How Hawaii's State Government Shares Transient Accommodation Tax Revenues With Its Local Governments

by

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Abstract

Many states in the U.S. give unrestricted financial support to their local governments. The reasons some state governments provide aid and others do not, and why a particular mode of revenue sharing is adopted remain unclear. This paper examines Hawaii's recent effort at developing a model to allocate the state's transient accommodation tax revenues between the State and the county governments. The paper documents the process and explains the rationale behind the model.

I. Introduction

Section 2 of Act 174, SLH 2014 passed by the Hawaii State Legislature establishes a 13-member State-County Functions Working Group (SCFWG)

> 1) To evaluate the division of duties and responsibilities between state government and counties (City and County of Honolulu, and Counties of Hawaiʻi, Kauaʻi, and Maui) relating to the provision of public services; and
>
> 2) Submit a recommendation to the Legislature on the appropriate allocation of the transient accommodations tax (TAT) revenues between the State and counties that properly reflects the division of duties and responsibilities relating to the provision of public services.

Hawaii's transient accommodation tax is more commonly referred to elsewhere as a "hotel room tax," "hotel occupancy tax," or "lodging tax."

The State-County Functions Working Group, or the Working Group (WG) for short, comprised of members appointed by county mayors (4), the Governor (4), President of the Senate (2), Speaker of the House (2), the Chief Justice of the Hawaii Supreme Court (1) (who would chair the working group) to review and provide recommendation to the 2016 Legislature on how best to allocate TAT revenues between the State and the counties. Most members were employed either by the state government or by the county governments in high level budget positions. Four members came from private (mostly visitor) industry. Belt Collins Hawaii LLC (BCH), a Hawaii planning and engineering firm, was retained as the lead consultant in mid-August, 2015. BCH retained Hospitality Advisors LLC to prepare a forecast of transient accommodation tax revenues and this author as economic advisor to provide "quality control services." The Office of the State Auditor provided staff support for the Group.

Between October 22, 2014 and November 12, 2015 the Working Group met 17 times, and many more meetings were held in smaller groups to work on special assignments. A lot of information and data were gathered and distributed.[1] This paper documents the process and explains the rationale behind the Working Group's recommendation. The author adds his own comments and analyses to provide perspective and shed further insights on the implications of decisions made along the way. The paper also explains why the 2016 State Legislature ultimately rejected the Working Group's recommendation but might reconsider the issue in "the years ahead".

Interest in intergovernmental revenue sharing extends beyond Hawaii. While some 27 states in the U.S. share state revenues unconditionally with their local governments, it remains unclear what economic and fiscal characteristics determine why some states share revenues with their local governments and some do not.[2] Fisher and Bristle note that…"both the reasons why some states have adopted or continue state revenue sharing to provide general financial support for local governments and the reasons why a particular structure for such programs is adopted are unresolved and provide interesting topics for future research."[3] This paper contributes to that research. Hawaii's attempt to link the distribution of state general-purpose aid to the cost of public service provision is unique among the U.S. states.[4]

II. Background: State Aid to Local Governments in the U.S.

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[1] All the detailed minutes, handouts, and reports are posted at http://auditor.hawaii.gov/task-forceworking-group/

[2] Fisher and Bristle, 2012, pp. 231-234.

[3] Fisher and Bristle, 2012, p. 234.

[4] Fisher and Bristle, 2012, p. 232.

State aid to local governments is an important feature of state-local public finance in the U.S. Historically, state aid has been provided in three ways. First, state governments can directly assume responsibilities to provide specific public services. Second, states can authorize local governments to impose a variety of taxes, fees and user charges. Third, states can provide direct grant-in-aid to provide partial funding for public services that are of mutual concern or to enhance intergovernmental fiscal equity within a particular state.

The use of grant-in-aid money can either be restricted or unrestricted. Most of the state aid to local governments in the U.S. is conditional/restricted aid. Local school districts are the largest recipients of state aid, but not in Hawaii. In Hawaii, the provision of K-12 public education is a state responsibility unlike in the other 49 states.

The U.S. Advisory Commission on Intergovernmental Relation (ACIR) defines unrestricted grant-in-aid as "revenue sharing."[5] According to the ACIR, "State-local revenue sharing can be defined as money given to localities…to be spent on purposes determined by the localities themselves. The amount and method of allocating aid is determined by the state legislature… This definition of state-local revenue sharing excludes categorical aids to all local governments and most payments to school districts and special districts since such districts generally must spend all aid in their particular functional area. The definition of state-local sharing also excludes piggyback taxes where there is a local option to tax or to determine the local tax rate." A Congressional Research Service study defines general revenue sharing simply as "General revenue that can be used for any purpose not expressly prohibited by federal or state law and is not

[5] ACIR, 1980, p. 2.

limited to narrowly defined activities."[6]

State revenue-sharing programs vary widely across the country. They can differ in which revenue streams are shared and how they are distributed. Some are more complicated than others. In sum, there is not one single model that describes all of them.

For example, South Carolina distributes money from a broad based fund, the State's general fund. Since 1991, South Carolina law, entitled *State Aid to Subdivisions Act,* has set the amount to be given to local governments (the Local Government Fund) at 4.5% of the State's last completed fiscal year's general fund. Amounts received by county and municipal governments depend solely on their population.

In Michigan, the State shares a portion of its 4% state sales tax with local governments. Since 1947, the Michigan Constitution requires the state to share sales tax revenues with the state's local governments. Michigan's unusual revenue sharing program is composed of two parts, one established by the State Constitution and the other by statute. An amendment to the Constitution in 1963 apportions 15% of the gross collections from the 4% state sales tax to be distributed to local governments on a per capita basis. The statutory portion apportions 21.3% of the 4% state sales tax to local governments. Exactly how the allocation percentages in South Carolina and in Michigan were determined is a mystery.

Hawaii's state government currently shares revenues from a tax with an even narrower base than the general sales tax --the transient accommodation tax.

III. Brief Profile of Hawaii's State and County Governments and Revenue Sharing

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[6] Dilger, 2015, p. 2.

In 2012 there were over 38,900 general-purpose local governments in the U.S.; they include 3,031 counties, 19,522 municipalities, and 16,369 townships. Hawaii, by contrast, has a very simple government structure. Government in Hawaii is highly centralized with the state government being the dominant player. Local governments in Hawaii comprise essentially of four county governments: Hawaii County, Maui County, Kauai County, and the City and County of Honolulu. Hawaii State Constitution assigns responsibility for a number of important service functions to the state government that elsewhere is assigned to local governments. The most notable such service responsibility is K-12 public education.

Counties in Hawaii also have less revenue raising authority than local governments do in most states.[7] The U.S. Advisory Commission on Intergovernmental Relations (ACIR) observed in 1989, "Consequently, [Hawaii's] counties are limited in their ability to initiate new functions."[8] Hawaii's state government guards its taxing power jealously. Hawaii has 17 separate tax laws of which 14 are administered by the State; the counties administer only the local property tax, the motor vehicle weight tax, and the public utility franchise tax.[9] Counties in Hawaii were not even authorized to set their own property tax rates until 1989. As seen in Table 1, in fiscal year (FY) 2013 the state government in Hawaii accounted for over three-fourth of state and local government

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[7] ACIR, 1989, p. 153; see also Pratt and Smith, 2000, Chapter 10.
[8] ACIR, 1989, p. 153. [ ] added by the author.
[9] Mak, 2008, p. 80.

revenues and direct expenditures; the comparable percentages are significantly lower for all state governments in the U.S.[10]

Table 1

State Government's Share in State and Local Finance in Hawaii and the U.S.: FY2013

	Hawaii	U.S
State Gov't Share of State-Local General Revenues	77.9%	62.7%
State Gov't Share of State-Local Own Source Revenues	76.0	55.0
State Gov't Share of State-Local Taxes	75.8	58.2
State Gov't Share of State-Local Direct Expenditures	77.2	47.4
State Gov't Share of State-Local Current Operating Expenditures	79.0	43.2

Source: U.S. Census Bureau, *Survey of State and Local Government Finances, 2013* at http://www.census.gov/govs/local/

Because of Hawaii's extremely centralized fiscal structure, Hawaii's state government has had a lengthy history of sharing its revenues with the counties. Between 1947 and 1965 portions from the yield of the general excise tax (GET) (and the modest public company service tax) were distributed to the counties by formula.[11] According to Lowell Kalapa of the Tax Foundation of Hawaii, for many years Hawaii's counties received about 40% of the GET revenues.[12] Of the amounts distributed, Honolulu received 55%; Hawaii County, 20%; Maui County, 15%; and Kauai County 10%.[13] Beginning in 1965, GET revenue sharing was replaced by a system of grant-in-aid (Act 155, SLH 1965). Distribution of Act 155 aid money was based on how much effort each

[10] The ACIR estimated that in FY 1987 the Hawaii State Government received 82 percent of total State and county own-source revenues while the counties received the remaining 18 percent. ACIR, 1989, p. 154.
[11] ACIR, 1989, p. 149. See also Pratt and Smith, 2000, Chapter 10.
[12] Kalapa, 1992, p. 42. GET revenues increased from $17.8 million in FY 1949 to $54 million in FY 1965. Schmitt, 1977, p. 637.
[13] ACIR, 1989, p. 154.

county made to raise property tax revenues.[14] A parade of county mayors to the Legislature to lobby for more state aid is held every year. Grant-in-aid to the counties increased annually from $9.363 million in FY 1966 to a peak of $19.5 million by FY 1972.[15] The counties could spend the money any way they wished.

In October 1972 the Federal Government (under Republican President Richard Nixon) initiated a program of General Revenue Sharing (GRS) with state and county governments in the U.S. The program was terminated during the presidency of Ronald Reagan in October 1986. In Hawaii 69.1% of the GRS local government money was distributed to the City and County of Honolulu, 9.9% to Maui County, 14.9% to Hawaii County, and 6.1% to Kauai County.[16] In order to receive revenue from the program, a state government "must maintain the amount of aid to local units at a level not less than the amount of aid given by the state in fiscal year 1972…"[17] If Hawaii's state government could not reduce aid to the counties without losing federal general revenue sharing money, it was not obliged to increase it either. And it did not.[18] Act 155 grant-in-aid was terminated around the time the Federal GRS ended.

In 1986, the Hawaii Legislature enacted legislation (Act 340) to tax occupancy of transient accommodations beginning January 1, 1987. The tax rate was set at 5%.[19] In FY 1987 (January 1 to June 30, 1987 only), the Department of Taxation (DOTAX) collected $23.5 million from the TAT; for the first full fiscal year in 1988, DOTAX

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[14] Kalapa, 2013.
[15] Schmitt, 1977, p. 154.
[16] ACIR, 1989, p. 151.
[17] ACIR, 1974, p. 2. Over this period, the Federal Government distributed about $83 billion to state and local governments. General revenue sharing with state governments ended in 1981.
[18] Kalapa, 1992, p. 49.
[19] This was in addition to the 4% general excise tax (GET).

collected $67.3 million. Initially, money collected from the TAT was not allocated to the counties directly as a replacement for Act 155 fiscal aid but was allocated, instead, to the State's General Fund. Pursuant to Act 345 (SLH 1986), the State distributed aid money to the counties for "infrastructure/or tourism related activities." The State distributed $12 million to the counties in FY 1987; the amount was raised to $20 million in FY 1989.[20]

An ACIR report written for the 1988 Hawaii Tax Review Commission recommended that the TAT be transferred from the State to the county governments "based on the proposition that its incidence is, more than any other revenue source in Hawaii's fiscal system, on the visitor. If the benefit principle is to be accorded high priority in tax policy, the TAT is especially well suited for financing public services from which visitors are beneficiaries."[21] The ACIR estimated that "approximately 53% of all outlays for services from which visitors directly benefit are made by the counties…By comparison the major services for which the State is responsible provide nearly all their benefits to residents of Hawaii. Services directly benefiting visitors amount to less than 14% of State spending."[22] However, ACIR concluded, "The major issues are whether the additional revenue loss to the State budget would be judged reasonable in light of competing claims, and whether the counties could sustain the necessary case that their outlays for services benefiting visitors are sufficient to justify the additional tax."[23] ACIR's recommendation came at a time when the State had a structural surplus.[24]

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[20] ACIR, 1989, p. 154.
[21] ACIR, 1989, p. 148.
[22] ACIR, 1989, p. 149.
[23] ACIR, 1989, p. 302.
[24] ACIR, 1989, p. 139.

The State Legislature did not act on ACIR's recommendation. The visitor industry—then and now—opposed the transfer fearing that granting the counties independent revenue setting authority would result in unequal TAT tax rates and confusion.[25] Since 1990 the counties have received some portion of the TAT revenues each year as general revenue sharing. The Conference Committee Report on the bill that introduced the county allocations noted that both houses of the Legislature also considered other taxes as potential candidates for revenue-sharing, including a portion of the public service company tax, animal fines, and unadjudicated traffic and parking fines and forfeitures to the counties, but the Conference Committee argued that "administrative costs and burdens of distributing revenues from several smaller sources will be considerably greater than the costs of distributing from one large source."[26]

IV. History of the TAT in Hawaii

The hotel room tax is the most widely employed tourist tax in the world. In the U.S the hotel room tax—separate from local sales taxes levied on tourist lodgings—is levied by both state and local governments, but most frequently at the local government level. Only five states, including Hawaii, do not allow local/municipal governments to levy a separate lodging tax. The other four states, besides Hawaii, are New Hampshire, Maine, Connecticut and Delaware,[27] and only New Hampshire and Maine, among these

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[25] A memo from member Ray Soon to the chair of the WG (dated May 29, 2015, p. 2) summarized the advantages and disadvantages of granting the counties the authority to levy their own TAT as follows: The primary strengths of the approach are that it fosters a greater sense of "home rule" and that it removes the annual petitioning by the Counties to the Legislature. The primary weaknesses are that the industry will have five legislative bodies with which to deal on TAT matters and the tax can be applied inconsistently, leading to confusion."
[26] The Department of Taxation Presentation to the WG handouts—April 1, 2015.
[27] Michel, 2012.

four states, share their lodging tax revenues with local governments to support the provision of general government services.

Although the TAT in Hawaii is imposed on the gross rental receipts of lodging suppliers (e.g. hoteliers), it is essentially passed on to consumers; thus it is a consumption tax. Since most of the consumers are non-resident visitors, the burden of Hawaii's TAT is largely exported. Research by several University of Hawaii economics professors found that Hawaii's 5% TAT of 1987 did *not* have a statistically significant negative revenue impact on lodging suppliers.[28] Since 1987 the tax rate has been raised several times to the current rate of 9.25%. Table 2 displays TAT rate changes and the corresponding effective dates since its inception:

Table 2

TAT Rate Changes and Effective Dates, 1987-Current

Effect Date	Rate
January 1, 1987	5.0%
July 1, 1994	6.0%
January 1, 1999	7.25%
July 1, 2009	8.25%
July 1, 2010	9.25%

Source: The Auditor, State of Hawaii, 2015, Exhibit 1-1, p. 1-3.

Hawaii was a latecomer in taxing hotel room rentals due to vigorous opposition from the visitor industry and powerful politicians. In time, the majority members of the Honolulu Chamber of Commerce came to support a tax on transient accommodation

[28] Bonham et al., 1992.

rentals because the visitor industry wanted to have a dedicated source of funding for generic tourism promotion, and later, a world-class convention center. In Hawaii, money to fund the Hawaii Visitors Bureau (HVB)—a private organization--for tourism promotion was raised through private membership subscriptions and State appropriation. Soliciting private money was difficult work and did not produce the desired results. Over time, the State's share of HVB's budget grew.[29] The industry simply could not raise enough money on its own to support HVB. While many wanted to see more money spent on tourism promotion, there were not enough of them who were willing to dip into their own pockets to pay for it. The incentive is to let someone else contribute and the non-contributor still benefits as a free-rider. It is a classic example of "market failure". The only way to overcome free-riding is to tax the industry and use the revenue to pay for the desired expenditures. It is one instance where the government can do something good for the industry that the industry cannot do for itself and with better outcomes for both the industry and the community.

There was also the matter of finding money for the still-to-be-built $350 million Hawaii Convention Center. The Hawaii Visitors Bureau was interested in attracting conventions to Hawaii as early as the 1960s but Honolulu did not have a convention center to host large meetings. The City and County of Honolulu had neither the authority to levy a hotel room tax nor an excise tax that could have funded a county facility; the State was in a better financial position to complete the task.

However, when Hawaii's statewide transient accommodation tax was first imposed in 1987, State lawmakers did not dedicate revenues from the 5% TAT to Hawaii

[29] Bonham and Mak, 1996; and Mak and Miklius, 1993.

Visitors Bureau, a private entity.[30] The Hawaii Convention Center—a state-owned facility—was still not close to being built in 1987; it would be completed 10 years later in October 1997. In 1990, the Legislature decided to allocate 95% of the revenues from the TAT to the counties, retaining the remaining 5% to defray "TAT-related administrative purposes". The counties received the following shares: 44.1% to the City and County of Honolulu, 22.8% to Maui County, 18.6% to Hawaii County, and 14.5% to Kauai County. How these shares—which remained unchanged to this day-- were determined was never explained.

As the convention center approached completion, there was no more money to pay for it unless the Legislature took back the TAT revenues from the counties. Instead, the Legislature raised the 5% TAT rate to 6% in 1994 to gain a head start in raising revenue for the convention center, and raised it again to 7.25% in 1999. Timeshare units that were rented were now subject to the TAT. TAT money was now divided into 3 pools. The Convention Center Capital Special Fund received 17.3% of the proceeds, the Tourism Special Fund (for marketing) received 37.9%, and the counties received the remaining 44.8%. Since then, general (macro-) economic conditions in the State dictated how the State distributed the TAT revenues. The State Legislature was more generous to the counties in good times; in bad times, the State diverted some of the TAT money for itself.

In recent years, capping existing distributions and diverting any excess revenues to the State's General Fund was one way the State dipped into the TAT revenue pool.

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[30] Act 156 signed into law by Governor Ben Cayetano on July 9, 1998, established the Hawaii Tourism Authority (HTA) to oversee tourism marketing. Thereafter, money for tourism marketing was appropriated to HTA, and HTA contracted with Hawaii Convention and Visitors Bureau (and others) to market tourism in specific markets.

Another measure taken to bolster the State's treasury during the Great Recession was to raise the lodging tax rate and allocate the additional money generated to the State's General Fund. The TAT tax rate was raised to 8.25% effective July 1, 2009 and to 9.25% in 2010 (to sunset in 2015 but in 2013 the Legislature made it permanent). The new law allocated $93 million to the counties instead of 44.8% of TAT revenues; the Convention Center Enterprise Special Fund received $33 million instead of 17.3%, and the Tourism Special Fund received $82 million instead of 34.2%.[31] The State kept what was left for itself. In a Conference Committee Report, the Legislature explained that it was part of a package of measures intended to increase and preserve State revenues derived from the TAT because of the State's extended economic crisis during and right after the Great Recession.[32]

Act 174 (H.B. No. 1671) enacted in 2013 to take effect on July 1, 2014 allocated $103 million to the counties in FY 2014-15, the same amount in FY 2015-16, and (back down to) $93 million for each fiscal year thereafter. The City and County of Honolulu would receive 44.1%; Maui County, 22.8%; Hawaii County, 18.6%; and Kauai County, 14.5%, the same shares as in 1990.[33] The county variables that appear to be most closely correlated with the current distribution of the TAT among the four counties are the visitor

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[31] See State-County WG (TAT) Interim Report DRAFT 11/28/2014, p. 11.

[32] See State-County WG (TAT) Interim Report DRAFT 11/28/2014, p. 9.

[33] Twenty-Seventh State Legislature, Second Special Session of 2013. *Act 174,* p. 613. The county variables that appear to be most closely correlated with the current distribution of the TAT among the four counties are the visitor daily census and the visitor plant inventory which are good proxy variables for public service needs of visitors. Members of the Working Group did not recommend a change to the distribution among the counties.

daily census and the visitor plant inventory which are good proxy variables for public service needs of visitors.

With all the rate changes, nominal TAT revenues collected by the State increased by more than six-fold, from $67.3 million in FY1988 to $421 million in FY2015.[34] During those 28 years, and through some trying times, collections declined in only four of those years, 1991, 1994, 2002, and 2009. The largest percentage decline in a single year was in FY2002 at 11.1%, followed by FY2009 at 8.2%.

Adjusted for inflation, TAT collections increased by 2.7 fold from $99.6 million to $270.7 million in (constant) year 2000 dollars.[35] Inflation-adjusted (real) TAT revenues declined during 7 fiscal years, 1991, 1993-1994, 2002, and 2007-2009. The increase in TAT revenues was in part fueled by several tax rate increases. A useful metric, which largely neutralizes the effects of tax rate increases, is the implied tax base that measures the lodging industry's taxable gross income.[36] It provides some indication of the financial health of the lodging industry.

Table 3 displays TAT collections and the associated tax bases in both nominal and constant (year 2000) dollars for FY2000 to FY 2015. FY2000 was chosen as the starting point because the State claimed almost none of the TAT revenues for its General Fund in that year.

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[34] Department of Taxation Presentation handout, April 1, 2015.
[35] I used the Honolulu CPI-U as the deflator. Since TAT revenue data are for fiscal years, I converted the annual CPI-U to a fiscal year basis. For example, for FY1987, I averaged the first half CPI-U for 1987 and the second half CPI-U for 1986, and so on. CPI-U data came from the 2014 State of Hawaii *Data Book*.
[36] This is done by dividing the annual TAT revenues by the applicable tax rate. Tax Revenue=Tax Base x Tax Rate.

Table 3

Nominal and Real TAT Revenues and Bases, FY2000-FY2015
(Millions of $)

Fiscal	TAT Collections		Implied Tax Base	
Year	Nominal	Real	Nominal	Real
2000	$168.6	$168.6	$2,326	$2,326
2001	177.2	174.8	2,444	2,410
2002	157.6	153.6	2,174	2,119
2003	170.9	164.5	2,357	2,269
2004	181.9	176.4	2,509	2,434
2005	198.8	192.6	2,742	2,657
2006	217.0	194.4	2,993	2,571
2007	224.9	183.4	3,102	2,530
2008	229.4	178.4	3,164	2,460
2009	210.6	160.6	2,714	2,070
2010	224.3	167.0	2,563	1,908
2011	284.5	204.2	3,076	2,208
2012	323.9	229.4	3,502	2,480
2013	368.6	253.9	3,985	2,744
2014	395.2	270.7	4,272	2,926
2015	421.0	284.8	4,551	3,079

Note: "Real" is measured in year 2000 dollars.
Source: Department of Taxation (DOTAX) and author's calculations.

Table 3 shows that Hawaii now collects about $421 million in TAT revenues from taxable lodging industry room revenues of nearly $4.6 billion. The lodging industry faced tough times during the second half of the 2000-decade as real TAT tax base declined every year between 2005 and 2010; the decline began even before the start of the latest financial crisis and Great Recession. Lower demand for lodging led to higher tax rates on lodging. Hawaii was not alone in raising taxes on tourism to balance government budgets during the Great Recession.[37]

V Allocating TAT Revenues Between the State and the Counties

[37] Cauchon, 2009.

Table 4 shows the amount of TAT revenues divided among four pools: the counties, the convention center, tourism, and the State's General (G-) Fund between FY2000 and FY2015. The numbers in (   ) are the percentages of allocated money in each pool, which add up to 100%. The current process of allocating TAT money to the four pools is best described in Act 174 as follows: The State Legislature first appropriates money to the counties, the convention center, and tourism; what is left is distributed to the General Fund. The amounts allocated to the counties, the convention center and tourism for the next few fiscal years are known in advance, but not the amounts going into the G-Fund.

Table 4

Distribution of TAT Revenues: FY2000-FY2017

(Millions of current dollars)

Fiscal Year	Counties	Convention Center	Tourism	G-Fund	Total
2000	$75.4	$29.2	$63.9	$ .2	$168.6
	(44.7%)	(17.0%)	(21.3%)	(0.1%)	(100%)
2001	$79.4	0	$67.1	$30.7	$177.2
	(44.8)	(0)	(37.9)	(17.3)	(100)
2002	$70.6	0	$59.7	$27.3	$157.6
	(44.8)	(0)	(37.9)	(17.3)	(100)
2003	$76.5	$29.6	$63.3	$1.5	$170.9
	(44.8)	(17.3)	(37.0)	(0.9)	(100)
2004	$81.4	$31.5	$63.3	$5.6	$181.9
	(44.8)	(17.3)	(34.8)	(3.1)	(100)
2005	$89.1	$32.5	$64.8	$12.4	$198.8
	(44.8)	(16.4)	(32.6)	(6.2)	(100)
2006	$97.2	$32.7	$70.7	$16.4	$217.0
	(44.8)	(15.1)	(32.6)	(7.6)	(100)
2007	$100.8	$33.8	$73.3	$17.1	$224.9
	(44.8)	(15.0)	(32.6)	(7.6)	(100)
2008	$102.8	$32.5	$78.2	$15.9	$229.4
	(44.8)	(14.1)	(34.1)	(7.0)	(100)
2009	$94.4	$30.7	$72.0	$13.6	$210.6
	(44.8)	(14.6)	(34.2)	(6.4)	(100)
2010	$90.6	$32.8	$69.1	$31.7	$224.3
	(40.4)	(14.6)	(30.8)	(14.1)	(100)
2011	$102.9	$36.8	$85.0	$59.8	$284.5
	(36.2)	(12.9)	(29.9)	(21.0)	(100)
2012	$93.0	$35.6	$69.0	$126.3	$323.9
	(28.7)	(11.0)	(21.3)	(39.0)	(100)
2013	$93.0	$33.0	$71.0	$171.6	$368.6
	(25.2)	(9.0)	(19.3)	(46.6)	(100)
2014	$93.0	$33.0	$82.0	$187.2	$395.2
	(23.5)	(8.4)	(20.7)	(47.4)	(100)
2015	$103.0	$33.0	$82.0	$203.0	$421.0
	(24.5)	(7.8)	(19.5)	(48.2)	(100)
2016	$103.0	$33.0	$82.0		
2017	$93.0	$33.0	$82.0		

Note: The numbers in ( ) represent % of the total TAT revenues in that year.
Sources: Department of Taxation (DOTAX) and Act 174.

Table 4 shows that from virtually nothing in FY2000, the State now controls almost 50 percent—indeed, the largest pool--of total TAT revenues. By comparison, the counties' share of total TAT revenues has declined from 44.7% in FY2000 to less than 25% (24.5%) in FY2015. If the State's current allocation policy remains unchanged, and total TAT collections continue to rise, the gap between the counties' and the State's shares will widen further. Over time, the purpose of taxing hotel room rentals in Hawaii has clearly changed from addressing tourism's market failures increasingly to extracting economic rent from tourism by the State government.

For the counties, *nominal* TAT revenues climbed steadily between FY2000 and FY2015, except in 2002 and in 2009. In FY2015, the counties received nearly $28 million more than they did in FY2000, but not in *constant* dollars.

Table 5

County TAT Revenues in Constant (Year 2000) Dollars: FY2000-FY2015

(Millions of $)

Year	Amount	Year	Amount
2000	$75.4	2008	$79.9
2001	78.3	2009	72.0
2002	68.8	2010	67.5
2003	73.6	2011	73.9
2004	79.0	2012	65.9
2005	86.3	2013	64.0
2006	83.5	2014	63.7
2007	82.2	2015	69.7

Source: Author's calculations. The deflator is Honolulu CPI-U.

Table 5 shows long-run erosion in the purchasing power of TAT revenues received by the counties.

VI. State and County Provision of Public Services

The language of Act 174 is unclear about whether the Legislature meant only tourism-related public services or all public services used by both tourists and residents. Working Group Chair Simeon Acoba, a retired Hawaii Supreme Court Associate Justice, observed "[The statute] makes no connection to tourism and this affirms that they [the State and the counties] both have different functions but share certain functions."[38] He opined that it is a broader mandate than just looking at the effect of tourism on the State and the counties.[39] Ultimately, the members of the Working Group decided that government spending on tourism should be the determining factor in the allocation of TAT revenues even though TAT revenues allocated to the counties have always been used for general government purposes. One interpretation of this decision is that the government that spends more on tourism deserves to be rewarded with a larger share of the TAT revenues (regardless of how the money received is subsequently spent). The decision would also give the counties a greater share of TAT revenues than the current distribution.

Given the severe time constraint to carry out its assignment, the Working Group made a valiant attempt at ascertaining State and county annual *operating* expenses attributable to the provision of tourism-related public services using expenditure data from their respective *Comprehensive Annual Financial Report* (CAFR) for FY2014.[40] Separating government spending on tourism from total spending was not an easy task since data do not exist on visitor (versus resident) usage of public services. It was further

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[38] Minutes of the June 3, 2015 meeting at page 8. The words in [ ] were added by this author.
[39] http://files.hawaii.gov/auditor/agendas/TATApprovedMinutes11-05-14.pdf
[40] See, for example, the CAFR for the State at http://ags.hawaii.gov/accounting/annual-financial-reports/

complicated by the fact that the State and county governments provide different types of services. Hawaii's counties supply police protection, lifeguards, park and beach management, traffic management, etc. that are consumed directly by visitors. The State, by contrast, provides public services many of them benefit tourists only indirectly; these include education, health and welfare. If there were no tourism, how much less State and local government spending would there be? The WG established separate investigative groups (IGs)—each comprising of five to six WG members--to look into the matter.[41]

Briefly, the members of the county investigative group took each expense item in the CAFR and first determined the degree of nexus between tourism and the expenditure item.[42] Numerical weights of 1.00, .50, .25 and .00 were assigned depending on whether the nexus was determined to be "high", "moderate", "low", or "none".[43] The same function in two counties may be assigned different weights. The weights were then multiplied by the ratio of (full-year equivalent) tourist population to the sum of tourist and resident population in each jurisdiction to determine the impact of visitors on total government operating expenditures. For example, for Maui County, the impact of visitors on total county expenditures for an expenditure item that has a "low" nexus to tourism is calculated by multiplying .25 (its numerical weight) by the tourists' share of

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[41] These were (1) County Duties and Responsibilities Investigative Group; (2) State Duties and Responsibilities Investigative Groups; and (3) Visitor Industry Investigative Group. The Visitor Industry Investigative Group's responsibility was to identify visitor-related needs for State and county services.

[42] For extended discussion on the methodology, see the minutes of the WG meeting on June 3, 2015. The investigative groups focused on gross expenditures rather than net expenditures; the latter net out revenues generated from user charges and grants.

[43] Member Ray Soon reportedly said "…when the WG went through the CAFR analysis and they decided on the nexus, they were all frustrated…that they didn't have enough information to do this really well." Hence they were "accepting the findings more as a guide than as precise percentages." Minutes of the October 7, 2015 Meeting on page 3.

Maui County's tourist plus resident population (.2528) = .0632. Thus, 6.32% of Maui County's total government operating expenditures in that category was attributable to visitors.[44] Maui County spent $40,000 on the Festivals of Aloha, which was determined to have a high nexus to tourism; the amount attributed to visitors was $40,000 x 1.0 x .2528= $10,112. Of the $75,342 spent on Film Industry Promotion (moderate nexus) the visitors' share was $9,523. None of the $121,475 spent on Agriculture Promotion was attributed to visitors. The results for all four counties for FY2014 are displayed in Table 6.

Table 6

Impact of Visitors on County Government Operating Expenditures: FY2014

	Honolulu	Maui	Hawaii	Kauai	All Counties
County Spending on Visitors (in millions of $)	$115.7	$59.2	$30.9	$30.1	$235.9
Visitors as % of Resident + Visitor Population	8.90%	25.28%	13.29%	25.13%	12.63%
Expenditures on Visitors as % of Total Expenditures	5.77%	10.62%	7.99%	19.06%	7.59%

Source: The Auditor, State of Hawaii, 2015, Appendix C.

Table 6 shows that in FY2014, the four counties together spent $235.9 million in operating expenditures on visitors. This amount represented 7.59% of total operating expenditures by the four counties (combined). In every county, visitors' share of county government spending was less than its share of total resident + tourist population. This implies that, on average, a visitor has a lesser impact on local government spending than a resident. For example, for the City and County of Honolulu, public service costs attributable to visitors averaged $1,205 per (full-year equivalent) visitor compared to

[44] Assignments by individual expenditure items for Maui can be seen at http://files.hawaii.gov/auditor/agendas/TATHandout5-6-15.pdf

$1,921 per resident in FY2014. For Hawaii County, per capita government expenditures were $1,056 for visitors and $1,862 for residents. For Kauai County, the local government spent $1,289 per visitors versus $1,837 for residents. Maui County is the obvious outlier. For Maui, per capita government expenditures were $1,091 for visitors and a startling $3,106 for residents.[45] These results are surprising since a massive 2005 study on sustainable tourism development in Hawaii determined that "When considering infrastructure use on a per person, per day basis, the visitor impacts are significantly higher than that of the typical resident."[46]

The same methodology was employed to assign State spending[47] except that the members of the State Duties and Responsibilities Investigative Group tried to identify "CAFR expenses which had a relationship to tourism, either direct or indirect. Those with an indirect relationship were functions which provided crucial support services to those functions that were directly related to tourism."[48] According to the State investigative group, Hawaii's state government spent $453.2 million in operating expenditures directly and indirectly on visitors in FY2014, representing 4.4 percent of total State government (gross) operating expenditures of $10.3 billion in that year.[49]

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[45] Per capita spending (full-year equivalent visitors and residents combined) on Maui was $2,591 compared to $1,858 for Honolulu, $1,757 for Hawaii County, and $1,698 for Kauai.

[46] R.M. Towill Corporation, October 20, 2005, p. 7 at http://files.hawaii.gov/dbedt/visitor/sustainable-tourism-project/drafts/Modeling-Report-Summary.pdf

[47] However, the counties used a more detailed level of expenditures than the State. See minutes of the June 3, 2015 WG meeting at page 8.

[48] http://files.hawaii.gov/auditor/agendas/TATHandout6-3-15.pdf

[49] The Auditor, State of Hawaii, 2015, Appendix D. Additional information and Working Group discussion can be found in the April 1, May 6, and June 3, 2015 meeting minutes posted at http://auditor.hawaii.gov/task-forceworking-group/.

Combining the State and county estimates, the State's share of total state and county expenditures on tourism was 66% and the counties' share was 34%.

The members of the investigative groups acknowledged that their cost estimates are crude. A memo from the chair of one investigative group to the Chair of the Working Group acknowledged that "The exercise that we just completed is characterized by gross estimates, which, if they are truly to determine the proportions, demand more precision than we can given them in the remaining time we have available."[50] But there was also another problem.

The procedure employed by the investigative groups to estimate tourism's incremental public costs is flawed. To illustrate, in FY2014, Maui County spent $3,577,230 to fund the Maui Visitors Bureau (an expenditure with high nexus to tourism). Using the investigative groups' cost assignment procedure, the visitors' share of the cost of the Maui Visitors Bureau would have been $3,577,230 x 1.0 x .2528=$904,324. The burden of the remaining $2,6732,906 fell on local residents. The result is obviously nonsense. The county investigative group "solved" the problem by creating a separate category ("All") for the Maui Visitors Bureau to assign all $3,577,230 spent on the Bureau to visitors. Technically, this is equivalent to skipping the second multiplication; i.e. multiplying the $3,577,230 by the tourist population ratio of .2528. The investigative group should have done the same for all other expenditure categories. Otherwise, expenditures which visitor impacts have been reduced once by a low nexus rating to tourism (i.e., 25%) will have their impacts reduced again by Maui's tourist population ratio. Under the existing procedure, 75% of $1,000,000 spent on a program

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[50] Dated May 29, 2015.

with high nexus to tourism in Maui County is allocated to residents; 87%, if the nexus is rated "moderate", and 94%, if the nexus is rated "low". In sum, the Working Group's estimates of government expenditures on tourism are too low.

VII. Dividing TAT Revenues Between the State and the Counties: Preliminary Model Within a Static Framework

"Fairness" was a recurring theme in WG meetings. Maui County Council Chairperson, Mike White, testified before the August 5, 2015 WG meeting that TAT revenues should, at a minimum, be divided evenly between the State and the counties.[51] He said, "With the State receiving 23 times more than in 2007 and the counties getting an increase of just 2.2 percent, it is only fair and appropriate for more parity and balance in the TAT distribution."[52] Hawaii County Council member Margaret Wille also argued for a 50-50 split.[53] By comparison, the simplest share model in which TAT revenues are divided strictly on their relative *total* expenditure responsibilities would allocate nearly 80 percent of the TAT revenues to the State (see Table 1). The State's share should be greater than its current share.

Another investigative group, the Allocation Models Investigative Group (AMIG), offered a three-stage allocation model to the WG for consideration.[54] It is useful to study this model in some detail as it helps to understand the Working Group's recommendation to the Legislature.

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[51] Mike White, *Meeting of August 5, 2015: Testimony on Allocation of Transient Accommodations Tax Revenues.* He testified on his own behalf.
[52] Mike White August 5, 2015 testimony before the WG, p. 4.
[53] Margaret Wille, Hawaii County Council, *Allocation of the Transient Accommodation Tax (TAT) Revenues. Testimony before the Working Group on October 21, 2015.*
[54] Memo to Chair Acoba, State-County Functions Working Group (TAT) from Ray Soon, Members of the Allocation Models Investigative Group, "Report on our Progress to Date," dated May 29, 2015, p. 3 (WG handout on 6-3-2015)

In the first stage (Stage I), AMIG suggested that marketing dollars allocated to the Hawaii Tourism Authority (HTA) should first be subtracted from total TAT collections. Then, in the second stage (Stage II), take 90% of the balance and allocate 60% to the State and 40% to the counties.[55] To protect each side in an economic recession, the floor amount should be set at no less than $100 million *each*. "This would give the Counties the opportunity to enjoy any upside, with some certainty that the downside will be limited and certain."[56] The State would be responsible for expenses related to the convention center and all other current State spending commitments. The latter presently include $1.5 million per year to settle a conservation agreement with Turtle Bay Resort on Oahu to prevent Turtle Bay from over-development,[57] and $3 million per year to the Special Land and Development Fund to be administered by the Department of Land and Natural Resources (DLNR) to protect, preserve, maintain, and enhance Hawaii's natural resources.

Why is funding for the Hawaii Convention Center not accorded the same priority treatment as tourism marketing? Finding money to pay for the convention center was the other principal reason for levying the TAT, or at least, raising the tax rate. Thus, either both are placed in Stage I before the 60-40 split or both are placed after the 60-40 split in Stage II.

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[55] The 60-40 split is very roughly based on the ratio of the counties' operating expenditures on tourism ($235.9 million and 34%) and the State's operating expenditures on tourism ($453 million and 66%) as estimated by the state and county investigative groups.

[56] Page 3 of the AMIG memorandum. If was unclear how this constraint would be satisfied if there were insufficient revenues to meet all claims. One assumption was that "the State and county shares would drop together." Minutes of the July 1 WG meeting at page. 8.

[57] Viotti, 2015, pp. A14-A15.

Moving the expense of the convention center (or any other Legislature-mandated expenditure claiming TAT revenues) above the 60-40 split amounts to imposing cost sharing on the counties to the extent that the residual sum available for sharing will now be reduced by the same amount. To illustrate: If AMIG's allocation model were implemented during FY2014, the counties would have received nearly $112.75 million. If the convention center allocation ($33 million per year) is moved above the 60-40 split *and* the 60-40 percentage shares are then applied to 90 percent of the remainder, the counties would have received $100.87 million. By comparison, the State would have received $151.33 million compared to $169.13 million previously; however, the $33 million for the convention center no longer has to be subtracted from the $151.33 million State's share. The counties lose while the State gains. For the counties to retain the same $112.75 million as before, the counties' share would have to be raised to 44.7% from 40%. In a memorandum to the Working Group, AMIG noted, "The closest we came to agreement was that 1) HTA expenses benefitted all Counties and the State as a whole and therefore should be covered by everyone, 2) the Convention Center expenses did not directly benefit the Neighbor Islands and they should not be required to pay for it, and 3) the DLNR set asides were State expenses and should come from that pot."[58]

Finally, in Stage III, AMIG proposed to set aside 10 percent of the TAT revenues, after the 60-40 split, for "Legislative discretion, with the recommendation that it is spent on visitor related expenditures. This reflects the political reality the problems that cannot be anticipated arise and that the Legislature will go to the TAT to help solve those problems." The 10 percent earmark for the Legislature would have amounted to

[58] From page 2 of the AMIG memorandum.

$31.3 million in FY2014. That is just another bundle of money in the State's pot. While it may have been well intentioned--as members of the Working Group expressed general agreement with the notion that tourism generated tax revenues should be used to support tourism--what it conjures up instead is an image of a fund with unspecified expenditures that is open to political abuse.[59]

If AMIG's three-stage allocation model were in place in FY2014, the counties would have received $112.75 million or 28.5 % of total TAT collections instead of the $93 million or 23.5% the counties actually received.

AMIG acknowledges, "The primary weakness of this model lies in the allocation of the 60-40 State and County…Our feeling was that it was fair, but it probably requires more discipline and precision to be defensible, and we would leave that calculation to the consultants."[60] Belt Collins Hawaii (BCH) took up the assignment using the same CAFR data.

BCH added a new twist by examining "net"—instead of "gross"—expenditures; i.e. expenditures "net of program revenues." The net expenditure approach is superior because TAT revenues are needed to cover only those costs that are not covered by a program's own source revenues from user charges, fees, etc. BCH explained, "Now, this way of filtering the data relies on broad functional categories. The new analyses are not fine-grain ones. But they do help to take into account the fact that many government functions do generate revenues, and this is especially true for some State functions, such as Airports and Harbors, that are clearly important for the well-being of the visitor

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[59] Minutes of the September 16, 2015 WG meeting. A "sandbox" as described in one WG meeting. One suggestion was to put the cost of the convention center and, perhaps, other current fixed obligations, in the sandbox.
[60] Page 3 of the AMIG memorandum.

industry." BCH concluded, "Taking the net analyses into account, we respectfully disagree with the Allocation Models Investigative Group. We find a 55-45 split between the State and counties to fit the expenditure data better than a 60-40 split."[61] However, the two sets of percentages are not strictly comparable since the 60-40 split is derived from data on gross government expenditures while the 55-45 split is derived from data on net government expenditures. Of the four net expenditure shares computed by BCH, the one that comes closest to the 55-45 split is 52% for the State and 48% for the counties.[62] Since BCH did not include the $94 million the State spent on the Hawaii Tourism Authority in its calculation, the State's cost share is underestimated. Following extensive discussions and compromise, members of the Working Group approved the use of the 55-45 split.

VIII. WG Recommended Model Within a Dynamic Framework

The Working Group's recommendation to the Legislature is a modified version of the initial AMIG three-stage allocation model, except there are now only two stages.[63] Stage III—the 10% Legislature discretionary fund—was wisely discarded.

The original three-stage model was cast within a static framework; a dynamic model, incorporating "time", had to be substituted. Likely outcomes were projected into

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[61] BCH Team Presentation to TAT Working Group, 10/7/15—Draft.

[62] Office of the State Auditor, 2015, Appendix G, Exhibit 1; Mak, 2016, Appendix. The other three net expenditure calculations produced State expenditure shares of 83%, 81%, and 46%. Office of the State Auditor, 2015, Exhibit 2-12.

[63] Eight other models were considered. See Office of the State Auditor, 2015, Chapter 3 and Appendix I. There was initial skepticism that every member could agree on a final model, and some reserved the right to submit minority reports; the final vote to approve the recommended model was unanimous among those present.

the future between FY2017 and FY2025. It would have been too late for the Legislature to impose a start date to implement any new legislation before the beginning of FY2017.

In Stage I, WG decided that tourism marketing dollars allocated to the Hawaii Tourism Authority (HTA) should be indexed beginning in FY2017 using the Honolulu consumer price index for urban consumers (Honolulu CPI-U). Inflation was expected to increase at 2.7 percent per year. Members of the WG preferred indexing to a fixed percentage share (at 20%) of TAT revenues for tourism marketing for two reasons. First, it would allow the HTA's marketing dollars to keep pace with inflation but would not encourage unnecessary increases in spending on marketing when actual TAT collections may spike sharply upward in some (future) years.[64] Second, in a recession, the Honolulu consumer price index is likely to be more stable than the TAT and hence would provide undiminished funding for HTA when more marketing dollars, rather than less, may be needed. Indeed, since CY2000 the Honolulu CPI-U has never experienced a year-to-year decline.

Still to be resolved was whether the convention center, and other existing obligations, such as the Turtle Bay conservation agreement and the DNLR land fund, should be moved up to Stage I alongside HTA marketing dollars where the counties would have to bear part of the financial burden, or should they remain in Stage II where the State has to bear the entire burden from its 55 percent share. Some members argued that all State initiated expenditures should be borne by the State and hence placed in Stage II. Moving existing obligations to Stage I would set a bad precedent and perhaps encourage the State to behave strategically in the future by placing other State initiated

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[64] However, a spike in its share of TAT revenues does not mean that HTA can spend all of the increase; the Legislature must still approve the spending by passing a spending bill.

expenditures in Stage I where the counties would have to help pay for programs that they did not initiate and may not want. The other side of the argument is that if the existing commitments are placed in Stage II, in a recession, TAT revenues available for distribution might fall but the State would be unfairly held responsible for the entire burden of these commitments. In the recommendation to the Legislature, all current commitments were moved up to Stage I. Future concerns were never quite resolved. Because the debt service on the convention center--as well as the Turtle Bay conservation agreement and DLNR land appropriate--are fixed obligations, no indexing is required.

For the counties, the 55-45 split, with the convention center and other existing commitments moved up to Stage I, potentially yields more revenues than the 60-40 split with the same existing obligations relegated to Stage II. Using Hospitality Advisors' TAT revenue forecasts, the 55-45 split would yield $162 million to the counties in FY2017; by comparison, the 60-40 split would yield $156 million. In FY2025, the 55-45 split could potentially yield $245 million to the counties; the 60-40 split would yield $230 million.

Finally, the recommended model eliminates the $100 million minimum guarantee to the State and the counties (each). Simulations performed under a severe recessionary environment like that experienced during the Great Recession indicated that TAT revenues would never fall to as low as $100 million each in the coming decade.[65] Table 7 displays the potential distribution of TAT revenues between FY2016 and FY2025 under the recommended model.

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[65] For a brief explanation of the methodology, see minutes of the October 7 WG meeting at page 5 at http://files.hawaii.gov/auditor/agendas/TATDraftMinutes10-07-15.pdf

Table 7

Distribution of TAT Revenues: FY 2015-FY2025
(millions of dollars)

	FY2015*	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
TAT Revenues	$421	$450	$474	$497	$520	$543	$568	$592	$623	$649	$678
Stage I Expenditures:											
HTA	$ 82	$ 82	$ 83	$ 85	$ 87	$ 89	$ 92	$ 94	$ 97	$99	$102
Turtle Bay	$1.5	$1.5	$1.5	$1.5	$1.5	$1.5	$1.5	$1.5	$1.5	$1.5	$1.5
Convention Center**	$26.5	$26.5	$26.5	$26.5	$26.5	$26.5	$26.5	$26.5	$26.5	$26.5	$26.5
DLNR	$3.0	$3.0	$3.0	$ 3.0	$3.0	$3.0	$3.0	$3.0	$3.0	$3.0	$3.0
Stage II Expenditures:											
Counties (45% of remainder)	$103	$103	$162	$172	$181	$190	$200	$210	$223	$234	$245
State (55% of remainder)	$205	$234	$198	$210	$221	$233	$245	$257	$272	$286	$300

Notes: * = actual
** Current allocation to the convention center is $33 million; the $26.5 million represents the debt service component.
Source: The Auditor, State of Hawaii, 2015, Exhibit 3-3, p. 3-14.

In Table 7, the amount of TAT revenues expected by the State and the counties depend on Hospitality Advisors' (HA) forecast of total TAT revenues that are projected to rise from the $421 million in FY2015 (actually collected) to $678 million in FY2025. HA anticipates TAT revenues to grow by an average annual rate of 4.9 percent over 10 years. By comparison, the historical transient accommodation tax base increased at an annual average rate of 5.5 percent between 2005 and 2015, and at a slightly lower average rate of 4.6 percent per year between FY2000 and FY2015.[66]

If TAT revenues were to increase at nearly 5 percent per year while inflation is expected to rise at 2.7 percent per year, both the State and the county governments can expect to reap significant real revenue gains from tourism's growth in the future. For the counties as a group, their share of total TAT revenues is projected to rise from 24.5% in FY2015 to 36.1% in FY2025. For the State, TAT revenues between FY2017 and FY2020 are projected to fall below the level in FY2016 but rise thereafter. In his

[66] October 21, 2015 WG handout on page 3.

"Message" to the Legislature, WG chair Acoba wrote: I believe we have attempted an approach that, among other things, is flexible in that it largely reflects the availability of tax revenue, equitable in that any increase or reduction in revenue is shared among the State and counties, and predictive in that the allocations are premised on definite shares.[67]

IX. Conclusion

Hawaii State government's long history of sharing revenues with its counties stemmed from the vertical fiscal imbalance created by the extreme centralization of the state's government structure. According to the ACIR, "The fiscal system of a state is vertically balanced when the costs of the expenditure responsibilities assigned to the state government, on one hand, and to local governments as a group, on the other, are roughly commensurate with the potential productivity at reasonable rates of the revenue sources available to each level of government." [68] ACIR's 1989 study of Hawaii's state and local government finances found that only Maui County "…could, with its own resources, provide average levels of services and taxes…"[69]

The Working Group's recommended model to redistribute TAT revenues between Hawaii's state government and the counties is based on government expenditure estimates that are flawed. Nonetheless, the basic framework is an improvement over the status quo. The shares approach replaces arbitrary, and fixed, appropriations with predictability and a reasoned approach to distributing the economic benefits from tourism.

Members of the 2016 State Legislature disagree. The chairs of the House Finance

[67] The Auditor, State of Hawaii, 2015.
[68] ACIR, 1989, pp. 192-193.
[69] ACIR, 1989, p. 212.

Committee and the Senate Ways and Means Committee of the State Legislature openly criticized the Working Group's report for failure to follow the Legislature's direction which, they believe, was to recommend a method to allocate TAT revenues based on the total public service responsibilities of the State and the county governments; instead, the WG focused too narrowly on the impact of visitors on State and county resources.[70] The Legislature rejected the Working Group's recommendation but Senate and House members could not independently agree on how much to increase the counties' share or for how long and hence decided to keep the current tax split, which means, under Act 174, TAT allocations to the counties will fall from $103 million in FY2016 to $93 in future years. The message from state lawmakers is clear: no more money to the counties even though the state's economy has recovered from the Great Recession. Lawmakers have other plans for the money. The 2016 State Legislature passed a budget that projects state government spending in fiscal year 2017 to exceed predicted new revenues by $390 million.

The ending was clearly disappointing. In hindsight, if the language of the statute was unclear about the assignment—i.e. whether to focus on *total* public services or *tourism-related* public services—the Working Group should have consulted with Legislative leaders before embarking on the assignment. Alternatively, the Working Group should have explained clearly why allocation based on the provision of tourism public services is superior. The current allocation of TAT revenues among the four counties, as mandated by the Legislature, roughly corresponds with their relative costs of providing public services to tourism. Perhaps state lawmakers are simply unwilling to

[70] Cocke, 2016.

give the counties a greater share of the revenues from the TAT because they have higher budget priorities.

One final observation. During a budget briefing on the WG report, legislators wanted to know the proper division of responsibilities between the State and the counties.[71] The key word is “proper.” Perhaps Hawaii’s State government is too centralized, and the counties should be given additional responsibilities that are presently assigned to the State under Hawaii’s constitution. The next Constitutional Convention may be able to provide an answer to the legislators’ question, but not the Working Group. Act 174 requires the Working Group to recommend “the appropriate allocation of the transient accommodations tax (TAT) revenues between the State and counties that properly reflects the division of duties and responsibilities relating to the provision of public services.” Act 174 only requires the Working Group to ascertain the appropriate allocation of TAT revenues within existing division of service responsibilities between the State and the counties and *not* the proper division of their service responsibilities. Even that less ambitious task is prohibitively challenging since (ideally) it requires the Working Group to ascertain the optimum amount of spending on each existing government function and not what is actually spent. It is not surprising that among U.S. states, the cost of providing government services is not a metric used in designing state-local government revenue sharing programs.

[71] Cocke, 2016, p. B1.

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