

COUNCIL ON REVENUES

No. 1 Capitol District Building
250 S. Hotel Street
Office on Aging Conference Room
Fourth Floor, Room 410
Honolulu, HI 96813

Thursday, October 31, 2013
2 p.m.

PRESENT:

Council Members:

Kurt Kawafuchi (Chair), Marilyn M. Niwao (Vice-Chair), Christopher Grandy,
Jack P. Suyderhoud and, Kristi L. Maynard

Staff Members:

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

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

Others:

Sharon Kotaka, Budget and Finance
Paul Harleman, Senate Minority Research Office

ABSENT:

Council Members:

Carl S. Bonham
Elizabeth P. Cambra

CALL TO ORDER:

The Chair called the meeting to order at 2pm. A quorum was present.

COMMUNICATIONS TO THE COUNCIL:

Chair Kawafuchi asked if there was any communication to the Council. There was none.

MINUTES OF THE MEETING OF SEPTEMBER 5, 2013:

Chair Kawafuchi called for a motion to approve the minutes.

It was moved by Dr. Suyderhoud and seconded by Dr. Grandy that the minutes of the September 5th meeting be accepted. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Carl S. Bonham	Absent
Christopher Grandy	Yes
Elizabeth P. Cambra	Absent
Jack P. Suyderhoud	Yes
Kristi L. Maynard	Yes

TOTAL PERSONAL INCOME FORECAST:

Next, the Council discussed the total personal income forecast. Mr. Jahanmir referred to the COR workbook, Table 2, and told the Council that the BEA (Bureau of Economic Analysis) has recently revised the personal income data back to the 1st quarter of 2001. He said the figure for 2009, which was originally negative 2%, is now slightly positive. He added that the 1st quarter of this year and the last quarter of 2012 were revised downward slightly. Dr. Suyderhoud said growth was now running at between 2.8% and 3%. Mr. Jahanmir said the growth rates for the last two quarters of this year were 2.9% and 2.8%, but the 1st quarter was 3.6%. Dr. Suyderhoud asked about the Council's current forecast. Mr. Jahanmir said Table 4 shows the models' forecasts and the Council's forecast in August. He said he added a simple average of all models, a simple average of all forecasts including DBEDT (Department of Business, Economic Development & Tourism), and UHERO's (University of Hawaii Economic Research Organization) forecast of October 25. Dr. Suyderhoud said it looks like UHERO's forecast took BEA's revisions into consideration. He said their forecast is almost a full percentage point below the Council's.

Mr. Jahanmir agreed. Dr. Suyderhoud said he did not recall UHERO's forecast being so low before. Ms. Niwao thought it might be the effect of the recent federal budget problems. Ms. Maynard said UHERO came out with the update on October 25th. Dr. Grandy said the BEA data were revised on September 30th. Mr. Jahanmir said the previous UHERO forecast from February 15 was for growth of 4.6% for 2013 and of 5.9% for 2014. Dr. Suyderhoud said the forecasts had been lowered and asked if they were in nominal numbers. Mr. Jahanmir said that they were. Ms. Maynard asked if the inflation rate has been about 1.8% to 2.0%. Dr. Suyderhoud said yes.

Ms. Maynard said there is very little growth on an inflation adjusted basis. Dr. Suyderhoud said about 1.5%. He asked about the Council's latest inflation numbers. Ms. Maynard said the income growth is 2.9% and 2.8% for the first two quarters of 2013, therefore real growth was around 1%. Dr. Suyderhoud said it was a little more, about 1.5%. He said it was 1% using the CPI (Consumer Price Index) as the deflator, but with the implicit GDP (Gross Domestic Products) deflator it was lower. He asked Dr. Grandy what he uses to deflate personal income. Dr. Grandy said he used the CPI.

Chair Kawafuchi asked how well the Council did in the past in terms of forecasting personal income growth. He asked if that is in one of the charts. Mr. Jahanmir pointed to the first line of Table 4.

Dr. Suyderhoud asked if any members believed that the personal income growth will average over 4% for 2013, given the new revised data. Ms. Maynard and Ms. Niwao said no. Chair Kawafuchi asked if the Council's estimates have been historically on the high side. Dr. Suyderhoud said when the economy was not good, the Council tended to under-estimate because personal income stayed stronger than GDP. Ms. Niwao said the Council had forecasts of 4.4% and 4.2% for 2012 but the actual number was 3.72%.

Dr. Grandy agreed with Chair Kawafuchi that it would be interesting to have a series of Council's forecasts, comparing them to the actual growth rates of income. Chair Kawafuchi said there is one for the general fund forecast. Mr. Jahanmir said the Council's 2009 forecast was fairly close to zero and that the BEA first estimated growth of minus 2% but had now revised it to slightly more than zero, close to the Council's forecast.

Ms. Maynard asked if income growth would be better in the second half of the year. Ms. Niwao said no. Dr. Suyderhoud said growth was decelerating.

Chair Kawafuchi asked if BEA later changes data that they had said were "actual." Dr. Suyderhoud said yes. He said once BEA lowered its estimate of income growth from 3.6% to 2.9%, which was a large change, and it might be revised again in the future. Dr. Grandy noted that Mr. Jahanmir had just mentioned that BEA revised the data from 2001 to date. Dr. Suyderhoud said the simple averages of all the model growth forecasts were 3.7% for 2013 and 4.4% for 2014. The Chair asked if these figures were before the inflation. Dr. Suyderhoud said no, they included inflation. Dr. Grandy said his estimate for calendar year 2013 is 3.1%. Ms. Maynard said that sounds good. Dr. Grandy added that his forecast for 2014 was 4.5%. Dr. Suyderhoud said that puts your forecasts below UHERO, which is 3.6% and 5.6%. Dr. Grandy said that is right. Ms. Niwao said she thought they were very optimistic. Dr. Suyderhoud said either that, or they have a stronger inflation assumption--but he did not recall UHERO having strong inflation assumptions.

Dr. Suyderhoud said he expected the inflation rate to be slightly more than 2% because of real estate prices. Mr. Jahanmir said UHERO reports real personal income growth and inflation separately. He said he added the two together to estimate the nominal growth. Ms. Maynard said UHERO's inflation rate forecast for 2013 is 2% and for 2014 is 2.1%. Dr. Suyderhoud said some of it is real estate price increases, rental price increases, hotel room price increases, and wage increases working their way through the economy.

Ms. Niwao said July 1st 2014 is when the small businesses in Hawaii with older workers will be affected by the Affordable Care Act (ACA) health insurance increases. She said some of the increases in insurance rates will be quite substantial for many businesses. She said she hoped there would be legislative solution, but if not, it would affect small businesses in Hawaii with older employees. She said the effect was quite substantial for her business, doubling what she

now pays. She said it would cause employers either to forego giving their employees raises, or to raise their prices to cover the cost, or perhaps both.

Dr. Suyderhoud said that he agrees that some people will be affected, but the question was how big the effect would be on the overall economy. Ms. Niwao said there are a lot of small businesses in Hawaii. The Chair asked about the sentiment of the business community. Ms. Niwao said people are in shock. She said a lot of small businesses have gotten notices about the premium increases, that they are very angry about it and that they wonder if they can survive the cost increases, since their profit margin is not very high. She said either they are going to raise their rates or cut salary costs.

The Chair asked if they are hiring more people. Ms. Niwao said no. She said the age rating of the health insurance would cause older employees to pay 3 times as much as the younger ones, and the insurance plans they get will not be comparable to the ones they currently have. She said the deductibles and the co-pays are much higher.

Ms. Maynard said she would not forecast growth for the latest quarter to be up substantially over the previous quarters, since the overall visitor spending dropped by 4.8% in September. Dr. Suyderhoud cautioned her that the Council had run into trouble in the past when it considered monthly numbers, which are subjects to a lot of 'noise.' He said that in the present case, it could be the result of the early Labor Day this year. He agreed that the tourism growth is decelerating, but he also noted that construction is accelerating, especially on Oahu, in terms of permitted activities, construction tax base and jobs. Therefore he would be cautious about weighing the latest visitor statistics.

Ms. Maynard said she saw low numbers and many revisions in personal income in the past. Dr. Suyderhoud said he would advise looking at trends and pointed to the uncertainty about the ACA (Affordable Care Act). Ms. Niwao said the ACA has imbedded taxes in addition to the increases in health insurance costs. Dr. Suyderhoud said from a macroeconomic perspective, if you tax somebody you spend it somewhere else, that actually can have a positive impact on the economy through what is called the balance budget multiplier, therefore it could cause overall spending on medical insurance to increase, and more money to go through the economy. He agreed with Ms. Niwao that the roll out of ACA is fraught with issues, including fundamental issues related to how the program is structured. He said he did not know what the overall macro-effect will be. Ms. Niwao said looking at the number of people who were already insured in Hawaii, about 92 to 93 percent, we are not going to have more money coming in compared to the other States. She said some of the other States are going to be subsidized with federal money, but that we will lose out because we pay more taxes and will get fewer subsidies.

The Chair asked the members if there was much news about the federal government. He said he has heard, for example, that the IRS says that they have 22 furlough days between now and the end of the federal fiscal year (September 30th). He said that is almost a month's pay for them and that he assumed other federal agencies would face similar cuts. Dr. Suyderhoud asked if he was talking about the sequestration effects. The Chair said yes, that the effects might be unwound and the pay restored, but that is what is now in the budget.

Dr. Suyderhoud said Mr. Kalbert Young (Director of the Department of Budget and Finance) reported at an economic conference that there are some small macro-effects from this, which he thought would be about \$50 million or so in terms of general fund revenues. Dr. Grandy said the year-over-year change in general fund revenue was 5 times that amount. He said from a macro perspective it does not have much of an effect on Hawaii's economy.

Chair Kawafuchi said it seems that it is more than offset by other factors. Dr. Grandy agreed. Ms. Niwao said if there is any effect, it would be on tourism: people who are affected on the mainland would not fly here. Dr. Suyderhoud said we saw a bit of that in 2011 when consumer confidence collapsed and then so did our economy.

Ms. Maynard asked what is the significance of the Council's forecast for personal income - what is it used for? Dr. Suyderhoud said general fund budgeting is limited by the growth in personal income, but that we have not been anywhere near that limit. Ms. Ohta said they actually exceeded the limit for fiscal year 2014. Dr. Suyderhoud asked how they had exceeded the limit. Ms. Ohta said she was referring to the executive budget; she said she thought the judiciary also exceeded their limit. Dr. Suyderhoud asked if there is a separate judiciary limit. Ms. Ohta said yes, there are separate limits for the executive and the judiciary branches. Dr. Suyderhoud asked if Budget & Finance takes the Council number and uses it to create a ceiling. Ms. Ohta said yes. Dr. Grandy said he had thought that we were pretty far away from the ceiling, but that he may be mistaken. Dr. Suyderhoud asked about the ceiling for fiscal year 2014. Ms. Ohta said we have exceeded the ceiling for fiscal year 2014. She said there were several money bills in the special session and that they had to notify the legislature that the executive budget exceeded the ceiling. Dr. Suyderhoud asked if the ceiling for the executive budget was the entire general fund. Ms. Ohta said no. Dr. Grandy said he thought there were an expenditure ceiling and an appropriation ceiling. Ms. Ohta said yes. Dr. Grandy asked Ms. Ohta if she was talking about the appropriation ceiling. Ms. Ohta said yes.

Dr. Grandy asked if the constitutional requirement was the limit on appropriations. The Chair asked if that were done through the budget resolution. Dr. Grandy said yes, that B&F calculates the ceilings and reports them in every budget, both the expenditure ceilings and the appropriations ceilings, and how close we are to those ceilings. He said he understood that the Council's mandate is to produce personal income forecasts so that the expenditure ceiling can be calculated.

The Chair asked if we have or have not exceeded that limit. Dr. Grandy said he has to go back and try to figure it out. Dr. Suyderhoud said regardless of the ceiling, the Council will have to come up with the best forecast they can. The Chair and Dr. Grandy agreed.

The Chair asked the consequence of exceeding the expenditure ceiling. Dr. Grandy said he did not think there were any.

Dr. Rousslang said the ceiling was mandated by the constitution. Dr. Suyderhoud said Ms. Ohta said that they just have to inform the legislature. Dr. Grandy said there were probably political consequences.

Chair Kawafuchi asked if there were any proposals for the forecast. Dr. Grandy proposed growth forecasts of 3.1% for 2013 and 4.5% for 2014, but said that he was flexible. Ms. Niwao asked Dr. Grandy why his figure goes up so much for 2014. Dr. Grandy said he thought some of the forces reflected in the DBEDT and the UHERO forecasts indicated stronger growth next year, perhaps from the mainland, and that there seemed to be a consensus among other forecasters that there would be stronger growth next year. Ms. Maynard noted that we would not have the 2% increase in payroll taxes after this year. Dr. Grandy said the US economy has been quite sluggish, and his sense was that economic forecasters are expecting some kind of breakout. Dr. Grandy said he expected that growth in the mainland will finally catch up and we will get a surge from that.

Dr. Suyderhoud asked Dr. Grandy if he thought that tourism was going to improve. Dr. Grandy said it might turn around. The Chair suggested that it was slowing down. Dr. Grandy agreed that it is now. The Chair asked if growth in construction permitting is slowing down. Dr. Grandy said he did not have data on permitting but he thought the growth rates were beginning to peak. Dr. Suyderhoud agreed about the deceleration of tourism. He said he was not sure that tourism was going to take off again, but he thought there was a bottom to its recent deceleration. He said he still expected positive tourism growth, but that job growth would come from construction. He added that there was a lot of excess capacity in the construction sector, and he thought some of that would come back in 2014. He said he expected to see a shift away from tourism-led-growth to more reliance on the construction-led-growth.

Ms. Niwao said that construction dropped so much that an increase may look like a high number in percentage terms, but that in absolute dollars it might still not reach previous levels. The Chair asked if there were big projects on line like Kaka'ako, Ala Moana, or Rail. Ms. Niwao said maybe on Oahu and Lana'i. Dr. Suyderhoud noted that Oahu was 80% of the State's economy and that there was a lot of activity on Maui. Ms. Maynard returned to the payroll tax that is 2% on a year-over-year basis. She said last year 2% was taken out of everybody's tax base, but that next year would not show the same year-over-year difference. She said it was like an extra 2 percent of income. Dr. Suyderhoud asked if she supported Dr. Grandy's claim that growth for 2014 will be higher than 2013. Ms. Maynard said yes. Ms. Niwao said her main concern was the impact of the health care act and increases in health insurance rates. Ms. Maynard agreed. Ms. Niwao said it would be substantial and she pointed to other drags on growth in the tax code.

Dr. Suyderhoud repeated the proposed forecast growth rates of 3.1% for 2013 and 4.5% for 2014. The Chair asked for a second to the motion. Ms. Maynard seconded the motion. The Chair asked for discussion.

Ms. Niwao said she was fine with the forecast of 3.1% for 2013, but she had some doubts about the forecast for 2014. She said the first half of the year should be okay, but not the second half. Dr. Suyderhoud said the Council could revisit the forecast next August.

Ms. Maynard asked how often the Council revises the number. Dr. Suyderhoud said in August and in October each year. Dr. Grandy noted that the forecasts last August were for growth of 4.3% for 2013 and 4.9% for 2014. He said the effects of the ACA were incorporated in the August forecasts, so the Council's new forecasts are down by more than a percentage point for 2013 and a half a percentage point for 2014. The Chair asked if there were any further discussion and if not, should they take a vote on the forecasts, one year at a time.

Dr. Grandy moved that the Council's forecast for 2013 nominal personal income growth to be 3.1%. Ms. Maynard and Ms. Niwao seconded the motion.

Chair asked if there was an opposition. There were none.

Next, Dr. Grandy moved that the Council's forecast for nominal personal income in calendar year 2014 be 4.5%. Ms. Maynard seconded the motion.

The Chair asked if any were opposed. Ms. Niwao repeated that they would not know the true effects of ACA until July 1st of next year. Dr. Suyderhoud said she could vote no. Ms. Niwao asked if he was referring to the forecast for 2014. Dr. Suyderhoud said yes. Dr. Grandy said she could also abstain from the vote. Ms. Niwao said she would abstain. The Chair so noted and asked whether everyone else agreed with the motion.

The Chair asked if there were anything further business. Dr. Suyderhoud said there was nothing else.

A motion was made by Dr. Grandy and seconded by Ms. Maynard and Ms. Niwao that the Total Personal Income forecast for CY2013 be 3.1%. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Carl S. Bonham	Absent
Christopher Grandy	Yes
Elizabeth P. Cambra	Absent
Jack P. Suyderhoud	Yes
Kristi L. Maynard	Yes

A motion was made by Dr. Grandy and seconded by Ms. Maynard that the Total Personal Income forecast for CY2014 be 4.5%. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Abstain
Carl S. Bonham	Absent
Christopher Grandy	Yes
Elizabeth P. Cambra	Absent
Jack P. Suyderhoud	Yes
Kristi L. Maynard	Yes

NEXT MEETING:

The Council tentatively agreed to meet on Tuesday, January 7, 2014 at 2pm; however, the date and time will be confirmed by e-mail. The Council staff will attempt to secure the DLIR Conference Rooms 310-313.

ADJOURNMENT:

The meeting adjourned at 2:43 p.m.