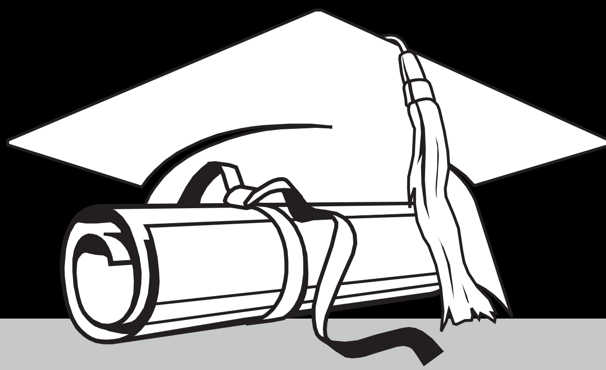
EDUCATION



LAO

60 YEARS OF SERVICE

2003-04 Analysis

MAJOR ISSUES

Education

☑ Proposition 98—Education Credit Card Maxed Out

- Assuming enactment of AB 8x (Oropeza), the state would start 2003-04 with around $2.9 billion in outstanding deferrals—including $1.1 billion of the principal apportionment, almost $900 million in state mandates, and $681 million in categorical programs

- We believe the Governor's budget is headed in the right direction by relying on ongoing rather than one-time spending reductions, and reducing the level of funding deferrals (see page E -22).

☑ K-12 Categorical Program Reform

- The Governor's proposal to combine 58 categorical programs into a K-12 Categorical Block Grant would have many advantages for school districts. It also would create significant problems. Most importantly, the proposed block grant does not adequately address the negative local incentives that led to the initial creation of many categorical programs.

- We recommend the Legislature consolidate 62 programs into five block grants. Districts would report to the state key fiscal and outcome data on each grant. We believe our proposal would increase district fiscal and program flexibility while increasing district accountability for providing needed services to students (see page E-43).

☑ State and Federal Accountability Programs

- We recommend that the Legislature take steps to integrate state and federal sanction and intervention programs to send a clear message of expectations to schools and districts. We recommend that state interventions be focused at the school district level and that the state intervene directly at only the lowest performing schools (see page E-113).

☑ **Child Care "Realignment" Merits Consideration**

- We believe the Governor's proposal to shift responsibility for most child care programs from the state to counties deserves legislative consideration. This realignment would give counties the flexibility to use child care funds as part of an integrated county strategy to serve low-income families and to tailor their child care programs to meet the needs of their communities' working poor. It would also reduce administrative complexity in the state's existing child care system by allowing counties to provide child care under their own set of program rules (see page E-137).

☑ **Alternative Higher Education Proposal**

- The budget calls for undergraduate student fees at the University of California (UC) and the California State University (CSU) to increase by about 25 percent. We recommend a more moderate increase of 15 percent, and the adoption of an explicit fee policy requiring annual adjustments that are gradual and predictable (see page E-177).

- The Governor's proposal would increase budgeted enrollment at UC and CSU by about 7 percent. We recommend a smaller enrollment increase of 4 percent, which is more in line with projected demand (see page E-188).

- The budget includes several financial aid proposals, including a significant increase in institutional financial aid at UC and CSU. We recommend a smaller increase in the institutional aid budgets and an expansion of statewide financial aid programs (see page E-196).

- For California Community Colleges, the budget increases student fees by $13 per unit and reduces enrollment funding by 5.7 percent. While we believe that the level of the proposed fee is reasonable, we recommend that the Legislature consider restoring some enrollment funding to ensure continued access (see page E-259).

TABLE OF CONTENTS

Education

OVERVIEW

Education

The Governor's budget includes a total of $52.1 billion in operational funding from state, local, and federal sources for K-12 schools for 2003-04. This is a decrease of $1.4 billion, or 2.7 percent, from estimated expenditures in the current year. The budget also includes a total of $30.3 billion in state, local, and federal sources for higher education. This is an increase of $447 million, or 1.5 percent, over estimated expenditures in the current year.

Figure 1 shows support for K-12 and higher education for three years. It shows that spending on education will reach $82 billion in 2003-04 from all sources (not including capital-related spending).

Figure 1

K-12 and Higher Education Funding

2001-02 Through 2003-04
(Dollars in Millions)

	Actual 2001-02	Estimated 2002-03	Proposed 2003-04	Change From 2002-03	
				Amount	Percent
K-12[a]	$51,663	$53,521	$52,078	-$1,443	-2.7%
Higher education[b]	28,890	29,874	30,320	447	1.5
Totals	**$80,553**	**$83,395**	**$82,398**	**-$997**	**-1.2%**

[a] Includes state, local, and federal funds. Excludes debt service for general obligation bonds.

[b] Includes state, federal, and local funds. Excludes direct capital outlay spending and debt service for general obligation bonds.

FUNDING PER STUDENT

The Proposition 98 request for K-12 in 2003-04 represents $6,723 per student, as measured by average daily attendance (ADA). Proposed spending from all funding sources (excluding capital outlay and debt service) totals about $8,750 per ADA.

The Proposition 98 budget request for California Community Colleges (CCC) represents $3,790 per full-time-equivalent (FTE) student. This compares to proposed General Fund spending of $7,816 for each California State University (CSU) FTE student and $16,754 for each University of California (UC) FTE student.

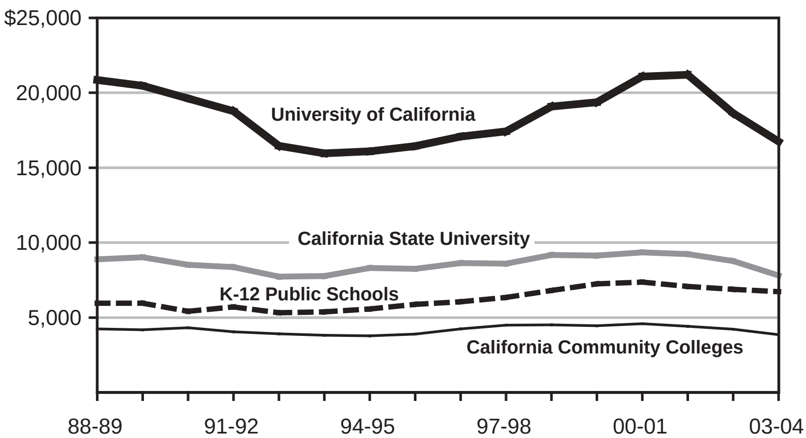
Historical Perspective of Funding Per Student

To place funding for K-12 and higher education into an historical perspective, we have compared state and local funding per FTE student in the four public segments from 1987-88 through 2003-04, adjusting for the effects of inflation over this 17-year period (see Figure 2). As the figure shows, per-student funding for K-12 schools remains near the high

Figure 2

Funding for K-12 and Higher Education Per Student[a] 1988-89 Through 2003-04

Constant 2003 Dollars



[a] K-12 data include state and local funding. Higher education data include state and local funding and Cal Grants.

point for this period. Per-student funding for higher education declines from historic highs in the past two years, although much of this decline is offset by student fee increases.

PROPOSITION 98

California voters enacted Proposition 98 in 1988 as an amendment to the California Constitution. That act, which was later amended by Proposition 111, establishes a minimum funding level for K-12 schools and CCC. Proposition 98 also provides support for direct educational services provided by other agencies, such as the state's schools for the deaf and the blind and the California Youth Authority. Proposition 98 funding constitutes over three-fourths of total K-12 funding.

The minimum funding levels are determined by one of three specific formulas. Figure 3 (see next page) briefly explains the workings of Proposition 98, its "tests," and other major funding provisions. The five major factors involved in the calculation of each of the Proposition 98 tests are: (1) General Fund revenues, (2) state population, (3) personal income, (4) local property taxes, and (5) K-12 ADA.

Proposition 98 Allocations

Figure 4 (see page 5) displays the budget's proposed allocations of Proposition 98 funding for K-12 schools and CCC. The budget proposes $44.1 billion for Proposition 98 in 2003-04. This proposed appropriation exceeds the constitutionally required minimum level by $104 million. In contrast, the Governor's 2002-03 mid-year revisions take the Proposition 98 allocation down from the *2002-03 Budget Act* amount of $46.5 billion to the revised minimum guarantee of $43.9 billion. Proposition 98 funding issues are discussed in more detail in the "Proposition 98 Budget-Year Priorities" and "California Community Colleges" sections of this chapter.

Proposition 98 "Split." For over a decade, state law has specified that K-12 districts and CCC receive the same percentage of Proposition 98 funds that they received in 1989-90 (89.17 percent and 10.93 percent, respectively). In every budget act since adopting this provision, the Legislature has allocated funding differently than described in this statute. (Of Proposition 98 funds provided to CCC and K-12 schools since Proposition 98 was enacted, CCC's share has ranged from 9.45 percent to 11.85 percent. The Governor's budget proposes a 2003-04 CCC share of 9.2 percent.) Rather than rely on a fixed percentage, we recommend the Legislature annually adjust the funding share to express its budget priorities in light of current circumstances.

Figure 3

Proposition 98 at a Glance

Funding "Tests"

Proposition 98 mandates that a minimum amount of funding be guaranteed for K-14 school agencies equal to the greater of:

- A specified percent of the state's General Fund revenues (Test 1).
- The amount provided in the prior year, adjusted for growth in students and inflation (Tests 2 and 3).

Test 1—Percent of General Fund Revenues
Approximately 34.5 percent of General Fund plus local property taxes.

Requires that K-12 schools and the California Community Colleges (CCC) receive at least the same share of state General Fund tax revenues as in 1986-87. This percentage was originally calculated to be slightly greater than 40 percent. In recognition of shifts in property taxes to K-14 schools from cities, counties, and special districts, the current rate is approximately 34.5 percent.

Test 2—Adjustments Based on Statewide Income
Prior-year funding adjusted by growth in per capita personal income.

Requires that K-12 schools and CCC receive at least the same amount of combined state aid and local tax dollars as was received in the prior year, adjusted for statewide growth in average daily attendance and inflation (annual change in per capita personal income).

Test 3—Adjustment Based on Available Revenues
Prior-year funding adjusted by growth in per capita General Fund.

Same as 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 only when it calculates a guarantee amount less than the Test 2 amount.

- **Test 3B Supplement.** Statute requires that, in Test 3 years, K-14 Proposition 98 funding per student grow at least as fast as per capita General Fund spending on non-Proposition 98 programs. This can require that a supplemental amount be added to the minimum guarantee.

Other Major Funding Provisions

Suspension

Proposition 98 also includes a provision allowing the state to suspend the minimum funding level for one year through urgency legislation other than the budget bill.

Restoration ("Maintenance Factor")

Following a suspension or Test 3 year, the Legislature must increase funding over time until the base is fully restored. The overall dollar amount that needs to be restored is referred to as the maintenance factor.

Figure 4

Proposed Proposition 98 Allocations[a]

2002-03 and 2003-04
(Dollars in Millions)

	Estimated 2002-03	Proposed 2003-04	Change From 2002-03	
			Amount	Percent
Allocations				
K-12	$39,297	$39,939	$642	1.6%
California Community Colleges	4,505	4,063	-442	-9.8
Other agencies	109	90	-19	-17.4
Proposition 98 Totals[b]	**$43,911**	**$44,093**	**$182**	**0.4%**

a General Fund and local property tax revenue.

b Totals may not add due to rounding.

ENROLLMENT GROWTH

Figure 5 (see next page) displays budgeted enrollment growth for K-12 and higher education. The increase in K-12 enrollment—1 percent—is considerably lower than annual growth during the 1990s. The K-12 enrollment is expected to grow even more slowly in coming years, as the children of the baby boomers move out of their K-12 years. Community college enrollment is projected by the administration to *decline* by 5.7 percent in 2003-04, largely due to attrition resulting from a proposed fee increase of $13 per unit. In contrast, the Governor's budget funds enrollment increases of about 7 percent at UC and CSU.

SETTING EDUCATION PRIORITIES FOR 2003-04

In this chapter, we evaluate the proposed budget for K-12 and higher education, including proposed funding increases and reductions, program consolidations and realignments, fund shifts and fee increases, and projected enrollment levels . The difficult fiscal environment that the state faces in 2003-04 provides the Legislature with the opportunity to reassess the effectiveness of current education policies and finance mechanisms. In both K-12 and higher education, we provide the Legislature with alternative approaches to achieve the level of savings that the Governor has proposed.

Figure 5

Budgeted Enrollment[a]

2002-03 and 2003-04

	Estimated 2002-03	Projected 2003-04	Change From 2002-03	
			Amount	Percent
K-12	5,895,275	5,954,154	58,879	1.0%
CCC	1,095,114	1,032,912	-62,202	-5.7
CSU	321,132	344,013	22,881	7.1
UC	189,628	202,628	13,000	6.9

a Enrollment shown in average daily attendance for K-12 and in full-time equivalent students for UC, CSU, and CCC.

K-12 Priorities. In K-12 we are generally supportive of the Governor's major initiatives—categorical program reform and child care realignment to counties. However, we believe that these two major proposals are currently at the conceptual level, and will require hard work to make them operable. Regarding the Governor's categorical block grant proposal (consolidating 58 programs into one block grant), we provide an alternative that addresses shortcomings in the Governor's proposal. Specifically, our proposal to consolidate most categorical programs into five block grants allows the Legislature to better hold districts accountable for meeting student needs while also increasing district fiscal and program flexibility.

Higher Education Priorities. In higher education the Governor proposes to achieve General Fund savings through a variety of programmatic reductions and by raising student fees at all three segments. The budget proposal also would fund enrollment growth of about 7 percent at UC and CSU, while reducing enrollment funding at CCC by 5.7 percent. While we recommend adoption of most of the proposed programmatic reductions, we offer an alternative budget in the areas of student fees, enrollment growth, and financial aid for UC and CSU. In general, we recommend lower fee increases and lower enrollment growth, as well as restructured financial aid. Our alternative would achieve about the same level of General Fund savings as proposed by the Governor while improving student access to higher education. With regard to the community colleges, we identify several options for improving student access, including enhancing financial aid and increasing enrollment funding.

CROSSCUTTING ISSUES

Education

2002-03 MID-YEAR REVISIONS: PROPOSITION 98

In this section, we discuss the 2002-03 mid-year reductions proposed by the Governor and the corresponding actions taken by the Legislature in February 2003 in AB 8x (Oropeza). Assembly Bill 8x has been passed by both houses, but had not been enacted as of this writing.

Proposition 98 funding totaled $46.5 billion in the *2002-03 Budget Act*, including General Fund and local property tax revenues. Due to declining General Fund revenues, the administration projects that the minimum guarantee has fallen by $2.6 billion to $43.9 billion. In the mid-year budget proposal, the Governor recommended reducing Proposition 98 funding to the minimum guarantee. The Legislature made substantially different changes than those originally proposed by the Governor, and reduced Proposition 98 funds to $44.2 billion. This results in Proposition 98 funding being $289 million higher than proposed by the Governor.

GOVERNOR'S MID-YEAR BUDGET PROPOSAL

The Governor's mid-year budget proposal recommended reducing Proposition 98 funds by $2.6 billion—over $2.2 billion for K-12 and $327 million for California Community Colleges (CCC). Key changes for K-12 and community colleges are described below.

Governor's Recommendations for K-12

Figure 1 highlights the significant changes the Governor proposed for K-12 Proposition 98 funds in the current year. Major changes include:

Figure 1

Governor's K-12 Mid-Year Budget Proposals
2002-03 Proposition 98

(In Millions)

2002-03 Budget Act	**$41,647.3**
Across-the-Board Reductions	
3.66 percent in December revision[a]	-$980.3
7.46 percent in January revision[b]	-481.7
Basic Aid district funding reduction	-15.3
Subtotal	(-$1,477.2)
Reversion Account Swaps	
Regional Occupation Centers and Programs (ROC/P)	-$356.8
Adult education	-81.1
Subtotal	(-$438.0)
Other Changes	
Eliminate Proposition 98 Reserve	-$132.2
Eliminate child care stage 3	-98.8
Shift federal child care funds to stage 3	-78.3
Special education restoration	78.3
Reduce High Priority Schools Grant Program	-22.6
Savings from adult education audits	-13.5
Property tax offset for ROC/Ps	-11.4
Savings from various programs	-47.7
Subtotal	(-$326.3)
2002-03 Mid-Year Proposed	**$39,405.8**
Change From *2002-03 Budget Act*	
Amount	-$2,241.5
Percent	-5.4%

a Reduction made to revenue limit and most categorical programs.

b Reduction made to selected categorical programs.

- $1.5 billion in savings from across-the-board reductions.
- $438 million in one-time savings from using funds from the Proposition 98 reversion account for current-year program costs.
- $99 million in savings from eliminating the California Work Opportunity and Responsibility to Kids (CalWORKs) child care Stage 3 starting April 1.
- $23 million in savings from not funding a second cohort of the High Priority Schools Grant Program (HPSGP).

Governor's Recommendations for CCC

Figure 2 highlights the significant changes the Governor proposed for CCC Proposition 98 funds in the current year. Major changes include:

- $158 million in savings from across-the-board reductions.
- $80 million in savings by eliminating funding for inappropriate or illegal concurrent enrollment.
- $51 million in one-time savings by using funds from the reversion account for current-year program costs.
- $33 million in lower than anticipated local property tax revenues.

Figure 2

Governor's CCC Mid-Year Budget Proposals 2002-03 Proposition 98

(In Millions)

2002-03 Budget Act	**$4,832.3**
Across-the-board reductions	-$157.9
Concurrent enrollment	-80.0
Extended Opportunity Programs and Services reversion account swap	-50.9
Other adjustments	-38.4
2002-03 Mid-Year Proposal	**$4,505.2**
Change From *2002-03 Budget Act*	
Amount	-$327.2
Percent	-6.8%

Using Prior-Year Savings to Reduce Proposition 98 Funding

The Governor's 2002-03 mid-year adjustments identify $489 million in current-year and prior-year savings for specific categorical programs. Figure 3 shows the specific program savings the Governor identified and the uses of the funds. The Governor proposes to revert the savings for these programs into the Proposition 98 Reversion Account. Since reversion account funds must be spent on K -14 programs, the Governor proposes to use the $489 million in place of General Fund support for a set of programs. Specifically, the Governor proposes to "swap" General Fund

Figure 3

Proposition 98 Reversion Account Governor's Proposals

2002-03 (In Millions)

Savings	Amount
Initial reversion balance	$124.4
Child care	79.0
Supplemental instruction (1998-99)	69.9
Math and Reading Professional Development (2001-02)	31.7
Child care facilities revolving fund	22.0
Mandates (2001-02)	20.0
CalWORKs carryover (2001-02)	17.7
High-risk youth (2000-01 and 2001-02)	16.4
Preintern/intern programs (2000-01 and 2001-02)	16.4
Community day schools (2001-02)	14.0
College prep partnership (2000-01 and 2001-02)	10.3
Other	67.1
Total	**$488.9**
Reversion Account Swaps	
K-12 Education	
Regional Occupation Centers and Programs	$356.8
Adult education	81.1
Subtotal	($438.0)
Community Colleges	
Community College Extended Opportunity Programs and Services	($50.9)
Total	**$488.9**

support for reversion account funds for Regional Occupational Centers and Programs, adult education, and community college Extended Opportunity Programs and Services. By swapping reversion account funds for General Fund, the Governor's proposal reduces current-year Proposition 98 appropriations by $489 million.

MID-YEAR REVISIONS ADOPTED BY LEGISLATURE

In response to the Governor's proposal, the Legislature reduced expenditures by $2 billion for K-12 programs and $231 million for community colleges, for a total of $2.3 billion. The Legislature's actions leave Proposition 98 funding $289 million higher than proposed by the Governor. Key changes adopted by the Legislature for K-12 and CCC are described below.

K-12 Reductions Made by Legislature

Figure 4 (see next page) highlights key actions taken by the Legislature for K-12. Major changes include:

- $1.2 billion in savings from deferring program costs to 2003-04, including: (1) the June principal apportionment payment for revenue limits, special education, adult education, supplemental instruction, and other categorical programs; and (2) payments for education mandates.
- $431 million in one-time savings from using funds from the reversion account for current-year program costs.
- $78 million in savings from using federal funds for stage 3 of the CalWORKs child care program. The Legislature rejected the Governor's recommendation to eliminate this program.
- $76 million in savings from aligning timing of funding with expenditures for HPSGP and the Immediate Intervention and Underperforming Schools Program.

The bill passed by the Legislature as amended in the Assembly on February 4, 2003, inadvertently excluded $176 million in savings intended to be in the bill. These savings include: (1) $103 million for instructional materials, (2) $60 million in available reversion account funds intended to be substituted for current-year adult education funds, and (3) $12 million for library materials. As of this writing, the Legislature had not made these technical changes. If these changes are made, then the Legislature's actions will leave Proposition 98 funding $113 million higher than proposed by the Governor instead of $289 million higher.

Figure 4

2002-03 Proposition 98 as Revised by Legislature K-12 Programs

(In Millions)

2002-03 Budget Act	**$41,647.3**
Deferrals	
Principal apportionment	-$1,087.0
Mandates	-122.1
Subtotal	(-$1,209.1)
Reversion Account Swaps	
Regional Occupation Centers and Programs	-$356.8
Adult education	-74.1
Subtotal	(-$431.0)
Other Changes	
Eliminate Proposition 98 reserve	-$132.2
Shift federal child care funds to stage 3	-78.3
Reduce HPSGP and II/USP[a]	-76.0
Summer school savings	-25.0
Reduce staff development	-21.8
Net savings from various programs	-75.4
Subtotal	(-$408.6)
2002-03 Revised	**$39,598.7**
Change From *2002-03 Budget Act*	
Amount	-2,048.6
Percent	-4.9%

a High Priority Schools Grant Program and Immediate Intervention Underperforming Schools Program.

CCC Reductions Made by Legislature

Figure 5 highlights key actions taken by the Legislature for CCC. Major changes include:

- $157 million in savings from targeted and across-the-board reductions.
- $33 million in one-time savings by using funds from the reversion account for current-year program costs.

Figure 5

2002-03 Proposition 98 as Revised by Legislature California Community Colleges

(In Millions)

2002-03 Budget Act	**$4,832.3**
Across-the-board reductions	-$157.3
Partnership for Excellence reversion account swap	-33.3
Defer health mandate	-1.7
Other adjustments	-38.4
Subtotal	(-$230.7)
2002-03 Revised	**$4,601.7**
Change From *2002-03 Budget Act*	
Amount	-$230.7
Percent	-4.8%

- $33 million in lower than anticipated local property tax revenue.
- $2 million in one-time savings by deferring the health fees mandate.

Additional Reductions Could Be Taken in the Current Year

We recommend that the Legislature make $382 million in targeted Proposition 98 reductions in the current year to bring expenditures down to our revised Proposition 98 guarantee of $43.8 billion.

The Legislature's mid-year Proposition 98 reductions were $289 million less than recommended by the Governor. In addition, our new projection of the Proposition 98 minimum guarantee for the current year is $93 million less than the Governor due to lower projections of General Fund revenues. Based on the Legislature's actions and our revised projection of the minimum guarantee, Proposition 98 would be overappropriated by $382 million. If the Legislature does not make further targeted reductions, the $382 million over-appropriation will become part of the Proposition 98 base in 2003-04. We recommend the Legislature reduce Proposition 98 spending to the minimum guarantee. In light of the $1.2 billion in deferrals made by the Legislature during the mid-year revisions, we do not recommend achieving this lower guarantee through further deferrals. Instead, we recommend targeted cuts to Proposition 98 programs. Making the technical corrections noted above would reduce the overappropriation by $176 million, necessitating $206 million in additional reductions.

Deferral May Threaten Federal Funding for Special Education

We recommend the State Department of Education report to the fiscal committees on the need for a federal waiver due to the deferral of 2002-03 special education payments adopted as part of the mid-year Proposition 98 funding adjustments.

The *2002-03 Budget Act* appropriates $2.7 billion as the state's share of total special education program costs of $3.7 billion. The remaining $991 million in program costs are funded by local property taxes ($314 million) and federal special education funds ($677 million). The Governor's proposed mid-year reductions to Proposition 98 programs included a $99.3 million reduction to special education.

Assembly Bill 8x did not make the $99.3 million reduction recommended by the Governor but did defer $214.1 million in program costs from 2002-03 to 2003-04. By deferring this payment, the Legislature reduced Proposition 98 spending for K-12 education in the current year and delayed reimbursing districts for the state share of program costs by a few weeks.

The deferral is unlikely to reduce the level of student services provided by local special education programs. Federal law requires districts to develop an individual learning plan that describes the services needed by each special education student. Local special education budgets are driven by the cost of fulfilling these individual plans. Because the Legislature's deferral is a reduction only in a technical sense, student services should remain relatively unaffected.

Does the Deferral Violate Maintenance of Effort (MOE)? Federal law requires, as a condition of receiving federal funds, that state spending on special education must not decrease from the prior year. (State spending is defined as General Fund support and local property taxes dedicated to special education.) States that do not maintain the prior-year level of spending may experience a reduction in federal funds. The *2002-03 Budget Act* level of state and local resources to the program exceeded prior-year spending by about $5 million.

The $214 million reduction caused by the deferral may result in a technical violation of the federal MOE requirement. Later in this chapter, we discuss a problem with maintenance of effort in the 2003-04 special education budget proposal and request the State Department of Education (SDE) to explore the issue of a waiver of the requirement with the federal government.

We think it makes sense for SDE also to discuss the 2002-03 technical violation of MOE with the federal government. If the federal government interprets the deferral as a MOE violation, the Legislature would have an opportunity to request that SDE submit a wavier to the federal government or make any needed adjustments in the 2002-03 budget before the end of the fiscal year and prevent the loss of federal funding

For this reason, we recommend SDE discuss this issue with the federal Department of Education and report to the budget committees on the need for changes to the 2002-03 budget during hearings.

PROPOSITION 98 BUDGET-YEAR PRIORITIES

The Governor's budget offers a reasonable set of solutions for addressing the 2003-04 budget situation. We highlight a number of areas, however, that are worthy of careful consideration and deliberation. Below, we identify these areas and discuss opportunities the Legislature has for responding strategically in K-14 education to the most pressing problems it is likely to face in the budget year.

BUILDING THE 2003-04 EDUCATION BUDGET WITH DUE CAUTION

Overall, the Governor's budget proposal for K-12 education is balanced and reasonable. The proposal contains three primary components. It: (1) reduces the level of funding deferrals, (2) relies on ongoing rather than one-time spending reductions, and (3) provides school districts with greater fiscal and programmatic flexibility to respond to these reductions. We recommend the Legislature adopt this general approach and include the same basic components in the budget.

Below, we discuss the importance of including each of these three components in the budget. We then propose LAO alternatives for specific K-12 education programs. Next, we discuss two other high-priority issues: (1) the child care realignment and (2) the funding reduction proposed for the California Community Colleges (CCC). We end this section by discussing two Proposition 98 issues—our revised estimate of the minimum guarantee in 2003-04 and the implications of suspending the guarantee.

Reduce the Level of Deferrals—Education Credit Card Maxed Out

As part of its budget solution in 2001-02 and 2002-03, the Legislature opted to defer significant education program costs to the subsequent fiscal year rather than make additional spending cuts. The result has been a steadily growing balance on the state's education "credit card." Figure 1 shows the obligations that the state has made from prior- and current-year funding deferrals.

Figure 1

K-12 Education Credit Card Maxed Out

(In Millions)

Deferrals From 2002-03 to 2003-04	
Principal apportionment June payment	$1,089[a]
Categorical deferrals	681
Estimated current-year mandates	210[a,b]
Subtotal	($1,980)
Other Outstanding Costs	
Estimated prior-year mandates	$650[b]
Prior-year settle up	250
Subtotal	($900)
Total	**$2,880**

a Assumes enactment of AB 8x (Oropeza).

b This consists of: (1) the $122 million deferral recently passed by the Legislature and (2) previously deferred mandate costs.

In the 2001-02 budget, the Legislature deferred $931 million in categorical program costs to 2002-03. This lowered the 2001-02 Proposition 98 appropriation level—thereby lowering the minimum guarantee for future years. It also helped the state meet the 2002-03 minimum guarantee without additional General Fund cost. In the 2002-03 budget, the state relied even more heavily on deferrals as a way to avoid further spending reductions. As part of the *2002-03 Budget Act*, the Legislature deferred $681 million in categorical program costs to 2003-04. In AB 8x (2003-04 First Extraordinary Session), the Legislature approved two other deferrals from 2002-03 to 2003-04—$1.1 billion of school districts' June apportionments and $122 million of state-reimbursable mandate costs.

Given the large and growing backlog of mandate claims, the mandate deferral presents special problems for the state. By the end of 2002-03, the state is likely to have a total of almost $900 million in outstanding Proposition 98 mandate liabilities.

Budget-Year Mandate Costs. Although district costs for ongoing mandates total about $210 million annually, the Governor's budget provides only $110 million for 2003-04 mandate costs. Thus, his proposal generates an increase in mandate deferrals of around $100 million, assuming no new mandate claims are approved.

The cumulative impact of all these deferrals has maxed out the education credit card. Each year the state relies on deferrals and other one-time solutions rather than ongoing solutions, the problem intensifies the following year. For example, if the state wants to capture budget-year savings by deferring additional apportionments, it would need to defer not only June apportionments but also May apportionments. Deferring such apportionments could cause many districts to experience serious cash flow problems. In come cases, these deferrals might even result in school districts only being able to cover payroll costs by incurring additional debt.

Establish Deferral Repayment Plan. We recommend the Legislature begin gradually paying off deferrals and develop a repayment plan to eventually restore all deferred funds. For 2003-04, the Governor's budget (1) repays $681 million in funds deferred from 2002-03 to 2003-04 and (2) restores the $681 million in base funding. While we believe the Governor's proposal heads in the right direction, we suggest an alternative repayment plan that prioritizes paying off specific deferrals faster than others. (Please see Figure 2 in the next section of this write-up, entitled "LAO Spending Alternatives.") In future years, we recommend the Legislature make it a priority to repay deferrals before making expenditure increases or funding new programs.

Make Ongoing Spending Reductions

Of the $2 billion in K-12 education solutions adopted by the Legislature in AB 8x, we estimate that around $1.8 billion was one-time in nature. Because few solutions made in 2002-03 were ongoing, the Legislature will essentially need to identify a new set of solutions in 2003-04. The Governor's budget proposes a total of $1.6 billion in ongoing spending reductions. The $1.6 billion is primarily due to a $1.5 billion across-the-board reduction to the proposed categorical block grant. In addition, the Governor proposes several minor targeted reductions. Faced with the need to identify $1.6 billion in new K-12 solutions, we believe the Legislature should make the same level of ongoing spending reductions as proposed in the Governor's budget. As discussed above, we would not advise the Legislature to use additional deferrals as a budget-balancing tool, as this generates increasingly difficult management problems at the local level and erodes future budgetary choices at the state level.

Provide Schools Greater Fiscal and Programmatic Flexibility

The Governor proposes continuing the $1.5 billion in across-the-board cuts to both revenue limits and categorical programs as well as making targeted cuts to various programs. To provide more flexibility in light of these cuts, the Governor's budget proposes to merge 58 K-12 categorical programs into a K-12 Categorical Block Grant. We believe this proposal takes a significant step in the right direction and, in conjunction with categorical reform, the $1.5 billion in proposed across-the-board reductions are reasonable. The Governor's proposal, however, does not adequately address the negative local incentives that led to the initial creation of the categorical programs. In addition, it misses several opportunities to extend the reforms. Please see our alternative categorical reform proposal later in this chapter.

AN LAO SPENDING ALTERNATIVE

We have identified approximately $427 million of additional Proposition 98 funding needs for 2003-04 because either (1) the Governor's budget under-funded specific programs or (2) the Legislature increased 2003-04 obligations because of actions taken to date in the First Extraordinary Session. We recommend that the Legislature fund these priority needs, and make other funding reductions to stay within the proposed Proposition 98 funding level. These alternatives are described in Figure 2 (see next page). Specifically, we recommend:

- ***Set-Aside Funding for Special Education Deferral ($214 Million).*** As discussed in the *2002-03 Mid-Year Revisions: Proposition 98* piece in the "Crosscutting Issues" section of this chapter, we believe that the Legislature's deferral of special education funding in AB 8x may result in a federal maintenance of effort (MOE) problem. Because an MOE violation could risk federal funds, we recommend the Legislature take two actions immediately: (1) direct the State Department of Education (SDE) to work with the federal Department of Education (DOE) to seek a possible waiver and (2) set aside $214 million for special education pending the outcome of SDE's discussion with DOE. This $214 million, if needed, would also reduce the state's level of outstanding deferrals. There is a similar MOE issue in the Governor's 2003-04 proposal that could cost the state an additional $28.5 million in General Fund (for which we also suggest setting aside funding).
- ***Paying Ongoing Mandate Costs ($100 Million).*** We recommend the Legislature increase funding for reimbursable state mandates by $100 million to better represent the ongoing costs of existing

mandates. This approach reduces the growth of the state's education deferrals. To eliminate some of the negative incentives the current funding mechanism creates, we recommend folding the mandate funding into the Core Service Block Grant recommended in the "Governor's Categorical Program Reform Proposal" section of this chapter.

- ***Fully Funding State Intervention and Sanction Programs ($50 Million).*** The cost of fully funding the state's intervention and sanction programs is higher than proposed in the Governor's budget in part because the Legislature rejected the proposed elimination of funding for a second cohort in the High Priority Schools Grant Program.

Figure 2

LAO Spending Alternative

2003-04
(In Millions)

Recognize Additional Costs	
Special education set-aside for 2002-03 deferral	$214.0
Pay ongoing mandate costs	100.0
PSAA[a] intervention	50.0
Fully fund programs deferred from 2002-03	33.3
Special education set-aside for 2003-04 General Fund offset	28.5
Healthy Start grants	1.0
Total	**$426.8**
Recommend Savings	
Equalization	$250.0
Assessments	18.6
Volunteer mentor	5.0
Angel Gate Academy	0.6
Total	**$274.2**
Balancer	
Limited categorical deferral to 2004-05	**$152.6**

[a] Public Schools Accountability Act.

To partially offset these additional costs, we have identified $274 million of recommended savings. The Governor's budget proposes using $250 million for equalization and $24 million to fund various other programs. Although equalizing revenue limit funding is an important goal, we think providing a $250 million augmentation for equalization, while at the same time making a $612 million reduction to revenue limits as part of an across-the-board cut, seems contradictory. We suggest the Legislature amend current law to delay equalization funding until the state can first pay for the base program.

Because the additional savings we have identified do not fully offset the additional costs, we suggest continuing a small portion of the categorical program deferrals ($153 million of the $681 million) into 2004-05. We believe that this alternative minimizes the total amount of deferrals. (As discussed later, we recommend the Legislature use any additional 2003-04 Proposition 98 funding to further reduce the level of education deferrals.)

Highlighting Other High-Priority Issues

In this section, we discuss two other high-priority issues: (1) the Governor's child care realignment proposal and (2) the proposed reductions to CCC.

Child Care Realignment Merits Consideration

The Governor's budget proposes a major "realignment" of state and county program funding responsibilities. Under this proposal, the state would shift responsibility for most child care programs administered by SDE to the counties. As we discuss in detail later in this chapter, the state's existing child care system creates significant problems for families and local providers. For example, the system: (1) requires local providers to comply with cumbersome rules regarding allowable expenditures, attendance accounting, eligibility, and reimbursement rates; and (2) treats families with similar incomes differently, depending on whether they have received assistance through the CalWORKs program.

In view of these problems, we believe the Governor's child care realignment proposal merits legislative consideration. Realignment would give counties the flexibility to use child care funds as part of an integrated county strategy to serve low-income families and to tailor their child care programs to meet the needs of their communities' working poor. It would also reduce administrative complexity in the system by allowing counties to provide child care under their own set of program rules.

California Community Colleges Face Sizeable Reduction

The Governor's budget proposes $4.1 billion in Proposition 98 funding for CCC, which is $442 million, or 9.8 percent, less than the revised current-year amount. Of this amount, $215 million is associated with targeted reductions to various categorical programs. The remaining savings are associated with two interrelated factors—changes in enrollment and student fees. The Governor's budget assumes savings due to an anticipated 5.7 percent decline in enrollment. This decline is expected to occur as a result of the proposed increase in student fees. The higher fee rate, however, will also generate additional revenue, which acts as a direct offset, thereby creating additional General Fund savings.

Most Spending Reductions Are Reasonable. Given the state's fiscal situation, we believe that most of the CCC reductions proposed by the Governor are reasonable. Total funding for categorical programs would be reduced about 25 percent from the revised current-year level, with changes to individual programs ranging from a 56 percent reduction (for the Fund for Student Success) to an 11.7 percent increase (for the administration of financial aid programs).

Fee Increase Reasonable. The proposed budget would increase community college fees from $11 to $24 per unit. The increase would amount to $338 dollars per year for the average full-time student. This would be the first fee increase in over a decade; in fact, fees were reduced twice in the 1990s. While the proposed increase is large in percentage terms, CCC fees would still be the lowest in the nation. We also note that all financially needy students are eligible to have their fees waived, and thus will not be affected by the increase. Finally, many middle-income students are eligible for a federal tax credit, which means they too will not be affected by the proposed increase.

Legislature May Wish to Restore Some Enrollment Funding. We believe that the proposed fee increase will affect enrollment and this impact should be accounted for in enrollment budgeting. We believe that the magnitude of the decline projected by the Governor, however, may be too large. This is because the Governor's proposal does not take into account the likely shift of some enrollment demand from the public universities to CCC in response to planned fee increases at the universities. Moreover, to the extent that the Legislature wishes to expand enrollment growth in higher education, it makes sense to focus that growth at the lower-cost community colleges.

Funding an Additional 25,000 Students. If the Proposition 98 minimum guarantee is higher than assumed in the Governor's budget and the Legislature does not suspend the guarantee (please see the next section for more detail on these Proposition 98 issues), then we recommend designating additional funding for CCC enrollment. Specifically, we recommend the Legislature fund an additional 25,000 full-time equivalent students, which is 2.6 percent of the current-year level. We believe this would more accurately reflect the level of enrollment CCC is likely to experience in the budget year. This would impose a Proposition 98 General Fund cost of $100 million, which could be funded by a higher guarantee.

ADDRESSING TWO OVERARCHING PROPOSITION 98 MINIMUM GUARANTEE ISSUES

Finally, in this section, we address two overarching Proposition 98 issues. We first provide our estimate of the Proposition 98 minimum guarantee in 2003-04. We then discuss the implications of suspending the Proposition 98 minimum guarantee.

Estimated Higher Proposition 98 Minimum Guarantee in 2003-04

We estimate that the 2003-04 Proposition 98 minimum guarantee for K-14 education is $373 million higher than assumed in the Governor's budget. This increase is due primarily to our higher estimate of budget-year General Fund revenues. If the estimate of the minimum guarantee remains above the level assumed in the Governor's budget, then we recommend the Legislature meet the higher guarantee by (1) expiring more of its debt (that is, paying off additional deferrals) and (2) funding additional enrollment at the community colleges.

Figure 3 shows the Proposition 98 amounts available for 2002-03 and 2003-04 under the Governor's budget forecast and under our forecast. For 2002-03, we forecast that the minimum guarantee will be $93 million lower than the Governor's mid-year revisions due to lower projections of General Fund revenues.

Figure 3

Governor's Budget and LAO Proposition 98 Forecasts

(In Millions)

Forecast	2002-03	2003-04
Governor's budget	$43,910.9	$44,093.1
LAO	43,818.5	44,465.6
Difference from Governor	**-$92.5**	**$372.5**

For the budget year, Figure 3 shows that our estimate of the Proposition 98 minimum guarantee is $373 million higher than assumed in the Governor's budget. This increase is primarily due to our estimate of General Fund revenues being $1.5 billion above the Governor's budget. In addition, our estimates of per capita personal income are higher than the Governor's and our estimates of state population are slightly lower. All of these factors lead to a higher minimum guarantee. We recommend the Legislature use any additional Proposition 98 funding to (1) further reduce the outstanding deferral costs and (2) provide up to $100 million for additional community college enrollment growth as discussed above.

Our Forecast Has Downside Risks. In the *2003-04 Budget: Perspectives and Issues*, we indicate that the main risks to our fiscal forecast are on the downside. To the extent that the economic recovery is delayed, the state could have significantly less Proposition 98 funding available. Because of the potential downside risks, we suggest that the Legislature make real cuts in 2003-04, reducing the base program and beginning to address the backlog of deferrals.

How Does Proposition 98 Suspension Work?

Up to this point, our analysis assumes that the Legislature would appropriate at the Proposition 98 minimum guarantee for 2003-04. However, the Legislature has the option to suspend the minimum guarantee, which we discuss below.

Changes in General Fund Revenues Have Major Proposition 98 Implications. The minimum funding requirement for Proposition 98 programs in 2003-04 is sensitive to changes in General Fund revenues. Assuming the Governor's proposal, the state would enter 2003-04 with a $3.5 billion "maintenance factor" that would have to be restored to the Proposition 98 base in future years. (A maintenance factor was created in 2001-02 when General Fund revenues fell significantly.) Starting from the General Fund revenues assumed in the Governor's budget, roughly half of any increase in General Fund revenues (either because of improved economic conditions or tax increases), would have to be spent on Proposition 98 programs. This relationship would continue until General Fund revenues increased by slightly over $7 billion, at which point the maintenance factor would be fully restored, and all additional revenues could be used for any purpose.

Impact of Realignment Proposal on Proposition 98. For 2003-04, the Governor proposes to increase taxes by $8.3 billion related to his realignment proposal. (Of this amount, $8.2 billion would provide funding for the realigned programs.) Because the new realignment revenues would be placed in a special fund, the administration indicates that it did not include the realignment revenues in its calculation of the Proposition 98 minimum-funding guarantee. Including these revenues in the calculation would raise the state's minimum funding level for schools by about $3.5 billion because of the requirement to restore the maintenance factor.

What About Suspending Proposition 98? Current law allows the state to suspend Proposition 98 in an urgency bill other than the budget bill. If suspended, the entire amount of any new General Fund tax revenues could be used for budget-balancing purposes.

Suspension would allow the Legislature to appropriate funds at any level determined appropriate for K-14 education. Under suspension, the state would achieve real savings but would continue to have a maintenance factor (the difference between the actual appropriation level and the long-term Test 2 Proposition 98 funding level) that would have to be paid over time.

Figure 4 illustrates the impact that suspending Proposition 98 to accommodate a General Fund revenue increase in 2003-04 would have on

Figure 4

Impact of Suspending Proposition 98 in 2003-04

Alternative 1:
Governor's Proposition 98 Funding and Realignment Proposal

Assumptions

- $8.3 billion in new tax revenues do *not* count toward Proposition 98.
- Proposition 98 funding at level proposed by Governor.

Proposition 98 Outcomes

- Proposition 98 funding level is $44.1 billion.
- Outstanding maintenance factor requiring restoration in future is $3.5 billion.

Alternative 2:
$8.3 Billion New General Fund Revenues and Proposition 98 Suspension

Assumptions

- $8.3 billion new tax revenues count toward Proposition 98.
- Suspension of Proposition 98.

Proposition 98 Outcomes

- Suspension would allow Legislature to appropriate Proposition 98 at any level.
- The Legislature could hold Proposition 98 harmless—$44.1 billion.
- Outstanding maintenance factor requiring restoration in future is $3.5 billion.

K-14 spending in 2003-04 and future years. Alternative 1 assumes the Governor's proposed 2003-04 Proposition 98 funding level of $44.1 billion and assumes the Governor's $8.3 billion of new tax revenues associated with realignment do not count toward Proposition 98. Alternative 2 illustrates the impact if instead the Legislature (1) increased state taxes to generate $8.3 billion in General Fund revenues, (2) suspended the Proposition 98 guarantee, and (3) provided the Governor's proposed Proposition 98 funding level.

In the example, Proposition 98 suspension would allow the state to (1) increase General Fund revenues, (2) provide school districts and community colleges the same amount they would have received absent an increase in General Fund revenues, and (3) not affect future-year Proposition 98 funding requirements. The maintenance factor is the same because we have assumed that Proposition 98 spending is equal under both scenarios. Therefore, the same "gap" between 2003-04 spending and the long-run requirements of Proposition 98 would remain.

In summary, realignment is not the only way available to the Legislature to raise new revenues without simultaneously increasing Proposition 98 spending. The Legislature can raise additional General Fund revenues from new taxes that count toward the Proposition 98 funding calculation, and yet through a one-time suspension of the minimum guarantee, it can (1) provide the same level of Proposition 98 funding for 2003-04 as proposed by the Governor and (2) not affect the long-term funding requirements of Proposition 98.

INTRODUCTION

K-12 Education

The budget includes an increase in K-12 Proposition 98 funding of $624 million in the budget year. This is $6,723 budgeted per pupil, or 0.6 percent more than the revised estimate of per-pupil expenditures in the current year. Adjusting funding for deferrals and realignment of child care, funding is $6,762 per pupil, or 1.8 percent more than the revised estimate of per-pupil expenditures in the current year.

Figure 1 (see next page) displays all significant funding sources for K-12 education for the budget year and the two previous years. As the figure shows, Proposition 98 funding constitutes over three-fourths of overall K-12 funding. For 2002-03, the Governor proposes a mid-year reduction in K-12 Proposition 98 funding of $2,242 million, or 5.4 percent, to bring Proposition 98 appropriations down to the revised calculation of the minimum guarantee. This brings budgeted Proposition 98 per-pupil spending down from $7,067 per average daily attendance (ADA) in the *2002-03 Budget Act* to $6,684. For 2003-04, the budget proposes to increase K-12 Proposition 98 funding by $624 million above the Governor's proposed mid-year revisions. This represents an increase of $39 per pupil, or 0.6 percent, bringing budgeted Proposition 98 per-pupil spending to $6,723. This increase in Proposition 98 funding is supported by a forecasted $677 million increase in local property taxes. General Fund support of Proposition 98 falls slightly.

The growth pattern of Proposition 98 spending is distorted because expenses were deferred from one fiscal year to another from 2001-02 through 2003-04. In addition, the Governor proposes realigning child care expenditures to counties, moving funding out of Proposition 98 in 2003-04, which makes cross-year comparisons difficult. Figure 2 (see page 35) displays the impact that the deferrals and child care realignment have on the growth of per-pupil spending. It moves deferred funds to the years when the expenditures occurred, and keeps child care expenditures in Proposition 98 for comparison purposes. Using this calculation, per pupil spending increased by $120, or 1.8 percent over the 2002-03 mid-year revision. The Legislature should focus on the programmatic funding outlined in Figure 2 when wanting to assess spending from a school district's perspective.

Figure 1

K-12 Education Budget Summary

2001-02 Through 2003-04
(Dollars in Millions)

	Actual 2001-02	Mid-Year Revision 2002-03	Proposed 2003-04	Change From 2002-03 Amount	Change From 2002-03 Percent
K-12 Proposition 98					
State General Fund	$27,105.4	$26,372.7	$26,319.8	-$52.9	-0.2%
Local property tax revenue	11,717.9	13,033.1	13,709.8	676.8	5.2
Subtotals, Proposition 98[a]	($38,823.4)	($39,405.8)	($40,029.7)	($623.9)	(1.6%)
Other Funds					
General Fund					
Teacher retirement	$805.5	$901.4	$51.0	-$850.4	-94.3%
Bond payments	1,014.9	809.8	907.5	97.7	12.1
Other programs	996.8	982.6	112.0	-870.6	-88.6
State lottery funds	826.6	799.6	799.6	—	—
Other state funds	146.0	113.0	80.0	-33.0	-29.2
Federal funds	5,365.0	6,599.0	6,397.0	-202.0	-3.1
Other local funds	4,699.5	4,719.6	4,609.1	-110.5	-2.3
Subtotals, other funds[a]	($13,854.3)	($14,924.9)	($12,956.2)	(-$1,968.8)	(-13.2%)
Totals[a]	**$52,677.6**	**$54,330.7**	**$52,985.8**	**-$1,344.9**	**-2.5%**
K-12 Proposition 98					
Average daily attendance (ADA)	5,809,083	5,895,275	5,954,154	58,879	1.0%
Budgeted amount per ADA	$6,683	$6,684	$6,723	$39	0.6%

[a] Totals may not add due to rounding.

Spending for K-12 education from all sources is projected to decrease by $1.3 billion, or 2.5 percent, below the Governor's mid-year revisions. This reflects decreases in most K-12 funding sources. Key changes in non-Proposition 98 funds include:

- ***Governor Proposes Reduced Contributions to State Teachers' Retirement System (STRS)—$850 Million.*** Teacher retirement decreases by $850 million (General Fund) due to two proposals which would: (1) use pension obligation bonds or a loan agree

Figure 2

K-12 Proposition 98 Spending Per Pupil Adjusted for Child Care Realignment and Funding Deferrals Between Years

2001-02 Through 2003-04

	Actual 2001-02	Mid-Year Revision 2002-03	Proposed 2003-04
Budgeted Funding			
Dollar per ADA	$6,683	$6,684	$6,723
Percent growth	—	—	0.6%
Programmatic Funding[a]			
Dollar per ADA	$6,844	$6,642	$6,762
Percent growth	—	-2.9%	1.8%

a To adjust for the deferrals, we counted funds toward the fiscal year in which school districts had programmatically committed the resources. The deferrals meant, however, that districts technically did not receive the funds until the beginning of the next fiscal year. To adjust for realignment, we counted 2003-04 child care spending in the budget-year per-pupil amount to make it comparable with prior-year numbers.

ment to pay the $448 million state STRS contribution in 2003-04, and (2) reduce funds for purchasing power protection by $500 million. Purchasing power protection is a program that ensures that retirees' pensions stay at 80 percent of their original purchasing power.

- ***Miscellaneous Reductions in Non-Proposition 98 General Fund Programs—$871 Million.*** Non-Proposition 98 General Fund spending for "other programs" decreases by $871 million, primarily because of $690 million in one-time current-year spending from reappropriations and reversion account funds.

- ***Federal Funds—$202 Million.*** Federal funds decrease by $202 million primarily due to $138 million in one-time current-year funds for school renovations. The federal government has not yet adopted the federal education budget for the fiscal year beginning October 1, 2002, but early indications are that total federal funds for California will increase.

The budget includes $1.5 billion in new resources for K-12 Proposition 98 for 2003-04. The budgeted Proposition 98 increase for K-12 education is $624 million. In addition, the Governor proposes to transfer child care funding and responsibilities to counties, which frees up $879 million in Proposition 98 for other uses. Figure 3 shows how the budget proposes to spend this $1.5 billion in new resources. Major changes recommended for 2003-04 include:

- Continuation of $1.5 billion in savings from across-the-board cuts.
- $382 million increase for the Public Employees' Retirement System offset reduction due to anticipated contribution rate increases.
- $364 million in net deferral costs.
  - — $931 million freed up from one-time costs of deferrals from 2001-02 to 2002-03.
  - — $648 million in 2002-03 program costs deferred to 2003-04.
  - — Building $648 million in programs back into the 2003-04 base.

Figure 3

Governor's K-12 Budget Proposals 2003-04 Proposition 98

(In Millions)

	Amount
Available Resources	
Increase in K-12 spending	$623.9
Funding "freed up" by realigning child care	878.8
Total	**$1,502.7**
Program Allocations	
Backfill programs funded from Proposition 98 Reversion Account	438.0
Public Employees' Retirement System offset	381.7
Net impact of funding deferrals	364.0
Revenue limit growth	321.5
Equalization	250.0
Cost-of-living increases	—
Public School Accountability Act reduction[a]	-153.8
Instructional materials reduction[a]	-145.8
Special education federal fund offset[a]	-115.8
Net other	163.0
Total	**$1,502.7**

[a] Proposals which free up funds for other K-12 purposes.

- $322 million increase for enrollment growth, based on a projected ADA increase of 1 percent in 2003-04.
- $250 million increase for school district funding equalization.
- No funding for cost-of-living-adjustments (COLA). The statutory COLA is 1.55 percent, which would cost about $635 million.
- No funding growth for any categorical programs except special education.

Proposition 98 Spending by Major Program

Figure 4 (see next page) shows Proposition 98 spending for major K-12 programs. "Revenue limit" funding (available for school districts and county offices to spend on general purposes) accounts for $29 billion in 2003-04, or over two-thirds of Proposition 98 expenditures. The General Fund supports about 53 percent of revenue limit funding, and local property taxes provide the remaining 47 percent.

The Governor proposes to consolidate most "categorical programs" into a $5.1 billion block grant. The two largest categorical programs, special education and K-3 class size reduction (CSR), would remain separate programs. The budget proposes $2.7 billion from Proposition 98 sources for special education, a decrease of $9 million. K-3 CSR funding remains the same at $1.5 billion.

ENROLLMENT TRENDS

Enrollment growth significantly shapes the Legislature's annual K-12 budget and policy decisions. When enrollment grows slowly, for example, fewer resources are needed to meet statutory funding obligations for revenue limits and K-12 education categorical programs. This leaves more General Fund resources available for other budget priorities both within K-12 education and outside it. Conversely, when enrollment grows rapidly (as it did in the 1990s), the state must dedicate a larger share of the budget to education. In light of the important implications of enrollment growth, we describe below two major trends in the K-12 student population.

The enrollment numbers used in this section are from the Department of Finance's Demographic Research Unit, and reflect aggregate, statewide enrollment. While the enrollment trends described here will likely differ from those in any given school district, they reflect the overall patterns the state is likely to see in the near future.

Figure 4

Major K-12 Education Programs Funded by Proposition 98

(Dollars in Millions)

	Mid-Year Revision 2002-03	Proposed 2003-04	Change Amount	Change Percent
Revenue Limits				
General Fund	$15,019.5	$15,289.3	$269.8	1.8%
Local revenue	13,033.1	13,709.8	676.8	5.2
Subtotals	($28,052.6)	($28,999.1)	($946.5)	(3.4%)
Categorical Block Grant[a]				
Targeted instructional grant[b]	$668.7	$662.4	-$6.3	-0.9%
Adult education[b]	506.9	500.4	-6.5	-1.3
Home to school transportation[b]	475.7	467.3	-8.4	-1.8
Economic impact aid	444.7	439.0	-5.7	-1.3
School improvement[b]	389.6	386.0	-3.6	-0.9
Regional Occupational Centers and Programs[b]	359.3	342.3	-17.0	-4.7
Instructional/library materials[b]	373.6	224.9	-148.7	-39.8
Supplemental grants[b]	229.9	229.9	—	—
Staff development day buy-out	204.8	202.2	-2.6	-1.3
Deferred maintenance	183.4	181.0	-2.3	-1.3
Deferrals paid	931.3	647.7	-283.6	-30.5
Other	853.4	859.3	5.9	0.7
Subtotals	($5,621.3)	($5,142.4)	(-$478.8)	(-8.5%)
Other Categorical Programs				
Special education	$2,667.8	$2,659.0	-$8.8	-0.3%
Class size reduction	1,479.7	1,479.7	—	—
Child development	1,199.6	421.5	-778.1	-64.9
Summer school/after school	433.3	436.8	3.6	0.8
Public schools accountability act	419.5	288.3	-131.2	-31.3
Mandates	111.9	110.4	-1.4	-1.3
Assessments	99.7	101.8	2.1	2.1
Other	406.4	390.7	-15.7	-3.9
Subtotals	($6,817.6)	($5,888.1)	(-$929.5)	(-13.6%)
Adjustments[c]	-1,085.6	—	1,085.6	-100.0
Totals	**$39,405.8**	**$40,029.7**	**$623.9**	**1.6%**

a Amounts shown for each program in categorical block grant for 2003-04 for illustrative purposes only.

b Includes funds deferred in 2002-03 and paid in 2003-04 and funds paid from reversion account for these programs.

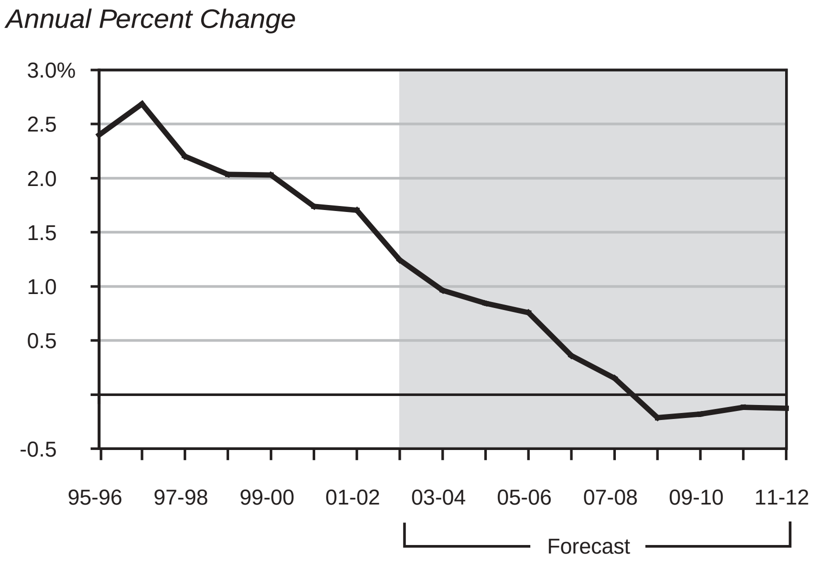
c Adjustments include deferred amounts appropriated in 2003-04 and programs funded by a Proposition 98 Reversion Account swap.

K-12 Enrollment Growth to Slow Significantly

K-12 enrollment is projected to increase by about 1 percent in 2003-04, bringing total enrollment to about 6.2 million students. Figure 5 shows how enrollment growth has slowed since 1996-97. Over the next ten years, K-12 enrollment growth will continue to slow and actually decline beginning in 2008-09. This contrasts with growth averaging 2.2 percent annually during the 1990s.

Figure 5

K-12 Enrollment Growth



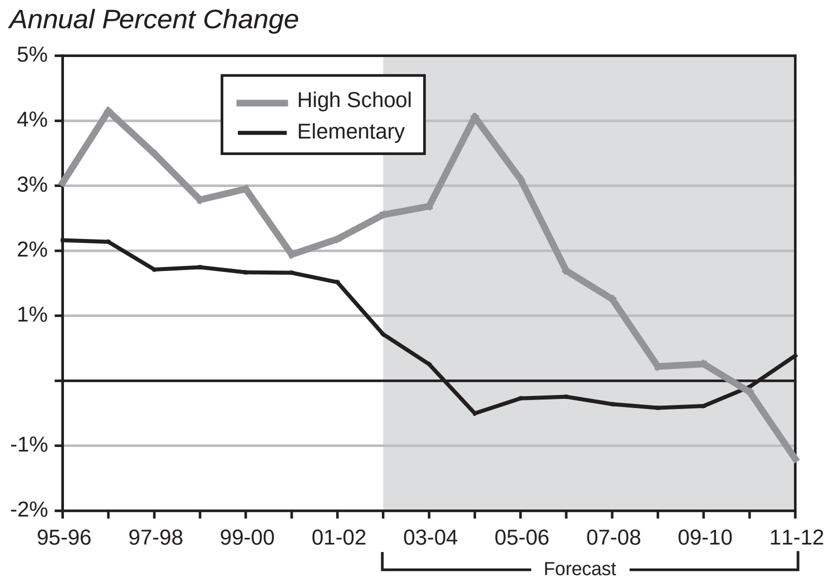
Divergent Trends in Elementary and High School Enrollment

Figure 6 (see next page) shows that the steady decline in K-12 enrollment growth masks two distinct trends in elementary (grades K-8) and high school (grades 9-12) enrollment. Elementary school enrollment growth has gradually slowed since 1996-97. Growth rates are expected to become negative in 2004-05 and remain negative through 2010-11. From the current year through 2010-11, K-8 enrollment is expected to decline by 87,100 pupils (2 percent).

In contrast, high school enrollment growth is expected to accelerate in the short term, reaching a 4.1 percent growth rate in 2004-05. Then, growth is expected to slow sharply, becoming negative in 2010-11. Expected growth from the current year to 2010-11 is approximately 246,000 pupils (14 percent).

Figure 6

Elementary and High School Enrollment Growth



Budget and Policy Implications

These trends have significant budgetary and policy implications for issues such as class size reduction, teacher demand, and facilities investment. A few of the major implications include:

- A 1 percent increase in K-12 enrollment requires an increase of approximately $440 million (General Fund) to maintain annual K-12 expenditures per pupil.
- As enrollment growth slows, a smaller share of the state's new revenues will be consumed by costs associated with funding additional pupils. The Legislature will then have the option of devoting these revenues to increasing per-pupil spending or to other budget priorities.
- In the near term, programs aimed at elementary grades (such as K-3 CSR) will face reduced cost pressures related to enrollment. Programs aimed at high school grades will face increased cost

pressures. This could present cost challenges for many unified school districts because per-pupil costs of educating high school students tend to be higher than for elementary school students.

- Because of declining enrollment provisions in state law, more school districts will benefit from the one year hold harmless provision in current law, increasing state costs per pupil.
- Despite the general downward trend in enrollment growth, significant variation is expected to occur across counties. For example, between 2002-03 and 2011-12, Los Angeles' enrollment is expected to decline by 82,000 students (a 5 percent decline) whereas Riverside's enrollment is expected to increase by 69,000 students (a 20 percent increase).

BUDGET ISSUES

K-12 Education

GOVERNOR'S CATEGORICAL PROGRAM REFORM PROPOSAL

The Governor's Budget proposes to create a $5.1 billion categorical block grant in lieu of funding 58 individual K-12 programs in order to provide school districts with greater fiscal and program flexibility. We recommend the Legislature improve the proposal in various ways, thereby increasing district fiscal and program flexibility and improving incentives for local decision making.

State funds for K-12 education fall into two main categories. The largest source of funds is provided through a general purpose "revenue limit" grant. Revenue limits support core education program costs such as teacher and administrator salaries, lights and utilities, maintenance, and other costs. Categorical education programs generally support specific supplemental costs. In 2002-03, the budget contained more than 80 categorical programs that provided $12 billion in state funds for the support of a wide range of district programs, including class size reduction, special education, teacher training, and child nutrition.

GOVERNOR'S PROPOSAL

The *2003-04 Governor's Budget* proposes to provide funding for 58 existing categorical programs through a K-12 Categorical Block Grant as a means of increasing school district fiscal and program flexibility. The block grant would total $5.1 billion in the budget year, although $648 million of that amount represents the payment of 2002-03 funding for four categorical programs the Legislature deferred until 2003-04. Thus, on an ongoing basis, the block grant would provide $4.5 billion to districts.

Figure 1 displays the Governor's proposed 2002-03 and 2003-04 funding levels for programs included in the Governor's block grant. As the

Figure 1

Proposed Categorical Block Grant 2003-04 Governor's Budget

(Dollars in Millions)

	2002-03			2003-04	
Program	Enacted[a]	Revised[a]	Change	Proposed[b]	Change, 2002-03 Revised
Targeted Instructional Improvement	$737.6	$668.7	-9.3%	$662.4	-0.9%
Adult Education	605.0	506.9	-16.2	500.4	-1.3
Home To School Transportation	519.6	471.7	-9.2	467.3	-0.9
Economic Impact Aid	498.7	444.7	-10.8	439.0	-1.3
School Improvement	429.2	389.6	-9.2	386.0	-0.9
Regional Occupation Centers/Programs	373.2	359.3	-3.7	342.3	-4.7
Supplemental Grants	241.7	229.9	-4.9	229.9	—
Instructional Materials	395.8	352.9	-10.8	204.5	-42.1
Staff Development Day Buyout	229.7	204.8	-10.8	202.2	-1.3
Deferred Maintenance	205.7	183.4	-10.8	181.0	-1.3
9th Grade Class Size Reduction	110.2	98.3	-10.8	97.0	-1.3
Teaching as a Priority	88.7	79.1	-10.8	78.0	-1.3
Peer Assistance and Review	87.0	77.6	-10.8	76.6	-1.3
Beginning Teacher Support and Assessment	88.1	75.6	-14.2	75.4	-0.3
School Safety	82.1	73.2	-10.8	72.3	-1.3
43 other programs	607.2	468.4	-22.9	480.4	2.6
Totals	**$5,299.5**	**$4,683.9**	**-11.6%**	**$4,494.8**	**-4.0%**

[a] Includes amounts deferred to 2003-04.

[b] Does not include amounts deferred from 2002-03.

Totals may not add due to rounding.

figure shows, the Governor proposed an 11.6 percent ($715 million) mid-year reduction in 2002-03 for the 58 programs. For 2003-04, the budget proposes an additional 4 percent reduction ($190 million).

According to the Department of Finance (DOF), the block grant would allow districts to direct categorical funds in a manner that best meets the needs of each district. While the trailer legislation to implement the proposed block grant was not available as this analysis was written, DOF advised it would propose the following rules:

- ***Current Distribution of Funds.*** The block grant would maintain the current distribution of funds to local educational agencies. That is, the budget would allocate funds to each district and county office based on the amount received from the 58 programs in 2002-03.
- ***Greater Program Flexibility.*** The budget proposal would eliminate most statutory requirements of the individual programs. The DOF advises that only a few existing state requirements would not be eliminated, including the requirement that districts (1) purchase standards-aligned textbooks and (2) spend one-half of 1 percent of its general purpose funding on maintenance.
- ***Unrestricted Use of Funds.*** The Governor's proposal would remove the supplemental nature of the categorical funds. This would allow districts the ability to use funds for almost any local priority, similar to general purpose revenue limits.
- ***Future Funding Increases.*** The DOF advises the proposal includes statutory growth and cost-of-living adjustments for the block grants. The proposal does not include any provision to equalize the per-pupil amounts distributed to districts in the future.

Proposal Excludes Some Categorical Programs

The budget does not include all K-12 categorical programs in the proposed block grant. The 2003-04 proposed budget would continue separate funding for 13 categorical programs. According to DOF, the budget maintains these separate programs because they reflect an administration priority (such as K-3 class size reduction [CSR]), satisfy a federal mandate (such as special education), or would be discontinued in the near future (year round schools, principal training, and mathematics and reading staff development).

Figure 2 (see next page) displays the programs and funding levels for separately funded categorical programs proposed in the 2003-04 budget. The 13 separately funded programs would distribute $5.6 billion in

2003-04. Four programs—special education, K-3 CSR, child development, and summer school—account for $5 billion, or 90 percent of the total.

Figure 2 also shows six additional categorical programs appropriated as add-ons to district revenue limits or separately funded county

Figure 2

Separately Funded K-12 Categorical Programs 2003-04 Governor's Budget

(Dollars in Millions)

Program	2002-03 Enacted	2002-03 Revised	2002-03 Change	2003-04 Proposed	2003-04 Change, 2002-03 Revised
Separately Funded					
Special Education	$2,711.1	$2,667.8	-1.6%	$2,659.0	-0.3%
K-3 Class Size Reduction	1,659.3	1,479.7	-10.8	1,479.7	—
Child Development	1,403.4	1,199.6	-14.5	421.5	-64.9
Summer School	449.7	433.3	-3.7	436.8	0.8
High Priority Schools Grant	217.0	172.5	-20.5	178.8	3.7
Public School Accountability	267.6	246.9	-7.7	109.9	-55.5
Student Assessment	111.8	99.7	-10.8	101.8	2.1
Child Nutrition	71.6	69.9	-2.4	71.6	2.5
Year Round Schools	84.2	75.0	-10.9	56.3	-25.0
Math and Reading Staff Development	31.7	28.3	-10.8	27.9	-1.3
Principal Training	5.0	2.5	-50.0	26.2	946.2
County Office Fiscal Oversight	10.7	9.8	-8.5	8.4	-14.5
Angel Gate Academy	0.6	0.6	-3.7	0.6	—
Totals	**$7,023.7**	**$6,485.5**	**-7.7%**	**$5,578.4**	**-14.0%**
Revenue Limit Funded					
Meals for Needy Pupils	$1,17.8	$1,15.2	-2.2%	$1,16.4	1.0%
Necessary Small Schools	101.0	102.7	1.7	103.7	1.0
Beginning Teacher Salaries	82.0	81.7	-0.3	81.7	—
Continuation Schools	34.6	34.7	0.1	35.0	1.0
COE Community Day Schools	37.9	40.9	7.8	55.2	35.0
COE Opportunity Schools	6.9	7.2	3.3	7.4	3.0
Totals	**$380.3**	**$382.4**	**0.5%**	**$399.3**	**4.4%**

Totals may not add due to rounding.

offices of education (COEs) programs. These programs are not separately identified in the budget, but are part of the system of district or county office revenue limits that are continuously appropriated. The programs included in the figure do not represent a complete list of the add-on programs. These six programs, however, are similar in purpose to those proposed for consolidation in the K-12 block grant. As Figure 2 shows, these programs provide $399 million to districts and COEs in the budget year. Unlike the separately funded programs, the add-on programs would experience increases in the budget year.

Benefits of the Governor's Plan

In creating the K-12 block grant, the Governor's proposal would generate several important benefits for school districts. These benefits are summarized in Figure 3 and are briefly described below.

Figure 3

Benefits of Categorical Reform

- ***Greater Fiscal Flexibility.*** Districts would have greater choice to direct funds to meet local program needs.
- ***Improved Program Flexibility.*** Districts would have greater control over the program models used to deliver services.
- ***Clearer State/Local Relationship.*** Reform focuses responsibility for program and funding choices on local districts and school boards.
- ***Administrative Savings.*** Reduces state and local administrative costs created by application, accounting, and compliance requirements.
- ***Improved Focus on Student Learning.*** Reducing program complexity helps districts concentrate on maximizing the impact of funds on improving student achievement.

Greater Fiscal Flexibility. The budget proposal would provide school districts with significant new fiscal flexibility to use categorical funds to better meet local needs. Under the block grant approach, a district that currently receives funding from one program would be able to redirect the funds to a different program that satisfies a higher priority for the district. Instead of hiring reading specialists through the Miller-Unruh Reading program, for instance, a district would be able to redirect that funding to train teachers in different, potentially more effective reading methodologies.

Improved Program Flexibility. The proposal would allow districts to choose a program model that best serves students. Many categorical programs contain program requirements that limit district flexibility. These restrictions may prevent districts from tailoring program services most efficiently and effectively. For instance, although reading specialists may be an effective strategy in some districts, the program's requirement to hire specialists may prohibit other districts from using a more cost-effective approach.

Clearer State/Local Relationship. By increasing local control over the use of categorical funds, the budget proposal clarifies decision making responsibilities in K-12 education. Categorical programs can result in confusion over which level of government—the state or school districts—is ultimately responsible for the provision of a high quality, well-managed education system. This may occur because the state assumes some responsibility for adequately funding a local need when it plays a direct role in the allocation of funds for that purpose. However, in cases where local performance is less-than-adequate, local officials can point to "insufficient" state funding as the problem. As a consequence, state intervention in basic educational inputs makes it difficult for the state, as well as parents and the local community, to determine which level of government is responsible for the inadequate performance of the district. By giving districts broad discretion over the use of categorical funds, the block grant simplifies the state/local relationships and increases local responsibility for district actions.

Administrative Savings. The budget proposal would yield state and district savings by reducing the administrative effort entailed in operating multiple categorical programs. Currently, districts must apply for, separately track, and monitor the appropriate use of categorical funds. The amount of local savings that would result is unknown. The budget identifies significant state savings, however, proposing to reduce State Department of Education (SDE) administrative support by $6.7 million and 97 positions to reflect workload savings resulting from the consolidation. This represents 15 percent of the department's 2002-03 General Fund support.

Improved Focus on Student Learning. The complex web of categorical program funding rules can inadvertently divert a district's focus from implementing state content standards and improving instruction. In these cases, district concerns about compliance with state rules and regulations result in ineffective and fragmented instructional programs. All of the benefits listed above—increased fiscal and program flexibility with the accompanying local accountability for spending and program decisions, and the elimination of administrative and compliance requirements—can assist districts to focus on the activities that are critical to improving student performance. Thus, categorical reform helps districts focus on improving curriculum and instruction and better align their local education program to meet the state's student performance objectives.

THE GOVERNOR'S PLAN—PROBLEMS AND SOLUTIONS

Given the significant benefits of categorical reform, we believe the administration's proposal merits serious attention. The proposed K-12 block grant, however, raises serious policy and technical questions. Below, we describe five major problems we identified with the proposal. We also identify ways the Legislature could address those problems and improve upon the budget's plan. The major concerns we have identified in the block grant and our recommended solutions are summarized in Figure 4 and discussed below.

Figure 4

The Governor's Categorical Reform Plan Problems and Solutions

- ***Proposal Ignores Negative Local Incentives.*** The proposal fails to grapple with the more complex issues underlying the existence of categorical programs. Solution: Increasing local accountability—using a combination of input and output measures—would result in improved local incentives for districts to "do the right thing."
- ***Categorical Grants Would Become General Purpose Funds.*** The proposal puts categorical program funding "on the table" for virtually any district expense. Solution: Block grants can provide additional flexibility to districts without undermining the Legislature's goal of reserving funds for supplemental services.
- ***Effectiveness of Accountability Systems Still Unproven.*** The proposal assumes state and federal accountability programs have improved district incentives to maximize the impact of spending on student achievement. Solution: Reserving funding for low-performing students and school-wide improvement activities would allow the Legislature time to evaluate the effectiveness of these programs.
- ***Block Grant Misses Opportunities to Clarify District Responsibilities.*** The proposal continues the practice of directly funding county programs for alternative and vocational education. Solution: By directing all funds for direct student services to districts, the state would increase district responsibility for adequately serving students.
- ***Some Programs Are Excluded Unnecessarily.*** The proposal maintains separate funding for several K-12 programs that are similar in nature to those included in the block grant. Solution: Including these programs would increase benefits of categorical reform.

Proposal Ignores Negative Local Incentives

One of the primary reasons the state establishes categorical programs is that it believes districts will underinvest in certain services unless the state guarantees those services through a dedicated source of funding. Frequently, low district spending results from a lack of accountability—that is, no state or local mechanism helps ensure districts devote sufficient resources to a specific program. The state can correct this accountability problem by creating a categorical spending program that results in a higher level of spending for those services.

Problem—Proposal Does Not Adequately Balance Flexibility and Accountability. A central question, therefore, is whether the Governor's proposal balances local incentives in such a way that districts would be encouraged to "do the right thing" with the flexibility afforded by the block grant. According to DOF, the Governor supports categorical reform, in part, because the state's accountability system holds districts responsible for the impact of local decisions on student performance.

Many categorical programs, however, have little direct connection to student achievement. For instance, it seems unlikely that school administrators and board members would invest in the adult education program because they see a direct connection between serving the adult population and K-12 student achievement. In fact, the imbalance between the strong K-12 accountability programs and the weak requirements for adult education suggests the budget proposal would create strong incentives for districts to *reduce* the level of adult services in order to increase services for K-12 students. While the budget proposal may result in a more effective use of funds from a local perspective, accountability for K-12 student achievement is unlikely to create the incentives that help districts balance the needs of the K-12 and adult population.

Solution—Get the Fiscal Incentives Right. While the budget proposal offers many benefits, it fails to grapple with the more complex issues underlying the existence of categorical programs. Understanding clearly why local incentives encourage districts to underinvest in a particular activity is the first step toward understanding whether a program needs to be continued as a separate program.

Most K-12 categorical programs address district incentives to underinvest in high-cost services needed by certain students. The higher cost of serving special needs students—such as special education or compensatory education—reduces funding available for all other students. To address this incentive problem, the state and federal governments subsidize services to these high-cost special needs students.

Solution—Use Data to Increase the Focus on Local Responsibility for Services. The state can improve local incentives in other ways than earmarking funds through categorical programs. The success of the state's accountability system in focusing schools on student achievement demonstrates the power of data to alter the local decision-making landscape. The state could apply this strategy to categorical programs as well.

The state already collects a substantial amount of performance data on schools. To use this data as an alternative to categorical funding streams, however, the state would need to ensure that the data are:

- ***Easily Accessed.*** Parents, voters, and state decision makers must be able to obtain the data easily so they can stay informed of district performance.
- ***Simple and Easy to Understand.*** Too much, or too complicated, data create a barrier to effective communication about district outcomes.
- ***Reliable and Comparable.*** Low-quality data undermine the value of information on district performance.

In summary, categorical reform requires an understanding of the spending pressures districts experience and the various ways the state can influence spending decisions in positive ways. In our view, the budget proposal goes too far in assuming that accountability for student performance alone corrects all local incentive problems. Through a combination of inputs (budget and policy regulation) and output measures (accountability mechanisms), we believe categorical reform can increase local flexibility *and* improve local incentives.

Categorical Grants Would Become General Purpose Funds

Budget bill language proposed as part of the block grant would allow districts to use funds for the "support of classroom education." Since virtually every district activity could be interpreted as supporting classroom education, this language would permit districts to use block grant funds for almost any cost. This could include district administration, employee salary increases, routine maintenance, or other expenditures supported from general purpose funds.

Problem—Proposal Undermines Supplemental Nature of Funds. As a result, the proposed budget bill language would transform supplemental categorical funding for specific activities into general purpose funding. In these tight budget times, eliminating the supplemental nature of categorical funding would create a strong local incentive for districts to use block grant funding to meet base program costs. This feature of the proposed budget would further undermine the Legislature's goal of ensuring adequate funds for specific supplemental services.

Solution—Protect Supplemental Funding, But Allow Flexibility. Districts need additional fiscal flexibility in tight budget times. The budget proposal provides districts with almost unlimited flexibility with state funds, which we think would provide strong incentives for districts to shift funds away from supplemental services to pay for base program costs. There are other ways to create flexibility for districts. The budget currently contains, for instance, provisions that allow districts to transfer limited amounts of funds between categorical programs. This type of flexibility can also be included in a system of block grants. This would allow the Legislature to provide districts with additional flexibility while also protecting the supplemental nature of categorical funds.

Effectiveness of Accountability Systems Still Unproven

State and federal accountability programs use student assessment data on achievement to hold districts and schools responsible for raising the level of student performance in California. If these accountability programs are effective, the proposal to give districts greater flexibility over the use of categorical programs targeted at compensatory or alternative education services would appear to be reasonable.

Problem—Time Needed to Prove System's Effectiveness. The effectiveness of the state and federal accountability programs is still unproven. California is at the beginning of a long process of learning to use these programs to substantially raise the level of student achievement of pupils who currently underperform. Although SDE has successfully intervened in districts to correct fiscal mismanagement, it has little experience in fixing broken educational processes.

We also are concerned that federal accountability under the No Child Left Behind (NCLB) Act is so demanding that it will prove ineffective in providing real accountability for the state's schools. The department's projections show more than 60 percent of schools in the state as failing to meet NCLB performance targets within a few years. It remains to be seen whether accountability can be meaningful if schools believe there is little chance of success.

Solution—Protect Compensatory and School Improvement Funding. As a result, we think it is premature to depend entirely on state and federal accountability programs to create the incentives that will ensure student needs are met. This suggests that protecting compensatory and alternative education funding is necessary. We also suggest protecting school improvement funds such as staff development and class size reduction.

Over time, the impact of state and federal accountability programs on student performance will become more evident. If these programs are successful, the Legislature would be able to adjust its funding structure to further increase local flexibility.

Block Grant Misses Opportunities to Empower Districts

Districts do not currently receive funding for several of the programs included in the proposed block grant. Instead, the state distributes funds directly to other local education agencies—usually COEs—and school districts choose whether to take advantage of the program's services. For example, the budget includes in the block grant $342 million in funds for Regional Occupational Centers and Programs (ROC/Ps), which is administered primarily by COEs (although some programs are run by school districts or by joint-powers agencies that serve multiple school districts).

Problem—Unknown Impact of Flexibility on COE Programs. Under the budget proposal, the block grant would direct ROC/P funds to COEs (or other agencies). This creates two problems. First, block grant funds distributed to these local agencies would come with no program requirements. Exactly what these entities would do with these funds is uncertain. COEs, for instance, could choose to divert ROC/P funds to pay for special education costs—even though the state supports special education through a separate appropriation. Under the block grant proposal, it appears joint powers ROC/Ps would receive funding with absolutely no accountability requirements. We are unclear how these programs would use this freedom.

Problem—Districts Are Not Accountable for Students in COE Programs. The second concern is that the proposal misses an opportunity to increase district responsibility to provide the type and quality of services needed by students. By directly funding COEs, the state blurs the question of which education agency is responsible for meeting the needs of students. In our view, districts have the best information (understanding of each student's needs) and the most effective accountability mechanisms (parents and local school board elections). By focusing resources on separate county administered schools, the state restricts district options for serving students and relieves the district of responsibility for the achievement of students referred to county office schools.

Solution—Fund Districts Not COEs. For these reasons, we believe categorical program funds supporting direct services to students are best allocated to districts. In our 1994 report entitled *School-to-Work Transition: Improving High School Career Programs*, we suggested the Legislature focus responsibility for vocational education on districts by apportioning ROC/P funds to districts rather than counties or joint powers agencies.

In addition, by receiving the funds directly, districts would have greater control to purchase the type and quality of services needed by students.

To make this change too quickly could result in severe program dislocations and result in service gaps to students who need county services. We think a transition period would allow both COEs and school districts to avoid these problems. During the transition, COEs and school districts would develop compacts that prevent large funding changes in any one year and create a funding source for students who would otherwise "fall through the cracks" of the district delivery system.

Some Programs Are Excluded Unnecessarily

The Governor's budget does not include all categorical programs in its proposed block grant. As described above, several separately funded programs are excluded. In addition, the proposal does not incorporate county office programs or district programs funded through revenue limit funding.

Problem—Proposal Excludes Similar Programs. The block grant proposal excludes programs that are similar in nature to the programs that are included. We have identified the following types of exclusions:

- ***Separately Funded District Programs.*** The proposed block grant excludes K-3 CSR, the At-Risk Youth program (also known as Los Angeles Unified School District's Angel Gate program), the Principal Training program, and the Mathematics and Reading Professional Development program.
- ***County Operated Programs.*** The block grant also excludes county office administered alternative education programs, including the Community School Program and Community Day School programs. Similar district-administered programs are included.
- ***Programs Funded Through Revenue Limits.*** The state distributes a few categorical programs as add-ons to the revenue limits. Continuation school funding is one example.
- ***Budget Proposal Ignores Mandate Programs.*** State-mandated local programs can be viewed as simply another way of paying for state categorical programs. The budget proposes to spend $110 million to reimburse districts for 36 mandates. Many mandated programs are similar in nature to the categorical programs proposed for the K-12 block grant, including graduation requirements and counseling.

Solution—Including Programs Would Increase Benefits of Reform. Adding the above programs to the block grant would be consistent with the overarching goals of the block grant proposal and would add to the benefits available from categorical reform. The budget proposal presents the Legislature an opportunity to simplify and consolidate the K-12 funding system. Excluding programs simply due to the funding mechanism fails to take advantage of that opportunity. Given the potential benefits that could result from reform of the categorical programs, we think the Legislature should include all programs—no matter how they are currently funded—in its deliberations over categorical consolidation.

IMPROVING THE GOVERNOR'S PLAN

We recommend the Legislature merge 62 separate categorical education programs into five block grants as part of a comprehensive effort to reform the K-12 funding structure and increase local flexibility and accountability

While the Governor's proposed K-12 categorical block grant presents significant benefits, it also raises major concerns. Most importantly, the proposed block grant does not adequately address the negative local incentives that led to the initial creation of many categorical programs. In addition, despite the proposal's broad-brush consolidation of most categorical programs, it misses opportunities to extend the reform.

Due to these concerns, we recommend the Legislature take steps to improve the Governor's block grant proposal. Given the many benefits of reform, we suggest the Legislature use the budget proposal as a starting point in its effort to revamp the existing system. With several major refinements, the Legislature can help districts use existing funds more effectively and increase district accountability for high-priority activities that are critical to the K-12 system.

Below, we describe the general features of our alternative proposal. We review the rationale behind the five block grants we propose, our strategy for using existing data to increase local accountability, and the fiscal and program rules that would guide districts in the use funds. Our proposal for transitioning county office alternative education programs also is discussed. Following a discussion of the general features of our alternative proposal, we describe the specific design of our proposed block grants.

General Features of the LAO Proposal

We have designed our alternative proposal to remedy problems with the Governor's proposal discussed above. We based our proposal on the idea that, like any new program, the final shape of categorical reform would evolve over time. Rather than reforming programs in one "big bite," we recommend the Legislature take a significant first step while also building in ways for the state to learn how the reforms actually work in districts. This information would allow the state to correct any problems as they emerge and make additional reforms in the future. At the same time, we have tried to keep our proposed block grants as large as possible to maximize local flexibility in the use of funds. This flexibility would assist districts in maximizing the effectiveness of categorical funds on improving K-12 educational programs.

Protect Program Areas That Alter Local Incentives

We identified several programs and program areas that warrant state protection. As discussed above, certain high-priority program areas merit separate funding until state and federal accountability programs have been more fully tested and shown effective. Accordingly, we recommend that the Legislature merge various programs into two block grants: a compensatory and alternative education block grant and an academic improvement block grant. This would give the Legislature an opportunity to monitor the progress of student performance while also expanding district choice over the use of funds.

We also propose a vocational education block grant to increase district responsibility for meeting the vocational needs of students and provide a source of funds to meet those needs. Current law fails to hold schools accountable for career preparation. In addition, most supplemental funding for vocational education goes to county office ROC/Ps, which reduces district flexibility to meet student needs. Our proposed block grant would address these problems by refocusing program responsibility and resources on districts.

Our proposal continues separate funding for a small number of programs that correct negative local incentives. For instance, we propose separate funding for the High Risk Youth program and the Foster Youth Program. These two programs help ensure that the educational needs of relatively small segments of the student population—foster care children and students returning to school from youth correctional facilities—are addressed. As the state's data systems improve, thereby allowing accountability programs to measure the progress of individual students, separate funding for these programs may be unnecessary.

We have also excluded the adult education program from any block grant because including the program would create negative local incentives. Merging the program into a K-12 block grant creates strong incentives for districts to reduce the level of adult services in order to increase services for K-12 students. We also remain unconvinced that the program fits among the basic responsibilities of the K-12 system. The state may be able to reduce redundancy and improve effectiveness by consolidating the K-12 adult programs into the community college system. Because any discussion of adult education goes beyond the question of the best way to provide supplemental funds for K-12 programs, we have excluded the program from our proposal.

Our proposal combines several programs that support core district functions into a block grant. This includes existing programs funding transportation, instructional materials, and major maintenance. Because these functions are not supplemental in nature, we considered merging the funds into district revenue limits. We opted for the block grant approach, however, to maintain the visibility of these funds while the state evaluates the effectiveness of using data to hold districts responsible for providing these services.

We also aggregated several small county administered technical assistance programs into a block grant. As discussed above, the state can play an important role in providing information and assistance to districts in the most effective uses of categorical funds. The COEs currently provide this type of assistance in lieu of a state program of technical help. We think it is an important role that counties are well positioned to provide, and the block grant approach permits COEs to be more responsive to district needs.

Use Data to Increase Local Accountability

Our alternative block grant proposal is designed as a first step in a process of learning how to support school districts in a manner that increases local flexibility and accountability. To support the ongoing learning process, we recommend the Legislature include data reporting requirements to help measure whether districts are effectively using funds to meet the state's goals. There are two elements to our proposal:

- First, districts would report (1) fiscal data on how they use state funds and (2) outcome data on their success in addressing the problems that the block grant seeks to resolve. While outcome data always would be preferable to fiscal data, high-quality measures of performance may be difficult to define or expensive to collect. As the state gains experience in administering block grants, we expect better measures would be developed and a reliance on fiscal data could be reduced. The SDE would compile and analyze the mandated data in an annual performance report to the Legislature and the public on each block grant.

- Second, the Legislature would provide SDE the capacity to monitor school district activities in each block grant. As discussed in the *Analysis of the 2002-03 Budget Bill,* we believe the department has an important role in a world of block grants. Specifically, SDE would reinforce the state's objectives in creating the block grants by (1) increasing local understanding of the elements of high-quality programs (evaluating promising programs, providing technical assistance) and (2) monitoring local programs (insuring funds were spent as intended).

The budget proposes to eliminate a significant portion of SDE's staff that currently perform these functions for existing programs. Therefore, the proposed reductions need careful review so that fewer resources do not prevent the department from performing these important tasks.

Allow Broad Program Flexibility

Our block grants would provide significant program flexibility. Existing statutes for the programs included in the block grants would be eliminated, making funds available for any activity consistent with the purpose of each block grant. Key provisions of existing law or new provisions, however, may be needed to guide district use of funds. Existing law, for instance, limits administrative spending on categorical funds to 15 percent and requires participation by school site councils in the categorical program planning processes. Except in rare cases, we recommend eliminating program rules and regulations.

Provide Fiscal Flexibility

The fiscal structure of our block grants is simple. All funds for direct student services would be allocated to school districts. Allocations generally would be proportional to the amount received by districts in 2002-03. Future funding growth would be based on growth in student attendance in each district (except for compensatory and alternative education funds). In addition, grants would be equalized over time by redirecting to low-funded districts a portion of the annual cost-of-living adjustment that would otherwise go to high-funded districts.

Our proposed block grants would significantly increase local fiscal flexibility. Districts could redirect funds to increase support for successful program models and eliminate support for less productive programs. In addition, the greater program flexibility would allow districts to further hone local programs down to the essential services, which would further reduce local costs. Finally, we expect large savings to districts due to the elimination of state application, accounting, and monitoring requirements.

Our proposal also calls for maintaining some flexibility for districts to move funds among block grants. The *2002-03 Budget Act* permits districts to transfer 20 percent of a program's funds to another categorical program and caps those transfers so that programs may grow by a maximum of 25 percent. Since districts currently use this flexibility to meet local priorities, we recommend similar provisions for our proposed block grant. The one exception to this rule is that transfers from the Compensatory Program Block Grant would be limited to 10 percent so that the Legislature's priority to ensure supplemental services for low-performing students remains intact.

Make Charter School Funding Consistent With Other Schools. Our proposal would make charter school funding as consistent as possible with other schools and neutralize any positive or negative fiscal incentive for the formation of charter schools.

Give Small School Districts Additional Flexibility. Very small districts experience unique problems that warrant additional fiscal flexibility. As we discussed in our *Analysis of the 2002-03 Budget Bill*, school districts with less than 1,500 average daily attendance (ADA) receive allocations that are too small to be used effectively—even when programs are grouped into block grants. For instance, based on statewide averages, we estimate a school district of 150 students would receive $37,000 from the Core Services Block Grant and a maximum of $50,000 from the Compensatory Program Block Grant.

The actual per-pupil amount of categorical funds received by many small districts, however, is considerably less than the average. Small districts are less likely to apply for state funds because the cost of complying with state application and administrative requirements are large relative to the amount of funds available through the program. Small districts also are less likely to receive funding from categorical programs that target resources to a limited number of specific districts. As a result, given block grant funds would be distributed in proportion to the amount districts received in the current year, the average small district block grant allocations would be smaller than the state average.

Therefore, we recommend the Legislature allow these districts additional flexibility to transfer funds among the block grants. We suggest setting the small district transfer authority at twice the percentage permitted to larger districts. If experience shows that greater flexibility is needed, the Legislature could adjust the limits in the future. As with charter schools, we suggest the Legislature require small districts to submit the accountability data required by each block grant.

Focus Funds and Responsibility on Districts

Three of our proposed block grants contain funds that currently support programs administered by COEs. In the preceding pages, we discussed the problems with direct funding of county office programs. For these reasons, our block grants apportion to districts the categorical funds currently distributed to county administered alternative education and vocational education programs. By taking this step, the Legislature would focus the responsibility for identifying and providing the services that best meets student needs on districts. Consistent with this responsibility, this change could give districts greater control to purchase the type and quality of services to meet those needs.

To make this change too quickly, however, could result in severe program dislocations and result in service gaps to students who need county services. Therefore, we recommend the Legislature create a transition period during which COEs and school districts would develop working plans to mitigate large funding changes in any one year and create a funding source for students who would otherwise fall through the cracks of the district delivery system (students who are referred by the courts, for example).

Specifically, we propose that in 2003-04, districts forward to COEs those funds that would have otherwise gone to county programs. During the year, the county office and districts would negotiate three-year plans for the type and amount of services desired by each district. At the end of the three years, districts would be free to use the funds for any district, county, or other program that is consistent with the intent of the block grant. The transition plan also would require districts to set aside a portion of the block grant for a countywide fund for students who require county services but are not the fiscal responsibility of any district. At the end of the transition period, these plans could evolve into annual contracts between COEs and districts.

The transition plan is similar to the process used by the Legislature as part of the recent special education funding reform. We think the planning process would provide COEs the opportunity to convince districts of the merits of their services, to make adjustments that render the services even more valuable or effective for districts, and to adjust slowly to the level of services desired by districts.

Specific Features of the LAO Block Grants

Our alternative block grant proposal combines funding from 62 existing programs into five new categorical block grants. Figure 5 summarizes our proposed block grants, which are described in greater detail below.

Figure 5

LAO Proposed Block Grants

- ***Academic Improvement Block Grant ($2.8 Billion).*** Combines 22 programs that support staff development, instructional or curricular support, or class size reduction. Funds would be available for a wide range of general school improvement activities.
- ***Compensatory and Alternative Education Block Grant ($1.8 Billion).*** Combines 19 programs that fund supplemental services for low-performing students or alternative education settings. Funds could only be spent on these two purposes.
- ***Core Services Block Grant ($1.4 Billion).*** Consolidates 12 programs that support basic district and classroom costs, including instructional materials and deferred maintenance. Funds would support any of the services currently allowed under existing programs.
- ***Vocational Education Block Grant ($385 Million).*** Merges five vocational education programs that could be used for career counseling, vocational instruction, and vocational components of integrated academic and vocation programs.
- ***Regional Support Block Grant ($31 Million).*** Consolidates six existing county office administered programs that provide technical assistance or coordination of services. Funds would support regional support services as needed by local districts.

Academic Improvement Block Grant

We recommend the Legislature create an Academic and Instructional Improvement Block Grant that consolidates 22 existing programs and $2.8 billion in Proposition 98 funds.

Our recommended Academic Improvement Block Grant would consolidate a total of $2.8 billion in Proposition 98 funds for 22 programs that support local activities designed to improve student achievement and enhance teacher quality. This includes 18 programs that are part of the Governor's proposed K-12 block grant and 4 programs the budget proposes to fund separately. Included among the 22 programs is K-3 CSR, the School Improvement Program, Summer School (partial), and Staff Development Day Buyout. Figure 6 (see next page) summarizes the 22 programs and the amounts included in the Governor's budget for these programs in 2003-04.

Figure 6

Programs Included in LAO Academic Improvement Block Grant

(In Millions)

Program	2003-04 Governor's Budget
Class Size Reduction, Grades K-3	$1,479.7
School Improvement Program, Grades 1-12	386.0
Core Academic Summer School, Grades K-12[a]	211.0
Staff Development Day Buyout	202.2
Class Size Reduction, Grade 9	97.0
Teaching as a Priority Block Grant	78.0
Peer Assistance and Review	76.6
Beginning Teacher Support and Assessment	75.4
Gifted and Talented	49.8
Mathematics and Reading Professional Development	27.9
Principal Training	26.2
National Board Certification	10.3
Tenth Grade Counseling	10.1
Local Arts Education Partnership Grant	5.7
College Preparation Partnership	4.8
Academic Improvement and Achievement Act	4.8
Advanced Placement Teacher Training	3.2
Intersegmental Staff Development	1.9
Bilingual Teacher Training	1.6
Advanced Placement Fee Waivers	1.4
International Baccalaureate	0.9
Institute for Computer Technology	0.5
Total	**$2,754.8**

a We place core summer school programs in this block grant and remedial summer school programs in the compensatory block grant

Currently, the state has almost two dozen categorical programs designed to either promote general academic achievement or improve teacher quality. Many of these programs restrict district choice to determine how best to improve the educational program. Our proposed block grant would allow districts to select the strategies that are best suited to their local situation—free from constraints imposed by the existing program.

This flexibility is particularly important given the lack of data on the relative effectiveness of particular improvement strategies. For example, research suggests K-3 CSR can, under certain conditions, improve student achievement. These conditions, however, were not widely in place in California when the CSR program was initiated. As a result, the state's $1.5 billion investment in K-3 CSR was much less effective than it could have been. In addition, a growing amount of research suggests that CSR may not be as cost-effective as other strategies for improving academic achievement. By giving districts greater flexibility, we think districts can use state funds more effectively.

We recommend broadly defining the allowable uses of block grant funds. This would allow districts to use funds in the block grant for staff development, school curriculum and instructional support, and schoolwide improvement activities. Allowable uses, for example, range from reducing class size to developing specialized college preparatory programs to having teachers participate in the California Subject Matter Projects.

Accountability Provisions. To track how districts use funds from this block grant, our proposal would require districts to report the amount of funds spent on CSR, staff support and development, and all other improvement activities. These data would allow the state basic information to compare the effectiveness of different academic improvement strategies.

Additional outcome data on schoolwide student performance probably is unnecessary. Existing state testing and school accountability data fulfill this need. Because of the strong link between teacher quality and student success, we think the state should collect outcome data on each district's staff development programs. Figure 7 (see next page) displays four outcome goals and measures that describe district responsibilities for hiring and training teachers: (1) improving the quality of beginning teachers, (2) supporting new teachers in the classroom, (3) involving teachers in high-quality training, and (4) ensuring that training translates into improved student performance.

To simplify these data and make it easier to understand, the Legislature could consider blending these data elements into a single Instructional Performance Index (IPI). In calculating the index, each goal would be weighted equally and school districts would receive an overall performance score. As with the Academic Performance Index, school districts would be ranked, thereby allowing parents more easily to assess the instructional quality of their school compared to other schools.

Figure 7

Elements of LAO Proposed Instructional Performance Index

Performance Goal	Outcome Measure
Enhance beginning-teacher quality.	Percent of new teachers hired with emergency permits or preintern certificates or any teacher working outside of his/her subject area.
Provide effective support to beginning teachers.	Retention rate of beginning teachers.
Involve teachers in high-quality professional development activities.	Percent of teachers participating in high-quality professional development activities consistent with new state standards and federal requirements.
Promote instructional improvements.	Percent of teachers whose average class score on relevant California Standards Tests improved annually.

One benefit to our proposed IPI is that two of the index's four performance goals are the same as the new federal Title II requirements. With the enactment of NCLB, the federal government now requires states to report on the percent of "highly qualified" public-school teachers and the percent of teachers receiving high-quality professional development. By incorporating these outcome measures into the proposed IPI, the teacher-related accountability systems at the state and federal levels would be aligned.

Compensatory and Alternative Education Block Grant

We recommend the Legislature create a Compensatory and Alternative Education Block Grant by consolidating $1.8 billion from 19 existing categorical programs designed to help students who need additional services to be successful in school.

The *2003-04 Governor's Budget* provides a total of $1.8 billion from the General Fund (Proposition 98) for 19 existing categorical programs designed to help students who need additional services to be successful in school. Students served by these programs include low-performing students, English language learner (ELL) pupils, and students with disciplinary problems or who are at risk of dropping out of school. Figure 8 summarizes the 19 programs and the amount included in the *2003-04 Governor's Budget*.

Figure 8

Programs Included in LAO Compensatory and Alternative Education Block Grant

(In Millions)

	2003-04 Governor's Budget
District Programs	
Targeted Instructional Improvement Grant	$662.4
Economic Impact Aid	439.0
Summer School Programs (remedial only)[a]	225.9
English Language Learner Implementation	47.0
California School Age Families Education	43.0
Continuation Schools	35.0
Community Day Schools	28.4
K-4 Intensive Reading	26.9
Miller-Unruh Reading	25.5
Dropout Prevention	19.3
Grade 7-8 Math Academies	11.2
American Indian Education Centers	3.5
Opportunity Programs	2.3
Native American Indian Education	0.5
Healthy Start	—
Subtotal	($1,569.9)
County Programs	
Community Schools	$123.0
Community Day Schools	55.2
Opportunity Programs	7.4
Subtotal	($185.6)
Total	**$1,755.5**

a We place the remedial summer school programs in this block grant and the core summer school programs in the academic improvement block grant.

The 19 programs included in our proposed block grant share the same general goal—improving the achievement of pupils with instructional needs that require a higher level of services or placement in an alternative setting. Of the 19 programs, 16 programs are currently administered by school districts and 3 by county offices. The programs have overlapping missions and may impose rigid program rules on districts. As a consequence, this funding structure unnecessarily restricts district flexibility to serve students most effectively.

The largest of these 19 programs are the Targeted Instructional Improvement Grant (TIIG) program ($662.4 million) and Economic Impact Aid ($439 million). The TIIG program provides grants to school districts to (1) fund any court-ordered desegregation programs in districts that have a court order currently in force and (2) improve instruction for the lowest-achieving students. The Economic Impact Aid program provides formula grants to districts based on the number of students who are poor or have limited English proficiency.

To increase district flexibility over the use of these funds, we recommend the Legislature combine these 19 categorical programs into a Compensatory and Alternative Education Block Grant that would provide extra help to pupils with higher-cost instructional needs. The consolidation of these programs into a block grant would give districts greater flexibility and would help districts coordinate state compensatory programs with the federal Title I program.

Allocation Formula. Consistent with the other four proposed block grants, district allocations would be proportional to the amount provided in 2002-03. Future allocations under this block grant would be distributed using an ADA-based formula. Unlike the other four block grants, however, the formula would base ADA on the number of ELL students, ELL students who were redesignated as proficient in the previous year, and economically disadvantaged pupils. Districts receiving funds from the block grant would be required to first fund the costs of any court-ordered desegregation program, if such an order is in force.

Accountability Provisions. Existing state and federal law already requires districts to report adequate outcome data to measure how well districts are serving the needs of these students. We recommend the Legislature require SDE to compile a performance report on this block grant using the following data:

- ***Academic Progress.*** Progress of low-income and ELL students on the state's standards-aligned tests (including the high school exit examination) would be the primary indicator of academic gains. Gains by ELL students on the California English Language Development Test would be a second indicator.
- ***Dropouts.*** Dropout data should be an indicator of performance for programs supported by the block grant. Although currently unreliable, with the implementation of a statewide student-level data base, we expect this data to improve significantly in the future.

- ***Truancy.*** Truancy is another important indicator of districts' ability to promote the educational success of at-risk students.
- ***Students Attending Alternative Schools.*** The SDE also should track the number of students served in alternative schools. These data would assist the state in tracking the number of students who are served outside regular K-12 schools.

Core Services Block Grant

We recommend the Legislature create a Core Services Block Grant by consolidating 12 programs to provide $1.4 billion in support for the basic district and classroom costs of K-12 education.

The *2003-04 Governor's Budget* proposes to spend $1.3 billion for 12 categorical programs and reimbursement for 36 state-mandated local programs that generally support basic district and classroom expenses. For instance, the instructional materials program funds the purchase of textbooks and other instructional materials needed by classroom teachers. Instructional materials constitute a core element in the resources needed by each classroom. While funds for these core activities could be added to district revenue limits, there are also legitimate concerns about whether districts are sufficiently accountable for these activities.

We propose to merge these core programs into one block grant that could be used for any of the basic district and school services that currently are allowed under the separate programs. Figure 9 (see next page) lists the programs that we recommend for the Core Services Block Grant and the funding levels proposed in the Governor's budget for those programs in 2003-04. We also add $95 million above the level in the proposed budget for K-12 mandates in order to bring annual funding more closely in line with the ongoing costs of current mandates. This brings the total block grant amount to $1.4 billion.

Accountability Provisions. Measuring outcomes for several of these programs is impractical. Gauging the adequacy of a district's major maintenance program, for instance, requires examining district maintenance logs. Similarly, assessing whether students have adequate instructional materials requires visiting classrooms and evaluating whether the supply and quality of materials is sufficient. Therefore, we recommend the Legislature require districts to report expenditures on instructional materials, major maintenance, and school library materials. The SDE performance report on the Core Services Block Grant would compare district expenditures to a reasonable standard for the level of services needed by students in these areas.

Figure 9

Programs Included in LAO Core Services Block Grant

(In Millions)

Program	2003-04 Governor's Budget
Home-to-School Transportation	$467.3
Instructional Materials Block Grant	204.5
Mandates	198.9
Deferred Maintenance	181.0
Meals for Needy Pupils	116.4
School Safety	84.8
Child Nutrition	71.6
Year Round Schools	56.3
School Library Materials	20.4
School Law Enforcement Partnership	13.1
Pupil Residency Verification	0.1
Teacher Dismissal Grants	—[a]
Total	**$1,414.6**

[a] Less than $100,000.

Outcome data, however, would be useful in two areas. The percentage of low-income students who receive subsidized meals would provide a direct measure of district efforts in this area. In addition, data required by federal law on student expulsions and suspension would summarize this aspect of the school environment.

Include Mandates in the Block Grant. We include reimbursement for school district mandates in the Core Services Block Grant to create district incentives to reduce mandate-related costs and distribute mandate reimbursement more fairly. The budget's proposed categorical block grant does not contain K-12 mandate funding. Instead, the Governor provides $110.4 million as a separate budget item.

Under our proposal, we add a total of $199 million for the school district share of mandate funding in the Core Services Block Grant. This amount includes $104 million budgeted for district mandates plus an additional $95 million we propose to add in order to more closely align state funding and actual district costs in the budget year (the COE share would remain separately budgeted). Mandate funds would be distributed in the block grant to each district based on a uniform amount per ADA. First call on the block grant funds would be to cover the costs associated with meeting the requirements of the specified mandates. If district costs exceeded the amount included in the block grant for mandate reimbursements, a district would have access to other funds in the block grant to satisfy those costs.

For additional information on this proposal, please see our analysis of K-12 mandates later in this chapter.

Vocational Education Block Grant

We recommend the Legislature create a Vocational Education Block Grant that consolidates five existing vocational education programs and $385 million in Proposition 98 funds.

The budget proposes to spend $385 million in Proposition 98 funds for five vocational education programs which we would consolidate into a new block grant. Of this amount, funding for ROC/Ps accounts for $342 million (89 percent) of the total. Figure 10 summarizes these programs and the amounts included in the Governor's budget.

Figure 10

Programs Included in LAO Vocational Education Block Grant

(In Millions)

Program	2003-04 Governor's Budget
Regional Occupational Centers and Programs	$342.3
Partnership Academies	20.3
Apprentice Programs	14.0
Specialized Secondary	4.5
Agricultural Vocational Education	3.8
Total	**$384.9**

We propose to protect funding for vocational education because there are few existing mechanisms to hold schools and districts accountable for career preparation. State graduation requirements and academic accountability programs have reduced district focus on career preparation and the time available to students to take vocational classes. The result is that students may be missing opportunities to obtain knowledge and skills that would help them find higher-paying jobs upon graduation.

Our 1994 report *School-to-Work Transition* identified several problems that result from an increased focus on academic preparation:

- ***Many Students Have No Clear Education Objective.*** A 1992 SDE survey revealed that more than one-quarter of high school students had no educational goals. The survey showed that about 70 percent of students were preparing for college and 3.4 percent identified their program goals as vocational.
- ***Students Receive Little Career Guidance and Counseling.*** The SDE survey also reported that half of high school seniors who had taken a vocational course received no career counseling during high school.
- ***ROC/Ps Serve Significant Numbers of Adult Students.*** Since fewer K-12 students were taking vocational classes, ROC / Ps enrolled greater numbers of adults in local job training programs. By 1993, half of ROC / P services were provided to adult students. Comparable data for more recent years was not available from SDE.

These problems suggest that schools are not meeting the career preparation needs of many K-12 students. The responsibility for helping students plan and achieve their educational goals begins in high school. Without adequate counseling and assistance in course scheduling, large numbers of students who are planning to work upon graduation will fail to obtain the vocational courses that could provide an advantage in the job market. While our report is almost a decade old, we believe the attention to career issues in California has not improved and may have worsened.

For these reasons, we propose the Vocational Education Block Grant as a means for the Legislature to increase district accountability for career preparation. Districts could spend these funds on any vocational activity—including career counseling and course placement activities, direct vocational training, and vocational components of programs like Partnership Academies. Holding districts accountable for vocational education—and providing funds for district programs—is an important step for improving career preparation in California.

Since the bulk of funding in the block grant is currently provided through ROC/Ps, a transition period—similar to what we describe earlier regarding county office services—would be needed. As discussed above, our proposal shifts to districts state funds currently appropriated to county office and joint-powers ROC/Ps. Our goal is not to eliminate ROC/Ps—we think they would remain a key part of the service delivery system—but to focus responsibility on districts and give them flexible resources to address student needs. The three-year compacts we describe as part of the transition process would allow the needed district planning to occur and give ROC/Ps an opportunity to revamp programs as necessary.

Accountability Provisions. Collecting the ideal outcome data on vocational programs is expensive because of the difficulty of tracking the work experience of high school graduates. For this reason, we suggest using both expenditure and outcome data to measure district performance in the vocational area. Expenditure data would include amounts spent on counseling, vocational classes, and other vocational support costs. Districts also would report the percent of funds dedicated to services provided to adults.

Several existing outcome measures would provide useful information in evaluating vocational programs. State test scores of students who take several vocational courses would reinforce the importance of academic success as a foundation for future success. The state could also collect data on the quality of students' work experience during school and the summer months. In the long run, data on employment rates and wages of high school graduates would provide the most meaningful assessment of local vocational programs. The SDE advises that it currently is discussing ways to capture this type of data in the future.

Regional Support Block Grant

We recommend the Legislature create a Regional Support Block Grant by consolidating six categorical programs that provide $31 million to county offices of education for technical assistance services to school districts.

The budget's categorical proposal includes $31.1 million for six programs that COEs administer to provide technical assistance and coordination of services to districts. The programs focus primarily on staff development and education technology. We recommend consolidating these six programs into a Regional Support Block Grant, as shown in Figure 11 (see next page). (The amount shown for the Beginning Teacher Support Program represents the program's base administrative support cost; actual training costs of the program have been included in the Academic Improvement Block Grant.)

Figure 11

Programs Included in LAO County Support Block Grant

(In Millions)

Program	2003-04 Governor's Budget
Education Technology	$13.9
Teacher Recruitment Centers	8.3
Administrator Training	4.7
Beginning Teacher (base funding)	2.2
Early Intervention for School Success	1.9
Civic Education	0.2
Total	**$31.2**

In administering these six programs, COEs fulfill a state-level function of providing information on best practices and ensuring that districts can obtain needed staff development providers. Because COEs establish ongoing relationships with districts, counties are better positioned than the state to know what types of services and providers would be most useful to districts.

By funding separate categorical programs to support this county office infrastructure, however, the state misses the opportunity to take advantage of these relationships in determining what mix of services would be most helpful to districts. For instance, some parts of the state may have a sufficient supply of teachers, but have a pressing need for help in creating effective parent participation programs. Because none of the six existing programs targets parent participation, counties have no resources to help districts meet this need. Thus, the existing framework of dedicated categorical funds limits the ability of COEs to respond to local needs.

Our proposal would distribute funds to the 11 county office regions to align the provision of services with other regionally delivered services (such as federally funded assistance to low-performing schools) and to take advantage of the economies of scale that regionalized services offers. County offices and school districts would develop regional three-year compacts that would describe district needs in the region and the use of funds. These compacts would require district approval of the regional spending plans.

Accountability Provisions. The design of this block grant creates accountability for the regional infrastructure system by giving districts a voice in the services provided with block grant funds. As a consequence, if district participation works as intended, there is no need for additional accountability measures. The Legislature, however, may want to monitor the use of funds over time to gain an understanding of district technical assistance needs in different regions of the state. In addition, SDE could annually survey a sample of districts to gauge satisfaction levels in the types of services provided through this block grant.

Information Needed on Proposed Staff Reductions

We withhold recommendation on the Governor's proposal to delete 97 positions and $6.7 million from the state Department of Education (SDE) pending a more accurate accounting of the actual positions to be cut and additional information on the implications of the reduction. We recommend the Legislature ask the Department of Finance and SDE to provide this information prior to budget hearings.

The Governor's budget proposes to cut 97 positions from SDE as a result of the elimination of programs included within the administration's categorical block grant proposal. The Governor's budget assumes this would generate $6.7 million in General Fund savings. This reduction would be in addition to the 82 positions proposed for elimination as a result of the child care realignment and a total of 29 positions cut for various other reasons.

We are unable to determine the appropriateness of the Governor's proposed state operations reductions associated with the categorical block grant reform for two reasons. First, DOF has been unable to justify neither the magnitude of the proposed reductions, nor the rationale for cutting specific positions. Second, although SDE has raised serious concerns about the Governor's proposal, it was unable, as of this writing, to provide an alternative proposal or document the likely implications of the Governor's proposed reductions.

Given this lack of clarity on the technical aspects of the Governor's proposal as well as appropriate alternatives, we recommend the Legislature ask DOF and SDE to provide additional information prior to budget hearings.

Although SDE had not yet documented the implications of the proposed reductions as of the time of this writing, it had identified at least two types of technical problems in the Governor's state operations proposal. In addition to these technical issues, we have two other potential concerns with the Governor's proposal as discussed in more detail below.

Technical Problem—Eliminating Federally Funded Positions. One technical problem with the Governor's budget proposal is that it cuts General Fund dollars when it eliminates federally funded positions. Obviously, eliminating a federally funded position does not yield General Fund savings. For example, the Governor's budget proposes to eliminate several positions within the Professional Development and Curriculum Support division even though the positions currently are not supported with state General Fund monies.

Technical Problem—Eliminating Positions When Duties Remain. Another major problem with the proposal is that it eliminates positions whose duties are unaffected by the proposed block grant. For example, the Governor's budget proposes to cut 62.5 positions from the Professional Development and Curriculum Support division, thereby eliminating the entire division. The department's initial review, however, identifies only 16 of the 62.5 positions in this division as working on programs included in the block grant. Under the Governor's proposal, this division would retain responsibility for administering both the Mathematics and Reading Professional Development program and the Principal Training program (which would receive a tenfold increase in funding in the budget year). This division also would retain numerous federally related responsibilities, including: (1) administering more than $330 million in federal Title II funds; (2) reporting on the state's ability to meet the new federal requirements regarding teachers and paraprofessionals; (3) monitoring school districts' efforts to hire, train, and retain highly qualified teachers; and (4) providing technical assistance to school districts in selecting and implementing high-quality professional development programs.

Potential Concern—Maintaining Data Collection Efforts. The SDE is involved in various data collection efforts of vital interest to both the state and federal governments. In evaluating the proposed reductions, the Legislature should ensure that these critical functions are not undermined. To date, it is unclear how the Governor's proposed reductions would affect these efforts.

Potential Concern—Future Role of SDE. The Governor's budget does not include a plan for managing the transition from a categorical to a block grant environment. The budget assumes SDE has no oversight or technical assistance role under categorical reform. As we discuss above, we believe the department has an important part to play even if most categorical programs became part of a block grant system. In addition, the Governor's budget does not confront some basic transitional issues likely to emerge during the budget year. For example, the proposal eliminates several positions related to multiyear audits the department has not yet completed.

For all these reasons, we withhold recommendation on the state operations portion of the proposal pending further information from DOF and SDE on the justification for and implication of the proposed reductions.

Proposition 98 Mandates

We recommend that the Legislature increase funding for Proposition 98 mandates by $100 million and include $199 million for school district mandates in our proposed Core Services Block Grant. This would create school district incentives to reduce mandate-related costs and distribute mandate reimbursements more fairly.

The proposed categorical block grant does not contain any Proposition 98 mandates. Instead, the Governor provides $110 million as a separate budget item. We recommend that the Legislature increase this funding by $100 million, for a total of $210 million to be allocated as follows: (1) include $199 million for K-12 mandates in our proposed Core Services Block Grant and (2) retain $10 million outside the block grant to be used by county offices of education (COEs). The remaining $1 million would not be allocated because we recommend repealing the mandate for physical fitness testing in the "Assessments" section of this chapter.

Background

Voters approved Proposition 4 (the Gann Limit) in 1979. One of the components of this measure generally requires the state to reimburse local agencies for costs incurred in carrying out new programs or higher levels of services that are mandated by the state. The Commission on State Mandates is responsible for determining whether a statute creates a state-reimbursable mandate. If the commission so determines, it develops an estimate of the statewide cost of the mandate. There are 36 mandates in the 2003-04 budget for which school districts and COEs can receive reimbursements.

Problems With Mandates

Although the state mandate requirements provide an important "check" on the power of the state to impose new programs on local governments, the administrative process for claiming reimbursements has many shortcomings:

Mandates Are Costly. The Governor provides $110 million for budget-year costs of education-related mandates, and proposes to defer payment of unfunded mandate costs from prior years and a portion of the ongoing costs of existing mandates. The amount budgeted for K-12 mandates has been historically underfunded. The state's education mandate liabilities through the budget year total somewhat over $1 billion.

No Incentive to Minimize Costs. Since local education agencies receive full reimbursement from the state for costs of implementing mandate requirements, they have little incentive to manage costs and implement requirements efficiently. There has also been concern of overclaiming by school districts. A sample of claims reviewed by the State Controller's Office suggests that school districts cannot substantiate over half of the claims surveyed.

Costs to Administer Mandates Vary Widely. The average amount claimed by school districts for all education mandates was $29 per average daily attendance (ADA) per year from 1998-99 through 2000-01. The amount claimed, however, varied widely from district to district. Figure 1 shows that about 88 percent of districts claimed zero to $50 per ADA per year, but a few outliers claimed over $300 per ADA.

Figure 1

School District Claims Per ADA for Proposition 98 Mandates

1998-99 Through 2000-01

Average Amount Per Year[a]	Number of Districts
$0-$25	618
$26-$50	252
$51-$100	84
$101-$200	23
$201-$300	5
Above $300	3
Total	**985**

[a] Claims do not reflect amounts actually reimbursed by the state.

Administrative Burden. From both the state's and local's perspective, the mandate reimbursement process is time-consuming and costly. Claiming instructions and reimbursement forms are lengthy and intricate, generating paperwork and additional state costs. One fact suggest-ing this burden: Our review of claims data indicates that about 60 districts did not submit any mandate claims from 1998-99 through 2000-01.

Benefits of Placing Mandates in a Block Grant

To address the shortcomings mentioned above, we recommend increasing funding for mandates by $100 million to better represent budget-year costs and including all mandate funding for school districts in our Core Services Block Grant. (Please see the preceding piece on categorical reform.) There are several advantages to such an approach. First, since school districts could redirect any savings from mandate implementation to other education purposes permitted by the block grant, they would have an incentive to meet the requirements of the mandates in a cost-effective manner. This means that more funds could be devoted to direct pupil services. Second, our recommended approach eliminates existing incentives to maximize claims, a process that contributes to the high level of state costs. Third, school districts' administrative costs would decrease because there would no longer be a need for the labor-intensive tracking and claiming process. Finally, districts would have an incentive to share information regarding which mandates appear, from their perspective, to no longer be cost effective. This information would help the Legislature to periodically reassess the need for certain education mandates.

How Mandates Would Work in a Block Grant

School districts currently claim about 95 percent of mandate costs while COEs claim about 5 percent. Under our proposal, 95 percent of mandate funding would be included in the Core Services Block Grant to be used by school districts ($199 million), and 5 percent would remain outside the block grant to be used by COEs ($10 million). The first call on the block grant funds would be to cover the costs associated with meeting the requirements of the specified mandates. The mandate funding included in the Governor's budget would be distributed in the block grant to each district based on a uniform amount per ADA. Based on our proposed funding level of $199 million, the amount per ADA for school districts would be $33.65.

Under this proposal, school districts would not be required to submit any reimbursement forms. Districts that spend less than the per-ADA amount could use the excess funds for other educational activities permitted by the block grant. In contrast, districts that spend more than the per-ADA amount would have access to other funds included in the block grant. We believe that this approach would create strong incentives for school districts to economize on mandates.

The Legislature would integrate new mandates into the Core Services Block Grant in the future. After a new mandate is established and the Commission on State Mandates has calculated an estimated ongoing cost, the budget would include that amount in the Core Services Block Grant on a per-ADA basis. (The Legislature would still be obligated to pay for the prior-year claims of new mandates through the mandates claims bill.) Similarly, the proposal would not affect past-year deficiencies that remain to be paid in future years. The Legislature will need to satisfy these claims at some point in the future.

Revenue Limits and Discretionary Funds

We recommend that the Legislature not fund revenue limit equalization as proposed by the Governor ($250 million), in light of the state's fiscal situation and increased flexibility generated by the categorical block grant. We also recommend that the Legislature delay revenue limit equalization until a year when Proposition 98 can fund growth, cost-of-living adjustments (COLAs), and pay off any remaining deferrals. We further recommend that the Legislature not create a deficit factor if it does not fund the statutory COLA.

Revenue limit spending, which is funded by local property taxes and the state General Fund, is the chief source of discretionary monies for school districts. Each year, revenue limits are increased to compensate for enrollment growth and COLAs. For 2003-04, the Governor's budget provides $322 million to compensate for 1 percent enrollment growth, but does not provide the statutory COLA of 1.55 percent, which would have totaled $441 million.

Do Not Create "Deficit Factor." In past years when the state did not fully fund the statutory COLA, the Legislature created a deficit factor which obligated the Legislature to restore the COLA at a future date. If the Legislature does not fund the COLA, we recommend that a deficit factor not be created. This would give the Legislature more flexibility to spend funds in future years yet would still permit the Legislature to restore the COLA if it wished to do so.

Delay Funding for Equalization. Despite not having sufficient funding for the COLA, the Governor provides $250 million for revenue limit equalization in the budget year. This amount exceeds by $47 million the $203 million that has already been appropriated for 2003-04 by Chapter 1167, Statutes of 2002 (AB 2781, Oropeza). In past years, we have argued in favor of revenue limit equalization because: (1) historic differences in revenue limit funding levels had no linkage to underlying cost factors and (2) it provided general purpose funding for school districts to improve academic achievement. Given the state's fiscal situation in 2003-04 and the increased flexibility generated by the proposed $5.1 billion categorical block grant, we recommend that the Legislature delay funding revenue limit equalization to future years. Specifically, we recommend that revenue limit equalization have first call on future Proposition 98 growth after the costs of enrollment, COLAs, and any remaining deferrals are addressed.

Budget Increases Discretionary Funds. Figure 1 shows general purpose funding as a percent of total K-12 Proposition 98 funding. It shows that the proportion of discretionary funds declined in the 1990s, but has been rising since 2000-01. In 2003-04, the proportion of discretionary funds increases dramatically—from 70.4 percent to 84.4 percent—due to the new categorical block grant, which we consider discretionary because of limited restrictions on the use of the funds. Given the fiscal situation districts face, creating this additional discretionary authority could help dis-

Figure 1

General Purpose Funds as Share of K-12 Proposition 98

1988-89 Through 2003-04
(Dollars in Billions)

Year	K-12 Proposition 98	General	
		Amount[a]	Percent of Total
1988-89	$17.3	$13.3	77.0%
1989-90	18.8	14.4	76.7
1990-91	18.7	15.5	82.9
1991-92	21.0	15.8	75.1
1992-93	20.6	15.7	76.3
1993-94	21.3	15.9	74.6
1994-95	22.7	16.7	73.6
1995-96	25.0	18.0	72.1
1996-97	27.0	19.6	72.5
1997-98	29.5	20.6	69.9
1998-99	32.0	21.8	68.2
1999-00	35.8	23.5	65.7
2000-01	38.5	26.0	67.5
2001-02	38.8	27.3	70.4
2002-03 revised	39.4	27.7	70.4
2003-04 proposed	40.0	33.8	84.4

a Includes revenue limit funding, charter school block grant, school site block grant (one-time 1999-00), special education settlement (one-time 1999-00), and categorical block grant (2003-04).

tricts focus on individual priorities and mitigate the impact of receiving neither a COLA nor new revenue limit equalization funding. Providing this local discretion over spending is also essential in the context of the state's new accountability framework. The accountability framework constructed by the Governor and the Legislature puts in place a means for assessing desired educational outcomes and creating incentives for achieving them. To maximize the chances for improving educational results, the state must give school sites flexibility to fit budgetary resources to local circumstances and needs.

BASIC AID DISTRICTS

Reduction to Basic Aid Payments

We recommend the Legislature approve the Governor's proposal to reduce basic aid payments by $15.3 million in 2002-03 and eliminate them entirely in 2003-04 for a savings of $17.8 million.

The Governor's budget proposes to eliminate basic aid payments over the two-year period from 2002-03 to 2003-04. In 2002-03, the budget would reduce basic aid payments by $15.3 million or 86 percent. In 2003-04, the proposed budget would end all basic aid payments, saving $17.8 million. According to the Department of Finance (DOF), this reduction is consistent with the Governor's proposal to reduce district revenue limit payments by 2.15 percent and is designed to help the state reduce expenditures to stay within the minimum Proposition 98 funding guarantee.

The California Constitution requires the state to apportion at least $120 per student (or for really small districts, a total of $2,400). For most districts, state funding for each district's general purpose grant (known as a revenue limit) far exceeds the Constitutional minimum. For a small number of districts, the revenue limit funding entitlement is met entirely with local property tax funds. However, the state provides funds above the level of the district revenue limit as means of meeting the $120 per student minimum. These additional funds are known as basic aid. In 2001-02, 82 districts received basic aid. There are two types of basic aid districts:

- ***"Excess" Tax districts***. These districts receive more local property taxes than is needed to fully fund district revenue limits. In 2001-02, there were 60 excess tax districts.
- ***"Not Quite" Excess Tax Districts***. These districts receive slightly less in property tax revenues than is needed to fully fund district revenue limits. In 2001-02, 22 districts received state general purpose funding of $120 per student—a portion of which came in the form of revenue limit payments and the remainder as basic aid.

The budget proposal assumes that any type of state aid—including categorical funding—satisfies the constitutional requirement for $120 in state funds. Only if a district did not receive the minimum from the combined sources of categorical and revenue limit funds would the state be obligated to supply the difference. According to DOF, no districts receive less than the required amount when all state funding sources are considered.

We recommended eliminating basic aid payments in our *Analysis of the 1997-98 Budget Bill* because the funds exacerbate wealth-related disparities in general purpose funding. Consequently, this proposal would save Proposition 98 funds and contribute to the Legislature's long-term effort to equalize district revenue limits. For these reasons, we recommend approval.

Funding Reductions to Excess-Tax Basic Aid Districts

We recommend the Legislature revise the Governor's budget proposal to recapture $150 million in excess tax revenues from basic aid districts and, instead, cap excess taxes at the levels received in 2000-01.

The Governor's budget proposes to reduce the General Fund cost of Proposition 98 in 2003-04 by recapturing $150 million in property tax revenues from excess tax K-12 school districts. As discussed above, if local property tax receipts exceed the amount needed to fund school district revenue limits, districts are permitted to keep the excess revenues to spend as they wish.

Recapture of Excess Taxes. The Governor's budget projects that excess tax districts will receive $161 million in excess revenues in 2003-04. Of that amount, the budget would recapture $150 million, or 93 percent, by redirecting the tax receipts to other school districts, county offices of education, and community colleges. This recapture of excess taxes would reduce funding available to the 60 excess tax school districts by $150 million.

State Should Cap Excess Tax Revenues. The 60 districts' excess tax averaged about $1,200 per student in 2001-02, although the amount ranged from $1.60 per student to about $13,000 per student. When added to the district revenue limit, general purpose funding in the highest funded district was almost $20,000 per student compared to the statewide average revenue limit of about $4,650 in 2001-02.

Excess taxes also appear to be increasing rapidly. Figure 1 shows the recent increase in the excess property tax, and the DOF projected increases. The total amount of excess taxes increased by 56 percent in 2001-02, reaching $148 million. The rapid increase resulted primarily from escalating property values and high turnover rates of property in certain parts of the state. The budget projects growth in 2002-03 and 2003-04 of about

4 percent in each year. Given the continuing increases in property values and high turnover rates, we anticipate excess tax collections will be higher than reflected in the budget.

Figure 1

K-12 Excess Tax Revenues

(Dollars in Millions)

Fiscal year	Amount	Percent change
2000-01 actual	$94.7	—
2001-02 estimated	147.8	56.1%
2002-03 projected	153.3	3.7
2003-04 projected	160.1	4.4

Excess taxes exacerbate the problem of unequal general purpose funding levels among districts. While relatively few in number, districts receiving large amounts of excess taxes are able to afford programs and services for their students that are out of reach for other districts. From our perspective, there are few policy reasons that justify allowing such large amount of revenues to benefit these districts.

Recapturing 93 percent of all projected excess taxes, however, would create severe disruption in districts with large amounts of excess tax receipts. Reducing funding levels for many of the excess tax districts by the amounts proposed would result in far greater reductions than those imposed on all other districts. As noted above, the average excess tax district receives $1,200 per student in additional general purpose funds. If 93 percent of this funding were recaptured (as proposed by the Governor), it would represent an $1,100, or about 20 percent, reduction in general purpose funding for these districts. For a few districts, the proposal represents more than a 50 percent reduction in general purpose funding.

Because of the disparate impact these reductions would visit on these districts, we do not recommend approval of the proposal as outlined in the Governor's budget. We agree, though, that it is appropriate to reduce the amount of excess taxes that the 60 districts would be permitted to keep as general purpose funding.

Therefore, we recommend the Legislature place a cap on the amount of excess taxes districts can keep as general purpose funds in 2003-04. Tax receipts above that level would be redistributed to other K-12 agencies and community colleges within the same county, as proposed in the budget. We suggest the Legislature set the cap at the amount of excess taxes distributed to districts in 2000-01. This would result in a savings of about $65 million in 2003-04. (The savings could be larger if the growth in excess taxes is greater than projected by DOF.)

Recapturing these amounts probably would not significantly harm districts. The level of excess taxes depends on a number of factors, including growth in total property taxes, student enrollment, and revenue limits. Because of these variables, districts are unable to depend on large increases in excess taxes as part of the budget planning process. For this reason, we believe it is unlikely that the rapid increase in 2001-02 property tax revenues has been fully incorporated into base districts budgets in 2002-03. In this event, districts could use savings from 2001-02 and 2002-03 to offset reductions resulting from the cap in 2003-04 and future years.

In summary, we think the concept of limiting districts that receive significant amounts of excess taxes has value. Limits, however, should be imposed in a way that does not unduly punish districts for the fact that, in the past, the state allowed excess tax districts to keep the additional revenues. If the DOF estimates are correct, our recommendation will require the Legislature to make $85 million in reductions elsewhere in the state budget.

Class Size Reduction

In 1996, the state established the K-3 Class Size Reduction (CSR) program. In 1996-97, the state provided $971 million in incentive funding for school districts voluntarily to reduce K-3 classes to 20 students per class. By 2002-03, funding for this program had grown to $1.7 billion—making it one of the most costly categorical programs in the state and the largest CSR program in the nation.

Program Intended to Improve Student Achievement. When California designed its CSR program, considerable research already had been conducted demonstrating that CSR could improve student achievement. The now famous Tennessee Student-Teacher Achievement Ration (STAR) project, and subsequent research, already had arrived at three central conclusions: (1) students in smaller K-3 classes performed better than students in larger classes; (2) students in smaller K-3 classes retained their achievement gains in grades four, six, and eight; and (3) minority and inner-city children gained the most from smaller classes—experiencing effects that were two to three times greater than the effect on other students. These findings helped motivate California to establish its own CSR program.

Research Has Since Emphasized the Importance of Integrating CSR Efforts With Broader Reforms. Since the mid-1980s, 20 states have established CSR programs—providing additional opportunities for researchers to examine the effects of CSR on student achievement. Program evaluations in Utah, Texas, North Carolina, and Wisconsin have concluded that CSR is most successful when states gradually phase in the program and combine smaller classes with teacher development initiatives. Wisconsin has conducted the most extensive and methodologically sound CSR evaluation. In 1996-97, Wisconsin created a statewide pilot CSR program targeting schools with high poverty rates. The program was phased in over five years and required K-3 classes be reduced to 15 students per class. In addition to reducing class sizes, participating schools were required to implement a rigorous academic curriculum, provide before-and-after school activities, implement professional development, and adhere to accountability plans. As with Tennessee's program, the Wisconsin evaluation found significant achievement gains, particularly among minority students.

California Implemented Large-Scale CSR Program Almost Overnight. Unlike the Tennessee and Wisconsin programs, California rapidly implemented its CSR program in all schools at one time. Schools began reducing class sizes only a couple months after the legislation was passed and, by the next year, almost all first grade and second grade classes in the state had been reduced to 20 students. By 1999-00, almost all K-3 classes had been reduced.

Evaluation of CSR Program Conducted. Although California took a different approach than Tennessee and Wisconsin in implementing its CSR program, it did contract for a scientific evaluation of its program. Like other states' evaluations, its primary purpose was to determine whether California's CSR program was effective in improving student achievement and to identify possible program enhancements. The state contracted with a group of researchers, known as the CSR Research Consortium, to conduct the evaluation. The consortium submitted its final evaluation in September 2002. In addition to this evaluation, the Public Policy Institute of California (PPIC) released the results of an independently conducted study in June 2002.

Evaluations Uncover Three Major Findings

The CSR Consortium evaluation and PPIC study uncovered three major findings.

Effect of CSR on Student Achievement Inconclusive. The CSR Consortium was unable to reach definitive conclusions about the effect of CSR on student achievement because of California's decision to implement the program across all schools at one time. Although the Consortium found that test scores did improve in California during the late 1990s, it could not attribute this improvement to CSR. This is because it did not have access to two systematically distinct groups of students—those exposed to CSR and those not exposed to CSR—and it could not control for other reform efforts that might have contributed to achievement gains. The Consortium only could conclude that CSR might have contributed to small achievement gains among third grade students. For example, it found the percentage of third grade students scoring above the national median on reading, spelling, language, and mathematics tests was 2 percent to 3 percent higher in the typical reduced-size class compared to the typical non-reduced-size class.

California's CSR Program Contributed to Decline in Teacher Quality. The implementation of CSR generated the need for many more K-3 teachers. Between 1995-96 (one year before CSR implementation) and 1998-99 (the third year of the CSR program), the total number of K-3 teachers increased by 28,886, or 46 percent. To meet the increased demand for K-3 teachers, many districts hired teachers who were not highly qualified (that is, they were not fully trained in subject matter and pedagogy or they lacked sufficient teaching experience). As a result of California's rapid and universal implementation of CSR, the percentage of K-3 teachers who were not fully credentialed increased from less than 2 percent before the program started to 14 percent in the third year of the program. The Consortium also found that the percentage of fourth and fifth grade teachers without full credentials increased significantly—from less than 2 percent in the year prior to the program to 15 percent in the third year of the program. Middle and high schools also experienced similar increases in the percentage of teachers not highly qualified.

California's CSR Program Generated Inequitable Distribution of Fully Qualified Teachers. California's implementation of CSR had a disproportionately adverse impact on disadvantaged schools because these schools had the most difficult time hiring fully credentialed teachers. Before CSR implementation, almost all California teachers held full credentials. Thus, little difference existed among schools in the percentage of K-3 teachers who were not fully credentialed. Even in the state's most disadvantaged schools, fewer than 4 percent of K-3 teachers were not fully credentialed. The state's CSR program changed this dramatically. By the third year of the CSR program, more than 21 percent of K-3 teachers were not fully credentialed in the lowest income schools whereas only 4.3 percent of K-3 teachers were not fully credentialed in the highest income schools.

Bottom Line—Any Positive Impact of Smaller Classes Likely to Be Offset by Deterioration in Teacher Qualifications. The results of the PPIC study confirmed and enhanced the Consortium's findings. Similar to the Consortium, PPIC also found that reduced-size classes were associated with small achievement gains. The PPIC, however, was able to measure the offsetting effects of having a new, less experienced teacher in a reduced-size class. It found that having a first-year or second-year teacher in the classroom essentially eviscerates any achievement gain likely to result from a smaller class size. Moreover, it found that certain groups of students were much more likely to be taught by inexperienced teachers, which offset the achievement gains possible from smaller classes. In short, many students, particularly those in the most disadvantaged schools, were likely to experience no net benefit from California's costly CSR program.

Three Policy Lessons for Developing Future Education Reforms

The Consortium and PPIC's research findings offer three policy lessons. The Legislature might consider these lessons when devising improvements for the CSR program and developing future education reforms.

- ***Focus Future Reforms on Schools With Greatest Need.*** Had the state first focused its CSR efforts in the types of schools prior research had indicated were most likely to benefit from reduced-size classes, it could have helped to attract highly qualified teachers to low-income schools. Indeed, rather than hurting the schools it had intended most to help, it perhaps could have improved teacher quality in these schools. The state's future reform efforts should offer schools with the greatest need the first opportunity to participate.
- ***Phase in Future Reforms.*** California's experience in the initial years of its CSR program vividly illustrates the possible dangers of rapidly implementing such large-scale education reforms. Had the state phased in the K-3 CSR program, it could have prevented some of the perverse outcomes that resulted, such as the decline in teacher quality in already disadvantaged schools. When applicable, future reforms should be phased in and implemented in only a subset of schools each year, starting with schools serving the reform's target population.
- ***Provide More Local Flexibility.*** Both the Consortium and PPIC note that the state's CSR program does not provide schools with much flexibility. The enacting legislation requires that all participating classes not exceed 20 students per class. This requirement has led to some adverse consequences, such as busing children to other schools in the district or creating combination classes—even when teachers and parents think these actions would be deleterious for students. As we have noted in prior analyses, more local flexibility would: (1) help districts minimize these counterproductive effects and (2) provide districts and/or the state the opportunity to garner some fiscal savings over the next couple years.

Include K-3 CSR Program in New Academic and Instructional Improvement Block Grant

We recommend the Legislature include the K-3 Class Size Reduction (CSR) program in a new Academic and Instructional Improvement Block Grant. Placing the K-3 CSR program in a block grant would allow districts greater flexibility to select the academic and instructional improvement strategies that best address local needs. It also would enhance accountability by: (1) requiring districts to report relevant fiscal

data to the State Department of Education, (2) creating a measure of districts' instructional improvement, and (3) tracking both academic and instructional performance.

The Governor's budget proposes to consolidate 58 existing education programs into a single categorical block grant, but it retains the K-3 CSR program as a separately funded categorical program. Earlier in this chapter, we recommend the Legislature create five block grants. One of these block grants would consolidate 22 existing academic and instructional programs, including the K-3 CSR program.

Academic and Instructional Improvement Block Grant Would Enhance Flexibility. In our categorical piece, we detail the potential benefits of allowing districts to use improvement strategies that best address local needs rather than having to use state-dictated strategies that might not be well suited for particular local contexts. We argue that this flexibility is particularly important given the lack of data on the relative effectiveness of particular improvement strategies. Although research suggests that K-3 CSR, under certain conditions, can improve student achievement, research has not yet been able to compare the relative cost-effectiveness of K-3 CSR compared to other reform efforts, such as high quality subject-based professional development programs, comprehensive support programs for inexperienced teachers, or specialized one-on-one reading programs for struggling K-3 students.

Block Grant Would Not Sacrifice Accountability. In our categorical piece, we argue that block grants can be structured so that local discretion is increased without sacrificing accountability. We recommend that school districts provide expenditure data to the State Department of Education (SDE) and identify the types of strategies they are using to improve performance. For the Academic and Instructional Improvement block grant, we suggest several outcome measures the Legislature might use to assess teacher performance. These performance indicators might include measures of school districts' ability to hire qualified teachers, retain competent teachers, and involve veteran teachers in high quality professional development programs.

Option—Create Pilot Program to Compare Cost-Effectiveness of CSR and Teacher Initiatives

If the Legislature retains a separate K-3 Class Size Reduction (CSR) program, we recommend it: (1) establish a pilot program to compare the cost-effectiveness of various CSR and teacher initiatives; (2) allow school districts voluntarily to participate in the program, in which they could use existing K-3 CSR funds to implement one of several allowable educational reforms; and (3) designate $500,000 in federal Title VI funds

for the State Department of Education to conduct the evaluation of the various reform options.

If the Legislature chooses to retain K-3 CSR as a separately funded categorical program, we suggest it create a pilot program that would allow districts to use existing K-3 CSR monies to implement a different reform strategy if they agreed to be evaluated. Specifically, we recommend the Legislature create a voluntary program in which school districts would be able to select one of several allowable education reforms. As a condition of receiving this programmatic flexibility, districts would agree to provide relevant outcome data to SDE.

School Districts Voluntarily Would Select One of Several Allowable Improvement Strategies. School districts choosing to participate in this pilot program would be required to select one of several allowable cost-neutral CSR and teacher improvement strategies. In addition, SDE would establish a control group consisting of districts that continued to use their CSR monies to reduce every K-3 class to 20 students. The allowable reform strategies offered to participating districts should include those that have significant potential for improving academic achievement. We suggest that participating schools be allowed to select from among the following five reform strategies. Three of the strategies would involve some variant of class size reduction, in which participating school districts could reduce certain classes even further (for example, to 15 students per class), while ensuring remaining classes were enlarged by no greater magnitude (for example, no more than 25 students per class). The other two strategies would involve teacher training and staff development.

- ***CSR—Target Specific Student Populations.*** Some research suggests that socioeconomically and educationally disadvantaged students benefit most from CSR. School districts volunteering for the evaluation program could have the option of using their existing CSR monies to reduce K-3 class size in their most disadvantaged schools, with an offsetting increase in class size in their less disadvantaged schools.

- ***CSR—Target Specific Teacher Populations.*** Some research suggests that student achievement is lower in classes taught by first-year and second-year teachers. Districts participating in the evaluation program could have the option of reducing K-3 class size for first-year and second-year teachers, with an offsetting increase in class size for more veteran teachers.

- ***CSR—Target Specific Grades.*** Some research suggests that CSR has the greatest impact when implemented in kindergarten and first grade. Participating districts therefore could have the option of further reducing class size in these grades, with an offsetting increase in class size for second and third grade.

- ***Teacher Training—Provide Embedded Professional Development.*** Comparisons with other countries show that teachers in the United States spend more time in direct instruction and less time preparing to teach. Districts choosing to participate in the evaluation program therefore could have the option of maintaining the same K-3 CSR staffing level but increasing class size and using the additional personnel-hours to augment teachers' instructional preparation time. For example, a school district could hire science, music, or art specialists that rotate among classes, freeing up time that regular classroom teachers could use to enhance the quality of their instruction.

- ***Teacher Training—Provide Intensive Institute-Type Professional Development in Core Subject Matter Areas.*** Over the last several years, the state has invested hundreds of millions of dollars in the California Professional Development Institutes, California Subject Matter Projects, Mathematics and Reading Professional Development program, and other similarly structured professional development activities. No research however has been conducted to evaluate the cost-effectiveness of these professional development activities compared to other instructional improvement strategies. Districts participating in the pilot program could have the option of increasing K-3 class size and using the freed-up resources to provide intensive, subject-matter professional development to all K-3 teachers.

Federal Funds Available for These Types of Evaluations. Because school districts would be redirecting existing K-3 CSR monies, this program would require only a modest amount to pay for data collection and research. If established, we recommend the Legislature include a budget bill provision designating $500,000 in federal Title VI funds to pay for the evaluation activities. Although the administration designates the bulk of Title VI funding for specific data collection and assessment projects, it does not have a well-developed plan for using $1.5 million of it. We recommend setting aside $500,000 of Title VI funding annually for several years to allow SDE to develop a meaningful longitudinal database and arrive at conclusions about the relative effectiveness of CSR and teacher initiatives.

In conclusion, if the Legislature chooses to retain K-3 CSR as a separate categorical program, we recommend it establish a program to compare the cost-effectiveness of various CSR and staff development initiatives. We further recommend the Legislature designate $500,000 in federal Title VI funds for SDE to manage the evaluation.

ASSESSMENTS

The Governor's budget proposes $131 million to develop, administer, and analyze state assessments, an increase of approximately $1 million over estimated current-year expenditures. Figure 1 shows the change in funding from 2002-03 to 2003-04. Appendix 1 provides background on major state assessments.

The Governor's budget includes five major assessment changes as shown in Figure 1 and described below:

- ***Eliminate Assessments in Career Education.*** The Governor proposes eliminating Assessments in Career Education, for savings of $0.9 million. These assessments are voluntary end-of course exams for students in certain vocational education programs. The State Department of Education (SDE) would use the Standardized Testing and Reporting (STAR) results to fulfill federal requirements for reporting achievement in vocational education.
- ***California English Language Development Test (CELDT).*** The budget proposes an augmentation of $5 million for increased contract costs for the CELDT and $1.5 million to pay district apportionments for 300,000 test takers at a reimbursement rate of $5 per pupil. These new funds would cover costs incurred in 2003-04, as well as costs incurred in 2002-03 that were deferred to 2003-04.
- ***California High School Exit Exam (CAHSEE).*** The budget augments this program by $2.9 million to pay district apportionments and CAHSEE workbooks for an additional 367,000 test takers.
- ***Golden State Exams.*** The Governor proposes to reduce current-year funding for the Golden State Exams by $8 million, leaving $7.4 million, as part of the mid-year budget adjustments. For 2003-04, the budget recommends an additional $1.5 million reduction due to savings in contract costs. The Department of Finance (DOF) indicates that the SDE will likely need to eliminate several of the 13 Golden State Exams, but should have sufficient funds for the three Golden State Exams that have been integrated

Figure 1

**Funding for State Assessments
General Fund (Proposition 98) and Federal Funds**

*2002-03 and 2003-04
(In Millions)*

	2002-03			
	Budget Act	Revised	2003-04	Change From 2002-03 Revised
STAR program[a]	$65.9	$65.9	$64.4	-$1.5
California High School Exit Exam	18.3	18.3	21.2	2.9
Golden State	15.4	7.4	5.9	-1.5
Test development	11.7	7.6	5.5	-2.1
California English Language Development Test	12.0	12.0	18.5	6.5
NCLB[b] longitudinal database	6.9	6.9	6.9	—
Assessment review and reporting	3.9	3.9	3.9	—
Unspecified	1.8	1.8	—	-1.8
Assessment data collection	1.8	1.8	1.8	—
Alternative Schools Accountability Model	1.4	1.4	0.8	-0.7
Physical Performance Test[c]	1.2	1.2	1.1	-0.1
Assessments in Career Education	0.9	0.9	—	-0.9
Students with disabilities	0.5	0.5	0.5	—
Totals[d]	**$141.8**	**$129.7**	**$130.5**	**$0.8**

a Standardized Testing and Reporting Program.
b No Child Left Behind Act of 2001(federal).
c Funding budgeted as a state mandate.
d Totals may not add due to rounding.

with STAR—reading/literature, written composition, and high school mathematics.

- ***Test Development.*** The budget reduces funding for test development by $2.1 million.

The budget bill also includes a provision requiring the State Board of Education (SBE) to annually establish the amount of funding to be apportioned to school districts for the CELDT and CAHSEE. The amount of funding to be apportioned per test would be subject to DOF approval.

At the time of this writing, the Legislature was considering alternatives to the Governor's recommendations for the current year.

OVERVIEW AND HISTORY OF STAR PROGRAM

While the state conducts numerous tests, the "backbone" of its assessment system is the STAR program. Established by Chapter 828, Statutes of 1997 (SB 376, Alpert), this program currently consists of three elements: (1) the California Achievement Test-6 (CAT/6) nationally norm-referenced test (NRT); (2) the California Standards Tests; and (3) the Spanish Assessment of Basic Education (SABE/2) primary language test.

California's assessment system has evolved over the last 12 years from testing a sample of students to testing all students in grades 2 through 11 as part of the STAR program. During this time-period, two types of assessments have dominated the landscape:

- An *NRT* is a standardized test designed primarily to compare the performance of students with a nationally representative sample of students that have taken the same exam. An NRT does not directly measure how students perform in relation to a state's academic content standards.
- A *criterion-referenced test* is a standardized test aligned with a state's academic content standards that measures students' performance with respect to these standards rather than to the performance of their peers nationally.

Two key concepts that have guided the development of California's assessment system are the terms "valid" and "reliable." Valid means that a test measures the skills and content matter that it purports to measure. Reliable means that a test score can be trusted to reflect actual student achievement at the applicable level of analysis—student, school, or district. If the test were to be repeated with the same group of students, a reliable test would produce similar results.

Prior to the creation of STAR, the state had a variety of assessment systems (see Appendix 2 for a brief history of these systems). In 1995, the state began an emphasis on academic performance standards through the California Assessment Academic Achievement Act. This statute aimed to develop academic content and performance standards that would eventually be used for state-approved local tests and a statewide basic and applied skills test for selected grade levels.

STAR Program Begins With NRT. Because of the length of time necessary to develop standards and standards-based tests, the Legislature used an NRT as an interim strategy when it created the STAR program in 1997. Under the STAR program, the state requires schools to test all students in grades 2 through 11 using an NRT. Tests originally required for students in grades 2 through 8 included reading, spelling, writing, and mathematics, while tests originally required for students in grades 9 through 11 included reading, writing, mathematics, history/social science, and science.

The legislation creating STAR required SBE to adopt an NRT for the program by November 1997 and expressed the Legislature's intent to augment the NRT with items that assess the standards being adopted by SBE. Until SBE adopted these standards, the test had to be aligned with the curriculum frameworks and program advisories jointly adopted in 1996 by SBE, the Superintendent of Public Instruction, and the Commission on Teacher Credentialing.

In November 1997, the SBE designated the Stanford Achievement Test, Ninth Edition, Form T (Stanford 9) as the test for the STAR program. The state used the same version of the Stanford 9, including the same test questions, from 1998 through 2002. For 2003, the CAT/6 will replace the Stanford 9 as the state's NRT.

Primary Language Test Added to STAR. Chapter 828 also created a new requirement that English language learner (ELL) pupils in grades 2 through 11 take a test in their primary language if they have been enrolled in the state for less than 12 months. The legislation made the test optional for students who had attended public school in the state for more than 12 months. The SBE adopted the SABE/2 to meet the primary language test requirement. The test, which the state first administered in spring 1999, is an NRT that measures basic skills in mathematics, language arts, reading, and spelling.

The STAR Program Transitions to Standards-Based Tests

In 2000, Chapter 576 (AB 2812, Mazzoni) began the transition of the STAR program to standards-based tests. The legislation created a standards-based test for students in grades 2 through 11 as part of the STAR program. It also eliminated a previous requirement to develop a standards-based test of basic and applied skills for selected grades. In 2001, the Legislature named the new standards-based test the California Standards Test. Chapter 576 requires the test to measure the degree to which pupils achieve the academically rigorous content and performance standards adopted by SBE. The legislation requires tests in reading, spelling, writing, and mathematics for grades 2 through 8. For grades 9 through

11, the legislation requires tests in reading, writing, mathematics, history/social science, and science.

The California Standards tests have been phased into the STAR program over time. The state administered the English language arts and mathematics standards tests on a pilot basis in 1999. In 2001, SDE first reported English language arts scores using the following performance levels: advanced, proficient, basic, below basic, and far below basic. In 2002, mathematics scores also began to be reported as performance levels. In addition, the state piloted social science and science tests in 2001 and first reported scores as performance levels in 2002.

In 2001, Chapter 722 (SB 233, Alpert), reauthorized STAR and changed the emphasis from NRT to standards-aligned tests by making the following key changes:

- Made standards-based tests independent of the NRT.
- Expressed intent to shorten the length of the NRT.
- Deleted the social science NRT for grades 9 through 11.
- Required continuation of the science NRT for grades 9 through 11 until the state develops a general standards-based test in science for these grades.

Figure 2 shows how SDE has implemented the provisions of Chapter 722 to de-emphasize the norm-referenced portion of STAR. It compares the elements in the 2002 NRT to the 2003 NRT and illustrates how there will be fewer and shorter tests in 2003.

Accountability System Transitions to Standards-Aligned Tests. The SDE has also reduced the NRT's impact on the school accountability system. As shown in Figure 3 and Figure 4 (see page 100), the NRT was 100 percent of a school's Academic Performance Index (API) in 2001. As the California Standards tests have been phased into STAR and established as valid and reliable, they have been making up a greater portion of the API. As shown in Figure 3, the weight of California Standards tests will increase from 36 percent in 2002 to 80 percent in 2003 for elementary and middle schools. Figure 4 shows that the weight of California Standards tests will increase from 24 percent in 2002 to 73 percent in 2003 for high schools. High school API will also include the CAHSEE in 2003.

LAO Assessment-Related Recommendations

We have identified several areas where the Legislature could reduce the assessment burden on school districts while maintaining the state's emphasis on academic content and performance standards. The four rec-

Figure 2

Changes in Norm-Referenced Tests

	2002 Stanford 9	2003 CAT/6
Length of test	Long form.	Short form.
English language arts tests	Separate tests for reading, vocabulary, reading comprehension, and language.	Single test combining reading and language.
Mathematics tests	Separate math procedures and math problem solving tests for each grade 2 through 8, math tests for grades 9 through 11.	Single math test for each grade 2 through 11.
Social science	Required for grades 9 through 11.	Not included.
Science	Required for grades 9 through 11.	Required for grades 9 through 11.

Figure 3

Increasing Role for Standards-Based Tests in the API[a]— Elementary and Middle Schools

	2001 Growth API	2002 Growth API		2003 Growth API	
Content Area	**NRT[a]**	**NRT[a]**	**CST[a]**	**NRT[a]**	**CST[a]**
English language arts	60%	24%	36%	12%	48%
Math	40	40	—[b]	8	32
Totals	**100%**	**64%**	**36%**	**20%**	**80%**

a API = Academic Performance Index. The norm-reference test (NRT) for 2001 and 2002 was the Stanford 9. The NRT for 2003 is the CAT/6. CST = California Standards Test.

b Test not included in API.

ommendations below address eliminating or reducing the following tests: the NRT portion of the STAR program, the primary language test, the Golden State Exams, and the physical fitness test.

Figure 4

Increasing Role for Standards-Based Tests in the API[a]—High Schools

Content Area	2001 Growth API	2002 Growth API		2003 Growth API		
	NRT[a]	NRT[a]	CST[a]	NRT[a]	CST[a]	CAHSEE[a]
English language arts	40%	16%	24%	6%	35%	10%
Math	20	20	—[b]	3	18	5
Science	20	20	—[b]	3	—[b]	—[b]
Social science	20	20	—[b]	—[b]	20	—[b]
Totals	**100%**	**76%**	**24%**	**12%**	**73%**	**15%**

a API = Academic Performance Index. The norm-reference test (NRT) for 2001 and 2002 was the Stanford 9. The NRT for 2003 is the CAT/6. CST = California Standards Test and CAHSEE = California High School Exit Exam.

b Test not available for particular subject or not included in API.

Reduce Emphasis on NRT

We recommend that the Legislature continue to reduce emphasis on the norm-referenced test by requiring school districts to administer the California Achievement Test-6 (CAT/6) only in grades 4 and 8 instead of grades 2 through 11. We further recommend reducing the allocation for the Standardized Testing and Reporting program by $10 million to redirect funds for the CAT/6 to other education priorities. (Reduce Item 6110-113-0001 by $10 million.)

Students in grades 2 through 11 take the CAT/6 nationally normed test and the California Standards Test. We recommend that the Legislature decrease emphasis on the NRT by only requiring school districts to administer the CAT/6 in grades 4 and 8 for the following key reasons:

- ***Standards-Based and Norm-Referenced Assessments Test Duplicative Subjects, Decreasing Instructional Time.*** Under current law, students in grades 2 through 11 take both norm-referenced and standards-based tests as part of the STAR program. These assessments cover duplicative subjects. Students take tests in English language arts, mathematics, and science under both assessments. While the length of the NRT has decreased in the past year, duplicative testing still results in higher costs and decreased instructional time. Decreasing the number of grade levels taking the NRT would significantly reduce the testing burden on schools.

- ***Standards-Based Tests Have Developed Sufficiently to Be the Focus of the School Assessment and Accountability System.*** The history of California's assessment system shows a long-standing commitment to developing academic content standards and assessments that measure those standards. The Legislature implemented the NRT as a transition strategy until standards and associated tests could be developed and shown to be valid and reliable. As the state has developed valid and reliable standards-based tests, the Legislature has shifted the focus of California's assessment system from an NRT to standards-based tests by shortening tests and testing fewer subjects. Reducing the number of grade levels assessed with the NRT would continue this trend. The state's school accountability system has also evolved from being composed solely of the NRT to standards tests making up more than three-fourths of the API. Now that standards-based tests have been shown valid and reliable, we believe it is appropriate to decrease the emphasis of an NRT in the API even further.

- ***The Federal Government Now Requires an Assessment and Accountability System Focused on Standards-Based Tests.*** New federal requirements for assessments and accountability systems also move towards standards-based assessments. No Child Left Behind (NCLB) requires states to develop accountability systems that use assessments aligned to state academic content standards.

- ***The State Should Send a Uniform Message to Teachers and Students Emphasizing the Academic Content and Performance Standards.*** Another key reason to decrease emphasis on NRT is to send a consistent message to teachers and students on the importance of the academic content and performance standards. Schools across the state have been integrating the standards into their curriculum in the past few years and some school districts are moving towards standards-based report cards. Making the NRT a significant portion of the STAR program undermines focus on the academic standards. Decreasing emphasis on the NRT would solidify the state's commitment to the academic content standards.

Retaining the NRT in Grades 4 and 8 Would Still Allow Comparisons With the Federal National Assessment of Educational Progress (NAEP). The state also participates in NAEP, which the federal government administers to a sample of students in grades 4 and 8 in reading, math, writing, and science. While the NAEP measures how California is doing compared to other states, it does not provide district, school, or student level information. Using an NRT in grades 4 and 8 would maximize the state's ability to compare student performance with national samples of students because the federal government administers NAEP in reading and math in the same grade levels every two years.

Reducing the Grades Tested Will Reduce State Costs. Reducing the number of grades tested would reduce costs by $10 million in 2003-04. It would also reduce future costs under a pending mandate claim for the NRT portion of the STAR program. Based on parameters and guidelines adopted by the Commission on State Mandates, the claims total $184.1 million for costs from 1997-98 through 2003-04. The commission estimates that ongoing costs will be approximately $32 million per year. Reducing the number of grade levels taking the NRT would substantially reduce the ongoing costs of the mandate.

Because the NRT was an interim assessment strategy and standards-based tests have developed sufficiently to become the core of the state's assessment system, we recommend that the NRT be given only in grades 4 and 8. This would save the state $10 million in 2003-04.

Eliminate Primary Language Test Requirement

We recommend that legislation be enacted to eliminate the requirement that districts test English language learner pupils in their primary language. This would result in Standardized Testing and Reporting program savings of $1.6 million, which could be used for other education priorities. (Reduce Item 6110-113-0001 by $1.6 million.)

Under the STAR program, school districts are required to test ELL pupils in grades 2 through 11 in their primary language if such a test is available and the pupils have been enrolled in a California public school for less than 12 months. In addition, districts *may* administer a primary language test to pupils enrolled for longer than 12 months. In order to address this requirement, the SBE has designated the SABE/2 for native Spanish speakers but has not approved any other primary language tests. This test, which is in Spanish, measures student achievement in reading, language, mathematics, and spelling.

The Governor's budget includes $1.6 million in Proposition 98 funds for the SABE/2 in order to (1) pay the test publisher for materials and exam scoring and (2) reimburse school districts, county offices of education, and charter schools for administering the exam. We recommend eliminating the primary language test requirement and reducing funding by $1.6 million for the following reasons:

- ***School Districts Use Other Tests for Placement and Monitoring Purposes.*** Local districts often administer separate primary language tests for initial placement and to monitor the academic progress of their ELL pupils. The SABE/2 is not useful for this purpose because it is given in the spring, almost at the end of the school year. Eliminating the requirement to administer the SABE/2 would help reduce testing time at the local level. Local entities could continue to use the SABE/2 for local testing, if school officials deemed the test useful for local purposes.

- ***SABE/2 Is Not Consistent With the State's Emphasis on English Language Development.*** Proposition 227, passed by the voters in June 1998, in essence requires that children in California's public schools learn English by being taught all subjects predominantly in English, and to limit bilingual education classes to specified exceptional circumstances. The proposition states that: (1) ELL pupils should move from special classes to regular classes when they have acquired a good working knowledge of English, and (2) normally these classes should not last longer than one year. Given the changes made by the proposition and its objective to help ELL pupils acquire English as quickly as possible, we believe there is no longer a reason for the state to require certain ELL pupils to be tested in Spanish, especially since districts generally use other primary language tests for placement and monitoring purposes. Under our recommendation, the state would continue to administer the CELDT to each ELL annually, providing a comprehensive assessment over time of English proficiency based on state standards.
- ***Only a Small Proportion of the State's ELL Pupils Are Tested.*** In 2001-02, the state administered SABE/2 to about 7 percent of the state's 1.6 million ELL pupils. This small number is because most schools do not administer the test to pupils beyond the required first year. Because only a small subset of ELL pupils take the test, the results cannot be extrapolated to all ELL pupils. This limits the test's usefulness for directing state policy and local district decision-making.
- ***SABE/2 Does Not Fit Into the State's Accountability System.*** Current law requires districts to administer the primary language test only once to any particular student. Because the state assesses a new set of students each year, it is not possible to use the test to assess academic growth or to make comparisons of achievement across schools. For these reasons, SABE/2 cannot be easily incorporated into the state's accountability system, which aims to show growth in student achievement over time. This limits is usefulness from the state perspective.
- ***Test Is Not Aligned to Standards as Required by NCLB.*** The SABE/2 does not comply with federal requirements that assess-

ments be aligned to state academic content standards. To comply with the federal law, the state would have to design a new test aligned to state standards. Because a primary language assessment is only required by the federal government "to the extent practicable," we do not recommend that the state invest its resources in development of a primary language test aligned to standards.

Because SABE/2 is not useful for state or local purposes, we recommend that the Legislature eliminate the primary language test requirement, saving $1.6 million in 2003-04. School districts would continue to administer primary language tests for placement and monitoring purposes.

Eliminate Golden State Exam

We recommend that the Legislature eliminate the Golden State Exam. This would result in savings of $5.9 million in 2003-04, which could be used for other education priorities. (Reduce Item 6110-113-0001 by $5.9 million.)

The Legislature created the Golden State Exam in 1983 through Chapter 498 (SB 813, Hart). These tests are voluntary, rigorous end-of-course exams given in grades 7 through 12. The tests are aligned to the state academic performance standards and contain open-ended analysis and writing questions in each test. There are 13 specific course tests: three math, two English/language arts, three social science, four science, and one Spanish. The state administers most of the tests at the end of the spring semester, but the government and economics tests are also administered in the winter. In 2001, students took a total of 1.2 million Golden State Exams.

In 2001, Chapter 722 required that SDE integrate the Golden State Exams into the California Standards Tests to reduce testing time and duplicative testing. The SDE has integrated three Golden State Exams into the California Standards Tests to date—reading/literature, written composition, and high school mathematics. Students wishing to take the Golden State Exam in these subjects take the test as an augmentation to the California Standards Test. The California State University (CSU) system also plans to start using the results from these three tests for placement purposes in 2003-04.

Students who perform well on the Golden State Exams can qualify for the Golden State Seal Merit Diploma. To qualify for this diploma, a student must achieve high honors, honors, or recognition on at least six Golden State Exams. The state has awarded more than 22,000 Golden State Seal Merit Diplomas since the program began in 1997.

The Governor recommends greatly reducing funding for the Golden State Exams. The *2002-03 Budget Act* provided $15.4 million for this purpose. As part of the 2002-03 mid-year revision, the Governor recommended reducing funding for the exam by $8 million to $7.4 million. In 2003-04, the Governor recommends funding of $5.9 million, which is an additional $1.5 million reduction. The DOF indicates that SDE would have to eliminate some Golden State Exams, but that the administration's priority would be to continue funding the three exams that have been integrated into the California Standards Tests.

We recommend that the Legislature discontinue the Golden State Exams for the following key reasons:

- ***Tests Are Voluntary and Not Part of the Accountability System.*** The Golden State Exams are not required by either state or federal law. In addition, they are not included in the state's API.
- ***Other Tests Are Available to Show High Achievement.*** The Golden State Exams are duplicative of other tests that recognize high achievement. The California Standards Tests include two performance levels that indicate above-grade level performance—proficient and advanced. In addition, students can take Advanced Placement Exams in many of the same subjects offered on the Golden State Exams. Advanced placement tests are often used for placement and college credit at various higher education institutions statewide.

Although CSU plans to use the Golden State Exams for placement purposes, the test will only be taken by a small proportion of students. Other students will still need to take a separate placement test. Therefore, it is not imperative that the Golden State Exam be provided for this purpose.

Eliminate Physical Fitness Test Mandate

We recommend that the Legislature make the physical fitness test optional for grades 5, 7, and 9, and reduce funding for the test by $1.1 million. (Reduce Item 6110-295-0001 by $1.1 million.)

In 1995, the Legislature adopted Chapter 975 (AB 265, Alpert), which mandated a physical fitness test in grades 5, 7, and 9. The state uses the Fitnessgram, which measures six major health-related areas of physical fitness, including aerobic capacity, body composition, abdominal strength, upper body strength, trunk strength, and flexibility.

The state also requires physical education for all students in grades 1 through 9, plus one additional year in high school. Students in grades 1 through 7 are required to have 200 minutes of physical education every

10 days, and students in grades 7 through 12 are required to have 400 minutes every 10 days.

While physical fitness is important, we believe that the state should make the physical fitness test optional to reduce the number of assessments mandated, reduce the testing burden, and increase instructional time. Our recommendation would not affect the existing requirement for physical education. Under our proposal, school districts interested in continuing to administer the physical fitness test could continue to do so. Adopting this recommendation would save $1.1 million that would be available for other educational priorities.

APPENDIX 1

Overview of Major State Assessments

California Achievement Test-6

- ***Purpose.*** Individual pupil measure of achievement used to compare pupils across all schools. Monitor student achievement in California against a national norm.
- ***Subjects.*** Reading/language and mathematics in grades 2 through 11, and science in grades 9 through 11.
- ***Requirement and Grade Level.*** Required, grades 2 through 11.
- ***When Offered.*** Spring.
- ***Positives.*** Allows schools and students to be easily compared. Tells students their achievement relative to others in the nation.
- ***Negatives.*** Not aligned to academic content standards, same questions used every other year.

California Standards Tests (CST)

- ***Purpose.*** Determine each student's proficiency at learning subject matter covered by state's academic content standards. Provides measure of student writing ability.
- ***Subjects.*** Writing in grades 4 and 7, English/language arts and mathematics in grades 2 through 11, science in grades 9 through 11, and social science in grades 8, 10, and 11. Science test being field-tested in grade 5 in 2003.
- ***Requirement and Grade Level.*** Required, grades 2 through 11.
- ***When Offered.*** Spring.
- ***Positives.*** Aligned to standards. Becoming a larger part of accountability system. Requires actual student writing, not just multiple choice questions.
- ***Negatives.*** State's challenging standards may make tests hard for many students. Writing assessments relatively expensive to grade.

Spanish Assessment of Basic Education

- ***Purpose.*** Pupil-level skills test in Spanish for English language learner (ELL) pupils whose primary language is Spanish.
- ***Subjects.*** Reading, language, math, and spelling.
- ***Requirement and Grade Level.*** Required for English learners in grades 2 through 11 enrolled 12 months or less, optional for other English learners.
- ***When Offered.*** Spring.
- ***Positives.*** Achievement information in core subjects for pupils not fluent enough to be tested in English. Indicates whether pupils are acquiring skills beyond language acquisition.
- ***Negatives.*** Not aligned to standards as required by the federal No Child Left Behind (NCLB) Act. Not consistent with policy goals of Proposition 227. Usually administered once per student, rarely used to assess growth.

Appendix 1 Continued

California Alternate Performance Assessment

- ***Purpose.*** Provides an alternative assessment to Standardized Testing and Reporting (STAR) for students with significant cognitive disabilities. Tests subset of content standards appropriate for this population.
- ***Subjects.*** English language arts and math in 2003. Health test being piloted in 2003. Other subjects being added in future years include: science, history/social science, and physical education.
- ***Requirement and Grade Level.*** Required for cognitively disabled students in grades 2 through 11 who cannot take the STAR tests.
- ***When Offered.*** Spring.
- ***Positives.*** Designed to meet the requirements of the federal Individuals with Disabilities Education Act and NCLB.
- ***Negatives.*** New test without established performance levels. Tests standards in a subjective manner.

Golden State Exam

- ***Purpose.*** End-of-course exams to compare pupil achievement in specific classes to statewide standards.
- ***Subjects.*** Thirteen specific course tests: three math, two English/language arts, three social science, four science, and one Spanish.
- ***Requirement and Grade Level.*** Voluntary, grades 7 through 12.
- ***When Offered.*** End of course—winter and spring.
- ***Positives.*** Feedback to students and teachers on how well students learn material compared to state standards. Being integrated with some CSTs to reduce testing time. Open-ended writing and analysis questions in each test.
- ***Negatives.*** Results not provided quickly enough to be meaningful for schools. Duplicative of CSTs and Advanced Placement tests.

California English Language Development Test

- ***Purpose.*** Diagnostic assessment to help schools place ELL pupils in appropriate settings. Measures acquisition of language skills over time, assists schools in deciding which pupils to redesignate as fluent in English.
- ***Subjects.*** Reading, writing, and listening/speaking.
- ***Requirement and Grade Level.*** Required for ELL students in grades K-12 until reclassified.
- ***When Offered.*** Annual assessment offered July through October, initial assessments offered year-round.
- ***Positives.*** Complies with NCLB requirement for English language development assessment, aligned to standards. Reinforces goals of Proposition 227 to transition students as quickly as possible.
- ***Negatives.*** Initial assessments are scored both locally and centrally, creating duplicative costs. Annual assessment results not provided until February, preventing it from being used as a placement tool. Listening and speaking portion is labor intensive for schools. Not included in Academic Performance Index.

Appendix 1 Continued

California High School Exit Exam (CAHSEE)

- ***Purpose.*** Improve high school achievement and ensure high school graduates reach grade-level competency in reading, writing, and math. First applies as a graduation requirement to class of 2004.
- ***Subjects.*** Mathematics, English/language arts, and writing.
- ***Requirement and Grade Level.*** Required for grade 10. Can be taken in grades 10 through 12.
- ***When Offered.*** Three testing cycles per year: either July or September; either November or January; and either March or May.
- ***Positives.*** Ensures a minimum level of academic achievement for all graduates. Aligned to standards. May improve performance at lower performing schools. Included in accountability system for first time in 2003.
- ***Negatives.*** May increase student dropout rates. Standards have not been in place throughout the entire school career of current cohort taking test. (The State Board of Education has until August 1, 2003 to decide whether to postpone application of the test.)

Physical Fitness Examination

- ***Purpose.*** Measure physical fitness level of students and encourage focus on physical fitness.
- ***Subjects.*** Aerobic capacity, body composition, abdominal strength, upper body strength, trunk strength, and flexibility.
- ***Requirement and Grade Level.*** Required, grades 5, 7, and 9.
- ***When Offered.*** March through May.
- ***Positives.*** Encourages physical fitness.
- ***Negatives.*** Administered as a mandate. Detracts resources from core academic mission.

Assessments in Career Education

- ***Purpose.*** End-of-course exams to recognize students who demonstrate outstanding achievement in selected career technical areas.
- ***Subjects.*** Agricultural core, computer science and information systems, health care, food services and hospitality, and technology core (industrial and technology education).
- ***Requirement and Grade Level.*** Voluntary, grades 7 through 12.
- ***When Offered.*** May.
- ***Positives.*** Provides recognition for students that perform well on the exams.
- ***Negatives.*** Is not representative of the vocational education curriculum. Same test items used each year. High cost per test. Declining participation rate. Results not available until fall.

Appendix 1 Continued

High School Proficiency Exam

- ***Purpose.*** Assessment that allows students to exit high school early and receive a Certificate of Proficiency.
- ***Subjects.*** Reading, writing, and mathematics.
- ***Requirement and Grade Level.*** Voluntary for ages 16 and up.
- ***When Offered.*** January, April, and May.
- ***Positives.*** Self-funded—students pay $50 fee to take the test.
- ***Negatives.*** Allows students to leave high school without completing coursework. Inconsistent with current academic content standards, less rigorous than CAHSEE.

APPENDIX 2

HISTORY OF ASSESSMENTS THROUGH 1996

California Assessment Program (CAP) Provided Only Schoolwide Data. Until 1990, the state had the CAP. The CAP tests calculated average student scores that indicated how well students fared in mathematics, reading, writing, social science, and science in grades 3, 6, 8, and 12. The state did not intend CAP results to be reliable for individual students. Instead, the state designed the results to provide a reliable gauge of average achievement at the school or district level. To minimize costs and test taking time, students took only part of each test and the state aggregated results at the school or district level.

California Learning Assessment System Focused on Performance Testing. In 1991, Chapter 760 (SB 662, Hart), authorized the California Learning Assessment System (CLAS) testing program, which tested students in mathematics, reading, and writing in grades 4, 8, and 10. The CLAS differed from CAP in two ways. First, CLAS focused on performance testing, which asks students to solve open-ended questions rather than answer multiple-choice questions. Second, CLAS tests provided individual student scores, rather than school-level scores. The Governor vetoed CLAS funding from the *1995-96 Budget Bill* after questions were raised over some test questions and the reliability of scores for individual students.

California Assessment Academic Achievement Act Launched Emphasis on Standards. In 1995, Chapter 975 (AB 265, Alpert), created the California Assessment Academic Achievement Act, which included both state-approved local tests and a statewide basic and applied skills test. It also set the stage for development and adoption of academic content and performance standards to be used for assessment purposes.

Chapter 975 set up a local testing incentive program that paid districts $5 per pupil to administer state-approved basic academic skills tests for students in grades 2 through 10. The legislation required the State Board of Education (SBE) to adopt tests aligned with the academic content standards. Until standards were in place, the tests had to be reasonably aligned with the state curriculum frameworks.

The legislation also authorized development of a test of basic and applied skills administered to students in grades 4, 5, 8, and 10 in reading, writing, mathematics, history/social science, and science. While the legislation prohibited SBE from adopting this assessment until it had adopted academic content and performance standards, it allowed SBE to contract for development of the assessment. In 1996, Chapter 69

(SB 430, Greene), postponed development of the basic and applied skills test until after SBE adopted content and performance standards. Ultimately, other standards-based tests were developed in lieu of this test.

The legislation also created a 21 member Commission for the Establishment of Academic Content and Performance Standards. This commission was required to develop "academically rigorous" content and performance standards for the K-12 curriculum and submit them to the SBE for approval by July 1, 1997. Content standards describe the knowledge and skills students should acquire in a given grade. Performance standards describe what students need to do to demonstrate they are "proficient" in the knowledge and skills outlined in the content standards. The statutes originally required SBE to adopt academic content and performance standards by January 1, 1998, in reading, writing, mathematics, history / social science, and science. Over time, the deadlines for some subjects were changed. The SBE adopted standards for: (1) English language arts and mathematics in December 1997, (2) English Language Development standards in July 1999, (3) history / social science and science standards in October 1998, and (4) visual and performing arts standards in January 2001.

ACCOUNTABILITY

In this section, we discuss the state's school accountability system and how it can be integrated with the federal school accountability system required by the No Child Left Behind (NCLB) Act of 2001. Under current law, there are multiple state and federal intervention and sanction programs for public schools that are struggling academically. Figure 1 provides highlights of each of these programs. There are two programs under state law—the Immediate Intervention/Underperforming

Figure 1

Highlights of Sanction and Intervention Programs

State Programs

Immediate Intervention/Underperforming Schools Program (II/USP)

- Targets schools in decile one through five that are not meeting Academic Performance Index (API) targets.
- Provides $200 per pupil for two to three years. Schools sanctioned if they do not make "significant growth."

High Priority Schools Grant Program (HPSGP)

- Targets lowest-performing schools starting with API decile 1.
- Provides $400 per pupil for three to four years. Schools sanctioned if they do not make significant growth.

Federal Programs

Comprehensive School Reform Demonstration Program

- Provides grant to schools to do comprehensive research-based reform.
- Provides $200 to $400 per pupil for three years. Generally integrated into II/USP and HPSGP.

No Child Left Behind Act of 2001

- Requires schools not making "adequate yearly progress" to implement progressively stringent interventions under Program Improvement.
- No additional funding provided to schools in Program Improvement.

Schools Program (II/USP) and the High Priority Schools Grant Program (HPSGP). The state programs have different planning requirements, funding levels, interventions, and sanctions. The state has also partially integrated the federal Comprehensive School Reform Demonstration (CSRD) program into II/USP and HPSGP. In addition, California must comply with the new federal accountability system mandated by NCLB, which requires certain interventions and sanctions for Title I schools that fail to meet annual student achievement targets.

Schools can participate in one or more of these state and federal programs, creating administrative complexities that subtract from the focus on school improvement. In this analysis, we recommend a framework for an integrated approach to interventions and sanctions at low-performing schools.

Background on State and Federal Sanction and Intervention Systems

II/USP and HPSGP

The state accountability system is based on the Public Schools Accountability Act (PSAA)—Chapter 3x, Statutes of 1999 (SB 1x, Alpert). The original sanction and intervention program under the PSAA was II/USP, which is currently serving 1,288 schools. In 2001, the Legislature added HPSGP to the PSAA. The HPSGP now serves 683 schools, of which 307 are also in II/USP. The II/USP targets schools scoring in the lowest five deciles of the state's accountability measure, the Academic Performance Index (API). The program provides a $50,000 planning grant and two to three years of implementation funding at $200 per pupil. In contrast, HPSGP focuses on schools in the first decile of the API. Schools have the option to receive a $50,000 planning grant and receive three to four years of implementation funding at $400 per pupil.

For both programs, schools that make "significant growth" in their API scores receive an additional year of funding, while schools that do not make significant growth are subject to sanctions. The State Board of Education (SBE) can decide to either have the state take over the school or assign a School Assistance and Intervention Team (SAIT). Schools in sanctions receive $150 per pupil for three years and can exit sanctions if they make significant growth for two consecutive years during the three-year sanction period.

NCLB Act of 2001

All schools must be part of the federal accountability system, which aims to have schools make "adequate yearly progress" (AYP) towards the goal of all students achieving academic proficiency by the 2013-14 school year. All schools must take the same assessments and have their AYP measured. About 57 percent of schools in the state receive Title I funding. Title I schools that do not make AYP for two consecutive years are subject to federal interventions and sanctions under Program Improvement as shown in Figure 2 (see next page). In contrast, schools that do not receive Title I funding do not face any other requirements. As of January 2003, the state had 955 schools in Program Improvement: 420 in level one, 507 in level two, and 28 in level three. The 955 Program Improvement schools represent 19 percent of Title I schools. Program Improvement also applies to school districts. Figure 3 (see page 117) shows the interventions and sanctions required for school districts.

FUNDING FOR SCHOOL ACCOUNTABILITY PROGRAMS

Current Year Changes Adopted by Legislature Create Future Obligations

As part of the 2002-03 mid-year revision, the Governor recommended: (1) across-the-board cuts of 10.8 percent to II/USP and HPSGP; and (2) eliminating funding for a new cohort of HPSGP. As of this writing, the Legislature had rejected these proposals. Instead, the Legislature reduced funding for HPSGP and II/USP by $76 million on a one-time basis to align the timing of funding with actual expenditures as part of AB 8x (Oropeza). Under current practice, the state provides the final 20 percent of II/USP and HPSGP funding in September. The Legislature's change will fund the September 2003 payment with 2003-04 Proposition 98 funds instead of 2002-03 funds. In addition, by opting to fund a new cohort of HPSGP, the Legislature creates additional funding obligations in 2003-04.

2003-04 Proposed Budget Reduces Funding for State Interventions

Figure 4 (see page 117) shows funding proposed by the Governor for state and federal sanctions and interventions for low-performing schools. The 2003-04 proposed budget includes $357 million for these programs from Proposition 98 and federal funds, which represents a decrease of $119 million from the *2002-03 Budget Act*, and a $54.2 million decrease from the Governor's proposed 2002-03 mid-year revisions. The Governor's budget includes the following major changes to accountability program funding:

Figure 2

**NCLB Program Improvement—
Sanctions and Interventions for Title I Schools**

✓ **Level 1—School Choice**

- Develop a two-year improvement plan.
- Use 10 percent of Title I funds for professional development focused on school improvement.
- Provide students with the option to transfer to any other school in the school district and pay the transportation costs.

✓ **Level 2—Supplemental Services**

- Level 1 interventions.
- Use Title I funds to obtain tutoring/after school program from SDE-approved public or private provider.

✓ **Level 3—Corrective Action.** Level 1 and 2 interventions, plus school district must do one of the following:

- Replace responsible staff.
- Implement new curriculum.
- Significantly decrease management authority at school level.
- Appoint an external expert to advise school.
- Extend school day or school year.
- Restructure internal organization of school.

✓ **Level 4—Restructuring.** Level 1, 2, and 3 interventions, plus prepare a plan that must be implemented within one year. Options include:

- Reopen school as charter school.
- Replace most of the school staff.
- Hire private management company to operate school.
- Turn the operation over to SDE.
- Other major restructuring.

High Priority Schools Grant Program. Funding for HPSGP increases by $5.8 million compared to the Governor's mid-year revision, but decreases by $38.6 million compared to the *2002-03 Budget Act*. These changes reflect: (1) continued savings from the across-the-board cut recommended in 2002-03; and (2) continued savings from not funding a new cohort of HPSGP in 2002-03.

Figure 3

**NCLB Program Improvement—
Sanctions and Interventions for School Districts**

✓ **Program Improvement for School Districts.** The State Board of Education (SBE) must identify school districts that do not make Adequate Yearly Progress (AYP) for two years and provide technical assistance for two years. Districts that do not make AYP after two years move to corrective action which requires SBE to do one of the following:

- Defer programmatic funds or reduce administrative funds.
- Institute a new curriculum.
- Replace school district personnel.
- Remove schools from jurisdiction of the school district and establish other public governance or supervision.
- Appoint a trustee in place of the superintendent or school board.
- Abolish or restructure the school district.
- Authorize students to transfer to other school districts.

Figure 4

**K-12 Intervention and Sanctions Programs
2003-04 Governor's Budget**

*Proposition 98 and Federal Funds
(Dollars in Millions)*

	2002-03			Change From 2002-03 Mid-Year	
	Budget Act	**Mid-year**	**Proposed 2003-04**	**Amount**	**Percent**
HPSGP[a]	$217.0	$172.5	$178.4	$5.8	3.4%
II/USP[a]	184.6	164.6	104.6	-60.0	-36.4
CSRD[a]	39.7	39.7	39.7	—	—
Sanctions	35.1	34.5	34.4	-0.1	-0.2
Totals	**$476.4**	**$411.3**	**$357.1**	**-$54.2**	**-13.2%**

a HPSGP = High Priority Schools Grant Program; II/USP = Immediate Intervention/ Underperforming Schools Program; CSRD = Comprehensive School Reform Demonstration.

According to the administration, the Governor will propose trailer bill language to clarify that schools jointly funded by II/USP and HPSGP can only receive a total of three years of funding. The third year of the program would be funded solely by HPSGP. The Governor's language would also clarify that jointly funded schools are not eligible for an additional year of funding under HPSGP if they make significant growth (currently defined as one point positive API growth). By not providing significant growth funding to jointly funded schools, the trailer bill language would generate savings in future years.

II/USP. Funding for II/USP decreases by $60 million compared to the Governor's mid-year revision, and decreases by $80 million compared to the *2002-03 Budget Act*. These changes reflect: (1) $20 million in continued savings from the across-the-board cut recommended by the Governor in 2002-03; and (2) $60 million in savings that occur as schools exit the program.

Funding Proposed for 2003-04 Is Insufficient

Based on the Legislature's actions in the 2003-04 First Extraordinary Session, we estimate that the Governor's 2003-04 proposed budget underfunds II/USP and HPSGP by an estimated $69 million due to: (1) the recommended across-the-board cuts, (2) the Legislature's decision to start a second cohort of HPSGP, and (3) the Legislature's decision to realign the timing of expenditures.

We estimate that $132 million is necessary to fully fund II/USP in 2003-04. The budget proposes $105 million, leaving a shortfall of $27 million. Current law allows the State Department of Education (SDE) to reduce the per pupil rate to be commensurate with the funding available. We estimate that SDE would have to reduce the per pupil rate from $200 to approximately $158 to accommodate this funding reduction.

For HPSGP, we project that $220 million would be necessary to fund cohorts one and two in 2003-04. Compared to the proposed funding level of $178 million, the program is underfunded by $42 million. To compensate for a funding shortfall, we estimate that SDE would need to reduce the per pupil amount from $400 to about $323. Under current law, SDE does not have the authority to reduce the per pupil funding rate for HPSGP. Therefore, the Legislature would either need to provide an additional $42 million for HPSGP, or insert trailer bill language allowing SDE to reduce the per pupil rate in 2003-04.

FUNDAMENTAL DIFFERENCES BETWEEN STATE AND FEDERAL ACCOUNTABILITY SYSTEMS

The NCLB fundamentally changes the school accountability landscape for California by requiring the state to have one integrated state and federal accountability system. The *state* accountability system is based on the PSAA, which (1) rewards schools for academic improvement, (2) provides external intervention for low-performing schools, and (3) sanctions schools that continue to fail after receiving external assistance. The new *federal* accountability system has some similarities to the state system, but has several fundamental differences, including: (1) growth targets which measure different goals than the state, (2) different entities responsible for intervention, and (3) sanctions and interventions which differ significantly.

Growth Targets Measure Different Goals

The two accountability systems require different ways of measuring student performance. The *federal* accountability system focuses on the percentage of students meeting proficiency targets while the *state's* accountability system focuses on growth in overall school achievement from year to year.

The NCLB requires all students to achieve academic proficiency in mathematics and English language arts by the 2013-14 school year. States must define the meaning of proficient and set annual objectives towards this goal, referred to as AYP. In order to meet AYP, schools must meet targets for all students and for the following subgroups: major racial and ethnic groups, economically disadvantaged, students with disabilities, and English language learners.

Federal law requires states to set a starting point of the percentage of students who are proficient based on prior-year assessment results. According to the accountability plan submitted by SDE to the federal government, the starting point for AYP will be 13.6 percent proficient for English language arts and 16 percent proficient for mathematics. These percentages will be the AYP targets for 2002-03 and 2003-04. Figure 5 (see next page) shows the percent of students who tested proficient or above on the California Standards Test. As the figure shows, schools with significant numbers of students in subgroups may have difficulty meeting the initial starting points.

Figure 5

Percent of Students Proficient or Above in English Language Arts and Mathematics

(Results From the 2002 California Standards Test)

	English Language Arts		Mathematics	
	Grade 3	Grade 7	Grade 3	Grade 7
All students	34%	33%	38%	30%
English language learners	12	5	22	9
Economically disadvantaged	18	16	25	16
Special education	17	6	21	6

In 2004-05, the targets will increase by 10.8 percent for English language arts and 10.5 percent for mathematics. The next increase in growth targets of 10.8 percent and 10.5 percent will occur in 2007-08. After that point, the growth targets will increase annually by 10.8 percent for English language arts and 10.5 percent for mathematics. As the state raises the bar per federal requirements, more and more schools will be unable to achieve these targets. Once a school has missed its target, it will be difficult for it to ever catch up because the target continues to rise. The level of growth required to meet these targets is unrealistically high in our view, and virtually every Title I school will likely be in Program Improvement within a few years.

In contrast, the state's accountability system is based on the API. Instead of measuring a particular *level* of achievement, it measures *growth* in schoolwide achievement from year to year. The API ranges from a low of 200 to a high of 1000. The statewide API performance target for all schools is 800. A school's API growth target is generally 5 percent of the difference between the school's API and the performance target of 800. There is also a target for significant ethnic and socioeconomically disadvantaged subgroups, which is 80 percent of the schoolwide target.

Entity Responsible for Interventions Different

State and school district roles are different under NCLB and the PSAA. The NCLB makes school districts primarily responsible for implementing interventions and sanctions. The state has two primary responsibilities under NCLB: (1) intervene in school districts that are not meeting AYP and (2) provide technical assistance to schools subject to sanctions and interventions through a "statewide system of school support." The state can also take over schools during the fourth level of Program Improvement at the request of the school district.

In contrast, the state role under PSAA is to support direct intervention and sanctions at schools, leaving school districts with a limited role in the school improvement process. During the intervention phase, many districts leave the school reform responsibilities to the school and external evaluator. During the sanction phase, the state can take over legal responsibilities for schools, leaving districts largely out of the solution. Some school districts do play a role in II/USP and HPSGP, functioning in place of the external evaluator, but this assistance is not mandatory. More importantly, districts do not face the possibility of sanctions if they do not help struggling schools to improve.

Different Sanction and Intervention Requirements

The state and federal accountability systems also have different sanction and intervention requirements. Four key differences are discussed below: eligibility, funding, timelines, and types of sanctions imposed.

- ***Eligibility Requirements.*** The eligibility requirements for sanction and intervention programs differ. Both II/USP and Program Improvement are for schools that are not meeting their academic improvement targets. In contrast, schools are eligible for HPSGP if they are in the lowest decile of the API, regardless of whether they are meeting their growth targets.
- ***Funding.*** The state's intervention programs are grounded in the assumption that additional financial resources are necessary for school improvement, while NCLB assumes that existing state and federal resources will be used more efficiently to support reform efforts.
- ***Timing.*** Schools enter Program Improvement after failing to meet AYP for two consecutive years. In contrast, schools can enter II/USP after only one year of not meeting API growth targets. In addition, the timeline for II/USP sanctions is more finite than for Program Improvement. Schools in II/USP begin sanctions after two or three years of implementation and the sanction process lasts for three years. For Program Improvement, a school could be subject to sanctions and interventions for many years because it is very difficult to meet the exit criteria of making AYP two years in a row.
- ***Types of Interventions and Sanctions.*** The types of interventions and sanctions required by state and federal systems differ. The

NCLB has some interventions in the first two years of Program Improvement—school choice and supplemental services—that are not required under state law. At the sanction phase under NCLB, there are two levels—corrective action and restructuring. State take-over of schools does not happen until the restructuring phase. In contrast, state sanctions can include state take-over of schools in the first year of sanctions.

Differences in Accountability Programs Create Unwieldy System

Figure 6 provides a comparison of state and federal accountability programs. There are 1,288 schools participating in II / USP, 683 in HPSGP, 195 in CSRD, and 955 in Program Improvement. There is substantial overlap among programs, with 711 schools participating in more than one program. The total number of schools involved in these programs is 2,050. Because many key elements of these accountability programs differ, schools in multiple programs must comply with two sets of rules. These multiple planning requirements, interventions, and exit requirements create a patchwork of conflicting messages for schools.

Use of Both API and AYP Creates Confusion

To comply with the NCLB requirement of one integrated state accountability system, SBE opted for a dual system that keeps the current API system while also reporting AYP to the federal government. Schools will receive a report that measures performance using both API and AYP scores. Currently, about half of the schools statewide make their API targets annually, but SDE projects that increasingly larger percentages of schools will not make AYP over time. Therefore, many schools will simultaneously meet their API targets and be identified for Program Improvement. This sends conflicting messages to schools.

To help schools wade through this confusion, SBE created a matrix to classify schools based on a combination of API and AYP. The matrix places schools in six categories: exemplary, commendable, on the move, some improvement, and academic watch. For example, a school with API growth equal to or less than zero that did not meet AYP would be on academic watch and would be the highest priority for intervention. A school that met schoolwide API and AYP targets but did not meet subgroup targets would be characterized as "on the move." Exemplary schools would be those that met all API and AYP targets. The matrix is intricate and may add yet another layer of complexity to the accountability system. It is also unclear how SBE anticipates using the matrix and

Figure 6

Comparison of State and Federal Accountability Programs

Item	State		Federal	
	II/USP	HPSGP	CSRD	Improvement
Number of schools	1,288	683	195	955
Eligibility	Bottom 5 deciles	Bottom 5 deciles—only decile 1 funded to date	Competitive grant process primarily for Title I schools	Title I Schools
Entry criteria	Fail API for one year	Not Applicable	Not Applicable	Fail AYP for two years
Planning funds	$50,000 grant	Optional $50,000 grant	No grant	No grant
Plan requirements	22 specific requirements	All II/USP requirements plus four additional requirements	11 specific components. Must use research-based model	Research based plan
Intervention year 1	Implement action plan—$200 per pupil	Implement action plan—$400 per pupil	Implement action plan—$200 per pupil	Intra-district choice
Intervention year 2	Implement action plan—$200 per pupil	Implement action plan—$400 per pupil	Implement action plan—$200 per pupil	Choice and supplemental services
Intervention year 3	Exit, sanctions, or significant growth and $200 per pupil	Implement action plan—$400 per pupil	Implement action plan—$200 per pupil	Choice, supplemental services, corrective action by school district
Intervention year 4	Continue sanctions	Exit, sanctions, or significant growth at $400 per pupil.	If part of II/USP or HPSGP, exit, sanctions, or significant growth	Plan for restructuring
Intervention year 5	Continue sanctions	Continue sanctions	Continue sanctions	Restructuring
Sanctions funding	$150 per pupil, $75,000 to $125,000 for School Assistance and Intervention Teams	Not specified	II/USP or HPSGP sanctions apply if under those programs	State sponsored audit team for schools in corrective action, regional support funded.
Exit criteria	Meet growth targets two years in a row	Not specified	II/USP or HPSGP exit criteria apply if under those programs	Make growth targets two consecutive years

what specific interventions will go with each category. In addition, the matrix does not change the underlying interventions required by NCLB as displayed in Figure 2 (see page 116).

Multiple Intervention Programs Create Mixed Messages

As noted earlier, about one-third of schools are participating in more than one program. This means that many schools must understand and coordinate multiple programs that can have conflicting messages. For example, a school could be required to implement the findings from a Program Improvement audit while implementing an HPSGP plan with different interventions. Schools can also graduate from II/USP, only to find themselves entering Program Improvement. In addition, state requirements for each program have changed from year to year, making it difficult for school districts to keep track of what is required.

Cost of Continuing Duplicative Programs High

The cost of continuing to administer duplicative programs will greatly increase in the next few years as many schools enter Program Improvement. If the state continues to add additional cohorts to II/USP and HPSGP while implementing the requirements of NCLB, the state will be funding multiple interventions at the same schools. In addition, the cost of sanctions for II/USP and HPSGP will rapidly increase as more cohorts reach the sanction phase. In 2002-03, 24 schools are subject to state sanctions. In 2003-04, the original 24 schools will continue sanctions and an estimated 76 additional schools will face sanctions, for a total of 100 schools. We estimate that the total number of schools being sanctioned will increase to 230 in 2004-05 and 330 in 2005-06.

NCLB Creates Unrealistic Standards

The new federal accountability system requires all students to be proficient by 2013-14. Schools that do not meet their annual AYP targets are identified for Program Improvement. As discussed below, the federal standards will identify a large number of schools for Program Improvement and the state's definition of proficiency will exacerbate this situation. This results in a system with unrealistic standards. The problems with the federal measure are described below.

Large Number of Schools Will Be Identified as Low-Performing. Preliminary analysis by SDE shows that a large number of schools will be identified for Program Improvement. The SDE has tried to mitigate this effect by providing schools with several years to meet targets in the early years of NCLB, but the number of schools entering Program Improvement will increase rapidly starting in 2007-08, when targets begin to increase annually by 10.8 percent for English language arts and 10.5 percent for mathematics. In the latter years of the 12-year timeline, virtually every Title I school will be in Program Improvement.

State Definition of Proficiency Too Stringent. As part of the definition of AYP, SBE opted to maintain the current definition of academic proficiency. For grades two through eight, students must score at the proficient or advanced levels on the California Standards Tests for English language arts and mathematics. For grades 10 through 12, a score will be selected on the California High School Exit Exam (CAHSEE) that corresponds to proficiency levels on the California Standards Tests.

The SBE designed the proficient and advanced achievement levels to roughly represent students achieving above grade level who are on track to attend the California State University (CSU) or the University of California (UC). Approximately one-third of students currently reach proficiency on the California Standards Tests, meaning that two-thirds of California's students will need to improve their performance to reach proficiency within twelve years as required by NCLB. Using this definition, it will be very difficult for all students to reach this standard and many schools will be identified for Program Improvement.

FRAMEWORK FOR AN INTEGRATED ACCOUNTABILITY SYSTEM

When the Legislature created the PSAA in 1999, federal law allowed states to craft their own sanction and intervention programs. The NCLB Act changed this landscape by requiring highly specific interventions and sanctions. As a result, the Legislature needs to integrate the state and federal accountability systems to create clearer expectations and focus resources on the neediest schools. Integrating these programs will be a complicated and detailed undertaking. To assist the Legislature toward that end, we offer the following guiding principles and recommendations in shaping a uniform system.

Focus State Interventions at the School District Level

We recommend that a restructured accountability system focus on providing technical assistance at the school district level to build capacity for districts to intervene at schools.

The NCLB makes school districts primarily responsible for interventions at schools under Program Improvement, while the state is primarily responsible for intervening in districts. This division of responsibilities is logical because the state interacts primarily with districts rather than schools. In addition, the state does not have the financial resources or the capacity to intervene at the school level in a large number of schools.

Under PSAA, the state focuses state interventions directly at the school level. This strategy overlooks the important role school districts should play in improving student achievement at the school level. School districts make key funding and management decisions for schools and should be the main entities the state holds accountable. At the sanction phase, PSAA gives the state the option to take over schools. This creates incentives for school districts to abdicate responsibility for improving schools since the district will not be held accountable if a school is sanctioned.

To make the largest impact with limited resources, we believe that interventions at the school district level should be the cornerstone of an integrated accountability system. The state could use the statewide system of school support required by NCLB to help districts build capacity to intervene at schools and to intervene in districts in Program Improvement and corrective action. Accordingly, we suggest that over time, the Legislature direct more resources to school district level interventions, and less funding to directly intervene in schools.

Target State Interventions at the Neediest Schools

In light of resource and capacity constraints, we recommend that the Legislature target state interventions at the neediest schools—those in decile one of the Academic Performance Index.

Analysis by SDE shows that many schools will fall under Program Improvement in the next few years because schools will find it difficult to make AYP for all subgroups as required by NCLB. The state does not have sufficient fiscal capacity to intervene at all of these schools and there are a limited number of individuals statewide with the expertise to help turn around these low-performing schools. In light of these constraints, we believe the state should focus its resources on the neediest schools as defined by the API. We recommend that the state intervene at all schools in API decile one because these schools will have the most difficulty reaching the NCLB goal of 100 percent proficiency by 2014. The NCLB only requires interventions and sanctions for Title I schools, but we recommend that the state also intervene at non-Title I schools. Using 2001 API data, there are 763 decile one schools, of which 682 receive Title I funding and 81 do not. It is important to intervene in all decile one schools because almost 11 percent of decile one schools are not in Title I and the accountability system should not create incentives for schools to forgo Title I funds in an effort to escape accountability. As discussed in more detail below, we recommend that the state restructure HPSGP to serve as the state's primary program for state and federal accountability purposes.

Provide Less Intensive Interventions at Higher Performing Schools

We recommend that the Legislature design the accountability system to provide less intensive state interventions and sanctions for higher performing schools.

While we recommend that state intervention focus on API decile one, many other Title I schools will be identified for Program Improvement. These schools should receive less intensive interventions and less severe sanctions than decile one schools. Local education agencies are primarily responsible for selecting and implementing corrective action and restructuring options. However, the state is responsible for providing technical assistance through the statewide system of school support, which is a regional system administered by county offices of education. We recommend that the state not provide any interventions beyond the required statewide system of school support for Title I schools in deciles two through ten.

Redesign HPSGP to Serve State and Federal Purposes

We recommend that the Legislature restructure the High Priority Schools Grant Program to serve as the primary accountability program for state and federal purposes.

In order to integrate the state and federal accountability systems, the Legislature needs to simplify state interventions and focus on the neediest schools. We believe the Legislature should phase out II/USP by not adding any new cohorts because only one-fifth of schools participating in II/USP are in decile one of the API. Instead, the Legislature should align HPSGP with NCLB. We recommend that the restructured HPSGP have the following key components:

- Provide funding for schools classified as decile one that are not currently in HPSGP (172 schools, using 2001 decile data). In designing this program, the Legislature should be careful to include non-Title I schools without creating a new state mandate.
- Make planning requirements uniform so that schools need only submit one plan for state and federal interventions.
- Provide all HPSGP schools with funding for a specified number of years and not use significant growth as a trigger for additional funding for the reasons discussed below.
- Modify sanctions to coincide with those required by NCLB for corrective action and restructuring.

- Assign HPSGP schools entering Program Improvement Level 3 a school support team through the statewide system of school support. These teams are similar to SAITs required under PSAA. School support teams would not be provided for any other schools in Program Improvement Level 3 or above.

Transition Schools in State Intervention Programs To New System Expeditiously

We recommend that the Legislature enact legislation that expeditiously transitions schools currently in the Immediate Intervention/Underperforming Schools Program and High Priority Schools Grant Program to the newly integrated accountability system while following through on existing sanction commitments. We further recommend that the Legislature end use of significant growth as a criterion for further funding.

The first cohort of II/USP has already reached the sanction phase. Other schools in II/USP and HPSGP will be reaching sanctions over the next few years. There is a large degree of overlap between schools in Program Improvement and the state intervention programs. Sixty percent of Program Improvement schools are currently participating in II/USP or HPSGP and many other II/USP and HPSGP schools will likely be identified for Program Improvement in the next few years. To simplify sanctions for these schools, we recommend that the Legislature align the timing and types of sanctions with the federal model as soon as possible.

In transitioning to a new accountability system, the state should be careful to follow through with original sanction commitments to maintain credibility. The SBE has been slow to implement the rigorous sanctions required by PSAA. The first year that II/USP schools could face sanctions was 2002-03. A total of 24 schools in cohort one had no growth or negative growth for two consecutive years and are subject to sanctions in 2002-03, but SBE has not yet formally sanctioned these schools. Chapter 1035 (SB 1310, Alpert), became effective on January 1, 2003, which requires SBE to determine whether a school made significant growth within 30 days of public release of a school's growth in API results. Growth API results were released publicly in October 2002. In November 2002, the SBE announced its intent to delay decisions on sanctions until March 2003. The SBE's reluctance to sanction schools stems primarily from concern that the schools being sanctioned are not the lowest performing schools. Only one of the schools is in decile one, 12 are in decile three (50 percent), and six are in decile five (25 percent). While the schools being sanctioned may not be the lowest performing schools, it is important for the state to follow through with the commitment to sanction schools that have not been able to make any improvement in order to maintain credibility.

The Legislature should also end use of significant growth as a criterion for continued funding. Schools that make significant growth after implementation receive another year of funding and avoid sanctions for one year. The SBE defined significant growth as one point positive growth in either implementation year. This was done to limit the number of schools facing sanctions because of capacity constraints. The result of this policy for II/USP cohort one schools was: 73 percent made significant growth, 7 percent faced sanctions, and 20 percent exited the program. An examination of the schools classified as significant growth reveals that almost 19 percent actually had a net decline in API over two years. In addition, only 35 percent of significant growth schools had positive API growth in both years.

The current significant growth definition is problematic because it is difficult to justify sanctioning some schools that had a net decline in API and not others. In addition, tying significant growth to receipt of an additional year of funding creates challenges because schools cannot plan for an additional year of funding. Funding for these schools is not available until around January because schools must wait until October or December for their final API growth results. Therefore, schools must decide whether to continue implementing their action plan several months before they know whether state funding will be available. For these reasons, we recommend against using significant growth for funding decisions and instead, providing funding for a fixed number of years. Under our recommendation, school districts could still use significant growth to determine the intensity of interventions and sanctions.

Change Definition of Proficiency

We recommend that the Legislature amend the Public Schools Accountability Act to define "proficiency" for purposes of the federal No Child Left Behind Act as passage of the high school exit exam for grades 10 through 12, and being on-track to pass the high school exit exam for grades two through eight.

As part of the definition of AYP, SBE opted to maintain the current definition of academic proficiency. For grades two through eight, students must score at the proficient or advanced levels on the California Standards Tests for English language arts and mathematics. For grades 10 through 12, SDE will select a score on the CAHSEE that corresponds to proficiency levels on the California Standards Tests. This score will be *higher* than the score required to pass the CAHSEE. Approximately one-third of students currently reach proficiency on the California Standards Tests, meaning that two-thirds of California's students will need to improve their performance to reach proficiency within twelve years as required by NCLB. It will be very difficult for all students to reach this standard and many schools will be identified for Program Improvement. In light of these consequences, we believe the Legislature should reconsider the definition of proficiency.

The SBE designed the proficient and advanced achievement levels to represent students achieving above grade level who are on track to attend CSU or UC. While the state expects all students to aspire to these proficiency levels, SBE did not establish these performance levels as a requirement for all students. The only performance requirement for all students is passage of CAHSEE. The SBE set the minimum passing score for CAHSEE at a level that reflected a performance expectation for all students, which is lower than what would be considered proficient on the California Standards Tests.

We recommend that the Legislature change the definition of proficiency to make passage of CAHSEE the ultimate goal for all students. The definition of proficiency for grades two through eight could be defined at a level commensurate with being on track to pass the CAHSEE. While this recommendation will create a lower standard than what SBE approved for the definition of AYP, it will provide a more consistent message for what the state expects of schools and students. It will also slow the rate that schools enter Program Improvement.

Set Aside Funding for Restructured Accountability System

We recommend that the Legislature set aside $50 million for the restructured accountability system. (Increase Item 6110-123-0001 by $50 million.)

The 2003-04 proposed budget contains $357 million for state and federal sanction and intervention programs. We estimate that the Governor's proposed budget underfunds II/USP and HPSGP by an estimated $69 million due to the across-the-board cuts, the Legislature's decision in the 2003-04 First Extraordinary Session to start a second cohort of HPSGP, and the Legislature's decision to realign the timing of expenditures. In addition, the restructured system will also create cost pressures. Because a more detailed proposal is necessary to estimate the cost of the restructured system, an exact cost estimate is unavailable at this time. We recommend that the Legislature set aside $50 million to address the funding shortfalls and fund a redesigned accountability system. We will provide more details at budget hearings on the cost options.

A restructured accountability system could be funded with a combination of state Proposition 98 and federal resources. In 2003-04, the state must spend 2 percent of its Title I allocation on Program Improvement activities ($29.1 million) which has been budgeted by the Governor. There will also be approximately $15.4 million in federal carryover funds available in 2002-03. Carryover funds have not been programmed in the budget. In 2004-05 and beyond, the set-aside climbs to 4 percent ($60 million). The state could use these federal funds for the statewide system of school support, school support teams for HPSGP Title I schools in corrective action, and per pupil funding for HPSGP Title I schools. The CSRD program could also bear some of the per pupil costs for HPSGP schools that apply for CSRD funding. The state would bear the remaining costs, and in the "Proposition 98 Budget-Year Priorities" section, we identify savings to pay these costs.

INSTRUCTIONAL MATERIALS

We recommend that the Legislature enact legislation to allow materials adopted in the interim adoptions required under Chapter 481, Statutes of 1998 (AB 2519, Poochigian), to be recognized as standards-aligned materials for the purposes of eligibility for categorical programs. In adopting this recommendation, the Legislature would: (1) recognize the $1 billion investment in Schiff-Bustamante Standards-Based Instructional Materials funding, much of which districts spent on these materials, and (2) relieve districts from the costs of new materials.

The Governor's budget proposes to create a $5.1 billion categorical block grant composed of 58 individual K-12 programs. The block grant includes $204.5 million that was previously budgeted for the Instructional Materials Funding Realignment Program (IMFRP). The Governor's block grant keeps the instructional materials program's laws and regulations in place, requiring school districts to provide each student with new standards-aligned materials within 24 months of a statewide adoption. Funding for instructional materials to school districts is based on an equal amount per pupil enrolled in elementary and high schools

Background. California began moving to a standards-based educational system in 1995 when Chapter 975, Statutes of 1995 (AB 265, Alpert), required the creation of the Commission for the Establishment of Academic Content and Performance Standards. The commission was required to develop academically rigorous content and performance standards in the core curriculum subject areas for grades K-12. In 1998, academic content standards were developed for English language arts, mathematics, history-social science, and science. Recognizing the necessity of providing pupils with standards-aligned materials, the Legislature passed legislation (Chapter 481, Statutes of 1998 [AB 2519, Poochigian]) directing the State Board of Education (SBE) to conduct a special interim adoption of basic and partial programs in English language arts and mathematics prior to 2001. These materials were required to cover a course of study, or a substantial portion of a course of study, essential to meeting adopted academic content standards. These materials were adopted in 1999 and remain in effect until June 30, 2005 for English language arts, and June 30, 2003 for mathematics. In addition, the Legislature created the Schiff-Bustamante Standards-Based Instructional Materials program—Chapter 312, Statutes of 1998 (AB 2041, Bustamante)—which appropriated $1 billion over a four-year period for school districts to purchase instructional materials that were aligned with state content standards. Between 1999 and 2001, many school districts purchased materials adopted during the interim adoption with their share of the $1 billion in Schiff-Bustamante funds.

Creation of IMFRP. Chapter 802, Statutes of 2002 (AB 1781, Hertzberg), created IMFRP, which consolidated three existing categorical programs—K-8 Instructional Materials Fund, 9-12 Instructional Materials Fund, and the K-4 Classroom Library Materials Program—into a new block grant that took effect January 1, 2003. The main purpose of the IMFRP is to provide a source of funding for the purchase of standards-aligned materials in the core subject areas of English language arts, mathematics, history-social science, and science. Districts are to use funding in the following manner:

- First priority is the purchase of standards-aligned materials in (1) English language arts, (2) mathematics, and (3) reading intervention programs for English language learners in grade 4 through 8 or students reading two or more years below grade level.
- Second priority is the purchase of standards-aligned materials in history / social science and science.
- Third priority is the purchase of other instructional materials for areas such as visual and performing arts, foreign language, health materials, supplementary materials, tests, technology based materials, and classroom library materials for grades K-4. However, before they may purchase materials from the third category listed above, the governing board of a district is statutorily required to certify that every pupil will be provided with standards-aligned materials in the four core curriculum areas.

SBE Excludes Chapter 481 Materials. In developing the IMFRP regulations, the SBE concluded that the English language arts and mathematics materials adopted in the interim adoption under Chapter 481, did not qualify as being standards-aligned because they were not adopted using the existing standards-aligned "framework." Essentially, the English language arts content standards designate what to teach at specific grade levels. The framework provides guidelines and selected approaches for implementing instruction to help pupils in meeting the standards.

For districts that purchased interim adopted materials and who wished to access the IMFRP funding, this decision in effect required them to reinvest in new English language arts and mathematics instructional materials even though they are not significantly different from the interim materials. The SBE also requires school districts to purchase the new materials if they want to participate in and receive state funding for the following set of programs:

- ***Reading First***—A federal reading intervention program focused on ensuring that all children learn how to read by the end of the third grade. Funding is also available for special education pupils in K-12.
- ***Mathematics and Reading Professional Development***—A Governor's initiative to provide funding for professional development in mathematics and reading language arts for teachers, instructional aides, and paraprofessionals. Training focuses on standards-based instructional materials.
- ***Principal Training***—Provides funding for principals and vice principals to receive instruction and training in school financial and personnel management, core academic standards, and curriculum frameworks and instructional materials aligned to the state academic standards.
- ***High Priority Schools Grant Program***—A state intervention program for the lowest performing schools (schools in the first decile of the Academic Performance Index).

Benefits of Recognizing Chapter 481 Materials

The Legislature has historically been committed to ensuring that pupils are provided with standards-aligned instructional materials and providing school districts with funding to make the investment in these materials. Consistent with this commitment, we recommend the Legislature pass legislation to allow materials adopted in the interim adoptions required under Chapter 481 to be recognized as standards-aligned materials. In adopting this recommendation, the Legislature would be: (1) recognizing the $1 billion investment in Schiff-Bustamante Standards-Based Instructional Materials funding that districts have made, (2) providing districts with greater flexibility in which to utilize IMFRP funding to purchase other instructional materials that will best meet their district needs, and (3) allowing districts using interim adopted materials to participate in new school reform programs.

SPECIAL EDUCATION

Budget Threatens Federal Funding

We recommend the State Department of Education report at budget hearings on the likelihood that the federal Department of Education would grant California a waiver of the special education maintenance of effort requirements for 2003-04.

The Governor's budget proposes $2.66 billion from the General Fund for special education in 2003-04, a reduction of $52.1 million from the revised 2002-03 estimate of $2.71 billion. The state supports special education costs with three sources of funding: General Fund, local property taxes, and federal funds. The General Fund covers the program's funding needs that are not met by federal funds or property taxes.

In our discussion of the 2002-03 budget reductions earlier in this chapter, we identified a federal maintenance-of-effort (MOE) problem created by the deferral of special education payments. Federal law contains an MOE requirement that states must meet to qualify for federal funding. This requirement mandates that state spending on special education must not decrease from the prior year as a condition of receiving federal funds. State spending for the purposes of the MOE is defined as state General Fund support and local property taxes going to special education.

The proposed 2003-04 special education budget presents two additional issues. First, state funds proposed by the budget fall $28.5 million short of meeting the MOE. Depending on the outcome of discussions with the federal government, this reduction could threaten a portion of our federal funds. Second, the budget includes $21 million in General Fund support to restore 2002-03 funds resulting from the Governor's across-the-board reduction. To date, the Legislature has not adopted this reduction, and therefore the restoration appears unnecessary. As a result, the Legislature could redirect these funds to other Proposition 98 priorities.

State Should Seek a Federal Waiver. According to the Department of Finance, the administration is considering two options to address the MOE issue: (1) apply for a federal waiver to allow California to continue receiving federal funds despite the fall in state funding for special education and (2) increase General Fund support for the program in the May Revision by $28.5 million.

California would appear to have a case for a waiver. The budget proposes to fully fund the projected need for special education funding (although without a cost-of-living adjustment), which would assure the federal government that student services as identified in each student plan would be provided. In addition, the state would have maintained its commitment to students at a time almost all other budgets are being reduced due to the state's fiscal crisis.

The waiver option is worth exploring given the savings it would generate. Therefore, we recommend the State Department of Education discuss the possibility of a waiver of MOE with the federal department and report to the budget committees during hearings on California's chances of obtaining a waiver.

If the waiver appears likely, the Legislature could not only recognize the $28.5 million in savings assumed in the budget, but also reduce the special education appropriation by $21 million. If a waiver does not appear likely, the Legislature will need to increase special education funding by the $28.5 million shortfall, and redirect the $21 million the Governor provided to restore the across-the-board cut to other special education purposes.

CHILD CARE AND DEVELOPMENT

The *2003-04 Governor's Budget* proposes $1.3 billion in state and federal funding for child care and development programs in the State Department of Education (SDE). This is a decrease of $1.1 billion, or 46.2 percent, from the enacted 2002-03 budget. (As we discuss below, $967.6 million of the proposed reduction reflects Proposition 98 savings associated with the administration's "realignment" proposal.) The $1.3 billion proposed for 2003-04 consists of $432.5 million from the General Fund (Proposition 98) and $903.9 million in federal funds. The SDE child care programs would be funded as follows:

- $314.2 million in General Fund support to serve about 100,000 children in state preschool.
- $107.3 million in General Fund support for the After School Education and Safety Program to provide homework assistance and recreational activities to about 116,000 students in kindergarten and grades 1 through 9.
- $11 million in General Fund carryover from 2001-02 child care appropriations.
- $863 million in federal funds for child care subject to pending realignment proposal.
- $40.9 million in federal funds for federal 21st Century Community Learning Centers, which provide academic enrichment and recreational activities to students in kindergarten and grades 1 through 12.

In addition, the Governor's budget provides another $546.5 million for California Work Opportunity and Responsibility to Kids (CalWORKs) child care in other departmental budgets, including $531.5 million in the Department of Social Services (DSS) budget. This brings the state's total child care and development expenditures from state and federal funds to approximately $1.9 billion in the budget year. This total does not include another piece of California's subsidized child care system—the federal

Head Start program, which provides preschool services at many sites in California but is managed directly by the federal government without state involvement. In federal fiscal year 2001-02, the federal government spent nearly $690 million on Head Start programs in California, serving roughly 98,000 children.

CHILD CARE REALIGNMENT

A centerpiece of the Governor's budget is a major realignment of state and county programs. In "Part V" of the 2**003-04 Budget: Perspectives and Issues** ***(a companion document to this*** **Analysis*****), we (1) present the Governor's realignment proposal, (2) discuss fiscal and policy considerations related to realignment, and (3) review the programs proposed for realignment. In this section, we summarize our assessment of the child care realignment proposal.***

The Governor's proposal shifts responsibility for most child care programs (excluding state preschool and before and after school programs) from the state to counties. Turning the programs over to the counties would result in savings of $967.6 million in General Fund (Proposition 98) from the level of the enacted 2002-03 budget. (The realignment proposal raises various issues regarding the Proposition 98 minimum funding level. See the text box (page 140) for a discussion of some of these issues.) Under the Governor's realignment plan, counties would receive $8.2 billion in revenue from increased taxes for child care and other programs proposed for realignment. (We further discuss available funding to carry out realignment responsibilities in "Part V" of the *2003-04 Budget: Perspectives and Issues*.)

Problems With the Current Child Care System

California's subsidized child care system is currently administered primarily through SDE and DSS. The enacted *2002-03 Budget Act* allocates about $3.1 billion—$1.7 billion from the General Fund and $1.4 billion in federal funds—for over 15 different child care and development programs. About half of this amount is spent on programs restricted to current and former CalWORKs recipients. All other programs, however, are also open to former CalWORKs recipients after they leave CalWORKs-funded child care, depending on space availability and income eligibility. The main rationale for the CalWORKs child care programs is to address the particular needs of families moving from welfare to work.

As we have discussed in prior budget analyses, the existing system of child care programs creates significant problems for families, local providers, and the state. These include:

- ***Child Care Delivery System Is Unnecessarily Complex.*** The state's child care programs generally are funded from different sources, use separate eligibility criteria, use different points of entry, and maintain separate waiting lists. The uncoordinated manner in which the programs have been designed and administered impedes families' access to the system. For example, the separation of the CalWORKs child care system into three stages can cause a disruption in services because not all Stage 1 providers are available under Stage 2. (We describe the CalWORKs child care system in further detail below.)

- ***Administration of Child Care Contracts Is Cumbersome and Expensive.*** The complexity of child care program rules creates problems for local child care providers. This complexity permeates every aspect of the child care system. For example, different programs have different eligibility rules and different rate structures. Providers that operate under more than one program also have to negotiate separate contracts for each program. They must also follow complex rules regarding allowable expenditures and attendance accounting, and collect detailed administrative information on these factors. Most of the child care-related positions in SDE are devoted to assisting contractors and implementing the cumbersome rules and requirements.

- ***Stage 3 Costs Are Growing.*** The Legislature created the CalWORKs Stage 3 child care program in order to provide continuing child care for former CalWORKs recipients who reach the end of their two-year Stage 2 time limit. (Participants can stay in Stage 2 while on CalWORKs for up to two years after the family stops receiving a CalWORKs grant.) So long as funding is available—and legislative practice to date has been to fully fund estimated need—former CalWORKs recipients may receive Stage 3 child care as long as they are income eligible. According to the administration, the cost to fully fund Stage 3 in the budget year is $451.4 million. This is an increase of $92.9 million, or 26 percent, above the enacted 2002-03 budget. With no restrictions for former CalWORKs recipients, costs can be expected to continue to increase in the out years.

- ***Current System Treats Similar Families Differently.*** As we pointed out in our *Analysis of the 2000-01 Budget Bill* (see page E-94), the current child care system treats families with similar incomes differently, depending on whether they have received public assistance in the CalWORKs program. In general, families who have been on CalWORKs and subsequently leave the program can continue to receive child care under Stage 3. However, working poor families that have never been on CalWORKs receive care only if space is available. (Typically, there are long waiting lists for non-CalWORKs child care.)

Realignment and the Proposition 98 Minimum Guarantee

The Governor's budget proposal to realign child care programs from the state to the counties raises two issues related to the Proposition 98 minimum guarantee, which we address below.

One of the major factors that drives the Proposition 98 minimum guarantee is the change in per capita General Fund revenues. At present, increases in General Fund revenue would also increase the minimum guarantee. The administration's position is that the realignment revenues it has proposed are *not* new General Fund revenues since they are directly deposited into a new special fund. Therefore, there is no impact on the minimum guarantee from this revenue change. A similar rationale was used during realignment in 1991. Others would argue that setting up a separate fund does not change the underlying nature of the revenues, and that these new revenues would be considered General Fund tax revenues for purposes of Proposition 98. If the proposed $8.2 billion in new net revenues were considered General Fund proceeds of taxes, then the minimum guarantee would require the state to provide an additional $3.5 billion in funding for Proposition 98 programs.

Conditional Suspension of Proposition 98 Would Remove Uncertainty. To address the uncertainty about the impact of the new revenues on the Proposition 98 minimum guarantee, the Legislature could "conditionally" suspend the minimum guarantee. A similar approach was taken by the Legislature when the sales and use tax was raised to pay for repair of damages caused by the Loma Prieta earthquake. Specifically, the legislation authorizing the tax stated that the sales and use tax revenues did not affect the minimum guarantee, and if a party ever legally challenged the impact the new tax had on Proposition 98, then the minimum guarantee would be suspended.

Child Care Realignment Merits Consideration

In view of the problems identified above, we believe the Governor's proposal to realign child care programs deserves legislative consideration. First, realignment would provide counties greater flexibility to use available funds as part of an integrated strategy to serve low-income families. Such flexibility would allow counties to use the funds to more efficiently tailor programs to their local child care needs and better coordinate with

"Rebenching" Proposition 98 to Reflect Transfer of Child Care Program. As part of transferring the child care programs out of Proposition 98, the Governor proposes to rebench the minimum guarantee downward by the amount of Proposition 98 funds provided for child care in 2002-03. The State Constitution is silent on whether the minimum guarantee can be rebenched when a program is moved into or out of the minimum guarantee. State law and administrative practice suggest, however, that the minimum guarantee can be rebenched to adjust for programs moving out of the minimum guarantee. Specifically,

- Education Code Section 41204 states legislative intent that the Proposition 98 minimum guarantee be increased by a corresponding adjustment if programs are shifted to school districts or community college districts from other entities.
- As part of the *CTA v. Gould* settlement, Chapter 78, Statutes of 1996 (SB 1330, Committee on Budget and Fiscal Review), removed 15 programs totaling $22 million from counting toward the minimum guarantee for 1995-96. The Department of Finance rebenched the minimum guarantee downward by the same amount.

While these two examples suggest that the Governor's proposal is reasonable, others believe that the Constitution does not allow the minimum guarantee to be rebenched. If the Legislature chooses to realign child care programs to counties, it could accept the administration's action to rebench the minimum guarantee, and provide statutory language stipulating that if the rebenching is legally challenged at the appellate court level, then the child care program's funding would be transferred back into the minimum guarantee. Since child care costs are likely to grow as fast as the minimum guarantee, such statutory language would remove any fiscal incentives to sue the state on this matter.

other social services, thereby providing families greater access to services. Second, realignment would reduce administrative complexity in the system by allowing counties to provide child care under their own set of program rules related to eligibility, family fees, and reimbursement rates. It recognizes that child care needs vary greatly from county to county, and that local governments are in the best position to make detailed program decisions. Finally, the proposal would allow counties to allocate resources in a way that more equitably serves welfare, former welfare and nonwelfare families. Such flexibility would facilitate innovative approaches in balancing the needs of these families.

Option of Realigning Child Care to the California Children and Families Commissions (CCFCs). The Governor's proposal does not address the question of which local agencies would receive the proposed child care realignment funds. The county-operated CCFCs are a potential candidate to receive these realignment funds. These commissions, created by Proposition 10 in 1998, receive certain tobacco tax revenues (about $460 million in the budget year) and use these funds for the purpose of improving early child development. The Legislature may amend this initiative statute by a two-thirds majority vote so long as the amendment advances the purposes of the initiative. County boards of supervisors appoint the local commissioners. The county commissions currently expend some of their funding on child care.

Potential advantages of realigning child care to the CCFCs include their expertise in child development, their existing administrative structure, and at CCFC discretion, additional funding for child care from the cigarette tax revenues. The main alternatives to the CCFCs would be county welfare departments (that currently oversee CalWORKs Stage 1 child care and thus have experience in this area), existing local child care and development planning councils, and newly created county child care departments.

State Operations Reduction Due to Realignment

We recommend that the Department of Finance and the State Department of Education provide additional information prior to budget hearings regarding the feasibility and implications of the proposed reduction of $9 million and 77.8 personnel years related to child care realignment, in order to better determine its appropriateness.

As part of the Governor's proposed realignment of child care programs, the budget reduces a total of $9 million ($2.7 million from the General Fund and $6.3 million in federal funds) and 77.8 personnel years (PYs) from SDE's state operations budget. Presumably SDE would no longer need this support if the various child care programs were shifted away to the counties. According to the Department of Finance (DOF), the proposed reduction would leave SDE with $4.7 million in the budget year for 38 PYs to (1) administer state preschool and before and after school programs, (2) assist in the realignment transition of state contracts to county allocations, and (3) close out pending child care audits.

At the time this analysis was being prepared, we were unable to determine the appropriateness of the proposed state operations reduction associated with child care realignment for two reasons. First, DOF has been unable to provide sufficient information to justify the magnitude of the proposed reduction and the rationale for cutting specific positions. Second, although SDE has raised preliminary concerns about the Governor's proposal, it has been unable thus far to provide an alternative proposal or explain the likely implications of the reduction. For example, the department cannot identify the level of funding and PYs necessary to adequately carry out the remaining activities after realigning most child care programs. In view of the above, we recommend DOF and SDE provide additional information prior to budget hearings to justify the magnitude of the proposed reduction and describe its possible implications. This information would allow the Legislature to determine the appropriateness of the reduction.

THE CALWORKS CHILD CARE SYSTEM

The Governor's budget fully funds the estimated need for California Work Opportunity and Responsibility to Kids Stage 1 child care. However, the budget eliminates funding for Stage 2 and Stage 3 child care due to realignment.

Background

Currently, the CalWORKs child care system is delivered in three stages. Stage 1 is administered by county welfare departments (CWDs) and begins when a participant enters the CalWORKs program. In Stage 1, CWDs refer families to resource and referral agencies that help families find child care providers. The CWDs then pay providers directly for the child care services.

Families transfer to Stage 2 when the county determines that the families' situations have become "stable"—that is, families develop a welfare-to-work plan and find a child care arrangement that allows them to fulfill the obligations of that plan. Stage 2 is administered by SDE through its voucher-based alternative payment programs. Participants can stay in Stage 2 while on CalWORKs and for up to two years after the family stops receiving a CalWORKs grant.

Once CalWORKs families leave grant aid, they have two years of further eligibility in Stage 2. During this time, they may apply for a space in the non-CalWORKs subsidized child care system. We note, however, that typically there are long waiting lists for such child care since demand from eligible families substantially exceeds available child care "slots." Families with incomes up to 75 percent of state median income are eligible for SDE's other subsidized child care programs, but priority is given to families with the lowest income. Most available slots, therefore, go to families with incomes below 50 percent of the state median.

The Legislature created CalWORKs Stage 3 child care in 1997 in order to provide continuing child care for former CalWORKs recipients who reach the end of their two-year Stage 2 time limit. Recipients timing out of Stage 2 are potentially eligible for Stage 3 if they have been unable to find a space in SDE's other child care programs. These families may receive Stage 3 child care as long as their income remains below 75 percent of the state median and their children are age 13 or younger.

Governor's CalWORKs Child Care Budget

As indicated in Figure 1, the Governor's budget proposes $546.4 million for CalWORKs child care. This is a decrease of approximately $1 billion from the level of the current-year enacted budget. As discussed earlier, this decrease is primarily due to savings associated with the Governor's realignment proposal. The budget does provide $474 million to DSS for CalWORKs Stage 1 child care in order to serve roughly 70,000 children.

The proposed budget also includes a CalWORKs child care reserve of $57.4 million. This amount represents a "hold back" of 5 percent of the estimated need of Stages 1 *and* 2. Although the Governor's budget eliminates state funding for Stage 2 and shifts program responsibility to counties, the budget does set aside funds in the reserve for the program. At the time of this *Analysis*, DSS staff could not specify how these reserve funds would be allocated under the Governor's realignment proposal. Below, we discuss the Governor's proposed funding for Stage 3 in the current and budget year.

Figure 1

Governor's Proposal for CalWORKs[a] Child Care

2003-04
(Dollars in Millions)

	Agency[b]	Estimated Enrollment	Proposed 2003-04 General Fund	Proposed 2003-04 Federal Funds	Proposed 2003-04 Total
Stage 1	DSS	69,900	$51.6	$422.4	$474.0
Stage 2	SDE	—	—	—	—[c]
Community colleges (Stage 2)	CCC	3,000	15.0	—	15.0
Child care reserve	DSS	8,500	—	57.4	57.4
Stage 3	SDE	—	—	—	—[c]
Totals		**81,400**	**$66.6**	**$479.8**	**$546.4**

a California Work Opportunity and Responsibility to Kids.

b DSS = Department of Social Services; SDE = State Department of Education; CCC = California Community Colleges.

c Governor's budget eliminates funding as part of proposed realignment.

Governor Eliminates Funding for Stage 3 in Budget Year

Current Year. As indicated in Figure 2 (see next page), the *2002-03 Budget Act* included a total of $358.5 million to fully fund the estimated Stage 3 need (approximately 58,000 children on an average monthly basis) as projected in the 2002 May Revision. This total includes $220.5 million in General Fund support (Proposition 98) and $138 million in federal funds. Figure 2 shows that $28.9 million of the General Fund support for Stage 3 consists of one-time funds from prior-year Proposition 98 savings and child care carryover.

For the current year, the Governor proposes to reduce total Proposition 98 funding for CalWORKs Stage 3 child care by $187.1 million (from $220.5 million to $33.4 million). The proposed reduction consists of:

- $10 million due to revised caseload estimates decreasing the average monthly caseload from 58,000 to 55,700 children.
- $98.8 million from the elimination of Stage 3 child care effective April 1, 2003.
- $78.3 million to be replaced with one-time federal funds.

At the time of this writing, both houses of the Legislature had taken action to approve the Governor's proposal to (1) reduce Stage 3 funding by $10 million due to revised caseload estimates and (2) use one-time federal funds to free up $78.3 million in current-year Proposition 98 funds. However, they rejected the Governor's proposal to eliminate Stage 3 effective April 1, 2003.

Budget Year. For 2003-04, the Governor's budget reflects the proposed elimination of Stage 3 child care services. We note that the $967.6 million General Fund (Proposition 98) savings associated with realignment in 2003-04 includes the $191.6 million base funding for Stage 3 that is proposed for elimination in 2002-03 (see Figure 2). Under the Governor's realignment proposal, counties would essentially have the flexibility to meet the child care needs of former CalWORKs recipients, or other low-income families.

Figure 2

CalWORKs[a] Stage 3 Child Care

2002-03 Budget Act
(In Millions)

	One-Time Funds	Ongoing Funds	Total
General Fund (Proposition 98)	$28.9	$191.6	$220.5
Federal funds	16.5	121.5	138.0
Totals	**$45.4**	**$313.1**	**$358.5**

a California Work Opportunity and Responsibility to Kids.

PROPOSITION 49: AFTER SCHOOL EDUCATION AND SAFETY PROGRAM

The Governor's budget for 2003-04 includes $107.3 million in General Fund support (Proposition 98) for the After School Education and Safety Program (known as the Before and After School Learning and Safe Neighborhoods Partnership Program prior to the passage of Proposition 49 in November 2002). This is a decrease of $14.3 million from the level of the enacted 2002-03 budget and an increase of $2.5 million from the Governor's proposed revision of the 2002-03 budget. For the most part, these changes result from the Governor's across-the-board reductions to categorical programs in K-12 education in the budget year.

What Are the Spending Requirements of Proposition 49?

Proposition 49 requires a "continuous appropriation" (that is, automatic year-to-year funding without further legislative action) from the General Fund beginning in 2004-05 for the After School Education and Safety Program. The annual amount of this appropriation would depend on growth in General Fund spending outside of Proposition 98, but not to exceed $550 million. Specifically,

- If General Fund spending on non-Proposition 98 programs will exceed by at least $1.5 billion the highest amount spent in any year between 2000-01 and 2003-04, then the state must increase funding for the after school program beyond its 2003-04 funding level. Once funding reaches $550 million, no further increases are required.
- Otherwise, the state is required to provide at least the same level of funding to the program as provided in the preceding fiscal year.

Thus, the minimum amount of the continuous appropriation starting in 2004-05 is the level of program funding the Legislature provides in 2003-04. (As discussed above, the Governor's budget proposes $107.3 million for the program.) According to Proposition 49, any annual increase in this amount would *not count* towards meeting the state's minimum funding requirement for Proposition 98 for that year. In effect, Proposition 49 would thus require the state to "over-appropriate" Proposition 98's minimum requirement. This would result in an increase in the annual level of state appropriations for K-14 education and would leave less money available for other General Fund supported programs.

When Will the State Be Required to Increase Funding?

In view of the significant General Fund budget shortfall facing the state, we believe that it is unlikely that additional funding would be required for the After School Education and Safety Program (Proposition 49) in 2004-05 and 2005-06.

Figure 3 (see next page) summarizes General Fund spending on programs that do not count towards the Proposition 98 funding guarantee for K-14 education. Under the Governor's budget proposal, General Fund (non-Proposition 98) spending is the highest in 2000-01 at $48.1 billion during the base years specified in Proposition 49. This means that General Fund spending on non-Proposition 98 programs must reach at least $49.6 billion ($48.1 billion *plus* $1.5 billion), in order for the proposition's funding formula to "trigger" in 2004-05 or any subsequent year. We note, however, that the Governor's budget reduces state spending on non-Proposition 98 programs to $34.5 billion. (Over $7 billion of this reduc-

Figure 3

Proposition 49 Spending Requirements

(In Millions)

	General Fund (Non-Proposition 98) Spending
2000-01	$48,144
2001-02	47,420
2002-03 (estimated)	46,563
2003-04 (proposed)	34,543
Proposition 49 Threshold	**$49,644**

tion stems from the Governor's proposal to realign non-Proposition 98 programs.) As a result, Proposition 49 would require additional funds for the program in 2004-05 (the first year of the proposition's funding requirements) only if General Fund non-Proposition 98 spending increases by $15.1 billion from the proposed 2003-04 level.

We believe that it is unlikely that additional funding would be required for the After School Education and Safety Program in 2004-05 and 2005-06, given the current budget situation.

COMMISSION ON TEACHER CREDENTIALING (6360)

The Commission on Teacher Credentialing (CTC) was created in 1970 to establish and maintain high standards for the preparation and licensing of public school teachers and administrators. The CTC issues permits and credentials to all classroom teachers, student services specialists, school administrators, and child care instructors and administrators. In total, it issues more than 100 different types of documents.

The Governor's budget includes a total of $67 million for CTC. This is $8.7 million, or 11 percent, less than CTC's revised current-year budget (assuming passage of AB 8x [Oropeza]). Of CTC's proposed 2003-04 budget, $40 million is from the General Fund (Proposition 98). These funds are designated for four CTC-administered local assistance programs. Three of these programs serve interns, preinterns, and paraprofessionals and the other program supports teacher assignment monitoring. The Governor's budget proposes defunding the California Mathematics Initiative for Teaching.

Major General Fund Budget Proposals

Figure 1 (see next page) lists the Governor's major General Fund budget proposals. The budget would reduce total General Fund spending by $5.6 million, or 12 percent, from the revised current-year level. The intern program would receive a $1.1 million, or 5 percent, augmentation in the budget year. Funding for the preintern program and paraprofessional program, on the other hand, would decline by 35 percent and 9 percent, respectively. The Governor proposes to eliminate the California Mathematics Initiative. This program was intended to provide financial assistance to individuals to encourage them to teach mathematics, but it has been undersubscribed since its inception in 1998. It was to sunset on June 30, 2004.

Figure 1

Commission on Teacher Credentialing General Fund Budget Summary

(Dollars in Millions)

	Revised 2002-03[a]	Proposed 2003-04	Change From 2002-03	
			Amount	Percent
Local Assistance—Proposition 98				
Internship Teaching Program	$21.5[b]	$22.5	$1.1	5%
Preinternship Teaching Program	16.0[c]	10.4	-5.6	-35
Paraprofessional Teacher Training Program	7.2	6.6	-0.6	-9
Teacher misassignment monitoring	0.4	0.3	—	-12
California Mathematics Initiative for Teaching	0.4	—	-0.4	-100
Totals	**$45.4**	**$39.8**	**-$5.6**	**-12%**

a Assuming passage of AB 8x (Oropeza).

b Of this amount, $17.3 million is Proposition 98 (General Fund) and $4.2 million is reappropriated from the Proposition 98 Reversion Account.

c Of this amount, $11.8 million is Proposition 98 (General Fund) and $4.2 million is reappropriated from the Proposition 98 Reversion Account.

New Federal Accountability Provisions Further Raise Stakes

In 2002, the federal government enacted the No Child Left Behind (NCLB) Act, which includes new accountability provisions relating to both teachers and paraprofessionals. In 2001-02, the federal government also increased California's total Title II Teacher Quality allocation to $332 million—a $105 million increase over the prior year. The new federal accountability provisions and funding augmentations generate even greater incentives for California to improve the quality of its teachers and paraprofessionals. Because CTC's local assistance programs are all designed to improve the quality of beginning teachers and paraprofessionals, CTC could play a role in helping the state meet the new federal requirements.

New Federal Teacher Accountability Provisions Create Added Incentives to Ensure All Beginning Teachers Are Qualified. The NCLB Act includes three new teacher accountability provisions: (1) all teachers funded with federal Title I monies and hired after the first day of the

2002-03 school year are to be "highly qualified," (2) *all* public school teachers are to be highly qualified by the end of the 2005-06 school year, and (3) states are to demonstrate increases in the percentage of teachers who receive high quality professional development. If these objectives are not met, states jeopardize their federal funding for K-12 education programs. These new accountability provisions therefore place even greater onus on the state to produce, hire, and retain highly qualified teachers. The state currently is working to develop its definition of highly qualified teacher.

New Federal Accountability Provisions Also Create Incentives to Ensure Paraprofessionals Are Qualified. Similar to the new teacher accountability provisions, the NCLB Act also includes two added accountability provisions relating to paraprofessionals. The act requires: (1) all paraprofessionals funded with federal Title I monies and hired after January 2002 to be highly qualified, and (2) all existing paraprofessionals funded with federal Title I monies to be highly qualified by the end of the 2005-06 school year. As with the new teacher provisions, these provisions generate even greater impetus for the state to ensure paraprofessionals are highly qualified.

Improve Coherence, Maximize Flexibility, and Increase Accountability Among CTC's Local Assistance Programs

We recommend the Legislature enact legislation that would create greater coherence and consistency among the Commission on Teacher Credentialing's (CTC) intern, preintern, and paraprofessional programs by equalizing per participant funding rates and establishing a consistent matching requirement. We also recommend the Legislature allow CTC maximum flexibility to shift funds among these three programs. Lastly, we recommend the Legislature require CTC to report annually on the effectiveness of its programs in helping districts meet the new federal requirements of having highly qualified teachers in every public school classroom by the end of the 2005-06 school year.

Currently, CTC administers three major local assistance programs—the intern, preintern, and paraprofessional programs. Figure 2 (see next page) provides a brief description of each of these programs, shows the statutorily set maximum per participant funding rates, and identifies the number of participants CTC is serving in the current year. The funding the state provides for these three programs is supplemental to the funding it provides directly for teacher education programs and K-12 professional development and support programs.

Figure 2

Summary of CTC's Major Local Assistance Programs

Program	Description	Funding Per Participant	Estimated Participants 2002-03
Internship Teaching	Provides training and on-site support for new teachers who have already demonstrated subject matter competency but have not yet obtained their full teaching credential.	$2,500	8,561
Preinternship Teaching	Provides subject-matter test preparation as well as training in classroom management and basic pedagogy for new teachers who have not yet demonstrated subject matter competency.	2,000	11,748
Paraprofessional Teacher Training	Provides academic scholarships to teachers' aides and assistants for the purpose of completing college coursework and obtaining teaching credentials.	3,000	2,268

Existing Anomaly—Per Participant Funding Rates Vary. As Figure 2 shows, the per participant funding rates vary among the intern, preintern, and paraprofessional programs. Although many policymakers would consider preinterns to have the greatest needs (because they are teachers of record who have not yet demonstrated subject matter competency), the state currently provides less funding per preintern than intern and paraprofessional.

Existing Anomaly—Only Intern Program Has Matching Requirement. Another anomaly is that only the intern program has a local matching requirement that statutorily requires school districts to pay half the costs associated with supporting interns. Given the direct localized benefits that accrue to school districts in having preintern and paraprofessional programs, it is unclear why matching requirements do not exist for these other programs.

Establishing Coherence and Consistency. Given the lack of sufficient justification for different funding rates and matching requirements, we recommend the Legislature enact legislation that would streamline CTC's programs. Specifically, we recommend the Legislature establish a single per participant funding rate for the intern, preintern, and paraprofessional programs. We recommend the Legislature set the rate at $2,000 and require a dollar-for-dollar school district match (which could be met using federal Title II monies). Although revising the per participant funding rate to $2,500 is an option, we recommend the lower rate because it would enable the state to serve almost 4,000 additional teachers and paraprofessionals in 2003-04 (please see Figure 3). Moreover, the new matching requirement would result in total funding of $4,000 per preintern and paraprofessional, which is a significant increase over the current per participant state funding rates.

Figure 3

Comparing Participation Levels at Various Per Participant Funding Rates

(2003-04)

	Number of Participants		
	Current Funding Rates	$2,500 Funding Rate	$2,000 Funding Rate
Internship Teaching Program	9,014	9,014	11,268
Preinternship Teaching Program	5,194	4,155	5,194
Paraprofessional Teacher Training Program	2,194	2,633	3,292
Totals	**16,402**	**15,802**	**19,753**

Increasing Funding Flexibility. To provide CTC with maximum flexibility to respond to teachers' needs over the next several years, we also recommend the Legislature allow CTC to shift funds among the intern, preintern, and paraprofessional programs. The CTC already has the statutory authority to shift funds from the intern program to the preintern program. This is the only flexibility, however, that it has to move funds among its programs. Flexibility to shift funds among all three programs would allow CTC to be more responsive to school districts' needs and transition as many teachers as possible into intern programs without unnecessarily constraining the size of the other two programs.

Enhancing Accountability. Because the state currently chooses to filter supplemental funding through CTC rather than provide it directly to school districts, we recommend the Legislature strengthen CTC's accountability system. Although statute currently requires CTC to report on the impact of its preintern programs on decreasing the number of emergency permits issued, it does not require CTC to compare the cost-effectiveness of its programs with those run independently by school districts. Most importantly, the Legislature should require CTC to demonstrate that:

(1) its programs produce better results compared to districts that operate without CTC's assistance, and (2) the districts CTC does serve are significantly better than they otherwise would have been without CTC's assistance. We recommend the Legislature require CTC to submit a report annually on these performance outcomes.

In conclusion, we recommend the Legislature enact legislation to streamline CTC's local assistance programs. Specifically, we recommend: (1) establishing a consistent per participant funding rate of $2,000, (2) instituting a dollar-for-dollar school district match (that can be met using federal Title II monies), (3) allowing CTC to shift funds among all three programs, and (4) requiring CTC to report on its ability to reduce emergency permit rates compared with those districts that do not have CTC programs.

Leverage Federal Funds to Expand Services for Emergency Permit Holders

We recommend the Legislature designate $3.1 million in federal Title II funds to expand subject matter training programs for emergency permit holders. These programs are a high priority because: (1) many emergency permit holders are likely to need additional support to become highly qualified by 2005-06, as required by the federal accountability provisions; and (2) the funds are not needed for the program for which they were originally designated.

Title II funds may be used for a variety of teacher training purposes, but the overriding objective is to encourage states to improve teacher quality by ensuring that all public school teachers are (1) proficient in the subject areas they teach and (2) highly qualified in teaching methodologies. Although (as of this writing) California still has not developed its state definition of "highly qualified," emergency permit holders will not be considered highly qualified unless they (1) already are fully credentialed in a different subject, (2) enrolled in a program to obtain a supplemental credential, and (3) have demonstrated subject matter competency in this supplemental area.

More Than 30,000 Emergency Permit Teachers Currently Not in Structured Training Programs. Currently, the only nonfully credentialed teachers the state supports with supplemental training funds are interns and preinterns in CTC-approved programs. The state does not provide supplemental training funds for the approximately 32,500 emergency permit holders currently teaching in districts without these approved programs.

Federal Title II Funds Available to Support Emergency Permit Holders. Not only is the need sizeable, but additional federal funds are available for state-level activities aimed at improving teacher quality and enriching subject matter knowledge. The *2002-03 Budget Act* and the 2003-04 budget proposal each designates $1.6 million in federal Title II funds for the Principal Training program. This program already is being fully funded by the state, so the federal funds designated in the current year have not been used and the funds designated in the budget year are not needed.

Designate Total of $3.1 Million in Federal Title II Funds for Subject Matter Programs for Emergency Permit Holders. Given the sizeable need and the available federal resources, we recommend the state designate $3.1 million in federal Title II monies for subject matter programs for emergency permit holders. The objective would be to provide emergency permit holders with supplemental services to assist them in improving their subject matter competency. So that the funds are not seen as a reward for hiring unqualified teachers, the funds should be one-time monies used on a transitional basis to help districts meet the new federal requirements. We recommend the Legislature require CTC to report on the change in emergency permit holder rates in each school district. Furthermore, as a condition of receiving the supplemental funding, districts should be required to annually reduce the number of faculty who hold emergency permits.

OTHER K-12 ISSUES

ACADEMIC VOLUNTEER AND MENTOR SERVICE PROGRAM

We recommend that the Legislature eliminate the Academic Volunteer and Mentor Service Program due to the existence of other state and federal programs that provide similar program services. (Delete Item 0650-111-0001—$5 million.)

The budget provides a total of $5 million Proposition 98 General Fund for the Academic Volunteer and Mentor Service Program. This program provides funds to school districts to recruit, screen, train, and place volunteers who want to act as mentors to at-risk children. The Office of the Secretary for Education administers the program. The program, established by Chapter 901, Statutes of 1992 (SB 1114, Leonard), provides competitive grants up to $125,000 each year to 60 local mentor programs operated by school districts and county offices of education.

Existence of Various State and Federal Programs Offering the Same Services. Our review indicates that several programs provide similar services to California's at-risk youth. As shown in Figure 1 (see next page), the budget includes funding totaling $749 million in 2003-04 for a wide variety of programs that provide students with academic assistance and enrichment and positive role models. Like the Academic Volunteer and Mentor Service Program, these state and federal programs target at-risk youth and are available before and after school, Saturdays, during the intersession, or during the summer. Many of these programs have grown in recent years. Specifically, the After School Learning and Safe Neighborhood program has grown from $87.8 million in 2000-01 to $121.5 million in the *2002-03 Budget Act*. Proposition 49 will require this program to expand in the near future to $550 million annually. Under a similar new federal program, California schools will receive $40.9 million in 2002-03.

Figure 1

Programs Available to K-12 Students Offering Academic, Mentoring, and Enrichment Services

2003-04
(In Millions)

	Agency[a]	Grades	Governor's Budget
Academic Assistance			
Remedial supplemental instruction	SDE	2-12	$225.9
Core academic summer school	SDE	K-12	210.9
Elementary School Intensive Reading Program	SDE	K-4	26.9[b]
Intensive Algebra Instruction Academies	SDE	7-8	11.2[b]
After School Learning and Safe Neighborhoods	SDE	K-9	107.3
21st Century Community Learning Centers	SDE	K-12	40.9[c]
English Language Acquisition Program	SDE	4-8	46.8[b]
Combination of Mentoring and Academic Assistance			
Partnership Academies	SDE	10-12	$20.3[b]
Advancement Via Individual Determination	SDE	K-12	5.2
Gang Risk Intervention Program	SDE	K-12	2.9[b]
AmeriCorp	Federal	K-12	31.0[c]
Higher Education Outreach Programs			
Early Academic Outreach Program	UC	7-12	$7.9
Math, Engineering, Science Achievement	UC	1-12	4.6
GEAR Up	UC	7-9	5.0
Puente	UC	9-12	1.0
Other outreach programs	UC	K-12	1.2
Total			**$749.0**

a SDE = State Department of Education; UC = University of California.

b These programs are included in the Governor's proposed $5.1 billion block grant.

c These programs are federally funded.

In addition, the federal AmeriCorps program provides about $31 million in 2002-03 to California for community service projects, some of which provide mentoring services targeted to at-risk youth. Finally, many of the University of California's student-outreach programs also offer mentor programs to middle and high school students who are: (1) from low-income families, (2) from groups historically underrepresented in colleges, or (3) will be the first in their families to attend college. Thus, a number of state and federal programs exist that provide opportunities to at risk students to receive academic assistance and enrichment activities that will help them become productive members of society.

Given the duplication of services provided through the above programs, we recommend that the Legislature eliminate the Academic Volunteer and Mentor Service Program.

ENHANCE STATE'S TEACHER INFORMATION SYSTEM

We recommend the Legislature enact legislation creating a comprehensive teacher information system that is compatible with the state's student information system. To this end, we recommend the Legislature redesignate $500,000 of federal Title VI funds, for which no expenditure plan currently exists, for the Department of Education to begin developing the system. The enhanced teacher information system would: (1) maximize the potential benefits of the state's data collection and evaluation efforts and (2) help the state meet new federal reporting requirements.

To ensure it is investing in worthwhile education programs, the state needs information on both students and teachers. Over the last several years, the state has begun developing a comprehensive student information system to compile student-level data and assess the effect of various education reforms on student achievement. The state has accelerated these efforts given new federal reporting requirements associated with monitoring schools' "adequate yearly progress." Although it already has taken steps to create a student information system, the state has not made similar progress toward developing a teacher information system.

Teacher Information Needed to Evaluate Instructional Programs and Improve Academic Achievement. The primary objective of a teacher information system is to collect the data necessary to determine which state efforts are likely to yield the best results in the classroom. Thus, a teacher information system must be compatible with a state's student information system. Once established, the two systems would enable policymakers, researchers, and state agencies to track important trends over time as well as study new issues as they emerged. The teacher information system would include data on teacher recruitment, education, quality, experience, retention, professional development, and instructional improvement. It would provide the state with information essential for identifying the programs that have the greatest potential of improving academic achievement and the academic environment. For example, the state could use a teacher information system to assess which of several staff development programs produced the largest gains in teachers' subject matter knowledge. The state also could use the system to determine which types of induction programs had the most beneficial effect on beginning teachers' performance and retention. The state also could use the system to analyze the effectiveness of various recruitment strategies in attracting highly qualified teachers to low-performing schools. The opportunities for the state to learn more about the cost-effectiveness of its investments in education are virtually endless.

Other States Already Have Teacher Information Systems That Greatly Enrich Possibilities for Assessing Cost-Effectiveness of Education Programs. Several states already have built impressive teacher information systems. Connecticut, Florida, and Texas, for example, already have well-developed, comprehensive systems. These states use a common teacher identifier (in these cases, the teachers' social security numbers [SSNs]) to merge relevant databases and track instructional outcomes. These states have developed highly secure systems with appropriate safeguards (such as sophisticated encryption) to ensure against identity theft and other violations of teachers' privacy. None of these states reports any controversy surrounding the collection and use of teachers' SSNs. In a recent study, SRI International (SRI) concluded that these states' systems "allow policymakers access to far more powerful information than California has on teacher placement, retention, retirement trends, and key shortage areas."

Existing Information System Hindered By Structural Problems. In its report, entitled *Strengthening California's Teacher Information System* (April 2002), SRI identified two major problems with the state's existing information system.

- ***Fragmented Responsibility for Data Collection, Analysis, and Reporting.*** Currently, several state agencies—including the Commission on Teacher Credentialing, the Department of Education (SDE), the State Teachers' Retirement System (STRS), the Student Aid Commission, the University of California, and the California State University (CSU)—compile data on teacher candidates and teachers of record. The state, however, does not coordinate or leverage these independent efforts to ensure that they complement one another and their potential usefulness is optimized. Lacking a coherent approach that clearly delineates agencies' responsibilities, the state's existing information system generates a voluminous amount of data that is neither easily accessible nor readily useful.

- ***Lack of Common Identifier Makes Comprehensive System Impossible to Construct.*** Building a coherent information system requires teacher-level data generated by multiple state agencies to be merged. Merging databases can only be done if all agencies have access to and use a common identifier for each teacher. For example, if the state wanted to know how many graduates from CSU's teacher education programs are teaching in public schools three years after their graduation, every teacher would need a unique identifier so they could be matched properly in the CSU and STRS databases.

Enhanced System Would Optimize Potential Benefits of Data Collection and Evaluation Efforts. In its study, SRI concluded that "a great deal of good data are collected currently, but because of a lack of a coordinated, systemwide plan and a few key technical issues, these data cannot be used to answer policymakers' most important questions." The SRI recommends the state develop a coherent organizational structure to enhance the accessibility, usability, and meaningfulness of data collection efforts. It also recommends that public agencies use common identifiers so multiple databases can be linked. Once operational, the system would optimize the potential benefits of the state's data collection and evaluation efforts.

Enhanced System Needed to Meet New Federal Reporting Requirements. As a result of the enactment of the No Child Left Behind (NCLB) Act in 2002, states now face two new teacher-related accountability provisions and added reporting requirements. The federal law requires: (1) all public school teachers to be highly qualified by the end of the 2005-06 school year, and (2) annual increases in the percentage of teachers who receive high-quality professional development. The law also requires SDE to report annually on the state's progress in meeting its performance goals in these two areas. Currently, the state neither collects nor synthesizes the data it needs to be able to comply with these reporting requirements.

Title VI Funds Available for Project. In 2003-04, California expects to receive a total of $28 million in federal Title VI funds, which may be used for a variety of data collection, evaluation, and reporting purposes. Of this amount, the Governor's budget designates $6.9 million for the continuing development of a student-level database. The Governor's budget designates an additional $1.5 million for "NCLB data collection," but the administration does not have a detailed plan for using these additional monies. We recommend the Legislature include a budget bill provision that would specify that $500,000 of this scheduled item be used for SDE to begin: (1) constructing the comprehensive teacher information system, (2) establishing common teacher identifiers, and (3) coordinating with the state's student information system. In future years, we recommend the Legislature continue to designate federal Title VI funds to maintain and enhance the system.

In conclusion, we recommend the Legislature enact legislation to create a comprehensive and coherent teacher information system that is compatible with the state's student information system. Many factors have coalesced to make this an opportune time for California to enhance its teacher information system. Several states already have these systems—demonstrating that they can be built and do have substantial benefits. Moreover, SRI has provided a blueprint that SDE can use to guide its efforts in developing the system and establishing common teacher identifiers. Finally, California needs an enhanced teacher information system to respond to new federal reporting requirements, and it now has the opportunity to leverage federal funds to build it.

INTRODUCTION

Higher Education

The Governor's budget proposes an $890 million decrease in General Fund expenditures for higher education in 2003-04. This represents a 9.8 percent decrease from the revised 2002-03 amount. However, the Governor's proposal assumes the enactment of student fee increases which, when coupled with other new revenue, would result in a $447 million, or 1.5 percent, increase in total higher education funding. The Governor's proposal includes no funding for cost-of-living adjustments. It includes funding for 6.9 percent enrollment growth at the University of California and 7.1 percent at the California State University. It also projects a 5.7 percent decline in enrollment at the California Community Colleges. The expected decline is attributable to attrition resulting from fee increases, as well as the elimination of enrollment that was inappropriately added in recent years.

Total Higher Education Budget Proposal. As Figure 1 (see next page) shows, the 2003-04 budget proposal provides a total of $30.3 billion from all sources for higher education. This amount is $447 million, or 1.5 percent, more than the Governor's revised current-year budget proposal. The total includes funding for the University of California (UC), the California State University (CSU), the California Community Colleges (CCC), Hastings College of the Law, the California Student Aid Commission, and the California Postsecondary Education Commission. Funded activities include instruction, research, and related functions, as well as other activities, such as providing medical care at UC hospitals and managing three major U.S. Department of Energy laboratories. The Governor's current-year estimates include a variety of technical adjustments and assume adoption of various mid-year reduction proposals, which would reduce current-year expenditures in higher education by $352 million.

Major Funding Sources. The 2003-04 budget proposal provides $8.2 billion in General Fund appropriations for higher education. This amount is $890 million, or 9.8 percent, less than proposed current-year funding. The budget also projects that local property taxes will contribute $2.2 billion for CCC in 2003-04, an increase of $178 million, or 9 percent, over the revised current-year amount.

Figure 1

Higher Education Budget Summary[a]

(Dollars in Millions)

	Revised 2002-03	Proposed 2003-04	Change	
			Amount[b]	Percent
University of California				
General Fund	$3,146.7	$3,013.0	-$133.7	-4.2%
Student fee revenue	758.2	1,014.4	256.2	33.8
Federal and other funds	12,837.8	13,401.8	563.9	4.4
Totals	**$16,742.7**	**$17,429.1**	**$686.4**	**4.1%**
California State University				
General Fund	$2,705.9	$2,582.9	-$123.1	-4.5%
Student fee revenue	768.2	981.5	213.2	27.8
Federal and other funds	1,949.9	1,922.7	-27.1	-1.4
Totals	**$5,424.0**	**$5,487.1**	**$63.1**	**1.2%**
California Community Colleges				
General Fund	$2,621.3	$1,914.7	-$706.6	-27.0%
Local property tax revenue	1,980.2	2,157.8	177.6	9.0
Student fee revenue	168.9	318.5	149.6	88.5
Federal and other funds	1,608.1	1,604.5	-3.6	-0.2
Totals	**$6,378.5**	**$5,995.5**	**-$383.0**	**-6.0%**
Student Aid Commission				
General Fund	$621.3	$699.4	$78.2	12.6%
Federal and other funds	662.2	662.1	-0.1	—
Totals	**$1,283.5**	**$1,361.6**	**$78.1**	**6.1%**
Other[c]				
General Fund	$16.6	$12.1	-$4.5	-27.0%
Student fee revenue	14.4	18.8	4.3	30.0
Federal and other funds	14.1	16.2	2.1	14.8
Totals	**$45.1**	**$47.1**	**$2.0**	**4.3%**
Grand Totals	**$29,873.8**	**$30,320.4**	**$446.6**	**1.5%**
General Fund	$9,111.7	$8,222.1	-$889.6	-9.8%
Property tax revenue	1,980.2	2,157.8	177.6	9.0
Student fee revenue	1,709.8	2,333.1	623.4	36.5
Federal and other funds	17,072.1	17,607.4	535.2	3.1

a General Fund amounts exclude capital outlay and payments on general obligation bonds (see "Capital Outlay" chapter).

b Numbers may not add due to rounding.

c Includes Hastings College of the Law and the California Postsecondary Education Commission.

In addition, student fee and tuition revenue at all the higher education segments account for $2.3 billion of proposed expenditures. This amount is $623 million, or 36.5 percent, greater than student fee revenue in the current year. This is due to proposed fee increases at all three segments, as well as unusually high enrollment projections at UC and CSU. The increased student fee revenue is expected to backfill unallocated General Fund reductions at the three segments.

Finally, the budget includes $17.6 billion in other funds—including federal funds, restricted funds, and funds from private sources. The amounts in Figure 1 do not include capital outlay expenditures or the General Fund costs associated with paying off general obligation bonds. These costs are discussed in the "Capital Outlay" chapter of this *Analysis*.

General Fund and Proposition 98 Proposals by Segment. For UC, the budget proposal provides General Fund appropriations of $3 billion, which is $134 million, or 4.2 percent, less than the Governor's revised current-year estimate. For CSU, the budget proposes $2.6 billion in General Fund support, a decrease of $123 million, or 4.5 percent, from the current year.

For CCC, the budget proposes General Fund appropriations of $1.9 billion, which is $707 million, or 27 percent, less than the current year. Incorporating local property tax revenue, the budget anticipates $4.1 billion in CCC's Proposition 98 funding, a decrease of $442 million, or 9.8 percent, from the current-year estimate.

Major Budget Changes

In a departure from past practice, the Governor's budget provides no funding for cost-of-living adjustments (COLAs) at the segments. While it also makes General Fund reductions for all three segments, these are offset in part by new student fee revenue. In addition, the budget provides for substantial enrollment increases at UC and CSU. Figure 2 (see next page) describes the major General Fund budget changes proposed by the Governor for the three segments.

Enrollment Growth. The Governor's budget provides funding for increases in budgeted enrollment of 6.9 percent at UC and 7.1 percent at CSU. This is more than 4 times the expected increase in the state's college-age population, and well above the amounts requested by the segments in their budget requests. As Figure 3 (see page 167) shows, the budget proposes total full-time equivalent (FTE) student enrollment at the two segments of 546,641 students, which is 35,881 FTE (7 percent) over the budgeted current-year amount. The Governor proposes $9,030 and $6,594, respectively, in General Fund support for each additional FTE student at UC and CSU. Thus, the total cost of accommodating proposed enrollment growth at UC is $117.2 million and the total cost at CSU is $150.9 million.

Figure 2

Higher Education
Proposed Major General Fund Changes

University of California	Requested:	$3.0 billion	
	Decrease:	$134 million	(-4.2%)

Base Budget Reductions: Total of $299.1 million (9.5 percent) in allocated and unallocated base reductions, partly offset by a $130.4 million increase in student fee revenue.

Enrollment Growth: $117.2 million (6.9 percent: 13,000 full-time-equivalent [FTE] students).

Student Fees: Undergraduate and graduate educational fees to increase 25 percent and 26 percent, respectively, in the 2003-04 academic year.

Proposed Current-Year Adjustments: Net decrease of $77.3 million, partly offset by an increase of $28.5 million in additional student fee revenue. (In December 2002 the UC Regents increased student fees for the spring 2003 quarter.)

California State University	Requested:	$2.6 billion	
	Decrease:	$123 million	(-4.5%)

Base Budget Reductions: Total of $266.4 million (9.8 percent) in allocated and unallocated base reductions, partly offset by a $141.5 million increase in student fee revenue.

Enrollment Growth: $150.9 million (7.1 percent: 22,881 FTE students).

Student Fees: Undergraduate and graduate fees to increase 25 percent and 20 percent, respectively, in the 2003-04 academic year.

Proposed Current-Year Adjustments: Net increase of $25.6 million, plus $30.1 million in additional student fee revenue. (In December 2002 the CSU Trustees increased student fees for the spring 2003 semester.)

California Community Colleges	Requested:	$1.9 billion	
	Decrease:	$707 million	(-27%)

Base Budget Reductions: Total of $581.4 million (22.2 percent) in targeted and across-the-board base reductions, partly offset by $327.2 million in additional local property taxes and student fee revenue.

Budgeted Enrollment: Net decline of 5.7 percent (62,202 FTE Students). This results from attrition due to proposed fee increases.

Student Fees: Resident student fees to increase from $11 to $24 per unit.

Proposed Current-Year Adjustments: Net reduction of $250 million due to targeted and across-the-board reductions.

Figure 3

Higher Education Enrollment

2001-02 Through 2003-04
Full-Time Equivalent Students

	Actual 2001-02	Budgeted 2002-03	Proposed 2003-04	Change	
				Amount	Percent
University of California					
Undergraduate	144,091	148,465	159,242	10,777	7.3%
Graduate	28,487	28,897	31,020	2,123	7.3
Health Sciences	12,726	12,266	12,366	100	0.8
UC Totals	**185,304**	**189,628**	**202,628**	**13,000**	**6.9%**
California State University					
Undergraduate	267,100	271,124	290,665	19,541	7.2%
Graduate/Postbacalaurate	49,295	50,008	53,348	3,340	8.7
CSU Totals	**316,395**	**321,132**	**344,013**	**22,881**	**7.1%**
California Community Colleges	1,103,776	1,095,114	1,032,912	-62,202	-5.7%
Hastings College of the Law	1,274	1,200	1,200	—	—
Grand Totals	**1,606,749**	**1,607,074**	**1,580,753**	**-26,321**	**-1.6%**

For CCC, the budget anticipates a net reduction of 62,202 FTE students, or 5.7 percent, from the budgeted current-year level. This enrollment figure accounts for some population growth, which is more than offset by anticipated attrition. This is due to a proposed fee increase as well as the elimination of funding for 20,000 FTE students that were inappropriately added to CCC's apportionments in recent years. (We discuss proposed enrollment levels in more detail later in this chapter.)

Compensation and COLA Increases. The Governor's budget proposal provides no funding for COLA increases at any segment. The enrollment growth funding is intended to support increases in associated workload demands (such as the hiring of additional faculty and staff), but is not intended for faculty and staff COLAs. To the extent that employee contracts call for COLAs in the budget year, either these will have to be renegotiated, or funding will have to be redirected from other purposes.

Student Fees. The proposed budget makes "unallocated" General Fund reductions at all three segments that it presumes will be backfilled with increased student fee revenue. In this way, the unallocated reductions would amount to fund shifts rather than true reductions in overall funding. For UC and CSU, the budget assumes the governing boards will approve fee increases of approximately 25 percent for most students. This is in addition to increases of 10 percent to 15 percent approved for both segments for the spring 2003 term (in the current fiscal year). The current-year increases are the first fee increases at the segments in eight years. For CCC, the budget assumes that resident fees will increase from $11 to $24 per unit in the budget year. Even with this increase, California's community college fees would remain the lowest in the nation. Proposed student fees are shown in Figure 4. (The proposed increases are discussed in detail later in this chapter.)

Figure 4

Proposed Higher Education Annual Student Fees in 2003-04

	Residents		Nonresidents	
	Educational Fee	Total Fee[a]	Tuition	Total Fee[a]
University of California				
Undergraduates	$3,916	$5,082	$12,980	$18,562
Graduates	4,156	6,196	11,577	18,033
Professionals[b]				
Lowest fee	6,856	8,896	11,577	20,473
Highest fee	12,762	14,802	11,577	26,379
California State University				
Undergraduates	$1,968	$2,466	$8,460	$10,926
Graduates	2,082	2,580	8,460	11,040
California Community Colleges	$720	$720[c]	$4,470[d]	$5,190[c]
Hastings College of the Law	$10,684	$12,445[e]	$10,666	$23,111[e]

a Total fee includes educational fees, registration fees, and campus-based fees (weighted average for UC and unweighted average for CSU).

b Represents range of fees charged to professional-school students.

c Represents only enrollment fees. Some community colleges charge additional fees (for purposes such as parking and health care). The amount of these additional fees varies considerably across campuses.

d Nonresident fees are set by districts to capture actual cost of education. Statewide average is shown here.

e Assumes adoption of new "academic enhancement fee" of $200 and new "exam materials and processing fee" of $120.

Student Financial Aid

The Governor's budget provides an $82 million augmentation for the Cal Grant A and Cal Grant B programs. Of this amount, $54 million is associated with recent and anticipated student fee increases at UC and CSU. This augmentation would ensure that all Cal Grant recipients attending UC and CSU would continue to receive full fee coverage in both the current year and the budget year. However, the budget also proposes to reduce the value of Cal Grant awards by 9 percent for students attending private colleges (for a General Fund savings of $10.2 million).

BUDGET ISSUES

Higher Education

INTERSEGMENTAL

LAO ALTERNATIVE BUDGET PROPOSAL

The Governor's higher education proposal would increase total higher education funding from all fund sources by $447 million (1.5 percent) from the revised 2002-03 level. For General Fund appropriations only, it would reduce funding by about $890 million (9.8 percent). It also would backfill about two-fifths of this reduction with revenue from student fee increases. Given the state's fiscal situation, we believe that the proposed level of General Fund reductions is appropriate. However, we believe that the same level of General Fund savings could be achieved in a way that provides better outcomes for students, the segments, and the state. In this section we outline the main features of an alternative that accomplishes this for the University of California, the California State University, and the Student Aid Commission. Details of the proposal appear in subsequent sections of this chapter. (We address the Governor's proposal for California Community Colleges, whose funding is subject to Proposition 98, in a separate section of this chapter.)

The Governor's budget for higher education involves a number of interrelated components. Among these are student fees, budgeted enrollment levels, and financial aid. The main features of these components are shown in Figure 1 (see next page).

Figure 1

Governor's 2003-04 Higher Education Proposal Selected Features

(In Millions)

Proposal	Amount
Unallocated General Fund Reductions	$356.7
Student Fees	
• Assume annualization of UC and CSU's spring 2003 fee increases in the budget year. Assume further increases in the budget year of 25 percent for undergraduates at UC and CSU, 26 percent for graduates at UC, and 20 percent for graduates at CSU. Assume only two-thirds of new revenue is available to offset General Fund cuts.	$290.5[a]
Remaining General Fund Reductions	$66.2
Enrollment Growth	
• 6.9 percent (13,000 FTE students) at UC.	$117.2
• 7.1 percent (22,881 FTE students) at CSU.	150.9
Financial Aid	
• Fund Governor's Scholarship awards for eleventh grade students.	$43.4
• Increase Cal Grant awards to compensate for proposed fee increases.	34.5
• Reduce Cal Grant awards for students at private colleges.	-10.2
• Increase institution-based financial aid using new student fee revenue.	165.4

[a] Amount of fee increase revenue available to offset unallocated General Fund reductions.

Student Fees

Student Fees Expected to Backfill Most of "Unallocated" General Fund Reductions. As shown in Figure 1, the Governor's proposal would make unallocated General Fund reductions totaling $356.7 million to the University of California (UC) and the California State University (CSU). The Governor's budget assumes that most of these reductions would be backfilled with student fee revenue generated by anticipated fee increases.

Specifically, the Governor has proposed unallocated reductions at UC and CSU of $213 million and $143 million, respectively, from the 2002-03 enacted budget. However, these cuts would exceed the anticipated new fee revenue of $291 million (available after diversion of one-third for financial aid) by about $66 million. The Governor assumes that the segments will accommodate this remaining unallocated cut by diverting resources from other, unspecified areas.

Although student fees at UC and CSU are set by their governing boards, the Governor's budget assumes that they will adopt increases of about 25 percent for most students. The proposed increases would begin in fall 2003, and would be in addition to already enacted increases of 10 percent to 15 percent that take effect in the spring 2003 term. Two-thirds of the revenue from the proposed fee increases would substitute for most of the lost General Fund revenue at the segments. The remaining one-third of the new fee revenue would augment the segments' campus-based financial aid programs.

Enrollment

Budgeted Enrollment to Increase. The Governor's budget proposes increases in budgeted enrollment of 6.9 percent for UC and 7.1 percent for CSU. The proposed enrollment growth at UC and CSU is approximately four times the estimated increase in the college-age population (18 through 24 year olds). It is also almost twice the administration's planning estimates for increases in enrollment demand and about 50 percent more than was requested by the two segments.

Enrollment Growth Is Not "Access." The Governor asserts that the proposed level of enrollment growth at UC and CSU is necessary to minimize the effect of proposed fee increases upon higher education access. However, we believe that access is best promoted by addressing financial and other barriers to higher education, such as the cost of attendance and inadequate academic preparation. Providing additional funding for enrollment in excess of projected demand does little to improve access.

Financial Aid

Financial Aid to Increase. The Governor's proposal assumes that the value of Cal Grant awards for UC and CSU students will be increased to cover the higher fees. In this way, Cal Grant recipients at UC and CSU would not experience any out of pocket expense from the proposed fee increases. The Governor's budget, however, reduces the value of Cal Grant awards by 9 percent for students attending private colleges. As noted earlier, the budget proposal assumes UC and CSU would augment their own financial aid programs by $165 million (using part of the new student fee revenue) to provide their students with additional financial aid support.

LAO Alternative

We believe that the Governor's proposal properly recognizes the interdependence of these three components of higher education funding. However, we believe that the proposal (1) expects budget-year increases in UC and CSU student fees that are too high, (2) provides an unjustified level of enrollment growth funding, and (3) allocates too much new financial aid funding to UC and CSU.

We offer an alternative budget that addresses these three points while maintaining the same level of General Fund savings proposed by the Governor. The main components of our proposal are outlined in Figure 2 and summarized below. We discuss our proposal briefly below, and in further detail in subsequent sections in this chapter.

Figure 2

LAO's 2003-04 Higher Education Proposal Selected Features

(In Millions)

Proposal	Amount
Unallocated General Fund Reductions	$356.7
Student Fees	
• Assume annualization of UC and CSU's spring 2003 fee increases in the budget year. Assume further increases in the budget year of 15 percent for undergraduates at UC and CSU and 20 percent in graduate fees at UC and CSU.	$320.1[a]
Remaining General Fund Reductions	$36.6
Enrollment Growth	
• 4 percent (7,585 FTE students) at UC.	$68.5
• 4 percent (12,845 FTE students) at CSU.	84.7
Financial Aid	
• Do not fund Governor's Scholarship programs.	—
• Increase Cal Grant awards to compensate for proposed fee increases.	$28.1
• Do not reduce Cal Grant awards for private college students.	—
• Provide fee assistance to first-year Cal Grant B students.	95.0
• Increase institution-based financial aid using student fee revenue.	31.3

[a] Amount of fee increase revenue available to offset unallocated General Fund reductions. Does not assume one-third allocation to institutional aid.

Student Fee Increases Should Be Moderate. Our proposal would reduce the magnitude of the assumed student fee increase in the budget year from 25 percent to 15 percent for undergraduates at UC and CSU. It would also reduce the graduate fee increase from 25 percent to 20 percent at UC. Our proposal would not alter the Governor's proposal to increase CSU graduate fees by 20 percent. We believe additional moderate fee increases in subsequent years may be necessary to gradually achieve a more appropriate fee base. At the end of this transition period, fees should be adjusted annually to account for inflation or other changes to cost.

Our proposal would be easier for students and their families to absorb, and is more in line with past expressions of legislative intent that fee increases be gradual. We recommend that the Legislature adopt a clear policy for future fee increases that results in students paying a reasonable share of educational costs and which results in annual adjustments that are moderate and predictable.

Enrollment Growth Should Match Demand. Our proposal would provide UC and CSU with funding for enrollment growth of 4 percent. This is about equal to the administration's own estimates of enrollment demand at the segments, and is only slightly less than what the UC Regents and CSU Trustees approved in their own 2003-04 budget proposals. It is also well above projected growth in the college-age population.

Financial Aid Should Be Adjusted for Fee Increases. Similar to the Governor, we recommend increasing Cal Grant funding to compensate for student fee increases. However, we recommend against the diversion of one-third of new student fee revenue to UC and CSU for their own financial aid programs. Instead, we recommend that the segments only divert the amount necessary to compensate for 4 percent enrollment growth. We also recommend (1) increasing the value of Cal Grant B awards to cover fees for first-year students and (2) maintaining the existing value of Cal Grant awards for students at private colleges. In these ways, our proposal would significantly increase access for needy students.

LAO Proposal Preserves Instructional Programs and Promotes Access

Figure 3 (see next page) compares the fiscal impact of our proposal with the Governor's. It requires no General Fund resources beyond the Governor's proposed level. Overall, our proposal has the following features that provide additional resources to improve student access, while avoiding additional reductions to instructional programs:

- ***Provides Lower Student Fees***. Our proposal would reduce the 2003-04 undergraduate fee increase from 25 percent to 15 percent.

This would be easier for students and their families to accommodate on fairly short notice (fall 2003).

- ***Funds a Reasonable Level of Enrollment Growth***. Our proposal ensures that UC and CSU would receive enough funding to increase budgeted enrollment growth by 4 percent. This is more than twice the projected growth in the college-age population, and is consistent with Department of Finance planning estimates.
- ***Provides More Flexible, Accountable Financial Aid***. Our proposal increases financial aid at the state's Cal Grant program, which is open to all higher education students. This is preferable to providing a similar level of increase at the segments' institutional financial aid programs, which are limited to students in the respective systems. (Our proposal does, however, increase institutional aid budgets to accommodate enrollment growth.)
- ***Avoids Further Reductions to Instructional Programs***. The Governor's proposal makes unallocated General Fund reductions which are partially backfilled by student fee revenue. Our proposal would make $30 million *more* fee revenue available to backfill the General Fund reductions.

Figure 3

Fiscal Impact of Proposed Budget and LAO's Higher Education Proposal

(In Millions)

Proposal	Budget	LAO	Difference
Fee revenue available to backfill unallocated General Fund reductions	$290.5	$320.1	$29.6
Enrollment growth	268.1	153.2	-114.9
Increase Cal Grant awards	24.3	123.1	98.8
Augmentation to institution-based financial aid	165.4	31.3	-134.1

We expand on these recommendations in the following sections.

INTERSEGMENTAL
STUDENT FEES

In response to the Governor's proposed mid-year reductions in December 2002, the University of California (UC) and the California State University (CSU) adopted resident student fee increases for the spring 2003 term—the first such increase in eight years. The Governor's budget assumes even steeper fee increases in the budget year. The budget assumes that mandatory resident student fees at UC and CSU will increase by slightly more than one-third over the two years. The Governor's proposal offers no rationale for this level of fee increases. Neither does it indicate expectations concerning fee adjustments beyond the budget year. While we believe student fee increases at UC and CSU are appropriate, we also believe any increases should be moderate and decided within the context of a rational fee policy. In this analysis, we (1) evaluate a recent California Postsecondary Education Commission proposal regarding fees, (2) discuss the need for an explicit student fee policy, (3) recommend the adoption of short-term and long-term fee policies, and (4) recommend the adoption of smaller student fee increases than those assumed by the Governor for the budget year.

Background

In our *Analysis of the 2002-03 Budget Bill* (see pages E-179 through E-190), we recommended that the Legislature enact in statute a consistent fee policy that provides for an appropriate sharing of educational costs between students and the state, and which preserves student access to higher education. We offered the following basic policy guidelines to serve as the basis of a new fee policy: students should contribute towards their educational cost, fees should change moderately over time, and fees should be adjusted annually. We also provided two options for establishing a new fee policy: (1) setting fees as a fixed percentage of educational costs or (2) setting fees at the average of the segments' national comparison institutions.

While the Legislature did not enact a fee policy in statute when it adopted the 2002-03 budget, the Legislature did adopt supplemental report language directing the California Postsecondary Education Commission (CPEC) to convene various parties to develop long-term student fee policy recommendations for students at UC and CSU. The commission held a series of meetings in the summer and fall of 2002 and adopted recommendations for a long-term resident student fee policy framework in December 2002. We discuss CPEC's fee policy recommendations further below.

Governor's Fee Proposal

Current-Year Fee Increases. To backfill some of the Governor's proposed mid-year reductions to the segments' budgets, the UC and CSU governing boards have implemented mid-year fee increases effective in spring 2003. Figure 1 displays fees at UC and CSU in 2001-02, in 2002-03 (assuming the full-year effect of the spring 2003 increase), and in 2003-04 (assuming the further increase noted in the Governor's budget).

Figure 1

Proposed UC and CSU Systemwide Fees[a]

			Change			Change From 2001-02	
	2001-02	2002-03[b]	Amount	Percent	2003-04 Proposed	Amount	Percent
UC							
Undergraduates	$3,429	$3,834	$405	12%	$4,629	$1,200	35%
Graduates	3,609	4,014	405	11	4,869	1,260	35
CSU							
Undergraduates	$1,428	$1,572	$144	10%	$1,968	$540	38%
Graduates	1,506	1,734	228	15	2,082	576	38

a For UC amounts include educational fee and registration fee. For CSU amounts include systemwide fee. Students also pay campus-based fees.

b Fee that would result if spring 2003 increases were applied to all quarters/semesters of the academic year.

Governor's Proposal Assumes Significant Fee Increases at UC and CSU in the Budget Year. The Governor's budget assumes additional student fee increases in the budget year. As Figure 1 shows, when combined with current-year fee increases, mandatory resident student fees at UC would increase 35 percent over the two years, rising by $1,200 for undergraduates and $1,260 for graduates. At CSU, the two-year increase in resident systemwide fees would be 38 percent, increasing $540 for undergraduates and $576 for graduates.

Although the Governor's budget assumes specific fee increases, it is not known whether the UC Regents or CSU Trustees will actually implement this level of increases. If the governing boards adopt a lower fee increase, then the segments may need to make additional cuts to their programs beyond those envisioned by the Governor to compensate for the reduced fee revenue.

The Governor's proposal indicates that the additional student fee revenue resulting from the combined fee increases in 2003-04 will be used to partially backfill unallocated General Fund reductions of $214 million for UC and $143 million for CSU. In effect, the Governor proposes what amounts to a substitution of fee revenue for General Fund support, thus reducing General Fund expenses while still providing programmatic support.

CPEC Recommendations for Long-Term Resident Student Fee Policy

In December 2002, CPEC adopted a report with its recommendations for a long-term resident student fee policy as directed by SRL. The document offers policy principles to guide the future setting and adjustment of mandatory systemwide resident student fees at UC and CSU and a framework for implementing the principles. Figures 2 (see next page) and 3 (see page 181) summarize selected policy principles and the framework for implementation from the CPEC report.

Commission's Fee Policy Recommendations Provide a Reasonable Starting Point for the Enactment of a Long-Term Fee Policy. We believe that many of the commission's recommendations on policy principles and implementation framework deserve serious consideration by the Legislature. We agree with CPEC's recommendations that a fee policy should clearly state which entities are responsible for setting fees, provide for an annual adjustment to fees, and state that there shall be no substitution of General Fund support for expected fee increases. In addition, we agree with CPEC's stated policy principles stating that (1) adjustments should be gradual, moderate, and predictable; (2) differential fees (for graduate and professional schools) are appropriate; (3) adequate notice to students should precede any fee increase; and (4) any negative impact on financially needy students should be mitigated.

Potential Outcome of Proposed Policy Unknown. Under current law, the segments have the authority to set their own student fees. The CPEC's recommendations would have the segments adopt their own explicit

Figure 2

Summary of Selected Policy Principles From CPEC Student Fee Policy

- ***Cost a Shared Responsibility.*** The total cost of a public postsecondary education shall be a shared responsibility of students, families, and the State of California.
- ***Gradual, Moderate, Predictable Changes.*** So that students and their families can better prepare financially for college expenses, any changes in resident student fees should be, to the extent possible, gradual, moderate, and predictable.
- ***Consider Total Costs and Ability to Pay.*** Changes in resident student fees should consider both the total cost of educating a student as well as published indices reflecting families' ability to pay, such as the percentage change in per capita personal income.
- ***Protect Financially Needy Students.*** As changes in resident student fees and financial aid resources are considered, efforts should be employed to mitigate any negative impact on financially needy students.
- ***Differential Fees.*** Students enrolled in graduate and professional programs may be subject to higher student fees.

methodologies for adjusting fees, albeit in consideration of certain principles. However, the Legislature is responsible for appropriating much of the segments' budgets, and these appropriations assume certain levels of fee revenues. Therefore, we believe that the Legislature should enact a fee policy that specifies a methodology for adjusting fees.

We recognize that there are various alternate fee methodologies that could be consistent with the broad principles identified by CPEC. Moreover, the Legislature and the segments may require some time to deliberate on these issues. Given the Governor's fee proposal, it would be timely for the Legislature to lay out its preferences on a longer-term fee policy. We discuss below some of our concerns with current practice of setting fees and provide a context for the Legislature to consider in enacting a future fee policy.

Implicit Student Fee Policy Has Hidden Costs to State, Difficult for Students

In recent years, the state's implicit "policy" concerning higher education fees has essentially been to avoid fee increases if possible. When

Figure 3

Summary of CPEC's Proposed Framework For Implementation

- ***Segments Responsible for Adjusting Fees.*** The UC and CSU bear the primary responsibility for adjusting student fees.
- ***Adopt Fee Methodology.*** The UC and CSU shall each develop and adopt a rational fee methodology.
- ***Report on Impact of Methodology.*** Each university system shall annually report on the impact of their student fee methodology on students.
- ***Annually Adjust Fees.*** The UC and CSU shall annually propose an adjustment to their resident student fees.
- ***Advance Notice to Students.*** Each university system governing board shall act upon any proposed changes in student fees by no later than November 30, and shall notify students of the proposed changes to enable students and their families to better plan financially.
- ***Avoid General Fund Backfill.*** The Governor and Legislature should allow student fees to increase or decrease consistent with the board-adopted methodologies. The Governor and Legislature should avoid using limited state revenues to substitute for proposed changes in fee levels.
- ***Follow-Up After Enactments of Budget.*** If fees need to be changed after enactment of the budget, the governing board shall meet in open public session to act upon the proposed fee change.

the state's fiscal condition deteriorates, however, the state has had to implement significant fee increases to offset a General Fund shortfall. In short, changes to student fee levels have been influenced more by the state's fiscal condition than through an established policy for sharing the cost of higher education between the state and students. In general, fees have been subject to "boom or bust" cycles, growing most rapidly during recessionary periods and declining or staying constant during expansionary periods. For students attending college during the bust periods, they and their parents have had difficulties planning for and dealing with huge increases in fees.

Ongoing Cost of State's Decision to "Backfill" Fee Increases. From 1995-96 through 2001-02, there was no increase in mandatory resident student fees at UC and CSU. In order to compensate for the reduced buying power of these fixed fees over time, the state has typically provided additional General Fund support in lieu of annual fee increases. The backfill becomes part of the segment's base and grows at the same rate as state support for the segment. As we noted in last year's *Analysis*, the cumulative total during the period of the General Fund backfill in UC and CSU's base is $518 million. Thus, while the decision to backfill fees in any particular year may appear not to have an ongoing impact on the segment's budget, there is a significant cumulative effect over time.

Fee Trends in California Contrary to Regional Trends. According to the Western Interstate Commission for Higher Education (WICHE), between 1997-98 and 2002-03 student fees *declined* by 8.6 percent at UC and 0.1 percent at CSU. Over the same period, the 15 western states for which WICHE compiles data experienced an average *increase* of 18.1 percent.

New Financial Aid Guarantee Insulates Needy Students From Fee Increases

The new Cal Grant entitlement program ensures the availability of financial aid to qualified students from low-income families. Cal Grant A awards cover systemwide fees at UC and CSU. The Cal Grant B awards cover the same fees as Cal Grant A (excluding fees for the freshman year of college) and provide recipients with a $1,551 stipend for other expenses for four years of college.

The Cal Grant entitlement and other forms of aid (such as federal Pell Grants) ensure that fees do not pose an obstacle to students from lower income families. Virtually all undergraduate students with parental income below $30,000 (and most with income below $60,000) qualify for Cal Grants or other forms of financial aid. In 2001-02, 37 percent of UC first-time freshmen and 34 percent of CSU first-time freshmen received Cal Grant entitlement awards.

In addition, California's fees are affordable to most upper income students even without financial aid. For example, UC reports that 32 percent of first-time freshmen in 1999 came from families with parental incomes above $90,000. Fee increases are more likely to affect students from middle-income families who do not qualify for the Cal Grants or other financial aid. However, because the Cal Grant A and B programs have a relatively high family-income ceiling ($66,200 for a family of four under Cal Grant A and $34,800 under Cal Grant B), many middle-income students are in fact insulated from the effect of fee increases.

Federal Tax Credits and Deductions Lower Cost of Higher Education for Middle Class. The federal Taxpayer Relief Act of 1997 created the "Hope Scholarship" and "Lifetime Learning" tax credits for higher education fees. Figure 4 displays the key features of these tax credits. These credits lower the after-tax price of higher education fees for most middle-income students (or their parents) by lowering their federal tax liabilities. Unlike deductions, tax credits are subtracted directly from an individual's federal income tax liability on a dollar-for-dollar basis. For example, in the current year, a full-time CSU student would pay about $1,998 in fees. If, however, the student (or their parents) qualified for the full amount of the Hope credit, the after-tax cost of those fee would be $498. In addition to tax credits, there are several tax deductions for tuition expenses and student loans. The existence of various federal tax credits and deductions effectively lowers the cost of higher education for students and their families.

Figure 4

Key Features of Federal Tax Credits for Higher Education

	Hope Scholarship	Lifetime Learning
Eligibility	First two years of postsecondary education.	Any undergraduate, graduate, or professional study.
Enrollment status	Must be at least half-time.	Enrolled in at least one postsecondary course.
Qualifying expenses	Tuition and related fees.	Tuition and related fees.
Credit amount	100 percent of first $1,000 and 50 percent of next $1,000.	20 percent of qualified expenses up to $10,000.[b]
Maximum credit or deduction amount	$1,500 per student.	$2,000 per family.[b]
Income limits	Single filer:[a] $41,000 to $51,000 Joint return: $82,000 to $102,000	Single filer:[a] $41,000 to $51,000 Joint return: $82,000 to $102,000

a Amount of credit is gradually phased-out within these income levels. The income phase-out amounts are indexed to inflation.

b Effective 2003.

Students and Families Pay Only a Small Share of Costs

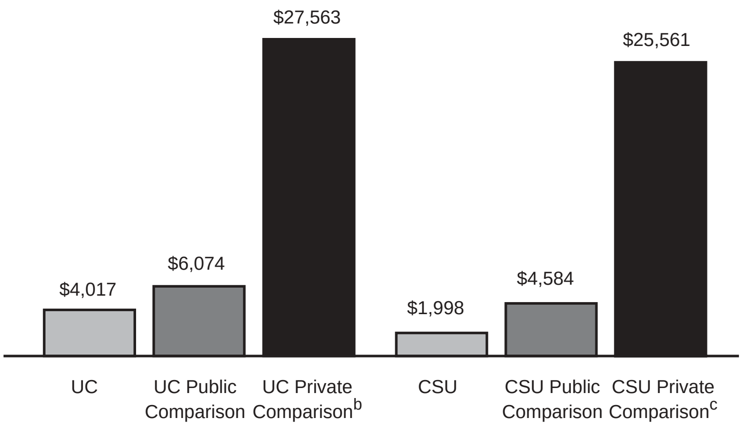
Although UC and CSU fees have increased from their levels in the 1980s, they still cover only a small portion of the costs the state incurs to provide educational services to undergraduate and graduate students. Moreover, student fees remain well below the national average.

Student Fee Revenue a Relatively Small Share of State Support. Student fees at UC and CSU cover a small portion of the costs the state incurs to provide educational services to students. In the current year total student fee revenue at UC constitutes less than 18 percent of instruction-related funding. At CSU, it constitutes approximately 22 percent. Under the Governor's proposal, this percentage would grow to 22 percent for UC and 27 percent for CSU in the budget year.

Fees Are Well Below the Segment's National Comparison Institutions. As Figure 5 shows, total student fees at UC and CSU are substantially lower than the average of the public and private institutions to which UC and CSU are compared when evaluating faculty salaries. The average resident student fee at UC's four public comparison institutions in 2002-03 is $6,074, which is almost one-third greater than UC's. The UC fee is well below the $27,563 average of fees charged by its four comparison private institutions—Yale, Harvard, Massachusetts Institute of Technology, and Stanford. At CSU's 15 public comparison institutions, the average student fee of $4,584 is more than double CSU's 2002-03 fee of $1,998.

Figure 5

California Annual Student Fees Versus National Comparisons[a]



[a] The UC and CSU amounts include mid-year fee increases in spring 2003. The data for UC and CSU comparison institutions represent 2002-03 fee levels.
[b] The UC's private comparison institutions are Yale, Harvard, Massachusetts Institute of Technology, and Stanford.
[c] The CSU's private comparison institutions are Bucknell, Tufts, Loyola, Reed, and USC.

Low Fees Can Hinder Informed Choices and System Accountability. As noted above, student fees cover only about one-fifth of UC's and CSU's cost of providing educational services. This level of subsidy can distort decision-making. For example, fees that are too low encourage some students to choose to attend that particular public university over other options, such as attending a private institution or enrolling in lower division courses at a community college. This is problematic because the state effectively subsidizes students who would have attended college without the subsidy. Low fees may also result in students' willingness to tolerate a lower level of service from the segments (such as poor quality instruction or inappropriately large class size). As a result, the segments' accountability is diminished.

LAO Alternative to Governor's Fee Increase

The budget proposes increasing resident student fees at the segments by about 35 percent within one calendar year. The Governor's fee proposal continues the boom and bust cycle where changes to student fees are influenced by the availability of state funds in any given year rather than through a deliberate, explicit policy for sharing the costs of higher education between the state and students. Without such a policy, the state loses the ability to promote state objectives and facilitate planning in higher education.

Given the significant increases in financial aid (state and federal) over recent years, we believe it is appropriate for the state to reexamine and make adjustments to the fee levels at UC and CSU. We also believe, however, that increases should be considered in the context of an ongoing fee policy, in addition to being moderate, predictable, and gradual.

LAO Budget-Year Proposal. We propose a budget-year fee increase that is more moderate than the Governor's proposal. Specifically, we recommend that the Legislature increase mandatory resident student fees at UC and CSU for undergraduates by 15 percent, rather than 25 percent, in the budget year. In addition, we propose a 20 percent increase in graduate fees at UC rather than the Governor's proposed 25 percent. Our proposal accepts the Governor's proposal to increase CSU graduate fees by 20 percent. While the increases for graduate students are higher than those for undergraduates, we feel that this is justified for two reasons. First, the cost of providing graduate education is typically higher than undergraduate education. Second, the economic returns to graduate education are usually higher than undergraduate education.

Our lower level of fee increases would be easier for students and their families to accommodate in the coming fall. At the same time, it would provide UC and CSU with about the same amount of fee revenue for backfilling proposed General Fund reductions. This is because we recommend that the segments direct a much smaller amount of new fee revenue to institutional financial aid than the amount assumed by the

Governor. (We discuss this recommendation in detail in the "Financial Aid" section of this chapter.)

Fee Adjustments Beyond the Budget Year. In addition to budget-year fee increases, we recommend that the Legislature adopt an explicit long-term fee policy that sets a specified target level. One of the most important issues for the Legislature and the segments to resolve is the basis for the target level. In last year's *Analysis,* we provided two options: (1) setting fees as a fixed percentage of educational costs or (2) setting fees at the average of the segments' national comparison institutions. We continue to believe that either option is appropriate.

In order to help students and their families plan, we recommend that the Legislature specify future fee increases in advance. For example, the Legislature could adopt a fee policy that increased UC and CSU undergraduate fees by 10 percent, and UC and CSU graduate fees by 15 percent each in 2004-05 and 2005-06. Under such a policy, fees would increase gradually and predictably, without compromising affordability.

Adjust Fees Annually. After reaching the target fee level, we recommend adjusting fees annually to reflect changing costs or inflationary effects. For example, fees could be linked to an inflationary index such as the change in per capita income or the state and local deflator. This would ensure that fees retain their buying power for the segments, and would ensure students of gradual, predictable, and moderate increases.

Another alternative is to adjust fees at the same rate as the growth of the General Fund portion of the segment's budget. For example, if the budget proposed a 7 percent increase for UC, it would also have to raise fees by 7 percent. This approach would give students and their families a strong stake in the process, helping to hold the segments more accountable for delivering services in a cost-effective way.

Conclusion

There is no one correct fee policy; the Legislature has many reasonable options from which to choose. However, we believe that controversy about the specific mechanics of a policy has prevented the state from adopting and maintaining a consistent rational fee policy. We recommend (1) more moderate fee increases in the budget year, (2) further adjustments in future years to either make fees more comparable to the segments' national comparison institutions or represent a larger share of support for postsecondary education, and (3) specifying a mechanism for annual adjustments once a reasonable target fee level is reached.

In conclusion, we believe our recommendation would help students and the segments to plan in the budget year and beyond by providing moderate and predictable fee increases. We also believe that UC and CSU would continue to be affordable under our fee proposal. Financially needy students would be unaffected by the increases under our proposal because their fees are typically covered through financial aid, such as Cal Grants.

INTERSEGMENTAL
ENROLLMENT GROWTH

For the past ten years, the state's public higher education segments have experienced moderate sustained enrollment growth. The Governor's budget proposes $268.1 million to fund enrollment growth at the University of California (UC) and at the California State University (CSU) of 6.9 percent and 7.1 percent, respectively. The proposed budget also assumes a net decline of enrollment at the California Community Colleges (CCC) of 5.7 percent. In this section, we (1) provide an historical perspective of enrollments at the three segments and (2) analyze the Governor's proposed levels of enrollment growth for UC and CSU in 2003-04 and recommend an alternative to those levels. (We discuss enrollment at CCC in the "California Community Colleges" section of this chapter.)

HIGHER EDUCATION ENROLLMENTS

In 2001, approximately 2.3 million students ("headcount enrollments") were enrolled either full-time or part-time at CCC, CSU, and UC. This is equal to roughly 1.6 million full-time-equivalent (FTE) students. (We describe the differences between *headcount* and *FTE* in the accompanying text box on page 190.) Figure 1 summarizes actual headcount enrollments from 1963 to 2001 for the state's public colleges and universities. The figure shows that enrollment grew rapidly through 1975, fluctuated up and down over the next two decades, and has grown steadily since 1995. Total enrollment in 2001 was 354,712 (or about 19 percent) more students than in 1990.

GOVERNOR'S BUDGET PROPOSAL

The budget requests a total of $268.1 million in General Fund support to increase budgeted enrollment at UC and CSU. The $268.1 million total consists of:

Figure 1

California Public Higher Education[a]
Actual Headcount Enrollments

[a]Includes the University of California, California State University, and the California Community Colleges.

- $117.2 million to UC for 6.9 percent enrollment growth, which is 13,000 FTE students above current-year budgeted enrollment.
- $150.9 million to CSU for 7.1 percent enrollment growth, which is 22,881 FTE students above current-year budgeted enrollment.

In contrast to the Governor's proposal for the public universities, the budget actually *reduces* funded enrollment at CCC by 5.7 percent. (Although $116 million is nominally provided to accommodate new enrollment, this is more than offset by funding redirections to account for attrition due to fee increases.) As a result, the budget provides funding for about 62,200 *fewer* FTE students in 2003-04.

Concerns With Governor's Proposal

Inconsistent Treatment of Enrollment Growth

As indicated above, the Governor's enrollment growth proposals for the two university systems and the community colleges vary considerably—roughly 7 percent enrollment growth for UC and CSU compared to a 5.7 percent decline for CCC. Some variation in funding for the segments is to be expected. The segments have different missions and serve somewhat different student populations, and so it is not necessary or even desirable to fund enrollment growth at all three segments equally. However, the segments do function as parts of an integrated higher education system, and thus have interactive effects. For example, price-sensitive students may choose to avoid the higher cost at UC and CSU by completing their lower-division coursework at CCC and then transferring to a four-year institution in their junior year.

Overall, we cannot find a basis for assuming, in a time of fee increases, such a large increase in enrollment at the higher-cost institutions while assuming such a large decrease in enrollment at the lower-cost institutions. In the balance of this writeup we focus on enrollment growth funding at UC and CSU. Enrollment growth funding at CCC, which is subject to the minimum funding guarantee of Proposition 98, is discussed separately in the "California Community Colleges" section of this chapter. Our recommendations in these two writeups call for reducing the enrollment funding gap between the state's universities and its community colleges.

FTE Versus Headcount Enrollment

In this analysis, we generally refer to FTE students, rather than headcount enrollments. Headcounts refer to the number of individual students attending college whether they attend on a part-time or full-time basis. In contrast, the FTE measure converts part-time student attendance into the equivalent full-time basis. For example, two half-time students would be represented as one FTE student. In 2001, one average headcount enrollment equaled 0.97 FTE at UC, 0.81 FTE at CSU, and 0.65 at CCC. For UC and CSU, FTE per headcount enrollment seldom varies by more than a few percentage points. Over the past 30 years, the number of FTE per headcount enrollment in the community colleges has varied from a high of 0.65 (2001) to a low of 0.55 (1990). The ratio varies more for CCC because they serve a much higher percentage of part-time students.

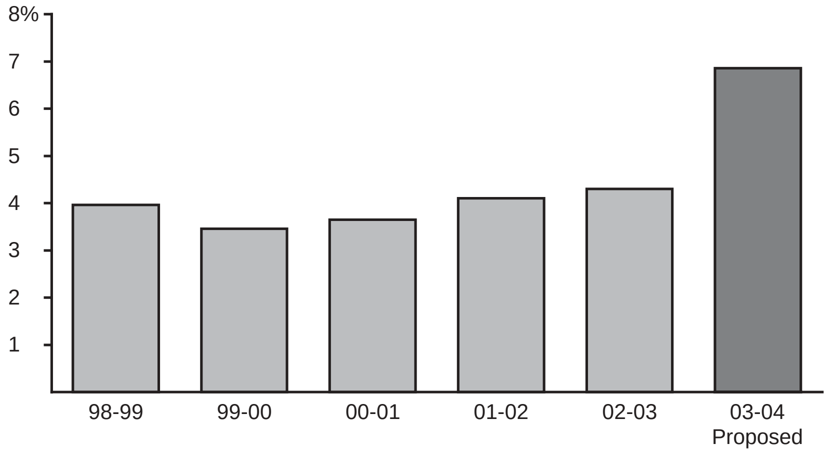
Headcount measures are typically used by the Department of Finance and the California Postsecondary Education Commission to make enrollment projections for future years. On the other hand, FTE measures better reflect the operating and capital costs required to serve students and is the measure the Legislature uses for state budgeting purposes.

No Rationale for Providing Excessively High Budgeted Enrollment Growth

Highest Budgeted Enrollment Growth in Recent History. Figures 2 and 3 (see next page) show UC and CSU's budgeted enrollment growth for each of the past five years and proposed enrollment growth for next year. From 1998-99 through 2002-03, UC and CSU received an average of about 4 percent for annual budgeted enrollment growth. As indicated in the figures, the Governor's budget proposes enrollment growth rates—6.9 percent at UC and 7.1 percent at CSU—that far exceed recent practice. For example, the state provided funding in the current year for increased enrollments of 4.3 percent at UC and 5 percent at CSU. In fact, based on historical data from UC, the proposed 6.9 percent enrollment growth for the system would be the highest in 25 years. At the time of this analysis, CSU was unable to provide data on budgeted enrollment growth prior to 1982-83. However, available data indicate that 7.1 percent would be the highest in at least the past 20 years.

Figure 2

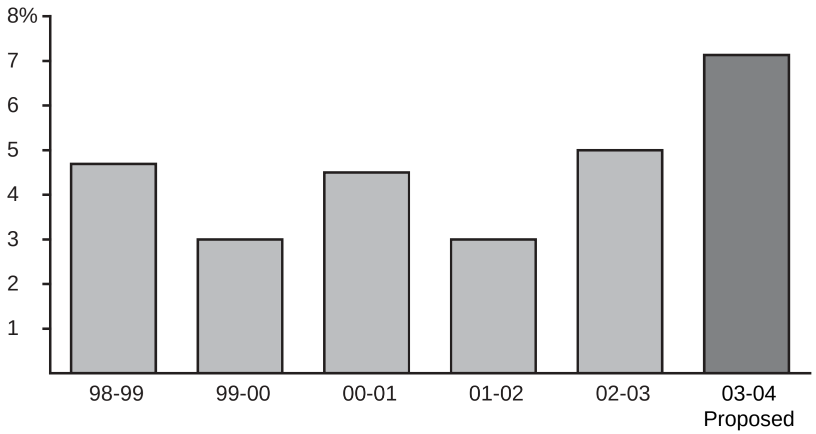
University of California
Budgeted Student Enrollment Growth[a]



[a]Budgeted enrollment growth percentages above do not reflect supplemental funding provided to UC in order to fully fund existing summer enrollments when campuses convert to year-round operation.

Figure 3

California State University Budget Student Enrollment Growth[a]



[a]Budgeted enrollment growth percentages above do not reflect supplemental funding provided to CSU in order to fully fund existing summer enrollments when campuses convert to year-round operation.

Budgeted Enrollment Exceeds Demographic Projections. As Figure 4 shows, the budgeted enrollment growth rates proposed by the Governor are significantly higher than growth rates projected by the Demographics Unit in the Department of Finance (DOF) and the California Postsecondary Education Committee (CPEC). For example, the proposed enrollment growth of 6.9 percent for UC is about three times CPEC's estimate of 2.26 percent, and almost twice the administration's own projection of 3.63 percent. The DOF and CPEC developed their projections using demographically based projections of growth in the number of high school graduates and in the adult population. In developing their baseline projections, both DOF and CPEC assumed that college-participation rates would generally increase or remain constant for high school graduates and for many adult age groups.

Moreover, we note that the Governor's budgeted enrollment growth rates for UC and CSU far exceed demographic projections regarding the state's college-age population. The state's 18-to-24-year old population is expected to grow by only 1.5 percent in 2003-04. This means that the proposed enrollment growth at UC and CSU is more than four times the estimated increase in the prime college-going population age group.

UC and CSU Requested Lower Enrollment Growth. Last fall, the UC Board of Regents and the CSU Board of Trustees approved 2003-04 budgets for their respective segments. These budgets—which were subsequently submitted to the Governor for consideration—included funding for enrollment growth rates of 4.2 percent at UC and 5 percent at CSU. The Governor's proposed enrollment growth rates are considerably higher.

Figure 4

Proposed Versus Projected 2003-04 Enrollment Growth Rates

	DOF[a]	CPEC[b]	Governor's Budget
UC	3.63%	2.26%	6.9%
CSU	4.03	2.51	7.1

a Department of Finance, 2002 Projection Series.

b California Postsecondary Education Commission, 2000 Projection Series.

More Effective Ways Available to Promote "Access"

Over the past several years, the Legislature has expressed considerable interest in preserving access to the state's public higher education segments. The administration argues that a large increase in budgeted enrollment is necessary to ensure such access when fees increase. We disagree. Increasing enrollment funding does nothing to address financial barriers to higher education. Nor does it increase the number of students who qualify for admission, or influence the enrollment decisions of admitted applicants. We believe access is best promoted by reducing financial barriers (such as those related to the cost of attendance) and improving academic preparation—not by expanding course sections at UC and CSU. We note that the budget provides substantially more funding than necessary to cover projected increases in the number of students that typically enroll at the segments. Such funds could be better spent on initiatives that would *increase* opportunities for students at the state's universities and colleges. In a later section, we recommend an expansion of student financial aid in the state's student-centered Cal Grant program.

No Need to Increase Funding for Students Already Enrolled at UC and CSU

The budget enrollment levels funded in each year's budget are targets for which funding is provided. Because the number of eligible students enrolling at the segments cannot be predicted with complete accuracy, in any given year UC and CSU typically serve slightly more or less FTE students than budgeted. Recent practice has been for the segments to internally redirect resources to accommodate any "overenrollment" in a given year.

The *Governor's 2003-04 Budget* proposal departs from recent practice in that it provides a separate, additional amount on top of the regular growth allocation to fund prior overenrollment. This special allotment is $45 million each for UC and CSU. We can find no justification for the state to alter how it budgets higher education enrollments, for the following reasons:

- ***Students Are Already Receiving Instruction.*** Essentially, the Governor's budget provides UC and CSU with additional funding for students that they have already enrolled. In view of the considerable General Fund budget shortfall facing the state, it is hard to justify providing the segments with additional funding for students they are already serving.
- ***Does Not Expand Access.*** The funding proposed for overenrollment would *not* increase the number of students enrolled in higher education. This is because the additional funds would be for enrollment growth that has already occurred.
- ***Not Budget Priority of the Segments.*** The UC Board of Regents and the CSU Board of Trustees did not ask for overenrollment funding in their budget requests to the Governor. The segments are already teaching these students using existing resources.
- ***Enrollment Management Strategies Available.*** We recognize that UC and CSU may from time to time face enrollment demand that exceeds their capacity and budgeted resources. However, the segments can utilize various strategies to control future enrollments.

RECOMMEND 4 PERCENT GROWTH FUNDING

We recommend the Legislature delete $114.9 million from the $268.1 million requested in the budget for enrollment growth at the University of California and the California State University, because budgeted growth rates significantly exceed demographic projections. Our proposal would leave each segment with adequate funding to increase budgeted enrollment by 4 percent. (Reduce Item 6440-001-0001 by $48.7 million and Item 6610-001-0001 by $66.2 million.)

As noted in the above analysis, we find no justification for the amount of enrollment growth funding proposed in the Governor's budget. We recommend therefore that the Legislature instead provide both UC and CSU funding for enrollment growth at a rate of 4 percent. Accordingly, we recommend a total General Fund reduction of $114.9 million, including $48.7 million from UC and $66.2 million from CSU.

Under our proposal, UC and CSU would receive budgeted enrollment growth at or slightly above the rates projected by DOF and CPEC. We believe that 4 percent enrollment growth allows the segments to accommodate enrollment growth due to increases in population and college participation. Accordingly, we recommend that the Legislature reject the Governor's proposal to increase funding for students already enrolled at UC and CSU.

INTERSEGMENTAL
FINANCIAL AID

Financial assistance for students in higher education comes in many forms and is offered by many entities. The major forms of financial assistance include grants (scholarships and fellowships), loans, work study, investment accounts, and tax credits. The major providers of financial assistance are the federal government, state government, universities, and private benefactors. California has several state programs to help students obtain financial assistance for college—including the Governor's merit scholarships, the Cal Grant entitlement and competitive programs, the University of California (UC) and the California State University's (CSU) institutional aid programs, the California Community Colleges Board of Governors' fee waiver program, and the Scholarshare Trust program.

The Governor's budget includes four major financial aid proposals.

- ***Modifies Funding Schedule for Governor's Scholarship Programs to Pay Award Winners After They Have Completed Eleventh Grade.*** The Governor's budget includes $43 million to fund eleventh grade students who qualify for Governor's Scholarship awards. The Governor's budget proposes to postpone funding ninth and tenth grade students who qualify for awards in 2003-04 until the award winners have completed the eleventh grade.
- ***Increases Value of Cal Grant Awards for Students Attending UC and CSU.*** The Governor's budget includes a $35 million Cal Grant augmentation to compensate for increases in student fees at UC and CSU. The augmentation would ensure that Cal Grant recipients attending UC and CSU continue to receive sufficient financial aid to cover all educational fees.
- ***Reduces Value of Cal Grant Awards for Students Attending Private Colleges.*** The Governor's budget proposes to reduce the maximum Cal Grant award amount for students attending pri-

vate colleges by 9 percent. This proposal generates a total of $10 million in savings. The maximum award amount would be reduced from its current level of $9,708 to $8,832 for new Cal Grant recipients attending private colleges. Existing Cal Grant recipients would continue to receive the higher current award level of $9,708.

- ***Assumes One-Third of Additional Student Fee Revenue Is Directed to UC and CSU's Institutional Aid Programs.*** Continuing a recent practice, the Governor's budget assumes that UC and CSU will direct one-third of additional student fee revenue to needs-based financial aid programs within their respective systems. This set-aside would augment UC and CSU's institutional aid budgets by $95 million and $71 million, respectively. This represents a 62 percent and 58 percent increase for UC and CSU, respectively, over their current-year institutional aid budgets (prior to the fee increase).

In the following sections, we provide an alternative to the Governor's financial aid proposals. Figure 1 compares the Governor's budget proposals with our alternative. We recommend the Legislature: (1) eliminate the Governor's Scholarship programs, (2) approve a Cal Grant augmentation for students attending UC and CSU, (3) reject the proposed Cal Grant reduction for students attending private colleges, (4) amend the proposed set aside for UC and CSU's institutional aid budgets, and (5) provide fee assistance to all first-year Cal Grant B recipients.

Figure 1

Comparing Governor's Budget Proposals On Financial Aid With LAO Alternative

(In Millions)

Financial Aid Proposal	Governor's Proposals	LAO Alternative
Governor's Scholarship programs	$43.4	—
Cal Grant augmentation for UC and CSU students	34.5	$28.1
Cal Grant reduction for private-college students	-10.2	—
Institutional aid augmentation at UC and CSU	165.4[a]	31.3[a]
Fee assistance for all first-year Cal Grant B recipients	—	95.0
Totals	**$233.1**	**$154.4**

[a] Student fee revenue.

GOVERNOR'S SCHOLARSHIP PROGRAMS

In 2000-01, the state established two new merit-based scholarship programs.

- ***Governor's Scholars Program Provides $1,000 Scholarships.*** This program provides a $1,000 scholarship to each high school student who obtains high combined reading and mathematics scores on state achievement tests. Specifically, students are eligible for these scholarships if they score either in the top 5 percent of test takers in their grade level statewide or in the top 10 percent of test takers in their grade level at their public high school.
- ***Governor's Distinguished Mathematics and Science Scholars Program Provides Supplemental $2,500 Scholarships.*** This program provides an additional $2,500 scholarship to each high school student who earns a Governor's Scholars award and obtains high scores on advanced mathematics and science achievement tests. Specifically, students must attain the highest possible score on an advanced placement calculus exam *and* an advanced placement exam in biology, chemistry, or physics. (If students do not have access to advanced placement exams or they are involved in alternative educational programs, they may qualify by obtaining comparably high scores on Golden State exams or International Baccalaureate exams.)

State Has Provided More Than $100 Million Annually Since Programs' Inception. In 2000-01 and 2001-02, the state provided $118 million annually for the Governor's scholarship programs. In 2000, approximately 106,000 students qualified for the $1,000 awards and approximately 500 qualified for the supplemental $2,500 math and science awards. In 2001, approximately 114,000 students qualified for the $1,000 awards and approximately 1,300 qualified for the supplemental $2,500 math and science awards. Since the programs' inception, slightly more than 80 percent of qualified students have claimed their awards. In 2002-03, the state provided $28 million in the budget act and the Department of Finance authorized an augmentation of $93 million—for a total funding level of $121 million.

Eliminate Governor's Scholarship Programs

We recommend the Legislature eliminate the Governor's Scholars Program and the Governor's Distinguished Mathematics and Science Scholars program because neither program is likely to enhance access to college. Moreover, the state already has longstanding, well-developed

programs designed to reward academic achievement. (Eliminate Item 0954-101-0001, for a savings of $43 million.)

The Governor's Scholarship programs are relatively new and high cost. Moreover, the state's fiscal situation has deteriorated substantially since the programs' inception in 2000. Given this background, we recommend the Legislature eliminate the programs because: (1) neither program is likely to enhance access to college; (2) the state already aids *all* qualified middle-income and low-income students through the Cal Grant A and Cal Grant B entitlement programs; and (3) the state already has a well-integrated higher education system with selective admission standards, relatively low student fees, and relatively generous financial aid packages for deserving students.

Governor's Scholarship Programs Unlikely to Enhance Access. The Governor's Scholarship programs provide financial awards only to top-ranking students, as defined by scores on achievement tests. As years of research has shown, a very high correlation exists between students' academic achievement and their parents' level of education and family income. Thus, the Governor's Scholarship programs are likely to benefit many students from relatively high-income families with college-educated parents. These students are the most likely already to be highly motivated and planning for college. In many cases, these scholarships therefore will not be a major factor in students' decision to attend college. Thus, these programs are unlikely to increase access—that is, they are unlikely to help students who would not otherwise be able to afford college.

Middle-Income Students Already Benefit From Cal Grant A Program. One concern might be that the Governor's Scholarship programs provide important financial aid benefits to middle-income students. California, however, has a well-developed Cal Grant A program aimed at meritorious, middle-income students. Moreover, this program is now an entitlement for recent high school graduates who are younger than 24 years old. To receive a Cal Grant A award, students must meet both academic and financial criteria. Academically, students must have a minimum grade point average (GPA) of 3.0. Financially, students must have some need, but the program's income and asset ceilings are relatively generous. For example, the income ceiling for a dependent student with a family size of four is $66,200 and the asset ceiling (excluding the principal residence) is $51,200. In 2002-03, almost 20,000 students received Cal Grant A awards.

State's Financial Aid Program Now an Entitlement for All Qualified Students. Through the establishment of the Cal Grant entitlement program in 2000, the state now guarantees that all qualified students with financial need receive financial resources for college. The entitlement program includes both the Cal Grant A program (mentioned above) and the Cal Grant B program, which targets low-income students meeting minimum GPA requirements. The state therefore already has financial aid programs specifically designed for both meritorious low-income and middle-income students. An additional scholarship program is not necessary either to help promote achievement or ensure access for financially needy students.

Public Higher Education System Already Designed to Promote and Reward Merit. Even before the state established the Governor's Scholarship programs, the state already had taken strong actions to promote and reward meritorious students. Indeed, the *Master Plan for Higher Education in California*: *1960-1975* was based on the fundamental principle that UC and CSU would have selective admission standards—serving the top one-eighth and one-third of high school graduates, respectively. If students do meet these admission standards, the state generously subsidizes their education regardless of financial need. On average, the state provides approximately $18,600 and $9,900 in General Fund support per full-time equivalent student at UC and CSU, respectively. Selective admission standards, generous subsidies, and relatively low student fees are indeed the cornerstones of the state's higher education system. In short, the state already has designed an integrated higher education structure that encourages and rewards academic achievement.

In conclusion, we recommend the Legislature eliminate the Governor's Scholarship programs because they distribute scarce resources in an inefficient manner—aiding all students, rich and poor, even if additional financial resources are not needed and will not promote access. Additionally, the state already has a well-designed postsecondary system that both promotes academic achievement through rigorous admission standards and provides deserving students with monetary resources to help them pay college-education costs.

Option—Convert Entirely to Pay-As-You-Go System

If the Legislature decides to retain the program, we recommend converting it to a pay-as-you-go system and having the Student Aid Commission (SAC) administer the program.

Current System Funds Award Recipients While Still in High School. Under the current funding system, ninth, tenth, and eleventh grade students take an achievement exam in the spring. If they qualify for a Governor's Scholarship award, they are notified the following winter. Funding for all awards is provided to the Scholarshare Investment Board, which establishes an account for each student (once he or she "claims" an award by filing the necessary paperwork). Money in these accounts is owned by the state but held in the award recipient's name. Funds from these accounts are invested and earn interest. The principal and interest remain assets of the state until used by a recipient for qualified higher education expenses. If an award recipient has not attended college by the age of 30, the funds then revert to the General Fund. Consequently, the state could reserve monies in an account for up to 16 years and then the funds could revert to the General Fund—never having benefited any student.

Governor's Proposal Also Funds Award Recipients While They Still Are in High School. Under the Governor's proposal, the state would place each student's total award in a state account once he or she is in the eleventh grade. Because some students might choose not to attend college, the state still could hold their award funds up to 14 years before reverting them to the General Fund. Again, during all this time, the funding never would have benefited any student.

If Retained, Convert to Pay-As-You-Go System. If the program is retained, we recommend converting it to a pay-as-you-go system, whereby the state would maintain a list of eligible award recipients and would pay the awards only once a recipient had entered college and actually needed the monies for qualified higher education expenses. As corollary adjustments, we recommend the state offer a set award amount without an interest-earning component and have SAC administer the program. As a result of this conversion, very few award recipients would be eligible for payment in 2003-04, thereby yielding approximately $43 million in General Fund savings. The state would begin to incur more sizeable costs in 2004-05 as the first award cohort under the new payment schedule entered college. Costs would then grow as more award cohorts entered college, but, even at full implementation, the cost always would remain lower than it currently is because no monies would unnecessarily be reserved for students who do not attend college.

Cal Grant Awards for Private-College Students

We recommend the Legislature reject the Governor's proposal to reduce the Cal Grant award for students attending private colleges because these awards, in many cases, actually provide the state with fiscal advantages and strengthen educational accountability among public universities. (Increase Item 7980-101-0001 by $10 million.)

Although we recommend the Legislature approve a Cal Grant augmentation for UC and CSU students, we recommend the Legislature reject the proposed Cal Grant reduction for students attending private and independent colleges. The Governor's budget proposes to reduce the maximum Cal Grant award for students attending private and independent colleges by 9 percent. This would reduce the maximum award from its current rate of $9,708 to $8,832.

Value of Cal Grant Award for Private-College Students Already Has Eroded Since 2000-01. The last time the state raised the maximum Cal Grant award for students attending private and independent colleges was in 2000-01—when the award was raised from $9,420 to $9,708. Since that time, inflation has eroded the value of the award by 5 percent (see Figure 2). In real dollars, the Governor's 2003-04 proposal would result in a 16 percent decline since 2000-01. By comparison, the Governor's budget proposes *increasing* the value of the Cal Grant award for students attending UC and CSU by 35 percent and 38 percent, respectively.

Figure 2

Value of Cal Grant Award for Private-College Students Already Has Eroded

Maximum Cal Grant Award

		Inflation-Adjusted Dollars[a]	
	Nominal Dollars	Amount	Percent Change
2000-01	$9,708	$9,708	—
2001-02	9,708	9,433	-3%
2002-03	9,708	9,194	-5
2003-04 (proposed)	8,832	8,115	-16

a 2000-01 dollars.

In Many Cases, Cal Grant Awards for Financially Needy Students Attending Private Colleges Can Reduce Overall State Costs. In many cases, the state provides less funding for a financially needy student who attends a private rather than a public university. Figure 3 compares the level of funding the state provides for a financially needy student attending UC, CSU, an independent college, and a private-career college.

State Pays More for Financially Needy Students Who Attend UC Rather Than Private Colleges. The Governor's budget proposal provides approximately $13,700 for each additional full-time, financially needy student attending UC. This amount does *not* include capital outlay funding or institutional financial aid UC provides to financially needy students. Even without including these components, the amount is approximately $4,800, or 55 percent, more than the amount the Governor proposes providing for a financially needy student who attends an independent or private

Figure 3

State Support for Financially Needy Students At Public and Private Colleges

2003-04
Funding Per Student

	Cal Grant Award	State Subsidy[a]	Total Funding
UC	$4,629	$9,030	$13,659
CSU	1,968	6,594	8,562
Independent colleges	8,832[b]	—	8,832
Private career colleges	8,832[b]	—	8,832

a Reflects marginal cost funding—that is, the subsidy the state provides for each additional student. Does not include capital outlay funding.

b Reflects Governor's proposal to reduce award by 9 percent. Current-year amount is $9,708.

college. Even if the private-college Cal Grant award was maintained at the existing level of $9,708, a financially needy student at UC still would receive almost $4,000, or 41 percent, more than a financially needy student who attends a private college. Despite this disparity, many financially needy students attend private colleges that are similar to UC in cost and quality. For example, in 2002-03, 820 Cal Grant recipients selected to attend the University of Southern California (USC) and 407 recipients attended Stanford University. More Cal Grant recipients attended USC and Stanford University in 2002-03 than any other private or independent college.

State Pays Slightly More for Financially Needy Students to Attend Private Colleges Rather Than CSU. The Governor's budget proposal provides approximately $8,600 for each additional full-time, financially needy student attending CSU. This amount also does not include capital outlay funding or institutional financial aid CSU provides to financially needy students. This amount is roughly $300 below the private-college Cal Grant award proposed by the Governor and $1,100 below the existing award level. Although slightly higher, the private-college Cal Grant award still is a wise fiscal investment because, to the extent it encourages students to attend private rather than public universities, it increases the overall capacity of the system and allows more individuals to receive the benefits of higher education.

Meaningful Choice Vital to Holding Public Universities Accountable. The value of a Cal Grant award should be sufficient to enable financially needy students to base their college selection on the comparative quality of universities rather than merely on the monetary incentive provided. Based on this rationale, the state should provide neither an overly generous nor a too paltry Cal Grant award for students attending private institutions. If the award amount is overly generous, students may select a private institution even if the quality of education is inferior to public institutions. Similarly, if the award amount is too low, students may attend a public rather than private institution even if the quality of education is lower at the public institution.

- ***Promoting Student-Driven Accountability.*** Providing an appropriately sized Cal Grant award to students considering private colleges is vital to maintaining accountability in higher education. This accountability mechanism is particularly significant given the absence of a formal accountability system in higher education. Unlike K-12 education, UC and CSU are given considerable latitude in allocating their state General Fund monies and are not required to establish and report on specific performance targets. In the absence of a state-driven accountability system, having a student-driven accountability system whereby students, including financially needy students, have the ability to make meaningful choices among colleges is significant.
- ***Maintaining Appropriate Incentives, Treating Students Consistently.*** Reducing the Cal Grant award for private-college students by almost $900 while at the same time increasing the award by $1,200 for UC students and almost $550 for CSU students weakens this accountability system. Ideally, Cal Grant award amounts for all students—those attending private colleges, UC, and CSU—would be adjusted in a consistent manner, to account for inflationary increases in fees and tuition costs. Given the fiscal difficulties the state is facing in the budget year, we recommend maintaining the existing Cal Grant award level for private students.

In conclusion, we recommend the Legislature reject the Governor's proposal to reduce the Cal Grant award for students attending private colleges. Instead, we recommend the Legislature maintain the award at its existing level because the existing level, in many cases, is fiscally advantageous for the state. That is, the state provides considerably less funding for a financially needy student attending a private college than it provides for students of all income levels who attend UC. It provides approximately the same amount for a financially needy student attending a private college rather than CSU. In addition to the fiscal benefit, Cal Grant awards for financially needy, private-college students promote meaningful choices among college campuses and encourage better educational accountability among public universities.

UC AND CSU'S INSTITUTIONAL AID PROGRAMS

In 1993-94, both UC's Board of Regents and CSU's Board of Trustees adopted new fee and financial aid policies. As part of the new policies, UC and CSU would divert one-third of additional student fee revenue to their institutional financial aid programs. Institutional financial aid programs are developed and administered directly by UC and CSU, and each system has a different set of rules regarding how aid is apportioned among students.

Even prior to the new 1993-94 fee and financial aid policies, UC and CSU had a practice of setting aside some revenue each year to use for their institutional financial aid programs. Over time, both General Fund monies and student fee revenues have been used to support institutional aid programs. Annually, the state and systems determine exactly how much funding to set aside and what funding sources to use. However, neither statute nor budget bill language controls how UC and CSU are to use financial aid monies.

Reexamining the Rationale for Institutional Aid Programs

The initial rationale for setting aside funds for institutional financial aid programs was to help financially needy students cover fee increases. The UC's institutional aid program was established in 1968-69—the same year UC instituted its registration fee, thereby increasing the total student fee from $220 to $300. Similarly, CSU's institutional aid program was established in 1982-83—the same year CSU instituted its education fee, thereby increasing the total student fee from $206 to $430. Because the Cal Grant entitlement program now guarantees that all financially needy students (as defined by the state) can receive aid to cover registration and education fees at UC and CSU, the initial rationale for institutional aid is no longer valid.

Because institutional aid programs are no longer needed to help financially needy students cover education fees, we think the Legislature should reexamine its objectives in supporting institutional aid programs. Specifically, we recommend the Legislature consider the following three issues.

- Should the state support institution-specific rather than student-centered financial aid programs?
- If the state should have institutional aid programs, then how should it fund these programs?
- When and how should it adjust these budgets?

The Case For and Against Institutional Financial Aid. In thinking about the case for and against institutional financial aid programs, we have identified three conditions under which the state should support institution-specific programs rather than statewide programs. The state should support institution-specific programs if: (1) the cost of education at UC and CSU is different, (2) the financial needs of UC and CSU students are different, and (3) the state is less able than UC and CSU to understand fully how these costs and needs vary. Under such circumstances, the state would do a qualitatively poorer job than UC and CSU in designing a financial aid system that rightly accounted for these differences. Considering the cost of education does vary at UC and CSU, and UC and CSU's student bodies do vary in terms of available financial resources, the pivotal question is whether the state is better or less able than the segments to design an appropriate financial aid system.

State Is Better Able to Appropriately Account for Differences in Cost of Education and Students' Financial Needs. We think the state is better positioned than UC and CSU to make critical redistribution decisions. This is because the state is entrusted with promoting the interests of *all* students statewide and it has broad budgetary responsibility to consider overall trade-offs in state spending priorities. By comparison, UC and CSU are entrusted with promoting the interests of students on their particular campuses and they are not required to assess the consequences of statewide redistribution policies and spending priorities. Moreover, the state already makes critical fiscal judgments regarding how much funding to provide for each additional UC and CSU student. The state also already tailors the Cal Grant program to individual students' needs, offering UC students larger awards than CSU students to account for UC's higher fee rate.

Redistribution Should Be State Responsibility. Given the importance of financial aid and the significant ramifications financial aid decisions have on students' access to higher education, we think the state, rather than UC and CSU, should weigh the merits of alternative aid principles and establish appropriate financial aid policies. Otherwise, important financial aid and redistribution policies will be made outside the purview of state policymakers and without consideration of overall state trade-offs.

Institutional Aid Principles Should Be Established in Statute and Funding Should Be Adjusted Annually Through Budget Bill Provisions. Left within the sole purview of UC and CSU, institutional aid policies are and will continue to be difficult for the Legislature to monitor, assess, and modify. Indeed, few policymakers at the state level can explain what types of students benefit from UC and CSU's institutional aid programs. In contrast, the state's Cal Grant policies are expressly stated in statute and high school students know whether they meet the academic and financial requirements for receiving state aid. We think institutional aid principles also should be expressly declared at the state level. General guidelines should be established through statute and annual adjustments should be expressed through related budget bill provisions.

In conclusion, we think the state should have financial aid policies that account for differences in college costs and students' needs. We believe the state, however, should make these policies publicly, in a transparent fashion, and should document these policies through statute, making appropriate annual adjustments through corollary budget bill provisions.

Governor Proposes Massive Augmentation to UC and CSU's Institutional Aid Budgets

The Governor's budget assumes that both UC and CSU will set aside a portion of new student fee revenue for their institutional financial aid programs. The UC plans to set aside one-third of all student fee revenue above the current-year level—including additional revenue generated from proposed fee increases as well as revenue generated as a result of enrollment growth. The CSU plans to set aside one-third of only student fee revenue resulting from proposed fee increases. It does not plan to set aside one-third of fee revenue generated from enrollment growth. Instead, CSU plans to use this revenue to help support instructional activities and fund mandatory budget-year costs.

Institutional Aid Budgets Increasing by Excessive Proportion. Figure 4 shows proposed changes in UC and CSU's institutional aid budgets from the enacted 2002-03 budget to the proposed 2003-04 budget.

Figure 4

Governor's Budget Assumes Large Increases in Spending on Institutional Aid Programs

(Dollars in Millions)

	2002-03 Enacted	2003-04 Proposed	Change	
			Amount	Percent
UC	$151.9	$246.6	$94.7	62%
CSU	122.7	193.5	70.7	58

The proposed augmentation at UC is $95 million, which is 62 percent more than was budgeted in the current year (prior to the fee increase). Similarly, CSU plans to designate an additional $71 million for its institutional aid program—an augmentation of 58 percent over the current year (prior to the fee increase). The budget provides no justification for such increases. Certainly there is no evidence that students' financial need increased by so much so quickly.

Appropriate Augmentation in Budget Act, Specify General Policy Guidelines

We recommend the Legislature provide additional guidance in the development of institutional financial aid policies. To begin these efforts, we recommend the Legislature appropriate General Fund and student fee revenue for institutional aid in the budget act, including budget bill language stating general guidelines on how the University of California (UC) and the California State University (CSU) are to distribute any budget-year augmentation for institutional aid. We further recommend the Legislature begin working with UC, CSU, and other interested parties to develop legislation that would establish appropriate financial aid principles for serving financially needy students at the various higher education segments. (Establish new UC Item 6440-001-0498 and new provision in CSU Item 6610-001-0498.)

Given the concerns we have outlined regarding making important redistribution decisions outside of the state's purview and given the extremely large augmentations scheduled in the budget year for UC and CSU's institutional aid programs, we recommend the Legislature:

- Appropriate all institutional aid funding—both General Fund and student fee revenue—explicitly in the *2003-04 Budget Act*.
- Reduce the proposed augmentation for institutional aid to a more reasonable level that reflects the actual costs UC and CSU are likely to incur as a result of enrollment growth. Increasing UC and CSU's institutional aid budgets by 4 percent—consistent with our recommended enrollment growth rates—results in an augmentation of $16 million for UC and $15 million for CSU. This is $79 million and $55 million less than the augmentation assumed for UC and CSU, respectively, in the Governor's budget proposal. The UC and CSU would retain this additional student fee revenue, which they could use to further offset proposed reductions.
- Adopt budget bill provisions that provide UC and CSU with general guidelines regarding how the augmentation for institutional aid is to be used to benefit students in 2003-04.

- Begin working with UC, CSU, and other interested parties to develop legislation that more clearly expresses the objectives of financial aid policies and more clearly identifies the intended beneficiaries of these financial aid monies. In developing this legislation, we recommend the Legislature consider an array of options—including retaining specialized UC and CSU programs, expanding and modifying existing statewide programs, such as the Cal Grant B program and the competitive Cal Grant program, and creating distinct programs for graduate and undergraduate students.

FEE ASSISTANCE FOR FIRST-YEAR CAL GRANT B RECIPIENTS

We recommend the Legislature provide fee assistance to all first-year Cal Grant B recipients to ensure these students are not affected adversely by fee increases at the University of California and the California State University. We estimate this would cost approximately $95 million.

The state's Cal Grant B program is designed to serve the financially neediest students in the state. The program provides a subsistence award of up to $1,551 during a student's first year of college. In the second, third, and fourth years of college, the Cal Grant B program provides a student with both the subsistence award and financial aid to cover educational fees and tuition (of up to $9,708). However, state law includes a special provision known as the "2 percent rule" that permits up to 2 percent of new Cal Grant B recipients enrolling in college for the first time to receive both a subsistence award and fee assistance during their *first* year of college. Priority for first-year fee assistance is given to students with the greatest financial need and the highest level of academic merit. The remaining 98 percent of first-year Cal Grant B recipients receive only a subsistence award.

Most First-Year Cal Grant B Recipients Will Be Affected by UC and CSU Fee Increases Unless Program Is Modified. Because only 2 percent of Cal Grant B recipients currently are eligible for fee assistance during their first year of college, most first-year Cal Grant B recipients—again, the financially neediest students in the state—will be affected by fee increases at UC and CSU. The proposed fee increases of 25 percent at both UC and CSU are of relatively large magnitude. (Elsewhere we recommend that this fee increase be reduced to 15 percent, which although more modest, still would be significant.) Depending on the severity of their financial circumstances, some students might find that they cannot afford the new fee levels and therefore might decide not to attend college.

In these cases, students who are both academically meritorious and financially needy would be denied access.

Current Fee-Assistance Policies Generate Several Perverse Outcomes. Currently, although the state does not provide fee assistance to most first-year Cal Grant B recipients, it does provide fee assistance to all Cal Grant A recipients during all four years of college. Cal Grant A recipients are on average less financially needy that Cal Grant B recipients (that is, the income and asset ceilings are substantially higher for the Cal Grant A program). The state's current fee-assistance policies generate two perverse outcomes—both of which would be corrected if the state provided fee assistance to all first-year Cal Grant B recipients.

- The financially neediest students in the state (Cal Grant B recipients) *would* be affected by UC and CSU fee increases whereas less financially needy students (Cal Grant A recipients) *would not* be affected. That is, the state *would* provide fee assistance to first-year Cal Grant A recipients, thereby removing any adverse effect of fee increases, whereas the state *would not* provide fee assistance to first-year Cal Grant B recipients.
- Currently, the state provides the financially neediest students who attend private colleges with fewer resources over their four years of college compared to less financially needy students. A Cal Grant B recipient currently attending a private college would receive a four-year aid package totaling $35,300. By comparison, a Cal Grant A recipient attending a private college would receive a four-year aid package totaling 38,800, which is $3,500, or almost 10 percent, more than a Cal Grant B recipient receives.

In conclusion, we recommend the Legislature provide all Cal Grant B recipients with fee assistance during their first year of college. This would ensure that these students are not adversely affected by fee increases at UC and CSU. It also would correct a couple of perverse outcomes resulting from the state's current fee-assistance policies. We estimate that providing fee assistance for all Cal Grant B recipients would cost approximately $95 million. To accommodate this amount of funding, we recommend various reductions to other higher education programs that, if taken in total, would be sufficient to fund this augmentation.

California Postsecondary Education Commission (6420)

The California Postsecondary Education Commission (CPEC) is responsible for the planning and coordination of postsecondary education. The CPEC provides analysis, advice, and recommendations to the Legislature and the Governor on statewide policy and funding priorities for colleges, universities, and other postsecondary education institutions. In addition, CPEC administers the federal K-12/University Professional Development Partnerships. The commission has 16 members, representing the public and private university segments, the State Board of Education, students, and the general public.

Proposed Budget. The Governor proposes total General Fund expenditures of $695,000, a decrease of $1.4 million, or 67 percent, from estimated current-year expenditures. This is due to the proposed elimination of 23.5 staff positions and related operating expenses and equipment. The proposed reduction would leave five positions (three General Fund positions and two federally funded positions). The Governor's current-year estimate assumes passage of his December revision, which reduced current-year spending for CPEC by $108,000.

As the state's administrator of the federal K-12/University Professional Development Partnerships, CPEC receives federal funds. The Governor's current-year estimate assumes a decrease in federal funds of $2.9 million, leaving a total of $5 million in federal funds. However, subsequent to the release of the Governor's budget, CPEC notified the Department of Finance that it would receive an additional $3.2 million in federal funds in the current year.

Analysis of the Governor's Proposal for CPEC

Governor's Proposal. As noted above, the Governor's 2003-04 proposal would leave CPEC with three General Fund positions and two federally funded positions. These include the director, the executive secretary, the postsecondary education manager in the external unit, and the chief associate and the office technician in the Federal Programs Unit. Thus, the Governor proposes no staffing for CPEC's information systems and administrative services unit.

Under the Governor's proposal, the two federally supported positions would continue to administer federal K-12 / University Professional Development Partnerships. The proposal does not address what responsibilities would be assigned to the remaining three state supported staff. The commission, however, would be unable to fulfill the majority of its current statutory responsibilities with such limited staff. In addition, there is little point in maintaining the commission and executive director position if there is no staff to direct or to carry out its research and public agenda.

Major Funding Changes Should Be in Context of Realigning Mission. We believe that any major changes to CPEC's overall funding should be made in the context of realigning its mission and responsibilities so that CPEC's resources match its duties. Once the Legislature determines CPEC's primary mission and statutory responsibilities, then it can determine the appropriate structure for the agency. This is consistent with the Legislature's intent, expressed in supplemental report language in 2002-03, that our office convene a working group to develop recommendations concerning CPEC. That working group met in the fall of 2002 to:

- Reexamine CPEC's statutory responsibilities.
- Identify ways that the commission can effectively perform its responsibilities within its budgeted resources.
- Consider recommendations put forth by the Joint Committee to Develop a Master Plan for Education related to current CPEC functions and the development of a successor agency.

Report Examines CPEC's Mission, Governance, and Data and Analysis

In our recent report, *The California Postsecondary Education Commission: A Review of Its Mission and Responsibilities*, we discuss in detail the major issues that were identified in the course of the working group's discussions and our own investigation. In general, we grouped the main observations and findings into three main categories: mission and statutory responsibilities, governance and structural issues, and data and analysis. Although, our report was informed by the working group's discussion, the group was unable to achieve a consensus on many issues. Thus, the following are our own conclusions and are not necessarily shared by all the working group's members.

In general, we found that there is a mismatch between CPEC's statutory responsibilities and its budgeted resources. We recommended that the Legislature assign highest priority to CPEC's data management functions. This is because CPEC has generally been effective in this area and the data that CPEC collects is useful for policymakers. We further noted that there is a tension in CPEC's mission and statutory responsibilities between coordination and independent analysis. Specifically, it is difficult for CPEC, or any other organization, to serve both as a part of the state's higher education infrastructure and as an objective analyst of it. We also found that CPEC's tendency to use a consensus building approach can interfere with its ability to produce objective and independent analysis.

What Role Should CPEC Play in the Future? In our report, we discuss two options for structuring CPEC beyond data management. Choosing between these options will depend on which function the Legislature identifies as CPEC's primary role: coordination or independent policy analysis. Under either scenario, we expect that CPEC would continue to act as a clearinghouse for current and historical postsecondary education information that is relevant to statewide needs. The CPEC would be expected to continue to make its data available to policymakers and stakeholders to improve coordination and long-term planning for higher education.

LAO Recommendation

We recommend (1) approval of $695,000 in General Fund support for the California Postsecondary Education Commission and (2) that the funds be designated for data management purposes.

As noted above, we believe the highest priority should be to preserve CPEC's information systems unit. If this unit were maintained, then CPEC could continue to collect statewide data on postsecondary education, maintain its website, and provide data to interested parties. We believe that the Governor's proposed level of General Fund support ($695,000) for CPEC is reasonable to maintain its data function at a basic level. It would provide funding for five or six information technology positions and general data systems maintenance.

Legislature Should Carefully Assess Responsibilities Beyond Data Management. To the extent that the Legislature wishes for CPEC to retain significant responsibilities beyond data collection and dissemination, we recommend that it take into consideration the tension between its coordination and independent policy analysis functions noted earlier.

Specifically, we would recommend that any effort to redefine CPEC's mission beyond data management focus on only one of these two areas.

CPEC Eligibility Study

We recommend the California Postsecondary Education Commission, along with the state's public higher education segments, report at budget hearings on their progress in completing the state's higher education eligibility study.

The 1960 *Master Plan for Higher Education* calls for the University of California (UC) to admit applicants from the top one-eighth of high school graduates, for the California State University (CSU) to admit from the top one-third, and for the community colleges to admit all adult applicants who can benefit from instruction. These targets were reaffirmed by the Joint Committee to Develop a Master Plan for Education last fall. By establishing these targets, the Legislature has sought to create an integrated system of higher education segments that provides sufficient opportunities for all the states' residents. However, it is up to the segments themselves to establish and periodically adjust their admissions criteria in a way that captures the target populations.

In order to gage how well the segments are doing this, existing law requires CPEC to "periodically" estimate the percentages of California public high school graduates that are eligible for admission to UC and CSU. The most recent CPEC eligibility study was based on a survey of California's 1996 high school graduates. In this report, CPEC found that CSU was drawing from the top 29.6 percent of high school graduates. This is about 3.7 percentage points below CSU's master plan target of about 33.3 percent. On the other hand, the study found that UC was drawing from a considerably larger pool than the top 12.5 percent. Based on CPEC's 1996 survey, the segment was selecting from the top 20.5 percent of public high school graduates.

Since the last CPEC eligibility study was based on a cohort of students that graduated from high school over seven years ago, we do not know how well the segments' current admissions standards achieve their master plan targets. Although CPEC has not performed an eligibility study in recent years, the past three budgets have provided CPEC with a total of $106,000 to conduct such a study. The state has also provided a total of $133,000 to the three segments to help CPEC prepare the study. Given the importance of the eligibility study for understanding enrollment demand, we recommend that CPEC, UC, CSU, and the California Community Colleges report at budget hearings on their progress in completing the study. This report should include their timeline for completing the study.

UNIVERSITY OF CALIFORNIA (6440)

The University of California (UC) includes eight general campuses and one health science campus. The university is developing a tenth campus in Merced. The budget proposes General Fund spending of $3 billion in 2003-04, a decrease of $134 million, or 4.2 percent, from estimated expenditures in the current year. The Governor's current-year estimate assumes passage of his mid-year reduction proposals, which would reduce current-year spending for UC by $74 million. Figure 1 displays these proposed reductions for the current and budget years.

Figure 2 (see page 218) summarizes the various changes in UC's budget. Major augmentations in 2003-04 include $117 million for enrollment growth, $24.4 million for lease revenue costs, $16.1 million for increased costs of annuitant health and dental benefits, and $11.3 million for the planned UC Merced campus. The budget also proposes General Fund base reductions of $299 million in 2003-04. Of this amount, $195 million is unallocated and $89 million reflects the budget year expansion of allocated reductions proposed in the December revision. In addition, the budget proposes a reduction of $15 million for the California Subject Matter Projects (SMP).

The budget assumes student fee increases will result in about $130 million of additional revenue that will be available to offset the unallocated General Fund reductions. As a result, the remaining unallocated reduction would be about $65 million.

Enrollment Growth of 6.9 Percent. The budget provides UC with $117 million to increase its budgeted enrollment by 13,000, or 6.9 percent, additional full-time equivalent (FTE) students in 2003-04. This would bring UC's budgeted enrollment to 202,628 FTE students.

First Student Fee Increases in Eight Years

Current-Year Increases. The budget reflects a current-year increase in resident student fees, professional school fees, and nonresident tuition

Figure 1

University of California
Governor's Proposed December Revision

(In Millions)

General Fund Reductions	2002-03	2003-04
Academic and institutional support	$20.0	$36.5
Student services	6.3	25.3
Outreach programs	3.3	33.3
Public service programs	2.5	15.0
Digital California Project (K-12 Internet Initiative)	1.1	1.1
Unallocated	19.0	19.0
Research[a]	18.0	28.8
Advanced Placement On-Line project[a]	4.0	4.4
Totals[b]	**$74.3**	**$163.5**

a The 2002-03 December revision identifies this amount as prior-year savings associated with the reversion of unused funds. Programs would be funded in 2002-03 using prior-year savings. Program services will be reduced in 2003-04.

b Detail may not add due to rounding.

for undergraduate students. In December 2002, the UC Regents approved a fee increase to be assessed in the spring 2003 term—the first undergraduate increase in eight years. Revenue from this and the professional school fee increase is intended to backfill the Governor's proposed unallocated $19 million General Fund reduction in the current year. Figure 3 displays 2002-03 fee levels and proposed budget-year fee levels.

Proposed Budget-Year Increases. The budget assumes further increases in resident student fees, professional school fees, and nonresident tuition in the budget year. (Although the Governor's budget assumes these further increases, UC student fees are established by the UC Regents.) These increases, excluding nonresident tuition, are expected to provide an additional $130 million in student fee revenue that would be available to partially offset the proposed $195 million unallocated reduction in UC's General Fund support. (We suggest some ways for UC to minimize the impact of the unallocated reduction on instruction later in this section.)

As Figure 3 (see page 219) shows, the budget assumes a 35 percent increase in the systemwide fee (educational and registration fee) for undergraduate resident students from 2001-02. When combined with cam-

Figure 2

University of California
Governor's Budget Proposals

(In Millions)

	General Fund
2002-03 Budget Act	**$3,223.9**
December Revision Reductions	**-$74.3**
Baseline Funding Adjustments	
Public Employees' Retirement System rate adjustment	$0.1
Unexpended balance lease revenue, estimated savings	-3.0
2002-03 Revised Budget	**$3,146.7**
Reduction of one-time expenditures in 2002-03	-$6.6
Proposed Increases	
Enrollment growth (6.9 percent)	$117.2
Lease revenue bond payments	24.4
Increased costs of annuitant health and dental benefits	16.1
Support for Merced campus	11.3
Subtotal	($169.0)
Proposed Reductions	
Unallocated base reduction	-$194.9
Expansion of December revision reductions	-89.2
Reduce funding for the Subject Matter Projects	-15.0
Subtotal	(-$299.1)
2003-04 Proposed Budget	**$3,013.0**
Change From 2002-03 Revised Budget	
Amount	-$133.7
Percent	-4.2%

pus-based fees, the percentage increase in total fees is slightly less than 35 percent. In 2003-04, the proposed total resident fee for a full-time student is $5,082 for undergraduates and $6,196 for graduates. This reflects increases of 32 percent and 33 percent, respectively, over fee levels in 2001-02.

Figure 3

UC Resident Undergraduate Fees

	Annualized Fee[a]						
			Change		Proposed	Change From 2001-02	
	2001-02	2002-03	Amount	Percent	2003-04	Amount	Percent
Systemwide fee[b]	$3,429	$3,834	$405	12%	$4,629	$1,200	35%
Total student fee[c]	3,859	4,287	428	11	5,082	1,223	32

a Amounts reflect full year implementation of current-year fee increase.

b Amounts include educational fee and registration fee.

c Includes systemwide fee and campus-based fees.

In addition to the educational and registration fees, professional school students pay a special fee which varies by program. Similar to the resident systemwide fee, the Regents approved a professional school fee increase to be assessed in the spring 2003 term. These fees are assumed to increase again in 2003-04 by varying amounts. Figure 4 (see next page) displays professional schools fees from 2001-02 through 2003-04. Generally, the budget assumes a 35 percent increase in professional school fees over the two-year period.

Nonresident students also pay a special, or supplementary, fee. The budget assumes the Regents will approve an increase in this fee of 4 percent from the annualized spring 2003 fee level. For nonresident undergraduate students, the supplementary fee would increase from $12,480 to $12,980, while nonresident graduate students fees would increase from $11,132 to $11,577. (When the supplementary fee for nonresident students is combined with educational and other fees, the increase in the total nonresident undergraduate and graduate charges is 10 percent.) The increase in nonresident tuition is expected to provide $11 million in the budget year. We discuss student fees in more detail in the "Intersegmental" section of this chapter.

UC Alternative Budget Proposal

We recommend alternatives to two major components of the Governor's budget proposal for higher education. First, we recommend lower student fee increases at UC and the California State University (CSU), adopted within the context of an explicit and rational fee policy.

Figure 4

Supplementary Fees for Selected Professional School Students[a]

Professional School	Actual 2001-02	2002-03[b]	Proposed 2003-04	Change From 2001-02 Amount	Change From 2001-02 Percent
Nursing	$1,800	$1,950	$2,430	$630	35%
Theater, film, and television	2,000	2,150	2,700	700	35
Pharmacy	3,000	3,250	4,050	1,050	35
Optometry	3,000	3,250	4,050	1,050	35
Veterinary medicine	4,000	4,350	5,400	1,400	35
Dentistry	5,000	5,400	6,750	1,750	35
Medicine	5,376	5,776	7,256	1,880	35
Business	6,000	6,400	8,100	2,100	35
Law	6,376	6,776	8,606	2,230	35

a Professional school students also pay mandatory systemwide fees and miscellaneous campus-based fees.

b Fees reflect increase in spring 2003.

Second, we recommend lower enrollment growth funding at UC and CSU that is more in line with anticipated demand and state budget priorities. We discuss both of these components more fully in the "Intersegmental" section of this chapter. Here we summarize the impact of our alternative on UC specifically.

Student Fees. We propose increasing mandatory resident student fees for undergraduates by 15 percent (rather than the Governor's proposal of 25 percent) in the budget year. For graduate fees at UC, we propose a 20 percent increase in the budget year (rather than the Governor's proposed 25 percent). In the "Intersegmental" section we note that additional fee increases beyond the budget year would be necessary to reach various "target" fee levels (such as the average fee level of the segments' comparison institutions). Once such a target is reached, we recommend that student fees be adjusted annually to maintain their purchasing power.

Enrollment Growth. The Governor proposes a 6.9 percent increase in UC's budgeted enrollment in 2003-04. We recommend the Legislature instead provide funding for enrollment growth of 4 percent (7,585 FTE students). This would cost $68.5 million, which is $48.7 million less than proposed by the Governor. Enrollment growth of 4 percent is comparable to the amount requested by the UC Regents in the fall (4.2 percent). We believe that this level of enrollment growth would allow UC to accommodate enrollment growth due to increases in population and college participation and is consistent with past practice.

Fee Revenue. As previously mentioned, the budget assumes that revenue from student fee increases will partially offset the proposed unallocated General Fund reduction. The budget assumes that the combined two-year increase in student fees will generate $224 million in additional fee revenue in 2003-04. The budget also assumes that one-third of this additional fee revenue will be earmarked for UC's own financial aid program. Thus, the "net" fee revenue available to offset the combined current-year and budget-year unallocated General Fund reductions of $214 million would be $149 million.

Under our alternative proposal, we estimate UC would receive $190 million, or $34 million less fee revenue than the budget assumes. This is due both to more moderate fee increases in the budget year and to a lower level of enrollment growth than the budget proposes. In addition, we believe that only $16 million of the additional fee revenue should be earmarked for financial aid. (Please see "UC and CSU's Institutional Aid Programs" in the "Intersegmental" section of this chapter.) Thus, under our proposal $174 million would still be available to offset the proposed unallocated General Fund reduction, which is $24 more than the Governor's proposal.

UC Can Minimize Impact of Unallocated Reduction on Instruction by Increasing Student-Faculty Ratio

The Legislature could direct the University of California to temporarily increase its student-faculty ratio (SFR) in order to minimize any potentially negative impact on instruction due to unallocated reductions. The university has some flexibility in how it chooses to increase its SFR—it could increase class size or it could redistribute faculty workload.

As discussed in the introduction, the budget proposes an unallocated reduction in UC's General Fund support. Under the Governor's proposal, all but $65 million of this reduction would be backfilled by student fee revenue. At the time of this analysis, UC was unable to provide detail on how the university would accommodate this reduction. In this section, we suggest a way for UC to minimize the impact of the unallocated reduction on instruction.

The Legislature Could Direct UC to Temporarily Increase Its SFR. The UC's current budgeted SFR is 18.7 to 1. An increase in UC's SFR would allow UC to serve more students with fewer faculty. The UC would experience savings because it would not need to hire as many new faculty as it would at a lower SFR. We note that UC has some flexibility in how it would accommodate a higher SFR. For example, the university could increase average class size, thus serving more students with the same number of faculty. Alternatively, UC could increase the portion of faculty time that is dedicated to teaching (rather than other activities, such as research, administration, or public service). The university indicates that in 1999-00, the average teaching load (undergraduate and graduate students) for regular-rank FTE faculty was 4.9 classes per year—less than two courses per quarter. Increasing the average teaching load of existing faculty above 4.9 classes per year would allow the university to offer more classes to students without hiring additional faculty, thus achieving savings in the budget year. This would not require an increase in faculty's overall workload. Instead, it would shift current workload to teaching from other activities. We believe that such an action could have less negative impact on instruction than other options for accommodating the proposed unallocated reductions.

Outreach Programs

The proposed budget includes approximately $36 million for UC's outreach programs (see Figure 5). Of this amount, $33 million is from the General Fund. This is a reduction of $37 million (General Fund), or 50 percent, from the current-year enacted budget. (The Governor's proposed mid-year reductions would reduce current-year spending for UC outreach by $3.3 million.) Rather than targeting only some specific outreach programs, the Governor proposes reductions in all of UC's systemwide outreach programs. Reductions range from 25 percent (informational outreach and recruitment) to 56 percent. Most, however, represent a 56 percent reduction from 2002-03 (enacted) levels.

Background

Purposes of Outreach. We believe the chief goal of outreach is to seek the enrollment of disadvantaged students in higher education by increasing their eligibility and qualifications. Generally, the three basic obstacles restricting student's access to higher education are: inadequate academic preparation, lack of information concerning the accessibility and purposes of a college education, and lack of information on and assistance with financial aid. As we noted in our *Analysis of the 2002-03 Budget Bill* (see pages E-219 through E-229), there are a variety of K-12 outreach programs, administered by different state agencies, that provide an array of ser-

Figure 5

Proposed Funding for UC Outreach Programs

(In Thousands)

	2002-03 Budget Act	2003-04 Proposed	Change	
			Amount	Percent
K-12 School-University Partnerships	$3,000	$1,325	-$1,675	-56%
Early Academic Outreach Programs	17,812	7,907	-9,905	-56
Student Initiated Outreach/Yield	1,000	442	-558	-56
MESA[a]	10,198	4,631	-5,567	-55
Puente	2,301	1,017	-1,284	-56
Test preparation programs	759	335	-424	-56
UC College Preparatory Initiative (online courses)	8,438	4,000	-4,438	-53
Charter schools	1,000	473	-527	-53
ArtsBridge	250	110	-140	-56
Central valley programs	2,316	1,071	-1,245	-54
Graduate and professional school programs	6,561	4,111	-2,450	-37
Informational Outreach and Recruitment	5,109	3,847	-1,262	-25
UC ACCORD[b]	809	374	-435	-54
Evaluation	700	309	-391	-56
Other outreach programs[c]	2,502	1,165	-1,337	-53
Community college programs:				
Community college transfer programs	$5,293	$2,853	-$2,440	-46%
Dual admissions	2,500	1,105	-1,395	-56
ASSIST[d]	432	191	-241	-56
MESA community college programs	1,350	596	-754	-56
Puente community college programs	802	354	-448	-56
Totals	**$73,132**	**$36,216**	**$36,916**	**-50%**

a Mathematics, Engineering, Science Achievement.

b All Campus Consortium on Research for Diversity.

c Other includes Urban Community—School Collaborative, Community Education & Resource Center, UC Nexus, UC Links, and Gateways.

d Articulation System Stimulating Inter-Institutional Student Transfer.

vices to K-12 students and schools. The state's outreach system is complex. In addition to systemwide programs, there are many federal, private, and campus-level outreach programs. In last year's *Analysis*, we reviewed the structure of UC's K-12 outreach programs, identified problems with the structure, and recommended steps for improving the efficiency and effectiveness of the system.

Types of Outreach. Generally, UC's approach to outreach falls into three categories:

- ***Student Academic Development Programs.*** These programs focus on increasing the academic preparation of students directly through activities such as tutoring, academic advising, and test preparation.
- ***University-School Partnerships.*** These programs are intended to improve student performance indirectly by systemically reforming/improving K-12 education.
- ***Informational Outreach and Recruitment.*** Programs in this category help students plan and prepare for college through informational outreach and recruitment programs.

In addition, UC's outreach strategy includes research to evaluate the root causes of educational disparity and the effectiveness of outreach programs.

Recent Funding History. The UC spent approximately $14 million on systemwide outreach in 1997-98. The majority of these programs focused on improving student academic development. In 1998-99, UC's K-12 outreach budget received a major augmentation of about $40 million—almost quadrupling its K-12 outreach budget to $54 million. The UC's K-12 outreach was augmented again by $20 million between 1999-00 and 2000-01. These augmentations allowed UC to expand student academic programs and to implement a number of new initiatives which broadened the scope of K-12 outreach. These programs grew quickly and in many cases, new programs were implemented with little substantive data on program effectiveness. Even with the reductions proposed by the Governor in 2003-04, UC outreach funding would still be almost three times greater than it was prior to augmentations in the late 1990s.

Little Evidence of Program Effectiveness. Budget bill language directs UC to report annually by March 15 on the outcomes and effectiveness of its outreach programs. The university has received about $6.7 million since 1998-99 to evaluate its outreach efforts. Despite this investment, little is known about the effectiveness of the state's outreach programs. Consequently, it is difficult for the Legislature to determine which outreach programs are most successful in achieving the important objectives of increased awareness, preparation, and access to undergraduate education.

In summer 2002, the university established the Strategic Review Panel on UC Educational Outreach. The UC indicates that the panel's purpose is to assess the effectiveness of UC's programs in meeting its goals, to define desirable changes to the university's overall outreach plan, to set reasonable short-term and long-term goals for the university in pursuing its outreach agenda, and to recommend a new working alliance with the state's K-12 educational bodies and the California Community Colleges (CCC). The Strategic Review Panel was to complete its work by December 2002. However, the completed work product of the panel was not available at the time of this *Analysis*.

LAO Recommendation

We recommend the Legislature approve the Governor's proposed level of reductions for outreach. However, we recommend a more targeted approach in achieving the savings.

In proposing an across-the-board reduction to all outreach programs, the Governor implicitly assumes that (1) all of UC's outreach programs are equally meritorious and (2) all programs can continue functioning with approximately half of their existing funding. We believe that these assumptions are faulty. Instead, we recommend targeting cuts to preserve programs that increase the eligibility and qualifications of students for higher education, or provide direct services to students or schools. We offer the following criteria that we believe can guide the Legislature in considering the Governor's outreach proposal.

Some Programs Are Better Than Others. Some of UC's outreach programs do not increase the academic preparedness of students or provide direct services to schools. Instead, they focus on "yield" or recruiting activities. As we noted in last year's *Analysis*, yield activities do not increase educational opportunities for disadvantaged students. Instead, they typically work to convince already qualified or eligible students to choose UC over some other higher education institution. These students *already have* an opportunity to participate in higher education. We believe that state resources should be used to increase the *number* of students that are eligible for higher education, rather than convince an already qualified student to choose a public rather than a private institution.

Other Sources Are Available to Fund Research on Outreach. Two programs which UC counts as outreach, UC All Campus Consortium on Research for Diversity and the Urban Community-School Collaborative, provide research grants to faculty to study the root causes of educational inequality. The budget proposes approximately $500,000 for these two programs in 2003-04. We recommend deleting funding for these two programs because they can be funded through UC's research budget. The budget proposes providing approximately $260 million in General Fund support for research. If the university believes that this type of research is a high priority, it can fund such research by reallocating funds within its substantial research budget.

Some Programs May Not Be Viable With Reduced Funding. Given the magnitude of the Governor's proposed reduction to individual outreach programs, it is unclear whether all programs are viable with such reduced resources. The Governor's proposal leaves many of the smaller programs such as the Community Education and Resource Center Initiative and UC Nexus with a few hundred thousand dollars. The university was unable to provide any detail on how these types of programs would absorb these reductions. It is also unclear whether these programs would be cost effective if scaled back. Therefore, it may be preferable to eliminate these programs and redirect funds to other outreach programs if programs are no longer viable under the proposal.

Comprehensive Approach Improves System. Although the state directs the majority of funding for outreach to UC, other state agencies provide outreach. In addition, various nonstate entities provide outreach services. In allocating outreach reductions, we recommend that the Legislature take a comprehensive approach that considers the interaction of outreach programs within agencies and among agencies. For example, CSU has two programs—the Collaborative Academic Preparation Initiative—Faculty-to-Faculty Alliance and the California Academic Partnership Program—that are similar in nature to UC's K-12 School-University Partnerships. Even though there is little data on the effectiveness of any of these programs, CSU has generally been able to serve more high schools at a lower cost than UC. Thus, the Legislature should consider the availability of other resources in allocating cuts. A comprehensive approach helps prevent overlap and duplication of services. It also makes it easier for K-12 schools to use outreach services effectively to help students.

Consolidate Existing Outreach Programs to Reduce Inefficiencies and Administrative Overlap. We believe that the Legislature should consolidate existing outreach programs at UC by the type of outreach provided, to reduce inefficiencies and administrative overlap. For example, while slightly different in academic focus, the Early Academic Outreach Programs (EAOP); Mathematics, Engineering, and Science Achievement (MESA); and Puente programs all offer academic development programs, academic advising, and informational outreach. In the long term, the Legislature should consider consolidating existing outreach programs according to function. Consolidation could limit duplication of services and improve coordination. Consolidation would also benefit the segments since less effort would be needed to administer the programs. At the time of this *Analysis*, we lacked sufficient data on program expenditures and effectiveness. Without this data, we were unable to determine how to best consolidate student academic development programs. Therefore, our alternative proposal retains separate funding for EAOP, MESA, and Puente. The UC evaluation and the Strategic Review Panel's work may provide some relevant information for future consolidation of programs.

Community College Outreach Programs. The Legislature has shown considerable interest in improving transfers from CCC to UC and CSU. Our proposal provides about 11 percent more funding ($545,000) for UC's community college outreach programs than the Governor's. We propose maintaining the current-year level ($432,000) of support for the Articulation System Stimulating Inter-Institutional Student Transfer program supported jointly by UC, CCC, and CSU. We believe that the Governor's proposed level of support from UC ($191,000) is insufficient to maintain existing service levels. We also recommend less severe reductions for various student academic development programs for community college students. We propose the elimination of funding for the dual admissions program, whereby UC admits some students who will complete their lower-division coursework at a CCC. This is a new program (first funded in the current year) which we believe the university can implement with existing resources.

LAO Proposal. Figure 6 (see next page) displays our alternative to the Governor's proposal. Using the above criteria, we have targeted the proposed reductions. We believe that this list provides a reasonable starting point for considering outreach funding in the budget year. We recommend a targeted approach to protect programs that increase student's academic development and improve the efficient delivery of outreach services.

OTHER ISSUES

Additional Funding for Unopened Campus Not a Clear Priority

We withhold recommendation on $11.3 million in additional General Fund support requested for the University of California Merced, pending our review of an expenditure plan for the campus to be submitted in mid-February. (Withhold recommendation on Item 6440-004-0001.)

The Governor's budget requests an $11.3 million augmentation to expand funding for the planned UC campus in Merced. This is in addition to $10 million in "base" funding, bringing total budget-year General Fund support for the campus to $21.3 million. Proposed budget bill language specifies that funding is for planning and startup costs associated with academic programs and ongoing support for the unopened campus, including academic planning activities, faculty recruitment, and

Figure 6

LAO Alternative to Governor's Proposal for UC Outreach Programs

(In Thousands)

	Enacted 2002-03	Proposed 2003-04	
		Governor	LAO
Central valley programs	$2,316	$1,071	$1,000
Graduate and professional school programs	6,561	4,111	2,000
Informational outreach and recruitment	5,109	3,847	3,500
UC ACCORD[a]	809	374	—
Evaluation	700	309	300
Student initiated outreach/yield	1,000	442	—
K-12 Student Academic Development Programs			
Early Academic Outreach Programs	$17,812	$7,907	$11,133
Mathematics, Engineering, Science Achievement (MESA)	10,198	4,631	6,551
Puente	2,301	1,017	1,438
Test preparation programs	759	335	335
University/K-12/School/Community Partnerships			
K-12 School-University Partnerships	$3,000	$1,325	—
UC college preparatory initiative (online courses)	8,438	4,000	$4,000
Charter schools	1,000	473	—
ArtsBridge	250	110	250
Other outreach programs[b]	2,502	1,165	66
Community College Programs			
Community college transfer programs	$5,293	$2,853	$3,705
Dual admissions	2,500	1,105	—
ASSIST[c]	432	191	432
MESA community college programs	1,350	596	945
Puente community college programs	802	354	561
Totals	**$73,132**	**$36,216**	**$36,216**

a All Campus Consortium on Research for Diversity.

b Includes Urban Community—School Collaborative, Community Education and Resource Center, UC Nexus, UC Links, and Gateways.

c Articulation System Stimulating Inter-Institutional Student Transfer.

ongoing support for faculty and staff. An additional $16.6 million in bond funds is proposed for capital outlay expenditures at the campus.

Supplemental report language from the *1998-99 Budget Act* requires UC to submit annual reports on expenditures for the Merced campus, including actual expenditures for the past year and budgeted expenditures for the current and budget year. These reports are due by February 15 each year until the campus opens. The campus is currently scheduled to open in 2004-05.

Little Detail on Proposed Augmentation. The university indicates it will hire 15 faculty by the end of 2002-03 using funds provided by the state in the current and prior years. The UC plans to hire an additional 20 faculty in the budget year and 25 in 2004-05 (for a total of 60 faculty by the time of the planned opening in fall 2004). Other than stating its intent to hire faculty, the university has provided little detail on expenditures in the budget year. Without an expenditure plan, we cannot determine the degree to which additional funds are necessary in the budget year. Neither can we evaluate how this proposal compares with other priorities in higher education and elsewhere. Therefore, we withhold recommendation on the $11.3 million proposed augmentation for the Merced campus until we receive and review the campus expenditure plan.

Avoid Dismantling Subject Matter Projects

We recommend the Legislature designate a total of $10 million (consisting of $5 million General Fund and $5 million federal Title II funds) to support four Subject Matter Projects (SMP). Despite the administration's concerns, we understand that this funding designation would not violate federal supplanting laws. We recommend retaining the four SMPs because: (1) a recent evaluation deemed them successful in enhancing teacher-leaders' content knowledge and classroom practices, and (2) they should help the state meet a new federal requirement to increase annually the percentage of teachers that receive high-quality professional development.

The SMP is a longstanding professional development program for K-12 teachers administered by UC. The model for the program was the Bay Area Writing Project—begun in 1974 as a partnership between UC Berkeley and nearby K-12 schools. Since this time, additional partnerships have developed, forming a statewide network of subject-specific professional development programs. Currently, UC is administering six SMPs in the following areas: history and social science; international studies; mathematics; reading and literature; science; and writing. Three characteristics distinguish the SMPs from most other professional development programs. The SMPs: (1) are subject-specific and aligned with the state's academic content standards, (2) develop teacher-leaders who are expected to serve in critical leadership positions at their school sites, and (3) are linked primarily with low-performing schools.

The Governor's budget proposes a $15 million General Fund reduction for the SMPs—reducing the total General Fund appropriation to $5 million. The administration indicates that the $5 million General Fund remaining for 2003-04 would support only the Science SMP. All other SMPs would be dismantled. The Governor's budget also includes $5 million in federal Title II funds for the Science SMP (the same amount as in the current year). Thus, in 2003-04, the Science SMP would receive a total of $10 million in state and federal funds.

Governor's Proposal Would Dismantle SMPs Unnecessarily. The administration argues the state must maintain the $5 million General Fund for this SMP or else it will violate federal supplanting laws. The federal supplanting concerns arise from the fact that in 2002-03, for the first time, the state designated $5 million in federal Title II funds specifically for the Science SMP. The administration believes therefore that if state funding for the Science SMP declines, it will appear as if federal dollars are now supplanting state dollars. Legal advice from the Department of Education's (SDE) federal counsel suggests this is not the case.

State Can Avoid Supplanting Concerns by Documenting That the SMP Program Would Have Been Dismantled. The SDE's federal counsel advises that states may argue that they have not violated federal supplanting laws if they would have eliminated a program in the absence of available federal funds. *Title II, Part A Non-Regulatory Draft Guidance*, issued by the US Department of Education on December 19, 2002, declares that states desiring to use federal Title II funds for state activities "should carefully identify the activities they would have supported in the absence of funding from the program [Title II]." In the absence of federal funds, the Governor's budget proposal still would be eliminating all but the science SMP. (Potentially, were the science SMP not partially federally funded, even it might have been eliminated.) We believe therefore that the state will be able to document successfully that it is not violating federal supplanting laws.

Achieve Efficiencies and Savings by Focusing on Four Core Subjects. Because additional state funds are not available to support the SMPs, we recommend UC consolidate the existing six SMPs into four SMPs that focus on the core subject areas of English language arts, social science, mathematics, and science. By collapsing the International Studies SMP with the Social Science SMP, and the Reading and Literature SMP with the Writing SMP, UC essentially would not have to dismantle any of its existing projects and it could maintain all of its core infrastructure. We recommend maintaining SMPs in all core subject areas because teachers appear to have considerable needs in each of these areas. The UC estimates that it could support these four consolidated projects with $10 million (of which it would designate $8 million for local project services and $2 million for centralized assistance, monitoring, and evaluation). We recommend the Legislature therefore designate a total of $10 million (consisting of $5 million General Fund and $5 million federal Title II funds) for these four projects. We think maintaining the basic infrastructure of the SMPs is in the interests of both the state and federal governments.

Three-Year Evaluation Concludes SMPs Have Positive Impact on Teachers. One reason to retain this infrastructure is because the SMPs are among the few professional development programs that evaluators have found even partially successful in enhancing teacher knowledge. Whereas most state-funded professional development programs have not been evaluated, the American Institutes for Research conducted a three-year evaluation of the SMP program (which it submitted in August 2002). The evaluation found that the SMP program made a positive impact on teachers. For example, teachers participating in SMPs gained a deeper knowledge and understanding of their subject area. Additionally, almost all SMP participants reported that the program had influenced their career and encouraged them to assume new school-site roles. Half of participants said the experience had profoundly influenced their career. (However, despite these positive effects on teachers, the evaluation did not find any clearly positive effect on student achievement.)

The SMPs Could Help State Meet New Federal Professional Development Requirement. Another reason to retain the four SMPs is that these programs should help the state meet a new federal professional development requirement. The federal No Child Left Behind Act, enacted in 2002, requires states to increase the percentage of teachers receiving high-quality professional development. States are to set annual performance targets and report on their ability to reach these targets. Dismantling all but the Science SMP might make it more difficult for the state to meet this new requirement, particularly because the SMPs focus on developing teacher-leaders. The SMPs expect these teacher-leaders to take on greater professional development responsibilities both within their school and in future professional development programs. Dismantling the SMPs therefore might have a ripple effect on the capacity and quality of the state's other professional development programs.

In conclusion, we recommend the Legislature designate a total of $10 million ($5 million General Fund and $5 million federal Title II funds) for four SMPs. Instead of maintaining only the Science SMP, this would allow the state also to preserve three other consolidated projects in English language arts, social science, and mathematics. These are all longstanding projects that a recent evaluation deemed successful in enriching teachers' subject-matter knowledge. We think preserving these SMPs is in the best interests of the state and federal governments and will not be considered in violation of federal supplanting laws.

California State University (6610)

The California State University (CSU) consists of 23 campuses. The Governor's budget proposes General Fund spending of $2.6 billion for the system in 2003-04. This is a decrease of $97.4 million, or 3.6 percent, from the enacted 2002-03 budget and a decrease of $123.1 million, or 4.5 percent, from the Governor's proposed revision of the 2002-03 budget. For the current year, the Governor proposes a $59.6 million unallocated General Fund reduction that is more than offset by proposed baseline increases. For the budget year, the Governor proposes $153.1 million in General Fund augmentations and $266.4 million in General Fund reductions. Figure 1(see next page) indicates changes from the enacted 2002-03 budget to the revised 2002-03 budget. It also describes the Governor's 2003-04 General Fund budget proposals.

Major Budget Proposals

The *2003-04 Governor's Budget* includes $5.5 billion for CSU from all fund sources—including General Fund, student fee revenue, and federal and other funds. This is an increase of $63.1 million, or 1.2 percent, from the revised current-year amount. Below, we discuss the major changes in the Governor's budget for CSU.

Enrollment Growth of 7.1 Percent. The Governor's budget provides CSU with $150.9 million from the General Fund for enrollment growth. This would increase CSU's budgeted enrollment by 22,881 full-time equivalent (FTE) students, or 7.1 percent, above the current-year level.

Proposed Reductions. While the Governor's budget proposes a total of $153.1 million in General Fund augmentations (primarily for enrollment growth), it also proposes $266.4 million in General Fund reductions. These reductions consist of:

Figure 1

California State University General Fund Budget Proposal

(In Millions)

	General Fund
2002-03 Budget Act	**$2,680.3**
December Revision Reductions	
Unallocated reduction	-$59.6
Baseline Adjustments	
PERS employer rate increase	$68.1
Carryover/reappropriation	17.2
2002-03 Revised Budget	**$2,705.9**
Baseline Adjustments	
Carryover/reappropriation	-$17.2
Other adjustments	7.5
Proposed Increases	
Enrollment growth (7.1 percent)	$150.9
Other increases	2.2
Subtotal	($153.1)
Proposed Reductions	
Unallocated reduction (in addition to December revision)	-$83.1
Academic and institutional support	-58.1
Increase student-faculty ratio	-53.5
Student services	-53.2
Outreach programs	-12.6
CalTEACH teacher recruitment	-2.0
Bilingual Teacher Recruitment program	-2.0
Other reductions	-1.9
Subtotal	-($266.4)
2003-04 Proposed Budget	**$2,582.9**
Change From 2002-03 Revised Budget	
Amount	-$123.1
Percent	-4.5%

- $83.1 million to expand the "unallocated" reduction proposed by the Governor in the current year to $142.8 million. (As we discuss below, increased student fee revenue is expected to essentially backfill the $142.8 million reduction.)
- $58.1 million reduction to academic and institutional support.
- $53.5 million from increasing the student-faculty ratio from 18.9:1 to 19.9:1.
- $53.2 million reduction to student services.
- $12.6 million reduction to CSU's K-12 outreach programs.
- $5.9 million in other program reductions.

Student Fee Increases. The Governor's budget assumes an increase in student fee revenue of $141.5 million in 2003-04 resulting from current-year and budget-year student fee increases. The CSU Board of Trustees approved increases of 10 percent and 15 percent for undergraduates and graduates, respectively, for the spring 2003 term (in the current fiscal year). This is the first fee increase for the segment in eight years. The Governor's budget assumes that the Trustees will approve an additional fee increase for the 2003-04 academic year of 25 percent for undergraduates and 20 percent for graduates. The total proposed fees for the budget year are:

- $2,466 for full-time resident undergraduates.
- $2,580 for full-time resident graduates.
- $10,926 for nonresidents.

The budget presumes that the increased student fee revenue of $141.5 million will essentially backfill the total $142.8 million unallocated General Fund reduction. Thus, nearly all the unallocated reduction would result in a fund shift rather than a true reduction in budgeted resources for CSU.

General Fund Support Per Student

The budget proposes average General Fund support of $7,508 per FTE student in 2003-04. This is $839, or 10.1 percent, less than the average General Fund support provided in the enacted current-year budget. (After accounting for the additional revenue from anticipated fee increases, however, average support for FTE students instead decreases by $428 per FTE student.) For each additional FTE student budgeted in 2003-04, the Governor provides $6,594 in "marginal" General Fund support. This is $106, or 1.6 percent, more than the marginal General Fund support provided in the current year.

LAO ALTERNATIVE BUDGET PROPOSAL

In the "Intersegmental" section of this chapter, we propose an alternative to the Governor's higher education budget regarding student fees, budgeted enrollment, and financial aid. Specifically, we recommend (1) a smaller increase in undergraduate fees at the University of California and the California State University, (2) a lower level of budgeted enrollment growth at both segments, and (3) an expansion of student financial aid in the state's student-centered Cal Grant program.

As discussed in an earlier section, we developed an alternative proposal to the Governor's higher education budget regarding student fees, budgeted enrollment, and financial aid. Figure 2 compares our proposal for CSU with the Governor's proposal. Specifically, we recommend:

- ***Moderate Student Fee Increases.*** The Governor's budget assumes that the CSU Board of Trustees will approve a fee increase of 25 percent for undergraduates and 20 percent for graduates. Our proposal would reduce the assumed fee increase from 25 percent to 15 percent for undergraduates. It would not alter the Governor's proposal to increase graduate fees by 20 percent. Because we recommend a smaller portion of new fee revenue be earmarked for financial aid than the Governor, our proposal results in *more* student fee revenue available to CSU to backfill proposed General Fund cuts.
- ***Enrollment Growth Closely Aligned to Demographic Projections.*** The proposed budget provides $150.9 million to fund 7.1 percent enrollment growth. We recommend the Legislature instead provide funding for enrollment growth at a rate of 4 percent, which better matches demographic projections. Accordingly, we recommend a General Fund reduction of $66.2 million for CSU.
- ***Institutional Financial Aid Augmentation for Enrollment Growth Only.*** The Governor's budget assumes that one-third of CSU's fee revenue resulting from the proposed fee increase ($71 million) will be directed to CSU's own financial aid program that serves students at CSU campuses. This amounts to a 58 percent increase in funding for that program. We believe that this level of increase is not justified. We note that under the Governor's proposal, the state's Cal Grant program already will increase the size of awards to account for the higher fees at CSU and the University of California (UC). Therefore, we recommend increasing CSU's financial aid program for enrollment growth only (4 percent). In the "Financial Aid" section of this chapter we also recommend adding fee coverage for first-year Cal Grant B students.

Figure 2

**California State University
Comparison of 2003-04 Budget Proposal
And LAO Alternative**

(In Millions)

Proposal	Budget	LAO	Difference
Student Fees Revenue Available for General Fund Backfill	**$141.5**	**$146.1**	**$4.6**
• Governor—25 percent fee increase for undergraduates and 20 percent for graduates (assumes one-third of fee revenue earmarked for financial aid)			
• LAO—15 percent fee increase for undergraduates and 20 percent for graduates (assumes $15.3 million earmarked for financial aid)			
Enrollment Growth	**$150.9**	**$84.7**	**-$66.2**
• Governor—7.1 percent increase in budgeted enrollment			
• LAO—4 percent increase in budgeted enrollment			
Institutional Financial Aid	**$71.0**	**$4.9**	**-$66.1**
• Governor—58 percent increase (funded from one-third of student fee increase)			
• LAO—4 percent increase (funded from student fee increase)			

For a detailed discussion on the above recommendations, please refer to the "Intersegmental" section of this chapter. In the sections below, we present additional recommendations regarding the Governor's budget proposal for CSU.

REMEDIAL EDUCATION

The California State University (CSU) currently admits many students who are unprepared for college-level writing and mathematics courses and must therefore enroll in and pass precollegiate (commonly known as "remedial" education) courses. The Governor's budget provides CSU with $6,594 for each additional full-time equivalent student, irrespective of whether the student is enrolled in precollegiate courses or college-level courses. The proposed budget for CSU also includes $6.5 million for various outreach programs designed to help prepare K-12 students for college-level studies. In this section, we (1) summarize current remediation policies and practices, (2) identify the proportion of students arriving at college unprepared over the last decade, and (3) present recommendations for increasing CSU's accountability in providing appropriate assistance to students who arrive unprepared. In the next section, we discuss CSU's K-12 outreach programs.

Determining College Preparedness

The CSU evaluates students to determine whether they are prepared for college-level writing and mathematics courses. Figure 3 summarizes the three ways CSU students can demonstrate they are prepared for college-level work. First, students can score above a minimum level on the SAT, American College Testing Assessment (ACT), or Advanced Placement (AP) exams. Second, students can pass the English Placement Test and the Entry-Level Mathematics test (which are both developed by CSU). Third, students who do not score sufficiently high on either college admission or placement exams must enroll in and pass the appropriate precollegiate course.

Figure 3

CSU Standards for Demonstrating College Preparedness

Writing	Math
• Score 550 on SAT I verbal test; 680 on SAT II writing test; 24 on ACT English test; or 3 on AP writing test.	• Score 550 on SAT I math test; 550 on SAT II math test; 23 on ACT math test; or 3 on AP math test.
• Pass CSU's English Placement Test.	• Pass CSU's Entry-Level Mathematics Test.
• Pass precollegiate course(s).	• Pass precollegiate course(s).

In a previous report, *Improving Academic Preparation for Higher Education* (February 2001), we examined the state's public higher education segments' efforts to identify and assist college-bound students who are not yet prepared for college-level work. Figure 4 summarizes the major findings of our report as they relate to CSU.

Figure 4

Major Findings Regarding CSU's Remediation Policies and Practices

- ✓ ***Unpreparedness Rates Have Risen.*** Percent of regularly admitted freshmen unprepared for college-level writing increased from 38 percent in fall 1989 to 46 percent in fall 2001.
- ✓ ***Current Process Poorly Serves Students.*** Current assessment process—which informs students of their skill deficiencies only *after* they have been admitted—often results in students paying higher college costs and taking longer to graduate.
- ✓ ***Lack of Accountability.*** The CSU does not assess and report on the effectiveness of its precollegiate courses in helping prepare students for college-level work. Thus, little accountability exists to ensure that CSU is providing appropriate and adequate assistance to at-risk students.
- ✓ ***State Funds Precollegiate Services in Widely Disparate Ways.*** The state funds precollegiate courses at UC, CSU, and the California Community Colleges at different rates. The CSU receives the same funding rate for precollegiate and college-level courses.

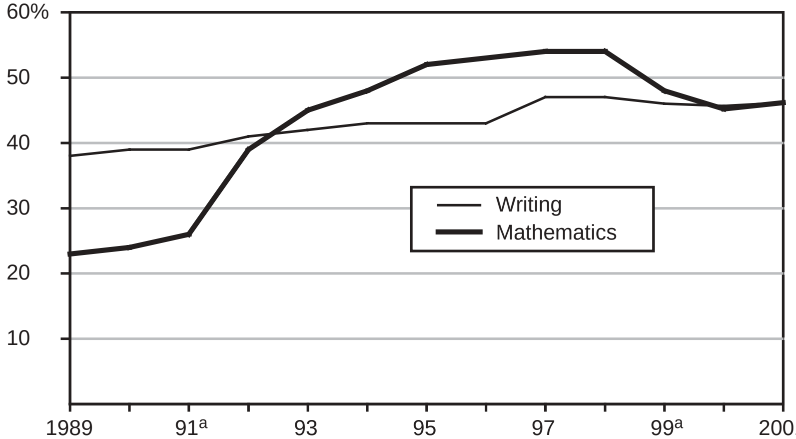
Many CSU Students Arrive Unprepared for College-Level Coursework

Almost Half of Regularly Admitted CSU Students Arrive Unprepared for College Writing and Mathematics. The CSU annually reports on the proportion of freshman that arrive unprepared for college-level work. Figure 5 (see next page) shows the CSU systemwide unpreparedness rate in writing and mathematics for regularly admitted freshmen over the last decade. In fall 1989, 38 percent of regularly admitted freshmen were unprepared for college-level writing and 23 percent were unprepared for college-level mathematics. By fall 2001, the unpreparedness rate in writing had increased to 46 percent. The unpreparedness rate in mathematics also increased sharply between 1989 and 1998—when 54 percent of regularly admitted freshmen arrived unprepared. Over the last three years, however, the unpreparedness rate in mathematics has fallen to 46 percent in fall 2001.

Figure 5

Almost Half of CSU Freshmen Not Academically Prepared

Regularly Admitted Freshmen Needing Remediation



[a] CSU made the mathematics exam more difficult in 1992, and allowed students to use calculators in 1999.

Most Specially Admitted CSU Students Arrive Unprepared. Some of the students admitted to CSU do not meet CSU's regular admission criteria. These "special admits" either have not yet completed the 15 required college preparatory courses or failed to obtain a sufficiently high grade point average or SAT score. The CSU admits these students because of their skills, ability, and disadvantaged background.

In fall 2001, about 8 percent of CSU freshmen were specially admitted. Of these specially admitted students, about 80 percent were unprepared for college-level writing and about 76 percent were unprepared for college-level mathematics.

Establish Accountability in Remedial Education

The CSU employs a variety of strategies to help students identified as unprepared to overcome their skill deficiencies. The CSU offers several nondegree-applicable precollegiate courses. Most of these courses are traditional, term-length classes taught by CSU instructors. Several CSU campuses, however, now also offer short workshops for students whose skill deficiencies are less severe. Additionally, CSU uses community college faculty to teach some of its precollegiate courses. (These courses are held on CSU campuses.)

Although CSU serves a large number of unprepared students, there is currently no mechanism for the state to monitor the quality and cost-effectiveness of CSU's precollegiate services. The lack of rigorous post-assessment procedures and the inadequacy of reporting requirements prevents the Legislature and the public from easily or meaningfully evaluating if CSU is in fact helping unprepared students obtain the skills they need to succeed academically. Furthermore, because of the inconsistency of the state's precollegiate funding policies, the Legislature lacks fiscal leverage to hold CSU accountable for providing cost-effective precollegiate services.

Require CSU to Assess the Effectiveness of Precollegiate Services

We recommend the Legislature require the California State University to assess and routinely report on the effectiveness of its precollegiate services, in order to ensure that at-risk students are provided appropriate and adequate assistance.

Currently, CSU does not require students to pass a standardized proficiency exam upon completion of a precollegiate course. The segment also does not track the future academic success of initially unprepared students. This means CSU cannot evaluate the effectiveness of any of the various precollegiate services it provides students. We therefore recommend CSU:

- ***Assess Proficiency Both Before and After Precollegiate Courses.*** If the standardized tests CSU relies on to measure a student's preparedness for college-level studies are valid, then they should also be valid indicators of whether a student has become adequately prepared *after* taking a precollegiate course. Such post-course assessments would allow faculty to know whether students were indeed prepared for college-level work after completing a precollegiate course. Post-course assessments would also allow administrators to measure the relative effectiveness of different instructional strategies.
- ***Track Future Academic Success in College.*** Currently, CSU collects very little information on the future academic performance of initially unprepared students. Periodically assessing the progress of a subset of students—including both those who are

initially prepared and unprepared—would provide greater assurances that CSU is meeting students' academic needs. It would also help Legislature evaluate institutional performance and identify the types of programs that best serve students.

Fund Precollegiate Courses at the Community College Credit Rate

We recommend the Legislature fund the California State University's precollegiate writing and mathematics courses at the same rate it funds credit courses at the community colleges. (Reduce Item 6610-001-0001 by $10 million.)

The state currently funds precollegiate services at CSU, UC, and the California Community Colleges (CCC) in widely disparate ways. At the community colleges, the *2003-04 Governor's Budget* provides $3,900 per FTE student for all credit courses regardless of whether they are precollegiate or college-level courses. Similarly, the budget provides CSU with $6,594 per additional FTE student for all credit courses regardless of whether they are precollegiate or college-level courses. In contrast, the Governor's budget provides UC with $9,030 per additional FTE student for its college-level courses only. The state provides no funding for precollegiate courses at UC.

Disparate Rates Generate Wrong Incentives. By providing CSU with the same level of funding for unprepared and prepared students, state policy encourages CSU to admit students regardless of their level of academic preparation. If the state funded CSU precollegiate courses at the community college rate, it would reduce this incentive (though it would not prevent CSU from accepting and enrolling all students it believed could succeed). In contrast, by providing UC with no funding for its precollegiate courses, state policy encourages UC to limit such courses and to advise unprepared students to take such courses at the local community college.

LAO Recommendation. In view of the above, we recommend the Legislature fund CSU's precollegiate writing and mathematics courses at the same rate it funds credit courses at the community colleges. We estimate that this action would result in General Fund savings of $10 million.

Funding CSU precollegiate courses at the rate the state currently funds community colleges would have two significant benefits. First, it would provide financial incentives for CSU to adopt the most efficient and effective way to deliver precollegiate services. Second, it would motivate CSU to expand its collaborations with community colleges for delivery of precollegiate services. Several CSU campuses (as well as a few UC campuses) currently contract with community college faculty to teach precollegiate courses on the campuses. Both CSU and UC have indicated that these collaborations are successful.

K-12 OUTREACH PROGRAMS

The Governor's budget provides a total of $6.5 million (General Fund) to CSU for various outreach programs that focus on preparing disadvantaged K-12 students for college. This is a decrease of $12.6 million, or 66 percent, from the current-year level. Under the Governor's proposal, CSU would have full discretion in allocating the $12.6 million reduction across its various programs. Figure 6 summarizes the major state outreach programs currently administered by CSU.

Figure 6

California State University Major K-12 Outreach Programs

Program	Description
California Academic Preparation Initiative	***Faculty-to-Faculty Alliance.*** CSU English and mathematics faculty collaborate with high school teachers to increase the rigor of high school courses to better prepare students in meeting CSU's standards.
	Learning Assistance Program. CSU students tutor high school students in English and mathematics.
Precollegiate Academic Development	CSU students tutor K-12 students in English and mathematics.
California Academic Partnership Program	K-12 and higher education institutions form partnerships for the purpose of strengthening high school curricula and improving instruction. Funds also support the Mathematics Diagnostic Test Project.
Educational Opportunity Program	Provides a comprehensive array of academic support services to K-12 students.

We believe that the Legislature should examine the Governor's proposed reduction to CSU's outreach programs in the context of the state's overall outreach strategy. (In addition to CSU, various other entities—

UC, CCC, the Student Aid Commission, and the State Department of Education (SDE)—also administer K-12 outreach programs.)

State's Overall Outreach Strategy

In our *Analysis of the 2002-03 Budget Bill*, we reviewed the state's system of K-12 outreach programs and proposed steps for improving its efficiency and effectiveness. Our review identified a number of concerns with the current structure and funding for outreach. We found that:

- ***Programs Often Overlap and Provide Duplicate Services.*** Currently, there are multiple K-12 outreach programs with many similar components targeting similar populations. As a result, the same student may be participating in multiple outreach programs that offer essentially the same type of service. We were not able to ascertain the extent to which this occurs. However, we believe that more students could be served if program inefficiencies and duplication were reduced.
- ***Focus on "Yield" Efforts Is Misplaced.*** In addition to improving educational opportunities for disadvantaged students, a goal of CSU's K-12 outreach is to improve the yield of already-qualified underrepresented students attending CSU. This approach may work against the state's outreach efforts. This is because rather than increasing preparedness or awareness among disadvantaged students, yield-focused efforts typically work to convince already qualified or eligible students to choose CSU over some other higher education institution.
- ***Lack of Information of Program Effectiveness.*** Little is known about the effectiveness of the state's K-12 outreach programs. Without reliable data on program effectives, it is difficult for the Legislature to determine which outreach programs are most successful in achieving the important objectives of increased awareness, preparation, and access to undergraduate education.

Target Proposed Outreach Reductions

We recommend the Legislature approve the Governor's proposal to reduce outreach funding, but target the reductions at programs that (1) provide duplicative services, (2) do not focus on students most in need of additional state help, and (3) are ineffective.

The Governor's budget provides what amounts to an "unallocated" reduction of $12.6 million to CSU's outreach programs. In view of the substantial and rapid expansion of these programs in recent years and the considerable General Fund budget shortfall facing the state, we believe that it is reasonable to reduce overall funding to a pre-expansion level.

We do, however, have concerns about the unallocated nature of the reduction. Specifically, we believe that the unallocated cut would give CSU far too much discretion in determining which programs or types of services are of lower priority. We are concerned that this could result in programmatic reductions that do not match the Legislature's priorities. In contrast, targeting the reductions at specific programs would allow the Legislature to preserve its priorities and exercise oversight. Based on our review of the state's current outreach system, we recommend the Legislature target the reductions at programs that (1) provide duplicative services, (2) do not necessarily focus resources at students most in need of additional state help, and (3) are least effective in improving the academic preparation of disadvantaged students.

For example, the state currently funds two outreach programs—the Precollegiate Academic Development Program ($5.2 million) and the Learning Assistance Program ($4 million)—at CSU that provide tutoring services specifically to K-12 students. Given the duplicative nature of these programs and the availability of other potential tutoring resources available through SDE, the Legislature could consolidate the two tutoring programs to achieve savings while still providing necessary services. Due to the limited data and information available about CSU's various outreach programs, we will work with the segment and provide further advice to the Legislature concerning additional opportunities for consolidation and other program efficiencies at budget hearings.

GENERAL FUND CARRYOVER

We recommend the Legislature amend budget bill language to count all unexpended allocations towards the $15 million carryover cap for the California State University, in order to increase legislative oversight. We further recommend that carryover funds be spent only on one-time purposes.

For virtually all General Fund appropriations in the annual budget act, money unspent at the end of the fiscal year reverts to the General Fund. This can create an incentive for some agencies to rapidly (and potentially wastefully) spend down any remaining balances as the end of the fiscal year approaches. To reduce this incentive, recent budget acts have included provisions that permit CSU to "carry over" unexpended funds from one fiscal year to the next. Specifically, General Fund monies provided to CSU but not expended in one fiscal year are reappropriated in the subsequent year.

In some years, the budget act has directed CSU to use the one-time carryover funds for specific purposes. More often, however, the budget has given CSU wide latitude in spending the monies. In such cases, CSU must propose an expenditure plan to the Department of Finance and the Joint Legislative Budget Committee, by September 30, for the balance of unexpended funds from the prior year.

The past six budget acts limited CSU's carryover funds to $15 million. They required that any unexpended funds in excess of this amount revert to the General Fund. Budget language has also specified that the $15 million cap only applies to funds generated from CSU's "systemwide" allocations. This means that the cap did not apply to unexpended funds that CSU had allocated to specific campuses or to the Chancellor's Office.

Previous Carryover Amounts and Uses

For multiple reasons, including the size of CSU's overall appropriation and spending choices, the amount of funds that CSU has carried forward has varied considerably from year to year. Figure 7 shows carryover amounts from 1996-97 (the first year of the $15 million systemwide-carryover limit) through 2001-02. During these years, the total carryover amount ranged from $10.8 million to $35.8 million. In the current year, CSU has $17.1 million available from funds originally appropriated in the *2001-02 Budget Act*. All of these unspent funds are from campus/Chancellor's Office allocations and thus are not subject to the cap. The CSU reports no carryover from systemwide allocations.

Figure 7

California State University General Fund Carryover

1996-97 Through 2001-02 (In Millions)

	Carryover Amount from Budget Act					
	1996-97	**1997-98**	**1998-99**	**1999-00**	**2000-01**	**2001-02**
Systemwide	$8.9	$14.2	$9.1	$6.4	$8.4	—
Campuses and Chancellor's Office	1.9	5.6	15.2	17.9	27.4	$17.1
Total	**$10.8**	**$19.8**	**$24.3**	**$24.3**	**$35.8**	**$17.1**

At the time the Legislature first placed a limit on carryover from CSU's systemwide allocations, the amount of unexpended funds that CSU had allocated to campuses and the Chancellor's Office was relatively small. However, as indicated in Figure 7, the level of carryover from campus/ Chancellor's Office allocations has grown in recent years from $1.9 million in 1996-97 to $27.4 million in 2000-01 and $17.1 million in 2001-02. Moreover, the percentage of campus/Chancellor's Office carryover compared to CSU's total carryover amount for a given fiscal year also has increased.

The CSU has used one-time carryover funds for a variety of purposes. Systemwide funds have been used for technology initiatives, special repairs, new campus start-up costs, unexpected needs, and other purposes. Carryover funds allocated to campuses and the Chancellor's Office have been used for one-time expenditures, including campus-initiated projects, technology upgrades, and acquisition of library books and materials. However, in the current year, CSU plans to use all of its available carryover ($17.1 million) for faculty compensation. We have serious concerns about the out-year implications of using one-time funds for ongoing initiatives.

Carryover Language Weakens Legislative Oversight

As with recent budget acts, the proposed budget bill contains language that would allow CSU to carry over up to $15 million in unexpended systemwide funds from the *2002-03 Budget Act*. The budget does not place a limit on carryover from allocations made to individual campuses and the Chancellor's Office. The proposed language does not direct CSU to spend the one-time carryover funds for specific purposes. As in past years, the proposed language imposes reporting standards and time frames similar to those described above.

Given recent trends in the composition of CSU's unexpended balances, we believe that the Legislature should reexamine CSU's authority to carry over an unlimited amount of funds from campus/Chancellor's Office allocations. Because CSU is able to move funds freely between the systemwide and the campus/Chancellor's Office allocations, distinctions between these allocations are not meaningful. The CSU can easily circumvent the cap by allocating amounts over $15 million to the campuses and the Chancellor's Office. By counting all unexpended allocations toward the $15 million cap, the Legislature would create a meaningful limit on carryover funds that CSU could spend without legislative oversight. (We note that this would be consistent with current budget act language regarding UC's carryover funds.) Accordingly, this would allow the Legislature to strengthen its budgeting flexibility to use fund balances in excess of $15 million on any of its budget priorities. Depending on the

Legislature's assessment of state needs in a given year, this could include CSU-related initiatives or not. We also believe that the Legislature should prevent CSU from allocating carryover funds to ongoing programs, in order to avoid cost pressures in the out years.

In view of the above, we recommend the Legislature amend Provision 1 of Item 6610-490 to read:

> Of the funds reappropriated in this item from Item 6610-001-0001, Budget Act of 2002 (Ch. 379, Stats. 2002), up to $15,000,000 shall be available for <u>one-time projects to</u> ~~the general~~ support ~~of~~ the California State University. ~~This $15,000,000 limitation applies to reappropriations generated from systemwide allocations.~~ As of June 30, 2003, the balance in excess of $15,000,000 shall revert to the General Fund.

We believe that our proposal strikes a balance between budget flexibility and legislative oversight. First, it would continue to provide CSU with some level of carryover authority. Such authority reduces the incentive for CSU to spend the funds quickly prior to the end of the fiscal year in which the funds were originally budgeted. In addition, our proposal prevents CSU from (1) carrying over high fund balances to address selected priorities without legislative oversight and (2) using one-time carryover funds for ongoing expenses.

CALIFORNIA COMMUNITY COLLEGES (6870)

The California Community Colleges (CCC) provide instruction to about 1.7 million adults at 108 campuses operated by 72 locally governed districts throughout the state. The system offers academic and occupational programs at the lower-division (freshman and sophomore) level. Based on agreements with local school districts, some college districts offer a variety of adult education programs—including basic skills education; citizenship instruction; and vocational, avocational, and recreational programs. Finally, pursuant to state law, many colleges have established programs intended to promote regional economic development.

Significant Funding Reductions Proposed. The Governor's budget proposes significant reductions to CCC in the budget year. Figure 1 shows CCC funding from all significant sources for the budget year and the two preceding years. As the figure shows, CCC spending from all sources is proposed to decline by $404 million, or 6.2 percent, from the revised current-year level. Proposition 98 General Fund expenditures would decline by $705 million, or 27 percent. Partially offsetting this reduction are significant assumed budget-year increases in funding from student fees ($150 million) and local property taxes ($178 million).

CCC's Share of Proposition 98. As shown in Figure 1 (see next page), the Governor's budget includes $4.1 billion in Proposition 98 funding for the community colleges in 2003-04. This is about 66 percent of total community college funding. Proposition 98 provides funding (approximately $44 billion in the budget year) in support of K-12 education, CCC, and several other state agencies (such as the Departments of Mental Health and Developmental Services). As proposed by the Governor, CCC would receive 9.2 percent of total Proposition 98 funding, K-12 education would receive 90.6 percent, and the other state agencies would receive the remaining 0.2 percent. This represents a historical low in CCC's share of Proposition 98 funding. The CCC's share in the current year is 10.3 percent.

Figure 1

Community College Budget Summary

(Dollars in Millions)

	Actual 2001-02	Estimated 2002-03	Proposed 2003-04	Change	
				Amount	Percent
Community College Proposition 98[a]					
General Fund	$2,693.6	$2,610.4	$1,905.7	-$704.7	-27.0%
Local property tax	1,852.1	1,980.2	2,157.8	177.6	9.0
Subtotals, Proposition 98	($4,545.7)	($4,590.6)	($4,063.5)	(-$527.2)	(-11.5%)
Other Funds					
General Fund					
State operations	$13.0	$10.9	$9.0	-$1.8	-16.7%
Teachers' retirement	66.3	74.1	39.8	-34.4	-46.4
Bond payments	77.9	80.5	94.1	13.7	17.0
Other state funds	11.9	11.3	7.7	-3.7	-32.5
State lottery funds	138.1	141.2	141.2		
Student fees	164.0	168.9	318.5	149.6	88.5
Federal funds	225.9	228.2	228.2	—	—
Other local	1,214.7	1,227.4	1,227.4	—	—
Subtotals, Other funds	($1,911.8)	($1,942.5)	($2,065.9)	($123.4)	(6.4%)
Grand Totals	**$6,457.5**	**$6,533.1**	**$6,129.4**	**-$403.7**	**-6.2%**
Students					
Headcount enrollment	1,686,663	1,779,629	1,678,190	101,439	-5.7%
Full-time equivalent (FTE)	1,103,666	1,136,776	1,072,207	-64,569	-5.7
Budgeted FTE	1,063,088	1,095,114	1,032,912	-62,202	-5.7
Amount Per FTE Student (whole dollars)					
Proposition 98	$4,012.9	$3,963.1	$3,789.8	-$173.3	-4.4%
All funds	5,964.4	5,887.7	5,934.1	46.4	0.8

a Expenditures, including Reversion Account funds.

Major Budget Changes

Figure 2 shows the changes proposed for community college Proposition 98 spending in the current year and the budget year. Major current-year base reductions include:

Figure 2

California Community Colleges Governor's Budget Proposal

Proposition 98 Spending[a]
(In Millions)

2002-03 (Enacted)	**$4,861.7**
Proposed Mid-Year Reductions	
Inappropriate concurrent enrollment funding	-$80.0
Apportionments (3.66 percent across-the-board)	-66.6
Categorical programs (10.8 percent across-the-board)	-91.2
Estimated shortfall in local property tax revenues	-33.3
Subtotal	(-$271.1)
2002-03 (Revised)	**$4,590.6**
Reduction due to one-time deferral of apportionment payment from 2001-02 to 2002-03	-$115.6
Restore one-time reduction in property tax estimate	33.3
2003-04 Base	**$4,508.3**
Proposed Budget-Year Reductions	
Apportionments (expected attrition due to proposed fee increase)	-$215.7
Apportionments (reduction to be backfilled with anticipated increase in student fee revenue)	-149.6
Categorical programs (targeted reductions)	-214.6
Eliminate health fees mandate	-1.5
Subtotal	(-$581.4)
Proposed Budget-Year Augmentations	
Enrollment growth of 3 percent	$115.7
Lease-revenue payments	19.3
Other adjustments	1.6
Subtotal	($136.6)
2003-04 (Proposed)	**$4,063.5**
Change From 2002-03 (Revised)	
Amount	-$527.2
Percent	-11.5%

a Includes Reversion Account funds.

- $80 million from apportionments to reflect the elimination of 20,000 full-time equivalent (FTE) students that were inappropriately claimed for concurrent enrollment of high school students.
- $66.6 million for a 3.66 percent across-the-board reduction in apportionment funding.
- $91.2 million for a 10.8 percent across-the-board reduction to categorical programs.

Major budget-year reductions include:

- $216 million reduction in apportionments due to expected attrition in response to proposed fee increases.
- $150 million as an offset to increased student fee revenue.
- $215 million in targeted reductions to categorical programs.

Proposition 98 Spending by Major Program

Figure 3 shows Proposition 98 expenditures for community college programs. "Apportionment" funding (available for the districts to spend on general purposes) accounts for $3.5 billion in 2003-04, or about 86 percent of total Proposition 98 expenditures. The state General Fund supports about 38 percent of apportionment expenditures, and local property taxes provide the remaining 62 percent.

"Categorical" programs (in which funding is earmarked for a specified purpose) are also shown in Figure 3. These programs support a wide range of activities—from services to disabled students to maintenance and special repairs. The Governor's budget would reduce total funding for categorical programs by about 25 percent from the revised current-year level. Changes to individual categorical programs would range from a 56 percent reduction for the Fund for Student Success to an 11.7 percent increase in financial aid programs.

STUDENT FEES

The Governor proposes that CCC student fees be increased from $11 per unit to $24 per unit. This represents an increase of $13 per unit, or 118 percent. For a student taking the average full-time load of 26 units per year, this would translate into an additional $338 for the academic year. Total student fees for the average full-time load under the Governor's proposal would be $624.

Figure 3

Major Community College Programs Funded by Proposition 98[a]

(Dollars in Millions)

	Estimated 2002-03	Proposed 2003-04	Change	
			Amount	Percent
Apportionments				
State General Fund	$1,858.9	$1,339.1	-$519.8	-28.0%
Local property tax revenue	1,980.2	2,157.8	177.6	9.0
Subtotals	($3,839.1)	($3,496.9)	(-$342.2)	(-8.9%)
Categorical Programs				
Partnership for Excellence	$267.5	$165.1	-$102.4	-38.3%
Extended Opportunity Programs and Services	85.7	52.9	-32.8	-38.3
Disabled students	74.5	46.0	-28.5	-38.3
Matriculation	48.4	43.3	-5.1	-10.6
Services for CalWORKs recipients	31.2	31.2	—	—
Part-time faculty compensation	50.8	50.8	—	—
Part-time faculty office hours	6.4	3.9	-2.4	-38.3
Part-time faculty health insurance	0.9	0.9		-4.6
Maintenance/special repairs	28.3	34.7	6.4	22.7
Instructional equipment/library	28.3	34.7	6.4	22.7
Economic development program	36.0	19.7	-16.2	-45.1
Telecommunications and technology	21.8	21.8	—	—
Basic Skills and Apprenticeships	36.2	36.2	—	—
Financial aid administration/ outreach	7.2	8.1	0.8	11.7
Teacher and Reading Development program	4.5	2.8	-1.7	-38.3
Fund for Student Success	5.6	2.4	-3.1	-56.1
Mandates	1.5	—	-1.5	-100.0
Other programs	16.7	12.3	-4.4	-26.6
Subtotals	($751.5)	($566.9)	(-$184.6)	(-24.6%)
Lease-revenue bonds[b]	($36.7)	($55.9)	($19.3)	(52.6%)
Totals	**$4,590.6**	**$4,063.8**	**-$526.8**	**-11.5%**

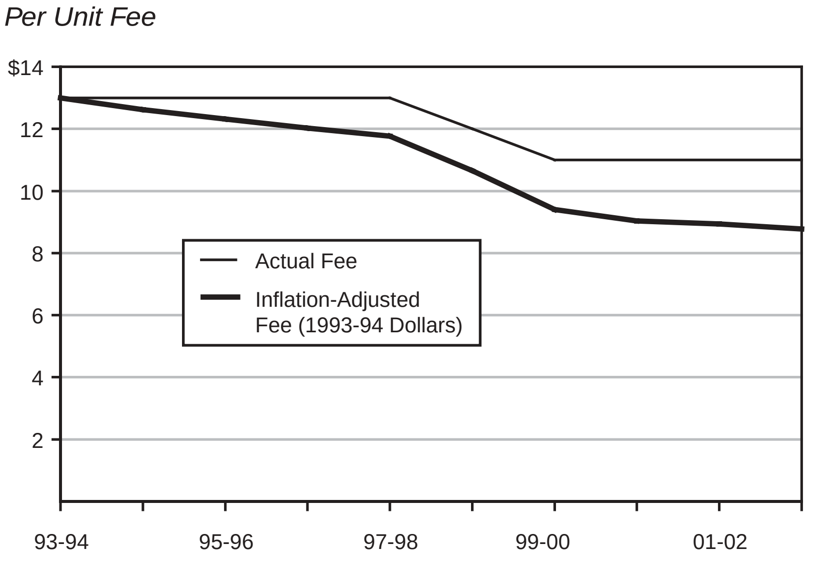
a Includes Reversion Account funds.

b Included as part of General Fund apportionments.

This would be the first fee increase for community college students in a decade. The last increase was in 1993-94, when the state raised fees from $10 per unit to $13 per unit. Since that time, the CCC fees have been reduced in two steps to its current rate of $11 per unit. Figure 4 shows the changes in fees during this period, both in actual dollars and 1993-94 dollars.

Figure 4

CCC Fees Have Declined Over Past Decade



Fee Revenue Permits General Fund Savings. Under current law, the state budget specifies a total amount of apportionment funding that is required for community colleges to operate their programs. Apportionment funding comes from three sources: the state General Fund, local property taxes, and student fee revenue. Local property taxes and student fee revenue are retained by the community college districts that collect this funding and are used to support their programs. The state General Fund provides the additional funding needed to meet each district's apportionment amount. The Governor's proposal anticipates that community colleges will receive an additional $150 million in student fee revenue as a result of the proposed fee increase. Therefore, the General Fund will supply $150 million less funding for apportionments than it otherwise would without a fee increase.

Fee Increases Also Proposed at the University of California (UC) and the California State University (CSU). In a preceding intersegmental section of this chapter ("Student Fees"), we note that the Governor's budget assumes 25 percent increases to undergraduate fees at UC and CSU in 2003-04. This would be in addition to 10 percent increases that the segments already imposed in the middle of the current year. While we agree that it is appropriate to raise student fees at UC and CSU, we recommend that the budget-year fee hike be reduced to 15 percent, and that the Legislature adopt a consistent and explicit fee policy to govern further fee adjustments.

The situation surrounding student fees at UC and CSU is different in many ways from fees at community colleges. For example, both student fees and overall educational costs at the state's public universities are much higher than at CCC. In addition, fees at UC and CSU are set by their respective governing boards, while CCC fees are set in statute by the Legislature. Moreover, funding for community colleges is subject to the provisions of Proposition 98, while funding for UC and CSU is not. Finally, state law provides for the waiving of fees for all needy community college students. Still, because the three higher education segments are interconnected through student transfer, competition for state funding, and other reasons, it is appropriate for the Legislature to consider CCC fees partly in the context of fees at the other systems.

In considering the Governor's fee increase proposal, the Legislature encounters three interrelated issues: the share of educational costs that community college students should pay, the size of fee increase that is reasonable in any given year, and how the negative effects of a fee increase can be minimized. We discuss these questions below.

What Share of Their Educational Costs Should Community College Students Pay?

We believe it is important that college students pay some share of their educational costs. When students make a financial investment in their own education, they are more inclined to demand quality services from the college. This increases accountability. In addition, students are more likely to be deliberate in their selection of courses and programs when they have a financial stake. Finally, fees help students to make choices that consider the relative costs of different postsecondary options open to them—for example, choosing between a community college and a state university for completing their lower division coursework.

In 2001-02, community colleges received about $4,635 to educate the average full-time student. A student paying full fees covered about 6.2 percent of that cost. This is considerably lower than UC and CSU, where student fees covered about 18 percent and 22 percent, respectively, of educational costs. The student share at CCC is also considerably lower than the national average for community colleges, which is about 20 percent.

Under the Governor's proposal, student fees (again, for a student paying full fees) would cover 14 percent of educational cost. This percentage, though still relatively small by national standards, seems to us to constitute a more reasonable share of cost to be borne by the student. It ensures greater accountability and student buy-in while still ensuring that the state subsidizes a far larger share—about 86 percent—of the cost.

Currently, California's community college fees are the lowest in the nation. This would still be the case under the Governor's proposal. In 2000-01 (the most recent year for which national comparison data are available), California's community college fee was less than half that of New Mexico ($866), which was the next most affordable public two-year institution. States to which California is often compared—New York and Texas—had annual fees of $2,557 and $931, respectively.

How Large of an Increase Is Appropriate?

While we believe that the actual fee level proposed by the Governor is reasonable when compared with the total cost of education and with fees in other states, there is a separate question of how large an increase students should be expected to absorb in a given year. The Governor's proposal would more than double the current fee. As a percentage, this does not meet the goal of "moderate" fee increases called for in past expressions of legislative intent and in our own recommendation for a UC and CSU fee policy.

Viewed in other ways, however, the proposed increase appears less dramatic. For the average full-time student, the Governor's proposal would cost an additional $338. Part-time students, which constitute the majority of community college students, would of course pay less than this. Compared with a total cost of attendance (including books, housing, transportation, and other costs), the proposed increase is much smaller.

Given the other budgetary choices faced by the Legislature, we believe the dollar amount of the proposed increase is reasonable. Although the percentage increase may have a short-term "sticker shock" effect, we believe this can be mitigated by raising student awareness about the availability of financial aid.

What Can Be Done to Minimize the Negative Effects of a Fee Increase?

Needy Students Do Not Pay Fees. In considering any fee increase, the Legislature should consider how potential negative effects (primarily a reduction in affordability) could be mitigated or eliminated. For CCC students, affordability is preserved through the Board of Governors' (BOG) fee waiver program. This program is designed to ensure that community college fees will not pose a financial barrier to any California resident. It accomplishes this by waiving the fees for all California residents who demonstrate financial need. By definition, therefore, all needy students (who are residents of the state) will pay no fees, and thus will be unaffected by the proposed fee increase.

How Is Need Defined? There are three ways for students to be eligible for a BOG fee waiver. First, they are eligible if they or their parents are receiving cash assistance from other need-based programs (such as California Work Opportunity and Responsibility to Kids). Second, they are eligible if they or their families have an adjusted gross income below a specified level. (For a family of four, this level is $27,150 in 2003-04). Finally, students from middle-class families are eligible if their federally-defined cost of attendance exceeds their ability to pay by $1 or more. In recent years about 23 percent of all community college students (representing 37 percent of all units taken) have received BOG fee waivers. The Governor's budget assumes this will increase to about 33 percent of all students (or 42 percent of all units taken in 2003-04) primarily as a result of the proposed fee increase.

What About Non-Needy Students? Many of the students who do not qualify for BOG waivers are nevertheless eligible for financial aid that covers all or a portion of their fees. For example, students with family incomes of up to $80,000 are eligible for a federal tax credit equal to their entire fee payment (up to $1,000 per year) for their first two years of college. Therefore, while students would have to pay their fees initially, they would be reimbursed for this cost as a federal income tax offset. In other words, for those students or families with federal tax liabilities, *the federal government in effect pays for the entire cost of the fee increase.*

In addition to federal programs, the state Cal Grant program pays the full cost of tuition and fees for middle-income students with a high school grade point average of at least 3.0 ("B"). For 2003-04, the income threshold is in the mid-$60,000s. Finally, many students are eligible for low-interest loans to cover their fees and other educational expenses through the Stafford loan program and other programs.

Some students will not qualify for financial aid and thus will have to pay the full fee of $24 per unit. As noted above, in our view this fee level provides for a reasonable sharing of educational cost between the student and the state. However, it is likely that some students who would have enrolled in community college courses at $11 per unit will not enroll when the fee is raised to $24 per unit. Because these students by definition are not financially needy, their decision not to enroll should not be considered a denial of access, but rather a choice they make about the benefit they will receive from community college classes.

Governor's Proposed Fee Increase Is Reasonable

We believe that the increased fee proposed by the Governor reflects a reasonable share of student educational costs, and is affordable for those students who are not exempted from fees altogether. However, we recommend that the Legislature approve an increase $1 higher than the level proposed by the Governor ($25 per unit) to enable needy students to each receive up to $108 in additional federal aid.

As noted above, we believe the Governor's proposal to raise CCC fees is a reasonable one. However, it misses an opportunity to significantly increase federal financial aid to needy students. This could be achieved by raising the per unit fee by $1 more than the Governor's proposal, as we detail below.

Federal Grant Program Serves More Than 213,000 CCC Students Annually. The federal government administers the Pell Grant program, which provides grant aid to financially needy undergraduate students to help cover educational fees and living expenses. In 2001-02, more than 213,000 CCC students received a total of approximately $464 million in Pell Grant assistance. Their Pell Grant awards ranged from $400 to $3,674, with an average grant amount of $2,173.

Students' eligibility for a Pell Grant is based on their "total cost of attendance" (which includes both educational fees and living expenses) and their "expected family contribution" (which accounts for family income, assets, and expenses). The grant amount a student receives is based on a sliding scale. Specifically, Pell Grant award amounts increase as students' cost of attendance goes up or as expected family contribution goes down.

CCC Only System in Nation That Prevents Students From Obtaining Maximum Pell Grant of $4,000. The maximum Pell Grant amount a CCC student currently can receive is $3,674. Under the Governor's fee increase proposal, this would increase to $3,892. *Students at all other postsecondary institutions in the nation are eligible for a maximum Pell Grant amount of $4,000.* This means students attending UC, CSU, and California's private colleges as well as students attending community colleges in all other states are eligible to receive more in federal assistance than CCC students.

CCC Students Are Ineligible for $4,000 Pell Grant Because CCC Fees Are So Low. The CCC students are not eligible for a maximum award of $4,000 because the federal government uses an alternative award scale for systems that charge less than $650 in fees for the average annual full-time load. Currently, no postsecondary institution in the nation except the CCC system is required to use the alternative award scale. The CCC campuses tend to have an annual average full-time load that is approximately 26 units per year. At the current fee rate, the average full-time load costs a student $286 per year—considerably less than $650. At the Governor's proposed fee rate, the average full-time load would be $624—still less than $650. The result is that the Pell Grant amount CCC students are eligible to receive must be determined using the alternative award scale and their maximum award still would be limited to less than $4,000.

Increasing Per Unit Fee $1 Above Governor's Proposal Would Allow CCC Students to Receive Up to $108 More in Federal Financial Aid. The state can help financially needy students by increasing the CCC fee to $25 per unit (or $650 per year for a full-time student). Based upon current federal policies, this would allow CCC students to use the regular award scale and qualify for a maximum Pell Grant award of $4,000, or $108 more than they currently may receive.

Increasing Fee Creates No Additional Out-of-Pocket Expense for Financially Needy Students. Fee increases are not paid by financially needy students because these students qualify for waivers that exempt them from the entire educational fee—whether the fee is $11, $24, or $25 per unit. A higher fee obviously could affect middle-income and high-income students, but these students, by definition, have more ability to pay the higher fee. And, as noted earlier, students eligible for federal higher education tax credits would have this additional cost fully offset by reduced federal taxes.

Even at $25 Per Unit, CCC Fees Would Remain Lowest in Nation. Even if the CCC fee were raised $1 more per unit than proposed by the Governor, the fee still would be considerably lower than the average fee for all other states' public two-year institutions. It also would be lower than any other state in nation.

ENROLLMENT FUNDING

The budget proposal provides funding for about 62,000 fewer FTE students than in the current year. This is about 5.7 percent of the current-year budgeted enrollment of about 1,095,000 FTE students.

The budget assumes that community colleges will experience reduced enrollment demand in 2003-04 primarily as a result of the proposed fee increases. Specifically, the Governor's proposal assumes that 5.7 percent fewer students will enroll as a direct result of the proposed fee increase. Another 2 percent of FTE enrollment is to be eliminated for high school students that are "concurrently enrolled" in community college classes. (We discuss this proposal in greater detail below.) A further 1 percent of FTE students are expected not to enroll because of categorical reductions that are proposed for Partnership for Excellence (PFE) and other general support programs. The total estimated reduction in enrollment therefore would be 8.7 percent. However, the budget also includes funding for "enrollment growth" of 3 percent, which is supposed to represent new students that will be entering the system due to population growth and other factors. The net result, therefore, is that 5.7 percent fewer FTE students will be funded in 2003-04.

Colleges Provide "Open Access." The state Master Plan for Higher Education calls for the community colleges to be open to all adults "who can benefit from instruction." As a result, campuses generally do not impose admissions requirements as a way to manage enrollment demand, and thus will enroll virtually all students who seek admission. If enrollment exceeds the level assumed in the budget, community colleges will be faced with enrollment demand that they are not funded to serve.

As a matter of practice, many districts already enroll students above their funded level. In the current year, for example, districts have "overenrolled" a total of about 42,000 FTE students, or about 3.8 percent of their budgeted enrollment. Community colleges have absorbed this level of over enrollment within existing resources. After accounting for projected attrition, the Governor's budget assumes about the same level of over enrollment.

What If the Governor Is Wrong? For the most part, the level of enrollment funding proposed for 2003-04 stems from the administration's prediction of how students will respond to fee increases. If the level of attrition projected by the Governor does not materialize, community colleges will be faced with more overenrollment than assumed in the budget. We believe this is a real possibility. We reviewed the enrollment attrition model used for the budget and found that it was based on a number of assumptions that, while logical, could not be validated. Student price sensitivity depends on a number of factors that interact in complicated ways. For example, the Governor's estimates do not account for any enrollment demand that could be shifted from CSU (whose fees are expected to increase 35 percent from last year's level). Moreover, student demand will respond in large part to choices the individual colleges make for 2003-04. The type of courses offered and when they are scheduled have a large effect on student demand. The budget's estimate assumes certain choices in this regard that the colleges may not make.

What If the Governor Is Right? Assuming the budget's assumptions about attrition are correct, then about 62,000 FTE students who would have attended a community college when fees were $11 per unit would now choose not to attend when fees are raised to $24 per unit. This is a significant decline at a time of weak state and national economic growth, and many adults are seeking job retraining and other skills.

A critical question is which students would choose not to attend as a result of fee increases. As noted above, the ready availability of fee waivers and other financial aid significantly reduces the chance that fees will pose a financial obstacle to enrollment. Therefore, we expect that the majority of decline would come from students who are making a choice about their own priorities, rather than being unable to afford college classes. If this is the case, open access is preserved.

What Is the Appropriate Level of Enrollment Funding? The Governor's proposal is based on assumptions about how enrollment demand will respond to student fee increases. Even if the Governor's assumptions are correct, this does not necessarily mean that the funded level of enrollment is the appropriate level. Demand for higher education is not purely a demographic phenomenon that the state needs to accommodate. Rather, demand is influenced by deliberate state policies about educational cost (such as fees and financial aid), eligibility (such as concurrent enrollment and basic skills), and institutional focus (such as transfer and vocational training). Funding for enrollment growth is another choice made by the state that influences enrollment demand (because as districts will schedule classes to the extent that funding is available). Thus, enrollment growth funding to some extent becomes a self-fulfilling prophesy.

We believe that some reduction in funded enrollment at the community colleges is justified. We believe that the proposed fee increase will indeed have an impact on enrollment that should be accounted for in enrollment budgeting. However, we believe that the magnitude of the decline proposed by the Governor may be too large. The Governor's proposal does not take into account the likely shift of some enrollment demand from CSU and UC to CCC in response to planned fee increases. Moreover, to the extent that the Legislature wishes to fund enrollment growth with the limited resources available to it, it makes sense to focus that enrollment at the lower-cost colleges. In the "K-14 Priorities" section of this chapter, we identify the option of increasing CCC enrollment funding by up to $100 million, which would increase the number of budgeted students by about 25,000 FTE students. Put another way, rather than enrollment declining by 5.7 percent in the budget year, the budget would assume a 3.1 percent decline.

Concurrent Enrollment

As part of his December revision, the Governor proposed reducing funding for the concurrent enrollment of high school students. Statute currently permits community colleges to enroll high school students as "special part-time students." The colleges receive the same funding for these students that they receive for regular students. The funding high schools receive for these students is unaffected. Legislative intent states that this concurrent enrollment is to provide "advanced scholastic or vocational work" as "enrichment opportunities for a limited number of eligible pupils." Each student's participation must be recommended by the high school principal and consented to by the student's parents.

Last year a number of newspaper reports called into question whether legislative intent was being observed. Specifically, the reports revealed that some community colleges were claiming enrollment funding for high school students that were participating in football practice and other physical education classes on the high school campuses. In other words, the community college "class" was a regular high school physical education class on a high school campus. It is difficult to see how these classes provided "advanced scholastic or vocational work" for these students.

Governor Proposes Reduction and Audit. The Governor proposed that an audit be conducted to determine the extent to which concurrent enrollment funding was being improperly claimed. He also proposed that community college apportionment funding be reduced by $80 million, and that the Chancellor be directed to allocate this cut to districts that were found by the audit to have improperly claimed concurrent enrollment funding. At the time this *Analysis* was being prepared, the Legislature had not taken action to reduce these funds for the current year.

For the budget year, the Governor again proposes the $80 million reduction, along with budget bill language specifying that this is to reflect a permanent reduction of 20,000 FTE students that were improperly claimed as concurrent enrollment. The budget bill language does not mention an audit, but requires the Chancellor to allocate the reduction to districts in proportion to the level of improperly claimed concurrent enrollment. The Governor also proposes legislation to strengthen statutory requirements for the claiming of concurrent enrollment funding. Specifically, the Governor proposes that concurrent enrollment be explicitly limited to academic and vocational courses which are not offered at the pupil's school district; that these may not include recreational, physical education, or personal development classes; that eligible classes must be "designed for and … advertised as open to the general public in the college course catalog"; and that eligible classes may not be offered on high school campuses during regular school hours.

Audit Might Not Be Complete Until Next Budget Cycle. Although the Governor called for an audit of concurrent enrollment practices in the December revision, he has not offered details about who would conduct the audit, how it would be structured, or when it would be completed. Neither is it clear whether the $80 million estimate of the problem would in fact be validated by the audit. The Chancellor's office indicated during mid-year budget hearings that an audit would be a somewhat complicated endeavor that could take a year to complete. At the time this *Analysis* was being prepared, the Chancellor's office and the administration were still negotiating over the terms of the audit.

LAO Recommendation—Approve $80 Million Reduction, Modify Concurrent Enrollment Statute

We recommend that the Legislature approve the $80 million reduction for concurrent enrollment. This represents about 35 percent of the amount CCC received for concurrently enrolled students in 2001-02. It is also about equal to the amount CCC receives for students concurrently enrolled in physical education classes on high school campuses. We believe that this represents a conservative estimate of concurrent enrollment that likely does not meet legislative intent.

Reduction Is Justified as a Policy Decision. During mid-year budget hearings, the Legislature considered whether it was reasonable to "take back" $80 million in current-year funding for concurrent enrollment prior to the completion of an audit that justified this amount. While there was a general consensus that any funding that was clearly proved to be illegal should be recaptured, there was a similar consensus that this was a high burden of proof that could not be met in a matter of weeks or months.

The Legislature now faces the question of how much concurrent enrollment to fund in the budget year. Because this funding decision is prospective and districts are able to accommodate it as they plan for the 2003-04 years, we believe that time is of the essence and the Legislature can simply reduce the amount as a policy decision. Specifically, the Legislature could choose to reduce funding for concurrent enrollment as a way to implement its stated intent that concurrent enrollment be restricted to "a limited number of pupils." We recommend that the budget bill language proposed by the Governor be modified to reflect this approach.

Statute Should Be Clarified. Some community college districts argue that the statute governing concurrent enrollment is too vague. The Chancellor's office has tried to suggest to districts how they should interpret the statute, but this has not resulted in consistent practices among districts. We therefore recommend that the Legislature clearly define in statute the circumstances under which concurrent enrollment is appropriate. We believe that the legislation suggested by the Governor provides a good starting place for discussion. The Legislature may wish to impose further restrictions. For example, it may wish to impose a limit on the percentage of budgeted FTE students that could be claimed as concurrent enrollment. Alternatively, it may wish to limit the percentage of students in any one course that are concurrently enrolled. We believe these discussions would be appropriate both in budget subcommittee and policy committee hearings.

PARTNERSHIP FOR EXCELLENCE

The Governor's budget would provide $164.5 million for PFE. This is a reduction of $135.5 million, or 45 percent, from the enacted 2002-03 budget.

Now in its fifth year, the PFE provides supplementary funding to community colleges in exchange for their commitment to improve student outcomes in specified areas. As we noted in last year's *Analysis* (please see pages E-241 through E-249), the PFE has resulted in only marginal improvement in the specified areas. Moreover, we found that the program lacked accountability. We recommended that the Legislature either terminate the PFE experiment early (it is scheduled to sunset at the end of 2004) or consider significant modifications to create a more meaningful link between funding and performance.

Withhold Recommendation Pending CCC Report.

We withhold recommendation on the proposed $164.5 million funding level for the Partnership for Excellence (PFE), pending receipt of the 2003 annual report on PFE performance.

Statute requires that the Chancellor's office annually provide the Legislature and Governor with a report on the expenditure of PFE funds and progress on meeting PFE performance targets. The next report is due April 15, 2003. This report should help the Legislature to determine the worth of the $300 million annual investment the state has been making in the PFE for the past several years. We will review that report and provide our assessment of it at budget hearings. Until that time, we withhold recommendation on the $164.5 million in proposed funding.

STUDENT AID COMMISSION
(7980)

The Student Aid Commission provides financial aid to students through a variety of grant, loan, and work-study programs. The proposed 2003-04 budget for the commission includes state and federal funds totaling $1.4 billion. Of this amount, $699 million is General Fund support. Of the total General Fund appropriation, 99 percent is for direct student aid for higher education and 1 percent is for the cost of operating the commission.

MAJOR GENERAL FUND BUDGET CHANGES

Figure 1 (see next page) compares the revised 2002-03 budget with the Governor's 2003-04 budget proposal for the commission. As the figure shows, the Governor's budget requests total General Fund support that is $78 million, or 13 percent, above estimated General Fund expenditures in the current year. This amount includes both a $2.2 million reduction in state operations and an $80 million augmentation for the commission's local assistance programs.

Augments Funding for Cal Grant A and Cal Grant B Programs

Chapter 403, Statutes of 2000 (SB 1644, Ortiz), significantly expanded and revised the existing Cal Grant program by creating three distinct programs: (1) an entitlement program for recent high school graduates, (2) an entitlement program for younger community college students transferring to four-year universities, and (3) a competitive program for older and returning students. Within each of these three programs, students may receive either a Cal Grant A or a Cal Grant B award depending on their grade point average (GPA) and their family's income and assets. Cal Grant A awards cover education fees and tuition (up to $9,708 in 2002-03). Cal Grant B awards provide a subsistence allowance of $1,551 in a student's first year of college. In the remaining years of college, Cal Grant B recipients receive the $1,551 subsistence allowance as well as fee assistance (up to $9,708 in 2002-03).

Figure 1

Student Aid Commission General Fund Budget Summary

(Dollars in Millions)

	2002-03 Revised	2003-04 Proposed	Change From 2002-03 Amount	Change From 2002-03 Percent
State Operations	$9.9	$7.7	-$2.2	-22%
Local Assistance				
New Cal Grant entitlement awards	$263.1	$424.3	$161.2	61%
New Cal Grant competitive awards	88.6	104.4	15.7	18
Existing awards	225.0	130.0	-95.0	-42
Subtotals, Cal Grant awards	($576.7)	($658.7)	($82.0)	(14%)
Cal Grant C awards	$12.1	$8.9	-$3.2	-26%
Cal Grant T awards	6.0	3.0	-3.0	-50
APLE[a] program	20.5	30.0	9.5	46
Graduate APLE program	0.2	0.5	0.3	130
Work study	5.3	—	-5.3	-100
Law enforcement scholarships	0.1	0.1	0.1	103
Federal Trust Fund[b]	-9.5	-9.5	—	—
Totals, local assistance	**$611.3**	**$691.7**	**$80.4**	**13%**
Grand Totals	**$621.3**	**$699.4**	**$78.2**	**13%**

a Assumption Program of Loans for Education.

b Federal Trust Fund monies directly offset Cal Grant program costs.

Under the entitlement programs, students must be recent high school graduates younger than 24 years old. Figure 2 provides GPA, income, and asset requirements for Cal Grant A and Cal Grant B entitlement recipients.

Students who do not qualify for entitlement awards still may receive financial aid under the competitive Cal Grant program. The commission assigns a score to each student applying for a competitive award using several factors—including GPA, family income and household size, household status, parents' educational level, and social and educational background (such as having divorced parents or graduating from a high school with a large proportion of students participating in the free or reduced-

Figure 2

Eligibility Criteria for Cal Grant Entitlement Program

2002-03

Eligibility requirement	Cal Grant A	Cal Grant B
Minimum high school GPA	3.0	2.0
Minimum transfer GPA	2.4	2.4
Income ceiling, by family size[a]		
Six +	$76,500	$42,000
Four	66,200	34,800
Two	59,400	27,800
Asset Ceiling[a]	$51,200	$51,200

[a] Represents ceilings for dependent students and independent students with dependents other than a spouse. A family's asset level excludes its principal residence.

price lunch program). Each year, the score needed to obtain an award depends on the number of applicants and the characteristics of the applicant pool. Chapter 403 authorizes the commission to issue 22,500 new competitive awards each year.

The Governor's budget includes a total of $659 million for the Cal Grant A and Cal Grant B programs. This is $82 million, or 14 percent, more than estimated current-year expenditures. The proposed augmentation results from three factors: (1) an increase in the total number of Cal Grant awards ($49 million), (2) an increase in the Cal Grant award amount for University of California and California State University students to accommodate proposed fee increases ($43 million), and (3) a partially offsetting reduction in the Cal Grant award amount for students attending private colleges ($10 million).

Figure 3 (see next page) compares the total number of Cal Grant awards issued in 2001-02 and 2002-03 and budgeted for 2003-04. As the figure shows, the Governor's budget assumes the commission will issue 66,000 new entitlement awards to high school graduates in 2003-04. This is approximately 5,600 awards, or 9.3 percent, more than the commission issued in the current year. The budget also assumes the commission will issue 8,000 new transfer entitlement awards in 2003-04. Additionally, it assumes the commission will issue 22,500 new competitive awards—the same number as issued in the current year.

Figure 3

Cal Grant A and Cal Grant B Awards

(Number of Award Recipients)

	Actual 2001-02	Revised 2002-03	Proposed 2003-04
High School Entitlement Program			
New awards	48,420	60,410	66,000
Renewal awards	—	38,735	79,315
Transfer Entitlement Program			
New awards	—	645	8,000
Renewal awards	—	—	515
Competitive Program			
New awards	22,500	22,500	22,500
Renewal awards	—	18,000	32,400
Pre-Chapter 403[a]			
Renewal awards	85,710	53,150	25,755
Total awards	**156,630**	**193,440**	**234,485**

a Represents Cal Grant awards issued prior to the enactment of Chapter 403, Statutes of 2000 (SB 1644, Ortiz). As the numbers suggest, this award group will be phased out as students graduate or otherwise do not renew their awards.

Increases Funding for APLE Program by Almost Half

The Governor's budget augments funding for the Assumption Program of Loans for Education (APLE). The APLE program was established in 1983 and since that time has been revised and expanded considerably. Today, the APLE program helps graduates of teacher preparation programs to repay their college loans. Students may receive $11,000 in loan forgiveness if they teach full time in a public K-12 classroom for four consecutive years. They may receive an additional $4,000 in loan forgiveness if they teach in a subject-shortage area (such as mathematics, science, or special education) or if they teach in a school ranked in the bottom two deciles of the Academic Performance Index. Students teaching both in a subject-shortage area and at a low-performing school may receive both of these additional benefits—resulting in a total of $19,000 in loan forgiveness.

The budget proposal includes a total of $30 million for the APLE program. This is $9.5 million, or 46 percent, more than estimated current-year expenditures. The augmentation would allow the commission to provide loan forgiveness for an additional 4,388 APLE warrants—bringing the total number of APLE warrants to be redeemed in 2003-04 up to 16,898. In addition, the Governor's budget proposes budget bill language to allow the commission to issue 6,500 *new* APLE warrants (at no cost in the budget year). This would be 1,000 fewer warrants than authorized for the current year, but the same number as authorized in 2001-02.

Reduces Cal Grant C Program Funding to Slightly Below 2001-02 Level

The Cal Grant C program is a needs-based program that provides financial aid of up to $2,592 for tuition and fees and up to $576 for tools, books, and supplies for students enrolled in occupational or vocational programs. These programs must be between four months and two years in duration. The Cal Grant C program is the only state-funded financial aid program for students pursuing short-term technical and occupational training.

The Governor's budget includes $8.9 million for the Cal Grant C program. This is $3.2 million, or 26 percent, less than estimated current-year expenditures. The proposed funding would permit the commission to offer 7,690 awards in the budget year. This is approximately 3,040 fewer Cal Grant C awards than the commission offered in the current year. If the proposed reduction is made, the program will operate at slightly below its 2001-02 level. In 2001-02, the commission funded 8,440 Cal Grant C awards at a total cost of $11.3 million.

Reduces Cal Grant T Program Funding by About 50 Percent

The state established the Cal Grant T program in 1998-99 to help pay educational fees for financially needy students enrolled in teacher preparation programs. In 2001-02, the state amended the program to require Cal Grant T recipients to teach for one year in a low-performing school for each $2,000 of financial aid they receive. Recipients who do not fulfill the teaching obligation must pay back their financial aid award.

From its inception through 2001-02, the Cal Grant T program never was fully subscribed. Whereas the commission was authorized to fund 3,000 awards, only 1,739 students used Cal Grant T awards in 2001-02. In 2002-03, the state reduced the Cal Grant T appropriation to align it better with anticipated expenditures. A further reduction in 2003-04 therefore would cause a real cut in the number of Cal Grant T awards issued to students.

The Governor's budget provides $3 million for the Cal Grant T program. This is $3 million, or 50 percent, less than estimated current-year expenditures. The reduction would result in the commission offering approximately 540 fewer Cal Grant T awards—dropping from an estimated total of 1,390 awards in the current year to 850 awards in the budget year. The effect of the reduction, however, might be moderated by another state financial aid program for aspiring teachers—the fifth-year Cal Grant program. Fifth-year Cal Grant awards are provided to all students meeting certain program and financial requirements (meaning its total budget is not capped). Moreover, the federal government funds two loan-forgiveness programs for teachers. In short, even if funding for the Cal Grant T program was reduced, other financial aid opportunities would remain for aspiring teachers.

Eliminates Work Study Program

Lastly, the Governor's budget proposes to eliminate the state's Work Study program, thereby achieving $5.3 million in General Fund savings. This program currently operates at 40 colleges. The commission estimates that slightly more than 3,000 students will receive work-study benefits in the current year. The state established the California State Work-Study program in 1986. The program provides students with employment subsidies to help them defray a portion of their college expenses. The program initially was structured as a pilot—with only 15 colleges participating. Since 1989-90, the program has expanded gradually, but it remains quite small. Additionally, many campuses benefit from the federal work-study program, which is slightly less restrictive than the state program.

Intersegmental Financial Aid Issues

We address several financial aid issues in the "Intersegmental" section of this chapter. Figure 4 summarizes the five financial aid recommendations we make in that section, including three that relate to the Cal Grant program.

Figure 4

Summary of Intersegmental Financial Aid Issues

Issues	Recommendation
Governor's Scholarship programs	Eliminate program because other programs reward academic merit and assist financially needy students. Results in $43 million General Fund savings.
Cal Grant awards for UC and CSU students	Approve $28 million Cal Grant augmentation associated with 15 percent increase in UC and CSU student fees.
Cal Grant awards for private-college students	Reject proposal to reduce value of Cal Grant awards for private-college students by 9 percent. Results in $10 million of additional Cal Grant costs.
UC and CSU institutional aid programs	End practice of setting aside one-third of additional student fee revenue for institutional financial aid. Instead, provide in budget act smaller augmentation for institutional aid. Frees up about $75 million in student fee revenue for general purposes.
Fee assistance for first-year Cal Grant B recipients	Provide fee assistance to all first-year Cal Grant B recipients. Results in approximately $95 million in additional Cal Grant costs.

Findings and Recommendations

Education

Analysis Page

2002-03 Mid-Year Revisions: Proposition 98

E-19 ■ **Make Additional Current-Year Proposition 98 Reductions.** Recommend the Legislature make $382 million in additional reductions in K-14 Proposition 98 programs.

E-20 ■ **Deferral May Threaten Federal Funding, Related to Item 6110-161-0001**. Recommend the State Department of Education report to the fiscal committees on the need for a federal waiver due to the deferral of 2002-03 special education payments adopted as part of the mid-year Proposition 98 funding adjustments.

Proposition 98 Budget-Year Priorities

E-29 ■ **General Fund Spending Could Increase by $373 Million for Proposition 98.** We estimate that the 2003-04 Proposition 98 minimum guarantee for K-14 education is $373 million higher than assumed in the Governor's budget. This increase is due primarily to our higher estimate of budget-year General Fund revenues. If the estimate of the minimum guarantee remains above the level assumed in the Governor's budget, then we recommend the Legislature meet the higher guarantee by (1) expiring more of its debt (that is, paying off additional deferrals) and (2) funding additional enrollment at the community colleges.

Analysis Page

Categorical Reform

E-43 ■ **Improving the Governor's Plan. Item 6110-001-230.** Recommend the Legislature merge 62 categorical programs into five block grants to increase local flexibility and accountability.

E-61 ■ **Academic Improvement Block Grant.** Recommend the Legislature create an Academic and Instructional Improvement block grant that combines 22 existing programs and $2.8 billion in Proposition 98 funds.

E-64 ■ **Compensatory and Alternative Education Block Grant.** Recommend the Legislature create a Compensatory and Alternative Block Grant by consolidating $1.8 billion from 19 existing categorical programs designed to help students who need additional services to be successful in school.

E-67 ■ **Core Services Block Grant.** Recommend the Legislature create a Core Services Block Grant by merging 12 programs to provide $1.4 billion in support for the basic district and classroom costs of K-12 education.

E-69 ■ **Vocational Education Block Grant.** Recommend the Legislature create a Vocational Education Block Grant by consolidating five categorical programs that provide $385 million in support for vocational education programs.

E-71 ■ **Regional Support Block Grant.** Recommend the Legislature create a Regional Support Block Grant by consolidating six categorical programs that provide $31 million for county office of education technical assistance services to school districts.

Analysis Page

E-73 ■ **Information Needed on Proposed Staff Reductions. Withhold on Item 6110-001-0001.** Recommend Legislature ask the Department of Finance and the State Department of Education to provide a more accurate accounting of the actual positions to be cut and additional information on the implications of the proposed reductions prior to budget hearings.

Proposition 98 Mandates

E-76 ■ **Include Proposition 98 Mandates in Core Services Block Grant.** Recommend Legislature increase funding for Proposition 98 mandates by $100 million (Item 6110-295-0001) and include $199 million in our Core Services Block Grant. This would create district incentives to reduce mandate-related costs and distribute mandate reimbursements more fairly.

Revenue Limits and Discretionary Funds

E-80 ■ **Revenue Limit Equalization. Reduce Item 6110-601-0001 by $250 Million**. Recommend Legislature reduce funding for revenue limit equalization by $250 million in light of the state's fiscal situation and increased flexibility generated by the categorical block grant. Delay revenue limit equalization until a year when Proposition 98 can fund growth, cost-of-living adjustments (COLAs), and pay off any remaining deferrals.

E-80 ■ **COLA Increases.** Recommend Legislature not create a deficit factor if it does not fund the statutory COLA.

Analysis Page

Basic Aid Districts

E-83 ■ **Reduction to Basic Aid Payments.** Recommend the Legislature approve the proposal to reduce basic aid payments by $15.7 million in 2002-03 and eliminate them entirely in 2003-04 for a savings of $17.8 million.

E-84 ■ **Funding Reductions to Excess-Tax Basic Aid Districts.** Recommend the Legislature revise the budget proposal to recapture $150 million in excess taxes and, instead, cap excess taxes at the levels received in 2000-01.

Department of Education

E-90 ■ **Include K-3 Class Size Reduction (CSR) Program in New Academic and Instructional Improvement Block Grant. Eliminate 6110-234-0001 and Shift $1.5 Billion to 6110-230-0001.** Recommend Legislature include K-3 CSR program in a new Academic and Instructional Improvement Block Grant. This block grant would provide greater flexibility by allowing school districts to use improvement strategies that best address local needs. The block grant would promote accountability by: (1) requiring districts to report expenditure data to the State Department of Education, (2) creating measures of instructional performance, and (3) tracking both academic and instructional outcomes.

E-91 ■ **Option—Create Program to Compare Cost-Effectiveness of Various CSR and Staff Development Initiatives. Include New Budget Bill Provision to Use $500,000 of Item 6110-113-0890, Schedule 10**. *If retained as a separately funded categorical program,* recommend Legislature improve it by creating a voluntary pilot program, whereby school districts would have the opportunity to use existing K-3 CSR funds to implement one of several allowable cost-neutral education reforms.

Analysis Page

Assessments

E-100 ■ **Reduce Number of Grade Levels Taking the California Achievement Test-6 (CAT/6). Reduce Item 6110-123-0001 by $10 Million.** Recommend Legislature reduce emphasis on norm-referenced tests by requiring school districts to administer the CAT/6 only in grades 4 and 8 instead of grades 2 through 11, and reduce funding by $10 million.

E-102 ■ **Eliminate Primary Language Assessment. Reduce Item 6110-123-0001 by $1.6 Million.** Recommend Legislature eliminate the primary language test requirement to be consistent with the state's emphasis on English language development and reduce funding by $1.6 million.

E-104 ■ **Eliminate Golden State Exams. Reduce Item 6110-123-0001 by $5.9 Million.** Recommend Legislature eliminate the Golden State Exams to reduce duplicative testing at the high school level and reduce funding by $5.9 million.

E-105 ■ **Eliminate Physical Performance Test Mandate. Reduce Item 6110-295-0001 by $1.1 Million.** Recommend Legislature make the physical fitness test optional for grades 5, 7, and 9, and eliminate funding of $1.1 million.

Accountability

E-125 ■ **Focus State Interventions at the School District Level.** Recommend Legislature focus on providing technical assistance at the school district level to build capacity for districts to intervene at schools.

E-126 ■ **Target State Interventions at the Neediest Schools.** Recommend Legislature target state interventions at the neediest schools—those in decile one of the Academic Performance Index, due to capacity and fiscal constraints.

Analysis Page

E-127 ■ **Provide Less Intensive Interventions at Higher Performing Schools.** Recommend Legislature design the accountability system to provide less intensive state interventions and sanctions for higher performing schools in federal corrective action and restructuring.

E-127 ■ **Redesign High Priority Schools Grant Program (HPSGP) to Serve State and Federal Purposes.** Recommend Legislature restructure the HPSGP to serve as the primary accountability program for state and federal purposes.

E-128 ■ **Transition Schools in State Intervention Programs to New System Expeditiously.** Recommend Legislature expeditiously transition schools currently in Immediate Intervention/Underperforming Schools Program and HPSGP to the newly integrated accountability system while following through on existing sanction commitments. In addition, recommend Legislature end use of "significant growth" as a criterion for further funding.

E-129 ■ **Change Definition of Proficiency.** Recommend Legislature amend the Public Schools Accountability Act to define "proficiency" for purposes of the federal No Child Left Behind Act as passage of the high school exit exam for grades 10 through 12, and being on-track to pass the high school exit exam for grades two through eight.

E-130 ■ **Set Aside Funding for Restructured Accountability System. Increase Item 6110-123-0001 by $50,000,000.** Recommend Legislature set aside $50 million for a restructured accountability system.

Analysis Page

Instructional Materials

E-132 ■ **Recognize Instructional Materials Purchased With Schiff-Bustamante Funds as Standards-Aligned.** Recommend that the Legislature pass legislation to allow materials adopted in the interim adoptions required under Chapter 481, Statutes of 1998 (AB 2519, Poochigian), to be recognized as standards-aligned materials for the purposes of eligibility for categorical programs. In passing this legislation, the Legislature would (1) recognize the $1 billion investment in Schiff-Bustamante Standards-Based Instructional Materials funding much of which districts spent on these materials and (2) relieve districts from the costs of new materials.

Special Education

E-135 ■ **Budget Threatens Federal Funding, Related to Item 6110-161-001**. Recommend the State Department of Education report at budget hearings on the likelihood that California would receive approval of a waiver request on the federal special education maintenance of effort requirement.

Child Care and Development

E-138 ■ **Child Care Realignment**. We recommend the Legislature consider realigning most of the subsidized child care programs administered by the State Department of Education (SDE) to the counties. Further recommend the Legislature require the Department of Finance and SDE to provide additional information at budget hearings regarding the feasibility and implications of the proposed state operations reduction associated with realignment, in order to better determine its appropriateness.

Analysis Page

E-143 ■ **California Work Opportunity and Reponsibility to Kids (CalWORKs) Child Care Program.** The Governor's budget fully funds the estimated need for CalWORKs Stage 1 child care. However, the budget eliminates funding for Stage 2 and Stage 3.

E-147 ■ **After School Education and Safety Program (Proposition 49).** We believe that it is unlikely that additional funding would be required for the After School Education and Safety Program in 2004-05 and 2005-06, given the current budget situation.

Commission on Teacher Credentialing

E-151 ■ **Enhance Coherence, Maximize Flexibility, and Increase Accountability Among Commission of Teacher Credentialing's (CTC) Intern, Preintern, and Paraprofessional Programs. Allow Funds to Be Shifted Within Item 6360-101-0001 Among Schedules 1, 2, and 3.** Recommend Legislature establish legislation streamlining CTC's intern, preintern, and paraprofessional programs. Specifically, recommend: (1) establishing a consistent $2,000 per participant funding rate, (2) instituting a dollar-for-dollar school district match, (3) allowing CTC to shift funds among all three programs, and (4) requiring CTC to report on its ability to reduce emergency permit rates compared with those districts that do not have CTC programs.

E-154 ■ **Expand Subject Matter Training Programs for Emergency Permit Holders. Redesignate Total of $3.1 Million From Item 6110-195-0890, Schedule 2 in Current Year and Budget Year.** Recommend Legislature designate $3.1 million in federal Title II monies for subject matter programs for emergency permit holders because: (1) this will help the state meet the new federal

Analysis Page

requirement of having all teachers highly qualified by the end of the 2005-06 school year, and (2) federal funds are available for just these kinds of programs.

Other Issues

E-156 ■ **Academic Volunteer and Mentor Service Program. Eliminate Item 0650-111-0001—$5 Million.** Recommend Legislature eliminate funding due to the existence of other state and federal programs that provide similar program services.

E-158 ■ **Building a Teacher Database. Enhance State's Teacher Information System. Designate $500,000 of Item 6110-113-0890, Schedule 10 for System.** Recommend the Legislature enact legislation creating a comprehensive teacher information system that is coordinated with the state's student information system. This system, coordinated by the State Department of Education, would: (1) maximize the potential benefits of data collection and evaluation efforts and (2) help the state meet new federal reporting requirements.

Student Fees

E-177 ■ **Reduce Governor's Proposed Fee Increases for the University of California (UC) and the California State University (CSU).** Recommend the Legislature (1) adopt a fee policy for UC and CSU and (2) assume fee increases that are more moderate than those proposed by the Governor in the budget year.

Analysis Page

Higher Education Enrollment

E-188 ■ **Reduce Budgeted Enrollment Growth for UC and CSU. Reduce Item 6440-001-0001 by $48.7 Million and Item 6610-001-0001 by $66.2 Million**. Recommend Legislature reduce funding in the budget for enrollment growth at the University of California and the California State University, because proposed growth rates significantly exceed demographic projections.

Financial Aid

E-198 ■ **Eliminate Governor's Scholarship Programs. Reduce Item 0954-101-0001 by $43.4 Million.** Eliminate these programs because neither is likely to promote access to college, the state already has well-developed programs that reward academic achievement while assisting deserving students in paying college costs, and the programs result in an extremely inefficient allocation of scarce resources.

E-201 ■ **Reject Cal Grant Reduction for Private-College Students. Augment Item 7980-101-0001 by $10.2 Million.** Maintain the existing Cal Grant award level for students attending private colleges because this has fiscal advantages and promotes educational accountability among public universities.

E-205 ■ **Provide Appropriately Sized Augmentation for Institutional Aid Programs at the University of California (UC) and the California State University (CSU) in Budget Act. Establish New UC Item 6440-001-0498 and New Provision in CSU Item 6610-001-0498.** Augment UC and CSU's institutional aid budgets by $16 million and $15.3 million, respectively—consistent with anticipated enrollment growth of 4 percent. Appropriate funding through budget act with accompanying

Analysis Page

language providing general guidelines on how UC and CSU are to distribute the funds.

E-209 ■ **Provide Fee Coverage to First-Year Cal Grant B Recipients. Augment Item 7980-101-0001 by $95 Million.** Provide fee assistance to all first-year Cal Grant B recipients to ensure these students are not affected adversely by fee increases at UC and CSU.

California Postsecondary Education Commission

E-213 ■ **Approve $695,000 in General Fund for the California Postsecondary Education Commission (CPEC) But Designate Funds for Data Management.** We recommend that the Legislature approve the Governor's proposed level of funding for CPEC. However, we recommend that the Legislature specify that these funds are for maintaining CPEC's data management infrastructure, and not for supporting the positions proposed by the Governor.

E-214 ■ **Eligibility Study.** Recommend CPEC, the University of California, the California State University, and the California Community Colleges report at budget hearings on their progress in completing the state's higher education eligibility study.

University of California

E-220 ■ **Proposed Fee Increases Should Be Reduced.** Recommend that the student fee increases assumes by the Governor should be reduced from 25 percent to 15 percent for undergraduates, and from 25 percent to 20 percent for graduates. Also recommend that most of this new fee revenue be available to backfill the Governor's proposed unallocated General Fund reduction.

Analysis Page

E-220 ■ **Reduce Enrollment Growth to 4 Percent. Reduce Item 6440-001-0001 by $48.7 Million.** We believe that the Governor's proposed increase of 6.9 percent is not justified by likely enrollment demand and the state's General Fund resources.

E-221 ■ **Minimize Impact of Unallocated Reduction on Instruction by Increasing Student-Faculty Ratio (SFR). Related to Item 6440-001-0001.** In order to minimize any potential negative impact on instruction due to unallocated reductions, the Legislature could direct UC to temporarily increase its SFR which could be achieved, for instance, by redistributing faculty workload.

E-222 ■ **Governor's Proposed Reductions for UC Outreach.** Recommend the Legislature approve the level of proposed reduction in UC's outreach programs. However, we recommend targeting cuts to protect programs that increase the academic preparedness of students and provide direct services to schools and students.

E-227 ■ **Additional Funding for New Campuses.** Withhold recommendation on the $11.3 million proposed augmentation for the University of California (UC) Merced campus, pending review of an expenditure plan to be submitted in mid-February.

E-229 ■ **Avoid Dismantling Subject Matter Projects (SMPs). Designate $5 Million in Item 6440-001-0001 and $5 Million in Item 6110-195-0890 for Four SMPs.** Recommend Legislature designate a total of $10 million to support English Language Arts, Social Sciences, Mathematics, and Science SMPs. This would: (1) not violate federal supplanting laws, (2) maintain a long standing, relatively high-quality professional development program, and (3) help the state meet a new federal professional development requirement.

Analysis Page

California State University

E-236 ■ **Student Fee Increase Should Be Reduced.** Recommend the Legislature assume fee increases that are more moderate than those proposed by the Governor. Specifically, we propose fee increases of 15 percent for undergraduates and 20 percent for graduates.

E-236 ■ **Reduce Budgeted Enrollment Growth. Reduce Item 6610-001-0001 by $66.2 Million.** Recommend Legislature reduce funding in the budget for enrollment growth at the California State University (CSU), because the proposed growth rate significantly exceeds demographic projections.

E-236 ■ **Student Financial Aid Should Be Linked to Growth.** Recommend Legislature increase CSU's financial aid program for enrollment growth only (4 percent).

E-241 ■ **Assess Effectiveness of Precollegiate Services.** Recommend Legislature require CSU to assess and routinely report on the effectiveness of its precollegiate services, in order to ensure at-risk students are provided appropriate assistance.

E-242 ■ **Fund Precollegiate Courses at a Uniform Rate. Reduce Item 6610-001-0001 by $10 Million**. Recommend Legislature fund CSU's precollegiate writing and mathematics courses at the same rate it funds credit courses at the community colleges.

E-243 ■ **K-12 Outreach Programs.** Recommend Legislature target proposed outreach reduction at programs that (1) provide duplicative services, (2) don't focus on students most in need of additional state help, and (3) are ineffective.

Analysis Page

E-245 ■ **Restrict CSU's Authority Over Unspent Funds.** Recommend the Legislature amend budget bill language to count all unexpended allocations toward the $15 million carryover cap. We further recommend that carryover funds be spent only on one-time purposes.

California Community Colleges

E-258 ■ **Approve Student Fee Increase.** Recommend Legislature enact $25 per unit student fee, which is $1 more than the Governor's proposal. This would allow needy students each to receive up to $108 in additional federal financial aid.

E-259 ■ **Enrollment Reduction Justified, Though Perhaps Too Large.** Reduce enrollment funding to a level justified by anticipated demand and state priorities. Recommend Legislature consider option of restoring up to $100 million of the $216 million reduction proposed by the Governor.

E-263 ■ **Reduce Concurrent Enrollment Funding as a Policy Choice.** Reduce concurrent enrollment funding by $80 million as proposed by the Governor. However, specify in budget bill language that this reduction reflects a decision to limit concurrent enrollment as intended in statute. Also recommend amending statute to more clearly restrict concurrent enrollment.

E-264 ■ **Funding Partnership for Excellence (PFE).** Withhold recommendation on the Governor's proposal to fund the PFE at $164.5 million, pending receipt of a report on PFE performance due April 15, 2003.