

HOUSE FINANCE COMMITTEE
May 18, 2003
11:20 AM

TAPE HFC 03 - 101, Side A
TAPE HFC 03 - 101, Side B

CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 11:20 AM.

MEMBERS PRESENT

Representative John Harris, Co-Chair
Representative Bill Williams, Co-Chair
Representative Kevin Meyer, Vice-Chair
Representative Ethan Berkowitz
Representative Mike Chenault
Representative Richard Foster
Representative Mike Hawker
Representative Beth Kerttula
Representative Carl Moses
Representative Bill Stoltze
Representative Jim Whitaker

MEMBERS ABSENT

None

ALSO PRESENT

Senator Con Bunde, Sponsor; Senator Gary Wilken, Sponsor; Senator robin Taylor, Sponsor; Johanna D. Bales, Tax Auditor, Department of Revenue; Tom McKay, Sr., Vice President, Costco Wholesale; Eddy Jeans, Manger, School Finance and Facilities Section, Department of Education and Early Development; Carl Rose, Association of Alaska School Boards; John Alcantra, National Education Association of Alaska; Jim Foster, Assistant Superintendent, Galena City School district; Kelly Huber, Staff, Senator Taylor, Sponsor.

PRESENT VIA TELECONFERENCE

Mike Elerding, Northern Sales; John Ayers, Keystone Distribution Services, Anchorage; Chris Mish, Forester, Department of Natural Resources.

SUMMARY

CSSB 149(RES)

"An Act relating to timber, to the sale of timber by the state, and to the management of state forests."

CSSB 149 (RES) was REPORTED out of Committee with a "do pass" recommendation and one zero fiscal note from the Department of Natural Resources.

CS SB 168(FIN) am

"An Act relating to issuance and revocation of licenses for the importation, sale, distribution, or manufacture of cigarettes and tobacco products; relating to a tax refund or credit for unsaleable, returned, or destroyed tobacco products; relating to restrictions on and penalties for shipping or transporting cigarettes; relating to records concerning the sale of cigarettes; amending and adding definitions relating to cigarette taxes; relating to the payment of cigarette taxes; relating to penalties applicable to cigarette taxes; relating to the definition of the wholesale price of tobacco products; relating to payment of cigarette taxes through the use of cigarette tax stamps; relating to provisions making certain cigarettes contraband and subject to seizure and forfeiture; relating to certain crimes, penalties, and interest concerning tobacco taxes and stamps; relating to cigarette sales; and providing for an effective date."

CSSB 168 (FIN) (am) was REPORTED out of Committee with "no recommendation" and two fiscal notes: one new fiscal impact note from the Department of Revenue and zero fiscal note #2 from the Department of Law.

CSSB 202 (RES)

"An Act relating to school transportation; relating to the base student allocation used in the formula for state funding of public education; and providing for an effective date."

CSSB 202 (FIN) was heard and HELD in Committee for further consideration.

#sb168

CS FOR SENATE BILL NO. 168(FIN) am

"An Act relating to issuance and revocation of licenses for the importation, sale, distribution, or manufacture of cigarettes and tobacco products; relating to a tax refund or credit for unsaleable, returned, or destroyed tobacco products; relating to restrictions on and penalties for shipping or transporting cigarettes; relating to records concerning the sale of cigarettes; amending and adding definitions relating to cigarette taxes; relating to the payment of cigarette taxes; relating to penalties applicable to cigarette taxes; relating to the definition of the wholesale price of

tobacco products; relating to payment of cigarette taxes through the use of cigarette tax stamps; relating to provisions making certain cigarettes contraband and subject to seizure and forfeiture; relating to certain crimes, penalties, and interest concerning tobacco taxes and stamps; relating to cigarette sales; and providing for an effective date."

SENATOR CON BUNDE, SPONSOR, provided information about the bill. He noted that the bill is not "anti tobacco" legislation, nor was it the intent to address taxation. The genesis was a radio spot by an Eastern company, which advertised the sale of tax-free cigarettes that would not be reported to the state [for tax purposes]. The Department of Revenue has been trying to address the leakage in the state of Alaska's tax law on cigarettes. The Department has indicated that they cannot enforce the tax law effectively without a tobacco tax stamp. The Department of Revenue, during litigation proceedings, was able to obtain a list of companies that do pay their tax. The federal government will not join the state in the enforcement of federal law [Jenkins Act] without a tobacco tax stamp. He referenced the state of Michigan, which also has a tobacco tax, and noted that tax revenues in Michigan increased 9 percent when they added a tax stamp. Hawaii saw a 25 percent increase with a tax stamp. He stated that for every one percent that tax revenues increase, Alaska would gain \$400 thousand. He stated that distributors acknowledged that the increase in tobacco price decreases use by youth. Distributors are concerned with fair business practices and have asked for a minimum price, which would prevent sales to youth and undercutting prices. He concluded that selling tobacco below price was poor public policy.

Senator Bunde noted that the Heart Association and the Alaska Tobacco Distributors both supported the bill.

Vice-Chair Meyer expressed support for the legislation but questioned if it were possible to put the burden on the distributor. Representative Bunde noted that other states have forced the industry to bear the full tax burden. The legislation allows the industry to deduct the costs of collecting the tax, for example investment in equipment needed to stamp the cigarettes.

Vice-Chair Meyer observed that even though the bill will cost the state some money, it would increase tax revenues. Representative Bunde predicted a \$3 million net gain or more.

Representative Hawker asked if the bill changed the timing of the tax collection. Representative Bunde speculated that it did not.

JOHANNA D. BALES, TAX AUDITOR, DEPARTMENT OF REVENUE testified via teleconference. She noted that she was the auditor for the state cigarette excise tax. She confirmed that the tax would continue to be collected monthly. In response to a question by Representative Hawker, Ms. Bales noted that the stamp would be purchased up front. Distributors could post a bond, which is what most distributors do, to put the actual payment of the tax off for a month and a half. This is the current practice of the reporting system. The tax payment is due about a month and a half after cigarettes are imported.

In response to a question by Representative Stoltze, Representative Bunde noted that his motivation is to make tobacco less assessable to teenagers. The motivation of tobacco distributor is to ensure a fair playing field.

Representative Stoltze asked if using tools for unfair trade practices might be a more appropriate vehicle, rather than focusing on a particular industry. Representative Bunde maintained that a great number of under-priced cigarettes would be sold before another tool would be effective.

Representative Berkowitz noted that Hawaii and Michigan achieved different revenue results, and asked if their statutes were different. Representative Bunde stated that Hawaii had an aggressive enforcement program.

Ms. Bales confirmed that Hawaii hired eleven enforcement individuals. She stated that the proposed bill was modeled after the state of Hawaii's. She added that the amount of tax collected in Hawaii resulted in an initial increase of 25 percent, the final numbers showed a 50 percent increase, from \$40 million to \$61 million in tax.

Co-Chair Harris noted his support of the bill, but reference complaints by wholesalers. Representative Bunde stated that smaller companies complained that larger wholesalers, like Costco, could sell tobacco under cost. He acknowledged that every business wants to preserve their advantage, but emphasized that every carton sold below cost promotes smoking, since it has been proven that price affects consumption, especially by young people. He also noted that imposing a minimum might affect fairness across the market.

Co-Chair Harris stated that wholesalers had threatened to close their stores in Alaska if the bill passes. Representative Bunde speculated that a company whose profit margins were so narrow might not be doing viable business.

Representative Kerttula asked if the tax was the same regardless of price. Representative Bunde noted that the tax was \$1 per pack, regardless of price. He clarified that companies would now have to meet the minimum price.

Ms. Bales explained that the minimum price stated that cigarettes could not be sold for less than the wholesale purchase price, plus tax, plus cost of doing business. Companies could use a 4.5 percent for wholesale or 6 percent at retail above wholesale to determine price. The price is not a dollar figure.

BOBBY SCOTT, JAN'S DISTRIBUTING, ANCHORAGE, testified via teleconference in support of the bill. He noted that his company had worked on the bill with Representative Bunde and Ms. Johanna D. Bales, Tax Auditor, Department of Revenue.

MIKE ELERDING, NORTHERN SALES, testified via teleconference in support of the bill. He summarized his written testimony (copy on file.) He discussed the history of the bill, and noted favorable testimony received along the way. He concluded that the legislation: provides increased revenue with no new taxes, provides a reasonable profit margin, creates a level playing field for Alaskan distributors, and ends predatory pricing that attracts youth consumption. He pointed out that 25 other states have similar laws.

JOHN AYERS, KEYSTONE DISTRIBUTION SERVICES, ANCHORAGE, testified via teleconference in support of an amended version of the bill. He noted that his company provides storage and distribution for tobacco companies. He asked that the bill be amended to remove the requirement for a customs bonded warehouse. He stated that it would cost his company \$100 thousand to become a customs bonded warehouse. He maintained that the requirement would result in products being distributed from Seattle. He also questioned the need for a minimum price. He asked what would happen if other products were sold at a loss, whether legislation would fix those prices. He also noted that tribal entities were exempted and questioned what would happen to the revenue stream if tribal status were enlarged.

TOM MCKAY, SR., VICE PRESIDENT, COSTCO WHOLESALE expressed concerns regarding minimum pricing and discounts for fixing stamps. He noted that he was responsible for the operations and purchasing for the three Alaskan stores. He noted that Costco had been unaware of the attachments regarding minimum pricing. He referred to page 9, line 22, which would allow a discount to some for fixing stamps. He noted that Costco did not oppose tax stamps, but questioned the need for discounts for certain distributors. He stated that under this provision, those distributing through Costco would be penalized, and asked that this be addressed.

Mr. McKay referred to the wholesale level of distribution, and stated that Costco was a wholesaler as well as retailer. He stated that they supplied small operations, and noted that the price affected where these businesses chose to buy.

He noted that if this provision were enacted, there would be a loss of 68 jobs in Anchorage, and a great loss of business in Juneau. He observed that Costco has a strict policy of never selling goods below cost. He maintained that tobacco is not generally sold below cost by anyone. He noted that markups range around 14 percent. The marketplace and efficiency in sales determine price. The cost of selling tobacco is below other products.

Mr. McKay explained that the cost for a carton of cigarettes was \$2 thousand; on this they are discounted 2 percent for paying in a prompt fashion, which is built into their price, as they do with all products. Under the bill, these savings cannot be passed on. He referred to page 20, line 21, Section 3, and quoted: "exempts the customary discount for cash". He explained that he must now take a markup of \$90 for this exemption. He contrasted this to lower markups for other products, and stressed that the State was now going to monitor these markups.

Mr. McKay noted a provision that might also force Costco to prove a higher cost of doing business. He stated that his labor costs were 4 percent, rent was 1 percent, depreciation and selling costs (which he stated was ambivalent) and licenses, and taxes, were all included in costs of doing business. He noted that their costs were 80 percent. He concluded that the bill was onerous and difficult from a business standpoint. He maintained that to discourage smoking, the tax should simply be raised. He stated that he was aware of only one other state has minimum pricing on tobaccos: Montana. He suggested that the legislation be changed to state that the product cannot be sold below cost, and allow cost to be set in a fair fashion.

Representative Berkowitz observed that a rational business response might be to set up a subsidiary to handle exclusively tobacco products. Mr. McKay acknowledged that it would be a possibility, but questioned the implications of such a practice.

Vice-Chair Meyer asked if the competitors were retailers or wholesalers. Mr. McKay noted that wholesalers were their competitors, and noted that they handled 15 percent of the cigarettes distribution market. Vice-Chair Meyer asked how Alaska would differ from Hawaii and Washington. Mr. McKay noted that these states did not have a minimum price requirement.

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In response to a question by Representative Whitaker, Mr. McKay clarified that they purchase from RJR and Brown Williamson through a bonded warehouse in Alaskan, which is a different class than a distributor.

Representative Whitaker observed that there would be a sliding scale paid for stamps based on volume, and asked the effect on Costco. Mr. McKay noted that they would not get the discount due to their volume and observed that the sliding scale was inverse of the normal economy of scale.

Representative Hawker clarified that in large volumes for significant distributors; there would be no discount available for those purchasers at lesser levels. He referred to Page 9, Line 27:

The discount under this subsection is equal to the sum of the amounts calculated using the following percentages of denominated value of stamps purchased by a licensee under this section in a calendar year:

- (1) \$1,000,000 or less, three percent;
- (2) The amount that is more than \$1,000,000 but not more than \$2,000,000, two percent;
- (3) The amount that is over \$2,000,000, zero percent., regarding the discount, and speculated that all distributors were availed of the same discount.

Representative Hawker summarized that everyone is availed of an equal discount. Mr. Kay acknowledged that he misunderstood the provisions. Representative Hawker concluded that there is no objection.

Representative Hawker refuted the statement that only one other state has minimum pricing on tobacco products. According to the Minnesota House of Representative Research Department there are 25 states that prohibit the sell of cigarettes below cost. An additional seven states have general fair trade law that prohibits the sell of cigarettes below cost. Mr. McKay reiterated that he was only aware of the state of Montana.

Representative Hawker MOVED to report CSSB 168 (FIN) am out of Committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION it was so ordered.

CSSB 168 (FIN) (am) was REPORTED out of Committee with "no recommendation" and two fiscal notes: one new fiscal impact note from the Department of Revenue and zero fiscal note #2 from the Department of Law.

#sb202

CS FOR SENATE BILL NO. 202(FIN)

"An Act relating to school transportation; relating to the base student allocation used in the formula for

state funding of public education; and providing for an effective date."

SENATOR GARY WILKEN, SPONSOR, spoke in support of SB 202. The legislation raises the Base Student Allocation (BSA) and addresses pupil transportation through a grant system. He noted that learning opportunity grants that had accumulated over the last three years were converted into the student dollar, which added \$2.2 million [to the BSA]. He provided members with a chart of pupil transportation costs from FY 97 to FY 04 (copy on file). Pupil transportation was funded at \$32.8 million in FY97. The request for FY04 is \$58.1 million. The cost of pupil transportation has increased 77 percent; the increase in student population, over the same time, has increased by 5 percent. The Anchorage Cost of Living has gone up 14 percent.

Senator Wilken gave a brief history of attempts to address pupil transportation. In 2000, Senator Torgerson, while he was the Co-Chair of the Senate Finance Committee, proposed a grant program, which was not accepted by the Administration. A second approach was developed to split the increase, which was not agreed on by the school districts. So nothing was done. The next Administration issued cuts of 20 percent, which held. The current grant proposal is a response to those reductions. He maintained that the issue is one of managing money. He observed that school districts have been asked to manage pupil transportation costs, but maintained that because the school districts have not had their "toes held to the fire" that there was no motivation to reduce costs. Under the legislation, school districts would be asked to present their bills. The rates would be calculated based on their costs and the number of students. School districts would be able to keep any savings, which could be used for other district funding.

EDDY JEANS, MANGER, SCHOOL FINANCE AND FACILITIES SECTION, DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT provided information on the legislation. He explained that the costs are being passed on to the state of Alaska under the current reimbursable system. Providers know that the state is holding the checkbook. He felt that contractors would be more disposed to bargain if they knew that school districts had a limited amount of funding.

Vice-Chair Meyer asked how the formula would take into account special needs children. Mr. Jeans explained that districts are currently being reimbursed for these routes and maintained that they would continue to be reimbursed.

Representative Berkowitz asked how the goods and services that go into cost increases would differ from the basket of group of goods and services that go into a consumer price index. Mr. Jeans observed that the Anchorage CPI is built

into every transportation contract. Contracts are negotiated on a five-year cycle and contractors are aware that it is 100 percent reimbursable by the state. He pointed out that insurance and fuel costs were built into contracts over the five-year period.

Representative Berkowitz noted that there was a 77 percent increase in costs, with only a 5 percent increase in students. Mr. Jeans responded that the five-year contracts contain a reimbursement for new buses, which were not offset later.

CARL ROSE, ASSOCIATION OF ALASKA SCHOOL BOARDS, testified in support of the current version of the bill, as opposed to the March 6 Governor's proposal. He emphasized that adequacy was not enough, and stated that every school district was currently reducing programs and opportunities for children. He pointed to the No Child Left Behind Act and the Alaska Quality Initiative and urged legislators to support the educational system. He stressed that the future of Alaska's young citizens are at stake.

JOHN ALCANTRA, NATIONAL EDUCATION ASSOCIATION OF ALASKA, spoke in support of the legislation. He noted that putting funding into the BSA allows districts stability of funding and helps them meet some of the requirements of state standards. He observed that NEA-Alaska has advocated for a BSA of \$4,280 per student since July of last year.

Mr. Alcantra maintained that \$4,280 is a conservative estimate. It asks for one year of inflationary costs and one year of unmet needs as identified by business leaders such as Roger Con, Jim Palmer and Carl Marrs in a report published two years ago. These leaders asked for a BSA increase of about \$365 per pupil over 5 years plus increases to deal with the erosion caused by inflation. He noted that NEA recognizes the budgetary situation of Alaska, but pointed out that there is a constitutional mandate to fund education. He concluded that the legislation is another step closer to the goal of adequately funding K-12 education for FY 04.

Mr. Alcantra observed that the budget for FY 03 was based on \$20.50/barrel oil and a CBR draw of approximately \$950 million. Oil averaged over \$28/barrel for the first 10 months of this Fiscal Year, which means the CBR draw will be about \$400-450 million less than anticipated. He pointed out that K-12 education needs just \$28 million or 6 percent of the CBR savings.

Mr. Alcantra stressed that the increase in the Base Student Allocation is a short term, one-year fix. He noted that NEA-Alaska believes the education community should take the remainder of the school year to identify pupil needs under

the state standards and the No Child Left Behind law. This data would be the basis for a long-term fix to education funding. He suggested an addition of \$23 million to increase the pupil allocation. He suggested that the CBR draw had been decreased due to increased oil prices, and emphasized this might provide the short-term fix to the foundation formula. He summarized that the bill would add only about \$2.2 million in new funding for K-12 education in FY 04 and observed that it would fall short of the needs of the next year.

JIM FOSTER, ASSISTANT SUPERINTENDENT, GALENA CITY SCHOOL DISTRICT addressed the affects of the bill on his school district. The Galena City School District would lose \$459 thousand [if the legislation were enacted without amendment]. There are twelve losers in under the proposal. The next largest loser is the Valdez School District, which loses \$60 thousand. There were 41 "winners". He noted that learning opportunity grants in his district pay for a number of important programs. He requested a provision to hold districts that would stand to lose harmless. He maintained that a hold harmless provision would have a minimal cost to the state.

Co-Chair Harris asked what would happen if student allocation were increased and the learning opportunity grants were eliminated in the next year. Mr. Foster stated that the problem would still exist. He noted that Galena had 3,600 children in the Correspondence Program, outside of the foundation formula. They would only receive 80 percent of this funding if it were rolled into the formula, which is a considerable loss, especially in view of the timing of the action. He noted that they were not informed about the change until May 14, after planning and contracts had been implemented.

Co-Chair Williams stated that they would work on these provisions with Mr. Jeans.

CSSB 202 (FIN) was HELD in Committee for further consideration.

#sb149

CS FOR SENATE BILL NO. 149(RES)

"An Act relating to timber, to the sale of timber by the state, and to the management of state forests."

KELLY HUBER, STAFF, SENATOR TAYLOR, SPONSOR, provided information on the bill. She observed that the legislation promotes resource development for timber management in Alaska's two state forests. There is a zero fiscal note attached.

CHRIS MISH, FORESTER, DEPARTMENT OF NATURAL RESOURCES testified via teleconference. He provided a brief overview of the bill. He noted that Section 2 would delete the reference to considerations under the forest land use plan section, and place them in a section under the forest management plan, which is a broader planning document. He noted that the document for forest timber sales would be biennial rather than annual. Timber sales would still be required to appear in at least one five-year schedule prior to sale. Individual sales would still be reviewed through the forest planning process. Sections 8 and 9 address management plans within the Haines State Forest. Sections 11, 12 and 15, would change the management emphasis in legislatively designated state forests: Haines (270,000 acres) and Tanana State Forest (1.8 million). The emphasis on timber management would allow for other beneficial uses, which are compatible with timber. The primary purpose of state forests would be changed from multiple uses to "timber management that provides for the production, utilization and replenishment of timber resources while allowing other beneficial uses".

Mr. Mish observed that they are currently required to review plans every five years. The legislation would allow plans to be reviewed as necessary. He added that Section 10 would only allow more stringent standards [than those under section (a)] if they were in the state's interest.

Representative Berkowitz questioned what would happen in the case of a conflict between fishing and timber. Mr. Mish noted that they would refer to the state Forest Practices Act, which establishes minimum protection standards for different stream standards. He speculated that if the conflict was not related to commerce, it might place timber on a higher level of consideration. He stressed that all parties agreed that the standards would protect habitat and clean water.

Representative Kerttula summarized that the bill would prioritize timber. Mr. Mish noted that the priority would only occur in time of conflict. Representative Kerttula asked what burden would have to be proved to show that timber is not the first use in a conflict. Mr. Mish noted it would depend on the merits of each use, but that timber would be weighted more heavily. Representative Kerttula questioned the reason for the bill. Mr. Mish stated that other conflicts had arisen and been resolved.

Representative Kerttula asked if the legislation would aid more timber development. Mr. Mish acknowledged that he had heard that justification from the timber industry.

Representative Kerttula asked about impact on other uses. Mr. Mish predicted no additional impact on other uses in the

short-term. He speculated that there would have to be a great increase in harvest levels before it would impact other uses.

Vice-Chair Meyer MOVED to report CSSB 149 (RES) out of Committee with individual recommendations and the accompanying fiscal note. There being NO OBJECTION it was so ordered.

CSSB 149 (RES) was REPORTED out of Committee with a "do pass" recommendation and one zero fiscal note from the Department of Natural Resources.

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ADJOURNMENT

The meeting was adjourned at 1:08 PM