Publication Policy

Staff Information Reports, Staff Briefs, Staff Technical Reports and Staff Working Papers are issued to promote the mission and objectives of the Commission. These reports are intended to share information and research findings relevant to important public policy issues in an attempt to promote wider understanding.

Only reports clearly labeled as “Commission Reports” represent the official position of the Commission.
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The staff of the TACIR would like to acknowledge several individuals whose assistance greatly improved this report. Mr. Jerry Lee, Assistant Commissioner, Tennessee Department of Finance and Administration, contributed extremely useful commentary on draft versions of this guide. Dr. Matthew Murray, Chair, University of Tennessee, Department of Economics, also provided useful feedback on the guide. Ms. Ginger Hausser, Policy Consultant, contributed valuable commentary and made several improvements to the guide’s format. Additionally, Mr. Bruce Davis, former TACIR Director of Administration, and Ms. Kim Robertson, former TACIR Publications Assistant, contributed to the guide while still on staff with the TACIR.
This is a guide to Tennessee’s state budget. It begins with a section on budget basics that describes how Tennessee’s budget document is organized and how the budget works. It then describes:

- the process of creating the budget,
- how the executive and legislative branches interact to resolve differences before the budget is signed into law,
- how the budget is funded,
- a discussion of some of the constraints the state faces in cutting the budget, and
- a discussion on how and why the budget grows.

In order to provide timely yet complete examples, this guide refers primarily to the fiscal year 2002 edition of The Budget. However, the lessons learned here in understanding the budget can also be applied to earlier or future versions of the budget.

In understanding how the state budget is created, it is important to remember that the budget is not just a financial document. It is a plan and a policy statement. It is the single consolidated instrument that reflects the Chief Executive’s policy recommendations on how the state’s financial resources should be allocated among various programs administered by state government. In essence, the budget is a “road map” for achieving desired results.

As the demand for government services has increased and government spending has grown, the budget has evolved into both an expenditure plan and a statement of tax policies. Elected officials, who are influenced by government agencies, special interest groups, and the people they represent, make the final decisions about which services are to be given the highest priority and how all government services will be financed.

State Taxpayers’ Budget

On February 6, 2002, Governor Sundquist and the Department of Finance and Administration released an important innovation for citizens wanting to better understand how their tax dollars are used, the State Taxpayers’ Budget. While the full state budget details all funds coming into the state, the State Taxpayers’ Budget discusses only funds raised by Tennessee state taxes. It does not include money from the federal government or from other state sources such as tuition or licenses. The State Taxpayers’ Budget provides a clear overview of how much money is raised by each tax and how that money is spent. It also provides examples of the services provided in fiscal year 2002 by the various state agencies, and what would be paid for by their recommended budget improvements for 2003.

TACIR strongly recommends reading the State Taxpayers’ Budget as an introduction to how the state spends your tax dollars. It can be used in conjunction with this guide, which explains the entire state budget and process, as presented in the full state budget document.
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Key Points

• A government budget outlines the costs of services provided by the government. These are services not usually available from private sources. The services include education, public safety, transportation, and many others. Taxes are the price we, as citizens, pay for those services.

• Governmental budgeting is complicated. The state must comply with intricate accounting rules when preparing the budget.

• The budget is not just a financial document; it is a political document.

• Using non-recurring revenue to fund recurring programs has become more common in recent years as legislators have struggled to maintain services for a growing population without increasing taxes in a slowing economy.

• Because of governmental accounting rules, Tennessee’s budget includes significant double counting of dollars, such as TennCare funding for mental retardation services. Less than half of the state’s budget is paid for using state tax dollars.

• Tennessee’s constitution requires the state to maintain a balanced budget. Title 9, Chapter 4, Part 51 of the Tennessee Code Annotated dictates the state’s budget process.

• The state’s ability to cut the budget is limited partly by federal mandates, state earmarking, and court orders.

• The state’s budget grows for five main reasons:
  1 Inflation
  2 Population growth
  3 New or enhanced services:
     • To meet the demands of the state’s residents
     • To remain competitive with other states
     • To comply with requirements for federal-state program participation or federal mandates
     • To comply with court orders
  4 Past neglect
  5 Changes in the way the budget is presented

• In 1999, Tennessee state and local government total own source revenues and own source taxes ranked 50th and 51st based on rankings of data about state and local government finances.

• Tennessee has been very successful at raising revenue from non-tax sources, primarily federal funding and payments from utility industries.

• Tennessee taxes as a share of personal income are low relative to both the US average and the average for surrounding Southeastern states.

• From 1970 to 2000, all southern states increased their level of state and local government taxes compared to the US average, but Tennessee did so at a slower pace than its sister states.
The following are some key terms that will be used, and in some cases further explained, in this report. A much more comprehensive list of budget terms is located in Appendix 1: Budget Glossary.

**Allotment** - Expenditure authority granted to state agencies by the General Assembly, the appropriation allotments are established in the state’s accounting system at the beginning of each fiscal year by the Division of Budget. The allotments become the authority for each state agency to expend funds. It is much like your personal checkbook in that it must be kept in balance.

**Appropriation** - The amount authorized from all revenue sources by the General Assembly to support agencies’ spending allotments.

**Budget** - A complete financial plan for a specific fiscal year. It includes proposed expenditures and estimates of revenues for the fiscal year. It is prepared by the Governor, modified and adopted by the General Assembly, and modified and signed by the Governor. Like any other legislation, the budget may become law without the Governor’s signature.

**Capital Budget** - The portion of the budget devoted to proposed additions to or maintenance of capital assets, such as buildings, and the means of financing them.

**Discretionary Spending** - Spending on programs that the General Assembly can choose whether to fund in the annual Appropriations Bill, in contrast to constitutionally required appropriations, such as the salaries of state judges, entitlement programs, or court ordered expenditures, for which funding is mandatory.

**Expenditure** - Decrease in net financial resources for the purpose of acquiring goods or services.

**Fiscal Year** - A 12-month accounting period. In Tennessee, the fiscal year is July 1 through June 30. The federal fiscal year is October 1 through September 30.

**Fund** - A separate accounting entity to which government resources are allocated based upon the purposes for which they are to be spent.

**General Fund** - The operating fund maintained by the State Treasurer into which revenues collected by the state, other than those required to go into special revenue funds, are deposited to support appropriations made by the General Assembly for the operation of state agencies. For presentation purposes in The Budget, many special revenue funds, as well as the state’s proprietary funds, are rolled into the General Fund.

**Improvements** - Increases in departmental budgets needed to implement mandated requirements, compensate for revenue reductions, initiate new programs, or enhance a current level of service.

**Non-Recurring Funds** - Funds that are appropriated from accumulated reserve balances, or revenues that occur only one time or without a pattern.

**Non-Discretionary Spending** - Spending that is not optional, such as items specified by the state’s constitution, court ordered expenditures, federally mandated programs, and entitlement programs for which funding is mandatory.

**Recurring Funds** - Funds that are appropriated on an ongoing basis and are used for repeated expenses.

**Revenue** - Governmental income used for public purposes.

**Revenue Estimate** - An estimate of revenues that will be collected by the state during a fiscal year that will be available for appropriation or to support a specific expenditure allotment.
Introduction
Introduction

Why Do Governments Prepare Budgets?

Budgets are primarily management tools. Governments, like businesses, use budgets to effectively manage their resources. Budgets provide information on how much money a government raises, from what sources it raises that money, how much money it spends and on what programs. According to one expert, budgeting, at its best, “articulates the choices of the citizenry for government services (and how those services will be financed) and manages the efficient delivery and finance of those services.”¹

Why Should Citizens Try to Understand Government Budgets?

Why elected officials need to understand the workings of government budgets seems fairly obvious. They are entrusted with wisely spending the public’s money. Understanding budgeting, the mechanism used to manage that money, helps them to be responsible public servants. But then, why do average citizens need to understand how government budgets work? Because, by understanding how the public’s collective wealth is managed they can better evaluate whether their elected officials are best serving the public’s interests.

Government isn’t them; it’s us. The government’s budget is our budget. It shows how the people we elect to represent us plan to spend the money we’ve decided through them should be pooled and devoted to the things we want done—things that the private sector cannot or will not do for us.

Budgeting is complicated. Even those citizens of Tennessee who make a serious effort to understand budgeting can be overwhelmed with the often contradictory claims they hear about how well their state handles their money. Citizens hear simplistic explanations of how government budgets work—or should work. They are told that the state budget should operate just like their home budget or the budget of a business. As you will see, these are not good comparisons. However, they remain popular. Citizens are told that the state budget is growing out of control, but they are not educated about why the budget grows or how its growth compares with the growth of the state as a whole.
Each year, Tennessee’s Governor presents his proposed budget for the next fiscal year to the Legislature (the General Assembly) for approval. The budget is presented in the form of a thick document, simply titled The Budget, which is prepared by his Commissioner of Finance and Administration. In this guide, wherever The Budget is capitalized and italicized it is referring to the official document; otherwise it refers to budgets in general.²

The Budget serves as the basic document for Tennesseans to study how their state government is funded. However, the dollar amounts listed in The Budget are not necessarily the same as the actual amounts spent by the state. This is because:

- there are always differences between revenue estimates and actual revenue collections;
- it is impossible to spend every dollar appropriated, and maintain a balanced budget; and
- the General Assembly may not agree to appropriate the same amounts for expenditures for the various programs, as recommended by the Governor.

For example, for fiscal year 2002, The Budget recommended expenditures of $19.9 billion. The General Assembly only authorized $19.5 billion, ³ $400 million less than recommended. The next section of this report, The Budget Process, will discuss the various stages that are involved in creating the budget and how the executive and legislative branches interact to resolve differences before the budget becomes law. First, let’s look at how The Budget is organized and at how budgets work. If you have a copy of The Budget, it would be helpful to refer to it as you study these budget basics. You can view a copy on the Internet at http://www.state.tn.us/finance/bud/overview/buddoc.html. That website also contains a good summary of The Budget. Your local library may also have a copy of The Budget.

How Is the Budget Organized?

The Budget has five main sections:

1. **Budget Overview.** This is a concise overview of Tennessee’s budget. It provides:
   - a short discussion of the budget process,
   - a short discussion of the modified accrual basis of accounting, which is the accounting method used to prepare The Budget,
   - summary statements and charts that provide an overview of the more detailed exhibits in the later sections of The Budget,
   - Tennessee’s Vision, Mission, and Goals statements, and
   - reports on recent state initiatives to improve government.

2. **State Revenues.** This section lists the state’s own sources of revenue (taxes, fees, etc.),
which state agency is responsible for collecting each source, and how the revenue is distributed among funds and programs. It does not include revenue from the federal government, or from current services or interdepartmental revenue. Current service revenues are program funds generated by a specific activity to support that activity such as certain fees, assessments, and gifts or endowments. Interdepartmental revenue represents payments by one state agency to another for services purchased. Because of governmental accounting standards this revenue becomes double counted in The Budget. It accounts for approximately $1.3 billion of the total state budget. This section also shows revenue estimates for the fiscal year The Budget has been prepared for, and compares those estimates to past collections.

3. Financial Statements. This section contains balance sheets for the two past years for three of the largest operating funds, the general fund, the education fund, and the highway fund. This section also includes information on the state’s bonded indebtedness, including the retirement schedule for the state’s bonded debt, and the principal and interest costs of outstanding bonds. You will also find in this section the principal and interest cost for any new bond issues proposed in The Budget.

4. Capital Outlay and Facilities Program. This section contains the proposed capital outlay for the coming fiscal year. Capital outlays are money spent for adding or maintaining physical structures, such as buildings. This section of The Budget shows specific projects for each affected department and the statewide capital maintenance effort. This section lists the proposed funding for each project, whether that funding is from the general fund, general obligation bonds, or other sources. It also includes a schedule of the estimated operating cost for the first year for each new facility to be constructed.

5. Program Statements by Functional Area. This section makes up the bulk of The Budget. It presents the state’s departments and agencies in six functional areas:

(1) General government

(2) Education

Kudos
The State of Tennessee has received a Distinguished Budget Presentation Award from the Government Finance Officers Association for the last five years and eight of the last eleven years, including the 2002 budget. The award signifies that The Budget meets the GFOA’s challenging requirement to effectively serve as a policy document, an operations guide, a financial plan, and as a communications device.

Congratulations to the Department of Finance and Administration, the Governor’s Office, and everyone else involved in preparing The Budget.
Budget Basics

The departments and agencies are grouped in the functional areas based on related missions, programs, goals, and objectives. The functional groupings allow policy makers and citizens to better understand the costs and responsibilities of Tennessee’s government.

Each functional area presentation contains a list of the included agencies, recommended improvements for the functional area, and tables showing the total expenditures, funding sources, and personnel for that area. The functional area presentations also include specific information about each of the included agencies:

• a narrative description of the agency,
• fiscal data for the last completed fiscal year, the current year, and the projected year,
• personnel data for the last completed fiscal year, the current year, and the projected year, and information on performance measures used by the agencies.

How Do Budgets Work?

As this guide says several times, budgeting is complicated. The Budget is prepared using intricate accounting principles set out by the Governmental Accounting Standards Board (GASB). Without delving too deeply into those principles, much of this guide will cover some of the more complex issues regarding budgeting and funding state government. However, to get started, one needs merely to grasp the general nature of how budgets work: budgets show how much money the government raises, how they raise that money, how much money they spend, and on what programs they spend that money. Basically, money in, money out.

Money In

Tennessee brings money in from four broad sources:

1. General tax revenue
2. Bonds
3. Federal revenue
4. Current services and other revenue

As the general tax revenue is collected, it is deposited into one of several funds to support the appropriations enacted by the General Assembly. The appropriations are made based on
revenue estimates contained in The Budget, or on revised estimates presented to the General Assembly prior to passage of the Appropriations Act. For ease of understanding, The Budget summarizes expenditures and the revenues by grouping all programs into one of six categories:

1. General fund  
2. Highway fund (Department of Transportation)  
3. Facilities revolving fund  
4. Local government fund (cities and counties-state shared taxes)  
5. Debt services fund (debt service requirements)  
6. Capital projects fund (capital outlay program)

The estimated revenue for recommended programs is reported in the Budget Overview section of The Budget, where it is compared to the estimated revenue for the current fiscal year and actual revenue for the prior fiscal year. A discussion of the revenue sources is found in the Funding Budgeted State Services section of this guide.

It is important to remember that the revenue estimates are just that—estimates. Revenues fluctuate. That is why there is a Revenue Fluctuation Reserve, or Rainy Day Fund. Tennessee law requires that at least 10 percent of all revenue growth be placed within the Rainy Day Fund, unless that account already equals five percent of estimated state tax revenues. For 2001, $178 million was placed in the Rainy Day Fund.

Money Out

Based upon agencies’ requests, the Governor recommends in The Budget how the estimated revenue should be expended in the coming fiscal year. The recommendations are reported in the Program Statements by Functional Area section of The Budget. The recommended expenditures are also reported by program type in the Budget Overview section of The Budget, where they are compared to the estimated expenditures for the current fiscal year and actual expenditures for the prior fiscal year.

As discussed in the Budget Process section of this guide, the General Assembly is responsible for making the actual budget appropriations. These may or may not agree with the Governor’s recommendations. Once the Appropriation becomes law, the Department of Finance and Administration’s Division of Budget, with input from fiscal personnel from the various agencies, reconciles the Appropriations Act with the recommended budget.

The Governor may veto the entire appropriation bill or any line item of the bill that he does not agree with, but the General Assembly only needs a simple majority in each House to override the veto.
# Table 1. Comparison of Programs and Revenue Sources

**The Budget, Fiscal Years 2000, 2001 and 2002**

<table>
<thead>
<tr>
<th>Programs 2000</th>
<th>Actual Fiscal Year 2000</th>
<th>Estimated Fiscal Year 2002</th>
<th>Recommended Fiscal Year 2002</th>
<th>Appropriation 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>$14,334,787,200</td>
<td>$16,290,125,325</td>
<td>$17,128,724,200</td>
<td>$16,947,649,300</td>
</tr>
<tr>
<td>Dept. of Transportation</td>
<td>1,260,934,000</td>
<td>1,414,943,000</td>
<td>1,446,612,000</td>
<td>1,431,212,000</td>
</tr>
<tr>
<td>Debt Service Requirements</td>
<td>246,970,000</td>
<td>254,279,000</td>
<td>256,836,000</td>
<td>242,709,600</td>
</tr>
<tr>
<td>Capital Outlay Program</td>
<td>70,866,000</td>
<td>163,495,000</td>
<td>239,147,200</td>
<td>66,716,700</td>
</tr>
<tr>
<td>Facilities Revolving Fund</td>
<td>77,597,400</td>
<td>112,098,900</td>
<td>155,104,000</td>
<td>157,074,000</td>
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<tr>
<td>Cities and Counties</td>
<td>648,248,000</td>
<td>672,900,000</td>
<td>690,900,000</td>
<td>678,900,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$16,639,402,600</strong></td>
<td><strong>$18,907,841,225</strong></td>
<td><strong>$19,917,323,400</strong></td>
<td><strong>$19,524,261,600</strong></td>
</tr>
</tbody>
</table>

## Revenue by Source

### State Funds

<table>
<thead>
<tr>
<th>Programs 2000</th>
<th>Actual Fiscal Year 2000</th>
<th>Estimated Fiscal Year 2002</th>
<th>Recommended Fiscal Year 2002</th>
<th>Appropriation 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>$6,541,847,400</td>
<td>$7,287,762,625</td>
<td>$7,894,674,300</td>
<td>$7,631,295,700</td>
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<tr>
<td>Dept. of Transportation</td>
<td>$717,045,200</td>
<td>$644,820,000</td>
<td>$667,220,000</td>
<td>$651,820,000</td>
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<tr>
<td>Debt Service Requirements</td>
<td>$246,970,000</td>
<td>$254,279,000</td>
<td>$256,836,000</td>
<td>$242,709,600</td>
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<tr>
<td>Capital Outlay Program</td>
<td>$52,364,000</td>
<td>$25,644,000</td>
<td>$56,630,000</td>
<td>$16,068,500</td>
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<tr>
<td>Facilities Revolving Fund</td>
<td>$4,023,700</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
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<tr>
<td>Cities and Counties</td>
<td>$648,248,000</td>
<td>$672,900,000</td>
<td>$690,900,000</td>
<td>$678,900,000</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$8,210,498,300</strong></td>
<td><strong>$8,885,405,625</strong></td>
<td><strong>$9,566,260,300</strong></td>
<td><strong>$9,220,793,800</strong></td>
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### Bonds

<table>
<thead>
<tr>
<th>Programs 2000</th>
<th>Actual Fiscal Year 2000</th>
<th>Estimated Fiscal Year 2002</th>
<th>Recommended Fiscal Year 2002</th>
<th>Appropriation 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dept. of Transportation</td>
<td>$0</td>
<td>$87,700,000</td>
<td>$80,000,000</td>
<td>$80,000,000</td>
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<tr>
<td>Capital Outlay Program</td>
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<td>$97,290,000</td>
<td>$147,700,000</td>
<td>$21,300,000</td>
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<tr>
<td>Facilities Revolving Fund</td>
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<td>$19,400,000</td>
<td>$61,300,000</td>
<td>$61,300,000</td>
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<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$0</strong></td>
<td><strong>$204,390,000</strong></td>
<td><strong>$289,000,000</strong></td>
<td><strong>$162,600,000</strong></td>
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### Federal Funds

<table>
<thead>
<tr>
<th>Programs 2000</th>
<th>Actual Fiscal Year 2000</th>
<th>Estimated Fiscal Year 2002</th>
<th>Recommended Fiscal Year 2002</th>
<th>Appropriation 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>$5,143,959,400</td>
<td>$6,039,772,400</td>
<td>$6,296,343,400</td>
<td>$6,457,682,200</td>
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<tr>
<td>Dept. of Transportation</td>
<td>$509,093,600</td>
<td>$648,438,000</td>
<td>$664,125,000</td>
<td>$664,125,000</td>
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<tr>
<td>Capital Outlay Program</td>
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<td>$30,291,000</td>
<td>$12,205,000</td>
<td>$6,896,000</td>
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<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$5,655,863,000</strong></td>
<td><strong>$6,718,501,400</strong></td>
<td><strong>$6,797,723,400</strong></td>
<td><strong>$7,128,703,200</strong></td>
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</table>

### Current Services and Other

<table>
<thead>
<tr>
<th>Programs 2000</th>
<th>Actual Fiscal Year 2000</th>
<th>Estimated Fiscal Year 2002</th>
<th>Recommended Fiscal Year 2002</th>
<th>Appropriation 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>$2,648,980,400</td>
<td>$2,962,590,300</td>
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<tr>
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<tr>
<td>Facilities Revolving Fund</td>
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<td>$92,698,900</td>
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<td>$95,774,000</td>
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<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$2,773,041,300</strong></td>
<td><strong>$3,099,544,200</strong></td>
<td><strong>$3,089,389,700</strong></td>
<td><strong>$3,012,164,600</strong></td>
</tr>
</tbody>
</table>

**TOTAL** $16,639,402,600 $18,907,841,225 $19,917,323,400 $19,524,261,600

Sources: *The Budget, February 20, 2001 and the Tennessee General Assembly.*
Tennessee's constitution requires the state to maintain a balanced budget. Article 2, Section 24 of the Constitution says

**Expenditures for any fiscal year shall not exceed the state's revenues and reserves, including the proceeds of any debt obligation, for that year.**

Table 1 compares the recommended expenditures by program to the estimated revenue collections by source and program from the 2002 edition of *The Budget*. Table 1 also shows the estimated amounts for fiscal year 2001 and the actual amounts for fiscal year 2000. Revenues and expenditures for 2002 are balanced, both equaling $19.9 billion.

Note that only $9.6 billion of the estimated revenues are from state sources, and that $690 million of those revenues go directly to local governments through state-shared taxes. Another $667 million goes directly to pay for the state’s highways and other transportation assets. The Department of Finance and Administration estimates that another $215 million of state revenue is dedicated to specific programs, leaving $8 billion in appropriations from general tax collections.

Also, recall that the final 2002 approved budget totaled $19.5 billion, of which $9.2 billion was from state sources. Table 1 compares the recommended 2002 budget to the approved appropriations. Unfortunately, due to the economic slow down, actual revenue collections have been lower than estimated, so the actual budget total for fiscal year 2002 will undoubtedly be less than the approved total.

**How Much Are We Spending on What?**

The program statements in Section B of *The Budget* show program by program how much is being spent, where the money comes from and what we’re getting for it. The program information covers three years:

- Actual 1999-2000: how much was spent in the most recent fiscal year
- Estimated 2000-2001: how much we expect to spend in the current fiscal year
- Base 2001-2002: how much we would spend next fiscal year without any changes
- Improvement 2001-2002: includes how much the Governor is recommending we add to each program, and the benefits to be derived from the increased funding
- Recommended 2001-2002: the total amount that would be spent next fiscal year if the Governor’s recommendations were adopted

Information about positions, revenues and performance measures are also included in the program statements. But before we get to that, there is some very interesting information at the beginning of each functional area that explains the Governor’s recommended improvements.
Budget Basics

One of the most important things to understand about the improvement listings is that they include some items that are increasing because of inflation or that were funded with non-recurring revenues and, therefore, require specific appropriations to continue them. Using non-recurring revenue to fund recurring programs has become more common in recent years as legislators have struggled to maintain services for a growing population without increasing taxes in a slowing economy.

Position Vacancies and the “Over Appropriation”… or Why Is There Such a Big Difference Between the Actual Year Amount and the Estimated and Base Year Amounts?

The presentation by functional area and program seems simple enough, especially given that the Governor’s improvement recommendations are summarized and detailed at the beginning of each functional area. However, there is one caution: the estimated and base years include funding for every position as though all of them were filled for the entire year. As a practical matter, they are not. As a whole, state agencies have a position vacancy rate of about five percent. This is a result of natural employee turnover, “employees come and employees go.”

The problem is that it’s impossible to pinpoint in advance by program or budget code exactly where those vacancies will occur at any given time. So instead of guessing, all of the positions for the estimated and base years are budgeted as though none of them will be vacant for even one day. With actual year data, you know exactly where they were, and the financial data in The Budget shows it. So part of the increase from the actual year to the estimated year is caused by the fact that no one can estimate, with any degree of certainty, where vacancies will occur. This difference is a large part of what is called the over appropriation. This is a process that allows the Governor to recommend and the General Assembly to appropriate, funds in excess of the state tax revenue estimates presented in The Budget. In absence of the utilization of the over appropriation concept or the discounting of full funding of the payroll, these funds would revert to the fund balance and become a non-recurring source of funding for future budgets.

The amount of the over appropriation for the estimated and recommended years is shown in Section A of The Budget on pages A-8 and A-9. It includes more than the amount generated by vacant positions. Other items may be slightly overestimated as well. One reason for this is that increases in appropriations of state tax dollars require legislative action. Unless changes are authorized in the appropriations bill or elsewhere by statute, increasing them by even one dollar would require calling the entire legislature into special session. This would be an expensive solution to a very minor problem.

Nevertheless, the differences between budgeted and actual amounts give the appearance that a significant amount of revenue was not spent. That may be the case, but by and large, the apparent savings was planned, expected, budgeted, and never represented real money in the first
The amount of the over appropriation in The Budget for fiscal year 2001-2002 was listed as $85,750,000 on page A-9. That figure is about one percent of the total general fund requirement of $7.9 billion listed on that page. In order to show the budget as balanced, the amount of the over appropriation is also added to the estimated state revenue. It’s called an over appropriation because the amount appropriated exceeds the actual revenue estimate.

**State, Federal and Earmarked Revenues…or Where Does the Money for Each Program Come From and Can It Be Spent on Anything Else?**

The program statements by functional area not only show how much money and how many positions are authorized (or recommended) for each program; they also show where the money comes from. Looking at them can give you an idea of what spending is not discretionary, that is, how much money in the budget cannot be spent for anything other than the program it’s being spent on now.

All of the federal money is earmarked for specific programs. Federal highway transportation funding cannot be spent on education, and federal education funding cannot be spent on highway transportation. In addition, what you cannot always see clearly in the program statements is how much of the state dollars (if any) are required in order to receive the federal funding. The transportation-funding example elsewhere in this guide shows how state matching funds, as they are called, work.

The other revenue shown in the program statements includes money that, like the federal funding, cannot be spent on any other program or would not exist if the program did not exist. It also includes a lot of double counted revenue. Why is it double counted? Because some programs like the state’s internal postal service and main print shop are funded from fees charged to other agencies. In order to authorize those other agencies to spend money on mail and printing, the money must be included in their budgets. At the same time, in order to authorize the print shop and the postal service to spend money to serve those other agencies, the money must also be included in their budgets. All of this double counting shows up in the summaries included in the overview at the beginning of The Budget.

The bottom line for those of us who are interested in understanding where our state tax dollars go is that we need to focus on the line in the program statements that says “state” and the amounts in the overview labeled “appropriations.” These terms are interchangeable. And here is where another caution is necessary: some amounts identified as “state” or “appropriations” are actually statutorily earmarked revenues. Examples include revenue from licenses and permits that must be spent on certain programs. That is how many regulatory programs, like elevator inspections, food safety, and the Department of Financial Institutions are funded.
For the most part, the regulated industries have agreed to pay the fees in order to fund testing and inspection that gives consumers confidence in their products and services. In many cases, the regulatory programs are funded entirely from sales of licenses or permits and from fees. Funding these programs in this way ensures that they are paid for by those of us who benefit most directly from them. And in some cases, as in the case of the Tennessee Wildlife Resources Agency, the license and permit fees are used to match federal dollars that would not otherwise be available.

So how do you know which state appropriations are earmarked in this way? One way is to go back to the overview and review the list of programs that are included in special revenue funds. The list is on pages A-x and A-xi. Also listed on page A-xi are internal service fund and enterprise fund programs. The internal service fund programs account for most of the double counting of revenue that shows up in the other revenue amounts listed in the program statements.

Program Objectives and Performance Measures...or What Are We Getting for All of This Money?
The final bit of valuable information in the program statements at the end of each functional area is a listing of objectives for each program and how achievement of those objectives is measured. Like the financial information, this information covers three years. Unlike the financial information, the third year of performance measures is labeled “estimated.” The reason for the difference in terminology is that you don’t budget performance.

These pages are a great place to find out a lot of things about the programs funded by our legislature. Among the facts presented are:
- the number of people served by various programs—for example, for programs designed to prevent disease, you can see how many people were diagnosed, tested or treated;
- the increase in effectiveness of various programs—for example, for the state’s special schools, you can see what percentage of students are expected to graduate or go to college;
- the workload for the employees of various programs—for example, for agencies with law enforcement authority, you can see how many cases were investigated and how many arrests were made.

This is the best place to look in The Budget to see what all of those state employees are really doing for you.

How Big Is the State Budget?
In The Budget for 2002, the Governor recommended expenditures of $19.92 billion. The General Assembly only authorized $19.52 billion. Simple enough. However, that doesn’t mean that Tennesseans will pay $19.52 billion in taxes for their government. Most of the estimated revenue used to fund the expenditures recommended in the budget comes from sources other than state taxes. Since the actual revenue and expenditures will not be available until after the fiscal year
ends, let's examine the recommended appropriations of $19.92 billion to see how much of the budget is paid for using your state tax dollars and how much control the state has over spending levels.

$6.97 billion of the estimated revenue funding the budget comes from the federal government. That means that 37 percent of Tennessee's budget is paid for using federal money. that leaves $12.95 billion.

$3.09 billion of the estimated revenue comes from current services or other non-tax sources, which includes interdepartmental revenue, other departmental revenue and revenue from higher education tuition and student fees. $1.28 billion of the estimated revenue comes from interdepartmental revenue. This money is double counted in the budget. It is funding that one agency uses to provide services to a second agency or to help fund services provided by the second agency. Since the interdepartmental transfer must be funded in both agencies for budgetary control, the expenditure is recorded twice in the state budget. Removing this double counting leaves $11.67 billion.

Another $1.28 billion is estimated revenue from current services. This is money collected by a specific activity to support that activity. This is money from licenses, user fees, etc. Likewise, $528 million in estimated revenue is from higher education tuition and fees. These revenues are not taxes. Removing them leaves $9.86 billion.

$289 million of the estimated revenue comes from the anticipated sale of bonds, not taxes. $148 million of this estimated revenue is from bonds to be sold for the Capital Outlay Program, $61 million is for the Facilities Revolving Fund, and $80 million is for the Department of Transportation. Removing the bond revenue leaves $9.57 billion, the total appropriation from state taxes. Bonds provide a very effective way to spread the costs for large improvements, such as new university classroom buildings, over many years. That way, today's taxpayers do not have to pay the entire bill for facilities that will be used by future generations of taxpayers as well.

So, the total recommended state appropriation equaled $9.57 billion. However, the state has little control over much of that money as well. $3.44 billion is money earmarked (dedicated) to the education trust fund. This is money from the sales and use tax, the tobacco tax, and the mixed drink tax that goes to pay for both elementary and secondary or higher education.

Another $691 million is not spent by the state government, but goes directly to local governments through state-shared taxes. $667 million is money raised from various fuel taxes that goes directly to paying for the state's highway and transportation services. An additional $216 million dollars is earmarked for various other programs, for a total of $5.01 billion in earmarked revenue.
It would require a change in state law to redirect any of the money currently earmarked for any of these specific programs. In the case of at least one program, education, changing its earmarked status could open the state up to new lawsuits. The current funding system for education was developed in response to an earlier lawsuit. Removing the $5.01 in earmarked revenues from the total leaves $4.56 billion.

It is easy to see how little control the state can have over much of its budget, and that is before you account for numerous other programs whose spending is controlled partially by outside forces. Many programs face special spending controls related to past and current lawsuits or federal spending requirements. Examples include limits placed on TennCare, the Department of Mental Health and Mental Retardation, and the Department of Corrections. As discussed in the Non-Discretionary Appropriations section of this guide, special non-discretionary items totaled $4.18 billion in fiscal year 2002.

Of the $5.97 billion in recommended appropriations from state taxes, the administration only has full discretion over $372 million, which is less than two percent of the state’s total budget. This severely restrains the state’s ability to respond to any fiscal crisis that may arise.

### Comparison of Total State Budget, Total State Appropriation, & Share of Appropriation Over Which the State Has Full Discretion, 2001-2002

<table>
<thead>
<tr>
<th>Total State Budget - All Funding Sources</th>
<th>$19,917,323,400</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Federal Revenue</td>
<td>$6,972,673,400</td>
</tr>
<tr>
<td>Current Services:</td>
<td></td>
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<tr>
<td>Interdepartmental Revenue</td>
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<tr>
<td>Other Departmental Revenue</td>
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<tr>
<td>Higher Education Student Tuition and Fees</td>
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<tr>
<td>Bonds</td>
<td>$289,000,000</td>
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<tr>
<td>Total State Appropriation</td>
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</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>$3,437,600,000</td>
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<tr>
<td>Transportation</td>
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<td>Cities and Counties</td>
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<td>Other Earmarked Taxes</td>
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<td>Special Non-Discretion Items</td>
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</tr>
<tr>
<td>State Appropriation Total with Full Discretion</td>
<td>$371,918,100</td>
</tr>
</tbody>
</table>

Source: The Budget and the Tennessee Department of Finance and Administration
Tennessee’s Constitution specifically requires the state to maintain a balanced budget\(^7\) while state statute dictates the budget process.\(^8\) The Governor is responsible for the preparation and execution of the budget.

**The Governor’s Role**

State statutes require the Governor seek and coordinate budget requests from state agencies. The Governor uses these requests to develop a complete financial plan balancing proposed expenditures and revenues. The Governor submits this plan to the General Assembly. At the same time, the Commissioner of Finance and Administration drafts legislation to enact the Governor’s budget, and has a sponsor from each chamber, the House and the Senate, introduce the bill, which is known as the appropriations bill. Other legislation is sometimes required to carry out the Governor’s budgetary recommendations. For example, if the Governor’s plan requires new sources of revenue to balance the budget, legislation would be required to create these new revenue sources. The Governor is also required to manage the budget through administrative actions during the fiscal year, which begins on July 1 and ends on June 30 (see Figure 1).

In creating the budget, the state uses a very conservative definition of base budget funding. It does not allow an inflation factor, the establishment of additional positions, the replacement of non-recurring appropriations with recurring state tax revenue, or the replacement of declining federal funds with state taxes. This stringent budgetary guideline requires state agencies to examine annually their priorities for continuing programs with limited resources, and forces them to consider the reallocation of funds to expand services in high priority areas before embarking upon new initiatives.

**Timeline of the Budget Process**

**Agency Budget Preparation (July-September)**

By the start of the current fiscal year (July), agencies have already begun to informally analyze their budget needs for the next fiscal year. State agency budget requests vary depending on an agency’s size, its internal practices, and the complexity of its programs, and funding requirements. Typically, agency budget development begins at the program level, with staff preparing individual program requests in accordance with instructions set forth by the Department of Finance and Administration’s Division of Budget. These instructions are intended to result in agency budget requests that are consistent with one another and help facilitate the development of the overall state budget. Agency commissioners or fiscal officers may hold internal hearings, at which time program managers outline their budgetary needs.
Figure 1: The Budget Process Timeline

1. **July through February**
   - State agencies begin reviewing their budgets for the next fiscal year by July of the current fiscal year. In August, the Governor sets policy guidelines for state agencies. In November, the State funding Board evaluates the state’s economic condition and provides a consensus estimate of revenue ranges for the next fiscal year. Starting on October 1, and continuing through December, the Budget Division analyzes budget requests and holds hearings with all state agencies in order to finalize recommendations. In February, the Governor submits The Budget and the necessary legislation for its implementation to the General Assembly for legislative consideration.

2. **February Through May**
   - The General Assembly: various standing committees of both Houses of the General Assembly review the bills necessary to implement the budget. Finally, these bills are introduced to the Finance, Ways, and Means Committees of both Houses. The Senate and House of Representatives must pass the exact version of these bills for them to be enacted into law.

3. **April to June**
   - The Governor has the authority to approve or veto line items in each of the bills necessary to implement the budget.

4. **Year Round**
   - The Division of Budget, with input from agency fiscal personnel, has the responsibility of reconciling the approved bills with the budget. It is the responsibility of the Division of Budget to continually monitor and analyze an agency’s spending plan for compliance with legislative intent as expressed in the Appropriations Act and revise it, if approved by the legislature, during the fiscal year.
The Budget Process

The formal budget cycle begins when the Commissioner of Finance and Administration issues a policy memorandum to agency heads (August). The policy memorandum outlines the Governor’s priorities for the next fiscal year, alerts agency heads to any expected fiscal constraints, and informs agencies of the schedule for submitting requests. By early fall, a final program package is assembled, reviewed for consistency with the policy memorandum, approved by the agency head, and submitted to the Department of Finance and Administration’s Division of Budget. Each agency budget request includes specific amounts for operating expenditures such as salaries, travel, rent, contracted services, equipment, etc. Each agency budget also includes the number of authorized employee positions.

Analysis of Agency Budget Requests (October - December)

Beginning in October, the Division of Budget evaluates agency requests, with these questions in mind:

- Did the agency conform to the guidelines?
- Are the agency’s priorities consistent with the administration’s?
- Are requests technically correct (i.e., do the numbers add up)?
- Has the agency clearly demonstrated and justified its funding needs?

In November, the Commissioner of Finance and Administration conducts a series of agency budget hearings. These hearings give agency heads an opportunity to present and discuss their budget requests and give the staff of the Division of Budget and the Governor’s Office an opportunity to raise critical questions about programs, policies and priorities. An agency’s budget request includes a baseline budget and an improvement request. A baseline budget provides the budget staff with estimated expenditures and associated revenues or appropriations necessary to maintain the current level of service or activity, not accounting for inflation. A baseline budget includes personnel expenditures, such as salaries and benefits, and non-

How State Revenues Are Projected to Fund the Budget:

The State Funding Board

In creating the budget, the Governor looks to the State Funding Board for revenue projections for the upcoming fiscal year. the State Funding Board consists of the Governor (who, due to his office, serves as the chair), the State Treasurer, the Secretary of State, the Commissioner of Finance and Administration, and the Comptroller of the Treasury (who serves as secretary). The Funding Board conducts public hearings to update estimates for the current fiscal year and develop first time estimates for the forthcoming fiscal year. The Funding Board has the authority to reevaluate its estimates later in the fiscal year if economic or fiscal conditions change.
personnel expenditures, which include travel expenses, computer equipment, employee training, etc.

Improvement requests include personnel and non-personnel increases in departmental budgets needed to implement mandated requirements, compensate for revenue reductions, initiate new programs, or adjust the department’s base budget for inflation. A department’s improvement requests go through a more intense review by the budget staff and the Commissioner of Finance and Administration.

**Budget Formulation (December)**

By January, the Commissioner of Finance and Administration will normally have completed his recommendations on both expenditures and appropriations for agencies—and have presented them to the Governor and the Governor’s staff. The Governor is kept up-to-date on the changing economic and revenue forecasts and confirms that program priorities are accurately reflected in the budget. Based on the preliminary recommendations and the most current reading of the economic and fiscal environments, the final budget recommendations are formulated in a series of meetings between the Commissioner of Finance and Administration and the Governor’s staff. These sessions focus on major fiscal and policy issues and may lead to significant revisions in agency budgets. The Division of Budget then prepares a comprehensive budget document that includes tables and narratives for each agency’s budget, and final forecasts of individual revenue sources.

**Release of the Budget (February)**

In February, the Governor presents the recommended budget. Its emphasis is on communicating the Governor’s policy initiatives and priorities. The objective of this public release is to ensure that the media, the public, and the General Assembly understand the budget. The Governor usually makes this release during the annual “State of the State” address to the General Assembly. It becomes the starting point for

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**How State Revenues Are Projected to Fund the Budget:**

**Sources for Revenue Projections**

The Funding Board relies on state revenue projections from several organizations, including:
- the Bureau for Business and Economic Research at the University of Memphis,
- the Business and Economic Research Center at Middle Tennessee State University,
- the Center for Business and Economic Research at the University of Tennessee-Knoxville,
- the Department of Revenue, and
- the Fiscal Review Committee.

The Funding Board considers all information and projections in formulating its revenue projections. The estimates adopted by the Funding Board provide the Governor with guidance on how much revenue Tennessee can anticipate collecting from state taxes.
legislative consideration. Although agency requests include specific amounts for various categories of operating expenditures, the Governor is only required to release summation amounts for personnel and for other expenses.10

Legislative Consideration and Negotiation (February – May)
Legislative consideration and negotiation is often the most public stage of the budget process and involves the greatest number of persons and interests. After the budget and State of the State address have been presented to the General Assembly, the appropriation process is initiated. The bills necessary to implement the budget are introduced. These bills are an Appropriation Bill, Bond Bill (if needed), Revenue Bill (if needed), and the Spending Limit Bill (if needed).11 These bills are prepared by the Department of Finance and Administration, sponsored by legislators, and referred to the General Assembly. The standing committees of the General Assembly make recommendations regarding the bills to the Finance, Ways, and Means Committees of both houses of the General Assembly. Individual agency budgets are reviewed by program area by the standing committees of the General Assembly and recommendations are made to the Finance, Ways, and Means Committees. Members of these committees may consult with the Legislative Budget Office for further analysis. The Senate and House of Representatives must each pass the exact same version of the bills necessary to implement the budget. The Governor has the authority to approve or use the power of the line-item veto in reviewing the bill that is passed by both houses of the General Assembly.12 Unless the veto is overridden by the General Assembly, the bill becomes law. A veto can be overridden by a simple majority vote in both houses of the General Assembly. The budget reflected in the bill now becomes the spending plan for the state against which the budget is and expenditures are measured.

Budget Execution (July–June)
When all the bills are passed and enacted into law, the execution of the budget begins. Invariably, there are changes to the budget as recommended by the Governor to the General Assembly. The Division of Budget, with input from agency fiscal personnel, has the responsibility of reconciling the approved bill with the budget. This may involve increases or decreases in allotments for specific agencies and divisions. The Division of Budget establishes an annual allotment for each agency and division using the reconciled bill. The agencies and divisions spend against these allotments in the upcoming fiscal year.

Spending plans must be adaptable to changing economic and political environments. Agencies can request revisions of their spending plan only if a source of funds is available. The Division of Budget must analyze an agency’s request to expand spending allotments supported by dedicated revenues. Once the Division of Budget provides its analysis, it goes to the Commissioner of Finance and Administration for his approval. The Commissioner then submits the request to the Chairmen of the House and Senate Finance, Ways, and Means Committees for their approval.
Some unspent agency funds can be carried forward to the next fiscal year, depending on the language in the Appropriations Bill or language elsewhere in the law. State auditors ensure that such funds are correctly spent for the purpose for which authorized. If unspent funds cannot be carried forward into the next fiscal year, then they revert to the fund from which they were allotted.
Funding Budgeted State Services

State government’s resources and the demand for government services drive the decision process for the budget. Tennessee law requires that the budget be in balance each fiscal year. Thus, The Budget counts every dollar that passes through state coffers, including state college tuition and fees, pass-through federal payments to welfare and food stamp recipients, and child support payments processed by the state. When limited by estimated available revenues, balancing the budget involves making tough decisions about increasing taxes, fees or borrowing, or cutting programs and services.

Tennessee derives revenues from a variety of sources, including state taxes, the federal government, borrowing (i.e. short term commercial paper or bonds), and current services (user and activity fees). State revenues, depending on their source, are placed in one of several funds from which they have been appropriated.

State Taxes
A detailed list of state tax revenues can be found in The Budget. A partial list, accounting for 95 percent of state revenues from taxes, follows:

- **State Sales and Use Tax**: A six percent rate that applies to certain retail sales, uses, and services.
- **Gasoline Tax**: ($0.20) on each gallon of gasoline sold.
- **Motor Fuel Tax**: $0.17 on each gallon of diesel fuel.
- **Hall Income Tax**: A six percent tax on income from dividends on stocks or interest on certain bonds.
- **Privilege Taxes**: Consists of taxes on realty transfers and mortgage taxes, litigation fees, and several other minor fees and taxes.

Why the State Budget Is Not Like Your Home Budget
Many people believe that the state government budget can be balanced as easily as their household checkbooks. Both the government and households try not to spend more money than they make. However, unlike a private citizen’s checkbook, the budget is shaped by changes in population, political realities, and the need to preserve the safety net for the poor and underprivileged.

Anyone who has ever managed a household budget knows that due to inflation it will cost more to buy some things next year than it does this year. Government has to budget for this inflation too. Government also has to budget for the fact that there will be more people in the state next year. So not only does the cost of providing the service for each person go up, so does the number of people being served.

When times get tough, private citizens can cut their personal spending: canceling family vacations, holding off on home improvements, or squeezing a few more miles out of their car. The state of Tennessee will do similar things; however, the state must contend with federal mandates, state statutes, and state federal court orders that require a certain level of spending for several programs regardless of the economic climate. It is during economic downturns as tax tax dollars shrink that the demand for many public services is the greatest.
**Funding Budgeted State Services**

- **Gross Receipts Taxes**: Levied principally on the gross receipts of certain types of businesses operating in the states. Includes several other tax levies and TVA in-lieu-of-tax payments.
- **Beer Excise Tax**: Registration fees imposed on beer wholesalers and manufacturers ($3.90 per barrel).
- **Alcoholic Beverage Tax**: Taxes levied on wine, spirits, and permit fees for manufacturers, wholesalers, retailers, and their representatives ($4 a gallon on liquor and $1.10 on wine).
- **Franchise Tax**: Tax levied on the value of outstanding stock surplus or undivided profits of corporations and certain other business in the state (25¢ tax rate).
- **Excise Tax**: A tax of six percent of net earnings of all corporations and certain other businesses conducted for a profit in the state.
- **Inheritance, Estate, and Gift Taxes**.
- **Tobacco Tax**: A tax of 13¢ per pack.
- **Mixed Drink Tax**: A gross receipts tax of 15¢ for the privilege of selling alcoholic beverage for consumption on premises.

**Other Sources of State Revenue**

**Debt Financing**

Government spending includes payments for resources directly or indirectly used over a short period of time, such as salaries, and resources that will be used over an extended period of time, such as for the construction of a higher education facility. Purchase of these long-lived assets represents an investment of public funds that provide use long beyond the period in which the funds were expended.

Capital expenses, which provide benefits over many years, are financed with debt and paid for

**Why the State Budget Is Not Like Business Budget**

Unlike a business, the state does not decide to fund a service or program based on whether or not it can generate a profit. The state must consider whether there is a need for the service and the most efficient and equitable manner to meet that need. For example, the state would not eliminate funding to its highway patrol because its operations do not return a profit. For government, the bottom line is not money, but the service and protection of its citizens.

Additionally, there are some services that the state cannot eliminate because of a downturn in the business cycle. During a recession, a private business can defer investing in plant expansion. So can the state; however, the state cannot defer spending on public education for a year because revenue collections are lower than projected.

Like businesses, state governments have developed performance measurements and rely on audits to find improvements in service delivery and to streamline costs. However, state government is held accountable to the needs of the electorate. Expectations of state services are different from the expectations that stockholders or board members have of a private or publicly held company.
Funding Budgeted State Services

over a period longer than their construction or acquisition time. This method can be described as a “pay-as-you-use” policy. Borrowing to spread the cost of capital investment over its useful life also can provide for a more equitable allocation of costs to the citizens receiving the benefit over an extended period of time.

However, pledging future resources to bondholders places the government at greater financial risk than payment out of current revenues. A commitment to pay bondholders their principal and interest when due represents competition for future budgeting resources. A decision to borrow funds long-term carries consequences that should be analyzed for affordability and risks over the term of the debt. Debt analysis must also address the purposes for which borrowing is undertaken. Relying on debt financing for operating expenditures, such as payroll and training, is illegal.14

Current Services & Interdepartmental Revenue

Tennessee charges various fees to offset the costs associated with certain government activities and services. Fees are defined as monetary charges that are made for licenses, permits, certifications, privileges, goods, or services. Privileges include the granting of access to state facilities or enforcing actions or behaviors that are otherwise restricted by law or regulation. Services include a wide range of benefits such as advisory services to local governments, social services to individuals, medical treatment, and institutionalization. In some cases, one state government entity charges another state government entity a fee for services. The revenue from these fees is classified as interdepartmental revenue. When a state agency charges a fee for services to either an entity or individual outside of state government, the revenue from these fees is usually referred to as current services revenue. However, most licenses/permits are treated like tax revenue and show up as state appropriations.

Two important fee sources for funding government in Tennessee are:

• tuition and other fees charged to students attending two and four year state universities and
• hospital fees charged at state facilities.

Rainy Day Fund

Tennessee law (TCA 9-4-211) requires that at least 10 percent of all revenue growth be placed within the Revenue Fluctuation Reserve (Rainy Day Fund), unless that account already equals five percent of estimated state tax revenues. The Rainy Day Fund provides an “emergency” reserve of revenue for the state to use to deal with fluctuations in revenue collections during times of economic downturn. The reserve equaled $178 million in fiscal year 2001, which is less than three percent of the budgeted 2002 general fund revenue estimate. The rule of thumb in governmental budgeting is to maintain a reserve of at least five percent.
Funding Budgeted State Services

**Federal Funding**

Federal requirements and conditions accompany virtually all federal funds. For entitlement programs, the number of clients or other entities that meet the eligibility criteria for the program determines the level of federal funding available. Funding is awarded to recipients on the basis of formulas in laws or regulations or efforts to promote a department’s priorities. Recipients are entitled to receive funds if they comply with the programmatic requirements outlined in the request for proposals. Generally, the state is committed to providing services for those who are eligible as defined by both the federal government and the state. The federal government, at a particular match rate, will reimburse the state for all who are eligible. Federal funds for entitlements are not capped by federal appropriation amounts.

Some types of federal funding require states to be directly responsible to the federal government for the implementation of Congressional policy decisions. This can take the form of participating in a program and following program guidelines such as submitting program plans and follow-up audits under the Single Audit Act. In some cases, federal requirements generate costs at the state level as a result of mandates that Congress has enacted without providing funding. This includes mandatory new programs, changes in existing federal programs, and increases in state financial participation in jointly funded federal programs resulting from decreases in federal match rates. The Americans with Disabilities Act (ADA) is an example of a federal mandate without funding.

Preparation of the Budget is complicated by the federal fiscal year. The federal government operates on a fiscal year that extends from October 1 to September 30. This timing requires Tennessee to anticipate federal funding levels far in advance of the actual availability of federal funds. To address this concern, some federal programs, including most programs administered by the U.S. Departments of Education and Labor, are forward-funded so funds appropriated on October 1 become available the following July 1. This allows the state to anticipate the level of federal support when the state budget is prepared.

**Non-Discretionary Appropriations**

Regardless of the revenue outlook, state government is obligated to pay for some services. Appropriations for these expenditures are classified as non-discretionary (versus discretionary). They are controlled by federal statute or judicial ruling rather than the state. Two nationally recognized budget experts made a comment regarding dedicated funding and the incremental nature of the federal budget that also can apply to the state budget:

At any one time, after past commitments are paid for, a rather small percentage—seldom larger than 30 percent, often smaller than 5—is within the realm of anybody’s … discretion as a practical matter.\(^{15}\)

The Citizens’ Guide 30
### Table 2. Estimated Discretionary and Non-Discretionary Appropriations, 2002

<table>
<thead>
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<th>Agency</th>
<th>2002 Recommended Appropriation</th>
<th>2002 Other Non-Discretionary Appropriations</th>
<th>2002 Discretionary Appropriations</th>
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<td>155,688,000</td>
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<td>$5,011,441,000</td>
<td>$4,182,701,200</td>
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</table>

The Citizens' Guide 31
Funding Budgeted State Services

In the 2001-2002 Recommended Budget, an estimated four percent of state appropriations in the General Fund were discretionary, while 96 percent of state appropriations were nondiscretionary ($372 million discretionary out of a total of $8.6 billion in recommended appropriations). In arriving at the four percent non-discretionary estimate, the Division of Budget defined appropriations as non-discretionary if the Governor’s control over recommending their spending levels was limited due to:

- Being outside of the control of the chief executive
- Federal requirements
- Current and past court orders
- State earmarking

Outside of Chief Executive Control

The Division of Budget considers appropriations over which the Governor as chief executive of the state has no control as non-discretionary. These are appropriations for agencies that are not in the executive branch, but fall under one of the other two branches of state government, the legislative or the judicial branch. The legislative and judicial branches are responsible for developing their own recommendations. In the 2002 recommended budget, $256 million of the appropriations were for these two branches of government. Eight million dollars of that amount were statutorily earmarked for claims and compensation programs, while another $611,300 was earmarked for the state’s court system. Earmarked funds will be discussed in more detail later in this section.

It is important to note that while the Governor has no discretion for appropriations outside of his control as chief executive, the state is not without discretion. Aside from the nine million dollars of earmarked funds going to the judicial branch, the legislature and the judiciary have discretion over their recommended appropriations. Undoubtedly, the Governor provides input concerning what he believes those recommendations should equal.

Federal Requirements

This category includes federal grant money and appropriations of state funds for federally mandated programs. Federal programs may be optional to the state or they may be mandated. In the case of optional programs, typically once a state commits to participate, it must continue the program. State funds committed to such programs become non-discretionary as in the case of the Infants and Toddlers Program, which serves families of pre-school children with disabilities and is housed in the Department of Education.

Federally mandated programs may or may not require state funds. An example of one that does not is the Unemployment Insurance Program housed in the Department of and Workforce Development. However, most federally mandated programs require state matching funds. Such programs effectively prevent the legislature from diverting the state revenue necessary for those
programs to other programs. An example is TennCare. When Tennessee gained approval from the federal government to establish TennCare in 1994, one of the conditions was that the state maintains budget neutrality, meaning that Tennessee cannot reduce the services it provided to Medicaid recipients.

**Court Orders**
The size of the budgets for many state programs is driven largely by the requirement to comply with current or past court orders. For example, in formulating a budget for the Arlington Developmental Center, the Department of Mental Health and Developmental Disabilities must submit an expenditure plan in order to meet legal obligations stemming from a federal court order and settlement agreement. Oral findings in November 1993 and supplemental written findings in February 1994 found that the conditions at Arlington were unconstitutional. The parties were directed to agree on a remedy. A remedial order was entered in September 1994.

The remedial order mandates actions by the state to guarantee the statutory and constitutional rights of residents of the Arlington Developmental Center. The remedial order created a protected class and requirements for those class members, including requirements for community services provided to those persons following their move from the Arlington Developmental Center. The Arlington example illustrates that for some agencies, state government has little or no discretion in spending. Other state programs whose spending discretion has been limited by court orders include education, corrections, mental health, and TennCare.

**Earmarked Revenue**
Earmarked revenue is another category of funds for which policy makers have limited discretion. Earmarked revenue can only be spent on programs for which those funds are “earmarked,” or reserved. An example is the money raised by Tennessee’s gasoline tax, motor fuel tax, and the gasoline inspection tax. A large portion of this money is placed in a special highway fund and is only available for transportation related projects. The highway fund also receives most of the money raised from the motor vehicle registration tax, and some of the money raised from the gross receipts and beer taxes. Of the $8.65 billion in estimated state revenue for 2002, $618 million (7.2 percent) would be distributed to the highway fund. This is compared to the $3.66 billion (42.3 percent) to be distributed to the general fund and the $3.44 billion (39.8 percent) to be distributed to the education trust fund.

Unlike other non-discretionary expenditures, the state does not have to spend earmarked revenue, but it cannot spend it on anything other than that for which it is earmarked. Any unspent funds at year end revert to the fund balances of the earmarked programs, and does not become available for general fund purposes. Only the General Assembly can change the restrictions on earmarked revenue by changing the law that establishes its earmarked status. It cannot use the Appropriations Bill to redirect the funds.
The Highway Fund—An Earmarking Case Study

A common misperception is that all of the money raised by Tennessee’s gasoline tax is earmarked to go directly to the Highway Fund in order to pay for road construction and maintenance. The truth is that for fiscal year 2002, only 46.9 percent of the revenue expected to be raised from the gasoline tax would be distributed directly to the highway fund. Moreover, money raised from several other revenue sources also goes into the highway fund. The Budget estimates that state revenue distributions to the Highway Fund will equal $618 million in fiscal year 2002. Let’s take a look at the sources for that revenue.

As shown in the table below, none of the state taxes that are earmarked for the highway fund would go entirely to that fund. All of the taxes earmarked for the Highway Fund are also partially distributed to the General Fund. All but the Motor Vehicle Registration Tax and the Gross Receipts Tax also are partially distributed to Tennessee’s city and county governments. At $591 million, the gasoline tax is the largest state source of revenue for distributions to the Highway Fund, but over half of the revenue from that tax would go to other sources. Over $8 million would go into the General Fund to cover the cost of collecting and administering the tax. That amount includes $400,000 earmarked for the Tennessee Wildlife Resource Agency. Another $225 million would go to Tennessee’s county and city governments as a portion of $691 million in state tax revenue shared with local governments. Eighty million dollars would be authorized for use in the Sinking Fund to fund the cost of highway projects, leaving $277 million to be allocated directly to the highway fund.

<table>
<thead>
<tr>
<th>Source of Revenue</th>
<th>Highway Fund</th>
<th>General Fund</th>
<th>Sinking Fund</th>
<th>Cities and Counties</th>
<th>Total</th>
<th>Highway Fund as % of Total</th>
</tr>
</thead>
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<td>$225</td>
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<td>0</td>
<td>230</td>
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<td>0</td>
<td>0</td>
<td>23</td>
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<td>17</td>
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<td>$101</td>
<td>$80</td>
<td>$283</td>
<td>$1,082</td>
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Source: The Budget
The Sinking Fund is a fund used to retire bonds in an orderly manner over the bonds life. Each year, the state sets aside a sum of money equal to a certain percentage of the total bond issue. It is the practice of the Tennessee Department of Transportation to pay for new construction from current revenues rather than by issuing bonds. Therefore, most, or all, of the bond authorizations would likely be cancelled, allowing the return of the $80 million in the Sinking Fund to the Highway Fund. Tennessee’s process of funding its highway program is often referred to as a “pay as you go” program. For many years this conservative approach to debt management has been one of the key factors in Tennessee’s ability to secure very favorable general obligation bond ratings from the nation’s leading rating agencies.

In addition to revenue earmarked for the Highway Fund, the Department of Transportation’s fiscal year budget includes estimated revenue from miscellaneous department sources ($17.1 million), fund balance and reserves ($12 million), bond authorization ($80 million), the transportation equity fund ($20 million), and the federal government ($664 million).  

Tennessee’s federal funding has improved significantly over the last several years. Prior to 1998, Tennessee only received about $.78 cents back for every dollar collected within the state from the federal gas tax. With the current federal transportation bill’s passage in 1998, Tennessee began receiving about $.90 cents back from every federal dollar. It is important to note that much of the federal revenue is only available when the state puts up matching dollars. For example, in 2001 the department budgeted $132.8 million for state matching of federal highway and transit programs. If the state had not spent this money it would have received considerably less federal money.

It is also important to note that even though the highway program comprises a large portion of the transportation funding in Tennessee, funding for other modes, including aeronautics, rail and transit, are included in the budget. The following table summarizes the Department of Transportation’s fiscal year 2002 work program, showing the recommended spending by category.

| Department of Transportation State Funding Sources, Fiscal Year 2002 ($Millions) |
|-----------------------------|------------------|
| Highway User Taxes          | $618             |
| Miscellaneous Department Revenues | 17              |
| Fund Balance and Reserves   | 12               |
| Bond Authorization          | 80               |
| Transportation Equity Fund  | 20               |
| Total Revenue               | $747             |

Source: Tennessee Department of Transportation
## Department of Transportation Work Program, Fiscal Year 2002 ($Millions)

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<th>Description</th>
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<td>$0</td>
<td>$111</td>
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<td>Subtotal</td>
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<td>$747</td>
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</table>

Source: Tennessee Department of Transportation

Note: Totals do not add due to rounding.
Budget Growth
Cities grow. Our state’s population grows. The number of children attending our schools grows. No one seems overly shocked by this growth. Actually, for the most part, we expect and encourage reasonable growth. However, for some reason, a lot of people don’t expect the state’s budget to grow along with the communities it serves. We should expect our state budget to grow; the challenge is to make sure that the growth is reasonable and that it supports the desires and needs of the public.

Why Do Budgets Grow?
State budgets grow for five main reasons:

1. Inflation
2. Population growth
3. New or enhanced services
4. Past neglect
5. Changes in the way the budget is presented

Inflation
General increases in resource prices (inflation) affect all spending. It costs more to buy a car today than it did twenty years ago. Thus, you got a lot more car for $15,000 then than you would now. Likewise, it costs more to provide most government services today than it did twenty years ago. Adjusting budget amounts for inflation provides a more meaningful figure by which to measure changes in government spending over long periods of time. In addition to general price increases, certain resources, such as teaching resources, have been subjected to increased competitive price pressures (higher wage levels) as a result of a growing demand for more highly educated workers.

Population Growth
The number of people served determines much of the total cost associated with providing government services. As Tennessee’s population has grown, so have program costs. More people means more roads on which those people will drive, more highway patrol troopers to protect those people, more drivers’ license branches, etc. When you have more people, it costs more just to maintain the current level of service.

As the total population goes up, so does the population of sub-sets of the population that require more government services. More people mean more children, which means more schools and teachers. More people will probably mean more criminals, which means more prisoners, which means more prisons. More people also probably means more poor and elderly, with their increased social service and healthcare needs.
New or Enhanced Services
Budgets also grow because of increases in the demand for services or for enhancements to services. Service growth can result from pressure to:

• enhance service levels to meet the demands of the state’s residents (such as reducing the number of students in elementary classes in order to improve education);
• remain competitive with other states (such as improving in our state’s transportation system);
• comply with requirements for federal-state program participation or federal mandates; or
• comply with court orders (examples include elementary and secondary education, corrections, mental health and state Medicaid/TennCare programs).

Neglect
Budgets also grow when legislatures try to repair the damage caused by years of funding neglect. Neglect can be in the form of concrete, physical neglect, such as failing to spend the money necessary to maintain an adequate infrastructure. One can either spend a reasonable amount of money each year to maintain a bridge, or one can spend a lot of money at one time to replace that bridge when it is no longer safe to use. Neglect can also be in the form of program neglect. For example, the large influx of funding for education that came with the passage of the Education Improvement Act in 1992 was a response to years of extremely low funding for education in Tennessee. When a program is greatly under funded, it can take a lot of money just to bring its funding to a merely adequate level.

Changes in Budget Presentation
Sometimes changes in The Budget are as simple as changes in what information is included or how that information is presented. These changes can have a huge impact on the size of the budget. For example, prior to 1998 the value of federal food stamps distributed to Tennesseans was not reflected in the state’s budget. A change in national governmental accounting standards now requires the inclusion of their value. In fiscal year 2002, this value was $450 million. Another example is the policy decision made in the 1981-82 budget to begin reflecting student tuition and fees as part of the higher education budget. This change adds $528 million to the 2002 budget.

Creation of the Facilities Revolving Fund during Governor McWherter’s administration added over $90 million to the budget. This money wasn’t really new money being spent by the state, but rather it was double counted revenue where one state agency was charging another state agency for its services. In order to authorize the agencies using the services to spend money, the money must be included in their budgets. At the same time, the money must also be included in the budgets of the agencies providing the services in order to spend the money needed to provide the service. The sum total of these three items alone inflates The Budget as now presented by over one billion dollars.
Tennessee's Budget Growth

Tennessee's total budget grew from $6.67 billion in 1988 to $16.64 billion in 2000 (see Table 3), an increase of nearly $10 billion. However, it is important to note that a very large share of that increase was from federal money sent to Tennessee, not taxes collected in Tennessee. The federal government sent $1.80 billion to Tennessee in 1988, compared to $5.66 billion in 2000. Actual appropriations of Tennessee raised revenue equaled $8.21 billion in 2000, compared to $3.95 billion in 1988. This would seem to be a greater than 100 percent increase until you take into account inflation. The 1988 amount of $3.95 billion is really equal to $5.75 billion in 2000 dollars. So, what accounts for the rest of the budget increase? Has it grown out of control?

Table 3. Tennessee State Budget, State Dollars vs. Federal Dollars ($Billions)
Fiscal Years 1988 and 2000

<table>
<thead>
<tr>
<th>Revenue Source</th>
<th>1988</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Appropriation</td>
<td>3.95</td>
<td>8.21</td>
</tr>
<tr>
<td>Federal Money</td>
<td>1.80</td>
<td>5.66</td>
</tr>
<tr>
<td>Total</td>
<td>6.67</td>
<td>16.64</td>
</tr>
<tr>
<td>Federal as % of Total</td>
<td>27%</td>
<td>34%</td>
</tr>
</tbody>
</table>


Table 4 further explores state dollars as a share of all revenue, looking at the state and total funding in fiscal year 2000 for several executive branch agencies. Table 4 also shows each of the agencies state dollars as a percent of all state dollars. At 30 percent, The Department of Education (kindergarten through grade 12) represented the largest share of state dollars.
Budget Growth

Table 4. Tennessee State Budget, Total Dollars and State Dollars
Fiscal Year 2000

<table>
<thead>
<tr>
<th></th>
<th>State Dollars</th>
<th>All Sources</th>
<th>% of State $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total State Departments</td>
<td>8,210,498,300</td>
<td>16,639,402,600</td>
<td>100.0%</td>
</tr>
<tr>
<td>Education</td>
<td>2,466,521,500</td>
<td>2,943,821,900</td>
<td>30.0%</td>
</tr>
<tr>
<td>Medicaid/TennCare</td>
<td>1,414,899,300</td>
<td>4,538,526,200</td>
<td>17.2%</td>
</tr>
<tr>
<td>Higher Education</td>
<td>985,529,200</td>
<td>1,938,936,600</td>
<td>12.0%</td>
</tr>
<tr>
<td>Transportation</td>
<td>717,045,200</td>
<td>1,260,934,000</td>
<td>8.7%</td>
</tr>
<tr>
<td>State-Shared Taxes (Local Govt.)</td>
<td>648,248,000</td>
<td>648,248,000</td>
<td>7.9%</td>
</tr>
<tr>
<td>Correction</td>
<td>395,283,400</td>
<td>415,870,800</td>
<td>4.8%</td>
</tr>
<tr>
<td>Debt Service Requirements</td>
<td>246,970,000</td>
<td>246,970,000</td>
<td>3.0%</td>
</tr>
<tr>
<td>Children’s Services</td>
<td>198,019,700</td>
<td>418,295,600</td>
<td>2.4%</td>
</tr>
<tr>
<td>Human Services</td>
<td>145,404,200</td>
<td>1,431,418,800</td>
<td>1.8%</td>
</tr>
<tr>
<td>Environment and Conservation</td>
<td>115,192,100</td>
<td>227,331,700</td>
<td>1.4%</td>
</tr>
<tr>
<td>Safety</td>
<td>88,396,500</td>
<td>124,233,700</td>
<td>1.1%</td>
</tr>
<tr>
<td>Health</td>
<td>78,979,300</td>
<td>333,392,800</td>
<td>1.0%</td>
</tr>
<tr>
<td>All Others</td>
<td>710,009,900</td>
<td>2,111,422,500</td>
<td>8.6%</td>
</tr>
</tbody>
</table>

Source: Tennessee Treasury Department

Why Did Tennessee’s Budget Grow?

Research by the Tennessee Treasury Department indicates that state spending in Tennessee is neither excessive nor out of control. The Treasury Department looked at growth in state appropriation amounts for various program areas in Tennessee from 1988 and 2000. Growth was demonstrated using the compound annual growth rate (CAGR), which is a measure of how much the appropriations grew each year. The 1988-2000 period was selected to measure growth between two comparable economic times.

Table 5 lists the CAGR for state appropriations for Tennessee’s major program areas. While certain state expenditures grew more rapidly during individual years during the 1990s, notably state funding to local governments for K-12 education (Basic Education Plan funding) and the state’s share of the federal Medicaid program (TennCare in Tennessee), the long-run history of spending in Tennessee reflects modest growth. The highest unadjusted CAGR was for Medicaid/TennCare, at 13.8 percent. TennCare replaced Medicaid in Tennessee in 1994. Between 1994-2000, TennCare grew at a rate of 4.1 percent per year after adjusting for medical inflation and population growth. This is much slower than the growth rate for Tennessee’s share of Medicaid, which was 10.1 percent per year for the period 1988-1993 after adjusting for medical inflation and population growth.
Table 5. Growth Rate for State Appropriations by Program Area, 1988-2000

<table>
<thead>
<tr>
<th>Program Area</th>
<th>Compound Annual Growth Rate (CAGR) in State Appropriations, 1988-2000</th>
<th>Rate Adjusted for Inflation1</th>
<th>Rate Adjusted for Inflation and Population Growth2</th>
</tr>
</thead>
<tbody>
<tr>
<td>K-12 Education</td>
<td>6.0%</td>
<td>2.9%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Higher Education</td>
<td>3.7%</td>
<td>0.7%</td>
<td>-3.1%</td>
</tr>
<tr>
<td>Health (Less Medicaid),</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Environment, and Conservation</td>
<td>3.3%</td>
<td>0.3%</td>
<td>-0.9%</td>
</tr>
<tr>
<td>Medicaid/TennCare</td>
<td>13.8%</td>
<td>7.2%</td>
<td>5.9%</td>
</tr>
<tr>
<td>Human Services</td>
<td>2.2%</td>
<td>-0.8%</td>
<td>-1.9%</td>
</tr>
<tr>
<td>Transportation</td>
<td>4.5%</td>
<td>1.4%</td>
<td>0.3%</td>
</tr>
<tr>
<td>Department of Safety</td>
<td>5.4%</td>
<td>2.3%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Corrections</td>
<td>4.4%</td>
<td>1.3%</td>
<td>-6.4%</td>
</tr>
<tr>
<td>Debt Service</td>
<td>6.1%</td>
<td>3.0%</td>
<td>1.8%</td>
</tr>
<tr>
<td>State-Shared Taxes</td>
<td>4.2%</td>
<td>1.1%</td>
<td>0.0%</td>
</tr>
<tr>
<td>All Other State Programs</td>
<td>5.8%</td>
<td>2.7%</td>
<td>0.6%</td>
</tr>
</tbody>
</table>

1 US Bureau of Economic Analysis’ Consumer Price Index used to adjust for inflation.
2 Enrollment growth used to adjust CAGR for K-12 and Higher Education; Inmate population growth used for corrections. Total state population growth used for all other program areas.

Source: Tennessee Treasury Department

The Treasury Department also demonstrated some of the impact of the four main causes of budget growth discussed in the first part of this section. They used the Consumer Price Index (CPI) to adjust for inflation, except with Medicaid/TennCare, where a more appropriate medical inflation index was used. Treasury also accounted for the impact of population growth on state appropriations adjusting for Tennessee’s population increase of 866,846 from 1988 to 2000 (4,822,437 to 5,689,283), or for increases in specific populations served by the program, where more appropriate. Remember, it costs more to provide the same level of service to more people. As shown in Table 5, appropriations growth is particularly modest when one adjusts the CAGR to reflect inflation and the increase in the state’s population. Funding for several program areas actually decreased when adjustments were made for inflation and population growth.

As shown in Table 5, much of the funding growth in Tennessee’s elementary and secondary education program area was the result of inflation and student population growth. The growth in this program area also serves as an example of growth caused by increased service demand, as well as neglect. The Tennessee General Assembly passed the Education Improvement Act (EIA) in 1992 in order to equalize education spending across the state’s local education agencies. When the
Tennessee Supreme Court later ruled on behalf of several of the state’s small school systems, finding that the state must equalize education spending, it determined that the equalization plan adopted by the EIA was sufficient to enact this equalization. The EIA required Tennessee’s public schools to reduce class sizes in primary and secondary school classrooms. This requirement was driven by studies showing that students learn more in smaller classes.

Reducing class sizes meant hiring more teachers, which meant that the state and the local governments had to spend significantly more money on education. The EIA created a mechanism for determining cost, the Basic Education Program, to help pay for the additional teachers, and to provide additional money for other classroom and non-classroom expenses that had been neglected and under funded for many years. A later court ruling required the state to spend additional money to help equalize teacher salary levels across the state.

Figure 3 compares the annual growth rate in demand for miscellaneous other services provided by the state to Tennesseans to the population growth rate for the period 1988-2000. As demonstrated, caseloads often grow faster than the population. This growth in service demands can reflect changes in the public’s priorities, new service requirements resulting from court decisions, or compliance with federal requirements.

Figure 3. Annual Growth of Selected Service Demands Compared to Population Growth, Tennessee, 1988-2000

Source: Tennessee Treasury Department
Evaluations of Government Spending in Tennessee

Budgeting is complicated. To truly understand and evaluate a state’s budget, one must move beyond simplistic comparisons and analogies. Following are three different ways to evaluate government spending in Tennessee.

Budget Size in Tennessee Compared to Surrounding States

Properly comparing growth in government spending and taxation across states requires a look at combined state and local operations, not the operations of state government alone. State and local fiscal responsibilities and interrelationships vary significantly from state to state. This is the result of varying historical and political developments in each state that cumulatively explain current state-local fiscal relationships. The trend in most states over the last 20 years reflects an increased fiscal role for state governments relative to local governments. However the degree of fiscal centralization (the state government percent of combined state and local revenue) that exists today varies significantly. As a result of significantly different state-local fiscal relationships, a comparative analysis of only state spending will result in faulty comparisons and conclusions.

Revenue Comparison

In 1999, Tennessee state and local government total own source revenues and own source taxes both ranked either 50th or 51st based on rankings of data on state and local government finances. Whatever criticisms may or may not be appropriate relative to government spending in Tennessee, excessive spending and taxation is not very likely given Tennessee’s bottom and near bottom rankings in many measures of state and local government finances. An important question is how low is too low. Even your blood pressure can be too low.

It should be pointed out that many of the relative comparisons of state and local government finances are inappropriate or, worse, meaningless. Comparing relative spending and taxation in Tennessee with states in which resource prices are significantly higher is inappropriate. In many states, labor costs (as well as the cost of land and construction) are significantly higher than in Tennessee (as well as higher than in many other southern states). It makes little sense to compare per capita (per person) tax collections or spending in Tennessee with states in the Northeast where wage rates are 20 percent-40 percent higher than in Tennessee. Clearly, if for no other reason than higher regional wage rates, Northeastern states must spend more per capita than Tennessee to hire the same number of employees. More appropriate comparisons require that Tennessee be compared to other states where labor prices are comparable, or that some adjustment be made for the cost of living differences.

Table 6 compares Tennessee’s per capita state and local revenue collections (total from all sources), own source revenue collections, and own source tax collections to that of eight other Southeastern states. It shows that while Tennessee ranked fifth among the nine Southeastern states
Budget Growth

analyzed in per capita collections from all revenue sources, the state ranked ninth in own source revenue and eighth in own source tax collections. This indicates that Tennessee has been very successful at raising revenue from non-tax sources, primarily federal funding and payments from utility industries.

Table 6. Tennessee’s Total Revenue, Total Own-Source Revenue & Total Own-Source Tax Collections, Compared to 8 Other Southeastern States Per Capita and Per Capita Ranked, 1999

<table>
<thead>
<tr>
<th>State</th>
<th>Total Revenue (thousands)</th>
<th>Own Source Revenue (thousands)</th>
<th>Own Source Taxes (thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TN</td>
<td>$31,367,892</td>
<td>$17,450,042</td>
<td>$11,748,362</td>
</tr>
<tr>
<td>AL</td>
<td>$23,620,939</td>
<td>$14,670,904</td>
<td>$8,770,411</td>
</tr>
<tr>
<td>AR</td>
<td>$13,867,261</td>
<td>$8,783,040</td>
<td>$6,076,982</td>
</tr>
<tr>
<td>GA</td>
<td>$46,264,608</td>
<td>$30,418,450</td>
<td>$21,503,096</td>
</tr>
<tr>
<td>KY</td>
<td>$22,769,157</td>
<td>$14,198,382</td>
<td>$9,760,823</td>
</tr>
<tr>
<td>MS</td>
<td>$14,973,344</td>
<td>$9,585,009</td>
<td>$6,086,891</td>
</tr>
<tr>
<td>NC</td>
<td>$49,072,731</td>
<td>$29,858,022</td>
<td>$20,214,709</td>
</tr>
<tr>
<td>SC</td>
<td>$21,640,397</td>
<td>$14,530,361</td>
<td>$9,067,175</td>
</tr>
<tr>
<td>VA</td>
<td>$39,931,184</td>
<td>$28,303,475</td>
<td>$19,557,644</td>
</tr>
</tbody>
</table>

Source: US Census Bureau

Expenditures

Revenue represents the money that state and local governments take in, while expenditures represent how much the governments actually spend on services. Remember, expenditures are paid for with money from various sources, including state and local taxes, as well as other own source revenue and federal funding. Table 7 compares total expenditures and expenditures for four of the biggest program areas in Tennessee’s budget—highways, K-12 education, higher education, and health expenditures—with expenditures for those areas in other Southeastern states in 1999. Tennessee’s per capita expenditures were ranked near the middle for each of the program areas. An important observation on the mix of state and local spending: Tennessee ranks at the bottom among the Southeastern states in K-12 education spending when one compares just state appropriations. Adding in local government spending, as done in Table 7, moves the state’s rank to fourth. This indicates that Tennessee requires its local governments to take a larger share of the responsibility of funding education than does many of the other states in the region.
Table 7. Highway, Education, and Healthcare Expenditures
Tennessee Compared to Other Southeastern States, Per Capita and Rank, 1999

<table>
<thead>
<tr>
<th>State</th>
<th>Total Expenditures (thousands)</th>
<th>Highway Per Capita</th>
<th>Higher Education Per Capita</th>
<th>K-12 Education Per Capita</th>
<th>Health Per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>TN</td>
<td>$30,640,825</td>
<td>$7,012</td>
<td>$387</td>
<td>$505</td>
<td>$1,266</td>
</tr>
<tr>
<td>AL</td>
<td>$23,377,945</td>
<td>$5,350</td>
<td>$286</td>
<td>$503</td>
<td>$1,044</td>
</tr>
<tr>
<td>AR</td>
<td>$11,749,417</td>
<td>$2,689</td>
<td>$197</td>
<td>$257</td>
<td>$583</td>
</tr>
<tr>
<td>GA</td>
<td>$41,056,839</td>
<td>$9,395</td>
<td>$286</td>
<td>$503</td>
<td>$1,044</td>
</tr>
<tr>
<td>KY</td>
<td>$20,420,819</td>
<td>$4,673</td>
<td>$362</td>
<td>$422</td>
<td>$862</td>
</tr>
<tr>
<td>MS</td>
<td>$14,298,546</td>
<td>$3,272</td>
<td>$261</td>
<td>$321</td>
<td>$628</td>
</tr>
<tr>
<td>NC</td>
<td>$42,198,350</td>
<td>$9,657</td>
<td>$575</td>
<td>$943</td>
<td>$1,902</td>
</tr>
<tr>
<td>SC</td>
<td>$21,159,446</td>
<td>$4,842</td>
<td>$237</td>
<td>$398</td>
<td>$1,025</td>
</tr>
<tr>
<td>VA</td>
<td>$35,498,879</td>
<td>$8,124</td>
<td>$620</td>
<td>$719</td>
<td>$1,868</td>
</tr>
</tbody>
</table>

Source: US Census Bureau

Ratio of Taxes to Income

One traditional measure of changes in tax burdens over time as well as in comparisons with other states considers the historical relationship between the public’s income (personal income) and the amount of that income paid to governments (taxes). Figure 4 shows the ratio of combined state and local taxes to personal income for Tennessee, the average of other Southeastern states that surround Tennessee, and the average for all states. This provides information on the degree to which state and local governments have pooled public resources in order to finance the provision of public goods and services.

The data show that Tennessee state and local governments used the same relative amount of personal income in 2000 as they did in 1970 (8.3 percent). This occurred despite the many individual tax increases imposed over the 30-year period, including four separate increases in the state sales tax (1971, 1976, 1984, and 1992), numerous increases in many other state taxes, and numerous increases in local property and sales tax rates.

Tennessee taxes as a share of personal income remains low relative to both the US average and the average for surrounding Southeastern states. The data also shows that while the ratio for Tennessee remained stable, surrounding states have increased their relative spending to more closely approximate the nation as a whole.
Figure 4. State and Local Taxes as a Share of Personal Income

Source: US Census Bureau

Per Capita Tax Collections
An alternative gauge of changes in tax burdens over time, as well as overall state and local government spending, focuses on the trend in the dollar tax burden on the average citizen. It is calculated by dividing total tax collections by population, producing per capita tax collections. This statistic is measured in current dollars. Many believe that this statistic is a better measure of the "tax burden" than one measured as a percent of personal income. While the statistic does provide an alternative measure of tax burden changes over time, increases in the figure do not provide a meaningful measure of real changes over time.

Over the period 1970 to 2000, the consumer price index rose by 344 percent. While the resources purchased by state and local governments differ from those purchased by households, average increases in consumer prices provide an approximation of the increases in prices of goods and services purchased by government. Adjusting per capita tax collections for inflation provides a more meaningful figure by which to measure changes in government spending over long periods of time. Tables 8 and 9 provide per capita state and local tax data, unadjusted and adjusted (for price changes), for Tennessee, the average of Southeastern states that border Tennessee, and the average for the US.
Table 8. Unadjusted Per Capita State and Local Taxes for Selected Years

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tennessee</td>
<td>$279</td>
<td>$441</td>
<td>$656</td>
<td>$1,006</td>
<td>$1,399</td>
<td>$1,818</td>
<td>$2,288</td>
</tr>
<tr>
<td>Average SE</td>
<td>$295</td>
<td>$465</td>
<td>$723</td>
<td>$1,084</td>
<td>$1,533</td>
<td>$2,038</td>
<td>$2,578</td>
</tr>
<tr>
<td>Average US</td>
<td>$427</td>
<td>$657</td>
<td>$986</td>
<td>$1,470</td>
<td>$2,017</td>
<td>$2,537</td>
<td>$3,210</td>
</tr>
</tbody>
</table>

Source: US Census Bureau

Tables 8 and 9 show that both unadjusted and price adjusted per capita taxes increased over the thirty-year period. Over the thirty-year period, real (price adjusted) per capita taxes increased 84.8 percent in Tennessee, 96.6 percent on average in the states that surround Tennessee, and 69.4 percent for all states combined. Even more revealing are various comparative ratios for adjusted per capita taxes.

Table 9. Adjusted Per Capita State and Local Taxes for Selected Years

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tennessee</td>
<td>$1,238</td>
<td>$1,412</td>
<td>$1,371</td>
<td>$1,610</td>
<td>$1,843</td>
<td>$2,054</td>
<td>$2,288</td>
</tr>
<tr>
<td>Average SE</td>
<td>$1,311</td>
<td>$1,487</td>
<td>$1,511</td>
<td>$1,734</td>
<td>$2,019</td>
<td>$2,303</td>
<td>$2,578</td>
</tr>
<tr>
<td>Average US</td>
<td>$1,895</td>
<td>$2,103</td>
<td>$2,061</td>
<td>$2,353</td>
<td>$2,657</td>
<td>$2,867</td>
<td>$3,210</td>
</tr>
</tbody>
</table>

Source: US Census Bureau

Figure 5 shows the thirty-year trend for three ratios: real Tennessee per capita taxes as a percent of the comparable US figure, real Tennessee per capita taxes as a percent of the comparable Southeast average figure, and real average Southeast per capita taxes as a percent of the comparable US figure.

Figure 5. Adjusted Per Capita State and Local Tax Burdens

Source: US Census Bureau
Both Tennessee and its surrounding states advanced relative to the United States average. Tennessee rose from 65 percent of the US average to 71 percent by 2000. The surrounding Southeastern state average rose from 69 percent of the US average to 80 percent by 2000. The trend of the ratio of Tennessee per capita taxes to the Southeast average is significant. While real per capita taxes in both Tennessee and its neighbor states were catching up with the average for all states, the ratio of Tennessee per capita taxes to those of its sister states was declining, from 94 percent of the average of its sister states in 1970 to only 89 percent in 2000. So while all southern states were increasing the real level of state and local government taxes (and spending) during this 30-year period, Tennessee was catching up at a slower pace than its sister states.

Distribution of Tax Burden

None of the tax burden measures so far discussed implies anything regarding the distribution of tax burdens among taxpayers. The fact that per capita taxes have increased does not automatically imply that everyone’s tax burden went up. The distribution of state and local taxes in any year as well as changes in the distribution of taxes among taxpayers over time depends on a state’s tax structure (combined state and local tax structure). A state with a progressive tax structure, which generally requires some form of progressive income tax, will find that growing tax levels will be financed by larger increases in relative tax burdens on upper income groups in contrast to lower income groups.

Conversely, increases in taxes over time in states with a regressive tax structure, Tennessee being a prime example, will result in larger increases in relative tax burdens on lower income groups than on upper income groups. This unfortunate situation is further compounded by the fact that lower income households did not fully participate in the rapid economic growth of the last two decades, resulting in an increase in income inequality in the United States.

Economic growth is not an equal opportunity provider, and national data show that income growth over the last 20-30 years was not distributed equally among households. A disproportionate amount of the growth in personal income over the last twenty years accrued to upper income groups, leaving many in the middle and low ends with little change in real income (income adjusted for inflation). This series of events helps explain why the lower end of the household income distribution, up to and including households with median incomes, did in fact experience increases in their real tax burdens in Tennessee.
Conclusion
Conclusion

In this guide we have looked at how Tennessee's budget works, how it is created, how it is funded, and how it has grown over the last several years. We have discussed how The Budget is a complicated plan that is not only an accounting document, but also a political document. We have also looked at how little discretion the administration has over much of the budget, due to legal spending requirements. Finally, we have seen that Tennessee's budget has not been growing out of control. Tennessee state and local governments used the same relative amount of personal income in 2000 as they did in 1970 (8.3 percent). Moreover, Tennessee taxes as a share of personal income remains low relative to both the US average and the average for surrounding Southeastern states.

We hope that this guide has helped you gain a better understanding of Tennessee's budget. Please feel free to send us your comments on this guide, or suggestions for other reports you would like to see. We can be reached at:

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Further Reading

For further reading on the topics of budgeting and government finance, see these:

Budgeting:

State Finance:
- State Taxpayers’ Budget, Tennessee Department of Finance and Administration, February 2002.
- The Budget, Tennessee Department of Finance and Administration, February 2001.

Local Government Finance:
The TACIR reports are available on the Internet at www.state.tn.us/tacir. Many of the other state reports are available online. You can get to the agency web pages from the state’s main web page at www.tennesseanytime.org.
Appendix 1

Budget Glossary

-A-

Agency - Any department, commission, board, authority, government-owned corporation, or other independent governmental entity.

Agency Funds - Funds collected by the various agencies of state government and retained to be spent on agency programs. These funds are estimated in the Governor’s Budget and the Appropriation Bills.

Allotment - Expenditure authority granted to state agencies by the General Assembly.

Allotment Code - The five-digit number used to designate a program or programs for budgeting and accounting purposes.

Appropriation - The amount authorized from all revenue sources by the General Assembly to support agencies’ spending allotments.

Appropriations Bill - Annual legislation authorizing the allocation and expenditure of funds for a two-year period, the year of bill passage and the subsequent year. The Appropriations Bill also sets some policies, assigns certain responsibilities, and at times specifies legislative intent on certain issues.

Authorized Positions - The maximum number of positions an agency may establish at any given time. Authorized positions must receive legislative approval by legislation or expansion.

-B-

Budget Request - The annual spending and revenue plan submitted by each agency for review by the Department of Finance and Administration, the State Comptroller, and the General Assembly.

-C-

Capital Budget - The portion of the budget devoted to proposed additions or maintenance to capital assets, and the means of financing them.

Capital Maintenance - Major routine repairs and replacements unrelated to new construction. Expenditures of this type have a cost of $100,000 or more.

Capital Outlay - Expenditures which result in the acquisition of or addition to major fixed assets (e.g., land, buildings, and equipment related to construction).
**Capital Projects Fund** - The fund used to account for financial resources related to the acquisition, construction, or maintenance of major capital facilities.

**Carry Forward** - Depending on the language of the Appropriation Bill, these are unspent agency funds that were allotted to a prior fiscal year that are brought forward for re-appropriation to the agency again for the next fiscal year.

**Current Services Revenue** - Program funds generated by a specific activity to support that activity. This includes fees and assessments, gifts, and interest from reserves or endowments (e.g., licenses, permit and certificate fees, and inspection fees).

**Debt Service** - Expenses for principal, interest, and discounts on bonds and other types of borrowed money.

**Debt Service Fund** - The fund of revenue which must be set aside to provide for all principal and interest payments on borrowed funds, i.e. notes and bonds.

**Discretionary Spending** - Spending on programs that the General Assembly can choose whether to fund in the annual Appropriations Bill, in contrast to entitlement programs for which funding is mandatory.

**Earmarked Revenue** - Funds that are legislatively limited in how they can be spent.

**Expansion** - An additional component of a budget that includes programs or purposes not previously funded by the General Assembly (for example, new programs, additional positions, or expansion of existing programs beyond the scope for which they were initially authorized).

**Expenditure** - Decrease in net financial resources for the purpose of acquiring goods or services.

**Facilities Revolving Fund** - A self-perpetuating fund for the maintenance and renovation of state-owned buildings and the leasing of office space.

**Fiscal Year** - A 12-month accounting period; in Tennessee, the fiscal year is July 1 through June 30.

**Fund** - A separate accounting entity to which government resources are allocated based upon the purposes for which they are to be spent.
GASB - Governmental Accounting Standards Board. GASB was organized in 1984 by the Financial Accounting Foundation (FAF) to establish standards of financial accounting and reporting for state and local governmental entities. Its standards guide the preparation of external financial reports of those entities.

General Fund - The fund maintained by the State Treasurer into which revenues collected by the state, other than those required to go into special revenue funds, are deposited to support appropriations made by the General Assembly for the operation of state agencies.

Improvements - Increases in departmental budget requests needed to implement mandated requirements, compensate for revenue reductions, initiate new programs, or enhance a current level of service.

Infrastructure - Structures and equipment owned by states and localities. This includes highways, bridges, buildings, mass transit systems, and public utilities such as water, sewer, or power systems.

Inter-Departmental Revenue - Revenue received by one entity of state government from another entity of state government. These funds represent the purchase of services by one agency from another.

Legislative Budget Office - An office within the Legislative Branch that serves as budget advisor to the General Assembly.

Lump Sum - A single appropriation for a specific purpose that does not specify a breakdown by object code classification.

Non-Recurring Funds - Funds that are appropriated from accumulated reserve balances, or revenues that occur only one time or without a pattern.

Non-Discretionary Spending - Spending that is not optional, such as items specified by the state’s constitution, court ordered expenditures, federally mandated programs, and expenditures for entitlement programs for which funding is mandatory.
Appendix 1

Object Code Classification - A breakdown of allotments and expenditures according to the types of services, articles, or other items involved (e.g., personal services, supplies and materials, and equipment), as distinguished by the purpose for which such obligations are incurred.

Operating Budget - A plan of annual expenditures detailed in the Appropriations Bill as necessary to fund a program. Operating budgets include such expenses as salaries, travel, equipment, and contracted services but exclude the cost of capital construction.

Other Revenue - A collection of funding sources, excluding state appropriations and federal funds. These funding sources are generally from local governments, current services, and inter-departmental activities.

Over-A appropriation - The anticipated savings or reversion resulting from position vacancies and other unexpended funds.

Pay-As-You-Go - A term used to describe the financial policy of a government which finances all of its capital outlays from current revenues rather than by borrowing. A government which pays for some improvements from current revenues and others by borrowing is said to be on a partial or modified pay-as-you-go basis.

Pay-As-You-Use - A term used to describe the financial policy of a governmental unit which borrows to pay for its capital needs. Pay-as-you-use allocates costs among the users of each "generation."

Performance Budgeting - is similar to program budgeting. Performance budgets are constructed by program but focus on program goals and objectives; measured by short-term outputs, projected longer-term outcomes, and cost/benefits analysis. Appropriations are not only linked with programs, but also with expected results specified by performance criteria.

Principal - The par value or face value of a bond, note, or other fixed amount security. It excludes accrued interest.

Program - Any of the major activities of an agency expressed as a primary function.

Program Budgeting - Budgets are formulated and appropriations are made on the basis of expected results of services to be carried out by programs. The focus on outcomes is usually over multiple years.
Rainy Day Fund - Also referred to as the Revenue Fluctuation Reserve Fund. A fund established to ensure stability in the event of an extended economic downturn that is set aside in the General Fund.

Recurring Funds - Funds that are appropriated on an ongoing basis and are used for repeated expenses.

Request for Proposal (RFP) - An announcement, often by a government agency, of a willingness to consider proposals for the performance of a special project or program component. A request for proposals is often issued when proposals for specific research projects are being sought.

Revenue - Governmental income used for public purposes.

Revenue Estimate - An estimate of revenues that will be collected by the state during a fiscal year that will be available for appropriation. These revenues include taxes, licenses and fees, sales, and other general revenues that flow into the state treasury and become available for expenditure as approved by the General Assembly. An official estimate is adopted and amended by the Governor in making budget recommendations to the General Assembly.

Reversion - The return of an agency’s unused portion of an allotment to the fund from which the allotment was made.

Revision - A change in an appropriation to an allotment code made during the fiscal year. Funds are transferred either from one department to another, one allotment code to another, or one object code to another.

Special Revenue Funds - Funds used to account for specific revenues earmarked to finance particular or restricted programs and activities. For example, funds earmarked for the Department of Transportation and funds for the Wildlife Resources Agency.

Supplemental Appropriation - Additional appropriations to the original allotment authorized by the General Assembly, made after the beginning of the fiscal year.

Tax-Exempt Bonds - Bonds where the interest is exempt from federal income taxes under Section 103 of the Internal Revenue Code of the United States or other federal legislation.
**Term (of Bond Issue)** - The number of years for which bonds are issued. Usually related to the number of years from date of issue to date of final maturity.

**User Fees** - Charges associated with using a particular service provided by state government to its citizens. The charge generally recovers the cost of providing the service. Examples include state park services and driver’s licenses.

**Veto** - An action by the Governor that rejects an entire Appropriations Bill, or an individual appropriation through a line-item veto.

Glossary Sources:  
- Tennessee Office of the Governor, *The Budget, and FY 2001-2002*  
- National Association of State Budget Officers  
- New York State Division of Budget  
- Georgia State Office of Planning and Budget
Appendix 2

Budget Funds

Fund Categories
As it is collected, Tennessee’s revenue is deposited into one of several funds. Tennessee’s funds are divided into three fund categories:

1. governmental funds,
2. proprietary funds, and
3. fiduciary funds.

Governmental Funds

Governmental funds are the main funds used to account for the financial transactions required to operate state government. There are four governmental fund types:

1. General Fund. The General Fund is used to account for all financial transactions not required to be accounted for in other funds.

2. Special Revenue Fund. Funds used to account for specific revenues earmarked to finance specific programs and activities. For example, funds earmarked for the Department of Transportation and funds for the Wildlife Resources Agency.

3. Debt Service Fund. This is the fund used to account for the payment of principal and interest on general short and long-term debt.

4. Capital Projects Fund. Used to account for the acquisition or construction of all major governmental capital facilities.

For ease of presentation and understanding in The Budget, the state includes all special revenue funds in the General Fund except for the Highway Fund. A major special revenue fund whose programs are rolled into the General Fund in The Budget is the Education Trust Fund. However, the tax revenue estimates for the Education Trust Fund are shown separately. Comparing these estimates to the expenditures for education demonstrates that the taxes earmarked and apportioned to the Education Trust Fund are less than the education appropriations and that additional general tax revenue is necessary to help pay for education programs.

Specific information on each of the special revenue funds that The Budget rolls into the General Fund can be found in the state’s Comprehensive Annual Financial Report (CAFR) prepared annually by the Department of Finance and Administration’s Division of Accounts.

Fiduciary Funds

Fiduciary funds include trust and agency funds that are used to account for assets that the state holds in a trust or agency capacity. Because they are not spent as part of the operating budget, they are not reflected in The Budget. However, information about these funds can also be found in the CAFR.
Appendix 2

Proprietary Funds
Proprietary funds include:

1. **Enterprise Funds.** Funds used to account for the operations of self-sustaining state agencies providing goods or services to the general public on a user-charge basis.

2. **Internal Service Funds.** Funds used to account for the operation of self-sustaining state agencies providing goods or services to other state agencies on a cost reimbursement basis.

Revenue and expenditure information for these funds are also included in the General Fund program for reporting purposes in *The Budget.*
Capital Budgets

The capital budget is a spending plan for the acquisition, construction, or improvement of facilities, lands, equipment, or other infrastructure (prisons, college buildings, etc.). It is a distinct spending plan that complements the operating budget. The focus of the capital budget tends to be longer term—both with respect to the type of facility or investment involved and with respect to the method of financing that may be employed. Capital budgets typically embrace the following:

- New construction
- Major renovation
- Reconstruction and capital maintenance
- Land acquisition
- Site improvements

Capital projects typically include the total cost of making a facility operational, including necessary initial equipment and furnishings, landscaping, utilities, parking, and roadwork.

The capital budget begins with the receipt of departmental and agency capital maintenance and project requests. The various agencies and departments submit their capital requests in priority order to the Division of Budget. After capital budget requests are submitted, the Division of Budget and the Division of Capital Projects and Real Property Management form review teams that assist in prioritizing specific capital projects. Both of these divisions are a part of the Department of Finance and Administration.

The review teams first look at the technical requirements of the capital request. This may require an on-site visit by the review team to ensure accuracy. The review teams finally analyze the funding requirements and the degree of consistency that each project has with the program goals as defined in the agency’s operating budget. If funding is not available for a particular project request, an agency may resubmit that capital project request for a future fiscal year.

Agencies request individual projects to help accomplish their mission and state decision makers decide on the most appropriate funding source for the projects. Funding for capital budgets is by and large a choice between using current operating revenues or proceeds from the issuance of debt. Obviously, the level of available current operating funds (whether from general revenues, fees, restricted accounts, etc.) and the levels of previously incurred debt affect these decisions.
1 John Mikesell, Fiscal Administration: Analysis and Applications for the Public Sector, 5th ed. (Fort Worth, Harcourt Brace College Publishers, 1999), and p. 30.

2 Unless otherwise referenced, the source for all technical information in this guide is The Budget, February 20, 2001.

3 Tennessee General Assembly, Senate and House Finance, Ways and Means Committees, Fact Book, November 1, 2001, p. 3.

4 The Rainy Day Fund isn’t actually an accounting fund, but rather an account within the General Fund.

5 TCA 9-4-211.

6 Gerald Adams, Deputy Commissioner, Tennessee Department of Finance and Administration.

7 State Constitution, Art. II, § 24 and TCA 4-3-1006

8 TCA 9-4-51.

9 New Governors do not have to present their recommended budget until March.

10 TCA 9-4-5106.

11 TCA 9-4-5106, 9-4-5108 and 9-4-5203

12 TCA 9-4-5106.

13 TCA 9-1-116.

14 TCA 9-9-113(a).


16 Department of Finance and Administration, Division of Budget.

17 Tennessee Department of Transportation FY 2001-2002 Work Program.

18 Tennessee Department of Transportation website at http://www.tdot.state.tn.us.

19 Tennessee Department of Transportation.
20 Inflation affect calculated using the US Bureau of Labor Statistics’ Consumer Price Index. Using a price index that specifically measures changes in the prices of government goods and services may or may not be an improvement over using the broader consumer price index. See Michael Shires, John Ellwood, and Mary Srague, Has Proposition 13 Delivered? The Changing Tax Burden in California, Public Policy Institute of California, 1998, page 55.


22 Ibid.

23 K-12 Education and Higher Education adjusted using enrollment rather than state population; corrections adjusted using inmate population. These programs were adjusted using more specific populations whose growth has a bigger impact on service demand than does the general population growth.

24 From a high of 80.6% in Delaware to a low of 44.7% in New York. Source: U.S. Census: “State and Local Government Finances, 1998-99 Estimates.”

25 Alternated between 50th and 51st depending on whether based on per capita calculations or as a % of personal income. Source: U.S. Census, “State and Local Government Finances, 1998-99 estimates.”

26 Data for Table 1 obtained from Tax Foundation website at www.taxfoundation.org.


28 Excludes Missouri.

29 Source: Texas Comptroller of Public Accounts website and Georgia Public Policy Foundation website (for estimated 2000 data).

30 In an annual publication on tax rates and tax burdens, Tennessee (Memphis) has consistently been ranked as having one of the most regressive tax systems in the country. Source: “Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison,” an annual publication of the Government of the District of Columbia.

31 Census data also shows that a significant change in the distribution of households, by type, over the period.
TACIR Members

Senator Robert Rochelle, Chairman
Truman Clark, Vice Chairman
Harry A. Green, Executive Director

Legislative
Senator Ward Crutchfield
Senator Tommy Haun
Senator Mark Norris
Senator Robert Rochelle
Rep. Jere Hargrove
Rep. Steve McDaniel
Rep. Randy Rinks
Rep. Larry Turner

Statutory
Rep. Matthew Kisber, Finance Ways and Means Committee
Senator Douglas Henry, Finance Ways and Means Committee
Comptroller John Morgan

Executive Branch
Lana Ball, Office of the Governor
Commissioner Ruth Johnson, Revenue

Municipal
Victor Ashe, Mayor of Knoxville
Mary Jo Dozier, Councilwoman of Clarksville
Sharon Goldsworthy, Mayor of Germantown
Tom Rowland, Mayor of Cleveland

County
Nancy Allen, Rutherford County Executive
Truman Clark, Carter County Executive
Jeff Huffman, Tipton County Executive
Jim Rout, Shelby County Mayor

Private Citizens
David Coffey, Oak Ridge
Thomas Varlan, Knoxville

Other Local Officials
Judy Medearis, County Officials Assn. of Tn
Maynard Pate, TN Development Dist. Assn.