

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

November/December 2005



### **Tobacco Settlement Revenue and Appropriations: An Update** **By Gary S. Olson, Director**

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On November 23, 1998, 46 states and the United States tobacco industry entered into a master settlement concerning lawsuits by the states against the tobacco industry. The master settlement agreement involved many provisions, including annual payments from the tobacco industry to the states. This article provides an update of the tobacco settlement revenue received by Michigan and a description of how the Michigan Legislature and the Governor have appropriated this tobacco settlement revenue.

#### **Tobacco Settlement Revenue Received by Michigan**

Michigan received its first payment from the master settlement agreement on December 14, 1999. The amount of Michigan's payments and the payments to other states are spelled out in the settlement agreement. The settlement agreement provides for national amounts that are distributed to the states based on cigarette consumption in each state. The amount of these payments is adjusted on an annual basis for growth in inflation and also is adjusted to changes in the volume of cigarettes sold in the United States by the tobacco companies participating in the settlement agreement. These payments to the states will continue indefinitely as long as the tobacco industry is financially viable.

Table 1 provides a summary of tobacco settlement revenue received by Michigan. During the period of fiscal year (FY) 1999-2000 through FY 2004-05, Michigan has received a total of \$1.82 billion of revenue through the master settlement agreement. The Senate Fiscal Agency (SFA) is estimating that Michigan's payment in FY 2005-06 will total \$282.7 million. The State should receive this payment on April 15, 2006. The SFA is estimating that Michigan's payment in FY 2006-07 will total \$283.6 million and the payment received in FY 2007-08 will total \$317.0 million. The increase in the level of the payment expected to be received by the State in FY 2007-08 involves the first year of a new strategic contribution fund payment that is part of the master settlement agreement. This payment will be in addition to the annual settlement payments that the State has received in prior fiscal years.

**Table 1**

<b>Tobacco Settlement Revenue</b>	
<b>Actual and Projected Payments to Michigan</b>	
<b>(Millions of Dollars)</b>	
<b>Fiscal Year</b>	<b>Total Settlement Revenue</b>
1999-2000 (Actual)	\$352.1
2000-01 (Actual)	261.3
2001-02 (Actual)	335.3
2002-03 (Actual)	320.4
2003-04 (Actual)	272.1
2004-05 (Actual)	<u>277.4</u>
Subtotal	\$1,819.0
2005-06 (SFA Estimate)	282.7
2006-07 (SFA Estimate)	283.6
2007-08 (SFA Estimate)	<u>317.0</u>
Subtotal	\$883.3



Until FY 2005-06, revenue received by Michigan under the terms of the master settlement agreement has been deposited into two separate trust funds created by State law. The Michigan Merit Award Trust Fund has received 75.0% of the settlement revenue and the Tobacco Settlement Trust Fund has received 25.0% of the revenue. The statutes creating these two trust funds provide that appropriations can be made from these trust funds for any purpose determined by the Legislature and the Governor.

While the SFA is estimating that Michigan will receive a settlement payment of \$282.7 million on April 15, 2006, the amount of this payment likely will be affected by a pending legal dispute between the states and the tobacco industry. A provision of the master settlement agreement requires the states to enforce the terms of the settlement agreement on companies selling cigarettes that were not part of the original master settlement agreement. Shortly after the master settlement agreement was reached, Michigan and the other states approved legislation to force tobacco companies that were not part of the original master settlement agreement to participate under the terms of the agreement or face fees levied by the state. Since the original master settlement agreement was approved, many of these tobacco companies that were not part of the original settlement agreement have joined the agreement and have been making payments to the states.

The legal issue that is being raised by the major companies in the tobacco industry involves a provision in the master settlement agreement under which states must diligently enforce the terms of the agreement on these other tobacco companies. If the major companies can prove that states are not diligently enforcing this requirement, their settlement payments to the states can be reduced. In April 2005, the three largest United States tobacco companies notified the states that they intend to reduce their April 15, 2006, payments to the states based on this provision. The amount of the reduction in the scheduled payment they are seeking equals 18.0%. This equates to a potential \$50.9 million reduction in Michigan's FY 2005-06 payment.

This payment issue is likely to take a considerable amount of time to be resolved. The states will try to prove that they have diligently enforced all of the terms of the master settlement agreement and the large tobacco companies will attempt to prove that the states have not done so. The timing of this legal dispute will determine how much money Michigan will receive in FY 2005-06 from the master settlement agreement. The enacted FY 2005-06 State budget assumes that Michigan will receive its full payment of \$282.7 million. Adjustments will have to be made in the enacted State budget if this legal dispute reduces the settlement payment received in the fiscal year.

### **Tobacco Settlement Appropriations**

Michigan first approved appropriations of tobacco settlement revenue during FY 1999-2000. Table 2 provides a summary of the annual appropriations of tobacco settlement revenue in Michigan for the period FY 1999-2000 through FY 2005-06. During the initial seven years of the settlement agreement, Michigan's appropriations of tobacco settlement revenue have totaled \$2.34 billion. The FY 2005-06 appropriation of \$289.0 million is funded with 100% of the estimated tobacco settlement revenue to be received by the State during the fiscal year.



**Table 2**

<b>Summary of Tobacco Settlement Appropriations FY 1999-2000 through FY 2005-06 (Millions of Dollars)</b>	
<b>Fiscal Year</b>	<b>Total Appropriations</b>
1999-2000	\$306.0
2000-01	321.8
2001-02	453.3
2002-03	398.2
2003-04	282.0
2004-05	289.4
2005-06	289.0
<b>Total</b>	<b>\$2,339.7</b>

As previously stated, the master settlement agreement left the appropriation of the tobacco settlement revenue up to each state. There are no requirements in the master settlement agreement that place any limitations on states as to the use of appropriations. A common misconception is that states must appropriate a certain portion of the tobacco settlement revenue for smoking cessation programs.

Michigan has chosen to appropriate its tobacco settlement revenue for a wide range of purposes. Table 3 provides a summary of the overall tobacco settlement appropriations in Michigan, by major program category, for the period FY 1999-2000 through FY 2005-06. The largest recipient of tobacco settlement-financed appropriations over this time period has been the Merit Award Scholarship Program and the administrative costs associated with the program. This program, established by Public Act 94 of 1999, provides \$2,500 postsecondary scholarships for Michigan students who achieve a targeted result on high school assessment tests. Appropriations for the Merit Award Scholarship have totaled \$836.9 million or 35.8% of all of the appropriations funded by tobacco settlement revenue. The next largest program category funded with tobacco settlement revenue is the Medicaid program. This low-income health care program has received \$389.0 million or 16.6% of all tobacco settlement appropriations. The third largest use of tobacco settlement revenue has been the transfer of \$352.0 million of tobacco settlement revenue to the State General Fund budget. This revenue has been used as a funding source for General Fund programs.

**Table 3**

<b>Summary of Tobacco Settlement Appropriations FY 1999-2000 through FY 2005-06</b>		
<b>Appropriations Category</b>	<b>Appropriation</b>	<b>Percentage</b>
Merit Award Scholarships/Administration .....	\$836.9	35.8%
Medicaid Base Funding.....	389.0	16.6
Transfers to General Fund Budget .....	352.0	15.0
Economic Development Programs .....	272.5	11.6
Elder Prescription Program.....	192.9	8.2
Other Higher Education Programs/Scholarships .....	99.9	4.3
All Other Appropriations.....	196.5	8.4
<b>Total Appropriations.....</b>	<b>\$2,339.7</b>	<b>100.0%</b>

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The next largest recipient of tobacco settlement appropriations is economic development programs. The State has funded \$272.5 million of economic development programs with tobacco settlement revenue. The largest type of these programs has been the grants to the Life Science Corridor which have totaled \$197.5 million. During FY 1999-2000, the State appropriated \$75.0 million of tobacco settlement revenue for the construction of technical training centers at community colleges across the State. The Elder Prescription Insurance Coverage Program, which provides prescription drug assistance to low-income senior citizens, has been funded by \$192.9 million of tobacco settlement revenue since FY 1999-2000. Other major appropriations of tobacco settlement revenue have included direct funding of other higher education financial aid programs, direct support for the operations funding of universities and community colleges, legal costs in the Office of the Attorney General, and numerous health initiatives.

The use of tobacco settlement revenue in the future in Michigan recently has been the subject of significant debate in the State. The Governor has signed into law a package of bills that would borrow against a portion of future tobacco settlement revenue to generate a \$400.0 million one-time revenue stream to be used for economic development projects in the State. This proposal also includes a commitment to appropriate \$75.0 million of tobacco settlement revenue annually, beginning in FY 2007-08, for the next eight fiscal years, for economic development initiatives. This economic development package will lead to different appropriations of tobacco settlement revenue in the future.