

## C. Diversifying Hawai`i's Economy

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*For much of its unified history, Hawai`i has depended on a single industry to be the backbone of its economy, moving from sandalwood to whaling to sugar and, finally, to tourism. Nonetheless, economic diversification has long been seen as the path to sustained and more robust development. While there have been many achievements along the path to diversification within the past several years, dependence on tourism remains a fact of life. We will seek to analyze the barriers and opportunities for successful economic diversification in Hawai`i, focusing in particular (though not exclusively) on the following issues areas:*

*Systematically identifying Hawai`i's intrinsic socioeconomic attributes and tailoring policies to them.*

*Analyzing processes of social change in order to build long-term competitive advantage.*

*Broadly analyzing forward and backward linkages for emerging sectors and generating holistic policy recommendations.*

### **Background**

Recounting past economic diversification policies in Hawai`i is a daunting task, since government policies explicitly aimed at achieving diversification date at least back to the early days of statehood and probably long before then. Ever since the 1980s, much of the diversification effort has been centered around high technology, with subsectors including computer software, biotechnology, astronomy, alternative energy research, and ocean science each receiving their share of attention. During this period, there have been a number of visible and tangible policies aimed at promoting high tech, including funding of the High Tech Development Corporation in the early 1980s, as well as the Act 221 tax credit more recently. A certain amount of emphasis has also been placed on overlapping sectors such as diversified agriculture and entertainment. Nonetheless, the Hawai`i economy remains the 5th least-diversified among those of all U.S. states.

Rather than attempting to go beyond this very brief summary to review the often frustrating history of diversification in more detail, I will instead try to challenge participants in this conference to move beyond well-worn topics by considering three issues that deserve more, or at least more systematic, attention than they currently receive in the diversification debate. Along the way, I will present a number of unconventional and semi-polemical proposals, some perhaps of dubious merit, but all intended to provoke debate.

### **Issues**

#### Hawai`i's Intrinsic Socioeconomic Attributes

Hawai`i's pluses and minuses as an investment destination, particularly the minuses, have been discussed to the point where they now often taken for granted. What is lacking, however, is much of

an attempt to go beyond physical and financial variables to look at a broader set of societal issues. In the debate over Hawai'i's base for economic diversification, too much attention is paid to "hard" economic attributes such as geographical location and natural resources and insufficient attention to "soft" ones such as human and cultural capital. A broader analysis is essential if we are to find ways to optimally leverage our unique attributes to maximum advantage rather than adopting generic solutions.

Despite earlier rhetoric, it is increasingly accepted that our location in the middle of the Pacific does not provide any major economic advantage (other than perhaps time zone) in the age of routine transcontinental flight and broadband communication. Moreover, beautiful scenery and pleasant climate, while definite pluses, are probably not going to play a crucial role in determining investment choices outside of the tourism industry. On the other hand, while a reduced tax burden on businesses is certainly relevant, low taxes are neither a necessary nor a sufficient condition for technology-fueled economic growth (think Northern California or Massachusetts).

On the other hand, the state does possess a set of unique assets whose economic importance is sometimes given short shrift. One is our cultural diversity, with its complex swirling and blending of Pacific, East Asian, and Western ethnicities. Arguably, no other place in the world contains the same concentrated variety of language, food, fashion, music, and arts within a comparably small space and population. This contrasts with our scenery and climate, for which there are (as much as we would like to think otherwise) plenty of competing destinations around the world. Moreover, our cultural diversity can have an economic impact far beyond that of drawing tourists to the islands. In the era of global corporations, multinational / multicultural workforces are becoming increasingly prevalent, particularly in high technology businesses. One consequence of this is the need for such corporations to locate facilities in areas that cater to the widely varying personal needs of educated employees from very diverse backgrounds. While some of the larger metropolitan areas on the mainland boast considerable cultural diversity, this diversity is typically segregated into relatively inaccessible ethnic enclaves. Hawai'i's offering of geographically concentrated, "one-stop" multiculturalism is an asset that can only increase in value as time goes on, and can be developed into a marketable commodity by selective promotion of businesses that involve sustained cross-national collaboration across the Pacific Rim.

Another asset is our strong cultural affinity towards technical education. Given the current crisis in public education within the state, this is a counterintuitive point to be making in our favor. Indeed, there is a frequent tendency to take a fatalistic or even derisive attitude towards the academic quality of the local population. However, once one takes into account the unusually high rate of private school enrollment and advancement to college (themselves indications of an academically-inclined economic culture), Hawai'i is statistically one of the best-performing of all states in S.A.T. math scores, and one of the fastest increasing with regards to both math and verbal scores. This performance is particularly impressive given the relatively large immigrant population in the state with limited facility in the English language, but is not surprising given the high percentage of our population drawn from cultures that regularly top of the world tables in math and science aptitude.

With improved recognition and cultivation, the technical talent of our local youth could become one of the state's major selling points.

### Social Change

Successful diversification is a medium to long-term proposition rather than an objective that can be accomplished overnight. It follows that success depends on policies that anticipate international economic trends rather than simply adjusting to the status quo. Social science theories of social change posit a number of major international trends that relate to the long-term development of our local economy. Among them are the continued spread of global capitalism and the rising inter-availability of consumer goods across different countries. However, this rising efficiency in production and distribution is seen as having two countervailing cultural effects. The first is the emergence in high-income countries of a so-called "post-materialistic" culture based on self-actualization and cultivation of taste rather than on physical comfort and security. A related effect is the emergence of "identity" and more specifically, a self-conscious identification with locality, as a major factor in determining demand for consumer products.

These trends imply that Hawai`i would be well-served by leveraging its international image as a tropical paradise to produce and market products that appeal to the taste aspirations of this newer breed of consumer. In diversified agriculture, the high cost of labor can be compensated for by shifting production away from the commodity market, where declining terms of trade seem to be the norm, into the "designer food" market where the local product can be clearly differentiated from cheaper imports. For instance, for the cane industry, this means moving away from white sugar and towards locale-branded unprocessed raw sugars with unique flavor and aroma characteristics that could eventually be given a state-registered "appellation contrôlée" similar to that recently implemented for Kona coffee.

Another way to take advantage of these trends is to actively position Hawai`i as the premiere destination for overseas tertiary education by East Asian nationals. A rapidly growing number of students from Japan, South Korea, Taiwan, and other developed East Asian countries are choosing to pursue higher education overseas rather than in their home countries, a wave that is expected to explode to tsunami proportions over the next several years. This is due to the anachronistic but politically entrenched objective exam-based system of college admission used in those countries.

This system is at odds with the growing importance East Asian youth place on self-actualization and lifestyle issues, making them unwilling to tolerate the "exam hell" suffered by earlier generations. While Hawai`i's aforementioned cultural advantages have already helped it to attract a steady stream of students from East Asia, much more could be done to market the state as an education destination and to build an infrastructure for nurturing foreign students once they arrive.

### Forward and Backward Linkages

The notion that sectoral policies cannot be created in isolation, that all economic sectors must be considered simultaneously as part of an interdependent whole, is a truism that is usually honored only in the breach. However, success in economic diversification depends not only on supporting infant industries directly, but on building linkages between them and mature industries, as well as developing capacities in supporting sectors.

For instance, there is a natural synergy between tourism and international education, something that HPU for instance has capitalized on in its advertising strategies. Youth who arrive from other countries on tourist visas are generally of the upper-middle and high-income categories that are likely to be candidates for overseas study. Hence a tourist audience is one to which we should systematically but subtly introduce the message that Hawai`i is not only culturally hospitable to foreign students, but also goes out of its way to ease their transition into education abroad. In addition, many of these students, if they study in Hawai`i, will eventually graduate to be bilingual and cosmopolitan entrepreneurs likely to found companies with the very kinds of multinational / multicultural workforces that will readily fit into local society.

However, a thriving high-tech sector requires not entrepreneurs with not only top-notch cultural skills, but cutting-edge technical skills as well. And, as the case of the Silicon Valley shows, the most reliable generator of technically innovative entrepreneurs is the presence of first-rate university engineering and applied science departments that attract the best local and international talent at both the graduate and undergraduate level. Given this, any money that can attract top-level faculty and students in these subjects to Hawai`i universities will be well spent, even if the money has to be taken away from other economic development programs.

What this short position paper envisions, then, is a relatively focused strategy in which Hawai`i's economic future is projected to center on its role as a multicultural arena for intellectual exchange and business collaboration among scientists and entrepreneurs from various Pacific Rim nations. Recognizing and maintaining this focus will allow us to more precisely target our development strategies, generating improved long-term results. While this is not the only possible vision for a truly diversified yet prosperous Hawai`i economy, it may be the most plausible one.