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Rhode Island is certainly not destined to be a stagnant economy.

The state had a vibrant and fast growing economy in the 1980s and ranked among the top ten fastest personal income growing states. Manufacturing was a major engine of economic growth and the state was attractive to both businesses and people. In the late 1980s, the unemployment rate was just about 4 percent and the headcount poverty rate was about six points below the national average. Of course, these good times are now gone. Two questions stand: What went wrong? What should be done to put Rhode Island back on a path of growth?

There is, of course, no single factor that explains Rhode Island's recent poor economic performance. While the national financial and economic crises have taken a big toll on Rhode Island's economy, the state performed below average in the 1990s and experienced little economic growth during the post-2001 recession. Between 1991 and 2000, Rhode Island was among the worst performing states in the nation in terms of job creation, experiencing just over 8 percent total employment growth during this period. Rhode Island added just over 22,000 jobs between 2000 and 2007. The current employment level is at about the same level that the state had in the late 1980s and the number of unemployed people (just over 72,000 people) is more than twice as large the historical averages observed during the 1980s, 1990s, and early 2000s.

The bottom line is that Rhode Island "just missed the train" by not taking advantage of the growth opportunities generated by the economic transformations of the new-economy in the mid-1990s and early 2000s. And Rhode Island missed the train because it did not prepare its economy for the knowledge-based economy and let other competing states leapfrog in areas in which the state had had a competitive advantage. In addition, the widespread factual perception that Rhode Island has become an unfriendly place in terms of taxes and regulations has sent away businesses and people who would certainly contribute to create jobs and income in the state.

Several forums, seminars, conferences and organizations have debated how to turn the Rhode Island economy around. While there is, of course, some conflicting views on how to do so, one can easily identify the fundamental problems that have been debated in these events. They include high taxes, unfriendly regulations, budget gap, and lack of a comprehensive growth strategy, among others.

The fixes to the economy are also straightforwardly identifiable, but require political will to be implanted because of potential political costs. I discuss below some of my own policy recommendations as well as ideas that have been discussed across the state. To my understanding, implementing these ideas will put Rhode Island back on a path of economic growth.



## Five Steps to Fixing Rhode Island's

### Economy

**First**, Rhode Island needs a competitive tax structure with New England states. Fortunately, the state leadership, pushed by business leaders, the state residents and economic experts, stepped out of automatic pilot and passed legislation that simplifies the income tax structure and reduces the top marginal rate. These changes to the tax system will certainly be beneficial to the state's economy in the medium and long terms. However, the just approved reform is not the ultimate solution and further revisions to the tax structure are still required to assure that the state will have a competitive tax structure. For instance, legislators might want to consider reducing sales tax, broaden the state sales tax base, make business corporate tax competitive, and alter the structure of the Franchise Tax by establishing a "tier" system aligned with neighboring states. These changes, implemented as a package, are potentially revenue-neutral, but would certainly improve competitiveness and help to redefine the factual perception that the state is a tax unfriendly place. Making the state tax competitive is key to attract and retain business and increase economic activity, which will then generate the revenues that the state badly needs to balance its budget.

**Second**, the state needs to take bold steps to eliminate structural budget gaps. It is critical to improve service quality and cut costs of public services in Rhode Island. As part of the cutting-cost measures, the package of benefits offered to state and local government employees needs to be comprehensively revised, including compensation, pension, and health care costs. As an example of the problems the state faces, while Rhode Island has the second lowest proportion of workers employed in state and local governments (11.8% in 2009), it has the highest average relative salary paid to state and local government employees as a proportion of the average salary in the state. State and local employees earn on average 147% more than the average Rhode Islander. Of course, the contracts signed should be honored – this is a state that honors its laws – but a new approach moving forward is necessary. As part of this new approach, market-based solutions should be considered. Particularly, state and local governments should consider offering 401K-like pension benefits and use properly regulated private organizations to deliver public services. In addition, sharing third party services and service consolidation may contribute to cut service costs and

improve service quality. However, this strategy must be implemented on a case-by-case basis and implemented where it makes economic sense.

**Third**, it is extremely important to improve the ease of doing business in Rhode Island. A well-crafted regulatory reform will certainly change the factual perception that Rhode Island is a complicated state to do business and live and, therefore, make the state more attractive to both new businesses and residents. The regulatory reform should focus on simplifying application processes, expediting permits and increasing the use of online technologies to collect and share information with people and businesses. It should also foster the standardization and unification of processes across cities and towns in the state. Overall, this reform should create a uniform, predictable, efficient and simplified regulatory environment.

**Fourth**, the state must develop a strategy to target infrastructure investments and efforts in areas that have the greatest potential for job and income creation. This strategy must consider the economic structural changes that have taken place over recent decades (for instance, traditional manufacturing will not come back to Rhode Island), and target resources on modern high-tech manufacturing activities and the service sector. It should also focus and target investments in education, workforce job training, and expansion of infrastructure. And promote the development of technology and business clusters in education, health care, and around the US Navy Center. And, of course, support small business development.

**Fifth**, it is crucial to identify the state's key assets and focus on branding the state as a modern economic environment that is strategically located and offers exceptional business and leisure opportunities. As part of this strategy, marketing campaigns should be used to advertise the state competitive advantages, including its location, qualified labor force, and science and technology base.

It is also important to recognize that the impacts of any of these proposals might be very limited if they were implemented on an individual base rather than as a part of a comprehensive package. For instance, a regulatory reform is more than welcomed, but if it is done without reforming the tax structure, then businesses might still be reluctant to come to Rhode Island. A game changer for the state consists of literally removing all major barriers to growth and job creation.

All of the recommendations above will have medium to long-term impact on the state economy. However, thousands of Rhode Islanders are unemployed and cannot wait several years to benefit from the policies proposed above. And they will certainly demand short-term solutions from policy makers. Unfortunately, short-term band-aid solutions will not work. The state leadership will need political courage and support from community and business leaders to avoid the temptations of populist, expensive and inefficient false solutions. The best course of action is to mitigate the social costs of the current economic conditions and implement long-lasting and effective policies that will turn Rhode Island's economy around.

Taken as a whole, Rhode Island's future economic growth is a matter of choice rather than destiny. If the "state" chooses to implement policies that put it on the map as a friendly place for businesses and people, target investments on infrastructure, prepare its workforce for the knowledge economy, and take advantage of its competitive advantages, then Rhode Island's economy will thrive in the near future.

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