RIPEC

Comments on Your Government

A SPECIAL PUBLICATION OF THE RHODE ISLAND PUBLIC EXPENDITURE COUNCIL

Overview of Rhode Island Expenditures and a FY 2012 Budget Blueprint

This RIPEC Comments is the first in a series of reports on the State's fiscal condition and budgetary outlook. The report provides an overview of Rhode Island's fiscal framework, including the identification of primary budget drivers, and examines how the State's fiscal trends compare to other states. The Comments also outline issues the State may want to consider as it addresses the FY 2012 budget shortfall.

Introduction

The fiscal soundness of the state budget relies on ongoing resources supporting current operations, state operations appropriately prioritized and adequately funded, and realistic revenue projections. A budget is a state's central policy document. It must guide the delivery of a finite amount of resources through expenditures prioritized to reflect the concerns and needs of citizens while accounting for out-year fiscal implications of those spending decisions to ensure continued delivery of services. Although Rhode Island's economy is beginning to recover after multiple years of economic distress the House Fiscal Staff estimate a FY 2012 budget shortfall of roughly $300 million, which is projected to grow to approximately $375 million by FY 2016.

Funds through the American Recovery and Reinvestment Act (ARRA) helped provide budgetary relief during the most serious years of the economic downturn. However, those funds, which represented approximately $240 million in general revenue expenditure relief in FY 2011, are not available in FY 2012. Moreover, a significant portion of the funds contained maintenance of effort requirements which prevented simultaneous reductions in expenditures or services. As a result, the State is faced with a continuing structural imbalance

Table 1
Projected Deficits FY 2011 - 2015 ($ million)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Available Revenues	$ 2,979.0	$ 2,984.1	$ 3,094.1	$ 3,208.6	$ 3,320.9
Total Expenditures	2,975.8	3,284.0	3,415.4	3,552.0	3,694.0
(Deficit)/Surplus	$ 3.2	$ (299.9)	$ (321.2)	$ (343.4)	$ (373.1)
As a % of Available Revenue	-0.1%	10.0%	10.4%	10.7%	11.2%

SOURCE: RIPEC calculations based on November 2010 Revenue Estimating Conference; FY 2010 closing documents; and House Fiscal Staff and State Budget Office Estimates that is projected to result in persistent out-year deficits.

As the national and Rhode Island economies emerge from the recession, it is imperative that Rhode Island resolve its structural deficit in order to grow its economy and attract new investment. If Rhode Island is to successfully compete for jobs, grow its economy and sustain necessary government programs, it is essential that the State adopt a structural response to the budget crisis it faces. The years of excess growth in spending over recurring revenues must be limited and the State must take a new approach to stay within revenue limits without using broad-based taxes, one-time or expenditure delays revenues to balance the budget.

Expenditure Overview

In order to provide context to the discussion, this section provides an overview of Rhode Island's historical and current expenditures, and examines how the State's general revenue spending compares to the rest of the country.

Rhode Island Overview

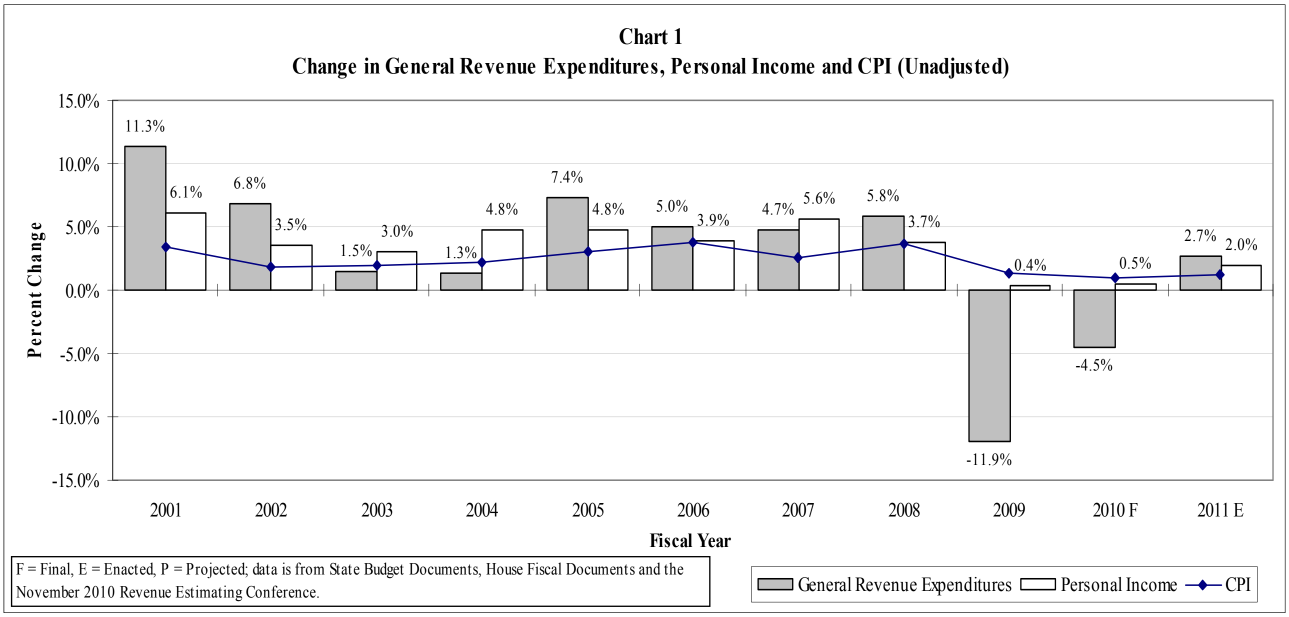
On an all-funds basis, expenditures increased from $4,839.2 million in FY 2001 to $7,864.1 million in FY 2011 (enacted) as shown on table 1. This translates into an average annual rate of 5.0 percent, compared to a 3.2 percent average annual increase in personal income and a 2.3 percent average annual increase in inflation. On an adjusted basis, all funds expenditures increased 35.4 percent between FY 2001 and the enacted FY 2011 budget, or by 3.1 percent annually. All funds spending accelerated in FY 2010, largely due to the infusion of stimulus funding from the federal government rather than an increase in State spending. While total expenditures increased by 9.9 percent between FY 2009 and FY 2010, general revenue spending decreased by 4.5 percent. At the same time, it should be noted that the decrease in state general revenue funding primarily reflects federal funds supplanting general revenue spending, rather than structural reductions on the part of the State.

Table 2
Rhode Island All Funds Expenditures
FY 2001 - FY 2011 (E) ($ millions)

Fiscal Year	All Funds Exp	Percent Change	REC Personal Income	Percent Change	Annual CPI	REC Percent Change
2001	$4,839.2	9.3%	$32.6	6.1%	178.1	3.4%
2002	5,189.9	7.2%	33.8	3.5%	181.3	1.8%
2003	5,433.1	4.7%	34.8	3.0%	184.7	1.9%
2004	5,776.6	6.3%	36.4	4.8%	188.8	2.2%
2005	6,000.3	3.9%	38.2	4.8%	194.4	3.0%
2006	6,507.5	8.5%	39.7	3.9%	201.8	3.8%
2007	6,564.0	0.9%	41.9	5.6%	207.1	2.6%
2008	6,935.2	5.7%	43.5	3.7%	214.7	3.7%
2009	7,342.5	5.9%	43.6	0.4%	217.7	1.4%
2010 F	8,068.3	9.9%	43.9	0.5%	219.9	1.0%
2011 E	7,864.1	-2.5%	44.7	2.0%	222.5	1.2%
FY 2001-11	**62.5%**		**37.1%**		**25.0%**	
Ave Annual	**5.0%**		**3.2%**		**2.3%**	

Source: State budget documents; Nov 2010 Consensus Economic Forecast; RIPEC calculations

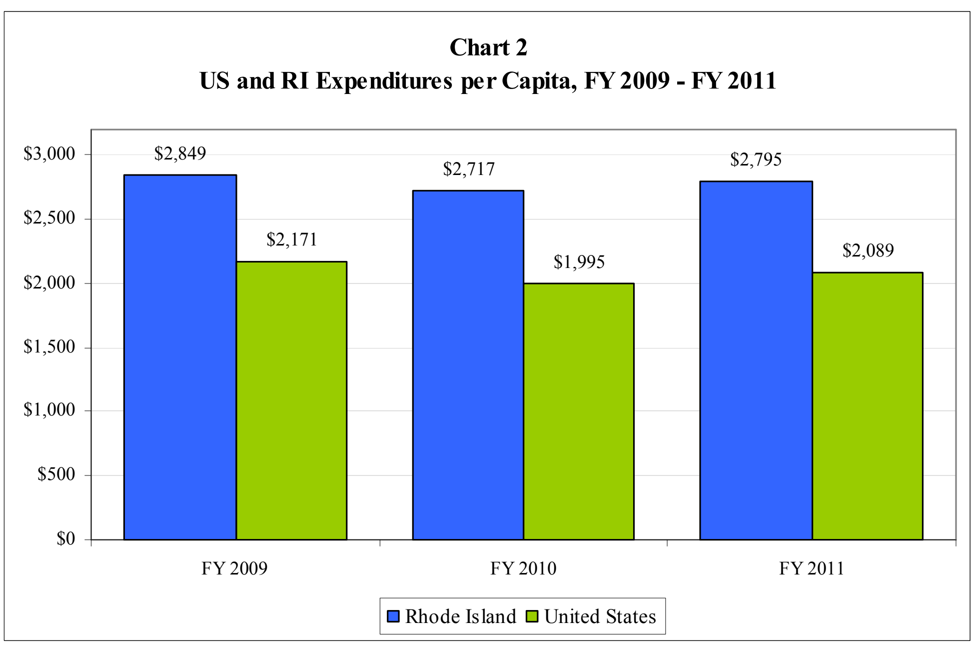
Chart 1 shows how general revenue expenditures compare to personal income growth and inflation from FY 2001 to FY 2011 (enacted). During this time, general revenue expenditures in Rhode Island have increased at an estimated average annual rate of 1.7 percent per year, or by 18.5 percent, from $2,651.7 million in FY 2001 to $2,942.1 million in FY 2011. On an adjusted basis, general revenue expenditures decreased 1.2 percent (an average annual rate of -0.1 percent) during the same time period. Unadjusted general revenue



expenditures grew at a slower rate than unadjusted personal income and the CPI during the 10-year time period; however, this is largely due to declines in general revenue spending in both FY 2009 and FY 2010, reflecting the contraction of revenues during these years.

How Rhode Island Compares

According to "The Fiscal Survey of the States, 2010", published by the National Association of State Budget Officers (NASBO) and the National Governors Association (NGA), Rhode Island's enacted FY 2011 general revenue expenditures of $2,795 per capita are 33.8 percent higher than national general revenue expenditures per capita of $2,089. In New England, general revenue expenditures per capita were the highest in Connecticut (136.6 percent higher than the national average), and the lowest in New Hampshire (41.1 percent below the national average).



Between FY 2009 and FY 2010, general revenue expenditures in Rhode Island decreased by 4.6 percent. Across the US, general revenue spending decreased by 8.1 percent. Rhode Island's decrease in expenditures was the third largest in the region, behind Vermont (5.2

percent) and Maine (5.5 percent). During the time period, Connecticut was the only New England state to see an increase in general revenue expenditures.

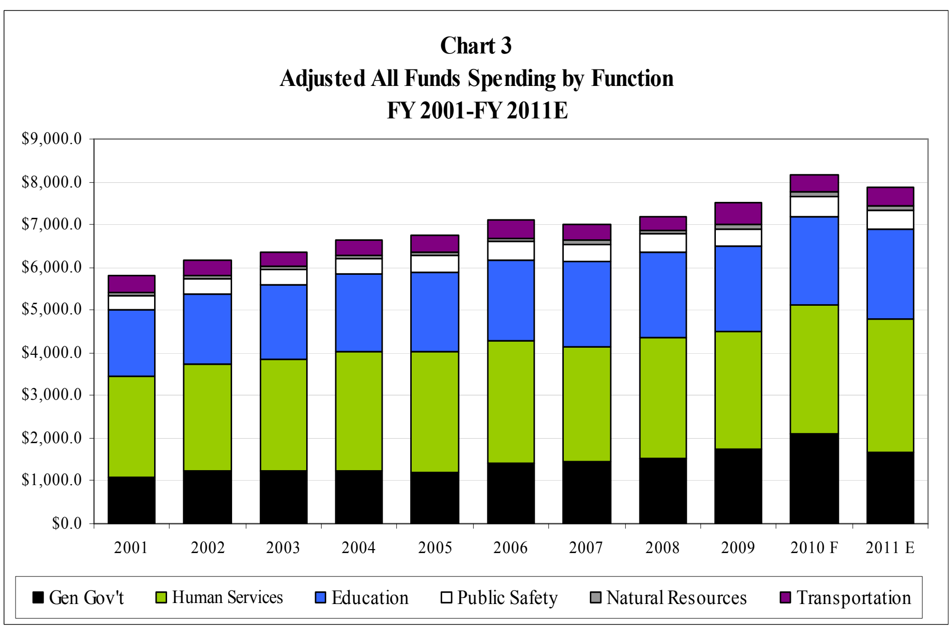
Expenditures by Function and Category

While examining total expenditures provides a baseline for how much a state spends, total spending does not reflect how a state allocates its available resources. In Rhode Island, expenditures are allocated by function, that is, by agencies with like programs and purposes. Functions include general government, human services, education, public safety, natural resources, and transportation. Expenditures are also allocated by accounting categories that reflect what is purchased, i.e. personnel, operations, local aid, grants and benefits, capital, debt service and operating transfers.

Expenditures by Function

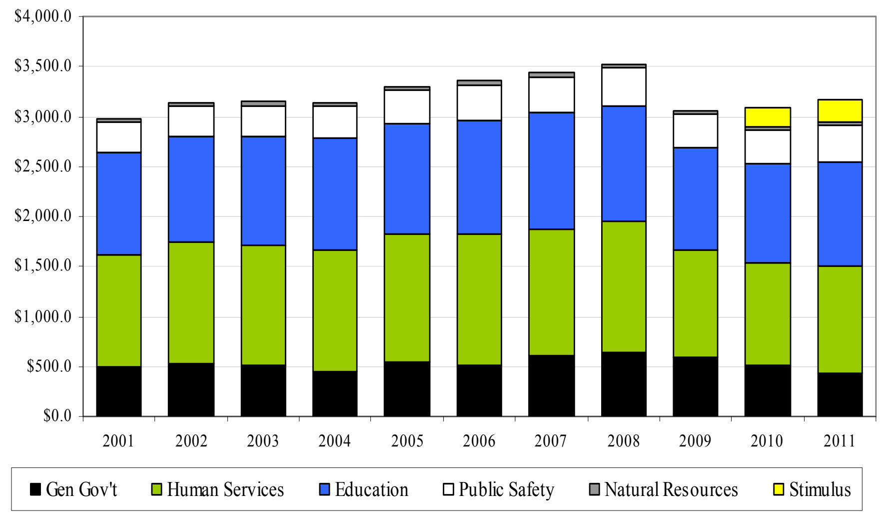
Chart 3 shows adjusted total expenditures from FY 2001 to FY 2011E allocated by function. Over the ten-year time period, adjusted all funds expenditures increased by $2,057.5 million. Human services accounted for the largest share of the increase (37.5 percent), followed by general government (28.8 percent) and education (26.3 percent). In all years, human services expenditures accounted for the majority of total spending (approximately 40 percent of the budget), followed by education, which accounts for approximately 25 percent of total expenditures. Despite growing by 11.7 percent during this time frame, transportation expenditures represent a smaller portion of the budget in FY 2011E compared to FY 2001 spending.

Adjusted general revenue expenditures – as shown on chart 4 – decreased from $2,979.0 million in FY 2001 to $2,942.1 million in the FY 2011 enacted budget. When the stimulus funds – which were largely used to supplant general revenue spending – are included in the FY 2011 budget, total general revenue-related expenditures were $3,175.9 million, or 6.6 percent higher than adjusted FY 2001 general revenue spending. As with total expenditures, the categories of human services and education accounted the largest share of the budget, representing 33.8 percent and 32.5 percent of all general revenue spending in FY 2011.



At the same time, human services-related expenditures represented a smaller share of the budget in FY 2011E when compared to the FY 2001 expenditure level. This is likely due to the enhanced federal medical assistance percentage (FMAP) available through ARRA rather than

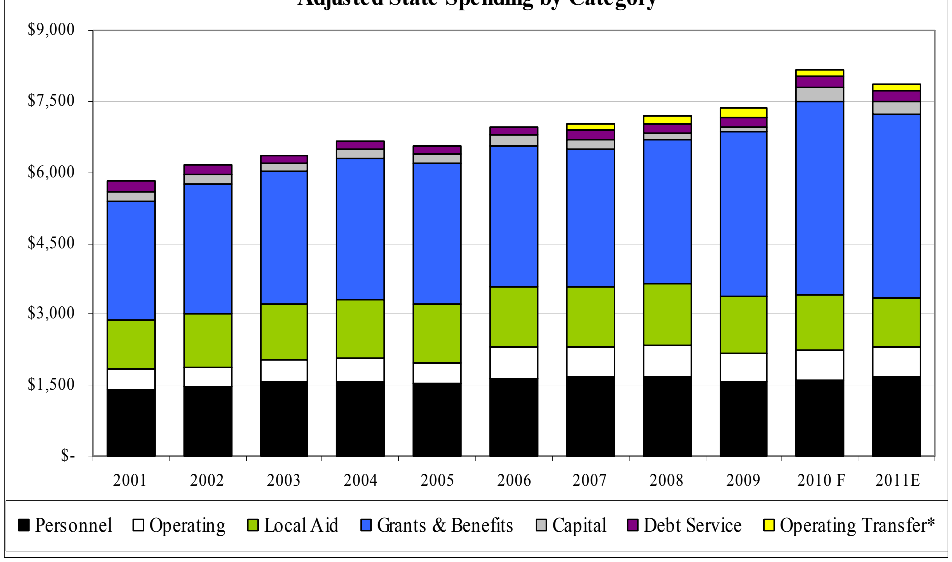
Chart 4
Adjusted General Revenue Spending by Function
FY 2001-FY 2011



structural change. At the same time, it should be noted that, the receipt of ARRA funds was contingent upon certain maintenance of effort (MOE) requirements, such as maintaining the same eligibility levels for Medicaid as those in place as of July 1, 2008.

In addition to lowered human services-related spending, general government and natural resources expenditures declined, both in absolute terms and as a share of the budget. Adjusted general government expenditures fell from $494.5 million in FY 2001 to $434.6 million in FY 2011E (12.1 percent) and account for 13.7 percent of total FY 2011E compared to 16.6 percent of the FY 2001 budget. By contrast, education and public safety-related spending increased over the ten-year time period.

Chart 5
Adjusted State Spending by Category



Expenditures by Category

As noted above, since FY 2001, all funds expenditures have increased by $2,057.4 million. Of this amount, $1,351.4 million, or 65.7 percent, was for grants and benefits. Further, grants and benefits have accounted for an increasingly larger share of the budget over the past ten years. In FY 2001, grants and benefits represented 43.3 percent of total State spending, compared to almost 50 percent in FY 2011E. Of note, unemployment insurance benefits, which are included in the grants and benefits category, more than doubled between FY 2008 and FY 2009, from $251.3 million to $561.1 million. The FY 2010 budget included unemployment expenditures of $770.2 million, while the FY 2011 enacted budget included $567.2 million.

The second-largest share of growth was in personnel expenditures, which accounted for 12.8 percent of the total increase during the time frame. When personnel and operating expenditures are combined, the two categories represented approximately 30 percent of the total increase in adjusted expenditures over the past ten years. As a share of the total budget, personnel and operating expenditures have accounted for between 28 and 32 percent of total spending since FY 2001.

Local aid accounted for less than one percent of the total increase over the ten years and accounted for just 13.4 percent of the State's FY 2011E budget. However, local aid has been cut significantly since FY 2008 when total spending in this category represented just over 18 percent of total spending. Despite reductions in this category of spending, local aid expenditures remain the third largest category of spending in the total budget.

Budget Drivers

The State's expenditure history reveals a number of trends. In general, Rhode Island has historically, and increasingly, devoted funds to three primary areas: human services/grants and benefits; personnel/operations; and local/education aid. National comparisons also indicate that Rhode Island's spending in these areas tends to be higher than the national average and frequently ranks among the top ten states (see: "How Rhode Island Expenditures Compare" for a more in-depth comparison). These areas appear to represent the most significant drivers of the State budget growth. This section of the report examines these areas of spending in additional detail, actions taken by other states to control spending growth in these areas, and structural changes Rhode Island may want to consider as the FY 2012 budget is developed.

Human Services/Assistance, Grants and Benefits

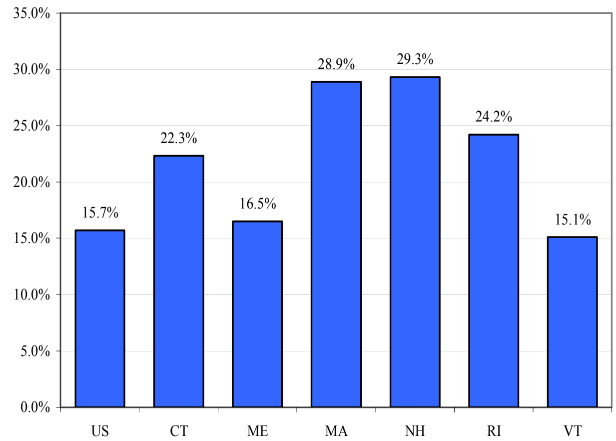
Grants and benefits for human services programs represent the largest share of expenditures in the total budget. Of the $3,121.9 million appropriated for human services in FY 2011E, 84.0 percent, or $2,621.0 million, was for grants and benefits. The FY 2011 enacted budget includes general revenue spending of $871.3 million for grants and benefits within human services departments. The majority of these expenditures are for medical assistance programs. Since FY 2001, total expenditures for medical assistance have increased at an average annual rate of 6.7 percent (3.6 percent for general revenues).

In an effort to contain Medicaid costs and to increase flexibility within the program, Rhode Island has received a waiver from the Federal Government which altered how the Medicaid program operates. The Rhode Island Global Consumer Choice Compact Waiver, or Global Waiver, was approved by the Centers for Medicare & Medicaid Services (CMS) on January 16, 2009. The Global Waiver establishes a new Federal-State compact that provides the State with greater flexibility to provide services in a more cost effective way that will better meet the needs of Rhode Islanders.

How Rhode Island Compares

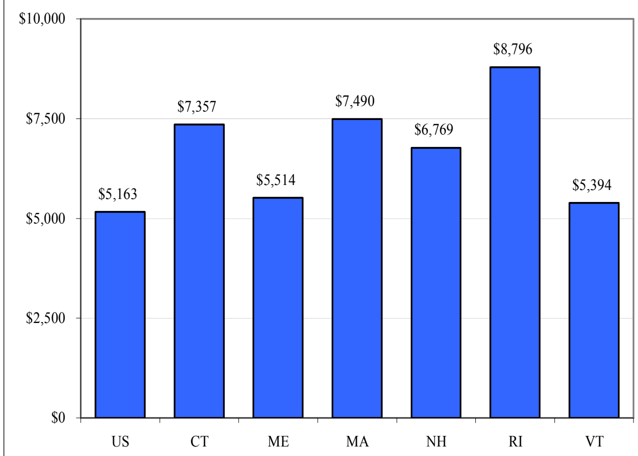
National data indicate that Rhode Island devotes more of its resources to Medicaid than most states. Census data from FY 2008, the most recent year for which data is

Chart 6
State Medicaid Spending, FY 2009



SOURCE: Kaiser Family Foundation "State Medicaid Facts"

Chart 7
Medicaid Spending per Enrollee, FY 2007



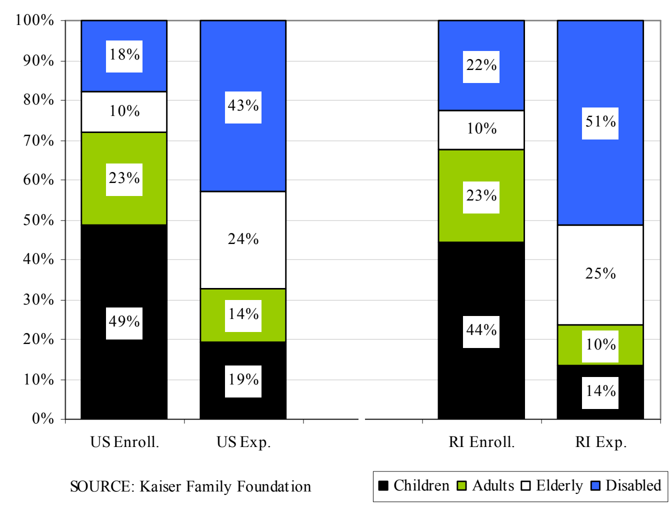
SOURCE: Kaiser Family Foundation "State Health Facts"

available, indicate that Rhode Island's vendor payments, which are primarily Medicaid-related expenditures, ranked 2nd highest on a per $1,000 of personal income basis, and highest on a per capita basis. The Henry J. Kaiser Family Foundation (KFF) maintains a database to track Medicaid spending by state, which includes more recent data. According to the Kaiser Foundation, in FY 2009, Rhode Island ranked fourth behind Ohio, New Hampshire and Massachusetts in state Medicaid spending as a percentage of their general fund.

The chart above shows how Rhode Island compares to the United States average and to the rest of New England for the most recent fiscal years available. Of the six New England states, only Massachusetts and New Hampshire dedicated a greater share of their general revenue budget to Medicaid spending. At the same time, Vermont was the only New England state that devoted a smaller share of own-source revenue to Medicaid compared to the national average.

Spending on Medicaid is driven both by the number of enrollees and the average cost per enrollee. According to the KFF, 16 percent of the population in Rhode Island and across the United States was covered by Medicaid in FY 2009. However, research by the KFF also shows Rhode Island ranked highest in the country for average Medicaid payment per enrollee. In FY 2007, the most recent year for which nationally comparable data is available, Rhode Island's per enrollee Medicaid expenditures of $8,796 were 70.4 percent higher than the national average of $5,163.

Chart 8
Enrollment and Expenditure by Enrollment Group,
FY 2008



SOURCE: Kaiser Family Foundation

Spending per enrollee is, in part, driven by the composition of the enrolled population and the share of expenditures devoted to each enrolled group. As shown on chart 8, the elderly and disabled populations accounted for approximately one-third of the enrolled population, but for over three-quarters of total expenditures in Rhode Island in FY 2008. Nationally, the elderly and disabled population accounted for roughly one-quarter of the FY 2008 enrolled population and two-thirds of total Medicaid expenditures.

State Medicaid Changes

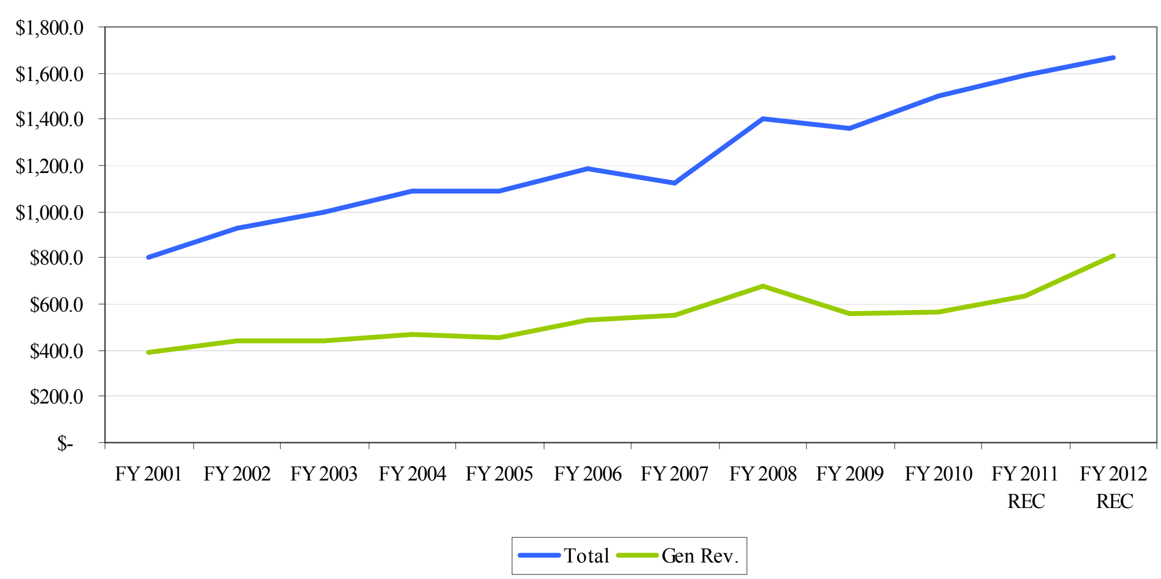
Although states have been somewhat limited with regard to changes to their Medicaid programs due to the terms of the enhanced Federal Medical Assistance Percentage (FMAP) in the ARRA, a number of states have taken actions in order to control Medicaid costs. The KFF notes that 36 states including DC made changes to provider rates including a payment freeze or cut. Thirty states made changes to pharmacy controls, affecting either utilization or cost control. Additional, state-specific changes include:

- *Connecticut*: Froze enrollment for Charter Oak, a state subsidized health care plan for uninsured adults.
- *Virginia*: Cut provider rate reimbursements and achieved savings of $366.8 million for the FY 2010 – 2012 biennium. The budget also made structural changes to programs that achieved savings in the long-run, such as eliminating all inflationary adjustments to reimbursement rates for Medicaid providers.
- *Washington*: Health and Recovery Services Administration eliminated 160 positions in the state Medicaid program.

Rhode Island Expenditures

Between FY 2001 and FY 2012 (estimated), total Medicaid expenditures within the Department of Human Services (DHS), which represent the majority of Medicaid-related spending, have more than doubled. Expenditures in this category are estimated to increase by $865.0 million, or 107.7 percent by FY 2012. General revenue expenditures for medical assistance have similarly increased, growing by $413.9

Chart 9
Medical Assistance Expenditures, FY 2001-FY 2012 (est.)



million, or 105.5 percent over the time period.

The Caseload Estimating Conference, which meets biannually in May and November, estimates medical assistance expenditures. These estimates provide the basis for the Governor's budget submission and the final budget as enacted by the General Assembly. Table 3 shows actual and estimated medical assistance expenditures (NOTE: categorical medical assistance expenditures prior to FY 2008 are not comparable due to the inclusion of Rhody Health as a separate line item). The majority of medical assistance spending is for managed care, which is estimated to account for $660.0 million (39.6 percent of the total) in FY 2012. Managed care also represents the largest share of the growth between FY 2011 and FY 2012 (estimated), accounting for 76.6 percent of the total one-year increase of $75.7 million. Some of the growth in managed care is related to shifting populations to managed care as a cost-saving measure in other categories. Since FY 2008, nursing homes and community-based care have increased at a slightly faster rate than managed care, growing by 26.9 percent compared to 26.3 percent growth in managed care. Three categories of expenditures have declined since FY 2008: hospitals, pharmacy, and "other". Together, these three categories represent a decrease in expenditures of almost $140 million.

Given current revenue estimates and limitations, controlling growth in medical assistance programs appears to need to be a high priority. With the sunset of ARRA funding and accompanying Federal mandates, the State will have the opportunity to reform medical assistance programs without loss of federal aid. There are several methods of controlling rising medical assistance costs: reducing or freezing provider payments, eliminating or limiting benefits, controlling expansions, limiting prescription drugs, instituting higher copayments, expanding managed care, restricting community-based long-term care, restricting institutional long-term care and restricting eligibility.

Table 3
FY 2008 - FY 2012 Medical Assistance Expenditures
($ in millions)

Medical Assistance Program	FY 2008 Actual	FY 2011 Revised	FY 2012 Estimated	FY11-12 Change	FY11-12 %
Hospitals*	$267.0	$244.2	$222.4	($21.8)	-9.1%
Nursing Homes	$314.5	$336.0	$343.3	$7.3	2.1%
Home and Community Care	18.3	71.9	79.0	7.1	9.9%
Subtotal	*$332.8*	*$407.9*	*$422.3*	*$14.4*	*3.5%*
Pharmacy	$42.8	$10.9	$11.3	$0.4	3.7%
Part D Clawback	40.2	36.4	46.5	10.1	27.7%
Subtotal	*$83.0*	*$47.3*	*$57.8*	*$10.5*	*22.2%*
Managed Care	$522.7	$602.0	$660.0	$58.0	9.6%
Rhody Health**	18.3	176.0	187.1	11.1	6.3%
Other	179.3	115.0	118.5	3.5	3.0%
Subtotal	*$720.3*	*$893.0*	*$965.6*	*$72.6*	*8.1%*
Total	**$1,403.1**	**$1,592.4**	**$1,668.1**	**$75.7**	**4.7%**
Gen Rev	*$678.9*	*$633.3*	*$806.0*	*$172.8*	*27.3%*

* Includes DSH Payments

** The Conference is now required to estimate Rhody Health as a separate line item

Source: RIPEC calculations based on May 2009 and November 2010 Caseload Estimating Conference data

During FY 2011, Rhode Island took several measures to control rising costs in medical assistance programs. The budget achieved savings of $1.0 million by establishing a cap for generic drugs dispensed to Medicaid enrollees receiving drugs through the fee-for-service system. The Budget also achieved savings by capping the outpatient rate paid to hospitals through managed care programs.

These efforts need to be continued to ensure that programs are affordable and maintainable. Review should focus on:

- What populations are the most costly?
- Are current levels of service sustainable?
- What are projected changes to cohorts if current levels are kept?
- Are such eligibility levels sustainable?
- How does new Federal legislation affect program levels?
- What is the state's plan to cope with continued growth in costs if current eligibility requirements are kept?
- What legislation and regulations are needed for implementing changes and what is the timeline?
- Are proposed changes realistic and can they be implemented within proposed timeframes?
- Are management practices used for controlling medical costs used by the insurance industry being used?

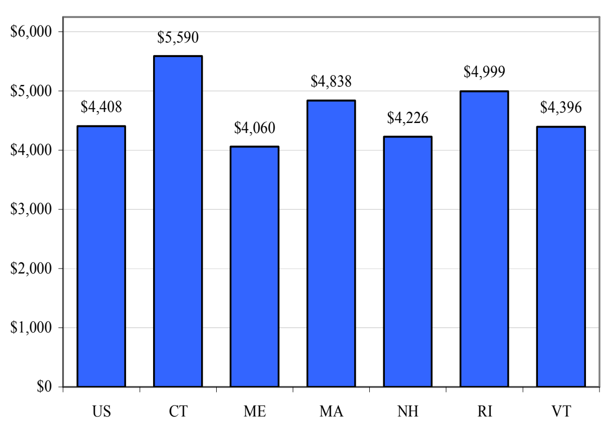
Personnel and State Operations

Personnel and state operating expenditures of $2,295.3 million accounted for 29.2 percent of the FY 2011E all funds budget (31.5 percent of the general revenue budget) and are the second-largest category of spending. In recent years, the rate of growth in personnel and operating costs has slowed somewhat due to a series of changes to personnel, primarily relating to workforce reduction plans and changes to pension and retiree healthcare. At the same time, personnel-related expenditures, particularly benefits, represent an area in which additional structural changes are needed.

How Rhode Island Compares

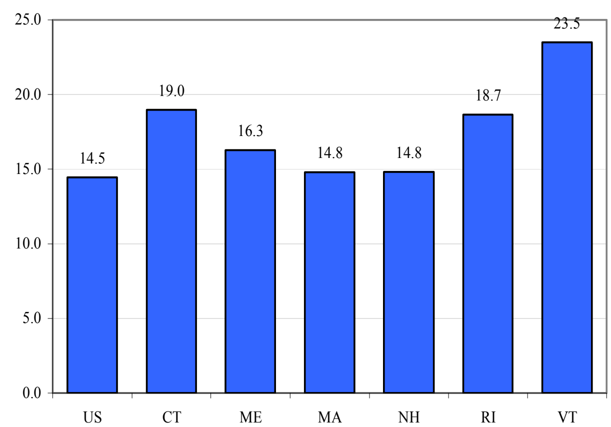
The United States Census Bureau gathers information on employee salaries in all 50 states every March. The most recent data available is from the March 2009 survey. RIPEC calculations using this data suggest that, on average, Rhode Island state workers' pay is the second-highest in New England (behind Connecticut) and above the national average. On average, total pay as of March 2009 was $4,999 per month

Chart 10
Average State Employee Pay per FTE
March 2009



SOURCE: US Census Bureau Census of Governments "Government Employment and Payroll", RIPEC calculations

Chart 11
State FTEs per 1,000 Population
March 2009



SOURCE: US Census Bureau Census of Governments "Government Employment and Payroll", RIPEC calculations (approximately $60,000 per year) in Rhode Island, the 6th highest average in the country. Nationally, average salaries per FTE were $4,408 (approximately $53,000 per year).

In addition to spending more per FTE, Rhode Island also has a higher level of state government FTEs when compared to the rest of the country. As shown on chart 11 as of March 2009, there were 18.7 FTEs per 1,000 of population in Rhode Island compared to a national average of 14.5 per 1,000 of population. Within New England, Rhode Island's FTEs as a share of the population were the 3rd highest, behind Vermont (23.5 FTEs per 1,000 of population) and Connecticut (19.0 FTEs per 1,000 of population).

State Personnel Changes

The Center on Budget and Policy Priorities (CBPP) estimates that 44 states made adjustments to their state workforce to balance the FY 2011 budget. Approximately 30 states, including Rhode Island, imposed furloughs or pay cuts for some employees and 25 states have implemented hiring freezes. The National Association of State Budget Officers (NASBO) notes that 24 states laid off state personnel in FY 2011. Of those states, 22 also reduced full-time positions in FY 2010. Other personnel-related state actions include:

- *California*: Requires a 2-5 percent pension contribution increase for employees, and certain contracts include an increased vesting period and prefunding of other post-employment benefits (OPEB).
- *Delaware*: Proposed reducing employee health costs by renegotiating the pharmacy contract for prescription drugs and maximizing prescription drug rebates for a savings of $5.1 million.
- *Maryland*: Established the Public Employees' and Retirees' Benefit Sustainability Commission to provide an external review of state funded pensions and post retirement benefits. Its findings and recommendations will be used in the 2011 session. The Budget decreased the state workforce by 0.9 percent, or 719.3 positions. State employees also have a 5-10 day furlough and service reduction requirement.
- *Missouri*: Requires new hires (after 12/31/2010) to contribute 4.0 percent to their retirement plan and increased out-of-pocket expenses related to employer-provided healthcare plans.

Rhode Island Expenditures

Between FY 2001 and the FY 2011 enacted budget, total state personnel costs increased by $498.1 million, or 42.5 percent (22.5 percent adjusted). The majority of state personnel expenditures are for salaries and benefits, which accounted for 80.4 percent of total FY 2011 enacted personnel costs. The FY 2011E budget provides for $1,343.3 million in salary and benefit expenditures. Over the ten-year time period, the cost per funded FTE position increased from $58,286 per FTE to $90,598 per FTE, an increase of 55.4 percent. On an adjusted basis, the cost per FTE increased 29.5 percent. Part of the increase per FTE expenditures is related to reductions in overall FTEs. However, even if the overall level of FTEs had remained constant, per FTE expenditures would have increased by 42.6 percent between FY 2001 and FY 2011E (18.8 percent adjusted).

Benefits appear to be the largest cost driver in terms of overall growth during this time period. Since FY 2001, total salaries and benefits have increased approximately 30

Table 4
State Personnel Costs - Unadjusted

Personnel Costs (Millions)	FY 2001 Actual	FY 2011 Enacted	FY 2001-2011E Change	FY 2001-2011E Percent
Net Salaries	$ 723.2	$ 933.7	$ 210.6	29.1%
Uncompensated Leave	-	(18.6)	-	-
Adjustment for Temp	(73.0)	(70.4)	2.6	-3.5%
Overtime	57.0	51.7	(5.3)	-9.3%
Retirement	60.7	147.9	87.2	143.6%
Medical	105.4	159.6	54.2	51.4%
Retiree Health*	-	52.2	52.2	-
Other Benefits/Payroll**	68.7	87.3	18.5	27.0%
Salaries & Benefits	*$ 942.0*	*$ 1,343.3*	*$ 401.3*	*42.6%*
Funded FTE Positions	**16,161.7**	**14,827.6**	**(1,334.1)**	-8.3%
Average Cost Per FTE	**$58,286**	**$90,598**	**$32,312**	55.4%
Other Payroll Costs***	$ 98.8	$ 104.0	$ 7.4	-
Purchased Services	131.4	222.9	91.5	69.7%
Other Personnel	*$ 230.2*	*$ 326.9*	*$ 96.7*	*42.0%*
Total Personnel Costs	**$ 1,172.2**	**$ 1,670.4**	**$ 498.1**	**42.5%**

Source: State Budget Office and Personnel Supplements
* Previously included in other costs
** Includes FICA, holiday pay, payroll accrual and other
*** Includes temporary and seasonal payroll, unemployment comp, statewide benefit assessment, anticipated retroactive payments, and workers comp

percent (32.8 percent excluding furlough days); however, benefits during this time grew at almost three times the rate of salaries, increasing by over 90 percent. As a share of the total personnel budget, salaries accounted for 39.1 percent of the total unadjusted growth between FY 2001 and the FY 2011 enacted budget when the savings from the furlough days were included (42.8 percent of total growth when the savings are excluded). Benefit growth accounted for 42.6 percent of the $498.1 million increase in total personnel spending.

A number of personnel changes were made in the FY 2011E budget including furlough days, salary COLAs and additional restrictions to pensions. The FY 2011 enacted budget also authorized 35.6 fewer FTEs than the enacted FY 2010 budget. These changes are explained in greater detail below:

- *Furlough days*: Each employee is required to take four payroll reduction days in FY 2011. In exchange, employees will accrue one and one-quarter additional days of paid leave, which may be taken in any subsequent pay period or as a cash payment upon the end of their employment. This change resulted in an estimated savings of $18.6 million from all sources.
- *COLAs*: The cost-of-living adjusted for state employees was delayed from July 1, 2010 to January 1, 2011 for approximately $9 million in savings from all sources.
- *Pensions*: The FY 2011E budget limited retiree cost of living adjustments to the first $35,000 of pension benefits, indexed to the lesser of inflation or 3.0 percent. This resulted in estimated savings of $18.5 million ($16.0 million from general revenues).

Issues to Consider
As the Governor and General Assembly continue to evaluate the effects of benefit costs on the State and local levels they should consider the following:

- Are current benefits sustainable?
- Are there additional cost-control measures that could be implemented, particularly with regard to medical expenditures?
- What are the future budgetary implications of not fully funding OPEB obligations?
- Are State and local pension systems adequately funded and have they performed as expected?

- Should a defined contribution or hybrid plan be initiated for new employees with conversion opportunities for existing employees?
- Should savings from changes be reinvested into the pension system to further lower out-year costs, or used to fund other expenditures as is current practice?

To limit the effects of rising costs per position, the administration should examine personnel levels and individual jobs functions in an effort to streamline government. It should initiate a staffing model that accounts for long-term personnel needs beginning with an examination of current staffing levels in each department against anticipated needs based on administration policies. The Department of Administration should institute this review process, asking the following questions to assess need for each position:

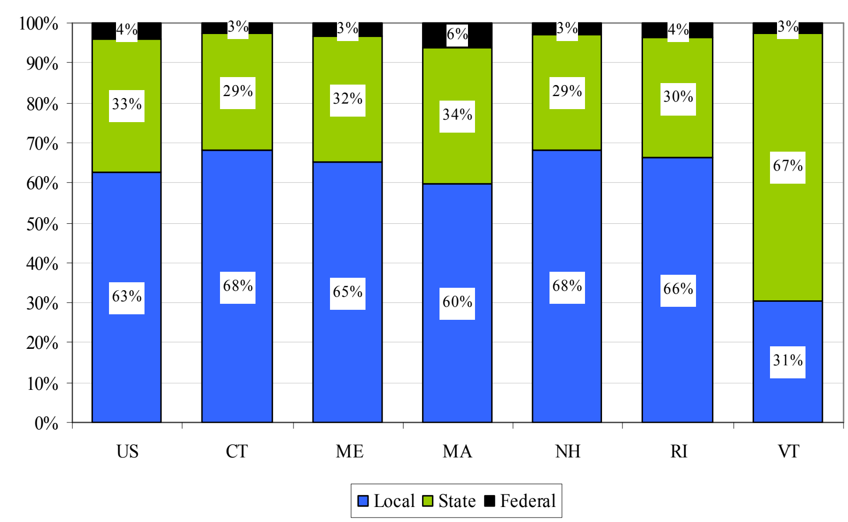
- Does the position meet the job description?
- Are there ways to consolidate or streamline job function?
- Do the responsibilities match the position level?
- Is the service necessary to state government?
- Is the service performed in the right department/agency?

The State's ability to control the rate of growth in future personnel costs depends on the implementation of a personnel reform agenda that targets specific cost drivers. Although current FTEs are below FY 2002 levels, total personnel costs have increased. A personnel review must target the State classification system; examine the possibility of a defined contribution plan for future employees; and negotiate aspects of the collective bargaining agreement that will result in long-term savings. 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. With a new administration and new policies, the State has the ability to seek structural changes that will have long-term implications on the cost structure of State personnel.

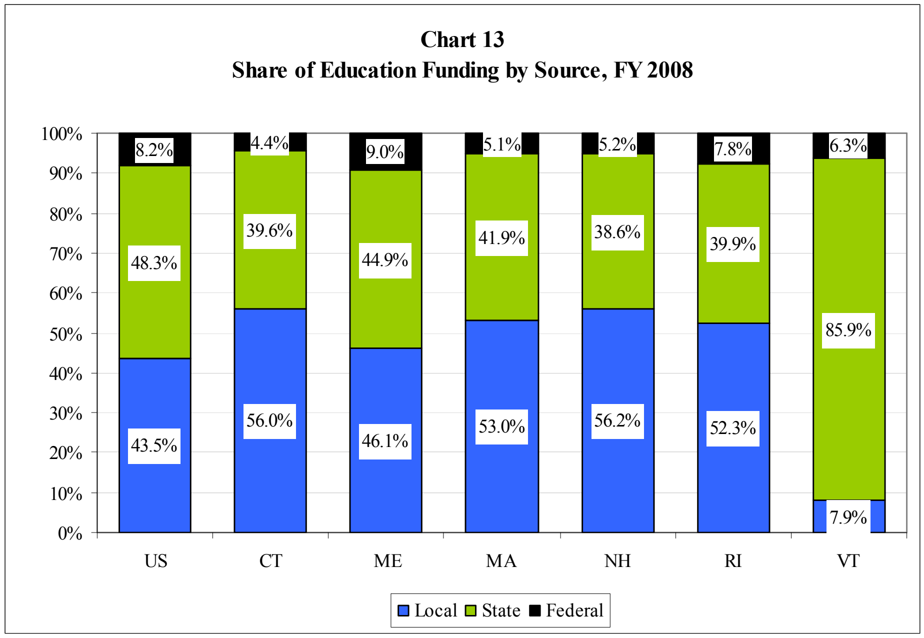
Local Aid and Education

FY 2011E local aid totals $1,053.9 million, 1.5 percent more than FY 2001 expenditures of $1,038.2 million. Although local aid has grown slower than all other budget categories over the past decade, expenditure growth in this category has not been linear, increasing through FY 2008 and decreasing over the past three fiscal years. Recent changes to local aid have put increased

Chart 12
Local Government General Revenue by Source, FY 2008



pressure on local governments to balance their budgets without relying on significant increases in property taxes.



How Rhode Island Compares

Based on the most recent nationally comparable data, FY 2008 local revenue sources in New England were roughly the same as the national average, with the exception of Vermont. While Massachusetts and Vermont were the only states in the region where state funding accounted for a greater share of total revenues, in general, local own-source funds represented approximately two-thirds of all local revenues throughout the country and region. One should note, however, that revenues as shown do not reflect Rhode Island's recent cuts to local aid. If no other changes were made to local revenues aside from the recent deductions in state aid, state sources would represent approximately 26 percent of total local revenues.

Education represents the largest source of local expenditures in Rhode Island and throughout the country. In general, New England states tend to rely more on local aid to support education expenditures as shown on chart 13. Nationally, 43.5 percent of FY 2008 education revenues came from local sources, compared to 52.3 percent in Rhode Island. Similarly, 48.3 percent of education revenues in FY 2008 came from state governments nationally, compared to 39.9 percent in Rhode Island.

State Changes to Local Aid

The National Conference of State Legislatures (NCSL) notes that a number of states included cuts to state aid in their FY 2011 enacted budgets. Most governments that cut local aid either cut a specific dollar amount or a percentage. However, some governments also pulled state support for specific initiatives or programs, such as transportation assistance, funding for housing prisoners, or fiscal support for school instructional days.

Based on an analysis by the CBPP, at least 34 states and the District of Columbia have cut aid to K-12 education. For example:

- *Arizona*: reduced or eliminated funding for preschool programs, all-day kindergarten, charter schools, and classroom supplies.
- *Colorado*: cut state support for education by approximately 5 percent compared to the prior year (roughly $400 per student).
- *Missouri*: reduced funding for K-12 transportation programs by almost 50 percent.

- *Washington*: suspended funding for class-size reduction programs and professional development.

Rhode Island Expenditures

Enacted FY 2011 state aid to local government of $893.2 million represents approximately 30 percent of total general revenue expenditures. The majority of the expenditures – $832.9 million or 93.3 percent – are dedicated to education, primarily direct education aid. The remainder, $60.2 million is for aid to municipal governments such as the payment in lieu of taxes (PILOT) program, distressed communities aid, and the remainder of the excise tax program phase-out aid. Total local aid expenditures increased through FY 2008, largely due to growth in the car tax exemption and education aid. The elimination of general revenue sharing and the state reimbursement for the motor vehicle excise tax account for almost all of the reduction in local aid from its peak in FY 2008.

Chart 14
Local Aid Expenditures ($ million)

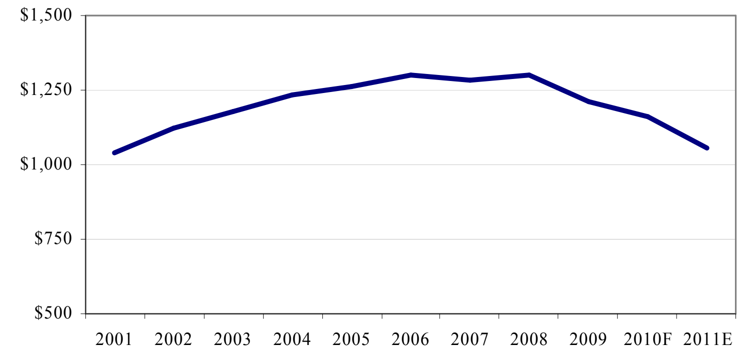


Table 5
State Aid to Local Government

Major State Aid Program	FY 2001	FY 2011E	2001-2011E Change	%
Education Aid				
Direct Education Aid*	$560.0	$632.5	$72.6	13.0%
Teacher Retirement	36.0	75.6	39.6	110.1%
School Housing Aid	30.8	70.8	40.0	130.0%
Met School	2.0	13.0	11.0	557.9%
Direct Charter School Aid	3.8	37.8	34.0	898.7%
Other Aid**	6.3	3.2	(3.1)	-49.1%
Subtotal - Education Aid	*$638.8*	*$832.9*	*$194.1*	*30.4%*
Municipal Aid				
General Revenue Sharing	$33.5	$0.0	($33.5)	-100.0%
Excise Tax Phase-out	76.6	10.0	(66.6)	-86.9%
PILOT	17.6	27.6	10.0	56.6%
Distressed Communities Aid	7.3	10.4	3.1	42.4%
Other Aid***	10.4	12.3	1.9	18.3%
Subtotal - Municipal Aid	*$145.4*	*$60.2*	*($85.1)*	*-58.6%*
Total State Aid	**$784.2**	**$893.2**	**$109.0**	**13.9%**

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

*Includes direct education aid, indirect charter aid, Central Falls, and all categorical funds except those specifically noted elsewhere.

** Includes progressive support and intervention, Hasbro hospital, school visit, RIDE professional dev., textbook loans, school breakfast, 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 the property revaluation program.

Since FY 2001, education aid has increased by $194.1 million, or 30.4 percent (8.7 percent adjusted). The largest component of this growth has been direct education aid, which increased by $72.6 million over the ten-year period. However, direct education aid had the slowest rate of growth during this time and actually declined when expenditures are considered on an adjusted basis. The fastest growing component of education aid during this time has been direct charter school aid. Fiscal support for charter schools increased by $34.0 million and accounted for 17.5 percent of the total growth in education aid over the decade. Teacher retirement and school housing aid expenditures more than doubled during this time period, each growing by approximately $40 million.

Municipal aid has declined by $85.1 million, or 58.6 percent, since FY 2001 when direct aid to municipal governments totaled $145.4 million. As noted above, the majority of this decline is related to the elimination of both general revenue sharing and the state reimbursement to municipal governments for the motor vehicle excise tax phase-out. The general revenue sharing program was reduced in FY 2009, from $55.1 million to $25.0 million, and was eliminated in the FY 2010 budget. Prior to FY 2011, replacement aid to local governments for the car tax phase-out represented the fastest growing – and most significant portion – of local aid. Since FY 2008, changes to the program include freezing the exemption at $6,000, reducing the reimbursement rate to 98.0 percent of the calculated reimbursement, and reducing the reimbursement to $500.

Issues to Consider

Due to out-year projections of growing structural deficits at the State level it is likely that future cuts to local aid will be considered. The effects of declining state aid on municipal budgets could be compounded by slower growth in property tax collections due to declining property values. As such, the State must work closely with local cities and towns to better understand the pressures on municipal budgets.

The incoming administration should develop a comprehensive policy to predictably and equitably distribute state aid and work to limit unforeseen cuts. Changes to local aid work best when cities and towns have budgeted appropriately for out-years. In addition, cities and towns must possess the tools to make fundamental changes to their cost structure to compensate for declining revenues. The State, through the General Assembly, can assist by empowering municipalities and providing the budget autonomy needed to better manage expenditures. State government should examine how it can help cities and towns do the following:

- Enable and empower management in collective bargaining agreements;
- Joint purchase of healthcare to leverage economies of scale; and
- Consolidate and regionalize services to reduce costs.

RIPEC Comments

As the national economy emerges from the recession, the need for Rhode Island to rectify its structural deficit is imperative if the State is to grow and attract new investment. Rhode Island will be well positioned to take full advantage of the looming recovery if it demonstrates sound fiscal management by balancing the State's budget in the short- and long-term.

Although the current fiscal year appears to be balanced, the State faces a FY 2012 budget gap of approximately $300 million, which is projected to increase to $375 million by FY 2016. State budgets with projected out-year deficits have become a common event in Rhode Island's fiscal landscape, inhibiting the State's ability to make strategic decisions that will stimulate economic growth, support a predictable basic services system and provide funding for long-term investments. In order to achieve these goals, the State must adopt a structural response to the current fiscal situation. Such a task requires taking a comprehensive view of the budget process which should address a number of critical questions for sound budgeting:

(1) Do recurring revenues fund ongoing expenditures? To monitor this process, the Budget Office should maintain five-year

budget projections throughout the budget process, as well as:

- Report regularly to the Governor on out-year effects of budget choices;
- Reach consensus out-year planning values with House and Senate Fiscal offices prior to September 1st; and
- Develop software to incorporate those values into agency budget submissions.

(2) Are expenditure and revenue projections realistic? There should be general consensus of projections among the Budget Office, the House Fiscal Office, and the Senate Fiscal Office, as well as:

- Understanding the consequences certain economic scenarios will have on the budget;
- Adherence to current statutes requiring agencies to prepare full cost estimates of budget needs; and
- Requiring submission of a constrained budget from each agency.

(3) Does the State's budget adequately fund services? The State should fund services and programs according to priority, and should evaluate whether service levels and program eligibilities are prioritized to meet the State's current policy objectives. In addition, the State should:

- Incorporate national performance and cost rankings in budgeting decisions and make this data available to the public; and
- Maintain long-term data for Rhode Island's national ranking on measures to ensure any changes are deliberate, rather than accidental policy changes.

(4) Are programs delivered effectively and held accountable? Service delivery systems should be maximized in order to produce the most effective and efficient outcome within current revenue limitations. The State should publish specific outcome goals for each program, which should:

- Be meaningful policy result measures subject to public input;
- Identify specific deliverables for each program; and
- Undergo regular review by the Governor and agency heads to maintain consistency between program goals and outcome variables.

In addition, the General Assembly should consider agency sunset legislation under which agencies exist for only ten years unless reauthorized, which would include a reauthorization process based upon sunset audits of outcome goals performed by the auditor general and result in ineffective programs being eliminated.

The years of excess growth in spending over recurring revenues must be limited and the State has to take a new approach to stay within fiscal limits without using broad-based taxes or one-time revenues to balance the budget. RIPEC believes that if the State incorporates the practices outline above into the budgeting process and moves toward a long-term plan that relies on an investment-based approach, Rhode Island will be able to eliminate the out-year deficits, sustain existing services and reorder priorities so that the State can focus on attracting and retaining economic investment.