CHAPTER 24

GOVERNMENT SPENDING

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"What ever happened to the state's fat surplus?"

The sackcloth and ashes routine around the State Capitol during the 1993 legislative session was a far cry from just a few years earlier when the unappropriated general fund balance contained nearly $650 million and questionable special funds hid another $150 million. The most recent estimate calls for the former to dip below $100 million by the end of the 1993–1995 biennium. The latter has been "found" and mostly spent.

The legislature likes to blame the dramatic decline in these balances on the slowdown in Hawai'i's economy. The *real* story is a bit complicated but highly instructive. It tells us much about how government works (or doesn't work) in Hawai'i.

How it all began. Our tax system is such that government's slice of the economic pie grows faster than the pie itself. For example, when Hawai'i's economy grows by 10 percent, state tax revenues increase 12 percent.

Tax revenues were pouring in so fast during the economic boom of the late 1980s, they simply could not be spent intelligently, at least not right away. State administrators and lawmakers, worried that taxpayers would demand a rebate or a tax cut, or both, did their best to spend or hide these funds as fast as they were collected.

One way to hide them was through the use of "smoke and mirrors" (see Chapter 11 of *The Price of Paradise*, Volume I). This approach channeled what should have been general fund receipts into newly created special funds. So, even if all available funds weren't spent during any particular year, the remaining balance would not lapse back into the general fund. These special funds never showed up as part of the surplus. Presto chango . . . and the surplus vanishes before your very eyes.

"Parking" excess funds. Another tactic was to earmark general funds for programs or projects that were expected to be canceled eventually or financed differently. For example, the 1991 session of the legislature appropriated $28 million in general funds for a controversial housing project that was unlikely to be built any time soon (if at all). People who understood the true purpose of this appropriation—to "park" excess funds out of taxpayer view—were not surprised when the means of financing was changed by the 1993 legislature.

Another example was the state's disingenuous offer to use its extra cash to pay for several county projects. Given the historically contentious relationship between the state and counties, it was highly unlikely that this would become a reality. Sure enough, the 1993 legislature "reclaimed" the cash it had authorized for certain county projects, like the Honolulu police telecommunications system and a foreign trade zone warehouse for Hilo.

Yet another way. Parking as a way of hiding surplus funds worked for a while, but when the amounts that needed to be hidden got bigger, the focus shifted again, this time to paying "cash" for major projects.

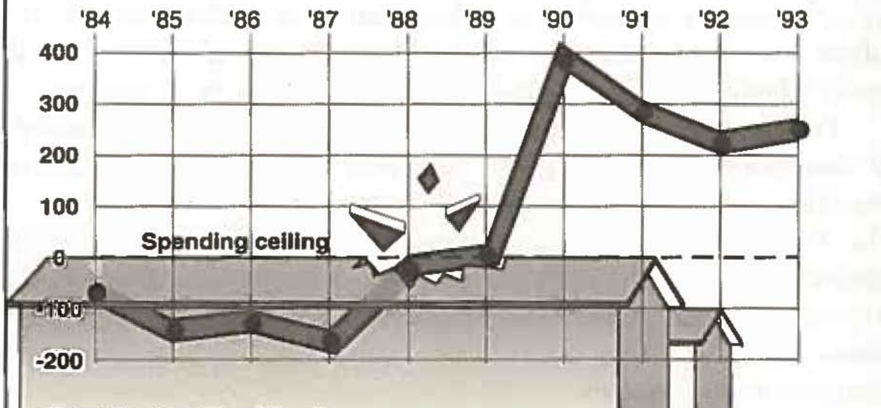
Capital projects (such as roads, sewers, and public buildings) are usually considered one-time expenditures that ought to be financed through bond sales. The basic idea is that facilities expected to last a long time should be paid for with taxes collected from the people who are actually benefiting from those facilities. But our lawmakers, wanting to tie up as much of the excess general fund cash as possible, appropriated staggering amounts from the general fund (nearly $500 million dollars) for capital improvement projects.

This approach, virtually unheard of outside Hawai'i, flies in the face of a basic public finance principle: the burden of long-term capital projects should be borne by the people who will directly or indirectly benefit.

The scheme worked in that it relieved the pressure to rebate the surplus or lower taxes, but it was also a major reason the constitutional spending ceiling was exceeded in each of the past four fiscal years. That's another story (oh, what a tangled web we weave).

Through the ceiling

The Hawai'i state Constitution provides for a spending ceiling but there are loopholes. The legislature has spent beyond the ceiling amount each of the past four years by an average of $293 million *per year.*



Source: Tax Foundation of Hawai'i.

Money is "found." This charade became obvious when state revenues dropped and, in a frantic search for cash, officials allowed many cash-financed capital improvement projects to lapse or changed the means of financing from cash to bond sales (which is how they should have been financed in the first place).

Government spending during these "hide and seek" years was illusory in the way it was accomplished but real in that an awful lot of money was eventually spent. For example, the size of state government, as measured by the number of employees, increased dramatically. This is clear, even if one accepts the state's version of the numbers, which does not reflect the many temporary and appointed positions. These hidden positions tend to be held largely by political appointees who generally serve as special assistants to special assistants. They are the people who can be found on street corners during political campaigns smiling broadly and waving signs.

A more accurate indication of just how much government grew during this period is the ratio of operating expenditures to state personal income (i.e., government's slice of the economic pie). State operating expenditures between 1986 and 1991 grew by more than 70 percent while total personal income was growing by less than 50 percent. In other words, government's forced share of the economic pie grew considerably faster than did the pie itself.

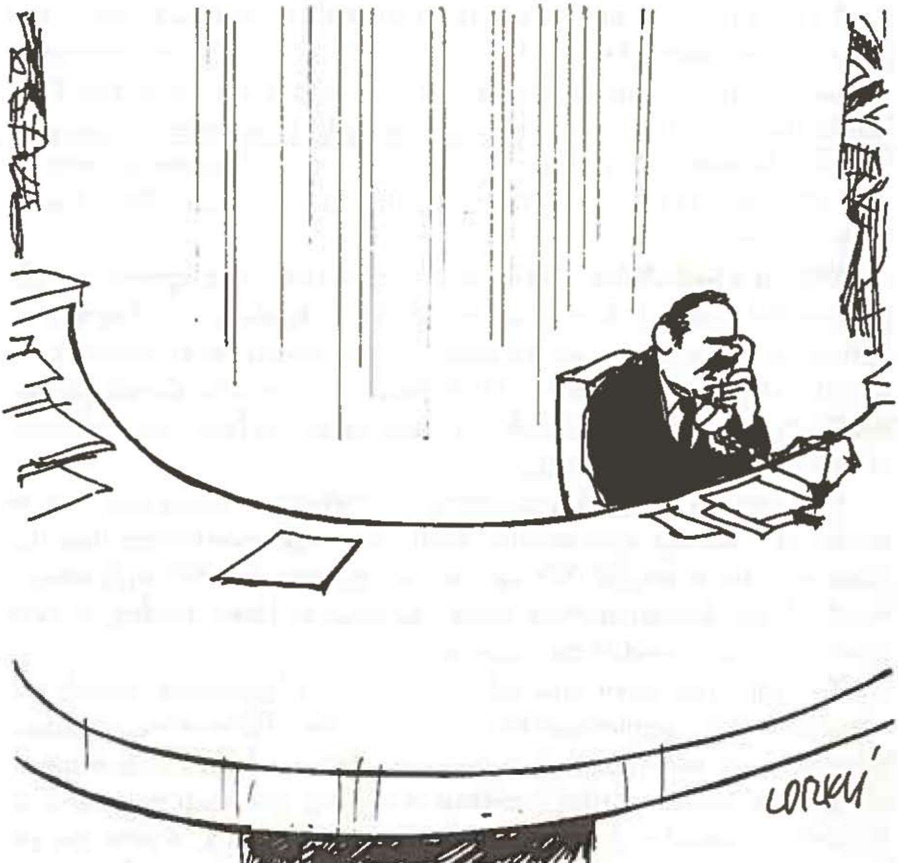
This might not have been cause for concern if the quality and quantity of government services had been increasing. But much of the growth was unproductive fat rather than hard-working muscle. An obese government that perhaps would be tolerated if times were still good is being roundly criticized now that the economy is hurting.

For example, voters might not have been up in arms a few years ago if they had been told the public tush would be sitting on $1,700 koa benches or that the governor would be affixing his "John Hancock" to the latest revenue-raising measure on a $10,000 koa desk. These amounts are pocket change to a multibillion dollar operation like the Hawai'i state government. How they were spent, however, says a lot about what happens when a giant surplus falls into the hands of a spendthrift government.

Broken promises. Perhaps you're wondering about all those wonderful promises to upgrade schools, repair roads, and improve government services. Those projects may be a long way off as a result of lower revenues, the switch to bond financing, and prolific spending in earlier years.

In fact, during the 1993 session of the legislature, when the reality of the economic slowdown finally hit them, lawmakers switched more than $82 million of infrastructure financing from general funds to bonds and lapsed another $20 million in projects. This freed up more than $100 million for operating expenses but resulted in the delay or cancellation of promised projects.

If general fund revenues continue to limp along, administrators will be faced with a self-created bottleneck in the state's capital improvement program. The amount the state can borrow is based on the percentage of general fund revenues available to make payments on its debt. Ironically, the trick of siphoning general revenues into special funds has caused the state to bump up against the constitutional debt



"COULD YOU HOLD ON? I THINK THAT PAPER'S ON THE MAKAI SIDE OF THE DESK...

limit. This will slow the effort to upgrade public infrastructure. In short, if you're waiting for your kid's elementary school to be repaired, don't hold your breath.

State misled the public. If you still don't recognize "smoke and mirrors" bookkeeping and "hide and seek" banking for what they are, consider this: despite all the hype about cuts that would have to be made to the budget, the 1993 state legislature actually increased its spending. Overall operations funded through the state budget grew by 11.6 percent from fiscal year 1993 to 1994. This percentage is a bit misleading because of certain changes in accounting, but even after adjusting for them the state operating budget grew by 6 percent.

If that's not enough to convince you that the state was not as bad off as officials wanted you to believe, consider this: no cuts were made in public employment. The total number of jobs funded by the 1993 legislature actually *grew*. By the time the budget had been massaged by the 1993 legislature, there was a net increase of 1,077 positions for fiscal year 1994 and 344 positions on top of that for fiscal year 1995. Tough times indeed.

Why it's bad. A few officials have suggested that taxpayers should be thankful that our clever leaders hid, er . . . "banked," all that money during the boom years so we wouldn't be caught short when times weren't so good. They contend that because state officials resisted the temptation to refund the surplus or lower taxes, we had enough money in 1993 to keep things going.

Granted, we kept government fed. But what if the economy is slow to recover? We are now saddled with a bloated government that has outgrown the economy. We satisfied its appetite in 1993 with money that had been hidden in prior years. But what will feed the dragon next year? Another round of tax increases?

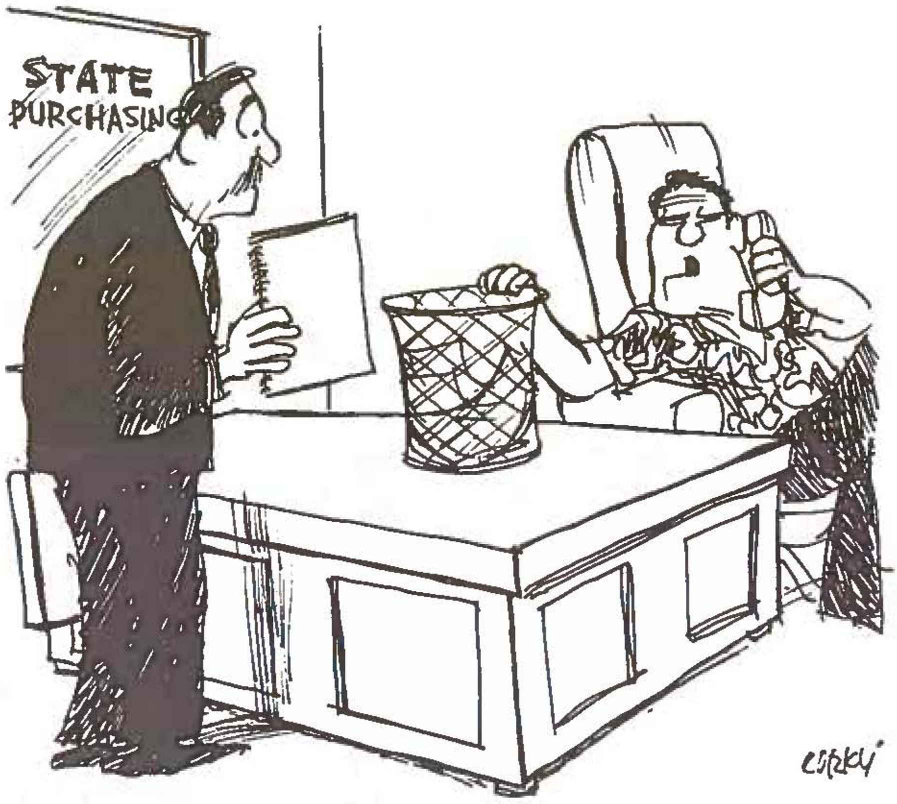
You may not have noticed, but the 1993 legislature quietly increased taxes to supplement its hidden reserves. There were no broad-based tax increases that might upset the general public. The legislature just picked on this or that constituency group too small to complain. Actions included a doubling of the conveyance tax, a new tax on hospitals and nursing homes, and something called "fees" which are a lot like tax increases. Over $60 million in new taxes and fees were raised. That was another big bite out of a pie that hasn't been getting any bigger.

Conclusion and prediction. So, where did all that surplus money go? Well, first it was hidden behind the smoke and mirrors of special funds, and then when the tax review commission and state auditor demanded a more honest approach, state officials started financing capital improvements with excess cash rather than through bond sales.

As the economy weakened and tax collections flattened, state officials managed to get by on the previously hidden money and quietly enacted new taxes. But the secret stash soon will be exhausted, leaving a big government with a big appetite. Don't be shocked by talk of more tax increases if the economy doesn't improve. At this time, a selfimposed diet is not even being considered.

In short, if you think things are bad now, wait till the state government's creative bookkeeping and love of band-aid solutions catch up with us. The individuals who created the mess won't be around; they'll be pulling the rip cord on their golden parachutes. We're the ones who someday will have to explain to our kids and to their kids how it was that we let this happen.

"EVERYBODY ELSE WILL HAVE TO GO ON DIET..."



"OH, SURE-WILL YOU PUT IN YOUR BID WITH THESE OTHERS AND WE'LL CALL YOU..."