CHAPTER 13

LEVEL OF TAXES

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"Are taxes in Hawaii too high?"

The answer is—drum roll, please—an unequivocal "it depends." Not satisfied? OK, here's what we're up against as we try to find a more definitive answer.

For one thing, it depends on whether you think the level of public services provided by state and county governments in Hawaii is too high, too low, or just about right. Oh sure, there's fat that could be cut, but that's the nature of the beast. Efficient government is an oxymoron. That's not to say some efficiency gains cannot be achieved but, even in this best of all possible worlds, these gains probably would be a one-shot deal. It might be more constructive to debate the level of government services. You tell me, is the current level of public services too high?

Do you think the distribution of responsibilities for the provision of public services between state and county governments is correct or incorrect? Hawaii's system of government and revenue collection is centralized at the state level. State expenditures in 1989 comprised 77 percent of all state and local government expenditures in Hawaii, compared to a national average of only 59 percent. Only one state (Delaware) had a higher percentage at that time. Hawaii's relatively high percentage reflects the consolidation at the state level of functions usually provided by counties or school districts on the Mainland. Such a concentration leads to higher, "urban" standards statewide. A shift of responsibilities to the counties arguably would lower tax burdens on the neighbor islands compared to Oahu because salaries of affected government workers living on neighbor islands would be lower.

Question of fairness. It also depends on whether, taking the level of public services as given, you think the tax burden is unfairly borne by residents versus nonresidents. In some states, this might not seem like an important issue, but interstate and international trade comprise more than two-thirds of Hawaii's gross product. This means that nonresidents are wound inextricably into the economic fabric of Hawaii and the forms of tax revenue generated by its economy.

One point cannot be minimized: the constant presence of large numbers of tourists consuming many public services significantly complicates measuring the tax burden. On an average day, more tourists are in Hawaii than residents of any of the neighbor-island counties—more, in fact, than the resident populations of Maui and Kauai counties combined. Two out of every five persons on Maui on any given day are tourists. One out of every four on Kauai is a tourist. Imagine a situation in which 15 percent of the adult population were randomly exempted from state income taxes. You have roughly that situation in Hawaii. That many adults pay taxes only on their retail purchases or through the property and room taxes paid by their hotels.

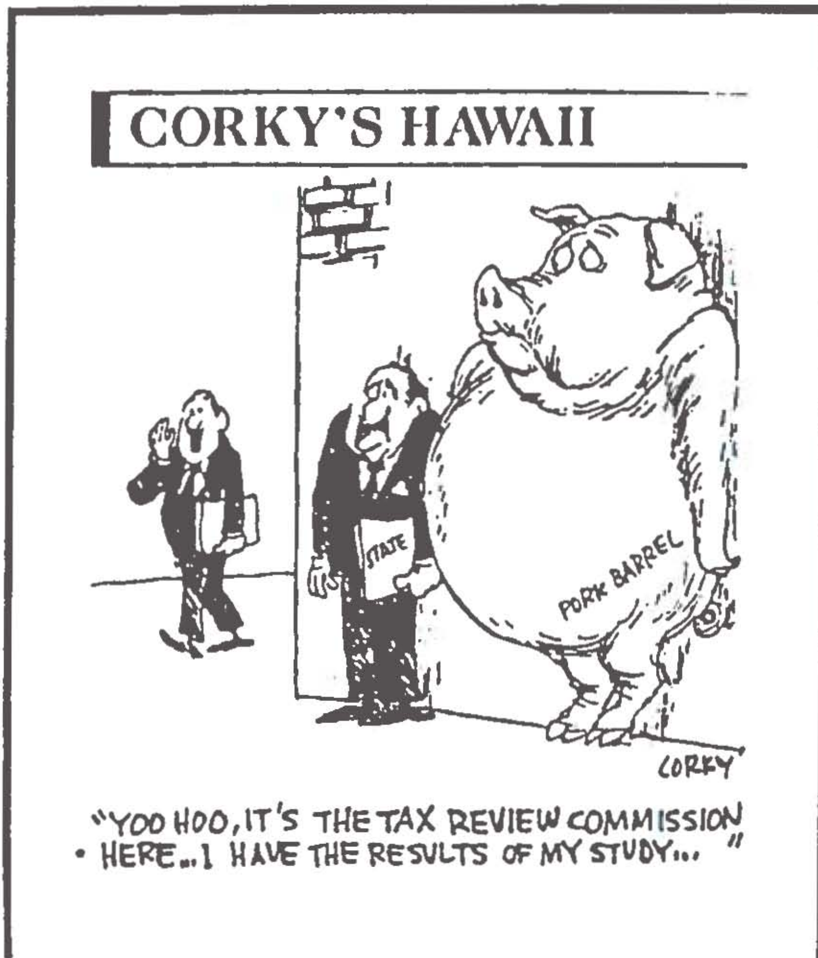
Despite these and other complications, some objective measures of relative tax burden allow for a few crude generalizations. Census of government finances data on per-capita tax revenues compare Hawaii to the other 49 states and the District of Columbia. Hawaii ranks number one (highest) in per-capita taxes on sales and gross receipts (excise taxes), number five in per-capita general revenues raised by state and local governments, number six in per-capita tax revenues, number seven in per-capita income-tax revenues, and number 39 in per-capita property taxes. At the same time, Hawaii is fourteenth in per-capita total state and local government expenditures.

Tourists' impact. How does one interpret these results? First, the high level of excise-tax receipts reflects both a potent tax system and the presence of tourists, who have a high propensity to spend. Per-capita excise tax revenues are especially high in Hawaii because taxes paid by tourists are taken into account, but the tourists themselves are not (the denominator is "number of residents"). With or without tourists, however, the comprehensive coverage of Hawaii's excise taxes creates an unusually high burden for residents.

Second, Hawaii's relatively high ranking in terms of the per-capita income-tax burden is a direct product of Hawaii's exceptionally high marginal income-tax rates and the cumulative impact of inflation (which through time pushes families into higher tax brackets). Changes in 1987 and 1989 that reduced the number of marginal tax brackets helped offset the base broadening and other effects of the federal Tax Reform Act of 1986 (TRA 86). These changes were touted locally as tax reductions, but really did no more than adjust for what otherwise would have been an inadvertent increase in state income taxes. The fact that the State initially resisted the temptation to rake in the TRA 86 "windfall"—the increase in state taxes resulting from federal tax-law changes—is good but, without further restructuring, it will eventually get a "windfall" anyway. In other words, income taxes in Hawaii are high now and are poised to increase without fanfare or vote.

Political football. Third, Hawaii's relatively low ranking in per-capita property-tax revenues reflects two contradictory aspects of taxes at the county level. Hawaii's notoriously high real estate values mean that lower property-tax rates are still capable of generating relatively high revenues. In repeated concessions to populist sentiment, however, property tax rates have been gradually lowered as property values have risen. Thus, the potential of the property-tax system as a revenue-generating mechanism has been allowed gradually to erode for short-term political gain, to the long-term detriment of tax collections. Perversely, those with the most wealth in the form of real property have benefitted the most from these tax changes. To add insult to the injury of increased regressivity, these property tax rate reductions have also diminished the tax system's ability to generate revenues from foreign investors, property owners notorious for their ability to circumvent other forms of taxation.

Fourth, the fact that Hawaii ranks fifth in per-capita general revenues collected from its own sources, but ranks fourteenth in per-capita general expenditures, suggests the extent to which Hawaii's residents are "not getting their money's worth." Because the presence


CORKY'S HAWAII
STATE
PORK BARREL
CORKY
"YOO HOO, IT'S THE TAX REVIEW COMMISSION HERE...I HAVE THE RESULTS OF MY STUDY..."

of large numbers of tourists requires commensurate public services to be directed at this *de facto* population component (not to mention government subsidies for tourism), Hawaii's residents get even less for their money. Other states that depend on large sources of external income generally are able to manage a level of per-capita government expenditure in line with their higher per-capita tax burdens. In a way, Hawaii's statistics suggest a "loaves and fishes" story, in reverse.

Fifth, even if one is inclined to throw out the rankings altogether, a look at the absolute levels of per-capita taxation leads to the same conclusion. The tax burden for fiscal 1989 was $4,897.20 per capita in Hawaii, 12 percent higher than the $4,368.77 nationwide average. Sophisticated studies suggest that the cost of government in Hawaii should be about equal to the national average, despite our high cost of living. Consequently, unless Hawaii residents are receiving a level or quality of public services 12 percent above the national norm, taxes in Hawaii are too high.

Finally, the most recent Hawaii State Tax Review Commission, after hundreds of hours of study and discussion, and based upon the reports of many consultants, put the following right at the top of its long list of recommendations: "In the aggregate, Hawaii's state taxes are being maintained at a higher level than necessary to fund current policy initiatives. Given the constitutional spending ceiling, the overall level of taxes could be lowered." In other words, if the State intends to adhere to the spirit of the constitutional spending ceiling, taxes are "too high."


HOTEL ROOM
TOURISM PROMOTION
1
TAX
'86 LEGISLATURE
TOURISM PROMOTION
2
TOURISM PROMOTION
GENERAL FUND
3