TESTIMONY BY KALBERT K. YOUNG
INTERIM DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON LABOR AND PUBLIC EMPLOYMENT
ON
HOUSE BILL NO. 824

February 15, 2011

RELATING TO GOVERNMENT

House Bill No. 824 sets aside from the general excise tax revenues an amount equivalent to the unfunded accrued liability contribution by the State for State employees and deposits the funds into a separate account in the general fund.

The Department of Budget and Finance opposes this bill.

The Administration recognizes the importance of ensuring the long-term viability of the Employees' Retirement System and submitted a package of measures to address the issues, including House Bill No. 1037, Relating to Employer Contributions to the Employees' Retirement System; House Bill No. 1038, Relating to the Employees' Retirement System and House Bill No. 1142, Relating to the Employees' Retirement System.

As a matter of budget policy and conformance with budgeting authority for executive and legislative processes, this bill will earmark general excise tax revenues before such revenues are deposited in the general fund, negatively affecting budget policy and reducing budgeting flexibility. Passage of this bill may also encourage the further earmarking of general excise tax revenues.

TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON LABOR & PUBLIC EMPLOYMENT
ON
HOUSE BILL NO. 824

FEBRUARY 15, 2011

RELATING TO GOVERNMENT

Chair Rhoads and Members of the Committee:

The Board of Trustees of the Employees' Retirement System of the State of Hawaii (ERS) supports H.B. 824 that proposes to set aside from the general excise tax revenues an amount equivalent to the unfunded accrued liability contribution by the State for state employees.

As of June 30, 2010, the ERS had an unfunded actuarial accrued liability (UAAL) of $7.1 billion. One of the main reasons for this large UAAL was attributed to a previous state law provision that allowed for excess ERS investment earnings to be credited against the annual employer contribution requirements. When the ERS earned more than its assumed investment return assumption, the State reaped the benefits. The investment return assumption is a long-term assumption and when the investment markets cycled downward in the 2000's the excess investment earnings from the prior decades were not in the System to help cushion the blow.

Over a 36-year period from 1967 to 2003, the ERS credited over $1.68 billion to the State and county employer contribution requirements (funds). Recently, the ERS Actuary determined that if those contributions had been made to the ERS, then combined with the investment earnings on those contributions would have increased the ERS's assets so that today the ERS's UAAL would be approximately $500 million. This means that the ERS would have a funded ratio of more than 95% if that had occurred. If the System were in that position today, the recommended contribution rate to the System would likely be less than 10% of pay.

As a result, the ERS supports H.B. 824 that assists with the funding of the ERS.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Disposition for unfunded liability of the employee's retirement system

BILL NUMBER: HB 824

INTRODUCED BY: Say

BRIEF SUMMARY: Amends HRS section 237-31 to earmark a sum equal to the unfunded liability contribution by the state for state employees during a fiscal year to be deposited in that fiscal year into a separate account in the general fund.

Amends HRS section 88-124 to provide that payments for the unfunded accrued liability portion of the state's monthly contribution for state employees shall be made from the account in the general fund; provided that reimbursements to the general fund from other funds, as required under section 88-125, shall be deposited into the general fund, but not the account.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: The proposed measure would earmark general excise tax revenues into a separate account of the general fund equal to the amount of the unfunded accrued liability contribution by the state for state employees during a fiscal year.

If this measure were adopted, it would prioritize these funds ahead of all other general funds and result in less general funds available for other programs and services. In addition, the danger in adopting this measure is that it may spawn additional requests for other "creative" accounting through the earmarking of general excise tax revenues. In addition, the automatic funding mechanism proposed in this measure would set aside general excise tax revenues without going through the appropriation process and, most importantly, without legislative scrutiny or intervention.

More importantly, because the general excise tax revenues are earmarked for this purpose, the question is whether or not when the sum set aside for the unfunded liability contribution is actually made, the amount will be appropriated as general funds and thus will it be counted again the constitutional general fund expenditure ceiling? Further, because the amount is designated for this purpose, will the taxpaying public know that this contribution is coming at the expense of all other programs or will it prompt a call for an increase in taxes so that both the unfunded liability and all other programs be funded?

How soon lawmakers have forgotten how earmarking general fund revenues can get the state into trouble. It was only 1989 when lawmakers approved earmarking $90 million for educational facilities as the "commitment" to education and only three years later they took back the earmarking because general fund revenues started to dwindle. Further, rather than spurring on construction of classrooms, the earmarking merely created apathy as school officials knew they would receive $90 million off the top and they didn't have to justify a request for funding. Lawmakers should go back and read a little of their own history and learn from their mistakes.

While this proposal may look prudent in setting aside money into a special account within the general fund, it can and probably will affect the general fund cash flow, putting the state in a possible precarious position of not being able to pay its bills, or pay its employees or the worst case scenario not being able to meet its repayment of debt. The state was in such a position a few years ago when an accounting error double counted tax collections because those collections from delinquent taxpayers were set out separately in one column and again included in the grand totals. Setting off amounts to meet certain standing obligations reduces the flexibility of state budget officials in managing the state's financial condition.

Finally, this measure violates the spirit, if not the intent, of the general fund expenditure ceiling. Inasmuch as the "set aside" would direct these tax revenues into the proposed special account within the general fund does not absolve the fact that this money is not being appropriated and there it remains questionable whether or not the "expenditure" of these funds would be measured against the constitutional spending ceiling of general funds. For the state Council on Revenues, this would represent yet one more adjustment they would have to make to their forecast of general fund tax revenues.

Digested 2/14/11