2015

HOW SUSTAINABLE IS THE STATE GENERAL FUND - FY 2014-21?

SENATE MINORITY RESEARCH OFFICE

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On September 17, 2014, the Senate Minority Research Office published an article[1] that raised serious questions regarding the financial sustainability of the state's general fund. The article projected that the state would have depleted its general fund cash reserves by FY 2016, if no major changes were made in FY 2014-15. Since the release of the article, however, several important factors have delayed this projection from FY 2016 to FY 2018.

Table 1. Factors that Impact the State Financial Plan – General Fund

A	Executive Spending Restrictions Implemented by Previous Administration	$ 163.3M
B	Additional Revenue - Council on Revenues (1/6/2015 projection)	$ 87.9M
C	Collective Bargaining Cost - Not Included in Financial Plan	($ 97M)
D	Adjustment - Long Term Expenditure Growth	($ 498.6M)

I. DISCUSSION OF FACTORS THAT IMPACT THE STATE FINANCIAL PLAN

A. Executive Spending Restrictions:

The first important factor that has positively contributed to this delay are the executive spending restrictions imposed by the Abercrombie Administration in FY 2014. As a result of lower than anticipated general fund revenues, the Abercrombie Administration imposed a 5 percent spending restriction on both discretionary and non-discretionary general fund appropriations. If these cuts are continued in FY 2015, the state's treasury is expected to have saved an estimated $163 million[2].

B. Council on Revenues Revised Projections (1/6/2015):

In addition to the positive impact of the executive spending restrictions, the Council on Revenues met on January 6, 2015, and increased the state's projection of anticipated general fund revenues for FY 2015 by $55.5 million. This means that both the executive spending restrictions and revised general fund forecast are projected to positively impact the state's financial plan by $218.5 million.

C. Collective Bargaining (Expiring HGEA contracts):

Despite the significance of these two factors, however, a careful analysis of the recently introduced Executive Biennium Budget, reveals two shortcomings that significantly impact the bottom-line of the state's financial plan. The first shortcoming relates to the Hawaii Government Employees Association (HGEA) collective bargaining agreements that expire on June 30, 2015. Currently, the financial plan does

[1] "The Implications of the Council on Revenues General Fund Forecast: What Happened to the $844 M Surplus." http://hawaiidocuments.com/SMO/2014-915-Report.pdf

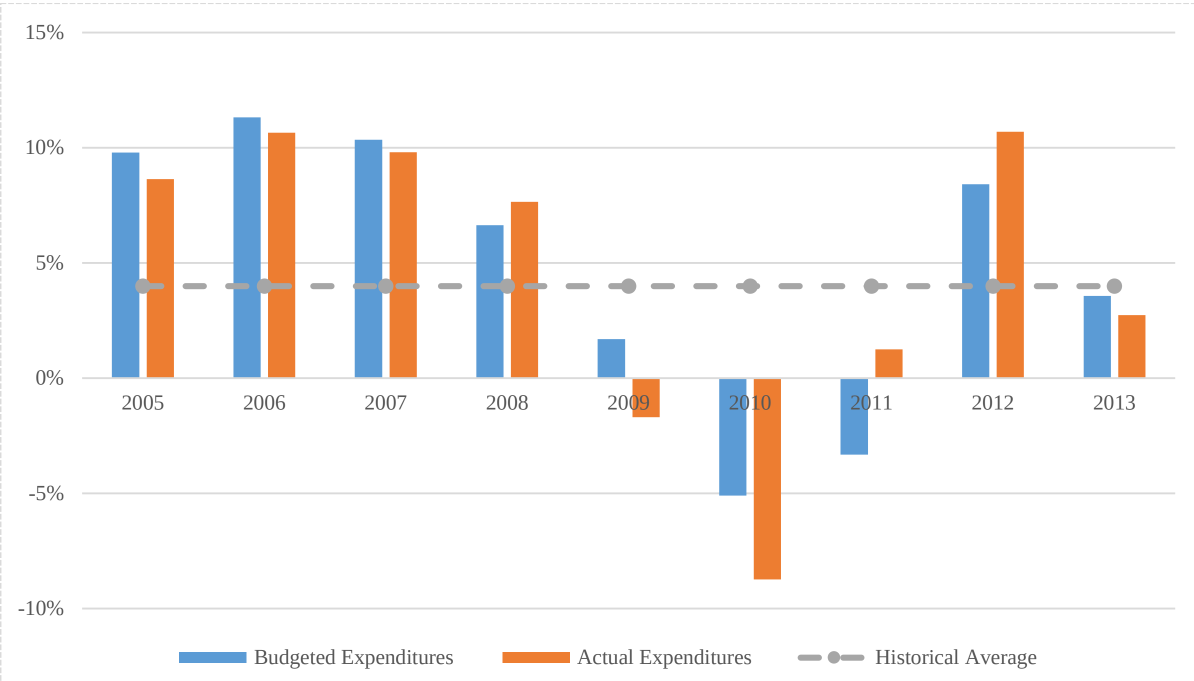
[2] The following calculation is used: FY 2014 lapses -/- 2015 lapses + FY 15 operating expenditures -/- FY 15 appropriation. ($124.5M -/- $80M + $6189.2M -/- $6070.4M). Executive Biennium Budget FB 2015-17, page 3.

not account for the potential costs associated with the renewal of these agreements. If the current HGEA agreements are extended to FY 2016-17, the state's financial plan would have to absorb an additional $97 million[3] in general funds.

D. Long-Term General Fund Expenditure Growth:

In addition to collective bargaining, the state's financial plan also understates the real long-term growth of general fund expenditures. The current financial plan assumes that general fund expenditures beyond the FY 2016-17 budget would grow at an annual rate of 2.3 percent. Over the last decade, however, both budgeted and actual general fund expenditures have grown at an annual rate of 4 percent. This is primarily the result of increases in non-discretionary expenditures, such as collective bargaining and retirement and health care benefits for state employees. To accurately account for these future costs, the long-term general fund expenditure growth assumption should be adjusted by $498.6 million[4].

Table 2: Budgeted vs. Actual General Fund Expenditure Growth (FY2005-13)



Source: "General Fund: schedule of revenues and expenditures - budget and actual (budgetary basis)". State of Hawaii - Comprehensive Financial Annual Report (CAFR). Periods: FY 2004-2013.

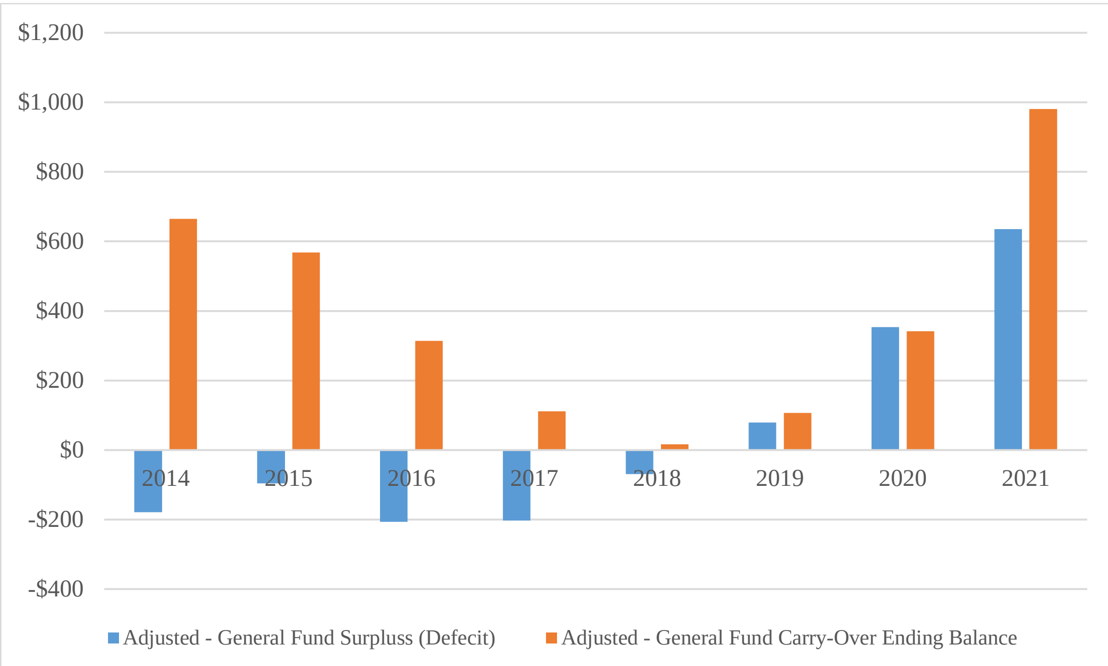
[3] Contracts for bargaining units 2-4,6,8-9 all expire on June 30th, 2015. $97 million amounts to the cumulative total appropriations for FY 2014 and 2015. The following general appropriation bills that were passed during the 2013 legislative session: HB 895, SB911,SB2073.

[4] $498.6 million amounts to the cumulative of the following adjustments: $74.7M (FY18) + $63.7M (FY19) + $182.2M (FY20) + $178M (FY21)

II. DISCUSSION OF FISCAL IMPLICATIONS

Although the state's general fund is no longer projected to be depleted as early as FY 2016, the current financial plan still shows significant financial challenges are ahead in FY 2017-18. Currently, the state is projected to run annual general fund budget deficits until FY 2018. Because the state is spending more than it receives, the current accumulated general fund cash reserve of $664 million is projected to decline to $16 million in FY 2018. To put this into perspective, $16 million would not be enough to fund current government operations for even one day.

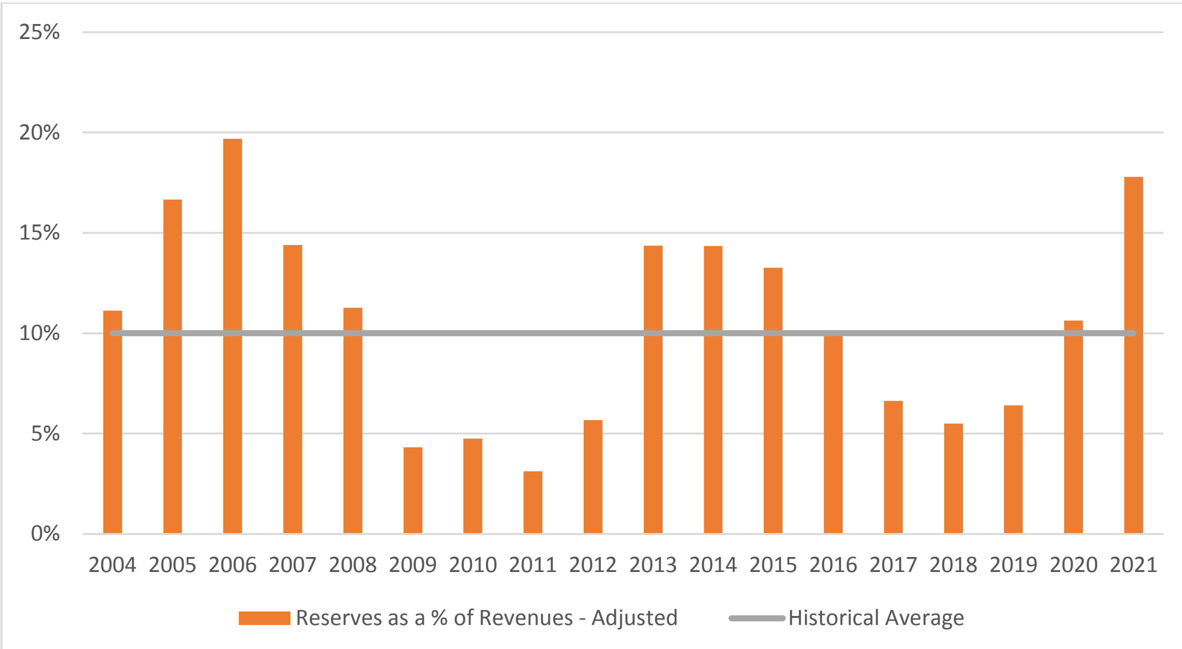
Table 3. Projected General Fund Deficits and Carry-Over Ending Balances FY 2014-21



Source: Executive Biennium Budget FB 2015-17. Totals have been adjusted to account for the 4 factors that are discussed in this paper.

The projected $16 million carry-over ending balance in the general fund for FY 2018 raises serious questions about the financial sustainability of the current Executive Biennium Budget. The deteriorating cash reserves not only threaten the state's current bond rating, but make the state vulnerable to economic recessions in the future. Over the last decade, the state has maintained at least 10 percent of general fund revenues in cash reserves on average, which includes the state's Hurricane Relief Fund and Emergency Budget Reserve Fund. Currently, however, the state's cash reserves are projected to decline from 13 percent in FY 2015 to only 5 percent in FY 2018. According to the Government Financial Officers Association (GFOA), states should keep at least 15 percent of general fund revenues in cash reserves. The projected 5 percent in cash reserves falls well below the GFOA standard and should be of great concern to the legislature.

Table 4: Projected Total Cash Reserves (General Fund)



Source: Supplemental Executive Budget Requests FY2004-2014. Executive Biennium Budget FY 2015-17.

The current imbalance between general fund spending and revenues is not caused by less-than-anticipated revenues, but rather by poor long-term financial planning. For decades, the legislature has failed to account for the full cost of retirement and health care benefits for state workers, as well as overall growth in program expenditures. As a result, short-term budget decisions have often been prioritized at the expense of the state's overall long-term financial position. The state's financial plan clearly indicates that the current budget deficits are not sustainable beyond the FY 2016-17 budget. The legislature should therefore carefully examine the assumptions in the state's financial plan and scale down general fund spending immediately. Instead of taking a reactive approach by relying on overly optimistic assumptions and retroactive actions through executive spending restrictions, the legislature should be proactive and balance the FY 2016-17 biennium budget by taking a stand to cut at least $425 million in spending. This would prevent the legislature from having to raise taxes and it would be put the state on a healthier fiscal trajectory.

III. MULTI-YEAR FINANCIAL PLAN – GENERAL FUND

Table 5: Adjusted Multi-Year Financial Plan – General Fund (in millions of dollars)

Fiscal Year	2014	2015	2016	2017	2018	2019	2020	2021
EXECUTIVE BUDGET:								
Projected Revenues: 9/22/2014 Projection	6096.2	6288.7	6541.7	6918.2	7264.4	7632.6	8014.4	8415.9
Adjustment : 1/6/2015 Projection		55						
Total Revenues	6096.2	6343.7	6541.7	6918.2	7264.4	7632.6	8014.4	8415.9
Total Expenditures	6275	6440	6747.9	7120.8	7333.3	7553.2	7661.2	7780.4
Rev. Over (Under) Expend.	(178.80)	(96.30)	(206.20)	(202.60)	(68.90)	79.40	353.20	635.50
Carry-Over Ending Balance	664.8	568.50	362.30	159.70	90.80	170.20	523.40	1158.90
PROPOSED ADJUSTMENTS:								
Collective Bargaining (HGEA)			48.5	48.5				
Long-term Expenditure Growth					74.7	63.7	182.2	178.0
Total Adjustments	0.0	0.0	48.5	48.5	74.7	63.7	182.2	178.0
Adjusted Carry-Over Ending Balance	664.8	568.5	313.8	111.2	16.1	106.5	341.2	980.9
LIQUIDITY POSITION:								
Reserve Balances:								
Emergency Budget & Reserve Fund (EBRF)	83.2	90.9	103.4	116.0	125.5	135.1	144.6	154.2
Hurricane Relief Fund (HRF)	126.6	182.4	182.7	183.0	183.0	183.5	184.0	184.5
Total Reserves:	209.8	273.3	286.1	299.0	308.5	318.6	328.6	338.7
Adjusted Carry-Over Balance and Reserves	874.6	841.8	599.9	410.2	324.6	425.1	669.8	1,319.6

Source: Executive Biennium Budget FB 2015-17. Totals have been adjusted to account for the 4 factors that are discussed in this paper.