CHAPTER 3

COST OF LIVING

LEROY O. LANEY
Vice President and Chief Economist
First Hawaiian Bank

"Why is the cost of living in Hawaii so high? Will it ever come down?"

Hawaii's cost of living ranks high on most people's list of complaints about our economy, and it heads many. Cost of living differences between Hawaii and the Mainland are indeed stunning—a "sticker shock" from which newcomers and long-time residents alike never really recover.

This is not a short-term aberration. To illustrate, let's consider a time frame well within the memory of most adult residents —1970 to 1990. The annual intermediate household dollar outlay for a four-person family on Oahu in 1970 was around 20 percent higher than the mainland average—enough to make the budget-minded blanch even then. As late as 1986 the outlay in Hawaii was still only 23 percent higher. Between 1986 and 1990, however, the difference grew to a staggering 34 percent.

Main culprit. Housing is the main culprit. Coldwell Banker does a survey each year comparing the cost of similar homes in 251 locations around the United States. The "subject home" and neighborhood are suitable for the "typical" corporate middle-management transferee. The 1992 price of a "subject home" in Honolulu—$594,750—was considerably above almost all of the other 250 locations. In most cases it was dramatically higher.

Price of "subject home" in
Coldwell Banker study
(partial list)

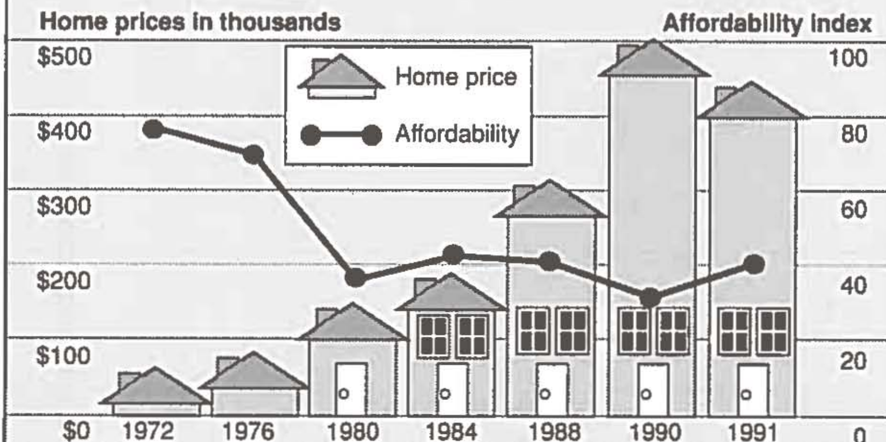
Albuquerque	$158,300
Anchorage	$165,700
Atlanta	$138,538
Austin	$149,250
Chicago-Lincoln Park	$387,833
Dallas	$131,000
Denver	$140,813
Honolulu	**$594,750**
Kansas City, KS	$107,883
Kansas City, MO	$172,500
Las Vegas	$139,981
Minneapolis	$168,107
Montreal	$102,343
Phoenix	$117,600
Pittsburgh	$142,000
Portland, OR	$147,833
St. Louis	$131,050
Salt Lake City	$136,967
San Jose	$380,825
Seattle	$174,750
Tampa	$125,100
Washington,D.C.-Inside Beltway	$318,625
Washington, D.C.-Outside Beltway	$197,550

The National Association of Realtors (NAR) uses a home affordability index to measure the degree to which a middle-income family can afford mortgage payments. A value of 100 means barely enough income to qualify for an 80 percent mortgage on a median-price home. The higher the index, the more affordable the housing. Honolulu's 1990 single-family home affordability index of 39.6 was lower than that of any of the 31 metropolitan areas studied. But in 1991 the index for Honolulu actually rose to 57.7. That lifted Honolulu off the bottom of the list, putting it at least ahead of the California cities.

So some relative progress occurred in 1991. The easing of speculative pressures associated with Japanese purchases caused an actual decline in average and median prices in Honolulu. This plus lower interest rates and continued rise in incomes helped to increase our affordability index.

Unaffordability

Oahu single-family home prices increased by 760% between 1972 and 1990, but affordability* stayed about the same during the 1980s and early 1990s.

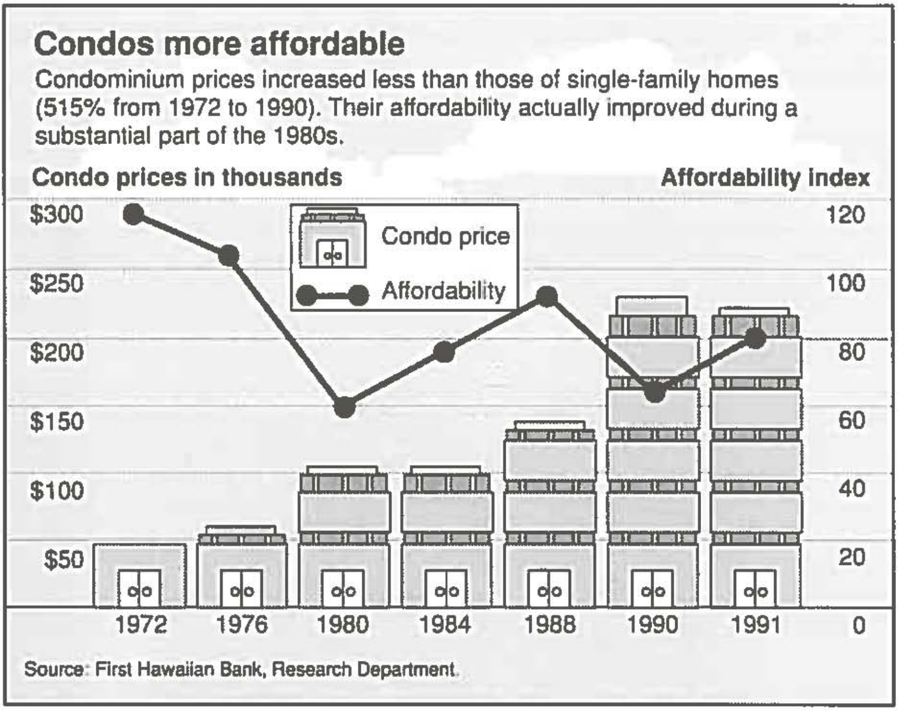


*Affordability measures the degree to which a "typical" middle-income family can afford the mortgage payments on a typical single-family home. An index of less than 100 suggests that housing is not generally "affordable". In order to chart Oahu's affordability index over two decades, it was necessary to use average rather than median prices.

Source: First Hawaiian Bank, Research Department.

Composite Affordability Index
(using metropolitan area median prices)

Metro area	1990	1991
Atlanta	123.7	128.5
Baltimore	100.1	97.6
Boston	65.9	64.9
Chicago	85.5	80.4
Cincinnati	115.7	118.9
Cleveland	116.4	115.8
Columbus	113.5	114.5
Dallas	114.2	123.6
Denver	118.6	123.0
Detroit	133.5	134.0
Honolulu	**39.6**	**57.7**
Houston	149.2	157.9
Indianapolis	120.0	127.0
Kansas City, MO/KS	122.8	122.8
Los Angeles	43.0	43.8
Louisville	134.8	136.7
Miami	89.7	91.1
Milwaukee	113.4	113.6
Minneapolis/St. Paul	121.6	129.5
New York	46.9	64.3
Philadelphia	89.6	93.5
Phoenix	109.2	117.2
Pittsburgh	122.1	124.1
Portland	103.3	102.5
Rochester	125.5	133.6
Salt Lake City	135.2	134.9
San Diego	51.2	49.4
San Francisco Bay	43.3	43.2
Seattle	68.2	72.2
St. Louis	131.7	129.6
Tampa	104.1	115.1
Washington, D.C.	88.4	90.9

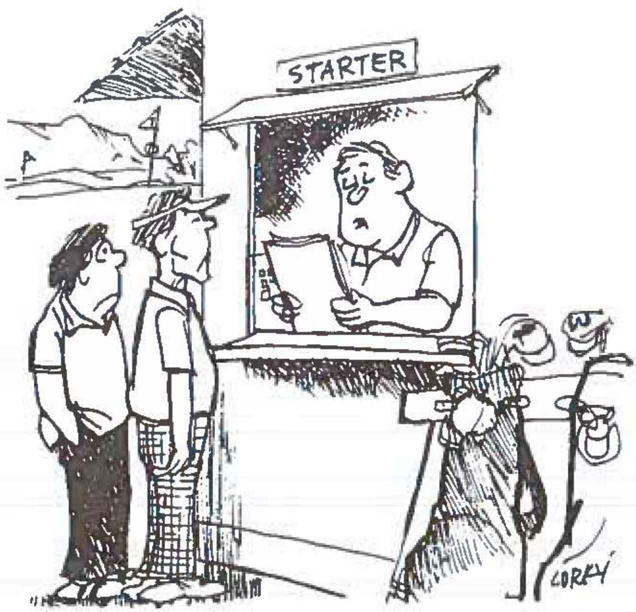


In Hawaii, homeowners spend an unusually high percentage of their income on housing. How do they get mortgage loans? Many can do so only if joined by mothers, fathers, uncles, aunts or other reluctant but cooperative souls.

Other prices high, too. Food prices in Hawaii are about 30 percent higher than on the Mainland. Most people assume that this is primarily due to added transportation costs. However, trans-Pacific shipping cost is a relatively minor factor, perhaps adding no more than 5 percent to the retail price of food. A much bigger factor is the need for grocers to maintain bigger inventories—in some cases three times bigger—in order to keep items on the shelves at all times. Mainland stores closer to food sources can keep their inventories down and still keep the shelves full.

Like other businesses in Hawaii, food wholesalers and retailers pay far more for the use of land and buildings than do their counterparts on the Mainland. And, of course, Hawaii's 4 percent excise tax adds to the cost of food. Some just assume they are being gouged by food retailers, but excess profit doesn't seem to be the problem. Net profit margins in Hawaii are about 1.3 percent, roughly equal to what one finds on the Mainland.

The prices for other major consumer outlays—car prices, gasoline, parking and day care, for example, just to list a few—are also affected by some of the same factors. In fact, few categories of consumption expenditure in the islands are not influenced to some extent by scarce land, logistical difficulties and scarce labor that is in turn partly due to the high cost of living.

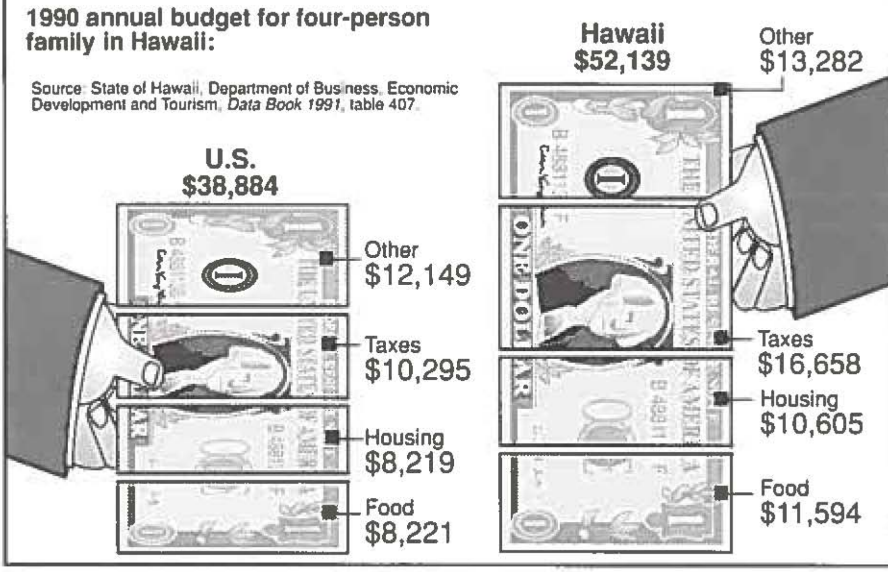


"FOR LOCALS-WE HAVE A COUPLE OF GREEN FEE FINANCING PLANS: PLAN A: 20% DOWN AND WEEKLY PAYMENTS AT 18%..."

In addition to this list, however, at least one other aspect of Hawaii's high cost of living deserves mention. Personal income taxes are particularly burdensome here. In fact, when one compares the average four-person family budget on Oahu to urban U.S. averages, it is the tax category here that outstrips the Mainland the most. Total personal income taxes were almost 62 percent higher in Hawaii in 1981; by 1990, that had risen to 76 percent higher.

Annual budget

The overall cost of living for a family of four is 34% higher in Hawaii than for the U.S. as a whole.



Change possible? Given that many of us have chosen to live in Hawaii, what can and cannot be changed in this painful situation?

First, the inevitable. Hawaii, like many isolated island economies, long has had high living costs. Land will always be high, and higher land costs affect not only the cost of living but of doing business as well. These higher business costs inevitably get paid by consumers.

It is harder to understand other aspects of the local cost of living. For example, some things actually produced locally carry a higher retail price in Hawaii than elsewhere.

Ever wonder why pineapple canned in Honolulu costs more in Hawaii than on the Mainland? To answer this frequently asked question, we must consider demand as well as supply. As for demand, "substitutes" like oranges and chocolate, for example, may cost so much they drive up the price of pineapples. On the supply side, retailers in Hawaii traditionally have chosen to compete primarily on levels other than price. This is not surprising in that they have a limited market and a more-or-less "captive" consumer. One consequence is that our retailers often are not very efficient, and prices tend to reflect that.

Blame for the primary contributor to the high cost of living—housing—has been leveled at foreign speculation, a strong economy and a growing population. Yet it is on the supply side that we find the real villain. Supply of new housing—the only viable way housing prices can be reduced significantly—is restricted by local land-use policies and a prolonged development process. This important topic receives extensive attention elsewhere in this book.

Negative consequences. High cost of living has far-reaching effects on Hawaii's economy. In-migration to this otherwise desirable location with plenty of jobs is discouraged, contributing to the state's chronic labor shortage. Out-migration, on which statistics are poor, also has become a serious problem. Those leaving are not just younger workers who can't make ends meet and retirees who can no longer afford to live here. People at midcareer with good jobs find it attractive to sell their Hawaii home and move to the Mainland where homes and other living costs are lower.

High land and other prices also are a major hurdle to diversification of Hawaii's tourism-dependent economy. Hawaii can thank its uniqueness as a tourism destination for the survival and health of its visitor industry. Many competitor destinations are lower priced and closer to their markets to boot. But other sectors of the economy such as film making and many high-tech applications are quite difficult to develop because of high costs. Thus, the diversification that would be hard for any economy as small and specialized as ours becomes an increasingly elusive goal as costs accelerate.

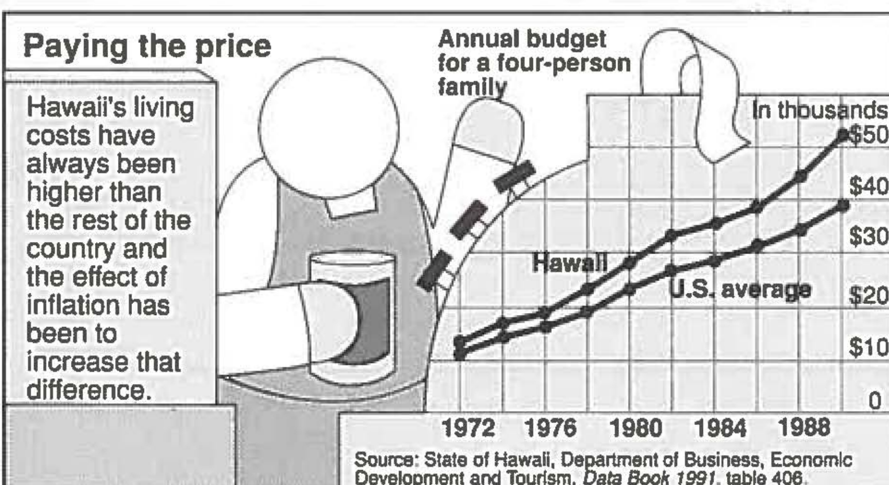
The perception that only the wealthy find it easy to live in Hawaii, combined with the fact that job creation is mainly of a lower income variety, leads to the conjecture that Hawaii is gaining untrained lower-income workers and losing the better educated, trained middle class. We fear a continuing "brain drain" of major proportions in the middle-income ranks, while rich and poor are left to stare at each other across the fence. Obviously, few things are more divisive in an economy, as increasing social tensions make any kind of consensus harder to achieve.

Research by First Hawaiian Bank, using federal income tax return data for Hawaii, shows income distribution got steadily more equal from about 1929 to 1959. Since then, however, it has become consistently less equal. Today, Hawaii ranks 32 on the list of the 50 states in the equality of income among its residents.

Though it is small comfort, there is some evidence that the distribution of income in Hawaii is on a trend similar to the Mainland. In fact, Hawaii's income distribution was slightly less equal than the nation's in 1970, but today it is barely more equal. Transition to a service economy is one reason for trends toward more unequal distribution of income at the national as well as the state level.

The bright side? Clearly, life in paradise does have its price. But economists generally embrace relative prices as a means to allocate scarce resources. Good things should and do cost more, so it is reasonable that living in Hawaii with its strong economy and beautiful environment might be more expensive than living elsewhere. High prices ration this favorable environment to those willing to pay those prices. In doing so, they preserve it.

If prices in Hawaii were in line with less attractive places, we would have more in-migration and less out-migration. More people, cars and effluents would make our environment permanently less desirable. From this perspective, who can say existing prices in Hawaii are "too high"? It may be trite to claim it, and the answer will not satisfy those of us who are trying to remain in the face of difficult odds, but from a broader perspective prices do their job.



"OK, HERE'S A LIST OF THINGS YOU CAN BUY HERE · SOUVENIRS, FOOD, CARS, ETC. BUT NOT, REPEAT, NOT HOUSES, CONDOS OR LANDS,,,"