In the 1990s, after years of excitement and prosperity, the economic winds suddenly dropped from Hawai‘i’s sails, and the state found itself perplexingly and unhappily becalmed for seven years. This was unprecedented in the state’s economic history—perhaps unprecedented since Captain James Cook’s arrival in 1778. To put this in perspective, the annual average rate of growth Hawai‘i experienced between 1959 and 1990 meant the economy doubled every 14 years. At the rate of growth experienced between 1991 and 1998, it would take Hawai‘i’s economy 93 years to double in size.

The economic slowdown significantly changed how Hawai‘i’s people think about their economy. In the high-growth years, Hawai‘i developed a reputation for innovative land use regulation, environmental remediation, and labor practices. The socially conscious looked to Hawai‘i as a model of progressivity. The high rate of economic growth made that progressivity politically acceptable because it hid the costs. When incomes grow at 7% or 8% per year, no one really worries about policies that shave one quarter to one half of one percentage point from the long-term rate of growth.

But in the 1990s Hawai‘i came to value those fractions of a percentage point. Voters forced Hawai‘i’s leaders to reconsider policies that may have met a political or economic need at one time but that came with a cost in terms of foregone economic activity. Hawai‘i made some adjustments during the period and showed a willingness to look at even more changes. Most tellingly, many in Hawai‘i began to realize the implications of the state’s economic connections to the rest of the world. Those connections imply pursuing policies with an eye to the economic alternatives available elsewhere. This means that we cannot examine policies just by looking at their
benefits—the costs, also, must be acknowledged. At high growth rates (such as 7% per year), we could too easily ignore or understate the costs; at growth rates of 0.5% per year, those costs became clearer.

Yet no matter what it did, Hawai‘i could not have avoided the downturn of the 1990s. Precisely because Hawai‘i is so connected (some would say dependent on) the outside world, external economic events can sweep Hawai‘i up. This is largely what happened early in the 1990s. To their credit, many in Hawai‘i took this as an opportunity to reexamine their ideas about how the economy should operate. Political leaders, responding to constituent demands that something be done, opened themselves to exploring formerly taboo policy options yet policy makers could do little to substantially improve Hawai‘i’s economic performance. Hawai‘i’s economy simply relies so heavily on export earnings (principally from the mainland and Japan), that its economic growth policies hardly leave a trace in economic statistics.

But in accepting this, we run a serious risk of becoming complacent. For while policy makers find it difficult to substantially improve Hawai‘i’s economic fortunes, they can easily impair its economic health. Policies that impose significant regulatory costs on individuals and businesses, that raise tax rates out of line with taxes elsewhere, and that ignore consumer choices beyond Hawai‘i’s goods and services, can easily plunge the state’s economy into decline. There are simply too many alternatives. Hawai‘i must compete or wither.

The Bubble

Hawai‘i emerged from the recession of 1981–1982 with a roar, fueled by demand from Japanese visitors and investors. Japan’s economy inflated during the second half of the 1980s in what turned out to be a bubble—an unsustainable expansion of income and wealth. Hawai‘i participated in Japan’s bubble in the form of surging numbers of yen-spending visitors and direct Japanese investment in Hawai‘i’s commercial and residential properties.

Three Pinpricks

A confluence of three events brought Hawai‘i up short. First, Iraq invaded Kuwait. Ordinarily, Middle Eastern events would have little effect in the Pacific, but the short Gulf War sent worldwide tourism demand into a nosedive. For several months during 1991 and 1992 many people
thought better of stepping onto an airplane—and that spelled trouble for Hawai‘i.

As the United States basked in the glow of winning the Gulf War, the American economy reached the depths of recession. This was the second of the three shocks to Hawai‘i’s economy. While most of the mainland’s recession proved short, California’s economy dipped again in 1993; this was enough to flatten westbound tourism for most of the decade, and with it Hawai‘i’s economy.

The third shock, the bursting of the Japanese economic bubble, turned out to be longer lasting and of greater effect than the other two. Hawai‘i’s economy had become tethered to the Japanese economy. This was not because most tourists came from Japan (most tourists were westbound), nor was it because of Japan’s economic size (the mainland is larger by far). Instead, Hawai‘i’s economic growth pattern mirrored Japan’s because that was where the action was: Japan generated Hawai‘i’s fastest-growing tourism segment and fastest-growing investment component. Compared to a more stable (though larger) base from the mainland, the movement in Hawai‘i’s economy reflected the movement in Japan’s economy.

So when the bubble burst—when Japan’s stock market fell, when the real estate market collapsed, and so on—Hawai‘i felt the pain. Double-digit growth in visitor arrivals and expenditures fell to the low single digits. Investment in lavish hotels and restaurants dried up. While some background activity continued, by comparison with the go-go years of the 1980s, Hawai‘i’s economy in the early 1990s felt sluggish.

A Change in Fortune

From 1992 through 1994 Hawai‘i’s private and public leaders denied the depth of the economic problem. While there was talk that government had grown too large, that taxes were too high, and so on, leaders expected to ride it out. They had some rationale for this: after all, Hawai‘i had seen recessions before and the downturns had been short, if unhappy, affairs. In the past, gross state product (GSP) would fall for one, or at most two, years and then start growing again. Thus it made sense to take a wait-and-see attitude.

During this period, a number of issues percolated in Hawai‘i, including whether to fund rail transit and whether to compel the conversion of residential leasehold property to fee interest. These issues affected how Hawai‘i’s economy would work in detail, but they were only the background of the basic macroeconomic picture. The one exception was the growing
concern over the size of state government. Many concluded that Hawai‘i’s government had grown too much during the 1980s and that its size was at least partly responsible for the poor economic performance—this despite the argument’s vagueness (what size is “too large”?) and in spite of evidence against it. That government had grown too large nevertheless became accepted as fact.

A Change in Administration

By the time Benjamin J. Cayetano was inaugurated as governor in 1995, Hawai‘i seemed ready for change. Cayetano used his first state of the state address to reveal how severely the budget was strained, and to lay the political groundwork for budget cuts and layoffs. The layoffs proved rather small compared with the total number of state workers, but the fact that they happened at all was remarkable. During this period there was also talk about the need to establish a rainy day fund when times got better.

The dramatic deterioration in the state’s fiscal fortunes paved the way for other changes that promised to have an even more profound impact on the economy. The Cayetano administration began to explore deregulating the telecommunications industry; Hawai‘i made a promising start with the passage of Act 225 (1995 SLH) early in Cayetano’s first year. (Unfortunately, this effort bogged down later.) Initial inquiries into maritime and land use regulations proved even less successful. Still, the issues were raised and serious efforts were made to examine them. Raising the level of consciousness about these and other issues was an important contribution of the Cayetano administration that may ultimately pay off down the road.

COR, ERTF, and Crisis

Through all of this the economy struggled, straining the state budget. The Council on Revenues (COR), constitutionally charged with forecasting revenues available to the state, sharply lowered its estimates in the middle of the 1997 legislative session. The ensuing administration challenge to the COR’s competence ultimately revealed that the COR had an important political, as well as economic and fiscal function.

In the year before his election to a second term, Governor Cayetano assembled a forum of community leaders to discuss problems and to determine an agenda for moving Hawai‘i’s economy forward. This forum evolved into the Economic Revitalization Task Force (ERTF), and it proved to be
a source of both controversy and some of the most sweeping proposals to be considered in Hawai‘i for decades. The ERTF made recommendations about, and legislation was eventually enacted on, tourism, education, university autonomy, government budget reform, taxation, and more. The ERTF dominated policy discussion in Hawai‘i from mid-1997 through the election in 1998. Ultimately, it helped secure Cayetano’s reelection.

As the ERTF began to form its proposal, in the summer of 1997, financial analysts around the world were maneuvering madly to pull their money out of an increasingly risky-looking Thailand. In July, the Thai baht collapsed and the ensuing creditor rush to the exits pulled down much of eastern Asia and threatened the rest of the world as well. The Asian crisis loosed a torrent of discussion about economic policies and institutions that in some ways mimicked the discussions taking place in Hawai‘i, discussions about deregulation, honesty and transparency in government, premiums on efficiency, and so on. Fortunately, the Asian crisis was contained; unfortunately, the deeper causes of the crisis may not have been addressed. It is unclear whether they were addressed in Hawai‘i.

The Election

For Hawai‘i Democrats, 1998 was the year of the great escape. Gubernatorial candidate Linda Lingle came within a whisker of ousting Cayetano to become the first Republican governor in 36 years. Ultimately, Cayetano convinced enough people that he was a “new Democrat” (that is, fiscally prudent and tolerant of lower taxes) without alienating the left. As far as economics goes, the challenger’s proposals and the incumbent’s record looked very much the same, and that probably saved Cayetano.

Second-Term Agenda

A second-term governor under a two-term limit enjoys certain freedoms. Without the pressure of reelection the incumbent can pursue policies that he or she truly believes in. Three such initiatives emerged in Cayetano’s second term: a tax credit for refurbishing hotels, incentives for attracting high-tech firms, and an increase in the minimum wage. All three have serious economic drawbacks.

The hotel tax credit and the incentives for high-tech firms were of a piece. Both targeted specific industries or firms for special treatment on the argument that they will boost economic growth. Whether this kind of industrial policy works in fact is an open question.
The minimum wage hike had a slightly different goal. Supporters argued for “sharing the gains” of renewed economic activity with low-income workers. This is a long-standing Democratic policy, successfully promoted on the national level. Yet standard economic analysis and some evidence suggest that the policy throws out of work the very people it intends to help.

These policies emerged in the last two years of the 1990s as Hawai‘i’s economy showed signs of recovery. A number of economic indicators turned upward including real gross state product growth, visitor arrivals, personal income, and jobs. It is interesting that policies about which many economists have reservations began to emerge once the economy picked up. Worryingly, this suggests a return to the Hawai‘i of the 1980s, when strong economic growth masked the costs of economically questionable public policy.

Lessons and Conclusions

In some ways the 1990s delivered a wake-up call to Hawai‘i. While it was clear that economic growth rates were trending downward from the very high levels of the 1960s and 1970s, no one expected the unprecedented, sustained collapse of the 1990s. To a large extent, the collapse lay outside Hawai‘i’s control. The Gulf War, the mainland recession of 1990–1991 (including California’s longer decline), and the deflation of Japan’s economic bubble all combined to slam Hawai‘i’s economic base.

After some hesitation it became clear that Hawai‘i’s economy would not bounce back within a year or two that. Something more serious was going on. When Hawai‘i’s residents came to this realization, our leaders began to look at things anew, to reexamine assumptions, and to question the old formulas and standard solutions. In terms of action, this fell well short of a revolution, yet we did take some steps and, perhaps at least as important, started thinking anew about Hawai‘i’s economy and its place in the world.

Hawai‘i’s economy began to recover in 1999. Growth rates picked up in a number of indicators, including personal income, employment, jobs, and tax revenue. As the economy rebounded some leaders felt pressured to adopt politically popular policies. Many of these policies were disguised as attempts to further strengthen the economy—such as tax credits for hotels and high-tech firms. Yet the economic arguments for such policies were weak at best. Other policies, such as raising the minimum wage, were directed at equalizing incomes, but in a way that could harm the very people the policy was trying to help.
Hawai‘i vigorously pursued these kinds of policies when the economy grew at double-digit rates in the 1980s. Such policies enjoy strong political backing, and probably reduce long-term economic growth by only small amounts. That makes them almost irresistibly tempting because the political benefits are clear whereas the economic costs are not.

Something like this has also happened in Asia. With the exception of Japan, the Asian economies that were hit hard by the economic crisis of 1997 and 1998—South Korea, Thailand, Indonesia, and Malaysia—rebounded smartly. Yet some observers worry that the recovery might have been too fast—that policy makers have not addressed the underlying problems and that the recovery undermined the pressure to deal with those problems. Similarly, Hawai‘i’s decision makers are inclined to support policies that make a great deal of political sense but that have dubious economic merit. While individual measures do not seriously threaten the economy, an accumulation of such policies can impair Hawai‘i’s competitiveness, as our experience of the 1990s has shown.

An important caveat must accompany this questioning of recent Hawai‘i policy. Economists’ concerns about certain policies really only apply as long as the costs go unrecognized. That is, environmental, regulatory, and other statutory requirements designed to achieve one goal or another will often have some negative implication for economic growth. The economist’s job is to remind policy makers of the costs and to encourage decisions that explicitly weigh the benefits against them.

Once that point is made and appreciated, the economist’s task is done. If Hawai‘i’s leaders—and, more importantly, Hawai‘i’s people—decide that the benefits of certain environmental protection measures, of particular regulatory actions, and of specific market interventions, are worth the costs, then economists have no more to say. Oftentimes we cannot accurately measure the benefits, yet they may well be quite high. For example, how highly does a community value pristine beaches and green space, or near-universal health coverage? As long as the community is aware of the costs of those policy positions, there can be no objection to incurring those costs. Economists may weigh things differently, but then they merely express their opinions as individuals and members of a community, with no greater say in what happens than anyone else.

So it comes down to weighing costs and benefits. Perhaps that is a prosaic, predictable conclusion for a book written by an economist. In my view, Hawai‘i’s experience in the 1990s drove this lesson home—at least for a time. As Hawai‘i’s citizens struggled to find a solution to our state’s economic problems, people began to think seriously about the costs of existing
policies, and in some cases, they made changes. Whether Hawai‘i continues this practice—particularly in the wake of uncertain economic conditions following the September 11 terrorist attacks—remains to be seen.

Notes

1. Noel J. Kent has made the classic statement of dependency theory as it applies to Hawai‘i. While acknowledging the costs of external connections, this book differs from Kent in arguing that Hawai‘i’s dependence also explains its relatively high standard of living.