RIPEC

Rhode Island's FY 2023 Enacted Budget and Fiscal Outlook

Executive Summary
September 2022

Rhode Island's enacted state budget for fiscal year (FY) 2023, which began on July 1, 2022, represents the state's third consecutive annual budget characterized by a massive influx of federal COVID-19 relief dollars and the second consecutive annual budget marked by large state revenue surpluses. As such, these budgets have presented extraordinary opportunities and challenges for policymakers, who have been tasked with determining how to strategically invest these abundant one-time revenues while avoiding unsustainable increases in continuing funding for state programs.

The FY 2023 enacted budget authorizes a level of spending that is dramatically higher than that of just a few years ago. The enacted budget for FY 2023 marks the third consecutive fiscal year in which total annual spending exceeds $13 billion, in contrast to total annual spending below $10 billion in FY 2019, the last fiscal year unaffected by the pandemic. State general revenue spending also reflects substantial growth (up 28.2 percent over the FY 2019 enacted budget). Among the drivers of increased overall and general revenue expenditures in the FY 2023 enacted and FY 2022 revised budgets are extraordinary levels of one-time revenues, including $877.5 million in surplus funds, as well as $1.24 billion in American Rescue Plan Act (ARPA) State Fiscal Recovery Fund (SFRF) and Capital Projects Fund allocations.

The large projected surplus is primarily the result of significantly higher revenues than expected for FY 2022 and FY 2023, as estimated most recently at the May 2022 Revenue Estimating Conference. The Conference principals estimated a considerable jump in revenues for FY 2022 but adopted a more conservative outlook for FY 2023, projecting a year-over-year decline in general revenues. Arguably, the revenue estimates for FY 2023 are overly conservative, particularly given the current inflationary environment, as well as robust economic projections for personal income and personal consumption. Over the past few years, the Conference has underestimated revenues, and state revenues already appear to be running substantially ahead of estimates for FY 2022.

The FY 2023 enacted budget contains no major changes to broad-based taxes but does include one major revenue initiative—a one-time child tax rebate program expected to cost $43.8 million—along with several smaller revenue changes. While technically an expenditure item, the FY 2023 budget notably utilizes $64.4 million in surplus general revenues to advance the final year of the motor vehicle excise tax phase-out, thereby eliminating the tax.

The centerpiece of Governor McKee's FY 2023 budget proposal was his plan for spending in full the state's ARPA allocation. In the enacted FY 2023 and revised FY 2022 budgets, the General Assembly adopted many of the governor's SFRF spending proposals while making some changes in the amounts of spending authorized, funding some of the governor's initiatives with other revenue sources, and adding some new ARPA spending items. In total, the Assembly approved $131.0 million of SFRF spending for FY 2022 and $535.9 million for FY 2023, with plans to spend the remaining $464.1 million between FY 2024 and FY 2027. The largest category of spending is public health ($271.7 million), followed by housing ($250.0 million), and aid to small businesses and impacted industries ($164.0 million), including $100.0 million to recapitalize the Unemployment Insurance Trust Fund.

The FY 2023 enacted budget directs most of the state's $877.5 million in general revenue surplus funds to the Rhode Island Capital Plan Fund (RICAP) for state facility infrastructure investments and a state match to federal transportation funding ($563.0 million). Among these RICAP investments is $108.2 million for construction of a new 100-bed Zambrano medical hospital.

The FY 2023 budget includes $400.0 million in bond referenda to be placed on the ballot for voter approval in November 2022: University of Rhode Island Bay Campus improvements ($100.0 million), K-12 school construction (250.0 million), and the green economy ($50.0 million).

While the most prominent feature of the enacted FY 2023 budget is the appropriation of one-time ARPA and surplus funds, the budget also is characterized by large increases in operating expenditures for a broad range of health and human services programs, primarily through provider rate increases. General revenue spending for the category of health and human services has grown from $1.46 billion in FY 2019 to $1.90 billion in FY 2023—an increase of 29.7 percent over that period.

Despite lowered enrollment and large allocations of federal funding currently available to school districts, K-12 education also saw large spending increases in the FY 2023 budget. The enacted FY 2023 budget contains $1,406.0 million in education aid for local education agencies for FY 2023, an increase of $107.3 million (8.2 percent) over FY 2022. Based on actual enrollment figures, state aid per pupil has increased by 17.4 percent between FY 2020 and FY 2023, an annual average increase of 6.4 percent.

The FY 2023 budget authorizes 15,455.5 full-time equivalent (FTE) positions in state government, which is 8.8 percent more than authorized in the enacted FY 2022 budget and the highest since FY 2008, after which hundreds of positions were eliminated due to the Great Recession. The number of vacant positions also has climbed consistently since the mid-2000s; both the average number of vacant positions for FY 2022 (1,827.1) and the annual average vacancy rate (11.9 percent) were higher than any fiscal year since at least FY 2005.

The enacted FY 2023 budget largely directs both ARPA and surplus funds to one-time investments, and while some spending commitments may be difficult to curtail, the budget does not appear to have materially added to any existing structural deficit. The House Fiscal Advisory Staff has estimated that the enacted FY 2023 budget reflects an average annual deficit going forward of approximately $100 million. This projected budget gap is based on estimates from the May 2022 Revenue Estimating Conference. Through May 2022, total general revenues were already running $70.5 million higher than estimated at the Conference, however. If this revenue trend continues, the structural revenue gap for future budget years would be substantially reduced or eliminated. Of course, a recession or economic downturn would alter this calculation, as would increased expenditure commitments due to inflation or other factors.

RIPEC offers to policymakers the following considerations:

Given the economic uncertainty ahead and the temporary nature of federal relief funding, the state needs to be vigilant in avoiding spending commitments beyond available resources. While state revenues have been strong, general revenue spending has been growing at a rate significantly greater than the historical growth rate. This trend is likely not sustainable over the long term, and it is important to constrain spending and minimize structural deficits so that the state is prepared to weather inevitable future economic headwinds.

The state needs to commit greater focus and resources to the planning, oversight, and execution of the many new projects and programs contained in the enacted FY 2023 budget. While there is some funding in the budget for the administration of ARPA funds, state government will likely be extremely challenged in its efforts to plan, oversee, and execute the dozens of new initiatives funded in the budget, particularly considering the extraordinary vacancy rate of authorized state personnel.

Policymakers should reconcile state education aid consistent with the school funding formula or reprogram excess state resources to reform the formula. Since it is likely that school districts may not fully recover their enrollment declines, state aid should be reconciled consistent with actual enrollment levels going forward. Alternatively, policymakers could use this opportunity to reform the funding formula to increase overall state aid and target more aid to disadvantaged districts. RIPEC recommended that policymakers reform the formula in a recent report on education finance that showed that many of Rhode Island's poorest districts have among the state's lowest per pupil expenditures.

Policymakers need to constrain the growth in health and human services spending and streamline and restructure the delivery of health and human service programs. The growth in expenditures for health and human services authorized in FY 2023 is likely not sustainable and will need to be moderated in future budgets. In addition, more focus is needed to streamline the delivery of health and human services programs. Policymakers should assess whether the hospital system under the Department of Behavioral Healthcare, Developmental Disabilities and Hospitals is on a fiscally sustainable path before moving forward with a new medical facility.

The state should consider increasing the rainy day fund. While Rhode Island's rainy day fund served the state well during the pandemic, the pandemic caused only transitory disruption and no permanent state revenue loss. To the extent substantial surplus funds become available, the state should amend its constitution to increase its contribution to the rainy day fund over time from 3.0 percent to 5.0 percent of revenues, and increase the rainy day fund cap from 5.0 percent to 10.0 percent.

The state should seek to improve its business tax climate. In the enacted FY 2023 budget, the Assembly declined to pursue revenue initiatives to materially improve the business tax climate. To the extent that excess continuing revenues become available in the future, policymakers should consider reforms to improve Rhode Island's business tax climate (which ranked 40th among states in a recent Tax Foundation study). In particular, the state should seek to mitigate the relatively high commercial and tangible property tax burden imposed on Rhode Island businesses.