EXECUTIVE CHAMBERS

HONOLULU

NEIL ABERCROMBIE
GOVERNOR

September 9, 2011

EXECUTIVE MEMORANDUM

MEMO NO. 11-10

TO: All Department Heads

SUBJECT: FY 12 Budget Execution Policies and Instructions

The attached Budget Execution Policies and Instructions are provided to guide your implementation of program appropriations for FY 12.

As we complete the first quarter of FY 12, it is important to be mindful of the developments that currently affect Hawaii and impact the State's financial condition.

By making difficult fiscal decisions, we overcame the $214 million deficit which confronted our Administration when we took office last December. For the first time in three years, the new fiscal year began in the black. As we moved into FY 12, the State's revenue picture continued to improve.

General fund tax revenue growth through the end of FY 11 was -0.9%, which exceeded the Council on Revenues (COR) projection of -1.6% by 0.7%. On September 6, 2011, the COR changed its FY 12 general fund tax revenue growth rate projection from 11% to 14.5%. On face value, the change appears favorable; however, it does not reflect the current assumptions built into our financial plan.

Earlier this year, we worked closely with the Legislature to address the potential $1.2 billion budget shortfall over FB 2011–13 while a great deal of uncertainty remained over the State's fiscal outlook. Several revenue enhancement tax measures, expected to generate a 7.2% general fund tax revenue increase, were enacted.

The COR's former projection of 11% for FY 12 did not yet include the general fund impact of the tax measures. If left unchanged, the additional impact of the tax measures would have resulted in a total 18.2% (11% plus 7.2%) general fund growth rate for FY 12. However, the COR decreased their original 11% projection to 9.5%, due to the slowdown of the State's economic recovery and the underlying uncertainties on the national and global levels, and adopted a more conservative general fund growth rate of 5% for the tax measures. Hence, the COR projection of 14.5% general fund tax revenue growth for FY 12 will result in a 3.7% (18.2% minus 14.5%) *"decrease"* in general fund revenues anticipated by the Administration.

Although we remain cautiously optimistic about Hawaii's economic recovery, we must keep things in perspective. Hawaii's tourism industry - a key economic driver – has slowed, though there are still signs of positive growth. Recent actions by Congress and the Federal government regarding debt limit issues and impending reductions to federal programs will also continue to impact our State and the nation. Across the country, unemployment levels remain high while job growth has stagnated. In addition, the recovery of Japan from the devastating earthquake and tsunami, instability in the European economy and the continuation of uprisings in Northern Africa add to the level of insecurity. Obviously, there is significant uncertainty and volatility affecting the national and global economies to which Hawaii remains vulnerable.

The State's general fund tax revenues are only expected to return to pre-recession levels (FY 08) this fiscal year but there are many substantial current and long-term financial challenges that we must address. Our emergency funds – the Hawaii Hurricane Relief Fund and the Emergency Budget and Reserve Fund - must be recapitalized. Our unfunded liabilities in the Employees' Retirement System and the Employer-Union Health Benefits Trust Fund exceed $20 billion. These challenges, along with the rising costs of Medicaid and potential cuts to federal moneys for defense, education and social services, will significantly impact the State's resources.

During the past several years, all State departments have suffered severe cuts, far and above the nearly $140 million in expenditure reductions which were included in Act 164, SLH 2011, for retirement benefit and health premium payments which we must now allocate within the Executive Branch:

1. Across-the-board labor savings reduction of $88.2 million in general funds in FYs 12 and 13 to be derived from proposed labor cost savings.

2. $50 million in general funds for fiscal restraints in FYs 12 and 13 to be taken as program specific adjustments pursuant to the 2011 Program Review.

I realize that these cuts may create additional difficulties for your operations; however, every effort must be made to operate efficiently in order to stay within your departmental allocation. We must also push ahead to accelerate the implementation of New Day Work Projects. The energy and expenditures generated by moving our CIP projects quickly and purposefully will support our infrastructure needs while producing immediate job growth and stimulating Hawaii's economy.

Although the State's revenue outlook is not as optimistic as we had hoped, because we addressed our potential revenue issues head-on and with an abundance of caution, no additional adjustments will be made to FY 12 allocations at this time.

Through your continued prudent and efficient use of resources, we will continue to make strides to improve the State's financial situation. While these budget execution policies delegate many responsibilities to the department level to facilitate your ability to effectively maintain your operations, I expect that the additional flexibility being provided will be responsibly utilized with the utmost care and accountability with consideration to the State's fiscal situation. As such, I will soon announce a reporting and accountability process consistent with my initiative establishing an executive management structure.

Exhibit 1 contains your department's FY 12 allocation of program appropriations and position ceilings from Act 164, SLH 2011, which may include the proposed 5% labor savings adjustment (general funds generally prorated to total $88.2 million statewide) and specific program adjustments pursuant to the 2011 Program Review.

Attachments A and B contain detailed, specific expenditure policies, guidelines, and procedures for FY 12 budget execution to provide for prudent and efficient implementation of legislative intent.

Questions on the specific policies and instructions should be directed to the Department of Budget and Finance or the appropriate agency referenced. Electronic files of appropriate forms will be provided for your use.

We must confront our challenges and work together to transform government in Hawaii by continuing to improve our ability to service Hawaii's people. We must continue our efforts to grow a sustainable economy. We must continue to invest in our State's most valuable asset, our people. We are committed. We will lead our State towards a New Day in Hawaii.

/s/ Neil Abercrombie

NEIL ABERCROMBIE
Governor, State of Hawaii

Exhibit 1
Attachment A
Attachment B
Operational Expenditure Plan