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BTC Brief

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Seeing Through the Budget Shortfall Numbers Game: Estimate of \$2.7 Billion Ignores Cuts Made During Recession

*Timely, accessible,
and credible
analysis of
state and local
budget and tax
issues*

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KEY FINDINGS:

- Governor Perdue's \$2.7 billion estimate for next year's revenue shortfall represents the amount next year's revenues are projected to fall short of maintaining current service and investment levels.
- State policymakers are considering using one-time funds—due to better than expected revenues and lower than expected costs in the current year's budget—to fund recurring expenses. Using one-time funds does nothing to address the long-term structural gap between demand for state-funded services and inadequate state revenues.
- Even with projected revenue growth, the "Great Recession Budget Gap" from pre-recession service levels will total about \$4.5 billion in each of the two years of the biennium. Using one-time funds to play a numbers game with next year's gap does nothing to address the state's long-term revenue shortfall.
- The improved revenue outlook in the consensus estimate will merely return state revenue levels to the same as in 2006-07 by the end of 2012-13 even before accounting for inflation and population growth. These revenue levels will not provide the state with adequate revenues to meet its responsibilities today or in the future.
- Over the course of the Great Recession, the demand for and the cost of state services has grown and changed. There are nearly 600,000 more residents in North Carolina today than in 2007, more than a quarter million more North Carolinians participate in Medicaid, and enrollment in the state's community college system has increased by the equivalent of adding an NC State-sized campus (over 30,000 new students). Since 2007, costs for providing health and education services have increased by one-fifth and one-sixth, respectively..
- A cuts-only approach to this new shortfall figure will not address the underlying issues of increased demand for state services going unmet and an outdated revenue system.

Putting the State Revenue Shortfall in Context

Governor Perdue recently announced that the projected budget shortfall for the coming fiscal year is down \$1 billion and is now \$2.7 billion. This estimated shortfall represents the amount next year's revenues are projected to fall short of maintaining current service and investment levels.

However, this amount does not take into consideration the deep budget cuts enacted since 2008 when the Great Recession brought the state's economy to a halt and revenue collections plummeted. Getting back to pre-recession levels of services would require restoring nearly \$1.8 billion in cuts to public schools (\$800 million), community colleges and universities (\$300 million), health services (\$500 million), and other valued public structures.

TABLE 1

Defining the FY2011-12 Budget Shortfall	
Preliminary FY2011-12 Base Budget	\$ 20,854,545,556
+ Budget Pressures	
<i>State Retirement System Contribution</i>	\$ 300,000,000
<i>State Health Plan Contribution</i>	\$ 150,000,000
<i>Enrollment growth (K-12, Community Colleges, UNC)</i>	\$ 110,000,000
<i>Medicaid</i>	\$ 200,000,000
Total Budget Pressures	\$ 760,000,000
= Preliminary FY2011-12 Continuation Budget	\$ 21,610,000,000
- Revised Baseline Revenue Forecast	\$ 18,826,000,000
+ Estimated One-Time Funds	
<i>FY2010-11 Medicaid Savings</i>	\$ 200,000,000
<i>Reduced State Health Plan Costs</i>	\$ 50,000,000
<i>Other Reduced Costs</i>	\$ 50,000,000
<i>Estimated Year-End Balance</i>	\$ 237,000,000
<i>Estimated Tax Collections Over Budgeted Amount</i>	\$ 156,400,000
Total One-Time Funds	\$ 693,400,000
FY11-12 Budget Shortfall - Current Service Levels	\$ (2,784,000,000)
Shortfall After Including Estimated One-Time Funds	\$ (2,090,600,000)
+ Cuts During Recession (excluding savings)	\$ 1,770,000,000
FY11-12 Budget Shortfall - Pre-Recession Service Levels	\$ (4,554,000,000)
Shortfall After Including Estimated One-Time Funds	\$ (3,860,600,000)

SOURCE: NC Fiscal Research - Joint Appropriations Briefing - February 1, 2011

http://www.ncleg.net/fiscalresearch/frd_reports/frd_reports_pdfs/Session%20Briefings/Joint%20Appropriations%20Briefing_02-01-11_web.pdf

NC Fiscal Research - General Fund Outlook - February 2011

http://www.ncleg.net/fiscalresearch/generalfund_outlook/generalfund_outlook_pdfs/2011%20Outlooks/Consensus%20Revenue%20Report%20February%202011.pdf

"The Final FY2010-11 Budget: Will It Support Economic Recovery" <http://www.ncjustice.org/?q=node/572>

"The 2009-2011 State Budget: Trifecta of spending cuts, tax increases and federal aid used to address historic shortfall" <http://www.ncjustice.org/?q=node/397>

These substantial cuts over the past two years have significantly impacted the lives of millions of North Carolinians—with larger class sizes and fewer resources for public-school students, higher tuition for students at public universities and community colleges, and fewer services for those who are elderly, disabled or struggling to provide for their families. Factoring in these cuts — excluding true cost-saving measures — puts the “Great Recession Budget Gap” from pre-recession service levels at more than \$4.5 billion.

Policymakers Likely to Use One-Time Funds to Pay for Recurring Services

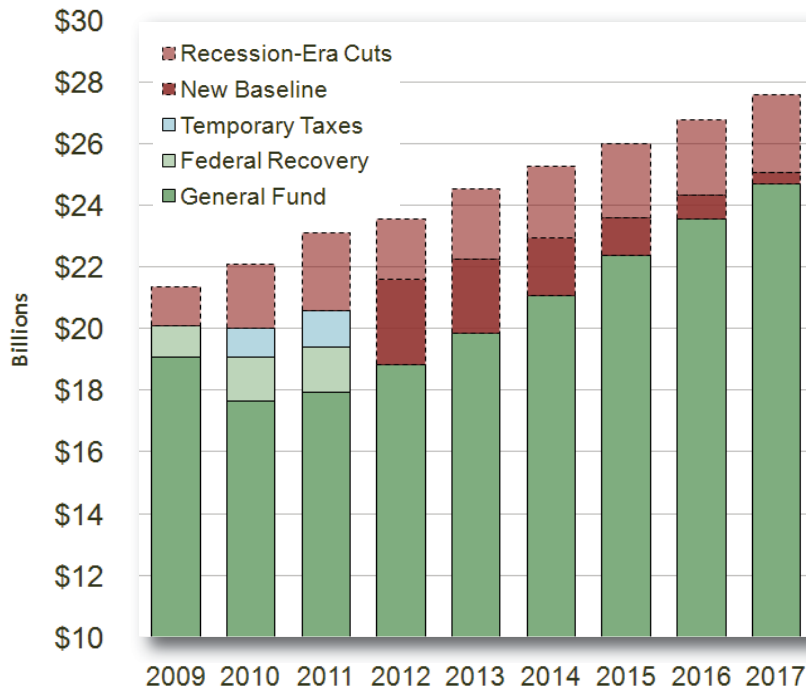
The NC Office of State Budget and Management and the General Assembly’s Fiscal Research Division consensus estimate for total tax and non-tax revenues in fiscal year 2011-12 is \$18.8 billion, about \$600 million more than expected last December. Better-than-expected revenues and lower-than-expected costs in the current year are predicted to provide policymakers with up to \$700 million in one-time funds at the start of the next fiscal year. If state policymakers decide to use all of these one-time funds to pay for recurring expenses in the next fiscal year, the shortfall could fall as low as \$2.1 billion from current-level services and \$3.9 billion from pre-recession levels (see Table 1).

Senate Bill 13, officially titled the “Balanced Budget Act of 2011,” authorizes the governor to make an additional \$400 million in cuts to the current budget and pulls nearly \$140 million from reserve funds. If Senate Bill 13 becomes law in its current form, the amount of one-time funds available in the next fiscal year could increase to more than \$1.3 billion.

FIGURE 1

Governor's Shortfall Estimate Ignores Cuts Made During Recession

Recession-Era Cuts Likely To Persist Through Rest of Decade Without New Revenue



SOURCE: General Fund revenue for fiscal years 2009 and 2010 from NC Office of the State Controller's (NCOSC) Monthly General Fund Reports. Federal Recovery data for fiscal years 2009 through 2011 from NC Office of State Budget and Management. Temporary taxes data from 2009-2011 Biennium Budget, adjusted for lower-than-expected revenues in both fiscal years. Recession-Era Cuts for FY2009 from NCOSC Monthly General Fund Report. Recession-Era Cuts for FYs 2010 and 2011 from 2009-2011 Governor's Adjusted Continuation Budget, plus additional enrollment growth in FY2011 Final Adjusted Budget. FY2012 and 2013 General Fund revenue estimates from Consensus General Fund Revenue Projections of the NC Office of State Budget and Management and NC Fiscal Research. General Fund revenues beyond FY2013 are projected to track with the Congressional Budget Office's national tax base growth. Continuation-level appropriations for FY2012 from NC Fiscal Research anticipated enrollment and inflation pressures, with growth expectations in base-level appropriations increasing at the long-run average of 3 percent per year.

However, relying on additional cuts to the current-year budget to raise extra one-time funds for the next fiscal year will put enormous strain on already-stressed state agencies and fail to put the state on a long-term path to fiscal responsibility. Using one-time funds to play a numbers game with next year's gap does nothing to address the state's long-term revenue shortfall.

Current Service Levels Below Pre-Recession Levels Despite Increased Demand

Even returning to service levels in place before the Great Recession will not be sufficient for the state's economic recovery. The state has grown and changed since 2007. There are now 600,000 new residents in North Carolina.¹ There are also more than 30,000 additional students enrolling in community colleges, seeking to gain the skills and education necessary for future jobs. And the population has also gotten older, putting strain on the state's health and human services.

And as demand has increased, so too has the cost of delivering services. For example, the cost of providing health services has increased by more than one-fifth,² while the cost of higher education has increased by one-sixth.³

Modernize Revenue System to Provide a Long-term Solution

At no point in the next biennium are state revenues expected to exceed the revenue levels of 2006-07. These revenue levels will fail to provide the state with adequate revenues to meet its responsibilities today and far into the future. Furthermore, with one-time funds expended, the shortfall from pre-recession service levels would remain above \$4.5 billion into the second year of the next biennium, with shortfalls expected to continue for years to come (See Figure 1).

Thus, while the improved revenue estimates mean a less dire budget and revenue outlook in the next year, state policymakers must still tackle the challenges in the immediate-term of meeting the increased demand for state services that result when economic hardship abounds and the state's population grows and ages. Playing a numbers game with one-time funds and mid-year budget cuts does not solve the state's structural revenue shortfall; it merely pushes off the reforms necessary to put the state's finances and the economy on a sustainable path.

To protect North Carolina's vital public structures over the next biennium and beyond, policymakers must not only take a balanced approach to the newly projected shortfall but modernize the state's revenue system and provide a long-term solution.

1 NC Office of State Budget and Management.

2 Bureau of Labor Statistics – Consumer Price Index – Medical Care

3 The College Board – Trends in College Pricing 2010 - http://trends.collegeboard.org/college_pricing/report_findings/indicator/45