CHAPTER 16

PARADISE TAX

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"What is the paradise tax and what are its implications?"

Hawai'i's unusually high cost of living—nearly 40 percent higher in 1992 than the mainland average, according to Bank of Hawaii economist Paul Brewbaker—has sometimes been called a "paradise tax." We prefer to call this number a "cost factor" and treat it as one of two components of the paradise tax. The other component is the level of income a person can earn in Hawai'i compared to the amount that same person could earn elsewhere. By combining these two factors, one can better understand and compare the degree of financial sacrifice that has to be made in order to live in Hawai'i. One can also better understand the steady flow of relatives, friends, and neighbors—of all races, many in their twenties and thirties—moving to the mainland in search of more hospitable economic conditions.

Situations vary. A very small number of residents would see their incomes drop by more than 40 percent if they were to make such a move. Because these lucky people are enjoying an "income premium" that exceeds the 40 percent cost factor, they are not making a monetary sacrifice by living here.

Most people earn just a little more in Hawai'i than they could on the mainland. Their small income premiums help a bit but don't come close to offsetting the 40 percent cost factor. Consequently, they would be financially better off elsewhere.

Some folks, however, actually earn *less* income in Hawai'i than would be possible elsewhere. They, therefore, are incurring a double-whammy—an "income penalty" as well as the cost factor.

Simple example. If Kim Kealoha pays 40 percent more to live in Hawai'i than she would in Las Vegas, but is earning 15 percent more here than she could there, her paradise tax is 25 percent. On the other hand, if Lisa Lee could be making 15 percent *more* working in Las Vegas than she's currently earning here, her paradise tax is 55 percent. Because Lisa's "tax" is higher than Kim's, her financial incentive to move is greater.

Unfortunately, data from the 1990 census are not yet complete, but retired state statistician Robert Schmitt, UH sociology professor Herb Barringer, and UH business professor Frank Abou-Sayf recently combined their considerable talents to provide a reasonable substitute set of data. What they found is quite interesting.

In 1989, Hawai'i residents who had completed fewer than twelve years of schooling enjoyed an average income premium of roughly 45 percent. The cost factor in 1989 was 31 percent (as compared to 1992's 40 percent), so this group enjoyed a paradise "bonus" of 14 percent that year. This bonus and the income premium which supports it may be linked to the fact that Hawai'i's economy is based largely on tourism and, to a much lesser extent, agriculture. These industries are known for generating jobs that require little in the way of formal education, yet workers in these industries in Hawai'i—perhaps because many of them are unionized—tend to earn high incomes compared to mainland counterparts.

Not all residents realize an income premium. Those with five or more years of college, for example, earned 5 percent *less* on average in 1989 than did their counterparts on the mainland that year. This slight income penalty, when added to the 31 percent cost factor, resulted in a paradise tax of 36 percent. Economist and UH business professor Jack Suyderhoud speculates that this figure may understate that group's actual paradise tax, because highly educated people tend to spend more

"Paradise Tax" =	The cost factor minus the income premium (or plus the income penalty).
"Cost Factor" =	The additional cost of living in Hawai'i, expressed as a percentage of the average cost of living on the mainland.
"Income Premium" =	The additional income that is being earned in Hawai'i, expressed as a percentage of the mainland average.
"Income Penalty" =	The additional income that could be earned on the mainland, expressed as a percentage of the mainland average.

educating their children and because of Hawai'i's comparatively progressive tax structure.

Different views. One view of the "bonus" for the lesser educated and the "tax" on the more highly educated is salutary: Hawai'i has less of an income gap between rich and poor than the mainland does. This might account in part for generally less volatile socioeconomic class conflicts in Hawai'i and generally more accommodating ethnic group relations.

Another view is that this bonus/tax phenomenon lessens incentives for residents to pursue further education, encourages more highly educated residents to move to the mainland, and discourages relocation here by outsiders with specialized training and education. In short, it may diminish the long-term chances of developing a vibrant, sophisticated economy.

New-starters pay more. The paradise tax also varies depending on when it was that a person settled in Hawai'i. Someone who bought a home ten, fifteen, or twenty years ago can more easily afford to live in Hawai'i than someone who is shopping for a starter home in today's market. People who have longer histories in Hawai'i also enjoy the cost savings associated with a *kokua* network of family and friends.

Conversely, for many *kanaka maoli* (Hawaiians), having been here longer than anyone else has not helped in terms of land and home ownership. Dispossessed of land and resources for over a century, many find themselves "new-starters" in their homeland, battling what some of them might term a "colony tax" rather than a paradise tax.

People who accept a particularly high paradise tax must really want to live here. Perhaps it's the pleasant climate and stunning beauty of the place. For many it's the intangibles like ethnic and cultural diversity and the aloha spirit.

People with deep roots here have those reasons, and more: it's always been home so there's probably an emotional, and maybe even a spiritual, connection. This makes it that much more special. Consider also the fact that a move from Hawai'i puts a wide ocean and expensive airline tickets between family and friends. A trip to see *tutu* or the kids becomes a very big deal. And yet, more than a few residents—*kanaka maoli*, *kama'aina*, as well as *malihini*—periodically think about moving to another place for economic reasons, and some actually do it. But most of us stay, despite the paradise tax.

Evidently, we can afford the price of paradise, at least for now. But we wonder about our loved ones. People with established roots in Hawai'i want their parents and grandparents nearby, and all of us want our children and their children to be able to call Hawai'i home. And yet the high cost of living can be increasingly difficult for retired people on fixed incomes whose paradise tax is now equal to the cost factor, and on young adults who are "new-starters" even if they were born and raised here.

No easy answers. Government could do things that would bring down the cost factor, especially to the extent that costs have been kept high through restrictive land use policies. But consider the implications. On the one hand, if the paradise tax gets too low, Hawai'i will be overwhelmed by people who want to live here. That, of course, would be the end of "paradise." Also, the home equity that many of us rely upon to educate our children or to retire comfortably might disappear, or at least drop significantly.

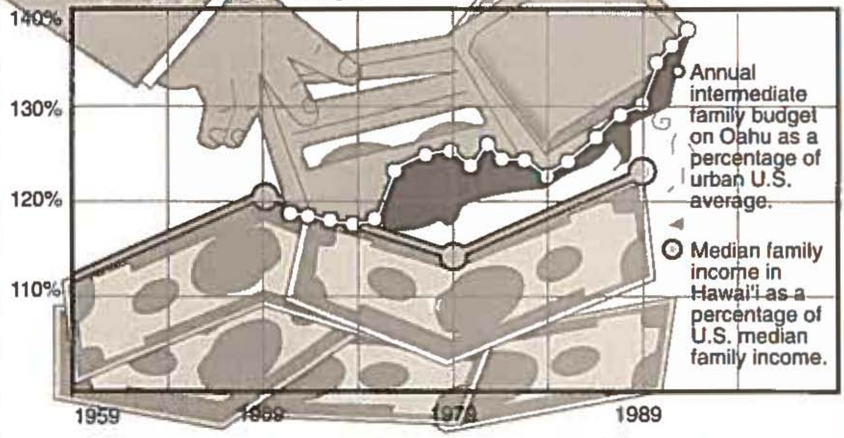
On the other hand, if government maintains a high paradise tax and does little more than attempt to reallocate its burdens, many of the sons and daughters of Hawai'i will continue to be pushed to leave the state.

So what's it going to be? Bring down the paradise tax and watch paradise and home equity deteriorate? Keep it high and watch our children and other loved ones settle on the mainland? Keep it high but try to give advantages to those we choose to favor in our community? Or something else?

Open discussion. No matter how difficult the choices seem, it's time for open and frank discussion. Even if we can't work out all the answers, clarity about the choices—and the implications that attend those choices—will serve us well. It is, in fact, one of the starting points for strengthening the quality of public life in our community, something that of necessity involves us all.

The hole in our wallets

Median family income in Hawai'i has consistently exceeded the comparable U.S. figure, but the cost of living in Hawai'i generally has exceeded costs on the mainland by a slightly higher percentage.



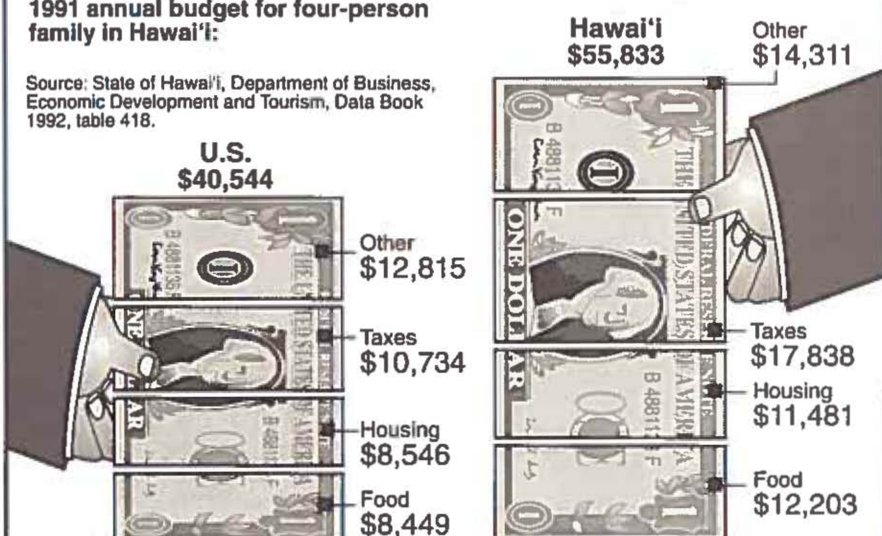
Source: 1980, PC 80-1-C1, table 73; 1980, PC 80-1-C-13, table 61; and 1990, CPR-5-1, table 5; compiled by Robert Schmitt, 1993.

Annual budget

The overall cost of living for a family of four was 38% higher in 1991 than for the U.S. as a whole.

1991 annual budget for four-person family in Hawai'i:

Source: State of Hawai'i, Department of Business, Economic Development and Tourism, Data Book 1992, table 418.



Don't blame me, I just made up the numbers!

Opportunity costs vary

Highly educated residents of Hawai'i enjoy incomes that are higher than those of residents with less education. But when the income of each group's mainland counterpart is considered, it appears that Hawai'i's economy tends to attract people with less education and repel those with more.

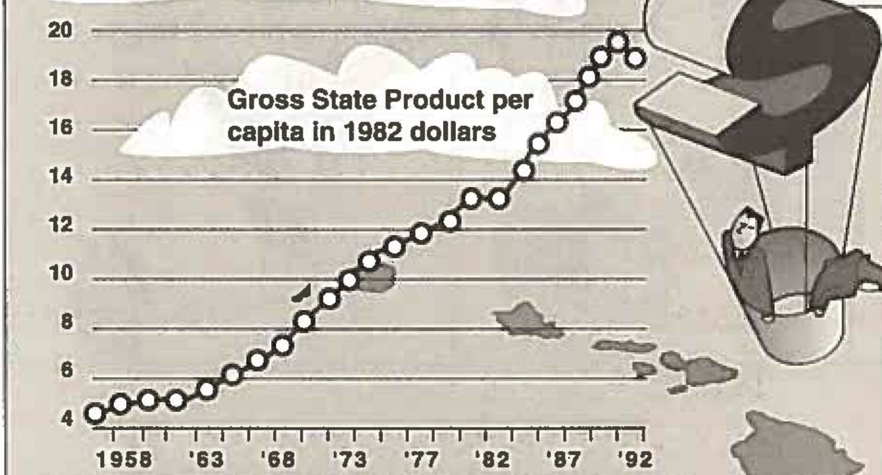
1989 Median Earnings

Level of education	Hawai'i	Nation	Income Factor
Less than 12 years	$13,195	$9,079	45% (premium)
12 years	17,679	15,495	14% (premium)
1 - 3 years college	21,454	20,073	7% (premium)
4 years college	26,453	27,378	-3% (penalty)
5+ years college	33,504	35,357	-5% (penalty)

Source C.P.R P-60, No 180 (August 1992); 1990 U.S Census, public use microdata sample

What goes up...

Tourism lifted Hawaii's economy to great heights, but the high-flying may be over.



Source: State of Hawai'i, Department of Business, Economic Development and Tourism, Data Book 1991, table 373 and 1992, table 385.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