

INTRODUCTION

Earlier this year, we began a discussion with MassINC on the role state government plays in the Massachusetts economy. As former economic advisors to Governors Dukakis and Weld, we were asked to reflect on our personal experiences in state government — in some cases stretching back nearly twenty-five years — and relate some of the lessons we had learned regarding state economic policy. We were also asked to look ahead and describe the major economic challenges Massachusetts confronts today. *Lessons Learned* is our attempt to collectively answer those questions.

Having faced very different challenges while in office, and having served leaders with obvious differences in political philosophies and policy priorities, we were surprised by the degree to which we — as policy practitioners — share opinions about the strengths and the limits of state government in shaping the Massachusetts economy. We've attempted in the following pages to describe in a concise, readable report some important areas of consensus.

We hope our effort to find common ground will encourage and assist today's leaders in building on past successes, avoiding past pitfalls, and developing a vision for the future that maximizes the Commonwealth's economic potential in the next century.



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The Massachusetts economy is arguably the most studied state economy in the nation. Home to world-class universities and a large consulting industry, there is no dearth of local expert opinions on what makes the Massachusetts economy tick. Yet for all the scholarly scrutiny, many citizens (and quite a few policy-makers) appear to have only a vague understanding of the forces that continue to transform the state economy.

So what should ordinary citizens and policy-makers understand about the Massachusetts economy? As importantly, what should people know about the abilities and the limits of state government to stimulate that economy? As former state policy-makers, we set out in the pages to follow lessons we've learned regarding the state's conduct of economic policy. It is our hope that these lessons will provide today's policy-makers with a bearing from which to chart the state's future economic course.

The most important lesson to understand — and the least acknowledged among political leaders — is that Massachusetts state government, like all state governments, actually has very limited power to influence the immediate condition of the economy. Despite the propensity of elected officials to take credit or cast blame for the economy's current performance, the reality is that state government is a minor actor in comparison to national business cycles, federal fiscal and monetary policies, and shifts in international financial and trade markets.

It is true that at the local level aggressive state intervention can often stimulate local economic activity in a relatively short period of time. And of course, a careless state government can do a lot to quickly undermine even a thriving state economy. But it is only over the long-run that state government has a broad positive influence on the economy as a whole. State government makes that lasting difference in four ways — all equally important:

- by creating a positive business climate,
- by providing a first-class physical infrastructure,
- by improving skill levels across the population, and
- by pursuing an overarching economic strategy that reflects — among other things — an emphasis on economic inclusion and technological innovation.

The national experience is clear: States that fulfill these responsibilities well — over time — outperform states that do these jobs poorly.

State government fosters a healthy business climate in two ways. The first is by keeping state finances on an even keel and maintaining fiscal stability. Fortunately, there is good reason to believe that the boom and bust cycles that have wreaked havoc with state finances in the past have made an indelible impression on today's leaders and the public. After more than two decades of economic and fiscal turbulence, we have all — in one sense — become fiscal conservatives. Boosting spending or cutting taxes excessively at the height of economic good times inevitably does more harm than good, whipping Massachusetts back into another negative cycle of budget cuts when citizens are most in need and tax increases when taxpayers are least able to afford them. The lesson learned is clear: Economic good times are a clarion call for fiscal caution and a signal to prepare state finances for the storm to come.

Reducing key costs of doing business in Massachusetts is the second element in fostering a healthy business climate. The state has wide discretion to influence many indirect costs such as worker's compensation, unemployment insurance, utility rates, and the overall regulatory burden, that together affect the attractiveness of Massachusetts as a place to do business. The Commonwealth will never be a low-cost state, but reducing key costs to levels comparable with our competitor states gives Massachusetts companies the best chance to grow and create jobs.

Taxes, of course, are a major and direct cost. And here it's important to recognize that economic good times do create opportunities to reduce the state's tax burden in meaningful ways. Being fiscally responsible and reducing taxes are not mutually exclusive. In fact, we believe that Massachusetts should pursue plans to reduce the personal income tax rate from 5.95 percent to 5 percent, both as a matter of fair-

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ness and as a matter of economic competitiveness. The important question is not whether to cut the personal income tax to its historic rate of 5 percent; it is how to cut the rate to that level as quickly as possible without jeopardizing the Commonwealth's fiscal condition. Linking a phased-in rate reduction to various fiscal or economic triggers will help ensure that the state will have sufficient funds to meet its needs in difficult economic times without raising taxes or slashing spending.

It's also important to not lose sight of the primary focus of tax reduction — which must continue to be targeted cuts that improve the prospects for sustained growth in key industries. Reductions in specific taxes that discourage growth — especially taxes that place key industries at a long-term competitive disadvantage with their counterparts in competitor states — are an investment in the state's economic future.

The state's commitments in recent years to expanding its rainy day fund, restraining growth in its outstanding debt, and limiting agency spending are all encouraging signs of fiscal maturity and bode extremely well for the Commonwealth's long-run economic prospects. Continued spending restraint, combined with a flexible income tax rate reduction and targeted cuts that increase the competitiveness of key industries, will keep state finances on a stable track essential to long-run growth.

A second element in the state's long-term economic success is a commitment to public infrastructure. State decisions about how much and where to invest in the range of infrastructure projects — from highways, to commuter rail, to airport facilities, to regional tourism centers, to convention and civic centers — all have an enormous effect on the nature, extent, and location of growth in a region. For example, decisions made decades ago to complete Route 128 and Interstate 495 have resulted in vibrant corridors of growth. The state decision-makers who conceived these projects and pursued them through to completion may have faded from the public's eye, but the measure of their leadership is felt every day as these investments continue to pay huge dividends a generation later.

No infrastructure investments have dominated the state's economic agenda more than the four "Mega" projects now underway — the Central Artery/Tunnel Project, the Logan Modernization Plan, the Boston Convention & Exhibition Center, and the Boston Harbor Cleanup — and with good reason. Without the timely completion of the Central Artery/Tunnel Project, Boston's Seaport District and Southwest Corridor will remain economic backwaters and congestion will continue to put at risk the entire region-

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al economy. The state's rapidly growing high-tech services industry depends on the successful completion of the Logan Modernization Plan to serve its clients around the world. And the new Boston Convention & Exhibition Center and Boston Harbor Cleanup represent the best opportunities yet for the state's tourism, travel, and entertainment industries.

Completing the four Mega-projects on time and within budget, without sacrificing one for another, and without jeopardizing the state's fiscal stability, is a test the state cannot afford to fail. And the challenge does not end there. State leaders must also find ways to exploit the new opportunities for growth made possible by the four Mega-projects and pursue the next generation of Mega-investments that will meet the Commonwealth's infrastructure needs in the next century — projects like the Urban Ring Transit System and the completion of High-Speed Boston-New York Rail Service.

Broadly raising education and skill levels across the population is the third element in long-run economic success. Massachusetts is uniquely dependent on a skilled workforce. While many states rely on natural resources or geographic advantages to fuel their economies, the Massachusetts economy is fueled, in large degree, by brainpower. To compete successfully, Massachusetts companies must continually innovate and create new products, and that innovation requires skilled workers who can master new

production technologies and get new products to market quickly.

Under the 1993 Education Reform Law, the state has made an unprecedented bipartisan commitment to improve our public schools, doubling the amount the state spends on K-12 education over the past five years. The lion's share of this \$3.25 billion increase has been directed at poor urban and rural school districts that for the first time have adequate funds to provide their students a quality education. The state's dramatic spending increase must now be matched with sustained pressure on teachers, principals, parents, and students to produce results. For the Education Reform effort to succeed, our schools must demonstrate that they are deserving of the taxpayers' unprecedented investment. Higher standards, student assessments, and accountability are the keys to bringing the necessary pressure to bear on our schools and improving student performance.

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The state's effort to broadly raise education and skill levels must extend well beyond students in our K-12 system. Fundamental changes are needed in the state's public higher education system to meet the economy's current demand for high-skilled workers. Every qualified Massachusetts resident, at a nominal cost, should be guaranteed access to two years of public college-level education. To make this possible, we must radically expand enrollment in public higher education — especially community colleges — through tuition reductions and expanded scholarship programs. Getting more students enrolled is a matter of simple economic competitiveness. States like California, Washington, and Illinois enroll two to three times as many students per capita in their community college systems, and Massachusetts cannot afford to fall further behind.

Cost is a major barrier, and despite progress, the state has a long way to go. With current tuition and fees totaling \$2,540, the cost of attending community college in Massachusetts is 73 percent above the nation-

al average — the third highest in the nation. Getting costs down to a nominal level will create a powerful incentive for high school students (who now often delay studies for financial reasons) to enroll immediately in community colleges upon graduation. It will also encourage more incumbent workers to resume part-time studies.

We must also remake the state's public higher education institutions so that they become the state's premier resources for workforce training. While training the state's workforce is not the only reason for having a system of public colleges and universities, it is a vital and increasingly important aspect of their mission. State and community colleges, in particular, must expand their roles as centers of college-level vocational training for incumbent workers. Curriculums must become more flexible so that classroom instruction is more tailored to specific job skills in demand by local employers. At the same time, local employers must continue to be willing to shoulder most of the cost of this type of training and extend it to more of their workers.

Massachusetts must also do more to address the needs of the state's least skilled workers. A shockingly high percentage of Massachusetts adults — one in five — are functionally illiterate. Thousands of immigrants languish in dead-end jobs or are unemployed because they lack basic English language skills. State leaders must find ways to expand Adult Education and English-as-a-Second-Language programs to ensure that every adult has the basic skills necessary to hold at least an entry-level job in today's economy.

It is not enough, however, for the state to recognize the importance of the three areas outlined thus far — the business environment, infrastructure, and education and training. The state must have an action plan, a detailed strategy for getting things done in these areas and others. A strategy is not a public relations nicety: It is an essential blueprint for conducting state economic policy.

It is also important to remember that economic strategies employed by other states don't necessarily make sense for Massachusetts. Many states pursue strategies based on their ability to lure companies from elsewhere owing to their advantages in geogra-

phy, climate, natural resources, or a low-cost environment. As a relatively high-cost state with several other competitive disadvantages, Massachusetts is not in a position to compete on those terms.

The only strategy that makes sense for Massachusetts is one that focuses on existing in-state companies and start-up ventures, that addresses the needs of key industry “clusters,” that puts a specific emphasis on fostering growth in exports, that promotes economic inclusion, and that encourages innovation and the development of new technologies.

A state economic strategy is important because it is a way to think comprehensively about how the state can reach out to people and places that don’t enjoy full participation in a thriving economy. Efforts at economic inclusion are important not just as a measure of moral and social responsibility, but as a matter of smart economics. With near zero population growth and an influx of new workers from other states unlikely, Massachusetts must rely on the existing labor pool to fuel its economy. The Commonwealth simply cannot afford the economic cost of allowing anyone or anyplace to fall through the cracks.

While the Commonwealth has many tools at its disposal to try to help spread economic prosperity geographically — from tax incentives, to infrastructure improvements, to community development initiatives, below-market financing and capital formation programs, and other forms of business assistance — the lessons about how best to use these tools are plain.

Foremost among these lessons is that state assistance — whatever its form — can make a difference when it builds on the existing strengths of a community. The barriers to economic growth in a community are often obvious enough, but what often goes unappreciated are the unique strengths of a community that can serve as a foundation for future growth.

Location, quality of life, proximity to transportation, historic architecture, cultural traditions, and an abundant labor force are all examples of strengths that dictate what kinds of opportunities are practical for a community. Communities that foster industries that capitalize on existing strengths succeed because only

these strengths can create the competitive advantages for businesses that lead to sustained growth. Local and state leaders make a mistake when they ignore a community’s existing economic assets, instead attempting to simply duplicate whatever has succeeded elsewhere — forgetting that those successes are often based on very different local circumstances.

On the other hand, none of these forms of state intervention can alter hard economic realities. Basic business assumptions about profitability always determine, in the end, whether or not companies decide to expand or locate in a particular community. State incentives alone will never outweigh these assumptions, nor should they be used to sustain companies that would otherwise be uncompetitive.

It is also clear after several decades of experience that an effective statewide strategy for revitalizing low-growth areas depends on the support of communities themselves. Local leadership is a prerequisite for local success. The leaders of each region and each community must come together to develop their own vision for economic growth and a broad consensus about how to achieve it before the Commonwealth can make its contribution. The state can help by increasing funds for regional and local economic planning and by challenging divided communities to organize, but community leadership will always be an essential ingredient in local revitalization efforts — no matter how earnest the state’s commitment.

A state economic strategy that makes sense for Massachusetts must also make special reference to the state’s technology needs. Technology has long been the life-blood of the Massachusetts economy. No other state spends more of its Gross State Product on R&D, and no other state economy is so closely tied to its premier research centers. For all its importance however, technology — as a subject of political discussion and as an explicit priority of state economic strategy — has not always received the policy emphasis it deserves.

Innovations and new ideas generated by the state’s

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research centers have fueled spectacular growth in software, telecommunications, biotechnology, and other industries, so ensuring their continued health and vitality in the face of possible federal funding reductions is crucial. With the proposed increases in federal R&D spending contingent on the successful resolution of controversial, unrelated issues (such as a tobacco settlement), the specter of federal cuts remains.

Massachusetts must expand its lobbying campaign to fend off possible federal R&D reductions, with more of the state's influential corporate, academic, and political leaders taking a direct personal role in the effort. The Governor should consider appointing a Technology Advisor to lead the expanded lobbying effort at the state level and raise public awareness. And the Commonwealth should consider committing state funds to a new merit-based system of grants that leverages or fills gaps in federally-supported research to improve the odds of Massachusetts researchers in competing for federal support.

A second technology-related issue that demands attention is the serious, growing deficiencies in the state's telecommunications network. The state's phone, cable, wireless, e-mail, and data transmission/Internet systems are as important to the Massachusetts economy today as was the creation of the interstate highway system nearly fifty years ago. Yet these systems are plagued by inadequate bandwidth and a lack of capacity. To reverse the situation, the state should order a top-to-bottom review of every regulation affecting the delivery of telecommu-

nications services with the goal of developing new regulatory incentives that encourage providers to make the necessary improvements in the telecommunications network. Only when providers have an opportunity to pursue a return on investments will the market respond to network deficiencies.

It's also essential for the state to closely monitor the F.C.C.'s ongoing implementation of the federal Telecommunications Reform Act and be prepared to take an aggressive stance with other like-minded states to promote industry competition and ensure universal service. As importantly, the Department of Telecommunications and Energy must take a firm stand against the "not-in-my-backyard" opposition of some communities to improvements in wireless communication services.

Finally, it is also clear after several decades of experience that the economic policy leadership of state officials and the way that leadership is organized, are critical factors in how well state government does its job.

We believe that the Commonwealth should establish a new position of Economic Growth Czar with broad authority over the major instruments of state economic policy. Having a single official overseeing and coordinating business assistance, business regulation, workforce development, community development, and relevant quasi-public agencies, would declare unambiguously that implementing a comprehensive economic agenda is a central priority of state government.