



ALABAMA AT THE CROSSROADS An Economic Guide to a Fiscally Sustainable Future

Alabama currently lags behind its regional neighbors and the nation in economic growth and performance. For example, Alabama's per capita personal income is \$2,800 below the average of the rest of the states in its region and it ranks 45th in *Forbes's* "Best States for Business." This is because of Alabama's poor performance in connection with several indicators of economic freedom, particularly its overspending, excessive regulation, and high public employment.

A new study for the Mercatus Center at George Mason University undertakes a comprehensive analysis of where Alabama stands today as well as the reforms necessary to put Alabama on the road to economic prosperity. Alabama must undergo comprehensive reform to expand economic freedom, which will lead to economic growth and prosperity.

To read the study in its entirety and learn more about its authors, Troy University economists John A. Dove and Daniel J. Smith, see "[Alabama at the Crossroads: An Economic Guide to a Fiscally Sustainable Future.](#)"

STATE BUDGET

Alabama's budget has experienced recent shortfalls leading to political gridlock, which demonstrates the need for a major budgetary overhaul to rein in spending and better streamline revenues and expenditures.

- A lack of transparency in spending further exacerbates the situation: unlike the vast majority of states, Alabama does not have a consolidated budget, but rather a number of separate budgets and trust funds.
- Each budget and trust fund receives its revenues from separate sources, and 85 percent of the state's revenue is earmarked for a particular purpose—by far the largest percentage of earmarking out of all the states in the country.

For more information, contact
Kyle Precourt, 703-993-8196, kprecourt@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Boulevard, 4th Floor, Arlington, VA 22201

Recommendations: Consolidate Alabama’s budgets into one general budget and curtail earmarking. Further, in order to limit the growth of state expenditures, several programs require long-term reform, such as Medicaid and others discussed below. Strict tax and expenditure limits, such as an expenditure limit that ties annual expenditure growth to the state’s population growth, would better align state expenditures with economic conditions. In addition, such limits would help minimize the negative effects that the business cycle can have on the state budget.

RETIREMENT SYSTEMS

Alabama’s public pension system is severely underfunded, putting retirees and taxpayers at risk.

- The funded ratio of the Retirement Systems of Alabama (RSA) has dropped precipitously as the actuarial value of assets in the Teachers’ Retirement System, the Employees’ Retirement System, and the Judicial Retirement Fund have declined while their liabilities have increased.
- The declining funding health of the RSA has prompted a reliance on increasing state and employee contributions to the system.
- In response to its declining funding health, the RSA has also increased its investment risk exposure—an exposure that taxpayers ultimately bear.

Recommendation: Transition new members of the RSA to private, defined contribution accounts, providing them with more portable and customizable retirement benefits.

ECONOMIC INCENTIVE PROGRAMS

Alabama currently offers a range of economic incentive programs, including film subsidies. This attempt to handpick economic winners and losers creates an unfair business environment and leads to cronyism.

- Economic incentive programs are costly, impede economic growth, and undermine the free market by granting politicians the opportunity to play venture capitalist with taxpayer money. Alabama’s incentive policies tend to crowd out private investment and leave certain firms or would-be entrepreneurs at a competitive disadvantage.
- Alabama has experienced a clear downward trend in net firm formation (for all firm sizes) in recent decades.

Recommendation: Eliminate Alabama’s economic incentive programs in favor of low, equal taxes, welcoming businesses of all varieties to Alabama.

PRIVATIZATION

Alabama's government currently provides many services that can—and should—be provided by the private sector.

- Many of the services Alabama provides are not proper functions of a limited government, meaning that state resources are being unnecessarily diverted from the core functions of government.
- Privatization of these services can decrease their cost, improve their quality, and reduce the number of public-sector workers who must be supported by the private sector.

Recommendation: Privatize ABC liquor stores, golf courses, and other non-public goods, turning them over to the competitive market.

EDUCATION

Underperforming K–12 schools in Alabama leave youth unprepared for college or the workforce.

- Only 20 percent of Alabama's 2013 high school graduates were fully ready for college based on their ACT results. In addition, Alabama has one of the highest dropout rates in the nation. Between 2002 and 2012, roughly 30 percent of Alabama's high school students failed to graduate within four years.
- Higher standards, across-the-board reductions in class size, more stringent teacher qualification requirements, promises to improve political-administrative accountability based on test scores, and large per-pupil spending hikes have all failed to address Alabama's education woes.
- The one-size-fits-all approach demonstrably fails to provide the necessary flexibility to encourage experimentation and meet the diverse educational needs of parents and students.

Recommendation: Systematically expand school choice in order to empower parents to hold schools accountable and use educational experimentation and innovation to meet the diverse needs of schoolchildren.

TAX REFORM

While Alabama's tax revenues per person may be low compared to those of other states, Alabama's tax rates are not. Furthermore, Alabama currently does not have tax and expenditure limits that would restrict the growth of government spending.

- Low, fair, and straightforward tax structures expand states' economies, attract residents and businesses, and eventually bring in more tax revenue.

- In its 2015 State Business Tax Climate Index, the Tax Foundation ranks Alabama's business tax climate 28th. Regionally, Alabama falls behind Florida, Mississippi, Tennessee, and Texas.

Recommendation: Eliminate loopholes and tax incentives in order to lower income and corporate tax rates for all Alabamians, offering a tax environment more conducive to economic growth and more competitive with Alabama's regional neighbors.

REGULATORY REFORM

Excessive regulation is impeding business growth and innovation in Alabama, restricting entrepreneurship and job growth.

- Alabama has the eighth-lowest rate of new entrepreneurs in the nation (tied with Kansas, Illinois, and Virginia), the absolute lowest opportunity share of new entrepreneurs, the fourth-lowest start-up density in the nation, and only one Fortune 500 company headquarters.
- While regulatory agencies are statutorily required to make all economic impact studies available to the public, in practice this rarely happens, making the entire regulatory process less transparent and increasing the likelihood of regulatory capture. Where economic impact studies do exist, their content tends to be insufficient.

Recommendations: Sensibly reform business, alcohol, health, and labor regulations to remove the regulatory thickets entrepreneurs and business owners face. The state should also consider a complete overhaul of its regulatory review process. Although the de jure review process should work in theory, in practice the outcomes are far from what is intended. This leads to greater regulatory burdens and uncertainty in the marketplace, which slow business formation and, with it, economic growth.

CONSTITUTIONAL REFORM

Alabama's lengthy and complex constitution centralizes power and undermines the state's ability to constrain and limit the size of state government.

- Largely as a result of the concentration of power that the constitution granted and continues to grant to the state legislature, Alabama's constitution is now the longest written constitution in the world at 276,006 words.
- Alabama's constitution denies local governments the opportunity to self-govern and to rapidly meet and deal with local problems as they emerge. Instead, the constitution bogs down the part-time state legislature by requiring it to address these local issues.

Recommendation: Undertake a complete constitutional overhaul to grant home rule to local governments, ensuring an effective delimitation of powers and empowering local authorities to deal with purely local matters.

CORRUPTION

Relative to other states, Alabama has a deep-seated problem of political corruption.

- The Edmond J. Safra Center for Ethics at Harvard University recently ranked Alabama as one of the most corrupt states in the nation, considering both illegal and legal corruption.
- This corruption, largely driven by lack of transparency, inhibits economic activity by creating an unfair political, legal, and business environment.

Recommendation: Increase government transparency and openness, especially as it pertains to spending, legislative activity, economic incentive programs, and public pension management, in order to foster accountability and help limit growth-restricting corruption.

CONCLUSION

Alabama requires systematic reforms that expand economic freedom and put the state on the road to economic prosperity. Some of these are broad, structural reforms, such as overhauling the constitution and consolidating the budget, as well as tackling corruption. Comprehensive reforms of specific policy areas are also required. Policy issues in need of attention include public pensions, taxes, privatization, and the regulatory system.