An LAO Report

What Will It Mean for California?

The Tobacco Settlement

Introduction

The attorneys general of most states and the major United States tobacco companies have agreed to settle more than 40 pending lawsuits brought by states against the tobacco industry. In exchange for dropping their lawsuits and agreeing not to sue in the future, the states will receive billions of dollars in payments from the tobacco companies and the companies will restrict their marketing activities and establish new efforts to curb tobacco consumption.

In this report, we review the settlement agreement and its potential impact on California, answer a number of questions about how the agreement would work, and raise a number of issues for consideration by the Legislature.

Major Findings

The settlement is projected to result in payments to California of $25 billion through 2025. The amount will be split between the state and local governments (all 58 counties and four cities). There are no restrictions on the use of the money. There are, however, a number of uncertainties surrounding how much money California will actually receive. The *1999-00 Governor's Budget* assumes the receipt of $562 million in the budget year, which is equivalent to the first two payments to the state.

Considerations for the Legislature

Although the settlement does not require any action by the Legislature in order to take effect, we suggest that the Legislature:

- **Recognize the uncertainties surrounding the level of funds the state will receive, especially in the long run, and not dedicate the settlement monies to support specific new ongoing programs.**
- **Consider the additional settlement revenues that will accrue to local governments when considering additional local government fiscal relief in the future.**
- **Monitor new national antitobacco programs in order to complement existing state efforts.**

Elizabeth G. Hill
Legislative Analyst

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On November 16, 1998, the attorneys general of eight states (including California) and the nation's four major tobacco companies agreed to settle more than 40 pending lawsuits brought by states against the tobacco industry. The agreement will result in significant new revenues to the state and local governments. In addition, it could result in reductions in smoking by citizens and thus have positive impacts on public health. In this report, we review the settlement agreement and its potential impact on California, answer a number of questions about how the settlement would work, and raise a number of issues for consideration by the Legislature.

SUMMARY OF THE SETTLEMENT

The settlement agreement calls for financial payments to the states, the creation of a national foundation to develop an antismoking advertising and education program, and the establishment of certain advertising restrictions to benefit public health. Figure 1 summarizes the key features of the agreement, many of which are discussed in more detail below.

***How Many States Are Part of the Agreement*?** Nationally, the attorneys general of 46 states and various territories have now signed on to the settlement proposal. The remaining four states—Florida, Minnesota, Mississippi, and Texas—had previously settled their cases with the tobacco industry.

***What Companies Are Part of the Agreement*?** The four major tobacco companies that negotiated the agreement are Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated, and R.J. Reynolds Tobacco Company. These four manufacturers account for more than 95 percent of the total sales of cigarettes nationally. Since the release of the settlement, most of the remaining smaller tobacco manufacturers have joined the agreement, so that the market share of the participating tobacco companies accounts for about 99.7 percent of total national sales.

Does the Settlement Require Validation? Under the terms of the settlement proposal, the courts in each participating state must approve the agreement. The settlement does not require that any explicit action be taken by the state legislatures. As we discuss later, however, the Legislature may wish to consider several actions related to the settlement.

In California, on December 9, 1998, the settlement agreement was approved by the San Diego Superior Court, where the state's case was being litigated. The settlement will become final in California if there are no appeals within 60 days of the court's decision. California was the nineteenth state whose court has approved the agreement. So far no court in any other state has rejected the settlement.

MONETARY PROVISIONS OF THE SETTLEMENT

The settlement agreement requires the tobacco companies to make payments to the states *in perpetuity*, with the payments totaling an estimated $206 billion through 2025 nationally. These funds will be divided among the states based on allocation percentages negotiated by the attorneys general. These allocation percentages are based on a variety of factors such as population and cigarette sales within the state. These state allocation percentages will not change over time. In order to pay for the settlement, the tobacco companies have raised the price per pack of cigarettes by 45 cents.

Figure 1

Key Features of the Tobacco Settlement

- ✔ ***Payments to States.*** Requires the tobacco manufacturers to make payments to the states in perpetuity, with the payments totaling an estimated $206 billion through 2025.
- ✔ ***National Foundation.*** Creates an industry-funded foundation whose primary purpose will be to develop an advertising and education program to counter tobacco use.
- ✔ ***Advertising Restrictions.*** Places advertising restrictions on tobacco manufacturers, including bans on cartoons, targeting of youth, outdoor advertising, and apparel and merchandise with brand name logos.
- ✔ ***Corporate Sponsorships of Events.*** Restricts tobacco companies to one brand name sponsorship per year.
- ✔ ***Tobacco Company Affiliated Organizations.*** Disbands the Tobacco Institute and regulates new trade organizations.
- ✔ ***Limit on Lobbying.*** Prohibits the tobacco manufacturers and their lobbyists from opposing proposed laws intended to limit youth access and use of tobacco products.
- ✔ ***Access to Documents.*** Requires the tobacco companies to open a website which includes all documents produced in smoking and health-related lawsuits.

Overview of Monetary Provisions

How Much Money Will California Get? California is projected to receive an estimated $25 billion through 2025, or about 12.8 percent of the total monies allocated for the states—the highest percentage of any of the state's participating in the agreement. While the average annual payment to California is estimated to be approximately $925 million, as can be seen in Figure 2, the estimated amount of funding per year changes considerably over time. California's share of the 1998 payment is estimated to be $306 million and there is no scheduled payment in 1999 under the terms of the settlement. New York has the next highest allocation percentage, an amount that is very close to California's allocation percentage.

The *1999-00 Governor's Budget* assumes the receipt of $562 million to the state's General Fund in 1999-00—the state's 1998 payment ($153 million) and 2000 payment ($409 million).

Who Gets the Money? Several California jurisdictions, including Los Angeles County and the City and County of San Francisco, had filed their

Figure 2

Estimated Annual Tobacco Settlement Payments to California

1998 Through 2025 (In Millions)

Year	State	Local[a]	Total
1998	$153	$153	$306
1999	—	—	—
2000	409	409	818
2001	442	442	884
2002	531	531	1,061
2003	536	536	1,071
2004 through 2007[b]	447	447	894
2008 through 2017[b]	456	456	912
2018 through 2025[b]	511	511	1,022
Totals	**$12,503**	**$12,503**	**$25,007**

[a] Includes all 58 counties and the four cities of Los Angeles, San Diego, San Francisco, and San Jose.

[b] Each year.

own lawsuits against the tobacco companies. On August 5, 1998, the Attorney General entered into a Memorandum of Understanding (MOU) with the local governments to coordinate their lawsuits with the state's suit and provide for the allocation of any monies recovered. The terms of the MOU include an even, 50-50, split of the financial recovery between the state and the local governments that sign onto the deal. Thus, the estimated $25 billion to be allocated pursuant to the tobacco settlement would be split between the state and local governments with each receiving $12.5 billion.

The local share will be further split between the counties and specified cities. Under the terms of the MOU, the state's 58 counties will receive 90 percent of the local share, or $11.25 billion. These monies will be distributed to the counties based on population.

The remaining 10 percent, or $1.25 billion, will be split equally among four specified cities—Los Angeles, San Diego, San Francisco, and San Jose. The MOU limits the recovery to these cities who could have filed an independent lawsuit pursuant to a specific provision of the Business and Professions Code.

Local governments do not automatically receive the funds unless they join the settlement and agree to its terms. To the extent that a county or city chooses not to participate, the monies that they could have otherwise received would be redistributed to the state and local governments.

Appendix 1 provides a breakdown of the estimated $12.5 billion going to the local governments as a result of the settlement. The table assumes that all of the local governments join the settlement.

How Can the Money Be Spent? The tobacco settlement agreement places *no restrictions* on the use of the monies by the states. Similarly, California's MOU with local governments contains no restrictions.

Many of the state and local lawsuits (including California's) had sought recovery from the tobacco companies of the tobacco-related health care costs (such as Medi-Cal) incurred by states and local governments. The settlement agreement and California's MOU with the local governments do not specify that any of the financial payments by the companies are to reimburse state and local governments for such costs.

Absent specific action by the Legislature, the funds received by the state from the settlement would be deposited into the General Fund. Because the money is not a proceed of taxes, it would not be counted as revenues for purposes of calculating the minimum guarantee under Proposition 98.

Does the Settlement Money Count Towards the VLF Trigger? As part of the 1998-99 budget package, the Legislature and Governor agreed to certain cuts in the state's vehicle license fee (VLF) in future years if specified revenue forecasts (or "triggers") are reached. We believe that the additional General Fund revenues from the tobacco settlement would be counted toward the triggers. Based on our most recent revenue projections, however, revenues from the settlement would *not* be enough by themselves to pull a trigger and generate an additional cut in the VLF. However, the settlement monies would bring General Fund revenues *closer* to the levels that would activate the trigger, and if revenues increase beyond current projected levels could result in an additional VLF cut in the future.

When Will the Money Be Available? The settlement agreement sets forth a payment and distribution schedule for the monies to the states. The tobacco companies will make payments into an escrow account. However, none of the money would be distributed to the states from the escrow account until there is a "final approval" of the agreement.

"Final approval" is defined in the agreement as the earlier of (1) June 30, 2000 or (2) when 80 percent of the states, representing 80 percent of the allocated distribution, obtain approval of their consent decrees and all challenges and appeals are heard by their state courts. Currently, it is unknown when final approval will be achieved, but it is likely that it will occur before June 30, 2000 (within the state's 1999-00 fiscal year).

As part of the settlement, the tobacco companies will make a total of $12 billion in "up-front" payments. The first payment of $2.4 billion was paid to the escrow account by the end of 1998. Additional up-front payments of $2.4 billion will be made each January in 2000, 2001, 2002, and 2003. Annual payments will begin on April 15, 2000 and will be made in the following increments:

- 2000: $4.5 billion.
- 2001: $5 billion.
- 2002 and 2003: $6.5 billion.
- 2004-2017: $8.1 billion.
- 2018 and annually thereafter: $9 billion.

Uncertainties Regarding Money to California

Our review finds that there are a number of factors that could have an impact on the amount of dollars available to California, especially in the long run. Most of these uncertainties would result in the state receiving less money than projected or receiving money with restricted uses, although two of the uncertainties could actually result in the state receiving more money.

Actions of the Federal Government That Could Offset Payments. The agreement has provisions to reduce the payments to the states in the event that the federal government takes certain specified actions against the tobacco companies by November 30, 2002. Specifically, if the Congress enacts legislation that provides for payments by the tobacco manufacturers (whether by settlement payment, tax, or other means), which the federal government then makes available to the states for health-related, tobacco-related, or for unrestricted purposes, the tobacco companies could offset their payments to the states by that amount. Under this scenario, the state might receive the same overall amount of money it would have otherwise received, but with the federal government setting the priorities or with significant strings attached. Neither the Congress nor the President have announced any intention to take such actions at this time; nevertheless, such actions remain a possibility in the future.

Actions of the Federal Government to Seek Reimbursement for Health Care Costs. The federal government shares with the states the costs of the Medicaid Program (Medi-Cal in California). Although the settlement with the states is not based on reimbursing states for costs of treating tobacco-related illnesses under Medicaid, federal law generally *requires* federal agencies to seek reimbursements for the federal share of any Medicaid costs. As a consequence, it is possible that the federal government could seek reimbursement for its tobacco-related Medicaid costs, either by seeking a share of the states' settlement funds or by taking legal action against tobacco companies in federal court. To the extent that federal authorities are successful in obtaining part of the settlement funds, this would reduce the amount of funds retained by the states. In addition, to the extent that a federal court action results in a large payout by the tobacco companies to the federal government, the companies may become less solvent and less able to make the payments to the states as specified in the states' settlement. Federal authorities have not indicated whether they plan to undertake such actions relative to this settlement. However, in response to a previously proposed settlement, they had indicated that they would seek a share of the funds.

Drop in Cigarette Sales. The settlement agreement contains provisions that allow the tobacco companies to decrease the amount they pay to the states if the nationwide sales of cigarettes decrease. Specifically, each year the amount of the payment to the states will be adjusted based on the volume of cigarettes shipped within the U.S. for sale. To the extent that this volume drops, the payments to states will decrease over time. The tobacco companies have raised their price per pack by 45 cents in order to pay for the settlement. To the extent that the increase in the price per pack reduces the amount of cigarettes consumed, the payments to the states would decrease over time.

This volume adjustment is based on *nationwide* sales, not just sales within California. This could minimize any negative financial impact on California since tobacco sales are more likely to decline faster in California than in the rest of the country due to (1) the additional 50 cents per pack tax placed on cigarettes beginning on January 1, 1999 as a result of Proposition 10 (discussed in greater detail below), and (2) the existing antismoking campaign that already exists in California that is funded from Proposition 99 monies.

Lawsuits by Nonparticipating Local Governments. If a local government does not join in the settlement but rather continues with a lawsuit against the tobacco companies, the local government would not receive any funds from the settlement. The share that they would be eligible for under the terms of the MOU would be divided by the state and the other participating local governments. However, any award, judgment, or settlement won by a nonparticipating local government would be offset against tobacco companies' payments to the entire state. At this time, based on informal discussions with local governments, it seems likely that most, if not all, local governments in California will participate in the state settlement.

Tobacco Company Bankruptcy. The tobacco settlement was entered into with the U.S. manufacturing subsidiaries of the tobacco companies. As a consequence, the *parent companies* are not responsible for payments to the states should one of the subsidiaries go bankrupt. Bankruptcy by one or more of the tobacco manufacturers is a possibility given that the manufacturers still face potential lawsuits from individuals and class actions. For example, there is currently a class action case in Florida against the tobacco manufacturers seeking $200 billion.

Should one or more of the tobacco companies declare bankruptcy, the amount of money going to the states could decrease significantly. The remaining companies would not be responsible for paying the obligation of the bankrupt companies.

Reduction in Market Share of Settling Companies. Over time, the payments of the participating manufacturers can decrease if they lose market share to nonparticipating manufacturers. Under the terms of the agreement, the states can protect themselves against a reduction in payments by passing a "model statute" included in the agreement that would require nonparticipating manufacturers to put funds into escrow accounts for 25 years equivalent to the amounts paid by the participating manufacturers.

This possibility of reduced payments due to a decline in market share is probably not a major concern. This is because, as indicated earlier, most of the smaller tobacco manufacturers have now agreed to the deal. Under the terms of the deal, the public health provisions of the agreement will apply to these companies. Should their market share increase to a specified level, they will become responsible for making payments corresponding to those due by the original participating companies. States would not receive any additional monies, but the shares paid by individual companies would change.

Increased Payments From the "Strategic Contribution." From 2008 through 2017, the tobacco companies will provide a "strategic contribution" of $861 million per year to the states in excess of the other payments. How these funds are allocated among the states will be determined by a panel committee of three former attorneys general. The criteria for the allocation of the strategic contribution will take into account each state's contribution to the litigation. California was a relatively late entrant among states to the litigation, which may hurt the state's chances of receiving a significant portion of the strategic contribution. However, the fact that the California Attorney General was one of the eight attorneys general that negotiated the agreement and the sheer size of the state's case against the companies may offset any disadvantage.

Increases Due to Inflation Adjustments. The payments made by the tobacco companies will increase above the currently estimated amounts due to an inflation adjustment. The future tobacco payments will be adjusted annually by 3 percent or the national Consumer Price Index (CPI), whichever is greater. Thus, to the extent that the volume of cigarettes shipped within the U.S. does not decrease, the total payments to the states will increase.

LEGAL IMPLICATIONS OF THE SETTLEMENT

The tobacco settlement agreement likely brings to a close various state and local government litigation against the tobacco companies and has a number of legal implications.

What Happens to the State's Case as a Result of the Settlement? On June 12, 1997, the California Attorney General filed a lawsuit against the major tobacco companies in the Sacramento Superior Court containing four causes of action, as shown in Figure 3. By the time of the settlement agreement, two of the causes of action had already been dismissed by the court and two others were yet to be addressed by the court.

Upon approval of the consent decree in the state court, the state's case against the tobacco companies will be considered settled. As previously indicated, the San Diego Superior Court approved the consent decree on December 9 and the settlement becomes final 60 days later unless the court order is challenged during that period. The settlement agreement generally releases the signing tobacco companies from any future lawsuits by the state and local governments that participate in the settlement.

How Is the Settlement Different From a Resolution Resulting From a Trial? It is difficult to say with a high level of certainty how a trial on California's lawsuit against the tobacco companies would have ended. It seems unlikely, however, that a court would have ordered provisions related to public health that the tobacco companies subsequently agreed to in the settlement (for example, restrictions on advertising and corporate sponsorship). It is not clear whether the monetary provisions provided in the settlement agreement are greater than the state would have obtained if it had won its case in court. However, because the companies have *agreed* to the settlement, it is likely that money will flow to the state more quickly and easily since the companies would likely have appealed a court decision.

Figure 3

What California Alleged in Its Lawsuit Against the Tobacco Companies

- ***Recovery of Tobacco-Related Medi-Cal Expenditures.*** The state sought reimbursement for health care services provided over the past three years to Medi-Cal beneficiaries who suffer from illnesses caused by tobacco products. This allegation was previously dismissed by the court.
- ***Violations of State Anti-Trust Laws.*** Tobacco firms (1) conspired to not develop or market safer cigarettes and tobacco products and (2) conspired to not compete on the basis of relative product safety. This allegation was awaiting action by the court.
- ***Violations of State Consumer Protection Laws.*** Tobacco firms conducted deceptive, unlawful, and unfair business practices by (1) making misrepresentations and deceptive statements to sell their products, (2) targeting minors to buy cigarettes, (3) manipulating levels of nicotine without adequate disclosure, and (4) improperly suppressing evidence about the health impacts of the product. This allegation was awaiting action by the court.
- ***Violations of State False Claims Act.*** Tobacco firms improperly sealed certain documents and records which would otherwise have been available to inform California authorities of the companies' wrongdoings. This allegation was previously dismissed by the court.

Can Californians File Lawsuits as Individuals or in Class Action Lawsuits Against the Tobacco Companies? While the settlement places restrictions on future lawsuits by governmental entities, lawsuits by individuals and classes of individuals against the tobacco companies could still go forward.

How Will the Settlement Be Enforced? The agreement provides the state courts with jurisdiction over implementing and enforcing the settlement. The state or the tobacco companies may apply to the court to enforce the terms of the agreement. If the court issues an order enforcing the agreement and a party violates that order, the court may order monetary, civil contempt, or criminal sanctions to enforce compliance.

On March 31, 1999, the tobacco manufacturers will pay $50 million which will be used to assist the states in enforcing and implementing the agreement and to investigate and litigate potential violations of state tobacco laws. Additionally, the National Association of Attorneys General will receive $150,000 per year until 2007 for oversight costs associated with monitoring potential conflicting court interpretations involving the settlement, and assisting states with inspection and discovery activities conducted to enforce the settlement.

PUBLIC HEALTH PROVISIONS OF THE SETTLEMENT

The settlement includes a number of provisions agreed to by the tobacco companies that are designed to reduce smoking and thus improve public health. Figure 4 summarizes the major public health-related provisions of the agreement.

It is unknown how effective these provisions will be. It should be noted, however, that some of the efforts that will be established as a result of the settlement, such as advertising and education programs to combat smoking, already exist in California and are supported with Proposition 99 funds.

Figure 4

Major Provisions Related to Public Health

Restrictions on Advertising

- Bans use of ***cartoon characters*** in advertising.
- Prohibits ***targeting youth*** in advertising, promotions, or marketing.
- Bans outdoor advertising including billboards, and placards in arenas, stadiums, shopping malls, and video game arcades.
- Limits size of ***advertising outside retail establishments*** to 14 square feet.
- Bans ***transit*** advertising.

Restrictions on Product Placement and Sponsorship

- Bans distribution and ***sale of apparel and merchandise*** with brand name logos, beginning July 1, 1999.
- Bans payments to promote ***tobacco products in movies, television shows, theater*** productions, live or recorded music performances, and videos and video games.
- Prohibits brand name ***sponsorship of team sports*** events or events with a significant youth audience.
- Limits tobacco companies to ***one brand name sponsorship per year*** (after current contracts expire).
- Bans tobacco ***brand names for stadiums and arenas.***

New National Foundation to Combat Smoking

- Establishes new national foundation to develop ***advertising and education programs*** to combat teen smoking and educate consumers about tobacco-related diseases.
- Industry will pay total of ***$1.45 billion*** for national public education campaign for tobacco control and ***$25 million per year*** to study programs to reduce teen smoking.

Other Restrictions

- Disbands certain ***organizations affiliated with tobacco industry***—Council for Tobacco Research, the Tobacco Institute, and the Council for Indoor Air Research.
- Prohibits tobacco firms from ***opposing proposed state and local laws which are intended to limit youth access*** to and consumption of tobacco products.
- Prohibits the industry from making any ***material misrepresentations regarding the health consequences*** of smoking.

DIFFERENCES BETWEEN THE SETTLEMENT AND PREVIOUS AGREEMENTS

The current agreement is the culmination of efforts to settle state lawsuits against the tobacco companies that have been ongoing for several years.

The 1997 "Global Settlement"

In mid-1997, the attorneys general of 40 states and the companies worked out the so-called "global settlement" agreement. Under this agreement, the companies would have made major monetary payments to the states. These payments would be in exchange for certain enactment of laws by Congress which would have essentially halted much of the litigation against the tobacco industry and placed certain restrictions on future litigation against the industry, including no punitive damages, no class actions, and an annual cap on damage payments. Although federal legislation was introduced to enact the global settlement, as well as legislation that went far beyond that settlement, Congress did not pass any legislation. The current multistate settlement requires no legislative action by Congress.

The current settlement does not provide for payments as large as the global settlement. The global settlement proposed $368 billion over 25 years in payments to the states as opposed to the current agreement which is $206 billion over 25 years.

From a public health standpoint, probably the most significant policy difference between the two settlements is that the global settlement would have changed current federal law to allow the U.S. Food and Drug Administration (FDA) to regulate tobacco. In addition, the global settlement contained somewhat broader restrictions on the content of tobacco company advertising than the current settlement, although the current agreement contains broader restrictions on the placement of advertising. The global settlement contained so-called "look-back" provisions that would have penalized tobacco companies if youth smoking did not decline over time. However, only the current settlement includes establishment of a national foundation to study youth smoking and fund antismoking advertising.

Settlements With the Four Other States

As indicated earlier, four states (Florida, Minnesota, Mississippi, and Texas) all have previously settled their cases against the tobacco companies with conditions and provisions similar to those of the current settlement. The amount of money projected for California under the current settlement, on a per capita basis, is similar to the amounts projected for Florida and Texas. However, in Mississippi, which was the first state to file a lawsuit, and in Minnesota, which settled just prior to the end of the trial, the per capita amounts were much greater than for California in the current multistate agreement.

RELATIONSHIP OF THE SETTLEMENT TO PROPOSITION 10

Proposition 10, enacted by the voters in the November 1998 election, created the California Children and Families First Program. This program will fund early childhood development programs from revenues generated by increases in the state excise tax on cigarettes and other tobacco products. The measure increases the excise tax on cigarettes by 50 cents per pack beginning January 1, 1999, bringing the total state excise tax to 87 cents per pack. The measure also will increase the excise tax on other types of tobacco products (such as cigars, chewing tobacco, pipe tobacco, and snuff) beginning July 1, 1999.

Although both the tobacco agreement and Proposition 10 will generate substantial additional revenues to the state and local governments in California, their similarities end there. The major difference between the two is that Proposition 10 revenues can only be used for specified purposes allocated by local commissions, whereas there are no restrictions on the use of the tobacco settlement monies by the state or local governments.

Figure 5 compares the major features of the tobacco settlement and Proposition 10. Appendix 2 shows our estimate of the revenues to the individual counties resulting from the measure for 1998-99 (partial-year implementation) and 1999-00 (full-year implementation). (For additional information on Proposition 10, please see our recent report *Proposition 10: How Does It Work and What Role Should the Legislature Play in Its Implementation?*

Figure 5

Comparison of Tobacco Settlement and Proposition 10

	Tobacco Settlement	Proposition 10
Revenue	$800 million to $1 billion annually, split 50-50 between state and local governments	$690 million in 1999-00 declining slightly in subsequent years[a]
Use of funds	No restrictions	Restricted to child development programs
Projected revenue	Significant uncertainty, especially in the long run	Likely to decline slowly
Control of funds	State and locally elected officials	County-appointed commission and state commission
How funds generated	Payments from tobacco companies (passed on to consumer)	New state tax on tobacco products
Effective date	1999-00	January 1, 1999

[a] Legislative Analyst's Office estimate.

WHAT SHOULD THE LEGISLATURE DO?

As indicated previously, the agreement does not require any action by the Legislature in order to take effect. However, the agreement raises a number of issues that the Legislature will need to consider.

Recognize Funding Uncertainties in the Long Run

Despite the uncertainties outlined above, we believe that it is relatively certain that the state will receive the projected amounts of revenues from the settlement at least in the short run (the next three years or so). However, several of the uncertainties, such as potential declines in smoking and future actions of the federal government, make the long-term funding levels much more questionable.

Given the long-term uncertainties about the revenues, we recommend that the Legislature refrain from dedicating the tobacco settlement monies to support specific new ongoing programs. Rather, we believe that it would be more fiscally prudent to reexamine the settlement projections regularly and continue to deposit the money in the General Fund without specific earmarking for a particular program. Should the Legislature wish to establish new programs, such programs should *compete* for revenues from the General Fund with all other legislative priorities. Our recommended approach is consistent with the Governor's 1999-00 budget proposal.

Recognize Benefit to Local Governments

Since the property tax shifts of the early 1990s, the Legislature has taken many actions to bolster the fiscal condition of California's local governments. For example, the Legislature has acted to provide cities and counties: Proposition 172 sales tax revenues, relief from trial court funding reform, and programs to support local law enforcement. Combined, these revenues offset more than 60 percent of the ongoing revenue loss due to the property tax shift. For 1998-99, we estimate that the "net harm" to local governments associated with the property tax shift is about $1.4 billion.

As shown in Figure 2, the tobacco settlement is expected to provide to local governments $153 million in the first year, rising to about $500 million annually within a few years. In the case of some California cities and counties, these settlement revenues will restore (or improve) the locality's fiscal condition relative to the locality's fiscal condition prior to the property tax shifts. Other cities and counties, while still benefiting significantly from the cigarette settlement, will not find that these settlement revenues fully "make up" the fiscal hole caused by the property tax shift. As the Legislature contemplates proposals for local fiscal relief in the future, we recommend that the Legislature keep in mind these additional financial resources provided through the settlement.

Monitor New National Antitobacco Programs

The settlement establishes a national foundation to combat smoking and includes a total of $1.45 billion in payments from the tobacco companies for establishment of a national tobacco control public education campaign and $25 million per year to study programs to reduce teen smoking. It is not clear how these monies will be used at this time. However, it seems likely that such efforts could complement or supplement the state's existing efforts to curb tobacco consumption. For this reason, it will be important for the administration and the Legislature to closely monitor implementation of these provisions of the settlement and make adjustments to the state's programs as necessary.

Consider Adopting the Model Legislation Included

The settlement agreement includes model legislation that would protect the payments made to the state from decreasing as a result of loss of market share or entry into the market by new tobacco companies. In view of this fiscal issue, we believe that the Legislature may want to consider enacting the model legislation.

CONCLUSION

The tobacco settlement will result in significant additional resources to California's state and local governments. As the Legislature debates its approach toward utilizing these funds, it is critical that the uncertainties surrounding the level of funds the state will receive in the future be taken into account.

Estimated Annual Payments to Local Governments From Tobacco Settlement[a]

1998 Through 2025
(In Thousands)

Local Government	1998	2000	2001	2002	2003	2004-2007 Per Year	2008-2017 Per Year	2018-2025 Per Year	Total
Alameda County	$5,925	$15,830	$17,094	$20,524	$20,719	$17,292	$17,635	$19,761	$483,696
Alpine County	5	14	15	18	18	15	15	17	421
Amador County	139	372	401	482	487	406	414	464	11,359
Butte County	844	2,254	2,434	2,922	2,950	2,462	2,511	2,813	68,865
Calaveras County	148	396	428	513	518	433	441	494	12,099
Colusa County	75	201	217	261	264	220	224	251	6,154
Contra Costa County	3,723	9,946	10,740	12,896	13,018	10,865	11,080	12,416	303,915
Del Norte County	109	290	313	376	380	317	323	362	8,871
El Dorado County	584	1,559	1,684	2,022	2,041	1,703	1,737	1,946	47,642
Fresno County	3,092	8,260	8,920	10,710	10,811	9,023	9,202	10,311	252,398
Glenn County	115	307	331	398	402	335	342	383	9,377
Humboldt County	552	1,474	1,592	1,911	1,929	1,610	1,642	1,840	45,042
Imperial County	506	1,353	1,461	1,754	1,770	1,478	1,507	1,689	41,331
Inyo County	85	226	244	293	296	247	252	282	6,913
Kern County	2,517	6,725	7,262	8,720	8,803	7,347	7,492	8,396	205,505
Kings County	470	1,256	1,356	1,628	1,643	1,372	1,399	1,567	38,368
Lake County	235	627	677	812	820	684	698	782	19,145
Lassen County	128	342	369	443	447	373	380	426	10,436
Los Angeles County	41,055	109,681	118,437	142,209	143,554	119,812	122,189	136,918	3,351,422
Los Angeles, City of	3,829	10,230	11,047	13,264	13,389	11,175	11,397	12,770	312,587
Madera County	408	1,090	1,177	1,413	1,427	1,191	1,214	1,361	33,309
Marin County	1,066	2,847	3,075	3,692	3,727	3,110	3,172	3,555	87,006
Mariposa County	66	177	191	229	232	193	197	221	5,408
Mendocino County	372	994	1,074	1,289	1,301	1,086	1,108	1,241	30,381
Merced County	826	2,208	2,384	2,862	2,890	2,412	2,459	2,756	67,459
Modoc County	45	120	129	155	157	131	133	150	3,660
Mono County	46	123	133	160	161	135	137	154	3,765
Monterey County	1,647	4,401	4,753	5,707	5,761	4,808	4,903	5,494	134,485
Napa County	513	1,371	1,480	1,777	1,794	1,497	1,527	1,711	41,883
Nevada County	364	972	1,049	1,260	1,272	1,061	1,082	1,213	29,687
Orange County	11,166	29,830	32,212	38,677	39,043	32,586	33,232	37,238	911,502
Placer County	800	2,138	2,309	2,772	2,799	2,336	2,382	2,669	65,339
Plumas County	91	244	264	317	320	267	272	305	7,464
Riverside County	5,421	14,484	15,640	18,779	18,957	15,822	16,136	18,080	442,568
Sacramento County	4,823	12,885	13,914	16,706	16,864	14,075	14,354	16,085	393,716
San Benito County	170	454	490	589	594	496	506	567	13,876
San Bernardino County	6,570	17,552	18,954	22,758	22,973	19,174	19,554	21,911	536,331
San Diego County	11,571	30,913	33,381	40,080	40,460	33,768	34,438	38,589	944,573
San Diego, City of	3,829	10,230	11,047	13,264	13,389	11,175	11,397	12,770	312,587

(Continued)

Local Government	1998	2000	2001	2002	2003	2004-2007 Per Year	2008-2017 Per Year	2018-2025 Per Year	Total
San Francisco, City and County of	$7,183	$19,189	$20,721	$24,880	$25,115	$20,961	$21,377	$23,954	$586,337
San Joaquin County	2,226	5,948	6,423	7,712	7,785	6,497	6,626	7,425	181,740
San Luis Obispo County	1,006	2,687	2,902	3,484	3,517	2,936	2,994	3,355	82,115
San Mateo County	3,009	8,039	8,681	10,423	10,522	8,782	8,956	10,035	245,642
Santa Barbara County	1,712	4,574	4,939	5,930	5,986	4,996	5,095	5,710	139,760
Santa Clara County	6,937	18,532	20,012	24,028	24,256	20,244	20,646	23,135	566,278
San Jose, City of	3,829	10,230	11,047	13,264	13,389	11,175	11,397	12,770	312,587
Santa Cruz County	1,064	2,843	3,070	3,686	3,721	3,106	3,167	3,549	86,869
Shasta County	681	1,820	1,965	2,359	2,382	1,988	2,027	2,271	55,599
Sierra County	15	41	44	53	54	45	46	51	1,255
Siskiyou County	202	539	582	698	705	588	600	672	16,460
Solano County	1,577	4,213	4,549	5,462	5,514	4,602	4,693	5,259	128,723
Sonoma County	1,798	4,804	5,188	6,229	6,288	5,248	5,352	5,997	146,798
Stanislaus County	1,716	4,585	4,951	5,945	6,001	5,009	5,108	5,724	140,105
Sutter County	298	797	861	1,034	1,043	871	888	995	24,357
Tehama County	230	614	663	796	804	671	684	767	18,765
Trinity County	61	162	175	210	212	177	180	202	4,940
Tulare County	1,445	3,860	4,168	5,005	5,052	4,217	4,300	4,819	117,945
Tuolumne County	224	600	648	777	785	655	668	749	18,323
Ventura County	3,099	8,279	8,940	10,734	10,836	9,044	9,223	10,335	252,975
Yolo County	654	1,746	1,885	2,264	2,285	1,907	1,945	2,180	53,351
Yuba County	270	721	778	934	943	787	803	900	22,018
Totals	**$153,167**	**$409,196**	**$441,866**	**$530,552**	**$535,573**	**$446,993**	**$455,864**	**$510,813**	**$12,503,486**

[a] Assumes all eligible local governments participate in tobacco settlement.

Estimated County Allocation of Proposition 10 Revenues[a]

(In Thousands)

County	1998-99	1999-00	County	1998-99	1999-00
Alameda	$11,370	$21,631	Orange	26,000	49,464
Alpine	4	7	Placer	1,427	2,716
Amador	148	281	Plumas	85	162
Butte	1,234	2,347	Riverside	12,768	24,290
Calaveras	179	341	Sacramento	9,479	18,033
Colusa	168	320	San Benito	486	925
Contra Costa	6,731	12,806	San Bernardino	15,505	29,498
Del Norte	177	337	San Diego	23,683	45,056
El Dorado	912	1,735	San Francisco	4,488	8,537
Fresno	7,729	14,704	San Joaquin	4,774	9,082
Glenn	234	445	San Luis Obispo	1,364	2,595
Humboldt	809	1,540	San Mateo	5,503	10,468
Imperial	1,304	2,480	Santa Barbara	3,170	6,030
Inyo	104	198	Santa Clara	14,464	27,516
Kern	6,171	11,740	Santa Cruz	1,949	3,707
Kings	1,141	2,171	Shasta	1,095	2,083
Lake	309	589	Sierra	7	12
Lassen	180	342	Siskiyou	233	443
Los Angeles	88,719	168,783	Solano	2,998	5,703
Madera	1,088	2,070	Sonoma	2,962	5,634
Marin	1,451	2,761	Stanislaus	3,718	7,073
Mariposa	74	141	Sutter	663	1,260
Mendocino	561	1,068	Tehama	343	653
Merced	1,977	3,760	Trinity	55	104
Modoc	54	102	Tulare	3,797	7,223
Mono	65	123	Tuolumne	256	486
Monterey	3,679	7,000	Ventura	6,177	11,751
Napa	821	1,561	Yolo	1,153	2,194
Nevada	436	829	Yuba	573	1,090
			Totals	**$287,000**	**$546,000**

[a] Based on Legislative Analyst's Office Revenue Estimates.

Acknowledgments

This report was prepared by Alexander S. MacBain, under the supervision of Craig Cornett. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.

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