May 21, 1999

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Connie Lemus
Initiative Coordinator

Dear Attorney General Lockyer:

This letter contains our review of the fiscal effect of proposed initiative file number SA1999RF0006, Amendment Number 1-S, called the "School Choice Amendment," as required by Elections Code Section 9005.

PROPOSAL

This constitutional measure:

- Establishes a system of nontaxable scholarships for parents sending their children to private schools.

- Replaces the state's constitutional funding guarantee for K-14 education (commonly known as "Proposition 98") with an alternate minimum guarantee operable under certain economic conditions.

Nontaxable Scholarships for Private School Education

The measure provides two types of "scholarships" to the parents or guardians of students attending "scholarship-redeeming" private schools: (1) "full" scholarships and (2) "partial" scholarships. The state would make these scholarship payments to the credit of parents' accounts at scholarship-redeeming schools.

Beginning in the first fiscal year following approval of the measure (which would be 2000-01 if the measure is approved at the March 2000 election), parents would be eligible for "full" scholarships of $4,000 for each child *newly enrolled* in a scholarship-redeeming private school. This eligibility would not extend to children attending a private school on the date of the measure's approval, or to children attending a private school for more than 100 school days in the fiscal year prior to approval (1998-99). Thus, in the 2000-01 fiscal year, full scholarships generally would be limited to children enrolling in kindergarten (or, in some cases, first grade) or children transferring from a public school to a private school. Gradually, over a period of about 13 years, potential eligibility for a full scholarship would extend to virtually all school-age children in the state.

Those school-age children not eligible for a full scholarship (generally, those already in private schools) would become eligible for a partial scholarship. The amount of the partial scholarship would depend on a specified calculation of state savings arising from the transfer of pupils from public to private schools, but in no instance could it exceed the amount of a full scholarship. The measure directs the Legislature to annually adjust the amount of the partial and full scholarships to the maximum amounts consistent with "fiscal neutrality," as defined.

In those cases where private school tuition is less than the amount provided by either partial or full scholarships, the State Treasurer would create trust accounts for the affected students. Funds deposited in a student's trust account could be applied towards (1) private school tuition in later years or (2) tuition/fees at any university or college in California.

The measure requires a three-fourths vote of the Legislature to enact any new *laws* pertaining to private schools. In addition, no new *regulation or ordinance* affecting private schools could be enacted without a two-thirds vote of the state or local governing body, and a majority vote of the electorate from within the affected jurisdiction.

The measure also makes changes to sections of the education and public finance articles of the State Constitution to allow the scholarships to be provided to the parents of students attending sectarian or denominational schools.

Minimum Funding Guarantee

Under the provisions commonly known as Proposition 98, the State Constitution requires appropriation of a minimum annual amount for public K-12 schools and community colleges (K-14 education) from the General Fund and local property tax revenues. Generally, this annual amount is based on the prior-year appropriations adjusted for (1) growth in the number of students attending public schools and (2) growth in the lesser of California per capita personal income or per capita General Fund revenue.

The measure replaces this Proposition 98 guarantee with separate minimum guarantees for the public K-12 schools and community colleges. For the public K-12 schools, the measure would guarantee a per-pupil amount that is at least equal to the amount provided in the prior fiscal year from the General Fund and local property tax revenue, and in no case less than $6,173. However, this guarantee would be in effect *only* in fiscal years in which percentage growth in California per capita personal income is less than percentage growth in per capita General Fund revenues. For the community colleges, the measure guarantees that the annual amount allocated from General Fund, local property tax, and enrollment fees per full-time equivalent student (FTES) is at least the amount provided in the 2000-01 fiscal year, or $4,038, whichever is greater.

FISCAL EFFECT

The fiscal impact of this measure would depend in large part on how people throughout the state (parents, students, and school officials) respond to its provisions. The measure's fiscal effects involve both impacts on public K-12 school operations and other effects. The two main effects on school operations are:

- Net savings from pupils leaving the public K-12 schools for private schools.

- Costs of scholarships for pupils who would have enrolled in private schools in the absence of this measure.

While the magnitude of these effects could vary substantially, the measure's fiscal neutrality provision ensures a relatively minimal net impact on overall state costs.

Operating Savings and Costs From
Pupils Leaving the Public School System

The availability of full scholarships (initially $4,000) would draw pupils from the public K-12 schools to private schools. As students leave the public school system, two fiscal effects occur: (1) the state saves funds otherwise needed for operation of the public K-12 schools and (2) the state incurs the cost of the full scholarships.

We estimate that, generally, for each student leaving the public school system annual state costs would decrease by about $6,200 (in 2000-01 dollars). Aggregate annual savings would depend upon the rate students leave the public schools each year. For example, if 1 percent of students left the public K-12 school system annually, we estimate that gross savings in 2000-01 would be roughly $360 million, growing to almost $3.8 billion by 2007-08 (the last year for which we have reliable enrollment forecasts). If 3 percent left annually, the savings would be roughly $1.1 billion in 2000-01, growing to about $10.5 billion by 2007-08.

At the same time, the state would incur costs for full scholarships for each of these students leaving the public K-12 schools. Under the 1 percent annual exit assumption, these annual costs would be about $230 million in 2000-01, growing to roughly $1.8 billion by 2007-08. Under the 3 percent annual exit assumption, these annual costs would be about $700 million in 2000-01, growing to about $7 billion by 2007-08. Under the above range of assumptions, we therefore estimate that net savings to the state from students transferring from public K-12 schools to private schools could range from $130 million to $400 million in the first year, growing to between $2 billion and $3.5 billion by 2007-08. These net savings from students enticed to transfer to private schools would, however, be offset by costs for private school students unaffected by the measure (as discussed below).

Scholarship Costs for Students Who Would Have Gone to Private School Anyway

The state also would incur costs to provide scholarships to students who would have gone to private schools absent the measure. These costs fall into two categories:

Full Scholarships to Newly Enrolled Private School Students. In 1996-97, approximately 10 percent of the state's school-age children—615,000 pupils—attended private schools. This percentage has remained fairly constant over time. Presumably, in the absence of the measure, 10 percent would continue to attend private schools. On this basis, we estimate that almost 70,000 kindergartners would attend private schools in the absence of this measure in 2000-01. Under the measure each of these students would be eligible to receive a $4,000 scholarship in that year, representing a potential cost of almost $300 million that the state otherwise would not have incurred. The cost of paying full scholarships for students who presumably would have attended private school anyway would grow each year as new cohorts become eligible. We estimate these annual costs would grow to between $2 billion and $2.5 billion by 2007-08.

Cost of Partial Scholarships to Existing Private School Students. The measure specifies that the initial amount of a partial scholarship be determined by subtracting the aggregate cost to the state of full scholarships from the ". . .total savings to public schools achieved through the transfer of public school pupils to private schools. . ." However, the derived amount for the partial scholarship is less than zero, due to the way the measure specifies the calculation of these "total savings." In addition, it may be difficult for the Legislature to change the formula to produce a positive initial amount for the partial scholarship because of the three-fourths voting requirement mentioned above. For purposes of this analysis, we assume that the *initial* amount of the partial scholarship would be less than zero (in effect, no partial scholarships would be issued).

Since the measure requires the Legislature to adjust the level of both the full and partial scholarship annually consistent with "fiscal neutrality," the future amounts provided for both full and partial scholarships would depend upon the net savings generated by the fiscal effects outlined above. If relatively few students leave the public school system, there would be no net savings, the partial scholarship amount would remain at zero, and the full scholarship amount would be adjusted downward. If, however, enough students leave the public K-12 school system to generate net savings, then the level of both the full and partial scholarships would increase.

Net Impact on School Operations

The effect of the measure on state and local education funding would depend mainly upon the number of students choosing to transfer to private schools. The measure would result in a major rearrangement of the state's system of school finance. Savings would be generated for each student choosing to leave the public school system, while extra costs would occur for pupils who would have chosen to attend private school anyway. Initially, the measure could have some net costs if few students leave the public schools. However, in future years, as the amounts of the scholarships were adjusted to achieve fiscal neutrality, the net fiscal effect would be minimal.

Other Fiscal Effects

Impact on Individual School Districts. As pupils shifted from public to private schools, school districts would receive less funding overall. The measure also would result in less funding per pupil to the extent the state chose to fund Proposition 98 at a lower minimum funding guarantee than required under current law. The effect of the initiative on school district revenue levels and spending patterns would vary significantly from district to district. For example:

- ***Increase in Proportion of Higher-Cost Pupils.*** Under this initiative, pupils who are the least costly to educate would be more likely to shift to a scholarship-redeeming private school than pupils who require services in addition to the regular classroom program—compensatory education or special education services, for example. This is because the scholarship amount would be most likely to cover the actual cost of serving these lower-cost pupils in private schools. Thus, their parents would be less likely to experience reduced services by shifting their child, while private scholarship-redeeming schools would more likely find serving these pupils to be in their financial interest. The proportion of higher-cost pupils in public schools, therefore, could increase and thereby reduce the average amount available for all remaining public school pupils.

- ***Increase in Interdistrict Funding Disparities.*** If a significant number of public school pupils shifted to scholarship-redeeming private schools, the state share of K-12 general-purpose funding would be reduced to the point that significantly more districts would become "excess tax" districts. In these districts, general-purpose funding would be supported almost entirely through local property tax revenues. Once a district reached this point, its level of funding, for the most part, would no longer depend on the number of pupils it served. If more pupils left, those who stayed would enjoy a higher level of funding per pupil. Consequently, interdistrict disparities in the level of general-purpose funding per pupil would increase.

Changing the K-14 Funding Guarantee Could Result in State Savings. As discussed above, the measure replaces the current minimum funding guarantee for K-14 education with separate new guarantees for K-12 schools and the community colleges. Because the replacement guarantees do not include inflation adjustments, and because the new K-12 guarantee is not in effect under certain economic conditions, future Legislatures would have greater discretion to spend less per student on K-12 public schools and community colleges than would be required under the current State Constitution provisions. To the extent future Legislatures spend less per student on public K-12 schools and community colleges, the state would experience annual savings.

Retirement Savings. Currently, each fiscal year state contributions to the State Teacher's Retirement System (STRS) are equal to 5.6 percent of the total spent on public school teacher salaries in the prior calendar year. Decreases in public school enrollment should result, over time, in a roughly commensurate decrease in the annual total spent on public school teacher salaries; therefore, state contributions to STRS would decrease proportionally. The state savings from reduced STRS contributions could range from the low tens of millions to the low hundreds of millions of dollars annually, depending on the reduction in the aggregate public school teacher payroll in California.

Capital Outlay Savings. The State Department of Education (SDE) estimates that enrollment growth over the next five years—totaling 270,000 pupils on a statewide basis—will create a need for $4 billion for construction of new school facilities. The SDE identifies an additional $9.3 billion in modernization and other facility-related costs over the next five years. Historically, state and local government funding has not been sufficient to meet all facility needs in the state. Thus, the SDE estimates of statewide facility needs should be seen as an upper bound of what the state and local agencies would spend on public school capital outlay in the absence of this measure.

This measure would reduce the number of students in the public school system which, to some extent, would diminish the need for new schools and modernization projects. Some new construction needs would remain since some high-growth areas would continue to experience enrollment increases. Thus, this measure could result in capital outlay savings to the state and local agencies, depending on the ultimate decline in public school enrollment and the geographic patterns of enrollment changes.

Loss of Federal Funds. Each year California receives almost $4 billion from the federal government to support a variety of public school programs. For many of these programs, the amount received by the state depends on the number of enrolled public school pupils. Thus, this measure would cause the state and local school districts to lose federal funds, to the extent the measure leads to fewer pupils in the public schools. This potential revenue loss is unknown.

State Administration. The measure would increase the workload of many state and local government agencies. The State Controller's Office estimates that the initiative would cost $12 million in one-time costs and $6 million annually for it to make the necessary calculations required by the measure, and to distribute checks to the parents of students receiving scholarships. The State Treasurer's Office and Attorney General's Office would also incur additional costs, although they estimate these to be minimal. County offices of education would also have additional oversight costs to verify the enrollment data of scholarship-redeeming private schools. We estimate that state and local administration expenses would total in the low tens of millions of dollars annually.

SUMMARY OF FISCAL EFFECTS

This measure would have the following major fiscal effects:

- A major rearrangement of the state's system of school finance, with growing annual savings on public school expenditures financing a new system of scholarships for children transferring to, or already attending, private schools. Possible initial state costs, with minimal net impact annually thereafter.

- Possible, unknown savings to the state from changes in the minimum funding guarantee for public K-12 schools and community colleges, depending on future budget decisions by the Legislature and Governor.

- Other fiscal effects include: (1) potentially significant annual savings to the state from reduced retirement contribution, (2) unknown savings to the state and local school districts from reduced capital outlay needs, and (3) unknown potential loss of federal education funds to the state.

Sincerely,

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