CHAPTER 5

INTERISLAND FAIRNESS

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"Do neighbor islanders get their fair share of benefits from the State?"

State government in Hawaii has long dominated the counties. Among other things, this has resulted in an "overfinanced" state and "underfinanced" counties, at least by mainland standards. This explains the annual ritual of mayors, tin plates in hand, begging for handouts from the Honolulu-based state government. The City and County of Honolulu always gets the largest handout—to be expected when almost all of the state's economic activity takes place there. But given recent surges in the population and amount of state taxes generated by activity outside Honolulu, it's easy to see why neighbor island residents would eye Honolulu's big slice and wonder if their county is getting a "fair share" of the state pie.

Until the early 1970s the neighbor islands were almost exclusively rural, with no industry to speak of other than sugar or pineapple. With this minimal economic base, it was a given that they needed more services from the State than their economies could pay for. Generally speaking, the State was generous, softening the adverse effect of a weak economic base and sparing residents the ills of economic development. All in all, it was a comfortable arrangement for neighbor islanders.

With the tourism boom, however, industrial bases broadened. Population and business activity increased dramatically, as did the neighbor islands' contribution to state revenues. At the same time, they started to notice traffic congestion, pollution, housing shortages and other by-products of progress.

Demanding an accounting. As a result, neighbor island residents have begun to demand some sort of accounting for what they contribute in state taxes, relative to the grants and services they receive. Although state revenues are derived from a variety of taxes, including income taxes, the focus has largely been on the 4 percent general excise tax. However, taxpayers doing business in more than one county would file their returns and pay their taxes in Honolulu. This "unified reporting" made it impossible to determine how much resulted from economic activity on each neighbor island. In 1990, unified reporting was repealed.

Unfortunately, allocation on a county-by-county basis still proved to be difficult. Data collected for 1991, the first year this new reporting requirement was in effect, were inaccurate and inconclusive.

On the other hand, the hotel-room tax is tied to the gross rental income of each specific property, so county-by-county reports are quite accurate. Although there have been slight variations in the percentage of county-by-county collections of this tax since it was first imposed in 1987, the slices have remained relatively constant. About 60 percent of the hotel-room tax is collected in Honolulu, 23 percent on Maui, 9 percent on Hawaii and 8 percent on Kauai.

The 1990 legislature decided to give the counties 95 percent of all future hotel-room taxes, retaining 5 percent for the cost of collection and administration. However, rather than return these funds to the counties on the basis of where the tax was generated, the legislature established an arbitrary schedule of percentage distribution with Honolulu receiving 44.1 percent instead of 60 percent, Maui 22.8 percent, Hawaii 18.6 percent and Kauai 14.5 percent. Based on this statutory division of the spoils, Honolulu receives less than its "fair share" of hotel-room taxes. Hawaii and Kauai counties appear to be the big winners.

One could argue that the allocation of hotel-room taxes to th counties should be based on where the money is needed rather tha where it was collected. But the formula used in the now-terminate federal revenue-sharing program—a formula generally acclaimed a one of the best ever implemented—suggests that a proper distributio of state funds to the counties would have been 69.1 percent t Honolulu, 9.9 percent to Maui, 14.9 percent to Hawaii and 6.1 percen to Kauai.

But what about other state tax collections? Are the neighbo islands getting their fair share of them?

Consultant report. The Hawaii State Tax Review Commissio sought assistance in 1989 from the independent Washington, D.C. based U.S. Advisory Commission on Intergovernmental Relation (ACIR) on this question. While the ACIR allocation of revenues an expenditures may not be the absolute last word on who benefits an who pays, it is the only known attempt to address this issue in complete and systematic fashion.

Analyzing revenue and expenditure data for fiscal 1987, the ACI found that, based on their allocations, Big Island residents were the bi winners, receiving $670 more per capita in state-provided services tha they contributed in state taxes. Running a not-too-distant second wer Kauai islanders who received $552 more per capita in state service than they paid in state taxes. Farther back in third position, Ma residents were $108 to the good.

Honolulu fell below the break-even line, with residents payin $114 more than they received from the State. While it could be argue that certain cost efficiencies can be achieved with delivery of stat services to a larger population base, the fact cannot be ignored th Honolulu subsidizes the delivery of those same services to neighb island residents.

The ACIR also examined how well the counties had tapped their ow sources of revenue, the idea being that neighbor islands deserve a hando only if they already are making the most of their taxing capacity.

Maui County's capacity to finance its own public services was $12. million or 19 percent above average. Kauai's excess capacity was $4. million, 14 percent above average. In other words, these two counti (relative to the other two) were able to finance service at leve substantially above average or could finance average service levels with below-average user fees and/or property tax rates. The ACIR found that Maui was in such a strong fiscal position that it could finance average service levels without any state assistance. Hawaii and Honolulu counties had revenue shortfalls, that is, revenue raising capacity was insufficient to meet the average level of service to be provided to their respective constituents.

"Winners" after all. The bottom line of all this is that as far as state expenditures are concerned, the neighbor islands have been beneficiaries—"winners," if you will—in the annual pie-slicing contest, receiving more in state grants and services than they have been contributing to the State. Honoluluans have been good neighbors, paying far more in taxes than they are receiving back in grants and services.

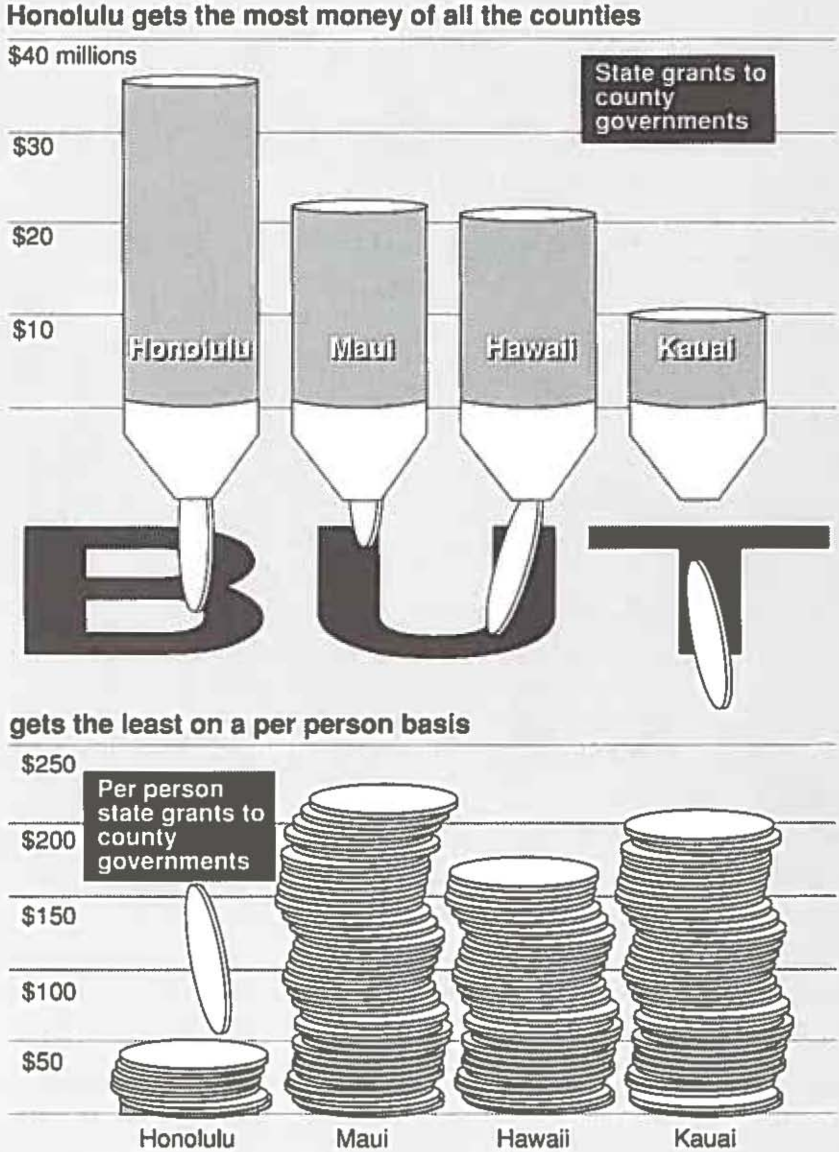
The ACIR analysis suggests that Maui and Kauai could do better in raising the money they need, while Hawaii county probably will continue to need an extra portion of the state pie.

Keep in mind, however, that this analysis is relative. As a group, the counties have a practical problem trying to raise user fees and property taxes when their constituents already are paying unusually high taxes to the State. People swamped by high total taxes are in no mood to pay more taxes to the counties simply because those counties may be underfinanced.

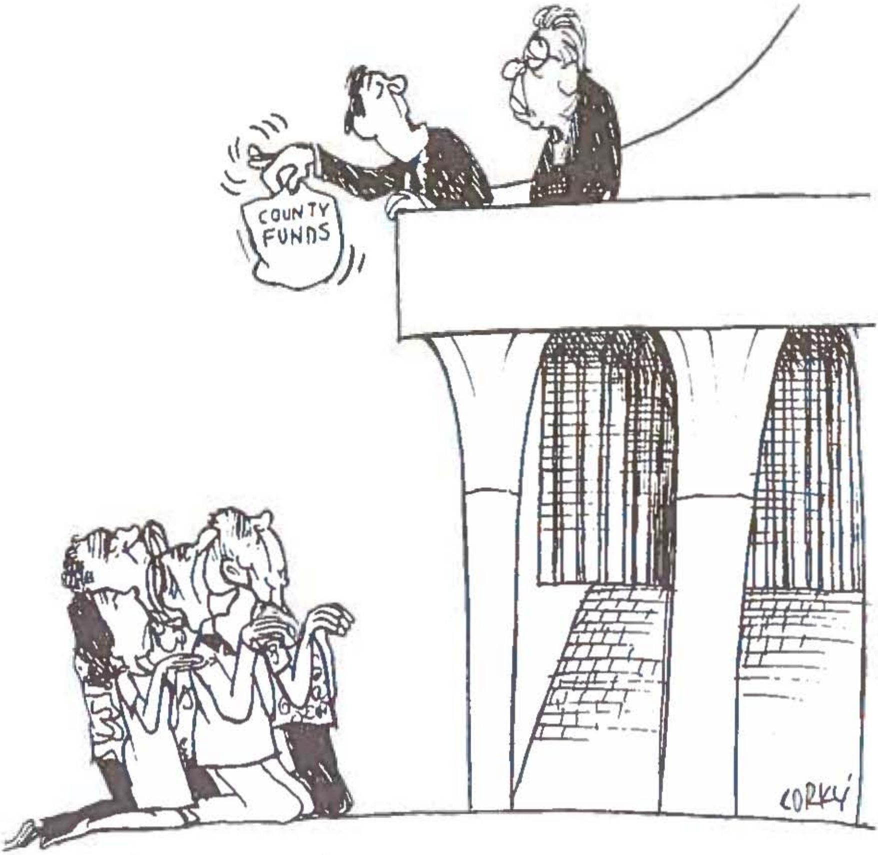
Are neighbor islands getting their "fair share" of services and grants from the State? Yes, that and more. Why are all the counties underfinanced as compared to the State? That's another question. Read on.

Getting a fair shake

Neighbor island counties are getting a fair share of state grants. While the City and County of Honolulu gets the most money, on a per person basis the grants to the other counties are much greater.



Source: State of Hawaii, Department of Business, Economic Development and Tourism, *Data Book 1991*, table 274.



"I DUNNO ABOUT THIS ROOM TAX TRANSFER—I KINDA LIKE HOW THE COUNTIES GET FUNDING NOW..."