December 1, 1999

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

Attention: Ms. Diane Calkins
Initiative Coordinator

Dear Attorney General Lockyer:

As required by Elections Code Section 9005, this letter contains our review of the fiscal effect of proposed initiative file number SA1999RF0045, Amendment No. 1-S, called "the National Average School Funding Guarantee and Parental Right to Choose Quality Education Amendment."

PROPOSAL

This constitutional measure:

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

- Replaces—under certain circumstances—the state's constitutional funding guarantee for K-14 education (commonly known as "Proposition 98") with an alternative minimum guarantee that requires California's spending per student (in grades K though 12) to equal or exceed the national average.

Nontaxable Scholarships for Private School Education

Beginning in the first fiscal year following the approval of the measure (which would be 2001-02 if the measure is approved in the November 2000 election), parents would be eligible for scholarships for each child *newly enrolled* in a scholarship-redeeming private school. Eligibility for parents of students already attending private schools would be phased in over a three-year period beginning in the second year of the measure. Private school student eligibility would include students in kindergarten through 2nd grade in year two, kindergarten through 8th grade in year three, and all grades in each subsequent year. The annual scholarship entitlement per student would be the greater of:

- $4,000 per student.
- One-half of national average spending per pupil in public schools.
- One-half of California's spending per public school pupil.

(Please see below for a description of how these per pupil spending averages would be calculated.)

In those cases where private school tuition is less than the amount provided by 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 a public or private university or college.

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

National Average 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 either California per capita personal income or per capita General Fund revenue.

Under this measure, if the state increases spending per public school student above the national average, the measure supersedes Proposition 98 with a new funding guarantee. This new guarantee would require the state to fund K-12 public schools at or above national average expenditures per student every year thereafter. The measure specifies that the calculation of public school student spending for both the state and national average use a broad measure of educational expenditures, including both operations expenditures and capital outlay. The Department of Finance would recalculate these averages annually to reflect fiscal actions by federal, state, and local governments across the nation. The measure allows the Legislature to suspend the national average minimum funding requirement for one fiscal year at a time with three-fourths votes by both houses of the Legislature.

It is not clear how the legal status of guaranteed funding for community colleges would be affected if Proposition 98 were superseded by the operation of this measure. For purposes of this analysis, we assume no practical effect on community college funding.

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 three main effects 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.

- Effect of national average funding guarantee.

Other potential fiscal effects include (1) various impacts on school districts, (2) reduced costs to the state to support the State Teacher's Retirement System (STRS), (3) capital outlay savings, (4) loss of federal funds, and (5) additional costs of state administration.

Fiscal Effects from Pupils Leaving the Public School System

The availability of 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 scholarships.

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 2001-02 would be roughly $350 million, growing to over $5.5 billion by 2008-09 (the last year for which we have reliable enrollment forecasts). If 3 percent left annually, the savings would be roughly $350 million in 2001-02, growing to over $13 billion by 2008-09. (The gross savings in 2001-02 under both scenarios are constrained to $350 million due to special declining enrollment provisions of Proposition 98.)

At the same time, the state would incur costs for scholarships for each of these students leaving the public K-12 schools. We estimate that, soon after the measure takes effect, national average spending per pupil would become the driving factor in setting the scholarship amount. Thus, the initial scholarship value of $4,000 would soon begin to increase, reaching around $5,500 by 2008-09. Under the 1 percent annual exit assumption, annual costs of the scholarships would cost the state about $250 million in 2001-02, growing to over $2.5 billion by 2008-09. Under the 3 percent annual exit assumption, these annual costs would be about $700 million in 2001-02, growing to over $7 billion by 2008-09.

Under the above range of assumptions, we therefore estimate that the net fiscal effect to the state from students transferring from public K-12 schools to private schools could range from costs of $350 million to savings of $100 million in the first year, growing to savings of between $3 billion and over $6 billion by 2008-09. These net savings from students enticed to transfer to private schools would, however, be offset by costs for students who would have attended private school without 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. 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 have attended private schools in the absence of this measure in 2001-02. Providing these pupils a scholarship would cost the state over $270 million. As discussed above, eligibility for students already attending private schools would be phased in over a three-year period with students in kindergarten through 2nd grade eligible in the second year the measure is in effect, followed by kindergarten through 8th grade in year three, and private school students in all grades in each subsequent year. By 2004-05 when private school students in all grades are eligible, we estimate that over 650,000 students who would have attended private school in the absence of the measure would receive scholarships, at a cost of over $3 billion. This would grow to over $3.5 billion by 2008-09.

Net Impact on School Operations

The measure would result in a major rearrangement of the state's system of school finance. Initially, the measure's impact on school operations could range from a cost of over $150 million to over $600 million. By 2008-09, these impacts would range from annual costs of over $500 million to an annual savings of approximately $2.5 billion.

In some of the fiscal scenarios described above, the measure's national average funding guarantee comes into play. The longer-term effect of this provision, however, is unclear. Basically, the impact would depend on the relative growth rates in this national average versus what the state otherwise would have spent under the provisions of Proposition 98.

Other Fiscal Effects

Impact on Individual School Districts. As pupils shifted from public to private schools, school districts would receive less funding overall. However, the measure could result in more funding per public school pupil. For example, if the Proposition 98 guarantee remains operational, per pupil funding would increase because Proposition 98 has a "hold harmless" provision that keeps aggregate funding levels constant for three years during periods of declining enrollment. Alternatively, if the measure's national average minimum guarantee were triggered, per pupil public school funding also would increase. However, the long-run effect on funding per pupil is uncertain since the actions over time of 49 other states would determine the guarantee levels.

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—for example, compensatory education or special education services. Since the scholarship amount would not likely cover the actual cost of serving higher-cost pupils in private schools, parents of higher-cost students would be more likely to experience reduced services by shifting their child from a public school to a private one. 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.

Retirement Savings. Currently, annual state contributions to the 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. This measure would reduce the number of students in the public school system, which would diminish the need for new schools and modernization projects. Thus, this measure would result in capital outlay savings to the state and local agencies. The magnitude and timing of such savings is unknown and would depend on such factors as the ultimate decline in public school enrollment and the geographic patterns of enrollment changes. These savings, however, are potentially significant, especially in the longer term.

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 Department of Finance, State Treasurer's Office and Attorney General's Office would also incur additional costs. 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. These costs could be offset either in part or in whole by net interest earnings on the scholarship trust accounts. The measure places these earnings in the state General Fund.

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 in public school expenditures, and growing annual costs of a new system of scholarships for children transferring to, or already attending private schools. Initial fiscal impact ranging from annual costs of over $150 million to over $600 million. Long-run fiscal impact ranging from net annual costs of over $500 million to net annual savings of around $2.5 billion.

- Other fiscal effects include: (1) potentially significant annual savings to the state from reduced retirement contribution, (2) unknown, potentially significant, 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,

Elizabeth G. Hill
Legislative Analyst

B. Timothy Gage
Director of Finance