
Tobacco Settlement, Phase II and Disaster Payments: An Overview and Status Report

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Tobacco-producing states are receiving tobacco-related payments from three primary sources: the tobacco Master Settlement Agreement, Phase II, and ad hoc federal appropriations. This paper generally describes each of these and provides current information about how tobacco growers and quota owners in major tobacco-producing states are affected by each source of funds.

The Master Settlement Agreement

After a year and a half of negotiations and failure of an earlier settlement proposal to obtain Congressional approval, the four largest cigarette manufacturers reached a settlement with 46 states over state claims against the tobacco industry on November 23, 1998. According to the Master Settlement Agreement (MSA), cigarette manufacturers agreed to pay participating states \$206 billion over the next 25 years. Four states – Florida, Mississippi, Minnesota, and Texas – settled suits individually with tobacco manufacturers prior to the 1998 MSA additionally committing cigarette makers to pay more than \$40 billion over the next 25 years. According to the terms of the settlement, payments are divided among participating states according to each state's share of Medicaid funding, which is largely population based. The MSA places no restrictions on state spending of settlement payments. The exact amount of future settlement payments is uncertain as payments are subject to annual adjustments for changes in cigarette consumption, inflation, and other factors.

Terms of the settlement direct payments to each state's general fund. Thus, decisions regarding spending state tobacco settlement funds generally rest with state legislatures. In most states, general funds can only be appropriated for the term of the legislative body, requiring annual or biannual decisions on state settlement spending, though several states have created separate trusts or foundations to receive tobacco settlement funds allowing multi-year appropriation and some states are considering securitization of expected payments. Figure 1 broadly summarizes state uses of MSA funds to date. All 43 states that have made decisions about spending settlement dollars have allocated some portion to health priorities. Most of the states (38 of the 43) have allocated

some settlement monies to tobacco use prevention and reduction. Other health uses include programs for the elderly, prescription drugs, Medicaid, research and chronic diseases. Education uses include scholarships, school construction, technology and literacy, among others.

Among the 22 states allocating some settlement monies to economic development and commerce, six are tobacco-producing states that have allocated funds to directly assist tobacco growers and quota holders. Table 1 summarizes the current standing of MSA allocations in major tobacco producing states. Virginia, North Carolina, Kentucky and Tennessee are all devoting at least half of

Figure 1. Summary of state allocations of MSA payments through December 2000.

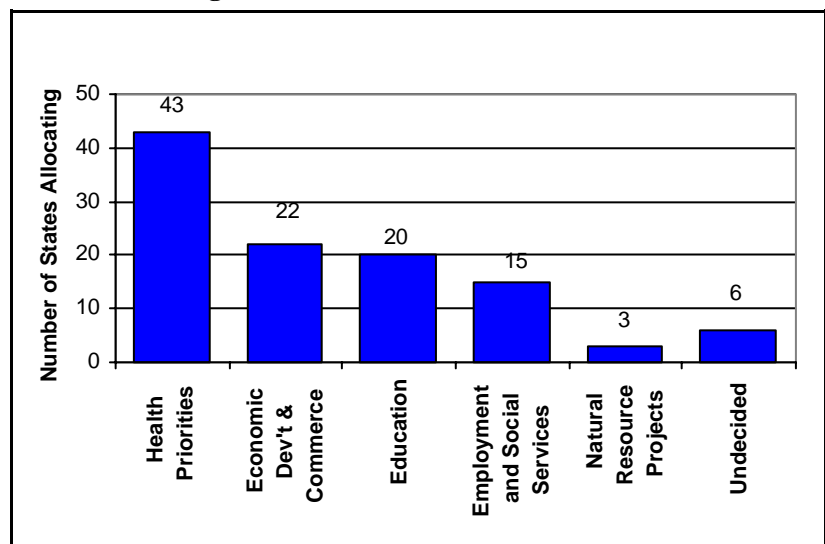


Table 1. Summary of the use of MSA payments in the six major tobacco producing states through December 2000.

Expected MSA Payments	Use of MSA Funds
North Carolina \$4.6 billion	Passed legislation in 1999 establishing a non-profit corporation for economic assistance to tobacco dependent communities (the Golden LEAF Foundation) with 50% of the settlement payments. The other half of the payments will be divided equally between two trust funds: one for tobacco producers, quota holders and tobacco workers and the other for health-related interests. Golden LEAF has just finished the first round of grants awarding more than \$5 million to 39 projects including alternative crops, education, research, economic development, and alternative employment.
Kentucky \$3.5 billion	In 2000, the General Assembly voted to allocate 50% of all settlement funds through 2002 to agriculture, 25% to early childhood development programs and 25% to health initiatives, with \$69 million reserved for a "Bucks for Brains" education endowment. Of the \$180 million expected in the agriculture fund through 2002, \$40 million will ensure a minimum support level under Phase II, \$91 million is for statewide ag development projects including market development and entrepreneurship and \$49 million will be available to county ag councils for local use.
Tennessee \$4.8 billion	In 2000, the Tennessee legislature decided to split current payments between two funds: one for health and one for agriculture. Legislative committees for each fund are meeting and will make spending recommendations to the legislature in early 2001. The agriculture committee has expressed interest in creating an endowment fund with most of the payments and allocating the earnings. The use of future settlement payments has not been determined.
Virginia \$4.0 billion	Passed legislation in February 1999 that allocates 50% of all settlement payments to a Tobacco Indemnification and Community Revitalization Fund with a governing board that will compensate tobacco farmers for loss of assets and promote economic growth in tobacco dependent communities. Same legislation allocates 10% of settlement payments to a youth tobacco use prevention program. Remaining 40% allocated annually by the legislature. 80% of the payments to the Tobacco Fund in 1999 and 2000 went to direct payments to growers and quota owners. Initial grants have been made for community economic development.
South Carolina \$2.3 billion	The legislature approved a plan allocating the majority of the payments (73%) to health care, including prescription drugs, home and community based care for the elderly, newborn health screenings, and youth smoking prevention. 15% was allocated to compensate tobacco growers and quota holders for production losses, and 12% was allocated for water and sewer infrastructure improvements, primarily in rural areas. The state is planning to securitize their expected future settlement payments and is reviewing securitization proposals.
Georgia \$4.8 billion	The legislature approved a plan allocating payments through fiscal year 2001 to rural economic development and health priorities. \$62 million was appropriated under the One Georgia Fund with four rural economic development projects funded at \$10 million each and \$22 million reserved for future economic development needs. \$87 million was appropriated among 15 health care programs, with 35% of the health funds for school nurses, 18% for smoking prevention and cessation and 12% for mental retardation support services.

their settlement payments (at least in the first few years) to agriculture uses. Other tobacco producing states such as Ohio and Maryland are also using some MSA funds to assist their tobacco growers and tobacco growing regions. In North Carolina, Golden LEAF grants totaling \$5 million awarded in the first round were for funding economic development partnerships; researching medical use of nicotine; alternative agricultural enterprise research and education including peppers, kenaf, aquaculture, organic crops, meat goats, timber, grapes, and fresh vegetables; alternative employment, including retraining for unemployed tobacco workers and retooling tobacco processing facilities; and education, including scholarships and teacher training. In Kentucky, some of the \$91 million allocated for statewide agricultural development projects will benefit agriculture by developing regional farm markets, supporting small farm diversification, sharing some of the costs of complying with the state water quality plan and other environmental targets, providing municipal water in prime agricultural areas, and developing farmland preservation programs. Kentucky's \$49 million allocated to county agricultural councils will be used for local projects such as low interest loans, grants for water line extensions, transitioning to other farm enterprises, and environmental stewardship. Grants in Virginia have been primarily for education and regional economic development projects.

Phase II Tobacco Settlement Payments

The Master Settlement Agreement contained language that called for participating manufacturers to meet with representatives of major tobacco producing states to come up with a plan to help compensate tobacco growers and quota holders for declining tobacco consumption and demand resulting from the settlement. The MSA did not specify what, if anything, tobacco companies should do to lessen the economic strain imposed upon growers as a result of the settlement. The outcome of these discussions resulted in both sides agreeing to establish the National Tobacco Growers' Settlement Trust Fund, which has come to be known as "Phase II" of the tobacco settlement. Phase II calls for the four participating cigarette manufacturers to pay \$5.15 billion into a national tobacco grower trust over 12 years. The fund is to be distributed among tobacco-growing states based on each state's share of 1998 tobacco quotas.

Table 2 presents a breakdown of the expected annual payment to all states in each of the twelve payment years. The total Phase II payment in 1999 was \$380 million with nearly two thirds of the total paid to North

Table 2. State allocations of Phase II payments, 1999-2010.

State	Annual Allocation	1999	2000	2001	2002-08	2009-10
	%	<i>Million Dollars</i>				
North Carolina	37.95	144.21	106.26	151.80	189.75	111.95
Kentucky	29.66	112.71	83.05	118.64	148.30	87.50
Tennessee	7.57	28.77	21.20	30.28	37.85	22.33
South Carolina	6.94	26.37	19.43	27.76	34.70	20.47
Virginia	6.58	25.00	18.42	26.32	32.90	19.41
Georgia	5.85	22.23	16.38	23.40	29.25	17.26
Ohio	1.36	5.17	3.81	5.44	6.80	4.01
Indiana	1.16	4.41	3.25	4.64	5.80	3.42
Florida	1.13	4.29	3.16	4.52	5.65	3.33
Maryland	0.62	2.36	1.74	2.48	3.10	1.83
Pennsylvania	0.43	1.63	1.20	1.72	2.15	1.27
Missouri	0.42	1.60	1.18	1.68	2.10	1.24
West Virginia	0.28	1.06	0.78	1.12	1.40	0.83
Alabama	0.05	0.19	0.14	0.20	0.25	0.15
TOTAL		\$380	\$280	\$400	\$500	\$295

Carolina and Kentucky. In 2000, the total payment is \$280 million, 26 percent less than the 1999 level. Payments in 2001 are expected to be slightly above the initial 1999 level at \$400 million, and then annual payments over the next seven years (2002-2008) further increase to \$500 million. The final two annual payments then fall to \$295 million.

The exact amount of each annual payment is subject to three adjustments: (1) if domestic cigarette consumption declines, payments will be reduced by the same formula as in the Master Settlement Agreement; (2) adjustments will be made upward to reflect inflation, up to 3 percent annually; (3) if tobacco excise taxes are increased and any portion of the proceeds is earmarked for direct grower compensation, payments made to the Phase II fund will be reduced dollar-for-dollar.

Payments will be made only for quotas of tobacco types used in domestic cigarettes: flue-cured and burley. Additionally, Maryland and Pennsylvania tobacco farmers, which are not part of the federal quota system, will also receive a small portion of Phase II funds. Producers and quota owners of other types of tobaccos are not eligible to receive funds from the trust. According to the agreement reached, the funds paid into the trust may only be used to make direct payments to tobacco quota holders and producers who suffer economic losses due to industry settlement of state lawsuits. Funds cannot be used for agricultural development, warehouse, or any purpose other than payments directly to quota owners and growers.

Table 3. State use of Phase II payments through December 2000.

State Total & Average Annual Payment	Payment Basis	Payment Sharing
North Carolina \$1.98 billion \$163 million	<i>Flue-Cured</i> : Payments based on lost quota in the payment year. <i>Burley</i> : Growers paid based on pounds actually marketed in the previous year. Quota owners paid based on pounds of lost quota in the payment year.	<i>Flue-Cured</i> : 50/50 split between growers and quota owners. <i>Burley</i> : 50/50 split between growers and quota owners.
Kentucky \$1.53 billion \$127 million	Quota owner payments based on basic quota in the previous year. Payments to growing farms and growers/tenants based on the average of the previous year marketings and effective quota.	Equal thirds paid to the quota owner, grower/tenant of the quota, and the growing farm.
Tennessee \$390 million \$32 million	Payments to quota owners based on basic quota in the previous year. Payments to growers based on actual marketings in the previous year.	80/20 split between growers and quota owners.
Virginia \$357 million \$30 million	<i>Flue-Cured</i> : Payments based on basic quota in 1998. <i>Burley</i> : Grower payments based on average of effective quota and marketings in 1998. Payments to quota owners based on basic quota in 1998. The base year will remain 1998 through 2004.	<i>Flue-Cured</i> : 50/50 split between growers and quota owners. <i>Burley</i> : 75/25 split between growers and quota owners.
South Carolina \$339 million \$28 million	Payments to quota owners based on basic quota in the previous year. Payments to growers based on actual marketing in the previous year.	50/50 split between growers and quota owners.
Georgia \$301 million \$25 million	Payments based on basic quota in the previous year.	50/50 split between growers and quota owners.

According to the agreement, each participating state is responsible for establishing a board to distribute funds among eligible tobacco quota holders and growers. The general composition of the state boards is established by the agreement and includes the Governor, the Commissioner of Agriculture, the Attorney General, two members of the state legislative body, 2 members of the state's congressional delegation, three to six tobacco growers or quota holders appointed by the governor, and one distinguished citizen appointed by the governor. The allocation of funds among the state's quota owners and growers (including owners, lessees, and tenants) is determined by each individual state board, which then submits their funding plans to the national board for annual approval. Upon approval, funds are released from the national trust to the state board for disbursement according to the plan. Table 3 summarizes the Phase II payment plans for the six major tobacco producing states.

Payments are generally split evenly between growers and quota owners of flue-cured tobacco. Burley tobacco payments are generally weighted more heavily toward growers or those bearing a larger share of financial risk. With the first two years of payments determined at this point, most states that used 1998 basic or effective quota or marketings (or some combination thereof) in the determination of payment rates for 1999 have followed the same pattern and used 1999 quota or marketing levels in the determination of 2000 payment rates. Virginia is the exception, where payments in 2000 through 2004 will be tied to quota and marketing levels in 1998. The Phase II board in Kentucky is also considering basing future payments on a fixed year.

Federal Tobacco Assistance

Over the past few years, Congress has legislated a number of broad and specific agricultural disaster assistance packages. Federal dollars allocated as compensation for reductions of tobacco quota or acreage have been administered by the U.S. Department of Agriculture's Farm Service Agency (FSA) under a program called the Tobacco Loss Assistance Program (TLAP). In October 1999, Congress appropriated \$328 million under broad farm disaster legislation to help compensate farmers for cuts made in tobacco quotas.¹ In July 2000, a second round of \$340 million in TLAP funds was appropriated by Congress.

According to federal law, each tobacco growing state received a portion of TLAP dollars based on its share of reduction in tobacco quota. The types of tobacco eligible for TLAP payments include flue-cured, burley, fire-cured, and cigar filler/binder, whereas Phase II payments are only available to flue-cured and burley types. Enabling legislation required each state to distribute their portion of TLAP funds according to the state's payment formula already established for Phase II payments or previous payment programs. Flue-cured and cigar/binder producers and quota owners split payments evenly and payments for burley and fire-cured tobaccos were split among growers, quota owners, and those in control of the quotas. Each round of TLAP payments roughly doubled the Phase II payments that burley and flue-cured producers and quota owners were receiving.

In September 2000, Congress incorporated a last-minute \$509 million bailout for burley tobacco farmers into the federal agriculture appropriations bill. The measure allowed the co-op to forfeit 250 million pounds of low-quality 1999 crop to the Commodity Credit Corporation (CCC), forgiving loans on the forfeited poundage. The CCC can then try to resell the forfeited tobacco overseas to recover some of the government's losses. Expectations are that the CCC can recover about \$259 million from foreign sales and taxpayers will pay the additional \$250 million. The level of pool stocks is a major component of the formula used to determine annual marketing quotas. The removal of very large, low quality stocks overhanging the burley market had a very significant impact on the outlook for the approaching burley quota determination and it now appears that burley basic quota could increase significantly in 2001 (somewhere around 30 percent). While that is considerably more optimistic than the previous outlook, it still only results in a basic quota that is less than half the 1997 level. Leaders in major flue-cured states are also pursuing a similar federal bailout for flue-cured tobacco stocks.

1. The TLAP payments were part of a large assistance program (\$6.5 billion) in response to low commodity prices in 1999 authorizing market loss payments to producers of grains, cotton, oilseeds, tobacco, dairy, and peanuts. In addition to the \$328 million in payments to tobacco growers, another \$2.8 million was approved for flood damaged tobacco on warehouse auction floors from Hurricane Floyd.