



Tobacco Settlement Allocates Large Sums to States but Leaves Many Questions Unanswered

"Uncertain" is definitely an appropriate word to describe the future of tobacco production, and many farmers in Tennessee and throughout the South have lots of questions about the recent activity surrounding tobacco.

One of the major sources of uncertainty is the recent \$206 billion settlement of state suits against cigarette manufacturers, which is projected to pay nearly \$5 billion to Tennessee over the next 25 years. Tennessee is also expected to receive about \$400 million from Phase II of the settlement. This issue of Policy Matters is dedicated to explaining the tobacco settlement and will shed light upon some of the most common questions surrounding the issue.

Overview of the Settlement

On November 23, 1998, 46 states, the District of Columbia, and the U.S. territories signed onto the Master Settlement Agreement (MSA) with major U.S. tobacco companies. The four remaining states - Mississippi, Texas, Florida, and Minnesota - had reached

individual settlement agreements with the tobacco companies previously

According to the MSA, major tobacco companies are expected to pay the 46 participating states well over \$200 billion over the next 25 years, and over \$32 billion within the first five years. The MSA also allows other tobacco companies to sign on under the same terms of agreement. In exchange for the payments and some marketing restrictions, states agree not to file suits in the future to recover smoking-related medical costs. Each state will determine independently how the settlement funds will be spent.

Tennessee is scheduled to receive a \$4.8 billion share over 25 years of the \$206 billion allotted in the MSA. Tennessee's first settlement payment of \$214 million is scheduled to be received by June 2000. Annual payments ranging from \$170-\$200 million are then expected for the next 25 or more years.

The MSA also laid the groundwork for Phase II of the tobacco settlement. In the Phase II agreement, cigarette manufacturers agreed to pay \$5.15 billion

into a national tobacco trust over 12 years to be used to provide economic assistance to tobacco growers and quota holders. The funds will be distributed among tobacco-growing states based on 1998 tobacco quotas. Each state will then be responsible for establishing a board to distribute funds among quota owners and growers. Tennessee is expected to receive \$29.1 million in Phase II payments in 1999, \$21.4 million in 2000, \$30.1 million in 2001, and then \$38.3 million for years 2002-2008 before payments decline in 2009 and 2010.

Policy Questions

Now that agreements have been reached, the big question is: "What will happen to the money?"

Funds from the Phase II agreement are specifically reserved for direct payments to growers and quota holders of tobaccos used to produce cigarettes (primarily burley and flue-cured). A government-appointed board of 11-14 members in each state will decide to whom and how these monies will be distributed. Because the allotment of Phase II monies is already relatively clearly defined in the agreement, the fate of large dollar amounts from the MSA is of much more immediate concern to most tobacco interests.

There are several uncertainties about the how monies from the MSA will be used. First, in opposition to many political leaders in Tennessee and other states, the Health Care Financing Administration, which administers the

federal portion of the Medicaid program, may attempt to claim a portion of settlement funds equal to the federal share of Medicaid. This equals about 63 percent in Tennessee. Also, settlement monies are paid directly to states. In Tennessee this means that the legislature will likely be responsible for appropriating the funds, and, since Tennessee's legislature can allot funds for only one year, the use of settlement funds would have to be approved by the legislature each year for only that year's monies.

The actual amount of the settlement funds also raises questions. According to the settlement, industry payments will decline if cigarette sales fall. Recent increases in cigarette prices to cover projected settlement costs are expected to reduce consumption, but the long-term impact on demand is unknown. Other factors could also affect demand for U.S.-made cigarettes such as increased health awareness or lower-priced competitor brands from abroad.

Other Concerns of Growers

The government has set a lower quota for 1999 - burley quota is down 28.8 percent and flue-cured down nearly 35 percent since 1997. This is in part a result of cigarette companies buying less American leaf because of a decrease in domestic cigarette sales and less expensive tobacco from Brazil and Africa. Such a reduction decreases the value of a quota holder's asset - his quota - which forces him to increase quota rental rates, possibly offsetting some or all of the loss

of quota value. This increases the grower's costs (because he has to pay more to rent the quota), which directly reduces the grower's net returns.

The future of the tobacco program, which stabilizes and supports domestic tobacco prices by restricting supplies through marketing quotas, is also a source of concern. Quota instability combined with political pressure to reduce government presence in agriculture, increased competition from foreign tobacco producers, and the potential to make direct payments to farmers through the settlement are all increasing pressure on the tobacco program.

Without a tobacco program, overall tobacco production would likely increase, sharply reducing tobacco prices. Further, if the tobacco program is eliminated, tobacco production in the long run (say, five to ten years) could look very different

than it does today, characterized by fewer, larger producers spread out over a much larger geographic area. For these reasons, many public health advocates are also concerned about the fate of the tobacco program because larger quantities of tobacco at lower prices would likely mean lower-priced cigarettes and increased profits for manufacturers.

In light of the recent settlement and renewed questions about the fate of the federal tobacco program, many tobacco growers and quota owners are very concerned about making investments in their tobacco operations. They are also concerned about planning their future around tobacco production. While any outlook for tobacco is speculative, as one Monroe County tobacco farmer said, "The more you know, the better - even if it's not what you wanted to hear."

How Are Tobacco States Spending Settlement Funds?

To date, most political leaders in Tennessee have not taken a position on potential uses of tobacco settlement funds. Several bills have been introduced into the legislature related to settlement spending, but no action has been taken.

Some neighboring states have already determined how most of their state's MSA funds will be spent. Legislation was recently passed in Virginia that allocates 50 percent of all MSA monies to a Tobacco Indemnification and Community Revitalization Fund for tobacco growers, quota holders, and tobacco-dependent communities. Money in the Fund may be used to directly compensate active tobacco farmers for the decline or elimination of tobacco quota, community and agricultural development for tobacco-dependent regions, or other tobacco-related uses such as researching potential alternative cash crops. Ten percent of all of Virginia's MSA funds will go into a separate foundation to reduce the use of tobacco products by minors. The remaining 40 percent of Virginia's MSA funds will be allocated by the legislature.

Under legislation that passed in North Carolina in mid-March, all of North Carolina's MSA funds will be split among two trusts and a foundation. Twenty-five percent of all funds will go to a trust fund to benefit health programs, and another 25 percent will go to a trust fund to benefit tobacco growers and allotment holders, as well as tobacco workers. The trust fund can provide assistance to farmers to compensate for lost business or cuts in tobacco quotas, or it can provide more help in tobacco communities. The remaining 50 percent of the money will go to a foundation for tobacco communities, which could use it to provide assistance in a variety of forms to tobacco-dependent communities, farmers, quota holders or health programs.