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BTC Brief

NC BUDGET & TAX CENTER

September 2010

BACK TO THE NIXON YEARS: State Spending in North Carolina Could Reach Lowest Level in 40 years

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

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KEY FINDINGS:

- **The combination of a weak economy, the end of federal stimulus funds and the expiration of the temporary tax package will leave North Carolina with a $3.3 billion revenue shortfall for the next fiscal year.**
- **A "cuts-only" approach—or even a majority-cuts approach—to the $3.3 billion revenue shortfall would drive state spending to the lowest level, as a share of state personal income, since 1972.**

OVERVIEW

In the midst of the worst economic crisis since the Great Depression, with state revenues declining by record levels, state lawmakers took a balanced approach to addressing the budget shortfall in 2009 by making responsible budget cuts and raising revenue through a temporary two-year tax package. Yet the combination of sustained economic distress, the end of federal stimulus funds and the expiration of the temporary tax package will combine to create a revenue shortfall of approximately $3.3 billion for the next fiscal year.

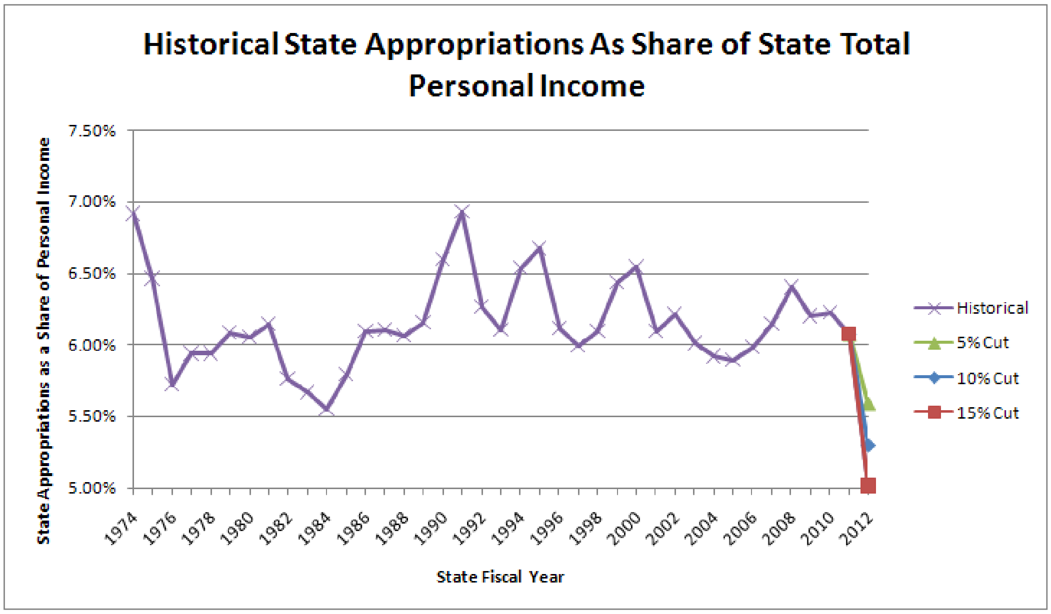
At the beginning of September, Governor Perdue instructed state agencies to develop budget plans for the next biennium with cuts of 5, 10, and 15 percent. Coming on top of more than two years of severe cuts averaging nearly 10 percent, across-the-board cuts of 10 or 15 percent would drive state spending to its lowest level since 1972. Even cuts of 5 percent would put state spending lower than all years save one of the past 40 years.

Perfect Storm to Cause Historically Low State Revenues

In more than two-thirds of the past 40 years, spending in the state budget has hovered between 6 percent and 7 percent of the total personal income (TPI), which serves as a measure of the state's economy and the size of the state's tax base. In the past 25 years, state spending dropped below 6 percent of TPI only three times (see figure).[i]

For the first time in 60 years, state TPI in 2009 was lower than the previous year. Because state revenues decline faster (and stay depressed longer) than state total personal income, state spending would have dropped well below the threshold of 6 percent of TPI without the nearly $2.9 billion in federal Recovery Act assistance to the state.

With Recovery Act dollars and the state's temporary tax package both expiring in the middle of next



SOURCE: US Bureau of Economic Analysis - State Personal Income - http://www.bea.gov/regional/spi/

year, expected revenues under existing law will fall short of sustaining state services at current levels by 12 percent to 15 percent. Addressing this revenue shortfall with a cuts-only approach would drive state spending down to just over 5.0 percent of state TPI. The only time in over forty years that state spending was below 5.0 percent of state TPI was 1972.

Since 1974, state spending has been above 5.5 percent of TPI in every year. Even across-the-board budget cuts of five percent, the lowest level of cuts for which Governor Perdue asked state agencies to plan, would put state spending only just above 5.5 percent of TPI, the second-lowest level in forty years.

Compounding the problem of historically low state spending is the increased need for public spending during periods of economic distress. The severity and extended duration of the recession has increased the number of families requiring assistance to get needed health care, workers needing re-training at community colleges, and families needing assistance with caring for elderly parents.

Each Cut Is More Damaging Than the Last

When agency directors make budget cuts, they attempt to protect core services by first cutting professional development and training, long-term planning and program support and improvements, and pilot projects. The budget cuts implemented over the past two years have all but eliminated these important but non-essential expenditures and have already hit core services. Even cuts of 5 percent will have a substantial negative impact on these vital programs, and across-the-board cuts of 10 or 15 percent will severely impair the ability of state government to make the critical investments in education, health, and public safety that form the foundation of a strong middle class.

Conclusion

If state lawmakers address the budget shortfall with cuts only, state spending will drop to its lowest level as a share of state total personal income in over forty years. Such historically low levels of state spending would cause severe harm to North Carolina's vital public structures, even as the enduring impact of the recession continues to elevate the need for state services. Protecting funding for these services by eliminating unjustified tax breaks and ineffective business incentives would help to ensure that the state continues to make critical investments in a healthy and trained workforce necessary to put the state on a path out of the recession.

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i Source for historical state total personal income data is from Regional Economic Information System, Bureau of Economic Analysis, US Department of Commerce. See http://www.bea.gov/regional/docs/footnotes.cfm?tablename=SQ1. Author's calculations for FY2012 state TPI is based on Congressional Budget Office national projections for wage and salary growth and domestic economic profits in The Budget and Economic Outlook: An Update. http://www.cbo.gov/ftpdocs/117xx/doc11705/08-18-Update.pdf

The source for historical state appropriations (including federal counter-cyclical aid) is the Historical Budget Data available on the website for the NC Office of Management and Budget: http://www.osbm.state.nc.us/new_content/historical_budget_data.pdf. Author's calculations assume that agency-proposed budget cut plans will be from a baseline of FY2011 appropriations plus federal Recovery Act aid to the state. The FY2012 baseline also includes a modest 2 percent "budget pressure" growth to estimate FY2012 continuation budget.

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