

Millions of dollars collected on Kentucky cigarette sales diverted to New York, California & other big states

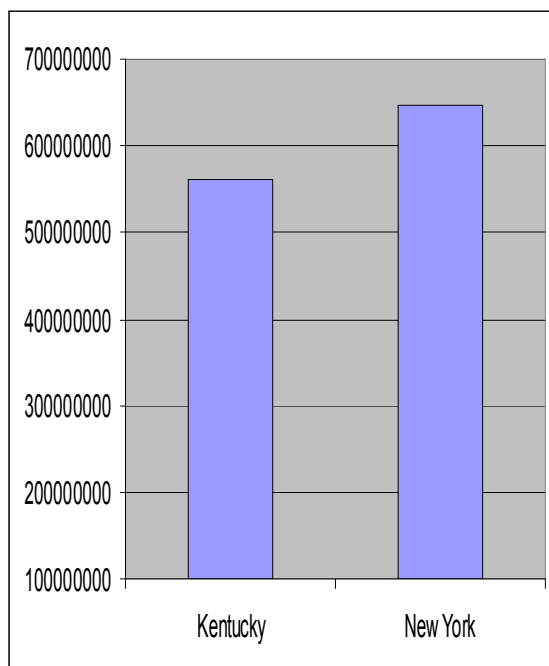
Ron Tully,
National Tobacco Company, Louisville, KY

In 1998, Kentucky and 45 other states brought lawsuits against big tobacco companies. Rather than go to trial, big tobacco agreed to a settlement requiring them to pay millions every year into a settlement fund. Tobacco companies pay about \$4.00 per carton into the settlement fund which is then allocated back to the states. One might think that each state would get back the amount that each state pays into the settlement. Think again!

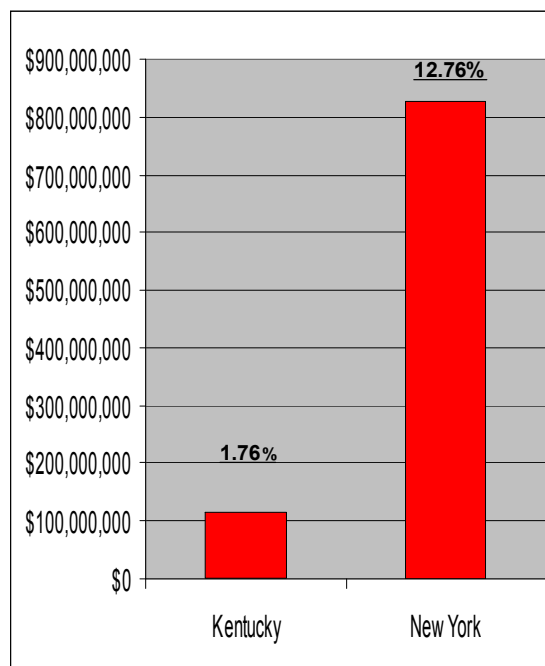
The formula used to distribute settlement funds back to the states heavily favors big states like New York and California. As it turns out, Kentucky leads a list of 29 mostly small to medium sized states that pay more into the settlement than they receive. For every \$4.00 payment to the settlement on a carton of cigarettes sold in New York, the Empire State gets back a whopping \$12.21. For every \$4.00 paid on sales made in Kentucky, the Bluegrass State only receives \$1.58. Don't assume that New York sells a lot more cigarettes than Kentucky – they don't. As can be seen from the bar graphs below, cigarette sales in New York and Kentucky are roughly equal. Allotments from the settlement fund are lopsided in favor of New York. Clearly, the settlement favors those who had the most prominent place at the negotiating table when the lawsuits were settled in New York in November of 1998. Kentucky only gets 1.76% of settlement money no matter how many cigarettes we sell while New York gets 12.76% of the settlement.

Equal Sales/Unequal MSA Payments

2004 Packs Sold



2004 MSA Payments



In his State of the Commonwealth speech on January 9, Governor Ernie Fletcher commented on this situation saying, "It's a good deal.....if you live in New York." The Governor asked legislators to consider revising the system to ensure that money collected on cigarette sales in Kentucky is no longer diverted to New York, California and other big states that got such a sweet deal under the tobacco settlement. Legislation will be introduced during the current session of the Kentucky General Assembly to replace financial payments to the tobacco settlement fund with a state tax on cigarette manufacturers equal to the per carton payments made by manufacturers under the settlement. Under this arrangement, Kentucky would keep all the money collected on Kentucky cigarette sales – about \$224M annually – over \$130M more than the State now keeps because of the diversion of these funds to other states.

This sounds like a great idea, but not to big tobacco. The same big tobacco companies that tried to get out of their Phase II tobacco settlement payments to farmers, want to maintain the status quo that forces Kentuckians to subsidize tobacco settlement funded programs in states like New York. Big tobacco lobbyists are already busy in Frankfort trying to snuff out the efforts of Republican and Democrat lawmakers who want to help the Governor keep Kentucky's future tobacco settlement money in Kentucky.

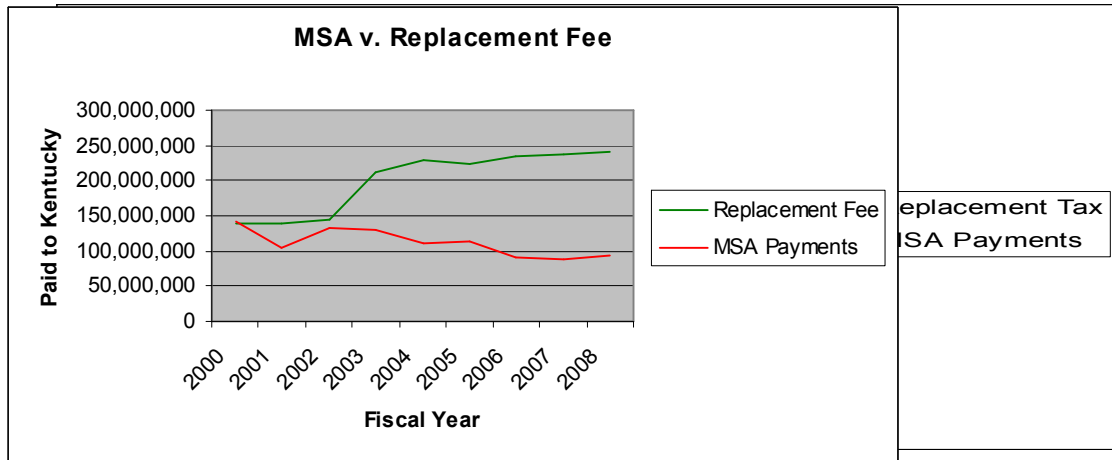
But the story gets worse. Not only is big tobacco working to continue the diversion of funds collected in Kentucky to other states, big tobacco has also worked since the settlement began in 2000 to lower their overall payment to the settlement. Due to these efforts, the amount Kentucky receives from the settlement has dropped by 36% - and will continue to decrease. In fact, the entire payment to Kentucky from the settlement could disappear overnight if one of the consumer lawsuits challenging big tobacco companies is ever successful, or if the settlement is ruled unconstitutional by one of the numerous lawsuits attacking it on constitutional and other grounds.

The beauty of the proposal to substitute settlement payments with a state tax directly on manufacturers, is that the increased revenue from the tax will come from smokers in New York, California and the other states that have been taking Kentucky's money for years. Smokers in Kentucky should not see any increase in cigarette prices if Kentucky adopts the replacement tax.

The 2006 Kentucky General Assembly is currently in session. Citizens can leave a message for legislators asking them to support the tobacco replacement tax by calling 1-800/372-7181. Legislators can also be contacted by email: firstname.lastname@lrc.ky.gov.

Benefits of substituting MSA payments with a tobacco manufacturers flat fee/tax system

The most compelling reason for Kentucky to adopt the flat fee/tax proposal in lieu of participating in the MSA is the amount of revenue the flat fee can generate for the state. This graph illustrates what the state could have collected had it instituted a flat fee in FY 2000, and the increasing value of such a flat fee/tax.



• Data for fiscal years 2006 - 2008 assumes 56 million cartons sold annually and the state's MSA revenue estimate.

How does the flat fee/tax produce more money than the MSA?

1. The flat fee captures MSA payment assessments on Kentucky sales that now go out-of-state. Kentucky sells about 3% of the nation's cigarettes, but only shares in 1.76% of the MSA assessments. As the chart below illustrates, KY is subsidizing programs in states that get a bigger share of the MSA allotment

KY's MSA allotment for each \$4 payment compared to other states				
	Kentucky	New York	Massachusetts	California
Amt. returned for each \$4 payment	\$1.58	\$12.21	\$8.55	\$6.85
Net gain/loss for each \$4 payment	(\$2.42)	\$8.21	\$4.55	\$2.85

2. Some of the manufacturers that pay the MSA assessment were granted exemptions allowing them to pay much lower amounts than other participating companies. Under the flat fee/tax, **all** companies will pay the same per carton assessment.
3. Cigarette manufacturers that are currently not signatories to the MSA are still required to pay the same per carton assessment into escrow accounts. These funds eventually revert to the companies, but going forward, would be paid directly to the state under this proposal.

Revenue from the flat fee would continue to grow for two reasons:

1. The flat fee/tax increases each year with inflation.
2. Even though the per carton MSA assessment continues to increase, the various adjustments signatory companies are likely to receive on their total MSA payments have caused the state to estimate a reduction in future MSA revenues.

Other Benefits:

- A possible bankruptcy by one of the major signatories due to various lawsuits would devastate the MSA revenue stream, but would have no effect on the flat fee/tax.
- Perhaps the most important benefit of the flat fee/tax would be to establish a stable revenue source for the state as opposed to the uncertain and erratic payments from the MSA.

Participation by Kentucky in MSA v. Collecting Flat Fee/Tax			
	Kentucky's MSA Allotments	Estimated Revenue from \$4.00 flat fee *	Net gain/loss from adoption of flat fee
2000	\$142,251,741	\$136,955,831	(\$5,295,910)
2001	\$105,727,660	\$139,608,901	\$33,881,241
2002	\$132,777,390	\$143,150,269	\$10,372,870
2003	\$130,829,140	\$212,783,311	\$81,954,171
2004	\$109,482,960	\$230,196,260	\$120,713,300
2005	\$112,241,980	\$224,000,000*	\$111,758,020
2006	\$91,300,000	\$224,000,000*	\$132,700,000
2007	\$88,800,000	\$224,000,000*	\$135,200,000
2008	\$94,000,000	\$224,000,000*	\$130,000,000