STAND. COM. REP. NO. 952

Honolulu, Hawaii
March 14, 2011

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

Honorable Calvin K.Y. Say
Speaker, House of Representatives
Twenty-Sixth State Legislature
Regular Session of 2011
State of Hawaii

Sir:

Your Committee on Finance, to which was referred H.B. No. 200 entitled:

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

begs leave to report as follows:

The purpose of this bill is to appropriate funds for the operating and capital improvement costs of the Executive Branch for fiscal year 2011-2012 and fiscal year 2012-2013.

The Department of Human Services, Department of Health, Hawaii Public Housing Authority, Hawaii Housing Finance and Development Corporation, Hawaii Tourism Authority, State Council on Developmental Disabilities, County of Hawaii Office of the Prosecuting Attorney, Hawaii Association of Independent Schools, Kamehameha Schools, Early Learning Council, The Mestizo Association, Papa Ola Lokahi, and numerous concerned individuals testified in support of this bill. The Hawaii Charter Schools Network, Hawaii Farm Bureau Federation, Na Pua Noeau, and numerous concerned individuals provided comments.

Introduction

What do we want Hawai'i to look like when the recession ends?

Your Committee on Finance sought the answer to this question as it struggled to close budget gaps of $2.1 billion in the 2009 Regular Session and $1.2 billion in the 2010 Regular Session. Additional questions used to guide the work of the Committee over the past two years included:

- How far can government programs and services be cut?
- What programs and services are the people of Hawaii willing to live without?
- Are Hawaii's residents and visitors willing to pay more for programs and services?

Your Committee notes that the budget submitted to the 2011 Legislature was submitted in two parts. The first part, prepared by the previous Administration, increased expenditures by thirteen percent, but provided no details on how to pay for them. The second part, created by the new Administration, anticipated growth of two additional percent, and provided details on how to pay for all expenditures and attempted to answer the questions posed by your Committee.

In his State of the State Address on January 24, 2011, the new Governor declared that:

> *"What appears on paper as an $844 million fiscal deficit through the next biennium belies the fact that there is also a severe operational deficit in government. In other words, as difficult as it will be to balance the budget, that effort will merely be life support for what has become a battered, under resourced, and often dysfunctional democracy."*

Major cost increases in the budget include:

- Replacing American Recovery and Reinvestment Act (ARRA) funds;
- Medicaid needs;
- Temporary Assistance for Needy Families (TANF);

- Fixed costs such as debt service payments, employee health benefit payments and retirement system payments;

- Delayed Employees' Retirement System (ERS) payments; and

- Furlough restoration as current supplemental contracts come to an end on June 30, 2011.

Approach

The financial plan submitted by the new Administration to the Legislature relied on controversial revenue enhancement and expenditure reduction proposals that attempted to:

- Provide long-term structural solutions to contain increases in fixed costs, including health and retirement benefits to government employees and retirees;

- Enhance parity and fairness in Hawaii's tax structure; and

- Pay all government obligations on time.

Your Committee acknowledges the effort made to retool and reprioritize functions of government, and appreciates the speed in which this was done in the modified budget submitted to the Legislature by the new Administration on February 22, 2010. However, after the legislative public hearing process, many of the proposed revenue enhancement and expenditure reduction initiatives were not adopted by your Committee. Your Committee was faced with a troubling dilemma:

- A lack of adequate revenues to pay for all the services supported by the public and the new Administration; and

- A need to make further cuts to government expenditures despite slowly uncovering the truth about the impacts of furloughs and the reduction in force.

Establishing a New Normal

Without additional revenues to pay for the restoration of critical services, establishing a new normal must be explored.

Your Committee on Finance approached this budget with three goals:

1. Control the growth of overall expenditures;

2. Provide the new Administration with the flexibility to retool and reprioritize to achieve a new normal; and

3. Require higher levels of accountability.

To determine appropriate levels of expenditure reduction, your Committee analyzed:

- Program costs - primarily the cost of contracts within all departments;

- The availability of position vacancy and overtime savings within each department; and

- The ability of departments to use non-general funds to supplement programs.

The budget adopted by your Committee on Finance reduces expenditures by $120 million. Some items to note regarding this budget:

- The cuts do not treat all departments the same - there are no across-the-board percentage cuts;

- Where prior cuts and furloughs have had deep impacts, there may be no reductions;

- Each department was evaluated at the program ID level, and any potential savings allocated as best as possible to mitigate serious impact; and

- Flexibility is provided at the department level to reallocate funding as needed.

Department Summary

The impact of the previous Administration's policies has been widespread, significant and devastating:

- In 2010, the Administration moved the Compact of Free Association (COFA) population into a lesser health plan. On December 13, 2010, a federal court injunction found this to be wrongful and ordered the state to move them back to their original plan.

- In another example in 2010, the previous Administration attempted to implement an electronic internet only access benefits program called E-POD. Although this was a noteworthy program, the proposed implementation plan did not consider how the low or no-income clients would access E-POD if they could not afford internet access.

- Yet another example in 2010 was the reckless spending of TANF reserve money and the predictably erroneous assumption that enhanced federal revenues would continue.

- Finally, the previous Administration's payment strategies were ineffective in addressing budget shortfalls. These failed strategies included delays in payment for the Medicaid program and the state's pension system in 2009, and the income tax refund delay in 2010. Despite delaying these payments, the previous Administration spent the state general fund into the red for two years in a row.

In summary, the can was kicked down the road too many times and the structural imbalances in the state's financial plan cannot be ignored.

Despite the Legislature's restoration of positions and funds during the 2010 legislative session, the reduction in force, furloughs, and hiring freeze has greatly hindered the statewide workforce and stunted departments' abilities to provide vital government services effectively and efficiently. The hardest hit has been the people who rely on services, particularly the needy and vulnerable; many of them barely able to make ends meet. The line between the "haves" and "have-nots" has grown starker.

As your Committee has cautioned throughout the past few years, its worst fears are being realized. Within the Department of Human Services (DHS), response times to allegations of adult abuse have lengthened, where the inability to sufficiently monitor such cases has resulted in a 4% increase in the re-abuse rate to our elderly.

Despite your Committee's warning and unsuccessful attempt to rein in expenditures last year, irresponsible spending and the erroneous assumption that federal funding would continue indefinitely, resulted in DHS depleting its TANF reserve of over $60 million dollars just when it is needed the most. Our families are still in need, and with the TANF reserve emptied, the new Administration has had no choice but to eliminate social service programs throughout the State. As such, DHS must rebuild the TANF program to ensure efficient delivery of crucial social services; a task which could take several years to fix.

The Department of Agriculture, whose resources were reduced by 50%, has estimated that about 90% of invasive species coming in through Honolulu International Airport cannot be intercepted. Budget constraints and lack of consistent leadership has left our prisons in extreme disrepair and has also led to a six-month delay in meeting the federal Department of Justice Settlement Agreement regarding mental health care standards for inmates.

In short, this new Administration and Legislature is faced with the responsibility of repairing the damage created by "one-time fixes" and short-term solutions that have proven to be difficult and more costly to fix. In an effort to alleviate some of these concerns, over the biennium your Committee has approved over $400 million in general funds to restore furloughs, to provide departments additional work hours to address growing backlogs; and nearly $240 million in recurring costs to address the "cliff" created when American Recovery and Reinvestment Act (ARRA) monies expire.

Such actions are only the beginning and your Committee realizes this will in no way return government services to optimum levels. Despite these efforts, your Committee must remain mindful of the ever increasing costs we must address. This budget includes over $475 million over the biennium for Employer-Union Trust Fund

(EUTF), ERS and debt services payments as well as over $500 million to pay for growing Medicaid needs.

Given the lack of resources to pay for these basic essentials, your Committee has found no other avenue than to look into the current State budget for the resources to address other critical needs. While carefully assessing the conditions within each department and their programs your Committee has preserved those areas that have been most impacted, such as the Department of Agriculture and the State Historic Preservation Division, but has also made a $120 million cut to other departments' budgets. While this was not an easy decision, your Committee is confident that through such cuts, we may also be able to address the growing needs in healthcare, Medicaid, and other vital services, while also providing a balanced financial plan. Your Committee notes that despite this reduction, departmental budgets will grow throughout the biennium. While your Committee recognizes that these increases may not be sufficient, it is meant to compel a restructuring and retooling of government services and programs to eventually establish a new normal.

This budget does not eliminate specific programs nor does it identify which areas should be cut. Rather, your Committee allows the departments to prioritize and refocus on their core services. Your Committee emphasizes that one of the biggest barriers to proceeding in this direction lies within each department and program wherever a "silo" mentality exists. If each department chooses to stand alone, this lack of cooperation will increase the potential for inefficiency and redundancy. By breaking down silos, state government can achieve a greater synergy and commitment to best addressing the needs of our communities. To further assist in this effort, this budget provides the Governor unprecedented, broader authority to transfer resources between programs and departments to enable greater flexibility in accomplishing this objective. In return, Your Committee seeks greater collaboration, transparency, and accountability.

As the consequences of the furlough, reduction in force and economic uncertainty continues to distress government; your Committee believes a new normal must be established to ensure the State's fiscal viability. We must do more with what we have; we must maximize the use of our available resources to ensure government operations are accomplished through a more resourceful, thoughtful, and expeditious manner. Perhaps more importantly, we must come back to the question your Committee has continuously posed:

"What do we want Hawaii to look like when the recession ends?"

Your Committee stresses the importance of doing so in accordance with Hawaii Revised Statutes, Chapter 5, Section 7.5, entitled "Aloha Spirit".

Capital Improvement Project Program

Your Committee recommends total appropriations for the 2011-2013 fiscal biennium of $2,913,856,000 for all means of financing, of which $1,477,697,000 is recommended for G.O and G.O.R. bonds. The largest areas funded by this budget are:

- $820,663,000 for the Department of Transportation (airports, harbors, highways);
- $390,000,000 to collateralize encumbered State Educational Facilities Improvement (SEFI) Special Funds that had lapsed on June 30, 2010;
- $360,166,000 for the Department of Education, public charter schools, and public libraries; and
- $282,792,000 for the University of Hawaii System.

Your Committee also focused on the departments of Health, Human Services, Land and Natural Resources, and Public Safety. In many instances, the infrastructure for these departments has deteriorated to a point necessitating immediate action to ensure the health and safety of Hawaii's people. Therefore, your Committee has included funds for the following projects:

- $82,490,000 for public housing facilities, including $5,600,000 to replace the solar water heating system at Mayor Wright Homes;
- $55,315,000 for state park facilities, statewide;
- $49,854,000 for community hospitals, statewide;

- $20,500,000 for correctional facilities, statewide, including $4,000,000 to replace the wastewater infrastructure at Waiawa Correctional Facility and $4,000,000 to replace the roofing system at Halawa Correctional Facility;

- $15,350,000 for infrastructure improvements at small boat harbors and ocean recreation facilities statewide; and

- $11,610,000 for various improvements to the Hawaii State Hospital.

Lastly, your Committee appreciates the cooperation extended by the Administration in preparing the capital improvement part of the budget and looks forward to continuing dialog as the capital improvement project budget moves through the legislative process.

Local, National and International Events

On March 10, 2011, the Council on Revenues revised its projected revenue forecast downward from 3.0% to 0.5% for fiscal year 2011 and upward from 10.0% to 11.0% in fiscal year 2012; resulting in a net two-year deficit of over $960 million. Your Committee is concerned that:

- In order to achieve 0.5% growth, tax collections must average approximately $400,000,000 per month for the remaining five months of the fiscal year; and

- Actual tax collections have been avergaging $360,000,000 for the last year.

On January 26, 2011, Moody's Investors Service issued an analysis combining debt and pension liabilities of the states. In that report, it was noted that:

> *"Hawaii … [one of] three states with the largest ratios of bonded debt to personal income - [is] also among states with the largest combined debt and pension obligations relative to their economies and revenues.*

… Hawaii (Aa1, negative) has a combination of very high debt … and it has struggled to make pension ARCs in recent years."

Despite the criticism, Moody's acknowledged that Hawaii has "… offsetting credit strengths that account for [its] high rating, underscoring that these liabilities are only one of many factors that contribute[s] to state credit ratings." Nonetheless, debt service and pension system liabilities continue to be a major influence on the budget.

Hawai'i could see fewer tourists, as recent events in Egypt, Iran, Saudi Arabia and other countries throughout the Middle East have the potential for causing the cost of airfare to rise. Oil prices have increased from a low of about $85 per barrel to a high of over $115 per barrel in recent weeks. National and international financial markets have been reactive and the political unrest in the Middle East may further dampen economic recovery and forestall the release of private investment capital.

This upward trend in oil prices saw a slight reversal following the earthquake and tsunamis released in the Pacific Ocean on March 11, 2011. Your Committee's thoughts and prayers are with the people of Japan who have suffered tremendously by these current events. Unfortunately, Hawaii will also be affected not only by damage caused by the tsunamis but also the economic fallout from a decrease in visitors from Japan.

CONCLUSION

This House draft of the Executive Biennium Budget represents one step in the legislative process. While the economy has shown improvement, the State still faces a deficit. The Legislature must take a cautious approach with the budget and managing the State's resources.

This budet:

- Controls the growth of overall expenditures;
- Provides the new Administration with the flexibility to retool and reprioritize to achieve a new normal; and

- Requires higher levels of accountability.

Although funding was restored to eliminate furloughs, thereby restoring greater access to government services, government agencies must still use resources wisely. Moreover, nothing in this budget hinders the use of the restored furlough funds for other operational purposes and uses, subject to the outcome of collective bargaining decisions. Your Committee hopes that contract negotiations with public workers will be settled before the close of the 2011 Regular Session so that appropriate action can be considered in the context of a balanced six-year financial plan.

Your Committee believes that the Administration should have the flexibility to make the decisions necessary to do what it can with limited resources and that it is incumbent upon all of Hawaii's people to work together to emerge from the State's economic challenges. This budget represents the next step in our ongoing evolution to a new normal.

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

Respectfully submitted on
behalf of the members of the
Committee on Finance,

MARCUS R. OSHIRO, Chair

HSCR952

State of Hawaii
House of Representatives
The Twenty-sixth Legislature

Record of Votes of the Committee on Finance

Bill/Resolution No.:	Committee Referral:	Date:
HB 200	FIN	3/9/11

☐ The committee is reconsidering its previous decision on the measure.

The recommendation is to: ☐ Pass, unamended (as is) ☒ Pass, with amendments (HD) ☐ Hold
☐ Pass short form bill with HD to recommit for future public hearing (recommit)

FIN Members	Ayes	Ayes (WR)	Nays	Excused
1. OSHIRO, Marcus R. (C)	✓			
2. LEE, Marilyn B. (VC)	✓			
3. CHONG, Pono	✓			
4. CHOY, Isaac W.	✓			
5. COFFMAN, Denny	✓			
6. CULLEN, Ty	✓			
7. HAR, Sharon E.				✓
8. HASHEM, Mark J.	✓			
9. ICHIYAMA, Linda	✓			
10. JORDAN, Jo	✓			
11. LEE, Chris	✓			
12. MORIKAWA, Dee				✓
13. TOKIOKA, James Kunane	✓			
14. YAMASHITA, Kyle T.	✓			
15. MARUMOTO, Barbara C.	✓			
16. RIVIERE, Gil				✓
17. WARD, Gene		✓		
TOTAL (17)	13	1	0	3

The recommendation is: ☒ Adopted ☐ Not Adopted
If joint referral, ______________ did not support recommendation.
committee acronym(s)

Vice Chair's or designee's signature: Marilyn B. Lee

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