

March 10, 2010

Hon. Edmund G. Brown Jr.
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Krystal Paris
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 10-0005). This measure would increase excise taxes on beer, wine, and distilled spirits sold in California.

Background

Excise and Sales Taxes. An excise tax is a fixed amount levied on a per unit basis. Current state law imposes an excise tax on alcoholic beverages. This tax varies according to the type of alcoholic beverage. (The current levels of these excise taxes are discussed below.) In 2008-09, California collected \$324 million in excise tax revenues on alcoholic beverages.

A sales and use tax (SUT) is levied as a percentage of the price of the item purchased. Sales of alcoholic beverages in California are subject to a state and local SUT imposed on the retail price plus the amount of the excise tax. In 2008-09, the SUT on alcoholic beverages in California raised about \$3.5 billion in revenues.

Alcohol Use and Addiction Affects State and Local Programs. The state and local governments administer programs that assist individuals and their families who have been adversely affected by alcohol use and addiction. These include programs that provide substance abuse treatment for alcoholics, medical care for persons with alcohol-related ailments or injuries from alcohol-related motor vehicle accidents, and social services for families of persons addicted to alcohol use.

The state and local governments administer law enforcement and criminal justice programs that are affected by alcohol use and addiction. The California Highway Patrol, county sheriff's departments, and city police departments enforce laws related to the use of alcoholic beverages, and in some cases incarcerate persons accused and convicted of drunk driving and other alcohol-related offenses.

Proposal

Excise Tax Increase on Alcoholic Beverage Manufacturers. This initiative increases excise taxes on beer, wine, and distilled spirits sold in California effective 90 days after its enactment. Figure 1 shows the existing excise tax on alcoholic beverages compared to the increased tax level proposed under the measure. (While the proposed tax increase is levied on a per gallon basis, we have converted it to standard drinks for purposes of illustration.) For example, this measure would increase the excise tax on a glass of beer by about \$1. The tax increases proposed under this measure would be significant in comparison to the cost of these products to consumers today.

Figure 1		
Proposed Excise Tax Per Drink		
	Current	Proposed
Beer (12 ounce glass)	\$0.02	\$0.98
Wine (5 ounce glass)	0.01	0.99
Champagne (5 ounce glass)	0.01	1.00
Spirits (1.5 ounce shot)	0.04	1.04

Alcohol-Related Harm and Damage Services Fund. This measure allows the revenues collected from the increase in alcohol excise taxes to be used to pay any refunds owed to taxpayers and to offset the cost of the administration of this measure. All other receipts from the new excise tax would be deposited into a special fund created by the measure called the Alcohol-Related Harm and Damage Services Fund. This measure would appropriate these monies on an ongoing basis to the Department of Alcohol and Drug Programs. This means that the monies would not be subject to appropriation by the Legislature in the annual budget act. The measure requires that monies distributed from the fund support a range of alcohol-related services including:

- **Addiction Treatment and Recovery.** Twenty-two percent for treatment and recovery services for alcohol addiction, including hospitalization and rehabilitation services for physical and mental health services caused or contributed to by alcohol use.
- **Support Services.** Twenty-two percent for programs that provide support services, including job training and placement, counseling, support groups, classes in parenting and budgeting, and legal and other types of advocacy and representation to family members of alcohol abusers.
- **Naturopathic Treatment Grants.** Fifteen percent to fund grants for naturopathic treatment and recovery programs for alcohol addiction.

- *Capital Expenditures for Facilities.* Twelve percent for capital expenditures for facilities to house and/or provide treatment for homeless and low-income persons recovering from alcohol-related problems.
- *Enforcement of Alcohol-Related Laws.* Ten percent for enforcement of alcohol-related laws, and related costs and services of the criminal justice and penal systems.
- *Driving Under the Influence Laws.* Ten percent to improve the enforcement of laws prohibiting driving under the influence of an alcoholic beverage and for related costs and services of the criminal justice and penal systems.
- *Public Awareness.* Five percent for programs and public awareness campaigns to prevent the use and abuse of alcoholic beverages.
- *Housing and Shelter for Victims.* Three percent for capital expenditures for housing and shelters for victims of alcohol-related abuse.
- *Administration.* One percent to evaluate and report on the effectiveness of the programs funded by the new excise tax.

The measure allows the new excise tax revenues to be used in lieu of current government spending for services that fall into the above categories.

Fiscal Effects

This measure would have a number of fiscal effects on state and local governments.

Impact on State and Local Government Revenues

Revenues Will Be Affected by Consumer Response. Our estimates of the revenues that would be raised by this measure assume that the prices of alcoholic beverages would be raised to reflect the tax increase. This would result in various consumer responses. The price increase would result in consumers reducing the quantity of taxable alcoholic beverages they purchase. Consumers would also change the way they acquire alcoholic beverages so that fewer transactions are taxed, such as through Internet purchases or purchases of out-of-state products. We have built into our estimates a projection of these consumer responses, but these estimates are subject to uncertainty given a variety of factors, including the large tax change involved.

New Excise Tax Revenues. We estimate that the increase in excise taxes required by this measure would raise billions of dollars annually. Given the uncertainty of consumer responses, we estimate a revenue increase in the range of \$7 billion to \$9 billion annually. Our estimate of the allocation of these new excise tax revenues based on that range is shown in Figure 2.

Figure 2	
Allocation of New Excise Tax Revenues	
<i>(In Billions)</i>	
	Range of New Revenues^a
Treatment and recovery	\$1.54 - 1.98
Support services	1.54 - 1.98
Naturopathic treatment and recovery	1.05 - 1.35
Housing and treatment facilities for homeless	0.84 - 1.08
Enforcement of alcohol-related laws	0.70 - 0.90
Enforcement of driving under the influence laws	0.70 - 0.90
Public awareness campaigns	0.35 - 0.45
Housing and shelters for victims	0.21 - 0.27
Administration	0.07 - 0.09
Totals	\$7.00 - \$9.00

^a Based on receipt of full annual revenues.

Effects on Existing State Excise and SUT Revenues. The decline in taxable consumption of alcoholic beverages that would likely be caused by this measure would reduce the revenues received for the General Fund from the existing state excise and SUT revenues. We estimate that this could potentially result in a loss of state revenues of several hundred million dollars annually.

Effects on Local Revenues. The likely decline in taxable consumption of alcoholic beverages due to the increase in the excise tax imposed under this measure would also affect local SUT revenues. We estimate that local governments, primarily cities and counties, would experience a decrease in sales tax revenues of approximately \$100 million on a statewide basis due to the excise tax increase.

Indirect Economic Effects. If the measure were to result in declines in overall economic activity in California, it could produce indirect state and local revenue losses. Such effects could occur, for example, if businesses were to close because they could no longer remain profitable as the overall economy adjusted to a lower demand for alcohol in the long run. If these lost resources were not redirected back to California’s economy into equal or more productive activities, then it would likely lead to a net loss in taxable income and spending for state and local governments. The magnitude of these potential revenue losses is unknown.

Other Impacts on State and Local Governments

State Administrative Costs. The state would incur administrative costs to collect the new tax, administer the newly created fund, and to report on the effectiveness of programs funded by the measure. These unknown costs—probably in the low millions of dollars annually—would likely be fully covered by the proceeds of the new excise tax.

Potential Program Savings in the Long-Term for Health and Social Services. State and local governments incur costs for providing (1) health care for low-income persons and insurance costs for state and local government employees, and (2) social service programs for low-income families. As noted above, the use of alcoholic beverages has been linked to various adverse health and family outcomes. The enactment of this measure could reduce these adverse consequences in two ways. First, the significant increase in alcohol taxes imposed under this measure would likely reduce consumption of alcohol beverages by consumers. Second, the programs supported by this measure may, to some unknown extent, also reduce alcohol consumption and addiction. In the long term, these factors are likely to reduce state and local government spending on alcohol-related health and social services programs. The magnitude of these potential savings is unknown.

Potential Costs and Savings for Law Enforcement. An increase in the tax rate on alcohol would increase the incentive for persons to illegally produce alcohol, smuggle alcoholic beverages into the state, or avoid the tax by other means. Law enforcement officials have some discretion as to how to allocate their resources. To the extent that illegal activities related to the production or procurement of alcoholic beverages increased, and law enforcement officials allocated additional resources to combat it, state and local law enforcement costs would increase.

On the other hand, law enforcement costs would be reduced if this measure is effective in reducing alcohol-related problems and addiction, either due to the effect of the tax increase on consumption of alcoholic beverages or through increased support for substance abuse treatment and other programs.

Summary

The measure would have the following major impacts:

- Additional state revenues of between \$7 billion and \$9 billion annually from an increase in state excise taxes on alcoholic beverages, with the proceeds going to support alcohol-related programs and services.

- A decrease in state and local revenues from existing excise and sales taxes on alcoholic beverages of several hundred million dollars annually due to a likely decline in consumption of alcoholic beverages.

Sincerely,

Mac Taylor
Legislative Analyst

Ana J. Matosantos
Director of Finance