

Legislative Orientation Presentation

December 7, 2010

- I. Introduction
 - A. Welcome
 - B. Introduce Legislative Fiscal Office (LFO) staff-16 members
 - 1. Non-partisan staff
 - 2. Fiscal notes on bills introduced
 - 3. Analyst for the budget and revenue committees
 - 4. Draft budgets for the legislative committees
 - 5. Research for individual legislators
 - C. Encourage members to arrange for a private or group discussions with LFO about state budgets or the budget process prior to the Regular Session
 - D. Discuss information available on the LFO website
 - 1. Budget Fact Book
 - a. it is designed to give you information about major state agencies that you can use for quick reference for speeches or meetings
 - b. for example, the information provided to you about the Department of Senior Services includes
 - i. the number of senior citizens served by the Department
 - ii. the number of meals served and the number of meals delivered to senior citizens
 - iii. the number of persons served under the SenioRx program (which is a donated prescription drug program for seniors)

- iv. the number of prescriptions submitted and the savings to seniors under the SenioRx program
- c. the Budget Fact Book also contains general information such as
 - i. outstanding debt service of the state of Alabama
 - ii. a history of salary increases for teachers and state employees
 - iii. a history of proration in the Education Trust Fund (ETF) and the State General Fund (SGF) and
 - iv. state employees' and teachers' health insurance and retirement costs and rates

2. Tax Guide

- a. The Tax Guide contains information on most state revenue sources including
 - i. the statutory or constitutional authority for the tax or fee
 - ii. the tax base
 - iii. the tax rate
 - iv. a recent history of collections
 - v. major exemptions from the tax
 - vi. the distribution of the tax
 - vii. a legislative history of the tax
 - viii. and a comparison of any comparable tax in Florida, Georgia, Mississippi, and Tennessee for most taxes/fees

3. other information on the LFO website includes
 - a. ETF and SGF comparison spreadsheets
 - b. K-12 and higher education handbooks
 - c. American Recovery and Reinvestment Act (ARRA) data and
 - d. a copy of my outline and the exhibits in this presentation will be available on the website this afternoon
- E. My presentation today will be general in nature
 1. I will not talk about agency-specific information and I will not give official revenue estimates for FY 2011 and FY 2012 until budget hearings early in 2011
 2. However, I will give you our latest projections for FY 2011 for both the State General Fund and the Education Trust Fund

II. Budget Process

- A. Because we have so many new members of the Legislature, I would like to highlight a few points about the budget process
- B. Exhibit 1 gives you a general timeline of Alabama's budget process
- C. Most agencies have already submitted budget requests for FY 2012 to the Executive Budget Office and to our office
 1. LFO analysts are already reviewing the budgets submitted by agencies in each analyst's area of expertise
- D. The Permanent Joint Legislative Committee on Finances and Budgets is required by statute to hold budget hearings

before the Regular Session and to report its findings and recommendations to the Legislature by the 7th legislative day of the Regular Session

1. The form and substance of budget hearings vary greatly based on the year and the interest of Committee members
- E. The Governor is required by the Constitution to present his budget recommendations to the Legislature by the 2nd legislative day of the Regular Session
- F. At that point, the Education Trust Fund budget and the State General Fund budget are treated as other bills and go through the committee process in both houses of the Legislature and are passed in both chambers
- G. Amendment 448 of the Alabama Constitution provides that it is the paramount duty of the Legislature to pass appropriation bills and no other bill shall be signed and transmitted to the other chamber until the basic appropriation bills are presented to the Governor
1. Unless the Chamber by a vote of 3/5 of a quorum present adopts a Budget Isolation Resolution (BIR) exempting a particular bill from the provisions of the Amendment
- H. Like other bills, if the House and Senate pass differing versions of appropriation bills, those budget bills go to a Conference Committee to address the differences
- I. When the appropriation bills go to the Governor, he can
1. Sign them
 2. Veto them

3. Send them back to the Legislature with an executive amendment-these 3 options are available to the Governor for all bills
4. The Governor has an option to line-item veto certain items in an appropriation bill and send only those items back to the Legislature for action without jeopardizing the remainder of the appropriation bill

III. Revenue and Appropriation Structure of the State

- A. Alabama, unlike most states, has two state appropriation bills
 1. The General appropriation bill (referred to as the State General Fund) and
 2. The Education Trust Fund
 3. Both of which contain appropriations of other earmarked state funds and federal funds (referred to as middle column appropriations)
- B. Alabama earmarks more of its state revenue than other states – for FY 2011 less than 16% of state funds appropriated were unearmarked
 1. according to the latest National Conference of State Legislatures' study
 - a. Alabama earmarked 84% of its receipts
 - b. the national average for earmarking was 24%
 - c. the highest state for earmarking next to Alabama was Michigan at 63%
 2. earmarking can be general or specific
 - a. sales taxes are earmarked for educational purposes

- b. gasoline taxes are earmarked for construction and maintenance of roads and bridges and traffic safety
 - 3. earmarking can be statutory or constitutional
 - a. sales taxes are earmarked by statute
 - b. income, ad valorem and gasoline taxes are earmarked by the state Constitution
- C. Exhibit 2 shows the appropriation of all state funds for FY 2011 based on appropriations made during the 2010 Regular Session
 - 1. the General Fund accounted for nearly \$1.6 billion
 - 2. the Education Trust Fund (ETF) accounted for \$5.5 billion
 - 3. all other state funds accounted for \$2.9 billion
 - 4. for a total of almost \$10 billion in state funds
 - 5. I will not talk about many of the numbers on this chart, you can review that data at your convenience
 - 6. But I do want to point out a couple of issues involving certain agencies
 - a. Medicaid is the largest consumer of General Fund dollars at \$345 million and FY 2011 is a lower than usual amount because of federal stimulus funds that I will talk about in more detail later
 - i. If you follow the chart for Medicaid, you can see that the agency is also appropriated a large number of other state funds (this number includes provider taxes and other departmental receipts) for a total of over \$1

billion in total state funds that are used to match federal dollars (not included in this number are intergovernmental transfers from other agencies totaling approximately \$330 million)

ii. In a non-stimulus year, every state dollar brings in over \$2 in federal funds-in FY 2011 every state dollar is drawing down more than \$3 in federal dollars

iii. Medicaid provides medical benefits for Medicaid recipients in the state and

iv. Medicaid is a large economic engine in your local communities providing payments to doctors, pharmacists, hospitals and nursing home providers throughout Alabama

b. The Department of Corrections is the second largest consumer of General Fund appropriations

i. Corrections and Medicaid together account for almost 50% of the General Fund

ii. If a person qualifies for Medicaid services, the state has to provide those services

iii. If a convicted felon is sentenced to state prison, the Department of Corrections is obligated to provide a bed and medical services for him or her

D. Sources of Revenue to the General Fund

1. Exhibit 3 is a pie chart showing the major sources of revenue to the General Fund for FY 2010

- a. the largest source was insurance premium tax receipts at 15.9%
 - b. the second largest source was one-time receipts at 11.3% (this includes the \$161.5 million from the Rainy Day Account that I will discuss further)- that creates a problem when one-time revenues are used for continuing expenses
 - c. interest income accounted for only 6.2% whereas in some years it is the major revenue source to the General Fund (averaging 13% of receipts annually for FY 2006 through FY 2009)
 - i. the General Fund receives interest income from regular state deposits and from interest earned on Alabama Trust Fund assets (which is composed of lease payments and royalties from offshore oil and gas wells)
 - ii. interest rates have been at historic lows and the balances available to be invested have been significantly reduced
 - d. You can see the other major sources of revenue and their percentages
- E. Sources of Revenue to the Education Trust Fund (ETF)
- 1. Exhibit 4 shows the sources of revenue to the ETF in FY 2010
 - a. the largest revenue source was individual and corporate income taxes which accounted for 55.6%

- b. sales taxes accounted for 29.8%
- c. utility taxes accounted for 8.1%
- d. use taxes accounted for 4.6% (use taxes are sales taxes paid on goods bought out-of-state and brought into Alabama)
- e. other revenue sources accounted for less than 2%
- f. you can readily see that there are far fewer tax sources in the ETF than in the General Fund; but the taxes that respond more rapidly to changes in the economy are earmarked for the ETF – that is good for the ETF in good economic times but not during recessions

IV. State of the Economy

- A. In December, 2007, the nation began the longest and most severe economic downturn since the Great Depression
- B. National unemployment
 - 1. Highest level in October, 2009 at 10.1%
 - 2. November rate is 9.8%
- C. Alabama's unemployment
 - 1. Highest level in January and February of 2010 at 11.1%
 - 2. October rate is 8.9%
- D. 3 state indicators of the severity of the Great Recession
 - 1. Medicaid enrollment increased by more than 59,000 in FY 2010
 - 2. Unemployment compensation claims increased by over 213,000 in FY 2009 (a 77.3% increase over FY 2008)-however, some good news is that

unemployment claims decreased by over 135,000 in FY 2010 (a 27.6% decrease from FY 2009 claims)

3. Food stamp issuances increased 46% in FY 2009 and an additional 26% in FY 2010
- E. The next 2 exhibits illustrate the effect of the Great Recession on state income and sales taxes in FY 2009
1. Exhibit 5 shows the annual percentage change in gross income tax receipts since 1971
 - a. In FY 2009, gross income tax receipts declined by 7.9%
 - b. There has been negative growth only 4 times since 1970 including FY 2009 and FY 2010
 - c. The largest decline before FY 2009 was a negative 1.8% in 1982
 2. Exhibit 6 shows the annual percentage change in gross sales tax receipts since 1965
 - a. In FY 2009, gross sales tax receipts declined by 9.9%
 - b. Sales tax receipts have shown negative growth only 4 times since its inception in 1937
 - c. Since 1965, sales tax receipts declined only once (in 2001) with a negative growth rate of 1.1%
 - d. When our office revised our estimates for FY 2009, we estimated a 4% decline and I thought that was very conservative based on this history; a decline of almost 10% illustrated the extent and severity of this recession

3. The questions that LFO will have to address as we make revised estimates for FY 2011 and estimates for FY 2012 are
 - a. Are we at the bottom of the recession and
 - b. How quickly and to what extent will this economy recover?
- V. Condition of the Education Trust Fund for FY 2008 and FY 2009
 - A. In order to give you an overview of where we are with the current budgets, I need to show you what has happened with the budgets over the last four years
 - B. I do not want to go into great detail today, we will do that at budget hearings, so I will try to give you a summary
 - C. Exhibit 7 shows the condition of the Education Trust Fund (ETF) for FY 2008 and FY 2009
 - D. We began to see the beginning of the recession even before the start of FY 2008
 - E. This chart shows a beginning balance of \$280 million but that was less than projected to be available for FY 2008
 - F. The ETF received almost \$6 billion in regular revenue in FY 2008- this was the largest amount of regular receipts to the ETF ever
 - G. However, expenditures for FY 2008 were \$6.7 billion
 - H. The Legislature had saved \$439 million over the previous 3 years of growth-this was accomplished by 2 methods
 1. The Legislature included language in the budgets that 75% of any unanticipated and unappropriated beginning balance would automatically be transferred to the Statutory Proration Prevention Account and

2. The Legislature appropriated a total of \$34 million over two years directly into the Account
 3. We had hoped that the \$439 million would be a hedge for several years against proration when the inevitable downturn occurred
 4. As it happened, the entire amount was needed to avoid proration in FY 2008
 5. However, it did allow educational entities one year to prepare for budget reductions
- I. The Statutory Proration Prevention Account allowed the ETF to avoid proration of more than 7% in FY 2008
 - J. For FY 2009, the Legislature reduced appropriations at the beginning of the budget cycle but it was not nearly enough
 - K. There was a reduction in receipts of over \$730 million
 - L. The voters ratified a Constitutional Amendment that reserved within the Alabama Trust Fund (the state's offshore oil and gas account) 6.5% of the previous year's appropriations from the ETF to be used to offset proration
 - M. That amount was \$437.5 million that was accessed in FY 2009 to mitigate the effects of proration
 - N. This money is required by the Constitution to be repaid within 6 years (none of which has been repaid as of yet)
 - O. In spite of the availability of the Rainy Day Account, the ETF appropriations were still prorated 11% (without the \$437.5 million, proration would have been 18%)
- VI. Condition of the Education Trust Fund for FY 2010 and FY 2011**
- A. Exhibit 8 shows the actual condition of the ETF for FY 2010 and the projected condition for FY 2011

- A. Receipts continued to decline in FY 2010 more than expected
- B. LFO missed our projections by \$156.5 million (all attributed to income tax receipts)
- C. Appropriations were prorated by 9.5% for FY 2010
- D. Expenditures from the ETF from FY 2008 through FY 2010 declined by almost \$1.5 billion
- E. LFO has made a preliminary revision of our estimates for FY 2011-we will make official estimates for FY 2011 and FY 2012 before budget hearings
- F. The FY 2011 appropriations are \$77.5 million higher than LFO original estimates
- G. Based on this office's preliminary revisions to FY 2011 estimates, the ETF receipts will be \$125.6 million short of funding current appropriations
- H. At this point, that would necessitate proration of 2.3% in the current fiscal year
- I. Revenue would need to grow 4.2% in order to fully fund FY 2011 appropriations
- J. Are we at the bottom of the Great Recession?
 - 1. A good sign-we have seen 9 consecutive months of growth in gross sales tax receipts (low growth but nevertheless growth)
 - 2. A bad sign-gross income tax receipts (which make up more than 50% of the ETF) are still negative-although the decline in withholdings have moderated

VII. Effect of Federal Stimulus Funds in the Education Trust Fund

- A. Congress passed the American Recovery and Reinvestment Act (ARRA) in February, 2009 that provided stimulus funds to states in a variety of ways
1. I want you to think about ARRA funds in two ways
 - a. First, Alabama is expected to receive a total of \$3.2 billion, much of which is for the expansion of existing programs such as clean water, highways, energy programs, etc.
 - b. Secondly, some of the ARRA funds that Alabama did and continues to receive are flexible and can be used to supplant and supplement General Fund and ETF appropriations
 - c. Exhibit 9 summarizes the flexible ARRA funds that Alabama has received and will receive for educational purposes
 2. Alabama received \$596 million from the State Fiscal Stabilization Fund (SFSF) to be used for education
 - a. The decision was made by Governor Riley to split those funds and appropriate $\frac{1}{2}$ in FY 2010 and $\frac{1}{2}$ in FY 2011 (\$298 million each year)
 - b. Fiscal Stabilization funds were flexible and could be used to supplant ETF revenues
 3. Alabama also received \$407 million for K-12 Title 1 and special education programs
 - a. Those funds were also divided between the two fiscal years and were expended by the local school systems to retain personnel (\$203.5 million each year)

4. I told you earlier that expenditures from the ETF were about \$1.5 billion less from FY 2008 to FY 2010
5. ARRA funds totaling \$1 billion were appropriated in FY 2010 and FY 2011 to alleviate some of those reductions

B. Education JOBS Act-Exhibit 10

1. Congress passed a \$10 billion Education Jobs Fund (EJF) in August of this year
2. Alabama's share of that Fund is approximately \$150 million
3. The Governor must make those funds available to the local school systems in the 2010-2011 school year but the schools have until September 30, 2012 to expend those funds
4. The funds must be used for compensation, benefits and other necessary expenses to retain existing employees, to rehire former employees or to hire new employees
5. School systems will receive \$3,079 per state-funded teacher unit

VIII. Funding Shortfall in the Education Trust Fund in FY 2012

- A. The loss of federal stimulus funds and the federal JOBS fund (if local systems spend all of their JOBS funds in FY 2011) would mean that the ETF agencies would be \$650 million short of maintaining current expenditures in FY 2012
- B. Other issues to consider for FY 2012 include
 1. Repayment of the Rainy Day Account- \$437.5 million owed with 4 years left to repay

2. Replacement of \$65 million in fleet renewal funds being paid from bond proceeds for FY 2010 and FY 2011 and
3. Increased cost of retirement and health insurance benefits for teachers and support employees

IX. Condition of the General Fund for FY 2008 and FY 2009

- A. As I did with the ETF, I want to show you a four-year overview of the General Fund
- B. Exhibit 11 shows the actual condition of the General Fund in FY 2008 and FY 2009
- C. FY 2008 and FY 2009 both started the year with a beginning balance, however, a great portion of those balances were made up of one-time receipts
- D. The Governor and Legislature recognized that the State General Fund would be facing a funding cliff in the near future but several things occurred to postpone this problem
 1. The Governor asked agencies to save 10% of their appropriations in FY 2009; he instituted a hiring freeze; and froze merit raises
 2. The Legislature added language in the State General Fund and ETF budgets allowing any funds reverted at the end of the fiscal year to be reappropriated to each agency in order for agency directors to develop a multi-year budget plan
 3. Congress enacted the American Recovery and Reinvestment Act and we began seeing its effect in FY 2009

- E. The Legislature passed a bill to reduce General Fund appropriations to Medicaid and other state agencies that provide Medicaid services by a total of \$225.4 million for FY 2009 as the result of the enhanced federal Medicaid match provided for in the federal act
 - 1. Basically, this meant that for a period of time states would have to put up less state funds in order to draw down the same amount of federal funds
 - 2. For example, before ARRA Alabama received approximately \$2.13 in federal funds for every \$1 in state funds
 - 3. After the original ARRA, Alabama received approximately \$3.47 for every \$1 in state funds
 - 4. The original enhanced federal match was started retroactively to October 1, 2008 and was scheduled to expire on December 30, 2010
 - 5. Congress extended the time frame for the enhanced match to June 30, 2011 albeit at a reduced match for the final two quarters
- F. You can see that expenditures declined by \$118 million from the General Fund in FY 2009 from FY 2008 and the ending balance was less than half
- X. Condition of the General Fund for FY 2010 and FY 2011
 - A. Exhibit 12 shows the actual condition of the General Fund in FY 2010 and the projected condition of the General Fund in FY 2011
 - B. In FY 2010, the General Fund receipts continued to decline

- C. The Governor declared proration of 12% which he increased to 20% at the end of the year
- D. The same Constitutional Amendment that revised the ETF Rainy Day Account created a General Fund Rainy Day Account
 - 1. The Governor can access 10% of the previous year's General Fund appropriations in the event of proration, and the amount accessed must be repaid within 10 years
 - 2. The Governor withdrew \$161.6 million from the Account to reduce proration from 20% to 10%
- E. FY 2010 receipts to the General Fund came in \$76 million less than LFO estimates
 - 1. From FY 2008 to FY 2010, receipts to the General Fund declined by \$386 million (21.3%)
- F. The FY 2011 General Fund budget was based on General Fund revenue that was \$130 million higher than LFO original estimates but even FY 2010 receipts came in lower than LFO estimates which does not bode well for FY 2011 receipts
- G. The FY 2011 General Fund budget was also based on the expectation of the federal enhanced match being extended in full through June 30, 2011 (an additional \$197 million)
- H. Therefore, based on LFO preliminary revised estimates for FY 2011, the General Fund will be \$126 million short of funding current appropriations which will result in proration of 8.5% if the same items that were prorated in FY 2010 are prorated in FY 2011

XI. Effect of Federal Stimulus on the General Fund

- A. I have talked about the fiscal stabilization funds and how some of those funds were used to supplant ETF appropriations-there were also fiscal stabilization funds and federal stimulus funds available for non-educational appropriations
- B. Exhibit 13 shows the effect of the federal stimulus funds on General Fund appropriations over a three-year period
- C. Alabama's share of the fiscal stabilization funds was \$133 million
 - 1. The Legislature appropriated those funds in FY 2010
 - 2. The Department of Corrections received \$118.6 million and
 - 3. The Departmental Emergency Fund received the remaining \$14.1 million
- D. I have explained the enhanced federal match for Medicaid
 - 1. Exhibit 13 also shows how federal stimulus funds and state fiscal stabilization funds offset General Fund appropriations by fiscal year
 - 2. There were no stimulus funds in FY 2008 when the General Fund appropriations were \$1.8 billion
 - 3. In FY 2009, General Fund appropriations were reduced to \$1.7 billion but Alabama had the infusion of \$354 million in enhanced federal matching funds to bring total spending to \$2.1 billion
 - 4. In FY 2010, General Fund appropriations were reduced further to \$1.5 billion but total federal stimulus funds of \$527.6 million brought appropriations back up to \$2 billion

5. In FY 2011, Congress extended the enhanced Federal match from December 30, 2010 (when it was scheduled to expire) to June 30, 2011 but at a reduced match for the last 2 quarters
 - a. However, the General Fund budget for FY 2011 is based on receiving the full enhanced match through June
 - b. That means that although Alabama will receive \$235 million in the enhanced match for FY 2011 Medicaid will be \$65 million short in state funds because that federal match is lower than anticipated and total spending will be down \$94 million (including the State General Fund and stimulus funds) even if State General Fund revenues were to come in enough to fund current appropriations (which seems unlikely at this point)
- E. If a decision is made that Medicaid cannot absorb a reduction of \$65 million in state funds, that amount could be added to the LFO projected \$126 million deficit which would increase the projected proration to almost 12%
 1. This does not assume that Medicaid and the Department of Corrections would be protected from proration which was done in FY 2010
 2. If that were done again proration would be more than 25%

XII. Funding Shortfall for the General Fund for FY 2012

- A. Even if General Fund revenues come in sufficient to fund current appropriations (which LFO does not expect), the funding shortfall for FY 2012 is still dire
- B. Shortfall
 - 1. Alabama will lose \$235 million in federal enhanced Medicaid match unless extended by Congress
 - 2. Replacing one-time revenue sources of \$153 million
- C. Just those 2 items would necessitate a growth rate of 26.6% for FY 2012 over LFO preliminary estimates for the General Fund for FY 2011

XIII. Conclusion

- A. I know that I have given you a lot of information to absorb
- B. This outline and exhibits will be posted on the LFO web-site this afternoon
- C. I reiterate my encouragement to meet with staff of the LFO at your convenience individually or in groups for more in-depth discussions of the budgets and
- D. I thank you for your time and attention
- E. Questions