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In This Issue

*Hawaii's economic future:
proposals of the ERTF*
page 1

Summary of the proposals
page 4

The ERTF process
page 5

Tax reform proposals
page 6

Tourism proposals
page 13

Education proposals
page 15

Government proposals
page 18

*Economic impact
of key proposals*
page 20

Economic conditions & outlook
page 22

Selected statistics
page 23

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Hawaii's Economic Future: Proposals of the Economic Revitalization Task Force

Virtually everyone in Hawaii has been impacted by the slow growth in the State's economy over the last six years. Real production and income have grown at a snail's pace. While job losses have stabilized in the past year, there were about 12,000 fewer jobs last year than in 1992. Government tax revenues have fallen in inflation-adjusted terms. All of this has taken place against the backdrop of one of the strongest economic expansions in U.S. history, an expansion shared by virtually every state except Hawaii.

The Economic Revitalization Task Force

Against this background Governor Ben Cayetano, Senate President Norman Mizuguchi, and House Speaker Joe Souki joined with key leaders in the private sector to form the Economic Revitalization Task Force (ERTF). These leaders realized that while Hawaii faces many challenges, a strong economy is the essential foundation for dealing effectively with Hawaii's non-economic problems. Moreover, they recognized that major economic reforms were needed and that formulating and enacting such reforms would be possible only through a large, cooperative effort involving segments of the community knowledgeable in how

Hawaii's economic and business system works. For these reasons, the Task Force and its Work Groups were composed of a wide assortment of leaders from big business, small business, labor, community groups, and others.

After months of work, the ERTF developed a set of recommendations that deal with taxation, tourism, education, regulation, government efficiency, and others. The recommendations are bold and a few are controversial; yet the ERTF feels that all can be realistically implemented.

The recommendations reflect the ERTF's conclusion that continuing on our current course is unacceptable. Its package of proposals represents a remarkable consensus on sweeping reforms designed to take our fate into our own hands. Whatever one thinks of the proposals individually, the package represents a coordinated and optimistic response to the challenges facing Hawaii.

How Hawaii Arrived at this Critical Turning Point

From statehood to 1990, Hawaii's economic engine has been the marvel of the nation, with real gross state product (GSP) increasing at an annual average rate of 4.4 percent. Hawaii's non-agricultural wage and salary job count grew at 3.6

percent per year for the period. But in this decade the story has been very different. From 1990 to 1996, the annual growth rate of real GSP has slowed to an average 0.5 percent. Since 1990 Hawaii has lost jobs in five out of seven years.

This recent period of stagnation is unprecedented in the State's history. Hawaii has suffered recessions and periods of slow growth in the past, but the length of such periods has always been short and the recovery swift. Such chronically poor performance is a sign that our economic problems are not a simple matter of the business cycle—they go much deeper into the way our economy is able to respond to the changes in the national and international economies around us. This is what is commonly meant by “structural” economic problems as opposed to problems caused by the occasional ups and downs of the business cycle.

Our economy must deal with many challenges. First, Hawaii faces much more competition in the long-haul, resort travel market today than in the past. Dazzling new resorts have been developed all around the Pacific Rim, from the Gold Coast of Australia to the Gulf of Mexico. Moreover, the profile of travelers is changing over time as the baby-boom generation ages and new niche markets develop. Hawaii's product and promotional targeting appears not to have kept pace with these changes. Consequently Hawaii has lost market share to other destinations.

Hawaii has failed to adjust in other areas as well. For instance, a high cost structure and excessive land use and business regulation discourage new business development and undercut the competitiveness of existing businesses. Cutbacks in defense expenditures with the end of the Cold War have eroded the job base at the Pearl Harbor Shipyard and caused a decline in the contribution to the economy from the defense sector. The once-dominant sugar and pineapple industries have declined to relatively minor activities at best, except on Maui and Kauai.

State and local government has not been immune from the economic drift. The number of State government jobs fell in two consecutive years (in 1995 and 1996) for the first time in state history. State general fund revenues have fallen in real terms by 4.3 percent between 1989

and 1997. This has translated into real reductions in services. Some would argue that the size of State government is too large in any case, while others are concerned about the reduction in services. The Task Force believes that further reduction in the size of government is necessary, but that too large a cut will have a negative impact on the economy as a whole.

Following the input of the general public, more than one hundred local business leaders, academics, government officials, and others, the Task Force spent an intensive two days developing a set of recommendations that all members considered bold, meaningful, and achievable. While some have taken the ERTF to task for not going far enough, by a large mar-

The Task Force focused on those issues that, in its opinion, were the most pressing for Hawaii's economy and about which there was consensus for bold action and a reasonable likelihood of successful implementation.

Options For Response

Given that Hawaii is experiencing something more serious than another dip in the business cycle, the question becomes what can we do to change things?

One option, of course, is to continue to do nothing and hope that the situation will change. However, after six years of slow economic growth in Hawaii while the Mainland booms, it is hard to find anyone who advocates depending upon hope alone. The weakness in our mainland visitor markets despite national economic growth leaves little room for optimism that tourism is likely to accelerate soon. The recent financial crisis in Asia also raises concerns about the growth of that market in the near future. Other economic indicators (including jobs, income, and tax revenues) have also exhibited slow growth for an unusually long period. Thus, trusting that recovery is overdue and will develop on its own, no longer seems a tenable or responsible position.

A second option is to be pro-active and make changes that will position Hawaii for a recovery and long-term viability (i.e., do something). The ERTF was created as the catalyst for this option.

gin most of the criticism appears to be from those who believe the Task Force went too far in one or more directions.

Regardless of whether one agrees entirely with the package of ERTF proposals, it seems clear that the package meets the criterion of bold, significant action in the face of Hawaii's problems. Other initiatives are certainly possible, but alternative proposals that are as comprehensive and that balance the needs of Hawaii citizens with economic growth have not been forthcoming. If any meaningful action is to be taken, then some consensus is necessary on how to move forward. Otherwise, Hawaii will choose the blind hope, “do nothing” option by default.

The Rationale Behind the Recommendations

The specific ERTF recommendations appear on pages 4 & 5. The rationale for their recommendations reflect the careful thought put into the effort by Task Force members.

Tourism

As the engine of Hawaii's economy, the Task Force felt it critical to address some

of the burning tourism issues. Foremost among these is the level and uncertainty of funding for tourism marketing and promotion. Long-term efforts to diversify Hawaii's economy must continue. But in the short term, the most likely source of general economic growth and job creation lies with the visitor industry. Because of its size (about 25% of the economy), tourism is also where positive changes are likely to have the largest effects.

Government

Two areas of the Task Force's recommendations deal with government. The first concerns how government conducts its legitimate regulatory functions. The second deals with improving the efficiency with which government provides services to Hawaii residents and visitors.

Regulatory Process Improvements

Deserved or not, Hawaii has a reputation for being a difficult and costly place to do business. Business people complain of the complicated and slow regulatory processes required to engage in economic activity. While the goals of government regulatory actions remain valid (such as assuring a clean environment, a safe workplace, and so on), the methods for achieving these goals can be improved. The recommendations of the Task Force in this area are intended to improve the efficiency of legitimate regulatory activity, and eliminate unnecessary costs associated with that activity.

Efficiency in Government Services

A second source of complaint about Hawaii government lies with the perception of the high cost of its services. Although the accounting systems necessary to evaluate the complaint are not in place, there is enough evidence about the duplication of government services between the State and the Counties, about the possibility of lowering the costs of services through greater private-sector participation, and about making the procurement process more flexible, that the Task Force urged action on these fronts.

Education

Education is the key to long-run economic success. Society needs its people to develop advanced skills and knowledge

in order to produce the complex goods and services that support our standard of living. Likewise, individuals need advanced skills in order to earn the level of income required to consume those goods and services. Acquiring advanced skills and well-paying jobs means that people must assimilate and actively use new information. This is what education is all about.

Public Schools

It is no secret that Hawaii's public education system faces challenges in meeting these goals. Some observers cite the weight of top-down, bureaucratic management as a problem. Others note the lack of real accountability. Still others refer to the lack of new technological resources (computers), the disincentives to outstanding performance in current labor-management arrangements, and the insecurity of funding programs that relate the classroom to the larger world. The Task Force felt that all of these areas deserve attention.

University of Hawaii

A high-quality university is vital to the educational support for economic well-being. This is where advanced skills are taught. This is where cutting-edge research is performed. While the University of Hawaii enjoys a solid reputation in several fields, government regulations and process sometimes stymie its effectiveness and ability to seize opportunities. The University can do more to take advantage of Hawaii's position in the Asia-Pacific area. An important component of that advantage lies in removing threats to the survival of the East-West Center as a vital center of intellectual and cultural exchange.

Native Hawaiian Claims

In addition to all the other issues raised by Hawaiian claims, the Task Force felt strongly that resolution of the claims and self-determination questions was an important *economic* issue facing the state. The current status of these questions creates uncertainty and fear that translate into higher business costs, lower investment rates, fewer jobs, and smaller household incomes for all of Hawaii's residents. The Task Force recognized that a variety

of forums are dealing with specific issues and that it might be counterproductive to make specific recommendations at this point. However, the Task Force felt it vital to recognize the importance of reaching resolution soon.

Taxation

The structure and level of taxation have much to do with the perception of Hawaii's poor business climate. Hawaii residents face the fourth-highest top income tax rate in the country. The overall level of taxation also ranks high, whether adjusted by personal income or by population. If Hawaii is to position itself to fully participate in economic recovery, it must reform the tax structure by lowering tax rates and following other jurisdictions in moving away from taxation of income and toward the taxation of consumption.

Conclusion

The Task Force could not address all, or even most, of the issues facing Hawaii. Many issues were raised and discussed that did not survive to the recommendation stage. The Task Force focused on those issues that, in its opinion, were the most pressing for Hawaii's economy and about which there was consensus for bold action and a reasonable likelihood of successful implementation.

Hawaii clearly faces an unusual period in its economic history. Even those initially so inclined can no longer assume that time and patience will reverse the slow growth that has plagued the state since 1990. We must take action to begin to reverse course. At the very least, we must act to position our economy to take full advantage of opportunities for recovery when they come—perhaps we can even accelerate the recovery's arrival. The ERTF proposals constitute a major, collaborative effort along these lines. It is a testament to the participants and their organizations that broad support was reached on a set of dramatic proposals. Whether they or some other set of proposals become law is yet to be determined. But if nothing happens—if we ultimately choose the "do nothing" course—then we, Hawaii's citizens, will only have ourselves to blame.

Summary of the ERTF Package of Proposals¹

- **Restructure the tax system to reduce resident taxes over the next three years and enhance the state's attractiveness for new and additional investment²**
 - Reduce personal income tax rates [highest rate falling over three years from 10% to 7.5%, and all other rates falling at least proportionately]
 - Create two low-income tax credits, funded in part by converting the existing food tax credit into a non-refundable tax credit. [single refundable credit for those with AGI below \$35,000]
 - Cut corporate income tax rates by 30%
 - Raise the GET [from 4% to 4.75%]
 - Exempt exported services from GET and impose an equivalent Use tax on imported services
- **Strengthen the competitive position of our tourism industry**
 - Provide increased funding for tourism promotion at the \$60 million level (1997 dollars)
 - Raise the TAT rate from 6 percent to 7 percent of hotel rentals and dedicate 3 percentage points of the 7 percent TAT for tourism marketing. Broaden the TAT base to include timeshare condominiums
 - Establish a 7-to-11 member tourism executive board, with geographic representation, to oversee all marketing and promotion. The board will assume responsibility and be accountable for expenditures from the dedicated tourism fund, contracting out, and measurement of fund's impact, while using no more than 10% of the funds for administration. The Board will be responsible for an annual report on objectives and performance to the Governor/Legislature
 - Consolidate tourism research functions, including statistics gathering, into DBEDT
 - Ensure that Waikiki remains competitive with other destinations through appointment of a joint State/City analysis group to address the revitalization of the visitor infrastructure and activities in Waikiki
- **Make structural improvements in the regulatory process and strengthen the efficient delivery of governmental services in Hawaii**
 - Require that all permits, approvals and licenses have a maximum timeframe for review and approval set by the appropriate State or County agency. Approval must be granted or denied (with appeal rights) within that timeframe without extensions, or approval is automatically granted
 - Eliminate the State Land Use Commission. Transfer responsibility for conservation district boundaries to the State Board of Land and Natural Resources, with all other re-classifications and parcel-specific reviews to become the responsibility of the Counties. Issues of statewide concern are to be administered by a state agency
- Create a GAAP-based (Generally Accepted Accounting Principles) government accounting and budgeting system, to more closely approximate the private sector system which focuses on fully accounting for both accrued and capital costs and budgeting for outputs and outcomes
- Reduce duplication of State-County government functions in such areas as highway and road maintenance, parks, health and ambulance services, human services, housing and civil defense. A group of State, County, and private sector representatives should analyze this issue, determine areas and methods to consolidate, and gain agreement on implementation plans
- Support cost-efficient government by implementing a system of managed public-private competition for government services. Such a system would determine whether a particular service can be provided more efficiently, effectively and economically by a public agency or a private enterprise, considering all relevant costs. Establish protections for affected State and County employees, and ensure that civil service laws and merit principles are not violated
- Revise the State procurement code to provide greater flexibility, while maintaining accountability
- Prohibit worker's compensation claims related to stress from appropriate disciplinary actions (the Mitchell decision)
- Resolve Hawaiian claims and self-determination issues
- **Make structural changes to better empower the public schools to meet needs of community, students, and faculty. Position the University of Hawaii as a preeminent institution in the world in key areas to help drive the local economy**
 - Create four County-based, 7-member school boards jointly appointed by the Governor with appropriate confirmation. Funding would remain at the State level. The Governor would appoint a statewide superintendent who would appoint county superintendents with concurrence of the County school boards
 - Basic academic standards and guidelines would be set at the State level, but how to best achieve those standards, given the various needs of the local communities, will be determined at the County level
 - Empower individual schools through the strong use of school-based budgeting through a decentralized community-based focus of the County boards, with particular consideration for schools with special needs
 - Establish two major strategic requirements for 21st century skills: (1) require that all students learn a second lan-

¹ For ease and clarity of presentation, the original seven categories of recommendations by the Task Force have been consolidated here into four categories.

² Bracketed data represent modified rates and income levels recommended by the State Administration as of February 5, 1998.

guage before graduation from high school by 2004; and (2) require computer literacy for all 8th grade students. To support the computer competency requirement, the private sector will commit \$10 million to provide computer network technology to schools

- Within existing labor-management relationship, restructure principal/vice principal framework to: (1) revise compensation programs to provide pay relating to identified performance measures; and (2) provide significant flexibility in assignment of principals to match school needs with individual skills
- Focus school boards, school management, faculty, parents and community on two fundamental issues in public schools: (1) “low tolerance” approach to discipline in public schools; and (2) establish programs to encourage (strongly) parental participation in day-to-day education

- Continue the Hawaii School-to-Work Opportunities program, which concentrates on preparing students for careers, after federal funding ends in 1999 through private sector funding
- Restructure the University of Hawaii into a quasi-public corporation with independent accountability. State support to be determined by the Legislature and Executive Branch
- Establish an advisory Board of Visitors comprising distinguished individuals from around the world to expand the horizon of the University and help position the University as a major institution in the Pacific
- UH will explore actions up to, and including, the acquisition of the East-West Center and position it as the preeminent Asia-Pacific institution in the world and a cornerstone of UH’s reputation in this broad arena

The ERTF Process

Once the Governor and the two legislative leaders agreed on the task force concept, they began the selection of members. In doing this, the three officials made a concerted attempt to bring together leaders from business, labor and academia who understand and also influence Hawaii’s economy. Representatives of Hawaii’s large and small businesses were included. Many people were considered for the Task Force, but the need to keep the number to a manageable size required making difficult choices.

Still, the ERTF planning group felt it critical to hear from the many other leaders in the community. For this reason, five Work Groups were established to concentrate on broad issues: Education and Workforce Training, Business Climate, Role of Government, Economic Development, and Taxation. Twenty to thirty leaders served on each of these Work Groups which met at least once per week in facilitated sessions through September. The Work Groups considered and shared a large amount of information, heard from experts, and formed recommendations to be forwarded to the Task Force.

During the process of Work Group

meetings, they received input from an active public. People voiced their concerns and expressed their views on economic revitalization by mailing, faxing, and phoning in comments to the Task Force and through e-mail. A special web site was created to keep the public informed and to receive comments. In all more than 800 public comments were received and considered.

The Task Force met initially on October 17 to discuss their mission and goals, and then met for two days, October 20 and 21, to develop recommendations. The first session began at 8:00 a.m. and ended after 10:00 p.m. The group then reconvened the following morning at 8:00 a.m. and agreed to a final set of recommendations by 7:00 p.m. The Task Force operated under a general set of rules in which each member could vote on proposals in one of five ways ranging from (1) enthusiastic, unqualified support to (5) active opposition. While there was substantial debate on individual issues, and many proposals surfaced that did not survive, the final package received the unanimous vote of (1) by all 26 members. Considering the degree of change proposed and

the composition of the Task Force, this was a remarkable achievement.

Town Meetings

On October 22, 1997 the ERTF presented its proposals to the public and members of the Legislature. Since then, more than a dozen town meetings have been held on Oahu and the Neighbor Islands, some broadcast via television and radio. Almost 550 comments and questions have been received. In addition, a number of newspaper articles and letters to the editor have been published regarding the ERTF proposals. If nothing else, the ERTF succeeded in raising critical issues and getting people to think and talk about how to move Hawaii forward.

Legislation

The next step is to begin the process of implementation. Rather than expending resources to develop a formal report, effort is being placed toward drafting legislation to implement the proposals. Ultimately, it is in the legislative arena that the relative merits of the package will be evaluated and action taken—or not.

From the evidence and testimony presented to it, the Economic Revitalization Task Force concluded that the state's tax system has a negative impact on Hawaii's existing businesses, its competitiveness in export markets, and its attractiveness to outside investment. Export markets for tourism and other goods and services are, of course, essential to the state's economic growth. Likewise, outside investment from domestic and foreign sources is key to expanding the capacity of our economy to produce exports and to maintain a high-quality visitor product.

Investment Discouraged

How is the tax system hurting Hawaii's competitiveness? To start with, the Task Force found that the amount and rates of State taxation are at levels that discourage firms from investing or reinvesting in Hawaii. For example, Hawaii's maximum personal income tax rate is among the highest in the nation. An accompanying article compares Hawaii's major taxes to other states and confirms the general impression that Hawaii has a relatively high tax burden.

A nationally recognized business recruitment expert told the Task Force that Hawaii's tax burden, particularly its high income tax rates, tend to exclude it from even first-round consideration as a site for business relocation and investment. This means that Hawaii's significant advantages as a player in Asian and Pacific

Tax Reform Proposals

commerce—in particular its geographic and time zone advantages, and its high quality of life and other strong points—may not be receiving due consideration if Hawaii's tax-related negatives eliminate it from consideration early in the location research process.

Penalty on Local Production

The Task Force found that the tax system also penalizes many Hawaii firms trying to either export their services to outside markets or compete with outside service providers in the local market. Hawaii firms exporting services must now pay general excise tax on its revenues. This effectively raises the cost of producing services and makes Hawaii providers less cost-competitive. On the other hand, outside firms providing services in Hawaii are not subject to general excise tax. This

causes them to be more cost-competitive relative to Hawaii service providers in the local market.

It was also determined that the pyramiding, or "tax on tax" aspect, of the GET as goods and services move through the distribution channel, raises business and living costs in Hawaii, and contributes to a less competitive business environment. For goods, pyramiding is not a serious problem because most pass-through, or wholesale-level, transactions are taxed at just one-half percent. However, for many service transactions, including subcontracting and subleasing arrangements, pyramiding can be significant.

Finally, the Task Force concluded that in addition to making Hawaii more competitive, lowering rates and readjusting the revenue system will put more money in the bank accounts of residents at a time when many households are struggling to make ends meet.

The Task Force Tax Reform Proposals

As a result of its investigations, the Task Force developed a tax package designed to turn Hawaii's tax system into a positive rather than a negative factor in attracting investment, and which would also lower taxes overall for residents and business (see page 4 & 5 for a description of the specific proposals). The Task Force accomplished this by shifting the burden of taxes away from income taxes and

Highlights of the Tax Provisions

Type of Tax Change	Original ERTF Proposal	Modifications Recommended by Administration
Personal income tax rate cuts phased in within two years (Top rate currently 10% at \$41,000 and up on joint returns.)	Top rate lowered to 6%. All other rates down proportionately	Three new brackets established: \$100,000 and above, 7.5% \$80- to \$100,000, 7.0% \$60- to \$80,000, 6.5% 40% reduction in all other brackets
Corporate and franchise tax rates	50% cut in rates	30% cut in rates
Reduce pyramiding of general excise tax	Reduce rate on direct inter-business transactions to 0.5%	Maintain current rates
Raise general excise tax rate from 4% to:	5.35%	4.75%
GET on exported services	Eliminate	Eliminate
Use tax on imported services	Establish	Establish
Additional low income tax credits	Two credits Value: \$60 million	One credit Value: \$67 million

toward the general excise tax, by setting rates that would lower total revenues to government, and by establishing tax credits to eliminate the negative impact of the GET increase on persons with little or no income tax liabilities.

The individual proposals, specific rates and other data that apply to the tax proposals are summarized in the accompanying highlights box. Shown are both the original ERTF rates and modifications to specific tax rates recently recommended to the Legislature by the State Administration. These modifications address concerns coming out of the process established for public input. The modifications reduce somewhat the shifting of taxes from the income tax to the GET, as well as increase

the level of the low-income tax credit. Thus, the increase in the GET is more modest under the Administration's recommendation while the decreases in the personal and corporate income tax rates are also smaller. In order to achieve a lower GET rate increase on consumer transactions, the modification does not lower inter-business GET rates on services as originally proposed by the ERTF to address the problem of "pyramiding." The modifications continue to support the basic strategy and goal of the Task Force, which were to lower income tax rates in order to stimulate investment and provide tax relief.

Under the modified rates, Hawaii's maximum personal income tax rate would

fall from the current 10 percent to 7.5 percent within two years and would apply only to incomes over \$100,000. All other rates would fall at least proportionately, as indicated in the table on page 6. In addition, the corporate income tax would be the second lowest in the nation among states that impose such a tax. Finally, though the GET will rise to 4.75 percent, it will still compare favorably with sales tax rates in other states across the nation and there will continue to be no local sales or excise tax, as is the case elsewhere. The questions and answers that follow adopt the administration's modified rates as the basis for evaluating the effects of the ERTF proposals.

Questions & Answers about the Tax Proposals

Q. Why reduce personal income tax rates?

A. To raise the after-tax rate of return from work and investment and to stimulate economic activity through increased consumer spending. Hawaii's current personal income tax rates are among the highest in the country. Tax experts generally agree that, especially for service-dominated economies, high marginal tax rates can impede investment, job creation, and incomes. If Hawaii is going to retain and attract businesses that can provide well-paying jobs, then adopting a tax structure that rewardshard work and investment is critical.

Q. Why lower corporate income tax rates?

A. To send a signal that Hawaii is prepared to aggressively compete in the global economy. Hawaii's corporate income tax rates are not as high relative to other states as are our personal income tax rates. Moreover, the corporate income tax raises a relatively small amount of revenue (1.8% of general fund revenue). However, many observers believe that the corporate income tax results in

An Expert's View of Investment Attraction

"A company starts its search with a universe of potential locations that may include anywhere from hundreds of locations to only a handful. A rigorous screening process is then used to systematically eliminate those locations with the greatest disadvantages and the fewest advantages for the particular operation. What this should suggest to island leadership is that fatal flaws in its image, business climate, or marketing program can quickly and irreversibly eliminate it from the site seeker's short list of locations."

Statement to the Task Force by
Robert M. Ady,
Deloitte & Touche Fantas Consulting

double taxation—earnings are taxed at the corporate level and then taxed again as either dividends or capital gains at the personal shareholder level. Lowering corporate tax rates may therefore be a relatively cost-effective way of reversing Hawaii's perception as an unfriendly place to do business.

Q. What is "pyramiding"?

A. "Pyramiding" refers to the payment of the general excise tax (GET) at more than one stage of production. The GET is a tax on virtually every transaction in Hawaii, from the manufacturer to the distributor, the wholesaler, the retailer, and eventually to the ultimate consumer. Because the tax is imposed at each step, the tax "pyramids" so that the after-tax price paid by the consumer includes an amount for taxes that is larger than the nominal amount (currently 4%).

The ERTF proposal reduced pyramiding by applying a lower GET rate for direct, inter-business transactions. In order to achieve a lower GET increase,

the Administration's proposed modifications defer action on pyramiding at this time.

Q. Why does the Task Force propose increasing the GET?

A. There are several reasons: First, the reduction in income tax rates will lower government revenue by approximately \$273 million to \$373 million. Although the ERTF recognized the need to reduce the size of government, it also recognized the need to preserve important governmental services and to avoid dismissing large numbers of government workers in this difficult economic period. This requires maintaining a certain level of revenue. Second, perhaps as much as 30% of the GET is borne by non-residents (mostly tourists) who benefit from many public services. Third, the shift toward a consumption tax and away from the income tax will encourage savings, investment, and the creation of jobs.

Q. Won't the increase in the GET offset the reduction of personal income tax and thereby raise taxes?

A. No. For most income tax payers, the reduction in personal income taxes will exceed the increase in payments when the GET rises. To see this, consider that for every \$100 reduction in income taxes, a family would have to spend approximately \$13,300 in order to pay that amount in higher excise tax.¹ It is estimated that a family of four with taxable income of \$50,000 will save more than \$750 in state income taxes under the plan. This family would have to spend an additional \$100,000 on goods and services before the increase in the GET would offset the gain in income taxes. Clearly, this family will be better off under the plan.

Q. What will be the effect on low-income people and those with pensions who currently do not pay much in income taxes?

A. In general, low-income people should also benefit under the plan. The ERTF recognized that income tax relief must

be augmented for low-income individuals. The Administration's proposed modifications would establish a refundable tax credit, partially funded by converting the current \$27 food tax credit available to everyone regardless of income to a low-income credit. The refundable credit varies by income group and phases out at \$35,000 of taxable income. With this credit, low-income individuals should also see a reduction in combined (income and GET) tax liability.

Low-income retirees with tax-exempt pensions will also benefit from the refundable credit. The low-income tax credit will phase out for non-taxable income (such as pensions) at a higher, \$50,000. In addition, those 65 years and older will be eligible for double the value of the tax credit, which could be a significant addition to their income. Some higher-income retirees may see an increase in their tax burden due to the increase in the GET rate. However, Hawaii is one of only 5 states listed by the U.S. Advisory Commission on Intergovernmental Relations as fully exempting pension income from taxation. Thus, recipients of pension income already receive a substantial tax break in Hawaii.

Q. Is it true that the income tax reductions will go mainly to those with incomes higher than \$40,000, while the GET increases will be paid mainly by those with incomes lower than \$40,000?

A. No. Income tax rates are reduced for **all** income groups. Some have noted that most of the savings will go to those with incomes above \$40,000, but this simply reflects the fact that people in that group currently pay most of the income tax. A claim has also been made that the increase in the GET will be borne primarily by those with incomes below \$40,000. This is very unlikely since this group accounts for only 35% of the total income produced in the state. Since GET payments depend upon spending, which depends upon income, most of the extra GET burden is likely to be borne by the group with higher incomes.

Q. Why did the Task Force not recommend

a larger cut in government revenue?

A. Larger reductions in government revenue would seriously threaten valued government services and could lower economic activity—at least in the short-run. The ERTF recognizes that government must continue to streamline and seek cost reductions as the private sector has done in recent years.

Q. Why didn't the Task Force recommend simply taking a fraction of the Federal tax liability?

A. This decades-old proposal has a number of problems with it: (1) it abdicates control of a major component of Hawaii's fiscal policy to the Federal government. This is likely to be undesirable especially when the condition of the national economy differs substantially from the condition of Hawaii's economy; (2) taken literally, it might result in an **increase** in income tax rates. For example, if the Hawaii rates were set at one-third of the Federal rates, the top income tax rate would rise from the current 10% to over 13%; and (3) depending upon the fraction chosen, it could lead to very large reductions in government revenue. As discussed in the answer to the previous question, too large a reduction in government revenue could undermine the effort to promote economic growth.

Q. Will the tax proposal really turn Hawaii's economy around?

A. The ERTF tax proposal must be seen as part of a package of proposals meant to stimulate Hawaii's economy. No single component by itself will turn Hawaii's economy around. Indeed, because Hawaii depends on the outside world for much of its economic activity, even the package as a whole will go only so far in boosting growth. But the ERTF stated its belief that Hawaii's citizens must do what they can to position the state for economic recovery. If nothing is done, the likelihood of recovery is lower and the extent of Hawaii's recovery, when it comes, will be smaller than otherwise.

Q. Is it true, as some claim, that experts have found no link between taxes and economic activity?

¹ .0075 × \$13,300 = \$100; where .0075 is the additional tax paid per dollar of spending.

A. No. The conclusions from the economic literature are that, on average, positive effects of tax reductions and economic activity exist, but they are often small and imprecisely measured. However, the literature also suggests that for states with tax structures quite different from those of others, the economic impacts are likely to be greater. Hawaii has the fourth-highest maximum income tax rates in the country, while the GET rate is below the average of sales tax rates nationally. Thus, the proposal to lower income tax rates significantly, while increasing the GET rate to a level that still leaves it below average, is likely to improve Hawaii's economic environment.

Q. Rather than general tax reductions, wouldn't it be more effective to target tax reductions to specific businesses or industries?

A. Tax reductions or credits targeted to particular economic activity are tools that work within the scope of the ex-

isting tax structure and are usually designed to accomplish specific objectives such as attracting firms to an area or nurturing promising infant industries. The Task Force, on the other hand, was focused on the strategic level of how the tax structure as a whole encourages or discourages economic activity. The members concluded that the tax structure itself is no longer appropriate in today's economic conditions in which firms and regions compete on a global playing field. They agreed with economists who generally argue that a tax system with low rates and a broad base is most effective in fostering growth and development. Within such an environment, all businesses face similar fiscal incentives. This tends to result in the most economically viable firms emerging throughout the economy rather than in a selected few sectors. Once the entire tax system is working more optimally, the need for additional targeted tax incentives can be considered.

Q. Will the tax savings really stay in Hawaii to help the economy?

A. This question misses a crucial fact about Hawaii's economy: since the early 1800s, our economic prosperity has depended on competing in markets beyond our borders. From whaling services to the rise of sugar, pineapple and tourism, the relatively high standards of living in Hawaii have been driven by exports and have benefited from imports. Because Hawaii participates in the global economy, we cannot force money to stay in the state—nor should we try. If Hawaii is to benefit from global competition, it must play by the rules. Money will be attracted to Hawaii because we offer innovative products, a desirable working and living environment, a well-educated workforce, and so on. That is, if we get the fundamentals right, then not only will the tax savings stay in Hawaii, but other capital will flow here as well.

Will Companies Be Able to Pass on the GET Increase?

The economics of who bears what types of taxes is complex, confusing, and sometimes controversial. The effects depend on the sensitivity of supply and demand in both the market for the goods and services that companies provide and in the markets for the goods and services that they purchase.

At a simplified level, standard economic analysis predicts that the more competition, the more likely are cost increases (say, via taxes) passed on to consumers. Many people find this result counter-intuitive. This short article attempts to set aside the complications of tax incidence analysis to focus on how and why the degree of competition affects who pays taxes.

Firms facing substantial competition have little room to change prices. If such a firm tries to raise its price above cost (including a margin for normal profit), then it

would lose customers as other firms either leave their prices at the original level or enter the market by offering the original price. At the same time, if such a firm tried to lower its price, then it would lose money in the long-run and go out of business. Therefore cost determines the level of prices in competitive markets. By implication, anything that raises costs—such as higher taxes—will ultimately result in higher prices, and this is true for all businesses competing on an equal footing in the market.

Firms facing less competition can earn above-market rates of return as their prices exceed costs. Such firms have some flexibility in where to set price, but they presumably set them in order to maximize profits. If they set price too high, the quantity demanded will fall too much as consumers purchase less. If they set

price too low, the price will fall below cost and they will lose money. When costs increase for this type of firm—say, because of an increase in taxes—the firm can raise price to some extent. But the price will not generally rise by the full amount of the cost increase because of the firm's concerns about reducing the quantity demanded too much.

Thus, there are two conclusions from these considerations: (1) Firms that operate in relatively competitive conditions will fully pass-on increases in costs—including taxes—in the form of higher prices; and (2) firms that operate in less-than-competitive conditions may partially pass-on increases in costs—such as taxes—but will be restrained by the effect of price rises on the quantity demanded.

A Brief Comparative View of Hawaii Taxes

It is tempting, but tricky, to compare Hawaii's tax structure and burden with other states. One must exercise care in making the comparisons to avoid reaching misleading conclusions. For example, it is straightforward to compare state tax collections either as a percentage of income or on a per-capita basis. However, Hawaii State government is responsible for public expenditures that are conducted at a local level in other states (such as public education). One must therefore base such aggregate comparisons on **state and local** tax collections. As another example, a comparison of sales tax revenue per capita would fail to reflect the fact that some states—such as Hawaii, Nevada and Florida—host significant numbers of out-of-state visitors at any point in time who also pay these taxes and consume public services. This brief article attempts to compare Hawaii taxes to other states while keeping in mind these qualifications.

The vast majority of State general fund tax revenues comes from the general excise tax (GET) and the personal

income tax. Of the \$2.8 billion in general fund revenue collected in calendar year 1996, \$1.47 billion came from the GET and \$1.0 billion came from individual income taxes (Figure 1). In other words, these two sources accounted for 88 percent of general fund revenues. The importance of these sources explains why they form the center of the ERTF tax proposals.

By several measures, Hawaii has a relatively high rate of taxation. Table 1 summarizes Hawaii's ranking in terms of overall state and local taxation according to three measures. Whether calculated as a fraction of total personal income or expressed on a per-person basis, Hawaii state and local taxes rank in the top five among the 50 states. The relative burden on a family of four is distinctly lower. This is because the calculation applies to a family and thereby excludes the significant portion of taxes borne by non-residents.¹

Individual Income Taxes

Table 2, which looks only at individual income taxes, also shows that Hawaii's

individual income taxes are high by all three measures.

General Excise Tax

In contrast, Hawaii's general excise tax presents a more complicated picture. As table 3 indicates, Hawaii's "sales tax" ranks high either as a fraction of total personal income or in per-capita terms. However, calculated for a family of four, Hawaii's ranking is relatively low. Several factors explain this. First, Hawaii's GET is not a "sales tax," but a "transactions tax." That is, the tax is applied at every step in the distribution chain, from production to retail, and this generates additional revenue. Second, Hawaii's GET is very broad-based, including services, food, and medical items that are excluded to one extent or another in some other jurisdictions. Third, as mentioned previously, a relatively large share of the GET is exported to non-residents (estimated at 30%). Combined, these three facts make Hawaii's ranking very high by the first two measures. However, the third fact helps explain why the family-of-four measure gives such a low ranking—the calculation accounts for the "exporting" of Hawaii's sales tax to non-residents.

Tax Rates

Economists argue that, as far as taxation is concerned, tax *rates* are particularly important when considering the effects of taxes on economic development. High tax rates tend to discourage economic activity; low tax rates tend to encourage economic activity.

Figures 2 and 3 provide interstate comparisons of individual income tax and sales tax *rates*. Figure 2 shows that Hawaii's current income tax rates are among the highest in the nation. With a top rate of 10%, only North Dakota (12%), Montana (11%), and Rhode Island (10.89%) have higher top rates. However, Hawaii has a relatively low combined state-local sales tax rate (Figure 3). The low sales

Table 1. Hawaii Comparative State and Local Taxation

Taxes per \$1,000 of Personal Income, FY 1994 ¹		Taxes per capita, FY 1994 ¹		Burden of Major Taxes on Family of Four, 1994 ²	
	Rank		Rank		Rank
\$136	3	\$3,185	5	\$4,542	19

Table 2. Hawaii Comparative State and Local Individual Income Taxation

Income taxes per \$1,000 of Personal Income, FY 1994 ¹		Income taxes per capita, FY 1994 ¹		Burden of Income Taxes on Family of Four, 1994 ²	
	Rank		Rank		Rank
\$35	6	\$816	5	\$2,759	6

Table 3. Hawaii Comparative State and Local "Sales" Taxation

"Sales tax" per \$1,000 of Personal Income, FY 1994 ¹		"Sales Tax" per capita, FY 1994 ¹		Burden of "Sales Tax" on Family of Four, 1994 ²	
	Rank		Rank		Rank
\$48	3	\$1,130	2	\$583	42

¹ Zieper, Matthew, "Interstate Tax Comparisons: Where Does Massachusetts Stand?" *State Tax Notes*, Dec. 1, 1997.

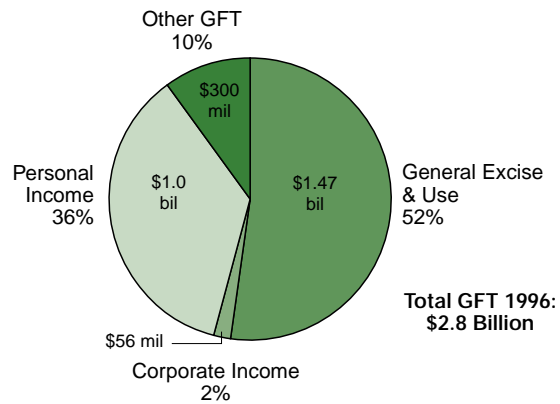
² For Honolulu compared to other urban areas in each state. Government of the District of Columbia, "Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison."

¹ The family-of-four comparison also includes property taxes which are relatively low in Hawaii. Hawaii's comparable property tax burden in 1994 averaged \$967, ranking 43rd among the states.

tax rate is due to the transactions nature of the tax, the broad tax base, and the exportation of the tax to non-residents as discussed above.

The figures also show in graphic terms the central feature of the tax proposal: relatively high income tax rates are lowered, while our relatively low "sales tax" rate is raised but will still remain low in comparison to other locations.

Figure 1. Distribution of Major Components of the General Fund Tax: 1996



Source: Hawaii Department of Taxation.

Figure 2. Maximum Individual Personal Income Tax Rates by State*

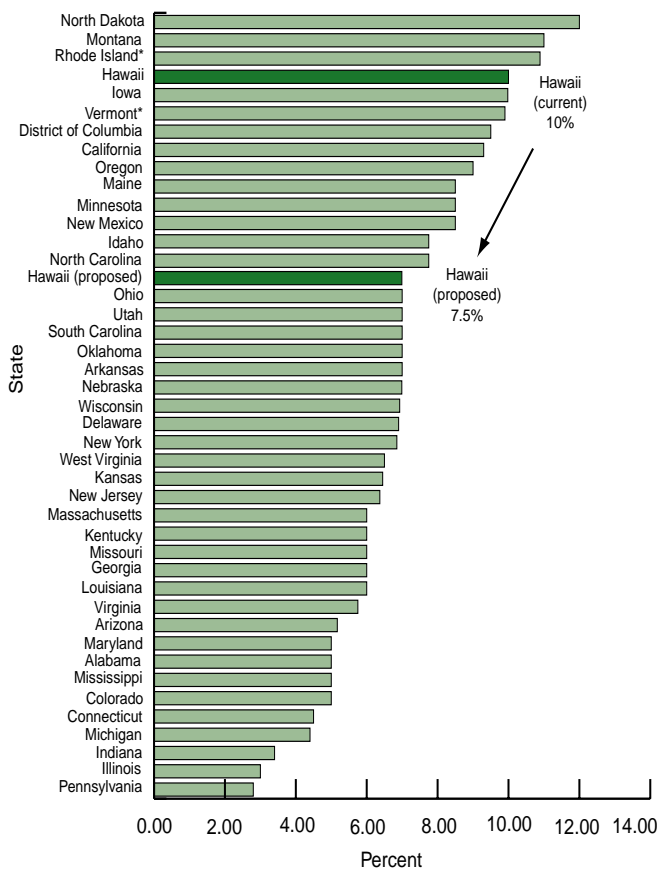
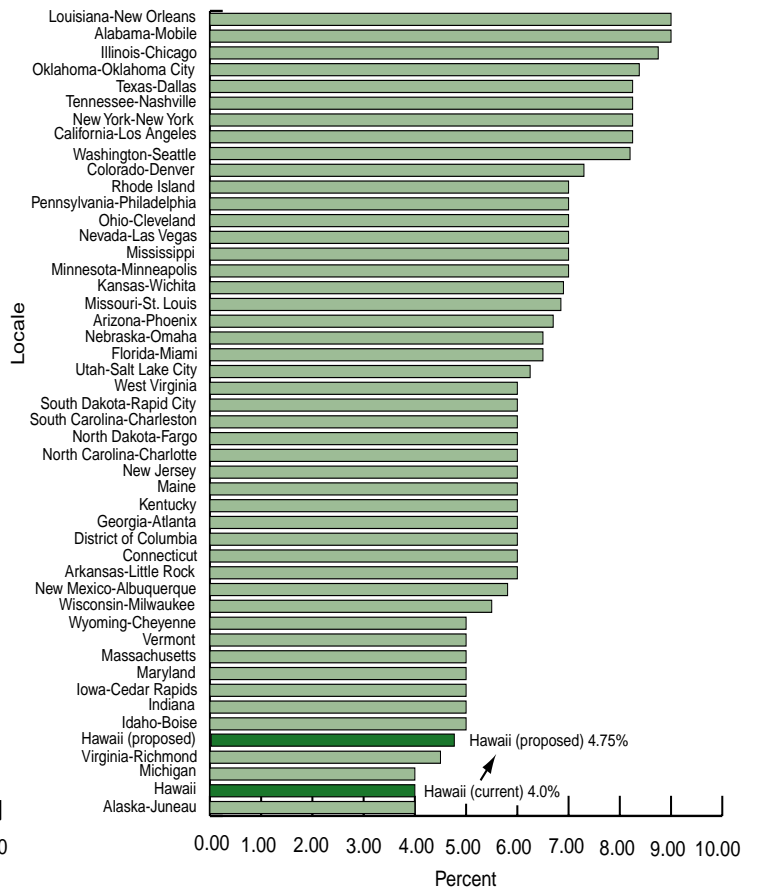


Figure 3. State-Local General Sales Tax Rates**



*Excludes states with no broad-based individual income tax. Rhode Island and Vermont tax a percentage of Federal tax liability. Thus, these represent implied rates for those states. Note that income taxes vary by state, as do the levels at which the top rate applies.

**Sales tax bases vary dramatically by location. Hawaii's GET has a relatively broad base. Also, Hawaii's GET is a tax on the sales revenue of firms rather than a retail sales tax on the consumer.

Sources: Figure 2: Research Institute of America, *State and Local Taxes: All States Tax Guide*, 1992 and weekly supplements.
Figure 3: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, June 1995.

Arthur Andersen Tax Impact Calculations

In a recent presentation to the Chamber of Commerce of Hawaii, *Arthur Andersen, LLP* (AA), provided a valuable analysis of the effects on business of the GET increase and the corporate income tax rate reduction. It also shows how sensitive such analyses are to assumptions about the ability to “pass on” the GET to the consumer.

AA prepared illustrative impact analyses for several types of businesses in Hawaii including a “professional services company,” three sizes of retailers, and a distribution company. Because the Chamber was primarily interested in the direct impact on businesses, AA elected to exclude from the calculations the effects of the individual income tax reductions on the ultimate owners of the business.

The AA analysis assumed that each company would charge the higher excise tax to its customers but would not raise their base prices by the amount of additional GET that they are charged by their suppliers. In addition, AA assumed (for simplicity) that there is no pyramiding of

the GET and that none of the companies has subleasing arrangements.

Overall, AA found that most of the companies would see a decline in after-tax income, with personal service com-

The assumptions by Arthur Andersen of only partial pass-through of GET and no estimate for the effects of lower personal tax rates on the bottom-line income of owners and stock holders, produced extremely conservative results.

panies impacted the most, followed by retail businesses and distribution companies impacted the least. Indeed, the case of the distribution company showed a

slight increase in after-tax income.

Personal services companies did not fare as well as the retail and distribution companies in the AA analysis because of the relatively large proportion of company expenses that are (presumed) subject to GET. About 40 percent of personal services company expenses are subject to GET, according to AA, compared with a high of 24 percent for retailing and only 8 percent for distribution.

The AA analysis provided a useful contribution to the discussion on the ERTF proposals. However, there were some limitations.

First the analysis did not include the effects of individual income tax reductions on the business owners’ or stockholders’ net income. Thus, while the *business’* after-tax income may be somewhat lower after taking account of the GET increase and the corporate income tax reduction, the *owner’s* or stockholder’s after-tax income may rise once the individual income tax rate reductions are included.

Second, AA did not attempt to include the positive impact on business of the ERTF proposal to reduce tax pyramiding.

Third, the AA analysis assumed that *none* of the increase in GET that suppliers charge a company will be passed on to consumers. This contrasts with AA’s assumption that *all* of the increase in GET that is due on the company’s own sales will be passed on customers.

While there may be legitimate accounting reasons for this distinction, there are no economic grounds.¹ The economic conditions that determine how much of the GET the company can pass through on its own sales also permit the company to pass through the increased GET it paid to its suppliers. These conditions have to do with the degree of competition facing the firm (see the related sidebar on what determines whether a company can pass through taxes).

But while AA assumed only limited

Table 1. Tax Impact on a Hypothetical Personal Services Corporation
(Approximately \$2 million per year in sales)

	Current ¹	Modified tax reform proposal ²
Corporate Side		
Gross income base (before tax adjustments)	\$81,000	\$81,000
Additional GET not passed on ³	0	1,359
Gross income before taxes	81,000	79,641
State corp. income tax	4,124	2,835
Fed Corp income tax	14,388	14,364
Net Corporate income	> \$62,488	> \$62,442
Personal Income Side		
Corporate Dividend ⁴	\$62,488	\$62,442
State indiv. income tax ⁵	3,511	2,245
Fed indiv. income tax ⁵	5,851	6,035
Personal income after income taxes	53,126	54,162
Estimated GET paid for year ⁶	1,815	2,212
Personal income after income & GET taxes	> \$51,311	> \$51,950

¹ Corporate model and data from A. Andersen. Personal data estimate, DBEDT.

² Represents rate and income level adjustments to the ERTF proposal recommended by the Administration on February 5, 1998. These are applied to the Andersen Corporate model.

³ Represents about 6% of the increase in the GET, which it is assumed will not be passed on to the final consumer.

⁴ A single owner of all the stock and all net income paid as the dividend is assumed for simplicity. This is also assumed to be the sole source of income for the owner.

⁵ A typical set of itemized deductions and four exemptions are assumed.

⁶ Consumer spending subject to GET is assumed to be about 82% of disposable income.

Continued on page 22

¹ Companies often add the GET on their receipts as a separate line on the customer’s bill, but they do not explicitly add the GET paid on expenses as a separate line on the bill.

The slowdown in tourism is a major cause of Hawaii's current economic difficulties because it powers about one-quarter of Hawaii's economy directly, and an even greater share indirectly. Therefore effective recommendations to reinvigorate tourism was a high priority for the Task Force, which addressed both the short-run and long-run needs of the industry.

Jump-Starting Growth in Tourism

As figure 1 shows, growth in visitor arrivals to Hawaii from 1990 to 1996 has declined 0.4 percent per year on average, compared with a 2.0 percent average annual increase in the U.S. Gross Domestic Product (GDP). This performance is in marked contrast to previous decades when tourism arrivals increased much faster than the growth of the U.S. economy as a whole.

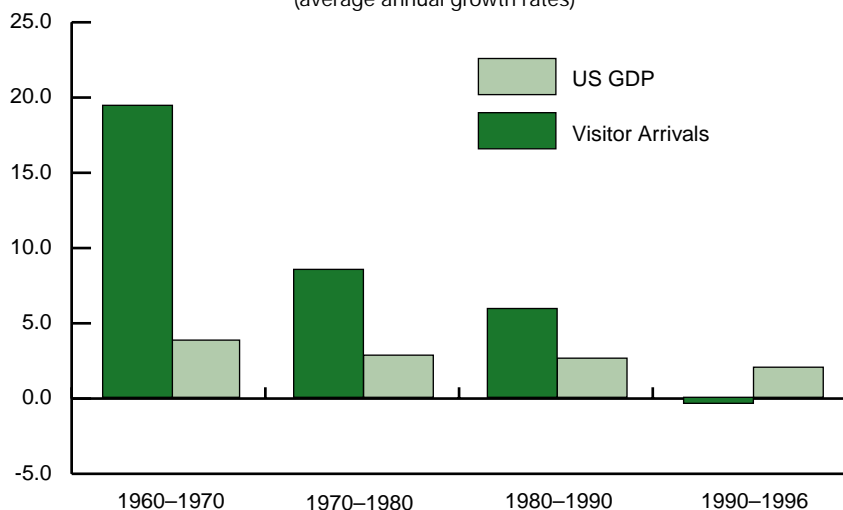
Of course, growth in tourism has been gradually slowing over the decades, so a narrowing of the tourism-GDP growth difference in the early 1990s was not unexpected. However, the drop-off in visitor arrival growth since the early 1990s has been more abrupt and prolonged than anyone would have predicted.

Looking more closely at the major market segments, it is clear that the major problem through most of the 1990s

Tourism Proposals

has been the erosion of Hawaii's competitive position in the U.S. market, where visitor arrivals have actually declined by nearly 18 percent since 1990. Foreign visitors have generally made up for the loss and then some, but not enough to generate much net growth. On the near horizon, the recent financial instability in Asia could instill caution in potential trav-

Figure 1. Visitor Arrivals & US GDP
(average annual growth rates)



Source: Hawaii Visitors and Convention Bureau; U.S. Department of Commerce.

Questions & Answers about the Tourism Proposals

Q. Why is \$60 million for tourism necessary?

A. Hawaii's attractiveness as a destination has been eroded by competition from other destinations and by the natural maturing of the Hawaii visitor product. In order to maintain the economic support that the tourism industry provides to Hawaii, effective and competitive promotion is critical.

Q. Why does tourism promotion need a dedicated source of funding?

A. Currently about \$25 million is annually appropriated from the State general fund to be expended by the Hawaii

Visitors and Convention Bureau for tourism promotion. As a general fund appropriation, this amount can change annually, making long-term promotion planning impossible. A dedicated source of funding, coming primarily from the tourism industry itself, will assure the kind of long-term planning that will make every promotional dollar count.

Q. Why would the board be responsible for tourism policy instead of leaving that responsibility within DBEDT?

A. In order to have a cohesive plan for Hawaii's tourism industry, the State

needs to have **one** entity responsible, and accountable, for all aspects of tourism—policy development, marketing and market development, product development and impact monitoring. These elements cannot be treated separately if we are to successfully revitalize tourism to Hawaii.

Q. Why does the board need to be concerned about product development?

A. Marketing and promotion alone will not make Hawaii more competitive. Marketing and product development go hand in hand. It is essential that we continue to revitalize our tourism prod-

elers from our major foreign markets, and soften growth in visitors from that region.

It became clear to the Task Force that a pressing need in tourism is to increase Hawaii's share of the tourism market. It was recognized that in addition to short-term (cyclical) problems, there are undoubtedly complex long-term (structural) problems that have caused the slower growth of tourism, which we have yet to fully understand. However the short-term situation is the most critical at this point and the Task Force identified the level of marketing and promotion effort as the strongest tool to help increase Hawaii's share of the long-haul visitor market.

To boost the contribution of tourism to the economy in the shortest possible time, the Task Force recommends a permanent and dedicated increase in funds for tourism to the level of \$60 million.

Laying the Groundwork for Stronger Long-Term Growth

To better address the long-term growth needs of tourism, the Task Force recommended restructuring tourism promotion, market development, product development and research efforts. As indicated in the

summary of Task Force recommendations on pages 4 & 5, the Task Force proposes a State-level tourism board to manage tourism promotion and market development functions. The appointed board would include both private and public sector mem-

...the Task Force recommends a permanent and dedicated increase in funds for tourism to the level of \$60 million.

bers. The Task Force recommended that research and statistical functions that track and explain tourism become a specific responsibility of DBEDT.

However, receiving little notice but with major implications was the Task Force's recommendation that all non-research functions within DBEDT be transferred to the board and that these activities be funded through the board. DBEDT's Tourism Office currently is responsible for formulat-

ing long-term tourism policy; implementing product-oriented policies and projects; coordinating with other governmental agencies, committees, task forces, community groups and industry representatives in addressing tourism problems and issues; establishing public information programs; and monitoring the economic, social and physical impacts of tourism on the state. Hence, it is clear that it was the intention of the Task Force that the board would oversee and fund more than just tourism marketing and promotion programs for the state.

The Task Force also recognized that one of the most important factors contributing to long-term tourism growth is the quality of the tourism product and infrastructure. Much work by the tourism board will need to be done to better define and improve Hawaii's offerings to visitors. Details of these efforts were beyond the strategic focus of the Task Force. However, the Task Force did specifically identify the need for the State government and the City and County of Honolulu to cooperate on a program to revitalize Waikiki, Hawaii's single most important resort destination.

uct—the physical as well as human elements—in order to remain internationally competitive. We need to continue to address the problems of a maturing destination. We need to make certain that our visitors continue to feel welcome and safe. We need to be sure that Hawaii maintains a high level of appeal to not only our new, but also our repeat visitors. All the money spent to promote our state as a destination will be for naught if visitors are not satisfied with their experience while in Hawaii.

Q. Why use the TAT as the source of funding?

A. Ideally, promotion of tourism would be financed by a broad tax on all forms of tourist expenditures. In this way, the

beneficiaries of the information provided by the promotion would bear the costs. Unfortunately, such a broad-based tax would be difficult to establish and costly to administer. The TAT, 97% of which is borne by non-residents, is a reasonable alternative. Effectively, the use of the TAT to fund tourism promotion amounts to a user fee—hotels and visitors reap the benefits and bear the costs.

Q. Why establish a new executive board to oversee tourism promotion—what about HVCB?

A. HVCB has a long and honorable history as the general promotional organization for tourism in Hawaii. However, in an era when government accountability and efficiency are particularly

important to Hawaii residents, improvements can be made. A public-private executive board can assure that promotion dollars are effectively expended. Furthermore, the fact that any organization—including HVCB—may bid to win the promotion contract injects healthy competition into the system and should lead to a higher level of accountability.

Q. Won't the increase in the TAT rate hurt the tourism industry by reducing the number of visitors or the level of tourism expenditures?

A. Probably not. At 7%, the TAT will still be well below the level of accommodations tax rates that apply in competitive destinations. Moreover, economic studies of past increases in the TAT

have shown no effect on hotel revenues.

Q. Combined with the proposed increase in the GET, won't our combined rate on hotels make them uncompetitive?

A. No. Currently, the combined tax rate on hotels is 10 percent (4 percent GET and 6 percent in TAT). Under the current proposal, the combined rate will rise to 11.75 percent (4.75 percent in GET and 7% in TAT). The combined proposed rate still falls below the rates prevailing in 24 other destinations (Table 1).

Q. Will the reduction in TAT revenues by the Counties force them to increase property taxes?

A. Not necessarily. As with the State, the County governments have worked to reduce costs and streamline. But there is still much that can be done. There are significant areas of duplication between the Counties and the State, and eliminating these areas of duplication can significantly lower the costs of government services. Ultimately, the Counties will choose how to respond to the change in TAT revenues.

Q. Is it fair to reduce the County revenues from the TAT?

A. TAT revenues have grown at double-digit rates for the last three years—far in excess of the growth rate of State general fund revenues over the period. The Counties have enjoyed the bulk of this windfall, and as a result, their general funds have relied increasingly on the TAT and have averaged higher

Ranking		State/Locale	Maximum Rate (percent)
Ten Highest	1	Washington-Seattle	15.20
	2	Illinois-Chicago	14.90
	3	Wisconsin-Milwaukee	14.60
	4	Ohio-Cleveland	14.50
	5	Missouri-St. Louis	14.10
	6	California-Los Angeles	14.00
	7	Georgia-Atlanta	14.00
	8	Michigan-Detroit	14.00
	9	New York-New York	13.25
	10	Oklahoma-Tulsa	13.10
Hawaii	25	Hawaii (proposed)	11.75
	35	Hawaii (current)	10.00
Ten Lowest	42	West Virginia-Charleston	9.00
	43	Delaware-Wilmington	8.00
	44	Mississippi-Jackson	8.00
	45	Nevada-Las Vegas	8.00
	46	New Hampshire-Manchester	8.00
	47	South Carolina-Charleston	8.00
	48	Vermont-Burlington	8.00
	49	Wyoming-Cheyenne	8.00
	50	Maine-Portland	7.00
	51	Montana-Bozeman	4.00

Source: National Conference of State Legislatures, survey of state tourism offices.

growth rates than the State general fund since 1992.

Q. How is the Administration handling the tourism-related recommendations of the Task Force?

A. The Administration has submitted an omnibus bill which will address the tourism-related recommendations of the Task Force, e.g., establishment of the Tourism Board and special fund; increase the transient accommodations

tax (TAT) to 7%; deposit 3 percentage points, or approximately \$60 million, of the TAT into the tourism special fund; require DBEDT to collect visitor-related data and conduct basic tourism-related research and transfers DBEDT's non-research tourism functions to the board. In addition, the bill will consolidate the Convention Center Authority and the Hawaii Convention Center into the board's responsibilities.

The Task Force looked at the roles and performance of the public school system in Hawaii (K-12th grade) and the State university system with respect to the economy and economic revitalization. The members found a need for organizational restructuring and refocusing in order for these institutions to realize their full potential.

Education Proposals

The Public School System

The Task Force recognized that public education is the foundation of our economy as well as a fundamental responsibility of society to its youth. If Hawaii's people are to compete successfully for the markets and jobs of the 21st century, the skills taught and effectiveness of the public school system in teaching them must

*“What is this autonomy to which everyone refers? It is **not** freedom from accountability—we are and will continue to be held accountable to the people through the legislative process, which includes the governor. [Through autonomy] we will be able to be more responsive to the changing world; we will be able to move quicker and be more effective...UH will be able to lead the state in the global competition of the 21st century.”*

UH President Kenneth P. Mortimer,
Ku Lama, October 24, 1997

meet the highest standards possible. The Task Force found that Hawaii student performance relative to the nation is average at best and well below international performance standards. The members concluded that the key to increasing the effectiveness of our public school system is to place authority and responsibility for education closer to the school level. The Task Force determined that this could best be accomplished by establishing four appointed County school boards, adopting school-based budgeting, and providing greater independence to principals. Members favored the establishment of State-level standards for education to be achieved through a County-based, decentralized school structure making program and allocation decisions suited to each County's schools. In addition, the Task Force recommended an emphasis on computer and language skills relevant to a technologically advanced economy engaged in international commerce. In short, the Task Force envisions a public school system that

is decentralized and accountable, with a 21st century curriculum.

University of Hawaii

The Task Force observed that few institutions can impact the course and success of Hawaii's economic development as much as the University of Hawaii, particularly the system's flagship campus in Manoa. Members concluded that the campuses, schools and departments of the University of Hawaii have the potential to become significant agents for economic development in the 21st century but that the University needs to focus its resources so that priority programs can become truly world-class. It found that the main problem standing in the way of the University becoming a more productive institution is a lack of independence and too little accountability. The Task Force also recommended that the University increase its proportion of private funding and provide outside perspectives into management decisionmaking.

Questions & Answers—Public Schools

Q. Specifically in what ways are the public schools lagging behind in student performance?

A. Compared to the nation as a whole, the performance of Hawaii's public school system is by no means seriously inadequate. In terms of student achievement, the most recent results from the nationwide SAT exams show that Hawaii youth scored about one percent below the average.¹ This suggests that performance of Hawaii schools is about average, and is perhaps a respectable result, given some of the challenges Hawaii's public school system faces. One challenge is that a higher proportion of Hawaii children attend private school, and they tend to be above-average achievers. Moreover, 15 percent of Hawaii residents in 1990 were foreign-born compared with 8 percent nationally, suggesting a greater chal-

lenge in teaching language skills tested on the SAT.

However, “average” is far from the level of excellence we will need if Hawaii youth are to compete in the global markets of the 21st century. Barriers should not be allowed to become excuses. For example, students in both California and New York scored higher on the SAT than did Hawaii students, even though those states have an even higher proportion of foreign-born residents.

Moreover, while Hawaii student performance may be about average by national standards, by international performance standards, both Hawaii and U.S. students fall well down on the list. This is the message from the most recent (third) International Maths and Science Study (TIMSS) testing conducted among 13-year-olds in 41 coun-

tries. This is a comprehensive math and science test, calibrated to reduce cultural and other biases to a minimum. U.S. students did not score in the top ten in either the math or the science test. U.S. student performance managed a 17th ranking in science but sunk to 28th out of the 41 nations in math. These results suggest that Hawaii student performance is only about average in a national system that has lost much ground to the rest of the world over recent decades.

Q. What is the rationale for County school boards?

A. County-based school boards and County superintendents under a State superintendent are part of a package of rec-

¹ Based on the average for participants in 24 states with 40 percent or greater student participation.

ommendations designed to decentralize program decisions. It is a basic managerial principle that the best decisions are usually made by those closest to the problem or issue; that is, by those at the lowest feasible level of an organization. In the case of education, teachers are probably closest to the needs of the classroom, and the principal is closest to the needs of their schools. Likewise, County boards would likely be more able than a State-level board to assess the needs and priorities of the schooling needs within the County.

Q. What about accountability?

A. Accountability was a key issue leading the Task Force to its recommendations. Currently there is controversy over who is ultimately responsible for educational results in Hawaii—the Board of Education? the Department of Education? the Governor? or the Legislature that allocates resources to education? The Task Force concluded that if a State-supported system of public education was to continue, the ultimate responsibility for the system's performance should rest with the chief executive of that level of government—i.e., the Governor. Thus, while the Task Force favored decentralizing of decisionmaking,

they also favored an effective system of accountability for results. Thus, all major governing agents of the restructured system, including the superintendent and the County boards, would be appointed by, and responsible to, the Governor for their effectiveness in working together to achieve educational goals and for the effectiveness of meeting them. Of course, the Legislature retains responsibility for providing educational resources.

The restructuring recommendations of the Task Force are accompanied by other organizational and program recommendations. These include adopting stronger budgeting procedures, restructuring the principal/vice principal framework, instituting a low-tolerance discipline policy, ensuring parent participation in day-to-day education, continuing school-to-work opportunity programs, and a system of State standards to guide County-level program decisions and resource allocations.

Q. What is the rationale for the Task Force's recommendations?

A. The Task Force recommended instilling a world-class focus on the Pacific Rim and computer technology into school curricula. It also recommended a low-tolerance policy with respect to

discipline and programs to strongly encourage the participation of parents in day-to-day education. The Task Force concluded that in Hawaii's economic future, Asia and the Pacific trade will play a much more prominent role. Our children must be prepared for this emphasis through language skills and a basic understanding of the history and cultures of the region. There is little question that computers and other high technologies will be immensely important tools of productivity growth in the future. Hawaii fully intends to be at the leading edge of technology use and even its development in some specialized areas. Therefore, our school system must educate our children in emerging technologies and the skills to use them. Finally, the Task Force is convinced that in order for our education system to produce world-class student performance, the energies of teachers and administrators must be focused fully on the educational needs of the children with the assistance of the parents. Thus, ways need to be found to deal quickly and effectively with distracting disciplinary problems and bring parents closer to the educational process.

Questions and Answers—The University

Q. Why is the University important to economic revitalization?

A. The Task Force viewed the University of Hawaii as a key institution for Hawaii's economic development as well as a center for advanced learning. This is because the technology-oriented businesses of today that are on the leading edge of economic growth need to partner with the researchers and faculties of world-class universities. According to management expert and UCLA Vice Dean, Dr. William Ouchi, the foundation for California's development of the agriculture, computer and biotechnology industries was the world-class research capabilities of the state's university system.

As part of the partnering effort, private sector firms and institutions

provide a major source of funding for the University to support research and programs. This funding augments public funds and tuition, and permits the University to expand research activities. The process is mutually reinforcing in that the more research capability that exists within the University, the greater the private sector support. More research and private funding tends to attract high-caliber faculty which feeds back into the expansion of research and private sector interest in partnering.

Q. Isn't the University meeting this role? If not, why not?

A. Objective performance indicators suggested to the Task Force that the University of Hawaii at Manoa has had difficulty excelling as a major national

university, despite funding levels that are among the highest in the nation. Based upon 21 criteria, the Carnegie Foundation rated 228 national universities in the U.S. and ranked UH Manoa a second-tier institution at number 99. UH-Manoa fared better among only the publicly run universities on the list, but still ranked only 25th among this group. This middle-of-the-road ranking as an institution came about despite the fact that per capita public expenditures on higher education in Hawaii was the 7th highest in the nation (according to Bureau of the Census data for 1994, the most recent available).

Moreover, the University of Hawaii has fallen behind most other public university systems in the amount of private support it is able to raise. This

is one measure of the effectiveness of a university's efforts to partner with the private sector. Nationally in 1995, the ratio of private-to-public sector funding for public colleges (both 2- and 4-year institutions) and universities averaged about 8 to 1. That is, for every 8 dollars of public funds, the average public institution of higher education obtained a dollar of private funds. For the University of Hawaii system, the ratio was only 20 to 1 (the UH ratio was reduced to 14 to 1 in 1996 but mainly due to a decline in public funds).

Q. If the University is not performing optimally, why give it more autonomy?

A. The Task Force expressed confidence

that the UH is trying to work toward a higher level of excellence and accountability for results. Rather than needing more oversight, the Task Force saw the major barrier to this goal as the inability of the University to establish and vigorously pursue those goals without undue interference (albeit well-meaning) from other parts of State government. The members viewed the quasi-public corporation as the best model for a more autonomous university. Priorities would be set by the University which would also manage its own lands, funds and other resources. In addition, the board of distinguished visitors that is being proposed would add a new level of depth, insight and world-class affiliation to the Univer-

sity. Finally, the University corporation would be accountable to the Governor and Legislature for results.

Q. Why does the Task Force want the University to absorb the East-West Center?

A. The Task Force views the East-West Center as a crucial asset for the continuation and enhancement of Hawaii's role as a center for Asian-Pacific education and research. The Task Force feels strongly that should the financial support from the Federal government be curtailed, the University should seek to acquire the Center in order to protect Hawaii's interests in the programs and role of that institution.

The Task Force determined that long permit approval processes and internal government efficiency problems are impeding the development and growth process.

Improving the Regulatory Process

The State government has been making steady progress over the past three years in accelerating the review of a wide range of permits and approvals that affect business and development. For instance, the processing time for clean water, clean air and ventilation permits has been cut substantially. Moreover, the State has reinstated its Consolidated Application Process for developers and conducts pre-application meetings among major developers and all agencies that might become involved. This allows all parties concerned to work out a strategy for the efficient application and review of all necessary permits. The State has also set up internet web sites to solicit input from business on regulations or other issues of concern involving government, so that they may be addressed.

However the Task Force found that a more basic change in the regulatory struc-

Proposals to Increase Government and Regulatory Efficiency

ture is warranted. The members noted that the duplicative land use functions of the State and Counties significantly complicate the approval process and extend the approval time horizon. As a remedy, the Task Force recommends that the State

Land Use Commission, which makes broad land classification changes, be eliminated, and its function be redistributed among the Counties and State as summarized on page 4. The Task Force also urges the State to move to a permit approval system with specified time limits, after which approvals will automatically be granted. An appeal process was also recommended.

Improving Government Efficiency and Coordination

The State government has taken a number of strong measures to reduce waste and inefficiency in government in the past three years. Of course, budget restrictions have made cutbacks in programs and personnel unavoidable. But beyond this, the State has also instituted stringent new procurement regulations to reduce costs and reorganized departments to increase efficiency. The State has also worked to lower costs for business including a more than 30 percent reduction in worker's compensation insurance premiums.

However, the Task Force identified a problem in the ability of government to do proper cost accounting for the services it provides and to measure the value or

benefit of those services to the public. Furthermore, members found that the current State procurement system does not permit enough flexibility that could make it more efficient. The Task Force also found that duplication of services between the State and Counties is a drain on resources and government effectiveness.

Recommendations

As a result, the Task Force made a series of recommendations. First the members proposed that State government should move towards a system of accounting which will show the actual cost of providing government services, including the capital charges associated with various programs.

Second, the Task Force recommended

that the budgeting system move from a focus on inputs to a focus on outputs. That is, the budget process should specify outputs and the outcomes sought, and then structure input estimates designed to address the output and outcome goals.

Third, members proposed that the State and Counties move to eliminate duplication of programs and administrative structures in currently overlapping areas. Areas to be examined include highways and park maintenance, health and emergency services, human services, housing and civil defense. This duplication not only wastes public sector resources but, in the view of the Task Force, also results in disparities in effort and effectiveness from County to County.

Fourth, the Task Force recommended

that a process of managed public-private competition be instituted to provide a fair and accurate evaluation of the costs and benefits of whether particular public services should be provided through the government structure or the private sector. In addition, the Task Force recommended building more flexibility into the procurement system and closing loop holes permitting payment of workers compensation for stress caused by appropriate disciplinary actions.

Finally, the Task Force urged all parties to work towards a resolution to issues of Hawaiian self-determination, which has been a source of uncertainty for both the community and economy.

Questions and Answers regarding Government Reform

Q. Won't the transfer of land use decisions to the Counties encourage poorly planned development?

A. Placing land use decisions at the level closest to the people most directly affected by development should make decisions more responsive and sensitive to local issues and desires. Local constituencies should therefore be better able to address and weigh between competing development proposals to maximize local benefits while minimizing local impacts. The State could provide the Counties with specific guidelines to address statewide issues and areas of concern when making land use decisions. In this way, local decisionmaking is enhanced while providing a method for Counties to address State concerns in their planning and land use processes.

Q. How will time limits and automatic approvals improve the permitting process?

A. For reasons of public safety, health and orderly development, government tries to ensure that a wide range of busi-

ness and development activities meet certain standards before they are allowed to proceed. However the process instituted to ensure that the standards are met can be a source of considerable delay which ultimately mean higher costs to business. Reducing the multiplicity of permits and processes for approval has been the subject of considerable effort by both State and local governments over the past three years and the situation is clearly improving. However, a definitive estimate for the time frame that any given permit request will be acted upon is still often unavailable. This uncertainty is a source of frustration for business. It is difficult for them to make firm commitments for future stages of activity without the risk of delays. A time limit on the approval process will improve business planning and set benchmarks for government agencies to improve upon. The time limit will be set by the agencies, so they can take into account the reasonable time they will need for review and better establish internal accountability for the process. For

business, time limits with automatic approvals if no action has been taken make the process predictable and allow firm commitments to be made further in advance.

Q. What do accounting and budgeting systems have to do with government efficiency and effectiveness?

A. While it is good to make sure that government gets a good price on what it buys, it is also important to know the true costs of programs and then compare this information with the value of the services being provided. Only then can government evaluate whether the program is cost-effective and investigate whether alternative ways of achieving the same public purpose are available at less cost or greater effectiveness.

Current accounting systems in government do not provide information to decisionmakers on such costs as construction, capital equipment, pensions, etc., for each program although there are legitimate costs of the program to the State. Current budgeting focuses

on things that must be purchased to achieve broad program goals. However, the product or service to be provided and the ultimate outcome or goal that the service is supposed to address is not quantified. As a result, there is less than desirable accountability for the efficiency and effectiveness of the services that are either provided or contracted for. The Task Force would like to see a budgeting system that focuses on the services (or outputs) and their relationship to the outcomes that government is trying to bring about. This will permit more realistic comparisons of relative efficiency among programs, and assist in making decisions about whether the service should be provided through government, the private sector, or at all.

Q. What is the difference between “managed public-private competition” and “contracting out”?

A. Contracting a government activity or function to the private sector is the end process of a decision that a certain activity will not be performed directly by government. However, it is not always clear what activities should be performed by government rather than a private contractor. Managed public-private competition is a process of evaluating what means of delivering public services is the most efficient and will best achieve the public purpose involved. It is also a means of improving the efficiency of government agencies by requiring them to submit proposals to perform a certain activity as if they were a private contractor. In this way, the benefits of either a private or public sector service provider can be evaluated. The process, however, depends on a “fair” comparison of the true costs and quality of public sector versus private sector service provision. This basically means that all costs must be

built into the public agency estimates, while the costs of the private provider must be adjusted to account for the true quality capability of that provider.

Q. What do Native Hawaiian claims and self-determination issues have to do with the revitalization of the economy?

A. The Task Force is empathetic to the goals of all parties to Native Hawaiian claims and other Hawaiian issues, and takes no position on the manner or content of their resolution. However, the Task Force notes that uncertainty and confusion over various claims and potential settlements can act as barriers to investments and developments. It is therefore in everyone’s interest to work with as much energy and good faith as possible to resolve all outstanding issues and eliminate this source of uncertainty which inhibits economic development.

What increase in economic activity might we expect if the proposals of the Task Force, adjusted by the Administration’s tax modifications, are implemented? Unfortunately only a partial answer to that question is possible at this time. But that partial answer is decidedly positive for the economy. The modified tax restructuring package could, by itself, lead to a permanent increase in overall economic activity of around 0.4 percentage points over what would have been achieved without the tax changes. Further, the package is designed to stimulate new investment in the economy and additional tourism growth. If a modest 3 percent increase in investment and a 1 percent per year increase in tourism are achieved, the added increase in economic activity could double to an additional 1 percentage point of growth.

Estimating Impacts

The Task Force proposals involve

Estimating the Economic Impact of the Task Force Proposals

making a substantial change from the existing structure of taxes, tourism marketing, education, and government operations. Translating the many potential impacts into actual changes in jobs and economic growth rates is very difficult.

However, for the changes in the tax structure alone, estimates of potential impacts are possible. In addition, if a few assumptions are made about how the package might affect investment and tourism, some reasonable illustrations of the potential impacts of those elements of the package on the economy are possible. DBEDT has recently completed such an analysis and the results are discussed below.

Impacts of the Tax Package

How do the changes in the tax structure result in more economic activity? First, they do not come about by simply cutting taxes. In fact, if taxes were simply to be cut, meaning that government

would receive less and taxpayers would keep more by the same amount, economic activity would actually suffer somewhat. This is because government tends to spend tax money in ways that keep it in Hawaii longer and result in more jobs and local income being created. The spending patterns of the average consumer, however, tend to result in money leaving the state more quickly to pay for goods brought in from overseas.

There are two reasons the Task Force tax proposals result in an increase in economic activity. The first is though the shifting of the tax burden from income taxes, paid by residents, to the General Excise Tax, which is paid by both residents and visitors. As a result, residents receive a larger overall cut in taxes than the state government loses in tax revenues. The dif-

ference, under the Task Force proposal, is made up mainly though more collection of GET from visitors, as well as by broadening the current use tax on imported goods to include imported services.

The second reason is that the lower tax rates stimulate more investment in the state economy.

In addition to the impact from tax reform, the Task Force proposal to restructure tourism marketing will help revitalize growth in tourism. The exact magnitude of the increases cannot be estimated at this time. However, if we are willing to make some assumptions about plausible increases in both investment and tourism, we can translate these into additional jobs, income and the output of the economy that would be generated.

Table 1 shows what we could expect

from increases in the rate of investment in Hawaii's economy due to the proposal for tax reform. A modest increase in the rate of investment to an additional 5 percent per year above the ten-year average would boost jobs in the economy by an additional 0.4 percent. An increase in annual average investment of 10 percent would boost overall state jobs by 0.8 percent. Disposable income and total output in the economy would also rise.

Table 2 shows how an increase in the rate of visitor arrivals would affect the economy. The restructuring and expansion of tourism promotion and marketing is expected to increase visitor arrivals and visitor spending. This, in turn, will generate further sales, additional household income, and additional jobs. For example, if the tourism proposals increase visitor arrivals by an additional 1 percent, then output would rise by 0.3 percent, disposable income would increase by 0.2 percent, and jobs would rise by 0.5 percent.

These impacts from the tax proposals—i.e., the increased investment and tourism—are cumulative. That is, they can be summed to estimate the combined impact of both the tax and tourism proposals. For example, if as a result of the ERTF tax proposals, investment expands by 5 percent over the 10-year average, and tourism increases by an additional 2 percent per year, then output and jobs could each grow by an additional 1.3 percent.

Cautions and Conclusions

This exercise in estimating impacts should be treated as an illustration of what could happen if the proposals are implemented in their current form, including the Administration's suggested tax proposal modifications. Many factors that could not be accounted for in this exercise may play a part in determining how much the actual impact of the proposals will be.

It is clear, however, that the proposals will likely boost economic activity, assuming the distribution of taxes is allowed to place more emphasis on the GET, where the contribution of visitors will play a key role. In addition, even modest increases in the rates of investment and tourism will add to economic growth.

Table 1. Economic Impact from Investment Increases Resulting from the Modified Tax Package

	Increase in New Investment from 10-year Average*	
	5.0%	10.0%
New investment (\$millions)	191.7	383.3
Total output generated (\$millions)	306.1	551.4
Total jobs generated (jobs)	2,953.3	5,648.1
Total household disposable income generated (\$millions)	206.3	292.3
Percentage point increase in growth (%)		
Output	0.59	1.05
Disposable income	0.79	1.12
Jobs	0.43	0.83

*10-year average is \$3.8 billion per year.

Table 2. Potential Tourism Proposal Impacts

	Increase in New Visitors from 1997 Level of 6,857,200				
	1.0%	1.5%	2.0%	2.5%	3.0%
New visitors	68,572	102,858	137,144	171,430	205,716
Total visitor expenditures (\$millions)	101.5	152.2	202.9	253.7	304.4
Total output generated (\$millions)	178.6	267.9	357.2	446.5	535.8
Total household disposable income generated (\$millions)	56.9	85.3	113.7	142.1	170.6
Total jobs generated (jobs)	2,471.3	3,707.0	4,942.6	6,178.3	7,413.9
Percentage point increase in growth (%)					
Output	0.34	0.51	0.68	0.85	1.02
Disposable income	0.22	0.33	0.44	0.54	0.65
Jobs	0.46	0.69	0.92	1.15	1.38

Arthur Andersen Tax Impact Calculations *continued from page 12*

pass through, the 1989 Tax Review Commission estimated that approximately 94 percent of the general excise tax paid by Hawaii residents is passed on to consumers.²

The assumptions by AA of only partial pass-through of GET and no estimate for the effects of lower personal tax rates on the bottom-line income of owners and stockholders, produced extremely conservative results. The net income estimates become relatively low compared to a higher assumption of GET pass through.

Of course, with the more recent modifications to the tax rates proposed by the Administration, the results of the AA analysis no longer apply. This is why the AA estimates are not presented here. How-

ever, the issue of how a business firm will be affected by the currently recommended rates is still very relevant.

Using income and cost elements from the AA study, DBEDT estimated the impacts of the tax changes on a personal services corporation as defined by AA. However, the DBEDT estimate adopts the 94 percent GET pass-through estimate from the 1989 Tax Review Commission study. The results are shown in table 1.

At the corporate level, the additional GET tax that cannot be passed through is roughly balanced by the lower state corporate tax rate. However, at the personal income level, the lower personal tax rate more than counters the increase in the GET faced by the business owner or stock-

holder as a consumer.

Thus, when the pass through of the GET and effect of lower personal tax rates are taken into account, there is a gain in net personal income of more than \$600 in this particular example. By AA's construction of the business examples, the personal services corporation was the worst-case example. Thus, we would expect a similar analysis of the retail and distribution corporations to show a more substantial net gain.

² Miklius, Walter, James E.T. Moncur, and PingSun Leung, "Distribution of State and Local Tax Burden by Income Class," *Tax Review Commission Working Papers and Consultant Studies*, December 1989, Vol. 2, p. 10.

Economic activity remained subdued throughout most of 1997, although job losses in construction slowed and westbound tourism showed some strength in the last few months of the year. For the first 11 months of 1997, wage and salary jobs totaled 535,300, roughly 500 jobs or 0.1 percent below the same as in the same period of 1996. An 8.7 percent loss of jobs in construction over the period was the major drain on the job count which could not be countered by gains in services and government. However, in the October-November period of 1997, construction job losses eased to a 3.1 percent decline over the same 1996 period. This suggests that in the coming months the level of construction jobs may stabilize.

Visitor arrivals grew only 0.5 percent for the first 11 months of 1997. A slight 0.6 percent decline in eastbound visitors from Asia and the Pacific was the cause. Westbound visitors (mostly from the U.S. mainland) increased 1.2 percent for the period. However, in the October-November period, westbound arrivals showed unusual strength, posting an 8.1

Economic Conditions & Outlook

percent increase over the same 1996 period. As the Selected Economic Indicator table on page 23 shows, eastbound visitors continued to perform below year-before arrival rates.

As Table 1 shows, Hawaii and Maui

*...in the coming months
the level of construction
jobs may stabilize.*

Counties showed job gains in the first 11 months of 1997 while Kauai's job market was flat and Oahu experienced a slight decline. Tourism continued to appear strongest on the Big Island and weakest on Oahu for the first 11 months of last year. While all counties experienced an increase in arrivals, westbound visitors were the major factor in gains for Maui and Kauai, while eastbound visitors propped up the total on Oahu. Hawaii County, on the other hand, did well in both markets. However, despite its gains, Hawaii County continues to experience the second-highest level of unemployment among the counties at 9.7 percent for the first 11 months. Kauai still has the highest level at 10.4 percent, a dubious distinction it has held since the aftermath of Hurricane Iniki in 1992. Unemployment rates on Oahu and Maui averaged 5.0 and 7.0 percent, respectively, for the period.

Economic Outlook

Based on current trends, DBEDT expects that the visitor industry will see moderate growth over the next several

years, with the number of visitor arrivals increasing 1.6 percent in 1998 and 1999, and rising to 2.0 percent in 2000. Assuming this level of visitor activity is realized, real gross state product should expand at

a 1.1 percent annual rate through the year 2000. The declining trend in jobs is expected to stabilize and reverse course in 1998 and beyond. Inflation, as measured by changes in the Honolulu Con-

sumer Price Index, is expected to grow at the historically low rate of 1.0 percent in 1997 and by 1.2 percent in 1998.

Selected Economic Indicators: State

Series	1997		Percent change from same period in previous year	
	Year-to-Date	October–November	Year to Date	October–November
Civilian Labor Force (persons) ¹	595,750	593,600	0.7	-0.2
Civilian Employment	559,100	559,550	1.2	0.5
Civilian Unemployment	35,650	34,050	-6.3	-10.0
Unemployment Rate (percent) ²	6.0	5.7	-0.4	-0.6
Total Wage & Salary Jobs ¹	535,300	536,350	-0.1	-0.1
Total Non-Agr. Wage & Salary Jobs	528,150	528,550	-0.1	-0.1
Contract Construction	21,450	21,600	-8.7	-3.1
Manufacturing	16,300	16,050	-2.1	-2.7
Trans., Comm., Utilities	40,950	40,850	0.1	-0.8
Trade	134,350	134,250	-0.5	-0.9
Retail	112,700	112,400	-0.8	-1.4
Finance, Insur. & Real Estate	35,850	35,450	-2.7	-3.1
Services & Miscellaneous	168,400	168,900	1.5	1.0
Hotels	39,100	38,850	1.8	-0.1
Government	110,800	111,450	0.8	1.5
State	63,100	64,150	1.9	2.5
Federal	30,650	30,500	-2.1	-1.0
Agriculture Wage & Salary Jobs	7,150	7,800	-2.7	0.6
(\$Thousands except as noted)				
State General Fund Tax Revenue ³	2,492,051	422,397	-2.3	1.1
Trans. Accom. Tax Revenue	115,999	18,288	1.2	2.0
General Excise & Use Tax ⁴	1,304,502	216,337	-2.9	-1.9
Retailing Tax	567,667	95,690	-3.0	2.0
Services Tax	196,296	33,509	-4.6	-2.5
Contracting Tax	105,261	19,580	-12.5	-7.7
Hotel Rental Tax	74,460	12,069	-2.0	-4.5
Producing Tax	2,263	356	1.8	-18.3
Unallocated Net Collections	58,449	4,678	27.3	-1.1
Visitor Arrivals (persons) ⁵	6,299,010	1,089,670	0.5	4.6
Westbound Visitors	3,739,160	660,920	1.2	8.1
Eastbound Visitors	2,559,850	428,750	-0.6	-0.4
Hotel Occupancy Rates (percent) ²	74.6	71.2	-1.5	-0.8

¹ Labor force and jobs averages are based on monthly rounded data. Labor force data were also rebenchmarked in February 1997. Self-employed data will no longer be published by DLIR.

² Change represents absolute change in rates rather than percentage change in rates.

³ If tax period ends on a weekend some of the collections may be shifted to the next period.

⁴ Components may not reflect true collections due to unallocated net collections.

⁵ Preliminary data.

Note: Data for 1995 and 1996 were rebenchmarked by DLIR.

Sources: Hawaii Department of Labor and Industrial Relations, Dept. of Taxation, Hawaii Visitors & Convention Bureau, and PKF-Hawaii. Compiled by Economic Planning Information System, READ, DBEDT.

Table 1. Selected Economic Indicators by County: January to November 1997
(value and percent change from same 1996 period)

Indicator	C&C of Honolulu		Hawaii		Maui		Kauai	
	Value	Percent Change	Value	Percent Change	Value	Percent Change	Value	Percent Change
Unemployment Rate ¹	5.0	-0.4	9.7	-0.9	7.0	-0.3	10.4	-1.8
Total Wage & Salary Jobs ²	402,850	-0.7	51,100	1.4	57,150	2.1	24,200	0.0
Non-Agr. Wage & Salary Jobs	400,950	-0.6	48,650	1.7	55,200	2.2	23,400	0.2
Construction	16,150	-9.3	2,250	-4.3	1,950	-9.3	1,100	-8.3
Retail	81,100	-2.5	11,350	4.1	13,900	3.7	6,350	4.1
Services & Miscellaneous	121,900	1.2	16,500	2.8	21,950	3.1	8,100	0.0
Hotels	18,450	1.9	6,450	8.4	10,900	0.5	3,350	-2.9
Government	89,000	0.7	10,200	1.5	7,600	2.0	3,950	0.0
State	48,400	1.9	7,100	1.4	5,100	3.0	2,550	2.0
Federal	28,850	-2.0	900	0.0	500	0.0	400	0.0
Agriculture Wage & Salary Jobs	2,000	-2.4	2,450	-3.9	1,950	0.0	800	-5.9
Total Visitors ³	4,578,170	0.2	1,148,650	4.3	2,156,190	0.3	910,240	1.1
Westbound	2,093,920	-3.9	838,430	3.5	1,735,950	2.6	792,510	3.2
Eastbound	2,484,250	3.8	310,220	6.5	420,240	-8.2	117,730	-10.9
Room Occupancy Rate (%) ¹	79.0	-2.9	65.7	3.2	72.5	-1.9	69.9	0.8

¹ Change represents absolute change in rates rather than percentage change in rates.

² Labor force and jobs averages are based on monthly rounded data. Labor force data were also rebenchmarked in February 1997.

³ Preliminary data.

Note: Data for 1995 and 1996 were rebenchmarked by DLIR.

Sources: State DLIR, HVCB, PKF-Hawaii. Compiled by EPIS/READ, DBEDT.

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