

**SENATE FISCAL AGENCY
MEMORANDUM**

DATE: December 3, 2001
TO: Members of the Senate
FROM: Gary S. Olson, Director
RE: Tobacco Settlement Update

The State of Michigan has received five payments from the national settlement agreement reached on December 23, 1998, between 46 states and the United States tobacco industry. Under the terms of the national settlement agreement, the State of Michigan will continue to receive tobacco settlement payments into the future. This memorandum provides an update on the impact of the national settlement agreement on the State of Michigan. Included in the memorandum are updated estimates by the Senate Fiscal Agency (SFA) as to the revenues the State will receive over the next several fiscal years, the current appropriations from the tobacco settlement revenues and estimates as to the balances in the two trust funds that were established to receive tobacco settlement revenues in Michigan.

State of Michigan Response to the National Settlement Agreement

Subsequent to the approval of the national settlement agreement reached on December 23, 1998, the Michigan Legislature has enacted three statutes in an effort to implement the agreement. Two statutes, Public Act 94 of 1999 and Public Act 489 of 2000, created two separate trust funds to receive the State's share of the tobacco settlement payments. Public Act 94 of 1999 created the Michigan Merit Award Trust Fund in the Department of Treasury and Public Act 489 created the Tobacco Settlement Trust Fund in the Department of Treasury. The tobacco settlement funds would flow into the State of Michigan and then be deposited into these two trust funds based on formulas outlined in each public act. Any expenditure of tobacco settlement funds from either trust fund could only be accomplished by an appropriation approved by the Legislature and signed into law by the Governor. The two trust fund acts provided that during FY 1999-2000, the Michigan Merit Award Trust Fund would receive 30% of the tobacco settlement funds. During FY 2000-01, the Michigan Merit Award Trust Fund would receive 50% of the tobacco settlement funds and this percentage distribution would increase to 75% of the tobacco settlement funds beginning in FY 2001-02 and would remain at 75% each year thereafter. The balance of the tobacco settlement funds not deposited into the Michigan Merit Award Trust Fund would be deposited into the Tobacco Settlement Trust Fund.

As part of the implementation of the national settlement agreement the Legislature also enacted Public Act 244 of 1999. This law provided a mechanism for tobacco companies that were not part of the national settlement agreement to make payments to the participating states based on the volume of cigarettes sold in each state. The law also gave the State the authority to levy assessments on these tobacco companies if they did not choose to comply with the conditions of the national settlement agreement. All the 46 states that were part of the national settlement agreement have passed similar legislation. If states failed to enact this legislation the State's tobacco settlement payments from the major tobacco companies would have been negatively affected.

Tobacco Settlement Payments to Michigan

The State of Michigan has received five payments as a result of the national settlement agreement through November 2001. These tobacco settlement payments will continue indefinitely into the future as long as the participating tobacco companies are selling cigarettes in the United States. The actual amounts of the tobacco settlement payments to be received by Michigan are spelled out in the national settlement agreement.

While the national settlement agreement provides for payments to states into the future, the exact level of the payments to be received by Michigan is unclear at this time due to adjustments to the payments built into the settlement agreement. The two major adjustments that will impact on future settlement payments are an inflationary adjustment and a volume adjustment. The inflationary adjustment is written to increase future payments to the states to ensure that agreed-upon payments are not eroded by inflation. The volume adjustment will reduce future payments if the overall volume of cigarettes sold in the United States continues to decline.

Table 1 provides a summary of the Senate Fiscal Agency (SFA) estimates of tobacco settlement payments Michigan will receive during the first six years of the national settlement agreement. During the FY 1999-2000 through FY 2002-03 period, Michigan will receive both initial and annual payments under the terms of the national settlement agreement. Beginning in FY 2003-04, Michigan will receive a single annual payment.

The estimated payments contained in Table 1 take into account the previously mentioned inflationary and volume adjustments. The SFA is assuming a 3.0% annual inflationary adjustment in each fiscal year and a 2.7% annual volume adjustment (sales decrease) in future years. To the extent that these assumptions of inflation and volume sales are incorrect, the estimated payments contained in Table 1 will be modified.

Table 1 Tobacco Settlement Payments to Michigan FY 1999-2000 through FY 2004-2005 (millions of dollars)			
Fiscal Year	Date of Payment	Type of Payment	Amount of Payment
1999-2000	12/14/1999	Initial	\$107.5 ^{a)}
	1/10/2000	Initial	93.6 ^{a)}
	4/15/2000	Annual	150.5 ^{a)}
Subtotal			\$351.6
2000-01	1/10/2001	Initial	\$ 84.2 ^{a)}
	4/15/2001	Annual	176.6 ^{a)}
Subtotal			\$260.9
2001-02	1/10/2002	Initial	96.1 ^{b)}
	4/15/2002	Annual	224.5 ^{b)}
Subtotal			\$320.5
2002-03	1/10/2003	Initial	93.6 ^{b)}
	4/15/2003	Annual	223.6 ^{b)}
Subtotal			\$317.2
2003-04	4/15/2004	Annual	\$273.9 ^{b)}
2004-05	4/15/2005	Annual	\$272.2 ^{b)}

Note: Updated 11/29/01.
 a) Actual payments received. b) Senate Fiscal Agency estimates.
Source: Michigan Senate Fiscal Agency

Table 2 provides a summary of the estimated distribution of tobacco settlement revenues between the Michigan Merit Award Trust Fund and the Tobacco Settlement Trust Fund for the period FY 1999-2000 through FY 2004-05. As previously stated, the percentage distribution of the tobacco settlement funds between the two trust funds is established by statute.

Table 2					
Michigan Tobacco Settlement Revenue					
(dollars in millions)					
Earmarking of Revenue					
Fiscal Year	Tobacco Settlement Revenue	Michigan Merit Award Trust Fund		Tobacco Settlement Trust Fund	
		Percent Share	Dollar Amount	Percent Share	Dollar Amount
1999-2000 ^{a)}	\$351.6	30.0%	\$105.5	70.0%	\$246.1
2000-01 ^{a)}	260.9	50.0%	130.5	50.0%	130.5
2001-02	320.5	75.0%	240.4	25.0%	80.1
2002-03	317.2	75.0%	237.9	25.0%	79.3
2003-04	273.9	75.0%	205.4	25.0%	68.5
2004-05	272.2	75.0%	204.1	25.0%	68.0

a) Actual payments received.

Source: November 29, 2001, Senate Fiscal Agency estimates.

Tobacco Settlement Appropriations

The FY 2001-02 State budget marks the third fiscal year during which tobacco settlement funds have been appropriated. Table 3 provides a summary of the tobacco settlement expenditures/appropriations for FY 1999-2000 through FY 2001-02. The initial appropriations of tobacco settlement funds were for such diverse purposes as the financing mechanism for the Michigan Merit Awards Scholarships, the funding of technical education centers, numerous health initiatives in the Department of Community Health and the funding of the State's Life Sciences Research Corridor. Beginning in FY 2000-01 the State began utilizing a portion of unallocated tobacco settlement revenues to help balance the General Fund budget. During FY 2001-02 the transfers from the two trust funds to the General Fund totaled \$159.0 million. During FY 2001-02 tobacco settlement appropriations from the Michigan Merit Award Trust Fund totaled \$261.7 million and tobacco settlement appropriations from the Tobacco Settlement Trust Fund totaled \$165.0 million.

Trust Fund Balances

The Michigan Merit Award Trust Fund and the Tobacco Settlement Trust Fund receive dedicated portions of the tobacco settlement revenues received by the State. Appropriations then are made by the Legislature from each trust fund for any purpose determined by the Legislature. Any funds in either trust fund which are not appropriated and expended remain in the trust fund for future appropriation needs. Based on the SFA estimates of revenues received in each trust fund and the continuation of future appropriation policy, the SFA has estimated the balances remaining in each trust fund through FY 2004-05. These estimates provide a longer-term look at the financial viability of each trust fund. Any projected deficit or surplus in either of the trust funds could be eliminated by adjusting the mix of appropriations from the funds.

Table 3			
Tobacco Settlement Appropriations/Expenditures			
(dollars in millions)			
	FY 1999-2000	FY 2000-01	FY 2001-02
	Expenditures	Expenditures	Appropriations
Merit Award Trust Fund			
Community Colleges:			
Postsecondary Access Student Scholarship . . .	\$0.0	\$0.0	\$2.0
Higher Education:			
Merit Award Scholarships	94.3	79.6	103.0
Tuition Incentive Program	5.3	5.3	5.3
Department of Treasury:			
Michigan Education Assessment Program	0.0	16.4	16.5
Merit Award Board	3.0	2.0	2.0
Tuition Incentive Program Administration	0.0	0.4	0.4
Michigan Education Savings Program	0.0	0.0	1.0
Lapse to General Fund	0.0	0.0	131.5
Total Merit Award Trust Fund	\$102.6	\$103.7	\$261.7
Tobacco Settlement Trust Fund			
Department of Career Development:			
Council of Michigan Foundations	\$10.2	\$6.0	\$4.0
Michigan Technical Education Centers	47.0	0.0	0.0
Community Colleges:			
Postsecondary Access Student Scholarship . . .	0.0	1.0	0.0
Department of Community Health:			
Senior Prescription Drug Program	0.0	1.1	45.0
Michigan Pharmaceutical Program	0.0	4.5	0.0
Personal Needs Allowance	5.0	5.0	5.0
Long-Term Care Health Advisor	0.2	3.0	0.7
Respite Care Services	5.0	5.0	5.0
Long-Term Health Care Grants	10.0	0.0	0.0
Local Indigent Medical Care	0.0	10.0	2.8
Rural Health Initiative	0.0	10.0	0.0
Medicaid Base Funding	0.0	20.0	30.0
Higher Education:			
Wayne State University Perinatal Research . . .	0.0	3.0	0.0
Strategic Fund Agency:			
Health Research/Development (Life Sciences)	50.0	50.0	45.0
Department of Treasury:			
Michigan Education Assessment Program	12.0	0.0	0.0
Michigan Education Savings Program	0.0	2.0	0.0
Lapse to General Fund	0.0	20.0	27.5
Total Tobacco Settlement Trust Fund	\$139.4	\$140.6	\$165.0

Table 4 provides a summary of the SFA estimates of the balances in the Michigan Merit Award Trust Fund for the period from FY 1999-2000 through FY 2004-05. Based on current appropriation trends the SFA projects this trust fund will close FY 2004-05 with a \$281.3 million surplus. Table 5 provides for similar estimates for the Tobacco Settlement Trust Fund. The SFA estimates for this trust fund result in a deficit of \$192.6 million at the close of FY 2004-05. Based on these assumptions it is apparent that the Legislature will have to consider either shifting future appropriations now funded out of the Tobacco Settlement Trust Fund to the Michigan Merit Award Trust Fund, or reducing appropriation levels. A shifting of future appropriations would provide for a continuation of existing appropriation decisions and positive balances in both trust funds.

If you have any questions on this information, please call my office at 373-5300.

/kjh

Table 4
Michigan Merit Award Scholarship Trust Fund
Revenues, Expenditures and Year-End Balances
(dollars in millions)

Fiscal Year	Beginning Balance	Expenditures					Post-Secondary Scholarship	Transfer to General Fund	Total Expenditures	Interest Earnings	Merit Trust Fund Balance
		Revenue from Tobacco Settlement	Merit Award Scholarship	MEAP Test Costs & Trust Fund Board	Tuition Incentive Program (TIP) Costs						
1999-2000	\$ 0.0	\$ 105.5	\$ 94.3	\$ 3.0	\$ 5.3	\$ 0.0	\$ 0.0	\$ 102.6	\$ 4.1	\$ 7.0	
2000-01	7.0	130.5	79.6	18.8	5.3	0.0	0.0	103.7	4.6	38.3	
2001-02	38.3	240.4	103.0	19.9	5.3	2.0	131.5	261.7	6.0	23.0	
2002-03	23.0	237.9	106.1	20.5	5.5	3.0	0.0	135.0	8.0	133.9	
2003-04	133.9	205.4	109.3	21.1	5.6	4.0	0.0	140.0	10.0	209.3	
2004-05	209.3	204.1	112.6	21.7	5.8	5.0	0.0	145.1	13.0	281.3	

Source: Senate Fiscal Agency estimates.

Table 5
Tobacco Settlement Trust Fund
Revenues, Expenditures and Year-End Balances
(dollars in millions)

Fiscal Year	Beginning Balance	Revenue from Tobacco Settlement	On-Going Appropriations							One-Time Appropriations				Interest Earnings	Tobacco Trust Fund Balance
			Senior Citizen Prescrip. Drug Prog.	Comm. Health Initiatives	Health/ Aging Res. i.e., Life Sciences	Local Indigent Medical Care	Postsec. Access Student Schlrshp.	Educ. Savings Plan	Council of Michigan Found.	MEAP Funding Shift	Michigan Tech. Educ./ Wayne State Perinatal	Transfer to General Fund	Total Approps.		
1999-2000	\$ 0.0	\$246.1	---	\$ 20.2	\$ 50.0	\$ 0.0	\$ 0.0	\$ 0.0	\$ 10.2	\$ 12.0	\$ 47.0	\$ 0.0	\$139.4	\$ 10.2	\$116.9
2000-01	116.9	130.5	5.6	43.0	50.0	10.0	2.0	1.0	6.0	0.0	3.0	20.0	140.6	11.0	117.8
2001-02	117.8	80.1	45.0	40.7	45.0	2.8	0.0	0.0	4.0	0.0	0.0	27.5	165.0	5.0	37.9
2002-03	37.9	79.3	46.4	43.0	50.0	2.0	0.0	0.0	6.0	0.0	0.0	0.0	147.4	0.0	(30.2)
2003-04	(30.2)	68.5	47.7	43.0	50.0	2.0	0.0	0.0	6.0	0.0	0.0	0.0	148.7	0.0	(110.4)
2004-05	(110.4)	68.0	49.2	43.0	50.0	2.0	0.0	0.0	6.0	0.0	0.0	0.0	150.2	0.0	(192.6)

Source: Senate Fiscal Agency estimates.