FY 2004 State Budget
Overview and Comments – Part I

RIPEC's analysis of the FY 2004 State Budget will be presented in several parts. Part I provides an overview of the Governor's FY 2003 Revised and FY 2004 Budget request along with RIPEC's Comments on the overall fiscal plan. Part II will discuss changes in the State's revenues per the May Revenue Estimating Conference, and Part III will discuss the Budget as Enacted.

Selected Highlights

1. The FY 2004 budget proposed by the Governor would increase State spending by $124.0 million, or 2.3 percent, over the FY 2003 revised budget (or 4.3 percent over the FY 2003 enacted budget).

2. The Administration's five-year forecast estimates operating surpluses beginning in FY 2006, with the surplus climbing to $85.3 million in FY 2008.

3. Growth in grants and benefits to individuals consumed approximately 45 cents of every new dollar spent in Rhode Island since FY 1996. Growth in the State's managed care program (Rite Care) by itself represented 16 cents of every new dollar spent since FY 1996.

4. Growth in aid to cities and towns consumed 31 cents of every new dollar spent in Rhode Island since FY 1996, with education aid representing the largest component of local aid.

5. The Governor's FY 2004 budget request level-funded school aid at $622.6 million, and capped the general revenue sharing program at 2.6 percent of the tax revenue collections two years prior.

6. Personnel expenditures increased by nearly 20.0 percent since FY 1996 (adjusting for inflation), and represented 16 cents of every new dollar spent since FY 1996.

7. State spending for medical insurance for State employees is the fastest growing component of the State's personnel budget, doubling since FY 1996. State medical insurance costs total nearly $170 million in FY 2004.

8. The FY 2004 average cost per FTE position of $70,234 represents a 2.8 percent increase over the FY 2003 average cost per FTE position ($68,314). Adjusting for inflation, the cost per FTE has increased by 25.0 percent since FY 1996 ($56,243).

9. The Governor has proposed increasing State employee and teacher pension contributions, producing an estimated $18.1 million savings to the State and $9.5 million savings to local governments.

May 6, 2003

I. RIPEC Comments

Rhode Island's economy and tax revenues have not been impervious to the regional and national economic slowdown. While the Ocean State's economy has weathered the Nation's recent economic sluggishness better than many other states, it still challenges the State's leaders in developing a financial plan for the State that reflects tough policy choices, particularly in the context of State spending.

RIPEC has always maintained that the test of fiscal soundness of any budget plan is whether ongoing resources are adequate to support current operating costs, whether current obligations are realistically funded and whether revenues are realistically projected. The following budget analysis reviews and evaluates the proposed fiscal plan as well as selected proposals contained in the Governor's FY 2004 budget request. RIPEC's analysis focuses on how budget decisions will impact the long-term fiscal health of the State and how they may position the State to be more effective and more competitive in the future.

Overview - The Governor should be commended for proposing a FY 2004 budget that grows by 2.3 percent over the FY 2003 revised budget. The Administration's FY 2004 spending plan would represent growth at a slower pace than personal income growth - a marked change from the growth rates in recent budgets where general revenue spending exceeded inflation and personal income growth.

The Governor's five-year forecast reflects estimated operating surpluses beginning in FY 2006. This is a significant change from previous forecasts where operating deficits were projected to exceed $150 million in the out-years.

The Administration's projected operating surpluses are a direct result of several budget proposals included in the FY 2004 Budget. First, the Governor has proposed changing the allocation of VLT (video lottery terminals) revenues in FY 2004 and thereafter in favor of the State, generating $48.1 million in FY 2004 and to nearly $80.0 million by FY 2008.

Second, the Governor has proposed to cap the General Revenue Sharing program at 2.6 percent of State tax revenues from two years prior in FY 2004 and thereafter, avoiding approximately $30.0 million in additional general revenue expenditures by FY 2008.

And third, the Governor proposed to eliminate the CPI adjustment to the program to phase out the excise tax on motor vehicles (which continues to be frozen at the $4,500 exemption). This action is expected to result in approximately $30.0 million in avoided general revenue expenditures by FY 2008.

The Governor's FY 2004 budget and five-year forecast do not include any major initiatives to curtail the growing costs of providing the various grants and benefits to individuals in the State. While the FY 2004 budget was designed to limit the impact of budget reductions on recipients of health and social services, it should be noted that these programs are responsible for nearly 45.0 percent of the net growth in spending since FY 1996 (adjusted for inflation). And the Governor's five-year forecast shows that the area of greatest expenditure pressure continues to come from these programs.

A forecast is only as good as the assumptions upon which it is built and the likelihood that the assumptions will be realized. For example, the Governor's FY 2004 budget request and the five-year forecast are dependent on an influx of additional revenues derived from gaming activities. Consumer behavior, economic trends (such as changes in personal income), legislative action and potential competition from neighboring states could affect projected revenues from gaming sources.

Within the recommended FY 2004 spending plan, the Governor has managed to direct limited resources to a series of economic development initiatives, such as moving the State's corporate business tax towards the double weighting of sales. The proposal is consistent with RIPEC's recommendation as outlined in its May 2000 publication – *A System Out of Balance: Rhode Island's State and Local Tax System*.

The Governor has proposed a two-year plan to permit manufacturers to double weight sales in the formula for the purposes of calculating Rhode Island corporate tax liability. The fiscal impact in FY 2004 is estimated to be a $2.0 million loss in State tax revenue. Rhode Island is one of only a dozen states that currently uses the equally-weighted three-factor formula (sales, capital and payroll).

The Governor's economic development package also directs an additional $1.4 million towards adult literacy. This investment, coupled with other economic development and workforce development components of the State budget, should assist in improving the overall competitive position of the State's workforce.

Government Operations – The FY 2004 average cost per FTE position of $70,234 represents a 2.8 percent increase over the FY 2003 revised cost per FTE position ($68,314). Costs related to providing State employees with medical insurance are expected to increase by 27.4 percent from FY 2003. In FY 1996, medical insurance costs represented approximately 10.0 percent of the salaries and benefits for State employees. This has since increased to 15.0 percent in FY 2004.

The Governor did not include any significant changes to the operation of State government in the FY 2004 budget. However, the Governor recently announced a 6-9 month effort (Fiscal Fitness) to review government operations, and expects to incorporate proposals in the FY 2005 budget. RIPEC will continue to monitor these efforts to determine the extent of the proposals and how they might impact the long-term operating costs of State government.

State Employee Pensions - In order to begin controlling personnel spending, the Governor has proposed to increase State employee pension contributions – with corresponding reductions in the State's contribution.

The Rhode Island employee is expected to contribute 8.75 percent of his salary to the State pension fund in FY 2004. The State would contribute 9.6 percent of employee salaries to the fund. The Governor has proposed to increase the State employee pension contribution from 8.75 percent to 10.75 percent, and it would reduce the State's rate from 9.6 percent to 7.6 percent.

There are a number of variables influencing State employee pensions. However, there are several key components of the Ocean State's pension system that are worth noting. First, Rhode Island does not have a minimum age provision – it only requires that employees serve 28 years to be eligible for the normal pension benefit. Second, the State provides an annual 3.0 percent COLA to the entire retiree pension benefit beginning on the third January after retirement. And third, the State funds 100 percent of the retiree's individual medical insurance if they have 28 years of service at age 60 and older.

In the body of the report, RIPEC compared the current state retirement systems in Rhode Island, Massachusetts and Connecticut, exploring the major components and requirements of each. RIPEC also provided a series of models to compare hypothetical scenarios for comparison purposes.

The report finds that while Rhode Island state employees certainly contribute more to the State pension fund as a percentage of income, the overall benefits received are significantly greater than similarly situated state employees in Massachusetts and Connecticut. This is a direct function of Rhode Island not having a minimum age for retirement and a COLA on the entire pension benefit. Not having to pay co-pays for health care benefits is also a significant benefit not enjoyed by Bay State employees.

It should be noted that as the Rhode Island employee approaches age 65, the initial pension benefit differential between the states closes quickly.

The following provides a summary of models presented in the body of the report. There are a number of assumptions that need to be considered when reviewing the table. First, it is assumed that the average final consecutive compensation (AFC) for the employee is $50,000. Second, it is assumed that the employee has served his or her state for 30 years at the time of retirement and has retired at age 55. And third, the table accounts for each state's COLA provision as it currently exists in contract or law.

It should also be noted that the following analysis does not take into account the benefits associated with individual health care. As noted earlier, neither Rhode Island nor Connecticut retirees meeting the criteria noted above are required to provide a co-pay for individual health care benefits. Massachusetts employees are required to provide a 15.0 percent co-pay. This would equate to approximately $700 for the 55-year-old Massachusetts employee with 30 years of service. The Rhode Island and Connecticut employee would not have to incur this additional cost.

As Table 1 on the following table shows, if the employee were to retire at age 55, Rhode Island would provide the largest initial pension benefit to its employee. Rhode Island would provide $33,000 for the employee, while Massachusetts would provide $22,500 and Connecticut would provide $30,000.

Because Rhode Island does not require a minimum age to retire with normal benefits – only a minimum of 28 years of service, the 55-year-old employee would retire with full benefits. Connecticut's minimum age is 55 years old with at least 25 years of service (for those hired before July 1984), so the 55-year-old Connecticut employee would also retire with full benefits. However, Massachusetts has a minimum age of 65 to receive full normal pension benefits. In this scenario, instead of receiving 2.5 percent for each year served (as one would if one were 65 years old) the employee receives 1.5 percent for each year served.

Since Rhode Island does not have a minimum age requirement, the 55-year-old employee with 30 years of service would still enjoy the maximum benefit under this model - $33,000. However, in Massachusetts, the 55-year-old employee with 30 years of service would be penalized for not reaching the State's 65-year old age limit. The employee would have to retire at a pension benefit level of $22,500 – approximately 45.0 percent of the AFC rather than at 75.0 percent if he or she were age 65. The Rhode Island employee benefit would be $10,500 more than the employee in Massachusetts and $3,000 more than in Connecticut.

Table 1
Estimated Pension Benefits - State Employee
Age 55 with 30 Years Service

Age	Estimated Pension RI	MA	CT	RI - MA Difference	RI - CT Difference
55	$33,000	$22,500	$30,000	$10,500	$3,000
56	33,000	22,860	30,750	10,140	2,250
57	33,000	23,220	31,519	9,780	1,481
58	33,990	23,580	32,307	10,410	1,683
59	35,010	23,940	33,114	11,070	1,895
60	36,060	24,300	33,942	11,760	2,118
61	37,142	24,660	34,791	12,482	2,351
62	38,256	25,020	35,661	13,236	2,595
63	39,404	25,380	36,552	14,024	2,852
64	40,586	25,740	37,466	14,846	3,120
65	41,803	26,100	38,403	15,703	3,401

Assumptions:	RI	MA	CT
Years of Service	30	30	30
Average Annual Salary	$50,000	$50,000	$50,000
Pension COLA	3.0%	3.0%	2.5%

Notes:
1. RI COLA is applied on the third January after retirement
2. MA COLA on pension applies to first $12K of income only.
3. CT COLA is up to 75% of CPI-W, with a guaranteed minimum of 2.5%.
4. CT pension shown for employee hired before July 1984

Source: RIPEC calculations based on State benefit formulas, derived from 2002 State Employee Benefits Survey, Workplace Economics Inc and MA Dept of Treasurer

The COLA component of the pension system takes hold very quickly for the 55-year-old Rhode Island retiree with 30 years of service. In Rhode Island, the employee's pension benefit increases to $41,800 by the time he is age 65. The $41,800 benefit by age 65 in Rhode Island would exceed the Massachusetts benefit of $26,100 by approximately $15,700 - nearly 60.2 percent.

In Connecticut, the employee's pension benefit increases from $30,000 at age 55 with 30 years of service to $38,400 by the time he is age 65. The Rhode Islander's pension of $41,800 would be 8.9 percent higher than the Connecticut employee's pension.

State Staffing - In FY 2001, the State provided language to exempt 330.4 FTE positions in higher education on the premise that these positions were funded by third-party resources - such as University funds and Federal Funding. The exempted positions were identified in order to provide the State's University additional flexibility in managing staffing patterns. The number of exempt positions has since decreased to 319.8 FTE positions in the Governor's FY 2004 budget request.

While this may be desirable for the University, it represents erosion of a tool that the State has to control spending. The FTE position authorization process is a means for the State to effectively measure the effectiveness of any initiatives to reduce or consolidate programs and departments. Without effective control over staffing, it is very difficult to manage permanent savings into proposed changes in government structure.

The State implemented the legislative authorization of FTE positions in order to begin understanding total personnel costs, staffing patterns and the proliferation of programs. An issue that the State continues to face is the impact third party financing has on the management of the entire budget. While positions and programs may initially receive other sources of funding, these positions and programs may shift over to the State's general revenue fund once other funds have expired.

A related issue is the Governor's budget proposal to create a new class of positions called *limited service positions*. These positions would not be subject to the FTE position authorization spelled out in the annual appropriations bill. According to Article 30 of the Governor's proposed budget, these positions would be funded by non-general revenue sources of revenue and would be limited to one year of employment.

These positions would not be eligible for retirement, health or other benefits ordinarily provided to State employees. The budget article clearly states that the limited service positions are being created in order to avoid the restrictions under the current FTE position authorization process.

Given the limited number of effective cost containment tools available, RIPEC continues to voice its concern about policies that exempt certain positions from the FTE authorization process outlined in the State's budget.

Overtime and Purchased Services - There are two additional personnel issues worth highlighting. Overtime has increased from $35.1 million in FY 1996 (unadjusted) to $44.5 million in FY 2004 – a $9.4 million increase during this period (26.8 percent). Overtime expenditures peaked at $59.8 million in FY 2002.

However, what is of concern is the ongoing practice of how overtime is budgeted in the State. For example, in FY 2001, the actual experience in overtime expenditures ($57.0 million) exceeded the enacted appropriation of $38.4 million by 50.0 percent. Similarly, the FY 2003 enacted budget included $46.6 million in overtime, whereas the Governor's FY 2003 revised budget includes $52.7 million in net overtime expenditures – a 13.0 percent increase from the enacted budget. The Governor's FY 2004 proposed budget includes $45.5 million in net overtime expenditures.

A similar budgeting pattern emerges in purchased services. In FY 2003, the budget as enacted included $130.1 million in contract spending – net of adjustments to reflect the State's program to reduce purchased services spending statewide by $4.2 million. However, the Governor has requested $160.6 million in spending for these services in the revised FY 2003 budget plan – a $30.5 million net increase from the enacted budget (a 23.4 percent increase). Of this amount, $45.8 million would be supported with general revenues - $7.1 million more than enacted.

The Governor's FY 2004 budget request includes $142.6 million in expenditures for contracted services, of which $38.6 million is supported with general revenues. This would represent a 15.7 percent decrease in purchased services spending supported by general revenues.

Therefore, RIPEC encourages policymakers to take a more critical view of how these expenditures are monitored and developed as part of the budget-building process. If the State continues to under-fund expected spending levels in overtime and purchased services, it would continue to require significant changes in the annual supplemental process. The Governor's initiative to review government services (Fiscal Fitness) should include an analysis of these spending patterns and how services may be affected over the long term.

Transportation - The Governor's FY 2004 budget plan also takes a number of steps to improving the way the State finances transportation costs, following several key recommendations included in RIPEC's transportation finance report published in September 2002 – *Rhode Island at the Crossroads*.

First, the Governor has proposed to shift 0.25 cents of the gasoline tax (as scheduled by law) to the Inter-modal Surface Transportation Fund and 0.60 cents of the gasoline tax to RIPTA (equating to $2.8 million in additional resources to RIPTA).

In addition, the Governor has proposed to permit the Department of Transportation to retain its savings in debt service derived from the defeasance of long-term debt through the tobacco securitization initiative. In FY 2004, this will provide an estimated $10.0 million in resources to DOT and RIPTA to be directed towards re-paving and bridge work, as well as RIPTA operating costs.

State Aid - The Governor's five-year forecast included a number of actions affecting State aid. The Governor has essentially frozen direct education aid to school districts in FY 2004, and has projected education aid to grow by 3.75 percent annually for the out-years.

The Administration has recommended a series of changes to the Housing Aid Program, which supports school facility development. The major change was to have the State only reimburse for the construction costs of projects – excluding interest costs. The Governor has proposed to fully-fund the PILOT program at 27.0 percent in FY 2004 and thereafter. The Governor has also proposed to permanently freeze the General Revenue Sharing Program, providing 2.6 percent of State tax revenues collected two years prior.

Direct Education Aid - For FY 2004, the Governor has proposed to level-fund direct aid to school districts. It should be noted that as a result of changing the employee/employer rate of contribution to the teachers' retirement system, local governments would save $9.5 million. The impact that the State spending freeze will have on local property taxpayers will be influenced by the degree of fiscal restraint local school committees are able to exercise.

Obviously, a fundamental issue facing Rhode Island's State and local government officials is how to control the rate of growth in school spending without compromising the reform agenda. Simply appropriating additional dollars for school aid after most school budgets have been developed and tax levies set may not necessarily insure that Rhode Islanders get more value from additional State investments in public schools.

Nevertheless, there are structural issues regarding the way Rhode Island finances the K-12 school system. A recent RIPEC study found that the Ocean State ranked 45th in the Nation in the percentage of revenue provided by the State to finance elementary and secondary schools. The State provided 37.4 percent of the FY 2001 revenues used to support schools. Conversely, Rhode Island's localities provide 58.5 percent of the FY 2001 revenue supporting schools – ranking 4th highest in the country. This problem needs to be addressed because property tax burdens can affect the location decisions of both families and businesses.

The first step to reforming the way public schools are financed is for the State to be in a position to provide additional support. This can only be achieved if the State first deals with its structural budget gap as the Governor has proposed. Second, the State must consider its education spending priorities. For example, the Governor is proposing to increase aid to Charter Schools and the Met School by $4.8 million, while level-funding direct aid to local school districts.

Third, the State should re-engineer the way schools are financed. While state aid for education grew by 30.0 percent (adjusted for inflation) between FY 1996 and FY 2004, it has done so despite the lack of a permanent, predictable State education aid formula.

Local communities need a dependable source of financial assistance that considers each district's ability and effort to raise revenue and student needs. The State needs a stable education finance environment in order to plan and allocate appropriate levels of funding. The State will need to engage in a discussion on how to balance education spending control with meeting student performance goals.

Therefore, given the unpredictability in the school funding process, RIPEC urges that the Administration develop and propose to the 2004 session of the General Assembly a predictable school aid formula based on student need and equalized property taxes.

<u>Payment-in-lieu-of-taxes</u> - The Governor should be commended for returning the PILOT (Payment-in-lieu-of-taxes) program to 27.0 percent. This program provides State aid to municipalities that host various institutions that are not on local property tax rolls. The Governor proposed language in his original budget request that would have authorized host communities to levy taxes on private colleges and universities – currently exempt from local property tax levies. The Governor withdrew this proposal from the FY 2004 budget request as of April 30, 2003.

Universities and colleges make a significant contribution to the State's economy and the well being of the communities in which they are located. Public policies should, therefore, be aimed at creating a climate where Rhode Island colleges and universities prosper.

Tax exempt institutions are also the beneficiaries of municipal services. These costs must be balanced against the economic and social benefits these institutions provide for the entire community and the cost of providing them with services. RIPEC has long believed that the most effective way to achieve the balance is by adequately funding the State's PILOT program.

Any decision to authorize municipalities to impose taxes or payments in lieu of taxes on colleges and universities must be considered from a broader public policy prospective than merely identifying additional revenues for local governments.

This will require independent consideration to the following types of questions:

- What current and projected economic contributions do and will institutions of higher education make to the State and the community in which they are located?

- What are the direct costs associated with municipal services used by colleges and universities?

- What relationships exist between colleges and universities and local governments in other states?

- What is the impact of the institution's growth on the municipality?

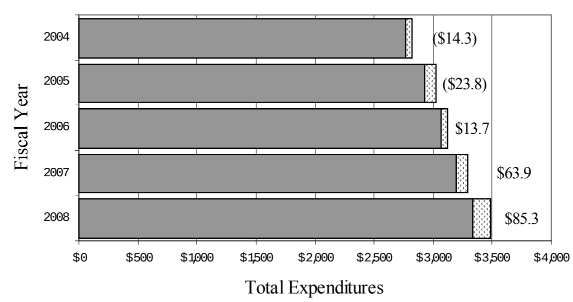
General Revenue Sharing - The Administration's proposal to discontinue the scheduled increases in the General Revenue Sharing Program raises a concern regarding the phase-out the wholesale and retail inventory tax. The programmed increases in the General Revenue Sharing Program were designed to provide municipalities with State revenues that would be used to replace the revenues foregone as they phased-out the tax. The Governor's proposal is silent as to the fate of this property tax relief program. It should be noted that if the Governor had continued the General Revenue Sharing Program as outlined under current law, the five-year forecast would still include operating surpluses projected in FY 2007 and FY 2008.

II. State Spending Patterns

Recent economic conditions have converged with slower revenue growth and increasing spending demands. Therefore, the Governor and the General Assembly face difficult fiscal decisions in the coming weeks in order to balance the budget and to ensure the State's long-term fiscal health.

Table 2

Governor's FY 2004 - FY 2008 Forecast



Recent five-year forecasts projected operating deficits of $150 - $175 million in the out-years. However, based on the data in the Governor's FY 2004 Budget, the five-year projection through FY 2008 indicates an annual and expanding operating surplus beginning in FY 2006. This is a significant change from previous five-year forecasts presented in the past eight years.

The forecast assumes revenues will grow at an average annual rate of approximately 5.6 percent while expenditures are projected to grow by 4.8 percent over the same period. The expenditure growth rate is nearly twice the estimated annual rate of inflation (2.5 percent).

The Governor's projected operating surpluses are a direct result of several key budget proposals included in his FY 2004 Budget Request. First, the Governor has proposed changing the allocation of VLT revenues in FY 2004 and thereafter in favor of the State, generating $48.1 million in FY 2004 and to nearly $80.0 million by FY 2008.

Second, the Governor has proposed to cap the General Revenue Sharing program at 2.6 percent in FY 2004 and thereafter, avoiding approximately $30.0 million in additional general revenue expenditures by FY 2008. And third, the Governor has proposed to eliminate the CPI adjustment to the program to phase out the excise tax on motor vehicles (which continues to be frozen at the $4,500 exemption). This action is also expected to result in approximately $30.0 million in avoided general revenue expenditures by FY 2008.

Growth in grants and benefits to individuals continues to apply the greatest pressure on the expenditure side of the ledger, with an average annual growth rate of 5.1 percent. This is principally driven by growth in medical care. However, the Governor's FY 2004 budget does not include any significant initiatives to curtail these costs.

As Table 3 shows, the FY 2004 budget (all funds) represents a $1.4 billion increase from FY 1996 (adjusted to 2004 dollars) - a 32.2 percent increase over this period. Assuming the Governor's budget were adopted, expenditures supporting grants and benefits (programs providing direct support to individuals) would increase by $610.5 million, representing 44.5 percent of the total growth in expenditures during this period.

These programs include Medicaid, childcare and TANF as well as other income support programs administered by the State. The increase in managed care programs (RIte Care) of $217.1 million represented 10.4 percent of the net increase in statewide spending during this period. FY 2004 RIte Care expenditures of nearly $323.7 million essentially make up all of the State's expenditures in Managed Care.

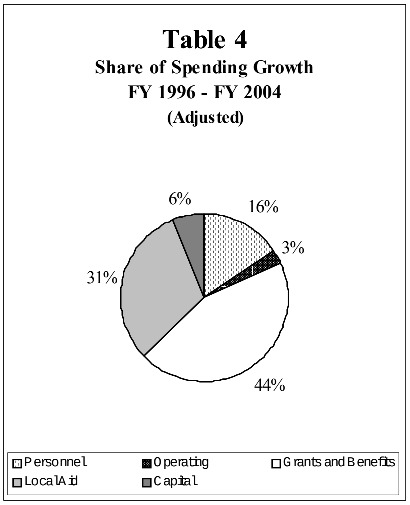
There are several factors driving the level of expenditures for grants and benefits to individuals. Most recognize economic forces as well as socio-economic and demographic trends (i.e. income levels and age cohorts) play critical roles in the expenditure responsibilities of the State. In addition, policymakers constantly adjust, refine and expand programs based on policy shifts. For example, in recent years, the State has expanded eligibility for state funded health care (RIte Care), pharmaceutical assistance and child-care.

Table 3

Rhode Island State Budget Drivers - All Funds (Adjusted)

Expenditure Category	FY 1996 Actual	% of Total	FY 2004 Proposed	% of Total	Increase	Share of Increase
General Operations						
Personnel	$1,126.9	26.5%	$1,341.8	23.8%	$214.9	15.7%
Operations	324.6	7.6%	359.7	6.4%	35.1	2.6%
Subtotal - Operations	$1,451.5	34.1%	$1,701.5	30.2%	$250.0	18.2%
Grants & Benefits						
Income Support (TDI & Employ)	$337.6	7.9%	$345.0	6.1%	$7.4	0.5%
Medical Assistance - Mgd Care	106.6	2.5%	323.7	5.7%	217.1	15.8%
Medical Assistance - All Other	602.8	14.2%	728.5	12.9%	125.7	9.2%
Development Disabilities	118.9	2.8%	175.3	3.1%	56.4	4.1%
Child Welfare	70.7	1.7%	104.5	1.9%	33.8	2.5%
TANF	154.4	3.6%	74.1	1.3%	(80.2)	-5.9%
Child Care	19.3	0.5%	73.3	1.3%	53.9	3.9%
SSI	23.6	0.6%	28.1	0.5%	4.5	0.3%
RIPAE	8.2	0.2%	14.1	0.3%	5.9	0.4%
Higher Education	92.0	2.2%	102.1	1.8%	10.1	0.7%
Dept. of Transportation	33.8	0.8%	53.6	1.0%	19.8	1.4%
Other Grants & Benefits	304.7	7.2%	460.8	8.2%	156.1	11.4%
Subtotal - Grants & Benefits	$1,872.7	44.0%	$2,483.2	44.1%	$610.5	44.5%
Local Aid						
Education Aid	$541.4	12.7%	$702.3	12.5%	$160.9	11.7%
Motor Vehicle Phase-out	0.0	0.0%	104.3	1.9%	104.3	7.6%
General Revenue Sharing	15.4	0.4%	48.3	0.9%	32.9	2.4%
PILOT	14.6	0.3%	21.7	0.4%	7.1	0.5%
Federal Aid	41.1	1.0%	140.8	2.5%	99.7	7.3%
Other	21.8	0.5%	42.7	0.8%	21.0	1.5%
Subtotal - Local Aid	$634.3	14.9%	$1,060.2	18.8%	$425.9	31.1%
Capital Expenditures						
Capital Expenditures	$91.2	2.1%	$236.4	4.2%	$145.2	10.6%
Debt Service	210.4	4.9%	149.5	2.7%	(60.9)	-4.4%
Subtotal - Capital	$301.6	7.1%	$385.9	6.9%	$84.3	6.2%
Total	**$4,260.1**	**100.0%**	**$5,630.8**	**100.0%**	**$1,370.7**	

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

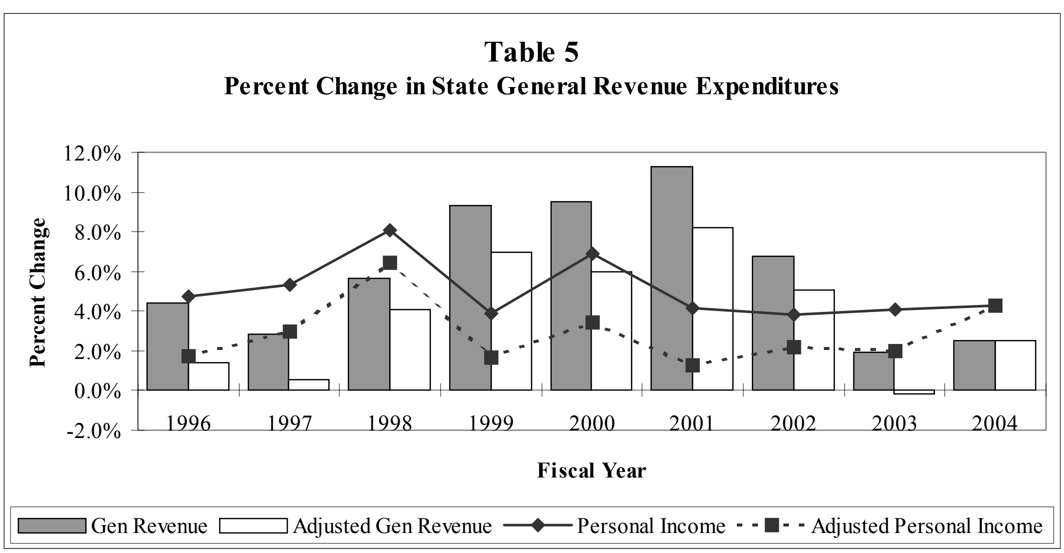


The second largest component of State budget growth has been in local aid. All local aid increased by $425.9 million, representing approximately 31.1 percent of the net growth in the budget since FY 1996. Education aid has been the principal driver within local aid. Of the $425.9 million net increase in local aid, nearly 40.0 percent is attributable to growth in education aid.

The third largest factor in budget growth during this period has been overhead costs. Of the $1.4 billion increase in net expenditure growth from FY 1996 to FY 2004, approximately 15.7 percent ($214.9 million) was attributable to personnel expenditures. An additional 2.6 percent ($35.1 million) of the growth was related to various operating expenditures. Therefore, nearly 18.2 percent of the growth in the State's total expenditure program since FY 1996 was related to general overhead for State programs.

If one looks at general revenue growth only, additional information can be derived. Table 5 displays unadjusted and inflation-adjusted (estimated 2004 dollars) percent changes in general revenue expenditures from FY 1996 – FY 2004. It also sets forth the estimated change in personal income in Rhode Island (both adjusted and unadjusted). Since FY 1996, the State's general revenue budget has grown at a faster rate than inflation and personal income. However, the Governor's FY 2004 budget request would represent growth similar to with expected inflation (2.5 percent).

Proposed spending would also represent growth at a slower pace than personal income growth - a marked change from the growth rates in recent budgets where general revenue spending exceeded inflation and personal income growth.



III. The Governor's Budget

Proposed FY 2003 Revised - The Governor has proposed a $5,506.8 million revised budget for FY 2003. While the FY 2003 enacted budget represented a 3.7 percent increase ($194.3 million) from FY 2002 actual experience, the Governor's revised budget represents a 5.8 percent ($300.1 million) increase over FY 2002 actual experience. Of the $300.1 million increase, $51.0 million (17.0 percent) is in general revenues, $231.0 million (77.0 percent) is in federal funds and the $18.1 million balance (6.0 percent) is the net increase in restricted and other funds.

While the overall change in the budget is important, the following concentrates on the changes to the State's General Revenue Budget. The Governor proposes a net increase of $36.8 million from the FY 2003 enacted general revenue budget (1.4 percent increase). General revenue appropriations for overhead (personnel and operating) are proposed to increase by $17.6 million (net). Of this amount, RIPEC estimates that nearly $16.6 million is associated with unachieved savings included in the FY 2003 enacted operating budget – the enacted budget included $25.7 million in unidentified general revenue savings in State operations. Grants and benefits to individuals are proposed to increase by $7.5 million. There are a number of proposed changes to the FY 2003 General Revenue Budget worth noting.

The Governor has proposed:

- $6.8 million for Institutional Corrections costs due to a reduced number of Federally reimbursed prisoners, increased prison population and medical and pharmaceutical costs;
- $4.8 million for a number of school construction projects that were completed in FY 2002; and
- $8.6 million for debt service payments from general revenues (debt service costs from all funds decrease by $7.1 million).

FY 2004 Budget Summary - The Governor has proposed a $5,630.8 million budget to support State operations in FY 2004. As measured against the budget originally enacted for FY 2003 ($5,400.9 million), FY 2004 appropriations represent an increase of $229.9 million, or 4.3 percent. Total FY 2004 expenditures are proposed to increase by 2.3 percent ($124.0 million) over the Governor's FY 2003 revised budget ($5,506.8 million). FY 2004 general revenue expenditures are budgeted at $2,768.9 million, which represents a 3.9 percent ($104.4 million) increase from the FY 2003 enacted budget, and $67.6 million more (2.5 percent) than the Governor's FY 2003 revised request.

Table 6
Budget Statement

Summary	FY 2002	FY 2003R	FY 2004
Opening Surplus	**$142.2**	**$40.7**	**$14.5**
Revenues			
Enacted	$2,603.5	$2,707.0	$0.0
Revenue Est. Conf.	-	8.0	2,672.4
Governor Changes	-	15.3	138.7
Total Revenues	**$2,603.5**	**$2,730.4**	**$2,811.1**
Cash Stabilization	($54.7)	($55.3)	($56.5)
Available Revenues	**$2,691.0**	**$2,715.8**	**$2,769.2**
Expenditures	**$2,650.3**	**$2,701.3**	**$2,768.9**
Free Surplus	$33.0	$14.5	$0.3
Reappropriations	7.8	-	-
Total Ending Balance	**$40.7**	**$14.5**	**$0.3**

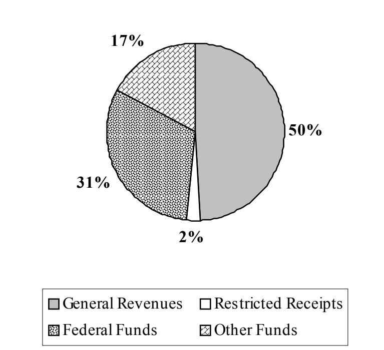
Note: FY 2003 Enacted spending of $2,664.5 million

Source: RIPEC Calcualtions based on FY 2004 Governor's Budget

Table 6 shows the State's Budget Statement from FY 2002 through FY 2004. The State has experienced a surplus in past fiscal years to varying degrees. In FY 2004, the $14.5 million opening surplus represents less than 1.0 percent of the total on-going operating revenues. The availability of an opening surplus has been critical in balancing the budget for the past several fiscal years.

Source of Funds: General revenues represent unrestricted resources the State generates through taxes, fees and other sources. General revenues fund approximately 50.0 percent of the State budget. Federal funds represent about 31.0 percent of the State's budget. Federal Medicaid payments account for nearly half of all federal fund expenditures.

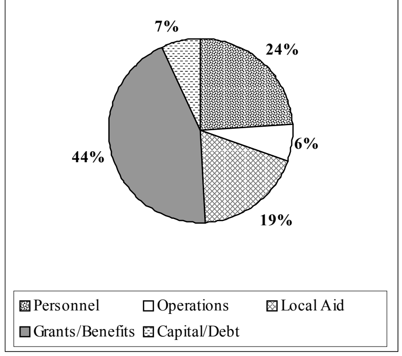
Table 7
FY 2004 By Source



Other funds, totaling $973.6 million in FY 2004, are primarily made up of university and college funds and employment and training funds, representing about 17.0 percent of the FY 2004 budget. Restricted funds of $139.2 million in FY 2004 represent the smallest resource to the State – 2.0 percent of all resources. These funds include a range of fees and charges dedicated to specific programs and activities.

Expenditure by Category: There are five major categories of expenditures - personnel, operating, local aid, grants and benefits and capital expenditures. Grants and benefits, which include medical assistance, temporary disability payments and other cash assistance, constitutes the largest category of expenditures, representing 43.0 percent of the total budget.

Table 8
FY 2004 By Category



Personnel expenditures represent 24.0 percent of the State's budget, and general operations expenditures represent an additional 7.0 percent. Local aid, which includes education aid and other direct assistance to municipalities, represents 19.0 percent of the budget. The remaining 7.0 percent of the budget is dedicated to capital and debt service expenditures.

The following highlights selected expenditure and program changes.

General Operations

- Proposed increasing State employee pension contributions by 23.0 percent – increasing the rate from 8.75 to 10.75;
- Proposed increasing teacher pension contributions by 21.0 percent – increasing the rate from 9.5 to 11.5 percent.

- Proposed pension contribution rate changes are expected to save the State $18.1 million, of which $13.4 million are general revenues. Local communities would experience $9.5 million in pension savings;

- Included $13.5 million in estimated reconciliation payments for the medical insurance contract for State employees with Blue Cross/Blue Shield; and

- Included the last retroactive payment for the Corrections Officers' contract totaling $2.9 million.

State Aid

- Level-funded direct State education aid to local school districts;

- Level-funded the General Revenue Sharing Program in FY 2004 and discontinued the expansion of the program to reimburse localities for phasing out the inventory tax by FY 2011;

- Restored PILOT funding to 27.0 percent, proposing $21.7 million in appropriations.

- Proposed to provide municipalities with the authority to begin taxing private colleges and universities; and

- Continued the freeze on the program to phase-out the excise tax on motor vehicles.

Grants and Services to Individuals

- Recommended full-funding for medical assistance programs;

- Proposed increasing uncompensated care payments to the state-run Eleanor Slater Hospital by $7.9 million to a total of $17.7 million. This would reduce the amount available for community hospitals by $5.9 million to $76.6 million.

Transportation

- Proposed to permit the Department of Transportation (DOT) and RIPTA to retain debt service savings derived from the tobacco securitization program to assist in financing highway maintenance;

- Proposed allocating 0.85 cents of the gasoline tax from the general fund to the DOT and RIPTA to dedicate additional funds to ongoing transportation needs; and

- Suggested using future Federal highway funds to finance transportation projects – known as GARVEE financing;

Economic Development

- Initiated a two-year program to double weight the sales tax for calculating the business corporations tax for manufacturers;
- Increased funding for adult literacy programs ($1.4 million);

- Doubled higher education need-based grants (an additional $5.0 million);

- Proposed $800,000 to plan a Bio-pharmaceutical training facility and a Biotechnology Center for URI; and

- Included $500,000 for municipal economic development and an additional $2.5 million for Slater Centers.

Other

- Proposed an increase of $2.1 million in general revenues based on projected increases in prison populations; and

- Recommended $3.6 million in additional general revenues for the Criminal Alien Assistance program (SCAAP) to offset the expected end of the Federal program.

Personnel Trends – FY 2004 personnel expenditures total $1,341.8 million, a $14.5 million (1.1 percent) increase from the FY 2003 revised personnel budget. The majority of the net increase in personnel spending was driven by an additional $36.6 million for additional health care insurance costs.

General revenues support 53.0 percent of all personnel expenses in FY 2004. Federal Fund support nearly 23.0 percent and the remaining funds (special funds, restricted receipts and internal service funds) would remain essentially the same, supporting 24.0 percent of the personnel budget.

The FY 2003 revised budget includes an additional $38.7 million net in personnel spending than was enacted last summer. The Administration has requested an additional $6.7 million in salaries and benefits for State employees, $30.5 million in additional purchased services expenditures and $1.5 million in other payroll costs. This is in part due to the State not achieving personnel savings built into the FY 2003 enacted budget. The additional expenditures for purchased services are also partially due to consistent under-budgeting of these expenses in the budget process (discussed further below).

As noted earlier in this report, personnel expenditures represent a significant portion of the State's budget. In FY 1996, personnel spending represented 26.5 percent of the State budget. It has since declined to 23.8 percent of the budget, principally due to faster growth in grants and benefits to individuals and local aid.

However, personnel expenditures continue

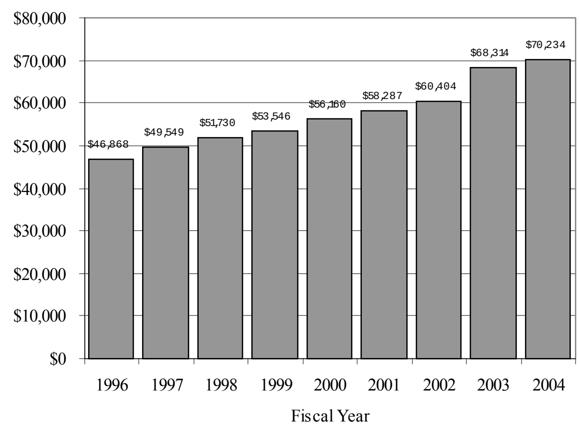
Table 9
State Personnel Costs - Unadjusted

					FY 2004 - FY 2003 Revised	
Personnel Costs (Millions)	**FY 1996 Actual**	**FY 2003 Enacted**	**FY 2003 Revised**	**FY 2004 Proposed**	**Actual Change**	**Percent Change**
Salaries & Benefits						
Net Salaries	$601.43	$811.0	$808.7	$812.1	$3.4	0.4%
Adjustment for Temp	($57.0)	($62.0)	($63.8)	($65.8)	($2.0)	3.1%
Overtime	35.1	46.6	52.7	44.5	(8.2)	-15.5%
Retirement	55.1	65.5	66.7	67.9	1.1	1.7%
Medical	85.2	130.4	133.4	169.9	36.6	27.4%
Other Benefits/Payroll Costs	55.2	75.8	76.4	76.0	(0.4)	-0.5%
Salaries & Benefits	*$775.1*	*$1,067.4*	*$1,074.1*	*$1,104.6*	*$30.5*	*2.8%*
Other Personnel Costs						
Other Payroll Costs	$74.6	$91.1	$92.6	$94.7	$2.1	2.2%
Purchased Services	89.3	130.1	160.6	142.5	(18.1)	-11.3%
Other Personnel	*$163.9*	*$221.2*	*$253.2*	*$237.2*	*($16.0)*	*-6.3%*
Total Personnel Costs	**$939.0**	**$1,288.6**	**$1,327.3**	**$1,341.8**	**$14.5**	**1.1%**

Source: State Budget Office and FY 2004 Personnel Supplement.

to grow – increasing by $402.8 million from FY 1996 to FY 2004 – a 19.4 percent increase over this period of time. If one adjusts these expenditures (2004 dollars), personnel expenditures increased by $215.0 million, or by 15.7 percent.

Table 10
Average Cost Per FTE Position



The average cost per FTE position has increased over this period of time as well. The average cost per FTE position has increased from $46,869 in FY 1996 to $70,234 per position in FY 2004 – increasing by 50.0 percent during this period.

If one adjusts FY 1996 expenditures per position for inflation, the average cost per FTE position has increased from $56,243 in FY 1996 to $70,234 per position in FY 2004 – a 25.0 percent increase during this period. This growth is attributed to increases in the salary base, medical insurance costs, and cost of living arrangements in the State's contracts.

In addition, providing medical insurance to State employees has doubled since FY 1996. Employee medical insurance costs have increased from $85.2 million in FY 1996 to $169.9 million in FY 2004. Adjusting for inflation, medical insurance costs increased from $102.2 million in FY 1996 to $169.9 million in FY 2004 – a $67.7 million or 66.2 percent increase. The FY 2004 budget also includes $13.5 million in estimated reconciliation payments to Blue Cross/Blue Shield to settle past claims not paid by the State. RIPEC had estimated the reconciliation payment to total $12.5 million last Spring, based on little variance between targeted and actual claims.

State Employee Pensions - The Governor has recommended legislation to increase employee pension contributions, and subsequently decrease employer (State) pension contributions to the State employees' retirement system. The FY 2004 budget includes approximately $10.9 million of expenditure savings due to this change.

There are a number of variables influencing State employee pensions, such as:

- Employee and Employer pension contributions;
- Employee age of retirement;
- Number of years in public service;
- Minimum years of service needed to be vested in the retirement system;
- Minimum number of years of service and minimum age needed to be eligible for full benefits;
- Average final compensation;
- Cost of Living Provisions (COLA); and
- Contributions to individual health care by retirees.

The following provides an analysis of the current state retirement systems in Rhode Island, Massachusetts and Connecticut. It explores the major components and requirements of each, and provides a series of models to compare hypothetical scenarios for comparison purposes.

Pension Contributions: Rhode Island employees are expected to contribute 8.75 percent of their salary to the State pension fund in FY 2004. The State would contribute 9.6 percent of employee salaries to the fund. The Governor's proposal would increase the State employee pension contribution from 8.75 percent to 10.75 percent, and it would reduce the State's rate from 9.6 percent to 7.6 percent.

In Massachusetts, contributions vary depending on date of hire. State employee contributions range from 5.0 - 9.0 percent, with an additional contribution of 2.0 percent of regular earnings above $30,000 for employees hired after 1979. The State does not contribute to the employee's pension.

The Connecticut pension plan is integrated into Social Security and requires no employee contributions for employees hired between July 1, 1984 and July 1, 1997. However, employees hired after July 1, 1997 contribute 2.0 percent of their salary towards pensions, while those hired before July 1984 contribute 2.0 percent of the salary up to the Social Security taxable wage base and 5.0 percent of their salary above the Social Security taxable wage base. Connecticut projects to contribute 16.42 percent of employee salaries to the pension fund in FY 2004.

Normal Benefit Requirements – Age and Years of Service: States have a range of age requirements and minimum years of service for employees to receive the normal pension benefit package. Based on the 2002 State Employees Benefits Survey (Workplace Economics Inc)., 22 states, including Rhode Island, allow state employees to retire at any age after a certain number of service years are achieved. Sixteen of these states require 30 or more years of service.

Table 11
Employee Requirements to Receive Normal Pension Benefits

Pension Systems	RI	MA (1)	CT (2)
Requirements for Full Benefits			
Minimum Age	none	65	55
Years of Service	28 years or age 60 & 10 years of service	10 years	25 Years
Vested	10	10	10
Retiree Contribution to Individual Health Care			
28 years & < age 60	10.0%	15.0%	0.0%
28 years & > age 60	0.0%	15.0%	0.0%
COLA	3.0%	3.0%	2.5%

1 - Health Care co-pay for emplyees that retire after July 1, 1994; COLA applies to first $12,000 of benefit only.
2 -Connecticut employees hired before 7/2/84 - All others normal retirement at age 60 with 25 years; age 62 with 10 years and age 65 with 5 years; COLA is minimum COLA (function of CPI-W)

Source: Workplace Economics Inc, 2002 State Employee Benefit Survey & RI Employee Retirement Handbook

Rhode Island requires that employees provide 28 years of public service in order to receive the normal pension benefits. As noted above, this may be accomplished regardless of age. Connecticut requires employees hired before July 1984 to reach age 55 and demonstrate at least 25 years of service. All other Connecticut employees may retire with full benefits at age 60 with 25 years of service, or age 62 with 10 years of service, or age 65 with 5 years of service. In order for a Massachusetts employee to retire with the normal pension benefit package, he must be at least 65 years of age and have at least 10 years of service.

Rhode Island, Connecticut and Massachusetts all require that employees serve a minimum of 10 years to be vested in the State's pension system.

Cost of Living Adjustments (COLAs): Cost of living adjustments have been integrated into nearly all State pension systems, principally to minimize the impact of inflation. States have typically established an annual COLA based on changes in the Consumer Price Index (a measure of inflation) or by establishing a percentage that is integrated into the plan.

Rhode Island applies an annual 3.0 percent COLA to pension benefits beginning the COLA on the third January after retirement. Massachusetts is a more ad hoc process where the COLA is subject to Legislative approval. The most recent COLA approved was 3.0 percent on the first $12,000 for retired members for the period beginning July 1 2001. Connecticut has tied its COLA to CPI, but has guaranteed a minimum of 2.5 percent and a maximum of 6.0 percent.

Calculating the Pension Benefit: All three states determine the average final compensation (AFC) based on the highest three annual salaries (Rhode Island is highest three consecutive years). Once this is calculated, each state has a formula based on a certain percentage multiplied by an employee's total number of years of service, and then multiplies the product by the AFC. Each state calculates it a little differently.

Rhode Island does not have a single multiplier. It applies 1.7 percent to the first 10 years of service, 1.9 percent for each of the next ten years, 3.0 percent per year for each of the next fourteen years, and 2.0 percent for the 35th year. The maximum benefit an employee can receive is 80.0 percent of the employee's AFC. So, for example, if an employee worked for Rhode Island for 30 years, is retiring at age 55 and has an AFC of $50,000, the calculation would look like the following calculation:

Table 12
Rhode Island Pension Benefit
Employee with 30 Years Service

Ave. Final Compensation: $50,000

Pension Calculation	Percentage Factor	Years Served	Pension Benefit
First 10 Years	1.7%	10	$8,500
Second 10 Years	1.9%	10	9,500
Third 10 Years	3.0%	10	15,000
35th Year	2.0%	0	0
Estimated Pension Benefit			**$33,000**
Percent of AFC:			*66.0%*

Note: Maximum benefit in RI is 80% of AFC

Source: RIPEC calculations based on RI Employee Handbook

Massachusetts uses a single multiplier when calculating the employee's pension. The formula applies 2.5 percent to the employee's total years of service, and then applies this product against the employee's average final compensation. Again, the maximum benefit is 80 percent of the AFC. However, as noted above, Massachusetts does require a minimum age of 65 to receive normal retirement benefits. Therefore, the Bay State has established a benefit rate chart based on age of retirement, penalizing employees for retiring at an earlier age than required. For example, if an employee were to retire at age 65 with 30 years of service and has an AFC of $50,000, the calculation would look like the following: (2.5 percent x 30) x $50,000, resulting in an estimated pension benefit of $37,500.

However, should the Massachusetts employee retire at age 55 with 30 years of service and has an AFC of $50,000, the calculation would look like the following: (1.5 percent x 30) x $50,000, resulting in an estimated pension benefit of $22,500.

Connecticut's calculation of pension benefits is similar to Massachusetts, in that it applies a single multiplier to the number of years of service (for those hired before July 1984). The formula applies 2.0 percent to the employee's total years of service (up to age 65), and then applies this product against the employee's average final compensation.

For example, if an employee were to retire at age 65 with 30 years of service and has an AFC of $50,000, the calculation would look like the following: (2.0 percent x 30) x $50,000, resulting in an estimated pension benefit of $30,000.

As noted earlier, Connecticut requires age 55 and 25 years of service (hired before July 1984) to be eligible for normal pension benefits. An employee cannot retire before age 55 and receive benefits. One must wait until age 55 with at least 10 years of state service to receive earned benefits. If an employee retires at age 55 or older, but with less than 25 years of service, the State applies a lower multiplier to the number of years served. For example, if one retired at age 55 and had 25 years of service, the multiplier would be 2.0 percent per year served. If one retired at age 55 with 10 years of service, the multiplier would be 1.0 percent per years served. Connecticut does not have any limitations as to the percentage of average final compensation an employee can enjoy.

Retiree Health Care Benefits: In Rhode Island, the State pays between 50 and 100 percent of the cost of individual health care, depending on age and number of years of service. Rhode Island employees with 28 years of service at age 60 do not contribute to their health insurance. Connecticut also covers the entire cost of individual health care for employees. In Massachusetts, retirees who retired after July 1, 1994 contribute 15.0 percent of the premium.

Models of Pension Systems: The following provides a series of models of State employee retirements in order to provide a comparison of the different pension systems. The following two tables illustrate the estimated pensions of Sate employees in Rhode Island, Massachusetts and Connecticut. There are a number of assumptions that need to be considered when reviewing these tables. First, it is assumed that the average final compensation (AFC) for the employee is $50,000. Second, it is assumed that the employee has served his or her state for 30 years at the time of retirement. And third, each table accounts for each state's COLA provision as it currently exists in contract or law. Note that the models assume a 2.5 percent COLA (minimum) for Connecticut pension benefits.

It should also be noted that the following analysis does not take into account the benefits associated with individual health care. As noted earlier, neither Rhode Island nor Connecticut retirees meeting the criteria noted above are required to provide a co-pay for individual health care benefits. Massachusetts employees are required to provide a 15.0 percent co-pay. This would equate to approximately $700 for the 55-year-old Massachusetts employee with 30 years of service. The Rhode Island and Connecticut employee would not have to incur this additional cost. In addition, Massachusetts exempts state pensions from state taxation.

If the employee were to retire at age 65, Massachusetts would provide the largest initial pension benefit to its employee. Massachusetts would provide $37,500 for the employee, while Rhode Island and

Connecticut would provide $33,000 and $30,000 respectively. However, at age 76 (within eleven years of retirement), the Rhode Island employee would surpass the Massachusetts employee – because the Ocean State applies its 3.0 percent COLA to the entire pension benefit, where Massachusetts applies the 3.0 percent pension to the first $12,000 of pension benefit. The Connecticut employee would take 16 years (age 81) to surpass the Massachusetts employee.

However, there is another major factor influencing the differences among the state's pension systems – age requirements. Rhode Island does not have a minimum age requirement, where both Connecticut (55) and Massachusetts (65) do. The age requirement, combined with the COLA differences, have a significant impact should an employee retire at a younger age.

For example, take an employee who retires at age 55 with 30 years of service. Since Rhode Island does not have a minimum age requirement, the 55-year-old employee with 30 years of service would still enjoy the maximum benefit under this model - $33,000. However, in Massachusetts, the 55-year-old employee with 30 years of service would be penalized for not reaching the State's 65-year old age limit. The employee would have to retire at a pension benefit level of $22,500 – approximately 45.0 percent of the AFC rather than at 75.0 percent if he or she were age 65. The Rhode Island employee benefit would be $10,500 more than the employee in Massachusetts.

The 55 year old employee with 30 years of service in Connecticut would receive the same level of pension benefits at age 55 as he would at age 65 because the State's minimum age requirement for normal benefits is age 55. With an AFC of $50,000, the employee would receive $30,000 at age 55 – $7,500 more than in Massachusetts, but still less than in Rhode Island ($3,000).

The COLA component of the pension system takes hold very quickly for the 55-year-old Rhode Island retiree with 30 years of service depending on the State. In Rhode Island, the employee's pension benefit increases to $41,803 by the time he is age 65. This is approximately 27.0 percent more than the employee would have received if he had retired at age 65 with 30 years of service. In addition, the $41,803 benefit in Rhode Island would exceed the Massachusetts benefit of $26,100 by $15,700 – nearly 60.0 percent.

In Connecticut, the gap between Rhode Island's pension benefits still exists, but not to the same degree as the gap between the Ocean and Bay states. In Connecticut, the employee's pension benefit increases to $38,403 by the time he is age 65. This is approximately 28.0 percent more than the employee would have received if he had retired at age 65 with 30 years of service. In addition, the $38,403 benefit in Connecticut would be $3,400 less than in Rhode Island – nearly 8.1 percent less.

Table 13

Massachusetts Employee With 30 Years of Service and $50,000 AFC

Age	55	56	57	58	59	60	61	62	63	64	65
55	**22,500**										
56	22,860	**24,000**									
57	23,220	24,360	**25,500**								
58	23,580	24,720	25,860	**27,000**							
59	23,940	25,080	26,220	27,360	**28,500**						
60	24,300	25,440	26,580	27,720	28,860	**30,000**					
61	24,660	25,800	26,940	28,080	29,220	30,360	**31,500**				
62	25,020	26,160	27,300	28,440	29,580	30,720	31,860	**33,000**			
63	25,380	26,520	27,660	28,800	29,940	31,080	32,220	33,360	**34,500**		
64	25,740	26,880	28,020	29,160	30,300	31,440	32,580	33,720	34,860	**36,000**	
65	26,100	27,240	28,380	29,520	30,660	31,800	32,940	34,080	35,220	36,360	**37,500**

Rhode Island State Employee With 30 Years of Service and $50,000 AFC

Age	55	56	57	58	59	60	61	62	63	64	65
55	**33,000**										
56	33,000	**33,000**									
57	33,000	33,000	**33,000**								
58	33,990	33,000	33,000	**33,000**							
59	35,010	33,990	33,000	33,000	**33,000**						
60	36,060	35,010	33,990	33,000	33,000	**33,000**					
61	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**				
62	38,256	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**			
63	39,404	38,256	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**		
64	40,586	39,404	38,256	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**	
65	41,803	40,586	39,404	38,256	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**

Difference in Estimated Pension Benefits

Age	55	56	57	58	59	60	61	62	63	64	65
55	**10,500**										
56	10,140	**9,000**									
57	9,780	8,640	**7,500**								
58	10,410	8,280	7,140	**6,000**							
59	11,070	8,910	6,780	5,640	**4,500**						
60	11,760	9,570	7,410	5,280	4,140	**3,000**					
61	12,482	10,260	8,070	5,910	3,780	2,640	**1,500**				
62	13,236	10,982	8,760	6,570	4,410	2,280	1,140	**0**			
63	14,024	11,736	9,482	7,260	5,070	2,910	780	(360)	**(1,500)**		
64	14,846	12,524	10,236	7,982	5,760	3,570	1,410	(720)	(1,860)	**(3,000)**	
65	15,703	13,346	11,024	8,736	6,482	4,260	2,070	(90)	(2,220)	(3,360)	**(4,500)**

Source: RIPEC calculations based on information from 2002 State Employee Benefits Survey, Workplace Economics Inc and MA Dept of Treasurer

Table 14

Connecticut Employee With 30 Years of Service and $50,000 AFC

Age	55	56	57	58	59	60	61	62	63	64	65
55	**30,000**										
56	30,750	**30,000**									
57	31,519	30,750	**30,000**								
58	32,307	31,519	30,750	**30,000**							
59	33,114	32,307	31,519	30,750	**30,000**						
60	33,942	33,114	32,307	31,519	30,750	**30,000**					
61	34,791	33,942	33,114	32,307	31,519	30,750	**30,000**				
62	35,661	34,791	33,942	33,114	32,307	31,519	30,750	**30,000**			
63	36,552	35,661	34,791	33,942	33,114	32,307	31,519	30,750	**30,000**		
64	37,466	36,552	35,661	34,791	33,942	33,114	32,307	31,519	30,750	**30,000**	
65	38,403	37,466	36,552	35,661	34,791	33,942	33,114	32,307	31,519	30,750	**30,000**

Rhode Island State Employee With 30 Years of Service and $50,000 AFC

Age	55	56	57	58	59	60	61	62	63	64	65
55	**33,000**										
56	33,000	**33,000**									
57	33,000	33,000	**33,000**								
58	33,990	33,000	33,000	**33,000**							
59	35,010	33,990	33,000	33,000	**33,000**						
60	36,060	35,010	33,990	33,000	33,000	**33,000**					
61	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**				
62	38,256	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**			
63	39,404	38,256	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**		
64	40,586	39,404	38,256	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**	
65	41,803	40,586	39,404	38,256	37,142	36,060	35,010	33,990	33,000	33,000	**33,000**

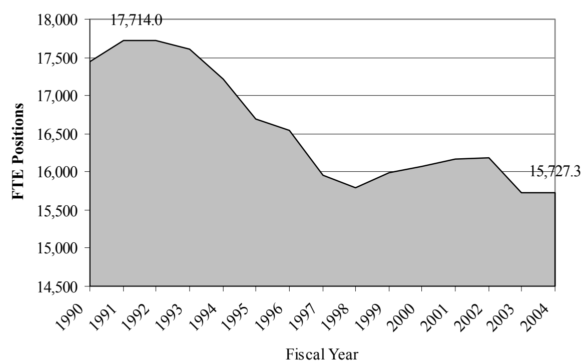
Difference in Estimated Pension Benefits

Age	55	56	57	58	59	60	61	62	63	64	65
55	**3,000**										
56	2,250	**3,000**									
57	1,481	2,250	**3,000**								
58	1,683	1,481	2,250	**3,000**							
59	1,895	1,683	1,481	2,250	**3,000**						
60	2,118	1,895	1,683	1,481	2,250	**3,000**					
61	2,351	2,118	1,895	1,683	1,481	2,250	**3,000**				
62	2,595	2,351	2,118	1,895	1,683	1,481	2,250	**3,000**			
63	2,852	2,595	2,351	2,118	1,895	1,683	1,481	2,250	**3,000**		
64	3,120	2,852	2,595	2,351	2,118	1,895	1,683	1,481	2,250	**3,000**	
65	3,401	3,120	2,852	2,595	2,351	2,118	1,895	1,683	1,481	2,250	**3,000**

Source: RIPEC calculations based on information from 2002 State Employee Benefits Survey, Workplace Economics Inc and MA Dept of Treasurer

Staffing - In order to manage the staffing levels in State government, the State allocates FTE positions (full time equivalent positions) to all agencies and departments. These FTE positions now exclude certain positions in higher education that are research oriented and are financed through federal or other third party sources. However, the following discussion includes these positions in the totals for comparison purposes.

Table 15
Authorized FTE Positions



The Governor's FY 2003 revised budget request includes 15,722.8 FTE positions, representing a 297.8 FTE position decrease from the FY 2003 enacted budget. The decrease is achieved through attrition and leaving positions open. It should be noted that this figure includes 321.8 FTE positions in higher education that have been designated as exempt from the enacted FTE authorizations.

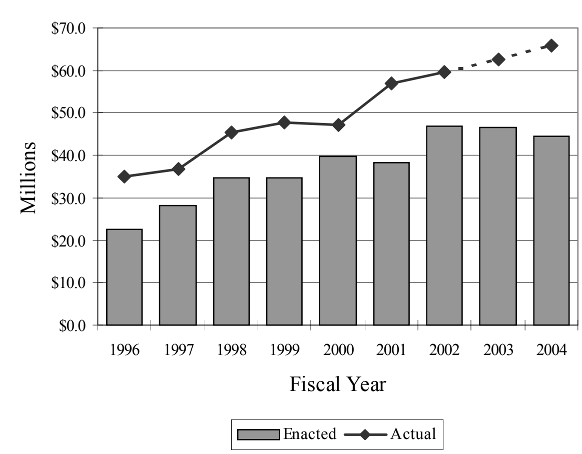
The Governor's FY 2004 budget includes 15,727.3 FTE positions, representing a 4.5 FTE position increase from the FY 2003 revised budget. It should be noted that this figure includes 319.8 FTE positions in higher education that have been designated as exempt from the enacted FTE authorizations.

The Governor's budget proposes to create a new class of positions called limited service positions. These positions would not be subject to the FTE position authorization spelled out in the annual appropriations bill. According to Article 30 of the Governor's proposed budget, these positions would be funded by non-general revenue sources of revenue and would be limited to one year of employment. These positions would not be eligible for retirement, health or other benefits ordinarily provided to state employees.

Other Personnel Issues - There are two additional personnel issues worth highlighting. First, the State's expenditures for overtime continue to display interesting trends. Overtime expenditures represent approximately 6.0 percent of the State's salaries and benefits. Overtime has increased from $35.1 million in FY 1996 (unadjusted) to $44.5 million in FY 2004 – a $9.4 million increase during this period (26.8 percent). Overtime expenditures peaked at $59.8 million in FY 2002.

However, what is of concern is the ongoing practice of how overtime is budgeted in the State. For example, in FY 2001, the actual experience in overtime expenditures ($57.0

Table 16
Statewide Overtime Experience



million) exceeded the enacted appropriation of $38.4 million by 50.0 percent. Similarly, the FY 2003 enacted budget included $46.6 million in overtime, whereas the Governor's FY 2003 revised budget includes $52.7 million in net overtime expenditures – a 13.0 percent increase from the enacted budget. The Governor's FY 2004 proposed budget includes $45.5 million in net overtime expenditures. The gap between budgeted and actual experience could continue if overtime continues to grow at a similar rate experienced over the past five years.

Purchased services, or contracted services, also have a number of interesting expenditure and budgeting trends. First, expenditures for purchased services have increased from $89.3 million in FY 1996 to $142.5 million in FY 2004 – a $53.2 million increase (60.0 percent) over this period of time. If one adjusts for inflation purchased services still increased by 33.0 percent. Purchased services expenditures represented 9.5 percent of the State's personnel budget in FY 1996. This has since increased slightly to 10.6 percent.

A similar budgeting pattern emerges in purchased services. In FY 2003, the budget as enacted included $130.1 million in contract spending. Of the $130.1 million in purchased services budgeted in the FY 2003 enacted budget, $38.7 million was supported with general revenues - $10.3 million less than actual experience in FY 2002. The FY 2003 enacted budget included adjustments to reflect the State's program to reduce purchased services spending statewide by 10.0 percent ($4.2 million).

The Governor has requested $160.6 million in spending for these services in the revised FY 2003 budget plan – a $30.5 million net increase from the enacted budget (a 23.4 percent increase). Of this amount, $45.8 million would be supported with general revenues - $7.1 million more than enacted.

The Governor's FY 2004 budget request includes $142.6 million in expenditures for contracted services, of which $38.6 million is supported with general revenues. This would represent a 15.7 percent decrease in general revenue supported purchased services spending.

State Aid - The Governor's FY 2004 budget request includes approximately $1,060.2 million in local aid, representing a 2.0 net percent increase over the FY 2003 revised budget. Approximately 66.0 percent of the $1,060.2 million in local aid program is related to general school aid. This is down from 85.4 percent in FY 1996.

Local aid to cities and towns has doubled since FY 1996 - from $528.5 million to $1,060.2 million in FY 2004 as proposed by the Governor – a $531.7 million increase over this period of time. If one adjusts for inflation, local aid increased from $634.3 million in FY 1996 – a $425.9 million increase in local aid during this period. It should be noted that the growth in local aid since FY 1996 represents 31.1 percent of all State spending growth during this period.

The three largest drivers of growth in local aid include the program to phase-out the excise tax on motor vehicles, education aid, Federal aid (schools) and general revenue sharing.

Of the $425.9 million net increase in local aid since FY 1996 (adjusted for inflation), nearly 37.8 percent of the increase was for additional education aid, and 24.4 percent ($104.3 million) was related to the program to phase out the excise tax on motor vehicles. Approximately 23.4 percent is related to various Federal aid programs for

Table 17
Aid Programs to Municipalities
(Thousands)

State Aid	1999	2000	2001	2002	2003	2004	2003-04
Direct Education Aid	$479.5	$515.1	$560.0	$596.4	$621.7	$622.6	$0.9
Teacher Retirement	30.2	40.0	35.5	31.3	39.1	40.4	1.2
Construction Aid	22.6	25.5	30.8	33.2	38.2	40.6	2.4
Motor Vehicle	22.3	47.3	76.6	99.6	100.2	104.3	4.1
General Revenue Sharing	19.7	27.6	33.5	43.6	48.3	48.3	0.0
PILOT	15.9	16.1	17.6	18.1	18.2	21.7	3.6
Distressed Community	6.2	6.6	7.3	7.7	7.5	7.5	0.1
Library Aid	3.6	5.7	6.0	6.3	6.6	6.9	0.3
Other State Aid - Various	8.3	13.6	16.1	20.5	21.1	27.0	5.9
Federal Aid	69.4	76.5	81.8	87.8	139.1	140.8	1.8
Total State Aid	**$677.7**	**$773.9**	**$865.2**	**$944.5**	**$1,040.0**	**$1,060.2**	**$20.3**
Change		*14.2%*	*11.8%*	*9.2%*	*10.1%*	*1.9%*	

Source: RIPEC calculations based on State Budget Office

local communities and 7.7 percent was due to increases in general revenue sharing. The 5.0 percent balance was in various other state aid programs.

Excise Tax on Motor Vehicles - The State embarked on an eight-year program to phase-out the excise tax on motor vehicles by FY 2007. The program requires all communities to freeze motor vehicle excise tax rates at the FY 1998 level, and increases the amount of vehicle value exempt from taxation until all vehicle value is exempt in FY 2007. In making up the lost revenues generated by the tax, the State holds communities harmless through advance reimbursements adjusted for inflation.

The Governor has continued the freeze on the eight-year phase out of the local excise tax on motor vehicles. The FY 2004 budget continues to reimburse local communities for an exemption of $4,500, requiring $104.3 million – this represents a $4.1 million increase from FY 2003, which also provided an exemption of $4,500. The growth in the program in FY 2004 is due to changes in the total value of eligible vehicles statewide. The Governor has proposed to eliminate the provision of an annual inflation adjustment, which was included as part of the program to replace the municipalities' ability to increase motor vehicle taxes in the future. The Governor estimates that the FY 2004 budget would have required an additional $3.3 million if the CPI adjustment were continued.

General Revenue Sharing - The program is based on the percentage of total state tax collections from two years prior. In FY 1999, the State started to eliminate local retail, wholesale and auto dealers' inventory taxes over a ten-year period, freezing FY 1999 local tax rates and requiring municipalities to reduce rates annually by 10 percent. Concurrently, the State embarked on a ten-year program to increase the percentage in the General Revenue Sharing Program from 1.3 percent in FY 1999 to 4.7 percent by FY 2009 to reimburse municipalities for revenues foregone. Since its inception the program has experienced a one-year delay in its implementation.

Under current law, FY 2004 General Revenue Sharing aid would be calculated based on 2.7 percent of FY 2002 total tax revenues. This would require an appropriation of approximately $51.4 million. However, the Governor has proposed to fund the program at 2.6 percent, or $48.3 million. The Governor has proposed funding the program without updating the distribution formula by community – in other words, he has proposed to provide each community with the same dollar amount in FY 2004 as they received in FY 2003, thereby avoiding the formula driven component of the formula for FY 2004. The Governor has argued that given the State would have used 2000 Census data and that FY 2002 tax collections were lower than those in FY 2001, 20 communities would have received less aid in FY 2004 than in FY 2003.

The Governor has also proposed to permanently hold the General Revenue Sharing Program at 2.6 percent thereafter. Under the original intent of the program, the State was to reimburse cities and towns through the General Revenue Sharing Program for revenues foregone as they eliminated the local inventory taxes. The Governor's proposal does not address the inventory tax side of the equation.

Payment-in-Lieu-of-Taxes (PILOT) - Established in 1986, the PILOT program is designed to provide payments to local communities for various institutions that are not on local property tax rolls. Prior to FY 2003, the program provided a rate of reimbursement of 27.0 percent of taxes that would have been collected if the properties were taxable. The FY 2003 enacted budget included language to permit the State to ratably reduce the appropriation for the PILOT program rather than to appropriate to the statutorily established rate of 27.0 percent. The State appropriated $18.2 million in FY 2003, which represented funding the PILOT program at 24.8 percent.

In his FY 2004 budget request, the Governor has proposed to restore PILOT funding to 27.0 percent, proposing $21.7 million in appropriations. This represents a $3.6 million increase in State funding for this program. The Governor has also included language in the budget that would give local communities the authority to tax private non-profit higher education facilities within their jurisdictions. It is unclear whether the State's PILOT program would adjust for these tax arrangements in the future.

Education Aid - As shown on Table 18, the Governor's FY 2004 education aid program totals $722.5 million, representing a $9.3 million (1.3 percent) increase over FY 2003 revised figures. However, there are several components to the Governor's program worth noting. First, direct education aid program would total $622.6 million to local school districts – a $890,000 increase from FY 2003. The increase is attributed to enrollment updates for full-day kindergarten and group homes. No additional direct school aid has been proposed. The Governor did include an additional $600,000 for the Hope High School Reform initiative.

The Governor has increased funding for charter schools and the MET school by $4.8 million. The Budget also increases funding for the State's contribution for the Teacher Retirement Pension Fund by $0.6 million and provides an additional $2.4 million for the State's Construction Aid program. The Governor has also proposed a number of changes to both the retirement program and the construction aid program.

Table 18
Rhode Island State Education Aid Program
(Thousands)

Education Aid	1999	2000	2001	2002	2003	2004	2003-04	Percent
Direct Education Aid	$479.5	$515.1	$560.0	$596.4	$621.7	$622.6	$0.9	0.1%
Teacher Retirement	30.2	40.0	35.4	30.7	38.4	39.0	0.6	1.6%
Construction Aid	22.6	25.5	30.8	33.2	38.2	40.6	2.4	6.3%
Charter Schools	0.0	2.8	3.8	6.2	9.4	12.4	3.0	31.9%
MET School	1.2	1.8	2.0	2.2	4.0	5.8	1.8	44.4%
Other Aid	0.5	0.7	5.9	6.4	1.5	2.1	0.6	40.0%
Total	**$534.0**	**$585.9**	**$637.8**	**$675.0**	**$713.3**	**$722.5**	**$9.3**	**1.3%**

Source: RIPEC calculations based on State Budget Office Documents

The State and school districts share the employer contribution to the Teacher Pension Fund. The State pays 40.0 percent the locality provides the balance. The FY 2004 Budget includes $39.0 million in funding for the State's contribution to the Teacher Retirement Pension Fund. This is net of an anticipated $6.3 million in savings to the State through the Governor's proposal to increase the teachers' contribution to their retirement fund.

Teacher Pensions - The Governor has proposed to increase the teacher's pension contribution from 9.5 percent to 11.5 percent, and the State's contribution rate would decline from 13.72 percent to 11.72 percent in FY 2004. Local governments pay 60 percent of the employer's share for the teacher's pension system, the State pays 40 percent. Local communities would experience net savings of $9.5 million. In Massachusetts, teachers contribute 11.0 percent of their salary towards their pensions, while in Connecticut, teachers contribute 7.0 percent of their salary towards their pensions.

School Construction Aid - School Construction aid is a program that reimburses municipalities for a share of completed school-related capital projects. The State's share of these costs is determined by each district's relative wealth as compared to the aggregate state wealth. The State has a minimum share of 30.0 percent. In FY 1998, the State expanded the type of projects eligible for reimbursement under the program, permitting not only general obligation bond financing, but other funding mechanisms, including third-party financing and capital reserve funds. This action increased the number of eligible projects. The Governor has proposed a number of changes to the method of reimbursement in an attempt to limit growth in the program. The most significant change would be that the State would only reimburse the construction costs of the projects, not the interest costs. This would not affect those projects already approved by the State.

IV. The Revenue Plan

The Governor's FY 2003 revised budget and FY 2004 proposed budget are based on revenue estimates established in November 2002 and in January of this year. It should be noted that the November 2002 Revenue Estimating Conference (REC) increased FY 2003 revenue estimates by $8.0 million – from $2,707.0 million to $2,715.0 million.

In January, there was a special revenue estimating conference held due to changes in the number of video lottery terminals permitted in the State. The REC increased estimated revenues in FY 2004 by $23.6 million due to this change.

The REC estimated revenues of $2,672.4 million for FY 2004. This is a decline of 2.1 percent or $58.0 million less than the revised revenues for FY 2003 ($2,730.4 million). The decline is mainly attributable to a decline within "Other Miscellaneous Revenues". The FY 2004 revenue estimate does include the remaining $37.7 million in revenues derived from the tobacco securitization. Also, the FY 2004 estimates did not include the Hospital Licensing Fee - estimated to be $62.3 million. The Governor and General Assembly have extended the fee each year. As shown on the next page the Governor recommended continuing the Hospital Licensing Fee.

The Governor has proposed changes to the revenue plan for both fiscal years. The Governor's proposed FY 2003 changes total $15.3 million.

Table 19
State General Revenues

	FY 2003		FY 2004		Change	
	REC	**Revised**	**REC**	**Governor**	**Amount**	**Percent**
Taxes						
Personal Income Tax	$829.7	$829.7	$875.1	$876.1	$45.4	5.5%
General Business Taxes	201.5	201.8	210.2	209.1	8.4	4.2%
General Sales & Use Tax	778.2	778.2	812.0	814.0	33.8	4.3%
Cigarette Tax	101.8	101.8	110.2	118.0	8.4	8.3%
Other Taxes	100.6	100.6	103.6	103.6	3.0	3.0%
Total Taxes	*2,011.8*	*2,012.1*	*2,111.1*	*2,120.8*	*99.0*	*4.9%*
Dept. Receipts	276.6	276.6	215.0	290.2	(61.6)	-22.3%
Taxes & Departmentals	**2,288.4**	**2,288.7**	**2,326.1**	**2,411.0**	**37.4**	**1.6%**
Other Sources						
Gas Tax Transfer	10.6	24.9	9.5	6.6	(15.4)	-61.8%
Other Miscellaneous	162.6	163.4	35.4	44.0	(128.0)	-78.3%
Lottery*	245.6	245.6	294.2	342.3	48.6	19.8%
Unclaimed Property	7.8	7.8	7.2	7.2	(0.6)	-7.7%
Total Other Sources	*426.6*	*441.7*	*346.3*	*400.1*	*(95.4)*	*-21.6%*
Total Gen. Revenues	**$2,715.0**	**$2,730.4**	**$2,672.4**	**$2,811.1**	**($58.0)**	**-2.1%**

* Lottery revenues for FY 2003 and FY 2004 are from REC from January 2003
REC= Revenue Estimating Conference

Source: FY 2004 State Budget, Executive Summary, November 2002 and January 2003 REC, and RIPEC calculations

These changes include:

- $0.3 million in additional general business taxes through expanding the group home tax base;

- $14.3 million in additional gas tax revenues through additional debt service savings from the tobacco defeasance and other debt service changes;

- $0.7 million in additional reimbursements of tobacco defeasance savings from the Rhode Island Airport Corporation and the Narragansett Bay Commission.

The Governor's FY 2004 changes total $138.7 million. Major revenue changes include:

Table 20

Major FY 2004 Revenue Changes

Hospital Licensing Fee	$62.3
Video Lottery Formula Change	48.1
Cigarette Tax Acceleration	9.3
Sinking Fund	7.0
Increase MHRH Share of Uncomp. Care	6.4
Corporate Income Tax	(2.0)
Gas Tax Transfer (RIPTA)	(2.8)
Other Revenues Changes	10.4
FY 2004 Proposed Revenue Change	**$138.7**

Source: FY 2004 State Budget - Executive Summary

- $62.3 million in revenue through the extension of the hospital licensing fee (current rate of 4.35 percent of net patient service revenues);

- $9.8 million in additional revenues from the sales and use tax, mainly from the acceleration of the cigarette tax increase ($8.3 million) and prepayment of sales tax on cigarettes ($1.0 million);

- $7.9 million through changes in the uncompensated care formula and an increase in the Department of Mental Health, Retardation and Hospitals share of uncompensated care payments made via the Medicaid program;

- $2.8 million decrease through the gas tax transfer of 0.6 cents per gallon from the General Fund to RIPTA;

- $8.5 million in other miscellaneous revenues which includes $0.6 million in reimbursements of tobacco defeasance savings from the Airport Corporation and the Narragansett Bay Commission and $7.9 million in transfers from sinking fund to the general fund; and

- $48.1 million in changes in the VLT net terminal income revenue sharing formula.

- $3.4 in additional revenues by increasing

  the fee charged for the registration of mutual funds. The Governor's proposal would increase the annual registration fee to $1,000.

The following highlights selected revenue changes:

Cigarette Tax - Cigarette tax collections increased from $53.1 million in FY 1996 to an expected $118.0 million in FY 2004, a 122.2 percent increase. In FY 1996, the cigarette tax per pack was $0.60 per pack.

The 2002 General Assembly increased the rate for FY 2003 to $1.32 per pack with increases to $1.50 for FY 2004 and additional ten cents per year until $2.00 per pack in FY 2009.

The Governor FY 2004 budget request accelerates the increase in the tax on cigarettes, increasing the FY 2004 rate from $1.50 to $1.61 per pack, with ten cent per year increases for FY 2005 through FY 2007 and nine cents in FY 2008.

Through these changes in the cigarette tax, FY 2004 general revenues would increase by $7.8 million. The State Budget Office estimates that the increase in the cigarette excise tax will also increase sales tax collections by an additional $0.5 million to a total of $8.3 million of additional revenues in FY 2004.

Increasing the cigarette excise tax to $1.61 per pack in FY 2004 will make Rhode Island's tax rate the highest in the nation. However, due to lower minimum markup provisions, the final price of a pack of cigarettes in Rhode Island would still be lower than in neighboring states. According to the House Fiscal Staff, the estimated final price in Rhode Island (including sales tax) would be $5.10 for major brands, $5.22 in Connecticut and $5.75 in Massachusetts.

Lottery – From FY 1996 to FY 2004, revenues from the lottery increased from $90.4 million in FY 1996 to an expected $342.3 million in FY 2004, a 278.7 percent increase. In 1996, lottery revenues were responsible for 5.2 percent of total general revenues. In 2004, gaming revenues account for an estimated 12.2 percent of total general revenues (includes the Governor's proposals).

In the Governor's proposed FY 2004 budget, lottery revenues are estimated to increase by $96.7 million when compared to FY 2003. The increase is due to three major issues. First, the November 2002 Revenue Estimating Conference added an additional $25.0 million in estimated revenues due to natural growth in the gaming industry.

Second, the Lottery Commission approved increasing the number of video lottery terminals (VLTs) permitted at Lincoln Park and Newport Grand Jai Alai from a total of 2,478 to 4,303 at the two facilities. The additional 1,825 machines are estimated to generate an additional $23.6 million in revenues in FY 2004.

And third, the Governor proposes to raise the State's share of net terminal income by decreasing the shares for Newport and Lincoln, the central communications system provider, and the technology providers. He

Table 21
Video Lottery Terminal Share Change

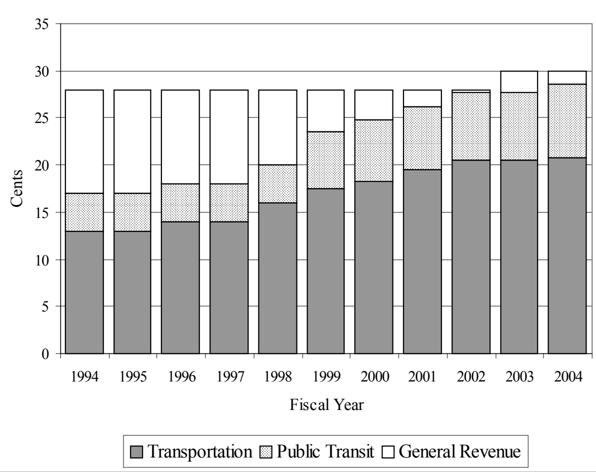
	FY 1996-FY 2000	FY 2001-FY 2002	FY 2003	FY 2004 Current Law	FY 2004 Gov	FY 96-04(Gov) Change
Lincoln Facility	31.0%	31.0%	30.5%	30.0%	24.0%	-22.6%
Jai Alai Facility	31.0%	31.0%	30.5%	30.0%	24.0%	-22.6%
Technology Providers	13.0%	8.5%	8.5%	8.5%	7.0%	-46.2%
Central System Provider	3.0%	2.5%	2.5%	2.5%	2.25%	-25.00%
Dog Kennel Owners (Lincoln only)	6.0%	6.0%	5.5%	5.0%	0.0%	-100.0%
City of Newport	1.0%	1.0%	1.0%	1.0%	1.0%	0.0%
Town of Lincoln	1.0%	1.0%	1.0%	1.0%	1.0%	0.0%
Transfer to State	**46.0%**	**51.0%**	**52.0%**	**53.0%**	**65.75%**	**42.9%**

Source: House Budget Analysis FY 2004

also proposes to eliminate any shares for the dog kennel owners in Lincoln. The Governor's proposal would increase the State's share from 52.0 percent in FY 2003 to 65.75 percent in FY 2004. Under current law, the State would receive 53.0 percent in FY 2004. The Governor's proposed changes would increase revenues by an estimated $48.1 million.

Gas Tax Transfer - The 1997 Assembly amended the law to increase the portion used by the Department of Transportation from 14 cents to 16 cents per gallon, increasing by one cent per year until the whole amount is used for transportation purposes. However, the law has been modified to dedicate a larger portion to the Rhode Island Public Transit Authority.

Table 22
Allocation of Rhode Island Gasoline Tax



Under current law, of the 30 cents gas tax per gallon, 20.75 cents are allocated to the Department of Transportation in FY 2004 to fund road and bridge repairs and maintenance programs. The Governor proposes to increase the share of the Rhode Island Public Transit Authority from 6.25 cents to 6.85 cents. This would reduce the amount of the gas tax funding to the General Revenue Fund to 1.4 cents per gallon. It would lower general revenues by $2.8 million when compared to the FY 2004 estimates.