January 11, 2000

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 "Investment of Tobacco Settlement Funds for Health" (File No. SA1999RF0067). This measure places the state's portion of funds received from the tobacco litigation Master Settlement Agreement of 1998 into a newly created special fund, and further requires that these funds be appropriated annually by the Legislature for specified health services.

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 the 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. These amounts will change based on annual inflation adjustments and changes in the volume of cigarettes shipped within the U.S. for sale. The amount will be split between the state and local governments (pursuant to a Memorandum of Understanding [MOU] established between the state's Attorney General and the local governments). The local share will be further split among counties and specified cities. Under the terms of the MOU, the state's 58 counties will receive 90 percent of the local share. These monies will be distributed to the counties based on population. The remaining 10 percent will be split equally among four specified cities—Los Angeles, San Diego, San Francisco, and San Jose.

Based on the most recent estimates, the state's annual portion of payments are projected to range from about $390 million in 2001 to about $470 million in 2003, before adjusting for inflation, with slightly smaller amounts received annually thereafter. 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 about $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. Pursuant to a more recent estimate, the state is expected to receive $517 million in the current year. 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.

Summary of the Initiative

Creation of New Fund. This measure creates the California Tobacco Settlement Fund as a repository for the *state* share of funds received by the settlement on or after January 1, 2001.

Fund Distribution and Purpose. The measure requires that the Legislature annually appropriate California Tobacco Settlement Fund monies (state's share of funds), pursuant to the following guidelines:

- Twenty-three percent for providing drugs and community-based long-term care for seniors and persons with disabilities.
- Twenty-two percent for emergency medical services for nonpaying patients provided by certain emergency room physicians.
- Fifteen percent for tobacco prevention and control, including cessation services.
- Fifteen percent for nonprofit community clinics to provide immunizations, primary care, and other health services.
- Ten percent for school nurses' services for students in public elementary schools.
- Ten percent for trauma centers and hospitals—including children's hospitals, university hospitals, community hospitals, and county hospitals—that provide a "disproportionate share" of unfunded health care services.
- Five percent for poison control centers, the Access for Infants and Mothers Program, and the Major Risk Medical Insurance Program, for the purpose of avoiding the closing of the poison control centers and reducing the waiting lists for health coverage for infants, mothers, and persons denied health insurance.

Other Provisions. The measure also includes the following provisions:

- If any of the services funded through the California Tobacco Settlement Fund's distribution formula are funded by "other" federal funds, the Legislature, by a two-thirds vote in each house, may reallocate the state's tobacco settlement funds to other services specified in the distribution formula. (The meaning of other federal funds is not clear in the initiative.)
- If state tax revenues, as estimated by the Legislative Analyst's Office, are forecasted to be lower in the budget year than in the current year, the Governor may propose and the Legislature, by two-thirds vote in each house, may allocate tobacco settlement funds in the budget year for any state government purpose.

- The tobacco settlement funds expended pursuant to the measure's guidelines must be used to supplement, and not supplant, 1999-00 levels of federal, state, and local funding for each of the services specified in the guidelines.

State 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, the state's share of payments is 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—estimated to be about $390 million in 2001, with subsequent annual amounts ranging from about $400 million to about $470 million. The total amount over the 25 years of receipt of the tobacco settlement funds is estimated at about $12.5 billion (adjusted for inflation and changes in the volume of cigarettes sold in the U.S.).

Expenditures. The measure will result in a redirection of the tobacco settlement funds from programs that would otherwise be supported by the General Fund (and/or the General Fund reserve) to specified health and human services 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 about $390 million to about $470 million annually (plus inflation adjustments).

Sincerely,

Elizabeth G. Hill
Legislative Analyst

B. Timothy Gage
Director of Finance