

STAND. COM. REP. NO.

1224

Honolulu, Hawaii

APR 09 2009

RE: H.B. No. 200  
H.D. 1  
S.D. 1

Honorable Colleen Hanabusa  
President of the Senate  
Twenty-Fifth State Legislature  
Regular Session of 2009  
State of Hawaii

Madam:

Your Committee on Ways and Means, to which was referred H.B. No. 200, H.D. 1, entitled:

"A BILL FOR AN ACT RELATING TO THE STATE BUDGET,"

begs leave to report as follows:

The purpose of this measure is to appropriate funds for the operating and capital improvements budget of the Executive Branch for FY2010 and FY2011.

One government agency submitted testimony in support of the measure. Three government agencies, one organization, and three individuals from government agencies submitted testimony in opposition. Four government agencies, six organizations, and two individuals from government agencies and a third individual submitted comments. Written testimony and comments presented to the Committee may be reviewed on the Legislature's website.

#### INTRODUCTION

This measure represents another major step in the process to refine the State's response to the global economic downturn. This measure is by far the largest component of the State's expenditure plan and was crafted to tighten up general fund spending while continuing to respond to our diverse community's needs and priorities. Contained herein is the spending authorization required for the operation of the public school, university, and

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public health systems; programs that make up the social safety net; programs that help to support various sectors of the economy; and other programs that support the governance of our society as required by our State Constitution. Regrettably, given the current economic condition, many difficult choices were made in developing this budget. In many cases, your Committee was unable to restore cuts made by the Governor to core programs or was forced to make additional cuts in less-core areas. Despite the difficulty of making these decisions, your Committee has approached this task as an opportunity to refocus and streamline state government where possible.

Your Committee appreciates the efforts of all those who have provided input regarding the budget, including the Department Directors who testified at the pre-session briefings, the state employees who fielded hundreds of questions from legislators and staff, and the thousands of engaged citizens who shared with us their thoughts and concerns.

## ECONOMIC OUTLOOK

### National Economic Outlook

As of April 2009, the National Economic Outlook remains uncertain.

Signs of the gravity of the current economic contraction became clear more than a year ago, when investors began to question the value of real estate assets held by Bear Sterns Companies, Inc. The problem began as individuals who could not afford home ownership were awarded mortgage loans known as subprime loans. Lenders who made such loans resold them to other institutional players, such as Fannie Mae, the Federal National Mortgage Association.

Specifically, the first landmark of our current economic contraction was the moment when investors determined that the credit default swaps that Bear Sterns was relying on to protect it from exposure to subprime loans were, in fact, worthless. Investors began to inspect the balance sheets of banks and other financial intermediaries and question the real value of mortgages on all commercial and residential property, which were stated as assets on the balance sheets. When investors concluded that the book value of these assets exceeded the market value, the selling,



and thus the economic contraction, began. Lehman Brothers Holdings, Inc. collapsed on September 15, 2008; and American International Group (AIG), which sold the credit default swaps that pay off if the mortgages enter default, became the subject of an ongoing "bailout."

When the banking system was called into question, the banks, having nothing to lend, cut the supply of credit, thus jeopardizing all businesses, which generally run on credit for one accounting period.

The selling of bank stocks became a general sell-off which sent the Dow Jones Industrial Average to 7450 in late November of 2008. The story continues to unfold even to this day in April 2009. Bank of America, JPMorgan Chase, Wells Fargo, and all financial institutions are among the companies with "underperform" ratings.

Despite the pervasiveness of the calamity, welcome signs of a recovery are emerging. Some economists say that a number of indicators appear to have bottomed out in recent months. Job losses may have peaked in January. Home sales are starting to pick up. Stocks are enjoying a limited rally. And because the economy has experienced such a steep decline in the current downturn, some economists are hopeful the recovery ahead will be much stronger than the modest gains that came about after the end of the previous two recessions.

While there may be movement towards recovery, many economists still think that the current recession will not end until much later this year, if not 2010. However, many of these forecasts were made before the nearly \$800 billion stimulus package that was enacted earlier this year began to have an effect. Some economists argue, based on more recent forecasts, that the stimulus plan could create stronger than expected growth, and much sooner than the consensus forecasts.

#### The Economic Outlook for Hawaii

The economic contraction has found its way to our islands. In February of 2009, the occupancy rate for Hawaii hotels was at its lowest rate since 1991, and total visitor expenditures fell 15.9 per cent, according to the Department of Business, Economic Development, and Tourism. Oahu experienced the smallest part of



the occupancy rate decline, and the island of Hawaii experienced the largest.

Our island economy continues to be impacted by the loss of ATA and Aloha Airlines, two cruise ships, Hawaii Superferry, and the closure of Molokai Ranch. As of April of 2009, Hilo Hattie, a local clothing favorite, lost \$4.6 million in its first five months in a Chapter 11 bankruptcy reorganization filed on October 2, 2008. Construction slowed dramatically in 2009, which resulted in additional job losses. The State's unemployment rate is not expected to peak until the fourth quarter of 2009.

Oil prices, the housing market, and U.S. credit remain wild-card factors that could have long-lasting impacts on the Hawaii economy. Your Committee finds that, as of April of 2009, the Economic Outlook for Hawaii is uncertain.

#### GENERAL FUND REVENUE OUTLOOK

By statute, the Council on Revenues (COR) reports its latest tax revenue forecast to the Governor and the Legislature on June 1, September 10, January 10, and March 15 of each year. The revenues come primarily from the general excise tax and the state income tax. Since the March 2008 forecast, the COR has each time reduced its prediction of tax revenues for the coming fiscal years. From March 2008 to October 2008, the COR general fund tax revenue projection through the upcoming biennium dropped by \$1.341 billion.

The Governor based her original Biennium Budget Request on the October 2008 COR projection. In early January 2009, soon after the Governor's budget was finalized and submitted to the Legislature, the COR revised its forecast downward; the projection was reduced by \$637 million through the coming biennium. Thus, from the COR March 2008 projection to the January 2009 projection, general fund revenues had declined by nearly \$2 billion.

The House of Representatives then had the unenviable task of crafting its draft of the budget, which needed to balance to the COR's January forecast. The House accomplished this, in part, by controlling expenditures through eliminating programs and filled and vacant positions, cutting into the base budget, and transferring general fund expenses to non-general funds.



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On March 12, 2009, the COR tax revenue outlook was again downgraded by \$262 million over the biennium (down \$92.8 million in the current year, \$115.8 million in FY2010 and \$53.4 million in FY2011). Then in mid-March, the Senate Committee on Ways and Means began in earnest the equally, if not more, unenviable task of crafting an even slimmer budget to balance with the new revenue projection.

### BUDGET OVERVIEW

Never before has the State of Hawaii faced a declining revenue picture approaching the magnitude of that currently confronting the 25th Legislature. In fact, the \$2 billion shortfall through the biennium budget as projected at the start of this legislative session seemed to have left many in various states of denial. While considerable budget reductions are a necessary component of a balanced financial plan, they are just one factor in aligning the State's expenditures and revenues.

In an effort to close the budget shortfall, the Governor attempted to reduce each department's discretionary budget by 20 per cent. The factors that determined the amounts deemed discretionary are still not entirely clear, and many departments did not meet the target reduction. Nonetheless, reductions resulting from this exercise and other adjustments made by the Governor resulted in a net decrease of operating costs of \$209 million for FY2010 and \$186 million for FY2011. Accounting for previously authorized collective bargaining amounts and other fixed cost adjustments resulted in the Governor's Fiscal Biennium 2009-2011 executive budget request of \$5.361 billion for the first fiscal year, and \$5.464 billion the second.

The State House of Representatives, setting forth to further close the budget gap, reduced the Governor's proposed budget by \$236 million for FY2010 and \$171 million for FY2011. These additional reductions came with a high price; the House draft of the executive budget would result in the elimination of 374 positions, currently filled by state workers, and the abolishment of a number of state programs.

Subsequent to the introduction of the House draft, the Governor adjusted the biennium budget request. These adjustments included reductions to account for the use of such funds as the Emergency and Budget Reserve Fund and American Recovery and



Reinvestment Act of 2009 (ARRA) stimulus funds. This, along with other adjustments, lowered the net executive budget request by \$190 million and \$69 million for FY2010 and FY2011, respectively.

Aware of the harm further reduction to the budget could cause to the State's ability to deliver vital services to the public, and of the potential for long-term disarray within State agencies that could arise, your Committee set out to reduce the Governor's proposed budget in areas it believes to be least detrimental to core and direct services. Your Committee achieved a net reduction to the Governor's proposed budget as adjusted for Governor's Message items of \$58 million in FY2010 and \$83 million in FY2011. Reductions were generally attained by:

- Moving operating expenses from general funds to non-general funds where appropriate;
- Reducing programs that are currently of limited value or are of great expense for the benefits derived;
- Reducing positions that, with some exception, were vacant for one year or longer; and
- Reducing a limited number of exempt positions that are not needed for the State to carry out its necessary functions.

#### DEPARTMENT HIGHLIGHTS

##### Human Services

Especially in these times, your Committee finds it important to support the Department of Human Services in its effort to provide services to those most in need. The Governor imposed a number of adjustments on this department's budget that would result in the loss of important services to the State's most vulnerable citizens.

Of particular note is the Governor's elimination of Adult Dental Services for Medicaid eligible adults. The program provides for those that could not otherwise afford services such as exams, cleanings, and benefits for dentures. An enhanced Federal Medical Assistance Percentage (FMAP) made available through the ARRA allows your Committee to restore the entire program with the provision of \$2.6 million for FY2010 and \$3.1 million for FY2011.



The enhanced FMAP rate under ARRA also allows your Committee to provide the same level of support for Medicaid eligible services while providing for significant general fund savings. While the Governor proposes removing \$182 million in general funds over the biennium from the program as a result of the enhanced rate, your Committee reduces just \$154 million in general funds to assist the program with a shortfall that would result in untimely payments to service providers.

Highlights of your Committee's biennium appropriations from the State general fund include \$433 million and \$541 million for FY2010 and, respectively, in the MedQuest Program; \$25.5 million in both fiscal years for Cash Support for Families-Self-Sufficiency; \$15 million in both fiscal years for Case Management for Self-Sufficiency, and \$19 million in both fiscal years for Cash Support for Child Care, which help to maintain the State's claim to an annual federal TANF block grant.

Your Committee reduced job acquisition training expenses in the Office of Community Services (OCS). These reductions have yielded a savings of \$1.8 million in each year of the fiscal biennium. Your Committee believes the existing supply of trained labor may exceed the demands of employers in the State through the upcoming biennium and that the training component of the OCS is not a core function of the department.

Your Committee remains concerned with the structure under which federal Temporary Assistance for Needy Families (TANF) funds are spent. Your Committee has allocated these funds as follows:

• Cash Assistance-TANF Purpose 1	\$44,000,000
• Work Training and Support Services-TANF Purpose 2	\$23,000,000
• Child Welfare Services Purchases of Services	\$ 3,000,000
• ENHANCED Healthy Start	\$ 4,000,000
• "UPLINK" after school Program	\$ 3,000,000
• TANF transfer to Child Care Development Fund	\$19,800,000



- TANF transfer to Social \$ 9,890,000
- Services Block Grant \$ 5,000,000  
Information Systems  
Development and Enhancements
- Administration \$ 9,500,000

Your Committee's TANF spending plan allows nearly \$10 million more dollars than the Governor's plan to be carried forward at the close of each fiscal year as part of the TANF Reserve Account, remaining available to the State should the current economic contraction persist.

#### Hawaii Health Systems Corporation and Kahuku Hospital

Your Committee affirms its support and commitment to providing the resources necessary to help Hawaii Health Systems Corporation (HHSC) maintain its current level of services. HHSC is essential, as it serves as a public safety net to many residents and visitors of our island communities and counties, especially those of the neighbor islands. To assist HHSC regions in meeting their cash flow needs, your Committee provided an additional general fund subsidy of \$30 million for each year of the fiscal biennium, to be expended to the extent possible for Medicaid eligible services.

Your Committee is concerned with the management, both fiscally and operationally, of the HHSC regions. Thus, your Committee created a new program, HHSC Regions (HTH 212), to increase transparency and accountability. In addition, your Committee provided \$500,000 of general funds to allow for a comprehensive review and evaluation of HHSC corporate and its regions.

#### Health

Your Committee is dedicated to protecting the health and well-being of people in Hawaii and ensuring basic health care to all. This is especially challenging, given the growing need for health care in the face of economic hardship. It is vital that health care be available and accessible to everyone. To meet this need, your Committee increased funding to critical services that were either reduced or eliminated in the Governor's budget.





Community health care centers serve as the safety net for individuals who otherwise could not receive vital health care. Health care centers are already experiencing an increase in the number of individuals seeking services; this demand is expected to grow. To ensure that all residents are able to receive medical care, your Committee increased funding to community health care centers throughout the State to a total of \$6,591,526 in each fiscal year.

Your Committee is also concerned that the downturn in the economy imposes untold stress on individuals and families. To address this concern, your Committee restored funding for the following program and services that were eliminated by the Governor. Funding for these services will come from special funds.

- Partnership in Community Living to provide last-resort support for families of developmentally disabled individuals who are not eligible for Medicaid: \$700,000.
- Healthy Start to prevent child abuse and promote positive parent-child relationships: \$3 million.
- Respite care to provide temporary relief to families that have ongoing caregiving responsibilities for family members with developmental or mental disabilities: \$412,024.

The ARRA provides stimulus funds in the amount of \$87,759,247 for FY2010 and \$15,240,740 for FY2011. This infusion of funding will have a significant impact on the following programs and services:

- Enhanced FMAP reimbursements will reduce the need of the following general fund expenditures:
  - ❖ Developmental Disabilities: \$14,473,221 in FY2010 and \$4,975,266 in FY2011;
  - ❖ Adult Mental Health: \$2,531,764 in FY2010 and \$870,310 in FY2011;
  - ❖ Child and Adolescent Mental Health: \$3,042,537 in FY2010 and \$1,045,893 in FY2011.



- Early Intervention to ensure compliance with the federal Individuals with Disabilities Education Act, Part C: \$2,139,843 in FY2011.
- Emergency Medical Services to improve communication between ambulances and hospitals; and to implement a statewide telecommunication system for critical patient information: \$11 million in FY2010 and \$7,865,000 in FY2011.
- Environmental Management to provide grants for drinking water and wastewater infrastructure improvements, diesel emissions reductions for school buses, regulatory oversight of underground storage tanks, and technical expertise for water quality standards: \$53,505,883 in FY2010.

Your Committee finds that the reorganization plan proposed by the Department of Health does not deliver any cost savings or efficiencies for the program or services. The reorganization may have a negative impact on clients and staff, disrupt the delivery of services, and incur additional costs.

Your Committee diligently strove to work with the department; however, it is unfortunate that the department chose not to assist in identifying less core services and possible areas for reduction. It must also be noted that your Committee has made its best effort in developing this budget without pertinent information from the department, particularly the itemized operating biennium budget for FB2009-2011.

#### Public Education

Your Committee recognizes the importance of providing a quality education to our children, to ensure their ability to thrive in the global society of today and tomorrow. Preserving school-level funding, particularly funds to be distributed via the Weighted Student Formula, is a top priority of your Committee. Unfortunately, your Committee was not able to restore the \$40 million in non-Weighted Student Formula program cuts that were included in the Governor's budget and accepted by the Board of Education.

Hawaii is fortunate to be receiving federal stimulus dollars to support education and other state programs in the upcoming biennium. Your Committee is pleased to have the ability to



appropriate stimulus dollars for the following educational programs: \$19.8 million for Title I and Educational Technology in FY2010; \$20 million for IDEA Part B & IDEA Part B Preschool funds in FY2010; and \$116,000 for the McKinney Vento Homeless Assistance Program in FY2010.

However, your Committee respectfully disagrees with the Governor's initial plan regarding the timing of the use of a large portion of federal stimulus funds intended for education stabilization. In the interest of insulating the school system from much of the impact of the budget shortfall, your Committee has provided \$56.6 million in stimulus dollars for education in each year of the biennium. These funds will be distributed between public schools and charter schools based on the latest enrollment projection available to your Committee. By contrast, the Governor has proposed to immediately use \$90 million of the \$113 million in the federal stabilization funds intended to go to lower education, in an effort to balance the state budget in the current fiscal year.

The receipt of federal stimulus dollars has provided your Committee with an opportunity to make adjustments to the charter schools' FY2010 and FY2011 budget allocations in order to accurately reflect the amounts prescribed by section 302B-12, Hawaii Revised Statutes. Charters will be able to make the \$5.3 million corrective reduction of general funds without substantial impact to delivery of services because their budget will be largely offset with the addition of funds for collective bargaining and \$2.8 million in federal stabilization funds. The net reduction to the charter school budget will be less than \$1 million, which represents a year-to-year reduction of less than two per cent.

Your Committee has struggled this session to make informed and equitable decisions regarding charter school funding because of the limited information charter schools made available. Charters currently enjoy an extremely flexible operating environment, which was provided to enhance program creativity and resourcefulness, with the goal of creating better outcomes for students. However, as a publicly-funded entity, charter schools must provide transparency and ensure that public funds are properly used. Your Committee requests that charter schools provide a budget that reflects all fiscal resources anticipated to be available to the schools for the next year; report on the consistency of procurement practices with the guidelines in



Chapter 302B, Hawaii Revised Statutes; and account for all exemptions to normal employee compensation levels. Your Committee also requests that all charter schools work with the Charter Schools Administrative Office annually to provide the Legislature full and accurate financial information to enhance future decision making processes.

Your Committee made no further reductions to the budget of the Hawaii State Public Library System. Use of the library system has increased during the current recession and the system would not be able to withstand additional cuts without decreasing security or closing branches.

Additionally, your Committee is transferring the fixed costs of debt service, health premiums, and retirement benefits from the department's budget to the Department of Budget and Finance and is transferring risk management costs to the Department of Accounting and General Services. The budgeting of these items with the department has no perceivable benefit and creates unneeded bureaucracy and confusion regarding the proportionate level of funding provided the department.

#### Higher Education

The University of Hawaii System is the State's only public institution for higher learning and plays a critical role in building a strong foundation for Hawaii's future. While budget reductions for most state agencies are unavoidable, the University is fortunate to have significant non-general fund revenues and access to federal stimulus funds.

Your Committee accepted the 20 per cent discretionary target reduction scenario approved by the Board of Regents, which amounts to an additional reduction of \$17.1 million in general funds each fiscal year. Your Committee further reduced \$15.4 million each fiscal year, which will be offset by an anticipated \$25 million increase per year in tuition and fees revenue based on built-in annual tuition increases. The addition of ARRA education stabilization funds will also reduce the impact of these adjustments.

The university system is now experiencing record-high enrollment as people seek additional training to increase their job prospects. The greatest increase is at the community college level, where enrollment has increased by 9.4 per cent. As such,



your Committee sought to maintain support for the Community Colleges by providing enough ARRA education stabilization funds to offset nearly all of the \$8 million in general funds reduced from their budget. In total, the University of Hawaii will receive \$54 million in ARRA education stabilization funds over the course of the biennium.

### Public Safety

Your Committee notes that Hawaii continues to struggle with the persistent growth of the inmate population. The traditional solution to prison overcrowding is to build additional facilities or expand existing ones. Since it is unlikely that any new facilities will be built in the near future, your Committee recognizes the need for interim measures.

The current administration's primary strategy for reducing overcrowding has been to transfer inmates out of the State. However, with a total of 2,298 inmates (2,093 male and 205 female) housed in out-of-state facilities, and the escalating costs associated with those inmates, your Committee finds it necessary to support programs that help reduce the number of inmates in Hawaii's corrections system. Your Committee provided \$565,677 for FY2010 and \$540,733 for FY2011 to establish a pilot program on Oahu that electronically monitors committed persons who are permitted to live and work in the community in lieu of continued incarceration.

Prior delays in transferring inmates to out-of-state facilities have resulted in the accumulation of \$7.7 million that is in excess of the department's need for contracted bed space. Your Committee has identified this amount as a one-time general fund savings in FY2010 that can be reduced with no impact to the department's operations.

Your Committee reviewed operations of the Sheriff Division and made the following adjustments:

- Reduced five vacant positions and funds for the Airport Unit to bring position count to the number required under the memorandum of understanding with the Department of Transportation Airports Division.
- Reduced four general funded positions and re-allocated resources to establish three additional warrant teams.



Your Committee continues to be concerned by excessive overtime expenditures and the reported abuse of sick leave benefits by employees. Overtime expenditures for FY2008 totaled \$9.8 million, which is 31.7 per cent above the budgeted amount of \$7.5 million. Your Committee reduced funds for overtime by 25 per cent of FY2008 actual expenditures or \$2.5 in general funds. Your Committee established a protocol fund that will be used to encourage employees to reduce sick leave abuse and the need for overtime.

#### Land and Natural Resources

Your Committee believes that protecting Hawaii's natural resources and preserving its unique endemic species should remain priorities, even in difficult financial times. Hawaii's resources are constantly being threatened by alien plant and animal pests and by public overuse. To prevent further degradation of these resources, your Committee has restored \$100,000 for invasive species support that was reduced in the Governor's budget. To protect the State's aquatic resources, your Committee has restored \$47,500 for coastal stock enhancement and \$90,000 for Anuenue Fisheries Research Center.

The department identified public safety and park operations as its top priorities, and accordingly, your Committee has restored, through the use of special funds, funding for lifeguard services at Kaena Point State Park and Keawaula beach that were reduced in the Governor's proposed budget.

#### Agriculture

Your Committee recognizes the importance of agriculture to Hawaii's economy, both as an exportable commodity and as a means to allow the State to become less dependent on imported food products. As such, your Committee has taken steps to ensure that the department continues to conserve, develop, and utilize the agricultural resources of the State. Your Committee has given high priority to preventing the introduction and establishment of pests in the State.

Act 9, Special Session Laws of Hawaii 2007, established a user fee for the inspection of sea and air containers bound for Hawaii that may be carrying pests. Your Committee has provided \$6 million in special funds to conduct harbor inspection programs and



early detection and rapid response activities for invasive species. These funds will allow the department to retain almost all plant quarantine inspector positions proposed for reduction by the Governor.

Your Committee has eliminated the detector dog program that has proven to be of limited value and has transferred the Measurements Standards Branch to the Department of Commerce and Consumer Affairs. The transfer of Measurements Standards will ease the administrative burden on the Department of Agriculture, create a general fund savings, and place the branch in a department with more appropriately aligned functions.

#### Business, Economic Development, and Tourism

Your Committee realizes the importance of Hawaii's existing businesses as drivers of Hawaii's economy. Your Committee has found that the Department of Business, Economic Development, and Tourism (DBEDT) has lost sight of its core functions and is unable to effectively manage the department's mission. With that in mind, your Committee created general fund savings, efficiencies, and transparency by transferring programs within DBEDT to more appropriate departments that share common missions and objectives. This will allow DBEDT to focus on its core functions and responsibilities.

Your Committee has made the following transfers of DBEDT programs:

- The Small Business Regulatory Review Board to the Department of Commerce and Consumer Affairs (DCCA);
- The Statewide Land Use Commission and Office of Statewide Planning and Coordination to the Department of Land and Natural Resources;
- Natural Energy Laboratory of Hawaii Authority, High Technology Development Corporation, and Research and Economic Analysis to the University of Hawaii;
- Creative Industries Arts and Culture Branch to the State Foundation on Culture and Arts; and
- Film Industry Branch to the Hawaii Tourism Authority (HTA). HTA's expertise in marketing and existing relationships will allow the Film Industry Branch to flourish and become



more of an economic driver and marketing tool for the State.

Your Committee understands that the modernization of our state harbors needs to be a priority. Aloha Tower Development Corporation (ATDC) remains entangled in litigation and has not completed any projects related to the Harbors Modernization Plan. Your Committee finds ATDC unable to effectively lead the Harbors Modernization Plan and carry out the functions for which it was created; consequently, your Committee restored the responsibility of improving harbors to the Department of Transportation, Harbors Division.

Hawaii currently relies on imported oil for over 93 per cent of its energy needs. Over the years, the Legislature has provided substantial resources for the Clean Energy Initiative, under the guidance of DBEDT, for the purpose of promoting energy independence for the State. With funding from the ARRA, DBEDT will have the opportunity to become more energy independent. Your Committee created a general fund savings of \$875,283 while retaining existing staff and creating new positions with the use of \$6.2 million in existing federal funds and \$30 million in new stimulus money. This will allow the department to focus on creating clear objectives with specific performance measures and goals.

#### Labor and Industrial Relations

With the exception of the elevators and boiler safety section, your Committee has reduced funding for the Hawaii Occupational Safety and Health Division (HIOSH) starting in FY2011. Your Committee made the proposal so the return to federal OSHA jurisdiction could be further discussed. Relinquishing jurisdiction of the program would result in releasing the State from the burden of administering the program and possibly returning the program to a higher level of effectiveness seen when the program was under past federal jurisdiction.

#### Transportation

Your Committee has become increasingly concerned with the department's financial plan with respect to deficit spending of its special funds. Accordingly, your Committee reduced spending through a \$5 million prorated reduction across all programs within the Harbors division and a \$10 million prorated reduction across





all programs within the Highways division. These reductions will allow the divisions' expenditures to better align with existing and future revenue projections.

Your Committee is also concerned with certain aspects of the Airports Division. Thus, your Committee requests that the State Auditor perform a financial audit of the Department of Transportation regarding its accounting procedures, procurement practices, controls over lease renewals and renegotiations, ability to monitor and collect outstanding receivables, and means of accurately charging fees.

#### Budget and Finance

Your Committee provides for the consolidation in the department of fixed costs for debt service, retirement benefits, and health premium costs chargeable to the University of Hawaii and the Department of Education. This consolidation is achieved by cost accounting in three of the department's existing program areas. Your Committee has ensured by proviso that the costs separately chargeable to the University of Hawaii and the Department of Education are clearly stated.

The Administration proposed to execute Act 177, Session Laws of Hawaii 2007, providing for the Public Utility Commission (PUC) reorganization by increasing staff and appropriating a large amount of funds for the relocation to new office space on Oahu. However, your Committee finds that there are no suitable facilities available to house the PUC at this time. Consequently, your Committee does not appropriate funds for any PUC reorganization at this time.

#### Accounting and General Services

Your Committee improves efficiencies by transferring \$9.2 million of funds earmarked for the State's insurance premiums from the University of Hawaii and the Department of Education to the department to reduce unnecessary delays. To generate general fund savings, your Committee changed the means of financing for \$3.5 million of insurance premiums from general funds to state risk management revolving funds.

Your Committee understands the State's fundamental obligation to conduct state and federal elections and recognizes the need for new voting equipment. For the Office of Elections, your Committee



reduced general funds by \$229,248 and provides \$925,000 for the voting system contract and purchase of voting equipment for FY2010, a non-election year. Funding for FY2011 remains unchanged from the Governor's proposed budget.

Your Committee recognizes the plight of maintaining historic sites and museums. Based on the passage of S.B. No. 602 relating to the Arts, your Committee restored a subsidy of \$418,000 to the Bishop Museum and provided \$250,000 for the Iolani Palace, both through non-general funding.

#### Attorney General

Your Committee recognizes the importance of the department in its role as legal counsel for the State of Hawaii. Your Committee made an effort to reduce the department's budget in areas that would have limited impact on services to state agencies and the general public.

Your Committee provided the department with \$6 million in federal funds over the biennium for the Crime Assistance Grant, the Byrne Memorial Justice Assistance Grant, the Violence Against Women Grant, and the Internet Crimes Against Children Grant. Your Committee also provided \$4.5 million in federal stimulus funds over the biennium for the Child Support Enforcement Agency.

#### CAPITAL IMPROVEMENT PROGRAM

Your Committee finds that well-maintained physical infrastructure and state facilities are essential to maintaining a positive business climate and a strong economic foundation, which will ultimately help to support the State's ability to navigate through the current, and any future, precarious economic conditions. Your Committee further finds that to combat the effects of the current recession and experience positive growth, the continued investment in our economy, by various means, is necessary. Investment in infrastructure and facilities is crucial for short-term economic growth and job creation. However, additional and increased investment in education, technology, communications, health care facilities, energy and environment, and other needs must also be examined to ensure sustained long-term economic recovery and growth for our State and its residents.



Your Committee finds that the need to invest in local infrastructure to help stimulate direct and indirect job creation is highly critical at this time when the State is experiencing its highest unemployment rate in thirty years. Fortunately, this type of investment is also a high priority of the federal government. Expediency in the creation and maintenance of local construction jobs, as well jobs for architects, engineers, and other consultants associated with capital projects, will generate more disposable income, which will in turn circulate throughout our economy.

Accordingly, the Administration's capital improvement program biennium budget, as amended pursuant to Governor's Messages, provided a total of \$955,155,000 for projects funded by general obligation (G.O.) bonds and general obligation reimbursable (G.O.R.) bonds and \$3,192,112,000 for all projects funded by all means of financing. Similarly, your Committee, after carefully considering the current economy along with the proposals, needs, and priorities of the Administration and the departments, has provided a total of \$939,787,000 for projects funded by G.O. and G.O.R. bonds and \$3,453,431,000 for projects funded by all means of financing.

However, your Committee, mindful of the Administration's proposed debt service level and the volatile bond market conditions that at present continue to curtail bond issuance plans, has followed a different approach than that of the Administration in formulating its capital improvement program biennium budget. First, your Committee has reevaluated the funding for prior appropriated Executive Budget projects and, as a result, has lapsed funding for several projects in the amount of \$45,553,719. These lapses represent unrequired balances for completed projects, funds for which the Administration has denied allotment for various reasons, funds that the departments have indicated are otherwise unnecessary, insufficient, or for projects that are unlikely to be undertaken within the necessary timeframe to avoid standard lapsing, and funds that do not demonstrate the current priorities of the State.

Next, your Committee crafted a biennium budget that includes projects that are essential to assist in achieving short-term economic stimulation, as well as projects that will help to stabilize the infrastructure to accommodate for long-term growth. This budget aggressively focuses on funding both crucial and significant capital projects that can be undertaken immediately in



FY2010. This approach not only concentrates on the merits of the proposed FY2010 funded projects, but, more importantly, also provides increased funding for several projects. Your Committee believes that front-loading funding for the biennium in FY2010 will provide an immediate infusion of funds for shovel-ready projects. This approach will empower departments and agencies with the ability and greater flexibility, as such funds will not lapse for three years, to address their current needs and requirements expeditiously. Although also providing for certain fixed capital improvement projects and costs for FY2011, your Committee's decision to primarily concentrate on FY2010 funding mirrors the federal government's initiative in demonstrating its commitment to stimulating the economy and funneling money to departments and programs throughout the State as quickly as possible.

Accordingly, your Committee believes that increased funding in the first year of the biennium will allow the State to:

- (1) Address many critical health, safety, and code requirements;
- (2) Reduce current repair and maintenance backlogs throughout several departments;
- (3) Provide jobs for unemployed and underemployed residents; and
- (4) Provide the framework for growth and expansion of services, programs, and facilities.

Additionally, prior to fully funding the capital investment needs of the State for FY2011, the Legislature will have had the opportunity to monitor and reassess the economic conditions; the needs and priorities of the State, Administration, and departments; the ability of the departments to utilize the funds previously appropriated; and the adequacy and capacity of the workforce to deliver necessary services. Your Committee believes that this approach will aid the Legislature in formulating a more comprehensive and responsive capital improvements program budget for FY2011.

A continuing concern for the State is to ensure that our keiki are properly educated and employable, which will contribute to the State's long-term economic viability. Investment in our



public schools, at all levels, is necessary to help improve, expand, and grow new programs and facilities. However, the continuing need to address the existing and growing backlog of repair and maintenance projects within the Department of Education and the University of Hawaii System is critical. Your Committee has demonstrated its ongoing commitment to reducing and ultimately eliminating these repair and maintenance backlogs over the next three to seven years by appropriating, for FY2010, \$155,000,000 for repair and maintenance projects of the Department of Education and \$107,000,000 for capital renewal and deferred maintenance projects of the University of Hawaii System. These commitments represent increases of \$110,800,000 and \$45,575,000 above the Administration's budget proposals for FY2010 for repair and maintenance projects of the Department of Education and the University of Hawaii System, respectively.

In the past, despite efforts to provide increased funding to the Department of Education to address the repair and maintenance backlog, the Administration has limited the Department's ability to utilize funds by failing to release the necessary funds to demonstrate progress. However, in light of the depressed economy and the Administration's commitment to stimulating the local economy through its Five-Point Plan, which highlights "investing in improvements to our infrastructure and state facilities" and the creation of jobs, as evinced through the Administration's \$1.8 billion capital improvement plan, your Committee is confident that the funds will be released and projects completed. At any rate, under your Committee's proposal, the Legislature will be able to revisit the issue and adjust funding levels accordingly for FY2010 and FY2011 during the next regular session. Additionally, as previously mentioned, because the funds will not lapse for three years, the potential remains for all FY2010 projects to move forward.

Another area of great import to the State is the goal of developing sustainable and renewable energy strategies and initiatives to increase energy efficiency and reduce energy consumption. Your Committee is supportive of energy efficiency improvements, which will ultimately lead to costs savings and reducing the State's carbon footprint. Consequently, the budget provides \$19,049,000 for conservation and energy efficiency measures of the Department of Accounting and General Services for FY2010, to be delivered through the use of Energy Savings Performance Contracting; \$5,340,000 for FY2010 and FY2011 for energy savings improvements and renewable energy projects of the



Department of Defense; \$3,088,000 for FY2010 for energy efficiency improvements projects at Department of Health facilities; and \$2,000,000 for FY2010 and FY2011 for energy efficiency and conservation improvements at state parks facilities under the Department of Land and Natural Resources.

Additionally, your Committee has provided critical funding for the following:

- (1) Hawaii Health Systems Corporation:
  - (A) \$20,222,000 in FY2010 for repair and maintenance projects of the Hawaii Health Systems Corporation, an amount that represents more than twice the amount proposed by the Administration; and
  - (B) \$35,031,000 for FY2010 and FY2011 for renovation and expansion projects at hospitals within the Hawaii Health Systems Corporation;
- (2) \$70,597,000 for FY2010 and FY2011 for repairs and improvements to Aloha Stadium to ensure safe conditions for spectators, players, participants, and workers and to allow the facility to maintain and attract sports and other entertainment events;
- (3) \$7,913,000 for FY2010 for nonroutine repair and maintenance projects of the Hawaii Public Housing Authority to repair and improve affordable public housing facilities throughout the State;
- (4) \$16,526,000 for FY2010 for grants-in-aid to nonprofit organizations for facilities improvements and expansion. Such assistance is vital, as these nonprofit organizations continue to provide additional services to our residents, in light of the fact that the State may be forced to reduce services due to the current economic climate; and
- (5) Various projects within the Department of Transportation, Department of Defense, Department of Agriculture, Department of Health, and the University of Hawaii, among others, to ensure that matching federal, private, and other funds contributions may be maximized and not lost or forfeited.



Finally, the biennium budget provides funding for various other capital projects that your Committee believes should be included at this time, but that may warrant further discussion as the budget is further refined during the remainder of session to meet the evolving needs and priorities of the State.

#### LARGER FISCAL CONTEXT OF THE BUDGET

Clearly, a budget is made up of both planned expenditures and planned revenues. While this measure represents the vast majority of planned state expenditures, the funding levels contained in this measure are contingent on other measures that have been passed by your Committee. These measures look to spread the cost of public services to segments of the community that may be in a better position to absorb the impact of the adjustment.

#### Increases to Income Taxes for High Wage Earners

Your Committee finds that Hawaii's current tax structure is regressive, with lower and middle income taxpayers shouldering the major portion of the tax burden. Generally, those who are more able to pay have a disproportionately greater interest in maintaining societal goods typically supported by taxation such as security of property rights and maintenance of infrastructure, since they have much more to lose if these fail than do the poor.

Also, economic demand can be stimulated by reducing the tax burden on lower income individuals, which encourages greater consumption, and raising the burden on higher income individuals, which encourages greater productivity.

While there have been many studies and proposals suggesting ways to shift the burden to those who can afford to pay more, little has been accomplished. Therefore, your Committee has passed House Bill No. 1747, H.D. 1, S.D. 1, Relating to Taxation, which increases the number of tax brackets and raises the tax rates on the high-income brackets.

#### State Retention of Transient Accommodations Tax (TAT) Collections

During these tough economic times, the legislature needs to balance the needs of the counties against the State's programs and expenses that are supported by the general fund. It must be



remembered that this direct tax allocation to the counties is really a windfall, given the counties' plea for complete control of the real property tax at the 1978 Constitutional Convention. At that time, the counties contended that if they could have complete control over the real property tax, they would be able to raise the revenues they needed. However, even after getting the real property tax, the counties continued to seek state financial support in the early 1980s, requesting grants-in-aid or other taxing powers. In the late 1980s, the Legislature did take some of the TAT funds to make a one-time grant to the counties, and later, when the TAT was earmarked for the convention center, lawmakers earmarked a fixed percentage of TAT collections for each county. In these difficult times, your Committee recognizes that county governments have not experienced the tremendous decline in revenues experienced by state government. Therefore, your Committee passed H.B. No. 1744, H.D. 1, S.D. 1, Relating to the Transient Accommodations Tax, to suspend the TAT distributions to the counties while providing counties, the authority to implement a TAT surcharge up to five per cent.

The funding provided to the State by this measure allowed your Committee to reallocate resources to programs that benefit and serve residents and visitors alike. As an example, the \$30 million general fund subsidy to the HHSC regional systems allows its facilities to continue serving its communities, a majority being rural communities on the neighbor islands, at the same levels of service and to work on important initiatives to expand needed services.

Over the years, the counties shifted more and more of the real property tax burden onto nonresidential classes of property. This created the illusion for residential owners that more programs could be provided without raising property taxes on residential property. Now that the nonresidential properties have been tapped out, counties have the option to go back to homeowners and ask for increases in their property taxes if they want to keep receiving the same level of county services. Therefore, your Committee has passed H.B. No. 1605, H.D. 1, S.D. 1, Relating to Taxation, to empower the counties to implement a one per cent sales tax on retail purchases.

#### Tightening up on Tax Credits

Hawaii's tax laws contain special tax credits and exemptions that were enacted to promote various social or economic goals. In





general, basic principles of public finance dictate that tax rates should be as uniform as possible to minimize the distortions that taxes create in the economy. It is therefore prudent to evaluate credits and exemptions from time to time and to tighten up these vehicles to ensure that they are working as intended. Therefore, your Committee passed H.B. No. 611, H.D. 1, S.D. 1, Relating to Taxation, to temporarily suspend the capital goods excise tax credit and H.B. No. 1451, H.D. 1, S.D. 2, Relating to Taxation, to reexamine the high technology tax credits.

#### Increased Taxes on Tobacco Products

Increasing the tax on tobacco products other than cigarettes is timely. The current tax of 40 per cent of the wholesale price was established in 1965 and has never been increased. Other states have much higher rates ranging from 65 per cent (Oregon) to as high as 90 per cent (Massachusetts).

Increasing the tax on such products will also provide funding to address increasing health care costs and, given the current economic downturn, ensure the sustainability of community health centers and tobacco control programs.

As experienced in other states that have implemented similar increases, the increased tax will also deter the use of such products, especially by Hawaii's youth, and provide revenues to support tobacco prevention programs. Therefore, your Committee passed H.B. No. 895, Relating to Tax on Tobacco Products Other Than Cigarettes, to increase the tax in three steps, from 40 per cent to 90 per cent by 2011.

#### Transfer of Excess Balances to the General Fund

Another tool available to help balance the budget is a transfer of non-required cash balances to the general fund. This is an option that the Governor exercised with the proposed transfer from the Beverage Container Deposit and the Wireless 911 special funds. Your Committee agrees with the reasonableness of redirecting non-required cash balances to help meet needs. Your Committee has passed H.B. No. 39, H.D. 2, S.D. 1, Relating to State Revenues, to draw an additional \$40 million in the Governor's financial plan in the current fiscal year (FY2009) and \$40 million in FY2010.



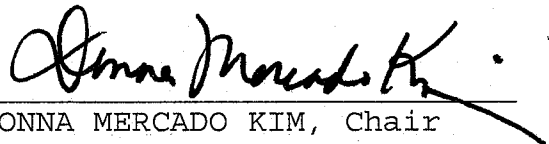
**CONCLUSION**

As your Committee looks to the upcoming conference phase of the session, we remain cognizant that, despite the differences in perspective held by the House of Representative and the Governor, only a truly collaborative effort will move the State through these difficult times while minimizing detrimental short- and long-term impact to the lives of Hawaii citizens. Your Committee on Ways and Means looks forward to working with both our legislative counterparts and the Executive Branch to find the most responsible and honest resolution to address the economic reality and produce a balanced State biennium budget.

In total, this budget amounts to \$5,113,810,721 in general funds and \$10,702,431,958 in all means of financing for FY2010 and \$5,311,995,243 in general funds and \$10,472,422,383 in all means of financing for FY2011. These figures represent an adjustment to the Governor's requested budget of \$57,506,986 in general funds and \$928,429,227 in all means of financing in FY2010 and \$82,737,865 in general funds and \$978,334,127 in all means of financing for FY2011.

As affirmed by the record of votes of the members of your Committee on Ways and Means that is attached to this report, your Committee is in accord with the intent and purpose of H.B. No. 200, H.D. 1, as amended herein, and recommends that it pass Second Reading in the form attached hereto as H.B. No. 200, H.D. 1, S.D. 1, and be placed on the calendar for Third Reading.


Respectfully submitted on  
behalf of the members of the  
Committee on Ways and Means,

  
DONNA MERCADO KIM, Chair



The Senate  
Twenty-Fifth Legislature  
State of Hawaii

**Record of Votes**  
**Committee on Ways and Means**  
**WAM**

Bill / Resolution No.:* <b>HB 200 HD 1</b>	Committee Referral: <b>WAM</b>	Date: <b>APRIL 7, 2009</b>		
<input type="checkbox"/> The committee is reconsidering its previous decision on this measure. If so, then the previous decision was to: _____				
The Recommendation is: <input type="checkbox"/> Pass, unamended 2312 <input checked="" type="checkbox"/> Pass, with amendments 2311 <input type="checkbox"/> Hold 2310 <input type="checkbox"/> Recommit 2313				
Members	Aye	Aye (WR)	Nay	Excused
KIM, Donna Mercado (C)	/			
TSUTSUI, Shan S. (VC)	/			
CHUN OAKLAND, Suzanne	/			
ENGLISH, J. Kalani	/			
FUKUNAGA, Carol	/			
GALUTERIA, Brickwood	/			
HEE, Clayton	/			
HOOSER, Gary L.	/			
KIDANI, Michelle N.	/			
KOKUBUN, Russell S.	/			
TOKUDA, Jill N.	/			
HEMMINGS, Fred			/	
<b>TOTAL</b>	<b>11</b>	<b>0</b>	<b>1</b>	<b>0</b>
Recommendation: <input checked="" type="checkbox"/> Adopted <input type="checkbox"/> Not Adopted				
Chair's or Designee's Signature: 				
<b>Distribution:</b> Original                      Yellow                      Pink                      Goldenrod File with Committee Report    Clerk's Office            Drafting Agency        Committee File Copy				

\*Only one measure per Record of Votes