RIPEC
Comments on Your Government
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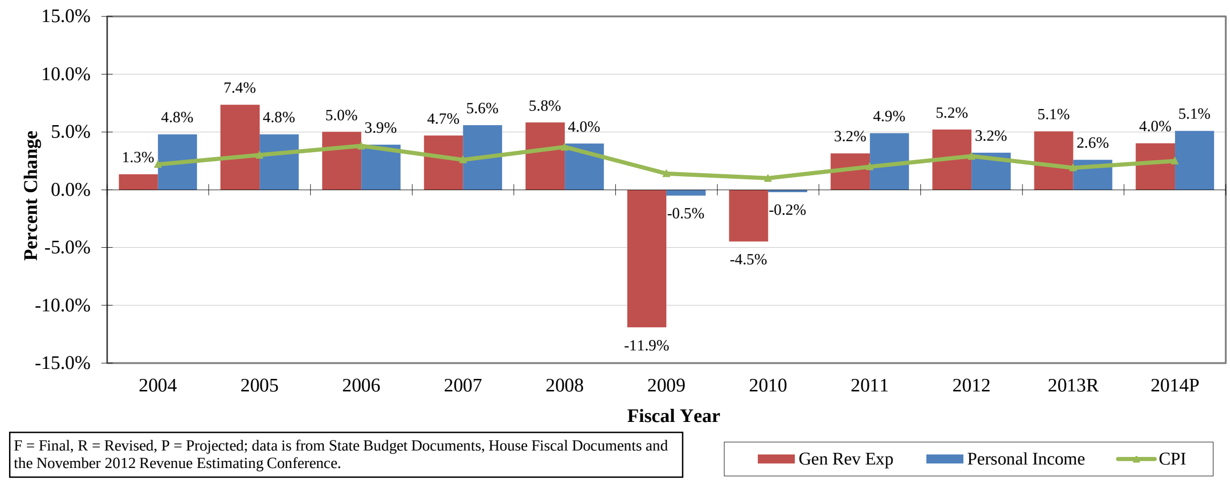
Governor's FY 2014 Budget as Proposed

This RIPEC Comments outlines the Governor's FY 2014 budget request and summarizes key policy issues. The proposed FY 2014 budget includes all funds expenditures of $8,172.5 million, an increase of $72.6 million (0.9 percent) from the FY 2013 enacted budget. Fiscal year 2014 general revenue expenditures total $3,399.2 million in the proposed budget, an increase of $131.5 million (4.0 percent) from the FY 2013 enacted budget.

Chart 1
Change in General Revenue Expenditures, Personal Income and CPI (Unadjusted)



The following highlights some of the comments contained in this report:

- Budgets are a state's central policy document and must reflect the priorities of the government and, thus, its citizens. As such, RIPEC believes it is appropriate to consider how the proposed budget defines the state's priorities and whether resources are directed to those priorities that reflect the needs and concerns of Rhode Islanders. An investment-based approach to budgeting, emphasizing the effective delivery of the core functions of government, creates a solid foundation for the state as it emerges from the recent recession.

- In addition, budgets must be considered in terms of the out-year fiscal implications of spending and revenue decisions to ensure continued affordability of state services. As proposed, the Governor's budget includes significant out-year deficits, related to the pace of economic recovery in the state and the introduction of casino gambling in Massachusetts. The Affordable Care Act (ACA), the outcome of statewide pension reform, and changing federal spending priorities (including the duration of federal sequestration) will also exert fiscal pressure going forward.

- Estimates of the impact of casino gaming on Rhode Island lottery revenues are predicated on the "likely case scenario" developed by Christiansen Capital Advisors for the state; however, the impact could be exacerbated if casinos are located closer to the Rhode Island/Massachusetts border. Table gaming at Twin River will bolster current operations, but will not fully compensate for lost revenues as Massachusetts moves forward with its gaming plans.

- Further revenue may also be lost through a shift in federal priorities away from state spending, specifically, federal aid and contracts related to sequestration. Although the size of the impact related to sequestration continues to be an unknown, reductions in federal spending will impact state-level budgets and tax revenue from associated businesses, as well as employment in associated fields.

- Projecting out-year expenditures is further complicated by uncertainties about outcomes related to recent heath care and pension reform efforts. Expanding the state's Medicaid population in 2014 will impact spending as the federal match is reduced, beginning in 2017. Additionally, health care reform will impact the way in which the state's health care providers will be reimbursed for free care and any premium based state fees. In addition, the state's future pension contributions will be dependent on the outcome of the mediation or litigation process.

- The proposed budget contains a number of investments in the state's future, including fully-funding the third year of the education funding formula, the acceleration of a number of infrastructure projects funded through RICAP funding, and the local road repair initiative. These examples demonstrate an investment-based approach to budgeting that should continue. However, the current uncertainty surrounding future revenues and expenditures makes prudent budgeting crucial now to avoid future tax increases or cuts to resolve out-year deficits.

RIPEC Comments

The Governor's budget shows a FY 2013 closing surplus of $79.3 million, the third consecutive year ending with a surplus. The closing surplus for FY 2013 is largely due to a larger-than-expected FY 2012 closing and lower–than-expected caseload estimates from the November Caseload Estimating Conference (CEC). Of note, there is no supplemental budget for FY 2013, as the administration expects that the majority of departmental spending will be at or lower than enacted levels. The FY 2014 budget process began with a projected deficit of $128.0 million, which is resolved without increasing any taxes. Instead, this revenue-expenditure gap is resolved through a combination of one-time revenues, expenditure adjustments, and cost-shifting.

Rhode Island's economy seems to be improving; however, the decisions made today, as the state creates and adopts a FY 2014 budget, will help create opportunities or barriers for the state as it moves out of the recession. In particular, the state faces four significant challenges in the out-years:

- The establishment of casino gambling in Massachusetts;
- The implementation of health care reform through the ACA, including, but not limited to, the expansion of Medicaid and the reduction in federal reimbursement for uncompensated care;

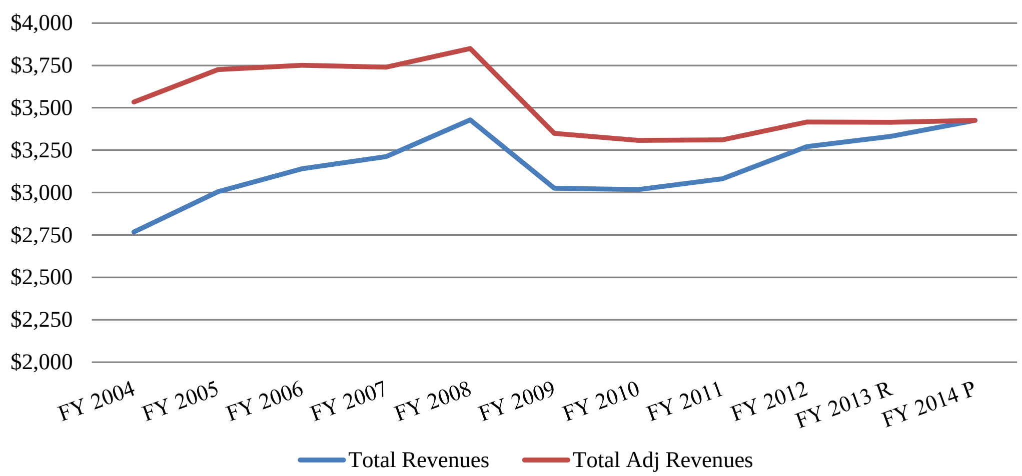
- Federal government spending reductions and a potential shift of federal priorities; and
- The outcome of pension reform mediation/litigation and whether contribution assumptions can be met.

It is not a question of whether these events will occur, but, rather, it is a question of the magnitude of their impact. Moreover, these four events are likely to occur within a fairly small time frame that could put significant pressure on the state budget. Now is the time to critically examine the state's spending and revenue priorities and structure.

In many ways, this budget takes an investment-based approach by focusing on government's core functions. Support for affordable higher education represents an investment in the state's future workforce. Expenditures related to infrastructure projects, especially the acceleration of shovel-ready projects funded through RICAP, will provide employment opportunities now and lay the foundation for a stronger Rhode Island in the future. Laying the groundwork to put the state on a solid foundation by focusing on funding investment-based initiatives and aligning state and taxpayer priorities, may promote investment and growth.

Recent revenue and expenditure trends indicate that Rhode Island's economy is beginning to recover after the Great Recession. In real terms, FY 2014 projected general revenues of $3,426.4 million have recovered to FY 2008 levels, as seen in chart 2. Similarly, FY 2014 projected expenditures from general revenues ($3,399.2 million) have also reached 2008 levels on an unadjusted basis. When adjusted for inflation, however, projected general revenues and general revenue expenditures in FY 2014 are about 11.0 percent lower than in FY 2008. While a recovery may be evidenced in nominal terms, in real terms the state's general revenues and expenditures remain below pre-recession levels. Furthermore, five-year estimates project expenditures will grow faster than both inflation and revenue increases through FY 2018.

Chart 2
Real and Adjusted General Revenues
FY 2004 - FY 2014P



SOURCE: State Budget Office documents; RIPEC calculations

Out-Year Uncertainties

Rhode Island's economy is dependent on the fiscal health of the nation as a whole, and on regional economic conditions. Although revenues have started to recover, the state has only just started to recover from the Great Recession. Three consecutive years of larger-than-anticipated surpluses and a slowing rate of growth in medical assistance spending have reduced the urgency of making difficult choices as in past years. Even with cautious planning, however, the unpredictable nature of the economic recovery, coupled with several major policy shifts, could exert pressure on the state's out-year budgets. As such, Rhode Island must continue to budget prudently by focusing on core government functions while being mindful of out-year implications.

Casino Gambling in Massachusetts

In response to the advent of casino gambling in Massachusetts, and the projected negative impact to Rhode Island casinos, Rhode Island voters approved the introduction of table games at Twin River in the 2012 election. However, the arrival of casinos in Massachusetts diverting revenue from Rhode Island facilities means that table gaming at Twin River will only mitigate, not prevent, revenue decline from the state's third largest source (behind income and sales tax; for more information, see "Impact of the Expansion of Gaming on State Finances in Rhode Island").

The impact of casino gambling in Massachusetts is a function of both time frame and location. A Massachusetts casino more proximate to Rhode Island could further reduce Rhode Island's gaming revenue. The projections used in the FY 2014 budget are for a "likely case" scenario with regard to the location of Massachusetts casinos that would result in $307.6 million in revenues lost between FY 2015 and FY 2018. A Massachusetts casino closer to Rhode Island, as in the "worst case" scenario, could result in greater revenue reductions for the state. Similarly, when the casinos open will determine when Rhode Island will begin to feel the impact on state revenues. Originally, the state assumed that a racino would open in FY 2015 and the other three casinos would open in FY 2016. Due to delays in the process in Massachusetts, the negative revenue impact has been pushed out by an additional year. Any changes to the Massachusetts timeline will continue to impact the state's forecast.

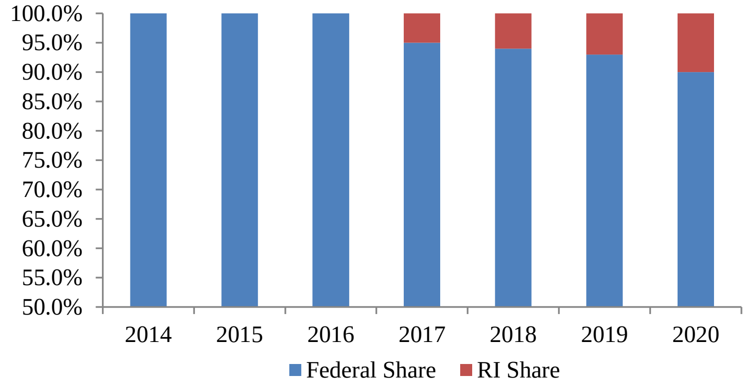
Affordable Care Act

The implementation of the Affordable Care Act, especially the provision to expand Medicaid, also creates uncertainties about potential future costs to the state. Some savings through reduced uncompensated care payments and the transition of some eligible Rhode Islanders from state-sponsored plans to Medicaid (such as the proposed shifting of some of the optionally covered populations) may produce short-term cost-savings to the state. Beginning in 2017, however, the state will begin to contribute to the share of Medicaid payments for newly eligible Rhode Islanders. Other factors, such as whether the reform will result in an increase of currently-eligible individuals opting in to the Medicaid program, increasing the state's obligation make predicting the net outcome of health care reform difficult.

Compounding the challenges is the potential impact of cuts to federal reimbursements for uncompensated care. While the ACA is projected to decrease the level of uncompensated care, this may have an impact on the state's revenue vis-à-vis the hospital licensing fee. At the same time, the decrease in reimbursements at the federal level may affect the ability of hospitals to provide these services and the state may have to reconsider the structure of the hospital licensing fee in order to ensure hospitals remain solvent going forward.

The federal match for Medicaid expansion declines from 100.0 percent to 90.0 percent by 2020 and thereafter as shown in chart 3, which will invariably increase state expenditures for Medicaid, assuming no changes are made to the program. Estimates of the state's uninsured population eligible for expansion range widely, making cost projections for the state's contribution to Medicaid expansion a challenge; however, it is clear that there will be an additional cost to the state as the federal match for the expansion population is phased down. Additionally, the so-called woodwork effect which suggests that individuals currently eligible, but unenrolled, for Medicaid may be enticed to enroll in the program, makes accurately predicting future obligations difficult. Of note, unlike the expansion population, coverage for currently-eligible Rhode Islanders will be matched at the current Federal Medical Assistance Percentage (FMAP) rate, requiring the state to pay for roughly half of the coverage.

Chart 3
Schedule of Enhanced Federal Medicaid Match



SOURCE: Kaiser Family Foundation, May 2010

Federal Funding Changes
Although the duration, and, subsequently, the impact of the sequester is unknown, federal budget cuts will have an effect on the state's budget in a number of ways. Reductions in federal expenditures will affect state-level budgets, long-term planning for industries dependent on government contracts, and other programs relying on federal funding. A recent report from the Congressional Budget Office proposes that national GDP growth could be reduced by as much as 1.5 percent over the next year as a result of the sequester. A continuing resolution, inclusive of the sequester cuts, was passed in March 2013. The cuts will be implemented by department in the coming months.

In Rhode Island and elsewhere, these cuts will translate to a loss of funding for education services, public health, and nutritional assistance for seniors, among others. If state-level expenditures cannot fill the gap in funding, programs may be suspended. In addition to a loss of services, jobs related to programs may also be eliminated. Moreover, the cuts to the defense budget will likely result in a reduction in industry jobs, with a potential ripple effect on the state's tax collections. Furthermore, the multiplier effect of a loss of services and reduced employment could intensify the negative impact of sequestration on the state's economic recovery.

Whether as a result of sequestration, or through other shifts in federal spending, less funding from the federal government is likely in the coming years. Since the impact of the reduction in federal dollars cannot be fully predicted, the state must prepare for lower reimbursements to programs and departments relying on federal funding accordingly.

State Pensions

The Rhode Island Retirement Security Act (RIRSA) of November 2011 reformed state pension contributions for public employees by reducing the state's unfunded liability and future payment obligations. However, a legal challenge over RIRSA has been filed and both sides were ordered into mediation in December 2012. The outcome of the mediation process (or litigation), will affect the state's contribution to the state's pension plan going forward. If the state does not prevail in court, not only will pension obligations increase to pre-legislation levels, the unpaid obligation will be amortized into future pension payments, further increasing the state's annual required contributions. Furthermore, ongoing market uncertainty and the potential for another economic contraction may affect the state's investment returns, thereby increasing the state's contribution even further.

As with the above issues, it is difficult to project the effect on the state's budget if RIRSA is overturned and if assumptions are not met. However, actuarial estimates from when the legislation was passed indicated that the state would see savings ranging from roughly $160 million in FY 2013 to just over $200 million in FY 2016. Based on these estimates, the additional annual required contribution would increase the size of the projected deficit by almost 80 percent in FY 2016, prior to the amortization of the underpayments in FY 2013 and FY 2014 or any actuarial changes.

Focus on the Future

Like many states around the country, Rhode Island continues to face a structural budget deficit and faces significant challenges with regard to resolving its budget imbalance. Years of recession have produced budgets that have already seen significant reductions in spending, leaving fewer options for future expenditure reductions, and there is little room to increase revenues at the present. Moreover, although out-year deficits are projected to be smaller than they were during the Great Recession, a number of unknowns have the potential to further increase the state's future budget imbalance. As such, the state must take proactive steps to build a sustainable budget that takes into account both the rate of budgetary growth and the myriad risks to the forecast as outlined above.

Concentrating expenditures on core governmental functions like education and infrastructure will help the state develop a foundation for sustainable growth. Such an approach is necessary to guarantee that resources will be available to support programs that will make Rhode Island a more prosperous state. Complimenting these investments should be initiatives to reinforce effective and efficient spending, such as regulatory reform and the development of an economic development plan. This investment-based approach, coupled with proactive economic development initiatives, will help mitigate the unknown impact of the above and will potentially decrease the state's structural budget problems.

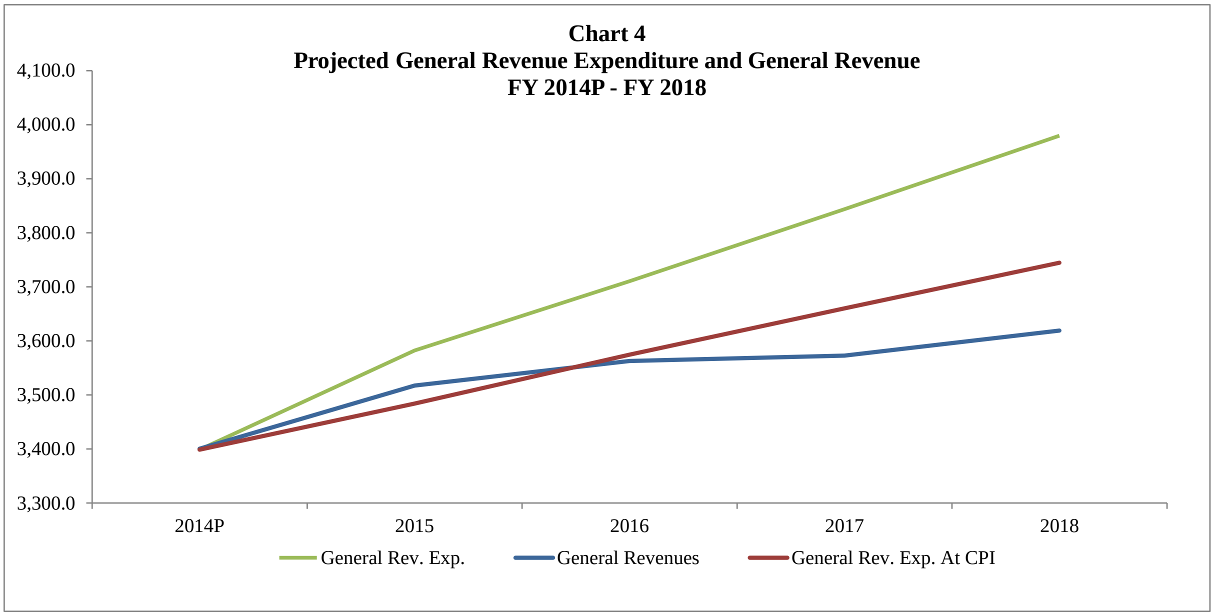
Supporting Strategic Investments
The Governor's FY 2014 budget takes an investment-based approach to the state's budget by focusing on a number of initiatives designed to improve the state's economic position in both the short- and long-term. For example, direct economic stimulation, like the proposal to accelerate shovel-ready construction projects, can put Rhode Islanders to work in the short-term. In the long-term, investments in education will make the workforce more competitive and establish a more robust infrastructure that may make Rhode Island a more desirable place to live and work.

The budget includes a number of initiatives designed to provide an economic stimulus in the short run. The majority of these include upgrading the state's infrastructure, which may, in turn, generate immediate employment opportunities, particularly for the struggling construction industry. Moving up $11.0 million in shovel-ready projects in the RICAP plan should help bolster employment, as well as provide necessary improvements to the state's infrastructure. The local roads initiative furthers another $10.0 million infrastructure investment across Rhode Island's municipalities. Similarly, the proposal to partially reinstate the Historic Preservation Investment Tax Credit, by using unallocated funds to support new projects, may allow for an additional short-term economic boost, as well as an opportunity to study the feasibility of the program going forward.

Long-term initiatives in the budget include a focus on workforce development. Specifically, the emphasis on affordable higher education – by providing additional state aid to state higher education institutions in order to facilitate a tuition freeze – may improve accessibility to higher education that could better prepare Rhode Island's workforce for the 21st century job market. Continued support for the educational funding formula, now in its third year, helps reinforce education as a priority for the state, while providing a predictable source of revenue for municipalities. Additionally, the budget provides for $3.0 million in workforce development proposals, part of which will go toward creating a state-wide internship program, intended to prepare Rhode Islanders for the workplace.

Managing Out-Year Deficits
More favorable than expected caseloads in November and higher than expected carry-overs from the end of FY 2012 contributed to the opening surplus for FY 2014; however, the state cannot continue to count on the continuation of these trends, which are the functional equivalent of one-time revenues, to balance the budget in the out-years. This is particularly true in the face of potential impacts of the variables discussed above. Although the budget takes into account the impact of casino gaming in Massachusetts, and incorporates some changes related to the ACA, issues such as the pension and impact of sequestration, as well as the full effect of the ACA, are not included, potentially understating the size of the deficit by a significant amount.

As shown in chart 4, budget projections through FY 2018 anticipate expenditures growing faster than both revenues and the rate of inflation, resulting in significant out-year budget gaps. Unchecked, these deficits represent a threat to the state's ability to support key government functions and will necessitate difficult choices in the future. While much of the growth in the state's deficits is related to lost gaming revenue, the rapid increase in expenditures must be brought under control.



The state must take a two-pronged approach to managing out-year deficits. First, it should proactively work to find areas in which programmatic change may result in a slowing of expenditure growth. This is particularly true with regard to medical assistance expenditures, which are the primary driver of the state's budget. Areas for consideration, some of which are contained in the budget, include continuing to look at vendor payments, more effective service delivery, and changes to eligibility. Second, the state should be careful to not commit to programs today that will be unsustainable in the future, simply because the budget situation appears to be better than it was a few years ago. The magnitude of projected current services deficits, even without taking into account potential risks to the budget, call for constrained budgeting in the near future.

Effective Expenditures

In conjunction with targeted investments to improve the state's workforce and economy, Rhode Island must continue to improve efficiencies and accountability. In setting investment targets, clear and measurable goals must be identified to determine progress and success, channeling resources to the highest priorities yielding solid results. The creation of the Office of Management and Budget and the emphasis on performance management will contribute to this goal, but only if its recommendations are reviewed and implemented strategically. Moreover, the General Assembly must continue to support this investment-based strategy, with spending concentrated on core governmental functions, designed to strengthen the state in the future. The state will be a better destination for investment if it invests its resources wisely.

FY 2013 Supplemental Budget

The Governor's FY 2013 supplemental budget decreases total expenditures by $20.2 million or 0.3 percent relative to enacted FY 2013 spending. Changes from the FY 2013 enacted budget to the supplemental budget include the following:

- General revenue funds decrease by $28.1 million (0.9 percent);
- Federal funds decrease 0.6 percent, or $17.2 million;
- Restricted receipts increase by $37.7 million, or 16.2 percent; and
- All other funds (including the gas tax) decrease 0.7 percent ($12.4 million).

Table 1
FY 2013 Supplemental Budget
($ millions)

Source of Funds	FY 2013 Enacted	FY 2013 Revised	Change
General Revenue	$3,295.8	$3,267.7	-0.9%
Federal Funds	2,676.3	2,659.1	-0.6%
Restricted Receipts	232.5	270.2	16.2%
Other Funds	1,895.2	1,882.8	-0.7%
Total	$8,099.9	$8,079.7	-0.3%

SOURCE: State budget documents; RIPEC calculations

Table 2
Changes to FY 2013 Enacted Budget ($ millions)

	FY 2013 Enacted	FY 2013 Revised	Change
Opening Surplus	$ 93.9	$ 115.2	$ 21.3
Other Adjustments	-	12.9	12.9
Re-appropriated Surplus	-	7.7	7.7
Subtotal Opening Surplus	*$ 93.9*	*$ 135.8*	*$ 29.0*
Revenues	$ 3,320.9	$ 3,320.9	$ -
November REC Changes to Enacted	-	7.5	7.5
Governor's Changes	-	2.8	2.8
Subtotal Revenues	*$ 3,320.9*	*$ 3,331.3*	*$ 10.3*
Cash Stablization Fund	$ (102.4)	$ (103.8)	$ (1.4)
Total Available Revenues	**$ 3,312.3**	**$ 3,363.3**	**$ 37.9**
Enacted Expenditures	$ 3,295.8	$ 3,295.8	$ -
November CEC Changes to Enacted	-	(24.3)	(24.3)
Reappropriations	-	7.7	7.7
Governor's Changes	-	(11.6)	(11.6)
Total Expenditures	**$ 3,295.8**	**$ 3,267.7**	**$ (28.2)**
Total Ending Balance	*$ 16.5*	*$ 95.6*	*$ 66.1*
Transfer to Other Funds	$ (16.4)	$ (16.4)	$ -
Free Surplus	**$ 0.1**	**$ 79.3**	**$ 79.1**

SOURCE: State budget documents; RIPEC calculations

The FY 2012 closing statements reflect a $115.2 million closing surplus, $12.9 million in other adjustments and a re-appropriated surplus of $7.7 million. In addition, the November 2012 Revenue Estimating Conference (REC) increased general revenues by an estimated $7.5 million. The Governor's revised FY 2013 budget includes $2.8 million in net additional revenues, reflecting an anticipated $4.4 million hospital licensing fee payment that was originally due in FY 2012, and a $1.6 million reduction in net lottery revenues due to additional staff needed to monitor table games at Twin River. After the $1.3 million cash stabilization adjustment, total available general revenues are projected to increase by $51.0 million relative to the enacted FY 2013 budget.

The Governor's revised budget includes a net decrease in expenditures of $28.2 million. Included in this total is a $24.3 million reduction in spending related to changes from the November 2012 Caseload Estimating Conference (CEC). Additional changes include:

- A $2.9 million decrease in teacher retirement;
- $4.1 million in non-reimbursable expenses relating to Hurricane Sandy ($3.0 million in RICAP funding);
- A proposal to remove the requirement that the state transfer surplus revenues to the state retirement system. This increase in available revenues ($12.8 million) is assumed in the Governor's budget;
- $1.0 million in additional funding for Workforce Development initiatives; and
- An increase of $5.0 million for additional Distressed Communities Aid.

FY 2014 Proposed Deficit Resolution

The projected FY 2014 deficit, based on current services levels, was estimated at $128.0 million. The Governor's budget resolution relies heavily on the use of the FY 2012 closing surplus of $77.0 million (net of the Rainy Day Fund transfer), which accounts for 59.5 percent of the total budget solution. Of note, this figure includes the assumption that the General Assembly will concur with the proposal to not make the $12.8 million payment to the state's retirement fund.

The balance of the Governor's proposed resolution is from revenue and expenditure modifications, which represent 21.6 percent and 18.9 percent of the resolution, respectively. Notably, the budget does not rely on any tax increases. Together, these changes result in an estimated FY 2014 closing of $1.4 million.

Table 3
FY 2014 Budget Deficit Resolution
as Recommended by Governor

	Amount $ millions	% of Total
Opening Surplus*	**$77.0**	**59.5%**
Revenue Modifications		
November REC*	$31.2	24.1%
Corporate Tax Changes	-5.3	-4.1%
Table Gaming Expenses	-4.3	-3.3%
Other Revenue Changes	6.3	4.9%
Total Revenue Modifications	**$27.9**	**21.6%**
Expenditure Modifications		
State Operations	1.6	1.2%
Local Aid & Education	-1.4	-1.1%
Health & Human Services Agencies	19.2	14.8%
Debt service reduction	5.6	4.3%
Other changes	-0.6	-0.5%
Total: Expenditure Modifications	**$24.4**	**18.9%**
Total	**$129.4**	**100.0%**
Closing Balance	***$1.4***	

* Net of Rainy Day Fund transfer

SOURCE: State budget documents; RIPEC calculations

Additional revenues are estimated to increase by a net $27.9 million. The majority of this increase ($31.2 million) is the result of the November REC. The Governor has proposed restructuring the corporate income tax by reducing the rate and eliminating credits, for a net revenue reduction of $5.3 million in FY 2014. The budget also includes a loss of $4.3 million in departmental revenues relating to table gaming expenses at Twin River. Other changes include an anticipated $5.6 million hospital licensing fee payment that was due in FY 2012, enhanced tax collection initiatives, and elimination of the Hazardous Substances Right to Know Fee.

The FY 2014 budget as proposed makes a number of expenditure adjustments across a number of state agencies. Select changes are highlighted below:

- The largest expenditure adjustments ($19.2 million) are within Health and Human Services agencies. Some of the proposed expenditure changes from these agencies include not providing a cost-of-living adjustment (COLA) to service providers ($14.5 million) and cost shifting related to the expansion of Medicaid coverage under the Affordable Care Act ($4.4 million).
- The budget also includes a number of local aid initiatives, such as increasing Distressed Communities Aid by $5.0 million and providing $10.0 million in local incentive aid, designed to encourage communities to improve the status of local pension plans. These changes are offset by the continued practice of level-funding PILOT and library aid, as well as other modifications to education spending.
- In addition, the proposed budget provides an additional $6.0 million in higher education support in order to help freeze tuition rates.
- Statewide expenditure adjustments include, among other changes, the elimination of health coverage for former spouses and changes to the state's prescription drug plan. Notably, the budget assumes no COLA in FY 2014 for state employees.

Revenues Summary

General Revenues

General revenues reflect those revenues that may be used for any purpose, as opposed to other sources of funding, which may be used only for specific purposes. These funds represent 41.6 percent of all funds. The majority of general revenues – approximately 75 percent – are derived from taxes including the personal income tax, general business taxes and sales taxes. The remaining revenue in the general revenue program is comprised of departmental receipts including the hospital licensing fee, lottery receipts, and other miscellaneous funds.

FY 2013 Revised Revenues

The Governor's FY 2013 revised budget includes a net increase in revenues of 0.3 percent ($10.4 million) when compared to the FY 2013 enacted budget. The majority of these changes – roughly 75 percent – reflect revisions made during the November 2012 Revenue Estimating Conference (REC). The balance reflects changes related to table gaming and deferred payments.

The REC forecasted a $2.3 million decrease in personal income taxes, a $17.2 million increase in general business tax collections, and a $7.3 million decrease in general sales and use taxes. Coupled with a $2.5 million reduction in all other taxes, total tax collections were projected to increase by $5.2 million over enacted estimates. In addition, the REC increased estimated departmental receipts by $4.6 million and decreased total revenues from other sources by $2.3 million, for a net increase of $2.3 million.

In addition to the REC changes, the budget includes an additional $4.4 million in departmental receipts, relating to a payment of the hospital licensing fee that was due in FY 2012, but not made due to the hospital being in receivership. Also included in the budget is a $1.6 million reduction in lottery revenues due to increased staffing needs at the department related to table gaming at Twin River.

Table 4
FY 2013 and FY 2014 Governor's Proposed General Revenue Program ($ millions)

General Revenues	FY 2012 Audited	FY 2013 Enacted	FY 2013 Revised	Change	FY 2014 Nov REC	FY 2014 Proposed	Change
Taxes							
Personal Income Tax	$1,060.5	$1,080.9	$1,078.6	-0.2%	$1,129.0	$1,130.8	0.2%
General Business Taxes	360.7	367.2	384.4	4.7%	388.6	382.7	-1.5%
General Sales & Use Tax	851.1	886.7	879.4	-0.8%	904.1	904.3	0.0%
Other Sales Taxes*	61.0	61.1	61.7	1.0%	61.9	61.9	0.0%
Cigarette Tax	131.1	138.1	137.7	-0.3%	137.4	137.4	0.0%
Other Taxes	54.2	44.2	41.5	-6.2%	43.2	43.2	0.0%
Subtotal - Taxes	*$2,518.4*	*$2,578.1*	*$2,583.3*	*0.2%*	*$2,664.2*	*$2,660.3*	*-0.1%*
Department Receipts**	$339.9	$342.9	$351.9	2.6%	$206.8	$353.3	70.8%
Other Sources	412.4	399.9	396.0	-1.0%	417.1	412.8	-1.0%
Total Revenues	**$3,270.7**	**$3,320.9**	**$3,331.3**	***0.3%***	**$3,288.1**	**$3,426.4**	***4.2%***

* Motor vehicle, motor fuel and alcohol sales taxes
** Department Receipts do not include hospital licensing fee
Source: State Budget Office documents, RIPEC calculations

FY 2014 Revised Revenues

General revenues in the Governor's FY 2014 proposed budget increase by 4.2 percent ($138.3 million) when compared to the REC. However, it should be noted that the REC estimates do not include the hospital licensing fee of $141.3 million as this payment must be reauthorized every year. When these funds are included, the FY 2014 proposed budget is $3.0 million lower than REC estimates. This decline is almost exclusively related to proposed changes in the business corporations tax, which would reduce revenues by an estimated $5.3 million. This decline is partially offset by provisions to increase tax enforcement and collections for income and sales taxes. Other changes include:

- A minor reduction in insurance companies gross premiums tax collections as a result of the proposed managed care rate reduction;
- A decrease of $0.4 million in health care provider taxes related to the suspension of the nursing home cost-of-living adjustment (COLA);
- An additional $5.6 million in revenue related to past-due collections of the hospital licensing fee payment from two hospitals; and
- A $0.4 million reduction in departmental revenues through elimination of the hazardous substances right to know fee.

2014 Proposed Tax Changes

The Governor's proposed FY 2014 budget does not include any tax increases, and total proposed tax changes are projected to result in a net tax revenue decrease of $3.9 million compared to November REC estimates. As noted above, the decline in tax revenue is driven by a $5.3 million net reduction in general business tax revenues related to changes in the business corporations tax. This revenue loss is partially offset by increased personal income tax revenue ($1.8 million) and sales and excise tax collections ($0.2 million) relating to enhanced collection efforts through the creation of a special investigation tax unit and relying on collection companies to collect past-due final payments from out-of-state individuals.

General Business Tax Changes
The Governor's proposal includes a reduction in the state's corporate tax rate from 9.0 percent to 7.0 percent over three years. Reductions in revenue from this rate reduction will be partially offset by changes to two current tax credits: the Enterprise Zone Tax Credit, and the Jobs Development Act Credit:

- The Enterprise Zone Credit is given to businesses located in certified Enterprise Zones and is equal to 50.0 percent of wages paid to newly-hired workers, capped at $2,500 per year ($5,000 per year if the worker resides in an Enterprise Zone). Companies must hire at least 5.0 percent more employees than the previous year to be eligible. It is expected that eliminating this credit would result in additional revenues of $3.0 million through FY 2018.
- The Jobs Development Act Credit allows for an incremental reduction in the corporate income tax rate for corporations that create and retain new employment in the state over a three-year period. Companies may reduce their tax rate by one-quarter for every additional unit of employment (units of employment vary based on the size of the corporation). Under the proposed corporate income tax rate reduction, the jobs development credit would be phased-down to 75.0 percent of its current value in tax year 2014, and to 50.0 percent of its current value thereafter.

Table 5
Proposed Changes to Business Tax Revenue ($ millions)

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Corporate Income Tax Rate Phased Reduction	($8.0)	($21.1)	($31.1)	($36.7)	($37.6)
Jobs Development Act Phased Reduction	2.4	7.5	10.4	10.8	11.0
Enterprise Zone Wage Tax Credit Elimination	0.3	0.6	0.7	0.7	0.7
Total Impact	**($5.3)**	**($12.9)**	**($20.1)**	**($25.2)**	**($25.9)**

SOURCE: RI Office of Management and Budget; House Fiscal Office

Under the Governor's proposal, the business corporations tax rate would be reduced from 9.0 percent to 8.0 percent, beginning in tax year 2014 (the last two quarters of FY 2014), resulting in a revenue decrease of $8.0 million for FY 2014. Revenues continue to decline in FY 2015 (by $21.1 million) and in FY 2016 (by $31.1 million). When combined with the elimination of the Enterprise Zone and phased reduction of the Jobs Development Act Credit, there is a projected net revenue loss of $5.3 million in FY 2014.

Expenditure Summary

Overview

As proposed, the Governor's FY 2014 budget includes all funds expenditures of $8,172.5 million, a 0.9 percent ($72.6 million) increase from the FY 2013 enacted budget. The budget includes projected increases in expenditures for personnel ($21.4 million), local aid ($47.9 million), grants and benefits ($113.5 million), capital ($9.3 million), and operating transfers ($2.4 million) totaling $194.5 million. The proposed 4.2 percent increase in local aid represents the largest percent increase in spending by category between the FY 2013 enacted and FY 2014 proposed budgets. Operating costs and debt service are projected to decline by $117.0 million and $5.0 million, respectively. The largest proposed reduction in spending, both net, and on a percent basis, is from operating expenditures; however, the reduction is primarily due to a change in the budget presentation for Eleanor Slater Hospital, distorting the comparison with prior years.

Table 6
Rhode Island State Spending - All Funds ($ millions)

By Category	2004	2013E	2013 R	2014P	2013E-14P Change
Personnel	$ 1,363.0	$ 1,824.5	$ 1,823.8	$ 1,846.0	$ 21.4
Operating	432.2	690.7	709.0	573.7	(117.0)
Local Aid	1,072.0	1,129.9	1,131.0	1,177.8	47.9
Grants & Benefits	2,589.3	3,665.1	3,595.2	3,778.6	113.5
Capital	169.7	370.5	375.5	379.8	9.3
Debt Service	150.5	274.4	283.4	269.4	(5.0)
Operating Transfer*	-	144.7	161.8	147.1	2.4
Total	$ 5,776.6	$ 8,099.9	$ 8,079.7	$ 8,172.5	$ 72.6
By Fund	**2004**	**2013E**	**2013R**	**2014P**	**Change**
General Revenue	$ 2,726.5	$ 3,295.8	$ 3,267.7	$ 3,399.2	$ 103.4
Federal Funds	1,835.0	2,676.4	2,659.1	2,645.1	(31.3)
Restricted Funds	141.1	232.5	270.2	252.8	20.3
Other Funds	1,074.0	1,895.2	1,882.8	1,875.5	(19.7)
Total	$ 5,776.6	$ 8,099.9	$ 8,079.7	$ 8,172.5	$ 72.6

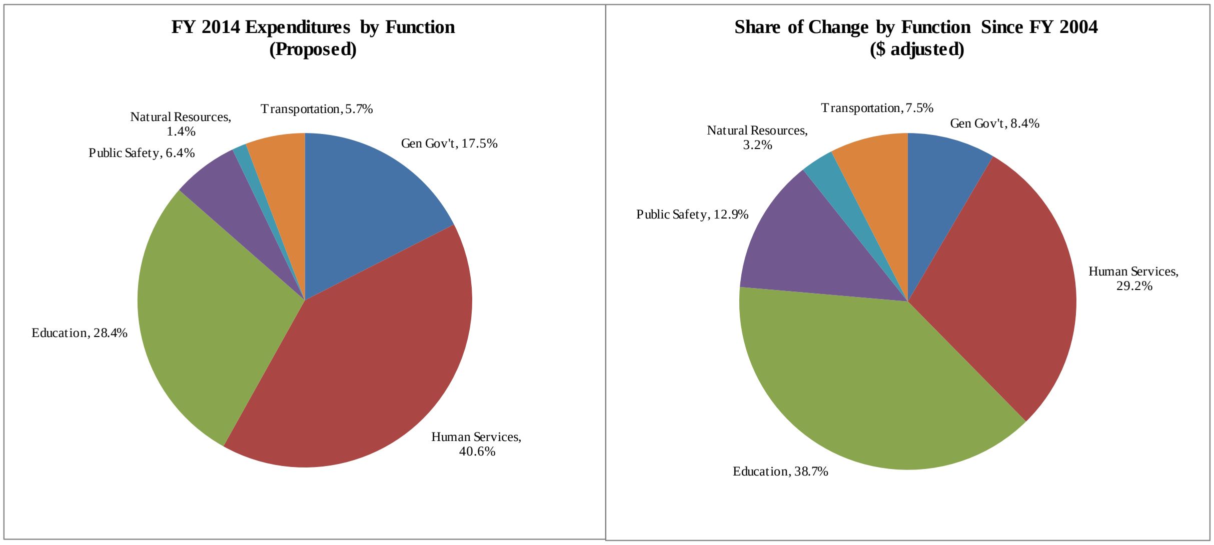
E = Enacted, R = Revised, P = Proposed
* Operating transfer is a change in accounting that was not in place in FY 2004
Source: RIPEC calculations based on State Budget Office data

General revenue expenditures of $3,399.2 million account for the majority of spending, supporting 41.6 percent of the total FY 2014 proposed budget. Expenditures from federal funds (the single largest share of which is Medicaid funds) of $2,645.1 million are 32.4 percent of total proposed spending and represent the second largest source of support. Expenditures from other funds (primarily university and college funds, and employment and training funds) total 22.9 percent of all spending and are the third largest source of funding in the FY 2014 budget. The smallest category of expenditures is from restricted receipts, representing just 3.1 percent of the total state budget.

All Funds Expenditures

Rhode Island allocates expenditures by both function and category. Function indicates spending by agencies with like programs and purposes and includes general government, human services, education, public safety, natural resources, and transportation. Chart 5 shows FY 2014 expenditures by function and the inflation-adjusted share of growth by function since FY 2004.

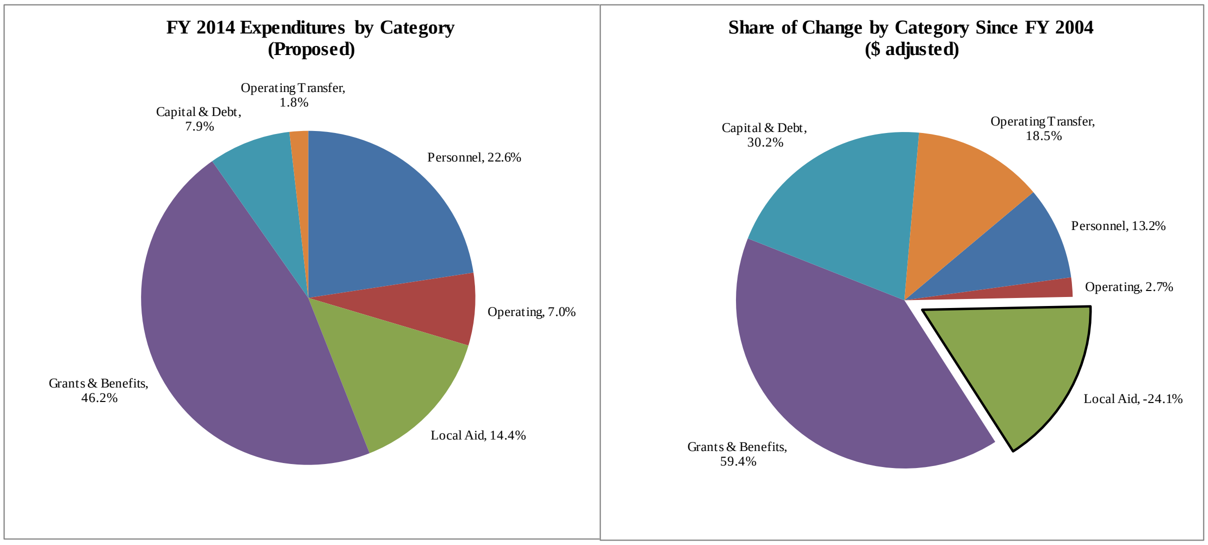
Chart 5
Expenditures by Function and Adjusted Share of Change Since FY 2004



SOURCE: State Budget Office documents; RIPEC calculations

- Human services expenditures, which include spending on entitlement programs (e.g., supplemental security income, cash assistance and medical assistance), elderly services, state hospitals, etc., represent the largest share of total FY 2014 expenditures ($3,316.7 million, 40.6 percent).
- Expenditures for human services programs also represent the second largest share of adjusted growth ($241.1 million), and the largest share of unadjusted growth ($901.4 million) since FY 2004. These programs account for nearly $0.30 of every new dollar spent since FY 2004.
- The proposed $2,318.8 million in education expenditures (i.e., elementary and secondary education, higher education, arts, historical preservation and heritage, and public television) represents the largest share of adjusted growth (and second largest share of unadjusted growth) by function since FY 2004.
- Since FY 2004, education spending has increased by $307.8 million in adjusted terms ($0.39 of every new dollar), the largest share of the increase in expenditures over the past ten years. In unadjusted terms, growth in education expenditures is $744.3 million.
- Combined public safety, natural resources and transportation represent 13.5 percent of the FY 2014 budget and 23.6 percent of adjusted growth (16.2 percent of unadjusted growth) over the past ten years.
- Proposed general government expenditures, that is, spending for programs that support all other functions including general government type activities, account for 17.5 percent of FY 2014 expenditures.
- Adjusted general government expenditures have increased by 6.3 percent ($67.1 million) since FY 2004, while unadjusted expenditures have increased 17.5 percent ($363.0 million).

Chart 6
Expenditures by Category and Adjusted Share of Change Since FY 2004



SOURCE: State Budget Office documents; RIPEC calculations

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. As shown on chart 6:

- Grants and benefits spending of $3,778.6 million for programs that provide direct support to individuals such as Medicaid, child care, and unemployment benefits, represent the largest all funds expenditure category, accounting for 46.2 percent of total proposed expenditures in FY 2014.
- Spending on grants and benefits also accounts for the largest share of the adjusted spending increase over the past ten years. Of every new dollar spent since FY 2004, $0.59 has gone to support the increase in grants and benefits spending. In unadjusted terms, proposed spending on this category is an increase of $1,189.3 million over the past ten years, representing approximately half of the total growth in expenditures during this time.
- Combined, personnel and operating expenditures represent the second-largest category of spending in FY 2014, accounting for 29.6 percent of proposed expenditures.
- Since FY 2004, adjusted personnel expenditures have increased by $122.5 million, while adjusted operating expenditures have increased by $4.9 million (unadjusted increases of $496.5 million and $128.3 million, respectively). Together, these two categories of spending account for $0.16 of every new dollar spent since FY 2004.
- The third largest category of expenditures is local aid, which includes education aid and other direct assistance to municipalities. In the FY 2014 proposed budget, proposed local aid expenditures of $1,177.8 million constitutes 14.4 percent of all expenditures.
- Local aid was the only category of expenditures to see a decrease (on an adjusted basis) between FY 2004 and the FY 2014 proposed budget. Over the ten-year period, adjusted local aid spending has decreased by 24.1 percent. In unadjusted terms, local aid expenditures proposed in the FY 2014 budget are $105.8 million more than in FY 2004, an increase of roughly 10.0 percent.

- Proposed capital and debt service expenditures account for 7.9 percent of the total FY 2014 budget. Since FY 2004, capital and debt expenditures have accounted for $0.30 of every new dollar in state expenditures. On an unadjusted basis, these expenditures account for $329.0 million, or 13.7 percent, of the total increase over the past ten years.
- The $147.1 million operating transfer category reflects transfers between state and quasi-government agencies. While this category of spending accounts for almost $0.19 of every new dollar in state spending, the category did not exist in FY 2004. The addition of this category impacts the distribution of funds across categories when comparing FY 2004 and proposed FY 2014 expenditures.

General Revenue Expenditures

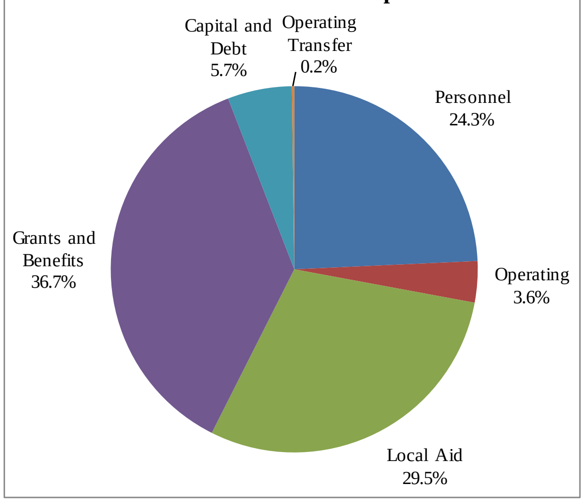
General revenue expenditures – effectively unrestricted spending that is primarily from own-source revenue – account for the largest share of total spending by fund (41.6 percent of all funds spending). Proposed FY 2014 general revenue expenditures of $3,399.2 million are 3.1 percent higher than FY 2013 enacted general revenue expenditures. The majority of this increase ($94.9 million, 91.7 percent) is related to growth in grants and benefits, partially attributable to increases in long-term care expenditures. Proposed local aid spending of $1,002.7 million for FY 2014 represents a 4.2 percent, $40.3 million increase over FY 2013 spending, accounting for a 38.9 percent share of the overall spending increase.

Table 7
FY 2013 and FY 2014 General Revenue Expenditures
($ millions)

Expenditure Category	FY 2013 Enacted	% of Total	FY 2014 Proposed	% of Total
General Operations				
Personnel	$858.4	26.0%	$825.2	24.3%
Operations	126.2	3.8%	123.9	3.6%
Subtotal Operations	*$984.6*	*29.9%*	*$949.1*	*27.9%*
Subtotal Grants & Benefits	*$1,152.8*	*35.0%*	*$1,247.7*	*36.7%*
Subtotal Local Aid	*$962.4*	*29.2%*	*$1,002.7*	*29.5%*
Capital Expenditures				
Capital	$5.6	0.2%	$6.7	0.2%
Debt Service	184.4	5.6%	185.8	5.5%
Subtotal Capital	*$190.0*	*5.8%*	*$192.5*	*5.7%*
Operating Transfer	*$5.9*	*0.2%*	*$7.1*	*0.2%*
Total	**$3,295.8**	**100.0%**	**$3,399.2**	**100.0%**

Source: State Budget Documents and RIPEC calculations

Chart 7
FY 2014 Expenditures by Category as a % of Total General Revenue Expenditures



- Proposed grants and benefits spending of $1,247.7 million accounts for 36.7 percent of total FY 2014 proposed general revenue expenditures. Proposed FY 2014 expenditures in this category are 8.2 percent ($94.9 million) higher than FY 2013 enacted spending.
- Spending on personnel and operating expenditures accounts for 27.9 percent of the FY 2014 proposed general revenue budget. The proposed $949.1 million in general revenues expenditures is 3.6 percent less ($35.5 million) than in FY 2013 enacted.

- Proposed local aid expenditures increase from $962.4 million in FY 2013 to $1,002.7 million in FY 2014, an increase of $40.3 million (4.2 percent). Local aid accounts for 29.5 percent of the total FY 2014 general revenue budget.
- Total proposed general revenue expenditures for capital and debt service increase 1.3 percent, from $190.0 million (5.8 percent) in the FY 2013 enacted budget to $192.5 million (5.7 percent) in the FY 2014 proposed budget.
- The FY 2014 proposed budget includes an increase in general revenue-supported operating transfer expenditures of $1.2 million (20.3 percent), from $5.9 million in FY 2013 to $7.1 million in FY 2014.

Budget Drivers

Overview

Table 8 outlines total adjusted expenditures between FY 2004 and FY 2014 by expenditure category and select subcategories. As shown on the table, although total spending has increased on an adjusted basis, not all categories or subcategories of expenditures have increased over the past decade. For example, adjusted expenditures in six of the 10 subcategories shown under grants and benefits decreased over the past decade by $174.4 million. This decrease, however, was offset by increases in medical assistance, higher education and other grants and benefits, which increased by a total of $781.7 million. The following provides a summary of expenditure highlights by category and notes areas of budget growth over the past decade. Detailed, select expenditure changes are included in the following sections.

Personnel/Operations

- Proposed expenditures for FY 2014 general operations (personnel and other state operations) of $2,419.7 million are 5.5 percent ($127.0 million) higher than adjusted FY 2004 expenditures. Together, these two categories account for 16.0 percent of the total adjusted growth between FY 2004 and FY 2014.
- Although salaries account for the largest share of unadjusted growth in personnel costs during the past decade, retirement expenditures account for the largest share of personnel spending on an adjusted basis.
- Since FY 2004, retirement costs have increased at a faster rate than any other personnel expenditure and have more than doubled on an unadjusted basis (from $79.1 million to $181.2 million).
- Although the Governor's proposed FY 2014 budget does not include funding for a COLA for state employees, most current labor contracts will expire at the end of FY 2013. The budget does include a proposed $150,000 for labor contract negotiations in FY 2013 and FY 2014.
- The budget also includes a proposed $1.3 million in general revenues for an outside review of the state's employee classification system, including $250,000 in the FY 2013 revised budget, for a personnel study.

Grants and Benefits

- The decline in income supports from $501.4 million in FY 2004 to $408.3 million in FY 2014 is largely related to changes in unemployment benefits. After increasing rapidly during the recession, unemployment benefits have fallen consistently since the FY 2012 budget.

- As noted above, the $471.7 million increase in adjusted grants and benefits expenditures between FY 2004 and FY 2014 is related primarily to increases in medical assistance ($313.8 million).
- Growth in Medicaid managed care accounted for about one-quarter of the total budget growth between FY 2004 and FY 2014. When all other medical assistance is included, these expenditures accounted for 39.5 percent of the share of spending increases over the past decade.
- The proposed FY 2014 budget makes a number of changes to medical assistance (Medicaid) programs related to the Affordable Care Act. Among the changes is shifting certain eligible populations, now eligible for coverage under Medicaid, from state-based programs to Medicaid in order to qualify for the 100 percent federal match. In total, these changes are projected to result in general revenue savings of $4.2 million.
- Adjusted spending on cash supports related to Rhode Island Works (formerly the Family Independence Program), the state's program under Temporary Assistance to Needy Families (TANF) has decreased by $63.6 million (62.9 percent) over the past decade.
- Similarly, child care assistance expenditures have decreased by $51.4 million (50.0 percent) during the same timeframe.
- Adjusted grants and benefits for higher education have almost doubled over the past ten years, from $148.9 million in FY 2004 to $294.9 million in FY 2014, accounting for about a fifth of the total budget increase during this time.

Local Aid

- Local aid expenditures declined 24.1 percent ($191.3 million), on an adjusted basis, over the past decade. Adjusted FY 2004 local aid spending accounted for 18.6 percent of total expenditures, while proposed FY 2014 local aid accounts for 14.4 percent of proposed spending. On an unadjusted basis, local aid expenditures increased $105.8 million over the last decade, but decreased as a share of overall spending.
- The reduction in the motor vehicle excise tax phase-out reimbursement and elimination of general revenue sharing account for a combined total reduction of $189.8 million ($146.4 million unadjusted) since FY 2004.
- The reduction of the reimbursement for the phase-out of the motor vehicle excise tax was the largest decrease – both on an absolute and as a share of the total change – in any expenditure category over the ten-year period, accounting for an 11.7 percent decrease in total spending during the time period on an adjusted basis (-4.0 percent, unadjusted).
- Education aid to local governments has decreased by 2.6 percent ($24.5 million), on an adjusted basis, over the past decade. In unadjusted dollars, local education aid increased $181.8 million, or 24.4 percent, during the same time period.
- The Governor proposes fully funding the third year of the education funding formula, increasing direct education aid expenditures by $27.7 million over FY 2013 revised spending. The budget also includes increases in most categorical aid programs (e.g., transportation, high-cost special education and early childhood funds), and eliminates expenditures for the regionalization bonus.
- Other local aid increased by $7.5 million, or 13.7 percent, on an adjusted basis. This category includes pass-through, distressed communities, and library aid, the state's property revaluation reimbursement program, and municipal fire and police incentive pay.

- Both federal aid and PILOT increased on an inflation-adjusted basis by $0.1 million and $5.3 million, respectively. On an unadjusted basis, these categories increased $29.7 million and $11.4 million, respectively, between FY 2004 and FY 2014.
- The Governor proposes creating a municipal incentive aid program totaling $10.0 million for FY 2014. Communities must meet certain criteria related to their pension plans to qualify for this funding. The proposed program would run from FY 2014 through FY 2016.

Capital, Debt and Operating Transfer

- The remaining categories, capital expenditures, debt service and the operating transfer account for 9.7 percent of total FY 2014 proposed expenditures.
- Adjusted spending on capital and debt increased by 58.8 percent in the past decade, accounting for 30.2 percent of the total increase in spending during this time.
- Proposed FY 2014 capital and debt expenditures of $649.2 million represent 7.9 percent of the total budget, compared to adjusted FY 2004 spending of $408.9 million (5.5 percent of the budget).
- The Governor's proposed budget includes $23.3 million for historic tax credit debt service and a proposal to use abandoned credits to fund new projects, while keeping the program within the original $300 million debt authorization.
- The Governor recommends using $10.0 million in Rhode Island Capital Plan (RICAP) funds for a local roads program. An additional $11.2 million is recommended to advance shovel-ready RICAP projects.
- The FY 2014 budget includes a payment of $2.4 million from general revenues for the debt service related to the $75.0 million Job Creation Guaranty Loan given to 38 Studios. Debt service will continue through FY 2021, for a total amount of $89.2 million.
- The FY 2014 budget is consistent with the state's use of general revenues for the Rhode Island Public Transit Authority's debt service payments for two years, to reduce the Authority's projected operating shortfall.
- The Governor recommends $900,000 from the Rhode Island Capital Plan funds for capital expenditures moved to free up the Convention Center Authority's operating funds to reduce a projected shortfall.
- The operating transfer category, which was not included in the FY 2004 budget, accounts for 1.8 percent of the FY 2014 proposed budget ($147.1 million).

Table 8
Rhode Island State Budget Drivers - All Funds (inflation-adjusted, $ millions)

Expenditure Category	FY 2004 Actual	FY 2004 % of Total	FY 2014 Proposed Base	FY 2014 Proposed % of Total	Actual Increase	Percent Change	Share of Increase
General Operations							
Personnel	$ 1,740.8	23.6%	$ 1,846.0	22.6%	$ 105.2	6.0%	13.2%
Operations	551.9	7.5%	573.7	7.0%	21.8	4.0%	2.7%
Subtotal - Operations	$ 2,292.7	31.1%	$ 2,419.7	29.6%	$ 127.0	5.5%	16.0%
Grants & Benefits							
Income Support (TDI & Employ)	$ 501.4	6.8%	$ 408.3	5.0%	$ (93.1)	-18.6%	-11.7%
Medical Assistance - Mgd Care*	418.9	5.7%	602.2	7.4%	183.3	43.8%	23.1%
Medical Assistance - All Other*	1,010.0	13.7%	1,140.5	14.0%	130.5	12.9%	16.4%
Development Disabilities	232.6	3.2%	212.3	2.6%	(20.2)	-8.7%	-2.5%
Child Welfare	143.4	1.9%	119.4	1.5%	(24.0)	-16.7%	-3.0%
TANF	101.1	1.4%	41.3	0.5%	(59.8)	-59.1%	-7.5%
Child Care	102.8	1.4%	51.4	0.6%	(51.4)	-50.0%	-6.5%
SSI	34.0	0.5%	18.8	0.2%	(15.2)	-44.7%	-1.9%
Higher Education	148.9	2.0%	294.9	3.6%	146.0	98.0%	18.4%
Other Grants & Benefits	613.8	8.3%	889.4	10.9%	275.6	44.9%	34.7%
Subtotal - Grants & Benefits	$ 3,306.9	44.8%	$ 3,778.6	46.2%	$ 471.7	14.3%	59.4%
Local Aid							
Education Aid	$ 950.8	12.9%	$ 926.3	11.3%	$ (24.5)	-2.6%	-3.1%
Motor Vehicle Phase-out	134.1	1.8%	10.0	0.1%	(124.1)	-92.5%	-15.6%
General Revenue Sharing	65.7	0.9%	-	0.0%	(65.7)	-100.0%	-8.3%
PILOT	27.7	0.4%	33.1	0.4%	5.3	19.3%	0.7%
Incentive Aid	-	0.0%	10.0	0.1%	10.0	-	1.3%
Federal Aid	136.2	1.8%	136.3	1.7%	0.1	0.1%	0.0%
Other**	54.6	0.7%	62.1	0.8%	7.5	13.7%	0.9%
Subtotal - Local Aid	$ 1,369.1	18.6%	$ 1,177.8	14.4%	$ (191.3)	-14.0%	-24.1%
Capital Expenditures							
Capital Expenditures	$ 216.7	2.9%	$ 379.8	4.6%	$ 163.1	75.2%	20.5%
Debt Service	192.2	2.6%	269.4	3.3%	77.2	40.2%	9.7%
Subtotal - Capital	$ 408.9	5.5%	$ 649.2	7.9%	$ 240.3	58.8%	30.2%
Operating Transfer***	-	0.0%	$ 147.1	1.8%	$ 147.1	-	18.5%
Total	**$7,377.5**	**100.0%**	**$8,172.5**	**100.0%**	**$ 794.8**	**10.8%**	**100.0%**

Source: RIPEC calculations based on state budget data - State Budget Office, DOA

* Prior to the FY 2010 budget year, the category "Rhody Health" was allocated throughout Medical Assistance incl. Managed Care; it is now designated as a separate category and incl. in "all other" in this table. As such, year-to-year comparisons should be made with caution.
** Includes: Pass-through, distressed communities, and library aid; property revaluation program; municipal fire and police incentive pay.
*** Operating transfer is a change in accounting that was not in place in FY 2004; prior to FY 2009 these expenditures were either in the grants and benefits category or in operations.

Personnel

Proposed FY 2014 personnel expenditures total $1,846.0 million, an increase of $22.3 million, or 1.2 percent, when compared to the Governor's revised FY 2013 budget. When compared to the FY 2004 budget, personnel expenditures increased from $1,354.2 million ($1,729.3 million adjusted). This represents an increase of 36.3 percent (6.7 percent adjusted). During this time, the unadjusted average cost per full-time equivalent (FTE) has increased 36.5 percent, from $70,336 in FY 2004 to $96,017 in FY 2014. On an adjusted basis, the average cost per FTE increased by $6,197, or 6.9 percent.

Table 9
State Personnel Costs - Unadjusted ($ millions)

Personnel Costs	FY 2004 Actual	FY 2013 Revised	FY 2014 Proposed	FY 2013 Revised - FY 2014 Actual Change	FY 2013 Revised - FY 2014 Percent Change
Salaries & Benefits					
Net Salaries	$ 794.6	$ 955.7	$ 966.8	$ 11.0	1.2%
Adjustment for Temp	(83.3)	(79.5)	(79.5)	(0.1)	0.1%
Overtime	61.3	59.6	50.3	(9.4)	-15.7%
Retirement*	79.1	166.5	181.2	14.7	8.8%
Medical	149.7	174.3	187.5	13.2	7.6%
Retiree Health (OPEB)**	-	53.5	59.9	6.3	11.8%
Other Benefits/Payroll***	74.0	90.3	90.6	0.3	0.3%
Salaries & Benefits	*$ 1,075.4*	*$ 1,420.6*	*1,456.7*	$ 36.1	2.5%
Funded FTE Positions	**15,289.4**	**15,102.5**	**15,171.6**	**69.1**	**0.5%**
Average Cost Per FTE	**$70,336**	**$94,063**	**$96,017**	**$5,389**	**5.7%**
Other Personnel Costs					
Other Payroll Costs****	$ 111.1	$ 111.2	$ 111.5	$ 0.3	0.3%
Purchased Services	167.7	292.0	277.7	(14.3)	-4.9%
Other Personnel	*$ 278.8*	*$ 403.2*	*$ 389.2*	*$ (14.0)*	*-3.5%*
Total Personnel Costs	**$ 1,354.2**	**$ 1,823.7**	**$ 1,846.0**	**$ 22.3**	**1.2%**

Source: State Budget Office and Personnel Supplements
* Includes Defined Contribution Plan as of FY 2013
** 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

Retirement costs remain the fastest growing component of total personnel expenditures over the decade, increasing by $102.1 million, or 129.2 percent between FY 2004 and FY 2014. When these figures are adjusted for inflation, retirement costs increased from $101.0 million in FY 2004 to $181.2 million in FY 2014, or 79.5 percent. In FY 2004, retirement costs accounted for 7.4 percent of salaries and benefits, compared to 12.4 percent in FY 2014.

In addition to increases in retirement expenditures, the largest benefit increase is for medical benefits. On an unadjusted basis, medical benefits have increased by 25.3 percent since FY 2004, from $149.7 million to $187.5 million in the proposed budget. However, in adjusted terms, medical benefits are projected to decline by 1.9 percent over the same period, and have decreased from 13.9 percent of salaries and benefits in FY 2004 to 12.9 percent in FY 2014.

Although retiree health was not shown as a separate category in FY 2004, this category of expenditures is one of the fastest-growing in the overall personnel budget, increasing by 9.3 percent between the FY 2013 enacted and the FY 2014 proposed budget. As a cost-saving measure, the Governor has proposed creating a statewide Medicare exchange for eligible retirees.

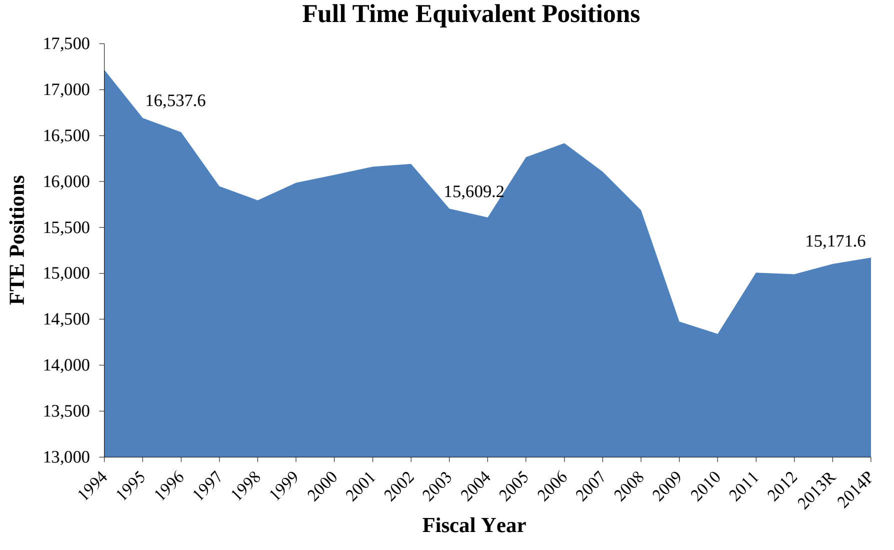
Several initiatives in the proposed FY 2014 budget are projected to generate savings in current and retiree health insurance costs, such as eliminating state health coverage for former spouses of state employees, and to replace prescription Nexium with a generic equivalent. These proposals are expected to result in health insurance cost savings for the state. Additionally, a proposal to extend the state's contract with Delta Dental for two years will reduce the annual increase in current dental services from 6.0 to 3.0 percent. Lastly, expected medical inflation rates are projected to fall to 5.8 percent for FY 2014, reducing the state's projected expenditures in this category.

In addition to the above initiatives, the Governor's proposed FY 2014 budget does not include a cost-of-living increase for state employees, though most contracts expire at the end of FY 2013. The budget includes $150,000 for contract negotiations in FY 2013 and FY 2014. In addition, the revised FY 2013 and proposed FY 2014 budgets include $1.3 million for an outside review of the state's personnel classification system and other personnel initiatives.

FTE Authorization

In order to manage staffing levels in state government, the state allocates FTE 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, these positions are included in the totals here for comparison purposes.

Chart 8
Full Time Equivalent Positions



- The FY 2013 enacted budget authorized 15,026.3 FTE positions; the revised budget includes a total FTE authorization of 15,102.5, 76.2 higher than in the FY 2013 enacted budget.
- As of January 2013, a total of 13,671.9 positions were filled in the state, 1,354.4 FTE positions lower than the enacted cap.
- There are a total of 15,171.6 FTEs, including 776.2 higher education positions, authorized in the Governor's FY 2014 budget. This represents a 0.5 percent increase over FY 2013 revised levels.
- Changes in FTE authorization include: a reduction in the Department of Labor and Training FTE positions by 70.5 positions due to the end of Extended Benefits Unemployment Insurance federal funds; an increase of 40.5 FTE positions in the Department of Administration due to program adjustments and relocation, including 15.0 FTE positions to staff the Health Exchange; an increase of 34.0 FTE positions in the Department of Revenue, including 31.0 in FY 2013 in the Lottery Division to supervise the recently-approved table gaming at the Twin River Casino; an increase of 101.9 FTE positions over the FY 2013 enacted budget for the departments within the Executive Office of Health and Human Services (EOHHS), largely to replenish health care and community workers; and an increase of 47.0 FTE positions in public safety, mostly related to the 2013 State Trooper Academy class.

Grants and Benefits Programs

Proposed grants and benefits expenditures for FY 2014 total $3,778.6 million, accounting for 46.2 percent of the total budget. Of this total, general revenue funds account for $1,247.7 million of expenditures for grants and benefits, an increase of 8.2 percent from FY 2013 enacted general revenue expenditures. Of note, this category is particularly impacted by the reforms related to the Affordable Care Act (ACA), especially Medicaid expansion. In anticipation of the October 2013 start date for enrollments in the state's Health Benefits Exchange, departments within the Executive Office of Health and Human Services (EOHHS) have started the foundational work associated with implementation of the ACA.

Medical Assistance

Medical assistance represents the single largest category of expenditures, as well as the fastest-growing category of spending in the budget. Expenditures, as presented on table 10, reflect Medicaid expenditures within the EOHHS, to which expenditures formerly in DHS were moved in the FY 2013 budget. These expenditures account for about two-thirds of total Medicaid spending and include expenditures related to hospitals, nursing homes, managed care (primarily RIte Care), and pharmacy expenditures. Projected managed care savings (specifically, Rhody Health), driven by lower-than-expected November caseload estimates and downward revisions to capitation rates, are largely responsible for the decline of expenditures for several programs between the enacted FY 2013 budget and the proposed FY 2014 budget. It should be noted that prior to the FY 2010 budget year, "Rhody Health" was allocated throughout Medical Assistance including Managed Care; it is now designated as a separate category. As such, year-to-year comparisons should be made with caution.

Table 10
FY 2004 - 2014 Unadjusted Medical Assistance Expenditures ($ millions)

Medical Assistance Program	FY 2004 Audited	FY 2013 Enacted	FY 2013 Revised	FY 2014 Proposed	FY 2013 R - 2014 P Change	%
Hospitals	$124.7	$95.2	$92.6	$91.8	($0.8)	-0.9%
DSH	107.3	127.7	127.7	129.8	$2.1	1.7%
Subtotal	*$232.0*	*$222.9*	*$220.3*	*$221.6*	$1.3	0.6%
Nursing Homes	$292.0	$358.5	$364.0	$375.2	$11.2	3.1%
Home and Community Care	1.2	74.1	76.1	79.4	$3.3	4.3%
Subtotal	*$293.2*	*$432.6*	*$440.1*	*$454.6*	$14.5	3.3%
Pharmacy	-	$3.9	$2.8	$3.0	$0.2	6.3%
Part D Clawback	-	49.7	50.2	53.2	$3.0	6.0%
Subtotal	*$0.0*	*$53.6*	*$53.0*	*$56.2*	$3.2	6.0%
Managed Care	$328.0	$595.7	$576.1	$602.2	$26.1	4.5%
Rhody Health	-	209.7	191.4	198.8	$7.5	3.9%
Other	17.7	117.8	115.8	190.3	$74.6	64.4%
Subtotal	*$345.7*	*$923.2*	*$883.2*	*$991.3*	$108.1	12.2%
Total*	**$1,118.8**	**$1,632.3**	**$1,596.6**	**$1,723.7**	**$127.1**	**8.0%**
Federal Funds	*$652.8*	*$821.2*	*$809.6*	*$893.7*	*$84.1*	*10.4%*
General Revenues	*$466.0*	*$799.6*	*$775.1*	*$820.9*	*$45.8*	*5.9%*
Restricted Receipts	-	*$11.5*	*$11.9*	*$9.0*	*($2.9)*	*-24.4%*

* Prior to the FY 2010 budget year, the category "Rhody Health" was allocated throughout Medical Assistance including Managed Care; it is now designated as a separate category. As such, year-to-year comparisons should be made with caution.

Source: State Budgets, Governor's FY 2013 proposed budget, and RIPEC calculations.

Additional highlights of the Governor's FY 2014 medical assistance budget include:

- The expansion of Medicaid to non-disabled, childless adults up to 138.0 percent of the federal poverty level beginning January 2014, per the ACA.
- An increase in primary care physician Medicaid payment rates for fee-for-service and managed care to bring rates into line with the federal Medicare program.
- Shifting $4.2 million in current costs not otherwise matchable (CNOM) expenditures into the Medicaid program through expanded eligibility related to the ACA (savings reflect half of the year based on the start date of January 2014).
- Reductions to all Medicaid managed care capitation rates, to limit the average annual growth to 1.6 percent, for a total savings of $8.9 million ($4.4 million in general revenue offset by a $0.2 million revenue loss in health care premium taxes).
- Freezing projected inpatient and outpatient hospital rate increases for fee-for-service and managed care programs to FY 2013 levels, which requires both a statutory change and a

change to the global waiver, resulting in total savings of $10.5 million ($5.2 million in general revenue).

- Freezing rate increases for nursing care and hospice facilities, yielding a total savings of $7.8 million ($3.9 million in general revenue offset by a $0.4 million revenue loss in health care taxes).

Other Human Services Initiatives

- In FY 2013, EOHHS, in coordination with its departments and the Rhode Island Health Benefits Exchange, launched an integrated eligibility system called the Unified Health Infrastructure Project (UHIP). The Governor's budget includes an additional $3.6 million in general revenue ($20.3 million from all sources) in FY 2014 for the development of EOHHS components of UHIP.
- Similarly, the Governor recommends $200,000 in general revenue ($2.0 million from all funds, anticipating a 90.0 percent federal match) to fund improvements in the Medicaid Management Information System.
- To coordinate these infrastructure enhancements, the Governor recommends $100,000 of general revenue ($200,000 from all sources) to facilitate the creation of an EOHHS strategy plan.
- A change is proposed in the budgeting methodology for state-run facilities (RICLAS and Eleanor Slater). In accordance with state payment methods for externally-provided services, the FY 2014 budget aggregates spending on these facilities, formerly allocated to specific categories, into grants and benefits, as opposed to operating expenditures.
- The Office of Program Oversight's efforts to reclaim fraudulent or inappropriate Medicaid payments resulted in general revenue savings of $500,000 (total projected savings of $1.0 million).

Local Aid

Total state aid (aid to local governments excluding federal aid) totals $1.0 billion in the Governor's proposed FY 2014 budget. This represents an unadjusted increase of 7.0 percent since FY 2004 and is $45.8 million (4.6 percent) more than FY 2013 enacted aid. Of the total increase, $29.6 million is related to increases in local education aid, including fully funding the third year of the state's education funding formula. Charter school aid is now included in "direct education aid", pursuant to the new funding formula. The increase in direct education aid reflects both the implementation of the funding formula to districts and to charter schools starting in FY 2012. The remainder of the increase relates to a proposed $5.0 million addition to the state's Distressed Communities Aid program, as well as a $10.0 million local incentive aid program, designed to urge communities to improve funding for local pension plans.

Table 11
State Aid to Local Government - Unadjusted ($ millions)

Major State Aid Program	FY 2004	FY 2013E	FY 2013R	FY 2014P	2013E-2014P Change
Education Aid					
Direct Education Aid*	$ 636.9	$ 675.7	$ 675.7	$ 696.0	$ 20.3
Teacher Retirement	45.0	79.8	76.9	82.5	2.7
School Housing Aid	40.7	74.6	72.1	71.1	(3.4)
Met School	5.8	11.6	11.6	11.1	(0.6)
Charter School Aid (direct and indirect)	13.3	47.1	46.7	54.5	7.4
Categorical Aid**	-	7.5	7.5	10.2	2.7
Other Aid***	2.7	0.5	0.9	0.9	0.4
Subtotal - Education Aid	*$ 744.5*	*$ 896.8*	*$ 891.5*	*$ 926.3*	*$ 29.6*
Municipal Aid					
General Revenue Sharing	$ 51.4	$ -	$ -	$ -	$ -
Excise Tax Phase-Out	105.0	10.0	10.0	10.0	-
PILOT	21.7	33.1	33.1	33.1	-
Incentive Aid	-	-	-	10.0	10.0
Distressed Communities Aid	7.5	10.4	15.4	15.4	5.0
Other Aid****	13.3	12.9	12.9	11.8	(1.1)
Subtotal - Municipal Aid	*$ 198.9*	*$ 66.3*	*$ 71.3*	*$ 80.3*	*$ 13.9*
Pass-through Revenues					
Meals and Beverage Tax	$ 13.5	$ 20.0	$ 21.5	$ 22.2	$ 2.3
Public Service Corporations Tax	16.3	12.7	12.7	12.7	-
Subtotal - Pass-through Revenues	*$ 29.8*	*$ 32.6*	*$ 34.2*	*$ 34.9*	*$ 2.3*
Total State Aid	**$ 973.2**	**$ 995.7**	**$ 997.0**	**$1,041.5**	**$ 45.8**

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

* Includes all direct categorical aid to LEAs prior to the passage of the funding formula, after implementation includes funding formula distribution, Central Falls operations, Urban Collaborative Accelerated Program, and group home funding.

** Includes high-cost special education, high-cost career and technical, transportation, regionalization bonus, and early childhood demonstration.

*** Includes progressive support and intervention, Hasbro hospital, school visit, RIDE professional dev., textbook loans, school breakfast, telecomm access funds, and the Permanent Education Fund.

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

Education Aid Highlights

Total proposed state education aid to local governments for FY 2014 is $926.3 million, including direct education aid, teacher retirement, school housing aid, funding for the Met school, charter school aid, categorical aid, and other aid. Funding for other state-run schools (Davies and the School for the Deaf) are not included in this figure. Proposed FY 2014 spending is $29.6 million higher than FY 2013 enacted expenditures.

Direct education aid, as shown on table 12, totals $696.0 million, and includes distributions through the education funding formula, including state funding for the operations of the Central Falls school district, and group home funding. The Urban Collaborative Accelerated Program (UCAP), an alternative high school for at-risk students from Central Falls, Cranston and Providence, will receive funding through the formula for the first time, and is also included in this category.

Table 12
Changes to Direct Education Aid ($ millions)

	Districts*	Charters	Met	Total
Enacted FY 2013 Distributed Aid	$ 675.7	$ 47.1	$ 11.6	$ 734.4
Year 3 Formula Change	21.4	7.4	(0.5)	28.3
Group Home Data Update	(1.1)	-	-	(1.1)
FY 2014 Proposed Distributed Aid	$ 696.0	$ 54.5	$ 11.1	$ 761.6

* Includes Central Falls and $0.3 million for UCAP funding

SOURCE: State budget documents; RIPEC calculations

The Governor's budget fully funds year three of the state's education funding formula. The funding formula includes a core instruction amount of $8,897, plus an additional 40.0 percent for each PK-12 student receiving free or reduced-price lunch. The state's share is calculated by multiplying the total amount by the state share ratio (more information on the formula and calculation of the state share can be found here). Education aid highlights in the Governor's proposed FY 2014 budget include:

- Funding UCAP operations through the funding formula, consistent with 2012 legislation. This change will be revenue-neutral to the state, but will result in a reduction in state formula aid to the three sending districts;
- Providing funding for the three new charter schools (Achievement First, Nowell Academy and Village Green), and increased funding for five charter schools expected to see an increase in enrollment. Growth in charter school enrollment is one of the primary drivers of the increase in education aid; and
- Fully-funding four of the five categorical aid programs (transportation, high-cost special education, career and technical, and the early childhood demonstration pilot grant). No districts were eligible to receive aid under the fifth categorical aid program – the regionalization bonus – so no funds were allocated to this program.

Municipal Aid Highlights

Recommended total municipal aid is $80.3 million in FY 2014, not including pass-through aid of $34.9 million (plus additional hotel tax revenue of $6.8 million). Proposed FY 2014 municipal aid is $13.9 million (21.0 percent) more than FY 2013 enacted aid. Local aid initiatives include:

- A permanent $5.0 million increase for the distressed communities program, beginning in FY 2013.
- The creation of an incentive aid program in FY 2014 for municipalities meeting certain criteria related to their pension systems. The proposed program would provide $10.0 million per year, from FY 2014 to FY 2016, distributed proportionally to municipalities based on population. Communities are eligible for the funds:
    - FY 2014: if the community does not have a locally-administered pension plan, if the city or town has no locally-administered pension plan less than 60.0 percent funded (critical status), or if the municipality has submitted funding improvement plans for all locally-administered plans currently in critical status to the Department of Revenue by May 1, 2013.
    - FYs 2015 & 2016: if the community does not have a locally-administered pension plan, if the city or town has no plans in critical status and is funding 100.0 percent of its annual required contribution (ARC), or if the municipality is adhering to its funding improvement plan.
- In addition to the above, the FY 2014 proposed budget includes an additional $10.0 million in RICAP expenditures for local governments to fund streetscape projects (not shown in the local aid budget).