

UPDATE ON STATE TOBACCO SETTLEMENT FUNDS

by Gary S. Olson, Director

On November 23, 1998, the Attorneys General from 46 states (including Michigan), Puerto Rico, the United States Virgin Islands, the Northern Mariana Islands, Guam, and the District of Columbia signed an agreement with the five largest tobacco companies in the United States ending the long-running legal battle between the states and the tobacco industry over the impact of tobacco consumption on the states. Four additional states (Florida, Minnesota, Mississippi and Texas) had previously reached individual settlement agreements with the tobacco industry. The states' settlement with the tobacco industry provides for a wide variety of issues including:

- **Significant Limitation on Tobacco Industry.** This includes a ban on cartoon characters in advertising, prohibitions against specifically targeting youths in advertising, prohibitions against tobacco billboards, and a ban on the sale of apparel, book packs and other merchandise with tobacco logos.
- **Teen Smoking.** The tobacco industry would fund a \$250 million foundation whose goal would be to reduce teenage smoking.
- **National Public Education.** The tobacco industry would contribute \$1.45 billion over the next five years to support a national advertising and education campaign to educate consumers about tobacco-related diseases.
- **Payments to States.** The tobacco industry would provide states up to \$206 billion over the next 26 years as a condition of the settlement. These payments would continue beyond 2025 (or "in perpetuity"), but estimates of the total payments to states are provided only through 2025. The use of the settlement funds would be up to each state to determine in its state budget process.

Tobacco Settlement Payments to Michigan

Under terms of the settlement agreement, the State of Michigan would begin receiving settlement payments no later than during calendar year 2000. During calendar year 2000, Michigan would receive a total of \$383.4 million, which includes a one-time up-front payment of \$104.4 million. The State then would receive funds through 2025 based on a formula outlined in the settlement agreement. [Table 1](#) provides a summary of the estimated payments Michigan will receive if the agreement is implemented.

The exact timing of the tobacco settlement payments to Michigan and other states depends on a series of legal steps that each state must take in order to finalize the settlement agreement. States are required to submit their settlement agreements to state courts for approval. If the settlement is approved by the state courts, the state has reached "State Specific Finality" under provisions spelled out in the settlement agreement.

Table 1 Tobacco Settlement Payments to Michigan (millions of dollars)	
Calendar Year	Payment
2000	\$383.4 ^{a)}
2001	\$301.3
2002	\$361.8

Table 1	
Tobacco Settlement Payments to Michigan	
(millions of dollars)	
2003	\$365.2
2004 to 2007	\$304.8 per year
2008 to 2017	\$310.9 per year
2018 to 2025	\$348.3 per year
Total Payments Over 26 Years ^{b)} \$8,526.3	
a) Includes up-front payment of \$104.4 million.	
b) Actual term of settlement is indefinite.	
Source: National Assoc. of Attorneys General	

Michigan achieved State Specific Finality on April 7, 1999, when representatives of the major tobacco companies agreed with the State of Michigan's settlement in Ingham County Circuit Court. The national tobacco settlement provides that when at least 80% of the states in the settlement agreement that represent at least 80% of the total amount of funds to be allocated to each state reach State Specific Finality, the settlement funds will begin to flow to the states. As of April 12, 1999, this 80% threshold had not been met. The settlement agreement provides that Michigan will receive an initial up-front payment of \$104.4 million as soon as the 80% state threshold is met. The balance of Michigan's initial settlement payment of \$279.0 million will be released on April 15, 2000, if the 80% state threshold is met. The national settlement agreement does provide that initial settlement payments will be released to any state that has achieved State Specific Finality on June 30, 2000, even if the 80% state threshold is not met. Therefore, Michigan will begin receiving its initial settlement payments by June 30, 2000, or earlier depending on the number of states that achieve State Specific Finality.

The tobacco settlement payments that Michigan and other states will be receiving will continue into the future. While the data in Table 1 refer to Michigan's \$8.5 billion of estimated tobacco settlement payments through 2025, the payments will continue indefinitely as long as tobacco products are consumed in the United States.

The amount of the tobacco settlement payments to Michigan outlined in Table 1 is based on estimates before any adjustments in the payments are factored in. The tobacco settlement agreement contains several complex mechanisms that will be used to adjust the future level of payments to the states. The major adjustment factors are an inflation adjustment and a volume adjustment.

The inflation adjustment provides for an upward adjustment in the payments to states each year based on the increase in the United States Consumer Price Index or 3.0%, whichever is greater. This inflationary adjustment will continue throughout the duration of the settlement agreement. The volume adjustment provides for an adjustment in payments to states based on the operating income generated by the tobacco industry from the sale of cigarettes in the United States. If the settlement agreement leads to reduced operating income for the tobacco industry, the amount of settlement payments will be adjusted accordingly. The combination of the inflation and the volume adjustments will lead to the actual levels of payments states receive from the settlement agreement.

Federal Issues Regarding the Tobacco Settlement

While the states' settlement with the tobacco industry does not include the Federal government, there has been plenty of activity involving the states' tobacco settlement at the national level. The major issue at the Federal level involves the Federal government's effort to recoup a portion of the settlement payments to the states.

The Federal Department of Health and Human Services notified states that any settlement funds the states receive would be subject to recoupment by the Federal government. The logic was that these settlement funds were

designed to reimburse the states for increased Medicaid expenditures resulting from tobacco-related health issues. Therefore, if the states received settlement funds to pay these increased Medicaid expenditures, the Federal government would be entitled to its share of the funds since Medicaid is a program supported by a combination of Federal and state funds.

In Michigan, currently 52.72% of total Medicaid expenditures are covered by Federal funds. Assuming that the Federal government is successful in its recoupment effort, the State of Michigan may be required to reimburse the Federal government up to \$4.5 billion of the \$8.5 billion in total payments the State would receive over the next 26 years under the settlement agreement.

The National Conference of State Legislatures (NCSL) has led a lobbying effort in Washington D.C. on behalf of the states to ensure that the Federal government does not recoup state tobacco settlement payments. As part of a fiscal year 1999 supplemental appropriation bill now pending in a congressional conference committee, language is being considered to prohibit Federal recoupment of state tobacco settlement funds. The Senate-passed version of the supplemental appropriation bill (S. 544) contains the antirecoupment language backed by the NCSL. The House-passed version of the supplemental appropriation bill (H.R. 1141) does not contain the antirecoupment language. The conference committee on the supplemental appropriation bill is expected to meet in mid-April to consider this issue. The outcome of this conference committee will help the states to determine the actual level of tobacco settlement payments each state will receive.

National Foundation on Tobacco Issues

The settlement agreement between the states and the tobacco industry includes the creation of and the funding by the tobacco industry of a national foundation. This nonprofit foundation will provide for the distribution of \$250 million in payments over the next 10 years to support programs to reduce teenage smoking. The foundation also will be responsible for the distribution of \$1.45 billion over the next five years for the support of a comprehensive national advertising and education program to reduce youth tobacco use and inform the general public about tobacco-related diseases.

The national foundation that will distribute these funds is controlled by an 11-member board. The board includes two representatives of state Attorneys General, two representatives of the nation's Governors, and two state legislators. These six members will select five additional members to complete the 11-member board. Senator John J.H. Schwarz of Michigan recently was appointed to the national foundation board as one of the two representatives from state legislatures.