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State of Alabama Research Project: Fiscal Year 2006

The state of Alabama, also known as the “Heart of Dixie,” is the twenty-third largest state in the nation and is representative with respect to strong growth in the areas of manufacturing and higher education. Hurricane Katrina appears to have had little effect on Alabama’s recent expansion, perhaps because it lost little of its population to the disaster. The budget of the state may appear sound, if in need of balancing, but Alabama is currently facing a looming fiscal crisis. This paper provides an overview of the budgeting process and reveals the key drivers of the fiscal process in Alabama.

According to the United State Census, between 2000 and 2005, the population decreased by .1% (4,452 citizens), while a larger percentage of the population lived below the poverty level. It was estimated in 2006 that that the loss was regained, and overall the population had risen 3.3% since 2000¹. This small growth is comparable with its peer states (Arkansas and Mississippi) that also increased or decreased at a very small rate over this five-year period. While one might attribute this lack of growth to isolated regional events such as Hurricane Katrina, many states all over the nation had stagnant growth as well. 12.9% of the Alabama population is 65 years of age or older, which is near the national average at 12.1%. However, in Alabama, 20% of residents reported a disability to the state, as compared to 14.9% of the total population, and 13.7% of families fell below the poverty level (3.5 points higher than the nation as a whole). This demographic profile contributes to higher costs of social and medical assistance requested from the state.

Unemployment was reported, in Alabama’s Comprehensive Annual Financial Report (CAFR), as 3.6% (cited from the Bureau of Labor Statistics [BLS])^{2,3}. The national unemployment rate according to the BLS was 4.6% in 2006; Alabama had the twelfth lowest rate in the nation⁴ (Arkansas and Mississippi were both higher, at 4.7%⁵ and 7.8%⁶ respectively). There was a net positive change of 37,500 jobs in non-farm industries in the state in 2006, which is growth of 1.9%. The majority of job growth was in service-providing industries, such as education and

¹ U.S. Census Bureau. “Alabama Fact Sheet, 2005.”

http://factfinder.census.gov/servlet/ACSSAFFacts?_event=Search&geo_id=&_geoContext=&_street=&_county=&_cityTown=&_state=04000US01&_zip=&_lang=en&_sse=on&pctxt=fph&pgsl=010 (accessed 06/30/2007).

² State of Alabama Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2006.

<http://www.comptroller.state.al.us/pdfs/CAFR/2006CAFR.pdf> (accessed 06/30/2007).

³ Bureau of Labor Statistics. “Employment status of the civilian noninstitutional population, 1940 to date.”

<http://www.bls.gov/cps/cpsaat1.pdf> (accessed 06/30/2007).

⁴ Bureau of Labor Statistics. “Unemployment Rates for States Annual Average Rankings Year: 2006.”

<http://www.bls.gov/lau/lastrk06.htm> (accessed 06/30/2007).

⁵ Arkansas Comprehensive Annual Fiscal Report, Fiscal Year Ended June 30, 2006.

http://www.arkansas.gov/dfa/accounting/documents/2006_arkansas_cafir-web_version.pdf (accessed 07/02/2007).

⁶ Mississippi Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2006.

[https://www.mmrs.state.ms.us/Web_Archives/SAASWA.nsf/626e6035eadbb4cd85256499006b15a6/f574fe882911d4fb98625727c0057cfc1/\\$FILE/2006%20CAFR%20NET%20READY.pdf](https://www.mmrs.state.ms.us/Web_Archives/SAASWA.nsf/626e6035eadbb4cd85256499006b15a6/f574fe882911d4fb98625727c0057cfc1/$FILE/2006%20CAFR%20NET%20READY.pdf) (accessed 07/02/2007).

health services⁷. This growth was the highest in the region, with Arkansas only gaining 17,900 new jobs, and Mississippi with 2,400 (due to the huge affect of Hurricane Katrina on its residents).

Per capita personal income grew in 2005 by 5% (\$1,569) to \$29,623, still below the national average of \$34,495 (cited from the US Department of Commerce). Overall the Alabamian economy grew approximately 3.1% in 2006, but it is expected to slow for 2007 due to high energy costs and rising interest rates. Manufacturing, especially of motor vehicles, grew the most (5.3% and 16.5%, respectively)⁸. In comparison, Arkansas had a per capita personal income of \$28,722, and Mississippi \$24,497 for the same period.

While the economic growth was documented, another measure of fiscal growth was the state's bond rating. "Moody's Investor Services has raised the State of Alabama's general obligation debt rating to Aa2 from Aa3 as of August 26, 2005."⁹ The Aa rating is the second highest rating that can be received, and indicates that there is relatively little credit risk associated with the State's debts. Mississippi earned an Aa3¹⁰ from the same agency, and Arkansas an Aa2¹¹.

The state of Alabama runs on a fund accounting system, including six major operating funds: State General Fund (GF), Education Trust Fund (ETF), Public Road and Bridge Fund, Alabama Medicaid Fund, Mental Health Fund, and Public Welfare Trust Fund¹². The first two funds receive appropriations in their own bills, while funding for the latter four is split among various other bills. The GF covers the major operating expenses of all state branches and any programs not directly under one of the other funds (such as corrections and economic development). The GF collects most revenues for the state, such as "sin" taxes, consumption taxes, and interest from the "rainy day" Alabama Trust Fund. The ETF will be described more fully later.

The Executive Budget Office (EBO) is part of the Department of Finance, which is an agency under the executive branch of the Alabama government. All data collection from state agencies, projections, and formulation of a tentative budget are executed by the EBO and transmitted to the Office of the Governor for the preparation of the Executive Budget Document.

Budget reporting and request forms and instructions for preparation and submission are sent to all state agencies at the end of August, with formal budget requests due at the beginning of November. Before requests are handed in, the EBO holds budget hearings to collect testimony from agency heads regarding large changes in programming costs and capital projects. The

⁷ Bureau of Labor Statistics. "State and Area Employment, Hours, and Earnings: Alabama, 2006" (see attached).

⁸ State of Alabama Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2006. <http://www.comptroller.state.al.us/pdfs/CAFR/2006CAFR.pdf> (accessed 06/30/2007).

⁹ State of Alabama Report on the Bond Indebtedness, October 1, 2005 through September 30, 2006. <http://www.examiners.state.al.us/PDFs/Audit07-0326.pdf> (accessed 06/30/2007).

¹⁰ Mississippi Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006. [https://www.mmrs.state.ms.us/Web_Archives/SAASWA.nsf/626e6035eadbb4cd85256499006b15a6/f574fe882911d4fb98625727c0057cfc1/\\$FILE/2006%20CAFR%20NET%20READY.pdf](https://www.mmrs.state.ms.us/Web_Archives/SAASWA.nsf/626e6035eadbb4cd85256499006b15a6/f574fe882911d4fb98625727c0057cfc1/$FILE/2006%20CAFR%20NET%20READY.pdf) (accessed 07/06/2007).

¹¹ Arkansas Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2006. http://www.arkansas.gov/dfa/accounting/documents/2006_arkansas_cafr-web_version.pdf (accessed 07/06/2007).

¹² State of Alabama Executive Budget Office. "Operating Funds." <http://budget.state.al.us/opfunds.htm> (accessed 07/01/2007).

“three year period” system requires numbers for the previous year’s actual spending, the current year’s budget, and the future year’s requests. The Governor has final authority, and will estimate numbers for agencies that do not submit their budget documents in a timely manner; such agencies may be excluded from the Executive Budget Document (EBD).

The Office of the Governor creates the EBD, which “represents the Governor’s judgment and recommendations for meeting the revenue and expenditure needs of the state government as well as taking into consideration the needs of the citizens, court orders, and statutory mandates.” The EBD includes the Governor’s budget message, a fiscal overview of the state, a summary of the appropriation requests (along with the proposed appropriation bills), and the detailed requests for each state agency. As the Constitution of Alabama of 1901 requires the state to have a balanced budget, the Governor also suggests alternate or additional revenue sources, fund shifts, or service cuts to the legislature. Further, Constitution Amendment 26 disables the government from deficit spending¹³. The Governor’s budget is presented to the legislature on the first or second day of its regular session, usually in the beginning of February. The regular session ends in May, and, if the budget has not passed, the legislature goes into special session until all appropriations are approved and signed by the governor.¹⁴ This process leads the state into the budget controls set in place by law, and all end-of-year data are collected by the Comptroller’s office and published as a Comprehensive Annual Financial Report. The Government Finance Officers Association of the United States and Canada awarded a Certificate of Achievement the state of Alabama for Excellence in Financial Reporting for its 2006 budget, its eighth consecutive award from the organization.

The General Fund has been in crisis recently, but due to large agency cuts and fund transfers, at the end of fiscal year 2006 revenues were higher than expenditures by \$62 million dollars (with appropriations totaling \$11.2 billion¹⁵). The Comptroller reported net assets as exceeding liabilities by \$23.9 million dollars during the same time period. Bond repayments stayed steady with \$61 million dollars of general obligation bonds being issued. Revenues were reported at \$16.8 billion dollars, of which \$8.1 billion were general (tax) revenues (42% of state revenues for “all tax types”). Special appropriations during fiscal year 2005 increased by \$22 million, most of which went to emergency funding for the Department of Corrections and the Department of Mental Health¹⁶.

In 2005, Governor Riley reported in his “State of the State Address” that the deficit in the Education Trust Fund had turned around, and in 2006 he reported the highest surplus on record in the ETF^{17, 18}. His balanced budget plan for 2004-2006 cut government spending by half a

¹³ State of Alabama Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2006. <http://www.comptroller.state.al.us/pdfs/CAFR/2006CAFR.pdf> (accessed 06/30/2007).

¹⁴ State of Alabama Executive Budget Office. “The Budget Process.” <http://budget.state.al.us/budproc.htm> (accessed 07/01/2007).

¹⁵ State of Alabama General Fund, Fiscal Year 2005-2006 Appropriations. <http://www.budget.alabama.gov/GF2006.pdf> (accessed 06/29/2007)

¹⁶ State of Alabama Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2006. <http://www.comptroller.state.al.us/pdfs/CAFR/2006CAFR.pdf> (accessed 06/30/2007).

¹⁷ Riley, Bob. “Governor Riley’s State of the State Address.” February 1, 2005. http://www.alabamainteractive.org/alabamainteractive_shell/Welcome.do?url=http://governor.alabama.gov (accessed 07/01/2007).

billion dollars, even though critics of the state government found many agency programs minimal to begin with. Riley's fiscal year 2006 budget included no new taxes, as the citizenry had rejected his previous requests for revenue growth. He reported in 2006 that, due to the large economic growth yielding surplus revenue, his fiscal year 2007 budget proposed a tax cut, yet continued to fund education at a high level. Even though he stated in his Address that transferring ETF funds to the General Fund is not permissible by the Alabama Constitution, he did attempt to transfer some GF expenses to the ETF budget, in order to maintain balance¹⁹. Three major agencies mentioned in the 2006 Address were education, Medicaid, and, at a lower level, the Department of Corrections. Economic development and education were top priorities for Governor Barbour of Mississippi in 2006²⁰, while Governor Huckabee of Arkansas in 2005 focused on school facilities, roads and highways, and higher education²¹.

The Education Trust Fund (ETF) is a separate accounting fund in the state of Alabama that covers all educational and cultural resources at the public level. As reported above in Governor Riley's remarks, prior to 2003 the fund had been in serious deficit, requiring major adjustments to secure correction. According to the EBD, a "rainy day account" transfer from the Alabama Trust Fund of nearly \$180 million occurred in fiscal year 2003, leading to a large end-of-year balance of \$182 million in fiscal year 2004. The reserve balance in the beginning of fiscal year 2005 jumped from \$7.5 million to \$189 million²². This large positive shift was even more apparent when the end-of-year balance for fiscal year 2005 totaling nearly \$300 million. As taxes were not raised, where did this influx of funding come from? It appears that former governor Don Siegalman (1999-2003) issued many types of bonds, totaling over \$2.5 billion dollars during his service to the state. These bonds gave the ETF a large cash boost, helping it overcome its deficit. Governor Riley began to see the improvement when he came into office in 2004, and has been reporting that the surplus is a result of his oversight.

In response to the temporary surplus, and to increases in income and sales tax revenues due to economic growth, the Governor was able to expand educational programs, give a 5% raise to all teachers, and to pay back the 2003 "rainy day" fund transfer. Riley's promise to fully fund K-12 education is clearly visible: the local boards requested \$2.87 million dollars, Governor Riley's recommendations were slightly above at \$2.96 million dollars, and full appropriations for fiscal year 2006 totaled \$3.9 million dollars, 36.9% of the total Education Trust Fund appropriations for the same period²³. The surplus has been eyed by the Governor and by the legislators as a possible source of aid for the strapped General Fund. Health programs for children and other

¹⁸ Riley, Bob. "Governor Riley's State of the State Address." January 10, 2006.

http://www.alabamainteractive.org/alabamainteractive_shell/Welcome.do?url=http://governor.alabama.gov (accessed 07/01/2006).

¹⁹ McGrew, Jannell and Davis, John. "Education fund shuffle scrutinized." Montgomery Advisor, February 6, 2005.

²⁰ Barbour, Haley. "Mississippi State of the State Address 2006." <http://www.stateline.org/live/printable/speech?contentId=79585> (accessed 07/06/2007).

²¹ Huckabee, Mike. "Arkansas State of the State Address 2005." <http://www.stateline.org/live/printable/speech?contentId=16585> (accessed 07/06/2007).

²² State of Alabama Executive Budget 2005-2006. <http://budget.state.al.us/BudDoc2006.pdf> (accessed 6/29/2007).

²³ State of Alabama Education Trust Fund Fiscal Year 2005-2006 Appropriations. <http://budget.state.al.us/etf2006.pdf> (accessed 07/01/2007).

items that could be construed as contributing to educational improvement have been proposed for transfer for payment to the ETF from the GF.

The largest “ticket item” in the General Fund is the Alabama Medicaid Agency (MA), which administers healthcare programs for eligible low-income citizens of the state. In fiscal year 2006, an average of 988,678 citizens per month was eligible for Medicaid benefits²⁴ (as compared to Mississippi’s 605,157 during the same time period²⁵). The MA requested \$4.1 billion dollars from the state for fiscal year 2006, an overall increase of 5.9% from the previous year. Additionally, requests for funding directly from the General Fund for administrative purposes rose 35% (\$227 million).²⁶ Appropriations were received in the amount of \$4.23 billion (nearly 38% of total spending for the entire General Fund), and expenditures were in line, totaling \$4.2 billion. 10.2% (\$431 million) of the expenditures came from the General Fund, and only 2% (\$111 million) went towards administrative costs for running the agency¹⁸. (Additional funding also included the approximately \$1.6 million dollars granted by the federal government for reimbursement to Hurricane Katrina evacuees who did not have insurance during a six-month period after the disaster.) Mississippi has a similar percentage, with 9.4% of all funds coming from their state’s General Fund²⁷. Actual spending in Mississippi (the only numbers available) decreased 8% (\$330 million dollars) from fiscal year 2005 to 2006²⁸.

The future of the Medicaid Agency’s programs is not bright, as Alabama has “...one of [the] more bare-boned Medicaid programs of the nation...”²⁹. As the economic well being of the average Alabamian increases, the funding from the federal government will decrease. In 2006 30% of Alabama’s Medicaid costs were paid by the state¹⁵ (as compared to Mississippi’s 25%¹⁹). According to the Federal Funds Information for States tracking service, the state share will increase by 1.21% for fiscal year 2007. This is calculated to equal \$50.4 million additional dollars required from the General Fund, which are already strapped for cash. When inflation and rising pharmacy costs are taken into account, this number could balloon to \$100 million dollars³⁰.

Options for helping ease the burden of Medicaid costs on the General Fund include raising revenues, such as creating a tax on soft drinks and/or “Bingo for Medicaid” (expansion of the gambling system); removing loopholes to ensure full collection of revenues; and freeing income and sales taxes, currently ear-marked for the Education Trust Fund (ETF), for general use by the State^{31,32}. As the citizens of Alabama have refused to support tax increase legislation proposed

²⁴ Alabama Medicaid Agency FY2006 Annual Report. Data from Lea Ann Webb, Business Analyst, Statistical Support Office. LeaAnn.Webb@medicaid.alabama.gov. (e-mailed 07/02/2007).

²⁵ Mississippi Office of the Governor, Division of Medicaid. SFY 2006 Annual Report Summary. http://www.dom.state.ms.us/Annual_Reports/AR2006Summary.pdf (accessed 06/30/2007).

²⁶ State of Alabama Executive Budget 2005-2006. <http://budget.state.al.us/BudDoc2006.pdf> (accessed 6/29/2007).

²⁷ Mississippi Annual Report of Budgetary Basis Expenditures for the Fiscal Year Ended June 30, 2006. [https://merlin.state.ms.us/Web_Archives/SAASWA.nsf/626e6035eadbb4cd85256499006b15a6/f574fe882911dfb98625727c0057cfc1/\\$FILE/BB2006.pdf](https://merlin.state.ms.us/Web_Archives/SAASWA.nsf/626e6035eadbb4cd85256499006b15a6/f574fe882911dfb98625727c0057cfc1/$FILE/BB2006.pdf) (accessed 06/30/2007).

²⁸ Office of the Governor, Division of Medicaid. “SFY 2006 Annual Report Summary.” http://www.dom.state.ms.us/Annual_Reports/AR2006Summary.pdf (accessed 07/01/2007).

²⁹ Montgomery Advisor. “Program Crucial for State.” Montgomery Advisor, January 31, 2005.

³⁰ Reilly, Sean. “Alabama could face higher Medicaid bill in 2007.” Montgomery Advisor, April 7, 2005.

³¹ Johnson, Bob. “Lawmakers say Medicaid needs more tax revenue.” Montgomery Advisor, January 19, 2005.

³² McGrew, Jannell and Davis, John. “Bingo will be back for Medicaid.” Montgomery Advisor, February 27, 2005.

by Governor Riley, and there are vocal opponents of moving the current surplus from the ETF towards something that is not clearly education-based, these suggestions probably will not be adopted.

While both education and Medicaid were key funding drivers for Alabama, there were other agencies in the state, which also had a serious impact on its fiscal health. The Alabama Department of Corrections (DOC) manages the prison system, inmate population, and transitional programs for offenders re-entering the population. This large executive agency received 3.4% of the total General Fund appropriations for the 2006 fiscal year, the fifth largest department item in the state³³. The DOC's current fiscal crisis has led to problems of prison overcrowding, staffing shortages, aging facilities, and is affected by the high costs of inmate healthcare. For fiscal year 2006, the DOC requested \$579 million dollars for its operating budget, which was an 87.39% increase from fiscal year 2005³⁴. As state requires a balanced budget, and the General Fund is already struggling to stay afloat, overall appropriations for the DOC for fiscal year 2006 were only \$379 million dollars, of which \$23 million dollars were granted during a special session of the legislature, following a request by the DOC commissioner to cover operations for the remainder of fiscal year 2005³⁵. 89% (\$325 million) of the DOC's total funding is granted from the General Fund. Compared to \$379 million in appropriations, actual expenditures for the DOC totaled \$373 million, of which 55% (\$203 million) went towards direct personnel costs and employee benefits, and 20% (\$75 million) paid for the high costs of inmate healthcare³⁶.

As mentioned in the previous paragraph, four major problems are forcing the DOC into further fiscal crisis. Prison overcrowding is 192% over capacity (unlike other states in the region where there are extra beds). Temporarily, more beds are being added to each room, and inmates are sent to private facilities or to states like Louisiana, where the state "pays rent" to cover expenditures. The county prison system also holds state inmates for extended periods of time.

Due to under funding, the DOC has not filled its authorized line quota of 2,927 corrections officers. It is currently 18% understaffed which translates to an average 10:1 prisoner-to-officer ratio in the prisons. Mississippi reported a 6:1 ratio for the same fiscal year³⁷. Salaries are also lower than for other law enforcement agencies, and the attrition rate for corrections officers is 360 members leaving annually. This number is not entirely offset by the number of cadets graduating per year, and the staffing shortfall is the clear outcome of this dilemma and likely to become worse.

As with many corrections departments in the United States, facilities are aging at a rapid rate, and the maintenance required has become increasingly costly. State Senator Roger Bedford reported to the senate's General Fund Committee, showing pictures of "rusted pipes in a prison

³³ State of Alabama General Fund, Fiscal Year 2005-2006 Appropriations. <http://www.budget.alabama.gov/GF2006.pdf> (accessed 06/29/2007)

³⁴ State of Alabama Executive Budget 2005-2006. <http://budget.state.al.us/BudDoc2006.pdf> (accessed 6/29/2007).

³⁵ Davis, John. "Corrections seeks bigger budget." *Montgomery Advisor*, June 21, 2005.

³⁶ Alabama Department of Corrections Fiscal Year Report 2006. <http://www.doc.state.al.us/docs/AnnualRpts/2006AnnualReport.pdf> (accessed 06/28/2007).

³⁷ Mississippi Department of Corrections 2006 Annual Report. http://www.mdcc.state.ms.us/Annual_report.htm (accessed 06/28/2007)

kitchen and the leaking roof of another facility's dining hall.”²⁷ While other states, such as Arkansas, are building more units and renovating existing ones³⁸, Alabama has not had the capital capacity to do so. As long as the DOC does not receive the necessary increase in appropriations, this problem will persist.

Inmate healthcare costs are rising at the same rate as costs for all Americans, and Alabama is one of the few states in its region that does not have an extensive prison hospital or infirmary system in place. Arkansas dedicates an entire section of its annual report to its inmate health program, showing its “pride” in its system³⁹. Inmates of Alabama prisons are taken to local hospitals, requiring multiple officers to monitor the patient while s/he is receiving care. This exacerbates the staffing problems. Additionally the DOC does not currently have a competitive health contract with any health maintenance organization or hospital to bring down the costs of this externally provided care.

There are a several possible solutions for these issues, some of which have been suggested to the legislature for enactment. These include recommendations from the Task Force on Prison Crowding, created by Governor Riley, but many require extensive funding that the state simply cannot offer at this time. Until additional revenue is generated, these issues will not be addressed, and will continue to pull the department into deeper crisis that will require increasing use of emergency funds.

Alabama is at a crossroad fiscally. One-time fixes, fund shifts, and the looming tax cuts (in a state with some of the nation's lowest tax rates), cannot keep the “balanced budget” solvent, and further agency cuts and restrictions will result in conditions that the residents of the state will not find acceptable. The ETF's temporary surplus will soon be overpowered by payments towards the principal of the billions of dollars in bonds sold to end the deficit. Medicaid's loss of the previous level of funding from the federal government will either force a raise in taxes, or some low-income citizens will be required to pay higher copays for their medical services, which they may not be able to do. New revenue streams need to be created, or the state will be completely “in the red.” Economic growth will continue, but even 2007's projections were not as robust as would be needed to continue funding some programs at the currently level, even if one disregards inflation. The legislature has some tough decision ahead, and citizens of the state will need to be receptive to suggestions that may, in the short term, not be high on direct incentives. Even Governor Bob Riley knows that the situation is not so rosy: “Not enough revenue plus more demand for services equals hard, tough choices. There is a name for people who make hard, tough choices. We call them ‘leaders’.”⁴⁰

³⁸ Arkansas Department of Correction Annual Report FY2006.

http://www.state.ar.us/doc/pdf/reports/2006_annual_report_.pdf (accessed 06/28/2007)

³⁹ Davis, John. “Corrections seeks bigger budget.” *Montgomery Advisor*, June 21, 2005.

⁴⁰ Riley, Bob. “Governor Riley's State of the State Address.” February 1, 2005.

http://www.alabamainteractive.org/alabamainteractive_shell/Welcome.do?url=http://governor.alabama.gov (accessed 07/01/2007).