CHAPTER 12

TAX HELL?

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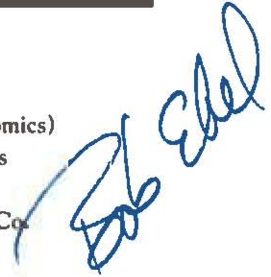

"Is Hawaii a 'Tax Hell'?"

Auwe! When they picked up the January 1992 issue of *Money* magazine and saw Hawaii referred to as a "Tax Hell," Alice and Arnie Aloha decided to take action. They packed up the keiki, tutu and popoki, and headed for "Tax Heaven"—Alaska. That's right, from Kaimuki to Kodiak. And why not? According to the magazine (January 1992, page 74), the Aloha family will save a whopping $4,680 on their state and local tax bill.

This silly little vignette is overly dramatic, but it reflects the magazine's unspoken message—it's best to live in a "low-tax" state. In fairness to *Money*, it is not the only one playing the annual "tax-ranking game." Players include other reputable magazines, business and labor associations, and conservative and liberal research groups.

The ranking game is popular because people everywhere want to know if their taxes are "too high." Individual states keep an eye on these lists, too. Why? Because a state whose tax burden is significantly "out of line" will lose businesses to states with lower taxes. Jobs will be lost and total state income and product will decline. In short, everyone in that state will be adversely affected by its ranking. Consequently, it

seems only logical to determine the likelihood of this by reference to tax levels in other states.

Simple measures. Two of the most common measures of tax level are ratios of taxes collected to population (per-capita tax burdens), and tax burden per $1,000 of household income. *Money*'s index is a mix, calculating the taxes paid currently by a "typical" subscriber family of four.

These simple measures provide easily calculated, quick, and consistent comparisons but these merits are also the source of inherent shortcomings. Consequently, when comparing state rankings, five caveats should be considered.

First, the rankings assume that state and local economies are closed, without movement of goods and services, factors of production, and even consumers, across borders. Accordingly, the numbers fail to take into account that tax costs may be shifted to nonresidents. For example, the fact that roughly a third of Hawaii's excise tax is borne by nonresidents is not reflected in its tax collections numerator.

Second, the ratios give no hint that services are related to tax levels. Residents of low-tax states often (but not always!) receive fewer services than do residents of high-tax states. Nor do these ratios indicate whether a state has legitimately greater spending "needs" (for example, more children of school age or families requiring social assistance) than others.

Third, the "fairness" of distribution of taxes is not considered in these measures. Nor do they address the issue of who benefits from government spending.

Fourth, tax collections, population and income are assumed to be unrelated. Thus, the ratios ignore the possibility that higher taxes and government expenditures may result in better services that attract new businesses and ultimately lead to higher personal income. In other words, an extra dollar in state taxes can result in an extra dime of income for the taxpayers. Of course, this process can also work the other way—higher state taxes can discourage job growth and result in less income for the taxpayer in future years. The point is that not all expenditures have the same effect.

Fifth, the numbers do not account for the fact that the prices of such inputs to produce public services as wages, gasoline prices and the cost

of asphalt will differ among states.

Guidelines. All of this suggests some guidelines. First, ask the simple question: might the group issuing the numbers have a hidden agenda such as reducing certain taxes or raising (or at least not lowering) taxes in order to promote some special-interest spending.

Second, recognize that, even if there is no special bias, the numbers just don't tell the whole story. It's up to you (and your elected representatives) to piece together a lot more information before concluding that taxes in Hawaii are "too high" or "too low."

Third, avoid loaded terms like "Tax Hell" and "Tax Heaven." The issue is too important for pejorative rhetoric.

Following these guidelines will require considerable effort, but it is not a hopeless task. Once all the caveats have been noted, policymakers and citizens alike must use their best collective judgment in addressing the issue of whether Hawaii's taxes are "too high." This is one of the reasons for the constitutional requirement that a tax review commission be formed every five years to look at things like the adequacy, efficiency and fairness of Hawaii's tax system.

Hawaii was once at the very bottom of *Money*'s list—their "Tax Hell." But at that time property taxes were ignored (property taxes are quite low in Hawaii, in comparison to other states). Now that they are taken into account (along with income taxes, sales taxes and death taxes), Hawaii has risen to number 35 on *Money*'s 1992 list. This adjustment in methodology was an improvement, and *Money* has contributed much by bringing the matter of relative state tax burden to the public's attention. Whether taxes in Hawaii are "too high," however, requires more than a review of *Money*'s (or any other player's) ranking game score card. The following chapter is a good next step.

"BOY, AFTER THE ELECTIONS, THEY SURE REDISCOVER THE WORD..."