



EXECUTIVE CHAMBERS

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LINDA LINGLE
GOVERNOR

Testimony of
Linda L. Smith
Senior Policy Advisor to the Governor

Before the
SENATE COMMITTEES ON HUMAN SERVICES AND HEALTH

Thursday, February 4, 2010, 2:45 p.m.
Room 016, State Capitol

**SB2692 RELATING TO THE STATE FISCAL STABILIZATION FUND
and
SB2693 PROPOSING AMENDMENTS TO THE CONSTITUTION OF THE STATE OF
HAWAII RELATING TO THE STATE FISCAL STABILIZATION FUND**

Chair Chun Oakland, Chair Ige, and Members of the Committees:

The Office of the Governor **supports SB2692 and SB2693**, which are Administration proposals that create the State Fiscal Stabilization Fund and require five percent of year end general fund balances to be deposited into the fund when certain conditions are met. These two proposals are necessary to ensure funds are available for future emergencies by building a financial reserve in good years to offset the state budget shortfall in bad years.

Specifically, SB2693 establishes the State Fiscal Stabilization Fund in the State Constitution and sets the condition for depositing into the fund at five percent of year end general fund balances whenever state general fund revenues for each of two successive fiscal years exceeds revenues for each of the preceding fiscal years by five percent. Deposits into the fund will occur through a transfer by the Director of Finance, and amounts deposited into the fund will not count toward satisfying the conditions that trigger a constitutional tax refund. The constitutional amendment

also stops deposits into the State Fiscal Stabilization Fund whenever the fund balance is more than ten percent of general fund revenues for the preceding fiscal year. Finally, the constitutional amendment requires that appropriations from the fund must be made with two-thirds approval from both houses of the Legislature.

To ensure that the constitutional requirements set forth in SB2693 are carried out in statute, SB2692 renames the Emergency Budget and Reserve Fund as the State Fiscal Stabilization Fund and places SB2693's constitutional requirements in statute. In addition, the bill also requires that interest earned from moneys in the State Fiscal Stabilization Fund remain in the fund.

Under these proposals and the current six-year financial plan, the deposit of year end general fund balances into the State Fiscal Stabilization Fund will begin in fiscal year 2011-2012, when \$1.62 million of the \$32.4 million in year end balance will be deposited into the fund. Over a four year period for fiscal years 2011-2015, an estimated \$33.8 million will be deposited into the State Fiscal Stabilization Fund under these proposals, as calculated using the current six-year financial plan. The estimates are attached.

The purpose of these two proposals is not to change the concept or use of the State's Rainy Day Fund, but rather to ensure a steady source of revenue is available to build the fund balance for future emergencies. We believe a constitutional amendment is the only way to safeguard against expending year end general fund balances that in good years will likely not be saved, but rather spent on new programs and services. SB2692 and SB2693 will increase the State's fiscal discipline by requiring deposits into the State Fiscal Stabilization Fund upfront, rather than have these funds remain as carry-over balances, which could easily be expended. As such, the Office of the Governor supports these Administration measures and respectfully requests that they be passed from your committees.

State Fiscal Stabilization Fund Projections

Fiscal Year	2011	2012	2013	2014	2015
Second Preceding Fiscal Year Rev.	4,203,081,000	4,097,243,000	4,408,318,000	4,672,817,000	4,953,168,000
First Preceding Fiscal Year Rev.	4,097,243,000	4,408,318,000	4,672,817,000	4,953,168,000	5,250,377,000
Current Fiscal Year Rev. (Council on Revenues)	4,408,318,000	4,672,817,000	4,953,168,000	5,250,377,000	5,512,896,000
Deposit Trigger Met (5% Increase for 2 Yrs)	NO	YES	YES	YES	YES
Year End Balance (Financial Plan)	162,700,000	32,400,000	27,800,000	165,800,000	461,800,000
Year End Balance (Due to Prev. Fund Deposit)	162,700,000	32,400,000	26,180,000	164,491,000	453,575,450
Deposit to Fund (5%)	0	1,620,000	1,309,000	8,224,550	22,678,773
Total Stabilization Fund Deposit	0	1,620,000	2,929,000	11,153,550	33,832,323
Fund As % of Previous FY Revenues	0.00%	0.04%	0.06%	0.23%	0.64%

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, State fiscal stabilization fund

BILL NUMBER: SB 2692; HB 2539 (Identical)

INTRODUCED BY: SB by Hanbusa by request, HB by Say by request

BRIEF SUMMARY: Amends HRS section 328L-3 to rename the emergency and budget reserve fund the state fiscal stabilization fund. Whenever the general fund balance at the close of each of two successive fiscal years exceeds 5% of general fund revenues for each of the preceding fiscal years, pursuant to article VII, section ___ of the constitution of the state of Hawaii, the budget director shall transfer an amount equal to 5% of the general fund balance into the state fiscal stabilization fund. For the purpose of this section, the general fund balance at the close of the fiscal year shall be determined before any tax refund or tax credit, pursuant to article VII, section 6 of the constitution of the state of Hawaii, is calculated. Transfers shall not be made to the state fiscal stabilization fund if the balance of the fund is more than 10% of general fund revenues for the preceding fiscal year.

Adds a new section to HRS chapter 37 to provide that the general fund expenditure ceiling shall not apply to appropriations made to the state fiscal stabilization fund but shall apply to appropriations authorized from the state fiscal stabilization fund.

This act shall take effect on July 1, 2011 following the ratification of a constitutional amendment to establish the state fiscal stabilization fund; provided that amendments made to HRS section 328L-3 by this act shall not be repealed when HRS section 238L-3 is reenacted by section 6 of Act 119, SLH 2009.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: This is an administration measure submitted by the state department of budget and finance BUF-12(10). This measure renames the emergency and budget reserve fund established by the legislature in 1999 by Act 304. The emergency budget and reserve fund was a recommendation of the 1990 Tax Review Commission which noted that one of the reasons policy makers used in deflecting past attempts to reduce the overall level of taxes in Hawaii was that the high level of taxes provides a cushion against an economic downturn. In doing so, the Commission noted that retaining the cushion can also lead to a mis-allocation of resources between public and private sectors. Thus, the Commission recommended that an explicit stabilization fund be established as a more reasonable way to provide a cushion that would help to even out the fluctuations in the economic cycle.

In establishing such a fund the Commission noted the following two basic considerations: (1) how the fund is to be underwritten - annual appropriation, automatic appropriation or revenues in excess of a threshold determined by an economic variable; and (2) determination of a fund size where their findings indicated a benchmark of 5% of expenditures. The Commission also noted the importance of explicit action requiring the drawing down of the monies in the fund and that the moneys can only be accessed through legislative appropriation.

While the existing emergency budget and reserve fund was established by the 1999 legislature, utilizing the realizations of the Master Settlement Agreement reached with the major tobacco companies, lawmakers have continually dipped into the fund to pay for ongoing programs. This allowed lawmakers to avoid making hard decisions and setting priorities as to which of the ongoing programs should be reduced or eliminated. This was not the intent of the Tax Review Commission. The emergency budget and reserve fund was viewed as a source of funding in the event of a natural disaster or some unforeseen crisis. It was not intended to supplement ongoing program funding when current resources were not available as was the situation a few short years ago. This is because the legislature provided that one of the purposes for which appropriations from the fund could be made is to “maintain levels of programs determined to be essential to the public health, safety and welfare.” This provision is much too broad and allows lawmakers to escape accountability for prudent use of such emergency funds.

It should be noted that this measure also proposes a cap on the balance that would be allowed in the newly renamed fund to 10% of general fund revenues. If that is the case, then the fund balance for the last four fiscal years would have exceeded that cap. Further, it should be noted that the budget reserve fund is the beneficiary of 15% of the proceeds of the Master Settlement Agreement (MSA). The amount has been estimated to total about \$12 million for the next few years. Further, there is another 15 years under the MSA during which the state will continue to receive payments. Thus, it is more than likely that the fund balance will continue to meet or exceed the cap proposed in this measure. Lawmakers need to determine just what an acceptable balance for the fund should be and they must also be more specific about the potential uses of the fund. This year, for example, the fund has been the target for solving “furlough Fridays” in the department of education as well as for budget shortfalls in the area of health and human services. It does not seem appropriate to use these funds to maintain the status quo in state programs at a time when the entire economy is undergoing stress and downsizing and restructuring is taking place in the private sector. On the other hand, unforeseen events which disrupt daily life in Hawaii such as hurricanes, earthquakes, or tsunamis are good examples of appropriate uses of the fund in times of emergencies. Given that deposits into the fund will not be ongoing as it is likely that there will be years when there are no excess revenues, expenditures should be for “one-time” occurrences.

While the administration is taking a prudent step in setting aside funds for a rainy day, consideration should be given to tightening up the list of events for which these rainy day funds may be used. If not, then this appropriation becomes nothing more than a strategy to avoid dealing with Hawaii’s heavy tax burden.

Digested 2/3/10

WRITTEN ONLY

TESTIMONY BY GEORGINA K. KAWAMURA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEES ON HUMAN SERVICES AND HEALTH
ON
SENATE BILL NO. 2692
AND
SENATE BILL NO. 2693

February 4, 2010

RELATING TO THE STATE FISCAL STABILIZATION FUND

PROPOSING AMENDMENTS TO THE CONSTITUTION OF THE STATE OF HAWAII
RELATING TO THE STATE FISCAL STABILIZATION FUND

Senate Bill No. 2693 proposes a constitutional amendment to establish the State Fiscal Stabilization Fund as a fiscal reserve during periods of economic downturns. In addition to an allocation of Tobacco Settlement moneys, five percent of the State's general fund balance at the close of the fiscal year would be transferred to the State Fiscal Stabilization Fund when State general fund revenues for each of two successive fiscal years exceeds revenues for each of the preceding fiscal years by five percent. Deposits into the State Fiscal Stabilization Fund are suspended when its balance is more than ten percent of general fund revenues for the preceding fiscal year.

Senate Bill No. 2692 renames the Emergency Budget and Reserve Fund, also known as the Rainy Day Fund, to the State Fiscal Stabilization Fund and revises Section 328L-3, Hawaii Revised Statutes, to allow the fund to accept deposits pursuant to the constitutional amendments proposed by Senate Bill No. 2693.

We strongly support these two Administration bills. These measures establish a mechanism for the State to deposit excess revenues, from periods of economic growth, to the State Fiscal Stabilization Fund. The Stabilization Fund would serve as a fiscal reserve to support the State's financial obligations during periods of economic difficulty and would provide an alternative to raising taxes at times when the people of our State can least afford it.

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TAX FOUNDATION OF HAWAII

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SUBJECT: CONSTITUTIONAL AMENDMENT, State fiscal stabilization fund

BILL NUMBER: SB 2693; HB 2540 (Identical)

INTRODUCED BY: SB by Hanbusa by request, HB by Say by request

BRIEF SUMMARY: Adds a new section to Article VII of the State Constitution to establish a state fiscal stabilization fund into which shall be deposited revenue sources previously deposited into the emergency and budget reserve fund and 5% of the state general fund balance at the close of the fiscal year whenever the general fund balance at the close of two successive fiscal years exceeds five percent of the total moneys received in the general fund for each of the two fiscal years. When the balance in the state fiscal stabilization fund is more than 10% of the general fund revenues for the preceding fiscal year, no deposits shall be made to the fund.

Stipulates that moneys shall be transferred into the fiscal stabilization fund before calculating whether the legislature, in the next regular session, shall provide for a tax refund or tax credit to the taxpayers of the state as provided under Article VII, section 6, of the state constitution.

Moneys in the state fiscal stabilization fund shall only be used during times of severe economic downturn or unforeseen reduction in revenues to cover current state fiscal obligations, as provided by law. Appropriations from the state fiscal stabilization fund to shall require a two-thirds majority vote of each house of the legislature.

EFFECTIVE DATE: Voter approval

STAFF COMMENTS: This is an administration measure submitted by the state department of budget and finance BUF-13(10). This measure proposes a constitutional amendment to establish a state fiscal stabilization fund similar to the emergency and budget reserve fund established by Act 304, SLH 1999.

The Emergency Budget and Reserve Fund was a recommendation of the 1990 Tax Review Commission which noted that one of the reasons policy makers used in deflecting past attempts to reduce the overall level of taxes in Hawaii was that the high level of taxes provides a cushion against an economic downturn. In doing so, the Commission noted that retaining the cushion can also lead to a misallocation of resources between public and private sectors. Thus, the Commission recommended that an explicit stabilization fund be established as a more reasonable way to provide a cushion that would help to even out the fluctuations in the economic cycle.

In establishing such a fund, the Commission noted the following two basic considerations: (1) how the fund is to be underwritten - annual appropriation, automatic appropriation or revenues in excess of a threshold determined by an economic variable; and (2) determination of a fund size where their findings indicated a benchmark of 5% of expenditures. The Commission also noted the importance of explicit action requiring the drawing down of the monies in the fund and that the moneys can only be accessed

through legislative appropriation.

While the current emergency budget and reserve fund was established utilizing the realizations of the Master Settlement Agreement reached with the major tobacco companies, lawmakers have continually dipped into the fund to pay for ongoing programs. This allowed lawmakers to avoid making hard decisions and setting priorities as to which of the ongoing programs should be reduced or eliminated. This was not the intent of the Tax Review Commission. The emergency budget and reserve fund was viewed as a source of funding in the event of a natural disaster or some unforeseen crisis. It was not intended to supplement ongoing program funding. This is because the legislature provided that one of the purposes for which appropriations from the fund could be made is to “maintain levels of programs determined to be essential to the public health, safety and welfare.” This provision is much too broad and allows lawmakers to escape the accountability for prudent use of such emergency funds.

Thus, while the administration may be viewed as taking a prudent step by establishing a state fiscal stabilization fund within the constitution, as drafted, the proposal incorporates too many specifics which should be left to statutory interpretation. As noted in the comments made on the statutory proposal, SB 2692/HB 2539, the proposed 10% cap on the existing emergency and budget reserve fund has been exceeded. Thus, putting such a cap into the constitution would restrict the flexibility of addressing such a situation. While it is understandable that the administration wants to replace the current emergency and budget reserve fund with the proposed fund, it is unnecessary to detail that change in the constitution. It is a one-time change and should be left out of the constitution and dealt with by statute.

Further, this proposal attempts to pre-empt the existing constitutional provision for the disposition of excess revenues by allowing the transfer of 5% of the general fund balance to be made before the calculation is made to determine that a tax refund is triggered. This means that if the general fund balance in the second consecutive year is just 5% of the year’s general fund receipts, the tax refund could be circumvented. This is not the intent of that refund provision. It does not seem unreasonable to honor both the tax refund requirement and also allow the transfer proposed under this constitutional amendment. Whether or not establishing a rainy day fund, consideration should be given to tightening up the list of events for which these rainy day funds may be used. If not, then this appropriation becomes nothing more than a strategy to avoid dealing with Hawaii’s heavy tax burden.

While the language of the current emergency and budget reserve fund is vague with respect to how the money in the fund is to be used, putting limitations on the use of funds in the constitution again restricts the flexibility in defining those uses. No doubt such savings should not be used just because there is a shortfall of revenues, on the other hand, the statute governing the fund should be more specific as to what the money can or cannot be used for should a need arise.

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