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RIPEC

Preliminary Analysis of FY 2008 Deficit

The Office of Accounts and Control released its preliminary, unaudited year end statements for FY 2008 on September 8, 2008. The statements reflect a projected \$33.6 million dollar deficit for the year ending June 30, 2008. The Rhode Island Public Expenditure Council (RIPEC) has reviewed various financial reports and has prepared the following report.

Current situation

Table 1 shows the preliminary budget statement for the revised FY 2008 budget and the changes to it based on the State Controller's preliminary analysis. Based on these updated numbers, FY 2008 will close with a deficit of \$33.6 million. The deficit is a combination of a revenue shortfall of \$8.2 million and overspending by State departments totaling \$27.0 million. Applying the previously projected surplus of \$3.2 million results in a FY 2008 deficit of \$33.6 million. One should note that the total expenditures of \$3,396.6 million in the preliminary audit for FY 2008 include reappropriations of \$1.7 million to be carried forward into FY 2009.

Table 1
Preliminary Budget Statement
(\$ million)

Summary	FY 2008R	FY 2008A
Total - Opening Surplus	\$0.0	\$0.0
Reappropriated Surplus	3.6	3.6
Transfer from Budget Reserve	-	-
Total Revenues	\$3,436.1	\$3,427.9
Cash Stabilization	(\$68.7)	(\$68.6)
Total Available Revenues	\$3,371.0	\$3,362.9
Expenditures*	\$3,367.8	\$3,396.6
Free Surplus	\$3.2	(\$33.6)

* In FY 2008A, includes reappropriation of \$1.7 million.

Source: RIPEC Calculations based on State Controller and State Budget Documents

Revenues

Table 2 provides an overview of the revised revenue situation. Overall, when comparing the FY 2008 revised budget and the preliminary audit for FY 2008, revenues have been revised downward by \$8.2 million, to \$3,427.9 million. The revenue shortfall is mainly attributable to the following:

- A decline in the sales and use tax of \$8.1 million;
- Within general business taxes, a decline of \$5.1 million from business corporations. This decline has been offset by additional revenues through public utilities gross earnings (\$2.1 million), insurance companies (\$4.5 million), and health care provider assessment (\$2.5 million). Overall, general business tax revenues increased by \$4.6 million;
- A decline in departmental receipts in the amount of \$5.4 million.

The revenue shortfall was partially offset by an increase of revenues from the personal income tax (\$4.7 million), and, as mentioned before, by a net increase in revenues from general business taxes (\$4.6 million).

Table 2
FY 2008 Revised and Preliminary General Revenues
(\$ million)

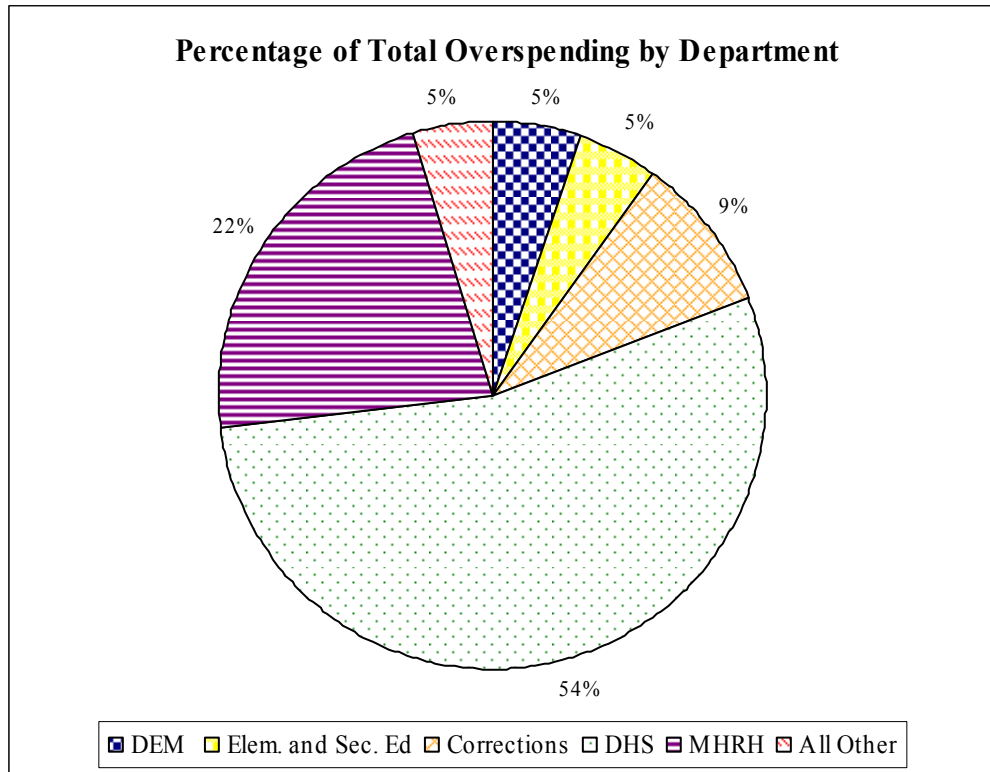
General Revenues	FY 2007 Unaudited	FY 2008 Revised	FY 2008 Preliminary	2008R-2008P Change	%
Taxes					
Personal Income Tax	\$1,065.4	\$1,069.1	\$1,073.8	\$4.7	0.4%
General Business Taxes					
Business Corporations	148.1	156.5	151.4	(\$5.1)	-3.3%
Public Utilities Gross Earnings	102.1	97.3	99.4	2.1	2.2%
Financial Institutions	4.4	1.2	1.8	0.6	50.0%
Insurance Companies	56.6	63.5	68.0	4.5	7.1%
Bank Deposits	1.7	1.7	1.7	0.0	0.0%
Health Care Provider Ass	48.0	50.9	53.4	2.5	4.9%
<i>Subtotal General Business Taxes</i>	<i>\$360.9</i>	<i>\$371.1</i>	<i>\$375.7</i>	<i>\$4.6</i>	<i>1.2%</i>
Sales & Use Tax					
Sales and Use	873.2	853.4	845.4	(\$8.0)	-0.9%
Motor Vehicle	46.9	45.2	48.6	3.4	7.5%
Motor Fuel	1.3	1.3	1.0	(0.3)	-23.1%
Cigarette Tax	120.5	118.1	114.7	(3.4)	-2.9%
Alcohol	10.7	10.9	11.1	0.2	1.8%
<i>Subtotal Sales & Use Tax</i>	<i>\$1,052.6</i>	<i>\$1,028.9</i>	<i>\$1,020.8</i>	<i>(\$8.1)</i>	<i>-0.8%</i>
Other Taxes	50.3	51.7	48.4	(\$3.3)	-6.4%
<i>Subtotal - Taxes</i>	<i>\$2,529.2</i>	<i>\$2,520.8</i>	<i>\$2,518.7</i>	<i>(\$2.1)</i>	<i>-0.1%</i>
Department Receipts	\$277.8	\$357.5	\$352.1	(\$5.4)	-1.5%
Other Sources*	424.0	557.8	557.1	(0.7)	-0.1%
Total Revenues	\$3,231.0	\$3,436.1	\$3,427.9	(\$8.2)	-0.2%

Source: State Budget Documents; May 2008 REC; RIPEC Calculations

* Includes Tobacco Securitization Revenues of \$124.3 million in FY 2008 only

Expenditures

Total general revenue expenditures based on the preliminary audited budget for FY 2008 were \$3,394.8 million, an increase of \$27.0 million over the appropriated level (not including \$1.7 million in reappropriations). The overspending was mainly caused by not implementing the furlough days and by not achieving all of the budgeted savings through a 2.7 percent across the board cut for most non-payroll expenditures (mainly within the Department of Human Services). The original budget included approximately \$48.3 million in savings from these two items.



When looking at the overspending by departments, about half of the State departments ran a general revenue deficit. However, five departments accounted for 96.0 percent of the total deficit (see chart). As stated before, the overspending has been partially caused by not implementing the proposed furlough days. Since these unachieved savings are included within each department's budgets, larger departments such as the Department of Mental Health, Retardation and Hospitals (MHRH), the Department of Human Services (DHS), and the Department of Corrections show a higher overspending than smaller departments.

Next steps and issues to be considered

To balance the FY 2008 budget, it appears that the Governor is planning to ask the General Assembly to tap into the Rainy Day Fund. If this should be the case and the General Assembly approves it, the amount taken out of the Rainy Day Fund would have to be paid back from the general revenue fund in FY 2009.

In addition, there have been recent calls to hold hearings on the FY 2008 deficit. When the hearings are held they should be used to determine the sources of the deficit, what it means for the future, as well as to address the following questions:

- What options does the State have to balance FY 2008 and what is the impact of these options on the State's overall fiscal situation?
- What implications does the FY 2008 shortfall have on the FY 2009 budget and out-years?
- What safeguards are needed to avoid an overspending in the future?
- Are the State's internal accounting procedures appropriate?

In addition, it is necessary for the State to reassess its fiscal situation after the November Estimating Conference has met to incorporate the updated revenue picture. At that time, the State should also address if ongoing resources are adequate to support current operations. If needed, the Governor should submit a supplemental budget in early January 2009. The General Assembly should act upon the supplemental budget as soon as possible in order to have sufficient time to implement any additional fiscal control measures. Furthermore, fiscal discipline must be heightened during the intervening time period to ensure the proposed savings in FY 2009 are realized or alternative plans need to be implemented to meet the proposed savings and avoid additional shortfalls in future years.

The use of the Rainy Day Fund for the second year in a row raises serious questions that should be addressed in order to have a fiscally sound budget process, not just for FY 2009, but beyond:

- Are the State's ongoing resources adequate to support current operations?
- Are current obligations appropriately funded?
- Are expenditure priorities responsive to the need of citizens?
- Are savings from cuts in expenditures realistically projected?
- Should the State consider alternative revenue sources, such as charges and fees?
- What are the State's policy goals and what are the procedures to ensure they are met?
- Has the State assessed and ranked critical functions and developed cost reductions based on this prioritization?
- Are the use of broad across-the-board-cuts effective and do they support the State's policy goals?