

May 15, 2013



TO: RI House Finance Committee
FROM: Mike Stenhouse, CEO
SUBJECT: Testimony re. House Bill 5365

Dear Chairman Melo and Committee members:

My name is Mike Stenhouse, CEO for the RI Center for Freedom & Prosperity, a non-partisan public policy think tank. I am a lifelong RI resident, I have a degree in Economics from Harvard University, and I am two-time small business owner in the state of RI, among other experiences.

As a tax-exempt nonprofit organization, our Center cannot specifically advise you to support or oppose this particular bill ... but we are allowed to discuss our research with regard to the underlying premise of the bill ... in this case the effects of a sales tax repeal on the state of Rhode Island, effectively bringing our sales tax to Zero.Zero %. This reform likely represents the largest tax relief and economic stimulus plan every considered by this committee ... or by our state.

This policy idea has been greatly researched by our Center. We have conducted significant study on this topic and we've utilized multiple experts and advanced tools, and we have thought this topic through, in as many ways as we can. It is our goal via our testimony today, to convince you that this is not an unachievable, pie-in-the-sky policy goal: but instead is a bold, yet sound policy reform.

Let me guess that most of you are initially thinking of the size of the reform and the budget; that how could RI ever consider doing something so big or giving up all that revenue? We'll get to the math later on, but let me say right up front, that the state will never see anything close to a \$900 million budget hit ... that by our calculations ... we can start down the path towards **25,000 new jobs** with only about a \$105 million in savings that you would have to find in the upcoming 2014 budget.

But, may I suggest this debate should be less about numbers ... and more about families. (see the Family Dinner Table cartoon poster)

Public policy in this state is tearing families apart. With this family table in mind, with all the empty chairs, and by way of background, the premise for the initial release of our ZERO.ZERO Sales Tax report in 2012 was to identify the tax policy that would most help rectify this sad situation for families and provide the biggest boost to our chronically depressed jobs market. It immediately became clear that repeal of the state sales and meals tax would provide that boost to our economy.

If you believe that our state needs an out-of-the-box, game-changing policy to give our economy a much needed boost - and to bring family members back to the dinner table - then I suggest that we not box ourselves in with our own budget.

May I state here, that while your committee has or will hear or hear about other 'economic development' ideas in other bills, nothing else you will review this year will come anywhere close to having the game-changing effect on our state that we will talk about today with regard to abolishing the sales tax.

The recent unemployment and revenue forecasts indicate that Rhode Island's economic recovery is not strong, fragile at best, and we continue to lag behind our national and regional neighbors. Chairman Melo, I commend your comments over the weekend where you recognized the need for meaningful changes to our approach to growing the state's economy.

Today, let us not continue talk of merely presiding over the decline of our economy. Let us talk, instead, about taking charge of our state's financial future! Let us consider a bold, but proven, new approach.

Today, we will discuss some of our Center's views on that approach as well as one significant policy reform that could be the first major step in that new approach: Repeal of the state sales tax ... a credible and highly impactful policy reform idea.

Today you will hear four types of testimony that ALL support the concept of eliminating the state sales tax for the well-being of our state. Today, you will hear:

- Free-market economic philosophy regarding the positive dynamic effects derived from tax cuts
- Empirical evidence of success from our NH neighbor, as well as regional and national trends
- Research & Projections from a credible modeling tool re. jobs, revenues, cash flow, and other figures
- Stories from real people affected by RI's existing sales tax policy

And you will hear this testimony from our expert panel in front of you today and from others to follow.

May I introduce the panel at this time who will speak following my remarks? First, **Scott Moody** is an economist, and author of our Center's original Zero.Zero Sales Tax report in 2012. He will discuss regional and national tax trends and comparisons among other states. Next, **Paul Bachman** from the Beacon Hill Institute, creator of the RI version of STAMP modeling tool, will present some findings and discuss the underlying assumptions utilized in the algorithm. Finally, **Justin Katz**, research director for our Center, will present some RI specific revenue and cash flow projections.

As we move ahead with testimony today, I ask you to keep in mind the real lives of real family members that at stake ... those at, or missing from, the family dinner table.

RI in a Death Spiral

Rhode Island is in the middle-stages of an increasingly destructive Death Spiral: oppressive overall tax burdens, combined with fewer job and economic opportunities, have created dwindling hope for our state's future ... and are driving more and more people and wealth out of our state. Yet, while we are decreasing our state's overall tax base ... we are increasing spending - at a rate 26% higher than where the combined inflationary and population levels would otherwise demand. This increasing burden on a citizenry with decreasing financial capacity only perpetuates the despair and out-migration problem we face as a state ... and the Death Spiral continues ... and it intensifies.

How did we get into this Death Spiral dilemma?

It is a reality that states compete against each other for families, entrepreneurs, and businesses. In this regard, our Ocean State is simply not competitive. First, please take a look at the Report Card on RI Competitiveness in your packet: 53 overall categories, 27 Fs, 13 Ds ... over 75% of our grades are D or F. Now think of that family dinner table. Do you see the correlation?

Perhaps I can best summarize the 53 categories in the report card with just four numbers: Picture the numbers **50, 50, 50 & 1**. Depending on which index you look at, for much of last year RI ranked at or near:

50th in its employment outlook; **50th** in its lack of population growth; **50th** in its business climate ...

... all because we are ... **#1** in terms of "redistribution of wealth" ... policies that take from some in order to give to others. This is the public policy approach that has failed our state and our citizens.

In our Center's view, this public policy culture in RI is the most anti-free market, anti-jobs, anti-family approach in the entire country.

We agree with Chairman Melo: A new public policy approach is needed. And I ask you to keep this in mind not only with regard to this specific bill, but to all tax bills that will come before your committee this year and in the future.

How Should "Taxes" be viewed?

Most budget analysts, and if I may, many legislators look at tax and fee hikes as a spreadsheet "revenue" item – a means to pay for desired spending programs, or, more recently as a test of "fairness". Our Center recommends a different approach.

Conversely, an economist looks at higher taxes and fees as a disincentive to productive economic activity for someone. Similarly, the subsidies and payments made to those individuals and companies that receive public assistance, provides a discreet incentive to less productive activity.

The tried and true economic adage applies: if you tax something – you end up with less of it; and when you subsidize something - you get more of that.

In RI's case, decades and decades of a public policy culture - that has continually raised taxes and fees in an attempt to provide assistance or fairness for some - has backfired. This culture has created dozens if not hundreds of laws that DIS-incentivize productive economic activity, while at the same time IN-centivizing less productive activity. Over the years, the cumulative effect of each of these "small" steps has led to a "big" problem for our state.

Thus, the alarmingly high number of failing grades we see on our state's report card ... and the empty chairs at the family dining table ... the result of all those unintended, yet perverse set of economic incentives and disincentives.

We call them WIN-LOSE, or LOSE-LOSE policies. And this is how we believe public policy in this state is harming families and businesses. Our home state of Rhode Island is no longer seen by many as a promising place to settle and raise their families. We all know that this must change.

Conversely then, of course, cutting taxes and reducing spending provides the proper incentives on both the production and the consumer side to see rapid economic growth.

The RI Sales Tax

Our state's general sales tax is the highest in New England. This matters to shoppers and consumers.

And in recent years, perhaps no tax has been tinkered with more – *as a means to obtain revenue* - than the sales tax. In perpetual search of ways to pay for an ever-increasing budget, our state has repeatedly considered which new items or services can be taxed; or at what higher rates ... but usually without much apparent regard for the negative economic consequences.

Additionally, and conversely, when some have realized that certain industries are being hurt by sales taxes, we occasionally look to repeal, exempt, or create holidays to undue some of the economic wreckage we've created.

This is wasted time and effort and it unnecessarily hampers our business sector.

In fact this year, there about two dozen bills dealing with some aspect of the sales tax, the vast majority of which seek to roll-back previously imposed sales taxes by some measure. And six of those bills are sponsored by members of this committee.

This annual sales tax shuffle makes it very difficult for the business community to plan ahead and creates a level of uncertainty that is harmful to productive activity and economic growth.

By repealing the sales tax ... we can end this counter-productive annual dance once and for all ... and start providing a clear vision for our local business community.

Further, our Center asks the question: if so many elected representatives, including members of this committee, believe that rolling back or repealing certain parts of the sales tax code is good for certain industries ... wouldn't repealing the entire sales tax be good for the entire state? If a little is good, isn't more better?

It's time to think of the sales tax not as a bunch of revenues, but as a barrier to economic stimulus and growth.

What's our state to do?

What our state needs now are WIN-WIN policy solutions! Lower taxes that spur economic growth. Our persistent last-place rankings in so many categories are absolute proof that the high-tax, revenue grab public policy culture has failed.

Interestingly, there has been some discussion that that by lowering income tax rates in recent years in RI, that this lower tax approach has itself already been tried and failed. Our Center could not disagree more.

Take another look at the report card ... while dropping the income tax rate upgraded that specific sub-category from an F to a C, the larger "tax burden" category, surrounded by all those other F's, still grades out at a D-. While we agree with lower income tax rates, it was merely a very minor reform. And you heard testimony last week from Justin Katz that there does appear to be a small, but measurable positive effect because of it. However, it was not a game-changing reform: something we could have predicted with our tax modeling tool, which we'll talk about in a few minutes.

The only way to provide immediate relief to tens of thousands of struggling families is to enact bold policy reforms that promote growth and provides them with new opportunities... not that further strangle our state economy or that restrict chances for upward mobility.

And JOBS is the key to unlocking this problem. With more people working, being productive and paying taxes ... our state's tax base is expanded, and in this way, more revenues can be available to our state, with everybody benefiting: a true WIN-WIN policy culture.

Bold Action is a National Trend Among States

Please refer to Chart #1 in your packet. RI is one of three outlier states, along with Indiana and Michigan, when it comes to NOT regaining jobs as compared with pre-recession peak levels. Neither Michigan and Indiana did not take this lightly or sitting down ... they took charge of their future, and indeed each state did do something bold with their public policy ... they both became Right To Work states.

So, will RI just sit on its hands and risk falling even further behind or will we take charge of our state's future and be equally as bold? Today, Right To Work is not an option in RI as the solution, but let's take a

close look at an equally bold proposal ... a bill in front of this committee today ... to repeal our state's onerous sales tax.

RI has the highest general sales tax in New England at 7%; and even higher for meals & beverages. If you'll forgive the analogy, it's like placing a 7 oz weight on a baseball bat and asking our business communities and shoppers to try to hit home runs. Imagine how much better off our small business community would be with that 7% sales-tax-weight off their bats?

Zero.Zero Means More

So, let's start analyzing what a 0.0% sales tax might mean for RI.

In discussing the projections we have made in our report, our Center utilized a proven economic modeling tool called STAMP – *State Tax Analysis and Modeling Program* – customized for RI, and previously used in a few dozen states and about a half-dozen major municipalities, including New York City.

The impact is enormous. In short ZERO.ZERO means MORE! Take a look at all of these projected benefits:

- 0.0% means **more jobs** – up to 25,000
- 0.0% means **more dollars back in the pockets of RI shoppers** and our economy – almost \$1 Billion
- 0.0% means **more shoppers** flowing over our borders to spend out-of-state money right here in RI (just like many of us now do in NH)
- 0.0% means **more people moving into our state**
- 0.0% means **more savings** on everyday items for every FAMILY in the state (about \$500 million collectively)
- 0.0% means more savings for **LOW-INCOME** families. As a highly regressive tax, RI low-income families suffer from one of the most burdensome overall state tax policies of any state in the nation, in large part due to our high sales tax
- 0.0% means more savings for every **BUSINESS** in the state (about \$400 million) in B2B sales taxes ... likely resulting in lower product prices across the board
- 0.0% means more **time and money to spend on business matters** instead of collecting and remitting taxes on behalf of the state – FOR FREE. The compliance costs for businesses is enormous and sometimes debilitating, especially when disputes arise with the Department of Revenue:
 - *Later today you will hear from a small business owner who believes he was driven out of business, in larger part, by the unyielding actions of the Department of Revenue.*
- And finally 0.0% means **more revenues for cities and towns** (up to \$150 million) that will put downward pressure on local residential and commercial property taxes ... so that taxpayers can enjoy lower rates, and maybe decide to stay at home here in RI.

Zero.Zero also means more popularity for you as legislators: this is a policy that will lower the cost of living or doing businesses for EVERY single individual and EVERY business in our state. Think about that.

What family or business owner would not benefit by your support of this bill?

In summary, Zero.Zero is a WIN-WIN policy. How often do you come across a policy that would provide so many benefits to so many people ... including your own public standing?

Revenue & Budget Implications

Now, undoubtedly, you are still concerned about the state budget ...

But as I mentioned earlier, RI is not about numbers or budgets. RI is about families and real people. People who are starving for work ... or family members who are leaving our home state in search of that work.

I ask ... what price could possibly NOT be worth turning this bad situation 180 degrees around?

We suggest that the only way our state can ever afford to provide levels of public assistance, health, safety, education, and other services that are necessary ... is via economic growth. An expanding economy is the only way to effectively fund desired spending programs... and to place a giant “open for business sign” on our state’s border posts.

A Zero.Zero % sales tax will create an initial and sustained burst of economic activity that will help fuel significant growth for years to come ... and it will fuel many spending programs.

OK, now that we’ve covered the philosophy and the projected benefits, let’s do some math. Justin Katz will take you through this in detail shortly, but, again, the bottom line is that there is never a revenue cliff or any thing close to a \$900 million budget hit; in fact, for as little as \$105 million this year, we can put our state on a path towards tens of thousands of new jobs by repealing our sales and meals tax.

Please refer to **Table 1** in the 2013 Zero.Zero Report.

The bill before you proposes to eliminate the sales and meals taxes as of October 1 of this year (2013), this will allow us to take advantage of our biggest sales tax quarter, one last time, during our summer months when tourism peaks.

It is projected that RI would normally take in about \$904 million from these taxes. Based on our projections, here’s how the state could account for this revenue under a Zero.Zero sales tax scenario in the upcoming 2014 budget:

- \$904 million	Projected <u>annual</u> sales tax revenue loss
+\$205 million	One-quarter (Q1-2014) sales tax revenues
+\$244 million	Projected increase in income tax receipts (with no rate hike)
+\$218 million	Projected increase in other state taxes and fees
+\$ 79 million	2013 budget surplus applied
<u>+\$ 52 million</u>	2014 Governor suggested budget increase eliminated
\$104 million	TBD budget savings

In 2015, an additional \$115 million or so in savings would be needed. This phased-in approach avoids a major hit to our budget, and allows us to monitor actual results over an extended period.

In the past 9 months, there has been much talk, dedicated events, and lots of ideas about how to turn our state’s struggling economy around. The Governor, virtually all leaders in this General Assembly, probably many of you, and business groups from around the state have all pledged that economic development and JOBS should be the state’s #1 priority.

If they – *if we* – are serious about this priority, then the state would:

- Apply last year’s budget surplus to help pay for the biggest JOBS bill this state has ever considered

- Freeze the budget at 2013 levels so that other program cuts will not have to be made
- Accept minimal savings in other areas of the budget, in exchange for ALL of these jobs and other benefits.

If this state is serious that creating jobs - *tens of thousands of jobs* - is indeed the state's #1 priority, then adjusting the budget to make this happen, can be done with the need for far fewer budget savings than you originally would have thought.

It is the view of our Center that the state budget should be reflective of the goals and objectives that are best for our state, even if some of those goals are new and out-of-the box thinking.

But I fear that, instead, we look at our budget as something that boxes-us in, and restricts us from considering WIN-WIN policies that will advance the well-being of families across our state.

More Discussion of some Benefit Areas

Let's dig into some of these findings in a little bit more detail.

JOBS:

Let me make two points about the 25,000 jobs projection: as large as it seems, it is not an unreasonable estimate.

First, many of these jobs will be created almost immediately, and we have some anecdotal experience with this. A few years ago, when Massachusetts added liquor to its state sales tax, we heard from multiple liquor store owners in RI how they saw an immediate increase in sales, sometimes 30-50% higher, and immediately hired new employees or expanded hours of existing part-time employees. This is an important point to keep in mind for when we do some math in a few minutes.

Also, with over 31,000 RI businesses registered for sales permits, if only half of them were to hire just one new employee ... that would account for 15,000 jobs on its own. Not to mention additional jobs created by the new businesses that would be formed, or by other businesses who don't collect sales taxes, but that would benefit from the new, booming economy.

And many of these jobs are created "immediately" ... you'll hear testimony from a small business owner in this regard later on ... and this is an important aspect of the cash flow analysis of this policy.

0.0% Means More Savings for Low Income Families

I'd like to also talk about our state sales tax as a regressive tax: a tax that disproportionately burdens lower-income families. A recent study by a left-leaning think tank showed that RI levies one of the highest tax burdens on families with the lowest incomes, mostly due to our high sales tax.

If we are looking for a policy that will help low-income families - directly in their pocket-books - and that might create jobs for them so they can begin earning paychecks instead of receiving welfare checks ... then repeal of the sales tax is the answer.

Later today, I believe you will also hear from Cal Carpenter, whose family lost their home and whose wife lost her business due to the economic downturn, and who could benefit greatly, and in multiple ways, from a ZERO.ZERO sales tax climate.

Municipal Windfall Could Mean Lower Property Taxes

According to our projections Cities and Town will also benefit from sales tax repeal. With the large number of new and expanded businesses expected to crop up due to increased consumer demand, municipalities are projected to receive about \$150 million in net NEW revenues ... mostly from commercial property tax receipts and other related levies and fees.

This means a brand new source of funds that can be used for local education, police, fire, and roads ... and which will create downward pressure on property tax rates for all residential and commercial property owners!

Sales Tax Border Wars

As we have just shown, repeal of the sales tax will have a massive positive effect on our state economy ... and we will likely see benefits right away ... because shoppers will change their purchasing habits tomorrow, if they are incentivized to do so. The effect, in many instances, may be almost immediate.

A few years ago, Massachusetts added a general sales tax to liquor sales. Because RI liquor stores were now in a much more competitive position, many of them saw an immediate increase in revenues, and immediately many businesses hired new staff or expanded hours of existing staff. More people, working more hours.

A year or so later, after Bay State businesses complained about the loss of customers, Massachusetts reversed course and once again exempted liquor sales from its general sales tax. Again, almost immediately, Rhode Island liquor stores saw their revenues drop back, and had to cut back on employment levels. Fewer people, working fewer hours.

The sales tax is a highly sensitive tax, when it comes to cross-border shopping. The effects are real and they are immediate. It affects the job security of real people and they impact the success - or not - of thousands of small businesses. Scott Moody will discuss this point in more detail next.

A little bit later on you will hear testimony from Vincent Bilotti, one such liquor store owner, who will attest to the reality and immediacy of how this type of tax reform affected jobs at his small business.

Once again, I ask you to not to focus solely on numbers and budgets, but on the effects tax policy has on the lives of real people.

So this year, in January, when Governor Patrick announced his plan to reduce the Bay State's sales tax to 4.5% - many in our business community understood the potential negative impact of this on RI's retail business, and all of a sudden our Zero.Zero report started to gain attention.

If Massachusetts is looking to instigate a sales tax border war with RI and its other neighbors, then we must not sit idly by. How about we go on offense for once ... for RI families and for RI small business owners?

Given all the economic problems we face here in the Ocean State, a sales tax-dagger from the Bay State, this year or in the future, would only make our RI Death Spiral even worse, with even more RI license plates ending up in Mass. parking lots.

But let me make a critical point – even if Mass. does NOT enact its sales tax reduction, RI's dismal economic situation is still in need of bold reform to our state sales tax.

If Massachusetts were to enact Governor Patrick's proposed cut, our hand, here in RI, would almost be forced at that point to do something. How about turning the tables? How about playing to WIN for once for our businesses and families ... imagine parking lots of RI businesses filled with cars from Massachusetts!

Imagine the ads and sales pitches our Chambers of Commerce and our state could make.

Internet Sales Tax: an Opportunity for Rhode Island?

One added possibility: the Internet Sales Tax debate at the national level could provide an interesting opportunity for Rhode Island. As mentioned earlier, shoppers will immediately change their buying routines if they are incentivized to do so. With the imposition of an Internet sales tax, more shoppers will shift their purchasing habits away from the internet and back towards brick-and-mortar stores on the ground ... on the ground in one state or another. But which states?

If RI does nothing with its sales tax, and Internet Sales Tax is enacted, New Hampshire will see an even larger retail boom. However, if we were to also offer a no-sales tax alternative, Rhode Island would undoubtedly earn a large share of this new, land-based shopping boom.

Rhode Island is nothing, if not a giant border county: so cross-border shopping is a reality. But also considering all of the pass-through drive traffic between New York, Connecticut and Boston: imagine this scenario: online surfers on the internet-highway being converted into in-store shoppers from our interstate highways ... buying right here from Rhode Island businesses. Let's put our state in a position to capitalize on this possibility.

Questions?

Mr. Chairman, at your discretion, I am happy to take questions now, or may I suggest that we wait until the rest of this panel presents other pertinent testimony that complements my remarks. I thank all committee members for your time today, and I offer the services of our Center to this committee if we can be helpful to you in the future.