Special Report

STATE OF THE STATE BUDGET 2017

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CONTENTS

Introduction 3
Gov. David Ige's Budget 4
Increased payments for unfunded liabilities 6
Public union salary increases 7
Growth assumptions 8
Gov. Ige plans to spend rainy day funds 9
Ways to achieve sound budget reform 10
Conclusion 12
Endnotes 13

INTRODUCTION

Hawaii's citizens are being misled by a combination of overly optimistic revenue projections and hidden costs when it comes to the state's finances. State leaders want us to believe that the state budget is balanced. Unfortunately, nothing could be further from the truth. In reality, Gov. David Ige's budget for fiscal 2018 runs the grave risk of running out of money and depleting the state's emergency reserve funds — all because major cost items were not included.

The governor's spending plan does not account for four significant cost items:

- Increased payments for unfunded liabilities
- Decreased tax revenue projections
- Increased payments for public union salary increases
- Historic spending trends

When the accurate cost of these big-ticket items is accounted for, the state actually runs out of money within the next two years under the governor's budget. Moreover, Hawaii would also be saddled with a $104 million deficit, which could grow to a $756 million deficit in future years.

State lawmakers must include accurate costs when planning for the future. This would help lawmakers balance the state budget and ensure that Hawaii has a healthy rainy day fund to weather any economic setbacks.

GOV. DAVID IGE'S BUDGET

Gov. Ige submitted his $28.5 billion spending plan to the state legislature in December 2016 based on sunnier projections of state tax revenues. However, in March, the Council on Revenues revised its tax-revenue projections downward from its December estimate of 5.5 percent to only 2.5 percent. This results in a loss of $258 million in expected tax revenues for fiscal 2017.

Although Gov. Ige reduced his spending plan by $220 million for fiscal 2018[i], the governor's budget still overspends by $292 million in fiscal 2018. This sets off a deficit of $104 million in fiscal 2019, which grows to a $269 million deficit in fiscal 2020.

Gov. Ige's budget overspends by hundreds of millions of dollars, even after proposed cuts

State Budget Analysis - General Fund: FY 2017-2019 (Executive Biennium Budget)

	Current FY	Biennium			*long-term projections*		
FY	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Projected Tax Revenues (3/13/17)	6349	6603	6867	7176	7499	7837	8189
Projected Non-Tax Revenues	784	751	770	788	809	811	812
Judicial Branch Revenues	36	37	37	38	38	39	40
Other Revenues	73	-69	-73	-74	-76	-77	-78
Lapsed Appropriations	80	80	80	80	80	80	80
TOTAL REVENUES	7322	7322	7601	7928	8271	8610	8964
Executive Operating Budget	7037	7158	7529	7664	7799	7986	8152
CIP	14	13	13	13	13	13	13
Specific Appropritions	455	5	5	5	5	5	5
Other expenditure Adjustments	99	230	198	201	205	208	212
Subtotal: Executive Branch	7605	7405	7744	7884	8022	8213	8382
Legislative Branch Budget	39	39	39	39	39	39	39
Judicial Branch Budget	162	166	167	167	167	167	167
OHA	3	4	4	4	4	4	4
Subtotal: Other Branches	204	209	210	210	210	210	210
TOTAL EXPENDITURES	7809	7614	7954	8093	8231	8422	8591
REV. OVER (UNDER) EXPENDITURES	-487	-292	-353	-165	39	188	372
CARRY-OVER BALANCE (DEFICIT)	541	249	-104	-269	-229	-42	331
Emergency Budget Reserve Fund	311	342	349	355	362	369	375

Note: Includes $220 million in cuts to various programs in fiscal 2018
In millions of dollars

Furthermore, the governor's fiscal 2018 budget ignores historic increases in salaries planned for public union members as well as increased inflation and general spending increases.[ii] When these costs are factored in, the deficit grows to $517 million in fiscal 2020 and grows to $756 million in fiscal 2022.

Gov. Ige's budget runs out of money when adjusted for accurate costs

State Budget Analysis - General Fund: FY 2017-2019 (Executive Biennium Budget), in Millions of $

	Current FY	Biennium			*long-term projections*		
FY	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Projected Tax Revenues (3/113/17)	6,349	6,603	6,867	7,176	7,499	7,837	8,189
Projected Non-Tax Revenues	784	751	770	788	809	811	812
Judicial Branch Revenues	36	37	37	38	38	39	40
Other Revenues	73	(69)	(73)	(74)	(76)	(77)	(78)
Lapsed Appropriations	80	80	80	80	80	80	80
TOTAL REVENUES	7,322	7,322	7,601	7,928	8,271	8,610	8,964
Executive Operating Budget	7,037	7,158	7,529	7,664	7,799	7,986	8,152
CIP	14	13	13	13	13	13	13
Specific Approprtions	455	5	5	5	5	5	5
Other expenditure Adjustments	99	230	198	201	205	208	212
Subtotal: Executive Branch	7,605	7,405	7,744	7,884	8,022	8,213	8,382
Legislative Branch Budget	39	39	39	39	39	39	39
Judicial Branch Budget	162	166	167	167	167	167	167
OHA	3	4	4	4	4	4	4
Subtotal: Other Branches	204	209	210	210	210	210	210
Grassroot Institute adjustment for accurate costs				248	256	210	241
TOTAL EXPENDITURES	7,809	7,614	7,954	8,341	8,487	8,632	8,833
REV. OVER (UNDER) EXPENDITURES	(487)	(292)	(353)	(413)	(217)	(23)	131
CARRY-OVER BALANCE (DEFICIT)	541	249	(104)	(517)	(733)	(756)	(625)
Emergency Budget Reserve Fund	311	342	349	355	362	369	375
Historic Spending Trends							
Current Expenditure Growth Rate %		*-2.5%*	*4.5%*	*4.9%*	*1.8%*	*1.7%*	*2.3%*
Historical Growth Rate				*5%*	*5%*	*5%*	*5%*
Governor's Proposed Budget Additions				*387*	*146*	*145*	*200*
Projected Budget Additions Based on Trend				*387*	*394*	*401*	*411*
Proposed Adjustment to Governor's Financial Plan					*248*	*256*	*210*

Note: Adjusted for historic spending trends, public union salary increases, inflation and general spending increases.

Gov. Ige's budget could lead Hawaii's government into an era of deficit spending and unbalanced budgets. The state's reckless spending could put public retirees in danger of losing their promised benefits and put taxpayers on the hook if the government decides to raise taxes to help pay for this financial meltdown.

INCREASED PAYMENTS FOR UNFUNDED LIABILITIES

Governor Ige has made it clear that he plans to be more aggressive in paying down the state's $12 billion unfunded liability for the state's public pension system. However, the governor's budget makes no mention of the increased payments in the future.

If the state continues to ignore the unfunded liabilities and delay payments into the future, then our children will be forced to pay off the debt. But if the legislature increases payments today, then the state will have hundreds of millions of dollars in unbudgeted expenses.

Already, the Board of Trustees at the Employee Retirement System proposed increasing taxpayer contributions to the state pension fund by $336 million annually.[iii] The proposals, which were introduced at the legislature and are not likely not advance this year, give a clue as to how much money is needed to pay down the debt.

New payments for pension debt would cost millions

	Additional Annual Contributions	As a Percentage of Operating Budgets
State of Hawaii	$246,319,883	3.5%
County of Honolulu	$70,990,294	4.5%
County of Hawaii	$7,532,612	2.9%
County of Maui	$7,864,468	3.2%
County of Kauai	$4,155,723	15.5%
Total	$336,862,980	-

Source: Hawaii Legislature SB927/HB1061

The proposed increases demonstrate Governor Ige's commitment to paying down the debt. However, this would take money away from local government services such as police, fire, schools, and building repair. Kauai County would be the most heavily affected by the new payments, which would total 15.5 percent of its entire budget.

On the one hand, the Governor should be commended for making a serious effort to confront the problem. However, the numbers make it clear that this alone is not a viable method of addressing the issue in the long term. Hawaii's budget and pension crises cannot be solved by throwing money at the problem. Fundamental change is needed in the pension system itself, such as switching from a defined benefit to a defined contribution plan.

Hawaii's broken defined-benefit pension system promises employees benefits regardless of how much money was put into the system. But this creates an unsustainable system that leads to a growing debt problem.

Defined contribution plans, on the other hand, match money going in with money going out, so the books are balanced. Switching to a self-managed, defined-contribution retirement plan would end the pension crisis while providing public workers an increasingly stable and secure retirement plan.

PUBLIC UNION SALARY INCREASES

All 14 public employee unions are in negotiations with the state this year over higher salaries and benefits. It is likely that public unions will receive salary increases this year, as historically, union leaders have been successful at negotiating an average salary increase of 3.5 percent per year.[iv]

In his 2017 State of the State address, Gov. Ige said, “While I will be planning for fair wage increases for all our public employees, we cannot presuppose what agreement will be reached. That would neither be fair nor appropriate.”[v]

Clearly, Ige is considering giving public union members salary boosts. However, the money has not been included anywhere in the governor’s budget.

A mere 1 percent pay increase across the board for all 14 public employee unions would cost more than [$113 million]() over the next two years.[vi] According to State Budget Director Wes Machida, this would completely eliminate all surplus revenues projected for fiscal 2019.

Public union salary increases will cost millions

Cost to state taxpayers over the next two years

Salary Increase	Cost
1%	$113,000,000
3.5%	$395,500,000
5%	$565,000,000

Source: State Budget Director calculations, January 5th, 2017

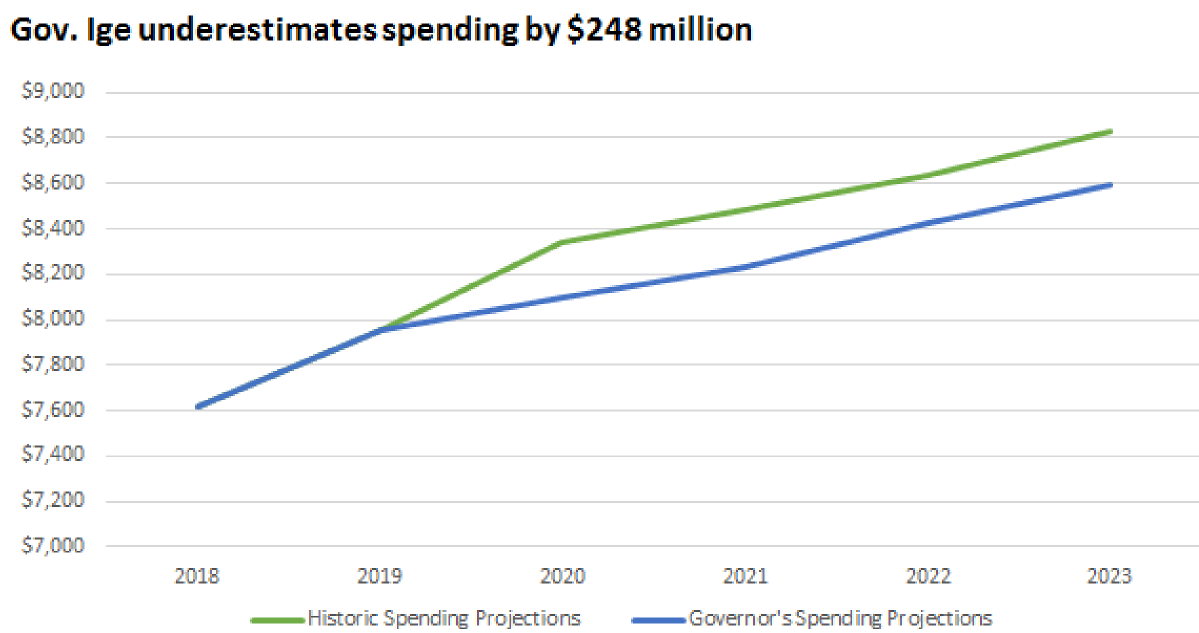
However, this year, Hawaii public unions are likely to push for pay raises of more than 3.5 percent, which is the typical payroll-growth assumption used for actuarial valuation reports for the Employees’ Retirement System and the Employer Union Trust Fund.

A 3.5 percent increase in salaries for public unions could add $395 million to payroll costs over the next two years. Even assuming that the state Department of Budget and Finance’s rosy assumptions about the future come true, the additional payroll costs would completely wipe out all extra monies available in the budget.

GROWTH ASSUMPTIONS

Since the year 2000, government spending in Hawaii has increased at an average rate of 5 percent per year. However, Gov. Ige has grossly underestimated the rate for future years, dropping estimated spending growth to 1.8 percent in 2021, 1.7 percent in 2022 and 2.3 percent in 2023.

When the collective bargaining, inflationary costs, and the historic growth rate of 5 percent are used, Ige's budget underestimates spending in fiscal 2020 by $248 million.



Source: Department of Budget and Finance, Executive Biennium Budget

At the current rate of spending, the governor's budget will completely run out of money in the next two years.

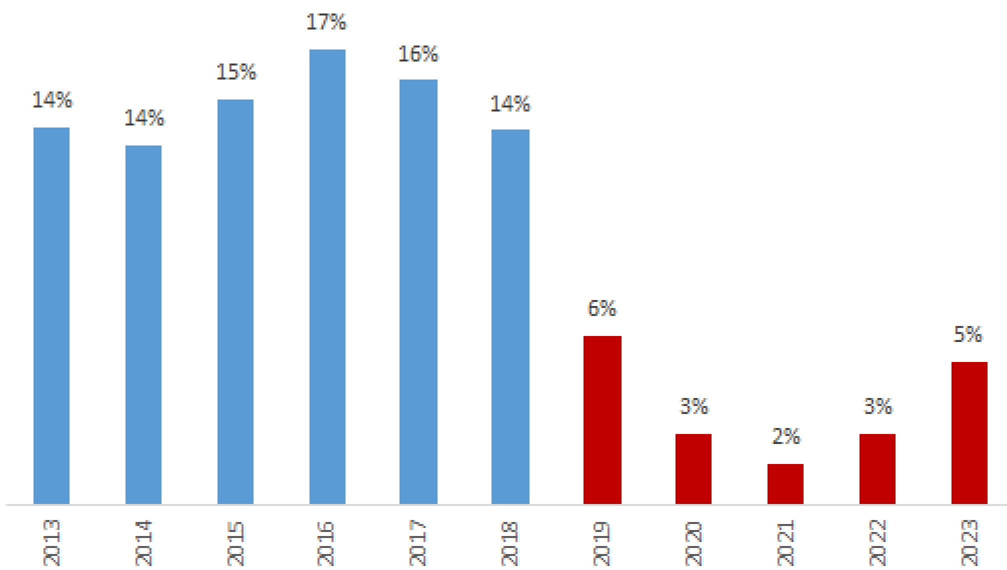
When using the government's own numbers for historic cost assumptions, Hawaii's state budget is unbalanced by hundreds of millions of dollars, not including the extra payments proposed for the unfunded liabilities of state employee pensions and health benefits.

GOV. IGE PLANS TO SPEND RAINY DAY FUNDS

During his second year in office, Gov. David Ige removed spending restrictions put in place by Gov. Neil Abercrombie.[vii] The spending restrictions required General Fund reserves to remain above 10 percent. The spending restrictions saved money, which kept spending low enough to generate a $1 billion surplus for Gov. Ige.

However, Gov. David Ige spent the surplus and quietly lowered the 10 percent spending restriction to 5 percent. This allowed Gov. Ige to propose massive spending increases in the future which could deplete funds meant for an emergency.

Gov. Ige dropped General Fund reserves below 10 percent



Source: Hawaii State Budget FYs 2007 - 2023

The deteriorating fiscal reserve could affect the state's bond rating and future borrowing costs. It may also endanger the state during an economic downturn, or a future crisis.

Hawaii leaders should work to reinstate the 10 percent spending restriction and refrain from raiding emergency funds. Cutting wasteful spending today and saving money will help ensure that government services won't be cut during a future recession.

WAYS TO ACHIEVE SOUND BUDGET REFORM

In order to fix the budget crisis, the state should adopt the following responsible measures:

1. Perform across the board cuts for all departments

Local departments and agencies are in the best position to know which areas should be cut. Reinstating the 10 percent across the board budget restriction for all departments would be a good place to begin saving money. This would save $152 million every year and help store money for hard times in the future.[viii]

Hawaii has cut back many times before, saving hundreds of millions of dollars in across the board cuts. The time has come once again to save Hawaii from a looming fiscal crisis by reinstating the 10 percent budget restriction.

2. Fix Hawaii's pension crisis through self-managed plans

Hawaii's public pension system is broken. Pensioners are worried about their toppling retirement plans. Younger government workers are forced to pay into a pension system that makes promises it cannot fulfill. Taxpayers pay more and more each year, but the debt continues to rise. And Hawaii's most vulnerable are seeing vital public services cut to make room for growing public pension costs.

At the heart of the problem is Hawaii's broken defined-benefit pension system, which gives employees benefits regardless of how much money was put into the system. But this creates the spiraling debt problem.

Hawaii should adopt reforms that have saved pension systems in more than a dozen states across the country, including Florida, Colorado, Montana, South Carolina, North Dakota, Ohio, Oklahoma, Michigan, and Alaska, which now offer defined-contribution plans (instead of defined-benefit plans) to their government pensioners.

Defined contributions plans match money going in with money going out, so the books are balanced. Switching to a self-managed, defined-contribution retirement plan would end the pension crisis while providing public workers an increasingly stable and secure retirement plan.

3. Align public union costs with what taxpayers can afford

Hawaii's public workers deserve competitive wages and benefits, however, the way they are compensated now -- through the raising of taxes on all citizens -- is not financially sustainable.

Finding other ways to increase salaries, rather than increases taxes, would avoid hundreds of millions of dollars in currently unbudgeted expenses. Cutting wasteful government spending or retooling Hawaii's public pension system may be a first step towards finding other ways to provide adequate incentives for public employment.

It's in the best interest of all Hawaii citizens to provide salary, health benefits, and pension benefits that are affordable for both state workers and taxpayers.

4. Cutting vacant positions

Earlier this year, Hawaii lawmakers grilled state departments about their funding for vacant positions. During a budget hearing, Committee on Ways and Means Chair Sen. Jill Tokuda said, "We have (vacant) positions that have been on here for four years or so, and they're funded. That's a problem."[ix]

For example, the Hawaii Department of Agriculture put in a budget request this year for 360 positions, but one third of those positions have been sitting vacant for years.[x] According to the Tax Foundation of Hawaii, the vacancies are typically used as slush funds to pay for vacation cash outs.

Cutting all vacant positions would save at least $82 million in fiscal 2018.[xi] Continuing the hiring freeze until fiscal 2021 would save a total of $455 million. This would also force the state to take a close look at the way vacation pay is budgeted and keep the process open and transparent.

5. Save $76 million annually through a public private partnership with the state hospital

Maui's public hospital labor was transferred to a private provider in 2015, which will save the state $33 million annually. Estimates based on a study by Stroudwater Associates show that the state could save more than $76 million annually by transferring the labor force of the State Hawaii Health Systems Corporation to a public private partnership.[xii]

Privatizing the labor force at the state public hospital would save millions

	FY2017	FY2018	FY2019	FY2020	FY2021
Saving from HHSC Privatization		$76,908,678	$80,860,532	$84,973,628	$89,288,593

Source: Estimates based on Stroudwater Associates Report, December 15, 2009

This change would save a compounded annual total of $331 million by fiscal 2021, which would help balance the budget and potentially save the state hundreds of millions of dollars in the long run. It would also provide higher quality service for islanders in need of medical care.

Already, the transfer at Maui's public hospital is underway and may help save the lives of thousands of people on the Valley Isle. The transfer could help Hawaii's state hospitals become sustainable in the long run, without having to rely on the state for future bailouts.

6. Cut Gov. Ige's Proposed Budget Additions

Gov. Ige proposed $387 million in budget additions in fiscal 2020, with hundreds of millions of dollars in spending additions the following years. Scaling back on the governor's new spending additions may be a good first place to begin saving money. These cuts would save a compounded total amount of $878 million by fiscal 2023.

CONCLUSION

Lawmakers in Hawaii want taxpayers to believe that they are cutting their spending to the bone, but that's just not true. In reality, there are many places to cut spending, as Hawaii's government is already spending at record high levels.

Now is the time to save money, especially when Hawaii's unfunded liability debt is virtually unsustainable. Hawaii's taxpayers should not be expected to bear the burden of the large spending increases in Gov. Ige's proposed fiscal 2018 budget.

As Hawaii's unfunded liability debt grows further, Hawaii lawmakers must find places to save money, pay off the state's debts, and reduce spending to levels that Hawaii families can afford. Otherwise, the budget will be unbalanced, which would not comply with the balanced budget mandate in the Hawaii State Constitution.

Reducing spending will also help build our rainy day funds for the future, which are intended to help when Hawaii faces unexpected economic storms.

By cutting spending, retooling our pension system, and making responsible payments on the state's financial obligations, we can brighten the future for our island families.

[i] Eagle, N. (2017, February 13). How Ige plans to cut $220 million from his budget. *Honolulu Civil Beat*, retrieved from http://www.civilbeat.org/2017/02/how-ige-plans-to-cut-220-million-from-his-budget/

[ii] Historic spending trends based on a 5 percent annual growth rate since FY 2000. Grassroot Institute adjustments for accurate costs based on calculations below:

Historic Spending Trends						
Current Expenditure Growth Rate %	*-2.5%*	*4.5%*	*4.9%*	*1.8%*	*1.7%*	*2.3%*
Historical Growth Rate			*5%*	*5%*	*5%*	*5%*
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[iii] Proposals SB927 and HB1061. RELATING TO EMPLOYER CONTRIBUTIONS TO THE EMPLOYEES' RETIREMENT SYSTEM. Hawaii State Legislative Session, 2017.

[iv] 3.5 percent payroll growth assumption taken from EUTF and ERS FY 2015 actuarial valuation reports.

[v] Ige, D. (2017, January 23). State of the State Address. Retrieved from http://governor.hawaii.gov/main/2017-state-of-the-state-address/

[vi] Machida, W. (2017, January 5). Testimony from State Budget Director. Retrieved from http://www.capitol.hawaii.gov/session2017/hearingnotices/HEARING_FIN-WAM_01-05- 17_INFO_.HTM

[vii] State of Hawaii Comprehensive Annual Financial Report FY 2015 page 27 and State of Hawaii Comprehensive Annual Financial Report FY 2016, page 27. See also http://www.hawaiinewsnow.com/story/25910664/exclusive-state-10-budget-restrictions-begin-tuesday

[viii] Harleman, P. (2016) Summary – Senate Minority Alternative Budget FY 2017. *Hawaii State Senate Minority*.

[ix] Comments on Ways and Means meeting January 5th, 2016, (Ag & DCCA). Retrieved from http://olelo.granicus.com/MediaPlayer.php?view_id=13&clip_id=52500

[x] Yamachika, T. (2017, January 23). Funding nonexistent people. *Tax Foundation of Hawaii.* Retrieved from http://www.tfhawaii.org/wordpress/blog/2017/01/funding-nonexistent-people/

[xi] Harleman, P. (2016) Summary – Senate Minority Alternative Budget FY 2017. *Hawaii State Senate Minority*.

[xii] Stroudwater Associates (2009, December). Available at http://hawaiifreepress.com/Portals/0/Article%20Attachments/HHSC_Study_Volume_1_Distribution_DRAFTFINAL_12.14.09.pdf $76 million savings based on Stroudwater Report and calculations from Senate Minority Alternative Budget FY 2017.