

February 1, 2013

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 statutory initiative regarding cigarette tax increases and financial aid programs for students enrolled at public universities (A.G. File No. 12-0018).

Background

Public Universities Charge Students Tuition. California has two public universities: the University of California (UC) and the California State University (CSU). The universities charge resident students tuition to pay for a portion of education costs, with state funding covering nearly all remaining education costs. Undergraduate and academic graduate students are charged about the same, while professional degree students are charged more. The state has no specific policy for how tuition levels should be adjusted annually.

Financial Aid Programs Help Students Cover Costs. The California Student Aid Commission (CSAC) is responsible for administering several state financial aid programs that help financially needy resident students cover education costs. The main state financial aid program is the \$1.5 billion Cal Grant program. This program guarantees financial aid awards to California high school graduates and community college transfer students who enroll as undergraduates and meet financial, academic, and other eligibility criteria. At UC and CSU, the awards typically cover tuition for up to four years. In 2011-12, 29 percent of UC undergraduates and 20 percent of CSU undergraduates received Cal Grant awards. Though the Cal Grant program historically has been supported almost entirely with state funds, the 2012-13 budget substituted over \$800 million of state funds with federal funds.

Campus-Based Financial Aid Programs Also Cover Costs for Certain Students. The UC and CSU also administer campus-based financial aid programs that provide tuition discounts and waivers as well as assistance for other expenses (such as room and board). Most of this aid is allocated based on systemwide policies, though some is based on individual campus policies. More than half of undergraduates at UC and CSU receive some form of campus-based financial aid. For example, 26 percent and 30 percent of students at UC and CSU, respectively, receive full or partial tuition coverage. In addition, the universities award financial aid to graduate students.

Existing State Tobacco Excise Taxes Support Various Programs. Current state law—including two voter-approved measures (Proposition 99 of 1988 and Proposition 10 of 1998)—imposes excise taxes on the distribution of cigarettes and other tobacco products, such as cigars and chewing tobacco. Excise taxes are generally applied to a specific amount of a certain product. For example, the cigarette excise tax is currently \$0.87 per pack. Tobacco excise tax revenues are used primarily for tobacco education and prevention efforts, tobacco-related disease research, breast cancer screenings for uninsured women, and early childhood education. These revenues totaled just under \$900 million in 2011-12. In recent years, revenues have decreased by about 3 percent to 5 percent annually because of the long-term trend toward lower levels of tobacco use in California.

State and Local Sales Tax Revenues Derived From Tobacco Products. Tobacco users also pay state and local sales and use taxes (SUT) on the retail price of tobacco products. This retail price includes the tobacco excise tax. For example, a pack of cigarettes with a retail price of \$5 includes \$0.87 in excise tax, and the SUT is applied to the \$5. In 2011-12, local governments received about \$210 million from the SUT on tobacco products and the General Fund received an additional \$230 million. These revenues are used to support a variety of programs.

Cigarette Excise Tax Linked With Other Tobacco Excise Taxes. Under Proposition 99, any increase in the cigarette excise tax triggers an automatic equivalent increase in the excise tax rate on other tobacco products. The resulting revenue is deposited into the Cigarette and Tobacco Products Surtax Account established by Proposition 99 and is used to fund Proposition 99 programs, including tobacco prevention and research efforts and various health care programs.

Proposal

Increase in Cigarette Excise Tax. The measure increases the state excise tax on cigarettes by \$1 per pack of 20, increasing the total state excise tax to \$1.87 per pack.

Tax Revenues Deposited Into New Special Fund. Revenues from the \$1 per pack cigarette tax increase imposed by this measure would be deposited to a new special fund—the California Residents College Accessibility and Affordability Fund. These funds would be continuously appropriated according to the measure’s provisions, as discussed below. The measure prohibits the state from transferring or loaning these funds to the state General Fund or any other state fund.

Revenues for Programs Currently Supported by Cigarette and Tobacco Taxes. The measure requires the transfer of some revenues from the new special fund to “backfill,” or offset, all revenue losses for existing tobacco tax programs that occur as a direct result of the new tax increase. These revenue losses would occur mainly because an increase in the price of cigarettes and other tobacco products would (1) reduce tobacco consumption and (2) result in some tobacco consumption shifting to Internet or out-of-state purchases to avoid the tax. Each year, the Board of Equalization (BOE) would estimate the amount of required backfill, and the State Controller’s Office (SCO) would transfer this amount from the new special fund to each program to offset any decreased funding. Administrative costs for BOE and SCO to perform these and other duties imposed by the measure would be paid from the new fund.

Revenues to Expand Financial Aid Programs. After making the transfers described above, the amount remaining in the California Residents College Accessibility and Affordability Fund would be transferred to CSAC. The measure requires that CSAC use this funding to expand financial aid for California residents enrolled at UC and CSU. The measure prohibits any of this funding from being

used to supplant existing state funds used for tuition assistance. In addition, the measure limits CSAC to using a maximum of 0.01 percent of the funds for administrative costs.

Annual Audits. The measure makes SCO responsible for having an independent annual audit conducted on the new special fund. In addition, the measure requires CSAC to display on its website the amount of money it received from the fund along with an accounting of its expenditures.

Oversight Committee. The measure establishes an Independent Financial Accountability Oversight Committee to issue an annual report to the public and the Legislature evaluating CSAC's performance. The State Controller would chair the committee and be responsible for appointing four other members with expertise in higher education, financial aid, finance, or governance. Members of the committee would serve four-year terms and would not be compensated, except to reimburse expenses.

Civil and Criminal Penalties. The proposal states that the Legislature is to establish civil and/or criminal penalties related to the willful misuse of funds appropriated by the measure, including exceeding the amount allowed for administrative expenses.

Amendments. The measure permits the Legislature to amend its provisions with a two-thirds vote. Amendments would be allowed only to further the purposes of the initiative.

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 is 2015-16.

Additional Excise Tax Revenues. We estimate the cigarette excise tax increase would initially result in about \$800 million deposited to the California Residents College Accessibility and Affordability Fund. These revenues would be somewhat lower each year thereafter, based on our projections of continued decline in cigarette consumption. In addition, the increase in excise taxes on other tobacco products that would be triggered by the measure would yield about \$45 million annually for the Cigarette and Tobacco Products Surtax Account.

Increased Spending on Certain Programs Supported by Tobacco Taxes. We estimate that the excise tax increases imposed by the measure would reduce cigarette and tobacco consumption, such that existing cigarette and tobacco tax revenues would decrease by about \$70 million. Programs supported by these revenues would receive transfers from the California Residents College Accessibility and Affordability Fund to backfill for this loss. As a result, spending on these programs would not change as a direct result of the measure. Proposition 99 programs, however, would benefit from the additional \$45 million in annual revenues from the tobacco excise tax increase triggered by the measure.

Likely Increased Spending on State Financial Aid Program. After making the transfers described above, about \$730 million would remain in the California Residents College Accessibility and Affordability Fund for CSAC to expand financial aid for resident students at UC and CSU. This could be done in a number of ways. For example, the financial and academic eligibility criteria for the Cal Grant program could be adjusted so that more students qualify for the program; full tuition coverage could be provided to the relatively few Cal Grant recipients at UC and CSU who do not receive tuition coverage their first year of college; additional aid could be provided for students' living expenses; or new programs could be created to provide financial aid to students currently

excluded from Cal Grants, such as graduate students or students without financial need. Though the measure prohibits the state from using the new revenues to supplant existing state funds used for tuition assistance, this may not prevent financial aid supported with other funds from being reduced. For example, the state potentially could use the new revenues to supplant some or all of the \$800 million in federal funds supporting the Cal Grant program.

Additional SUT Revenues. State and local sales tax revenue from cigarette and tobacco products also would increase under this measure. These additional revenues, which we estimate to be in the low tens of millions of dollars, would be offset to some extent by reduced spending on other taxable goods as tobacco users spend less elsewhere as a result of higher tobacco taxes.

Other Fiscal Effects. As discussed above, this measure would result in a decrease in the consumption of tobacco products. The use of tobacco products has been linked to various adverse health effects by federal health authorities and numerous scientific studies. Thus, this measure would reduce state and local government health care spending on tobacco-related diseases over the long term. Individuals living longer as a result of less tobacco-related disease also could generate additional economic activity for the state through higher lifetime earnings and greater consumption. This measure would have other fiscal effects, however, that could offset these benefits. For example, state and local governments could incur future costs for the provision of health care and social services for individuals who otherwise likely would not have lived as long. Given the many possible effects resulting from individuals potentially living longer due to the measure's provisions, the net fiscal impact of these factors is unknown.

Summary of Fiscal Effects:

The measure would have the following major fiscal effects:

- Additional annual state tax revenues of (1) \$800 million from the cigarette excise tax increase of \$1 per pack and (2) \$45 million from the excise tax increase on other tobacco products triggered by the measure.
- The additional cigarette tax revenue would be spent on financial aid for resident students at the state's public universities (\$730 million) and backfilling losses to existing tobacco programs (\$70 million). The additional revenue from other tobacco products would be used for other existing programs, including tobacco-prevention and education.

Sincerely,

Mac Taylor
Legislative Analyst

Ana J. Matosantos
Director of Finance