



A “bird’s eye” tour of public finance

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A few simple topics to cover....

- How do gov'ts intervene in economies?
- Why even have a gov't?
- If we have a gov't, what should it do?
- How should we pay for it?
...and, why can't we have everything we want?
- Finally, what does the resulting flow of funds look like in Tennessee?

*All through the “lens” of traditional public finance;
not political science, politics, law, or ideology*



NO voluntary txns free of
gov't intervention:

Gov't controls resource
allocation across
individuals in the
economy

“Command Economy”

ALL txns voluntary w/
no gov't intervention

Resource allocation
determined by initial
“endowments” and
voluntary transactions

**“Pure Free Market
Economy”**



***Where are we on the spectrum of
gov't intervention in the economy ?***



“Command Economy” ←————→ “Pure Free Market Economy”

How do gov'ts intervene in the economy?

- Property rights and their enforcement, public safety (minimal)
- & taxes, subsidies, mandates, fines, regulations, etc. (moderate)
- & centrally planning production and price-setting (extreme)





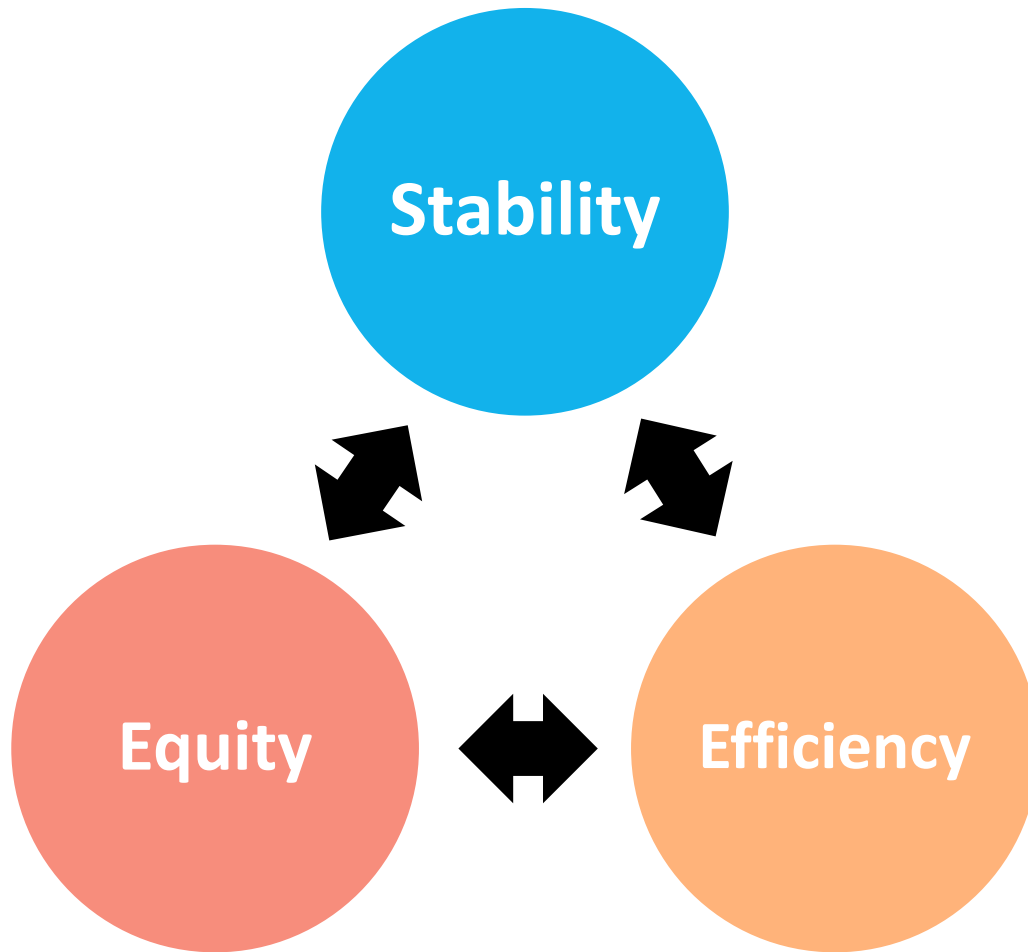
Even moderate taxes/subsidies change relative prices...

but not due to *scarcity* or *preferences*,
which shape supply and demand in the free market:

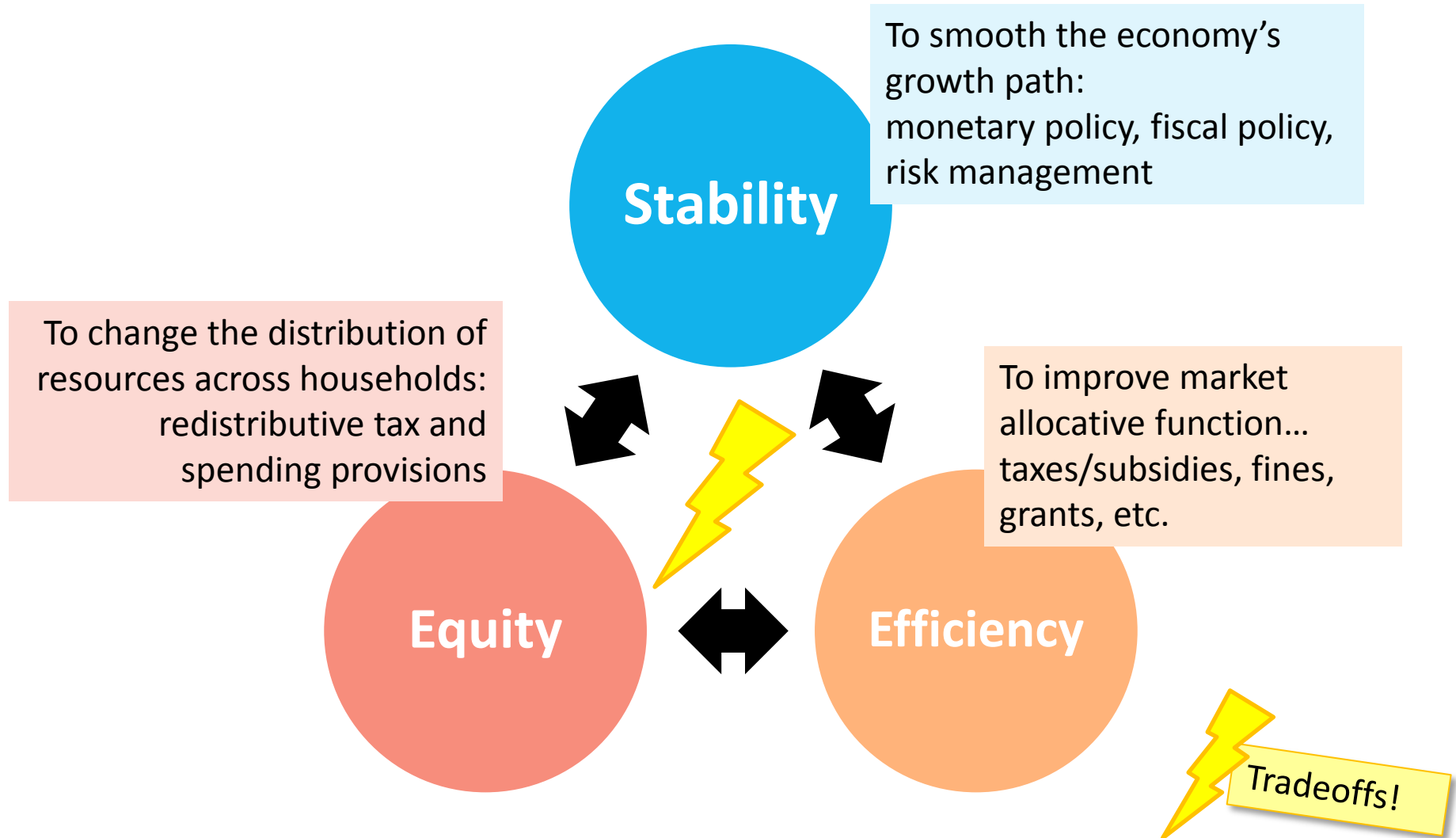
- Gas car vs. electric car
- Labor vs. leisure

...taxes/subsidies distort private choices and create inefficiency,
not always resolved by how we use the revenues.

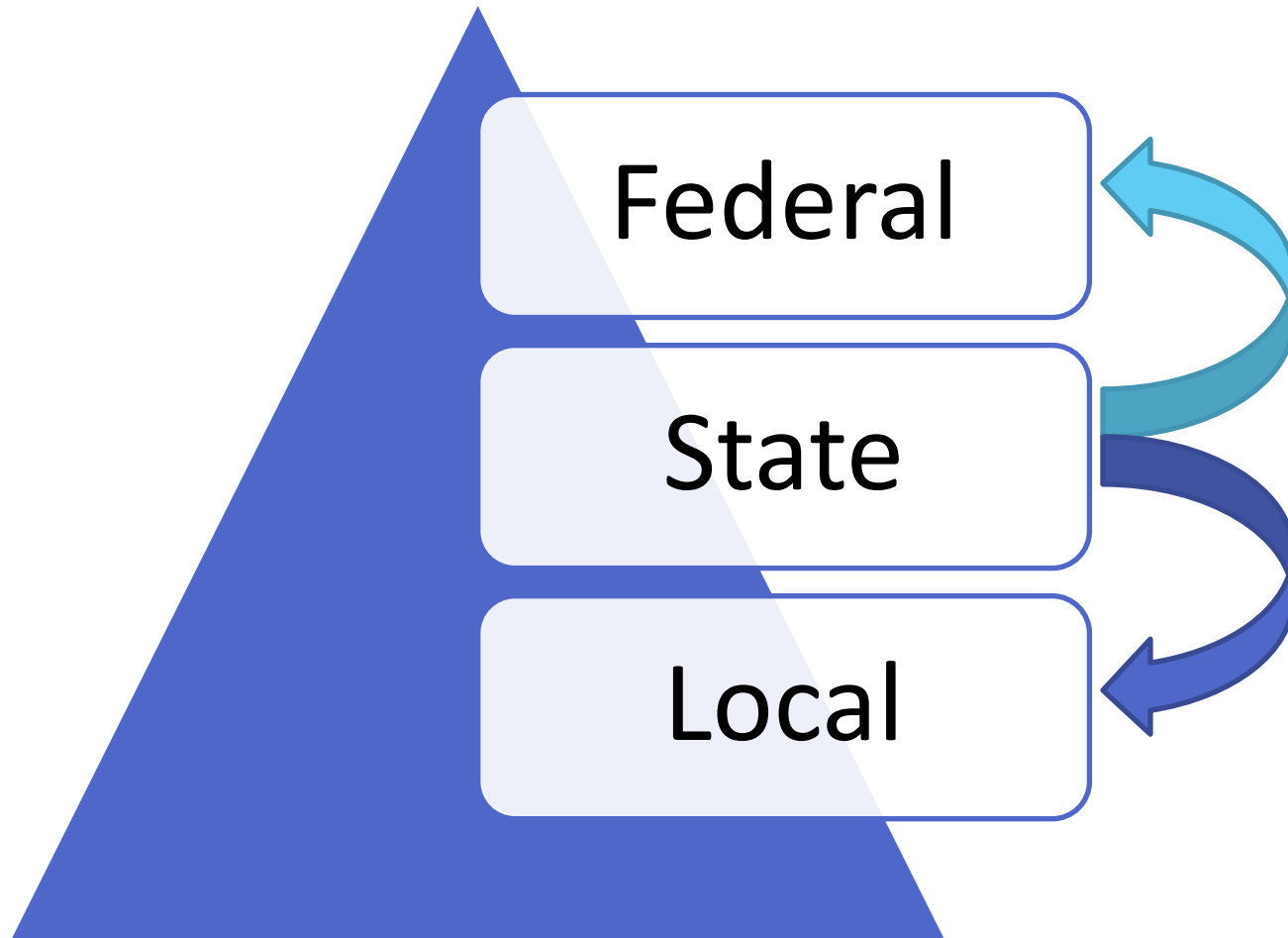
So, why let gov't intervene in markets at all?



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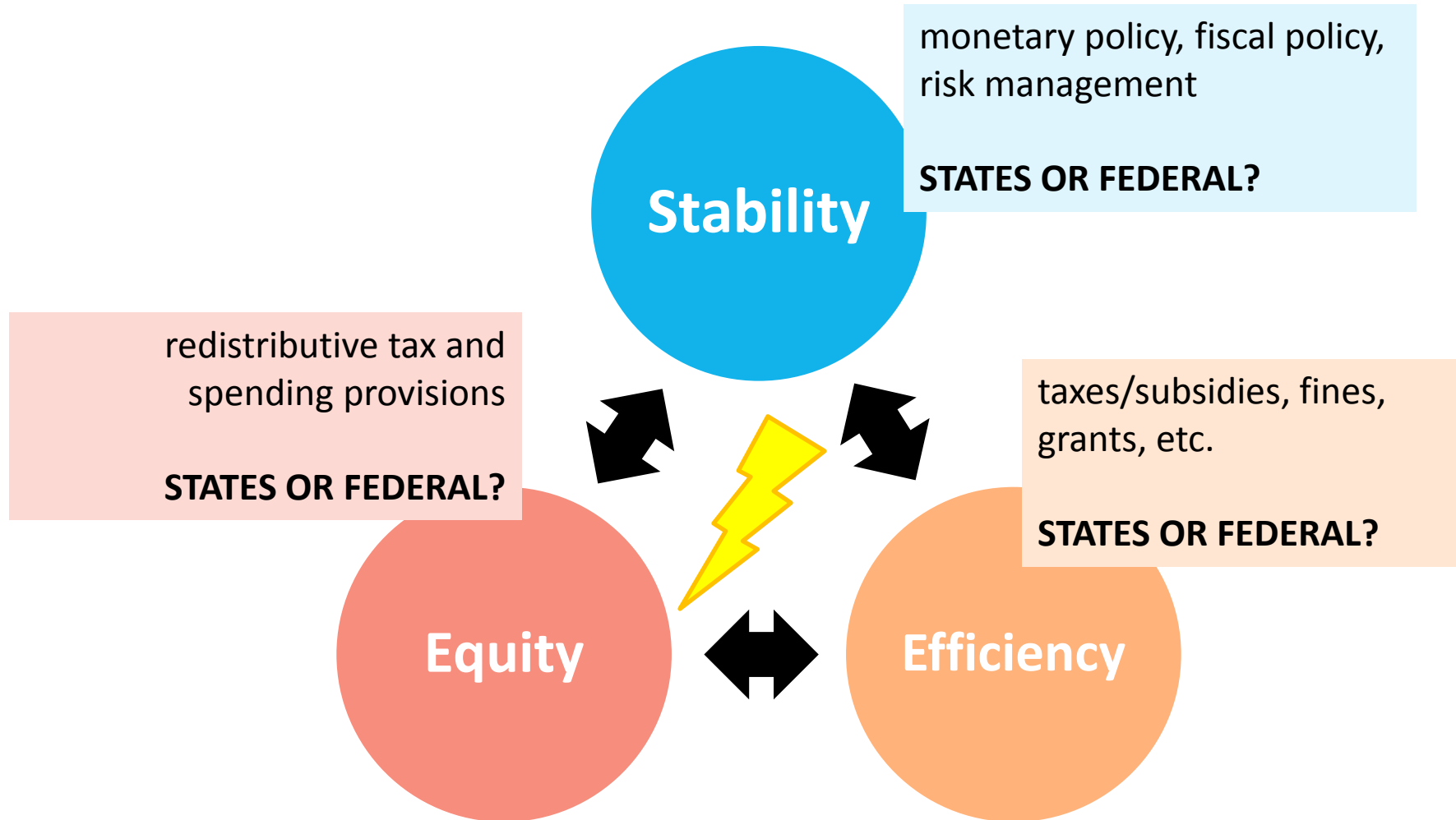


Another complication...Federalism



So, now which LAYER should intervene?

“Fiscal federalism”



...focus on efficiency rationales

Handout!

- **Market failures**
 - “Public goods”
 - Externalities (negative, positive)
 - Asymmetric information
 - Natural monopoly
- **Fiscal federalism principles**
 - Correspondence
 - Subsidiarity



Efficiency

OK, if we decide to have gov't,
how do we pay for it?

Public finance is...

SOURCES

and

USES of funds



Revenue side



Expenditure side



Revenue side



Expenditure side



(Selling)



Taxing



Spending

Revenue side

Expenditure side

(Selling)



Taxing



Spending

Tax (or subsidize) NOW:
residents; non-residents,
directly; non-residents
indirectly (revenue from a
higher gov't)

...Emphasize **BENEFITS** principle (efficiency)
or **ABILITY TO PAY** principle (equity)

Tax LATER:

Borrow in bond market (pledging
future taxes or future revenues from
project); match lifespan of asset to
lifespan of payments

...Dedicate funds to a **single** purpose
("earmarked") or for **general** use

Handout!

The diagram consists of two large arrows at the top pointing towards each other, labeled 'Revenue side' and 'Expenditure side'. Below them is a circular flow diagram: a grey circle labeled '(Selling)' followed by a plus sign, a green circle labeled 'Taxing', an equals sign, and a blue circle labeled 'Spending'. At the bottom right, there are two light blue boxes. The first box, titled 'Spend NOW:', contains the text 'Current transfers (redistributive programs) or payments for goods and services'. The second box, titled 'Spend LATER:', contains the text 'Rainy Day Fund; infrastructure investment with bond proceeds; pledged future transfers or payments'.

Revenue side

Expenditure side

(Selling)



Taxing



Spending

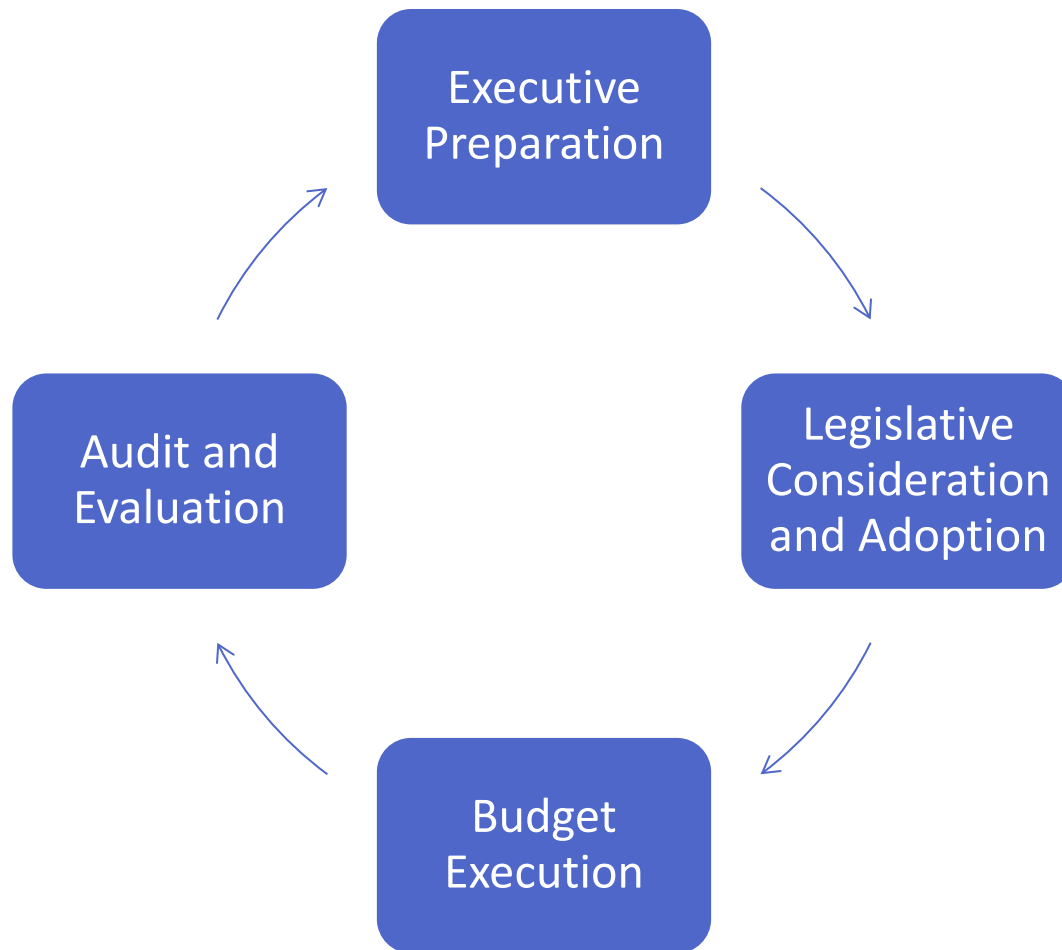
Spend NOW:

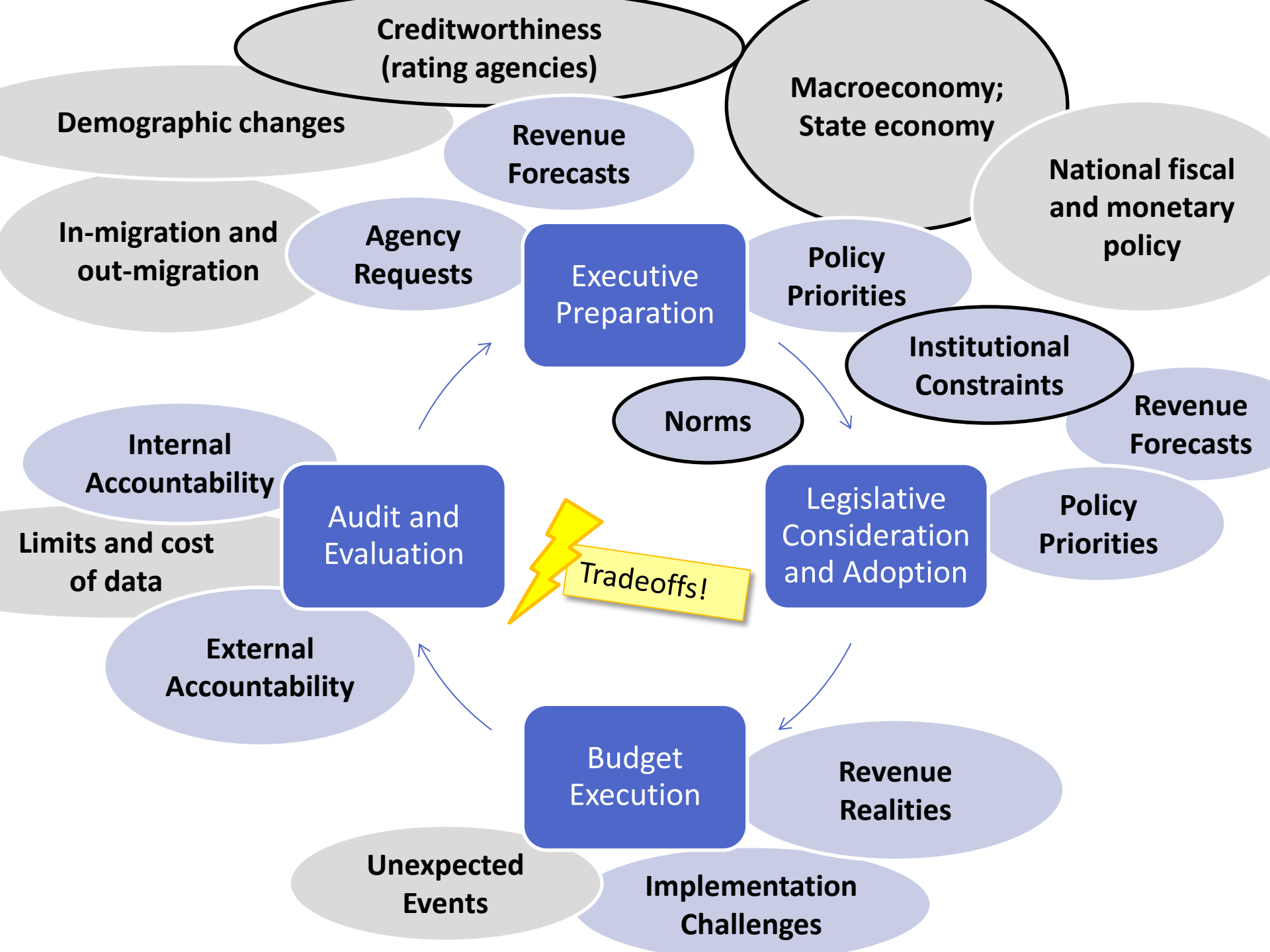
Current transfers (redistributive programs)
or payments for goods and services

Spend LATER:

Rainy Day Fund; infrastructure
investment with bond
proceeds; pledged future
transfers or payments

Making choices: why can't we have everything we want?





Tennessee State Constitution



Institutional Constraints

Section 24. No public money shall be expended except pursuant to appropriations made by law. Expenditures for any fiscal year shall not exceed the state's revenues and reserves, including the proceeds of any debt obligation, for that year. No debt obligation, except as shall be repaid within the fiscal year of issuance, shall be authorized for the current operation of any state service or program, nor shall the proceeds of any debt obligation be expended for a purpose other than that for which it was authorized.

In no year shall the rate of growth of appropriations from state tax revenues exceed the estimated rate of growth of the state's economy as determined by law. No appropriation in excess of this limitation shall be made unless the General Assembly shall, by law containing no other subject matter, set forth the dollar amount and the rate by which the limit will be exceeded.

Any law requiring the expenditure of state funds shall be null and void unless, during the session in which the act receives final passage, an appropriation is made for the estimated first year's funding.

No law of general application shall impose increased expenditure requirements on cities or counties unless the General Assembly shall provide that the state share in the cost.

An accurate financial statement of the state's fiscal condition shall be published annually.

Statutory limit on borrowing: via constraint on debt service (principal and interest payment on outstanding debt), which cannot exceed 10% of previous year's general fund revenues (NASBO, 2015)

Statutory measurement of economic growth for "Copeland Cap": via growth in personal income...

Balanced budget req't

No long-term debt for current operations

Constitutional expenditure limitation (w/out special law)
"Copeland Cap" (1978)

Limit on unfunded mandates

US median household income \$53,046

US mean HH income \$73,487

TN median household income \$44,298

TN mean HH income \$61,291

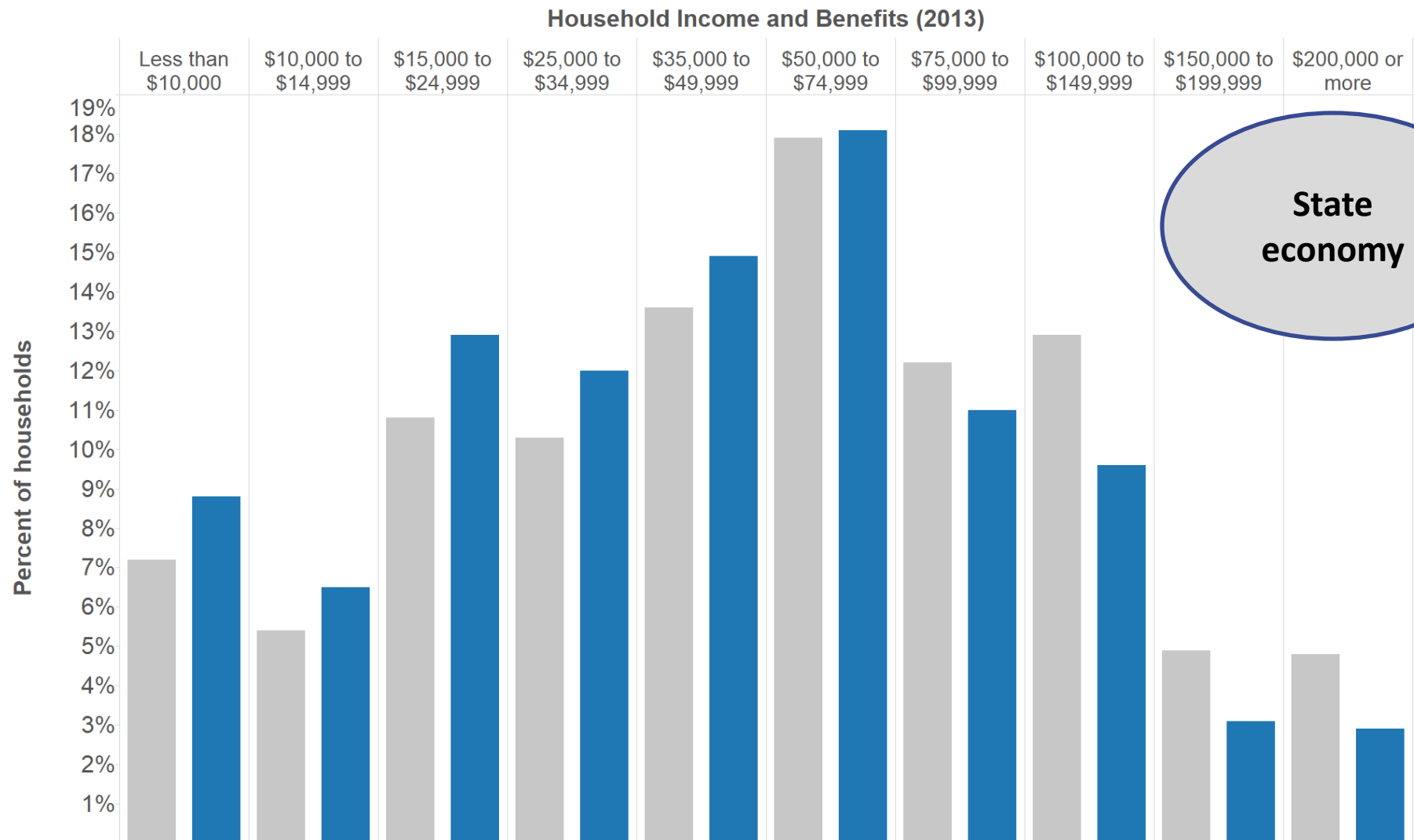


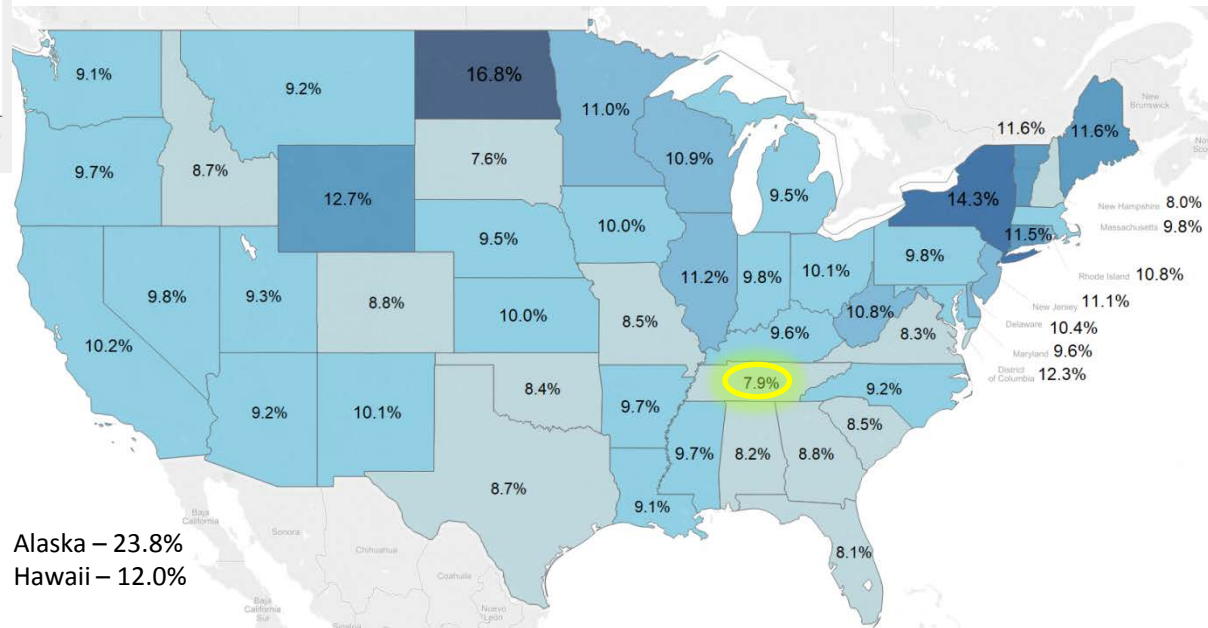
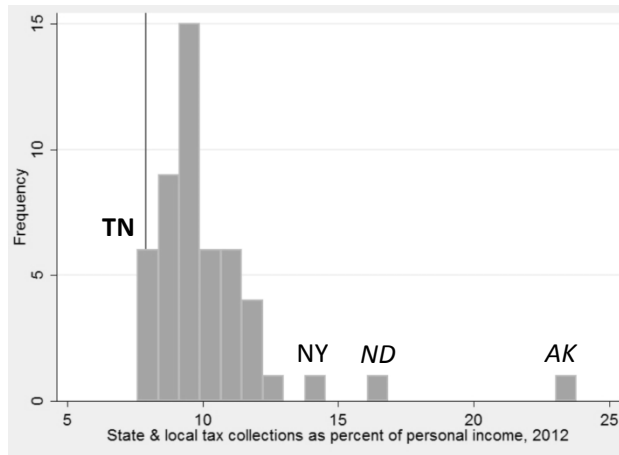
Figure based on data from US Census – [Selected Economic Characteristics 2009-2013 ACS 5-year estimates](#)

TN ranks 49th in state and local tax collections as a percent of personal income (2012):

TN 7.9%, state average 10.2%

Norms

State
economy



Alaska – 23.8%
Hawaii – 12.0%

Ratings: Moody's Aaa; Fitch Aaa; S&Ps AA+

Creditworthiness
(rating agencies)

S&P ratings 2001-2014:

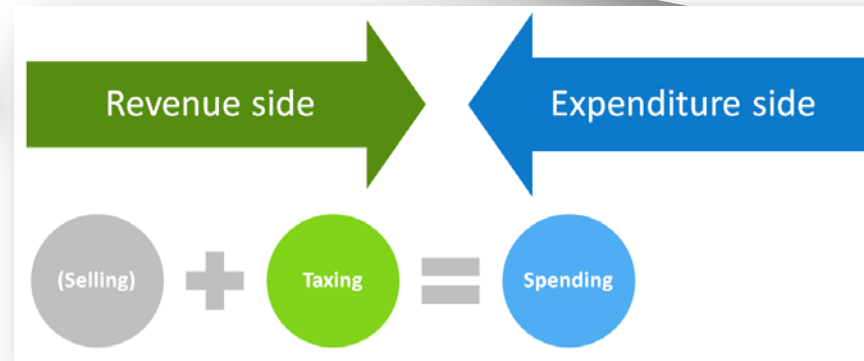
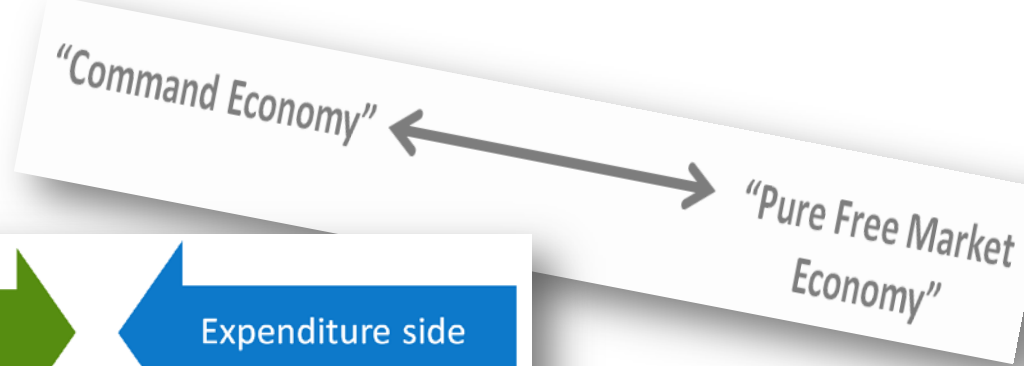
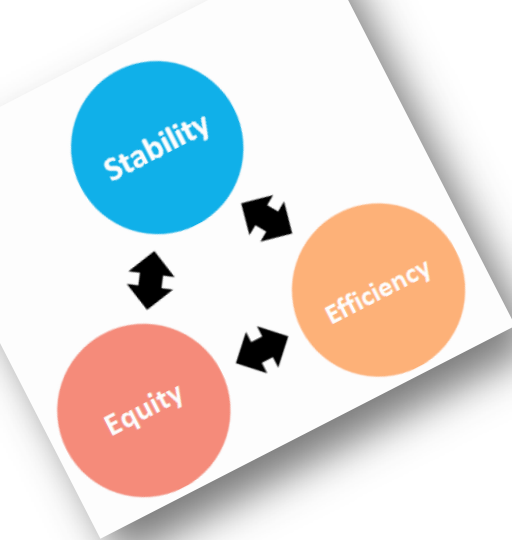
| | May 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 |
|----------------|----------|------|------|------|------|------|------|------|------|------------|------|------|------|------|
| | AAA | AA+ | AA | AA- | A+ | A | A- | BBB+ | BBB | Not Ranked | | | | |
| Alaska | AAA | | | | | | AA+ | | | | | AA | | |
| Delaware | AAA | | | | | | | | | | | | | |
| Florida | AAA | | | | | | | | | AAA | | | | |
| Georgia | AAA | | | | | | | | | | | | | |
| Indiana | AAA | | | | | | AAA | | AA+ | | AA | | | |
| Iowa | AAA | | | | | | AAA | | | | | | | |
| Maryland | AAA | | | | | | | | | | | | | |
| Missouri | AAA | | | | | | | | | | | | | |
| Nebraska | AAA | | | AAA | | | | | | | | | | |
| North Carolina | AAA | | | | | | | | | | | | | |
| North Dakota | AAA | AAA | | | | AA+ | | | | AA | | | | |
| Texas | AAA | AAA | | | | AA+ | | | | | | | | |
| Utah | AAA | | | | | | | | | | | | | |
| Virginia | AAA | | | | | | | | | | | | | |
| Wyoming | AAA | | | AAA | | | AA+ | | | | | | | |
| Idaho | AA+ | | | AA+ | | | | | | | | | | |
| Kansas | AA+ | | | | | | | | | | | | | |
| Massachusetts | AA+ | | | | | | | | | AA | | | | |
| Minnesota | AA+ | | | | | | | | | | | | | |
| New Mexico | AA+ | | | | | | | | | | | | | |
| Ohio | AA+ | | | | | | | | | | | | | |
| Oklahoma | AA+ | | | | | | AA+ | | | | | | | |
| Oregon | AA+ | | | AA+ | | | | AA | | | | AA- | | |
| South Carolina | AA+ | | | | | | | | | AA+ | | | | |
| South Dakota | AA+ | | | AA+ | | | | | AA | | | | | |
| Tennessee | AA+ | | | | | | | | AA+ | | | | | AA |
| Vermont | AA+ | | | | | | | | | | | | | |
| Washington | AA+ | | | | | | | AA+ | | | AA | | | |
| Alabama | AA | | | | | | | | | | | | | |
| Arkansas | AA | | | | | | | | | | | | | |
| Colorado | AA | | | | | | | AA | | | | | AA- | |
| Connecticut | AA | | | | | | | | | | | | | |

Ratings from State of Tennessee
(accessed 8/19/2015).

["Transparent TN - Fiscal
Strength & Efficient Gov't."](#)

Figure from Pew Trusts (2014, June 4).

["State credit ratings from Standard &
Poor's, 2001-2014"](#) Stateline.



Tensions and trade-offs: Most of the time, TANSTAAFL

