WHAT WOULD PROPOSITION 1D MEAN FOR CALIFORNIA?

Proposition 1D, which will appear on the May 19, 2009 special election ballot, would temporarily divert tobacco tax revenues raised by Proposition 10 of 1998 – which fund First 5 early childhood development programs and services – to help balance the state's budget. Proposition 1D would make additional changes, including permanently restricting the types of services funded through First 5. This *Budget Brief* provides an overview of this measure and the policy issues it raises. The California Budget Project (CBP) neither supports nor opposes Proposition 1D.

What Is First 5?

Proposition 10, approved by voters in 1998, established the California Children and Families Program with the aim of "promoting, supporting, and improving the early development of children" through age 5.[1] Funding for the program – commonly known as "First 5" – comes from a 50-cent-per-pack state tax on cigarettes.[2] Twenty percent of revenues raised by Proposition 10 are allocated to the state First 5 California Children and Families Commission; the remaining 80 percent of revenues are distributed to the 58 county First 5 commissions based on each county's share of the total number of children born in California each year.[3] First 5 funds support a wide range of statewide and local programs and services – including preschool, school readiness programs, health coverage for children who would otherwise be uninsured, immunizations, and screenings for developmental delays – that assist more than 850,000 California children age 5 and younger.[4] First 5 funds must be used to "supplement existing levels of service" and cannot be used to "supplant state or local General Fund money for any purpose."[5] County First 5 commissions received $438.9 million in 2007-08, while the state commission received $109.7 million during the same period.[6]

What Would Proposition 1D Do?

Proposition 1D would divert – for five years – a portion of tobacco tax revenues intended for state and county First 5 activities to the state's General Fund to help balance the state's budget. Proposition 1D also would make a number of other programmatic changes to First 5. The Legislature placed Proposition 1D on the May 19, 2009 special election ballot as part of the recent budget agreement. Specifically, Proposition 1D would:

- **Divert more than $1.6 billion of First 5 funds to help balance the state's budget.** Proposition 1D would annually divert $268.0 million of state and county First 5 funds to the General Fund between 2009-10 and 2013-14.[7] In addition, this measure would shift between $275.0 million and $340.0 million from the state First 5 Commission's balances "that are not encumbered or expended by July 1, 2009" to the state's General Fund. These funds – totaling between $1.62 million and $1.68 billion over five years – would replace General Fund dollars that currently support state health and human services programs for children up to age 5, generating more than $1.6 billion in state General Fund savings. This five-year fund shift requires voter approval because it is inconsistent with Proposition 10's intent to use tobacco tax revenues raised by the measure exclusively to expand child development programs and services. Programs that could be funded with First 5 funds under Proposition 1D include child welfare services, foster care, adoption assistance, and services for infants and toddlers with developmental disabilities.

- **Narrow the range of services that could receive First 5 funds.** Currently, the state and county First 5 commissions can use First 5 funds for the broad purpose of promoting, supporting, and improving early childhood development. Proposition 1D would limit the use of First 5 funds to the provision of direct health care services; direct early education services, including preschool and child care; and human services, including services for families who are involved with the child welfare system.[8] However, the measure does not define what is meant by "direct" services.

- **Eliminate dedicated funding for statewide public information campaigns and redirect a portion of the funds to small counties.** Currently, funds in the state First 5 Commission's mass media communications account support public information campaigns related to child care, school readiness, effective parenting, and other child development issues. Proposition 1D would eliminate the mass media communications account and redirect the funds to the state commission's unallocated account.[9] Proposition 1D also would require every county commission to receive a "base level of funding" of at least $400,000 per year regardless of the number of children born in the county – a change that would primarily benefit counties with relatively small populations. Funds in the state commission's unallocated account would be used to bring small counties up to the $400,000 threshold.[10] Any funds remaining in the unallocated account could be used to support public information campaigns and other purposes.[11]

- **Make additional minor changes.** Proposition 1D would allow counties to borrow First 5 funds, repayable with interest; require county First 5 commissions to submit audits and reports to the county board of supervisors and the county auditor; and establish the county auditor as an ex officio member of each local First 5 commission.

What Policy Issues Are Raised by Proposition 1D?

Proposition 1D would make significant changes, both temporary and permanent, to First 5 funding and services, but also would provide substantial General Fund savings as California's policymakers grapple with an unprecedented budget crisis.

Should a Portion of First 5 Funds Be Used To Generate State Budget Savings?

In February 2009, California's policymakers closed an unprecedented $40 billion budget gap for 2008-09 and 2009-10 with a package of spending cuts, temporary tax increases, borrowing, and federal funds from the economic recovery bill.[12] As part of this package, the Legislature placed Proposition 1D on the ballot to divert a total of more than $1.6 billion of Proposition 10 revenues otherwise intended for First 5 activities to the General Fund over a five-year period. Specifically, this measure would provide up to $608.0 million in General Fund savings in 2009-10 and additional annual state savings of $268.0 million between 2010-11 and 2013-14 – a period in which the Legislative Analyst's Office (LAO) projects the state's annual operating shortfalls will rise from $12.6 billion to $26 billion.[13] If voters approve Proposition 1D, the total amount of funds available for First 5 early childhood development activities would decline. Consequently, some First 5 programs and services would likely be reduced or eliminated, and, in some cases, these cuts could

Table 1: Proposition 1D Would Shift an Increasing Percentage of Annual First 5 Funds to the General Fund, 2009-10 to 2013-14 (Dollars in Thousands)

State Fiscal Year	Projected Proposition 10 Tobacco Tax Revenues*	First 5's Projected Share of Revenues Under Current Law**	Annual Revenues Shifted to the General Fund Under Proposition 1D	Shifted Revenues as a Percentage of First 5's Share of Revenues	Revenues Remaining for First 5 Activities After Proposition 1D Fund Shift
2009-10	$500,000	$467,948	$268,000	57.3%	$199,948
2010-11	$485,000	$450,448	$268,000	59.5%	$182,448
2011-12	$470,450	$432,780	$268,000	61.9%	$164,780
2012-13	$456,337	$414,812	$268,000	64.6%	$146,812
2013-14	$442,646	$396,385	$268,000	67.6%	$128,385

* These estimates are based on the LAO's assumption that Proposition 10 revenues will decrease by approximately 3 percent annually due to declining tobacco consumption. In addition, these estimates reflect the LAO's estimate of the impact of the April 1, 2009 increase in federal tobacco taxes on the sale of cigarettes and other tobacco products in California.
** Assumes that 3.4 percent of Proposition 10 revenues will be transferred each year to Proposition 99 and the Breast Cancer Fund to backfill those accounts for lost tobacco tax revenues, as required by Proposition 10. In addition, assumes that the amount of Proposition 10 revenues received by the Board of Equalization for tobacco tax administration and enforcement will increase by 20 percent each year from the estimated 2008-09 level of $12.5 million.
Source: Proposition 1D and CBP analysis of Department of Finance and LAO data

be permanent since Proposition 1D would also narrow the range of services that could be funded with First 5 dollars. If voters reject Proposition 1D, policymakers would have to adopt other measures, such as additional spending cuts and/or revenue increases, to make up for the lost General Fund savings and help bring the state's budget into balance in 2009-10 and beyond.

Proposition 1D Would Divert a Rising Share of Tobacco Tax Revenues Each Year That the Fund Shift Remains in Effect

Tobacco tax revenues – the primary source of funding for First 5 activities – have fallen as the prevalence of smoking in California has decreased.[14] For example, tobacco tax revenues raised by Proposition 10 declined from $686.1 million in 1999-00 to $576.7 million in 2007-08, a 16.0 percent drop.[15] The LAO projects that Proposition 10 revenues will continue to fall by approximately 3 percent per year due to the downward trend in tobacco consumption.[16] In addition, state tobacco tax revenues are estimated to drop steeply due to the recent 62-cent-per-pack increase in the federal excise tax on cigarettes, which is expected to further reduce sales of cigarettes and other tobacco products.[17]

The ongoing decline in state tobacco tax revenues means that Proposition 1D would divert an increasing share of annual First 5 funds to the General Fund each year for five years (Table 1).[18] For example, the annual $268.0 million shift would equal an estimated 57.3 percent of 2009-10 First 5 funds, leaving $199.9 million for state and county First 5 activities.[19] By 2013-14, however, the $268.0 million shift would equal an estimated 67.6 percent of First 5 funds, leaving $128.4 million for First 5 programs and services. In short, the impact of the fund shift on First 5 programs would increase each year that the diversion remains in effect, as tobacco consumption declines.

Could First 5 Commissions Use Unspent Funds To Help Mitigate the Impact of the Five-Year Fund Shift?

Proponents of Proposition 1D note that the state and county First 5 commissions have total unspent fund balances of more than $2 billion. In addition, proponents argue that – given the state's unprecedented fiscal crisis – a portion of these funds should be temporarily diverted to help close the budget gap and avoid additional General Fund budget cuts.[20] First 5 officials, in contrast, argue that these unspent funds reflect prudent planning.[21] County First 5 commissions, for example, had total unspent funds of $2.1 billion as of June 30, 2008.[22] More than half (54.6 percent) of this amount – nearly $1.2 billion – was earmarked for multiyear programs, including preschool and health coverage initiatives for children who would otherwise be uninsured.[23] In addition, more than one-third (37.6 percent) of these unspent funds – $795.5 million – was set aside to help launch new local initiatives and to help sustain First 5 programs as tobacco tax revenues continue their long-term decline.[24] The remainder – $166.2 million (7.8 percent) – was not set aside for a specific purpose or otherwise obligated.[25] On the one hand, some county commissions may choose to use a portion of their unspent funds – such as those intended to launch new local programs – to help mitigate the impact of the fund shift between 2009-10 and 2013-14. On the other hand, using such funds for short-term purposes could undermine the ability of First 5 commissions to sustain their programs and services over the longer term. Clearly, First 5 commissions would face difficult choices about how to adjust their funding priorities if Proposition 1D passes.

Proposition 1D Would Likely Result in Cuts to First 5 Programs and Services

The magnitude of the Proposition 1D fund shift would make it unlikely that First 5 commissions could make up for the diverted tobacco tax revenues solely by tapping unspent funds, in light of outstanding multiyear commitments for the majority of these funds at the local level. Furthermore, the state First 5 Commission would lose $268.0 million in tobacco tax revenues during the same five-year period, as well as up to $340.0 million of its unspent balances in 2009-10, likely reducing funds available for multiyear, state-county matching grant programs. As a result, this more-than-$1.6 billion fund shift would likely lead to the reduction and/or elimination of at least some programs and services as state and county First 5 commissions respond to the loss of more than half of their annual revenues.

Proposition 1D Would Permanently Restrict the Types of Services Funded Through First 5

Proposition 1D would narrow the range of First 5 services to the areas of health care, early education, and human services. In addition, the measure would further restrict the use of First 5 funds for health care and early education to the provision of "direct" services.[26] If this restriction were interpreted narrowly, it could prevent the state and county commissions from supporting a number of currently funded early childhood development initiatives that may not be considered direct services, including:

- Funding the operating costs of county health coverage programs for children who would otherwise be uninsured;
- Paying insurance premiums for low-income families with young children;
- Training and recruiting pediatric dentists, preschool teachers, and child care providers;
- Funding health and dental facilities, including mobile vans and clinics; and
- Developing and renovating facilities for preschools.[27]

Proponents Argue

Proponents argue that Proposition 1D "will help solve California's current budget crisis" and that "the state must use all of its available resources to protect and sustain existing programs," such as the child welfare and foster care programs.[28]

Opponents Argue

Opponents argue that Proposition 1D "will take $1.6 billion away from critical local health and education programs for young children and give it to Sacramento politicians" and "is the kind of short-term Sacramento gimmick that created our state budget crisis in the first place."[29]

Conclusion

Proposition 1D would divert – for five years – a portion of tobacco tax revenues raised by Proposition 10 of 1998 to replace state dollars that currently support state health and human services programs for children up to age 5. In addition, Proposition 1D would make a number of programmatic changes to First 5, including permanently restricting the types of services funded through the state and county First 5 commissions. California voters should weigh Proposition 1D's potential impact on First 5 programs and services, if the measure passes, against the potential for additional General Fund spending cuts and/or revenue increases, if the measure fails.

Scott Graves prepared this Budget Brief. The California Budget Project (CBP) neither supports nor opposes Proposition 1D. This Budget Brief is designed to help voters reach an informed decision based on the merits of the issues. The CBP was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

1 California Health and Safety Code, Division 108. Proposition 10 created the "California Children and Families First Program" and the "California Children and Families First Trust Fund," but the statute was subsequently amended to eliminate the word "First."

2 Proposition 10 also imposed an equivalent tax on other types of tobacco products. State excise taxes on cigarettes total 87 cents per pack. Of this amount, 50 cents is raised by Proposition 10 of 1998, 25 cents is raised by Proposition 99 of 1988, 10 cents is deposited into the state's General Fund, and 2 cents is deposited into the Breast Cancer Fund. See Board of Equalization, *Cigarette and Tobacco Products Taxes* (Publication 93: September 2008), downloaded from http://www.boe.ca.gov/pdf/pub93.pdf on March 25, 2009.

3 California Children and Families Commission, *First 5 California 2007-2008 Annual Report* (no date), p. 2, downloaded from http://www.ccfc.ca.gov/pdf/annual_report_pdfs/Annual_Report_07-08.pdf on March 24, 2009. The distribution of Proposition 10 revenues to the state and county First 5 commissions occurs after mandatory transfers to non-First 5 programs have been made. Specifically, a small share of Proposition 10 revenues supports the state Board of Equalization's (BOE) tobacco tax administration and enforcement activities. In addition, a small share of Proposition 10 revenues is used to offset revenue losses experienced by other programs that rely on tobacco taxes and which saw their revenues decline due to decreased sales of tobacco products after Proposition 10 took effect.

4 First 5 Association of California, *Kids Served by First 5* (no date), downloaded from http://www.f5ac.org/files/First%205%20Numbers%20ASSN%20FIN_1.pdf on March 24, 2009.

5 California Revenue and Taxation Code, Section 30131.4. This *Budget Brief* uses the phrases "First 5 funds" and "Proposition 10 revenues" interchangeably.

6 Department of Finance, *Governor's Proposed Budget, 2009-10,* Item 4250, California Children and Families Commission, downloaded from http://www.dof.ca.gov/budget/ on March 26, 2009.

7 County commissions would lose 80 percent of these funds each year ($214.4 million), and the state commission would lose 20 percent ($53.6 million).

8 Proposition 1D does not appear to limit the scope of *human* services funded with First 5 dollars to "direct" services. However, the measure is not entirely clear on this point.

9 The share of First 5 revenues deposited into the unallocated account would increase from the current 2 percent to 8 percent.

10 Twenty-two counties are projected to fall below $400,000 in annual revenues during the next five years if Proposition 1D passes and therefore would receive additional funding from the state commission's unallocated account. First 5 Association of California, *Provisions of Prop 1D* (March 2, 2009), p. 3, downloaded from http://www.f5ac.org/item.asp?id=3904 on March 23, 2009.

11 Funds in the unallocated account could continue to be used for any purpose except the administrative costs of the state First 5 Commission.

12 California Budget Project, *Governor Signs Budget Plan* (Updated February 20, 2009).

13 Legislative Analyst's Office, *2009-10 Budget Analysis Series: The Fiscal Outlook Under the February Budget Package* (March 13, 2009), p. FOV-21.

14 The Department of Public Health reports that the share of California adults who smoke fell from 22.7 percent in 1988 to 13.8 percent in 2007, a decline of more than one-third (35.0 percent). In addition, California adults who do smoke are smoking less: "Light smokers" – defined as those who smoke fewer than 15 cigarettes per day – increased from 58.2 percent of smokers in 1996 to 72.3 percent of smokers in 2007. See Department of Public Health, *California Tobacco Control Update 2009: 20 Years of Tobacco Control in California* (2009), pp. 19 and 21, downloaded from http://www.cdph.ca.gov/programs/tobacco/Documents/CTCPUpdate2009.pdf on March 28, 2009.

15 Department of Finance, *2001-02 Governor's Budget,* Item 4250, California Children and Families Commission, and *Governor's Proposed Budget, 2009-10,* Item 4250, California Children and Families Commission, downloaded from http://www.dof.ca.gov/budget/ on March 26, 2009.

16 Legislative Analyst's Office, "Prop 1D Protects Children's Services Funding. Helps Balance State Budget," in Secretary of State's Office, *California Statewide Special Election: Tuesday, May 19, 2009 Official Voter Information Guide,* downloaded from http://www.voterguide.sos.ca.gov/pdf-guide/props/prop1d-anaysis.pdf on March 26, 2009.

17 The federal government increased the federal excise tax on cigarettes from $0.39 per pack to $1.01 per pack – and also increased federal taxes on other tobacco products – effective April 1, 2009. These additional revenues will support increased federal funding for the Children's Health Insurance Program. The BOE estimates that state tobacco tax revenues will drop by $43.6 million below the previously projected level in 2009-10 due to the federal tobacco tax increase. This BOE estimate is cited in First 5 California, letter to First 5 county commission executive directors (February 20, 2009).

18 The estimates in this paragraph are based on a CBP analysis of Department of Finance and LAO data. The estimates are based on several assumptions. First, the analysis assumes, per the LAO, that Proposition 10 tobacco tax revenues will decrease by 3 percent annually due to declining tobacco consumption. Second, the analysis reflects the LAO's estimate of the impact of the April 1, 2009 increase in federal tobacco taxes on the sale of cigarettes and other tobacco products in California. Third, the analysis assumes that 3.4 percent of Proposition 10 revenues will be transferred each year to Proposition 99 and the Breast Cancer Fund to backfill those accounts for lost tobacco tax revenues, as required by Proposition 10. This estimate reflects the average annual share of Proposition 10 revenues transferred to these accounts between 2003-04 and 2007-08. Finally, the analysis assumes that the amount of Proposition 10 revenues provided to the BOE for tobacco tax administration and enforcement will increase by 20 percent each year from the estimated 2008-09 level of $12.5 million. BOE expenditures of Proposition 10 funds increased by more than 40 percent per year between 2004-05 and 2007-08 and are estimated to further increase by 19.4 percent in 2008-09. In addition, the BOE is seeking a Proposition 10 funding increase of 21.0 percent in 2009-10. In light of these trends, the analysis assumes that Proposition 10 revenues used to support BOE activities will increase by 20 percent per year, which approximates the estimated increase between 2007-08 and 2008-09 as well as the proposed increase between 2008-09 and 2009-10.

19 This estimate excludes the proposed shift of up to $340.0 million from the state First 5 Commission's balances in 2009-10. This shift is excluded in order to focus the analysis on Proposition 1D's impact on annual revenues received by the state and county First 5 commissions.

20 "Argument in Favor of Proposition 1D" and "Rebuttal to Argument Against Proposition 1D," in Secretary of State's Office, *California Statewide Special Election: Tuesday, May 19, 2009 Official Voter Information Guide,* pp. 36 and 37, downloaded from http://www.voterguide.sos.ca.gov/pdf-guide/props/prop1d-arguments.pdf on March 23, 2009.

21 See, for example, Michael M. Ruane, executive director, Children and Families Commission of Orange County, letter to Senator Lou Correa (June 19, 2008), downloaded from http://www.f5ac.org/files/OC%20fund%20balance%20Ltr%20to%20Correa.doc on March 24, 2009.

22 The figures that follow are based on a CBP analysis of data provided by the First 5 Association of California.

23 This entire $1.2 billion reflects funds that were encumbered, obligated, or reserved to meet the state First 5 Commission's matching fund requirements. The health coverage initiatives, known as Children's Health Initiatives, operated in 23 counties in 2007-08.

24 The First 5 Association of California characterizes these funds as "unreserved but designated."

25 This reflects funds that were "unreserved and undesignated" ($118.2 million) or "reserved but not yet obligated" ($48.0 million).

26 Proposition 1D clearly states that First 5 funds must be used to provide direct health care services and direct early education services; however, the measure does not define the word "direct." Proposition 1D does not appear to limit the scope of *human* services funded with First 5 dollars to "direct" services, although the measure is not entirely clear on this point.

27 These examples are from First 5 Association of California, *What Will Prop 1D Do to First 5?* (no date), downloaded from http://www.f5ac.org/item.asp?id=3904 on March 23, 2009.

28 "Argument in Favor of Proposition 1D," in Secretary of State's Office, *California Statewide Special Election: Tuesday, May 19, 2009 Official Voter Information Guide,* p. 36, downloaded from http://www.voterguide.sos.ca.gov/pdf-guide/props/prop1d-arguments.pdf on March 23, 2009.

29 "Argument Against Proposition 1D," in Secretary of State's Office, *California Statewide Special Election: Tuesday, May 19, 2009 Official Voter Information Guide,* p. 37, downloaded from http://www.voterguide.sos.ca.gov/pdf-guide/props/prop1d-arguments.pdf on March 23, 2009.