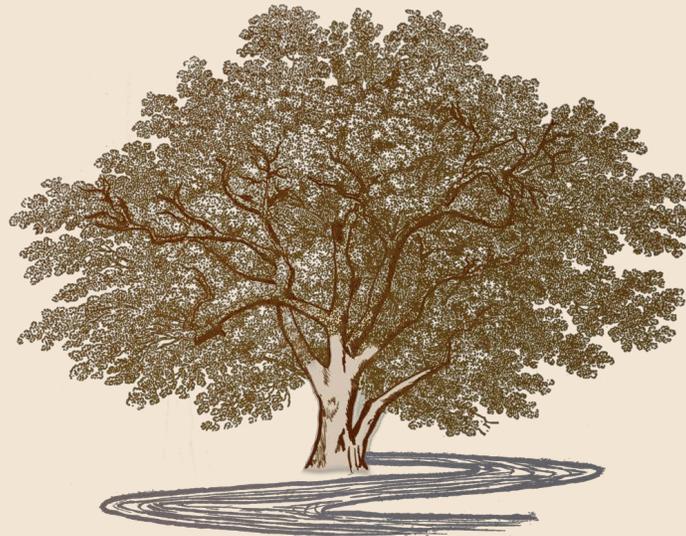


2nd Edition

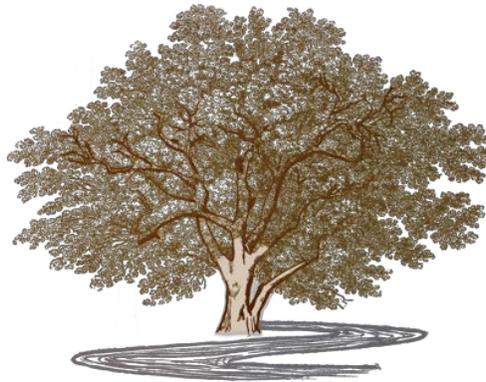


THE SYCAMORE INSTITUTE

BUILDING A STRONGER TENNESSEE THROUGH DATA AND RESEARCH

TENNESSEE STATE BUDGET PRIMER A Foundation for Understanding Our State's Public Policies

November 2018



THE SYCAMORE INSTITUTE

BUILDING A STRONGER TENNESSEE THROUGH DATA AND RESEARCH

The Sycamore Institute exists to help policymakers, the media, and the public understand issues that affect and connect Tennesseans' health, prosperity, and public policy. As an independent, nonpartisan public policy research center, our work advances health and prosperity by informing the development of sound, sustainable public policies that improve the lives of all Tennesseans.

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SycamoreInstituteTN.org



THE SYCAMORE INSTITUTE

Dear Friends and Fellow Tennesseans,

The state Budget is one of the most significant pieces of public policy our governor and General Assembly tackle each year. Yet, understanding what's in the Budget, why it matters, and how it works can be a challenge.

The Sycamore Institute's Tennessee State Budget Primer explains what you need to know to advocate for public policies you support. It unpacks the process, breaks down the numbers, and explores historical trends using simple language and charts.

With this second edition, our Budget Primer is now more informative than ever. We have revisited every detail to make it even easier to find and digest the information you need.

Sycamore is committed to putting reliable research and analysis in your hands. Our bipartisan leadership and staff bring together a wide range of political perspectives bound by a shared vision of a healthy and prosperous Tennessee. We believe in data-driven decision-making and the value of robust debate to guide our progress toward that vision.

We hope you find value in this primer and all our work on topics that affect and connect health, prosperity, and public policy in Tennessee. We would love to hear your feedback and learn how we can better support your work.

Sincerely,

Jim Bryson
Board Chair

Laura Berlind
Executive Director

CONTENTS

| | |
|---------------------------------|----|
| Summary Infographic | 1 |
| Key Takeaways | 2 |
| Budget Basics | 4 |
| What is the State Budget? | 5 |
| Budget Overview | 6 |
| Tennessee’s Budget Cycle | 8 |
| The Budget Process | 9 |
| Budget Formulation | 10 |
| Appropriations | 12 |
| Budget Execution | 15 |
| Revenues and Expenditures | 18 |
| Overview | 19 |
| Historical Trends | 20 |
| Expenditures by Program | 22 |
| Digging Deeper | 24 |
| State Taxes | 25 |
| Federal Funding | 32 |
| “Strings Attached” | 33 |
| Deficits and Surpluses | 35 |
| Parting Words | 43 |
| Appendix | 44 |
| Our Method | 44 |
| Key Budget Documents | 44 |
| Glossary of Key Terms | 48 |
| Sources | 51 |

Graphics downloads, a historical data explorer, and notes about our methods are available at:

SycamoreInstituteTN.org/TN-Budget/Primer

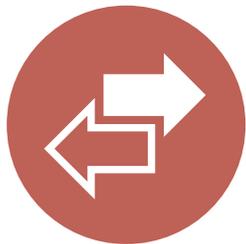
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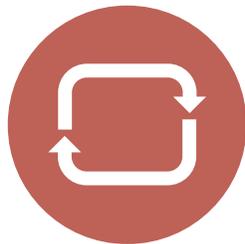
TENNESSEE STATE BUDGET

WHAT IS THE BUDGET?

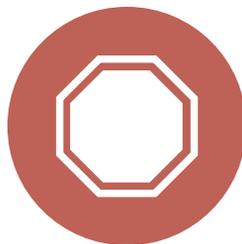
The state budget represents our policymakers' goals, the public goods and services intended to help meet those goals, and detailed plans to finance them.



It is full of constant **TRADE-OFFS**,



often changing and **DYNAMIC**,



and subject to many **LIMITATIONS**.



Tennessee's state constitution requires a **BALANCED BUDGET**.

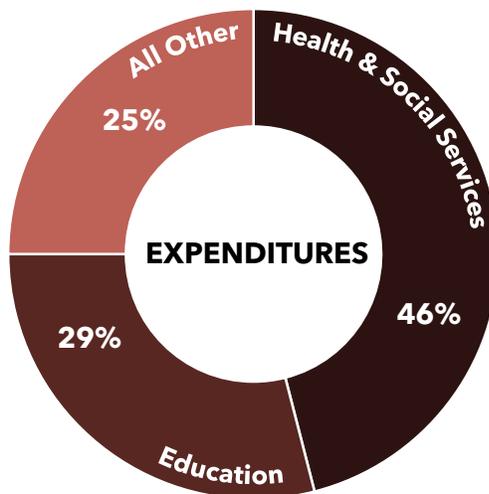
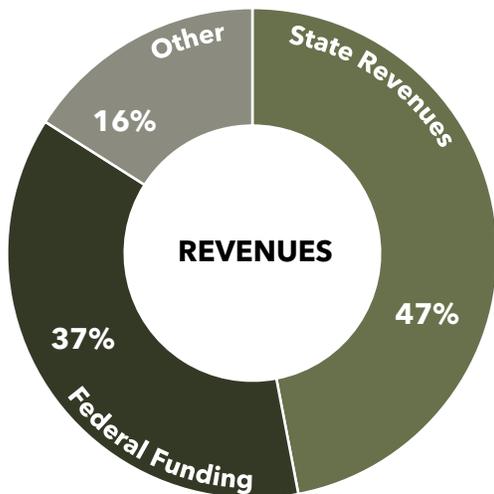


Major **RESTRICTIONS** or **RULES** limit how TN can spend about **81%** of the FY 2018 General Fund.

BUDGET FACTS

FY 2019 Recommended Budget

\$37.5 Billion



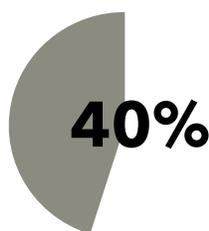
26 DAYS

period TN could operate with expected **RAINY DAY FUND** and **TENNCARE RESERVE** balances in FY 2019.

This is 40% less cushion than in 2007.



3 of every 4 **FEDERAL DOLLARS** in TN's budget go to health & social services.



40% of all **STATE DOLLARS** in TN's budget go to education.



54% of TN taxes come from **SALES TAX**.



#8 LOWEST per capita total state taxes in the country

#6 LOWEST per capita total state spending



1 OF 9 states with little or no income tax



#9 HIGHEST per capita total corporate taxes



#2 HIGHEST average state/local sales tax rate

KEY TAKEAWAYS

Tennessee's budget is one of the most significant pieces of public policy our governor and General Assembly tackle each year. The budget represents our policymakers' goals, the public goods and services intended to help meet those goals, and detailed plans to finance them.

With this primer, The Sycamore Institute seeks to:

- **Shed light on the dynamic processes that create and guide Tennessee's budget.**
- **Provide a picture of where we are and where we've been.**
- **Illuminate the difficult trade-offs involved in making budget decisions.**

Ultimately, we hope this information fosters thoughtful planning and informed stakeholder engagement around the budget in ways that advance Tennesseans' health and prosperity.



Stay plugged in to Tennessee's budget, health, prosperity, and public policy.

Visit our website and sign up for email alerts now.

[SycamoreInstituteTN.org](https://www.SycamoreInstituteTN.org)

Highlights

The governor's FY 2019 recommended Budget totaled \$37.5 billion. Three-quarters (75%) went toward health and social services (46%) and education (29%). The money came primarily from the state's own taxes and reserves (47%) and federal funding (37%).

Process

- **Fiscal Year:** The state's fiscal year (FY) begins July 1 and ends June 30.
- **Starting Point:** Early each year, the governor sends the legislature a recommended Budget that builds off the prior year's recurring base budget. The governor's recommendation is the starting point for the legislature's work.
- **Balanced Budget Requirement:** Tennessee's constitution requires the budget to balance. This means in any given fiscal year, spending cannot exceed revenue collections plus reserves.
- **Dynamic:** To meet this requirement, the budget is often dynamic. As revenue collection estimates change throughout both the planning and spending phases, the budget also changes.
- **Budget Management:** The executive branch has flexibility to manage the budget and reduce spending to keep it balanced during the fiscal year.

Expenditures

- **Overall Spending Levels:** Tennessee's per capita state spending was the 12th lowest in the country in FY 2017 when accounting for all revenue sources. Its per capita spending from state revenue sources was the 6th lowest.
- **State Revenue Spending:** Funding for education, law, safety, and corrections programs and activities largely comes from state revenues. Education accounts for 40% of all state dollars in the budget, followed by health and social services at 27%.
- **Federal Revenue Spending:** Federal dollars fund the lion's share of health, social services, transportation, and economic development programs and activities. Health and social services account for 78% of all federal dollars in the state budget.

Revenues

- **Overall Tax Load:** Tennesseans have a relatively low state tax load. At about \$2,400 per Tennessean, the state tax load was the 8th lowest in the country in FY 2016.
- **Sales Tax:** The sales tax is Tennessee's largest source (54%) of state tax revenue. The state and local rate in most counties is 9.75%, while the average rate is about 9.5%. Tennessee has the 2nd highest average state and local sales tax rate in the U.S.
- **Online Sales Tax:** With online shopping on the rise, Tennessee collects sales tax on a smaller share of consumer spending than in the past. A 2018 U.S. Supreme Court ruling lets states change their tax laws to include more online sales.
- **Income Tax:** Tennessee is one of 9 states with little or no individual income tax. The state's only income tax – the Hall Income Tax on investment income – will phase out by 2021 under current law, and the state constitution prohibits any new state earned income taxes.
- **Federal Reliance:** Tennessee's budget relies more on federal dollars than all but four other states.
- **Strings Attached:** Most of the money in the state budget has strings attached – such as programmatic and/or matching requirements for federal dollars, state revenues earmarked for specific purposes, or funding required by lawsuits against the state.
- **Discretionary Base:** Only 19% of total FY 2018 General Fund spending was considered "discretionary." The General Fund is about 90% of the total budget.

Rainy Day Savings & Long-Term Planning

- **Recession Readiness:** Tennessee could fully fund current state government operations for around 26 days with rainy day and TennCare reserves alone. That's about 40% less cushion than we had going into the Great Recession.
- **Next Recession:** Tennessee's 50th governor and the General Assembly are likely to face a recession at some point in the coming years.
- **Rainy Day Best Practices:** Tennessee follows most of the best practices when it comes to saving for a rainy day – including having a defined purpose in law, setting a target balance, and having rules for replenishment.
- **Long-Term Planning:** Tennessee does not publish long-term estimates of revenue collections and potential spending needs. These tools can help states plan for the future, invest and save adequately, and identify any structural problems.

BUDGET BASICS

This section introduces Tennessee's state budget – including what it is, the state's balanced budget requirement, the size of the most recent budget, and the cycle that guides the process.

WHAT IS THE STATE BUDGET?



The state budget represents our policymakers' goals, the public goods and services intended to help meet those goals, and detailed plans to finance them.



Tennessee's budget is an accounting of money coming into and going out of the state government. The money going out includes the state's expenditures – spending on everything from roads and schools to TennCare benefits and state employee salaries. The money coming in makes up the state's revenues – the ways that the state collects taxes, fees, and other funds.

The budget also represents a delicate balance where all the pieces work in concert toward public policy goals. In this way, the budget represents policymakers' vision and direction for the state.

Balanced Budget Requirement

The state constitution requires a balanced budget.¹ In any given fiscal year, spending cannot exceed revenue collections and reserves.

The budget represents the governor's and legislature's public policy priorities within limited resources. Because the state's budget is finite, spending decisions about one program affect the dollars available for other programs.

A Word of Caution

All budget decisions involve trade-offs. While this primer includes rankings and performance metrics comparing Tennessee with other states, use them with caution. Nearly every decision in the budget about spending and taxing represents a trade-off between a direct outcome and an opportunity cost.

Individual values and political perspectives will inform how people view these trade-offs. For example, low taxes mean more money in Tennesseans' pockets. The trade-off is less funding for state services and programs for Tennesseans. Varied stakeholders may view this trade-off as good or bad.

The Budget at Work²



67,000 teachers in over 1,800 public schools educated nearly 1 million students last year.



The Department of Transportation is responsible for nearly 96,000 miles of public highways.



The Department of Environment & Conservation oversees 200,000 acres of public land in 56 State Parks and 85 Natural Areas.

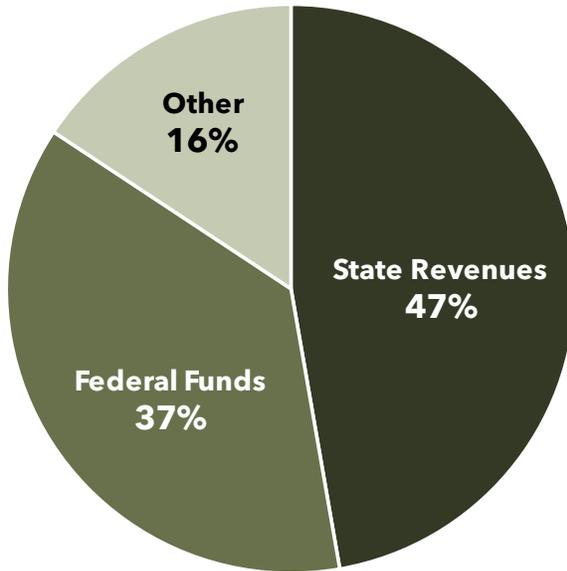


About 1.3 million low-income and disabled individuals receive health care through TennCare.

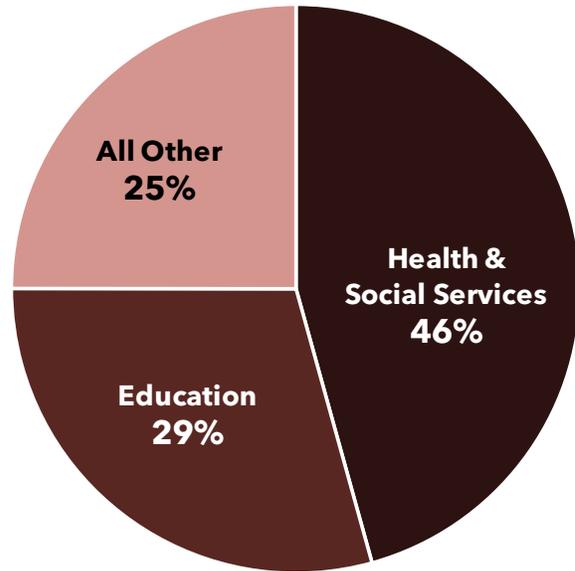
BUDGET OVERVIEW

The Governor's FY 2019 Recommended Budget

\$37.5 Billion



REVENUES



EXPENDITURES

Source: The Sycamore Institute's analysis of the *FY 2018-2019 Tennessee State Budget*

Budget Highlights

Several long-term trends define where most of the money in the budget comes from and where most of it goes. While the numbers used here come from the FY 2019 recommended Budget, the relative size of these budget categories varies little from one year to the next (see page 20).

The money flowing into the state government primarily comes from state revenues (\$17.7 billion) and the federal government (\$13.9 billion).³ The \$9.0 billion in general sales tax revenues represents the

largest source (54%) of state tax dollars (see page 25). Examples of "other" revenues include licenses and fees for specific services and privileges, tuition to state colleges and universities, and lottery ticket sales.

This money overwhelmingly goes to health and social services (\$17.1 billion) and education (\$11.0 billion).⁴ Together, they comprise 75% of the state's budget. The rest of the budget includes everything from supporting transportation and tourism to operating prisons and providing for public safety.

The Budget's Various Funds

Revenues get deposited in the state's various funds and then distributed to departments to spend. Some of Tennessee's dedicated funds include the Education Fund and the Highway Fund. Each fund draws from specific state revenue sources that are established by the laws enacting each state tax. For example, about 60% of gasoline taxes go to the state's Highway Fund while cities and counties get about 38% to spend on transportation (see page 27).⁵ This approach affects how much money is available for certain purposes.

With a few exceptions, the term "General Fund" usually refers to both the General and Education Funds together because General Fund revenues are always needed to help pay for education spending. Together, these two funds comprise about 90% of the total budget.⁶ In this primer, we use the term "General Fund" when referring to both funds together.

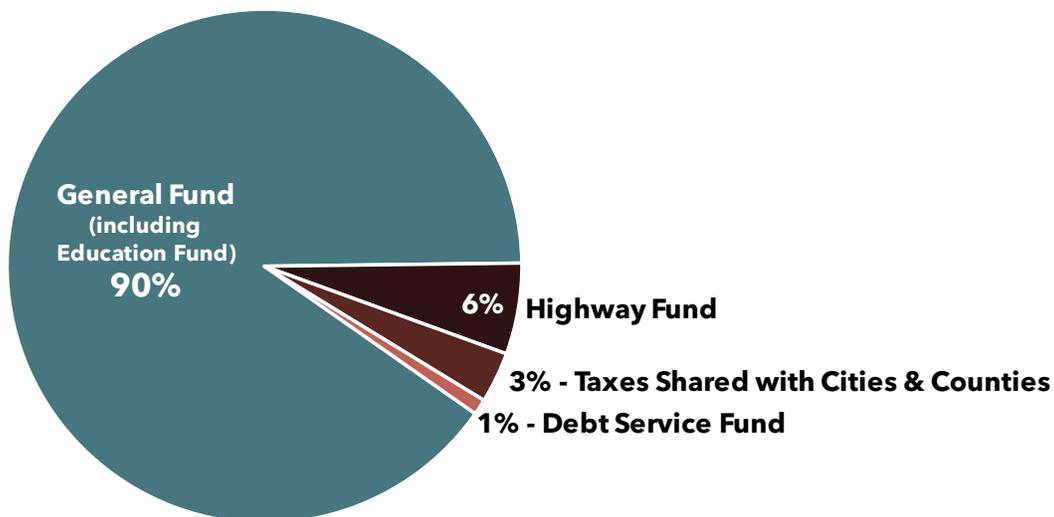
Recurring v. Non-Recurring

To keep things balanced and help with long-term planning, the Budget distinguishes between recurring and non-recurring funds.

- **Recurring** expenses and revenues are those reasonably expected to occur every year. To help ensure the budget remains in balance over the long-term, growth in recurring revenues or reductions to *existing* recurring expenses should offset any *new* recurring expenses (see page 39).
- **Non-recurring** expenses are typically one-time costs paid for with one-time revenues or one-time spending cuts. Despite their name, however, some non-recurring expenses may appear in the Budget year after year.

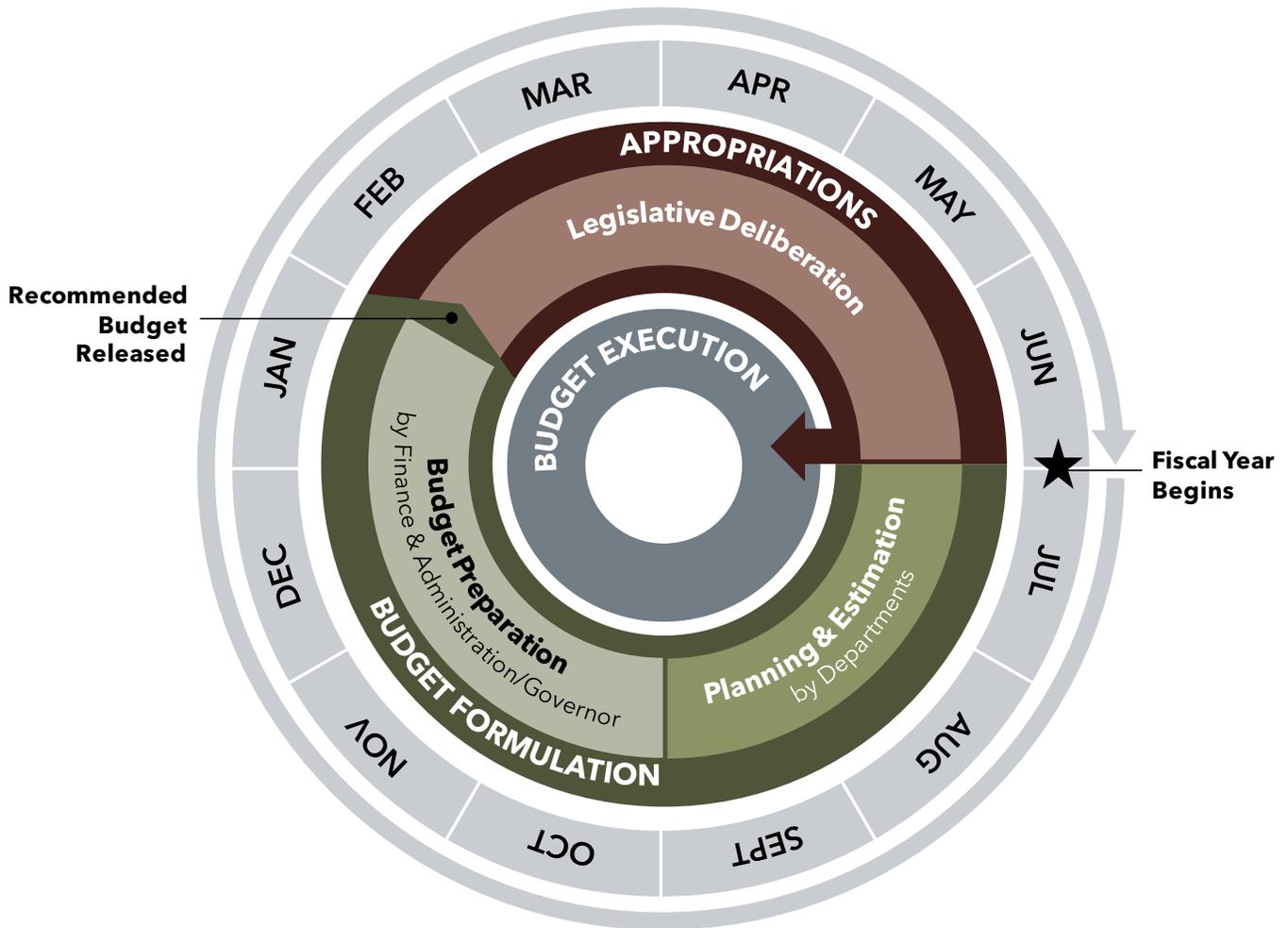
In the FY 2019 recommended Budget, about 94%, or \$14 billion, of state General Fund revenue source spending was considered recurring and about 6%, or \$1 billion, was non-recurring.⁷

The Funds in the FY 2019 Recommended Budget



Source: The Sycamore Institute's analysis of the FY 2018-2019 Tennessee State Budget

TENNESSEE'S BUDGET CYCLE



Tennessee’s fiscal year (FY) spans July 1st to June 30th. Acceptable shorthand references include FY 2018-2019, FY 18-19, or FY 2019 (using the current fiscal year at publication time as an example). The federal government’s fiscal year is different, beginning October 1st and ending September 30th.

Our state government often works on as many as three fiscal years at once. After a new fiscal year begins, work continues into December to close out and audit the prior fiscal year. At the same time, the governor and

executive branch begin working on the recommended Budget for next fiscal year.

The budget formulation and appropriations processes determine taxing and spending levels. The executive branch leads budget formulation and works with the General Assembly on appropriations.

However, changes always occur throughout the fiscal year. The state constitution’s balanced budget requirement gives rise to the dynamic nature of the budget process.

THE BUDGET PROCESS

This section explains the steps that go into formulating and executing Tennessee's budget – including the dynamic processes and trade-offs required to balance the budget while weighing political priorities.

BUDGET FORMULATION



The state budget process begins in the executive branch with the formulation of the governor's budget

recommendation to the legislative branch (the General Assembly).

Tennessee largely takes an incremental approach to budgeting. Much of the focus is on funding increases and decreases compared to the prior year. Executive branch officials use the prior fiscal year's recurring base budget as their starting point for creating the governor's budget recommendation. As a result, non-recurring expenses and new recurring costs are often considered to be the most scrutinized in the budget process.

Planning & Estimation



During the planning and estimation phase of the budget process, the Department of Finance and Administration (F&A)

works on tax revenue projections while other departments work on proposed spending plans.

The process starts when F&A's Budget Division sends "Budget Instructions" to each state department about 11 months before the fiscal year begins. These instructions ask departments to project their needs and wants for the upcoming fiscal year. Departments must explain what they need to fund current services, cost increases, mandated requirements, and new initiatives or priorities. In addition, Budget Instructions often ask departments to identify opportunities for recurring savings. For FY 2019, for example, departments had to identify savings of at least 2.5%.⁸

Meanwhile, F&A's Budget Division and the State Funding Board begin the challenging task of estimating revenues. The Funding Board consists of the governor, the F&A commissioner, the comptroller, the secretary of state, and the treasurer. The Funding Board gets separate revenue estimates from several experts:

- The Fiscal Review Committee,
- The Department of Revenue, and
- Outside economists (for example, from the University of Tennessee's Boyd Center for Business and Economic Research and East Tennessee State University's Bureau of Business and Economic Research).

The budget process is more than tradition. It's the law.

Tennessee's constitution requires the legislature to approve (i.e. appropriate) all public spending. Constitutional amendments added in the 1970s also require the budget to balance. This means in any given fiscal year, state spending cannot exceed the state's revenue collections and reserves. In other words, we cannot spend more than we have on hand.

State laws dating back to 1937 detail many of the steps in the budget process. These laws require the governor to send the legislature a budget recommendation, dictate what information the Budget must include, and – to some extent – define the steps necessary to prepare the Budget.

The Funding Board uses these estimates to recommend a range of revenue projections for the upcoming fiscal year, as well as a revised range for the current fiscal year. Finally, the governor and staff choose from within this range for the recommended Budget's official revenue projection (see page 14).

Budget Preparation



Next, officials must align each department's proposed spending plan with projected revenues and the demands of politics. The Budget

Division, the F&A commissioner, and the governor undertake the difficult job of weighing departmental needs and priorities against available revenues, legal requirements, and the governor's own policy goals.

The governor and staff use information provided by career staff and department leadership to decide on a final budget recommendation. Career staff in F&A's Budget Division present budget overviews to the F&A commissioner and the governor based on information submitted by each department. The

governor also conducts public hearings with department heads (see text box below).

Months of work culminate in the Budget document, which the governor must send to the legislature no later than February 1st, although it is usually released in late January with the governor's annual State of the State address. At the beginning of each four-year gubernatorial term, governors have until March 1st to submit the Budget. The General Assembly granted extensions in 2003 and 2011 to allow time for the new governors to hold public budget hearings. At times, extreme economic downturns have also justified deadline extensions.

Once the governor delivers the recommended Budget, the legislature begins its work. The General Assembly approves hundreds of bills every year, but the budget (including the appropriations bill and any related revenue and program bills) is the only legislation that it must pass. Without it, almost all of the state government could not legally spend money and thus could not operate.⁹



PUBLIC MEETINGS

Many meetings and hearings about the Budget and revenue projections are open to the public.

In recent years, governors have held public hearings on the upcoming budget for each department in November and December (for new governors, these usually occur in late January or February). These are often announced in mid-November on the [governor's website](#) and are recorded and available to view live or after the fact. Hearings typically include presentations by department leadership followed by a questions from the governor, the state's chief operating officer, the commissioner of F&A, and the director of F&A's Budget Division.

The State Funding Board holds public meetings to discuss revenue projections. These are announced on the [comptroller's website](#) and usually occur in November or December (for new governors, they may occur in late January).

The House and Senate Finance Committees and other Senate standing committees also hold public hearings on the recommended Budget – generally in February and March. These presentations are announced with the Committees' weekly calendars on the [House](#) and the [Senate calendar webpages](#). These hearings usually include a presentation from administration officials followed by a question session with committee members.

APPROPRIATIONS



The legislative phase of the budget process begins with a draft of the appropriations bill that

reflects the governor's recommendation.

F&A translates the Budget into legislative language, which is introduced in the state Senate and House of Representatives as the appropriations bill.



The Appropriations Bill

is the legislature's starting point for passing the budget. It begins as a reflection of the governor's Budget recommendation.

Passing the Appropriations Bill

The House and Senate both have Finance, Ways & Means Committees (or Finance Committees), whose primary job is to work on the Budget. They hold hearings on the recommended Budget and consider amendments to the appropriations bill. Other committees may also hold hearings on parts of the Budget under their jurisdiction.

Every dollar spent – including federal funds – must be approved by the legislature. As a result, the General Assembly performs its own balancing act. Lawmakers are tasked with weighing the governor's priorities as outlined in the Budget with their own priorities and initiatives – all while making the math work.

Amendments to the appropriations bill represent incremental changes to the recommended Budget. Lawmakers can amend

the appropriations bill throughout the legislative process. These amendments stipulate specific increases or reductions to the governor's recommendation.

The Finance Committees get the first opportunity to make changes, and then the full House and Senate consider additional amendments and approve their respective versions of the bill. An identical bill must ultimately pass both chambers. If the approved bills are not identical, the chambers must reconcile the differences before the budget can go back to the governor for his/her signature.

The executive branch remains highly involved during the appropriations phase. They and the General Assembly's Office of Legislative Budget Analysis provide updated estimates to ensure the appropriations bill stays balanced as it is amended and revenue projections change. In addition, the governor typically submits an **administration amendment**, which includes updated revenue projections and other last-minute changes to the Budget.

Once the House and Senate have approved an identical appropriations bill, it goes to the governor's desk. The state constitution gives the governor the power to veto the entire bill or strike or change individual line items in the bill (known as a line-item veto).¹⁰ The use of either power is rare, and the legislature can overturn vetoes with a simple majority vote.

Appropriations usually get approved and signed into law during the final weeks of the legislative session, which has recently occurred in April. In the rare event that this does not occur by June 30th, the state would be unable to spend most of the money it collects until an appropriations bill becomes law. Only twice in modern history has the legislature had

to pass temporary, short-term appropriations bills to continue state operations while Budget issues were resolved after June 30th. This occurred in 2001 and 2002 during contentious debates about tax increase proposals.

Other Legislation with a Fiscal Impact

To get the Budget's math to work, the legislature may also have to consider and pass other "general law" measures. For example, lawmakers may want to change the tax code in ways that affect revenues or change a program's eligibility rules in a way that affects spending. Under state law, appropriations bills cannot include this type of change to permanent laws. Lawmakers must consider and pass them separately.¹¹

The appropriations bill must fund the estimated first year's cost of any new legislation, or the legislation becomes void.

This can complicate decisions that legislators have to make in the appropriations bill. As a result, the Finance Committees must consider all legislation with a fiscal impact, where those bills are placed "**behind the budget.**" That is, the Finance Committees hold the legislation until the appropriations bill passes.

The appropriations bill typically includes funding for specific legislation. In many years, appropriations bills also include a "sweeper clause" that funds any new laws with a cost less than \$50,000. For bills placed "behind the budget," the Finance Committees usually approve those funded in the appropriations bill



"Behind the Budget"

Any legislation expected to have a fiscal impact goes "behind the budget" to ensure it does not become law without the funding to pay for it.

or covered by the sweeper clause. All other bills with a fiscal impact effectively die.

Fiscal Notes

A bill's fiscal impact is determined by the nonpartisan staff of the General Assembly's Fiscal Review Committee. Fiscal Review publishes "**fiscal notes**" that estimate the cost or savings associated with each and every bill introduced. To create a fiscal note, Fiscal Review staff use assumptions outlined in the note and feedback from affected state departments, agencies, and others with relevant data or information.

Fiscal notes often do not reflect ancillary effects – such as how preventive health expenditures impact long-term health care costs or how tax code changes affect the broader economy. This type of "dynamic scoring" can be difficult to quantify, making it a less reliable foundation for balancing revenues with expenditures.

The Copeland Cap

Under a 1978 state constitution amendment, the Budget's annual growth in spending from state taxes cannot exceed annual growth in Tennesseans' total personal income unless the General Assembly waives the Copeland Cap. Lawmakers may pass legislation that allows greater growth by specifying the dollar amount and percent by which the budget will exceed the economic growth rate.¹² This requirement is often called the constitutional spending limit, the index, or the Copeland Cap – after its chief proponent then-Rep. David Copeland.

Growth in taxes is more likely to exceed growth in personal income when there is a significant tax increase or during an economic recovery. The General Assembly has waived the Copeland Cap in about half of the fiscal years since the current implementing law took effect in 1984.

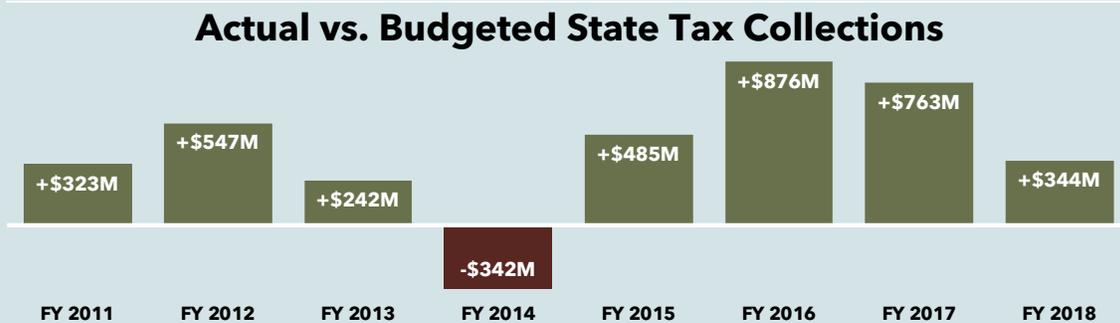


HOW ARE WE DOING?

Tennessee’s Revenue Estimates vs. Actual Collections

Under a balanced budget, revenue forecasts underpin decisions about spending. Forecasting revenue collections is difficult and comes with trade-offs. An overestimate could force policymakers to cut spending mid-year while an underestimate may let them save for a rainy day or fund non-recurring priorities. On the other hand, consistently underestimating revenues could mean policymakers have needlessly shortchanged their recurring policy priorities.

The figure below shows the difference between Tennessee’s budgeted and actual tax collections. When green, the state underestimated revenues and collected more than expected. When dark red, the state overestimated and collected less than expected.



Note: Based on July 1 official budgeted revenue estimates.

Source: The Sycamore Institute’s analysis of information from *Tennessee State Budgets* and the Tennessee Department of Finance and Administration

Each major type of tax that states levy comes with trade-offs (see pages 25-31). Among these trade-offs is how reliably each tax can be forecasted.

Tennessee’s state tax structure is one of the least volatile in the country due to its reliance on sales tax. Volatility refers to annual fluctuations in collections. General sales taxes are considered the least volatile of the major types of taxes that states levy.

Income and corporate taxes are harder to predict than sales taxes. Compared to sales taxes, individual incomes and corporate profits tend to rise and fall more dramatically with the economy. Consumption of the goods that make up the base of sales tax revenues – especially staples like groceries – tends to be more stable.

The Department of F&A reports on revenue collections every month, which lets the state and the public see how actual revenues compare to the projections on which the Budget was based. The Sycamore Institute tracks the reports monthly with our [Tennessee Tax Revenue Tracker](#).

See page 53 for a full list of sources.

BUDGET EXECUTION



After the appropriations bill becomes law, the administration begins executing the new Budget when the fiscal year starts on

July 1st. The resulting budget plan is called the “work program.” Departments and programs can begin spending money through allotments issued by F&A that are consistent with the amounts appropriated by the legislature.

Throughout the fiscal year, the Budget must be actively managed to maintain balance and meet program needs. These needs can include responding to changed circumstances, economic downturns, or unintended estimation errors.

Why Appropriations Change

While only the General Assembly can appropriate funds, actual spending may ultimately differ from appropriations for several reasons:

1. **The governor often recommends supplemental appropriations for the current year when submitting the upcoming year’s Budget recommendation.** The legislature typically enacts these supplemental requests as part of the appropriations bill for the upcoming year.



“Over-Appropriation”

is a bottom-line savings figure in the Budget that accounts for the fact that some departments or programs will spend less than allowed, particularly when state employee positions are vacant.

2. **The appropriations bill includes “sum-sufficient” appropriations for some programs.** These undefined appropriations let departments spend collected or reserved funds with the F&A commissioner’s approval, usually from dedicated taxes or fees available only to specific programs. As a result, a program or department’s actual overall budget may differ from the amounts spelled out in the Budget document or the appropriations bill.

3. **The appropriations bill recognizes all federal and departmental revenues that may become available.** For example, the state could receive an unanticipated federal grant in the middle of a fiscal year. Before the affected department can spend these funds, the F&A commissioner must approve, report the change to the Finance Committees (often called a “program expansion report”), and get the committee chairs’ written acknowledgment.

If the legislature is in session, the Finance Committees must hold hearings before acknowledging the change. This method cannot increase appropriations from state taxes, but it can increase a program or department’s overall budget for that year.

4. **The Budget accounts for an “over-appropriation” because many programs will spend less than what is allowed.** For example, all state employee positions are fully funded in the Budget but are never all filled all the time. This allows program managers the flexibility to fill positions as needed. Because programs almost always have some vacancies during the year, most state agencies spend less than what is budgeted for employee compensation. Many refer to General Fund program underspending as “reversions” because unspent funds revert to the General Fund.

Because **underspending** can be tough to predict for individual departments or programs, the Budget estimates and combines the **over-appropriation** into a single line item. This lets program directors manage their budgets without prejudging where savings will occur.

In recent years, the over-appropriation for recurring spending has totaled about \$80 million.¹³

- 5. **By law and in practice, the executive branch has considerable flexibility to manage the budget within available resources** – particularly when state revenues fall below the budgeted estimates. This most often occurs during economic downturns or recessions (see page 35).

The governor cannot eliminate programs created by law without legislative action. Instead, the F&A commissioner may keep vacant positions unfilled, restrict state employees’ out-of-state travel, limit equipment purchases, and require other temporary measures to reduce spending. These one-time or time-limited actions

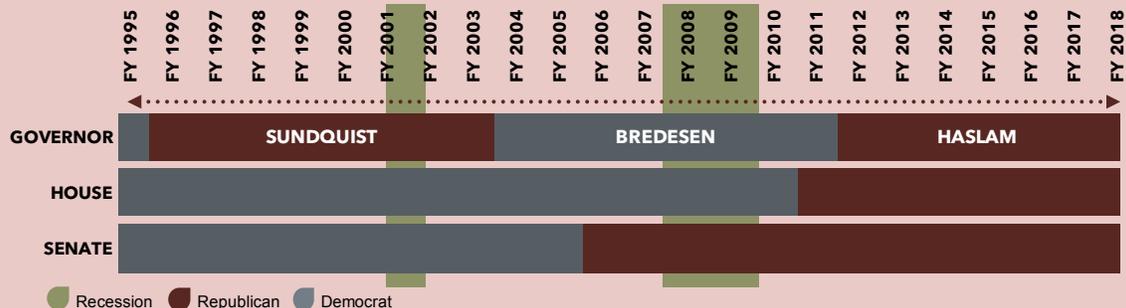
create non-recurring savings to help weather revenue shortfalls. When this occurs, the administration will re-estimate the total over-appropriation to include the one-time savings and help keep the budget balanced. The additional one-time savings are considered non-recurring over-appropriations.

During the Great Recession of 2007-2009, recurring revenues did not fully cover recurring expenditures for several years. Both recurring and non-recurring savings, non-recurring reserves, and non-recurring federal aid were used to balance the budget each year.

Because actual expenditures can vary significantly from enacted appropriations, comparing “budget” numbers and “actual” numbers is misleading. The “actual” column in the Budget represents what the government did in-fact spend (i.e. expenditures) in a given year. Columns that display current-year “estimated” spending and upcoming-year “recommended” spending show estimates that do not account for underspending. This can make current and upcoming fiscal year spending look higher than previous years even if the “budgeted” amount has not grown.

Political & Economic Context for Historical Budget Data

The Budget is inextricably tied to both politics and the economy. To understand some of the historical trends, it’s important to understand the political and economic context. The figure below shows recessions and the political parties of Tennessee’s governors and state House and Senate majorities during the period covered in this primer.





BEST PRACTICES

Consensus Best Practices in State Budgeting

Widely-accepted best practices in state budgeting include the following key principles:

- **Clear Process:** The budget process should be clear and consistent – with an established timeline, instructions, and processes.
- **Established Goals and Policies:** Clear goal-setting and established policies on items like rainy day funds, the use of recurring and non-recurring revenues, and debt should inform the development of the budget.
- **Long-Term Planning:** The budget process should involve long-term planning, including multi-year forecasts of spending needs and revenue collections.
- **Consensus Revenue Estimates:** Revenue estimation should occur multiple times a year using a consensus approach with input from the legislative and executive branches.
- **Current Service Projections:** Budget documents should include a “current services baseline” estimating the cost of continuing all existing programs and services – with thought given to things like cost increases and population/eligibility growth.
- **Evidence-Based:** Performance monitoring and program evaluations should inform budgets.
- **Fiscal Impact of Legislation:** Legislatures should employ a nonpartisan fiscal office to analyze the budget and other legislation. Publicly-available fiscal notes should accompany legislation and estimate multi-year effects on the state budget.
- **Transparency:** States should make budget materials and data available online.

See page 53 for a full list of sources.

REVENUES AND EXPENDITURES

This section covers the ins and outs of money coming in and going out – including historical trends, how different revenue streams are spent, and how various programs are funded.

OVERVIEW

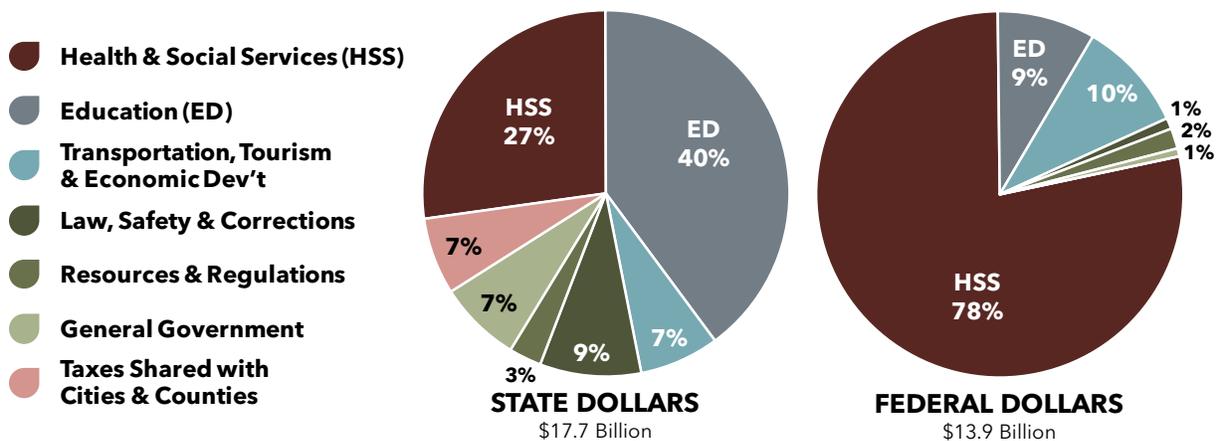
The governor and legislators have varying degrees of discretion over different revenue sources (see page 33). Understanding how they spend each revenue stream and fund each program can provide insight into how policymakers use their discretion.

Not all of the state’s revenues are allocated to programs in the same way. For example, health and social services is the largest overall spending category, but these programs also get

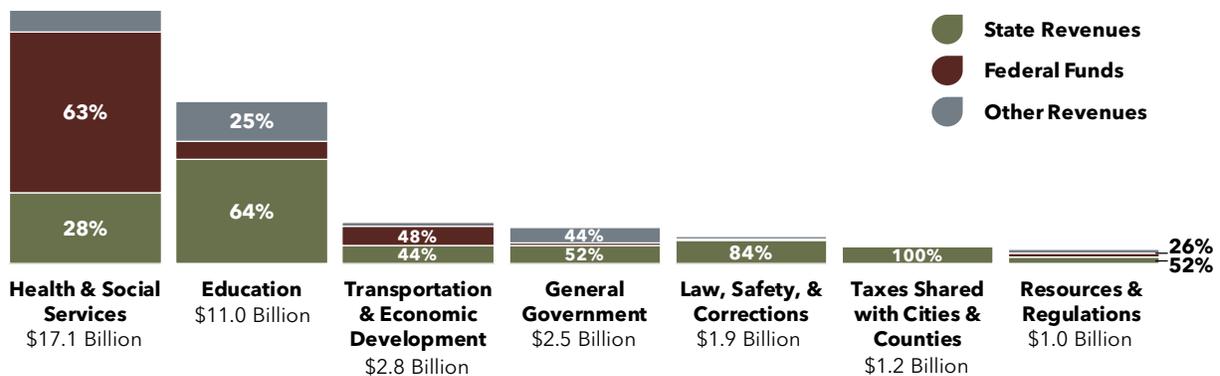
more federal support. When looking at state dollars alone, education is the largest category of spending.

Not all programs are funded with the same mix of revenues. For example, federal dollars fund the largest share of health and social services and transportation. Meanwhile, funding for education, law, safety, and corrections largely comes from state dollars.

FY 2019 Recommended Budget How Tennessee Spends State and Federal Revenues



How Tennessee Funds Different Program Categories



Source: The Sycamore Institute’s analysis of the *FY 2018-2019 Tennessee State Budget*
 Note: Numbers may not add up to 100% due to rounding. Expenditures are categorized differently than those shown in the FY 2019 Budget (e.g. capital outlays have been categorized in this figure as “General Government”).

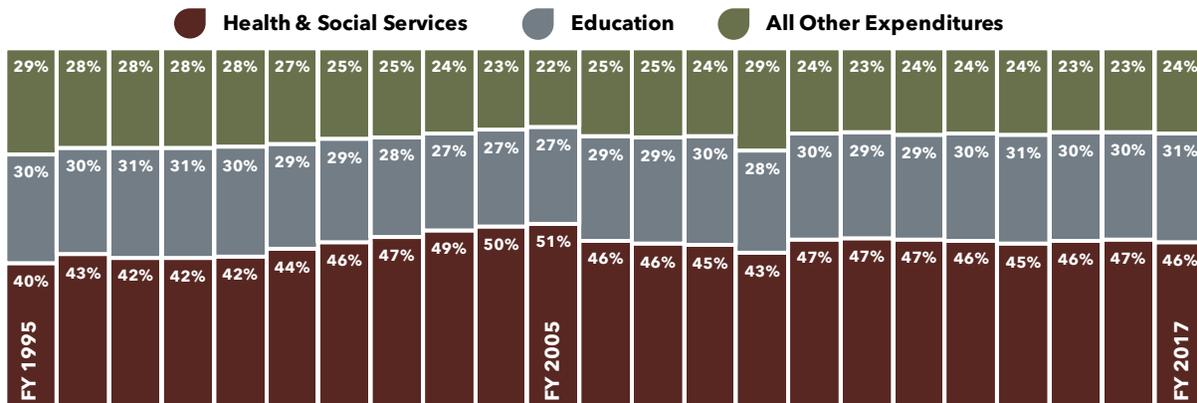
HISTORICAL TRENDS

Over the last two decades, the mix of programs in the Budget has ebbed and flowed. After TennCare launched in 1994, health and social services comprised about 40% of the budget while education and all other expenditures accounted for about 30% each. By FY 2005, health and social services peaked at 51%, while education was 27%.¹⁴

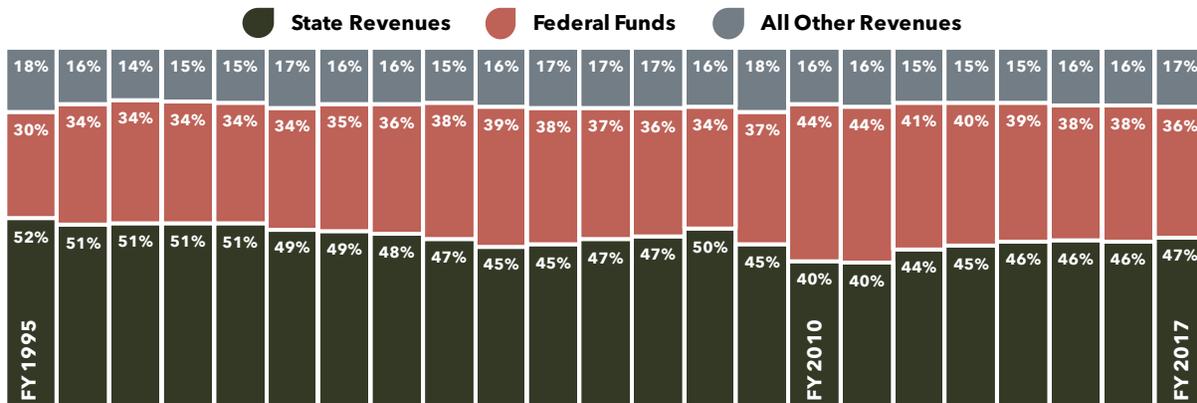
The revenue mix has also changed. Federal dollars accounted for 30% of all revenues in FY 1995. Due to the Great Recession and the federal Recovery Act in 2009, federal dollars grew to a peak 44% in FY 2010 and FY 2011.¹⁵



Tennessee Budget by Program Category



Tennessee Budget by Revenue Source



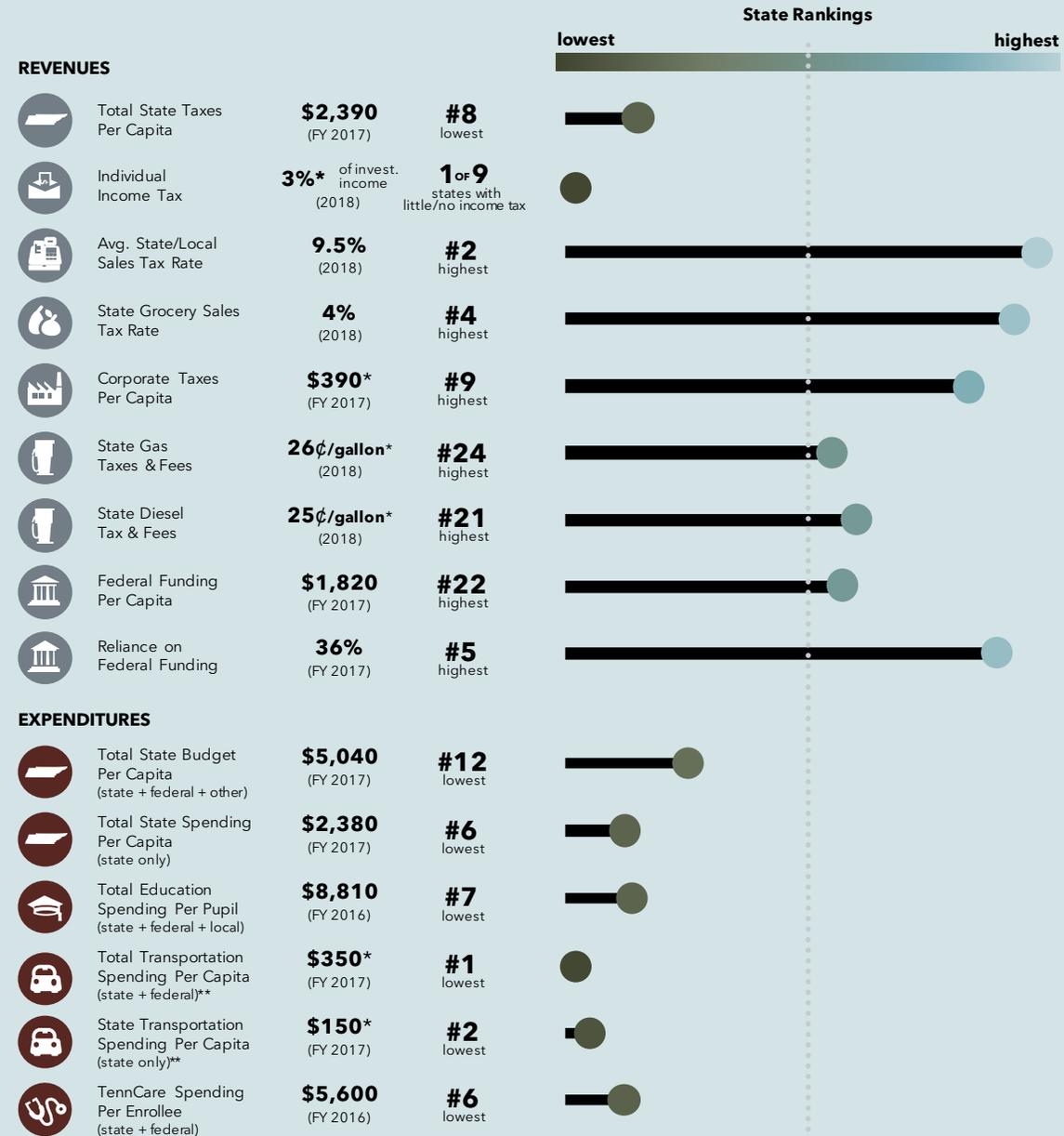
Note: Includes all funding sources. Numbers may not add up to 100% due to rounding.
Sources: The Sycamore Institute’s analysis of the FY 1996-1997 - FY 2018-2019 Tennessee State Budgets



FAST FACTS

How Tennessee's Revenues & Expenditures Compare

The figure below shows how Tennessee compares to other states for select state budget revenue and expenditure measures. These rankings provide context for Tennessee's budget policies, but each is associated with trade-offs (see page 5).



* These data and rankings do not reflect the full implementation of the 2017 IMPROVE Act, which eliminates the Hall income tax on investment income on Jan. 1, 2021, reduces corporate taxes by an estimated \$17 per capita beginning in FY 2019, increases the gas and diesel taxes on July 1, 2019, and results in increases to state transportation spending beginning in FY 2018. **Does not include state taxes shared with cities and counties for transportation.

See page 54 for a full list of sources.

EXPENDITURES BY PROGRAM

FY 2019 Recommended Budget

| PROGRAM | TOTAL (in millions) | % of TOTAL BUDGET | PROGRAM FUNDING COMPOSITION | | | CATEGORY |
|---|---------------------------|-------------------------|--------------------------------|-------------------|-----------------|-----------|
| | | | % from STATE | % from FEDERAL | % from OTHER | |
| Total State Budget | \$37,516 | -- | 47% | 37% | 16% | -- |
| Bureau of TennCare (Dept of F&A) | \$12,013 | 32.0% | 31% | 62% | 6% | HSS |
| Dept of Education (K-12) | \$6,395 | 17.0% | 80% | 18% | 2% | ED |
| Higher Education | \$4,606 | 12.3% | 43% | 1% | 56% | ED |
| Dept of Human Services | \$2,876 | 7.7% | 7% | 91% | 2% | HSS |
| Dept of Transportation | \$2,151 | 5.7% | 45% | 47% | 8% | TRANS |
| State Shared Taxes with Cities & Counties | \$1,203 | 3.2% | 100% | 0% | 0% | CC |
| Dept of Correction | \$1,026 | 2.7% | 98% | 0% | 1% | LAW |
| Dept of Children's Services | \$817 | 2.2% | 39% | 21% | 39% | HSS |
| Dept of Health | \$632 | 1.7% | 33% | 39% | 28% | HSS |
| Dept of Finance & Administration | \$412 | 1.1% | 4% | 14% | 82% | GG |
| Dept of Environment & Conservation | \$407 | 1.1% | 49% | 21% | 31% | REG |
| Dept of Mental Health & Substance Abuse | \$373 | 1.0% | 68% | 21% | 11% | HSS |
| Debt Service Requirements | \$367 | 1.0% | 100% | 0% | 0% | GG |
| Miscellaneous Appropriations | \$351 | 0.9% | 100% | 0% | 0% | GG |
| Capital Outlay Program | \$331 | 0.9% | 55% | 1% | 44% | GG |
| TN Housing Development Agency | \$326 | 0.9% | 0% | 91% | 9% | TRANS |
| Facilities Revolving Fund | \$261 | 0.7% | 6% | 0% | 94% | GG |
| Dept of Safey | \$246 | 0.7% | 65% | 14% | 20% | LAW |
| Strategic Health Care Programs | \$233 | 0.6% | 9% | 90% | 1% | HSS |
| Dept of Commerce & Insurance | \$222 | 0.6% | 72% | 0% | 28% | REG |
| Dept of Economic & Community Development | \$209 | 0.6% | 86% | 13% | 2% | TRANS |
| Dept of Labor & Workforce Development | \$202 | 0.5% | 23% | 70% | 7% | REG |
| Dept of General Services | \$172 | 0.5% | 25% | 0% | 75% | GG |
| Court System | \$154 | 0.4% | 95% | 1% | 4% | LAW |
| Dept of Intellectual & Developmental Disabilities | \$147 | 0.4% | 17% | 0% | 83% | HSS |
| District Attorney Generals Conference | \$135 | 0.4% | 71% | 0% | 29% | LAW |
| Dept of Revenue | \$133 | 0.4% | 75% | 0% | 25% | GG |
| Claims and Compensation | \$118 | 0.3% | 11% | 3% | 86% | GG |
| Military Department | \$109 | 0.3% | 16% | 80% | 4% | LAW |
| Comptroller of the Treasury | \$107 | 0.3% | 91% | 0% | 9% | GG |
| Dept of Agriculture | \$106 | 0.3% | 72% | 13% | 15% | TRANS |
| Wildlife Resource Agency | \$103 | 0.3% | 63% | 23% | 15% | REG |
| TN Bureau of Investigation | \$80 | 0.2% | 63% | 14% | 24% | LAW |

Categories: Health & Social Services (HSS), Education (ED), General Government (GG), Transportation, Tourism & Economic Development (TRANS), Law, Safety & Corrections (LAW), Resources & Regulations (REG), Taxes Shared with Cities & Counties (CC)

Expenditures by Program
FY 2019 Recommended Budget

(continued)

| DEPARTMENT / AGENCY | TOTAL (in millions) | % of TOTAL BUDGET | DEPT/AGENCY FUNDING COMPOSITION | | | CATEGORY |
|---|---------------------------|-------------------------|------------------------------------|-------------------|-----------------|----------|
| | | | % from STATE | % from FEDERAL | % from OTHER | |
| Secretary of State | \$75 | 0.2% | 43% | 41% | 16% | GG |
| District Public Defenders Conference | \$60 | 0.2% | 99% | 0% | 1% | LAW |
| Treasury Dept | \$51 | 0.1% | 8% | 0% | 92% | GG |
| Legislature | \$49 | 0.1% | 100% | 0% | 0% | GG |
| Attorney General and Reporter | \$44 | 0.1% | 70% | 0% | 30% | LAW |
| Commission on Aging & Disability | \$43 | 0.1% | 34% | 65% | 1% | HSS |
| TN Rehabilitative Initiative in Correction | \$30 | 0.1% | 0% | 0% | 100% | LAW |
| Dept of Tourist Development | \$29 | 0.1% | 67% | 0% | 33% | TRANS |
| Dept of Financial Institutions | \$25 | 0.1% | 100% | 0% | 0% | REG |
| Dept of Human Resources | \$13 | 0.0% | 0% | 0% | 100% | GG |
| Alcoholic Beverage Commission | \$9 | 0.0% | 0% | 0% | 100% | GG |
| TN Regulatory Authority | \$9 | 0.0% | 74% | 10% | 16% | GG |
| Board of Parole | \$8 | 0.0% | 100% | 0% | 0% | LAW |
| Arts Commission | \$8 | 0.0% | 82% | 11% | 7% | REG |
| Veterans Services | \$8 | 0.0% | 80% | 15% | 5% | GG |
| State Musuem | \$8 | 0.0% | 100% | 0% | 0% | GG |
| Commission on Children & Youth | \$6 | 0.0% | 55% | 21% | 23% | HSS |
| Executive Dept | \$5 | 0.0% | 100% | 0% | 0% | GG |
| TN Advisory Comm. on Intergov'tal Relations | \$3 | 0.0% | 6% | 0% | 94% | GG |
| TN Human Rights Commission | \$3 | 0.0% | 69% | 31% | 0% | GG |
| Office of Post Conviction Defender | \$3 | 0.0% | 100% | 0% | 0% | LAW |
| Council on Developmental Disabilities | \$2 | 0.0% | 11% | 87% | 2% | HSS |
| Fiscal Review Committee | \$2 | 0.0% | 100% | 0% | 0% | GG |
| Health Services & Development Agency | \$1 | 0.0% | 100% | 0% | 0% | HSS |
| Emergency & Contingency Fund | \$1 | 0.0% | 100% | 0% | 0% | GG |
| State Building Commission | \$0 | 0.0% | 63% | 0% | 38% | GG |

Categories: Health & Social Services (HSS), Education (ED), General Government (GG), Transportation, Tourism & Economic Development (TRANS), Law, Safety & Corrections (LAW), Resources & Regulations (REG), Taxes Shared with Cities & Counties (CC)

Source: The Sycamore Institute's analysis of "Comparison of Programs" from the FY 2018-2019 Tennessee State Budget

DIGGING DEEPER

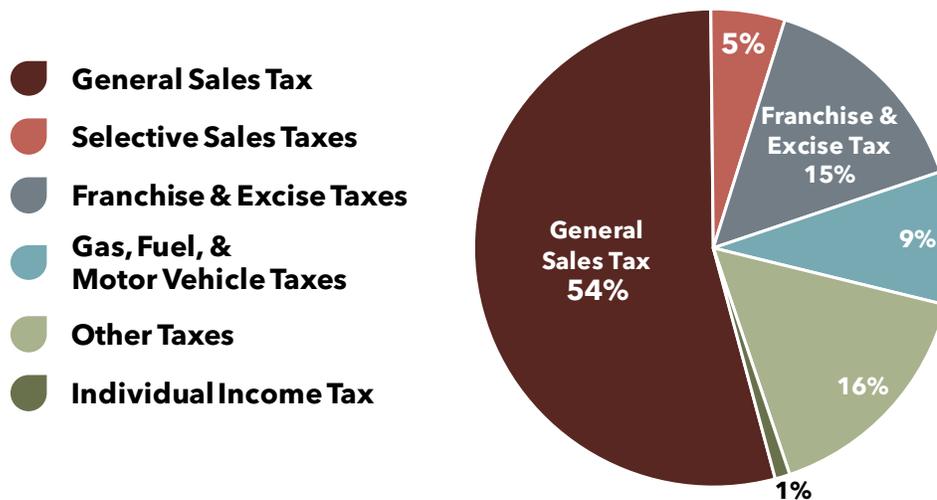
This section takes a deeper look at our state's revenue sources, their trade-offs and limitations, and key issues that may affect the long-term balance of the state budget.

STATE TAXES

State Tax Collections by Revenue Stream

FY 2019 Recommended Budget

\$16.6 Billion



Source: The Sycamore Institute's analysis of the FY 2018-2019 Tennessee State Budget

State Tax Overview

By most accounts, Tennessee is a low-tax state. Looking only at state tax revenues, Tennessee collected about \$2,400 per person in FY 2017 – the 8th lowest per capita tax load in the country.¹⁶ State tax collections represent about 5.4% of total state personal income.¹⁷

States primarily collect tax revenues through sales, income, and corporate taxes. In Tennessee, state tax revenues predominately come from sales taxes (54%) and corporate taxes (15%).¹⁸ The state's corporate taxes are also known as the franchise and excise taxes.

Tennessee shares some revenues from state taxes with cities and counties. In FY 2019, for example, the state expects to transfer 8% of the Tennessee Department of Revenue's total collections to cities and counties.¹⁹ The share of revenue transferred and the method for allocating it across cities and counties varies with each individual tax.

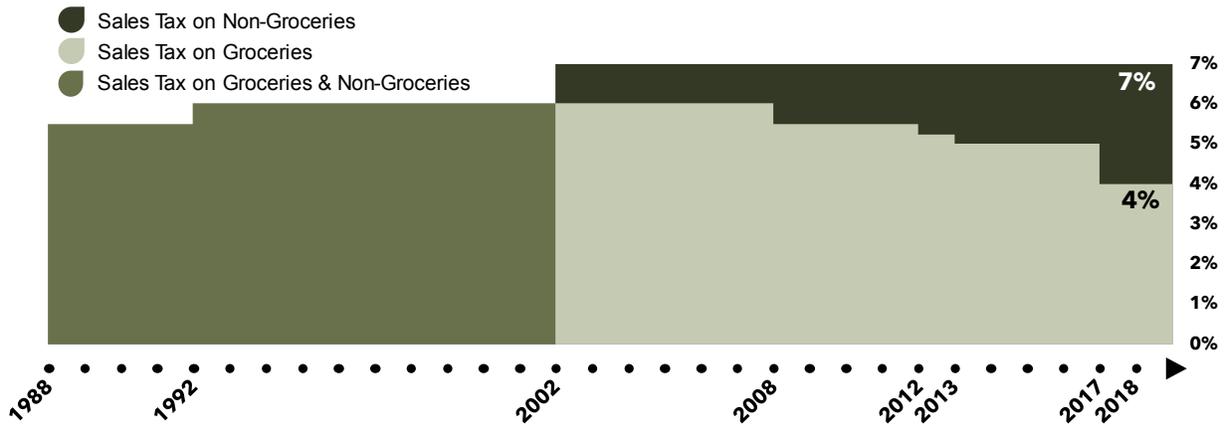
General Sales Tax

Tennessee's general sales tax is the state's single largest source of state tax revenues. As with all taxes, the amount collected depends on the **tax rate** (the percent at which sales are taxed) and the **tax base** (the type and value of purchases that are taxed). These concepts are important to understand. For example, a broad base with a low rate might bring in the same dollars as a narrow base with a high rate. In addition, unintended changes to the tax base could compromise revenues.

Sales Tax Rate

Sales taxes in Tennessee are a combination of the state sales tax and a local option. The local option is an optional county and municipal sales tax add-on. The timeline on the next page shows the history of Tennessee's state sales tax rate over the last 30 years.

Tennessee State Sales Tax Timeline



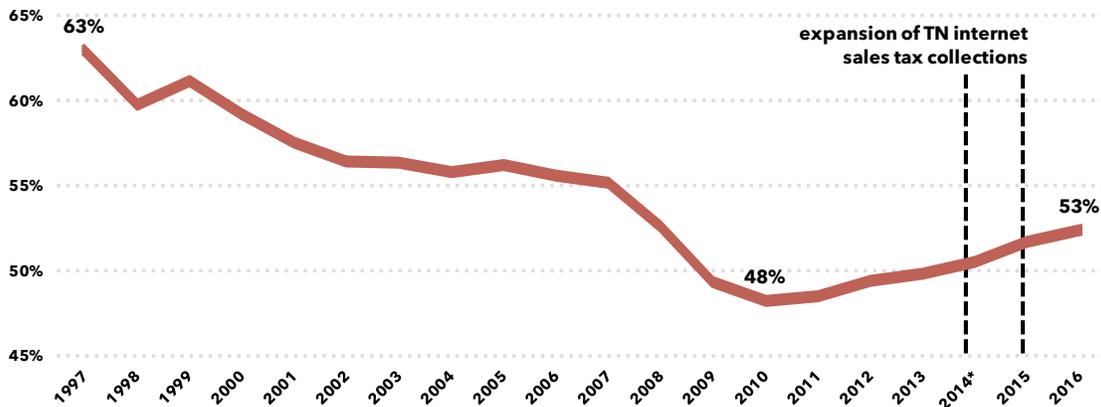
Note: This timeline excludes local sales taxes.

Tennessee has the country’s 2nd highest average combined state and local sales tax rate and the 4th highest grocery sales tax as of January 1, 2018.²⁰ Since 2002, the tax rate on groceries has been cut several times while the rate for other purchases has been held steady. In 2018, non-grocery purchases in most cities and counties are taxed at 9.75% – which includes the 7% state tax and the maximum 2.75% local option.²¹ Tennessee is one of 13 states that tax groceries.²² The sales tax for groceries in most of the state is 6.75%.

Sales Tax Base

As commerce shifts from goods to services and physical stores to the internet, Tennessee collects sales taxes on a smaller share of consumer spending than in the past. Tennessee does not collect sales taxes on many services and online purchases. These exceptions and Americans’ changing shopping habits have eroded states’ sales tax bases.²³ The figure below shows how Tennessee’s sales tax base (i.e. taxable sales) shrank as a percent of spending (i.e. personal consumption expenditures) over the last two decades.²⁴

Tennessee Taxable Sales as a Percent of Personal Spending



Source: The Sycamore Institute’s analysis of information from U.S. Bureau of Economic Analysis and UT Knoxville’s Center for Business and Economic Research

Until it was overturned in 2018, a 1992 U.S. Supreme Court decision effectively barred states from collecting sales tax from most companies with no physical presence in their state (e.g. a distribution center).²⁵ Tennessee took steps to collect sales tax from internet retailers within these restrictions. Under a 2012 law, the state began collecting sales tax from Amazon in 2014.²⁶ A 2015 law requires out-of-state retailers with no physical presence in the state to collect and remit sales tax if they meet other criteria for having a “substantial nexus” in Tennessee.²⁷

A proposed Tennessee rule to collect sales tax from more online retailers cannot take effect without legislative approval. The Department of Revenue proposed the rule in 2016 to “protect the State of Tennessee’s tax base and fiscal health as remote sales continue to increase each year” and ensure “that all businesses selling to Tennessee consumers compete on a level playing field.” Estimating it would increase state revenues by \$200 million per year, the proposed rule would collect sales tax from online retailers with at least \$500,000 in Tennessee sales.²⁸ However, a 2017 legal challenge under the old U.S. Supreme Court decision delayed its implementation.²⁹ Meanwhile, the General Assembly passed a law barring the rule’s implementation without legislative approval.³⁰

In June 2018, the Supreme Court removed federal obstacles to the proposal by overturning its 1992 ruling. This step smoothed the path for Tennessee to move forward with the rule and leaves the ball in the hands of the General Assembly.

Franchise & Excise Taxes

Tennessee’s franchise and excise taxes are corporate taxes and make up 15% of the state’s tax revenues. Corporate taxes generally refer to taxes on private firms and businesses. Tennessee’s excise tax is 6.5% of the Tennessee

taxable income of for-profit businesses. The franchise tax is the greater of 0.25% of the net worth or 0.25% of real and tangible property of Tennessee businesses.³¹

Gas, Fuel & Motor Vehicle Taxes

Tennessee levies several taxes and fees on the use of motor vehicles. For example, as of July 1, 2019, the state will charge a \$26.50 fee to register a personal vehicle, a \$0.26 tax on every gallon of gas, and a \$0.27 tax per gallon of diesel.³²

Some refer to these taxes as “user fees” because they fund goods and services (roads and highways) used by people who pay the tax. These taxes and fees are the primary state funding source for state and local transportation projects. About 66% of these revenue streams go to the Highway Fund, and another 27% go to counties and cities for transportation spending.³³

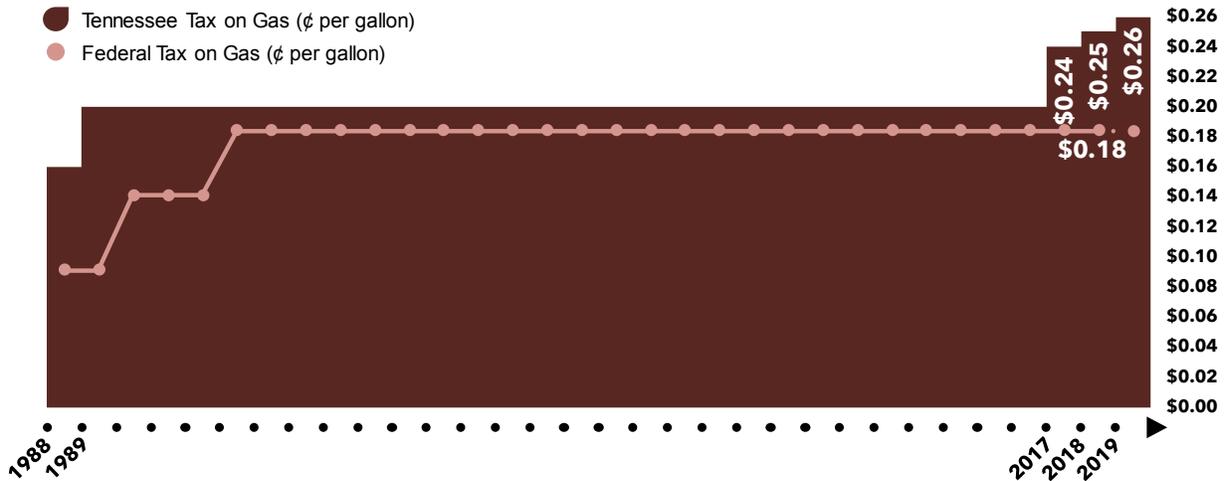
The structure of fuel taxes means the purchasing power of these revenue streams tends to fall over time. Because the tax is a fixed amount per defined quantity (i.e. cents per gallon), the revenue they generate rises and falls with the number of gallons sold (i.e. consumption), not the price per gallon (i.e. inflation) – even as inflation increases the cost of road construction.

The IMPROVE Act, which became law in 2017, raised gas and diesel taxes for the first time since 1990 and 1989, respectively.³⁴

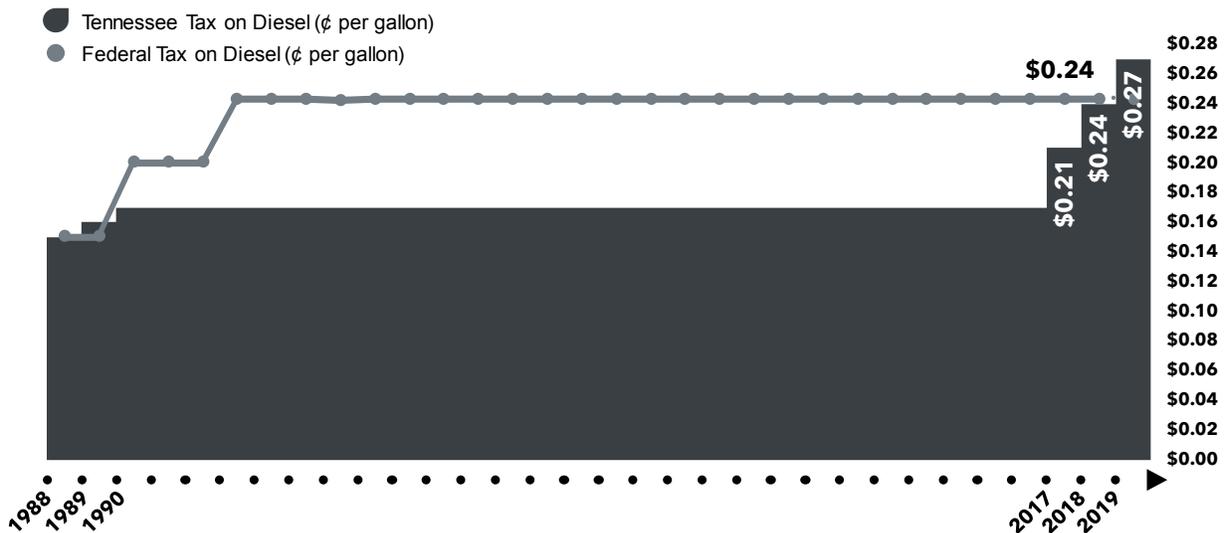
Over that period, the purchasing power of the gas tax declined by almost half, while the fuel efficiency of new vehicles improved.³⁵

Gas and diesel are also subject to federal taxes of \$0.18 and \$0.24 per gallon, respectively, which fund the federal Highway Fund. These tax rates have been the same since 1993.³⁶

Tennessee Gas Tax Rate Timeline



Tennessee Diesel Fuel Tax Rate Timeline



Sources: Tennessee Department of Transportation and U.S. Department of Transportation

Selective Sales Taxes

Selective sales and gross receipts taxes apply to the sale or use of specific items or to specific types of businesses. They typically levy a different rate than general sales taxes. Gross receipts taxes apply to the total earnings of select types of businesses or services – e.g. bars, electric companies, and soft drink bottlers. Selective sales taxes target specific items or types of goods, such as alcohol and tobacco. For example, Tennessee taxes cigarettes at \$0.62 per pack, the 10th lowest rate in the U.S. as of January 1, 2018.³⁷

Individual Income Tax

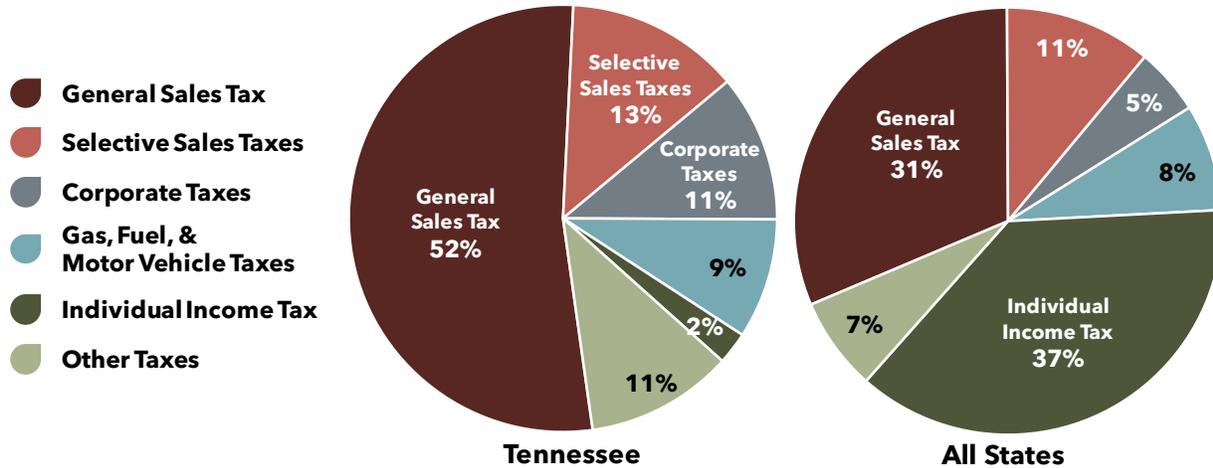
Tennessee does not have a broad-based individual income tax, and the Hall Income Tax on investment income will phase out by 2021. The Hall Income Tax is 3% of interest and dividends from investments in 2018. State law passed in 2017 reduces the tax by one percentage point each year until it disappears on January 1, 2021.³⁸ The Budget projects the Hall Income Tax will account for 1% of state tax revenues in FY 2019, or about \$158 million.³⁹

Tennessee is one of 9 states with little or no individual income tax.⁴⁰ A state constitutional amendment approved by voters in 2014 prohibits the creation of any new tax on earned income.⁴¹

State Taxes in Context

Tennessee relies more on sales taxes and corporate taxes and less on income tax than other states, on average.⁴²

State Tax Collections (2016)



Note: Data are for comparative purposes only. Due to the format of the national dataset, taxes may be categorized differently than analyses based on state-level data. For example, Tennessee’s tax on certain health insurance premiums are categorized as a selective sales and gross receipts tax in the Census data but are categorized as “other” taxes in the chart on page 25. Sources: The Sycamore Institute’s analysis of U.S. Census Bureau data⁴²



PROGRESSIVE VS. REGRESSIVE TAXES

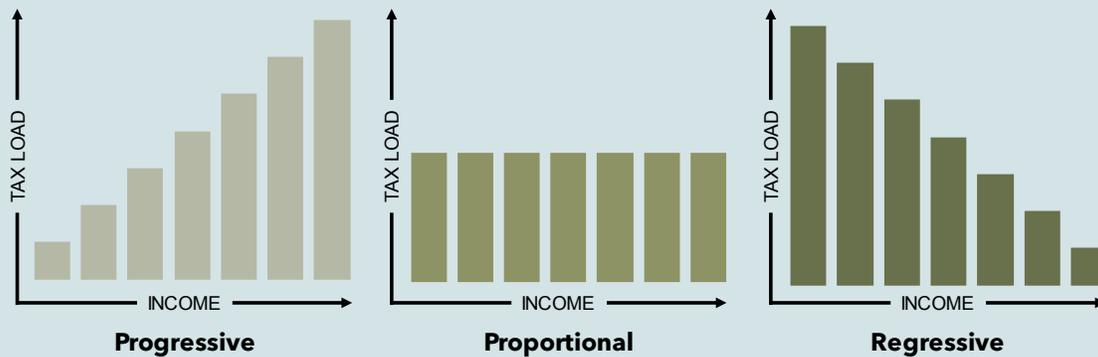
When tax loads as a share of income rise as incomes get higher, the tax structure is considered **progressive**. When the opposite occurs, the tax structure is considered **regressive**. When tax rates are the same across all income levels, the tax structure is **proportional**.

The federal tax structure is progressive because it relies most heavily on an income tax that imposes progressively higher rates as people earn more money.

Most state tax structures are regressive because states rely more heavily on sales tax. Those that tax necessities like groceries tend to be more regressive. Because lower-earners spend a larger share of their incomes than higher-earners, a larger share of their incomes is subject to taxation.

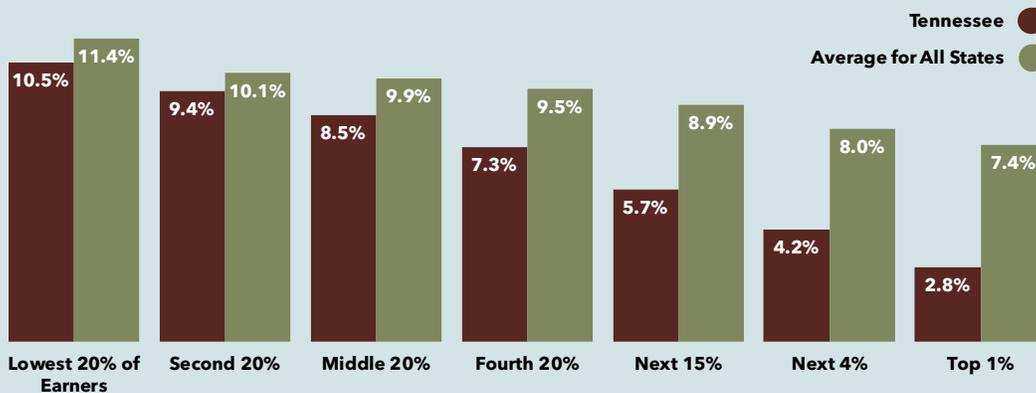
The figure at the bottom estimates how Tennessee’s state and local tax burden compares with the average for all states across different income levels in 2018. Because 54% of Tennessee’s state tax collections come from sales tax (see page 25), Tennessee’s tax structure is more regressive than most other states.

Illustrative Tax Structures



Average State and Local Tax Load by Income Level

(2018)



Source: Institute on Taxation and Economic Policy

See page 54 for a full list of sources.



BEST PRACTICES

National Conference of State Legislatures' Principles for Evaluating a State Tax System

The National Conference of State Legislatures (NCSL) maintains the following set of principles to help states evaluate their revenue systems – understanding that not every state will value each principle in the same way.

Reliability

- Are revenues relatively stable and constant over time?
- Are changes to the tax system kept to a minimum?
- Are revenues sufficient to finance spending over time?

Balance

- Is there a balanced mix of tax types?

Equity

- Are people in similar circumstances taxed similarly?
- How are tax loads distributed across people at different income levels?

Compliance and Administration

- Is it easy to understand and comply with the tax laws?
- Is it costly for the state to collect and enforce taxes?

Responsiveness to Interstate and International Competition

- How do the tax policies of surrounding states impact the revenue potential of different state taxes?

Economic Neutrality

- Unless clearly articulated, does the system unintentionally influence behaviors to avoid or evade taxes?

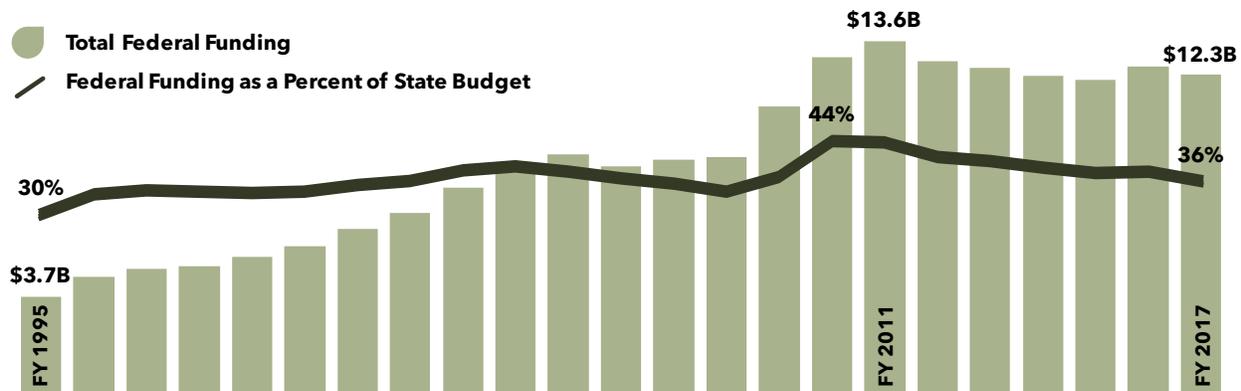
Accountability

- Are tax laws and changes publicly available and transparent?
- Do policymakers regularly examine the effectiveness of tax policies in accomplishing the goals they were meant to accomplish?

See page 54 for a full list of sources.

FEDERAL FUNDING

Total Federal Funding in Tennessee's State Budget



Sources: FY 1996-1997 - FY 2018-2019 Tennessee State Budgets

Reliance on Federal Funds

The recommended Budget for FY 2019 included \$13.9 billion in funding from the federal government. In nominal terms, that is the largest amount ever. As a share of the total budget, however, Tennessee's reliance on federal dollars peaked in FYs 2010 and 2011. In those years, Congress gave states an infusion of one-time federal money via the Recovery Act in response to the Great Recession.

About 36¢ of every \$1.00 spent by the state of Tennessee in FY 2017 came from the federal government. Tennessee relied more heavily on federal revenues than all but four states in FY 2017 – Michigan, New Mexico, Mississippi, and Montana.⁴³

That ratio only reflects the state budget – it does not include *all* the federal money spent in Tennessee. In state FY 2017, for example, the Budget included \$12.3 billion in federal funds. Meanwhile, in federal FY 2017, an estimated \$79.2 billion in federal funds entered Tennessee as direct awards, contracts, and benefits.⁴⁴

Funds in the State Budget

The state budget includes all federal funds awarded directly to state government departments and agencies to carry out programs and deliver services. Examples include TennCare (i.e. Medicaid), Temporary Assistance for Needy Families (TANF), block grants for substance abuse and mental health prevention and treatment, the Army and Air National Guards, and clean water activities.

Funds Not in the State Budget

The state budget does not include federal funds given directly to local governments, non-governmental organizations, or individuals. Examples include Medicare and Social Security benefits, Pell Grants, and grants for scientific research.

In some cases, states and other organizations can get the same types of funding. For example, the federal government provides money for transportation, education, and housing to states *and* directly to local governments. Only the dollars awarded directly to the state government are included in the state budget.

“STRINGS ATTACHED”

Most of the Budget Has Strings

Various rules dictate or limit how most of the money in the state budget can be spent.

Some limit the governor’s and the General Assembly’s discretion to adjust numbers. Others can amplify the effects of decisions to increase or cut funding.



The Discretionary Base

The “discretionary base” refers to recurring state spending that is less restricted for budgeting purposes. At \$6.1 billion, it amounted to about 19% of the General Fund and 41% of state dollars in the General Fund in FY 2018.⁴⁵ In other words, some rule or restriction limited how the state could spend about 81% of the General Fund.

The discretionary base tends to get the most scrutiny for reductions during the annual budget process, while all cost increases get close attention. Many base reductions and cost increases are incremental, although economic circumstances and gubernatorial priorities often require a deeper evaluation of the underlying programs and services themselves.

Examples of “Strings”

State Earmarks

State law dictates or “earmarks” the use of some state revenue streams. The state can only use the money in these funds for their designated purposes. For example, the Education Fund gets about 55¢ of every 62¢-tax paid on a pack of cigarettes.

Federal Limits on Purpose

All federal money awarded to states has a specific purpose, and state governments rarely have much authority to redirect those dollars. For example, the Department of Human Services gets nearly \$2 billion from the feds for the Supplemental Nutrition Assistance Program (SNAP). Not only can those dollars not be spent on other purposes, they must be spent in a very particular way.

Federal Match Requirements

The federal government often requires states to chip in their own money with matching and/or maintenance-of-effort requirements.

This means for every federal dollar spent on certain programs, Tennessee must also spend a set amount of state revenue. Matching provisions also multiply the effect of state funding decisions. For example, the federal government pays 65% of most of TennCare (i.e. Medicaid) costs. As a result, the overall budget falls by \$2.86 for every \$1.00 reduction in state funding for TennCare.



Federal strings can also put a price on non-budgetary decisions.

A 2016 change in Tennessee DUI laws for underage drinkers put \$60 million in federal funding at risk and required a special legislative session to untangle.

Court Mandates

Court rulings can obligate the state to fund something a certain way. For example, in court challenges that began in the 1980s, local school systems charged that state education funding allocations were inequitable. The courts agreed, resulting in a 1992 court-approved funding formula for public education in Tennessee known as the Basic Education Program (BEP).

Double Counting

Some money appears in the Budget more than once because departments provide services and supplies to one another. For example, departments often pay the Facilities Revolving Fund to “rent” office space in state-owned buildings. In this example, the Budget shows that money as an expense for departments paying the rent and as revenue and maintenance expense for the Facilities Revolving Fund.

DEFICITS AND SURPLUSES

Because the budget must balance, deficits and surpluses can confront policymakers with choices about taxing and spending. The governor and General Assembly must evaluate countless trade-offs each year in order to balance the budget and protect the state's fiscal health in both the long- and short-term. Even with the best revenue and spending forecasts, unexpected economic conditions and underlying policy trends can back policymakers into a corner.

Cyclical Deficits

Cyclical deficits occur when economic downturns throw revenues and spending out of balance. A recent example is the Great Recession of 2007-2009.

Economic downturns create higher-than-usual demand for programs and services while reducing the revenues that fund them.

Personal income falls during recessions, which curtails personal spending and shrinks the state's sales tax revenue. At the same time, more people typically enroll in state-funded programs to help bridge the gap. For example, Tennessee sales tax collections fell nearly 8% from FY 2008 to FY 2009, or over half a billion dollars. At the same time, TennCare enrollment rose 4% – the highest annual increase in a decade.⁴⁶



Many government programs are **COUNTER-CYCLICAL**. Demand for them increases when the economy falters.

Rainy Day Funds

Rainy day funds help policymakers smooth out the ups and downs of the economic cycle. Rainy day funds allow states to set money aside when revenues are strong and/or demands are relatively low. States can then tap those reserves when revenues are weak and/or demands increase.

The Reserve for Revenue Fluctuations and the TennCare Reserve together represent Tennessee's ability to respond to a downturn.

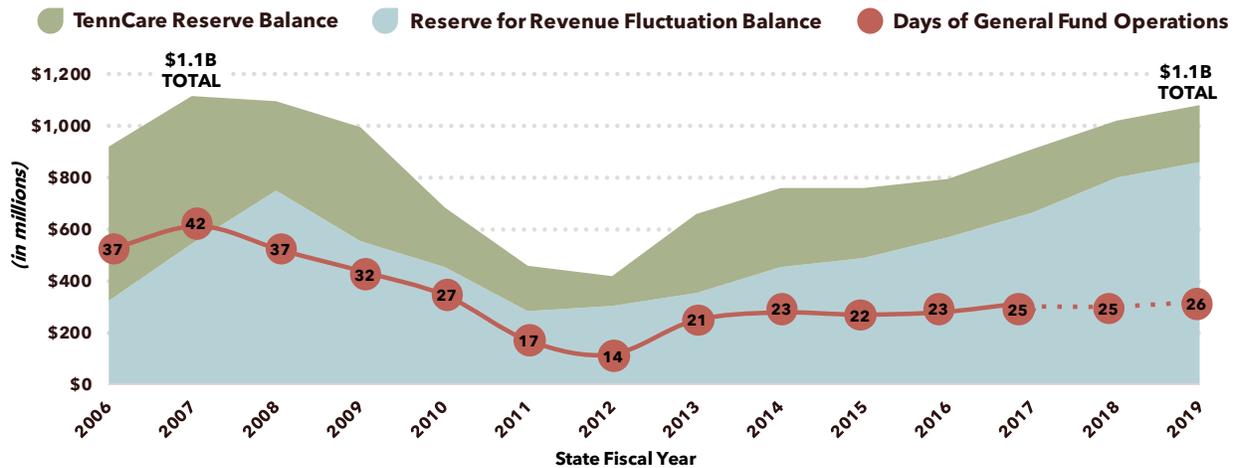
The Reserve for Revenue Fluctuations is specifically for unexpected changes in revenue collections. The TennCare Reserve is a separate fund that holds excess dollars for TennCare. In dire situations, the legislature can make the TennCare Reserve available to shore up both TennCare and the larger General Fund.

Money collected but not spent does not automatically go into the Reserve for Revenue Fluctuations. The amount deposited each year depends on the Reserve's target balance as specified in the annual appropriations bill. This target balance determines the size of the deposit even if the state has a surplus and could "afford" to set aside more.

Weathering the Great Recession

During the Great Recession, Tennessee drew down reserves (a non-recurring source of revenue), reduced recurring spending, and froze state employee salaries. The state tapped almost \$800 million combined from the Reserve for Revenue Fluctuations and the TennCare Reserve over the course of the recession and recovery. Unlike many other states, Tennessee never depleted either reserve.

Tennessee's Rainy Day Reserves



Source: The Sycamore Institute's analysis of the FY 2006-2007 - FY 2018-2019 Tennessee State Budgets and information from the General Assembly's Office of Legislative Budget Analysis

Nearly every state resorted to some combination of spending less, raising taxes, and/or tapping reserves, even with additional federal money for everything from highway projects to Medicaid. For example, 45 states cut their General Fund expenditures in FY 2010 – including 39 that cut spending mid-year.⁴⁷

The Great Recession exhausted many states' rainy day funds. By the end of FY 2012, 22 states had totally or nearly depleted theirs.⁴⁸

Tennessee's Rainy Day Reserves

The combined balance of Tennessee's two main rainy day reserves will exceed \$1.1 billion by the end of FY 2019, according to official projections.⁴⁹ In nominal terms, that is the largest amount in years (about \$61 million shy of FY 2007 levels).

The Budget has about 40% less cushion than before the Great Recession. In FY 2007, the combined balance was enough to cover just under 42 days of General Fund operations. In FY 2019, the combined balance would cover just over 26 days. In other words, Tennessee would exhaust these reserves about 37% faster than before the last recession.

Many states have replenished their rainy day funds faster than Tennessee. In 2017, rainy day funds in about half of states had the same or more buying power as before the Great Recession.⁵⁰

Recession Likely for Next Governor

As of 2018, the current U.S. economic recovery has lasted about three times longer than average.⁵¹ Since 1854, economic expansions have had an average lifespan of just over three years. When this primer was published, the expansion that began in June 2009 had endured for more than nine years. That is the second longest U.S. economic recovery on record.

Every Tennessee governor since 1945 has experienced a recession while in office (with the potential exception of Bill Haslam). If the economy grows through January 2019, Haslam would be the first Tennessee governor not to face a recession since Prentice Cooper held the office from 1939-1945. While Governor Frank Clement did not experience a recession during his third term (1963-1967), his first two terms (1953-1959) saw two different recessions.

Governors of Tennessee and the Recessions They Faced (1939 through November 2018)



The last governor that did not experience a recession at some point during his term was Gov. Prentice Cooper (1939-1945).

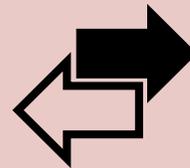
When the next recession comes to Tennessee, policymakers' options could prove more limited than in years past. In addition to the rainy day reserves' reduced buying power, \$2 billion in recurring budget reductions since FY 2008 could make identifying additional cuts more of a challenge.⁵² Public policy and political appetite limit Tennessee's ability to raise new revenues, and states may or may not receive significant federal aid during the next recession.

Surpluses and Other Reserves

When revenue collections outpace budgeted estimates, the state may accumulate money it cannot spend that year (see page 14). This excess revenue goes into the Reserve for Future Requirements (often called "the surplus") unless policymakers set it aside for another purpose.

Programs spending less than their appropriation can also add to a budget surplus (see page 15). Some programs will not spend all of their available revenue during a fiscal year. In some cases, they can keep and roll over these program reserves into the next year. Unspent General Fund revenues, however, revert back to the General Fund and its Reserve for Future Requirements, where it becomes available for re-appropriation in future years.

The Budget treats surpluses as one-time revenue, even if the money came from recurring revenue sources. For example, the state ended FY 2017 with a record-setting \$1.2 billion surplus largely due to unbudgeted revenue growth in FYs 2016 and 2017.⁵³ While normal recurring taxes accounted for most of this money, it appeared in the FY 2019 Budget as non-recurring (i.e. one-time) revenue to pay for non-recurring spending.



Savings and surpluses both have trade-offs.

Revenues saved for a rainy day provide a cushion when hard times come. The flip side is less money available today for programs, services, or tax relief.

Likewise, conservative budgeting reduces the likelihood of imbalances but makes a surplus more likely – which is money that otherwise could have been used for programs, services, or tax relief.



BEST PRACTICES

Tennessee Follows Most Best Practices for Rainy Day Funds

Tennessee updated its laws governing the Reserve for Revenue Fluctuations (the Reserve) in the wake of the Great Recession. Here's how they stack up against common best practices:

Best Practice: Rainy day funds should have a purpose defined in law, which helps states consider how much to save and when, why, and how to tap savings.

Tennessee's Practice:

- The statutory purpose of Tennessee's Reserve is "to meet unexpected shortfalls of revenue or to meet expenditure requirements in excess of budgeted appropriations levels."

Best Practice: To inform long-term planning, states should routinely evaluate and forecast changes in revenues and spending – including when and why they may be unexpectedly high or low.

Tennessee's Practice:

- Tennessee does not have a formal process for making long-term projections.
- In the Great Recession's wake, the FY 2010 through 2014 Budgets had multi-year projections of revenue and spending growth. Later Budgets did not continue this practice.

Best Practice: States should establish rules and criteria for replenishing the rainy day fund instead of relying on unplanned surpluses. The criteria should allow for bigger deposits when revenues grow.

Tennessee's Practice:

- Under state law, the recommended Budget must set aside at least 10% of growth in General Fund state tax revenues until the Reserve balance equals 8% of state tax revenue collections.

Best Practice: Rainy day fund caps should not limit states' ability to weather long recessions. Rainy day fund convention used to be about 5% of a state's budget. Many now agree that is too low. At least one credit rating agency only gives its best rating when reserves exceed 8% of annual revenues.

Tennessee's Practice:

- Tennessee law sets a target balance of about 8% of state tax revenues. It does not explicitly cap the Reserve.
- The Reserve was about \$440 million shy of 8% at the end of FY 2017. Adding the TennCare Reserve, estimates show a combined balance near 8% when FY 2019 ends.

Best Practice: States should have flexibility to use rainy day funds when needed. Rules like requiring a 60% vote of the legislature or capping withdrawals may limit that flexibility.

Tennessee's Practice:

- When revenues fall short, there is no statutory limit on using the Reserve for existing appropriations. The law requires legislative notification and a committee hearing, but it does not require a vote of the General Assembly.
- When expenses exceed line-item appropriations, state law limits the use of the Reserve to the greater of \$100 million or half of the Reserve. The law requires legislative notification, a committee hearing, and the approval of the additional spending by the General Assembly in the appropriations act.
- In both scenarios, the law expresses legislative intent that spending should be cut before using the Reserve.

See page 54 for a full list of sources.

Structural Deficits

A structural deficit is a fundamental imbalance in budget policy that causes spending to exceed revenues. It differs from a cyclical deficit, which stems from temporary factors like an economic downturn. The term structural deficit can refer to two situations:

- 1) Current revenues cannot pay for current programs.
- 2) Long-term forecasts project that spending will grow faster than revenue over time.

Identifying both *if* and *why* a structural deficit exists is necessary but can be difficult and subjective. Tennessee's incremental budget process was not designed to confront many of the broad policy questions inherent in both.

Identifying a Structural Deficit

It can be tough to identify a structural deficit in budgets that must balance every year. The growing national debt makes it easy to see a structural deficit in the federal budget. However, since Tennessee's annual revenues and expenditures must balance, determining if the state budget has a structural deficit can be harder (and in some cases more subjective).

Those seeking to determine if a structural deficit exists in Tennessee have a few potential methods available, all of which involve trade-offs.

Direct Approaches

The most direct approaches to identifying if a structural deficit exists largely focus on whether or not the math works.

Recurring v. Non-Recurring
Comparing a state's recurring spending with recurring revenues may be the simplest way to identify a structural deficit.⁵⁴ Distinguishing between the two helps states avoid persistent imbalances in repeat vs. one-time income and expenses (see page 7). In fact, the major ratings

agencies largely use this method to assess states' budget structures (see page 42).⁵⁵

The major trade-off is that this approach does not ask if recurring revenues and expenditures reflect actual demand or need.

Recurring v. Non-Recurring in Tennessee

In Tennessee, the Budget clearly articulates changes from the prior year in recurring and non-recurring items.⁵⁶

Recurring expenses do not automatically grow as part of Tennessee's base budget under any circumstance. Absent a change in policy, the recommended Budget generally projects revenue growth from existing sources and allocates spending within that constraint. How any recommended recurring increases are allocated is based on a number of factors.

The recommended Budget typically includes recurring cost increases for programs with "strings attached," like TennCare and the Basic Education Program (see page 33). These increases often pay for things like expected enrollment and health care cost growth.

Other recurring line items do not necessarily get more funding each year. For example, the Department of Transportation had a backlog of over \$6 billion in approved transportation projects in 2015 that existing recurring Highway Fund revenues could not cover.⁵⁷ This backlog was the impetus for the 2017 IMPROVE Act, which increased the Highway Fund's recurring revenue sources (see page 27).



Recurring expenses do not automatically grow as part of Tennessee's base budget. However, the recommended Budget typically includes recurring cost increases for programs with "strings attached."

Multi-Year Projections

Multi-year projections of revenue growth and spending needs are another way to identify a structural deficit.⁵⁸ Tennessee's Budget does not include multi-year projections for revenues or expenditures. The state does project some longer-term liabilities, such as retiree costs (see text box below).

The major trade-off is that making projections is difficult. On the revenue side, projecting even one year out is technically difficult and prone to error (see page 14). On the expenditure side, states typically base projections on maintaining "current services" but often use different assumptions.⁵⁹ Common differences include whether and how to account for things like inflation, population growth, economic cycles, and infrastructure deterioration. In Tennessee, these factors are considered on an annual basis to varying degrees for different programs (see page 39).



HOW ARE WE DOING?

Tennessee Leads States in Funding Long-Term Retiree Liabilities But Has Room for Improvement

Long-term obligations to retired state employees can add to states' potential structural deficits because they promise future spending using future revenues. These obligations include the cost of pensions and other post-employment benefits (OPEB) like health insurance.

If states do not prepare for these spending obligations, they may have to raise taxes, cut other spending, or underfund retiree benefits. Adequate planning depends on long-term projections of how much money states will need (obligations) and how much they will have (dedicated revenue).

Like most states, Tennessee maintains trust funds to pre-fund these long-term liabilities. The money comes from a combination of employee contributions and premiums, income from investments made with the funds, and state appropriations.

Tennessee had funded 96% of its \$45.9 billion long-term pension liability, according to July 2016 projections. A number of recent national analyses list Tennessee among the top five states for funding its pension liabilities.

As of July 2015, Tennessee had not funded any of its projected \$1.4 billion in long-term OPEB liabilities – but began to do so in FY 2018. One analysis listed Tennessee among 19 states that had funded less than 1% of their long-term OPEB liabilities at the end of FY 2015. To begin pre-funding these obligations, the FY 2018 and 2019 budgets included \$153 million and \$63 million, respectively.

See page 55 for a full list of sources.

Indirect Approaches

More indirect approaches to identifying a structural deficit ask if existing policies provide the appropriate capacity for public programs and services. These approaches are generally more subjective than direct approaches. For example, those who think the appropriate size and scope of a state program exceeds the capacity of existing revenues may view that gap as a structural deficit. Those who do not will not.

Using Other Trends as Proxies

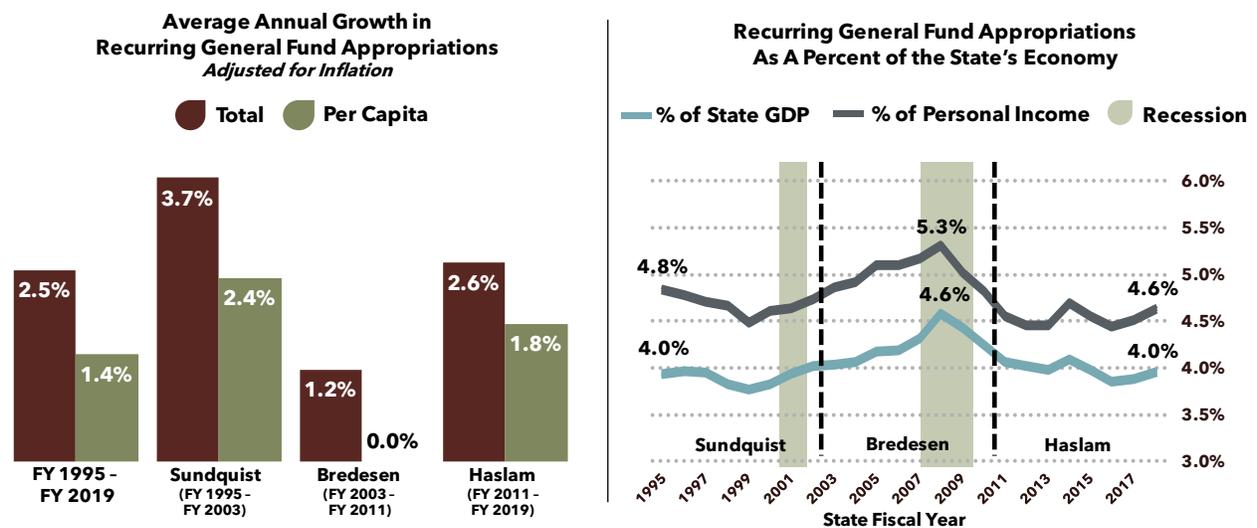
The proxy method attempts to calculate external trends' effect on the capacity of and demand for state programs and services. For example, calculating the effect of inflation typically shows the buying power of state dollars falling over time. Population or economic growth may serve as a proxy for the demand for state services.

The major trade-off to this approach is that these comparisons are imperfect, incremental in nature, and based on assumptions. To compare trends, we must select a start date and make an assumption about the appropriateness of state spending and revenues on that date. In addition, state budgets are multi-dimensional. No single measure perfectly reflects the need for each state program and service – which is as much a policy question as it is a math question.

Proxy Trends v. the Budget in Tennessee

Since 1994, recurring General Fund appropriations represented about 4% of state GDP and grew 2.5% per year (on average and adjusted for inflation). The figure below shows these appropriations in the context of other trends that might drive or illustrate demand for state programs.⁶⁰ On the left, we compare the inflation-adjusted growth of total and per capita appropriations under three governors. On the right, we show appropriations as a percent of the state's economy – as measured by gross domestic product (GDP) and total personal income.

Tennessee Recurring Appropriations



Note: FYs 1995 - 2018 are based on the recurring General Fund appropriations. FY 2019 is the recurring General Fund recommendation.
 Source: The Sycamore Institute's analysis of information from Tennessee State Budgets, the U.S. Census Bureau, and the U.S. Bureau of Economic Analysis.

“Risky” Policies

Specific policies or practices that can contribute to long-term imbalances may serve as a warning sign for structural deficits.

For example, certain features of state policy may contribute to structural deficits because they mandate certain expenditures or compromise the ability to pay for them. These features can include sales tax exemptions (see page 26), age-related tax breaks, and constitutional or statutory ceilings or floors on taxes and spending.⁶¹

The Cause Depends on Who You Ask

If a structural deficit is identified, deciding on the cause and appropriate policy response is a judgment call.

At heart, the answers depend on whether you believe revenues are too low or spending is too high. Short of consensus on the appropriate size and scope of a particular program, personal values and life experiences may shape opinions on need vs. want in the state budget.



WHAT ARE STATE CREDIT RATINGS?

In 2018, Tennessee has a AAA credit rating from the three main state rating agencies. Here is what that means.

What is a credit rating?

Like an individual’s credit score, a state’s credit rating estimates the likelihood that the state will pay off its debts. The highest credit rating a state can receive is AAA.

What determines our credit rating?

Credit rating agencies determine a state’s credit rating after answering two basic questions:

- 1) **What are a state’s financial obligations?**
- 2) **Does the state have the ability and will to meet those obligations?**

To answer these questions, rating agencies look at both quantitative and qualitative information, such as:

- Legal and political ability to constrain spending and/or raise revenues if needed
- Demographic and economic trends that affect expenditures and revenues
- Reliability of the tax structure and the will to change it if needed
- Availability of reserves to fill unexpected holes in the budget (see page 36)
- The structural balance of a state’s budget (see page 39)
- Long-term spending obligations (see page 40)
- Outstanding debts

Credit ratings say nothing about the appropriate size and scope of state programs and services.

A credit rating is simply a tool to assess a state’s legal (and, to varying degrees, political) ability to meet its financial obligations. It cannot tell us what our public policy should be.

What is the benefit of a good credit rating?

Having a good credit rating reduces Tennessee’s borrowing costs. Tennessee issues bonds to help finance longer-term transportation and infrastructure projects. The state spends several million dollars in interest on these bonds each year – costs that would likely go up if our credit rating falls.

See page 55 for a full list of sources.

PARTING WORDS

Tennessee's budget is one of the most significant pieces of public policy our governor and General Assembly tackle each year. It represents our policymakers' goals, the public goods and services intended to help meet those goals, and detailed plans to finance them.

As always, there are trade-offs. Policymakers must weigh their priorities against each other while keeping the budget in balance. It is a challenging task that often demands difficult choices.

Those choices affect the long-term health and prosperity of our state and its residents in countless ways. Do our children have the chance to get a high quality education? Does our infrastructure meet the needs of our population and economy? Do our families, friends, and neighbors have resources and opportunities to help us live healthy, productive lives?

Many Tennesseans will disagree on the answers to those questions. That's ok. Debate, disagreement, and compromise are all essential to a healthy civil society.

Where we should all agree is on a shared set of facts. This primer is our attempt to help every Tennessean understand why the state budget matters, how it works, and what you need to know to advocate for public policies you support.

APPENDIX

Our Method

Unless otherwise noted, all budget data come from the relevant year's Budget document. For most historical trends, we used FY 1995 as the starting point for two reasons. First, that timeframe captures three governors' terms. Second, it captures the full lifespan of Tennessee's current Medicaid program (TennCare), which launched in 1994 and is the single largest item in the budget today.

All historical data for FY 1995 through FY 2017 represent actual expenditures obtained from the relevant year's Budget document. FY 2018 data are mid-year estimated budget numbers, and FY 2019 are recommended budget numbers – both from the FY 2019 Budget document. Although FY 2018 has ended and the General Assembly passed appropriations for FY 2019, we used these numbers because the Budget document is the most reliable source of publicly available information about these years. For the reasons discussed beginning on page 15, these numbers are not directly comparable to actual historical expenditures.

Key Budget Documents

The Budget is the governor's recommendation to the General Assembly for the upcoming fiscal year. Throughout this primer, it is referred to interchangeably as the Budget document, the recommended Budget, and the governor's Budget. In recent years, the Budget has included three separate documents:

- **The Budget** includes most of the information and numbers of interest. This document slices and dices topline numbers in multiple ways (e.g. by revenue source, by expenditure category, by program) and includes program-specific funding information.
- **Volume 2: Base Budget Reductions** shows recommended funding reductions at various levels of detail.
- **Recommended Budget: Expenditures by Object and Funding by Source** provides an extremely detailed accounting of the Budget dollars by "object." Objects are categorizations that help the state keep track of spending on specific types of activities like salaries, travel, supplies, grants, and employment levels in each agency.

All three documents are available on the [Department of Finance and Administration's website](#).

The Administration Amendment includes changes to the recommended Budget submitted by the governor prior to the enactment of appropriations. Summaries of the amendment are typically available on [the Department of Finance and Administration's website](#).



BUDGET DOCUMENT HIGHLIGHTS

A few can't-miss items in the Budget document (with FY 2019 Budget page numbers) include:

- **Budget Highlights** (beginning on page xix) includes a discussion of the overall Budget, its themes, and issue-specific strategies.
- **Total State Budget - Comparison of Programs and Revenue Sources** (page A-8) shows the overall Budget with high level information on the programs across which spending is distributed and the sources from which revenue comes.
- **Comparison of Programs** (beginning on page A-17) shows total funding levels for each department by revenue category.
- **Comparison Statement of State Revenues** (page A-62) displays actual and estimated collections for specific state taxes.
- **Program Statement by Functional Area** (beginning on page B-3) provides additional Budget information at a more granular program level. These pages display total funding by revenue source for activities within departments and include brief explanations for recommended funding increases. This information is organized by "functional area," which represent related activities like health and social services.

The Appropriations Bill is passed by the state legislature and is signed into law by the governor, becoming the appropriations act that enacts the Budget. Initially mirroring the governor's Budget, the General Assembly amends it during the legislative process to incorporate changes from lawmakers and the administration.

Section 1 includes the appropriation of state funding by department and program while Section 4 appropriates other revenue sources. Subsequent sections earmark funds within each department's appropriation for specific purposes and/or incorporate amendments that may increase or reduce the appropriation.

The most recent appropriations bill can be found on the [General Assembly's website](#) or the appropriations act on the [Secretary of State's website](#).

Example of an Appropriations Act Earmark:

Section 7, Item 38 (p32 of 2018 Public Chapter 1061) - Department of Mental Health and Substance Abuse Services, Community Mental Health Services, in Section 1, Title 111-14, Item 2.5, an amount of \$700,000 is to be paid to Centerstone Military Services, in three regions of Tennessee for the purpose of providing professional counseling services to veterans and their families who suffer from post-traumatic stress disorder (PTSD).

Example of an Appropriations Act Increase Amendment:

Section 62, Item 47 (p106 of 2018 Public Chapter 1061) - In addition to any other funds appropriated by the provisions of this act, there is appropriated the sum of \$500,000 (non-recurring) to the Tennessee Bureau of Investigation for the sole purpose of expenses related to the operation of the Tennessee Dangerous Drug Task Force.

Example of an Appropriations Act Reduction Amendment:

Section 60, Item 8 (p100 of 2018 Public Chapter 1061) - The appropriation to the Department of Health, Health Services, in Section 1, Title III-16, Item 4, for grants to counties to reduce tobacco-related diseases, is reduced by the sum of \$4,000,000 (non-recurring). Such funding reduction is for the purpose of eliminating funding for grants to counties to reduce tobacco-related diseases.

Fiscal Notes are created by the staff of the General Assembly's Fiscal Review Committee. This is a joint oversight committee of the House and Senate with 15 total members, supported by a nonpartisan staff of 16. Fiscal notes estimate the cost or savings associated with all legislation introduced in a session.

Fiscal Memos estimate the impact of amendments to legislation. If an error is discovered, the fiscal notes/memos are re-issued as corrected fiscal notes and memos. Fiscal notes are posted alongside their respective legislation on the [General Assembly's website](#).

After the end of each legislative session, the Fiscal Review Committee presents a **Cumulative Fiscal Note** that adds up the net effect on revenues and expenditures of all legislation passed and funded during the session. These are usually posted on the [General Assembly's website](#).

The Session Summary is created by the General Assembly's Office of Legislative Budget Analysis and summarizes the enacted appropriations. It also includes selective information on "noted" legislation for which the appropriations bill includes funding and amendments to the appropriations bill. These summaries are usually posted on the [General Assembly's website](#).

The State Fact Book is created by the General Assembly's Finance Committees and Office of Legislative Budget Analysis. It provides high-level funding information for each department that reflects a mid-year estimate of the Budget and is available on the [General Assembly's website](#). It is usually published in November.



KEY PLAYERS IN THE BUDGET PROCESS

- Governor
- Governor's Senior Staff
- Commissioner and Deputy Commissioner of Finance and Administration
- Department of Finance and Administration's Budget Division
- Department of Revenue
- Commissioners & Directors of other state departments and agencies
- The State Funding Board
- Treasurer
- Comptroller of the Treasury
- Secretary of State
- Tennessee General Assembly
- House Finance, Ways and Means Committee
- Senate Finance, Ways and Means Committee
- Legislature's Fiscal Review Committee
- Legislature's Office of Legislative Budget Analysis
- Legislature's Office of Legal Services
- UT Boyd Center for Business & Economic Research
- ETSU Bureau of Business & Economics Research

Monthly Revenue Reports provide monthly updates on the Department of Revenue's collections. They show how actual collections compare to the estimates on which the budget was based and collections in the previous year. These are made available each month on the [Department of Finance and Administration's website](#).

The Comprehensive Annual Financial Report (CAFR) gives an accounting of the state's actual financial activities and comes out after a fiscal year has ended. Due to accounting standards, the CAFR reports information in a different format than the Budget document. CAFRs are normally published in December on the [Department of Finance and Administration's website](#).

Glossary of Key Terms

Additional budget terms and context for the terms below are discussed throughout this primer. The Budget document also includes a glossary of key budget and accounting terms (beginning on page B-339 of the FY 2019 Budget).

Appropriation: Funding authorized by the General Assembly through the appropriations act. The legislative process associated with the budget and appropriations bill may also be referred to as the appropriations process. The Budget document also uses the terms appropriation and state appropriation to refer to amounts authorized to be spent from state revenues and reserves.

Allotment: The allocation of funds to an agency or program by the Tennessee Department of Finance and Administration. These allocations must be consistent with the appropriations made by the General Assembly.

Balanced Budget Requirement: The state constitution's requirement that state expenditures in a given year cannot exceed revenues and reserves in that year. This requirement is applicable at year-end.

Base Budget: A part of the budget appropriated to continue the current level of services, usually on a recurring basis. The base budget grows as new recurring cost increases are enacted. The base budget does not increase for non-recurring cost increases.

Budgeted Revenues: Collections and revenue sources that are appropriated for specific purposes in a given fiscal year - whether for spending or deposit to a [reserve](#). [Collections](#) that exceed revenue estimates are not budgeted for expenditure. They are often referred to as [overcollections](#) and are held in reserve and become available to be budgeted in subsequent fiscal years.

Capital Budget: Includes items related to the acquisition, construction, renovation, and maintenance of buildings, grounds, and other capital assets.

Collections: State tax revenues collected by the state of Tennessee. [Budgeted](#) collections are spent in the fiscal year in which they are collected or held in reserve for future needs. Collections in excess of those budgeted are often referred to as [overcollections](#).

Constitutional Spending Limit: The restriction in the state constitution that limits the rate of growth of appropriations from state tax revenues in any fiscal year to no more than the estimated rate of growth of the state's economy, which has been defined by law as the year-over-year rate of growth in Tennessee personal income. Often referred to as the [Copeland Cap](#).

Copeland Cap: See [Constitutional Spending Limit](#).

Cost Increases: The Budget's recommended funding increases in the operating budget (both recurring and non-recurring). In FY 2011-2012 and earlier Budget documents, these were referred to as "program improvements."

Current Services Revenues: Includes revenues raised directly by agencies, departments, programs, and activities that support specific agency purposes – including some fees and licenses.

Departmental Revenues: Includes revenues received directly by departments. These include things like current services revenues, program-specific reserves, interdepartmental revenues, and donations.

Discretionary: Refers to state funding in the recurring base budget that is considered to be open to recurring budget reductions. Usually (but not always) excludes earmarked funding, state funding associated with a federal matching requirement, and funding associated with fulfilling a court mandated requirement. This differs from the federal budgeting term, which refers to funding that is appropriated on an annual basis (versus mandatory or entitlement funding).

Earmark: Funding for which the specific purpose is defined in law.

Expenditures: State government spending.

Federal Revenues: Funding that the state receives from the federal government for specific activities – often via grants, cooperative agreements, contracts, and entitlements. Also referred to in the primer as federal funds and federal dollars. Also commonly referred to as federal grants-in-aid.

Fiscal Year: Tennessee’s state fiscal year spans July 1 to June 30. The federal fiscal year spans October 1 to September 30.

Funds: Repositories of money for specific purposes and often funded by specific revenue sources. The General Fund, Education Fund, Highway Fund, Debt Service Fund, Capital Projects Fund, Facilities Revolving Fund, and Local Government Fund (Cities and Counties – State-Shared Taxes) are state’s main funds to which the Budget document refers.

The Great Recession: The economic downturn that began December 2007 and ended in June 2009.

Interdepartmental Revenue: Revenues collected directly by a department from another department for a particular good or service.

Non-Recurring: Non-recurring expenditures are one-time expenses or projects. Non-recurring revenues are those from one-time sources that, once used or depleted, would not be expected to be available again.

Operating Budget: Includes all the costs associated with operating a department or program *except* capital costs.

Over-Appropriation: The bottom-line estimate of underspending across all of the Budget’s departments and programs. Underspending is associated with spending less than the amount explicitly appropriated or allotted.

Overcollections: The amount of state tax collections in excess of budgeted state tax revenues.

Recurring: Recurring expenditures are ongoing expenses or projects. The absolute dollar amount associated with recurring expenditures are carried forward in the recurring base budget. Recurring cost increases must be recommended in order for the recurring base to grow - even for programs like TennCare in which expenditures are expected to grow due to the underlying requirements of the program (e.g. enrollment growth and inflation).

Recurring revenues are from regular ongoing sources of revenue such as state tax collections.

Reserves: Funding held for future needs.

Reserve for Revenue Fluctuations: Tennessee's rainy day fund, reserved for use when revenue collections fall short of budgeted tax revenues.

Revenues: All of the sources of funding used to fund the state government's expenditures – including state tax collections, reserves, federal funding, tuition and fees paid by students to the state's public colleges and universities, state lottery proceeds, and current services and other departmental revenues.

Reversion: Refers to amounts associated with departmental and programmatic General Fund underspending that revert back to the General Fund.

Supplemental Appropriations: The appropriation of additional funding from state tax revenues or reserves for a department or program in the middle of a fiscal year.

Sweeper Clause: A provision in the appropriations bill that makes funding available for any legislation with a fiscal note cost estimate of less than a certain amount in its first year. In the 2018 appropriations act, the sweeper clause included any amounts less than \$50,000. The sweeper amount may vary from year to year.

Tax Expenditures: Estimates of the amount of state revenue lost for state tax exemptions.

Underspending: When a department or program spends less than the amount explicitly appropriated or allotted. Actions taken to generate savings mid-year would be categorized as one type of underspending. Another type of underspending occurs when departments do not fill all of their vacant state employee positions, which are funded in the Budget. Aggregate underspending is estimated at the bottom-line of the Budget instead of within each department or program. This bottom-line estimate is known as the over-appropriation.

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