CHAPTER 7

GOVERNMENT SIZE

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"Has government in Hawaii grown too big?"

A constant concern among taxpayers (here and elsewhere) is that government has grown too big. This is not new. As early as 1880, the German economist Adolph Wagner advanced his "law of rising expenditures" which anticipated that, as societies developed, the demand for government intervention and services would grow. A corollary—call it the "law of money to burn"—says this tendency will be magnified when a tax system regularly generates "excess" revenue.

Hawaii is a relatively high-tax state, where state and local governments collect nearly 30 percent more taxes per person than the national average.

This was not always the case. In the early 1950s, our territory was only slightly above the national average. But for the first 20 years after statehood, tax revenues grew much faster than personal income. By 1975, state and local tax collections were considerably above the national average. Although they declined a bit in the early to mid-1980s, Hawaii today is well above the national average in tax collections.

Different in California. In contrast, California experienced a fiscal revolution in the late 1970s. Its most famous manifestation, Proposition 13, enacted in 1978, rolled back property taxes. Like Hawaii, California taxes were well above the national average. Thereafter they dropped rapidly to about the national average. Clearly, California demonstrates that if voters want to rebel against high taxes, they can do so.

One reason Hawaii's taxes are high is our relatively low reliance on nontax revenues such as user charges for water, sewer, boat slips, golf course fees, bus fares and university tuition. California has become more reliant on this type of revenue in order to make up for the tax shortfalls caused by Proposition 13 and other tax revolt measures.

Not surprisingly, expenditure trends in Hawaii are similar to the revenue patterns. After all, governments do not collect money to have it sit around; they generally spend it as fast as possible. Hawaii has always been a relatively big-spender. In territorial days, this was made possible by federal grants. Between statehood and the mid-1970s, government spending boomed in Hawaii. It dwarfed even the robust growths of the national and California averages. Since then, however, spending growth has slowed.

California again provides a contrast to this experience. Its state-local spending also grew substantially and was above the national average. The tax revolt of the late 1970s, however, forced spending down to the national average.

California enjoyed remarkable growth and prosperity until the early 1990s when a severe national recession whacked it particularly hard. That state's fiscal crisis in 1992 was not the result of its tax revolt some 15 years earlier. Even so, if Hawaii ever decides to roll back the size of its government, there are much better ways to do it than those used in California.

State employment booms. The largest component of any government's budget is for wages and salaries. Since before statehood, Hawaii has been above the national average in the number of government workers per 10,000 population. Up to 1977, that figure grew much more rapidly than the population, to about 540 government workers per 10,000 population. That was 12.5 percent above the national average of 480. This relationship has changed little since then. Reflecting the effects of its tax revolt, California started out with higher-than-average government employment, but is now below the national average.

Government payroll, as a percent of state personal income, grew considerably between the 1950s and the late 1970s. Hawaii government payrolls were 6.6 percent of personal income in 1957 compared to the national average of 5.6 percent. Currently, it is 8.4 percent and the national average is 8.3 percent.

In spite of the higher cost of living, Hawaii government payrolls in the 1980s were consistent with the national average. Since Hawaii had more workers than the national average, these workers must have been paid less than the national average. There may be good reasons for this. For example, the fringe benefits of government employment here are higher than elsewhere. In addition, and in contrast to many other states where "low-skill" jobs such as refuse collection are privatized, Hawaii has many "low-skill" public-sector employees. On the other hand, it may be as my boss says, "We make up for the high cost of living by paying you less."

For the two decades starting in the mid-1950s, state governments in general experienced high rates of growth. This was largely due to the higher voter demands that governments provide goods and services ranging from infrastructure to education. During this period, states enacted new sales and income taxes to finance their new expenditure responsibilities. For Hawaii, the experience was similar, except the growth rates were higher. This was due in part to the stronger underlying population and economic growth of Hawaii. The infrastructure requirements for this were greater than for most other states.

Why Hawaii's government keeps growing. The 1980s saw a reversal of this trend in most states. Nationally, state and local governments stopped their relative growth. In many states—California, for example—state and local governments actually shrank. This was not the case in Hawaii for several reasons.

First, Hawaii has long been a "centralized" state. This has resulted in an inflexible bureaucratic government, public sector unions with considerable power, and an overall lack of innovation and efficiencies.

Second, for better of worse, Hawaii has a long tradition of paternalistic "rulers." Where other states have "privatized" public services, Hawaii has done the opposite. For example, after-school child care was provided by the private sector until 1991 when the state-financed "A+"

program put them out of business. Increasingly, the State and counties are providing housing, a traditionally private-sector enterprise. On Oahu, traffic reports once were provided by private-sector radio stations at no expense to taxpayers; now the State Department of Transportation pays for it. When something is not quite what the people want, the tradition in Hawaii is to ask government to step in.

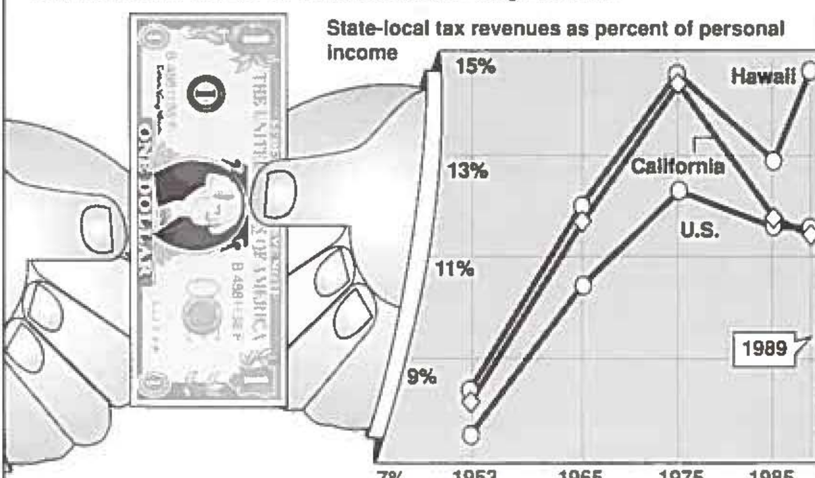
Third, the underlying economy was strong prior to 1992. Economic growth results in a demand for an expansion of public services. Also, economic growth provides exceptional tax-revenue growth. Hawaii relies on a broad-based general excise tax and a progressive income tax, both of which are exceptionally responsive to economic growth. For every 10 percent growth of personal income, state tax collections are estimated to increase by almost 12 percent. Our political leaders have these "money trees" at their disposal.

Fourth, the fact that we have a one-party state has reduced the likelihood that anyone will "shake up the system." Accountability is reduced and tough questions either do not get asked or, if raised, are ignored. The lack of general public input into annual fiscal decisions may have a role here.

So, has government in Hawaii become too big? The answer depends on how you feel about what government has done and how well it has done it. My feeling is that it *has* become too big. It is not responsive, creative or flexible. It is not using our tax dollars efficiently; it should be able to do more with less. In Hawaii, the combination of a tax structure that causes revenues to grow faster than the economy, a centralized government with an entrenched bureaucracy, people with a tradition of overdependence on government, and a one-party power structure pretty much insures that an already-big government will continue to get bigger.

High-tax state

As a percent of state personal income, state-local government revenues grew between the mid-1950s and mid-1970s. But unlike California, which experienced a fiscal revolution in the late 1970s, Hawaii remains a high-tax state.



Source: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1991, Vol. II, Revenues and Expenditures*, M-176-II, Washington, D.C., October 1991, p. 180.

"IN THE LEGISLATURE, YOU MAY CHARGE OVERTIME TO FINISH A JOB YOU FAIL TO DO WITHIN YOUR REGULAR HOURS, KEOKI ... HERE, YOU'RE JUST FIRED."