

# Clip Job

The state budget's in shambles and seems doomed to remain so. Here are ten ways to fix it.

**BY ELLEN LIBERMAN**

**In 2005, following a press conference** with popcorn and a couple of Hollywood celebrities, the General Assembly enacted a 25 percent transferable tax credit for film and television producers with no caps on spending for any production with a budget of more than \$300,000. It was among the most generous tax incentives in the nation, and thirty months later, the rebates had brought \$175 million worth of production into the state — not to mention Billy Baldwin sightings at Raphael's.

In 2006, the legislature continued to bury its anti-business, tax-happy reputation. It approved a 10 percent property tax credit for biotechnology firms that pay fulltime workers 125 percent above the average state salary. It dropped the top-tier income tax rate from 9.9 to a flat 5.5 percent rate. Next year, the capital gains tax is scheduled to be phased out.

One of the more immediate effects of this binge has been buzz. The state's revenue-slashing has made headlines in publications from Variety to Budget and Tax News. The editorial page of the Wall Street Journal and the Boston Globe Magazine cast admiring glances in our direction.

But, as is often the case, what follows the buzz is the hangover. Rhode Island is now staggering through a two-raw-egg-with-a-shot-of-Worcestershire whopper. By May, the state budget deficit estimates topped \$360 million over the next two years, and the public backslapping has given way to private hand-wringing.

"I was talking to a top legislative official who told me that for the first time in well over two decades he had no idea how he would balance the budget," recalls Dan Beardsley, executive director of the Rhode Island League of Cities and Town.

In the short term, pulling ourselves out of the hole will be painful. But, in the long run, how will we turn around a structural deficit? Simply put, how can we wrestle with spending that outpaces income? From herewith, in no particular order, are ten suggestions for avoiding future budget crises:

**1. Fund the Office of Revenue Analysis.** In 2006, the General Assembly did a smart thing in creating the Department of Revenue, a new office charged with collecting revenues, overseeing motor vehicle registrations and the state lottery. The Office of Revenue Analysis, within it, is responsible for studying the tax system and making recommendations to revise it to improve the state economy. But the office exists in name only, because it has never received funds to hire staff. In the meantime, policymakers alter the balance sheet in the absence of good information. University of Rhode Island economist Len Lardaro says, too often, “We treat symptoms in Rhode Island, not problems. If we do this piecemeal, we make it more difficult to move forward.

**2. Broaden the sales tax.** It's time to consider applying the sales tax to other categories of commerce, including services. Rhode Island's sales tax now stands at 7 percent for consumer goods, some food and beverages, with services largely out of the mix. Beardsley says the state might lower the sales tax rate by a percent or two, but apply it to many more categories. This makes sense, given the nation's shift to a service economy. According to the Center on Budget and Policy Priorities, Rhode Island only taxes one household service, cable television, while other states average about fifteen.

**3. Invest in adult education.** There is growing concern that Rhode Island is headed for a demographic disaster in the next twenty years, with a rapidly aging population leaving the workforce and the vacuum being filled largely by unskilled immigrant labor. Under this scenario, a labor force with limited earning power would have to support the needs of a burgeoning elderly population. Kip Bergstrom, executive director of the Rhode Island Economic Policy Council, says it is critical that the state focus on raising the skill level of all its workers or lose competitiveness and risk future state budget imbalances.

**4. Reform the state pension system.** In 2005, the state's unfunded pension liability stood at \$3.1 billion dollars. Going forward, the state may have to switch from a costly defined benefit plan in which the retiree receives a specific amount based on his salary and years of service and the state assumes all the risk, to a defined contribution plan, such as a state 401K, in which the employee bears the investment risk. Politically, it's an unpopular option, but many believe it's time to consider changing the system for non-vested employees.

**5. Build accountability into the state budgeting system.** There are no professional consequences if a state department manager blows his budget, says Kevin Hively, a former aide to Governors Sund-lun and Almond, and a business strategy consultant. While managers can't be held responsible for cost overruns they can't control — an influx of prisoners at the ACI, for example — “there's got to be a system of performance accountability and professional liability, or the budget doesn't mean anything,” he says.

**6. Roll back or eliminate some of the tax credit programs.** Legislators must look to the revenue side of the ledger to resolve the crisis, says Ellen Frank, senior economist for the Poverty Institute at Rhode Island College. Rhode Island has too many tax credits whose cost or effectiveness has never been evaluated. The New England Public Policy Center, for example, recently questioned the value of film tax credits and found that their costs were high and their ability to stimulate the economy, modest. Frank adds: “We should look at rescinding the elimination of the capital gains tax. We can't afford it, and it's a tax cut beneficial to the 2 percent who get 80 percent of capital gains.

**7. Control Medicaid costs.** Recent studies show that one of state government's single biggest line items could use an overhaul. Hively says that the system could save money by becoming more efficient in the delivery of its services. “We have to think hard about how to restructure Medicaid. Not by cutting beneficiaries, but by looking hard at the kind of care and the setting and how many services they get. We have a high rate of utilization of emergency rooms and nursing homes,” Hively says. The savings would slow the growth of Medicaid and perhaps be invested in expanding the number of enrollees.

**8. Reduce the size of the government labor force.** More than 30 percent of state workers are approaching retirement age, says Hively. The state can take advantage of the coming outflow of retirees by combining jobs, where feasible. “You don’t have to back fill every one of those jobs,” he says.

**9. Reduce the reliance on one-time revenues.** Too often, the state has used a windfall, such as the 1999 tobacco settlement, to cover shortfalls. In 2002, the state approved a plan to sell the state’s rights to \$1.9 billion in future settlement money for a one-time payment of \$600 million to close some budget gaps. This budget cycle, a \$100 million payment from American International Group to settle fraud and deceptive business practices claims, was supposed to provide rescue — until the deal stalled. “We have to wean ourselves off of one-time revenues and replace them with permanent, sustainable revenues,” says Gary Sasse, executive director of the Rhode Island Public Expenditure Council.

**10. Define the safety net.** Rhode Island currently spends forty cents of every dollar on entitlement and welfare programs. Sasse says the state must find the balance between its desire and its ability to offer these programs: “How do you make those changes so that the programs are sustainable? What’s the appropriate means test? We have to define a clear policy paradigm.”

Two years ago, the Center for Policy and Budget Priorities took a snapshot of each state’s risk of slipping into a structural deficit. Rhode Island wasn’t at the top of the list. Out of ten factors, Rhode Island had eight, which placed it in the high-risk category. Eleven states had weaker vital signs. But by 2007, Rhode Island, Michigan and Wisconsin were the only states that actually had structural deficits.

“Since we wrote that, Rhode Island dug itself in deeper,” says the center’s deputy director, Iris Lav. “And the fact that you have a deficit in this economy is a very bad sign.”

*This article appears in the **August 2007** issue of *Rhode Island Monthly*.*

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