject to the provisions of Proposition 98. That will have the effect of increasing the size of the pie from which education's minimum guarantee is calculated and from which K-12 schools receive the bulk of their funding.

Current law requires that about 40% of the state's general fund revenues be allocated to K-14 education each year. (See the box on Proposition 98 for a more detailed explanation of this minimum funding guarantee.) Since 2008-09, severe economic circumstances have prompted state leaders to take a variety of budget actions that have shortchanged education on that guarantee.

Proposition 30 sets up a mechanism whereby all the additional revenues generated by the tax increase are earmarked for education. This might successfully place additional education funding obligations on state leaders and bolster the state's ability to meet the Proposition 98 minimum funding guarantee in 2012-13 and going forward.

At the same time, the initiative places into the constitution a 2011-12 shift of more than $5 billion out of the General Fund to local governments to support public safety programs. That shift reduced the Proposition 98 guarantee by over $2 billion. There is nothing in the measure that prevents state leaders from using other, similar mechanisms to reduce the minimum guarantee.

What amount of funding will the initiative provide to K-12 in both the near term and over a longer time period?

This measure assumes that the additional money will enable state leaders to comply with both the letter and the spirit of Proposition 98. If that assumption is valid, the state's current Proposition 98 funding mechanisms—combined with the revenue increases and other provisions in the initiative—would net K-12 education an increase from about $42 billion in 2011-12 to about $57 billion in 2015-16. A large portion of this increase is due to an improving economy. The Department of Finance estimates that the initiative would add about $3 billion annually to Proposition 98 funding, with approximately 89% of that, or $2.7 billion, going to K-12 education.

The governor, separately in his budget proposal, recommended that the first call on these funds in 2012-13 should be to begin reversing a series of funding deferrals that total about $10 billion. These repayments would be made over the next three budget years (2012-13 to 2014-15). The governor has recommended that in the two subsequent years—2013-14 and 2014-15—half of all growth in Proposition 98 funding would be provided to schools to continue retiring the deferrals and half would be provided to fund programmatic growth. (For more about deferrals and other complicating factors see the box below.)

What does the initiative do to assure that the additional funds are spent on education and to control how they are used locally?

The funds generated by Proposition 30, while counted toward the state's General Fund, are to be deposited quarterly into a newly created Education Protection Account. The funds would be allocated as follows:

- 11% to community colleges for general purposes, with no community college receiving less than $100 per full time equivalent student (FTES).
- 89% to local school districts and other local education agencies (i.e. charter schools and county offices of education) for general purposes with no agency receiving less than $200 per student (based on average daily attendance).

The initiative places additional constraints on K-12 agencies, prohibiting the funds from being used for administrative salaries. The use of the funds would have to be determined in a public meeting and accounted for on the agency's public website. The annual independent audit, already required, would be expanded to assure compliance with these rules.

Outside of K-12 education, what else does the initiative affect?

Because this initiative adds revenues that will support fulfillment of the Proposition 98 guarantee it also provides increased funds for community colleges. Thus Community Colleges would get about $300 million in additional funding each year if the initiative passes, in addition to the expected growth in the Proposition 98 guarantee.

In addition, Proposition 30 places into the state constitution a change in funding for public safety that the Legislature enacted in 2011. This makes permanent a shift of about $5 billion in General Fund revenues to a Local Revenue Fund and guarantees continued funding to local governments for the cost of providing specified "public safety services," including, for example, employing law enforcement personnel, managing local jails, and providing a variety of treatment and prevention services. It also prohibits states lawmakers from adding to these local responsibilities without additional funding.

Complicating Factors in Comparing the Two Measures

<u>Current education deferrals</u>

The state has accrued $10 billion in debts to education through its deferrals of current funding into future years. These need to be paid back out of Proposition 98 funds.

Calculations about when and how this payback would occur vary, and the final decision is part of the budget process. It is not part of either initiative. However, in the next few years this obligation will mean less of a funding increase for K-12 districts than is estimated here under either measure. The exact amounts depend on future decisions by state policymakers.

<u>Repayment of state General Obligation bonds</u>

The state has an obligation to pay back these bonds at a rate of about $2.5 billion per year.

The governor, as part of his budget proposal, recommended that this amount be counted toward the Proposition 98 minimum guarantee if his initiative does not pass. This would be a departure from current practice, which takes those bond payments out of the non-98 part of the budget. If Proposition 30 does pass, providing more General Fund dollars, the shift would be unlikely to occur.

Proposition 38 would cover the cost of these bonds out of the 30% set aside for debt reduction in its first four years.

A SIDE-BY-SIDE COMPARISON
THE NOVEMBER BALLOT INITIATIVES AND THEIR IMPACT ON K-12 EDUCATION

In November 2012, Californians will vote on two ballot measures that both promise increased funding for the state's K-12 public schools and would increase taxes to do so. As the comparison below details, Propositions 38 and 30 differ in several important ways.

	PROP 38: Our Children. Our Future.	**PROP 30: The Schools and Local Public Safety Protection Act**
The basic approach to funding education	Creates a dedicated revenue source outside of the state's General Fund and the Proposition 98 funding formula.	Provides increased General Fund revenues that could support growth in the state's Proposition 98 education funding guarantee.
Tax increase proposed	Raises income taxes on most Californians, with the rate increasing along with income.	Increases state sales tax by ¼% and raises income taxes on annual income above $250,000.
Projected total annual revenue increase	About $10 billion per year to start, with steady increases estimated over time (e.g. $12.4 billion by 2017-18).	An average of about $6 billion per year ($7.7 billion estimated for 2011-12 and 2012-13 combined).
What revenues would be used for	2013 – 2016: more than $6 billion annually (60%) to K-12 education, $1 billion (10%) to early childhood programs, and $3 billion (30%) for state debt reduction 2017 and beyond: about 85% to K-12 education, 15% to early childhood programs	To augment the state's General Fund and thus support the state's Proposition 98 obligation: of the estimated $3 billion in annual revenues for education, about 89% would be for K-12 education, 11% for community colleges.
Duration of tax increase	Begins in January 2013. Effective for 12 years, but voters could extend it longer.	Sales tax effective Jan. 2013 –Dec. 2016. Income tax effective 2012-2018 tax years.
Estimated total funding for K-12 education in 2015-16. (Using DOF estimated $54 billion Prop 98 guarantee as a baseline.)	About $61 billion	About $57 billion
Controls on use of K-12 funds	Creates CA Education Trust Fund, excludes revenue from state budget process. Specifies that districts must use funds for school site expenditures, with oversight and reporting requirements.	New revenues go into Education Protection Account, earmarked for education. Current legislative discretion over Prop 98 provisions and K-12 funding amount remain in place. Districts cannot use funds for administrative salaries, must publicly decide and disclose use.
FOR MORE INFORMATION	www.ourchildrenourfuture2012.com	www.YesOnProp30.com

Both Measures Provide Needed Funding

If either of these two measures passes in November, California's K-12 education system will see increased revenues. The revenue enhancements under the governor's Proposition 30 would bring funding up to about $57 billion in 2015-16. *Proposition 38: Our Children, Our Future* could net education about $61 billion in 2015-16.

Either measure, combined with the projected improvements in the state's economy, would provide a substantial financial boost for K-12 education compared to current funding. To put these figures in perspective, total Proposition 98 funding allocated to K-12 education five years ago, in the 2007-08 budget, was $50 billion, but had been cut to about $42 billion by 2011-12.

Winners and losers in each scenario

Proposition 30 addresses the current shortfall in the state's General Fund and earmarks the increased revenues for K-14 education in order to bolster and protect the existing provisions of Proposition 98. Combined with his separate recommendations related to the overall state budget and education funding, the initiative's goal is to patch over the state's current budget gap but largely preserve the state's formula for deciding how much funding K-12 education receives. If the governor's recommendations relative to paying down state debt are also enacted, the measure's contribution to new K-12 program funding would be modest in the initial few years.

By contrast, the *Our Children, Our Future* initiative instead sets up a firewall to make sure that the substantial revenue it generates is outside of the state's regular budget process. It also adds constraints on the decision-making power of local school districts and education agencies to assure that the funds directly benefit school sites and are spent on programs aimed at improving student outcomes.

If only the latter initiative were to pass, the community college system would not see a direct benefit. A smaller General Fund—and thus a lower Proposition 98 guarantee—would result in a lower guaranteed level of funding for community colleges. It would be up to state lawmakers to decide whether the community colleges benefitted from any of the savings realized thanks to the *Our Children, Our Future* 30% set-aside for debt payment.

Conversely, if only Proposition 30 succeeds, the state's early childhood programs would not be guaranteed an earmarked increase in funding. Again, state lawmakers could, with a healthier General Fund, choose to put more resources into these programs.

It is unclear what would occur if both initiatives were to pass, despite the fact that each calls for the measure with the most votes to prevail. Various interpretations of these provisions exist but none should be considered definitive.

California's children lose if both initiatives fail

For those who believe that California's K-12 schools must be protected from further cuts, the worst case scenario is that both of these measures fail. Absent some other dramatic increase in state revenues through legislative action—which at this point seems politically unfeasible—further education cuts appear to be inevitable.

For education advocates, either of these initiatives would provide a more acceptable funding level for K-12 schools. *Our Children, Our Future* raises more revenues and nets more for schools directly. The increase from either measure would likely still leave California far short of the national average in per-pupil funding. That represents a huge challenge for schools given the needs of California's student population, the high cost of living in this state, and the high expectations for student achievement.

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