



# Tennessee State Budget Primer

A Foundation for Understanding Our State's Public Policies

THE SYCAMORE INSTITUTE

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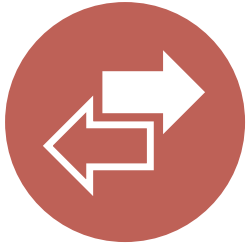
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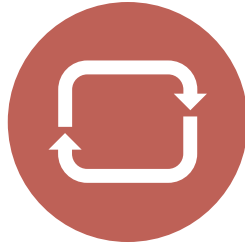
# Tennessee State Budget

## What is the Budget?

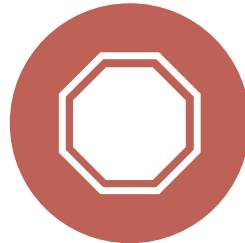
The state budget represents our policymakers' goals, the public goods and services intended to help meet those goals, and detailed plans to finance them.



It is full of constant **trade-offs**,



often changing and **dynamic**,



and subject to many **limitations**.



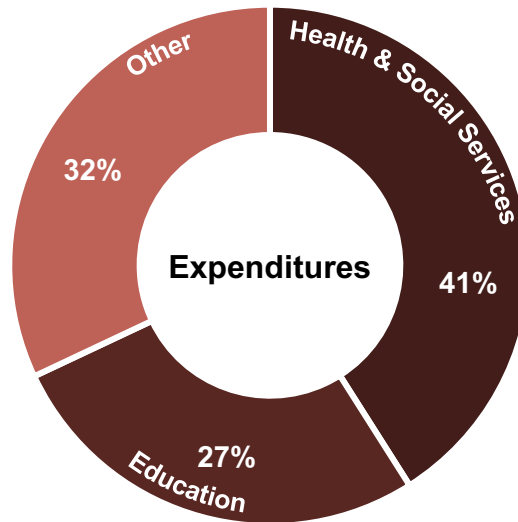
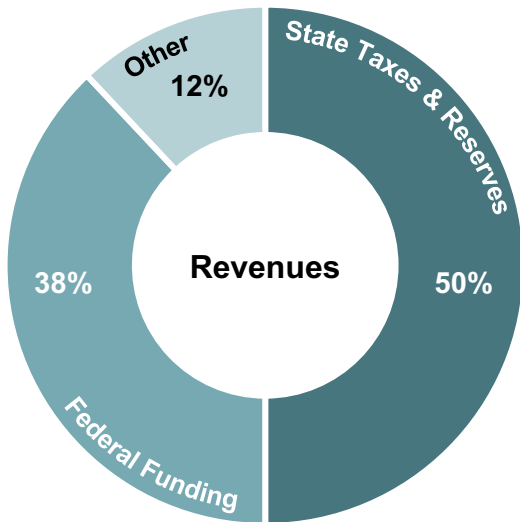
Tennessee's state constitution requires a **balanced budget**.



Major **restrictions** or **rules** limit how TN can spend about 82% of the FY 2022 General Fund.

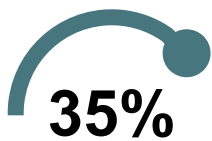
## Budget Facts

**FY 2023 Recommended Budget**  
\$52.5 Billion



**56** days

period TN could operate with expected **rainy day fund** and **TennCare Reserve** balances in FY 2023.



of all **state dollars** in TN's budget go to education.



of all **federal dollars** go to health & social services.

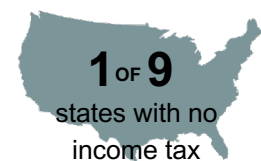


**63%** of TN taxes come from **sales tax**.



**#10 lowest** per capita total state taxes in the country

**#22 lowest** per capita total state spending



**#6 highest** per capita total corporate taxes



**#2 highest** state 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 support a thriving Tennessee.

## Highlights

The governor's FY 2023 recommended budget totaled \$52.5 billion. Over two-thirds (68%) went toward health and social services (41%) and education (27%). The money primarily came from the state's own taxes and reserves (50%) and federal funding (38%).

## Process

- **Fiscal Year** – The state's fiscal year (FY) begins July 1st and ends June 30th.
- **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 that in each 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 reduce spending and manage the budget to keep it balanced during the fiscal year.

## Expenditures

- **State Revenue Spending** – Funding for education, general government and capital outlay, and law, safety, and corrections programs and activities largely comes from state revenues. Education accounts for 35% of all state dollars in the budget, followed by health and social services at 23%.
- **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 70% of all federal dollars in the state budget.
- **Overall Spending Levels** – With 1st being the highest, Tennessee ranked 38th in the U.S. for per capita state spending in FY 2021 when accounting for all revenue sources. Its per capita spending from state revenue sources was the 29th highest.
- **Spending Growth** – The extent of growth in Tennessee's recurring spending depends on how it's measured. Total and per capita spending reached the highest levels in three decades in FY 2022. As a percent of state personal income and GDP, however, spending fell to historic lows.

## Revenues

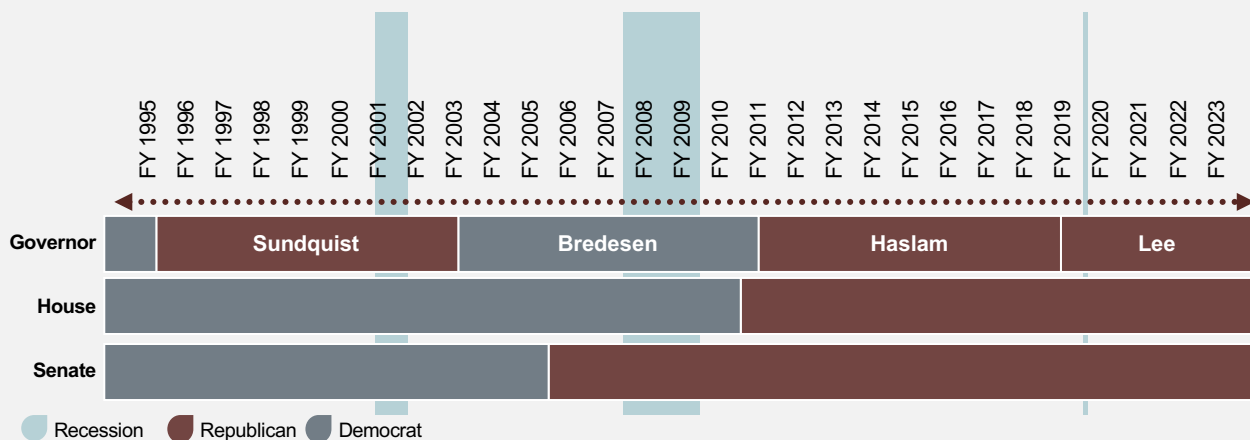
- **Overall Tax Burden** – Tennesseans have a relatively low state tax burden. At about \$2,300 per Tennessean, the state tax burden was the 10th lowest in the country in FY 2020. Because the state has no income tax, however, many of Tennessee's other taxes are high compared to those taxes in other states.
- **Sales Tax** – The sales tax is Tennessee's largest source (63%) of state tax revenue. At 7%, Tennessee's state sales tax rate is the 2nd highest in the U.S.
- **Federal Reliance** – With 1st being the highest, Tennessee ranks 8th for the share of federal funds in the state budget.
- **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 18% of total FY 2022 General Fund spending was considered "discretionary." The General Fund was about 87% of the total FY 2023 recommended budget.

## Surpluses, Deficits, and Rainy Day Funds

- **Projecting Revenues** – The accuracy of state tax projections plays a major role in whether surpluses and deficits occur. Recent history suggests that making projections is difficult and rarely accurate.
- **Surpluses** – A surplus occurs when Tennessee has collected more and/or spent less money at the end of a fiscal year than lawmakers budgeted. Not all reserves are surplus, and in fact, most of the state’s unspent reserves are tied up in specific requirements and obligations.
- **Recession Readiness** – Tennessee could fully fund current state government operations for around 56 days with rainy day and TennCare reserves alone. That’s about 34% more cushion than the state had going into the Great Recession.
- **Rainy Day Best Practices** – Tennessee follows most of the best practices when it comes to saving for a rainy day — including defining a purpose in law, setting a target balance, and having rules for replenishment.
- **Long-Term Liabilities** – Tennessee maintains trust funds to pre-fund long-term liabilities for state employee retiree benefits and is among the top states in the nation for covering these obligations.

### Text Box 1. Political & Economic Context for Historical Budget Data

Politics and the economy have significant influence on the state budget and offer important context for historical trends. The timeline below shows recessions and the political parties of Tennessee’s governors and state House and Senate majorities during the period covered in this primer.



# 1

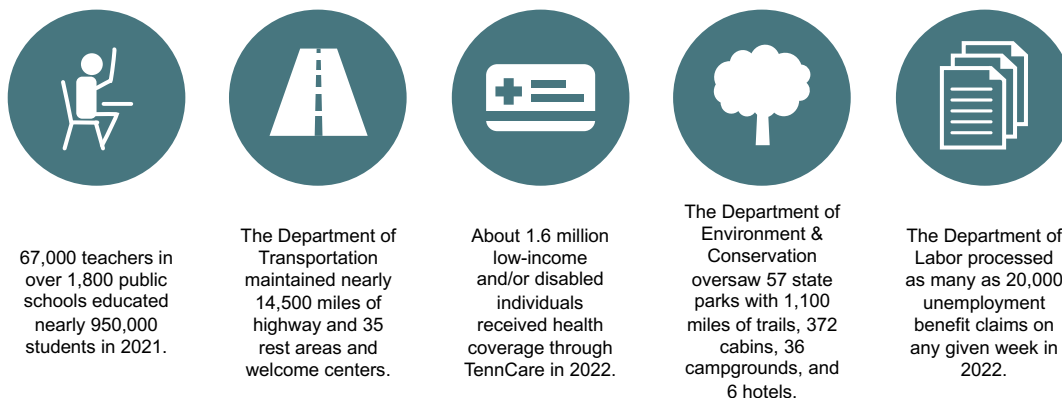
## **Budget Basics**

An introduction to 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?

Tennessee’s budget is an accounting of money coming into and going out of the state government. The money going out is the state’s expenditures — spending on everything from roads and schools to TennCare benefits and state employee salaries (**Figure 1**). The money coming in makes up the state’s revenues — what the state collects from taxes, fees, and other resources to fund the things it does.

**Figure 1. The State Budget at Work**



Sources: Tennessee Departments of Education (75), Transportation (74), and Environment & Conservation (73) (87), TennCare (77), and U.S. Department of Labor (76)

## 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.

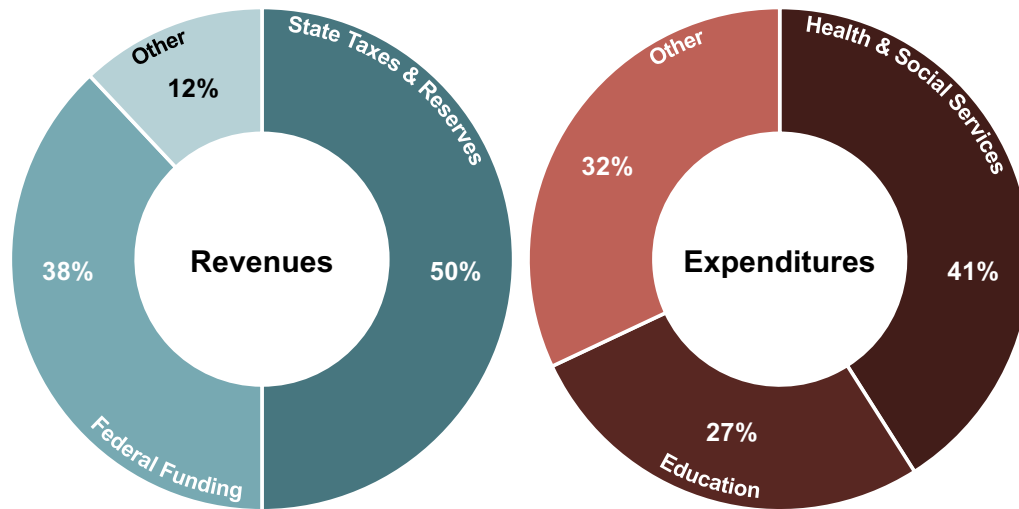
## Trade-Offs

**All budget decisions involve trade-offs.** While this primer includes rankings that compare Tennessee with other states, use them with caution. Nearly every budget decision 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 for Tennesseans. Different stakeholders may view this trade-off as good or bad.

## Budget Overview

**Figure 2. The Governor’s FY 2023 Recommended Budget**

\$52.5 Billion



Sources: The Sycamore Institute’s analysis of the FY 2023 Tennessee State Budget (21)

### 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 2023 recommended Budget, the relative size of these budget categories varies little from one year to the next (see page 26).

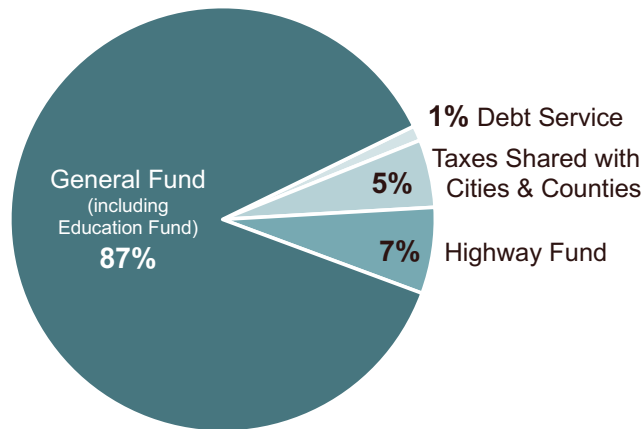
**The money flowing into the state government primarily comes from state revenues (\$26.4 billion) and the federal government (\$19.8 billion) (Figure 2).** Those state revenues include a mix of tax collections<sup>1</sup> (72%), prior years’ balances (16%), and various other assessments, lottery proceeds, and collections (13%). The \$12.4 billion in general sales tax revenues represents the largest source of both state taxes<sup>1</sup> (63%) and all state revenues (47%) (see page 29). Examples of “other” revenues include licenses and fees for specific services and privileges and tuition to state colleges and universities.

**This money overwhelmingly goes to health and social services (\$21.5 billion) and education (\$14.2 billion) (Figure 2).** Together, they comprise over two-thirds 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.

<sup>1</sup> Includes only state taxes collected by the Department of Revenue.

## The Budget's Funds

**Figure 3. The Funds in the FY 2023 Recommended Budget**



The "General Fund" also includes capital outlays and the facilities revolving fund.  
Sources: The Sycamore Institute's analysis of the FY 2023 Tennessee State Budget (21)

**Revenues get deposited in the state's various funds and then distributed to departments to spend.** Two of Tennessee's dedicated funds include the Education Fund and the Highway Fund. Each fund draws from specific revenue sources dictated in state tax laws. 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 30). These allocations can affect 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.** General Fund revenues are always needed to help pay for education spending, because education appropriations exceed the Education Fund's dedicated revenue sources. Together, these two funds typically comprise around 90% of the total budget (**Figure 3**). 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.

- **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 2023 recommended budget, about 77% of General Fund state revenue allocations were considered recurring and about 23% were non-recurring.

## Text Box 2. What Are State Credit Ratings?

In 2022, Tennessee had a AAA credit rating from the three main state rating agencies. (80) (78) (79) Here is what that means. (18) (19) (20)

### 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:

- What are a state's financial obligations?
- 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 43).
- The structural balance of a state's budget (see page 43).
- Long-term spending obligations (see page 42).
- Outstanding debts.

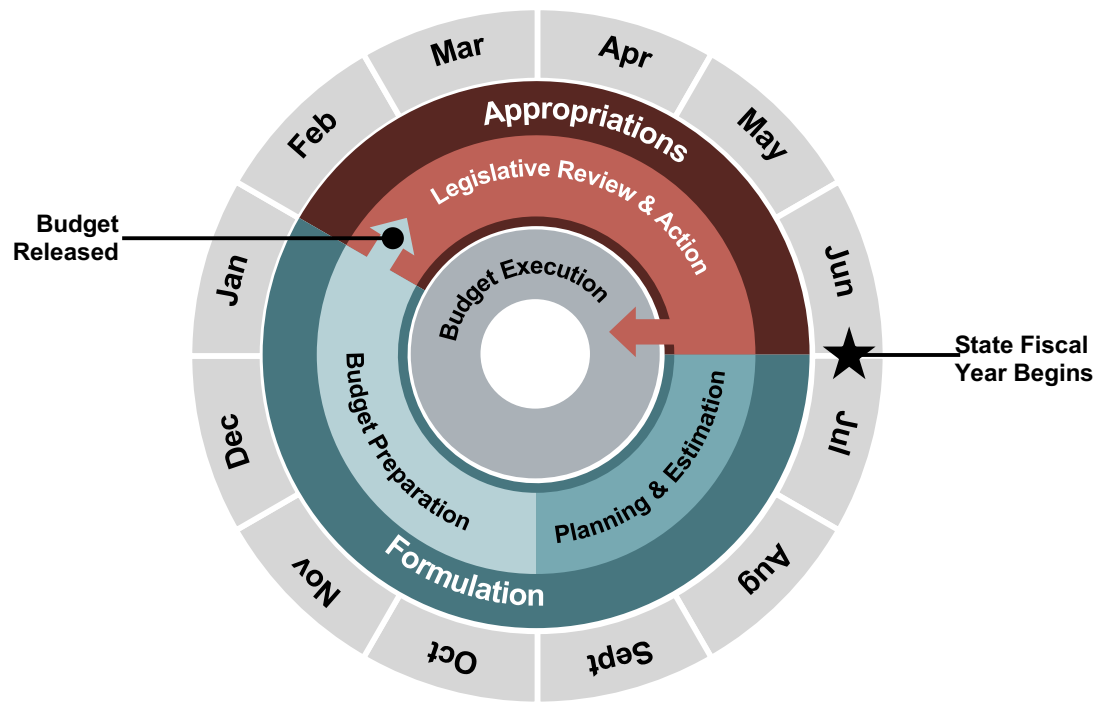
Credit ratings say nothing about the appropriate size and scope of state programs and services. A credit rating is simply a tool to assess a state's legal (and, to varying degrees, political) ability to meet its financial obligations. It cannot tell us what our public policy should be.

### 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, infrastructure, and capital projects. The state spends several million dollars in interest on these bonds each year — costs that could go up if our credit rating falls.

## Tennessee's Budget Cycle

Figure 4. Tennessee's Annual Budget Cycle



Tennessee's fiscal year spans July 1st-June 30th (Figure 4). Acceptable shorthand terms include FY 2022-2023, FY 22-23, or FY 2023 (using the current fiscal year at publication as an example). The federal fiscal year is October 1st-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 start working on the recommended budget for next fiscal year – while implementing and monitoring the current year's enacted budget.

The budget formulation and appropriations processes determine tax 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 budget's dynamic nature.

# 2

## **The Budget Process**

The steps to formulate and execute 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 with the executive branch developing a recommendation that the governor will send 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 with 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 often get the most scrutiny.

### Planning & Estimation



**The process starts when the Department of Finance & Administration (F&A) sends “Budget Instructions” to each state agency 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 direct departments to identify opportunities for recurring savings. For FY 2023, for example, departments had to identify savings of at least 1%. (2)

Meanwhile, F&A's Budget Division and the State Funding Board begin the challenging task of estimating revenues. See page 45 for a more thorough discussion of revenue projections.

#### Text Box 3. 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, the state cannot spend more than it has 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. (50)

### Text Box 4. Evidence-Based Budgeting in Tennessee

**Tennessee is ahead of many other states in deploying processes that support evidence-based funding decisions.**

(71) (72) In 2019, Tennessee established the Office of Evidence and Impact (OEI) and launched internal processes to more routinely consider program effectiveness during the budget process. Now, as part of the planning and estimation phase, agencies must support requests for new programs or cost increases with information on program results.

**OEI categorizes evidence used to support agency funding requests based on its rigor.** At the low end are theories of change that logically connect a program's activities with a desired outcome. Information on a program's outputs and outcomes lie in the middle, and rigorous evaluations of cause and effect are the gold standard. (92) Multiple national organizations maintain databases of available evidence and cost-benefit estimates for thousands of social service programs, and OEI has begun its own inventory of available evidence on state-funded programs and services. (69) (70) (93)

**History suggests that evidence is among many factors policymakers consider when allocating the state's finite resources.**

In 2002, officials added performance-based budgeting requirements to Tennessee state law. (95) It is unclear what effect these requirements had on budgeting decisions before being repealed in 2013. (96) (97)

## 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.

**Months of work culminate in the budget document.** The governor must send to the legislature no later than February 1st, but it usually happens in late January with the governor's annual State of the State address. At the start of each four-year gubernatorial term, governors have until March 1st to submit the budget. The General Assembly granted extensions in 2003, 2011, and 2019 to allow time for the new governors to hold public budget hearings. At times, extreme economic downturns have also justified deadline extensions.

The **appropriations bill** is the legislature's starting point for passing the budget. It begins as a reflection of the governor's recommendation.

**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 none of state government could legally spend money and thus operate.<sup>2</sup>

## 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.

### Passing the Appropriations Bill

**The House and Senate both have a Finance, Ways & Means Committee (or Finance Committee), 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 – usually those in the Senate – 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 preferences 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 and legislative initiatives.

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<sup>2</sup> Exceptions include the salaries of constitutional and statutory officials whose salaries are set in permanent law; retirement system and unemployment compensation benefits, which have continuing appropriations in permanent law; and debt service payments on previously sold bonds.

**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 they can send it to the governor. This reconciliation typically occurs on the Senate and House floors without the need for a formal joint conference committee.

**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** based on 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). (3) The use of either power is rare since the legislature can overturn vetoes with a simple majority vote of each chamber.

**Appropriations usually get approved and signed into law during the final weeks of the legislative session,** typically 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 and reform 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. (4)

**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 make in the

### "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.

appropriations bill. As a result, the Finance Committees must consider all legislation with a fiscal impact. Those bills are placed “**behind the budget.**” That is, the Finance Committees hold the legislation until the appropriations bill passes out of the committee.

**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. (5) For bills placed behind the budget, the Finance Committees usually approve those funded in the appropriations bill or covered by the sweeper clause, and they receive Senate and House floor action only after consideration of the appropriations bill. At times, the committees may disapprove even a funded bill for policy reasons. All unfunded bills with a fiscal impact effectively die.

### Text Box 5. 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 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.

## 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 every bill introduced and **fiscal memos** for amendments.

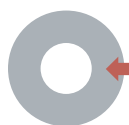
**Fiscal notes often do not reflect ancillary effects** — such as how tax code changes affect the broader economy. This type of “dynamic scoring” can be difficult to quantify, making it a less reliable foundation for balancing revenues with expenditures.

## The Copeland Cap

**Unless the General Assembly waives the “Copeland Cap,” annual spending growth from state taxes can’t exceed growth in the state’s personal income.** Under a 1978 state constitutional amendment, 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. (1) This requirement is often called the constitutional spending limit, the index, or the Copeland Cap — after its chief proponent then-Representative 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.

## 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 start spending money through allotments issued by F&A that are consistent with legislative appropriations.

**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 specific appropriations for several reasons:

1. **The governor often recommends supplemental appropriations for the current year when submitting the upcoming year’s budget.** The legislature typically enacts these supplemental requests as part of the appropriations bill for the upcoming year.
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 unforeseen 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 (i.e., 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. When out of session, the committee chairs typically notify their members and provide an opportunity for any objections before acknowledging

## Text Box 6. More About Fiscal Notes

### The Making of Fiscal Notes

**To create fiscal notes, Fiscal Review Committee (FRC) staff get input from affected state agencies, do independent research, and make assumptions where necessary.** (40) State law does not specify how FRC staff must develop their estimates. Their research may include looking at other states, nonpartisan studies and research, and the state's own historical information. (39) Given FRC's staffing capacity, access to data, and workload, fiscal notes also rely on information from the executive agencies expected to be affected by proposed legislation.

**FRC staff solicit input from executive agencies using fiscal note support forms and independently vet that information.** The kinds of questions that agencies are asked to consider in filling out these forms include: Does the bill have a one-time or recurring impact on costs? Would the bill in any way impact how much federal funding the state receives? Is any fiscal impact of the bill already reflected in the governor's budget?

### Special Rules for Some Fiscal Notes

Special rules are attached to the content and treatment of some fiscal notes.

- **Impact on State Commerce** – Fiscal notes for bills referred to the House Insurance and Banking, House Business and Utilities, and Senate Commerce and Labor Committees must assess the bill's impact on commerce and jobs in Tennessee. (51)
- **Effects on Incarceration Costs** – Until 2021, fiscal notes for bills expected to raise incarceration rates had to account for both operating and capital costs, and the budget had to pre-fund the highest-cost year expected over a 10-year period. These rules were put in place to ensure the state dedicated the funds necessary to prevent prison overcrowding – an issue that afflicted the state throughout the 1970s and 1980s. Lawmakers changed those rules in 2021. Now, these fiscal notes only reflect operating costs, and the budget must only account for the highest-cost year expected over a 3-year period. (42) (53)

the change. These methods cannot increase appropriations from state taxes but can increase a program or department's overall budget for that year.

4. **The budget accounts for one lump-sum “over-appropriation” because many agencies and programs will not spend their full appropriation.** For example, all state employee positions are fully funded in the budget but are never all filled all the time. This allows 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.

#### “Reversions”

reflect unspent program funds that revert to the General Fund at the end of the fiscal year.

Each agency's **underspending** can be tough to predict, so 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. Many refer to General Fund underspending as “**reversions**” because unspent funds revert to the General Fund.

In recent years, the recommended budget has included a recurring over-appropriation of about \$80 million. The administration amendment usually includes an additional non-recurring over-appropriation based on internal mid-year projections of program spending.

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 41).

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. Recurring and non-recurring savings, non-recurring reserves, and non-recurring federal aid were used to balance the budget each year (see page 47).

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

### Text Box 7. Consensus Best Practices in State Budgeting

Widely-accepted best practices in state budgeting include the following key principles (54) (55) (56) (57) (91):

- **Clear Process** – The budget process should be clear and consistent with an established timeline, instructions, and procedures.
- **Established Goals and Policies** – The budget should be informed by clear goals and established policies on items like rainy day funds, the use of recurring and non-recurring revenues, and debt.
- **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.

# 3

## **Revenues & Expenditures**

The ins and outs of money coming in and going out of state government — including historical trends, allocation of revenue streams, and how various programs are funded.

## Overview

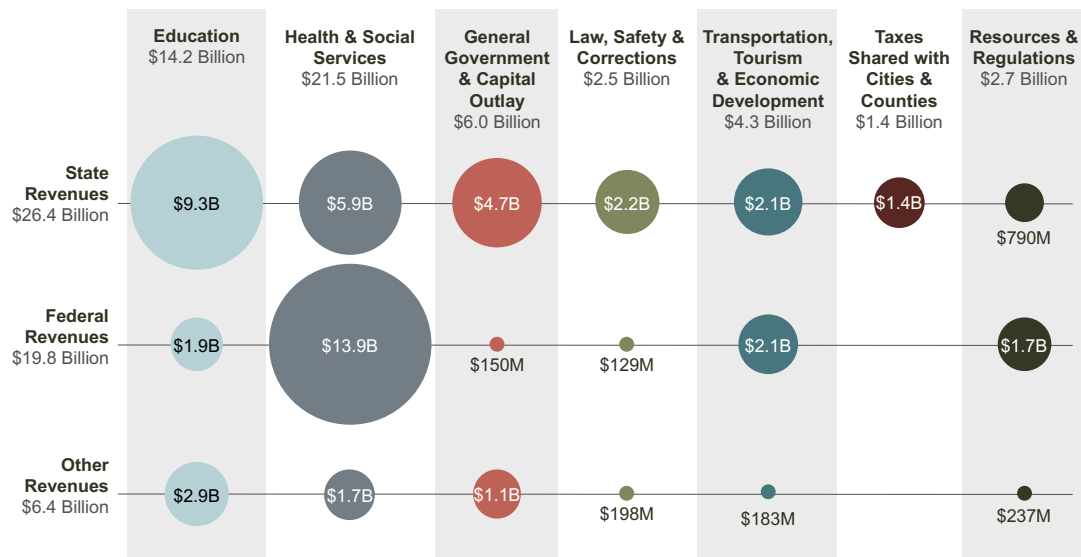
The governor and legislators have varying degrees of discretion over different revenue sources (see page 37). Understanding how they spend each revenue stream and fund each program can provide insight into how policymakers use their discretion (Figure 5).

Not all 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. In fact, 70% of all federal dollars in the FY 2023 recommendation were for health and social services. Meanwhile, education is the largest category of spending when looking at state dollars alone – accounting for 35% of all state revenues.

Not all programs are funded with the same mix of revenues (Table 1). For example, federal dollars fund almost two-thirds of health and social services and nearly half of transportation, tourism, and economic development spending. Meanwhile, state dollars make up the largest share of funding for law, safety, and corrections (87%), general government activities and capital outlay (79%), and education (66%).

**Figure 5. How Tennessee Spends Revenue Sources & Funds Program Areas**

FY 2023 Recommended Budget (\$52.5 Billion)



Source: The Sycamore Institute’s analysis of the FY 2023 Tennessee State Budget (21)

**Table 1. Program Expenditures in FY 2023 Recommended Budget**

Program (FY 2023 Recommended Budget)	Total (in millions)	% of Total Budget	Program Funding Composition			Category
			% from State	% from Federal	% from Other	
<b>Total State Budget</b>	<b>\$52,524</b>	<b>--</b>	<b>50%</b>	<b>38%</b>	<b>12%</b>	<b>--</b>
TennCare (Dept of F&A)	\$13,892	26.4%	32%	62%	5%	HSS
Dept of Education (K-12)	\$8,430	16.0%	76%	22%	2%	ED
Higher Education	\$5,736	10.9%	51%	1%	48%	ED
Dept of Human Services	\$4,445	8.5%	4%	94%	1%	HSS
Dept of Transportation	\$3,189	6.1%	54%	42%	4%	ECD
Capital Outlay Program	\$3,025	5.8%	91%	<1%	8%	GG
Dept of Environment & Conservation	\$1,904	3.6%	18%	76%	7%	REG
State Taxes Shared with Cities & Counties	\$1,361	2.6%	100%	--	--	CC
Dept of Correction	\$1,250	2.4%	98%	<1%	2%	LAW
Dept of Children's Services	\$1,120	2.1%	41%	17%	41%	HSS
Dept of Health	\$941	1.8%	27%	50%	23%	HSS
Miscellaneous Appropriations	\$900	1.7%	100%	--	--	GG
Dept of Finance & Administration	\$695	1.3%	29%	13%	58%	GG
Dept of Mental Health & Substance Abuse	\$505	1.0%	70%	21%	8%	HSS
Dept of Safety	\$483	0.9%	84%	6%	10%	LAW
Dept of Economic & Community Dev't	\$437	0.8%	41%	58%	1%	ECD
Housing Dev't Agency	\$433	0.8%	--	94%	6%	ECD
Dept of Commerce & Insurance	\$328	0.6%	80%	<1%	20%	REG
Dept of Intellectual & Dev'tal Disabilities	\$322	0.6%	36%	3%	62%	HSS
Debt Service Requirements	\$303	0.6%	100%	--	--	GG
Dept of Labor & Workforce Dev't	\$247	0.5%	25%	66%	9%	REG
Strategic Health Care Programs	\$210	0.4%	26%	73%	1%	HSS
Dept of General Services	\$183	0.3%	32%	--	68%	GG
Court System	\$177	0.3%	96%	<1%	4%	LAW
Facilities Revolving Fund	\$163	0.3%	8%	--	92%	GG
District Attorney Generals	\$159	0.3%	73%	<1%	27%	LAW
Dept of Agriculture	\$157	0.3%	68%	20%	12%	REG
Wildlife Resource Agency	\$134	0.3%	58%	26%	17%	REG
Dept of Revenue	\$128	0.2%	73%	<1%	27%	GG
Dept of Military	\$125	0.2%	30%	69%	1%	LAW
Comptroller	\$123	0.2%	91%	--	9%	GG
TN Bureau of Investigation	\$123	0.2%	71%	9%	20%	LAW
Claims & Compensation	\$107	0.2%	26%	2%	71%	GG

Revenues & Expenditures

(continued)

Program (FY 2023 Recommended Budget)	Total (in millions)	% of Total Budget	Program Funding Composition			Category
			% from State	% from Federal	% from Other	
Dept of Tourist Dev't	\$85	0.2%	58%	30%	12%	ECD
Secretary of State	\$83	0.2%	49%	36%	15%	GG
Commission on Aging & Disability	\$82	0.2%	35%	64%	<1%	HSS
District Public Defenders	\$73	0.1%	99%	--	<1%	LAW
Other Post-Employment Benefits	\$72	0.1%	100%	--	--	GG
Dept of Treasury	\$60	0.1%	11%	--	89%	GG
Legislature	\$59	0.1%	100%	--	<1%	GG
Attorney General & Reporter	\$58	0.1%	75%	<1%	25%	LAW
Arts Commission	\$37	<0.1%	24%	71%	5%	REG
Dept of Financial Institutions	\$31	<0.1%	100%	--	<1%	REG
TRICOR	\$29	<0.1%	--	--	100%	LAW
Dept of Veterans Services	\$20	<0.1%	93%	7%	--	GG
Dept of Human Resources	\$18	<0.1%	--	--	100%	GG
Commission on Children & Youth	\$11	<0.1%	80%	10%	9%	HSS
Alcoholic Beverage Commission	\$10	<0.1%	--	<1%	100%	LAW
Public Utility Commission	\$10	<0.1%	75%	10%	15%	GG
State Museum	\$10	<0.1%	100%	--	<1%	REG
Board of Parole	\$9	<0.1%	100%	--	<1%	LAW
Corrections Institute	\$7	<0.1%	99%	--	1%	REG
Sports Wagering Advisory Council	\$6	<0.1%	100%	--	--	GG
Executive Department	\$6	<0.1%	100%	--	--	GG
Advisory Council on Intergov'tal Affairs	\$4	<0.1%	5%	--	95%	GG
Human Rights Commission	\$3	<0.1%	69%	31%	--	GG
Post-Conviction Defender	\$3	<0.1%	100%	--	--	LAW
Council on Dev't Disabilities	\$2	<0.1%	12%	72%	16%	HSS
Fiscal Review Committee	\$2	<0.1%	100%	--	--	GG
Health Facilities Commission	\$2	<0.1%	100%	--	--	HSS
Emergency & Contingency Fund	\$1	<0.1%	100%	--	--	GG
State Building Commission	<\$1	<0.1%	--	--	100%	GG

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

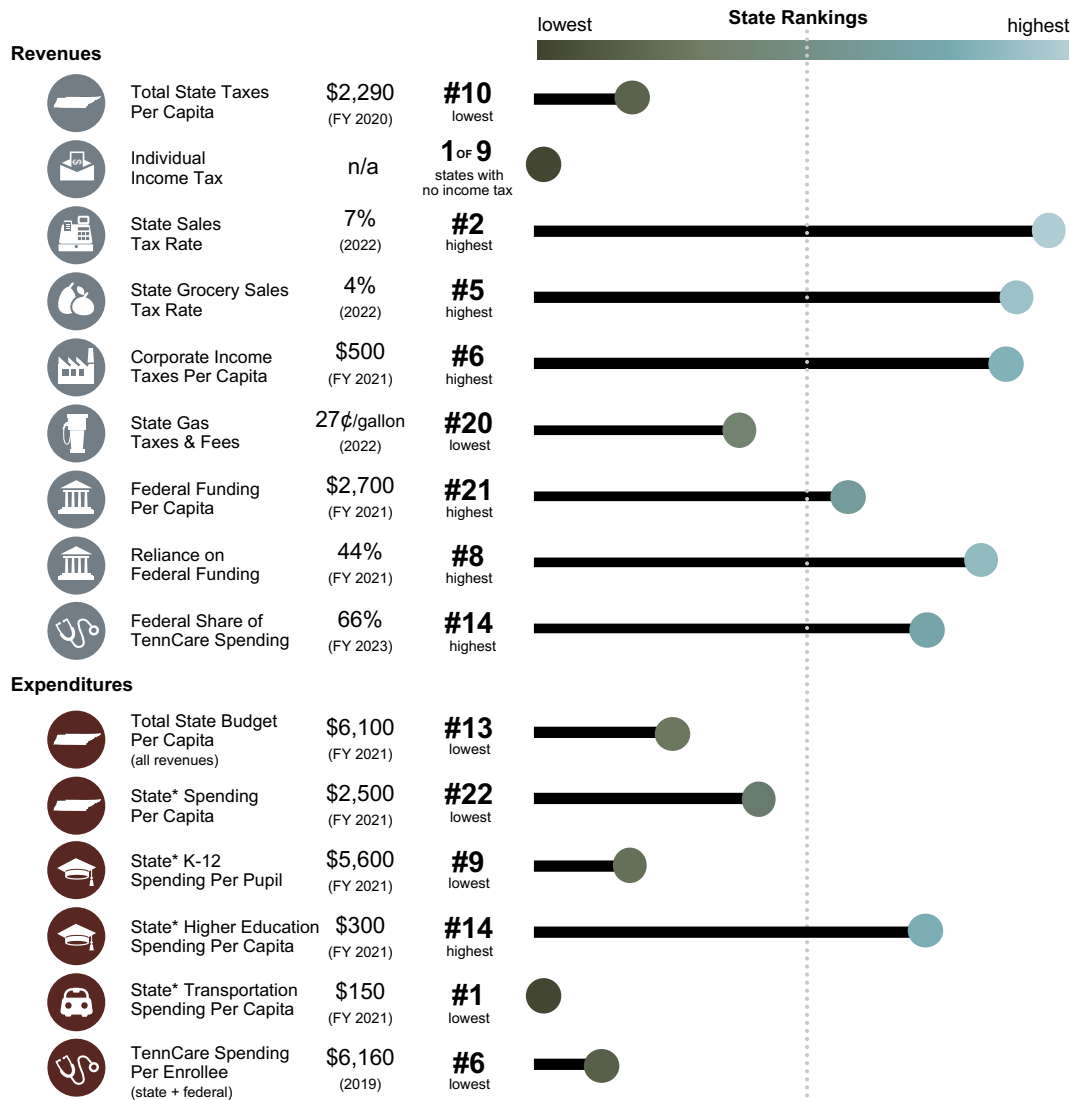
Source: The Sycamore Institute's analysis of the FY 2023 Tennessee State Budget (21)

# How Tennessee Compares

Tennessee taxes and spends less overall than most other states (Figure 6).

Because the state has no personal income tax, however, many of Tennessee’s other taxes are high relative to other states’. These rankings provide context for Tennessee’s budget policies, but each of the underlying policies has trade-offs (see page 6).

**Figure 6. How Tennessee’s Revenues and Expenditures Compare**



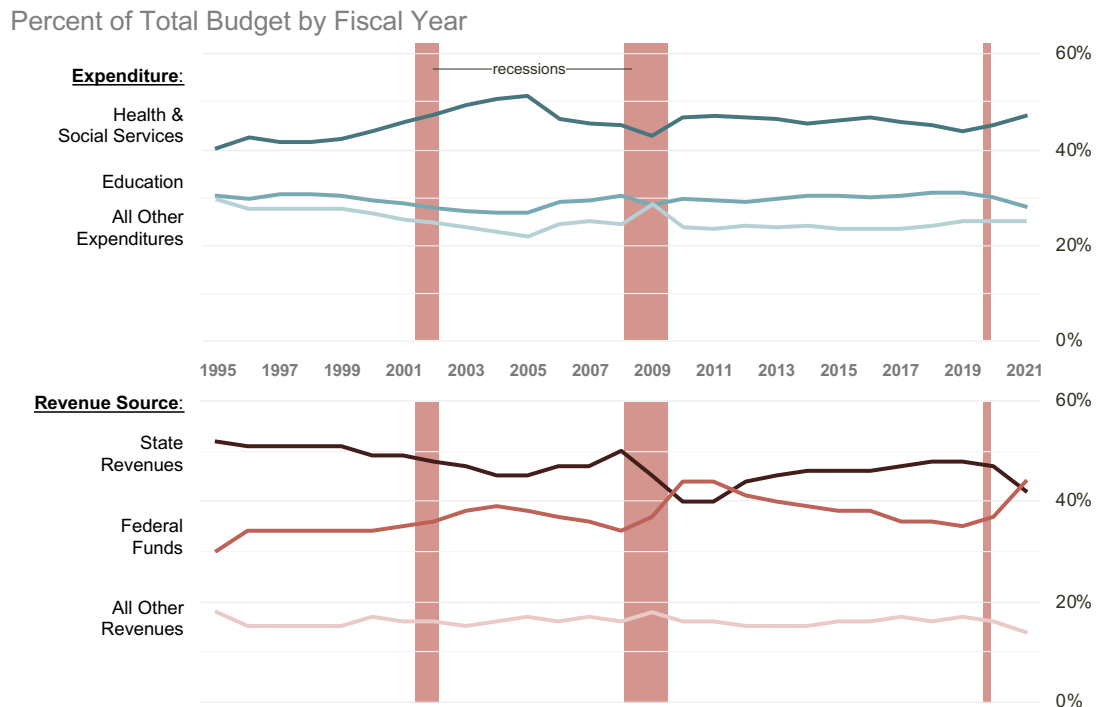
\*State revenues only. Sources: The Sycamore Institute’s analysis of information from the State Budget (21), U.S. Census Bureau (8), Tax Foundation (9), National Association of State Budget Officers (15), Kaiser Family Foundation (67) (68), National Center for Education Statistics (65), and Tennessee Department of Education (66)

## Historical Trends

**Over the last two decades, the mix of program areas in the state budget has ebbed and flowed (Figure 7).** After TennCare launched in 1994, health and social services comprised about 40% of the budget while education and all other expenditures each accounted for about 30%. By FY 2005, health and social services peaked at 51% and education was 27%. As of FY 2021 in the midst of the COVID-19 pandemic, health and social services was about 47% and education about 28%.

**The revenue mix also has changed – much of it driven by ups and downs in federal funding (Figure 7).** Federal dollars accounted for 30% of all revenues in FY 1995. Due to the Great Recession and the 2009 federal Recovery Act, federal funds peaked at 44% in FY 2010 and FY 2011. These dollars declined as a share of the total budget for about a decade but ticked back up to 44% in FY 2021 because of multiple rounds of federal funding tied to the pandemic.

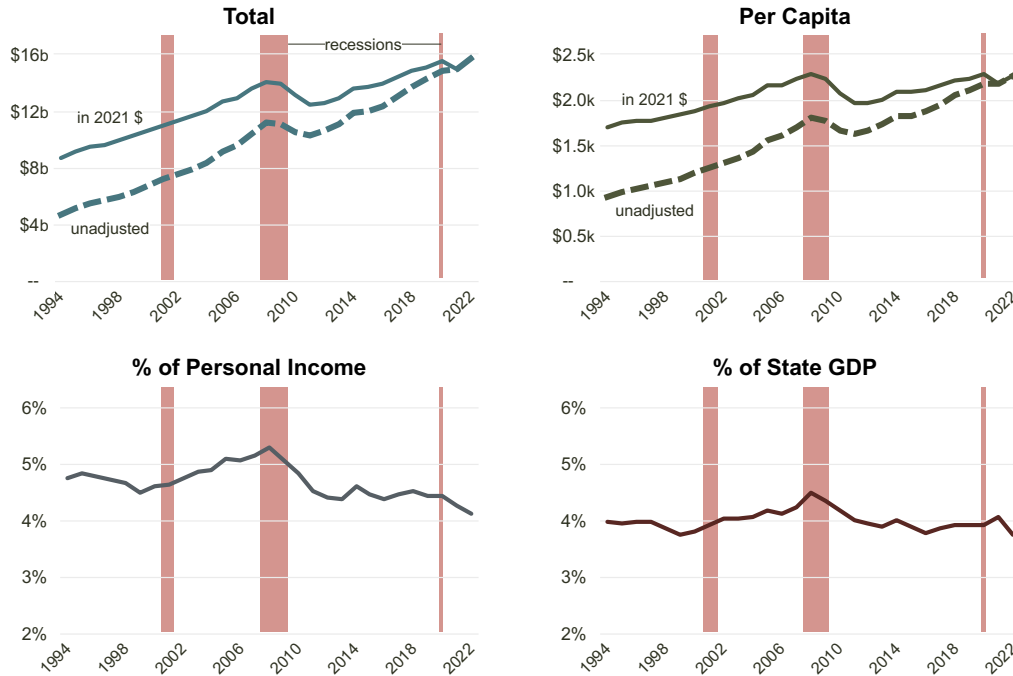
**Figure 7. The Mix of Programs & Revenues in Tennessee’s Budget Over Time**



Source: The Sycamore Institute’s analysis of Tennessee State Budgets (21)

**Figure 8. Tennessee’s Historical Spending Growth Depends on How It’s Measured**

Appropriations from Recurring State Revenues (FYs 1994-2022)



Inflation-adjusted amounts are shown in 2021 dollars using the GDP Price Index.  
 Sources: The Sycamore Institute’s analysis of information from Tennessee State Budgets (21), the Bureau of Economic Analysis, the U.S. Census Bureau. (6) (7) (8)

**The extent to which Tennessee’s recurring spending has grown over the last 30 years depends on how it is measured (Figure 8).** Appropriations from recurring revenues totaled \$15.8 billion in FY 2022 – or about \$2,300 per Tennessean – 30-year highs even after adjusting for inflation. However, that same amount represented historic lows as a share of Tennessee’s GDP and total personal income – a point to keep in mind when certain annual increases require separate legislative approval under the Copeland Cap (see page 17). (6) (7) (8)



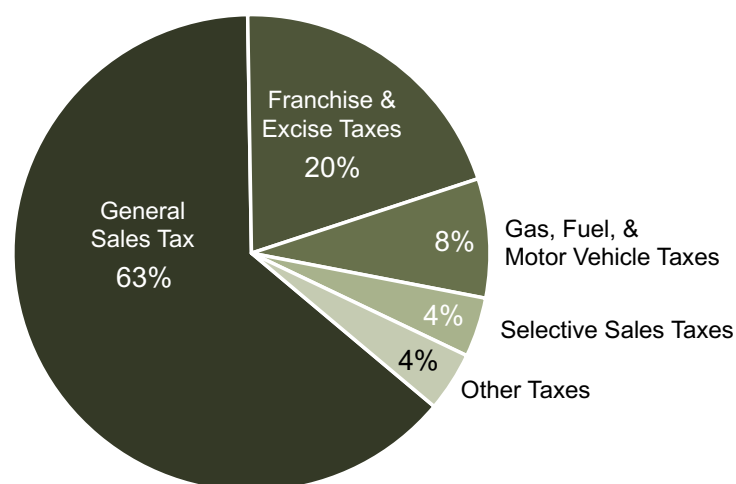
## **Digging Deeper**

A closer look at our state's revenue sources and their trade-offs and limitations.

## State Taxes

**Figure 9. State Tax Collections by Revenue Stream**

FY 2023 Recommended Budget (\$19.7 Billion)



Includes only taxes collected by the Department of Revenue

Source: The Sycamore Institute's analysis of the FY 2023 Tennessee State Budget (21)

### State Tax Overview

**By most accounts, Tennessee is a low-tax state.** Looking only at state tax revenues, Tennessee collected about \$2,600 per person in FY 2021.<sup>3</sup> In the prior year, the state had the 10th lowest per capita tax burden in the country (**Figure 6**). (8) (9)

**States primarily collect tax revenues through sales, income, and corporate taxes.** In Tennessee, state tax revenues predominately come from sales taxes (63%) and corporate taxes (20%) (**Figure 9**). The state's corporate taxes are also known as the franchise and excise taxes.

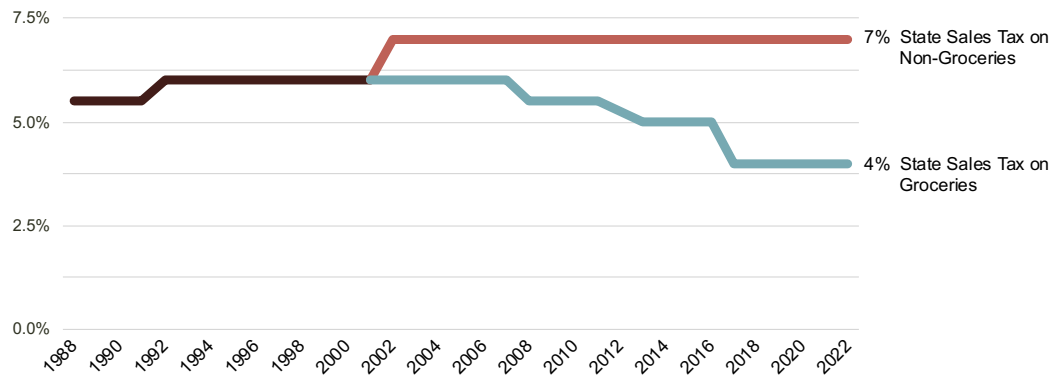
**Tennessee shares some revenues from state taxes with cities and counties.** In FY 2023, for example, the state expects to transfer 7% of the Tennessee Department of Revenue's total collections to cities and counties. The share of revenue transferred and the method for allocating it across cities and counties varies according to the law associated with each individual tax.

<sup>3</sup> Includes only state taxes collected by the Department of Revenue.

## General Sales Tax

Tennessee’s general sales tax is its single largest source of state tax revenues. As of 2022, the state taxes groceries at 4% and most other purchases at 7% (Figure 10). In addition to the state sales tax, county and municipal governments have the option to levy an additional local sales tax of up to 2.75%.

**Figure 10. Tennessee’s Sales Tax Rate Over Time**



Note: Excludes any local option sales tax.

Tennessee has the country’s 2nd highest average combined state and local sales tax rate and the 5th highest grocery sales tax as of January 1, 2022. (9) As of 2022, 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. The combined tax on groceries in most of the state’s 95 counties is 6.75%. (10) Tennessee is one of 14 states that tax groceries. (9)

## Franchise & Excise Taxes

Tennessee’s franchise and excise taxes are corporate taxes and make up 20% 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. (11)

## Gas, Fuel, & Motor Vehicle Taxes

Tennessee levies several taxes and fees on the use of motor vehicles. For example, the state charges a \$26.50 fee to register a personal vehicle, a 26¢ tax on every gallon of gasoline, and a 27¢ tax per gallon of diesel (Figure 11). (12) Gas and diesel also are

subject to federal taxes of 18¢ and 24¢ per gallon, respectively, which go to the federal Highway Fund. (13)

**Some refer to these taxes as “user fees” because they fund the roads and highways used by the people who pay the tax.** These taxes and fees are the

primary state funding source for state and local transportation projects. About 61% of these revenue streams go to the state’s Highway Fund, and another 26% go to counties and cities for transportation spending.

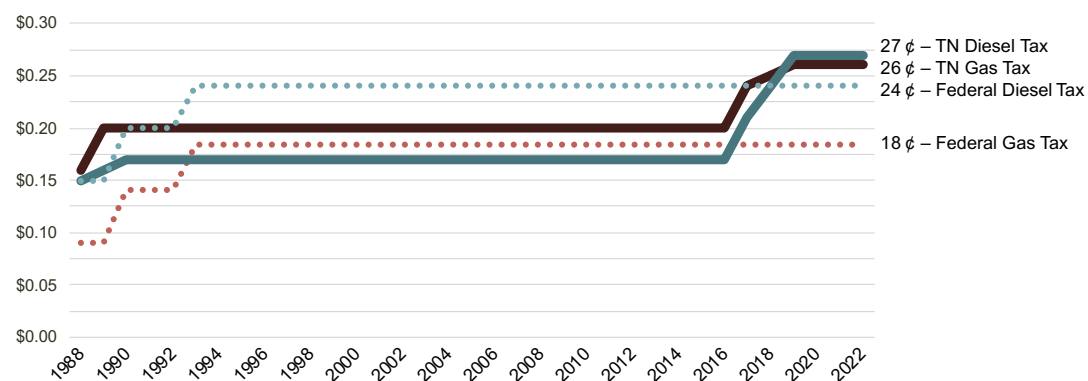
**Because of their structure, the purchasing power of fuel taxes tends to fall over time.** These taxes are a fixed amount per gallon, so the revenue they generate rises and falls with the number of gallons sold rather than the price per gallon — even as the costs of road construction rise. In addition to inflation, the shift to more fuel-efficient and electric-powered vehicles also puts more downward pressure on the revenue streams that fund road construction and maintenance (Figure 12).

### Key Tax Terms and Concepts

- **Ad Valorem Tax** – a tax that is a percent of the value of a specific good/service
- **Consumption Taxes** – taxes on the purchase of a good/service
- **Excise Tax** – a tax that is a fixed amount per unit of a specific good/service
- **Income Taxes** – taxes on earnings
- **Tax Base** – the total amount of income, assets, sales, etc. subject to a tax
- **Tax Burden** – the share of income that goes to taxes
- **Tax Incidence** – who ultimately pays the cost of a tax
- **Tax Rate** – the percent at which something is taxed
- **Vertical Equity** – the tax burden at different levels of income
- **Volatility** – unexpected swings in tax collections over time
- **Wealth Taxes** – taxes on the value of an asset (e.g. property)

**Figure 11. Tennessee’s Fuel Taxes Over Time**

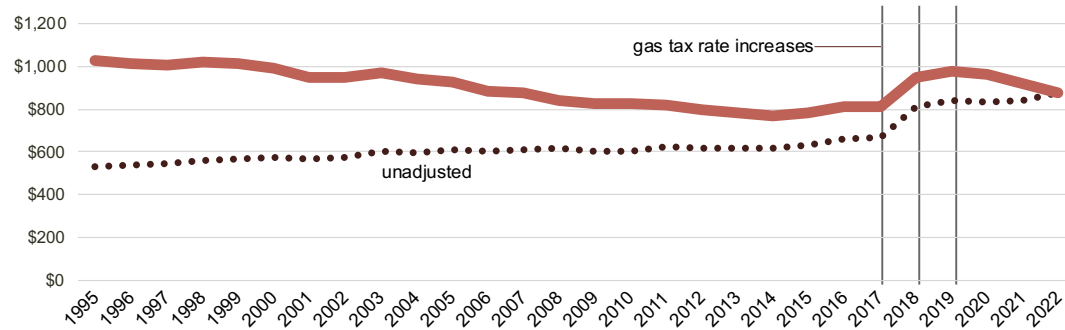
¢ Per Gallon



Note: Excludes the general sales tax and additional special petroleum tax.  
Source: Tennessee and U.S. Departments of Transportation (12) (13)

**Figure 12. Gas Tax Collections Do Not Typically Keep Up With Inflation**

Tennessee Gas Tax Collections in Millions of 2022 Dollars (FYs 1995-2022)



Adjusted for inflation using the annual June seasonally-adjusted CPI-U index.

Sources: The Sycamore Institute's analysis of data from Tennessee State Budgets (21), the Tennessee Department of Revenue (88), and the U.S. Bureau of Labor Statistics (87).

## Selective Sales Taxes

**Selective sales and gross receipts taxes apply to the sale or use of specific items or to specific types of businesses.** These taxes are typically 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, utility companies, soft drink bottlers. Selective sales taxes target specific items or types of goods, such as alcohol and tobacco. For example, Tennessee taxes cigarettes at 62¢ per pack.

## Income Tax

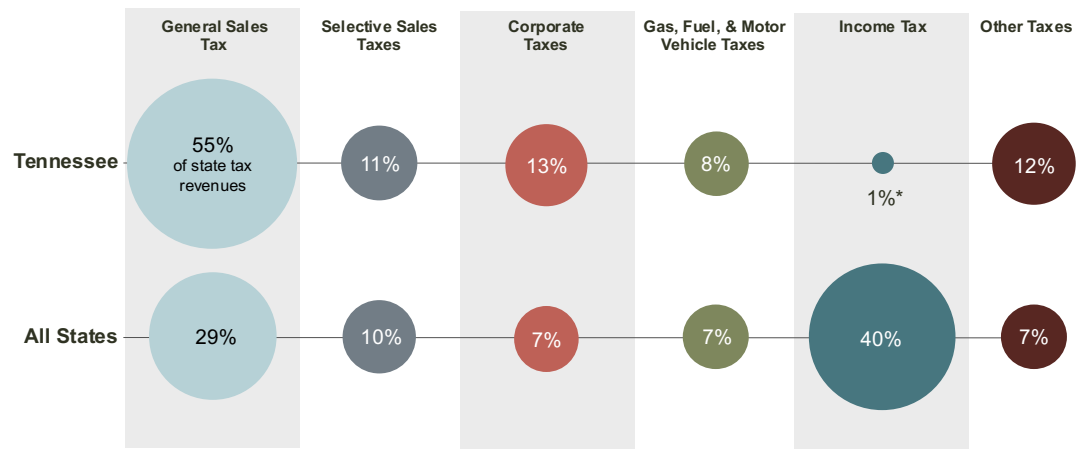
**Tennessee is one of 9 states with no individual income tax.** (9) The Hall Income Tax on investment income was phased out in 2021, and a 2014 state constitutional amendment prohibits the creation of any new tax on earned income. (1)

## State Taxes in Context

Tennessee relies more on sales taxes and corporate taxes and less on income tax than other states, on average (**Figure 13**). (14)

**Figure 13. How Tennessee's State Tax System Compares**

TN vs. 50-State Total (FY 2021)



\*Last year of the Hall Income Tax phase-out.

Source: U.S. Census Bureau's 2021 Annual Survey of State Government Tax Collections (14)

### **Text Box 8. 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. (43) (44)

#### **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 burdens 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?

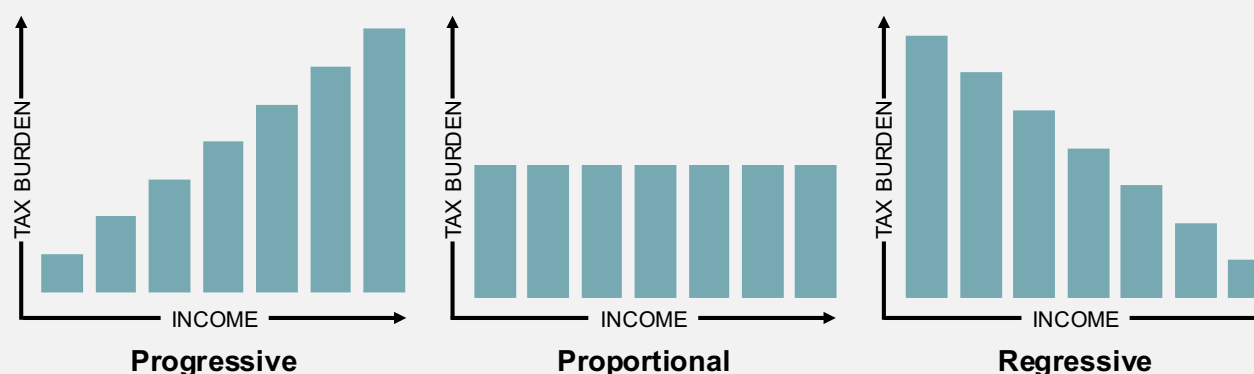
### Text Box 9. Regressive v. Progressive Taxes

Tax structures can be progressive, regressive, or proportional depending on what they require of people at different income levels. A person’s tax burden is the total amount of taxes they pay measured as a percent of their total income. When the tax burden increases as incomes get higher, the tax structure is considered progressive. When the opposite occurs, the tax structure is considered regressive. When burdens are the same across all income levels, the tax structure is proportional (Figure 14).

Most state tax structures are regressive because states rely more heavily on sales taxes. 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 low-earners’ incomes is subject to taxation. 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.

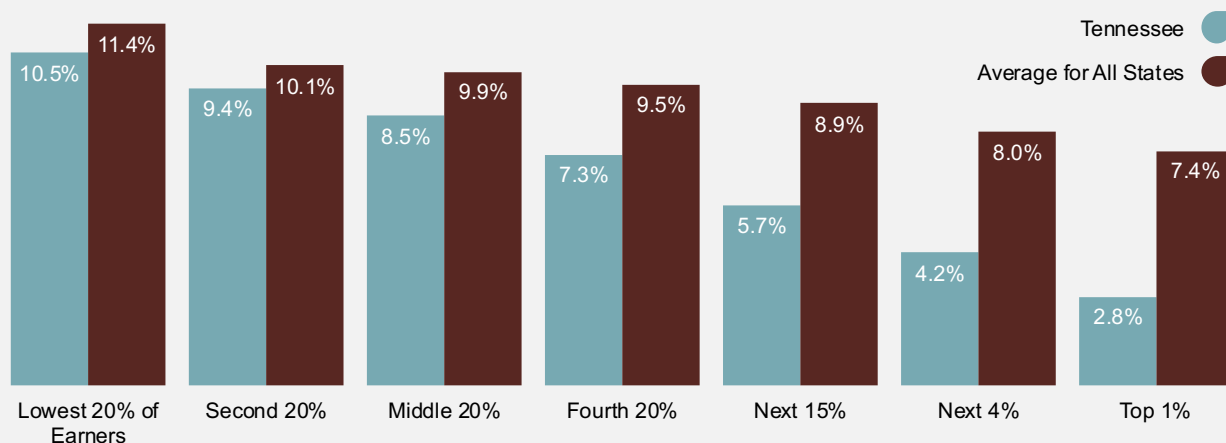
Figure 15 estimates how Tennessee’s tax burden compares with the average for all states across different income levels in 2018. (58) Because 63% of Tennessee’s state tax collections come from sales tax (see page 30), Tennessee’s tax structure is more regressive than in most other states’.

### Figure 14. Illustrative Tax Structures



### Figure 15. Average State and Local Tax Burden by Income Level (2021)

The Share of Income That Goes to State & Local Taxes

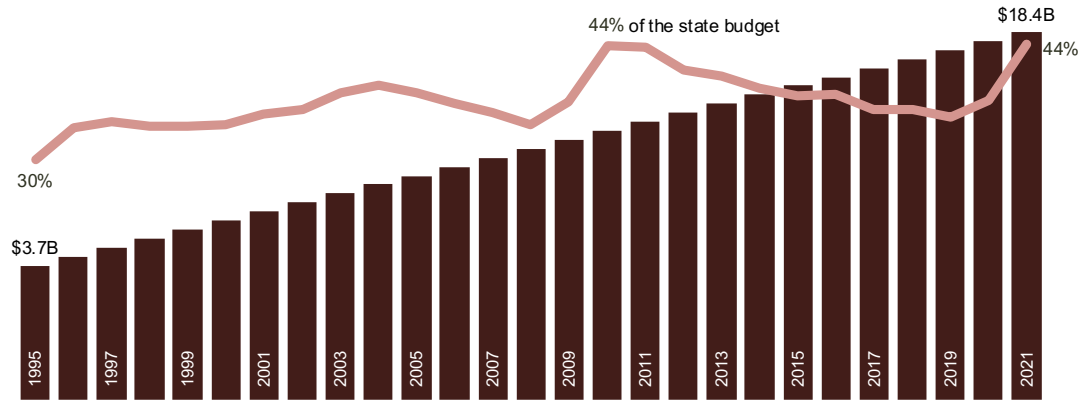


Source: Institute on Taxation and Economic Policy (58)

## Federal Funding

**Figure 16. Federal Funding in the State Budget**

FYs 1995-2021



Source: The Sycamore Institute’s analysis of Tennessee State Budgets (21)

### Reliance on Federal Funds

**The FY 2023 recommended budget included \$19.8 billion in funding from the federal government.** In nominal terms, that is the largest amount ever (**Figure 16**). As a share of the total budget, however, Tennessee’s reliance on federal dollars peaked at 44% in FYs 2010 and 2011 and again in 2020 and 2021. In those years, Congress gave states large infusions of federal money – first in response to the Great Recession and again during the COVID-19 pandemic.

**About 44¢ of every \$1.00 spent by the state of Tennessee in FY 2021 came from the federal government.** Tennessee relied more heavily on federal revenues than all but seven other states that year. (15)

**That ratio only reflects the state budget — it does not include all the federal money spent in Tennessee.** In state FY 2021, for example, the budget included \$18.4 billion in federal funds. Meanwhile, in federal FY 2021, an estimated \$112.9 billion in federal funds entered Tennessee as direct awards, contracts, and benefits. (16)

### Federal Funds in the State Budget

**Tennessee’s budget includes all federal funds awarded directly to the state government 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, transportation infrastructure, and clean water activities.

## Federal 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.

## Restrictions on the Use of Funds

### Most Money in the Budget Comes with Strings Attached

**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 with fewer restrictions for budgeting purposes.**

At \$6.7 billion in FY 2022, it amounted to about 18% of the recommended General Fund and 38% of recommended state dollars in the

General Fund. In other words, the administration determined that some rule or restriction limited how the state could spend about 82% of the total General Fund.

18%

of the total FY 2022  
General Fund was  
considered discretionary.

**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 Restrictions

### State Earmarks

**Tennessee law “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 states rarely have much authority to redirect those dollars.** For example, the Department of Human Services is expected to get \$3.4 billion from the federal government for the Supplemental Nutrition Assistance Program (SNAP). Not only can those dollars not be spent on other purposes, but they must also 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 66% of most TennCare (i.e., Medicaid) costs. As a result, the overall budget changes by about \$2.95 for every \$1.00 increase or reduction in state funding for TennCare.

### Court Mandates

**Court rulings can obligate the state to fund something a certain way.** For example, in court challenges that began in the 1980s, small local school systems charged that state education funding allocations were inequitable. The courts agreed, resulting in a 1992 funding formula for public education in Tennessee known as the Basic Education Program (BEP), which was subsequently approved by the courts. The state replaced the BEP with a new formula – the Tennessee Investment in Student Achievement (TISA) – in 2022.

### 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.

# 5

## **Surpluses, Deficits and Rainy Day Funds**

Exploration of surpluses and deficits, the role of revenue projections and rainy day funds, and the trade-offs Tennessee's policymakers must weigh when crafting the budget.

## Overview

**In recent years, Tennessee has amassed some of its largest budget surpluses ever while at times facing the prospect of deficits.** Since the budget must balance, situations like these confront policymakers with significant tax and spending decisions. Yet even with the best forecasts, underlying trends and unexpected changes in the economy can limit their options.

## Surpluses

**A surplus occurs when Tennessee has collected more and/or spent less by the end of a fiscal year than lawmakers had approved in the budget.** The state cannot use this leftover money in subsequent years until the General Assembly decides how to allocate it.

**When revenue collections outpace budgeted estimates, the state accumulates a surplus that it cannot yet spend.** This type of surplus is known as an “overcollection.” At the end of a fiscal year, this excess revenue goes into a Reserve for Future Requirements until lawmakers appropriate it for use in a subsequent fiscal year.

**Surpluses can also accumulate when programs spend less than their appropriation.** At the end of a fiscal year, some programs with unspent appropriations can roll over all or part of their savings into a program reserve for future years. Most other unspent General Fund revenues revert back to the General Fund and go into the Reserve for Future Requirements.

**Mid-year revenue re-estimates can also yield additional funds not anticipated when the fiscal year began, but this money is not necessarily surplus.** For example, the FY 2023 recommendation projected \$2.9 billion in additional expected FY 2022 General Fund revenue collections that weren’t budgeted at the start of the fiscal year. Based on the re-estimate, the General Assembly approved those funds for one-time investments in FYs 2022 and 2023.

**Most other unspent fund balances that Tennessee carries from year to year are tied to specific purposes.** At the end of FY 2021, the state had a total balance of about \$11.8 billion across the General, Education, and Highway Funds. (17) About one-third of that was year-end surplus in the Reserve for Future Requirements. The remaining \$8.0 billion has specific purposes required by state law or restrictions by 3rd parties – including the federal government, state or federal courts, or donors. They are not available to spend on other purposes. Examples of funds restricted by state laws include

rainy day funds, one-time appropriations for construction, road, or other projects that span multiple years, and fees that pay for specific programs or agencies, such as licensing boards.

Most of the state's unspent reserves are tied to specific purposes and obligations.

## Deficits

**Deficits occur when spending exceeds revenues.** There are two basic types of budget deficits, cyclical and structural, which differ in significant ways.

### Cyclical Deficits

**Cyclical deficits can occur when economic downturns throw revenues and spending out of balance.** Even with the best year-to-year and mid-year revenue and spending estimates, unexpected economic conditions and underlying trends can challenge the state's ability to balance its budget as constitutionally required.

**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. Unexpected events like natural disasters and public health emergencies can also increase demand for state assistance.

**Because the budget must balance, Tennessee cannot end its fiscal year with a deficit.** When facing the prospect of a deficit, policymakers have to actively manage the budget mid-year by cutting spending, raising revenues, tapping reserves and/or rainy day funds, or some combination thereof (see page 47). Tennessee has very rarely turned to raising revenues or tapping reserves.

### Structural Deficits

**A structural deficit arises from a fundamental imbalance in budget policy that causes spending to exceed revenues.** This 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 anticipate 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 either situation.

**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 subject to interpretation.

**The state rarely publishes multi-year budget forecasts.** All recent multi-year projections have been aimed at addressing recession-related imbalances. The FYs 2010 through 2014 budgets, for example, included multi-year projections for weathering the Great Recession and its protracted recovery. Governor Lee also presented a multi-year projection during the brief COVID-19 pandemic recession in early 2020. Looking further back, Governors Dunn, Blanton, and Alexander each published a single multi-year budget outlook as they were wrapping up their terms. Budget officials may routinely carry out internal projections at other times, but those are not typically made public.

### **Text Box 10. How Tennessee Funds Long-Term Retiree Liabilities**

**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 99% of its \$53.9 billion long-term pension liability, according to projections from December 2021.** (60) A number of recent national analyses list Tennessee among the top states for funding its pension liabilities. (61) (62) (63)

**As of June 30, 2021, Tennessee had funded about 39% of its projected \$1.2 billion long-term OPEB liabilities.** (59) Most national analyses rely on data from before or shortly after the state began pre-funding OPEB obligations in FY 2018. The most recent of those placed Tennessee in the middle of the pack compared to other states for funding these obligations (64). At 39%, however, Tennessee would have been near the top of the rankings.

## Rainy Day Funds

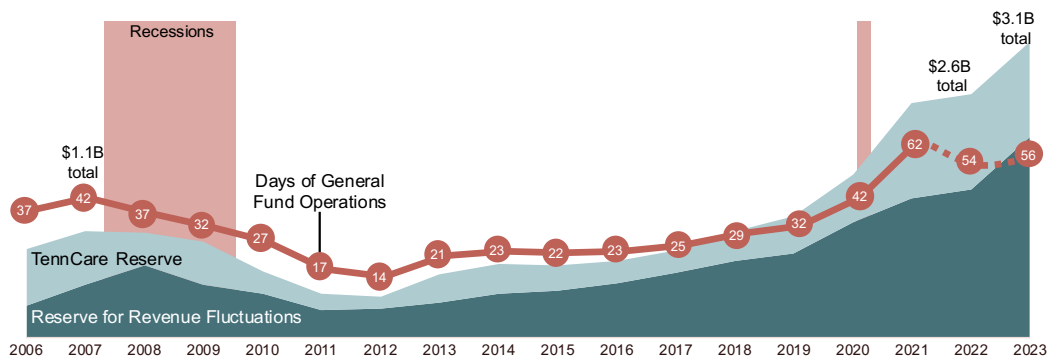
**A rainy day fund is one tool that helps policymakers smooth out the ups and downs of the economic cycle.** Rainy day funds allow states to set money aside when revenues are strong and/or demands are relatively low. States can then tap those reserves when revenues are weak and/or demands increase.

**The Reserve for Revenue Fluctuations and the TennCare Reserve are important tools in Tennessee’s ability to respond to a downturn.** The former is specifically for unexpected changes in revenue collections. The latter is a separate fund of excess TennCare dollars. In dire situations, the legislature can make the TennCare Reserve available to shore up both TennCare and the larger General Fund.

**The Reserve for Revenue Fluctuations balance is made up of one-time deposits** — usually from budget surpluses. Surpluses, however, do not automatically go into the Reserve. The amount deposited each year depends on the reserve’s target balance as specified by policymakers in law. This target balance determines the size of the deposit even if the state has a larger surplus and could “afford” to set aside more.

**The combined target balance of Tennessee’s two main rainy day reserves will reach historic highs by the end of FY 2023.** The balance is set to exceed \$3.1 billion and could cover nearly two months of state-funded General Fund operations at the FY 2023 recommended spending levels (**Figure 17**). This is about 34% more cushion than the state had at the end of FY 2007 going into the Great Recession.

**Figure 17. Tennessee’s Rainy Day Reserves**



Note: FYs 2022-2023 “Days of General Fund Operations” are based on estimates of General Fund expenditures. Prior years are based on actual expenditures.  
 Source: The Sycamore Institute’s analysis of Tennessee State Budgets (21)

## Text Box 11. Tennessee Follows Most Best Practices for Rainy Day Funds

Here's how Tennessee's rainy day fund ("the Reserve") policies stack up against common best practices (81) (20) (19) (82) (83) (84) (85) (90) (86) (94):

**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 Approach:**

- The statutory purpose of Tennessee's fund 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 suddenly high or low (i.e., volatility) – and stress test their rainy day funds.

**Tennessee's Approach:**

- Tennessee does not have a formal public process for making long-term projections or stress-testing. In the Great Recession's wake, the FYs 2010-2014 budgets had multi-year projections of revenue and spending growth. Later budgets did not continue this practice (see page 42).

**Best Practice:** States should establish criteria for replenishing the rainy day fund instead of relying exclusively on unplanned surpluses. That criteria should also allow for bigger deposits when revenues grow.

**Tennessee's Approach:**

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

**Best Practice:** Rainy day funds should ensure states are able to weather long recessions. Convention used to be that funds should equal about 5% of a state's budget, but now, most experts agree that the appropriate level depends on each state's unique circumstances.

**Tennessee's Approach:**

- State law sets a target Reserve balance of about 8% of state tax revenues but does not explicitly cap it. The Reserve was about \$8 million over the 8% at the end of FY 2021.

**Best Practice:** Perspectives on rainy day fund withdrawals vary. Some groups advocate for maximum flexibility to use rainy day funds when needed. Others support requiring legislative super-majority approval, capping withdrawals, or building in specific triggers to ensure the most prudent use of reserves.

**Tennessee's Approach:**

- When revenues fall short in Tennessee, there is no statutory limit on using the Reserve for existing appropriations. The law requires legislative notification and a committee hearing, but the law 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 balance. The law requires legislative notification, a committee hearing, and the approval of the additional spending by the General Assembly in an appropriations act.
- In both scenarios, the law expresses legislative intent that spending should be cut before using the reserve.

## State Tax Projections

**The accuracy of state tax projections plays a major role in whether surpluses and deficits occur.** Conservative forecasts contribute to surpluses, while overly optimistic projections can force policymakers into difficult decisions to make ends meet.

### How Tennessee Projects Revenues

**Tennessee law lays out the process for projecting state revenues.** (18) (19) (20) Each year's budget is based on an expected revenue range recommended by the State Funding Board. The Funding Board consists of the governor, the commissioner of finance and administration, the comptroller, the secretary of state, and the treasurer. To inform its recommendation, the Funding Board typically gets separate revenue estimates and economic forecasts from:

- The legislature's Fiscal Review Committee.
- The Department of Revenue.
- Outside economists (e.g., 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 Funding Board uses those estimates to recommend a range of revenue predictions** for the upcoming fiscal year and a revised range for the current fiscal year. The Funding Board's range usually encompasses at least some of the expert projections (**Figure 18**). In some years, it has recommended a range below that of any of the expert estimates but never above the highest estimates. (21)

**Finally, the governor and budget staff use the Funding Board's range to select an official revenue projection for the recommended budget.** The governor's proposals for the budget's spending and revenues are based on this official estimate. Governors have always recommended revenue estimates within the Funding Board range, almost always at the high end, and the General Assembly has approved appropriations above the recommended range only once and by a relatively small amount.

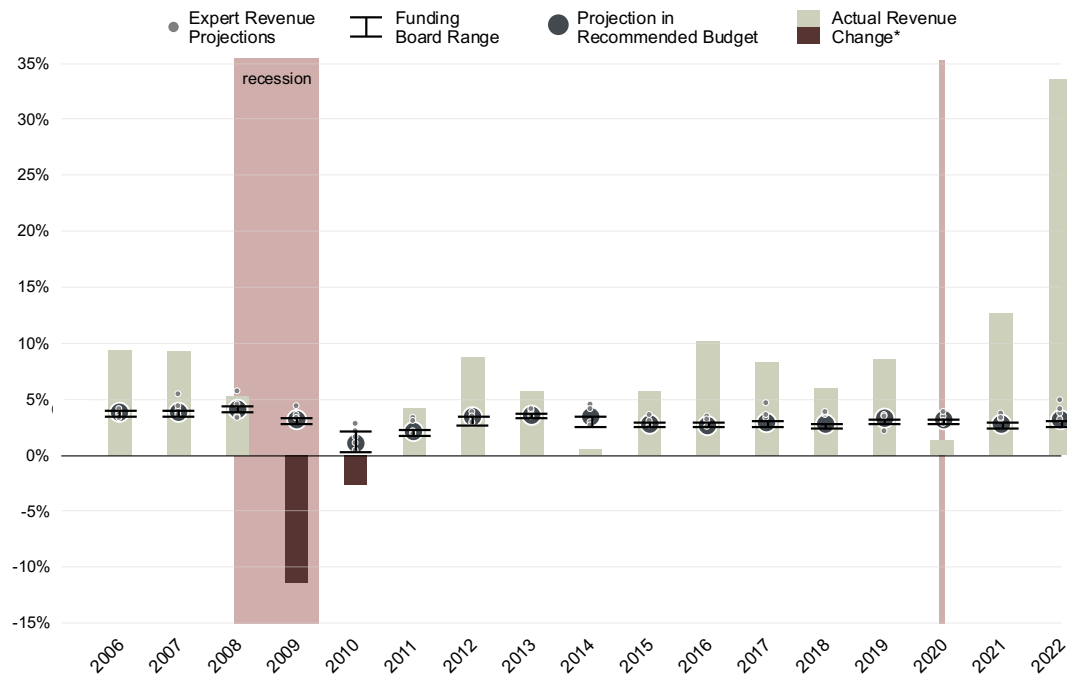
### Projection Accuracy

**Recent history suggests that state tax revenue projections are difficult and rarely accurate (Figure 18).** (22) Based on recent experience, Tennessee tends to overestimate its tax revenues during and immediately after recessions and underestimate them during times of economic growth. (21) (23)

The state reports its actual revenue collections every month. This lets policymakers and the public see how actual revenues compare to the estimates on which the budget was based.

**Figure 18. State Tax Revenue Projections Are Difficult and Rarely Accurate**

Percent Change in Tennessee State Tax Revenues (FYs 2006-2022)



\*The actual revenue change for FY 2022 represents the difference in FY 2022 actual collections and the FY 2021 mid-year estimate (the basis for the FY 2022 recommended budget projection). All other fiscal years are shown the same way.

Note: Includes state tax revenues collected by the Department of Revenue.

Sources: The Sycamore Institute's analysis of information from Tennessee State Budgets (21) and the Tennessee Department of Finance & Administration (88)

## Weathering Recent Recessions

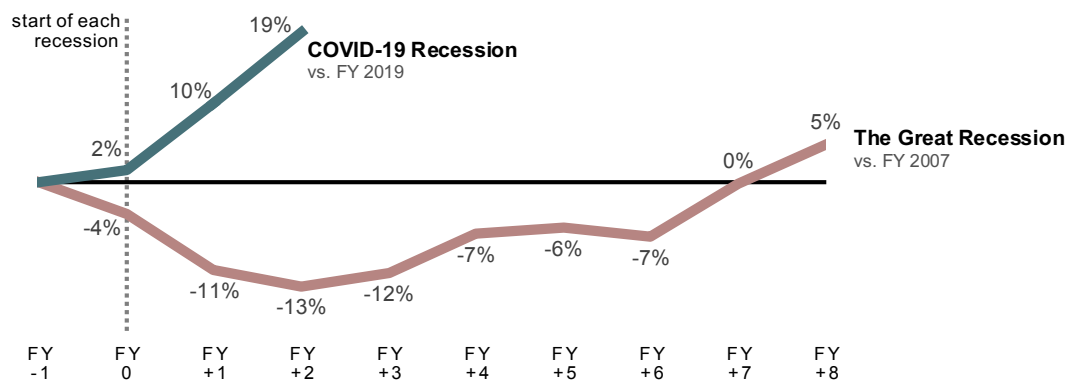
**Tennessee’s state budget has weathered two recessions in the past 15 years – each with different causes and effects.** The causes of the 18-month-long Great Recession were complex and led to a broad-based economic crisis that erased massive amounts of wealth, restricted lending, and reduced jobs in certain industries. As a result, economists agree that its legacy affected the economy for at least another decade. (24) Meanwhile, the 2-month-long COVID-19 recession was spawned by a global health crisis and the ensuing response, both of which disrupted jobs, supply chains, and spending patterns at home and abroad.

### The Federal Responses

**Federal lawmakers responded to each of these recessions differently.** In 2009, lawmakers enacted the American Recovery and Reinvestment Act that provided over \$800 billion – or roughly \$990 billion in 2021 dollars – to help states cover their expenses and to create jobs in transportation and infrastructure. (25) Meanwhile, between March 2020 and March 2021, federal policymakers approved six different funding packages totaling over \$5.1 trillion in the name of COVID-19 relief and recovery. (26) (27)

**Figure 19. State Tax Revenues After the Great Recession vs. the COVID-19 Recession**

Change in Annual Inflation-Adjusted Tax Collections (Post- vs. Pre-Recession)



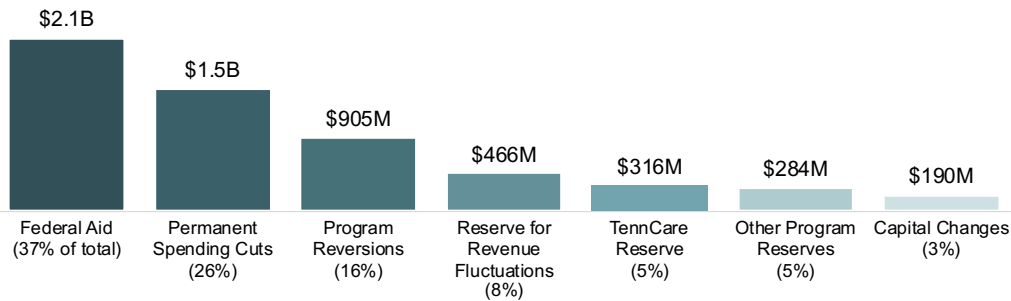
Note: Underlying collection totals were adjusted for inflation using the CPI-U. Includes only Department of Revenue tax collections. Source: The Sycamore Institute’s analysis of information from Tennessee State Budgets (21), the FY 2022 Monthly Revenue Collections Spreadsheet (89), and the U.S. Bureau of Labor Statistics (88)

## The State Effects and Response

Tennessee’s tax collections took years to recover from the Great Recession but experienced strong growth after the COVID-19 recession (Figure 19). After adjusting for inflation, tax collections during and after the Great Recession dipped below pre-recession levels for seven years. Meanwhile, the state has seen historic tax growth in the years following the COVID-19 recession.

**Figure 20. How Tennessee Balanced Its Budget Through the Great Recession**

\$5.8 Billion Between FYs 2008-2011



Source: Information obtained from Bill Bradley, Former TN State Budget Office Director (28)

To address shortfalls during and after the Great Recession, policymakers needed about \$5.8 billion in resources to keep the budget balanced. Between FYs 2008-2011, that included a mix of federal aid, permanent and temporary spending changes, and program and rainy day reserves (Figure 20) (28):

### Non-Recurring Federal Aid

- \$2.1 billion in non-recurring federal funding, most of it for TennCare.

### Spending Changes

- \$1.5 billion from permanent, recurring program spending reductions, the brunt of which reduced state college and university funding and eliminated certain TennCare services.
- \$905 million from time-limited, non-recurring spending reductions.
- \$190 million from changes to capital spending, such as cancelling or delaying some projects and funding others with bonds.

### Non-Recurring Reserves

- \$466 million from the Reserve for Revenue Fluctuations.
- \$316 million from the TennCare Reserve.
- \$284 million from other program reserves.

**In 2020, state policymakers braced for a \$1.5 billion revenue shortfall over the course of FYs 2020 and 2021 that did not materialize.** Lawmakers approved a budget for FY 2021 that gave Governor Lee's administration access to nearly every tool available to keep the budget balanced. It relied on permanent tax changes, spending cuts, forgone increases, borrowing, federal funds, and non-recurring revenues like program reserves.

**Ultimately, a strong rebound in consumer spending and some well-timed tax changes headed off the revenue impacts officials had feared.** Tennessee's economy rebounded sooner and faster than many other states' due to an influx of federal money, fewer shutdown orders, and different attitudes about the risk of COVID-19 transmission. (29) (30) Meanwhile, the pandemic also coincided with changes in how Tennessee collects sales tax on internet purchases. (31) (32) (33) These changes boosted revenue when many people shifted more of their shopping online.

## The Trade-Offs of Surpluses and Savings

**Both surpluses and savings come with trade-offs.** Surpluses often reflect budgeting choices that aim to reduce the likelihood of imbalance and the difficult decisions they can require. Surpluses also let the state make one-time investments in the rainy day fund or other non-recurring priorities. Meanwhile, the rainy day fund helps smooth out the ups and downs of the economy and can insulate policymakers from those tough choices that they may otherwise face. The trade-off, however, is that both surpluses and savings represent revenues that policymakers could have used for recurring priorities (e.g., spending for programs and services, tax relief).

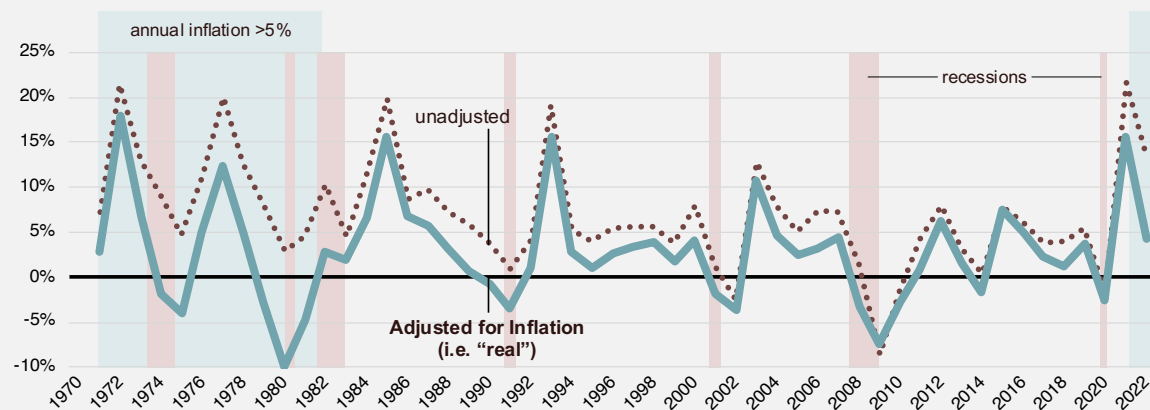
### Text Box 12. How Inflation Affects the State Budget

High inflation and its consequences can pose challenges for policymakers managing and balancing the state's budget.

**Inflation increases the short- and long-term costs of doing government business.** The cost of both service delivery and capital projects increases with inflation. Because state government comprises one of the largest employment sectors in Tennessee, it must also contend with a tight labor market and a demand for higher wages. (45) (46) Higher public worker wages also come with increased long-term retiree costs, which are tied to salary levels. (47) (48) Any federal actions to raise interest rates also increase the long-term interest costs of any new state debt. (46)

**Inflation reduces the value of revenue collections, which makes it harder for policymakers to budget.** Lawmakers build their budgets around projections of future revenue. State sales taxes generally keep pace with prices and consumer spending. However, when inflation grows faster than expected, officials may have to revise their plans and/or shortchange certain priorities. In 10 of the last 50 years, for example, inflation outpaced the nominal (i.e., unadjusted) increase in state tax collections (**Figure 21**). In other words, tax revenues in those years actually fell in real terms. (49) (89) (6)

**Figure 21. Real Collections Fall When Inflation Outpaces Revenue Growth**  
Annual Change in Tennessee Department of Revenue Tax Collections (FYs 1980-2022)



Numbers were adjusted for inflation using the annual June CPI-U.  
Source: The Sycamore Institute's analysis of data from the Tennessee Department of Revenue and U.S. Bureau of Labor Statistics (49) (89) (88)

## 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, and 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 the Sycamore Institute's 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 Methods

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 five 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 2021 represent actual expenditures obtained from the relevant year’s budget document. Any FY 2022 data are mid-year estimated budget numbers, and FY 2023 are recommended budget numbers — both from the FY 2023 budget document. Although FY 2022 has ended and the General Assembly passed appropriations for FY 2023, 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 17, 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.

### Text Box 13. Budget Document Highlights

A few can't-miss items in the budget document (with FY 2023 budget page numbers) include:

**Budget Highlights** (beginning on page xix) includes a discussion of the overall budget, its themes, and issue-specific strategies.

**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 Budget Overview** is a shorter document posted online alongside each year's full budget. This short document largely focuses on the incremental changes recommended in the budget – concentrating on new revenue, spending reductions, and cost increases for the current and next fiscal years.

Each of the above documents are available on the Department of Finance & 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 & Administration's website.

**The Appropriations Bill** is the budget in legislative form. Once passed by the state legislature and signed into law by the governor, it becomes the appropriations *act*. Initially mirroring the governor's budget, the General Assembly amends the bill during the legislative process to incorporate changes from lawmakers and the administration.

Section 1 of the bill 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. For the most recent appropriations act, visit the Secretary of State's website.

Example of an Appropriations Act Earmark:

*Section 7, Item 32 (p29 of 2022 Public Chapter No. 1130) – Department of Education, in Section 1, Title III-9, Item 2.1i, Early Childhood Education, the sum of \$3,050,000 for family resource centers.*

Example of an Appropriations Act Increase Amendment:

*Section 61, Item 22 (p102 of 2022 Public Chapter No. 1130) – In addition to any other funds appropriated by the provisions of this act, there is appropriated the sum of \$9,720,000 (recurring) to the Department of Children's Services for the sole purpose of salary increases for case managers.*

Example of an Appropriations Act Reduction Amendment:

*Section 60, Item 6 (p98 of 2022 Public Chapter No. 1130) – The appropriation in Section 1, Title 111-9, for "Tennessee Safe Schools -Flood Plain Relocation and Rebuilding Fund" as described on Page B-92 of the 2022-2023 Budget Document, hereby is reduced by the non-recurring sum of \$200,000,000.*

**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 14 total members, supported by a nonpartisan staff of about 16. Fiscal notes estimate the cost or savings associated with all legislation introduced in a session. Fiscal notes and memos (below) are both posted alongside the relevant legislation on the General Assembly's website.

**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.

**A Cumulative Fiscal Note** adds up the net effect on revenues and expenditures of all legislation passed and funded during a session. These are usually posted after the end of each legislative session 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 at the end of each legislative session.

**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.

**Monthly Revenue Reports** provide monthly updates on the Department of Revenue's collections. The reports 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 & Administration's website.

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

### Key Players in the Budget Process

- Governor
- Governor's Senior Staff
- Commissioner and Deputy Commissioner of Finance & Administration
- Department of Finance & Administration's Budget Division
- Department of Revenue
- Commissioners and 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 & Means Committee
- Senate Finance, Ways & Means Committee
- Legislature's Fiscal Review Committee
- Legislature's Office of Legislative Budget Analysis
- Legislature's Office of Legal Services
- Economists from state universities

## 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-377 of the FY 2023 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 & Administration. These allocations must be consistent with the appropriations made by the General Assembly.

**Balanced Budget Requirement** – The Tennessee constitution’s requirement that state expenditures each fiscal year cannot exceed revenues and reserves in that year. This requirement applies 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.

**Behind the Budget** – Occurs when the Finance Committees hold a piece of legislation with a fiscal impact until the appropriations bill passes out of the committee. This practice is used to ensure that General Assembly does not mistakenly pass a bill that must be voided due to lack of funding.

**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 over-collections or surplus, are held in reserve, and become available for use 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 those that are spent in the fiscal year in which they are collected or

allocated to a reserve for a future purpose. Collections in excess of those budgeted are often referred to as over-collections.

**Constitutional Spending Limit** – The restriction in Tennessee’s constitution that limits the growth rate of appropriations from state tax revenues in any fiscal year to no more than the estimated growth rate of the state’s economy. State law defines the latter metric law as the year-over-year rate of personal income growth in Tennessee. 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 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** – The 12-month period covered by an annual budget. Tennessee’s state fiscal year spans July 1st to June 30th. The federal fiscal year spans October 1st to September 30th.

**Funds** – Repositories of money for specific purposes that often draw on 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 the state’s main funds to which the budget document refers.

**Great Recession** – The economic downturn that lasted December 2007-June 2009.

**Interdepartmental Revenue** – Revenues collected directly by a department from another state 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, are not 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 official 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.

**Over-Collections** – The amount of state tax collections in excess of budgeted state tax revenues. Also referred to as a surplus.

**Recurring** – Recurring expenditures are ongoing expenses or projects. The absolute dollar amount associated with recurring expenditures is carried forward in the recurring base budget. Recurring cost increases must be appropriated 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 come from regular ongoing sources 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 the sources of money used to cover the state government’s expenditures — including state tax collections, reserves, federal funding, tuition and fees paid by

students at public colleges and universities, state lottery proceeds, and current services and other departmental revenues.

**Reversion** – Refers to amounts associated with departmental and programmatic underspending that revert back to the General Fund at the end of the fiscal year.

**Stripper Amendment** – An amendment to the appropriations bill that is often adopted on the floor of the House and Senate to strip the bill of any changes that have occurred in the other chamber. Typically, the second chamber to act on the bill on the floor would adopt a stripper amendment and then attach its own amendments – many of which may be identical to those from the chamber.

**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 2022 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 not collected because of exclusions or exemptions from a tax.

**Underspending** – An amount by which 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 employee positions funded in the budget. Aggregate underspending is officially 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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*Written By:*

Mandy Pellegrin, Deputy Director

*Other Contributing Staff:*

Sarah Clark Henderson, Senior Policy Analyst

Brian Straessle, Executive Director

*Technical Advisor:*

Bill Bradley

**For further information, contact [Research@SycamoreTN.org](mailto:Research@SycamoreTN.org).**

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