PolicyMatters

A Journal of the Goldman School of Public Policy

UNIVERSITY OF CALIFORNIA, BERKELEY

Volume 9
Number 1
Special Edition
Fall 2011

FINANCING CALIFORNIA:

IDEAS FROM THE 14TH ANNUAL TRAVERS CONFERENCE

FOR CIRCULATION AT POLICYMATTERS' CONFERENCE ON GOVERNING CALIFORNIA
OCTOBER 18, 2011 • SACRAMENTO, CA

CRIMINAL JUSTICE

The Role of Criminal Justice in the California Budget Crisis

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California's budget crisis could be somewhat alleviated by amendments to the state's criminal justice system. Correcting some of the system's flaws (including overcrowding, sentencing issues, as well as burden of health care for prisoners) would result in fiduciary benefits to the state. This paper examines what the budget crisis means for California's criminal justice, and cost-savings measures for the future.

What does the budget crisis mean for California criminal justice? What does the criminal justice crisis mean for the California budget? A few general (and somewhat inconsistent) views and assumptions drive these questions:

- California criminal justice, especially the prison system, is so large a part of the budget that there can be no serious deficit reduction without a reduction in this area.
- Reductions in this area will be exceptionally painful because they might threaten public safety, or will at least appear to voters as having that effect.
- There are flaws in the system that would be serious concerns even if we weren't in a budget crisis, but financial constraints underscore and exacerbate the effects of those flaws.
- The flaws make the system excessively expensive, so addressing them might actually be consistent with improvements in the cost-effective protection of public safety.

Here are some perspectives on these questions. First, criminal justice is an important part of the state budget, but a relatively small one compared to such things as education, pensions, and health care. Nevertheless, the state has been unusually constrained in its efforts to reduce the costs of imprisonment. Various structural constraints in the legislative process and the tradition of mandatory spending allocations in our budget inhibit reductions in many policy areas. But there is a unique set of constraints in the imprisonment area. More or less, the prisons have to take the prisoners sent there by county prosecutors and courts. Further, the major cause of the high numbers of these bodies so delivered to the state is the Penal Code itself and its extremely long and determinate sentences. It has become politically toxic for legislators to even consider changes in the Penal Code, especially in light of powerful lobbying from law enforcement and district attorneys.

Second, the key manifestation of the ills of the criminal justice system is the set of federal injunctions over the prison system. We now have a tentative court ruling that California's prison system is at least 40 percent overcrowded. That ruling may not survive imminent U.S. Supreme Court scrutiny, but the health and mental health care cases that underlie the overcrowding case will continue anyway and exert de facto pressure to reduce population or increase per-prisoner expenditure. Ironically, all these court pressures mean even zero cuts in the current prison budget represent a cut, because the proper baseline may not be the current cost of prisons, but the higher constitutionally required costs of the prisons. In effect, the court orders carry a financial debt that must be added to the state's liabilities. And to the extent the state finesses the injunctions (as it regularly does, testing the courts' patience), it is canceling debt.

Third, there have been, and will continue to be, some ways to reduce imprisonment and costs without directly facing the resistance to changes in the Penal Code. One instance of this occurred in 2009 and even involved the legislature—the new principle that low-risk parolees do not need supervision and that more parole agent time should be spent on very high-risk parolees. Regardless of whether this change reduces the costs of parole supervision, it might reduce costs to the prison system overall, since prisons will be less burdened by new inflows of low-risk prisoners sent back for technical violations. The last governor was somehow able to get this change through the legislature, in part because it did not change the Penal Code and hence stayed below the demagogic radar. Notably for 2011 and beyond, the new governor may be able to extend changes of this sort, either by more low-visibility legislation or through executive branch rulemaking and discretion.

Fourth, although the bulk of inmates go on mandatory three-year parole and much of the overcrowding of prisons results from the recycling of these prisoners because of parole revocations, old-fashioned life sentences still play a major role. Over 20,000 California prisoners are on indeterminate sentences as the result of life sentences for murder and other violent crimes, or via the state's "three strikes" law. These prisoners are very expensive because they stay so long, because they are numerous, and because they reach the age when they need more medical care. Conversely, as they age they become progressively less risky to release. Geriatric chemotherapy clinics in the prisons are a telltale sign of inefficient incarceration, as are two-person teams of prison guards sent with some older prisoners to public hospitals. The governor is reexamining the discretionary parole hearing process and may find below-the-radar ways to induce the Board of Parole Hearings to recommend more releases and to allow more release recommendations to go through without gubernatorial veto.

Fifth, the biggest cost-saving measures all fall under the popular rubrics of "devolution" and "realignment." There is no question that this is the way the state is going. The questions are by what means it gets there and with what effects. These two terms refer to shifting responsibilities from state to county (or even city). Perhaps the smaller part of it, though it might involve some changes to the Penal Code, is about reclassifying certain low-level felonies to misdemeanors so they can't affect state prisons at all. These include varieties of DUI, drug, and theft crimes. The premise is that even though some county jails are crowded, some have space, whereas the state has none. An indirect trickle-down-pressure consequence might be more probation sentences for very low-level misdemeanants so even the jails are spared more bodies.

The bigger change will be parole/probation realignment. Whether by unifying the two systems (as is done in many states) or just through some administrative reconfiguration, large numbers of prison parolees would be supervised by counties, not the state. To some extent this could end up as a budgetary sleight of hand—shifting costs from state to county. That will not be true to the extent that the state promises to shift money with costs. If there are savings, there will be two reasons: First, there is the theory that counties will handle reentry more efficiently because of their proximity to and knowledge of social services, housing, and rehab programs, as well as possible economies of scale with probation. The state already doesn't spend much money on reentry programs, but maybe even if it pays for the counties' new burdens here the costs will be lower. Recidivism might be lower if reentry works better this way. (That is good for everyone's budget, but most directly would help the state get out of the federal injunctions.) But another argument lies in simple economic theory. Right now the system is rife with negative externalities: (Mostly) city police decide whom to arrest and thereby shift costs to county prosecutors and jailer-sheriffs (although, interestingly, a mechanism called booking fees somewhat mitigates this externality); county prosecutors (and judges, if you think of them as county employees) convict defendants and shift costs to the state for prison and parole. So devolution is

A Closer Look at Medi-Cal Cuts: The Formidable Road Ahead

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This article discusses Governor Jerry Brown's $1.7 billion proposed cuts to Medi-Cal introduced in 2010 at the beginning of his term, and the likely ineffectiveness of theses cuts to achieve the desired savings needed to close California's budget deficits. The discussion identifies three major challenges that will adversely affect implementation and ultimately lead to greater budget obstacles in the long term.

Editors' Note: Because this article discusses a budget proposal and is not longer quite up-to-date, we recommend either updating to include the most current information, or adding an up-front explanation of when the article was written and the most recent developments.

HEALTHCARE

California currently faces ongoing deficits that will require substantial cuts across most budget areas in the coming year. This written brief evaluates prospects for the $1.7 billion cut proposed in 2010 to Medi-Cal, a program that provides health benefits to nearly 20 percent of California's residents. The following discussion cautions that the current proposals will likely be ineffective in achieving desired savings, and the Medi-Cal program is poised to face even greater long-term budget challenges. The discussion first describes the nature of the proposed cuts and the feasibility of their implementation. It next explores three challenges to Medi-Cal's future solvency: (1) the concentration of program costs in a small share of medically needy beneficiaries, (2) the shift in enrollment from traditional fee-for-service to more expensive managed care plans, and (3) the program's new spending obligations under the Patient Protection and Affordable Care Act (PPACA).

Governor Jerry Brown's budget for 2011–2012 included $1.7 billion in cuts to the Medi-Cal program. Federal regulations make it very difficult for state Medicaid programs such as Medi-Cal to achieve savings by limiting participation. Therefore, cuts are limited to four main areas: (i) caps on benefits, (ii) copayments for beneficiaries, (iii) reductions of benefits, and (iv) reductions of provider payments. Since a large portion of state Medi-Cal spending is matched by federal dollars, the impact of state cuts would be amplified by a corresponding decrease in matching expenditures. It is not apparent, however, that enacting these reforms will be feasible or achieve the desired savings.

Caps on Benefits. The 2011–12 budget proposed caps on Medi-Cal benefits that are projected to yield $217.4 million in savings for the California general fund. This figure represents 13 percent of the total expected savings. The proposed caps would limit physician/clinic visits to ten per year and drug prescriptions to six per month for all adult Medi-Cal beneficiaries. Additionally, they cap spending for durable medical equipment, medical supplies, and hearing aids at the ninetieth percentile.

It is not immediately clear, however, that these caps can be imposed. What does one do with a diabetic who requires more than ten office visits per year? Will that beneficiary be sent to a hospital to receive treatment? Will a transplant patient be denied immunosuppressant drugs because he/she has already reached the cap on prescriptions? It is difficult to imagine that caps could be imposed without some shifts in care to more expensive services and considerable allowances for exceptions.

Copayments for Beneficiaries. Next, the governor's budget proposed imposition of copayments for many covered services that are forecasted to yield $557.2 million in savings for the General Fund, a figure that represents a third of the total expected savings. The copayments would be required for services in almost all settings, including physician/clinic visits, dental office visits, emergency room (ER) visits, inpatient stays, and prescription drug benefits.

While Medicaid programs have the right to charge copayments, the amounts cannot be as high as the ones proposed in California's budget without applying for a federal waiver. For example, the governor's proposed copayment for an emergency room visit is $50, but according to federal regulation it cannot exceed $6. Moreover, PPACA does not allow any state provisions that discourage or restrict eligibility; therefore, it is questionable whether the federal government will allow California to proceed at all with this proposal.

Elimination of Benefits. In addition to benefits that Medi-Cal is required to offer to qualify for federal matching, the program currently provides certain supplemental benefits. The governor's budget proposed eliminating some of these services, including the Adult Day Health Care program and coverage for certain over-the-counter drugs. It also suggested limiting coverage for nutritional supplements for a total general fund savings of $193.2 million, representing 11 percent of total expected savings.

The General Fund benefit from the elimination of these programs, however, is likely overstated as costs will need to be offset elsewhere. For example, elimination of the Adult Day Health Care program may result in increased spending for long-term care, which is one of Medi-Cal's most expensive benefits.

Reduction in Provider Payments. Finally, the largest share of the $1.7 billion in budget savings was expected to come from a 10 percent cut in provider payments and a 10 percent cut in payments to long-term care facilities. These cuts are intended to save $709.3 million for the General Fund, representing 42 percent of the expected total savings.

Even prior to implementation of any proposed cuts, Medi-Cal reimbursement rates are already some of the lowest in the country. In 2008, California rates were nearly half of Medicare's reimbursement rates for the same set of services and were 17 percent below the national average for Medicaid. Consequently, California providers are not currently incentivized to treat Medi-Cal beneficiaries, and further cutting reimbursement rates would likely lead to even more provider withdrawal from the program. This, in turn, limits Medi-Cal beneficiaries' access to care.

Moreover, previous attempts to reduce provider payments have been blocked by legal challenges for precisely this reason. In response to proposed cuts in 2008, a group of health professionals filed a lawsuit and successfully prevented implementation of the cuts with a favorable court ruling. On January 18, 2011, the U.S. Supreme Court agreed to hear California's appeal regarding the aforementioned ruling and will thus soon determine whether private parties have the right to file in federal court to enforce Medicaid law. Even if the Supreme Court sides with California, however, the plaintiffs could file a similar lawsuit in state court or appeal to the Centers for Medicare and Medicaid Services (CMS) to disallow the cuts; CMS has rejected such requests by other states in the past and may now even see the proposed cuts as violating PPACA. Therefore, it is not clear that Medi-Cal will be allowed to proceed with the current proposal and, even if it is permitted, these cuts will not be allowed in the near future.

In conclusion, then, the governor's budget assumed that caps on benefits, copayments for beneficiaries, reductions of benefits, and reductions of provider payments would save $1.7 billion for the Medi-Cal general fund. Achieving these savings, however, will be difficult to attain; many will be blocked by federal regulation or the courts, and others will be infeasible to implement without inducing costs in other forms of services.

Unfortunately, budget solvency will become even more challenging in the upcoming years due to three distinct features of the program. First, saving money will require restricting services to the most intensive users of Medi-Cal, which encounters a number of associated political challenges. Second, shifts in enrollment from traditional fee-for-service to managed care have not saved money for the program. Finally, California's obligations under the PPACA will place additional burden on the Medi-Cal program in the coming decade.

The first challenge faced by the Medi-Cal program is that the vast majority of benefits go to a small share of the sickest beneficiaries. In fact, the top 5 percent of enrollees represent 60 percent of program costs, while the bottom 75 percent of enrollees account for less than 6 percent. This implies that even if benefits were cut in half for the bottom 75 percent of participants, the program savings would be less than 3 percent. Therefore, saving money will require limiting benefits for the highest-cost individuals.

This is a tremendous policy challenge, however, because high-cost cases disproportionately include disabled and elderly enrollees, and the costs are dominated by nursing home and hospital stays. For the top 5 percent of beneficiaries, 51 percent of costs are incurred by blind/disabled individuals, and an additional 31 percent of costs belong to the elderly. Two-thirds of the expenses are concentrated in nursing home and hospital stays, whereas individuals with below-average spending primarily use physician services. It is difficult to imagine that a budget that denies care to these vulnerable populations would be politically palatable without new ways of providing health care services, which are yet to be discovered.

A further ongoing challenge for Medi-Cal is the recent shifting of enrollment from fee-for-service plans to Medicaid HMOs that has taken place over the past decade. Managed care enrollment increased from around 20 percent in the early 2000s to nearly 40 percent in late 2009. Research suggests that this trend has not saved money nor improved health outcomes. The work of Duggan (2004, *Journal of Public Economics*), Hurley and Draper (2002, *Health Care Financing Review*), and Spitz (2007, *Journal of Health Politics, Policy and Law*) indicates that average beneficiary costs may have increased on the order of 20 percent for those beneficiaries shifted to managed care in California.

There are four reasons why Medicaid managed care should not be expected to achieve the same level of savings seen in commercial HMOs. First, Medicaid HMOs are unable to extract significant rate discounts from providers, because Medicaid fee-for-service rates are often much lower than commercial rates. Also, because fewer providers participate in Medicaid, the HMOs have less leverage to demand rate discounts than in the commercial market. Second, most Medicaid programs already use prior authorization and other utilization controls in their fee-for-service system prior to shifting beneficiaries to Medicaid managed care. Therefore, the savings associated with those controls are already built into the fee-for-service base. Third, to the extent that a usual source of care is established under HMOs where none existed in fee-for-service, utilization under managed care can be expected to increase in response to caring for unmet needs. Fourth, Medi-Cal HMOs are not subject to risk adjustment in premiums of the sort used in the Medicare system. This results in managed care being able to price low-cost beneficiaries at "average" cost rates, which overcompensates when Medi-Cal HMOs use carve-outs to shift high-cost beneficiaries to fee-for-service; the premiums of HMOs are not correspondingly docked for this avoidance of cost.

In the future, achieving savings through managed care will require Medi-Cal to redesign its payment system to include appropriate forms of risk adjustments and binding capitation that eliminates carve-outs.

The third challenge for Medi-Cal in the coming decade will be a required expansion of the program under the PPACA. PPACA stipulates that, beginning in 2014, almost all people under 65 with an income of up to 133 percent of the federal poverty line must be covered by a state Medicaid program. States are also required to add benefits such as free-standing birth clinics, tobacco cessation programs for pregnant women, and coverage of certain drug classes like barbiturates and benzodiazepines. These changes, along with new administrative costs, will add to the financial burden of Medi-Cal.

States will receive some federal funding to help offset the new program costs. From 2014 to 2016, federal funds will cover 100 percent of the Medicaid expansion. However, by 2020, states will be required to cover 10 percent of expansion costs for newly eligible beneficiaries. There will also be a reduction in disproportionate share hospital payments, totaling $4 billion by 2020. States can expect reductions in Medicaid reimbursements for prescription drugs via a redefinition of the average manufacturer's price. Finally, federal matching funds for SCHIP are guaranteed only until 2015, and states are still required to provide existing levels of SCHIP between 2015 and 2019 at their own expense.

To pay for the expansion in Medi-Cal rolls, the estimated increase in California's Medicaid spending is 2 percent (relative to baseline growth) for newly eligible individuals from 2014 to 2019. This represents the cost of expanding coverage to two to four million new Medi-Cal beneficiaries, primarily adults without dependent children. In addition, Medi-Cal can expect increased enrollment among "old-eligibles"—individuals who previously qualified for the program but did not enroll—due to individual insurance mandates. The addition of this old-eligibles group is projected to increase the cost of reform 4 to 4.5 percent above baseline growth. The burden will be significantly larger if employers elect to drop health coverage for low-wage workers.

All considered, the challenges faced by California in containing costs of its Medi-Cal program are formidable, and looking into the future makes the problems of the past appear quite modest in comparison. Clearly, a major requirement for California to deal with these challenges is for the federal government to give the state far more flexibility in altering its program rules and features.

A Long-Term Plan for California Schools: Enhancing, Reallocating, and Optimizing Resources in K–12 Education

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After thirty years of decline, California's K–12 public education system now ranks below most states in measures of revenues per student and student achievement. This article recommends long-term strategies for enhancing per-pupil revenues by broadening the tax base and revising state financing formulas to more equitably distribute funds. Additionally, the author proposes reforms to facilitate both the effective use of funds and the expansion of compound, complex, and abstract resources such that new revenue can positively affect student outcomes.

Someone recently congratulated me on the "level funding" of K–12 education for 2011–12, compared to cuts in higher education of $1.4 billion. But this year's budget includes approximately $2 billion of "deferrals" of Prop 98 funding until 2012–13, and savings of almost $1 billion by eliminating cost-of-living adjustments. It's impossible to "defer" spending on next year's students, so this looks like $3 billion in cuts for K–12 education . More cuts are in the offing, depending on the future of state revenues. In addition, other cuts will indirectly affect education: cuts in CalWORKs, Medi-Cal, Healthy Families, and child care. Low incomes and stressed families are not good for schooling, so these have to be counted as costs to the education system too.

But the problem of lower funding and lower performance is not a recent issue, and therefore improving schools in California requires a long-run agenda for enhancing revenue, distributing that revenue in different ways, and making sure that revenue is spent effectively. In this note I concentrate on long-run improvements, rather than the short-run fixes that will preoccupy most educators and policymakers.

Enhancing Revenue

Real revenues per student have been declining since Prop. 13 passed in 1978; California is now about forty-sixth among the states, whereas it was in the top five in spending per pupil before that. In terms of National Assessment of Educational Progress (NAEP) scores, the only basis for comparison among states, California is near the bottom in almost every subject and grade level. As John Merrow said in a PBS documentary, the state has gone "From First to Worst." Many of the consequences fall on higher education, where a huge proportion of the student body entering community colleges and the California State University system tests into remedial or developmental courses, and where in many ways students are not "college ready." In terms of K–12 improvement, schools have been cut to the bone, to the point that the schools that most need improvement cannot reform themselves because teachers and leaders are too burdened with extra duties.

California's schools will need an adequate resource base; otherwise, with K–12 education the largest category of state spending (almost 43 percent of the budget), schools will continue to be targets for budget-cutting. If it has taken us thirty years to get into the current crisis, it might take another thirty years to work our way out of it. Here are a few directions for a long-term plan:

- Slowly eliminate or moderate Prop. 13, the property tax limitation. Of course, this has to be done carefully so that taxpayers don't experience abrupt increases in property taxes, and it needs to be accompanied by "circuit breakers" to protect the elderly and the poor from objectionably high property taxes. But without restoring at least part of the traditional tax base for schools, school funding will never stabilize.

- Increase other taxes, not by increasing tax rates but by broadening the base of such taxes as the sales and personal income taxes. This would also lead to more equitable, more efficient (non-distorting), and less volatile tax revenues.

- Reverse the decline in corporate taxes, particularly since the business sector has been especially insistent about the need for better schools and colleges.

Revising the State's Financing Formulas

Two different commissions have addressed the hideous complexity of the state's school finance formulas in the past decade, including the Master Plan Commission of 2001–2003 and a set of studies published by Stanford University called "Getting Down to Facts," along with several summary papers. This is an area where more research is not needed. Several of these reports agree on a number of recommendations:

- The state's large number of categorical funds for specific educational expenditures need to be dramatically reduced. While this process started in 2009, there's a long way to go.

- Local districts need to be given their own revenue bases, partly to redress the shift in policymaking toward Sacramento. Lifting Prop. 13 would accomplish this; the Master Plan Commission considered a local supplement to the state income tax but recommended greater use of parcel taxes.

- State funding needs to be equalized for differences among communities (e.g., in the property tax base per capita). However, funding formulas can also equalize among students by using weighted pupil funding formulas with higher weights for some students—for example, for low-income students, English language learners, and special education students.

- Less popular are adjustments for differences in the cost of education around the state.

Making Money Matter, or Doing More with What We Have

Most educators and reformers believe in the "Money Myth": the contention that "the question of sufficient revenue lies back of every other educational problem" (as stated by an early proponent of the notion, Ellwood Cubberley, in 1905). But the relationship between money and outcomes is weak to nonexistent in both the United States and the UK. Money may be necessary, but it is not sufficient to ensure high levels of learning and advancement through the educational system. Instead of focusing on the amount of money, we need to emphasize the different resources that educate students—capable teachers, leaders engaged in instructional improvement, supportive school climate, stability—and emphasize putting these resources in place.

Some resources (simple resources like teacher salary levels, to attract a pool of capable teachers and reduce turnover) require money in obvious ways; other compound resources require combinations of inputs, like class size reduction plus adequate professional development plus adequate facilities; some complex and abstract resources cannot be bought, but have to be constructed by teachers, leaders, and parents working in cooperation, with vision and information about effectiveness.

The following policies might help schools and districts make money matter:

- Returning decision-making to the school level rather than the district and state levels. School-site budgeting is one way to give schools both the incentives and the funding to make their own resource decisions; another is to restore a funding base to districts.

- Improving the ability of school leaders and teacher-leaders (like school-site councils) to make decisions about effective resources. This requires much more preparation in thinking about alternatives to the Money Myth. Some of this can be embedded in principal and teacher preparation programs, which are weak and usually include very little information about money and resources; some should take place in induction programs and support programs for veteran teachers and leaders.

- Engaging in "waste audits" at the school and district level to identify the large amount of funds that are effectively wasted. The state of California needs to engage in its own "waste audit": it has developed some multibillion-dollar programs with no effects on the average, and it needs to learn from its mistakes of the past.

- Engaging in "resource audits" in place of fiscal audits, focusing not on money but on resources, and examining whether a school has a sufficient number of effective resources in place.

- Developing a source of information about effective practices (an improvement on the existing What Works Clearinghouse), so that schools and districts need not learn about effective and ineffective practices on their own. But since a repository of information is only the first of six or seven steps in the process of adopting innovations, a better policy would be to develop an Educational Extension Service, based on practices of the successful Agriculture Extension Services, with "extension agents" serving to help schools move ideas and innovations into practice.

- Shifting from "programitis" as a reform strategy—adopting a series of supplementary programs like special interventions, after-school and other out-of-school-time programs, coaches for English and math—to enhancing the basic capacities of teachers, leaders, and other school personnel.

Learning and practicing the perspectives explained above will, like the restoration of the state's revenue base, take a long period of sustained efforts. But the alternative is to perpetuate the current situation where money doesn't matter that much to outcomes, money is constantly wasted, the right resources are not put in place, and the great needs of many students go unaddressed.

Investing in California Schools during Tough Times

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FORMER STATE SENATOR
FORMER SECRETARY, CALIFORNIA DEPARTMENT OF EDUCATION

California schools already suffer serious challenges and now risk financial burdens that could limit the ability to provide a quality education to all California children. During these difficult economic times, it's critical to support new sources of revenue and invest in promising education initiatives.

There are many school finance issues that demand our attention, including stability, equity, and transparency, but the most pressing issue remains adequacy. California is far below the median of the states in per-student funding; today we rank $2,500-per-student less than the national average even though we have a more challenging set of students to educate, with an enormous English language learner population (25 percent) and a larger-than-average economically impoverished population (20 percent).

New Revenue

Although there are many proposals for reforming our tax structure (most notably those to broaden the sales tax), there are two tax revenue ideas that recent polling indicates popular support for even in these difficult economic times:

A parcel tax by a 55 percent majority of local voters. Currently parcel taxes can be enacted by a two-thirds vote, which is extremely difficult to accomplish. Many school districts believe garnering a 55 percent vote is attainable and could provide valuable additional funding. An added benefit of a parcel tax is it helps connect local schools to local funding—a worthwhile government reform. A recent Public Policy Institute of California (PPIC) poll (January 2011) indicates a majority of voters in favor of a 55 percent parcel tax.

A split-roll property tax (non-homeowner property would be assessed at current market value) earmarking the funds for K–12 education. This would generate approximately $8 billion in new ongoing revenue and would provide important stability as well as new revenue for schools. The split roll could be phased in over a number of years to soften its immediate impact. The PPIC poll indicates 55 percent voter support for an increase in business taxes if earmarked for education.

It is extraordinary that in these tough economic times, with an aging voting population, voters are open to new taxes to support our schools. The public understands that a strong education system is essential to fulfill the American and California Dreams. Of course, passage of these measures is not assured, but with strong advocacy from the governor and the educational community these measures have a reasonable chance of passing. The alternative is to depend on the vagaries of the state economy and, in all likelihood, continue to see a decline in already inadequate resources for California schools.

School Budget Cuts

In recent years, K–12 schools have faced significant budget shortfalls and have taken three major actions to absorb the cuts:

- Reduce the school year from 180 to 175 days and restrict or eliminate summer school.
- Increase class size (California already ranks forty-ninth out of the fifty states in class size).
- Reduce teacher and other school personnel salaries.

In terms of effects on student academic performance (especially of poor children) the loss of instructional time is particularly worrisome; research indicates that "time on task" has a direct impact on student performance. Further cuts resulting in loss of instructional time ought to be resisted.

If further cuts are necessary, one area long overdue for attention is the "step and column" teacher salary schedule in place in California school districts for well over half a century, where teachers receive compensation based upon seniority and college credits taken even though there is little or no correlation between experience, college credits, and teacher effectiveness. If step and column were revised or eliminated (we currently spend more than $1 billion annually on this outdated system), we could create teacher career ladders where the most effective teachers are paid more for assuming new responsibilities (e.g., mentoring new teachers, developing curriculum, teaching more students, teaching more challenging students) and substitute clinically based professional development for the wasteful laissez-faire college credit reward system.There are many school finance issues that demand our attention, including stability, equity, and transparency, but the most pressing issue remains adequacy. California is far below the median of the states in per-student funding; today we rank $2,500-per-student less than the national average even though we have a more challenging set of students to educate, with an enormous English language learner population (25 percent) and a larger-than-average economically impoverished population (20 percent).

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Education Initiatives

Promising new approaches to education reform are long overdue and ought to be encouraged with state funds even in this challenging budgetary environment. Embracing the status quo is neither educationally nor politically sound. Some ideas worth pursuing:

- A student-weighted funding formula that provides resources to students based upon need rather than the current inequitable and Byzantine system.
- By late elementary school we know which students are likely to drop out in high school (our dropout rate is a distressing 25 percent) and we need to develop early intervention programs for such students in middle school in order to retain them.
- Expansion of the Early Assessment Program for all high school juniors to ensure that the senior year of high school is relevant and will reduce the need for remediation at the University of California, the California State University, and California community colleges.
- Technology needs to be embraced as a central instructional strategy to provide greater classroom efficiency and student engagement. Resources of high-tech industries and research universities need to be deployed to create software, design teacher professional development, and develop curriculum materials. Why can't Silicon Valley, the University of California, and the California State University lead the way on this promising educational front?

California's K–12 Education Budget: An Opportunity to Revise Teacher Workforce Policies, Data Systems, and Funding Allocation

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Despite the long duration of the current state budget crisis, Proposition 98 has helped ensure that cuts to California's K–12 education system have not been as severe as cuts to other funding areas. This article suggests methods for best allocating K–12 funding so that the education system will protect students both in times of economic recession and in times of growth. The authors recommend systematically considering education priorities in allocating addition funds, overhauling the current teacher retention and compensation policies and extending California's Open Enrollment Act, which gives students in low-performing schools the opportunity to transfer to a school with a higher Academic Performance Index. However, while K-12 spending was largely uncut in the current budget (unlike other program areas), a number of adopted policies, namely the lack of funding for the Longitudinal Teacher Data System and the potential shortening of the school year, seem like steps in the wrong direction in creating an education system most likely to lead to student success.

California's current budget imposes less extreme cuts to K–12 education than other funding areas, in large part because Proposition 98 generally translates to K–14 education receiving at least 40 percent of the General Fund budget. Although education funding may decrease during periods of economic distress and revenue decline, cuts are unlikely to be as sharp as those in other states with shortfalls, and spending must be restored when fiscal conditions improve. Indeed, growing cost pressures elsewhere in the budget, such as growing health care costs, tied to Proposition 98 guarantees, may drive education spending to grow faster than the rest of the economy in future years. Both during the short-term fiscal crisis and later on as funding is restored, policymakers should act strategically to best protect or boost student performance.

Unlike other program areas, the 2011 – 2012 budget largely maintained K–12 education funding at 2010 – 2011 levels. However due to realignment in other budget areas, the Proposition 98-required funding level was reduced by $0.9 billion, though these cuts were largely implemented in cuts to child care and community colleges, and not in funding for K–12 education. Outside of education funds guaranteed under the Serrano limit, whose calculation remains intact in the current-year budget, California also delivers funding forto districts for "categorical" programs in instructional materials, teacher development, remediation, ninth-grade class size reduction, and workforce development, among other areas. In 2009–2010, then-Governor Arnold Schwarzenegger and the legislature suspended about forty of these mandates, allowing districts to allocate $4.5 billion in funds for any K–12 purpose. In part, these actions replaced funds cut from revenue limit amounts, but these deficit factors will eventually need to be restored. The current budget extends this flexibility in categorical funds for two additional years. The budget also extended other steps toward flexibility. These included a reduction in penalties assessed for districts' failure to comply with class size reduction requirements in kindergarten through the third grade and reductions in districts' required budget reserves and maintenance accounts. Maintaining this flexibility is positive as it may prevent further furloughs and layoffs, which in recent years threatened to disrupt core instructional services in many districts, according to a survey by the California's Legislative Analyst's Office.1 However, there is room for improvement in what programs should be combined. Programs that do not directly promote K–12 performance goals, such as adult literacy programs, should be evaluated on their own merits and kept separate, while other categorical programs (for example, K–3 class size reduction) seem prime candidates for consolidation. A report by the Public Policy Institute of California (PPIC) examines the current distribution of these funds across similar districts and finds inequities due to the historical arbitrariness of programs' creation.[2] However, understanding how these disparities affect school districts' bottom lines will depend on what categorical programs are combined and what are left separate. The governor and legislature should more systematically evaluate what consolidation makes the most sense.

As funding for education increases over the next decade, the governor and legislature face many choices about how funds should be allocated. Should money go to basic aid and revenue limits, or would this step merely lead to increased salaries across the board? Should money go to equalize combined categorical programs and flex money, or be earmarked for high-needs students? A recent PPIC report raises these questions;[3] California must proceed systematically in identifying priorities and strategies. In determining final school aid amounts, legislators may want to consider revising revenue limit formulas to take greater account of student needs and differences in the property tax base. This could involve using a weighted student formula and ideally pricing school inputs (like teachers) at their actual cost rather than a district average cost.

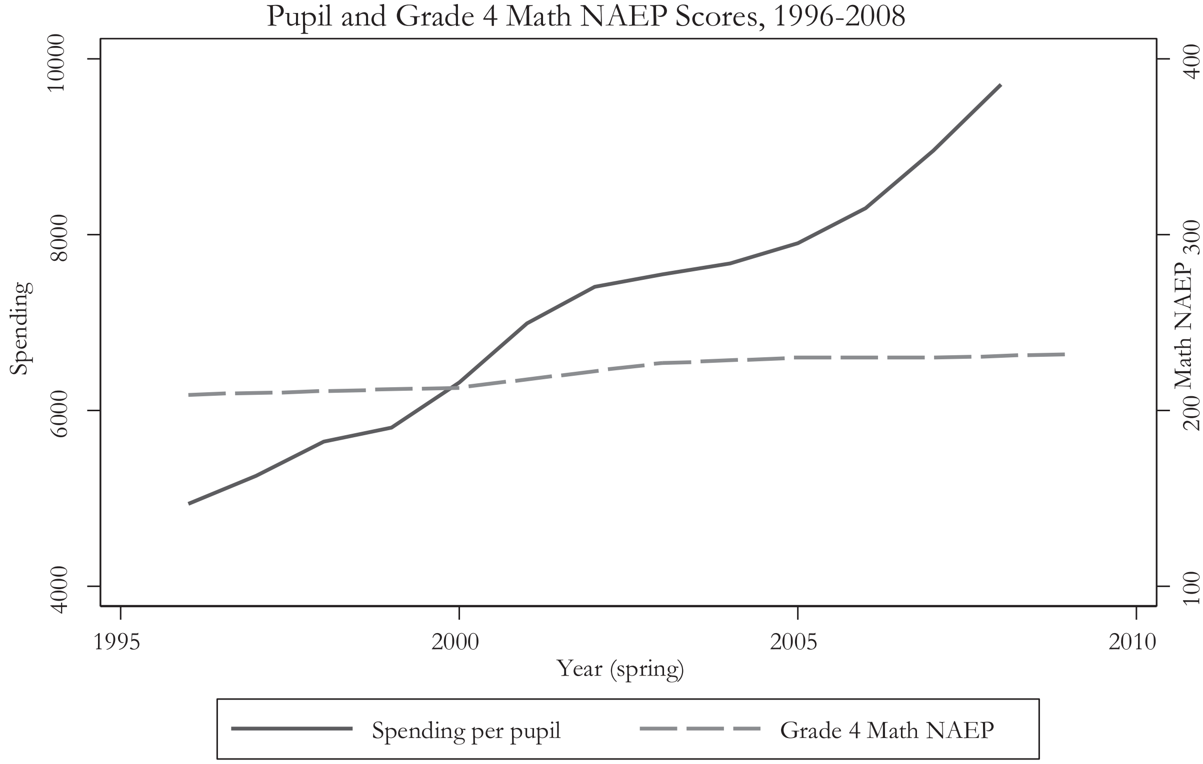
However, getting an adequate amount of money to schools is only a first step because funding, by itself, means little for student achievement.[4] The experience of California over the past decade supports this conclusion, as Figure 1 reveals. From 1996 to 2008, California's scores on the U.S. Department of Education's National Assessment of Educational Progress (NAEP) show only slight increases in performance in fourth-grade mathematics, despite a twofold increase in spending per pupil. Instead, California should look to the innovations of other states as a useful guide for some of the dramatic steps toward accountability that will be necessary for additional funds to produce greater performance. Evidence from other states shows that high-quality teachers are the most important asset of schools and replacing weaker teachers with stronger ones can help close achievement gaps between students from different socioeconomic classes and improve both achievement in school and future earnings.[5] A first step toward improving California's teaching force would be changing both the way student achievement is measured (to value-added measures) and having data information systems that allow the linking of students over time to both the teachers they have and the schools they attend. However, measuring effectiveness was made harder with the Governor's vetoing of funding for the Longitudinal Teacher Data System, an information system that would have made it easier to follow teachers over time. While measuring teacher performance is complicated, districts would be better served by having more, rather than less, information.

Beyond coming up with a systematic way to reinstate spending, we suggest that California take action to strengthen the incentives and capacity for performance evaluation for participants in its school systems. California's Open Enrollment Act, which went into effect in January 2010, is an important step, offering students in one thousand low-performing schools an avenue to transfer to a school with a higher Academic Performance Index (API). The decisions of students and families work to draw resources in the direction of schools that will use them most efficiently.[6] The Act should be strengthened to allow all students to transfer schools, not just the one thousand "low-achieving" schools, in order to expand these incentives to the entire public education market in California; also, relaxation of the API restriction should be considered given the error in the API measurements. Teacher compensation and retention deserve an overhaul. Attention should be paid to the incentives created by the current compensation system, including retirement benefits. For example, the rule prohibiting teachers who work for a short period of time from receiving retirement benefits encourages ineffective teachers to remain in the profession longer than they would otherwise. Understanding the true costs of retirement programs and health care benefits for retirees is also critical. The current system heavily weights compensation toward generous future benefits at the expense of current salary, weakening the incentives for young people with the highest lifetime earning potential to serve as teachers. Moreover, current entitlements imply unfunded liabilities as large as $500 billion. California should consider shifting to a hybrid plan that mixes a defined-contribution plan with a defined-benefit plan to promote flexibility and portability for employees.

California's current system also rewards seniority and graduate degrees, neither of which is significantly related to student performance, in awarding pay raises and deselecting teachers. Instead, compensation and retention decisions could be more closely related to student performance, within school evaluations and broader labor market conditions. Recent work by the Gates Foundation examines the relationship between value-added measures, videotaped classroom instruction, and surveys of students, principals, and teachers. Students who report learning every day and classroom stimulation also have higher test scores.[7] While putting together a more nuanced teacher evaluation system could be complicated, the agreement across evaluation methods gives some comfort that the system can be based on more than seniority. Taking account of teacher effectiveness when layoffs need to occur could help maintain student achievement, even during tougher economic times. Current policies of laying off the most junior teachers in a district can have perverse effects of concentrating layoffs in schools with less experienced teaching staffs, which often serve the lowest-income students. A recent simulation based on data from the state of Washington found that switching from a layoff regime based on seniority to a system based on the "value added" by each teacher in terms of student performance would result in approximately 50 percent fewer layoffs at any given level of budget reduction and an increase of 0.19 standard deviations in expected future student performance.[8] Indeed, the Washington legislature has introduced SB 5399, which would authorize school districts doing layoffs to first choose teachers who received the lowest average rankings during their last two evaluations.9 Merit pay should also be considered. The Wisconsin Education Association Council, that state's largest teachers' union, released a report endorsing a statewide teacher evaluation system and performance pay for teachers.10 Performance pay can create incentives for the most talented teachers to remain teachers, while encouraging less effective teachers to exit the profession.11 Districts should be able to offer additional pay for employees in challenging school environments or for those who have more attractive alternative opportunities, such as teachers of mathematics. Pay increases for highly effective teachers could be linked to their willingness to teach larger classes, recognizing teachers and compensating them for their effectiveness while exposing more students to effective instruction. These merit pay proposals will depend critically on our ability to measure teacher effectiveness. Thus, adoption of both different ways of measuring student test scores (through valued added measures), an ability to link students to teachers, and a broader set of teacher evaluations would be necessary to move forward in this way. This requires California investing in technology to help link teacher and student information over time, a process that may have become harder with the end of investment in the Longitudinal Teacher Data System. We believe actual compensation and layoff decisions are best left to individual districts; however, the state can give districts flexibility in compensation and layoff decisions and also provide systems that allow better measurement of performance.

There is also a short-term question mark in funding for education, namely whether current revenues forecasts will be realized. Following stronger than expected tax revenues this spring, the governor and legislature increased expected revenues by $4 billion in the enacted budget. However, because it was unclear where these stronger revenues were coming from, automatic mid-year spending cuts were specified if revenues fell short by December. If updated revenue estimates in December are projected to be more than $2 billion below forecast, an additional $1.9 billion in education reductions would be implemented—shortening the school year by seven days, eliminating some school transportation programs and reducing community college apportionments. These across-the-board service reductions do not improve the efficiency of the educational system and are especially damaging to the neediest students. (Fewer days in the classroom have been shown to lead to less progress in the school year, especially for lower-income students.) Since passage of the budget, state receipts have been below forecast, potentially leading to these cuts in programs and the exact opposite of thoughtful planning.

Figure 1: California K-12 Education Spending Per Pupil and Grade 4 Math NAEP Scores, 1996-2008



Source: National Center for Education Statistics, Institute of Education Sciences, U.S. Department of Education. Available nces.ed.gov/nationsreportcard/naepdata/dataset.aspx.

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California Higher Education in Context: The Impact of States' Financial Stress on Public Support for Higher Education

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This article provides context for California's current fiscal stresses in higher education by briefly examining longer-term finance trends across the country and explaining the basic cyclical and structural forces at work. In short, California's situation is not unique, but in fact is widely shared among the states. Public higher education support is being sorely squeezed and the prospects for a "full recovery" in state support do not look bright.

Higher education's share of the state budget "pie" has been decreasing for many years. This share fell from 12.9 percent to 11.5 percent of states' general fund budgets between 1995 and 2009, i.e., over less than a decade and a half, and has likely fallen further in the current economic doldrums.[1] Expenditures on elementary and secondary education (the largest piece of states' general fund budgets), Medicaid (the fastest-growing piece), and corrections have squeezed out dollars for higher education during an era when the growth of the budget has been constrained by anti-tax and anti-spending sentiment and legislation.

All of these budget components share the characteristic that they are affected by a legally driven need to meet caseload growth, which higher education does not share. Medicaid and corrections, along with the much smaller public assistance component, are also recession-sensitive. Finally, none of these other budget components can generate much revenue from client charges, again unlike higher education, which can raise tuition rates.

The net effect has been that, since the late 1970s, the share of states' aggregate personal income going to higher education operating expenses has fallen by 38 percent. Higher education's share of personal income has decreased in forty-nine of the fifty states from 1980 to 2010, with California showing one of the steeper declines, at 47 percent.[2]

Going forward, as the population ages, Medicaid costs will continue to grow well above the general inflation rate, as the caseload will need more care and as long as unit costs in health care remain hard to control. Per-person costs of the prison caseload will also grow as inmates with long sentences age. Also related to population aging, looming in the near future are heavy pension obligations as generous but underfunded public pension systems face the burden of baby boomer retirements. Due to its earlier funding decisions, California is particularly affected by underfunded pension costs.

In addition to these basic structural issues, public higher education's finances are dramatically affected by economic cycles. When recessions hit, state tax revenues decline sharply (particularly in states like California that are dependent on progressive income and capital gains taxes) and many of the above state budget cost drivers start to climb. Although states have done a bit better in building reserves during recent periods between recessions than in the past, powerful pressures to return surpluses to taxpayers limit this buffering strategy. Thus, downturns are quickly felt and also tend to affect states' revenues for several years after recessions are officially declared over as unemployment lingers, which affects sales and income tax receipts.

For the reasons already suggested, higher education appropriations are particularly vulnerable in downturns. Indeed, higher education is often called the "balance wheel" of state budgets as it tends to be cut more deeply in recessions and, if prosperity lasts long enough, eventually gets some reinvestment. The question now is whether this typical cycle will repeat itself in the wake of the very deep and extended "Great Recession" and, if so, when the benefits for higher education might be felt.

Looking back over the last twenty-five years (1984–2009), state appropriations per full-time-equivalent (FTE) student, in inflation-adjusted 2010 dollars, have been quite volatile in response to economic cycles, rising from around $6,700 in 1984 to nearly $8,000 in the late 1980s, then falling to $6,912 by 1993 in the wake of the early 1990s recession; rising again to $8,076 in 2001, then falling back sharply to $6,662 in 2005 after the "dot-com" recession; and climbing again to $7,235 by 2008 before once again dropping off, to $6,451, in fiscal 2010, the lowest level in at least a quarter century.[3] There will certainly be a further decline when the data are in for fiscal 2011.

These per-student spending figures are affected by the fact that higher education enrollments tend to rise in recessions as individuals see limited labor market opportunities and, rationally, seek to enhance their human capital. On the other hand, institutions at some point may also limit their intake as resources decline and, of course, in such times students usually face substantially increased tuition costs. This is a perverse pattern as students' needs come into conflict with those of institutions that are denied state support when it is most needed.

This brings us to the question of tuition trends. As state funding for public higher education has fluctuated but, overall, been stagnant over a quarter century, tuition revenue per student in public institutions has nearly doubled, to $4,321 in 2010.[4] Thus students are paying a substantially larger share of public higher education costs than was the case a generation ago. The tuition increases have been much larger in periods of economic stress that lead to decreases in state appropriations. They moderate, but generally still exceed general inflation rates and growth in family incomes, in periods of relative prosperity. As a result, tuition in relation to family incomes has increased sharply over time, which raises a serious question as to whether continued large increases in tuition are sustainable in economic or political terms.

Looking ahead, projections of state fiscal prospects are not encouraging. A leading academic analyst of state fiscal issues developed projections of all states' fiscal health through 2016, based on data that pre-dated the Great Recession of 2008–2009.[5] He found that all fifty states faced structural budget deficits going forward assuming then-current tax rates and best available projections of costs associated with caseloads in K–12 education, Medicaid, corrections, public assistance, and higher education. This, then, did not bode well for higher education support—even before the recession took its toll.

To sum up, public higher education likely faces a "new normal" in terms of its level of state support (much lower) and dependence upon tuition and other sources of revenue (much higher). This will affect various types of public colleges and universities differently as they face different alternative revenue prospects. Community colleges and non-elite "comprehensive" colleges and universities are likely to be most severely affected, but all institutions will need to consider strategies designed to improve efficiency and seek new sources of revenue while creatively sustaining their public missions. Large tuition increases, unless accompanied by commensurate need-based financial aid, threaten to exclude the student groups that higher education particularly needs to reach as the nation's demographics change. Achieving President Obama's goal of increasing America's production of college degree holders substantially so as to lead international competitors will surely require true creativity and innovation from higher education.

ENDNOTES

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3. State Higher Education Executive Officers, State Higher Education Finance Report, Fiscal Year 2010.

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The Good Old Days Are Gone: Facing Hard Choices in California Public Higher Education

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The facts about deep cuts in state financial support for California public higher education are well known. These cuts will not be reversed either by state or federal action in the foreseeable future. Less well known are the unaddressed opportunities for reducing college costs and improving rates of student persistence to successful graduation. The state has failed to set goals for attaining the number of college graduates needed in our future work force. This failure is part of a larger problem: the state has neither wise policies nor the likelihood of adopting such policies.

The dominant view of the ongoing cuts in California public higher education among members of the public is that higher education is the one function funded by state government that works well. From the public perspective, the only issue is whether student access to public higher education will be affordable.

The dominant view of these cuts from faculty and staff on public campuses is that:

- times are tough, but the funding cuts are temporary,
- there is no need to change anything important as to how our colleges and universities function—just wait until the good times roll again, and
- it would help enormously to dial up the positive public relations and political lobbying on behalf of larger appropriations for higher education.

Every aspect of these prevailing public and campus views of the cuts is wrong. Let's begin with the public perception that all is well in California higher education aside from rising tuition levels. The facts are that:

- California is fortieth in the nation in the rate of high school graduates going directly to college.
- California is forty-seventh in the nation in the number of degrees and certificates awarded in relation to enrollment.
- California is falling precipitously in its ranking of the percentage of its population with college degrees; we are failing to educate young generations of Californians to the level of older generations.
- Within California, serious gaps across racial and ethnic groups are present for nearly every measure of performance.
- The Public Policy Institute of California projects that within the next 15 years the California work force will demand one million more baccalaureate degree holders than our current system is producing, and that figure does not count the need for two-year college graduates.

Neither the federal nor the state government will be riding to the rescue of public higher education in California. Governor Jerry Brown projects that there will be no appreciable recovery in state revenue for at least five years. Growth rates of state revenue are likely to be modest for much longer than that. Further, there are enormous unfunded liabilities for employee retirement benefits at both the state and local levels in California. And the pressures for increases in state expenditures for medical care, prisons, and public schools, which have dramatically reduced the portion of the state budget devoted to higher education in the last 25 years, will continue and will accelerate in the health field.

There are many supporters of higher taxes within our colleges and universities. But the fact is that the most we can hope for is the longer-term preservation of our current level of taxation. State tax increases beyond that are simply not going to happen, because federal taxes must go up significantly in the next decade. Anyone who read the reports in December of the two commissions on the national debt knows that we face profound difficulties—both in raising federal taxes and in cutting all aspects of federal spending (including Medicare and Social Security)—if the burden of the national debt is to be kept manageable. The state and federal governments will simply be unable to restore past expenditure levels for higher education. We are in a new and much less generous era. The golden days of support for California higher education are over. If they return, it will not be in my lifetime.

We are not making the wisest use of the revenues that public higher education already has. The clearest examples reside in the community college. Only 31 percent of entering community college students successfully transfer to a four-year institution, or obtain a career/technical certificate or an associate's degree within six years after enrollment in our "two-year" institutions. Community colleges are America's great contribution to higher education in the world. California has the biggest such system, filled with idealistic and dedicated people. But there are many flaws.

California community colleges do not insist that students be assessed upon entrance and directed into the courses they need to achieve their educational goals; state law says that people over 18 who can "benefit from instruction" are to be admitted, but we have no working definition of who can "benefit from instruction." Therefore, the community colleges bear a much heavier burden for remedial instruction than they can carry. Course prerequisites are often ignored; there are no requirements for making adequate academic progress, including for the 50 percent of community college students who are exempted from paying tuition; and the tuition level that is charged is, by far, the lowest in the United States. The community colleges receive the bulk of their funding from the state, and those state allocations are based on student enrollment in the third week of the semester. Community colleges suffer no loss of income if students drop out immediately thereafter. Are we surprised that student persistence is not a top priority for the community colleges?

Let me give you one specific example of the lack of priorities within the community colleges: Sixty semester units are required to transfer to a four-year university and/or to obtain an associate's degree. Career and technical programs typically require less than 60 units. Many students take more than 100 units, 40 more units than needed for any recognized educational objective. As a result, these students use a disproportionate share of the community college's resources, while many entering students can enroll in few, if any, of the courses they need. The Legislative Analyst has now wisely proposed that taxpayer subsidies be limited to the first 100 units and all courses after that would be fully paid for by the student. This one straightforward, commonsense reform would save in excess of $200 million per year that could be redirected toward students just getting started.

Within the University of California (UC) system, there has been relative stability in the total number of dollars available in the last four years, but only because student tuition has skyrocketed to make up for the loss of taxpayer funding. The university is by no means out of the woods, and more deep cuts are likely to be imposed. The university has its own large financial overhang of unfunded retiree pension and health care costs. Some cuts in the generosity of the UC pension system have been made, but more cuts are likely to be necessary. There is now a determined effort, led by the Berkeley campus, to reduce administrative costs, and those savings, university-wide, might reach $500 million per year. Hard choices are going to be faced in terms of recovering indirect costs from external grants and contracts. But all of these steps may not prove to be sufficient to match the reductions in state financial support.

The UC must get smaller. As these downsizing decisions are made, whose interests will be served? Historic centers of excellence, such as UC Berkeley, or the newer campuses such as Merced? Will the interests of retirees be protected at the price of reducing educational opportunities for students? Will graduate enrollment be maintained, or even increased, at the cost of deeper restrictions on undergraduate enrollment? And we have seen only the beginning of new technology's impact on instruction, and of the possibilities for the UC in a world where there are widespread demand for the development of new universities.

In addition to changes in institutional policies to make wiser use of the dollars provided to public higher education, there are possibilities for changes in state policies that, over the period of a decade or more, might begin to better protect funding for public higher education and better protect college opportunity for low-income students. The University of California and California State University have already moved toward a "high tuition, high student aid" model and are likely to move further. There are substantial advantages to such a policy, but also substantial dangers. One response at the state level could be a shift from funding institutions to funding students. This would be a change similar to the use of Pell grants at the federal level. It turns out to be easier for legislatures to cut institutional budgets than to reduce student entitlement for grants in aid.

Consideration could also be given to income-contingent student payment plans that require students to repay part or all of their college tuition costs only if their income after college is substantial. And if we are serious about reducing gaps in opportunity based upon social class and ethnicity, California will have to get serious about "early college commitment" plans to assure financial aid for prospective college students early in their high school careers. Such plans have been pioneered in other states such as Indiana. In addition, if we really want to reach desirable state goals for an educated citizenry and work force, then we need to adopt a state Dream Act that would treat undocumented high school graduates wishing to go to college on the same basis as California high school graduates who are citizens.

At the institutional level, the capacity for tough-minded examination of unpleasant alternatives is small indeed. The most disappointing recent example is the report of the Commission on the Future of the University of California. As a state we are failing at these basic tasks:

1. We have not set goals for the number of college-educated Californians that we need.

2. We have paid little or no attention to the enormous waste of student time and taxpayer resources in our current system: students who drop out before educational goals are realized.

3. We have no coherent plan to increase both college access and success for low-income students.

4. We have no unit of the executive or legislative branch of state government, other than the Legislative Analyst, that is deeply informed about higher education issues and prepared to engage in fresh thinking.

In other words, we neither have wise state policies nor the means to establish those policies.

Reconsidering the Financing of Higher Education in California with a Focus on Community Colleges: Recommended Actions for Students, the State, and Institutions

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The problem of financing higher education in California is being mischaracterized as a short-term budget-balancing issue, when in reality the recovery from this recession is likely to be slow, and the challenge of developing a globally competitive workforce is more than a purely financial issue. In order to meet this challenge, action is required by students, institutions, and the state. Students will have to pay more in tuition. The state will have to allow this increase in tuition, while changing budgeting practices and pursuing serious regulatory reform of higher education with an emphasis on community colleges. Institutions will have to maintain or increase effectiveness with limited resources. In order to make these changes possible, California will have to overcome its policymaking gridlock.

Like most states, California is faced with the daunting challenge of balancing its budget under conditions of rising demand for services and a bleak revenue picture. The upshot is a state budget that imposes substantial cuts on all segments of public higher education. Budget constraints have led to actions that fly in the face of the commitment to access that has undergirded higher education policy in California for half a century—denial of access to qualified students and failure to provide transfer slots for students who have demonstrated their abilities in the community colleges.

While the cuts are substantial, they result in per-student funding levels not substantially below levels of 2007–8, a generally good funding year for higher education in California. Having noted this, several related points must also be made:

- The comparisons do not consider the effects of inflation over this period of time.
- The comparisons mask substantial variations in the intervening years, with 2009–10 being the low point.
- Especially for the University of California (UC) and California State University (CSU) systems, reductions in state funding were largely offset by fee (tuition) increases and American Recovery and Reinvestment Act (ARRA) funding. This was less the case for community colleges, where the trend in per-student funding has been consistently downward.

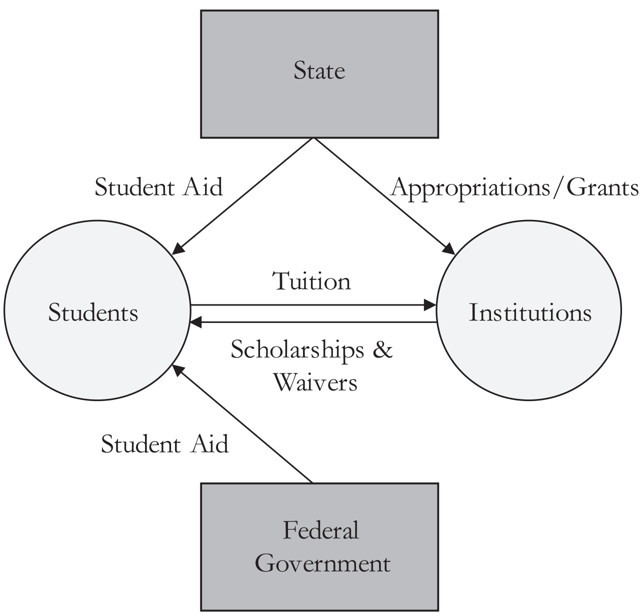
My conclusion after a quick look at the data is that the four-year segments are stressed but not in crisis. The situation for the community colleges, however, is dire since they must cope with students for whom there is no room in the four-year institutions, are funded at comparatively low levels, and have far less ability to close the revenue gap by imposing substantially higher fees (tuition).

Regardless of the judgment about the severity of the situation facing each of the segments, it is clear that the time has come to reconsider the financing of higher education in California and the assumptions that underlie that financing. Within this context, I would like to make several points.

1. The higher education funding problem facing California is being misspecified. It is being framed as a budget-balancing issue; that is, as a purely financial issue. It is a financial issue to be sure, but it is so much more. California is failing to educate enough of its citizens to develop a globally competitive workforce; it will have to produce nearly 5 percent more graduates each year than it did the year before to be a world leader in 2025. This means that it would be far better to frame the issue in terms of how best to pursue the objective of graduating more Californians, even in the face of reduced state funding. The imperative of improving the educational attainment levels of the state's population cannot be ignored. California's economic well-being and the quality of life of its citizens depend on the capacity to improve education attainment even in the face of diminished state resources.

Furthermore, the challenge of higher education funding is being framed as a short-term, next year problem. It is not. The recovery from this recession will be slow, and appropriations to higher education are likely to return even more slowly. Responses that are not strategic serve only to postpone an inevitable day of reckoning.

2. Policy responses are being too narrowly circumscribed. The discussion in California is focused almost exclusively on General Fund appropriations to the segments. The diagram below describes in simplified form the flow of funds that can be used to support the basic instructional part of institutional missions.



This diagram illustrates two related points: First, finance policy has to deal simultaneously with appropriations, tuition, and student financial aid. Solutions to the funding crisis must deal with all three, but in California, policies in these areas are trains on their own tracks. Second, responses to the fiscal environment require actions by the state and students as well as by institutions.

3. The basic analytic and policy leadership capacity needed to chart a path through these problems is missing in California. California does not have the venue for establishing goals that reflect the needs of the state and provide a context for developing financing policy. The state also lacks the venue for developing financing policy that is nuanced and combines appropriations to institutions, tuition, and student financial aid as components of an integrated financing policy.

4. Any approach to dealing with higher education funding policy must start with a focus on community colleges. The UC and CSU systems start the funding-reduction process from a position of "reasonable" funding. Through tuition policy and other mechanisms, they also have more tools for coping with the problem of reduced state funding. Community colleges, on the other hand, start from a position of substantial underfunding and have very limited capacity to generate funding from other sources.

5. The funding dilemma can be addressed, and goals for the state pursued, if certain actions are taken by each group of key participants in the process. Students, especially those at community colleges, will have to pay more tuition. California has prided itself on being a state that promoted access to higher education by keeping fees very low (technically there was no tuition until recently). The four-year segments have moved away from this practice in recent years, increasing tuition at rates that were, for them, far outside the norm. Even so, UC and CSU have fee levels that make them comparative bargains when viewed nationally. At California Community College (CCC) institutions, on the other hand, tuition rates remain suppressed. Even with a $10 per credit-hour increase, the fees at these colleges will be less than half the tuition of community colleges in most other states. In the name of promoting access, California has kept tuition so low that it contributes to denial of access. The revenue stream from fees is so small that it doesn't pay the marginal costs of accommodating more students. The consequence has been an inability to accommodate tens of thousands of students seeking admission and a lack of capacity to provide necessary courses for tens of thousands more who didn't get enrolled in the courses they needed.

The one obvious way to inject new funds into the California higher-education enterprise is by raising tuition in the community colleges. The good news is that tuition could be increased substantially and low-income students would not be harmed; the federal government, through its tuition tax credit as well as the Pell program, would pick up virtually the entire tab. With ARRA funding disappearing, the one pipeline to federal funds for general institutional operations lies in student aid programs. California can ill afford to leave billions of these dollars on the table in the name of maintaining unrealistically low tuition in its community colleges.

The state must take action on several fronts. It must

- allow community colleges to increase tuitions to nationally comparable levels.
- change budgeting practices so that all community college tuition stays at the institutions for use as they see fit and necessary.
- undertake a process of serious regulatory reform of its higher education enterprise. Again, the focal point should be community colleges.

> They function in what is the most complicated and constraining regulatory environment of any community college system in the country. The list of "have-tos" and "can't-dos" is extraordinary. The colleges are so tightly regulated that they can't be held accountable for performance. They—and California—would be much better off if the institutions got budgets free of categorical allocations and the freedom to use the resources in ways best suited to the unique needs of each institution.

- create an entity with the necessary capacity and clout to fashion sophisticated higher-education financing policy.

The institutions will have to commit to doing things differently and to pursuing aggressive state goals within the constraints of limited resources. Because the segments start in different places, their challenges will be different. The four-year segments are already reasonably effective in graduating students they enroll. Their challenge will be to continue this level of success with fewer resources, using tools such as:

- technology, and redesign of courses using that technology (see National Center for Academic Transformation),
- competency assessments that allow students to "test out" of courses covering material they already know,
- limiting credits for a degree, and the number of credits for which the state will provide subvention, and
- creating efficiency councils to share money-saving ideas and foster collaboration in key areas.

Four-year systems in other states have shown they can produce high results with fewer funds per student than California. There is no reason to think that California institutions can't respond similarly if given the freedom to take action.

For the community colleges, the issue is more one of effectiveness—producing more graduates with the resources that are available. For this segment, the task should be to take (additional) resources and produce many more degrees and certificates with those resources. Like their four-year counterparts, there is evidence from other states that such improvement is possible. But in this case, considerable regulatory relief will be required.

6. California is going to have to find a way to get past its policymaking gridlock. Given experience in California and elsewhere, thoughtful individuals can reasonably quickly create an action agenda for coping with the financing dilemma while improving performance. It is not a technical problem. These are problems we know how to solve. But the decision-making capacity in California is so immobilized that the likelihood of implementing any of these initiatives is slim. This set of conditions will require an approach that buffers political leaders from direct involvement in crafting a solution, but allows them the necessary final decision authority. The mechanism employed in other contexts has been a special commission with a charge to propose solutions that must be accepted or rejected on a simple up or down vote. The Base Realignment and Closure (BRAC) commissions are examples of this approach.

The long-term nature of the problem to be addressed and seeming incapacity to take the necessary actions suggest that California should, by legislative action, create such a commission, charge it with the following tasks, and subject the recommendations to an up or down vote:

- set statewide goals for higher education
- establish a long-term financing solution that encompasses general fund appropriations to institutions, tuition, and student aid policies
- recommend changes to the regulatory environment
- recommend the creation (and characteristics) of an entity that can carry the necessary policy leadership forward.

California has a serious problem with regard to financing its higher education enterprise, a problem that will get worse without some substantial changes—changes that are possible only if the necessary political will can be mustered.

Inefficiencies in Federal Funding for Higher Education: The Impact of Private For-Profit Schools and a Flawed Accreditation System on Aid Distribution and Access

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Systemic change in federal funding mechanisms for higher education is needed to ensure that the United States does not fall further behind other developed nations in college access and completion rates. The current funding and accreditation schemes provide unintended incentives to for-profit institutions, which produce graduates with larger debt loads and a higher likelihood of defaulting on their loans. This article examines the complexities of the higher education marketplace and introduces ideas for reform that would extend college access to a greater number of low-income and underrepresented students.

A recent issue of The Economist referred to the "Wild West" of higher education in America—a most apt metaphor, especially in view of how higher education is funded in this country. In a nation proud of its federalism and choice in the economic marketplace, the funding of higher education has become excessively complex and fiscally inefficient. Perversely, this system has manifested itself in a decline in state tax effort of 41 percent since 1980, with the unhappy result of an unremitting escalation in student fees and tuition. The current poorly contrived federal funding scheme has unaccountably given fiscal incentive for states to reduce government funding and shift the financial burden to students and parents.

This misdirection has made Wall Street entrepreneurs and richly endowed private colleges and universities the beneficiaries of the system, rather than the intended students and parents. Systemic change is required if real progress toward President Obama's educational goal of leading the world in college graduates by 2020 is to be achieved. Unfortunately, instead of discussing necessary systemic changes that could substantively benefit students and the institutions serving our neediest student populations, the U.S. Congress is debating how to reduce Pell Grants and has already eliminated the summer Pell Grant program that was only in place for one year. Before adopting further reductions, three important factors need to be considered if we are to change direction for the common good.

First, we must reconsider the assumption that rational college choices can be made by students and parents in the higher-education marketplace when they are overwhelmed by the media's siren song that lures them to enroll in educationally suspect colleges and universities. The theory of the inefficient market is nowhere better demonstrated than in American higher education, where "imperfect information" is the norm. The state of affairs is such to lead Johnstone and Marcucci, in their authoritative book Financing Higher Education Worldwide, to state "[t]he U.S. financial assistance system may be more accurately described as a non-system."

Second, the accreditation process in American higher education does not mitigate the imperfect information problem, but rather aids and abets distortion. In fact, the "American Dilemma" of ineffective, and even misguided, accreditation is the source of much mirth among educational observers of most other OECD countries. The stories are legion about how less-than-academically-stellar private for-profit and not-for-profit institutions have intimidated accreditation agencies, and of how the agencies have traditionally relied on idiosyncratic standards only remotely related to a quality education. With accreditations in hand, many Wall Street for-profit institutions have been able to seize on federal largesse to fund at least

90 percent of their high-priced entrepreneurial education enterprises at many institutions. Furthermore, the remaining 10 percent of revenues originally intended to be generated from private sources, according to the 90/10 federal regulations, is mostly being generated from state government student aid grants and new G.I. Bill grant benefits. The new G.I. Bill overwhelmingly provides more grant aid to higher-charging for-profit and other private institutions than to lower-charging public institutions due to inflated sticker pricing. This is evident not only in the maximum award available to an institution in the basic GI Bill plan, which is approximately twice the national public university average, but through a supplementary Yellow Ribbon Program. The Yellow Ribbon Program essentially matches up to 50 percent of the remaining listing price of higher priced institutions with federal resources. It seems that despite the rhetoric that for-profit institutions are successful due to the invisible hand of the market, these for-profit institutions are actually government-reliant institutions instead of market-based ones.

Additionally, many state student aid grant programs also base their funding awards on inflated sticker pricing, disadvantaging institutions that have tried to remain affordable. For example, in California, the Cal Grant A student aid program in 2010 – 2011 awarded students from comparable family income levels attending for-profit and not-for-profit universities an average award of $9,228, while students attending California State University institutions received an average award of $4,037. At the much higher-priced University of California, students received average awards of $9,957 per recipient.

Breaking this program down a bit more, it is interesting to note that due to price only, University of California students received 55 percent of all Cal Grant A funding, with having 45 percent of the Cal Grant individual recipients. Private for-profit and not-for-profit institutions received nearly 33 percent of all Cal Grant A funding, or $184 million, while having 28 percent of the Cal Grant individual award recipients. At the much lower-priced California State University, students accounted for 26 percent of all Cal Grant individual award recipients, while receiving only 13 percent of all Cal Grant funding. This program, like many state student aid programs in the nation were designed to indirectly aid those colleges and universities that have more rapidly inflated their prices, and thus created an incentive system that disproportionately disadvantages those institutions that continually struggle to remain affordable.

These additional facts speak for themselves: Currently, for-profit colleges and universities enroll approximately 12 percent of students in higher education while receiving nearly 27 percent of all federal student aid grant funding (nearly $9 billion a year). In addition, the for-profits benefit to the tune of about 25 percent of all federal student loan subsidies. This gives for-profit colleges and universities approximately $26.5 billion in federal grant and loan funding annually. However, as might be expected, the avarice of the for-profits has unfortunately resulted in approximately 45percent of all federal student loan defaults nationwide.

At four-year for-profit institutions, 96 percent of the students borrow funds to pay for their higher education. The average debt load of students in for-profit institutions upon graduation is 20 percent higher than for graduates of four-year not-for-profit institutions and 35 percent greater than for graduates of four-year public institutions.

To its credit, the U.S. Department of Education, with the assistance of some key U.S. Senators and House members, has sought by regulation to introduce a "gainful employment" performance standard and other restrictive rules to insert some semblance of integrity into the federal funding process. This initiative was roundly criticized by the new majority in the U.S. House of Representatives, thanks in part to the highly financed for-profit college and university lobby.

Sadly, most state governments have abrogated their duty to ensure that public funds for higher education are not wasted on the corporate greed of an unregulated marketplace. One can readily gauge the failure of state governance in this arena by simply being a sentient traveler on America's highways and observing the hundreds of green-and-white government-installed highway signs beckoning enrollment in the for-profit higher education corporations. No caveat emptor accompanies such signage warning that many of these institutions have been subject to censure and have, on occasion, been compelled to repay the federal government millions of dollars for various regulatory violations, including Pell Grant fraud.

Third, to ensure that Pell Grant awards are not reduced and the summer Pell program might get reinstated in future sessions , it is important to rethink the widespread "mission-blind" distribution of these federal funds. Currently, access to college and university education is not just an affordability issue, but also an institutional selectivity issue. Many of the nation's richest universities in terms of spending per student and endowment dollars per student enroll the lowest percentages of lower-income students in the nation. If existing federal student aid funds can be accompanied with federal lower-income student thresholds, then some additional funds could be made available while also incentivizing institutions to enroll more lower-income and underrepresented students. Without federal pressure or leverage designed to maximize overall public benefit, many of our nation's top universities will continue to reduce their commitments to our neediest students. According to 2008 data, the average enrollment of Pell Grant-eligible students at private research universities was only 12 percent, while the average at public research universities was only 19 percent. These averages are considerably lower compared to years past and continue in a declining direction. This disturbing trend, accompanied with federal budgetary reductions on the horizon, indicates that maybe it is time to ask why publicly generated federal student aid funds flow to some universities that only manage to enroll 8 or 9 percent lower-income students despite having multibillion-dollar endowments. In fact, the vast majority of colleges and universities with less than 15 percent Pell Grant-eligible student populations are the very same institutions with the largest endowments and per-student endowments in the world. Perhaps Pell Grant outlays are a better measure of an institution's true commitment to lower-income student populations. By incentivizing institutions to provide greater access, we will be able to provide more resources to needy students while also giving lower-income students wider college and university choice. However, this is based on the assumption that our wealthy institutions are actually committed to expanding access.

Preserving what is most important in our federal funding of higher education can be accomplished by making difficult choices in the way that we spend billions in publicly generated support. It can also help our nation tame the "Wild West" of higher education and create a system much like many of our OECD counterparts have done, which has enabled them to surpass our nation in college access and completion rates. Therefore, before recommending cutting the total amount of federal funding for higher education, which we know will have a deleterious impact on students and the future economy of the nation, we should make sure that our tens of billions in public invested resources are spent to produce the outcomes that the public expects. By ensuring that public dollars are spent on students and institutions providing the greatest public good and do not accrue to the benefit of shareholders on Wall Street or to wealthy institutions that continue to reduce their public commitments, we can build a better, more efficient, and more effective federal funding system for higher education. This will undoubtedly help us move closer to the President's 2020 goal. Many of our OECD peers have already made these choices and are in better control of their own educational destiny. It is time that we follow their lead.

CRIMINAL JUSTICE

Reducing Prison Populations and Crime Rates in California Through Enhanced Community Supervision Mechanisms

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California's expensive and overcrowded prison system has been a major contributor to the state's fiscal problems. This article presents new approaches to community supervision through more active probation and parole systems in which prisoners could be released into the community with minimal risk and at a lower cost than incarceration.

California spends $5 billion a year on its prisons, but incarceration was one of the few areas of state spending spared from Governor Jerry Brown's 2011–12 budget cuts. Cutting the corrections budget would not, in a sane world, be a high priority. Both crime and the suffering caused by incarceration are more pressing problems than the dollar expenditures. If having more people in prison actually meant having less crime, that combination could easily prove to be a bargain from the viewpoint of taxpayers. But the political and institutional impossibility of tax increases means that not cutting the prisons requires another round of brutal cuts to higher education.

The good news is that it would be possible to have a much smaller prison population and much less crime. The driver of the massive increase in prison spending has been the massive increase in the incarcerated population. In the mid-1960s, the last time we had crime rates similar to today's, we had about a fifth as many people locked up. There are inefficiencies in the system, but spending substantially less money requires keeping substantially fewer offenders in prison: sending fewer people there in the first place, imposing shorter sentences, and reducing the flow of those sent back to prison either for new crimes or for violating parole conditions.

Incarceration is subject to the law of diminishing returns: With a large number of the worst offenders already behind bars, adding more prisoners means locking up progressively less serious offenders. There aren't many harmless people among California's inmates, but there are many prisoners who wouldn't be doing $50,000 a year worth of damage if they were let out—and $50,000 is what it costs to keep them in prison.

The key to reducing incarceration and crime at the same time is doing a better job of controlling offenders not behind bars. At any one time, there are three times as many people on probation, parole, and pretrial release as there are in prison. But the existing system of community supervision—probation and parole—dramatically fails at its central task: punishing people and reducing their future criminal behavior without locking them up. About two-thirds of those released from prison are back inside within three years. The bail-bond system doesn't even pretend to attempt to control the large but unknown number of offenders on the street while awaiting trial.

A major problem with probation and parole, and with programs such as Proposition 36 that divert offenders from incarceration to drug treatment, is their inability to enforce the rules they nominally impose. Violations of probation and parole terms—missed appointments, missed treatment sessions, missed or "dirty" drug tests—are very common, and the most frequent response to those violations is no more than a verbal warning from a probation officer or parole agent not to do it again. It's a social trap: the sheer volume of violations makes it impossible for the system to follow through with real sanctions, and the lack of penalties keeps the violation rate high. An offender who racks up a sufficient number of violations may eventually face a revocation and several months behind bars, but such deferred and inconsistent threats have little power to shape behavior.

The way to reduce the violation rate is to make the punishment for breaking the rules swift and certain. Hawaii's Opportunity Probation with Enforcement (HOPE) probation program demonstrates that offenders with long criminal histories and severe methamphetamine problems can and will quit if they are drug tested frequently and jailed for a few days every time they come in "dirty" or fail to come in. Most do so without needing any formal drug treatment. The rate of new arrests for probationers in the HOPE program is less than half that of similar probationers under routine supervision—and rates of revocation and of incarceration for new crimes are cut by nearly two-thirds.

The results might be even more dramatic if position monitoring via GPS anklet were added to the supervisory mix. That doesn't have to be the expensive "active monitoring" now used for sex offenders, with an official or contractor watching 24/7 to see if the offender has strayed from where he was supposed to be. "Passive monitoring"—where a violation is simply reported electronically to the probation or parole supervisor for sanctioning—costs only a few dollars a day (compared to more than $130 a day to keep someone incarcerated).

GPS brings with it the ability to impose curfews—thus making probation a real punishment rather than a mere inconvenience—and the ability to easily observe whether probationers and parolees are at work when they're supposed to be at work, attending anger-management or drug-treatment sessions as scheduled, and staying away from forbidden locations (e.g., drug markets and the addresses of their previous victims). It also means that offenders can't easily commit new crimes without being detected: monitors can just compare the records of their location against crimes reported via 9-1-1.

HOPE-style sanctioning combined with tight monitoring could create what amounts to "outpatient prison": a program that costs about 20 percent as much as incarceration but does almost as well at preventing new crimes. That, in turn, means that we could both save money and reduce the crime rate by letting people out of prison and spending some of the money we don't have to spend on feeding and housing them on supervision.

In thinking about replacing incarceration with real community supervision, we shouldn't be thinking small. No one knows what fraction of the people now being sent to prison would behave reasonably well under tight monitoring in the community, or how many of those now in prison could be safely released with GPS monitors. But a goal of reducing the prison headcount by 75 percent over ten years doesn't seem out of reach.

That could contribute a couple of billion dollars a year to closing the state's fiscal gap. More to the point, it could omit untold amounts of needless suffering: suffering both by crime victims, by incarcerated offenders, and by those who care about them.