CHAPTER 28

GOVERNMENT BAILOUTS

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"Should the state bail out failing private companies?"

Hamakua Sugar Company worker Isaac Fiesta phrased the question a bit differently. "How come the governor's doing nothing to save our jobs?" Fiesta angrily asked at a meeting two weeks before the planned shutdown of the 110-year-old plantation. "Waihee's a Honoka'a boy; how come he no show face?"

Obviously stung, Governor (and Honoka'a native) John Waihee came lumbering to the rescue on a proverbial white elephant. Waihee proposed an $8 million state loan guarantee—quickly rubber-stamped by the state legislature—to finish the final harvest of the bankrupt sugar company and avoid the "economic and social fallout" of an immediate shutdown. State attorneys told the bankruptcy court there was at least a reasonable chance the harvest could be completed and the loan repaid. What a deal! Hamakua's main creditor, already $115 million in the hole but needing cooperation from the state to sell off the plantation lands, found it difficult to say no.

Traditional pattern. State officials, mindful that times were tough elsewhere around the state, emphasized that this was merely a loan guarantee, not an outright giveaway. Still, the Hamakua deal followed the traditional pattern, where politics and personalities rather than long-term planning and policy considerations trigger state aid to dying companies. Ultimately, taxpayers' money will only forestall the inevitable.

When the state gave Hamakua Sugar its initial $10 million rescue loan in 1988, owner Francis Morgan declared that he needed only temporary help to get over some weather-related and cash-flow problems. The state agricultural director proclaimed, "The loan is fully collateralized. . . . the state will get its money back no matter what happens."

Such sweet talk is cheap; sugar production is not. Although Hamakua stayed alive for another five years, nothing was done to diversify the district's economic base or prepare for the inevitable shutdown. In the end, Hamakua was charged with violating federal environmental laws; it had run up millions of dollars more in debt to creditors (including local businesses); and it had let its workers compensation insurance fund lapse so that the state had to shell out at least $6 million to cover employees' claims. That's on top of what it will have to pay for unemployment insurance and any default on the final harvest loan guarantee. And no matter how the harvest goes, all jobs will be history by late 1994.

By comparison, the $8.5 million state loan to Hilo Coast Processing Company in 1989 has been a success. That loan is current, and the company appears well managed. Moreover, because the money was used to buy and continue operating the plantation's 18-megawatt electricity generating plant, the Big Island had fewer rolling blackouts that surely would have followed a shutdown.

Nonetheless, when Governor Waihee signed the bill for the Hilo Coast loan, he announced that it would "help save 700 jobs." Not for long. In 1994 that plantation will also close, leaving just thirty employees to run the power plant.

Beyond the bottom line—and in spite of the imminent death of King Sugar—there might be legitimate social arguments for state aid to sugar companies, given the sheltered, self-contained nature of plantation communities and their historic role in Hawai'i's development. Unfortunately, none of those arguments fit the state's $12.6 million loan guarantee on behalf of Hawaiian Airlines.

Recent bailout. By early 1993, Hawaiian Air had the look of a fiscal dodo bird. Its operating losses over the prior four years had totaled $350 million (about $240,000 a day); it was in default on its aircraft leases; and its outside auditors had expressed "substantial doubt about its ability to continue as a going concern." Only Boris Yeltsin had a worse credit rating. Still, the state government made and then defended the Hawaiian loan guarantee as a "good, conservative business deal."

No one disputes that interisland air travel is critical to Hawai'i's economic health. To justify the deal, government business analysts projected that shutdown of Hawaiian Air would result in a loss of 3,500 jobs and $94 million in annual household income statewide. Those doomsday guesstimates, however, rested on the highly questionable assumption that no new competitor would enter the Hawai'i market with comparable service.

Besides being just plain wrong, that assumption was more than a trifle self-serving on Hawaiian Air's part, given its past efforts to kill one competitor (Discovery Airways) and keep out another (United Airlines). Business practice and common sense should have dictated that

"TURNED DOWN OUR LOAN AGAIN 'CAUSE THEY WANT SOMEONE TO GUARANTEE THE STATE LEGISLATURE'S GUARANTEE..."

there would be new entrants in the interisland air market (perhaps Mahalo Airlines) and that they would hire mostly local people.

State legislators' response to Hawaiian Air's plea was classic Marx (Karl, not Groucho). Along with the loan guarantee, lawmakers voted to reregulate the interisland air business via a state commission with the power to set fares and restrict new competition. In an amazing display of double-talk, Governor Waihee claimed regulation would "foster competition by keeping the industry economically viable."

Our elected officials were convinced not by numbers but by bodies: the hundreds of Hawaiian Air employees who descended on the Capitol to plead for help to save their jobs. Honest, tearful testimony can be devastatingly effective, and in this case it was.

More to come? Such bailout plans consume an extraordinary amount of time and attention that might be better spent on more productive state business. History shows that bailouts provide a false sense of long-term security for employees. And with the floodgates now open, more "worthy but troubled" companies surely will stagger up to the trough. How can their pleas be denied?

Rather than ricocheting from crisis to crisis, the state has to determine what's crucial to its long-term economic prosperity—and then stick to it. A dying duck cannot be transformed into a phoenix. Belated government intervention, whether with loans or price controls, will only make an inefficient business less efficient.

It is ironic that Hawai'i, a state with close ties to Asia, has not yet learned this economic lesson. From Thailand to South Korea, countries are deregulating, privatizing, and encouraging private companies to work out their own problems. In Singapore, even government-backed enterprises are allowed to go bankrupt. Meanwhile, starting and operating a business in Hawai'i is an increasingly byzantine paper chase.

Government role. This is not to say that Hawai'i government should be a disinterested observer. Some regulation of business is important to protect the health and welfare of consumers. But it is just as critical to distinguish between those regulations that promote the free market and those that interfere with it. One cannot see the difference while sitting behind a desk; government officials must get out and talk to the thousands of business people who are forced to live by the rules.

Hawai'i's state government, especially its business development department, must set clearer goals and provide some direction for future growth. The 1978 Hawai'i State Plan never got much respect, was generally ignored, and is now just an expensive relic. Nagging new questions need answers: Which tourism markets will we target over the long term? Do we want more foreign investment? Do we even really know how foreign investment affects Hawai'i?

Only when those bigger issues are settled can government effectively provide incentives to encourage desirable new industries, instead of bailing out businesses that should be laid to rest. It is interesting to see that the state's 11-year-old Innovation Development Program, intended to promote the development of new products, had made only three loans by the end of 1992.

State officials have always defended the relatively high delinquency rates on other state loan programs by noting that the state is a "lender of last resort." That is, businesses who borrow from the state must show they can't get the money from anybody else. Such spin-control reflects a jumbled mind-set. Rather than a lender of last resort, the state government must be a facilitator of first ideas.

Broader vision. Economic development officials have recently said that they're focusing on making Hawai'i a sports and film-making center. Those may be worthy goals, but a strategic plan must have a broader vision. For example, the state might decide to target "knowledge-related" industries, high-tech niches that don't require large land areas or mass production. With a wonderful climate to attract both doctors and patients, Hawai'i might become a center for medical research and treatment—a sort of Mayo Clinic of the Pacific.

And in spite of the recent furor over foreign investment, the state must foster closer ties with Asia. Billions of dollars of goods and services now fly over Hawai'i every day between Asia and the U.S. mainland. We must be outward-looking and ready to compete if we are to become a part of that action. Bailouts are inward-looking activities that make Hawai'i a place serious business people like to fly over.

Consider this: Despite the lack of a convincing policy rationale, there was meager opposition to the Hawaiian Air loan guarantee. Evidently legislators worried more about a small but vocal bloc of votes than a large number of silent votes. Surprised?


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HOUSE
TO: SENATE
TRUSTEE
THE TRUTH
GEOTHERMAL
TAX SURPLUS
HAWAIIAN HOMELANDS
INITIATIVE
JOHNSTON ATOLL
SOLD
SMALL BUSINESS
TAX HELL
HOUSING CRISIS
POLLUTION
BRAIN DRAIN
LOW WAGES
HIGH COST OF LIVING
CRIME
TRAFFIC MESS