The Year Without Tourism:
Hawai‘i’s FY2022 Pandemic Budget

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> Now is not the time to visit the islands.
>
> —Governor David Ige, August 23, 2021

Abstract

Hawai‘i’s economy was devastated by the COVID-19 pandemic. The effective closure of the tourism industry created an unemployment crisis and led to a dramatic decline in tax revenues. Nevertheless, Hawai‘i managed to avoid mass layoffs of public employees and draconian cuts in public services because of federal relief funds. The $15.9 billion budget for FY2022 restored funding to most departments, but the state’s dependence on the visitor industry has left it particularly vulnerable to future pandemic travel restrictions.

1. Introduction

In 2019, Hawai‘i welcomed a record 10 million visitors to the islands. These tourists collectively spent more than $17.75 billion, generating $2.07 billion in state tax revenue, and supporting well over 200,000 jobs (Hawai‘i Tourism Authority 2020). Although residents began to voice concerns about “overtourism,” record numbers of visitors from Asia and the mainland United States continued to choose Hawai‘i for their vacations. When the 2020 legislative session opened in January, the state’s low unemployment and economic prosperity seemed assured for years to come.

One month later, nearly everything changed as the COVID-19 pandemic began. On March 20, 2020, Governor David Ige declared a mandatory 10-day quarantine for anyone entering Hawai‘i (Ige 2020). This announcement was followed by an extraordinary request from the Hawai‘i Visitor and Convention Bureau to media and tourism outlets around the world, asking that they “refrain from publishing any stories about Hawai‘i that might encourage people to travel to the islands.” (Monahan 2020). For all intents and purposes, Hawai‘i’s all-important tourism industry was closed for business. By April, the state recorded only 4,000 visitor arrivals, most of whom were Hawai‘i residents returning home.

The Governor’s decision to lock down the islands spared Hawai‘i from the worst of COVID-19. In November 2021, it was ranked as one of the ten safest states in the nation with the lowest hospitalization rate and one of the highest rates of vaccination (McCann 2021). Much of

Hawai‘i’s success in managing the pandemic was due to the state’s unique geography. As an archipelago in the central Pacific accessible to visitors almost exclusively by airplane, state authorities were able to impose testing requirements and to screen passengers on arrival. In addition, compliance with public health guidelines was high throughout the pandemic. A November 2020 survey found that 79% of residents reported wearing masks nearly all of time when in public, and 66% gave the state a positive rating for its response to the pandemic (Moore and Hayashida 2020).

Yet closing the state to visitors had devastating economic consequences and demonstrated the risks of Hawai‘i’s longtime dependence on tourism. In less than two months, Hawai‘i’s unemployment rate rose rapidly to the highest in the nation as resorts were shuttered and thousands of workers were told to go home. The state was hit particularly hard by the closure of foreign travel because international visitors tend to spend more than tourists from the US mainland. Visitor arrivals from Japan and other international destinations were between 84% to 98% below their pre-pandemic numbers (UHERO 2021).

The state began a modest economic recovery as tourism returned to the islands in late 2020, but the arrival of the Delta variant in late July caused visitor arrivals to drop again. In July 2021, 75% of jobs had returned nationally, but only 50% had returned to Hawai‘i (UHERO 2021).

The collapse of the visitor industry had potentially ruinous consequences for the state budget. At the beginning of 2021, the dramatic decline in tax revenue seemed to necessitate cuts to social services, education, and the imposition of mandatory furloughs for tens of thousands public workers. Yet, none of these draconian measures turned out to be necessary because of the massive amounts of federal aid provided to state and local governments through the Coronavirus Aid, Relief, and Economic Security Act (CARES) Act and the American Rescue Plan (ARP) Act. In this article, I trace the efforts of state lawmakers to manage Hawai‘i’s budget from the rise of the COVID-19 crisis in March 2020 until the passage of the biennial budget in June 2021.

2. The COVID Crisis and the Collapse of Tourism

The pandemic devastated Hawai‘i’s tourism economy. As Figure 1 shows, unemployment surged from a low of 2.1% in February 2020 to a historic high of 21.9% in May 2020. It remained elevated for much of 2020 as Hawai‘i’s recovery lagged behind many states on the US mainland. Although the situation improved somewhat by September 2021, the state’s unemployment rate was still two percentage points higher than the national average.

Figure 1. Hawai'i Unemployment Rate, 2018 - 2021

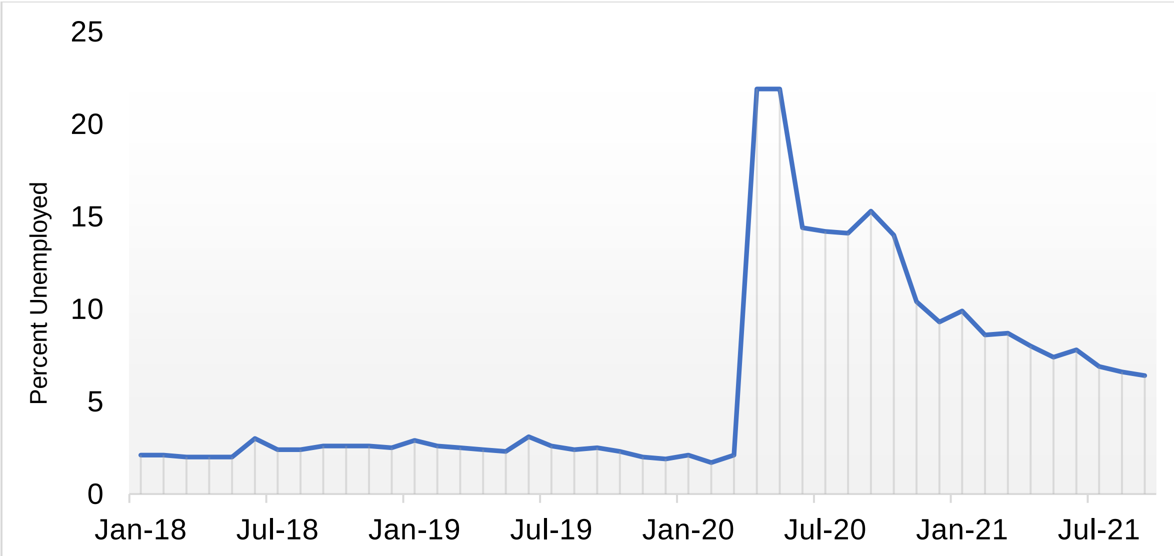
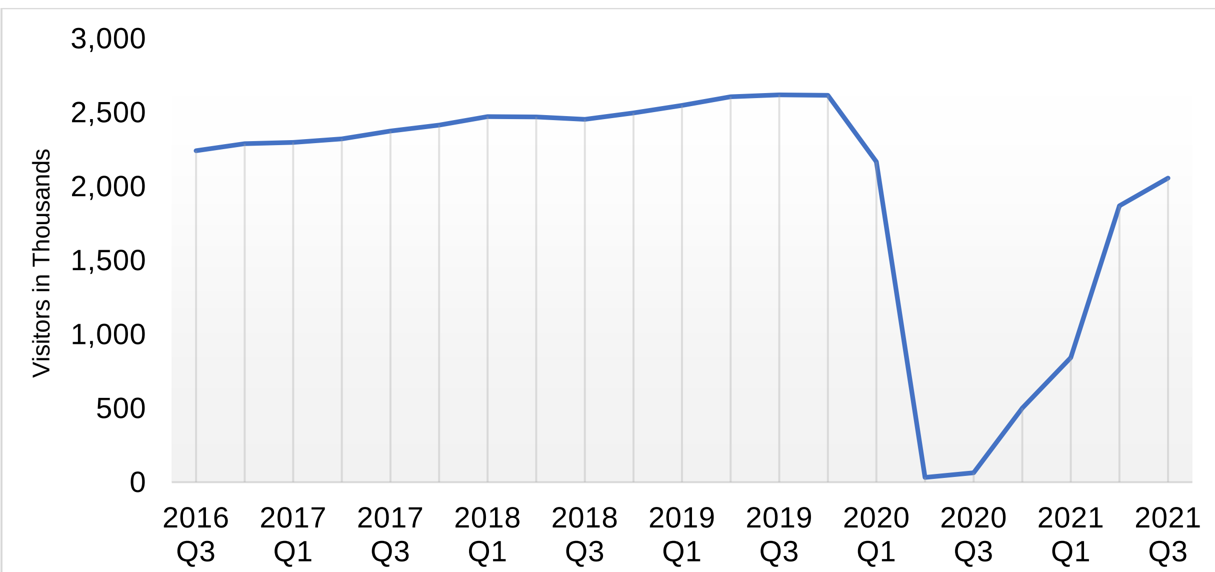


Figure 2. Quarterly Visitor Arrivals in Hawai'i, 2016 – 2021



Source: University of Hawai'i Economic Research Organization

The cause of this dramatic rise in unemployment was the effective closure of the state's tourism industry. As shown in Figure 2, the state had virtually no visitors during the second and third quarters of 2020, and it was not until the second quarter of 2021 that tourists began to return in significant numbers. With the decline in visitors came a 73.4% decline in visitor spending (Table 1). The result was a massive 7.6% decline in the state's Gross Domestic Product (GDP).

The effect on local businesses was predictably devastating. One survey of restaurant owners found that thousands were behind on their bills. Over half predicted that they would be forced to close by April 2021, and another 87% feared that they would need to exit the industry for good if the business environment did not improve soon (Nitz et al. 2020).

As in many states, the burden of pandemic restrictions was felt most acutely by the working poor. Filipino and Native Hawaiians families, who were already more likely to face economic challenges, were hit the hardest. Unite Here Local 5, Hawai‘i’s major hospitality union, noted that 9,000 of its 12,000 members were either furloughed or unemployed by November 2020. Nearly 75% of workers who lost their jobs made less than $20 per hour, while wealthy households, making more than $200,000, faced almost no loss of income (Hawai‘i Budget and Policy Center 2021).

Table 1.
Hawai‘i Economic Indicators: Year-Over-Year Percentage Change

	2019	**2020**	**2021**	**2022**	**2023**	**2024**
Visitor Arrivals by Air	5.0	-73.8	142.9	29.8	8.8	4.4
Real Visitor Spending	-0.4	-73.4	134.9	25.7	11.0	7.8
Non-farm Payrolls	0.0	-14.8	2.7	5.2	4.6	1.9
Inflation Rate, Honolulu	1.6	1.6	3.2	3.0	2.8	2.5
Real Personal Income	1.2	5.2	-1.1	-4.9	2.9	2.0
Real GDP	1.2	-7.6	3.5	2.4	3.3	1.8

Note: Figures for 2021 – 2024 are forecasts.
Source: University of Hawai‘i Economic Research Organization

The economic consequences of the pandemic were compounded by the inability of Hawai‘i’s unemployment office to process insurance claims. The delays were due in part to the unprecedented increase in applications, but technical problems played a role as well. At its peak, the unemployment office was receiving about 40,000 calls per day (Hofschneider 2021b). Compounding the problem, the department’s aging mainframe computer systems, largely unchanged since the 1980s, proved incapable of handling the massive workload (Honore 2020a). This meant that by May 2020 more than 100,000 residents had received no benefits (Hofschneider 2020). The situation became so bad that angry citizens organized a demonstration in downtown Honolulu that led to the temporary closure of the state’s main unemployment office (Honore 2020c).

Hawai‘i’s Pandemic Unemployment Assistance (PUA) program for self-employed workers also suffered enormous delays, leaving independent contractors and small business owners without financial support for months. During the first week of April 2020, 53,000 new PUA claims were submitted. By August 2020, the office registered a backlog of 22,000 claims, a delay the unemployment division blamed on the large number of fraudulent applications (Honore 2020b).

Despite its failure to provide timely payment of unemployment claims, Hawai‘i managed to institute some innovative policies to alleviate the pandemic’s burden on families and the unemployed. Perhaps the most significant was the distribution of $500-dollar debit cards to about 100,000 unemployed workers to use at any Hawai‘i restaurant (Dayton 2020b). This accomplished the twin goals of assisting the unemployed while offering some financial support to struggling local restaurants.

Hawai‘i also put into place an eviction moratorium, a crucial policy in a state where about 40% of households are renters and where 44,000 renter households were impacted by job loss (Garboden and Picciotto 2020). The moratorium was paired with one of the nation's most extensive rental assistance programs. By January 2021, more than 13,000 households were receiving federal rental subsidies (Hofschneider 2021a).

Nevertheless, at the beginning of 2021, 20% of renter households were estimated to be behind on their rent. By September 2021, the situation had slightly improved with only 10-14% of households owing back rent, but this was still a significant increase from the estimated 5-6% of renters who fell behind on their rent in the years prior to the COVID-19 pandemic (UHERO 2021). As University of Hawai‘i housing expert Philip Garboden wrote, "Left unchecked, this will necessarily result in bad outcomes for tenants, additional strains on our already overwhelmed housing systems, and a decline in our state's rental stock as landlords sell their properties into what remains a hot homeownership market" (Garboden 2021).

Curiously, the state's rental vacancy went up during this period. Most likely this was due to Hawai‘i's high unemployment rate as workers who had relocated to the state now found themselves unemployed. Many returned to the mainland and vacated their rental units, which caused rental rates to decline somewhat during the pandemic (Garboden 2021).

3. Political Context and the Budget Process

The Hawai‘i State Legislature is a part-time legislature that meets from January to May every year. The Legislature, dominated by Democrats since Hawai‘i became a state in 1959, is generally progressive and has a long history of enacting pro-labor policies. Democrats control the House of Representatives with 47 Democrats to 4 Republicans and the State Senate with 24 Democrats to 1 Republican. This supermajority means that fights are rarely partisan. More often conflicts result from the shifting alliances of senior Democrats whose loyalties are based on personal trust as much as policy goals.

The state's legislative leaders tend to be drawn from the Democratic Party's more conservative ranks. They are known for their fiscal caution and usually favor policy incrementalism. Their governing philosophy is somewhat akin to European-style corporatism or an older, New Deal style of Democratic politics. These senior Democrats mainly draw their support from organized labor, perhaps no surprise in a state where unions, both public and private, have a storied history (Coffman 2003). Unlike in many states on the US mainland, unions are still a powerful political force in Hawai‘i, where they represent 26% of all workers, the highest rate in the nation and more than double the national average of 12% (US Bureau of Labor Statistics 2021). In recent years, a small but increasingly vocal minority of progressives have become critics of the legislative leadership (Blair 2021a). Their support is drawn from Hawai‘i's large environmental lobby and, at times, from the powerful coalition of organizations that represent Native Hawaiians.

Governor David Ige is a Democrat who easily won reelection for a second term against his Republican opponent in 2018 with 61% of the vote. Despite his commanding election victory, Ige and the legislative leadership have been at loggerheads for nearly the entirety of his second term in office. These fights tend to be less about ideology and more about the Governor's perceived failures of leadership. Many legislators consider him weak and ineffectual, a reputation he earned through several high-profile disasters, including a false missile alarm in 2018 that triggered panic throughout the state (Grube et al. 2018). These challenges were exacerbated by the Governor's abysmal approval ratings, which have made him an easy target for legislators who would likely temper their criticism if he had more public support. In September 2019, Ige's approval rating was just 35%, a remarkably poor result for a Democratic governor in one of the nation's most Democratic states (Cocke 2019).

The pandemic has only increased the animosity between the Governor and the Legislature. In March 2020, House Speaker Scott Saiki wrote to the Governor to castigate him for his management of the pandemic, calling it "utterly chaotic" and noting that "there is mass confusion among the public" (Blair 2020b). The Speaker later developed his own House Select Committee on COVID-19, prompting one veteran journalist to ask, "Is Scott Saiki the de facto Governor of Hawaiʻi?" (Blair 2021b). For his part, Ige frequently pressed for more fiscal austerity during the pandemic, threatening public worker furloughs and introducing budgets that were developed with the most pessimistic revenue forecasts. The Governor claimed that he was being fiscally responsible, while some legislators believed that his conservatism was leading to unnecessary fear and misery (Dayton 2020e). These frequent public fights between the Governor and his fellow Democrats in the Legislature did little to increase the public's confidence in the state's ability to manage the social and economic consequences of COVID-19.

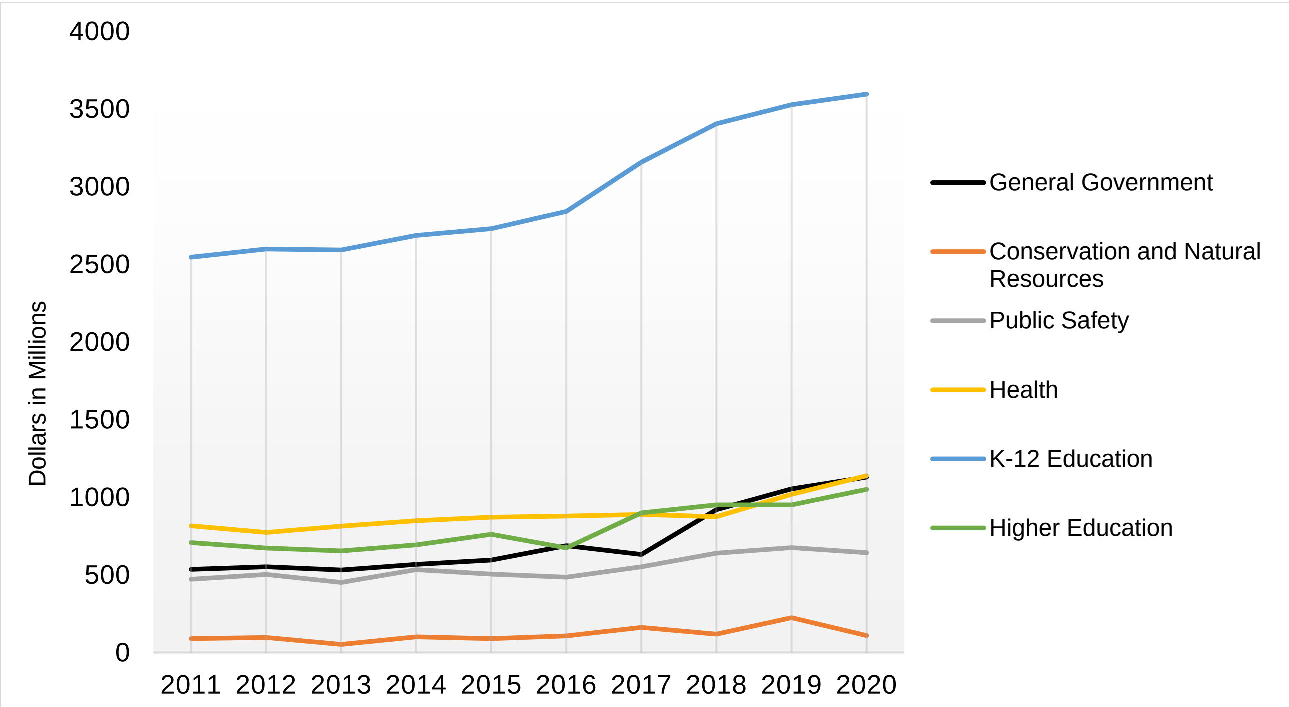
Every year, Hawaiʻi plans a biennial budget that must be balanced, and this often requires the Legislature to make off-year amendments to adjust spending. The state Constitution requires the Governor to present a budget request, prepared in consultation with executive departments, which request reflects the needs of 17 departments, the Governor's office, the Office of the Lieutenant Governor, and the University of Hawaiʻi System. The Governor is also required to submit a six-year financial plan for the state (Hawaiʻi Budget and Policy Center 2020).

At the Legislature, the Senate Ways and Means Committee and the House Finance Committee consider all financial bills. The budget's first section is for general departmental spending and the second is for Capital Improvement Project (CIP) appropriations that include state infrastructure investments and renovations. These are funded by general obligation bonds and are not included in the overall state budget. General fund revenues are set aside to pay for the day-to-day operating expenses of the state that are not financed by revenues from a special fund. The general fund is the chief operating fund of the state and holds both recurring tax and non-tax revenues (Hawaiʻi Budget and Policy Center 2020).

In any given year, roughly half the budget is devoted to fixed costs such as debt service and payments for public employee pensions and health care. As Figure 3 shows, the state's expenses have grown modestly over the past ten years. Spending for K-12 education, Hawaiʻi's largest expenditure category, has grown significantly, while health and higher education have increased at a slower rate. The growth in education spending is due, in part, to significant pay raises for

Hawaiʻi's public school teachers in 2015 and again in 2017. The state's most recent contract with the Hawaiʻi State Teacher's Association provides raises of 13.6% over a four-year period (Hawaiʻi News Now 2015, Kalani 2017).

Figure 3. Selected Government Expenses by Function



Source: Hawaiʻi Data Collaborative

The state's largest source of tax revenue comes from the General Excise Tax (GET), which is a broad 4% tax on all purchases and all services. The counties are permitted to add surcharges to the base GET rate. For example, the City and County of Honolulu has increased it to 4.7% to provide dedicated funding for the city's rapid-transit rail system. The regressive nature of the GET tax hits poor families particularly hard. Studies consistently show that it takes a greater percentage of income from lower-income households (Hawaiʻi Budget and Policy Center 2020).

Hawaiʻi also relies on an individual income tax with a top marginal rate of 11% for individual incomes over $200,000 (Hawaiʻi Budget and Policy Center 2020). Typically, half of the state's budget comes from non-general fund revenues. These include special funds, various federal funds, and the Transient Accommodations Tax (TAT) paid through a tax on visitor lodging (Blair 2020c). User charges make up about half of the $717 million in non-tax revenues (Mak et al. 2020).

A provision in the Constitution requires the Legislature to establish a general fund expenditure ceiling developed by the Council on Revenues, a board made up of economists and business leaders who are appointed by the Governor, President of the Senate, and Speaker of the House. Hawaiʻi is a balanced-budget state, so its general expenditures cannot exceed its revenues and cash on hand. According to Article VII, Section 5 of the Hawaiʻi State Constitution, "general fund expenditures for any fiscal year shall not exceed the State's current general fund revenues and unencumbered cash balances" (Constitution of the State of Hawaiʻi).

For example, in FY2019, the state recorded general fund tax revenues of $7.14 billion and non-tax revenues of $717 million for a total revenue of $7.86 billion. In that year, total expenditures were $7.94 billion, leaving a deficit of $82 million. This deficit was covered by a carry-over balance of $829 million from the beginning of FY2019, leaving a balance of $747 million to carry over into FY2020 (Mak et al. 2020).

The state is required to raise more revenue or to cut spending to cover the balance if there are no remaining carryover funds (Mak et al. 2020). An exception to this rule can only be made when the Governor determines that there is a threat to health, safety, or welfare – a factor that became relevant during fiscal year 2021 when the state passed a budget with a deficit for the first time in history (Hawaiʻi Budget and Policy Center 2020).

4. Containing the Damage: The 2020-21 Supplemental Budget

The Hawaiʻi State Legislature was one of the first institutions directly affected by the coronavirus pandemic. Although it had gone into recess on March 17, legislators and their staff were forced to vacate the State Capitol just two days later when a senior state senator tested positive for COVID-19. House Speaker Scott Saiki immediately released a memo instructing all personnel to "make immediate arrangements to leave your workplace as soon as possible" (Blair 2020a). As in other state legislatures, policymakers were forced to grapple with massive losses in tax revenue while trying to navigate unfamiliar remote working conditions.

The House had earlier passed a supplemental budget on February 18, 2020, but massive losses in tax state revenue required a complete overhaul of this proposal. This left the status of the $8.1 billion supplemental operating budget that was previously planned for the FY2021 in flux (Blair 2020b). As early as April, economists were predicting that Hawaiʻi's tax revenue could decline by as much as 25% which would create a potential shortfall of up to $1.85 billion. Such dire predictions were greeted with alarm throughout the Capitol. "We are worried — very worried — about the state's funding in the short and long term," said Scott Saiki, the normally taciturn Speaker of the House (Blair 2020b).

The situation worsened in May. "Don't freak out" the state tax director warned legislators before announcing that general excise tax collections were only $151 million, a decline from $314 million at the same time in May 2019. Even more alarming, the all-important hotel tax had only produced $4 million. State economist Eugene Tian predicted a decline in revenue of 6% in 2020 and 14% in 2021, and other economists warned that the revenue shortfall could reach as much as $1.8 billion (Lovell 2020d).

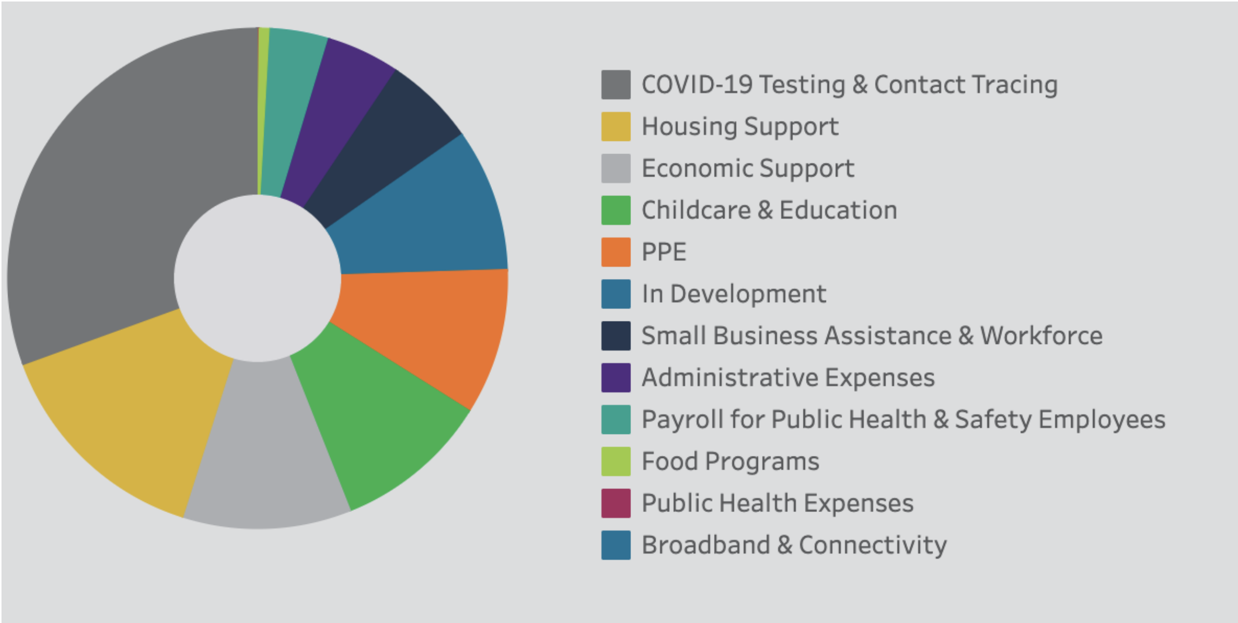
As the legislative session began again on June 21, 2020, it became clear that the Governor and the Legislature differed on exactly how much state revenue had declined during the pandemic. Gov. Ige believed that the budget hole was nearly $1.5 billion, while legislators held firm to the slightly less-alarming estimate of $1 billion. Whatever the exact number, lawmakers were left scrambling to fill a hole in the budget that was unprecedented and impossibly large (Lovell 2020d).

The options available to address this huge shortfall in funds were limited. At the beginning of the pandemic, Hawai‘i had $395 million in its rainy-day fund, but officials estimated those funds would cover only six weeks of government spending. House Finance Chair, Sylvia Luke, proceeded to identify special funds with pots of money that could be absorbed into the general fund. Nothing was considered off-limits. For example, even $20 million in a Mental Health and Substance Abuse special fund was transferred to the general budget. Lawmakers estimated that there were $286 million in unused funds from state departments and $71 million from unfilled vacant positions. They also proposed financing some expenses through bonds rather than paying with current tax revenues. This allowed them to avoid using general funds to cover $250 million in costs for the Rental Housing Revolving Fund used to support affordable housing (Lovell 2020a).

Hawai‘i did receive a modest lifeline on March 27, 2020, when President Trump signed the Coronavirus Aid, Relief, and Economic Security Act also known as the CARES Act. This $2.2 trillion economic stimulus bill provided funds for state and local governments through the Coronavirus Relief Fund (CRF). Hawai‘i was granted $1.25 billion in CRF funds; the state received $863 million while the City and County of Honolulu received $387 million (Hawai‘i Budget and Policy Center 2020). As Figure 4 shows, CARES Act funds provided significant assistance for housing support, purchase of personal protective equipment, and funds for contact tracing.

The Governor’s fractious relationship with the legislative leadership led to disputes over how the state’s CRF funds could best be used. The Legislature wanted $553 million in unused CARES Act money to be placed in the state’s rainy-day fund to address future needs, while the Governor planned to move this money to the unemployment fund, which was being rapidly drained by new claims (Lovell and Blair 2020). In the end, the Governor lost this battle and was forced to borrow $700 million to shore up the state’s unemployment system.

Figure 4. CARES Act Expenditures in Hawai'i by Category



Source: Hawai'i Data Collaborative

In April 2020, the state benefited from further federal assistance when it was given a line of credit through the Federal Reserve's Municipal Liquidity Facility (MLF). This authorized the MLF to purchase up to $500 billion in short-term notes from eligible governments and public entities with terms of up to three years through December 2020. For Hawai'i, this meant that the state now had access to a $2.1 billion line of credit (Federal Reserve Bank of New York 2020).

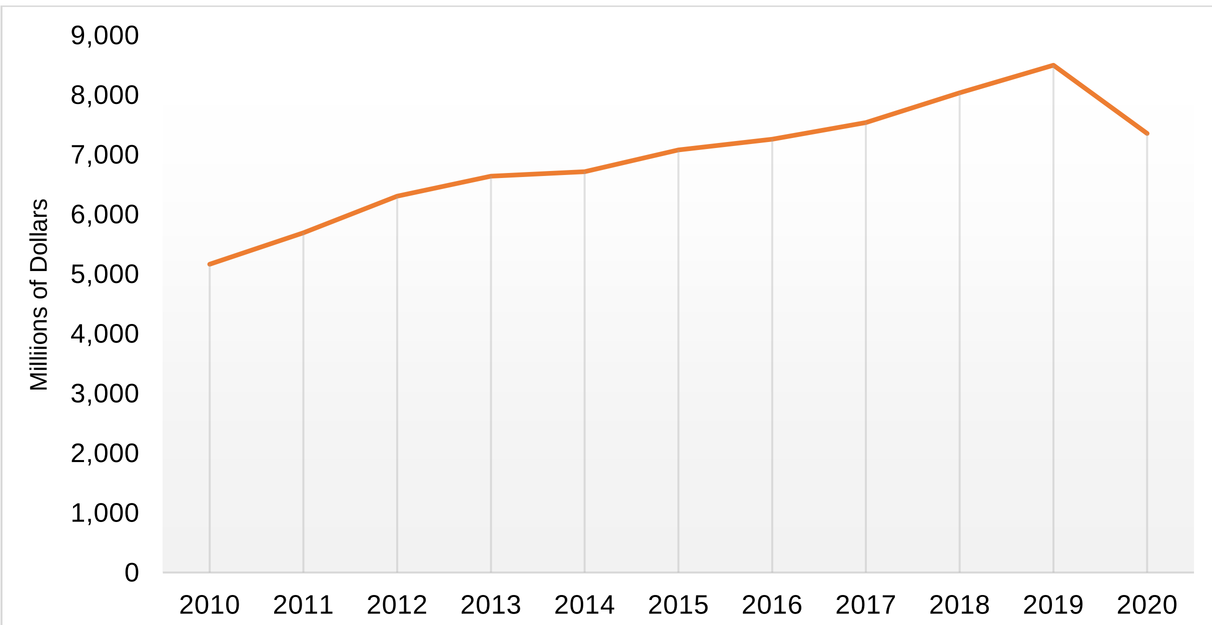
By May, the Legislature was ready to announce its plan to address the funding shortfall. It cut $357 million in funding for positions that state agencies had not filled, moved $270 million in planned expenditures from general revenue to bond financing, and used the entirety of the state's $359 million rainy-day fund to fill the $1 billion hole in the budget (Lovell 2020b). The decision to eliminate vacant positions immediately put the legislative leadership in conflict with state bureaucracies whose leaders feared this action would cripple their agencies. Yet for most policymakers, this was more politically palatable than increasing taxes or furloughing existing workers (Lovell 2020c).

More controversial were pay raises for Hawai'i's public employees, which had previously been approved but had not yet been funded (Lovell and Blair 2020). Progressives were concerned that they were taking away resources that could be used to help more vulnerable residents, while fiscal conservatives worried that the state simply could not afford them at a time when its tax revenues were plummeting (Lovell 2020f). In the end, the Legislature did vote to appropriate more than $200 million to fund the pay raises. Even in a fiscal crisis, few legislators were eager to pick a fight with Hawai'i's powerful public-sector unions, especially as they headed into an election year. The Governor made no effort to block these raises but he did make it clear that layoffs and furloughs for public employees were still on the table (Lovell 2020f).

5. Economic Conditions Leading to the FY 2022 Budget

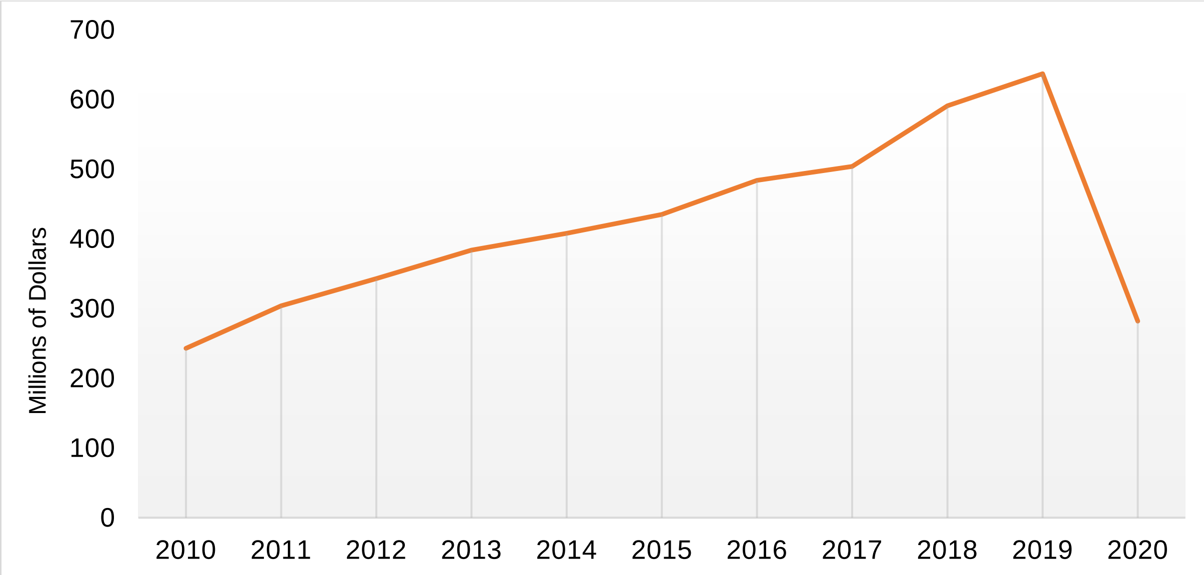
When the 2021 legislative session began, Hawai‘i and Nevada were tied for the nation’s highest unemployment rate at 9%. But Hawai‘i’s economy was recovering at an even slower rate than the Silver State’s (Peterkin 2021). As Figure 5 shows, total state tax revenues declined from $7.14 billion in 2019 to $6.69 billion at the end of the 2020 fiscal year. Economists projected tax revenue to dip to $5.96 billion in FY2021 (Council on Revenues 2020). Revenue from the TAT collapsed from a high of $637 million in 2019 to only $282 million in 2020 (Figure 6). Overall, economists predicted state tax collections for FY2020 and FY2021 to decline by $2.2 billion and projected that they would not return to the 2019 baseline until 2024 (Dayton 2020c). Although tourists flocked to the Aloha State during the summer of 2021, this flood of new visitors was not nearly enough to close the massive budget gap.

Figure 5. Total State Tax Revenue, 2010 - 2020



Source: University of Hawai‘i Economic Research Organization

Figure 6. Transient Accommodations Tax Revenue



Source: University of Hawai'i Economic Research Organization

Hawai'i was left with few options. Direct borrowing through general obligation bonds for day-to-day operations was discouraged because of fears that it would downgrade the state's credit rating. Article VII, Section 13 of the Hawai'i State Constitution also limited the state's ability to borrow funds. Given that the State had an outstanding debt of $10.5 billion at the time, this left only $576.8 million for additional borrowing (Mak et al. 2020).

In August 2020, as legislators and the Governor began to plan for next year's legislative session, they assumed that no federal bailout would arrive. As the Chair of the state's powerful Ways and Means Committee said, "It's better to be more conservative than to assume it's coming, and (then) it doesn't" (Dayton 2020a). Joe Biden's victory in the 2020 presidential election provided more hope that the federal government would pass another relief package, but the Governor's budget proposal assumed that this would not happen. "Clearly we hope that aid will be coming," Governor Ige said, "but we've really built our budget on what we know today, as I am required to do by law and by [the] Constitution" (Dayton 2020e).

To prepare the budget under this doomsday scenario, the Governor authorized all special funds to be tapped, including $183 million from Hawai'i's Hurricane Relief Fund. In July of 2020, Ige gave the state further room to maneuver by waving the requirement to pay into a health care trust fund for retired state workers. One state official estimated that it would save as much as $840 million if the state made no contribution during fiscal year 2021, but many feared that the consequences for the long-term health of the fund could be dire (Dayton 2020c).

Despite vehement opposition from public employee unions, the Governor continued to plan furloughs for all state employees, effectively forcing them to take a pay cut of 9.23% (Dayton 2020c). "I wish there was a way that I could say we wouldn't be laying people off," the Governor said, "but I do think that because of the size of the program review and the amount of money that we need to cut from the budget, I do believe that it does include layoffs" (Dayton

2020d). Ige, who was elected in part because of his support for government employees, faced fierce criticism from Hawai‘i’s powerful public employee unions who threatened to challenge his decision in court.

The remaining policy tools available to the state were tax increases and draconian cuts to the budgets of state agencies. The Governor instructed all state agencies to plan for two scenarios: a 5% cut and a 10% cut of general fund revenues. According to the Governor, these cuts were necessary because of COVID-19, and the “rapid deterioration in the state’s short- and medium-term fiscal outlooks” (Mak et al. 2020).

The Hawai‘i Budget and Policy Center estimated the effects of both scenarios. In each case, they predicted that the long-term consequences for the economy would be devastating in a state where public employment amounts to 12% of the nonagricultural wage and salary jobs. As Table 2 shows, a cut of $400 million in the general-fund supported budget could lead to a $600 million loss in economic activity. The University of Hawai‘i’s Economic Research Organization warned that such cuts would add “to the pain and misery already in the community. Across-the-board cuts and restrictions will reduce needed services” (Mak et al. 2020). There was no doubt that these cuts would have dire effects on the ability of state agencies to deliver services, but the Governor had few options at the end of 2020.

Table 2. Economic Effects of Expected Cuts

	Direct Cut	Full Economic Effect
Proposed 5% cut in General Fund-supported budget	$400 million	$600 million
Contingency 5% cut in General Fund-supported budget	$400 million	$600 billion
Proposed State Worker Furloughs 2-days/ month	$331 million	$497 million
Effect of cutting 10% from nonprofit service contracts	$58 million	$86 million
Total	**$1.189 billion**	**$1.783 billion**

Source: Hawai‘i Budget and Policy Center (January 2021)

The planned budget cuts in education were particularly devastating. Hawai‘i has a single, centralized state school district run by the Department of Education (DOE) that serves 161,000 students through 257 schools. Its $2 billion budget supports 22,000 employees, 13,000 of whom are teachers (Nakaso 2021a). In 2020, the DOE faced budget reductions of up to 20% and the loss of 1,000 teachers (Lee 2020a, Lee 2020b). State Education Superintendent Christina Kishimoto described these cuts as potentially “decimating” and noted the “extraordinary pressure on education officials to deliver quality education in these leaner times” (Lee 2020a).

Similar cuts were planned for the state’s higher education system. The University of Hawai‘i’s budget chief warned that the state was planning to cut $181 million from its $1 billion budget. The consequence, he warned, “will be prolonged, possibly perpetual changes to how the university is run” (Lovell 2020e).

By November 2020, the situation had become so bad that Ige was considering a plan to defer scheduled payments to the state’s health care fund for current and retired public workers. With the Legislature’s approval, he had already deferred a $388 million payment for health care obligations, and he was looking to defer four more years of payments to save $1.85 billion (Dayton 2020d). For Governor Ige, this must have been a particularly painful decision. Years before, as a legislator and chair of the Senate Ways and Means Committee, he wrote the very law he now planned to suspend. Nevertheless, the legislative leadership largely agreed with this decision, but held out hope that they might still avoid taking this drastic action. “I think that is kind of a last resort because it does add to the unfunded liability, and it is kind of not a good policy for us to defer,” said House Finance Chair Sylvia Luke (Dayton 2020c).

6. 2021 Executive Budget

Governor Ige’s executive budget proposal, which was released on December 21, 2020, began with the goal of cutting an astonishing $600 million from the annual budget. The Department of Education was due to see its budget cut by $165.7 million for each of the next two fiscal years, and the University of Hawai‘i system was facing cuts of $70 million each year. Ige also planned to cut $800 million from planned bond sales to fund various state construction projects (Dayton 2020f). The Governor had authorized a $750 million loan from the federal government so the state could meet its payroll and operating expenses. Yet, he noted that the loan was not a solution to the underlying problems, since it would need to be paid back over five fiscal years, potentially serving as a drain on the state for years to come (Ige 2020).

In his message to the Legislature, the Governor painted a dismal picture of the state’s fiscal situation. “If we continue the current rate of state spending,” Ige reported, “the projected shortfalls are overwhelming, and it is our responsibility to take action to ensure the state’s fiscal stability. The longer we wait to act, the larger these shortfalls become, and the more drastic corrective actions will need to be” (Ige 2020). In the words of veteran Hawai‘i political reporter Kevin Dayton, the Governor’s budget proposal had “something for everyone to hate” (Dayton 2020e).

Furloughs for 10,160 public employees were projected to save $300 million per year. The Governor also planned to lay off 149 state employees and eliminate 550 vacant jobs. Facing fierce opposition from the public sector unions, some legislators began to question the need for furloughs. Senate President Ron Kochi noted that other avenues were being pursued “because of the possibility that we wouldn’t prevail in a court case.” House Finance Chair Luke argued that some of the money could be made up by moving $600 million in various special funds into general funds (Dayton 2020e).

Another emergent problem was the status of Hawaiʻi's unemployment insurance payments. In theory, local businesses were responsible for repaying the $700 million loan the state used to cover unemployment benefits during the pandemic. This meant that the state's unemployment insurance rates were likely to increase dramatically for the 30,000 businesses covered through the state's program; payments that many struggling small businesses would be unable to make. House Finance Chair Luke was deeply opposed to burdening Hawaiʻi's businesses with this obligation. She feared that it would "force employers out of business, because they can barely keep their business afloat, and then you are going to hit them with a huge price tag" (Dayton 2021a).

Not all the news was bad. By late 2020, the state's economy began a slow recovery. Hawaiʻi's Safe Travels program instituted a system whereby visitors could skip the previously-required 10-day quarantine by receiving a negative test result prior to arriving in Hawaiʻi. By June 14, 2020, this system was expanded to include fully-vaccinated travelers who only needed to provide proof of vaccination to enter the state (Hawaiʻi News Now 2021).

By the fourth quarter of 2020, these new policies and a decline in mainland COVID-19 cases brought nearly 500,000 visitors to Hawaiʻi. This was only a fifth as many as arrived during the same period in 2019, but it was still a remarkable improvement from the previous two quarters when the islands were essentially closed to visitors. Despite this progress, economists at the University of Hawaiʻi estimated that tourism would not return to pre-pandemic levels until 2025 (Yerton 2021a).

In another piece of good news, the state's Council on Revenues increased its estimation of state revenues for FY2022 from $6.46 billion to $6.63 billion because of increased tourism and better than expected income tax returns (Council on Revenues 2021). The slight boost in state revenues caused Ige to revise his planned cuts from 10% to 2.5% (Lee 2021). The Governor's final budget, released in December 2020, proposed $7.6 billion in general fund spending, which represented a reduction of $4.5% from FY2021 and assumed budget shortfalls of $1.4 billion for FY2022 and FY2023 (Dayton 2020f).

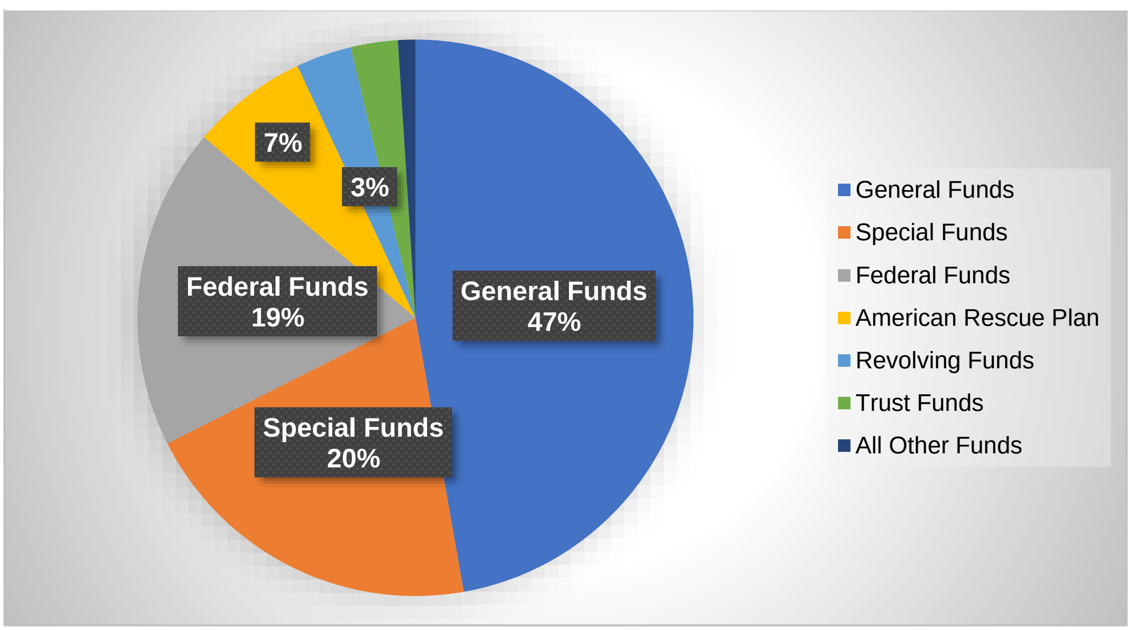
7. A Federal Lifeline and the Legislature's Response

Relief for Hawaiʻi came with the passage of the American Rescue Plan (ARP) on March 11, 2021. This bill pumped $6.1 billion of federal assistance into the state's economy and provided direct payments of $1,400 to most adults. As Hawaiʻi's senior US Senator Brian Schatz wrote in a press release, "Billions of dollars are coming to Hawaiʻi to help families and small businesses. This new package will deliver immediate help to people who have lost their job or can't make their rent" (Schatz 2021). The direct funding it provided to state and local governments to make up for lost tax revenue immediately ended the panic at the State Capitol. The State of Hawaiʻi was due to receive $1.6 billion, while the City and County of Honolulu was granted $365 million, with smaller amounts going to the less populated islands (Schatz 2021).

The American Rescue Plan allowed the Legislature to consider the state's budget under entirely different circumstances compared to when Ige developed it in the dark days of November and December 2020. Indeed, the federal bailout funds closed the budget holes and even allowed the state to replenish its rainy-day fund. House Finance Chair Luke and her Senate counterpart Donovan Dela Cruz set to work restoring the funding for most state departments whose budgets had been slashed in the Governor's proposal. Painful layoffs for state workers were immediately taken off the table, and the Governor's planned furloughs were suspended. Most cuts to public education were also cancelled because some federal funds were dedicated to support education, including nearly $400 million for K-12 schools (Dayton 2021d). Luke made plans to repay the $750 million loan that Ige had borrowed from the Federal Reserve's MLF to cover the state's payroll. Also off the table were the state's plans to defer its required contributions to the Hawai'i Employer-Union Health Benefits Trust fund for current and retired state employees (Dayton 2021d).

As Figure 7 shows, ARP funds made up 7% of the general state budget for FY 2022 with much of the rest going to repay the state's loans from the Federal Reserve's Municipal Liquidity Facility. These federal dollars allowed state officials to avoid making painful tradeoffs and to maintain funding for crucial state services. With the $1.6 billion in federal aid and $226 million in special funds, the House restored funding to a variety of nonprofit programs as well, including Hawai'i's Sex Abuse Treatment Center, which Luke had earlier singled out as a priority (Dayton 2021b). In addition, the Legislature was able to avoid the planned $80 million in cuts to vital state programs for child support, HIV prevention, and other social and public health priorities (Nakaso and Cocke 2021). The Legislature's confidence in state finances led them to abandon a proposal to increase income taxes on Hawai'i's highest earning households, which was projected to supply an extra $1.8 billion in tax revenue over the next six years (Dayton 2021c).

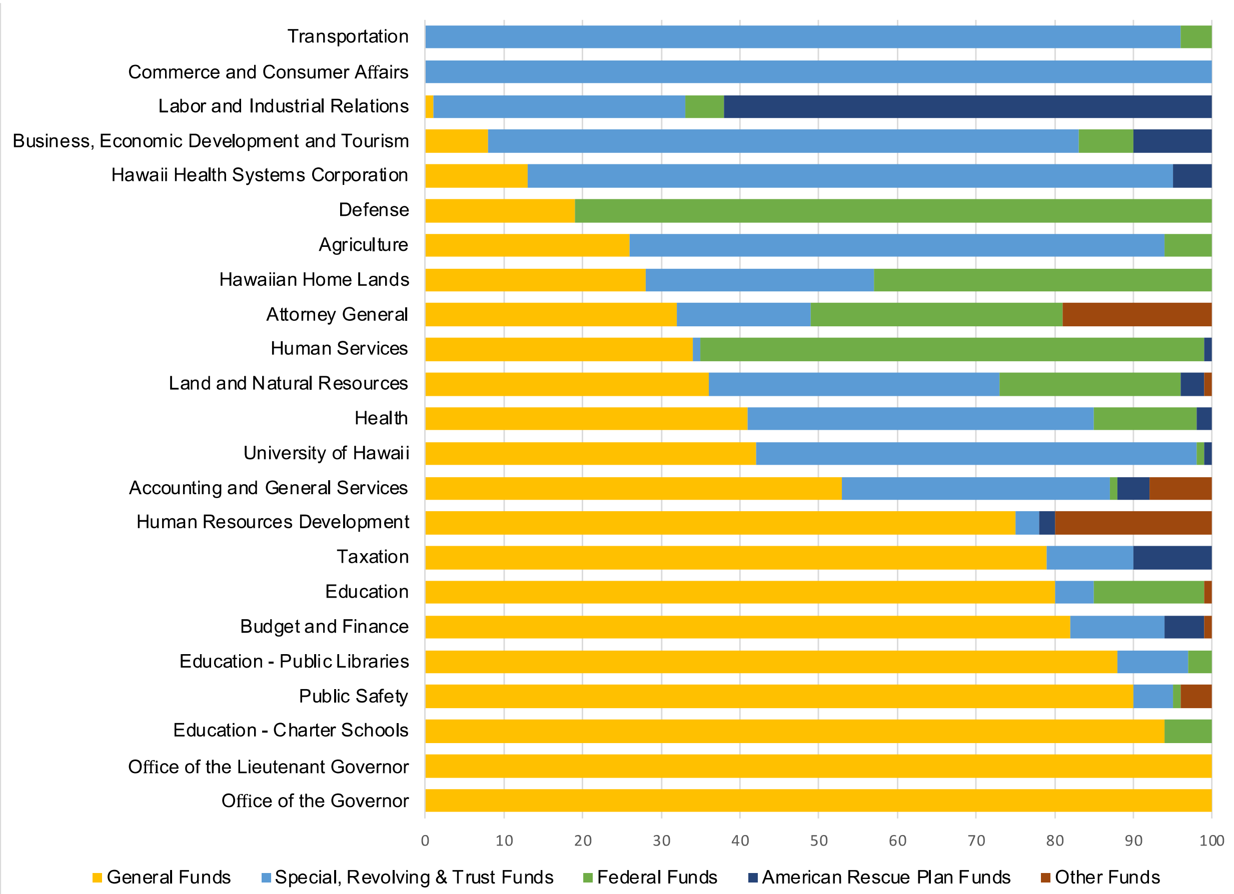
Figure 7. Budget by Means of Financing



Source: Hawai'i Data Collaborative

In a more controversial move, House Finance Chair Luke proposed to use federal funds to pay off the $700 million loan the state had taken to make its unemployment payments. According to Luke, state pandemic restrictions required businesses to shut down. “We think it is the state’s responsibility,” Luke said, “We don’t want the unemployed population not to get paid” (Lovell 2021). Although Ige agreed that the state should help, he did not include this in his original proposal written before funds from the ARP were available (Dayton 2021b).

Figure 8. Departments by Means of Financing



Source: Hawai‘i Data Collaborative

Figure 8 shows the mix of funds that were used to cover the budgets for each department. Some, like the Department of Transportation were covered almost entirely though special funds. Others, like basic government operations for the Office of the Governor, were covered through general funds. The ARP funds went primarily to the Department of Labor and Industrial Relations to repay the federal loan that secured the unemployment insurance trust fund. ARP funds were also allocated to the Department of Business, Economic, Development and Tourism to cover the costs associated with the Hawai‘i Tourism Authority, the state’s tourism marketing agency.

Table 3 shows the changes in budget drafts during the 2021 Legislative Session. Although some departments had modest cuts, the Legislature reversed most of the cuts proposed by the Governor. Some department budgets even increased, such as state funding for the University of Hawai‘i, K-12 education, Transportation, and Land and Natural Resources. One of the most dramatic increases was due to the one-time payment to retire the state's unemployment insurance fund loan from the federal government. Additional funds were used to support the beleaguered unemployment office, which, by June 2021, was managing 150,000 active unemployment claims (Hofschneider 2021b). The large reduction in funds to the Department of Business, Economic, Development and Tourism stemmed from a controversial decision to reduce funding to the Hawai‘i Tourism Authority.

Table 3. Changes in Budget Drafts During 2021 Legislative Session

Department	Base Budget	Governor's Draft	Conference Draft	Percent Change from Base Budget to Conference Draft
All Departments	$30,813.5M	$30,938.1M	$31,162.9M	1.1% ($349.4M)
Business, Economic Development and Tourism	$574.0M	$573.6M	$321.6M	-44.0%(-$252.4M)
Office of the Governor	$8.4M	$8.4M	$7.1M	-15.1%(-$1.3M)
Budget and Finance	$7,129.2M	$6,930.7M	$6,659.8M	-6.6%(-$469.4M)
Defense	$215.1M	$209.5M	$206.9M	-3.8%(-$8.2M)
University of Hawaii	$2,499.9M	$2,354.1M	$2,415.1M	-3.4%(-$84.8M)
Agriculture	$104.3M	$105.9M	$101.6M	-2.6%(-$2.7M)
Education - Charter Schools	$222.9M	$199.4M	$217.1M	-2.6%(-$5.7M)
Attorney General	$207.4M	$203.1M	$204.6M	-1.3%(-$2.8M)
Health - Hawaii Health Systems	$1,464.6M	$1,536.4M	$1,447.9M	-1.1%(-$16.8M)
Taxation	$60.5M	$63.4M	$60.5M	0.0%($0.0M)
Office of the Lieutenant	$1.9M	$1.9M	$1.9M	0.0%($0.0M)
Human Resources Development	$52.1M	$52.8M	$52.1M	0.0%($0.0M)
Education - Public Libraries	$85.0M	$77.9M	$85.1M	0.1%($0.1M)
Education	$4,148.1M	$3,817.5M	$4,158.5M	0.3%($10.4M)
Public Safety	$582.7M	$599.1M	$584.6M	0.3%($2.0M)
Accounting and General	$379.0M	$355.8M	$382.1M	0.8%($3.1M)
Health	$2,097.8M	$2,204.4M	$2,140.3M	2.0%($42.5M)
Human Services	$7,320.6M	$7,845.5M	$7,471.8M	2.1%($151.2M)
Commerce and Consumer	$178.8M	$184.8M	$184.8M	3.4%($6.0M)
Transportation	$2,132.0M	$2,219.5M	$2,241.3M	5.1%($109.2M)
Land and Natural Resources	$319.6M	$340.9M	$347.3M	8.7%($27.7M)
Hawaiian Home Lands	$95.6M	$109.6M	$107.3M	12.2%($11.6M)
Labor and Industrial Relations	$933.9M	$943.9M	$1,760.6M	88.5%($826.7M)

Source: Hawaii Data Collaborative and Office of the Governor

By April, the House and Senate leadership had settled on a $15.9 billion budget for FY2022. Funding for most programs were restored and furloughs and layoffs were avoided. The federal bailout funds were certainly a relief to legislators who had prepared to make painful cuts to nearly every state program. "We weren't expecting any federal bailout, and we were expecting to make drastic cuts in the state budget. There was a lot of uncertainty in January," noted House Speaker Saiki (Nakaso 2021b).

The Governor's frosty relationship with the legislative leadership was on display when he vetoed more than 20 bills at the end of the session, including a bill to use stimulus funds to return money to the state's rainy-day fund (Nakaso 2021c). The vetoes largely stemmed from disagreements between the Governor and the Legislature about the proper use of COVID-19 relief funds. The Legislature had planned to use millions in federal funds to cover some of the state's general obligation bond debt, which Ige argued was forbidden by federal rules. The Governor eventually won this battle when further guidance from Washington, D.C. clarified that states were not permitted to use relief monies to settle debt obligations or to contribute to programs that had federal matching fund requirements (Mizuno 2021).

8. Tourism: An Emerging Issue

Perhaps the most surprising controversy to emerge during the pandemic was a backlash against the tourism industry. For a state that was suffering dire economic consequences from the collapse of its number-one industry, this was an unexpected development. Yet after record-breaking visitor arrivals during 2019, residents were deeply frustrated by the crowds and the allegedly bad behavior of a handful of tourists who were entering closed trails and disturbing wildlife (Nguyen 2020). The rise of vacation rental units, easily available through websites such as VRBO and Airbnb, contributed to the problem. Residents bristled at having their neighborhoods turned into small resort areas. Indeed, by 2019 one out of every four houses on O‘ahu's fabled North Shore was a vacation rental (Yerton 2019).

The break from tourism during 2020 only seemed to fuel anti-tourist attitudes. For the first time in recent memory, residents could visit beaches and take hikes without contending with crowds of visitors. According to one survey, "If it were possible, about 52% would prefer limiting the number of visitors," and these sentiments were even stronger on the less-populated and more tourism-dependent islands of Maui and Kauai (Knox and Moore 2021). One popular Facebook group called "Enough Tourists Already" emerged to catalog the sins of Hawai‘i's visitor industry and the bad behavior of tourists from the US mainland. There was also a sense that tourists weren't paying enough to visit the state. Residents largely supported increasing rental car surcharges and imposing a "green fee" on visitors to fund infrastructure improvements and to protect the state's natural resources (Knox and Moore 2021).

These negative attitudes toward tourism took center stage during the legislative session. Legislators had long criticized the Hawai‘i Tourism Authority (HTA) for marketing Hawai‘i to so-called "budget tourists." Among the most dramatic actions during the 2021 session was the decision to remove the dedicated stream of funding from the Transient Accommodations Tax that had sustained the HTA since its creation in 1998. The HTA argued that this would limit its flexibility to advertise Hawai‘i as a destination and to respond quickly to changes in market dynamics. But these arguments did little to dissuade angry legislators who slashed the HTA's budget, leaving its future as a state agency uncertain.

The Legislature also made dramatic changes to the TAT. Not only would that money no longer provide dedicated funds to HTA, but the Legislature used the fiscal crisis to redirect all hotel tax funds to state coffers. In the past, the state had provided a large portion of those funds to the counties (Yerton 2021b). As a compromise, the counties were given the authority to levy their own taxes of up to 3% on top of the existing 10.25% state hotel tax (Yerton 2021b). The once all-powerful tourism industry was unable to block any of these changes or to receive a sympathetic hearing from legislators. In response to industry complaints that higher taxes would lead to fewer visitors, House Finance Chair Sylvia Luke exclaimed, “Isn’t that what people want?” (Schaefers 2021).

The visitor industry’s concerns were taken seriously by Governor Ige who spoke out strongly against the bill and later vetoed it. “The visitor industry is the No. 1 industry in this state,” the Governor noted, “It creates 200,000 jobs plus, and we are not going to have economic recovery until the visitor industry recovers” (Schaefers 2021). But in an unusual move for Hawaiʻi, the Legislature overrode his veto and passed the bill.

The proper management of tourism will likely be a major theme of the 2022 legislative session as the state navigates the return of this crucial industry while trying to achieve a better balance between visitor demand and resident needs. One proposal that is likely to take center stage is the creation of a Regenerative Tourism Fee, sometimes called a “green fee,” that would require visitors to pay a tax for conservation and natural resource regeneration efforts (Mak 2021). For its part, HTA has already released a variety of new tourism management proposals designed to appeal to residents.

9. Conclusion

From a public health perspective, Hawaiʻi weathered COVID-19 much better than many states. On the one hand, the number of cases remained relatively low even during the worst days of the crisis. In large part this was due to the state’s unique geography, which allowed it to restrict entry only to those who could show a negative COVID test or proof of vaccination. The relatively enthusiastic support of residents for public health measures, such as social distancing and wearing masks, also played an important role.

From an economic perspective, however, the COVID crisis devastated Hawaiʻi’s tourism economy and created a fiscal crisis that led the state to have the highest unemployment rate in the nation for much of 2020. Without federal aid, particularly the aid provided in the ARP, thousands of workers would have lost their jobs and even more local businesses would have been forced to close. No state benefited more from the federal COVID bailout than Hawaiʻi. If the pandemic forces the visitor industry to shut down again, the Aloha State will face a new fiscal crisis, and this time it may not be able to rely on money from Washington.

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