



**RIPEC**

# Comments on Your Government

A SPECIAL PUBLICATION OF THE RHODE ISLAND PUBLIC EXPENDITURE COUNCIL

## FY 2005 State Budget Budget as Enacted – Part V

RIPEC's FY 2005 Budget Analysis has been presented in several parts. Part I provided an overview of the Governor's FY 2005 Budget request along with RIPEC's Comments on the overall fiscal plan. Subsequent RIPEC publications focused on the State's Pharmaceutical Assistance Program for the Elderly (RIPAE), Medicaid, and revised revenue forecasts and caseload estimates. RIPEC will publish an analysis in October of the State's revised Capital Budget Program and the bond questions presented for voter consideration in November.

**Table 1**

**Rhode Island State Expenditures - All Funds**

<b>By Category</b>	<b>2003</b>	<b>2004E</b>	<b>2004R</b>	<b>2005</b>
Personnel	\$1,311.9	\$1,355.8	\$1,378.9	\$1,424.4
Operating	376.2	368.4	381.7	377.2
Local Aid	1,005.7	1,086.0	1,103.3	1,081.9
Grants & Benefits	2,424.8	2,553.5	2,653.2	2,718.0
Capital	143.5	229.7	207.4	147.9
Debt Service	136.7	147.0	151.7	210.0
<i>Total</i>	<i>\$5,398.8</i>	<i>\$5,740.6</i>	<i>\$5,876.0</i>	<i>\$5,959.5</i>
<b>By Fund</b>	<b>2003</b>	<b>2004E</b>	<b>2004R</b>	<b>2005</b>
General Revenues	\$2,682.0	\$2,783.8	\$2,789.7	\$2,937.8
Federal Funds	1,587.5	1,837.5	1,905.9	1,861.9
Restricted Funds	114.3	144.6	135.4	114.1
Other Funds	1,015.1	974.6	1,045.0	1,045.7
<i>Total</i>	<i>\$5,398.8</i>	<i>\$5,740.6</i>	<i>\$5,876.0</i>	<i>\$5,959.5</i>
<i>Percent Change</i>	<i>4.0%</i>	<i>6.3%</i>	<i>8.8%</i>	<i>1.4%</i>
Adjusted Expenditures	\$5,600.4	\$5,832.4	\$5,970.0	\$5,959.5
<i>Percent Change</i>	<i>1.7%</i>	<i>4.1%</i>	<i>6.6%</i>	<i>-0.2%</i>

Source: RIPEC calculations based on State Budget Office and Bureau of Labor Statistics Data

## **Selected Budget Highlights**

1. The FY 2005 budget will represent a net increase in total State spending of \$218.9 million, or 3.8 percent, over the FY 2004 enacted budget (\$83.5 million, or 1.4 percent, over the FY 2004 revised budget).
2. The FY 2005 general revenue budget would represent a net increase of \$154.0 million, or 5.5 percent, from the FY 2004 enacted general revenue budget (\$148.1 million, or 5.3 percent, from the FY 2004 revised budget).
3. In FY 2005, there is a projected \$42.8 million operating deficit. Based on the FY 2005 Budget as Enacted, the House Fiscal Advisory Staff forecasts a \$135.0 million operating deficit for FY 2006.
4. Since FY 1996, general revenue spending has increased by 71.5 percent, whereas personal income has increased by 49.5 percent and overall inflation was 25.2 percent (Based on CPI).
5. Nearly \$22.6 million in general revenue savings or enhanced revenues were built into the FY 2005 Budget as Enacted that were developed through the Governor's Fiscal Fitness Initiative. Approximately \$9.2 million would be derived from enhanced revenues and the \$13.4 million balance through cost savings or cost avoidance actions.
6. For every new \$1.00 spent by the State since FY 1996, approximately \$0.49 was used to support grants and benefit programs to individuals, \$0.23 was used to support various local aid programs (primarily education aid), \$0.19 was used to support personnel expenditures and the \$0.09 balance was for operating and capital expenses.
7. The FY 2005 budget includes 468.2 FTE positions more than requested from the Governor. Of this increase, 419.2 FTE positions are for additional research positions in higher education supported by third party financing.
8. The General Assembly restored direct aid for local school districts to the FY 2004 funding level, updating enrollment and other data to reflect the most recent information. The Budget included an additional \$3.0 million in municipal aid through the General Revenue Sharing Program, PILOT and Distressed Communities Relief Fund.
9. The Budget includes \$392.0 million in new general obligation bonds to be presented to the voters in November 2004. This represents the largest total bond referenda put before the voters in the history of the State. In November 1996, the State placed \$254.1 million on the ballot – the second largest bond referenda in the State's history.

## Overview

**Operating Deficits** – In FY 2005, there is a projected operating deficit of \$42.8 million. In the House Fiscal Advisory Staff’s FY 2005 Budget as Enacted, a revised five year forecast is presented where the House projects a \$135.0 million general revenue operating deficit for FY 2006 based on the changes it has made to the FY 2005 budget request submitted by the Governor. Overall, general revenue spending continues to outpace growth in both personal income and inflation.

**Pensions** - The State faces unfunded pension liabilities for both State employees and teachers of well over \$3.0 billion, with State contributions expected to exceed 20.0 percent of payroll by FY 2008. The increasing obligation could prevent the State from making other investments in programs, services or tax relief.

**State Debt** – The Budget includes \$392.0 million in bond referenda for voter consideration in November 2004, the single largest referenda in the State’s history. When total general obligation debt is combined with other State tax supported debt, Rhode Island’s outstanding debt is projected to near \$1.5 billion by June 30, 2005.

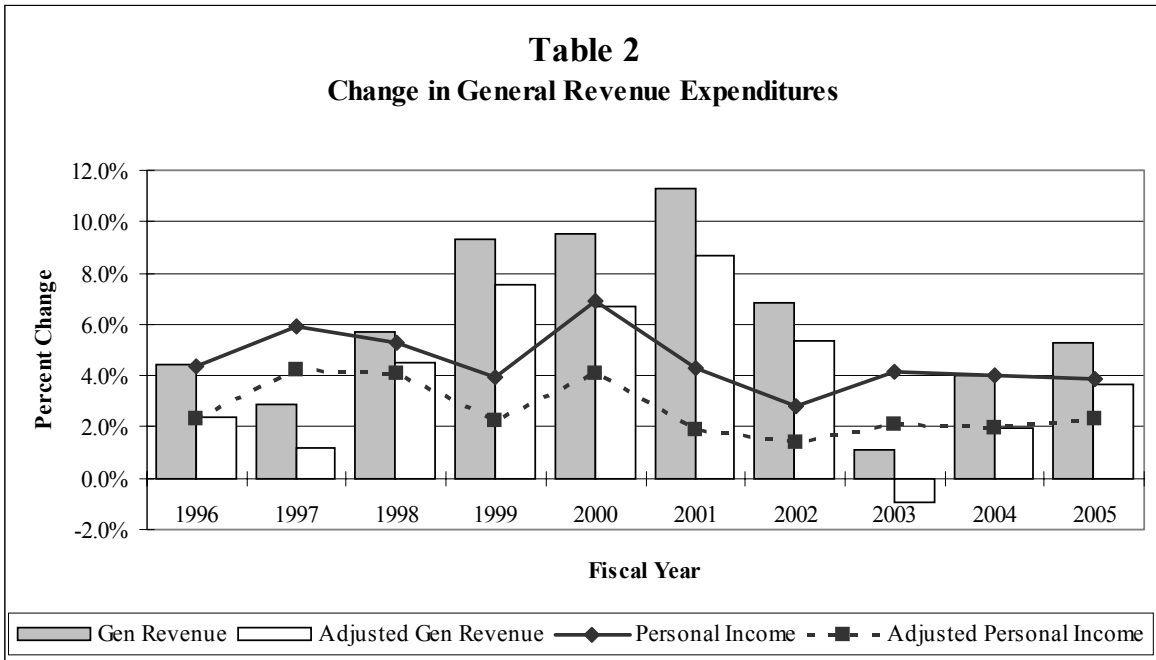
**Executive Budgeting** - Article 45 of the FY 2005 Budget Bill includes language that provides the judicial branch with additional controls over its budget, purchasing and personnel procedures. The Judiciary’s budget would not be subject to amendment by the Governor, and the Judiciary would be permitted to set up its own rules, regulations and procedures relating to purchasing, payroll, merit system and auditing practices.

**Entitlements** – Since FY 1996, \$0.49 of every new \$1.00 spent by the State has been for grants and benefits (mostly entitlement programs). While the State has been successful in developing and implementing a range of social services for its citizens, these programs consume the greatest portion of the State’s budget and represent the fastest growing component of spending. The demographics driving these expenditures will continue to put pressure on spending levels throughout the decade.

## FY 2005 Budget

The General Assembly voted to override the Governor’s veto to enact a \$5,959.5 million expenditure plan 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 \$218.9 million, or 3.8 percent. As compared to the Revised FY 2004 budget plan of \$5,876.0 million, the FY 2005 budget represents an \$83.5 million increase –a 1.4 percent increase over FY 2004 revised spending.

Table 1 (on front page) summarizes the budget plans for FY 2004 and FY 2005. It shows spending by major category of expenditure as well as spending by source of funds. Expenditures by fund reveal greater information than net change in total expenditures. For instance, while net expenditures are expected to increase by \$83.5 million from FY 2004 revised, this is net of an increase of \$148.1 million in general revenue spending and nearly \$64.6 million in less spending from Federal and other sources. This pattern may reflect continued over-budgeting of available Federal funds in order to have access to them without returning to the Legislature for approval to spend beyond appropriation lines.



It should be noted that the FY 2005 total budget of \$5,959.5 million represents a 2.2 percent increase over the FY 2004 enacted budget (adjusted for inflation). However, Table 2 does show that the increase in general revenue spending of 5.3 percent is greater than projected increases in inflation and in personal income. Adjusting these expenditures for inflation reveals that there is 3.7 percent real growth in general revenue spending in the FY 2005 State budget.

Personal income growth is projected to continue at 4.0 percent through 2005. From FY 1996 through FY 2005 enacted, general revenue spending will have grown by 71.5 percent (unadjusted), while personal income will have grown by 49.5 percent during the same period. Adjusting to FY 2005 dollars, general revenue expenditures will have grown by 45.5 percent while personal income will have grown by 26.9 percent.

Source of Funds: General revenues represent unrestricted resources generated through taxes, fees and other sources. General revenues fund nearly half (49.3 percent) of

the State budget in FY 2005, up from 47.5 percent in the Revised FY 2004 budget. Federal funds represent 32.0 percent of the State's budget, with Medicaid payments representing nearly half of all Federal funds.

Other funds, totaling \$1,045.7 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 \$114.1 million in FY 2005 represent 2.0 percent of all resources. These funds include 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 45.6 percent of the total budget.

**Table 3**  
**Budget Statement - FY 2005**

<b>Budget Statement</b>	<b>FY 2003</b>	<b>FY 2004</b>	<b>FY 2005</b>
<b>Total - Opening Surplus</b>	<b>\$38.8</b>	<b>\$50.3</b>	<b>\$43.9</b>
<b>Revenues</b>			
Enacted/Governor	\$2,749.7	\$2,805.4	\$2,789.4
Final Closing	\$8.7	-	-
Revenue Estimating Conference		(20.5)	-
Governor Changes		15.7	168.9
General Assembly Changes		40.3	(4.0)
<b>Total Revenues</b>	<b>\$2,758.4</b>	<b>\$2,841.0</b>	<b>\$2,954.3</b>
<i>Cash Stabilization</i>	<i>(\$55.8)</i>	<i>(\$57.7)</i>	<i>(\$60.0)</i>
<b>Total Net Available Revenues</b>	<b>\$2,741.4</b>	<b>\$2,833.6</b>	<b>\$2,938.3</b>
<b>Expenditures</b>			
Actual/Enacted/Governor	\$2,699.0	\$2,787.7	\$2,899.0
Closings/Reappropriations	(7.9)	7.4	-
General Assembly Changes	-	(5.4)	38.8
<b>Expenditures</b>	<b>\$2,691.1</b>	<b>\$2,789.7</b>	<b>\$2,937.8</b>
Free Surplus	\$50.9	\$43.9	\$0.5
Reappropriations	(8.0)	-	-
<b>Total Ending Balance</b>	<b>\$43.0</b>	<b>\$43.9</b>	<b>\$0.5</b>
<b>Operating Surplus (Deficit)</b>	<b>\$12.1</b>	<b>(\$5.4)</b>	<b>(\$42.8)</b>

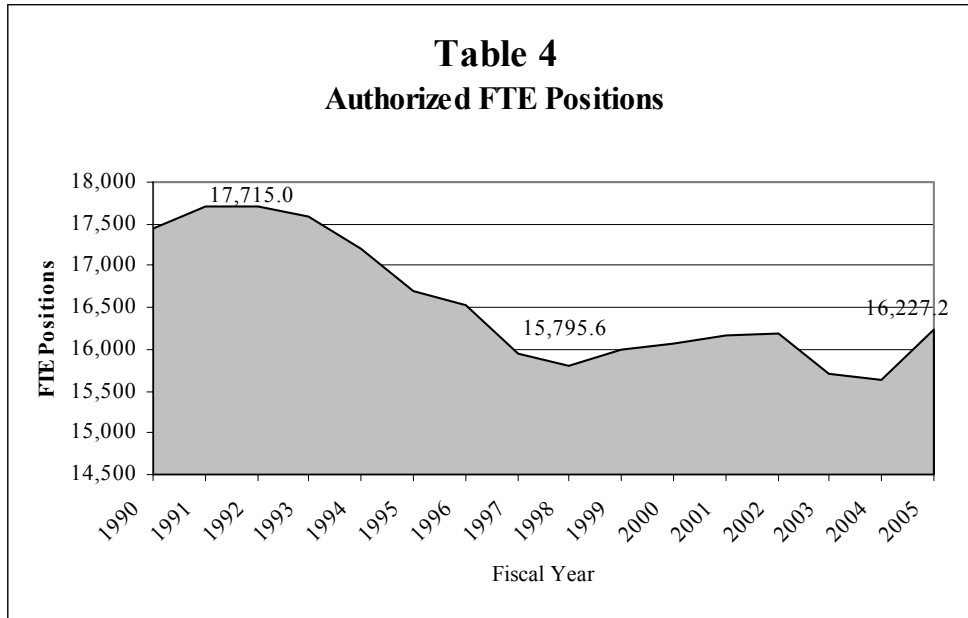
Source: House Fiscal Staff - Budget As Enacted - FY 2005

Personnel expenditures represent nearly 24.0 percent of the State's budget, and general operations represent an additional 6.0 percent. Local aid, which includes education aid and other direct assistance to municipalities, represents 18.0 percent of the budget. The remaining 6.4 percent of the budget is dedicated to capital and debt service expenditures.

The House Fiscal Advisory Staff prepared a revised Budget Statement based on the FY 2005 Budget as Enacted. Table 3 shows that with the expenditure and revenue changes to the Governor's FY 2005 Budget request, the FY 2005 budget is projected to end with a \$0.5 million surplus. However, given that the FY 2005 opening surplus of \$43.9 million will not be available in FY 2006, there is a net projected operating deficit at the close of FY 2005 of \$42.8 million.

One management tool available to the State is the use of the Full Time Equivalent (FTE) authorization process, where the State allocates the number of authorized positions that may be filled in a given fiscal year by department and agency. In FY 2005, the Budget includes 16,227.2 authorized FTE positions, of which 781.0 FTE positions are considered higher education exempt positions. These positions are funded through third party arrangements, therefore it is reasoned that they should not fall under the same restrictions as the balance of the State.

**Table 4**  
**Authorized FTE Positions**



The following highlight selected expenditure and program changes.

**General Operations**

- The State’s contribution for retirement increased from 9.6 percent to 11.51 percent - increasing the State’s contribution by \$15.7 million. Projections indicate that the State’s contribution rate will reach over 20.0 percent by FY 2008;
- The Budget includes \$3.0 million for the Slater Centers of Excellence, a \$1.0 million reduction from FY 2004 appropriations. The Budget did include the \$1.5 million in funding for the EPSCOR funding to leverage \$9.0 million in National Science Foundation Funding; and
- The Budget continues the two-year phase in of double weighting the sales apportionment formula for manufacturers.

**State Aid**

- The FY 2005 Budget level funds aid for local school districts, updating enrollment and other data to reflect the most recent information;
- The Budget includes an additional \$4.8 million for Charter Schools, but also placed a one-year moratorium on expanding charter schools;
- The Budget includes an additional \$3.0 million in municipal aid through the General Revenue Sharing Program, PILOT and Distressed Communities Relief Fund; and
- The Budget increases the State’s actuarial contribution to the Teacher Pension Fund by \$7.1 million and the contribution for School construction by \$3.1 million.

**Grants and Services to Individuals**

- The Budget incorporates the Governor’s proposal to save \$3.0 million through accelerated sanctions for Family Independence Program (FIP) clients not actively participating in required workforce development programs;
- The Budget maintains state child care eligibility at 225 percent of Federal Poverty Level;
- The Budget anticipates nearly \$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; and
- The Budget reinstates the \$50.00 monthly payment for Family Independence Program participants from child support collections.

**Debt**

- The enacted five-year capital plan includes \$3.4 billion in total outlays, requiring \$1.8 billion in debt issuances – (\$392.0 million proposed in November 2004 and \$235.5 million in November 2006).
- The General Assembly shifted several projects from Certificates of Participation and other non-voter approved financing mechanisms to proposals for General Obligation Bonds. This has shifted the State’s debt policy towards relying more heavily on voter-approved debt rather than on non-vote approved tax supported debt.

Open Space, Recreation and Watershed Protection	\$70.0
Transportation - Highways	66.5
Higher Education Residence Halls	50.0
URI Biotechnology Center	50.0
Quonset Point-Davisville	48.0
Rehabilitation of State Owned Facilities	46.5
Regional Career and Technical Schools	15.0
Pell Library - Undersea Exploration Center	14.0
Cranston Street Armory	12.3
Emergency Water Interconnect	10.0
Athletic Performance Center - URI	6.7
Historic Preservation and Heritage	3.0
<b>Total</b>	<b>\$392.0</b>

Source: Article 5 of H-8219 Sub A

- The FY 2005 Budget includes \$125.4 million in GARVEE debt, representing approximately 23.0 percent of the total GARVEE debt projected to be issued.
- The FY 2005 Budget proposes to place \$392.0 million in General Obligation bonds on the November 2004 ballot for voter consideration. This is the largest referenda in the State’s history.
- RIPEC will publish an analysis of the State’s overall debt position and a summary of each of the proposed bond referenda in October, 2004.

## Fiscal Fitness Initiative

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 revenues 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.

The Governor's FY 2005 State Budget request included nearly \$32.7 million in cost-savings and revenue enhancements proposed by the Fiscal Fitness team. The House Fiscal Staff estimates that approximately \$26.5 million in savings/revenue enhancements from Fiscal Fitness initiatives are included in the FY 2005 Budget as Enacted. However, there are several items that the Administration did not score as Fiscal Fitness Initiatives.

Therefore, the State Budget Office estimates that the FY 2005 Budget as enacted includes approximately \$22.6 million in Fiscal

**Table 6**  
**Impact of Fiscal Fitness on the FY 2005 State Budget**

Budget Action	FY 2005 Enacted
<b>Revenue Changes</b>	
<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 & drivers licenses	6,500,000
<i>Natural Resources</i> - Increase select permit and license fees	365,795
<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	605,045
<i>Transportation</i> - Increase fees for alteration permits	211,700
<i>DCYF</i> - Child Care Licensing	386,300
<i>Subtotal - Revenue Changes</i>	\$9,243,683
<b>Expenditure/Cost Savings/Avoidance</b>	
<i>Purchasing</i> - Take advantage of state's purchasing power	\$1,823,096
<b>Department of Human Services</b>	
Improve eligibility monitoring	2,800,000
Medicaid quality review	2,501,838
Strengthen LTC/Estate Collections	973,500
Third Party Recoveries	945,880
Overpayment Recoveries	2,155,000
Casualty Recoveries	856,680
Medical Support Enforcement	440,000
Error Reduction	880,000
<i>Subtotal - DHS Fiscal Fitness</i>	\$11,552,898
<b>Total Expenditure Savings/Cost Avoidance</b>	<b>\$13,375,994</b>
<b>Total Fiscal Fitness Financial Impact in FY 2005</b>	<b>\$22,619,677</b>

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

Fitness initiatives. This includes approximately \$9.2 million in revenue enhancements and \$13.4 million in expenditure savings or cost avoidance actions.

The additional revenues derived through Fiscal Fitness initiatives are principally driven by an estimated \$7.0 million revenue enhancement by requiring tax clearance for professional licenses and increasing the number of field auditors. Other revenue enhancements include increases in selected fees and licenses.

On the expenditure side of the equation, nearly \$11.6 million of the \$13.4 million in savings are associated with changes in Department of Humans Services programs and administration. There is approximately \$5.3 million in savings built into the FY 2005 budget that relate to more effective monitoring of eligibility (identifying misuse of State medical insurance and state funded child care), Medicaid quality and claim reviews (alternative payers for services and tax refund intercepts). There is over \$5.0 million in Medicaid related savings through recoveries associated with third parties, and overpayments, as well as error reductions in reporting.

Bottom line to the FY 2005 Budget as Enacted is that there is over \$22.6 million in projected savings and revenue enhancements. It will be critical for State policymakers to monitor the progress of implementing these initiatives to ensure that the budgeted savings are realized. RIPEC will publish a series of reports that monitor the progress of Fiscal Fitness initiatives. The first full report is expected to be available in March 2005.

## **The Revenue Plan**

The FY 2005 Enacted budget is grounded in the revenue estimates established in May 2004. The May 2004 Revenue Estimating Conference (REC) increased projected revenues over a two year period (FY 2004 and FY 2005) by \$42.5 million. This takes into account additional projected revenues of \$79.6 million from the November REC, revenue and expenditure items included in the Governor's budget request and changes in expenditure requirements due to changes in caseload estimates for entitlement programs.

The Governor's FY 2005 revenue plan included approximately \$168.9 million in revenue changes beyond what was estimated by the November 2003 REC. The enacted budget includes approximately \$153.3 million in net revenue changes to the FY 2005 revenue plan, which includes changes to the Governor's proposals as well as new initiatives from the legislature. The following highlights some changes made to the revenue program to support the FY 2005 spending plan:

- \$58.6 million through extending the hospital licensing fee in FY 2005 at 3.14 percent of net patient service revenues. This is projected to generate \$58.6 million in gross revenues to the State, where nearly 95.0 percent (\$55.2 million) would be generated from community hospitals and the balance from the Eleanor Slater Hospital;
- \$36.6 million in net revenues from cigarette taxes – increasing the tax per pack by \$0.75, additional sales tax collections on increased cigarette taxes and additional floor stock taxes from an increased tax per pack;

**Table 7  
State General Revenues**

General Revenues	FY 2004	FY 2005		Enacted - May REC	
	Enacted	May REC	Enacted	Amount	Percent
<b>Taxes</b>					
Personal Income Tax	\$885.0	\$913.8	\$926.3	\$12.5	1.4%
General Business Taxes	245.5	251.3	260.6	9.3	3.7%
General Sales & Use Tax	821.8	856.4	858.6	2.2	0.3%
Cigarette Tax	117.0	108.6	143.8	35.2	32.4%
Other Taxes	98.8	99.3	99.3	0.0	0.0%
<i>Subtotal - Taxes</i>	<i>2,168.1</i>	<i>2,229.4</i>	<i>2,288.6</i>	<i>59.2</i>	<i>2.7%</i>
Department Receipts	293.9	240.7	303.5	62.8	26.1%
<b>Taxes &amp; Departmentals</b>	<b>\$2,462.0</b>	<b>\$2,470.1</b>	<b>\$2,592.1</b>	<b>\$122.0</b>	<b>4.9%</b>
<b>Other Sources</b>					
Gas Tax Transfer	\$8.0	\$6.7	\$9.6	\$2.9	42.9%
Other Miscellaneous	70.4	10.3	19.2	8.9	87.1%
Lottery	283.9	318.0	322.4	4.4	1.4%
Unclaimed Property	16.7	9.3	11.2	1.9	-
<i>Total Other Sources</i>	<i>379.0</i>	<i>344.2</i>	<i>362.3</i>	<i>18.0</i>	<i>5.2%</i>
<b>Total Gen. Revenues</b>	<b>\$2,840.9</b>	<b>\$2,814.3</b>	<b>\$2,954.4</b>	<b>\$140.0</b>	<b>5.0%</b>

REC= Revenue Estimating Conference

Source: FY 2005 State Budget as Enacted, May 2004 REC, and RIPEC calculations

- \$12.5 million in additional personal income tax collections through requiring tax clearance for State issued licenses, adjustments to various enterprise zone tax credits and requiring income tax withholdings for nonresident shareholders;
- \$10.6 million in enhanced uncompensated care revenues at the Eleanor Slater Hospital;
- \$9.3 million in various business tax increases, to include increasing the corporate minimum and franchise tax to \$500 and repealing of the various enterprise zone tax credits;
- \$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;
- \$4.4 million in net revenues from eliminating the Dog Kennel Owners share of the Video Lottery Terminal Net Terminal Income. The Budget also increases the share for Lincoln Park from 27.0 percent to 28.85 percent and increases the Town of Lincoln's share of net terminal income from 1.0 to 1.25 percent effective January 1, 2005; and
- \$1.0 million in additional sales tax collections from permitting the sale of liquor on Sundays in the State.