

COUNCIL ON REVENUES

Princess Ruth Keelikolani Building
DLIR Conference Rooms Third Floor
Room 310-313
Honolulu, HI 96813

January 3, 2013
10:00 a.m.

PRESENT:

Council Members:

Richard F. Kahle, Jr. (Chair), Jack P. Suyderhoud (Vice-Chair), Avery K. Aoki,
Carl S. Bonham, Christopher Grandy, Kristi L. Maynard and, Marilyn M. Niwao

Staff Members:

Department of Taxation (DOTax): Donald Rousslang, Hamid Jahanmir and
Jacquelyn Guitguiten

Department of Budget and Finance (B&F): Terri Ohta, Keith Shimada and
Gregg Hirohata-Goto

Others:

Paul Young, Health Association of Hawaii
Paul Harleman, Senate Minority Research Office
Lowell Kalapa, Tax Foundation of Hawaii
Michelle Scala, Senate Ways and Means
Nandana Kalupahana, House Finance
Diane Erickson, Attorney General's Office
Derick DePledge, Star Advertiser
Paul Kanoho, House Minority Research Office
Sharon Kotaka, Budget and Finance
Eugene Tian, DBEDT-READ
Laurel Johnston, UH System
Mark Duda, HI Dev. Coalition
Andrew Pereira, KITV4 News
Titin Sakata, Department of Taxation
Ted Shiraishi, Department of Taxation

CALL TO ORDER:

Chair Kahle called the meeting to order at 10:00 a.m. with a quorum present.

COMMUNICATIONS TO THE COUNCIL:

None.

MINUTES OF THE MEETING OF OCTOBER 30, 2012:

Chair Kahle asked the members for comments on the minutes of the October 30th meeting. There were no comments. Chair Kahle asked for a motion to accept the minutes.

It was moved by Ms. Niwao and seconded by Ms. Maynard that the minutes of the October 30, 2012 meeting be accepted. The Chair called for the vote, and the motion passed with the following votes:

Richard F. Kahle, Jr.	Yes
Jack P. Suyderhoud	Yes
Avery A. Aoki	Yes
Carl S. Bonham	Absent
Christopher Grandy	Yes
Kristi L. Maynard	Yes
Marilyn M. Niwao	Yes

LETTER FROM SENATOR DAVID IGE REQUESTING COPIES OF THE WORKBOOK PREPARED FOR THE COUNCIL:

Next, Chair Kahle told the Council that a letter was sent to the Office of Information Practices (OIP) and a response was received stating that the COR workbook is confidential, but that the Council could release it if they wished. If it were released to Senator Ige, it would be subject to the same rules as apply to those who now receive the document. Chair Kahle asked for comments on the letter. Dr. Suyderhoud asked why the Council might be reluctant to share the workbook. Mr. Aoki asked whether the conditions for release meant that Senator Ige could not pass the workbook out to others. Chair Kahle said that was correct. He also said that Senator Ige has sent a letter to the Attorney General's Office asking whether a different HRS section applied that might invalidate these conditions. He then introduced Diane Erickson from the Attorney General's Office.

Dr. Suyderhoud said most of the material in the workbook is past data and that the only thing he thought might be controversial was the forecast based on the Council's input. Chair Kahle pointed out that the document did not necessarily match the forecast.

Ms. Niwao expressed concern that the document might be misleading, because it might lead one to expect a certain number and did not reflect the Council's deliberations. Chair Kahle agreed, but said that could easily be taken care of in the letter transmitting the document. Dr. Suyderhoud expressed a concern that the tables in the workbook might be construed as a draft forecast. Chair Kahle pointed out that the Council submitted its formal forecast in a letter to the Governor, so it should be clear that the workbook is not a final document. Dr. Suyderhoud agreed.

Dr. Grandy suggested a blurb on the cover saying that it was a working document of the Council on Revenues and did not reflect the Council's final decisions. He also said he did not think the Senator would need to repeat his request for every Council meeting.

(Dr. Bonham arrives at the meeting.)

Chair Kahle agreed, as long as he was Chair. Dr. Grandy said they might anticipate a similar request from House Finance.

Dr. Suyderhoud said it needed to be clear that the workbook was prepared prior to the meeting and did not reflect the results of the meeting. Mr. Aoki said he was not sure about the confidentiality of the material. Ms. Niwao asked whether it was possible that the Senator might want the material to second-guess the Council. Chair Kahle said that would be fine, the Council would do its job and anyone was free to second-guess their projections.

Chair Kahle asked Dr. Bonham for his opinion. Dr. Bonham said that he didn't see any reason why the Council should object to the workbook going out with the caveats that were discussed.

Dr. Bonham said the sub-headers for Table 5A might be altered to make clear that the line-item projections generated by the Tax Research & Planning Office to be consistent with the Council's total growth forecast were based solely on the Council's forecasts of general fund total tax revenues and that all other forecasts are constructed by Tax Research & Planning.

Dr. Bonham also suggested language to the effect that the workbook did not actually reflect the Council's decision at the meeting. Chair Kahle said that would be on the cover.

Dr. Suyderhoud pointed out that Tables 5A and 5B were prior forecasts and were part of the record, but that Tables 6A, 6AA, 6B and 6BB were called 'estimates of general fund tax revenues based on Council's mean forecast' and that it would be easy for somebody to interpret that to be saying that it was the Council's actual current forecast.

Dr. Bonham suggested that every table heading could say, 'pre-meeting workbook' or 'pre-meeting estimates.' Dr. Grandy suggested using the name "Model 1," "Model 2," or Model 3" in the table headings.

Ms. Niwao asked about the line-item detail in the tables and whether people interpret them to be Council forecasts. Dr. Bonham said that some people do that, including some other agencies. He pointed out that the City and County did that for the general excise tax estimates to estimate the county surcharge. Chair Kahle asked for a vote on releasing future workbooks to Senator Ige. All were in favor.

The Chair called for the vote, and the motion passed with the following votes in favor of forwarding the GF COR workbook to Senator David Y. Ige beginning with the next GF meeting:

Richard F. Kahle, Jr.	Yes
Jack P. Suyderhoud	Yes
Avery A. Aoki	Yes
Carl S. Bonham	Yes
Christopher Grandy	Yes
Kristi L. Maynard	Yes
Marilyn M. Niwao	Yes

Chair Kahle said the Senator wants the workbook at the same time it is given to the Council. Ms. Niwao asked whether the workbook was ever revised. Dr. Suyderhoud and Chair Kahle clarified that they were talking about the next document, not the January 3rd issue.

Dr. Bonham questioned whether it was useful to have separate results from each different model. He pointed out that some of the members attended a seminar a year and a half ago in which it was argued that it is better to use the average of the models. Dr. Grandy thought the separate results from the different models provided useful information. Ms. Maynard asked if the Council would refuse any requests for the workbooks. Chair Kahle said requests would be approved on a case-by-case basis.

Dr. Bonham suggested that if the workbook contained sufficiently clear caveats about what were Council forecasts and what was not, then perhaps it could be included with the other materials that are put on the Tax Department's website. Chair Kahle asked how long it took to post the materials. Dr. Rousslang answered that he did not know. Dr. Bonham suggested including Chart 1 with the materials transmitted to the Governor, to show the range of the member forecasts. Dr. Suyderhoud pointed out that the middle of this range is not necessarily the official forecast and that the entire forecast could be outside the range in the workbook. Chair Kahle said the uncertainty is mentioned in the transmittal letter. Dr. Grandy said that although he is comfortable with releasing the workbook to the Chair of Senate Ways and Means as a work product, he was less sure whether it should be released more widely. He said the OIP letter was quite careful in distinguishing the two levels of release.

Chair Kahle suggested moving to the next topic.

DISCUSSION OF FUTURE REVENUE COSTS OF THE RENEWABLE ENERGY CREDIT:

Chair Kahle invited Dr. Tian to participate in the discussion on the renewable energy tax credit. Dr. Tian told the Council that they didn't do any new estimates and that he stuck by his original estimate of \$174 million for tax year 2012. He said part of the cost would be recovered through additional economic activity caused by the tax credit. He also pointed out that the actual credits applied against tax would be smaller than \$174 million, because some households won't have enough tax liability to claim the full credits earned in that year.

Dr. Bonham asked if Dr. Tian's estimates were based on building permits. He said some installers were claiming that the City and County changed their rules for how permits were given (in person instead of on-line) and that they were hiring temporary workers in the 4th quarter of this year, and that there was evidence that installers were putting on systems without permits in order to complete them before the end of the year.

Dr. Suyderhoud asked whether the members who provide construction forecasts included the solar activity in their forecast? Dr. Bonham said yes. Dr. Suyderhoud said a second question is whether the tables in the workbook contained numbers for the renewable energy credit?

Dr. Rousslang said the number for the renewable energy credit for 2013 is based on the Council's estimate for the cost of the credit in 2013. Dr. Bonham asked if that was \$170 million. Dr.

Rousslang said yes. He said the below-the-line adjustment for the energy credit is \$90 million for FY 2013, which is an estimate for the increase in the cost of the credit from FY 2012 to FY 2013. That's based on the credit being about \$80 million in FY 2012. The estimate for the cost of the credit was \$230 million for FY 2014 and \$250 million for 2015 and beyond. After the new Administrative Rules, that is, after FY 2013, the cost of the credit is estimated to be about \$150 million per year. So, the below-the-line adjustment for the cost of the credit is now \$70 million for FYs 2014 through 2019.

Dr. Bonham noted that the some people might attribute the below-the-line adjustments to the Council. Ms. Niwao noted that the refundable credit could mean a bigger revenue loss. Dr. Grandy noted that the credit has been refundable for some time. Ms. Niwao noted that people with pension income were taking the refund. Dr. Bonham noted that there was a good deal of uncertainty over what would happen with the tax credits. Dr. Suyderhoud asked about the possibility of new legislation. Chair Kahle asked if the Council was ready to move to the next topic.

GENERAL FUND REVENUE FORECAST:

Next, the Council discussed the general fund revenue forecast. Chair Kahle asked Dr. Suyderhoud if he would like to lead off on the discussion. Dr. Suyderhoud asked if the members wanted to start by discussing the above-the-line forecast (the growth of revenues before the adjustments for tax law changes or anticipations of unusual changes in tax credits). Mr. Aoki asked if there were any preliminary tax collections for December.

Dr. Rousslang said that for December there was only the Oahu collections, and that was for total collections, not general fund dedications. He said he hadn't had a chance to translate that into a guess for December general fund collections. Mr. Aoki noted that state general funds for November where we're up 12.3%. Dr. Rousslang referred to an email he had sent to the members comparing year-to-date general fund collections in fiscal year 2013 with those in previous years. Mr. Aoki said the email was very informative.

Dr. Suyderhoud noted that two months from now they would have to consider the federal debt ceiling and what Congress would decide to do about it. Dr. Bonham noted that he didn't think anybody expected the payroll tax cut to be extended, but that it was a serious hit. But he said the tax changes being considered could take \$600 billion coming out of the economy. Dr. Suyderhoud asked how that compared with the fiscal cliff. Dr. Bonham noted that the fiscal cliff would have been much worse. He said that compared with the Bush tax cuts, the law that was just passed would add about \$600 billion in tax collections over about 10 years, whereas the President's \$250,000.00 threshold plan would have increased collections by well over a trillion dollars. He said that compared with the fiscal cliff, tax increases and spending cuts were much milder. He noted, however, that the current plans did little to solve the problem of debt sustainability and only delayed possible sequestration. He said he was concerned about the issues of sequestration and the raising the debt ceiling coming at the end of March would create uncertainty and might slow the economy. He said that he had read a paper on a new index of economic uncertainty that argued that such uncertainty could materially affect GDP.

Ms. Niwao said that she had seen estimates that the latest tax laws passed (including the change in the payroll tax break) would reduce GDP by about .75% to .8%. Dr. Bonham said he thought those

estimates were too high. Ms. Niwao referred to material she had passed out to the members summarizing the measures and noted that there was a lot of uncertainty over the tax changes, including retroactive tax changes. Dr. Bonham asked which changes were retroactive from January 1, 2012. Ms. Niwao said just about everything. Dr. Bonham noted that the change in the alternative minimum tax would help economic growth. Ms. Niwao noted that the retroactive tax changes made it hard to advise clients and created uncertainty for businesses and for individuals trying to plan. She also noted that the Obama health penalties will take effect next year, requiring a lot of businesses on the mainland to provide health insurance for their employees or face penalties and that the same thing would happen with unemployed and some self-employed individuals in Hawaii who would be required to obtain health insurance. Dr. Grandy noted that the members had already been considering some of the issues Ms. Niwao mentioned. He said his view on the macro economy today is similar to what it had been in September. He said that aside from the renewable energy credits, he was forecasting general fund tax revenue growth of about 7% for 2013, based only on economic factors, and something like 6% for 2014. He said he appreciated Dr. Bonham's point about March being another perfect storm opportunity, but that he didn't think we would go over the fiscal cliff in March. Dr. Bonham agreed, but said he was concerned about the extra uncertainty caused by the debt ceiling. He noted, though, that the things that are causing growth haven't changed. He noted that the bottoming of housing and the beginning of its contribution to growth is significant, because it was dragging the US economy down for years. He noted that one of the positive things in the tax law changes was that they extended for one more year the provision allowing people avoid claiming as income their 'short sale.' Another important positive thing is the end of state local government contraction.

Dr. Suyderhoud asked if anybody was forecasting negative real GDP growth for the next couple of years. Dr. Bonham said he was forecasting growth 2.25% to 2.50%. Dr. Suyderhoud said he was forecasting 2.1% growth. Ms. Niwao said she was concerned about proposed cuts on military spending and the loss of earmarks that might come with the loss of Senator Inouye (she gave several examples). Dr. Grandy noted that real national defense expenditures have been climbing since 2011 on a quarterly basis according to BEA statistics, but that his forecast for real defense spending was negative for several years, owing to the anticipated winding down of efforts in Afghanistan and Iraq. He said he did not factor in the loss of Senator Inouye. Ms. Niwao noted that the Senator brought in more money than just military. Dr. Bonham noted that a large amount of what Senator Inouye accomplished won't go away in the very near term. He said the Senator's loss would have some effect, but he didn't know how much. Ms. Maynard agreed the magnitude of the effect was the question. Ms. Niwao said she was unable to get numbers from all the military, owing to confidentiality. She said there were a number of articles about how much Senator Inouye had brought into Hawaii (\$400 million for earmarks alone) and that the total could be \$1 billion. Dr. Bonham noted that the State had lost earmarks in 2010, including the concurrent resolution on spending -- funds that went to the National Science Foundation. Dr. Grandy noted that Hawaii's economy is about \$60 billion. Dr. Bonham said the effect might be about 1% of GDP.

Dr. Grandy agreed that the effect would probably be less than 1%. Dr. Bonham agreed. He said his forecasting models showed general fund growth of 7.6% for 2013 and 8.8% in 2014. He said when his economic forecasts were put in the Tax Department's model, he got one of the lower forecasts. Chair Kahle asked Dr. Grandy if he had a forecast. Dr. Grandy said the above-the-line forecasts in the workbook were consistent with his above-the-line forecasts. He noted that his personal forecast is closer to 7% (slightly below that in the workbook). Dr. Suyderhoud noted that in order to have

the growth predicted in the workbook, since growth through November was 12.3%, there would need to be a substantial slowdown in the second part of the fiscal year. Ms. Niwao noted that the effects of tax credits on net income tax collections might be slowed because some tax forms won't be available until March. Dr. Bonham noted that most taxpayers wouldn't be affected by the late forms. Chair Kahle noted that most of these issues have to do with federal as opposed to State taxes. Ms. Niwao agreed but said late federal filings would cause late State filings.

Dr. Bonham said the above-the-line forecast of 7.7% was reduced to 5.1% by tax credits and other below-the-line adjustments. Dr. Grandy said the model forecasts looked good to him, but he was open to adjustments. Dr. Bonham agreed with the below-the-line adjustments, but he had some questions about the below-the-line adjustments for the TAT (Transient Accommodations Tax). Dr. Rousslang explained that the above-the-line figure for the TAT was the total collections and that adjustments were made below-the-line for changes in tax rates and allocations to various funds.

Dr. Suyderhoud asked if anyone wanted to suggest a forecast significantly different from that in the workbook (Table 6AA). He noted that the model showed a slightly higher above-the-line forecast from the last meeting, but that the below-the-line estimate was considerably higher, largely due to the reduction in the energy tax credits caused by the change in the administrative rules. Dr. Bonham asked why the above-the-line growth rate was lower for 2014 than for 2013. Dr. Suyderhoud said he projected slower visitor arrival and expenditure growth in 2014.

Ms. Niwao asked Mr. Aoki for his hotel forecast. Mr. Aoki predicted slower growth going forward. Dr. Bonham predicted job growth would pick up in 2014, as in other tourism-only recoveries. He said construction was improving and the loss of State jobs was ending. He said his projections had pushed back rail until late spring of 2013 and that construction would be even stronger for 2015, including the effects from rising home prices. He said the construction cycle played an important role in driving tax revenues. Ms. Niwao asked if Oahu had the cash to pay for the rail. Dr. Bonham said they did if their financial plan was correct.

Dr. Suyderhoud said the current discussion indicated growth of about 6.4% for 2014. Dr. Bonham said he would raise the above-the-line forecast to 7.5% for 2014. Dr. Grandy agreed. Dr. Bonham explained that his more optimistic projection might be due to projected growth in construction. He noted that the Council typically underestimated the growth in recoveries. Dr. Grandy asked Dr. Bonham for his predictions for 2013 through 2019. Dr. Bonham predicted growth rates of 7.7% for 2013, 7.5% for 2014 and 6% for 2015. He asked about adjustments for the suspension of GET exemptions and for the changes in net income tax rates. Dr. Rousslang said that the Act 105 expired at the end of fiscal year 2013 and the tax rates would return to their old levels at the end of tax year 2015.

Dr. Suyderhoud suggested a motion to adopt above-the-line forecasts of 7.7% for FY 2013; 7.5% FY 2014; 6% FY 2015; and the remaining fiscal years 2016 through 2019 (as indicated on Table 6AA of the workbook), seconded by Dr. Bonham.

Dr. Bonham amended the motion to include accepting the Tax Department's below-the-line adjustments. Chair Kahle called for a second to the motion. Dr. Grandy seconded the amended motion.

Dr. Suyderhoud made a motion that the general fund tax revenues growth rate (above-the-line) be 7.7% for FY 2013; 7.5% for FY 2014; 6% for FY 2015; and the remaining fiscal years 2016 through 2019 as indicated on Table 6AA. Dr. Bonham seconded and asked to amend Dr. Suyderhoud's motion to accept the Tax Department's below-the-line adjustments, seconded by Dr. Grandy. The Chair called for the vote, and the motion passed with the following votes:

Richard F. Kahle, Jr.	Yes
Jack P. Suyderhoud	Yes
Avery A. Aoki	Yes
Carl S. Bonham	Yes
Christopher Grandy	Yes
Kristi L. Maynard	Yes
Marilyn M. Niwao	Yes

Dr. Suyderhoud said the members needed to make clear what their bottom line numbers would be. Chair Kahle asked for the new numbers. Dr. Suyderhoud said general fund revenue growth of 5.1% in 2013 and about 6.8% for 2014 and about 6.2% for 2015.

Next, the Council heard the report by Budget and Finance.

Ms. Ohta provided the Council with revenue updates for Budget & Finance.

REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES:

Significant Changes from September 2012 Report

General Fund Non-Tax Revenues

Federal Grants - increases in FYs 13-19 reflect estimates for the federal interest subsidy on Build America Bonds (Department of Budget and Finance (B&F)) that were not previously reported.

Non-Revenue Receipts - increase in FY 13 reflects the premiums on bonds that were sold in November 2012 (B&F).

Special Tax Revenues

There were no significant changes to the special tax revenue estimates.

Special Fund Non-Tax Revenues

Charges for Current Services - the net increases in FYs 12-19 are reflective of increases in HMSA (Hawaii Medical Service Association) reimbursement rates and Medicaid payment rates for the Hawaii Health Systems Corporation.

Other than Special Fund Non-Tax Revenues

Federal Grants - the net decrease in FY 12 reflects decreases in federal funds for the Temporary Assistance to Needy Families program (Department of Human Services (DHS)) and lower than projected reimbursements for the Childcare and Development Fund (DHS) and the First to Work Program (DHS). The net increases in FYs 14-16 are due to increases in federal funds for the Hawaii Electric Vehicle Demonstration Project (DBEDT).

It was moved by Dr. Suyderhoud and, seconded by Dr. Grandy to accept the B&F report as submitted. The Chair called for the vote, and the motion passed with the following votes:

Richard F. Kahle, Jr.	Yes
Jack P. Suyderhoud	Yes
Avery A. Aoki	Yes
Carl S. Bonham	Yes
Christopher Grandy	Yes
Kristi L. Maynard	Yes
Marilyn M. Niwao	Yes

Mr. Aoki expressed concern that the media may confuse the above-the-line and the below-the-line forecasts. Dr. Grandy suggested that Dr. Rousslang calculate the below-the-line general fund forecasts to be sure the correct numbers were reported. He asked for clarification on the motion that the members had voted on, that they had agreed on the above-the-line forecasts, to be adjusted by the below-the-line adjustments specified by the Tax Department in the workbook. Chair Kahle, Dr. Suyderhoud and Dr. Bonham agreed. Dr. Rousslang asked for clarification on whether the Council wanted the growth rates or dollar amounts for the above-the-line projections to be used. Dr. Suyderhoud said the above-the-line growth rates should be used. Dr. Rousslang said that meant that all of the above-the-line numbers after 2014 would change and all of the below-the-line numbers would change correspondingly. Dr. Suyderhoud and Ms. Maynard agreed.

It was agreed that the Department of Taxation's Tax Research & Planning Office would prepare a Table with detailed line-item estimates for the Governor, along with the Council's forecast as submitted.

Chair Kahle asked for a motion to adjourn. Dr. Suyderhoud so moved. Ms. Maynard seconded the motion.

Dr. Suyderhoud moved to adjourn the meeting, seconded by Ms. Maynard. The Chair called for the vote and the motion passed with the following votes:

Richard F. Kahle, Jr.	Yes
Jack P. Suyderhoud	Yes
Avery A. Aoki	Yes
Carl S. Bonham	Yes
Christopher Grandy	Yes
Kristi L. Maynard	Yes
Marilyn M. Niwao	Yes

NEXT MEETING:

The Council's next meeting is tentatively scheduled for Wednesday, March 13, 2013 at 2:00 pm, but the date and time will be confirmed by e-mail. The Council staff will attempt to secure the DLIR Conference Rooms 310/313 for the meeting.

ADJOURNMENT:

The meeting adjourned at 11:42 a.m.