

It's the Economy, Stupid!

It's hardly any secret that the Rhode Island economy is in bad shape.

In the most recent monthly data from June 2014, the seasonally adjusted unemployment rate is 7.9 percent - a tie for worst in the nation between Rhode Island and Mississippi. It has been a lot worse, and Rhode Island improved since June 2013 with unemployment dropping from 9.5 percent. What the oft-quoted unemployment rate actually means is a surprisingly complicated matter in dispute, taking into account problems such as people who have been unemployed so long that they count as "discouraged" and roll off the unemployment numbers.

While the unemployment data has been stealing the headlines, far too little attention has been given to the state budget deficit, arguably the most grave single political problem facing the state. We are collectively in denial about the fiscal situation, with projections for the deficit to balloon to nearly a half-billion dollars per year. Even the 38 Studios scandal is a drop in the bucket in terms of pure numbers compared to that.

Although official projections in the state budget ("Appendix F - Five-Year Financial Projection") contain a lot of weasely words about the unpredictability of Federal Reserve interest rate policy and federal defense contracting, annual operating deficits are expected to increase each fiscal year (FY): "\$151.1 million in FY 2016, \$256.7 million in FY 2017, \$330.5 million in FY 2018, and \$419.3 million in FY 2019. In percentage terms, the deficits are projected to range from 4.2 percent of spending in FY 2016 to 10.4 percent of spending in FY 2019."

A significant contributor to these expected growing deficits is that Rhode Island depends far more than it should upon income from gambling, according to state budget documents: "The expected opening of gaming facilities in Massachusetts in the coming years is projected to significantly impact [future] year revenues. Lottery transfers to the State general fund are projected to diminish by a total of \$422.1 million over the five-year forecast period, due to the increased competition to Rhode Island's gaming facilities in Lincoln and Newport."

This looming fiscal crisis could result in Providence looking like Detroit within a shockingly short time if nothing is done. In five years, will cities and towns be unable to pay teachers, police officers, fire fighters and even trash collectors? Central Falls went bankrupt in 2011, resulting in tax increases, pension cuts by nearly half and a reduction in the number of city employees from 174 to 118.

Woonsocket in recent years operated with cash flow so inadequate that there was doubt the city could meet payroll without state aid. On July 9, Moody's Investor Service confirmed its B3 rating of Woonsocket's general obligation (GO) bonds. According to Moody's, "Obligations rated B are considered speculative and are subject to high credit risk." (The suffix "3" indicates that the bonds are in the lowest quality tertile within that rating.) In the Moody's system of nine rating groups, the top four (Aaa, Aa, A, Baa) are generally considered investment grade, while the bottom five (Ba, B, Caa, Ca, C) are generally considered risky "junk" bonds.

By contrast, Providence general obligation bonds on June 17 were rated Baa1, and those of the state itself on April 9 were rated Aa2, although with a negative outlook. Even Central Falls, having emerged from bankruptcy in 2012, on June 23 had its GO bonds upgraded from B1 to Ba3 - still "junk," but not as

bad as Woonsocket.

Perusing the web sites of the various candidates for governor, none seem even to acknowledge the depth of the budget deficits the state is likely to be facing within their coming four-year term of office. Republicans Ken Block and Allan Fung offer various proposals for cutting taxes, but whatever merits that may have, I am unable to find any statements from them about how to compensate for the resulting lost revenue. Democrats Clay Pell, Gina Raimondo and Angel Taveras talk about economic issues almost entirely in terms of job creation, but also never address the budget deficit squarely.

It's very easy for politicians to promise job creation. After all, who in their right mind would oppose it? The devil is in the details, and ultimately job growth depends primarily on factors far outside the control of state and local officials, such as the conditions of the broader national economy, interest rates, international currency and trade imbalances that drive exports and imports, and so forth. Even actions that state government could undertake to promote job creation will tend to be so indirect as to take five or 10 years to bear fruit.

Control of the state budget, however, lies entirely and immediately in the hands of the governor and the General Assembly. They will be forced to make some difficult choices, and the electorate should be prepared to accept that painful process provided that the pain is distributed fairly and equitably, and provided that the process is transparent and clearly explained. Voters understand that the state cannot indefinitely live beyond its means. Silence on this issue from politicians is, quite simply, irresponsible.

Fiscal management is the lynchpin of everything else: If the state cannot pay its bills, worrying about arts and tourism will be pointless.

U.S. Bureau of Labor Statistics: www.bls.gov/lau/tables.htm

R.I. State Budget, FY 2015, Appendix F:
budget.ri.gov/Documents/CurrentFY/ExecutiveSummary/13_Appendix%20F%20Five-Year%20Financial%20Projection.pdf

Moody's definitions of ratings: moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004

Candidates for governor on economic policy (listed alphabetically):

Ken Block: blockforgovernor.com/theblockplan

Allan Fung: fungforgovernor.com/taxreform.html

Clay Pell: claypell.com/issues/economy-jobs

Gina Raimondo: ginaraimondo.com/issues/jobs-and-economy

Angel Taveras: angel2014.com/issues/jobs-economic-development