

COUNCIL ON REVENUES

Land Use Commission Conference Room
Leiopapa A Kamehameha Building
(State Office Tower)
Fourth Floor, Room 405

Thursday, July 26, 2007
2:00 P.M.

PRESENT:

Council Members:

Paul H. Brewbaker (Chair), Jack P. Suyderhoud (Vice-Chair), Carl S. Bonham,
Pearl Imada Iboshi, and Richard F. Kahle, Jr.

Staff Members:

Department of Taxation: Tu Duc Pham, Yvonne Chow, Glenn Ifuku, and
Cathleen Tokishi

Department of Budget and Finance: Karen Matsunaga, and Terri Ohta

Others:

Gordon Arakaki, Senate Committee on Ways and Means
Calvin Azama, Office of Speaker of the House Calvin Say
Richard Borreca, Honolulu Star-Bulletin
Sean Hao, Honolulu Advertiser
Lowell Kalapa, Tax Foundation of Hawaii
Kim Langley, Office of Senator Donna Mercado Kim

ABSENT:

Council Members:

Dean Hirata and Albert Yamada

CALL TO ORDER:

The Chair called the meeting to order at 2:08 P.M. with a quorum present.

COMMUNICATIONS TO THE COUNCIL:

Dr. Suyderhoud stated that the meeting materials envelope he received upon his arrival at the meeting also contained a letter, dated June 25, 2007, from Governor Lingle, thanking him for the Council's May report on its revised estimates of General Fund revenue.

The Chair noted that such correspondence is usually sent to his office, but will give it to the Tax Department staff in the future. Any correspondence for the Council that is received by the Tax Research and Planning will be given to Ms. Tokishi to open, review, and take any appropriate action.

The Chair welcomed to the Council former Director of Taxation Richard F. Kahle, Jr., and noted Mr. Kahle's significant tax expertise.

MINUTES OF THE MEETING OF MAY 21, 2007:

The Chair asked if there were any corrections to or comments about the minutes of the May 21, 2007, meeting. There were none, so the Chair called for a motion to approve the minutes.

It was moved by Dr. Suyderhoud and seconded by Mr. Kahle, that the minutes of the May 21, 2007, 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	Yes
Dean Hirata	Absent
Pearl Imada Iboshi	Yes
Richard Kahle, Jr.	Yes
Albert Yamada	Absent

TOTAL PERSONAL INCOME FORECAST:

The Chair stated that their General Fund numbers, before taking into account the below-the-line adjustments, were consistent with their prior total personal income (TPI) forecast. He noted that 1st quarter nominal personal income seemed to be growing at the rate of about 6%, which they have been seeing within a couple of tenths. The Chair noted that Dr. Bonham had distributed the University of Hawaii Economic Research Organization (UHARO) quarterly forecast update, "Another Year With No Visitor Growth," dated June 4, 2007, and that he had distributed a draft of the next Bank of Hawaii "Hawaii Economic Trends" publication that he has been working on.

Dr. Pham stated that the Council's CY 2006 TPI forecast in November of 6.5% was within the range of the current Bureau of Economic Analysis (BEA) actual revised estimate of 6.1%, which is subject to further revision.

At the same meeting, the Council forecast a 6% TPI growth rate for CY 2007; no forecast was made for 2008. Based on the Council's May meeting, they averaged the last two fiscal years to

arrive at projected growth rates of 6.25% and 5.95% for CY 2007 and CY 2008, respectively. The staff ran various models, and based on the Council's assumptions regarding construction expenditures, visitor arrivals, etc., they came up with growth rates of 6.1% to 6.3% for CY 2007, which was well within the range of the Council's forecast, and 5.73% to 5.86% for CY 2008, which also was close to the Council's forecast of 5.95%. He noted that the 6.25% and 5.95% forecasts were very close to the UHERO projections.

In summary, the Chair stated that the estimate based on the Council's May assumptions is 6.25% for CY 2007, down to 6% (5.95%) for CY 2008; UHERO's estimates are 6.3% and 5.8%, respectively, and DBEDT's estimates are 6.4% and 5.8%, respectively. The results of models used by Dr. Pham range from 6.07% to 6.32% and 5.54% to 5.86%, respectively, which are very close. Dr. Bonham noted that these are not statistically significant differences.

The Chair thought they should stay with 6.0% for CY 2007. He also thought that 6.0% would be an upper bound for CY 2008 given that the slowing or flattening in a number of areas in the economy (e.g., tourism, housing, and construction) were beginning to be reflected in the payroll numbers, though unfolding more slowly. Unemployment, for example, had gone up from an upper bound of 2.0% to 2.5% more recently.

Dr. Bonham stated that the real story was in the inflation numbers. In real terms, taking inflation into account, UHERO's TPI is forecast to increase from roughly 0.2% or 0.3% for 2006 (revised downward from 0.4% to take into account the latest numbers) to 1.5% for 2007 and 2% for 2008. Inflation comes down from roughly 5.9% for 2006, to 4.8% in 2007, and to 3.8% in 2008.

The Chair stated that this was because the shelter component flattens, energy flattens a little sooner, and the medical component, while still high, is a small share; the rest of the core is about 2% to the extent that it follows the national tendency.

Dr. Bonham agreed, adding that Hawaii should converge back to the U.S. inflation rate in 2 to 3 years, assuming that Hawaii does not experience another housing spike.

Dr. Suyderhoud noted that, in the aggregate, they are largely offsetting each other such that the nominal growth rate remains fairly flat although, as Dr. Bonham pointed out, the real growth rate is increasing.

Dr. Bonham stated that it would probably converge on a steady state of about 2% so that inflation and the nominal balance out. He also noted that the pay raises discussed in the press were not coming in at 6%, though you couldn't always tell because contracts were a combination of pay raises and step increases though the nurses seem to have done better than 6%. The Chair noted that the negotiated increases have generally gravitated to 4% rather than 6%. Dr. Bonham stated that he was comfortable with 6% for both 2007 and 2008.

Dr. Imada Iboshi preferred the 6.25% and 5.95% based on their May general fund meeting. The Chair stated that he liked the quarter-point step-down, but from 6% in 2007.

In response to a question, Dr. Imada Iboshi said that year-to-date job growth was 2.1%. However, the Chair noted that there is a flattening on a seasonally adjusted basis. It was about 2% on a year-over-year basis, but annualizing the quarterly numbers reveals significant slowing.

At this time, the Chair called for a motion on the 2007 and 2008 forecast.

It was moved by Dr. Bonham and seconded by Dr. Imada Iboshi, that the Council's forecast of nominal total personal income growth be 6.2% for calendar year 2007 and 5.9% for calendar year 2008. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Dean Hirata	Absent
Pearl Imada Iboshi	Yes
Richard Kahle, Jr.	Yes
Albert Yamada	Absent

NEXT MEETING:

The Chair announced that he, as the Council's representative, had been asked to give a presentation before a joint Senate Committee on Ways and Means and House Committee on Finance informational briefing on Thursday, September 13, 2007. Dr. Imada Iboshi and Dr. Bonham would also be giving presentations at that meeting, which is scheduled to begin at 10:00 A.M. and end at 12:00 P.M., as will Director of Finance Georgina Kawamura.

The briefing is being held after the Council's September 10 General Fund reporting date, but the Council was asked to meet well ahead of that date to allow Director Kawamura time to review the Council's forecasts.

With that in mind, the next meeting was scheduled for August 28, 2007, at 2:00 P.M. Preliminary July 2007 tax revenue figures and the CPI for the first half of the year should be available. Dr. Pham will try to reserve the Office of Aging Conference Room.

The Chair asked Dr. Pham to identify anything that would help the Council filter out the underlying economic movement from tax credits and other special factors for the previous fiscal year. The Chair noted that the general excise tax and withholding numbers are consistent with what their economic forecasts would suggest, and that is 90% of the revenue stream.

Mr. Kahle stated that one thing to be aware of is that the general excise tax revenue reported in the Department of Taxation's monthly "Preliminary Statement of State General Fund" includes the county surcharge tax; a later report is "scrubbed" and therefore more accurate. Dr. Pham

stated that some county surcharge tax collections may be in the total reported in the Preliminary Statement and may subsequently be allocated to the county surcharge in the following month.¹

Dr. Suyderhoud said that he suspected that their assumptions and model would result in a higher forecast than what the actual revenue growth has been. This, according to the Chair, was his question – to what extent are their economic assumptions still pretty good and to what extent are special factors causing the forecast error.

Dr. Pham stated that last year's 6% forecast last September was mainly the result of adjusting the model's 5% forecast upward instead of downward because they thought that the economy was still growing. Several Council members recalled that the upward adjustment was in part due to special factors. Dr. Bonham noted, for example, that their forecast the year before would have been accurate but for the huge end of the fiscal year delinquent tax collections. There were no such "May-June surprises" for FY 2007.

The Chair also noted that the Council had previously discussed reviewing modeling alternatives, and that Dr. Pham had secured some resources to do that. He asked Dr. Pham to include his suggestions for utilizing these funds as an agenda item; Dr. Pham agreed to do so. Dr. Pham noted that the Legislature had appropriated \$25,000 per year for FY 2008 and FY 2009, in exchange for which they will have to report on how the money was spent by December 1.

Dr. Imada Iboshi asked if the Council would be given some numbers on tax credits and special factors. Dr. Pham stated that the 2004 tax credit report had been completed and that they may have some 2005 data available.

The Chair said that even preliminary numbers would be useful in helping them understand the most recent fiscal year. The Council seems to have the economic part okay since the general excise and withholding numbers are in line with where they feel that the economy is heading. These constitute the bulk of the core, but they need to fill in the edges with the details. The Chair noted that, for the last couple of years, the Council seems to have been spending a lot of time on details compared to the core. Dr. Bonham agreed, adding that the variance has been in the details.

Dr. Imada Iboshi also asked for information on the status of delinquent tax collections, which, as the Chair noted, the Council expects to go down. Dr. Suyderhoud clarified that they expected the growth rate of delinquent tax collections to slow rather than the absolute amount. The Chair noted that the past increases were largely the result of exploiting the computer system improvements, which would not yield as much over time. Dr. Bonham noted that the yield would

¹ Recorder's Note: County surcharge tax payments should not normally be included in the State General Fund's general excise tax totals. However, some taxpayers have failed to complete, or to correctly complete, the portion of the general excise tax return that allows the Department to automatically separate the county surcharge tax payments from the State general excise tax payments. As a result, some county surcharge payments may be included with the State general excise tax totals until such time as the county surcharge amounts can be properly credited.

not go down unless enforcement resulted in a change in behavior. Dr. Pham noted that taxpayer behavior had changed with the advent of automatic billing.

Mr. Kahle noted that there was a difference between delinquencies and collections. The boost in collections will flatten; delinquencies will not flatten and will get worse as the economy gets worse. Collections will flatten out because you can only get so much out of the new system, but the total amount may in some ways start turning up.

Dr. Suyderhoud asked if the Department had started looking at the impact of the 0.5% county surcharge on reporting patterns (e.g., if people are relocating their businesses from Oahu to another island). Dr. Pham stated that, for the first few months, county surcharge collections were about \$11 million per month; in June, they collected \$17 million in county surcharge. He asserted that the Department's audit staff could not do anything until taxpayers file their annual returns. Dr. Bonham noted that they would like to know the number of businesses that had changed their addresses from Oahu. Mr. Kahle noted that those kinds of changes would be slow. Dr. Pham stated that, although they expected 70% of the economy to be on Oahu, the numbers indicate that it was only 53%. The Chair, however, stated that the census of industry by establishment shows 70% on Oahu.

ADJOURNMENT:

The Chair noted that all these issues, and more, would be discussed at the next meeting and thanked everyone for attending. He adjourned the meeting at 2:40 P.M.