



Use of Phase II Payments in Tennessee

Policy Update

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The Phase II Agreement

The Master Settlement Agreement contained language that called for participating manufacturers to meet with representatives of major tobacco producing states to come up with a plan to help compensate tobacco growers and quota holders for declining tobacco consumption and demand resulting from the settlement. The result was establishment of the National Tobacco Growers' Settlement Trust Fund, which has come to be known as "Phase II" of the tobacco settlement. Phase II calls for participating cigarette manufacturers to pay \$5.15 billion into a national tobacco grower trust over 12 years to be distributed among tobacco-growing states based on each state's share of 1998 tobacco quotas.

Phase II funds may only be used to make direct payments to tobacco quota holders and producers who suffer economic losses due to industry settlement of state lawsuits. Funds cannot be used for agricultural development, warehouses, or any purpose other than payments directly to quota owners and growers. Payments are only for quotas of tobacco types used in domestic cigarettes. According to the agreement, each participating state is responsible for establishing a board to distribute funds among eligible tobacco quota holders and growers. The allocation of funds among the state's quota owners and growers (including owners, lessees, and tenants) is determined by each individual state board. In flue-cured regions, state boards have generally split payments evenly between growers and quota owners. In burley regions, payments have generally been weighted more heavily toward growers or those bearing a larger share of financial risk. This issue of *Policy Update* focuses on Phase II funds in Tennessee, while another issue describes the use of Phase II funds in other major tobacco states.

Phase II in Tennessee

Total Phase II payments to Tennessee growers are expected to be \$390 million over the 12 year period. The Tennessee Tobacco Farmers Certifying Board is charged with developing and implementing annual plans for distributing Tennessee's share of the National Tobacco Growers Settlement Trust (Phase II) payments. Similar to 1999, the board decided to allocate 80% of the 2000 Phase II payments to tobacco growers and 20% to quota owners. Payments to quota owners are based on basic quota in the previous year and payments to growers are based on actual marketings in the previous year. In 1999, Tennessee distributed nearly \$29 million in Phase II payments to more than 68,000 tobacco growers and quota owners. Payments for 2000 were nearly \$19 million.

The state's Phase II board is considering fixing future payments to a benchmark average of quota and marketings to reduce the transfer of payments from growers to quota owners through higher quota lease costs. Additionally, some concern has been expressed that a rolling base year is keeping some producers in production to avoid losing Phase II payments who otherwise may transition out of tobacco production. At this time, no decisions have been made. The board will likely take up the issue again over the summer prior to determining payment basis for 2001. Several neighboring states have fixed their future Phase II payments to base years or are considering similar measures.

The Agriculture Fund

The agriculture committee is recommending that their half of the current settlement dollars be used to fund agricultural development programs—in the areas of (1) alternative agricultural development, (2) agribusiness and industrial infrastructure, (3) creation/expansion of agricultural processing facilities, (4) agricultural marketing development, and (5) agricultural production efficiency and effectiveness—and educational financial assistance programs. Educational assistance funds could be used for scholarships for persons directly or indirectly affected by changes in the tobacco and/or agricultural economy or it could provide scholarships for students who agree to provide services in rural or underserved communities such as nurses and teachers. Guidelines for scholarships and educational assistance would be determined by an advisory board. All agricultural development programs would operate through the Tennessee Department of Agriculture.

The committee is recommending that any unspent agriculture funds be placed in a trust fund with only the future interest eligible for expenditures in the recommended areas. They are further recommending that half of all future MSA payments to the state go to an agriculture fund trust to use investment income for the same program areas. They also recommend securitization of the future income stream.

The Health Fund

The health committee's final recommendations included funding the state's tobacco plan at the minimum level suggested by the Centers for Disease Control and Prevention, \$37 million. The \$37 million includes \$22 million for tobacco prevention and cessation programs and \$15 million for comprehensive school health programs. The committee also recommended allocating \$30 million to six hospitals to reimburse them for costs of treating sick smokers. Additionally, the committee recommended allocating \$10 million for tobacco addiction, prevention, and treatment research, \$5 million for voluntary smoking cessation programs, \$5 million for administration, \$3 million for a statewide counter-marketing campaign emphasizing minorities, \$2 million for grants to other anti-smoking projects, \$1 million to a lung center, and \$1 million for Department of Health oversight and grant writing.

The health committee also recommended that the other half of the Health Fund (about \$90 million) be placed in a trust account with only the future interest available for health expenditures. They are also recommending that half of all future settlement funds in the state (beyond 2001) go to the Health Fund.

The Future of Tennessee's Settlement Payments

The legislature will take up the issue this spring. It is expected that the recommended uses may compete with using the money to avoid a projected budget shortfall. Some legislators are considering combining the recommendations of the health and agriculture committees into one bill to broaden the base of support and avoid having the settlement issue on the table twice. While still unknown at this time, several legislators feel that the settlement spending issue will not come before the full legislature for a vote until mid- to late-spring.