How Can the State Government Restore Fiscal Balance?

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The impact of COVID-19 and the efforts taken to contain it have led to a rapid deterioration in the state's short- and medium-term fiscal outlooks. At its May 28 meeting, the State Council on Revenue (COR) cut its general fund tax revenue forecast for FY2020-FY2026 by almost $10 billion.[1] The Hawaii Constitution requires the Legislature and the Governor to "consider" the COR forecast numbers in developing their budgets.[2] If the Legislature and/or the Governor prepares a budget that exceeds the Council's revenue estimates, they must publicly declare this fact, including the reasons for it.

Article VII, Section 5 of Hawaii State Constitution states: "general fund expenditures for any fiscal year shall not exceed the State's current general fund revenues and unencumbered cash balances, except when the Governor publicly declares the public health, safety or welfare is threatened as provided by law."[3]

General fund revenues are money set aside to pay for the day-to-day operating expenses of the State that are not financed by revenues from a special fund.[4] The general fund is the chief operating fund of the State and holds both recurring tax and non-tax revenues.[5] The general excise tax (GET) and the individual income tax comprise the largest percentage of total GF tax revenues. Non-tax revenues include investment earnings, rents, fines, license and permits, federal grants, user charges, and a few other items. In FY 2019, charges for current services (user charges) were the largest component of non-tax revenues, comprising a little over half of the $717 million non-tax revenues in the general fund. In FY2019, total general fund revenues were $7.858 billions of which $7.141 billions were tax revenues and another $.717 billions were non-tax revenues.[6] COR members forecast only general fund (GF) tax revenues. The Department of Budget and Finance (B&F) supplies estimates of non-tax revenues.

The State also collects tax revenues that are not distributed to the general fund. For example, the fuel tax accounts for 2% of total state tax collections in a typical pre-pandemic fiscal year, but none of it is distributed to the general fund. The transient accommodation tax (TAT) revenues comprise 7.2% of total state tax collections but only 4.8% of general fund revenues.[7] In FY2019, total tax collections were $8.275 billion; the amount distributed to the general fund was $7.141 billion.[8] This brief discusses options for restoring fiscal balance to the general fund; "fiscal/operating balance" is a measure of the state's ability to cover current expenditures out of current receipts.

1 Forecasts from the May 28 meeting (and earlier meetings) are available at https://tax.hawaii.gov/useful/a9_1cor/.

2 For those who are not familiar with Hawaii government budgeting, the following brief document is helpful: https://budget.hawaii.gov/wp-content/uploads/2018/12/03.-Statewide-Overview-and-General-Information-FB19-21-PFP.ef3_.pdf

3 https://lrb.hawaii.gov/constitution#articlevii

4 A special fund is one where money is earmarked (set aside) for a specific use. See http://files.hawaii.gov/auditor/Reports/2020/20-08.pdf

5 Capital budgeting is prepared separately.

6 The financial data here are from the State of Hawaii Comprehensive Annual Financial Reports (COFR) at https://ags.hawaii.gov/accounting/annual-financial-reports They are all in nominal dollars.

7 Seth Colby, COVID-19: *Fiscal Impacts & Monetary Response*, State of Hawaii Department of Taxation, Hawaii Economic Association Presentation, May 7, 2020.

8 State of Hawaii Department of Taxation, *Annual Report* 2018-2019 at https://files.hawaii.gov/tax/stats/stats/annual/19annrpt.pdf

THE STATE'S FISCAL OUTLOOK

How does the State's "balanced budget requirement" work in practice? In FY19 (which ended on June 30, 2019), general fund tax revenues were $7.141 billion. Non-tax revenues were $717 million. Thus, general fund tax and non-tax revenues totaled $7.858 billion. General fund total expenditures were $7.941 billion, leaving a deficit of $82 million (=$7.858 - $7.941 billion). The deficit is covered by a carry-over balance of $829 million at the beginning of the fiscal year, leaving an end of the fiscal year (2019) balance of $747 million (= $829 million - $82 million). That ending balance was carried over to FY2020. If there were no carry-over revenues, the $82 million deficit would have to be covered either by cutting spending, finding more revenue, or some combination of the two.

The simple illustration (above) can be used to simulate future operating balances. Instead of using actual revenue and expenditure data, we forecast future values of general fund tax and non-tax revenues and future general fund expenditures. We rely on the COR's latest (May 28th) forecasts of GF tax revenues for FY2020 to FY2026. We assume non-tax revenues are fixed at $717 million (the actual value for FY2019) for all years. (Average annual non-tax revenues collected for FY2014-FY2019 were $801 million; in the six years before that, which included the Great Recession, annual non-tax revenues averaged $614 million.)[9] If the $717 million figure turns out to be too high (low), it would make future deficits look smaller (larger). We develop two fiscal scenarios: Scenario I holds total annual general fund expenditures constant at the FY2019 level of $7.941 billion. In Scenario II, we assume spending on existing services rise at the expected annual rate of inflation.[10]

In both scenarios, the revenue and expenditure data do not include federal pandemic-related transfers (which are one-time grants) to the state government or COVID-19 induced expenditures. COVID-19 may have long-lasting impacts on state government expenditures that are not accounted for in our scenarios.

In Scenario I (Appendix), with future expenditures held at the FY19 level, total general fund deficits are expected to reach $582 million in FY20. The worst year is yet to come in FY21 with an expected deficit of $1.379 billion. The accumulated carry over balance would allow spending to exceed revenues in FY2020, but not the following year. In FY2021, spending would have to be cut, revenues would have to be increased, or the State will need to borrow $1.214 billion (=$1,379 million - $165 million) or some combination of these options. The expected deficits are far worse than those encountered during the Great Recession.[11] Moreover, it is not until FY2026 when general fund revenues once again are expected to exceed expenditures.

In Scenario II (Appendix), we assume nominal spending on existing services grows at the rate of inflation. The annual deficit in FY20 would be $677 million and $1.394 billion for FY21. There is sufficient carry-over balance to fill the funding gap in FY20; but for FY21, the shortfall would be $1.324 billion. After FY21 annual deficits decrease but exceeds $450 million at the end of FY2026.[12] Persistent fiscal deficits like these are not sustainable. The term "fiscal sustainability" is defined as "the degree to which a government is able to maintain its existing programs and services and to meet its current financial obligations without increasing its debt or raising taxes."[13]

Figure 1 displays the differences between the actual annual general fund revenues and general fund expenditures for FY05-2019 and Scenario I and Scenario II values for FY20-FY26. Projected deficits in FY20-FY26 are expected to be far greater than anything we have experienced in the last 20 years, including the Great Recession.

9 Non-tax revenues grew between FY05 and FY17, reaching a peak of $969 million in FY2017 and declined in FY18 and FY19.

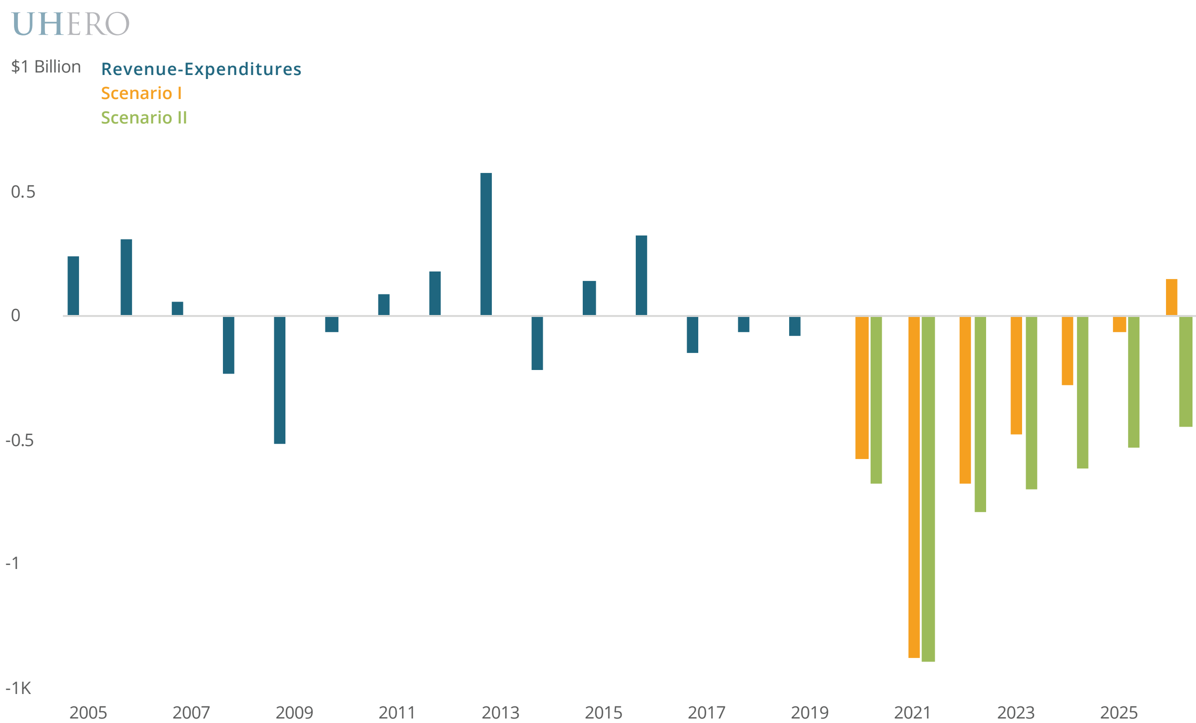
10 UHERO forecasts 1.2% inflation in FY20, -1% in FY21, and 1.3%, 1.3%, 1.4%, 1.5%, and 1.6% over FY22-FY26.

11 General fund spending exceeded general fund revenues by $233 million in FY2008, $521 million in FY2009 and $67 million in FY2010.

12 We also developed a third scenario in which we assumed both non-tax revenues and general fund expenditures increase at the rate of inflation. The annual deficits are slightly smaller than those in Scenario II. In FY2026 the fiscal deficit is expected to be $398 million.

13 Richard M. Bird, *Reflections on Measuring Urban Fiscal Health*, University of Toronto, February 2014.

FIGURE 1



Note: *Revenues do not include carry over balances.*

OPTIONS FOR RESTORING FISCAL BALANCE

There are several options for addressing the budget gap. The first, would be for Congress to provide more federal aid for state and local governments. The case for federal aid is underpinned by the widely accepted notion that in the case of major disasters, like the current pandemic, the central government should intervene without hesitation since only it has the financial flexibility to act. States, unlike the federal government, cannot create money. However, it seems unlikely that the federal government will provide sufficient fiscal aid to state and local governments. During the Great Recession, federal funds did not offset state and local government revenue losses. Most states cut spending, with cuts falling predominantly on education, health and social services as these represent the largest shares of state budgets. Overall, state payrolls declined 2.6% between 2008 and 2012.[14] Such cuts are counter-productive in the long run as they also impair future economic growth.

Next to more federal aid, responsibly re-opening businesses (including tourism) would begin to restore the state's fiscal balance. Without substantial tourism recovery—which accounts for 30 to 35 percent of state tax revenues (pre-COVID-19)[15]—it will be impossible to overcome the current fiscal crisis.

It has been suggested that economic diversification can be a solution to our *current* economic crisis.[16] It cannot. An economy's industrial structure tends to change very slowly. It took decades for Hawaii to diversify *into* tourism from sugar and pineapple production.

14 Tracy Gordon, *State and Local Budgets and the Great Recession*, Brookings, December 31, 2012 at https://www.brookings.edu/articles/state-and-local-budgets-and-the-great-recession/

15 Seth Colby, COVID-19: *Fiscal Impacts & Monetary Response*, State of Hawaii Department of Taxation, Hawaii Economic Association Presentation, May 7, 2020.

16 Schaefers, May 22, 2020, B3.

During the Great Recession some states enacted business incentives to spur economic recovery.[17] The evidence is clear that not only are most tax incentives ineffective at spurring economic recovery, they also reduce revenues needed to pay for public services when, at a time such as now, those revenues are declining due to the pandemic.

Borrowing to pay for the day-to-day bills of the state government is not a realistic solution except for short-term exigencies. There are two reasons. First, creating a long-term liability (such as floating bonds) to pay for short-term operating costs is generally frowned upon as unsound policy (borrowed money has to be repaid with interest) leading down the road to the potential down-grade of the state's credit rating.[18] Second, Article VII, Section 13 of the Hawaii State Constitution limits the state's ability to borrow.[19] As of June 30, 2019, the State has outstanding debt of $10.5 billion of which $7.9 billion were general obligation bonds backed by the full faith of the government; the rest consisted of revenue bonds. The legal debt margin (additional amount available to be borrowed) was $576.8 million.[20]

A new Federal Reserve (Fed) lending program targeting state and local governments opens the way for the Fed to purchase notes (i.e. short-term debt) issued by state and local governments. For the state government, the total note size is limited to 20% of the borrower's 2017 own-source revenue.[21] For Hawaii's state government, the limit amounts to a little over $2.1 billion.[22] Given the severity of the fiscal crisis, borrowing will need to be one part of the package of State policy responses. It solves the State's short- and near-term cash flow problem, but will still require long term solutions to restore fiscal balance.

State lawmakers can shift money from special and revolving funds to the General Fund. A special report issued by the State Auditor in May 2020 identified more than $483 million in excess money that could be transferred from 57 special and revolving fund accounts to the general fund without adversely affecting programs.[23]

The State can also tap into the Emergency and Budget Reserve Fund—also known as the "rainy day fund".[24] At the start of FY20, Hawaii's rainy day fund stood at $396 million.[25] But there are restrictions on when and how much the legislature can tap into the fund. The statute states: the legislature shall *not* appropriate from the emergency and budget reserve fund: (1) more than 50 percent of the total balance in

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17 Josh Goodmand and John Hamman, "Why Business Incentives May Not Speed State Economic Recoveries," *Pew Charitable Trusts*, May 21, 2020 at https://www.pewtrusts.org/en/research-and-analysis/articles/2020/05/21/why-business-incentives-may-not-speed-state-economic-recoveries

18 Jeff Chapman, Adam Levin and Mark Robyn, "States Contemplate Borrowing to Help Manage Pandemic's Fiscal Impact," *Pew Charitable Trusts*, June 9, 2020 at https://www.pewtrusts.org/en/research-and-analysis/articles/2020/06/09/states-contemplate-borrowing-to-help-manage-pandemics-fiscal-impact

19 Article VII, Section 13 provides an exception to the debt limit if an emergency condition is declared to exist by the governor and concurred to by a two-thirds vote of the members to which each house of the legislature is entitled. See https://lrb.hawaii.gov/constitution#articlevii

20 State of Hawaii COFR for FY2019, p. 168. It is possible to shift some capital spending projects from GF-funding to borrowing, but that would count against the debt margin.

21 Chapman, Levin and Robyn, June 9, 2020.

22 Hawaii's state own-source revenue in 2017 was $10.664 billion, according to the U.S. Census Bureau at https://www.census.gov/data/datasets/2017/econ/local/public-use-datasets.html

23 State Auditor, COVID-19 Special Projects: Supplement to Report No. 20-06, Report on Special and Revolving Fund Accounts with Inactive or Excess Balances, COVID-19 Report No. 20-08/ May 2020 at http://files.hawaii.gov/auditor/Reports/2020/20-08.pdf

24 State of Hawaii Department of Budget and Finance, State Fiscal Reserves at https://budget.hawaii.gov/budget/about-budget/state-fiscal-reserves/

25 Jared Walczak and Janelle Cammenga, "State Rainy Day Funds and the COVID-19 Crisis," Fiscal Fact No. 703, Tax Foundation, April, 2020 at https://files.taxfoundation.org/20200406182235/State-Rainy-Day-Funds-and-the-COVID-19-Crisis.pdf Hawaii's rainy day fund balance represents 4.8% of general fund expenditures compared to the median among all 50 states of 8%.

a fiscal year; (2) in a fiscal year, an amount that exceeds 10 percent of the authorized expenditures from the general fund for operating expenses less non-discretionary funds; (3) any amount for expenditure in the succeeding fiscal year, unless the State has collected or is projected to collect less general fund tax revenue in the current fiscal year compared to the immediately preceding fiscal year.[26]

Lawmakers can also take the counties' share of the transient accommodations tax (TAT) revenues (it already has for this year). But that only amounts to about $100 million per year in recent years, and the Tax Research and Planning Office projects total TAT revenues to decline by more than 40% in FY21.

Raiding special and revolving funds, emptying (if permitted) the rainy day fund, and withholding TAT money from the counties add up to a little over $1 billion in FY20 and FY21, resulting in hundreds of millions of dollars of potential deficits remaining each year for FY21 and ensuing years. Absent borrowing, that leaves increasing taxes or decreasing spending or some combination of the two to restore fiscal balance; neither option is politically popular nor will they enhance the prospect for near-term economic recovery.

REDUCING THE COST OF GOVERNMENT

Hawaii is not alone. Across the nation, state and local governments are cutting spending as tax revenues plummet due to COVID-19 and efforts to contain it.[27] Hawaii Governor David Ige had earlier proposed cutting government workers pay by 20%; the Legislature disagreed. Senate Ways and Means Committee Chairman Donovan Dela Cruz said in an interview with the Honolulu Star-Advertiser (May 9), "We're not cutting from existing operations."[28] With the latest COR general fund tax revenue forecast, public employee pay cuts and furloughs are not off the table.

The problem with cutting government spending is that it adds to the pain and misery already in the community. Across-the-board cuts and restrictions will reduce needed services. (For FY20, Governor Ige imposed a 5% spending restriction on discretionary operating expenses for all departments and agencies of the Executive Branch.) However, in the current unprecedented fiscal environment, the State may have no choice. Moody's Investors Service noted that during the 2008 financial crisis states cut funding to local governments, increased taxes and received more federal aid but still had to cut spending.[29] Hawaii still remembers Governor Linda Lingle's infamous teacher furloughs that prompted parent sit-ins in her office in 2010.

Stephen Goldsmith (Harvard Kennedy School) and Charles "Skip" Stitt (Faegre Drinker Consulting) in a May 11, 2020 article in the *Governing* magazine offer a number of sensible and proven ideas on how local governments can cut costs and maintain services, not just for now but for the long term, by improving efficiency.[30] While their recommendations are directed at county and city governments, some may work for Hawaii's state government as well. Their basic message is that governments must focus on becoming more cost-conscious and work smarter to reduce costs. Their recommendations:

26 https://codes.findlaw.com/hi/division-1-government/hi-rev-st-sect-328l-3.html; non-discretionary funds include such things as debt service, employer contributions for pension and retirement benefits of state government employees, contributions to health insurance benefits for state government employees and retirees, Medicaid service costs, etc.

27 Alison Felix, "COVID-19 Challenges State and Local Government Finances," *kcFed Economic Bulletin*, May 13, 2020 at https://www.kansascityfed.org/publications/research/eb/articles/2020/covid-19-challenges-state-local-government-finances;

28 Kevin Dayton, "Tax collections tank as lawmakers plan budget fixes to avoid furloughs," *Honolulu Star-Advertiser*, May 9, 2020 at https://www.staradvertiser.com/2020/05/09/hawaii-news/tax-collections-tank-as-lawmakers-plan-budget-fixes-to-avoid-public-worker-furloughs/

29 Eleanor Mueller and Kellie Mejdrich, "State, local governments slash services as demand rises," *Politico*, May 13, 2020 at https://www.politico.com/news/2020/05/13/state-local-governments-slash-services-256212; See also Tracy Gordon, 2012.

30 Stephen Goldsmith and Charles "Skip" Stitt, "Strategic Fiscal Management for a Crisis—and Beyond," Governing, May 11, 2020 at https://www.governing.com/finance/Strategic-Fiscal-Management-for-a-Crisis-and-Beyond.html

- Re-examine public value. Look at each agency's definition of public value—what the agency contributes to the good of the community—and then examine performance scorecards to determine whether each activity really advances the jurisdiction's mission.
- Create a dedicated office of cost savings and innovation—a small, separate internal organization that focuses on cost management.
- Transition to a culture relentlessly focused on data; everybody must know and manage by data, not by instincts.
- Use lateral benchmarking to drive innovation and performance. Instead of making comparisons to similarly sized local governments, look to other industries and business sectors whose practices your jurisdiction might emulate.
- Rapidly adopt external innovations; conforming local practices to widely accepted standards may be the best solution.
- Reward productive employees.
- Adopt self-managed teams. With proper training and oversight, line workers can operate as self-managed teams which lower costs and facilitate gainsharing.
- Release value trapped in public assets by selling or leasing them.
- Eliminate red tape.
- Rapidly adopt technology tools. Governments should create center-led technology teams, success-based contracting processes and integrated solutions for which the provider partner is fully accountable.
- Consider private partners.
- Implementing flexible hiring freezes, whereby departures are an opportunity to re-examine productivity and employee transfer/retraining programs ensure that essential jobs are filled without new hiring.
- Insisting on third-party reviews of claims, contracts, expenditures and capital projects to avoid inadvisable contract renewals, poor performers and low standards.
- Trimming non-essentials and focusing on the core mission; this is not the time for pet projects.
- Capturing unspent capacity and definitely ending the public sector's notorious end-of-the-fiscal year "use it or lose it" practice.
- Supporting nonprofit partners by sustaining and leveraging their value by providing physical space, technology, equipment and other supports to reduce their costs while in turn utilizing their innovative reach.

Hawaii state lawmakers are required by the State Constitution to appoint a tax review commission every five years to review the state's revenue system, but there is no commission to review state spending. An earlier UHERO research brief argued that one way to more carefully manage future government spending and discourage pet projects is to require (as 38 states and the District of Columbia now do)[31] a *Fiscal Notes*

31 Elizabeth McNichol, Iris J. Lav and Kathleen Masterson, "Better Cost Estimates, Better Budgets," Center on Budget and Policy Priorities, November 24, 2015 at https://www.cbpp.org/research/state-budget-and-tax/better-cost-estimates-better-budgets.

analysis on every piece of major spending legislation to identify where the additional money and/or revenue increases will come from to pay for the new spending program.[32] Hard choices have to be made.

RAISING MORE REVENUE

People should be required to pay for the benefits they obtain from consuming government provided services. Under the benefit model of government finance, the first rule should be "whenever possible, charge."[33] Roy Bahl (Andrew Young School of Public Policy) and Richard Bird (University of Toronto) explain that "it is both equitable and efficient for the direct recipients of services—whether residents, businesses or properties (whoever owns or occupies them)—to pay for what they get."[34] Only then will the right amount of services be provided. It is disturbing to see the admission fee to climb Diamond Head ($1 per head) remains the same as what it was 20 years ago. The City and County of Honolulu charges no fee for its popular pickleball classes at community parks. The list of under charging goes on and on. The State (and counties) need to examine their user charges to make sure that people who benefit from the services that it provides pay their own way. However, raising user charges won't be enough to eliminate the budget gap. This leaves finding ways to generate more tax revenue.

A good state fiscal system relies on a mix of taxes.[35] When raising additional tax revenue, it would be preferable to raise the required amount of revenue from several taxes instead of piling it on a single tax, thus avoid having to impose a higher tax rate on one tax. If a state relies on just one tax, the resulting budget crisis can be especially severe. A good example is the State of Florida which has no personal income tax. In Florida, sales taxes account for 80% of their tax revenue. As of last month " the state will be short billions and could face years of smaller budgets. The state's two main economic drivers — tourism and agriculture — have been crushed since Floridians started staying home." [36]

Another way to raise more tax revenue is to broaden the tax base or to raise the tax rate on a specific tax such as the GET. (The tax base is what is taxed; thus, tax revenue generated = tax base x tax rate). Hawaii's state government relies heavily on two taxes: the general excise tax and the individual income tax. For several reasons, raising the GET rate should be given top consideration in the state's tax policy response to close the short and near-term budget gap. (The more practical strategy is to borrow money short-term and use the additional tax revenue to repay the loan.[37]) The GET has several strengths. It has a broad and stable base and relatively low rate. And because of the state's heavy dependence on tourism, a large part of it is paid by non-residents (unlike the individual income tax).[38] It is simple to understand and thus also easy to administer. When the economy finally re-opens, consumer spending will likely lead the way to economic

32 James Mak and Robert Ebel, "Charting a New Fiscal Course for Hawaii: Fiscal Architecture Approach," UHERO Brief, January 29, 2020 at https://uhero.hawaii.edu/charting-a-new-fiscal-course-for-hawaii-a-fiscal-architecture-approach/

33 Roy Bahl and Richard M. Bird, Fiscal Decentralization and Local Finance in Developing Countries, Studies in Fiscal Federalism and State-Local Finance, Edward Elgar Publishing, 2018, p. 169.

34 Bahl and Bird, 2018, p. 169.

35 See an earlier UHERO blog on what makes for a quality revenue system. James Mak, "To Tax or Not To Tax: Making a High-Quality State Revenue/Tax System," UHERO Blog, March 6, 2020 at https://uhero.hawaii.edu/to-tax-or-not-to-tax-making-a-high-quality-state-revenue-tax-system/

36 https://www.miamiherald.com/news/politics-government/state-politics/article242699226.html

37 Byron Gangnes, Carl Bonham, James Mak, and Sumner La Croix, "Tap Fed Lending Facilities to Support Local Economy," UHERO Blog, April 21, 2020 at https://uhero.hawaii.edu/tap-fed-lending-facilities-to-support-local-economy/

38 According to the Department of Business, Economic Development and Tourism (DBEDT), tourism contributes about 30% of GET revenues, including direct and multiplier (indirect + induced) effects. Tourism's direct contribution to the GET is estimated at 18%. Shifting taxes to non-residents (or, tax exporting) is controversial, and not all of us agree on the merits. See, for example, Bahl and Bird, 2018, Chapter 5; and James Mak, *Developing a Dream Destination: Tourism and Tourism Policy Planning in Hawaii*, University of Hawaii Press, 2008, Chapter 4.

recovery, and the GET base will probably be the first to recover from the pandemic. But because it is also regressive, raising the GET rate should be paired with tax relief for those with less income. What should not be done is to narrow the tax base by exempting some goods and services from the GET.

Hawaii's individual income tax structure is progressive at higher income tax levels. Creating another bracket at the very high end of the income distribution should not be dismissed. Unlike at the federal level (and in some states), Hawaii's individual income tax brackets are not adjusted for inflation. As incomes rise with inflation over time, more and more taxpayers are pushed into higher income tax brackets compressing the brackets. Today, Hawaii's top rate is reached at a relatively low income. The current individual income tax also exempts a growing source of revenues (e.g. defined pensions and social security benefits) from taxation as Hawaii's population ages rapidly; over the longer time horizon, the shrinking tax base should be of growing concern to state lawmakers. Right now, the retiree who draws money from his/her individual retirement account (IRA) has to pay the state's income tax; the retiree who receives a pension from the state government does not. Just on fairness, these exemptions should be gradually reduced, and ultimately eliminated.

In a recent op- ed piece in the *Honolulu Civil Beat*, our colleague, Tim Halliday, argued that the transient accommodation rate (also known as the hotel room tax) should be raised a lot to compensate Hawaii for the negative effects of travel and tourism on Hawaii residents during the pandemic.[39] Raising the hotel room tax will discourage some visitors[40] and raise revenue. And once the pandemic subsides, the tax can be lowered. Making this scheme work will require the counties to vigorously enforce the ban on illegal vacation rentals. (Some of the additional tax revenues can be shared with the counties to cover their enforcement costs.) Right now, all short term vacation rentals with or without permits are declared to be non-essential and thus banned.

There are two ways to implement Halliday's proposed hotel room tax increase. One way is to raise the current TAT rate. The other is to impose a *per diem* tax (say, $35 per occupied room per night)[41]; it can be called the COVID-19 Surcharge. Guests can be informed that the surcharge will be eliminated once the pandemic subsides.

Finally, the rise of e-commerce has eroded the sales tax bases of state and local governments in the U.S., including Hawaii. The State needs to expend vigorous effort to ensure that it is collecting all the revenues that it is due from remote sellers.

LONG-TERM FISCAL BALANCE

What Hawaii does in the short- and medium term to restore fiscal balance should also look to the future. When making budget decisions (on both future revenues and expenditures), it is always wise to consider whether the fiscal decisions being taken "fit" with what we know about the state's long-term changes in the economy, demography, and institutions. Hawaii currently does no long-term fiscal planning. For the nation as a whole, the U.S. Government Accountability Office (GAO) paints a sobering fiscal outlook for America's state and local governments.[42] In its latest report, which assumes the current set of policies in place, GAO simulations indicate that state and local governments will find it increasingly difficult in the next

39 Timothy Halliday, "The Hotel Tax Should Be Raised—A Lot," *Honolulu Civil Beat*, May 16, 2020.

40 Hopefully the low-spending, price sensitive and high risk visitors. Hawaii Tourism Authority's new tourism strategic plan aspires to attract high spending and low impact visitors.

41 This would be comparable to what many hotels charge in mandatory resort fees, excluding parking. See https://travel-hawaii.com/hawaii-resort-fee-study.html

42 United States Government Accountability Office, State and Local Governments' Fiscal Outlook, 2019 Update. December, 2019 at https://www.gao.gov/assets/710/703475.pdf

50 years to cover their current expenditures out of their current revenues. Growth in overall expenditures will largely be driven by rising health care costs and population aging. Hawaii faces the same problems. An earlier UHERO research brief— *Charting a New Fiscal Course for Hawaii: Fiscal Architecture Approach*[43]—described the major problems (slower population and economic growth, population aging, and climate change) that will have significant fiscal repercussions on the state's future budgets. To achieve long-term fiscal balance for Hawaii, the options outlined in that research brief are worth considering.

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43 James Mak and Robert D. Ebel, January 29, 2020, https://uhero.hawaii.edu/charting-a-new-fiscal-course-for-hawaii-a-fiscal-architecture-approach/.

APPENDIX

Scenario I
(Annual GF Spending Fixed at FY2019 Level)

Fiscal Year	GF Surplus (+) or Deficit (-) (in millions of dollars)	Beginning FY Carry Over Balance
2018*	-65	894
2019*	-82	829
2020	-582	747
2021	-1,379	165
2022	-678	
2023	-481	
2024	-279	
2025	-71	
2026	+144	

Note: *Actual

Scenario II
(Annual GF Spending Increases at Inflation Rate)

Fiscal Year	GF Surplus (+) or Deficit (-) (in millions of dollars)	Beginning FY Carry Over Balance
2018*	-65	894
2019*	-82	829
2020	-677	747
2021	-1,394	70
2022	-796	
2023	-704	
2024	-616	
2025	-532	
2026	-452	

Note: *Actual