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Proposition 98— A Brief Look at the Current Situation

The 1991-92 fiscal year concluded without passage of administration-sponsored legislation to reduce the level of 1991-92 appropriations for Proposition 98 by $1.1 billion. This legislation would also have allowed the Legislature to lower the level of Proposition 98 appropriations for 1992-93 by up to $1.2 billion, for a potential budget savings over the two-year period of up to $2.3 billion.

In this report, we explain the current status of the Proposition 98 minimum funding guarantee, and review how other budget proposals that have already been advanced would affect the level of the guarantee for 1992-93. Finally, we discuss other options that may be considered to generate savings for 1992-93.

Status of the 1992-93 Minimum Funding Guarantee

Background. Proposition 98 requires that the state provide a specific minimum amount of funding for K-14 school districts each year. This amount is determined according to a set of complex formulas, which essentially adjust the minimum funding guarantee according to whether the state is experiencing high, medium or low rates of growth in General Fund revenues. These formulas are commonly referred to as Test 1, Test 2 and Test 3.

- **Test 1.** Under this formula, the state's funding obligation is equal to 40.33 percent of General Fund tax revenues. This formula is used whenever it produces a higher funding requirement than Test 2 or Test 3.
- **Tests 2 and 3.** Under both the Test 2 and Test 3 formulas, the state must provide the same amount as was provided in the prior fiscal year, adjusted for the growth in average daily

attendance and adjusted either for the growth in per capita General Fund revenue (Test 3) or state per capita personal income (Test 2). Test 3 serves as an alternative to Test 2 whenever per capita General Fund revenue growth is less than per capita personal income growth by more than one-half of one percent. If the Test 3 formula is used, however, the state's funding obligation for subsequent years is increased so as to eventually restore the funding level to what it would otherwise have been. This part of the Proposition 98 formula is known as the "maintenance factor" requirement.

The 1991-92 "Base". Because no legislation was enacted to lower the level of 1991-92 appropriations, the total amount of prior-year appropriations that will be used in determining the 1992-93 guarantee is the amount actually appropriated in the 1991 Budget Act—$18,353 million, based on the May Revision. Using current estimates, the 1991-92 minimum funding guarantee was $1,129 million lower than the amount appropriated. This is because revenue declines and ADA reductions lowered the amount of maintenance factor payments below the level anticipated when the 1991 Budget was enacted. Approximately $1,005 million of this difference represents a loss of temporary or one-time savings to the General Fund. In effect, the state has made the maintenance factor payments earlier than it was required to. The remaining $124 million of the over-appropriation, however, represents a permanent addition to the state's funding obligation—the state will be required to include this amount as part of the minimum funding guarantee for all future years.

The 1992-93 Guarantee. We estimate that the state will be required to provide $18,728 million in 1992-93, based on the Test 2 formula. This estimate of the 1992-93 guarantee reflects current estimates of General Fund revenues (adjusted to include $580 million attributable to an anticipated delay in the repayment of tax refunds associated with the Aerospace lawsuit), ADA and local property tax revenues under current laws. This estimate also assumes that no other budget proposals are enacted that would affect the state's funding obligation.

Using this estimate of the 1992-93 funding guarantee, we estimate that funding available to K-12 school districts would increase by $176 per ADA over the funding level for 1991-92, as illustrated in Figure 1. These estimates reflect the actual amount of cash funding available to school districts in each year, that is, they have been adjusted to account for the funding shifts that affected spending in 1990-91 and 1991-92.

Figure 1

Proposition 98
Annual Increase in Per-ADA Funding for Schools[a]

[a] Adjusted for funding shifts.

Figure 2

Proposition 98 Funding Guarantee 1992-93

(in billions)[a]

[a] Adjusted to exclude enterprise special district proposal and include aerospace-related revenues.

Figure 2 illustrates the effect of different revenue estimates for 1992-93 on the level of the funding guarantee. As the figure indicates, a $300 million decrease in the estimate of revenues would cause a change from the Test 2 funding formula to the Test 3 funding formula, and revenue decreases of more than $300 million would begin to result in decreases in the funding guarantee. A revenue increase of approximately $5.1 billion would be required to bring the Test 1 formula into play, but revenue increases below that level would not result in any increases in the funding guarantee. Again, these figures assume that no changes are made to existing laws that would affect the state's funding obligation.

Implications of Current Budget Proposals

This section examines the implications for the level of the Proposition 98 funding guarantee of other budget proposals currently under consideration by the administration and the Legislature. Because state revenue increase proposals would have only a minor potential effect on the guarantee (as noted above), they are not discussed in this section. It should be noted however, that the revenue and other proposals may "interact" with each other, and these interactions must be taken into account in determining the aggregate effect of the adopted proposals on the funding guarantee. The General Fund savings associated with these other budget proposals are summarized in Figure 3, next page.

Property Tax Changes. Several of the proposals under consideration would reduce the level of property taxes now allocated to cities, counties and special districts, and reallocate these property taxes to K-14 school districts. These proposals include the elimination of enterprise special districts' property tax allocations; the partial or complete recapture of city, county and special district "AB 8" property tax allocations; and a proposal to recapture increased local Vehicle License Fee allocations through a shift of city and county property taxes to schools. These proposals would generally result in a dollar-for-dollar reduction in the state funding guarantee, but would not reduce the amount of funds actually available to the schools. This relationship holds as long as the amount of the property tax transfer is less than approximately $2 billion. At this point, the state's funding obligation would be based on the Test 1 formula, because it would produce a higher state funding obligation than would the Test 2 formula used up to that point.

Kindergarten Age Change. The administration has proposed a change in the age requirement for the entry of children into kindergarten. This proposal would reduce the number of children admitted to kindergarten, and thereby reduce the level of aver-

Figure 3

State Budget Impact of Current Proposition 98-Related Proposals

(in millions)	1992-93 General Fund Savings
Property Tax Proposals	
■ Recapture "AB 8" property tax transfer (SB 1364)	$1,141
■ Recapture "AB 8" property tax transfer (Republican leadership proposal)	1,000
■ Shift enterprise special district taxes	250
■ Recapture increased VLF revenues (SB 1364)	100
■ Shift redevelopment funding	25
Other	
■ Kindergarten age change	up to 538

age daily attendance used in the Proposition 98 calculations. We estimate that this change could lower the minimum funding guarantee—and the total amount of funds available to schools—by up to $538 million for 1992-93.

Implications of Other Potential Budget Actions

In this section, we consider the implications of other potential budget actions that have not surfaced as budget proposals.

Suspension of the Guarantee. The State Constitution provides that the minimum funding guarantee may be suspended in any year by passage of a statute other than the budget bill authorizing the suspension. This statute must be passed by a two-thirds vote of the Legislature. Once the guarantee is suspended, the Legislature could authorize any level of funding for the schools. However, as in the case where the guarantee is determined pursuant to Test 3, the state would be obligated to restore school funding in subsequent years through maintenance factor payments.

Underfund the Guarantee. It has been suggested that the Legislature can achieve 1992-93 savings by simply appropriating a lower amount of funds than is called for by the minimum funding guarantee. The lower level of appropriations would control the amount of funds actually expended in 1992-93. In this regard it should be noted that Proposition 98 specifies that the amount of funds actually provided must be reconciled against the final guarantee calculation once the fiscal year is over, and any shortage must then be provided to school districts by the state. As a result, such an action would merely defer 1992-93 state costs until 1993-94, resulting in no net savings over the two-year period.

Conclusion

The Legislature and the Governor face an enormous task in resolving the state's present budgetary crisis. The primary option for reducing K-14 expenditures to assist in the resolution of this crisis is no longer available. This brief demonstrates that other options generally fail to provide savings of comparable magnitude or merely substitute local government funds for state funds while leaving overall school funding intact. The only option remaining to make a significant reduction in the funds available to school districts is the suspension of the Proposition 98 guarantee. Given the magnitude of the crisis, the Legislature and the Governor must consider all available options and all recipients of state funds in their efforts to enact a balanced budget for 1992-93.

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