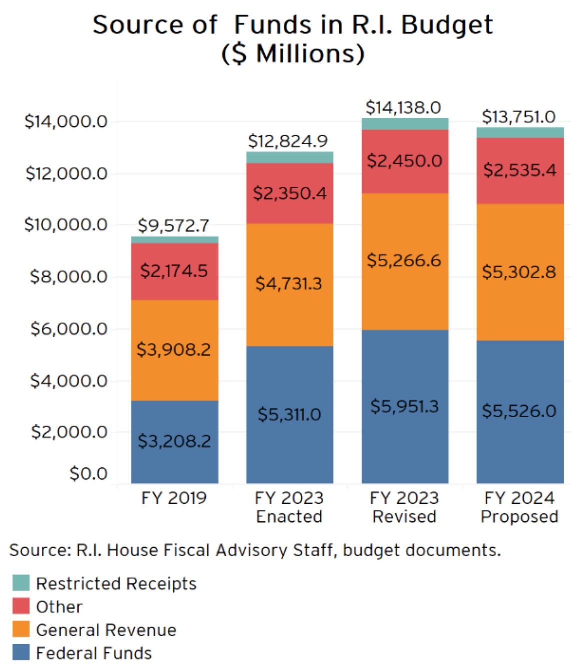
The Governor's FY 2024 Budget and the State's Fiscal Outlook

Weaker Revenues Signal End to Flush State Budgets

Executive Summary
May 2023

This report analyzes Governor Daniel J. McKee's proposed budget for fiscal year (FY) 2024—including revisions to the enacted FY 2023 budget—in the context of the budget outlook for the current and future fiscal years. Given projections that state revenue growth will shrink significantly compared to the last few years, it appears that the governor's proposed FY 2024 budget will be the last of a series of flush budgets fueled by enormous allocations of federal pandemic funding and very large general revenue surpluses.

With total expenditures of $13.75 billion, the governor's spending plan is 43.7 percent more than just five years ago (FY 2019). Most of this increase is driven by a large uptick in federal funding connected with the COVID-19 pandemic, but state general revenue expenditures of $5.30 billion are 35.5 percent higher than in FY 2019. The governor additionally proposed significant revisions to spending in the current FY 2023 fiscal year; total expenditures would increase by 3.9 percent and general revenue spending would increase by 4.5 percent from the enacted budget under his plan.



The governor's proposed FY 2024 budget relies on a projected $610.0 million surplus carried over from FY 2023. This surplus is in large part the result of federal funding and anticipated reimbursements, but the single largest driver is an increase of $358.9 million in expected revenues for FY 2023. Recognizing these surplus funds are non-recurring, the governor's budget allocates most ($522.3 million) of these funds to one-time and non-recurring investments.

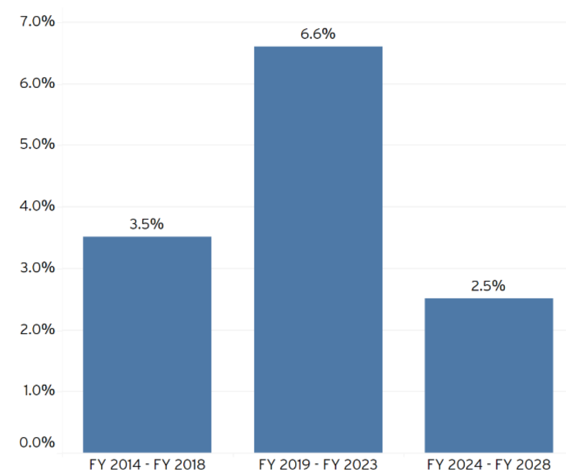
The governor's FY 2024 budget puts forth several tax relief measures. The most significant is the reduction of the sales and use tax from the current rate of 7.0 percent to 6.85 percent, which would cost the state a projected $25.0 million in revenue reduction in FY 2024 (partial year) and $34.7 million in FY 2025 (full year). Other proposed tax relief measures include reductions in the corporate minimum tax, a pause in scheduled increases in the gas tax, and rebates of taxes on electricity and natural gas.

The governor's FY 2024 spending plan also includes significant changes to K-12 education funding, seeking to address recent issues affecting the funding formula. To prevent significant declines in state formula aid, districts have been held harmless from enrollment declines for the last two fiscal years. The governor's FY 2024 proposal calls for a significantly scaled-down version of hold harmless support, recommending a one-time fund of $8.5 million to aid districts experiencing non-charter related enrollment losses, as well as a one-time $7.9 million fund to aid districts experiencing resident student enrollment in charter public schools. The governor also proposes changes related to the student success factor (SSF), a core component of the funding formula that directs greater educational resources to students living in poverty. The governor recommends an increase in the SSF bonus from 40.0 percent to 42.0 percent for an estimated additional $9.9 million in state funding. However, this increase is partially offset by a proposed change in the method of counting economically disadvantaged students which results in a count of 3.9 percent fewer students statewide, and a significantly smaller proportion of students in some districts, as compared to the calculation under current law. In addition, the governor's K-12 education spending plan includes an increase of $21.9 million in state categorical aid to public schools for a total of $60.6 million. The largest categorical increases were those for early childhood education, high-cost special education, and English language learners.

Several new investments are also proposed in the governor's budget, including an allocation of $45.0 million in federal State Fiscal Recovery Fund (SFRF) dollars to a bioscience initiative, and $25.0 million to finance the next phase of the South Quay Marine Terminal in East Providence. Programs to respond to homelessness and affordable housing also would receive substantial additional resources under the governor's plan, including $30.0 million in SFRF funds to expand shelter capacity in the governor's original submission, as well as $21.0 million in SFRF for housing development and a new Low Income Housing Tax Credit Program ($30 million per year for five years) in proposed budget amendments. The governor also proposes the creation of an additional fund to supplement the state's Budget Reserve and Cash Stabilization Account ("rainy day fund") with $55.0 million in surplus revenues. The supplemental fund would represent approximately 1.0 percent of general revenues and would effectively increase the state's rainy day reserves from 5.0 percent to 6.0 percent.

State revenue growth in FY 2024 is projected to be much weaker than for the prior fiscal year, marking the beginning of more constrained revenues forecasted for future fiscal years. The May Revenue Estimating Conference projected FY 2024 state revenues to be $81.8 million greater than revised FY 2023 revenues, a modest growth rate of only 1.6 percent. State budget forecasters anticipate that revenue growth will continue to be constrained at an average annual growth rate of 2.5 percent between FY 2024 and FY 2028, significantly lagging the pre-pandemic (FY 2014 – FY 2018) average annual growth rate of 3.5 percent, and dramatically lower than the average annual growth rate of 6.6 percent for FY 2019 through FY 2023.

Rhode Island General Revenues Five-Year Average Annual Growth Rate, Actual and Projected FY 2014 - FY 2028



Note: General revenues for FY 2013-FY 2022 are actual. Projections for FY 2023 and FY 2024 were determined by the May 2023 Revenue Estimating Conference. FY 2025-2028 general revenue projections were supplied in R.I. OMB's executive summary of the FY 2024 budget as proposed.
Source: R.I. OMB, May Revenue Estimating Conference Reports, 2014-2023; R.I. OMB, FY 2024 Budget as Proposed, Executive Summary; RIPEC calculations.

Based on the report's findings and analysis, RIPEC makes the following recommendations to policymakers:

- **Given the constrained revenue outlook for FY 2025 and beyond, the state needs to avoid spending commitments beyond available resources and prepare to curtail the level of spending growth.**

- **The General Assembly should approve the governor's proposed creation of a supplemental rainy day fund and should consider further increases to the fund.** At 6.0 percent of revenues, Rhode Island's rainy day fund would still be well below the median percentage among states of 11.9 percent of general revenue expenditures.

- **Policymakers should reconcile state education aid consistent with the funding formula and reform the formula to direct more aid to economically disadvantaged and multilingual students.**

- **Transportation funding deserves special focus to ensure that a sufficient state match is available to access increased federal infrastructure funding.** Rhode Island is set to receive $885.0 million in transportation funds under the federal Infrastructure Investment and Jobs Act, but this aid requires an increased allocation of state matching funds. At the same time, the state's commercial truck tolling program has been ruled unconstitutional, resulting in substantial potential lost toll revenues, and gas tax revenues are expected to decline given the increasing prevalence of electric and hybrid vehicles.

- **Policymakers should focus on the health and human services delivery system since spending demands in this area will likely present the most challenging issue for the FY 2025 budget.** Inflationary forces will likely lead to considerable pressure to increase expenditures and rates, which will be difficult given future revenue constraints. Policymakers should focus on consolidating programs and streamlining delivery systems.

- **The state should seek to improve its business tax climate.** Rhode Island's business tax climate was ranked 42nd highest (ninth worst) by the Tax Foundation. The governor has proposed tax relief measures, but the leading recommendation—to slightly reduce the sales and use tax—relates to a tax in which Rhode Island is already relatively competitive. The state should consider mitigating the relatively high property tax burden on businesses, and in particular should consider approving pending legislative proposals to provide a statewide tangible tax assessment exemption.

- **There are several expenditure issues that will require attention for FY 2025 and beyond.** Several spending items will need to be assessed given the constrained revenue forecast, including a plan to more than double the number of pre-K seats, the high per-patient cost of state hospitals, the sharp increases in the projected cost of the South Quay terminal project in East Providence, and the structural gap between revenues and administrative expenditures in the workers' compensation fund.