

Understanding the basics about
RHODE ISLAND's
State Budget

Fiscal Status



BUDGET RHODE MAP

US Economy

“The economy now faces a potential double shock. The first shock is from housing and the credit crunch. Housing remains in free fall...Looming is a second shock from oil, where prices are approaching \$100/barrel. Already-high recession risks would rise sharply if this retreat (oil prices to under \$75/barrel by mid-2008) does not materialize.”

Global Insight. U.S. Executive Summary. November 2007.

RI Economy

“Rhode Island’s economy has begun to slow noticeably. Perhaps more troubling is the fact that its growth rate has decoupled from that of the US Economy. I place the odds of a US recession in the next 6-9 months at 45 percent. For Rhode Island, I believe that probability is an uncomfortable 65 percent.”

Leonard Lardaro, Ph.D. Current Conditions Index-URI. September 2007.

Mortgage Pressure - US

“These coming resets (mortgage loan rates) are akin to a tropical storm off the coast. Everyone is trying to figure out the magnitude of the losses. They don’t know if it will remain a tropical storm, or turn into a Category 5 hurricane. Right now, we’re pricing for a hurricane.”

Jack Ablin, Chief Investment Officer at Harris Private Bank. USA Today - “Cracks Appear All Over the Street”. November 23, 2007.

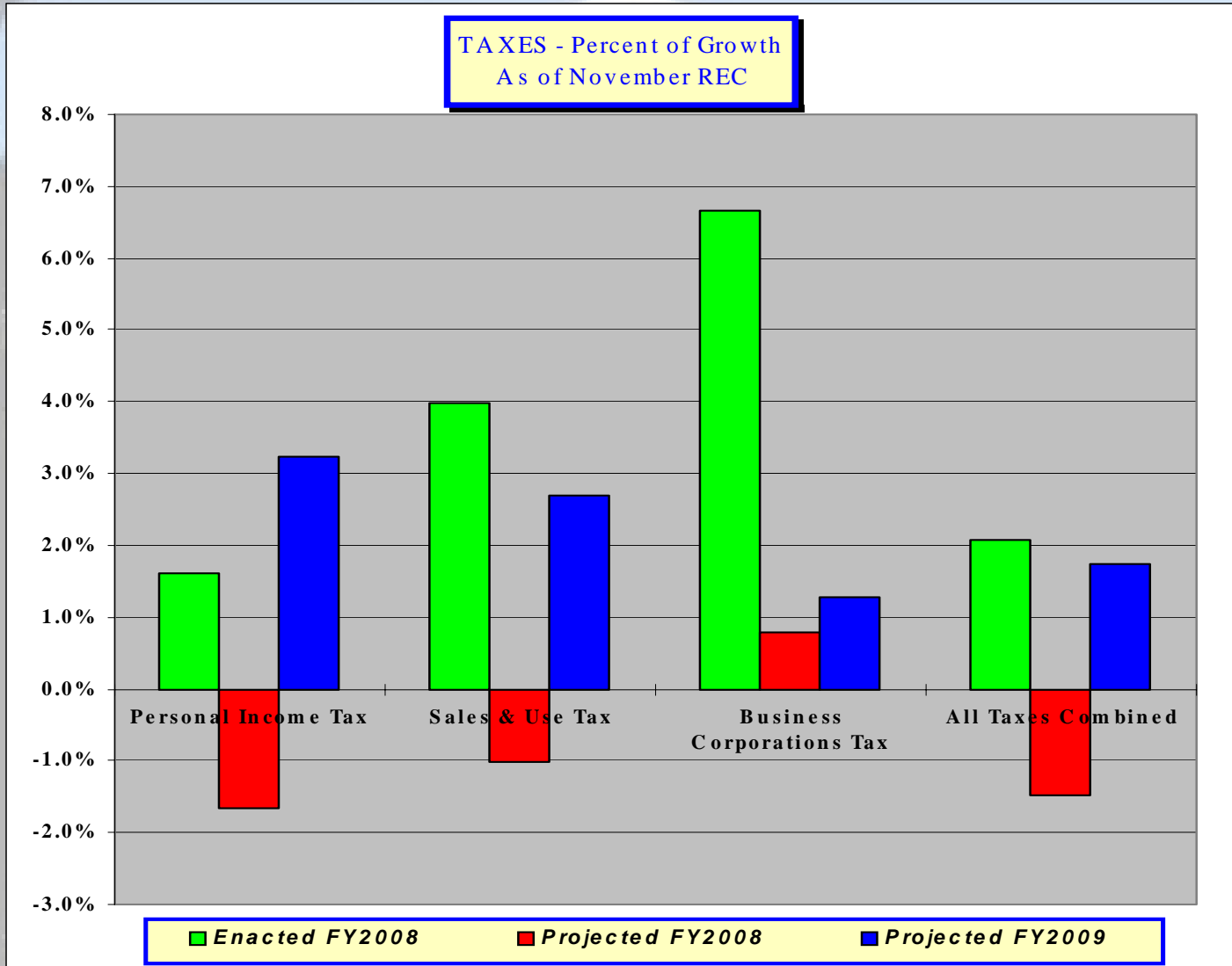
Mortgage Pressure - RI

“Delinquency rates for RI are higher than any other state in New England and the U.S. average. The effect on credit quality is significant, as state delinquency and foreclosure rates are reaching alarming levels. The indication is that the RI housing market will endure excess inventory well after most of the country’s housing markets have rebounded.”

Moody’s | Economy.com. Forecast Report: U.S., New England, and Rhode Island. November 2007.

Revenue Estimating Conference

November 2007



Revenue Estimating Conference

November, 2007

(All Amounts in Millions of Dollars)

Personal Income Tax – Not just Personal Income,
Corporate Income Tax as well.

| | | | |
|----------------------------|-----------|-----------------|-------------|
| FY2007 Actual | \$1,065.7 | | |
| FY2008 Enacted | \$1,082.9 | +\$17.2 | +1.6% |
| FY2008 Estimated | \$1,048.1 | - \$17.6 | - 1.6% |
| Change to Enacted | | - \$34.8 | |
| Dec '06 vs. Dec '07 | | | 1.2% |

Lottery Winner \$151.9 -- Lump Sum = \$5.3 w/o Payment Growth 0.1%

| | | | |
|---------------------------------|-----------|-----------------|-------|
| FY2009 Estimated | \$1,082.1 | +\$34.0 | +3.2% |
| Change to FY2008 Enacted | | - \$ 0.7 | |

Revenue Estimating Conference

November, 2007

(All Amounts in Millions of Dollars)

Sales & Use Tax – Retail & Motor Vehicle Sales

| | | | |
|---------------------------------|---------|-----------------|--------------|
| FY2007 Actual | \$873.8 | | |
| FY2008 Enacted | \$908.7 | +\$34.9 | +4.0% |
| FY2008 Estimated | \$865.0 | - \$ 8.8 | - 1.0% |
| Change to Enacted | | - \$43.7 | |
| Dec '06 vs. Dec '07 | | | -2.1% |
| FY2009 Estimated | \$888.4 | +\$23.4 | +2.7% |
| Change to FY2008 Enacted | | - \$20.3 | |

Revenue Estimating Conference

November, 2007

(All Amounts in Millions of Dollars)

Lottery – 3rd Largest Source of Revenue

| | | | |
|---------------------------------|---------|----------------|-------|
| FY2007 Actual | \$320.7 | | |
| FY2008 Enacted | \$339.7 | +\$19.0 | +5.9% |
| FY2008 Estimated | \$349.5 | +\$28.8 | +8.9% |
| Change to Enacted | | +\$ 9.8 | |
| FY2009 Estimated | \$363.9 | +\$14.4 | +4.1% |
| Change to FY2008 Enacted | | +\$24.2 | |

Revenue Estimating Conference

November, 2007

(All Amounts in Millions of Dollars)

Business Corporations – “C” Corporations

| | | | |
|---------------------------------|---------|-----------------|-------|
| FY2007 Actual | \$156.8 | | |
| FY2008 Enacted | \$167.2 | +\$10.4 | +6.7% |
| FY2008 Estimated | \$158.0 | +\$ 1.2 | +0.8% |
| Change to Enacted | | - \$ 9.2 | |
| FY2009 Estimated | \$160.0 | +\$ 2.0 | +1.3% |
| Change to FY2008 Enacted | | - \$ 7.2 | |

Revenue Estimating Conference

November, 2007

Business Corporations – “C” Corporations – TY2005

Minimum Tax \$500 per year

Total Taxpayers 45,840

Minimum Taxpayers 42,974 93.7%

Taxpayers >Minimum 2,866 6.3%

Revenue Estimating Conference

November, 2007
(All Amounts in Millions of Dollars)

Financial Institutions – Bank Tax

| | | |
|---------------------------------|---------|-------------------|
| FY2007 Actual | \$23.4 | \$19 Overpayment |
| FY2008 Enacted | \$ 2.0 | - \$21.4 - 91.4% |
| FY2008 Estimated | -\$ 0.6 | - \$24.0 -102.6% |
| Change to Enacted | | - \$ 2.6 |
| FY2009 Estimated | -\$19.0 | - \$18.4 -3066.7% |
| Change to FY2008 Enacted | | - \$ 21.0 |

Revenue Estimating Conference

November, 2007
(All Amounts in Millions of Dollars)

Total General Revenues

| | | | |
|---------------------------------|-----------|------------------|--------|
| FY2007 Actual | \$3,241.4 | | |
| FY2008 Enacted | \$3,473.0 | +\$231.6 | +7.1% |
| FY2008 Estimated | \$3,359.7 | +\$118.3 | +3.6% |
| Change to Enacted | | - \$113.3 | |
| FY2009 Estimated | \$3,193.3 | - \$166.4 | -5.0 % |
| Change to FY2008 Enacted | | - \$279.7 | |

Not In FY2009 --One Time -- Tobacco = \$124.0; Hospital License Fee =\$79.6

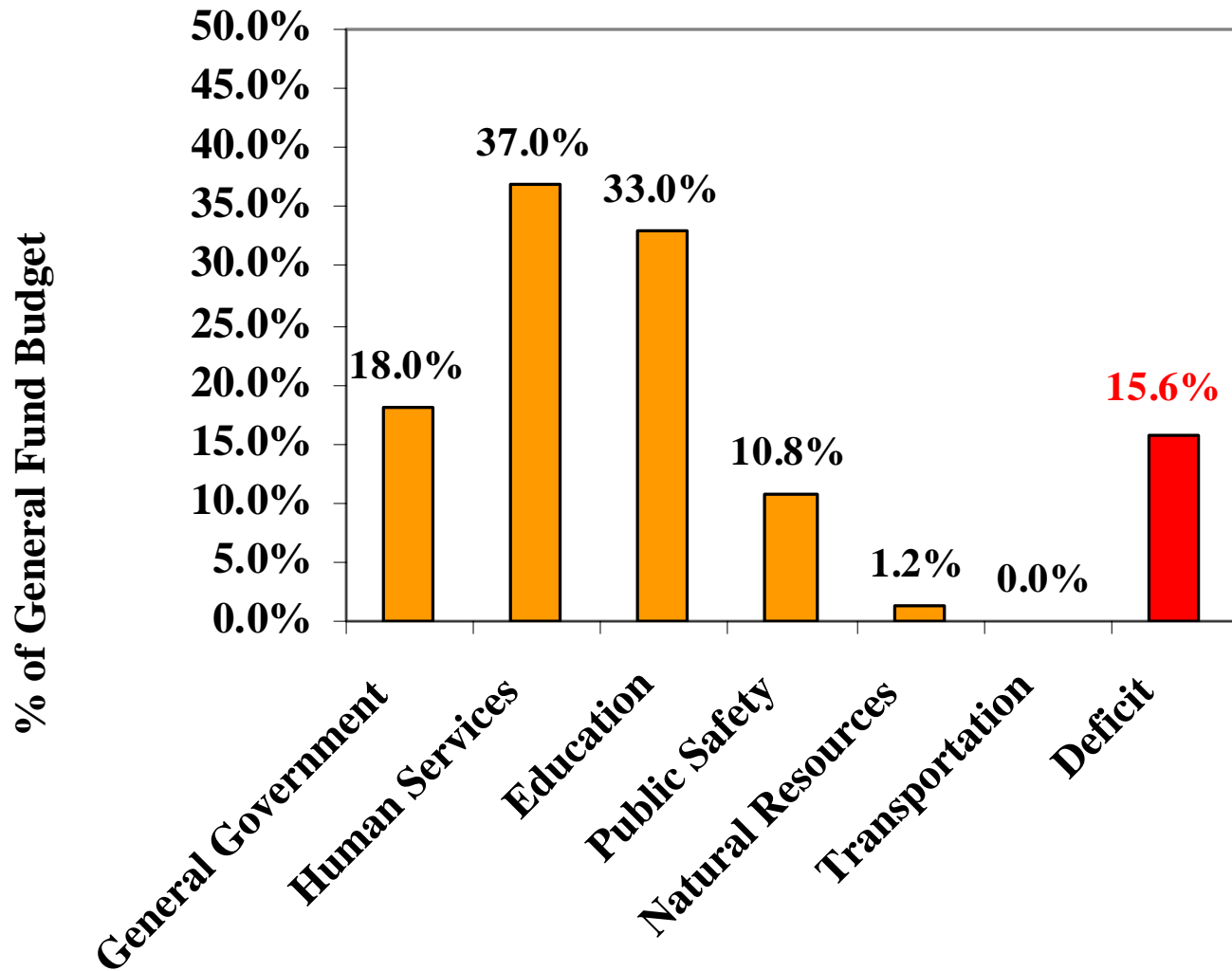
Deficit Projections

(All Amounts in Millions of Dollars)

FY2008

| | | |
|-----------------------------|------------------|----------|
| Available Resources Enacted | \$3,403.7 | |
| Estimated | \$3,298.8 | -\$104.9 |
| Expenditures Enacted | \$3,403.6 | |
| 1 st Q | \$3,450.3 | +\$ 46.7 |
| FY2008 Deficit | -\$ 151.5 | |

General Fund Budget by Issue Area



Problem in Expenditure Terms

- Deficit is larger than the Gross Domestic Product of 17 countries in the world (*World Bank, 2006 list*)
- Deficit (\$530M) is larger than the budget of each individual State agency and department except for DHS and Elementary & Secondary Education
- Elimination of ALL Public Safety and Natural Resources departments and agencies would still leave \$165 million shortfall
- Elimination of ALL Purchase Services (Contracts) would only account for 34% of the projected deficit

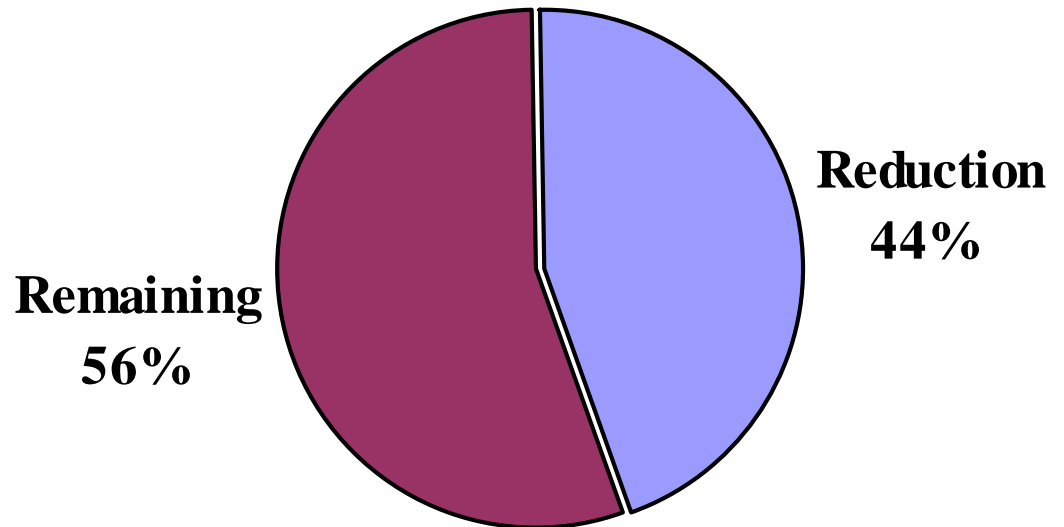
Deficit in FTE Terms

Need to
reduce 44%
of workforce
to realize
\$530M in
savings

15,987.3 Authorized FTEs

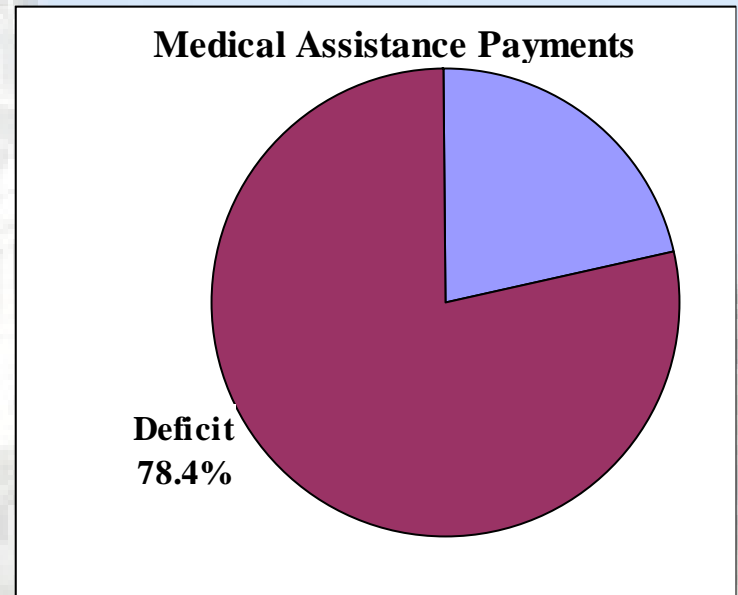
7,103.9 FTE Reduction

8,883.4 Remaining FTEs



Deficit in Medical Assistance Terms

- Medical Assistance accounts for 20% of General Revenue spending
- Deficit equals 78% of total Medical Assistance
- For perspective, to reach \$530M in savings, all hospital payments, long-term care payments, Rite Care and Rite Share payments would have to be completely eliminated



Deficit in State Aid Terms

- State Aid to municipalities accounts for 30% of General Revenue spending
- Deficit equals 52% of total State Aid to municipalities
- If you completely eliminate general municipal aid, you would still need to cut 38.3% of education aid to eliminate the deficit



Fitch Places State of Rhode Island GOs on Rating Watch Negative

❖ “The rating action reflects *weak tax revenue collections* this year and the announcement of lowered revenue forecasts for the current and upcoming fiscal years.”

❖ “Fitch will *resolve the Rating Watch Negative* based on the direction of the state's economy and revenues in the coming months and ...

... *state actions to address* the projected deficits in the current and next fiscal years.”

Fitch Places State of Rhode Island GOs on Rating Watch Negative

❖ “Rhode Island's financial stress reflects *underlying weakness in key revenue sources* and

∴ numerous tax *credit* and tax *cut* programs undertaken in recent years.”

❖ “This month's revenue estimating conference reduced estimates ... *reflecting weakness in overall consumer confidence* and the housing market in the state.

Fitch Places State of Rhode Island GOs on Rating Watch Negative

- ❖ “Rhode Island has added jobs in every year since 1992 and outperformed both the U.S. and neighboring states in the most recent recession.”
- The pace of *growth has lagged* the U.S. in recent years
- The rate of personal income growth also has *been below* that of the nation in recent years.
- ❖ Rhode Island is experiencing one of the highest rates of growth of the states in overall *mortgage delinquencies*, fueled by subprime delinquencies.

Personal Income Tax

Optional AGI Percentage Method – Flat Tax

| Estimated General Revenue Loss Optional AGI Percentage Method | | | | |
|--|------------|------------------------|--------|------|
| Tax Year | Percentage | Total Loss | Change | |
| 2006 | 8.0% | \$ 6.2 | | |
| 2007 | 7.5% | \$ 12.5 | \$ | 6.4 |
| Loss Thus Far | | <u>\$ 18.7</u> | | |
| 2008 | 7.0% | \$ 21.5 | \$ | 8.9 |
| 2009 | 6.5% | \$ 33.6 | \$ | 12.1 |
| 2010 | 6.0% | \$ 49.2 | \$ | 15.6 |
| 2011 | 5.5% | \$ 68.7 | \$ | 19.6 |
| Total Loss | | <u><u>\$ 191.7</u></u> | | |
| As of 11/5/2007 -- TY2006 | | \$ 4.9 | | |
| | | \$ 1.3 | | |

Capital Gains

TY2007 Rate dropped from 5% to 1.67%

Rhode Island Capital Gains Collections

(In Millions)

| AGI Brackets | | 2005 Net Capital Gains Tax | Percent of Total Collected |
|--------------|---------|----------------------------------|-------------------------------|
| <30,000 | \$ | 0.4 | 0.4% |
| 30,000 | 50,000 | 0.6 | 0.7% |
| 50,000 | 75,000 | 1.5 | 1.7% |
| 75,000 | 100,000 | 2.2 | 2.5% |
| 100,000 | 200,000 | 10.4 | 11.6% |
| >200,000 | | 74.9 | 83.2% |
| | | \$ | 90.1 |

Source: RI Division of Taxation

Capital Gains

TY2009 Reinstatement to 5% to 1.67%

Current Law -- Revenue Loss

| | <i>TY 2008</i> | | <i>TY 2009</i> | | <i>FY Total</i> | |
|---------|----------------|--------|----------------|--------|-----------------|--------|
| FY 2008 | \$ | (19.5) | \$ | (19.5) | \$ | (39.0) |
| FY 2009 | \$ | (19.5) | \$ | (19.5) | \$ | (39.0) |
| FY 2010 | \$ | (19.5) | \$ | (19.5) | \$ | (39.0) |

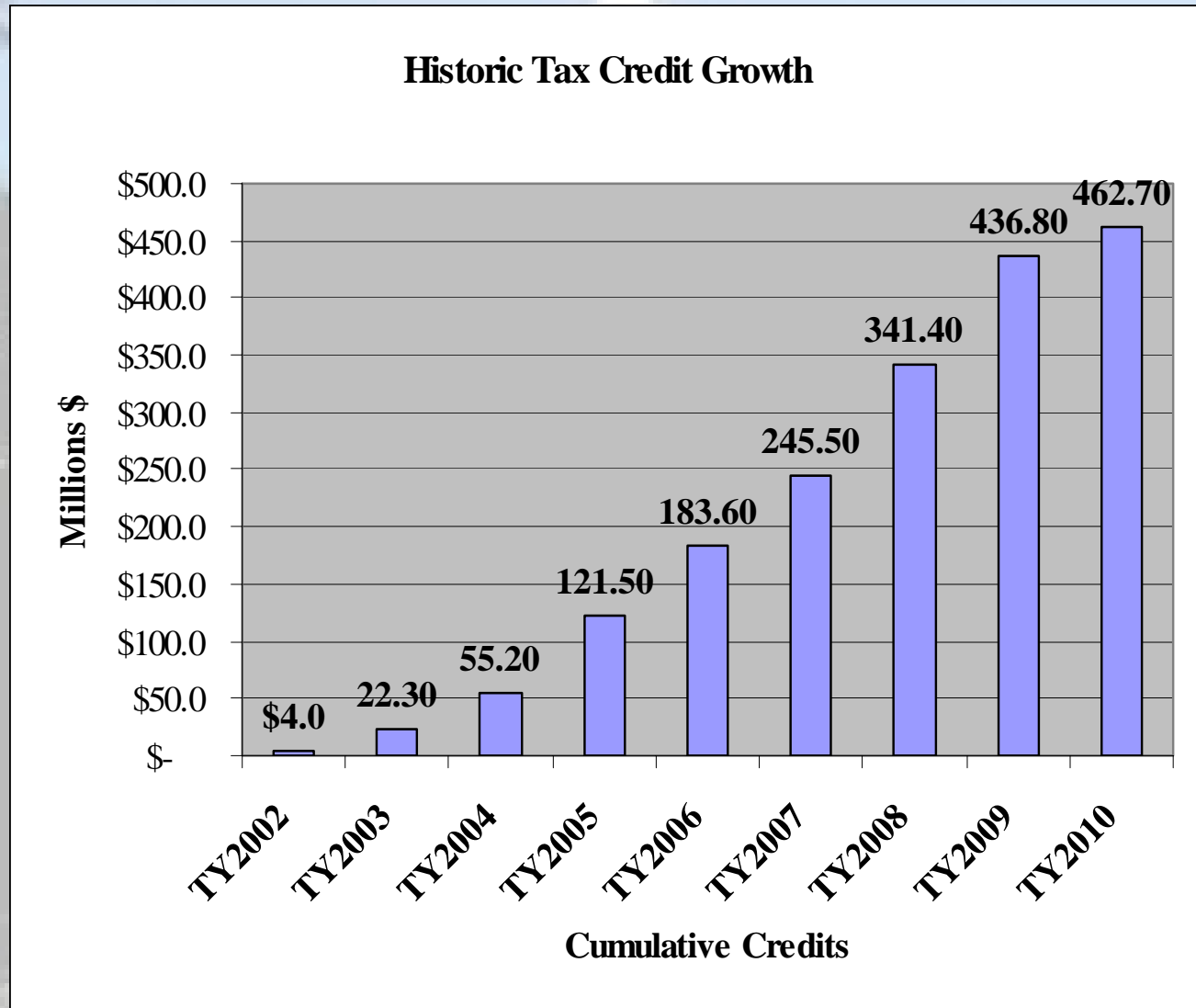
Reinstatement 5% -- Revenue Gain

| | <i>TY 2008</i> | | <i>TY 2009</i> | | <i>FY Total</i> | | <i>Difference to Current Law</i> |
|---------|----------------|--------|----------------|--------|-----------------|--------|----------------------------------|
| FY 2008 | \$ | (19.5) | \$ | (19.5) | \$ | (39.0) | \$ - |
| FY 2009 | \$ | (19.5) | \$ | - | \$ | (19.5) | \$ 19.5 |
| FY 2010 | | | \$ | - | \$ | - | \$ 39.0 |

Historic Preservation Tax Credits

- Enacted in 2001
- Now includes 287 projects worth more than \$474 million in State tax credits
- Roughly one-half of tax credit projects are in Providence
- RI does not have any per-project or annual caps on the amounts of credits
- While credits reduce revenues that are available to the State, the Legislature plays no role in granting these credits

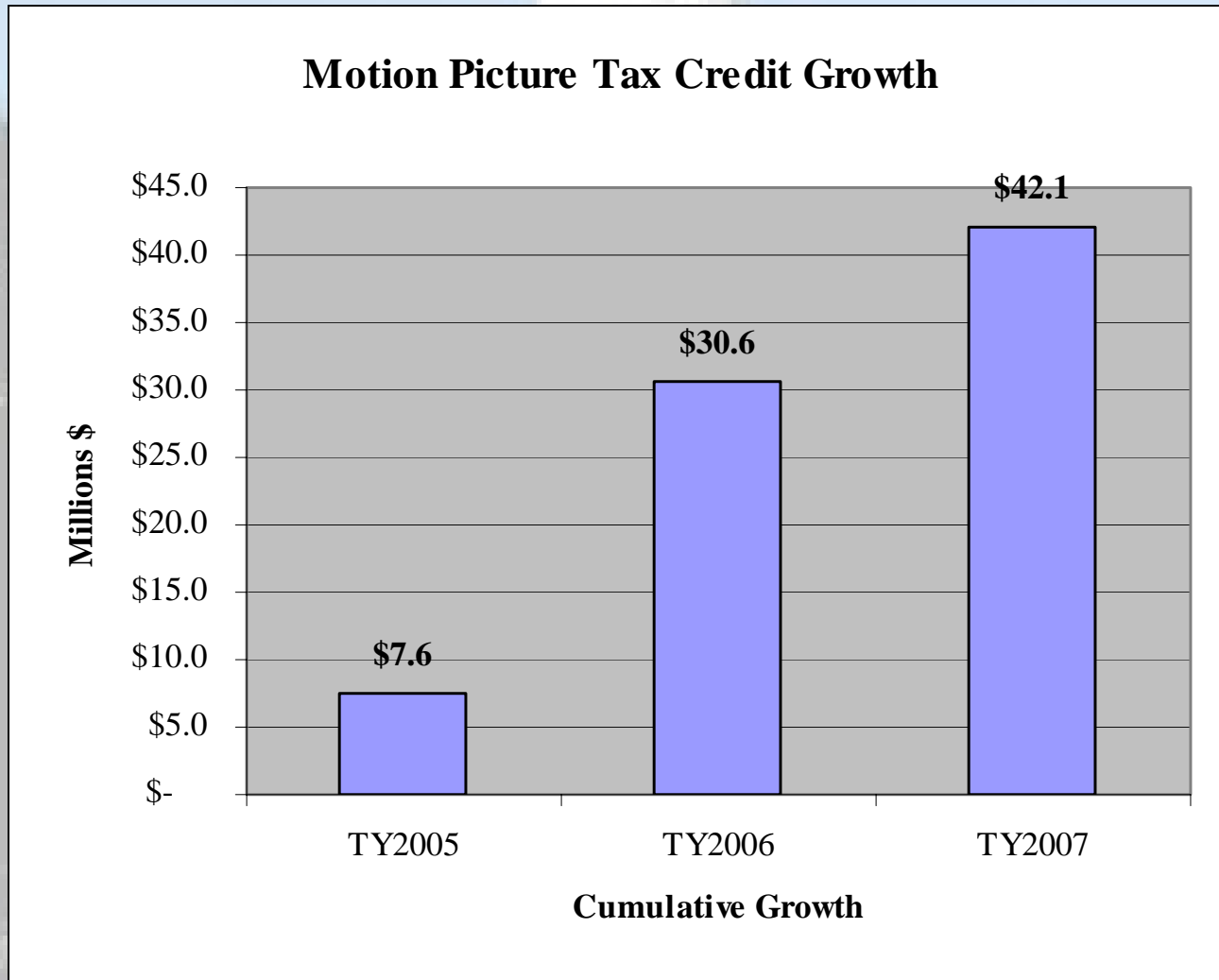
Historic Tax Credit Growth



Motion Picture Tax Credits

- Enacted in 2006
- Program requires minimum investment of \$300,000 for eligibility
- Now includes 22 projects worth more than \$44 million in State tax credits
- RI does not have any per-project or annual caps on the amounts of credits

Motion Picture Tax Credit Growth



Other Tax Credits

(All Amounts in Millions of Dollars)

| | |
|--|--------|
| Tuition – Donations to Scholarship Organizations | \$ 1.0 |
| Investment – Manufacturing Equipments & Property | \$ 8.3 |
| Job Development – New Jobs, some since 1995 | \$11.4 |
| Day Care – 30% of Day Care Costs | \$ 0.1 |
| Research & Development – 10% on Property | \$ 0.5 |
| Research & Development – 5% on Expenses | \$ 0.2 |
| Enterprise Zone – Donation, Interest, Wages | \$ 0.2 |
| Earned Income Tax Credit – Refundable 15% | \$ 3.9 |
| Property Tax Relief – Elderly, Disabled, Poor | \$14.1 |

Sales & Use Tax Exemptions

Division of Taxation – Tax Expenditure Report, 2006

Medicine & Drugs

- Includes Prescriptions & Patent Medicines
- Tax Expenditure -- \$24.3 million
- New England States – All exempt only prescriptions. ME also exempts diabetic equipment & supplies.

Newspapers – Publications Issued Regularly

- More than once in 3 months
- Tax Expenditure -- \$5,657,000
- New England States – All have exemptions for publications.

Sales & Use Tax Exemptions

Division of Taxation – Tax Expenditure Report, 2006

Gasoline

- Exempt but per gallon tax applied.
- Tax Expenditure -- \$66.4 million
- New England States – All have have similar exemptions.

Food Products

- Sold for Human Consumption. Not excluding meals.
- Tax Expenditure -- \$130.5 million
- New England States – All have similar exemptions.

Sales & Use Tax Exemptions

Division of Taxation – Tax Expenditure Report, 2006

Textbooks

- Sale or use by an educational institution.
- Tax Expenditure -- \$1.6 million
- New England States – Only MA has similar provision.

Clothing

- Articles of clothing and footwear.
- Tax Expenditure -- \$89.6 million
- New England States – CT, MA, & VT have purchase price limits (\$50, \$175, \$110)
- IF RI at \$500 = \$900,000

Sales & Use Tax Exemptions

Division of Taxation – Tax Expenditure Report, 2006

Boats

- Sales, use and storage of a new or used boat.
- Tax Expenditure -- \$4.0 million
- New England States – No similar provision.
- Sales to Non-Residents – MA & ME have exemption.
- Trade In – MA & ME have exemption

Airplanes

- Applies to all aircraft and aircraft parts.
- Tax Expenditure -- \$1.0 million
- New England States – All have similar exemption.

1% Local Taxes to Cities and Towns

Local Taxes

*1% Meals &
Beverage*

1% Hotel

Total

| | | | | | | |
|----------------------|----|------|----|-----|----|------|
| <i>FY2004</i> | \$ | 13.5 | \$ | - | \$ | 13.5 |
| <i>FY2005</i> | \$ | 17.2 | \$ | 0.6 | \$ | 17.8 |
| <i>FY2006</i> | \$ | 17.6 | \$ | 1.8 | \$ | 19.4 |
| <i>FY2007</i> | \$ | 18.8 | \$ | 1.9 | \$ | 20.7 |
| Total | \$ | 67.1 | \$ | 4.3 | \$ | 71.4 |

The Next Step?

FY2008 Deficit -\$ 151.5

FY2009 Deficit -\$ 379.3

Two Year Budget Issue - \$530.8

§ 35-3-7 Submission of budget to general assembly – Contents. – (a) On or before the third Thursday in January in each year of each January session of the general assembly, the governor shall submit to the general assembly a budget containing a complete plan of estimated revenues and proposed expenditures ...

17 January 2007