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2017 Fiscal Year Budget Falls Short of Being a Visionary Plan for North Carolina's Economic Future:

Lawmakers Double Down on Tax Breaks, Set Limited Aspirations

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Introduction

North Carolina lawmakers approved a 2017 fiscal year state budget that falls short of being a visionary plan for the state's future. The pursuit of a rigid spending formula combined with another round of tax breaks prevented lawmakers from proposing an adequate budget, let alone a bold one.

These new tax breaks come on top of recent tax breaks, which together are projected to cost more than $2 billion annually once fully implemented.[1] These are resources that the state will not have for public education, affordable housing, the court system, and other vital services that help children, families, and communities thrive. Instead, these multiple rounds of tax breaks will primarily benefit the wealthy and profitable corporations who are already doing well in today's uneven and weak economic recovery.

The $22.34 billion budget that lawmakers enacted reflects their limited aspirations for North Carolina.

The $22.34 billion budget that lawmakers enacted reflects their limited aspirations for North Carolina, increasing spending by only 2.8 percent, or $606.7 million, over 2016. While the budget reinvests in some worthy programs and services, these additional investments represent a small fraction of what is needed to boost economic opportunity and help North Carolinians doing their best to get by—North Carolinians like the children stuck on persistently long waitlists for early childhood education, jobless workers facing too few jobs and job training programs, and older adults going without the in-home and community support that they need.

This slight year-to-year increase in investments is below the historical average, and it is too small to operate core public services, catch up and keep up with the needs of a growing state population, and substantially address the persistent challenges in ensuring that every community has access to opportunity.[2] The reality is that without additional tax giveaways to the wealthy and powerful, much more could have been possible to improve North Carolinians' quality of life and to build a stronger, more inclusive economy for all.

Lawmakers Set Sights Low with Use of a Rigid Formula

Legislative leadership artificially constrained reinvestment by using a rigid formula to set a low budget target that has no basis in economic realities or community needs. This formula limits year-to-year growth in total state spending to the rate of inflation-plus-population growth, thereby replacing lawmakers' judgment with arbitrary numbers. The goal of this rigid and arbitrary formula is to radically restrict state spending and shrink the reach and effectiveness of critical public services, regardless of need or cost.

While lawmakers sold this formula as a common-sense measure, in reality it is not a responsible way to measure the cost of providing basic public services. Instead, such limits merely ensure perpetually insufficient funding and never allow policymakers to fully replace the recession-era cuts to schools, health care, public safety, and other building blocks of a strong economy.

Inflation, as measured by the Consumer Price Index, doesn't accurately reflect the cost of providing public services over time. That's because this index measures changes in the cost of goods and services that urban households purchase—not changes in the cost of public goods that benefit all of us and often grow faster than inflation. This is especially true for education and health services, the two biggest chunks of the state budget. Also, our state serves population groups, such as older adults, that grow more rapidly than the overall population growth used in the formula.

Rigid Formula Wreaks Havoc in Colorado

The use of this rigid formula is a developing and dangerous trend in North Carolina. Lawmakers have used this formula to guide budget deliberations in recent years, despite the fact that it will likely fail to produce the promised economic benefits. Colorado enacted a similar formula in the 1990s, and it has seriously diminished the state's ability to fully fund education and public health programs, leading to hardship and drops in rankings among several key indicators. That state's formula also contributed to a credit rating downgrade.[3]

Use of the formula, combined with tax cuts, is undermining the economy-boosting investments that are needed for a stronger economic future, such as education, health care, and public safety.

Paying for the 2017 Fiscal Year Budget in Light of Growing Tax Cuts

Lawmakers expected to have nearly $22.2 billion in base revenues for the 2017 fiscal year, with about 96 percent coming from tax sources—like the state income tax, sales tax, and corporate income tax—and the rest coming from non-tax sources (see Figure 1, p. 3). This is a meager 1-percent increase over the 2016 fiscal year—far below the historical average as well as what is normal during periods of economic growth.[4] Revenue is diminished by sizeable tax breaks in the personal and corporate income taxes that lawmakers prioritized over the last few years. Recent tax changes, including the sales tax base expansion, are on net expected to result in a $1.4 billion revenue loss in the upcoming 2017 fiscal year.[5]

On top of base revenues, lawmakers expected to have $926.5 million available from one-time revenues carried over from the 2016 fiscal year. These dollars include collections expected to come in above officials' conservative projections, money that agencies were expected to return to the state through reductions in services or because of changes in costs to deliver services, and unappropriated money left on the table last year.

Lawmakers contributed slightly more than half of those one-time dollars to the Savings Reserve Account, the state's rainy day fund. Such an aggressive effort to contribute to this fund is ill-timed given the unmet needs in communities—such as too few school nurses to help keep students healthy, scores of outdated textbooks that put learning outcomes at risk, and long wait-times for people in

FIGURE 1: How Lawmakers Paid for Their 2017 Fiscal Year Budget

	FY2017
REVENUE FORECAST (Includes Next Round of Income Tax Cuts)	**$22,228,000,000**
+ Net General Fund Credit Balance	**$221,487,216**
Unappropriated Balance	$175,488,544
Overcollections	$330,200,000
Agency Reversions	$420,815,473
Rainy Day Fund	($473,616,801)
Repairs and Renovations Reserve	($81,400,000)
Transfer to the Medicaid Transformation Fund	($150,000,000)
+ Recommended Revenue Changes	**($108,049,626)**
Individual Income Tax - Increase Standard Deduction	($145,000,000)
Mill Machinery Tax - Expand 1%/$80 rate to Secondary and Precious Metal Recyclers, Metal Fabricators, and Ports	($6,000,000)
Sales Tax - Repeal Automotive Service Contracts (RMI Services Taxable)	($1,600,000)
Sales Tax - Exempt Styrofoam Pellets for Alternative Wastewater System Materials	($1,000,000)
Sales Tax - Limit Repair and Maintenance Tax on Airplanes and Boats	($500,000)
Sales Tax - Modify Base on RMI - Removes Retail/Non-retail Distinction, Applies Capital Improvement Test	$22,400,000
Sales Tax - Elimination of State Contribution to Local Sales Tax Distribution	$17,600,000
Adjustment for Transfer from NCGA Special Fund	$3,000,000
Adjustment for Transfer from Insurance Regulatory Fund	$2,532,502
Adjustment for Transfer from Treasurer's Office	$517,872
TOTAL REVENUE AVAILABLE	**$22,341,437,590**
— Appropriation Requirement	**$22,341,437,590**
REMAINING GENERAL FUND BALANCE	**$-**

SOURCE: Availability Statement, FY2017 budget.

need of mental health beds. Lawmakers also put a quarter of those one-time dollars into the reserve used to repair and renovate state-owned properties and the Medicaid Transformation Fund, and carried over $221 million into the 2017 budget.

Lawmakers squandered the opportunity to reinvest to better meet needs by proposing another round of tax changes that, on net, reduce available revenue by $114.1 million. They raised the standard deduction, provided preferential sales tax treatment to certain groups, phased in more services that are subject to the sales tax, and eliminated the state contribution to local sales tax distribution—which is another blow to local governments across the state. They offset part of this revenue loss by transferring funding from three special funds into the General Fund.

In the end, lawmakers had $22.3 billion available to invest and they appropriated every available dollar, leaving no money on the table as has been the case in the last few years.

Lawmakers Rely on Disproven Economic Theory to Justify New Round of Tax Breaks

When pushing through the package of tax changes in the 2017 budget, state lawmakers relied on a largely disproven theory that reducing taxes for the wealthy and profitable corporations will deliver improved economic outcomes for all North Carolinians.[6] Legislative leadership pointed to the state's apparent economic recovery, which mimics the overall national recovery, while failing to address the fact that wages aren't recovering for everyday North Carolinians, there aren't jobs for everyone who wants to work in the majority of North Carolina counties, and there is persistently high poverty in urban and rural communities alike.[7]

Despite costly tax cuts in recent years, North Carolina's economy has not seen any extraordinary growth or boost in job creation. Rather, just like most other states, North Carolina's recovering economy is in large part the result of an improving overall national recovery.[8]

Poorly Targeted and Costly Income Tax Cuts

Lawmakers raised the standard deduction amount up to $16,500 from $15,500 for married couples filing jointly this year. For 2017, the standard deduction amount increases up to $17,500 for married couples filing jointly. Raising the standard deduction amount—commonly referred to by lawmakers as a zero tax bracket—means that this income is not subject to the state personal income tax and reduces available revenue by $145 million for the upcoming fiscal year. The cost will grow as the tax break phases in.

With the personal income tax rate already set to drop to 5.499 percent from 5.75 percent in 2017, the cost of raising the standard deduction adds onto the significant and growing cost of income tax cuts passed since 2013. Next year, the state will lose more than $1.4 billion as a result of tax cuts—that's more than what the state invests each year into the entire Community College System. The price tag of these tax breaks grows to more than $2 billion once all tax changes are fully in place.[9]

Next year, the state will lose more than $1.4 billion as a result of tax cuts.

Increasing the standard deduction by $2,000 is not only costly, but it is also a poorly targeted way to help moderate- and low-income taxpayers keep more of what they earn. Increasing the standard deduction reduces the income taxes paid for all tax filers who don't itemize, including millionaires, not just lower income North Carolinians.

A state Earned Income Tax Credit (EITC) is a better tax policy tool to address tax equity in North Carolina's upside-down tax system. Some moderate- and low-income North Carolinians are not subject to a state income tax because they don't earn enough income. Thus, raising the standard deduction provides no benefit to these taxpayers. However, these families and individuals pay a significant share of their income in other taxes—like sales and property taxes—and as a result pay a larger share of their income in state and local taxes relative to wealthy taxpayers.

Restoring a state EITC, which lawmakers eliminated in 2013, at 5 percent of the federal EITC amount would cost around half the price tag of raising the standard deduction by $2,000. It would also reach nearly one million working but low-income families and their children.[10]

Sales Tax Changes Harm Lower Income North Carolinians

North Carolinians now pay sales tax on more activities and services than they did prior to 2013. This is a result of lawmakers expanding the sales tax base to include more than 40 services that were either not taxed at all or only partially taxed prior to the sales tax changes that they have approved beginning in 2013.[11]

This growing list of services subject to sales tax in the budget results in North Carolinians paying at least $20.3 million in additional sales taxes in the 2017 fiscal year. That amount balloons to at least $675 million in the 2017 fiscal year when accounting for all tax changes passed since 2013.

Expanding the sales tax base is part of a larger transformation of the state's tax code by state leaders that shifts away from the income tax and increasingly relies on revenue from the sales tax. Lawmakers have opted for this tax swap even though an income tax structure based on ability to pay is more likely to achieve long-term revenue adequacy than an overreliance on the sales tax.[12] Lawmakers have failed to acknowledge how the tax swap increases the tax responsibility on middle- and low-income taxpayers.

The sales tax hits low-income North Carolinians particularly hard, as they spend a larger share of their income on goods and services subject to the sales tax. As lawmakers continue to expand the sales tax base without putting into place measures that address tax equity, the shifting of the tax load to middle- and low-income taxpayers and away from the well-off and profitable corporations will continue.

Lawmakers must take deliberate actions to stop shifting the tax responsibility to middle- and low-income taxpayers:

- *Restore a state EITC to help families that earn low incomes keep more of what they earn.*
- *Return to a graduated income tax structure that is based on ability to pay in order to help ensure that lower income taxpayers don't pay a greater share of their income in state and local taxes compared to the wealthy.*

These policy changes help promote tax equity, make sure that adequate resources are available for public investments, and ensure that all communities across the state can thrive.

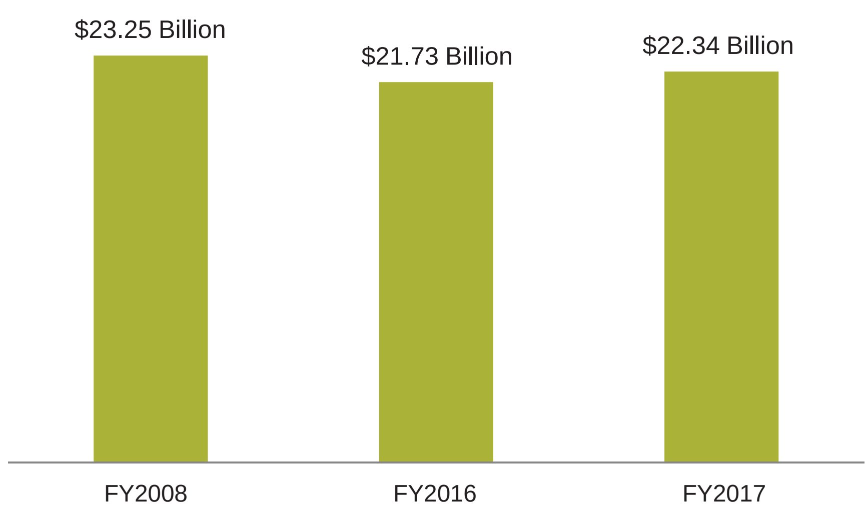
Skimping on Public Investments Hampers North Carolina's Future Economic Success

Public investments—quality schools, affordable healthcare, housing, and safe, healthy neighborhoods— are the essential building blocks of long-term economic growth and shared prosperity. In the past, North Carolina leapt ahead of its Southern neighbors when lawmakers invested in good roads, early childhood programs, quality public schools and universities, and healthcare. Today, state lawmakers have drifted far from this bipartisan legacy that primed the state for economic growth and inclusion for decades.

Case in point: In the face of the self-imposed low budget target and a blitz of lopsided tax breaks, lawmakers continued to struggle with how to substantially replace the worst cuts from the recession while paying for essential ongoing public services. Compared to the 2016 fiscal year budget, the

FIGURE 2: Nine Years Later, Final Budget Fails to Catch Up to Pre-Recession Levels Despite Growing Needs

Total General Fund Appropriations by Fiscal Year



SOURCE: NCGA-approved budgets, FY2008, FY2016, and FY2017; FY2008 budget is adjusted for inflation.

2017 fiscal year budget increases total General Fund spending by 2.8 percent, which is lower than reinvestment levels during previous post-recession periods.[13]

Most of these new dollars pay for salary raises and bonuses for teachers and other public employees as well as higher public school and UNC system costs resulting from rising enrollments. In other words, new spending covers some pressing needs and leaves little for rural economic development initiatives, environmental protection, and other vital services. This is the case even with modest savings resulting from lower-than-expected enrollment and utilization costs in the Medicaid program and enrollment in the Community College system.

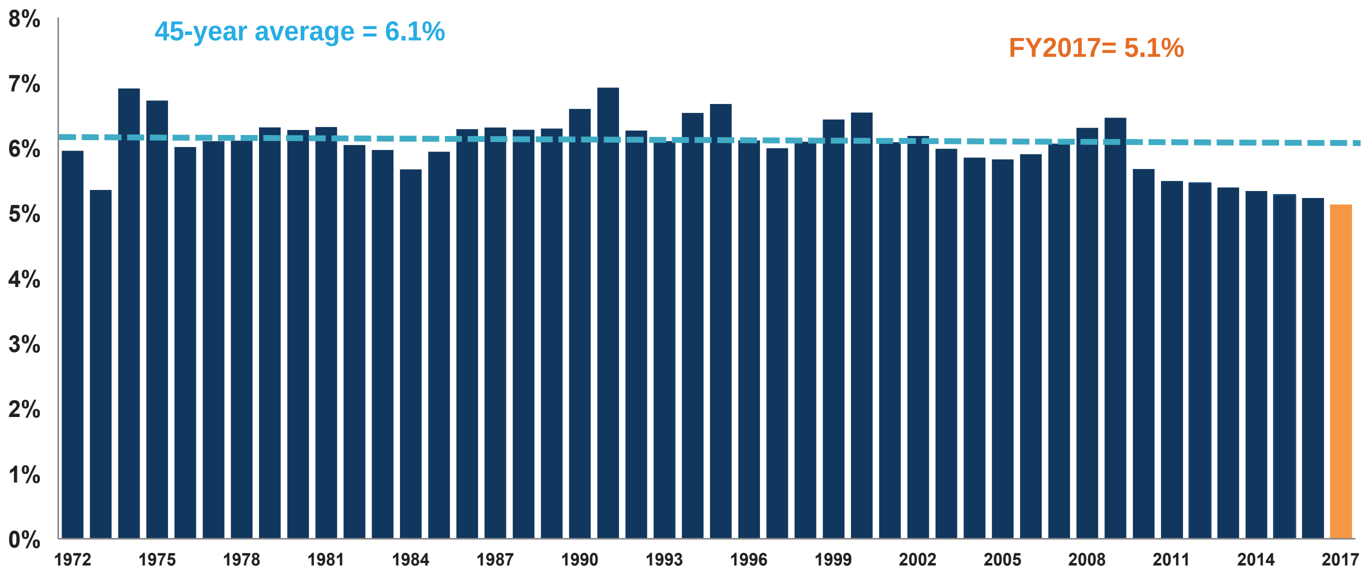
State investments will remain 3.9 percent below the 2008 fiscal year—the last budget in place prior to the economic downturn—when adjusted for inflation (see Figure 2). That would be fine if public needs had shrunk. But they have grown.

State budgets enacted since the 2010 fiscal year have increasingly failed to keep up with public needs (see sidebar on page 7). State spending as a part of the economy—measured by state personal income—has consistently fallen year after year in the past few years. The new budget continues this trend. It caps off the only period as far back as 1971 in which state spending declined as a part of the economy for eight consecutive years while the economy itself grew.

Under this measure, state spending remains below the 45-year average in the 2017 fiscal year (see Figure 3). Why is that a problem? State budgets typically allow spending to grow as the population grows and the economy changes, especially after an economic downturn when revenues plummet and services are frozen or cut. This growth in spending isn't done for its own sake. Rather, it enables the state to keep up with the needs of the people it serves—like building schools and purchasing enough textbooks to meet a growing number of students, or providing quality medical care and residential services to our growing number of older adults.

FIGURE 3: A New Low that Hurts All North Carolinians

State Spending as a Part of the Economy Continues to Shrink, Remains Below the 45-Year Average



SOURCE: NCGA-Approved General Fund budgets, FY1972-FY2017; and BLS State Personal Income and Projections using May 2015 Consensus Revenue Forecast.

Unmet Needs Persist, Hold Back the Economy

Lawmakers' fiscal strategy of flawed rigid formulas and persistent tax breaks is hurting our economy by leaving many investments that support thriving communities unmet or underfunded. This approach hampers North Carolina's ability to generate improved economic outcomes today and in the future through proven strategies—strategies like investing in public services and programs that expand opportunity, build pathways to the middle class, and connect people to jobs and communities to markets.

There are three particular mechanisms by which public investments can support thriving communities:[14]

1. **Expanding the talent and pipeline for innovation and new markets: investments in education, job training programs, and small business development.**
2. **Boosting the wages of state workers beyond a level that merely allows them to make ends meet, thus increasing their spending power in local communities.**
3. **Investing in infrastructure to directly create good-paying jobs and make communities attractive by making the environment ripe for entrepreneurship: transportation, affordable housing, and rural internet access.**

The tax-cut, disinvestment approach is not in line with these evidence-based mechanisms and is unlikely to expand employment and deliver the economic gains that lawmakers promise, as research and prior experience show.[15] This approach merely diminishes the ability of the state to pursue the investments that support shared prosperity and deliver returns to the broader economy.

Investments like preparing every child for kindergarten, which the budget fails to achieve by leaving thousands of children on the waitlists for early childhood development programs. Not only do parents miss out on a work support that allows them to stay on the job as a result, but collectively as a state we lose the potential to improve children's academic performance. In fact, these investments pay off in the long-term and benefit us all by strengthening human capital and earnings as well as increasing the quality of the state's workforce overtime.[16]

Investments like customizable job training programs help people build basic skills to overcome employment barriers and regain their footing on the economic ladder. Yet, the budget fails to make significant strides in ensuring that jobless workers can get the training they need to find a good-paying job in today's economy. Training programs that help produce a talented and skilled workforce provides direct benefits to the worker by way of better preparing them for work that allows them to afford the basics and avoid public benefits. They also provide indirect benefits to entrepreneurs, particularly small- and medium-sized ones, by improving productivity and lowering their training costs as well as to communities by making them more attractive to businesses.[17]

These are not the only unmet needs. Schools will continue to face a shortage of textbooks and digital learning resources—which are the basic tools of a 21st century education system. And in-home and community services for older adults—such as day services and home delivered meals—that help family and community costs remain underfunded. The span of programs for which lawmakers sacrificed for tax cuts and chose not to repair after years of budget cuts and inadequate funding is lengthy, as the following section of this report details.

A Breakdown of the Budget by Core Public Policy Goals for North Carolina

Compensation of Public Employees

The 2017 fiscal year budget provides a pay raise and/or a step increase for all state employees and teachers except for the most-experienced teachers. Of the last eight budget cycles, only three times have lawmakers provided all teachers and state employees raises and/or bonuses.[18] Lawmakers provided a 1.5 percent recurring pay raise and a 0.5 percent one-time bonus to most permanent, full-time state employees. School based administrators received a step increase, a 0.5 percent bonus, and the value of each step was increased by 1.5 percent, bringing the average increase somewhere north of 3 percent. Judicial Branch and Indigent Defense Services employees received a higher annual raise at 4.5 percent.

Lawmakers improved the state teacher salary schedule for early- and mid-career teachers, ensuring that they earn annual pay raises over the first 15 years of their teaching career going forward. Under the previous salary schedule, teachers earned an experience-based salary increase every five years, which was particularly problematic when considering that average teacher pay for North Carolina remains among the lowest in the nation.[19]

Under the new salary schedule, for the 2016-17 school year teachers in the first 15 years of their teaching career will receive a permanent pay increase that ranges from $750 to $5,250 based on their level of teaching experience.[20] Going forward, these early- and mid-career teachers will earn annual experience-based pay raises that range from $250 to $2,000, depending on their level of teaching experience.

Teachers with 15 or more years of experience also receive a permanent salary increase for the upcoming school year ranging from $0 to $4,500.[21] However, these veteran teachers will still face a salary schedule that only guarantees experience-based salary increases (ranging from $2,000 to $3,000) every five years going forward. The new plan raises the maximum base salary to $51,000 from $50,000 for North Carolina's most veteran teachers—those with 25 years or more of teaching experience. This modest pay increase for veteran educators replaces one-time bonuses that lawmakers provided during the last two years, but it nevertheless keeps maximum salaries below what they would have been under the older, pre-2014-15 salary schedule.

And for only the second time in eight budget cycles, lawmakers provided state retirees a one-time 1.6 percent cost-of-living adjustment.

Teachers returning for the 2016-17 school year will receive, on average, a 4.7 percent raise this year, according to the budget document. Lawmakers claim that the average salary for educators from all sources (local, state, and federal) will exceed $50,150. Whether the average pay for educators will actually reach this level is uncertain. The claim is based on several key assumptions that are beyond the control of lawmakers.[22]

Lawmakers also set aside several pots of money for performance- and merit-based bonuses, with specific guidelines on how to allocate that pay. For public schools, lawmakers provided $10 million for a new pilot program that will award bonuses to 3rd grade teachers with the best reading outcomes. They also set aside tens of millions of dollars for one-time merit-based bonuses for employees working in specific sectors of the state government as well as non-educator employees in Local Education Agencies.

And for only the second time in eight budget cycles, lawmakers provided state retirees a one-time 1.6 percent cost-of-living adjustment. These adjustments are a vital part of retirement economic security, and many retirees count on the boost to make ends meet. But the adjustments have not kept up with the growing prices in the household budget, like utilities and rent.

Early Childhood Education

Early childhood programs, like the state's NC Pre-K and Child Care Subsidy Program, enhance school readiness and build a pathway for more of North Carolina's children to achieve economic security as adults. Unfortunately, lawmakers reinvested minimal state dollars in terms of what's needed to eliminate persistently long waiting lists in these two crucial early childhood programs. And for yet another year they relied more on federal block grants to fund these programs, freeing up $12.8 million state dollars. That funding could have been used to leverage state dollars, rather than replacing them.

Lawmakers provided a $1.325 million increase for NC Pre-K, which provides pre-school services for children who otherwise would likely start school lacking important social and academic skills. This is expected to provide services to an additional 260 children, boosting the total number of slots to 29,400 children served. While this is an improvement over last year, there are still 5,476 fewer slots available today than there were in 2009 (peak levels). This is also slim progress in light of the fact that 7,260 children were on the waiting list for the program last year.[23]

This boost will help more children get the early education that they need to thrive but will barely make a dent in providing access to the 20,350 eligible children on the subsidy waiting list.

Lawmakers also provided a $1.325 million increase for an additional 260 child care subsidy slots, which help low-income workers afford safe, quality care for their children. This boost will help more children get the early education that they need to thrive but will barely make a dent in providing access to the 20,350 eligible children on the subsidy waiting list.[24] Lawmakers also provided $3.45 million to increase the child care subsidy market rate for children ages 3 to 5 in Tier 1 and 2 counties, which are the most economically-distressed counties in the state. Yet, they failed to restore previous income eligibility guidelines for the child care subsidy program that made the program more accessible to moderate-income families with children ages 6-12.

In the policy section of the budget, lawmakers directed state agencies to develop, implement, and measure progress for a statewide vision for early education and the transition from Pre-K to Kindergarten. This is an opportunity for the state to create an ambitious plan that will allow North Carolina to lead on early childhood investments, align the pay of educators in this field with what is needed to meet the basics, and produce substantial long-term educational and economic gains.

K-12 PUBLIC EDUCATION

More than 1.54 million students will enter public K-12 classrooms across the state for the 2016-17 school year. Since 2008, total enrollment in public schools has increased by nearly 82,000 students. To put this in perspective, two-thirds of North Carolina's 100 counties have respective populations smaller than 82,000 residents.[25] Amid steady growth in enrollment, public schools will continue to face the challenge of educating more students with inadequate resources under the new budget.

Lawmakers provide $8.4 billion in General Fund dollars for K-12 public schools in the 2017 fiscal year (see the Appendix to learn how we looked at the numbers). This is a 1.5 percent increase in spending compared to last year's budget and a 2.9 percent decrease compared to 2008 pre-recession levels when adjusted for inflation. State support has not kept up with enrollment growth in public schools, as state funding per student is still 8.1 percent below 2008 pre-recession spending when adjusted for inflation (see Figure 4).

Tax cuts and the adoption of an arbitrarily low spending target have resulted in few available dollars to boost state support for lagging areas of the public schools budget. Lawmakers made little progress in boosting state support for many areas of the public schools budget that are crucial to driving improved student learning, while several unmet needs go unaddressed.

Lawmakers continued to rely on Lottery dollars to support areas of the public schools budget that have been funded with General Fund appropriations in the past. The original purpose of the state-sponsored Lottery was to supplement state investments in public school, not replace it. For the 2017 fiscal year, available education Lottery revenues increased by $57.3 million to a total of $591.7 million. Rather than using these additional dollars to supplement state investments in public schools, the General Assembly directed these dollars to the non-instructional support allotment, which had previously been supported with General Fund dollars. This supplanting of state funds allowed the General Assembly to appropriate these freed up funds elsewhere in the state budget, or to offset the cost of tax breaks.

FIGURE 4: State Spending Per Student Remains Below 2008 Pre-Recession Level Under FY2017 Budget

Per Pupil Spending by Fiscal Year, K-12 Budget

SOURCE: NCGA-Approved budgets FY2002-FY2017, adjusted for inflation; for FY2015-FY2017, authors assume that pay raises are in Salaries & Reserves as explained in the Appendix of this report.

Other Core Areas of Investment

Expansion funding includes $46.8 million to account for projected enrollment growth for the upcoming school year. Lawmakers provide an additional $2.5 million for instructional supplies, which represents little progress in boosting the persistent underfunding of this area of the budget. Under the new budget, state support per student for instructional supplies is 54 percent below peak 2010 spending when adjusted for inflation. A total of $4 million in recurring state funding is included in the budget to implement the state's digital learning plan for public schools, far short of the estimated $245 million in annual appropriations that NC State's Friday Institute estimates is required to provide devices and digital content to all of North Carolina's students.[26]

Lawmakers expanded two voucher programs that provide public dollars to students to attend private schools. They expanded an existing private voucher program (named Opportunity Scholarship Program) by establishing a reserve fund and forward funding it with $34.8 million in state dollars. By forward funding this program, lawmakers are attempting to ensure that funding is available to expand the program in the years ahead despite evidence that current demand is limited. The new plan will allow unused voucher funds to sit idle in a reserve fund while other areas of the public schools budget that are inadequately funded go unaddressed.

Changes to the Opportunity Scholarship voucher program are expected to cost $170 million over the next five years, despite lackluster accountability measures that make it impossible to objectively determine whether voucher students are learning.[27] Lawmakers also provided an additional $5.8 million in recurring state funding for special education scholarships for eligible K-12 education students, more than doubling existing state support for the program.

Funding Cuts and Change in Nature of State Support

Lawmakers shifted portions of funding to non-recurring from recurring for an area of the public schools budget, which means the non-recurring funding is not guaranteed to be included in subsequent state budgets and instead will depend on whether lawmakers choose to continue funding these respective areas. A portion of state funding for grants for after-school programs that serve at-risk students was shifted to non-recurring. Lawmakers also cut funding for this grants program by $2.8 million and cut funding for central office administrative support for local school systems by $2.5 million.

Rather than provide permanent additional dollars for textbooks and digital resources, lawmakers provide a modest one-time boost for textbooks and digital materials, which are not guaranteed to be provided beyond the upcoming school year. Under the budget, state funding per student for textbooks remains 44 percent below 2010 peak-level spending.

Lawmakers left some areas of the public schools budget totally unaddressed. They failed to boost funding for school nurses in order to get nurse-to-student ratio closer to the recommended national average. They also failed to restore funding for professional development for teachers—an investment that lawmakers eliminated in 2010, meaning there are no state dollars dedicated to ongoing professional development for teachers. Likewise, lawmakers did not include recurring state support in the new budget for literacy coaches or mentor teachers. On the other hand, lawmakers opted to provide a small $3.5 million boost to support a Principal Preparation Program that will provide competitive grants for school leadership development.

The 2017 fiscal year budget for public school represents limited progress and dampened expectations for public education in North Carolina. The lack of available resources is directly a result of state leaders choosing an arbitrary spending target that has failed to take into account the needs of public schools or the persistent challenges faced in ensuring that all students receive a quality education no matter where they live in the state.

Higher Education

The 2017 fiscal year budget provides $3.8 billion for the state's public four-year universities (UNC System) and its community colleges (CC System) across the state. For the UNC System, state spending represents a 2.0 percent increase over prior year spending, and for the CC System, a 2.2 percent annual increase in spending (see the Appendix for how we looked at the numbers). Lawmakers make little progress in replacing the significant funding cuts experienced by the UNC System in recent years or in boosting funding in the state's community colleges.

UNC SYSTEM

Consists of 16 four-year public universities across the state serving more than 220,000 students, as well as the NC School of Science and Mathematics

Under the 2017 fiscal year budget, state funding per student attending UNC system institutions remains 14.7 percent below 2008 pre-recession spending. Public four-year universities have increased tuition and fees by nearly 50 percent since 2008 in order to help replace the significant and steady reduction in state support in recent years. As students and families increasingly bear more of the increasing cost of a college education, lawmakers aim to provide more certainty for students and families regarding the cost of a college education. Yet, their failure to restore and boost funding in public four-year universities leaves an important component of the cost of a college education unaddressed.

As such, these higher education institutions will continue to face the challenge of providing quality education services to a growing number of students with inadequate resources.

Partial Effort to Make College Affordable

Lawmakers take three particular actions to address the college affordability issue, including offering a fixed tuition option to students, capping tuition at selected institutions, and limiting the amount of student fees charged at public four-year universities.

A Fixed Tuition Payment plan included in the new budget guarantees that tuition at any public four-year university will remain constant or decrease during a specified tuition period (eight consecutive academic semesters for degrees designated as four-year programs or 10 consecutive academic semesters for degrees designated as five-year programs) for future freshman or transfer undergraduate North Carolina residents. Students must remain enrolled continuously at the institution during the entire tuition period.

The budget also limits increase in student fees to no more than 3 percent for institutions within the UNC System. For Elizabeth City State University, UNC Pembroke and Western Carolina, in-state tuition is capped at $500 per academic semester and $2,500 per academic semester for nonresident students beginning with the Fall 2018 academic semester. The tuition cap at these selected institutions aim in part to address lagging enrollment the both resident and non-residents.

Lawmakers include a provision in the new budget that allows additional state funding to these institutions impacted by the capped tuition plan. There is no guarantee, however, that additional state funding will be provided to fully offset the lost tuition revenue in future years.

Additional Spending

The UNC system budget provides $31 million for expected enrollment growth at UNC System schools. Full-time equivalent enrollment within the UNC System will be more than 206,000 students for the 2016-17 academic year.

Expansion funding includes $2.3 million for an initiative to recruit, retain, and graduate students who have started, but not finished, their undergraduate degree. State funding targeted to specific institutions includes $3 million for the UNC School of Medicine's Asheville Campus to support administration, faculty, and related programs. Lawmakers kept the $8 million appropriation flat for ECU's Brody School of Medicine to provide support for the school due to lost revenue, but they converted $4 million of this funding into non-recurring dollars, meaning funding next year will be cut in half absent further action.

Since 2010, the UNC System has experienced more than $660 million in state funding cuts through "management flexibility" cuts.[28] Management flexibility cuts require the UNC Board of Governors to identify and make permanent funding cuts across the university system. The budget requires the UNC System to reduce its operating budget by an additional $16.3 million, adding to the management flexibility cuts of recent years. This $16.3 million cut mirrors the amount of restored state funding for university advancement activities (i.e., fundraising). In last year's budget, the General Assembly capped state spending on advancement activities and reduced the System's budget by $16.3 million. In other words, the management flex cut simply pays for the restoration of $16.3 million for advancement activities spending.

COMMUNITY COLLEGE SYSTEM

Consists of 58 community colleges across the state serving all of North Carolina's 100 counties

State funding per student in North Carolina's community colleges exceeds 2008 pre-recession spending under the 2017 fiscal year budget by 0.4 percent when adjusted for inflation. This is one of the rare areas of the budget where state support surpasses pre-recession spending, in part due to an improving state and national economy that has led to a decline in the number of North Carolinians enrolling in community colleges to gain requisite training and skills to improve their employment prospects. This additional funding does not represent a major boost in resources that allow community colleges to enhance and expand education and training programs.

Tuition at community colleges increased by 81 percent since 2009, and lawmakers make no effort in the new budget to improve affordability and access to North Carolina's community colleges.

Additional Spending

A total of $26 million in savings is reflected in the budget due to an expected decline in enrollment for the 2016-17 academic year.

The budget also includes $12.4 million in state funding to restore some of the recurring funding cuts to community colleges in prior years. Only half of this restored state funding is permanent, meaning community colleges will once again have to find $6.2 million in permanent cuts in the 2018 fiscal year. A total of $6 million in one-time state funding is provided to purchase instructional equipment and technology at all 50 community colleges. Furthermore, $3.4 million in one-time state funding is provided for the Gaston Community College Center for Advanced Manufacturing to be used for capital and equipment.

Funding is also provided to administer the Connect NC Bond program, passed by North Carolina voters earlier this year; the Community College System is set to receive $350 million of the bond proceeds for facility construction and renovation.

Health and Human Services

Second only to education spending, the largest state investment goes towards health and human services. This area of funding aims to ensure that vulnerable populations have access to quality and affordable health care, mental health services, and social services as well as ensure that people with disabilities have the support they need to fully engage as citizens and contribute to their communities.

The 2017 fiscal year budget spends more than $100 million, or 2 percent, below last year's budget for this area of the budget.[29] Modest savings resulting from lower-than-expected enrollment and utilization costs in the Medicaid program, totaling $318.6 million, explains this drop in funding. But so does lawmakers' choice to not fully reinvest those savings back into programs that enhance and protect the health and well-being of all North Carolinians.

Medicaid, Public Health, and Mental Health

The Medicaid program provides health insurance and long-term care to more than 1.6 million people who are poor, disabled, or elderly. In the budget, lawmakers failed to expand Medicaid under the Affordable Care Act—a decision that leaves in place a coverage gap for 300,000 North Carolinians and will cost the state billions in federal dollars that would boost the economy.[30] Lawmakers, however, provided more than $4 million to support Alzheimer's patients and people with developmental disabilities by creating additional slots in community alternatives programs. They also provided nearly $2.3 million to increase RN rates in effect for private duty nurses working in community alternatives programs serving children.

The budget provides several one-time expansions to improve public health outcomes, including $16 million to local health departments and children's development services agencies to offset the impact of reduced Medicaid reimbursement rates and $250,000 for You Quit Two Quit—a smoking prevention and cessation program for pregnant and postpartum women. Lawmakers also provided $100,000 in state aid, on top of $300,000 in federal block grants, to crisis pregnancy centers, which are facilities that the state does not regulate to make sure clients receive medically accurate information or comprehensive, non-directive counseling.[31]

Lawmakers created a $20 million reserve fund to implement the Governor's Task Force on Mental Health and Substance Use recommendations. They also provided a one-time $2 million boost from special funds for crisis centers serving children who experienced trauma and/or have behavioral health needs. They use another $18 million in special funds to expand inpatient behavioral health beds in rural parts of the state facing too few beds. Noticeably absent from the budget is restoration of the single stream funding cut last year for Local Management Entities/Managed Care Organizations, which manage mental health, substance use or intellectual/developmental disability services for people enrolled in Medicaid and those who do not qualify for Medicaid or have other insurance.

Social Services and Other Programs

To build up expansions and improvements enacted last year, lawmakers provided a one-time $8.4 million appropriation and a recurring $167,083 appropriation to implement the Program Improvement Plan for child welfare. The goal of the plan is to enhance children's safety while keeping families together and reducing the likelihood of children entering foster care. Lawmakers boosted funding to improve oversight and accountability in the child welfare system as well as a small one-time $60,000 grant to improve child welfare services in state-recognized Native American communities.

Lawmakers also provided a one-time $1.1 million appropriation for the Children's Angel Watch Program, which is a foster care program for children ages 0-6 (with siblings up to age 10) who are not in the custody of the Department of Social Services and whose families are temporarily unable to care for them because of a crisis. They also provided one-time funding to promote food and nutrition services outreach among older adults, despite other efforts during the legislative session to scale back access to food assistance.[32]

In an effort to support employment opportunities, lawmakers enacted two modest one-time expansions. They provided a $300,000 grant to create jobs for people who are chronically unemployed and to fund staff time to focus on business development leadership and technical support for advanced manufacturing. They also allocated a one-time $50,000 boost for the Able to Work, USA program to assist persons with disabilities to find meaningful employment.

The budget provides no increase to programs and services to people who are blind, deaf, or hard of hearing. It also fails to boost the Home and Community Care Block grant, which helps pay for Meals on Wheels and other services, despite the 10,700 older adults stuck on the wait list for services.[33]

Affordable, Safe, and Vibrant Communities

With a few exceptions, lawmakers opted to provide a patchwork of modest expansions to promote affordable, safe, and healthy communities—a sign of the squeeze resulting from the low budget target and tax cuts.

Affordable Housing

Efforts to significantly expand access to affordable housing are lacking in the budget. Lawmakers only boosted the Workforce Housing Loan Program by $5 million, bringing total funding to $20 million, all of which is one-time money. This program replaced the Low-Income Housing Tax Credit that state lawmakers recently eliminated, but that credit was worth $50 million in the 2014 fiscal year, meaning funding has eroded. Lawmakers also failed to provide a boost to the Housing Trust Fund, despite a $14 million drop in state investments since 2007, when adjusting for inflation.[34]

Half of renters in the state are unable to afford the cost of fair market housing, and these programs help ensure that these families can pay for housing expenses and still pay for other necessities like food and clothing.[35] With such persistent needs, lawmakers ought to be more aggressive in their efforts to reinvest state funding into affordable housing infrastructure to not only support families but to boost local economies as well.

Lawmakers directed that $5.5 million of the Community Living Housing Fund (i.e. not the General Fund) be used to support access to permanent, community-based integrated housing for individuals with disabilities in support of the Olmstead Settlement.

Safe and Fair Communities

Lawmakers made slim progress in improving access to an efficient court system and safe communities beyond raises and bonuses for state employees. This is the case despite unmet needs in North Carolina, such as gaps in re-entry services for ex-offenders returning into local communities and no access to life-changing state drug treatment courts. While both of these programs can support pathways to economic security and improve quality of life, neither received increased funding in the budget.

In a positive move, lawmakers provided $3.5 million in one-time state funding to pay for private counsel assigned to at-risk people who can't afford an attorney. Other areas of expansion include moderate levels of one-time funding to promote School Risk Management Plans for public schools, repair a gym for National Guard youth, and provide a pass-through grant to the Veterans Leadership Council of North Carolina. Lawmakers also purchased an $8 million plane that will be used to catch suspected offenders and perform search and rescue missions, and they also reinvested in the State Crime Laboratory.

Vibrant Communities

The budget includes nearly $26.3 million to cover the debt service costs for the Connect NC bond, which is an initiative to issue $2 billion in new debt to finance public infrastructure across the state. This is an effort that will address a backlog of repair and renovation work while boosting our economy in the short run and position the state to be more completive in the long-term.[36]

Yet, lawmakers missed an opportunity to use the budget as a tool to put forward a robust economic development strategy specifically for rural parts of the state that continue to be largely left out of economic growth. The one-time allocation of $5.7 million in main street revitalization for small rural towns is not comprehensive and will be insufficient to meet needs. The case is the same for the modest $500,000 one-time support for broadband infrastructure in just two counties and the $336,000 to support planning positions that will provide technical assistance to rural areas to develop "prosperity zones." These expansions are steps in the right direction, but, again, they fall short of levels necessary to significantly foster inclusive economic growth.

Likewise, lawmakers failed to develop a comprehensive plan for retraining the long-term unemployed and people facing barriers to work. The budget provides a one-time $500,000 boost to increase apprenticeship opportunities in the NCWorks Apprenticeship Program, bringing total funding to $1.4 million. And there is no state funding for the SNAP Employment and Training Program, which only operates in 9 of the state's 100 counties and provides skills training to low-skilled, low-income adults receiving federally-funded food assistance. At a time when there are more people looking for work than jobs available in most of the state's counties, this budget does not devote sufficient resources to ensure that everyone who wants to work can get the training they need to find a job in the post-recession economy.[37]

And while lawmakers reinvested to promote some laudable environmental and public health goals, at the same time they took the state backwards by blocking some core environmental protections and transit opportunities.

For example, lawmakers set aside $250,000 for the Healthy Corner Store Initiative, which makes healthy food options more accessible in food deserts and supports the sustainability of small businesses. They also boosted conservation investments, including for water infrastructure projects and farmland preservation efforts. But they froze the implementation of clean-up water quality plans and required them to be replaced with a new set of rules, and they also blocked local governments from implementing stormwater protections. They also undermined health and economic development goals by repealing the existing $500,000 light rail funding cap enacted last year and replacing it with a new cap that limits state funding to a maximum 10 percent of total project costs. Both policies are harmful and don't allow transit to compete for the same amount of funding as roads and bridges.

Conclusion

Opportunity exists to make sure that North Carolina lives up to its official state toast: "Where the weak grow strong and the strong grow great." That will, however, require lawmakers to make better fiscal choices and stop pursuing arbitrary budget targets and a bevy of tax breaks that are primarily benefitting powerful special interests and the wealthy. This current strategy of shortchanging crucial public investments poses real harm to state's ability to boost North Carolinians' quality of life and shared prosperity.

Instead, lawmakers ought to pivot and refocus. A smarter strategy would be to concentrate on rebuilding North Carolina by making economy-boosting investments that support ladders of opportunity, especially for people doing their best to get by and for economically distressed counties.

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APPENDIX

HOW WE LOOKED AT THE NUMBERS

There are two primary ways to analyze the current budget and compare it to previous budgets. One method is to measure the budget against the continuation budget. Another method measures the budget against the dollars that were appropriated in last year's 2016 fiscal year budget and/or previous historical budgets.

For many decades, the starting point for the budgeting process in North Carolina has been the amount of resources necessary to maintain the current quality of public systems that Tar Heels have come to expect. Starting with this type of continuation or "current services budget" is a best practice for virtually all responsible governing bodies across the country.[1] Yet, the Governor and the legislature redrew the starting point for the budget process recently.

Now, the continuation budget no longer accounts for the changing costs required to deliver the same level of services approved by the previous General Assembly. For example, the continuation budget no longer reflects estimates for school enrollment growth, debt service, and mandated rate increases for certain programs such as Social Security. As such, measuring the 2017 fiscal year against the continuation budget is not the best methodology to assess budget adequacy or progress.

State lawmakers made a second major change to the budget process. In breaking from the norm, in the 2015 budget state lawmakers started including funding for pay raises for teachers and state employees in the respective agency sections of the budget rather than in the salaries and reserves section of the budget, which is the usual practice. This practice artificially inflates spending levels for core areas of the budget and disallows accurate funding comparisons over time.

To account for these changes, the Budget & Tax Center's methodology has been to remove pay raises and/or bonuses out of the core sections of the FY2015, FY2016, and FY2017 budgets and place them in the salaries and reserves section of the budget. Doing so allows for a more accurate apples-to-apples funding comparison over time to old money reports and budget bills.

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