

## **COUNCIL ON REVENUES**

No. 1 Capitol District Building  
250 S. Hotel Street  
DBEDT-Diamond Head Conference Room  
Fourth Floor, Room 436  
Honolulu, HI 96813

Thursday, July 28, 2011  
2:00 P.M.

### **PRESENT:**

#### Council Members:

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

#### Staff Members:

Department of Taxation (DOTAX): Donald Rousslang, Hamid Jahanmir,  
Yvonne Chow and Jacquelyn Guituiten

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

Others: Ross Tsukenjo, Senate Ways and Means  
Sharon Kotaka, Budget & Finance  
Lowell Kalapa, Tax Foundation of Hawaii

### **CALL TO ORDER:**

Dr. Suyderhoud called the meeting to order at 2:02 p.m. with a quorum present.

### **SELECTION OF THE NEW CHAIR AND VICE-CHAIR**

Dr. Suyderhoud started the meeting and moved to the first item on the agenda to select a new Chair and Vice-Chair. Dr. Suyderhoud said that he did not want to be nominated for the Chair since it does not look good for the Council to be chaired by a State government employee. He, however, agreed to serve as the Vice-Chair. He suggested that it would be better for the Council if the Chair is someone who is not a State government employee. Mr. Migita asked if there is any requirement or regulation that prohibits this. Dr. Bonham said that he does not think that this has ever happened before, but it is something that the COR has not discussed for a long time. He said he has a similar problem as Dr. Suyderhoud. As the Director of the UHERO (University of Hawaii Economic Research Organization), Dr. Bonham brought up this issue to his Executive Board and asked whether they thought it was a good idea. The problem, Dr. Bonham thought,

would be the conflicts of interest with UHERO's mission because the Council Chair speaks for the Council when it comes to tax issues. He said they have an unwritten rule that they do not go out and talk about Council activity, so his Executive Board said, "no, you don't want to do that--don't be Chair".

Dr. Grandy said it might make sense for Mr. Kahle to be Chair and either Dr. Bonham or Dr. Suyderhoud, who is the most experienced amongst the members, to be Vice-Chair.

Dr. Suyderhoud said Mr. Kahle has experience in both the Council and the Tax Department. Mr. Kahle said it is alright for him to be nominated as Chair as long as the Tax Research & Planning Office (TRP) drafts all the required language. Dr. Suyderhoud agreed to work with Mr. Kahle on the language and indicated that the Tax Department is good about drafting the language as well.

In a formal motion, the members of the Council nominated Mr. Kahle as Council Chair and Dr. Suyderhoud as Vice-Chair. Both Mr. Kahle and Dr. Suyderhoud accepted the nomination.

**Mr. Migita moved that Mr. Kahle serve as Chair and Dr. Suyderhoud serve as Vice-Chair. Mr. Aoki seconded the motion.**

Dr. Suyderhoud asked if there was any discussion and if they were all in favor. He asked for the show of hands.

<b>Richard F. Kahle, Jr.</b>	<b>Yes</b>
<b>Jack P. Suyderhoud</b>	<b>Yes</b>
<b>Avery A. Aoki</b>	<b>Yes</b>
<b>Carl S. Bonham</b>	<b>Yes</b>
<b>Christopher Grandy</b>	<b>Yes</b>
<b>Ronald K. Migita</b>	<b>Yes</b>
<b>Marilyn M. Niwao</b>	<b>Yes</b>

The vote was unanimous.

#### **COMMUNICATIONS TO THE COUNCIL:**

The Chair asked if there was any communications to the Council. Dr. Rousslang told the Council that he would like to change the functional form of the regression equations used for the general fund tax revenue forecasting from estimating tax levels to estimating differences and log differences. He indicated that there are a number of technical reasons for this change and in addition it will eliminate a lot of the below-the-line tax revenue adjustments, which would simplify the tables that are presented to the Council.

There was a lengthy technical discussion between Dr. Bonham, Dr. Suyderhoud and Dr. Rousslang about the model. Dr. Bonham thought that there is a problem with using a pure growth rate model, but he said that it is his understanding that TRP is running their models to

provide information for the Council to consider in coming to its own forecast for general fund revenue. He did not think that it is desirable for the Council to pass on what specific economic models TRP uses.

Dr. Grandy thought that it is very useful to know what TRP is doing and that the information Dr. Rousslang provided was helpful. And, that he did not think that TRP really needs the Council to approve what they are doing other than seeking the Council's input. He thought that TRP should do what they think is right. Dr. Rousslang said he is glad that Dr. Grandy said that, since he forgot to preface his remarks by asking if he needs the formal Council approval to make changes in the model. Dr. Bonham said that he thought, historically, there was always some input from the Council and some of the Council members might have even worked on the models.

Dr. Rousslang said that the new model he is proposing has exactly the same inputs, only its functional form will be changed. Dr. Suyderhoud asked if the variables are changed. Dr. Rousslang said no and his results, he thought, were as good as those from the UCLA model without using the California dummy, the US recession dummy, or the defense spending data. Dr. Suyderhoud asked about the possibility for the next Council meeting on just estimating the total general fund revenues. Dr. Rousslang replied he would try to do that. He said he has to find out what variables would explain the general fund tax revenue the best. Dr. Bonham said he was going to suggest something similar, switching to top-down or at least considering it. He said he will send Dr. Rousslang what he is using and then he can look at that and do whatever he wants with it. Dr. Bonham said he would consider estimating the model quarterly. He said when you run an annual model; you are throwing away a lot of data when the forecast is updated. You are losing at the minimum a month or two, a quarter or half a year, or three quarters of a year. He suggested doing a quarterly model, estimate it through around 2003/2004 and see how it forecasts out of sample.

Ms. Niwao said the economy is very poor, everybody is really struggling; we do not see very much economic growth. And another factor is tax policy changes which could increase taxes on the income that everybody does have. So when the Council presents one number that it says is the growth rate in tax revenue, there are at least two components: the actual underlying economy and the tax changes. She would like to see the effects every time there are tax law changes, so people can distinguish between changes in the underlying economy and changes in taxes. Dr. Bonham and Dr. Suyderhoud said that is the exact conversation that the Council has. Some of it is written in the report to the Governor and some is captured in the minutes. Dr. Suyderhoud said when the Council has a general fund forecast meeting, they will provide input to the Tax Department model on what they think the economy is doing. That is, what is happening to the State general excise tax, visitor arrivals, construction, and recession in California, etc. Each one of them provides forecasts that go 7 years into the future. The Tax Department then takes those numbers and puts them into their models to get a revenue forecast. The Council gets that information back when they meet. They then discuss where the economy is going, the effect of changes in tax laws, and other events. Then, they come up with a forecast. Ms. Niwao said okay, but the Legislature and the Governor are getting only one number. Dr. Suyderhoud explained that they are getting one number because that is what they want; they only look at one number, there is only one number

they focus on. Dr. Bonham added that the letter from the Chair to the Governor containing the forecast also describes some of the conditions. Also, the minutes of the meetings are available publicly later. Dr. Suyderhoud said they take the number, even though everyone knows it is uncertain. In the letter to the Governor, the Council tries to say, "please keep in mind that there is a potential for error in the forecast".

Mr. Aoki said the delay in tax refunds have a critical role that must still be recognized going forward.

Ms. Niwao said she would say the public looks at the Council's numbers and they cannot see how they were derived. Dr. Suyderhoud said they try to explain it the best they can but sometimes it is just hard to do that. Ms. Niwao said she is not sure that the 20% forecast is really that good. Dr. Suyderhoud said that is one of the things they are going to talk about in the general fund forecast meeting. Dr. Bonham said they do not just take the number that comes out of the TRP model. They rarely ever adopt that number. Ms. Niwao asked how they come up with alternative numbers. Dr. Bonham said they discuss for an hour or two and come up with a consensus. Ms. Niwao asked if the members can get whatever information they want from the Tax Department. The Chair said within limits. Dr. Bonham said TRP uses the best estimates they have available, but do not always have the data the Council needs. Ms. Niwao asked what happens if the numbers are not available from the Tax Department. Dr. Suyderhoud said the Council talks about these things and what they think is a reasonable number. They then create a single total general fund revenue forecast and all the detail to that forecast is prepared by the Tax Department, because if the Council had to do it from the bottom-up, they would never finish their meeting. Mr. Aoki agreed.

Dr. Suyderhoud said the Council will make a forecast when it meets in September (reporting deadline is September 10) for the general fund revenues. The Tax Department will prepare their economic models, the Council will sit down and say "okay, what do we think of this? Do we think the results of the models are accurate?" The members then discuss what the model says; they share their own opinions and eventually reach a consensus on the forecast.

Dr. Grandy asked Dr. Rousslang if he got his answer (regarding the change in the model's functional form). Dr. Rousslang said yes.

Dr. Suyderhoud said his preference would be for the Tax Department to estimate the total general fund both in the old and new fashion ways. Dr. Bonham clarified that the old way is the full model. Dr. Suyderhoud agreed. Dr. Rousslang said he will add a top-down model to the bottom-up model. He asked if they meant one equation only. Dr. Suyderhoud said one dependent variable.

Dr. Suyderhoud asked if the Council had any minutes to approve this time. Ms. Guitguiten said no since the Council already approved the minutes previously via email.

**MINUTES OF THE MEETING OF MAY 26, 2011:**

The minutes of May 26, 2011 meeting was previously approved via email and accepted as written by the Council Members prior to the expiration of their terms on June 30, 2011.

Paul Brewbaker (Chair)

Jack Suyderhoud (Vice-Chair)

Avery Aoki

Carl Bonham

Pearl Iboshi

Richard F. Kahle, Jr.

Albert Yamada

**TOTAL PERSONAL INCOME FORECAST:**

The Council then turned to the forecast for the growth of total personal income. Dr. Suyderhoud explained the process by going through the personal income booklet prepared by the Tax Department. He said the last time the Council met to forecast the personal income (November 2010), they forecast the growth rate of personal income to be 3% in 2011. As of July 2011, the models were predicting anywhere from 2% to 4.50% forecast for 2011. He explained to the Council that in their meeting of May 26, 2011 (to forecast the general fund) on average the members were assuming 3.4% growth rate.

Ms. Niwao asked if the problem is that in the beginning of this year the tourism was not really doing well. Mr. Aoki said, yes, tourism fell off a little bit but not as much as they had first thought it would with the Japan effect. Dr. Suyderhoud asked Mr. Aoki what he sees in terms of Japan's quake. Mr. Aoki said he thinks it is behind us. Dr. Bonham said the non-Japanese, non-US market has boomed. Mr. Aoki agreed that we are getting visitors from other markets. Dr. Suyderhoud added that the Australians and the Canadians are happy with the value of their currency. Ms. Niwao said the US dollar is becoming like the Mexican peso. Dr. Bonham said they never get the data on month-to-month comparisons because nobody seems to adjust it. He said we have plateaued; we are not going to see the kind of strong growth (in visitor numbers) that we did a year ago or even 6 months ago. Dr. Suyderhoud asked if in terms of personal income, whether the first half of the year is going to be stronger than in the second half in terms of growth. Dr. Bonham said, not necessarily. Dr. Grandy asked if the US visitor arrivals have been fairly steady. Mr. Aoki said yes.

Ms. Niwao pointed out that the unemployment rate has been going up. Dr. Bonham said it was not going up in Hawaii. Ms. Niwao said the neighbor islands are really, really bad. Dr. Bonham agreed.

Dr. Suyderhoud pointed out that in the first quarter of this year personal income grew at 4.4% including inflation. Dr. Bonham confirmed that it is a nominal growth rate. Dr. Suyderhoud asked if anybody had an inflation forecast. He thought energy prices have pretty much leveled-off.

After discussing inflation and the job market, Ms. Niwao said maybe growth would be 2% for the personal income in 2011. Dr. Suyderhoud thought that was too low. Dr. Bonham said his real forecast is 1.8% for the year and, his inflation forecast is 1.8%. Ms. Niwao asked if all the government workers are getting a 5% pay cut, how that will factor in. Dr. Bonham said it is a pay raise, because they were getting about 8% cuts before and now are only getting 5% cuts (or something like that). Dr. Bonham thought that the bigger problem on the government side is continued reduction in number of workers.

After some further discussion, Dr. Suyderhoud asked the members if they thought that 3% or 4% is too high. Ms. Niwao said yes. Dr. Suyderhoud said we have 4.4% growth in the first quarter but we do not have 4% anywhere. The Council's latest forecast (using the May 26, 2011 meeting) is about 3.4% in 2011 and 4.5% in 2012. Ms. Niwao pointed out that last year in November the Council thought it would be 3%. Dr. Suyderhoud agreed.

The Chair asked if the members have a forecast for the growth rate of personal income in 2011. Dr. Suyderhoud suggested 3.5% for 2011 and 4.0% for 2012.

The Chair said okay and asked if there was a discussion about Dr. Suyderhoud's numbers. Ms. Niwao said she still does not see the 4%. She suggested maybe 3.0%. She pointed out that to her, this economy looks like Japan's; it feels like it is just plugging along and she was concerned with Hawaii's demographics. She thought they needed to look at the demographics in Hawaii, the aging of the population and the baby boomers who will be retiring soon. Dr. Bonham reminded Ms. Niwao that they are looking at 2011 and 2012; just two years. In 2010, income growth was over 2%, which was not a great year. The economy really did not start to see the visitor recovery until half way through the year and we did not see any job growth. He was pretty sure job growth was negative that year--we were still losing jobs.

After more discussion about the impact of the visitor and defense sectors between Ms. Niwao and Dr. Bonham, Dr. Grandy indicated that a growth rate of 3.5% for 2011 is okay with him. But, he suggested something less than 4.0% for 2012. He thought maybe a 3.8%. Dr. Bonham said that his model is actually lower in 2012 than 2011. The Chair asked the members if they want to give him a motion on those numbers. Ms. Niwao asked if the forecast of personal income is used for the general fund estimates. Dr. Grandy explained that the personal income forecast is just for the expenditure ceiling and that the State is very far below the ceiling. He moved for 3.8% (for 2011) and 3.5% (for 2012). The Chair asked if someone will second that. Dr. Suyderhoud seconded the motion.

The Chair asked for discussion.

Mr. Migita said he feels comfortable with 3.8% and 3.5%. Ms. Niwao asked for confirmation that part of the figures is inflation. Dr. Bonham and Dr. Suyderhoud confirmed that it was. Mr. Migita said that he prefers to be on the lower side and if we exceed it then that is great, rather than being on the high side and we do not hit it and become subject to more criticism.

The Chair asked if there were any more discussion and if the members were ready to vote. There was no more discussion.

**It was moved by Dr. Grandy, and seconded by Dr. Suyderhoud, that the Total Personal Income forecast for CY2011 be 3.8% and CY2012 be 3.5%. The Chair called for the vote, and the motion passed with the following votes:**

<b>Richard F. Kahle, Jr.</b>	<b>Yes</b>
<b>Jack P. Suyderhoud</b>	<b>Yes</b>
<b>Avery A. Aoki</b>	<b>Yes</b>
<b>Carl S. Bonham</b>	<b>Yes</b>
<b>Christopher Grandy</b>	<b>Yes</b>
<b>Ronald K. Migita</b>	<b>Yes</b>
<b>Marilyn M. Niwao</b>	<b>Yes</b>

**NEXT MEETING:**

The Council tentatively agreed to meet on Tuesday, September 6, 2011 at 10am; however, the date and time will be confirmed by e-mail. The Council staff will attempt to secure the DBEDT Diamond Head Conference Room for the meeting.

**ADJOURNMENT:**

The meeting adjourned at 3:06 pm.