April 10, 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 concerning oil and gas severance taxes and funding for education, parks and recreation, clean energy research and development, and local infrastructure projects (A.G. File No. 13-0002, Amdt. #1-S).

Background

Oil and Gas Related Taxation in California. Oil and gas producers pay the personal or corporate income tax depending on their form of organization, as well as a regulatory charge on production in the state or in state waters. Also, property owners pay local property taxes on the value of both extraction equipment such as drills and pipelines and (unlike most other states) underground oil and gas reserves.

Proposition 98. Proposition 98, passed by voters in 1988 and modified in 1990, requires a minimum level of state and local funding each year for schools and community colleges. This funding level is commonly known as the Proposition 98 minimum guarantee. This minimum guarantee generally grows with increases in state General Fund revenues.

Proposal

New Oil and Gas Severance Tax to Fund Public Programs. The measure imposes a 9.5 percent tax on the value of all oil and gas extracted in California or its state offshore waters that extend out three miles from the coastline. Oil and gas produced in federal waters would be exempt, and "stripper" wells—defined, for oil wells, as those capable of producing less than ten barrels a day—are exempt if the price of oil from those wells is $50 a barrel or lower.

Distribution of Severance Tax Funds. Beginning in an unspecified state fiscal year (presumably after voter approval of this measure) and continuing until the 2024-25 fiscal year, the revenues raised would be distributed to the following new state treasury accounts: 60 percent to the California Education Accessibility Fund; 22 percent to the California Clean Energy Research, Development, and Implementation Fund; 15 percent to the California Community Development and Modernization Fund; and 3 percent to the California Parks and Recreation Fund.

Starting in the 2025-26 fiscal year, the allocation of the severance tax funds would change to: 80 percent to the California Education Accessibility Fund; 15 percent to the California Community Development and Modernization Fund; and 5 percent to the California Parks and Recreation Fund.

Education Funding Split Evenly Among Four Areas. The measure allocates 25 percent of the California Education Accessibility Fund to each of the following: the Superintendent of Public Instruction (SPI), the California Community Colleges (CCC), the California State University (CSU), and the University of California (UC). These funds could be used to support "direct classroom instruction and access." Under the measure, direct classroom instruction and access at CCC, CSU, and UC only includes reducing student fees, restoring courses that have previously been eliminated, and hiring professors. For the SPI, direct classroom instruction and access only includes reducing K-12 class sizes, hiring K-12 teachers and providing K-12 instructional materials for California's public school districts, county offices of education, and certain other public schools such as the California School for the Deaf and the California School for the Blind. In addition, for CCC only, the measure allows funds to be spent on student services. The measure defines student services to mean instructional support programs that assist students with their educational and career goals.

Proposal Creates Clean Energy Research Program. The measure's Clean Energy Research, Development, and Implementation Program at the California Energy Commission would provide research grants to businesses in the energy industry for research and development of renewable energy technologies. Program administration costs would not be permitted to exceed 1.5 percent of the money in the fund.

Local Infrastructure Funding. The measure's Community Development and Modernization Fund would provide funds to each county for developing and maintaining local infrastructure, roads, public works projects, public health services, and public safety services. Eighty-five percent of the fund's moneys would be "equally distributed" to counties that have 100,000 or more registered vehicles as of an unspecified date each year, with the remaining 15 percent equally distributed to counties with fewer than 100,000 registered vehicles on an unspecified date each year.

State Park Funding Supports Park Operations and Reduced User Fees. The measure directs funds from the California Parks and Recreation Fund to the state's Department of Parks and Recreation "for allocation…in the following order": park operations and maintenance, user fee reduction, land acquisition, hiring additional parks personnel, species and ecosystem protection, and other purposes. User fees shall be reduced in state parks that receive funding from this fund.

Other Provisions of the Measure. This *statutory* measure requires using its revenues to supplement, not supplant, existing state funding for affected education and parks programs, but it does not specifically describe what this means in light of the state *constitutional* requirement for the Legislature to balance the annual state budget, including, in some circumstances, making reductions to state General Fund appropriations in these areas. The measure also is designed such that the additional revenues generated would not count toward the Proposition 98 minimum guarantee. Funds raised by the measure for education and clean energy programs generally could not be transferred or loaned to the state General Fund.

Restrictions on Oil and Gas Price Increases. The measure forbids oil and gas producers from ultimately passing the tax on to consumers and empowers the State Board of Equalization to investigate attempts to do this.

Fiscal Effects

New Revenues. The 9.5 percent severance tax would likely generate between $1.5 billion and $2 billion annually in its first years, subject to much fluctuation as oil and gas prices are highly volatile. Historically, the level of oil production in the state has not been very responsive to changes in the after-tax price, so the tax would likely induce only a small decline in output. If, however, oil prices were to fall to levels that prevailed before 2005 (less than $40 per barrel) it is more likely that the tax would push after-tax prices below the costs of operating some of the state's wells, thus resulting in a potentially bigger negative effect on production.

In the longer run, these annual revenues could grow if, for example, extraction of oil and gas increases from the Monterey Shale, a geological formation underlying hundreds of square miles of Central California with resources that may be extractable using methods like those known as hydraulic fracturing. On the other hand, if prices and/or accessible extraction sources remain fairly constant, revenue also could decline over time given that oil and gas production has been falling in the state in recent years.

Reductions in Certain Public Revenue Sources. Various financial changes related to the severance taxes may result in reductions of other state and local revenues such as income and property taxes—perhaps totaling in the tens of millions of dollars or more per year.

Increased Spending on Various Public Programs. The measure's revenues generally would be distributed to public educational entities, clean energy research and development, parks and recreation, and local infrastructure projects pursuant to the specified percentages in the measure. There also would be additional administrative costs for various state departments and local governmental entities to administer the tax and expenditure elements of this initiative.

Summary of Fiscal Effect

The measure would have the following major fiscal effect:

- Increased state revenues from a new oil and gas severance tax of $1.5 billion to $2 billion per year initially (which could either grow or decline over time), to be spent on public schools, colleges, and universities; clean energy research and development; local infrastructure projects; and state parks.

Sincerely,

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Mac Taylor
Legislative Analyst

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Ana J. Matosantos
Director of Finance