



North Carolina
Justice Center

*Opportunity
and Prosperity for All*

BTC Reports

Vol 18 No 5 • May 2012

THE NEWSLETTER OF THE BUDGET & TAX CENTER

THE GOVERNOR'S PROPOSED 2012-13 BUDGET:

A Balanced Approach that Deserves Legislative Consideration

BY BRENNA BURCH, *Public Policy Analyst*

CONTACT:

BRENNA BURCH
919/856-2176
brenna@ncjustice.org

Budget & Tax Center
P.O. Box 28068
Raleigh, NC
27611-8068
www.ncjustice.org

Enjoy reading these
reports?
Consider making
a donation to
support the
Budget & Tax Center
at
www.ncjustice.org

Executive Summary

- On May 10, Governor Perdue released her recommended \$20.9 billion FY2012-13 state budget. It includes a ¾-cent extension of the state sales tax, which would raise a projected \$760 million in revenue. While the governor's proposal represents a 4.9-percent increase over the \$19.7 billion FY2012-13 continuation budget, it would nonetheless spend 8.2 percent less than the last state budget approved before the onset of the Great Recession (FY2007-08) when adjusted for inflation.¹
- Revenue availability for FY2012-13 increased as a result of stronger-than-expected personal income tax collections, resulting in a projected revenue surplus of \$232.5 million. Combined with an unappropriated balance of \$41 million, \$122.5 million in agency reversions, \$9.6 million in General Fund restitution from the National Mortgage Settlement, and \$757 million in net new revenue, the governor's budget is predicated on \$1.16 billion in revenue in excess of the continuation forecast of \$19.94 billion.
- State investment in almost every area of the budget is far below pre-recession levels under both the governor's proposal and the continuation budget. When compared to the pre-recession inflation-adjusted FY2007-08 state budget, the governor's proposal spends \$1.88 billion less and the continuation budget spends \$2.85 billion less.
- The governor's budget would restore \$562 million in funding to public schools—an amount greater than the current budget's largest single recurring cut to public education, the \$503.1 million "LEA Adjustment." While her proposal calls for a 7.6-percent increase to total state funding for public schools, it would still spend 5.9 percent less than the pre-recession budget.²
- The governor's budget includes \$200 million in one-time money to address the current year's shortfall in funding to pay Medicaid claims. While this amount fully addresses the FY2011-12 Medicaid shortfall as estimated by the Office of State Budget and Management and the Department of Health and Human Services, the governor's suggested funding increase for Medicaid in FY2012-13 falls \$143 million short of the \$243 million needed to meet program obligations.³

Overview

As North Carolina's economy continues to struggle through an uneven and slow-paced recovery, Governor Beverly Perdue has released a budget proposal for fiscal year 2012-13 (FY2012-13) that offers a balanced approach to meeting needs for public investment by raising revenues – a choice that would more adequately finance long-standing state investments in education, health, and safety. However, the governor's budget would cap the state gas tax, which would mean \$63 million less for fixing North Carolina's 5,000 structurally deficient or functionally obsolete bridges and overpasses.

Last year, state lawmakers chose to address a \$2.4 billion budget gap with \$1.7 billion in spending cuts, a \$520.4 million one-time credit balance, \$218.5 million in fund transfers and diversions, and \$63.9 million in fee increases. The final budget also artificially inflated total General Fund spending with a \$219.8 million accounting maneuver, transferring \$196.8 million for the State Highway Patrol from the Highway Fund into the General Fund.⁴ The sum effect of last year's budget was to reduce North Carolina's current services, or baseline, budget to its lowest level in more than 40 years.⁵

FIGURE 1: GOVERNOR PERDUE'S FY2012-13 BUDGET

	FY2012-13
Pre-Recession Budget (FY2007-08, Inflation-Adjusted)	\$ 22,783,606,634
FY 12-13 Original Recommended Continuation Budget	\$ 20,817,534,214
FY 12-13 Certified Approved Budget	\$ 19,937,449,375
<i>Recommended Expansion Budget</i>	\$ 1,346,998,044
<i>Recommended Cuts to Budget</i>	\$ (377,360,654)
Total FY 12-13 General Fund Appropriations	\$ 20,907,086,765
% Change from Pre-Recession Budget	-8.2%
% Change from Original Recommended Continuation	0.4%
% Change from Certified Approved Budget	4.9%

This year, Governor Perdue has proposed revisions to the continuation budget that would partially restore state funding to most General Fund budget functions, although she has also proposed both tax and spending cuts within the Transportation budget. This issue of BTC Reports analyzes the governor's proposed budget in detail with a special focus on the potential impacts on low- and moderate-income North Carolinians and the long-term fiscal health of the state.

The Governor's Balancing Act

With \$757 million in new revenue from raising the state sales tax by ¾-cent, a \$232.5 million revenue surplus attributable largely to stronger-than-expected personal income tax collections, \$122 million in end-of-year agency reversions, and \$9.6 million in one-time funds from the National Mortgage Settlement, the governor's budget is predicated on \$1.16 billion in revenue over the continuation forecast. The governor's proposal would set aside \$200 million of that availability to pay outstanding Medicaid claims for services rendered in FY2011-12, closing the current-year Medicaid budget gap. Total revenue availability for the governor's budget is \$962.6 million.

A budget shortfall is the difference between maintaining the current quality and quantity of state services and the amount of revenue that the current tax system is expected to generate.⁶ The governor's budget does not reflect a shortfall for two

Estimating the Continuation Budget Shortfall

FIGURE 2: HOW DOES THE GOVERNOR PAY FOR HER BUDGET?

	FY 12-13
Baseline Revenue Forecast	\$ 19,944,500,000
Initial Appropriation Requirements	\$ 20,907,086,765
Recommended Base Budget	\$ 19,937,449,375
Recommended Expansion Budget	\$ 1,346,998,044
Recommended Cuts	\$ (377,360,654)
Governor Perdue's Projected Shortfall	\$ (962,586,765)
+ Recommended Revenue Changes	\$ 757,000,000
Reinstate 0.75% Sales Tax Increase effective July 1, 2012	\$ 760,000,000
Small Business Jobs Credit + Extend Various Tax Sunsets	\$ (3,000,000)
+ Net General Fund Credit Balance	\$ 205,832,325
Unappropriated Balance	\$ 41,232,325
Revenue Overcollections	\$ 232,500,000
Reversions	\$ 122,500,000
Medicaid Provider Payments in FY2011-12	\$ (200,000,000)
Other Revenue	\$ 9,600,000
Total Available to Address Shortfall	\$ 962,832,325
Remaining Balance	\$ 245,560

reasons: one, because the \$1.7 billion in cuts to state services made in last year's budget reduced the overall service level, or baseline, against which this year's budget proposals are measured; and two, because some of the most significant budget pressures – particularly the expiration of \$258 million in federal EduJobs money in the K-12 public schools⁷ – occur beyond the scope of accounting for the state's General Fund budget. In the schools, however, the expiration of these federal funds will necessarily impact the level of services offered because those funds are currently being used to maintain between 4,000 and 5,000 public-school jobs and there is no replacement for those monies in the current-law continuation budget.

Another major budget pressure facing North Carolina this year is the forecasted \$243 million shortfall in funding for Medicaid.⁸ This is the net amount that the Department of Health and Human Services officials project they cannot "backfill" with other agency funds or operational savings from efficiencies, and it includes estimates of what would be needed to comply with the recent federal ruling on personal care services.⁹ Taken together, these two budget pressures alone constitute nearly a half-billion-dollar budget gap for FY2012-13.

The governor's proposal to extend the ¾-cent sales tax would provide revenue more than adequate to address these immediate needs. However, without new revenue, North Carolina faces a budget gap this year of approximately \$288 million.

Proposed Changes to Revenue

The governor's proposed budget would raise \$760 million in recurring state General Fund revenue by raising a ¾-cent state sales tax effective July 1, 2012. The governor also proposes a Small Business Jobs Credit, which would provide a tax credit of up to \$5,000 to qualified small businesses that hire a veteran who has served since the 9/11 terrorists attacks or a person who has been unemployed for more than 180 days. The

IMPROVED PERSONAL INCOME TAX COLLECTIONS RESULT OF RECOVERY FOR SOME

North Carolina's better-than-anticipated personal income tax collections for tax year 2011 are reflective of trends in past recessions where higher-income taxpayers made earlier and stronger income gains than did low- and moderate-income taxpayers. After the 2001 recession, the average inflation-adjusted income of the bottom

90 percent of households grew by 4 percent while the incomes of the top 1 percent grew more than ten times faster.¹⁰

With five months of declines in the unemployment rate, an improved employment picture is in part driving the \$232.5 million revenue surplus, which has been largely attributed to withholding from wages and

salaries for the personal income tax. It is also possible that the surplus is a function of higher-income individuals returning to the workforce at higher levels of income, in which case the progressive nature of North Carolina's personal income tax would be responsible for higher collections by capturing more of that economic activity.

governor also proposes to extend several existing tax credits for research and development that are set to expire this year. The cost of the new tax credit and the extension of the R&D credits would not be fully realized in FY2012-13 and are estimated to cost just \$3 million in the upcoming fiscal year. In total, the governor's tax provisions would raise a total of \$757 million in new revenue for FY2012-13.

The 3/4-cent State Sales Tax

The governor's proposal would raise the 3/4-cent state sales tax that was allowed to expire in last year's final legislative budget. The tax is projected to raise \$760 million in FY2012-13. By including revenue in this proposal, the governor has taken a balanced approach to addressing North Carolina's budget needs. However, relying exclusively on the sales tax, rather than the progressive personal income tax or the corporate income tax, means the responsibility of maintaining needed state investments will fall disproportionately on low-income families. North Carolina's revenue system already requires low-income families and individuals to pay greater shares of their incomes in state and local taxes than high-income families and individuals do, and a sales-tax increase would worsen that imbalance.

Small Business Jobs Credit

The Small Business Jobs Credit proposed by the governor would allow qualified businesses that hire a post-9/11 veteran or a person unemployed for 180 days or more to claim a tax credit equal to 6.2% of wages paid to that employee, up to a maximum credit of \$5,000. To be eligible for the credit, the job for which a veteran or unemployed person has been hired must pay at least \$20,000 per year; must be full-time; must be a

WHO WOULD PAY MORE UNDER THE GOVERNOR'S 3/4 CENT SALES TAX?

Average Impact as a % of Income and Average \$ (2007)

2007 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than \$16,000	\$16,000 – \$28,000	\$28,000 – \$46,000	\$46,000 – \$75,000	\$75,000 – \$159,000	\$159,000 – \$379,000	\$379,000 – Or More
Tax Change as % of Income	+0.5%	+0.4%	+0.3%	+0.2%	+0.2%	+0.1%	+0.1%
Average Tax Change	+54	+82	+117	+148	+198	+290	+866

“net new job,” increasing the number of full-time jobs statewide; and must be held by one employee during the entire year. The credit is limited to existing businesses that had five or more employees as of December 31, 2011, and total credits to any individual business taxpayer cannot exceed \$200,000, which is equivalent to 40 new jobs at the maximum allowed value of the credit. Furthermore, a taxpayer that claims the Small Business Jobs Credit is not eligible for any other job creation credit with respect to the same job. The credit is estimated to cost \$24 million in FY2013-14.

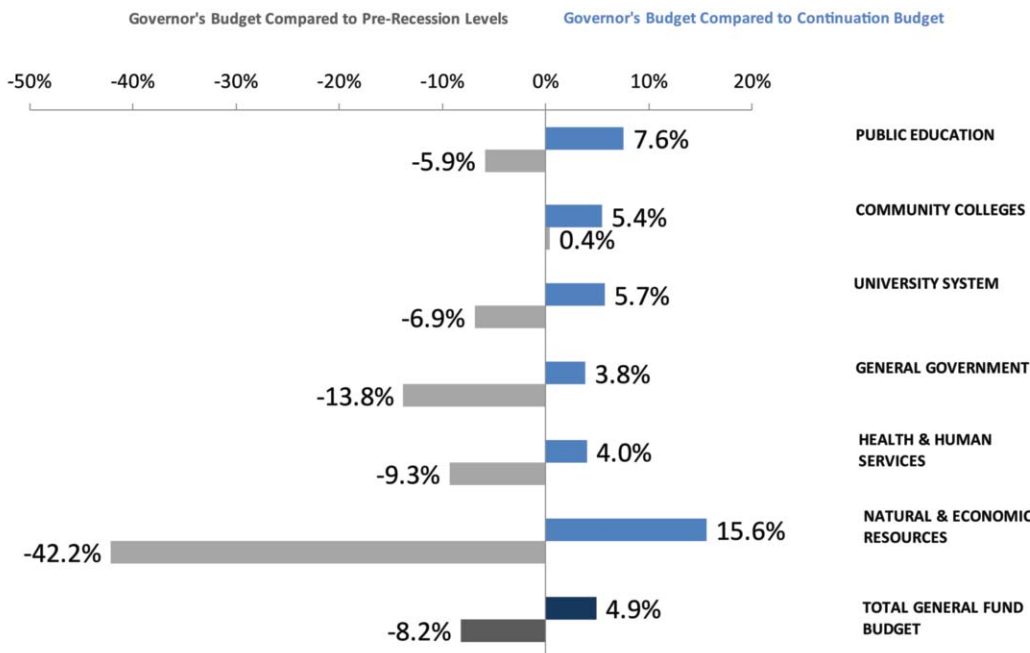
Prioritizing re-employment of North Carolina’s post-9/11 veterans and long-term unemployed workers is a laudable policy goal. However, eligibility for this credit is narrow enough that it may not result in remarkable employment gains for either of these groups. Of the two, the number of long-term unemployed workers is larger by far.

With unemployment near 9 percent, North Carolina’s unemployed population is approximately 400,000, and in 2010, 48.9 percent of all unemployed workers in North Carolina had been unemployed for more than 180 days, according to Economic Policy Institute analysis of Bureau of Labor Statistics data.¹¹ For the long-term unemployed, this situation has not improved significantly since that time.

Similarly, there are only estimated to be

6,000 veterans of Afghanistan and Iraq living in North Carolina that have separated from active duty and are likely to be either in the workforce or looking for work.

FIGURE 3: Governor's Budget Improves Investment in Critical Budget Areas over Continuation Budget, but Falls Short of Returning to Pre-Recession Levels



SOURCE: Governor's Recommended Adjustments, 2012-2013 North Carolina State Budget and Final FY 2011-2013 Budget. Pre-recession spending levels from FY 2007-2008 adjusted for inflation.

Proposed Changes to Spending

While a year-over-year comparison of the current state budget and the governor’s budget proposal shows significant improvement in spending on core governmental functions, comparing the governor’s recommendations to pre-recession spending, adjusted only for inflation, reflects a diminished baseline budget. Nonetheless, the governor’s plan would be a step toward restoring public investments to pre-recession levels, boosting demand and strengthening North Carolina’s economy in turn.

The governor's proposed FY2012-13 General Fund budget would increase total state appropriations by \$969.6 million, or 4.9 percent. The following sections provide an overview of major changes proposed in Education, Health and Human Services, Justice and Public Safety, Natural and Economic Resources, and Transportation.

EDUCATION

The governor proposes an overall increase to the General Fund education budget of \$760.8 million, or 6.9 percent compared to the continuation budget. The increase would restore some, but not all, of the cuts to public schools, community colleges, and the UNC system that the legislature made last year. The total \$760 million in revenue that would be raised by reinstating the 3/4-cent state sales tax is equivalent to the amount of total funding the governor's budget would restore to the education budget as a whole.

*Kindergarten through
12th Grade (K-12)
Education*

The K-12 public education budget would increase by \$562.3 million, or 7.6 percent over the continuation budget. The single largest item in the governor's proposed education budget is elimination of the Local Education Agency (LEA) Flexibility Adjustment, a massive recurring cut to the K-12 public school budget that is set to increase from \$429 million to \$503.1 million in the upcoming FY2012-13 budget year.¹² The governor's budget for K-12 public education would eliminate the LEA Flexibility Reduction entirely.

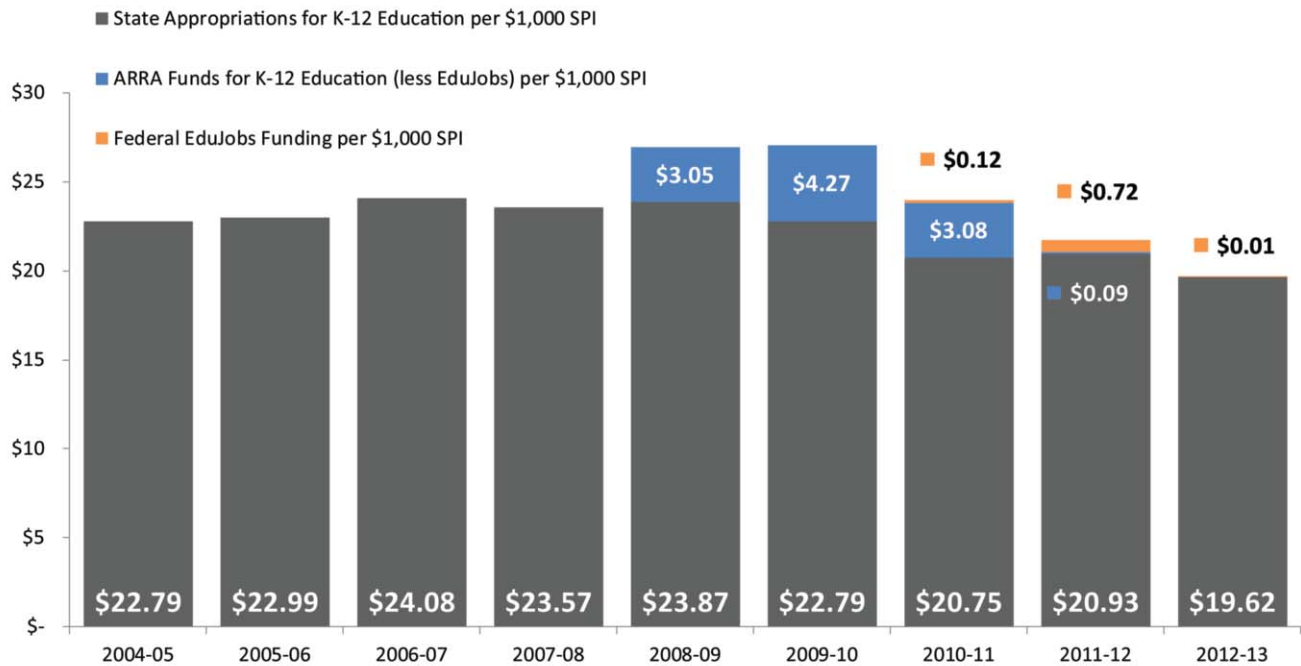
FIGURE 4: RECOMMENDED EDUCATION APPROPRIATIONS

	FY2012-13 Continuation Budget	FY2012-13 Governor's Recommended	Change (\$)	% Change from Continuation
Public Instruction	\$ 7,444,122,100	\$ 8,006,375,540	\$ 562,253,440	7.6%
Community Colleges	\$ 985,000,000	\$ 1,038,504,897	\$ 53,504,897	5.4%
UNC System	\$ 2,551,672,698	\$ 2,696,757,060	\$ 145,084,362	5.7%
TOTAL	\$ 10,980,794,798	\$ 11,741,637,497	\$ 760,842,699	6.9%

However, North Carolina public schools face another budget pressure in the coming fiscal year. They must spend the last \$258 million of the federal recovery dollars they received by September 2012 in order to comply with federal law.¹³ Neither the continuation budget nor the governor's proposed budget would replace these "EduJobs" dollars, which are supporting between 4,000 and 5,000 public schools jobs through the 2011-12 school year.¹⁴

The governor has also proposed a salary step increase for certified public school personnel, which includes teachers, principals, counselors, and others, and a 1.8 percent across-the-board pay increase for all other public school employees. The total cost of this pay increase for public school employees is approximately \$87.6 million.¹⁵ The governor's proposal to give these employees, who have been working under a pay freeze since FY2009-10, is both timely and appropriate. One of the only widely agreed upon tenets of education policy is that high quality teachers are the key to boosting student achievement.¹⁶ According to the Department of Public Instruction, North Carolina ranked 41st in the United States for teacher compensation in FY2010-11, paying teachers an average salary of \$46,701 – nearly \$10,000, or 16 percent, less than the national average teacher salary of \$55,623.¹⁷ Moreover, the starting salary for a teacher is just \$31,000, which is too low to be truly competitive for attracting skilled college graduates that also possess a teaching certification. According to the National Education Associations, North Carolina ranks last out of all 50 states and the District of Columbia for increases in average teacher pay over the past 10 years.¹⁸ In order to continue to

FIGURE 5: Even with recovery dollars, state investment in public education as a share of North Carolina's economy is lower than before the Great Recession



SOURCES: NC Office of State Budget and Management, Post-Legislative Summaries for FY2004-05 through FY2010-11; NC General Assembly, Fiscal Research Division, Report on the Continuation, Expansion, and Capital Budgets, FY2011-13; and NC Department of Public Instruction, State Level Expenditures, ARRA Programs.

recruit businesses and grow our economy, North Carolina must have a well-educated workforce, and in order to develop that workforce, we need strong and motivated teachers. North Carolina must raise teacher pay from its current level in order to pay teachers a competitive wage for the important work that they do.

Community Colleges

Community colleges provide education and skills training for thousands of North Carolinians each year and have been particularly effective at connecting businesses to the skilled workforce they need to be competitive. During the Great Recession, enrollment in community colleges increased significantly, but projections for next year suggest a slight decline of 1 percent, or 2,600 full-time-equivalent students.

Under the governor's proposal, the community college system would see its budget increase by \$53.5 million, or 5.4 percent over the continuation budget. The single largest line item in the governor's budget for the community college system is restoration of \$55 million in funding delivered through a management flexibility cut. These cuts were distributed across the 58 community colleges in the system.

Community colleges received a net \$117.5 million cut in the two-year FY2011-13 legislative budget, and the governor's total recommended adjustments – net of downward-revised enrollment projections and several other technical adjustments – would restore community college funding to \$1.04 billion, up from \$985 million in the continuation budget.

UNC System

The university system has long provided North Carolinians with an affordable option in post-secondary education and has connected communities to research, innovation and opportunity. Cuts in the FY2012-13 budget reduced the state's investment in need-based aid, limited the number of semesters a student could receive aid to nine, and cut into academic programs such that classroom sizes grew and course offerings were reduced. The Board of Governors voted to increase tuition by 23 percent to make up for the loss in state support.¹⁹

Under the governor's proposed budget, state funding for the UNC system would increase by \$145.1 million, or 5.7 percent over the continuation budget. The proposal notably includes \$35 million in expansion funding for UNC Need-Based Financial Aid. Additionally, \$1.6 million in funds are allocated to efforts to improve retention and completion outcomes for students, something that is increasingly critical for the state's future competitiveness as the share of jobs requiring post-secondary education grows. For campuses that meet key targets for improving students' educational outcomes, the governor's budget invests \$8 million in performance accountability measures, one way to ensure the effectiveness of these institutions that can complement their core funding.

STUDENT FINANCIAL AID

At the onset of the Great Recession in 2008, the National Center for Public Policy and Higher Education found that low- and moderate-income households in North Carolina must dedicate nearly a third of their incomes to pay for education at a public four-year university.²⁰

The addition of \$35 million to the state's need-based aid program for UNC students will make a four-year degree more affordable for nearly 5,000 students who are income-eligible for financial aid. Moreover, these dollars will be particularly important for low-income students as tuition continues to rise.

HEALTH AND HUMAN SERVICES

The Health and Human Services budget has received deep state-level cuts over the Great Recession and subsequent recovery. Since FY2007-08, spending on health and human services has decreased by \$652 million, or 14.1 percent. At the same time costs have risen due to increased and widespread hardship during the recession and lack-luster recovery. Major drivers of the health and human services budget – namely, Medicaid eligibility and food stamp enrollment – have increased significantly. With more residents struggling and eligible for assistance but the state spending less on health and human services, North Carolina invests far less in the health and economic security of low-income residents today than before the recession.²¹

The governor's proposed budget would increase spending on health and human services by \$176.3 million, or 4 percent over the continuation budget. The single largest increase in the budget is restoration of the Medicaid rebase, an adjustment to the Medicaid budget that takes into account inflationary factors beyond the control of the North Carolina Department of Health and Human Services, such as the demographics of the state's Medicaid enrollment and prescription drug prices negotiated at the federal level.

Perhaps the most significant change in the governor's Health and Human Services budget is her restoration of funding for early childhood education via NC Pre-K (formerly More at Four). The governor's proposal would increase state funding support for the pre-kindergarten program by \$25 million in FY2012-13, bringing total funding for

FIGURE 6: RECOMMENDED HEALTH AND HUMAN SERVICES APPROPRIATIONS

	FY2012-13 Continuation Budget	FY2012-13 Governor's Recommended Budget	Change (\$)	% Change from Continuation
Central Management & Support	\$ 44,577,987	\$ 57,798,511	\$ 13,220,524	29.7%
Aging Division	\$ 37,019,667	\$ 41,895,316	\$ 4,875,649	13.2%
Child Development	\$ 266,102,933	\$ 309,287,534	\$ 43,184,601	16.2%
Public Health	\$ 157,538,834	\$ 168,365,609	\$ 10,826,775	6.9%
Social Services	\$ 186,183,068	\$ 177,103,952	\$ (9,079,116)	-4.9%
Medical Assistance	\$ 2,907,276,302	\$ 3,014,833,460	\$ 107,557,158	3.7%
NC Health Choice	\$ 83,717,865	\$ 80,915,808	\$ (2,802,057)	-3.3%
Services for the Blind	\$ 8,372,886	\$ 8,204,550	\$ (168,336)	-2.0%
Mental Health / DD / SAS	\$ 710,712,232	\$ 717,535,251	\$ 6,823,019	1.0%
Health Service Regulation	\$ 16,133,031	\$ 18,025,590	\$ 1,892,559	11.7%
Vocational Rehabilitation	\$ 37,528,128	\$ 37,528,128	\$ -	0.0%
TOTAL HHS APPROPRIATIONS	\$ 4,455,162,933	\$ 4,631,493,709	\$ 176,330,776	4.0%

the program to just 1.2% below its pre-recession level.²² The governor's budget would also shift the balance of funding for pre-kindergarten from a roughly even split between General Fund and lottery monies to 60 percent General Fund support and 40 percent lottery dollars. In total, the governor's proposal would backfill the legislature's 20-percent cut to General Fund dollars for NC Pre-K (\$16 million for FY2012-13 under the continuation budget) and would increase total funding for NC Pre-K by almost 20 percent.

FIGURE 7: NC Pre-K Funding by Source

NCPReK Funding by Source	FY2007-08 Adjusted	FY2011-13	FY2012-13	Governor's Proposal	Difference,	Difference,
		Original Recommended Continuation	Certified Continuation Budget		Governor's Proposal	from Current Law
General Fund Appropriations	\$ 61,757,378	\$ 81,011,611	\$ 65,011,611	\$ 90,011,611	38.5%	45.8%
Lottery Funds	\$ 93,337,134	\$ 79,135,709	\$ 63,135,709	\$ 63,135,709	0.0%	-32.4%
Total NCPReK funding	\$ 155,055,132	\$ 160,147,320	\$ 128,147,320	\$ 153,147,320	19.5%	-1.2%

The governor's budget would also restore half of last year's \$32 million cut in General Fund dollars to Smart Start, appropriating \$18.2 million to the North Carolina Partnership for Children to increase the capacity of this early childhood education program statewide.

The governor's Health and Human Services budget also restores funding to multiple programs that were partially or entirely de-funded in last year's budget. These items include the following:

- \$10 million to continue tobacco prevention and cessation efforts formerly supported by the Health and Wellness Trust fund, including:
 - The TRU Media Campaign
 - Community-based TRU grants
 - Quitline NC
- \$8.6 million in nonrecurring funding for multiple nonprofit organizations that were previously supported by federal funds, including:
 - \$2.5 million for the Boys and Girls Club
 - \$943,000 for Maternity Homes
 - \$375,000 for Children's Advocacy Centers
 - \$400,000 for the ALS Association, Jim "Catfish" Hunter Chapter
 - \$188,263 for the Easter Seal Society/UPC NC
 - \$150,000 for Prevent Blindness
 - \$250,000 for NC Inter-Agency Council for Coordinating Homeless Programs
 - \$3.8 million for food banks
- \$1.7 million for the Medication Assistance Program (MAP), which helps seniors and low-income individuals identify and apply for the lowest-cost prescription drugs available through public and private programs²³ (formerly supported by the Health and Wellness Trust Fund).
- \$1.7 million for CheckMeds NC, a program that helps Medicare-eligible seniors comply with their medication regimes (formerly supported by the Health and Wellness Trust Fund)
- \$500,000 in recurring funding for Project CARE (Caregiver Alternatives to Running on Empty), a nationally recognized program supporting families caring for persons with Alzheimer's disease and dementia

In addition, the governor's budget would provide expansion funding for the following items that were not adjusted in last year's budget:

- \$2.4 million to establish a Vulnerable Adult Protective Services pilot program to be administered through county departments of social services
- \$2 million in recurring state funds for the Home and Community Care Block Grant, a county-administered fund supporting multiple key programs that provide nutrition and in-home care to senior citizens
- \$1.2 million for the establishment of the new State Public Health Lab and Office of the Chief Medical Examiner facility
- \$350,000 for the operation of the High-Risk Pregnancy Prevention Program at East Carolina University's School of Medicine

The governor's budget proposal does not address the U.S. Department of Justice's recent ruling accusing the State of North Carolina of violating the Americans with Disabilities Act (ADA) by unnecessarily institutionalizing mental health patients instead

JUSTICE AND PUBLIC SAFETY

of providing them with support in their own communities.²⁴ Given that the state does not yet have a comprehensive plan or set of reforms to bring its mental health system into compliance with this order, it is not possible to estimate the cost of either full or partial compliance with this order.

The governor's proposed budget would increase appropriations for Justice and Public Safety by \$1.7 million, or 0.1 percent over the continuation budget. Notable adjustments to the Justice and Public Safety budget include the recommended allocation of \$14.3 million in one-time National Mortgage Settlement funds and \$12.2 million in appropriations supporting the Justice Reinvestment Act.

NATIONAL MORTGAGE SETTLEMENT FUNDS

North Carolina will receive a total of \$338 million as its share of the landmark \$25 billion settlement reached between the U.S.

Department of Justice, the U.S. Department of Housing and Urban Development (HUD), 49 state attorneys general, and the country's five largest mortgage loan servicers: Bank of America Corp., Citigroup Inc., JP Morgan Chase & Co., Wells Fargo & Company, and Ally Financial Inc.²⁵ Of that amount, approximately \$275 million will be returned in the form of restitution, refunds, and/or refinancing to homeowners in or at risk of default. The settlement also allows up to \$10 million in restitution to the state General Fund and \$6.3 million in civil penalties payable to North Carolina's public school. Up to \$32 million is to be used for assistance to distressed homeowners in the form of housing counseling through the North Carolina Housing Finance Agency and legal guidance for homeowners

facing foreclosure or other lending procedures. The remaining \$15 million is to be used for the prevention of future lending and financial abuses against homeowners.

Although the vast majority of settlement funds are not General Fund dollars and, as such, do not require appropriation, the governor's budget outlines usage of these funds in a manner that appears to be consistent with provisions in the national settlement agreement.²⁶ The governor's proposed allocations for settlement funds include the following:

- **\$30.6 million** to the North Carolina Housing Finance Agency for housing counselors to assist distressed homeowners (\$19.12 million) and for legal guidance for homeowners facing possible foreclosure or other lending proceedings (\$11.47 million)²⁷
- **\$6.7 million** in nonrecurring funds to the North Carolina

Administrative Office of the Courts to administer a program of grants for the state's prosecutorial districts to expand investigative abilities and prosecution of lending and financial crimes

- **\$2.9 million** to the State Bureau of Investigation for five time-limited positions to expand its accounting and financial investigative ability and expertise to investigate financial and lending crimes
- **\$4.8 million** to the Consumer Protection Division within the Office of the Attorney General for 7.5 time-limited positions to include attorneys, investigators, financial accountants and other specialists and staff to increase the office's efforts to investigate and pursue cases related to financial fraud and unfair or deceptive trade practices in mortgage lending or financial services.

Justice Reinvestment Act

The governor's budget makes a series of appropriations to increase state staffing for widely expanded probation and community sentencing support as part of implementing the Justice Reinvestment Act, a law passed in 2011 that makes major changes to sentencing and corrections in North Carolina in an effort to reduce state spending on corrections and to reinvest the savings in community programs that decrease crime and strengthen neighborhoods. This allocation is an acknowledgement that although these reforms are expected to save the state a great deal of money over time, they do entail a series of up-front implementation costs.

The governor's budget would also restore \$2.9 million in funding for Family Court, which was placed on continuation review in last year's budget.

FIGURE 8: RECOMMENDED JUSTICE AND PUBLIC SAFETY APPROPRIATIONS

	FY2012-13 Continuation Budget	FY2012-13 Governor's Recommended	Change (\$)	% Change from Continuation
Public Safety	\$ 1,694,715,876	\$ 1,686,139,368	\$ (8,576,508)	-0.5%
Judicial	\$ 435,141,107	\$ 444,034,884	\$ 8,893,777	2.0%
Judicial - Indigent Defense	\$ 112,748,733	\$ 112,748,733	\$ -	0.0%
Justice	\$ 80,864,138	\$ 82,245,859	\$ 1,381,721	1.7%
TOTAL	\$ 2,323,469,854	\$ 2,325,168,844	\$ 1,698,990	0.1%

**NATURAL AND
ECONOMIC
RESOURCES**

The governor's proposed budget would increase appropriations for Natural and Economic Resources by \$56.2 million, or 15.6 percent over the continuation budget. Notable items in the proposal include restoration of \$11.8 million in funding to the Department of Environment and Natural Resources to operate its regional offices, all of which were eliminated in last year's budget, and full funding for the Drinking Water State Revolving Fund at \$9.9 million, up from \$7.1 million in last year's budget. The proposal also would restore the \$800,000 Conservation Education program operated by the Wildlife Resources Commission.

FIGURE 9: RECOMMENDED NATURAL AND ECONOMIC RESOURCES APPROPRIATIONS

	FY2012-13 Continuation Budget	FY2012-13 Governor's Recommended	Change (\$)	% Change from Continuation
Agriculture and Consumer Services	\$ 62,198,634	\$ 62,504,083	\$ 305,449	0.5%
Commerce	\$ 33,250,463	\$ 53,351,176	\$ 20,100,713	60.5%
Commerce - State Aid	\$ 73,080,423	\$ 96,605,423	\$ 23,525,000	32.2%
Environment and Natural Resources	\$ 148,148,105	\$ 160,312,552	\$ 12,164,447	8.2%
Wildlife Resources Commission	\$ 17,221,179	\$ 17,665,000	\$ 443,821	2.6%
Clean Water Management Trust	\$ 11,250,000	\$ 11,250,000	\$ -	0.0%
Labor	\$ 15,836,887	\$ 15,536,887	\$ (300,000)	-1.9%
TOTAL	\$ 360,985,691	\$ 417,225,121	\$ 56,239,430	15.6%

Within the Department of Commerce, the governor's proposal would restore \$2.5 million in cuts to Regional Economic Development Commissions made in last year's budget. It would also expand funding for many existing economic development programs under the JobsNOW Initiative (see box for details).

JobsNOW INITIATIVE

The governor's proposed JobsNOW Initiative is an effort to stimulate job creation through significant expansion funding for existing economic development programs. Although most of the recommended appropriations in this category are nonrecurring, the funds would be available for use and disbursement over multiple years as eligible firms meet criteria. Funding includes the following:

- **\$8 million** for the OneNC Fund, which provides matching funds to local governments to enhance local incentive packages for the retention and expansion of existing industry and the recruitment of new industry. The OneNC Fund disburses payments to eligible governments over a three-year period, so this pool would carry on beyond FY2012-13.
- **\$2.5 million** in nonrecurring funds for the OneNC Small Business Fund, which provides technical assistance and financing for early-stage small businesses in high-growth or high-tech sectors. These funds are used to match federal Small Business Innovation Research grants and Small Business Technology Transfer grants, both of which are used to help commercialize and scale up production of new manufacturing technologies.
- **\$1 million** to expand BizBoost, an existing program that provides technical assistance to small in-state manufacturers in economically distressed counties.
- **\$7.5 million** in new, nonrecurring funding for the Job Maintenance and Capital Development Fund (JMAC). The fund targets large-scale capital investments that create more than 1,000 jobs in Tier I counties, but it has been used only twice since its inception. The additional funds will supplement \$9 million in currently unobligated JMAC funds.
- **\$15 million** in one-time funds for the Rural Jobs Fund, which provides grants to local governments for various economic development projects. In FY2011-12, \$4.1 million in grants were awarded from this fund, which leveraged an additional \$32 million in capital investments that, in turn, generated total investment of \$796 million and almost 2,000 new jobs in rural communities throughout North Carolina.

TRANSPORTATION

Foremost in the governor's proposed transportation budget is her recommendation to cap the state gas tax at 37.5 cents per gallon beginning in July 2012. The Office of State Budget and Management estimates the cap would cost approximately \$63 million in FY2012-13. Currently, the gas tax is 38.9 cents per gallon.

The gas tax is a revenue source that provides funding for vital transportation projects. Putting in place a cap on the gas tax could have major consequences on much-needed transportation investments, especially if construction costs continue to rise. To pay for this tax cut, the governor proposes a total spending cut of \$118.1 million from the Highway Fund, primarily for road maintenance, and a reduction of \$31.6 million in Highway Trust Fund spending on new construction, which would reduce overall investment in North Carolina's roads, bridges, and highways at 4.9 percent below continuation levels.

Ferry Tolls

The governor's proposal postpones all new and increased ferry tolls until July 2012 and restores \$2.5 million in budget reductions to the Ferry Division. Like road tolls, these tolls are regressive and fee-for-service. Given the economic hardship caused by Hurricane Irene, this one-year moratorium will likely ease some level of economic hardship faced by coastal families.

CONCLUSION

The governor's budget proposal recognizes the need for a balanced approach to North Carolina's budget challenges – an approach including revenue that is necessary to rebuild and reinvest in our schools, roads, communities and businesses in the aftermath of the Great Recession. The impacts of a cuts-only approach have been clear in communities across the state: fewer teachers in the classroom, less access to health care, higher costs to accessing the courts, and reduced protections for the health and well-being of our environment and communities.

While this proposal is a strong first step in restoring state funding for education to pre-recession levels, it still falls short of getting North Carolina back on track to investing adequately in the supports necessary for widespread, shared economic prosperity. Beyond education, there are many other needs across the state that, if left unaddressed, will lessen the well-being of North Carolinians and undermine the state's uneven recovery.

The decisions made in the state budget have real consequences for all North Carolina families. This budget acknowledges the necessity of funding the educational needs facing young people and the future economy, and in that spirit, lawmakers should

THE GAS TAX

The state gas tax generates the majority of revenue that the NC Department of Transportation uses to build and maintain roads, bridges, and related transportation infrastructure throughout the state. The gas tax has two components; a flat tax of 17.5 cents-per-gallon tax, and a variable portion that is adjusted every six months to correspond to 7 percent of the average wholesale price of gasoline. The reason for allowing part of the gas tax rate to rise and fall with the price of gas is that much of the cost of road maintenance and construction is linked to the cost of petroleum-based materials, particularly asphalt.²⁸ Statutorily, 75 percent of revenues from the gas tax are deposited into the Highway Fund, which supports the state's maintenance needs, the Division of Motor Vehicles, and five intermodal divisions. The remaining 25 percent supports the Highway Trust Fund, which is the state's road construction fund.

According to General Assembly's Fiscal Research Division, the continuation budget included \$375 million in additional gas tax revenues for the biennium based on the final revenue forecast. In the Highway Fund, additional revenues were budgeted to repair structurally deficient bridges and to resurface pavements. In the Highway Trust Fund, additional revenues supported the intrastate system, aid to municipalities for road maintenance and construction, and urban loops.²⁹

However, the governor's proposed budget cuts road maintenance by nearly \$147 million and road construction – including the intrastate system, urban loops, state aid to municipalities for roads,³⁰ and secondary roads – by approximately \$30 million.

consider revenue when approaching the second year of this budget. While adjusting the sales tax is one option—if done in connection with strengthening the Earned Income Tax Credit— there are many other responsible reforms to North Carolina’s tax system that could ensure the equitable and adequate revenues North Carolina needs to invest in a brighter future for all.

- 1 Comparison of Governor’s proposed \$20.9 billion FY2012-13 budget to the FY2007-08 inflation-adjusted certified budget of \$22.8 billion (\$20.7 billion, unadjusted).
- 2 Comparison of Governor’s proposed \$8.0 billion FY2012-13 public education budget to the FY2007-08 inflation-adjusted certified budget of \$8.5 billion (\$7.7 billion, unadjusted).
- 3 Owen, Steve, January 20, 2012. Update on Medicaid Budget: Medical Care Advisory Committee. NC Department of Health and Human Services, Division of Medical Assistance: Raleigh, NC. Available at <http://www.ncdhhs.gov/dma/mcac/01202012%20MCAC%20Budget%20Presentation.pdf>
- 4 Burch, Brenna, and McLenaghan, Edwin. “THE 2011-2013 FINAL BUDGET: Neglecting a Balanced Approach, Budget Costs Jobs and Delays Economic Recovery,” NC Budget and Tax Center: June 2011. Available at <http://www.ncjustice.org/?q=node/889>
- 5 McLenaghan, Edwin. “BTC BRIEF: State Investments in Public Services Declining Even as Demand Grows,” NC Budget and Tax Center: December 2011. Available at <http://www.ncjustice.org/?q=node/1055>
- 6 Mejia, Elaine, November 2008. Understanding the Current and Upcoming State Budget Shortfalls. BTC Brief: NC Justice Center, Raleigh, NC.
- 7 See Burch, Brenna, May 2012. TIME TO STEP UP: With Federal Recovery Funds Gone, State Lawmakers Must Recommit to Funding Public Education with General Fund Appropriations. BTC Brief: NC Justice Center, Raleigh, NC and McLenaghan, Edwin, September 2011. North Carolina’s Disappearing Educators. BTC Brief: NC Justice Center, Raleigh, NC.
- 8 Owen, Steve, January 20, 2012. Update on Medicaid Budget: Medical Care Advisory Committee. NC Department of Health and Human Services, Division of Medical Assistance: Raleigh, NC. Available at <http://www.ncdhhs.gov/dma/mcac/01202012%20MCAC%20Budget%20Presentation.pdf>
- 9 North Carolina: L.S., et al. v. Delia, et al. 5:11-CV-354FL. More information available at http://www.pascenter.org/olmstead/olmstead_cases.php?state=northcarolina&id=129#summary
- 10 McNichol, Elizabeth, Michael Leachman and Dylan Grundman, July 2011. Better-Than-Expected State Tax Collections Highlight Importance of Income Taxes. Center on Budget and Policy Priorities: Washington, DC.
- 11 Sirota, Alexandra Forter, 2010. State of Working North Carolina, 2010. NC Justice Center, Raleigh, NC.
- 12 See supplemental budget request for North Carolina Department of Public Instruction at <http://www.ncpublicschools.org/docs/fbs/finance/legislation/budget/suppbudgetrequest12-13.pdf>.
- 13 Burch, Brenna, May 2012. TIME TO STEP UP: With Federal Recovery Funds Gone, State Lawmakers Must Recommit to Funding Public Education with General Fund Appropriations. BTC Brief: NC Justice Center, Raleigh, NC. Available at <http://www.ncjustice.org/?q=node/1360>
- 14 McLenaghan, Edwin, September 2011. North Carolina’s Disappearing Educators. BTC Brief: NC Justice Center, Raleigh, NC.. Available at <http://www.ncjustice.org/?q=node/956>
- 15 Only 25 percent of the total cost of pay increases for public education employees is included in the public education section of the budget. The remaining 75 percent of funds would be appropriated under Reserves and Adjustments within an expansion line item called “Salary Increase for All State Employees.”
- 16 Ellinwood, Matt, September 2011. To attract better teacher, improve compensation. NC Policy Watch: <http://www.ncpolicywatch.com/2011/09/15/to-attract-better-teachers-improve-compensation/>
- 17 North Carolina Department of Public Instruction. Facts and Figures 2011-12. Available at <http://www.ncpublicschools.org/docs/fbs/resources/data/factsfigures/2011-12figures.pdf>
- 18 National Education Association, December 2011. Rankings and Estimates: Rankings of the States 2011 and Estimates of School Statistics 2012. Available at <http://www.nea.org/home/44479.htm>
- 19 Sirota, Alexandra and Brenna Burch, April 2012. Underpreparing for the Future: North Carolina’s Divestment in Post-Secondary Education. BTC Brief: NC Justice Center, Raleigh, NC.
- 20 http://measuringup2008.highereducation.org/print/state_reports/long/NC.pdf
- 21 Burch, Brenna, and Searing, Adam. Five Reasons Why Everyday North Carolinians Need Medicaid, Even If They Don’t Know It. NC Health Access Coalition: NC Justice Center, Raleigh, NC.
- 22 The governor’s proposed total funding for NCPReK of \$153.1 million is 1.2% less than \$155.1 million in inflation-adjusted total prekindergarten funding from FY2007-08.
- 23 http://www.healthwellnc.com/hwtfc/htmlfiles/fundprty_medmgmnt.htm
- 24 On November 17, 2010, the Civil Rights Division of the United States Department of Justice notified the State of North Carolina of its intent to investigate the state’s mental health system pursuant to Title II of the American with Disabilities Act (ADA), 42 U.S.C. § 12132. On July 28, 2011, the United States issued a 16-page letter of findings regarding the state’s mental health system, which concluded that the state fails to provide services to individuals with mental illnesses in the most integrated setting appropriate to their needs in violation of federal law. See Letter dated July 28, 2011, from Assistant Attorney General Thomas E. Perez to North Carolina Attorney General Roy Cooper, available at http://www.ada.gov/olmstead/documents/nc_findings_letter.pdf. The letter indicates that the Department of Justice will work with the State to negotiate a voluntary compliance agreement. If negotiations are unsuccessful, Perez wrote, “the Attorney General may initiate a lawsuit pursuant to the ADA . . . to correct [the] deficiencies.” Letter at p. 15.
- 25 Brennan, Morgan. “How the \$25 Billion Foreclosure Settlement Will Really Affect the Housing Market,” Forbes.com; February 2, 2012. Available at <http://www.forbes.com/sites/morganbrennan/2012/02/09/how-the-25-billion-foreclosure-settlement-will-really-affect-the-housing-market/>
- 26 North Carolina Department of Justice. “Foreclosure Settlement Benefits to North Carolina Economy,” released February 2012. Available at <http://www.ncdoj.gov/getdoc/3b791613-2ed1-4448-8d29-89396c6b203d/Foreclosure-Settlement-Benefits.aspx>
- 27 The NC Housing Finance Agency is accounted for within the General Government budget function, not Justice and Public Safety.
- 28 McLenaghan, Edwin. “Capping state gas tax would mean more potholes, fewer jobs,” NC Policy Watch: December 6, 2011. Available at <http://www.ncpolicywatch.com/2011/12/06/capping-state-gas-tax-would-mean-more-potholes-fewer-jobs/>
- 29 An urban loop is a road that improves traffic flow within a city, such as a beltway or bypass, providing more direct route for travelers to reach their destination.
- 30 State street-aid, provided under NCGS §136-41.1 through §136-41.4 and also known as the Powell Bill, is restricted funding provided by the state to municipalities for the purposes of maintaining, repairing, constructing, reconstructing or widening of local streets that are the responsibility of the municipalities or for planning, construction, and maintenance of bikeways or sidewalks along public streets and highways. See http://www.ncdot.gov/programs/Powell_Bill/

North Carolina Justice Center

P.O. Box 28068 ■ Raleigh, NC 27611-8068
919/856-2176 ■ alexandra@ncjustice.org

BTC *Reports*