December 17, 1999

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Diane Calkins
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to the Elections Code Section 9005, we have reviewed the proposed initiative entitled "The Tobacco Treatment and Health Care Act" (File No. SA1999RF0058, Amendment #1-S). This measure places the state's portion of funds received from the tobacco litigation Master Settlement Agreement of 1998 into a special fund and, using a specified formula, requires that the Legislature appropriate the funds annually for the purpose of supplementing three general areas of health care delivery.

Background

In November 1998, the attorneys general of 46 states, including California, signed an agreement with five of the country's largest tobacco firms to settle several 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 are expected to receive $206 billion in payments from the tobacco companies over the next 25 years.

California is projected to receive about $25 billion in settlement funding through 2025. The amount will be split between the state and local governments. The state's annual portion of payments ranges from $442 million in 2001 to a maximum of $536 million in 2003, before adjusting for inflation, with slightly smaller amounts received annually thereafter. (The settlement provides for annual inflation adjustments to the amounts the state will receive.) The settlement places no restrictions on the use of the money.

We note that there are a number of factors that could affect the amount of money available to California, pursuant to the provisions of the settlement. For example, allocations to the states could be affected if any of the tobacco companies declare bankruptcy, or if the volume of cigarette sales changes (relative to the 1997 baseline level of sales).

The *1999-00 Budget Act* assumes that the state General Fund will receive $562 million in the current year from the tobacco settlement (which includes the initial two annual payments), to be deposited in the General Fund as unrestricted revenues. This funding reflects half of the tobacco settlement monies that California is expected to receive in the current year; the other half would go to California's local governments. The state expects to receive these funds by June 30, 2000. Subsequent payments to California will be made on April 15 of each year.

Several legislative bills were introduced in the current year that would have appropriated the tobacco settlement funds for specific purposes. The Legislature passed two of these bills, but the Governor vetoed them.

Summary of the Initiative

Creation of New Fund. This measure amends the Health and Safety Code to create the Tobacco Settlement Fund as a repository for the *state* share of funds received on or after January 1, 2001 from the tobacco litigation Master Settlement Agreement of 1998, for the purpose of supplementing certain health care services.

Fund Distribution and Purpose. The measure requires that the Legislature appropriate all Tobacco Settlement Fund monies annually, pursuant to the following guidelines:

- ***Cessation Programs.*** Twenty percent of the annual amount must be appropriated for tobacco use cessation programs recommended and approved by the

Secretary of the Health and Human Services Agency. This includes, but is not limited to, the following programs: payments for nicotine and nonnicotine therapies, substitution programs, and maintenance regimens; counseling services; necessary health services for individual tobacco users participating in cessation programs, which are not otherwise covered by private or public health insurance programs; and "aggressive" outreach and recruitment programs informing tobacco users of the availability of such services at minimal or no cost to individuals. The measure prohibits using these funds to supplant payments that would otherwise be covered by private or public health insurance programs.

- ***Access to Health Care.*** Sixty percent of the annual amount must be appropriated for expanding access to health care services. This is to include, but is not limited to, the following services: basic health care services for uninsured children and adults; immunization programs; prescription medication coverage for senior citizens; and innovative treatments for chronic diseases correlated with tobacco use. The measure prohibits using these funds to supplant payments that would otherwise be covered by private or public health insurance programs.

- ***Primary Care Clinics.*** Twenty percent of the annual amount must be appropriated for a grant program administered by the state Department of Health Services, for the purpose of expanding programs in certain licensed and tribal primary care clinics. At least 35 percent of these funds must be designated for use in providing smoking prevention and cessation health education programs and treating patients with diseases correlated with tobacco use. Finally, under this provision of the measure, grants must be made only for services for which payment will not be made through any private or public third-party reimbursement.

Other Provisions. The measure also includes the following provisions:

- ***Notification.*** The measure directs the Office of the Legislative Analyst to publicly announce, within 30 days of the receipt of any monies into the Tobacco Settlement Fund, the total amount received and the total amount available for distribution in the next calendar year, or other appropriate time period, for each of the purposes set forth in the measure.

- ***Supplement, Not Supplant.*** Funds expended pursuant to the above guidelines must be used to supplement, and not supplant, existing levels of service.

- ***Amendments.*** The measure prohibits amending any of its provisions, except to further the measure's purpose by a bill passed by a vote of two-thirds of the membership of both houses of the Legislature and signed by the Governor.

Fiscal Effects

Revenues. Under current law, there is no statutory provision directing where the tobacco settlement payments are to be deposited. However, under current practice, these payments are deposited into the General Fund. Using current practice as our point of reference, this measure would result in an annual General Fund revenue loss and a corresponding state special fund revenue gain, beginning January 1, 2001. These amounts would be equal to the state share of the funds California will receive annually from the tobacco settlement. The amount is estimated to be $442 million in 2001, with subsequent annual amounts ranging from $447 million to $536 million, plus the inflation adjustments. The total amount over the 25 years of receipt of the tobacco settlement funds is estimated at $12.5 billion (plus the inflation adjustments).

Expenditures. The measure will result in a redirection of the tobacco settlement funds from unspecified programs that would otherwise be supported by the General Fund (and/or from the General Fund reserve) to specified health programs.

Our analysis assumes that all administrative costs (primarily in the Department of Health Services) will be funded by the newly created Tobacco Settlement Fund.

Vehicle License Fee (VLF). Under current state law, additional reductions in the VLF (beyond the reduction implemented in 1999) will be "triggered" if specific General Fund revenue levels are reached, beginning in 2000-01 and extending through 2003-04. Current law also provides that any resulting losses of VLF revenues, which are allocated to local governments, will be "backfilled" with state General Fund monies.

Because this proposed initiative would reduce General Fund revenues, it is possible that the measure would prevent the future triggering of a VLF reduction and therefore result in General Fund savings. Based on our current projections of General Fund revenues, however, we estimate that the initiative will have no effect on the VLF triggers.

Summary of Fiscal Effects. The measure will result in a General Fund revenue loss, and a corresponding state special fund revenue gain, ranging from $442 million to $536 million annually (plus inflation adjustments).

Sincerely,

Elizabeth G. Hill
Legislative Analyst

B. Timothy Gage
Director of Finance