

# School Finance Highlights 2003–04

Funding for California's public education system was a central consideration in the 2003–04 budget debates as state leaders faced a daunting two-year deficit of about \$38 billion. The budget was finally passed more than a month after the constitutional deadline, just in time for California's history-making gubernatorial election.

The 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.

## Proposition 98 puts education center stage in budget talks

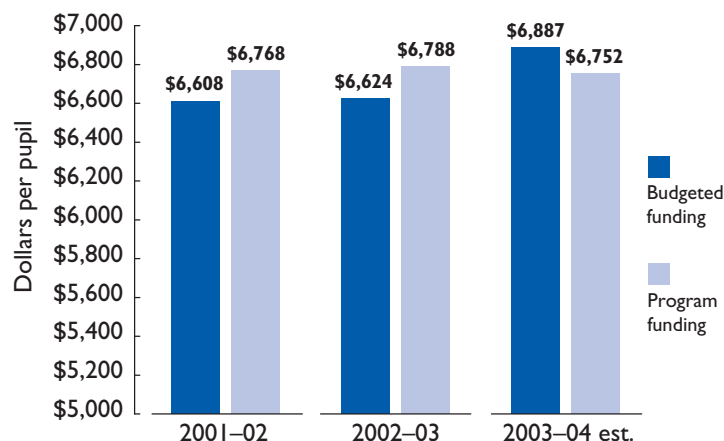
The state Legislature and governor determine, for the most part, how much money school districts receive each year. When voters approved Proposition 98 in 1988, they guaranteed K–14 education (kindergarten through community college) a minimum amount of state and property tax revenue largely based on the health of the state's economy.

Determining the amount of the Proposition 98 guarantee in 2003–04 was complicated by uncertainties surrounding the 2002–03 budget. During the first half of 2003, General Fund revenues were coming in below projections. In response, state leaders made reductions for K–14 education that eventually totaled about \$2.7 billion. 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, which comes to \$45.7 billion.

This budget also depends heavily on deferring \$3 billion owed to education into future years. With the 2003–04 budget, the state reduced this liability to \$2.7 billion.

To get a perspective on how this maneuvering affected schools, it helps to use a per-pupil amount. This amount has changed very little under the Proposition 98 funding guarantee since 2000–01 when it was \$6,608, according to the Legislative Analyst's Office (LAO). The state budget estimates the per-pupil amount for 2003–04 at \$6,887 (which could change based on final enrollment 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

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)

EDSOURCE 11/03

allocation of \$6,624. These figures, however, distort the actual level of growth. When per-pupil amounts are adjusted to include the deferrals, as shown in Figure I, it is clear that the “program funds” 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

Proposition 98 funds represent the lion's share of money for schools but certainly not the whole amount. For 2003–04 public education receives about \$12 billion more than Proposition 98 allocations for a total of \$55.7 billion. The sources include the federal government (\$7.1 billion), the California State Lottery (\$0.8 billion), and “local miscellaneous” money (\$3.5 billion that includes, for example, donations and income from interest or leases).

Federal education support has grown steadily in recent years from \$5.4 billion (about 10% of the state's K–12 budget) in 2001–02 to \$7.1 billion (almost 13%) in 2003–04.

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, called No Child Left Behind (NCLB), created a set of sweeping new policies to which California has been gradually responding. The 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.

While operating budgets have suffered, local schools have been able to address facility needs since 2001 thanks to voters passing two major statewide bond measures for K–12 schools, the most recent for \$11.4 billion in November 2002. Voters have also supported local general obligation bond elections that have raised a total of \$12.3 billion since January 2001.

### How the cuts were made

In general, about two-thirds of the money that goes to school districts and county offices of education is “revenue limit” funding that districts can largely spend at their discretion, and the rest is “categorical aid” earmarked for special purposes.

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 by: 1) not giving districts the 1.8% cost-of-living adjustment (COLA) they were due; and 2) cutting revenue limit amounts by 1.2%. These actions 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. However, the state did add \$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).

To help districts absorb the general-purpose cuts, state policymakers granted them some limited-term financial flexibility, including the use of a large portion of their unspent 2002–03 categorical fund reserves.

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, state leaders reduced or even eliminated programs they created and funded just a few years ago for such things as instructional materials and professional development.


In other cases, federally funded programs with similar goals but different requirements superceded recently created state programs.

### Important issues loom on the horizon

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 the fundamental problem—the state’s income does not 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 expenditures that has created a huge debt since 2001–02. The LAO estimates that the cumulative deficit could total \$8 billion at the end of 2004–05 if no corrective actions are taken.

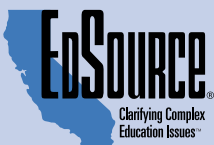
California’s school finance system is the 800-pound gorilla that has yet to be tamed. The last few years have made clear just how central the education budget is to the state’s overall budget planning process. Further, a substantial portion of the extra expenditures during the growth years was for education—money to support measures aimed at improving school performance and raising the skills of educators, goals most Californians see as a high priority. But these 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 is difficult. Californians may take on these issues 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.
- A reconsideration of the entire school finance system—including equity, financial management, and the appropriate level of school funding—is on the agenda of the Quality Education Commission (QEC).
- The issue of flexibility in categorical programs has become a separate subject of debate among state leaders, including newly elected Gov. Arnold Schwarzenegger. 

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**EdSource thanks the Ahmanson Foundation for their investment in our work.**