Rhode Island Policy Reporter

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What's responsible about this?

OUR STATE IS FACING a monster budget deficit this year and next. Between now and next June, the state budget is short around $100 million, and if we make no cuts in the state budget and no additions to revenue, we'll have a $250 million shortfall in fiscal year 2008. Early speculation is about decimating the state police force and releasing all minimum-security prisoners from the ACI, among the more routine options of slashing Medicaid and other aid to the poor. The scale seems shocking, but all this news only to people who thought the government was supposed to balance its budget each year. Everyone else has known about it for months—or years.

The budget last spring was only balanced through what might be called chicanery, were one inclined to be kind about it. For example, the Governor proposed some changes in the rules governing personnel in state government. He proposed to end "statutory status" which guarantees a job for a state employee after 20 years of service, to end cash payouts of sick leave, and to limit the amount of vacation time that can be accrued. His estimate was that these changes would save $32 million in the state budget.

You may think his reforms were lousy ideas or you may think they are long overdue. Either way, it's difficult to admire what the legislature did, which was to accept the estimate for personnel savings, but ignore the reforms. That is, the budget they passed had the dollar estimates for the reform savings, but not the reforms themselves.

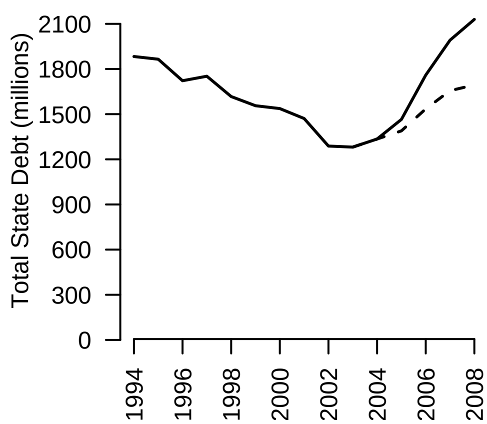

Figure 1: State debt levels. During the 1990's, to Bruce Sundlun's and Lincoln Almond's credit, you can see that work was done to lower the level of our state's indebtedness. This culminated with the tobacco settlement money in 2001 when state debt dropped to its lowest level in years. Governor Carcieri inherited a good situation (2003 was his first budget) and has done a yeoman's job of ruining it. The dotted line shows the official "tax-supported debt" number. The solid line shows what it would be if the official numbers included the off-books Department of Transportation debt. (See box, page 3.)

Their message to the Governor was, "We like the idea of saving $32 million in personnel reforms, but we don't like your idea. Think of something else in personnel that would save the same amount."[1]

The Assembly also passed an income tax cut for the richest taxpayers. Under this plan, the top tax rate, for people earning more than about $250,000 per year, will be lowered a half-percent a year for the next five years, until the top rate is 5.5% of income, roughly equivalent to the tax rate in Massachusetts. For some of the richest citizens of our state, this could cut their tax bill by 40%. But the legislature specified no way to pay for this cut, which will cost between $70 million (their estimate) and well over $100 million (my estimate) when it's fully implemented. They didn't bother to say which state expenses should be foregone in exchange for this gift to the wealthy, and left the issue of paying for this tax break up to future legislatures.

Deficits are the cost of craven budgeting in the not-very-distant past.

But lest the Governor's partisans be tempted to count me among the people pointing fingers of blame at the Assembly, let's stipulate up front that the Governor's original budget was not exactly a model of fiscal responsibility. For example, four years of Carcieri administration have gone by without any proposal to rein in Department of Transportation (DOT) borrowing. In fact, the pace has accelerated, as the Governor acceded to DOT's mad plan to finance its current building binge by borrowing against future Federal highway funds (These are the "GARVEE" bonds, see graph and then the box on page 3.) DOT plans to borrow $40 million each year in 2008 and beyond, which will be less than the debt service payments it makes in any of those years.[2] Reading the public budget documents, you can be fooled into thinking that DOT is managed well. After all, its budget page shows revenue equal to expenses. But that's only because a huge chunk of its debt service expense was moved to the Department of Administration budget pages in Lincoln Almond's administration to hide the scandal.

In this fiscal year, DOT expects to pay $39 million in debt service payments in addition to what's shown on the budget page. Had the Governor stopped this practice

[1] Obviously, the hole had to be plugged on paper, and it was, with estimates about employee attrition and potential insurance settlements. But it's unlikely that the people who thought of those estimates actually believed any of them. Governor and Assembly leaders alike seemed to think it best not to tell voters the truth about the budget.

[2] In Fiscal year 07, DOT is planning to borrow only $18 million, less than in past and future years. This is not in the name of reform, but only because GARVEE debt service payments have scooped up about $44.5 million of this year's federal funds, almost a quarter of the total, reducing the need for the matching funds we usually borrow [CB110].

when he came into office, the state budget would have had to grow by $30 million to make up the difference. But by now, we would have saved around $10-12 million in debt service per year, and be free of over $100 million in debt. Had Lincoln Almond bitten the bullet and stopped the practice in 1996 instead of giving us a meaningless tax cut, DOT would be paying almost no debt service from the general budget, and the state would have avoided over $300 million in borrowing (and would probably be in surplus this year). This is, of course, spilt milk, but it's the cost of craven budgeting.

***Why* do we borrow?** Government borrowing, like any borrowing, can be justified in two different ways. Either you have some investment that will pay off in the future, returning more than you invested, or you have some unusual expense that is large enough to be worth the financing costs to amortize over several years. Quite a lot of state borrowing meets neither of these criteria. Building roads is not going to have an economic payoff (even at Quonset Point, see page 4) and most of the state's borrowing can't be justified by the amortization criterion, either. The GARVEE projects can be (for them, it's the repayment plan that is bizarre) but what else?

Is it wise, for example, to insist that RIPTA borrow to replace buses? This is an expense that happens every year. Responsible budgeting would have that agency putting aside some money for it every year. What about open space? From a town's perspective, an open space purchase may be an unusual expense. But from the state's perspective, it's a routine expense that happens every year. How about affordable housing? Why on earth would we think that $50 million—approved in the last election to help build houses for people who can't afford them—is a one-time expense, to be amortized over many years? These are routine, predictable expenses, but Rhode Island borrows for all of them, guaranteeing that they cost two to three times as much as necessary—and that they eventually become someone else's problem. Since 2004, total tax-supported state debt is up over 24%, while state revenues are up only 18%. Debt service payments are now $177 million a year, up almost $40 million since 2004, and will shoot up past $200 million in less than 2 years [CB B-12].[3] This doesn't even count the GARVEE bonds at more than $44 million per year and slated to rise considerably as more are issued next year and beyond.

Debt is for investment or amortization. If it's not either one, why borrow?

How do we measure debt?

The level of a state's indebtedness is important for a couple of reasons. Obviously, too much debt means it's hard to pay it back. Another reason is that a high debt load means a low rating from the bond-rating agencies like Moody's and S&P, and a low rating means you have to pay higher interest rates. Rhode Island's bond rating isn't great, though it's not disastrous. (Moody's has us at "AA3.") There are lots of states that do much better. The important variable from the rating agencies' perspective is the debt level per capita and per dollar of personal income in the state, which they use to judge a state's ability to repay the debt. Nationally, our level is fairly high among states, but comparisons aren't really that enlightening since most other states have active county governments that borrow.

Our debt level as a fraction of personal income has actually been declining over the past few years, but this is not because our debt has declined (see figure, page one) but because our income has grown, *and* because the biggest additions to the debt don't have to be counted. They're not repaid with state tax dollars but with federal dollars, and therefore not "tax-supported debt."

But this is just what it seems: silly hair-splitting whose only purpose is to hide embarassing admissions. This debt still has to be repaid, and the debt payments will displace other expenses that will be paid with general revenue or ignored. Its true cost will become more apparent as road improvements are put off because this debt will eventually devour the majority of our federal road dollars for a long time. –TS

Unpaid tax cuts, imaginary budget savings and unnecessary debt are all excellent ways to get into budget trouble. Is it worth a moment to speculate on *why* our government so often acts like a candidate for credit counseling?

The answer is pretty obvious: from the perspective of the government itself, these are pretty expensive and dumb ways to acquire the goods and services the government is committed to providing. But from the perspective of any particular politician, they're smart politics. The Governor can claim to be spending $50 million on affordable housing, but it will only cost $4 million per year to do so.[4] He looks good, wins re-election, and repayment be-

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[3] These are budget page numbers of the 2007 state budget documents. "CB" means a page from the Capital Budget document.

[4] Plus, of course, the $7.5 million we borrowed to pay for this for the current fiscal year. We paid for this program out of current revenues last year and the year before, but we decided to borrow for this year,

comes someone else's problem after he leaves office. The same thing happens within government. The DOT director retired as this issue went to press, and many of the other principals at DOT are near that point. It won't be their problem that the state has no money for vital road projects in 2012. It's easy to understand why this happens, but why do we let people get away with calling it "responsible?"

This is a game that everyone on Smith Hill has learned to play: Governor, Assembly leaders and lobbyists alike. But what makes it possible? Why does fiscally irresponsible behavior so routinely lead to re-election?

***Why* is this smart politics?** James Madison, in a resolution passed in Virginia in 1798, wrote that the "right of freely examining public characters and measures, and of free communication among the people thereon," is "the only effectual guardian of every other right." The press routinely takes this to be an endorsement of the importance of their role. But Jefferson spoke of *examining* public figures and what they do. We only have a press willing to *display* them.

The regnant guiding principle of American journalism is that their job is simply to report what happens, and leave the matter of judgment to the people reading it. The problem is that few articles have space enough to include all the relevant context that people would need to make a judgment, and not everyone is equally qualified to render judgments about everything.[5] What about matters that require specialized judgment? There, the press turns to articles that present opposing viewpoints about the matter in question. But in an attempt to remain impartial, all such articles must present the opposing views in equally attractive lighting. It's said to be "biased" for a reporter to say that one perspective is less appealing, let alone calling it stupid. Members of the press often style themselves as referees, but without being willing to call folly by its proper name, they cannot possibly fulfill the role.

A fight without referees is an ugly thing. But where are the referees on the state budget?

Try this thought experiment. Suppose that Rep. Steven Costantino (D-Prov), the chair of the House Finance Committee were to propose a tax to pay for DOT's expenses out of current revenue instead of through debt. (Not that he would; this is only a thought experiment.) Would the next press release from the Governor's office likely contain anything like this?

> "Thank you for being such responsible stewards of the public's finances."

Or is it more likely to contain this?

> "There go the terrible tax-and-spend Democrats again, intent on squandering your hard-earned dollars."

In a partisan atmosphere, perhaps you can't expect any better, but what would happen next is that the *Providence Journal* would dutifully report those words—even if the reporter thought Costantino's action long overdue—the

Contractor GRAVEE

To finance several very large projects—relocating Route 195 in Providence, building an access highway to Quonset, rebuilding the Sakonnet River bridge, and adding a third rail line between Quonset and Providence—the state DOT found a creative way to borrow money. The plan involves the "Grant Anticipation Revenue VEhiclE" bonds (GARVEE), and are a perfect illustration of how a foolish idea can come to seem rational when it's decorated with enough syllables and acronyms.

The idea is that the department borrows against future federal highway funds. This might be considered a good idea if you believe that these projects are worth more than a quarter of all our federal highway aid over the next couple of decades. About \$534 million of these bonds are to be issued [CB108], and repaying them will cost almost a billion dollars. This program—the biggest bond issue in state history—was enacted with no voter approval.

In addition to the GARVEE bonds, the state also issued, via the Economic Development Corporation, and again without voter approval, \$42 million in bonds to be paid back with 2¢ of the gas tax. Plans call for issuing another \$82 million of these bonds between now and 2011 [CB176–179] These bonds will ultimately cost us around \$170 million to repay. With the GARVEE bonds, this is five entire years' worth of federal highway money.

The projects paid for via the GARVEE bonds plainly do meet the sensible-borrowing test. (Though one can question the wisdom to the projects themselves. The I-195 relocation was originally suggested because repairing the existing bridge was predicted to cost \$50 million.) These are projects that it makes sense to amortize over a number of years. But they are also plainly projects which our state couldn't afford to pay for under the existing budget. So DOT planners invented a method to pay for them that required no voter approval and will crowd out many other budget items. The consequences will be suffered in future years, when many of the planners have retired and moved to Florida, where it will be difficult to make them face any blame for the fiasco. –TS

because it's \$1.7 million each year until 2012 instead of \$7.5 million in one year. That's fine for the current year, but what will we do next year? This is how the madness at DOT started in the 1980's.

[5] Some of us have spent way too much time to be healthy reading state budget documents, for example.

talk shows would scream about them, the controversy would result in a revolt among the rank-and-file legislators, and there would be approximately zero positive feedback for the action. To doubt this chain of events would be evidence you'd spent much of the past 20 years on a lonely and distant island. But none of this is a law of nature. It doesn't have to be this way.

At this point, it's pretty clear that Republicans have lost any right to belabor Democrats about spending, but it continues to happen all the time.[6] What's more, the press often joins in on their own accord. The script they read from says that Democrats spend more and Republicans cut more, so reporters know they're supposed to call on Democratic candidate Fogarty to explain how he's going to pay for his proposals, but they don't pester Republican candidate Carcieri about the significant increase in debt or about the melt-down in municipal finance on his watch. So you have Democrats who acquire no advantage by being fiscally responsible, and Republicans who see no disadvantage to astonishing irresponsibility.[7] It's a recipe for perpetual stalemate, which can't end so long as no one acknowledges it—let alone addresses it. Until the impasse ends expect more of the same in the state budget follies. ■

A happy debt story – in Rhode Island

The state budget documents reveal a justifiable pride in the fact that we paid off the DEPCO debt, from bailing out the credit unions after the RISDIC debacle of the early 1990's. The state canceled this debt 22 years early, a highly unusual achievement by any state. The FY07 capital budget document claims this as an achievement to be proud of, even though it happened six years ago [CB13].

But please let's remember *how* it was paid off so early: the state raised taxes to pay the bonds. In this case, it was relatively easy: we skipped a scheduled decrease in the sales tax rate, and dedicated that half-point of the sales tax to repaying the bonds. We did not rely on hopes for magic payouts from insurance companies or manna from tobacco companies to fall into our laps, though quite a lot did eventually fall there as the DEPCO suits were settled. What happened was that Governor Sundlun looked at the cost, and acted responsibly by creating a tax to pay this debt, and lo and behold, it worked so well we're still boasting about it, six years later. Would that we had Governors today who, when faced with similar problems, would do the same responsible thing. –TS

Quonset, again

A huge amount of recent borrowing is intended to make Quonset Point more attractive to businesses. We've added a third rail line to make freight train service to the park easy, and we're building a highway (parallel to the existing, no-traffic-light, road) to serve the park and little else. The total cost of these two improvements alone is more than $400 million, and over half of that is borrowed money [CB176–179]. The state's Economic Development Corporation has also borrowed around $24 million for improvements at the park, and plans to borrow $42 million more soon [CB135]. Assuming optimistic interest rates, this will cost us around $400 million to repay, say around $20 million per year for 20 years.

Our investments in Quonset Point will never be repaid by business activity there. So let's invest more!

There is a certain amount of lease income coming to EDC from park tenants, but the real reason for financing this kind of effort is to hope that tax collections on the incomes of the businesses there (and their employees) will make up the difference. But this is plainly absurd. It would take more than 15,000 *new* jobs at Quonset Point even to begin to approach that much tax revenue, and that's being pretty generous in what those jobs pay. In other words, in order to pay back this investment, the park would have to see 15,000 jobs created there, that didn't come from elsewhere in Rhode Island (as have *all* the jobs "created" there in the past several years) and that all paid better than $50,000 per year.

Now that the Narragensett Indian casino is dead (for the moment) there are calls for looking at Quonset again. William Murphy, the Speaker of the House, describes the park as "underutilized," for example. But the prospects that Quonset can ever repay the amount we've already invested are nothing you'd want to bet on. The improvements we've made—railroad and highway access—are all about moving goods into and out of the park, so apparently the state has been preparing the ground for a resurgence of manufacturing at Quonset.

Or a port.

The port proposal of 1999 was said to be able to generate about 22,000 jobs, but these estimates were far from credible. The port proposal itself only covered a few thousand employees, and their numbers were difficult to square with the revenue estimates they made. The other 18,676 employees were estimated in a 1997 EDC report:[8] they counted the number of developable acres at Quonset and multiplied by the average number of employees

[6] In fact, it's fairly clear that they never earned that right, only claimed it for themselves. Republicans always professed hostility to social programs, and hence were supposedly against high taxes and therefore responsible spenders. But the reality has long been different, even if self-styled conservatives get elected by saying these things.

[7] You would think that they, of all people, would see the merit in funding all programs at their full cost. See **RIPR** issue 19 for a discussion of the wisdom of lowballing the costs of government programs and thinking that cutting taxes will reduce the size of government.

[8] Written by the consultant Parsons Brinckerhoff. See table 4.5.

per acre at industrial parks across the country. The plan they presented to create those jobs? Find people to buy the land and sell it to them. Pretty smart, no?

Be ready to hear the argument that the investment we've already made at Quonset is money that will be "wasted" if we don't invest still more.[9] As the discussion about Quonset and its potential uses rears its head again, it's worth remembering that repayment on this investment is far from likely under the rosiest of possible circumstances. ■

The state they're in

> [C]ities and towns are facing a long-term financial crunch caused by increasingly restricted and unpredictable local aid levels, constraints on ways to raise local revenue, and specific costs that are growing at rates far higher than the growth in municipal revenues.
>
> Municipal managers and elected officials across the state—regardless of whether they live in cities, towns, resort communities and rural hamlets—understand that municipal government is nearing a crisis point. Citizens are feeling increasingly sour toward local government because their family's property tax bill has increased dramatically, they are now paying fees for many services that used to be covered by general revenue, and, still, core local government services are being cut.

Sound familiar? It sounds like any number of recent reports about Rhode Island, but this is about Massachusetts, and is quoted from *Local Communities at Risk: Revisiting the Fiscal Partnership between the Commonwealth and Cities and Towns*, a 2005 report from the Municipal Finance Task Force, a group convened by the Metro Area Planning Council, the umbrella planning authority for greater Boston.[10]

[9] An almost identical argument, of course, is why we're still squandering money and lives in Iraq.

[10] A link to the full report is available at *whatcheer.net*.

Balancing the '07 Budget

Even though state tax collections in Massachusetts are up a bit this year, the $26 billion budget Governor Mitt Romney signed last July is still out of balance, by at least $250 million.

The budget passed last spring was only balanced by taking $550 million from the state's budget stabilization fund (the "rainy day" fund). The Governor vetoed that part of the budget, along with some $40 million in municipal funding. The Legislature put the municipal funding back, but couldn't override the veto of the rainy day appropriation.

And there the matter sits. The Governor vetoed another supplemental bill in October that took only $450 million from the fund, and then slashed budgets across the board using his emergency authority. The legislature failed to override the action, and is currently holding tight, waiting for the new Governor to take office, and praying that tax collections improve.

During last year's legislative session, taxes in Massachusetts took a prominent role in conversations about Rhode Island's budget. The legislature even adopted a tax bill whose purpose is to lower taxes on the wealthiest taxpayers to levels not to exceed those in Massachusetts. The goal, apparently, is to lure rich people to live here instead of there.

Left unsaid in most of the debate last spring was what is really going on in our neighbor state. Massachusetts's economy is strong, it is a much wealthier state than ours, with a strong high-tech industry, and they were not facing any serious budget cuts this past year. So it logically follows that therefore we should achieve their success by emulating their tax policy. Right?

Massachusetts is said to be a model for us, but shouldn't we ask how they're doing?

But as usual, policy makers in Rhode Island take only a superficial look at the factors they profess to know about, and lead us further into a disaster.

Their Budget Massachusetts was able to balance its fiscal 2007 budget this past spring for two simple reasons. One is that the recession of 2001-2002 hit Massachusetts very hard (harder than Rhode Island who didn't have nearly as many high-tech companies to fold), and their budget that year was a debacle, with many cuts all across the board. The second reason is that since then, there has been no political will to restore those cuts, and so services that suffered in 2002 have not been restored. Even so, the Massachusetts legislature only balanced the budget this year by trying to take funds from the budget stabilization fund (the Governor objected, see box on previous page).

Their Debt Borrowing is another classic method for making a budget seem better than it is, and Massachusetts has used it freely. Not counting its counties, Massachusetts carries the highest debt per capita of any state in the nation. At $4,128 per citizen, it's close to three times our level of $1,402. (And it's also more than double as a percentage of personal income.) This is perhaps not a problem for them, since they are also one of the wealthiest states in the nation. Their bond rating has not suffered tremendously over it (it's a bit better than ours). But how is it that our House finance committee can consider their tax and budget practice a model for us? With our lower state income, if our debt level was that high, our bonds would be junk bonds.

Their Cities and Towns What has suffered the most in Massachusetts is services provided by the state's cities and towns. Municipal aid was one of the big losers in the 2001-2002 budget cuts. Adding insult to injury, the legislature has added new restrictions on state aid since the recession, forcing cities to fund some services at the expense of others. Education funding has largely been maintained, but fire departments, libraries and public works departments across the state have laid people off, closed doors, and turned off streetlights. The 2005 report quoted above was compiled in response to the crisis, though it's not clear that it has provoked any significant action in the legislature.

Can we succeed by blindly copying larger, richer states? Why would you think so?

Rhode Island is a small state, nestled in between larger and richer states. The actions we can take are obviously limited by these facts. But the fact that we are near those states does not mean that we are identical to them, and it also does not mean we can succeed by copying.

It is possible to make a case that the tax cuts in Massachusetts over the past 25 years have had a benefit to their economy. One has to ignore MIT, Harvard, and the other universities there, along with the high-tech industry concentration there to make the case convincing, but let's suppose for a moment that it is true. The evidence is pretty clear that even if some benefit accrued to the state economy as a result of the tax changes, it did not also accrue to the state budget.

To translate this into Rhode Island's terms: it may well be that last year's tax cut for the rich will be a modest stimulus to the state's economy, but no one should be fooled into thinking that this kind of stimulus will mean anything besides tighter and tighter state and municipal budgets in the future. This is "trickle-down" economics at its purest: make life better for the rich, and simply hope that the rest of us benefit. ■

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