

A Review of Rhode Island's Business Climate and Cost of Doing Business Rankings

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Introduction

Over the past few months, Rhode Island policymakers have initiated myriad reforms related to the state's role in economic development. Despite these steps toward reform, the state's overall role in economic development is often contested. As defined by the world's largest membership organization for economic development professionals, the International Economic Development Council (IEDC), economic development is a collection of policies that government undertakes to: meet overarching economic growth objectives such as inflation control; provide services and infrastructure; and improve the business climate. Business climate is described as the ways in which "state, regional, and local policies support business development," which is enhanced when business investors have lower risk and higher returns for investing in a geographic area. This report attempts to analyze and compare the factors associated with business climate.

In an effort to determine the risks and returns of developing business in a region, competitiveness rankings were developed around the 1970's. These rankings aim to measure and compare the business climates of particular geographic areas, most often at the state level. Today, most business climate studies measure factors impacting business development that may or may not be controlled by local, state, or federal government policies. Though these studies have become more widespread over the past few decades, there is little evidence to suggest that these indices are predictive of economic growth, outcomes. However, the rankings affect public perception and public policy agenda setting.

For this reason, states should understand the dynamics and indicators explored in these rankings. In particular, states should not only analyze how they rank, but which of the factors are within their policy control. For example, there are some factors such as weather, geography, or local industry mixes, that may affect economic growth but are not within policymakers' short-and medium-term control. However, there are some factors, such as the cost-of-doing-business, which often include factors under state policy control.

The following RIPEC report introduces the ways in which state-level business climates are compared in these rankings, and analyzes how Rhode Island compares nationally and regionally. Additionally, it defines and measures factors related to Rhode Island's relative cost of doing business. Two of the overall business climate rankings examined were performed by research organizations – (the Tax Foundation's "2013 State Business Tax Climate Index", The Beacon Hill Institute's "Eleventh Annual State Competitiveness Report") – and two performed by media outlets (CNBC's "Top States for Business 2011," and *Forbes's* "Best States for Business 2012"). The two cost-of-doing-business studies examined in this report are "Location Matters" by the Tax Foundation and KPMG, and "Competitiveness of State and Local Business Taxes on New Investments" by the Council on State Taxation (COST) and Ernst and Young. While each of these studies factors different variables, Rhode Island ranks poorly throughout most rankings.

Rhode Island cannot improve its relative standing without a thorough examination of the ways in which the state fares on factors comprising business climate. This report attempts to begin this conversation by benchmarking and comparing the state's status in existing rankings.

**Table 1
New England Business Climate Rankings**

Category	Weight	Connecticut			Maine			Massachusetts			New Hampshire			Rhode Island			Vermont					
		2010	2011	2012	2013	2010	2011	2012	2013	2010	2011	2012	2013	2010	2011	2012	2013	2010	2011	2012	2013	
CNBC Rankings:																						
Cost-of-doing-business	14%	--	45	46	--	26	19	--	41	49	--	37	35	--	46	45	--	--	42	38	--	
Workforce	14%	--	33	40	--	44	45	--	31	32	--	40	44	--	26	46	--	--	37	41	--	
Quality of Life	14%	--	11	12	--	6	4	--	10	11	--	2	1	--	24	23	--	--	3	3	--	
Economy	13%	--	44	40	--	34	42	--	15	21	--	10	34	--	42	49	--	--	21	27	--	
Transportation	13%	--	43	43	--	448	42	--	29	45	--	45	46	--	49	50	--	--	49	48	--	
Technology & Innovation	9%	--	19	18	--	40	35	--	3	7	--	29	26	--	27	37	--	--	40	43	--	
Education	9%	--	3	2	--	9	6	--	4	3	--	7	8	--	24	23	--	--	4	4	--	
Business Friendliness	8%	--	40	33	--	32	21	--	15	29	--	6	2	--	48	49	--	--	34	25	--	
Access to Capital	4%	--	17	15	--	30	46	--	2	1	--	20	19	--	35	10	--	--	32	23	--	
Cost of Living	2%	--	47	48	--	39	39	--	41	41	--	40	40	--	43	44	--	--	42	42	--	
Overall Ranking	100%	--	39	44	--	40	35	--	6	28	--	17	19	--	50	50	--	--	44	39	--	
Forbes Rankings:																						
Cost-of-Doing-Business		45	47	47	--	44	40	--	50	49	--	40	45	--	41	40	41	--	42	43	45	
Labor Supply		17	19	23	--	26	28	34	--	10	18	9	20	--	34	38	38	--	16	15	19	
Regulatory Environment		39	42	37	--	48	45	46	--	13	23	42	41	--	50	50	50	--	45	47	49	
Economic Climate		23	17	35	--	45	42	44	--	22	14	8	22	--	50	49	49	--	39	38	31	
Growth Prospects		35	36	31	--	44	50	49	--	28	17	16	16	--	23	17	28	--	45	44	46	
Quality of Life		3	2	3	--	16	17	17	--	1	1	1	6	--	17	18	18	--	15	15	14	
Overall Ranking		36	35	39	--	50	50	50	--	16	18	17	19	27	49	48	49	--	45	45	44	
Tax Foundation Index Rankings:																						
Individual Income Tax	33%	24	31	31	31	40	30	27	14	15	15	9	9	9	38	43	36	37	41	46	47	47
Sales Tax	21%	27	28	30	30	6	10	10	26	17	17	2	1	1	13	27	24	25	14	14	14	14
Corporate Tax	20%	18	19	25	35	43	47	41	47	37	34	50	46	46	36	41	40	42	28	42	41	43
Property Tax	14%	48	49	50	50	41	41	38	45	46	47	40	42	41	47	48	46	46	44	43	43	48
Unemployment Tax	11%	34	32	32	31	40	43	40	49	49	49	39	38	39	50	50	50	50	18	18	19	22
Overall Ranking	100%	38	40	40	40	34	38	37	36	28	24	7	6	6	44	47	46	46	41	43	47	47
Beacon Hill Inst. Rankings:																						
Govt. & Fiscal Policy		48	39	--	--	41	42	--	34	27	--	16	9	--	42	31	--	--	29	40	--	--
Security		6	4	--	--	20	25	--	15	22	--	22	15	--	2	6	--	--	21	12	--	--
Infrastructure		10	15	--	--	38	45	--	40	29	--	44	48	--	34	34	--	--	50	50	--	--
Human Resources		9	8	--	--	13	11	--	1	1	--	6	4	--	18	23	--	--	3	3	--	--
Technology		44	50	--	--	47	46	--	1	1	--	11	10	--	8	4	--	--	4	3	--	--
Business Incubation		8	8	--	--	25	20	--	11	12	--	6	24	--	32	34	--	--	40	40	--	--
Openness		39	33	--	--	43	43	--	9	9	--	38	31	--	21	21	--	--	16	13	--	--
Environmental Policy		28	26	--	--	4	1	--	40	28	--	12	16	--	35	30	--	--	5	5	--	--
Overall Ranking		28	26	--	--	32	28	--	3	1	--	10	11	--	20	19	--	--	19	14	--	--

Business Climate

As table 1 indicates, there is no single consensus about what factors should be included in the definition of business climate. Though the four major business climate studies use different combinations of categories in their climate rankings, indicators such as tax burden, regulatory environment, and workforce are consistently used across studies.

CNBC's "Top States for Business, 2012"

Rhode Island Rank: 50th

CNBC is a cable and satellite business news channel owned by NBC Universal. The network and its international affiliates cover business headlines and provide live coverage of financial markets. CNBC has been issuing its annual "Top States for Business" report since 2007. The analysis is based on an index that consists of the following ten categories (in order of importance): cost of doing business, workforce, quality of life, the overall state of the economy, transportation and infrastructure, technology and innovation, education, business friendliness, access to capital, and cost of living. Each state receives a raw score in each category, and this raw score is used to create a categorical rank from one to 50. The overall rank consists of a weighted average across the ten categories.

Category	Weight	Connecticut			Maine			Massachusetts			New Hampshire			Rhode Island			Vermont		
		2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Cost of Doing Business	14%	47	45	46	38	26	19	39	41	49	34	37	35	45	46	45	42	42	38
Workforce	14%	42	33	40	47	44	45	23	31	32	38	40	44	25	26	46	36	37	41
Quality of Life	14%	2	11	12	6	6	4	6	10	11	4	2	1	33	24	23	3	3	3
Economy	13%	30	44	40	25	34	42	17	15	21	12	10	34	49	42	49	12	21	27
Transportation	13%	43	43	43	41	48	42	39	29	45	47	45	46	48	49	50	46	49	48
Technology & Innovation	9%	22	19	18	41	40	35	3	3	7	27	29	26	28	27	37	40	40	43
Education	9%	9	3	2	7	9	6	1	4	3	6	7	8	14	24	23	4	4	4
Business Friendliness	8%	20	40	33	28	32	21	14	12	29	9	6	2	48	48	49	37	34	25
Access to Capital	4%	17	17	15	40	30	46	2	2	1	16	20	19	23	35	10	40	32	23
Cost of Living	2%	43	47	48	39	39	39	40	41	41	39	40	40	40	43	44	43	42	42
Overall	100.0%	35	39	44	39	40	35	5	6	28	19	17	19	49	50	50	37	44	39

SOURCE: CNBC Best States for Business - 2012

Table 2 shows how the six New England states ranked in each of the ten categories and overall in 2010-2012. The table also shows the weight that CNBC gives to each ranking category, which was used to calculate each state's overall score. Rhode Island ranked 50th overall in both 2011 and 2012, down from 49th in 2010.

In all three years, the state ranked lower than other New England states. Across all six states, from 2011 through 2012, Vermont and Maine were the only states that increased in the rankings: Connecticut ranked 39th in 2011 and 44th in 2012 and Massachusetts ranked 6th in 2011 and 28th in 2012. Notably, no New England state ranked in the top ten in 2012 (though Massachusetts ranked 6th in 2011).

In all three years, Rhode Island ranked in the bottom ten states in five categories and ranked in the top half of the country in three categories in 2012: quality of life (23rd), education (23rd), and access to capital (10th). Between 2010 and 2012, Rhode Island fell by 21 rankings in the workforce category (25th in 2010 to 46th in 2012). The state also fell by nine rankings in the technology and innovation category (28th in 2010 to 37th in 2012) and the education category (14th to 23rd). The study provided a summary of the factors considered within each ranking as summarized below:

- Cost-of-Doing-Business: This category includes tax burden, business taxes, utility costs, wages and workers' compensation insurance, and rental costs. Each New England state except Maine ranked in the bottom half of the country in this category. Rhode Island's ranking of 45th in 2012 was the third lowest in New England, and only ranked above Connecticut (46th) and Massachusetts (49th).
- Workforce: This category includes the quality and availability of the workforce, union membership, government-sponsored training programs and the relative success of such worker training programs in job placement. Between 2011 and 2012, Rhode Island's ranking dropped by 20 positions, from 26th to 46th.
- Quality of Life: This category includes several factors such as local attractions, crime rate, health care, air and water quality, and perceived livability. In general, the New England states ranked higher than the rest of the country in this category – with three New England States ranking in the top ten (Maine, New Hampshire and Vermont). Rhode Island's ranking, 23rd, has improved by ten positions since 2010, when it ranked 33rd.
- Economy: CNBC looked at the diversity of each state's economy (the variety of industries as well as access to, and number of, large companies within those industries), as well as a variety of indicators of economic vitality and growth. In 2011, CNBC began measuring fiscal health by considering projected state budget gaps for the coming fiscal year. In 2012, New England rankings in this category ranged from a low of 49th in Rhode Island to a high of 21st in Massachusetts. Of note, between 2010 and 2011, Rhode Island improved its ranking in this category, from 49th to 42nd.
- Transportation: CNBC evaluated the cost of goods transported (by air, land and water), as well as availability of air travel and quality of roads. In general, New England performed poorly in this category, as each state ranked in the bottom ten states. Rhode Island ranked last in the nation.
- Technology and Innovation: Included in this category is how well states support innovation, the number of patents issued to residents, the deployment of broadband services, and federal health and science research grants. Rhode Island ranked 27th in 2011 and 37th in 2012 in this category, out-performing only Vermont across the New England states. Of the six New England states, only Massachusetts ranked in the top ten in 2012.
- Education: CNBC's ranking is based on traditional metrics of K-12 education performance (e.g., test scores, class size and spending), as well as the number of higher education

institutions throughout the state. Generally, New England performs well in this category, as every state but Rhode Island ranked in the top ten nationally. Rhode Island, which ranked 14th in 2010 ranked 23rd in 2012.

- Business Friendliness: This category includes data regarding legal and regulatory frameworks for businesses. Rhode Island's rank of 49th in this category in 2012, and 48th in 2011, was the lowest of all the states in the region. New Hampshire, which was ranked the highest in New England, ranked 2nd in the country in 2012, up from 6th in 2011. Massachusetts was the only state in New England aside from Rhode Island to see their ranking decline between 2011 and 2012 (from 12th in 2011 to 29th in 2012).
- Access to Capital: This category assesses the flow of venture capital into states. Every New England state except Maine ranked in the top half of states in this category (Connecticut – 15th, Massachusetts – 1st, New Hampshire – 19th, Rhode Island – 10th and Vermont – 23rd). In 2012, Rhode Island saw a significant improvement from its 2011 ranking (10th in 2012, 35th in 2011).
- Cost of Living: CNBC notes that “[from] housing to food, to energy, wages go further when the cost of living is low.” All of the New England states fared poorly in this category and, with the exception of Maine, ranked in the bottom ten states in the country in 2012. Rhode Island's rank of 44th in 2012 was lower than Maine (39th), Massachusetts (41st), New Hampshire (40th) and Vermont (42nd). However, Rhode Island outperformed Connecticut (48th) in this category.

Forbes “The Best States for Business, 2012”

Rhode Island's Rank: 49th

Forbes is a privately owned publication and media company. Its main publication, the bi-weekly *Forbes Magazine*, has been in print since 1917. Their survey, “The Best States for Business” is an annual ranking that measures each state through the six “vital” categories of cost, labor supply, regulatory environment, current economic climate, growth prospects and quality of life. These six categories encompass thirty-three points of data used to determine the overall rank. Though Rhode Island improved from 49th in the nation to 48th between 2010 and 2011, the state's ranking dropped back to 49th in 2012.

- Business Costs: Costs to businesses, which include labor, energy and taxes, are weighted heavily in the Forbes rankings. The publication incorporates Moody's Analytics “cost-of-doing-business” index, along with the Tax Foundation state tax index. The cost of doing business in Rhode Island ranked 41st in the nation in 2012 according the Forbes study. Although all six New England states were in the bottom ten on the cost of doing business measure, Rhode Island was ranked the second-highest among them, only out-ranked by Maine (40th). The report shows little change from New England's rankings by Forbes in previous years.
- Labor Supply: The labor supply ranking uses high school and college degree attainment rates, as well as net migration and projected population growth, based on Census information.

Rhode Island ranked 38th in the country in this category in 2011 and 2012, after ranking 34th in 2010. Only Massachusetts, New Hampshire and Vermont ranked in the top 20 positions in the US for this category in 2012 - a change from 2011 when every New England state except for Maine and Rhode Island ranked in the top 20 positions for labor supply.

- **Regulatory Environment:** The regulatory environment in the Forbes rankings measures the regulatory and tort climate, business incentives, transportation infrastructure, and bond ratings. The metric uses data from a variety of sources, including Moody’s bond rating for state general obligation debt and the regulatory component of the Pacific Research Institute’s U.S. Economic Freedom Index. New England has historically performed poorly in the regulatory environment category of this Index; every New England state ranked in the bottom half of the country in the most recent Forbes survey. Rhode Island ranked 50th in 2010, 2011 and 2012.

Category	Connecticut			Maine			Massachusetts			New Hampshire			Rhode Island			Vermont		
	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
Cost of Doing Business	45	47	47	47	44	40	50	50	49	40	45	44	41	40	41	42	43	45
Labor Supply	17	19	23	26	28	34	10	18	9	6	8	20	34	38	38	16	15	19
Regulatory Environment	39	43	37	48	45	46	13	23	42	47	38	41	50	50	50	45	47	49
Economic Climate	23	17	35	45	42	44	22	14	8	32	34	22	50	49	49	39	38	31
Growth Prospects	35	36	31	44	50	49	28	17	16	5	12	29	23	17	28	45	44	46
Quality of Life	3	2	3	16	17	17	1	1	1	2	5	6	17	18	18	15	15	14
Overall	36	35	39	50	50	50	16	18	17	19	27	32	49	48	49	44	45	44

SOURCE: Forbes Best States for Business 2010 - 2012

- **Economic Climate:** To measure the economic climate of a given state, Forbes uses growth in jobs, income and gross state product, as well as the unemployment rate and the presence of large companies in each state. Rhode Island ranked 49th in the nation in the category in 2011 and 2012, up one place from 2010 when the state ranked last in the country. Neighboring states Connecticut and Massachusetts ranked 35th and 8th in the nation, respectively. In 2012, every New England state except for Massachusetts and New Hampshire ranked in the bottom half of the country in this category.
- **Growth Prospects:** The growth prospects rank uses Moody’s projections of job, income and gross state product growth. The survey also evaluates a given state’s business openings and closings and the presence of venture capital investment. Rhode Island ranked 17th in the “prospect for growth” category, tied with Massachusetts. Rhode Island’s 2011 ranking was six places higher than the state’s 2010 rank. Connecticut, Maine, and Vermont all ranked in the bottom half of the country in 2011.
- **Quality of Life:** Forbes ranks quality of life through an index based on poverty rates, cost of living, school performance, health, and crime, using data from the Bureau of Economic Analysis, Moody’s, the US Department of Education, the United Health Foundation, and the

FBI. Forbes also looked at culture and recreation opportunities using an index created by the organization. Although Rhode Island ranked 18th in 2011 and 2012 for quality of life, it continues to lag behind the other New England states. Notably, Connecticut, Massachusetts and New Hampshire consistently rank in the top 10 in the country.

The Tax Foundation’s 2013 State Business Tax Climate Index
Rhode Island Rank: 46th

The Tax Foundation is a nonpartisan research group whose mission is to educate taxpayers about sound tax policy and the size of the tax burden borne by Americans. The Tax Foundation annually publishes the State Business Tax Climate Index (SBTCI), which attempts to measure the “business-tax friendliness” of each state’s tax system. In general, states that operate economically neutral and simple tax systems fare much better in the SBTCI than states that rely on complex and multi-rate tax codes. The most recent version of the study was published in October 2012.

Unlike other business climate indices that produce rankings using numerous categories such as taxation, regulation, workforce, and living environment, the SBTCI relies exclusively on tax-related factors. The Tax Foundation acknowledges that non-tax factors play a role in shaping a state’s business climate, but the Foundation puts an emphasis on taxation because of the capacity of lawmakers to change a state’s taxation policy compared with other factors that may take years to fully implement. Furthermore, tax policy changes are often phased-in, and take time to generate results.

Table 4
New England Rankings
Tax Foundation Study - 2013

Category	Weight	Connecticut			Maine			Massachusetts			New Hampshire			Rhode Island			Vermont		
		2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
Individual Income Tax	33%	31	31	31	30	30	27	15	15	15	9	9	9	43	36	37	46	47	47
Sales Tax	21%	28	30	30	10	10	10	17	17	17	1	1	1	27	24	25	14	14	14
Corporate Tax	20%	19	25	35	47	47	41	37	34	33	46	46	48	41	40	42	42	41	43
Property Tax	14%	49	50	50	41	38	39	46	47	47	42	41	43	48	46	46	43	43	48
Unemployment Tax	11%	32	32	31	43	40	32	49	49	49	38	39	42	50	50	50	18	19	22
Total/Overall	100%	40	40	40	38	37	30	28	24	22	6	6	7	47	46	46	43	47	47

SOURCE: The Tax Foundation

Each state’s ranking in the SBTCI is based on how it competes in five taxation categories: corporate taxes, individual income taxes, sales taxes, property taxes, and unemployment taxes. Each category consists of two sub-indices (generally rate and base), which are also broken down into multiple categories. A weighting factor is applied to each primary category based on the level of variability across states with respect to their scores. That is, the wider the range in scores, the heavier the weight for that particular category.

Despite improvement over the state's 2011 ranking of 47th, Rhode Island ranked 46th overall in the FY 2013 SBTICI – placing it once again among the ten worst business climates in the country. The state's ranking has improved in recent years, from 50th in FY 2006 and 47th in FY 2011. Vermont was the only other New England state to rank lower than Rhode Island in 2013, ranking 47th overall, down from 43rd in the 2011 index. Table 4 shows how each New England state ranked overall and in each sub-category in the 2011-2013 indices.

- Individual Income Tax: States are ranked on the basis of their performance in two sub-indices: tax rate/structure, and tax base. Many businesses, such as sole proprietorships, partnerships, and S-corporations pay the individual income tax, rather than corporate tax, making the individual income tax an important factor in a state's business climate. Rhode Island ranked 37th overall, and of New England, had a more favorable individual income tax ranking than Vermont (47th). Similar to the federal income tax code, the state's personal income tax system includes three brackets and a top rate of 5.99 percent, which begins at the \$129,000 income level. Of the states that levy personal income taxes, Rhode Island's top rate (5.99 percent) is the 3rd highest.
- Sales Tax: Despite having one of the highest state sales tax rates in the country (7.0 percent, tied for 2nd highest with four other states) Rhode Island ranked 25th overall in this category. The state's high general sales tax rate, and high excise tax rates, coupled with a narrow base, put businesses in Rhode Island at a competitive disadvantage according to the Tax Foundation. At the same time, the state received high marks for lacking local option sales taxes and exempting a large number of "business-to-business inputs".
- Corporate Income Tax: Though Rhode Island has the 6th highest rate in the country (9.0 percent), in 2013 the state ranked 42nd in the nation – in front of New Hampshire (48th) and Vermont (43rd). Rhode Island's 2013 ranking declined from 2012, when the state ranked 40th for the corporate income tax. Although no changes have been made to the state's corporate income tax, changes in other states helped Rhode Island's rank in this category.
- Property Taxes: The Foundation also looks at eight kinds of property taxes (property, intangible personal property, inventory, and five asset transfer taxes: estate, generation-skipping, inheritance, gift and real estate transfer taxes), as well as capital stock taxes. Rhode Island was among the worst-performing states on the indicator, ranking 46th in the country. Factors which affected the state's ranking include high property tax collections both on an absolute basis and as a share of personal income, the state's capital stock structure (despite having one of the lower rates among states that levy a capital stock tax, a slight majority of states do not levy the tax), and the decoupling of the estate tax system from the federal system.
- Unemployment Insurance Tax: In the past eight SBTICI reports, Rhode Island has ranked 50th in the unemployment insurance tax category. The state's high minimum and maximum rates (1.9 percent and 10.0 percent, respectively), above-average taxable wage threshold (\$19,600), and complicated experience formula and charging methods (the determination of the employer who is charged the benefit) contribute to the state's low ranking. Mandatory Temporary Disability Insurance (TDI) and a lack of voluntary contributions also hurt the state's unemployment insurance tax ranking.

Beacon Hill Institute “State Competitiveness Rankings”
Rhode Island Rank: 19th

The Beacon Hill Institute (BHI) is a research organization that operates out of Suffolk University in Boston. Founded in 1991, the Beacon Hill Institute performs research on tax analysis, education, government accountability and regulation, and state competitiveness. Since 2001, the Beacon Hill Institute’s “State Competitiveness Ranking” has focused on measuring the long-term competitiveness of each state. The competitiveness report produced by BHI ranks each state through a series of metrics that examine government and fiscal policy, crime rates, the quality of infrastructure, the availability of technology, the quality of the workforce, environmental regulations, and business viability at the state level. The organization ranks states using such indices, using a scale of zero to ten for each category – zero being not competitive to ten being highly competitive. The sum of the indices determines the rankings of the states.

Category	Connecticut			Maine			Massachusetts			New Hampshire			Rhode Island			Vermont		
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011
Govt. & Fiscal Policy	48	48	39	45	41	42	30	34	27	17	16	9	37	42	31	43	29	40
Security	15	6	4	16	20	25	22	15	22	25	22	15	20	2	6	44	21	12
Infrastructure	41	42	43	38	38	45	40	40	29	43	44	48	42	34	34	33	50	50
Human Resources	8	10	15	13	13	11	1	1	1	6	6	4	22	18	23	3	3	3
Technology	9	9	8	24	47	46	1	1	1	11	11	10	7	8	4	3	4	3
Business Incubation	35	44	50	15	25	20	4	11	12	12	6	24	32	32	34	38	40	40
Openness	11	8	8	44	43	43	8	9	9	38	38	31	25	21	21	16	16	13
Environmental Policy	38	39	33	3	4	1	37	40	28	12	12	16	32	35	30	5	5	5
Overall Ranking	26	28	26	23	32	28	1	3	1	15	10	11	29	20	19	18	19	14

SOURCE: Beacon Hill Institute, Eleventh Annual State Competitiveness Report

In the 2011 BHI analysis, Rhode Island ranked 19th overall. All New England states except for Connecticut (26th) and Maine (28th) ranked in the top half of the country. Massachusetts (1st), New Hampshire (11th), and Vermont (14th) ranked higher than the Ocean State in this study. Rhode Island’s rank of 19th was a notable improvement over the 2009 rankings when the state ranked 29th overall, the worst showing of all New England states.

The following is a summary of the eight sub-indices used by the Beacon Hill Institute to create their overall long-term competitiveness rankings, along with a look at Rhode Island’s performance in each category.

- **Government and Fiscal Policy:** The government and fiscal policy ranking uses state and local taxes per capita, worker compensation rates, bond ratings, budget surplus/deficits, and state and local government employees per 100 residents to determine rank. Rhode Island’s rank of 31st was the third best in the region (behind Massachusetts, which ranked 27th and New Hampshire, which ranked 9th). New Hampshire was the only New England state that ranked in the top half of the country. Between 2010 and 2011, the Ocean State improved by eleven

places in the rankings. In 2011, Rhode Island received positive marks for its projected budget deficit as a percent of gross state product and full-time public workers as a share of the population, but BHI noted that competitive disadvantages include taxes, the state's bond rating and average unemployment benefits.

- **Security:** The security index uses crime rates, the change in crime rates, and murders per 100,000 inhabitants. The study also uses the BGA Integrity Index, which measures the relative strength of existing transparency, ethics and accountability laws (e.g., open meeting, whistleblower protection, and conflict of interest laws). Rhode Island was ranked 6th highest in this category, up from 20th in the 2009 analysis, but down from 2nd highest in the 2010 rankings. This was the state's second highest ranking across all sub-indices.
- **Infrastructure:** The infrastructure index in the BHI rankings considers access to air travel, high-speed rail lines, average commute, cell phone usage, electricity prices, and monthly housing costs state by state. Rhode Island ranked 34th in the nation, the second highest in New England behind Massachusetts (29th). The state's competitive advantages include the share of high-speed lines relative to the state's population and average travel time to work. Notable disadvantages include electricity prices and rental housing costs.
- **Human Resources:** The human resources index uses health insurance data, education measures, infant mortality rates, unemployment rates, and school outcomes to determine each state's ranking in this category. Rhode Island was ranked 23rd in the nation, the lowest of the New England states. Massachusetts (1st), Vermont (3rd), New Hampshire (4th), Connecticut (15th), and Maine (11th) all ranked higher in the human resources category. Additionally, the state's 2011 rank represents a decline over its 2010 ranking of 18th. Competitive advantages include access to health insurance and healthcare, the share of the population enrolled in a degree-granting institution, and the rate of active physicians as a share of the population. Disadvantages, however, include the share of the adult population that graduated from high school and the state's high unemployment rate.
- **Technology:** The technology index examined research and development, National Institute of Health (NIH) grants to support institutions in the state, patents, the number of science and engineering graduates, and employment in high-tech industries. In this sub-index, Rhode Island ranked 4th in the nation, behind Massachusetts (1st) and Vermont (3rd), but ahead of Connecticut (8th), Maine (46th), and New Hampshire (10th). The institute did not note any competitive disadvantages for Rhode Island in this category. On the positive side, Rhode Island ranked 3rd in the country for NIH support and science/engineering degrees per 100,000 residents.
- **Business Incubation:** This measurement reflects the ability for businesses to acquire finances for investment and also considers the rate at which businesses are created within each state. Rhode Island ranked 34th in the nation in 2011. The state out-performed neighboring state Connecticut, which was ranked 50th, and Vermont, which ranked 40th. Rhode Island was out-performed by Maine (20th), Massachusetts (12th), and New Hampshire (24th). The state received positive marks for firm births, bank deposits, and venture capital per capita; however, BHI also noted that union membership, the minimum wage, and the cost of labor put the Ocean State at a competitive disadvantage.

- Openness: The openness index uses exports per capita, incoming foreign direct investments per capita, and percentage of population born abroad to gauge how connected firms and people in the state are with the rest of the world. Rhode Island was ranked 21st in the nation, behind Connecticut (8th), Massachusetts (9th), and Vermont (13th). Maine (43rd) and New Hampshire (31st) were ranked lower than the Ocean State in the 2011 index. While Rhode Island has a high level of direct foreign investment and a large share of the population born abroad, the state ranked 41st in the country in terms of dollars of exports per capita.
- Environmental Policy: The environmental policy index looks at environmental problems within states and environmental regulations that influence business location decisions. This index examines air quality, toxic release inventory (in pounds/1,000 square miles), and carbon emissions. The Ocean State was ranked 30th in the nation, faring better than Connecticut (33rd). Maine was ranked highest in the nation, followed by Vermont (5th) and New Hampshire (16th). Rhode Island's high carbon emissions – ranking 49th in the country – contributed to the state's relatively poor ranking in 2011.

Summary

Rhode Island often ranks at or near the bottom of business climate rankings – the result of tax policies and a regulatory environment that businesses consider to be among the nation's most burdensome, as well as the high cost of doing business, poor transportation infrastructure, and weak economy. The Beacon Hill Institute ranked Rhode Island as the 19th best state to do business in, an exception to the other three studies, which ranked the state in the bottom 10 of business climate rankings.

As indicated by Rhode Island's relatively better performance in the Beacon Hill Institute study, the Ocean State's economy has the potential to become more competitive. However, before policymakers can enhance the state's strengths and reform policies related to its weaknesses, they must have an understanding of its relative status on each business climate measure. Once areas for improvement are established, policymakers must identify the specific actions that will help enhance the state's economic profile.

Taxes

The cost-of-doing-business – a category that broadly includes taxes, labor costs, utilities, and real estate costs – is weighted heavily in business climate studies and is an area in which Rhode Island has the most opportunity to improve its position in national rankings. Taxes are one of the most significant components of the costs of doing business in a state and are an area in which Rhode Island has some of the most opportunity for improvement.

The CNBC and Forbes studies factor the cost of doing business into their analyses, while the Tax Foundation report focuses on specific tax policy factors related to the cost of doing business. Two other recent studies specifically focus on comparing the impact of state taxation policies and states' costs of doing business. These studies illustrate that although several factors impacting the cost of doing business - such as utility prices - may be out of the state's control, others - such as health care regulation, minimum wage and tax burden - are affected by policymakers' actions, and offer areas in which states may want to focus reform efforts.

Tax Foundation and KPMG, “Location Matters: A Comparative Analysis of State Tax Costs on Business”

Methodology

This study by the Tax Foundation and KPMG aims to provide an “apples-to-apples” comparison of corporate tax costs in each state for the following taxes paid by business: corporate income, property, sales, unemployment insurance, capital stock, inventory, and gross receipts. The model analyzes data for seven model firms twice in each state: once for new firms eligible for tax incentives, and once for mature firms not eligible for incentives (mature firms are categorized as those that are at least ten years old). It includes four ways to evaluate tax competitiveness: tax burden or total effective rate (TETR); the impact of incentives; relative measures of which states have lowest and highest average tax costs; and relative measures of which industries and firm-types have the lowest and highest tax burdens.

This study includes “two tiers” of geographies to help control for the fact that location plays a role in industry location decisions. Tier One sites are major cities, while Tier Two sites are mid-size cities with populations of less than 500,000. Under this categorization, of the seven model firms, three are in Tier One sites and four are in Tier Two sites. It is important to note that, while every other state is divided into these tiers, Rhode Island is not. [Due to RI’s small size, all analysis relates to the Providence metro area.] The seven model firms include: a corporate HQ or regional managing office; a scientific R&D facility; an independent clothing store; an independent telemarketing or call center; a distribution warehouse; a capital-intensive manufacturer, such as a steel company; and a labor-intensive manufacturer, such as a bus or truck company.

	Tier Two				Tier One			Average
	MC	ML	CC	DC	CO	RD	RT	
Connecticut								
TETR	9.6%	10.3%	32.1%	0.40.2	20.0%	0.18.3	34.1%	--
Index	84.0	88.4	128.8	111.3	123.7	124.2	104.6	109.3
Rank	25	18	37	34	40	35	29	30
Maine								
TETR	8.3%	12.5%	19.2%	36.2%	17.1%	10.6%	25.1%	--
Index	73.2	106.4	76.9	100.0	105.7	71.6	77.1	87.3
Rank	19	32	13	31	28	12	9	20
Massachusetts								
TETR	7.9%	13.1%	38.5%	60.2%	19.8%	21.2%	0.41.9	--
Index	69.5	112.0	154.5	166.5	122.7	143.7	128.4	128.2
Rank	17	37	46	49	39	42	43	43
New Hampshire								
TETR	7.7%	12.8%	0.29.7	36.1%	12.9%	14.2%	21.0%	--
Index	67.8	109.8	119.4	99.8	80.0	96.3	64.2	91.0
Rank	16	36	33	30	16	19	5	22
Rhode Island								
TETR	6.0%	13.2%	39.0%	54.6%	19.3%	23.9%	45.4%	--
Index	57.6	112.4	156.5	151.0	119.5	162.1	139.4	128.4
Rank	12	38	48	46	37	47	47	44
Vermont								
TETR	10.7%	11.3%	13.8%	24.2%	13.6%	10.9%	27.2%	--
Index	94.1	96.8	55.3	66.9	84.4	73.7	83.5	79.2
Rank	32	25	9	8	19	14	13	12

MC= Capital-Intensive Manufacturing Operation; ML= Labor-Intensive Manufacturing Operation; CC= Call Center; DC= Distribution Center; CO= Corporate Headquarters; RD= Research and Development Facility; RT= Retail Store
SOURCE: Tax Foundation & KPMG

Table 7
2012 Tax Foundation and KPMG- "Location Matters" Rankings
Mature Operations

	Tier Two				Tier One			Average
	MC	ML	CC	DC	CO	RD	RT	
Connecticut								
TETR	8.1%	7.6%	24.5%	30.7%	17.8%	12.0%	0.17.6	--
Index	64.0	65.6	116.8	100.3	113.2	93.4	103.9	93.9
Rank	9	6	38	29	42	21	32	21
Maine								
TETR	1.8%	14.6%	14.9%	30.7%	15.9%	8.4%	16.4%	--
Index	143.5	125.3	70.8	100.0	101.2	65.1	97.1	100.4
Rank	45	41	6	28	29	9	26	27
Massachusetts								
TETR	15.3%	15.6%	28.3%	44.2%	16.2%	14.1%	20.3%	--
Index	120.4	133.6	134.7	144.2	103.4	109.4	119.6	123.6
Rank	38	44	46	44	31	33	41	44
New Hampshire								
TETR	12.9%	12.6%	24.6%	31.0%	11.9%	13.1%	15.6%	--
Index	101.9	107.8	117.0	101.1	75.9	101.9	92.2	99.7
Rank	29	33	39	31	6	27	23	26
Rhode Island								
TETR	14.7%	16.2%	30.5%	45.3%	17.6%	14.1%	22.7%	--
Index	115.7	138.9	145.4	147.9	112.2	109.4	134.3	129.1
Rank	33	46	49	45	41	33	46	46
Vermont								
TETR	16.4%	13.3%	18.4%	28.8%	15.0%	13.0%	17.7%	--
Index	128.9	114.3	87.5	93.8	95.7	100.9	104.9	103.7
Rank	41	35	20	25	24	25	34	31

MC= Capital-Intensive Manufacturing Operation; ML= Labor-Intensive Manufacturing Operation; CC= Call Center; DC= Distribution Center; CO= Corporate Headquarters; RD= Research and Development Facility; RT= Retail Store
 SOURCE: Tax Foundation & KPMG

Tables 6 and 7 lists each New England state's TETR, index score, and rank for new operations and mature operations. This study defined TETR as including corporate net income taxes, capital taxes, unemployment taxes, sales taxes, property taxes, gross receipts taxes, and other general business taxes. The index shown is the effective tax rate divided by the national average within that firm type. A number above 100 in the index indicates that that state has an effective rate higher than the national average. The rank shown is based on an ordered list of the average index scores across the seven firm types for each state.

Rhode Island's Profile

In terms of newly established firms, Rhode Island ranks 44th overall—higher than its average for mature operations (46th). In both categories, Rhode Island ranks lower than every other New England state. For newly established firms, on average, Vermont ranked highest (12th), followed by Maine (20th), New Hampshire (22nd), Connecticut (30th) and Massachusetts (43rd).

Rhode Island ranked highest for newly established capital-intensive manufacturing operations (12th), more than 20 positions better than every other Rhode Island category and better than every other New England state. This study classifies capital-intensive manufacturing firms as those with initial capital investment of \$300 million and approximately 200 employees (including management, administrative, installation, maintenance, production, transportation, and materials). The study estimates that on average, the revenue of these types of firms is approximately \$200 million with 10 percent before-tax earnings. The Tax Foundation and KPMG suggest that these firms benefit from Rhode Island's property tax abatement program.

For mature firms, on average, Connecticut ranked highest (21st), followed by New Hampshire (26th), Maine (27th), Vermont (31st), Massachusetts (44th), and Rhode Island (46th). Rhode Island's average TETR index is 28.4 percent above the national average for newly established firms, and 29.1 percent above the national average for mature firms.

The Ocean State ranked lowest for mature call center operations. The study classifies these operations as “low-wage service businesses” that have 600 employees (including management, sales and administrative employees), and revenue of approximately \$29 million. Before tax earnings of these firms is approximately 7 percent. The authors suggest that Rhode Island’s low ranking is due to the 9.0 percent corporate income tax rate and throwback rule. Property taxes and unemployment insurance rates also partially explain the state’s low ranking in this category.

COST and Ernst and Young “Competitiveness of State and Local Business Taxes on New Investment”

Methodology

The Council on State Taxation (COST), and Ernst and Young, compiled an index that compares state and local business marginal tax burdens as they would be incurred by companies doing business in a state. To do this, the model defines five facility investment types: headquarters, research and development facilities, office and call center facilities, durable manufacturing facilities, and non-durable manufacturing facilities. It also includes estimates of major state and local taxes (including corporate income and alternative business income taxes, as well as sales, property, and net worth taxes). It then determines which tax features should be incorporated for each tax (ex. base and rate definitions).

Using estimated tax rates for a thirty-year period, they calculate an effective tax rate (ETR) for each facility type. The ETR for each investment is then weighted by employment and capital expenditures to determine rankings. Weighting by capital investment elevates the importance of the tax rate on investments by capital intensive industries (e.g. manufacturing). Alternatively, weighting by the number of jobs created puts more emphasis on the effect of taxes on labor intensive industries. It is important to note that this study uses FY 2009 tax data, and, therefore, does not reflect Rhode Island’s recent individual income tax reforms.

	Weighted by Capital Investment		Weighted by Jobs	
	ETR	Rank	ETR	Rank
Rhode Island	11.5%	49	13.4%	49
Connecticut	8.9%	38	9.4%	32
Maine	3.0%	1	4.3%	1
Massachusetts	8.2%	32	9.7%	34
New Hampshire	5.4%	7	5.9%	6
Vermont	7.8%	31	9.0%	29

*Uses 2009 data
SOURCE: COST and Ernst & Young, 2011

According to this study, Rhode Island’s ETR is the 49th highest in the nation, either when weighted by capital investment (11.5 percent), or when weighted by jobs created (13.4 percent). This differential suggests that the tax burden on capital intensive industries is lower than labor intensive industries. Only New Mexico had higher ETRs (16.6 percent capital intensive and 17.9

percent labor intensive). The next highest ETR in New England was Connecticut's at 8.9 percent for capital intensive industries, and 9.4 percent for labor intensive industries.

Alternatively, Maine's ETR was the lowest in the nation. Ernst & Young and COST attribute this to four factors: a single sales factor corporate income apportionment formula; an average property tax rate; a lack of a franchise tax; and a low combined state and local sales tax (5.0 percent compared to the national average of 6.2 percent).

RIPEC Comments

Rhode Island's economic recovery since the Great Recession has been uneven at best. The state's housing market is lagging, its unemployment is still the second highest in the nation, and national economic indicators show that the state's economic momentum is lower than regional peers and the national average. Further, while Rhode Island tends to fare better than the national average on some economic benchmarks, such as personal income, it often trails its regional peers the same indicators.

Factors such as a high tax burden and complicated regulatory environment have made it difficult for the state to create an attractive environment for businesses. While business location decisions are driven by a number of factors, including quality of life, cost of living, and quality of the workforce, taxation and regulatory environments are two areas in which states and municipalities are able to affect change, which, in turn, may help spur business investment. Moreover, as the studies reviewed in this report show, these are areas in which Rhode Island must make improvements if it is to reinvigorate its economy.

Rhode Island's business tax burden is higher than most other states. According to the Tax Foundation and KPMG "Location Matters" study, Rhode Island's average effective tax rate index is 28.4 percent above the national average for newly established firms and 29.1 percent above the national average for mature firms – higher than any other New England state and among the highest in the country. Similarly, according to the COST and Ernst and Young study, Rhode Island has the highest effective tax rate on the tax competitive index of all New England (11.5 percent when weighted by capital investment and 13.4 percent when weighted by jobs), and the second highest in the country and roughly 45 percent above the national average, by either measure.

As indicated by several of these studies, taxes are not the only component of the cost of doing business. The state's regulatory environment is another important factor, and one in which Rhode Island performs poorly. Forbes specifically included states' regulatory environments as an indicator in their overall ranking, measuring factors such as tort liability, the regulatory component of an economic freedom index, bond ratings, and right-to-work status: Rhode Island has ranked 50th over the past three years on this indicator. Another report, by the Small Business and Entrepreneurship Council, included a regulatory cost measure that ranked states based on their number of health insurance mandates. As of 2012, Rhode Island had 70 health insurance mandates, tying with Virginia for the most in the U.S.

It is important to recognize that policymakers have made positive changes over the past few years. The General Assembly enacted changes to the state's income tax structure in 2010. In

addition to reducing the number of brackets (from five to three), and lowering the top marginal rate from 9.9 percent to 5.99 percent, the state also eliminated a majority of credits, increased the standard deduction and made modifications to personal exemptions. The alternative flat tax option was also eliminated. The legislature has also continued to preserve the state's landmark property tax cap legislation, often referred to as S 3050, which limits growth in the levy to no more than 4.0 percent per year.

Relating to the state's regulatory burden, lawmakers recently passed several new policies to spur reform, including but not limited to, the creation of the Office of Regulatory Reform, which reviews and streamlines the regulatory process, and the creation of a single, uniform statewide building permit system. Together, these measures promote a more systematic approach to reducing the cost-of-doing-business in Rhode Island.

While these changes are steps in the right direction, these studies indicate that the Ocean State is in need of a comprehensive, long-term business climate strategy (see RIPEC's September 2012 study "Defining Government's Role in Economic Development in the Ocean state"). A thoughtful plan to reinvigorate the state's business climate, distinct from the piecemeal approaches of the past, will enable Rhode Island to compete in today's increasingly competitive economic environment. A significant part of this work will involve reforming the state's tax system. To this end, RIPEC recommends that state and local leaders develop a multi-year strategic tax plan with the objectives of:

- Lessening the overall tax burden;
- Ensuring a proper balance between state and local taxes;
- Reducing tax inequities among localities in the state;
- Equitably and efficiently funding public services, particularly education; and
- Improving Rhode Island's competitive position.

To assist in these efforts, RIPEC will publish a multi-part tax briefing series for 2013 focused on: sales taxes, income taxes, business taxes, and property taxes. These briefs will provide an overview of the state's current tax structure, and will highlight some issues that require further attention by policymakers. As Rhode Island moves forward, it is incumbent upon the state's leaders to focus attention on the overall structure of our state and local tax system, and how it fits into the overall strategic vision of the state, while providing for a sustainable and competitive tax structure.