

Financing Our Future James T. Beale, RISC President

I hope that the ides do not bode poorly for the Independent Man of Rhode Island. Originally named “Hope”, he represents freedom and independence and alludes to the independent spirit which led Roger Williams to settle and establish Providence and, later, Rhode Island.

In 2008, the people of Rhode Island find themselves searching for hope in the future economic health of this, the smallest state. Furthermore, **the state is hardly one of independence but rather one of considerable dependence: dependence on a system of disproportionately large public sector employment and growing dependence on social welfare benefits.**

Rhode Island confronts truly horrific problems: the worst tax climate for business in the country; an unemployment rate above the national average; state budget deficits in the hundreds of millions of dollars; skyrocketing property taxes; wildly unsustainable benefits for public employees; a culture of corruption in the legislature; rampant foreclosures and declining housing prices; the flight of upper-middle-class taxpayers to jurisdictions that punish them less; an influx of poor people, many apparently illegal immigrants, requiring services and putting a severe strain on the state budget; mediocre public schools and an education establishment that opposes greater accountability, parental choice, and the idea of serving students rather than unions.” -Edward Achorn, The Providence Journal

Rhode Island is at a tipping point, and we must work together to manage a difficult state budget, improve our tax competitiveness, and provide businesses with the tools they need to grow. We must become a knowledge economy that produces better jobs for all Rhode Islanders. Recent employment numbers only increase our resolve to accelerate the transition.

Rhode Island has to improve its business and tax climate. Changes to create a flat-tax option, lower capital-gains taxes, cap property-tax increases and phase out the car and inventory tax are good steps. Increasing taxes will only make us less competitive – Saul Kaplan, March , 2008

Our target high-wage sectors include health and life sciences, financial services, IT and digital media, marine and defense, and consumer and industrial products. These are sectors where Rhode Island has real strengths and opportunity for growth. We are working to modernize our financing and business-development programs to align them to these sectors. We are replacing outdated programs with those that improve our ability to attract entrepreneurs and create new companies. And we need to make certain that our workforce is well trained and ready for the challenges of the new economy. - Saul Kaplan, October, 2007

In Rhode Island, it seems as if we still don’t know what we stand for economically. Is it hospitality and tourism? Biotechnology? Manufacturing? Financial services?

We have made some gains in these areas, but we have been unable to define a core economic strategy for any of them. We need to match our incentive programs with our natural strengths. Strengthening our high-tech manufacturing sector means ensuring thriving ports and an educated workforce. Strengthening our biotechnology sector means

a user-friendly water policy and intensive collaboration with universities across the state. Bringing more national and international businesses to Rhode Island means improving and expanding our airport.

Finally, and crucially, job growth in Rhode Island depends on a qualified and educated workforce. Businesses look at public schools, and at the education level of the state work force, when they are deciding whether to invest. Both of those areas need substantial investment and restructuring. Creating job growth will mean developing and retaining human capital in Rhode Island. It will also mean an intensive interface between higher education and business in our state, to make sure that graduates are ready for employment and to keep the channels of innovation humming – Representative Steven M. Costantino, February 2008

In both my President's Remarks at the RISC Annual Meeting last August and in the RISC Newsletter at year end, I highlighted three interrelated concerns:

- 1. The prospect of serious annual budget deficits for the foreseeable future;**
- 2. An inability to attract new business investment and the jobs it would create;**
- 3. The high cost of education, leading to property taxes near the highest in the nation, yet producing results near the bottom.**

In August I stated that, "A three-pronged approach to returning Rhode Island to fiscal solvency focuses upon improving education, attracting entrepreneurial activity, and increasing business tax revenue at lower rates.

The above statements from Ed Achorn of the Providence Journal, Saul Kaplan, Executive Director of the Rhode Island Economic Development Corporation, and, Representative Steven Costantino, Chairman of the House Finance Committee, all are woven with common threads: **improving education; stimulating high wage jobs in a knowledge economy; and, improving our tax competitiveness.**

Tax Competitiveness

The Rhode Island **Individual** Income Tax rate is between 3.75% and 9.9%, the latter being the marginal rate. In contrast, neighboring Massachusetts' marginal tax rate for individuals is 5.3% and Connecticut is 5%. **Therefore, to improve our tax competitiveness, Rhode Island needs to lower its marginal tax rate on individuals to at least 6%.** The **Corporate** Income Tax Rate in Rhode Island is 9%; in Connecticut it is 7.5% and Massachusetts it is 9.5%. There is an advantage in Connecticut and not in Massachusetts; however, **remember that many small businesses are subchapter S corporations and pay at the individual rate.**

FY 2009 Budget

The Governor's proposed budget for the next fiscal year, ending June 30, 2009 totals \$6.889 billion. In order to not put you to sleep with too many numbers, I will take the liberty of rounding. Where does this almost \$7 billion come from? 16% comes from Personal Income Taxes; 6% from Business Income Taxes; 15% from Sales and all Use Taxes and Motor Vehicle Taxes. These and other smaller categories add up to 48% from General Revenue. Of the remaining half, 29% is from Federal Funds; 21% from other sources; and 2% is from Restricted Receipts. Within Federal Funds, 69% is primarily for Medicaid. A major component of Other Sources is the Lottery. Simply stated, half the

budget comes from General Revenues (i.e. taxes); the other half comes from the Federal Government and Other Sources.

How is the money spent? Human Services absorbs 38%; Education 29%; General Government 20%; and, Public Safety, Transportation and Natural Resources use 13%.

Tradeoff: Cut Spending to Attract Business

If Rhode Island needs to lower its income tax rate to stimulate business investment, the state must first cut spending by approximately \$500 million or 7%. The State should do this in the FY 2010 budget. The Budget Office and Department of Revenue will have more precise numbers but I think this is a good estimate of what it would take to lower the tax rate to 6%. There is compelling economic evidence, referred to as the “Laffer Curve” effect, that when tax rates are lowered, tax revenues eventually increase at that lower rate as a result of increased economic activity. **In order to offer business and individuals the economic stimulus of a lower tax rate, a state has to reduce spending. This is different from the federal government which can and does run deficits but a state cannot.**

Spending Cuts

Governor Carcieri’s proposed FY 2009 Budget is \$131 million or 3.8% less than FY 2008, as enacted. This is a start. It calls for a reduction in headcount; consolidation of some departments and redesign in the delivery of social services. These are steps to remedy a fiscal crisis and attempt to balance the budget. Even if these steps are successful – and, they *have* to be – Rhode Island will not have altered its unattractiveness to the entrepreneur. **Spending cuts have to continue in the area of headcount and salaries and benefits.** Just this week, we have read of the highest paid municipal workers. Beyond superintendents and firefighters, 671 municipal employees made more than \$100,000. That is 1.4% of the total municipal workforce of 46,500. 1,001 state employees were paid more than \$100,000. That is 3.5% of the total state workforce of 28,500.

By the way, does that combined total of 75,000 government employees strike any of you as much too much for such a small state? (*Representative Joe Trillo reports that 30% of the General Assembly has union ties.*) As of January, 2008 total jobs in Rhode Island were 489,000. Unemployment was 5.7% vs. national of 4.9%. This statewide total of 75,000 government employees is the largest segment of employment at 15%. (*Incidentally, the percentage of government workers in neighboring states is also high: CT 15%; MA 13%; NJ 15%; and NY 21 %.*)

Other high segments in Rhode Island are Healthcare at 15%; Retail Trade at 10%; Manufacturing at 10%; Accommodation & Food Services at 9%. **In 2007, Rhode Island had a net loss of 5,200 jobs, the first annual decline since 2001.** The job losses were in the higher paying between \$46,000 and \$53,000 in fields such as mortgage brokers, real estate agents, loan officers and construction workers. The jobs that gained paid below \$40,000 in fields such as healthcare and social assistance.

A Better Tomorrow

Those job losses were related to housing. **What we want and need are the higher wage jobs in a knowledge economy** – as is so well stated by Saul Kaplan and Representative Costantino. Rhode Island has many assets to be able to recruit those companies and jobs. First, we have an Ocean State with much natural beauty –especially along our coastline. Think of Save the Bay’s new facility and picture research scientists in marine biology, bioengineering, health and life sciences all looking out at Narragansett Bay. Rhode Island has excellent colleges and universities where today too many graduates have to leave the state because there are no employment opportunities here which are commensurate with their achieved education. Rhode Island is well located between Boston and New York with excellent transportation by rail, air or interstate to the country’s major medical and financial centers.

The more I think about it, you couldn’t find a better place for new, entrepreneurial, higher tech companies to want to locate. There is just one problem. Why in the world would they willingly disadvantage themselves in a state with high income taxes and high property taxes?

During the recent primaries, there was a stark difference between Texas and Ohio. Texas had **no** income tax and is a right to work state. Ohio has an income tax and is not right to work. Texas’ population is growing; Ohio is declining. There is not enough time this morning to point out state by state all across the United States that ***our national population is moving to states with no or lower income tax rates and to those with higher quality education.***

Change the Major Stakeholders

In order to survive and thrive, Rhode Island has to change the stakeholders. Thirty years of domination by non-risk takers in the public sector has run the well dry. The Ocean State needs to pump new water. **The public employees and their power hungry union leaders are draining this state of any hope of renewal.** Everywhere in the country or the world where I have had the pleasure to visit and observe, vitality and the promise of a better tomorrow is driven by young people. Anywhere from New York to Silicon Valley to Shanghai and others, young people are crucial to new ideas and growth. Be honest, Rhode Island. Do we have much of that? I don’t think so. But we had better, or **we will wind up a land of only property tax payers and public employees.**

So, let’s not just balance the budget; let’s cut spending so that we can enter a new era of growth with a lower tax rate and higher tax revenues. It won’t take that much to turn a rather puny Business Tax Revenue from just under \$400 million to closer to \$1 billion or equal to the Personal Income Tax Revenue today, but it has to be done at a lower income tax rate. That is the *sine qua non!* Think of all the state aid to education and bonafide help to the truly needy we could afford with that \$600 million! In fact, let’s change the call to cut spending by 7%.**LET’S CUT BY 10 in 2010!**