

State Budget Process and State Revenue Distributions

Joint Legislative Task Force on Budget
Reform Meeting

September 28, 2016

Presentation Overview

- Historical State Budget Background
- Current Budget Process and Methodology
- Comparison with Other States
- Fiscal Outlook
- Current Reform Measures

Historical State Budget Background

Why Two Budgets?

- Act Number 163 of the 1927 Regular Session levied new revenue sources for educational purposes and provided that all revenue collected from those sources would be set apart as a Trust Fund for educational purposes only, designated as the Special Educational Trust Fund¹
- Only 2 other states (Michigan and Utah) have separate education and general fund budgets²

¹ Ira W. Harvey, *A History of Educational Finance in Alabama*, 1989

² National Conference of State Legislatures

Why Not One Budget?

- Section 71 of the Constitution of Alabama of 1901:

“The general appropriation bill shall embrace nothing but appropriations for the ordinary expenses of the executive, legislative, and judicial departments of the state, for interest on public debt, and for public schools....All other appropriations shall be made by separate bills, embracing but one subject.”

- The courts have interpreted the phrase “for public schools” in this section to include only elementary and secondary schools and not universities and colleges (*Alabama Educ. Association v. Board of Trustees*, 374 So.2d 258 (Ala 1979); *Opinion of the Justices*, 512 So. 2d 72 (Ala. 1987))
- The courts have also ruled that appropriations from the Education Trust Fund cannot be made in a general appropriation bill unless they are for the public schools (*Childree v. Hubbard*, 524 So.2d 336 (Ala. 1988))

Budget Periods

- Section 48 of the Constitution of Alabama of 1901 provided for the Legislature to meet quadrennially
 - The general assembly of 1903 was the first to meet under the new constitution and appropriate funds for four years¹
- Amendment 39 to the Constitution of Alabama of 1901 (1939), provided for the Legislature to meet in May of 1943 and on the first Tuesday in May in each second year thereafter, until the date of meeting shall have been changed by act of the Legislature and approved by the Governor
- Amendment 339 to the Constitution of Alabama of 1901 (1975), provided for regular sessions of the Legislature to be held annually beginning in the year 1976 on the first Tuesday in May, or on such other day prescribed by law

¹ Ira W. Harvey, *A History of Educational Finance in Alabama*, 1989

Budget Submission

- Amendment 448 to the Constitution of Alabama of 1901 (1984):
 - Specifies that the paramount duty of the Legislature at any regular session is to make the basic appropriations for any budget period that will begin before the start of the next regular session
 - Requires the Governor to transmit to the Legislature on or before the second legislative day of each regular session of the Legislature a proposed budget for the then next succeeding budget period
 - “Basic appropriations” is defined to mean such appropriations as the Legislature may deem appropriate for the expenditures by the state during the ensuing budget period for the ordinary expenses of the executive, legislative and judicial departments of the state, for the payment of public debt, and for education

Appropriation Required to Spend

- Section 72 of the Constitution of Alabama of 1901:
 - Provides that no money shall be paid from the treasury except upon appropriations made by law
 - This includes the State General Fund, Education Trust Fund, and other state and federal funds (Sample subdivision from Education Trust Fund Appropriations Act for FY 2017 follows)
 - Revenues may be earmarked to a specific fund or agency, but those funds must be appropriated in order to be spent
 - The only exceptions to appropriating specific amounts in the appropriations acts include open-ended appropriations, including estimated appropriations for debt service and Fair Trial Tax Fund and various revolving funds
 - Also, language in both the Education Trust Fund and State General Fund appropriations acts appropriates any unanticipated gifts, grants, including grants by the Congress of the United States, municipalities or counties, insurance proceeds, contributions or entitlements, to any department, division, board, or agency for the purpose for which the grant or contribution was made

Reappropriation of Unexpended Appropriations

- Language included in the back of State General Fund appropriations act for fiscal year 2017 that allows any appropriations that were unexpended and reverted at the end of fiscal year 2016 to be reappropriated to the respective offices for fiscal year 2017
- Similar language has been included in the State General Fund appropriations act since fiscal year 2005 – initially applied to only legislative agencies, but expanded to all
- State General Fund amounts reappropriated were \$37.1 million in fiscal year 2015 and \$31 million in fiscal year 2014
- Similar provisions were included in the Education Trust Fund appropriations act from fiscal years 2009 through 2012, but no longer apply due to provisions of the Rolling Reserve Act

Current Budget Process and Methodology

Important Terms

- **Receipts**
 - The amount or quantity of revenues received
 - For budget requests and budget preparation purposes, these are estimated amounts
- **Appropriations**
 - An appropriation is an authorization for an agency to make expenditures and to incur obligations for specific purposes
 - State agencies may not spend more than the amount appropriated annually by the Legislature
 - State agencies shall not spend more than available revenues – both the constitution and statute prohibit deficit spending
 - Agency appropriations include all fees, receipts and income received by an agency including revenue sources dedicated to specific agency funds or functions. Funds are not subject to withdrawal by the agency except as appropriated and allotted
- **Earmarking**
 - The direction of revenues to a specific fund or for a specific purpose
 - Funds can be earmarked by statute or by the constitution
 - For example, sales taxes are earmarked by statute while income taxes are distributed to the Education Trust Fund for public school teacher salaries pursuant to Amendment 61 of the Constitution

General Timeline

DATE	REQUIREMENT
August-September	Budget instructions and forms distributed by the Executive Budget Office to state agencies
By November 1	State agencies submit budget requests to the Governor (Executive Budget Office) and Legislature (Legislative Fiscal Office)
Not later than the first day of the second month preceding each regular session	The Department of Finance (Executive Budget Office) prepares a tentative budget for the Governor's consideration
At least two weeks prior to the start of each regular session	Governor provides for executive budget hearings
On or before the second legislative day of each regular session	The Governor transmits the Executive Budget document and related bills to the Legislature outlining his or her financial program for the next fiscal year, which begins October 1

Agency Budget Requests

- Estimates of the expenditure requirements for the next fiscal year by the administrative head of each budgeted agency
 - The budget is prepared for each fund, appropriation unit and activity by each major object of expenditure
 - Contains a detailed statement of actual agency revenues for the preceding fiscal year and estimated revenue for the current and next fiscal year
 - Also contains a personnel classification budget request form showing employees and amounts by classification
 - After receiving the agency budget requests, the Executive Budget Office prepares a tentative budget utilizing revenue estimates prepared by the staff, state officials and other consultants

Executive Budget Document

- The budget document recommended by the Governor is published and transmitted to the Legislature on or before the second legislative day of each regular session (Amendment 448)
- The document is comprised of three parts:
 - Part I – Contains the Governor’s budget message and fiscal data (including revenue estimates)
 - Part II – Provides the detailed recommended appropriations for each agency
 - Part III – Contains the proposed appropriation bills and revenue bills needed to implement the recommendations. The appropriation bills indicate the programmatic appropriation to each agency and the source of funds from which each appropriation is made
- The appropriation recommendations, as altered by the Legislature, are adopted by the Legislature as the Appropriation Acts

Comparison with Other States

Revenues and Taxes

- The Alabama Department of Revenue reported total net state revenue collections in FY 2015, for the taxes administered by the Department, of roughly \$9.05 billion
- Alabama's largest state revenue source is income taxes
 - Total net collections (after refunds) in FY 2015 were \$3.83 billion
 - Individual income tax collections were \$3.34 billion
 - Corporate income tax collections were \$491.6 million (including \$90.4 million in one-time receipts)
 - 43 other states levy an income tax - Alabama is one of only 6 of these states that allow the deduction of federal income taxes
 - Georgia, Mississippi and Tennessee levy income taxes – Tennessee levies their income tax on interest and dividend income only
 - Florida does not levy an income tax

SOURCE: Federation of Tax Administrators

Revenues and Taxes

- Alabama's second largest state revenue source is sales and use taxes
 - Total combined net collections (after refunds) in FY 2015 were \$2.46 billion
 - Sales taxes were \$2.14 billion
 - Use Taxes were \$319.9 million
 - 45 other states levy sales and use taxes with the U.S. median rate being 5.75%¹
 - Florida, Georgia, Mississippi and Tennessee each levy sales taxes with rates ranging from 4% in Georgia to 7% in Mississippi and Tennessee¹

¹Federation of Tax Administrators

Tax Burdens

- In 2013, there was \$25.8 billion in state and local own source revenues collected in Alabama – own source revenue being defined as all revenues collected by state and local governments from its own sources (excluding federal transfers)

State	Revenues Per Capita	Rank
Alabama	\$5,320	42
Florida	\$5,462	40
Georgia	\$4,910	48
Mississippi	\$5,538	37
Tennessee	\$4,735	49

SOURCE: Federation of Tax Administrators

Tax Burdens

- Of the total own source revenues in Alabama, \$14.7 billion was state and local taxes

State	Revenues Per Capita	Rank
Alabama	\$3,036	50
Florida	\$3,328	45
Georgia	\$3,289	46
Mississippi	\$3,428	43
Tennessee	\$3,081	49

Tax Burdens

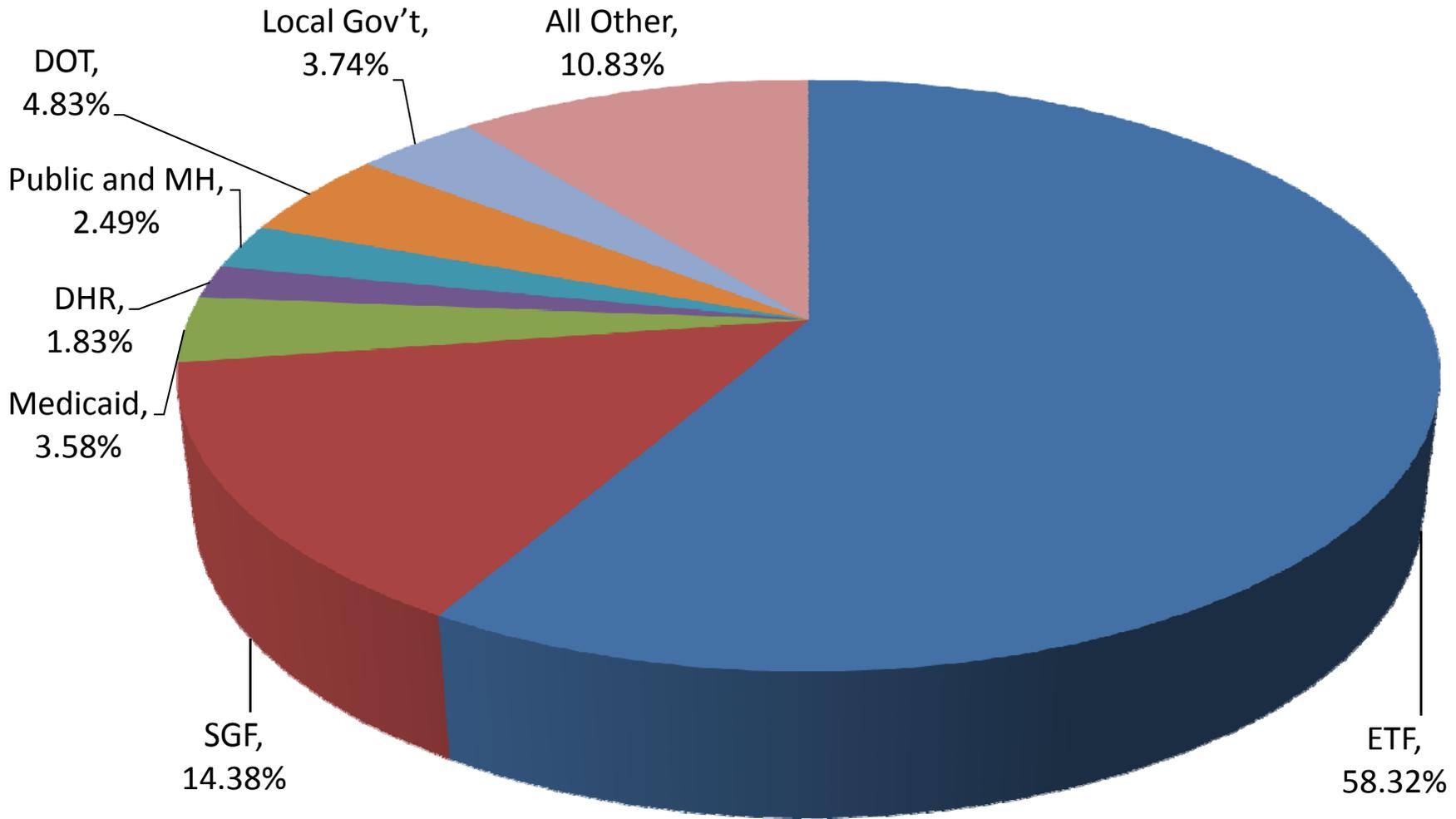
- In 2014, there was \$9.29 billion in state taxes only collected in Alabama

State	Revenues Per Capita	Rank	Percentage of Personal Income	Rank
Alabama	\$1,917	43	5.3%	39
Florida	\$1,779	49	4.4%	48
Georgia	\$1,845	47	4.9%	42
Mississippi	\$2,530	27	7.5%	10
Tennessee	\$1,803	48	4.1%	46

Earmarking

- Earmarking can be general or specific
- Earmarking can be constitutional or statutory
- According to a 2008 report from the National Conference of State Legislatures, the average proportion of state tax revenue earmarked in Fiscal Year 2005 was 24%
 - Alabama earmarked 84%, far exceeding any other state
 - The highest percentage of our surrounding states was 56% with Tennessee
 - Florida and Mississippi both earmarked 27%
 - Georgia only earmarked 6%
- In 2015, approximately 86% of state revenues were allocated to agencies and funds other than the State General Fund
 - The percentage would be approximately 93% if federal revenues were included

Where Did State Revenues Go in FY 2015?



Primary Budget Approach

- Incremental
 - Requires an explanation only for additions and deletions from current budgeted expenditures
 - A total of 30 states, including Alabama, use this approach
- Line-item
 - Focuses on objects or lines of expenditures (such as personnel, capital outlay, or supplies)
 - Only 3 states use this approach
- Program
 - Identifies programs or activities as the primary budget units and presents information on the missions, goals and objectives of each program
 - Information intended to aid in understanding the policy implications of funding decisions
 - A total of 13 states, including Georgia, use this approach

SOURCE: National Association of State Budget Officers, *Budget Processes in the States, Spring 2015*

Primary Budget Approach

- Performance
 - Uses programs or activities as budget units and presents information on program goals and performance
 - Places emphasis on including program information into the budget development process
 - Only 3 states use this approach
- Zero-Based
 - Subjects all expenditures to justification
 - Funding requests for existing and new programs are ranked in priority order on the basis of alternative service levels, which are lower, equal to or higher than current levels
 - Only Oregon uses this approach

SOURCE: National Association of State Budget Officers, *Budget Processes in the States, Spring 2015*

Other Budgeting Concepts

- Annual vs. Biennial Budgets
 - 30 states, including Alabama, adopt annual budgets
 - 20 states adopt biennial budgets
- Fiscal year begin date
 - 46 states have fiscal years that begin on July 1
 - 4 states, including Alabama, have fiscal years that begin on other dates
 - Alabama and Michigan are the only states with an October 1 start date, which matches the federal fiscal year

SOURCE: National Association of State Budget Officers, *Budget Processes in the States, Spring 2015*

Fiscal Outlook

Appropriation of State Funds FY 2017 (as Enacted)

- General Fund - \$1.85 billion
- Education Trust Fund - \$6.33 billion
- Other State Funds - \$3.75 billion
- Total All State Funds - \$11.93 billion
- Total Federal and Other Funds - \$17.79 billion
- Total All Funds - \$29.72 billion

Medicaid Funding

- FY 2017:
 - State General Fund appropriation for FY 2017 - \$720 million
 - BP settlement proceeds from FY 2016 - \$50 million
 - BP bond proceeds - \$15 million
 - Total of \$785 million from these sources

- FY 2018:
 - Projected amount needed - \$865 million
 - BP bond proceeds - \$105 million
 - Excluding one-time sources and maintaining the final FY 2017 State General Fund appropriation, it would require an additional \$40 million to meet this request

Children's Health Insurance Program (CHIP)

- Serves uninsured children under age 19 in families with incomes too high for the children to qualify for Medicaid
- Historically funded jointly by the federal government and states based on the Federal Medical Assistance Percentage (FMAP)
- The Affordable Care Act (ACA) extended the program through fiscal year 2019 and increased the enhanced FMAP rate by 23% beginning October 1, 2015 – thereby authorizing 100% federal funding for the program through fiscal year 2019
- Appropriated 100% federal funding for fiscal years 2016 and 2017; however, Congress must provide the increased federal funding for fiscal years 2018 and 2019

Children's Health Insurance Program (CHIP)

- If Congress does not act, both the Department of Public Health and the Medicaid Agency will have significant increases in their State General Fund requirements for those years
- According to the Department of Public Health, if CHIP is not 100% federally funded, the State General Fund requirement for CHIP would increase by approximately \$68.6 million in fiscal year 2018 and \$71.7 million in fiscal year 2019
 - Of these amounts:
 - Medicaid - \$20.5 million in fiscal year 2018 and \$21.5 million in fiscal year 2019
 - Public Health - \$48.1 million in fiscal year 2018 and \$50.2 million in fiscal year 2019

Corrections Lawsuit

- Southern Poverty Law Center (SPLC) filed a lawsuit in 2014 claiming that Alabama knew about problems within the prison system but had not acted to bring conditions to a “humane and constitutional” level
- Federal judge approved an agreement in September 2016 to resolve part of the lawsuit over inadequate care for inmates with disabilities
- Pursuant to this agreement DOC will:
 - Appoint an ADA coordinator at each facility and hire a statewide coordinator
 - Offer ADA training to personnel
 - Provide ADA-compliant cells to house prisoners with disabilities
 - Ensure those with disabilities can access programs, including educational, vocational and rehabilitative services

Corrections Lawsuit

- DOC will have 32 months to make any architectural changes required to make sure the inmates with disabilities are appropriately housed and can access programs and facilities
- Unresolved portions of the lawsuit related to the medical and mental health care of prisoners are set for trial October 17, 2016

Current Reform Measures

Performance Measures

- Legislative Fiscal Office (LFO) Contract with GlassRatner
 - Hired to develop a method of evaluating the effectiveness of state programs
 - Intent is to develop a program that can be repeated with other agencies
 - Department of Public Health selected to be initial agency
 - Work has begun and LFO will be receiving weekly progress update

Review of Tax Expenditures

- Report on Tax Expenditures
 - Act 2015-237 requires the LFO to prepare an annual report that lists all state tax expenditures and the estimated cost associated with each expenditure
 - First report is due by the second legislative day of the 2017 Regular Session
 - The act also requires the House Ways and Means-Education Committee and the Senate Finance and Taxation-Education Committee to conduct joint hearings on the tax expenditure report every even-numbered year
- Report of economic tax incentives
 - Act 2016-389 requires agencies and departments that administer economic tax incentives to report certain information to the Department of Revenue beginning in fiscal year 2018
 - The Department will establish a 4-year cycle to review each of the programs

Report on Federal Funds

- Act 2015-438 requires agencies to annually report the amount of federal funds received by the agency
- Also requires agencies to provide plans if they have a reduction in federal funds of 5% or more and 25% or more
- Requires the Department of Finance to collect the information along with the FY 2018 agency budget requests
- Requires the Executive Budget Office to submit the report to the Joint Fiscal Committee by January 1, 2017
- Requires the Joint Fiscal Committee to review and make recommendations, upon receiving the report

Other

- Certificates of exemption
 - Act 2015-534 requires entities exempt from certain taxes in Alabama to annually obtain a tax exemption certificate and report the amount of tax exempt purchases
- Department of Revenue contract
 - Entered into a contract for the review of several specific tax credit programs, including the Historic Tax Credit and CAPCO
 - Requires the entity to review number of recipients and cost of the credits
 - Requires evaluation of whether the program accomplishes its purpose and the impact on the state's economy

Q&A