

FY 2005 State Budget

Overview and Comments – Part I

RIPEC's analysis of the FY 2005 State Budget will be presented in several parts. Part I provides an overview of the Governor's FY 2004 Revised and FY 2005 Budget request along with RIPEC's Comments on the overall fiscal plan. Subsequent RIPEC publications will examine several human services programs including Medicaid, the changes in the State's revenues per the May Revenue Estimating Conference, and the Budget as Enacted.

Selected Highlights

1. The FY 2005 budget would represent a net increase in total State spending of \$42.2 million, or 1.0 percent, over the FY 2004 revised budget (\$205.6 million, or 3.7 percent, over the FY 2004 enacted budget). The FY 2005 general revenue budget would represent a net increase of \$103.4 million, or 3.7 percent, from the FY 2004 revised budget (\$115.2 million or 4.0 percent from the FY 2004 enacted general revenue budget).
2. The Administration's five-year forecast estimates operating deficits beginning in FY 2006, with the deficits climbing to \$177.8 million in FY 2009, representing approximately 5.0 percent of available resources in FY 2009.
3. Growth in grants and benefits to individuals consumed approximately \$0.47 of every new dollar spent in Rhode Island since FY 1996. Growth in the State's managed care program represented \$0.16 of every new dollar spent since FY 1996.
4. Nearly 53.0 percent of the growth in entitlement spending since FY 1996 was for Medical Assistance, principally driven by the State's RIte Care program, where enrollment increased from 71,100 in FY 1996 to a projected 130,000 in FY 2005.
5. The Governor's FY 2005 budget request reduced direct education aid by \$7.9 million, capped the general revenue sharing program at 2.7 percent of the tax revenue collections two years prior, and level funded PILOT, thereby reducing the PILOT program from 27.0 percent reimbursement to 25.1 percent.
6. Personnel expenditures increased by nearly 26.0 percent since FY 1996 (adjusting for inflation), and represented \$0.18 of every new dollar spent since FY 1996. This includes a \$21.4 million appropriation for a 2.0 percent COLA in FY 2005. The FY 2005 average cost per FTE position of \$73,100 represents a 2.3 percent increase over the FY 2004 average cost per FTE position (\$71,424).
7. State spending for medical insurance for State employees is the fastest growing component of the State's personnel budget, doubling since FY 1996. State medical insurance costs total nearly \$155.0 million in FY 2005. This is net of a proposed 7.0% cost sharing arrangement from employees, which is expected to save the State \$10.6 million (all funds) in FY 2005.

April 14, 2004

RIPEC Comments - Summary

The growth in the Governor's FY 2005 Budget (3.7 percent) is slightly less than projected personal income growth (3.9 percent). RIPEC believes that growth in State spending should not consume a greater portion of the State's economy. In addition, the Governor's FY 2005 Budget does not include any increases in either the personal income or sales tax. However, questions regarding changes to the Enterprise Zone Wage Tax Credit need to be further explored, as does the proposed Creative Companies Act.

The FY 2005 Budget would close a projected \$190.0 million deficit with \$168.9 million in revenue enhancements, including \$56.8 million in tax and fee increases. The FY 2005 Budget is also balanced with some difficult fiscal choices. For example, some entitlement programs are modified, direct school aid is reduced by 1.2 percent (\$7.9 million), and State employees are asked to pay a portion of their health insurance.

The Budget projects a deficit of \$68.5 million in FY 2006, which represents a significant improvement from the \$190.0 million budget gap the Governor addressed in his FY 2005 Budget. The deficit is projected to increase to \$177.8 million in FY 2009 -- an amount that would exceed 5.0 percent of estimated revenue in that fiscal year.

Successful implementation of the Governor's Fiscal Fitness program could help alleviate the State's structural budget gap. The Program will contribute \$32.7 million to balancing the FY 2005 Budget -- Nearly \$19.0 million (60.0 percent) would come from revenue enhancements and a health cost-sharing agreement with State employees.

Even with the number of filled State FTE positions (14,957.0) at its lowest point since the State started allocating FTE positions, significant challenges to control personnel costs continue to exist. These challenges include:

- Adequately funding a State retirement system in a way that is both fair to State employees and affordable to Rhode Island taxpayers;
- Negotiating health insurance cost-sharing agreement with State employees;
- Limiting efforts to erode the FTE position allocation process; and
- Adequately budgeting and managing overtime and purchased services.

A systematic approach to intergovernmental tax policy requires a complete review of the way public education is financed. The salient issue is not the level of school aid in FY 2005, but rather building cost-containment and property tax relief into a permanent school aid formula that is sensitive to both student and taxpayer need.

Proposed levels of total net tax supported debt in Rhode Island are expected to return to similar levels experienced prior to the defeasance of State debt through the tobacco securitization initiative. While the defeasance permanently eliminated over \$40 million in annual debt service payments over the next decade, the Governor's Capital Budget returns the State's net tax supported debt levels to \$1.6 billion by FY 2006.

I. RIPEC Comments

Maintaining a fair, balanced and competitive tax climate starts with controlling the rate of growth in spending, setting spending priorities, and effectively managing resources.

The framework of the Governor's FY 2005 Budget attempts to accomplish these objectives. As an alternative to broad-based tax increases, the Governor recommends a number of difficult choices be made on the expenditure side of the fiscal equation. In the FY 2005 Proposed Budget, entitlement programs are modified, State operations aid for Rhode Island's 36 school districts is reduced, and State employees are being asked to pay part of their health insurance premium. Whether one agrees or disagrees with these choices, the Governor's Budget does establish a set of spending priorities given limited State resources.

The Governor's FY 2005 Budget parallels growth in personal income. As a result, the State Budget should not be taking a larger share of the State's economy. As recommended, the FY 2005 Budget represents a 4.0 percent increase from the Enacted FY 2004 Budget, and is 3.7 percent over the revised FY 2004 spending plan. In FY 2005, personal income in Rhode Island is forecast to grow by 3.9 percent. It should be noted that the FY 2004 enacted budget included one-time Federal revenues that have to be replaced in the FY 2005 budget.

RIPEC has traditionally maintained that the test of the fiscal soundness of any budget plan is whether ongoing resources are adequate to support current operations, whether current obligations are realistically funded, and whether out-year budgets are projected to be in balance.

The FY 2005 Proposed Budget does not appear to be overly dependent on either large opening surpluses or significant non-recurring revenues. RIPEC estimates that at the Governor's budget includes at least \$16.5 million in one-time revenues. This is in marked contrast to some recent budgets that included structural deficits, i.e., current expenditures exceeding current revenues. Previous budget gaps were closed with tobacco securitized proceeds, large opening surpluses and one time Federal monies.

However, the FY 2005 Budget is largely balanced by revenue enhancements as opposed to streamlining government operations. Over 50 percent of the solutions of the projected \$190.0 million FY 2005 Budget deficit are from revenue enhancements rather than efforts to streamline government operations. Excluding the reauthorization of the hospital license fee, the Budget includes over \$100.0 million in new revenue, of which \$56.8 million are tax and fee increases.

Analysis of how realistic specific Budget items are funded raise some issues that RIPEC believes require consideration. One area of concern is the manner in which overtime is being budgeted. For example, the FY 2004 Enacted Budget included \$40.6 million in overtime; whereas the Governor's FY 2004 Revised Budget includes \$52.4 million – a 29 percent increase. The Governor's FY 2005 Proposed Budget includes \$47.4 million in net overtime expenditures – a 9.5 percent decrease.

The Governor does include an additional 60.0 FTE positions for correctional officers, which if managed properly could translate into lower overtime costs. However, the potential overtime savings must be aggressively pursued given the investment in new corrections officers.

As discussed in this report, a similar budgeting pattern to overtime emerges in purchased service items. In FY 2004, the Enacted Budget included \$145.7 million for purchased services compared to \$182.2 million in spending for these services in the Revised FY 2004 Budget plan. In FY 2005, the Governor has requested \$175.7 million.

The FY 2005 also includes savings of \$10.6 million in health insurance costs, which would result from negotiating a cost-sharing arrangement with State employees. It should be noted that the \$10.6 million is net after adjusting for a 2.0 percent COLA proposed by the Governor. While this goal may be laudable, is it realistic to budget such savings before the contract is negotiated?

Another test of fiscal soundness of any budget proposal is whether or not out-year structural deficits emerge.

Each year the State Budget Officer is required to prepare a five-year financial forecast. Given this year's forecast, there are questions about the impact the FY 2005 Budget plan could have on the long-term fiscal health of Rhode Island. The FY 2005 Budget projects a deficit of \$68.5 million in FY 2006, which will increase to \$177.8 million in FY 2009. The projected deficit in FY 2009 would exceed 5.0 percent of estimated resources in that fiscal year. However, the FY 2002 projected deficit of \$68.5 million represents a significant improvement over the \$190.0 million Budget gap problems that the Governor had to resolve in submitting his Budget request for FY 2005. Unfortunately, the projected deficit will continue to grow to \$177.8 million in FY 2009.

The FY 2005 Budget does not solve all of the State's long-term structural budget concerns, and, therefore, the effective implementation of the fiscal fitness initiative will be necessary to address Rhode Island's future fiscal problems. The forecast of annual and growing operating deficits requires that spending controls and fiscal restraint be the hallmark of upcoming budget deliberations.

Another way to measure the fiscal soundness of the State Budget is to consider initiatives to control the rate of growth in Budget drivers. Nearly 47 cents of every new dollar spent by the State since FY 1996 has been allocated to support direct assistance to Rhode Islanders through employment assistance, medical care, income support programs and child care. This area of State spending has represented the fastest growing component of expenditure during this period of time.

While the Governor's Budget does not include any major changes to entitlement programs, it does recommend a number of changes to grant and benefit programs that affect eligibility for selected programs as well as the range of benefits provided to participants.

The Governor has proposed to eliminate the present practice of paying the health plans up to six months of the capitated rate for clients who no longer receive the service. The Governor expects to generate approximately \$2.6 million in total savings to the State, of which \$1.1 million would be in general revenues.

The Governor has proposed additional initiatives related to staving off expenditure growth in the Family Independence Program (FIP), such as enforcing full-family sanctions at the 12th month of non-

compliance of program requirements, which are designed to move people into the workforce. The Governor projects to save \$4.0 million through this effort. Similarly, the Governor has projected \$1.7 million in savings by eliminating the child support disregard for FIP participants. In other words, recipients in the FIP program are currently permitted to keep the supplemental \$50.00 per month cash benefit from child support without reducing program benefits. And while increasing State subsidized child care slots from 13,075 to 14,215 in FY 2005, the Governor proposed to reduce a family's income eligibility for child care services to 200 percent of the Federal poverty level from 225 percent, which would produce savings of \$4.0 million.

The proposals represent difficult choices by the Governor to reign in a major driver of the State's spending.

Fiscal Fitness and the Budget - In 2003 the Governor formed the Fiscal Fitness Program for the purpose of developing specific ways to improve the efficiency, economy and effectiveness of State government operations. The Fiscal Fitness Team made 140 recommendations that when fully implemented are projected to improve the State's bottom line by \$180.0 million annually. However, \$48.0 million of the savings and new revenue would be derived from Federal funds of which \$29.0 million may be reallocated. After adjusting for Federal savings, the annual bottom line benefit to Rhode Island taxpayers would be \$161.0 million annually.

Fiscal Fitness Action	Savings
Administration	
Increase number of field auditors to generate revenue, Div of Tax	\$2.55
Increase the number of revenue officers to generate income, Div of Tax	5.20
Require tax clearance for professional and drivers licenses, Div of Tax	6.70
Savings from taking advantage of state's purchasing power	4.35
Modify state law to allow online reverse auctions within purchasing	3.10
Sell surplus properties	5.90
Move select agencies from leased space to state-owned property	3.80
Negotiate health plan design components	12.50
Negotiate health coverage cost sharing agreement	22.50
Competitively bid health coverage administrative fees	3.90
Health & Human Services	
Create Health and Human Services Secretariat	4.20
Create a single contract/procurement office, Human Service - Secretariat	4.50
Improve children's behavioral health services, DCYF	9.50
Decrease overtime, DCYF	2.90
Reorganize long term care, DHS	12.50
Reorganize field operations, DHS	8.20
Improve eligibility monitoring, DHS	12.30
Centralize and strengthen estates and collections, DHS	3.00
Move a portion of disabled adults to managed care, DHS	3.80
Department of Transportation	
Reorganize DOT	4.10
Reduce overtime costs	3.10
Total Projected Savings	\$138.60

Twenty-one of the 140 recommendations are valued at over \$2.5 million. These proposals account for \$138.6 million, or over three-quarters of all the savings and revenue enhancements. Over 20 percent of the savings, or \$38.9 million, would result from proposals to modify the State employee health insurance program.

The FY 2005 State Budget appears to include cost-savings and revenue enhancements proposed by the Fiscal Fitness team, which total \$32.7 million in general revenue items. Revenue enhancements represent approximately 40 percent of the contributions the Fiscal Fitness Project would make to the bottom line of the FY 2005 State Budget. Almost

one-half (48.7%) of the new revenues would be derived by requiring tax clearance from professional and drivers' licenses. The Fiscal Fitness team has proposed that before any professional licenses, drivers' licenses, or car registrations are issued, the Division of Taxation determine that no unpaid tax obligations exist. The Governor has added 11.0 FTE positions in taxation dedicated to collecting these and other revenues.

Of the \$19.3 million of anticipated general revenue savings and cost avoidance of approximately \$6.0 million, or 30.8 percent would come from State employees negotiating a health cost sharing agreement.

Table 2
Impact of Fiscal Fitness on the FY 2005 State Budget

Budget Action	Revenue Enhancement	Cost Savings/Avoidance
Central Administration		
<i>Child Support</i> - Eliminate child support disregard	\$1,700,000	-
<i>Taxation</i> - Charge cigarette tax to distributors	1,895,581	-
<i>Taxation</i> - Require annual tobacco dealer's license renewal	40,000	-
<i>Taxation</i> - Increase number of field auditors to generate revenue	560,043	-
<i>Taxation</i> - Require tax clearance for professional and drivers licenses	6,500,000	-
<i>Purchasing</i> - Take advantage of state's purchasing power	-	1,823,096
<i>Human Resources</i> - Negotiate health cost sharing agreement	-	5,954,340
Health and Human Services		
Improve eligibility monitoring, DHS	-	2,800,000
Centralize and strengthen estate collection	-	983,411
Medicaid cost improvements (1)	-	5,649,240
Increase select fees, DOH	588,435	-
Medicaid quality review	-	2,130,838
Child Care Licensing - DCYF	386,300	-
Other State Functions		
<i>Education</i> - Revisit teacher certification fee structure	450,000	-
<i>Labor and Training</i> - Trade exam fee	124,800	-
<i>Business Regulation</i> - Revisit professional licensing fee structure	611,090	-
<i>Transportation</i> - Increase fees for alteration permits	211,700	-
<i>Natural Resources</i> - Increase select permit and license fees	292,298	-
<i>Subtotals:</i>	<i>\$13,360,247</i>	<i>\$19,340,925</i>
Total Fiscal Fitness Financial Impact in FY 2005		\$32,701,172

(1) Sources include the State Budget Office - figure includes comprehensive third party liability recovery, overpayment detection & recovery, Claims Check/Claims Review, Casualty Recovery, Medical Support Enforcement and Error Reduction and Eligibility Determination.

Source: RIPEC calculations based on State Budget Office documents and FY 2005 State Budget Request.

The Governor's FY 2005 Budget projects out-year budget deficits through FY 2009. Therefore, the successful implementation of the Fiscal Fitness recommendations can have a significant impact on the future fiscal well-being of Rhode Island.

In March 2004 the Fiscal Fitness Program reported that "the full realization of Fiscal Fitness savings and efficiencies is expected to take up to eighteen months...." And that the first task of Fiscal Fitness and the operating agencies would be to take the next two months to develop detailed implementation plans. A critical task is for the Administration to develop timelines and criteria for evaluating progress and verifying performance, as well as integrating the Fiscal Fitness recommendations into the State's five-year fiscal projections.

In developing benchmarks, focus and priority should be given to those recommendations that will have the most significant impact on the State's Budget. As noted on the 140 recommendations, 21 would account for over three-quarters of the potential savings forecast by the Fiscal Fitness team.

The Fiscal Fitness Program includes recommendations that if successfully implemented would enhance the efficiency of State government operations. Several of the proposals contained in the Fiscal Fitness report address concerns that RIPEC has identified over the years. The chance to reform State government in such a broad scale may only come along once in a decade. Successful implementation will require transparency in establishing timelines and reporting results. The House Fiscal Advisory staff has reported that they will track the annual progress of implementation and report results. Perhaps a legislative committee or sub-committee

should be created to oversee the Fiscal Fitness process as it goes forward.

Implementation of recommendations dealing with consolidating and reorganizing agencies and centralizing services will require the cooperation of State employee organizations. Implementation efforts will also need to be supported by State laws and regulations that govern personnel practices and labor relations. Therefore, as the Fiscal Fitness team proceeds, it may be necessary to revisit Rhode Island's personnel laws and contract provisions. If Rhode Island's state government personnel system is not reformed, proposals to reorganize and streamline state agencies will not necessarily enhance the effective and efficient delivery of public services.

Tax Policy - The Governor's FY 2005 Budget does not contain rate increases in either the personal income or sales tax. In his message, the Governor noted that Rhode Island already has one of the highest state and local tax burdens in the United States. To document this, the Governor referenced a study published by the Tax Foundation, which ranked Rhode Island state and local tax burdens 4th highest in the Nation. This ranking varies somewhat from the relative tax burden analysis prepared by RIPEC based on data from the U. S. Department of Commerce, Bureau of the Census. Using Bureau of the Census information and RIPEC calculations, the Ocean State's state-local tax burden is 10th highest when measured by taxes as a percentage of personal income.

The reasons for the differences between these measures of tax burden result from differences in methodology. The **Census Bureau** and RIPEC calculate the tax burden by dividing the total state and local tax collections by personal income. The **Tax**

Foundation incorporates a geographical tax incidence analysis. Depending on demography, geography and a variety of economic activity, states either collect more or less revenue from out-of-state residents than their own residents pay to other states. For example, in Alaska the severance tax on oil is incorporated into the price of oil, enabling Alaska to simultaneously collect the taxes and export the burden of the tax to purchasers across the country. The Tax Foundation model adjusts for severance taxes, and taxes on tourism and corporate income.

Given Rhode Island's already high state-local tax burden, the solution to Rhode Island's projected out-year deficit should come from fiscal restraint, not higher taxes.

To balance the proposed FY 2005 State Budget the Governor has recommended tax and fee increases totaling \$56.8 million. This represents approximately 30 percent of the resources needed to close a projected \$190.0 million gap in the FY 2005 State Budget.

Revenue Action	Amt.
<i>Taxes and Fees</i>	
Cigarette Tax	\$40.8
Corporate Income and Franchise Fees	7.0
Department Licenses and Fees	2.8
<i>Sub-Total</i>	<i>\$50.6</i>
<i>Repeal of Tax Credits and Tax Expenditures</i>	
Enterprise Zone	\$ 3.9
SBA & ISO Credits	0.6
Child Support Enforcement Parent Distribution	1.7
<i>Sub-Total</i>	<i>\$6.2</i>
Total Taxes, Licenses and Fees	\$56.8

Over 70 percent of the new taxes and fees would be generated primarily by an increase in the State's cigarette tax by \$0.75 per pack. Adoption of this recommendation will result in a State cigarette tax of \$2.46 per pack beginning on July 1, 2004. Based on State cigarette tax rates, as of January 1, 2004 this would be the highest cigarette tax rate among the 50 states.

The Governor is also recommending that direct taxes paid by businesses be increased by \$7.6 million. The business tax increase would result from a proposal to increase Rhode Island's minimum corporate income and franchise tax from \$250 to \$450, raising \$7.0 million in revenue. The balance of the corporate tax increase, \$0.6 million, is due to the repeal of tax credits primarily in enterprise zones. The minimum corporate tax in Massachusetts and Connecticut are \$456 and \$250, respectively.

The tax program suggested by the Governor does, however, raise some questions.

Cigarette Tax – According to an analysis by the House Fiscal Staff, Rhode Island's retailers may not be able to sell cigarettes competitively with Connecticut and Massachusetts even when one considers the lower minimum markup provisions in Rhode Island.

Business Tax Increases - The Governor is proposing to eliminate existing tax credits for ISO certification fee costs, SBA loan guarantees and Enterprise Zone wages, donations and interest income credits. Elimination of these tax credits are projected to yield \$4.5 million in FY 2005, with the majority (\$3.9 million) resulting from the elimination of the Enterprise Zone tax credits.

These recommendations resulted from a study that the Economic Development Corporation commissioned to determine the effectiveness of various business tax incentives to stimulate the State's labor market. The study constructed a "Job Quality and Quantity Index" to help measure the relative economic effectiveness of the various business tax incentives. The research found that tax incentives that promote new investment were the most effective in job creation, followed by those encouraging the development of high quality jobs.

Regarding Enterprise Zone tax incentives, the Job Quality and Quantity Index does not appear to have considered the economic impact of Enterprise Zone investments. A footnote in the table summarizes the Job Quality and Quantity Index, the report states, "This table excludes Enterprise Zone Investment due to insufficient data records."

Additional information should be made available before legislation is enacted that would discontinue all Enterprise Zone tax credits. The analysis of Enterprise Zone tax credits should consider all dimensions of the Enterprise Zone objectives, as well as examining the impact of Enterprise Zone tax credits over a reasonable time period.

The Executive Summary to the FY 2005 Budget states that the Governor supports the Creative Companies Act. Under this proposal, the Economic Development Corporation would exempt any income or capital gain for investors in, managers of, and owners of companies that have been certified as a creative company from Rhode Island personal income tax. To be certified as such, a business must demonstrate the potential within five years of certification for annual gross revenues of no less than \$25.0 million. In addition, a certified

creative company must either create in Rhode Island at least 200 jobs or have an annual payroll to Rhode Island employees of no less than \$10.0 million. The Economic Development Corporation could only grant such status to no more than 20 companies annually.

This legislation raises a number of issues that should be carefully considered before it is enacted into law by the General Assembly, such as:

- Does granting preferential tax treatment to individuals involved with 20 select businesses violate the basic tenet of taxpayer equity? An equitable tax system is one that imposes similar tax burdens on taxpayers in similar circumstances. Granting special tax incentives to 20 firms that are selected by a Quasi-Public Agency, and not providing the same benefits to other qualifying firms raises a question of equity.
- Is there a regulatory conflict of interest because the agency that selects the 20 companies who would receive the tax break also monitors compliance with the performance requirement to receive the preferential tax treatment?
- Does the proposed Creative Companies Act have any fiscal impact? If the Act serves to stimulate jobs and investments, it should generate additional tax revenues, which would offset any lost revenues that result from the tax expenditure.
- Will the tax incentive result in the creation of quality jobs? A definition of a high quality job in the Creative Companies Act is one that pays 150 percent of the minimum wage or approximately \$20,000.

- In 2001, the General Assembly enacted a two-year phased elimination of the tax on capital gains from assets held more than five years beginning in 2007. Therefore, how would the Creative Companies Act interact with this initiative?

Tax incentives may be needed to help attract entrepreneurial companies to Rhode Island. To determine which incentives may be the most effective, State decision makers must have the tools to analyze and assess the potential impact tax changes may have on job retention and growth. This will require that State government establish a comprehensive tax policy function supported by professional staff and appropriate resources.

Intergovernmental Fiscal Policy - As measured by tax as a percentage of personal income, almost 40 percent of Rhode Island’s tax burden results from property taxes. Of the ten highest tax states, as reported by the U.S. Census Bureau, only Vermont’s property tax consumed a higher percentage of personal income than Rhode Island.

Tax and spending decisions made at one level of government have an impact on other units of government. Therefore, the intergovernmental aspects of tax and spending decisions should be considered in the budgeting process.

A systematic approach to intergovernmental tax policy requires a complete review of the way public education is financed. In light of the State’s current fiscal condition, a comprehensive school finance plan that addresses taxpayer and student need is not feasible in FY 2005. However, a Coalition of Mayors and RIPEC has suggested a plan of action to begin the process of doing more to control school spending and providing property tax relief.

There is one item in the Budget that could directly result in higher property taxes. Article 16 would, among other things, authorize municipalities to increase or decrease their property tax levy after the June 15 statutory levy date in the event that state aid approved by the General Assembly exceeded or failed to meet estimates established in the municipal budget.

Article 16 is problematic because it would allow municipalities to levy supplemental property tax increases after their property tax levies have been established. The process of adjusting property tax levies could erode fiscal discipline and result in unpredictable consequences for property taxpayers.

Rank	State	Total State/Local Taxes	Total Property Tax	Property Tax as % of Total Taxes
1	New York	13.06	3.79	29.0
2	Maine	13.00	4.87	37.5
3	Alaska	12.31	4.05	32.9
4	Wisconsin	12.13	3.72	30.7
5	New Mexico	12.07	1.56	12.9
6	Hawaii	11.96	1.76	14.7
7	Minnesota	11.44	2.87	25.1
8	Vermont	11.24	4.69	41.7
9	Utah	11.16	2.48	22.2
10	Rhode Island	11.11	4.42	39.8
	United States	10.38	2.97	28.6
	Massachusetts	9.96	3.17	31.8
	Connecticut	11.09	3.83	34.5

*Source: U.S. Census Bureau, 2002 as reported in *State Policy Reports*, and RIPEC calculations.

The municipal government could also increase its property tax in mid-year if it received an unfavorable ruling from the Superior Court in cases of budget disputes with their school committees. The consequence of this action could be a disincentive to control the rate of growth in school spending, which have exceeded inflation and personal income growth over the last decade.

Furthermore, the process by which a supplemental property tax levy could be levied is also unclear. The Budget Article states cities and towns may impose a supplemental property tax levy if the amount of state aid they estimated does not materialize. What is the basis of the estimates of state aid that a municipality includes in its proposed budget?

State Staffing - The State implemented the legislative authorization of FTE positions as a means to control spending. Without effective control over staffing levels, it is difficult to translate personnel savings into proposed changes in governmental structures. As of March 20, 2004, the State has 14,956.7 of the 15,289.4 FTE enacted positions filled, leaving 332.7 authorized FTE positions currently vacant. This level of staffing is the lowest since the inception of the FTE authorization. The FTE position authorization process is a critical tool that enables the State to measure the effectiveness of initiatives, such as those included in the Governor's Fiscal Fitness Program, to reduce or consolidate programs and agencies.

An issue that state administrators continue to face is the impact third party financing has on the management of the entire budget, but, particularly, personnel costs. In FY 2001, the General Assembly provided language exempting 330.4 FTE positions in higher education on the premise that they were funded by third party resources. The number of exempt positions has since increased to 361.8 FTE positions in the Governor's FY 2005 Budget request. While positions and programs may initially receive third party funding, these positions and programs may shift over to the State's general revenue fund once other funds have expired, putting additional burdens on State general revenues.

A related issue is the Governor's budget proposal to create a new class of positions called limited service positions. These positions would not be subject to the FTE position authorization spelled out in the annual appropriations bill. According to Article 40 of the Governor's proposed budget, these positions would be funded by non-general revenue sources of revenue and would be limited to one year of employment.

According to the Budget Article, these positions would not be eligible for retirement, health or other benefits ordinarily provided to State employees. The budget article indicates that the limited service positions are being created in order to avoid the restrictions under the current FTE position authorization process.

Given the limited number of effective cost containment tools available, RIPEC continues to voice its concern about policies that exempt certain positions from the FTE authorization process outlined in the State's budget.

Pensions -- Another driver of personnel costs is how the State will fund its pension obligation to State employees in both a fair and fiscally sound manner. Between FY 2004 and FY 2005, the State's cost for retirement benefits will increase by \$15.7 million, or almost 20 percent. Preliminary projections indicate that the fiscal health of the State employee and teacher retirement could be in jeopardy unless there are adjustments in contribution and/or benefit modifications. The Governor appointed a Committee to identify options to address the pension funds issue. The Committee is expected to issue a report shortly, and the results of this analysis should be considered by the General Assembly as part of its deliberations on the FY 2005 State Budget.

State Debt - The Governor's FY 2005 – FY 2009 Capital Plan projects total net tax supported debt at \$1.5 billion in FY 2005. Based on the Governor's Capital plan, this is projected to increase to \$1.6 billion in FY 2009. Direct Debt – debt that the State has pledged its full faith and credit – represents 54.3 percent of the total net tax supported debt in FY 2005. This is expected to increase to 62.1 percent by FY 2009.

The State's net tax supported debt as a percentage of income is expected to remain around 4.0 percent during the Capital Plan period. In FY 2005, debt as a percent of personal income is projected at 4.11 percent, and is expected to decline to 3.76 percent by FY 2009. The State's costs to service this debt will increase from \$151.8 million in net debt service in FY 2005 to \$184.1 million in FY 2009. Debt service as a percent of general revenues is projected at 4.91 percent and would be 4.98 percent in FY 2009 based on the Governor's Capital Plan. Debt service as a percent of general revenues would peak at 5.42 in FY 2007 based on planned debt issuances and capital outlays.

The Governor's FY 2005 – FY 2009 Capital Budget Plan includes nearly \$3,330.0 million in capital outlays during the five year period, which includes approximately \$1,010 million in Federal capital funds (primarily Highway Funding), \$312.0 million in new general obligation bond referenda proposed by the Governor and nearly \$170.0 million in Certificates of Participation Notes (COPS). Certificates of Participation represent approximately 15.0 percent of the total tax supported debt in the State.

Transportation related capital projects represent more than half (51.2 percent) of the State's entire Capital Plan. The State recently issued \$270.0 million in bonds

using the Grant Anticipation Revenue Vehicle and Motor Fuel Tax Revenue Bonds (GARVEE), which are secured with Federal Highway Funds and two cents of the State's gasoline tax. The State plans to issue these bonds in three installments, for a total of \$660.5 million.

In June 2002, the Tobacco Settlement Financing Corporation was established to securitize future State revenues provided through the Master Settlement Agreement in November 1998. The Corporation issued \$685.4 million in bonds, resulting in net proceeds of \$544.2 million to the Corporation. The State used \$295.3 million of the proceeds to defease nearly \$250.0 million in outstanding general obligation and COPS debt. The balance was used to balance the State's operating budgets (FY 2002 – FY 2004). The State is projected to save nearly \$344.0 million in debt service through the defeasance of the State debt. The bonds issued by the Corporation are currently not considered debt of the State.

What is of interest is that total net tax supported debt is expected to return to similar levels experienced prior to the defeasance of State debt through the tobacco securitization initiative. The defeasance certainly provided the State with significant relief to the State operating budget by permanently eliminating over \$40 million in annual debt service payments. However, under the Governor's FY 2005 – FY 2009 Capital Budget, new initiatives return the State's net tax supported debt levels to \$1.6 billion by FY 2006. RIPEC plans on publishing further analysis of the Capital Budget and the State's overall debt burden later this year.

II. State Spending Patterns

Recent five-year forecasts projected operating deficits of \$68.5 - \$177.8 million from FY 2006 through FY 2009. The forecast assumes general revenues in support of state spending will annually increase by approximately 4.7 percent during the forecast period while expenditures are projected to grow by approximately 6.0 percent over the same period. The expenditure growth rate is nearly three times the estimated annual rate of inflation (2.2 percent) during this period.

Growth in grants and benefits to individuals continues to apply the greatest pressure on the expenditure side of the ledger, with an average annual growth rate of approximately 5.5 percent. This is principally driven by growth in medical care.

As Table 6 shows, the FY 2005 budget (all funds) represents a \$1.7 billion increase from FY 1996 (adjusted to 2005 dollars) - a 39.0 percent increase over this period. Assuming the Governor's budget were adopted, expenditures supporting grants and benefits (programs providing direct support to individuals) would increase by \$783.0

million, representing 47.0 percent of the total growth in expenditures during this period.

These programs include Medicaid, childcare and TANF as well as other income support programs administered by the State. The increase in managed care programs (Rite Care) of \$260.8 million represented 15.7 percent of the net increase in statewide spending during this period.

There are several factors driving the level of expenditures for grants and benefits to individuals. Most recognize economic forces as well as socio-economic and demographic trends (i.e. income levels and age cohorts) play critical roles in the expenditure responsibilities of the State. In addition, policymakers constantly adjust, refine and expand programs based on policy shifts. For example, in recent years, the State has expanded eligibility for state funded health care (Rite Care), pharmaceutical assistance and child-care. In Rite Care, enrollment has increased from 71,100 in FY 1996 to a projected 130,000 in FY 2005, primarily through expansions in eligibility. The Rite Care enrollment represents 12.5 percent of the State's total population.

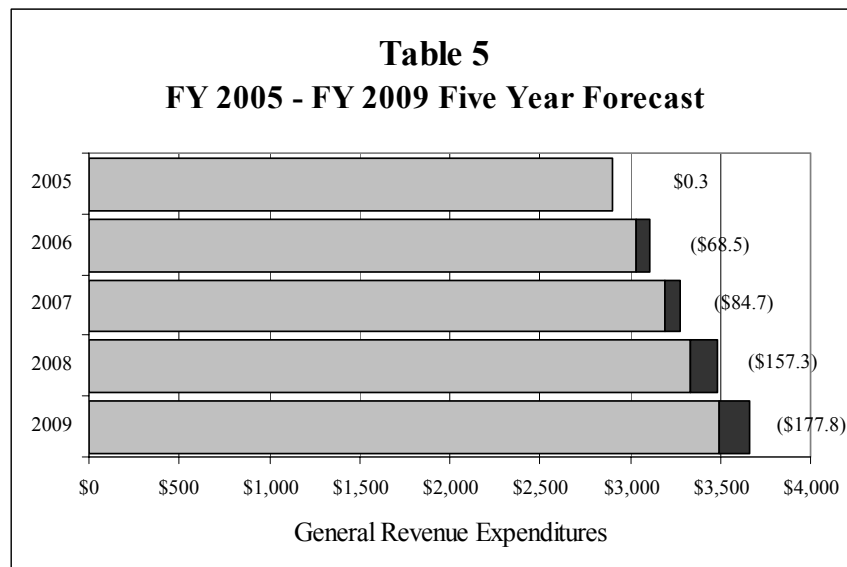


Table 6
Rhode Island State Budget Drivers - All Funds
(Adjusted for Inflation)

Expenditure Category	FY 1996 Adjusted	% of Total	FY 2005 Proposed	% of Total	Increase	Share of Increase
<u>General Operations</u>						
Personnel	\$1,132.3	26.5%	\$1,425.7	24.0%	\$293.4	17.6%
Operations	326.1	7.6%	375.2	6.3%	49.1	2.9%
Subtotal - Operations	\$1,458.4	34.1%	\$1,800.9	30.3%	\$342.5	20.6%
<u>Grants & Benefits</u>						
Income Support (TDI & Employ)	\$339.2	7.9%	\$373.9	6.3%	\$34.7	2.1%
Medical Assistance - Mgd Care	107.1	2.5%	367.9	6.2%	260.8	15.7%
Medical Assistance - All Other	605.7	14.2%	757.1	12.7%	151.4	9.1%
Development Disabilities	119.5	2.8%	179.8	3.0%	60.3	3.6%
Child Welfare	71.0	1.7%	112.1	1.9%	41.1	2.5%
TANF	155.1	3.6%	70.6	1.2%	(84.5)	-5.1%
Child Care	19.4	0.5%	77.0	1.3%	57.5	3.5%
SSI	23.7	0.6%	28.3	0.5%	4.6	0.3%
RIPAE	8.2	0.2%	14.3	0.2%	6.1	0.4%
Higher Education	92.5	2.2%	115.7	1.9%	23.2	1.4%
Dept. of Transportation	34.0	0.8%	50.5	0.8%	16.5	1.0%
Other Grants & Benefits	306.2	7.2%	517.4	8.7%	211.2	12.7%
Subtotal - Grants & Benefits	\$1,881.6	44.0%	\$2,664.6	44.8%	\$783.0	47.0%
<u>Local Aid</u>						
Education Aid	\$544.0	12.7%	\$727.0	12.2%	\$183.0	11.0%
Motor Vehicle Phase-out	0.0	0.0%	105.0	1.8%	105.0	6.3%
General Revenue Sharing	15.4	0.4%	51.4	0.9%	36.0	2.2%
PILOT	14.7	0.3%	21.7	0.4%	7.0	0.4%
Federal Aid	41.3	1.0%	153.5	2.6%	112.2	6.7%
Other	21.9	0.5%	54.0	0.9%	32.1	1.9%
Subtotal - Local Aid	\$637.3	14.9%	\$1,112.6	18.7%	\$475.3	28.5%
<u>Capital Expenditures</u>						
Capital Expenditures	\$91.6	2.1%	\$158.4	2.7%	\$66.8	4.0%
Debt Service	211.4	4.9%	209.8	3.5%	(1.6)	-0.1%
Subtotal - Capital	\$303.0	7.1%	\$368.2	6.2%	\$65.2	3.9%
Total	\$4,280.4	100.0%	\$5,946.3	100.0%	\$1,665.8	

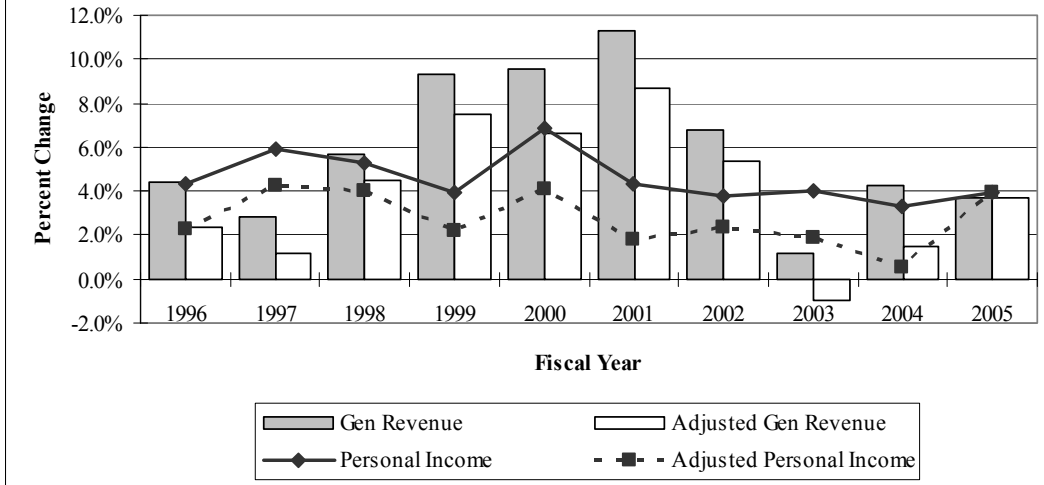
Source: RIPEC calculations based on State Budget Data - State Budget Office, DOA

The second largest component of State budget growth has been in local aid. All local aid increased by \$475.3 million, representing approximately 28.5 percent of the net growth in the budget since FY 1996. Education aid has been the principal driver

within local aid. Of the \$475.3 million net increase in local aid, nearly 39.0 percent is attributable to growth in education aid.

The third largest factor in budget growth during this period has been overhead costs.

Table 7
Change in General Revenue Expenditures



Of the \$1.7 billion increase in net expenditure growth from FY 1996 to FY 2005, approximately 17.6 percent (\$293.4 million) was attributable to personnel expenditures. An additional 2.9 percent of the growth was related to various operating expenditures. Therefore, nearly 20.6 percent of the growth in the State's total expenditure program since FY 1996 was related to general overhead for State programs.

If one looks at general revenue growth only, additional information can be derived.

Table 7 displays unadjusted and inflation-adjusted (estimated 2005 dollars) percent changes in general revenue expenditures from FY 1996 – FY 2005. It also sets forth the estimated change in personal income in Rhode Island (both adjusted and unadjusted). Since FY 1996, the State's general revenue budget has grown at a faster rate than inflation and personal income. In FY 2005, personal income growth is expected to be approximately 3.9 percent. The Governor's FY 2005 budget request increases general revenue spending by 3.7 percent (from FY 2004 revised).

III. The Governor's Budget

Proposed FY 2004 Revised - The Governor has proposed a \$5,904.0 million revised budget for FY 2004. While the FY 2004 enacted budget represented a 6.3 percent increase (\$341.8 million) from FY 2003 actual experience, the Governor's revised budget represents a 9.4 percent (\$505.2 million) increase over FY 2003 actual experience. Of the \$505.2 million increase, \$113.6 million (22.5 percent) is in general revenues, \$339.2 million (67.1 percent) is in Federal funds and the \$52.4 million balance (10.4 percent) is the net increase in restricted and other funds.

Nearly 44.0 percent of the increase in Federal appropriations is associated with the Human Services Function. Approximately 20.0 percent of the increase is associated with Education services, principally the Department of Education. The balance of the increase in Federal expenditures is in transportation, public safety (homeland security) and natural resources.

The following discussion concentrates on the changes to the State's General Revenue Budget. The Governor proposes a net increase of \$11.8 million from the FY 2004 enacted general revenue budget. General revenue appropriations for overhead (personnel and operating) are proposed to increase by \$6.3 million (net).

- \$4.6 million in general revenues to leverage \$5.6 million in Federal funds for uncompensated care.

FY 2005 Budget Summary - The Governor has proposed a \$5,946.2 million budget to support State operations in FY 2005. As measured against the budget originally enacted for FY 2004 (\$5,740.6 million), FY 2005 appropriations represent an increase of \$205.6 million, or 3.7 percent. Total FY 2005 expenditures are proposed to increase by 1.0 percent (\$42.2 million) over the Governor's FY 2004 revised budget (\$5,904.0 million).

FY 2005 general revenue expenditures are budgeted at \$2,899.0 million, which represents a 4.0 percent (\$115.2 million) increase from the FY 2004 enacted budget, and \$103.4 million more (3.7 percent) than the Governor's FY 2004 revised request.

Table 9 shows the State's Budget Statement from FY 2003 through FY 2005. The State has experienced a surplus in past fiscal years to varying degrees. However, the Governor's FY 2005 budget relies on an opening surplus of \$104,000.

Table 8
Rhode Island State Expenditures - All Funds

By Category	1996	2003	2004	2005
Personnel	\$939.0	\$1,311.9	\$1,389.3	\$1,425.7
Operating	270.5	376.2	379.7	375.2
Local Aid	528.5	1,005.7	1,102.2	1,112.6
Grants & Benefits	1,560.4	2,424.8	2,673.6	2,664.6
Capital	76.0	143.5	207.0	158.4
Debt Service	175.3	136.7	152.2	209.8
<i>Total</i>	<i>\$3,549.7</i>	<i>\$5,398.8</i>	<i>\$5,904.0</i>	<i>\$5,946.2</i>
By Fund	1996	2003	2004	2005
General Revenues	\$1,713.5	\$2,682.0	\$2,795.6	\$2,899.0
Federal Funds	1,037.8	1,587.5	1,926.7	1,876.4
Restricted Funds	104.4	114.3	126.4	123.4
Other Funds	694.0	1,015.1	1,055.3	1,047.4
<i>Total</i>	<i>\$3,549.7</i>	<i>\$5,398.8</i>	<i>\$5,904.0</i>	<i>\$5,946.2</i>
<i>Percent Change</i>		<i>4.0%</i>	<i>9.4%</i>	<i>0.7%</i>
Adjusted Expenditures	\$4,280.4	\$5,551.4	\$5,992.7	\$5,946.2
<i>Percent Change</i>		<i>1.7%</i>	<i>7.9%</i>	<i>-0.8%</i>

Source: RIPEC calculations based on State Budget Office Data

Grants and benefits to individuals are proposed to increase by \$16.6 million, principally driven by additional expenditures for human services programs.

There are a number of proposed changes to the FY 2004 General Revenue Budget worth noting. Examples include:

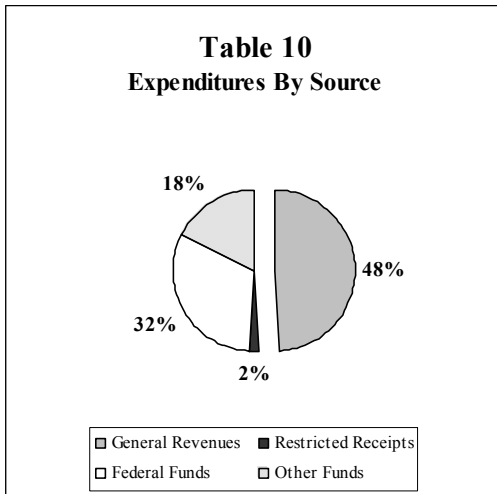
- \$8.0 million in reappropriations from FY 2003 resources;
- \$17.0 million shifted from General Revenues to other sources, the majority of which (\$14.7 million) represents debt service expenditures shifted from general revenues to the Rhode Island Capital Plan; and

Table 9
Budget Statement

Summary	FY 2003	FY 2004	FY 2005
Total - Opening Surplus	\$38.8	\$51.9	\$0.1
Revenues			
Enacted	\$2,750.8	\$2,805.4	\$0.0
Nov Estimating Conference		(20.5)	2,789.4
Governor Changes		15.7	168.9
Total Revenues	\$2,750.8	\$2,800.7	\$2,958.3
Cash Stabilization	(\$55.6)	(\$56.9)	(\$59.2)
Total Available Revenues	\$2,734.0	\$2,795.7	\$2,899.3
Expenditures	\$2,682.0	\$2,795.6	\$2,899.0
Free Surplus	\$44.0	\$0.1	\$0.3
Reappropriations	8.0	-	-
Total Ending Balance	\$51.9	\$0.1	\$0.3

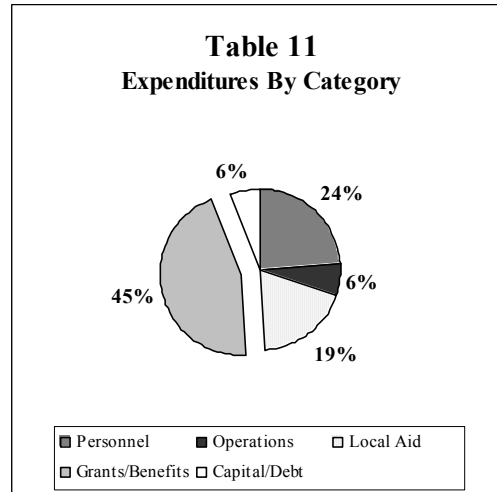
Source: RIPEC Calculations based on FY 2005 Governor's Budget

Source of Funds: General revenues represent unrestricted resources the State generates through taxes, fees and other sources. General revenues fund approximately 48.0 percent of the State budget. Federal funds represent about 32.0 percent of the State's budget. Federal Medicaid payments account for nearly half of all Federal fund expenditures.



Other funds, totaling \$1,047.4 million in FY 2005, are primarily made up of university and college funds and employment and training funds, representing about 18.0 percent of the FY 2005 budget. Restricted funds of \$123.4 million in FY 2005 represent the smallest resource to the State – 2.0 percent of all resources. These funds include a range of fees and charges dedicated to specific programs and activities.

Expenditure by Category: There are five major categories of expenditures - personnel, operating, local aid, grants and benefits and capital expenditures. Grants and benefits, which include medical assistance, temporary disability payments and other cash assistance, constitute the largest category of expenditures, representing 45.0 percent of the total budget.



Personnel expenditures represent 24.0 percent of the State's budget, and general operations expenditures represent an additional 6.0 percent. Local aid, which includes education aid and other direct assistance to municipalities, represents 19.0 percent of the budget. The remaining 6.0 percent of the budget is dedicated to capital and debt service expenditures.

The following highlights selected expenditure and program changes.

General Operations

- Adjusts salaries for a 2.0 percent COLA for State employees and anticipates \$10.6 million savings in State employee health care cost sharing initiative (7.0 percent cost-sharing from employee);
- State's actuarial contribution for retirement increases from 9.6 percent to 11.51 percent - contribution increases by \$15.7 million;
- Includes \$32.7 million in revenue enhancements and expenditure savings developed through the Fiscal Fitness initiative; and

- Increases total FTE authorization by 144.1 FTEs to account for new Correction Officer and State Police Classes, as well as CCRI campus expansions in Providence and Newport.

State Aid

- Proposal to reduce direct education aid by \$7.9 million in FY 2005;
- Increases funding for Charter Schools and MET School by \$7.5 million;
- Increases State's actuarial contribution to Teacher Pension Fund by \$6.4 million and the contribution for School construction by \$4.1 million;
- Level funds the General Revenue Sharing Program at \$51.4 million, but does not delay continued phase-out of local inventory taxes;
- Level funds PILOT program at \$21.7 million, reimbursing communities for 25.1 percent of foregone tax collections from tax exempt institutions; and
- Level funds the State's car tax reimbursement at \$105.0 million and changes the reference year for calculation purposes.

Grants and Services to Individuals

- FY 2005 represents the end of a temporary enhanced Federal Medicaid match, requiring an additional \$42.0 million in state funding;

- Increases uncompensated care payments to Eleanor Slater Hospital of \$10.5 million, of which \$4.7 million is general revenue;
- Projected savings of \$4.0 million through accelerated sanctions for Family Independence Program (FIP) clients not actively participating in required workforce development programs;
- Projected decline in overall FIP caseloads is expected to produce \$3.6 million in savings;
- Proposes to reduce Child Care eligibility from 225 percent of Federal poverty level to 200 percent - Savings of \$4.0 million in general revenues;
- Projects a \$2.1 million savings by requiring RIPAE recipients eligible under the Federal Medicare Prescription Drug and Improvement Act of 2003 to enroll in the Federal drug benefit.
- Reimbursement of child care providers at lower rates – anticipated savings of \$2.5 million while increasing the total number of subsidized child care slots.

Economic Development

- Continues two-year phase-in of double-weighting sales apportionment formula for manufacturers;
- Continues the \$4.0 million in Slater Centers of Excellence appropriations;

- Proposal for a \$1.5 million investment to participate in the National Science Foundation Experimental Program to Stimulate Competitive Research (EPSCOR) – leveraging \$9.0 million in NSF grants over the next three years;
- Proposed shifting \$1.4 million in general revenue funds for adult education to the Human Resources Investment Council; and
- \$48.0 million in GO Bonds for infrastructure improvements to Quonset Point; and \$50.0 million GO bond for the Center for Biotechnology and Life Sciences at URI.

Debt

- Net tax supported debt is projected to total \$1.5 billion as of June 30, 2004;
- FY 2005 debt as a percent of personal income is 4.15 percent and is projected to peak at 4.24 percent in FY 2006;
- FY 2005 debt service as a percent of general revenues is 4.9 percent and is projected to peak at 5.4 percent in FY 2007 during the next four fiscal years;
- Governor proposes \$234.5 million in new bond referenda for November 2004 and \$111.4 million for November 2006;
- Capital budget includes approximately \$425.0 million in GARVEE bonds for five major transportation projects; and

- Tobacco Securitization Initiative resulted in reducing debt service obligations in FY 2005 by \$40.3 million:

Other

- State budget includes tuition increases of 11.5 percent at the University of Rhode Island, 9.7 percent at Rhode Island College and 12.0 percent at the Community College of Rhode Island:

Personnel Trends – FY 2005 personnel expenditures total \$1,425.7 million, a \$36.4 million (2.6 percent) increase from the FY 2004 revised personnel budget. The majority of the net increase in personnel spending was driven by an additional \$25.0 million for salaries.

The Governor anticipates a 2.0 percent Cost of Living Adjustment for State employees to cost approximately \$21.0 million, of which \$11.8 million would be from general revenues. The value of this additional expenditure is adjusted down by \$10.6 million in savings to the State through a proposed State employee cost-sharing arrangement for 7.0 percent of the health insurance costs.

General revenues support 52.1 percent of all personnel expenses in FY 2005. Federal Fund support nearly 23.5 percent and the remaining funds (special funds, restricted receipts and internal service funds) would remain essentially the same, supporting 24.4 percent of the personnel budget.

The FY 2004 revised budget includes an additional \$33.2 million net in personnel spending than was enacted last summer. The Administration has requested a net increase of \$5.2 million in salaries and

Table 12
State Personnel Costs - Unadjusted

Personnel Costs (Millions)	FY 1996 Actual	FY 2003 Actual	FY 2004 Revised	FY 2005 Proposed	FY 2005 - FY 2004 Revised	
					Actual Change	Percent Change
Salaries & Benefits						
Net Salaries	\$601.43	\$800.0	\$807.9	\$840.7	\$32.8	4.1%
Adjustment for Temp	(\$57.0)	(\$80.0)	(\$63.5)	(\$66.4)	(2.9)	4.6%
Overtime	35.1	57.5	52.4	47.4	(5.0)	-9.5%
Retirement	55.1	66.4	79.3	95.0	15.7	19.8%
Medical	85.2	127.6	161.4	154.6	(6.8)	-4.2%
Other Benefits/Payroll	55.2	74.5	77.8	80.7	2.9	3.7%
<i>Salaries & Benefits</i>	<i>\$775.1</i>	<i>\$1,045.9</i>	<i>\$1,115.2</i>	<i>\$1,152.0</i>	<i>\$36.7</i>	<i>3.3%</i>
Funded FTE Positions	16,537.6	15,704.4	15,614.9	15,759.0	144.1	0.9%
Average Cost Per FTE	\$46,868	\$66,598	\$71,422	\$73,098	\$1,676	2.3%
Other Personnel Costs						
Other Payroll Costs	\$74.6	\$107.8	\$91.8	\$98.1	\$6.2	6.8%
Purchased Services	89.3	158.2	182.2	175.7	(6.5)	-3.6%
<i>Other Personnel</i>	<i>\$163.9</i>	<i>\$266.1</i>	<i>\$274.1</i>	<i>\$273.7</i>	<i>(\$0.3)</i>	<i>-0.1%</i>
Total Personnel Costs	\$939.0	\$1,311.9	\$1,389.3	\$1,425.7	\$36.4	2.6%
Adjusted (2005 \$)	\$1,132.3	\$1,349.0	\$1,410.2	\$1,425.7	\$15.5	1.1%

Source: State Budget Office and FY 2005 Personnel Supplement.

benefits for State employees (primarily for overtime), \$36.5 million in additional purchased services expenditures and a net \$8.5 million reduction in other payroll costs. The additional expenditures for purchased services are also partially due to consistent under-budgeting of these expenses in the budget process (discussed further below).

Personnel expenditures represent a significant portion of the State's budget. In FY 1996, personnel spending represented 26.5 percent of the State budget. It has since declined to 24.0 percent of the budget, principally due to faster growth in grants and benefits to individuals and local aid.

However, personnel expenditures continue to grow – increasing by \$486.7 million from FY 1996 to FY 2005 – a 51.8 percent increase over this period of time. If one adjusts these expenditures (2005 dollars),

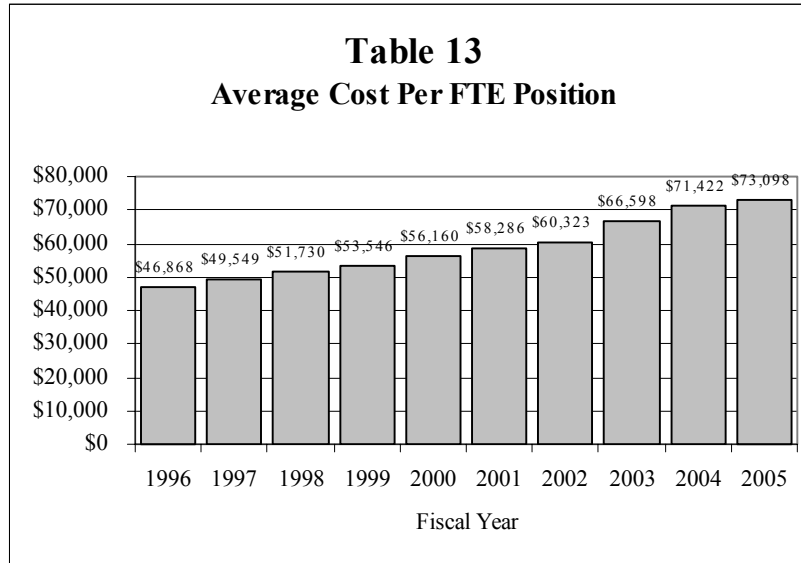
personnel expenditures increased by \$293.3 million, or by 25.9 percent.

The average cost per FTE position increased over this period. The average cost increased from \$46,869 in FY 1996 to \$73,100 per position in FY 2005 – increasing by 56.0 percent during this period.

If one adjusts FY 1996 expenditures per position for inflation, the average cost per FTE position has increased from \$56,524 in FY 1996 to \$73,100 per position in FY 2005 – a 29.3 percent increase during this period. This growth is attributed to increases in the salary base, medical insurance costs, and cost of living arrangements in the State's contracts.

In addition, providing medical insurance to State employees has doubled since FY 1996. Employee medical insurance costs have

Table 13
Average Cost Per FTE Position



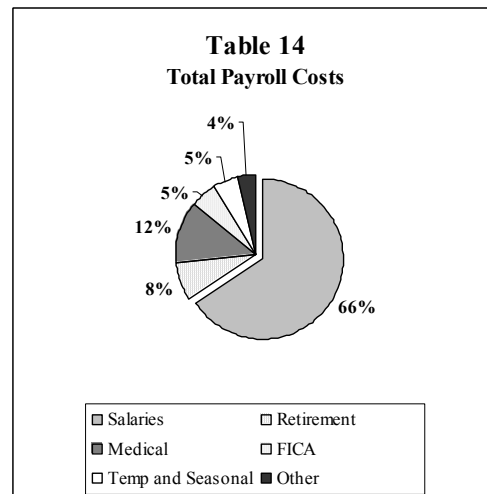
increased from \$85.2 million in FY 1996 to \$154.6 million in FY 2005. Adjusting for inflation, medical insurance costs increased from \$102.8 million in FY 1996 to \$154.6 million in FY 2005 – a \$51.8 million or 50.4 percent increase.

The State’s actuarial contribution for retirement increased from 9.6 percent to 11.51 percent - increasing the State’s contribution by \$15.7 million. Preliminary projections indicate that the State’s contribution rate will reach 20.0 percent by FY 2008.

It should be noted that the FY 2005 expenditures related to health coverage for State employees includes an adjustment in anticipation of successful contract negotiations that would translate into a 7.0 percent cost-sharing arrangement with State employees. According to the Administration, this would equate to approximately \$10.6 million in savings to the State.

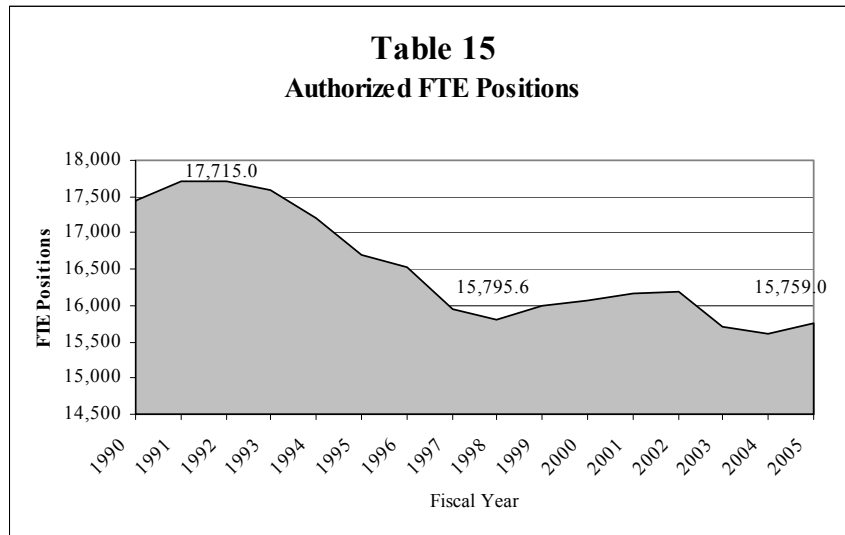
Another growing cost in the State budget is the State’s pension obligations. In FY 1996, the State contributed \$55.1 million for support of the pension system – this has since increased to \$95.0 million in FY 2005. This represents an increase of \$39.9 million or 72.4 percent. If one adjusts the FY 1996 figures to 2005 dollars, the increase translates to \$28.5 million or 42.9 percent growth during this period.

Table 14
Total Payroll Costs



Staffing - In order to manage the staffing levels in State government, the State allocates FTE positions (full time equivalent positions) to all agencies and departments. These FTE positions now exclude certain positions in higher education that are research oriented and are financed through federal or other third party sources.

Table 15
Authorized FTE Positions



However, the following analysis includes these positions in the totals for comparison purposes.

The Governor's FY 2004 revised budget request includes 15,614.9 FTE positions, representing a net increase of 5.7 FTE positions from the FY 2004 enacted budget. It should be noted that this figure includes 355.5 FTE positions in higher education that have been designated as exempt from the enacted FTE authorizations.

The Governor's FY 2005 budget includes 15,759.0 FTE positions, representing a 144.1 FTE position increase from the FY 2004 revised budget. It should be noted that this figure includes 361.8 FTE positions in higher education that have been designated as exempt from the enacted FTE authorizations.

The net increase of 144.1 FTE positions can be attributed to several initiatives:

- The Budget includes an additional 82.0 FTE positions for various public safety programs – corrections (new officer class), state police (new class) and the fire marshal office;

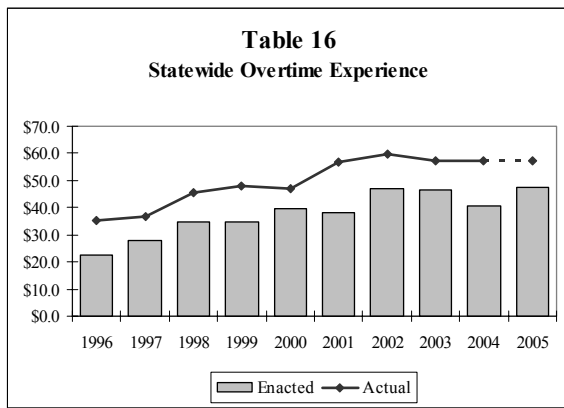
- Nearly 77.0 FTE positions were added to higher education, of which 50.0 are related to the new CCRI campus in Newport and 11.0 for expansions in the Providence Campus; and
- An additional 11.0 FTE positions in Taxation assigned to “enhance collections” by a net \$6.6 million in FY 2005.

The FY 2005 Budget proposes a new class of positions called limited service positions. These positions would not be subject to the FTE position authorization spelled out in the annual appropriations bill. According to Article 40 of the Governor’s proposed budget, these positions would be funded by non-general revenue sources and would be limited to one year of employment. These positions would not be eligible for retirement, health or other benefits ordinarily provided to state employees.

Other Personnel Issues - There are two personnel issues worth highlighting. First, the State’s expenditures for overtime continue to display interesting trends. Overtime expenditures represent approximately 5.0 percent of the State’s salaries and benefits. Overtime has increased from \$35.1 million in FY 1996

(unadjusted) to a FY 2005 request of \$47.4 – a \$12.3 million increase during this period (35.0 percent). Overtime expenditures peaked at \$59.8 million in FY 2002.

However, what is of concern is the ongoing practice of how overtime is budgeted. In FY 2003, actual experience in overtime expenditures (\$57.5 million) exceeded the enacted appropriation of \$46.6 million by 23.3 percent. Similarly, the FY 2004 enacted budget included \$40.6 million in overtime, whereas the Governor’s FY 2004 revised budget includes \$52.4 million in net overtime expenditures – a 29.0 percent increase from the enacted budget. The FY 2005 proposed budget includes \$47.4 million in net overtime expenditures. This would represent a \$5.0 million decrease in overtime expenditures from the Governor’s FY 2004 revised budget – a 9.5 percent decrease in overtime spending.



Purchased services also have a number of interesting expenditure and budgeting trends. First, expenditures have increased from \$89.3 million in FY 1996 to \$175.7 million in FY 2005 – an \$86.4 million increase. If one adjusts for inflation purchased services still increased by 63.1 percent. Purchased services expenditures represented 9.5 percent of the State’s personnel budget in FY 1996. This has since increased to 12.3 percent.

A similar pattern emerges in purchased services. In FY 2004, the budget as enacted included \$145.7 million in contract spending. Of the \$145.7 million in purchased services budgeted in the FY 2004 enacted budget, \$39.8 million was supported with general revenues - \$12.5 million less than actual experience in FY 2003.

The Governor has requested \$182.2 million in spending for these services in the revised FY 2004 budget plan – a \$36.5 million net increase from the enacted budget (a 25.1 percent increase). Of this amount, \$49.1 million would be supported with general revenues - \$9.3 million more than enacted.

The Governor’s FY 2005 budget request includes \$175.7 million in expenditures for contracted services, of which \$48.5 million is supported with general revenues.

There are two areas within purchased services that have experienced the most growth in spending over time. First, Management and Audit services increased from \$39.2 million in the enacted FY 2004 budget to \$50.0 million in the FY 2004 revised spending plan and to \$50.4 million in the FY 2005 proposed budget. Similarly, Educational and Professional Services have increased from \$22.0 million in the FY 2004 enacted budget to \$29.5 million in the FY 2004 revised spending plan and totals \$27.4 million in the FY 2005 proposed budget.

Grants and Benefits – Expenditures relating to direct assistance to individuals are considered grants and benefits in the State’s operating budget. These expenditures include medical assistance, employment security and temporary disability funds, food stamps, and other cash assistance.

Total grant and benefit expenditures (adjusted for inflation) increased by \$783.0 million from FY 1996 to FY 2005 – a 41.6 percent increase over this period of time. The \$783.0 million increase in grants and benefits represented nearly 47.0 percent of the total growth in State spending during this period of time.

Of the \$783.0 million increase from FY 1996 to FY 2005, \$412.2 million – or 53.0 percent – was associated with medical assistance programs, such as Rite Care and nursing homes. This growth has been a function of both demographic shifts in the State as well as public policy decisions to expand eligibility and services to more Rhode Islanders.

The Governor's FY 2005 budget includes \$42.0 million from general revenues to adjust for the Federal Medical Assistance Percentage rate (FMAP). The FMAP determines the State-Federal share of Medicaid related expenditures. The FY 2004 enacted budget recognized \$40.0 million in general revenue savings from a 2.95-point enhancement in the FMAP rate as part of the Jobs and Growth Tax Relief Reconciliation Act of 2003.

Prior to the Federal Act, Rhode Island's FY 2004 base FMAP rate was 44.1 percent, with the Federal government providing the 55.9 percent balance. The one-time FMAP enhancement provided by the Federal government established Rhode Island's enhanced rate at 41.2 percent, with the Federal government providing 58.8 percent.

The FMAP rate, which adjusts annually, is expected to return to the scheduled rate of 44.5 percent for Rhode Island in FY 2005, with the Federal Budget providing the 55.5 percent balance.

The Governor included a number of changes to grant and benefit programs that affected eligibility for certain programs as well as the range of benefits provided to participants. There were also changes that affect the State's obligations to certain providers of services. The following highlights selected initiatives included in the Governor's FY 2005 budget request.

Managed Care – Principally the Rite Care program, provides families on the Family Independence program and eligible uninsured pregnant women, parents and children up to age 19 with comprehensive health care. The Department of Human Services purchases health insurance or provides a premium subsidy for employer sponsored health insurance.

Managed care programs have increased from \$107.1 million in FY 1996 (adjusted for inflation) to \$367.9 million in FY 2005. This represents a 244.0 percent increase during this period. Enrollment has increased from 71,076 in FY 1990 to a projected 130,012 in FY 2005. This increase in enrollment has been primarily due to changes in eligibility, which permitted additional Rhode Islanders to participate in the program. The FY 2005 projected enrollment in Rite Care represents a 3.6 percent increase in enrollment from FY 2004 (125,549 persons).

The Governor has proposed to eliminate the present practice of paying the health plans up to six months of the capitated rate for clients who no longer receive the service. The Governor expects to generate approximately \$2.6 million in total savings to the State, of which \$1.1 million would be in general revenues. This savings is reflected in the total expenditures reported above.

Table 17
FY 1996 - FY 2005

Fiscal Year	Child Care	Rite Care	TANF	SSI	GPA	Food Stamps	Prisons
1996	4,983	71,076	58,405	24,328	1,085	0	3,002
1997	6,066	75,484	54,783	25,153	847	0	3,240
1998	6,830	74,853	54,287	25,318	485	4,236	3,392
1999	8,206	94,510	53,243	26,156	576	3,201	3,384
2000	10,553	105,504	51,487	27,162	651	2,545	3,196
2001	11,795	107,526	47,764	28,050	699	2,320	3,019
2002	12,107	116,393	45,180	28,916	400	2,266	3,387
2003	13,057	120,896	42,364	29,008	468	2,140	3,537
2004	13,815	125,549	40,350	29,705	460	0	3,600
2005 CEC*	14,215	130,012	38,700	30,350	460	0	
2005 Gov	12,879	130,012	36,259	30,350	460	0	3,640
1996-2005 (Gov. Change)	7,896 158.5%	58,936 82.9%	-22,146 -37.9%	6,022 24.8%	-625 -57.6%	0 0.0%	638 21.3%

*CEC= Caseload Estimating Conference (The CEC does not estimate Rite Care enrollment)

Source: DHS, FY 2005 State Budget Documents, November 2003 Caseload Estimating Conference, and RIPEC calculations.

Family Independence Program (FIP) – In 1996 the Aid to Families with Dependent Children Program (AFDC) was replaced by the Family Independence Program (FIP) to implement the Federal Temporary Assistance to Needy Families (TANF) block grant

The FIP is designed to provide child-care, health care and cash payment support to families with needy children. The program has an emphasis on assisting families in preparing for gainful employment. The FIP has a lifetime limit of 60 months for cash assistance for adults. Child-care, health care and other services are entitlements to all those pursuing economic self-sufficiency.

There are two major components of FIP – direct cash assistance and a child care subsidy. In FY 1996, the State spent \$174.5 million on the program, of which \$155.1 million (89.0 percent) was in support of cash assistance and \$19.4 million (11.0 percent) for child care subsidies.

In FY 2005, the Governor has budgeted \$147.6 million for the program, of which \$70.6 million (48.0 percent) is related to

cash assistance and \$77.0 million (52.0 percent) for child care subsidies. The FY 2005 budget represents a \$26.9 million reduction in total spending for the program since FY 1996 (adjusted).

Overall, the State is projected to provide approximately 43.4 percent (\$64.1 million) of the funding for the programs in FY 2005. For the cash assistance program, the State provides 15.0 percent (\$10.7 million) of the funding and the Federal government provides the 85.0 percent (\$59.9 million) the balance. However, the child care program funding structure is considerably different, where the State provides 69.4 percent of the funding and the Federal government the balance.

The reduction in cash assistance is due to a continued decline in projected enrollment for the cash assistance component of the program. In FY 1996, there were 58,400 persons enrolled in the TANF program. If the Governor's proposals are enacted, caseloads would decline to approximately 36,300 in FY 2005. This represents a 22,100 caseload reduction, or 37.8 percent.

Conversely, the portion of the program allocated for child care has increased by \$57.5 million from FY 1996 to FY 2005. This represents a 296.4 percent increase during this period. Child care slots have increased from 4,983 in FY 1996 to a projected 12,879 in FY 2005 based on the Governor's budget request. Therefore, caseloads have increased by 158.5 percent. The annual subsidy per child care slot has increased from \$3,893 in FY 1996 (\$3,228 actual adjusted for inflation) to \$5,979 in FY 2005 – a 53.6 percent increase.

The Governor has proposed a number of recommendations affecting the FIP and child care programs. The following highlights some of the Governor's initiatives:

The Governor's FY 2005 budget includes \$4.0 million in net general revenue savings based on a full family sanction beginning at the 12th month of non-compliance of program requirements.

The Governor has projected \$1.7 million in savings by eliminating the child support disregard for FIP participants. In other words, recipients in the FIP program are currently permitted to keep the supplemental \$50.00 per month cash benefit from child support without reducing program benefits.

Expenditures for child care decrease by \$5.4 million (7.0 percent) from the \$82.4 million included in the FY 2004 revised budget. Declining expenditures are attributable to general revenue savings from the implementation of eligibility reviews and additional changes to child care assistance.

For example, the Governor recommends reducing a family's income eligibility for child care services to 200 percent of the federal poverty level. This amounts to

savings of \$4.0 million. The Governor has also proposed to increase the cost-sharing of child care that is based on a percentage of income for eligible families between 150 and 225 percent of the Federal Poverty Level. This would shift \$0.7 million in costs to program recipients from State obligations.

In addition, the Governor has proposed to save \$2.5 million in child care expenditures by paying child care providers at or below the 75th percentile based on the rate charged to individual providers' private clients.

Rhode Island Pharmaceutical Assistance Program to the Elderly (RIPAE) – RIPAE provides pharmaceutical subsidies for low-income and middle-income residents age 65 and older. Assistance is provided by paying for a range of medications for eligible Rhode Islanders. Prescriptions used for treating Alzheimer's disease, diabetes, heart problems, cholesterol, asthma and other medical conditions are covered under this program.

Rhode Island has the 6th highest concentration (14.5 percent of population) of elderly in the U.S. (age 65 and older), and the baby-boomer generation is quickly approaching eligibility for the program. Caseloads for RIPAE program have increased by 62.0 percent since FY 1996 – primarily due to expansion of eligibility requirements.

Program expenditures continue to outpace inflation, totaling over \$14.3 million in FY 2005, with program costs principally driven by increases in pharmaceutical use and cost. FY 2005 RIPAE program costs have increased by \$6.1 million since FY 1996 – a 74.4 percent increase during this period.

The Governor has proposed two initiatives within the RIPAE program to begin containing costs. First, the Governor has proposed requiring all those participating in RIPAE to enroll in the Federal drug benefit program as part of the Medicare Prescription Drug and improvement Act of 2003. This program pays \$600 a year for those who are eligible. The State estimates that 7,500 of the 43,000 total RIPAE enrollment would be both eligible for the Federal program and actually take advantage of the benefit. This would shift \$2.1 million in RIPAE expenditures to Federal sources, thereby saving the State the general revenues to support these services.

Second, the Governor has proposed providing RIPAE participants the option of conducting their pharmaceutical business through mail order, which would generate an additional \$0.4 million in savings.

State Aid - The Governor's FY 2005 budget request includes approximately \$1,112.6 million in local aid, representing a 1.0 percent increase over the FY 2004 revised budget. Approximately 65.3 percent of the \$1,112.6 million in local aid program is related to general school aid. This is down from 85.4 percent in FY 1996.

Local aid to cities and towns has doubled since FY 1996 - from \$528.5 million to \$1,112.6 million in FY 2005 as proposed by the Governor - a \$584.1 million increase over this period of time. If one adjusts for inflation, local aid increased from \$637.3 million in FY 1996 - a \$475.3 million increase in local aid during this period. It should be noted that the growth in local aid since FY 1996 represents 28.5 percent of all State spending growth during this period.

The four largest drivers of growth in local aid include the program to phase-out the excise tax on motor vehicles, education aid, Federal aid (primarily for schools) and general revenue sharing.

Of the \$475.3 million net increase in local aid since FY 1996 (adjusted for inflation), nearly 38.5 percent of the increase was for additional education aid, and 22.1 percent (\$105.0 million) was related to the program to phase out the excise tax on motor vehicles. Approximately 23.6 percent is related to various Federal aid programs for local communities and 7.6 percent was due to increases in general revenue sharing. The 8.2 percent balance was in various other state aid programs.

State Aid	1999	2000	2001	2002	2003	2004	2005	2004-05
Direct Education Aid	\$479.5	\$515.1	\$560.0	\$596.4	\$621.7	\$637.6	\$629.7	(\$7.9)
Teacher Retirement	30.2	40.0	35.5	30.7	38.4	46.2	52.6	6.4
Construction Aid	22.6	25.5	30.8	33.2	38.2	40.6	44.7	4.1
Motor Vehicle Reimbursement	22.3	47.3	76.6	99.6	100.2	105.0	105.0	0.0
General Revenue Sharing	19.7	27.6	33.5	43.6	48.3	51.4	51.4	0.0
PILOT	15.9	16.1	17.6	18.1	18.2	21.7	21.7	(0.0)
Distressed Community	6.2	6.6	7.3	7.7	7.5	7.5	7.5	(0.0)
Library Aid	3.6	5.7	6.0	6.3	6.6	7.6	7.8	0.2
Other State Aid - Various	8.3	13.6	16.1	21.1	20.8	28.9	38.8	9.9
Federal Aid	69.4	76.5	81.8	88.6	105.7	155.6	153.5	(2.2)
Total State Aid	\$677.7	\$773.9	\$865.2	\$945.3	\$1,005.6	\$1,102.2	\$1,112.6	\$10.4
<i>Change</i>		<i>14.2%</i>	<i>11.8%</i>	<i>9.3%</i>	<i>6.4%</i>	<i>9.6%</i>	<i>0.9%</i>	

Source: RIPEC calculations based on State Budget Office Documents

Table 19
Rhode Island State Education Aid Program
(Millions)

Education Aid	1999	2000	2001	2002	2003	2004	2005	2004-05	Percent
Direct Education Aid	\$479.5	\$515.1	\$560.0	\$596.4	\$621.7	\$637.6	\$629.7	(\$7.9)	-1.2%
Teacher Retirement	30.2	40.0	35.4	30.7	38.4	46.2	52.6	6.4	13.8%
Construction Aid	22.6	25.5	30.8	33.2	38.2	40.6	44.7	4.1	10.1%
Charter Schools	0.0	2.8	3.8	6.2	9.4	12.6	18.0	5.4	42.5%
MET School	1.2	1.8	2.0	2.2	4.0	5.8	7.8	2.1	36.3%
Other Aid	0.5	0.7	5.9	6.4	1.5	2.8	3.7	0.9	32.1%
Total	\$534.0	\$585.9	\$637.8	\$675.0	\$713.3	\$745.6	\$756.6	\$10.9	1.5%

Source: RIPEC calculations based on State Budget Office Documents

Education Aid - As shown on Table 19, the Governor's FY 2005 education aid program totals \$756.6 million, representing a \$10.9 million (1.5 percent) increase over FY 2004 revised figures. However, there are several components to the Governor's program worth noting. First, the direct education aid program would total \$629.7 million – a \$7.9 million decrease from FY 2004.

However, the Governor has increased funding for Charter Schools and the MET school by \$7.5 million. The Budget also increases funding for the State's contribution for the Teacher Retirement Pension Fund by \$6.4 million and provides an additional \$4.1 million for the State's Construction Aid program.

Payment-in-Lieu-of-Taxes - Established in 1986, PILOT was designed to provide payments to municipalities for various institutions that are not on property tax rolls. Prior to FY 2003, the program provided a 27.0 percent reimbursement rate for taxes that were foregone due to the property's tax exempt status. The FY 2003 enacted budget included language to permit the State to ratably reduce the appropriation for the PILOT program rather than to appropriate to the statutorily established rate of 27.0 percent. The State appropriated \$21.7 million in FY 2004, which represented fully funding the PILOT program at 27.0 percent.

In his FY 2005 budget request, the Governor has proposed to level-fund the PILOT program with \$21.7 million in appropriations. This would translate into a reimbursement rate of 25.1 percent. In order to maintain 27.0 percent funding, the State would have to increase the appropriation by \$1.6 million.

General Revenue Sharing - The program is based on the percentage of total state tax collections from two years prior. In FY 1999, the State started to eliminate local retail, wholesale and auto dealers' inventory taxes over a ten-year period, freezing FY 1999 local tax rates and requiring municipalities to reduce rates annually by 10.0 percent. Concurrently, the State embarked on a ten-year program to increase the percentage in the General Revenue Sharing Program from 1.3 percent in FY 1999 to 4.7 percent by FY 2009 to reimburse municipalities for revenues foregone. Since its inception the program has experienced a one-year delay in its implementation – scheduled to be fully implemented by FY 2010.

Under current law, FY 2005 General Revenue Sharing aid would be calculated based on 3.0 percent of FY 2003 total tax revenues. This would require an appropriation of approximately \$60.4 million. However, the Governor has

proposed to fund the program at 2.7 percent, or \$51.4 million. The Governor has proposed delaying the program to increase the General Revenue Sharing Program to 4.7 percent from FY 2010 to FY 2011.

Under the original intent of the program, the State was to reimburse cities and towns through the General Revenue Sharing Program for revenues foregone as they eliminated the local inventory taxes. The Governor's proposal does not address the inventory tax side of the equation.

Excise Tax on Motor Vehicles – In FY 1999, the State embarked on an eight-year program to phase-out the excise tax on motor vehicles by FY 2007. The program requires all communities to freeze motor vehicle excise tax rates at the FY 1998 level, and increases the amount of vehicle value exempt from taxation until all vehicle value is exempt in FY 2007. In making up the lost revenues generated by the tax, the State holds communities harmless through advance reimbursements adjusted for inflation.

The Governor has continued the freeze on the eight-year phase out of the local excise tax on motor vehicles. The FY 2005 budget continues to reimburse local communities for an exemption of \$4,500, requiring \$105.0 million. This essentially level-funds the program, but is approximately \$5.7 million less than what is required under current law. The Governor has proposed changing the reference year for reimbursing municipalities in order to achieve level funding. The proposal would reimburse municipalities based on the prior fiscal year rather than the concurrent year of tax information.

IV. The Revenue Plan

The Governor's FY 2004 revised budget and FY 2005 proposed budget are based on revenue estimates established in November 2003. It should be noted that the November 2003 Revenue Estimating Conference (REC) decreased FY 2004 revenue estimates by \$20.4 million – from \$2,805.4 million to \$2,785.0 million.

The REC estimated revenues of \$2,789.4 million for FY 2005. This is a net increase of \$4.4 million from the revised revenues for FY 2004 (\$2,785.0 million). However, the FY 2005 estimates did not include the Hospital Licensing Fee - estimated to be \$62.4 million. The Governor and General Assembly have extended the fee each year. As shown on the next page the Governor recommended continuing the Hospital Licensing Fee.

The Governor has proposed changes to the revenue plan for both fiscal years. The Governor's proposed FY 2004 changes total \$15.7 million. Of this increase, \$11.2 million are additional departmental receipts and \$4.6 million is from other sources. These changes include:

- \$10.0 million in enhanced Uncompensated Care Revenues at the Eleanor Slater Hospital;
- \$4.1 million in revenues from the elimination of the Dog Kennel Owners Share of the Video Lottery Terminal Net Terminal Income;
- \$1.1 million in departmental fees related to increased RIPAE rebates and Child Support enforcement; and

Table 20
State General Revenues

General Revenues	FY 2004		Governor FY 2004R		FY 2005		Governor FY 2005	
	REC	Governor	Change	Percent	REC	Governor	Change	Percent
Taxes								
Personal Income Tax	\$854.9	\$854.9	\$0.0	-	\$893.1	\$906.3	\$13.2	1.5%
General Business Taxes	226.3	226.3	0.0	-	255.8	263.4	7.6	3.0%
General Sales & Use Tax	816.0	816.0	0.0	-	850.0	854.3	4.3	0.5%
Cigarette Tax	121.4	121.4	0.0	-	116.3	154.7	38.4	33.0%
Other Taxes	104.1	104.1	0.0	-	106.0	106.0	0.0	0.0%
<i>Subtotal - Taxes</i>	<i>2,122.7</i>	<i>2,122.7</i>	<i>0.0</i>	<i>-</i>	<i>2,221.2</i>	<i>2,284.8</i>	<i>63.6</i>	<i>2.9%</i>
Department Receipts	287.0	298.2	11.2	3.9%	227.8	310.8	83.0	36.5%
Taxes & Departmentals	\$2,409.7	\$2,420.9	\$11.2	0.5%	\$2,449.0	\$2,595.6	\$146.6	6.0%
Other Sources								
Gas Tax Transfer	\$6.6	\$7.1	\$0.5	7.3%	\$6.7	\$9.6	\$2.9	42.9%
Other Miscellaneous	71.0	71.0	(0.0)	0.0%	10.1	19.0	8.9	87.8%
Lottery	283.1	287.2	4.1	1.4%	315.0	325.6	10.6	3.4%
Unclaimed Property	14.5	14.5	0.0	-	8.6	8.6	0.0	-
<i>Total Other Sources</i>	<i>375.2</i>	<i>379.8</i>	<i>4.6</i>	<i>1.2%</i>	<i>340.4</i>	<i>362.7</i>	<i>22.3</i>	<i>6.6%</i>
Total Gen. Revenues	\$2,784.9	\$2,800.7	\$15.7	0.6%	\$2,789.4	\$2,958.3	\$168.9	6.1%

REC= Revenue Estimating Conference

Source: FY 2005 State Budget, Executive Summary, November 2003REC, and RIPEC calculations

- \$0.5 million in additional gas tax revenues transferred from RIPTA to the general fund.

The Governor's FY 2005 changes total \$168.9 million. However, if one excludes the Hospital Licensing Fee of \$62.4 million (apparently reauthorized each year), the Governor's FY 2005 revenue plan increases total revenues by \$106.5 million. Of this increase, \$84.2 million are additional revenues generated from taxes and fees and \$22.3 million is from other sources. Major revenue changes include, but are not limited to:

- \$62.4 million in revenue through the extension of the hospital licensing fee (current rate of 4.0 percent of net patient service revenues);

- \$42.7 million in net cigarette taxes – increasing the tax per pack by \$0.75 per pack, additional sales tax collections on increased cigarette taxes, additional floor stock taxes from increased tax per pack and the prepayment of sales tax on cigarettes;

- \$13.2 million in additional personal income tax collections through requiring tax clearance for state issued licenses, elimination of various enterprise zone tax credits and requiring income tax withholdings for nonresident shareholders;

- \$7.6 million in various business tax increases, to include increasing the corporate minimum and franchise tax to \$450 and repealing of the various enterprise zone tax credits;

- \$10.6 million in revenues from the elimination of the Dog Kennel Owners Share of the Video Lottery Terminal Net Terminal Income;
- \$10.6 million in enhanced Uncompensated Care Revenues at the Eleanor Slater Hospital;
- \$9.9 million in additional revenues from various transfers from the Resource Recovery Corporation and the Sinking Fund, as well as the sale of Surplus Land.

Revenue Proposal	Amount
Reinstate Hospital Licensing Fee	\$62.4
Cigarette Taxes (includes sales and use impact)	42.7
Personal Income Tax	13.2
Lottery - Dog Kennels	10.6
Uncompensated Care - slater hospital	10.6
Transfers from other funds and Surplus Land	9.9
Business Corporations Tax	7.6
Other - Fines, Charges and Fees	6.8
Gas Tax Transfer	2.9
Other - Increased RIPAE Rebates and other	2.2
Total FY 2005 Proposed Revenue Change	\$168.9

Source: FY 2005 State Budget - Executive Summary

The following discussion highlights selected revenue changes:

Hospital Licensing Fee – The Governor has recommended extending the licensing fee in FY 2005 at 4.0 percent of net patient service revenues. This is projected to generate \$62.4 million in gross revenues to the State, where nearly 95.0 percent (\$58.3 million) would be generated from community hospitals and the balance from the Eleanor Slater Hospital. The community hospitals are projected to receive \$25.0 million more in uncompensated care payments than they pay in hospital fees to the State.

Cigarette Tax - Cigarette tax collections increased from \$53.1 million in FY 1996 to an expected \$121.4 million in FY 2004, a 128.6 percent increase. In FY 1996, the cigarette tax per pack was \$0.60 per pack. As of FY 2004, the State’s cigarette tax is \$1.71 per pack. The Governor has proposed increasing the State’s tax rate by \$0.75 to \$2.46 per pack.

Additional revenues associated with all proposed actions on cigarettes would total \$42.7 million. There are several components of the total increase in cigarette tax revenues proposed by the Governor.

- \$34.2 million in additional revenues from increasing the tax rate by \$0.75;
- \$3.7 million in additional cigarette floor stock tax based on the higher cigarette taxes;
- \$2.4 million of additional sales tax revenues would be generated based on the higher cigarette prices;
- \$1.9 million in an initiative to prepay sales taxes on cigarettes; and
- \$0.6 million through freezing the cigarette stamping discount.

According to an analysis by the House Fiscal Staff, Rhode Island’s retailers may not be able to sell cigarettes competitively with Connecticut and Massachusetts even when one considers the lower minimum markup provisions in Rhode Island.

Personal Income Taxes – The Governor has proposed a series of changes that would increase personal income tax collections by \$13.2 million.

Of this increase, the requirement for tax clearance for state issued professional licenses is projected to generate \$6.5 million in FY 2005.

The Governor has proposed to repeal enterprise zone wage, donation and interest income tax credits, which would generate approximately \$3.4 million. The elimination of the wage tax credit represents the largest component of this initiative, resulting in \$2.6 million of the \$3.4 million in projected revenues.

The Governor also proposes to require income tax withholdings for nonresident shareholders, estimated to increase personal income tax collections by \$2.0 million.

Business Tax Changes – The Governor has proposed increasing business taxes and fees by \$7.6 million in FY 2005. The principal increase is the Governor's initiative to increase the minimum tax and franchise fee from \$250 to \$450, generating an estimated \$7.0 million in revenues for the State.