

COUNCIL ON REVENUES

Meeting Minutes, March 11, 2020

Tax Conference Room
Princess Ruth Keelikolani Building
830 Punchbowl Street, Second Floor
Room 223
Honolulu, Hawaii 96813

Wednesday, March 11, 2020
10:00 a.m.

PRESENT:

Council Members:

Kurt Kawafuchi (Chair), Marilyn M. Niwao (Vice-Chair), Carl S. Bonham,
Jack Suyderhoud, Kristi L. Maynard, Jessica Gluck, Scott Hayashi

Staff Members:

Department of Taxation (DOTAX): Seth Colby, Baybars Karacaovali, Dawn Hayashi

Department of Budget and Finance (B&F): Terri Ohta, Donovan Chun,
Gregg Hirohata-Goto, Kenneth Shirokane, Craig Hirai, Sharon Kotoka,
Neal Miyahira

Others:

Rona M. Suzuki, Director of Taxation
Diamien Elefante, Deputy Director of Taxation
Neal Miyahira, Budget of Finance, Eugene Tian, DBEDT,
Kevin Dayton, Honolulu Star Advertiser, Blaze Lovell, Civil Beat,
Ross Tsukenjo, Senate, Joe Kent, Grassroot Institute of Hawaii,
Micah Lewal, Office of Rep. Tray Hashimoto, Carole Kwok and Capsun Poe,
Hawaii Department of Education Fiscal Office, Scott Teruya, Maui, Michael Victorino, Mayor of Maui, Jordon Higa, Legislative Reference Bureau, Laurie John Roberts, Hawaii Association of Public Accounting, Stacey Ferreire, Moya Gray, Committee on Ways and Means

CALL TO ORDER:

Chair Kawafuchi called the meeting to order at 10:00 a.m. A quorum was present.

COMMUNICATIONS TO THE COUNCIL AND PUBLIC COMMENT:

There were no communications to the Council and no public comment.

APPROVED MINUTES OF THE MEETING OF JANUARY 9, 2020:

There were some minor edits submitted by Ms. Maynard. Ms. Gluck pointed out another typographical error. Ms. Gluck moved to approve the minutes after the changes. Ms. Maynard second the motion. Chair Kawafuchi called to vote on the approve the minutes for the meeting of January 9, 2020.

It was moved by Ms. Jessica Gluck and seconded by Ms. Kristi Maynard that the minutes of the January 11, 2020 meeting be approved. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Jessica Gluck	Yes
Kristi L. Maynard	Yes
Scott Hayashi	Yes

**POTENTIAL IMPLICATIONS OF CORONAVIRUS ON STATE REVENUES –
DR. EUGENE TIAN, DBEDT**

Chair Kawafuchi invited Dr. Eugene Tian, the Chief Economist for the State of Hawaii to share his views on potential implications of COVID-19 on state revenues. Dr Tian is originally from Jilin province, People's Republic of China. Dr. Tian prepared a power point presentation, on the current status of the economy.

Dr. Tian said that most data is still not available to identify a trend that shows the impacts of COVID-19 on Hawaii's Economy. The current data is very positive as visitor spending was strong in February. February is also a leap year, with one extra day for revenue collection. Dr. Tian expects March revenues to be strong.

Speaking from the presentation, Dr. Tian said that visitor counts for January and February were strong. In the first ten days of March, we see a decrease in passenger count of 8%. The passenger count is a day by day count. There are two ways to do a comparison: one is date to date, which uses the first ten days of March this year compared to the first ten days of March last year. The second way is a day to day comparison that compares data from March 1st, which is the first Sunday of the month and compare it to March 3 which is the first Sunday of last month. Dr. Tian uses the second comparison method for his graph.

There is an increase in domestic flights in January and February and slight decrease in the first ten days of March, less than 1%. For international arrivals, the trend declined sharply by 31%. The was updated this morning at 7:30 a.m., the decrease was at 33.1%. The day by day comparison has been decreasing. Internationally, it has been decreasing since late February. Chair Kawafuchi asked what percentage is international versus domestic.

Dr. Tian replied 1/3 is international and 2/3 domestic. Dr. Colby asked about Canada. Dr. Tian replied that Canada is international. Dr Bonham said that we do not have the seat data for Canada. The data on the slide excludes Canada. Canada is not included in the data as Canadian visitors do not need to go through customs in Hawaii. The international data is mainly Japanese visitors. February has been struggling and there is a big decrease in March. The decrease is 30%.

We were going to look at the 2003 data, during the SARS outbreak. However, this is more serious than SARS. There is a decrease in the Japan and China Market and an increase in the US market. The impact is more like 2001 where there is a decrease in international and domestic arrivals. The decline in the Financial Crisis 2007 lasted three years, which is more serious than a one-time event.

Dr. Tian said the good news is that the air seats have increased. This is after the cancellation from international carriers like Hawaiian Airlines, Delta Airlines, China Eastern and United Airlines. Dr. Suyderhoud wanted to clarify if Korean airlines has cancelled flights as he thought he read it somewhere. Chair Kawafuchi said the cancellation was from Hawaiian Airlines cutting their flights to Seoul.

Dr. Bonham said that they (UHERO) have been looking at the same data. In terms of the seats outlook, it is soft. Dr. Tian responded that United Airlines as of right now is going to cut flights across the board by 20% internationally and domestically, before it was just 20% internationally and 10% domestic. That is for May. The cuts are coming; they have not happened yet. The increase in seats is still 8.1% after the cut in flights and before the cuts it was 10%.

Dr. Bonham said what that means is that if the Japanese passenger count is down by 30% in March. If it continues, the capacity count will be off by 30%. While the supply of seats remains high, there are many empty seats on these flights, and demand is decreasing.

Dr. Tian said looking at tourism, the GET collection is following the same trend when the industry spending is up, the GET is up. Dr. Suyderhoud asked if there is any lag. Dr. Tian replied that there is a lag of one month. Visitor spending does affect the tax collection. According to Dr. Tian's calculations, each 1% decrease in visitor spending correlates to a \$21 million decrease in General Fund collections.

Another piece of good news is in the Blue Chip Economic indicators, which was revised down yesterday from 1.9% to 1.7%. This was only adjusted down by 0.2% in real terms. For next year it is going to be adjusted to 2%. Dr. Tian expects a slow 2020 and a rebound in 2021.

The unemployment insurance claims report will be out tomorrow. All in all, Dr. Tian said that the economic data was strong up until February. Things are looking more difficult in March. DBEDT has not released its economic forecast. The US economy is still strong. Hawaii growth will slow down but will not be in recession. He predicts that state GDP growth will be 0.5% in calendar year (CY) 2020 and 1.5% for CY2021.

Dr. Tian said the tax revenue forecast should be in positive not negative because of the strong collection in the first three quarters of the fiscal year. With the COVID-19 impacts, tax revenues will decrease \$48M from the baseline of 4.1%. Dr. Tian believes the fourth quarter revenue

growth will be lower than projected, but it should not be negative. Dr. Tian thinks the fourth quarter forecast will be 3.0% to 4.0% in FY2020. The Board thanked Dr. Tian for his presentation and his input.

GENERAL FUND REVENUE FORECAST FOR FISCAL YEAR 2020:

Chair Kawafuchi opened the discussion for the General Fund forecast for FY 2020. Dr. Bonham prepared two charts that highlight two different events, the 2007 Financial Crisis and the 2001 9/11 event. The chart shows that in 2001, there were several quarters of a decline in tourism arrivals while General Fund revenues remained relatively ok. It took nearly two quarters for the drop in tourism to show up in the tax collection data. Looking at the Financial Crisis in 2007, there was a two to sometimes three quarter lag between an economic shock and when revenues meaningfully decline. GET generally responds quite quickly to economic activity. There is a much longer lag between individual income receipts and economic shocks.

Dr. Bonham said we do not have a clue about how long the outbreak will last. From our point of view, Eugene's (Dr. Tian) view is optimistic. Dr. Tian's baseline scenario is UHERO's optimistic scenario. These are all calendar years. Even with our decline in our forecast, we do not expect a decline in tax revenue this year. It would be very difficult for revenues to go negative given where collections are in February 2020. The third quarter of the fiscal year started out strong. According to UHERO's model, the General Fund revenue model predicts 2.0% more points of growth relative to the last meeting. He was at 4.0% in the last meeting and is now closer to 6.0% growth in this fiscal year. He gets a decline in revenues in the next fiscal year (FY 2021).

Dr. Bonham's team ran a model of passenger count and seat outlook. They lowered the seats outlook for international visitors by 30% and kept domestic visitors flat for the next two months assuming this would recover in June. We get recovery by 2021 next summer the same level by next summer. This results in a 7.0% drop in visitors and a 10.0% drop in spending. This is the positive outlook, with positive revenue growth in FY 2020. FY2021 is not so pretty. The real problem is how long this thing is going to last.

Dr. Colby had prepared some hand-outs with data. The first document is the preliminary collection numbers for February 2020, which showed a 7.5% year on year increase for General Fund revenues. That is driven by healthy GET, TAT, and income tax collections. The income tax performance is driven by the higher declared estimated taxes and payments with returns. The second handout consists of two graphs that give the Board a historical perspective. In 2002, the economy was still recovering from 9/11. The graphs suggest that there is a six to nine month lag between a dip in economic performance and tax collections. During the SARS epidemic, there was 2.6% revenue growth during that period and then accelerated afterwards. The handout also shows the fiscal year General Fund growth rates for different years. This table is meant to serve as reference material for members as they make their decisions.

Dr. Bonham said that during the 9/11 event, we were starting off from a higher level of economic activity. This is different from recent years where Hawaii's economy was barely growing. We are entering this difficult period with high tax revenues but anemic economic activity. Real visitor spending fell last year. UHERO's baseline forecast looks something more like tourism

post 9/11 as opposed to SARS.

Dr. Colby presented a document, prepared at the request of Chairman Kawafuchi, that shows the growth rates required in the last four months of the fiscal year that are needed to hit different year-end growth rates.

Chairman Kawafuchi asked what occurred during the last three months of last fiscal year. Dr. Colby replied that there was large increase in collections in April 2019 due to the delay in making tax payments from December 2018 until April 2019, which resulted from exemption change in the 2017 Tax Cut and Jobs Act. The increase occurred at a national level and was probably magnified by the increase in high income tax rates in Hawaii that took effect January 1, 2018. Spring 2019 was the first time that high-end taxpayers calculated the new tax liability, which prompted higher payments with returns in April 2019 and higher estimated tax payments in the following tax year.

Ms. Niwao pointed out that we should not expect a huge bump in the tax collections like last year as the taxpayers have adjusted their withholdings. The taxpayers have changed their withholdings and paid higher estimated taxes in the subsequent year.

Dr. Bonham pointed out that the amount will be spread out throughout the rest of the year. Ms. Maynard said the bump in April 2019 was around \$100 million, which will not be seen in April 2020. When we are estimating the rest of the four months, we need to adjust for the fact that the \$100M will not occur in April 2020, which represent about 1.2% for the fiscal year.

Dr. Colby said that tax types lag economic activity differently. The GET collections usually lag economic activity by a month. The individual income collections have a longer delay because they represent last year's income. He expects the first impact of dampened visitor spending to be in the April 2020 numbers, which will be reported early May.

Dr. Suyderhoud said that they recognized that there was going to be uncertainty, and we don't know what is going to happen in April. Most of the impact of COVID-19 will occur in the next fiscal year. Ms. Maynard said there will be a decline in three months of GET and TAT spending in this fiscal year.

Ms. Niwao said that she is concerned about the concentration of risk. She is worried that Hawaii's economy is not sufficiently diversified. She said that COVID-19 is acting differently from other diseases like MERs and SARS. The virus can mutate, and there is a lot of uncertainty. Ms. Niwao was in the Bay Area last week and mentioned that the streets were empty. She said that this disease is disrupting a lot of economic activity.

Mr. Hayashi agreed that this would have a large economic impact. However, the trends presented by Dr. Tian, Dr. Bonham, and Dr. Colby suggest that most of the revenue impact will be felt in FY2021.

Dr. Bonham said UHERO is not assuming that this virus is going to be like SARS. He agrees that there are large amounts of risk.

Ms. Niwao said that there is greater amount of uncertainty surrounding the virus. The disease is

moving faster. Everything depends on our response to this pandemic.

Dr. Bonham pointed out there is a lot of uncertainty, and the forecast is not going to be accurate due to the unknowns. However, the Council must come up with a forecast. His model assumes there is a 10% drop in April and May for domestic arrivals. That may be too optimistic, and it may be even 20%. The models are not assuming that the impact is limited to international visitors. Dr. Bonham did a calculation where there was a 4.0% growth rate for the rest of the fiscal year, and then he deducted \$100M out of April. For the second quarter, he gets a -1.0% year over year for the quarter, which translates into a year-end growth rate of 4.0%, close to our forecast.

Mr. Hayashi suggested that considering this information, it seems like 4.1% is appropriate. This accounts for taking out the \$100M in April.

Ms. Gluck asked Dr. Bonham if this includes the downturn in tourism spending. He said no.

Ms. Maynard asked if we take out the \$42M that Dr. Tian forecasted, that would result in 3.5% growth? Dr. Bonham said that the \$42M figure probably uses the I-O Model which assumes a general equilibrium, which may not be appropriate.

Ms. Niwao is uncomfortable to have the forecast at 4.0% and would like to lower it down.

Ms. Gluck said that with all this discussion, we are still close to 4.0% where we were in January.

Dr. Suyderhoud says that most of the action will occur in next fiscal year, so he suggests making a decision for FY2020.

Ms. Niwao said she would be comfortable with 3.5%. Ms. Maynard thinks it should be less than 4.1%. Events are being canceled. There seems like there will be a large decline in spending.

Mr. Hayashi said his contacts in Waikiki say that spending has remained relatively stable until now.

It was motioned by Dr. Bonham to have the growth rate be reduced to 3.8% for FY 2020 and Ms. Maynard seconded the motion.

It was moved by Dr. Carl Bonham that the General Fund tax revenues growth rate would be 3.8 % for FY 2020. Ms. Kristi Maynard seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Jessica Gluck	Yes
Kristi L. Maynard	Yes

Scott Hayashi

Yes

GENERAL FUND REVENUE FORECAST FOR FISCAL YEARS 2021 THROUGH 2026:

Chairman Kawafuchi said there was a consensus that there will be greater effects felt in FY2021 and the current forecast is unrealistic. Dr. Bonham said his models are producing negative growth rates for FY2021. He said that things are very uncertain, and it is impossible to model until we know more how this COVID-19 will behave. In a case where people return to travel as normal in the beginning of the summer, there would be no decline in revenue. In another case, if visitor spending stays depressed for a long period of time, the impacts of revenue will be much more severe.

Chairman Kawafuchi suggested that they revisit the FY2021 forecast in May when they have more information. Ms. Maynard agreed and said that the current forecast of 4.0% should be revised down.

Ms. Niwao says she believes that growth will be negative compared to last year due to the decline in tourism revenues. The return of tourism will depend on the response to the virus. Dr. Bonham said that this will not result in the complete destruction of the tourism industry. People will still be coming at a reduced rate though they are likely to be spending less. Dr. Bonham suggested that they lower the forecast and revisit the estimate in May.

The board agreed that they do not have enough data to make proper estimates and would revisit the numbers in May as there are too many unknowns. Ms. Maynard motioned to have FY2021 be at 0.0% and Ms. Gluck seconded the motion. We will have two months more of information in the next meeting.

A motion was made by Ms. Kristi Maynard to have the General Fund revenue for fiscal year 2021 to be at 0.0%. Ms. Jessica Gluck seconded the motion. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Jessica Gluck	Yes
Kristi L. Maynard	Yes
Scott Hayashi	Yes

Dr. Suyderhoud suggested that the remaining years remain as 3%, 3%, 4% and 4.0% across the board. Dr. Colby pointed out that the lower years of 3% represent the risk of a downturn. Since it the Council is anticipating the downturn in 2021, the out years should be higher. Dr. Suyderhoud suggested that the long term rate be 4.0% across board. Dr. Bonham suggested 5% for the bounce back in FY2022 and 4% for the following years. Dr. Suyderhoud seconded the motion.

A motion was made by Dr. Jack Suyderhoud to have the out years to be as follows: 5.0%

(2022); 4.0% (2023); 4.0% (2024); 4.0% (2025) and 4.0% (2026). Dr. Carl Bonham seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Jessica Gluck	Yes
Kristi L. Maynard	Yes
Scott Hayashi	Yes

REPORT BY THE DEPARTMENT OF BUDGET & FINANCE ON OTHER REVENUES:

Significant Changes from January 2020 Report

Mr. Donovan Chun said we have provided you with our report of projections of General Fund non-tax revenues, non-General Fund tax and non-tax revenues since the January 19, 2020 meeting. Mr. Chun said the report includes a summary few significance changes:

General Fund Non-Tax Revenues

There is no significant change.

Special Tax Revenues

There is no significant change.

Special Fund Non-Tax Revenues

There is no significant change

Other Than Special Fund Non-Tax Revenues

Federal Grants – the net decreases in FYs 19-26 reflect the actual and estimated federal funds to be received by the Department of Defense for reimbursements to provide support for operation, maintenance, and repair cost for Army National Guard Facilities statewide.

Charge for Current Services – the net increases in FY 20 reflect an increase in rebates on prescription drugs, performance guarantee payments on medical and dental plans, and rate credits or experience gains from insurance carriers in the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) (Department of Budget and Finance (B&F).

Non-Revenue Receipts – the net increases in FYs 20-26 reflect increases in premiums for State retirees in the EUTF (B&F).

Dr. Jack Suyderhoud moved to accept the B&F report as submitted. Ms. Kristi Maynard seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Jack P. Suyderhoud	Yes
Carl S. Bonham	Yes
Jessica Gluck	Yes
Kristi L. Maynard	Yes
Scott Hayashi	Yes

NEXT MEETING:

The Council tentatively agreed to meet on Thursday, May 28, 2020 at 2:00 p.m.

The Chair adjourned the meeting.

ADJOURNMENT:

The meeting adjourned at 12:06 p.m.