October 31, 2012

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional and statutory initiative regarding certain tax increases and public postsecondary funding (A.G. File No. 12-0015).

Background

Public Universities and Colleges Charge Students Tuition/Fees. California has three public systems of higher education (also known as segments): the University of California (UC), the California State University (CSU), and the California Community Colleges (CCC). In general, students must pay tuition (at the universities) and fees (at the community colleges). Tuition and fees for resident students cover a portion of education costs, with state funding (and some local property tax revenue) covering nearly all of the remainder of the costs. Nonresident students generally are charged full cost. Tuition and fees generally increase as corresponding education costs increase, with undergraduate students charged less than graduate and professional degree students. The state has no specific policy for how tuition and fees should be adjusted annually.

State Financial Aid Programs Help Cover Costs for Needy Students. The state administers several financial aid programs that provide grants and other forms of aid to help cover higher education costs for financially needy students. The main program administered by the state is the Cal Grant program. Historically, this program has been supported primarily with state funds. In a departure with this past practice, the 2012-13 budget supports about half the program with federal funds. Under current state law, costs for this program automatically increase whenever UC or CSU increase tuition since, for most recipients, the grants cover the full cost of tuition at these universities.

Effect of Proposition 30 on Public Higher Education Budgets and Tuition/Fee Levels. The state's 2012-13 budget plan assumes the passage of Proposition 30 by the voters at the November 2012 election. This measure would raise several billions of dollars annually in new sales and income tax revenues starting in 2012-13 to fund the state budget. If the measure does not pass, then the state budget contains several "trigger" provisions that would reduce spending on education programs, including higher education. In 2012-13, the triggers would reduce state spending at UC and CSU by $250 million each and at CCC by about $550 million. In addition, if the measure does not pass, UC and CSU would likely increase tuition levels.

Proposal

Increases in Certain Taxes. The measure increases a number of state taxes:

- ***Vehicle License Fee (VLF).*** An increase in the VLF equal to 0.5 percent of the value of the vehicle.
- ***Motor Vehicle Fuel (Gas) Excise Tax.*** An additional tax of 2.5 cents per gallon of motor vehicle fuel.
- ***Diesel Excise Tax.*** An additional tax of 2.5 cents per gallon of diesel fuel.
- ***Cigarette and Tobacco Products Excise Tax.*** An additional tax of 1.25 cents per cigarette, or 25 cents per pack of 20. (If this new tax were to go into effect, existing provisions of state law would increase taxes automatically on other tobacco products at a comparable rate.)
- ***Alcohol Excise Taxes.*** An additional tax of 5 cents per gallon of wine and beer, 8 cents per gallon of sparkling wine, 83 cents per gallon of distilled spirits of 100 proof or less, and $1.65 per gallon of distilled spirits over 100 proof.

Tax Revenues Deposited Into New Special Fund. Revenues from the taxes increased by this measure would be deposited to the Restore Public Postsecondary Education Fund. The initiative states that 80 percent of these funds would be apportioned between UC and CSU in proportion to the number of students enrolled at each segment. The remaining 20 percent would be provided to CCC. The funds could be used for education-related expenses.

State Spending Requirements. The initiative establishes minimum state spending requirements for higher education. The new tax revenues generated by the initiative could be used to help meet these requirements. For UC, CSU and CCC, the state would be required to spend at least the same amount on each segment as it did in 2009-10, adjusted for inflation. The spending requirement would be calculated based on either *total* state funding provided to the segment in 2009-10 or the *per-student* state funding level in 2009-10, whichever results in a higher amount. The proposal establishes a similar guarantee for state-administered financial aid programs, but it would be based on the amount of state spending in 2010-11. The proposal also prohibits the state from eliminating financial aid programs.

Tuition and Fee Roll Back. This proposal reduces tuition and fees at UC, CSU, and CCC to their 2009-10 levels, adjusted for inflation. We estimate this would result in full-time annual resident tuition/fee charges of approximately $9,461 at UC, $4,549 at CSU, and $881 at CCC in the first full year of the measure's implementation. The proposal also appears to roll back tuition charged to professional students and nonresidents.

New Commission. The initiative would have the Speaker of the California Assembly establish a new commission. Within 600 days of the measure taking effect, this commission would be required to make recommendations to improve efficiencies at the three segments. These recommendations would be published on a publicly accessible state website. In addition, the Legislative Analyst's Office (LAO) would be required to publish all available statistical data relating to the three segments on this same website.

Fiscal Impact

This analysis assumes that the initiative appears on the November 2014 ballot. In that case, the first full year in which the proposal would be in effect would be 2015-16.

Additional Tax Revenues. We estimate the taxes established by this measure would result initially in about $2.2 billion of additional annual tax revenues being available for the proposed postsecondary education fund. The majority of these revenues would result from the higher VLF required by this measure. Of the revenues raised annually in the initial years, we estimate UC, CSU, and CCC would receive about $700 million, $1.1 billion, and $400 million respectively.

Minimum State Spending Requirements for Public Universities and Colleges. We estimate that initially the new minimum spending requirements would be substantially above the projected level of spending on the segments under current law. This is due to recent reductions in state support for the segments. (The exact magnitude of this gap would depend on future state budget actions, including whether the trigger reductions related to Proposition 30 are implemented.) The revenues generated by the measure could be used to meet the spending requirements.

Tuition and Fee Roll Back. The measure would reduce tuition and fees to levels significantly lower than they otherwise would have been. As a result, tuition and fee revenues also would be significantly reduced. The exact magnitude of these revenues losses is difficult to estimate since it depends on what tuition and fees would have been in the future absent the measure.

Net Funding for Public Universities and Colleges. Depending on the magnitude of the changes described above, total funding for the segments (state support and tuition) could either increase or decrease from what it otherwise would have been. This would depend in large part on whether the increase in state funding would be sufficient to offset the loss in tuition and fee revenues. It would also depend on state actions in situations where the new tax revenues resulted in state spending in excess of the minimum spending requirements. For example, the state could choose to use these "excess" funds to cover tuition and revenue losses or to reduce its General Fund spending on the segments.

State Financial Aid Programs. In the short term, it is unclear what effect the initiative's minimum spending requirement would have on financial aid programs. Since the state recently reduced *state* spending on the Cal Grant program by substituting federal funds, the state could be required to increase *state* spending significantly to meet the minimum state spending requirements. At the same time, it is possible that the state could shift these same federal funds to other program areas in the state budget and reduce state costs in those programs. The net fiscal effect in the short term would depend on these future state budget actions. In the long run, the limits on tuition increases that the proposal imposes upon UC and CSU would likely slow growth in Cal Grant costs.

Effects on Other Parts of the State Budget. The measure could have positive or negative effects on other parts of the state budget. On the one hand, if the revenues generated under the measure were more than sufficient to meet the required higher spending levels, then the state could spend more than the required minimum on higher education, redirect some General Fund revenues from higher education to other areas of the budget, or lower other state taxes. On the other hand, if the revenues generated by the measure fall short of meeting the required higher spending levels, then the measure could result in spending on other program areas being reduced and/or higher state taxes. In addition, some programs that receive funding from the taxes changed by the measure could be affected. For example, the increased cigarette taxes could reduce consumption of cigarettes such that certain programs funded through cigarette taxes (such as tobacco education and early childhood development programs, for example) receive less funding.

New Commission. The state likely would incur minor administrative costs to create the new commission directed at identifying efficiencies in higher education. These costs could be more than offset if some (or all) of the commission's efficiency recommendations were implemented and resulted in sufficient savings. The LAO would incur minor costs to publish statistical information about the segments.

Summary of Fiscal Effects:

The measure would have the following major fiscal effects:

- Additional state tax revenues from increases in various taxes of about $2.2 billion annually that would be dedicated to public universities and colleges.
- Depending on whether the new state tax revenues are sufficient to replace lost tuition and fee revenues (due to lower student tuition and fee levels), unknown effect on total funding for public universities and colleges.
- Depending on whether the new state tax revenues are sufficient to satisfy increased state spending requirements on public universities and colleges, unknown effects on other parts of the state budget and the state General Fund.

Sincerely,

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Mac Taylor
Legislative Analyst

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Ana J. Matosantos
Director of Finance