



**RIPEC**

# Comments on Your Government

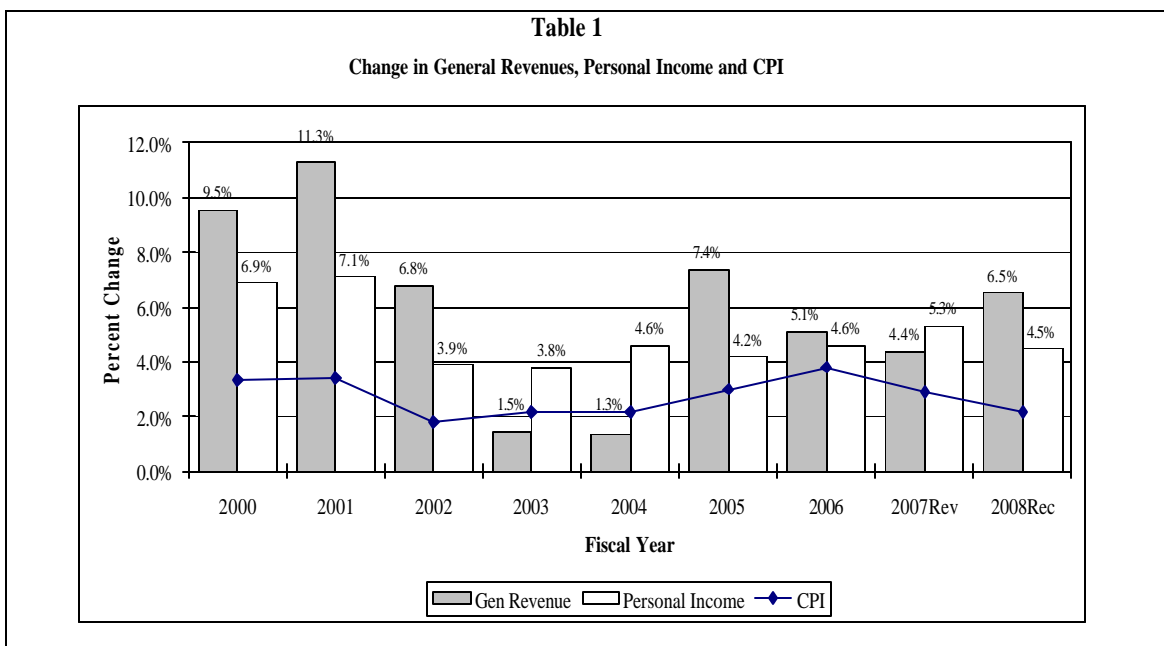
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## Summary of the Governor's FY 2008 Budget Request - RIPEC proposes Fiscal Get Well Plan for Rhode Island -

The proposed FY 2008 general revenue request of \$3.4 billion represents a 6.2 percent increase over the FY 2007 Enacted Budget, or 6.5 percent over the FY 2007 Revised Budget. As presented, the budget would grow faster than inflation (2.2 percent), and personal income (4.5 percent). However, what should be of paramount concern to taxpayers is the level of spending growth and projected out-year deficit that need to be addressed as the FY 2008 Budget is developed.

RIPEC believes 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 appropriately funded and revenue realistically projected, whether expenditure priorities are responsive to the needs of citizens, and what the out-year fiscal implications of the proposed spending plan are.

The following RIPEC Comments not only outline the Governor's FY 2008 Budget request and summarizes key policy issues, but also focuses on a *Fiscal Get Well Plan* that is needed to eliminate out-year deficits, enable investments in programs that will improve Rhode Island's economy and maintain the State's credit worthiness.



April 2007

## **RIPEC Comments – A Fiscal Get Well Plan for Rhode Island**

The annual structural budget deficit and repeated out-year projected deficits have inhibited the State's ability to make strategic budget decisions that are needed to stimulate economic growth and support basic services necessary to maintain the quality of life. State budgets with projected out-year deficits have become a common event on Rhode Island's fiscal landscape. Submission of the proposed FY 2008 State Budget marks the tenth consecutive budget that has been proposed with out-year deficits. In the past, some operating budgets were balanced by using non-recurring revenues. As a result, budgets have been adopted with a structural deficit, i.e., current operating expenses exceeding current revenues.

If Rhode Island is to successfully compete for jobs and sustain necessary government programs, it is essential that the State adopt an Investment-Based Budgeting process to replace the current method of annually patching budget deficits to meet the legal obligation of balancing the budget without addressing the fundamental fiscal imbalance in the State. Such an approach is necessary to guarantee that resources will be available to support programs that will make Rhode Island a more prosperous State. The first step in a get well plan for the State is to eliminate the out-year deficit so the State can continue to sustain existing services while reordering priorities.

In RIPEC's view, the initial targets of an Investment-Based Budget should focus resources on programs that support educational initiatives so Rhode Island's workforce has the necessary skills for 21<sup>st</sup> century jobs. In setting these investment targets, there must be specific and measurable goals that go beyond mere rhetoric. Clear targets should be established so that resources are focused on the highest priorities. We might, for example, adopt benchmarks such as:

- Funding a school foundation formula where the State provides approximately 50.0 percent of the cost of education, coupled with initiatives that hold schools accountable for results, enhance operating efficiencies, and allow equitable implementation of the Property Tax Relief Act of 2006.
- Adopting a "fair share formula" to keep public higher education affordable in the Ocean State. Such a plan might provide that students and their families bear 50.0 percent of the net tuition costs per student at the University of Rhode Island, and 40.0 percent and 30.0 percent at Rhode Island College and the Community College of Rhode Island respectively. Such a goal would help ensure that higher education in State institutions remains affordable, allowing for the development of a better-educated workforce for Rhode Island.

Recognizing that higher education has become less affordable for Rhode Island students and their families, the Governor has proposed an 8.9 percent increase in State funding for higher education, which RIPEC supports. However, achieving the goal outlined above may require a fiscal capacity currently out of reach for the State.

The importance of a “fair share formula” approach in financing higher education takes an added importance when the capacity of Rhode Island families to pay for college is compared to neighboring Massachusetts and Connecticut. For example, the median family income for a family of four in Connecticut is \$92,205, Massachusetts \$85,420 and Rhode Island \$78,297.

The affordability issue signals the urgent need for a comprehensive reexamination of higher education finance. Additional public investment may be essential, particularly to extend higher education opportunities to low-income Rhode Islanders. However, it is critical that questions regarding effectiveness and accountability also be addressed if the State is to realize economic improvement commensurate with such investments.

In addition, the State should identify incentives that can be used to spur research activities at universities and colleges that will enhance investment and job creation.

Or, alternatively, we might also set one or more goals for the State in terms of resources provided for health care, e.g., use of technology to enhance quality of care and improved access to primary care, thereby potentially reducing the State’s spending on medical services.

Achieving these goals will be difficult unless the General Assembly first enacts a *Multi-Year Fiscal Get Well Plan* that addresses both the Fiscal Year 2008 structural budget deficit and the projected out-year deficits.

Therefore, the initial goals for the *Fiscal Get Well Plan* should be aimed at annually reducing out-year deficits until they are eliminated, no later than FY 2012. The first step to achieve this goal should be to limit the reliance on non-recurring revenues and initiate a spending cap.

In RIPEC’s opinion, the *Fiscal Get Well Plan* should include the following elements:

1) Three to Five Year Binding Cap on State Spending Growth – Section 35-3-7 of the General Laws places a 5.5 percent spending cap on the budget the Governor submits to the General Assembly. (The Governor has proposed a 6.2 percent increase). This is indeed a most peculiar cap because it does not apply to the budget enacted by the Legislature. Previously, RIPEC and the Affordable Rhode Island Coalition suggested a constitutional expenditure limit on State spending equal to the sum of the CPI + 1.5 percent. Based on the projected inflation included in the State’s five-year financial forecast, this would allow State spending to increase by approximately 3.5 percent annually. Therefore, it is suggested that such a statutory cap be mandated for the next 3-5 fiscal years and apply to spending supported by all revenues, with the exception of federal receipts.

If the annual increase in State spending was limited to the CPI + 1.5 percent the projected deficit in FY 2012 would decline from approximately \$425.0 million to a projected \$250.0 million.

2) Define a Sustainable Safety Net – Adoption of a temporary statutory cap on the rate of growth in State spending should be viewed as a first step in addressing Rhode Island’s growing budget deficit. However, simply limiting the growth in spending will not assure that necessary government programs can be sustained, delivered in a cost-effective manner, and are responsive to Rhode Island’s citizens.

Therefore, concurrent with establishing a temporary spending cap there is a need to create a public process to help inform the Governor and General Assembly as they:

- Establish the priorities of government and the outcomes that matter most to citizens;
- Determine how much citizens are willing to spend; and
- Decide how best to deliver and sustain such services.

A starting point for such public input might first consider the question “*What should the Ocean State’s safety net encompass?*” Approximately 41.0 percent of the State budget supports programs for Rhode Island’s most needy citizens. Since fiscal year 1998 over 43¢ of each additional dollar the State has spent was for entitlement and other welfare programs. Given available resources to balance the annual operating budget, proposals have been made to modify existing human services programs. RIPEC believes that reforming and limiting the cost of entitlement spending is necessary to make State government affordable. However, these tough choices should be based on clearly articulated long-term policy goals and objectives. Unfortunately, this has not always been the case. For example, the kind of questions that need to be addressed include:

- What are the appropriate means-testing criteria for entitlement programs and should they vary by program?
- What consequences do selected changes to human services programs have on other State supported programs, and to what degree?
- Should per capita State spending in Rhode Island for cash assistance and Medicaid programs continue to rank 3<sup>rd</sup> and 4<sup>th</sup> highest respectively in the United States?

3. Reduce Reliance on One-time Revenues – Periodically, one-time revenues have been used to balance State operating budgets. Approximately six percent of the revenues used to balance the Fiscal Year 2008 State budget would be generated by non-recurring revenues.

As shown on Table 2, the Governor’s FY 2008 budget includes approximately \$210.5 in one-time revenues. Of that amount, \$80 million are related to the AIG settlement (included by the Revenue Estimating Conference) and \$63.0 million by transferring funds out of the budget reserve fund in FY 2007 for use in FY 2008. The constitutionality of using the budget reserve fund as proposed has been questioned. It also includes \$28.2 million in proposed land sales, \$15.2 million from a tax on health insurers, \$14.1 million through an accelerated settlement with the hospitals, and \$10.0 million through a proposal to buy back a portion of the historic structures tax credit. If the \$210.5 million in one-time revenues

included by the Governor were taken out in FY 2008, revenues would approximate current year levels (compared to 6.5 percent growth in general revenue expenditures).

A *Fiscal Get Well Plan* must reduce the reliance on the use of one-timers to balance the budget. Therefore, existing tax credits should be evaluated to determine if they are achieving their objectives. If they are not, they should be modified and used to help eliminate the structural budget gap. For example, the benefits provided under both the Film and Historic Tax Credits should be revisited. Also, a determination should be made as to what tax credits are important to existing Rhode Island businesses. Those that enhance competitiveness should be retained, and those whose benefits cannot be demonstrated should be revised.

<u>Item</u>	<u>Amount \$ million</u>
<b>REC</b>	
AIG Settlement	\$80.0
<b>Governor's FY 2008 Budget</b>	
Tapping Budget Reserve Fund	\$63.0
<b>One-time Revenues</b>	
Land Sales*	\$28.2
Health Insurer Tax	15.2
Accelerated Hospital Settl.	14.1
Historic Structures Tax Credit	
Buyback	10.0
Subtotal	\$67.5
<b>Total</b>	<b>\$210.5</b>

\*One should note that the Governor took out the proposal to sell the land in Charlestown. However, the Administration is planning on replacing the sale of this property with another property, resulting in similar savings.  
Source: State Budget Documents, House Fiscal Staff Analysis, and RIPEC calculations.

In 2006 the General Assembly created a Department of Revenue that included a tax policy function. It is critical that the Office of Revenue Analysis be created so it can assess the economic, fiscal and social effects on various revenue options to replace one-time revenues. Additionally, in 2006 the State awarded a consultant contract to assess the competitiveness of the State's tax structure and make recommendations for changes to the tax structure where appropriate. The results of this study should be carefully reviewed to determine if additional opportunities exist to replace non-recurring revenues included in the proposed Fiscal Year 2008 State Budget.

Further, a review of the application of the State's sales tax to insure that Rhode Island's tax structure is competitive, balanced and equitable is necessary. For example, the feasibility of expanding the sales tax to cover selected personal services (as distinguished from services for businesses) should be considered as long as it can be demonstrated that such actions will not result in Rhode Island's consumers crossing state lines to Massachusetts or Connecticut to purchase goods and services. This approach was proposed in RIPEC's comprehensive analysis of the State's tax structure in 2000 (see "A System Out of Balance").

The fiscal soundness of the FY 2008 budget is affected by the over-dependence on one-time revenue sources. As noted above, permanent revenue enhancements are needed to reduce the State's reliance on such revenues. Bottomline, it is recommended that a target be established to replace approximately \$65.0 million of non-recurring revenues with permanent resources. Such action would significantly reduce the projected out-year deficit provided the General Assembly does not use the proceeds generated by permanent revenue to increase spending above the level proposed by the Governor.

4) Reorganize Medicaid and Human Services Delivery, Purchasing and Management – Last year the Executive Office of Health and Human Services (EOHHS) was created to provide for greater policy and program coordination among the five agencies whose budgets represent nearly 40.0 percent of the entire State budget.

It was hoped that the EOHHS would be in a position to address program issues that cut across departmental responsibilities, coordinate the fiscal and policy framework driving the departments and ensure that clients have access to cost effective services. Based on RIPEC's work with the Governor's Medicaid Study Group it appears that the State does not have the organizational structure to achieve these critical management objectives. Therefore, there is a need to reorganize the way human services programs are managed.

The Study Group identified a need to review the functions of the Executive Office of Health and Human Services, and specifically address the following organizational questions:

- What is the appropriate division of responsibilities between agencies and EOHHS?
- What agency or office should be the official Medicaid authority?

Additionally, there currently is no uniform database for all human service departments. Therefore, a statewide analysis of caseloads and expenditures is not readily available for the Executive Office of Health and Human Services and the General Assembly. Information is not easily accessible among agencies and analytical capacity for planning, assessment and budgeting varies greatly among human services agencies.

There is a need to take steps to ensure greater coordination of data storage, retrieval and analysis among the health and human service agencies. Furthermore, standardized data sharing agreements among health and human service agencies should be explored.

In addition, there has not been a comprehensive review to consider the methods used to reimburse provider institutions, and to determine if patients are in the most appropriate settings.

The issues outlined above are just a few examples that suggest that a comprehensive reorganization of the State's Human Services agencies may have the potential to produce significant economies in the way Medicaid and other human services are provided to Rhode Island's neediest citizens. In the Governor's FY 2008 budget, the five health and

human services departments are directed to review their processes for acquiring community-based services (Buy Rite initiative). The budget includes savings of \$7.0 million through this initiative.

The success of any effort to improve the delivery of human services programs is linked to improving the cost-effectiveness and efficiency of the Medicaid program. Given existing and projected resources, RIPEC believes that reforms to the Medicaid program are necessary public policy choices to constrain the growth in State spending. Growth in Medicaid will, by itself, continue to create a large structural problem in the State's budget. Medicaid spending is projected to grow from \$1.1 billion in FY 2000 to more than \$1.8 billion in FY 2008, with State taxpayers paying approximately one-half of the latter amount. Medicaid expenditures accounted for \$0.28 of every new dollar spent since FY 2000.

RIPEC supports the Governor's recommendation to limit the growth in medical assistance programs given the State's finite resources. However, decisions to reform and control medical spending will require a clearly articulated, strategic and organizational vision that drives budget choices. One should also note that these recommendations occur in the context of rising health care costs which are rendering more people uninsured. The burden for financing the care for these uninsured people will continue to be shifted through complex payment subsidies and Medicaid financing borne by the remaining insured population. Broad efforts for affordable health insurance and to slow the trend of medical expenses must continue.

In December 2006, the Report of the Governor's Medicaid Study Group set forth a blueprint for developing a strategic approach for financing the State's Medicaid program. The report stated:

"The root causes are increased spending on services provided by institutions for both acute and long-term care. Therefore, information to support fundamental reforms of the system will require a thorough and comprehensive examination of the following:

- Medicaid's financial sustainability over the next five years, with sustainability defined in terms of the program's impact on the State's overall financial situation;
- The principle of reimbursement and the way institutional reimbursement is established;
- Benefit design, which includes a comparative analysis of the amount, duration and scope of benefits;
- The methods and procedures used to conduct utilization reviews for high-cost cases, particularly those where multiple agencies are involved; and
- The feasibility of shifting more program expenditures from fee for services to managed care."

As part of Rhode Island's *Fiscal Get Well Plan*, the State will need to build the necessary organizational infrastructure to tackle the issues outline above. As was found by the

Medicaid Study Group, an overall strategy for purchasing Medicaid services is needed. This strategy should be based on a clear and measurable accountability for achieving value (high quality at low costs) for a given population, and a philosophical commitment to integrating medical care in a consumer-oriented fashion. This will require leadership and a multi-year commitment.

5) Limit Growth in Personnel Spending – FY 2008 personnel expenditures total \$1,708.1 million, a \$113.6 million (7.1 percent) net increase from the FY 2007 revised personnel budget. Since FY 1998, personnel expenditures have increased at an average annual rate of 5.8 percent (3.8 percent real growth). The FY 2008 average cost per FTE position of \$90,629 represented a 10.5 percent increase (8.1 percent real growth) over FY 2007 revised (\$81,985).

The State's long-term ability to control the rate of growth in future personnel costs depends on the consideration of a personnel reform agenda. This agenda should review the State classification system, examine the feasibility of changing the retirement system for future employees from a defined benefit to a defined contribution plan as well as renegotiation of aspects of the collective bargaining agreement with regard to longevity pay and use of sick time. Most importantly, the State should look toward the creation of a personnel system that places greater emphasis on performance in all types of human resource decisions.

The Governor's personnel budget aims to slow the growth in personnel spending through a series of workforce reduction and benefits reforms:

- Privatization of dietary and housekeeping services at Eleanor Slater and Zambarano Hospitals and dietary services in the Veterans Affairs Program;
- Vacating an additional 108 FTE positions throughout State government;
- Outsourcing of workers compensation claims;
- Lower budgeted medical insurance due to an arrangement with the insurance provider;
- The creation of a new class of "limited service positions" intended to eliminate administrative costs incurred by the State for contracting with an outside vendor for positions of limited duration; and
- Additional potential savings are negotiated with the Unions.

RIPEC supports the Governor's efforts to limit growth in personnel spending. However, it will be important to review and understand the impact of the staffing reductions given their duties and impact on the delivery of services. The Governor has not identified specific positions that will be eliminated. Rather, he called for State agency directors to identify low priority activities or areas that have excess management or line staff. 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.

Furthermore, RIPEC is supportive of the Governor's proposal in creating "limited service positions". This would give the Administration more flexibility in hiring personnel. Under



current law, the State cannot hire a person for a limited period of time without the person being entitled to status as a State employee and the accompanying benefits – retirement benefits, sick time, vacation, paid holidays, and credit for longevity and seniority. Consideration of this proposal indicates the need to define the relationship between civil service and collective bargaining laws.

6. Tobacco Securitization – 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 resulted in payments to participants in perpetuity, 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 State operating budgets. 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 the retirement of the original bonds to possibly as early as 2023 or 2024.

The Governor has proposed that the State engage in a second initiative to securitize the residuals of the tobacco settlement. He proposed that the Tobacco Settlement Financing Corporation (TSFC) execute another bond transaction that would securitize the residual payments due to the TSFC upon the retirement of the bonds from the 2002 securitization deal. The Governor projects that such a transaction could yield between \$150 – 180 million. He further recommends that all of the proceeds be used for capital purposes.

Assuming that \$160 million would be received, the Governor proposes that \$20.0 million be received in FY 2007 and assigned to fund capital projects in the Capital Fund. In FY 2008, \$72.5 million would be transferred from the Tobacco Settlement Trust Fund to the Capital Fund to fund capital projects. The remainder of the proceeds, an additional \$67.5 million, would be reserved for transportation related projects.

Is further securitization of tobacco proceeds a good deal for Rhode Island taxpayers? RIPEC does not have sufficient information to answer this question at the present time. The evaluation of the proposed tobacco settlement securitization is dependent on the way the deal is structured, the cost of the transaction, and the use, by the State, of the proceeds. The General Assembly's decision regarding securitization of the residual of the tobacco settlement and how those proceeds might be used could have a significant impact on a *Fiscal Get Well Plan*.

When considering the proposal the following questions should be considered:

- Should the bonds be tax-exempt or taxable? Tax-exempt bonds usually yield a higher rate of return for the State. However, tax-exempt bonds are restricted in what they can be used for.

- Will the use of tobacco securitization proceeds be for one-time purposes, including capital investments, or will it be used to finance ongoing operational costs?
- Is there currently a market? Recently, New Jersey and California have completed major tobacco transactions.
- How would the State's bond rating be impacted by the deal?
- Would it be better for the State to securitize now or to wait?
- What are the costs to the State in moving forward with this proposal?

## General Revenues Summary

The Governor's FY 2007 Revised and FY 2008 budgets are based on revenue estimates established in November 2006. The Revenue Estimating Conference revised FY 2007 revenues are \$74.2 million less than enacted, reducing available general revenue resources for FY 2007 to \$3,189.6 million. The Governor's proposed FY 2007 Revised budget accounts for this reduction in anticipated revenues and proposes to partially offset the shortfall through \$30.8 million in revenue enhancements. Included in this amount are \$20 million in revenues from the securitization of tobacco settlement bonds and \$6.6 million from the delay and phase-in of the Energy Act Assessment and Credits.

<b>General Revenues</b>	<b>FY 2007 Enacted</b>	<b>FY 2007 REC</b>	<b>FY 2007 Governor</b>	<b>FY 2007 REC-Gov Change</b>	<b>FY 2008 REC</b>	<b>FY 2008 Governor</b>	<b>FY 2008 REC-Gov Change</b>
<b>Taxes</b>							
Personal Income Tax	\$1,051.8	\$1,068.8	\$1,068.8	\$0.0	\$1,087.6	\$1,096.2	\$8.6
General Business Taxes	319.6	338.0	344.6	6.6	328.8	337.3	8.5
General Sales & Use Tax	920.8	895.0	895.0	0.0	929.5	929.5	-
Cigarette Tax	123.8	121.7	121.7	0.0	117.5	117.5	-
Other Taxes	112.5	109.4	109.4	0.0	110.8	116.7	5.9
<i>Subtotal - Taxes</i>	<i>\$2,528.4</i>	<i>\$2,532.9</i>	<i>\$2,539.5</i>	<i>\$6.6</i>	<i>\$2,574.2</i>	<i>\$2,597.2</i>	<i>\$23.0</i>
Department Receipts	296.4	295.2	296.4	1.2	236.3	378.6	142.3
Other Sources	439.0	361.5	384.5	23.0	445.3	451.7	6.4
<b>Total Revenues</b>	<b>\$3,263.8</b>	<b>\$3,189.6</b>	<b>\$3,220.4</b>	<b>\$30.8</b>	<b>\$3,255.8</b>	<b>\$3,427.5</b>	<b>\$171.7</b>

Source: FY 2008 State Budget Documents

## FY 2008 Proposed

The Governor proposes general revenues of \$3,427.5 million in his FY 2008 budget. This revenue plan includes a net increase of \$171.7 million (6.4 percent) in revenues over the November estimates including:

- Removal of the health insurer gross premium tax exemption from health management organizations (\$15 million);
- The sale of state property including Chapin Laboratory and the land adjacent to the Garrahy Courthouse (\$28.2 million)
- An \$8.6 million increase in personal income tax receipts due primarily to savings generated by the Historic Structure Tax Credit buyback plan;
- Reinstatement of the Hospital Licensing Fee (\$71.6 million); accelerated collection of Hospital settlement payments (\$14.1 million); a new provider assessment on ambulatory service and imaging centers (\$4.0 million);
- An additional \$5.9 million in DMV revenue through implementation of a tiered registration fee structure and additional motor vehicle registration fee; and
- \$7.1 million in changes to, or creation of, State fees including professional licensing, health regulation and motor vehicles.

### State Spending Summary

The Governor's FY 2008 budget proposes \$7.0 billion in total funds to support state operations. Appropriations for FY 2008 represent an increase of \$352.5 million, or 5.3 percent, over the enacted FY 2007 budget, and \$319.1 million, or 4.8 percent, over the Governor's revised FY 2007 budget. The revised FY 2007 budget represents an increase of 0.5 percent from FY 2007 Enacted.

**Table 4**  
**Rhode Island State Spending - All Funds (\$ million)**

<b>By Category</b>	<b>1998</b>	<b>2007E</b>	<b>2007R</b>	<b>2008P</b>	<b>2007E-08P</b> <b>Change</b>
Personnel	\$ 970.6	\$ 1,600.6	\$ 1,594.4	\$ 1,708.1	\$ 107.5
Operating	302.6	614.1	541.4	560.2	(53.9)
Local Aid	582.8	1,264.4	1,267.4	1,313.2	48.8
Grants & Benefits	1,633.9	2,760.3	2,722.9	2,845.9	85.6
Capital	45.6	187.9	246.8	234.8	46.9
Debt Service	187.4	237.7	177.1	202.2	(35.5)
Operating Transfer*	-		148.4	153.0	153.0
<i>Total</i>	<i>\$ 3,723.0</i>	<i>\$ 6,665.0</i>	<i>\$ 6,698.4</i>	<i>\$ 7,017.4</i>	<i>\$ 352.5</i>
<b>By Fund</b>	<b>1998</b>	<b>2007E</b>	<b>2007R</b>	<b>2008P</b>	<b>Change</b>
General Revenue	\$ 1,865.0	\$ 3,221.5	\$ 3,210.9	\$ 3,420.7	\$ 199.1
Federal Funds	1,062.0	1,948.2	1,997.5	2,010.6	62.4
Restricted Funds	127.9	129.1	138.0	154.6	25.5
Other Funds	670.5	1,366.2	1,351.9	1,431.5	65.3
<i>Total</i>	<i>\$ 3,725.6</i>	<i>\$ 6,665.0</i>	<i>\$ 6,698.4</i>	<i>\$ 7,017.4</i>	<i>\$ 352.4</i>

E = Enacted, R = Revised, P = Proposed

\* Operating transfer reflects a change in accounting practices to reflect grant transfers between State entities.

Source: RIPEC calculations based on State Budget Office Data

The largest funding resource to the State in FY 2008 is general revenues, which represent slightly over 48.0 percent of the State budget. Federal funds (mostly Medicaid) represent about 29.0 percent. Other funds (primarily university and college funds, and employment and training funds), represent about 20.0 percent. Restricted funds comprise the smallest resource to the State at just 2.2 percent of all resources.

The Governor's FY 2008 general revenue budget of \$3,420.7 million is \$199.1 million more than FY 2007 Enacted. This represents a 6.2 percent increase in general revenue expenditures compared to 5.0 percent growth in general revenues.

**Selected highlights of the FY 2008 Spending Plan include:**

- Sale of approximately \$160 million in tobacco settlement bonds to provide \$72.5 million in funds for capital projects in FY 2008 and an additional \$67.5 million in reserve capital funds to be allocated to transportation-related projects.
- Personnel savings of \$54 million through: a net reduction of 344.9 FTE positions; privatization and consolidation of food and housekeeping services; outsourcing of the State's workers' compensation program; implementing a three-quarter percent salary reduction for State employees (or equivalent savings); and creation of limited service positions.
- A 10.5 percent increase from FY 2007 revised in the average cost per FTE position of to \$90,629. Since 1998 the cost per FTE has increased 75.2 percent.
- General revenue savings of \$25.9 million through changes to State-sponsored child care by: lowering the program's eligibility ceiling; delaying a schedule provider rate increase, changing provider reimbursement rates, and enforcing eligibility requirements.
- Decreasing DCYF costs by restricting services to those under the age of 18, anticipated to produce \$17.6 million in general revenue savings.
- \$6.7 million in additional general revenue expenditures due to a decrease in the Federal Medical Assistance Percentage to 52.47 percent in FY 2008
- Increasing direct education aid by \$22.3 million for all communities.
- Funding increases for public higher education and the Rhode Island Higher Education Assistance Authority of \$17.4 million (8.9 percent) including increasing available scholarship funds and increased debt service costs.
- Unfreezing the expansion of charter schools and provision of an additional \$2.6 million in aid for existing charter schools.
- Level funding of all municipal aid at FY 2007 levels with the exception of the Motor Vehicle Excise Tax, exempting \$6,000 in vehicle value from taxation through the State motor vehicle excise tax phase-out, consistent with current law.
- Savings of \$4.0 million through initiatives designed to reduce the inmate population through promotion of alternatives to incarceration for non-violent offenders. Approximately \$1.0 million would be reinvested into the Community Corrections program.

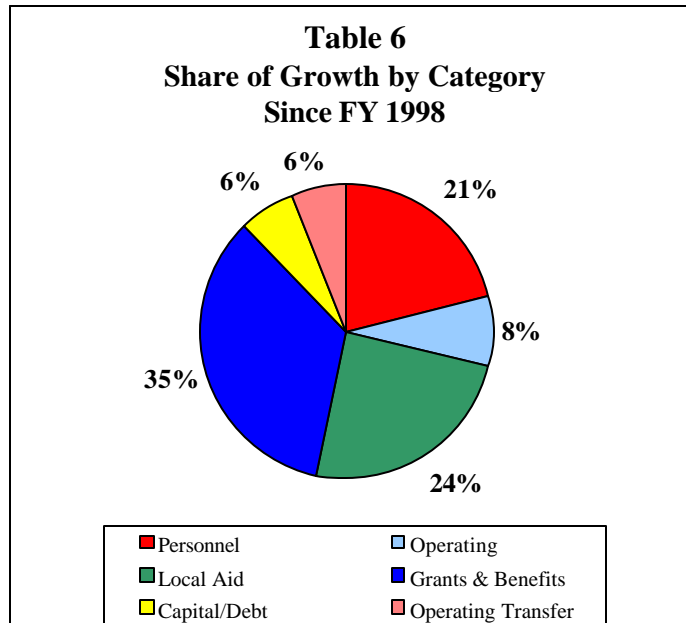
**Table 5**  
**Rhode Island State Budget Drivers - All Funds (Adjusted, \$ million)**

<b>Expenditure Category</b>	<b>FY 1998 Actual</b>	<b>% of Total</b>	<b>FY 2008 Proposed</b>	<b>% of Total</b>	<b>Actual Increase</b>	<b>Percent Change</b>	<b>Share of Increase</b>
<b>General Operations</b>							
Personnel	\$1,181.6	26.1%	\$1,708.1	24.3%	\$526.5	44.6%	21.2%
Operations	368.4	8.1%	560.2	8.0%	191.8	52.1%	7.7%
Subtotal - Operations	\$1,550.0	34.2%	\$2,268.3	32.3%	\$718.3	46.3%	28.9%
<b>Grants &amp; Benefits</b>							
Income Support (TDI & Employ)	\$295.9	6.5%	\$372.1	5.3%	\$76.1	25.7%	3.1%
Medical Assistance - Mgd Care	140.7	3.1%	555.7	7.9%	415.0	294.9%	16.7%
Medical Assistance - All Other	597.8	13.2%	815.7	11.6%	217.9	36.4%	8.8%
Development Disabilities	199.5	4.4%	207.7	3.0%	8.2	4.1%	0.3%
Child Welfare	79.8	1.8%	90.5	1.3%	10.7	13.4%	0.4%
TANF	161.7	3.6%	54.3	0.8%	(107.3)	-66.4%	-4.3%
Child Care	28.2	0.6%	48.3	0.7%	20.1	71.2%	0.8%
SSI	26.7	0.6%	29.1	0.4%	2.3	8.7%	0.1%
Higher Education	97.8	2.2%	147.0	2.1%	49.2	50.4%	2.0%
Other Grants & Benefits	361.0	8.0%	525.5	7.5%	164.5	45.6%	6.6%
Subtotal - Grants & Benefits	\$1,989.1	43.9%	\$2,845.9	40.6%	\$856.8	43.1%	34.5%
<b>Local Aid</b>							
Education Aid	\$600.2	13.2%	\$889.0	12.7%	\$288.8	48.1%	11.6%
Motor Vehicle Phase-out	0.0	0.0%	140.6	2.0%	140.6	-	5.7%
General Revenue Sharing	16.7	0.4%	65.1	0.9%	48.4	288.9%	1.9%
PILOT	17.5	0.4%	27.8	0.4%	10.2	58.3%	0.4%
Federal Aid	49.3	1.1%	137.5	2.0%	88.1	178.8%	3.5%
Other	25.7	0.6%	53.3	0.8%	27.6	107.1%	1.1%
Subtotal - Local Aid	\$709.6	15.7%	\$1,313.2	18.7%	\$603.6	85.1%	24.3%
<b>Capital Expenditures</b>							
Capital Expenditures	\$55.5	1.2%	234.8	3.3%	\$179.3	323.1%	7.2%
Debt Service	228.2	5.0%	202.2	2.9%	(26.0)	-11.4%	-1.0%
Subtotal - Capital	\$283.7	6.3%	\$437.0	6.2%	\$153.3	54.1%	6.2%
Operating Transfer	-	-	\$153.0	2.2%	\$153.0	-	6.2%
<b>Total</b>	<b>\$4,532.4</b>	<b>100.0%</b>	<b>\$7,017.4</b>	<b>100.0%</b>	<b>\$2,485.1</b>	<b>54.8%</b>	

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

### Spending Patterns

The proposed FY 2008 spending plan of \$7,017.4 million, summarized on Table 5, represents a \$3.3 billion increase since FY 1998. This translates into an average annual rate of growth of 6.7 percent during this period. However, if one adjusts FY 1998 spending to 2008 dollars, the Governor's FY 2008 budget represents a \$2.5 billion increase, an adjusted average annual growth rate of 4.6 percent. The following discusses changes on an adjusted (real) basis. It should be noted that the FY 2008 expenditures include the addition of an "operating transfers" category reflecting a change in accounting practices (comprising 2.2 percent of the total budget).



There are five major categories of expenditures - grants and benefits, personnel, operating, local aid, and capital expenditures. These categories of expenditure represent how the State allocates funds within programs and services.

- Grants and benefits, which include programs providing direct support to individuals such as Medicaid, child care and unemployment insurance, are the largest category of expenditures, and constitute 40.6 percent of the total FY 2008 budget.
- Expenditures supporting grants and benefits increase by \$856.8 million over FY 1998 adjusted expenditures, to \$2,845.9 million in FY 2008, representing a 43.1 percent increase (real growth).
- Of every new dollar spent since FY 1998, \$0.35 support grants and benefits. The increase in managed care programs (mainly Rite Care) of \$415.0 million represented 16.7 percent of the net increase of \$2.5 billion in adjusted statewide spending during this period.
- The second largest component of State budget growth has been for personnel and operating expenditures. Of the total net expenditure growth of \$2,485.1 million, from FY 1998 to FY 2008, approximately \$526.5 million (21.2 percent) is attributable to personnel expenditures. An additional \$191.8 million (7.7 percent) in the growth was related to various operating expenditures.

- Personnel expenditures represent 24.3 percent of the State's budget and operations represent 8.0 percent. Combined personnel and operating expenditures account for 28.9 cents of every new dollar spent since FY 1998.
- Local aid, which includes education aid and other direct assistance to municipalities, represents 18.7 percent of the budget and is the third largest factor in budget growth during the past decade. All local aid increased by \$603.6 million – an 85.1 percent increase since FY 1998. The growth in local aid represents approximately 24.3 percent of the total net growth in the State budget since FY 1998. Education aid has been the principal driver within local aid.
- Slightly over six percent of the FY 2008 budget is dedicated to capital and debt service expenditures, with 6.2 cents of every new dollar since FY 1998 allocated to support these expenditures. The majority of the growth in this category is attributable to increases in capital expenditures. Debt service declined throughout the decade.
- The \$153.0 million operating transfer category in the FY 2008 proposed budget reflects transfers between state and quasi-governmental agencies, thus the actual distribution of funds across categories in FY 2008 varies from FY 1998.



## Medical Assistance Expenditures

Medical assistance expenditures grew annually by 7.4 percent, from \$701.1 million in FY 2000 to \$1,371.4 million in the Governor's recommended FY 2008 budget (does not include 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 as presented on Table 7 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 52.5 percent during this period. This means Rhode Island will draw down less than \$0.53 from the Federal government for every \$1.00 it will spend in FY 2008;
- Of the \$670.3 million net growth between FY 2000 and FY 2008, 54.5 percent (\$365.4 million) are related to managed-care costs, which are primarily RIte Care costs. One should note that these costs include a transfer of \$79.9 million of children's behavioral health expenses from the Department of Children, Youth and Families to the Department of Human Services.

**Table 7**  
**FY 2000 - 2008 Medical Assistance Expenditures\* (\$ million)**

Medical Assistance Program	FY 2000	FY 2007*	FY 2008	FY 2000-08 Change		FY 2007-08* Change	
	Audited	Revised	Gov	\$	Avg Ann	\$	Avg Ann
Hospitals	\$144.2	\$155.0	\$251.4	\$107.2	8.3%	\$96.4	62.2%
Nursing Homes	245.6	307.8	310.7	65.1	3.4%	2.9	0.9%
Managed Care	190.3	453.1	555.7	365.4	16.5%	102.7	22.7%
Other	121.0	236.6	253.6	132.6	11.2%	17.0	7.2%
<b>Total</b>	<b>\$701.1</b>	<b>\$1,152.5</b>	<b>\$1,371.4</b>	<b>\$ 670.3</b>	<b>7.4%</b>	<b>\$218.9</b>	<b>19.0%</b>
<i>Gen Rev</i>	<i>\$323.6</i>	<i>\$560.8</i>	<i>\$679.2</i>	<i>\$355.6</i>	<i>8.2%</i>	<i>118.4</i>	<i>19.0%</i>

\* Medical Assistance Expenditures reflect Medicaid expenditures incurred by the Department of Human Services.

\* In FY 2007, uncompensated care payments of app. \$110.0 million were deferred to FY 2008 and not included in the total expenditures. Including this amount would bring hospital expenditures in FY 2007 to \$265.0 million.

Source: State Budgets, Governor's FY 2008 recommended budget, and RIPEC calculations.

### **Governor's FY 2008 Medical Assistance Program**

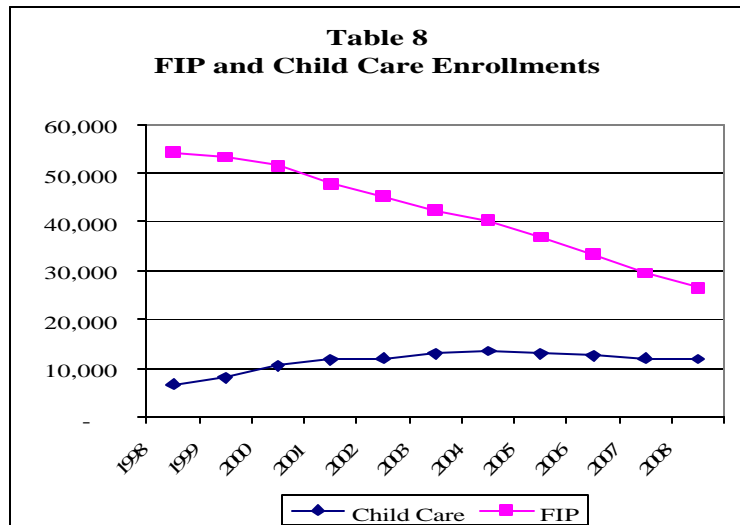
There are a number of changes and initiatives in the Governor's FY 2008 budget that impact the Medical Assistance Program. These changes include:

- **Medicaid Program Integrity** – Anticipated savings of \$19.9 million through citizenship documentation, eligibility reviews, and verification of the State as the payer of last resort. This initiative is based on the Federal Deficit Reduction Act of 2005, which requires states to codify requirements for documentation of medical claims including citizenship and identify verification.
- **Pharmaceutical Co-Payment** – The FY 2008 budget assumes \$1.3 million in savings through implementation of a pharmaceutical co-pay program for individuals on the fee-for-service Medicaid program who are not eligible for Medicare Part D.
- **Federal Medical Assistance Percentage** – The decrease in the federal Medicaid reimbursement rate from 52.87 percent in FY 2007 to 52.47 percent in FY 2008 increases the State's responsibility by \$6.7 million (general revenue funds).
- **Uncompensated Care Payments** – The Governor's budget includes \$110.0 million in reimbursements to state and community hospitals for uncompensated care.
- **Nursing Facilities** – By reducing the maximum allowable ceiling for direct labor costs from 125 percent of the state median to 110 percent, the governor anticipates savings of \$4.8 million in nursing home reimbursements.
- **Nursing Home COLA Delay** – The Governor also proposes delaying the nursing home cost of living adjustment until April 1, 2008 (instead of October 1, 2007), saving the State \$2.6 million.
- **Hospital Reimbursements** – Funding to the State's community hospitals is expected to decline \$6.8 million due to a 10.0 percent reduction in rates for outpatient procedures, restructuring of emergency room rates, and rates paid for imaging services.
- **Hospital Settlements** – The Governor proposes to amend the current process for determining hospital settlements and includes expenditure savings of \$29.3 million, of which \$14.1 million are from general revenues.
- **Children's Intensive Services** – The FY 2008 budget includes savings of \$1.7 million (\$0.7 million in general revenues) by shifting children's intensive services from fee for service to an in-plan RItE Care benefit.

## Family Independence Program (FIP) and Child Care Subsidies

In 1996 the State's Family Independence Program (FIP) was enacted to implement the Federal Temporary Assistance to Needy Families (TANF) block grant, which replaced the Aid to Families with Dependent Children Program (AFDC). The reforms were designed to move people from welfare to work by creating time limits and work requirements to which recipients must adhere.

In FY 1998, the State spent \$156.0 million (\$189.0 million adjusted) on the program. The Governor's FY 2008 budget proposes a total of \$102.7 million in funding, a decrease of 34.3 percent (46.0 percent adjusted). Since FY 1998, general revenue funds for the family independence program have declined by \$42.6 million (65.5 percent).



*FIP* – The allocation for the FIP program in FY 2008 is \$54.3 million, of which \$3.9 million are from general revenues. Spending has declined 66.4 percent since FY 1998 (adjusted for inflation). Projected enrollments for the cash assistance program continue to decline. In FY1998 there were 54,287 persons enrolled in the program. The budget assumes an estimated caseload of approximately 26,500 in FY 2008, a projected decrease of 10.0 percent from FY 2007 and a 51.2 percent decrease from FY 1998.

*Child Care* -- The budget for child care has increased significantly over the past decade. In FY 1998 the total child care budget was \$28.2 million; the Governor has allocated \$48.3 million in FY 2008 (\$18.5 million from general revenues), a 71.2 percent increase (adjusted for inflation). Enrollment in the program has decreased since 2004, when child care enrollments were at a high of 13,601 persons. The November Caseload Estimating Conference (CEC) estimates child care enrollments of 11,950. The Governor's budget estimates FY 2008 child care enrollments of approximately 8,122, a decrease of 32.0 percent from the CEC. This decrease is due to the proposed change in eligibility requirements.

The Governor's proposals to change the program are projected to result in general revenue expenditure savings of \$25.9 million, when compared to CEC estimates, in child care by:

- Reducing eligibility ceilings for child care to 150 percent of the federal poverty limit, down from 225 percent;
- Postponing a scheduled provider rate increase until FY 2009;
- Restructuring provider payments for part-time child care; and
- Enhancing eligibility and accountability reviews.

## Personnel Expenditures and Trends

As Table 9 shows, FY 2008 personnel expenditures total \$1,708 million, a \$113.6 million (7.1 percent) net increase from the FY 2007 revised personnel budget. The FY 2008 average cost per FTE position of \$90,629 represents a 10.5 percent increase over FY 2007 revised (\$81,985).

Personnel Costs (Millions)	FY 1998 Actual	FY 2007 Revised	FY 2008 Proposed	FY 2008 - FY 2007 Revised	
				Actual Change	Percent Change
<b>Salaries &amp; Benefits</b>					
Net Salaries	\$ 633.8	\$ 893.9	\$ 947.5	\$ 53.6	6.0%
Adjustment for Temp	(60.0)	(70.7)	(80.9)	(10.2)	14.5%
Overtime	45.4	58.9	50.2	(8.7)	-14.8%
Retirement	64.6	140.1	166.1	26.0	18.6%
Medical	75.3	157.6	186.4	28.8	18.3%
Retiree Health*		26.1	30.6	4.5	17.3%
<b>Other Benefits/Payroll**</b>	<b>58.0</b>	<b>85.6</b>	<b>91.6</b>	<b>6.1</b>	<b>7.1%</b>
<i>Salaries &amp; Benefits</i>	<i>\$ 817.1</i>	<i>\$ 1,291.4</i>	<i>\$ 1,391.4</i>	<i>\$ 100.0</i>	<i>7.7%</i>
<b>Funded FTE Positions</b>	<b>15,795.6</b>	<b>15,751.3</b>	<b>15,353.3</b>	<b>(398.0)</b>	<b>-2.5%</b>
<b>Average Cost Per FTE</b>	<b>\$51,730</b>	<b>\$81,985</b>	<b>\$90,629</b>	<b>\$8,644</b>	<b>10.5%</b>
<b>Other Personnel Costs</b>					
Other Payroll Costs***	\$ 75.5	\$ 106.4	\$ 134.3	\$ 27.9	26.2%
<b>Purchased Services</b>	<b>78.0</b>	<b>196.6</b>	<b>182.3</b>	<b>(14.3)</b>	<b>-7.3%</b>
<i>Other Personnel</i>	<i>\$ 153.5</i>	<i>\$ 303.0</i>	<i>\$ 316.6</i>	<i>\$ 13.5</i>	<i>4.5%</i>
<b>Total Personnel Costs</b>	<b>\$ 970.6</b>	<b>\$ 1,594.4</b>	<b>\$ 1,708.0</b>	<b>\$ 113.6</b>	<b>7.1%</b>

Source: State Budget Office and FY 2008 Personnel Supplement.

\* Previously included in other costs.

\*\* Includes FICA, Holiday Pay, Payroll Accrual and Other

\*\*\* Includes temporary and seasonal payroll, unemployment compensation, statewide benefit assessment, anticipated retroactive payments, and workers compensation

Since FY 1998, personnel expenditures have increased at an average annual rate of 5.8 percent (3.8 percent real growth). FY 1998 personnel spending represented 26.1 percent of the State budget, compared to 24.3 percent proposed for FY 2008.

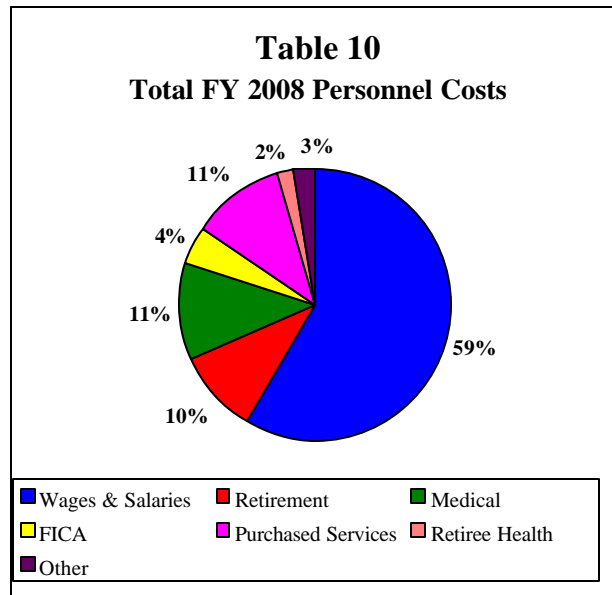
General revenues support 51.6 percent of all personnel expenses in FY 2008. Federal funds constitute nearly 21.9 percent and the remaining funds (special funds, restricted receipts and internal service funds) maintain 26.5 percent of the personnel budget.

The average cost per FTE position increased from \$51,730 in FY 1998 to \$90,629 in FY 2008 – an increase of 75.2 percent for an average annual rate of growth of 5.8 percent (43.9 percent and 3.7 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.

Employee medical insurance costs have increased from \$75.3 million in FY 1998 to \$186.4 million in FY 2008, translating into an average annual rate of growth of 9.5 percent (7.4 percent real growth). FY 2008 medical insurance expenditures increased by 18.3 percent over FY 2007 revised spending (\$157.6 million).

The FY 2008 personnel budget includes \$166.1 million for the State's contribution to employee pensions. State contributions to pensions have increased at a 9.9 percent average annual rate (7.8 percent real growth) since FY 1998.



**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. It should also be noted that there are currently 273 part-time and full-time employees who are employed by an outside firm that are not included in the FTE count.

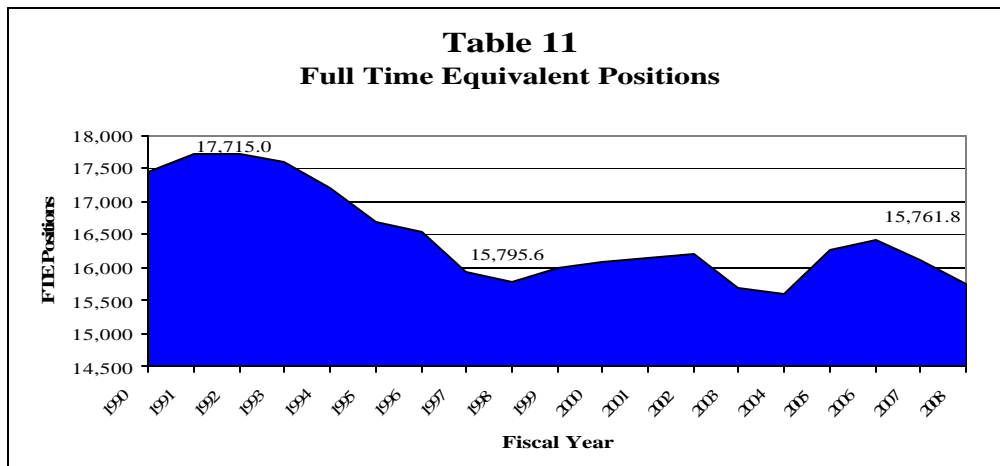
- The Governor's FY 2007 Revised Budget request includes 16,106.7 FTE positions, representing a net increase of 68.7 FTE positions from the FY 2007 enacted budget. The increase reflects unachieved turnover by State agencies, current service additions and vacancy reductions.
- The FY 2008 Budget includes 15,761.8 FTE positions (includes FTE positions related to higher education), adjusted for 60.0 FTE positions, replacing part of force reduction initiative, representing a net decline of 344.9 FTE positions from the FY 2007 Revised Budget.
- The Governor proposes a net decrease of 238.2 FTE in the Human Services function, largely due to the privatization of dietary and housekeeping services at Eleanor Slater and Zambarano Hospitals and dietary services in the Veterans Affairs Program.

The FY 2008 budget includes savings of approximately \$ 54.0 million in personnel costs through a series of initiatives:

- The budget includes the proposal of vacating 108 FTE positions for a savings of \$9.3 million; specific positions were not identified in the budget. Rather, the Governor requested agencies determine areas with excess staff or identify low-priority areas for targeted lay-offs.
- Outsourcing of workers compensation claims, expected to save \$993,251.
- Lower budgeted medical insurance due to an arrangement with the insurance provider, saving \$5.8 million.
- Savings of \$1.4 million through the creation of a new class of “limited service positions” by eliminating administrative costs incurred by the State for contracting with an outside vendor for positions of limited duration.

Since the FY 2008 budget was proposed the Governor has withdrawn his recommendations for furlough days. He had recommended the shut down of all non-essential state operations for four days in FY 2007, and three days in FY 2008, for savings from all funds of \$9.6 million in FY 2007 and \$7.7 million in FY 2008. Currently, the Administration is negotiating these matters with the unions representing State workers. Savings are projected to be similar to the previously included value of shut down days in the Governor’s budget.

Although the Governor suggested the creation of a retiree health care trust fund to pay down unfunded liabilities and provide financing for retiree health expenses, he recommends delaying the implementation of this fund due to fiscal constraints.



## State Aid

The Governor's FY 2008 budget includes \$1,175.7 million in state aid to local governments - a 4.4 percent increase over the FY 2007 Revised Budget. Since FY 1998 this category of aid has more than doubled, increasing by \$633.4 million, an average annual rate of 8.1 percent (5.9 percent, adjusted). It should be noted that \$140.6 million (22.2 percent) of this increase is attributable to the motor vehicle excise tax phase-out, which is the second largest budget driver for local aid. Direct education aid continues to be the largest component of aid to local governments, accounting for 44.6 percent of growth between FY 2007 revised and FY 2008 and 44.3 percent of the increase since FY 1998.

**Table 12**  
**State Aid to Local Government (\$ million)**

Major State Aid Program	FY 1998	FY 2006	FY 2007R	2007R-2008	
				FY 2008	Change
<b>Education Aid</b>					
Direct Education Aid*	\$430.5	\$655.6	\$688.7	\$711.0	\$22.3
Teacher Retirement	35.6	56.1	67.3	78.1	10.8
School Housing Aid	19.7	46.6	46.8	52.9	6.0
Met School	0.9	8.8	10.4	11.5	1.1
Charter School Aid (direct and indirect)	0.0	23.3	25.6	28.2	2.6
Other Aid**	1.3	4.8	4.5	7.4	2.9
<i>Subtotal - Education Aid</i>	<i>493.0</i>	<i>795.2</i>	<i>843.3</i>	<i>889.0</i>	<i>45.8</i>
<b>Municipal Aid</b>					
General Revenue Sharing	13.8	65.0	65.1	65.1	\$0.1
Excise Tax Phase Out	-	117.6	136.2	140.6	4.3
PILOT	14.4	27.0	27.8	27.8	-
Distressed Communities Aid	6.2	10.6	10.4	10.4	-
Other Aid***	4.8	13.0	14.2	13.4	(0.8)
<i>Subtotal - Municipal Aid</i>	<i>\$39.2</i>	<i>\$233.3</i>	<i>\$253.7</i>	<i>\$257.2</i>	<i>\$3.7</i>
<b>Pass Through Aid</b>					
Meals and Beverage Tax	-	\$17.6	\$18.6	\$19.1	\$0.6
Public Services Corporation Tax	10.1	12.2	10.3	10.3	0.0
<i>Subtotal - Pass Through</i>	<i>\$10.1</i>	<i>\$29.8</i>	<i>\$28.9</i>	<i>\$29.5</i>	<i>\$0.6</i>
<b>Total State Aid</b>	<b>\$542.3</b>	<b>\$1,058.3</b>	<b>\$1,125.9</b>	<b>\$1,175.7</b>	<b>\$50.0</b>

Source: RIPEC calculations based on State and House Fiscal Staff Budget Documents

\* Includes local school operations, targeted aid, core instruction equity, student equity, professional dev., early childhood, student tech., student language assist., full-day kindergarten, vo-tech equity, group home funding, and Central Falls operations.

\*\* Includes progressive support and intervention, Hasbro hospital, school visit, RIDE professional dev., textbook loans, school breakfast (school food services for FY 1998) and telecomm access funds.

\*\*\* Includes state library aid, statewide reference library resource grant, library construction reimbursement, municipal police incentive pay, municipal fire incentive pay, and property revaluation program.

The Governor's budget proposes an increase of \$45.8 million (5.4 percent) in total education aid relative to the revised FY 2007 budget. This increase includes a three percent across-the-board increase in direct local education aid, \$2.6 million more for charter school aid, and an additional \$10.8 million for teacher retirement.

- Direct education aid increased from \$430.5 million (unadjusted) in FY 1998 to \$711.0 million in FY 2008 – increasing at an average annual rate of 5.1 percent. Direct education aid in FY 1998 accounted for 79.4 percent of total State aid. The share of direct education aid has since declined to 60.5 percent in FY 2008, in large part due to increasing State responsibility in other State aid programs.
- The FY 2008 budget increases direct aid to charter schools to \$27.0 million and provides \$1.2 million in indirect charter school aid. Additionally, the Governor proposes legislation that would lift the ban on the opening of charter schools during the 2007-2008 school year.
- State contributions for teacher retirement total \$78.1 million in FY 2008, a 12.1 percent increase from FY 2007 Revised. State contributions have increased at an average annual rate of 8.18 percent since FT 1998.

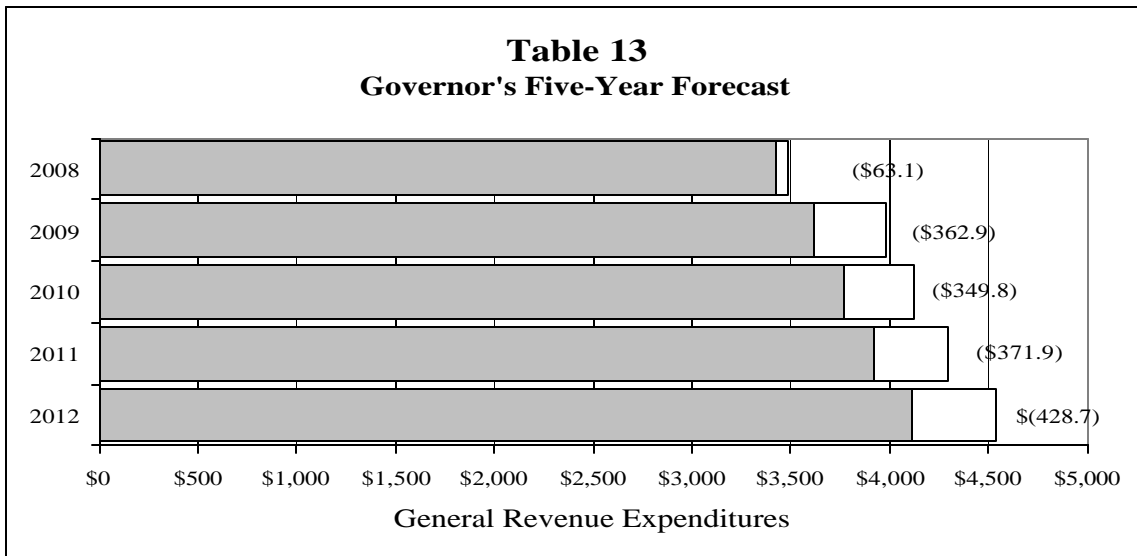
The Governor's FY 2008 budget recommends \$257.2 million in municipal aid, an increase of \$3.7 million (1.4 percent) over FY 2007 Revised. The majority of the increase is from the state reimbursements from motor vehicle excise tax phase out. Additionally, the governor recommends total pass-through aid of \$29.5 million.

- All municipal aid programs are level funded at FY 2007 levels, excluding the Motor Vehicle Excise Tax Reimbursement, exempting \$6,000 in vehicle value from taxation through the State motor vehicle excise tax phase-out.
- Distressed communities aid – general revenue funds for communities that have an insufficient tax base to meet demand – is frozen for each community at FY 2007 revised levels and precludes Coventry and Cranston, which would otherwise receive funds.
- The general revenue sharing program is funded at the FY 2007 amount of \$65.1 million, with each community being guaranteed the same level of funding. The Governor proposes to freeze future distributions at 3.0 percent of tax revenues in 2009 instead of increasing the amount to 4.7 percent in 2011.



## Outyear Deficits

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 for assessing 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.



The Governor's Budget request includes a five-year forecast projecting operating deficits ranging from \$362.9 million in FY 2009 to \$428.7 million in FY 2012. This represents an average operating deficit of \$378.3 million during the forecast period. One should note that the forecast has been lowered by the State Budget Office by an average of \$19.7 million when compared to the forecast presented in the Governor's printed FY 2008 budget.

The State's five-year financial forecast shows a serious imbalance in the projected growth of revenue when compared to anticipated spending. The result is out-year deficits, which, if not addressed, bode ill for the State's long-term fiscal health.

The forecast assumes general revenues that support state spending will actually decline by 5.1 percent (\$165.9 million) between FY 2008 and FY 2009, mainly due to the use of one-time revenues to balance the FY 2008 budget, thereby inflating the FY 2008 revenue base. Between FY 2008 and FY 2012, revenues are projected to increase by approximately 1.8 percent annually, while expenditures are projected to grow by approximately 4.7 percent.

Expenditures for both grants and benefits and local aid are projected to grow at a faster rate between FY 2009 and FY 2012 than they have over the last ten years. 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 6.2 percent during the forecast period, principally driven by growth in Medicaid. It should be noted that grants and benefits increased at an average annual rate of 3.6 percent from FY 1998 to FY 2008

(adjusted for inflation). The Governor's forecast projects local aid to municipalities and school districts will increase by 3.2 percent annually and growth in personnel and operating costs are projected to increase at an average annual rate of 3.9 percent. From FY 1998 to FY 2008, local aid increased at 6.3 percent annually and personnel and operating costs increased by 3.9 percent annually (adjusted for inflation).

While the five-year financial forecast presents difficult fiscal challenges, what is of immediate concern is the \$362.9 million deficit projected for FY 2009. Therefore, spending decisions made in FY 2008 should not only be aimed at balancing next year's State budget, but must begin to reduce the projected operating deficit in FY 2009. RIPEC believes that one way to engender the necessary fiscal discipline is to place a statutory limit on the growth in the future State budget.

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 have fewer income taxpayers to rely on to support the growing need for public services.