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BTC Brief

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WORSE THAN WORST CASE? Even Governor Perdue's Worst-Case Cuts Will Still Require More Revenue

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

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KEY FINDINGS:

- **Even the worst-case budget cut scenarios of 10 percent for public schools, community colleges, and universities and 15 percent for all other state agencies will come up \$1.1 billion short of closing the state's \$3.7 billion estimated revenue shortfall next year.**
- **Closing the shortfall with additional cuts to non-education agencies would force across-the-board cuts of 27 percent compared to this year and more than one-third compared to pre-recession levels. Cuts of this magnitude would jeopardize long-term investments in North Carolina's public structures and would compromise public safety, environmental protection, and the health of communities across the state.**
- **Raising revenue equal to the amount in the current temporary tax package—just under \$1.4 billion—would merely hold the line at the “worst case” scenarios proposed by state agencies. Comprehensive revenue reform could raise even more revenue and preserve many of the public investments in initiatives like Smart Start, More At Four, smaller class sizes, and community-based care that North Carolinians overwhelmingly support and that save the state money in the long run.**

Even Worst-Case Cuts Fall Short of Closing State Revenue Shortfall

The media has been abuzz with stories of the budget cuts outlined by state agencies responding to Governor Perdue's request for cut scenarios up to 15 percent. The devastating impact of the proposed cuts on the public structures that form the foundation of the state's economy and the quality of life of all North Carolinians has warranted the attention. Some of the worst-case cuts have included the following:

- Increasing class sizes in public schools by eliminating more than 5,000 teachers and more than 13,000 teacher assistants
- Raising tuition while cutting nearly 3,000 teaching and non-teaching positions at community colleges and universities
- Cutting Medicaid services that enable thousands of North Carolinians with physical and mental health problems to receive cost-effective care in their communities instead of institutions and nursing homes
- Eliminating substance abuse programs at several correctional facilities across the state

Yet the reports on the worst-case cuts proposed in response to Governor Perdue's request fail to note that even cuts of this magnitude will not be enough to close the revenue shortfall.

The most recent estimates by the General Assembly's Fiscal Research Division show that anticipated revenues will fall \$3.7 billion short of what is necessary to maintain current services in next year's budget.¹ Fiscal Research estimates the state would need to spend \$21.9 billion to keep services at the same level as in the current year (see Table 1).

This figure includes \$1.6 billion to replace lost federal stimulus funds, roughly \$400 million in one-time cuts, \$500 million to shore up the State Health Plan and State Retirement Systems, and at least \$350 million to cover additional enrollment in public schools, community colleges, universities, and the state's Medicaid program. The temporary tax package passed in 2009 is set to expire next year, which leaves the state with an estimated \$18.2 billion in general fund revenue, \$3.7 billion less than the \$21.9 billion necessary to keep services at current-year levels.

FIGURE 1

WORST-CASE CUTS STILL COME UP OVER \$1.1 BILLION SHORT

FY 2011-12 Budget	Continuation Budget	Worst-Case Cuts
Public Schools	\$8,006	\$7,214
Community Colleges	\$1,067	\$957
Universities	\$2,844	\$2,573
Total Education	\$11,916	\$10,743
All Other Agencies	\$9,283	\$7,891
Debt Service	\$708	\$720
Budget	\$21,907	\$19,354
Available Revenue	\$18,227	\$18,227
Revenue Shortfall	\$3,679	\$1,127

All Amounts in Millions

SOURCE: NC Budget & Tax Center calculations based on NC Fiscal Research data

To close the gap between current service levels and anticipated revenues, Governor Perdue requested plans to reduce state funding for public schools, community colleges, and the UNC system by 5 and 10 percent, with all other state agencies asked to prepare an additional plan cutting state funding by 15 percent. The worst-case scenarios from all agencies, including agencies that provided budget-cut plans and those that did not, account for less than \$2.6 billion of the total shortfall of \$3.7 billion.

These estimates presume that revenues will grow at the historical rate of 5 percent—nearly twice the rate of growth in the current year—and that lawmakers will exempt North Carolina from federal tax law changes that are projected to reduce state revenues by \$423 million in the next budget year.² If continued weakness in the economy reduces revenue growth to the same rate as this year and lawmakers choose not to exempt North Carolina from expected federal tax law changes, next year's revenue shortfall would climb to \$4.4 billion.

Raising Revenue Only Way to Avert

Severe Budget Cuts & Preserve Critical Public Investments

Governor Perdue and the new GOP leadership in the General Assembly have stated they intend to close next year's state revenue shortfall without raising new revenue or severely impacting the quality of instruction in public school classrooms. Closing the remaining \$1.1 billion gap without new revenue while holding the line at 10-percent cuts in education would force cuts in the rest of state government of 27 percent relative to this year.

Compared to pre-recession levels, a cuts-only approach would reduce funds by more than one third for state agencies responsible for public services such as providing health care to the poor, disabled, and mentally ill, running our courts and prisons, protecting our environment, and overseeing state contracts. Cuts of this magnitude to the state's public structures would be unprecedented.

Continuing the temporary tax package passed in 2009 would raise nearly \$1.4 billion next year, likely enabling the governor and lawmakers to avoid making budget cuts beyond those already proposed by state agencies. Comprehensive revenue reform could raise even more revenue and preserve many of the public investments in initiatives like Smart Start, More At Four, smaller class sizes, and community-based care that North Carolinians overwhelmingly support and that are likely to save the state money in the long run. A recent poll by Elon University demonstrates that North Carolinians strongly oppose closing the state revenue shortfall through cuts alone, and more than 6 in 10 support extending most of the existing temporary tax package to protect North Carolina's investments in the state's public.

The governor and the new leadership in the General Assembly wisely recognize that the unprecedented shortfall caused by the Great Recession and exacerbated by the state's out-dated revenue system cannot be fixed by short-term measures that have gotten the state through previous recessions. Efforts to improve the efficiency and cost-effectiveness of state government, if designed and implemented well, could save the state millions of dollars each year and maximize the benefit of each dollar spent in the public interest. It's also clear, however, that even successful efforts to improve the efficiency of state government will fall far short of closing the revenue shortfall caused by the recession. New revenue will be essential to preserving state investments in the education, health, and safety of North Carolinians while helping to pave the way to economic recovery.

1 NC Fiscal Research Division, "North Carolina's FY 2011-12 Budget Gap," December 7, 2010. http://www.ncleg.net/fiscalresearch/frd_reports/frd_reports_pdfs/Fiscal_Briefs/Fiscal%20Brief_%20FY%202011-12%20Budget%20Gap.pdf

2 Jonathan Tart, "Fiscal Analysis Memorandum: 2011 IRC Update," December 1, 2010. <http://www.ncleg.net/DocumentSites/committees/revenue/laws/2009-2010/Meeting%20Documents/Meetings%20for%20Report%20to%202011%20Session/12-1-2010/FM%202011%20IRC%20Update%20Rev%20Laws%2012-1-10-2011%20IRC%20Update.pdf>