RIPEC

Comments on Your Government

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Proposed FY 2011 and FY 2012 Budget Approach

As the state works to balance its FY 2012 budget, it is imperative that policymakers take a long-term view with regard to fixing the state's persistent structural deficits. This RIPEC Comments examines a number of new programs proposed in the FY 2012 budget, and their estimated impact on out-years. In addition, the Comments provide a general policy outline that may be used to evaluate the proposed policy options.

Introduction

Over the past three years, Rhode Island has experienced historic revenue declines that have put significant pressure on the state's budget. However, the state has long faced a structural deficit, whereby expenditure growth outstrips projected revenue growth. Based on State Budget Office estimates, expenditures are projected to increase almost twice as fast as estimated revenue growth, leading to a projected deficit of $411.0 million by FY 2016. The state must work to achieve fiscal stability in order to ensure that the needs of its citizens are met in the most cost-effective manner. As such, Rhode Island must develop a long-term spending plan that strategically sets investment priorities while maintaining a revenue program that generates sufficient revenue without over-burdening state residents.

Table 1
Budget Office General Revenue Budget Projections ($ millions)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Available Revenues	$ 3,170.7	$ 3,243.4	$ 3,315.8	$ 3,391.1	$ 3,437.8
% Growth		2.3%	2.2%	2.3%	1.4%
Expenditures	$ 3,169.8	$ 3,369.4	$ 3,515.1	$ 3,686.8	$ 3,848.8
% Growth		6.3%	4.3%	4.9%	4.4%
Difference	$ 0.9	$ (126.0)	$ (199.3)	$ (295.7)	$ (411.0)

SOURCE: State Budget Office documents; RIPEC calculations

FY 2012 Overview

According to the State Budget Office, Rhode Island faces a projected revenue-expenditure gap of $331.1 million in FY 2012. The original estimate of $294.6 million was based on current services and changes to those estimates based on the Revenue and Caseload Estimating Conferences in November 2010. The additional $36.5 million in the Governor's deficit projections include statutory increases, i.e., the increase in housing aid. However, the proposed budget also includes a number of items, such as increased funding for higher education and support for Central Falls, that reflect policy choices on the part of the Administration.

New Program Summary

The Governor's proposed FY 2012 budget includes approximately $66 million in new initiatives, such as:

- The Municipal Accountability, Sustainability and

Transparency (MAST) fund – a local aid program funded by retaining the 8.0 percent meals and beverage tax and dedicating 1.0 percent of the revenue generated to the fund ($19.3 million in FY 2012);

- The Tourism Asset Protection (TAP) fund – a designated fund for capital projects related to the tourism industry, funded by retaining the hotel tax at 8.0 percent and dedicating 1.0 percent of the revenue generated to the fund ($2.6 million in FY 2012);
- Dedicated funding for the State Department of Transportation (DOT) – shifting general revenues to the "Intermodal Surface Transportation Fund" to support a consistent source of transportation funding ($12.0 million in FY 2012);
- Support for Central Falls to resolve their projected FY 2012 deficit; and
- The full implementation of the education funding formula as per statute.

Table 2
FY 2012 Proposed New Programs
($ millions)

MAST Fund	$19.3
TAP Fund	2.6
DOT Reallocation	12.0
Education Funding Formula	17.1
Higher Education	10.0
Central Falls Support	4.9
Total	$65.9

SOURCE: FY 2012 Budget Documents

Revenue Summary

In addition, the budget includes a significant increase in new revenues, generated through the expansion of the sales tax. Projected revenues generated through the proposed sales tax expansion total $165.9 million in FY 2012. The sales tax expansion includes lowering the rate from the current rate of 7.0 percent to 6.0 percent and broadening the base to include items previously not subject to the sales tax. In addition, the proposal would create a two-tiered tax structure by adding a 1.0 percent sales tax on certain exempt items. These additional revenues would be used to support some of the newly-proposed programs, as well as to balance the estimated FY 2012 deficit.

The proposed FY 2012 budget also includes four major initiatives that are projected to decrease net business tax revenue by $0.9 million in FY 2012, but will result in a net decrease in revenue of $14.6 million by FY 2016. The corporate tax changes include: phasing-in a reduction of the corporate tax rate from 9.0 percent to 7.5 percent; eliminating the Jobs Development Act over a three-year period; implementing combined reporting; and restructuring the corporate minimum tax by broadening the entities subject to the tax and by implementing a tiered tax structure.

Impact on Out-Years

Based on RIPEC estimates, growth in the proposed new programs would exceed revenue growth from the sales tax expansion. Primarily as a result of the DOT proposal, the proposed new programs would grow by $48.4 million, or 73.5 percent, between FY 2012 and FY 2016. At the same time, sales tax collections are projected to grow at a rate of 2.6 percent in FY 2013 and 0.7 percent thereafter. Although the proposed reforms will generate significant new revenues for the state, the rate of growth in these revenues is slower than the projected rate of growth in the proposed new programs. The corporate tax changes are projected to decrease revenues in each year; by FY 2016, the state will see a decrease in corporate tax collections of $14.6 million. While the additional revenue will

Table 3
Projected Budget Impact ($ millions)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
MAST Fund	$ 19.3	$ 19.8	$ 20.0	$ 20.1	$ 20.3
TAP Fund	2.60	2.69	2.71	2.73	2.75
DOT Reallocation	12.00	24.40	37.20	50.50	64.20
Funding Formula	17.10	17.10	17.10	17.10	17.10
Higher Education	10.00	10.00	10.00	10.00	10.00
Central Falls Support	4.90	-	-	-	-
Total	$ 65.9	$ 74.0	$ 87.0	$ 100.4	$ 114.3
% Change		12.3%	17.5%	15.5%	13.8%
Sales Tax	$ 164.9	$ 169.2	$ 170.4	$ 171.6	$ 172.8
% Change		2.6%	0.7%	0.7%	0.7%
Corporate Tax	$ (0.9)	$ (6.8)	$ (13.9)	$ (14.2)	$ (14.6)
% Change		-650.5%	-103.4%	-2.5%	-2.3%
Net Impact	$ 98.1	$ 88.3	$ 69.5	$ 56.9	$ 43.9
% Growth		-9.9%	-21.3%	-18.2%	-22.8%

SOURCE: FY 2012 Budget Documents; RIPEC calculations

offset the projected expenditure increases in the new programs, it will do so at a declining rate.

The state is currently facing a projected $126.0 million deficit in FY 2013. Based on RIPEC estimates the new programs and revenue changes account for roughly 60 percent of the projected FY 2013 deficit. An additional $22.0 million is related to the proposed repayment of the state's Rainy Day Fund in FY 2013 as opposed to repayment in FY 2012. By FY 2016, the net impact of these programs, coupled with the two revenue initiatives is a net decrease in available revenues by $43.9 million, or approximately one tenth of the projected deficit in that year. Of note, the current deficit picture does not include increases in the state's pension obligation as a result of the recent experience study. Due to changes made as a result of the study, the state's pension funding obligation for state employees is projected to increase by roughly $100 million in FY 2013, almost doubling the projected deficit.

May 2011 Revenue Estimating Conference Impact

Since the Governor's FY 2012 budget submission, which was based on the November 2010 Revenue and Caseload Estimating Conference (REC/CEC) the May 2011 REC/CEC was convened. The Conference revised projected revenues and caseload expenditures relative to the November estimates for both FY 2011 and FY 2012. Based on these revisions, projected FY 2011 revenues increased by $53.8 million compared to November estimates, while caseload expenditures increased by $3.3 million. For FY 2012, the estimators increased the revenue estimate by $65.9 million, relative to their November estimates, while caseload expenditures were decreased by $7.3 million. The impact of these changes is a $50.5 million net decrease in the FY 2011 deficit and a $73.2 million decrease in the projected FY 2012 deficit.

Alternative Approach

RIPEC recommends that policymakers first consider each new program or revenue proposal in the context of how well each program fits with the state's priorities and capacity. While the programs have merit, the state's ability to support program expansion, particularly without a specified plan of action with regard to fiscal support, may require revaluation and prioritization. While the REC/CEC resulted in increased revenues for FY 2011 that will result in a positive budget balance, these funds should not be used to support programs that will create, or increase, out-year deficits; repayment of the Rainy Day Fund should be a priority.

Table 4 shows the fiscal outlook for FY 2011 and FY 2012 as a result of changes made at the May REC/CEC. In addition, the table shows how the budget would change if all the proposed programs were not implemented in FY 2012. (NOTE: this assumes passage of the Governor's sales tax proposal, and that the state would retain the additional revenue through maintaining the 8.0 percent rate for hotel and meals and beverage taxes rather than reducing the rate to 7.0 percent as would otherwise occur). As shown on the table, the combined impact of the changes results in a revised closing balance of $184.7 million in FY 2012, even after repayment of the Rainy Day Fund in FY 2011. If the sales tax increase were excluded, there would still be a positive balance of approximately $19 million at the end of FY 2012.

Table 4
Budget Adjustments ($ millions)

	FY 2011	FY 2012
Governor Proposed		
Available Revenues	$2,981.5	$3,170.7
Expenditures	2,965.3	3,169.8
Proposed FY 2011 Surplus	*16.2*	*0.8*
Revised Surplus	-	$ 44.7
May REC/CEC Changes*		
Revenue Increase (Decrease)	$ 53.8	$ 65.9
Caseload Increase (Decrease)	3.3	(7.3)
Total May Changes	*$ 50.5*	*$ 73.2*
Repayment to Rainy Day Fund	$ (22.0)	-
Program Adjustments**	-	65.9
Revised Closing Balance	**$ 44.7**	**$ 184.7**

* Compared to November REC/CEC
** Elimination of additional funding for MAST, TAP, Education Funding Formula, Higher Education, and DOT initiatives

SOURCE: FY 2012 Budget Documents; May 2011 REC/CEC Documents; RIPEC calculations

As a second step, RIPEC recommends the General Assembly consider each program on its merits, as well as whether aspects of each program may be implemented without requiring additional revenues. For example, there are a number of components to the MAST program, such as enhanced reporting requirements, that may be implemented at the local level without necessitating additional funds or requiring enhanced municipal funding. Moreover, the state may be able to provide a level of fiscal relief to municipalities above and beyond the proposed funding levels by providing municipalities with the ability to modify pension and health care costs, the funding of which is at the core of the MAST proposal.

Similarly, there may be mechanisms by which the state can set in motion the creation of a dedicated funding source for DOT without reducing general revenue funds. The state may simply establish the fund and delay support until FY 2013. Alternately, selected motor vehicle fees may be increased, and then adjusted, by the annual inflation rate and the additional revenue transferred into the highway trust fund. The latter option would provide for a dedicated source of funding that would also increase over time.

Funding of the state's recently-enacted education funding formula should be a priority. In addition to fulfilling the statutory requirement to implement the formula in FY 2012, support of the education funding formula represents the kind of long-term investment RIPEC has advocated. One funding option would be to establish a trigger mechanism that uses growth in state revenues to provide a dedicated funding source for education. Alternately, the state could opt to dedicate a portion of revenues generated through the meals and beverage tax – similar to the proposed MAST funding – to school districts. This would both ensure that growth in the funding formula would be supported by a dedicated revenue source, and that locally-generated revenues were used to support local initiatives.