

# HAWAI'I'S BUDGET

## Understanding the Challenges of the Fiscal Biennium

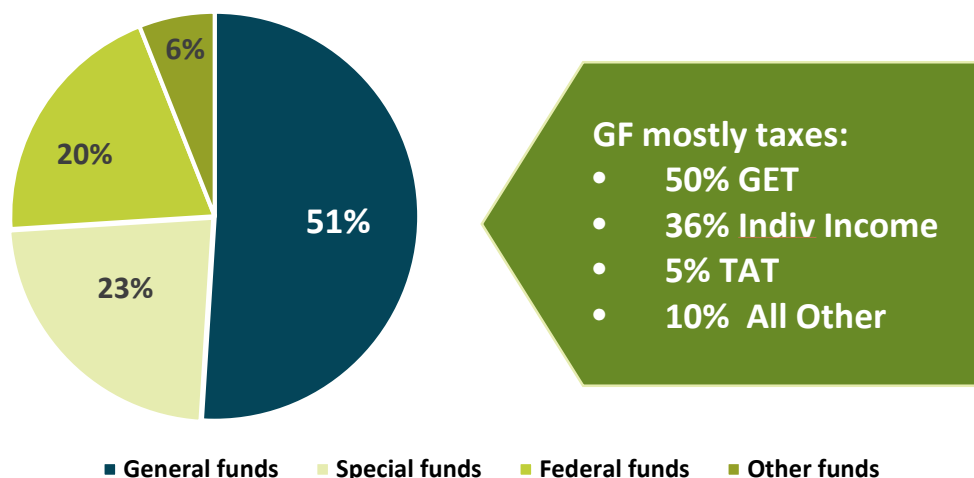
The Hawai'i legislature's foremost task this session is approving a budget for the fiscal biennium, that is, the two-year period that starts July 1, 2021 and ends June 30, 2023. The first year of the two-year budget is most important to focus on because the legislature can make significant amendments to spending for the second year when they meet again in 2022. This brief highlights the budget challenges that will guide the choices the legislature and administration will make on spending for the near future.

**General Funds Are Really Important.** General fund revenues and spending are the main focus for budget makers every year, and they drive the budget process even more during an economic downturn.

Why? General funds typically pay for half of the state budget (*fig. 1*). Other funds, such as federal or special funds, may be unaffected by a recession but they can be spent only on the purpose for which they're provided. They cannot be stretched to help cover general fund deficits.

*Figure 1 shows the "means of finance" supporting Hawai'i's FY2021 operating budget, highlighting the importance of general funds, which pays for half of state spending.*

### How Hawai'i's \$16.2 Billion Operating Budget is Financed



The focus on general funds intensifies when the economy is bad since general funds are largely made up of tax revenue, which shrinks during recessions as incomes and spending decline. That’s true for the pandemic recession. Actual and projected tax collections are way down. Lawmakers are looking at a budget forecast that compares the pre-COVID [January 2020 forecast](#) to the updated [January 2021 projections](#) (figs. 2 and 3).

Figure 2 compares the Council on Revenues’ (COR) projection in January 2020 to its updated projection in January 2021.

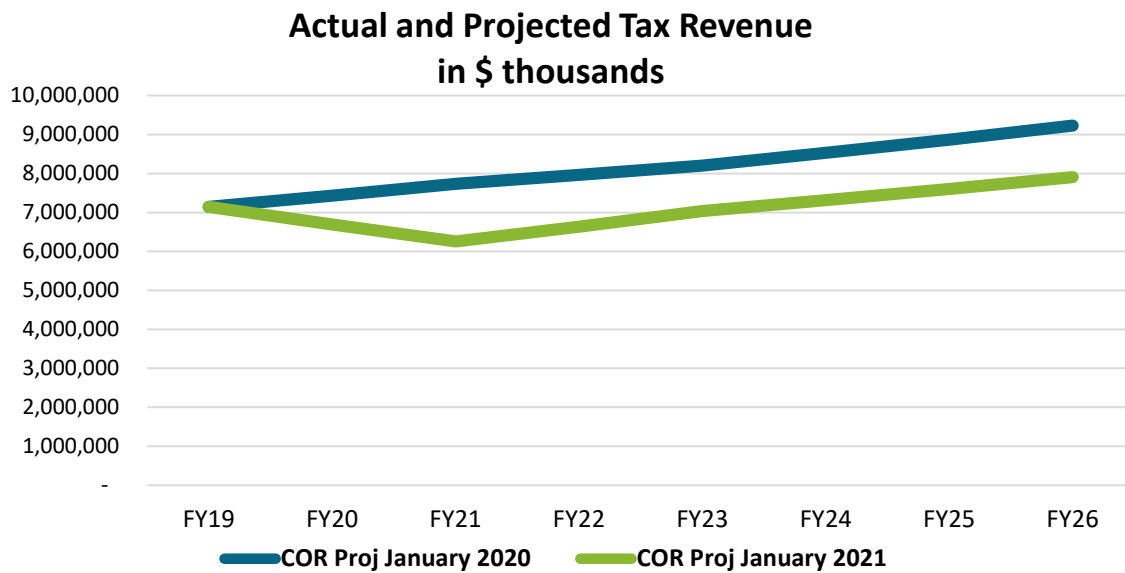
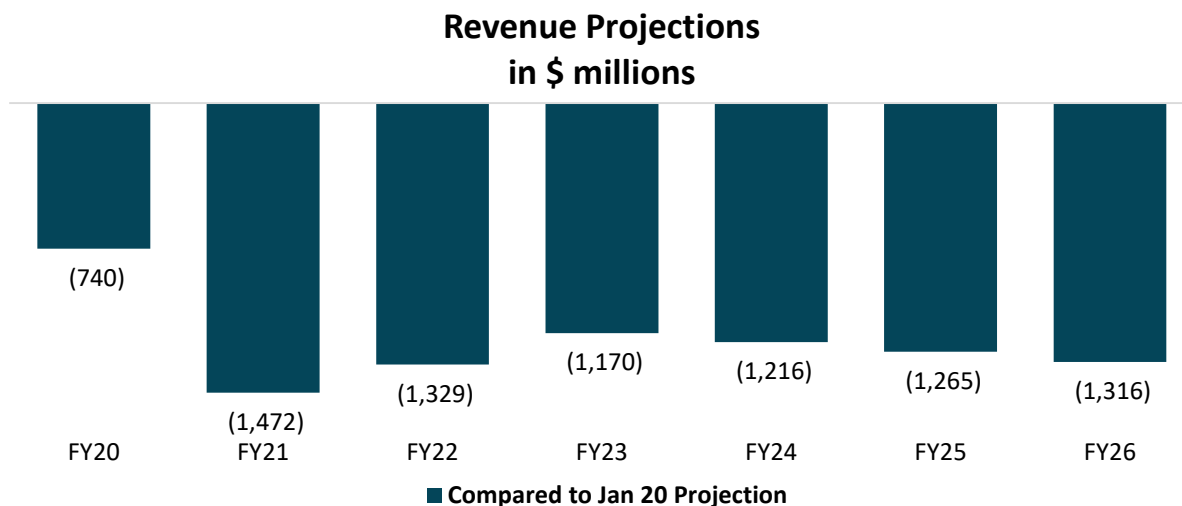


Figure 3 shows that projected tax collections in January 2021 fall far short of projections in January 2020. In the current fiscal year, collections are expected to be \$1.47 billion less than expected a year ago.



**Fixed Costs Put the Squeeze on Limited General Funds.** Even as tax revenues are down, “fixed costs” remain high. These are the obligations that the state must pay before considering any other expenses. They’re made up of the state’s share of Medicaid, interest on bonds and borrowing, health and social security payments for current employees, and payments to state pension and retiree health funds (*fig. 4*). (The governor proposes to reduce payments toward the retiree health trust fund for up to four years, paying only current costs.)

By FY2019, fixed costs had risen to consume more than half of all general fund tax revenue. Now, with reduced tax revenue and increased fixed costs, the percentage is budgeted to be as much as 65 percent (*fig. 5*).

*Figure 4 shows the significant growth in fixed costs over the years. Note the decrease budgeted for state retiree health costs consistent with the governor’s proposal to pay only current costs for at last the next several years. The total budget for fixed costs is \$4.1 billion.*

**Growth Trends in Hawai'i Fixed Costs  
in \$ millions**

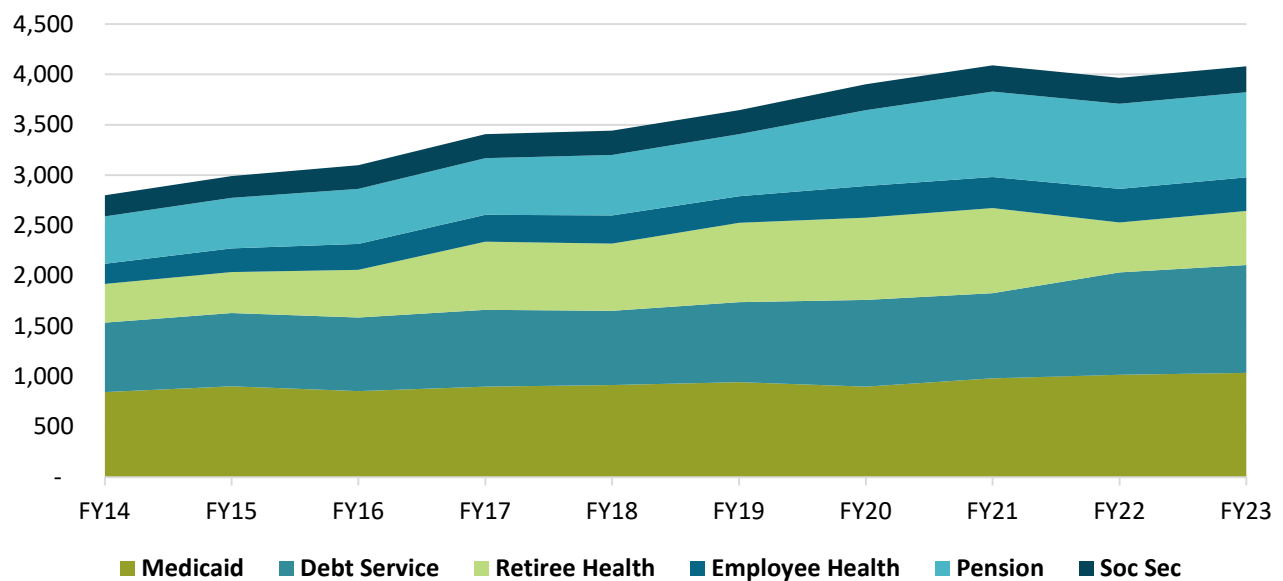
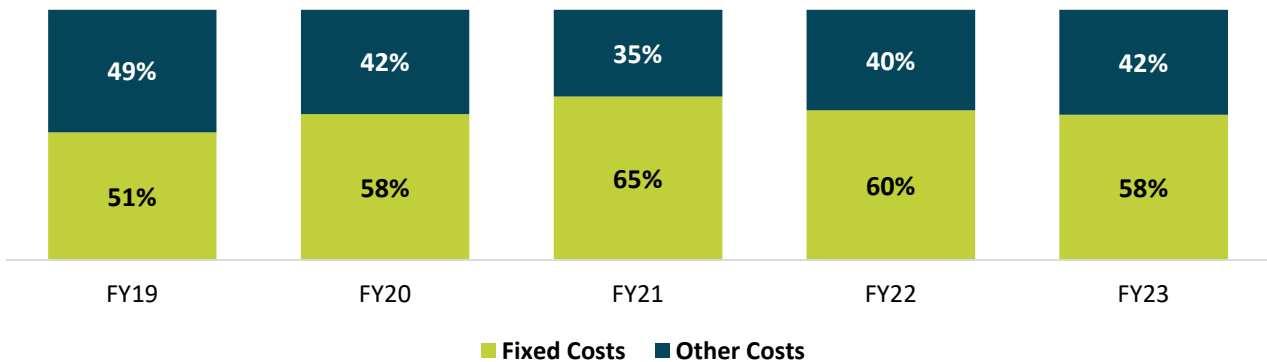


Figure 5 shows how steadily increasing fixed costs will consume the majority of tax revenues this year and over the next two years. Projected tax revenues for FY21-23 are \$6.3 billion, \$6.6 billion and \$7.0 billion, respectively.

### Spending General Fund Tax Revenues: Fixed Costs vs Other Expenses



**General Funds Pay the Salaries of Most State Workers.** Nearly a fourth of the state budget goes to salaries for state workers (fringe benefits, at a rate of 51 percent of salaries, are included in fixed costs). About 75 percent of state salary costs are financed by general funds.

### STATE SALARY COSTS

- **Number of state employees (November 2020): 66,500**
- **Average salary (incl. 3% raise granted in 2020): \$55,056**
- **Total payroll: \$3.66 billion**

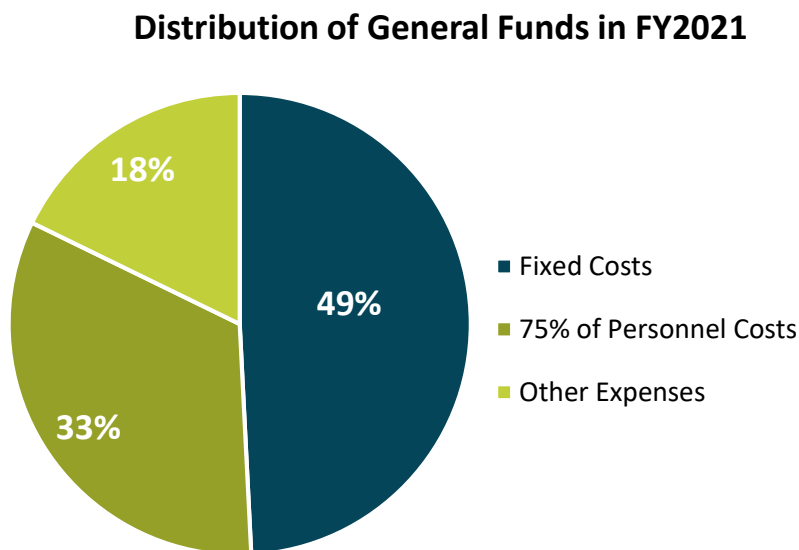
**Proposed 2 day/month furlough would reduce spending by \$338 million if applied to all workers.**

**Distribution of Budget Cuts.** Cuts in state spending will be aimed at programs funded by general funds. Programs supported by federal, special, or other funds should be affected much less if at all.

That means the competition for scarce general funds is great. Fixed costs are at the top of the priority list because they have to be paid, and state worker salaries are usually the second on the list. As a result, nonprofit services contracts and all other expenses supported by general funds are apt to face deep cuts. To the extent that contracts and other costs are funded by federal or other funds, they are much less likely to be decreased.

General funds supporting the current budget amount to \$8.3 billion. That’s significantly more than \$6.3 billion in projected tax revenues, but rainy day funds and borrowed money are bolstering general funds this year. Expenses budgeted for general fund support in FY2021 include \$4.1 billion for fixed costs and \$2.7 billion for salaries. That leaves just \$1.5 billion for all other general fund operating expenses (*fig. 6*).

*Figure 6 shows how general funds are distributed this year.*



**General Funds \$8.3 Billion**

- Fixed costs: \$4.1 Billion
- Salaries: \$2.7 Billion
- All other: \$1.5 Billion

*(Nonprofit POS dollars in FY20 totaled \$575 million. That would be 39% of “all other” if funded in FY21.)*

**Actions Taken or Proposed to Support State Needs.** The state budget is a big part of Hawai'i's economy and maintaining state spending will support a faster recovery. The governor and legislature have identified and in some cases taken action to cover state general operating costs, but most come at a cost. Borrowing is essential to support

general fund-supported operations and to keep special funds flowing for unemployment insurance but both of these have short pay-back periods and will add to fixed costs for debt-service payments until they are repaid. The pause in full funding of required retiree health payments should be reversed as soon as possible to reduce future indebtedness. Furloughs are damaging to the economy as well as to workers. Increasing certain taxes is on the table but putting them in place and collecting the revenue will take some time.

## **ACTIONS TAKEN OR PROPOSED TO SUPPORT STATE NEEDS**

- **Rainy Day Fund: \$396 million**
- **Borrowed short-term bonds: \$750 million**
- **Borrowed for Unemployment Insurance Trust: \$700 million (and may increase)**
- **Defer full retiree healthcare payments for 4 years: \$1.85 billion**
- **Freeze position vacancies: \$130 million (proposed)**
- **Furlough state workers 2 days/month: \$338 million (proposed)**
- **Raid special fund balances: \$400 - \$600 million (proposed)**
- **Restrict general fund expenses after paying fixed costs and personnel: 10-20% (or more)**
- **New tax revenue: TBD**

**Tools to Understand the Budget.** The budget unveiled in December was created before an additional federal aid package was approved and new tax revenue projections were released by the Council on Revenues so it was out-of-date as soon as it was released. The budget will be redrafted several more times in coming months. Typically, the House revises the governor's budget, then the Senate edits the House draft. The final conference draft will have the benefit of the Council on Revenue's most current projections, which will be issued on March 8. This year, deliberations may be further affected by much hoped-for additional federal assistance.

To understand the budget process and keep track of spending details as the budget moves toward approval in April, we recommend the following resources:

### **Governor's Budget Proposal: Budget in Brief**

- Details assumptions about revenues, operating expenditures, capital improvements and approved staffing levels
- Focuses on executive branch but provides some information about revenues and budgets for other branches (legislative, judiciary, OHA)
- Describes each department's mission, goals, functions, and measures of effectiveness
- Summarizes each department's staffing and funding by source

### **Legislature's Budgets: Budget Worksheets**

- There will be a House Draft, then a Senate Draft and finally a Conference Draft.
- Find them on the Capitol website: click on "Legislative Information" box
- Details executive, judiciary, and OHA budgets by program ID (i.e., function)
  - Ceilings for number of permanent and temporary staff
  - Funds budgeted by funding source (means of finance)
  - Changes proposed by House and Senate as they develop their drafts

### **Executive Budget Details: Departmental Reports to FIN and WAM**

- Highlights programs and accomplishments
- Explains budget additions, trade-offs, reductions
- Details staff vacancies, new positions, and overtime
- Lists contracts with outside vendors, including nonprofits
  - Contract amounts, outstanding balances, start and end dates, purposes
- Capital improvement project requests and lapses

Reports may also be posted on departmental websites.

*[Note: These are full of great, detailed information but they're all in PDF and some are hundreds of pages long so they're hard to analyze.]*

### **User-Friendly Details for Each Version of the Budget: Hawai'i Data Collaborative**

- Scrapes data from PDFs to make budgets easier to analyze and understand
- Allows reader to organize budget data of interest
  - Means of finance
  - Department
  - Year
- Graphics and colors help organize complex information

- Currently shows governor's budget but will update and add versions

**Hawai'i Budget & Policy Center: Budget Basics and Blogs**

- Budget Primer provides overview of state budget process and documents
  - Operating and capital budgets
  - Distribution of budget by department
  - Means of finance (where the money comes from)
  - Challenges for the budget
- Subscribe to get periodic updates via blogs