Rhode Island Policy Reporter

Issue 4 **10 March 2004**

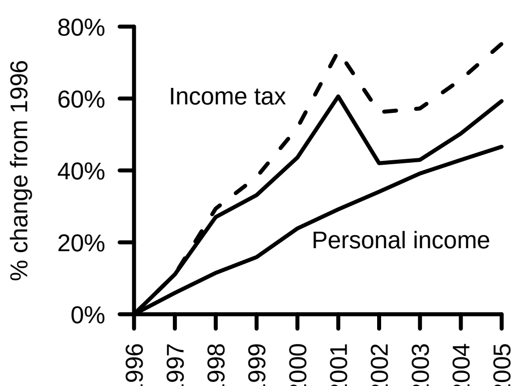
Here we go again

SELF-PROCLAIMED COURAGE is rarely the real thing. Real heroes don't claim bravery, they show it. Hard political decisions are the ones that involve risking one's popularity to do right, not the ones that might wound one's compassionate self-image. What risk did the Governor take in this year's budget? Like many before him, he again banked on the idea that increasing the burden on the state-aided poor and imposing many small irritations on all of us—increased fees and tuitions, declining services, local tax increases—would outweigh the supposedly larger pain of a broad-based tax increase. That's what happens every year. What's so hard about that?

What would it be like to live in a world where public services were funded to a level that would make them *attractive*? Where schools could afford the faculty and space to lavish the attention on our children that they might get at private schools? Where the competition to get into public housing was because it was so nice? Where public transportation was so efficient that it might be considered a rational choice to live without a car?

John Kenneth Galbraith described America as "a land of private opulence and public squalor." Is there any wonder why? When you have a governing class so unwilling to ask the populace for what it really costs to provide services, what are the results? From what we see, the results are underfinanced programs that can never do what they are intended to do; state departments running up unnecesary debt to hide true costs; and good projects that languish for years waiting for the political "right moment" that never comes.[1]

[1]Well, we don't skimp on everything. Clearly we can spend money on things that our governing class uses. The statehouse, the airport, and the convention center all look fine. When the Legislature finally builds their office building, does anyone doubt it will have first-class carpeting?



Personal income and personal income tax collections. The income statistic is frequently cited as a measure of the state's economy, but it's not a very good predictor of how much money the state collects. (The dashed upper line shows what the tax collections would be if the tax rate hadn't been lowered between 1997-2002.)

But enough complaining, let's look at the FY05 state budget. Sadly, most of the analysis presented in last year's budget issue (**RIPR** issue 1) is still apt. To us, some of these budget features are like old familiar warts that just won't go away. We commend that issue to you (it's available online at *whatcheer.net*), and will try to confine this year's analysis to different topics.

Fun with statistics

Part of any budget is its justification. Governor Carcieri has been using two statistics to great effect in his public speeches, and in budget documents: one describes our stratospheric tax burden, the other our overpaid teachers. It is not true that you can make statistics say anything. But it is true that you have to be careful to see exactly what your statistics support.

Our stratospheric tax burden The Governor has made bales of rhetorical hay with a finding from the Tax Foundation, a Washington advocacy group, that Rhode Island has the fourth-highest state and local tax burden in the country, as a proportion of personal income. It appears that the Tax Foundation calculates these rankings by simply dividing the total of state and local taxes collected by the total personal income in the state.[2]

Personal income statistics do not include important categories of income, such as capital gains, and they are also silent about the distribution of that income. That matters in Rhode Island, because our income tax is progressive—the higher your income, the higher percentage of tax you pay. If everyone in the state doubled their income, personal income would double, but the tax collected would go up higher, because we'd all be taxed at a higher rate. The reverse is also true, if everyone's income was cut by half, income tax collections would fall by more. The tax collected is obviously related to total personal income, but it's a complicated relationship.

You don't have to believe us. Look at the numbers: in the years from FY96 to FY05, personal income has risen 44%. But income tax collections, when adjusted for the rate cuts, rose 75% (see figure to left). This could mean either that there has been an increase in capital gains income, or that upper-income folks did much better than everyone else in the '90's. There is decent evidence that both are true, but we don't have the data to say which one is the more important effect.

As if that weren't enough, the Tax Foundation analysis overlooks the fact that people pay tax on their property whether or not they live there. By their reckoning,

[2]The Tax Foundation makes its reports available at *taxfoundation.org*, but they explain their methodology nowhere we can find.

Maine is listed as the highest-tax state in the country. This is simply not true. Maine—"Vacationland" on their license plates—is the location of tens of thousands of vacation homes, all of which are taxed, and few of which are owned by people who work in Maine. Each one of those houses is tax without income. And every Matunuck beach house or Newport condo owned by a New Yorker does the same for us.

Finally,[3] it is also true that our taxes vary by how much you earn. What happens if we take that into account? The wealthiest taxpayers in RI pay around 9% of their income in state income taxes, about half a percent in sales taxes, and about a percent in property taxes if they live in rural towns, or three times that if they live in Providence. The poorest taxpayers pay a bit more than 3% of their income in sales taxes, and 2-4% of their income in property taxes, depending where they live.[4]

Which is to say that if you're among Rhode Island's wealthy, and if you live in Providence, your state and local taxes are potentially as high as they would be if you lived in New York. But if you live in say, East Greenwich, your taxes are substantially less. Numbers like the Tax Foundation's are pretty useless for analysis, but they seem to be useful as rhetorical ploys, where they are often disappointingly effective. As a public service, we offer the following tables in rebuttal to the Governor:[5]

Income	Providence	North Kingstown
Low	Tennessee (47)	Montana (37)
Median	Idaho (11)	Rhode Island (4)
High	New York (2)	Wisconsin (7)
Very high	Maine (1)	Minnesota (3)

This table, like the Tax Foundation data it's taken from, omits important details about the other states, so don't take this too far. We hope by this point it's abundantly clear: this data is only for people who hate doing homework. We wouldn't use this data for anything other than to rebut its use.

[3]Does it seem like we're piling on? We'll stop after this, and skip talking about the precision of BEA income estimates.

[4]These numbers are from a **RIPR** study of state and local taxes, compiled from IRS, Census Bureau, and Treasury Department (Office of Tax Analysis) data, and presented in issue 2. You can find that issue, as well as methodology notes explaining how the study was done, online at *whatcheer.net*.

[5]"Low" = half the median in that town, "High" = two times the median, and "Very high" = five times the median. Providence's median is substantially less than NK's.

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But let's go ahead and have some more fun with it. If we remove Rhode Island's local property taxes from the calculation and confine ourselves only to a comparison of state taxes, the Tax Foundation data gives us a table where the taxes on Rhode Island residents look much more reasonable:

Income	Providence	North Kingstown
Low	New Hampshire (50)	Oregon (44)
Median	New Hampshire (50)	Oregon (44)
High	Virginia (41)	Rhode Island (21)
Very high	Utah (14)	New Mexico (5)

Without property taxes, we're a bargain. So there it is: yet another way to say that property taxes are the real problem for Rhode Islanders, in case you hadn't noticed. So isn't it incumbent on the Governor to explain exactly how *cutting* $7.9 million in state education aid to cities and towns [ES11][6] will make this situation better? He says that some towns have out-of-control union contracts. Perhaps this is true. But his budget punishes all of them. How does that help?

Our overpaid teachers The other statistic we hear from the Governor concerns the costs of Rhode Island's public schools. He complains that Rhode Island ranks seventh in the nation in cost per pupil. Scandalous, no? The list came from the NEA teachers' union via the RI Public Expenditure Council.[7]

The real scandal is that the Governor should imagine this proves anything at all. The teacher salary ranking is reproduced here. For comparison, we include a similar ranking for accountants.[8] Isn't it remarkable how similar the two lists are? And don't you think it's a scandal that Rhode Island accountants, probably including some on our very own state payroll,

Rank	Teachers	Accountants
1	California	New Jersey
2	Connecticut	DC
3	New Jersey	Alaska
4	Michigan	Connecticut
5	New York	New York
6	Pennsylvania	California
7	Massachusetts	Rhode Island
8	Rhode Island	Hawaii
9	Illinois	Massachusetts
10	Alaska	Maryland
50	North Dakota	South Dakota
51	South Dakota	North Dakota

[6]These are page numbers referring to one of the volumes of the budget. "ES" is the Executive Summary volume. "B" is the Budget, "CB" the Capital Budget, and "P" the Personnel Supplement.

[7]The RIPEC report quoted by the Governor is "Results: Education in RI, 2003" (page 19) available at *www.ripec.org*. The data originally came from the NEA's annual report "Rankings and Estimates", 2003, teacher salaries are from table C-11, p.19, the per-pupil data is from table H-11, p.55, *www.nea.org*. RIPEC apparently deleted DC from the per-pupil expense list, either to compare states to states, or to bump Rhode Island up one notch).

[8]Accountant salary data is from *CareerJournal.com*, a service of the Wall Street Journal online. The national average accountant salary is $45,297, and is $44,683 for public school teachers. Why accountants? No special reason. Bricklayers or bankers would show the same results.

are the seventh-highest paid in the country? What, we wonder, will the Governor do about this? We await the press releases.

So the only thing we really learn from this statistic is that the cost of living is higher in the northeast, and it's higher in urban areas, and northeast states with a high proportion of urban areas are more likely to be at the top of these lists (plus Alaska, which has its own issues). But why do we have to get everyone mad at teachers to learn this? Again, how does that help?

Expenses

Here's a brief and very random look at some of the expenses included in the budget, and some suggestions of places we might think about spending less. We have no doubt that some of the things described below are useful and valuable. But the cuts proposed this year are pretty draconian in important places, like child care and income supports for people who really need them.

Capital items There are a host of air conditioning and repaving projects in the capital plan funds that don't need to be done this year [CB122ff]. There is also $5 million earmarked for affordable housing [ES13], to be paid from general revenue. Some or all of this housing money could be moved to the capital budget, displacing the projects that can wait, and freeing up to $5 million in general revenue for something else.

Education aid There isn't much to say about education aid that isn't already screamingly obvious from the newspapers. This budget cuts education aid, to local school districts and to higher education. But we did enjoy the heading on the paragraph that presented this: *"Local Education Aid Up $11.1 million, a Modest 1.4%"* [ES11]. Needless to say, this is the most generous spin possible on the change. Local aid that actually goes to city and town bottom lines goes *down* $7.9 million, which, quite coincidentally, is precisely the amount of the increase in funding for the Met School and the state's other charter schools. Thanks are due to the Governor for once and for all ending the argument over whether the growth of charter schools will mean less money for public schools.

The $11.1 million refers to contributions to teacher pension funds, and to school construction funds. Both of these are important, but neither helps a school department balance next year's budget. Under this budget, every school district besides Central Falls, Chariho, Little Compton, and Westerly will receive less money to run their schools. These towns will get increases of about 1%.

Transportation The biggest unexamined scandal in the budget is in the Department of Transportation—as usual. We have no idea what fiscal magic the planners there have found that lets them imagine that borrowing $30 million year in and year out is a good idea. But that's what they've been doing for years, and that's what they plan to continue doing for the foreseeable future.

As if that's not bad enough, this year, they borrowed $216 million more, and will again next year, and then again, to total $660.5 million. Including the amount borrowed this year under the same program, it comes to *$660.5 million*, all without voter approval [CB162]. These bonds are to be repaid from federal highway funds and from the gas tax, so DOT claims this borrowing "will have no fiscal impact on the state and offer no financial exposure to the taxpayers" [CB101], but then go on to outline all the ways in which this is simply false. We are not raising taxes, or getting more money from the federal government to service this massive debt, and it will cost us $51.4 million every year to service it. (Starting this year.) $9.6 million of that sum is to be paid with gas tax revenue. In what way can that truthfully be called "no fiscal impact?"

The extra debt is for moving I-195, replacing the Sakonnet Bridge, building the freight rail to Quonset, building a highway to Quonset, and reconstructing the Washington Bridge. Perhaps these are all worthwhile projects, but at precisely what point does the department expect to say "we can't afford that?"

Property Tax Increases, another look

A great deal of the pain expressed in the annual ritual of property-tax riots around the state is caused by changes in assessments, rather than out-of-control town budgets. Obviously you can't discount the possibility of the latter without closer examination of each town, but the data are suggestive (see **RIPR** issue 2, at *whatcheer.net*). Property tax assessment changes are dramatic, sudden, and arbitrary. Further, because of the out-of-control real estate market, the price of one's house can be completely unrelated to one's ability to pay. In other words, there are some very good reasons property taxes make people angry, but the real problem is often the distribution of the town's tax burden, not the size of the burden itself.

Our own town is undergoing a revaluation, and because of the vagaries of the real estate market—not to mention the arbitrary assumptions of the appraisal company—some residents of our town will see their taxes rise dramatically, while about a third of the town will be seeing their taxes go *down*. They, of course, will not be among the ones who bring pitchforks and torches to the town council meetings.

In the current climate, it is simply not true that the value of one's home is a decent indicator of one's ability to pay. The procedures for assessing taxes should be changed to take this into account. Issue 2 contains a proposal for reforming assessment. A related, though slightly different, proposal can be found at *www.righttax.org*.

Public Transportation As usual, that point is where the public meets the road. The Governor's budget contains some nice public transit projects, but funding for them is not really there. We intend to build a train station at the airport, but apparently it has to wait until everyone can agree on how to finance $170 million, not just for the station, but also for a "people mover" and a 4000 car garage. It doesn't cost $170 million to build a train station. It costs $170 million to build a train station only when you include these other extras. But why not build the station first and let demand drive the construction of the other parts? What have we gained by waiting?

Meanwhile, the Governor continues the tradition of slowly starving RIPTA. A comparison between RIPTA and DOT is interesting.

DOT	RIPTA
Infinite credit, $30 million per year and more. Most debt service doesn't appear on its own accounts, hiding true cost of program	Borrows little, uses it for "repairs," all debt service appears on its own bottom line, showing true cost of program.
Isn't supposed to earn its own way. Doesn't.	Supposed to earn its own way, for some reason. Doesn't.
Sacrifices nothing, but pulls state budget into debt.	Sacrifices everything including service and reliability in order to make its bottom line decent.

Health care

The Governor's budget proposes to deal with the rising cost of Blue Cross by passing the expense along to the state employees. He proposes to save $10.6 million this way [P42] ($5.9 million from general revenue [ES3]). But what is the Governor planning to do about containing those costs in the first place? The state is the only actor in the health care drama who can act to keep health insurance costs down. And the state has power: between employees, retirees, and Medicaid recipients, state and local governments in Rhode Island insure around a quarter of the population. But until the state acts to use that power, state employees have every right to resist paying for their health insurance.

Little stuff

The Governor proposes to slash the money available for Legislative grants, from $3.6 million to $1 million [B140]. These grants often go to worthy causes, but they're awarded on a strictly "who you know" basis. Legislative shadow makes it impossible really to know about the details, but the ones we know about are generally money given to poorer organizations that gets immediately spent and injected into the state's economy. In other words, not such a bad deal for the state, though some kind of competitive public process would smell better.

But what about the fatter legislative targets? Could the Governor really have gotten all the way through the Fiscal Fitness process without someone mentioning to him that having three state environmental agencies is perhaps a little redundant? Two state television stations? Two elections agencies? This is where fighting with the legislature might start to be worth it.

Press relations Leafing through the Budget's Personnel Supplement, we counted around 71.5 press officers throughout state government.[9] Lots of them are in places like the DHS Office of Substance Abuse, or in Emergency Management, where getting information to the public is part of the office's responsibility. But lots are in less likely spots. What purpose does the Lt. Governor's press secretary serve? The General Treasurer's? Elderly Affairs'? Corrections'? The Supreme Court's? The Secretary of State and the Attorney General each have around 3. What for? The Legislature has five, who really serve only the House and Senate leadership, which is not really that many people. Is informing the public about the General Treasurer's office such an important state function? Would we be as well served if the Supreme Court didn't have a press office? It's quite easy to come up with a list of a dozen press officers whose function is not obvious, and that's almost $750,000.

The Governor even added a new one this year, at CRMC [P376]. We don't doubt the need for disseminating information of the sort CRMC has, but we also don't see why Rhode Island needs more than one environmental agency. DEM has a couple of press officers already. Do these agencies have to become completely redundant, instead of only partly redundant, like they are now?

The Department of Transportation alone has four press officers in the central management division. If asked, they will say these are a necessary part of managing the public comment phase of their planning. But these people are also available to explain—to the legislature and to the press—why we have to borrow yet more money to support department operations, and that's how they spend their time during election years. Is this a state function more important than health care for poor children?

Lobbyists? DOT also employs a lobbyist (a "Legislative Liaison Officer") to explain to the legislature why the DOT budget isn't insane [P382]. We suspect that this, plus the PR staff (!) at that department, is partly why DOT has been allowed to become the financial nightmare it is.

Almost all the state departments lobby the state legislature at one time or another, defending their budgets or their regulations or other policies. But is it better to do it directly, with directors or deputies appearing at hearings and giving public testimony, or is it better that they hire someone to spend time at the legislature, and so peddle their influence through back channels? We think the public is better served by the public method, and that paving contractors are better served by the back channels.

[9] To be precise, we only counted employees with titles that make them sound like one: "Public Relations Officer", "Public Information Specialist" and the like.

There are more. The Economic Policy Council [B441] and the Economic Development Corporation [B472] are organizations whose purpose seems to be to lobby for the corporate agenda. Each year, they bring to the Assembly a wish list of corporate tax breaks and development schemes for approval, and they rarely leave empty-handed (though see 5 for a surprising development in this year's budget). We think the corporate agenda is amply served by corporations and the organizations they support, and don't see the crying need for the state to chip in. We don't notice the state financing a labor lobbyist.

EDC takes in $6 million in state funding each year in support of their budget of $15.5 million [B441]. Much of EDC's operations are supported by income from rentals and other operations at Quonset Point/Davisville. It's worth asking what kind of value we're getting for the remainder. They have a few good deals to their credit, but we would welcome an informed debate on the agency's cost-effectiveness.

Similarly, the EPC costs us $300,000 per year, half of their operating budget. The other half is largely supplied by corporate contributions. If the corporations think this is a good investment, they should support it. EPC is supposed to provide a forum for hammering out economic policy, but so is the State Planning Council [B90], and there are people there who have access to much broader policy expertise (i.e. environmental and health concerns as well as economics) than anyone on the EPC board.

Finally, now that the Lt. Governor does not preside over the senate he has virtually no official responsibilities. He has kept himself busy by having his office do policy research and lobbying. But he still has a staff of nine at a cost of about $700,000 [P89]. To what end?

Revenue

In the budget discussions that matter this year, increased revenue is somehow off the table, not even discussed. But why? (Especially because the cigarette tax is going up a lot [ES37]. A sin tax is still a tax.) Our income taxes can't be called high by any defensible standard, there are 27 states where sales are taxed at a steeper rate than here,[10] and federal income taxes are as low now as they've been at any time since our Governor was a very young man. So why all the griping about taxes? How low is enough?

If you really look at the data, what you see is that taxes in Rhode Island are far from out of control. For most of our citizens, taxes are at or significantly below national averages. (Look again at how the Tax Foundation has to twist things to make it seem otherwise.) And even property taxes haven't gone up as fast as you'd think. Since 1996, municipal budgets have gone up 55%, far less than sales or income tax collections.[11] What *has* changed dramatically in the last ten years is the distribution of the tax burden, as many unlucky people discovered they live in highly desirable neighborhoods. See box on page 3.

Were Rhode Island to restore the income tax to the levels that prevailed in the bad old days of 1996, we'd raise $90 million, more than enough to wipe out all of the projected cuts in human services, and enough to provide some relief to many towns. Half of all taxpayers would see an increase of less than $60 per year, and most of those would see significantly less. For 65%, the increase would be less than $100, and for 83%, the increase would be less than $200 per year.

Another alternative is to enact a progressive surtax, like the one enacted in the early 1990's. A 16% surtax on people earning more than around $150,000 (for those familiar with the details of our tax system, this would be an increase to 29% from 25% on federal tax liability over $25,000) would earn around $40 million, and most of the taxpayers affected would see their total tax bills rise only a few percent.

The taxpayers most heavily affected by this proposal are precisely the ones who have benefited so handsomely from the Bush income tax cuts. Most of them would still pay less in taxes this year than last.

Tax breaks We were not surprised that the Governor learned that some corporate tax breaks don't work the way they were intended to do, but we were pleasantly surprised that he decided to act by ending them [ES37]. He is also proposing to raise the minimum corporate income tax. Let's take this opportunity to applaud, and then to point out that there are an assortment of corporate tax loopholes that should be closed (ones that other states have already acted to close). These include technical fixes to how multi-state companies allocate their income to this or that state and redefinitions of "business income," to outlawing certain common tax shelters. The potential for revenue here is around $8 million.[12]

Housing

Our 5¢-analysis of Rhode Island's housing crisis: The lack of affordable housing is a market failure, and any solution that doesn't address the market is bound to fail.

When the stock market boom ended in 2000, smart money flowed out of stocks, and where could it go? Interest rates were (and are) at record lows so bonds were out. But real estate is always said to be a good investment. A recent RIPEC report[13] attributes the run-up in

[10] Data from the National Conference of State Legislators *ncsl.org*. Many states have counties and cities that levy sales taxes, so there is variation within some states.

[11] Data from RI Office of Municipal Affairs.

[12] The estimate is from the Center for Budget and Policy Priorities, via the Poverty Institute. You can find more information about these loopholes at (*povertyinstute.org*).

[13] "The Economic Impact of the Housing Crisis in Rhode Island."

prices to increases in demand, but demand tends to build slowly. It's hard to see why demand would have spiked up in 2000. In contrast, a stock market debacle like the one we had is a spiky sort of event. People who used to have extra cash in the stock market began that year to pull it out, and use it for second homes, larger homes, and rental property, "investments" that will appreciate. Combined with the record low interest rates of the past few years, the outcome was readily predictable.

Though the creed of deregulation has been the dominant ideology among our ruling classes since the 1970's, we can't really do away with all market regulation. The federal government still regulates markets in stocks, bonds, drugs, cattle futures, and much more. The state regulates markets in insurance, health care, and heating oil, as well as taxi service, towing companies, and a host of professional services (electricians, plumbers, real estate agents, architects). We live in a cold climate, where it's challenging to survive the winter without a roof over your head. And real estate prices have a direct effect on the taxes many of us pay. In other words, the real estate market is arguably much more important to all of us than taxicabs and tow trucks. Why should it be off-limits to regulation?

Unregulated markets *can* work, but don't always work. Or rather, they usually work to set a price at which everyone with something to sell can sell it, but that's of little consolation to those who are priced out of the market. If it is important to Rhode Island to have housing available to everyone on the income spectrum (and if it's important for us to have stable property taxes), we need to consider modifying the excesses of the marketplace. When rich speculators can make $100,000 in six months by flipping a piece of residential property, no one benefits, except them.

The market forces in question are huge. In residential real estate alone, over $3.4 billion was spent in 2003 (see *riliving.com*). Contrast this with the $5 million proposed for affordable housing projects [ES13]. Contrast the 400,000 houses and apartments in RI with the 100 units this will build. This market is a behemoth that will swallow at a gulp any meager attempt we make to build ourselves out of it. The problem is not a lack of supply, the problem is the market. We can choose not to address the market, and to concentrate on building new affordable housing, but we will have no excuse for being surprised at our failure. ■

Some suggestions for market regulation

Assess capital gains tax on land sales A tax on the gains earned by realty sales could dampen speculation. Short duration owners would pay a higher percentage than people who've owned a property for a long time. A tax, of 70% on the capital gains of any residential property held less than one year, 50% on property held between one and three years and 25% on property held between three and six years, could raise as much as $15 million, though a better result would be to raise less and cool the market.

Rent control Was wildly popular in Cambridge and Boston, though not with people who wanted to make a bundle from their property. Rent control is gone now, and with it has gone the working class neighborhood of Cambridgeport, near Central Square, among many others.

Real estate price controls Why not set a maximum price for a piece of real estate held for less than a certain amount of time. Exactly who would be hurt if a piece of land held less than a year could be sold for no more than 105% of its purchase price?

These suggestions are not without their drawbacks, but how many of the drawbacks would be worse than the homelessness and unpredictable taxes we have now?

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