

COUNCIL ON REVENUES

Office on Aging Conference Room
No. 1 Capitol District, Hemmeter Center
Fourth Floor, Room 410

Tuesday, December 12, 2006
4:00 P.M.

PRESENT:

Council Members:

Paul Brewbaker (Chair), Jack Suyderhoud (Vice-Chair), Carl Bonham (arrived late), Vito Galati, Michael Hirai, Pearl Imada Iboshi, and Eric Yeaman

Staff Members:

Department of Taxation: Tu Duc Pham, Yvonne Chow, Donald Rousslang, and Cathleen Tokishi

Department of Budget and Finance: Keith Shimada, Karen Matsunaga, Neal Miyahira, and Terri Ohta

Others:

Huong Bassford, Department of Budget and Finance
Harry Blanchette, Senate Minority Research Office
Nancy Cook Laner, Stephens Media
Sean Hao, Honolulu Advertiser
Randy Hiyoto, Senate Committee on Ways and Means
Lowell Kalapa, Tax Foundation of Hawaii
Kurt Kawafuchi, Department of Taxation
Nandana Kalupahana, House Committee on Finance
B. J. Reyes, Honolulu Star-Bulletin

CALL TO ORDER:

The Chair called the meeting to order at 4:00 P.M.

COMMUNICATION TO THE COUNCIL:

None.

MINUTES OF THE MEETING OF NOVEMBER 2, 2006:

The Chair asked if there were any corrections to or comments about the minutes of the November 2, 2006, meeting. There were none, so Dr. Brewbaker called for a motion to approve the minutes.

It was moved by Mr. Yeaman and seconded by Mr. Hirai, that the minutes of the November 2, 2006, meeting be accepted. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Absent
Vito Galati	Yes
Michael Hirai	Yes
Pearl Imada Iboshi	Yes
Eric Yeaman	Yes

The Chair stated that he had been asked by a member of the media for a copy of past minutes, and asked if there was a protocol. The minutes requested had been approved by the Council, and thus were public and a copy could be released. Dr. Pham noted that there was a copying fee, although the fee paid went to the Department of Budget and Finance rather than to the Department of Taxation. He also stated that it was possible for the minutes to be posted on the website and thus avoid the problem of requests.

It was moved by Dr. Suyderhoud and seconded by Mr. Galati, that the Council on Revenues post its minutes on the website. The Chair called for a vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Absent
Vito Galati	Yes
Michael Hirai	Yes
Pearl Imada Iboshi	Yes
Eric Yeaman	Yes

Ms. Tokishi will work with the Department's webmaster to put them online.

The Chair announced that he would not be able to make the January informational briefing of the Senate Committee on Ways and Means and House Committee on Finance, and that Dr. Suyderhoud would testify on the Council's behalf. The Chair will prepare some slides, and the Tax Research and Planning Office will draft a written statement regarding the Council's

forecast based on today's outcome. Any suggestions that the members may have for Dr. Suyderhoud should be sent to Dr. Pham who will forward it to Dr. Suyderhoud.

REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES

Mr. Shimada preceded his report presentation by announcing that he would be doing these reports as Shirl Fujihara had accepted a position in the Department of Commerce and Consumer Affairs. He also introduced Karen Matsunaga and Terri Ohta.

General Fund Non-Tax Revenues: Mr. Shimada reported that in the category, Revenues from Use of Money and Property, the decrease for FY 2006 reflects the transfer of the general fund portion of public land trust revenues to the Office of Hawaiian Affairs (OHA) to make up a shortfall in the \$15.1 million that must be transferred to OHA annually pursuant to Act 178, SLH 2006. Increases for FYs 2007-2013 reflect increases in estimated interest earnings resulting from greater investment balances and higher interest rates.

In the category, Charges for Current Services, the increase for FY 2006 reflects a one-time federal payroll reimbursement for child support for the Department of the Attorney General, federal reimbursement for the Department of Human Services, and a reimbursement of prior years' expenditures for the University of Hawaii. Increases for FYs 2007-2013 reflect the reimbursement to the State for the costs of assessment, collection, and disposition of the county surcharge on the general excise tax (GET), as authorized by Act 247, SLH 2006. The amount is based on 10% of the gross proceeds of a respective county's surcharge on the GET.

In the category, Other Non-Revenue Receipts, increases for FYs 2008-2013 are due to increases in excess funds transferred from the Unclaimed Property Trust Fund.

Special Fund Tax Revenues: There are two significant changes. In the Transfer of Transient Accommodations Tax category, increases for FYs 2007-2013 reflect the Council's most recent projections. In the Transfer of Conveyance Tax category, increases for FYs 2007-2013 resulted from a reporting error in the September 2006 estimates. Instead of \$27.5 million, the September estimates should have been \$36.8 million.

Special Fund Non-Tax Revenues: In the category, Use of Money and Property, the increase for FY 2006 reflects higher than estimated interest earnings for Airport revenue and bond funds.

In the category, Federal Grants, the increase for FY 2006 is due to an increase in federal grants for airport improvements. The changes in FYs 2007-2013 reflect changes in federal grants for airport improvements and Medicare payments.

In the category, Charges for Current Services – Utilities, the decrease for FY 2006 reflects lower than projected concession fees for airports. Decreases for FYs 2008-2013 reflect anticipated increases in concession fees and earnings from utilities consumption, offset by anticipated

decreases in landing fees and system support charges. In addition, for FYs 2007-2013, harbor revenues for wharfage and rental of land and wharf space are expected to decrease due to transfers to OHA of public land trust revenues.

In the category, Charges for Current Services – Others, the changes for FYs 2006-2013 are due to the following: increases in hospital revenues from patient, Medicaid, HMSA, and Kaiser Permanente payments offset by decreases in other third party payments; and increases in airports passenger facility charges due to projected increases in passenger enplanements and an increase in rates.

In the category, Non-Revenue Receipts, the increase for FY 2006 is due to transfers from the Tourism Special Fund.

Other than Special Fund Non-Tax Revenues: In the category, Federal Grants, the decreases for FYs 2006-2013 are due to reduced funding for the Medical Assistance program resulting from the implementation of Medicaid Part D (pharmacy drugs), which would reduce federal expenditures for Medicaid. In addition, beginning in October 2007, the federal match rate is expected to be reduced from 57.55% to 56.50%.

In the category, Charges for Services, the changes for FYs 2006-2013 reflect increases for federal reimbursements for Medicaid resulting from increased collection efforts, offset by decreases for FYs 2009-2013 that are due to the correction of a reporting error for miscellaneous income for the Department of Accounting and General Services.

It was moved by Dr. Suyderhoud and seconded by Dr. Imada Iboshi, that the report of the Department of Budget and Finance be accepted. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Vito Galati	Yes
Michael Hirai	Yes
Pearl Imada Iboshi	Yes
Eric Yeaman	Yes

GENERAL FUND REVENUE FORECAST:

The Chair noted that withholding taxes in the November year to date collection report were up 5.7%, which was within the range of their forecast. Dr. Pham stated that there were slower corporate and individual estimated tax payments, but the 10% general excise tax increase was still strong. He noted that there might be a slight under-reporting of the conveyance tax under "All Others," and that it might be responsible for a decrease of 0.5%. The Bureau of

Conveyances had not provided monthly conveyance tax reports since July, and had reported a \$10 million adjustment in October.

The Chair then moved to a discussion of the Council members' economic outlooks. Dr. Bonham noted that the 5.7% increase in withholding tax collections was slightly lower than what they had forecast. The Chair noted that his inflation rate for the second half of the year was 4.2%; Dr. Bonham's inflation rate for the second half of the year was close to 4.0%. Dr. Imada Iboshi's 4% inflation rate was for the whole year.

Dr. Bonham stated that they had lowered both their U.S. and Japanese forecasts, citing an increased risk of a sharper slowdown in the U.S. economy due to housing and some risk that the Federal Reserve may not adjust fast enough if the economy should slow more sharply; they are watching to see if the core number comes down. They also focused on the effect of the downturn in the housing market on consumer spending, noting that Japanese consumer spending was weak with a forecasted 2% growth. Dr. Bonham stated that Japan's population would decrease next year for the first time and that Japan's consumption tax was increasing next year; the demographics and bad fiscal state were working against them. He thought that keeping the nominal income growth between 5.5% and 6.5% was still okay. They forecast a sharp decline in job growth to 1.5% next year. Dr. Imada Iboshi's forecasts agree; construction growth was nonexistent.

The Chair noted a slowing in the growth of the employment and payroll numbers for the last three months. Tourism did not appear to be coming through as hoped and the turning point in construction was clearer. The Chair's forecasts are now at or below the consensus at 5.5% to 5.75% for below the line revenue. His inflation numbers were 5.8% for the first half of the year and 4.6% for the year, so his second half inflation rate was about 3.8%; real total personal income growth was down to 1%. Dr. Bonham stated that their real total personal income growth ranged from 1% to 2%, and their nominal assumptions were off by about 0.5% such that they were all close to 6%.

The Chair's impression was that they were over-forecasting just as they did during Governor Waihee's second term. Dr. Imada Iboshi and Dr. Bonham noted that they had been forecasting a slowing for about nine months and had actually been under-forecasting. However, the Chair noted that the higher than forecasted revenue was in part due to increased delinquent collections resulting from the Department's new computer system and money from settlements.

Regarding the sustainability of increased delinquent collections, Director Kawafuchi stated that they were better than expected and that he was cautiously optimistic about the future. Current delinquent collections are ahead of the previous year, but he was not sure if that pace could be sustained for the remainder of the year. The Chair asked if most of those collections were for the general excise tax, as the general excise tax was up 10% whereas the others were up 5%. Director Kawafuchi stated that he believed that to be the case.

Dr. Suyderhoud asked if they should first consider the 2007 and 2008 forecasts, as changes are anticipated beginning in 2009, and consider the 2009-2013 forecasts later. He also recommended that they retain the 6% and 6% forecasts for 2007 and 2008, respectively.

Dr. Imada Iboshi asked if they should consider the impact of the county surcharge on the general excise tax beginning in 2007. Dr. Suyderhoud said that their consensus was that it would result in a decrease, but noted that Director Kawafuchi had indicated that delinquent collections have remained strong, such that they had some insulation from the effect of the county surcharge.

There was additional discussion about the county surcharge and whether the Council would need to forecast the county surcharge collections. Dr. Pham clarified that the 0.5% county surcharge would not go into the general fund other than the 10% that was intended to compensate the State for the administrative costs of collecting the county surcharge, but that this amount would go into the general fund as non-tax revenue. Any additional amount visibly passed on to customers by businesses in excess of 4.166% was not significant for purposes of the current discussion.

However, Dr. Bonham pointed out that, since the general excise tax is part of the price charged the customer, the county surcharge would impact the consumer price index beginning with 2007. The Chair and Dr. Suyderhoud noted the impact of the change in consumer behavior and the pyramiding effect of the general excise tax in addition to the actual tax increase.

Dr. Bonham thought that they should go with the higher 6.1% in 2007 and 6.3% in 2008 rates. Tourism is a negative this year, but his models indicate an increase in 2008. However, neither he nor the Chair actually thinks tourism will strengthen in 2008, noting that it should have strengthened this year. Dr. Bonham thought that the county surcharge could increase gross income.

Dr. Suyderhoud indicated that he was satisfied with the 6% rates, and Mr. Yeaman stated that he would rather err on the low side. The Chair expressed concern about the federal deficit putting a damper on federal funding of Hawaii projects, military spending diverted to the war in Iraq, etc.

It was moved by Dr. Suyderhoud and seconded by Mr. Galati, that the September forecasts for 2007 and 2008 of 6% and 6%, respectively, be retained. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Vito Galati	Yes
Michael Hirai	Yes
Pearl Imada Iboshi	Yes
Eric Yeaman	Yes

The 2009-2013 years show a drop due to disinflation and decreased construction. The old forecast was 4.4%; the models show a 3.7% rate. The Chair said that, since the September

meeting, they had moved up the downturn in construction into 2006 with an attendant deepening of the descent in real terms. Dr. Bonham noted that, in nominal terms, their construction forecast went from 6% for FY 2008 to -3% for FY 2009. The Chair added that there was not enough nonresidential construction to offset the decline in residential construction.

With respect to the impact of the construction of a rail system, the Council's policy was to not consider something until it was a certainty. Since the rail project was not yet a certainty, they would reconsider its impact at the March meeting.

The percentage difference between the current 4.4% forecast and the 3.7% forecast that the models show is a big difference, but Mr. Galati noted that the actual dollar amounts were not that much different.

It was moved by Mr. Yeaman and seconded by Mr. Galati to take the levels reported for FYs 2009 through 2013 in Table 3a and the associated changes in the growth rates of 4.1%, 4.6%, 4.5%, 4.9%, and 5.6%, respectively. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Vito Galati	Yes
Michael Hirai	Yes
Pearl Imada Iboshi	Yes
Eric Yeaman	Yes

The Chair noted that this fulfills the ir requirement to submit a forecast by January 10, 2007. The next reporting date is March 15, 2007.

NEXT MEETING:

The next meeting is March 13, 2007, at 1:00 P.M.

ADJOURNMENT:

The Chair called for a motion to adjourn. Dr. Suyderhoud moved to adjourn the meeting and Mr. Hirai seconded the motion. The motion carried unanimously and the meeting adjourned at 5:15 P.M.