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P.O. Box 28068
Raleigh, NC
27611-8068

EDITOR: **Elaine Mejia**
919/856-2176
elaine@ncjustice.org
www.ncjustice.org

THE HOUSE'S BUDGET: A familiar script with a few plot twists

BY JONATHAN PALMER, POLICY ANALYST

Executive Summary

- On June 4, the North Carolina House of Representatives passed a budget bill that makes changes to the certified budget already in place for fiscal year (FY) 2010-11. The House's proposed budget would reduce overall General Fund appropriations by \$684 million, or 3.5%, compared to the certified budget. Compared to the budget for the previous year (FY 2009-10), the House's proposed budget is \$132 million, or 0.7%, less.
- Like the Senate's and the governor's proposals, the House budget assumes that tax revenues will be lower next year than was projected when the two-year budget was adopted in 2009. And like the Senate's plan, the House's budget assumes that the state will lose an additional \$85 million in estate tax revenues due to federal tax law changes. The House's revenue plan also includes a \$34 million revenue loss from other unspecified tax changes.
- The House's proposed budget, like the governor's and Senate's plans, assumes that Congress will extend a temporary increase in the share of Medicaid expenses paid for by the federal government. That increase is set to expire in December, right in the middle of the state's fiscal year.
- The spending plan includes \$892 million in proposed reductions, the largest of which are a reduction in General Fund appropriations to public school funding, which will be offset by lottery funds, a reduction to the projected costs for teacher salaries, management flexibility reductions within the UNC system, and reductions to Medicaid-funded community support services.
- The budget also provides for \$252 million in new spending, the vast majority of which would pay for increased enrollment in community colleges and Medicaid, each of which have experienced unprecedented enrollment pressures since the start of the recession.
- The House's budget includes some noteworthy policy changes, such as limiting enrollment growth in the university system for one year and allowing the extent to which a particular school district is addressing racial and socioeconomic segregation to be considered when allocating funds. The plan also establishes a new Mobility Fund to address high-priority transportation projects, most notably the Yadkin River Bridge project, by redirecting money from the Turnpike Authority and Highway Trust Fund.

Overview

The House of Representatives moved quickly to approve a 2010-11 budget, doing so only 15 days after the Senate passed its version. While there are some noteworthy differences between the plans, the proposals are similar overall. Both plans would reduce funding in all areas of state government spending to accommodate a lower revenue forecast, rely on federal funds for Medicaid that have yet to be approved by Congress, and provide some funding for high-priority spending pressures such as community college enrollment growth and the state employee retirement system. This report examines the House's proposed budget, paying special attention to its potential impacts on low- and moderate-income North Carolinians.

FIGURE 1

OVERVIEW OF HOUSE'S ADJUSTMENTS TO FY10-11 GENERAL FUND BUDGET		
FY10-11 General Fund Appropriations Only		
FY09-10 Certified Budget	\$19,008,079,980	
FY10-11 Certified General Fund Budget	\$19,559,764,576	
FY10-11 House's Recommended Adjusted General Fund Budget	\$18,875,484,769	
<i>Change from FY 09-10 Certified General Fund Budget</i>	<i>\$(132,595,211)</i>	<i>-0.7%</i>
<i>Change from FY 10-11 Certified General Fund Budget</i>	<i>\$(684,279,807)</i>	<i>-3.5%</i>
FY10-11 General Fund Appropriations + Federal Recovery Assistance		
FY09-10 Certified Budget	\$20,405,943,837	
FY10-11 Certified General Fund Budget + Federal Recovery Dollars	\$20,597,354,925	
FY10-11 House's Recommended Adjusted General Fund Budget + Federal Recovery Dollars	\$19,504,057,186	
<i>Change from FY 09-10 Certified General Fund Budget</i>	<i>\$(901,886,651)</i>	<i>-4.4%</i>
<i>Change from FY10-11 Certified General Fund Budget</i>	<i>\$(1,093,297,739)</i>	<i>-5.0%</i>

The Revenue Plan

The House's revenue plan adjusts the baseline revenue forecast for FY 2010-11 down by \$709 million to account for a more pessimistic economic outlook. This reduction is slightly larger than what the Senate and the governor anticipated in their budgets. Like the Senate's plan, the House assumes the state will lose an additional \$85 million in estate tax revenues because the state's estate tax is tied to the federal tax, which expired at the end of 2009. Under state law, if an estate is not subject to the federal tax then it is also not subject to the state estate tax. Therefore, because Congress has allowed the federal tax to sunset, North Carolina will also suffer a revenue loss.

The House budget would leave \$75 million unspent that, if it materializes, could be deposited into the state's rainy day fund. The Senate's budget anticipates no money would be left to appropriate to the fund. The House's plan, like the Senate's, does not reduce the transfer from the Highway Trust Fund to the General Fund in order to create a new Mobility Fund. Instead, the House would create the fund by redirecting money from the Turnpike Authority and the Highway Trust Fund. The governor initially proposed creating such a fund, which would be matched with increased transportation-related fees, to pay for high-priority transportation projects such as replacing the Yadkin River Bridge.

Proposals from the House, Senate and governor all include an additional \$110 million in anticipated revenues because of the Department of Revenue's ongoing efforts to more

FIGURE 2

DEFINING THE BUDGET GAP	
FY10-11 General Fund Appropriations Only	
FY10-11 Certified Budget	\$19,559,764,576
+ Budget Pressures	
Medicaid growth	\$430,564,713
Retirement	\$40,000,000
Higher Education Enrollment growth	\$90,678,446
Restoration of Continuation Review Programs	\$23,491,648
Total Budget Pressures	\$584,734,807
= New Recommended Total GF Appropriations	\$20,144,499,383
- Revised Baseline Forecast	\$18,940,011,278
New FY10-11 Budget Gap	\$(1,204,488,105)

HOW DID THE HOUSE CLOSE THE BUDGET GAP?	
FY10-11 General Fund Appropriations Only	
+ Adjustments to Availability	\$11,456,294
Reserve for Pending Finance Legislation	\$(34,300,000)
Department of Revenue Settlement Initiative	\$110,000,000
Loss of Estate Tax Revenue	\$(85,000,000)
Disproportionate Share Hospital Payments	\$35,000,000
Tax Reductions	\$(18,000,000)
Other Adjustments	\$(7,700,000)
Transfers from Other Funds	\$11,456,294
+ Additional Federal Recovery Dollars (used to offset reduced GF appropriations)	\$570,671,452
FMAP extension for Medicaid	\$489,830,066
FMAP funds for Part D Clawback	\$79,419,834
Other ARRA	\$1,421,552
+ Other Federal Dollars	\$57,900,965
+ Net Spending Changes	\$640,442,197
Spending Cuts	\$892,463,467
Expansion items other than budget pressures	\$(252,021,270)
Total Available to Close Gap	\$1,280,470,908

accurately assess corporate tax payments. The Department of Revenue has publicly stated that it will not be able to generate these funds if a provision from the Senate's budget bill limiting the department's ability to levy tax penalties on corporations is passed into law.

The House offers tax incentives to small businesses that provide health insurance or add to employment rolls. This is in contrast to the Senate plan, which lowers the highest income tax rate for small businesses from 7.5% to 6.9%. Furthermore, the House includes a placeholder for \$34 million in additional tax reductions, likely for economic development

The Spending Plan

purposes. If this proposal is part of the final budget, then a separate bill could be adopted later in the session.

Unlike the Senate's proposal to raise an additional \$22 million from increased fees, the House plan uses transfers from other funds, such as the Mercury Pollution Prevention Fund and the Wildlife Resources Commission, to increase General Fund availability by \$36.6 million.

During the 2009 legislative session lawmakers adopted a two-year budget. The budgets prepared by the House, Senate and governor during this session propose adjustments to the second year of that budget to account for changes in revenue and spending estimates. The House's proposed changes would reduce spending by \$684 million, or 3.5%, compared to the certified budget already in place for FY 2010-11. Compared to the previous fiscal year's budget, the House's proposal would reduce General Fund spending by \$132 million, or 0.7%. The House plan, like the Senate's, does not include pay raises for any state employees or teachers. In addition, the plan only funds \$40 million of the

FIGURE 3

SIGNIFICANT SPENDING CUTS IN THE HOUSE'S RECOMMENDED FY 10-11 BUDGET	
Public Education	\$(260,722,334)
Revise salary cost projections	\$(44,950,676)
Supplant K-12 appropriations with lottery funds	\$(126,638,646)
More at Four preschool program	\$(39,186,721)
Cuts to Schools (instructional support, assistant principals, supplies)	\$(3,289,447)
Cuts to aid for vulnerable populations	\$(14,900,000)
Other K-12 cuts	\$(31,756,844)
Community College Cuts	\$(76,262,649)
Tuition increase (replaces General Fund appropriations)	\$(37,147,110)
Management flexibility reductions	\$(22,750,000)
Other Community College cuts	\$(16,365,539)
University Cuts	\$(181,662,195)
Management flexibility reductions	\$(147,020,779)
Non-resident scholarship in-state tuition waivers	\$(15,488,223)
Other UNC system cuts	\$(19,153,193)
Medicaid Cuts	\$(176,393,430)
Reform in-home Personal Care services	\$(34,519,278)
Savings from Community Care of NC initiatives	\$(28,000,000)
Reduced Community Support Team services	\$(41,000,000)
Savings from increased fraud enforcement	\$(36,188,013)
Other Medicaid cuts	\$(36,686,139)
Other Health and Human Service Cuts	\$(55,929,679)
Vaccines for children (replace with 3rd party payments)	\$(15,894,853)
Other HHS cuts	\$(40,034,826)
All Other Cuts	\$(141,493,180)
General Government	\$(16,764,778)
Justice and Public Safety	\$(83,492,871)
Natural and Economic Resources	\$(18,790,146)
Reserves, Adjustments and Debt Service	\$(22,445,385)

FIGURE 4

SUMMARY OF "EXPANSION" SPENDING IN THE HOUSE'S RECOMMENDED FY 10-11 BUDGET	
Fund Enrollment Growth (Medicaid + higher education + retirement obligations)	\$561,243,159
Allow Universities to Retain Proceeds from Tuition Increase	\$34,776,301
Restore Continuation Review Programs	\$23,491,648
Restore Mental Health Funds	\$18,809,089
AIDS Drugs Assistance	\$14,177,632
Need-based financial Aid for UNC	\$12,000,000
Expansions to Commerce Department initiatives	\$32,700,000
Capital Improvements	\$9,130,000
Other "Expansion"	\$130,428,248
Total	\$836,756,077

\$180 million requested by the state treasurer for the state retirement plan, but this amount is double what the Senate and governor proposed. The following sections assess the House's proposed changes to the certified budget for Public Education, Health and Human Services, and Justice and Public Safety. (See Figures 3 and 4 for a list of the major proposed spending cuts and expansions by area.)

Public Education

The proposed House budget would reduce public education spending by \$282 million compared to the certified budget adopted during the last legislative session. The House's proposal sits between that of the governor and the Senate. The House plan provides for \$63 million less funding for public schools than the proposed Senate plan, but \$31 million more than the plan from the governor.

When strictly comparing General Fund spending for public schools, the Senate and House proposals are not significantly different. The House spending plan, however, would allow school districts to offset \$127 million in reductions with lottery proceeds. Traditionally, lottery funds are allocated based on a formula, with certain percentages going to preschool programs and class-size reduction, scholarships, and school construction. This year, the House would allow the unanticipated receipts from the current year, the projected increase in proceeds next year, and the funds transitionally slated for school construction to be applied to teacher salary costs.

Despite funneling some lottery funds to school operations, the House still cuts education services for some of North Carolina's vulnerable children. In particular, the proposed budget would reduce funding for the More At Four preschool program for disadvantaged students (\$6.2 million reduction), resulting in roughly 600 fewer children served. The budget would also eliminate funding for teacher mentoring (\$9.2 million reduction) and would reduce funding for Limited English Proficiency efforts (\$4 million reduction). The House also proposed eliminating certain end-of-the-year tests, saving the state \$2.7 million. Like the Senate's plan the House does not include funding for salary increases for teachers.

Unlike the Senate's and governor's proposals, the House budget contains two proposals related to school desegregation. The House plan, if adopted, would establish a Legislative Commission on Diversity in the Public Schools, and it would allow the extent to which a

local school district is addressing segregation to be considered when awarding money from the Disadvantaged Student Supplemental Fund.

Community Colleges

The House's proposed budget for the community college system would increase General Fund spending by \$36 million (3.6%) compared to the certified budget already in place. This increase is modest given the fact that enrollment increased by 34,118 full-time equivalent students during the recent school year.

The House's proposed budget includes \$22.7 million in discretionary reductions that system administrators and campus presidents would make. The Senate's plan included only \$13.5 million in discretionary reductions. The House budget, like the governor's, also includes a tuition increase of \$8 per credit hour, the proceeds from which would offset a cut in General Fund appropriations, so there would be no net gain to community college resources. The Senate's budget proposed a \$5 per hour tuition increase.

The community college system expects to collect an additional \$10 million in tuition receipts because of growing enrollment. Rather than allowing the campuses to retain the gains from these receipts, the House's budget proposes cutting General Fund appropriations by an equal amount. Finally, the budget provides an additional \$85 million to fund enrollment growth in the system.

Health and Human Services

The House's budget would reduce HHS appropriations by \$350 million, or 8.1%, compared to the certified budget. This cut is \$55 million less than the cut proposed by the Senate and \$36 million less than the cut proposed by the governor. Of the \$350 million reduction, \$315 million would come from the Division of Medical Assistance (i.e., Medicaid).

Like the Senate plan, many of the reductions come from projected savings from fraud detection and program efficiencies. For example, Medicaid is set to save \$28 million by expanding the Community Care Network, \$5.5 million by changing reimbursement policies for prescriptions, \$10 million by moving mental health drugs to the Preferred Drug List process, and \$5 million from conducting independent assessments of certain high-cost services.

Some cuts, however, will directly impact services, such as the reduction in the number of hours of community support services available for those eligible under mental health. Similarly, funding for the In-Home Personal Care services program would be reduced by \$34.5 million, which is less than the cut proposed by the governor and Senate for this program.

The House, like the Senate, included several significant expansion items in its proposal. The Division of Mental Health would receive \$18.8 million in increased funding to local management entities to provide community-based services, far less than the \$40 million expansion proposed by the Senate. The spending plan also includes an additional \$3.2 million to NC Health Choice, which provides health coverage for children in low-income families. While technically an increase, this money is not enough to cover the cost of the services provided to those currently enrolled in program, much less the expected increase in enrollment. If this small increase is approved, the program will have to freeze enrollment despite the fact that some 3,000 children have enrolled in the program since the beginning of this year. Other expansions include \$14 million in additional funding for the AIDS Drug Assistance Program to eliminate its waiting list, \$5 million to buy vaccines for the 2010-2011 school year, and \$1.6 million in grants to rural hospitals for capital needs.

Like the governor's and Senate's budgets, the House's spending plan anticipates that

Congress will pass legislation extending \$489 million in federal assistance for Medicaid. This assistance was part of the original federal economic recovery package but is set to expire in December.

Justice and Public Safety

The Senate's proposed budget for Justice and Public Safety would reduce funding overall for this area of the budget by \$129 million, or 2.9%, compared to the certified budget for FY 2010-11. The House projects to save \$27 million due to lower than expected inmate populations, as well as \$20.5 million by setting inmate medical care costs at Medicare rates. Like the Senate budget, the House plan includes cuts to Harriet's House and Summit House, and it eliminates funding for Our Children's Place. All three are community programs that help female ex-offenders, many of whom have children, reintegrate into society, thereby reducing recidivism and state expenditures on prisons.

The House included several expansion items, such as \$1.6 million to establish Community Work Crews, \$3.5 million to restore the Samarkand Youth Development Center and \$2.2 million for prisoner legal aid services. The House budget would also restore funding to programs that have been subject to "continuation review," meaning their funding was contingent on successfully completing a legislative review process. Programs in this category include the Prisoner Education Program and the Sentencing Services Program.

Conclusion

The House budget, like the Senate's, makes relatively modest changes to the certified budget already in place for the next fiscal year, which begins on July 1. Like the Senate, the House finds considerable savings from changes that will increase efficiency, but the plan also includes spending reductions that will erode the ability of the state to meet its responsibilities. As the budget moves through the conference process it is critical that legislative leaders look at every possible option for maintaining a strong public sector that can respond to immediate challenges and plan for the future. Moreover, maintaining critical services for vulnerable populations, like low-income children without health insurance and those suffering from mental illness, must be the top priority for budget writers during these last few weeks of the budget process.

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