Proposition 86
Tax on Cigarettes.
Initiative Constitutional Amendment and Statute.

BACKGROUND

Tobacco Taxes

Current state law imposes certain taxes directly on cigarettes and other tobacco products that are known as excise taxes. Excise taxes are taxes collected on selected goods or services. Currently, the excise taxes total 87 cents per pack of cigarettes (with a similar tax on other types of tobacco products). The total tax of 87 cents per pack consists of:

- 50 cents to support early childhood development programs, enacted by the voters as Proposition 10 in 1998.
- 25 cents to support tobacco education and prevention efforts, tobacco-related disease research programs, health care services for low-income uninsured persons, and environmental protection and recreational programs, enacted by the voters as Proposition 99 in 1988.
- 10 cents for the state General Fund.
- 2 cents to support research related to breast cancer and breast cancer screening programs for uninsured women.

Current taxes on cigarettes and other tobacco products are estimated to raise about $1.1 billion in 2006-07.

Children's Health Care Coverage

Medi-Cal. The Medi-Cal Program (the federal Medicaid Program in California) provides health care services to low-income persons, including eligible children (depending on the age of the child). Families with incomes up to 133 percent of the federal poverty level (FPL) (about $27,000 per year for a family for four) are generally eligible for coverage. The program is administered by the state Department of Health Services (DHS).

Under the Medicaid Program, matching federal funds are available for the support of comprehensive medical services for United States citizens and to "qualified aliens"—that is, immigrants who are permanent residents, refugees, or a member of certain other groups granted the legal right to remain in the United States. Federal matching funds are also available for nonqualified aliens, but only for emergency medical services.

The Medi-Cal Program currently serves about 3.2 million adults and 3.2 million children.

Healthy Families. The Healthy Families Program (HFP) offers health insurance to eligible children in families who generally have incomes below 250 percent of FPL (about $50,000 per year for a family of four) who do not qualify for Medi-Cal. (Children in some families with higher incomes are also eligible.) Funding is generally on a two-to-one federal/state matching basis. Children in HFP must be eligible United States citizens or qualified aliens. The HFP is administered by the Managed Risk Medical Insurance Board (MRMIB).

The HFP provides medical coverage for about 781,000 children.

Local Health Coverage Programs. The County Health Initiative Matching (CHIM) Fund program, which is administered by MRMIB and counties, provides health coverage for children in families with an income between 250 percent and 300 percent of FPL (between $50,000 and $60,000 per year for a family of four). The CHIM program relies on county funds as the match required to draw down federal funds to pay for this health coverage. This program has a caseload of about 3,000 children.

In addition to the CHIM program, some counties have established their own health coverage programs for children that are ineligible for Medi-Cal or HFP. These programs are primarily supported with local funding. These programs serve about 69,000 children.

PROPOSAL

This measure increases excise taxes on cigarettes (and, as discussed below, indirectly on other tobacco products) to provide funding for hospitals for emergency services as well as programs to increase access to health insurance for children, expand nursing education, support various new and existing health and education activities, curb tobacco use and regulate tobacco sales. Major provisions of the measure are described below.

New State Tobacco Tax Revenues

A pack of cigarettes now costs roughly $4.00 in California, including 87 cents in excise taxes. This measure increases the existing excise tax on cigarettes by $2.60 per pack effective January 2007. Existing state law requires the Board of Equalization (BOE) to increase taxes on other tobacco products—such as loose tobacco and snuff—in an amount equivalent to any increase in the tax on cigarettes. Thus, this measure would also result in a comparable increase in the excise tax on other tobacco products. All of the additional tobacco revenues (including those on other tobacco products) would be used to support various new and existing programs specified in this measure.

How Additional Tobacco Revenues Would Be Spent

Revenues from the excise tax increase would generally be deposited in a new fund called the Tobacco Tax of 2006 Trust Fund and would be allocated for various specified purposes, as shown in Figure 1 later in this analysis.

Backfill of Proposition 10 Programs. An unspecified amount of the additional excise tax revenues would be used to fully backfill Proposition 10 programs for early childhood development for a loss of funding that would result from the enactment of the new tax measure. This is because the tax increases contained in this measure are (1) likely to result in reduced sales of tobacco products and (2) could result in more sales of tobacco products for which taxes would not be collected, such as for smuggled products and out-of-state sales. This, in turn, would reduce the amount of revenues collected through the excise taxes imposed under Proposition 10. The amount of backfill payments needed to offset any loss of funding for the Proposition 10 program would be determined by BOE.

Health Treatment and Services Account. Under the measure, 52.75 percent of the funds that remain after providing the Proposition 10 backfill funding would be allocated to a Health Treatment and Services Account. This funding would be used for the purposes outlined below:

- ***Hospital Funding.*** Nearly three-fourths of the funds in this account would be allocated to hospitals to pay their unreimbursed costs for emergency services and to improve or expand emergency services, facilities, or equipment. Allocations would be based largely on the number of persons that hospitals treat in their emergency departments and their costs for providing health care for patients who are poor. Private hospitals and certain public hospitals, including those licensed to the University of California (UC), would be eligible to receive funding. Hospitals licensed to other state agencies or the federal government would not be eligible for funding.
- ***Nursing Education Programs.*** These funds would be used to expand nursing education programs in UC, California State University, community college, and privately operated nursing education programs.
- ***Additional Allocations.*** Funding would be allocated for the support of nonprofit community clinics; to help pay for uncompensated health care for uninsured persons provided by physicians; for college loan repayments to encourage physicians to provide medical services to low-income persons in communities with insufficient physicians; to provide prostate cancer treatment services; and for services to assist individuals to quit smoking.

Health Maintenance and Disease Prevention Account. Under the measure, 42.25 percent of the funds that remained after providing the Proposition 10 backfill funding would be allocated to a Health Maintenance and Disease Prevention Account. This funding would be used for the purposes outlined below:

- *Children's Health Coverage Expansion.* Almost one-half of these funds would be allocated to expand the HFP to provide health coverage to include (1) children from families with incomes between 250 percent and 300 percent of the FPL and (2) children from families with incomes up to 300 percent of the FPL who are undocumented immigrants or legal immigrants not now eligible for HFP. This measure requires MRMIB and DHS to simplify the procedures for enrolling and keeping children in HFP and Medi-Cal coverage and creates a pilot project to provide coverage for uninsured children in families with incomes above 300 percent of the FPL.
- *Tobacco-Related Programs.* These funds would support media advertising and public relations campaigns, grants to local health departments and other local organizations, and education programs for school children to prevent and reduce smoking. Funding would also go to state and local agencies for enforcing laws and court settlements which regulate and tax the sale of tobacco products. Also, some funds would be used to evaluate the effectiveness of these tobacco control programs.
- *Health and Education Programs.* Part of these funds would be set aside for various new or existing health programs related to certain diseases or conditions, including colorectal, breast, and cervical cancer; heart disease and stroke; obesity; and asthma.

Health and Disease Research Account. Under the measure, 5 percent of the funds that remained after providing the backfill funding discussed above would be allocated to a Health and Disease Research Account. This funding would be used to support medical research relating to cancer in general and breast and lung cancer in particular. In addition, it would support research into tobacco-related diseases, as well as the effectiveness of tobacco control efforts. Part of these funds would be used to support a statewide cancer registry, a state program that collects data on cancer cases.

Other Major Provisions

In addition to the provisions that raise tobacco excise taxes and spend these same revenues, this measure contains a number of other significant provisions, which are described below.

Existing Funding for Physician Payments Continued. In recent years, the state has spent almost $25 million per year in Proposition 99 funds for allocations to counties to reimburse physicians for uncompensated medical care for persons who are poor. This measure requires that this same level of Proposition 99 funds be allocated annually in the future for this purpose.

Expenditure Rules. The funds allocated under this measure would not be appropriated through the annual state budget act and thus would not be subject to change by actions of the Legislature and Governor. The additional revenues would

generally have to be used for the services noted above and could not take the place of existing state or local spending. The state and counties could not borrow these new revenues to use for other purposes, but they could be used to draw down additional federal funds. Contracts to implement some of the new programs funded by this measure would be exempted from state contracting rules for the first five years.

Oversight Provisions. This measure requires DHS to prepare an annual report describing the programs that received additional excise tax funding and how that funding was used. This information would be made available to the public by DHS on its Web site. Programs receiving these funds would be subject to audit. New state committees would be established to oversee the expansion of children's health coverage and antiobesity programs.

Hospital Charges and Bill Collections. Hospitals that are allocated funds under this measure for emergency and trauma care services would be subject to limits on what they could charge to certain patients in families with incomes at or below 350 percent of the FPL. These hospitals would also have to adopt written policies on their bill collection practices and, under certain circumstances, could not send unpaid bills to collection agencies, garnish wages, or place liens on the homes of patients as a means of collecting unpaid hospital bills.

Coordination of Medical Services by Hospitals. Subject to the approval of certain local officials, hospitals receiving funding under this measure would be allowed to coordinate certain medical services, including emergency services, with other hospitals. For example, hospitals would be permitted to jointly share the costs of ensuring the availability of on-call physicians who provide emergency services. The measure seeks to exempt such coordination of emergency services from antitrust laws that might limit or prohibit such coordination efforts.

FISCAL EFFECTS

This measure would have a number of fiscal effects on state and local governments. The major fiscal effects we have identified are discussed below.

Impacts on State and Local Revenues

Revenues Affected by Consumer Response. Our revenue estimates assume that the excise tax increase of $2.60 per pack is passed along to consumers by the distributors of tobacco products who actually pay the excise tax. In other words, we assume that the prices of tobacco products would be raised to include the excise tax increase. This would result in various consumer responses. The price increase is likely to result in consumers reducing the quantity of taxable tobacco products that they purchase. Consumers could also shift their purchases so that taxes would not be collected on tobacco products, such as through Internet purchases or purchases of smuggled products.

The magnitude of these consumer responses is uncertain given the size of the proposed tax increase. There is substantial evidence regarding the response of consumers to small and moderate tax increases on tobacco products in terms of reduced tobacco consumption. As a result, for small-to-moderate increases in price, the revenue impacts can be estimated with a reasonable degree of confidence. However, the increase in taxes proposed in this measure is substantially greater than that experienced previously. As a result, we believe that revenue estimates based on traditional assumptions regarding this consumer response would likely be overstated. Therefore, our revenue estimates below assume a greater consumer response in terms of reduced tobacco consumption to this tax increase than has traditionally been the case. These estimates are subject to uncertainty, however, given a variety of factors, including the large tax changes involved.

Revenues From Tax Increase on Tobacco Products. We estimate that the increase in excise taxes would raise about $1.2 billion in 2006-07 (one-half year effect from January through June 2007). It would raise about $2.1 billion in 2007-08 (first full-year impact). This excise tax increase would raise slightly declining amounts of revenues thereafter.

Effects on State General Fund Revenues. The measure's increase in the excise tax would have offsetting effects on state General Fund revenues. On the one hand, the higher price and the ensuing decline in consumption of tobacco products would reduce state General Fund revenues from the existing excise taxes. On the other hand, the state's General Fund sales tax revenues would increase because the sales tax is based on the price of the tobacco product *plus* the excise tax. The decreases in revenues would approximately equal the increases in revenues.

Effects on Local Revenues. Local governments would likely experience an annual increase in sales tax revenues of as much as $10 million.

Effects on Existing Tobacco Excise Tax Revenues. The decline in consumption of tobacco products caused by this measure would similarly reduce the excise tax revenues that would be generated for Proposition 99 and 10 programs and for the Breast Cancer Fund. We estimate that the initial annual revenue losses are likely to be about $180 million for Proposition 10, about $90 million for Proposition 99, and less than $10 million for the Breast Cancer Fund. However, these losses would be more than offset in most cases by additional tax revenues generated by this measure, as discussed below.

Impacts of New Programs on State and Local Expenditures

State and local government expenditures for the administration and operation of various programs supported through this measure would generally increase in line with the proposed increase in excise tax revenues. Figure 1 shows the main purpose of the accounts established by the initiative, the percentage of funds allocated to each purpose, and our estimate of the funding that would be available for each account in the first full year of tax collection. These allocations would probably decline in

subsequent years as excise tax revenues also declined, potentially resulting in a corresponding decrease in state and local expenditures for these new programs.

The state administrative costs associated with the tax provisions of this measure would be minor.

Figure 1

How Tobacco Tax Funds Would Be Allocated[a]

Purpose	Allocation	Estimate of 2007-08 Funding (Full Year in Millions)
Backfill of California Children and Families First Trust Fund—Proposition 10	Unspecified amount determined by Board of Equalization	**$180**
Health Treatment and Services Account	**52.75 percent of remaining funds**	**$1,015**
Hospital emergency and trauma care	74.50 percent of account	$756
Nursing education programs	9.00 percent	91
Nonprofit community clinics	5.75 percent	58
California Healthcare for Indigents Program—reimbursement of emergency care physicians	5.75 percent	58
Tobacco cessation services	1.75 percent	18
Prostate cancer treatment	1.75 percent	18
Rural Health Services Program—reimbursement of emergency care physicians	0.75 percent	8
College loan repayment program to encourage physicians to serve low-income areas lacking physicians	0.75 percent	8
Health Maintenance and Disease Prevention Account	**42.25 percent of remaining funds**	**$810**
Children's health coverage	45.50 percent of account	$367
Heart disease and stroke program	8.50 percent	69
Breast and cervical cancer program	8.00 percent	65
Obesity, diabetes, and chronic diseases programs	7.75 percent	63
Tobacco control media campaign	6.75 percent	55
Tobacco control competitive grants program	4.50 percent	36
Local health department tobacco prevention program	4.25 percent	34
Asthma program	4.25 percent	34
Colorectal cancer program	4.25 percent	34
Tobacco prevention education programs	3.50 percent	28
Tobacco control enforcement activities	2.25 percent	18
Evaluation of tobacco control programs	0.50 percent	4
Health and Disease Research Account	**5.00 percent of remaining funds**	**$95**
Tobacco control research	34.00 percent of account	$32
Breast cancer research	25.75 percent	24
Cancer research	14.75 percent	14
Cancer registry	14.50 percent	14
Lung cancer research	11.00 percent	10
Total Allocations		**$2,100**

[a] Because the overall revenues from the tobacco tax increase are subject to uncertainty, the actual allocations to programs could be greater or less than the amounts shown here.

Totals may not add due to rounding.

Impacts on Other Tobacco Tax-Funded Programs

This measure would have a number of significant fiscal effects on the three existing programs supported by tobacco excise taxes—Proposition 99 (which supports various health and public resources programs), Proposition 10 (which supports early childhood development programs), and the Breast Cancer Fund (which supports breast and cervical cancer screening and breast cancer research programs).

Proposition 99. This measure does not directly backfill any Proposition 99 accounts for the loss of revenues that would be likely to occur as a result of the excise tax increase proposed in this measure. Specifically, we estimate that this measure would initially result in an annual funding reduction of about $5 million for the public resources account and initially almost $25 million for an account that can be used to support any program eligible for Proposition 99 funding.

However, while this measure would reduce revenues for other Proposition 99 accounts, it would also initially provide significant increases in funding in the new accounts created under this measure for activities comparable to those now funded through Proposition 99. This includes health education and tobacco research, hospital services, and physician services. In the aggregate, these activities could initially experience a net gain in funding of almost $950 million if this measure were enacted.

Proposition 10. Proposition 10 would receive full backfill funding under the terms of this measure. We estimate that this backfill would initially amount to about $180 million annually.

Breast Cancer Fund. No backfill funding would be provided for the Breast Cancer Fund to offset the loss of revenues resulting from the tax increases proposed in this measure. However, this measure would allocate a set portion of the new tax revenues for breast cancer research and breast cancer early detection services, with the result that these activities initially would likely experience a net gain of about $80 million annually.

Revenues and Costs From Provisions Affecting Public Hospitals

Some of the hospital emergency services funding provided under this measure could be allocated to public hospitals licensed to state and local agencies, such as those run by UC, counties, cities, and health care districts. This and certain other provisions of the measure could potentially result in increased revenues and expenditures for support of these hospital operations. The magnitude of the fiscal effects of all of these provisions is unknown, but is likely to result in a net financial gain for hospitals operated by state and local government agencies up to the low hundreds of millions of dollars annually on a statewide basis.

Fiscal Impact on State and Counties From Children's Coverage Provisions

Long-Term Increase in State Costs for Increased HFP Enrollment. In the short term, the revenues allocated by this measure to expand HFP would probably exceed the costs

to make additional children eligible for health coverage. This would particularly be the case in the early years as enrollment gradually increased. Any excess revenues for expanding children's health coverage would be reserved to support this same purpose in future years.

Over time, however, as the excise tax revenues allocated for this purpose declined (for the reasons mentioned above) and the number of children enrolled in HFP grew, the costs of the expanded HFP could eventually exceed the available revenues. Current state law would permit MRMIB to limit enrollment in the program to prevent this from occurring. If actions were not taken to offset program costs at that point, however, additional state financial support for the program would be necessary. These potential long-term state costs are unknown but could be significant.

State and County Savings From Shift in Children's Coverage. This measure allows some children now receiving health coverage in local health coverage programs, such as CHIM, to instead be enrolled in the expanded HFP. Also, some children in low-income families receiving health care from counties without local health initiatives would be likely to become enrolled in HFP. These changes would likely result in unknown, but potentially significant, savings on a statewide basis to local governments, particularly for counties.

The Medi-Cal Program could also experience some state savings for emergency services as some children would instead receive their coverage for these and other services through HFP. These savings to the state could reach the tens of millions of dollars annually unless the state decided, as this measure permits, to have these children continue to receive emergency services through Medi-Cal.

Net Increase in State Costs From Pilot Projects and Simplified Enrollment. This measure requires MRMIB and DHS to simplify the procedures for enrolling and keeping children in HFP and Medi-Cal coverage. For example, among other changes, these provisions could allow applicants to "self-certify" their income and assets on their applications for coverage without immediately providing employer or tax documents to verify their financial status. From an administrative perspective, some changes that simplified enrollment rules would reduce state costs, while others, such as changes in computer systems for enrollment activities, would likely increase state costs. As regards caseloads, these changes are likely to increase program enrollment and, therefore, costs for the state. This would occur because children who are eligible for, but not enrolled in, Medi-Cal and HFP would be signed up for medical benefits and existing enrollees continued to be served in these programs.

As noted earlier, this measure also directs the state to establish a pilot project to provide health coverage for uninsured children in families with incomes above 300 percent of the FPL. This would also increase state caseload costs.

The net fiscal effect of these provisions is an increase in state costs that could exceed $100 million annually after a few years. Some of these costs could be paid for using the new excise tax revenues generated under this measure.

Potential State and Local Savings on Public Health Costs

Currently, the state and local governments incur costs for providing (1) health care for low-income persons and (2) health insurance coverage for state and local government employees. Consequently, changes in state law that affect the health of the general populace would affect publicly funded health care costs. Because this measure is likely to result in a decrease in the consumption of tobacco products which have been linked to various adverse health effects, it would probably reduce state and local health care costs over the long term.

Some of the health programs funded in this measure are intended to prevent individuals from experiencing serious health problems that could be costly to treat. To the extent that these prevention efforts are successful and affect publicly funded health care programs, they are likely to reduce state and local government health care costs over time. In addition, the proposed expansion of these state health programs could reduce county costs for providing health care for adults and children in low-income families.

The magnitude of state and local savings from these factors is unknown but would likely be significant.