United States General Accounting Office

GAO

Report to the Honorable John McCain, Ranking Minority Member, Committee on Commerce, Science, and Transportation, U.S. Senate

June 2001

TOBACCO SETTLEMENT

States' Use of Master Settlement Agreement Payments

GAO

Accountability * Integrity * Reliability

GAO-01-851

Contents

Abbreviations

AHCCCS	Arizona Health Care Cost Containment System
CDC	Centers for Disease Control and Prevention
CPI	Consumer Price Index
HCRA 2000	Health Care Reform Act
KEY	Kansas Endowment for Youth
MOU	memorandum of understanding
MSA	Master Settlement Agreement
NAAG	National Association of Attorneys General
NCSL	National Conference of State Legislatures
NGA	National Governors' Association
NPM	non-participating manufacturers
SCF	Strategic Contribution Fund
SCHIP	State Children's Health Insurance Program
SPE	special purpose entity
TICR	Tobacco Indemnification and Community Revitalization Commission

GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

June 29, 2001

The Honorable John McCain, Ranking Minority Member
Committee on Commerce, Science, and Transportation
United States Senate

Dear Senator McCain:

In November 1998, the attorneys general of 46 states[1] signed a comprehensive agreement with the nation's largest tobacco companies requiring them to make annual payments to states in perpetuity as reimbursement for past tobacco-related costs, such as Medicaid expenditures. This settlement—referred to as the Master Settlement Agreement (MSA)—is the largest civil settlement in U.S. history and commits tobacco companies to pay approximately $206 billion over the first 25 years of the agreement.[2] The four states that are not party to the MSA—Florida, Minnesota, Mississippi, and Texas—had reached earlier, individual settlements with the tobacco companies that call for payments totaling $40 billion over 25 years.[3]

The MSA imposes no requirements on how states spend their MSA payments; states are free to use the funds for any purpose. As a result, the receipt of millions of MSA dollars has presented states with a unique opportunity to finance programs in a variety of policy areas. Although the MSA does not require states to spend settlement payments on tobacco control programs, many antismoking and health care observers are concerned that states are not using enough of the MSA payments to enhance their tobacco prevention and control efforts.

[1]The District of Columbia and the five U.S. territories are also party to the agreement.

[2]$206 billion is the original estimate of the total payments from the MSA. Of this total, $204.5 billion is the estimated total payment to 46 states, the District of Columbia, and the five U.S. territories. An additional $1.8 billion is provided for other initiatives agreed to in the MSA including a national foundation and administrative costs of the National Association of Attorneys General.

[3]An earlier GAO report, *Tobacco Settlements: States' Use of Settlement Proceeds* (HEHS-98-147R, April 22, 1998) studied the preliminary use of settlement payments by these four states.

The scope of the MSA and the magnitude of the payments involved have generated a great deal of attention. During the past year, several organizations have issued reports on states' use of their MSA payments and/or state spending on tobacco control, including the Campaign for Tobacco-Free Kids, the Centers for Disease Control and Prevention (CDC), the National Conference of State Legislatures (NCSL), and the National Governors' Association (NGA).[4]

You asked us to provide a comprehensive review of how states are using their MSA payments—in particular, to what extent states are using these funds for smoking prevention and cessation programs. Our report responds to your request by examining (1) the amount of payments received by states and the states' decision-making processes regarding allocation of the MSA payments in state fiscal years 2000 and 2001,[5] and (2) the types of programs that states funded with their MSA payments in those two fiscal years. As agreed with your staff, our report focuses exclusively on the 46 states covered by the MSA and exclusively on MSA payments.[6]

To address our objectives we studied the allocation of all MSA payments through states' fiscal year 2001. We collected and analyzed budget-related and legislative documents and interviewed officials from each of the 46 state executive budget offices about the plans for use of the MSA payments for the two fiscal years in our study. In some cases, state budget officials included staff from the state attorney general's office, the governor's office and the state agency responsible for tobacco control programs in the interview. In order to present as comprehensive a review as possible, we collected data on all estimated MSA payments to the 46 states and the allocations of those payments regardless of whether a decision was made on the use of the funds or whether all funds were appropriated by the legislature. Our study focuses only on the state shares of MSA payments. In California and New York, the two states in which the counties receive MSA payments, we did not track the MSA payments to counties or the allocation of those payments. We did not collect information on payments to the

[4]See appendix VIII for a list of these organizations and their reports.

[5]Throughout this report, fiscal year will refer to state fiscal year. In most states the fiscal year begins on July 1 and ends on June 30; the exceptions are as follows: in Alabama and Michigan the fiscal year begins on October 1 and in New York the fiscal year begins on April 1.

[6]We did not report on other sources of funding for tobacco control programs.

District of Columbia or the five territories that are also party to the MSA. We categorized states' use of settlement payments for state fiscal years 2000 and 2001 according to selected program areas and developed a methodology for allocating dollars to specific categories. To obtain a comprehensive understanding of the states use of MSA payments, we reviewed recent reports and studies and spoke with representatives from the organizations conducting these studies. See appendix I for a more detailed description of our scope and methodology.

Results in Brief

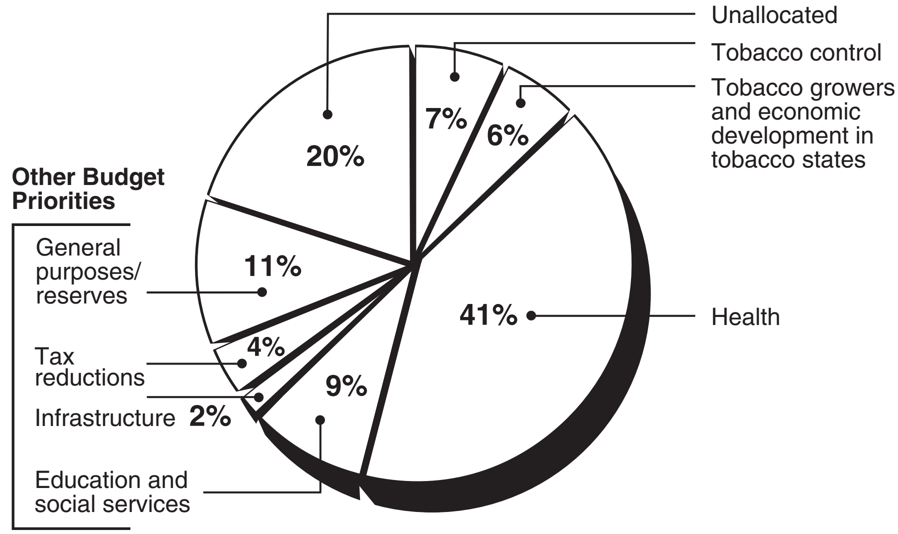
As of April 2001, 45 of the 46 states that are a party to the Master Settlement Agreement (MSA) received nearly $13.5 billion of the $206 billion estimated to be paid by the tobacco companies over the first 25 years of the agreement.[7] While this amount represents only about 1.7 percent of these states' general fund revenues for the same two-year period, the receipt of MSA payments prompted many states to engage in a deliberative decision-making process to determine long-term uses for the payments. Many states established dedicated funds—categorized as either special funds or endowment funds—for receipt of at least a portion of the MSA payments. To ensure that the MSA payments are used to expand programs and services, approximately one-third of the states also passed legislation requiring MSA payments to be used to supplement rather than supplant existing state funding. Nearly two-thirds of the states earmarked the MSA payments and enacted laws governing the future use of the payments, while others used voter-approved initiatives to decide how to allocate the MSA payments. Some states also established special commissions to develop recommendations and long-term plans for the payments. Four states—Missouri, Oregon, Pennsylvania, and Tennessee—had not yet decided how to use their MSA payments as of April 2001.

[7] Missouri had not received any payments as of April 2001.

The MSA allows states to use their payments for any purposes, and states have used their MSA payments for a variety of programs and budget priorities, including, but not limited to, tobacco control and health care programs. States allocated about 7 percent of the MSA payments for new or expanded tobacco control programs. The goal of these programs is to reduce tobacco use through various intervention strategies, including promoting smoking cessation and preventing youth from starting to smoke. The MSA has encouraged a commitment to tobacco control, and all 42 states that have made decisions on the use of the MSA funds now provide funding for tobacco control. Some of these programs are funded not by MSA payments but by tobacco excise taxes or other sources of state funding, and the amount of funding for these programs varies widely among states. Health-related programs constitute the category that received the largest allocation of MSA payments (41 percent); most states allocated a portion of their settlement proceeds to this area. The increased spending went to a variety of health programs; many states expanded coverage under their Medicaid and State Children's Health Insurance Program (SCHIP) programs. Seven of the 13 tobacco states allocated 6 percent of the total MSA payments for assistance to tobacco growers and economic development projects.[8] States also viewed the MSA payments as an opportunity to fund other needs that they had not been able to fund in the past. They allocated 26 percent of the payments to a variety of priorities or mandated areas including education and social services, infrastructure, and budget reserves. Only two states reported allocating MSA payments for tax reductions. Finally, 20 percent of the MSA payments remained unallocated during the two fiscal years in our study.

[8]The 13 tobacco states are Alabama, Georgia, Indiana, Kentucky, Maryland, Missouri, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Virginia, and West Virginia.

Figure 1: State Allocations of MSA Payments (State Fiscal Years 2000 and 2001)



Source: GAO analysis.

Several states issued bonds backed by their MSA payments—a process referred to as "securitization." Securitization allows states to receive funds up front rather than over time as MSA payments are made according to the terms of the agreement. Three states, and many counties in New York State, have already securitized a portion of the expected payment stream from the MSA; and 10 more states reported that securitization was under consideration. Thus far, most of the bond issues have been in the form of tax exempt bonds, the proceeds of which often are earmarked for capital projects or reducing existing state debt, allowing states to fund large one-time needs.

Background

Beginning in the mid 1990s, more than 40 states and some localities sued tobacco companies, alleging that the industry violated antitrust and consumer protection laws, withheld information about the adverse health effects of tobacco, manipulated nicotine levels to keep smokers addicted, and conspired to hold back less risky and less addictive tobacco products from the market. In 1997 and 1998, four states—Florida, Minnesota, Mississippi, and Texas—settled their lawsuits by negotiating independent agreements with the tobacco industry. In November 1998, four of the nation's largest tobacco companies—Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company (referred to as the "original participating manufacturers")[9]— negotiated an agreement with the attorneys general of the remaining 46 states thereby settling a number of lawsuits brought by these states against these tobacco companies.[10] The terms of this agreement, known as the Master Settlement Agreement (MSA), apply only to those tobacco companies and states that are parties to the agreement. Under the MSA, the tobacco companies are required to provide monetary relief to states in the form of annual payments and reimbursement for attorney fees. The MSA also imposes restrictions on the tobacco companies' marketing and advertising practices. Furthermore, the MSA established a national foundation to support study and programs to (1) reduce youth tobacco use and substance abuse and (2) prevent diseases associated with tobacco use. Tobacco companies are required to provide funding for this foundation, as well as funding for the National Association of Attorneys General (NAAG), which is responsible for assisting states in the implementation and enforcement of the MSA.

After the MSA was signed, each state had to take action to receive approval of the agreement from its respective state court in order to make the terms of the agreement legally binding within that state. Under the MSA, once state court approval was final, the state achieved "state-specific finality" status, thereby permitting that state to receive payments under the MSA. No state payments were to be released to any of the states, however, until the agreement reached final approval. This occurred in November 1999 when 80 percent of the states whose shares equaled 80 percent of the total settlement payments had achieved state-specific finality.

[9]Several other tobacco companies have joined the MSA since the time of the agreement.

[10]This study reports on the 46 states that are party to the agreement. The agreement also included the District of Columbia and the five U.S. territories.

In addition, to receive its full share of the settlement payments, each state was required by the MSA to enact a statute addressing the potential competitive advantage that tobacco companies not party to the MSA may experience. Under the MSA, if the aggregate market share of the tobacco companies that are party to the agreement ("participating manufacturers") falls more than two percent below their base level of 1997 and the loss is caused in significant part by provisions of the MSA, the MSA payments may be reduced based on a formula that corrects for this market share loss.[11] The MSA provided that individual states can avoid this downward adjustment—known as the "non-participating manufacturers" (NPM) adjustment—to their payments by enacting and enforcing a statute that is intended to prevent a competitive disadvantage for the participating manufacturers. The MSA provided a model statute that, if enacted and enforced by a state, would protect that state from any adjustment for market share loss, although states are permitted to enact and enforce any statute that achieves the same desired result.

The MSA also placed restrictions on the tobacco companies' business practices, primarily in marketing targeted to youth, advertising, and lobbying. For example, the MSA banned all outdoor advertising by the tobacco companies such as billboards and signs in arenas and stadiums, as well as sponsorship of sporting events with a significant youth audience. Moreover, the tobacco companies are prohibited from lobbying the state or any political subdivision against efforts to enact certain kinds of state laws and regulations intended to reduce underage tobacco access and use. Tobacco companies are not prohibited from lobbying against legislation that would raise excise taxes or restrict smoking in public places. The MSA also required the tobacco companies to pay a total of $50 million for enforcement activities including state enforcement of the terms of the agreement and investigation of suspected violations of antitrust or consumer protection laws related to tobacco products. In addition, the MSA required the tobacco companies to fund a national foundation, the American Legacy Foundation, dedicated to discouraging youth tobacco use and to preventing disease associated with tobacco use through supporting study and education. The participating tobacco companies are required to pay a total of $1.45 billion over 5 years for the advertising and education programs (performed directly or through grant-making) aimed at countering youth tobacco use and informing consumers about prevention

[11] A nationally recognized team of economic consultants determines whether the decrease in market share is due to the effects of the MSA.

of tobacco-related diseases, and an additional $250 million over 10 years for other activities of the foundation.

The MSA was preceded by a proposed national settlement between the states and the tobacco industry reached in June 1997. This earlier more far-reaching proposal included payments to states and was a blueprint for a comprehensive national tobacco-control policy, including federal regulation and oversight. The June 1997 proposal could take effect only after federal legislation was enacted. Several comprehensive tobacco policy bills, including legislation to implement the June 1997 proposal, were introduced in the 105th Congress. However, only the National Tobacco Policy and Youth Smoking Reduction Act (S. 1415), introduced by Senator McCain, saw legislative action. The bill debated on the Senate floor provided for new authority for the Food and Drug Administration to regulate tobacco products, measures to restrict tobacco industry marketing and advertising, and measures to reduce underage tobacco use. The bill also required up-front and annual payments by the tobacco companies to provide for settlement of relevant state lawsuits. These and other payments would be deposited into a fund for the benefit of states that settled their lawsuits against the tobacco companies and for the benefit of the federal government.

When S. 1415 did not pass in the summer of 1998, states resumed negotiations with the tobacco industry that eventually resulted in the November 1998 Master Settlement Agreement. The MSA was a scaled-down version of the June 1997 proposal and did not require federal action to be implemented. This agreement did not resolve states' uncertainty over whether the federal government might lay claim to a portion of the payments to the states. In May 1999, Congress moved to resolve that uncertainty by enacting legislation that prohibited treating states' MSA payments as federal overpayments for purposes of Medicaid.[12]

[12]This provision was contained in the 1999 Emergency Supplemental Appropriations Act (P.L .106-31).

States Have Received Billions to Date From the Master Settlement Agreement

As of April 2001, 45 of the 46 states that signed the Master Settlement Agreement had received nearly $13.5 billion in payments from the tobacco companies.[13] MSA payments to the states, some of which states will receive in perpetuity, were originally estimated to total nearly $205 billion through 2025.[14] There are different types of payments, the largest two of which are "initial" payments— made in five installments through 2003— and "annual" payments which continue in perpetuity. Both of these types of payments are distributed based on "allocation percentages" for each state agreed to by the 46 state attorneys general when they negotiated the MSA. (See appendix IV for the types of MSA payments.) The final agreement resulted from negotiations that began with a formula. However, unlike many other legal settlements with a fixed level of compensation, while the MSA payments are based on set payment amounts, these payments are adjusted for several factors, most notably, the future sales of the tobacco industry. Each state's payments are adjusted annually based on the participating manufacturers' cigarette sales and market share, as well as inflation. All adjustments resulted in reductions of about $1.6 billion between 1999 and 2001.

Payment Shares Were Determined Through Negotiations

The formula that provided the basis for determining the allocation percentages for the MSA payments was composed of two variables each weighted equally: smoking-related Medicaid expenditures and smoking-related non-Medicaid health care costs of each state. The smoking-related health care cost variable included factors for each state's population and smoking prevalence. After this initial formula was developed, negotiations resulted in some adjustments for state-specific concerns. For example, some smaller states argued that they should receive a larger percentage to enable them to fund smoking cessation programs because they did not have the same economy of scale as larger states. The negotiations resulted in the allocation percentages that are applied to each initial and annual MSA payment. In general, larger states receive a higher percentage of each payment and smaller states receive a lower percentage, however because

[13]Missouri achieved state-specific finality in late April 2001 and had not yet received any MSA payments.

[14]The estimated total of $204.5 billion includes all types of payments to the 46 states, the District of Columbia, and the five U.S. territories. Additional payments estimated at $1.8 billion are to be paid for the American Legacy Foundation, administrative costs for the National Association of Attorneys General, and an enforcement fund.

the allocation percentages were determined by negotiations the payments are not strictly proportional to population. Table 1 shows the final state allocation percentages as explicitly agreed to in the MSA.

Table 1: MSA State Allocation Percentages

State	Percentage
Alabama	1.6161308
Alaska	0.3414187
Arizona	1.4738845
Arkansas	0.8280661
California	12.7639554
Colorado	1.3708614
Connecticut	1.8565373
Delaware	0.3954695
Georgia	2.4544575
Hawaii	0.6018650
Idaho	0.3632632
Illinois	4.6542472
Indiana	2.0398033
Iowa	0.8696670
Kansas	0.8336712
Kentucky	1.7611586
Louisiana	2.2553531
Maine	0.7693505
Maryland	2.2604570
Massachusetts	4.0389790
Michigan	4.3519476
Missouri	2.2746011
Montana	0.4247591
Nebraska	0.5949833
Nevada	0.6099351
New Hampshire	0.6659340
New Jersey	3.8669963
New Mexico	0.5963897
New York	12.7620310
North Carolina	2.3322850

State	Percentage
North Dakota	0.3660138
Ohio	5.0375098
Oklahoma	1.0361370
Oregon	1.1476582
Pennsylvania	5.7468588
Rhode Island	0.7189054
South Carolina	1.1763519
South Dakota	0.3489458
Tennessee	2.4408945
Utah	0.4448869
Vermont	0.4111851
Virginia	2.0447451
Washington	2.0532582
West Virginia	0.8864604
Wisconsin	2.0720390
Wyoming	0.2483449

Source: Master Settlement Agreement, Exhibit A.

Prior to the MSA, some counties in California and New York had independently filed lawsuits against the tobacco industry. In these states, the counties bear financial responsibility for a share of Medicaid costs, and the lawsuits sought compensation for the counties' cost of treating smoking related illnesses. In both these states, under different arrangements, counties receive a share of MSA payments.

The state of California had entered into a memorandum of understanding (MOU) with its counties and four major cities in August 1998—prior to the MSA—to coordinate their lawsuits with the state's suit and provide for the allocation of any settlement. The terms of the MOU included an even 50/50 split of the financial recovery between the state and local governments, with the local share further split between the counties and four major cities. In California's case, all MSA payments are made to the state and the state distributes payments to the 58 counties and four cities. (See appendix II for the counties' and cities' share of payments in California.)

In the case of New York, the state's consent decree provides for allocation of a portion of its MSA payments to the counties and New York City based on the county share of Medicaid costs and population as well as some specific considerations for individual counties. In New York's case, each of the state's 57 counties and New York City receive payment directly from the escrow account established by the MSA rather than the state receiving all payments and then distributing them to the localities. (See appendix III for the counties' and New York City's share of payments in New York.) As explained in the introduction to this report, this study focuses on how states are using their MSA payments, and we did not track the counties' use of MSA payments.

Types of MSA-Related Payments

Currently, states receive two types of payments as a result of the MSA—annual payments and initial payments. Although there are several types of potential adjustments to the annual payments received by each state, the two most significant adjustments are a "volume adjustment" and an "inflation adjustment." The volume adjustment is based on increases or decreases in the number of cigarettes shipped by the original participating manufacturers, and the inflation adjustment is set at the actual percentage increase in the Consumer Price Index (CPI) or 3 percent, whichever is greater. The terms of the MSA also call for states to receive five initial payments between 1998 and 2003. These initial payments are also subject to annual volume adjustments, but they are not adjusted for inflation after the first payment. (See appendix IV for a summary of payment types and amounts.)

A third type of payment, known as the Strategic Contribution Fund (SCF) payment, will begin in 2008 and continue through 2017. The base amount of each year's SCF payment is $861 million and will be adjusted for volume and inflation. SCF payments are intended to reflect the level of the contribution each state made toward final resolution of the state lawsuits against the tobacco companies and will be allocated to the states based on a separate formula developed by a panel of former state attorneys general. (See appendix V for estimated Strategic Contribution Fund payments to states.)

Finally, tobacco growers and producers in states that grow cigarette tobacco also receive a fourth type of payment through a separate agreement, the National Tobacco Grower Settlement Trust Agreement, known as "Phase II." The MSA required the tobacco companies to meet with the political leadership of states with grower communities to address the economic concerns of these communities. The Phase II agreement resulted from that requirement. (See appendix VI for information on the Phase II agreement.) This agreement is intended to provide compensation for financial losses due to the anticipated decline in cigarette consumption and payments to the trust fund are expected to total $5.15 billion over 12 years. This report does not track Phase II payments to states or the allocation of these payments.

Table 2 summarizes the types of payments that states will receive as a result of the MSA and Phase II. (See appendix IV for estimated payment amounts for the first 25 years of the MSA.)

Table 2: MSA and Phase II Payments

Type of payment	When payment is made	How payment is determined
Annual	In perpetuity (paid by April 15 of each year)	Payments distributed to states based on the MSA allocation percentages, with adjustments. Base payment amount increases each year from 2000-2018; constant after 2018.
Initial	5 payments from 1998 through 2003 (payments after the first one are due by January 10 of each year)	Set base amount per year, distributed to states based on the MSA allocation percentages, with adjustments.
Strategic Contribution Fund	Annual payments beginning in 2008 through 2017 (paid by April 15 of each year)	Set base amount of $861 million per year, distributed to states based on a separate formula, with adjustments. Formula is based on level of state's contribution to litigation or resolution of state tobacco lawsuits.
National Tobacco Grower Settlement Trust (Phase II)	Paid annually over 12 years: 1999-2010 (paid as follows in years 2000-2010: 25% by March 31, 25% by June 30, 25% by September 30, 25% by December 15.)	Based on a separate agreement between tobacco-growing states and tobacco companies. Set base amount, with adjustments, deposited in trust and distributed directly to tobacco growers based on state allocation methodology. State share based on its 1998 share of production of cigarette tobacco.

Note: No payments were distributed to states until 80 percent of the states with shares equal to 80 percent of the total settlement payments had achieved state-specific finality.

States Received Nearly $13.5 Billion From 1999 Through 2001

States received their first MSA payments at different points in time based on the date the agreement became final in their state (referred to as having achieved "state-specific finality").[15] Forty-three states received their first payment in state fiscal year 2000. Arkansas and Tennessee received their first payments in fiscal year 2001. Since Missouri did not achieve state-specific finality until late April 2001, its payments were not included in the total payments received through April 2001.[16] The first MSA payments were made in December 1999, and as of April 2001 all initial and annual payments combined totaled nearly $13.5 billion. States are not scheduled to receive any more payments until January 2002. California and New York have received the largest amounts so far—nearly $1.8 billion each.[17] Together, six states received more than 50 percent of all the MSA payments from 1999 through 2001: California, Illinois, Michigan, New York, Ohio, and Pennsylvania. Table 3 shows the breakdown of expected payments by state, as originally estimated at the time of the Master Settlement Agreement, as well as the actual payments received as of April 2001.

[15]None of the state payments were released to any of the states until 80 percent of the states with shares equal to 80 percent of the total settlement payments had achieved state-specific finality. This occurred in November 1999.

[16]As a result, neither the payments to Missouri nor any of the state's allocations are included in this report.

[17]California payment amounts include payments to four cities and the 58 counties in the state which amount to 50 percent of the total payments. New York payment amounts include payments to the 57 counties in the state and New York City, which amount to 49 percent of the total payments. (See appendices II and III for distribution of payments in California and New York.)

Table 3: Original Estimated and Actual MSA Payments Received by States as of April 2001

Dollars in thousands

State	Original estimated payments through 2001	Actual payments received through 2001	Percent difference estimated vs. actual payments
Alabama	$254,304	$228,618	-10.1
Alaska	53,724	49,120	-8.6
Arizona	231,922	207,996	-10.3
Arkansas	130,300	121,546	-6.7
California[a]	2,008,461	1,790,356	-10.9
Colorado	215,711	197,225	-8.6
Connecticut	292,134	260,406	-10.9
Delaware	62,229	55,470	-10.9
Georgia	386,219	353,121	-8.6
Hawaii	94,706	84,420	-10.9
Idaho	57,161	52,262	-8.6
Illinois	732,365	669,603	-8.6
Indiana	320,971	293,465	-8.6
Iowa	136,846	125,118	-8.6
Kansas	131,182	119,940	-8.6
Kentucky	277,126	247,028	-10.9
Louisiana	354,889	324,476	-8.6
Maine	121,060	110,686	-8.6
Maryland	355,692	325,210	-8.6
Massachusetts	635,549	566,526	-10.9
Michigan	684,797	610,424	-10.9
Missouri[b]	357,918	0	-
Montana	66,837	61,110	-8.6
Nebraska	93,624	85,600	-8.6
Nevada	95,976	87,751	-8.6
New Hampshire	104,787	95,807	-8.6
New Jersey	608,488	557,730	-8.3
New Mexico	93,844	85,802	-8.6
New York[c]	2,008,159	1,790,083	-10.9
North Carolina	366,994	327,137	-10.9
North Dakota	57,594	52,658	-8.6
Ohio	792,673	724,742	-8.6
Oklahoma	163,041	149,068	-8.6

Dollars in thousands

State	Original estimated payments through 2001	Actual payments received through 2001	Percent difference estimated vs. actual payments
Oregon	180,589	160,976	-10.9
Pennsylvania	904,292	664,190	-26.6
Rhode Island	113,123	103,428	-8.6
South Carolina	185,104	169,241	-8.6
South Dakota	54,909	50,203	-8.6
Tennessee	384,084	354,356	-7.7
Utah	70,004	64,006	-8.6
Vermont	64,701	57,675	-10.9
Virginia	321,749	294,180	-8.6
Washington	323,089	295,401	-8.6
West Virginia	139,489	127,534	-8.6
Wisconsin	326,044	290,634	-10.9
Wyoming	39,079	34,834	-10.9
Total[b]	**$15,095,621**	**$13,477,162**	**-10.7**

[a]California payment amounts include payments to four cities and the 58 counties in the state which amount to 50 percent of the total payments.

[b]Total excludes original estimated payments to Missouri.

[c]New York payment amounts include payments to the 57 counties in the state and New York City which amount to 49 percent of the total payments.

Source: GAO analysis of data from the National Association of Attorneys General.

Adjustments Affect State Payments

As noted above, payments are adjusted for a number of factors such as fluctuations in the volume of cigarette sales, inflation, and changes in participating manufacturers' market share. The combined effect of all adjustments has been to lower payments by about $1.6 billion—or nearly 11 percent below the original estimate. The 45 states that had reached state-specific finality and received payments were originally estimated to receive $15.1 billion through April 2001 but actually received nearly $13.5 billion during this period—an overall reduction of about $1.6 billion.[18] The adjustments varied by state, from a high of 26.6 percent in Pennsylvania to a low of 6.7 percent in Arkansas.

[18]Missouri reached state-specific finality in late April 2001 and did not receive any MSA payments through April 2001.

Consumption has declined since the Master Settlement Agreement was signed in November 1998—by about 6.5 percent in 1999 alone—mostly due to one-time increases in cigarette prices that the tobacco companies implemented after the MSA took effect.[19] Analysts project that in the future total cigarette consumption will decline by an average of nearly 2 percent per year.[20] As a result, cigarette consumption is estimated to decline by 33 percent between 1999 and 2020. Declining consumption will result in lower MSA payments than originally expected.

Offsetting the sales volume decline is the adjustment for inflation. The inflation adjustment equals the actual percentage increase in the CPI for the preceding year or 3 percent, whichever is greater. The effect of compounding, especially given that the payments are made in perpetuity, is significant. Assuming a 3-percent inflation adjustment and no decline in base payments, settlement amounts received by states would double every 24 years. Some analysts estimate the positive inflationary adjustments to be greater than any negative adjustments for consumption.

Adjustments were also made for losses in participating manufacturers' market share. The NPM adjustment encourages states to enact a model statute in order to receive their full share of MSA payments. Because they had not enacted a model statute by the end of 2000, 16 states had amounts withheld from their January 2001 payments.[21] An independent auditor initially determines how much, if any, market share has been lost and reduces the MSA payments for this loss. However, amounts withheld from the payments are held in escrow pending a final determination by an independent team of economists as to whether the market share loss was a result of the MSA. As of April 2001, all states had enacted model statutes, so the NPM adjustment will not affect future payments.

[19]WEFA, Inc., *A Forecast of U.S. Cigarette Consumption (2000-2020) for Alabama 21st Century Authority* (September 12, 2000).

[20]A number of factors affect cigarette consumption such as pricing, advertising, health warnings, restrictions on smoking in public places, nicotine dependence, youth consumption, population trends, and disposable income. Cigarette consumption in the United States peaked in 1981 and has been declining since.

[21]These states were Alabama, Arizona, California, Connecticut, Delaware, Hawaii, Kentucky, Massachusetts, Michigan, New York, North Carolina, Oregon, Pennsylvania, Vermont, Wisconsin, and Wyoming.

Excise Taxes Provide Another Source of Tobacco Related Revenues

MSA payments are not the only source of tobacco-related revenue. State excise taxes on tobacco products represent a state-controlled source of tobacco-related revenue for all 50 states, although cigarette tax rates vary widely—from a low of 2.5 cents a pack in Virginia to a high of $1.11 in New York. The 46 MSA states collected nearly $7 billion in revenues in 2000 from excise taxes on cigarettes, which were not directly affected by the MSA. Between January 1999 and January 2001, four of the 46 MSA states—Louisiana, Maryland, New Hampshire, and New York—increased their tax rates on cigarettes. These increases drove the average cigarette tax rate in the 46 states up by about 5 percent over two years, from 39.8 cents in January 1999 to 41.8 cents in January 2001.

Many States Earmarked MSA Payments for Specific Purposes

Most state legislatures viewed the MSA payments as a discrete funding stream and engaged in a structured decision-making process to determine long-term uses for these revenues. Although most states will continue to appropriate MSA payments through an annual or a biennial budget process, those appropriations will be guided by long-term legislation earmarking the use of the funding stream for specific purposes. As part of the decision-making process, some states established planning commissions and working groups to develop recommendations that resulted in a strategic plan for the state's use of the funds. In six states voter-approved initiatives restricted the use of the funds. Forty-two of the 46 states have made decisions about the allocation of MSA payments, and in 30 of these states the legislature enacted laws to ensure that these payments are restricted or used for specific purposes. Of the states with these legislative goals, almost all established dedicated funds that separate the MSA payments from other state funding sources. New York did not establish dedicated funds but enacted restrictions on the use of the payments which are deposited directly into the state's general fund. Six states (Alaska, California, Georgia, Illinois, New Jersey, and Rhode Island) had not earmarked the payments deposited into the state's general fund; in these states decisions on uses of the MSA payments were made as part of the annual appropriations process.

States Engaged in Decision-Making Processes Focused on MSA Payments

The states have engaged in a decision-making process involving considerable deliberations over the long-term use of MSA payments. In some states, a permanently established board or a special committee makes recommendations and oversees the use of a portion of the payments. Other states, including Maryland and Ohio, engaged in a comprehensive planning process to develop initial recommendations for use of the MSA payments. In Maryland, the Governor convened three task forces, each focused on one of three areas—smoking cessation, health, and agricultural initiatives. Composed of legislators, experts in the field, and community and business representatives in each of these areas, these groups developed recommendations for each program area. Each task force prepared an implementation plan and presented a final report to the Governor that was used to develop a 10-year budget proposal. In Ohio, a bipartisan task force composed of representatives from the legislature and the Governor's administration developed recommendations that resulted in legislation creating a long-term plan for allocation of the MSA payments. The plan allocates the payments for specific purposes through fiscal year 2012 and establishes three new commissions and foundations. The plan also requires the state's Tobacco Oversight Accountability Panel to develop benchmarks for each of seven dedicated funds that were created.

Some States Used Ballot Referenda to Determine Allocations

In seven states ballot initiatives were proposed by the legislature to restrict the use of some portion of the MSA payments, and in six of the states these proposals were approved by voter referendum. In Arizona and Arkansas laws were enacted, and in Louisiana, Montana, Oklahoma, and Utah constitutional amendments proposed by the legislature were approved.[22] All of the ballot initiatives proposed the creation of dedicated funds to restrict at least a portion of the MSA payments. In some of the states the ballot initiatives were supported by local health advocacy organizations.

In four of these states (Arkansas, Louisiana, Montana, and Oklahoma), portions of the endowment funds are earmarked for tobacco control and health care programs. In Arizona, the ballot initiative dedicated the full amount of MSA payments to expanding eligibility for the state's health insurance program. In Utah, an endowment fund was established, but the fund was not dedicated to any particular purpose. These initiatives become effective between fiscal years 2000 and 2002, and in some states, the proportion of MSA payments allocated for specific purposes increases over the first few years of the agreement in order to reach a specified level of funding.

In Oregon, two ballot initiatives proposed by the legislature were defeated by the voters in the November 2000 election. Both proposals would have

[22]In Louisiana, the ballot initiative was proposed and passed in the November 1999 election; the other five states' ballot initiatives were passed in the November 2000 election.

dedicated all MSA payments to special funds allowing only the earnings on the principal to be spent. One of the initiatives would have earmarked the MSA payments for the state's health insurance program, maximizing funding for the State Children's Health Insurance Program (SCHIP) in particular, and the other proposed allocating funds for health care and tobacco control as well as other social services. As both proposals were defeated, the decision over allocation of MSA payments was referred back to the legislature.

Four States Had Not Made Decisions on the Use of MSA Payments

Oregon, Pennsylvania, Tennessee and Missouri had not reached decisions about the use of the payments as of April 2001. In Oregon, after the defeat of the two ballot initiatives the Governor's budget recommended earmarking the MSA payments for health care and tobacco control programs and establishing a dedicated fund for the majority of the payments. In Pennsylvania, the Governor submitted budget recommendations for the use of the payments, but the legislature had not acted on these proposals. The Governor's proposed "Health Investment Plan" for the MSA payments presented principles developed with public input to guide use of the MSA payments and recommended dedicating the payments for health care and tobacco control programs. In Tennessee, the legislature earmarked the payments for two purposes—agriculture and health—and established two ad hoc committees to develop recommendations on the specific uses of the funds. The committees held public hearings, developed proposals for program oversight and funding, and presented their final reports in February 2001 for consideration by the General Assembly. These three states have placed their payments in holding accounts until final decisions are made. Missouri achieved state-specific finality in late April 2001 and had not received any MSA payments during the period of our study.

Many States Established Dedicated Funds for MSA Payments

Thirty-six of the 46 MSA states established dedicated funds to separate at least a portion the MSA payments from other state funds and dedicate their use for specific purposes. In many cases, both the principal and investment earnings of these funds are available for expenditure, while in other cases only the earnings may be used. For simplicity, in this report we refer to the former as special funds and the latter as endowment funds.[23] Endowment funds are intended to ensure a long-term source of funding for programs. In many cases, boards and/or commissions oversee these funds. In some cases these bodies make recommendations for the use of the funds and in other cases they have the authority to make decisions and distribute the funds in keeping with the dedicated uses of the funds. Although over three-fourths of the states established dedicated funds for their MSA payments, only about 35 percent of the total payments were allocated to these funds during fiscal year 2001. Of this 35 percent, about 28 percent were in special funds and the remaining 7 percent in endowment funds. Table 4 shows the funds established by each of the states and how the fiscal year 2001 MSA payments in each state were allocated among fund types.

[23]Many states refer to these earmarked funds as trust or endowment funds. However, the states are inconsistent in their definitions of this term. For example, the same type of fund may be referred to as a trust fund in one state and an endowment fund in another state. In a couple of states, the fund structures do not fit precisely into one of our fund categories. In these cases, we categorized the funds according to our determination of closest fit. For example, New Mexico allocated a percentage of its settlement monies to a “permanent fund,” which cannot be spent for any purpose without new legislation. We categorized it as an endowment because the principal of this fund cannot be spent.

Table 4: States' Dedicated Funds and Allocation of MSA Payments in Fiscal Year 2001

	Dedicated fund type		Percent allocation of receipts		
State	Special	Endowment	Special	Endowment	General
Alabama	X		66	0	34
Alaska			0	0	100
Arizona	X		66	0	34
Arkansas	X	X	75	25	0
California			0	0	100
Colorado	X	X	46	54	0
Connecticut	X		12	0	88
Delaware	X		100	0	0
Georgia			0	0	100
Hawaii	X	X	40	25	35
Idaho	X	X	[a]	100	0
Illinois			0	0	100
Indiana	X		20	0	80
Iowa	X		100	0	0
Kansas	X		28	0	72
Kentucky	X		100	0	0
Louisiana	X	X	55	45	0
Maine	X		100	0	0
Maryland	X		100	0	0
Massachusetts	X	X	30	70	0
Michigan	X		100	0	0
Missouri			[b]	[b]	[b]
Montana		X	0	40	60
Nebraska	X	X	19	81	0
Nevada	X	X	90	10	0
New Hampshire	X		100	0	0
New Jersey			0	0	100
New Mexico	X	X	40	60	0
New York			0	0	100
North Carolina	X		100	0	0
North Dakota	X		100	0	0
Ohio	X	X	99	1	0
Oklahoma		X	0	49	51
Oregon			[b]	[b]	[b]

State	Dedicated fund type		Percent allocation of receipts		
	Special	Endowment	Special	Endowment	General
Pennsylvania			[b]	[b]	[b]
Rhode Island			0	0	100
South Carolina	X	X	100	0	0
South Dakota	X	X	[a]	100	0
Tennessee		X	[b]	[b]	[b]
Utah		X	0	50	50
Vermont	X	X	100	[a]	0
Virginia	X		60	0	40
Washington	X		3	0	97
West Virginia	X	X	50	50	0
Wisconsin	X		12	0	88
Wyoming	X	X	[a]	100	0
Total[c]	**32**	**19**	**n/a**	**n/a**	**n/a**

[a]Includes interest earnings from other dedicated funds.

[b]Four states had not made decisions on the use of payments as of April 2001. Tennessee established an endowment fund but did not allocate payments to this fund.

[c]36 states established at least one type of dedicated fund; 15 of those states established both special and endowment funds.

Source: GAO analysis.

In establishing dedicated funds, several state legislatures opted to delegate decision-making authority over use of the funds to boards and/or commissions. For example, Virginia created the Tobacco Indemnification and Community Revitalization Commission (TICR). The Commission is composed of state legislators, agency heads, representatives of the agricultural community, and other citizens. While the MSA payments to the TICR fund may only be used for payments to tobacco farmers and economic development in tobacco communities, the Commission determines the specific allocations from the fund. In Oklahoma, voters approved the creation of the Tobacco Settlement Endowment Trust Fund and a Board of Directors distributes the earnings of the fund among specified programs. Ohio created two new foundations that receive MSA payments, the Tobacco Cessation and Control Foundation and the Southern Ohio Agricultural and Community Development Foundation. Each of these foundations is governed by a separate board of trustees.

States Use MSA Payments for Many Purposes

The Master Settlement Agreement does not require states to use the payments for any particular purpose and states had varying views of the settlement payments. Because claims for compensation for past health care costs, including Medicaid, were the basis for many of the initial lawsuits filed by the states, many states gave high priority to the use of MSA payments for health related funding and tobacco control programs. Some states also told us that they viewed the settlement payments as an opportunity to fund needs that they were not able to fund previously due to the costs of health care. States' other priorities and mandates included education, infrastructure projects and funding budget reserves to be saved for future needs. As a result, the states' total allocations fund a variety of programs. Figure 1 shows the major categories of states' use of MSA payments.

Our analysis of states' use of MSA payments shows that during fiscal years 2000 and 2001 states allocated seven percent of their payments to tobacco control efforts and another six percent for tobacco growers and economic development projects. The single largest category of funding was for health related purposes. Other major areas of funding included education and social services, infrastructure and general purposes including budget reserves. Finally, a substantial amount of the MSA payments was not allocated during the two fiscal years. States reported on a total of $11.6 billion in estimated MSA payments for fiscal year 2000 and 2001. (See appendix I for definitions of the allocation categories and a description of our methodology.) Table 5 shows the percentage of each state's individual allocation to these categories.

Table 5: Percent Allocations of MSA Payments by Category, State Fiscal Years 2000 and 2001

State	Tobacco control[a]	Assistance for tobacco growers and economic development in tobacco states	Health	Other budget priorities: Education and social services	Other budget priorities: Tax reductions	Other budget priorities: Infrastructure	Other budget priorities: General purposes/ reserves	Other budget priorities: Unallocated[b]	Total
Alabama	0.2	7.1	37.6	46.4	0.0	0.0	8.7	0.0	100.0
Alaska	6.1	0.0	91.2	2.6	0.0	0.0	0.0	0.0	100.0
Arizona	0.0	0.0	80.0	0.0	0.0	20.0	0.0	0.0	100.0
Arkansas	5.7	0.0	35.8	0.0	0.0	5.7	0.0	52.9	100.0
California	0.0	0.0	100.0	0.0	0.0	0.0	0.0	0.0	100.0
Colorado	10.6	0.0	22.1	13.4	0.0	0.7	0.0	53.2	100.0
Connecticut	1.9	0.0	29.6	22.4	38.2	0.0	7.8	0.0	100.0
Delaware	5.0	0.0	24.9	0.0	0.0	0.0	26.2	43.9	100.0
Georgia	4.6	23.1	31.8	0.0	0.0	0.0	0.0	40.5	100.0
Hawaii	15.2	0.0	21.3	0.0	0.0	0.0	24.4	39.0	100.0
Idaho	5.8	0.0	0.0	0.0	0.0	0.0	0.0	94.2	100.0
Illinois	4.8	0.0	15.0	0.3	51.7	4.1	24.1	0.0	100.0
Indiana	12.0	0.0	29.7	0.0	0.0	3.4	0.0	54.8	100.0
Iowa	7.6	0.0	37.1	0.0	0.0	0.0	52.5	2.8	100.0
Kansas	0.4	0.0	0.0	27.6	0.0	0.0	72.0	0.0	100.0
Kentucky	2.0	50.0	8.7	39.3	0.0	0.0	0.0	0.0	100.0
Louisiana	0.5	0.0	65.7	27.5	0.0	3.1	3.3	-0.1	100.0
Maine	19.4	0.0	69.8	8.8	0.0	0.0	0.9	1.2	100.0
Maryland	5.5	3.5	53.3	16.3	0.0	0.0	24.8	-3.4	100.0
Massachusetts	5.2	0.0	90.3	0.0	0.0	4.5	0.0	0.0	100.0
Michigan	0.0	0.0	28.0	57.7	0.0	0.0	0.0	14.3	100.0
Missouri[c]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0	100.0
Montana	11.5	0.0	16.4	2.6	0.0	0.0	69.5	0.0	100.0
Nebraska	19.8	0.0	80.2	0.0	0.0	0.0	0.0	0.0	100.0
Nevada	10.0	0.0	35.0	55.0	0.0	0.0	0.0	0.0	100.0
New Hampshire	3.2	0.0	0.0	96.4	0.0	0.0	0.5	0.0	100.0
New Jersey	8.8	0.0	71.8	9.6	0.0	2.2	7.6	0.0	100.0
New Mexico	2.6	0.0	22.9	0.0	0.0	0.0	71.4	3.1	100.0
New York	4.5	0.0	58.1	0.0	0.0	0.0	37.4	0.0	100.0
North Carolina	0.0	75.0	25.0	0.0	0.0	0.0	0.0	0.0	100.0

State	Tobacco control[a]	Assistance for tobacco growers and economic development in tobacco states	Health	Other budget priorities: Education and social services	Tax reductions	Infrastructure	General purposes/ reserves	Unallocated[b]	Total
North Dakota	0.0	0.0	10.0	45.0	0.0	45.0	0.0	0.0	100.0
Ohio	31.3	3.0	2.0	1.8	0.0	18.4	2.7	40.8	100.0
Oklahoma	1.3	0.0	64.6	2.7	0.0	0.0	31.3	0.0	100.0
Oregon[d]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0	100.0
Pennsylvania[d]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0	100.0
Rhode Island	0.0	0.0	0.0	0.0	0.0	0.0	100.0	0.0	100.0
South Carolina	1.1	0.0	98.9	0.0	0.0	0.0	0.0	0.0	100.0
South Dakota	1.4	0.0	0.0	0.0	0.0	0.0	0.2	98.4	100.0
Tennessee[d]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0	100.0
Utah	8.3	0.0	19.7	4.1	0.0	0.0	50.0	17.9	100.0
Vermont	29.9	0.0	68.2	0.0	0.0	0.0	0.0	1.9	100.0
Virginia	10.0	50.1	0.0	0.0	0.0	0.0	39.9	0.0	100.0
Washington	33.4	0.0	66.3	0.0	0.0	0.0	0.2	0.0	100.0
West Virginia	4.4	0.0	95.6	0.0	0.0	0.0	0.0	0.0	100.0
Wisconsin	8.1	0.0	75.4	0.0	0.0	0.0	16.5	0.0	100.0
Wyoming	100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
Total state allocations	**6.8**	**5.6**	**41.3**	**9.3**	**3.6**	**2.5**	**10.6**	**20.2**	**100.0**
Total number of states	**36**	**7**	**35**	**19**	**2**	**10**	**23**	**21**	

[a]See table 6 for more information on states with previous funding for tobacco control prior to the MSA and states in which an unspecified amount of MSA funding was provided for tobacco control.

[b]Unallocated category may include adjustments for over-allocation of MSA payments.

[c]Missouri had not received any MSA payments.

[d]Had not decided how to spend MSA payments.

Source: GAO analysis.

States' Allocations for Tobacco Control Varied Widely

According to our analysis, in fiscal years 2000 and 2001, 36 states allocated $790 million of their MSA payments to tobacco control programs. The goal of these programs is to reduce tobacco use through various intervention strategies including promoting smoking cessation and preventing youth from starting to smoke. The amounts of the state allocations to these programs varied widely. In approximately one-third of the states, the development of a strategic plan for tobacco control is now required. In allocating MSA payments for tobacco control programs, most states applied guidelines established by the Centers for Disease Control and Prevention (CDC) to some extent. Tobacco control is one area where looking only at MSA payments can be misleading. While all of the 42 states which were decided on the use of the payments now provide state funding for tobacco control programs, two of these states, Arizona and California, fund these programs through state cigarette excise taxes rather than through their MSA payments. Sixteen other states reported that they provided state funding for tobacco control prior to the MSA. Further, although over one-quarter of the states with decisions on MSA payments allocated at least 10 percent of their MSA payments to tobacco control, most of these states had spent little or nothing on tobacco control programs prior to the settlement. Some states allocated payments for tobacco control but did not specify the amount for these programs. Table 6 summarizes the percentage of the states' allocation of their MSA payments to tobacco control programs.

Table 6: Percentage of MSA Payments Dedicated to Tobacco Control for State Fiscal Years 2000 and 2001 (excluding Missouri, Oregon, Pennsylvania, and Tennessee)

	Previous funding[a]	No funding	Less than 5	6-10	11-20	21-100	Amount unspecified[b]
Alabama	x		x				
Alaska[c]	x			x			
Arkansas[c]	x			x			
Arizona[c]	x	x					
California[d]	x	x					
Colorado					x		
Connecticut			x				
Delaware[c]	x		x				
Georgia			x				
Hawaii					x		
Idaho[c]	x			x			
Illinois			x				
Indiana					x		
Iowa				x			
Kansas			x				
Kentucky			x				

	Previous funding[a]	No funding	Less than 5	6-10	11-20	21-100	Amount unspecified[b]
Louisiana			x				
Maine					x		
Maryland[c]	x		x				
Massachusetts[c,d]	x		x				
Michigan	x						x
Montana					x		
Nebraska					x		
Nevada				x			
New Hampshire			x				
New Jersey				x			
New Mexico[c]	x		x				
New York[c]	x		x				
North Carolina							x
North Dakota							x
Ohio						x	
Oklahoma[c]	x		x				
Rhode Island							x
South Carolina[c]	x		x				
South Dakota[c]	x		x				
Utah[c]	x			x			
Vermont						x	
Virginia				x			
Washington[c]	x					x	
West Virginia			x				
Wisconsin[c]	x			x			
Wyoming						x	
Total	**18**	**2**	**17**	**9**	**6**	**4**	**4**

[a]State funding for tobacco control prior to the MSA.

[b]State in which an unspecified amount of MSA funding for tobacco control was included in allocations for health programs or in the general fund.

[c]State is using MSA payments to supplement current tobacco control funding.

[d]State had model tobacco control program as defined by CDC prior to the MSA. (Oregon also has a model program.)

Source: GAO analysis.

MSA Payments Allowed States to Establish or Expand Tobacco Control Programs

For the most part, the states that dedicated larger percentages of their MSA payments to tobacco control were states that spent little or nothing on such programs prior to the settlement. The MSA provided 24 states that reported they had not provided any state funds for tobacco control[24] prior to the agreement the opportunity to initiate funding for these programs.[25] Fourteen states said that the MSA payments have allowed them to develop and implement more comprehensive tobacco control programs. (See Table 6 for these 14 states.)

Ten states dedicated over 10 percent of their MSA payments to tobacco control. Of these states, only Washington had dedicated state funds to tobacco control prior to the MSA. Three of these states, Hawaii, Ohio, and Virginia have established foundations to develop new tobacco control programs. Wyoming has dedicated its settlement payments to an endowment fund and all of the interest in fiscal years 2000 and 2001 was allocated to tobacco control.

Washington, New York and Maryland are examples of states that used tobacco settlement payments to significantly expand existing programs. Washington allocated over 33 percent of its MSA payments to create a new $100 million trust fund dedicated to prevent and reduce tobacco use by youth; it had previously provided less than $1 million for enforcement activities. Maryland provided $18.1 million, or 5.5 percent, of its settlement payments in fiscal year 2001 to fund a comprehensive tobacco control program and plans to meet the CDC guidelines in the future. Prior to the settlement, Maryland had allocated approximately $1.8 million in state funds for its tobacco control program. New York allocated $30 million or 4.5 percent of its MSA payments in fiscal year 2001 to expand its tobacco control program which was previously funded with $2.5 million in state funds. New York also nearly doubled its cigarette excise tax to $1.11 from 56 cents a pack with the proceeds of the tax increase designated for expansion of the state's health insurance and tobacco control programs.

[24]Most states had small programs in place, which were funded exclusively with federal grants from agencies such as CDC and the Substance Abuse and Mental Health Services Administration (SAMHSA). In addition, states funded enforcement activities required under the Substance Abuse Prevention and Treatment Block Grant program, pursuant to 42 U.S.C. § 300x-26.

[25]Additionally, in Tennessee, although there was no final decision on the use of the MSA payments, 50 percent of the state's total payments were earmarked for health, and the health advisory committee recommended that a portion of that amount be allocated to tobacco control programs.

States Applied CDC Guidelines to Varying Degrees

A CDC report entitled *Best Practices for Comprehensive Tobacco Control Programs* sets out nine essential elements for a comprehensive program and provides CDC's recommendations for an appropriate level of funding for each component based on specific characteristics of each state.[26] Budget officials in 35 of the 46 MSA states told us that their state considered the CDC guidelines in determining how to allocate settlement funds. In another four states in which budget officials said that their state did not apply the guidelines, the pre-existing tobacco control programs have been cited as model programs by the CDC (Arizona, California, Massachusetts, and Oregon). The CDC reports that six states in our study (Arizona, Indiana, Maine, Massachusetts, Ohio, and Vermont) are meeting or exceeding the lower estimate of their recommended funding range by combining state and federal resources and private grants. In addition, Hawaii (at 98 percent) came close to meeting the *Best Practices* lower funding recommendations.

Of the states with model tobacco control programs, Arizona, California, and Oregon did not supplement their programs with allocations from the MSA payments. Officials in Arizona said that the state already spent $37.3 million from tobacco excise tax revenues in fiscal year 2001. California was the first state to establish a comprehensive tobacco control program funded by tobacco excise taxes in 1989 and the excise tax provided $114.6 million for tobacco control in fiscal year 2001. Oregon spends approximately $8.5 million annually for tobacco control, and the governor has also proposed that part of the settlement be used to expand tobacco control programs. Massachusetts did provide additional funding for tobacco control and allocated a total of $31 million in MSA payments in fiscal years 2000 and 2001 to supplement its program, bringing the total annual allocation to $63.3 million in fiscal year 2001.

States Allocated Largest Share of MSA Payments to Health Care

Thirty-five states allocated a portion of their MSA payments for health-related purposes not specifically related to tobacco control for a total of nearly $4.8 billion in fiscal years 2000 and 2001. These allocations include funding for Medicaid and SCHIP, mental health, substance abuse, public health, medical research, medical technology, and long-term care. The extent to which these states allocated MSA payments for health purposes varied considerably: 16 states allocated more than half of their payments to

[26]Centers for Disease Control and Prevention, *Best Practices for Comprehensive Tobacco Control Programs—August 1999.*

health care and in several of these states health allocations composed more than 90 percent of the state's total MSA payments. California was the only state that allocated all of its payments to health programs in fiscal years 2000 and 2001. (See Table 5 for the share of each state's allocation to health care.)

Eighteen states reported that they have used MSA payments to increase enrollment in existing health insurance programs for low-income individuals, usually through Medicaid or SCHIP.[27] In addition, several of these states have allocated their MSA payments to implement SCHIP for the first time (e.g., Hawaii, Montana, and Utah). Other states allocated payments for Medicaid and SCHIP but used these amounts for purposes other than expanding health insurance coverage, such as increasing services for existing beneficiaries, increasing reimbursement rates to providers, and providing prescription drug coverage for senior citizens.

Arizona, California and New York are examples of states that used MSA payments to significantly expand state health care programs. In all three states the health care expansion is expected to cost more than the state's total MSA payments, and the state plans to use other funding sources to fully fund the programs. In Arizona the voter referendum dedicated all of the state's MSA payments to a large expansion of the Arizona Health Care Cost Containment System (AHCCCS)—Arizona's Medicaid program. Beginning in fiscal year 2002, eligibility for AHCCCS will be expanded to all people with incomes below 100 percent of the federal poverty level, increasing access for as many as 380,000 people. This expansion is expected eventually to cost as much as $140 million per year. California used all of its MSA payments, a total of $900 million, to expand the state's public health insurance programs. This expansion will encompass several programs and include services for all individuals eligible for SCHIP, enhanced Medicaid coverage for working families, and increased payment rates for providers who participate in the state's public health insurance programs, including Medicaid. Similarly, New York enacted a new Health Care Reform Act (HCRA 2000) and dedicated $388 million to create a new, comprehensive program for the uninsured. This program, called "Healthy New York," which will eventually receive 70 percent of the state's annual MSA payments, also encompasses several initiatives including expansion

[27]These states were Alabama, Arizona, Arkansas, California, Connecticut, Delaware, Georgia, Hawaii, Kentucky, Maine, Massachusetts, Montana, New Jersey, New Mexico, New York, South Carolina, Utah, and Washington.

of SCHIP to include parents of children already covered by the program; increases in Medicaid eligibility to include families with incomes below 150 percent of the federal poverty level and individuals with incomes below 100 percent of the federal poverty level; and health insurance subsidies for certain individuals, families, and small businesses.

Some Tobacco States Provide Assistance for Tobacco Growers and Economic Development Projects

Seven of the 13 tobacco states allocated $651 million of their MSA payments for assistance to tobacco growers and/or economic development projects. Because most tobacco farming and manufacturing jobs are concentrated in regions in just a few states, declines in tobacco consumption could result in job losses in all sectors of the economy of these areas.[28] To help mitigate these economic consequences, these states allocated a total of 14 percent of their MSA payments to fund projects aimed at stabilizing the economy of the tobacco regions within the state and 7 percent for direct payments to tobacco growers. North Carolina, Kentucky and Virginia, which produce 74 percent of the country's tobacco crop, allocated MSA payments for both of these purposes. Of the six tobacco states that did not allocate payments for either of these purposes, Indiana and West Virginia produce a relatively small share of the country's tobacco, South Carolina plans to allocate payments for these purposes in the future, and the remaining three states had either not received MSA payments or not made a decision on the use of their payments. Table 7 shows the percentage of each state's MSA payments allocated for each of these purposes in fiscal years 2000 and 2001.[29]

[28]An earlier GAO report, *Tobacco: Issues Surrounding a National Tobacco Settlement* (GAO/RCED-98-110, April 15, 1998), studied the potential effects of a tobacco settlement on the economy of this region.

[29]Tobacco growers also receive additional payments as part of a separate, "Phase II," agreement with the tobacco industry. See appendix VI for information on this agreement.

Table 7: Percentage of MSA Payments for Economic Development and Tobacco Growers in Ten Tobacco States for State Fiscal Years 2000 and 2001

State	Percent of funds for economic development	Percent of funds for direct payments to tobacco growers
Alabama	7	0
Georgia	23	0
Indiana	0	0
Kentucky	35	15
Maryland	0	4
North Carolina	50	25
Ohio	3	0
South Carolina	0	0
Virginia	15	35
West Virginia	0	0
Average For 10 tobacco states	**14**	**7**

Notes:

1. Table excludes three tobacco states that had either not received funds (Missouri) or had not made decisions regarding allocations (Pennsylvania and Tennessee).

2. North Carolina allotted 25 percent of its settlement payments to a trust fund aimed at assisting tobacco growers—all or part of which will be used to make direct payments to these growers. However, the state had not yet allocated specific amounts for specific purposes.

3. Georgia's funding for economic development includes funds that may be used to compensate farmers in the event of crop loss due to drought.

Economic Development Projects in Tobacco States

Six tobacco states allocated MSA payments for economic development projects, mostly in the tobacco regions of these states, in order to ease the burden of declining tobacco production. North Carolina and Kentucky, the two largest producers of tobacco, each allocated substantial amounts of their MSA payments for economic development, whereas Ohio and Alabama, which produce a much smaller amount of tobacco, allocated a relatively small percentage of their payments for this purpose. The tobacco states have taken different approaches to assisting the regions that will be most affected by declines in tobacco consumption.

Several tobacco states used MSA payments to offer educational assistance such as scholarships to community colleges and job training for tobacco growers to help them transition to other careers. Several states also funded research projects to identify new uses for tobacco or other cash crops that farmers could grow instead of tobacco. In addition, several states used

MSA payments to provide economic incentives to help develop the economy of rural tobacco regions. For example, Alabama securitized a portion of the MSA payments to finance economic development projects including construction of an automobile manufacturing plant. While some initiatives focused on tobacco regions, some were broader. Some states used MSA payments for statewide agricultural priorities that affect tobacco growers indirectly. Georgia, for example, used payments for rural sewer and water projects.

Kentucky and North Carolina both allocated substantial amounts for economic development in tobacco regions. Kentucky established the Agricultural Development Fund which received 35 percent, or $87 million, of the state's MSA payments. Kentucky plans to provide a variety of economic assistance programs to the state's agricultural community, including programs that will provide business development and technical assistance to farmers and distribute funds for farm diversification, cooperative development, marketing, and new product development. North Carolina allocated 50 percent of its MSA payments, a total of $168 million, to projects directed at areas whose economy is dependent upon tobacco production. Specifically, the state created the Golden LEAF (Long-term Economic Advancement Foundation) to provide economic assistance to tobacco-dependent regions of North Carolina. The Golden LEAF will fund a range of programs including education, job training and employment, scientific research to develop new uses for tobacco or alternative cash crops, and recruitment of new industries to rural areas of the state. In December 2000, the foundation awarded $5 million in grant funds for 39 projects.

Direct Payments to Tobacco Growers

Four tobacco states allocated MSA payments for direct payments to tobacco growers. Maryland is the only state that offered to pay farmers specifically to stop growing tobacco; Kentucky and Virginia provided subsidies or direct payments to tobacco farmers with no strings attached. North Carolina has not yet allocated specific amounts for direct payments, but its program will not require farmers to cease or reduce tobacco production.

Maryland and Virginia provide an illustration of two states with different levels of tobacco production and different approaches to using their MSA payments for assistance to tobacco farmers. Maryland convened a special task force that developed a long-term plan with two main components: a tobacco buyout and a tobacco transition program. Both of these programs are designed to encourage farmers to cease tobacco production but to remain in the agriculture business. Only the buyout program was operational in fiscal years 2000 and 2001, and Maryland allocated a total of $11.5 million for this program. Payments will be based on the growers' recent tobacco production and participants will receive payments based on this level of production for a period of ten years to ease the transition to other crops. The state's program requires participants to agree both to permanently cease production of tobacco for cigarettes and other personal consumption, and to keep the land in agricultural production for ten years. The property must also carry a deed prohibiting, in perpetuity, the production of tobacco for cigarettes and personal consumption. In contrast, Virginia focused on compensation rather than reducing production. Virginia allocated 35 percent of its MSA payments, a total of $102 million, for direct payments to tobacco growers. These subsidies are not designed to encourage growers to end tobacco production but are intended to compensate tobacco growers for their business losses such as investments in specialized tobacco equipment and lost production opportunities associated with declines in the demand for tobacco.

MSA Payments Were Also Used for Many Other Budget Priorities

State budget officials said that they used MSA payments to fund other needs and priorities in addition to tobacco control, health care, and assistance to tobacco farmers and communities. For example, education and infrastructure were areas of long-term need that required additional funding that had not been available in some states prior to the MSA. In other cases, states did not make decisions on the use of all of their MSA payments during the period of our study. In fiscal years 2000 and 2001, states left 20 percent of their total MSA payments unallocated and allocated another 26 percent for other priorities such as education and social services, infrastructure projects, and general purposes including budget reserves, attorneys fees and amounts not earmarked for any specific purpose. (See Table 5 for each state's allocations to each of these categories.)

Education and Social Services

States allocated over $1 billion of their MSA payments to education and social services including programs for children and senior citizens. Of this amount, 12 states allocated $848 million in MSA payments to education. This category included allocations for preschool and daycare programs, elementary and secondary education (grades kindergarten through 12) and higher education. Louisiana and Maine allocated MSA payments to preschool and daycare programs, such as Head Start. Nine states (Colorado, Connecticut, Kentucky, Louisiana, Maryland, Montana, New Hampshire, North Dakota, and Ohio) allocated funds to local districts for a range of purposes including upgrading technology, increasing teachers' salaries, enhancing teacher training and augmenting special education programs. Seven states (Connecticut, Kentucky, Louisiana, Maryland, Michigan, Nevada, and Ohio) allocated funds for higher education programs at colleges, universities, and community colleges and some of these allocations included funding for new college scholarship programs.

In the area of elementary and secondary education, New Hampshire allocated 96 percent of its MSA payments, $92 million, to elementary and secondary education in order to comply with a state court decision on funding of the state's public schools. In 1997, the New Hampshire Supreme Court ruled that the state's reliance on local property taxes to fund nearly 90 percent of the cost of public education placed a disproportionate burden on residents in districts with low property values. Prior to the MSA, the state had attempted to address the court decision by increasing statewide property taxes, but the court subsequently ruled that the plan to phase in the property tax increase in certain districts with higher property values was unconstitutional. As a result, New Hampshire relied on MSA payments as a source of additional funding for local school districts.

Michigan focused on higher education and created a program that will allocate 75 percent of its MSA payments beginning in fiscal year 2002 to provide college scholarships for high school students who achieve certain scores on statewide examinations. Officials told us that this program was a long-time priority for Michigan's Governor, but prior to the MSA payments the state did not have sufficient resources available to fund the program. Students received grants for the first time in fall 2000, totaling $60 million. Under the program, high school juniors and seniors who pass an assessment test may receive a one-time $2,500 grant to pay for college. Also, students currently in grades 7 and 8 who pass the test may receive a $500 grant when they go to college in addition to the $2,500 grant. Students have up to seven years from the time they graduate to claim their grants.

Kansas (28 percent) and Alabama (45 percent) each allocated a substantial portion of their MSA payments to children's programs. These states funded programs for children in a variety of areas, including health and education, for services such as immunizations, after-school activities, mentoring efforts, and research, but they did not specify the precise amounts allocated to each of these areas. Kansas established the Kansas Endowment for Youth (KEY) Fund which will be invested to provide a permanent source of funding for children's programs. In fiscal years 2000 and 2001, the state allocated a total of $55 million from this fund for at-risk youth, prenatal care, parent education, pediatric biomedical research, and school violence prevention. Beginning in fiscal year 2001, Kansas will direct all of its MSA payments to KEY and a set percentage of the fund will be allocated for children's programs each year . Similarly, Alabama allocated over $100 million of its MSA payments to its Children First Trust Fund. According to a state official, the Governor and legislature felt there was a need for new programs serving children and adolescents, but because Alabama earmarks nearly all of its revenue, little funding was available for new programs. The MSA payments provided the state with a new funding source. Alabama's trust fund was used to pay for programs including school safety, foster care, juvenile justice, teen pregnancy, literacy, and drug and alcohol abuse.

Infrastructure

Ten states allocated $294 million for physical infrastructure purposes. States dedicated MSA payments to four types of physical infrastructure: health care, long-term care and retirement facilities, education facilities, water and transportation projects, and municipal and state buildings. Arizona, Arkansas, Colorado, Indiana, and Massachusetts allocated payments to construction and renovation of health facilities such as hospitals, medical research facilities, home health centers, and retirement facilities for veterans. In addition, Arkansas, New Jersey, and Ohio allocated payments for constructing, upgrading, and/or remodeling schools and universities. Louisiana and North Dakota allocated MSA payments for transportation and water projects. Finally, Illinois and Louisiana used payments to improve municipal and state buildings.

Both North Dakota and Ohio are examples of states that plan to allocate millions annually to infrastructure projects. North Dakota enacted legislation placing 45 percent of the state's annual MSA payments in a water management trust fund dedicated for projects related to the state's long-term water development and management needs. Also, the fund will be used to repay bonds the state issued to finance several flood control projects, the Southwest Pipeline project, and a lake outlet project. Ohio used 18 percent of its allocations, or $138 million, for school construction which has been a recent priority in Ohio. The state created two dedicated funds—an endowment to provide a permanent source of revenue for capital projects for education and a trust fund to begin funding construction and renovation projects for elementary and secondary schools.

Tax Reductions

Only Connecticut and Illinois used MSA payments explicitly to fund tax reductions, but the total amounts they allocated for this purpose were large

4 percent of the total MSA allocations for all states. Connecticut used a total of 38 percent, or $50 million per year, of its MSA payments for property tax reductions. Illinois used 50 percent of its MSA payments, $316 million, for an earned income tax credit and a one-time property tax reduction. For both states, these were part of a series of recent tax reductions.

Funds Allocated for Budget Reserves and Other General Purposes

States allocated $1.2 billion for budget reserves and other general purposes. Of this amount, $602.8 million was allocated for state budget reserves or rainy day funds, which act as state savings accounts, allowing states to save for a future economic downturn or emergency. Nine states (Delaware, Hawaii, Illinois, Louisiana, Montana, New Jersey, New Mexico, New York, Oklahoma) allocated MSA payments to reserves. Budget officials in five of these states told us that their state made one-time deposits to a rainy day or reserve fund and does not plan to allocate further payments for this purpose. New York made a one-time allocation of 37 percent of its MSA payments to the state's Debt Reduction Reserve Fund.

Hawaii and New Mexico took unique approaches to making allocations to budget reserves. Hawaii plans to allocate 40 percent of its MSA payments each year to a new rainy day fund that was established as a result of MSA payments; prior to the settlement, the state did not have a rainy day fund. New Mexico created a special long-term reserve fund that is distinct from a rainy day fund. New Mexico devotes 50 percent of its MSA payments to a special "permanent fund," which is intended to be a long-term savings fund for the benefit of future generations. New legislation would be required to access this fund. New Mexico had other permanent funds with assets totaling more than $12 billion.

Sixteen states allocated $623 million of the MSA payments for other general purposes. This category includes allocations to the state's general fund—not earmarked for any particular purpose—and some allocations for other specific purposes such as attorneys' fees. In most cases, if MSA payments were deposited into the general fund, states could not tell us the purposes for which the payments were used. Iowa, Kansas, Oklahoma, and Wisconsin made one-time transfers to their general funds, and some of these deposits were a substantial portion of the states' MSA payments. For example Kansas made a one-time transfer of $70 million, or 56 percent, to cover revenue shortfalls. Other states decided to allocate set amounts annually to their general fund and to make decisions about the use of these payments on a year by year basis. For example, Virginia allocated

40 percent of its MSA payments each year—over $115 million in fiscal years 2000 and 2001—to its general fund. Rhode Island allocated all of its MSA payments, $100 million in fiscal years 2000 and 2001, to its general fund, and the state plans to continue this practice in the future.

Some states' allocations for general purposes reflected payments for attorneys who worked on tobacco lawsuits; in most cases, these amounts represented a relatively small percentage of MSA allocations. Maryland is unusual among these states in that it has reserved 25 percent of all MSA payments pending resolution of a dispute over attorneys' fees. State officials told us that prior to the MSA, Maryland entered into a contract with a private attorney for a fee equal to 25 percent of the state's share of the settlement. Because the MSA provides for payment of attorneys' fees, this agreement has been contested and the funds have been set aside until the case is resolved.

Unallocated MSA Payments

More than $2 billion of the MSA payments in fiscal years 2000 and 2001 remained unallocated as of April 2001. The 15 states with unallocated funds cited different reasons. In some states there is a year lag between the time the state receives the MSA payments and the time it allocates them for specific purposes. These states followed a practice of allocating only the MSA payments received in the previous fiscal year. In other states, a portion of the MSA payments remained unallocated after the appropriations process, leaving these amounts available for appropriation in future years pending decisions by each state's governor and legislature. In Hawaii state law established a ceiling on the amount of MSA payments available for use; as a result, only a portion of the dollars could be distributed to specific funds during fiscal years 2000 and 2001. Since the state's total MSA payments exceeded the limit, nearly $34 million in unallocated MSA payments will be available for appropriation in the future.

Idaho, South Dakota, and Utah decided to distribute large portions of their settlement payments to endowment funds not designated for any particular purpose. South Dakota created a People's Trust Fund into which all of the state's MSA payments are deposited. The legislation creating the People's Trust Fund did not dedicate the fund for any particular purpose, but only the interest is available to be spent. Similarly, Idaho enacted legislation requiring that all MSA payments be deposited into the Millennium Trust Fund, which is invested but does not have any specified purpose. Each year, the earnings on the fund may be appropriated without restrictions. This endowment fund is simply intended to provide a continuous source of funding for state programs.

Three states—Oregon, Pennsylvania, and Tennessee—had not made final decisions about the allocation of their MSA payments as of April 2001. In addition, Missouri had not received any MSA payments because it did not reach state-specific finality until late April 2001.

Several States Considered Issuing Bonds Backed by MSA Payments

MSA payments have also been used to back bonds, which is known as "securitization." Securitization is a type of structured financing based on the cash flow of receivables or rights to future payments. Securitization structures are different from traditional public finance and are sold differently from traditional municipal bonds. In the process of securitizing, state and local governments sell their tobacco settlement revenue stream to a special purpose entity (SPE) established for the purpose of issuing bonds backed by these funds and paying the debt service on the bonds. The SPE is designed to be legally separate and "bankruptcy remote" from the government entity. This means that the credit rating for these bonds is separate from the state or local government's rating and is based on the credit worthiness of the tobacco industry and the structure of the financing. The government entity does not bear financial responsibility for the bonds, and the purchasers of the bonds bear any risk that the bonds will not be repaid. The interest paid on the bonds issued through securitizing the MSA payments may be either subject to federal and state income taxes or exempt from such taxes, depending on a number of factors including the intended use of the proceeds.

Securitization allows states to receive funds up front rather than over time as MSA payments are made according to the terms of the agreement. States have securitized to finance one-time expenses such as capital projects, paying down existing state or local debt, or establishing an endowment with a large initial amount. States have considered their overall needs in deciding whether to securitize the tobacco settlement revenues. Three states—Alabama, Alaska, and South Carolina—and many counties in New York state have already securitized a portion of the expected revenue stream, and ten additional states told us that securitization was under consideration. Budget officials in other states said that their states have rejected the option of securitizing these assets but that securitization may be considered again in the future.

Alabama and South Carolina, two tobacco states, securitized a portion of their MSA payments to finance economic development projects. Alabama was the first state to securitize MSA payments through an SPE in September 2000. The Alabama 21st Century Authority was created to issue bonds for the purpose of promoting economic and industrial development, and it issued $50 million of tax-exempt bonds to fund an automobile manufacturing plant. In South Carolina, the Tobacco Settlement Revenue Management Authority was created to issue bonds to establish four dedicated funds for specific purposes. Two of the funds, which will receive 25 percent of the proceeds of the bond issue, will be used to provide economic assistance. One will be used primarily to develop the state's water and wastewater infrastructure and one will be used to compensate individuals for losses in tobacco production. In addition, 73 percent of the proceeds of the bond issue in South Carolina will be used to fund a variety of health care programs. South Carolina's bond issue is the largest securitization of MSA payments to date and the first to issue taxable bonds for a portion of the transaction.

New York City was the first locality to securitize MSA payments followed by several of the largest counties in New York State including Erie, Monroe, Nassau and Westchester. In addition, 17 counties in New York participated in a pooled transaction, and additional counties plan to participate in a future pooled transaction. All but two of these counties (Nassau and Westchester) have used the proceeds of the securitization to pay down their debt.[30] For these counties, reducing their total debt has in turn allowed them to improve their individual credit ratings. Westchester County did not issue bonds to pay down existing debt but rather decided on a one-time securitization transaction to pay off its ten-year transitional obligation to subsidize the county medical center. New York City established the Tobacco Settlement Asset Securitization Corporation (TSASC) which issued bonds to finance capital projects including school construction. The City has been constrained by the state's constitutional debt limit for some time and has capital needs that are greater than the debt limit allows. Selling the MSA payment stream to TSASC and issuing bonds for a portion of the future payments allowed the City to proceed with its capital program.

[30]In New York State, the debt limit is governed by the state constitution and is based on a percent (10 percent in New York City) of the full value of taxable real property within a municipality averaged over the current and four preceding fiscal years.

Many States Established Restrictions Against Supplantation

To ensure that MSA payments were used to expand or establish new programs, 16 states enacted legislation including a requirement that MSA payments be used to supplement rather than to replace or supplant existing state funding. The restrictions on supplantation are intended to help ensure that existing state funding will not be reduced and that MSA payments will increase the total amount of funding for selected programs.[31] These restrictions apply to the portion of the state's MSA payments that are deposited in dedicated funds established by states. The majority of these provisions apply to funds earmarked for health care and tobacco control programs. In a few states, these provisions apply to other uses such as education, social services, and agriculture. For example, in Maryland the provision applies to all MSA payments that are earmarked for three purposes—smoking cessation, health, and agriculture. In Louisiana the legislation requires that MSA payments allocated for education be used to supplement rather than replace existing state funding. (See appendix VII for a summary of the states' restrictions against supplantation.) While the remaining states did not enact specific provisions, budget officials in 15 of these states reported to us that it was their policy not to supplant pre-existing funding with MSA payments.

Conclusions and Observations

During state fiscal years 2000 and 2001, most states allocated at least some portion of their MSA payments for tobacco control and health care while also considering other state budget needs. Many tobacco states responded to the demands for assistance to tobacco growers and economic development by providing funding in those areas. Other needs such as education, infrastructure and budget stabilization were also priorities in several states, and a large portion of the MSA payments was not allocated in the two fiscal years of our study.

Consistent with the long-term nature of the MSA payments, states developed plans for the payments including enacting laws and establishing dedicated funds earmarking their future use. Although these plans are intended for the long term, they may be affected by fluctuations in state budget conditions. When the states first began receiving and planning for the use of their MSA payments for fiscal years 2000 and 2001, they were

[31] An earlier GAO report, *Federal Grants: Design Improvements Could Help Federal Resources Go Further* (GAO/AIMD-97-7, December 18,1996), studied supplantation restrictions in the federal grant system.

budgeting during a period of projected surpluses. Most states had the budgetary resources to fund mandated needs from other state revenues to allow them to dedicate the settlement payments for expansions in health care, tobacco control, and other new projects. As the forecasts for state budgets begin to change, states may be faced with more difficult choices in determining the uses of their MSA payments for the near future. The earmarking of the payment stream may have the effect of subsidizing state programs if states reduce their own funding in these areas. States that included provisions against supplantation when they created dedicated funds for the MSA payments, or established endowment funds that prevent the use of the principal, have developed some protection against using the payments to subsidize state programs. States' future decisions over the use of the MSA payments will likely require balancing state-specific priorities and needs within the context of overall budget conditions.

As agreed with your office, unless you release this report earlier, we will not distribute it until 30 days from the date of this letter. At that time, we will send copies to relevant congressional committees and subcommittees and other interested parties. We will also make copies available to others upon request. If you or your staff have any questions concerning this letter, please contact me at (202) 512-9573. Key contributors to this assignment were Thomas James, Amelia Shachoy, John Forrester, Carol Henn, Rosellen McCarthy, Brady Goldsmith, and Thomas Yatsco.

Sincerely yours,

Paul L. Posner

Paul L. Posner
Managing Director
Federal Budget Issues, Strategic Issues

Scope and Methodology

This review focused on states' use of payments received under the Master Settlement Agreement (MSA) for state fiscal years 2000 and 2001. We collected and analyzed budget-related and legislative documents and interviewed officials from the executive budget offices on the plans for use of the MSA payments in the 46 states that were a party to the MSA. In some cases, our discussions included officials from the state attorney general's office, the governor's office and the state agency responsible for tobacco control programs. We also reviewed previous GAO reports and other recent reports and studies, and we spoke with representatives from the organizations conducting these studies.[1] We spoke with experts to obtain background information on specific issues covered in this report, such as the legal provisions of the MSA and securitization of MSA payments. We conducted our work from July 2000 through April 2001 in accordance with generally accepted government auditing standards.

We obtained information on the states' plans for MSA payments through state fiscal year 2001. We conducted our work and collected information for fiscal year 2001 while the fiscal year was in progress and states were at various stages in the process of planning for the use of their payments. Because we completed our fieldwork in April, we did not obtain final information for the fiscal year, which for most states ends on June 30.[2] In order to present as comprehensive a review as possible, we report on the total amounts planned for by states even if final decisions were not made or all amounts were not appropriated by the legislature. We refer to these total amounts planned for and reported by states as "allocations." State allocations for fiscal years 2000 and 2001 totaled $11.6 billion. While we did gather budget documentation on states' plans, we did not verify the accuracy of the data reported by states.

[1]See appendix VIII for a list of other reports.

[2]In most states, the state fiscal year begins on July 1 and ends on June 30; the exceptions are: Alabama and Michigan, where the fiscal year begins on October 1, and New York, where the fiscal year begins on April 1.

For informational purposes, we also obtained data on actual MSA payments made by the tobacco companies to states, which totaled $13.5 billion through April 2001.[3] Most states developed plans and allocated dollars based on estimated payments for the fiscal year. Because the payments made by the tobacco companies are subject to adjustments that are not determined until the payments are made, actual payments received by the states differed from estimated payment amounts and from the states' allocations of $11.6 billion. The major difference between the $13.5 billion in payments received and the $11.6 billion in states' allocations is the payments to the counties in California and New York. These payments were reported in the total payments to those states[4] but were not included in the total allocations for those states. Our study tracked only the states' use of MSA payments and not the allocations of counties' share of the payments.

Categorization of States' Allocations

To standardize the information reported by the 46 states, we developed categories for the program areas to which states allocated their MSA payments. (See the definitions of these categories below.) We used states' descriptions of their programs to categorize the $11.6 billion in allocations according to these definitions. In cases where no final decision had been made on the allocation of the payments, we reported these amounts in the "unallocated" category. In cases where the total amount had not been appropriated by the legislature but the funds had been earmarked for a particular purpose (e.g., health), we reported the allocation amounts in the category for which they had been earmarked. We used this method to categorize all allocations including those to dedicated funds and states' general funds. Except where noted in examples of individual state's allocations, for the purposes of our analysis, we combined the states' allocations for fiscal years 2000 and 2001 and reported on the total for the two-year period.

Definitions for Categories of States' Allocations

Economic Development for Tobacco Regions: This category comprises amounts allocated for economic development projects in tobacco states such as infrastructure projects, education and job training programs, and

[3]We obtained this data from the National Association of Attorneys General (NAAG) which monitors the actual payments made to states as determined by an Independent Auditor.

[4]See table 3: Original Estimated and Actual MSA Payments Received by States as of April 2001 for these amounts.

research on alternative uses of tobacco and alternative crops. This category includes projects specifically designed to benefit tobacco growers as well as economic development that may serve a larger population within a tobacco state.

Education: This category comprises amounts allocated for education programs such as day care, preschool, Head Start, early childhood education, elementary and secondary education, after-school programs, and higher education.

General Purposes: This category comprises amounts allocated for attorneys fees and other items, such as law enforcement community development, that could not be placed in a more precise category. This category also includes allocations to the state's general fund that were not earmarked for any particular purpose.

Health: This category comprises amounts allocated for direct health care services, health insurance including Medicaid and the State Children's Health Insurance Program (SCHIP), hospitals, medical technology, public health services, and health research.

Infrastructure: This category comprises amounts allocated for capital projects such as construction and renovation of health care, education and social services facilities, water and transportation projects, and municipal and state government buildings.

Social Services: This category comprises amounts allocated for social services such as programs for the aging, assisted living, Meals on Wheels, drug courts, child welfare and foster care. This category also includes allocations to special funds established for children's programs.

Payments to Tobacco Growers: This category comprises amounts allocated for direct payments to tobacco growers including subsidies and crop conversion programs.

Reserves/Rainy Day Funds: This category comprises amounts allocated to state budget reserves such as rainy day and budget stabilization funds not earmarked for specific programs. Allocations to reserves that are earmarked for specific areas are categorized under those areas (e.g., health).

Tax Reductions: This category comprises amounts allocated for tax reductions such as property tax rebates and earned income tax credits.

Tobacco Control: This category comprises of amounts allocated for tobacco control programs such as prevention, including youth education, enforcement and cessation services.

Unallocated: This category comprises amounts not allocated for any specific purpose, such as amounts allocated to dedicated funds that have no specified purpose; amounts states chose not to allocate in the year MSA payments were received that will be available for allocation in a subsequent fiscal year; unallocated interest earned from dedicated funds; and amounts that have not been allocated because the state had not made a decision on the use of the MSA payments.

Note: In this report, we consolidated the following related categories: (1) education and social services and (2) economic development for tobacco states and payments to tobacco growers.

Allocation of MSA Payments in California

Total payments in California are allocated 50 percent to the state and 50 percent to local governments. The 58 counties receive 90 percent of the local share, to be distributed based on population, and the remaining 10 percent is split equally among four cities: Los Angeles, San Diego, San Francisco, and San Jose.

Entity	Percentage
State of California	50.000
Alameda	1.934
Alpine	0.002
Amador	0.045
Butte	0.275
Calaveras	0.048
Colusa	0.025
Contra Costa	1.215
Del Norte	0.035
El Dorado	0.191
Fresno	1.009
Glenn	0.037
Humboldt	0.180
Imperial	0.165
Inyo	0.028
Kern	0.822
Kings	0.153
Lake	0.077
Lassen	0.042
Los Angeles County	13.402
City of Los Angeles	1.250
Madera	0.133
Marin	0.348
Mariposa	0.022
Mendocino	0.121
Merced	0.270
Modoc	0.015
Mono	0.015
Monterey	0.538
Napa	0.167

Entity	Percentage
Nevada	0.119
Orange	3.645
Placer	0.261
Plumas	0.030
Riverside	1.770
Sacramento	1.574
San Benito	0.055
San Bernardino	2.145
San Diego County	3.777
City of San Diego	1.250
San Francisco County	1.095
City of San Francisco	1.250
San Joaquin	0.727
San Luis Obispo	0.328
San Mateo	0.982
Santa Barbara	0.559
Santa Clara	2.264
City of San Jose	1.250
Santa Cruz	0.347
Shasta	0.222
Sierra	0.005
Siskiyou	0.066
Solano	0.515
Sonoma	0.587
Stanislaus	0.560
Sutter	0.097
Tehama	0.075
Trinity	0.020
Tulare	0.472
Tuolumne	0.073
Ventura	1.012
Yolo	1.213
Yuba	0.088
Total	**100.00**

Source: GAO analysis of data provided by California State Office of the Attorney General.

Allocation of MSA Payments in New York

Total payments in New York are allocated 51 percent to the state and 49 percent to the 57 counties and New York City. Allocation to the counties is based on the county share of Medicaid costs and population along with some specific considerations for individual counties.

Entity	Percentage
New York State	51.176
Albany	0.593
Allegheny	0.107
Broome	0.446
Cattaraugus	0.179
Cayuga	0.166
Chautauqua	0.308
Chemung	0.212
Chenango	0.104
Clinton	0.170
Columbia	0.126
Cortland	0.100
Delaware	0.101
Dutchess	0.500
Erie	2.194
Essex	0.075
Franklin	0.098
Fulton	0.121
Genesee	0.118
Greene	0.085
Hamilton	0.013
Herkimer	0.142
Jefferson	0.190
Lewis	0.054
Livingston	0.112
Madison	0.131
Monroe	1.536
Montgomery	0.114
Nassau	2.739
New York City	26.670
Niagara	0.467

Entity	Percentage
Oneida	0.544
Onondaga	0.972
Ontario	0.181
Orange	0.564
Orleans	0.078
Oswego	0.239
Otsego	0.122
Putnam	0.152
Rensselaer	0.317
Rockland	0.560
St. Lawrence	0.239
Saratoga	0.304
Schenectady	0.319
Schoharie	0.063
Schuyler	0.038
Seneca	0.069
Steuben	0.211
Suffolk	2.673
Sullivan	0.155
Tioga	0.100
Tompkins	0.170
Ulster	0.334
Warren	0.113
Washington	0.113
Wayne	0.172
Westchester	1.926
Wyoming	0.081
Yates	0.044
Total	**100.00**

Source: New York Consent Decree.

Master Settlement Agreement Payments

Table 8: Original Estimated Payments through 2025 to 46 states, the District of Columbia, and 5 U.S. Territories

Dollars in thousands

Calendar year	Initial payments	Annual payments	Annual payments less previously settled states reduction	Strategic contribution fund payments
1998	$2,400,000			
1999				
2000	2,472,000	$4,500,000	$3,939,750	
2001	2,546,160	5,000,000	4,377,500	
2002	2,622,545	6,500,000	5,690,750	
2003	2,701,221	6,500,000	5,690,750	
2004-2007		8,000,000	7,004,000	
2008		8,139,000	7,143,000	$861,000
2009-2017		8,139,000	7,143,000	861,000
2018-2025		9,000,000	8,004,000	
Total	**$12,741,926**	**$207,890,000**	**$183,176,750**	**$8,610,000**

Base foundation payments (American Legacy Foundation)	National public education fund payments	National Association of Attorneys General administration payments	Attorney general enforcement fund
		$150	
$25,000	$250,000	150	$50,000
25,000	300,000	150	
25,000	300,000	150	
25,000	300,000	150	
25,000	300,000	150	
25,000		150	
25,000			
$250,000	**$1,450,000**	**$1,500**	**$50,000**

Note: Original estimated payments without adjustments other than the previously settled states reduction. The annual payment continues in perpetuity. The $300 million annual payments to the National Public Education Fund *may* continue in perpetuity.

Source: Master Settlement Agreement.

Strategic Contribution Fund Payments

The Strategic Contribution Fund payments (made from 2008 through 2017) are intended to reflect the level of the contribution each state made toward final resolution of the state lawsuits against the tobacco companies and will be allocated to states based on a separate formula developed by a panel of former state attorneys general.

Dollars in thousands

State	SCF annual payment	Percent of total
Alabama	$6,500	0.8
Alaska	14,739	1.7
Arizona	26,306	3.1
Arkansas	6,500	0.8
California	44,540	5.2
Colorado	20,271	2.4
Connecticut	28,526	3.3
Delaware	6,500	0.8
Georgia	8,062	0.9
Hawaii	20,359	2.4
Idaho	6,500	0.8
Illinois	23,393	2.7
Indiana	22,816	2.6
Iowa	23,428	2.7
Kansas	15,931	1.9
Kentucky	6,500	0.8
Louisiana	22,626	2.6
Maine	11,436	1.3
Maryland	28,313	3.3
Massachusetts	41,425	4.8
Michigan	22,189	2.6
Missouri	13,358	1.6
Montana	8,995	1.0
Nebraska	6,500	0.8
Nevada	8,871	1.0
New Hampshire	7,740	0.9
New Jersey	24,512	2.8
New Mexico	8,575	1.0

Dollars in thousands

State	SCF annual payment	Percent of total
New York	47,246	5.5
North Carolina	16,723	1.9
North Dakota	14,971	1.7
Ohio	23,953	2.8
Oklahoma	26,860	3.1
Oregon	20,802	2.4
Pennsylvania	28,045	3.3
Rhode Island	9,432	1.1
South Carolina	11,470	1.3
South Dakota	6,500	0.8
Tennessee	6,500	0.8
Utah	15,720	1.8
Vermont	15,649	1.8
Virginia	6,500	0.8
Washington	49,634	5.8
West Virginia	19,609	2.3
Wisconsin	22,538	2.6
Wyoming	6,500	0.8
Subtotal (All 46 states)	834,066	96.9
District of Columbia and 5 U.S. territories	26,934	3.1
Total	**$861,000**	**100.0**

Note: Original estimated payments without adjustments.

Source: GAO analysis of estimated Strategic Contribution Fund payments.

Phase II: The National Tobacco Grower Settlement Trust Agreement

The Master Settlement Agreement (MSA) required the tobacco companies to meet with the political leadership of states with grower communities to address the economic concerns of these communities. The National Tobacco Grower Settlement Trust Agreement, referred to as Phase II, resulted from that requirement and is intended to compensate tobacco growers and quota owners[1] for potential reductions in their tobacco production and sales resulting from the MSA. The Phase II agreement was reached in July 1999 between the four major tobacco companies[2] and the 14 states that produce and manufacture tobacco used for cigarettes. The agreement includes the 13 tobacco states that are a party to the MSA and the state of Florida, which reached an earlier, independent settlement with the tobacco industry. Tobacco production has remained principally in the southeastern states. Because most tobacco farming and manufacturing jobs are concentrated in this region, any declines in tobacco consumption could result in job losses in all sectors of the economy of this area. The Phase II agreement was intended to help mitigate any such consequences.

Payments to States' Tobacco Growers and Quota Owners

The Phase II agreement requires the tobacco companies to make payments to the National Tobacco Grower Settlement Trust each year for a period of 12 years beginning in 1999 and continuing through 2010. The trust is administered by a trustee and payments are distributed from the trust directly to tobacco growers and quota owners in the states that are a party to the agreement. Each state's growers and quota owners receive a fixed percentage of the payments from the trust. This percentage was calculated either on the basis of the 1998 basic quota for production of cigarette tobacco or, in states where no quota existed, 1998 production of tobacco for cigarettes.[3] Three states—Kentucky, North Carolina, and Tennessee—are the largest producers of cigarette tobacco in the country, and growers and quota owners in those states receive over 75 percent of the Phase II payments. Table 8 identifies the percentage of the Phase II payments allocated to each state's growers and quota owners.

[1]Generally speaking, a quota owner has rights to produce a specified amount of tobacco annually.

[2]The four tobacco companies are Philip Morris Incorporated, Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, and R.J. Reynolds Tobacco Company.

[3]Maryland and Pennsylvania do not participate in the quota program.

Table 9: Allocation Percentages for Phase II Payments

State	Percent
Alabama	0.05
Florida	1.13
Georgia	5.85
Indiana	1.16
Kentucky	29.66
Maryland	0.62
Missouri	0.42
North Carolina	37.95
Ohio	1.36
Pennsylvania	0.43
South Carolina	6.94
Tennessee	7.57
Virginia	6.58
West Virginia	0.28
Total	**100.0**

Source: National Tobacco Grower Settlement Trust Agreement.

Distribution of Payments

Each state through its “Certification Entity” was required to develop a plan identifying the tobacco growers and quota owners within the state and a methodology for distributing payments. The Phase II states are categorized as either Class A (Georgia, Kentucky, North Carolina, South Carolina, Tennessee and Virginia) or Class B (Alabama, Florida, Indiana, Maryland, Missouri, Ohio, Pennsylvania and West Virginia) based on the amount of tobacco produced in the state. In Class A states, the Certification Entity comprises a Board of Directors with the following membership: the governor (Chairman), the state commissioner of agriculture (Vice-Chairman), the state attorney general (Secretary), one member each from the state Senate and House of Representatives, not less than three and no more than six citizens of the state who are tobacco growers or quota owners in the state, one citizen with a distinguished record of public service, and two members of the state congressional delegation. In Class B states, the Certification Entity comprises the governor, state attorney general, and the state commissioner of agriculture. Each state’s plans may be revised on an annual basis; plans are due to the trustee by June 1 of each year in 2000 through 2010.[4]

The three largest tobacco states—North Carolina, Kentucky and Tennessee—each developed somewhat different methodologies for distributing payments in 1999 and 2000. In North Carolina, growers and quota owners each received 50 percent of the payments distributed within the state. Kentucky used the following methodology to distribute payments: one-third of the total distributions to quota owners, one-third to the owners of the land used to grow tobacco, and one-third to the farmers who produced the crop. In Tennessee, growers received 80 percent of the payments and quota owners received 20 percent. All three states distributed payments based on the prior year’s tobacco crop.

[4] In 1999, these plans were due by October 1.

Payment Amounts and Adjustments

Table 10: Estimated Annual Payments to the National Tobacco Grower Settlement Trust

Dollars in thousands

Year(s)	Amounts
1999	$380,000
2000	280,000
2001	400,000
2002-2008	500,000
2009-2010	295,000
Total	**$5,150, 000**

Source: National Tobacco Grower Settlement Trust Agreement, Schedule A.

Note: In years 2000-2010 payments are made in installments of 25 percent of the total annual amount on or before March 31, June 30, September 30, and December 15. In 1999, payments were made in three installments: 50 percent within 10 days of the effective date of the agreement, 25 percent on or before October 1 and 25 percent on or before December 15, 1999.

Payments to the trust were initially estimated to total approximately $5.15 billion for the 12-year period from 1999 through 2010. (See Table 9 for the estimated annual Phase II payments.) Payments could not be distributed to individuals in a state until the state had achieved “state-specific finality” as required by the MSA. Similar to the MSA payments, Phase II payments are subject to a number of adjustments including adjustments for inflation and volume of cigarette sales.[5] The inflation and volume adjustments are calculated on the same basis as they are for the MSA payments. The inflation adjustment equals the increase in the Consumer Price Index for the preceding year or three percent, whichever is greater. The volume adjustment reduces or enhances payments based on the amount by which the number of cigarettes shipped in a calendar year declines or increases relative to the base year.

[5]The 1999 annual payments were not subject to inflation and volume adjustments, but all subsequent years’ payments are adjusted for these factors.

States' Restrictions Against Supplantation

State	Restrictions Against Supplantation
Alabama	1. Alabama 21st Century Fund is funded with tobacco settlement revenues. Funds are transferred from this fund to other funds including the general fund from which 50 percent is to be appropriated to the Alabama Medicaid Agency with a portion to the Medicaid Waiver Program at the Commission on Aging. "Sufficient safeguards shall be implemented to ensure that these new monies will increase and not supplant or decrease existing state support." 2. Alabama Senior Services Trust Fund is funded with tobacco settlement revenues. "Any funds appropriated pursuant to this section shall be additional funds distributed to the Alabama Department of Senior Services or its successor and shall not be used to supplant or decrease existing state or local support to the Alabama Department of Senior Services or its successor. Appropriations from the trust fund shall be used to both expand existing services and create new services for Alabama's elderly." 3. Children First Trust Fund is funded with tobacco settlement revenues and revenues received from other sources. Funds are transferred to children's services provided by several state agencies. "Twenty-one percent of the fund shall be allocated to the State Board of Education. Sufficient safeguards shall be implemented to ensure that the new monies will increase and not supplant or decrease existing state or local support." "Twenty percent of the funds shall be allocated to the Alabama Department of Human Resources. Sufficient safeguards shall be implemented to ensure that these new monies will increase and not supplant or decrease existing state and local support received from any source." "Seventeen percent of the revenues shall be allocated to the Department of Youth Services. Sufficient safeguards shall be implemented to ensure that the new monies will increase and not supplant or decrease existing state or local support, except the portion of funds used year to year according to needs enumerated in this section."
Arizona	The Initiative added an additional definition of eligibility for the Arizona Health Care Cost Containment System (the state's health insurance program) and established the Arizona Tobacco Litigation Settlement Fund for receipt of all tobacco settlement revenues. "Monies in the fund shall be used to supplement and not supplant existing and future appropriations to the Arizona Health Care Cost Containment System."
Colorado	Policy on use of tobacco settlement funds provides "The majority of the moneys received by the state from the Master Settlement Agreement shall be dedicated to improving the health of the citizens of Colorado, including tobacco use prevention, education, and cessation programs and related health programs. Such moneys are intended to supplement any moneys appropriated to health-related programs established prior to the effective date of this part 11." and "A portion of the settlement monies shall be used to strengthen and enhance the health of all residents of Colorado by supplementing and expanding statewide and local public health programs."
Connecticut	Created the Tobacco and Health Trust Fund to support and encourage tobacco control and substance abuse programs, and to develop and implement programs to meet the unmet physical and mental health needs in the state. Trust fund receives transfers from the Tobacco Settlement Fund and may accept gifts and grants. "Recommended disbursements from the trust fund shall be in addition to any resources that would otherwise be appropriated by the state for such purposes and programs."
Delaware	Created the Delaware Health Fund for receipt of all tobacco settlement revenues. "Expenditures from the Delaware Health Fund shall not be used to supplant any state expenditures appropriated in fiscal year 1999 for purposes consistent with those outlined in subsection (c) of this section." Subsection (c) dedicates funds for the following purposes: expanding access to health care and health insurance for uninsured or under insured; long-term investments in health care infrastructure; tobacco control and substance abuse; testing for detection of costly illnesses; prescription drug program for low-income senior and disabled citizens; payment assistance for those with expenses of chronic illnesses; other expenditures for health-related purposes.
Hawaii	Created three new funds including the tobacco prevention and control trust fund. "The Hawaii tobacco prevention and control trust fund may receive appropriations, contributions, grants, endowments, or gifts in cash or otherwise from any source, including the State, corporations or other businesses, foundations, government, individuals, and other interested parties; provided that any appropriations made by the State shall not supplant or diminish the funding of existing tobacco prevention and control programs or any health related programs funded in whole or in part by the State."

State	Citation
Alabama	1. An Act to Provide for the Creation of a Special Fund Known as the Alabama 21 st Century Fund, 1999 Ala. Act 99-353 § 19(a)(3), Ala. Code §§ 41-10-629, -638 (1999). 2. An Act to Create the Alabama Senior Services Trust Fund, 1999 Ala. Act 99-444 § 1(d), Ala. Code § 41-15C-1 (1999). 3. An Act Relating to the Children First Trust Fund, 1999 Ala. Act 99-390 §§ 2-3, Ala. Code §§ 41-15B-2 - 15B-2.2 (1999).
Arizona	Ariz. Rev. Stat. §§ 36-2901.01 –2901.02 (2000) (added by Prop. 204, approved Nov. 7, 2000).
Colorado	An Act Concerning Use of Moneys Received Pursuant to the Tobacco Litigation Settlement, 2000 Colo. Legis. Serv. ch. 154, § 1, Colo. Rev. Stat. § 24-75-1103 (2000).
Connecticut	An Act Concerning Expenditures for the Programs and Services of the Department of Public Health, 2000 Conn. Acts 00-216, § 15(d)(1), Conn. Gen. Stat. § 4-28f (2000).
Delaware	An Act to Create the Delaware Health Fund, 72 Del. Laws, ch. 198, § 1 (1999), Del. Code Ann. tit. 16, § 137 (1999). .
Hawaii	An Act Relating to the Hawaii Tobacco Settlement Special Fund, 1999 Haw. Sess. Laws Act 304, § 2, Haw. Rev. Stat. § 328L-5 (1999).

State	Restrictions Against Supplantation
Indiana	Created the tobacco master settlement fund for receipt of all revenues and several additional funds to which funds are transferred. Several of these funds have non-supplant provisions: (1) Indiana Tobacco Use Prevention and Cessation Trust Fund requires funding proposals to state "the extent to which the expenditure will supplement or duplicate existing expenditures of other state agencies, public or private entities, or the executive board." Other funds—(2) Indiana Health Care Trust Fund funds health programs including CHIP, cancer detection, local health departments and community centers; (3) Biomedical Technology and Basic Research Trust Fund; (4) Indiana Local Health Department Trust Fund; (5) Indiana Prescription Drug Fund—include the language: "Appropriations and distributions from the fund under this chapter are in addition to and not in place of other appropriations or distributions made for the same purpose."
Kansas	The children's trust, renamed the Kansas Endowment for Youth (KEY) fund, was established to receive all tobacco settlement funds. All moneys credited to the KEY fund must be invested to provide an ongoing source of investment earnings available for periodic transfer to the Children's Initiatives Fund. "Moneys allocated or appropriated from the Children's Initiatives Fund shall not be used to replace or substitute for moneys appropriated from the state general fund in the immediately preceding fiscal year."
Louisiana	Established the Millennium Trust Fund and the Louisiana Fund and creates the Education Excellence Fund as a special fund within the Millennium Trust Fund. "No amount appropriated as required in this paragraph shall displace, replace or supplant appropriations from the general fund for elementary and secondary education, including implementing the Minimum Foundation Program. This subparagraph shall mean that no appropriation for any fiscal year from the Education Excellence Fund shall be made for any purpose for which a general fund appropriation was made in the previous year unless the total appropriations for the fiscal year from the state general fund for such purpose exceed general fund appropriations of the previous year."
Maine	The Fund for a Healthy Maine was created for receipt of all tobacco settlement revenues. "When allocations are made to direct services, services to lower income consumers must have priority over services to higher income consumers. Allocations from the fund must be used to supplement, not supplant, appropriations from the General Fund."
Maryland	Created the Cigarette Restitution Fund for all revenues received by the state resulting from the tobacco settlement. Expenditures from the fund shall be for tobacco control, cancer prevention, Maryland agricultural plan for alternative crop uses, Maryland Health Care Foundation, primary health care in rural areas, substance abuse, and any other public purpose. "Disbursements from the fund to programs funded by the state or with federal funds administered by the state shall be used solely to supplement, and not to supplant, funds otherwise available for the programs under federal or state law as provided in this section."
Massachusetts	Established the Tobacco Settlement Fund to receive 30% of tobacco settlement payments received by the state and 30% of the earnings on the Health Care Security Trust as well as other sources of funding. "Amounts credited to said fund shall be expended, subject to appropriation, to supplement existing levels of funding for the purpose of funding health related services and programs including, but not limited to, services and programs intended to control or reduce the use of tobacco in the commonwealth. Amounts credited to said fund shall not be used to supplant or replace other health related on non health related expenditures or obligations of the commonwealth."
Montana	Constitutional amendment dedicated trust fund interest earnings for health care benefits, services or coverage and tobacco disease prevention and states "The trust's interest and principal cannot be used to replace current funding for these programs."
Nevada	Created the Fund for a Healthy Nevada for receipt of 50% of all tobacco settlement funds received by the state. Funds are to be allocated for pharmaceuticals for senior citizens, programs for independent living for senior citizens, tobacco control, health services for children and disabled. "Money expended from the fund for a healthy Nevada must not be used to supplant existing methods of funding that are available to public agencies."

State	Citation
Indiana	An Act to Amend the Indiana Code Concerning State Offices and Administration, 2000 Ind. Leg. Serv. P.L. 21-2000, §§ 2-6, Ind. Code §§ 4-12-4-13, -5-7, -6-5, -7-8, -8-3 (2000).
Kansas	An Act Concerning the Disposition of Certain Moneys for the Benefit of Children, 1999 Kan. Sess. Laws ch. 172, §§ 1-2, Kan. Stat. Ann. §§ 38-2101 - 2102 (1999).
Louisiana	La. Const. art. VII, §§ 10.8-10.10 (added by 1999 La. Sess. Law Serv. Act 1392, § 1, approved Oct. 23, 1999).
Maine	An Act to Make Supplemental Appropriations and Allocations for the Expenditures of State Government, 1999 Me. Legis Serv. ch. 401, § V-1, Me. Rev. Stat. Ann. tit. 22, § 1511 (1999).
Maryland	An Act Concerning the Cigarette Restitution Fund, 2000 Md. Laws ch. 18, § 1, Md. State Fin. & Proc. § 7-317 (2000).
Massachusetts	An Act Making Appropriations for Fiscal Year 2000, 1999 Mass. Legis. Serv. ch. 127, § 42, Mass. Gen. Laws Ann. ch. 29, § 2xx (1999).
Montana	An Act Submitting to the Qualified Electors of Montana an Amendment to Article XII of the Montana Constitution, 2000 Mont. Laws Ballot Meas. 35 (approved Nov. 7, 2001).
Nevada	An Act Relating to State Financial Administration and Creating the Fund for a Healthy Nevada, 1999 Nev. Laws ch. 538, §§ 3-5, Nev. Rev. Stat. §§ 439.620 - 630 (1999).

State	Restrictions Against Supplantation
North Carolina	Established the Health Trust account to receive 25% of the tobacco settlement revenues. Health and Wellness Trust Fund receives funds from the Health Trust Account to address health needs of vulnerable and underserved populations, and to fund programs including research, education, and treatment of health problems, to develop a comprehensive tobacco control plan. "It is the intent of the General Assembly that the funds provided pursuant to this Article to address the health needs of North Carolinians be used to supplement, not supplant, existing state funding of health and wellness programs."
West Virginia	Created two funds for receipt of tobacco settlement revenues. 50% of all revenues shall be deposited into the West Virginia Tobacco Settlement Fund and appropriated for the following purposes: the public employees insurance agency, public health programs, state health facilities. The legislation provides "funding for expansion of the federal-state Medicaid program as authorized by the legislature or mandated by the federal government." State budget official said this language is intended to not supplant existing funds.

State	Citation
North Carolina	An Act to Provide for the Creation of the Health and Wellness Trust Fund, 2000 N.C. Sess. Laws 2000-147, §§ 1-2, N.C. Gen. Stat. §§ 143-16.4, 147-86.30 (2000).
West Virigina	An Act Relating to Appropriations, Expenditure of Interest, and Authorization of Expenditures from Tobacco Settlement Funds, 1999 W. Va. Acts ch. 281, W. Va. Code §§ 4-11A-1 –11A-3 (1999).

Sources of Information

Show Us the Money: An Update on the States' Allocation of the Tobacco Settlement Dollars. A Report by the Campaign for Tobacco-Free Kids, American Cancer Society, American Heart Association and the American Lung Association, October 1, 2000.

Centers for Disease Control and Prevention. *Best Practices for Comprehensive Tobacco Control Programs—August 1999*. Atlanta, GA: U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, August 1999. Reprinted with corrections.

Centers for Disease Control and Prevention. *Investment in Tobacco Control—State Highlights 2001*. Atlanta, GA: U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, 2001.

Congressional Research Service. *Tobacco Master Settlement Agreement (1998): Overview, Implementation by States, and Congressional Issues*. Washington, D.C.: November 1999.

General Accounting Office. *Tobacco: Issues Surrounding a National Tobacco Settlement*. (GAO/RCED-98-110, April 15, 1998)

General Accounting Office. *Tobacco Settlements: States' Use of Settlement Proceeds*. (GAO/HEHS-98-147R, April 22, 1998).

National Association of County and City Health Officials. *Program and Funding Guidelines for Comprehensive Local Tobacco Control Programs*, April 2000.

National Conference of State Legislatures. *State Allocation of Tobacco Settlement Funds: FY 2000 and FY 2001*, August 1, 2000.

National Governors Association. *State Tobacco Plans—March 1, 2001, National Governors Association, Center for Best Practices, 2001.*

President's Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production While Protecting Public Health. *Tobacco at a Crossroad—A Call For Action: Final Report of the President's Commission on Improving Economic Opportunity in*

Communities Dependent on Tobacco Production While Protecting Public Health. Washington, D.C.: U.S. Department of Agriculture, May 14, 2001.

Ordering Information

The first copy of each GAO report is free. Additional copies of reports are $2 each. A check or money order should be made out to the Superintendent of Documents. VISA and MasterCard credit cards are accepted, also.

Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:
U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

Orders by visiting:
Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders by phone:
(202) 512-6000
fax: (202) 512-6061
TDD (202) 512-2537

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

Orders by Internet:
For information on how to access GAO reports on the Internet, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web home page at:

http://www.gao.gov

To Report Fraud, Waste, or Abuse in Federal Programs

Contact one:

- Web site: http://www.gao.gov/fraudnet/fraudnet.htm
- e-mail: fraudnet@gao.gov
- 1-800-424-5454 (automated answering system)

United States
General Accounting Office
Washington, D.C. 20548-0001

Official Business
Penalty for Private Use $300

Address Correction Requested

Presorted Standard
Postage & Fees Paid
GAO
Permit No. GI00