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Rhode Island Unemployment

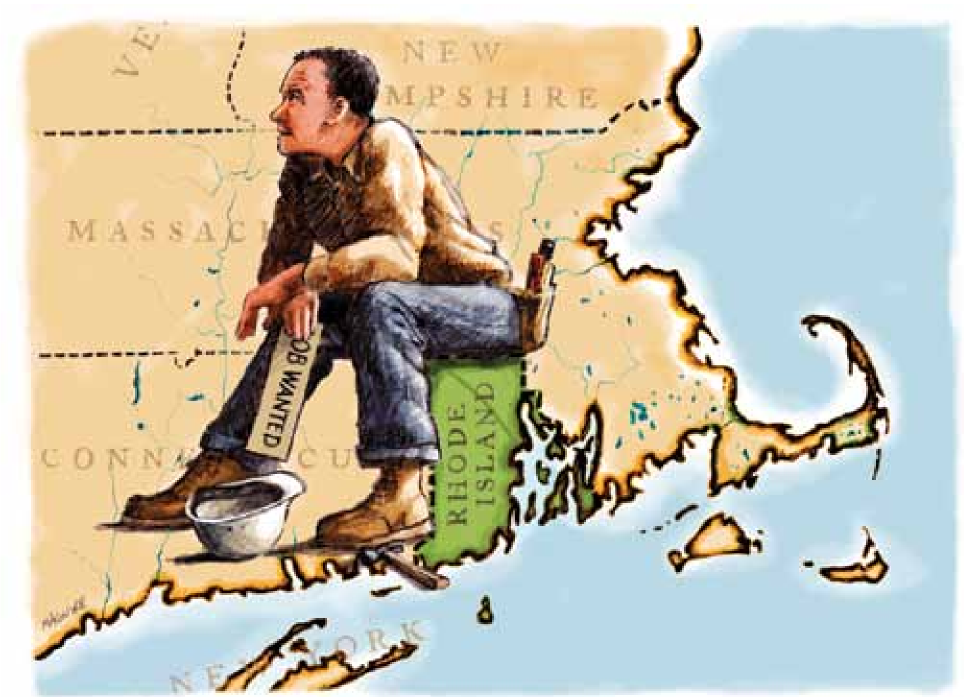

Illustration: Barrie Maguire

How can a state like Rhode Island have such a high unemployment rate? This question has been asked often over the past year, especially since at one point, Rhode Island found itself with the dubious distinction of having the highest unemployment rate in the United States. Following that extreme, Rhode Island seemed to settle into a niche where its rank was third nationally.

by Leonard Lardaro
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Multiyear Losses

The underlying causes for Rhode Island's very high unemployment rate are unfortunately not just cyclical. There are a host of structural obstacles within the state's economic environment that also play substantial roles. Taken together, they have produced an array of less than flattering statistics:

- Rhode Island's population began a prolonged period of decline in July 2004;
- Rhode Island was one of the first states to experience budget deficits, well before the start of its current recession;
- payroll employment in Rhode Island peaked in January 2007, a full 11 months before the national employment peak; and
- Rhode Island's economy lapsed into recession in June 2007, six months before the U.S. recession began.

The interaction of Rhode Island's structural negatives and the recent housing bubble produced its most severe economic crisis since the 1991 banking crisis.

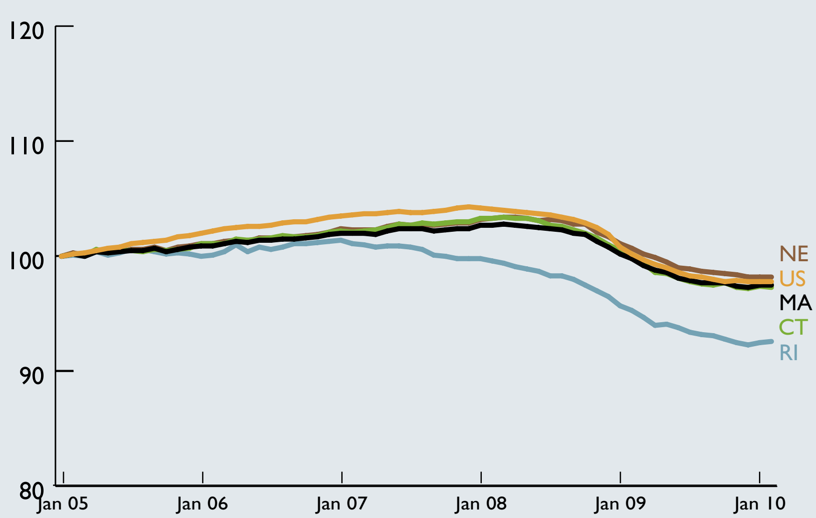
A look at payroll employment since 2005—as a percentage of the January 2005 value—for the United States, New England as a whole, and southern New England shows Rhode Island as the clear outlier. (See "Employment since 2005.")

Three observations stand out. First, Rhode Island's employment peak occurred far earlier than any of the others. Second, its employment gain through its peak was less than for the others. Finally, its employment fell faster and by a significantly greater percentage relative to its January 2005 base than did employment in the United States, New England, or the other southern New England states.

Rhode Island's employment behavior over this period is the joint result of both cyclical and longer-term or secular factors. Perhaps the most prominent cyclical factor affecting Rhode Island's labor market over this period was the housing bubble, although national weakness took its toll on manufacturing as well. Construction employment in Rhode Island rose by over 21 percent from 2002 through its peak in January 2007, well above the rates of growth for either the United States or New England for that period. After the January 2007 peak, construction employment in Rhode Island fell by 30 percent, and the combination of declines in construction and manufacturing employment (a loss of 18,400 jobs) accounted for 42 percent of the total decline in Rhode Island employment.

In addition to taxes, Rhode Island has competitiveness issues with its fees, regulations, electricity costs, and most important, the skills of its workforce.

Employment since 2005



Source: Federal Reserve Bank of Boston's Indicators Interactive.

What are the secular factors, the things that kept Rhode Island's prerecession employment gains below those of the other entities? Many people cite taxes as the lone culprit, but taxes are only part of the problem.

The problem for Rhode Island is more encompassing. In addition to taxes, Rhode Island has competitiveness issues with its fees, regulations, electricity costs, and most important, the skills of its workforce. Unfortunately, businesses throughout the country know these facts about Rhode Island. In almost any 50-state comparison of business climates, Rhode Island ranks among the worst.

Recently, the Tax Foundation's State Business Tax Climate Index provided rankings going back to 2006. That year, Rhode Island's rank was 50^{th}—dead last. The following year, when Rhode Island's economy peaked, its rank had "improved" to 49^{th}. Since that time, there have been further improvements. The 2010 ranking by the Tax Foundation places Rhode Island at 44^{th}. In a recent comparison published by *Forbes*, "The Best States for Doing Business," Rhode Island's overall ranking was 43^{rd}, New England's second worst (Maine was 46^{th}). Rhode Island's worst category was the Regulatory Environment category, where it came in 50^{th}. Although the state was not close to 50^{th} in any other category, it had no highly favorable rankings, resulting in a poor overall ranking.

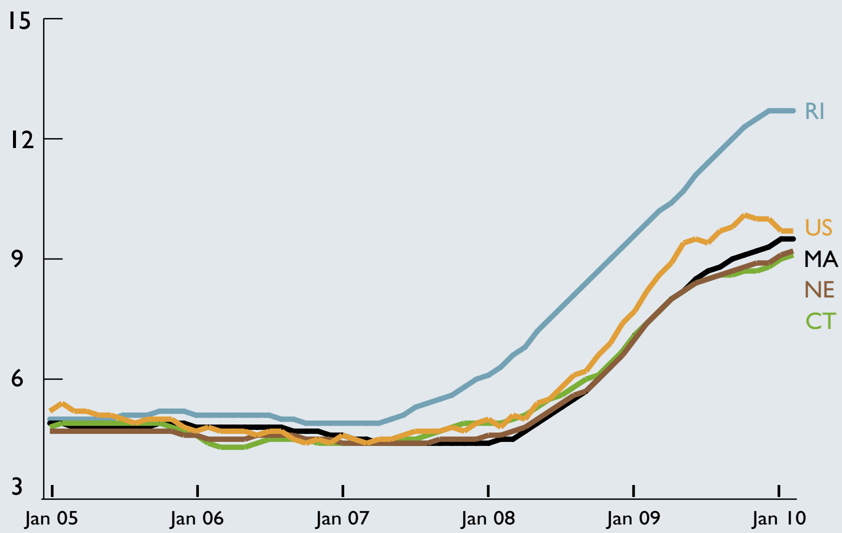
In response to all of this, Rhode Island at long last passed significant reforms to its personal income tax that are scheduled to begin in 2011.

Education and Other Challenges

Another secular factor with an important contribution to Rhode Island's high jobless rate is its ongoing defunding of public education, in progress for well over a decade. As the state has continued to contribute ever less to its higher education system, tuition, fees, and other costs to students have continued to rise, making higher education less and less affordable to residents.

That problem is compounded by Rhode Island's relatively high cost of doing business. Although Rhode Island has high-tech jobs, its nondefense tech sector pays less than jobs available in Massachusetts and Connecticut. In addition, Rhode Island's

Unemployment Rates (Percentage)



Source: Federal Reserve Bank of Boston's Indicators Interactive.

high-tech jobs often have lesser job ladders than tech jobs in neighboring states. As a result, Rhode Island loses college graduates each year to other states, and because of its size, graduates who remain Rhode Island residents can commute to neighboring states. All of this exacerbates problems with the skills of the state's labor pool (which contributes to Rhode Island's relatively high cost of doing business). Moreover, it restricts the supply of skilled workers available to tech firms, making it difficult for the state to attain a critical mass in technology-oriented and growth industries.

The commuting portion of this phenomenon is a brain drain: It occurs Monday through Friday, 9 a.m. through 5 p.m. In effect, Rhode Island rents out some of its most highly skilled workers to neighboring states. The upside is that those individuals bring home their income, helping to fuel housing demand and retail sales. Still, a healthy portion of Rhode Island's economic momentum through the time of its employment peak was predicated on employment opportunities in other states.

Another area that has contributed to Rhode Island's relatively high joblessness is the performance of its goods-producing sector. There are cyclical elements at work, but longer-term trends exist as well. As in other states, this sector no longer produces the volume of jobs it once did, even in the best of times. Since the 1980s, when new home construction in Rhode Island attained high levels, space limitations, local growth restrictions, and the like have held down new home construction, although construction employment did rise sharply through early 2007. The last time Rhode Island manufacturing employment rose was 1984. So, Rhode Island's goods-producing sector can no longer be counted on to generate the number of jobs it once did. However, as we have seen, it is capable of creating substantial job loss during economic downturns.

One other instance of secular trends interacting with cyclical factors to produce higher joblessness concerns Rhode Island's budget. Even before the housing market collapse and the global recession, Rhode Island had experienced continuing problems balancing its budget. The actions taken to balance those budgets materially sapped the state's economic momentum, further exacerbating the cyclical and secular factors at work. The effects of persistent budget problems, along with deteriorating cyclical performance in the goods-producing sector, were significant factors in raising Rhode Island's unemployment rate.

In sum, Rhode Island's economy had already weakened materially before either its own recession in mid-2007 or the national recession at the end of that year. In effect, Rhode Island had a negative margin for error against such cyclical weakness, the result of the housing collapse and the slowdown in national activity and a host of its own structural deficiencies. Thus Rhode Island's unemployment rate has remained well above that of the United States, New England overall, and the rest of southern New England. (See "Unemployment Rates.")

From 2005 through its employment peak in early 2007, Rhode Island's unemployment rate was comparable to unemployment in the United States, New England overall, and the rest of southern New England. But after the employment peak, the state's unemployment rate rose substantially, reaching almost 13 percent by late 2009.

An Addendum

The severe flooding of early April 2010 clearly hurt Rhode Island's economy. Fortunately, the floods occurred at a time of building economic momentum. Ironically, Rhode Island's April jobless rate fell from its March level as flood-related job loss was classified as "weather related." Add census hiring and May's rate fell even further. Retail sales also held up well, as persons shifted their purchases to other retail locations, some of which were more "high end."

Ironically, construction expenditures for rebuilding and the federal funds that will flow into Rhode Island for disaster relief will raise its rate of growth above what it otherwise would have been had the flooding not occurred. So in 2011, we may expect Rhode Island's unemployment rate to decline faster than it would have otherwise, the result of Rhode Islanders exhausting all federal unemployment insurance benefit entitlement and the enhanced growth effects of post-flood activity.

To conclude, the most significant long-run reconstruction for Rhode Island will occur only when the skills of its labor force are substantially enhanced. And that will require continued progress in primary and secondary educational attainment and an end to the state's decade-long defunding of public higher education.

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