Memorandum

To: Hawaii Tax Review Commission

From: Alton Miyashiro

Date: September 18, 2021

RE: Proposed 2022 Tax Review Commission Recommendation

Background

The Hawaii State Constitution requires the establishment of a Tax Review Commission (TRC) every five years. The commission shall submit to the legislature a report evaluating the State's tax structure, recommend revenue and tax policy and then dissolve. Hawaii Revised Statute (HRS) Section 232E-3 states the TRC's duties are to "conduct a systematic review of the State's tax structure, using such standards as equity and efficiency".

The TRC is fully aware that formulating the State's budget includes consideration to both revenues and expenditures. The TRC is also fully aware the Commission's mandate is to make recommendations on the State's tax structure, or revenue component, and not expenditures. Despite this mandate, past TRC's have recommended the establishment of a commission similar to the National Commission on Fiscal Responsibility and Reform (also known as the "Simpson-Bowles Commission") which was created at the federal level in 2010 to create a plan to reduce the federal deficit. Due to the anticipated magnitude of the projected budget shortfall, the 2010-2013 TRC suggested that policy makers give serious consideration to establishing a Simpson-Bowles type of commission. This commission would provide a "drill down" study and recommendations that should be of great value to policy makers.[1] The 2015- 2017 TRC also recommended that the State create a task force similar to the Simpson-Bowles Commission to examine the unfunded and underfunded liability for health care and pension benefits for retired state workers.[2]

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1 State of Hawaii Tax Review Commission (2010-2013), Report of the 2010-2013 Tax Review Commission, at p. 4-7 (Nov. 28, 2012)

2 State of Hawaii Tax Review Commission (2015-2017), Report of the 2015-2017 Tax Review Commission, at p 24 (Feb. 8, 2018)

The Simpson-Bowles Commission

The Simpson-Bowles Commission was created in 2010 by President Barack Obama to identify “policies to improve the fiscal situation in the medium term and achieve fiscal sustainability over the long run”. The bipartisan, 18 member commission consisted of twelve members of Congress and six private citizens.
In summary, the commission’s plan recommended the following six steps.

1) Cap government spending at 21% of GDP which included cutting the White House budget by 15%, freezing all government employee pay and reducing the federal government workforce by 10% through attrition.

2) Reduce mandatory spending by reducing federal retirement benefits by $70 billion over 10 years, reduce farm subsidies and school loans for states and tribes.

3) Reduce federal health care spending by focusing Medicare payments to physicians based upon quality of care not quantity. Increase funding to reduce Medicare fraud. Better coordinate Medicaid and Medicare benefits.

4) Make Social Security sustainable lowering benefits for higher income earners and increasing normal retirement age to 69 by 2075.

5) Make changes to the tax code and increase government revenue at 21% of GDP while lowering tax rates by taxing capital gains and dividends as ordinary income, end the Alternative Minimum Tax and itemized deductions, tax income from state and municipal bonds. Eliminate 150 other tax loopholes, corporate tax subsidies and certain deductions.

6) Various Process Reforms which included mandating the president’s budget show no deficit by 2015, unless there is a recession and added other measures to control spending.

On December 1, 2010, the Commission released its final report “The Moment of Truth”. It failed to gain enough support of its own Commission members to pass. The Commission needed 14 members to approve the final report but only received 11 votes. Due to the divisiveness within the Commission, Congress would not consider it. In 2012, Congress still without a bipartisan plan to reduce the deficit faced mandated spending cuts and tax increases reconsidered the Simpson-Bowles plan but unfortunately on one was willing to risk their re-election to support the necessary but painful steps required.[3]

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[3] Amadeo, K. (2021, February). Simpson-Bowles Plan Summary, History, and Whether It Would Work. The Balance.

Proposed Recommendation

In the Governor's message to the State legislature in January 2021, Governor Ige estimated an annual general fund revenue shortfall of $1.4 billion for the current fiscal year as well as the next four years. The Governor discussed measures necessary to reduce the shortfall including government employee layoffs/furloughs as well as other cost cutting measures. In March 2021, the State received $1.6 billion from the federal government through the American Rescue Plan Act. The State also received federal funds in 2020 through the Cares Act. The Legislature agreed on a budget for the next two fiscal years of $31.2 billion that relies on $1.35 billion in federal aid. Without federal aid, the State's budget may have been very different.

With the projected revenue shortfall of $1.4 mil for the next four years and the uncertainty of receiving federal aid in the future, the State needs to continue to look for ways to manage the budget shortfall in the future. **The State Legislature should consider forming a Simpson-Bowles type of commission to look at specific ways to raise revenue and manage costs.**