

## State Budget Consolidation

### Background

Annually, the Legislature's only required duty is to approve the State's budget for the upcoming fiscal year. Alabama's Constitution mandates that the State pass a balanced budget and an amendment adopted in 1933 requires the proration—or across the board cuts—of State funds when revenues received are less than the monies appropriated.<sup>1</sup> Alabama's budget is unique in that it was bifurcated, or split, into the General Fund (GF) and the Education Trust Fund (ETF) when public education began in 1927. Currently, Alabama is one of only three states to maintain two separate budgets. Governor Bentley proposed the idea of consolidating the two budgets in order to establish one unified budget for the state; but, Governor Bentley's proposals have yet to be earnestly debated by the legislature.

The differences between the ETF and GF budgets are distinct leading to a contentious debate over the priorities of the legislature for the State's budget. The ETF primarily funds K-12 education and higher education, including salaries and benefits for teachers, administrators, and support staff. The GF covers nearly everything else. This includes expenditures such as the operation of the executive, legislative, and judicial branches of state government, public safety, and Medicaid. Together, the ETF and GF accounted for \$7.5 billion of the State's \$11 billion expenditures in the Fiscal Year 2014.<sup>2</sup>

The ETF receives 52% of the State's overall appropriations and is funded predominantly by revenues from state income and sales taxes. While on the other hand, the GF is financed by tax revenue such as the ad valorem and insurance premium taxes; however, the GF only receives 15.9% of the State's total appropriations per fiscal year.<sup>3</sup>

### ISSUE SNAPSHOT

Increasing budgetary demands from Medicaid and corrections are the predominate factors behind the projected shortfall in the General Fund.

Some lawmakers have proposed combining the two state budgets into one unified budget to fix the shortfall in the GF.

However, fiscal responsibility dictates that the long-term shortfalls in the GF be addressed before the state takes any steps toward consolidating the two budgets.

The increasing demands of Medicaid and corrections on the GF is a predominate factor driving the shortfall in the GF. 35% percent of GF appropriations are directed to the State's Medicaid obligations and 22% is directed to corrections. According to the Legislative Fiscal Office, funding for Medicaid and corrections has increased from 34% of the GF in 1984 to 57% in 2014. The proportion of the State budget devoted to these two commitments explains (at least in part) the ongoing attention given to Medicaid expansion and prison reform.

### Policy Consideration

The separate revenue sources for each budget have resulted often in one budget being funded better than the other, depending on the economic conditions within the State. The ETF budget has remained in relatively good shape over recent years because its funding stems primarily from growth related revenue sources and taxes. Furthermore, the Legislature took steps in 2011 to prevent future revenue shortfalls by enacting The Education Rolling Reserve Act (ERRA).<sup>4</sup> This act provides for an appropriations cap for the ETF, based on

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a fifteen-year average growth rate in revenues.<sup>5</sup> However, due to the increasing demands for State resources from Medicaid and corrections, the GF is expected to experience a significant budget shortfall. Current projections vary from \$200 million to upwards of \$700 million, depending on the timeline.<sup>6</sup>

The legislature cannot consolidate the two budgets into one unified system without a Constitutional amendment because Constitutional amendments stipulate how earmarked money is divided and how and when it can be withdrawn. In order to pass a Constitutional amendment the legislature is required to obtain approval from three-fifths majority of all members in each; then the Constitutional amendment will be presented to the entire state for approval. Only if the whole state approves a Constitutional amendment can the two budgets be consolidated into one unified budget. This option is not a substantive solution nor is it guaranteed to gain approval from state voters. Any attempts to consolidate the two budgets into a unified budget would likely be viewed unfavorably by the general public as the state legislature taking money from Peter to pay Paul, or more realistically, taking money from education and school children in order to give to prisoners and Medicaid.

Fiscal responsibility dictates that the long-term shortfalls in the GF be addressed before the state takes any steps toward consolidating the two budgets. Any proposals that fall short of addressing the underlying issues within the GF will fail to solve the budget problems facing Alabama; this includes any immediate moves to combine the GF and the ETF.

## Recommendation

The legislature must address the underlying problems in the GF before passing a Constitutional amendment to consolidate the budgets because the shortfall will still exist. A Constitutional amendment would not address the long-term problems in the GF that require immediate attention. Furthermore, a Constitutional amendment is not guaranteed to gain general approval from the state voters. For these reasons, the legislature should not propose a Constitutional amendment to consolidate the budget, yet. The state cannot afford further stop gap

measures, which merely kick-the-can down the road, instead of enacting fiscally responsible solutions. First, the legislature should consider reducing the number of earmarks within the state budgets first. Earmarks are used to direct funding to specific projects outside of the control and oversight of the state legislature. Currently, 88% of Alabama's tax revenue is earmarked for a specific purpose. Lawmakers are prohibited by these earmarks to conduct yearly oversight over the budget. Reducing the number of earmarks within the state budgets would immediately allow lawmakers to have greater flexibility in the budgeting process.

Once the spending issues within the GF budget are address then the legislature would be better situated to consider combining the two budgets. However, until tangible reforms are made to corrections, Medicaid, and public pensions, no amount of trimming or shifting funds will make the significant dent needed to fix the state's budget woes.

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<sup>1</sup> <http://www.alabamapolicy.org/budget-basics-facts-alabamas-budget-system/>

<sup>2</sup> <http://www.alabamapolicy.org/wp-content/uploads/GTI-Formatted-Budget-FY2015-Education-Trust-Fund-2014-01-21-ASK1.pdf>; Author's Calculations: 1,749,713,969 (General Fund) + 5,765,396,233 (Education Trust Fund) = 7,515,110,202. NORRIS W. GREEN, A Legislator's Guide to Alabama's Taxes – 2014 Edition, ALABAMA LEGISLATIVE FISCAL OFFICE, 393 (2014).

<sup>3</sup> Note: The 32% that doesn't go into either of the two major funds.

<sup>4</sup> <http://www.alabamapolicy.org/wp-content/uploads/GTI-Formatted-Budget-FY2015-Education-Trust-Fund-2014-01-21-ASK1.pdf>

<sup>5</sup> H.B. 57, 2011 Leg., Reg. Sess., 3-4 (Ala. 2011), <http://alisondb.legislature.state.al.us/acas/searchableinstruments/2011RS/Printfiles//HB57-enr.pdf#page=4>. The cap is calculated in the following manner: "recurring revenues deposited into the Education Trust Fund in the last completed fiscal year" + ("recurring revenues deposited into the Education Trust Fund in the last completed fiscal year" x average annual percentage change in the recurring revenues deposited into the Education Trust Fund for the past 15 completed fiscal years) + [(40% x (the previous year's recurring revenue – the year preceding the last completed fiscal year's recurring revenue) \* only if the percentage of the last completed fiscal year's recurring revenues deposited was higher than the 15-year average growth rate)] + [95% of expected revenue from newly enacted recurring revenue sources] + nonrecurring revenue.

<sup>6</sup> [http://www.al.com/news/index.ssf/2014/10/house\\_speaker\\_mike\\_hubbard\\_ala.html](http://www.al.com/news/index.ssf/2014/10/house_speaker_mike_hubbard_ala.html);

[http://www.al.com/opinion/index.ssf/2014/11/so\\_now\\_you\\_tell\\_us\\_after\\_reel.html](http://www.al.com/opinion/index.ssf/2014/11/so_now_you_tell_us_after_reel.html)