ECONOMICS

RI RANKS 43RD NATIONALLY

TABLE 1

ECONOMICS MAJOR INDEX RATINGS		
Measure	**National Rank**	**New England Rank**
Economics	43rd	5th
Private Sector Share of Personal Income	34th	4th
Real, Per Household Personal Income	19th	4th
Cost of Living	28th	2nd
Entrepreneurship	44th	6th
Unemployment	50th	6th

Source: Rhode Island Center for Freedom and Prosperity and American Conservative Union Foundation

Private Sector Share of Personal Income

- **Rhode Island ranks 34th nationally and 4th in New England on this FPI sub-index**

Increased government revenues are not always a positive indicator. Personal income is derived from two sources: the private sector and the public sector. The distinction between the two sectors is important because only the private sector creates new income. The public sector, in contrast, can only redistribute income through taxes and spending. More specifically, public sector spending consists of personal current transfer receipts (Medicare, Medicaid, Social Security, etc.) and government employee compensation (federal, state, and local).

This information is important because there is a significant positive correlation between per-household personal income and the private sector share of personal income.[7] Put simply, the bigger the private

7 As such, the public sector crowds out the private sector. For example, see: Moody, J. Scott, "Expanding Medicaid Will Hurt North Carolina's Families, Lower Income, and Reduce Jobs," *Federalism In Action*, No. 5, March 23, 2015. http://www.federalisminaction.com/study-no-5

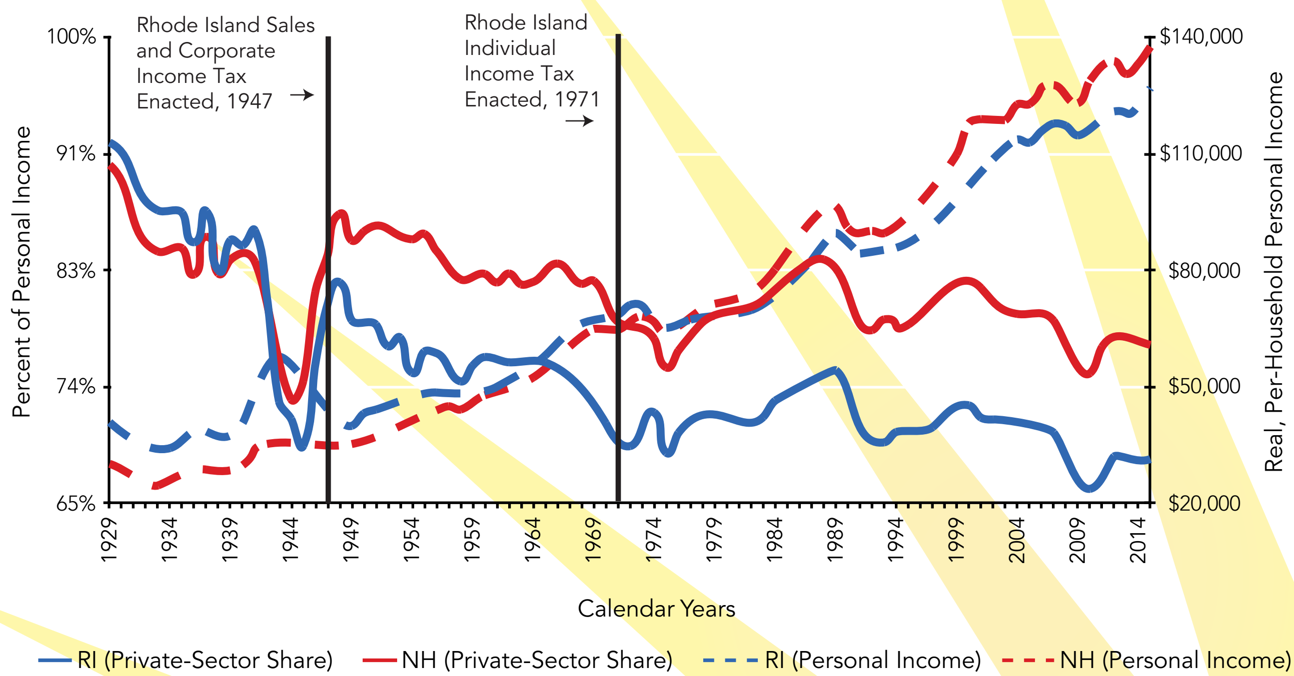
sector, the greater the per-household personal income. When examining the lower 48 states, on average, a one-percentage-point decrease in the size of the private sector yields a decrease in per household income of approximately $3,300.[8]

Of course, correlation does not equal causation. Fortunately, Rhode Island has a regional neighbor that allows for a very strong natural experiment to better show causation: New Hampshire. While Rhode Island and New Hampshire are alike in many ways — geography, climate, demographics, and culture — they diverge significantly in approach to public policy.

As shown in **Chart 1**, prior to WWII, Rhode Island had higher per-household incomes (adjusted for inflation) and a larger private-sector share (as a percentage of personal income) than New Hampshire. In 1947, Rhode Island enacted the sales tax and corporate income tax, which led to ***increased public sector spending and essentially started to crowd out the private sector***. Consequently, New Hampshire's per-household income began to steadily converge with Rhode Island's.

CHART 1

Rhode Island Versus New Hampshire
Calendar Years 1929 to 2015



Source: U.S. Department of Commerce: Census Bureau, Rhode Island Center for Freedom and Prosperity, and American Conservative Union Foundation

8 Alaska and Hawaii are excluded, as is common practice in state analyses, due to their unique economic characteristics.

This trend accelerated in 1971 when Rhode Island enacted the personal income tax, a few years after the federal government enacted Medicaid. With this new source of revenue, Rhode Island continued to spend, which further expanded its public sector at the expense of the private sector. In stark contrast, New Hampshire remains the only state in the Union not to have enacted a state or local sales tax or state or local income tax.

Medicaid's role in this divergence is highlighted in the spending per capita, where Rhode Island spent $2,512 per person in 2015 (4th highest in the nation), while New Hampshire spent $1,290 per person (34th highest in the nation).

This difference in approach to public policy, such as determining appropriate levels of Medicaid spending, has resulted in a dramatic difference in the size of each state's private sector. Between 1929 and 2015, Rhode Island's private sector shrank by 25.8 percent, to 68.3 percent, from 92.1 percent, and is now only the 34th largest private sector in the country. New Hampshire, on the other hand, has seen its private sector shrink by a much smaller 14.9 percent, to 76.9 percent, from 90.4 percent, and now has the 2nd largest private sector in the country.

As a result, New Hampshire's private sector in 2015 is 12.5 percent larger than Rhode Island's: 76.9 percent and 68.3 percent, respectively. Consequently, New Hampshire's per-household income is now eight percent higher than Rhode Island's: $137,511 and $126,882, respectively. This is a complete turnaround from the situation prior to WWII, when Rhode Island's per-household income was higher than New Hampshire's.

This matters because personal income is perhaps the most important measure of a family's *economic* well-being. A higher level of personal income means that a family is able to buy more goods and services, such as a home, a car, education, and healthcare, which, in turn, is an important component of family prosperity.

If Rhode Island's private-sector share of personal income had been at the national average, that would have meant an additional $1 billion pumped into Rhode Island's private sector. This investment in the private sector would, in the long run, result in significantly higher incomes for all Rhode Islanders and, most likely, also a higher ranking on FPI's social sub-indexes.

Entrepreneurship

▶ **Rhode Island ranks 44th nationally and last in New England on this FPI sub-index**

Organic versus Artificial Job Growth

High rates of sustainable job growth — essential for a sense of long-term family economic security — can primarily be achieved as a result of organic entrepreneurship, not from a strategy that stresses government "investment" in targeted companies or industries, an artificial form of job creation whereby government picks economic winners and losers. Therefore, understanding the health of entrepreneurship in a state is essential to understanding its job growth potential — or lack thereof. As economist Tim Kane succinctly puts it:

> *The oft-quoted American sports slogan, 'Winning isn't everything. It's the only thing!' could well be attributed to the economic importance of firm formation in creating jobs. A relatively new dataset from the U.S. government called Business Dynamics Statistics (BDS) confirms that startups aren't everything when it comes to job growth. They're the only thing.*[9]

9 Kane, Tim, "The Importance of Startups in Job Creation and Job Destruction," Ewing Marion Kauffman Foundation, July 2010. http://www.kauffman.org/~/media/kauffman_org/research%20reports%20and%20covers/2010/07/firm_formation_importance_of_startups.pdf

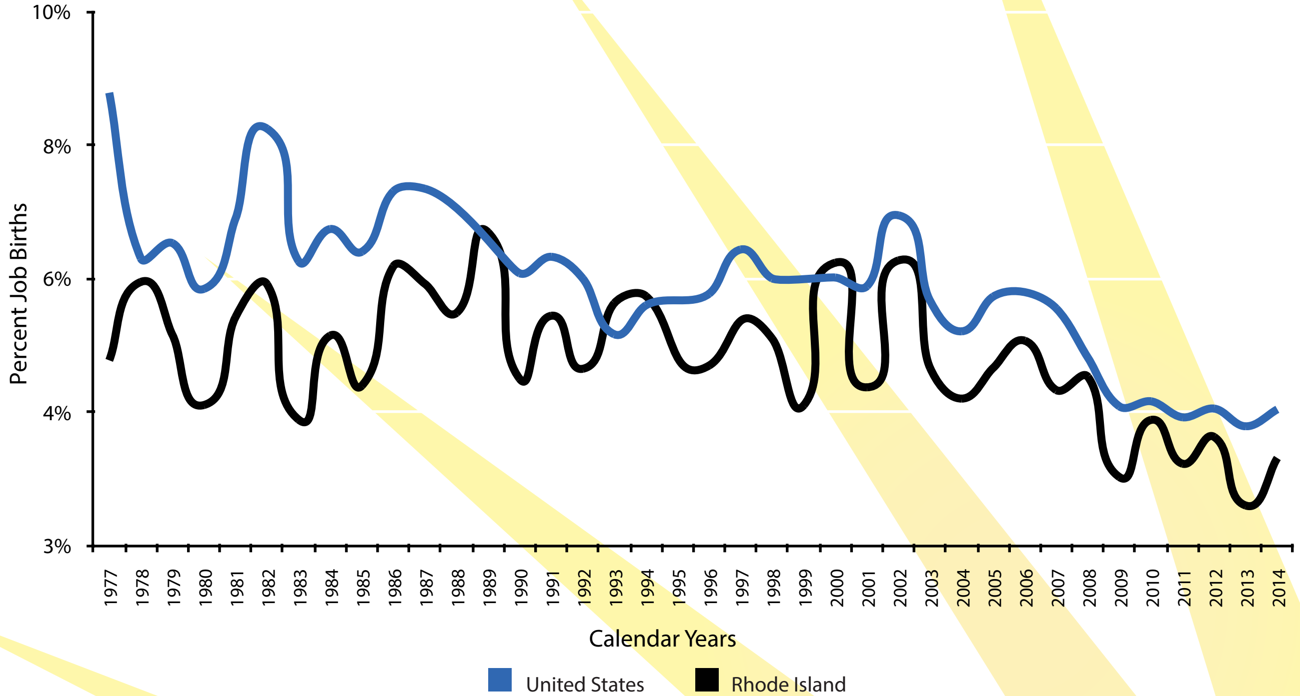
Charts 2 and 3 show the variance in the various measures of entrepreneurship (job and establishment birth rate) nationally and in Rhode Island from 1977 (the earliest year of available data) to 2014.[10]

As shown in **Chart 2**, the job birth rate (as a percentage of total jobs) decreased nationally by 50 percent, to 4.4 percent in 2014, from 8.9 percent in 1977. In Rhode Island, the job birth rate has not only fallen below the national average, but it has also declined 27 percent, to 3.7 percent in 2014, from 5.1 percent in 1977. ***Rhode Island currently has the 14th lowest job birth rate in the country.***

[S]tartups aren't everything when it comes to job growth. They're the only thing.

CHART 2

Job Births as a Percentage of Total Jobs
Calendar Years 1977 to 2014



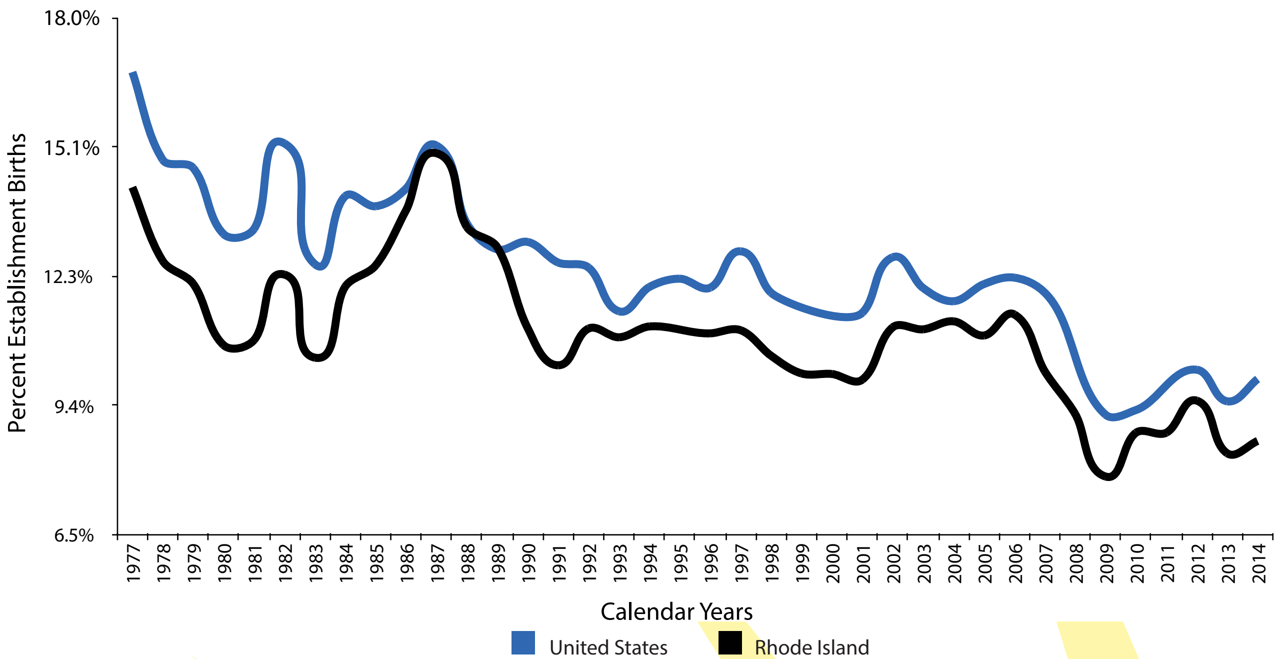
Source: U.S. Department of Commerce: Census Bureau,
Rhode Island Center for Freedom and Prosperity, and American Conservative Union Foundation

10 Business Dynamics Statistics, U.S. Department of Commerce: Census Bureau http://www.census.gov/ces/dataproducts/bds/data_estab.html

As shown in **Chart 3**, the establishment birth rate (as a percentage of total establishments) decreased nationally by 41 percent, to 10 percent in 2014, from 16.8 percent in 1977. In Rhode Island, the establishment birth rate has long been below the national average and has fallen 40 percent, to 8.6 percent in 2014, from 14.2 percent in 1977. ***Rhode Island currently has the 12th lowest establishment birth rate in the country.***

CHART 3

Establishment Births as a Percentage of Total Establishments
Calendar Years 1977 to 2014



Source: U.S. Department of Commerce: Census Bureau,
Rhode Island Center for Freedom and Prosperity, and American Conservative Union Foundation

Increasing the level of entrepreneurship in Rhode Island is vital to making sure that the economy can sustainably generate the well-paying jobs that can form the basis for enhanced family prosperity. To put this into perspective, in 2014, if Rhode Island had been at the national average for entrepreneurship, the state's economy would have created another 2,890 new jobs and 342 new establishments.

These jobs are especially important given that Rhode Island has only the 39th best score in the unemployment sub-index. In particular, these new jobs would have shaved nearly a half-percentage point off its historical unemployment rate (U3). In turn, Rhode Island's FPI unemployment sub-index score would have ranked higher.[11]

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11 For more recent data and analysis of Rhode Island's unemployment situation, see the Jobs & Opportunity Index: http://rifreedom.org/joi/