



# **UNIVERSITY OF HAWAII SYSTEM**

## **Legislative Testimony**

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Written Testimony Presented Before the  
House Committee on Tourism  
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By

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And

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### **HB 2259 – RELATING TO ECONOMIC LEAKAGE**

Chair Brower, Vice Chair Ohno and members of the committee:

As Executive Director of the University of Hawai'i Economic Research Organization (UHRO), and a Professor of Economics, on behalf of the University of Hawai'i, we offer comments on HB 2259 which appropriates funds and directs the Department of Business, Economic Development, and Tourism to prepare a report examining the severity of economic leakage in the State's tourism industry.

We support funding additional research on Hawai'i's tourism industry. However, focusing on leakages from the tourism industry is not the most productive area of research. Import substitution as an economic development tool has been discredited and for good reason. Instead, economic development policy today focuses on specialization and trade as the path to economic growth. The bill provides examples of leakages including foreign tour operators offering tours in Hawai'i, foreign debt incurred by Hawai'i resorts, and the sale of souvenirs that are imported rather than produced in Hawai'i. The last two examples are particularly interesting. We are unaware of any Hawai'i resorts whose primary source of funds for initial development or subsequent renovation was a local bank. Rather than look at external finance as a negative for Hawai'i's tourism industry, it is a sign of the strength of the industry and the solid investment opportunities available in Hawai'i. If we were to eliminate the "leakage" of external finance, very little investment would occur in new resorts or in upgrading existing visitor plant. The second example of imported souvenirs may be important if you look at it through the lens of Hawai'i's existing strong clusters. The economic development literature points to the presence of strong clusters as a driver of wage growth, innovation and establishment birth and even the growth of new industries in a region. Research that focuses on the existing strong Hawai'i clusters in Hospitality and Tourism, Jewelry, Apparel, Music and Sound Recording, and Performing Arts to understand the inter cluster relationships may be more useful than focusing on measuring leakages. Porter (2009) suggests several forms of policy, beginning with work to identify existing clusters to better understand their composition, membership, employment and performance. Once clusters have been identified, government may

serve as a convener of cluster participants where the private sector has not already done so. Where clusters are already well organized through associations or other groups, engaging cluster participants to understand how policy can hinder or facilitate growth in the cluster is important. For example, cluster participants may benefit from shared assets and infrastructure such as community college curricula or shared university-cluster research space. Government policy can facilitate the investment in such assets, and because these investments benefit many different firms in different industries, the risk of distorting competition is lower than in the case of industrial policy. By developing a better understanding of the challenges facing the clusters of industries that are already competing internationally and selling to Hawai'i visitors and the hospitality cluster, it may be possible to design policies that in the end result in less leakage. But the leakage is not the target, leveraging Hawaii's existing strong clusters is the target.

Finally, we would like to make a more general point about economic research in Hawai'i, particularly when it comes to economic development policy. To the best of my knowledge, no Hawai'i economist is an expert in the area of regional economic development or the important and rapidly growing area of innovation and entrepreneurship. While UHERO has often volunteered or been drafted into one-off studies that may inform Hawai'i's economic development policies, the current 2.5 FTE faculty at UHERO do not have the expertise to cover this important area of research. The end result of under investing in economists is that research does not occur, the research that does occur is only cursory, or the leakage is state funding for mainland consulting firms.