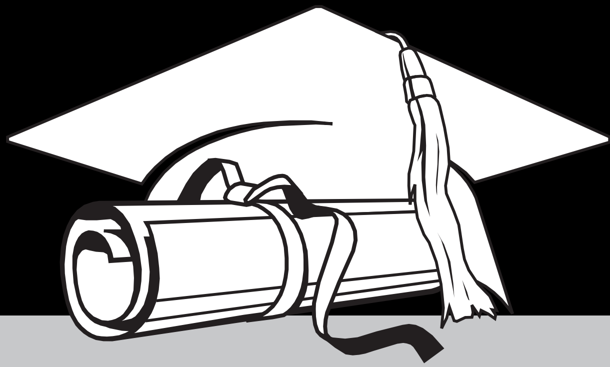
EDUCATION



LAO

60 YEARS OF SERVICE

2004-05 Analysis

MAJOR ISSUES

Education

Proposition 98—Governor Proposes $2 Billion Suspension

- The budget proposal suspends the Proposition 98 minimum guarantee by $2 billion in 2004-05. It also spends below the minimum guarantee in 2002-03 and 2003-04 by a combined $966 million, but does not suspend for these years, thereby creating a "settle-up" obligation.
- We recommend the Legislature (1) suspend the minimum guarantee for 2002-03 through 2004-05, and (2) balance funding for K-14 education with other General Fund priorities without regard to the exact suspension level proposed by the Governor (see page E-13).

Education Credit Card Balance Continues to Grow

- We estimate that the state would end 2004-05 with a $3.8 billion debt to K-14 education under the Governor's proposal. The outstanding balance increases by over $300 million because the Governor defers the 2004-05 costs of state reimbursable mandates, and does not reduce other deferrals or deficit factors (see page E-20).

K-12 Categorical Reform Headed in Right Direction

- The Governor proposes to consolidate $2 billion in funding for 22 existing categorical programs into revenue limits to provide schools and districts with greater funding flexibility. We recommend the Legislature transfer 17 programs into revenue limits, including 14 proposed by the Governor, plus two class size reduction programs and deferred maintenance. We propose redirecting the remaining programs in the Governor's proposal into a professional development block grant, or a restructured Economic Impact Aid program (see page E-). We also propose a separate block grant for school safety programs (see page E-37)

☑ Higher Education Access Can Be Maintained

- The Governor proposes various budget and policy changes that achieve General Fund savings but which could unreasonably restrict student access to higher education. We recommend ways the Legislature could achieve a similar level of savings while maintaining student access.

- Whereas the Governor proposes to eliminate General Fund support for outreach programs at the University of California (UC) and the California State University (CSU), we propose a new College Preparation Block Grant for K-12 schools to contract for outreach services (see page E-160).

- Although the Governor proposes no new funding for enrollment growth at UC and CSU, we find that both universities have unused enrollment funding in their base budgets that would permit them to enroll more students in 2004-05 than in the current year (see page E-182).

- The Governor proposes a variety of fee increases at all three public segments. While we believe most of these increases are reasonable, we recommend slightly smaller increases for several fees. We also recommend establishing a long-term fee policy that links student fees to a fixed percentage of educational costs (see page E-197).

- The Governor proposes significant new restrictions and reductions for the Cal Grant program. We recommend the Legislature reject these proposals and link grant levels with fee levels. We also offer an alternative way to achieve comparable General Fund savings (see page E-214).

Table of Contents

Education

OVERVIEW

Education

The Governor's budget includes a total of $56.4 billion in operational funding from state, local, and federal sources for K-12 schools for 2004-05. This is an increase of $1.2 billion, or 2.2 percent, from estimated appropriations in the current year. The budget suspends the Proposition 98 minimum guarantee by $2 billion, providing less funding for K-14 education than otherwise would be required. The budget also includes a total of $32.2 billion in state, local, and federal sources for higher education. This is an increase of $803 million, or 2.6 percent, from 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 $88 billion in 2004-05 from all sources (not including capital outlay-related spending).

Figure 1

K-12 and Higher Education Funding

2002-03 Through 2004-05
(Dollars in Millions)

	Actual 2002-03	Estimated 2003-04	Proposed 2004-05	Change From 2003-04 Amount	Change From 2003-04 Percent
K-12[a]	$53,026.1	$55,193.7	$56,393.4	$1,199.7	2.2%
Higher education[b]	30,519.7	31,414.4	32,217.4	803.0	2.6
Totals	**$83,545.0**	**$86,608.1**	**$88,610.8**	**$2,002.7**	**2.3%**

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 2004-05 represents $6,941 per student, as measured by average daily attendance (ADA). Proposed spending from all funding sources (excluding state capital outlay and debt service) totals about $9,338 per ADA.

The Proposition 98 budget request for California Community Colleges (CCC) represents about $4,100 per full-time equivalent (FTE) student. When all state and local sources (including student fees) are included, CCC will receive about $4,550 for each FTE student. This compares to proposed total funding (state funds and student fees) of $19,880 for each FTE student at the University of California (UC), and $10,500 for each FTE student at the California State University (CSU).

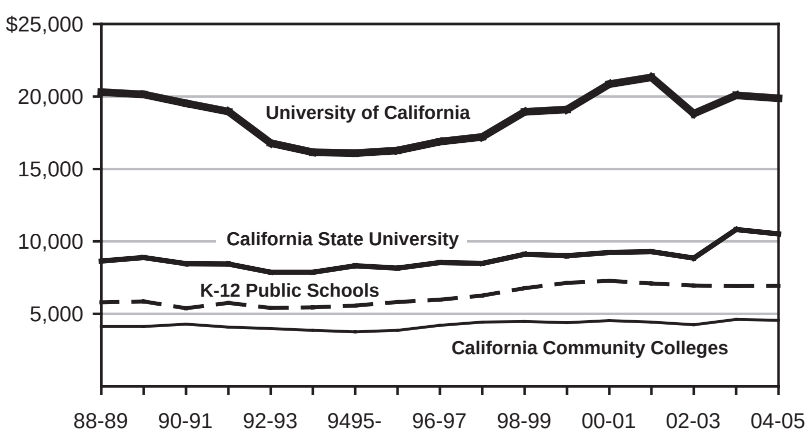
Historical Perspective on Funding Per Student

To place funding for K-12 and higher education in a historical perspective, we have compared state and local funding per FTE student in the four public segments from 1988-89 through 2004-05, adjusting for the effects of inflation over this period (see Figure 2). As the figure shows, per-student funding for K-12 schools remains near the high point for the period. Per-student funding for higher education has recently declined somewhat due to the state's fiscal problems.

Figure 2

Funding for K-12 and Higher Education Per Student 1988-89 Through 2004-05

Constant 2004 Dollars



[a] K-12 data include state and local funding. Higher education data include state and local funding, including student fees.

PROPOSITION 98

California voters enacted Proposition 98 in 1988 as an amendment to the State Constitution. This measure, 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 70 percent of total K-12 funding and about two-thirds of total CCC 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 $46.7 billion for Proposition 98 in 2004-05, which is $2 billion less than if the Governor had not suspended the minimum guarantee. The General Fund costs of Proposition 98 fall $444 million from the current-year level. The budget also proposes to provide less than the minimum guarantee in 2002-03 and 2003-04 by a combined $966 million, deferring these settle-up costs until at least 2006-07. Proposition 98 funding issues are discussed in more detail in the "Proposition 98 Budget Priorities" section of this chapter.

ENROLLMENT FUNDING

The Governor's budget makes changes to enrollment funding levels for K-12 and higher education. The budget funds a 1 percent increase in K-12 enrollment, which 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 funded for 3 percent growth in 2004-05, which is somewhat higher than the rate of expected population growth. This is because the Governor's budget anticipates that 10 percent of UC and CSU's freshman enrollment would be diverted to CCC through a new program. Consistent with legislative intent expressed in the 2003-04 budget package, the Governor's budget includes no new funding for enrollment growth at UC and CSU. However, as we discuss later, UC and CSU have unused base enrollment funding they could use to admit more students in 2004-05.

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 34.7 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 34.7 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 they 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.

Other Major Funding Provisions

Suspension

Through urgency legislation other than the budget bill, the Legislature may suspend the minimum guarantee, providing K-14 education any funding level consistent with Legislative priorities. The difference between the guaranteed amount and the level provided is added to the "maintenance factor," discussed below.

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. A portion of the maintenance factor is required to be restored in years the General Fund grows faster than personal income.

Figure 4

Governor's Proposed Proposition 98 Funding

(Dollars in Millions)

	2003-04			Change From 2003-04 Revised	
	Budget Act	Mid-Year Revised[a]	2004-05 Proposed	Amount	Percent
K-12 Proposition 98					
State General Fund	$27,646	$27,845	$27,233	-$612	-2.2%
Local property tax revenue	13,609	13,664	14,709	1,046	7.7
Subtotals[b]	($41,255)	($41,509)	($41,942)	($433)	(1.0%)
CCC Proposition 98					
State General Fund	$2,244	$2,244	$2,414	$170	7.6%
Local property tax revenue	2,121	2,115	2,264	150	7.1
Subtotals[b]	($4,365)	($4,359)	($4,679)	($320)	(7.3%)
Total Proposition 98[c]					
State General Fund	$29,983	$30,184	$29,740	-$444	-1.5%
Local property tax revenue	15,730	15,779	16,974	1,195	7.6
Totals[c]	**$45,713**	**$45,963**	**$46,714**	**$751**	**1.6%**

a These dollar amounts reflect appropriations made to date, or proposed by the Governor in the current year. In order to meet the minimum guarantee in 2002-03 and 2003-04, the Legislature would need to appropriate an additional $518 million and $448 million, respectively.

b Subtotals may not add due to rounding.

c Total Proposition 98 also includes between $93 million and $95 million in funding that goes to other state agencies for educational purposes.

Setting Education Priorities for 2004-05

In this chapter, we evaluate the proposed budget for K-12 and higher education, including proposed funding increases and reductions, proposed consolidations and realignments, fund shifts and fee increases, and projected enrollment levels. The difficult fiscal environment that the state faces in 2004-05 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 significant budgetary savings.

K-12 Priorities. The overriding issue for the Legislature in crafting the 2004-05 budget for K-12 education and CCC (both funded largely through Proposition 98 funds) is whether to suspend the Proposition 98 minimum guarantee, and if so, by what amount. How the Legislature addresses these proposals will shape K-14 budgets for several years. The proposed suspension allows the Legislature the flexibility to trade off Proposition 98 and non-Proposition 98 priorities. We recommend the Legislature approve a Proposition 98 suspension, and determine the appropriate Proposition 98 funding level by balancing K-14 programs and other budget priorities. We raise concerns with the level of deferrals and the growing balance on the education "credit card," which will require the state to provide an additional $3.8 billion to schools and community colleges in the future. The Governor proposes transferring $2 billion in categorical program funding into revenue limits (general purpose spending) to provide districts greater flexibility in exchange for greater local accountability. We are generally supportive of the concept, but suggest some significant modifications to the proposal.

Higher Education Priorities. In higher education, the Governor proposes to achieve General Fund savings by raising student fees at all three segments, by making various programmatic reductions at UC and CSU, and by modifying certain financial aid policies. We believe that the combined effect of several of the Governor's proposals would unnecessarily reduce access to higher education. Most notably, we are concerned that the Governor seeks to impose new limitations on critical financial aid programs at the same time that he proposes substantial fee increases for students at all three segments.

In the "Intersegmental" sections of this chapter, we offer alternative budget approaches in the areas of K-14 outreach, enrollment funding, student fees, and financial aid. While our recommendations would achieve a level of General Fund savings that is similar to the Governor's, we believe our proposal would better preserve student access to higher education.

CROSSCUTTING ISSUES

Education

PROPOSITION 98 BUDGET PRIORITIES

The Governor's budget offers a good starting point for addressing the 2004-05 budget problem. Given the structural budget situation the state faces, we believe the Governor's proposed suspension of the Proposition 98 minimum guarantee is appropriate. If suspension is approved, we recommend the Legislature balance K-14 funding priorities with other General Fund priorities without regard to the exact Proposition 98 funding level proposed in the Governor's budget.

The Governor's budget proposal (1) suspends the Proposition 98 minimum guarantee by $2 billion in 2004-05 and (2) spends below the minimum guarantee in 2002-03 and 2003-04 by a combined $966 million. Thus, the overriding issue for the Legislature in crafting the 2004-05 budget for K-12 education and the community colleges (both funded largely through Proposition 98 funds) is whether to approve the proposed suspension. If suspended, the Legislature then could set the funding level for K-12 education and the community colleges at whatever level it felt appropriate. How the Legislature addresses these two issues of suspension and the K-14 funding level will shape K-14 budgets for the next several years.

Within the budget's proposed Proposition 98 funding level of $46.7 billion, there are sufficient resources available to fully fund enrollment growth, cost-of-living adjustments (COLAs), and some program expansions and restorations. The Governor's budget generally funds these priorities, including statutory COLAs, but does not provide a COLA for the community colleges and some K-12 categorical programs. The budget also provides school districts and community college districts greater fiscal and programmatic flexibility by transferring $2.4 billion in categorical funding into revenue limits and community college apportionments. However, the budget continues to rely on funding deferrals—increasing future K-14 obligations to almost $3.8 billion. Below, we discuss the Governor's approach to the 2004-05 budget, addressing: (1) overarching Proposition 98 issues, including Proposition 98 suspension, certification, and K-14 deferrals; (2) K-12 issues, including categorical flexibility and LAO proposed spending reductions; and (3) major California Community Colleges (CCC) budget issues, including enrollment growth, equalization, and categorical reform.

GOVERNOR'S SUSPENSION PROPOSAL REASONABLE

Given the size of the structural deficit and Proposition 98's share of General Fund expenditures (roughly 40 percent), it would be very difficult to close the budget gap without suspending Proposition 98. The following two examples explain the difficulty of balancing the budget *without* suspending the minimum guarantee:

- ***Additional Non-Proposition 98 Reductions.*** On the one hand, the Legislature would need to make an additional $2 billion in reductions in non-Proposition 98 programs (health, social services, higher education, and corrections), which would be difficult on top of the Governor's proposed reductions in those program areas.
- ***Additional General Fund Tax Revenues.*** Alternatively, if the Legislature were to increase tax revenues, much of the new revenue would need to go to Proposition 98. If, for example, the Legislature increased General Fund revenues by $5 billion, $4 billion of the increase would need to be appropriated for Proposition 98 (absent suspension). This is because the higher General Fund revenues would significantly increase the minimum guarantee level.

As noted above, even with suspension, the Governor's proposed Proposition 98 funding level provides sufficient resources to fully fund growth, COLA, and some additional expansions and program restorations. Accordingly, we recommend the Legislature suspend the minimum guarantee for 2004-05.

The Governor proposes suspending the minimum guarantee by $2 billion from the 2004-05 minimum guarantee level. If at the May Revision, the minimum guarantee is higher or lower, the Governor's proposal would adjust the proposed K-14 appropriation level to keep the suspension amount at $2 billion. If the Legislature chooses to suspend, we recommend the Legislature determine the appropriate level of K-14 funding by balancing K-14 priorities with its other General Fund priorities—without regard to the dollar amount of the suspension. In other words, the Legislature should just spend at the Proposition 98 level it deems appropriate.

If the Legislature were to suspend Proposition 98 and fund K-14 education below the guaranteed level in 2004-05, this would create real General Fund savings (relative to the guarantee). In some future fiscal year the state would be required to fund K-14 education at the same level that would have been required in that year if suspension had never occurred. But our analysis suggests that this level of spending will not be required for several years, and in the meantime the state would realize General Fund savings each year by spending below this "long-term" guaranteed level. We discuss this scenario below.

How a Proposition 98 Suspension Would Work

Over the long run, the Proposition 98 minimum guarantee is determined by the growth in K-12 attendance and growth in per capita personal income (commonly known as the Test 2 factor). The Constitution allows the Legislature to appropriate funding for K-14 education below this "long-term Test 2 level" under two circumstances: (1) the Legislature suspends the requirements of Proposition 98 or (2) per capita General Fund revenues (commonly known as the Test 3 factor) grow more slowly than per capita personal income.

In either of these circumstances, the Constitution requires the state to provide accelerated growth in Proposition 98 funding in future years until the state has "restored" funding to the long-term Test 2 level. During this restoration period, the state calculates the difference between the actual level of spending and the long-term Test 2 level of spending. This difference is referred to as the "maintenance factor" and it is restored in one of two ways:

- When General Fund revenues grow faster than personal income, the state must reduce the maintenance factor by providing additional growth funding for Proposition 98.
- The Legislature can opt to provide funding above the minimum guarantee ("overappropriate")—restoring the maintenance factor faster than required under law.

When the maintenance factor is fully restored, K-14 spending is returned to the long-term Test 2 level. However, the state is *never* required to "pay back" the earlier savings achieved in the years when Proposition 98 funding was below its long-term Test 2 level. These savings therefore are not "loans" from prior years, but actual savings. The Department of Finance estimates that absent suspension, the state would end the 2004-05 fiscal year with a $2 billion maintenance factor (resulting from recent Test 3 years). The proposed suspension would create an additional maintenance factor of $2 billion, resulting in a year-end maintenance factor obligation of $4 billion.

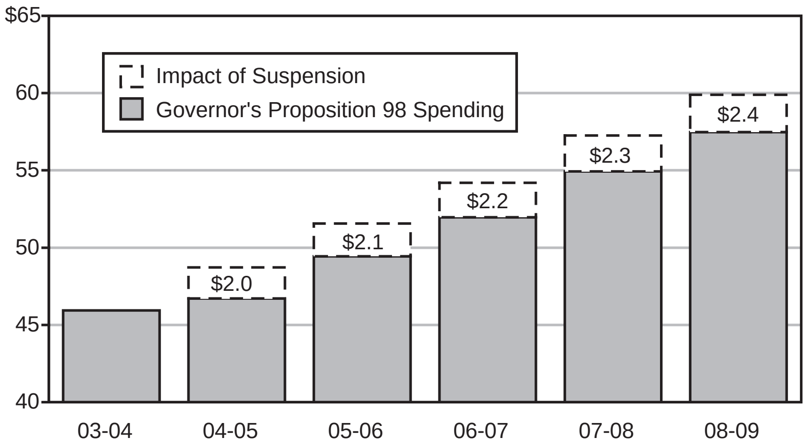
Governor's Proposal Would Save at Least $2 Billion Annually for Several Years

Figure 1 shows our estimate of the annual savings to the state from the Governor's proposed suspension. The figure shows that the $2 billion of savings in 2004-05 actually grows to $2.4 billion by 2008-09. The fiscal impact of the 2004-05 suspension grows by roughly $100 million annually (to $2.1 billion in 2005-06 and so forth). In other words, the savings grow with the annual growth in the minimum guarantee. We explain in detail below why the additional maintenance factor resulting from the Governor's proposed suspension does not decline over the forecast period.

Figure 1

Impact of Governor's Suspension Proposal on Future Proposition 98 Spending[a]

(In Billions)



[a] Based on LAO revenues and assuming the state appropriates funds at the minimum guarantee in out years.

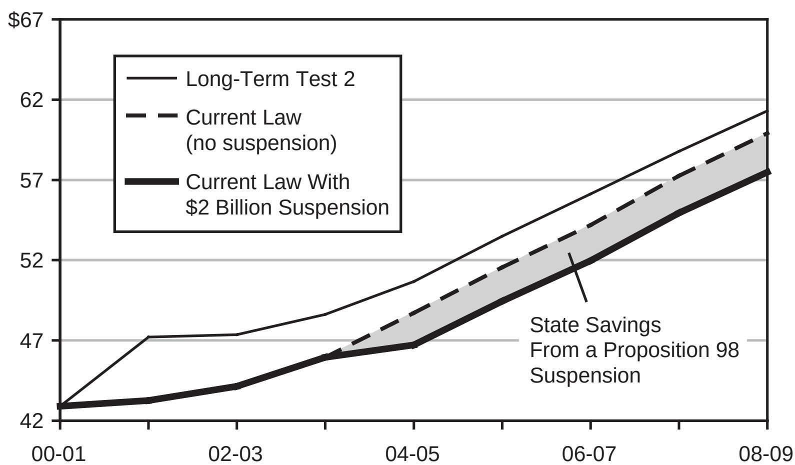
Current Maintenance Factor in Effect Paid Off First. Figure 2 shows the impact that a $2 billion suspension would have on widening the gap (maintenance factor) between the required minimum guarantee and the long-term Test 2 level. Under current law but absent suspension, the state would slowly close the gap between the Proposition 98 funding level and the long-term Test 2 level over the forecast period. (We estimate this maintenance factor payoff at over $200 million annually on average.) Lowering the 2004-05 spending level by $2 billion through suspension widens the gap from the long-term Test 2 level. The shaded area between current law absent suspension and current law with a $2 billion suspension represents the savings to the state from the Governor's proposal.

Since the state does not pay off its preexisting maintenance factor over the period shown, the maintenance factor created by suspension ($2 billion) generates savings of that magnitude each year. (As noted above, it actually grows slightly because of growth in ADA and per capita income.) When the state fully restores all maintenance factor and returns to the long-term Test 2 level (which based on our forecast would be after the period shown in Figure 2), the savings to the state from the $2 billion suspension would end. However, in the interim, the state would generate annual savings from the Governor's proposed suspension.

Figure 2

Impact of Suspension On Proposition 98 Funding Over Time[a]

(In Billions)



[a]LAO Estimates.

What Would It Take to Restore the Entire Maintenance Factor? Based on past experience, sudden turnarounds in General Fund revenues can require rapid restorations of maintenance factor. Under our forecast, General Fund revenues would grow from $75.9 billion in 2004-05 to $95.1 billion in 2008-09, or 5.8 percent, annually on average. In order to fully restore the maintenance factor by 2008-09, we estimate that, other things held constant, revenues would need to grow to about $103 billion, or almost 8 percent annually.

Legislature Can Eliminate Prior- and Current-Year Proposition 98 Obligations Through Suspension

We recommend the Legislature suspend the minimum guarantee in 2002-03 and 2003-04 to eliminate $966 million in Proposition 98 "settle-up" obligations the Governor proposes to postpone until at least 2006-07.

For 2002-03 and 2003-04, the Governor proposes to fund Proposition 98 below the existing minimum guarantee, but does not propose suspension in these years. Thus, for these years, the state would need at some future time to appropriate additional resources to "settle up" to the minimum guarantee. However, the State Constitution does not specify a timeline by which the state must accomplish this. Under the Governor's proposal, the state would not begin paying the settle-up obligation of $966 million until 2006-07. This effectively creates a $966 million loan from Proposition 98 to the General Fund until that time. While this would help the state's balance sheet in the short run, the "tab" would have to be paid starting in 2006-07. Given that the budget does not fully address the state's structural problem (see "Part I" of the *2004-05 Perspectives and Issues*), the loan would add to the state's problem when the settle-up payments were made in 2006-07.

For similar reasons that we recommend suspending the minimum guarantee for 2004-05, we recommend the Legislature suspend the minimum guarantee for 2002-03 and 2003-04, thereby eliminating the $966 million out-year obligation. If the state does not suspend the minimum guarantee for 2002-03 and 2003-04, the state will be obligated to pay off the $966 million in the near term regardless of the state's fiscal situation at the time.

Proposition 98 Certification Process in Need of Reform

We recommend the Legislature (1) "close the books" (certify) the Proposition 98 funding level for fiscal years 1995-96 through 2001-02 and (2) certify the 1995-96 and 1996-97 funding level at the existing appropriation level—eliminating a potential obligation of $251 million.

Current law requires the State Department of Education (SDE), CCC, and the Department of Finance (DOF) to jointly certify the Proposition 98 calculation—including the formula inputs (ADA, per capita General Fund revenues, per capita personal income) and the overall Proposition 98 appropriation level within nine months of the end of a fiscal year. However, these parties have ignored the statutory requirement for a number of years. The last time that the calculation was certified was when the Legislature certified fiscal years 1990-91 through 1994-95 as part of the implementing legislation for the settlement of the *California Teachers Association v. Gould* lawsuit. So, technically changes to any of the Proposition 98 calculation inputs could lead to a change in the minimum guarantee for any year after 1994-95.

Lack of Proposition 98 Certification Only Leads to Increases in State Costs. The practical implication of these unreasonably long delays in certification is that the state's Proposition 98 obligation could increase unexpectedly in any future year due to a change applied retroactively to some fiscal year in the distant past. Just such an obligation has been identified for fiscal years 1995-96 and 1996-97. Data from the 2000 census adjusted the state's estimate of state population for the late 1990s, slightly lowering the prior estimates. This adjustment results in higher per capita General Fund revenues, which in turn increases the Proposition 98 guarantee. If the Proposition 98 calculation were adjusted to reflect this revision, the state would owe schools and community colleges an additional $251 million ($85 million for 1995-96 and $166 million for 1996-97) settle-up obligation. If, on the other hand, adjustments to the inputs had resulted in a lower Proposition 98 minimum guarantee, the state could not ask the schools to return funding for those prior years. Thus, by allowing fiscal years to remain uncertified, the three agencies put the state at risk of increased funding obligations. Moreover, any additional funding applied to the distant past would represent a windfall provided to schools without any associated oversight or accountability.

Close the Books. We believe that the intention of the Legislature is clear. The SDE, CCC, and DOF should work collaboratively to certify the Proposition 98 guarantee within a reasonable time period after the close of a fiscal year. At the end of this period, they should "lock in" the Proposition 98 funding level for a specific year. Because of the fiscal risk to the state, we recommend the Legislature adopt trailer bill language to certify the Proposition 98 calculations for 1995-96 through 2001-02. As part of that certification, we recommend the Legislature certify the Proposition 98 calculation based on the state's population estimates available in the late 1990s and used to determine the state's minimum guarantee for 1995-96 and 1996-97. By certifying now (using the most accurate estimates that were available in the late 1990s), the Legislature would eliminate a potential out-year liability of $251 million.

Develop a More Definitive Certification Process. Because of the potential state liabilities that can arise from not certifying the Proposition 98 calculation in a timely fashion, we recommend the Legislature work with the administration to develop a more definitive statutory certification process. We believe it would be ideal if the state certified a given fiscal year's Proposition 98 level prior to the start of the second following fiscal year. For example, the 2002-03 Proposition 98 amount would be known and certified prior to the start of 2004-05. This would limit uncertainty over unanticipated changes in the Proposition 98 spending level to developments which occurred in 2003-04. We acknowledge that even after the end of a fiscal year, estimates of population, attendance, and General Fund revenues can change. But the Legislature needs to balance the marginal improvement in accuracy provided by these adjustments with the uncertainty caused by leaving fiscal years open.

CREDIT CARD BALANCE HIGH AND GROWING

Starting in 2001-02, the Legislature opted to defer significant education program costs to the subsequent fiscal year rather than make additional spending cuts. Under the Governor's proposal, the recent trend of increasing future state obligations to fund current or prior costs continues. The result has been a steadily growing balance on the state's education "credit card." Figure 3 shows the year-end spending obligations that the state has agreed to pay in the future. There are two distinct portions of the education credit card balance—(1) deferrals requiring one-time payments by the state and (2) revenue limit "deficit factor" which requires ongoing payments. Combined, the credit card balance would grow from $3.5 billion in 2003-04 to $3.8 billion in 2004-05 under the Governor's budget, an increase of $321 million. Most of the increase in the credit card balance results from lack of funding for state-reimbursable mandates in the budget. We estimate that the annual costs of K-14 mandates in 2004-05 will exceed $300 million. Given the large and growing backlog of mandate claims, the mandate deferral presents special problems for the state. By the end of 2004-05, the state is likely to have a total of almost $1.6 billion in outstanding Proposition 98 mandate liabilities. We provide several mandate reform proposals to reduce out-year costs later in this chapter and in the *2004-05 Budget: Perspectives and Issues.*

Figure 3

Update on the Education Credit Card

Year-End Balances (In Millions)

	2001-02	2002-03	2003-04	2004-05
One-Time Costs				
Revenue limit and categorical deferrals	$931.3	$2,158.1	$1,096.6	$1,071.3
Community college deferrals	115.6	—	200.0	200.0
Cumulative mandate deferrals	655.6	958.1	1,266.2	1,583.1
Ongoing Costs				
Revenue limit deficit factor	—	—	$883.3	$912.5
Totals	**$1,702.5**	**$3,116.2**	**$3,446.1**	**$3,766.9**

A major component of the 2003-04 Proposition 98 budget solution was a 1.2 percent reduction in revenue limits, and a foregone 1.8 percent COLA. Combined, these reductions saved the state almost $900 million. However, the Legislature created an obligation to restore the reduction—referred to as the "deficit factor"—by 2005-06 at the latest. It also adopted trailer bill language stating that the first priority for increases in Proposition 98 funding is to restore these revenue limit reductions.

The cumulative impact of all these deferrals and out-year obligations 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.

Establish Deferral Repayment Plan. We recommend the Legislature begin gradually paying off deferrals and develop a repayment plan to eventually restore all deferred funds. We note that since school districts and community colleges have already spent the funding to meet the program obligations of the deferred programs, any funding provided to reduce deferrals is effectively general purpose in nature at the local level. In the budget and future years, we recommend the Legislature make it a priority to repay deferrals before making expenditure increases or funding new programs. Below, we identify almost $400 million in K-14 savings recommendations. We suggest that if the Legislature decides to appropriate at the Governor's proposed Proposition 98 funding level, the freed up funds be used to reduce the credit card debt.

OTHER ISSUES

LAO Recommended Reductions

Throughout this chapter, we recommend more than $400 million in Proposition 98 funding reductions that the Legislature could use to reduce the balance on the education credit card or redirect to other General Fund priorities. Figure 4 summarizes these reductions. Redirecting identified savings to pay off K-14 debts would keep the credit card from growing above its 2003-04 level. Most of these reductions are discussed in detail later in the chapter. Two that are not are discussed below:

- ***Current-Year K-3 Class Size Reduction Participation Rate Falls (Reduce $50 Million).*** Several school districts have stopped or reduced participation in K-3 class size reduction (CSR) in the current year because of lack of local funding to fully fund the cost of the program. As a result, early data collected by SDE suggest the state may save as much as $100 million in the current year. Given that more accurate data will not be available until June, we suggest the Legislature plan conservatively and redirect only half of the potential savings to other K-14 priorities. The declining participation reemphasizes the need for reform of the enrollment caps for K-3 CSR, which we recommended in the *Analysis of the 2003-04 Budget Bill.*
- ***State Will Receive Higher Federal Funds for Special Education ($33 Million).*** In the recently adopted federal budget, California will receive additional federal funds. The state can use $33 million of the increase to cover the costs of special education growth and COLA in 2004-05 and still meet the federal maintenance-of-effort requirement.

Increase K-12 Local Fiscal and Program Flexibility

The Governor proposes to consolidate $2 billion in funding for 22 existing categorical programs into revenue limits. With this change, districts would have complete discretion over the use of these funds. The proposal would balance this new flexibility by requiring a district plan that is intended to increase local accountability for district spending decisions. In addition, the budget proposes to provide additional flexibility for five small school safety competitive grant programs.

We believe these proposals take a significant step toward the goal of establishing a streamlined system of categorical programs. In particular, consolidating categorical funds into revenue limits results in several benefits, including greater fiscal and program flexibility, savings in state and

Figure 4

LAO Proposition 98 Savings Recommendations

(In Millions)

Program	Amount
Instructional materials	$113
K-12 equalization	110
CCC equalization	80
Current-year K-3 class size reduction	50
Internet access	21
Special education federal fund offset	33
Basic aid categorical reduction	10
Title VI federal fund offset	8
School safety reversion	2
Fully fund school safety mandates	-30
Total	**$396**

local administrative costs, and more local focus on outcomes rather than program rules.

In our analysis of the administration's reform proposal, we provide the Legislature with criteria to use when determining which categorical programs are good candidates to move into revenue limits. We focus on whether local incentives might cause a school district to underinvest in specific activities. Based on our assessment of local incentives, we recommend several modifications to the list of programs included in the revenue limit shift. Most significantly, we recommend the Legislature move only 17 categorical programs into revenue limits. We recommend the Legislature exclude from the shift both staff development programs and programs that support services for special-needs students because we are concerned that local incentives are likely to lead districts to underinvest in these two areas. Instead, we recommend (1) creating a teacher quality block grant from ten existing categorical programs and (2) restructuring Economic Impact Aid by adding programs serving special needs students.

Of the 17 programs we recommend shifting into revenue limits, three are not ones the administration proposes shifting. Specifically, we recommend shifting K-3 and high school class size reduction, as well as a deferred maintenance. Given the popularity among parents and teachers of smaller classes, we think school boards would have to make a convincing case that alternative uses of class-size reduction funds would lead to better outcomes for students. For deferred maintenance, recent state bond acts improve local incentives for providing adequate maintenance by requiring a minimum level of spending by participating districts. Because of the new bond act requirements, the deferred maintenance program does little to further increase local maintenance spending. By consolidating this program into revenue limits, the Legislature would clarify that long-term facility maintenance is the responsibility of school boards, not the state.

We also suggest modifying the budget's school safety program proposal. Specifically, we recommend creating a block grant that would contain funding from all existing categorical and state-mandated local programs in this area. This would give districts greater flexibility over the use of funds and reduce the state and local administrative burden of existing categorical programs and mandates.

CCC Spared From Higher Education Reductions

While the Governor's budget makes a variety of programmatic reductions to the University of California (UC) and the California State University (CSU)—including reductions in freshman enrollment funding, the elimination of outreach programs, increases in student-faculty ratios, and cuts in general administrative funding—CCC receives almost no programmatic reductions. Instead, CCC would receive an augmentation of about $121 million for a 3 percent increase in enrollment, and $80 million to fund equalization. The budget, on the other hand, does not provide a COLA. Total funding for CCC (including General Fund, local property taxes, student fees, and federal and other funds) would increase by $507 million, or 8 percent, from the current year.

Deferral Affects Proposition 98 Funding. The 2003-04 budget package allows CCC to defer $200 million in costs from June to July 2004. This deferral of current-year costs to the budget year creates Proposition 98 savings in the current year without affecting CCC's *programmatic* support. By reducing CCC's Proposition 98 appropriations in the current year, however, the deferral distorts traditional measures of CCC's "share" of Proposition 98 resources. It also distorts measures of year-to-year change in CCC's level of support. Adjusting for the deferral (that is, counting the $200 million towards CCC's 2003-04 budget) provides a more meaningful measure of how CCC's funding will increase under the Governor's proposal. With this adjustment, CCC's total funding would increase by $307 million, or 4.7 percent. This includes an adjusted Proposition 98 increase of $120 million, or 2.6 percent. Other significant new funding comes from a proposed fee increase ($91 million) and non-Proposition 98 General Fund support ($96 million).

Funding for 35,000 Additional Students. The proposed budget would provide $121 million for 3 percent growth in general apportionments, plus an additional $4 million for growth in noncredit instruction. The combined $125 million would fund about 35,000 additional full-time equivalent students, or 3.2 percent more than in the current year. This is significantly higher than the 1.8 percent growth rate called for by statutory guidelines. The budget recognizes the additional enrollment demand that will likely be diverted from UC and CSU because of a proposal to reduce the number of first time freshman at those segments. While we believe the 3 percent growth in general apportionments is reasonable, we are concerned that the $4 million in special growth funding for noncredit instruction deviates from longstanding practice and would hinder the efficient allocation of growth funding.

Equalization Proposal Deserves Broader Consideration and Longer Review. The Governor proposes $80 million to help equalize per-student funding among CCC districts. While we support the goal of equalization, we believe that the state's fiscal situation requires that funding for new programs instead be directed to existing obligations. We nevertheless recommend the Legislature move forward in adopting an equalization plan that reflects its priorities, in order to expedite equalization efforts when funding is more readily available.

Categorical Reform Proposal Falls Short. The Governor proposes a "categorical reform" of funding for some CCC programs. While we agree that the categorical funding of CCC programs is in need of reform, we are concerned that the Governor's proposal lacks adequate accountability measures. In addition, we think that a substantial part of the Governor's proposal would have no meaningful effect on how community colleges are funded.

Additional Budget Options Provided in Perspectives and Issues

As discussed above, we believe that suspending the Proposition 98 minimum guarantee makes sense given the overall budget picture. If the Legislature chooses to suspend the minimum guarantee, we suggest that the Legislature balance its priorities between Proposition 98 funding and other General Fund spending independent of the minimum guarantee requirements. In order to assist the Legislature in the 2004-05 budget deliberations, we provide a list of additional Proposition 98 cut options in "Part V" of the *2004-05 Budget: Perspective and Issues.*

INTRODUCTION

K-12 Education

The budget proposes to suspend the Proposition 98 minimum guarantee, providing $2 billion less than would be required absent suspension. The budget also proposes to postpone until at least 2006-07 payments of $518 million and $448 million needed to meet the minimum guarantee for 2002-03 and 2003-04, respectively. Taking into account both the growth in the guarantee and monies freed up from paying off deferrals in the current year, there are adequate funds to cover growth in student attendance, cost-of-living adjustments, and other purposes. Adjusting funding for deferrals funding, schools would receive $6,941 per pupil, or 2.6 percent more than the revised estimate of per-pupil expenditures in the current year.

Overview of K-12 Education Spending

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 70 percent of overall K-12 funding. The increase in K-12 Proposition 98 funding is supported by a forecasted $1 billion increase in local property taxes (LPT), allowing General Fund support for Proposition 98 to actually fall by $612 million. The growth in LPT results from a combination of natural growth in school LPT, a proposal to transfer additional property tax revenues from local government to school districts through the Educational Revenue Augmentation Fund (ERAF), and transfers of ERAF revenues from schools districts to local governments as part of the "triple flip" payment mechanism for the Economic Recovery Bond on the March 2, 2004 ballot.

The budget proposes to increase non-Proposition 98 General Fund spending by almost $1.4 billion in 2004-05. Key changes in non-Proposition 98 General Fund spending include:

- ***Increased Contributions to State Teachers' Retirement System—$497 Million.*** Last year, there was a large balance in a state fund that provides retired teachers with purchasing power protection.

Figure 1

K-12 Education Budget Summary

2002-03 Through 2004-05
(Dollars in Millions)

	Actual 2002-03	Mid-Year Revision 2003-04	Proposed 2004-05	Change From 2003-04 Amount	Change From 2003-04 Percent
K-12 Proposition 98					
State General Fund	$26,106.4	$27,844.9	$27,232.6	-$612.3	-2.2%
Local property tax revenue	12,799.9	13,663.9	14,709.4	1,045.5	7.7
Subtotals, Proposition 98	($38,906.3)	($41,508.8)	($41,942.0)	($433.2)	(1.0%)
Other Funds					
General Fund					
Teacher retirement	$901.4	$469.5	$966.4	$496.9	105.8%
Bond payments	788.7	989.1	1,665.0	675.9	68.3
Other programs	1,003.5	283.6	506.2	222.6	78.5
State lottery funds	806.5	793.4	793.4	—	—
Other state funds	99.1	90.1	85.9	-4.2	-4.7
Federal funds	6,390.7	7,118.8	7,159.5	40.7	0.6
Other local funds	4,918.7	4,929.6	4,940.0	10.4	0.2
Subtotals, other funds	($14,908.5)	($14,674.1)	($16,116.4)	($1,442.3)	(9.8%)
Totals	**$53,814.8**	**$56,182.8**	**$58,058.4**	**$1,875.6**	**3.3%**
K-12 Proposition 98					
Average daily attendance (ADA)	5,905,715	5,978,127	6,039,207	61,080	1.0%
Budgeted amount per ADA	$6,588	$6,943	$6,945	$2	—

Totals may not add due to rounding.

(This program ensures that retirees' pensions stay at 80 percent of their original purchasing power.) In 2003-04, the state determined that it could forego a $500 million payment on a one-time basis, and still honor statutory obligations to teachers. The Governor's budget augments spending for teacher retirement by $497 million in 2004-05 to restore the base funding level.

- ***School Bond Debt Service Increases—$676 Million.*** The budget's increase in debt service on school bonds reflects a combination of (1) the recent investment the state has made in school construction and renovation through Proposition 1A (1998) and Proposition 47 (2002), and (2) the restructuring of the state's long-term debt, which reduced payments the last two years but increases them in 2004-05 and subsequent years.

- ***Proposition 98 Reversion Account and Other Non-Proposition 98 General Fund Increases—$223 Million.*** Non-Proposition 98 General Fund spending increases by $223 million from 2003-04. Most of this results from funds being reappropriated from the Proposition 98 Reversion Account in 2004-05 as a result of K-14 education program savings in 2003-04 and prior years.

Deferrals Distort Year-to-Year Comparisons. The growth pattern of Proposition 98 spending is distorted because numerous expenses have been deferred from one fiscal year to another from 2001-02 through 2004-05. These deferrals make cross-year comparisons difficult. Figure 2 displays the impact that the deferrals have on the growth of per-pupil spending by moving deferred funds into the years in which the expenditures occur. We refer to this deferral-adjusted funding level as "programmatic" funding because this is when programs actually used the money, and suggest the Legislature focus on changes in programmatic funding to gauge the impact that this budget has on actual school spending. Using this calculation, per pupil spending increases by $175, or 2.6 percent, over the 2003-04 revised funding level. In contrast, funding fell between 2002-03 and 2003-04 by $30 per pupil or 0.4 percent.

Figure 2

K-12 Proposition 98 Spending Per Pupil Adjusted for Inter-Year Funding Deferrals

	Actual 2002-03	Revised 2003-04	Proposed 2004-05
Budgeted Funding			
Dollar per average daily attendance (ADA)	$6,588	$6,943	$6,945
Percent growth	—	5.4%	—
Programmatic Funding			
Dollar per ADA	$6,796	$6,766	$6,941
Percent growth	—	-0.4%	2.6%

[a] To adjust for the deferrals, we count funds toward the fiscal year in which school districts programmatically commit the resources. The deferrals mean, however, that the districts technically do not receive the funds until the beginning of the next fiscal year.

Major K-12 Funding Changes

Figure 3 displays the proposed major K-12 funding changes from the *2003-04 Budget Act*. In the current year, the Governor's budget reflects a $261 million increase in revenue limit deferred from June to July 2003. Because revenue limits are continuously appropriated, a technical error in estimating the size of the June revenue limit payment resulted in 2002-03 appropriations being reduced by $261 million and 2003-04 appropriations increasing equivalently.

In 2004-05, the Governor's budget proposes about $1.9 billion in new K-12 expenditures. Funds for these proposals come from three main sources:

- ***Increased Proposition 98 K-12 Spending—$433 Million.*** This is the growth in the total amount of Proposition 98 funding the Governor proposes for K-12 education.
- ***Reduced Deferral Costs—$1 Billion.*** The budget takes advantage of $1 billion in funding freed-up from one-time uses in 2003-04. In 2003-04, the state used over $1 billion to pay off categorical and revenue limit deferrals. These costs were one-time in nature, and can be used for ongoing purposes beginning in 2004-05. The Governor uses these funds for the priorities outlined below.
- ***Fund Shifts and Program Reductions—$469 Million.*** The budget takes advantage of two fund shifts to reduce the Proposition 98 funding obligations for K-12—$146 million in one-time funds in the Proposition 98 Reversion Account (funds appropriated but not spent in prior years), and $74 million in federal funds for special education. In addition, the Governor proposes savings of $249 million from (1) spending reductions in child care programs, (2) savings in the state accountability programs for low-performing schools, and (3) various other program reductions.

The budget proposes to use $1.9 billion from the sources discussed above to provide growth, cost-of-living adjustments (COLAs), and other funding increases (see Figure 3). Of the increases, the budget provides roughly $1.2 billion to increase "revenue limit" funding (available for school districts and county offices of education to spend on general purposes). Specific revenue limit proposals include:

- ***Revenue Limit Growth and COLA—$280 Million and $555 Million.*** The Governor fully funds a 1.02 percent growth in revenue limits ($280 million) and a 1.84 percent COLA ($555 million). The budget proposes to continue the revenue limit "deficit factor" created in 2003-04. Specifically, the 2003-04 budget suspended the 1.8 percent COLA and reduced revenue limits by an addi-

Figure 3

Major K-12 Proposition 98 Changes

(Dollars in Millions)

2003-04 Budget Act	**$41,255**
Additional K-12 apportionment deferred from 2002-03	261
Other changes	-8
Total	**$254**
2003-04 Revised K-12 Spending	**$41,509**
Increases	
Revenue Limits	
Cost-of-living adjustments (COLAs)	$555
Growth	280
Unemployment insurance	136
Equalization	110
Increase Public Employees' Retirement System cost	106
Subtotal	($1,187)
Categorical Programs	
Growth	$89
COLAs	185
Instructional materials	188
Deferred maintenance	173
Other increases	116
Total, Increases	**$1,938**
Decreases	
Net reduction in funds needed to pay deferred costs	-$1,036
Proposition 98 Reversion Account swap	-146
Special education federal fund offset	-74
Combined child care proposals	-69
Immediate Intervention/Underperforming Schools Program	-46
High priority grants	-28
Other decreases	-105
Total, Decreases	**-$1,505**
2004-05 Proposed	**$41,942**
Change, 2004-05 Proposed Over 2003-04 Revised	
Amount	$433
Percent	1%

tional 1.2 percent, but created a deficit factor requiring the state to build the foregone funding back into the base starting in 2005-06. In total, the outstanding deficit factor is around $900 million.

- ***Unemployment Insurance Costs and Public Employees' Retirement System (PERS) Costs—$136 Million and $106 Million.*** Under current law, the state is required to provide funding to school districts to cover cost increases in unemployment insurance and PERS. The unemployment insurance rate increases from 0.3 percent in 2003-04 to 0.7 percent in 2004-05, costing an additional $136 million. School district PERS costs increase because the PERS contribution rate for classified employee salaries increased from 10.4 percent to 12.2 percent.
- ***Equalization—$110 Million.*** The Governor proposes to use $110 million to equalize base revenue limit funding across school districts. According to the Department of Finance (DOF), the equalization funding will be distributed using the current revenue limits (as adjusted for excused absences). Equalization would occur before the transfer of $2 billion in categorical programs into revenue limits under the administration's proposal.

The budget provides growth and COLAs for those categorical programs with statutory requirements. The Governor's proposal excludes growth and COLAs for some categorical programs that have received growth and COLAs in the recent past. For example, programs like home-to-school transportation, year-round schools, gifted and talented education, dropout prevention, and tenth grade counseling will not receive growth or COLAs in 2004-05. The Governor also provides additional categorical funds to fully restore deferred maintenance to one-half of 1 percent of total expenditures ($173 million), and augment instructional materials funding by $188 million.

Proposition 98 Spending by Major Program

Figure 4 shows Proposition 98 spending for major K-12 programs. Revenue limit funding accounts for $30.3 billion. In addition, the Governor proposes to transfer $2 billion in categorical programs into revenue limits. The two largest categorical programs, special education and K-3 class size reduction, would remain separate programs. The budget proposes $2.9 billion for special education including local property tax revenues. The budget provides roughly the same $1.7 billion for K-3 class size reduction, reflecting a slight reduction because of lower K-3 enrollment.

Figure 4

Major K-12 Education Programs Funded by Proposition 98

(Dollars in Millions)

	Revised 2003-04[a]	Proposed 2004-05[a]	Change	
			Amount	Percent
Revenue Limits				
General Fund	$15,777.3	$15,970.6	$193.3	1.2%
Local property tax	13,325.3	14,328.3	1,003.1	7.5
Subtotals	($29,102.3)	($30,298.9)	($1196.4)	(4.1%)
Categorical Programs Transferred to Revenue Limit				
Home-to-school transportation	$519.6	$519.6	—	—
School improvement	387.2	396.1	$8.9	2.3%
Staff development day buyout	229.7	235.7	6.0	2.6
Targeted instructional improvement grants[b]	199.4	205.1	5.7	2.9
Instructional materials[c]	175.0	175.0	—	—
Supplemental grants	161.7	161.7	—	—
Other	328.9	331.1	2.2	0.7
Subtotals	($2,001.5)	($2,024.4)	($22.9)	(1.1%)
Other Categorical Programs				
Special education[d]	$3,018.6	$3,051.5	$32.9	1.1%
K-3 class size reduction	1,659.3	1,651.8	-7.6	-0.5
Child development	1,177.6	1,279.6	102.0	8.7
Adult education	577.8	603.1	25.3	4.4
Targeted instructional improvement grants b	538.2	553.7	15.5	2.9
Economic impact aid	498.7	547.7	49.1	9.8
Regional occupation centers and programs	370.4	391.1	20.7	5.6
Supplemental instruction programs	351.8	362.0	10.1	2.9
Deferred maintenance	77.0	250.3	173.3	225.2
Public School Accountability Act	352.4	249.2	-103.2	-29.3
Instructional materials[c]	—	188.0	188.0	—
Other programs, deferrals, and adjustments	1,782.9	490.7	-1292.2	-72.5
Subtotals	($10,404.7)	($9,618.7)	(-$786.0)	(-7.6%)
Totals	**$41,508.8**	**$41,942.0**	**$433.2**	**1.0%**

a To adjust for the deferrals, we count funds toward the fiscal year in which school districts programmatically commit the resources. The deferrals mean, however, that the districts technically do not receive the funds until the beginning of the next fiscal year.

b Targeted Instructional Improvement Grants provided for active court-ordered desegregation remains outside revenue limit reform.

c The Governor proposes to fold the existing instructional materials program into revenue limits, and then create an instructional material categorical program.

d Special education funding includes both General Fund and local property tax revenues.

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 DOF'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.

K-12 Enrollment Growth to Slow Significantly. K-12 enrollment is projected to increase by about 1 percent in 2004-05, bringing total enrollment to about 6.3 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.

Divergent Trends in Elementary and High School Enrollment. Figure 6 shows that the steady decline in K-12 enrollment growth masks two distinct trends in elementary (grades K-8) and high school (grades 9 through 12) enrollment. Elementary school enrollment growth has gradually slowed since 1996-97. This enrollment is expected to decline annually between 2004-05 and 2010-11. From the current year through 2010-11, K-8 enrollment is expected to decline by 56,000 pupils (1.3 percent). In contrast, high school enrollment growth is expected to accelerate in the short term, reaching a 4 percent growth rate in 2004-05. Then, growth is expected to slow sharply, becoming negative in 2011-12. Expected growth from the current year to 2011-12 is approximately 200,000 pupils (11 percent).

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 $415 million to maintain annual K-12 expenditures per pupil.

Figure 5

K-12 Enrollment Growth

Annual Percent Change

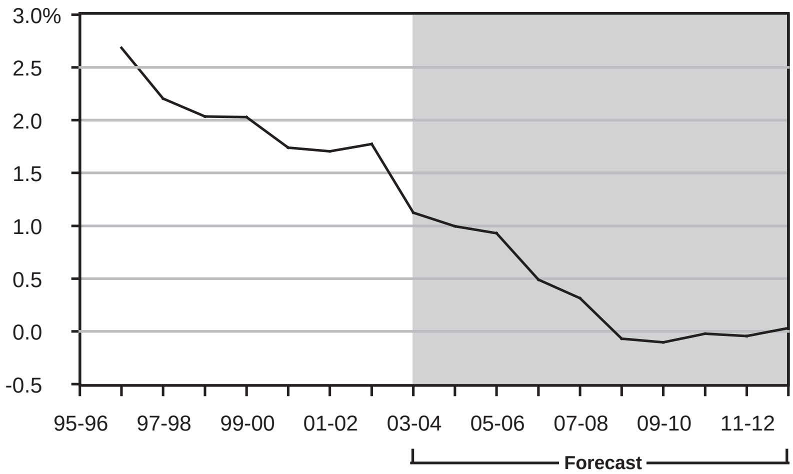
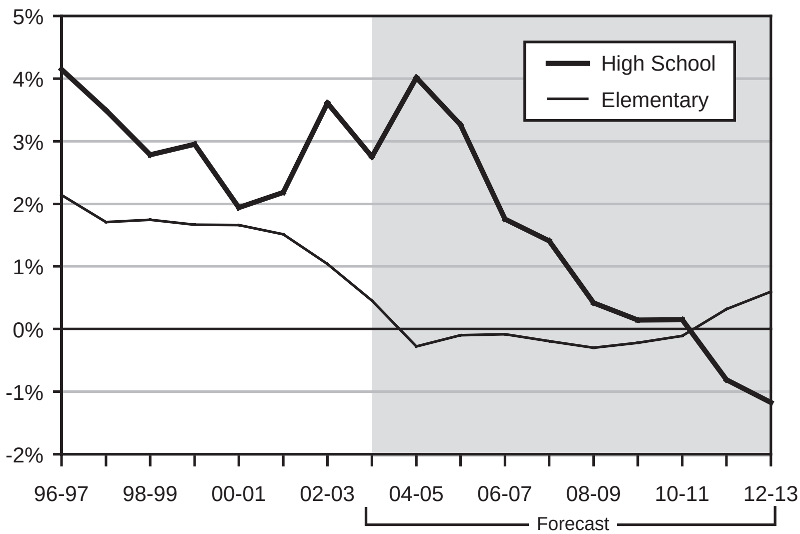


Figure 6

Elementary and High School Enrollment Growth

Annual Percent Change



- 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 class size reduction) 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 2003-04 and 2012-13, Los Angeles' enrollment is expected to decline over 100,000 students (a 6 percent decline) whereas Riverside's enrollment is expected to increase by almost 80,000 students (a 22 percent increase).

BUDGET ISSUES
K-12 Education

GOVERNOR'S CATEGORICAL CONSOLIDATION PROPOSAL

The Governor's budget proposes to increase district fiscal and program flexibility by consolidating $2 billion in existing categorical program funds for 22 programs into revenue limits. While parts of the proposal are still in development, we recommend the Legislature approve the proposal with several modifications that we believe will further the goals of the reform.

State funds for K-12 education fall into two main categories. The largest source of funds is provided through a general purpose "revenue limit." Revenue limits support "core" education program costs such as teacher and administrator salaries, lights and utilities, maintenance, and other costs. Categorical programs generally support specific supplemental costs. The *2003-04 Budget Act* contains more than 70 categorical programs that provide almost $12 billion in state funds for a wide range of district programs, including class size reduction, special education, teacher training, and child nutrition.

GOVERNOR'S PROPOSAL

The *2004-05 Governor's Budget* proposes to consolidate $2 billion in funding for 22 categorical programs into a general purpose grant that would be distributed through each district's and county office's of education (COEs) revenue limit formula. Of this amount, the budget proposes to defer payment of $146 million until 2005-06. As a result, about $1.9 billion would actually be available to districts and county offices in the budget year.

By including the categorical funds in the revenue limit, the proposal would extend new flexibility to districts over the use of the $2 billion. As revenue limit funds, the consolidated grant could be used for any purpose—not just those permitted by the 22 existing categorical programs. Along with this new flexibility, the proposal requires a district plan that is intended to increase local accountability for district spending decisions.

The budget proposal would maintain the current distribution of funds to school districts and COEs. This would be accomplished by calculating the new grant for each district equal to the amount districts would otherwise receive in 2004-05 from the 22 categorical programs. In future years, the proposal would increase the grant annually to compensate for growth in the student population and inflation.

Programs Proposed for Consolidation

Figure 1 displays the 22 categorical programs that would be consolidated under the budget proposal. According to the administration, the programs selected for consolidation meet one of three criteria: the programs (1) contain few restrictions on the use of funds, (2) do not support services for special needs students, or (3) have stable district allocations.

The 22 existing programs support a wide variety of local activities. Among the largest programs included in the consolidation are Home-to-School Transportation ($520 million), which subsidizes bus services for students, and the School Improvement program ($396 million), which funds supplemental services that are identified by local school site councils. The proposed new grant also includes the portion of the Targeted Instructional Improvement Grant (TIIG)—$205 million—that pays for activities called for under all voluntary desegregation agreements and those court-ordered agreements that have been terminated by the courts. Funding provided for “active” court-ordered desegregation plans is not included in the proposed consolidation.

Almost all state-funded staff development programs are consolidated into the new grant, accounting for $385 million (19 percent) of the total. This includes $235 million for the Staff Development Day Buyout program and $88 million for the Beginning Teacher Support and Assessment program. Instructional Materials funds ($175 million) also are merged into the consolidated grant (although a new $188 million Instructional Materials program is proposed separately from the consolidated grant).

Figure 1

Governor's K-12 Categorical Consolidation[a]

(Dollars in Millions)

	2003-04	2004-05	Percent Change
Home-to-School Transportation	$519.6	$519.6	—
School Improvement	387.2	396.1	2.3%
Staff Development Day Buyout	229.7	235.7	2.6
Targeted Instructional Improvement Grants[b]	199.4	205.1	2.9
Instructional Materials	175.0	175.0	—
Supplemental Grants	161.7	161.7	—
Beginning Teacher Support and Assessment	86.0	87.5	1.8
Year Round Schools	84.1	84.1	—
English Learner Assistance	53.2	53.2	—
Mathematics and Reading Professional Development	31.7	31.7	—
Peer Assistance Review	25.2	25.9	2.9
Dropout Prevention	21.9	21.9	—
Tenth Grade Counseling	11.4	11.4	—
Specialized Secondary Programs	5.1	5.1	—
School Library Materials	4.2	4.2	—
Intersegmental Staff Development	2.0	2.0	—
Bilingual Teacher Training	1.8	1.8	—
International Baccalaureate	1.1	1.1	—
At-Risk Youth	0.6	0.6	—
Center for Civic Education	0.3	0.3	—
Pupil Residency Verification	0.2	0.2	—
Teacher Dismissal	—[c]	—[c]	—
Totals	**$2,001.5**	**$2,024.4**	**1.1%**

a Amounts include "deferred" funds—funds that are earned in one year but not paid until the next.
b Excludes funds provided pursuant to a court-ordered desegregation plan.
c Less than $50,000.

Accountability Requirements

The proposal requires districts and COEs to submit to the State Department of Education (SDE) an allocation plan that would describe the use of the grant funds and address six specific "accountability" issues.

While draft legislation to implement the proposed block grant was not available at the time this analysis was written, the Department of Finance advises that district plans would include the following:

- An estimate of additional funding needed by districts to ensure adequate school maintenance (including clean bathrooms).
- An estimate of funding increases necessary to provide standards-aligned textbooks to all students.
- The amount of the new grant districts would use to fully restore the state-required level of reserves for economic uncertainty by 2005-06. (Trailer legislation to the *2003-04 Budget Act* permits a two-year opportunity to reduce reserves by half in order to give districts greater flexibility to accommodate reductions in state funding levels, but requires the reserves to be restored by 2005-06.)
- The proportion of the new consolidated grant that would be subject to collective bargaining.
- A description of the decision making process that would govern funding distributed for school-site uses.
- A plan for public participation in district funding allocation processes.

Despite the requirement that districts address these six accountability issues, the proposal actually would not place specific requirements on the local use of the funds. Districts would *not* be required to spend consolidated grant funds on maintenance, textbooks, and district reserve funds—even if the local plan found that existing funding levels failed to adequately meet district needs. Similarly, the proposal does not mandate that districts distribute a share of the funds to school sites.

Instead of creating new mandates on the use of the new grant, the budget seeks to increase local accountability over district spending practices. The budget proposes to accomplish this by involving greater numbers of parents, teachers, and principals in district budgeting decisions. Highlighting maintenance, textbooks, and adequate reserves is intended to provide new information to these community members—information meant to further spur participation and discussion of district budget priorities.

In short, the administration's proposal seeks to eliminate state-level decision making over the $2 billion and the 22 narrow categorical program requirements. In its place, the proposal provides local decision making over the funds, which makes school boards accountable for making the broad trade-offs that improve local outcomes. This represents a significant change in the state's approach to school funding. In the following sections, we review the strengths and weaknesses of the proposal.

Benefits of the Governor's Plan

By giving districts greater flexibility over the use of existing categorical funding, the Governor's proposal would generate a number of important benefits for school districts. These include:

- ***Greater Fiscal and Program Flexibility.*** Greater fiscal flexibility would allow districts to direct the new grant funds to the highest priority local needs and to craft local programs that address those needs most effectively. Thus, the additional flexibility helps districts maximize the local impact of state funds.

- ***Administrative Savings.*** Eliminating the individual program requirements of the existing programs helps districts reduce local administrative costs associated with process, accounting, and compliance requirements.

- ***A Focus on Outcomes Rather Than Rules.*** Eliminating the categorical program requirements reduces the complexity of managing funds and helps districts concentrate on using funds most effectively to increase student achievement rather than compliance with state rules.

- ***Clearer State/Local Relationship.*** By increasing local autonomy over the use of funds, the state would clarify the school board's role in decision making over these funds. This would make it easier for parents and voters to participate in local budget decisions and hold school board members accountable for how funds are used.

While we have few details on the specifics of the proposal, the accountability provisions that are intended to spur increased participation in district budgeting decisions also could result in significant benefits. The state's current accountability system for student achievement is designed, in large part, to increase local pressure on districts to improve by making parents and community members more aware of the quality of education provided locally. District budgets reflect many important policy and fiscal decisions that affect the quality of education provided to students. Increasing parent and community participation in budgetary decisions can help ensure that decisions reflect the needs and desires of parents and students for improving student achievement. In addition, broader participation can increase community awareness of issues facing the district and generate new ideas that expand the range of possible solutions to those issues.

Issues and Recommendations

We have long recommended categorical program reform. Our *2002-03* and *2003-04 Analysis of the Budget Bill* provided the Legislature with a description of the proposals included in prior budgets and offered two alternative proposals to consolidate current programs into categorical block grants (please see the *2002-03 Analysis,* p. E-77 and *2003-04 Analysis,* p. E-43*).* We think the Governor's proposal represents a significant step towards the goal of establishing a streamlined system of categorical programs that provides significant local flexibility and addresses the accountability issues that are implicit in the creation of many of the supplemental funding programs.

Accordingly, we recommend the Legislature approve the general approach of the proposed consolidation. We would, however, suggest several modifications to address four broad concerns we have identified with the proposed consolidation:

- ***Selection Criteria.*** We outline alternate criteria for determining which programs should be included in the new grant. Based on these criteria, we identify two types of programs where increased local accountability may not provide a sufficient balance of local interests. We also have identified several other programs the Legislature may want to consolidate in the new grant.
- ***Transition Issues.*** We have identified two "transition" issues that could undermine the goals of the proposal in the near term.
- ***State Information Role Is Missing.*** We identify a missing element of the proposal—increasing information to districts and school sites on effective uses of funding.
- ***Accountability Through Community Involvement.*** We review the essential elements of the accountability portions of the district plan—a key element of the proposal—that are needed to increase participation of community members in school affairs.

Below, we discuss these areas of concern.

Which Programs Should Be Consolidated?

We recommend the Legislature modify the list of categorical programs that are included in the proposed grant in order to consolidate those programs for which existing or expanded levels of community involvement would provide sufficient local accountability.

As discussed above, the budget proposal cites three criteria for choosing which categorical programs were included in the consolidated grant. Specifically, the programs: (1) contain few restrictions on the use of funds, (2) do not support services for special needs students, or (3) have stable district allocations. We have two concerns with the criteria. First, we think the criteria should more explicitly address whether strengthened local accountability would eliminate the need for separate categorical funding streams. Second, the proposal applies its own criteria inconsistently, consolidating programs that do not meet the three tests and excluding other programs that satisfy the criteria.

LAO Alternate Criteria—A Focus on Accountability

Categorical programs are designed to address situations where local incentives cause districts to underinvest in a particular input that is critical to the educational process. 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 input. Categorical funding guarantees that districts will spend at least a minimum amount on a particular service, thereby countering, at least in part, the local incentives to underinvest.

For this reason, we believe the criteria for categorical consolidation should focus on whether local accountability would resolve the problem of underinvestment. The proposal's criteria only implicitly address incentive problems. For example, one of the proposal's criteria is that programs included in the consolidation do not provide support for services to special needs students. This suggests that, by excluding these programs, the administration is not comfortable that local incentives for funds targeted at special needs students is sufficient to ensure the needs of these students would be met.

We think there are two basic criteria the Legislature should consider as it reviews the proposed consolidation of categorical programs (see Figure 2 next page). The first is whether local accountability is sufficiently strong that the Legislature can feel comfortable that districts generally will provide the needed level of services and, as a result, categorical funding streams are unnecessary. The second criterion is whether adding funds to revenue limits provides a reasonable allocation of funds to districts in the future. We discuss our criteria in greater depth below.

Is Local Accountability Sufficient? Meaningful parent, teacher, and principal participation in district budget processes can provide a sufficient level of local accountability—particularly for services that have a direct impact on core classroom inputs to education. These groups directly experience the impact of spending shortfalls for inputs such as textbooks and maintenance. As a result, we believe that most categorical programs supporting core classroom services could be included in the consolidated grant. If, however, local accountability cannot adequately counterbalance a local incentive to underinvest, the program should not be consolidated.

Figure 2

LAO Criteria for Including Categorical Programs In the Proposed Revenue Limit Grant

Local Accountability

Is local accountability sufficient to offset district incentives to underinvest in program services?

There are two situations where local accountability may be sufficient:

- Where meaningful participation of parents, teachers, and principals can hold districts accountable for providing a sufficient level of services to students (or schools).
- Where local accountability is created by other state or federal requirements to provide the targeted services.

Funding Distribution

Is district need for funds measured reasonably well by district attendance?

District revenue limits are adjusted each year for growth in student attendance and inflation. Adding categorical funds into district revenue limits means that changes in district need for program services should generally be proportional to changes in district attendance.

External mandates—such as other state or federal requirements—also can create local accountability for certain actions. In these cases, categorical funding streams are not necessary. For instance, TIIG funds district costs of voluntary and court-ordered desegregation agreements. Similarly, the Beginning Teacher Support and Assessment (BTSA) program satisfies the state's induction requirement that all new teachers must meet before obtaining a teaching credential. Because these funds are designed to help districts address specific requirements, consolidating these categorical programs as proposed would not alter any requirements districts must meet.

Is District Need for Funds Measured Reasonably Well by District Attendance? By adding funds to district revenue limits, future budgets would adjust the new grant based on changes in district attendance. Therefore, programs that are identified as candidates for consolidation should be reviewed to ensure that changes in attendance supports a reasonable level of funding for program services in the future. Otherwise, consolidation may create new distributional issues—affecting districts in very different ways. Therefore, the Legislature should avoid consolidating programs for which the level of need changes differently from changes in district enrollment.

Most of the programs proposed for consolidation meet our criteria. Some do not, however. Below, we discuss modifications to the programs that, based on LAO criteria, should be included in the proposed consolidation. Specifically, we recommend:

- Removing staff development programs from the new grant.
- Removing the English Language Assistance Program (ELAP) and the portion of TIIG funds that districts with voluntary desegregations programs use for instructional services for low-performing students.
- Including in the new grant the noninstructional portion of TIIG funds allocated to districts with court-ordered desegregation programs.
- Including K-3 and high school class-size reduction and deferred maintenance in the consolidated grant.

Remove Staff Development Programs

State staff development programs—especially BTSA and the Staff Development Day Buyout—do not meet our accountability criterion. We are concerned that the difficulty of making staff development programs work effectively may result in a local incentive for teachers, administrators, and school board members to underinvest in this activity. In addition, staff development activities support a critical part of the school improvement process. Eliminating the state's programs at a time when the state and federal governments are placing significant pressure on schools to improve teacher quality may send a confusing signal to the school community.

The budget would consolidate six staff development programs into the new grant: Staff Development Day Buyout ($236 million), BTSA ($88 million), Mathematics and Reading Professional Development ($31.7 million), Peer Assistance and Review ($25.9 million), Intersegmental Staff Development ($2 million), and Bilingual Teacher Training ($1.8 million).

We are concerned that there is insufficient local accountability for providing needed high-quality staff development. Although teacher quality is one of the largest determinants of student achievement—which suggests that districts should have considerable incentives for investing in teacher training—neither teachers nor administrators may see staff development as an effective way to improve student achievement.

Effective staff development is very difficult to implement because teachers may resist making changes in their teaching practices. Research has documented the mismatch in the types of training teachers want and the types they need. Teachers often want training in areas that have immediate usefulness in their classrooms, yet this type of short-term training usually has little impact on the quality of instruction.

Staff training that results in higher student achievement has to help teachers replace less effective teaching practices with more effective approaches. Like other professionals, however, teachers are reluctant to abandon old teaching methods. Research also has documented that teachers often resist major changes in their teaching methods unless they are convinced that change is needed and likely to benefit students.

These findings suggest that staff development needs to take place in a cooperative atmosphere, where districts hold school sites accountable for improving instructional practices when needed, and teachers are involved in identifying problems and crafting solutions. This balanced approach is very difficult to implement successfully. As a result, teachers, administrators, and board members may see staff development as a relatively inefficient way of improving the quality of education.

Both the state and federal governments emphasize the importance of staff development in improving student performance. Under the federal No Child Left Behind (NCLB) Act, for example, all K-12 teachers are required to meet the state's definition of "highly qualified" by 2005-06. It appears unlikely that California will meet this deadline. The contribution of teachers to school quality also is recognized in the two state intervention programs for low-performing schools—the Immediate Intervention in Underperforming Schools Program and High Priority Schools Grant Program. At a time when the state and federal accountability programs are pressuring schools and districts to invest in their teachers' ability to meet student needs, transferring to revenue limits the state-funded categorical programs targeted at improving teacher quality may send a contradictory message to districts.

In addition, the BTSA program violates our distributional criteria. Because induction programs are required for new teachers, BTSA funds are distributed based on the number of first- and second-year teachers working in each district. As a result, district allocations of BTSA funds change over time. In addition, new teachers are not evenly distributed among districts. Districts with large numbers of poor students are more likely to have a disproportionate share of beginning teachers. Thus, changes in student enrollment do not adequately measure district need for BTSA-type induction services.

For these reasons, we think this may be the wrong time to consolidate categorical funding for staff development into the proposed new grant. This does not suggest that we believe that the existing state training programs, such as the Staff Development Day Buyout, represent the most effective approach to providing staff development. Because teacher buy-in is so critical to the success of staff development programs, greater local flexibility over the use of these funds for staff development activities is likely to result in a greater impact on teaching practices. As an alternative, therefore, we recommend grouping staff development programs into a block grant that would protect funds for this purpose but provide districts with significant additional flexibility (see our recommendation later in this chapter). If, after several years, the additional flexibility does not allow districts to create more effective staff development programs for their employees, the Legislature may want to revisit the issue of folding state funds for these programs into the revenue limit.

Remove Funding for Services to Special Needs Students

Two programs that support services for special needs students are proposed for consolidation—ELAP and TIIG. We would remove funds targeted for special needs students from the proposal, as we remain unconvinced that local accountability is sufficient. Funds for supplemental instructional services to English learner or low-performing students are protected under our proposal because districts sometimes have underinvested in services to students who may need intensive supplemental assistance to achieve. State and federal accountability programs based on student assessments are designed to alter local incentives related to this underinvestment. The success of these programs is still unproven, however. Only 19 percent of sixth grade economically disadvantaged students in California achieve at the proficient or advanced levels on the state's mathematics and English standards-aligned tests; over 50 percent of noneconomically disadvantaged students in the same grade score at these levels. Until the accountability programs on student achievement show demonstrable progress in closing the achievement gap, we recommend the Legislature maintain the protections on funds targeted for instructional services to special needs students.

The inclusion of ELAP also violates our funding distribution criteria. The program provides additional funding for services to students in grades four through eight who are learning English as their second language. District ELAP grants are not based on district attendance. Instead, district amounts change as the number of English learner students in the district changes. Since including the program would violate both of our criteria, we would exclude the program from the consolidation.

The TIIG presents a more complex situation, as the program supports instructional services for special needs students and a wide variety of other types of district services (transportation, teacher stipends, and magnet schools). Some districts spend a considerable portion of their TIIG grant on these other services, especially transportation. Because TIIG expenditures for these other services may be so interwoven into a district's overall educational program, it may be difficult to determine whether these expenditures directly benefit low-performing students or whether they underwrite base district costs.

One solution is to include TIIG funds that districts use to support instructional services to low-performing students as part of the Economic Impact Aid (EIA) program and consolidate the funds targeted at the "other" services into the revenue limits. The EIA program provides districts with targeted support for low-performing and English-learner students. In that way, the state could protect funds targeted at supplemental student services and increase district flexibility over the remaining portion of the grant without changing how districts currently use TIIG funds. Since the ultimate goal of desegregation and TIIG funding is improving the achievement of disadvantaged students, this division appears consistent with the Legislature's original intent in establishing the programs.

The budget proposal excludes from the consolidated grant TIIG funds for districts with court-ordered desegregation programs. We suggest including funds for these districts in the reform, as the court-ordered programs are not fundamentally *different* from the voluntary programs. Only one district program is still under court supervision. The other districts operate essentially voluntary programs. For these reasons, we think court-ordered district programs should be treated the same as voluntary programs.

Therefore, to continue state protections on funds for instructional services to special groups of students, we recommend two changes to the categorical proposal. First, we recommend the Legislature remove the ELAP from the consolidated grant. In addition, we recommend dividing TIIG grants into two parts. Funds for instructional services to students would be added to EIA and the remaining funds would be consolidated into revenue limits. We suggest the Legislature allow each district to identify the amount of its TIIG that would be included in the consolidated grant and the amount that would be added to the EIA program.

Add Three Programs to the New Grant

We have identified three additional programs that we believe warrant the Legislature's consideration for inclusion in the consolidated grant. These programs were selected because each has a direct impact on school and classroom services that are important to the school community. Consequently, we think the existing level of local accountability would likely provide a sufficient level of community oversight regarding the use of program funds. The three programs are discussed below.

Elementary and High-School Class-Size Reduction. We would include in the consolidated grant the $1.8 billion proposed for these two programs in 2004-05 for several reasons. Class-size reduction—especially in elementary schools—is very popular among parents and teachers. We think involvement of these two groups in the district budget process likely would require school boards to make a strong case that an alternative use of these funds would lead to better outcomes for students.

In fact, including class-size reduction programs in the new grant could also stimulate local participation in district financial decisions. The popularity of smaller classes could motivate individuals to participate in district affairs in order to protect the program from district budget cuts. As a consequence, including these funds in the consolidated grant could actually contribute to the success of the accountability features of the proposal.

Including these funds also would increase local flexibility over the implementation of smaller classes, thereby relieving districts of rigid state rules over the use of the funds. In the past, we have recommended changes in the 20:1 classroom cap because it creates significant administrative challenges and unnecessarily increases district costs. Furthermore, these high costs may be contributing to a reduction in district participation in the program—preliminary SDE data shows a 5.4 percent decline in the number of students in smaller K-3 classes from 2002-03 to 2003-04. Including the program in the consolidated grant would both increase flexibility over the design of local programs and actually help districts protect smaller classes from local budget pressures if they so chose.

Deferred Maintenance. We also would include $250 million in funding for deferred maintenance in the new grant. This program supports major maintenance and infrastructure projects—such as exterior painting, roof replacement, and long-term repairs to electrical, heating, and plumbing systems that result because districts do not fully fund long-term maintenance. As we have observed in the past, by funding only deferred projects, the Deferred Maintenance program may actually *create* a fiscal incentive for districts to defer needed projects, rather than deal with them in a more timely manner.

Local incentives for providing an adequate level of ongoing maintenance have improved with changes in the states' bond-funded modernization program. Until 1998, the state paid 80 percent of modernization programs with state bond funds. This created an incentive for districts to underinvest in major maintenance on an annual basis and correct the resulting infrastructure problems as part of modernization programs. Since 1998, however, state bond acts require districts to (1) provide 40 percent of the cost of modernization and (2) increase to 3 percent from 2 percent the proportion of district budgets spent annually on major maintenance for those districts participating in state bond-funded programs. In addition, the local matching funds required under the Deferred Maintenance program count toward the 3 percent major maintenance requirement in the bond acts. As a result, the program does little to *increase* local maintenance spending.

For these reasons, we recommend the Legislature include $250 million for the Deferred Maintenance program in the proposed consolidated grant.

Impact of the LAO Recommendations

Figure 3 displays the 18 programs that would be consolidated as a result of our recommendations and the seven programs that are proposed in the Governor's budget that we recommend excluding from the consolidation. While we would recommend consolidating fewer programs, we include several large programs that are not part of the budget proposal. As a result, under our recommendations, $3.8 billion in existing categorical support would be shifted to revenue limits—almost double the level proposed in the budget.

Transition Issues May Result in Unintended Consequences

We recommend the Legislature limit the uses of the consolidated grant in the budget year in order to allow district governing boards, parents, teachers, and principals time to consider local uses of the funds as part of district 2005-06 budget processes.

The new consolidated grant would contain funds that districts currently receive for the 22 existing categorical programs. Districts use these categorical funds for a wide variety of activities. Many of these district activities will need to continue in 2004-05 even if the categorical funds come to the district as general purpose monies. Thus, how the new grant operates at the district level in the budget year is critically important. Below we identify two important transition issues that may need to be addressed.

Figure 3

Summary of LAO Recommendations to Consolidate Categorical Programs Into Revenue Limits

Programs Included:

- Class-Size Reduction (both K-3 and High School)[a]
- Home-to-School Transportation
- Dropout Prevention
- School Improvement
- Deferred Maintenance[a]
- Instructional Materials
- Supplemental Grants
- Year Round Schools
- Targeted Instructional Improvement Grants (partial)
- Tenth Grade Counseling
- Specialized Secondary Programs
- School Library Materials
- At-Risk Youth
- Center for Civic Education
- Pupil Residency Verification
- Teacher Dismissal

Programs Excluded:

- Staff Development Day Buyout
- Beginning Teacher Support and Assessment
- English Learner Assistance
- Intersegmental Staff Development
- Peer Assistance Review
- Mathematics and Reading Professional Development
- Bilingual Teacher Training

[a] Programs LAO recommends adding to the Governor's grant consolidation proposal.

Proposal May Trigger Collective Bargaining Provisions

District collective bargaining agreements may force districts to spend a large share of the consolidated grant on salaries—thereby actually reducing district flexibility over the use of the categorical funds. Many districts have approved collective bargaining agreements with teacher and other employee unions that require the district to dedicate a proportion of new general purpose funds to increasing employee salaries. As a result, the Governor's proposal to transform the categorical funds into general purpose funds could trigger these provisions and require districts to spend a portion of the consolidated grant on salaries. These automatic provisions can require districts to devote 50 percent or more of general purpose funding increases to raising employee salaries.

In our discussions with district staff about these agreements, the automatic provisions were characterized as a way of avoiding acrimonious negotiations each year over the use of cost-of-living adjustments (COLAs)—or other increases—provided by the state. In addition, the proportional nature of the increases allows districts to avoid committing to specific salary adjustments that may prove difficult to afford if state funding is lower than anticipated.

In this case, however, districts are already receiving the consolidated grants as categorical funds and, presumably, they are spending the categorical funds on their intended purposes. As a result, if the budget proposal triggers these automatic salary provisions, districts will be unable to afford the same amount of services that the categorical funds purchased in the current year. If half of a district's grant is consumed by automatic salary increases, what existing services will the district forego? It is likely that "discretionary" activities, such as school improvement, will experience the brunt of any funding reductions, as districts may have little flexibility in the near term to reduce spending on transportation, textbooks, or staff development day buyout (which is included in teacher salary schedules in some districts).

If the new grant triggers the automatic salary provisions, therefore, the outcome of the budget proposal in many districts would be contrary to one goal of the proposal—to increase local funding flexibility. Elimination of state categorical restrictions may allow districts to spend the remaining funds more efficiently. Because the amount of funds that would be diverted to salaries is so large, efficiency savings would be unlikely to allow districts to obtain the same level of services as currently provided through the existing categorical programs.

This problem is easily remedied, however. The Legislature could place the consolidated grant off-limits to collective bargaining for a year or two. The COLA proposed in the Governor's budget will still provide a source of funds for teacher and staff salary increases. By protecting these funds, the Legislature would prevent the new grant from triggering automatic provisions of local employee agreements and give districts time to work with local employee unions to ensure that funding is available to satisfy high-priority local needs for transportation, textbooks, or school-site discretionary funding. In future years, when districts, unions, and community representatives have had an adequate opportunity to plan and adjust collective bargaining agreements, the legislation would allow funds to be collectively bargained.

Expanded Community Participation Is Unlikely to Occur With 2004-05 Funds

School districts begin detailed budget planning many months before the start of the new fiscal year. Districts commonly use conservative assumptions about anticipated state funding during the development process. Once the state budget is enacted, districts revise their budgets based on actual funding levels appropriated by the state.

This process protects districts from making financial commitments based on legislative proposals that are ultimately unsuccessful. Districts are particularly reluctant to assume enactment of significant new proposals, such as the Governor's categorical consolidation. As a result, unless the Legislature signals agreement to the consolidation early in the budget process, we think it is unlikely that many districts would include the consolidation—and the accompanying accountability provisions—in their spring budget development process.

Instead, district decisions about the use of the consolidated grant would likely take place as part of the fall budget revisions. Because of the short timelines of the fall revision process, we would expect most districts would not use the flexibility afforded by the new grant—except to cover shortfalls in district base budgets. Using the new grant to "plug holes" in district base budgets would result in a very different allocation of the funds compared to the existing categorical uses. In these cases, strengthened local accountability would become very important so that parent, teacher, and principal priorities were recognized during the revision process.

The short timelines of the budget revision process, however, also would make it difficult for districts to implement the accountability provisions in the proposal. Developing a meaningful assessment of whether the district has adequately provided textbooks and maintenance could take considerable time. In addition, a large proportion of parents, teachers, and principals may be on vacation during July and August when much of the budget planning would occur. We think the Legislature should consider limiting district flexibility over the use of the new grants to their current categorical uses in 2004-05. This would help ensure that meaningful community participation could occur as part of the 2005-06 district budget process.

Limit District Discretion During Transition Period

Given the above, we recommend the Legislature limit district discretion over the use of funds in two ways. First, we recommend the Legislature require districts to use funds in the consolidated grant as if the categorical programs were in place for 2004-05 (including the existing "mega-item" flexibility that allows districts to move funds between categorical programs). This would allow the funds to be reprogrammed as part of the 2005-06 local budget process. Second, we recommend the Legislature prohibit districts from spending funds from the consolidated grant for district-wide salary increases for two years. This would allow time for

(1) districts to work with unions on the appropriate uses of the funds and (2) parents, teachers, and principals to gain experience in the local budget process and a greater understanding of the needs of their district and various options for using the funds before the new grant could be used for salary increases.

State Information Role Is Neglected

We recommend the Legislature appropriate $500,000 in unallocated federal Title VI funds to develop a strategic plan for meeting school and district information needs on effective programs. This plan would provide a roadmap for a longer-term program to help local decision makers make informed decisions about the uses of K-12 funds.

Decentralizing decision making as proposed in the budget magnifies the importance of ensuring that district and site staff are informed of the relative effectiveness of different expenditure options. This type of information gathering is expensive, as there are few state or federal programs that make such information easily available. Worse, existing studies may conflict in their findings on the effectiveness of services or the needed data simply may not exist.

It is easy to imagine the types of questions that may arise. For instance, under the K-3 Class-Size Reduction program, districts have little flexibility to determine how best to maximize the impact of smaller classes. If the program is included in the consolidated grant, however, districts would have to decide if a different approach to smaller classes would result in larger increases in student achievement. Of course, districts could choose to continue existing practice. If a district felt a different approach might benefit its students, how would it evaluate its options? Which grades most benefit from smaller classes? Do the benefits increase as the class size falls? Do English learner students benefit more than other students? What type of training helps teachers maximize the advantages of smaller classes?

Because the budget proposal makes no provision to assist districts and school sites in finding and interpreting available data, the proposal places this significant burden at the local level. This is not an argument against decentralization, however. Rather, we think the state should support the role of generating and disseminating information on program effectiveness. By addressing district information needs, the state could help districts obtain a higher quality of data at a much lower cost.

The absence of any such proposal in the Governor's categorical consolidation constitutes a missing element of the administration's strategy for reforming education finance. As a start to correcting this problem, we recommend the Legislature appropriate $500,000 in federal Title VI funds to support development of a strategic plan for a state information dissemination program. Title VI funds are available to states for a variety of assessment and accountability activities, including information designed to "identify best educational practices." In addition, the Governor's proposal for the Title VI funds (discussed later in this section) does not fully allocate available federal funds in the budget year.

The plan would be based on an assessment of the types of information that district staff, teachers, and principals would find most valuable. The plan would also review available sources of information that currently exist from other state, federal, and academic sources. Based on district needs and currently available information, the plan would recommend an initial program of information collection and dissemination that the Legislature could consider as part of its 2005-06 budget deliberations. In addition, the plan would identify steps the state could take to satisfy information needs that cannot be met through existing sources.

Community Involvement Is a Key Element

As we discussed above, the proposal to increase participation of parents, teachers, and principals in the district budgeting process is a key part of the budget proposal. Unfortunately, details on the administration's proposal were not available at the time this analysis was written. We will provide comments on the specifics of the proposal during budget hearings.

In our 1999 report *A K-12 Master Plan*, we discussed the importance of local accountability in helping school boards make decisions that are in the best interests of students. We suggested that understanding and balancing school board powers in order to create strong local accountability is an ongoing responsibility of the state. For this reason, we think the budget proposal addresses a governance issue that is critical to the overall success of our schools.

To make this feature effective, however, it is important that the proposal create incentives for community members to participate in the budget process *and for districts to seek a broader range of input*. Many barriers face the parent who tries to participate in local budget decisions. District staff or school board members may not want greater participation—they may see expanded involvement as only making decisions more difficult. In addition, education budgets are complex and often require substantial knowledge about the district, requirements attached to state and federal funds, and the educational improvement process. Districts may be reluctant to make the significant investment in time needed to educate new participants to the process.

In many other states, citizen involvement is spurred by a personal financial interest in the district's budgeting practices because the district governing boards establish a property tax rate as part of the budget process. Inefficient use of funds results in higher taxes for district property owners. This dynamic creates strong incentives for community involvement in school affairs. Since the passage of Proposition13, school boards in California no longer have independent taxing authority.

It may be useful, however, to examine the local processes required in other states when school boards exercise their taxing authority. For instance, some districts in Massachusetts require citizens to approve the annual budget—and the resulting tax rate—in a "town-hall meeting." Citizens in attendance at the district's annual budget approval meeting vote to approve or disapprove the proposed budget for the coming year. If citizens reject the budget, the school board must develop a new proposal for a second vote.

This process creates incentives that can lead to meaningful local accountability. The ability to vote on the district's budget empowers citizens to demand the types and amounts of services that will promote the education of the town's children. The vote also creates an incentive for districts to ensure that citizens who are likely to vote on the budget are informed about how and why district funds are spent in the manner proposed. It also encourages districts to involve "citizen leaders" in the budget process as a way of educating and soliciting input from the community. Although the town-hall meeting may not work in California because many districts are quite large, it is an example of the type of local process that empowers the local community to participate in the local decision making process and creates the incentive for districts to *want* increased local involvement.

CONCLUSION

In general, we think the proposed consolidation warrants serious consideration by the Legislature. Our recommendations are designed to improve on the proposal—protecting the Legislature's interest in using categorical funding streams to improve the incentives facing districts, avoiding near-term problems that could undermine the proposal's goals, and addressing the information needs districts face in making expenditure decisions.

While this proposal would simplify the state's system of K-12 categorical programs significantly, the Legislature may want to consider further reforms. Proposals our office has provided in the *2002-03* and *2003-04 Analysis of the Budget Bill* merit consideration in expanding the flexibility of school districts in exchange for revised accountability. Below, we discuss creating new block grant programs with existing staff development and school safety programs as one avenue for building on the reforms proposed in the consolidated grant.

TEACHER QUALITY

Currently, the state provides Proposition 98 funding for 11 teacher support and development programs. Each of these 11 programs has a slightly different objective and is designed for a slightly different group of teachers. For example, the state has separate programs for teaching assistants, new teachers who lack adequate subject matter training, new teachers who lack adequate pedagogical training, new teachers who have sufficient subject matter and pedagogical training but need extra classroom support and mentoring, veteran teachers who are struggling, veteran teachers who are not struggling but might benefit from one to three-day workshops, veteran teachers who seek special leadership training, and veteran teachers who seek National Board certification.

The Governor's budget proposes to eliminate one of these programs, retain three programs, and shift funding associated with the remaining seven programs into school districts' revenue limits. Specifically, the Governor's budget eliminates funding for the preintern program because preinterns, by definition, have not demonstrated subject matter competency and therefore do not meet the new federal requirements for highly qualified teachers. Additionally, the Governor's budget retains three teacher-related programs as distinct categorical programs for which certain school districts may apply separately for funding. Lastly, the Governor's budget shifts funding for seven teacher-related programs into revenue limits. Although these seven programs would retain statutory authorization, all associated funding provisions would be removed.

Figure 1 identifies the specific teacher-related programs that would be shifted into revenue limits and those that would be retained as separate categorical programs per the Governor's budget proposal. As the figure shows, the Governor's budget includes a total of $423 million (Proposition 98) for teacher-related programs. Of this amount, $385 million would be shifted into revenue limits. The remainder would be distributed according to existing program-specific rules.

Figure 1

Administration's Categorical Reform Proposal For Teacher Quality Programs

Teacher-Related Programs	2004-05 Appropriation (In Millions)
Shifted Into Revenue Limits	
Staff Development Buyout Days	$235.7
Beginning Teacher Support and Assessment	87.5
Intersegmental Staff Development[a]	2.0
Bilingual Teacher Training	1.8
Mathematics and Reading Professional Development	31.7
Peer Assistance and Review	25.9
Total	**$384.6**
Retained as Separate Categorical Programs	
National Board Certification Incentives	$7.3
Intern program	24.9
Paraprofessional teacher training program	6.6
Total	**$38.8**
Grand Total	**$423.4**

[a] Refers to two small programs—the College Readiness program and the Comprehensive Teacher Education Institutes.

In this section, we briefly summarize our concerns with the administration's proposal specifically as it relates to teacher-related programs. As an alternative to shifting these programs into revenue limits, we recommend the Legislature consolidate all ten remaining programs into a teacher quality block grant and link funding with specific outcome measures and data requirements.

Shifting Sends Confusing Message

In the previous piece, we discussed our overall concerns with the administration's categorical reform proposal and offered alternative criteria for identifying whether specific categorical programs would be appropriate candidates for shifting into revenue limits. Based upon these criteria, we recommend the Legislature maintain separate funding associated with teacher-related programs rather than shifting them into revenue limits. Our primary concern with the Governor's proposal is the confusing message its sends to the school community at this time. Despite research findings, large state investments, and new federal requirements all emphasizing teacher quality, the Governor's budget proposal would eliminate virtually all state focus on teacher quality.

Teacher Quality Is Key to State Reform Efforts. Research consistently has found teacher quality to be the most important school-site determinant of student achievement and a vital ingredient in any school improvement program. Largely based upon recent research indicating that California continues to suffer from an inadequate number and an inequitable distribution of qualified teachers, the state has made substantial investments in teacher quality over the last decade. The *2001-02 Budget Act* included more than $800 million for teacher quality programs. Even after considerable reductions over the last two years, the Governor's budget proposal includes more than $400 million in teacher-related funds.

Federal Reforms Also Stress Teacher Quality. Federal law also places considerable emphasis on teacher quality. Indeed, by the end of the 2005-06 school year, federal law is requiring all teachers working in public schools to be "highly qualified" in all the core subjects they teach. Despite this requirement and the short period within which states have to comply, the Governor's revenue limit proposal essentially would dismantle the state's teacher quality efforts. Moreover, in a related proposal, the Governor's budget eliminates the preintern program—the program the state has developed specifically to help unqualified teachers demonstrate subject matter competency. Taken together, these actions send a very dubious message regarding the state's commitment to helping school districts meet the new federal requirements.

Retaining Existing System Perpetuates Mixed Messages

The existing system of staff development programs suffers from its own mixed messages. For the last two years, our *Analysis* has included sections detailing many of the problems with the existing system. The state currently is funding a dizzying array of programs that have overlapping objectives yet are poorly coordinated. For example, the state supports three different programs for new teachers, though new teachers may participate in only one program at a time. Moreover, the new teachers who are least prepared (many of whom are working in the most difficult schools) are required to participate in the program that offers the smallest amount of funding, least amount of support, and most narrowly defined services. For veteran teachers, the state's largest program funds one-to-three day workshops—a type of professional development that research has found to be relatively ineffective. Add to this the fact that few of the programs are linked with specific outcome measures and none has periodic reporting or evaluation requirements. (Even if they did have evaluation components, the lack of a teacher-level data system makes it virtually impossible to track teacher improvement in any meaningful way.)

Consolidate Existing Programs Into Teacher Quality Block Grant

Given the concerns expressed above, we recommend the Legislature consolidate the ten remaining teacher-related programs into a teacher quality block grant. This would allow the state to retain its focus on teacher quality while simultaneously allowing school districts to pool their existing resources and use them more strategically.

Rather than shifting most teacher-related programs into revenue limits or retaining them as separate categorical programs, we recommend the Legislature consolidate all ten programs into a teacher quality block grant. Below, we discuss specific recommendations relating to the basic elements of the block grant.

- ***Simple Funding Process.*** Similar to the administration's revenue-limit approach, we recommend distributing block grant funding in a simple, streamlined manner using the Department of Education's (SDE) consolidated funding application.
- ***Per Teacher Funding Rates.*** We recommend allocating funding to school districts based upon their number of new teachers. Recognizing the additional support new teachers need, we recommend setting a higher funding rate for new teachers than veteran teachers. If funding for these programs were pooled, we estimate that the state would be able to provide $3,560 per first-year and second-year teacher (slightly higher than the projected 2004-05 Beginning Teacher Support and Assessment rate of $3,506) and $1,000 per veteran teacher (slightly higher than the projected 2004-05 Staff Development Buyout rate of $914). (These 2004-05 rates do not include funding currently provided for the National Board program because most of this funding would be used to honor existing state obligations. Annually, as existing awards expire, National Board funding could be shifted into the block grant, thereby raising per teacher funding rates.)
- ***Broad Discretion to Implement Teacher Quality Programs.*** We recommend allowing school districts broad discretion to implement teacher quality programs that are tailored to their specific needs. Districts, therefore, would be allowed to participate in existing state programs, join with nearby districts, county offices,

and / or universities to operate collaborative programs, or develop their own programs.

Pooling Resources Allows for More Strategic Deployment. Similar to a revenue-limit approach, a block grant allows school districts to pool all available teacher quality funds and dedicate them to their most pressing teacher quality needs. This would help school districts achieve efficiencies by leveraging their existing resources more effectively. For example, a block grant would provide school districts with greater opportunities to conduct more sustained activities for struggling teachers rather than require short-term workshops for all teachers. Additionally, a block grant allows school districts to better coordinate their teacher preparation, induction, and professional development programs, and it simplifies the relatively complex administrative process districts must currently maneuver to obtain teacher quality monies. Lastly, in contrast to a revenue-limit approach, a block grant would have the additional benefit of retaining the state's focus on teacher quality and preserving fiscal incentives for making investments in teacher quality.

Enhance Accountability for Improving Teacher Quality

To ensure that the greater flexibility provided through a teacher quality block grant is balanced with greater accountability, we recommend the Legislature develop a comprehensive teacher information system. Specifically, we recommend the Legislature: (1) develop clear teacher quality objectives and associated performance measures, (2) enhance data-collection efforts to ensure performance can be tracked, and (3) provide feedback and assistance to struggling school districts.

Whether teacher-related programs ultimately are funded separately, consolidated within a block grant, or shifted into revenue limits, we think the state should have a comprehensive teacher information system that is compatible with the state's student information system. Although a teacher information system is critical under all three funding scenarios, it is particularly critical in a block-grant or revenue-limit environment that has few, if any, specific compliance requirements. In establishing a teacher information system, we recommend the Legislature include: (1) explicit outcome measures, (2) data reporting requirements, and (3) feedback to struggling school districts.

Establish Explicit Outcome Measures. To hold districts accountable for improving teacher quality, the state's overriding objectives need to be clear and measurable. In other words, the state needs to define the goals of staff development and determine how success is to be measured. We recommend the state evaluate school districts' teacher quality investments by tracking their performance in four areas—beginning teacher quality, teacher retention, professional development, and overall instructional improvement. Figure 2 lists these areas and links each one to a specific outcome measure. Two of these areas——beginning teacher quality and professional development—would overlap with the federal accountability system. The other two areas—teacher retention and instructional improvement—have long been state goals and the basis for several of the state's programs. For ease of assessment and comparison, we recommend the Legislature merge these indicators into an Instructional Performance Index that would be analogous to the state's Academic Performance Index except that it would focus directly on teacher quality.

Figure 2

Elements of Instructional Performance Index

Performance Goal	Outcome Measure
Quality of beginning teachers	• Percent of new teachers with full credentials in subject areas they teach.
Teacher retention	• Retention rate of beginning teachers.
Professional development	• Percent of teachers participating in high-quality professional development.
Overall instructional improvement	• Percent of teachers whose average class score on relevant California Standards Tests improve.

Promote Strategic Data Collection. In addition to establishing explicit outcome measures, we recommend the Legislature develop a comprehensive teacher information system to ensure that teacher quality investments can be monitored and evaluated. Currently, some teacher information is collected by various state agencies, but the state does not coordinate or leverage these independent efforts. Additionally, because no common teacher identifier is being used in the separate data systems that do exist, the value of the data already collected is substantially reduced, and many meaningful state-level analyses cannot be conducted. For example, the state lacks data to determine if certain professional development programs actually enhance either teacher quality or student achievement. Similarly, data are not available to determine if certain professional development programs are more cost-effective than other programs. Given the considerable shortcomings of these existing data-collection efforts, we recommend the Legislature promote the development of a coordinated teacher-level data system and align it with the student-level data system the state is currently developing. To enable the linking with other state data, we recommend the Legislature require school districts receiving teacher quality block grant funds to provide teacher-level data using a common teacher identifier. If integrated into the automated student-level data system (currently underway using Title VI funds), this would place little additional burden on school district reporting requirements while significantly enhancing the state's ability to conduct meaningful program evaluations.

Provide Feedback and Assistance to Struggling Districts. A comprehensive teacher information system would allow the state to identify the vital ingredients that make certain programs work in certain kinds of school districts. This information would provide significant state-level benefits—helping the state to make wise and strategic investments—but it also would provide significant local-level benefits—helping school districts learn from one another. Thus, we recommend that the teacher information system be used to routinely disseminate best practice models. Moreover, given that the block grant structure would result in fewer program-specific administrative responsibilities for SDE, it could begin shifting resources to provide this kind of feedback to struggling school districts. This feedback might include sharing information about the effective strategies and reform efforts used by similar school districts, helping redesign districts' staff development programs, or connecting struggling districts with high-quality induction and professional development providers.

In sum, we have several concerns with the administration's proposal to shift funding associated with most teacher quality programs into districts' revenue limits. Most importantly, by removing the direct fiscal incentives school districts have for investing in teacher quality, we are concerned that this funding shift might reduce the overall emphasis placed on teacher quality. Rather than the administration's revenue-limit approach, we recommend the Legislature consolidate ten categorical programs into a teacher quality block grant. As a condition of receiving block grant funds, we recommend the Legislature require participating school districts to report teacher-level outcome data in four performance areas. Lastly, we recommend the Legislature embed these data in a new comprehensive teacher information system.

GOVERNOR'S SCHOOL SAFETY CONSOLIDATION

The Governor's budget proposes to consolidate five of seven existing school safety programs into a School Safety Competitive Grant, leaving two programs outside of the block grant. We recommend the Legislature expand on the Governor's proposal by creating a formula-driven School Safety Block Grant combining all seven school safety programs and 12 school safety-related state reimbursable mandates. We also recommend reversion of $1.6 million in current-year funds for competitive grant programs that the State Department of Education does not plan to administer.

The *2004-05 Governor's Budget* provides $100 million for school safety programs (including deferrals), the same amount provided in 2003-04. The budget also consolidates the Gang Risk Intervention Program and four School / Law Enforcement Partnership Programs into a School Safety Competitive Grant Program to increase local flexibility and effectiveness. Currently, these programs provide competitive grants to school districts and county offices of education (COEs) based on criteria including need and quality of implementation plans. According to the Department of Finance (DOF), funding for these five programs will be consolidated into one budget item, but the underlying statute for the five programs will continue to govern the use of the funds. In addition, current grantees will have priority access to the funds. According to DOF, the Governor excludes from his block grant the School Safety and Violence Prevention Grant Program and the Safety Plans for New Schools Program because these programs provide funding to school districts on a formula basis. Figure 1 (see next page) lists the funding level for school safety programs for the budget year.

Problems With Current Situation

Below, we summarize some of the basic problems with the current array of school safety programs.

Figure 1

Governor's School Safety Competitive Grant Consolidation

(In Millions)

Included Programs	Proposed 2004-05
Gang Risk Intervention Program	$3.0
School/Law Enforcement Partnership Programs	
School Community Policing Partnership	10.0
School Community Violence Prevention	0.7
Partnership Mini-Grants/Safe School Planning	0.6
Conflict Resolution	0.3
Subtotal	($11.6)
Total	**$14.6**
Excluded Programs	
School Safety and Violence Prevention Grant Program	$82.1[a]
School Safety Plans for New Schools Program[b]	3.0
Total	**$85.1**
Total, All Programs	**$99.7**

a The Governor proposes to use $46.3 million in Proposition 98 reversion account funding and defers the remaining amount until 2005-06.

b This program was previously within the School Law Enforcement Partnership Program; however, the Governor proposes to maintain this program separately in the budget year.

Competitive Grants Have Significant Administrative Costs. The State Department of Education (SDE) does not plan to administer three of the competitive grant programs in 2003-04—School Community Violence Prevention ($700,000), School Partnership Mini-Grants / Safe School Planning ($628,000), and Conflict Resolution ($280,000)—because the department advises that it does not have adequate staff resources to administer these small, but staff intensive grant programs. The SDE also did not administer these programs in 2002-03, and the funds reverted.

In addition to the administrative demands on the state, the competitive grant programs place an even more onerous administrative burden on schools. State law requires every school to develop a school safety plan. School districts applying for one of the four School Law Enforcement Partnership Programs must develop an additional plan explaining how their school district will collaborate with law enforcement and what the school district will do with the funding. In addition, the school district must submit data justifying their "higher level of need." Figure 2 (see next page) shows details on the specific requirements of each program.

Current Programs May Not Target Greatest Need. Schools with the most need may not receive funding through the current competitive grant programs for one of two reasons: (1) they choose not to apply because of the involved application process, or (2) lack of comparable data makes it difficult to assess which schools have greatest need. Thus, schools with the most to gain from additional school safety funding may not receive it, while others with lower needs but high-quality grant writers may get additional funding. We believe that funding should be used to target the highest-risk schools on a formula basis, and that a uniform set of eligibility criteria should be used.

Concerns With the Governor's Proposal

Since the Governor's school safety consolidation proposal maintains the five existing competitive grant programs—including the existing program requirements, eligibility criteria, and application processes, the only benefit of the proposal is to allow SDE some flexibility to move funds among the five grant programs. We believe the Governor's school safety consolidation proposal does not provide school districts any increased flexibility or go far enough to consolidate programs that provide funding for similar intents and purposes. Specifically, the proposal misses the opportunity to truly streamline the existing school safety programs by: (1) continuing to operate the five competitive grant programs, (2) excluding the School Safety Violence Prevention Grant Program funding, and (3) excluding reimbursement funding for state mandates. We discuss each of these concerns below.

Governor Continues Five Competitive Grant Programs. By consolidating the funding for the five competitive grants into one budget item, the administration would provide SDE with the flexibility to adjust the funding distribution among the five grants. However, according to DOF staff, the proposal would not eliminate statutes for any of the programs, and current grant recipients would have priority in continuing to receive funding. Since the Governor's proposal would continue to administer five grant programs, it does not eliminate any of the bureaucratic burden of these programs. We also believe that using a formula process to target "high" need schools may be more effective than the competitive grant process.

Figure 2

Description and Funding Information for Programs Included in the Governor's School Safety Block Grant

2003-04

Program	Criteria	Grant Cycle	Grant Amount	2003-04 Grants Funded
Gang Risk Intervention Program. County offices of education (COEs) offer counseling, sports, cultural activities, and job training to specific schools in county.	Plan must prove need using safety data, justify merits of proposal, and have line-item budget and evaluation.	1 year	\$100,000 to \$1,075,000	15
School Community Policing Partnership Program. Districts or COEs implement plans collaboratively with local law enforcement to improve school safety.	Plan must prove need, collaboration with community and law enforcement, and sustainability. Requires local match, evaluation, and annual reporting. Grants geographically distributed.	3 year	\$325,000	33
Other Competitive Grant Programs. Three programs fund school safety plan implementation, community policing measures, and conflict resolution programs and training: Partnership Mini-Grants/Safe School Plan Implementation, School Community Violence Prevention, and Conflict Resolution.	Plan must prove need; demonstrate collaboration with students, community, and law enforcement; and justify budget. Requires local match and evaluation.	1 year	\$5,000 to \$10,000	—[a]

[a] According to the State Department of Education, grants were not awarded in 2002-03, nor will they be awarded in the current year because they do not have sufficient staff to oversee the grant process. As a result, this funding will revert to the General Fund in the current year, similar to what occurred in 2002-03.

Proposal Excludes School Safety Violence Prevention Grant Program. The budget provides $82.1 million to school districts through the School Safety Violence Prevention Grant Program. These funds may be used by school districts for any purpose that improves school safety or that reduces violence among students. Given this discretion, the program is tailor-made for inclusion in a larger block grant. Essentially, consolidating this program with the existing competitive grant programs would provide school districts greater flexibility to use school safety funding to meet their local needs and priorities.

Proposal Excludes Funding for School Safety Mandates. As with all other mandates in 2004-05, the budget does not fund ten state reimbursable mandates that require school districts to perform specific school safety activities. This has the effect of deferring $30.3 million in 2004-05 costs to future years. Under the current system, the state reimburses school districts for the cost of meeting certain state mandates, such as (1) implementing school suspension and expulsion policies and procedures, (2) providing for emergency procedures, and (3) reporting crimes/incidents at schools.

The Governor's consolidation proposal does not incorporate these programs in the reform of school safety funding. We believe there would be benefits from doing so. For instance, school districts currently have an incentive to maximize the size of their mandate claims because 100 percent of the costs of the mandates are reimbursed by the state. The costs of documenting and submitting state reimbursable mandate claims are also significant. If school districts instead received their mandate funding through the block grant, they would have a greater incentive to be more efficient because any savings realized could then be redirected to fund any purpose that meets the safety needs of the district.

LAO School Safety Block Grant Proposal

We recommend the Legislature create a formula driven School Safety Block Grant, which consolidates the seven existing school safety programs with funding for ten state reimbursable school safety mandates. Figure 3 (see page 71) shows the programs included in the LAO proposal, and provides a breakdown of the funding into the three components of our block grant proposal—per pupil grant formula, high-risk schools formula, and a new school planning grant.

- ***Per Pupil Grant.*** Most of the school safety funding, $112 million, would go to districts by a per pupil formula, based on enrollment in grades 8 through 12. This funding level is equivalent to the current funding provided for the School and Violence Prevention Grant Program and an amount necessary to fully fund school safety state mandates.

- ***High-Risk Schools Formula Grant.*** We propose combining $14 million from the five existing competitive grant programs into a formula grant targeted at high-risk schools. We recommend that these high-risk grants target the 20 percent of schools with the highest safety needs, based upon uniform school safety data. Currently, school districts are in the process of collecting suspension, expulsion, and truancy data to comply with No Child Left Behind data collection requirements. We believe the expulsion data collected, specifically the mandatory expulsion data, would provide the Legislature with a useful measure of "need" to identify high-risk schools that would benefit from additional school safety funding. The $14 million would be distributed to the high-risk schools on a per pupil basis. These schools would also face specific accountability requirements linked to their decreasing the number of mandatory expulsions over a multiyear period (see below).
- ***New School Planning Grant.*** We propose to retain the earmarked funding to support new schools in developing school safety plans, and provide $1 million for this purpose.
- School districts would be required to fund the costs of state mandates prior to funding other school safety purposes. In addition, COEs would be eligible for block grant funding.

Accountability Provisions for High-Risk Funding. With regard to high-risk schools receiving added funding under our proposal, the Legislature may want to consider some added accountability provisions. Given the serious problems at these schools, it is imperative that either improvements be made or other, stronger interventions occur. One option would be to link the high-risk component of our block grant to current federal law related to "persistently dangerous" schools. The state could define this term as those high-risk schools which fail to make adequate enough improvement over time with the funding available from their school safety block grant funds. This would then trigger more serious district and state interventions required under federal law to address the problem.

Benefits of the LAO School Safety Block Grant Proposal

We believe that our alternative block grant proposal has the following benefits: (1) it maximizes local control and flexibility, (2) targets funding to districts that have a greater need for school safety funding,

Figure 3

Programs in LAO School Safety Block Grant

2004-05
(In Millions)

Programs	Amount
Per Pupil Grant Formula	
School Safety and Violence Prevention Grants	$82.1[a]
State Mandated Programs	30.3
Notification of Truancy	9.2
Habitual Truants	6.9
Notification to Teachers of Pupil Expulsion	5.2
Pupil Suspensions, Expulsions, and Expulsion Appeals	3.4
Pupil Classroom Suspension: Counseling	2.5
Law Enforcement Agencies	1.8
Pupil Suspensions: Parent Classroom Visits	0.7
Juvenile Court Notices II	0.7
Expulsion Transcripts	—
Subtotal	($112.4)
High Risk School Formula	
School/Law Enforcement Partnership Programs	$11.6
Gang Risk Intervention	3.0
Subtotal	($14.6)
School Safety Plans for New Schools	1.0
Total	**$128.0**

[a] Includes $82 million deferred from 2004-05 into 2005-06.

(3) creates an incentive for districts to meet mandate requirements more efficiently, and (4) limits administrative burden by combining programs that have similar purposes. We discuss these benefits below:

Maximizes Local Control and Flexibility. Our School Safety Block Grant proposal would provide school districts with greater control and flexibility in regards to how they use school safety funding. Under the block grant proposal, school districts would have more choice related to the: (1) needs they choose to target, (2) types of programs they create, and (3) program models they use to deliver services. School districts could use their School Safety Block Grant funding for a variety of purposes that support their local needs and priorities, including hiring personnel and counselors, providing training, and purchasing safety devices.

Targets Funding to Schools With Greatest Need. Under our proposal, schools that demonstrate a higher need for funding based on their number of mandatory expulsions would receive additional funding to assist them in meeting their school safety needs. By providing these funds on a formula basis instead of a competitive basis, all of the resources would go to improving school safety, thereby foregoing the administrative costs that accompany the grant process. These schools could then use this funding to provide additional services to reduce the incidences of violence against pupils and school staff.

Creates Incentive to Meet Mandated Requirements More Efficiently. Under the current system, school districts receive full reimbursement funding from the state for completing certain school safety activities. Including funding for state mandates into the block grant creates the incentive for school districts to be more efficient because any savings realized could then be redirected to fund other school safety needs and priorities.

Limits Administrative Burden by Consolidating School Safety Programs. The existing system of funding school safety through multiple programs increases state and local administrative costs. State administrative efforts are focused on such oversight functions as: (1) reviewing applications and (2) tracking and monitoring the appropriate use of categorical funding. School districts also incur high administrative costs because they must apply separately to multiple programs for funding and, like the state, must track and monitor the appropriate use of categorical funding. Consolidating these programs would minimize the administrative burdens associated with (1) reviewing and submitting numerous applications for funding and (2) tracking and monitoring of different pots of categorical funding. Free of the various administrative requirements, SDE could focus more on providing locals with program support, and locals could focus more on maximizing the impact of funding on their school safety efforts.

Provides Added School Safety Accountability for High-Risk Schools. We believe that targeting additional resources at schools with the greatest safety risk and requiring improvements at these schools would help ensure that school and district administrators take school safety seriously. Our proposal would provide schools an opportunity to fix their safety problems with the additional resources. It would also provide external assistance for schools failing to improve.

High Administrative Costs Prohibit SDE From Administering Current-Year Grants

We recommend the Legislature revert $1.6 million provided in 2003-04 for three school safety competitive grant programs that the State Department of Education is not administering because of the administrative burden of the programs.

The *2003-04 Budget Act* provided $1.6 million for three competitive school safety grant programs—School Community Violence Prevention, Partnership MiniGrants / Safe School Planning, and Conflict Resolution. As described earlier, these programs provide grants of $5,000 to $10,000 to each school meeting specific requirements. Because the grant size is so small, the $1.6 million would result in a large number of grants to administer. According to SDE, because the administrative burden of operating these programs is high and SDE does not have staff to operate the programs, the department will not administer the three competitive grants in 2003-04. (Similarly, SDE did not administer these grant programs in 2002-03, and the funding reverted on the natural.) We recommend the Legislature revert these funds as part of the 2004-05 budget, and redirect the savings to other K-14 priorities.

Safety Plans for New Schools Program Overfunded

We recommend that the Legislature reduce funding for the Safety Plans for New Schools Program by $2 million, leaving $1 million to meet anticipated needs of new schools.

The *2004-05 Governor's Budget* provides $3 million in funding for the Safety Plans for New Schools Program. This funding is provided to new schools to implement a comprehensive safe school plan. School districts opening new schools receive $91 per pupil or a minimum grant of $5,000 per site to develop a safety plan. According to SDE, funding has not been fully allocated in recent years. Last year, for example, SDE reverted approximately $2 million because actual need for funding totaled $1 million. For the budget year, SDE estimates that as many as 80 new schools may open and that $1 million dollars would be a sufficient level of funding for this program. Therefore, we recommend that the Legislature reduce funding by $2 million to reflect the actual demand for this program.

CHARTER SCHOOLS

The Governor's budget proposal makes significant changes to the existing charter school funding model. This existing funding model consists of three components: revenue limit funding, block grant funding, and categorical funding. The Governor's budget proposal makes a variety of adjustments to charter schools' revenue limits and eliminates the charter school categorical block grant.

Specifically, the budget adjusts the charter school funding model so as to mirror the administration's overall categorical reform proposal. This entails: (1) transferring the funding associated with 22 categorical programs into charter schools' revenue limits (as is proposed for traditional public schools), (2) eliminating the charter school block grant and shifting remaining funds into charter schools' revenue limits, and (3) providing charter schools with Economic Impact Aid (EIA) funds directly rather than providing in-lieu funding through the block grant.

Details of Governor's Proposal Problematic

Although the Governor's budget proposal seemingly would simplify the charter school funding model, we have several concerns with the details of the proposal.

Cements Certain Inequities. Under the proposal, the Department of Finance (DOF) uses two distinct methods for shifting categorical funding into charter schools' revenue limits. For 18 of the 22 categorical programs, DOF provides a per pupil funding rate to charter schools equal to the average per pupil rate for traditional public schools. However, for four of the 22 programs (Home-to-School Transportation, Instructional Materials, School Library Materials, and Staff Development Days), DOF locks in place the existing funding distributions. This has significant implications for charter schools because these four particular programs are among the largest of the 22 programs and together account for almost $1 billion of the $2 billion to be shifted into revenue limits. They also are programs in which charter schools are less likely than traditional public schools to be participating during the current year. Moreover, legislation enacted just last year (2003) moved two of these four programs into the charter school block grant—signaling the Legislature's intent that associated per pupil funding rates be the same for charter schools and traditional public schools. The Governor's budget proposal would prevent these funding changes from ever occurring.

Potentially Creates New Inequities. In the process of dismantling the charter school block grant, the Governor's budget moves ten programs into charter schools' revenue limits (see Figure 1 next page). This shift occurs only for charter schools. This has two potentially troubling implications:

- In the future, if any funding adjustment were made to one of these ten programs, charter schools would be immune from the impact. This could result in charter schools being treated either considerably better (if one or more of the ten programs were defunded) or considerably worse (if one or more of the ten programs were augmented) than traditional public schools.
- Given this shift occurs only for charter schools, the charter school revenue limit would be slightly higher than that of the average traditional public school. Because of this anomaly, in the future, charter school revenue limits would be adjusted independently—no longer linked directly to the average revenue limit of traditional public schools. This also could generate disparities between charter schools and traditional public schools because their revenue limits would no longer be adjusted automatically in a consistent manner.

Potentially Reduces Future Fiscal Flexibility. Entirely dismantling the block grant means the state no longer has a vehicle for providing charter schools with in-lieu categorical funding. Lacking a block grant option, in the future charter schools might need to apply separately for all newly created categorical programs. Over time, this could drastically reduce their fiscal flexibility and autonomy—among the cornerstones of charter school legislation.

Retains More Than 20 Categorical Programs for Which Charter Schools Have to Apply Separately. Even if no new programs were created in the future and 22 categorical programs were shifted into revenue limits in the budget year, charter schools still would have to apply separately for more than 20 existing categorical programs. Lacking a block grant structure, the state has no straightforward vehicle for providing charter schools with in-lieu categorical funding. Reforming the existing system therefore would be more difficult, more complicated, and potentially lead to greater inequities (as discussed above).

Figure 1

Charter School Block Grant Programs Governor Shifts Into Revenue Limits[a]

Advanced Placement Fee Waiver Program
Agricultural Vocational Education
Apprentice Program
Community Day School
Foster Youth Programs
Gifted and Talented
High-Risk Youth
Opportunity Programs
Partnership Academies
School Safety

[a] The Governor's proposal shifts these programs only into charter schools' revenue limits. It does not shift these programs into revenue limits for traditional public schools.

Restructure Charter School Funding Model—Simplify and Equalize

We recommend the Legislature reform the charter school funding model to promote greater transparency and ensure more comparable funding rates between charter schools and traditional public schools. Specifically, we recommend the Legislature: (1) shift funding associated with 17 categorical programs into charter schools' revenue limits, (2) consolidate 21 categorical programs into charter schools' base block grant, (3) enlarge the disadvantaged student component of the block grant by including eight additional programs, and (4) amend charter school law to include a comprehensive listing of the programs excluded from the block grant.

In January 2004, we released a report entitled, *Assessing California's Charter Schools*, in which we recommended the Legislature restructure the charter school categorical block grant and strengthen charter school oversight and accountability. (Please see report for a more detailed discussion of charter school finance.) Below, we recommend the Legislature make a variety of changes to the charter school funding model. Although we recommend the Legislature apply certain aspects of the administration's revenue limit proposal to charter schools, we recommend retaining the existing charter school block grant and using it to further categorical reform. Figure 2 summarizes the major components of our alternative funding model.

Figure 2

LAO Alternative Charter School Finance Reform

✓ ***Revenue Limits.*** Shift funding associated with 17 categorical programs into revenue limits. Charter schools' revenue limit per pupil funding rate would equal the average rate for traditional public schools.

✓ ***Charter School Block Grant.*** The block grant would consist of two subgrants:

- ***Base Grant.*** Provide an in-lieu grant based on the average per pupil funding rate for 21 categorical programs that address general education needs.
- ***Supplemental Disadvantaged Student Grant.*** Provide an in-lieu grant based on the average per pupil funding rate for nine categorical programs that target disadvantaged students.

Shift 17 Categorical Programs Into Revenue Limits. Earlier in this chapter, we discussed the administration's overall categorical reform proposal. In that piece, we highlight the benefits of categorical consolidation and recommended the Legislature shift the funding associated with 17 categorical programs into revenue limits. We recommend this funding shift occur for both traditional public schools and charter schools. In the process of shifting these programs, we recommend providing a per pupil funding rate to charter schools equal to the average per pupil funding rate for traditional public schools.

Consolidate Many Remaining Categorical Programs Into Block Grant. We recommend retaining the base charter school block grant and consolidating 21 programs within it. Figure 3 (see next page) lists these 21 programs. More than two-thirds are programs already in the existing block grant. Given the remaining six programs all serve traditional K-12 populations, we think they too should be consolidated within the charter school block grant. In the process of consolidating these programs, we recommend providing a per pupil funding rate to charter schools equal to the average per pupil funding rate for traditional public schools.

Expand Disadvantaged Student Component of the Block Grant. We also recommend the Legislature expand the disadvantaged student component of the block grant by consolidating charter schools' in-lieu EIA funding and funding associated with eight other programs designed spe-

Figure 3

Consolidate 21 Programs Within Base Block Grant[a]

Programs in Existing Block Grant
Advanced Placement Fee Waiver Program
Agricultural Vocational Education
Apprentice Program
Beginning Teacher Support and Assessment
Community Day School
Foster Youth Programs
Gifted and Talented
High-Risk Youth
Intersegmental Programs
Mathematics and Reading Professional Development
Opportunity Programs
Partnership Academies
Peer Assistance and Review
School Safety
Staff Development Buyout Days
Additional Programs Recommended for Inclusion
After School Programs
Core Supplemental Instruction
Intern Program
Paraprofessional Program
Principal Training
Regional Occupational Programs and Centers

[a] Reflects LAO recommendation.

cifically for disadvantaged students. Figure 4 lists these nine programs. We recommend that disadvantaged student funding continue to be based on a count of the disadvantaged students enrolled in charter schools. Consolidating all nine programs would generate additional incentives for charter schools to serve disadvantaged students—one of the core legislative objectives of charter schools—without increasing administrative burdens or adding new fiscal complexities.

Amend Charter School Law to Promote Greater Transparency. Lastly, we recommend the Legislature codify in a single section (specifically, in

Figure 4

Expand Disadvantaged Student Component of Block Grant[a]

Programs in Existing Block Grant
Economic Impact Aid
Additional Programs Recommended for Inclusion
California School Age Families Education
English Language Learners Student Assistance
Gang Risk Intervention Program
Mandatory and Remedial Supplemental Instruction
National Board Certification for Teachers in Low-Performing Schools
Public School Accountability Programs
Remedial Supplemental Instruction
Targeted Instructional Improvement Block Grant

a Reflects LAO recommendation.

Education Code 47634[b]), all programs that are excluded from the charter school block grant. In tandem, we recommend the Legislature adopt a new statutory provision requiring all newly established categorical programs that are to be excluded from the block grant to be specified in this code section. Together, these actions would promote a common understanding of excluded programs and make block grant calculations less controversial.

In sum, we recommend the Legislature make a variety of changes to the charter school funding model. Similar to the administration's overall reform proposal, we recommend shifting 17 categorical programs into revenue limits for both charter schools and traditional public schools. In contrast to the administration's specific charter school proposal, we recommend the Legislature use the categorical block grant to further categorical reform and enhance charter schools' fiscal flexibility. Specifically, we recommend consolidating 21 programs within the base component and nine programs within the supplemental disadvantaged student component of the block grant. Lastly, we recommend amending charter school law to codify in a single section all the categorical programs excluded from the block grant.

ECONOMIC IMPACT AID

We find that the Economic Impact Aid (EIA) funding formula is outdated and results in district allocations that appear arbitrary and unpredictable. We recommend the Legislature simplify the EIA formula so that district allocations are predictable and meet local needs for serving both poor and English learner students.

The 2004-05 Governor's budget provides $548 million for the Economic Impact Aid (EIA) program. This funding level represents a $49.1 million increase from the current year due to: (1) $34.6 million for growth and inflation and (2) the Governor's proposal to shift $14.5 million in EIA funding from the charter school block grant into a separate schedule within the EIA budget item.

The EIA program provides funding to school districts to provide compensatory education services to low-performing and English learner (EL) pupils. School districts use funding for a variety of purposes, including: (1) extra assistance to low-achieving pupils, (2) supplemental instructional services to EL students, (3) training to teachers who instruct EL students, and (4) supplementary materials.

School districts receive EIA funding based on two main formulas:

- ***Primary Formula.*** The primary formula uses a complex multistep process that includes the following features:
  - "Need" for EIA funds is measured by each district's relative concentration of EL, poor, and transient students.
  - Poverty is by far the most important factor in determining district EIA need. The formula uses two different measures of poverty—the enrollment of students from families receiving California Work Opportunity and Responsibility to Kids (CalWORKs) grants and poverty data from the 1990 Census.

  In 2003-04, the primary formula determined EIA allocations for 205 school districts, providing an average of $280 (ranging from $220 to over $1,000) for each EL and CalWORKs student in these districts.

- ***Secondary Formula.*** The secondary formula distributes funds to districts whose primary funding allocations would not be sufficient to serve a "reasonable" portion of the population of pupils from disadvantaged backgrounds. The secondary formula has two elements:
  - ***Per-Pupil Grant.*** Districts that would receive a relatively small allocation through the primary formula receive funding based solely on the number of CalWORKs and EL students. In 2003-04, approximately 600 school districts received $219 for each student in the two target groups.
  - ***Minimum District Grant.*** Districts with very low numbers of EL pupils and pupils from families receiving CalWORKs receive a minimum grant. In 2003-04, approximately 175 school districts received minimum grants.

EIA Formula Is Outdated and Problematic

The EIA funding mechanism has been in existence for more than 25 years. During this time, the state's demographics and the needs of the student population have changed dramatically. For example, 25 years ago, pupils living in poverty represented a majority of the student population in need of compensatory funding. Since that time, poverty as measured by students in CalWORKs families has declined and the number of EL students has grown dramatically. Figure 1 (see next page) displays the trends for these two groups.

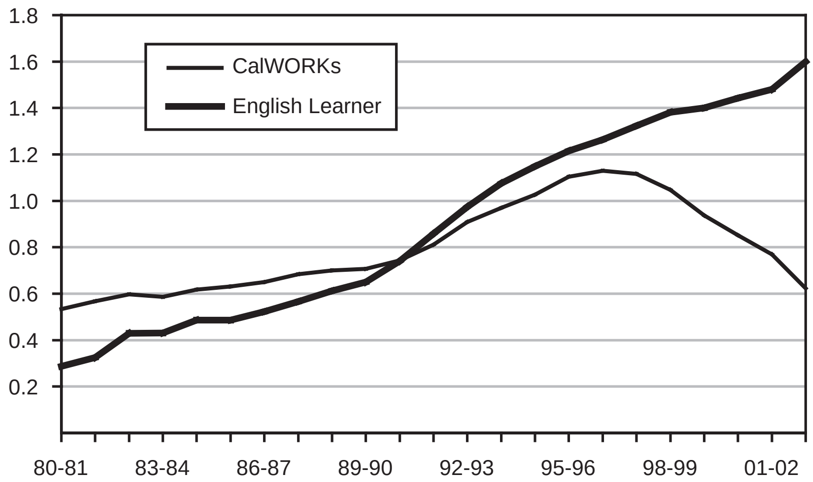
As the figure shows, the number of EL students increased by 450 percent since 1980 and CalWORKs increased by 17 percent. As a result, the EL population, which was half the size of the group of students whose families received welfare in 1980, is now 2.5 times larger than the CalWORKs group. District use of EIA funds reflect these trends. Districts report using about 85 percent of EIA funds for EL services.

These changes in student demographics have resulted in the allocation of a greater share of EIA funds to districts with large proportions of EL students. Because of the formula's heavy emphasis on poverty, however, districts with large numbers of poor students still receive far more than districts with large numbers of EL students. In addition, the complexity of the EIA formula results in allocations that appear arbitrary and unpredictable. We discuss these issues in greater detail below.

Figure 1

K-12 Enrollment of English Learners and Students in Families Receiving CalWORKs

(In Millions)



Heavy Emphasis on Poverty Skews Per-Pupil Payments

As noted above, districts report using 85 percent of EIA funds for EL services. The heavy emphasis on poverty in the EIA formula, however, results in allocating large per-pupil amounts to districts with high poverty rates. As a result, we question whether the formula does a reasonable job of allocating funds to help districts address the needs of both groups of students.

A close look at EIA allocations for two districts of similar size illustrates the heavy emphasis on poverty. Figure 2 displays the EIA allocations and the number of EL and CalWORKs students in Oakland and Santa Ana Unified School Districts. In 2003-04, Oakland received $350 for each EL and CalWORKs student in the district based on about 31,500 students in the two groups. Santa Ana received $221 for each based on about 46,000 students in the two groups. As a result, Oakland received about $11 million, or about $900,000 more than Santa Ana, despite having many fewer targeted students.

Figure 2

Economic Impact Aid (EIA) Allocations

Oakland and Santa Ana Unified School Districts 2003-04

	Oakland	Santa Ana
English learner students	18,589	41,278
CalWORKs[a] students	12,946	4,655
Total students	**31,535**	**45,933**
EIA Funding		
Totals (in millions)	$11.0	$10.1
Per pupil	350.0	221.0

[a] California Work Opportunity and Responsibility to Kids.

District Allocations Appear Arbitrary and Unpredictable

As discussed above, the EIA formula is extremely complex. This complexity results in district allocations that are hard to understand based on underlying district demographics. Our review of district EIA allocations reveals that the formula:

- ***Treats Similar Districts Very Differently***. Districts with almost identical numbers of EL and CalWORKs students can receive very different amounts of EIA funds. For instance, Burrel Union Elementary receives $812 for each of the 34 EL and CalWORKs students in the district (21 and 13, respectively). Buena Vista Elementary receives only $221 for each of the 35 students in the two groups (23 and 12, respectively). Given that the number of students needing extra assistance in these two districts are almost identical, the widely differing amounts seem hard to justify.

- ***Generates Unpredictable Changes in District Allocations.*** The EIA formula creates unpredictable results from year-to-year, which complicates district planning efforts. For instance, more than 300 districts received increases in 2003-04 even though the number of EL and CalWORKs students enrolled in the district *declined*. Similarly, 16 districts received funding decreases in 2003-04 despite experiencing an increase in the number of students in the two groups.

Simplify and Refocus EIA Formula

Given these problems, we recommend the Legislature revamp the EIA formula so that it distributes funding based on the number of poor and EL pupils enrolled in each district. This would direct more of the funds to districts based on the number of EL pupils, which is consistent with how districts currently use EIA funds. This also would result in more stable and predictable district allocations, which would change as the target populations rise or fall. Below, we describe the features of our proposed EIA formula.

Maintain Key Features of the Current Funding Model

Rather than completely redesign the EIA formula, our proposal builds on three existing features of the formula, as follows:

- ***Per-Pupil Grants.*** Districts would receive a set amount of funding for each EL and CalWORKs pupil, similar to the existing secondary formula.
- ***Concentration Grants.*** Additional funding would be distributed to districts with a large proportion of poor and EL pupils.
- ***Minimum District Grants.*** A minimum grant would be available for districts with small numbers of eligible pupils.

These three design elements would ensure that districts receive a level of funding that is proportional to the needs of the targeted populations. While most districts would receive a uniform amount for each EL and CalWORKs student, the concentration and minimum district grants recognize that all districts do not face the same circumstances. The minimum grant ensures a minimal level of funds to operate a program—no matter how few EL or poor students attend the district. The concentration grant recognizes that districts may face a more difficult challenge in educating students when the proportion of EL and poor students is relatively high.

Per-Pupil Grants. Under our proposal, most EIA funds would be distributed to districts through a per-pupil grant of approximately $210 for each EL or CalWORKs student enrolled in the district. In addition, our EIA formula would provide a per-pupil grant for each EL student who was redesignated as "fluent" in the previous year. This is intended to reduce the fiscal incentive for school districts to keep students classified as EL.

Concentration Grants. Districts with a large proportion of EL and poor pupils would receive additional funds. Under our proposal, districts in which the proportion of CalWORKs and EL students exceeds

55 percent of their total enrollment would be eligible to receive an additional $180 per pupil for each pupil above the 55 percent threshold. We estimate that, using our formula, about 125 school districts would receive a concentration grant.

One benefit to our proposed concentration grant is that it increases as the proportion of students in the two groups increases. For example,

- District A, with 55 percent of its students EL or CalWORKs, receives only the base funding of $210 per pupil.
- District B has 70 percent of its students EL or CalWORKs, and receives almost $250 per pupil.
- District C, with 90 percent of its students EL or CalWORKs, receives $280 per pupil.

As with the existing formula, EL students could be counted as both EL and a poor student.

Minimum District Grant. Our proposal would continue the two existing EIA minimums ($4,901 and $7,356), which are based on the number of EL and CalWORKs students in the district.

District Allocations Under the LAO Proposal

Our proposal provides several "levers" within the revised funding formula that could be used to alter the distribution of funds. For instance, by increasing concentration grants, the formula would provide more funds to heavily impacted districts and less to all other districts. Similarly, increasing the concentration "threshold" focuses concentration funds on a smaller subset of districts.

We ran several simulations using different assumptions for these policy options to find the combination that minimized the number of districts that would receive significant funding reductions under our proposed formula. By increasing the formula's emphasis on EL students, however, our proposal would create a significantly different distribution of EIA funds.

Under our formula, about half of all districts would not experience a change of more than 5 percent in their existing EIA grants. There is, however, a fairly large group of districts whose allocation would change significantly. For instance, about 18 percent of districts would experience an increase of more than 20 percent. These districts generally have larger EL populations and smaller numbers of CalWORKs students. Another 13 percent of districts would experience a reduction of at least 20 percent.

In recognition of the fiscal difficulty a significant decrease in EIA funding could cause districts, we suggest a transition period that limits reductions in district EIA allocations to 15 percent each year. This practice is similar to protections afforded school districts under the current funding mechanism.

Merge Other Funds Into EIA

We recommend including funding for the English Learner Assistance Program and a portion of the Targeted Instruction Improvement Grants into Economic Impact Aid in order to consolidate all state programs that support instructional services to English learners and low-income students.

Earlier in this section, we reviewed the Governor's proposed consolidation of 22 categorical funds into revenue limits. In that analysis, we recommend the Legislature exclude two programs from the consolidation—English Learner Assistance Program (ELAP) and a portion of Targeted Instruction Improvement Grants (TIIG). We made this recommendation because we think categorical protection for instructional services to "at-risk" students is needed.

Rather than maintain separate appropriations for ELAP and TIIG, however, we suggest an alternative course. Specifically, we recommend consolidating ELAP funds into the EIA program and appropriating TIIG funds districts spend for instructional services to low-performing students as part of EIA. This would maintain the current uses of these funds and simplify the state's system of categorical funding.

ELAP. Adding the $53.2 million in ELAP funds into EIA would result in distributing the ELAP funds based on our proposed formula. The ELAP increases state support for services to EL students in grades four through eight. Folding ELAP funds into EIA would resolve two issues with the existing program. First, by providing additional funds for students in grades four through eight, the state may reward districts that have failed to redesignate quickly their English learner students. Because of the program's focus on grades four through eight, districts that help students master English quickly receive a smaller share of the ELAP funds. Merging ELAP funds into EIA would eliminate this problem.

Second, districts would like to be able to use ELAP funds for students in grades other than four through eight. A recent evaluation of EL programs in California included survey results showing that district staff believe that restricting these funds to students in the five grades creates a barrier to using the funds most effectively. By distributing the ELAP funds through the EIA formula, our recommendation would give districts flexibility to use funds to meet their highest priority needs.

TIIG. We suggest a different course for the TIIG funds. Specifically, we recommend the Legislature maintain district allocation of TIIG funds used for instructional services as an "add-on" to the amount these districts receive through the EIA formula. We do not propose folding TIIG funds into the main EIA formula because it would redistribute the desegregation funds now going to a few districts to a much larger set of districts. Because of the large amounts districts receive through TIIG and because they may have formal or informal local agreements about how these funds are used for desegregation purposes, we think the Legislature should not at this time alter the distribution of TIIG funds. In the future, the Legislature could reduce differences in the amounts of total EIA funds provided to "desegregation" districts and all other districts.

Conclusion

The EIA program provides critical resources to schools for meeting the needs of EL and low-income students. Our recommendations would retool the EIA funding formula to be more responsive to changes in these K-12 populations. Our proposal also would simplify the funding formula, making district allocations easier to understand and more predictable. Finally, our recommendations would streamline the state's system of categorical funding by consolidating into EIA two programs that provide support for the same populations. While our recommendations would reduce some district allocations while increasing others, in the long-run, we think all districts would be better served by a simple, transparent funding formula that recognizes district needs for both their EL and poor students.

Revenue Limits

The largest source of school district revenues comes in the form of revenue limits. Revenue limits provide general purpose funds—money districts may use at local discretion for the support of local programs. In 2004-05, the budget proposes $31.4 billion from local property taxes and the General Fund for school district revenue limits, an increase of $2.7 billion from the revised 2003-04 budget. Revenue limits represent about two-thirds of all state and local property tax funds districts receive.

Several significant increases account for the rise in revenue limits:

- $1.9 billion due to the proposal to shift funding for 22 categorical programs into revenue limits.
- $545 million for a 1.84 percent cost-of-living adjustment(COLA).
- $293 million to pay for a 1 percent anticipated increase in the number of K-12 students in the budget year.
- $225 million due to significantly higher district Unemployment Insurance ($129 million) and Public Employees' Retirement System (PERS) costs ($96 million).
- $110 million to further equalize school district revenue limits.

These increases are offset by a $447 million reduction due to increases in revenue limit payment deferrals and deficits.

Below, we discuss three issues regarding the budget proposal for revenue limits. First, we review problems with the existing structure of the revenue limit formula. We also examine the budget's proposal to provide equalization funds in 2004-05. Finally, we discuss the *2004-05 Governor's Budget* proposed restoration of reductions made in the current year to "excess tax" districts.

SIMPLIFY THE REVENUE LIMIT FORMULA

We recommend the Legislature revise the system of district revenue limits by merging funds provided through six "add-on" programs into base revenue limits. This would greatly simplify the computation of general purpose funding, make school funding easier to understand, and allow the state to equalize over time the amount of general purpose funds districts actually receive.

In December 2003, we issued *The Distribution of K-12 Education General Purpose Funding*, which examines how well the existing system of revenue limits serves the state in creating a reasonably uniform distribution of general purpose funding. The report concludes that the formula has become unnecessarily complex and results in district general purpose funding levels that are significantly less uniform than is usually recognized.

Figure 1 (see next page) displays the major elements of the revenue limit formula and the budget's proposed amount for each part of the formula. As the figure illustrates, there are ten existing elements in the formula that affect district funding levels. The formula begins with the base revenue limit. The state has assigned each district a base revenue limit, which is based on a variety of historical factors. The base revenue limit is the amount typically used to measure the fairness of the distribution of state funding to districts, and past legislative efforts to equalize general purpose funding has focused on reducing differences in this grant.

Except for Necessary Small Schools (NSS), each of the other elements provides add-on support to districts. That is, for each district that qualifies for the various adjustments, the state adds to—or, in the case of the PERS reduction, reduces—district revenue limit funds. The NSS program is an alternative funding source to revenue limits, and small schools receive NSS funds in lieu of revenue limit funds. In total, the budget proposes to spend $2 billion in state funds and property tax revenues for these nine adjustments to base revenue limits.

Continuation school funding provides a good example of these add-on programs. State law requires all high school and unified school districts to operate a continuation school to provide an alternate educational setting for students. Districts that opened new continuation schools after 1978-79 are eligible for supplemental funding. Funding for schools existing in 1978-79 was added to base revenue limits as part of the Proposition 13 revisions to school finance.

In 2002-03, 361 districts received an average of $53 in additional general purpose funds for each student in the district. The per-student amount varied significantly—ranging from $0.50 per average daily attendance (ADA) to $853 per ADA—in part because the continuation school formula is designed to ensure that very small continuation schools can operate. The other 57 districts operated continuation schools in 1978-79 and, therefore, received no additional funding.

Figure 1

Major Elements of the District Revenue Limit Formula

2004-05
(In Millions)

Program	Description	Total Cost
Base Revenue Limit	Pays for the basic costs of educating a student.	$27,753.4[a]
Necessary Small Schools	Subsidizes very small schools, usually in small districts.	109.7
Excess Taxes	Property tax revenues in excess of the amount needed to fund a district's revenue limit entitlement. These districts receive only basic aid and categorical funds from the state. (Non-Proposition 98).	201.4
Meals for Needy Pupils	Funding in lieu of property tax revenues that were approved by voters prior to Proposition 13.	126.8
SB 813 Incentive Programs	Funding to increase the length of the school day and school year and to increase minimum teacher salaries. Enacted in 1983.	1,231.7
Minimum Teacher Salary Incentive	Funding to increase minimum teacher salaries. Enacted in 1999 and 2000.	87.1
Interdistrict Attendance	Funding for an interdistrict attendance program affecting two districts.	0.5
Continuation Schools	Funding for continuation high schools if the school was opened after the passage of Proposition 13.	34.4
Unemployment Insurance (UI)	Reimbursement for district UI costs in excess of the district's 1975-76 UI costs.	212.2
Public Employees' Retirement System (PERS) Reduction	Reduces district funding based on the difference between the current district contribution for PERS employees and a specified base amount.	-10.3
Total		**$29,715.7**

[a] Amount includes deferrals in payments to districts, and proposed equalization funding. Excludes revenue limit funds resulting from the budget's proposal to merge 22 categorical programs and the charter school block grant into revenue limits.

Which Add-Ons Provide General Purpose Funds?

The nine adjustments are similar to the continuation school add-on in several ways. Each alters base revenue limits to reflect the Legislature's action to pay for a specific initiative. Except for one, the adjustments date from the 1970s and 1980s. Finally, the add-ons are similar in that each adjustment treats districts differently, usually for reasons that were important at the time the Legislature created them.

Because the add-ons support a specific funding "program," however, we reviewed each adjustment to determine whether they provide categorical rather than general purpose funding. We developed two criteria for determining whether the adjustments—from our perspective—should be considered general purpose funding:

- First, is the funding free of any state-imposed conditions on districts that accompany the money? If the answer is yes, the funds are clearly general purpose in nature.
- Second, if the answer to the first test is no, do all (or virtually all) districts participate in a program supported by the funds? If the answer to this question is yes, the activities are, in essence, a part of the base program for K-12 schools in California and the supplemental funds should be considered general purpose.

After reviewing the nine add-on programs, we conclude in our report that eight of the nine adjustments provided general purpose funds. The only adjustment that we identify as categorical in nature is the Minimum Teacher Salary Incentive program. Below, we briefly discuss how the eight add-ons meet our criteria as general purpose funds.

Funds That Are Free of State-Imposed Conditions. Three of the eight adjustments place no state requirements on districts in exchange for the additional state funds, as follows:

- ***Necessary Small Schools.*** This program supports the cost of very small schools that operate in small districts. The program operates as an alternate funding source rather than as a supplement to base revenue limits—that is, districts do not receive a base revenue limit for students attending a school funded through the small school program. The higher level of funds provided through this program may be used for any district cost.
- ***Excess Tax Revenues.*** In 2002-03, property tax revenues in 60 districts exceeded these districts' revenue limit entitlement. Districts are permitted to keep these additional local revenues, which may be used for any district purpose.

- ***Meals for Needy Pupils.*** This program provides funding to districts that enacted property tax levies to support free or reduced-price meals prior to Proposition 13. Despite the name of the program, the 372 districts receiving these funds have complete freedom over their use.

Programs in Which All Districts Participate. Five programs met our criteria as general purpose funds because the programs have become part of the state's "base" K-12 education program. These programs include:

- ***SB 813 Incentive Programs.*** Three programs created by Chapter 498, Statutes of 1983 (SB 813, Hart), provide incentive funds to districts in exchange for increasing instructional time and teacher salaries. Since virtually all districts participate in these programs, the programs have become part of the state's base K-12 education program, and the incentive money is essentially general purpose funding. In fact, both the state Departments of Education and Finance include these incentives in their cost estimates of *base* revenue limits (although the payments are excluded for equalization purposes).
- ***Interdistrict Attendance Agreements.*** Since 1993, state policy has encouraged interdistrict attendance. The state does not, however, provide additional funds to districts that allow students to use "choice" to attend school in a different district that where they reside. Two districts, Capistrano Unified and Fallbrook Union High, receive a revenue limit adjustment pursuant to an interdistrict attendance agreement affecting the two districts. As a result, funding provided for this arrangement constitutes an increase in general purpose funding for the two districts.
- ***Continuation Schools.*** The state provides additional funds for continuation schools created after 1978-79. Since state law requires all unified and high school districts to operate at least one continuation school, this program's subsidies result in an increase in general purpose funds to districts that have opened continuation schools more recently.
- ***Unemployment Insurance (UI) Reimbursement.*** This program pays district UI costs that exceed the amount each district incurred in 1975-76. All districts are required to participate in the UI program. By paying for these costs, the state increases general purpose funding to districts.
- ***PERS Reduction.*** This adjustment *reduces* the amount of general purpose funds districts receive by the difference in each year's PERS contribution rates and the rate required in 1981-82. Virtu-

ally all districts experience a reduction in revenue limit funds because of this adjustment. If it did not exist, districts would have a larger amount of general purpose funds.

One revenue limit add-on, the Minimum Teacher Salary Program, did not meet our criteria because a relatively large proportion of districts—about 13 percent—do not participate in the program. Even this program, however, was a close call. For many districts, the incentives clearly are general purpose funds, as districts were eligible for incentive payments even if their minimum salaries exceeded the program's required minimum at the time the program was established.

Add-Ons Distort Funding Distribution

The eight adjustments add an average of $238 per ADA in large unified school districts. Figure 2 displays the average per-pupil amounts this group of districts received for base revenue limits and the eight add-on programs in 2002-03. The data do not represent actual figures for any one district. Instead, they represent the average amounts distributed to all large unified districts through the various adjustments in the revenue limit calculation.

Figure 2

LAO General Purpose Funds
Large Unified School Districts

2002-03
Dollars Per Average Daily Attendance

	Average	High	Low
Revenue Limit	$4,571.20	$6,592.16	$4,406.37
Necessary Small School	14.23	1,312.72	—
Excess Taxes	51.65	5,843.40	—
Meals for Needy Pupils	22.25	616.17	—
SB 813 Incentive Programs	216.69	385.75	168.99
Unemployment Insurance	4.61	13.04	—
Continuation School	12.84	122.82	—
PERS[a] Reduction	-87.88	—	-232.33
Totals[b]	**$4,809.40**	**$10,684.40**	**$4,549.53**

a Public Employees' Retirement System.

b Includes constitutionally required "basic aid" payments. Funding for these payments was eliminated in the *2003-04 Budget Act.*

Figure 2 also shows the high and low amounts large unified districts actually received for base revenue limits and each adjustment in 2002-03. The range in base revenue limits is about $2,200 between the highest- and lowest-funded large unified districts. After including funding from the add-on programs, the range is more than $6,000 per pupil. While excess property taxes and Meals for Needy Pupils contribute the largest increases, several of the other adjustments provide per-pupil increases in the hundreds or thousands of dollars to some districts while providing other districts nothing. Even the SB 813 Incentive programs—in which all large unified districts participate—show a $215 per pupil difference between the highest and lowest funding level.

Because some districts receive large increases through the add-on programs while other districts receive little, the adjustments to base revenue limits increase disparities in district general purpose funding levels. In 2002-03, 66 percent of large unified districts received a base revenue limit that was within $100 per ADA of the average for the group. Using our definition of general purpose funding, however, only 22 percent of these districts fell within $100 per ADA of the $4,809 average general purpose funding level received by large unified districts.

Consolidate Add-Ons Into Base Revenue Limits

We recommend the Legislature revise the revenue limit formula by consolidating six of the add-on programs in the current formula into one general purpose grant. This would have several important benefits. From a fiscal standpoint, folding these adjustments into the base revenue limit would allow the Legislature to equalize the amount of general purpose funds districts actually receive, not just the amount represented by the base revenue limit. Over the long run, this would result in a more uniform distribution of funds to districts.

A second important benefit of the consolidation is that it would simplify the state's funding system. This would reduce an extensive amount of state and district paperwork and add transparency about school funding for the education community, policy makers, and parents. Thus, by simplifying this part of the state's funding system, our proposal is consistent with one of the goals of the Governor's categorical reform plan.

For these reasons, we recommend the Legislature consolidate the following revenue limit adjustments into district base revenue limits: Meals for Needy Pupils, SB 813 Incentive Programs, Interdistrict Attendance, Continuation Schools, Unemployment Insurance, and the PERS Adjustment. We recommend against including the NSS subsidy in the base because the current program allows the state to tailor these grants each year as the size of the school and other conditions warrant. In addition, excess tax revenues also should not be included in the consolidation, as this would permanently award the higher funding levels resulting from the high level of property tax revenues to these districts.

DELETE EQUALIZATION FUNDS

We recommend the Legislature delete $110 million in General Fund support for revenue limit equalization proposed by the Governor due to the state's fiscal situation. We also recommend the Legislature adopt trailer bill language directing the Quality Education Commission to establish new equalization targets for small school districts.

The *2004-05 Governor's Budget* proposes $110 million to make progress towards establishing more uniform district base revenue limits. In past years, we have argued in favor of equalizing revenue limits for two reasons. First, equalization funding provides general purpose funds that districts can use to meet local needs. Second, historic differences in revenue limit funding levels have no analytical foundation to suggest that these differences reflect local need for general purpose funds.

Given the state's fiscal situation, however, we recommend the Legislature delay equalizing revenue limits to future years. This would provide the Legislature with $110 million in General Fund support that could be used to reduce the structural budget gap between ongoing state program costs and General Fund revenues.

If the Legislature desires to maintain Proposition 98 appropriations at the level proposed in the budget, we recommend using the $110 million to reduce the Proposition 98 "credit card" obligations. As discussed earlier in this chapter, the budget proposes to continue the current-year level of payment deferrals ($1 billion) and revenue limit "deficits" ($900 million). In addition, the budget proposes to defer paying the $300 million budget-year cost of state mandated local programs (bringing total deferred mandate costs to more than $1.5 billion).

For instance, using the $110 million on a one-time basis to reduce the proposed level of deferrals would generate two benefits. First, by improving district cash flow, reducing the level of deferrals would improve district finances. Second, using the funds for this one-time purpose would provide the Legislature with additional discretionary funds in 2005-06. This would help ensure that funds are available in the future to adequately support base K-12 programs.

Assess "Size and Type" Funding Distinctions

The budget's proposal to equalize revenue limits sets a goal of bringing all districts to the amount currently provided to the district at the ninetieth percentile of all districts within each size and type. This is calculated by listing all districts beginning with the lowest-funded district and counting the average daily attendance of each district until the ninetieth percentile student is reached. The base revenue limit of that student's district would establish the proposal's long-term equalization goal.

In comparing revenue limits, the state groups districts by size (large and small) and by type (elementary, unified, and high school). These groupings were created by the Legislature in the 1970s and are based on the idea that some types of districts (small and high school) are more costly to operate than others (large and elementary). For instance, certain fixed costs—such as a superintendent and school board—result in some administrative costs which are higher (on a per-pupil basis) in small districts than in large districts. Unified district funding levels were intended to reflect a blend of elementary and high school district funding levels. While in theory these size and type funding differentials make sense, we are not aware of any assessment of whether the current funding levels are appropriate.

In the past, state equalization efforts have increased district base revenue limits to the previous year's average for each size and type. Because of historical factors, however, the average for some size and type groups was disproportionately affected by a relatively small number of very high funded districts. As a result, these groups of districts experienced significantly larger equalization increases than other groups. This occurred simply because of the way equalization was implemented and not for particular policy reasons.

Proposal Has Unintended Consequences. The approach proposed in the Governor's budget is intended to treat different types and sizes of districts similarly. Unfortunately, district data from 2002-03 indicate the budget proposal would result in somewhat arbitrary increases that would further distort average revenue limits for districts of different sizes and types. Figure 3 shows the 2002-03 median (or fiftieth percentile) and ninetieth percentile revenue limits for the six size and type groups. The difference between these two figures is the amount a typical district would receive if the equalization targets proposed by the budget were fully funded. For instance, the median large unified district would receive a $68 revenue limit increase (1.5 percent). By comparison, the median small unified district would receive a $206 increase, or 4.2 percent. The smaller adjustment for large districts is due to the fact that their revenue limits are much more uniform than for small districts.

Figure 3

Effect of the Governor's Equalization Proposal Revenue Limits by Size and Type

2002-03 Data

Size and Type	Number of Districts	Median	Ninetieth Percentile	Difference	
				Amount	Percent
Unified Districts					
Large (more than 1,500 ADA[a])	258	$4,512	$4,580	$68	1.5%
Small	69	4,856	5,062	206	4.2
High School Districts					
Large (more than 300 ADA[a])	87	$5,191	$5,300	$109	2.1%
Small	4	5,720	5,812	92	1.6
Elementary Districts					
Large (more than 100 ADA[a])	473	$4,347	$4,429	$82	1.9%
Small	91	5,323	5,484	161	3.0

[a] Average daily attendance.

The figure shows that the budget proposal would result in significantly different increases for districts in the different size and type groupings. For instance, the budget proposal would give small unified districts a 4.2 percent increase but only a 1.5 percent increase to large unified districts. If we assume the current median revenue limit represents the relative costs of each size and type, the budget proposal would distort these relationships by providing very different amounts to districts in the various groups.

The problem with the budget proposal is that it would equalize revenue limits based on the existing distribution of revenue limits (ninetieth percentile district) rather than on an amount that is derived from the relative costs facing districts in each size and type category. Because of the many changes made to revenue limits in the past 25 years, we think equalizing based on the current distribution of revenue limits, such as the budget proposes, would result in equalization targets that are somewhat arbitrary and may have unintended consequences. For this reason, we believe the state should reexamine the size and type categories and develop new equalization targets.

Quality Education Commission Should Examine Targets. We think the state Quality Education Commission could develop new targets relatively easily as an extension of what it is already required to do by state law. The commission was created by the Legislature in 2002 to develop an estimate of reasonable funding levels needed to allow all students to meet state performance levels. The authorizing legislation requires the commission develop adequate funding levels for elementary, middle, and high schools. This information would provide the data needed to establish new targets for large districts.

Existing law, however, does not require the commission to examine the differential for small districts or to reassess the existing definitions of small districts. Given the large number of districts that qualify as small under existing definitions, it would seem reasonable for the commission to revisit these issues as part of its work. Therefore, to provide the Legislature with the information to establish sound equalization targets for all types and sizes of districts, we recommend the Legislature adopt trailer bill language to require the commission to develop definitions of the appropriate maximum size of a "small" elementary, unified, and high school district and the adequate funding level needed by these districts.

REINSTATE REDUCTIONS FOR BASIC AID DISTRICTS

We recommend the Legislature enact trailer bill language to reduce $9.9 million in funds proposed to restore categorical program reductions to "basic aid" districts until the state also restores the 3 percent revenue limit reductions for all other K-12 districts.

The *2003-04 Budget Act* reduced district base revenue limits by about 3 percent. This reduction (also known as the revenue limit "deficit") was accomplished in two parts. First, base revenue limits were reduced to offset the statutorily required 1.8 percent COLA in 2003-04. Second, an additional 1.2 percent reduction was applied to the 2002-03 funding levels. The budget proposes to continue these reductions in 2004-05 for a savings of $907 million.

The Legislature also reduced funding for basic aid districts by a similar proportion. The State Constitution requires the state to provide a minimum of $120 per pupil (or $2,000 per district, whichever is higher) in state "basic aid" funds. Districts receiving basic aid payments receive all or almost all revenue limit funds from local property taxes. In 2002-03, the state provided this minimum level to 61 districts through the revenue limit.

In 2003-04, the Legislature made two changes to funding for basic aid districts. First, it eliminated the revenue limit payment of $120 per pupil by counting categorical funding toward the constitutionally required minimum. Second, because basic aid districts receive no or almost no state revenue limit funds, the Legislature reduced categorical program funding for these districts by up to 3 percent of their base revenue limits. This resulted in a $9.9 million savings to the state. Each district was required to identify the categorical programs from which funds would be taken to accommodate this reduction.

The 2004-05 budget proposes to restore the $9.9 million reduction to categorical funds of basic aid districts. According to the Department of Finance, it believes the reduction was intended as a one-time savings. While the Legislature drafted the statutory language implementing this reduction to apply only to the current year, this does not necessarily imply the Legislature intended to restore the reduction to basic aid districts while maintaining the cuts to revenue limits. In fact, the Legislature also enacted trailer bill language as part of the *2003-04 Budget Act* that expressed its intent to eliminate the 3 percent revenue limit reduction as soon as possible.

In our view, the Legislature made the reduction to basic aid districts in an attempt to implement a consistent base funding reduction to all districts. Treating basic aid districts and all other districts inconsistently seems at odds with this intent. Therefore, we recommend the Legislature adopt trailer bill language to eliminate $9.9 million proposed to backfill in 2004-05 the current year cut to basic aid districts. By making this reduction, the Legislature would have additional funds to meet its other budget priorities or reduce the structural General Fund gap between revenues and expenditures.

MANDATES

The Governor's budget recognizes 49 state-mandated local programs for K-12 education in 2004-05. These mandates require districts and county offices of education (COEs) to conduct a wide range of instructional, fiscal, and safety activities, and require local processes designed to protect parent and student rights.

The State Constitution requires the state to reimburse local governments for the costs of complying with state mandates. State law requires the Commission on State Mandates (CSM) to determine whether state law or regulation creates a state-mandated local program and whether the mandate requires the state to reimburse local governments for their costs of following the mandate. The CSM also develops claiming guidelines for the specific mandated local activities that are eligible for reimbursement.

The budget proposes basically no funding for K-12 mandates in 2004-05. This is because the budget defers payment for 2004-05 claims to future budgets due to the fiscal condition of the state. With these budget-year deferrals (estimated at roughly $300 million), we estimate the state will owe about $1.6 billion in unpaid mandate claims at the end of 2004-05.

New Mandates Recognized. The budget recognizes for the first time eight mandates approved by CSM. These mandates are (1) Peace Officer's Procedural Bill of Rights, (2) Financial and Compliance Audits, (3) Physical Education Reports, (4) Health Benefits for Survivors of Peace Officers and Firefighters, (5) County Office of Education Fiscal Accountability Reporting, (6) Employee Benefits Disclosure, (7) School District Fiscal Accountability, and (8) Photographic Record of Evidence. Claims submitted by school districts and county offices for these eight mandates in 2001-02 total $4.5 million.

The budget does not recognize the Standardized Testing and Reporting (STAR) mandate, which also was approved by CSM. According to the Department of Finance (DOF), the administration believes districts' claims far overstate the level of actual mandated costs experienced by districts. As a result, DOF proposes to delay recognizing this mandate until STAR claims are audited.

Mandates Proposed for Suspension or Elimination. The budget also proposes to suspend or repeal five existing mandates that were suspended as part of the *2003-04 Budget Act*. These mandates are: (1) School Crimes Reporting II, (2) School Bus Safety II, (3) Investment Reports, (4) Law Enforcement Sexual Harassment Training, and (5) County Treasury Oversight Committee. The first two mandates proposed for suspension or repeal affect only K-12 education; the remaining three mandates affect all local government entities. District and county office claims for these five mandates totaled $34.3 million in 2001-02. The School Crimes Reporting II ($11.9 million) and School Bus Safety II ($22.1 million) account for almost all of the total cost for these five mandates.

Reform of the Mandate Process

The budget also proposes several changes to the mandate reimbursement process, including:

- Legislation that would allow the Legislature to limit mandate costs through the annual budget act.
- Revising the CSM process so that the Legislature approves reimbursement guidelines and cost estimates earlier in the process.
- Limiting mandate reimbursement to the "least costly approach," rather than actual costs of complying.
- Increasing audits of K-12 education mandate claims.

The budget proposal to reform the process for reimbursing local agency costs of mandates reflects the administration's concerns that the existing law "has created a confusing, expensive process that is not resulting in either the expected reimbursement for local agencies nor informed fiscal choices for the Legislature and the administration."

We share those concerns. In our *2004-05 Budget Bill: Perspectives and Issues,* we discuss problems with the current mandate process. Given the magnitude of the problems with the existing process, we conclude that the Legislature should consider a fundamental revamping of the state mandate process. Please see our *Perspectives and Issues* for our analysis of this issue.

K-12 Mandate Issues

Below, we discuss four issues specific to state-mandated programs in K-12 education. These issues were discussed in our December 2003 report entitled, *New Mandates: Analysis of Measures Requiring Reimbursement*. In that report, we reviewed six K-12 education mandates that were approved by CSM in 2002 and 2003 (several other mandates discussed in the report apply to all local agencies, including school districts and COEs). The report finds several problems, including:

- ***Offsetting Revenues.*** The state may pay more than necessary for K-12 mandated costs because the CSM guidelines sometimes do not recognize offsetting revenues that are provided through the annual budget act.
- ***Federal Mandates.*** The CSM decision on the STAR mandate ignores federal assessment requirements that were in place at the time the Legislature enacted the STAR program. In addition, state law does not authorize the commission to recognize expanded federal testing requirements required under the No Child Left Behind (NCLB) Act. Without the Legislature's intervention, the state is likely to pay unnecessarily high costs for student assessment and other mandates.
- ***Unnecessary Programs.*** We identified two mandated local programs that we believe are unnecessary and should be eliminated.

We discuss these issues further below.

Recognize Offsetting Revenues

We recommend the Legislature add budget bill language to several K-12 budget items in order to guarantee that districts use funds the state appropriates to satisfy local mandated costs. We also recommend adoption of trailer bill language to request the Commission on State Mandates to revisit the issue of offsetting revenues in one program.

The Legislature appropriates funds in the annual budget act to pay for two programs that were recently approved as reimbursable state mandates by the CSM. The programs are the STAR program, which tests students in grades 2 through 11, and the County Office of Education Fiscal Accountability Reporting program, which requires county office oversight of school district budgeting processes. The proposed *2004-05 Budget Bill* includes $11.8 million for STAR district administrative support and $5 million for county office fiscal oversight activities. Appropriations for these programs have been provided annually in the budget act since the inception of the programs.

The CSM claiming guidelines do not recognize the county office appropriations and inappropriately narrow the use of the STAR funding to offset mandated costs. As a result, our review of district STAR claims showed a sample of districts often failed to appropriately use state apportionments as an offset to district expenses. County office fiscal claims appeared to represent total costs—without recognizing state funds provided for the program. As a result, we believe the state may wind up paying for some mandated activities twice—once through the direct appropriation and a second time as part of the local mandate claims.

The budget bill does not contain explicit language requiring districts to use these funds to satisfy the programs' mandated costs. While we believe the state's intent in providing these funds is clear, there may be some legal question about whether districts and county offices could give first priority over the funds to satisfy nonmandated activities associated with the programs, and then use any remaining funds to pay for the required activities. Adding clear budget language requiring districts and county offices to use state funds appropriated for these two programs for their mandated costs would protect the state from the possibility of having to pay for the same mandates twice.

There are two other programs for which we suggest the same language. While not currently established as mandates, the CSM will consider in the future whether the California English Language Development Test (CELDT), the California High School Exit Examination (CAHSEE), and state Remedial Instruction programs constitute reimbursable mandates. The 2004-05 proposed budget also contains funds to cover remedial instruction program costs and local administrative costs for the testing programs. Adding our proposed language could reduce future mandate claims for these programs.

For this reason, we recommend the Legislature add budget bill language to Item 6110-113-0001 and Item 6110-113-0890 requiring districts to use state apportionments to first satisfy any mandated local costs of STAR, CELDT, and CAHSEE. We also recommend amending Provision 2 of Item 6110-107-0001 (county office fiscal oversight) and remedial education programs (Item 6110-104-0001) to provide the same requirement.

Require CSM to Revisit the Fiscal Accountability Reporting Mandate. As we discussed above, the CSM guidelines make no mention of existing funding that is available to counties to satisfy any local mandates created by their fiscal oversight responsibilities. The Legislature has attempted to pay for county office costs in a direct manner by providing funds in the annual budget act. Since the commission's decisions makes no acknowledgement of this appropriation, we recommend the Legislature adopt trailer bill language to request the commission to reconsider its decision on the County Office of Education Fiscal Accountability Reporting mandate and make any modifications necessary to clarify the extent to which budget act appropriations to county offices should be considered offsetting revenues to any state-mandated local costs of the program. This change could eliminate all outstanding claims for this mandate, which total $2 million through 2003-04.

Reconsider the STAR Mandate

We recommend the Legislature adopt trailer bill language requesting the Commission on State Mandates to reconsider its decision on the Standardized Testing and Reporting program mandate to clarify whether federal testing requirements would reduce the scope of the state-mandated costs and to address the issue of offsetting state revenues.

As we noted above, the Governor's budget does not recognize the CSM action to approve as state-reimbursable mandates various local activities required under the STAR testing program. In 2001-02, local claims for this program totaled $36 million.

In our December report, we identified two problems with CSM's findings on this program. First, as discussed above, CSM claiming guidelines inappropriately narrow the activities against which state funds should apply as offsetting revenues.

Second, the commission did not consider whether federal testing mandates contained in the Improving America's Schools Act (IASA) would reduce the number and cost of reimbursable state mandates. State statutes guiding the mandate process direct CSM to deny reimbursement when the state creates a local mandate in the implementation of federal law. State-required activities that exceed the federal mandate, however, are still reimbursable.

Several of the reimbursable mandates identified by the CSM were required by the federal IASA. The state's decision to enact the STAR program was, at least in part, designed to bring California into compliance with the federal Title 1 program (which was part of IASA). Assessment requirements included in the IASA that could affect the CSM decision on STAR include:

- ***Administering the STAR Tests in Three Grades.*** Although STAR requires testing students in ten grades, federal law required testing in at least three grades.

- ***Reasonable Accommodations for Special Education Students.*** Federal law requires special testing arrangements for students with special learning needs.
- ***Parental Notification.*** The IASA requires certain Title I schools to notify parents of individual student assessment results.

Our review suggests that federal mandates contained in the IASA should render a significant portion of the STAR mandate costs ineligible for reimbursement. The CSM approval of the STAR mandate makes no mention of the federal requirements, however. According to commission staff, issues of federal mandates are normally raised by DOF or the State Department of Education (SDE). The record shows neither agency raised the issue of federal mandates in this case.

At this point, the commission has completed its work on the STAR mandate and the three-year period for an appeal by DOF of this decision has expired. As a result, the Legislature's only recourse is to request CSM to revisit the issue of federal mandates and modify its decision on the STAR mandate as appropriate to reflect the requirements of federal law. The Legislature also could request the commission to revisit the issue of offsetting revenues for this program. To accomplish this, we recommend the Legislature adopt trailer bill language as follows:

> The Legislature requests the Commission on State Mandates review its Statement of Decision regarding the *Standardized Testing and Reporting* test claim and make any modifications necessary to this decision to clarify (1) whether federal testing requirements in place at the time the program was enacted should reduce the scope of the state-mandated costs and (2) whether the parameters and guidelines appropriately identify the activities against which funds provided through the annual budget act should apply as offsetting revenues.

Revise Statutes to Broaden Federal Exclusion

We recommend the Legislature, as part of any reforms to the mandate process, broaden the federal mandate exclusion so the Commission on State Mandates could waive state reimbursement any time federal law requires the same local program. This change would result in significant savings for the existing Standardized Testing and Reporting program and several other potential K-12 mandates the commission will consider in the future.

As noted above, existing state mandate statutes direct CSM to deny reimbursement to local agencies when a mandated local program is created in the implementation of a federal program requirement. To deny reimbursement, however, the federal requirement must be in place at the time the local activities were mandated by the state.

State law requires, however, reimbursing local agencies when state law creates a mandated local program and federal law changes to also require the same program or activity. There are two situations where this can occur. State mandates that are approved by CSM and, subsequently, are required by the federal government remain a state-reimbursable local program. In 2002, for instance, NCLB was enacted to replace IASA. Testing requirements in the new federal law parallel closely those of the STAR program. Under NCLB, annual testing is required in seven grades, rather than the three required by IASA. If CSM was allowed to update its STAR decision to reflect the NCLB testing requirements, we would expect the number and cost of reimbursable STAR mandates would fall substantially.

The second situation occurs when federal law changes to conform with a program creating a state-mandated program that has not completed the CSM process. The CELDT, for instance, was first administered as a state-required testing program in 2001. In 2002, federal law changed to require a virtually identical test. Under existing law, the local costs of administering CELDT will likely constitute a reimbursable mandate for as long as state law requires the test to be administered. This situation applies to several other K-12 mandates, including the School Accountability Report Card and special education Behavioral Interventions Plans mandate claims.

This creates a rather absurd position for the state. The Legislature could eliminate the costs associated with these programs by deleting the Education Code requirements that mirror the federal mandate. The program requirements on school districts would not change, but now the mandate would be considered a federal, not state, mandate. If the state does not make these technical changes, however, the state would continue to pay for the local costs of the mandate each year.

The distinction in law that state mandates are not reimbursable *only* if the federal requirement comes before the state requirement is artificial. It elevates process above common sense, and disadvantages the state in the mandates process. Therefore, we recommend the Legislature change state statute so that state mandates become nonreimbursable any time federal law requires the same local activities.

Eliminate Two Mandates

We recommend the Legislature eliminate the Physical Education Reports mandate and—contingent on an expected change in accounting requirements—the Employee Benefits Disclosure mandate because they are unnecessary. Elimination of the two mandates would result in annual savings of at least $500,000.

Physical Education Reports. This mandate directs districts to report annually whether students in grades 1 through 8 received 200 minutes of physical education instruction every ten days, as required by state law. The SDE also is required to audit a sample of district records each year. District claims for this mandate in 2001-02 totaled $55,000.

This mandate overlaps with information obtained through another mandate—Physical Fitness testing, which requires schools to assess the physical fitness of students in three grades every two years. The results of these tests are posted on the SDE website for each school and district, and inform the Legislature, parents, and local communities about the success of school physical education programs.

In addition, the department never implemented the district report portion of the Physical Education Reporting mandate. Instead, SDE incorporated the 200-minute requirement into its review process that assesses district compliance with several state and federal mandates. The reviews of the 200-minute instructional requirement began during the current year. As a result, we are uncertain what mandated activities resulted in $55,000 of district claims in 2001-02. Because SDE implemented the intent of the Legislature in a way that does not require district reports, we recommend the Legislature delete the Physical Education Reporting mandate.

Employee Benefits Disclosure. This mandate requires districts to:

- ***Estimate Future Retiree Health and Welfare Benefit Costs.*** Districts and COEs are required to conduct an actuarial study every three years to estimate their multiyear fiscal liabilities for retiree health and welfare benefits.

- ***Report on Budget Changes Due to Collective Bargaining.*** Districts must report to county superintendents on budget revisions that result from adopting a collective bargaining agreement.

Districts submitted $450,000 in claims for these mandated activities in 2001-02.

The Governmental Accounting Standards Board (GASB) is currently considering whether to require all governmental agencies to recognize future liabilities for retiree health benefits in their financial statements.

The GASB establishes standards of accounting and financial reporting used by state and local governments. The GASB proposal would require all local agencies to conduct an actuarial report on retiree health benefits every three years.

The GASB plans to issue a final ruling on its policy in spring 2004. If it adopts its proposed policy, the state mandated actuarial reports would no longer be necessary. Therefore, we recommend the Legislature delete the mandated reports if the GASB proposal is approved. We will report in budget hearings on the status of GASB's final ruling.

Federal Accountability and Assessments

Accountability

The federal No Child Left Behind (NCLB) Act requires the state to develop an integrated state and federal accountability system. In summer 2003, the state submitted its consolidated state NCLB plan. The state plan created a new accountability system that measures school and district "adequate yearly progress" (AYP) that operates parallel to the existing state system measured by the Academic Performance Index (API).

The state and federal systems are based mainly on Standardized Testing and Reporting (STAR) assessment results. However, the two systems measure school performance differently. The *federal* accountability system focuses on the percentage of students at a school that meet a certain level of achievement. The *state* accountability system measures the growth in school achievement from year-to-year—regardless of the level of student achievement at the school.

Low-Performing School Intervention Programs. Accompanying the two measurements of school performance are two systems of interventions and sanctions for schools that fail to meet accountability targets. The state programs include the Immediate Intervention for Under Performing Schools (II/USP) and the High Priority Schools Grant Program (HPSGP). Generally, II/USP targets schools with below-average API scores that also failed to achieve their API growth scores, and HPSGP targets the 10 percent of schools with the lowest API scores. Both state programs are voluntary, providing fiscal incentives ($200 per pupil for II/USP and $400 per pupil for HPSGP) to support the cost of developing and implementing a school improvement plan.

In contrast, the federal intervention and sanction system—known as Program Improvement (PI)—relies on districts to intervene in schools using existing Title I funding. Figure 1 shows the interventions for Title I schools that fail to meet AYP targets. A school that does not make its AYP target for two consecutive years enters PI (Year 1). Each year a PI school fails to make AYP results in additional sanctions. After four years, federal law requires a major restructuring of the school. To leave PI, schools must make AYP targets in two successive years.

Figure 1

No Child Left Behind Program Improvement— Sanctions and Interventions for Title I Schools

✓ **Year 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.

✓ **Year 2—Supplemental Services**

- Level 1 interventions.
- Use Title I funds to obtain tutoring/after school program from the State Department of Education (SDE) approved public or private provider.

✓ **Year 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.

✓ **Years 4 and 5—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.

Figure 2 shows the number of schools in California in PI in 2003-04. More than 1,200 schools are at different stages of PI. An additional 1,155 Title I schools failed to make their AYP for the first time in 2002-03. If their 2003-04 assessment results do not improve, these schools will have failed to make AYP for two consecutive years, and therefore will enter PI. Over the next several years, we expect that most of the 5,469 Title I schools will face interventions unless the state amends the AYP system (discussed below).

Figure 2

No Child Left Behind Program Improvement Schools

2003-04

Level of Intervention	Number of Schools
Year 1	640
Year 2	220
Year 3	335
Year 4	11
Total	**1,206**

Integrate State and Federal School Intervention Programs

We recommend the State Department of Education report at budget hearings on its proposal for the integration of state and federal intervention programs in order to inform the Legislature of how it intends to bring California into compliance with federal law.

Federal law requires states to develop one system of accountability and intervention. The State Board of Education (SBE) approved California's integrated accountability program, which uses both the concepts of AYP and API. The board has not approved any policy for integrating the state and federal intervention systems. As a result, the state continues to operate the II/USP and HPSGP programs—which are oriented to *school*-based accountability—even though the federal system encourages states to focus on *district* accountability.

In the *Analysis of the 2003-04 Budget Bill*, we provided a framework to integrate the state and federal accountability systems. Figure 3 (see next page) outlines the principles we recommended the Legislature use to design these systems. We would place the state's focus on intervening at the district level and the lowest-performing schools. Interventions in the remainder of schools would be the responsibility of school districts and the federally-mandated network of county office of education assistance called the "statewide system of school support."

Figure 3

Framework for an Integrated Accountability System

- ✓ Focus state interventions at the school district level.
- ✓ Target state interventions only at the neediest schools.
- ✓ Require districts to intervene at other schools needing assistance.
- ✓ Redesign High Priority School Grant Program to serve state and federal purposes.
- ✓ Transition schools in state intervention programs to new system expeditiously.
- ✓ Align outcome expectations with other state goals.

Under our principles, schools participating in II/USP would be transitioned to the federal system as quickly as possible. The HPSGP, which targets schools in the first decile, would continue and become the only state program directly intervening in schools. Finally, federal and state outcome expectations on student assessments would be aligned with passage of the high school exit exam.

In approving California's NCLB plan, the federal government reminded the state that the plan was incomplete, as the state had not included a plan for the integration of state and federal intervention programs. At the time this analysis was written, the board had not approved such a plan nor had the State Department of Education (SDE) issued a formal proposal on the issue.

Therefore, to inform the Legislature of how California will come into compliance with federal law, we recommend SDE report to the budget committees on its proposal to integrate the state and federal intervention programs.

Federal Law Requires District Interventions

We recommend the State Department of Education and State Board of Education provide the Legislature with a detailed plan on how the state will meet the intervention requirements for school districts whose schools are failing to improve.

The federal system also requires states to establish performance targets for school districts, and requires the state to intervene in districts failing to meet those targets (see Figure 4). Thus, for the first time, the state will hold school districts responsible for the academic outcomes of their students. We believe this relationship makes sense and aligns the accountability system with the finance system—the state provides funding to school districts and not schools.

Figure 4

No Child Left Behind Program Improvement—Sanctions and Interventions 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 consecutive 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.

By investing more resources to directly assist districts, the state can help districts build and sustain the capacity to assist low-performing schools. Without effective district involvement in school-level reform, change is much more difficult. In the recent *Evaluation Study of the Public School Accountability Act*, the American Institute of Research found that districts have a significant influence on the effectiveness of direct state intervention in schools. The report found that district influence was not always positive, and that for some districts, the impact of the district on the school actually reduced the effectiveness of the reform. These findings suggest that improving district administration and governance is a prerequisite to improving the performance of individual schools.

No school districts are facing state intervention in 2003-04. The district intervention feature of NCLB is new and a school district must fail for two years to enter NCLB PI. The SBE has not determined specific performance targets for districts, and therefore it is not known how many districts will require state intervention. Even if the numbers are relatively small, the state will need to build capacity fast, and determine how to ration limited funds to assist districts with the greatest need. As such, we recommend SDE and SBE provide the Legislature with a detailed plan on how the state will meet the intervention requirements for school districts whose schools are failing to improve.

Federal Funds to Assist Schools and Districts Going Unused

We identify unallocated Title I funds available for district and school interventions to assist low-performing schools, $13 million of which must be spent before October 2005 or the state will lose it. We recommend the Legislature require the State Department of Education and the administration to provide a comprehensive plan on how the funds will be used to assist low-performing schools and districts.

Along with the new intervention requirements of NCLB, federal law requires states to set aside a portion of the main Title I grant to intervene in districts and schools not making AYP. Figure 5 shows the amount and uses of these resources over the last two years and the administration's 2004-05 proposal.

Under federal law, states have 27 months to spend federal funds or they revert to the federal government. Currently, assuming all 2002-03 and 2003-04 appropriations are spent, the state will have used $29.5 million by the end of 2003-04. This amount is slightly greater than the amount of federal funds received in 2002-03 (which must be spent by October 2004). Therefore, the state will not lose any federal funds in the current year.

In contrast, we estimate that the proposed Governor's budget could result in the state returning over $13 million to the federal government in October 2005. There are several high-priority uses for these available funds:

- ***District Accountability.*** The first PI districts will be identified in 2004-05. Since the state has little experience assisting low-performing districts, a portion of these funds could be used to support improvement programs for districts that fail to meet state performance targets.

Figure 5

Federal Accountability Funding for School and District Interventions

(In Millions)

	2002-03 Actual	2003-04 Estimated	2004-05 Proposed
Funds available (including carryover funds)	$29.1	$48.3	$98.1
Expenditures	13.6	15.9	19.1[a]
Carryover	**$15.5**	**$32.5**[b]	**$79.0**

a Administration's estimate of budget-year expenditures.

b The Legislature set aside $17.2 million pending legislation on school district accountability and other issues; however, no legislation was introduced.

- ***PI Schools.*** As discussed above, a large number of schools will likely enter PI in 2004-05. The Legislature may want to consider using a portion of the intervention funds to assist districts that have a significant number of schools in PI.
- ***Evaluation.*** The state should support an in-depth evaluation of its district intervention program in order to learn what assistance is critical to strengthening district capacity to assist schools.

To avoid losing federal funds, we recommend SDE and the administration provide the Legislature with a comprehensive plan for spending at least $13 million—and up to $79 million—in Title I intervention funds that would assist schools and districts with the difficult task of turning around low-performing schools. We recommend that these plans focus around district interventions because (1) state intervention in districts supports the current governance structure, and (2) federal law requires states to intervene in failing school districts.

Legislature Should Set Realistic Expectations For Federal Accountability

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 3 through 8.

As part of the definition of AYP, SBE opted to maintain the current definition of academic proficiency. For grades 3 through 8, students must score at the proficient or advanced levels on the California Standards Tests (CST) for English language arts (ELA) and mathematics. For grades 10 through 12, SBE selected a score on the California High School Exit Exam (CAHSEE) that corresponds to proficiency levels on the CST. This score is *higher* than the score required to pass the CAHSEE.

Figure 6 shows that on average a little more than one-third of students are proficient as measured by the CST in math and ELA in grades 4 and 8. However, for English learners and economically-disadvantaged students, as few as 14 percent and at most 34 percent, score at the proficient or advanced levels depending on grade and subject. For special-education students, the scores are even lower. Over the next 12 years, the schools will have to improve until *all* students are proficient. It will be very difficult for all students to reach this standard and many schools will be identified for PI. In light of these consequences, we believe the Legislature should reconsider the definition of proficiency, to a level more consistent with student expectations established in state law.

Figure 6

Percent of Students Proficient and Above On State Assessments

Results From the 2003 California Standards Test

	Grade 4		Grade 8	
Type of Student	**Math**	**English**	**Math**	**English**
All	46%	39%	29%	31%
English learners	34	21	18	14
Economically disadvantaged	33	24	16	16
Special education	20	15	6	5

The SBE designed the proficient and advanced achievement levels to correspond to students who are on track to attend the University of California or the California State University. 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, and this level is lower than what would be considered proficient on the CST.

Since schools are under pressure to meet AYP, schools have an incentive to concentrate on students near the proficient level—those who need only a little extra attention to reach the proficient level. Such a local strategy could ignore students scoring at the below-basic, and far below-basic level. We believe that creating such an incentive is contradictory to recent legislative efforts to focus more attention and resources at the lower-performing students and schools.

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 3 through 8 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 NCLB PI.

ASSESSMENTS

State Risks Losing Federal Funds

We recommend (1) the Department of Education report at budget hearings on the status of federal Title VI spending and whether the state is likely to return a portion of these funds in 2003-04 or 2004-05, and (2) the Legislature adopt trailer bill language to appropriate $8 million in Title VI funds in the current year for the California English Language Development Test to ensure the state does not lose any of the 2002-03 or 2003-04 federal grants. This also would save $8 million in General Fund support for this program in 2003-04.

The Governor's budget proposes spending $32 million in federal Title VI funds for the support of state assessment and data collection programs, an increase of $4 million from the current-year revised amount. This net increase results primarily from proposals to augment STAR by $2.4 million, increase funding for the CAHSEE by $6.3 million, and reduce funding for development costs of the longitudinal student assessment data base by $4 million.

Title VI funds are intended to pay for state and local costs of assessment and data reporting activities required under NCLB. Federal rules governing the Title VI funds require states to spend—not just obligate—each year's grant within 27 months from the beginning of the state's fiscal year in which they are received. Any funds that remain unspent must be returned to the federal government.

The state received $29 million in federal Title VI funds in 2002-03. It appears that the state will spend roughly this amount by October 1 of this year. If, however, the state spends less than $29 million by that date, it will have to return some federal funds. The state could be in a similar situation come October 1, 2005.

To provide the Legislature with better data on the status of these federal funds, we recommend SDE report during budget hearings on actual and projected expenditures of Title VI funds in 2002-03, 2003-04, and 2004-05. (The department was able to provide estimates of when 2002-03 appropriations would be spent, but could not supply the same data for the current or budget years.) Because the Legislature needs this information to assess the state's Title VI spending plan, we recommend SDE provide a quarterly accounting of Title VI spending over the three years.

We also recommend the Legislature adopt trailer bill language to appropriate $8 million in unspent Title VI funds for the California English Language Development Test (CELDT) in 2003-04. As we note above, part of the problem placing the state at risk of losing federal funds is the large amount of unspent carryover that has developed over the first two years of the grant. By spending a portion of this grant on a 2003-04 program that spends funds relatively quickly, the state could guarantee that no federal funds would be lost in either year. The CELDT test is a good candidate because it is supported primarily by the General Fund and is administered in the fall (and therefore spends most of its appropriation relatively early in the fiscal year). For these reasons, we recommend using $8 million of unspent Title VI funds for current-year CELDT costs. This would replace a like amount of one-time General Fund monies, resulting in savings the Legislature could use to meet its priorities in K-12 education or other parts of the state budget.

Our recommendation would leave about $7 million in Title VI funds unspent. We believe this reserve should be maintained until the costs of the longitudinal student assessment data base become clear. The department expects to begin the development of a feasibility study in 2004-05 and select a vendor for the construction of the data base in 2005-06. Keeping a reserve of federal funds would ensure that funds are available to support this high-priority data system and meet other unexpected assessment and data needs that may develop over the next two years.

Instructional Materials

We recommend that the Legislature shift $250 million in instructional materials funding into revenue limits, $75 million more than the Governor's proposed shift. This level of funding restores funding to the 2002-03 base level, and reflects expected need for 2004-05. We recommend the Legislature reject the Governor's creation of a new categorical program proposal because it contradicts the streamlining provided in the Governor's revenue limit proposal. Combined, these recommendations free up $113 million for other legislative priorities.

Governor's Proposal Contradictory

In the 2004-05 budget, the Governor shifts $175 million of existing instructional materials funding into the revenue limit as part of his proposal to streamline categorical programs and provide school districts increased flexibility. The budget also provides $188 million for a new instructional materials categorical program. According to the Department of Finance (DOF), programs selected for inclusion in revenue limits met the following criteria: (1) they contain few restrictions on the use of funds, (2) they do not support services for special needs students, and (3) they have stable district allocations. Given these criteria, the Governor folds the ongoing instructional materials funds into revenue limits. At the same time, however, the Governor proposes to create a new categorical program with $188 million in instructional materials funding, distributed similarly to the current program.

DOF Has Not Been Able to Explain the Rationale for the Contradictory Proposals. Instructional materials funding clearly meets the Governor's criteria for inclusion in the revenue limits—it provides a stable source of funding and every school district receives this funding. The Governor's proposal, however, disregards the administration's criteria and creates a new program providing funding for the same purpose as the funding folded into the revenue limit. The Governor's initial reason for shifting program funding into the revenue limit was to streamline the categorical system and provide school districts increased flexibility by:

(1) eliminating the number of programs and requirements and (2) alleviating administrative burden. Instead, the Governor has failed to streamline and has continued the current bureaucratic process.

Fold Instructional Materials Into Revenue Limits. In our analysis of the Governor's categorical consolidation proposal earlier in this chapter, we provide the Legislature with a set of criteria to use to determine whether a categorical program should be included in the revenue limit. Our suggested criteria focus on whether districts have local incentives to underinvest in a particular service. We believe that instructional materials are inputs that are critical to the educational process. Because standards-aligned materials play a large role in ensuring that a school district's pupils perform well on standardized tests, we do not believe this is an area where school districts would have an incentive to underinvest. In addition, having instructional materials funds in the revenue limit would provide school districts with greater flexibility to determine which instructional materials are highest priority for their district. Therefore, we recommend the Legislature shift all of the instructional materials funding into the revenue limit. In the next section, we examine the appropriate level of instructional materials funds to fold into the revenue limit given recent legislative action and upcoming instructional materials adoptions.

Governor's Funding Level Too High

In the budget year, the Governor provides a significant increase above current-year instructional material funding levels by providing an additional $188 million in funding. According to DOF, the Governor provides this increase to: (1) restore funding for the instructional materials block grant to an amount closer to the level intended to provide for purchase of the 2002 English language arts adoption and (2) provide incentive funding to school districts to purchase newly adopted English language arts and the 2005 history / social science standards-aligned materials.

Figure 1 provides instructional materials funding information. As shown in 2002-03, instructional materials funding within the instructional materials block grant was $293 million, including $250 million ongoing and $43 million one-time (the latter prioritized for purchasing standards-aligned materials for English language learners and reading intervention materials for pupils in grades 4 through 8). In the current year, the Legislature reduced ongoing instructional materials funding from $250 million to $175 million—a reduction of $75 million. We recommend restoring $75 million of base funding, returning instructional materials funding level to $250 million, for the reasons discussed below.

Figure 1

Instructional Materials Funding

2002-03 Through 2004-05
(In Millions)

			2004-05 Proposed	
	2002-03	**2003-04**	**Governor**	**LAO**
Instructional Materials Block Grant				
Base	$250	$175	$188	—
One-time incentive funding	43	—	—	—
Revenue limit	—	—	175	$250
Lottery funds for instructional materials[a]	81	72	72	72
Totals	**$374**	**$247**	**$435**	**$322**

[a] Represents Proposition 20 funding that is specifically designated for instructional materials. Dollar amounts represent projections by the Lottery Commission.

Many Districts Have Funds Available for English Language Arts (ELA) Materials. Figure 2 (see next page) provides recent history related to standards-aligned instructional materials and highlights important legislative actions. As shown, Chapter 481, Statutes of 1998 (AB 2519, Poochigian), required the State Board of Education (SBE) to conduct an interim adoption of basic and partial programs in ELA. To provide school districts with funding to purchase these materials, the Legislature created the Schiff-Bustamante Instructional Materials Program, Chapter 312, Statutes of 1998, (AB 2041, Bustamante). The SBE adopted *interim* ELA materials in summer 1999. In January 2002, the SBE adopted *fully-aligned* ELA materials. In recent years, the Legislature has attempted to balance the desire to transition school districts to the 2002 ELA materials, while recognizing the investments that some school districts made in the 1999 ELA materials. Since the state has not adopted new materials in any subject areas in the last two years, school districts have continued to focus their resources on purchasing ELA materials.

Districts used different strategies, however, with regard to their Schiff-Bustamante funding. Many districts spent their funds on the interim materials, and they now need additional funds to purchase the fully-aligned ELA materials. Other districts, however, did not purchase the interim materials and "banked" their funds, which can now be used to purchase the 2002 ELA materials. We believe that the Governor's proposed augmentation does not recognize that many districts have been banking funds the last two years to pay for the 2002 ELA materials.

Figure 2

Recent History of Standards-Aligned Instructional Materials

- ***1995 Through 1998—State Develops Academic Content Standards.*** As required by law, the State Board of Education (SBE) adopts academic content standards in English language arts (ELA), mathematics, science, and history/social science.
- ***1998—Schiff-Bustamante Instructional Materials Program Provides $1 Billion.*** In order to get standards-aligned instructional materials in the hands of students, the state invests $1 billion over a four-year period to purchase instructional materials adopted by SBE in 1999.
- ***1999—State Adopts First Standards-Aligned Materials.*** Chapter 481, Statutes of 1998 (AB 2519, Poochigian), requires SBE to conduct a special interim adoption of basic and partial programs in ELA and mathematics. By July 1999, the board adopted ELA materials. Under current law, school districts can purchase ELA materials through June 2005.
- ***2002—State Adopts Comprehensive ELA Materials.*** The SBE recently adopted new ELA materials that include reading intervention programs for English learners in grades 4 through 8.
- ***2002—Legislature Creates Instructional Materials Funding Realignment Program.*** Legislature merged three existing programs into one instructional materials block grant. The Legislature prioritizes the use of the funds: (1) newly adopted standards-aligned materials in ELA and math, (2) standards-aligned materials in history/social science and science, (3) other materials.

School Districts Likely to "Pilot" History/Social Science Materials in 2005-06. The history / social science instructional materials are scheduled for adoption in January 2005. Because the purchase of instructional materials represents a significant investment to school districts, they typically choose to pilot various instructional materials to determine which materials best meet the needs of their district. Piloting the materials involves a structured and monitored process in which various materials are used in different classrooms to provide teachers experience with the program's organization, assessment, and range of instructional strategies. Typically, school districts pilot newly adopted materials in the spring and fall following the adoption, usually for a period of six months to two years. We expect school districts to begin piloting the history / social science instructional materials during the spring of the budget year and to purchase these materials in budget year plus one or later depending on their pilot period. Therefore, less funding is required in the budget year because piloting does not cost a great deal.

Restore Instructional Materials Funding to 2002-03 Level by Redirecting $75 Million From Governor's Categorical Program. We believe that the Governor's combined funding level of $363 million is too high given that (1) many districts already have funds for their ELA purchases and (2) school districts likely will pilot—rather than purchase—history/social science materials in the budget year. We recommend, therefore, that the Legislature reduce funding for instructional materials by $113 million from the Governor's proposed level and redirect those savings to other legislative priorities. We believe that this level of funding would provide districts sufficient funds to both purchase ELA materials and sufficient history/social materials to pilot the materials in 2004-05.

EDUCATION TECHNOLOGY

COUNTY OFFICES OF EDUCATION INTERNET ACCESS

We recommend the Legislature delete $21 million in funding provided to county offices of education for the high-speed Internet2 access, as the program has limited benefits to schools and school districts and the technology is still relatively expensive.

The *2004-05 Governor's Budget* creates a new Internet access program providing $21 million in funding to county offices of education (COEs) to provide high-speed Internet access (commonly referred to as Internet2) to schools and school districts. According to the Office of the Secretary for Education, the Governor provides these funds to maintain the state's investment in the Digital California Project (DCP). To date, the administration has failed to provide (1) information about the effectiveness of DCP and (2) basic program information including the relationship of the new program to DCP, the funding distribution mechanism, and a budget.

Background

What Is Internet2? Internet2 is a high-speed national network developed by a working group of 34 universities. It provides faster, more reliable Internet service and can transmit up to 45,000 times more information than the existing Internet technology. Figure 1 summarizes key features of Internet2. Currently, over 200 universities across the nation are connected to Internet2.

What Is DCP? The DCP is a multiyear project to develop, implement, and manage a statewide education network for K-12 schools. To date, the University of California has had oversight responsibility for DCP, but has contracted with the Corporation for Education Network Initiatives in California, a nonprofit corporation of California higher education Internet users, to develop and implement K-12 access points for Internet2.

Figure 1

Features of Internet2

- ✓ Significantly larger bandwidth than the standard Internet.
- ✓ Information can be transferred 45,000 times faster than with standard Internet technology.
- ✓ Ability to transmit video, complex images, and large amounts of data.
- ✓ Fewer people on the network, which relieves congestion.
- ✓ Private network, which reduces privacy concerns and eliminates advertising.

The DCP has extended Internet2 to 56 of the 58 COEs. The DCP would eventually provide access to K-12 schools. The goals of DCP, as stated in the DCP plan, are shown in Figure 2. Meeting these goals could provide K-12 schools with benefits such as access to enhanced computer applications (such as interactive video and multimedia learning experiences), as well as access to higher education resources (such as online staff development programs and digital libraries).

Figure 2

Goals of the Digital California Project

As Specified in the Digital California Project Plan

- ✓ Provide a common communications infrastructure foundation for K-12 and higher education in California.
- ✓ Facilitate access to content resources for teaching and learning in grades K-12.
- ✓ Enable the state and educators to effectively address some of the challenges of learning in grades K-12 in the 21st century.
- ✓ Develop an ongoing mechanism that will enable California education to sustain a cohesive K-12 and higher education statewide infrastructure.

For schools to realize these benefits, however, they must be able to connect to the Internet2 access points at the COEs. This is often called the "last mile" connection. The DCP is missing this critical piece since it does not include funding to connect Internet2 to districts, schools, or the classroom. Thus, in order to benefit from the proposed state expenditures for DCP, nearly all districts and schools would have to purchase computers, local area networks, and/or telecommunications services for the last mile. We estimate this cost would be significant. While the goals of DCP are noble, schools and districts have demonstrated few uses for the technology and high speed connectivity available through Internet2.

Governor's Proposal—High Cost and Low Benefit

We recommend the Legislature reject the Governor's Internet2 proposal for the following reasons:

Schools and Districts Would Need to Spend Funds to Connect to COEs. As mentioned above, the schools and districts would have to make sizable one-time and ongoing investments to connect the last mile to COEs. The administration has been unable to demonstrate that schools and districts are willing to make such investments at this time. Without the investment and the last mile connection, DCP has little value to schools and districts.

Few Software Products Require Such High-Speed Access. Part of the reason that few schools and school districts have invested in the infrastructure to connect to the counties is that there are few software products that require high-speed connectivity. Because so few schools and districts nationwide have access to high-speed connections, publishing and software design companies have not yet invested resources to develop products that take advantage of this technology. And, given that other states are in similar state budget situations as California, it is not likely that the demand for these products will increase soon.

Potential Uses of Internet2 Are Not Necessarily Cost Effective. As mentioned above, some of the potential uses include online professional development. While these are clearly viable applications, currently it is likely to be more cost effective to pay teacher travel costs to attend offsite professional development, or to pay a consultant to come to the district, than to pay the costs to connect to DCP.

Cost Likely to Fall in Future. Generally, state-of-the-art technology is relatively expensive. As usage of a specific technology increases, the price generally falls. Internet2 is likely to follow a similar trend. In the future, when applications for Internet2 are widely available and the cost to connect is cheaper, investing in faster connectivity may be a worthwhile investment. However, since that time may be many years in the future, we recommend the state delay such investments and redirect the $21 million to other budget priorities.

CHILD CARE

The Governor's budget proposes a number of significant reforms to California's subsidized child care system. These proposals effectively prioritize limited child care resources. However, the Governor's proposals lack important policy, implementation, and administrative details that would help the Legislature weigh state savings against reducing child care services for a significant number of lower-income families. We evaluate the proposals' effect on children, families, and the state budget, and present some alternative approaches.

BACKGROUND

California's subsidized child care system is primarily administered through the State Department of Education (SDE) and the Department of Social Services (DSS). A limited amount of child care is also provided through the California Community Colleges. Figure 1 summarizes the funding levels and estimated enrollment for each of the state's various child care programs as proposed by the Governor's 2004-05 budget.

As the figure shows, the Governor's 2004-05 budget proposes about $3 billion ($1.8 billion General Fund) for the state's child care programs. This is a decrease of about $60 million from the estimated current-year level of funding for these programs. About $1.4 billion (49 percent) of total child care funding is estimated to be spent on child care for current or former California Work Opportunity and Responsibility to Kids (CalWORKs) recipients. The total proposed spending level will fund child care for approximately 684,100 children statewide in the budget year.

CalWORKs Child Care System

State law requires that adequate child care must be available to CalWORKs recipients receiving cash aid in order to meet their program participation requirements (a combination of work and/or training ac-

Figure 1

California Child Care Programs

2004-05
(Dollars in Millions)

Program	State Control[a]	Estimated Enrollment	Governor's Budget
CalWORKs			
Stage 1[b]	DSS	89,000	$510.4
Stage 2[b]	SDE	93,500	546.2
Community Colleges (Stage 2)	CCC	3,000	15.0
Stage 3	SDE	57,000	368.8
Subtotal		(242,500)	(1,440.4)
Non-CalWORKs			
General Child Care	SDE	86,100	$593.4
Alternative Payment Programs	SDE	29,800	182.3
Pre-School and After-School	SDE	308,500	511.0
Other	SDE	17,200	225.1
Subtotal		(441,600)	(1,511.8)
Totals—All Programs		**684,100**	**$2,952.2**

[a] Department of Social Services (DSS); State Department of Education (SDE); California Community Colleges (CCC).

[b] Includes holdback of reserve funding which will be allocated during 2004-05 based on actual need.

tivities). If child care is not available, then the recipient does not have to participate in CalWORKs activities for the required number of hours, until child care becomes available. The CalWORKs child care is delivered in three stages:

- ***Stage 1.*** Stage 1 is administered by county welfare departments (CWDs) and begins when a participant enters the CalWORKs program. In this stage, CWDs refer families to resource and referral agencies to assist them with finding child care providers. The CWDs then pay providers directly for child care services.
- ***Stage 2.*** The CWDs transfer families to Stage 2 when the county determines that participants' situations become "stable." In some counties, this means that a recipient has a welfare-to-work plan, or employment, and has a child care arrangement that allows them to fulfill their CalWORKs obligations. In other counties, stable means that the recipient is off aid altogether. Stage 2 is

administered by SDE through a voucher-based program. Participants can stay in Stage 2 while they are in CalWORKs and for two years after the family stops receiving a CalWORKs grant.

- ***Stage 3.*** In order to provide continuing child care for former CalWORKs recipients who reach the end of their two-year time limit, the Legislature created Stage 3 in 1997. Recipients timing out of Stage 2 are eligible for Stage 3 if they have been unable to find other subsidized child care. Assuming funding is available, former CalWORKs recipients may receive Stage 3 child care as long as their income remains below 75 percent of the state median income (SMI) level and their children are below age 13.

Non-CalWORKs Child Care System

As discussed above, CalWORKs recipients are guaranteed child care in certain programs that are reserved for current and former CalWORKs recipients. In contrast, non-CalWORKs child care programs (primarily administered by SDE) are open to all low-income families at little or no cost to the family. Access to these programs is based on space availability and income eligibility. This is because child care for low income non-CalWORKs families is not fully funded and waiting lists are common.

Families receive child care subsidized by SDE in one of two ways, either by (1) receiving vouchers from the Alternative Payment (AP) program providers that offer an array of child care arrangements for parents or (2) being assigned space in public or private child care centers or "family child care homes" that contract with SDE to provide child care. (Family child care homes provide care in the home of the provider.)

Current-Year Child Care Reforms

As part of the 2003-04 budget package, the Legislature approved a number of child care reforms that affected both CalWORKs and non-CalWORKs child care. These changes to eligibility and provider reimbursement rates are described below.

Elimination of Child Care Eligibility for 13-Year Olds. Budget trailer bill provisions eliminated child care services for 13-year olds. This age group could previously receive subsidized care if they were in families with incomes below 75 percent of the SMI level.

Elimination of Child Care Eligibility for "Grandfathered" Families. In 1997, the Legislature reduced the family income eligibility requirements for subsidized child care from 100 percent to 75 percent of the SMI, adjusted for family size pursuant to Chapter 270, Statutes of 1997

(AB 1542, Ducheny). However, Chapter 270 specified that children from families with incomes between 75 percent and 100 percent of SMI that were already receiving subsidized care could maintain (be grandfathered in) their right to such care as long as their family income did not exceed 100 percent of SMI. The 2003-04 budget package eliminated this eligibility exception.

Changes in Regional Market Rates. The state reimburses AP child care providers based on the regional market rate (RMR). The RMR is a survey of what child care providers charge in each region. This information is used to determine the maximum reimbursement rate the state will pay providers in any given region. Separate rates are calculated depending on provider type, age of children, and time in care. The Legislature lowered the maximum reimbursement rate from the 93rd percentile to the 85th percentile of the RMR. This means that under the new policy, the state will fully reimburse about 85 percent of regional providers, and will not fully reimburse the 15 percent of providers with the highest costs.

GOVERNOR'S BUDGET PROPOSES ADDITIONAL REFORMS

Figure 2 (see next page) compares the Governor's child care reform proposals to current law. The Governor's budget proposes a number of reforms to the CalWORKs and non-CalWORKs subsidized child care systems including changes in program eligibility, family fees, and provider reimbursement, which we describe below.

Eligibility Restrictions

The Governor's budget proposes several child care eligibility changes. The administration estimates tht these changes would result in combined savings of about $84.8 million and appproximately 20,000 children losing elibility for subsidized child care. (The Governor's budget assumes that the 11 and 12 year olds that lose eligibility for subsidized child care would receive after-school care under the proposal.) The proposed eligibility restrictions achieve savings by eliminating the funding associated with the "freed-up" child care slots that are vacated due to eligibility restrictions rather than redirecting the savings to fund child care for children on waiting lists. We summarize the proposals, describe the impact of the proposed eligibility changes on children and families, and offer issues for legislative consideration.

Figure 2

Administration's Child Care Proposals Compared to Current Law/Current Practice

	Current Law/Current Practice	Administration's Proposal (and Budget-Year Impact)
Eligibility		
Income Eligibility	Family income up to 75 percent of the SMI (for a family of four).	Implement a three-tiered eligibility structure. Maximum income eligibility in "high" cost county would remain the same. Income eligibility in "medium" and "low" cost counties would decrease. Annual adjustments based on CNI. ***($9.3 million savings; 1,900 children lose eligibility.)***
Age Eligibility	Children up to age 13 are eligible for both CalWORKs and non-CalWORKs child care.	Eliminate eligibility for 11 and 12 year olds if after-school programs are available (for which they would receive priority placement). ***($75.5 million savings; 18,000 children lose eligibility and move to after-school programs.)***
Stage 3 Child Care	Former CalWORKs participants are eligible for Stage 3 as long as they meet income and age eligibility. Current practice prevents families from applying for non-CalWORKs child care while receiving aid.	Limit Stage 3 child care to one year (in addition to two years in Stage 2). Families currently in Stage 3 would receive one additional year. CalWORKs families could sign up for non-CalWORKs care as soon as they have income. ***(No impact in the budget year.)***
Eligibility for Nonworking Parents	No time limit as long as families remain eligible.	Limit eligibility to two years. ***(No savings scored; caseload impact unknown.)***

Continued

Other Proposals		
Reimbursement Rates	Providers are reimbursed at up to 85th percentile of the RMR.	Creates a six-level reimbursement rate structure that reimburses providers between 40th and 85th percentile of the RMR[a], depending on licensure, training, and whether they serve private pay clients. ***($57.7 million savings; 95,592 children impacted.)***
Family Fees	Families with income over 50 percent of SMI pay fees up to 8 percent of their gross income.	Families with income over 40 percent of SMI[b] pay fees up to 10 percent of gross income. ***($22.3 million savings; fees increased for 77,250 children.)***
Totals		
Savings (All Funds)		***$164.8 million***
Children Losing Eligibility		***20,000 (including those children switching to after-school care)***
Children Subject to Increased Fee		***77,250***

a RMR=Regional Market Rate.

b SMI=State Median Income.

Income Eligibility

The Governor's proposal to create a three-tiered child care eligibility structure reflecting the cost-of-living differences among counties has merit. The proposed eligibility structure would, however, lower the income eligibility threshold for subsidized child care in medium- and lower-cost counties, resulting in an estimated 1,900 children losing eligibility for subsidized child care programs for a state savings of $9.3 million in 2004-05. While the proposal lowers the eligibility threshold, it does maintain eligibility for families with the lowest income.

Proposal Creates a Three-Tiered Income Eligibility Structure. Under current law, income eligibility (last increased in September 2000) for child care is based on the SMI (adjusted for family size). The administration proposes creating a three-tiered income eligibility structure that reflects the differences in cost of living among counties. Current eligibility levels for families in "high-cost" counties would remain the same, while eligibility for families in all other counties would be reduced. Figure 3 shows the proposed income eligibility levels for subsidized child care. As the figure shows, a family of three in a "medium-cost" county with monthly income above $2,729 would no longer be eligible for subsidized child care.

Figure 3

Proposed Maximum Monthly Subsidized Child Care Income Eligibility[a]

	Family Size				
	1 and 2	3	4	5	6 or More
High cost county[b]	$2,730	$2,925	$3,250	$3,770	$4,290
Medium cost county[c]	2,606	2,792	3,102	3,599	4,095
Lower cost county[d]	2,482	2,659	2,954	3,427	3,900

a Current income eligibility is the same as the high cost county figures.

b High cost counties: Marin, San Francisco, and Santa Clara.

c Medium cost counties: Alameda, Contra Costa, Los Angeles, Monterey, Napa, Orange, San Diego, San Luis Obispo, Santa Barbara, Santa Cruz, Solano, Sonoma, and Ventura.

d Lower cost counties: All other counties.

The Governor's budget proposes basing income eligibility thresholds on the fixed dollar amount shown in Figure 3 beginning in October 2004. This amount would be adjusted annually in accordance with changes in the California Necessities Index (CNI). The income eligibility changes would result in an estimated 1,900 children losing eligibility for child care for a total state savings of $9.3 million.

Child Care Costs Vary by Region. Like the cost of living, child care costs vary across the state. A recent study done by the Public Policy Institute of California and the SPHERE Institute showed that both family-based care and center-based care was significantly more expensive in the Bay Area, with the highest statewide costs in Santa Clara, San Francisco, and Marin Counties. Furthermore, the study showed that child care costs varied across the state.

Conclusion. We believe that an income eligibility system that takes regional cost of living into account has merit because a family living in a high cost region of the state will, on average, need to spend more on housing, child care, food, and other necessities.

In considering the administration's proposal, the Legislature should first evaluate the merits of a differential income eligibility system, and then determine the level of savings it would want to achieve with such a policy. The administration has devised a differential income eligibility system by adopting the current income eligibility threshold as the eligibility ceiling in high cost counties and then lowering eligibility thresholds in low and medium cost counties. As a result, the administration's proposal generates General Fund savings. Alternatively, a state income eligibility system that recognizes differences in regional costs of living could be developed in a fiscally neutral way.

Age Eligibility

The administration proposes to eliminate subsidized child care for 11 and 12 year olds, except when after-school programs are not available to serve these children. Under the proposal, 11 and 12 year olds would be given priority in after-school programs. Although we believe that the proposal is reasonable given the state's fiscal constraints, our analysis indicates that the administration has significantly overestimated savings resulting from this proposal. In addition, the proposal lacks key details regarding the definition of "available" as it applies to after-school programs, as well as important implementation details.

Proposal Restricts Eligibility for 11 and 12 Year Olds. Under current law, children age 12 or below from families with incomes below 75 percent of the SMI are eligible for child care. The administration proposes to eliminate child care eligibility for 11 and 12 year olds when after school programs are available for an estimated savings of $75.5 million. The administration estimates that about 18,000 children ages 11 and 12 would lose subsidized child care eligibility and obtain after-school care.

Governor's Proposal Lacks Detail. The proposal lacks key details that are necessary to evaluate both the number of children that might be affected by this proposal as well as projected savings. For example, the administration's policy states that 11 and 12 year olds will lose child care eligibility *only if* after-school programs are available to the child. However, it is unclear what constitutes "availability." After-school programs typically operate for only a limited time period, often no later than 7:00 p.m., and usually not on the weekends and during the summer. About 70 percent of the working adults receiving CalWORKs are employed in the service or retail trade industries that often require nontraditional work hours. The administration's policy is unclear as to whether or not the definition of available would include a standard that after-school programs be available to CalWORKs participants even on nights and weekends.

Another area needing clarification is how the proximity of after-school programs to the child's residence or a parent's employer would be factored into determining availability. For example, some families may face transportation or other barriers that prevent them from accessing after-school programs.

Availability of Current After-School Programs. The state and federal governments currently fund two major before and after-school programs—the After School Education and Safety Program and the 21st Century Community Learning Centers—for K-12 students in California. The Governor's budget includes $121.6 million (Proposition 98) for the After School Education and Safety Program to serve about 133,000 students. At some time in the future, Proposition 49 (passed by the voters in November 2002) will require an additional $429 million annually for the program. (Please see the discussion below.) Federal 21st Century Learning Centers also provide before- and after-school services. In the current year, California received about $76 million in federal funds to serve about 79,000 students.

Although schools currently offer an array of after-school programs, it remains uncertain whether these programs have the capacity to accommodate the 18,000 11 and 12 year olds estimated to lose child care eligibility under the Governor's proposal. In some areas, there may be waiting lists for after-school programs. If the programs have the capacity, these additional students would in effect displace generally younger students currently being served by the program. This is because the 11 and 12 year olds would have priority in publicly supported after-school programs under the Governor's proposal.

Estimated Savings Not Likely to Be Achieved. The administration's stated intention is that either 11 and 12 year olds should receive care in after-school programs, or when after-school programs are not available, through the existing subsidized child care system. Yet, the administration's savings estimate assumes that *all* 11 and 12 year olds will be eliminated from the child care system. We believe that this expectation is unrealistic given that many CalWORKs recipients work in industries often requiring nontraditional work hours, when traditional after-school programs may not be available.

Conclusion. The Governor's proposal to eliminate subsidized child care eligibility for 11 and 12 year olds when after-school care is available, significantly overestimates savings and lacks important details the Legislature needs to evaluate the proposal.

Stage 3 Eligibility Limits

The Governor's budget proposes to limit Stage 3 CalWORKs child care to one year (in addition to two years in Stage 2) once a family has left cash aid, and allow CalWORKs families to sign up for a slot in the non-CalWORKs child care system as soon as they begin to earn income. Those families currently in Stage 3 child care would have one more year of eligibility. Given limited child care resources, we believe the proposal is reasonable because it addresses the differential treatment of working poor families and families previously in CalWORKs. However, limiting eligibility for Stage 3 child care creates a transition problem for families currently in Stages 2 or 3 of the CalWORKs child care system. We offer two options that would help address this transition problem.

Proposal Would Limit Stage 3 Child Care to One Year. Generally, families are eligible for Stage 3 child care after they have been in Stage 2 child care for two years. Under current budgeting practices, families may remain in Stage 3 until their income exceeds 75 percent of the SMI or until their children are 13 years old or older. The Governor's budget proposes restricting the amount of time that a family can receive Stage 3 child care to no more than one year after they have left cash aid and have exhausted their two-year transitional eligibility in Stage 2. Under the proposal, families who began receiving Stage 3 services on or before June 30, 2004 and meet other eligibility standards will be allowed to continue receiving services until July 1, 2005. As a result, the administration estimates that budgetary savings and Stage 3 caseload reductions will not be realized until 2005-06.

Proposal Allows CalWORKs Families to Apply for Non-CalWORKs Child Care as Soon as They Have Income. Current practice generally prohibits CalWORKs families from signing up on a waiting list for non-CalWORKs child care until they no longer receive CalWORKs aid. The Governor's budget proposes to allow CalWORKs families to apply for such care as soon as they have some income, even while they are still on aid. This change is intended to help ensure that these CalWORKs families would not be disadvantaged in accessing child care once they leave CalWORKs.

Stage 3 Reforms May Disadvantage Certain Current and Former CalWORKs Families. This proposal would disadvantage some current and former CalWORKs families because these families would not have had the benefit of putting their names on a non-CalWORKs child care waiting list at the time they started earning income. Generally, the lowest-income families on a non-CalWORKs child care waiting list are given priority for available child care slots. These current and former CalWORKs families may have higher incomes then other families on a child care waiting list and, therefore, they may be given lower priority for available child care slots. Also, current Stage 3 families may simply have less time to move up the waiting list.

We view the disadvantages for current Stage 2 and 3 families as a transition problem that the Legislature may want to address. If the Legislature decides to accept the administration's proposal to limit Stage 3 to one year, it may want to consider the following options that would help to mitigate some of the barriers to child care that some families might experience as a result of the proposed Stage 3 reforms.

- ***Allow Families in Stages 2 and 3 Child Care to Remain Eligible.*** This option would allow current CalWORKs families to sign up for non-CalWORKs child care immediately, but remain eligible for Stage 3 eligibility until they are able to find a slot in the broader subsidized child care system. Under this option the Governor's one year limit on Stage 3 only applies to future Stage 3 families. This option would assist CalWORKs families, but would lower out-year savings.
- ***Allow Families in Stage 2 and 3 Child Care to Remain Eligible for Up to Three Years.*** As a variation of the above option, for three years after implementation of the proposed change CalWORKs families would maintain Stage 3 eligibility, after which time they would not be able to extend their time in Stage 3, regardless of whether or not they secured other arrangements. Again, this option would smooth the transition to regular subsidized child care for CalWORKs families, but would lower out-year savings, compared to the Governor's budget.

Although the above alternatives reduce out-year savings, they also reduce the potential that families will return to CalWORKs to obtain needed child care. In addition, these alternatives would reduce future Stage 3 child care costs once the respective transition periods conclude.

Conclusion. The current child care system provides differential eligibility for CalWORKs and non-CalWORKs families. Specifically, families that leave CalWORKs receive child care until they are no longer income or age eligible, while working poor families receive subsidized child care *only if space is available*. The Governor's Stage 3 proposal addresses this differential treatment. Accordingly, we believe that the Governor's proposal is reasonable. However, we do recognize that there is a transition issue for families currently in Stage 2 or 3 child care, and provide two options to address that circumstance.

Eligibility Limits for Nonworking Parents

The administration proposes to limit eligibility for families who are eligible for child care based on their participation in education and training activities to two years. All families would receive two additional years of eligibility after the policy is implemented. Given limited child care resources, we believe this proposal is reasonable.

The administration proposes to limit eligibility for families who are eligible for child care based solely on their participation in education or training-related activities to two years. Currently, there is no time limit on eligibility for this group. Upon implementation of the proposed change, families would receive an additional two years of eligibility regardless of how many years they had been receiving child care. The administration does not anticipate out-year savings because it will make the vacated child care slots available to other families.

The administration was unable to provide information on the number of children who are eligible for subsidized child care based solely on parental participation in education and training activities. Similarly, the administration was unable to estimate how many children would be impacted by this change. Given limited child care resources, however, we believe that it is reasonable to limit eligibility for families that are not working, but participating in education and training activities.

Weighing the Costs and Benefits of Restricting Child Care Eligibility

As the Legislature considers whether to adopt the child care eligibility changes contained in the Governor's budget proposal, it should examine the impact on the state budget, families, and children. The state is facing a difficult financial situation that may necessitate limiting the level of service provided through public programs. The proposed child care eligibility restrictions are estimated to save $164.8 million (all funds), which could help address the budget shortfall or be used for other legislative priorities.

On the other hand, research has shown that access to reliable, affordable child care is an important part of employment stability for low-income families. Eliminating eligibility for child care for some low-income families may make them more susceptible to employment disruptions that could increase their likelihood of needing CalWORKs and other income dependent public aid programs. This is especially relevant beginning in 2005-06 under the budget plan, as transition funding would end and Stage 3 families would lose their CalWORKs child care eligibility. The Governor's budget does not propose any additional non-CalWORKs child care spending related to his proposed child care reforms. Under the Governor's proposals, children who had formerly received care through the CalWORKs child care system would begin moving into the non-CalWORKs system in 2005-06. This could result in increased demand for child care in a system that often has waiting lists for eligible families. As a result, additional families may not be able to secure subsidized child care, which could result in additional employment disruptions for some families.

Provider Reimbursement

While we believe the policy objective is sound, we withhold recommendation on the administration's proposal to create a tiered-provider reimbursement rate structure pending additional detail from the administration regarding health, safety, and education standards as well as implementation and administration issues.

Proposal Creates a Tiered Reimbursement Rate Structure. Generally, AP providers are reimbursed under current law up to the 85th percentile of the rates charged by other providers in the area offering the same type of child care. Figure 4 shows the administration's proposed reimbursement rate structure. The Governor's proposal creates a six-tiered child care reimbursement rate structure that reimburses providers from the 40th to 85th percentile of the RMR, depending on licensing and accreditation, health, safety, and childhood development training, and the mix of subsidized or unsubsidized families served. This means that under the proposed new structure, licensed exempt providers without specialized education or training will be reimbursed by the state at a rate no greater than the 40th percentile of the rate charged by child care providers in the region. At the other end of the proposed reimbursement rate structure, licensed, accredited providers with specialized training will be reimbursed by the state at a rate up to the 85th percentile of the rate charged by regional child care providers.

We believe that the policy of basing reimbursement rates on a provider's level of training, education, and other factors has merit in that it (1) reflects the reimbursement structure in the nonsubsidized child care market and (2) better reflects the cost of providing care.

Legislature Needs Additional Detail to Evaluate Merits and Impact of Proposal. The administration's proposal does not provide adequate detail that would allow the Legislature to fully evaluate how the proposed changes will affect child care providers, families, and quality of care. The administration includes a provision that SDE and DSS, in consultation with the Department of Finance (DOF) shall establish a standardized process for documenting a provider's early childhood education, health and safety training, and accreditation for purposes of determining a reimbursement limit. However, the true impact of the proposal on families, counties, and state finances cannot be fully evaluated until the Legislature receives more information regarding these and other details such as rate determination and the oversight process.

Figure 4

Proposed Child Care Provider Reimbursement Schedule

Provider Type	Maximum Reimbursement Rate
Licensed	
Accredited: specialized education and/or training; serve subsidized and unsubsidized children.	Up to 85th percentile of RMR[a]
No specialized education and/or training; serve subsidized and unsubsidized children.	Up to 75th percentile of RMR.
Accredited: specialized education and/or training; serve only subsidized children.	Up to 75th percentile of RMR.
No specialized education and/or training; serve only subsidized children.	Up to 50th percentile of RMR.
License Exempt	
Specialized education and/or training.	Up to 50th percentile of RMR.
No specialized education and/or training.	Up to 40th percentile of RMR.

[a] RMR=Regional Market Rate.

Analyst's Recommendation. We believe the policy of tying reimbursement rates to the level of training, education, and other factors has merit. However, we withhold recommendation on the administration's proposal to create a tiered child care provider reimbursement structure given uncertainties regarding important definitional, implementation, and administrative details.

Family Fees

The administration proposes to lower the income threshold at which a family must begin paying fees, raise the maximum amount a family would have to pay for child care, and limit fee deferral for certain children at risk for neglect or abuse. The combined policy changes would result in state savings of about $22.3 million and would increase fees for about 77,250 children. In considering this proposal the Legislature may want to examine linking the amount of family fees paid to the provider's cost of providing care, level of training, licensure, and other factors.

Proposal Increases the Number of Families Required to Pay a Fee and Increases Maximum Amount of Fees. Currently, families are required to pay a fee for child care once their income reaches 50 percent of the SMI. The fees are not to exceed 8 percent of their total income. The administration's proposal would instead require families to pay a fee once they exit cash aid—approximately 40 percent of the SMI—in an amount not to exceed 10 percent of family income. For example, under the Governor's proposal a family of three with an annual income of about $25,000 would pay about $56 more for child care each month. Figure 5 shows the proposed new fee schedule.

The Governor's budget further proposes that families pay the family fees directly to providers to achieve administrative simplicity. Currently, counties have some flexibility in the way fees are collected. In most counties fees are collected through an AP Program or county agency which then reimburses providers. In some counties, fees may also be collected directly by providers. In most cases, the administration's proposal will shift the burden of collecting the fees from the counties to child care providers. To the extent that providers are unable to collect these fees, it would effectively result in a provider rate reduction.

Fee Limitation for CWS Referred Kids. Under the Governor's proposal, families receiving a referral for child care services from Child Welfare Services (CWS) because the child is considered to be at risk for neglect or abuse are exempt from family fees for no more than one year. Currently they are exempt indefinitely. Children who are considered at risk and are referred by a non-CWS professional will be exempt from family fees for no more than three months.

Weighing the Costs and Benefits of Fees. Increasing family fees will allow the state to fund child care for more children at the same level of state funding. Although the Governor's proposal recognizes the ability of families to pay for child care through its sliding scale fee structure, increasing fees puts an additional financial burden on relatively low-income families.

Figure 5

Family Child Care Fees[a]
Administration's Proposed New Monthly Fee Schedule

Full-Time Care			Part-Time Care		
Income	**Fee**	**Percent of Income**	**Income**	**Fee**	**Percent of Income**
$1,564	$22	1%	$1,564	$9	1%
1,994	100	5	1,994	40	2
2,216	151	7	2,216	60	3
2,438	210	9	2,438	84	3
2,659[b]	266	10	2,659[b]	106	4
2,792[c]	279	10	2,792[c]	112	4
2,925[d]	293	10	2,925[d]	117	4

a Family of three full-time care.
b Income limit for lowest cost counties.
c Income limit for high cost counties.
d Income limit for highest cost counties.

Linking Fees to Cost of Care. When considering this proposal, the Legislature may also wish to consider basing the fee structure on the cost of care, thereby enabling families to make decisions about the type of care they utilize related to the amount they pay. Requiring families in the subsidized child care system to pay a portion of the cost of care more accurately reflects the reimbursement arrangements they will be subject to once they leave the subsidized system.

Conclusion. The administration's child care fee proposals would increase fees for about 77,250 children. As the Legislature considers this proposal, it may want to also consider linking the amount of family fees paid to the provider's level of training, licensure, the cost of providing care, and other factors.

PROPOSITION 49: AFTER SCHOOL EDUCATION AND SAFETY PROGRAM

We find that, based on the Governor's proposed budget and our fiscal forecast, Proposition 49 would not trigger an increase in funding for the After School Education and Safety Program until 2007-08. In part, the exact timing of when Proposition 49 will require additional spending depends on (1) how the state solves the structural imbalance between General Fund expenditures and revenues and (2) future growth in General Fund revenues.

As approved by voters in 2002, Proposition 49 requires that the state appropriate additional funding for the After School Education and Safety Program beginning as early as 2004-05. The state must increase funding for the program from the $121.6 million provided in 2003-04 to $550 million (a $428.4 million increase) when certain conditions are met, which we describe below. The funding for Proposition 49 is "continuously appropriated" (that is, there is no need for annual legislative action to appropriate funds). When additional funds are provided for the program, they will be "on top of" the state's minimum guarantee funding requirement for Proposition 98 for that year (referred to as an "overappropriation").

When Will Proposition 49 Trigger?

Proposition 49 requires the state to provide additional funding for the After School Education and Safety Program when specified General Fund spending reaches a required level. The Proposition 49 "trigger" funding level is determined by (1) establishing a base year between 2000-01 and 2003-04 in which the "nonguaranteed General Fund appropriation" level was the highest and (2) adding $1.5 billion to that base year funding level. Our interpretation of the initiative is that nonguaranteed General Fund appropriations are non-Proposition 98 General Fund appropriations plus any over-appropriations of the Proposition 98 minimum guarantee.

Figure 6 shows the calculation of the nonguaranteed General Fund appropriation level that would trigger the additional $428 million in spending on after-school programs. The figure shows that 2001-02 is the base year, and that the base appropriation level is $54.7 billion. This means that the state would not have to spend additional dollars to meet the proposition's requirement until nonguaranteed General Fund appropriations in any year exceeded this amount. At such time, all spending above the base amount would go to after-school programs until the $550 million cap was reached. In 2004-05, the Governor's budget proposes a nonguaranteed appropriation level of $49.3 billion, $5.4 billion less than the trigger level.

Figure 6

What Is the Proposition 49 Trigger?

(In Billions)

	2000-01	2001-02	2002-03	2003-04
Non-Proposition 98 appropriations	$47.9	$47.2	$48.6	$44.8
Proposition 98 appropriations above minimum	0.5	6.1	—	—
Nonguaranteed appropriations	$48.3	$53.2	$48.6	$44.8
“Add-on” amount	1.5	1.5	1.5	1.5
Potential Trigger Amounts	$49.8	$54.7	$50.1	$46.3

[a] As the highest amount during the four base years, this amount would serve as the "trigger" level.

Based on our revenue forecast and assuming implementation of the Governor’s budget, we estimate that the state would not be required to augment after-school spending until 2007-08. However, when the initiative will actually trigger will depend largely on two factors:

- ***Solution to the Structural Deficit in 2004-05 and Beyond.*** The Governor has proposed to solve the 2004-05 structural imbalance between General Fund expenditures and revenues through a combination of expenditure reductions, a property tax shift from local governments, borrowing, and deferrals. To the extent the final budget resolution involves less expenditure reductions, the state would trigger the Proposition 49 appropriations sooner.
- ***Growth in the Economy.*** If General Fund revenue grows faster than either the LAO or the Department of Finance have forecasted, the augmentation requirements could trigger earlier than 2007-08.

INTRODUCTION

Higher Education

The Governor's budget proposes a $197 million reduction in General Fund expenditures for higher education in 2004-05. This represents a 2.3 percent decrease from the revised 2003-04 amount. However, the Governor's proposal assumes the enactment of student fee increases which, when coupled with changes in all other revenue sources, would increase total higher education funding by $802 million, or 2.6 percent. Pursuant to legislative intent expressed in the 2003-04 budget package, the Governor's proposal includes no funding for enrollment growth and no funding for cost-of-living adjustments at the state's public universities. It does, however, include funding for 3 percent enrollment growth at the California Community Colleges. The budget also proposes various changes to student financial aid programs, including reductions in the size of aid awards and tighter income restrictions on eligibility.

Total Higher Education Budget Proposal

As Figure 1 (see next page) shows, the 2004-05 budget proposal provides a total of $32.3 billion from all sources for higher education. This amount is $802 million, or 2.5 percent, more than the Governor's revised current-year 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 (CSAC), 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 implementation of various midyear proposals.

Figure 1

Higher Education Budget Summary[a]

(Dollars in Millions)

	Revised 2003-04	Proposed 2004-05	Change Amount	Change Percent
University of California				
General Fund	$2,868.2	$2,670.5	-$197.7	-6.9%
Student fee revenue	1,084.1	1,271.0	186.9	17.2
Federal and other funds	14,068.2	14,498.8	430.6	3.1
Totals	**$18,020.5**	**$18,440.4**	**$419.9**	**2.3%**
California State University				
General Fund	$2,630.1	$2,409.6	-$220.5	-8.4%
Student fee revenue	1,016.5	1,165.6	149.1	14.7
Federal and other funds	2,191.1	2,180.1	-11.0	-0.5
Totals	**$5,837.6**	**$5,755.2**	**-$82.4**	**-1.4%**
California Community Colleges				
General Fund	$2,252.8	$2,423.0	$170.2	7.6%
Local property tax revenue	2,114.8	2,264.4	149.7	7.1
Student fee revenue	265.1	356.1	91.0	34.3
Federal and other funds	1,579.3	1,579.2	-0.1	—
Totals	**$6,212.0**	**$6,622.8**	**$410.8**	**6.6%**
Student Aid Commission				
General Fund	$630.2	$684.0	$53.8	8.5%
Federal and other funds	665.2	664.6	-0.5	-0.1
Totals	**$1,295.3**	**$1,348.6**	**$53.3**	**4.1%**
Other[b]				
General Fund	$13.1	$10.1	-$3.0	-22.6%
Student fee revenue	18.5	24.6	6.1	32.9
Federal and other funds	17.2	15.6	-1.6	-9.6
Totals	**$48.9**	**$50.3**	**$1.5**	**3.1%**
Grand Totals	**$31,414.4**	**$32,217.4**	**$803.0**	**2.6%**
General Fund	$8,394.4	$8,197.2	-$197.1	-2.3%
Property tax revenue	2,114.8	2,264.4	149.7	7.1
Student fee revenue	2,384.3	2,817.3	433.1	18.2
Federal and other funds	18,520.9	18,938.4	417.4	2.3

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

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

Major Funding Sources

The 2004-05 budget proposal provides $8.2 billion in General Fund appropriations for higher education. This amount is $197 million, or 2.3 percent, less than proposed current-year funding. The budget also projects that local property taxes will contribute $2.3 billion for CCC in 2004-05, an increase of $150 million, or 7.1 percent, from the revised current-year amount.

In addition, student fee revenue at all the higher education segments account for $2.8 billion of proposed expenditures. This amount is $433 million, or 18.2 percent, greater than student fee revenue in the current year. This increase is due to proposed fee increases at all three segments, which would backfill roughly half of the proposed General Fund reductions.

Finally, the budget provides $19 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.*

Funding by Segment

For UC, the budget proposal provides General Fund appropriations of $2.7 billion, which is a net $198 million, or 6.9 percent, less than the Governor's revised current-year estimate. This reduction is almost completely offset by the proposed increase in student fee revenue. When student fees and all other fund sources are considered, UC's budget actually increases by $420 million, or 2.3 percent.

For CSU, the budget proposes $2.4 billion in General Fund support, which is a net reduction of $221 million, or 8.4 percent, from the Governor's current-year estimate. Proposed increases in student fee revenue would offset two-thirds of this reduction. When all fund sources are considered, CSU's budget decreases by $82 million, or 1.4 percent.

For CCC, the Governor's budget proposes $2.4 billion in General Fund support, which is $170, or 7.6 percent, above the current-year amount. Incorporating local property tax revenue, the budget anticipates $4.7 billion in Proposition 98 funding, which reflects an increase of $320 million, or 7.3 percent. When student fees and all other fund sources are considered, CCC's budget increases by $411 million, or 6.6 percent.

Major Cost Drivers for Higher Education

Annual base adjustments for higher education funding generally arise from three major factors: (1) enrollment, (2) inflation, and (3) student fee levels. Specifically, these factors influence costs in the following ways:

Enrollment Growth Increases Instructional and Other Costs. For UC and CSU, the state uses a "marginal cost" formula that estimates the added cost imposed by enrolling each additional full-time equivalent (FTE) student. This estimate includes instructional costs (such as faculty salaries and teaching assistants), related educational costs (such as instructional materials and libraries), administrative costs, and student services. Because faculty (particularly at UC) spend part of their time performing noninstructional activities such as research, the marginal cost formula "buys" part of these other activities with each additional student enrolled. A similar approach is used for funding enrollment growth at community colleges. As a practical matter, each additional student is funded at the current per FTE apportionment amount.

Inflation. Higher education costs rise with general price increases. For example, inflation increases the costs of supplies, utilities, and services that are purchased by campuses. In addition, price inflation creates pressure to provide cost-of-living adjustments to maintain the buying power of faculty and staff salaries.

Student Fees. Student fees comprise a portion of total revenue available to the segments. When fees are increased, this creates new revenue that can substitute for General Fund revenue. In other words, fee increases can reduce the level of General Fund support required to maintain a given level of services. Conversely, fee reductions (such as those experienced in the late 1990s) make less revenue available and can create cost pressures on the General Fund. Even when fees remain flat from year to year, the state has usually increased General Fund support to compensate for the reduced buying power of those fees.

Major Budget Changes

Although the Governor's higher education proposal provides for a net General Fund savings of $197 million, this results from a combination of reductions to selected programs, the substitution of new student fee revenue for General Fund support, and General Fund augmentations in several areas. Figure 2 shows the major General Fund budget changes proposed by the Governor for the three segments.

Figure 2

Higher Education
Proposed Major General Fund Changes

University of California	**Requested:**	**$2.7 billion**	
	Decrease:	**$198 million**	**(-6.9%)**

Base Budget Reductions: Total of $360 million in allocated and unallocated reductions, partly offset by a $196 million increase in student fee revenue.

Base Budget Augmentations: Net total of $162 million in base augmentations and adjustments, including $80.5 million to restore an unallocated one-time reduction in 2003-04 and $34.4 million for increased health costs.

Enrollment Reduction: Assumes a 10 percent reduction in enrollment of new freshmen. These freshmen would be redirected to community colleges.

Student Fees: Increases of 10 percent for undergraduate fees, 40 percent for graduate fees, 20 percent for nonresident tuition, and professional school fee will rise to offset proposed General Fund reductions.

California State University	**Requested:**	**$2.4 billion**	
	Decrease:	**$221 million**	**(-8.4%)**

Base Budget Reductions: Total of $299 million in allocated and unallocated base reductions, partly offset by a $102 million increase in student fee revenue.

Base Budget Augmentations: Net total of $78 million in base augmentations and adjustments, including $69.5 million to restore a one-time unallocated cut in 2003-04.

Enrollment Reduction: Assumes a 10 percent reduction in new freshmen. These students would be redirected to community colleges.

Student Fees: Increases of 10 percent for undergraduate fees, 40 percent for graduate fees, and 20 percent for nonresident tuition.

California Community Colleges	**Requested:**	**$2.4 billion**	
	Increase:	**$170 million**	**(+7.6%)**

Base Budget Reductions: Total of $236 million in base reductions, including $143 million to be backfilled with increased local property tax revenue and $91 million to be backfilled with new student fee revenue.

Base Budget Augmentations: A total of $406 million, including $121 million for enrollment growth, $80 million for equalization, and $200 million to restore a reduction that resulted from the 2003-04 Proposition 98 deferral.

Enrollment Growth: Funds an increase of 33,120 full-time equivalent students (about 3 percent) from the budgeted 2003-04 level. In addition, the budget includes $4 million specifically to fund further growth in noncredit enrollment.

Student Fees: Increase in enrollment fee from $18 per unit to $26 per unit (44 percent). Students with baccalaureate degrees would pay a higher fee of $50 per unit.

Enrollment Growth

In keeping with legislative intent expressed in the 2003-04 budget package, the Governor's proposal provides no new funding for enrollment growth at UC or CSU. In fact, the Governor proposes to reduce new freshman enrollment at UC and CSU by 10 percent, with the foregone enrollment being redirected to CCC. Partly in recognition of this diverted enrollment, the Governor's budget provides funding for enrollment growth of 3 percent at CCC, which is considerably higher than the statutory growth rate of 1.8 percent. Figure 3 shows enrollment changes at the three segments. We discuss proposed enrollment levels in more detail later in this chapter.

Figure 3

Higher Education Enrollment

Full-Time Equivalent (FTE) Students

	Actual 2002-03	Budgeted 2003-04[a]	Proposed 2004-05	Change: Amount	Change: Percent
University of California					
Undergraduate	152,527	159,242	154,896	-4,346	-2.7%
Graduate	30,531	31,020	32,166	1,146	3.7
Health Sciences	13,130	12,366	12,366	—	—
UC Totals	**196,188**	**202,628**	**199,428**	**-3,200**	**-1.6%**
California State University					
Undergraduate	276,607	290,665	286,865	-3,800	-1.3%
Graduate/Postbacalaurate	54,746	53,348	53,348	—	—
CSU Totals	**331,353**	**344,013**	**340,213**	**-3,800**	**-1.1%**
California Community Colleges	1,128,954	1,104,030	1,137,150	33,120	3.0%[b]
Hastings College of the Law	1,262	1,250	1,250	—	—
Grand Totals	**1,657,757**	**1,651,921**	**1,678,041**	**26,120**	**1.6%**

a These reflect the enrollment levels assumed in the *2003-04 Budget Act*. However, UC and CSU plan to enroll fewer students as they redirected some enrollment funding to offset reductions in other areas.

b In addition to this general growth funding, the Governor's budget includes $4 million to fund additional noncredit FTE students. With this funding included, the Governor's budget funds a total enrollment increase of about 35,000 FTE students, or 3.2 percent.

Student Fees

The Governor proposes fee increases at all three segments. For UC and CSU, he proposes fee increases of 10 percent for undergraduate students, 40 percent for graduate students, and 20 percent in the tuition surcharge imposed on nonresident students. The budget reduces General Fund support for professional school students with the expectation that the segments would recoup some or all of these reductions by increasing professional school fees. Although the Governor assumes that professional school fee increases would vary by type of degree, the average fee increase required to backfill the General Fund reduction would be about 34 percent. For CCC, the Governor proposes a 44 percent fee increase (from $18 to $26 per unit) for most students, with a higher fee of $50 per unit charged to students who already possess a bachelor's degree. The combined effect of all these fee increases is expected to offset the budget's unallocated General Fund reductions. Proposed student fees are shown in Figure 4, and are discussed in more detail later in this chapter.

Figure 4

Annual Student Fees Proposed for 2004-05[a]

	Residents		Nonresidents	
	Systemwide	Total[b]	Tuition	Total[b]
University of California				
Undergraduates	$5,482	$6,028	$16,476	$22,504
Graduates	7,307	8,931	1,4991	23,922
California State University				
Undergraduates	$2,250	$2,776	$10,170	$12,946
Graduates	3,156	3,682	10,170	13,852
California Community Colleges[c]	$624	$624	$4,470	$5,094
Hastings College of the Law	$17,948	$19,828	$12,799	$32,627

a Governor's proposal reduces General Fund support for professional schools by 25 percent. While the budget assumes this reduction would be backfilled by fee increases, it does not specify how the various fees would increase.

b Includes campus-based fees (weighted average for UC and unweighted average for CSU).

c Average full-time course load of 24 units.

The Governor also proposes a new "long-term fee policy," where undergraduate and graduate fees at UC and CSU would be adjusted annually to reflect the change in per-capita personal income. The annual increase could exceed this level "to address unforeseen fiscal needs," but in no event would increase by more than 10 percent in one year. The Governor proposes that the 10 percent threshold immediately be imposed on undergraduate fees, but that graduate fees be exempt from this limit until they reach a target level equal to 150 percent of undergraduate fee levels. The Governor proposes no fee policy for community college fees.

Student Financial Aid

The Governor's budget provides $684 million in General Fund support to CSAC, primarily for the Cal Grant programs. This reflects an increase of $53.8 million from the revised current-year level. The increase in funding is largely due to a projected increase in the number of Cal Grant awards. At the same time, the Governor's proposal includes several cost-saving measures, including (1) reducing the size of the maximum Cal Grant award for students at private institutions by about 44 percent, (2) *not* increasing Cal Grant awards for students at UC and CSU to reflect proposed fee increases, and (3) reducing the income eligibility threshold by 10 percent for all new Cal Grant recipients.

The Governor's proposal also reduces from 33 percent to 20 percent the amount of new student fee revenue that UC and CSU divert to their own institution-based financial aid programs. As a result of this proposal, UC and CSU would divert $43 million less to institutional financial aid, thus achieving a like amount of General Fund savings.

BUDGET ISSUES
Higher Education

INTERSEGMENTAL: PRESERVING STUDENT ACCESS IN TOUGH FISCAL TIMES

The Governor's budget proposal includes major reductions in higher education, including the elimination of General Fund support for outreach programs at the University of California (UC) and the California State University (CSU), increases in UC and CSU's student-faculty ratios, a 7.5 percent reduction in funding for academic and administrative support at UC and CSU, new restrictions and reductions for state financial aid programs, and unallocated reductions. These reductions, however, would be backfilled in part by proposed increases in student fees at the two segments. The budget proposal would reduce freshman enrollment at UC and CSU, while increasing enrollment at the California Community Colleges by about 35,000 full-time equivalent students.

While the state's fiscal situation justifies efforts to achieve General Fund savings in various areas, including higher education, we are concerned that the Governor's proposal does not adequately safeguard student access to postsecondary education. In this section, we outline our recommended changes to the Governor's budget, which we believe would better preserve student access. Details of our specific proposals appear immediately after this introductory section.

The Governor's budget for higher education involves policy and budget changes in a number of interrelated areas. Among these are K-14 outreach programs, budgeted enrollment, student fees, and financial aid. Major proposed changes in these areas are summarized in Figure 1.

Figure 1

Selected Features of Governor's Higher Education Budget Proposal

General Fund (In Millions)

	Change From 2003-04 Revised
K-14 Outreach	
Eliminates General Fund support for outreach programs at UC and CSU[a]	-$60.6
Enrollment Growth	
Reduces freshman enrollment at UC and CSU by 10 percent	-$45.9
Increases CCC[a] enrollment by 3 percent	121.0
Increases CCC noncredit enrollment	4.0
Reductions Backfilled by Student Fees[b]	
Increases UC and CSU undergraduate fees 10 percent	-$103.9
Increases UC and CSU graduate fees 40 percent	-106.0
Increases UC and CSU nonresident tuition 20 percent	-49.0
Reduces General Fund subsidy for professional schools	-42.6
Increases CCC fees by 44 percent	-73.4
Imposes excess units surcharge at UC and CSU	-33.7
Imposes surcharge on CCC students with baccalaureate degrees	-17.6
Financial Aid	
Reduces Cal Grant income ceilings	-$11.2
Reduces maximum Cal Grant award for students at private colleges	-32.7

[a] UC = University of California; CSU = California State University; and CCC = California Community Colleges.

[b] Fee increases are used to offset proposed General Fund reductions. The negative amounts shown here reflect these reductions.

We recommend a number of changes to the Governor's proposal that in our view would (1) better preserve student access to higher education, (2) make better sense on policy grounds, and (3) achieve a similar level of General Fund savings. We summarize the Governor's major proposals and our recommendations below:

K-14 Outreach

Governor's Proposal Would Eliminate State Support. The state supports many K-14 outreach programs that focus on preparing students from disadvantaged backgrounds for college. The Governor's budget proposes to reduce funding for these programs at the University of California (UC) and the California State University (CSU) in both the current year and budget year. For 2003-04, the Governor proposes (pursuant to Section 27.00 of the *2003-04 Budget Act*) to reduce General Fund support for outreach at the two universities by $24.7 million. For 2004-05, the Governor proposes an additional $60.6 million in reductions, thus eliminating all General Fund support for UC and CSU outreach programs. The budget does include $43.2 million in General Fund (Proposition 98) support for the California Community Colleges' (CCC) outreach efforts, including $37 million for financial aid outreach.

LAO Recommendation—Establish College Preparation Block Grant. In the "K-14 Outreach Programs" intersegmental section immediately following, we assess the state's current outreach efforts and present a framework for improving the effectiveness and efficiency of these efforts. First, we recommend the creation of a College Preparation Block Grant targeted at K-12 schools with very low college participation rates. Under our proposal, K-12 schools would have the flexibility to contract with UC, CSU, or other providers for outreach services. This block grant could be funded by redirecting $30 million from community college financial aid outreach in the budget year.

In addition, we recommend that the Legislature redirect the $3.5 million proposed for dual admissions counseling to preserve selected outreach programs at UC and CSU, in order to more accurately target limited resources at students most in need of college preparation. Overall, our proposal allows the Legislature to achieve the same amount of General Fund savings as proposed by the Governor, while still providing outreach services for disadvantaged students.

Enrollment

Governor Proposes No Enrollment Growth Funding for UC and CSU. In keeping with legislative intent expressed in the 2003-04 budget package, the Governor's proposal includes no new funding for enrollment growth at UC and CSU. In fact, the Governor proposes to reduce new freshman enrollment at UC and CSU by 10 percent, with the forgone enrollment being directed to CCC through a new dual admissions program. Under this program, students who are *already eligible* to attend UC or CSU directly from high school would be admitted to a specific campus, provided they first complete a transfer program at a community college.

Partially in recognition of this diverted enrollment, the Governor's budget increases funded enrollment at CCC by 3 percent.

LAO Finding—UC and CSU Have Room to Accommodate Additional Students. As discussed in our recent report, *Maintaining the Master Plan's Commitment to College Access*, we believe the segments are currently drawing students outside their Master Plan targets and thus would have room to accommodate additional *eligible* students if they realigned their admissions criteria with Master Plan guidelines. Moreover, both UC and CSU have enrollment growth funding in their base budgets that they can use in 2004-05 to serve additional students above their actual current-year enrollment levels.

LAO Recommendation—Encourage Community College Participation on Voluntary Basis. We recommend establishing a policy similar to the Governor's proposal, whereby UC and CSU would admit qualified freshmen but redirect a portion of them to enroll in community colleges for their lower division coursework. Under our proposal, students would be redirected on a *voluntary* basis, and the university would encourage participation by guaranteeing a student's admission to his or her first-choice campus. We discuss this recommendation, as well as our findings concerning UC and CSU's enrollment funding and admissions policies in the "Higher Education Admissions and Enrollment" intersegmental section.

Student Fees

Governor Proposes Various Fee Increases and Long-Term Fee Policy. The Governor's budget achieves approximately $390 million in General Fund savings by increasing student fees at all three segments of higher education. The size of these increases ranges from 10 percent for undergraduates at UC and CSU to 40 percent for graduates at UC and CSU. Although community college fees would increase by 44 percent, the low level of the current fee means that the average full-time student would pay less than $200 per year in additional fees. In order to guide the setting of future fee levels, the Governor proposes a long-term fee policy intended to make future fee adjustments moderate and predictable. However, the Governor's proposal would not include CCC fees, professional school fees, or nonresident tuition under the long-term policy.

LAO Recommendation—Establish Clear Basis for Long-Term Fee Targets, Adopt Some of the Proposed Fee Increases, and Modify Others. We agree that the state should adopt a long-term fee policy that ensures moderate and predictable annual adjustments to student fees. However, we believe the Governor's proposal lacks a meaningful basis for setting fee targets. We also believe the fee policy should extend to *all* student fees, including those paid by community college students, professional school students, and nonresident students. Finally, we believe the

Governor's proposal violates its own stated policy by increasing graduate fees too quickly.

In the "Student Fees" intersegmental section, we propose a long-term fee policy that sets student fee levels at a fixed percentage of total educational costs. We believe this establishes a meaningful basis for student fees that acknowledges both the private and public benefits that are derived from higher education. Moreover, our suggested policy would extend to all types of students. We also recommend that the proposed increase in graduate student fees at UC and CSU be slightly reduced to a more reasonable level. We also identify ways that this foregone fee revenue could be made up from other areas.

Financial Aid

Governor Proposes New Restrictions, Reductions for Cal Grants. The Governor's budget proposal would add new restrictions on the state's Cal Grant programs, lowering the income eligibility ceilings for both Cal Grant A and Cal Grant B. In addition, the proposal would break with longstanding practice by *not* increasing the Cal Grant award amounts for UC and CSU students to reflect the proposed fee increases. The proposal also reduces the Cal Grant award amount for needy students attending private universities. At the same time, the Governor's proposal would increase financial aid funding that UC and CSU administer themselves.

LAO Recommendation—Preserve Integrity of Cal Grant Program. In the "Financial Aid" intersegmental section, we express concern that the Governor's proposal would undermine the integrity of the Cal Grant program. In recent years the Legislature has made important strides in ensuring that needy students are provided with a level of financial support to ensure their access to higher education. By "decoupling" the Cal Grant award amount from the level of student fees at UC and CSU, the Governor's proposal would weaken state assurances that Cal Grants—especially those under the entitlement program—will address their financial needs. The proposed reduction of the Cal Grant award for students at private colleges similarly undermines a long-standing practice to link aid awards to anticipated costs.

We therefore recommend that the Legislature reject the Governor's proposals to reduce Cal Grant awards and further restrict eligibility. We recommend that the General Fund savings the Governor envisions from those actions instead be achieved by reducing the planned increases in UC and CSU's institutional financial aid programs. In this way, the state would preserve the integrity of statewide financial aid programs that are geared to *all* students, including those attending UC and CSU.

INTERSEGMENTAL:
K-14 OUTREACH PROGRAMS

The state maintains over 35 different K-14 outreach programs that focus on preparing students from disadvantaged backgrounds for college. The *2003-04 Budget Act* included $233.3 million for such programs. As indicated in Figure 1, this amount consists of $94.2 million from the General Fund (non-Proposition 98), $50.7 million in Proposition 98 funds, and $88.4 million in federal and other funds. Of the over 35 programs, the University of California (UC) administers 23 programs and the California State University (CSU) administers 5 programs. The California Community Colleges (CCC), Student Aid Commission, and the State Department of Education (SDE) administer the remaining programs. Figure 1 shows the amount of funding each of the agencies received for outreach in the enacted 2003-04 budget and the Governor's proposed revision of the 2003-04 budget. It also shows the amount proposed in the Governor's budget for 2004-05.

GOVERNOR PROPOSES OUTREACH REDUCTIONS

The Governor's budget proposes to reduce funding for K-14 outreach programs in both the current year and budget year, as discussed below.

Current-Year Proposal. For 2003-04, the Governor proposes to reduce General Fund support for outreach by $12.2 million (or 38 percent) at UC and $12.5 million (or 24 percent) at CSU. The Governor has proposed to make these reductions pursuant to Section 27.00 of the *2003-04 Budget Act*. Under the Governor's proposal, the segments would have full discretion in allocating the reductions across their various programs. However, the administration indicates that funding for CSU's Educational Opportunity (EOP) financial aid grants would not be affected by these mid-year reductions.

Figure 1

K-14 Outreach Budget Summary

(In Millions)

	2003-04		2004-05
	Budget Act	**Revised Budget**	**Proposed Budget**
General Fund (Non-Proposition 98)			
University of California	$31.9	$19.7	—
California State University	52.0	39.5	—
State Department of Education	10.3	10.3	$10.3
Subtotals	($94.2)	($69.5)	($10.3)
General Fund (Proposition 98)			
California Community Colleges	$44.2	$44.2	$43.2
State Department of Education	6.5	6.5	1.5
Subtotals	($50.7)	($50.7)	($44.7)
Federal and Other Funds			
University of California	$43.8	$43.8	$43.8
California State University	25.2	25.2	19.5
Student Aid Commission	15.7	15.7	15.7
State Department of Education	3.7	3.7	3.7
Subtotals	($88.4)	($88.4)	($82.7)
Totals	**$233.3**	**$208.7**	**$137.7**

Budget-Year Proposal. For 2004-05, the Governor's budget expands the proposed mid-year reductions to UC and CSU outreach programs. Specifically, the budget reduces outreach funding for UC by an additional $21.1 million (for a total of $33.3 million over the two-year period) and for CSU by an additional $39.5 million (for a total of $52 million over the two-year period). (We note that the Governor's budget proposes to reduce UC's General Fund outreach budget in 2004-05 by an amount *greater* than the revised current-year funding level.) These actions would eliminate all General Fund support for UC and CSU outreach programs, including EOP financial aid grants at CSU. (We discuss the elimination of EOP financial aid grants in the "Financial Aid" section of this chapter.)

The Governor's budget for 2004-05 also eliminates funding for the Academic Improvement and Achievement Act , which is an outreach program administered by SDE. This reduction would result in General Fund (Proposition 98) savings of $5 million. The proposed budget also reduces outreach funding for CCC by $1 million (Proposition 98), but does not propose any outreach funding adjustments for the Student Aid Commission.

In this section, we (1) discuss the definition of outreach, (2) provide an historical review of outreach programs and funding, (3) assess current outreach efforts, and (4) present recommendations for improving the effectiveness and efficiency of the state's overall outreach strategy.

WHAT IS OUTREACH?

In general, outreach refers to a variety of activities aimed at helping students from disadvantaged backgrounds enroll in college for either an undergraduate or graduate education. However, the term outreach can take on many different meanings depending on the context of the discussion. This often makes it difficult to clearly define the state's outreach efforts. For example, in recent years UC and CSU have repeatedly changed their definition of outreach, and have reclassified which programs fall under their definition. In our view, outreach efforts seek to address three basic obstacles that can restrict students' access to higher education: (1) inadequate academic preparation, (2) lack of information concerning the accessibility and purposes of college education, and (3) lack of information on and assistance with financial aid.

The state has long supported K-14 outreach programs that focus on preparing disadvantaged students for college. For example, UC's Early Academic Outreach Program (EAOP) and the Mathematics, Engineering, Science Achievement (MESA) program have been in existence for over 25 years. The Puente Project, a joint program cosponsored between UC and CCC, has been in operation for over 20 years. On the other hand, some outreach programs are relatively new, and many programs have expanded their scope in recent years. This was made possible by significant increases in state outreach funding from 1998-99 through 2001-02.

Outreach Programs Rapidly Expanded in Late 1990s

UC Outreach. In 1995, the UC Board of Regents approved SP-1, a policy that prohibited campuses from using race, religion, sex, color, ethnicity, or national origin as criteria in granting admission. In 1996-97, UC began a major initiative to improve and expand outreach efforts at the university. As part of this new effort, the Regents established an Outreach Task Force (OTF). The OTF proposed a comprehensive plan, which the Regents adopted in 1997, to help disadvantaged students become aware of and prepare for higher education. The plan generally called for the university to improve its partnerships with K-12 schools, expand student academic development programs, and increase efforts to encourage students to pursue a higher education.

In order to implement this outreach strategy, the state provided UC with substantial General Fund augmentations to its K-14 outreach budget. Prior to the implementation of the OTF strategy, UC spent approximately $24 million in General Fund support on systemwide K-14 outreach in 1997-98. The majority of this money supported K-14 student academic programs and informational outreach and recruitment. In 1998-99, UC's K-14 outreach budget received a major General Fund augmentation of about $40 million—almost tripling its General Fund outreach budget to $64 million. (The university also received significant additional funding from the federal government.) The state augmented UC's outreach budget again by about $10 million in 1999-00 and another $10 million in 2000-01. The above augmentations allowed UC to expand its student academic development programs and to implement a number of new initiatives which broadened the scope of K-14 outreach.

CSU Outreach. During this same period, the state also increased funding for CSU's outreach programs. In 1999-00, CSU's General Fund support for outreach grew by about $14 million (36 percent), increasing from about $39 million to $53 million. This augmentation was to expand programs aimed at increasing the number of K-12 students from diverse backgrounds that become eligible and prepared for CSU admission. The state augmented CSU's outreach budget again in 2000-01 by $6 million.

Other Outreach Programs. Although the majority of the state's outreach funding has been directed to UC and CSU, additional state funding has also been provided to support outreach programs administered by the Student Aid Commission and SDE. Figure 2 (see next page) summarizes spending on the state's major outreach programs from 1997-98 through the enacted 2003-04 budget.

As shown in Figure 2, the *2003-04 Budget Act* included $233.3 million for various K-14 outreach programs from all fund sources—including General Fund, federal, and other funds. This is about two and one-half times as much (or about $140 million more) than the amount provided in 1997-98 (the year prior to the rapid expansion of the state's outreach efforts). Specifically, the enacted budget included General Fund spending on outreach of about $145 million. This is an increase of $80.4 million, or 125 percent, from the 1997-98 funding level. We note that General Fund support for outreach programs peaked in 2000-01, but has fallen in recent years.

Figure 2

Spending on Major Outreach Programs

1997-98 Through 2003-04
(In Millions)

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04[a]
University of California							
General Fund	$23.6	$63.7	$74.2	$83.9	$83.0	$74.0	$31.9[b]
Federal and other funds	29.1	60.6	64.9	64.3	66.2	63.4	43.8
Totals	**$52.7**	**$124.3**	**$139.1**	**$148.2**	**$149.1**	**$137.3**	**$75.8**
California State University							
General Fund	$36.9	$39.3	$52.9	$58.8	$58.8	$64.6	$52.0
Federal and other funds	—[c]	—[c]	—[c]	—[c]	—[c]	25.2	25.2
Totals	**$36.9**	**$39.3**	**$52.9**	**$58.8**	**$58.8**	**$89.8**	**$77.2**
California Community Colleges							
General Fund	$1.4	$1.4	$5.2	$6.2	$6.2	$6.2	$44.2
Federal and other funds	—	—	—	—	—	—	—
Totals	**$1.4**	**$1.4**	**$5.2**	**$6.2**	**$6.2**	**$6.2**	**$44.2**
Student Aid Commission							
General Fund	$1.6	$2.8	$3.6	$8.6	$8.5	—	—
Federal and other funds	0.1	0.1	0.1	0.1	0.1	$8.6	$15.7
Totals	**$1.7**	**$2.9**	**$3.7**	**$8.7**	**$8.6**	**$8.6**	**$15.7**
State Department of Education							
General Fund	$1.0	$1.0	$17.5	$17.8	$28.8	$21.8	$16.8
Federal and other funds	1.0	1.0	5.5	12.6	3.1	3.5	3.7
Totals	**$2.0**	**$2.0**	**$23.0**	**$30.4**	**$31.9**	**$25.3**	**$20.5**
Grand Totals	**$94.7**	**$169.9**	**$223.9**	**$252.2**	**$254.6**	**$267.2**	**$233.3**
General Fund	$64.5	$108.2	$153.4	$175.3	$185.3	$166.6	$144.9
Federal and other funds	30.2	61.7	70.5	76.9	69.3	100.6	88.4

a Does not reflect proposed mid-year reductions.

b Although this reflects a $42.1 million reduction from 2002-03, the *2003-04 Budget Act* reduced General Fund support for the University of California (UC) outreach by $37.8 million. The remaining $4.3 million is due to UC's efforts to redefine which programs to classify as outreach and correct prior-year reporting errors.

c The California State University was unable to provide data on federal and other funds spent on outreach for these years.

Funding for Some Outreach Programs Recently Declined

As indicated in Figure 2, General Fund support for some outreach programs has declined in the past two years. For example, UC received a total General Fund reduction of $51 million over the two-year period from 2001-02 to the enacted 2003-04 budget. However, the impact of these funding reductions on the quality and magnitude of UC's outreach efforts in the current year has been minimal. This is because the university chose to make reductions in other program areas to essentially offset the outreach reductions contained in the enacted 2003-04 budget. In other words, UC did not make most of the outreach reductions assumed in the *2003-04 Budget Act*.

Funding for outreach programs at CSU has also declined in the past year, from $64.6 million in 2002-03 to $52 million in 2003-04. In response to this reduction, CSU restructured and consolidated many of its outreach programs in order to more effectively serve students with fewer fiscal resources.

Even with these various reductions, the enacted 2003-04 budget still includes more than twice the General Fund support for all state outreach programs than was provided in 1997-98. We also note that CCC received a $38 million General Fund (Proposition 98) augmentation in their financial aid outreach budget for the current year. (We discuss this particular augmentation in more detail later in this analysis.)

LAO Assessment of Current Outreach Efforts

Given recent programmatic and funding level changes in the state's outreach programs, we believe the Legislature should revisit and assess the state's overall outreach strategy. This would allow the Legislature to find ways to reform and improve the effectiveness and efficiency of its K-14 outreach programs. Such a review is particularly important at this time because the Governor's budget proposes to eliminate all General Fund support for outreach at UC and CSU.

Based on our assessment of the state's current outreach efforts, we have developed a series of principles that we believe can guide the Legislature in improving its outreach efforts. Figure 3 (see next page) outlines the principles, which we discuss in further detail below.

Figure 3

Guiding Principles for Improving Outreach

- ✓ ***Focus Outreach Efforts Where They Are Most Needed.*** The Legislature should ensure that resources are first provided to students most in need of assistance. Given limited resources, it may be necessary to shift funding away from programs that do not provide direct services to students.
- ✓ ***Minimize Program Duplication Within Outreach.*** Similar programs should be consolidated in order to create greater efficiencies and effectiveness in the state's outreach efforts.
- ✓ ***Specify Clear Program Goals That Directly Link With Services Provided.*** In order to improve efforts to evaluate the state's outreach programs, each program should have specific goals and well-formulated objectives that directly link to particular types of services.
- ✓ ***Make Better Use of Other Education Funding.*** Some outreach programs provide services that are similar to those offered through existing K-12 education programs not typically classified as outreach. Moreover, these other programs may be able to provide these services more efficiently.
- ✓ ***Outreach Should Focus on Needs of K-12 Students.*** Local schools should have the flexibility to use outreach funds and design programs in ways that allow them to more efficiently and effectively meet their students' needs.

Focus Outreach Efforts Where They Are Most Needed

As previously discussed, the scope of outreach has expanded in recent years to include many different types of programs and activities. Currently, there are four major categories of activities that these programs perform:

- ***Recruitment and Dissemination of Information.*** Some high school students do not have a full understanding of the value a college degree can provide them, or are not familiar with the state's higher education institutions. Some students also may not be familiar with college admissions requirements and thus might not take the classes or maintain the grades required for admission. Students may also not be aware of financial aid opportunities and thus incorrectly conclude that they cannot afford to attend college. To address this, recruitment and informational activities encourage students to pursue higher education and make them aware of the various requirements for financial aid and admission to postsecondary institutions.

- ***Academic Preparation.*** Some students need additional assistance to meet college admissions requirements and prepare for college-level courses. In order to help these students, some outreach programs offer a variety of academic development activities. These include student advising and course planning, SAT test preparation, personal statement workshops, academic enrichment courses, and tutoring. Activities take place at both college campuses and K-12 schools.

- ***Yield Activities.*** Some outreach programs seek to improve the "yield" (the rate at which admitted students actually enroll) of qualified underrepresented students attending UC and CSU. Although yield activities primarily focus on encouraging admitted students to actually enroll at the campus, they can also take the form of persuading eligible students to select particular segments or campuses instead of others. Several graduate and professional school programs also conduct yield activities, including hosting admitted applicants for campus visits, tours, and receptions.

- ***Research and Evaluation.*** Some outreach efforts do not necessarily provide direct services to students, but instead involve the research of educational issues in the state. For example, UC's All Campus Consortium on Research for Diversity (ACCORD) program supports research that examines access to higher education by disadvantaged students. Outreach funding is also used to evaluate the effectiveness of individual programs, in order to measure progress and improve service delivery.

Given the state's fiscal constraints, we believe the state should focus its outreach funding on activities that promote the Legislature's highest priorities. As a result, the state should (1) shift funding away from programs that do not provide direct services to students and (2) ensure that resources are first provided to students most in need of assistance.

Eliminate Funding for Programs That Do Not Serve Students. As previously mentioned, UC currently uses state funds to support the ACCORD program and the Community Partnerships program, which provide research grants to faculty to study educational equity issues. We believe that these two programs are of a lower priority compared to those programs that directly help students prepare for higher education. Moreover, the ACCORD and Community Partnerships programs could be supported with funding in UC's research budget. The Governor's budget proposes providing over $200 million in General Fund support for research. To the extent the university considers outreach-related research a high priority, it could fund such research by reallocating funds within its substantial research budget. We also note that individuals at other universities and organizations may already be conducting similar research on educational disparities.

Redirect Resources to Students Most in Need of Assistance. Although not a large source of outreach costs, UC and CSU's yield activities encourage already admitted underrepresented students to enroll at a particular campus. This approach may inadvertently work against the state's outreach efforts. Rather than increasing preparedness or awareness among disadvantaged students, yield-focused efforts typically work to convince already qualified or eligible students to choose a UC or CSU campus over some other higher education institution. For example, UC campuses may use outreach resources to compete for students, trying to convince potential students to choose a particular campus or attend UC rather than CSU or a private institution. To the extent these students have already been admitted to a university, they already have been provided an opportunity to participate in higher education. We believe the state's limited resources should be focused on increasing the number of students that are eligible for higher education, rather than convincing already qualified students to choose one institution over another.

Minimize Program Duplication Within Outreach

Figure 4 summarizes the goals and services of selected K-14 outreach programs funded by the state. Though not a comprehensive listing of the over 35 different programs, our list includes the major programs by each state agency. As the figure shows, many programs have overlapping goals and services. For example, while slightly different in academic focus, EAOP, MESA, and the Puente Project all share a common goal of increasing UC eligibility among high school graduates from disadvantaged backgrounds. In their efforts to achieve this shared goal, all three programs offer academic advising, informational outreach, SAT preparation, and financial aid counseling. Other outreach programs also offset similar services and may compete with one another for the same students.

As indicated in Figure 4, many outreach programs help students prepare for college entrance examinations (such as the SAT). For example, many UC outreach programs include a test preparation service component. In addition to these programs, UC administers a program that focuses solely on improving testing rates and performance. In our opinion, such program duplication is inefficient and wastes valuable outreach resources. Instead, the different programs could coordinate with one another and share resources and expertise by delivering each type of ser-

Figure 4

Major K-14 Outreach Programs Funded by the State

University of California (UC)

Early Academic Outreach Program

- ***Goal:*** Increase number of UC-eligible graduates from disadvantaged backgrounds.
- ***Services:*** Informational outreach, academic enrichment, summer residential programs, academic and career advising, financial aid counseling, test preparation, application workshops, campus tours, field trips, and cultural activities.

Mathematics, Engineering, Science Achievement[a]

- ***Goals:*** (1) Increase number of UC-eligible graduates from disadvantaged backgrounds and (2) prepare and encourage disadvantaged students to attend college and pursue math and science-based fields.
- ***Services:*** Informational outreach, academic and career advising, financial aid counseling, test preparation, field trips, parent workshops, and K-12 teacher professional development.

Puente Project[a]

- ***Goals:*** (1) Increase number of UC-eligible graduates from disadvantaged backgrounds and (2) increase number of "underrepresented" students that enroll in college and earn degrees.
- ***Services:*** Informational outreach, academic advising, campus tours, cultural activities, field trips, applications workshops, financial aid counseling, test preparation, parent workshops, professional development for high school teachers and counselors, and mentoring.

Central Valley Programs

- ***Goals:*** (1) Increase college participation in the Central Valley and (2) increase number of UC eligible graduates from disadvantaged backgrounds.
- ***Services:*** Informational outreach, academic enrichment, academic advising, financial aid counseling, test preparation, application workshops, campus tours, and field trips.

Informational Outreach and Recruitment

- ***Goals:*** (1) Inform students and their families about college admissions and (2) encourage students to pursue a higher education.
- ***Services:*** College information days, campus tours, parent workshops, and mailings and other publications.

College Preparatory Initiative

- ***Goals:*** (1) Increase number of UC-eligible graduates from disadvantaged backgrounds and (2) offer Advanced Placement (AP) courses to students attending schools that offer few or no AP courses.
- ***Services:*** AP online courses and AP test preparation.

Continued

University of California (UC)

UC Links Technology Initiatives

- ***Goal:*** Develop aspirations for higher education.
- ***Services:*** After-school programs.

Transfer Programs

- ***Goal:*** Increase number of community college students transferring to UC.
- ***Services:*** Academic advising, support services, and conferences for community college counselors.

Graduate and Professional School Programs

- ***Goal:*** Increase participation of "underrepresented" students in graduate and professional school programs.
- ***Services:*** Academic enrichment, informational outreach and recruitment, and summer research programs.

California State University (CSU)

Early Assessment Program

- ***Goal:*** Improve high school students' proficiency in English and mathematics prior to entering CSU.
- ***Services:*** Early assessments to determine college readiness, tutoring, academic enrichment, and professional development for high school teachers.

Educational Opportunity Program

- ***Goal:*** Increase the college enrollment and graduation rate of underrepresented students.
- ***Services:*** Academic counseling, application workshops, financial aid grants, mentoring, tutoring, and motivational activities.

Campus-Based Outreach Programs

- ***Goal:*** Prepare disadvantaged students for higher education.
- ***Services:*** Academic advising, academic enrichment, and retention services.

California Community Colleges

Middle College High School

- ***Goal:*** Encourage high school students from disadvantaged backgrounds to complete college coursework.
- ***Services:*** Academic instruction in college-level courses and career advising.

California Student Aid Commission

Student Opportunity and Access Programs

- ***Goals:*** (1) Inform students about college and financial aid opportunities and (2) raise academic achievement levels of disadvantaged students.
- ***Services:*** Academic advising, informational outreach, financial aid counseling, and tutoring.

Continued

State Department of Education
Advancement Via Individual Determination Program
• ***Goal:*** Prepare students for college eligibility and success.
• ***Services:*** Classroom instruction, test preparation, teacher professional development, tutoring, campus tours, and motivational activities.
Academic Improvement and Achievement Act
• ***Goal:*** Increase percentage of students meeting UC and CSU admission requirements.
• ***Services:*** Informational outreach, test preparation, parent workshops, academic advising, and tutoring.
[a] Community colleges also receive funding for this program.

vice (such as test preparation) through one designated program. Minimizing program duplication and overlap would create greater efficiencies and effectiveness in the state's outreach efforts.

Specify Clear Program Goals That Directly Link With Services Provided

Over the past few years, the Legislature has sought to evaluate how well outreach programs prepared disadvantaged students for college. Partly in response to legislative direction, UC has spent millions of dollars evaluating the effectiveness of its outreach programs. In summer 2002, the university established the Strategic Review Panel on Educational Outreach. The purpose of this panel was to (1) assess the effectiveness of UC's outreach programs, (2) define desirable changes to the university's overall outreach plan, (3) set reasonable short-term and long-term goals for the university in pursuing its outreach agenda, and (4) recommend a new working alliance with the state's K-12 educational bodies and the community colleges. In February 2003, the panel released a final report that summarizes its findings.

Evidence of Effectiveness Is Elusive. The panel's report indicated among other things that the number of EAOP, MESA, and Puente Project participants eligible for UC admission upon graduation has increased since 1998-99. However, it is unclear from the report whether this increase results from programs simply serving more students. The report also notes that the proportion of all newly enrolled freshmen from disadvantaged backgrounds has increased from 15.5 percent in 1998 to 17.8 percent in 2002. However, as the panel acknowledged, the cause and effect relationship between outreach efforts and increased underrepresented enrollment cannot be conclusively demonstrated. The report recognizes that "it is difficult to specify the magnitude of change because of the many influences and events in student lives that affect this behavior." For instance, other K-12 education reforms (such as supplemental instruction) also could have contributed to the increase in underrepresented student enrollments.

Our preliminary review of CSU and other UC outreach program evaluations also found little conclusive evidence regarding program effectiveness. This is not to say that outreach programs are ineffective in helping disadvantaged students enroll in college. Rather, the data we have reviewed does not demonstrate whether students participating in outreach programs would have been eligible for college without these services. In addition, it is unclear whether the state's current outreach efforts are cost-effective in comparison to alternative approaches. For example, the UC Strategic Review Panel report states that "with a few important exceptions, UC evaluation activities have not established clear, quantitative causal relationships between program interventions and outcomes such as student achievement and college attendance."

Explicit Goals Would Facilitate Evaluation. In order to better facilitate evaluation and to permit the Legislature to direct resources to its priorities, each outreach program should have specific goals and well-formulated objectives for meeting those goals. Each program should further be directed to focus specific activities and services for achieving its objectives. Each type of outreach service provided to students should be designed to produce an expected outcome that directly links to a specific objective. In other words, activities funded under outreach should be explicitly directed at a particular outcome that helps disadvantaged students. Our assessment indicates that there could be a mismatch between the *goals* of some programs and the *services* they provide. We believe that directly linking specific program goals with available services would help the Legislature better understand the investments it is making in outreach and what the impact would be if it decided to reduce or increase its investments.

Make Better Use of Other Education Funding

In our review of the state's current outreach efforts, we found that some programs (1) receive duplicative funding for the same tasks and (2) offer services that are available through other K-12 education programs.

UC Charter School Already Receives K-12 Funds; Supplemental Funds Not Needed. The state currently provides $500,000 from the General Fund to UC's outreach budget for the Preuss Charter school, which is located on the San Diego campus. The state also provides the Preuss school with (1) general purpose funding that is provided to K-12 school districts, county offices of education, and other charter schools; (2) charter school block grant funding; and (3) funding from selected federal and state categorical programs. Like most charter schools in the state, the Preuss school has a specified mission and focus. For example, some charter schools may focus on math and science subjects, while others may center on fine arts. The purpose of the Preuss Charter School is to help disadvantaged students become eligible for admission to UC and other four-year universities.

Since the Pruess Charter School already receives K-12 funds like other charter schools, it is unclear why the school should receive additional state funding above this base amount to carry out its mission. If students at the Preuss Charter School need additional college preparation, many of them could participate in one of the many other state outreach programs.

Some Outreach Services Available Through Other Education Initiatives. Our analysis indicates that some outreach programs provide services that are similar to those provided by nonoutreach educational programs. In some instances, these other programs may be able to provide the services more efficiently. For example, the *2003-04 Budget Act* provided funds to UC for its Links Technology initiative. Under this program, undergraduate college students provide learning support to K-12 students at local school sites after regular school hours. Although this type of activity has merit, the state currently supports many after-school programs. For example, the Governor's budget includes $121.6 million in Proposition 98 funds for the After School Education and Safety Program and $75.5 million in federal funds for federal 21st Century Community Learning Centers. Moreover, Proposition 49, approved by the voters in November 2002, requires that future funding for the After School Education and Safety Program increase by up to $550 million. Absent funding for UC Links, local schools could continue to solicit the assistance of college students with these other after-school resources.

Similarly, some outreach programs provide professional development services to K-12 teachers. At the same time, the state provides over $300 million for several professional development programs that are not considered to be outreach programs. Better coordination between these professional development programs and outreach programs could achieve greater efficiencies.

Outreach Should Focus on Needs of K-12 Students

Our review suggests that local K-12 schools are in the best position to assess the academic and counseling needs of their students and provide the necessary services to address those needs. We have observed that outreach programs that actively involve school-site teachers, administrators, and districts in designing and structuring services are most likely to succeed. This is because teachers and staff at school sites interact with students almost daily, and therefore are familiar with local students, their families, and the community.

We believe, therefore, that K-12 schools should have significant control over how certain outreach services are provided to their students. However, we find that schools currently have very little control over outreach activities, since most of the state's outreach funding is provided to UC and CSU. This can lead to the problems discussed below.

Difficult to Coordinate Multiple Outreach Programs. The existence of so many different outreach programs makes it difficult for local school sites to keep track of available services. In addition, school administrators and teachers have the burden of trying to coordinate and integrate various outreach programs. The UC acknowledges this in its 2001 outreach status report: "The number and variety of these programs is such that many teachers and principals have reached a point of initiative fatigue, as managing these efforts (coordinating various outreach programs) can be a demanding job in and of itself."

Primary Focus on Higher Education Needs. Some outreach programs are designed to simply meet the needs of the higher education segments. For example, the goal of some UC outreach programs is to increase the number of disadvantaged high school graduates that are eligible for admission to UC (versus some other institution). The UC's Strategic Review Panel report acknowledges "many K-12 representatives do not feel engaged in the UC outreach enterprise because the University's efforts are focused on increasing the number of UC-eligible students." Moreover, some outreach services (like yield and recruitment) seek to direct students to a particular college campus. We believe that outreach should prepare students for higher education at any college.

Universities Maintain Considerable Control Over Outreach Efforts. Typically, the segments take an approach to outreach that prohibits local innovation and overlooks variation in schools and populations throughout the state. For example, the need for specific outreach services, whether it be college test preparation or tutoring assistance in math, varies widely among schools. However, the state's current outreach program and funding structure may not provide local schools with adequate flexibility to direct resources to local needs.

Monopoly Providers. Currently, the state's higher education segments essentially operate their programs as monopoly providers of outreach to K-12 schools. This arrangement reduces incentives for the segments to improve program quality or service delivery because they do not necessarily have to compete for schools' business. In addition, by keeping other outreach providers out of the market, the current structure limits the outreach services available to schools.

Difficult to Integrate Outreach With Other K-12 Education Reforms. According to UC's Strategic Review Panel report, "A fundamental disconnect exists between the efforts to reform K-12 and the University's efforts to ensure a diverse UC student body." We agree and believe that this is in part because K-12 schools have little control to incorporate outreach into their overall strategy to improve the educational outcomes of students. Greater flexibility and control would allow schools to better coordinate outreach with various state and federal compensatory education programs.

LAO RECOMMENDATIONS

The Governor's budget proposes to eliminate all state support for UC and CSU outreach programs. While we agree that the state's outreach services are in need of reform and restructuring, we believe the state should continue to advance the goal of outreach—expanding access to postsecondary education. With this goal in mind, we propose a different approach for funding and delivering outreach services. In developing our alternative proposal, we attempted to achieve the same level of General Fund savings as proposed by the Governor while still providing well-targeted outreach services for disadvantaged students. However, we recognize the Legislature has made outreach its priority in recent years and may wish to provide additional funding for this purpose.

Our alternative proposal would provide K-12 schools with greater flexibility and control over outreach funding and services. We also identify a small number of programs that we believe are most appropriate for UC and CSU to administer. More importantly, we believe that our proposal begins to address many of the problems associated with the current outreach program and funding structure. Specifically, we recommend:

- Establishing a College Preparation Block Grant targeted at K-12 schools with very low college participation rates. Schools could use these funds to contract with UC, CSU, or other providers for outreach services.
- Preserving selected outreach programs at UC and CSU by redirecting funds proposed by the Governor for a new program.

We discuss our proposals in detail below.

Establish College Preparation Block Grant For K-12 School Districts

We recommend the Legislature establish a College Preparation Block Grant targeted at K-12 schools with low college participation rates. We recommend redirecting $30 million from community college outreach to fund this block grant. In addition, we recommend the Legislature broaden the permissible uses of the remaining $7 million available for community college financial aid outreach, in order to provide the colleges greater flexibility in assisting disadvantaged students.

Earlier, we identified some of the problems associated with the current structure of the state's outreach programs and offered some guiding principles for improving its effectiveness and efficiency. For example, we noted that directing a majority of outreach funding to higher education institutions makes it difficult for K-12 schools to coordinate multiple programs and integrate outreach with other education reforms. While the current system of funding outreach programs through UC and CSU appears to be neither efficient nor effective, we believe it is important to maintain a base level of outreach services for disadvantaged students. We also believe that these services could be better delivered through school districts. Accordingly, we recommend the Legislature create a College Preparation Block Grant for K-12 school districts, with funds allocated to districts with very low college participation rates.

The goal of our proposed College Preparation Block Grant is twofold: (1) targeting limited resources to students most in need of additional state help to enroll in college and (2) facilitating local discretion to determine the best mix of outreach interventions. These interventions could include tutoring, academic advising, test preparation, and college application workshops. There is no one answer to helping disadvantaged students prepare for college, because the barriers to higher education vary from individual to individual and school to school. Our approach to outreach acknowledges this reality.

Under our proposal, school districts would have the flexibility to use outreach funds as part of an overall strategy to assist disadvantage students. This is because school districts would have broad latitude over the use of funds, selecting a service delivery model that best meets the needs of their students. Districts could implement their own programs, or could contract with UC, CSU, or whichever provider can best meet those needs. As a condition of receiving funds through the block grant, we propose requiring districts to submit a plan to SDE specifying the types of outreach services that will be provided and how these services will accomplish measurable objectives.

We acknowledge that our proposal would make significant changes to how the state currently provides outreach service. Consequently, the Legislature would have to address many implementation and transitional issues. For example, the Legislature would need to define eligibility for block grant funds and the role of SDE in allocating the proposed college preparation block grant. In addition, steps would need to be taken to assist local schools in coordinating with UC, CSU, and other outreach providers. We believe, however, providing these funds to districts will result over time in the improved delivery of outreach services.

Redirect Some Community College Outreach Funds To Proposed Block Grant

The Governor's budget provides a total of $43.2 million in General Fund support (Proposition 98) for outreach programs administered by CCC. This total includes $37 million for financial aid outreach, which is $1 million less than the $38 million augmentation provided in the *2003-04 Budget Act* to CCC's financial aid outreach budget.

The new financial aid outreach funds are a substantial augmentation provided in the current year specifically to help mitigate a possible decline in enrollment associated with the current-year increase in community college student fees. The $38 million augmentation provided in the current year consists of (1) $3.8 million for a statewide media campaign to promote the availability of financial aid and (2) $34.2 million for counseling potential and current financial aid applicants. Per a requirement in the *2003-04 Budget Act*, CCC provided the Legislature with a preliminary report in November 2003 regarding its use of these financial aid outreach funds. Some of the highlights from this report include:

- ***Statewide Media Campaign Has Not Started.*** At the time this *Analysis* was prepared, the Community Colleges Chancellor's Office was still in the process of selecting a media firm to develop and implement the financial aid media campaign. According to the report, "It is anticipated that the initial phase of the public campaign will target Spring 2004 enrollments."

- ***Many Colleges Planning for One-Time and Temporary Expenditures.*** The report discussed how the colleges planned to use the financial aid outreach funds. Many colleges intend to offer a variety of outreach activities to potential and current students. However, many planned expenditures were characterized as one-time or temporary in nature. For example, the report notes that many campus administrators are unwilling to hire permanent staff, given the possibility that the funds may not be provided by the state in 2004-05. Many campuses also plan to use funds for hardware and software acquisitions, whose ongoing costs are less clear.

Although the $38 million financial aid outreach augmentation was intended to help students adjust and plan for the current-year student fee increases, the current academic year is more than half over and the community colleges have not used most of the funds. The Legislature's intent was to help students become aware of the fee increases and the availability of financial aid *prior* to paying the higher fee. We also noted above that many colleges plan to use their outreach funds for one-time or temporary expenditures. For these and other reasons identified below, we believe the current level of support for this program is not justified in the current fiscal environment, and that these funds could be put to better use. Accordingly, we recommend the Legislature redirect $30 million (of the $37 million proposed for the community colleges in 2004-05) to fund a College Preparation Block Grant for K-12 schools. (In other sections of this chapter, we recommend reductions to various K-14 budget proposals that together "free up" Proposition 98 funds. These freed-up funds could be redirected to increase outreach funding.)

Expand Uses of Remaining Community College Financial Aid Outreach Funds

In view of the Governor's budget proposal to eliminate all General Fund support for UC and CSU outreach programs (particularly those programs targeted at community college students), we recommend the Legislature broaden the permissible uses of the remaining $7 million for community college financial aid outreach. (This is based on our proposal to redirect the other $30 million of the $37 million total to K-12 school districts.) Specifically, we propose that the colleges be allowed to use the funds to provide counseling services to students interested in transferring to a four-year institution. This is because we believe that the community colleges are in a better position than UC or CSU to provide such services. Under our proposal, the colleges would still be able to provide financial aid outreach to help students with the proposed student fee increases for 2004-05. We note that our proposal would still result in a significant increase in the community college financial aid administration budget from its 2002-03 funding level—almost double the amount. In addition, the Governor's budget does provide the Student Aid Commission with about $16 million for financial aid outreach, including statewide media campaigns, to make *all* students aware of financial aid opportunities.

Preserve Selected UC and CSU Outreach Programs

We recommend the Legislature preserve selected outreach programs that the Governor proposes to eliminate at the University of California and the California State University. We recommend redirecting the $3.5 million proposed for dual admissions counseling to these programs, in order to better target limited resources at students most in need of college preparation assistance.

UC's ASSIST Program and Graduate and Professional School Outreach

Our review has identified several meritorious outreach programs that we believe are best administered by UC. One of these is UC's ASSIST program, which provides community college counselors and students with access to articulation agreements via the Internet at no charge to the student. The goal of ASSIST is to allow students to identify all community college courses that satisfy UC's and CSU's general education requirements, as well as specific requirements relating to certain majors (such as engineering) and specialized programs (such as nursing). Because ASSIST is the only complete statewide database that provides transfer information to community college students, we believe that the Legislature should redirect funds to preserve the program. This is especially important given the Legislature's priority to ensure access from community colleges to UC and CSU and the proposed dual admissions program.

Our review also found value in the academic enrichment activities that graduate and professional school outreach programs provide to students. Consistent with our suggested principles for improving outreach, we suggest the Legislature direct UC to develop clear and specific goals for these programs that link to services provided. Clear program goals will help the Legislature determine the effectiveness of these programs and whether future appropriations are warranted.

CSU's Early Assessment Program

In the current year, CSU consolidated many of its outreach programs into a new Early Assessment Program, in order to more effectively serve students with fewer fiscal resources. The purpose of this program is to improve high school students' proficiency in English and mathematics prior to entering CSU. This is especially important because CSU currently admits many students who are unprepared for college-level coursework and must take precollegiate (or "remedial") courses. In fall 2002, 49 percent of regularly admitted freshmen were unprepared for college-level writing and 37 percent were unprepared for college-level mathematics.

As part of the 2003-04 budget package, the Legislature adopted supplemental report language directing CSU to submit by December 1, 2005, a report evaluating the effectiveness of the Early Assessment Program. If the program is effective, it will help reduce the future costs associated with providing remedial courses at CSU and may increase the retention rates of unprepared students. For these reasons, we recommend the Legislature provide some support to the Early Assessment Program in 2004-05 and determine subsequent funding based on the university's evaluation findings.

Redirect Funds to Support Outreach

The Governor's budget for 2004-05 includes an augmentation of $3.5 million in General Fund support for UC and CSU to provide "appropriate" counseling services to students participating in the proposed dual admissions program. Specifically, the budget provides $1.6 million to UC and $1.9 million to CSU. Under the new dual admissions program, students who are eligible to attend UC or CSU directly from high school would be admitted to a specific university campus provided they first complete a transfer program at a community college. (The UC currently operates a similar program for students who are *not* eligible for UC admission as freshmen.)

As we discuss in the "Higher Education Admissions and Enrollment" section of this chapter, we believe that the Governor's proposal to encourage eligible students to enroll at community colleges for their lower division coursework has merit, especially given the state's fiscal constraints. However, we believe the $3.5 million proposed for UC and CSU counseling services for these dual admission students would be better directed to other outreach activities. Specifically:

- ***Target Those Not Yet Prepared for College.*** Under the Governor's proposal, the segments would receive about $500 for each student it redirects to a community college. These students are already eligible for admission to UC or CSU. Thus, these funds would essentially provide counseling services to students who are already prepared and qualified for college and who have already shown the motivation to apply. At the same time, however, the Governor's budget eliminates the universities' General Fund support for outreach services to students not yet prepared for college. We believe that the proposed $3.5 million should be targeted to disadvantaged students most in need of additional assistance.

In view of the above analysis, we recommend that the Legislature redirect the $3.5 million proposed for dual admissions counseling to preserve other, more critical outreach programs at UC and CSU. Specifically, we recommend redirecting (1) $1.6 million to UC's ASSIST program and academic enrichment services for potential graduate and professional school students and (2) $1.9 million to support CSU's Early Assessment Program. We note that both UC and CSU would still be able to provide additional outreach services using remaining nonstate funding, such as federal funds.

INTERSEGMENTAL:
HIGHER EDUCATION
ADMISSIONS AND ENROLLMENT

For the past ten years, the state's public higher education segments have experienced sustained moderate enrollment growth. In keeping with legislative intent expressed in the 2003-04 budget package, the Governor's budget for 2004-05 does not include new funding for enrollment growth at the University of California and the California State University. The proposed budget does, however, provide funding for an increase of enrollment at the California Community Colleges of 3 percent. In this section, we (1) review current-year enrollment levels at the segments, (2) review the principles for access adopted by the Legislature in the Master Plan for Higher Education, and (3) recommend a series of steps the Legislature can take to preserve the Master Plan's commitment to access even with the state's current fiscal limitations.

Governor's Budget Proposal

As part of the 2003-04 budget package, the Legislature expressed its intent to provide no new funding for enrollment growth at the University of California (UC) and the California State University (CSU) in 2004-05. In keeping with that intent, the Governor's budget proposal includes no new enrollment growth funding. In fact, the Governor proposes to reduce new freshman enrollment at UC and CSU by 10 percent, with the foregone enrollment being redirected to the California Community Colleges (CCC) under a new dual admissions program. This would result in a $45.9 million General Fund reduction as follows:

- $24.8 million reduction to UC for a 1.6 percent overall enrollment decline, which is 3,200 full-time equivalent (FTE) students below current-year budgeted enrollment.

- $21.1 million reduction to CSU for a 1.1 percent overall enrollment decline, which is roughly 3,800 FTE students below current-year budgeted enrollment.

Under the proposed new dual admissions program, students who are eligible to attend UC or CSU directly from high school would be admitted to a specific campus provided they first complete a transfer program at a community college. (The UC currently operates a similar program for ineligible students.) The Governor's budget requests a total of $3.5 million in General Fund support—$1.6 million for UC and $1.9 million CSU—to provide counseling services to students participating in the new program. (We make recommendations concerning the proposed funding for dual admission counseling in the "K-14 Outreach Programs" section of this chapter.)

In contrast to the Governor's proposal for the public universities, the budget actually *increases* funded enrollment at CCC by 3 percent, which is considerably higher than the statutory growth rate of 1.8 percent. The budget requests $121 million in Proposition 98 funds for the community colleges to serve an additional 33,120 FTE students above the current-year budgeted level. This increase is partly in recognition of the enrollment that is expected to be diverted from UC and CSU to the community colleges. (We discuss enrollment at CCC in the "California Community Colleges" section of this chapter.)

Segments Have Base Enrollment Funding To Serve Additional Students

Typically, the Legislature provides funding in the annual budget act to the state's public higher education segments to support a specific level of enrollment growth. For the current year, the *2003-04 Budget Act* provided about $268 million to fund enrollment growth rates of 6.9 percent at UC and 7.1 percent at CSU. These current-year funded growth rates for each segment are the highest in at least the past 20 years.

Segments Not Following Budget Language. Notwithstanding *budgeted* enrollment growth, the segments report that they plan to serve *significantly fewer* students than they are funded to serve. Essentially, UC and CSU have chosen to redirect enrollment growth funding away from serving additional students to essentially "backfill" budget reductions in other program areas. In other words, the current-year enrollment levels are lower than called for in the *2003-04 Budget Act* as a result of specific choices by the segments—not because of demographic changes or lack of enrollment funding. We recognize, of course, that UC and CSU experienced significant current-year reductions in their General Fund budgets. However, during the 2003-04 budget hearings, the Legislature deliberated how the segments should accommodate their reductions. As part of these deliberations, the Legislature considered whether a portion of the General Fund reductions should be taken from enrollment growth funding. (Our office in fact recommended this approach in the *Analysis of the 2003-04 Budget Bill*.) During conference committee, the Legislature ultimately decided to leave the segments' enrollment funding (and budgeted enrollment levels) where the Governor had originally proposed—that is, reflecting about 7 percent growth. The enacted budget made some of the segment's General Fund reductions in specific programs (such as outreach), and left some unallocated (with language expressing the Legislature's intent that the segments implement their reductions in a manner that minimizes the impact on instructional programs, student services, and outreach programs).

UC Has Funding in Its Base Budget To Enroll Additional Students in 2004-05

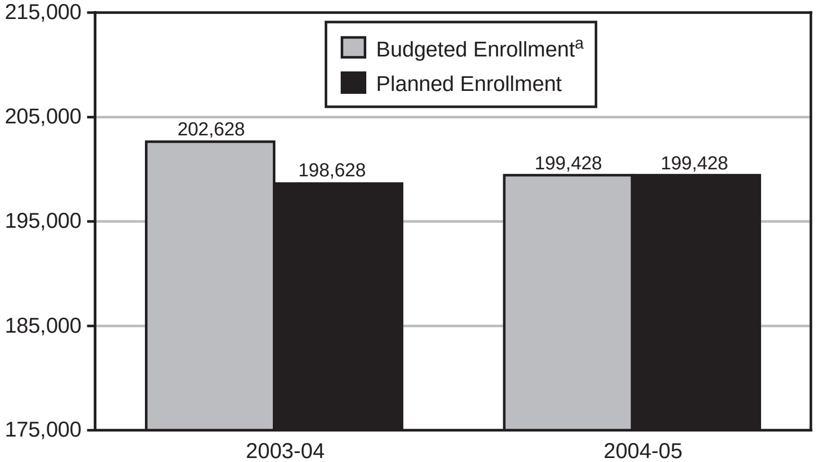
UC's Current-Year Enrollment. The 2003-04 budget provided $117 million to UC to enroll 13,000 additional FTE students above the prior-year funded enrollment level, for a total of 202,628 FTE students. However, as indicated in Figure 1, the university plans to serve only 198,628 FTE students. This is a difference of 4,000 students, which equates to about $33 million in enrollment funding (based on the "marginal" cost associated with each additional student). In order to help reduce expected enrollment below the budgeted level and "free up" enrollment funds for other purposes, UC announced last fall that it would not consider the applications of about 1,600 freshmen and CCC transfer students seeking winter or spring admission. Specifically, the university returned the applications and application fees to these students. It was unclear which particular program reductions the university chose to offset with this portion of the funds the Legislature provided for enrollment growth.

UC's Budget-Year Enrollment. For 2004-05, the Governor's budget proposes funding for total FTE enrollment at UC of 199,428 students. (This total is less than the 2003-04 budgeted level of 202,628 FTE students because it reflects the redirection of 3,200 students to the community colleges.) At the time this analysis was prepared, the university was making plans (such as admissions decisions) based on this enrollment target for next year. As indicated in Figure 1, the Governor's enrollment target of 199,428 FTE students for 2004-05 is about 800 FTE students *more* than the university is planning to serve in the current year. In other words, the proposed budget allows UC to retain base enrollment funding into the

Figure 1

UC Enrolling Fewer Students Than Budgeted

2003-04 and 2004-05
Full-Time Equivalent Students



[a] LAO estimate based on 2003-04 budget language.

budget year to accommodate an *additional* 800 students above the current-year level.

CSU Plans to Enroll Fewer Students Than Proposed in Governor's Budget

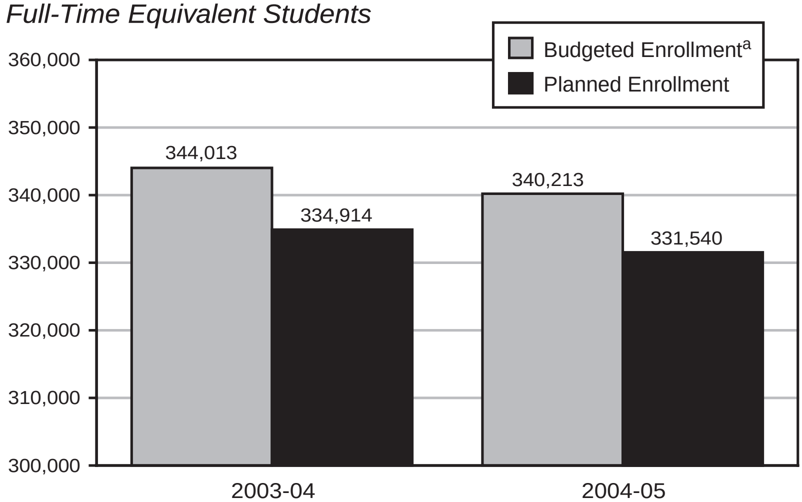
CSU's Current-Year Enrollment. For 2003-04, the enacted budget includes $151 million to fund 22,881 more FTE students at CSU than budgeted in the prior year. This results in a total funded enrollment level of 344,013 FTE students at CSU in 2003-04. However, as indicated in Figure 2 (see next page), the university plans to serve only 334,914 students. This is a difference of 9,099 FTE students, which equates to approximately $60 million in enrollment funding (based on the marginal cost associated with each additional student). In order to reduce enrollments in the current year below the budgeted level, CSU campuses took steps to reduce spring 2004 admissions.

According to the Chancellor's Office, CSU is using this diverted enrollment growth funding to backfill various budget reductions. For example, $45.5 million is being used to offset part of a one-time unallocated reduction of $69.5 million. As we discuss in the "California State University" section of this chapter, the Governor's budget for 2004-05 proposes to restore this entire $69.5 million unallocated reduction.

Figure 2

CSU Plans to Enroll Fewer Students Than Budgeted

2003-04 and 2004-05
Full-Time Equivalent Students



[a]LAO estimate based on 2003-04 budget language.

CSU's Budget-Year Enrollment. For the reasons described above, we believe the Governor's 2004-05 budget for CSU includes enough enrollment funding to serve 340,213 FTE students. (This total is less than the budgeted level for 2003-04 of 344,013 FTE students, because it reflects the redirection of about 3,800 students to the community colleges.) As indicated in Figure 2, this enrollment target of 340,213 FTE students for 2004-05 is about 5,300 FTE students *more* than the university plans to serve in 2003-04. Essentially, the Governor's budget allows CSU to retain base enrollment funding into the budget year that can accommodate an *additional* 5,300 students above the current-year level. At the time this analysis was prepared, however, the university was making plans (such as admissions decisions) to serve only 331,540 FTE students for next year. This amount is almost 8,700 FTE students *less* than can be served with available enrollment funding. Moreover, the Chancellor's Office has indicated that the university may *further* reduce its planned enrollment target for the budget year, in order to accommodate various budget reductions proposed by the Governor (such as reductions to academic and institutional support).

In conclusion, the Legislature made enrollment growth a priority when it provided UC and CSU with funding to increase the number of students by 7 percent in the current year. The segments, however, chose to redirect some of these enrollment growth funds to preserve their own priorities. It is unclear why UC and CSU disregarded the Legislature's direction. Because the segments decided to enroll fewer students than they received funding for in 2003-04, they have base enrollment funding to serve a total of 6,100 additional students in 2004-05. Thus, even though the budget provides no new funding for enrollment growth, UC and CSU can serve additional students within existing resources.

CAN THE STATE MAINTAIN ITS COMMITMENT TO THE MASTER PLAN?

Increasingly, the Legislature has expressed concern about the state's ability to ensure "access" to public higher education. In response to this, over the past few years UC and CSU have adopted various changes to their freshman admissions processes. Because these changes cumulatively can have significant policy implications, it is important for the Legislature to revisit and assess the process of higher education admissions in California. Such a review is particularly important at this time because, as discussed earlier, the Governor's budget for 2004-05 provides no new funding for enrollment growth at UC and CSU. In a recent report, *Maintaining the Master Plan's Commitment to College Access*, we reviewed the principles for access adopted by the Legislature in the *Master Plan for Higher Education* and in this context we examined the current admission practices of UC and CSU. We summarize the major findings of our report below.

Master Plan's Principles for College Access

As a reference point to guide legislative and executive decisions, the Master Plan (adopted by the Legislature in 1960 and periodically updated) established admission guidelines that remain as the state's official policy today. The plan calls for the community colleges to accept all applicants 18 years and older that can benefit from attendance. The plan calls for CSU to draw from the top one-third (33.3 percent) of public high school graduates, and to accept all qualified community college transfer students. The Master Plan calls for UC to draw from the top one-eighth (12.5 percent) of public high school graduates and to accept all qualified community college transfers. In short, the Master Plan specifies a target for the subgroup of high school graduates to be selected to attend each segment.

In order to serve the above populations, UC and CSU have adopted their own specific admissions criteria—such as grade point average (GPA) and SAT requirements. Students meeting these requirements are identified by the segments as being "eligible" for admission. As we discuss later, we believe it is likely that UC and CSU are currently drawing students for admission from outside their Master Plan targets.

Eligibility applies to each segment as a whole, and does not guarantee admission to any particular campus. This is because some campuses do not have the capacity and resources to admit all eligible applicants who desire to enroll there. As a result, some campuses use additional *admissions* criteria (which are stricter than systemwide *eligibility* criteria) to select new students from among eligible applicants. Eligible students who cannot be accommodated at the campus of their choice typically are offered a space at a different campus in the system.

No Need to Abandon Master Plan Commitment

The Legislature's intention (expressed in the 2003-04 budget package) not to provide funding for enrollment growth at UC and CSU in 2004-05 raises important policy questions regarding higher education admissions. The state must find ways to both ensure continued access to eligible students and preserve the Master Plan principles with limited resources. Anticipating no new enrollment growth funding in 2004-05, the UC Board of Regents and the CSU Board of Trustees discussed various alternatives in summer and fall 2003 for bringing admissions and enrollment policies more in line with budgeted resources. Some of these alternatives being discussed would, we believe, jeopardize some principles expressed in the Master Plan. However, as we noted in our admissions report, we do not think this is necessary.

We recognize that the state's fiscal constraints are requiring that the segments enroll fewer additional students than they likely would have in better fiscal times. However, for reasons described below, we believe the state can continue to maintain the Master Plan's commitment to access even with these resource constraints.

Segments Can Accommodate Additional Eligible Students

Based on our review of the University of California and the California State University's admissions policies and enrollment funding levels, we believe the segments can accommodate additional eligible students in 2004-05 without increased funding for enrollment growth.

In order to gauge how well the segments are selecting the target populations called for in the Master Plan, existing law requires the California Postsecondary Education Commission (CPEC) to periodically estimate the percentages of California public high school graduates that the segments determine are eligible for admission. The most recent CPEC eligibility study was based on a survey of California's 1996 public 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. (See accompanying box on issue of determining the eligibility pool.)

A Note on Measuring the Eligibility Pool for UC

In its report, *Eligibility of California's 1996 High School Graduates for Admission to the State's Public Universities,* the California Postsecondary Education Commission (CPEC) described the eligibility pool for the University of California (UC) in two ways. First, it estimated that 11.1 percent of high school graduates in 1996 were "fully eligible" for UC because they had achieved the then-required 3.3 grade point average (GPA) on UC preparatory classes *and* taken the SAT and three separate SAT II achievement tests. The CPEC also estimated that 20.5 percent of high school graduates in 1996 were "potentially eligible" for UC. These potentially eligible students, according to CPEC, included those who had achieved a 3.3 GPA but may not have taken the SAT I and SAT II test. At the time of the 1996 CPEC report, the university required students to take these tests, but did not use the test scores to determine a student's eligibility if their GPA was 3.3 or above. (High school graduates with GPAs between 2.82 and 3.3 could have become eligible for UC if their SAT I scores were sufficiently high.)

Top high school graduates that choose to attend CSU rather than UC do not need to take either the SAT I or SAT II, and many probably do not. Similarly, top high school graduates that choose to attend other top universities in the country do not need to take SAT II tests, and many probably do not. By excluding students who have not taken these tests when it identifies top high school graduates, UC significantly understates the size of the pool from which it draws freshmen. When such students are included, as we believe they should be, UC is drawing from the top 20.5 percent of high school graduates.

Although we do not know how well the segments' current admissions standards are achieving their Master Plan targets, recent initiatives have probably expanded their eligibility pools in recent years. For example, UC established the Eligibility in the Local Context (ELC) program in order to extend eligibility to additional students who do not meet UC's minimum standards for *statewide* eligibility. (The ELC program extends eligibility to the top 4 percent of graduates [as determined solely by GPA in UC-approved courses] at each California high school.) The CSU has also in recent years made changes to its eligibility requirements (such as modifying its high school course requirements) in order to increase its eligibility pool.

Moreover, both UC and CSU admission policies currently exceed the Master Plan's limits on "special admissions" of otherwise ineligible students. Specifically, the Master Plan states that no more than 2 percent of freshman and 2 percent of transfer students should be admitted through special procedures outside the state's minimum eligibility standards for academic coursework and standardized test scores. Because students "admitted by exception" to UC and CSU are otherwise ineligible for admission, a special admit essentially takes up a "slot" at the university that could otherwise have gone to an eligible student. (Please refer to our report, *Maintaining the Master Plan's Commitment to College Access*, for a more detailed discussion about special admissions.)

In view of the above, we believe it is likely that UC and CSU are currently drawing students outside their Master Plan targets and special admission pools. Rather than accept as many students from outside the Master Plan targets, the segments could more strictly observe these targets and refocus existing funds at the state's high school graduates who fall within the targets. In effect, realigning UC and CSU's eligibility criteria with the Master Plan targets may create "room" to fund additional eligible students in 2004-05. Ineligible students denied admission to UC might be able to attend CSU instead. In addition, students denied admission to UC and CSU would be eligible to attend a community college.

As previously discussed, the segments also have base enrollment funding to serve additional students in 2004-05. Thus, we believe the segments have room to accommodate additional students who qualify for admission in 2004-05 even without increased funding for enrollment growth.

Updated CPEC Eligibility Study Forthcoming. Although CPEC has not completed an eligibility study in recent years, the past three budgets have provided funding for CPEC to conduct such a study. This funding was included in the budgets of CPEC and the three public higher education segments. As part of the 2003-04 budget, the Legislature adopted supplemental report language directing CPEC and the segments to complete and submit an eligibility study based on 2003 public high school graduates by May 15, 2004. Given the importance of understanding enrollment demand and determining where the segments actually are relative to their Master Plan targets, the Legislature should carefully consider the results of CPEC's eligibility study in its upcoming budget and policy deliberations.

Task of Defining Eligibility Under the Master Plan Has Largely Been Delegated to the Segments

Our review suggests that the current eligibility requirements established by the University of California and the California State University may not be accurately defining the state's top high school graduates under the Master Plan.

Since the Legislature first established the student population targets in the Master Plan in 1960, the segments have been permitted to define for themselves who are the state's top high school graduates that fall within those targets. In adopting and modifying eligibility criteria, UC and CSU can (1) increase or decrease the percentage of students eligible for freshman admission at each segment, (2) alter the profile of eligible students without changing the percentage of eligible students, and (3) change the allocation of students across the three segments. These definitions of eligibility therefore reflect important policy choices that affect access to and the quality of the state's higher education system. Yet, they have been made with very little legislative oversight. We note also that the Legislature has little information about the appropriateness of existing criteria and how well the criteria are aligned to its K-12 education priorities and expectations.

For example, the Master Plan does not require that students complete a college entrance exam (such as the SAT) in order to be considered among the state's top public high school graduates. However, UC defines its eligibility pool to exclude those students who have not taken the SAT I and SAT II exams, regardless of their other academic achievements. As noted above, the 1996 CPEC eligibility study identified "potentially" UC eligible students who completed the required courses and earned exceptionally high grades but chose not to take the required tests. In other words, these students simply had to take the SAT I or SAT II tests in order to become fully eligible under UC's definition. We believe it would make more sense, and would be easier to calculate the top one-eighth and one-third of high school graduates, if the definition of these pools did not depend on whether a student voluntarily chose to take a test. Instead, we believe the targets specified in the Master Plan should—to the maximum extent possible—be defined on the basis of data available for *all* students.

Recommendations to Ensure Continued Access

In our recent report, we reviewed UC's and CSU's current admission policies and practices and identified a number of important policy issues that merit legislative consideration. Based on our findings and the Legislature's desire to preserve the Master Plan, we recommend (1) redirecting lower division students on a voluntary basis to enroll at a community college, (2) returning to the Master Plan special admission caps, (3) implementing enrollment management policies, and (4) reexamining current eligibility standards.

Redirect Lower Division Students to Community College

In order to preserve college access, we recommend the Legislature establish a policy (similar to that proposed by the Governor) whereby the University of California and the California State University would admit qualified freshmen but redirect a portion of them to enroll in specific community colleges for their lower division coursework. We further recommend the Legislature reject the Governor's proposal to waive the fees for students redirected to community colleges. We also recommend that students be redirected on a voluntary basis, but that the segments encourage participation by guaranteeing a student's admission to his or her first-choice campus. (Reduce Item 6870-001-0001 by $3.4 million.)

One of the major drivers of higher education cost is growth in student enrollment. As enrollments increase, the segments face additional costs for serving more students. Based on projections of enrollment increases and the Legislature's budget priorities each year, funding is added to UC's and CSU's budgets for the cost of serving additional students (commonly referred to as the "marginal cost"). Similarly, the state provides funding for additional students at the community colleges using an established budget formula.

Because of the different missions of the three segments, the per student support rate for new students varies substantially. For 2003-04, the state provided UC with $9,030 for each additional FTE student compared to $6,594 at CSU and about $4,132 at CCC. In addition, the student fees charged by the segments also vary substantially. In the current academic year, UC full-time undergraduate student's systemwide fee is $4,984 compared to $2,046 at CSU and $432 at CCC (based on an average full-time load of 24 units).

All three segments of higher education offer lower division (freshman and sophomore) instruction. In recent years the Legislature has identified transfer from community colleges to UC and CSU as a central priority for all segments of higher education. Given the high costs to the state and student to attend UC and CSU, it can be cost-beneficial for students to attend the community colleges for lower division work and then transfer to either UC or CSU for upper division work. The Legislature through the Master Plan and other initiatives has recognized the importance and value of facilitating a four-year student's ability to complete lower-division courses at a community college. For example, existing statutes place a high priority for the enrollment and admission of community college transfer students to UC and CSU. As noted earlier, UC recently developed a "dual admissions" program so that students who are *not* eligible to attend the university directly from high school can be admitted to a specific UC campus provided they first complete a transfer program at a community college.

LAO Redirection Proposal. Given the state's fiscal condition and projections for enrollment growth, we believe encouraging eligible students to enroll at community colleges for their lower division coursework helps preserve college access. Accordingly, as we have in prior analyses and most recently in our report on college admissions, we recommend the enactment of legislation establishing a policy whereby UC and CSU would admit qualified freshman but redirect a portion of them, *on a voluntary basis*, to enroll at community colleges for their first two years. Some students may find it more advantageous to initially attend a community college and incur lower direct costs (such as student fees and housing costs). In order to encourage a student to participate in this "redirection," the segments could guarantee a student's admission to his or her first-choice campus after completing lower-division coursework at a community college. This would be beneficial to students who otherwise could not attend their campus of choice because of its selectivity. Finally, we acknowledge that the proposal would take time to implement and would require a commitment on the part of UC and CSU to fully inform students and parents about the program in order to be successful.

Governor's Redirection Proposal Has Merit, But Needs Improvement. As noted earlier, the Governor's budget for 2004-05 proposes to reduce new freshman enrollment at UC and CSU by 10 percent (or 7,000 FTE students), with the foregone enrollment redirected to the community colleges. Overall, we believe the Governor's redirection program makes sense on policy grounds and shares some of the basic features of our proposal. However, there are some major differences. Under the Governor's proposal, some eligible students would be guaranteed admission to a specific UC or CSU campus (though not necessarily their first-choice campus) provided they first attend a community college.

As an incentive to encourage participation in the new dual admissions program, the administration proposes waiving the community college fees of participating students. However, we do not think this is an effective and efficient incentive. First, students would already have a preexisting fiscal incentive to attend a community college versus UC or CSU. This is because of the lower direct costs (such as student fees and housing) associated with attending a community college. In the current academic year, student fees at the community colleges are on average about one-tenth the undergraduate systemwide fee at UC and roughly one-fourth CSU's undergraduate systemwide fee. We also note that all of the redirected students who demonstrate financial need will *already* pay no fees at the community colleges as a result of the Board of Governors' fee waiver program. (About one-third of CCC students receive this waiver.) We believe that a better incentive to encourage students to attend a community college is to guarantee admission to their first-choice UC or CSU campus, as we propose above. For these reasons, we recommend the Legislature reject the Governor's proposal to waive the fees for students redirected from the universities to the community colleges. We estimate that this action would result in General Fund (Proposition 98) savings of $3.4 million.

At the time this analysis was prepared, it was also unclear how certain aspects of the Governor's proposal would be implemented. For example, while the administration told us they expected the program to be voluntary, UC told us eligible students selected for the program would not be given the option of enrolling at UC as a freshman. Our view is that students should be redirected on a voluntary basis.

Return to Master Plan's Special Admission Caps

We recommend the Legislature require the segments to return to the Master Plan's special admissions cap of 2 percent, in order to maximize access for eligible students with the state's limited fiscal resources.

As discussed earlier, both UC and CSU admissions policies exceed the Master Plan's special admission provisions. Given the state's fiscal constraints and the desire to maintain access for eligible students, we recommend that the Legislature reinforce the Master Plan's admission priorities and require the segments to return to the 2 percent special admit cap. Under this proposal, UC and CSU would still retain the flexibility to admit a small percentage of otherwise ineligible students whose special circumstances warrant an exception. We recommend that priority be given to those students from disadvantaged backgrounds.

Implement Policies to Preserve Access for State's Eligible Students

We recommend the University of California and the California State University implement policies (such as limiting consideration of new applications to a specified filing period) on a systemwide basis that seek to manage enrollment demands by preserving access for state residents who are eligible for admission.

The CSU campuses currently use enrollment management tools at their discretion to align enrollment demand with available resources without specifically denying California high school graduates who are eligible for admission. (Please refer to our admissions report for a detailed description of CSU's enrollment management policies.) One tool is for campuses to stop accepting applications after a reasonable filing period. We note that 15 of the 23 CSU campuses were still accepting applications in March 2003 for fall 2003 admissions. This was well after the official filing deadline of November 30, 2002. In limiting acceptance of applications to a specific period, CSU would be accommodating all eligible students who apply by the deadline, thereby encouraging potential applicants to plan and prepare. This would also have the effect of giving CSU more time to plan for enrollment demands and make admissions decisions.

Under CSU's enrollment management policies, campuses can also limit or not accept applications from lower-division transfer students. Such students can essentially "defer" their transfer to the university until after they finish their lower-division coursework at a community college. This protects access for students who are eligible for freshman and upper-division transfer admission. In view of the above, we recommend both segments implement policies on a systemwide basis that seek to manage enrollment demands.

Reexamine Existing Eligibility Standards

We recommend the Legislature more clearly define how the segments should select the state's top high school graduates, in order to preserve its higher education priorities.

As we concluded above, the current eligibility requirements established by UC and CSU probably do not accurately define the state's top high school graduates as called for in the Master Plan. Consequently, we recommend the Legislature examine alternative ways for defining eligibility. For example, the Legislature could specify that the segments determine eligibility solely based on high school GPA and scores on the California High School Exit Exam or the California Standards Test (CST). (The CST, which *all* public high school students must take, measures the degree to which students achieve the academically rigorous content and performance standards adopted by the State Board of Education.) Under this scenario, UC and CSU eligibility requirements would be objective, transparent, and based on measurements aligned to K-12 curriculum standards.

The segments could choose to place additional requirements (such as requiring students to take the SAT and complete a specific high school course pattern) as a condition for *admission to a specific campus,* particularly for those students seeking admission to a highly selective campus. However, such supplemental criteria would not be used to identify the *pool* of students that each segment should draw from for systemwide eligibility. We note that CSU currently uses portions of the CST to identify high school students that need assistance in improving their proficiency in English and mathematics prior to entering CSU.

Conclusion

In conclusion, many state and campus policies—including admission standards, institutional capacity, student fees, financial aid, and K-14 outreach efforts—affect access to the state's public higher education segments. We believe it is important for the Legislature to think broadly about access and consider the interaction of these policies in its budget and policy deliberations. In this section, we have recommended a series of admissions-related steps the Legislature can take to preserve the Master Plan's commitment to access with limited resources. In another section of this chapter, we examine the state's outreach programs.

INTERSEGMENTAL:
STUDENT FEES

The Governor's budget includes numerous proposals relating to student fees. Specifically, the budget proposes to:

- Increase the per unit fee at the California Community Colleges (CCC) by 44 percent—from the current-year rate of $18 per unit to $26 per unit.
- Waive the per unit CCC fee for freshmen who have been redirected from the University of California (UC) and the California State University (CSU).
- Increase resident undergraduate fees at UC and CSU by 10 percent, resident graduate fees by 40 percent, and nonresident tuition by 20 percent.
- Reduce by 25 percent the General Fund subsidy provided to UC professional schools as well as Hastings College of the Law—with the expectation that this reduction would be offset with increases in student fees.
- Establish two new surcharges: (1) an "excess unit" surcharge at UC and CSU for each unit taken in excess of 110 percent of the units required for a baccalaureate degree (for which students would be charged full cost), and (2) a surcharge for CCC students who already have a baccalaureate degree (raising their per unit fee from $18 to $50).

In addition to these budget-year proposals, the administration proposes to establish a long-term undergraduate and graduate fee policy for UC and CSU. The policy would not apply to CCC or professional schools. The administration's policy consists of two major components.

- ***Modest and Predictable Annual Adjustments.*** Undergraduate and graduate fees at UC and CSU would increase annually. Typically, fees would increase by the change in per capita personal income, but the policy would allow for increases of as much as 10 percent.

- ***Differential Rates for Undergraduates and Graduates.*** Graduate fees would be pegged at 150 percent of undergraduate fees and would be allowed to increase more quickly than undergraduate fees over the next several years until this target was met. (That is, over the near term, graduate fees would not be subject to the 10 percent cap.) Once the target has been reached, graduate and undergraduate fees would be adjusted annually by the same rate (change in per capita income) and both would be subject to the 10 percent cap.

In this chapter, we discuss the Governor's budget and policy proposals relating to (1) undergraduate and graduate fees, (2) professional school fees, and (3) the fee surcharges.

UNDERGRADUATE AND GRADUATE FEES

In this section, we assess the administration's proposed long-term fee policy and offer an alternative. We then use this alternative policy to analyze the Governor's budget proposals relating to undergraduate and graduate fees. We recommend the Legislature approve the proposed 10 percent increase in undergraduate fees but adopt a more moderate increase (of 30 percent) in graduate fees. We then use our alternative policy to illustrate how fees might be increased over the next several years. Finally, we recommend the Legislature (1) encourage higher fees for higher-cost graduate programs at CSU (consistent with existing practice at UC) and (2) achieve an additional $9.5 million in General Fund savings by counting summer fee revenue at CSU as available for offsetting General Fund reductions in 2004-05.

Background

California's existing higher education fees are not rooted in a long-term policy that designates how fees should be set and adjusted over time. Instead, existing fees are the result of a series of short-term decisions driven almost entirely by the state's fiscal situation. For example, in the late 1990s, the state actually reduced fees despite a strong economy, healthy rises in per capita income, burgeoning financial aid opportunities, and a general increase in fees across the county. Similarly, over the past two years, student fees have been raised significantly in response to the state's fiscal condition, yet these fee increases have not been linked to any specific fee target or underlying policy rationale.

Not only do California's existing fees lack a long-term policy foundation, they are also very low by various standard measures. Figure 1 (see next page) compares existing fees at UC and CSU with their comparison institutions and compares CCC fees with the national average. As the figure shows, resident undergraduate and graduate fees at UC and CSU are the lowest of all their public comparison institutions. In the current year, total UC undergraduate and graduate fees are 20 percent less and 25 percent less, respectively, than the average fees charged by its four public comparison institutions. Total CSU undergraduate and graduate fees are less than half the average fees at its 15 public comparison institutions. Fees at CCC are the most anomalous. The current level of $18 per unit is the lowest in the nation and roughly one-fourth of the national average. Furthermore, students currently are paying a small share of their total education costs. In 2003-04, UC, CSU, and CCC students are paying only 26 percent, 17 percent, and 12 percent, respectively, of their total education costs.

Set Fees at Fixed Percentage of Students' Total Education Costs

We recommend the Legislature adopt a long-term statutory policy for the University of California, the California State University, and the California Community Colleges that would set fees at a fixed percentage of students' total education costs. This policy would provide an underlying rationale for fee levels. It also would ensure moderate and gradual fee increases, treat students fairly across time, create incentives for students to hold the segments accountable for keeping costs low and quality high, and formally recognize the private as well as public benefits of higher education.

The Governor's proposed fee policy adheres to two principles that we think are important components of any fee policy: (1) fees should be adjusted annually in a moderate, gradual, and predictable manner; and (2) fees should reflect underlying costs. Thus, the Governor's policy proposal serves as a useful starting point for building a long-term fee policy. However, the Governor's proposal lacks an underlying rationale for fee levels. Instead, it assumes that the current undergraduate fee is appropriate. The graduate fee is then set 150 percent higher than the undergraduate fee and both fee levels are adjusted in tandem annually thereafter.

Adopt Rationale for Fee Levels. Given the current undergraduate fee level is not rooted in an underlying policy basis, we do not think it is a sound foundation for a new long-term policy. In contrast to the Governor's proposal, we recommend the Legislature adopt a long-term statutory policy that provides an underlying rationale for fee levels—that is, an explicit statement about what fee levels should be and how they should be adjusted over time. We specifically recommend that resi-

Figure 1

California's Existing Fee Levels Are Very Low Compared to Other States

2003-04 Fee Levels

	Resident Undergraduate Fees	Resident Graduate Fees
University of California	$5,530	$6,843
Public Comparison Institutions[a]		
State University of New York, Buffalo	$5,851	$7,987
University of Virginia	6,149	7,856
Comparison institution average	6,873	9,133
University of Illinois, Urbana-Champaign	7,010	7,756
University of Michigan, Ann Arbor	8,481	12,933
California State University	$2,572	$2,782
Public Comparison Institutions[b]		
University of Nevada, Reno	$2,830	$3,016
Arizona State University	3,595	3,769
University of Colorado, Denver	3,662	4,432
Georgia State University	3,920	4,562
University of Texas, Arlington	4,423	4,532
North Carolina State University	4,985	4,189
University of Wisconsin, Milwaukee	5,107	7,403
George Mason University	5,112	5,880
Comparison institution average	5,272	5,925
Illinois State University	5,340	5,127
Wayne State University	5,693	6,826
Cleveland State University	5,916	8,960
State University of New York, Albany	6,343	7,890
University of Connecticut	6,844	7,746
University of Maryland, Baltimore	7,388	4,719
Rutgers University	7,927	9,830
California Community Colleges	$540[c]	—
National average	$2,155	—

a Refers to the four public universities with which UC compares itself for faculty salary purposes.

b Refers to the 15 public universities with which CSU compares itself for faculty salary purposes.

c Based on national standard of 30 units.

dent fees be linked to a fixed percentage of students' total education costs (for example, 30 percent or 50 percent of total costs). For nonresident students, we recommend setting fees equal to total education costs.

In determining the specific percentage(s) at which to set student fees, the Legislature may want to consider many factors—ranging from fee and financial aid policies at comparison institutions to students' future earnings potential to the public benefit society receives from higher education. For purposes of illustration, at the University of Michigan (UM), Ann Arbor—one of UC's comparison institutions—resident undergraduate tuition is about 28 percent of total per student expenditures. For the University of Wisconsin (UW), Milwaukee—one of CSU's comparison institutions—undergraduate tuition is about 41 percent of total education costs.

Account for Differences in Education Costs. Because the cost of providing graduate education is generally higher than the cost of undergraduate education, our policy proposal would result in graduate fees that are higher than undergraduate fees. Both segments estimate that graduate education costs about 50 percent more than undergraduate education. (Although neither UC nor CSU has conducted a recent study of the difference between undergraduate and graduate education costs, both suggest this type of study would be very intensive because most faculty members have responsibilities for teaching both undergraduates and graduates and their particular mix of responsibilities varies by term.) We think the segments' estimate is reasonable and provides an adequate basis for approximating the costs of graduate education. Therefore, we recommend the Legislature set graduate fees at 150 percent of undergraduate fees.

This differential is similar to that in place at many comparison institutions. Graduate fees at UC's comparison institutions, on average, are 133 percent of undergraduate fees. Among UC's public comparison institutions, UM has the greatest differential—charging resident graduates 52 percent more than resident undergraduates. Graduate fees at CSU's comparison institutions, on average, are 112 percent of undergraduate fees, although UW has a 145 percent differential and Cleveland State University (another of CSU's comparison institutions) has a 151 percent differential.

Set Fee Targets. We recommend the Legislature establish fee targets based upon this long-term policy. For purposes of illustration, Figure 2 (see next page) shows what the fee targets would be if resident student fees were set at 50 percent of total education costs, nonresident fees were set at 100 percent of total costs, and graduate fees were set at 150 percent of undergraduate fees. As the figure shows, the fee targets for resident undergraduates at UC, CSU, and CCC would be $8,900, $5,800, and $2,300, respectively, whereas the fee target for resident graduates at UC and CSU would be $13,400 and $8,600, respectively.

Figure 2

Linking Fees to Education Costs— An Illustration for 2004-05[a]

	UC	CSU	CCC
Residents			
Undergraduates			
Estimated cost of education[b]	$17,800	$11,500	$4,600
Target level[c]	8,900	5,800	2,300
2003-04 fee	5,500	2,600	540
Amount (percent) from target	-$3,400 (-38%)	-$3,200 (-55%)	-$1,760 (-77%)
Graduates			
Estimated cost of education[b]	$26,800	$17,200	—
Target level[c]	13,400	8,600	—
2003-04 fee	6,800	2,800	—
Amount (percent) from target	-$6,600 (-49%)	-$5,800 (-67%)	—
Nonresidents			
Undergraduates			
Estimated cost of education[b]	$17,800	$11,500	$4,600
Target level[d]	17,800	11,500	4,600
2003-04 fee	19,700	11,000	4,470
Amount (percent) from target	$1,900 (11%)	-$500 (-4%)	-$130 (-3%)
Graduates			
Estimated cost of education[b]	$26,800	$17,200	—
Target level[d]	26,800	17,200	—
2003-04 fee	19,300	11,200	—
Amount (percent) from target	-$7,500 (-28%)	-$6,000 (-35%)	—

a All amounts, except for the current CCC fee rates, are rounded to the nearest $100.

b We estimate the cost of education assuming graduate education costs 50 percent more than undergraduate education. Multiplying the estimated cost amounts shown by undergraduate and graduate enrollment, respectively, equals total systemwide education costs.

c For purposes of illustration, we assume the target rate for resident students equals 50 percent of total education costs.

d For purposes of illustration, we assume the target rate for nonresident students equals 100 percent of total education costs.

Benefits of Adopting Explicit Fee Basis. Adopting an explicit policy basis for setting fee levels has numerous benefits. In particular, the percentage-of-total-costs methodology: (1) ensures that different cohorts of students are treated fairly over time, (2) provides direct incentives for students to hold the segments accountable for keeping costs low and quality high, and (3) formally recognizes the private as well as public benefits of higher education. We highlight these benefits below.

- ***Treats Students Fairly Over Time.*** Linking fees to a fixed percentage of total education costs would ensure that students attending public colleges and universities over time contribute equally to their college education. This would be fairer than the current practice of reducing students' contribution in good fiscal times and increasing students' contribution in bad fiscal times—that is, having different expectations for different cohorts of students depending on when they attended college. Under our policy alternative, the state's expectation is consistent over time across all cohorts of students.
- ***Strengthens Accountability.*** If student fees were linked to total education costs, students would have a greater incentive to hold universities directly accountable for keeping costs low and quality high. This is because a portion of any increase in the cost of education would be automatically passed on to students in the form of higher fees.
- ***Recognizes Both Public and Private Benefits of Higher Education.*** Our policy alternative also explicitly recognizes that higher education provides both public and private benefits. Although causation is difficult to assess, many studies have found a very high correlation between individual earnings and level of education attainment. In 2001, for example, the median earnings of males age 25 or older working full-time was $33,000 for those with a high school diploma, $53,100 for those with a baccalaureate degree, $66,900 for those with a Master's degree, and $100,000 for those with a professional degree—more than three times the earnings of a male without a postsecondary degree.

Use New Policy to Develop Budget-Year Plan and Out-Year Implementation Plan

We recommend the Legislature use the percentage-of-total-costs policy to assess the appropriateness of existing fee levels, determine specific fee increases for the budget year, and develop a plan for raising fees over the next several years until the established fee targets have been met. Once met, we recommend the fee levels be adjusted annually holding the percentage-of-total-costs steady.

Once a certain percentage of total education costs has been selected as the underlying basis of student fees, we recommend that current fee levels be examined in relationship to the fee targets. This assessment process then could be used to determine both specific fee increases for the budget year and scheduled fee increases over the next several years.

Distance From Current Rates to Fee Targets Varies. Figure 2 compared existing fee levels with a 50 percent-of-cost fee target for resident students and a 100 percent-of-cost fee target for nonresident students. For resident undergraduate fees, UC's existing fee is closest to the target (at 38 percent beneath target), the community college fee is farthest from the target (at 77 percent beneath target), and CSU's fee is more than 50 percent beneath the target. Resident and nonresident graduate fees at UC and CSU also are considerably lower than the targets. In contrast, nonresident undergraduate fees at CSU are only slightly lower than the target and, at UC, they already are above target (meaning these students already are paying more than their full cost of education). Even if the Legislature selected different targets than used in our illustration, the basic relationships shown would remain the same.

Recommend Adoption of Governor's Resident Undergraduate Fee Proposals. For the budget year, as the first step in linking fees to a percent-of-cost policy, we recommend approving the (1) relatively moderate 10 percent increase in UC and CSU fees and (2) $8 per unit increase in CCC fees. Although CCC fees would experience a larger percentage increase than UC and CSU fees, the amount of the increase for the average full-time student would be $192 per year—still reflecting a very moderate increase. Moreover, raising the per unit fee to $26 would enable financially needy CCC students to obtain the maximum federal Pell Grant. As we discussed in the *2003-04 Analysis*, California is the only state in the nation that has such low CCC fees that its financially needy students are not eligible for the maximum Pell Grant award. A per unit fee of $26 is the lowest fee level that would enable CCC students to obtain the maximum grant of $4,050, or $112 more than they currently are able to receive. (Given that the Board of Governor's fee waiver program covers all student fees for needy students, this additional Pell Grant assistance would be available to cover a greater share of students' living expenses.)

Recommend Adoption of Governor's Nonresident Graduate Fee Proposals. We also recommend the Legislature approve the 20 percent increase in nonresident graduate fees at UC and CSU. As Figure 2 shows, these students currently are paying considerably less than their full education costs. At both UC and CSU, these fees are less that 80 percent of total costs. Thus, we recommend raising these fees as the first step in linking them with a percent-of-cost policy.

Recommend Moderate Increase in Graduate Fees. Although graduate fees (like undergraduate fees) are considerably beneath the 50 percent-of-cost target, we think the proposed 40 percent fee increases are too large and substantially deviate from the principle that fees be increased gradually and moderately. Additionally, UC already has stated that the Board of Regents is likely either to: (1) increase undergraduate fees by more than 10 percent to reduce the proposed 40 percent graduate fee increases or (2) redirect monies from its undergraduate institutional aid budget to its graduate institutional aid budget. In essence, this latter option would result in undergraduates directly subsidizing graduate students. This would represent a significant deviation from a longstanding UC policy that avoids this kind of direct cross-subsidization. Rather than allowing for these types of deviations, we recommend the Legislature increase graduate fees more moderately (by 30 percent) and then schedule additional increases in future years. Raising graduate fees by 30 percent rather than 40 percent would result in less fee revenue being available to offset General Fund reductions. Specifically, UC and CSU, respectively, would generate $18 million and $15 million less in student fee revenue. We have identified potential savings elsewhere in higher education sufficient to offset this foregone revenue.

Recommend Not Charging Nonresident Undergraduates More Than Full Cost. Although the Governor's budget proposes to increase nonresident undergraduate fees by 20 percent, these students already are paying either more than their full cost of education (at UC) or just slightly less than their full cost of education (at CSU). At UC, nonresident undergraduates are paying about $2,000, or 11 percent, more than their total education costs. For the next few years, we recommend holding these fee levels steady. Once the fee is equal to total education costs, we recommend adjusting it annually so that it continues to equal total costs.

By comparison, nonresident undergraduates at CSU are paying about $500 less than their total costs. In the budget year, we recommend raising the fee by 3.5 percent, such that the new tuition and fee level would equal total education costs. As for nonresidents generally, we recommend annually adjusting the fee level such that it continues to equal total costs. As with lowering the graduate fee increase, lowering the nonresident undergraduate fee increase would result in UC and CSU collecting less fee revenue than under the Governor's budget proposal. Specifically, UC and CSU, respectively, would generate $18 million and $11 million less in student fee revenue. We have identified savings elsewhere in higher education sufficient to offset this foregone revenue.

Develop Out-Year Implementation Plan. We further recommend the Legislature develop an implementation plan that schedules future fee increases. The specific schedule would depend on the percent-of-cost target the Legislature selected. For example, if the target were set at 50 percent of total costs, then UC resident fees could be raised 10 percent annually from 2005-06 through 2010-11, at which time both undergraduate and graduate fees would have reached the target. At CSU, with 10 percent annual increases, undergraduate and graduate fees would reach the 50 percent-of-cost target by 2014-15 and 2017-18, respectively. By comparison, with 10 percent annual increases, CCC fees would not reach the 50 percent-of-cost target until 2020-21. Regardless of the specific targets selected, having a systematic out-year implementation plan would ensure that the fee adjustments needed to reach the selected targets were scheduled in a gradual, moderate, and predictable manner.

Encourage Higher Fees for Higher-Cost Graduate Programs at CSU

We recommend the Legislature encourage the California State University (CSU) to establish higher fees for its higher-cost graduate programs. This would be consistent with current practice at the University of California and most of CSU's comparison institutions, as well as consistent with our recommended long-term fee policy that links student fees with actual education costs. If these higher fees were instituted, we estimate CSU could generate $2 million in additional student fee revenue, thereby providing a like amount of General Fund savings.

Currently, CSU charges the same graduate fee to students enrolled in all its graduate programs. We recommend the Legislature encourage CSU to establish higher fee levels for higher-cost graduate programs, thereby generating additional fee revenue and a like amount of General Fund savings.

Consistent With Fee Structures at Many Other Public Universities. Differential graduate fee levels already exist at UC and at least 10 of CSU's 15 public comparison institutions. These universities have multiple graduate fee levels that vary by graduate program. For example, UC charges higher student fees for Master degree programs in business, nursing, and cinema. Similarly, many of CSU's public comparison institutions charge higher fees for graduate programs in business, engineering, architecture, nursing and other health sciences, and social work. One of the primary reasons these types of programs charge higher fees is because they are more costly to operate. For example, many of these types of programs involve clinical fieldwork or rely on expensive instructional equipment.

Consistent With Alternative Long-Term Fee Policy. Encouraging higher fees for higher-cost programs also would be consistent with the fee policy that we recommend the Legislature adopt for undergraduate and graduate students. This policy, as described above, would connect student fees to education costs. As it applies here, CSU would be allowed to calculate costs separately for certain types of graduate programs, thereby allowing it to set fees that more accurately reflect actual education costs. Currently, although the state General Fund is contributing more to these programs, participating students are not required to pay higher fees than graduate students participating in substantially lower-cost programs.

Score $2 Million in General Fund Savings. For the budget year, we recommend the Legislature score $2 million in General Fund savings associated with these higher fees. Although the precise amount of revenue CSU would generate from these higher fees obviously would depend on the number and size of the programs to which the Board of Trustees applied the fees, we estimate that at least 4,000 students likely would be subject to higher fees. (This estimate is based on the number of students enrolled in graduate programs in business, nursing, and cinema in 2002-03.) If these students each paid 15 percent more than the 2004-05 graduate fee level (either as proposed in the Governor's budget or recommended as part of our fee alternative), CSU would generate approximately $2 million.

Score Additional $9.5 Million Associated With CSU's Summer Term

We recommend the Legislature achieve an additional $9.5 million in General Fund savings by applying the 2004-05 undergraduate and graduate fee increases either to summer 2004 or summer 2005.

Since 2001-02 (when the state began directly funding summer sessions), UC and CSU have considered summer the first term of the fiscal year. Following this practice, UC imposed the 2003-04 fee increases beginning in summer 2003. This budgeting practice meant that the fee revenue UC generated in summer 2003 could be used to backfill General Fund reductions taken in the 2003-04 fiscal year. Similarly, UC plans to impose the 2004-05 fee increases beginning in summer 2004, and it anticipates that fee revenue generated in summer 2004 would be available to backfill General Fund reductions taken in 2004-05. Thus, UC's 2004-05 fee revenue estimates account for the additional fee revenue expected in summer 2004.

In contrast, CSU did not impose the 2003-04 fee increases until fall 2003. Thus, this fee increase did not affect summer-term students until summer 2004. Apparently, this was done because of the late enactment of the budget. Despite this decision, the 2003-04 budget assumed that additional summer fee revenue would backfill a portion of CSU's 2003-04 General Fund reductions. The CSU's decision to delay the fee increase until summer 2004 generated a short-term cash flow problem for 2003-04 that will be alleviated once CSU collects summer 2004 fee revenue.

Consistent with CSU's current-year practice, the Governor's budget assumes that the 2004-05 fee increases will not be operative at CSU until fall 2004, but, *unlike* CSU's current-year practice, it assumes revenue generated in summer 2005 would count as 2005-06 revenues rather than toward the 2004-05 fiscal year. In short, the Governor's budget would treat 2004-05 as an anomalous year in which CSU would count no summer fee revenue as available for offsetting proposed General Fund reductions.

We recommend the Legislature score additional summer fee revenue as available to offset 2004-05 General Fund reductions. Specifically, we recommend the Legislature take one of two actions—either of which would achieve an additional $9.5 million in General Fund savings in the budget year:

- ***Apply the 2004-05 Fee Increases to CSU's Summer 2004 Term.*** Given CSU's delay of the 2003-04 fee increases until summer 2004, this action, in essence, would result in applying both the 2003-04 and 2004-05 fee increases simultaneously on the summer 2004 term. This action, however, would realign CSU with UC's existing practice, which, as noted above, would be to apply the 2004-05 fee increases beginning in summer 2004.
- ***Delay Fee Increase to Summer 2005 but Apply Revenue Toward 2004-05.*** Alternatively, the 2004-05 fee increases could be delayed until fall 2004 but the revenue generated in summer 2005 could be counted toward 2004-05. This practice would be consistent with CSU's current-year practice.

We think the first option has the distinct advantages of being consistent with both the standard practice of counting summer as the first term of the fiscal year as well as with UC's existing practice. The second option, however, would allow CSU to phase in the proposed fee increases more gradually. Regardless of which option is selected, the result would be the same level of General Fund savings.

PROFESSIONAL SCHOOL FEES

The Governor's budget proposes to reduce total General Fund support for professional schools by 25 percent. This reduction would apply to all UC professional schools except nursing, as well as to Hastings College of the Law. The Governor's budget assumes $42.6 million in General Fund savings associated with UC's professional schools and $3 million in savings associated with Hastings. The Governor's budget assumes that UC and Hastings would increase student fees to offset these General Fund reductions.

Specific Fee Increases Not Yet Determined. At the time of this analysis, neither UC nor Hastings had finalized its 2004-05 fee levels. The UC therefore had not yet determined the specific fee increases that would apply to each of its nine professional programs. It has suggested that student fees likely would be raised by between $4,000 and $7,000 for each professional program (except nursing, for which student fees would remain at the 2003-04 level). Figure 3 illustrates what 2004-05 student fee levels would be if the same dollar increase were applied to each of UC's existing professional fee levels. The average fee increase would be $4,900. By comparison, Hastings proposes to increase student fees by approximately $4,200 for resident students and $6,300 for nonresident students.

Figure 3

Estimated 2004-05 Fees Resulting From 25 Percent Reduction in General Fund Support

	Resident Fees	Nonresident Fees
University of California[a]		
Law	$21,820	$34,065
Business	21,331	33,576
Medicine	20,520	32,765
Dentistry	20,031	32,276
Veterinary medicine	18,536	30,781
Pharmacy	16,846	29,091
Optometry	16,846	29,091
Theater, film, and television	15,156	27,401
Nursing	10,013	22,258
Average Fee[b]	$18,886	$31,131
Hastings College of the Law	$19,828	$32,627

a The fees listed here assume that the 25 percent General Fund reduction results in the same dollar increase across all UC's professional schools except nursing, which is excluded from the Governor's reduction proposal.

b Excludes nursing.

Professional Fee Increases Comparable to or Less Than Other Graduate Fee Increases. We estimate that UC could accommodate the proposed General Fund reduction by raising total resident and nonresident charges each by 25 percent. (This would result in resident and nonresident students paying, on average, $3,500 and $8,200 more, respectively, in 2004-05 than in 2003-04.) Similarly, Hastings-proposed 2004-05 fees are 27 percent and 24 percent higher than the current-year levels for resident and nonresident students, respectively. These percentage increases are actually less than the 40 percent increases the Governor's budget proposes for other graduate students at UC and CSU. They are comparable to the 30 percent increases we recommend for graduate students at UC and CSU. Thus, we think the proposed General Fund reductions are reasonable and proportional to reductions proposed for other areas of higher education.

Critical Budgeting Assumption Reduces Potential General Fund Savings by $56 Million

When calculating the amount associated with the Governor's 25 percent reduction proposal, the Governor's budget adopts a critical budgeting assumption that reduces potential General Fund savings by $56 million. To assess both the viability of the proposed savings and the potential to achieve additional savings, we recommend the Legislature request the University of California (UC) to provide additional detail on current-year expenditures for its professional schools. Specifically, during budget hearings, UC should provide: (1) an accurate accounting of its professional school enrollment and (2) the current-year budget for each of its professional schools.

In spring 2003, UC provided our office with an accounting of professional school expenditures for 2001-02—the most recent year for which actual expenditure data were available. According to these data, UC's professional programs spent a total of $2.6 billion. Of this amount, $444 million was from the state General Fund. Assuming UC's professional programs experienced General Fund reductions in 2002-03 and 2003-04 consistent with UC's overall General Fund reductions, we estimate the state currently is providing about $395 million for these programs.

Budgeting Assumption Reduces Potential General Fund Savings by $56 Million. As described above, the Governor's budget proposes to reduce total General Fund support for UC professional schools by 25 percent. For purposes of calculating this reduction, the budget assumes that less than half of the $395 million currently provided for UC's professional programs is associated directly with professional school students. This assumption reduces potential General Fund savings by $56 million. (Rather than saving $99 million [25 percent of $395 million], UC estimates savings of only $43 million.) The UC made this assumption because it estimates that only about half of the students enrolled in classes in professional programs are graduate professional-degree seekers. The rest are assumed to be undergraduates, graduate students seeking doctoral degrees rather than professional degrees, or medical residents who already have obtained their professional degree. The UC has not been able to provide any documentation substantiating this claim.

Insufficient Documentation to Determine if General Fund Savings Calculated Appropriately. These figures are troubling because they suggest either (1) about half of UC's documented professional school expenditures are not really related to professional school activities or (2) the Governor's budget proposal substantially underestimates potential savings. To determine just how much savings actually is associated with specific reduction proposals, we recommend the Legislature request UC to provide the following information during budget hearings.

- An accurate accounting of undergraduate, graduate, and professional school enrollment in each of UC's professional programs.
- The current-year budget for each of UC's professional programs, broken down by funding source and major expenditure categories.

We recommend the Legislature use this information to determine if additional General Fund savings should be achieved.

NEW FEE SURCHARGES

The Governor's budget proposes to establish two new fee surcharges. Below, we discuss these proposals. We recommend the Legislature approve both of the new surcharges.

Excess Unit Surcharge

The Governor's budget proposes to establish a per-unit surcharge for undergraduate students at UC and CSU who enroll in considerably more classes than required to obtain a baccalaureate degree. Specifically, for each unit taken beyond 110 percent of the units required to obtain a baccalaureate degree, students would be charged the full cost of instruction. For most programs, the cap would be set at 198 quarter units and 132 semester units. The Governor's budget includes associated General Fund reductions of $9.3 million and $24.4 million for UC and CSU, respectively. The Governor's budget is ambiguous in that it scores the General Fund savings but assumes that the new surcharge actually would generate no additional fee revenue in 2004-05. Thus, it remains unclear whether the proposal is intended as a fund shift (from General Fund to fees) or an unallocated General Fund reduction.

The UC and CSU have raised four issues regarding the implementation of the surcharge in the budget year. We discuss these issues below.

Still Determining Who Would Be Subject to the New Surcharge. The UC in particular has several concerns about applying the surcharge policy to students pursuing double majors and "high-unit" majors. Despite these concerns, the administration's proposal offers UC considerable flexibility in implementing the surcharge and presumably UC could choose to exempt certain students, such as double majors, from the unit cap. Exempting students from the surcharge, however, obviously reduces the additional fee revenue that could be generated.

Different Interpretations of Phase In. No common understanding appears to exist regarding the proposal's phase-in requirements. The CSU, for example, interprets phasing in to mean that the policy should apply only to entering freshmen. Under this scenario, CSU would not begin to generate additional fee revenue until 2008-09 (at the earliest). In contrast, the Governor's budget documents suggest that phasing in would mean the policy would be applied selectively in the budget year—affecting only some of the students taking excess units.

Revenue Estimates Still Being Disputed. Both UC and CSU have expressed some reservations about their ability to generate additional fee revenue sufficient to offset the associated General Fund reductions proposed in the Governor's budget. Compared to the $9.3 million estimate included in the Governor's budget, UC estimates that it would generate between $2.7 million and $10.5 million when the surcharge policy was fully implemented. Because CSU believes it would phase in the surcharge beginning with freshmen in 2004-05, it questions whether it can achieve *any* associated fee revenue in the budget year.

If Effective Over Long Term, Little Additional Fee Revenue Would Be Expected. If this surcharge policy is effective, then most undergraduates would focus their studies and avoid taking excess units. As a result, UC and CSU actually would generate little additional fee revenue. They would, however, free up state-supported enrollment slots, which would either permit the enrollment of additional students with the same level of funding or reduce overall costs.

Aggressively Pursue Option, Link With Reporting Requirement

We recommend the Legislature institute the general policy of charging full cost for excess units, and, unless the segments can reasonably defend alternative revenue estimates, score the $33.7 million in General Fund savings included in the Governor's budget. Additionally, we recommend the Legislature request the University of California and the California State University to report on the actual implementation of the surcharge during next year's budget hearings.

Despite the segments' concerns noted above, we believe the administration's estimates of General Fund savings are relatively conservative. Rather than assuming that the new surcharge would apply to every excess unit likely to be taken in 2004-05, the Department of Finance (DOF) assumes the surcharge would apply only to one in every five excess units taken. This assumption affords UC and CSU considerable discretion to determine how best to apply the policy in the budget year. Because we believe the policy itself is reasonable, in the absence of more refined revenue estimates from the segments, we recommend the Legislature score the $33.7 million in General Fund savings as proposed in the Governor's budget.

At the same time, we recognize there are legitimate concerns regarding how this policy will be implemented. We therefore recommend the Legislature adopt supplemental report language requesting UC and CSU to provide an implementation update by April 1, 2005. Specifically, UC and CSU should provide the following information regarding their implementation of the surcharge: (1) the policy they used to determine who would be subject to the surcharge, (2) the specific surcharge they applied, (3) an estimate of the number of students subject to the surcharge, and (4) the average number of excess units taken by these students. The Legislature then could review this material, reassess the associated budget estimates, and make appropriate budget adjustments.

Baccalaureate Surcharge

The Governor's budget proposes to establish a surcharge for CCC students who already have obtained a baccalaureate degree. Rather than paying $26 per unit, as the Governor's budget proposes for other CCC students, baccalaureate holders would pay $50 per unit. A typical full-time CCC student with a baccalaureate degree would pay $1,200 per year—still almost 40 percent less than the national average and only about 30 percent of their total education costs. The DOF estimates that approximately 48,000 full-time equivalent students would be subject to the surcharge, and CCC would generate an additional $18 million in associated student fee revenue.

We recommend the Legislature approve this baccalaureate surcharge. Akin to the Governor's proposal to institute an excess-unit surcharge for UC and CSU students, we think charging higher fees to CCC students who already have obtained a four-year college education would appropriately target state higher education subsidies where they are needed most.

INTERSEGMENTAL: FINANCIAL AID

The Governor's budget includes several financial aid proposals relating to the statewide Cal Grant program as well as the University of California (UC) and the California State University's (CSU) institutional aid programs.

Cal Grant Proposals. As Figure 1 shows, the Governor's budget includes four Cal Grant proposals. The Governor's budget funds an increase in the total number of Cal Grant awards to be issued in 2004-05, but it reduces the Cal Grant income ceilings. This latter proposal would reduce the number of new students who would qualify for the Cal Grant Entitlement program. Additionally, the Governor's budget reduces the Cal Grant for private university students by 44 percent (dropping the award from its current-year level of $9,708 to $5,482) and maintains Cal Grants for UC and CSU students at their current-year level (equal to the 2003-04 systemwide student fee at both segments). Because the Governor's budget proposes to increase the systemwide student fee at UC and CSU by 10 percent, Cal Grants for UC and CSU students would, for the first time in many years, be "decoupled" from the full systemwide fee. Whereas the income ceiling proposal and private university grant proposal would affect only new award cohorts, the public university grant proposal would affect both new and renewal cohorts.

Institutional Aid Proposals. Regarding institutional financial aid programs, the Governor's budget assumes that UC and CSU will set aside 20 percent of additional student fee revenue for need-based institutional aid. At CSU, the Governor's budget also proposes to eliminate a relatively small and specialized institutional aid program known as the Educational Opportunity Program (EOP).

Figure 1 compares the Governor's financial aid proposals with our recommended alternative. Our general approach is to restore reductions to the Cal Grant Entitlement program by freeing up resources elsewhere. Specifically, we recommend the Legislature reject the Governor's budget proposals to (1) lower the Cal Grant Entitlement program's income ceilings, (2) reduce the private university Cal Grant, and (3) decouple the public university Cal Grant from the proposed 2004-05 systemwide fee level. To offset these expenditures, we recommend the Legislature (1) not expand UC and CSU's undergraduate institutional aid programs and (2) approve the Governor's budget proposal to eliminate CSU's EOP program and make a comparable reduction to UC's base undergraduate institutional aid budget. In total, our alternative package would save $4.2 million compared to the Governor's proposal.

Figure 1

Financial Aid Proposals

(In Millions)

Budget Proposal	Change From 2003-04 Governor's Budget	Change From 2003-04 LAO Alternative	Change From 2003-04 Difference
Cal Grant Program			
Increase number of Cal Grants	$93.1	$73.3	-$19.8
Reduce income ceilings	-11.2	—	11.2
Reduce grant for private-college students	-32.7	1.5	34.3
Decouple grant from UC and CSU fees	—	18.7	18.7
Totals	**$49.2**	**$93.5**	**$44.3**
University of California			
Institutional aid augmentation for undergraduates	$19.4	—	-$19.4
Base reduction to undergraduate institutional aid	—	-$16.2	-16.2
Institutional aid augmentation for graduates	18.9	18.9	—
Totals	**$38.3**	**$2.7**	**-$35.6**
California State University			
Institutional aid augmentation for undergraduates	$12.9	—	-$12.9
Eliminate Educational Opportunity Program	-17.4	-$17.4	—
Institutional aid augmentation for graduates	13.5	13.5	—
Totals	**$9.0**	**-$3.9**	**-$12.9**
Net Effects	**$96.6**	**$92.4**	**-$4.2**

In this piece, we:

- Raise concerns regarding the projected Cal Grant cost estimates for the budget year.
- Analyze the Governor's budget proposals to lower the Cal Grant income ceilings, reduce the private university Cal Grant by 44 percent, and decouple the public university Cal Grant from UC and CSU's systemwide student fee levels.
- Assess the Governor's budget proposals to expand UC and CSU's primary institutional aid programs but eliminate CSU's EOP program.

CONCERNS WITH PROJECTED CAL GRANT COST ESTIMATES

As Figure 2 shows, since 2001-02, the Cal Grant A and Cal Grant B programs have been consistently overbudgeted. The *2001-02 Budget Act*, for example, provided $72 million more than was needed to fully fund the program that year. This represented a 14 percent budgeting error. This overestimation of costs was commonly attributed to the "newness" of the Cal Grant entitlement program. During its first year of operation, entitlement costs were uncertain and the state budgeted generously. The *2002-03 Budget Act*, however, continued to overbudget—providing $83 million, or 15 percent, more than needed to fully fund the program. For the current year, the Governor proposes to revert $50 million in excess Cal Grant funding, though the commission has not yet reconciled all its Cal Grant payments and even more may revert by the end of the fiscal year. We are concerned with both the magnitude and regularity of the overbudgeting these last three years.

Budget-Year Estimates Appear Inflated. As shown in Figure 1, the Governor's budget includes a net Cal Grant augmentation of $49 million, which represents growth of 8 percent. Although some growth in program costs would occur in a typical year due to population growth, the Governor's budget includes several proposals that would reduce program costs. Specifically, the Governor's budget proposes lowering Cal Grant income ceilings, thereby reducing the number of new students who would qualify for the program. It also proposes to provide no enrollment growth at UC and CSU and redirects 10 percent of their first-time freshmen to the community colleges. Finally, the proposal would reduce the maximum award amount for students attending private institutions. Taken together, these proposals would noticeably reduce Cal Grants costs. Given the size of the proposed augmentation, these changes do not appear to have been taken fully into account.

Figure 2

Cal Grant A and Cal Grant B Programs Consistently Overbudgeted

(Dollars in Millions)

	Cal Grant A and Cal Grant B Budget
2001-02	
Budget Act	$567.5
Revised budget	505.1
Actual expenditures	495.4
Reversion	**72.1 (14%)**
2002-03	
Budget Act	$612.1
Revised budget	556.7
Actual expenditures	528.9
Reversion	**83.3 (15%)**
2003-04	
Budget Act	$648.9
Revised budget	599.4
Reversion[a]	**49.5 (8%)**

a Current estimate.

Inflated Award Assumptions. One of our primary concerns is the trend to overestimate the number of new entitlement awards. As Figure 3 (see next page) shows, new entitlement awards have been significantly overestimated every year since the inception of the program. The Governor's budget appears to continue this trend by assuming that 66,000 new high school entitlement awards will be issued in 2004-05. This is almost 6,000 more awards than issued in the current year—despite the effect of the Governor's proposals to reduce the number of awards issued in the budget year. The Governor's budget also is likely to have overestimated the number of new transfer entitlement awards. Again, notwithstanding the Governor's offsetting budget-year proposals, it assumes 32 percent growth in the number of new transfer entitlements issued in 2004-05. Given prior-year take rates and attrition rates, we also have concerns that the Governor's assumption of 40 percent growth in the number of renewal competitive awards is likely to be too high.

Figure 3

New High School Entitlement Awards Have Been Overestimated Every Year

	2001-02	2002-03	2003-04
Awards assumed in *Budget Act*	72,568	65,000	66,000
Actual awards issued	48,420	60,743	60,359
Overestimate	**24,148**	**4,257**	**5,641**

Excess Funding Should Be Used for Identified Cal Grant Needs

We recommend the Legislature adopt more realistic Cal Grant assumptions, thereby generating $20 million that could be used for identified Cal Grant needs.

Given the trend over the last three years to substantially overestimate Cal Grant awards, overfund Cal Grant costs, and revert substantial savings at year's end, we recommend the Legislature initially adopt more realistic budgeting assumptions. Figure 4 lists the various adjustments we recommend. Specifically, given our concerns expressed above, we recommend the Legislature make more realistic assumptions regarding the number of new and renewal awards to be issued in the budget year. Additionally, we recommend the Legislature revert an additional $1.5 million (on top of the $50 million the Governor's budget reflects) that the commission already is reflecting as current-year savings.

The aggregate fiscal effect of all these changes is $20 million in General Fund savings. We recommend these monies be designated in the budget year for maintaining the existing Cal Grant eligibility pool and sustaining existing Cal Grant entitlement benefits, as discussed below.

INCOME CEILINGS

The Governor's budget proposes to lower the Cal Grant income ceilings by 10 percent. The proposal would apply to both the Cal Grant A and Cal Grant B programs and to both dependent and independent students. The change, however, would affect only new award cohorts (not existing Cal Grant recipients). The Governor's budget assumes this proposal would achieve $11 million in General Fund savings—all attributable to fewer students qualifying for entitlement awards. The proposal would result in approximately 5,000, or 8 percent, fewer entitlement awards being issued in 2004-05, with a slightly greater loss in Cal Grant A awards than Cal Grant B awards. (No savings would be associated with the competitive program because the number of new competitive awards already is capped at 22,500. Thus, reducing the income ceilings merely would change slightly the income profile of competitive recipients.)

Figure 4

More Realistic Award Assumptions Would Save $20 Million

	Assumed Number of Awards	Associated General Fund Savings (In Millions)
New High School Entitlement Awards		
Governor's budget	66,000	—
LAO recommendation	60,500	$10.1
New Transfer Entitlement Awards		
Governor's budget	3,000	—
LAO recommendation	2,500	$1.8
Renewal Competitive Awards		
Governor's budget	31,940	—
LAO recommendation	29,540	$6.4
Current-Year Reversion[a]		$1.5
Total Savings		**$19.8**

[a] This would be in addition to the $50 million already included in the Governor's budget.

Adhere to Existing Policy for Adjusting Cal Grant Income Ceilings

Rather than reducing the Cal Grant income ceilings, we recommend the Legislature adhere to its existing statutory policy for annually adjusting these ceilings. Unlike the Governor's proposal, which reduces the number of students eligible for entitlement benefits (but simultaneously enlarges the University of California and the California State University's institutional aid programs), we recommend the Legislature retain the existing entitlement eligibility pool. In the budget year, this would help many middle-income students cover likely increases in student fees and tuition and would prevent some of California's financially neediest students from being denied entitlement benefits.

In 2000, when the Legislature enacted legislation creating the Cal Grant Entitlement program, it set in statute both the income ceilings that would be operative for the 2001-02 award year and the mechanism for annually adjusting these ceilings in the future. Specifically, the commission was directed to annually adjust the ceilings based on the percent change in California's per capita income from the preceding year—consistent with the annual adjustments made to many other education programs. The commission has adjusted the ceilings each of the last three years.

Statutorily Derived Income Ceilings About 14 Percent Higher Than Ceilings Proposed in Governor's Budget. Figure 5 compares the 2004-05 income ceilings generated by the Governor's budget proposal with the income ceilings that would be generated based on current law. Our current estimate of the change in per capita income for 2003 is 3.5 percent, so the amounts listed under "Current Law" simply reflect the current-year ceilings adjusted by this percentage. These ceilings would be about 14 percent higher than the ceilings proposed in the Governor's budget. (As one way of assessing the appropriateness of California's income ceilings, we compared them with the income ceilings other states use for their financial aid programs. Please see the nearby gray box for our findings.)

Figure 5

Cal Grant Income Ceilings

2004-05
(Rounded to Nearest $100)

	Cal Grant A		Cal Grant B	
	Proposed	**Current Law**	**Proposed**	**Current Law**
Dependent Students				
Family Size				
Two	$54,000	$62,100	$25,200	$29,000
Three	55,300	63,500	28,400	32,600
Four	60,000	69,000	31,600	36,300
Five	64,400	74,000	35,300	40,600
Six+	69,400	79,800	38,200	43,900
Independent Students				
Marital Status				
Single	$22,100	$25,400	$22,100	$25,400
Married	25,200	29,000	25,200	29,000

Proposed Lowering of Cal Grant A Income Ceilings Would Affect Many Middle-Income Students Across All Higher Education Segments. The Cal Grant program is essentially a two-tiered system that offers a tuition / fee award for middle-income students (through the Cal Grant A program) and both a tuition / fee award and a subsistence award for the financially neediest students (through the Cal Grant B program). The Cal Grant A income ceilings are higher than the Cal Grant B ceilings. The Cal Grant A program, therefore, helps many middle-income students attending all of California's higher education segments—including UC and

Few Other States With Explicit Income Ceilings

In assessing the appropriateness of California's income ceilings, few other states lend themselves as direct comparisons. This is because few other states have explicit income ceilings above which students no longer qualify for financial aid. Instead, most states use a modified form of the federal needs methodology to determine students' eligibility for state-funded financial aid. The federal needs methodology considers a student's total cost of attendance at a particular college and then subtracts from this cost the student's expected family contribution (EFC). If students' EFC is insufficient to cover their total costs (including living expenses), then they are deemed financially needy. Students' EFC is driven largely by family income, assets, family size, and the number of family members simultaneously attending college.

Of the few states that have income ceilings, California appears competitive. For example, New York funds a large need-based entitlement program for full-time college students (the Tuition Assistance Program). Its current income ceiling for dependent students is $80,000, which is slightly higher than California's Cal Grant A income ceiling. New York's income ceiling for independent students, however, is $10,000, which is substantially lower than California's ceiling for independent students. (New York's income ceilings do not vary by family size.) By comparison, Ohio's income ceilings for dependent students range from $35,000 for an only-child family to $39,000 for a five-child family. These ceilings roughly are comparable to California's Cal Grant B ceilings but substantially lower than the Cal Grant A ceilings. For independent students, Ohio's income ceiling is $16,300, or almost $6,000 less than California's comparable ceiling.

Given so few other states use explicit income ceilings, only tenuous conclusions can be drawn about the reasonableness of California's ceilings relative to other states' policies.

CSU—cover their educational fees. (In 2003-04, more Cal Grant A High School Entitlement awards were issued to UC students than to students attending any other segment and, together, UC and CSU students received more than half of all these awards.) Retaining aid benefits for middle-income students is likely to become increasingly important as student fees are raised (as is proposed for 2004-05).

Lowering Cal Grant B Income Ceilings Directly Affect Some of the Financially Neediest Students. As described above, the Cal Grant B income ceilings are intended to identify those students that are so financially needy that the state will provide them with not only a tuition/fee award but also a subsistence award. To lower the Cal Grant B income ceilings, as proposed in the Governor's budget, therefore would result in some of California's financially neediest students losing all their entitlement benefits. (This is very different from lowering the Cal Grant A income ceilings, which would affect the least needy of the overall Cal Grant eligibility pool.) We think the Legislature has many other options it could consider before denying these students Cal Grant benefits. As part of our alternative aid package, we identify several of these options.

Fiscal Effect of Adhering to Longstanding Policy. Relative to the Governor's budget, it costs approximately $11 million to adhere to existing policy and adjust the current-year income ceilings by the percent change in California's per capita income. As part of our alternative aid package, we have identified resources elsewhere that are sufficient to cover this cost (and still generate net General Fund savings).

In sum, we recommend the Legislature continue to adhere to its longstanding and statutorily based practice of annually adjusting the Cal Grant income ceilings consistent with the percent change in California's per capita income. This would allow the Legislature to continue helping middle-income students at all the state's higher education segments cover their educational fees while simultaneously maintaining entitlement benefits for some of California's financially neediest students.

THE PRIVATE UNIVERSITY CAL GRANT

The Governor's budget proposes to reduce the maximum Cal Grant for students attending private colleges and universities by 44 percent—from the current-year level of $9,708 to $5,482. The administration sets the new maximum private university award equivalent to the proposed 2004-05 UC systemwide student fee. (The rationale for this particular link is unclear.) The proposal would affect only new Cal Grant recipients; thus students obtaining Cal Grants before 2004-05 would retain their higher-value award. The Governor's budget assumes that the proposal would generate $33 million in General Fund savings. Below, we discuss our concerns with this proposal. (In the gray box at the end of this section, we also discuss the argument sometimes made that reducing the private university Cal Grant is a way to ensure private universities are sharing the budget "pain" felt by public universities.)

Link Private University Cal Grant to Standard Subsidy

We recommend the Legislature adopt a long-term Cal Grant policy through legislation that would link the private university Cal Grant to the weighted average General Fund subsidy the state provides for financially needy students attending the University of California and the California State University. For 2004-05, this policy actually would result in a slight increase in the private university Cal Grant (raising it to $9,906).

Rather than reducing the maximum Cal Grant for financially needy students attending private colleges and universities by $4,226, or 44 percent, we recommend providing these students a subsidy equivalent to that provided to needy students at the public universities. Specifically, we recommend setting the private university grant at the weighted average of the General Fund subsidy provided for each additional UC and CSU student plus the weighted average of the public university Cal Grant. This formula is a simple means by which the state can ensure that it provides about the same amount of support for all financially needy students (taking into account actual costs students incur at the public universities). Figure 6 (see next page) shows how we calculate our recommended 2004-05 grant amount using this formula. Given the fee component of the formula, this long-term aid policy would be linked logically and consistently with a long-term fee policy (if one were to be adopted).

This recommendation (1) is consistent with the state's historical private university Cal Grant policies, (2) treats financially needy students attending private and public universities equitably, and (3) preserves the value of the award over time. Later in this analysis, we also recommend that the state continue to adhere to its historical public university Cal Grant policies by maintaining the link between UC and CSU fees and the value of the public university Cal Grant. (That is, we recommend that the Cal Grant for UC and CSU students continue to cover their total systemwide fees.)

Restores Long-term Policy Basis. When determining how much to provide a financially needy student for college, the state typically tries to balance its policy goals of access and choice with fiscal fairness. Thus, the state generally has attempted to provide the same subsidy for all financially needy students, with some adjustment made for the actual costs

Figure 6

Private University Cal Grant Using Long-Term Aid Policy

2004-05

General Fund Marginal Cost[a]		
UC	$8,050	
CSU	5,773	
Weighted average[b]		**$6,551**
Public University Cal Grant[c]		
UC	$5,482	
CSU	2,250	
Weighted average[b]		**$3,355**
Private University Cal Grant		**$9,906**

a Reflects base subsidy provided for each additional UC or CSU student. Does not include funds the state provides for capital outlay, overhead, or institutional aid.

b Students attending UC and CSU comprise 34 percent and 66 percent, respectively, of all four-year public university students.

c Reflects additional state subsidy that covers systemwide fees for financially needy students attending UC or CSU.

a student incurs. Historically, the Cal Grant award for financially needy students attending private universities has been roughly equal to the state subsidy provided to financially needy students attending public universities. Indeed, for many years, the state had a long-term grant policy in statute. The policy stated, "The maximum award for students attending nonpublic institutions shall be set and maintained at the estimated average General Fund cost of educating a student at the public four-year institutions of higher education."

Reconnects Budgeting With Underlying Policy Basis and Promotes Fiscal Fairness. Throughout the mid-to-late nineties, the state's budgeting practices generally reflected this long-term statutory policy. As Figure 7 shows, from 1995-96 through 2000-01, the state annually adjusted the private university Cal Grant. Our recommendation would have the same effect of annually adjusting the private university Cal Grant. Moreover, the formula we recommend ensures that the state provides about the same level of support for all financially needy students regardless of whether they attend a private or public university. It does this by linking the private university grant directly to the General Fund subsidy the state provides to financially needy students attending UC and CSU.

Figure 7

Private University Grant Change Over Time

Maximum Award Amounts

	Actual Award	Value in 2004-05 Dollars	Year-to-Year Change in Real Value
1994-95	$5,250	$6,675	—
1995-96	5,250	6,516	-2%
1996-97	7,164	8,681	33
1997-98	8,184	9,704	12
1998-99	9,036	10,506	8
1999-00	9,420	10,543	—
2000-01	9,708	10,448	-1
2001-02	9,708	10,326	-1
2002-03	9,708	10,097	-2
2003-04	9,708	9,931	-2
2004-05[a]	5,482	5,482	-45

[a] Governor's budget proposal.

Stops Devaluation of Award. As Figure 7 shows, the last time the state increased the maximum private university Cal Grant award was in 2000-01—when the award was raised from $9,420 to $9,708. Given inflation, the real value of the award therefore has declined 6 percent over the last four years. The Governor's budget proposal would reduce the award in real terms by an additional 45 percent—dropping the award to its lowest value in more than a decade. By comparison, our recommendation both retains the real value of the award and links it to an underlying policy basis that treats financially needy students fairly and consistently.

Fiscal Effect of Adopting Long-Term Private University Cal Grant Policy. Our recommendation would increase Cal Grant costs by $1.5 million over the current-year level. However, the Governor's grant-reduction proposal would achieve $32.7 million in savings. Thus, relative to the Governor's budget, our recommendation would result in a $34.3 million General Fund cost. As Figure 1 indicates, our alternative aid package identifies sufficient resources to cover this cost and still achieve net General Fund savings.

THE PUBLIC UNIVERSITY CAL GRANT

The Governor's budget proposes to decouple the Cal Grant for UC and CSU students from the systemwide student fee level at each of the segments. Thus, rather than increasing the public university Cal Grant to cover the proposed 10 percent fee increases, the maximum Cal Grant for students attending UC and CSU would remain at the current-year levels of $4,984 and $2,046, respectively. In other words, although the Governor's budget proposes fee increases, it does not propose a corollary increase to the value of the UC and CSU Cal Grant. We estimate this results in $18.7 million of cost avoidance in 2004-05.

Private University Cal Grant Serves Financially Needy Students At Many Kinds of Higher Education Institutions

During difficult fiscal times, some policymakers argue that the private university Cal Grant should be reduced as one way to ensure that private universities share the budget "pain" felt by public universities. The purpose of the Cal Grant program, however, is not to enrich private universities but to promote access and choice for financially needy students at many kinds of colleges and universities. Although some private institutions are well endowed and might be able to offset any reduction made to their financially needy students' Cal Grant awards, many other private institutions are unlikely to be able to offset a reduction. Indeed, financially needy students who attend one of these latter types of colleges because it is close to home, small, or offers a specialized program aligned with their educational and career objectives are likely to be affected directly by a substantial reduction in their Cal Grant award. For some financially needy students, the reduction might mean not attending or postponing college or going to a less expensive college. Moreover, given the no enrollment growth and first-time freshmen redirection proposals in the Governor's budget, some of these students might have even fewer choices. In this environment, maintaining incentives to enroll in private institutions might be particularly important.

Retain Existing Policy Basis Used to Set Value of Public University Cal Grant

Rather than decoupling the public university Cal Grant from the University of California and the California State University's systemwide fee level, we recommend the Legislature adhere to existing law and existing budgeting practice and increase the grant to cover the entire systemwide fee. This would send the clear and consistent message that financially needy students at all three public higher education segments will continue to receive full student fee coverage.

Rather than decoupling the public university Cal Grant from UC and CSU's systemwide fee level, we recommend the Legislature increase the grant to the proposed 2004-05 systemwide fee levels at UC and CSU. This would increase the Cal Grant for UC students from its current-year level of $4,982 to $5,482, and it would increase the Cal Grant for CSU students from its current-year level of $2,046 to $2,250. This recommendation (1) retains the existing long-term policy basis for the public university Cal Grant and (2) reconnects budgeting practices with this policy. In addition, it would not generate any additional net cost for the state because we further recommend redirecting new institutional aid monies to the Cal Grant program.

Retains Existing Long-Term Policy Basis. Even prior to the creation of the Cal Grant Entitlement program, the state's long-term statutory policy had been to link the public university Cal Grant with systemwide student fees at UC and CSU. Historically, students' educational fees have been viewed as the major fiscal hurdle to attending college. Although living costs are a substantial component of overall college costs, these costs are borne by all individuals whether or not they attend college. Thus, the state's primary goal has been to cover all systemwide student fees. Our recommendation to maintain the integrity of the public university Cal Grant by linking it to the 2004-05 systemwide fee level therefore is consistent with the state's overall Cal Grant policy.

Reconnects Budgeting With Long-Term Policy Basis. Over the last 15 years, the public university Cal Grant has covered total systemwide student fees at UC and CSU every year except one. (In 1992-93, the public university Cal Grant covered 75 percent and 70 percent of UC and CSU systemwide fees, respectively.) In every other year, the public university Cal Grant equaled or exceeded the systemwide fee level. Thus, decoupling the public university Cal Grant from the systemwide fee level would be a noticeable departure from typical budgeting practice. Moreover, since the inception of the entitlement program, the Cal Grant has always covered the full systemwide fee at UC and CSU. Our recommendation therefore would reconnect the state's budgeting practice with its long-term underlying policy objectives.

Does Not Create Any Additional Net Cost—Uses New Institutional Aid Monies More Transparently. We estimate the additional Cal Grant funding required by the proposal would total $19 million, and we have identified funding that would be sufficient to cover this cost. Specifically, the Governor's budget assumes augmentations for both UC and CSU's undergraduate institutional aid programs (totaling $32 million in redirected student fee revenue). We discuss these institutional aid programs in more detail in the following section.

THE INSTITUTIONAL AID SET ASIDE

The UC's primary need-based institutional aid program is the University Student Aid Program (USAP), and CSU's primary need-based aid program is the State University Grant (SUG) program. As in prior years, the Governor's budget proposes to allow UC and CSU to set aside a portion of additional student fee revenue for these institutional aid programs. Specifically, the Governor's budget proposes that UC and CSU set aside 20 percent of all additional student fee revenue for institutional aid. This would be a modest deviation from the typical budgeting practice over the last decade, which has been to set aside one-third of all additional fee revenue. For 2004-05, we estimate the 20 percent set aside would increase UC and CSU's institutional aid budgets by $38 million and $26 million, respectively. As Figure 8 shows, within each segment, the new funds are distributed almost evenly between undergraduate and graduate students.

No Analytical Basis for Set Aside. Neither the concept of a set aside nor the mechanism for calculating the set aside ever has had a solid analytical basis. For example, neither UC nor CSU has had a consistent policy regarding what "new" fee revenue counts toward the set aside. Some years, for example, CSU has counted fee revenue generated from enrollment growth toward the set aside whereas other years it has counted only fee revenue generated from fee increases. Similarly, in the budget year, both segments suggest they will set aside fee revenue associated with the proposed systemwide fee increase but not the proposed excess unit surcharge. Moreover, the precise percentage of additional fee revenue set aside for aid has varied over time. For example, from 1990-91 through 1993-94, UC set aside a different percentage each year (gradually increasing from 20 percent to 32 percent). In short, the general notion as well as specific calculation for the set aside has changed frequently and unpredictably.

Figure 8

Governor's Budget Expands UC and CSU's Aid Programs

(In Millions)

	2004-05 Augmentation
University of California	
Undergraduate students	$19.4
Graduate students	18.9
Subtotal	$38.3
California State University	
Undergraduate students	$12.9
Graduate students	13.5
Subtotal	$26.4
Total	**$64.7**
Undergraduate students	$32.2
Graduate students	32.5

Large Growth in Institutional Aid in Current Year. The set aside also has resulted in exceptionally large increases to UC and CSU's institutional aid budgets. Figure 9 (see next page) shows the growth in UC and CSU's institutional aid budgets between 2002-03 and 2003-04. As the figure shows, during this brief period, despite the state's difficult fiscal situation, these aid budgets grew dramatically. The UC's institutional aid budget grew by $118 million, or 50 percent, whereas CSU's SUG budget grew by $76 million, or 66 percent.

Exceptional Augmentations Disconnected From Actual Need. The current year was anomalous in that UC and CSU's institutional aid budgets increased to reflect both slightly higher than normal enrollment growth and large fee increases. These factors led to a substantial increase in student fee revenue, and one-third of this increase was redirected to institutional aid programs. Although the additional students and higher fees undoubtedly increased the total financial need of students at UC and CSU, the actual size of the augmentations was entirely disconnected from any measure of actual need. Moreover, the augmentations were much greater than needed to hold UC and CSU's aid budgets harmless. Indeed, the sizeable augmentations resulted in both substantially more stu-

Figure 9

UC and CSU's Institutional Aid Programs Grew Dramatically in Current Year

(Dollars in Millions)

	2002-03	2003-04	Change From 2002-03 Amount	Change From 2002-03 Percent
University of California				
Undergraduate students	$149.4	$230.5	$81.1	54%
Graduate students	85.5	122.2	36.7	43
Subtotals	$234.9	$352.8	$117.8	50%
California State University				
Undergraduate students	$95.9	$161.9	$66.0	69%
Graduate students	19.1	29.1	9.9	52
Subtotals	$115.1	$191.1	$76.0	66%
Totals	**$350.0**	**$543.8**	**$193.8**	**55%**
Undergraduate students	$245.3	$392.4	$147.2	60%
Graduate students	104.7	151.3	46.6	45

dents receiving awards—in excess of enrollment growth—and substantially larger awards—in excess of that needed to cover the fee increases. For example, at CSU, the number of SUG recipients grew by 16 percent between 2002-03 and 2003-04—considerably more than the 4 percent enrollment growth CSU achieved. Similarly, the average SUG award grew by 43 percent—noticeably more than CSU's 35 percent fee increases.

Below, we focus specifically on the Governor's budget proposal to further expand UC and CSU's undergraduate institutional aid programs. Because the state currently does not have a comparable Cal Grant-like program for graduate students, we do not have the same concerns with the Governor's budget proposal for graduate institutional aid. The lack of a state-structured program for graduate students, coupled with the sizeable fee increases the Governor's budget proposes for graduate students, actually suggests that some augmentation to graduate institutional aid programs is warranted. Thus, over the short term, we recommend the Legislature approve the Governor's budget proposal to augment UC and CSU's graduate institutional aid programs by $32.5 million (though we also recommend the Legislature begin to consider other options for promoting graduate education). In contrast, as we discuss in more detail below, we have several concerns with the Governor's budget proposal to augment undergraduate institutional aid.

Maintain Integrity of Cal Grant Program Before Further Expanding Undergraduate Institutional Aid

Rather than augmenting the University of California (UC) and the California State University's (CSU) undergraduate institutional aid programs, we recommend the Legislature achieve $32.2 million in General Fund savings and use the freed up resources to sustain existing Cal Grant entitlement benefits. We think maintaining existing Cal Grant benefits is of higher priority than further expanding institutional aid programs because the Cal Grant program (1) is more transparent and easier for students to understand, (2) already accounts for segment-specific differences, and (3) allows the state more simply and directly to address critical policy trade-offs.

We think maintaining existing Cal Grant benefits is of higher priority than further expanding UC and CSU's institutional aid programs. Compared to UC and CSU's institutional aid programs, the Cal Grant program: (1) is more transparent, (2) already accounts for specific cost differences at each of the segments, and (3) allows the state to address critical policy trade-offs more comprehensively and coherently. Moreover, even if UC and CSU's undergraduate institutional aid programs were not expanded in the budget year, they would retain a total of $392 million in their base budgets (as shown in Figure 9).

Cal Grant Program Intended to Simplify and Streamline Complicated Aid System. As most students and policymakers alike can attest, the realm of financial aid is complicated. Multiple entities (including the federal government, state government, universities, corporations, and philanthropists) offer financial aid, and the aid they offer comes in multiple forms (including grants, scholarships, loans, work-study, tax credits, and savings plans). The CSU Sacramento's Financial Aid Office, for example, has accounting codes for almost 300 different financial aid programs. Dating from 1976, Education Code Section 69530 even has a provision declaring, "The entire student aid system, due to a proliferation of programs, has resulted in substantial confusion and inefficiencies." The subsequent provision finds that "One statewide student assistance program supplementary to the Pell Grant Program would increase simplicity and effectiveness. The most appropriate program for this purpose is the Cal Grant program."

Cal Grant Program More Transparent, Sends Clearer Message. Not only is the Cal Grant program intended to simplify and streamline the system, but it also is one of the few financial aid programs whose eligibility criteria and aid benefits are specified explicitly in statute. Additionally, since the enactment of the entitlement program, neither the eligibility criteria nor the aid benefits have changed, and the California Student Aid Commission has devoted substantial time and resources to advertising these benefits. Under our recommendation, these benefits would remain intact. For example, financially needy students attending UC and CSU would know that their Cal Grant award would continue to cover all systemwide student fees—just as it had for prior Cal Grant recipients.

Institutional Aid Programs Not in Statute, Evolve Annually, Lack Clear Message. In contrast, neither UC's USAP program nor CSU's SUG program is in statute. Moreover, UC and CSU's institutional aid policies and practices often change, and neither policymakers nor students are notified in advance of the changes. For example, following the enactment of the Cal Grant Entitlement program, CSU decided to substantially revise its aid policies—increasing its maximum award and decreasing its need requirement. It did not share these changes formally with the Legislature until two years after the fact, and only then due to a newly established reporting requirement. Similarly, in the current year, UC created an entirely new institutional aid program for students with family incomes between $60,000 and $90,000—students who in prior years would not have met UC's own definition of financially needy. It created the program only months before the beginning of the fall term. (Thus, it very likely had little, if any, impact on students' enrollment decisions.) Similarly, for the budget year, neither UC nor CSU can clearly specify how they would use their institutional aid monies. Thus, under the Governor's proposal to augment institutional aid, financially needy students at best could only speculate as to what kinds of existing or new aid UC or CSU might provide them. In contrast, under our recommendation, students would know if they qualified for a Cal Grant and they would know the actual value of the award they would receive.

Cal Grant Program Already Segment-Specific. Although one might argue that institutional aid programs need to expand as a way to help each segment address the unique needs of its students, the Cal Grant program already accounts for the most important cost differences among the segments. Indeed, the complexity of the Cal Grant program is due entirely to its efforts to tailor its benefits to segment-specific needs. For example, because the UC systemwide student fee is higher than the CSU fee, the state already offers a larger Cal Grant to financially needy students attending UC. Additionally, because financially needy students at community colleges already receive a Board of Governor's fee waiver, their Cal Grant covers only subsistence costs (for example, living, food, and transportation costs). In the budget year, under our recommendation, these segment-specific differences would continue to be addressed through the Cal Grant program.

Cal Grant Makes Segment-Specific Trade-Offs Explicit—Prevents New Disparities From Emerging. In their institutional aid programs, the segments can develop increasingly idiosyncratic definitions of need. For example, a student deemed financially needy at UC and deserving of a UC institutional aid grant, might be considered less needy at CSU and ineligible for a CSU institutional aid grant. This actually is already the case. For example, in 2001-02, the median income of a need-based aid recipient at CSU was only half the median income of a need-based aid recipient at UC ($12,200 and $25,700, respectively). Under our recommendation, the Legislature can better coordinate and align aid opportunities by making all critical trade-offs through the Cal Grant program. For example, the Legislature could decide to increase the Cal Grant A income ceilings to help all upper middle-income students attending UC. By making these decisions through the Cal Grant program, the Legislature would be able to assess more easily the relative costs and benefits of these options.

In short, we recommend the Legislature capture $32.2 million in General Fund savings by rejecting the Governor's budget proposal to augment UC and CSU's institutional aid programs. Alternatively, we recommend the Legislature use these freed up resources to sustain existing Cal Grant entitlement benefits. This would provide greater transparency for financially needy students (promising that student fee increases will be covered) and much greater transparency for the Legislature (allowing it to compare critical trade-offs in a comprehensive, coherent, and consistent fashion).

Eliminate Small, Specialized Institutional Aid Programs

In addition to not expanding the University of California (UC) and the California State University's (CSU) major institutional aid programs, we recommend eliminating their small, specialized institutional aid programs. Specifically, we recommend the Legislature approve the Governor's budget proposal to eliminate CSU's Educational Opportunity Program as well as capture additional savings by eliminating UC's University Fee Grant program. These programs result in disparities both among and within the segments and are not well coordinated with the state's larger financial aid objectives.

In addition to the SUG program, CSU offers the EOP program—a small, specialized institutional aid program. This program provides low-income undergraduate students with a supplemental grant of up to $2,000 that may be used for student fees (if the recipient does not also have a Cal Grant or SUG) and / or living expenses. Grants may be renewed until the student has received a baccalaureate degree or has completed five academic years (whichever comes first). Although the 1995 statute reauthorizing the program required that academic records of EOP grant recipients be kept so the program could be evaluated, the Chancellor's Office does not collect this information regularly, and the program has not been evaluated in the eight years since its reauthorization. For the last three years, funding for the program has remained constant at $17 million annually. The Governor's budget proposes to eliminate the program, thereby achieving $17 million in General Fund savings.

In addition to the USAP program, UC began a new institutional aid program in the current year—the University Fee Grant program. Begun in an effort to alleviate the sticker shock of the 2003-04 fee increases, this program provided students who formerly would have been ineligible for UC aid with a grant of $778 to cover half of the current-year fee increase. These students did not demonstrate financial need by UC's own criteria. As mentioned above, UC does not yet know if it will retain this program in the budget year, and the Governor's budget is silent as to its future.

These Types of Programs Create Disparities Across Systems. Although well-intentioned, programs such as the EOP program and the new University Fee Grant program can produce undesirable disparities. For example, although the Governor's budget proposes reducing the income ceilings for both the Cal Grant A and Cal Grant B program, the EOP income ceilings actually are scheduled to rise in 2004-05. Moreover, the EOP income ceilings already are higher than the Cal Grant B income ceilings. Additionally, under the Governor's proposal, a small select group of middle-income students might continue to receive a UC fee grant while some financially needier students attending other segments would be losing basic Cal Grant entitlement benefits.

These Types of Programs Create Disparities Within Systems. An illustration of the disparities that can result within systems is the effect the University Fee Grant program had on UC's work / loan expectation for undergraduate students. The work / loan expectation is how UC attempts to ensure equity across students. Typically, UC applies the same work / loan expectation—about 12 hours to 15 hours of work a week and a low-interest loan of approximately $4,000 annually—for all its students. (Historically, by assuming a consistent, manageable work / loan expectation, UC has been able to package sufficient financial aid to help all financially needy students meet all their college costs.) The UC deviated from this aid model in 2003-04—the result of which was to disregard its own equity goals and allow nonneedy students to have a lower work-loan expectation. This, in turn, meant that the work-loan expectation was higher than it otherwise would have been for poorer students.

Not Well Coordinated With State's Overall Financial Aid Objectives. These small institutional aid programs are not well aligned with the state's overall financial aid objectives. Given the state's fiscal challenges, we do not think it should be sustaining programs that retain or enlarge benefits for less needy or nonneedy students. Additionally, rather than providing specialized benefits (such as an EOP grant) to only a select group of students when many other students are equally needy and deserving, we think the Legislature should make budget-year adjustments through the Cal Grant program. Given the Cal Grant program is a statewide program benefiting students across all higher education segments, it is a better vehicle than institutional aid programs for ensuring that financially needy students are being treated fairly and appropriately.

In sum, we recommend the Legislature approve the Governor's budget proposal to eliminate the EOP program (for $17 million in General Fund savings) as well as eliminate $16.2 million from UC's base undergraduate institutional aid budget. Although UC still has not yet decided whether it will continue the University Fee Grant program in 2004-05, we think the use of the $16.2 million in the current year for students who are not needy by UC's own definition demonstrates that higher statewide financial aid priorities exist. Furthermore, these small specialized programs generate disturbing disparities among and within the segments and are not well coordinated with the state's extensive Cal Grant program.

UNIVERSITY OF CALIFORNIA (6440)

The University of California (UC) consists of eight general campuses and one health science campus. The university is developing a tenth campus in Merced. The Governor's budget proposal includes about $18.4 billion for UC from all fund sources—including General Fund, student fee revenue, federal funds, and other funds. This is a decrease of $420 million, or 2.3 percent, from the revised current-year amount. The budget proposes General Fund spending of $2.7 billion for the segment in 2004-05. This is a decrease of $232 million, or 8 percent, from the enacted 2003-04 budget and a decrease of $198 million, or 6.9 percent, from the Governor's proposed revision of the 2003-04 budget.

For the current year, the Governor proposes a $15.7 million unallocated General Fund reduction and a $12.2 million targeted reduction to UC's K-14 outreach programs. The Governor proposes to make these reductions pursuant to Section 27.00 of the *2003-04 Budget Act*. In addition, the Governor proposes to reduce funding in the current year for UC's labor research institute by $2 million. For the budget year, the Governor proposes $82.1 million in General Fund augmentations, $360 million in General Fund reductions, and a $79.9 million net increase for various baseline adjustments. Figure 1 indicates changes from the enacted 2003-04 budget to the revised 2003-04 budget. It also describes the Governor's 2004-05 General Fund proposals.

Proposed Augmentations. The Governor's budget provides UC with an $80.5 million General Fund augmentation to restore a one-time unallocated reduction made in 2003-04. The budget also includes $1.6 million in General Fund support for UC to provide counseling services to students that participate in the Governor's proposed dual admissions program for otherwise eligible students. Under this new program, students who are eligible to attend the university directly from high school would be admitted to a specific UC campus provided they first complete a transfer program at a community college. (The UC currently operates a similar program for ineligible students.)

Figure 1

University of California
General Fund Budget Proposal

(Dollars in Millions)

	General Fund
2003-04 Budget Act	**$2,902.1**
Mid-Year Reductions[a]	
One-time unallocated reduction	-$15.7
Reduce outreach programs	-12.2
Reduce labor research institute funding	-2.0
Subtotal	-($29.9)
Other Adjustments	
Public Employees' Retirement System rate adjustment	$0.2
Unexpended balance from lease revenue	-4.2
2003-04 Revised Budget	**$2,868.2**
Baseline and Technical Adjustments	$79.9
Proposed Increases	
Restore one-time reduction from 2003-04	$80.5
Dual admissions program	1.6
Subtotal	($82.1)
Proposed Reductions	
Unallocated reduction (to be backfilled with increased student fee revenue)	-$195.8
Reduce academic and institutional support	-45.4
Increase student-faculty ratio	-35.3
Reduce freshman enrollment	-24.8
Expand mid-year outreach reduction (for a total of$33.3 million)	-21.1
Eliminate Digital California Project	-14.3
Reduce funding for research by 5 percent	-11.6
Eliminate subsidy for excess course units (Phase I)	-9.3
Expand mid-year reduction to labor research institute	-2.0
Subtotal	(-$359.7)
2004-05 Proposed Budget	**$2,670.5**
Change From 2003-04 Revised Budget	
Amount	-$197.7
Percent	-6.9%

[a] Proposed under Section 27.00 of the *2003-04 Budget Act*.

Proposed Reductions. While the Governor's budget proposes $84.8 million in General Fund augmentations, it also proposes $360 million in General Fund reductions. These reductions consist of:

- $196 million unallocated reduction. (As we discuss below, increased student fee revenue is expected to backfill this reduction.)
- $45.4 million from reducing academic and institutional support by 7.5 percent.
- $35.3 million from increasing the student-faculty ratio by 5 percent (from 19.7:1 to 20.7:1).
- $24.8 million from reducing freshman enrollment by 10 percent. These students would instead be directed to the new dual admissions program, as discussed above.
- $21.1 million to expand the reduction to K-14 outreach programs proposed by the Governor in the current year to $33.3 million. (This proposal would eliminate all General Fund support for UC's outreach programs.)
- $14.3 million from eliminating the California Digital Project.
- $11.6 million from reducing research support by 5 percent.
- $9.3 million for the first phase of eliminating General Fund support for students that exceed by more than 10 percent the minimum number of units for their degree programs.
- $2 million to expand the proposed mid-year reduction and eliminate all General Fund support for the labor research institute.

Student Fee Increases

For 2004-05, the Governor's budget assumes increases in systemwide fees for undergraduate and graduate students, professional school fees, and nonresident tuition. (Although the budget assumes these increases, student fees at UC are established by the UC Board of Regents.) The fee increases are expected to provide an additional $196 million in student fee revenue that would fully backfill the proposed unallocated reduction to UC's General Fund support.

Undergraduate and Graduate Systemwide Fees. Figure 2 summarizes the Governor's proposed increases in undergraduate and graduate systemwide fees. As the figure shows, the budget assumes an increase of 10 percent in the systemwide fee (educational and registration fees) for undergraduate students. The budget also assumes a 40 percent increase in the systemwide fee for graduate students. When combined with campus based fees, the proposed total student fee for a full-time student in 2004-05 is $6,028 for undergraduates and $8,931 for graduates. In addition to the systemwide and campus-based fees, professional school students and nonresident students also pay special supplementary fees, as we discuss below.

Figure 2

UC Systemwide Fees[a]
For Full-Time Undergraduate and Graduate Students

			Change From 2003-04	
	2003-04	Proposed 2004-05	Amount	Percent
Undergraduates	$4,984	$5,482	$498	10%
Graduates	5,219	7,307	2,088	40

a Amounts include educational fee and registration fee.

Professional School Fees. The Governor's budget reduces General Fund support for professional school students by 25 percent, with the assumption that UC would offset this reduction by increasing professional school fees (except for nursing school students). Currently, these fees vary by program. For 2003-04, the professional school fee ranged from a low of $2,925 for students in nursing school to a high of $9,849 for law school students. In order to backfill the proposed reduction in General Fund support, the Regents would need to increase professional school fees by an average of $4,900. At the time this *Analysis* was prepared, the university had not yet determined the specific fee increases that would apply to each of its nine professional school programs.

Nonresident Tuition. The proposed budget also assumes that the Regents will increase the tuition surcharge imposed on nonresident students by 20 percent from their current-year levels. For nonresident undergraduate students, the surcharge would increase from $13,730 to $16,476, while the nonresident graduate student surcharge would increase from $12,245 to $14,991.

INTERSEGMENTAL ISSUES INVOLVING UC

In the "Intersegmental" section of this chapter, we address several issues relating to UC. For each of these issues, we offer an alternative to the Governor's proposal that in our view better preserves student access to higher education. We summarize our main findings and recommendations below.

Preserve Selected K-14 Outreach Programs. The Governor's proposed budget eliminates all General Fund support for UC's K-14 outreach programs. As we discuss above, the budget does include a $1.6 million General Fund augmentation for UC to provide counseling services to students participating in the Governor's proposed dual admissions program for eligible students. We recommend the Legislature redirect these funds to preserve other, more critical outreach programs at UC—specifically the ASSIST program and academic enrichment services for potential graduate and professional school students. In the "K-14 Outreach Programs" section of this chapter, we also recommend the establishment of a College Preparation Block Grant, which K-12 schools could use to contract with UC for outreach services.

Redirect Lower Division Students to Community Colleges. Similar to the Governor's proposal, we recommend establishing a policy whereby UC would admit qualified freshmen but redirect a portion of them to enroll in specific community colleges for their lower division coursework. However, in contrast to the Governor's proposal we recommend that students be redirected on a *voluntary* basis, and that the university encourage participation by guaranteeing a student's admission to his or her first-choice campus. Earlier in this chapter, we also provide a synopsis of our recent report, *Maintaining the Master Plan's Commitment to College Access*, and recommend the Legislature and UC (1) return to the special admission caps established in the state's *Master Plan for Higher Education*, (2) implement enrollment management policies, and (3) reexamine current eligibility standards.

Align Student Fee Increases to Education Costs. The Governor's budget assumes that the UC Board of Regents will increase (1) undergraduate systemwide fees by 10 percent, (2) graduate systemwide fees by 40 percent, and (3) nonresident tuition by 20 percent. The budget also assumes increases in professional school fees and establishes a new surcharge for each unit taken in excess of 110 percent of the units required for a baccalaureate degree. We recommend adoption of the proposed 10 percent undergraduate fee increase. However, we recommend that graduate fees increase by a slightly lower rate (30 percent) than the Governor's budget proposes. We further recommend that UC provide additional information regarding professional school expenditures and the implementation of the excess unit surcharge policy. In the "Student Fees" section, we also propose the Legislature adopt a long-term fee policy that sets fees at a fixed percentage of students' total education costs.

Increase Cal Grant Awards for UC Students. Although the Governor's budget does increase funding for UC's own financial aid program, it does *not* increase financial aid awards under the state's Cal Grant program to account for the higher fees at UC. We recommend the Legislature retain its existing policy of setting Cal Grant award amounts to cover UC's entire systemwide fee, thus ensuring that fees do not impede access for financially needy students. We believe that it is important to maintain existing Cal Grant benefits before further expanding UC's institutional financial aid program (which grew dramatically in the current year). Accordingly, we recommend a General Fund reduction of $35 million to UC's institutional aid budget and a related increase in General Fund support for the Cal Grant program. We further recommend shifting $35 million in EdFund operating surplus monies from the Student Aid Commission to UC for financial aid administration, thereby achieving a like amount of General Fund savings.

For a detailed discussion on the above recommendations, please refer to the "Intersegmental" section of this chapter. Below, we present additional recommendations regarding the Governor's budget proposal for UC.

OTHER ISSUES

Restoration of One-Time Reduction From 2003-04

We recommend the Legislature reduce by $33 million the Governor's proposed restoration of an $80.5 million one-time unallocated reduction made in 2003-04. Our proposed reduction accounts for the availability of ongoing funds the university has dedicated to partially offset this one-time reduction. (Reduce Item 6440-001-0001 by $33 million.)

The enacted 2003-04 budget included a one-time unallocated reduction of $80.5 million to UC's General Fund support budget. The Governor's budget for 2004-05 proposes an $80.5 million General Fund augmentation to fully restore this reduction.

Our analysis indicates that UC accommodated the reduction in its current-year budget in two ways. According to UC's official reports summarizing its final budget plan for 2003-04 (as approved by the Board of Regents), the university redirected $33 million in additional fee revenue resulting from student fee increases in the current year to partially backfill the unallocated reduction. The remaining $47.5 million of the reduction was addressed through internal borrowing from funds within the university.

Consequently, the university backfilled $33 million of the $80.5 million unallocated reduction with an ongoing revenue source—student fee revenue. This source will produce another $33 million of revenue in 2004-05, even if the General Fund it is currently backfilling is restored. This means that the Governor's proposal has the effect of *increasing* UC's available revenue by $33 million. Because the university has already offset part of the one-time reduction, we recommend that the Legislature reduce the proposed General Fund augmentation by $33 million.

Merced Campus

We recommend the Legislature reject the $10 million proposed augmentation for the planned Merced campus, because neither the administration nor the University of California could provide adequate justification for the additional funds. (Reduce Item 6440-004-0001 by $10 million.)

For the current year, the *2003-04 Budget Act* includes a total of $17.3 million in General Fund support for the planned UC campus in Merced. This amount consisted of $10 million in base funding and a one-time increase of $7.3 million. Provisional language in the enacted budget expressed the Legislature's intent that the opening of the new campus be delayed from fall 2004 to fall 2005. At the time this *Analysis* was prepared in early February, the university was unable to provide any information on how the university spent (or plans to spend) the funds provided for the Merced campus in the current fiscal year, which began over seven months ago. Moreover, the university could not provide information on how many faculty members have been hired thus far by the campus and what activities these faculty members have undertaken in the current year.

For the budget year, the Governor proposes a total of $20 million for the Merced campus. This consists of $10 million in base funding and $10 million in a one-time augmentation. 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 ongoing support for faculty and staff. An additional $9.3 million in bond funds is proposed for capital outlay expenditures at the campus.

At the time this *Analysis* was prepared, the administration and the university were unable to provide any information on how the university plans to spend the funds proposed in the Governor's budget for UC Merced in 2004-05. Lacking an expenditure plan for the budget year and no detail on expenditures in the current year, we can find neither justification nor rationale for the $10 million augmentation proposed for the budget year. Therefore, we recommend the Legislature reject the $10 million proposed augmentation for the Merced campus. Under our proposal, the university would still have $10 million in its base support budget for the campus.

California State University (6610)

The California State University (CSU) consists of 23 campuses. The Governor's budget includes about $5.8 billion for CSU from all fund sources—including General Fund, student fee revenue, federal funds, and other funds. This is a decrease of $82.4 million, or 1.4 percent, from the revised current-year amount. The budget proposes General Fund spending of $2.4 billion for the system in 2004-05. This is a decrease of $82.5 million, or 3.3 percent, from the enacted 2003-04 budget and a decrease of $220.5 million, or 8.4 percent, from the Governor's proposed revision of the 2003-04 budget.

For the current year, the Governor proposes an $11.3 million unallocated General Fund reduction and a $12.5 million targeted reduction to CSU's K-12 outreach programs. The Governor proposes to make these reductions pursuant to Section 27.00 of the *2003-04 Budget Act*. In addition, the Governor proposes a $155 million General Fund augmentation in the current year for increased Public Employees' Retirement System benefit costs. For the budget year, the Governor proposes $71.4 million in General Fund augmentations and $299 million in General Fund reductions. Figure 1(see next page) indicates changes from the enacted 2003-04 budget to the revised 2003-04 budget. It also describes the Governor's 2004-05 General Fund budget proposals.

Proposed Augmentations. The Governor's budget provides CSU with a $69.5 million General Fund augmentation to restore a one-time unallocated reduction made in 2003-04. The budget also includes $1.9 million in General Fund support to provide counseling services to students that participate in the Governor's proposed dual admissions program. Under this new program, students who are eligible to attend the university directly from high school would be admitted to a specific CSU campus provided they first complete a transfer program at a community college.

Proposed Reductions. While the Governor's budget proposes a total of $71.4 million in General Fund augmentations, it also proposes $299 million in General Fund reductions. These reductions consist of:

Figure 1

**California State University
General Fund Budget Proposal**

(Dollars in Millions)

	General Fund
2003-04 Budget Act	**$2,492.0**
Mid-Year Reductions[a]	
One-time unallocated reduction	-$11.3
Reduce outreach programs	-12.5
Other Adjustments	
Public Employees' Retirement System employer rate increase	$155.1
Carryover/reappropriation[b]	7.6
Other adjustments	-0.9
2003-04 Revised Budget	**$2,630.1**
Baseline and Technical Adjustments	$6.7
Proposed Increases	
Restore one-time reduction from 2003-04	$69.5
Dual admissions program	1.9
Subtotal	($71.4)
Proposed Reductions	
Unallocated reduction (to be backfilled with increased student fee revenue)	-$101.5
Increase student-faculty ratio	-53.5
Reduce academic and institutional support	-52.6
Expand mid-year outreach reduction (for a total of $52 million)	-39.5
Eliminate subsidy for excess course units (Phase I)	-24.4
Reduce freshman enrollment	-21.1
Defer some Common Management System costs	-6.0
Subtotal	(-$298.6)
2004-05 Proposed Budget	**$2,409.6**
Change From 2003-04 Revised Budget	
Amount	-$220.5
Percent	-8.4%

a Proposed under Section 27.00 of the *2003-04 Budget Act*.

b This corrects a technical error in the Department of Finance's planning estimates.

- $102 million unallocated reduction. (As we discuss below, increased student fee revenue is expected to backfill this reduction.)
- $53.5 million from increasing the student-faculty ratio by 5 percent (from 19.9:1 to 20.9:1).
- $52.6 million from reducing academic and institutional support by 7.5 percent.
- $39.5 million to expand the reduction to K-12 outreach programs proposed by the Governor in the current year to $52 million. (This proposal would eliminate all General Fund support for CSU's outreach programs.)
- $24.4 million for the first phase of eliminating General Fund support for students that exceed by more than 10 percent the minimum number of units required for their degree programs.
- $21.1 million from reducing freshman enrollment by 10 percent. These students would be directed to a new dual admissions program, discussed above.
- $6 million from deferring costs associated with CSU's Common Management System.

Student Fee Increases

For 2004-05, the Governor's budget assumes increases in the systemwide fees for undergraduate and graduate students, and in nonresident tuition. (Although the budget assumes these increases, student fees at CSU are established by its Board of Trustees.) The fee increases are expected to provide an additional $102 million in student fee revenue that would fully backfill the proposed unallocated reduction in CSU's General Fund support. Figure 2 summarizes the Governor's proposed fee increases for full-time students.

Figure 2

CSU Systemwide Fees and Nonresident Tuition For Full-time Students

			Change From 2003-04	
	2003-04	Proposed 2004-05	Amount	Percent
Undergraduate fee	$2,046	$2,250	$204	10%
Graduate fee	2,256	3,156	900	40
Nonresident tuition	8,460	10,170	1,710	20

As Figure 2 shows, the Governor's budget assumes an increase from 2003-04 of 10 percent, or $204, in the systemwide fee for undergraduate students. The proposed budget also assumes a 40 percent increase in the graduate student systemwide fee (from $2,256 to $3,156). At CSU, nonresident students also pay a supplementary fee (commonly known as nonresident tuition). The budget assumes that the Trustees will increase this supplementary fee from $8,460 to $10,170. This reflects an increase of 20 percent over the current-year fee level.

In addition to the above systemwide fees and nonresident tuition, students at CSU also pay specific campus-based fees. When combining all mandatory fees, the total proposed fees for a full-time student in 2004-05 are:

- $2,766 for resident undergraduates.
- $3,683 for resident graduate students.
- $12,946 for nonresident undergraduates and $13,852 for nonresident graduate students.

Intersegmental Issues Involving CSU

In the "Intersegmental" section of this chapter, we address several issues relating to CSU. For each of these issues, we offer an alternative to the Governor's proposal that in our view better preserves student access to higher education. We summarize our findings and recommendations below.

Preserve Selected K-12 Outreach Program. The Governor's proposed budget eliminates all General Fund support for CSU's K-12 outreach programs. As noted above, the budget does include a $1.9 million General Fund augmentation for CSU to provide counseling services to students participating in the Governor's new dual admissions program for eligible students. We recommend that the Legislature redirect these funds to support CSU's Early Assessment Program, in order to more effectively and efficiently target limited resources at students most in need of college preparation. In the "K-14 Outreach Programs" section of this chapter, we also recommend the establishment of a College Preparation Block Grant, which K-12 schools could use to contract with CSU for outreach services.

Redirect Lower Division Students to Community Colleges. Similar to the Governor's proposal, we recommend establishing a policy whereby CSU would admit qualified freshmen but redirect a portion of them to enroll in community colleges for their lower division coursework. We recommend that students be redirected on a *voluntary* basis, and that the university encourage participation by guaranteeing a student's admission to his or her first-choice campus. Earlier in this chapter, we also provide a synopsis of our recent report, *Maintaining the Master Plan's Commitment to College Access*, and recommend the Legislature and CSU (1) return to the special admission caps established in the state's *Master Plan for Higher Education*, (2) implement enrollment management policies, and (3) reexamine current eligibility standards for freshman admissions.

Align Student Fee Increases to Education Costs. The Governor's budget assumes that the CSU Board of Trustees will increase (1) undergraduate systemwide fees by 10 percent, (2) graduate systemwide fees by 40 percent, and (3) nonresident tuition by 20 percent. The budget also establishes a new surcharge for each unit taken in excess of 110 percent of the units required for a baccalaureate degree. We recommend adoption of the proposed 10 percent undergraduate fee increase. However, we recommend that graduate fees increase by a slightly lower rate (30 percent) than the Governor's budget proposes. We further recommend the Legislature apply the 2004-05 undergraduate and graduate fee increases to either summer 2004 or summer 2005, resulting in $9.5 million General Fund savings. In addition, we recommend the Legislature (1) approve the Governor's policy to charge the full cost of instruction for excess course units and (2) establish a special fee for CSU's high-cost graduate programs. In the "Student Fees" section, we also propose a long-term fee policy that sets fees at a fixed percentage of students' total education costs.

Increase Cal Grant Awards for CSU Students. Although the Governor's budget does increase funding for CSU's own financial aid program, it does *not* increase financial aid awards under the state's Cal Grant program to account for the higher fees at CSU. We recommend the Legislature retain its existing policy of setting Cal Grant award amounts to cover CSU's entire systemwide fee, thus ensuring that fees do not impede access by financially needy students. We believe that it is important to maintain existing Cal Grant benefits before further expanding CSU's institutional financial aid program (which grew dramatically in the current year). Accordingly, we recommend a General Fund reduction of $13 million to CSU's institutional aid budget and a related increase in General Fund support for the Cal Grant program. We further recommend shifting $32 million in EdFund operating surplus monies from the Student Aid Commission to CSU for financial aid administration, thereby achieving a like amount of General Fund savings.

For a detailed discussion on the above recommendations, please refer to the "Intersegmental" section of this chapter. Below, we present an additional recommendation regarding the Governor's budget proposal for CSU.

Restoration of One-Time Reduction From 2003-04

We recommend the Legislature reduce by $24.5 million the Governor's proposed restoration of a $69.5 million one-time unallocated reduction made in 2003-04. Our proposed reduction accounts for the availability of ongoing funds the university has dedicated to partially offset this one-time reduction. (Reduce Item 6610-001-0001 by $24.5 million.)

The *2003-04 Budget Act* included a one-time unallocated reduction of $69.5 million to CSU's General Fund support budget. The Governor's budget for 2004-05 proposes a $69.5 million General Fund augmentation to fully restore this reduction.

Our analysis indicates that CSU accommodated the reduction in its current-year budget in two ways. First, the university redirected $24.5 million in additional fee revenue resulting from student fee increases in the current year to partially backfill the unallocated reduction. In addition, CSU decided to redirect $45 million from the funds the Legislature provided in the budget for enrollment growth. This caused the university to enroll 6,744 fewer full-time equivalent students than funded in the budget. (We note that CSU redirected additional enrollment growth funding to backfill other reductions in its budget. Please see the "Higher Education Admissions and Enrollment" section of this chapter for a more detailed discussion of CSU's current-year enrollments.)

Consequently, the university backfilled by $24.5 million of the $69.5 million unallocated reduction with an ongoing revenue source—student fee revenue. This source will produce another $24.5 million of revenue in 2004-05, even if the General Fund reduction it is currently backfilling is restored. This means that the Governor's proposal has the effect of *increasing* CSU's available revenue by $24.5 million. It is unclear how the university will allocate these additional funds in the budget year. For the above reasons and given the state's current fiscal constraints, we recommend that the Legislature reduce the proposed augmentation by $24.5 million.

California Community Colleges (6870)

The California Community Colleges (CCC) provide instruction to about 1.7 million students at 108 campuses operated by 72 locally governed districts throughout the state. The system offers academic, occupational, and recreational 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. In addition, pursuant to state law, many colleges have established programs intended to promote regional economic development.

Funding Increases Proposed. The Governor's budget includes significant increases in Proposition 98 funding and student fee revenue. As shown in Figure 1 (see next page), the Governor's proposal would increase total funding for CCC by 8 percent. However, this figure does not take into account an additional $200 million of costs incurred in 2003-04 that are paid for (deferred) to 2004-05. (The 2003-04 budget package included this deferral as a way to reduce Proposition 98 expenditures in the current year.) Taking this accounting issue into consideration produces a "programmatic spending level," which appears at the bottom of Figure 1 (see next page). As the figure shows, CCC's programmatic spending increases by about 4.7 percent under the Governor's proposal.

CCC's Share of Proposition 98 Funding. As shown in Figure 1, the Governor's budget includes $4.7 billion in Proposition 98 funding for the community colleges in 2004-05. This is about two-thirds of total community college funding. Proposition 98 provides funding (approximately $47 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 10 percent of total Proposition 98 funding, K-12 education would receive 89.8 percent, and the other state agencies would receive the remaining 0.2 percent.

Figure 1

Community College Budget Summary

(Dollars in Millions)

	Actual 2002-03	Estimated 2003-04	Proposed 2004-05	Change Amount	Change Percent
Community College Proposition 98					
General Fund	$2,642.1	$2,244.1	$2,414.4	$170.3	7.6%
Local property tax	1,981.0	2,114.8	2,264.4	149.7	7.1
Subtotals, Proposition 98	($4,623.1)	($4,358.9)	($4,678.8)	($319.9)	(7.3%)
Other Funds					
General Fund	$237.4	$125.7	$221.7	$96.1	76.4%
Proposition 98 Reversion Account	85.4	0.1	—	-0.1	-100.0
State operations	10.9	8.6	8.6	—	—
Teachers' retirement	74.1	40.3	90.5	50.2	124.6
Bond payments	66.9	76.6	122.6	46.0	60.0
State lottery funds	141.2	140.9	140.9	—	—
Other state funds	11.3	11.0	10.9	-0.1	-0.5
Student fees	169.2	265.1	356.1	91.0	34.3
Federal funds	228.2	228.2	228.2	—	—
Other local funds	1230.2	1230.2	1230.2	—	—
Subtotals, other funds	($2017.6)	($2001.1)	($2188.0)	($187.0)	(9.3%)
Grand Totals	**$6,640.7**	**$6,360.0**	**$6,866.9**	**$506.9**	**8.0%**
Deferrals[a]	-$115.6	$200.0	—[b]	-$200.0	-100.0%
Programmatic spending levels	6,525.1	6,560.0	$6,866.9	306.9	4.7

[a] Adjustments to reflect when funds are spent on programs as opposed to when funds are appropriated.

[b] Net effect of zero because $200 million payment of 2003-04 costs is backfilled with a new deferral of $200 million in 2004-05 costs to 2005-06.

State law calls for CCC to receive approximately 10.9 percent of total Proposition 98 appropriations. However, in recent years, this provision has been suspended in the annual budget act and CCC's share of Proposition 98 has been lower than 10.9 percent. The Governor's budget proposal would again suspend this provision.

Major Budget Changes

Figure 2 (see next page) shows the changes proposed for community college Proposition 98 spending in the current year and budget year. Major base increases include a restoration of the $200 million deferred from 2003-04, $121 million for 3 percent enrollment growth, and $80 million for equalization. The proposal also achieves $91 million in General Fund savings by substituting new fee revenue from a proposed student fee increase. The budget proposal includes no significant reductions to CCC programs from current year levels.

Proposition 98 Spending by Major Program

Figure 3 (see following pages) shows Proposition 98 expenditures for various community college programs. (We have shown spending on a programmatic basis, as discussed above, correcting for the effect of deferrals.) The Governor's proposal seeks to consolidate and reorganize funding for some CCC programs through budget bill language and trailer bill language. In order to facilitate comparisons across fiscal years, Figure 3 generally shows funding categories as they are scheduled in the budget bill. (We discuss the Governor's proposed categorical changes later in this section.)

As shown in Figure 3, apportionment funding (available to districts to spend on general purposes) accounts for $3.9 billion in 2004-05, or about 84 percent of total Proposition 98 expenditures. Total Proposition 98 funds available for general purposes would increase to about $4.3 billion, or 92 percent of Proposition 98 funding, under the Governor's categorical reform proposal.

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 part-time faculty health insurance. The Governor's budget proposes almost no changes to the overall level of funding for these programs, although—as mentioned above—it envisions some consolidation of funding categories.

Student Fees

The Governor proposes that CCC student fees be increased from $18 per unit to $26 per unit. This represents an increase of $8 per unit, or 44 percent. For a student taking the average full-time load of 24 units per year, this would translate into an additional $192 for the academic year. Total student fees for the average full-time load under the Governor's proposal would be $624.

Figure 2

California Community Colleges Governor's Budget Proposal

Proposition 98 Spending (In Millions)

2003-04 (Enacted)	**$4,365.5**
Property tax shortfall (not backfilled)	-$6.6
2003-04 (Revised)	**$4,358.9**
2003-04 costs deferred to 2004-05	$200.0
2003-04 Base	**$4,558.9**
Proposed Budget-Year Augmentations	
Enrollment growth of 3 percent	$121.1
Equalization	80.0
Additional enrollment growth in noncredit programs	4.0
Increase lease purchase payments	2.3
Additional BOG[a] fee waiver administrative costs	1.8
Other adjustments	5.7
Subtotal	($214.9)
Proposed Budget-Year Reductions	
Apportionments (reduction to be backfilled with anticipated increase in student fee revenue)	-$91.0
Eliminate Teacher and Reading Development program and Fund for Instructional Improvement	-4.0
Subtotal	(-$95.0)
2004-05 (Proposed)	**$4,678.8**
Change From 2003-04 (Revised)	
Amount	$319.9
Percent	7.3%

[a] Board of Governors.

The Governor proposes a different fee for students who already possess a baccalaureate degree. These students would pay $50 per unit (rather than $26 per unit) under the Governor's proposal. The higher fee causes the state's subsidy for these students to be reduced, thus permitting CCC resources to be more focused on students who have not yet earned a baccalaureate degree.

Figure 3

Major Community College Programs Funded by Proposition 98[a]

(Dollars in Millions)

	Estimated 2003-04	Proposed 2004-05	Change: Amount	Change: Percent
Apportionments				
State General Fund	$1,702.1	$1,671.7	-$30.4	-1.8%
Local property tax revenue	2,114.8	2,264.4	149.7	7.1
Subtotals	($3,816.9)	($3,936.1)	($119.2)	(3.1%)
Categorical Programs[b]				
Partnership for Excellence	$225.0	$225.0	—	—
Extended Opportunity Programs and Services	94.9	94.9	—	—
Disabled students	82.6	82.6	—	—
Matriculation	54.3	54.3	—	—
Services for CalWORKs[c] recipients	34.6	34.6	—	—
Part-time faculty compensation	50.8	50.8	—	—
Part-time faculty office hours	7.2	7.2	—	—
Part-time faculty health insurance	1.0	1.0	—	—
Maintenance, repairs, instructional equipment, and library materials	24.9	24.9	—	—
Economic development program	35.8	35.8	—	—
Telecommunications and technology	22.1	22.1	—	—
Basic skills and apprenticeships	40.6	40.6	—	—
Financial aid/outreach	46.4	47.3	$0.8	1.8%
Teacher and Reading Development	3.7	—	-3.7	-100.0
Growth in noncredit full-time equivalent student	—	4.0	4.0	—
Fund for Student Success	6.2	6.2	—	—
Other programs	12.0	11.6	-0.4	-3.4
Subtotals	($742.0)	($742.7)	($0.7)	(0.1%)
Lease-revenue bonds[d]	($55.0)	($57.4)	($2.3)	(4.3%)
Totals	**$4,558.9**	**$4,678.8**	**$119.9**	**2.6%**

a Includes costs deferred to later fiscal years. Thus, costs are expressed on a programmatic spending basis.

b Governor's budget proposes to consolidate and reorganize some of these programs. See Figure 4 and associated discussion later in this section.

c California Work Opportunity and Responsibility to Kids.

d Included as part of General Fund apportionments.

The budget assumes that the base fee increase and the surcharge for baccalaureate holders together will generate about $91 million in new student fee revenue. This revenue would facilitate General Fund savings of the same amount. We discuss the proposed CCC fee increases, as well as fee increases at the other higher education segments, in the "Intersegmental" section of this chapter. In general, we recommend that the Legislature approve the Governor's proposed CCC fee increases.

ENROLLMENT FUNDING

The budget proposal includes an augmentation of $121 million in general apportionment funding to serve an additional 33,120 full-time equivalent (FTE) students in 2004-05. This is an increase of 3 percent above the current year budgeted level. This funding is available to serve both credit and noncredit students. (See nearby box for a description of credit and noncredit courses.)

In addition to this general apportionment funding, the budget proposal includes an additional $4 million to serve an additional 1,900 FTE students specifically in noncredit courses. This additional noncredit funding would be available only to districts that did not receive any of the $80 million in equalization funding that the budget provides for CCC.

When the two growth funding amounts are combined, the Governor's budget provides for overall growth of 3.2 percent. Because $4 million is earmarked for noncredit instruction, noncredit enrollment is projected to grow by at least 5 percent from the current-year level.

Special Treatment of Noncredit Instruction Not Warranted

The Governor's proposal to provide a special appropriation for noncredit instruction represents a departure from longstanding practice and lacks justification. We recommend that the Legislature reject this augmentation. (Reduce Item 6870-101-0001 by $4 million.)

Under current law and regulations, community college districts receive enrollment growth funding that can be used for both credit and noncredit instruction. Districts may spend this funding on any combination of credit and noncredit FTE students that they deem appropriate. Because noncredit instruction is reimbursed at roughly half the rate of credit instruction, an average district could substitute two noncredit FTE students for a single credit FTE student when selecting the mix of enrollment they will serve with their apportionment funding. (As a practical matter, district choices about their credit/noncredit mix are of course affected by the nature of local student demand.)

Proposal Deviates From Longstanding Practice. The Governor's proposal would break with this longstanding policy by sectioning off a portion of apportionment funding exclusively for growth in noncredit instruction. It is unclear why this would be desirable. Indeed, by effectively creating a categorical program for the entire noncredit programs administered by districts, the administration appears to work against another of its proposals (discussed later in this section) to *remove* categorical boundaries in order to provide greater flexibility for districts in allocating their funding across programs.

What Is Noncredit Instruction?

Community college districts provide both credit and noncredit instruction. *Credit* courses generally deliver collegiate-level instruction, and students enrolled in them receive college credit (generally one to three units, depending on the number of classroom hours). *Noncredit* courses do not provide collegiate instruction, and students receive no college credit and pay no fees for these courses.

State law assigns the community colleges a "primary mission of academic and vocational instruction." Beyond this mission, the colleges are also assigned the "essential and important function" of providing adult noncredit instruction "in areas defined as being in the state's interest." The state funds noncredit courses (albeit at a lower rate than credit courses) in the following areas:

- Basic skills (such as remedial academic courses).
- English as a Second Language.
- Immigrant education (such as citizenship).
- Courses for disabled students.
- Short-term vocational programs.
- Parenting (such as child growth and development, or parent-child relationships).
- Courses for older adults.
- Home economics.
- Health and safety.

In 2002-03, California Community College districts spent about $200 million of their apportionment funding for noncredit instruction. This funding was used to serve about 95,000 full-time equivalent students.

Because the Governor's proposed noncredit allocation would be available only as growth funding, districts receiving this money must provide additional noncredit instruction above their current levels. Therefore, the proposal would have the practical effect of "locking in" current noncredit funding for those districts seeking an allocation.

Proposal Draws Illogical Link Between Noncredit Instruction and Equalization. More troubling is the Governor's proposal that the special noncredit funding would be available only to districts that did not benefit from equalization. *Equalization* funding goes to districts whose level of funding per credit FTE student is lower than a specified level. Districts eligible for the special *noncredit growth* allocation, therefore, are those whose funding per FTE student is above that level. We are unaware of any reason that the latter group of districts—those with higher per FTE funding—would necessarily have a greater need to provide additional noncredit instruction.

Proposal Should Be Rejected. For these reasons, we recommend that the Legislature reject the Governor's proposal to provide an additional $4 million for growth in noncredit instruction. Even without this funding, CCC districts would still have $121 million in new funding to allocate for both credit and noncredit instruction in any combination they felt was warranted by local needs.

GOVERNOR PROPOSES CATEGORICAL REFORM

The Governor's budget proposal would restructure the funding for a number of categorical programs. The elements of this proposal are illustrated in Figure 4.

Description of the Proposal

Shifting of Categorical Funding to Base Apportionments Increases Local Flexibility. As the figure shows, the budget would move all the funding currently provided for five categorical programs, and about half the funding for a sixth categorical program, into the base apportionments provided to districts. As discussed earlier, apportionments are the general purpose funding received by districts from the state. This is a significant funding change in that it transfers money that had been earmarked for specified purposes (such as matriculation and part-time faculty compensation) into an allocation that is largely unrestricted. In other words, by shifting categorical funding to base apportionments, the Governor's proposal permits districts to decide for themselves how much money they will allocate for these targeted categorical purposes.

Figure 4

Governor's Categorical Reform Proposal

General Fund
(In Millions)[a]

Program Consolidations	2003-04	2004-05
General Apportionments		
Base general apportionments	$1,589.1	$1,589.1
Partnership for Excellence	225.0	350.8
Matriculation	54.3	
Part-time faculty compensation	50.8	
Part-time faculty office hours	7.2	
Part-time faculty health insurance	1.0	
TTIP[b]	12.5	
Totals	**$1,939.9**	**$1,939.9**
Telecommunication and Technology Services		
TTIP[b]	$9.6	10.9
California Virtual University	1.3	
Totals	**$10.9**	**$10.9**
Targeted Student Services		
Extended Opportunity Programs and Services	$94.9	101.1
Fund for Student Success	6.2	
Totals	**$101.1**	**$101.1**
Physical Plant and Institutional Support		
Maintenance, repairs, equipment, and library materials	$24.9	29.3
Hazardous substances	4.4	
Totals	**$29.3**	**$29.3**
Program Deletions		
Teacher and Reading Development Program	$3.7	—
Fund for Instructional Improvement	0.3	—
Program Additions		
Special growth allocation for noncredit instruction	—	$4

a Includes costs whose payments are deferred to subsequent fiscal year.

b Telecommunications and Technology Infrastructure Program.. Current-year funding of $22.1 million is split in budget year between general apportionments and new Telecommunication and Technology Services category.

In addition, enrollment growth and cost-of-living adjustment (COLA) calculations apply to the general apportionment base. Therefore, funding for these targeted categorical programs would increase at the growth and COLA rates provided in subsequent annual budget acts. Currently only one of the targeted categorical programs (matriculation) traditionally receives growth and COLA funding.

Grouping of Categorical Programs Would Not Increase Local Flexibility. As shown in Figure 4, the Governor's proposal would also provide funding for six existing categorical programs in three new groups: Telecommunication and Technology Services, Targeted Student Services, and Physical Plant and Institutional Support.

Although the budget includes these new groups, provisional language would continue to require the current level of funding for each existing categorical program under each group. For example, current-year funding for the Extended Opportunity Programs and Services (EOPS) and the Fund for Student Success (FSS) is $94.9 million and $6.2 million, respectively. The Governor's proposal combines these two amounts for a $101 million appropriation to fund the proposed Targeted Student Services category. However, provisional language specifies that $94.9 million of this amount is for EOPS and $6.2 million is for FSS.

Proposal Would Eliminate Two Small Programs. In addition to the reorganization of funding described above, the Governor's proposal would eliminate the Teacher and Reading Development program and the Fund for Instructional Improvement. In the current year, these two programs received a total of $4 million. Under the Governor's proposal, this funding would be redirected to a new purpose (growth in noncredit instruction, discussed earlier) in 2004-05.

Benefits of Categorical Reform

We believe that reducing categorical restrictions on funding can have several important benefits:

- ***Greater Fiscal and Program Flexibility***. Greater flexibility would allow districts to direct funding to the highest priority local needs and to design local programs that address those needs most effectively. There are 72 locally governed community college districts in the state, each with different student populations, local resources, and job environments. District needs, therefore, can vary greatly. For example, some districts may have a relatively high need for matriculation services, while other districts may require relatively less matriculation funding and more resources for expanding technology in the classroom.

- ***Administrative Savings***. Eliminating the individual program requirements of existing programs can help districts reduce local administrative costs associated with accounting and administrative requirements.
- ***Less Emphasis on Inputs***. Eliminating categorical program requirements reduces the state's emphasis on what kind of activities districts fund. To the extent that this is accompanied by a renewed emphasis on outcomes, this allows districts to select for themselves the best strategies for achieving student-focused results.
- ***Clearer State/Local Relationship***. By increasing local autonomy over the use of funds, the state would clarify the role of local district trustees in decision making over these funds. This would make it easier for students and voters to participate in local budget decisions and hold trustees accountable for how funds are used.

Proposal a Step in Right Direction, But Falls Short

We believe the Governor's categorical reform proposal is a step in the right direction, as it makes progress toward rationalizing CCC's categorical funding. However, we believe that (1) part of the categorical consolidations are more symbolic than substantive, and (2) proposed accountability provisions are not fully developed. We discuss these concerns and offer recommendations below.

Some Categorical Consolidations Are Largely Symbolic

The Governor's budget includes 11 categorical programs in the categorical reform proposal. While we believe that the particular combinations make sense, some of the program consolidations would have no practical effect. We recommend that the Legislature delete provisional language specifying funding levels for supposedly combined categorical programs.

Categorical Groupings Make Sense. Five of the categorical programs (and part of a sixth) would be consolidated into CCC's general apportionments. We believe this consolidation is logical, given that these programs achieve general-purpose objectives shared by all districts. For example, the Partnership for Excellence (PFE)—which constitutes 75 percent of the categorical funding being consolidated into apportionments—already is largely unrestricted. Similarly, all districts enroll a number of new students each term that must be matriculated. We therefore think it makes sense to combine these funds into a single schedule and permit districts to allocate them in a way that matches their particular needs.

The remaining five programs (and the rest of the sixth) would be grouped under three new program areas. The proposal respects functional similarities among programs. For example, we believe that grouping the California Virtual University program with the Telecommunications and Technology Infrastructure Program is logical, in that it groups programs that facilitate the development and use of technology. We support this general approach of grouping funding for similar programs. For example, in 2002-03 we proposed that 11 categorical programs be consolidated into two block grants: one for the provision of student services and one for the support of faculty. (Please see our *Analysis of the 2002-03 Budget Bill*, pages E-253 through E-255.)

Three "Broadened" Categorical Programs Largely Symbolic. As observed earlier, the Governor's proposal to rearrange six existing categorical programs under three larger headings is logical, respecting programmatic similarities among programs. However, this regrouping is largely symbolic and would do nothing to increase local flexibility in expending funds, which should be a central goal of categorical reform. Instead, the regrouping of these programs has no practical effect because provisional language retains the current allocation of funding among the component programs.

To the extent that the Legislature wishes to create local flexibility in these program areas, we recommend the deletion of provisional language specifying funding levels for the component programs within each of the three new categories. This would permit local districts to allocate funding with each broadened category in a way that best suits its needs. At the same time, the Legislature may wish to add some provisional language that better defines the parameters of each broadened category. If the Legislature wished to pursue a more comprehensive reform of categorical funding, we would recommend a block grant approach such as the one we described in our *2002-03 Analysis*.

Proposal Lacks Adequate Accountability Measures

We recommend that the Legislature (1) clarify its expectations as to outcomes it expects districts to achieve with their apportionment funding, and (2) establish clear consequences for failure to meet those expectations.

The state created CCC's categorical programs to ensure that districts address specific priorities. In principle, categorical programs are designed to address situations where local incentives lead districts to underinvest in a particular input that the state views as critical to the educational process. As noted above, a drawback to this approach can be a lack of local flexibility. There can be situations where districts identify ways to provide more or better services for their students, but categorical restrictions prevent districts from implementing them.

Priority Courses Specified and Progress Toward PFE Goals Required. The Governor's budget takes a step toward local flexibility by moving some categorical funding into district apportionments. At the same time, it imposes certain accountability provisions on districts. Specifically, language in the budget proposal would require that districts receiving these consolidated funds agree to two conditions: (1) that they will "assure that courses related to student needs for transfer, basic skills, and vocational and workforce training are provided to the maximum extent possible within budgeted funds" and (2) that they will "make annual increases in the number of transfer ready and transfer students, the number of degrees and certificates awarded, rates of successful course completion, and workforce development and basic skills improvement." (The five areas identified for annual increases are currently the focus of the soon-to-sunset PFE.) The CCC Board of Governors (BOG) is to report annually on each district's progress toward these goals.

In addition, proposed trailer bill language would prohibit districts that accept the consolidated funds from using them to fund the concurrent enrollment of K-12 students in physical education, dance, recreation, study skills, and personal development courses.

Accountability Provisions Need Work. While we support the Governor's effort to clarify priorities and expected outcomes for the districts, we have various concerns about the accountability provisions. Specifically:

- ***Expectations Are Vague***. The proposal does not specify what standard will be applied to determine whether a district in fact gave highest priority to the specified types of courses. Similarly, it is unclear whether annual increases in the PFE areas must be achieved for all five areas each year, or only for a majority of those areas. In interpreting the existing PFE statute, for example, the CCC has considered meeting goals in three of the five areas to be adequate progress.

- ***Consequences for Failing to Meet Requirements Are Unclear***. The proposed budget language states that a district must agree to the two requirements as a condition of receiving funds. However, if a district agrees to meet requirements but does not in fact meet the requirements, it is unclear whether funding would be withheld. It is also unclear whether all of a district's new apportionment funding would be in jeopardy, or only a portion (or none) of it.

- ***Limitations on Concurrent Enrollment Have Loophole***. The proposed language prohibits districts from using the *apportionment funding redirected from six categorical programs* on certain low-priority concurrent enrollment courses. This funding makes up only a fraction a district's total apportionment funding. It is unclear how one could determine whether this targeted funding or base apportionment funding was used to fund particular courses.

Expectations Should Be Clarified. The current statutory mission for the community colleges is broad, vague, and even contradictory. As can be seen in Figure 5, statute assigns to CCC *two* primary missions, several essential and important functions, as well as additional authorized functions and permitted activities. Moreover, the statutory description of most of these functions is quite broad—for example, providing "community service courses and programs." We believe that the breadth of CCC's mission makes it difficult for the state to ensure that funding provided to CCC is used to advance state priorities. This was illustrated, for example, by controversies in recent years about some districts' enrollment of large numbers of high school students in physical education classes. Some districts argued that such enrollment was consistent with the state's expectations, while some legislators asserted that this was not the case. In the end, the Legislature amended statute as a way to try to resolve the problem.

Given the breadth of CCC's mission, it is difficult to know whether the course priorities proposed by the Governor (transfer, basic skills, and vocational / workforce training) are consistent with the Legislature's intent. We recommend, therefore, that the Legislature clearly express its priorities for CCC in statutory language accompanying any categorical reform.

We also think it is important to clarify expectations about outcomes. The Governor's proposed language calls for annual increases in five outcome measures. These outcome measures are currently specified in the PFE, which is to sunset at the end of 2004. We recommend that the Legislature (1) revisit these measures and evaluate them for consistency with state priorities (as discussed above), (2) consider whether to adopt the expectation of annual increases in these measures, as proposed by the Governor, and (3) consider target levels beyond which further improvement is not required.

Consequences Should Be Clarified. We recommend that the Legislature amend the proposed budget language to clarify the consequences of failing to meet the Legislature's expectations in providing apportionment funding. This could involve reducing district funding (as implied by the Governor's proposal, and as allowed under the PFE). Alternatively, the Legislature could indicate simply that it intends to monitor annual

Figure 5

CCC Statutory Missions and Functions

Primary Mission—Education Code Section 66010.4(a)(1)	
"Offer academic and vocational instruction at the lower-division level."	
In Addition to Primary Mission—Education Code Section 66010.4(a)(2)	
"Essential and important functions."	• Provide remedial education for those in need of it. • Provide instruction in English as a Second Language. • Provide adult noncredit education in areas defined as being in the state's interest.
"Authorized function" to the extent it does not reduce CCC's ability to fulfill its "primary missions."	• Provide community services courses and programs.
"A primary mission."	• Provide education, training, and services that help to continuously improve California's workforce.
"Permitted activity to the extent that state funding is provided."	• Conduct research on student learning and retention.

progress toward the specific goals, and make future decisions about CCC's system budget and statutory provisions in response to the adequacy of that progress. We note that this second approach is similar to that envisioned by the Senate's Higher Education Accountability Advisory Group, which has developed an outcomes-based data collection proposal to facilitate greater accountability within the state's higher education system. A third alternative would be to ensure that information on district performance is made available to local voters, students, and other stakeholders to permit local accountability of district decisions. In all three cases, we believe it is important for the Legislature to more clearly link CCC's success in achieving student outcomes with meaningful state and / or local oversight. As we have observed in prior *Analyses*, we believe the lack of clear consequences has hindered the PFE's ability to promote meaningful improvements in outcomes.

GOVERNOR PROPOSES $80 MILLION FOR EQUALIZATION

The budget includes $80 million to help equalize the funding each community college district receives to serve a full-time equivalent student. While we support this objective, we believe that the state's fiscal situation requires that funding be directed to existing obligations before new programs are funded. We therefore recommend the Legislature delete the $80 million in General Fund support provided for equalization in the budget year. (Reduce Item 6870-101-0001 by $80 million.)

The Governor's 2004-05 budget proposal includes $80 million to help equalize the amount of apportionment funding each community college district receives to serve an FTE student. Currently, this amount varies from about $3,550 to $8,150 per FTE student, with a statewide average of about $3,800.

Various efforts have been made over the years to equalize CCC funding (see nearby box). We support the goal of equalizing per-student funding for three reasons:

- ***Fairness***. Students in different parts of the state should have access to comparable educational services. Although similar per-student funding does not guarantee similar quality, it does make this goal easier to achieve.
- ***Efficiency***. Eliminating historical anomalies in district funding can promote a more efficient allocation of state resources. When per-student funding is equalized, apportionment funding goes to districts based on their anticipated "workload" (number of students to be served), rather than these historical anomalies.
- ***Simplicity***. Community college funding should be relatively easy to understand and administer.

Budget-Year Funding Should Be Directed To Existing Obligations

While we support the goal of equalization, we believe that the state's current fiscal situation requires that funding for new programs such as the Governor's equalization plan instead be directed to existing fiscal obligations. As we discuss earlier in this chapter, the state has deferred payment on a number of education expenditures in order to reduce Proposition 98 appropriations. These deferred payments include $200 million in community college apportionments, which the Governor proposes to defer again to 2005-06. The Governor also proposes to defer payments for various local mandates. Rather than continue to defer these obligations, the Legislature could apply the proposed equalization funding toward them. This would reduce the "balance" the state is carrying on its education "credit card," thereby helping to restore structural balance to the state budget. At the same time, it would not affect the overall level of Proposition 98 appropriations for the community colleges, since it would simply reallocate a portion of CCC's Proposition 98 funding from a new program (equalization) to existing programs (such as reducing the deferral of apportionment costs).

Efforts to Equalize Funding Have a Long History

The Governor's proposal is the latest in a number of efforts to equalize community college funding. In fact, current law already contains funding allocation mechanisms that are in part intended to gradually equalize district funding. For example, the allocation of the California Community College's cost-of-living adjustment funding involves a number of calculations that in theory should gradually move funding for low-revenue districts closer to the statewide average. In addition, funding for new enrollment growth is allocated relatively equally on a per-student basis, and thus would have the effect of equalizing funding at the margin. Finally, the state has made special additional appropriations for equalization. For example, the *1996-97 Budget Act* appropriated $14 million for this purpose, and the *1997-98 Budget Act* appropriated an additional $8.6 million for this purpose.

We note that there a number of different equalization proposals which have been offered in recent years, including some introduced as legislation and some developed through extensive discussions among community college districts. Although these proposals share the goal of equalizing apportionment funding among community colleges, their different approaches would result in quite different outcomes. For example, they address the issue of small district costs in different ways that would result in different equalization targets. The length of time required to equalize also differs among the proposals. Moreover, some differences affect other fiscal and policy issues such as the allocation of growth funding, and funding for noncredit instruction.

Even if the Legislature ultimately provides no funding in the 2004-05 budget for equalization, however, we still recommend the Legislature move forward in adopting an equalization plan reflecting its priorities. By resolving the policy issues surrounding equalization now, the state will be prepared to expedite actual equalization efforts when funding is more readily available. Moreover, early action on the various statutory and regulatory changes can facilitate better planning by community college districts.

Overdue Reports Hinder Accountability

In adopting the 2003-04 budget, the Legislature included a number of reporting requirements to allow the Legislature to monitor how the California Community Colleges (CCC) implement important features of the budget and to evaluate the effect of budget actions on student access. At the time this analysis was prepared in early February, CCC had failed to provide two of the required reports. We recommend CCC report at budget hearings on these required reports.

The *2002-03 Budget Act* includes a number of reporting requirements for CCC. We focus on two overdue reports below:

Report on Allocation of $25 Million Concurrent Enrollment Reduction

The 2003-04 budget reflects a $25 million reduction in apportionment funding for concurrent enrollment of high school students in certain courses. This reduction was prompted by the Legislature's concern that some CCC districts were violating the intent of the concurrent enrollment statute, which provided for the enrollment of high school students in CCC courses under limited circumstances. With the funding reduction, the Legislature intended that CCC districts would reduce the number of concurrently enrolled high school students by approximately 6,500 FTE students. The Legislature directed the Chancellor to allocate the funding reduction among districts proportionate to their reported levels of concurrent enrollment in physical education, recreation, study skills, and personal development courses. The Chancellor was permitted to limit a district's reduction if he believed that district's financial integrity otherwise would be jeopardized.

During budget hearings, various districts expressed concern over how the reductions might be allocated. For example, some districts were concerned that the selection of a particular base year for measuring districts' reported levels of concurrent enrollment could skew the allocation of reductions. Others were concerned that the definition of jeopardized financial integrity might be too liberally applied, thus shifting a greater share of the $25 million reduction to other districts. Still others believed that the allocation might unfairly fail to distinguish between reported enrollment which is legal (albeit of a low priority) and enrollment which was illegal (such as claiming enrollment for courses which did not exist).

In order to monitor how the $25 million reduction is ultimately allocated, the Legislature directed the Chancellor to report on the allocation by January 1, 2004. No report had been provided as of early February.

Given the importance of ensuring that the Chancellor's office has appropriately implemented the Legislature's intent in allocating these reductions, we recommend that the Legislature direct CCC to report at budget hearings on how the $25 million reduction was allocated. Not only would this facilitate greater accountability on the part of CCC, but it would also be helpful as the Legislature deliberates on further changes to the state's policy concerning concurrent enrollment.

Report on Allocation of Apportionment Funding

The *2003-04 Budget Act* includes General Fund appropriations of $1.4 billion for base apportionments and $57.9 million for enrollment growth. Given ongoing concerns about the extent to which district course offerings reflect state priorities, the budget act includes language directing the CCC BOG to adopt criteria for allocating these funds in a way that gives highest priority to three types of courses: (1) those related to student needs for transfer, (2) basic skills courses, and (3) vocational and workforce training courses. The report was due on February 1, 2004. As of early February, no report had been provided.

As discussed earlier, there is a need to ensure that funding provided to community colleges is used in a way that is consistent with the Legislature's intent in providing that funding. During 2003-04 budget hearings, the Legislature expressed considerable concern on this topic, especially given CCC's own statements that total course offerings were being reduced in response to real and anticipated budget reductions. We therefore recommend the Legislature direct the CCC to report at budget hearings on (1) how it ensured that highest priority was given to the types of courses specified in the budget language, and (2) the degree of success that was achieved in focusing on these types of courses.

STUDENT AID COMMISSION (7980)

The Student Aid Commission provides financial aid to students through a variety of grant and loan programs. The proposed 2004-05 budget for the commission includes state and federal funds totaling $1.3 billion. Of this amount, $684 million is General Fund support—all of which is used for direct student aid for higher education. A special fund covers the commission's operating costs.

In this section, we (1) summarize the Governor's budget proposals for the Cal Grant program and the Assumption Program of Loans for Education (APLE), (2) explain our concerns with the administration's proposed trailer bill language for the APLE program, and (3) discuss an issue relating to EdFund's operating surplus. We recommend a portion of this operating surplus be used to fund financial aid administration at the University of California (UC) and the California State University (CSU), thereby achieving General Fund savings. At the end of this section, we also have a figure summarizing the financial aid recommendations that we make in the "Intersegmental" section of this chapter.

MAJOR BUDGET PROPOSALS

Figure 1 compares the commission's revised 2003-04 budget (including the Governor's mid-year proposals) and the proposed 2004-05 budget. As the figure shows, the Governor's budget requests a General Fund augmentation of $54 million, or 8.5 percent, over current-year expenditures. This augmentation primarily consists of two components—a net increase of $49 million for the Cal Grant A and Cal Grant B programs and an increase of $6 million for the APLE program. These augmentations represent growth of 8.1 percent and 22 percent, respectively, over current-year expenditures.

Figure 1

Student Aid Commission General Fund Budget Summary

(Dollars in Millions)

Program	2003-04 Budget Act	2003-04 Revised[a]	2004-05 Proposed	Change From 2003-04 Amount	Change From 2003-04 Percent
Entitlement	$414.5	$356.8	$470.7	$113.9	32%
Competitive	104.4	121.1	149.2	28.2	23
Pre-Chapter 403	130.0	121.5	27.8	-93.6	-77
Cal Grant C	12.9	10.9	11.7	0.8	7
Subtotals	($661.8)	($610.2)	($659.5)	($49.2)	(8%)
Cal Grant T[b]	—	$1.6	$0.1	-$1.5	-95%
APLE[c]	$30.0	28.0	34.0	6.1	22
Graduate APLE[b]	0.5	0.5	0.5	—	1
Law enforcement scholarships	0.1	0.1	0.1	—	18
Federal Trust Fund[d]	-9.5	-10.2	-10.2	—	—
Totals	**$682.9**	**$630.2**	**$684.0**	**$53.8**	**8%**

a Revised per administration's mid-year budget proposals.

b New awards associated with both of these programs were defunded, beginning in 2003-04.

c Assumption Program of Loans for Education.

d These monies directly offset Cal Grant program costs.

Cal Grant A and Cal Grant B Augmentation. The net increase of $49 million for the Cal Grant A and Cal Grant B programs is associated with four separate proposals.

- ***Increase Number of Cal Grant Awards ($93 Million Cost).*** The Governor's budget includes funding for almost 25,000 additional Cal Grant awards. This substantial growth is largely attributable to the fourth-year phase-in of the High School Entitlement program.
- ***Reduce Cal Grant Income Ceilings ($11 Million Savings).*** The Governor's budget would reduce the Cal Grant A and Cal Grant B income ceilings by 10 percent. These lower income ceilings would apply only to new cohorts. Existing Cal Grant recipients would not be affected by the change.

- ***Reduce Private University Cal Grant ($33 Million Savings).*** The Governor's budget also achieves savings by reducing the maximum Cal Grant for students attending private colleges and universities by 44 percent. The 2004-05 Cal Grant award would be $5,482 (or $4,226 less than the current-year level). As with the income ceiling proposal, only new cohorts would be affected by this change.
- ***Decouple Cal Grant From Segments' Systemwide Fee Level.*** The Governor's budget maintains the Cal Grant at its current-year level for students attending UC and CSU. Given the Governor's proposed fee increases at UC and CSU, the Cal Grant would not be sufficient to fully cover systemwide fees for these students. This deviates from a longstanding policy that links UC and CSU Cal Grants to these systemwide fees.

APLE Augmentation. The $6 million APLE augmentation is associated with loan-forgiveness warrants issued in prior years for which the state owes payment in 2004-05. To reduce out-year costs, the Governor's budget proposes to issue 4,200 fewer new APLE warrants—decreasing the number of new APLE warrants from 7,700 (the budgeted 2003-04 level) to 3,500. The administration proposes that this reduction be made both for 2003-04 and 2004-05. This reduction would result in total out-year savings of approximately $57 million per new cohort. (For example, the 2004-05 new-warrant reduction would generate approximately $14 million annually in 2006-07 through 2009-10.)

Retain Existing APLE Priorities

We recommend the Legislature retain the Assumption Program of Loans for Education's existing eligibility criteria and give highest priority for new warrants to those individuals teaching in a critical subject shortage area in a very low-performing school.

Given the proposed reduction in the number of new APLE warrants, the administration proposes corresponding trailer bill language that changes the existing APLE eligibility criteria. Currently, the APLE program provides loan forgiveness for individuals agreeing to teach in a subject shortage area (as identified by the Department of Education [SDE] and determined annually) or in a disadvantaged school (defined as low-income, low-performing, or having a high percentage of uncredentialed teachers). The amount of loan forgiveness provided increases as individuals assume increasingly challenging assignments. The greatest amount of loan forgiveness ($19,000), for example, is offered to individuals teaching mathematics, science, or special education in a school ranked in the bottom two deciles of the Academic Performance Index (API).

The administration's trailer bill language proposes new eligibility criteria—eliminating the general disadvantaged-school component and replacing the subject-shortage-area component with specific allowable subject areas (mathematics, science, reading, and instruction for students with visual impairments). Of the individuals teaching in one of these four areas, those working in a school within the bottom two deciles of the API would be given first priority for new warrants.

The administration's proposed changes to the eligibility criteria have two significant ramifications.

- ***Disqualifies Special Education Teachers.*** The proposed language disqualifies all special education teachers from receiving APLE benefits except for those who hold a specialist credential for the instruction of students with visual impairments. Given special education is the most critical subject shortage area in the state (based upon SDE's January 2004 listing of California's designated subject shortage areas), the rationale for making this change is unclear.
- ***Removes General Disadvantaged-School Requirement.*** Although the proposed language does offer first priority to individuals teaching in a school within the bottom two deciles, it removes the general requirement that individuals serve in a disadvantaged school. Thus, contrary to the current program, an individual teaching mathematics or science in a high-performing school now would become eligible for APLE warrants. (Whether these individuals actually received warrants would depend upon how many applicants agreed to work in a school within the bottom two deciles of the API.)

We do not think the APLE eligibility criteria should be changed in these ways. Instead, we recommend the Legislature adopt trailer bill language that simply would give priority to those teachers who assume the most challenging assignments (as defined by existing APLE criteria).

The EdFund Surplus

EdFund is a nonprofit public benefit corporation that is an auxiliary to the Student Aid Commission. EdFund administers the Federal Family Education Loan (FFEL) program on behalf of the state. Colleges and universities that are interested in participating in the FFEL program may choose to work with EdFund or one of several other independent guaranty agencies. Alternatively, colleges and universities may participate in the Federal Direct Student Loan program, in which case their student loans are guaranteed and administered directly by the federal government.

EdFund Has Been Experiencing Sizeable Operating Surplus. For several years, the Student Loan Operating Fund (SLOF) has been generating increasingly large annual operating surpluses. Figure 2 shows EdFund's annual operating surplus from federal fiscal year (FFY) 2000-01 through 2002-03. Over the last three years, EdFund's annual operating surplus has grown from $38 million to more than $100 million. At the end of FFY 2002-03 (September 30, 2003), the cumulative surplus was $267 million. For FFY 2003-04, EdFund expects an annual operating surplus of $31 million, which means its cumulative surplus will reach almost $300 million by year end.

Figure 2

EdFund Operating Surplus Large and Growing[a]

Federal Fiscal Years
(In Millions)

	2000-01	2001-02	2002-03
Revenues	$123.0	$169.6	$222.1
Expenditures	84.6	90.4	118.1
Annual Operating Surplus	**$38.4**	**$79.2**	**$104.1**

[a] At the end of federal fiscal year 2002-03, the cumulative surplus was $267 million.

Operating Monies May Be Used for Various Purposes. Federal statute governs the use of guaranty agencies' operating funds. Specifically, federal statute allows these monies to be used for (1) guaranty agency-related activities, including application processing, loan disbursement, enrollment and repayment status management, default aversion activities, default collection activities, school and lender training, and compliance monitoring; (2) financial aid awareness and related outreach activities; and (3) other student "financial aid-related activities." Currently, EdFund uses its operating fund monies both for loan-related activities and financial aid outreach activities. Additionally, the commission uses SLOF monies to support all its operating costs.

Use EdFund Operating Surplus to Relieve General Fund

We recommend the Legislature use a portion of EdFund's operating surplus to relieve the General Fund of a current obligation. Specifically,

we recommend the Legislature designate $66 million in surplus monies from the Student Loan Operating Fund (SLOF) for financial aid administration at the University of California and the California State University—reducing General Fund support by a like amount. We recommend reviewing the SLOF fund condition annually to determine the viability of future swaps.

As noted above, EdFund's operating monies may be used for various purposes, including general financial aid-related activities. Financial aid-related activities generally have been thought to include administration. For example, as indicated above, the commission already uses SLOF monies to support its administration of the Cal Grant program. Recently, New York has interpreted statute more broadly to include not only state-level financial aid administration but also campus-level financial aid administration. New York reports no problems related to its decision to use its operating surplus for this purpose. (Please see nearby gray box for more information about New York's recent decision to use its operating fund to cover campus-level financial aid administration.)

Replace $66 Million General Fund With $66 Million SLOF. The UC and CSU have budgeted a total of $66.3 million for their systemwide and campus-level financial aid administration in 2004-05. Of this amount, $34.7 million and $31.6 million are associated with financial aid administration at UC and CSU, respectively. For the budget year, we recommend the Legislature simply replace $66 million of existing General Fund support with $66 million of SLOF surplus monies.

New York Uses Student Loan Operating Surplus For Campus-Level Financial Aid Administration

In 2002-03, confronted with fiscal difficulties, New York swapped its state General Fund monies with surplus monies from its Student Loan Operating Fund (SLOF). Specifically, the New York State Higher Education Services Corporation used $26 million in SLOF surplus monies to fund financial aid administration both at the state and campus level. At the campus level, it used the surplus monies to fund financial aid administration at all its state and city universities. Prior to 2002-03, the state had funded these activities using General Fund monies. The agency already has completed an annual compliance audit of its 2002-03 activities, and the funding swap was not flagged as inappropriate. New York continued this practice in 2003-04 and the Governor has proposed extending it through 2004-05.

Swap Will Need to Be Revisited Annually. Although EdFund's SLOF has experienced sizeable annual surpluses for the last three years, its fund condition will need to be reviewed annually to determine the viability of future swaps. Although EdFund is very likely to experience another surplus in FFY 2004-05, future surpluses are likely to be influenced by the pending reauthorization of the federal Higher Education Act. To date, it is uncertain whether reauthorization will occur during the 2004 or 2005 congressional session.

Intersegmental Financial Aid Issues

We discuss several financial aid issues in the "Intersegmental" section of this chapter. Figure 3 summarizes the various recommendations we make in that section.

Figure 3

Summary of Intersegmental Financial Aid Issues

Issue	LAO Recommendation
Cal Grant budget	• Adopt more realistic budget assumptions, thereby saving $20 million that could be used for identified Cal Grant needs.
Cal Grant income ceilings	• Adhere to statutorily based policy to annually adjust the income ceilings consistent with the percent change in California's per capita income. Restore $11 million General Fund support.
Private university Cal Grant	• Adopt long-term policy linking private university Cal Grant to the weighted average General Fund subsidy provided for financially needy students attending UC and CSU. Restore $34 million General Fund support.
Public university Cal Grant	• Retain existing policy that links Cal Grant for UC and CSU students to full systemwide fees. Augment General Fund support by $19 million.
Institutional financial aid programs	• Maintain integrity of Cal Grant program before further expanding undergraduate institutional financial aid programs. Achieve $32 million General Fund savings.
Student Loan Operating Fund	• Use EdFund's operating surplus to fund campus-level financial aid administration at UC and CSU, thereby reducing General Fund costs by $66 million.

Findings and Recommendations

Education

Analysis Page

Proposition 98 Budget Priorities

E-13 ■ **Governor's Proposed Suspension Would Save $2 Billion Annually for Several Years.** The Governor's budget offers a good starting point for addressing the 2004-05 budget problem. Given the structural budget situation the state faces, we believe the Governor's proposed suspension of the Proposition 98 minimum guarantee is appropriate. If suspension is approved, recommend Legislature balance K-14 funding priorities with other General Fund priorities without regard to the exact Proposition 98 funding level proposed in the Governor's budget.

E-18 ■ **Eliminate Prior- and Current-Year Proposition 98 Obligations Through Suspension.** Recommend Legislature suspend the minimum guarantee in 2002-03 and 2003-04 to eliminate $966 million in Proposition 98 "settle-up" obligations the Governor proposes to postpone until at least 2006-07.

E-18 ■ **Proposition 98 Certification Process in Need of Reform.** Recommend Legislature (1) "close the books" (certify) the Proposition 98 funding level for fiscal years 1995 96 through 2001-02 and (2) certify the 1995-96 and 1996-97 funding level at the existing appropriation level—eliminating a potential obligation of $250 million.

Governor's Categorical Consolidation Proposal

E-37 ■ **Governor's Categorical Consolidation.** Recommend the Legislature approve the proposed consolidation of 22 programs into revenue limits with specific modifications.

Analysis Page

E-42 ■ **Remove Staff Development Programs.** Recommend the Legislature remove from the consolidation six staff development programs because including these programs would send a confusing signal about the value of these programs.

E-47 ■ **Remove Programs Providing Services to Special Needs Students.** Recommend the Legislature remove the English Language Assistance Program and the portion of the Targeted Instructional Improvement Program that districts use for compensatory services from the consolidated grant and, instead, add these funds to the Economic Impact Aid program.

E-49 ■ **Include Class-Size Reduction and Deferred Maintenance Funds.** Recommend the Legislature add deferred maintenance and the K-3 and high school class-size reduction funds to the consolidated grant in order to extend the reach of the proposed reform.

E-50 ■ **Address Transition Issues.** Recommend the Legislature limit district discretion in the near term in order to give teachers, principals, and parents meaningful opportunities to participate in determining how the consolidated grant funds would be used.

E-54 ■ **Address District Information Needs.** Recommend the Legislature appropriate $500,000 in unbudgeted federal Title VI funds to develop a strategic plan for best meeting district information needs about effective programs.

Teacher Quality

E-58 ■ **Create Teacher Quality Block Grant.** Recommend Legislature consolidate ten teacher-related programs into a teacher quality block grant. This would allow the state to retain its focus on teacher quality while simultaneously allowing school districts to pool their existing resources and use them more strategically.

E-62 ■ **Enhance Accountability for Improving Teacher Quality.** Recommend Legislature require school districts receiving funds through the teacher quality block grant to provide

Analysis Page

teacher-level data using a common teacher identifier in four specific performance areas. Recommend Legislature embed these data in a new comprehensive teacher information system.

Governor's School Safety Competitive Block Grant Consolidation

E-65 ■ **Create a Formula Driven School Safety Block Grant.** Recommend that the Legislature combine all seven school safety programs and ten school safety related state reimbursable mandates into a School Safety Block Grant.

E-73 ■ **Revert $1.6 Million in Current-Year Funds for Competitive Grant Programs.** Recommend the Legislature revert $1.6 million provided in 2003-04 for three school safety competitive grant programs that the State Department of Education is not administering because of the administrative burden of the programs.

E-73 ■ **Reduce Item 6110-226-0001(5) by $2 Million.** We recommend that the Legislature reduce funding for the Safety Plans for New Schools Program by $2 million, leaving $1 million to meet anticipated needs of new schools.

Charter Schools

E-74 ■ **Restructure Charter School Funding Model—Simplify and Equalize.** Recommend Legislature: (1) shift funding associated with 17 categorical programs into charter schools' revenue limits, (2) consolidate 21 programs into charter schools' base categorical block grant, (3) enlarge the supplemental disadvantaged student component of the block grant by including eight additional programs, and (4) amend charter school law to include a comprehensive listing of the programs excluded from the block grant.

Economic Impact Aid (EIA)

E-80 ■ **Revise the EIA Formula.** Recommend the Legislature simplify the EIA formula so that district allocations are

Analysis Page

predictable and meet local needs for serving both poor and English learner students.

E-86 ■ **Merge Other Funds Into EIA.** Recommend including funding for the English Learner Assistance Program and a portion of the Targeted Instruction Improvement Grants into EIA in order to consolidate all state programs that support instructional services to English learners and low-performing students.

Revenue Limits

E-88 ■ **Simplify The Revenue Limit Formula.** Recommend the Legislature simplify the system of revenue limits in order to make school funding easier to understand and allow the state to equalize in the future the amount of general purpose funds districts actually receive.

E-95 ■ **Delete Equalization Funds. Reduce by $110 Million.** Delete funding for revenue limit equalization because, due the state's fiscal situation, these funds could be used to reduce the state's structural budget gap or other legislative priorities. Further recommend trailer bill language directing the Quality Education Commission to review existing school district "size and type" definitions and develop a funding differential for small school districts.

E-98 ■ **Reinstate Reductions for Basic Aid Districts. Reduce by $9.9 Million.** Enact trailer bill language to reduce categorical funds for basic aid districts by $9.9 million until reductions to district revenue limits are restored.

Mandates

E-100 ■ **Recognize Offsetting Revenues.**. Recommend adding budget bill language to ensure districts use funds to satisfy any reimbursable state-mandated costs. Further recommend adopting trailer bill language to request the Commission on State Mandates (CSM) to revisit the issue of offsetting revenues in one program.

Analysis Page

E-104 ■ **Reconsider the Standardized Testing and Reporting (STAR) Mandate**. Recommend adopting trailer bill language requesting CSM to reconsider its decision on the STAR mandate in light of additional information that could reduce the scope of state-mandated costs.

E-105 ■ **Broaden Federal Exclusion**. Recommend adopting trailer bill language to broaden the federal exclusion to state payment of reimbursable state-mandated costs so the CSM could waive state reimbursement any time federal law also requires the same local program.

E-107 ■ **Eliminate Two Mandates.** Recommend eliminating the Physical Education Reports and Employee Benefits Disclosure mandates because they are unnecessary.

Federal Accountability and Assessments

E-109 ■ **Integrate State and Federal School Intervention Programs.** Recommend the State Department of Education (SDE) report at budget hearings on its proposal for the integration of state and federal intervention programs in order to inform the Legislature of how it intends to bring California into compliance with federal law.

E-113 ■ **State Required to Develop School District Interventions.** Recommend SDE and State Board of Education provide the Legislature with a detailed plan on how the state will meet the intervention requirements for school districts whose schools are failing to improve.

E-114 ■ **Federal Funds to Assist Low-Performing Schools and Districts Going Unused.** Identify $79 million in unallocated Title I funds available for district and school interventions to assist low-performing schools, $13 million of which must be spent before October 2005 or the state will lose it. Recommend the Legislature require SDE and the administration to provide a comprehensive plan for assisting districts and schools with the difficult task of turning around low-performing schools.

Analysis Page

E-115 ■ **Legislature Should Set Realistic Expectations for Federal Accountability.** Recommend Legislature amend the Public Schools Accountability Act to redefine “proficiency” for purposes of the federal No Child Left Behind Act.

E-117 ■ **State Risks Losing Federal Funds.** Recommend SDE report at budget hearing on the status of state expenditures of federal Title VI funds and whether the state risks losing federal funds. Also recommend the Legislature appropriate $8 million in federal funds for the California English Language Development Test to ensure the state will not lose federal funds and to save a like amount of General Fund dollars.

Instructional Materials

E-119 ■ **Instructional Materials.** We recommend that the Legislature shift $250 million in instructional materials funding into revenue limits, $75 million more than the Governor’s proposed shift. This level of funding restores funding to the 2002-03 base level, and reflects expected need for 2004-05. We recommend the Legislature reject the Governor’s creation of a new $188 million proposal because it contradicts the streamlining provided in the Governor’s revenue limit proposal. Combined, these recommendations free up $113 million for other legislative priorities.

Education Technology

E-124 ■ **Internet2 Access for County Offices of Education (COEs).** Recommend Legislature eliminate $21 million in funding provided to COEs for the high-speed Internet2 Access, because the program has limited benefits to schools and school districts, and the technology is still relatively expensive.

Child Care

C-128 ■ **Budget Proposes New Child Care Reforms.** The Governor’s budget proposes a number of significant reforms to California’s subsidized child care system. Given the state’s

Analysis Page

difficult fiscal situation, these proposals effectively prioritize limited child care resources. However, the Governor's proposals lack important policy, implementation, and administrative details that would help the Legislature weigh state savings against reducing child care services for a significant number of lower-income families. We evaluate the proposals' effect on children, families, and the state budget, and present some alternative approaches.

C-144 ■ **Proposition 49 Not Likely to Trigger for Several Years.** Based on the Governor's proposed budget and our fiscal forecast, Proposition 49 would not trigger an increase in funding for the After School Education and Safety Program until 2007-08. This assessment, however, depends on (1) how the state solves the structural imbalance between General Fund expenditures and revenues and (2) future growth in General Fund revenues.

K-14 Outreach Programs

E-176 ■ **Establish College Preparation Block Grant. Reduce Item 6870-001-0001 by $30 Million and Redirect Funds to New Block Grant Item**. Recommend Legislature redirect $30 million for community college financial aid outreach to a College Preparation Block Grant targeted at K-12 schools with very low college participation rates.

E-178 ■ **Expand Use of Community College Financial Aid Outreach Funds**. Recommend Legislature broaden the permissible uses of the remaining $7 million available for community college outreach, in order to provide community colleges greater flexibility assisting disadvantaged students for higher education.

E-179 ■ **Preserve Selected University of California (UC) and California State University (CSU) Outreach Programs.** Recommend Legislature redirect the $3.5 million proposed for dual admissions counseling to preserve selected outreach programs at UC and CSU, in order more accurately target limited resources at students most in need of college preparation.

Analysis Page

Higher Education Admissions and Enrollments

E-188 ■ **No Need to Abandon Master Plan Commitment.** Based on our review of current admissions policies and practices, we find that (1) the University of California (UC) and the California State University (CSU) could accommodate additional eligible students in 2004-05 without increased funding for enrollment growth and (2) current eligibility requirements established by the segments may not be accurately defining the state's top high school graduates.

E-192 ■ **Redirect Lower Division Students to Community Colleges. Reduce Item 6870-001-0001 by $3.4 Million**. Recommend the Legislature establish a policy, similar to the Governor's proposal, whereby UC and CSU would admit qualified freshmen but redirect a portion of them to enroll in specific community colleges for their lower division coursework. Recommend rejection of the Governor's proposal to waive the fees for students redirected from UC and CSU to the community colleges.

E-194 ■ **Return to Master Plan's Special Admission Caps.** Recommend the Legislature require UC and CSU to return to the Master Plan's special admissions cap of 2 percent, in order to maximize access for eligible students with the state's limited fiscal resources.

E-195 ■ **Implement Enrollment Management Policies.** Recommend UC and CSU implement policies (such as limiting consideration of new applications to a specified filing period) on a systemwide basis that seek to manage enrollment demands by preserving access for state residents who are eligible for admission.

E-195 ■ **Reexamine Existing Eligibility Standards.** Recommend Legislature more clearly define how the segments should select the state's top high school graduates, in order to preserve its higher education priorities.

Analysis Page

Intersegmental—Student Fees

E-199 ■ **Establish Long-Term Fee Policy—Set Undergraduate and Graduate Fees At Fixed Percentage of Students' Total Education Costs.** Recommend Legislature adopt a long-term statutory fee policy for the University of California (UC), the California State University (CSU), and the California Community Colleges that sets fees at a fixed percentage of students' total education costs. This would provide an underlying rationale for fee levels. It also would treat students fairly over time, offer incentives for students to hold the segments accountable for keeping costs low and quality high, and formally recognize the private as well as public benefits of higher education.

E-203 ■ **Use New Fee Policy to Develop Budget-Year Plan and Out-Year Implementation Plan. Augment Item 6440-001-0001 by $36 Million and Item 6610-001-0001 by $26 Million**. Recommend Legislature use the percentage-of-costs policy to assess the appropriateness of existing fee levels, determine specific fee increases for the budget year, and develop a plan for raising fees over the next several years until the established fee targets have been met. Once met, we recommend fee levels be adjusted annually holding the percentage-of-costs steady. In the budget year, for UC and CSU, we recommend more moderate increases in resident graduate fees and nonresident undergraduate fees. We have identified savings elsewhere in higher education sufficient to offset the forgone revenue.

E-206 ■ **Encourage Higher Fees for High-Cost Graduate Programs at CSU. Reduce Item 6610-001-0001 by $2 Million**. Recommend Legislature encourage higher fees for higher-cost graduate programs at CSU. This would be consistent with existing practice at UC and at least 10 of CSU's 15 comparison institutions, as well as consistent with a percent-of-cost fee policy. If instituted, we estimate CSU could generate $2 million in additional student fee revenue, thereby providing a like amount of General Fund savings.

E-207 ■ **Count Summer Fee Revenue as Available to Offset General Fund Reductions. Reduce Item 6610-001-0001 by $9.5 Mil-**

Analysis Page

lion. Recommend Legislature achieve an additional $9.5 million in General Fund savings by applying the 2004-05 undergraduate and graduate fee increases either to summer 2004 or summer 2005 and counting the additional revenue toward 2004-05.

E-210 ■ **Request UC to Provide Detail on Current-Year Professional School Expenditures.** Recommend Legislature request UC to provide additional detail on current-year expenditures for its professional schools. Specifically, UC should provide: (1) an accurate accounting of its professional school enrollment and (2) the current-year budget for each of its professional schools.

E-212 ■ **Link Excess Unit Surcharge With Implementation Update in Spring 2005.** Recommend Legislature adopt the administration's policy proposal to charge full cost for excess course units. Given legitimate implementation concerns, we also recommend the Legislature adopt supplemental report language requesting UC and CSU to report on the actual implementation of the surcharge during next year's budget hearings.

Financial Aid

E-218 ■ **Rather Than Another Likely Reversion, Use Overbudgeted Monies for Identified Cal Grant Needs. Reduce Item 7980-101-0001 by $20 Million**. Given three straight years of substantial overbudgeting for the Cal Grant program, recommend Legislature adopt more realistic budget assumptions. Specifically, recommend assuming fewer new and renewal awards will be issued in 2004-05, thereby generating $20 million that could be used for identified Cal Grant needs.

E-219 ■ **Adhere to Existing Policy for Adjusting Cal Grant Income Ceilings. Augment Item 7980-101-0001 by $11 Million.** Recommend Legislature adhere to its longstanding and statutorily based policy to annually adjust the Cal Grant income ceilings consistent with the percent change in California's per capita income. This would prevent some of California's financially neediest students from being denied

Analysis Page

entitlement benefits as well as help some middle-income students cover likely increases in student fees and tuition.

E-219 ■ **Restore Policy Basis Used to Set Value of Private University Cal Grant. Augment Item 7980-101-0001 by $34 Million**. Recommend Legislature adopt a long-term Cal Grant policy through legislation that would link the private university Cal Grant to the weighted average General Fund subsidy the state provides for financially needy students attending the University of California (UC) and the California State University (CSU). This policy would promote fiscal fairness by ensuring that a similar state subsidy is provided to all financially needy students regardless of whether they attend a private or public university.

E-223 ■ **Retain Existing Policy Basis Used to Set Value of Public University Cal Grant. Augment Item 7980-101-0001 by $19 Million**. Recommend Legislature retain its existing policy to have the public university Cal Grant cover UC and CSU's entire systemwide fee. This would ensure financially needy students remain able to overcome the primary fiscal hurdle to attending UC and CSU.

E-227 ■ **Maintain Integrity of Cal Grant Program Before Further Expanding Undergraduate Institutional Aid Programs. Reduce Item 6440-001-0001 by $19 Million and Item 6610-001-0001 by $13 Million.** Recommend Legislature maintain existing Cal Grant benefits before further expanding institutional aid programs (which grew dramatically in the current year). The Cal Grant program (1) is more transparent and easier for students to understand than institutional aid policies, (2) already accounts for segment-specific differences, and (3) allows the state more simply and directly to address critical policy trade-offs.

E-233 ■ **Approve Elimination of CSU's Educational Opportunity Program (EOP). Reduce UC's Base Institutional Aid Budget by Additional $16 Million. Reduce Item 6440-001-0001 by $16 Million.** Recommend Legislature eliminate small, specialized institutional aid programs at both CSU and UC. These

Analysis Page

programs continue to spur disturbing disparities both within and among the segments.

University of California (UC)

E-241 ■ **Restoration of One-Time Reduction From 2003-04. Reduce Item 6440-001-0001 by $33 Million.** Recommend Legislature reduce by $33 million the Governor's proposed restoration of an $80.5 million one-time unallocated reduction made in 2003-04, in order to account for the availability of ongoing funds the university has dedicated to partially offset this one-time reduction.

E-242 ■ **Additional Funding for New Merced Campus. Reduce Item 6440-004-0001 by $10 Million.** Recommend the Legislature reject the $10 million proposed augmentation for the new Merced Campus, because neither the administration nor UC could provide adequate justification for the additional funds.

California State University

E-248 ■ **Restoration of One-Time Reduction From 2003-04. Reduce Item 6610-001-0001 by $24.5 Million.** Recommend Legislature reduce by $24.5 million the Governor's proposed restoration of a $69.5 million one-time unallocated reduction made in 2003-04, in order to account for the availability of ongoing funds the university has dedicated to partially offset this one-time reduction.

California Community Colleges

E-254 ■ **Delete Special Funding for Noncredit Instruction. Reduce Item 6870-101-0001 by $4 Million.** Governor's proposal departs from longstanding practice and lacks justification.

E-260 ■ **Categorical Reform Proposal Needs Work.** Amend budget bill language (BBL) to strengthen accountability measures. Also, eliminate BBL that blocks genuine consolidation of funding.

Analysis Page

E-264 ■ **Equalization Funding Should Be Applied to Existing Obligations. Reduce Item 6870-101-0001 by $80 Million.** While we support goal of equalization, we believe state's fiscal situation requires that funding be applied to existing obligations (such as deferred costs and mandates) rather than new programs.

E-266 ■ **Overdue Reports Hinder Accountability.** Direct Chancellor to report at budget hearings on how concurrent enrollment reduction was allocated and how state priorities were maximized in allocating apportionment funding.

Student Aid Commission

E-270 ■ **Retain Existing Priorities of Assumption Program of Loans for Education (APLE).** Rather than approving the administration's proposed trailer bill language, recommend retaining APLE's existing eligibility criteria and giving highest priority for new warrants to individuals teaching in a critical subject shortage area in a very low-performing school.

E-272 ■ **Use EdFund Operating Surplus to Relieve General Fund. Shift $66.3 Million From Item 7980-001-0784 to Items 6440-001-0001 ($34.7 Million) and 6610-001-0001 ($31.6 Million)**. Given EdFund's increasingly large operating surpluses, recommend Legislature shift $66 million in surplus monies to fund financial aid administration at the University of California and the California State University, thereby achieving a like amount of General Fund savings.