



July 7, 2016

TO: Hawai'i State Tax Review Commissioners

FM: John M. Knox

Summary of Study on State/Local Govt. Finances

The attached is background information that is largely peripheral to our work but provides a certain perspective.

It is a sort of “hobby study” of U.S. Census data that I recently completed, focusing on comparing various aspects of local government – revenue, expenditures, employment, debt, and holdings – for Hawai'i vs. other U.S. states. It is difficult to make valid comparisons without combining state and local governments, which means most numbers do not include our mandate of the State government only.

Attached are:

1. The Summary of the main report text; and
2. Charts that summarize some FY 2013 Revenue data for Hawai'i vs. the “Average State:”
 - Fig. 1a and 1b show data for combined state/local governments.
 - Fig. 2a and 2b show similar data for state governments only.

Although the comparisons in Fig. 2a and 2b are less valid than those in Fig. 1a and 1b, they do provide a breakdown of Hawai'i's state government total revenues (not just taxes) and the relative importance of various categories.

Mahalo,

A handwritten signature in black ink, appearing to read 'J.M.K.', is written over a light blue horizontal line.



**COMPARING HAWAII STATE/LOCAL GOVERNMENT
FINANCES TO THOSE OF OTHER AMERICAN STATES**
(From Fiscal 1993 to Fiscal 2013 for most data)

Volume I: Report Text (SUMMARY)

John M. Knox & Associates, Inc.
May 2016

SUMMARY HIGHLIGHTS

For the ordinary person, there may be few topics more boring than statistics on government finance. And this report mostly paints the overall condition of government finances in Hawai'i as boringly ordinary.

What is *extraordinary* is how this conclusion flies in the face of popular stereotypes of Hawai'i as being a "tax hell" with "bloated bureaucracy." For the most part, the numbers say otherwise, at least since the turn of the century. Our combined governments' Total Revenue, Total Expenditures, and Workforce have, for the most recent years of available data, been very close to those of the statistical "Average State" in the nation. However, our governments' Total Debt is somewhat higher, and Cash and Securities Holdings lower, than in the "Average State" (i.e., all state results divided by 50).

The validity of these conclusions depends, of course, on the data source and how states are measured against each other.

Sources: This study is based entirely on U.S. Census data – mostly (1) the *U.S. Census Survey of State and Local Government Finances* (all years from Fiscal Year 1993 to 2013, except 2001 and 2003), with some limited information from (2) the Census Bureau's *Annual Survey of Government Employment and Payroll* (one month per year for each year from 1993 to 2014, except 1996). We also used Census data on state population and U.S. Bureau of Economic Analysis data on state GDP (Gross Domestic Product).

Key Principles of Measurement and Comparison:

- 1. *Need to Compare Combined State/Local Government Data*** – Comparing financial data for Hawai'i's state government (alone) to other state governments (alone) will generally produce incorrect or misleading results. Hawai'i's state government takes on functions (such as Education, Airports, and Hospitals) that in most other places are assumed far more by local governments. Valid comparison requires use of the Census dataset for combined State/Local governments. This limits action implications for any one level of government, but is critical for appropriate comparisons.

2. **Value of Looking at Comparisons over Time** – While the appendices (Vol. II and III) and some exhibits in this Vol. I provide detailed focus for the most recent available data (generally FY 2013), any one year’s results could be atypical. It is also useful to see change or stability over time. So the study repeatedly charts Hawai‘i data against the other 49 states and the “Average State” since FY 1993.
3. **For Any Component of Spending or Revenue, Look First at Composition, Then at Levels** – Whether through deliberate grand policy actions that may be enshrined in state/local constitutions, or through a series of independent small actions, each set of governments has made de facto general decisions about how it will allocate revenue sources and expenditures. Before asking, “Does Hawai‘i have a higher level of some *particular* form of taxation (e.g., individual income tax) than other states?” it is important to understand the composition of *all* revenue sources. If Hawai‘i leans more to taxes than to charges/fees, then of course many types of taxes will be higher here ... but perhaps balanced by lower revenue from other sources. That context is critical.
4. **Preference for GDP over Per-Capita Measures for Comparing Levels** – Dollars or jobs must be divided by something to produce a “yardstick” for comparison among states. We provide two such “yardsticks,” (1) dividing by state Gross Domestic Product (Percent of GDP – “How much of the *economy* is represented by government?”); and (2) dividing by resident population (Per Capita – “How much do *people* pay for or receive from government?”). However, we recommend the former, in good part because the Per-Capita approach misses the fact that tourists demand services and pay taxes.

We also caution the reader to remember that comparisons are always tricky because all states differ in geography, history, economy, etc. We attempted to identify a limited set of truly “Comparable States” to Hawai‘i (based on land size, GDP, population, etc.) but did not find this feasible or helpful for the study.

General Purpose and Value: This is a “50,000-foot level” analysis aimed at *comparison*. It also helps clarify the structure of Hawai‘i’s combined governments’ finances, at least by standard Census categories. There are many questions unaddressed by the study, including whether Hawai‘i or the “Average State” is taxing and spending wisely; if government is effective or intrusive; impacts on business and equity; etc. Census data focus on current finances, *not* future liabilities/revenue, so do not measure fiscal “health.”

Revenue Results Overview: Especially as measured by Percent of GDP, Hawai'i governments' Total Revenue has been very close to the "Average State," but *sources* of revenue have been skewed toward taxes – especially taxes borne in part by tourists (e.g., the general excise tax), yet also strongly affecting residents. These are arguably balanced by comparatively low levels of corporate income taxes, transfers from the federal government, local property taxes, and various "other" taxes and fees.

Expenditure Results Overview: In the 1990s, as a Percent of GDP, Hawai'i Total Expenditures were higher than those of the "Average State," and Hawai'i combined governments had one of the nation's poorest marks for spending more than they received. But in more recent years, especially since the Great Recession, Hawai'i governments' Total Expenditures closely resemble those of the "Average State," and spending has roughly matched income. Hawai'i spends relatively less than other places on certain functions (e.g., Correction or, given reliance on private schools, K-12 Education), and relatively more on others (Airports, Sewerage/Solid Waste at the local level, and various general governmental activities).

Workforce/Payroll Results Overview: Hawai'i's combined governments' workforce size and salaries are now very much in line with the rest of the country, despite greater population demands for services (including the visitor population) and despite Hawai'i's greater cost of living.

Debt Results Overview: Total Debt for Hawai'i has been higher than for the "Average State" but not among the very highest. Hawai'i has consistently ranked Number 50 among states for the percent of Total Debt used for what the Census calls "Private Purposes" – e.g., as a conduit for things like housing or student loans, private stadiums and conference centers, etc. This is much more common elsewhere.

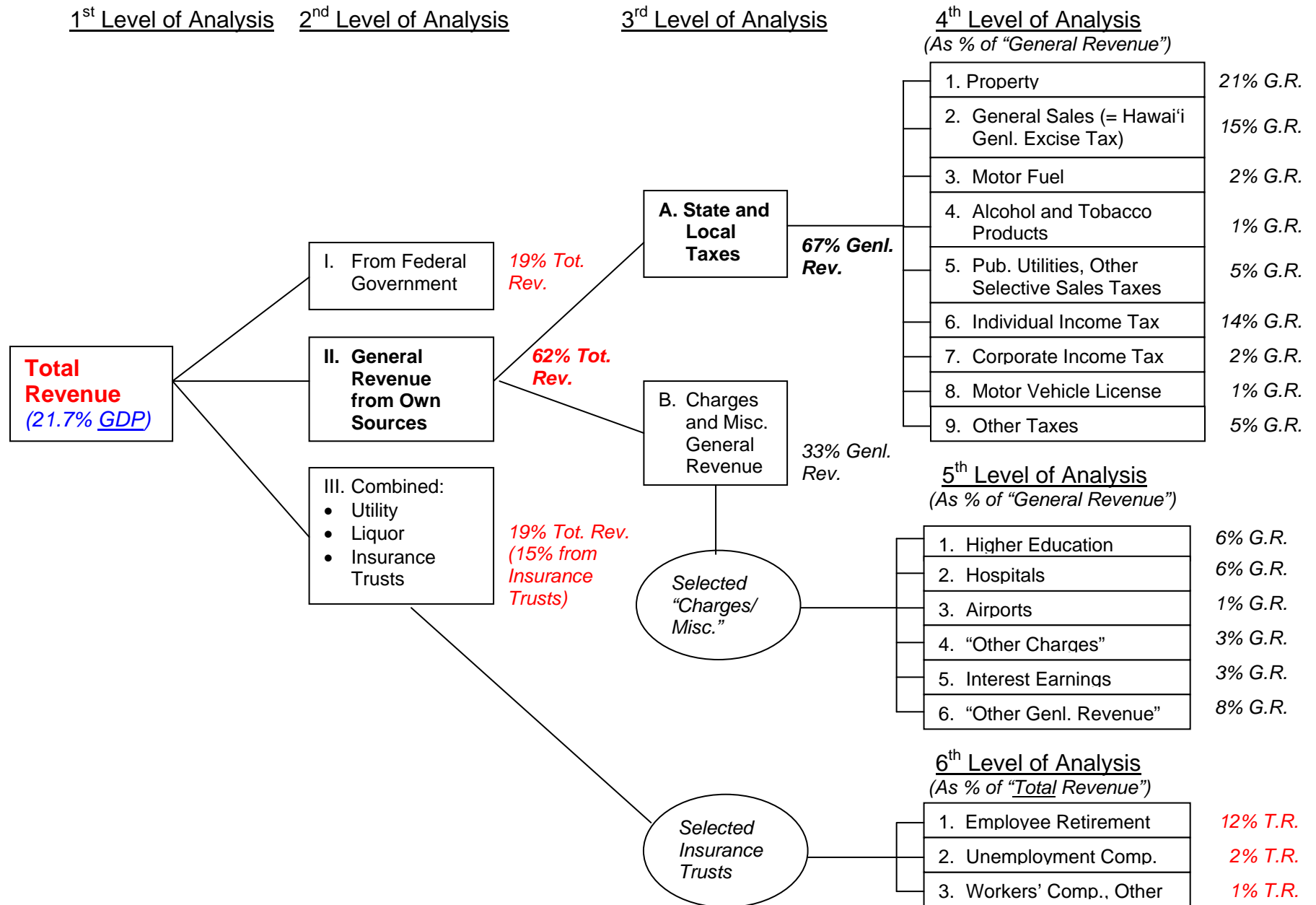
Cash/Securities Holdings Results Overview: For Total Holdings, Hawai'i strongly resembled the "Average State" in the 1990s, but from FY 2004 to FY 2013 has had below-average figures. This appears due in part to increasingly low reserves set aside as Offset to Debt, and also because Hawai'i Employee Retirement System (ERS) holdings went from being a bit above average in the 1990s to below average in the 2000s (though the State has subsequently started to put more funds into the ERS).

Selected Specific Findings of Interest:

- Hawai'i's unusually high concentration of government activity at the state level is best illustrated by FY 2013 data on how much of the combined state/local annual payroll (76%) and full-time-equivalent workforce (78%) were at the state level alone. The next highest figures, for Delaware, were 52% and 53% – and for the “Average State” just 34% and 31% – respectively.
- Though Hawai'i governments' *Total Revenue* closely matches that of the “Average State” relative to GDP, Hawai'i consistently gets comparatively less from the federal government and from government-run utilities (or state-run liquor stores). So combined “General Revenue from *Own Sources*” has been somewhat higher than average, and since the Great Recession was trending up through FY 2013 while figures for the “Average State” trended down. Drivers for this recent Hawai'i revenue growth appear to include General Excise Tax, Transient Accommodations Tax, and the small but regressive Motor Vehicle Tax – all increasing faster than GDP during this period.
- At the same time, governments in both Hawai'i and virtually all other states since the Great Recession have been cutting back on Total Expenditures relative to GDP. This has helped both Hawai'i and the “Average State” get back recently to something like “balanced budget” outcomes. This report does not attempt a comprehensive analysis of all specific areas where Hawai'i particularly cut funding during this period, but Interest on General Debt and Elementary/Secondary (K-12) Education were clearly among them.
- There have been great swings in how much of Hawai'i governments' expenditures have gone both to Capital Outlays (infrastructure and purchase of land/buildings/equipment) and also to Salaries/Wages. At different times since FY 1993, Hawai'i was last or near-last in the nation for each, and at times highest or near-highest for Capital Outlays (but never much above average for Salaries/Wages).

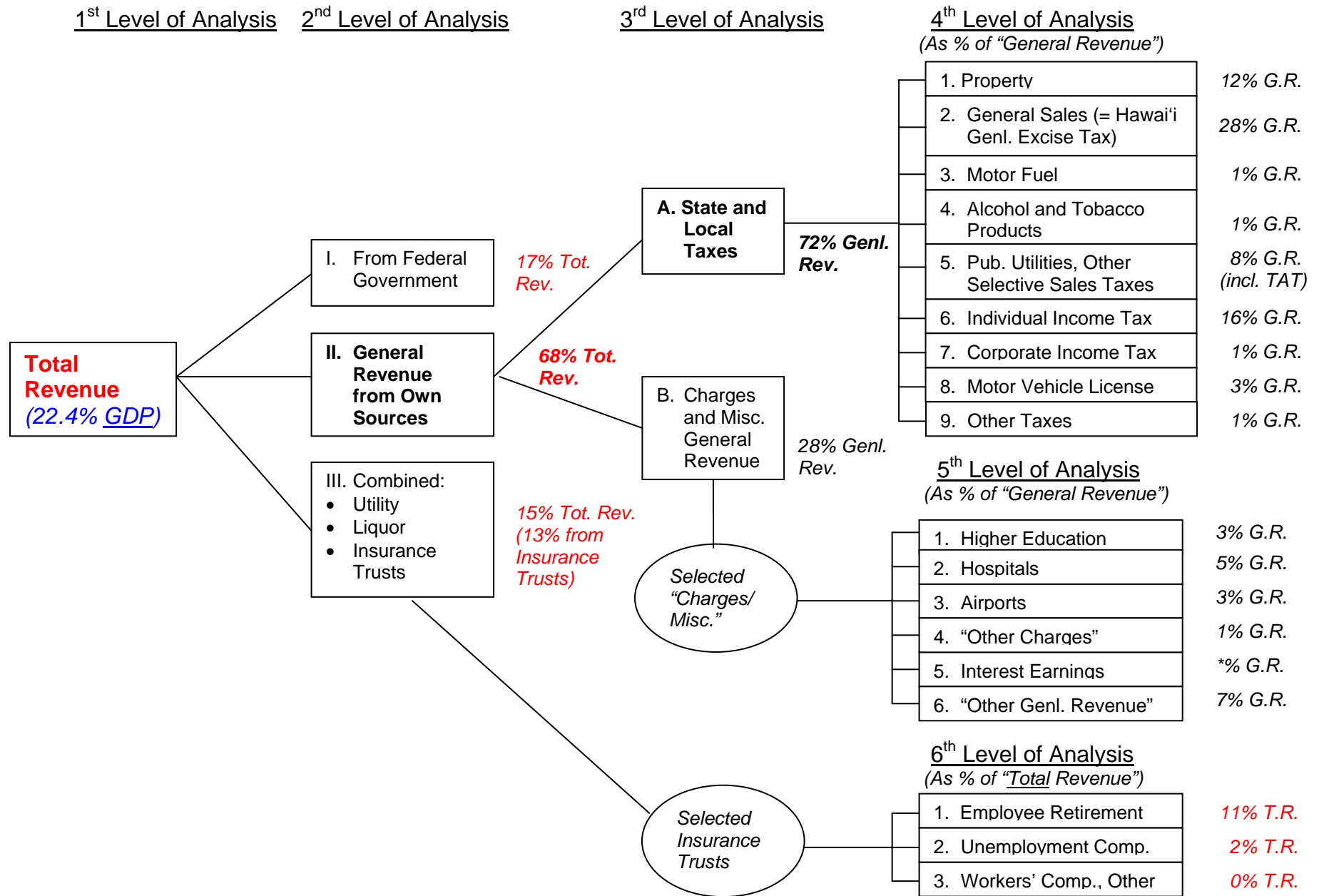
Next Steps: This is a very simple, unsophisticated study – mostly just charts to illustrate comparisons, with little attempt to explore reasons or implications. We hope it can provide a foundation for some State agency and/or University researchers to maintain and further develop.

Figure 1A: COMBINED STATE/LOCAL GOVERNMENTS – FY 2013 – “AVERAGE STATE” GOVERNMENTS



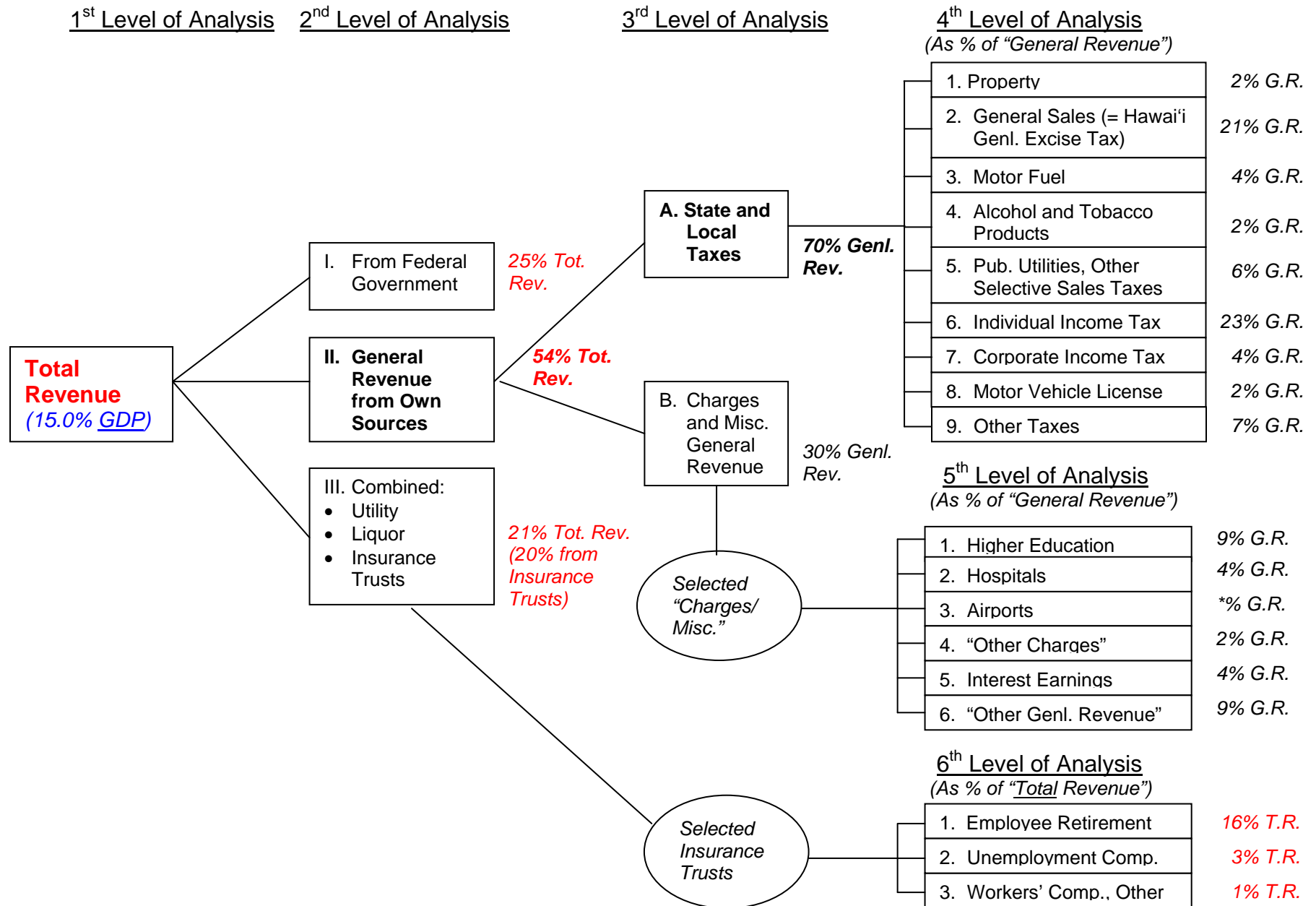
Information summarized from *Comparing Hawai'i State/Local Government Finances to Those of Other American States*, John M. Knox & Associates, Inc., May 2016

Figure 1B: COMBINED STATE/LOCAL GOVERNMENTS – FY 2013 – HAWAI'I GOVERNMENTS



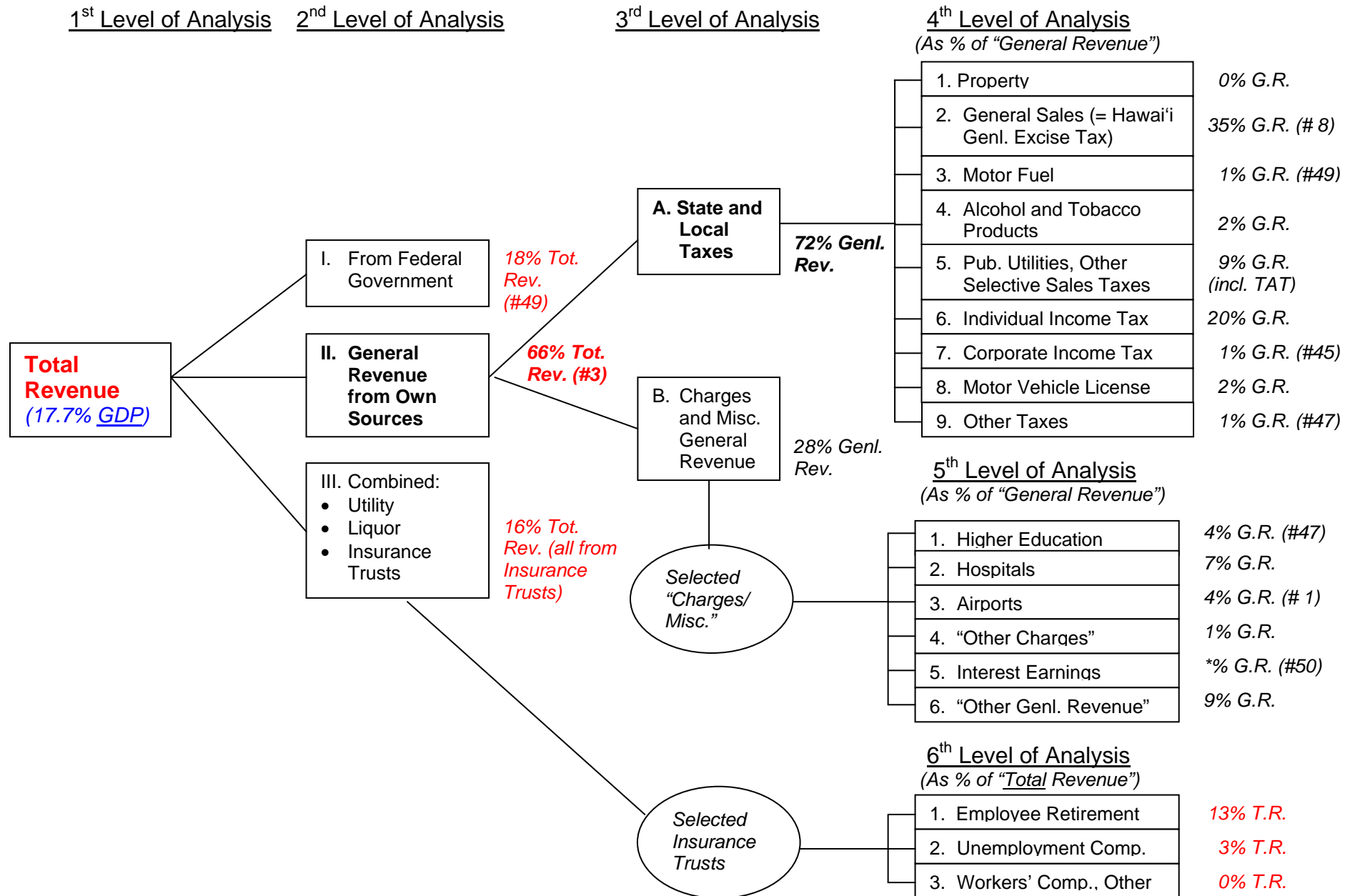
Information summarized from *Comparing Hawai'i State/Local Government Finances to Those of Other American States*, John M. Knox & Associates, Inc., May 2016

Figure 2A: State Government Only – FY 2013 – “AVERAGE STATE” GOVERNMENT



Information summarized from *Comparing Hawai'i State/Local Government Finances to Those of Other American States*, John M. Knox & Associates, Inc., May 2016

Figure 2B: State Government Only – FY 2013 – HAWAI'I



Information summarized from *Comparing Hawai'i State/Local Government Finances to Those of Other American States*, John M. Knox & Associates, Inc., May 2016