RIPEC

Comments on Your Government

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Summary of the Governor's FY 2007 Budget Request

The proposed FY 2007 general revenue request of $3.2 billion represents a 1.0 percent increase from the FY 2006 Revised Budget. If one adjusts this for deferring uncompensated care payments and converting a portion of the Judiciary budget to restricted receipts, the Governor's budget would increase by 3.3 percent. As presented, the budget would grow faster than inflation (2.5%) but slower than personal income (5.1 percent).

The following RIPEC Comments outlines the Governor's FY 2007 Budget Request and summarizes key policy issues RIPEC has identified. In addition, as the State closes in on the May Revenue Estimating Conference, it is incumbent on policymakers to position the State so that its spending demands do not further outpace projected revenues. The following highlights some of the comments contained in this report:

- The Governor has proposed a number of entitlement reforms to reign in the fastest growing component of the State's budget. For example, Rhode Island's per capita Medicaid expenditures are the second highest in the Nation. RIPEC believes it was necessary for the Governor to pursue entitlement reform and cost control.

- Another significant budget driver is the continued demands personnel costs place on the operating budget – which equal one-quarter of the State spending. If the Governor had not proposed significant changes to personnel rules, additional service rollbacks or tax increases would have had to be considered.

- However, there are proposals that defer expenses to future years and increase the use of one-time resources to close the budget gap. Furthermore, the Governor has recommended restoring items previously included as service reductions in his FY 2007 budget request. It is also clear that the use of the $50.0 million in tobacco reserve funds to balance the FY 2006 budget is problematic.

- If the May Revenue Estimating Conference estimates revenues in excess of November figures, RIPEC believes these resources should be used to close the existing budget and maintain the bottom line proposed by the Governor. Additional revenues should retire debt or be set aside to reduce future projected deficiencies.

- The Governor has continued the recent practice of allocating a significant portion of the Rhode Island Capital Fund to support debt service rather than pay-go capital financing. While the Capital Fund has served as a relief valve when the State faces operating deficits, this is at the expense of pay-go financing to maintain State assets.

April 2006

RIPEC Comments

RIPEC's Overview – It is essential for the State to develop a spending plan that is affordable, sustainable, and fiscally responsible to ensure the State maintains a fair and competitive economic and tax climate. In order to achieve this goal, Rhode Island must focus on controlling the rate of growth in spending, setting investment priorities, and effectively managing its limited resources. The Governor's budget documents report that the FY 2007 budget process began with a projected deficit in excess of $200 million. The Governor's FY 2007 Budget attempts to close this deficit and to achieve the goal of affordable government by proposing entitlement reforms, controlling Medicaid costs, reducing the size of the State workforce, and deferring certain expenditures into future fiscal years.

Entitlement spending accounts for 41¢ of every new dollar the State will have spent since FY 1997. Rhode Island's per capita Medicaid expenditures are the second highest in the Nation, and Rhode Island has underperformed the country in moving people from welfare to work. Therefore, RIPEC believes it was necessary for the Governor to recommend tough choices that will result in entitlement reform and cost control.

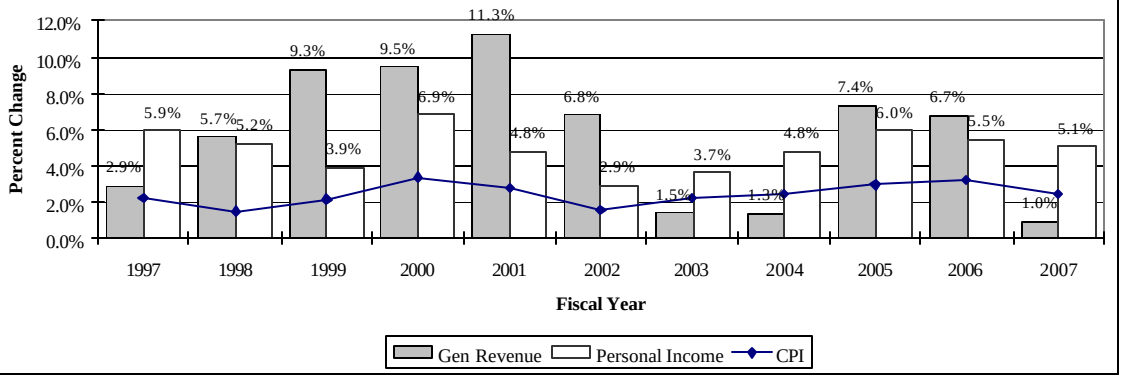
Since FY 1997, 21¢ of every additional dollar appropriated will have been spent for personnel, and personnel costs equal one-quarter of the entire State Budget. If the Governor had not proposed changes to personnel rules that would reduce the State's workforce by 420.0 FTE positions, additional service rollbacks or tax increases would have had to be considered.

If one combines the FY 2007 financial constraints with projected operating deficits through the next three years, there is a compelling need to reign in the State's budget drivers. RIPEC, therefore, commends the Governor for proposing the entitlement and personnel cost reductions to address the State's current and future budget gaps.

On the other hand, a number of the proposals in the Budget would defer expenses to future years and increase the use of one-tine resources to close the budget gap. Furthermore, the Governor has recommended restoring items previously included as service reductions in his FY 2007 budget request. It is also clear that the use of the $50.0 million in tobacco reserve funds is problematic. These aspects of the proposed FY 2007 are obviously a matter of concern to RIPEC and are discussed below.

The Governor's FY 2007 general revenue budget request would represent a 1.0 percent increase from the FY 2006 Revised Budget. This is somewhat understated given the Governor has proposed delaying $110.0 million in uncompensated care payments to hospitals to FY 2008 and shifting $22.5 million in Judiciary funding from general revenue to restricted receipts. If one adjusts for these two items, the Governor's FY 2007 budget would increase by 3.3 percent from the FY 2006 revised spending plan. As presented, the budget would grow at a slower rate than personal income, which is projected to grow by 5.1 percent during the fiscal year.

Table 1
Change in General Revenue Expenditures, Personal Income and CPI



The level of growth in general revenue spending recommended for FY 2007 is in marked contrast to recent budgets. The State's general revenue budget has grown at a faster rate than both inflation and personal income since FY 1997. This trend was principally driven by increases in general revenue spending from FY 1998 through FY 2002. Since FY 1997, the average annual rate of growth in general revenue spending has been approximately 6.1 percent – compared to 4.9 percent annual growth in personal income. Inflation, as measured by the Consumer Price Index (CPI) has been running at an average rate of 2.5 percent during this period.

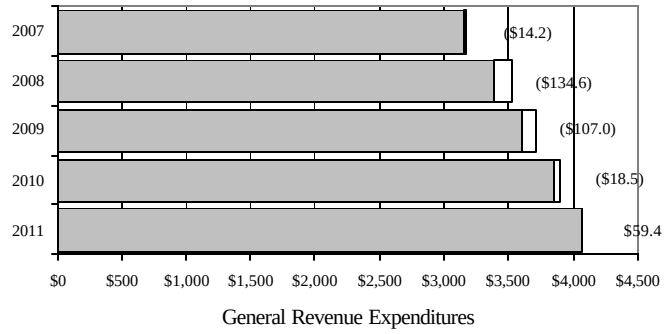
Staying Within The Bottom-line -- Over the past decade, the estimated revenues developed in May have generally exceeded the revenues projected in November (the figures the Governor relies on to build the budget). The House Fiscal Staff recently published a revenue report indicating that revenues are running in the neighborhood of $40 million ahead of November projections, and the Governor recently announced the potential for an additional $9-$10 million in Federal State Children's Health Insurance Program (SCHIP) funds that will help defray costs in the coming fiscal year. However, given recent history, the State is likely to rely on these and other revenue sources to balance the budget – in other words, business as usual will result in the State spending all the resources it takes in.

Therefore, the fundamental question to ask is what the State will or should do with any revenues that exceed the Governor's $3,154.0 million operating budget? RIPEC believes the first goal should be to fill the holes in the existing budget plan and maintain the bottom line proposed by the Governor. Therefore, any additional revenues should be to retire debt or set aside to reduce future projected deficiencies.

Enhancing Fiscal Discipline – The Governor is required to submit a five-year financial forecast with the annual budget to provide a planning tool to examine the potential impact budget choices proposed in the coming fiscal year might have on future budgets. The forecast is a useful tool to assess the long-term affordability of the State's current policies. As with any forecast, the projections are only as good as the assumptions used to design it.

Table 2

Governor's Five-Year Forecast



The Governor's Budget request includes a five-year forecast projecting operating deficits ranging from a high of $134.6 million in FY 2008 to an operating surplus of $59.4 million by FY 2011. This represents an average operating deficit of slightly more than $68.6 million though FY 2010.

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 3.3 percent.

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 4.2 percent. This is principally driven by growth in Medicaid. It should be noted that grants and benefits increased at an average annual rate of 5.4 percent from FY 1997 to FY 2007. The Governor's forecast projects local aid to municipalities and school districts to increase by 3.6 percent and growth in personnel and operating costs are projected to increase at an average annual rate of 2.4 percent. From FY 1997 to FY 2007, local aid increased at 8.3 percent annually and personnel and operating costs increased by 5.4 percent annually.

The good news in the FY 2007-2011 financial forecast is that general revenues are projected to increase faster than the average annual rate of growth in sending, and as shown above the rate of growth in grants and benefits, local aid and personnel and operating costs are forecast not to reach the level of growth experienced over the last ten years.

However, what is of immediate concern on the five-year financial forecast is the projected deficit forecast for FY 2008. Spending and tax decisions made in FY 2007 will impact the State financial health over the next couple of years. This matter is heightened by the possibility that the projected FY 2008 deficit of $134.6 million may be understated.

RIPEC recently developed a report – *Rhode Island 2010* - which projected the financial, economic and social conditions the State will face in 2010. The report demonstrated that Rhode Island faces and will continue to face significant demographic challenges and the report concludes that we will not be able to sustain important public services with a "business as usual" approach. For example, by 2010, Rhode Island will be older, yet have fewer workers in their prime productive years. It will be less self-sufficient, with one in four Rhode Islanders potentially eligible for Medicaid programs. And Rhode Island will continue shifting the burden for funding schools to the property tax and rely on fewer income taxpayers to support growing public services.

Therefore, to avoid an "instant replay" of the current budget debate next year, there is a need to build greater fiscal discipline in the State Budget decision-making process. Right now, spending is generally limited by the revenues generated in a given year. What then can be put in place to begin bringing government spending more in line with what the average Rhode Island can afford to pay?

Limits on what government can tax and spend should be viewed as a positive force in improving productivity, emphasizing efficiency, highlighting vital services, and freeing government from the obligation to do things whose benefits do not match their cost.

Without limitations on government spending and taxation, discipline may be overshadowed by political pressures of the moment. The use of one time funds and continued reliance on tobacco securitization proceeds to balance operating budgets demonstrate that this remains the case in Rhode Island. RIPEC is participating in a new coalition to bring about this type of change. The Affordable Rhode Island Coalition's single purpose is to have a Constitutional Amendment placed before the voters to establish spending limits at the state level and property tax limits in our cities and towns. The following is a brief explanation of the proposal:

State Limitation – The amendment would ensure that no appropriations, supplemental appropriations or budget act could cause the aggregate State general revenue appropriation to exceed 98% of available general revenues; and total general revenue appropriations could not exceed the product of total general revenue appropriations for the base year and the sum of the CPI + 1.5% for each year after base year. In other words, the State can only appropriate 98% of available revenues (current law) and growth in state spending would be limited to inflation plus 1.5% per year.

In addition, any unencumbered general revenue end-year balances would be transferred to a budget reserve account until the account equals 5% of State general revenues. After making the allocation to the budget reserve account, the first 2% of unencumbered general revenues would be appropriated to fund capital projects or unfunded State pension obligations. The balance of any unencumbered funds would be refunded to taxpayers in a manner recommended by the Governor and approved by the General Assembly.

Upon the request of the Governor and with approval of two-thirds of the entire membership of the General Assembly, funds in the budget reserve fund may be used to fund the costs related to an emergency. In addition, the proposal includes a sunset provision. Every 10 years the voters will be asked to extend the limitation.

Local Limitation **-** The language specifies that the annual aggregate property tax levy in each municipality could not exceed 2.5% of the full market value of property. Nor could the increase in the aggregate property tax levy for any fiscal year exceed 4.0% of the property levy for the prior fiscal year. Taxpayers could not exceed the 4.0% levy limit without the prior approval of a majority of the voters of that municipality.

There are exceptions to the 4.0% levy limit – communities could exceed the limit by the amount accounting for the net revenue loss resulting from a reduction in net State aid compared to the prior year; and/or for increases in debt serve costs from the immediate preceding fiscal year in excess of the 4.0%.

Finally, there is an anti-mandating provision in the language where the State could not impose on any municipality any part of the total cost of new programs or services or increases in existing programs and services, unless a specific State appropriation was made to pay the local unit.

RIPEC recognizes that the constitutional limit on spending and levy growth is not a substitute for sound financial management and planning, but believes it represents a tool to promote fiscal discipline in the State and local budget making process.

Tobacco Securitization – The Governor has proposed using the tobacco reserve fund to balance the FY 2006 State Budget. Specifically, the Governor's budget plan called for converting approximately $50.0 million in the reserve fund to a surety policy in order to access these funds to shore-up the FY 2006 Budget to the tune of $49.0 million.

Given events since the Governor made this proposal, the opportunities to substitute a surety policy for the reserve fund are problematic. Recent arbitration decisions and market conditions make it appear that the State's ability to convert the reserve into a surety policy would not be economical and the cost would be prohibitive even if the transaction could be done. Furthermore, no other state has used this financial instrument to date to access the tobacco reserve – indicating that this approach may not be readily available. Therefore, new options must be found to close a potential $49.0 million gap in the FY 2006 State Budget.

In November 1998, 46 states (including Rhode Island), Puerto Rico, the U.S. Virgin Islands and others signed the Master Settlement Agreement (MSA) with the principle domestic tobacco manufacturers. The agreement results in payments to participants in perpetuity. The payments are subject to certain adjustments, including volume of cigarette sales and annual inflation.

In 2002, the State received $544.2 million in net proceeds from tobacco securitization. Of this amount, $295.3 million was used to retire debt and the $248.9 balance was used to balance several State operating budgets. As part of the sale of these proceeds, the State was required to establish cash reserve fund of approximately $52.0 million. The 2002 tobacco securitization was designed to repay the 40-year bonds in 26 years – by 2029. This is referred to as a modified turbo amortization program to retire debt. A full turbo amortization program would result in full payment by FY 2022 (where 100 percent of available tobacco payments are used to repay the bonds with no residual).

The Governor has proposed that the State engage in a second initiative to securitize the residuals of the tobacco payments that are projected to be available at the close of 2023 for an additional $200 million in net proceeds to establish two trust funds.

- The first fund would be to deposit $100 million in a government retiree health benefits trust fund to begin addressing the projected $650 million in unfunded liability.
- The second fund would use the other $100 million to create a trust fund for affordable health care in the State.

As has been well publicized in the media, there is a possibility that tobacco companies may obtain an adjustment to scheduled payments due to a loss in market share as provided in the Master Settlement Agreement. This uncertainty may have an impact on the cost of securitizing future tobacco proceeds.

While there may still be a market for further proceeds from residual tobacco settlement payments, the relative cost to go to market may be higher than the previous tobacco deal. A fundamental problem is the underlying rating on pure tobacco credits without a state pledge of the general fund.

There is little evidence that these funds would be used for appropriate one-time purposes, such as those proposed by the Governor. Rather, it is likely that some of these proceeds might be used to offset the FY 2006 problem discussed above as well as funding demands in the FY 2007 budget. RIPEC believes that using additional tobacco proceeds to balance the Budget at this time would be a short-sighted solution to the fiscal issues the State is currently addressing.

Personnel Reform - FY 2007 personnel expenditures total $1,593.7 million, a $31.0 million (2.0 percent) net increase from the FY 2006 revised personnel budget. Since FY 1997, personnel expenditures have increased at an average annual rate of 5.4 percent (2.8 percent real growth). The FY 2007 average cost per FTE position of $83,159 represented a 7.6 percent increase (5.0 percent real growth) over FY 2006 revised ($77,293). FY 1997 personnel spending represented 26.0 percent of the State budget. It has since declined to 24.2 percent - principally due to faster growth in grants and benefits to individuals and local aid.

The Governor's FY 2007 Budget includes 15,953.9 FTE positions (including 785 FTE positions related to higher education), representing a net decline of 463.5 FTE positions from the FY 2006 Revised Budget. The thrust of the Governor's personnel budget is a series of reforms or actions designed to achieve $50.4 million in savings. To achieve this savings the Governor has included a series of initiatives to eliminate 419.4 FTE positions:

- Eliminate pay-out for sick leave as of July 1, 2006;
- Eliminate statutory status (20-year rule);
- Eliminate all new longevity and freeze existing longevity amounts;
- No longer permit carry-forward of 2-years unused vacation time;
- Reform employee bumping process whose positions are eliminated; and
- Change probationary period from 6 months to one year.

Of the $50.4 million in savings, the Governor includes $6.7 million in savings through two shut down days (July 3rd and November 24th), $7.0 million through several initiatives on medical expenditures including carving out pharmacy from the current medical plan, and a net savings of $1.0 million through the use of limited service positions (permitting the State to eliminate $12.1 million in contracted services).

In addition to the workforce reduction program, the Governor has proposed a merit pay program that would reflect bonus pays no greater than 3.0 percent of salary, employee evaluations conducted no less than every two years, and tuition waivers for work-related courses at the State's public university and colleges.

RIPEC supports the Governor's efforts to limit growth in personnel spending. Many of the reforms will reduce costs and move the State towards stronger management rights. However, the question is whether the Administration can demonstrate the need to set aside the contract in order to achieve the projected savings from the proposed workforce reduction initiatives. In addition, it will be important to review and understand the impact of the staffing reductions given their duties and impact on the delivery of services. If approved by the General Assembly, it will be incumbent on the Governor to establish a formal process to monitor the efforts to implement the workforce reduction initiative.

A personnel practice that has recently emerged in the budget is use of GARVEE and Motor Vehicle Bond Proceeds to support ongoing personnel costs. The FY 2006 revised and FY 2007 proposed personnel budgets continue to fund 106.0 FTE positions in the Department of Transportation using GARVEE and Motor Vehicle Bond Proceeds to the tune of $3.1 million each year. The practice of using bond proceeds to fund permanent positions may have played a role in the financial difficulties the Department of Transportation faced in the mid-1990s. Therefore, RIPEC recommends that the use of GARVEE Bond proceeds be reviewed to determine to what degree they are being used to fund permanent operating personnel and how this is affecting the overall costs.

Entitlement Reforms – Given existing and projected resources, RIPEC believes that entitlement reforms are necessary public policy choices to constrain the growth in State spending. The Medical Assistance Program remains a principal budget driver in Rhode Island. Growth in Medicaid will, by itself, continue to create a large structural problem in the State's budget. Medicaid expenditures will represent approximately 30.0 percent of all State spending. Medicaid expenditures have increased by nearly 63.5 percent since FY 2000.

In addition to continued growth in Medicaid spending, there is growing concern over the impact future Federal action may have on the State's financial condition. In FY 2007 the Federal match for Medicaid expenditures declined by $34.7 million, and projections indicate that it will be reduced by another $20.0 million in FY 2008. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 will also have additional impacts on the State's finances.

The Governor has proposed a number of changes to services in Medical Assistance programs, such as scaling back eligibility thresholds and increasing the participants' share in the costs of providing these services, projected to save $35.0 million in FY 2007.

These, and other potential changes to the Medicaid and Medicare Programs, are complicated and substantial to the State. Therefore, RIPEC calls for establishing an Affordability Task Force on Medicaid and health related entitlement programs. This Task Force has the potential of demonstrating not only how vital social services can survive the structural budget deficit, but how decision-makers can turn that challenge into an opportunity to reinvent the way government delivers services.

An important aspect is to develop and maintain a unified Medicaid Budget. Data is often dated, making it increasingly difficult to evaluate Medicaid spending choices available to policymakers. A unified Medicaid budget that incorporates expenditures across departments and analyzes spending by type of service and caseload could lead to greater accountability and service delivery.

In addition, the Governor has proposed a series of policy changes in the State's Family Independence Program (FIP) designed to move participants towards work. RIPEC was a principle architect of the FIP program that was enacted in 1997, and given the State's experience compared to other states, it is now time to adjust these policies to bring them further in line with the Nation. The Governor's proposals to reform FIP may serve to move participants into the workforce more quickly and to ensure that we continue to move away from cash assistance and towards services that support entry into the workforce. This policy change is justified by the fact that between 1996 and 2005 Rhode Island ranked 37th in the percentage decline of TANF recipients.

Tax Policy Analysis - There are several actions taken in the Governor's FY 2006 and FY 2007 budgets relating to tax policy and administration. The State's approach to tax analysis is disjointed. Tax policy tasks require individuals in the Division of Taxation, the Budget Office, and/or the EDC to take time away from their normal responsibilities. This, by definition, limits the breadth and depth of any tax policy analysis that is conducted. For example, the Division of Taxation does not have a unit devoted solely to researching, analyzing and preparing tax policy options. The EDC often proposes tax policies, but that agency is primarily responsible for analyzing the economic versus tax impacts of projects that it is promoting. The Budget Office may consider tax policy issues, but that agency is primarily responsible for proposing revenue enhancements to help balance the Governor's budget. These organizational deficiencies limit the State's ability to consider tax policy matters in a timely and comprehensive fashion.

Decision-makers must not only consider the fiscal impact that tax programs may have on revenues, but they must also understand the potential impact on the State's economy and private investments, as well as any distributional burden associated with any tax change. This will require the appropriate resources and organization.

RIPEC has been calling for creating a tax policy function for State government. Funding for this activity was included in the FY 2006 Budget and the Governor issued an executive order establishing a Tax Policy Office. However, the office has not been established to date. Rather, the State has recently issued a RFP to catalogue, assess, compare and make recommendations regarding the State tax structure. RIPEC questions whether a tax competitiveness study will add significant value to what is already known without better data being available. RIPEC recommends the State should solicit expertise on the best way to build the organizational infrastructure and data bases needed to make policies that would contribute to maintaining a competitive, fair, balanced, and efficient state tax structure.

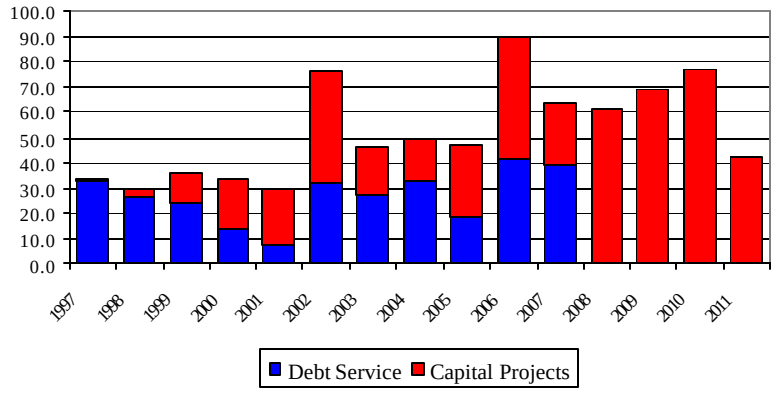
Specifically, the State should seek expertise in evaluating organization structure options, and the cost and benefits of each, e.g., a Department of Revenue, Department of Finance, Office of Tax Policy Analysis, etc. The analysis should consider the following responsibilities and functions as outlined in Executive Order 5-17. These include:

- Developing a data base and tax impact model;
- Developing and maintaining expertise in data collection and statistical analysis to provide qualitative and quantitative analysis of the State's tax structure and various tax incentives;
- Preparing an annual assessment of the effectiveness of tax incentives;
- Maintaining a state of the art econometric tax modeling capacity; and
- Providing an ongoing study of the State tax structure and identifying trends.

Capital Fund - Current law provides up to 2.0% of annual revenues to be used for capital expenditures or debt service once the Budget Stabilization Fund has reached 3.0% of resources. Because the Budget Stabilization Fund has reached 3.0 percent, there are only marginal contributions to the fund and most flow into the Rhode Island Capital Plan.

The Budget Stabilization Fund has increased from $36.9 million in FY 1997 to $98.1 million in FY 2007 – more than doubling over this period of time. The Rhode Island Capital Fund – the spillover fund that may be used for debt service or capital projects - has increased from $33.8 million in FY 1997 to $64.4 million in FY 2007 – again, more than doubling during this period of time.

Table 3
Allocation of Rhode Island Capital Fund



From FY 1997 to FY 2007, a total of $534.9 million has been spent from the Capital Fund, of which $296.0 million (55.3 percent) was used to support debt service and $238.9 million (44.7 percent) for capital projects. In the FY 2007 budget request, approximately 61.1 percent ($39.0 million) of the $63.8 million in the Capital Fund is proposed to be used for debt service, and the 38.9 percent ($24.8 million) balance for capital and asset protection activities.

While the Capital Fund has served the state well as a countercyclical tool, there is a need to return to the State's policy of using a greater portion of the fund for capital projects rather than debt service. This enables the State to target these funds to asset protection activities using a pay-as-you-go financing tool rather than considering long-term debt or foregoing the asset protection activities altogether.

The Governor's FY 2007 budget does indicate that the policy will be to return the fund to 100 percent funding for asset protection and capital projects in FY 2008. That means that the State will have to shift the $39.0 million in debt service that would be supported by the Capital Fund in FY 2007 to the general fund in FY 2008. While this is a laudable goal, given financial projections, RIPEC questions whether it is a realistic goal to accomplish in one fiscal year.

Other Comments -- Since the budget was submitted, the Governor has announced several changes to the originally proposed operating budget. For example, the Governor has announced he will not pursue his proposal to close seven DMV satellite offices – an initial savings of $1.3 million and 17.5 FTE positions, nor will he pursue his proposal to reduce $5.8 million in the services for adults with disabilities program in the Department of Mental Health and Retardation. Given the FY 2007 operating budget was balanced with an ending surplus of less than $300,000, the General Assembly will need to identify where in the operating budget it can find $7.1million to replace the unachieved savings. In addition, it appears the Governor will no longer pursue his proposal to remove undocumented children from RIte Care, which was estimated to save $4.0 million in FY 2007 if the State receives additional Federal SCHIP funds.

There are a number of actions taken in the budget, such as delaying the uncompensated care payments to hospitals until FY 2008 and delaying provider rate increases to nursing homes that enable the Governor to submit a budget within current revenue streams. While the deferral of uncompensated care payment is permanent, it is clearly a budgetary action to free up resources in FY 2007. This action may also essentially require that the hospital licensing fee to become a permanent fixture in the State's revenue structure – despite the uncertainties that the Federal government could change the rules, making this revenue-expenditure arrangement with the hospitals less advantageous. In addition, the Governor's budget delays a number of provider rate increases that will have to be accounted for in FY 2008. These actions could have on adverse affect on the State's overall fiscal health.

General Revenues Summary

The Governor's FY 2006 Revised and FY 2007 budgets are based on revenue estimates established in November 2005. The Governor's FY 2006 revised budget had to account for a net reduction in estimated revenues of $61.7 million (The Revenue Estimating Conference revised estimated revenues down from $3,165.6 million to $3,078.9 million – a net reduction of $86.7 million, but this does not account for an audit adjustment of $25.0 million). The Governor's proposed FY 2006 changes include an additional $70.8 million in net revenues. The REC estimated revenues of $3,148.6 million for FY 2007.

Table 4

FY 2006 Revised and FY 2007 Proposed General Revenue Program

General Revenues	FY 2006 Enacted	FY 2006 REC	FY 2006 Governor	FY 2006 Change	FY 2007 REC	FY 2007 Governor	Change
Taxes							
Personal Income Tax	$1,033.5	$1,015.9	$1,015.9	$0.0	$1,066.9	$1,071.7	$4.8
General Business Taxes	308.7	303.2	311.3	8.1	315.7	313.2	(2.5)
General Sales & Use Tax	887.9	881.5	881.5	0.0	925.8	927.7	1.9
Cigarette Tax	126.3	129.7	129.7	0.0	126.7	126.7	0.0
Other Taxes	112.2	109.4	109.4	0.0	111.9	112.0	0.1
Subtotal - Taxes	*$2,468.6*	*$2,439.7*	*$2,447.8*	*$8.1*	*2,547.0*	*$2,551.4*	*$4.4*
Department Receipts	312.6	275.1	275.8	0.7	207.5	255.6	48.1
Other Sources	384.4	364.1	426.1	62.0	394.1	397.5	3.4
Total Revenues	**$3,165.6**	**$3,078.9**	**$3,149.7**	**$70.8**	**$3,148.6**	**$3,204.5**	**$55.9**

Source: FY 2007 State Budget Documents

- The Governor proposed using the tobacco reserve fund established in the first tobacco securitization in FY 2002 to balance the FY 2006 budget by converting the reserve to a surety policy to access $49.0 million in funds.

- Other FY 2006 revenue changes include nearly $18.4 million in one-time revenue sources, such as transfers from the Rhode Island Health and Education Building Corporation and the Resource Recovery Corporation.

The Governor's FY 2007 revenue plan includes a net increase of $55.9 million in revenues over the November estimates, including:

- While the Governor proposes to defer both the Hospital Licensing Fee and uncompensated care payments into FY 2008, he proposes to accrue $36.6 million in net revenues from the Hospital Licensing Fee in FY 2007.

- The Governor proposes to convert $22.5 million of court charges and fees that are currently deposited into the General Fund into restricted receipts and subsequently reduce the Judiciary's general revenue budget.

- The Budget includes one-time revenue sources totaling $19.9 million, which includes a Tax Amnesty Program, proceeds from a land sale and additional transfers from the Resource Recovery Corporation.

State Spending Summary

The Governor has proposed a $6.6 billion all funds budget to support State operations in FY 2007. As measured against the FY 2006 enacted budget ($6.35 billion), FY 2007 appropriations represent an increase of $230.3 million, or 3.6 percent. Total FY 2007 expenditures are proposed to decrease by less than 1.0 percent ($57.0 million) over the Governor's FY 2006 Revised Budget.

Table 5

Rhode Island State Spending - All Funds

By Category	1997	2005	2006E	2006R	2007P	Change
Personnel	$941.3	$1,447.6	$1,532.1	$1,562.7	$1,593.7	$31.0
Operating	301.1	425.4	394.7	658.5	655.1	(3.3)
Local Aid	562.3	1,117.7	1,170.7	1,185.6	1,247.2	61.6
Grants & Benefits	1,577.7	2,647.7	2,882.6	2,793.1	2,667.3	(125.9)
Capital	57.5	171.6	149.9	222.0	180.4	(41.6)
Debt Service	184.2	149.0	219.9	215.3	236.6	21.3
Total	*$3,624.0*	*$5,959.0*	*$6,349.9*	*$6,637.2*	*$6,580.2*	*($57.0)*

By Fund	1997	2005	2006E	2006R	2007	Change
General Revenue	$1,762.5	$2,926.9	$3,142.1	$3,123.9	$3,154.0	$30.1
Federal Funds	1,079.2	1,857.6	1,979.5	2,049.5	1,915.8	(133.6)
Restricted Funds	103.1	105.4	110.0	117.0	145.3	28.3
Other Funds	679.3	1,069.1	1,118.3	1,347.0	1,365.2	18.2
Total	*$3,624.0*	*$5,959.0*	*$6,349.9*	*$6,637.2*	*$6,580.2*	*($57.0)*

E = Enacted, R = Revised, P = Proposed

Source: RIPEC calculations based on State Budget Office Data

FY 2007 general revenues represent nearly 48.0 percent of the State budget; while Federal funds (mostly Medicaid) represent about 29.0 percent. Other funds (primarily made up of university and college funds and employment and training funds), represent about 21.0 percent. Restricted funds represent the smallest resource to the State – 2.2 percent of all resources.

The Governor's FY 2007 general revenue budget of $3,154.0 million represents an increase of $11.9 million over FY 2006 enacted general revenue spending levels – this equates to less than 1.0 percent growth. The Governor's FY 2007 budget request is 1.0 percent higher than his revised FY 2006 general revenue spending program.

It should be noted that the FY 2007 budget does not include uncompensated care payments to hospitals – these expenditures have been shifted to FY 2008. In addition, there is a proposal to shift $22.5 million in general revenues to restricted receipts for the Judiciary. Therefore, if one were to adjust FY 2007 expenditures for these changes in budget practices, FY 2007 total expenditures would have increased by 3.3 percent over FY 2006.

Selected highlights of the FY 2007 Spending Plan include:

- The Administration's five-year forecast shows an operating deficit of $135.0 million in FY 2008, with projected deficits continuing until FY 2011, where the Governor shows an operating surplus of $59.4 million.

- The FY 2007 proposed budget includes a series of personnel reforms that are aimed at reducing the State's overall workforce by nearly 420.0 FTE positions. These include eliminating longevity pay and replacing the program with merit pay, eliminating the State's pay-out for accumulated sick leave, as well as eliminating statutory status (20-year rule).

- The average cost per FTE position is projected to increase from $77,293 in the FY 2006 revised budget to $83,159 in FY 2007 – an increase of 7.6 percent. It should be noted that since FY 1996, the average cost per FTE position has increased by 5.4 percent annually.

- The Governor has proposed a series of actions to curtail the growth in selected entitlement programs, such as Medical Assistance and Temporary Assistance to Needy Families (TANF). These include eliminating selected persons from eligibility for managed care programs as well as reducing the length of time TANF participants can remain on cash assistance programs.

- The Governor proposes to shift $110 million in uncompensated care payments from FY 2007 to FY 2008.

- Rhode Island's allocation of Federal Medicaid funds was reduced by $34.7 million (from a Federal Matching Assistance Percentage of 54.68 percent in FY 2006 to 52.87 percent in FY 2007).

- The Governor has proposed increasing direct education funding for school districts by $19.2 million, distributing the funds based on the projected local contribution for teacher retirement obligations.

- The $28.3 million in net new restricted receipt funds is primarily a reflection of the Governor's proposal to convert $22.0 million of the Judiciary's general revenue operating budget into restricted receipts, as well as including $7.7 million in additional restricted receipts that the Courts are expected to pursue.

- Beginning in FY 2006, the lottery was included in the Department of Administration. The Lottery is budgeted at $210.3 million in FY 2006 and $215.0 million in FY 2007 (not reflected in years prior to FY 2006). This adjustment includes 64.5 FTE positions and a $4.7 million increase over FY 2006 revised spending.

Spending Patterns

The proposed FY 2007 spending plan of $6,580.2 million represents a $3.0 billion increase since FY 1997 ($3,624.0 million). This translates into an average annual rate of growth of 6.1 percent during this period. However, if one adjusts FY 1997 spending to 2007 dollars, the Governor's FY 2007 budget represents a $1.9 billion (41.6 percent) increase, which translates to an adjusted average annual growth rate of 3.5 percent. The following discusses changes on an adjusted (real) basis.

- Expenditures supporting grants and benefits (programs providing direct support to individuals such as Medicaid, child care and unemployment insurance) would increase by $644.1 million over FY 1997 adjusted expenditures, representing a 31.8 percent increase (real growth).

- The growth in grants and benefits since FY 1997 represents 33.3 percent of the net total growth in State spending during this period. The increase in managed care programs (mainly RIte Care) of $291.3 million represented 15.1 percent of the net increase of $1.9 billion in adjusted statewide spending during this period.

- The second largest component of State budget growth has been in local aid. All local aid increased by $526.1 million – a 73.0 percent increase since FY 1997 (adjusted). The growth in local aid represents approximately 27.2 percent of the total net growth in the State budget since FY 1997.

- Education aid has been the principal driver within local aid. Of the $526.1 million net increase in local aid, nearly 38.0 percent is attributable to growth in education aid.

- The third largest factor in budget growth during this period has been for overhead. Of the $1.9 billion increase in net expenditure growth from FY 1997 to FY 2007, approximately $386.6 million (20.0 percent) would be attributable to personnel expenditures (includes benefits). An additional 13.9 percent of the growth was related to various operating expenditures.

- In other words, 33.9 percent of the net growth in the State's total expenditure program since FY 1997 would be attributed to general overhead for State programs. However, as noted earlier in this report, the Lottery was not included in the FY 1997 budget, but it has since been included in the State's spending program – thus overstating recent personnel and operating expenditures in FY 2007 when comparing to FY 1997. Second, the Governor has proposed to shift the FY 2007 uncompensated care payment of $110 million to community hospitals to FY 2008, thereby understating the FY 2007 expenditure program.

- Therefore, adjusting FY 2007 for these two changes would change the relative growth in spending by expenditure category. This would increase the grants and benefits share of net new growth from 33.3 to 42.1 percent over this period of time.

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

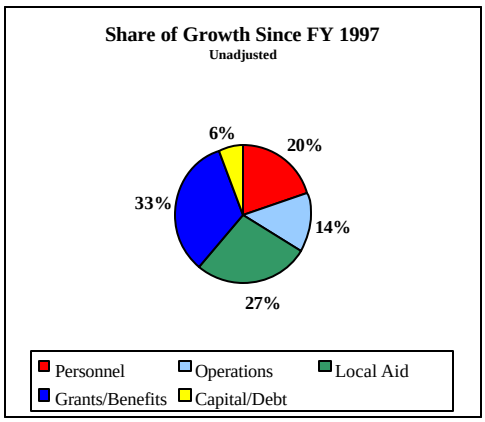
Expenditure Category	FY 1997 Actual	% of Total	FY 2007 Proposed	% of Total	Actual Increase	Percent Change	Share of Increase
General Operations							
Personnel	$1,207.1	26.0%	$1,593.7	24.2%	$386.6	32.0%	20.0%
Operations	386.1	8.3%	655.1	10.0%	269.0	69.7%	13.9%
Subtotal - Operations	$1,593.2	34.3%	$2,248.8	34.2%	$655.6	41.2%	33.9%
Grants & Benefits							
Income Support (TDI & Employ)	$346.7	7.5%	$381.8	5.8%	$35.0	10.1%	1.8%
Medical Assistance - Mgd Care	144.8	3.1%	436.1	6.6%	291.3	201.2%	15.1%
Medical Assistance - All Other	628.3	13.5%	709.9	10.8%	81.6	13.0%	4.2%
Development Disabilities	133.9	2.9%	191.4	2.9%	57.5	43.0%	3.0%
Child Welfare	80.0	1.7%	119.8	1.8%	39.8	49.8%	2.1%
TANF	154.0	3.3%	56.9	0.9%	(97.1)	-63.1%	-5.0%
Child Care	24.1	0.5%	73.7	1.1%	49.6	205.7%	2.6%
SSI	27.3	0.6%	28.5	0.4%	1.2	4.4%	0.1%
Higher Education	101.8	2.2%	131.3	2.0%	29.4	28.9%	1.5%
Other Grants & Benefits	382.2	8.2%	537.9	8.2%	155.7	40.8%	8.1%
Subtotal - Grants & Benefits	$2,023.1	43.5%	$2,667.3	40.5%	$644.1	31.8%	33.3%
Local Aid							
Education Aid	$596.0	12.8%	$796.0	12.1%	$200.0	33.5%	10.3%
Motor Vehicle Phase-out	0.0	0.0%	129.1	2.0%	129.1	-	6.7%
General Revenue Sharing	16.9	0.4%	65.2	1.0%	48.3	285.5%	2.5%
PILOT	15.6	0.3%	29.0	0.4%	13.4	85.4%	0.7%
Federal Aid	57.6	1.2%	162.0	2.5%	104.4	181.4%	5.4%
Other	34.9	0.8%	65.9	1.0%	31.0	88.9%	1.6%
Subtotal - Local Aid	$721.1	15.5%	$1,247.2	19.0%	$526.1	73.0%	27.2%
Capital Expenditures							
Capital Expenditures	$73.7	1.6%	$180.4	2.7%	$106.7	144.9%	5.5%
Debt Service	236.1	5.1%	236.6	3.6%	0.4	0.2%	0.0%
Subtotal - Capital	$309.8	6.7%	$417.0	6.3%	$107.2	34.6%	5.5%
Total	**$4,647.2**	**100.0%**	**$6,580.2**	**100.0%**	**$1,933.1**	**41.6%**	

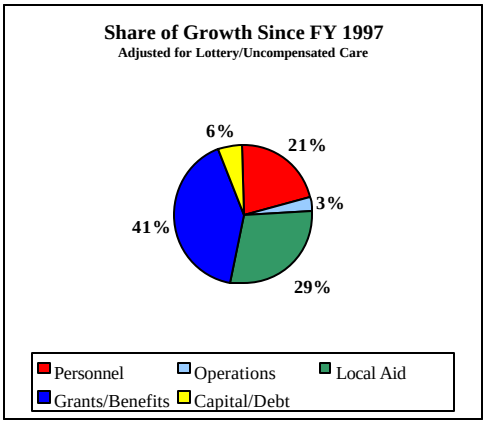
Source: RIPEC calculations based on State Budget Data - State Budget Office, DOA

Expenditure by Category and Function

There are five major categories of expenditures - personnel, operating, local aid, grants and benefits and capital expenditures. These categories of expenditure represent how the State allocates funds within programs and services. As noted earlier in this report, the Lottery was not included in the FY 1997 budget, but it has since been included in the State's spending program – thus overstating recent personnel and operating expenditures in FY 2007 when comparing to FY 1997. Second, the Governor has proposed to shift the FY 2007 uncompensated care payment of $110 million to community hospitals to FY 2008, thereby understating the FY 2007 expenditure program. Adjusting FY 2007 for these two changes would change the relative growth in spending by expenditure category.

Table 7





- Grants and benefits, which include medical assistance and cash assistance programs, constitute the largest category of expenditures, representing 41.0 percent of the total FY 2007 budget. Direct grant and benefit programs are the single fastest budget driver, consuming 33.3 cents of every dollar spend since FY 1997. Adjusting for Lottery and the uncompensated care payment deferral, grants and benefits have consumed 42.1 percent of every new dollar since FY 1997.

- Personnel expenditures represent 24.0 percent of the State's budget, and operations represent 10.0 percent. Combined, personnel and operating expenditures have represented 34 cents of every new dollar spent since FY 1997.

- Local aid, which includes education aid and other direct assistance to municipalities, represents 19.0 percent of the budget. However, since FY 1997, nearly 27 cents of every new dollar has been allocated for additional local aid.

- The remaining 6.0 percent of the FY 2007 budget is dedicated to capital and debt service expenditures, with 6 cents of every new dollar since FY 1997 allocated to support these expenditures. However, as discussed later in this report, this is in part due to the State's use of the Rhode Island Capital Fund for debt service to provide some relief to the general revenue fund.

Medical Assistance Expenditures

Medical Assistance expenditures grew annually by 7.3%, from $701.1 million in FY 2000 to $1,146.0 million in the Governor's recommended FY 2007 budget (does not include FY 2007 disproportionate share payment or the Federal share of Medicare Part D related costs). Note that reliable and comparable Medical Assistance data prior to FY 2000 is not available. Medical assistance expenditures reflect Medicaid expenditures incurred by the Department of Human Services. These expenditures account for about two-thirds of the total Medicaid budget and include expenditures related to hospitals, nursing homes, managed care (mainly RIte Care), as well as pharmacy expenditures.

- The State's general revenue appropriations have had to bear a greater share of Medical Assistance expenditures since FY 2000 because the State's Federal matching rate has declined from 53.8 percent to 52.9 percent during this period. This means Rhode Island will draw down slightly less than $0.53 from the Federal government for every $1.00 it will spend in FY 2007;

- Of the $444.9 million net growth between FY 2000 and FY 2007, 55.2% ($245.8 million) are related to managed care costs, which is mainly RIte Care.

Table 8

FY 2000 - 2007 Medical Assistance Expenditures

Medical Assistance Program	FY 2000 Audited	FY 2006 Revised	FY 2007* Rec	FY 2000-07* Change $	FY 2000-07* Change Avg Ann	FY 2006-07* Change $	FY 2006-07* Change Avg Ann
Hospitals	$144.2	$257.2	$162.7	$18.5	1.7%	($94.5)	-36.7%
Nursing Homes	245.6	298.6	304.9	59.3	3.1%	6.3	2.1%
Managed Care	190.3	437.1	436.1	245.8	12.6%	(1.0)	-0.2%
Other	121.0	262.2	242.3	121.3	10.4%	(19.9)	-7.6%
Total	**$701.1**	**$1,255.1**	**$1,146.0**	**$444.9**	**7.3%**	**($109.1)**	**-8.7%**
Gen Rev	*$323.6*	*$577.4*	*$563.2*	*$239.6*	*8.2%*	*(14.2)*	*-2.5%*

* In FY 2007, uncompensated care payments of app. $110.0 million are deferred to FY 2008 and not included in the total expenditures. Including this amount would bring hospital expenditures in FY 2007 to $272.7 million. Also, the Federal share of the Medicare Part D expenses are no longer included in total medical assistance expenditures.

Source: State Budgets, Governor's FY 2007 recommended budget, and RIPEC calculations.

Governor's FY 2006 and FY 2007 Medical Assistance Program

Based on the Governor's budget request, between FY 2006 revised and FY 2007 recommended, medical assistance expenditures are proposed to decline by 8.7 percent. If one adjusts the FY 2007 budget to include the deferred uncompensated care payment and the Federal share of Medicare Part D expenses, the Governor's FY 2007 Medical Assistance budget would represent a 4.1 percent increase over FY 2006 revised rather than a proposed 8.7 percent decline. However, there are a number of changes and initiatives in the Governor's FY 2007 budget that impact the Medical Assistance Program. These changes include:

- Federal Matching Rate - Due to the revised Federal matching rates noted above, the State will have a net loss in Federal funds of nearly $34.7 million in FY 2007.

- Medicare Part D – The Federal Medicare Part D drug plan provides coverage for people enrolled in Medicaid, as well as Medicare (dual eligibles). Before this law was enacted, the State paid a portion of the dual eligibles' drug costs matched by the Federal participation rate. Under the new law, the State no longer directly pays for the drug costs. However, the State will pay a portion of the savings to the Federal government (claw-back provision). For FY 2007, the Governor includes State payments for this claw-back provision of $47.1 million.

- Uncompensated Care Payments – The FY 2007 Medical Assistance budget of $1,146.0 million does not include uncompensated care payments to community hospitals totaling approximately $110.0 million. The Governor proposes to shift these disproportionate share payments to the State and community hospitals to FY 2008. At the same time, the Governor recommends extending the hospital licensing fee and deferring uncompensated care payments into FY 2008. However, the Governor would accrue this payment to FY 2007 – translating into a net gain of $36.6 million in general revenue receipts in the FY 2007 budget.

- The Governor proposes savings of about $15.3 million in general revenue funds through various Medicaid operational efficiencies such as:

    - Enhancing pharmacy rebates and establishing a preferred drug list for fee-for-service clients,
    - Enrolling dual eligible RIte Care clients in Part D Medicare,
    - Defer a scheduled nursing home cost-of-living adjustment by three months, and
    - Restructuring provider reimbursements for RIte Care.

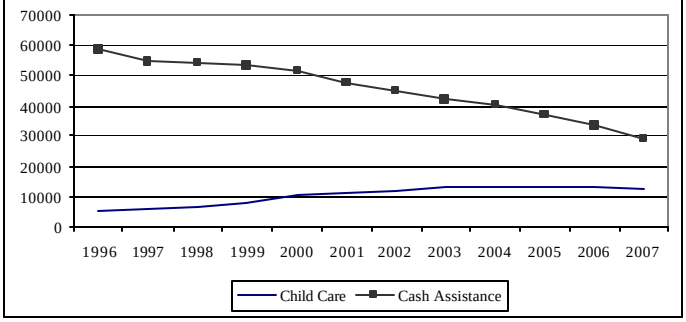
- The Governor also identified $14.2 million in savings in the RIte Care program by:

    - Establishing RIte Care co-payments for families between 133% and 150% of the Federal Poverty Level (FPL);
    - Increasing RIte Care co-payments for families above 150% FPL; Eliminating health care coverage for parents of Medicaid eligible children in families above 133 FPL; and
    - Eliminating health care coverage for undocumented children (funding might be restored, contingent on the State receiving additional Federal SCHIP funds).

Family Independence Program

In 1996 the State's Family Independence Program (FIP) was enacted to implement the Federal Temporary Assistance to Needy Families (TANF) block grant – replacing the Aid to Families with Dependent Children Program (AFDC). The reforms were designed to move people off welfare into work. The Governor's FY 2007 budget includes $130.6 million for FIP, of which $56.9 million is for cash assistance and $73.7 million is for child-care subsidies.

Table 9
Family Independence Program/Child Care Enrollments



In FY 1996, the State spent $144.7 million on the program, of which 89.0 percent was in support of cash assistance and 11.0 percent was for child care subsidies. This has since declined to $130.6 million, with 44.0 percent allocated for cash assistance and 56.0 percent for child care. The total expenditures for the program declined by $14.1 million or 9.7 percent. However, when adjusted for inflation, FY 2007 expenditures of $130.6 million represent a $59.3 million decline in spending, or 31.2 percent less than FY 1996.

The reduction in cash assistance for FIP is due to a continued decline in projected enrollments. In FY 1996, there were 58,400 persons enrolled in the TANF program. The Governor's budget assumes an estimated caseload of approximately 29,300 in FY 2007, representing a projected 1,450 net decrease from the November estimate due to proposed changes in the FIP program. According to the U.S. Department of Health and Human Services, Rhode Island's TANF/FIP caseload declined by 42.0 percent between 1997 and 2004 compared to 48.0 percent in Massachusetts and a national average of 56.0 percent. However, the percentage of Rhode Island's population who are TANF recipients is the 3rd highest in the Nation compared to 18th in Massachusetts.

The Governor's proposals to change the program are projected to result in general revenue expenditure savings of $9.5 million, $5.9 million of which would be in cash assistance (FIP) and the $3.6 million balance in child care by:

- Requiring recipients to sign an employment plan, and sanction them after three months if they choose not to participate in that plan;
- Reducing the length of eligibility from 60 to 30 months for those enrolled after July 1, 2007 and increasing work requirements from 30 to 35 hrs/week;
- Counting time on welfare in other states for length of eligibility in Rhode Island and implementing a graduated reduction in benefits after 24 months; and
- Tightening child care programs by mandating a $10,000 resource test, increasing co-shares for families at or above 150 percent of the Federal poverty level, and delaying a rate increase for child care providers for one year.

Personnel Expenditures and Trends

FY 2007 personnel expenditures total $1,593.7 million, a $31.0 million (2.0 percent) net increase from the FY 2006 revised personnel budget. The FY 2007 average cost per FTE position of $83,159 represented a 7.6 percent increase (5.0 percent real growth) over FY 2006 revised ($77,293).

Table 10
State Personnel Costs - Unadjusted

Personnel Costs (Millions)	FY 1997 Actual	FY 2006 Revised	FY 2007 Proposed	FY 2007 - FY 2006 Revised Actual Change	FY 2007 - FY 2006 Revised Percent Change
Salaries & Benefits					
Net Salaries	$610.5	$876.2	$898.6	$22.4	2.7%
Adjustment for Temp	($56.0)	($74.7)	($76.5)	($1.8)	2.5%
Overtime	36.7	54.3	52.0	(2.3)	-4.1%
Retirement	57.8	127.7	153.4	25.7	27.3%
Medical	85.4	174.4	185.4	11.1	6.6%
Other Benefits/Payroll	55.9	83.0	86.1	3.1	3.9%
Salaries & Benefits	*$790.2*	*$1,240.9*	*$1,299.0*	*$58.2*	*5.1%*
Funded FTE Positions	**15,948.7**	**16,054.1**	**15,621.0**	**(433.1)**	-2.7%
Average Cost Per FTE	**$49,549**	**$77,293**	**$83,159**	**$5,866**	8.1%
Other Personnel Costs					
Other Payroll Costs	$72.1	$118.4	$114.3	($4.1)	-4.1%
Purchased Services	79.0	203.4	180.4	(23.0)	-11.6%
Other Personnel	*$151.1*	*$321.8*	*$294.7*	*($27.1)*	*-9.1%*
Total Personnel Costs	**$941.3**	**$1,562.7**	**$1,593.7**	**$31.1**	**2.1%**

Source: State Budget Office and FY 2007 Personnel Supplement.

Since FY 1997, personnel expenditures have increased at an average annual rate of 5.4 percent (2.8 percent real growth). FY 1997 personnel spending represented 26.0 percent of the State budget. It has since declined to 24.2 percent - principally due to faster growth in grants and benefits to individuals and local aid.

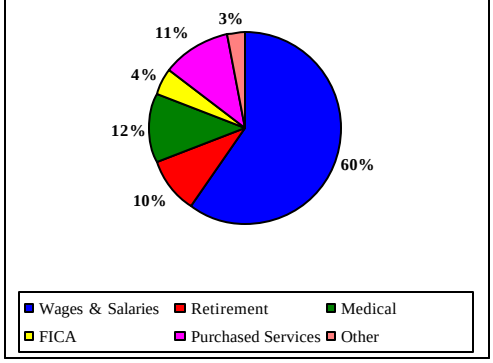
It should be noted that the FY 2006 Revised Budget includes an additional $30.6 million net in personnel spending than was enacted last summer. This represents a 2.0 percent increase over enacted personnel spending. Understating personnel expenditures in the enacted budget has been a trend in recent years.

General revenues support 49.0 percent of all personnel expenses in FY 2007. Federal funds support nearly 22.0 percent and the remaining funds (special funds, restricted receipts and internal service funds) support 29.0 percent of the personnel budget.

The FY 2007 personnel budget includes nearly $42.0 million in personnel savings due to a series of initiatives designed to reduce the State's workforce by 419.4 FTE positions. These savings also include a proposal to shut down the State for two days (July 3rd and November 24th) and requiring nonessential staff to take time without compensation.

There has been a significant increase in the use of internal service funds (Funds that are used to allocate costs between agencies and departments for services provided), from $21.8 million in FY 2006 to $51.7 million in FY 2007. This is due to the centralization of several functions (human resources, information technology, legal services and facilities) within the Department of Administration.

Table 11
Total FY 2007 Personnel Costs



The average cost per FTE position increased from $49,549 in FY 1997 to $83,159 in FY 2007 – an increase of 67.8 percent for an average annual rate of growth of 5.3 percent (30.9 percent and 2.7 percent when adjusted for inflation). This growth is attributed to increases in the salary base, pension contributions, medical insurance costs, and cost of living arrangements in the State's contracts.

The cost of providing medical insurance to State employees has more than doubled since FY 1997. Employee medical insurance costs have increased from $85.4 million in FY 1997 to $185.4 million in FY 2007, translating into an average annual rate of growth of 8.1 percent (5.4 percent real growth). FY 2007 medical insurance expenditures increased by 6.3 percent over FY 2006 revised spending ($174.4 million).

The FY 2007 personnel budget includes $153.4 million for the State's contribution to employee pensions. This includes the net savings from the 2006 pension reforms. Even with these reforms, retirement expenditures are expected to increase by $25.7 million (20.1 percent) over FY 2006 spending.

FTE Position Authorization and Governor's Workforce Reduction Plan

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. However, RIPEC continues to include these positions in the totals for comparison purposes.

- The Governor's FY 2006 Revised Budget request includes 16,417.4 FTE positions, representing a net increase of 68.3 FTE positions from the FY 2006 enacted budget. This is primarily due to incorporating the Lottery's 64.5 FTE positions and related personnel costs into the Department of Administration.

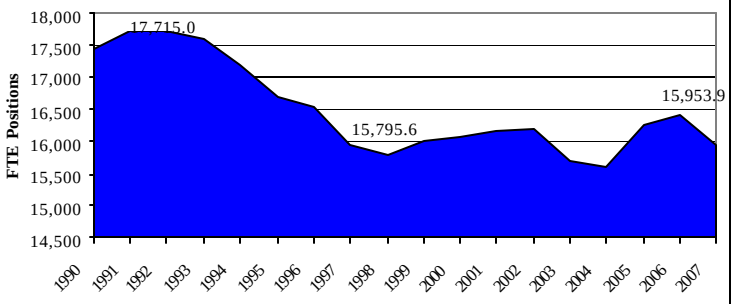
- The Governor's FY 2007 Budget includes 15,953.9 FTE positions (includes 785 FTE positions related to higher education), representing a net decline of 463.5 FTE positions from the FY 2006 Revised Budget.

- The thrust of the Governor's personnel budget is a series of reforms or actions designed to achieve $50.4 million in savings. Of this amount, the Governor is projecting to save $35.7 million by targeting a 5.0 percent reduction of State-funded workforce positions, eliminating 419.4 FTE positions through:

  - Eliminate pay-out for sick leave as of July 1, 2006;
  - Eliminate statutory status (20-year rule);
  - Eliminate all new longevity and freeze existing longevity amounts;
  - No longer permit carry-forward of 2-years unused vacation time;
  - Reform bumping process for employees whose positions are eliminated;
  - Change probationary period from 6 months to one year.

- The Governor has proposed reducing 42.0 FTE positions in Mental Health through shifting services to private providers; and eliminating 17.5 FTE positions through the elimination of DMV satellite offices (note Governor has since indicated he would no longer pursue the DMV satellite closures).

Table 12
Full Time Equivalent Positions



- Of the $50.4 million in savings, the Governor includes $6.7 million in savings through two shut down days, $7.0 million though several initiatives on medical expenditures including carving out pharmacy from current medical plan, and a net savings of $1.0 million through the use of limited service positions (permitting the State to eliminate $12.1 million in contracted services).

- The Governor has also proposed transferring 321.0 FTE positions from various agencies to the Department of Administration to centralize human resources, facilities, information technology and legal services.

- In consolidating the various FTE positions, the State is setting up a series of internal service funds for the purposes of charging these services back to the agencies that receive the assistance.

- The FY 2006 revised and FY 2007 proposed personnel budgets continue to fund 106.0 FTE positions in the Department of Transportation using GARVEE and Motor Vehicle Bond Proceeds to the tune of $3.1 million each year.

State Aid

The Governor's FY 2007 budget includes $1,247.2 million in local aid - a 5.2 percent increase over the FY 2006 Revised Budget. Since FY 1997, state aid increased at an average annual rate of 8.3 percent, more than doubling aid since FY 1997 – a $684.9 million increase over this period of time. Adjusted for inflation, state aid grew by $526.1 million – an average annual rate of 5.6 percent.

Table 13
State Aid to Local Government

Major State Aid Program	FY 1997	FY 2006R	FY 2007	Change
Education Aid	$411.9	$657.7	$676.9	$19.2
Excise Tax Phase Out	0.0	117.9	129.1	11.2
State Teacher Retirement	34.5	56.3	69.4	13.1
General Revenue Sharing	13.2	65.0	65.2	0.2
School Housing Aid	18.1	46.6	49.7	3.1
PILOT	12.2	27.0	29.0	2.0
Other Aid	72.4	185.3	197.2	11.9
Subtotal - Direct Aid	*$562.3*	*$1,155.8*	*$1,216.4*	*$60.7*
Meals and Beverage Tax	$0.0	$17.7	$18.6	$0.9
Public Services Corporation Tax	0	12.2	12.2	0.0
Subtotal - Pass Through	*$0.0*	*$29.9*	*$30.8*	*$0.9*
Total State Aid	**$562.3**	**$1,185.6**	**$1,247.2**	**$61.6**

Source: RIPEC calculations based on State Budget Documents

- The FY 2007 budget includes an additional $19.2 million in direct education aid, distributed based on pension contribution requirements. The Governor has also proposed to increase the State's share of employer contributions for teacher retirement from 40 to 50 percent starting in FY 2008.

- Direct education aid increased from $400.7 million (unadjusted) in FY 1996 to $676.9 million in FY 2007 – increasing at an average annual rate of 4.9 percent. In FY 1996, approximately 76.0 percent of State aid was direct education aid. This has since declined to 54.3 percent in FY 2007, in part due to the initiatives to phase out the excise tax on cars and expand the general revenue sharing program.

- The budget includes $65.2 million for the general revenue sharing program - approximately $16.1 million less than current law requires. The Governor proposes to freeze the program at 3.0 percent of the second prior year's general tax revenues rather than phasing the program up to 4.7 percent by FY 2011.

- The FY 2007 budget includes $29.7 million for the Payment in Lieu of Taxes program (PILOT); reimbursing communities for 27.0 percent of collections given properties are tax exempt through State action. The Governor included the first year of a two-year phase in of adding T.F. Green Airport in the PILOT program.

- The budget exempts $5,500 in vehicle value from taxation through the state phase out of excise taxes on motor vehicles - an increase of $500 over FY 2006.